

Sino Clean Energy's \$20 Million Chinese Ponzi Share Scheme

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In my previous report, available [here](#), I questioned whether Sino Clean Energy (NASDAQ: SCEI) had ever made a profit in its nearly 5 years as a public company. Four years of tax records and four months of surveillance of SCEI's three factories show little or no operations, sales or income. Today I will show how SCEI Chairman Baowen Ren defrauded over \$20 million from Chinese investors using a Ponzi share scheme, in which he raised money at 1 RMB per share from friends and relatives and then using a network of sales agents to raise more money from the Chinese public, repaying original shareholders and pocketing the difference himself in successive rounds at 4 to 7 RMB per share from 2004 to 2007, in total violation of Chinese securities laws. As everyone knows, Ponzi schemes are built on confidence. As long as SCEI stock went up the defrauded Chinese investors stood quietly by, hoping for an exit, until now.

SCEI's Original Operating Company Ownership Records Conceal a \$20 Million Ponzi Scheme

According to the 8-K filing ([here](#)) on 8/18/06, just prior to the reverse merger, SCEI's original Chinese operating business, Shaanxi Suo'ang Biological Science & Technology Co., Ltd., ("Suo'ang BST"), was owned by 13 investors who together invested 70 million RMB at 1 RMB per share to purchase 70 million shares. These amounts can be seen in the consolidated statements of shareholders' equity in the 2006 third quarter 10-QSB ([here](#)).

However, these records conceal the fact that Suo'ang BST had in fact over 1000 shareholders, mostly retirees, who bought stock between 2004 and 2007 from unscrupulous agents and promoters authorized by Baowen Ren. At least 30 million shares were sold at prices ranging from 4 - 7 RMB (\$0.61 - \$1.08) per share, both before and after SCEI's reverse merger, according to various web reports and eyewitness interviews my team uncovered, some of which are referenced in this report. Purchasers of Suo'ang BST shares never received official share certificates nor had their names entered into the company's official SAIC government ownership record. Instead Chairman Ren signed and issued them legally unenforceable "pre-U.S. listing individual shareholder verification registry receipts," an example of which is shown below (with its holder's identifying details redacted):

陕西索昂生物科技股份有限公司赴美上市前个人股权复核确认登记凭证

股东姓名	股数	2005年 月 日	联系电话
确认编号	身份证号	身份证号	联系电话
股东地址	身份证号	身份证号	联系电话
代办人姓名	身份证号	身份证号	联系电话
备注	<p>1. 公司赴美上市前为了向股东负责，收回原有凭证存入股份公司档案，用此股票复核确认凭证作为股东将来更替全国上市股权依据。如复核确认登记时属于股东个人所带的票据不全、联系方式不清楚，造成的登记失误，责任自负。</p> <p>2. 本确认凭证一式两联，第一联公司存根，第二联股东存根。</p>		

复核确认人： 经办人：周周红 股东签字： 代办人：

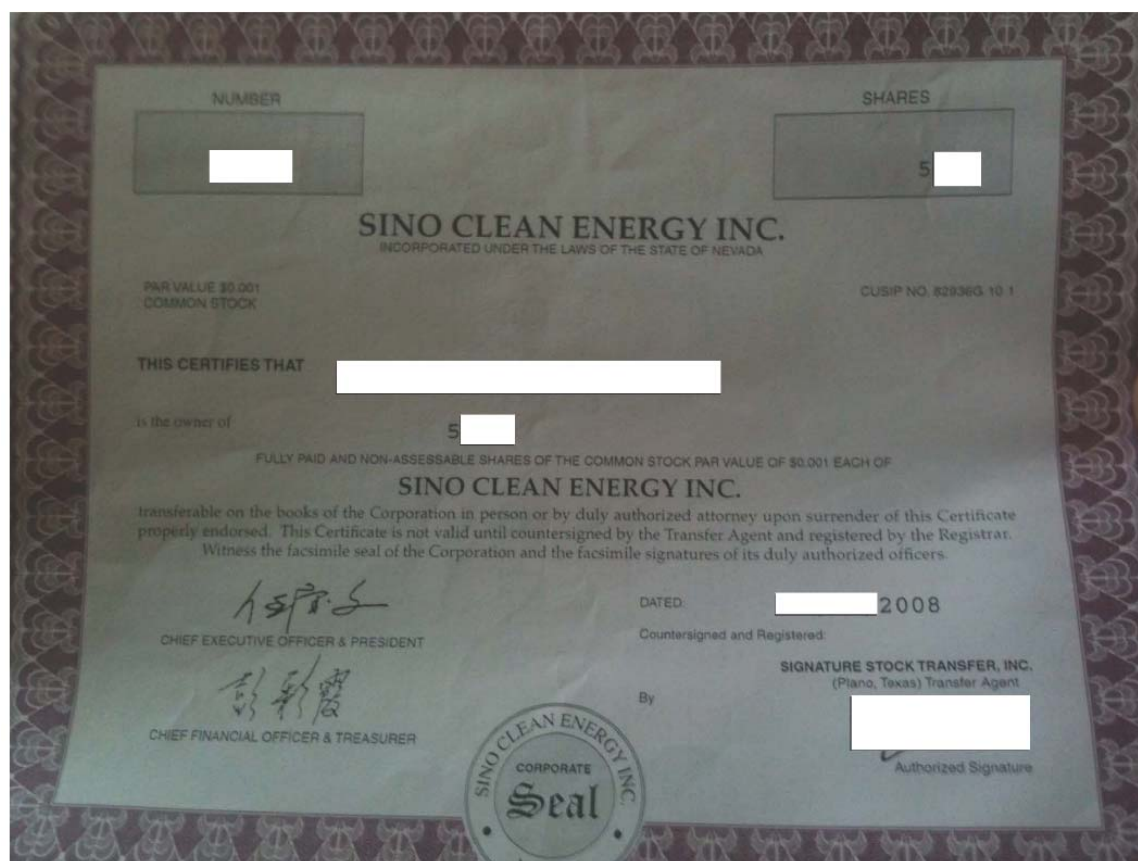
What happened to the difference between the 4-to-7 RMB prices paid by the 1000+ small retail investors and the 1 RMB purchase price paid by the 13 official shareholders identified on Suo'ang BST's financials and consolidated into SCEI's audited financials?
Given at least 30 million shares sold to Chinese retail investors in this manner, the shortfall is at least 135 million RMB, or \$20.8 million. Where did this money go?

Investors my team interviewed said Baoren Wen split the proceeds from these share sales between himself and the sales agents. As documented in this news article ([here](#)), one investor from Jiangsu Province bought shares in early 2006 from a SCEI sales agent who promised him the company would go public in Singapore. The projected return on the investment would be 329%. In late 2006, instead of getting listed in Singapore, SCEI went public in the US. In July 2007, SCEI asked these Chinese investors to pay 1,300 RMB each to exchange their shares to SCEI's U.S. listed company shares. But when the investor tried to contact SCEI's agent he found out the agent was in jail for selling shares illegally. The agent has pocketed a large portion of the proceeds. The lawyer interviewed in the article said SCEI already broke Chinese securities laws for fabricating going public information and selling shares illegally to the general public. The lawyer suggested investors should ask for their money back from SCEI.

Growing numbers of Chinese retail investors eventually realized they had been defrauded. They began to doubt the value or enforceability of the pre-IPO share receipts. Those who could read English could see that their investments were carried on the books of SCEI at 1 RMB per share, far below the 4 to 7 RMB purchase price they had paid. In 2007, angry investors threatened to expose Ren's Ponzi scheme to Chinese authorities if he didn't make them whole on their money losing investment. So in 2007 Ren offered to "exchange" their Suo'ang BST "share receipts" on a 1:1 basis for real share certificates of SCEI, the U.S. public listed company. To do this on a simple, 1:1 basis, Ren first had SCEI split its stock 3:1 effective 8/15/07, an unusual move for a penny stock.

As a result of the 3:1 forward split as of 9/30/07 SCEI had 84,681,750 shares outstanding, compared to 70,000,000 shares of Suo'ang BST. Deducting the roughly 15% of SCEI that

belonged to shell owners and other middlemen involved with the reverse merger (who of course had to be kept whole), SCEI had 72 million shares outstanding owned by Chinese citizens, nearly a 1:1 match. Chinese retail shareholders who agreed to the exchange each had to pay 1300 RMB expense to Ren's agents (as mentioned in the article cited above). Groups of Chinese investors who paid the fee began receiving SCEI shares in October 2007 and continuing on through 2008. The example pre-IPO share receipt shown above was exchanged for the following SCEI share certificate shown below (again, redacted to preserve the privacy of the man defrauded):



Investors I interviewed felt safer owning the SCEI share certificates vs. pre-IPO share receipts, but were not sure whether the SCEI certificates were real and could be sold. Unfortunately these defrauded Chinese investors found they could not sell the SCEI shares since the shares bore restrictive legends that required a legal opinion to resell, under Rule 144. Once again they were at the mercy of Baowen Ren.

Again, groups of angry investors pushed Ren to let them sell their SCEI shares. Throughout 2009 and 2010 Ren made up excuses delaying the sales. In September and October 2010, Ren notified Chinese shareholders that he would help them, for a fee of 1800 RMB each, to open U.S. brokerage accounts at First Trade where they could deposit and sell their shares. Ren's notices to the Chinese shareholders can be found [here](#) and [here](#). Then in a March 25, 2011 [announcement](#), the company told the Chinese investors due to the fact First Trade had to manually fill out all the W-8 tax forms the account opening will be delayed until the

end of April. As of April 2011 none of the Chinese investors have been able to sell any shares. I estimate that approximately 3 million of these shares would be sold, immediately, once these accounts are finally open and Ren authorizes the sale.

Remember SCEI promised a letter to shareholders on Friday? Well Ren, mindful of his constituencies, did publish a letter to his Chinese shareholders on Friday (on SCEI's Chinese website link [here](#)). The letter can be summarized as stating: A US firm published untruthful information about company's operation recently resulting stock price decline. The management hopes every shareholder can side with the company to go through this difficulty. Please trust the management team's ability to deal with current issue.

Basically Ren is saying in the letter that his Chinese shareholders should rest assured that everything will be fine, "trust me". Right. Bernie Madoff was more trustworthy than Baowen Ren. To be sure, just check out this Chinese financial website ([here](#)) where many defrauded Chinese retail shareholders vent their anger at the SCEI's management and Ren.

Video Surveillance Update - Irrefutably Shows Little or No CWSF Production

100% of SCEI's revenues come from the sale of Coal Water Slurry Fuel (CWSF). The videos tell the naked truth. Four months of documented surveillance are far more reliable than Weinberg's "audit alternative". The surveillance videos clearly show SCEI's three plants neither day nor night produce much CWSF (most of the videos run until midnight). Just like I did with China Integrated Energy (CBEH), I continue to upload surveillance videos to my [SCEI Vimeo Channel](#). I encourage everyone to check them out. No trucks = no production.

CBEH could not disprove the surveillance videos and neither can SCEI. Multi-month video surveillance is the gold standard of operational due diligence. Both CBEH and SCEI completely fail this test. CBEH's stock is halted and in the process of delisting. NASDAQ will soon do the same to SCEI when management fails to adequately explain their idle factories and Ponzi share sales scheme.

Tax Record Update – Confirms SCEI has Never Turned a Profit

From 2006 to 2008, the Shaanxi Suo'ang New Energy Enterprise Co Ltd (Tongchuan) subsidiary was the only operating subsidiary of SCEI producing CWSF, and hence the only entity paying PRC VAT and corporate income tax to the state and local branches of the Chinese State Administration of Taxation (SAT). In mid October 2009 SCEI established the Shenyang subsidiary. IFRA did not collect Shenyang's tax record since Shenyang, at best, is only producing one tanker truck load of CWSF per day during the winter heating season. What is the point?

The following table reflects the nearly 100% variance between SCEI's Shaanxi Suo'ang New Energy Enterprise Co Ltd (Tongchuan) SAT and SEC reported revenue, VAT and corporate income tax payments for 2006 to 2009:

Revenue SCEI (Tongchuan) Reported to SAT versus SEC

Year	Revenue (RMB) - SAT	Revenue (USD) - SAT	Revenue - SEC	Variance
2006	¥ -	\$0	\$923,129	-100.0%
2007	¥ -	\$0	\$2,802,750	-100.0%
2008	¥ 431,082	\$60,998	\$13,785,125	-99.6%
2009	¥ 1,236,586	\$181,161	\$46,012,353	-99.6%
1H 2010	¥ 2,284,653	\$334,743	NA*	NA*

Corporate Income Tax SCEI (Tongchuan) Paid: SAT versus SEC

Year	CIT Paid (RMB) - SAT	CIT Paid (USD) - SAT	CIT Paid - SEC	Variance
2006	¥ -	¥ -	\$0	0
2007	¥ -	¥ -	\$92,654	-100.0%
2008	¥ -	¥ -	\$24,760	-100.0%
2009	¥ -	¥ -	\$1,161,346	-100.0%
1H 2010	¥ -	¥ -	NA*	NA*

Value-Added Tax SCEI (Tongchuan) Paid: SAT versus SEC

Year	VAT Paid (RMB) - SAT	VAT Paid (USD) - SAT	VAT Paid - SEC	Variance
2006	¥ -	\$0	NA	NA
2007	¥ -	\$0	NA	NA
2008	¥ 25,890	\$3,664	NA	NA
2009	¥ 36,983	\$5,418	NA	NA
1H 2010	¥ -	\$0	NA	NA

*SEC filings do not break out Tongchuan Revenue or CIT for 2009 or 1H 2010

For the first half of 2010, the SAT records show the SCEI's main subsidiary (Tongchuan) only generated a paltry \$334,743 in sales and paid no VAT or corporate income tax. After four years in operation, SCEI's main subsidiary had yet to turn a profit.

The original records as well as a translation can be downloaded ([here](#)). The fact SCEI's main subsidiary did not make any tax payments over these four years is totally consistent with the video surveillance record proving the company has no meaningful production or sales and is therefore a total hoax. Note: Separately, my legal team confirmed Shaanxi Suo'ang Biological Science & Technology Co., Ltd., the parent of Shaanxi Suo'ang New Energy Enterprise Co Ltd. (Tongchuan), did not report any sales for 2008 or 2009 to the SAT state tax bureau and therefore paid no VAT or corporate income tax. A copy of the statement from the state tax bureau regarding Suo'ang BST can be downloaded ([here](#)).

Conclusion: Nothing Left for U.S. Investors

Baowen Ren defrauded over \$20 million from Chinese investors in a giant Ponzi share scheme. These investors have long thought their investment was worthless. No one even knows what Ren and his agents did with the money. U.S. investors funneled another \$29.6 million into Ren's pyramid scheme in December; briefly giving the Chinese investors I interviewed hope that the resulting liquidity in the pyramid might help get their money back.

Any remaining "pyramid" cash on the SCEI's Chinese books is worthless to U.S. investors, since Chinese courts will certainly award it to the legions of small Chinese retail investors first defrauded by Ren. I expect SCEI's shares will soon be halted and delisted from NASDAQ and the company will simply go dark. Right now NASDAQ is no doubt drafting questions based on this very report and videos; questions that SCEI cannot adequately answer, no different than CBEH.

Next Steps

I am working with the defrauded PRC investors to 1) help them get a legal opinion from U.S. counsel letting them immediately sell their approximately 30 million SCEI shares (pre-1:10 reverse split); and 2) help them initiate legal action against Ren in China. Even after dumping their SCEI shares the average Chinese investor will lose 60-90% of their investment. Under PRC law, Baowen Ren could get a long prison term for what he has done if he does not compensate the victims.

I am short SCEI and CBEH.

About the Author

Mr. Little has over 35 years investing experience having begun his career as an accountant at Deloitte. He spent 10 years in China, from 1994 to 2004, representing various foreign investors including Coke, P&G, and Budweiser as they established beachheads in the world's fastest growing economy. Today he lives in Shanghai and spends his time researching Chinese and other high growth companies. Having built a very successful track record investing the last decade, he now shares all his investing ideas in his financial blog "Little Al's Big Emerging Market Picks".

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