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Company:

Orient Paper Inc. (NYSE: ONP)

Recommendation:

Strong Sell

Target Price:

< \$1.00

Report Date:

June 28, 2010

Price:

\$8.43

Market Cap:

\$154.0 million

Float:

11.8 million

Avg. Volume:

230,766

We are confident that ONP is a fraud. Its purpose is to raise and misappropriate tens of millions of dollars.

- Approximately \$30 million has been misappropriated since October 2009.
- ONP overstated 2008 revenue by 27x.
- ONP overstated 2009 revenue by approximately 40x.
- ONP's claims about its top 10 customers support our fraud conclusion.
- ONP overvalues its assets by at least 10x.
- The value of ONP's Production Lines is greatly overstated.
- ONP's inventory is overstated by millions of dollars.
- ONP's claims of inventory turnover of 32.5x and 16.8x in 2008 and 2009 (respectively) are without credibility when compared to those of China's industry leaders, which range from 4.3x to 7.7x.
- ONP overstates its gross profit margin by hundreds of basis points.



ONP "main competitor" Shandong Chenming Paper Holdings Ltd.



ONP - a sizeable quality gap.

“Strong Sell” Summary

We are confident that ONP is a fraud. Its purpose is to raise and misappropriate tens of millions of dollars.

We believe that most to all of the \$31.5 million (net of commissions, fees, and discounts) ONP raised from October 2009 through April 2010 has been misappropriated. This conclusion is based on our investigation of the values of the assets that ONP purports to have purchased with the funds it raised.

We have determined that ONP has overstated its fiscal 2008 revenue by 27 times, and its fiscal 2009 revenue by approximately 40 times. Our determination is based on a review of public records in China, onsite due diligence at ONP's production facility, and contacts with ONP's purported 10 largest customers.

ONP overstates the values of its assets by at least 10 times. ONP's 2008 audited PRC balance sheet shows total net assets worth less than half of what it claimed in its 2008 Form 10-K. Our further due diligence, which included contacting suppliers of comparable assets, indicates that ONP's PRC financial statements further overstate its fixed asset values by approximately five times. Thus the total overstatement in the SEC filings is around 10 times. We corroborated these conclusions by having an expert analyze photographs and video of ONP's production equipment. Our onsite due diligence and interview with Chairman Liu shows that ONP overstates its inventory values by millions of dollars.

This report includes photographs of ONP's production equipment and inventory.

Despite inflating the value of its inventory by at least several times, ONP's inventory turns are far fewer than it reports. Once armed with knowledge of the poor state of ONP's production equipment and processes, a comparison of ONP's claimed inventory turnover to those of China's industry leaders lays bare the overstatements.

ONP overstates its gross margin by at least several hundred basis points. We received a quotation from ONP for product. Then, using data of industry production costs in China, we concluded that it would be impossible for ONP to generate the margins that it claims. Once armed with knowledge of the poor state of ONP's production equipment and processes, a comparison of ONP's claimed gross margins to those of China's industry leaders further lays bare the overstatements.

Approximately \$30 Million Has Been Misappropriated since October 2009

Most – if not all – of the \$31.5 million (net of commissions, fees, and discounts) that ONP raised between October 2009 and May 2010 has been misappropriated. ONP purported to raise these funds to finance the purchases of two groups of assets: a) used digital photo paper coating equipment for \$13.6 million,¹ and b) one new corrugating medium production line for \$27.8 million.² In the best case scenario, ONP paid less than \$5 million total for both sets of assets, thereby leaving over \$25 million unaccounted for. We believe it is more likely that there have not been (nor will there ever be) any such equipment purchases; and, thus almost the entire amount of money has been misappropriated.

March / April 2010 Raise and the Corrugating Medium Production Line

Between April 6, 2010 and April 14, 2010, ONP raised a net amount of \$26.9 million from investors in a private placement.³ On April 12th, 2010, ONP announced that it had “entered into a definitive equipment purchase agreement” to purchase one corrugating medium paper production line with annual capacity of 360,000 tons for approximately US\$27.8 million.⁴ The purported seller is Henan Qinyang First Paper Machine Ltd. (“Qinyang”).⁵ This implies that the money raised will be used to fund the equipment purchase.

Little – if any – of the money raised will be spent on an equipment purchase. Further, to the extent that ONP purchases this production line, the annual capacity will be well below 360,000 tons.

We spoke with the purported seller of the equipment, Qinyang, and four other Chinese papermaking equipment manufacturers. Qinyang told us that its highest capacity 5.6 m corrugating medium production line (the type ONP purports to have purchased) produces only 150,000 tons per year and costs approximately \$4.4 million. This stands in stark contrast to ONP’s contention that it is purchasing a single line from Qinyang that will produce 360,000 tons per year for a total price of \$27.8 million.

None of the other four companies makes a 5.6 m corrugating medium line that can exceed 200,000 tons per year. Moreover, each company – including Qinyang – stated that no Chinese manufacturer makes such a line with an annual capacity in excess of 200,000 tons. Finally, none of these companies sold lines for prices above \$7.3 million. The following table shows the companies contacted, their URLs, and the rough prices of their highest capacity 5.6 m corrugating medium production lines. (Note that Qinyang is included in the list.)

¹ Orient Paper, Inc., November 25, 2009 Form 8-K (filed December 10, 2009).

² Orient Paper, Inc., April 9, 2010 Form 8-K (filed April 12, 2010).

³ March 31, 2010 Form 10-Q, p. F-14.

⁴ April 9, 2010 Form 8-K.

⁵ April 9, 2010 Form 8-K, Exhibit 10.1 is an English translation of the purported sales contract dated December 8, 2009 for one production line producing 5.6 meter corrugating medium for a price of RMB 190 million (\$27.8 million).

Chinese Manufacturers' Quotations on Highest Capacity 5.6m Corrugating Medium Production Lines		
<u>Company Name</u>	<u>URL</u>	<u>Rough Quotation (USD)</u>
Henan Qinyang First Paper Machine Ltd.	http://www.qyyj.com.cn/index.asp	\$4.4 million
Henan Sheng Qinyang Shijinling Ji Xie Co. Ltd.	http://www.jinlingjx.com/	\$4.4 million
Shandong Sky Paper Machinery Co. Ltd.	http://www.haitianjx.com/About.asp	\$7.3 million
Shandong Zhucheng Jinridong Papermaking Machinery Factory Co. Ltd.	http://www.ridong.com/	\$7.3 million
Jiangsu Huadong Papermaking Machinery Factory Co.	http://www.kszlzz.com/Info/index.asp?id=4	\$7.3 million

Thus, either ONP is purchasing a line (at far lower capacity than claimed) and misappropriating most of the \$26.9 million; or, ONP is not purchasing any line and misappropriating all of the \$26.9 million.

October 2009 Raise and Digital Photo Paper Assets

In October 2009, ONP raised a net amount of \$4.9 million,⁶ of which \$4.6 million was to be used as a down payment to purchase two digital photo paper coating lines purportedly owned by He Bei Shuang Xing Paper Co. Ltd. (“Shuang Xing”) for \$13.6 million.⁷ However, our due diligence shows that Shuang Xing’s tangible assets were worth no more than a few hundred thousand dollars. (We would not be surprised if ONP did not acquire these assets at all.)

According to its most recent business license, Shuang Xing had only been capitalized with equity totaling \$439,000.⁸⁹ Not coincidentally, Shuang Xing’s 2008 audited financial statements show that its fixed assets had a total gross value of \$439,000.¹⁰ The same statements show that the depreciated value of the fixed assets at the end of 2008 was only \$387,000.

Because Shuang Xing has a longstanding close relationship with ONP, it may be complicit in the fraud. On January 1, 2003, Shuang Xing leased space at ONP’s administrative headquarters for ten years.¹¹ ONP’s 2009 Form 10-K states that Shuang Xing’s former assets are located at ONP’s administrative offices.¹²

⁶ Orient Paper, Inc., October 7, 2009 Form 8-K (filed October 8, 2009).

⁷ November 25, 2009 Form 8-K.

⁸ The business license, updated and reissued in September 2007, shows “registered capital” (the Chinese statutory term for equity capital) of RMB three million.

⁹ Under PRC law, this document is available for inspection by any PRC licensed attorney at the local office of the Administration of Industry and Commerce (“AIC”). Inspecting attorneys may photocopy most such documents and provide them to clients. The Xu Shui County AIC office (which has files for HBOP and Shuang Xing) is located at 39 Zhen Xing West Road (振兴西路39号) and may be telephoned at +86 312 868 3320. The Bao Ding City AIC office (which has files for Sheng De) is located at 68 Qi Yi Middle Road (保定市七一中路68号) and may be telephoned at +86 312 335 5017.

¹⁰ Ibid.

¹¹ Ibid.

¹² December 31, 2009 Form 10-K, p. 26.

ONP claims to have hired a professional appraisal company to value the assets it acquired from Shuang Xing in order to ensure that the transaction price was fair.¹³ The appraiser is located in Bao Ding City, He Bei province (where ONP is located).¹⁴ Even in the most developed Mainland Chinese cities (Beijing, Shanghai, Guangzhou, and Shenzhen), accounting and appraisal firms have difficulty managing the conflict between pleasing their clients and maintaining standards. As we discuss in ONP's *Financial Statements Overvalue Assets by Tens of Millions of Dollars*, assuming that there actually was an appraisal, this would be at least the second instance in which ONP has obtained an inflated appraisal.

Because Shuang Xing's assets were worth only approximately \$400,000, to the extent that ONP actually acquired assets from Shuang Xing, it would leave at least \$4 million unaccounted for.

ONP Overstated 2008 Revenue by 27x

ONP overstated its 2008 revenue by approximately 27 times. Put another way, ONP's actual revenue of \$2.4 million was only 3.7% of the amount it reported in its Form 10-K.¹⁵

There is a smoking gun that proves ONP overstated its 2008 revenue by 27 times. The audited 2008 PRC financial statements for He Bei Oriental Paper Co. Ltd. ("HBOP", which is ONP's China operating subsidiary) show revenue of only \$2.4 million (RMB 16,320,687.26).¹⁶ (ONP claims in its SEC filings that HBOP generated net revenue of \$65.2 million.¹⁷) As we discuss in *Our Theory as to Why ONP's Auditors Have Missed the Fraud*, while many companies in the PRC underreport profits, they do so by inflating expenses. Because of the way that the tax reporting system works in China, we can conceive of no way that ONP would be able to understate its revenue for tax purposes by 96.3% or \$62.8 million. (On a related note, ONP paid only \$45,350 in PRC taxes in 2008,¹⁸ which is much less than the \$2.9 million it claims to have paid.¹⁹)

ONP Overstated 2009 Revenue by approximately 40x

We do not yet know the exact amount of ONP's revenue overstatement for 2009; but, we believe that ONP's actual revenue grew little – if at all – from \$2.4 million. Our January 5, 2010 site visit showed that ONP is operating at roughly the same scale as it was in 2008. It exhibited almost no truck traffic or logistics activity. We saw no sign that ONP's claimed 600 workers exist. Given that ONP claimed \$102.1 million in 2009 revenue,²⁰ we believe that the overstatement is approximately 40 times actual revenue.

¹³ November 25, 2009 Form 8-K, Exhibit 10.1 is the purported asset purchase agreement (dated November 25, 2009) with Shuang Xing. The purported asset purchase agreement claims that an appraisal firm (where ONP is located) valued the assets at RMB 103.6 million (\$15.1 million).

¹⁴ Ibid.

¹⁵ Orient Paper, Inc., December 31, 2008 Form 10-K (filed March 27, 2009), p. F-4.

¹⁶ Supra FN 11.

¹⁷ December 31, 2008 Form 10-K, p. F-4.

¹⁸ Supra FN 11.

¹⁹ December 31, 2008 Form 10-K, p. F-17.

²⁰ December 31, 2009 Form 10-K, p. F-5.

The Truck Stops Here

Based on ONP's claimed production and sales volume, there would be at least 100 trucks in and out of the factory gate on a typical day. There would be trucks lined up waiting to load finished product and ship out. There would be a sizable logistical support operation, with workers and equipment moving around busily. This would be even more so on the day we visited, January 5, 2010 (the roads had reopened 24 hours earlier after a major snowstorm).

However, during our 90-minute visit, there was shockingly little activity. There was only one truck lazily idling with a full bed. (It was clear to us that the truck was there for show.)

Based on ONP's claimed volume, there would be approximately 30 to 40 trucks of finished product leaving the factory gate on a typical day. During our visit, Chairman Liu told us that ONP's production capacity was then at 250,000 tons per year. He also said that ONP was then operating at eighty-five percent of capacity. Chairman Liu told us that ONP runs each line twenty-four hours per day (three shifts), 365 days per year. Chairman Liu also told us that ONP has no finished goods warehouse and keeps no finished goods inventory (this contradicts the financial statements – see *ONP Has Overstated Inventory Values by Millions of Dollars*). Rather, he said that customers pick up the paper as it comes out of production. Therefore, HBOP would be shipping out 582 tons of paper per day at the time of our visit.

582 tons of paper is 831 rolls. One roll of 110 gram brown paper weighs approximately 700 kg (approximately 1,500 lbs.). A typical truck will hold 20 to 30 rolls in its bed. (A video taken by a correspondent for TheStreet.com during our visit and available online – discussed further in *ONP's Production Lines are Worth Only Hundreds of Thousands – Not 45 Million Plus Dollars* – shows the one truck present during our visit fully loaded with 23 rolls in its bed.) If the average truck left ONP with 25 rolls, there would be an average of 33 fully loaded trucks leaving per day.

There should be two to three incoming trucks fully loaded with paper fiber for each finished goods truck leaving. According to industry experts who viewed photos and video of HBOP's raw material stock, HBOP likely wastes twelve to fifteen percent of its brown paper stock – called “old corrugated container” or “OCC” – in the production process due to eliminating rejects, plastics, staples, glass, leather, sand, and other contaminants. Incoming paper fiber shipments also contain air and water, and are not packed as efficiently as finished product. Therefore, there would be about 60 to 120 trucks of fiber entering ONP's gates each day.

There would be a number of other trucks coming into the factory delivering chemicals for the pulping process, food for the claimed 600 workers, coal, clay, and additives. Therefore, there would be at least 100 trucks into and out of ONP on a typical day. The level of activity needed to support the logistics of a paper mill generating the revenue that ONP claims would be substantial. This is even more so on January 5, 2010.

In contrast, we saw shockingly little activity at the factory. There was one truck that was lazily idling inside the factory gates (shown in the aforementioned video). We did not witness a line of trucks being loaded, as one would expect to see at a paper mill cranking out over 800 large rolls of paper per day. Nor

did we see incoming trucks. We did not see any signs of the logistics support operation such a factory would require. Moreover, the road on which the factory is located is a small country road that likely could not support anywhere near the truck traffic that a paper mill producing over one hundred thousand tons annually would require.

Workers' Paradise

ONP claims to have 600 workers.²¹ In reality, it either has a one million dollar contingent labor liability, or it does not have nearly the number of workers it claims. We think the latter is the case. During our site visit, we did not see nearly the level of activity that would imply ONP employs 600 workers. The dormitories could conceivably fit 600 workers if crammed in, but the buildings were dilapidated (replete with broken windows despite the bitterly cold weather) and looked largely unused. Interestingly, Chairman Liu admitted that few of ONP's workers have written labor contracts. It would be surprising for a U.S.-listed company in China to employ so many workers without labor contracts today.

On January 1, 2008 a new labor law went into effect in China. One of the more discussed provisions of the law is the penalty for employers who do not conclude written labor contracts with their employees. Under the law, the penalty is one-month back wages (in addition to the wages already paid) for each month a worker has worked without a written contract, subject to a maximum penalty of 11 months of wages.²² In addition, after one year without a written contract, the employees will be deemed to be working under "open term" contracts,²³ which are generally the least favorable type of contract from the employer's perspective.

We believe that this portion of the law is fairly well enforced in many parts of China. In light of the downsides, we do not understand why a sizable employer would refuse to have written contracts with so many employees. If ONP really has this many employees without contracts, we estimate that there is a contingent liability of approximately one million dollars. But most signs instead point to ONP having nowhere near 600 workers.

ONP's Claims About its Top 10 Customers Support Our Fraud Conclusion

The companies that ONP claims are its top 10 customers are mostly obscure, and thus difficult to perform due diligence on. Nonetheless, we confirmed that ONP's claims with respect to the purchasing volume of two of its 2008 top 10 customers are false – by a large margin, if not entirely. Based on our due diligence (results are shown infra in this section), we believe that all but one of ONP's top 10 2009 customers are too small (if they even exist) to buy the amount of product that ONP claims they do. That ONP replaced 80% of its 2008 top 10 customers in 2009, while still growing its overall sales volume 62.5% would be almost miraculous if true. (It would also strongly indicate that ONP churns and burns its customers.)

²¹ December 31, 2009 Form 10-K, p. 12.

²² Labor Contract Law of the People's Republic of China, articles 82 and 97; Regulations on the Implementation of the Labor Contract Law of the People's Republic of China, articles 6 and 7.

²³ Labor Contract Law of the People's Republic of China, article 14; Regulations on the Implementation of the Labor Contract Law of the People's Republic of China, article 7.

It should be understood how a customer's volume of paper purchases relates to its own sales volume. A basic principle of manufacturing is to diversify your supply base so that you are not reliant on one supplier. (Switching suppliers in the event of quality or delivery problems is costly and difficult, and the carrying cost on an idle business is substantial.) Moreover, if purchasing significant volumes from a given supplier for the first time, it is likely that a given customer would be somewhat conservative with the percentage of paper it orders from the new supplier. (This would be even more so if the supplier's operation does not inspire confidence, as is the case with ONP – see *The Value of ONP's Production Lines is Greatly Overstated*.) Including other inputs and gross margin, a previously existing customer purchasing two million dollars of paper from ONP would most likely be generating at least six million dollars in annual revenue.

We confirmed with two of the 2008 top 10 customers that ONP's purported sales amounts to them were false by at least a very large amount – if not entirely. Neither Baoding Dadi Colour Printing Co. Ltd. (“Dadi”)²⁴ nor China Lucky Offset Group Integrated Services Co. Ltd. (“Lucky”)²⁵ generate sales volume for their own companies approaching the amounts that ONP claims each purchased from it in 2008. Dadi told us that its annual revenue is less than \$1.5 million (RMB 10 million). Lucky told us that the most revenue it ever generated in its history is \$1.3 million. Yet ONP claims that in 2008, each respectively purchased paper worth \$2.7 million and \$2.2 million.

In China, a printing, publishing, or paper trading company generating six million or more dollars per year in revenue would be relatively large. A company that large would almost always have a website, staff available to answer phones during working hours, and would usually be somewhat open in responding to questions about its sales volume and company size. (It is in a supplier's interest to ensure that it is matched with the right size customer – a customer too small is not worth the supplier's time, a customer too big would not place orders after on site due diligence reveals the supplier's true size.)

The next page contains a table showing the results of our attempts to conduct due diligence on ONP's purported top 10 2009 customers.

²⁴ Telephone: +86 312 2066963.

²⁵ Telephone: +86 0312-7922236, URL: <http://www.luckyhy.com/web/info.asp?bcid=21>.

Results of Due Diligence on ONP's Purported 2009 Top 10 Customers

Company	Chinese Name	Phone Number	Purported Volume (USD)	Comments
Hebei Tianpurun Printing Co. Ltd.	河北天普润印刷厂	+86 312 869 8999	5,333,532	Claims to generate revenue of approximately \$5.9 million, so it is implausible it purchased \$5.3 million from ONP.
Baoding Huatai Printing Co. Ltd.	保定华泰印刷有限公司	+86 312 759 9259 / 502 1712	4,920,583	Seems like a reasonably large printer that might be able to purchase \$4.9 million.
Beijing Huafumei Paper Sales Co. Ltd.	北京华富美印纸张销售公司	+86 156 0125 7705	4,516,621	It wouldn't specify, but it seems like a small company - revenue is likely not in excess of \$1.5 million annually. It is a trading company and does business with ONP, but ONP is not one of its top suppliers. It is implausible that it purchased \$4.5 million from ONP.
Baoding Hengyi Printing Co. Ltd.	保定恒艺印务公司	N/A	4,284,054	This company has no website, can't be found, and existence can't be confirmed.
Mancheng Wenzhai Printing Co. Ltd.	保定市满城文斋印刷厂	+86 312 706 2608	3,435,540	The cleaning woman answered the phone during business hours and was the only employee working. She said that there are only a few employees, and they are all part-time. It does not have "ordinary taxpayer" status, which means that its revenue is almost certainly less than \$700,000 annually. Implausible that it purchased \$3.4 million from ONP.
Baoding Times Printing Co. Ltd.	保定时代印刷公司	+86 312 703 4300	3,112,362	This company has no website, can't be found, and existence can't be confirmed.
Baoding Morning Light Printing Co. Ltd.	保定市晨光印刷厂	+86 312 594 2034 / 320 4298	2,902,108	This company has no website. Nobody answered the telephone.
Beijing Yuewei Culture Development Co. Ltd.	北京阅微文化发展有限公司	N/A	2,586,026	This company has no website, can't be found, and existence can't be confirmed.
Shanghai Hengxin Paper Co. Ltd.	上海恒鑫纸业有限公司	+86 21 5717 5682 / 5169 2148	2,573,800	This is a medium-sized carton supplier, selling about \$3.5 million annually. The contact did not know whether it buys from ONP, but it is unlikely that it would purchase \$2.6 million from ONP.
Hebei Marching Paper Products & Packaging Co. Ltd.	河北前进纸制品有限公司	+86 316 656 5385	2,101,852	This is an extremely small company with only a handful of employees. Being that it is based in a small village, its revenue is likely no more than \$100,000. Implausible that it purchases \$2.1 million from ONP.

Our due diligence on the purported customers supports our fraud thesis in that a) in two 2008 cases, we confirmed that the purported purchasers were literally too small to purchase the amounts claimed; and, b) we are comfortable that for nine of the purported 2009 top 10 purchasers, it would be implausible to purchase from ONP in the volumes that ONP claims they did.

At a glance, ONP's claimed lists of top 10 customers and purchase volumes for 2008 and 2009 are suspicious in and of themselves. ONP's 2009 top 10 customer list changed eight of 10 customers from 2008, while keeping constant the minimum threshold to make the top 10 roughly constant (\$2.1 million). This means one of two mutually exclusive possibilities is true: a) ONP churns and burns its customers and miraculously finds new ones to make up for the lost volume (plus 62.5%); or, b) that ONP is lying about its sales volumes to these customers (which is the possibility we believe).

Below is the list of ONP's purported top 10 customers for 2008 and 2009.²⁶

Purported 2008 and 2009 Top 10 Customers	
<u>2009</u>	<u>Purported Volume</u>
Hebei Tianpurun Printing Co. Ltd.	5,333,532
Baoding Huatai Printing Co. Ltd.	4,920,583
Beijing Huafumei Paper Sales Co. Ltd.	4,516,621
Baoding Hengyi Printing Co. Ltd.	4,284,054
Mancheng Wenzhai Printing Co. Ltd.	3,435,540
Baoding Times Printing Co. Ltd.	3,112,362
Baoding Morning Light Printing Co. Ltd.	2,902,108
Beijing Yuewei Culture Development Co. Ltd.	2,586,026
Shanghai Hengxin Paper Co. Ltd.	2,573,800
Co. Ltd.	2,101,852
Total	35,766,478
<u>2008</u>	<u>Purported Volume</u>
Beijing People's Fine Arts Publishing House	3,336,984
Beijing Qiuhao Printing Co. Ltd.	2,957,782
Baoding Binghe Printing Co. Ltd.	2,876,174
Beijing Yutian Planet Books Co. Ltd.	2,760,200
Baoding Dadi Colour Printing Co. Ltd.	2,743,550
Baoding Xida Printing Co. Ltd.	2,705,405
Beijing Yuewei Cultural Development Co. Ltd.	2,644,575
Baoding Xinmin Printing Co. Ltd.	2,298,147
China Lucky Offset Group Integrated Services	2,244,297
Baoding Huatai Printing Co. Ltd.	2,199,226
Total	26,766,340

²⁶ December 31, 2009 Form 10-K, p. 9.

In committing this aspect of its fraud, ONP could choose to list larger companies for which it would be possible to purchase the volumes ONP claims; however, larger companies would be easier to contact, and with some relationship building efforts, likely to disclose that ONP's claims of purchase volume are false. By sticking to a changing list of small companies, ONP (in a typical Chinese fashion) creates more misdirection and more stones to overturn – not to mention that the proverbial stones (purchasers) are better hidden by virtue of their obscurity. Fortunately, Muddy Waters Research has the ability to hunt for such pebbles.

ONP Overvalues its Assets by At Least 10x

We estimate that ONP has overstated its asset values by at least ten times. ONP's 2008 audited PRC balance sheet shows total net assets worth less than half of what it claimed in its 2008 Form 10-K. However, we believe that even the PRC balance sheet values are greatly overstated. We estimate that the true value of ONP's PP&E is not more than five million dollars, as compared to the \$54.4 million in the most recent balance sheet.²⁷ If, as we suspect, ONP has only the two legacy production lines we were shown (see *The Value of ONP's Production Lines is Greatly Overstated*), then its PP&E would be well less than five million dollars.

ONP's 2008 Form 10-K lists asset value that is more than twice what is listed its 2008 audited PRC tax return. HBOP's audited 2008 PRC financials show assets of \$24.3 million (RMB 165,868,258.64),²⁸ which is 54.0% (\$28.5 million) less than the \$52.8 million shown in the balance sheet of ONP's 2008 Form 10-K.²⁹ Therefore, according to the PRC filings, ONP's 2008 Form 10-K has roughly doubled the value of its assets.

However, we have found evidence that the PRC financial statements overstate (likely by at least \$20 million or two times) the value of ONP's assets. ONP was a tiny company with equity capital of only \$512,000 (RMB 3.5 million) until 2003.³⁰ In 2003, Chairman Liu and his brother, Xiaodong Liu, invested \$10.5 million (RMB 71.5 million) in equity capital.³¹ The problem is that none of the investment was in the form of cash. Rather, it was in the form of equipment, the values of which value were established by an "independent" appraiser. (In 2009, ONP apparently found an "independent" appraiser that greatly overvalued the Shuang Xing assets by about 40x or \$14.5 million – see *Approximately \$30 Million Has Been Misappropriated Since October 2009*.)

We have established that the value of these contributed assets was overstated by millions of dollars. We chose five of the higher priced items in the list of 21 pieces of equipment in the capital verification report (see FN 33), and called vendors to obtain quotations on comparable new equipment today.

²⁷ March 31, 2010 Form 10-Q, p. F-2.

²⁸ Supra FN 11.

²⁹ December 31, 2008 Form 10-K, p. F-3.

³⁰ HBOP December 21, 2001 business license.

³¹ HBOP March 27, 2003 capital verification report. The capital verification report contains a detailed schedule of equipment contributed and assessed values. These assessed values count as "registered capital" (the PRC term for equity capital).

The comparison between the values ONP provided in the capital verification report and the quotations we received is below. Keep in mind that ONP's equipment values were supposed to be as of 2003. (Moreover because we believe that the equipment dates from the mid-1990s at the newest, it was likely well used at the time of contribution. However, the verification report did not specify whether the equipment was new or used.) In contrast, we received quotes on brand new equipment at 2010 prices. Note two things about the below comparison: a) the prices are in RMB (not USD), and b) the quotations we received do not include shipping and assembly, which should not exceed 10% of the equipment cost.

Comparison of Claimed Values on a Sample of Assets Contributed in 2003, Versus 2010 Brand New Prices (RMB)				
<u>Asset</u>	<u>2010 Brand New Cost</u>	<u>ONP Claimed 2003 Values (likely used)</u>	<u>Overstatement</u>	<u>Overstatement Multiple</u>
1800 Fourdrinier Multi-Cylinder Printing / Writing Paper Production Line	2.8 - 4.0 million	20.1 million	16.1 - 17.2 million	5.0 - 7.2x
Moisture Quantity Analysis and Measurement Instrument	1.0 million	11.1 million	10.1 million	11.1x
Slurry Flow Measurement and Control Instrument	0.5 million	8.4 million	7.9 million	16.8x
3200 Multi-Cylinder Paper Production Line (100 MT / day capacity)	5.0 million	6.2 million	1.2 million	1.2x
10 Metric Ton Boiler (100 MT / day capacity)	0.5 million	1.2 million	0.7 million	2.4x
Total:	9.8 - 11.0 million	47.0 million	36.0 - 37.2 million	4.3 - 4.8x

The foregoing sample makes clear that ONP's asset values in its PRC financial statements are inflated by many millions of dollars – and likely by at least five times as of 2003. Based on these overstatements, and the other evidence of fraud, we believe that it is reasonable to infer that ONP's PP&E is worth no more than five million dollars. If as we suspect, ONP only has the two legacy production lines we were shown, then the value of its PP&E would likely be well less than five million dollars.

The Value of ONP's Production Lines is Greatly Overstated

We showed video and photos of ONP's production equipment (infra in this section) to a salesperson for a large European paper manufacturing equipment producer. He has been selling production lines into the China market for a number of years. Based on the photos and video, he speculated that the two production lines we saw were probably only each worth "a few hundred thousand [US] dollars." If we are correct in our suspicion that ONP only has two production lines, one need look no further than the two production lines listed in the capital verification report (see *ONP Overvalues its Assets by At Least 10x*) to see that today the value of each line would be well under \$1 million.

We asked to see all of ONP's production lines, but were only shown two (apparently there was a pressing need to have a two hour lunch). The two lines that we saw were old, poorly maintained, and in some of the worst manufacturing workshops we have ever seen. There was steam and water throughout the workshop, which is anathema to paper products.

As we walked along the second of the two lines we were shown, we believe we saw that the drive gears at the input end of the production line were not connected by any belts. If our observation is correct, it would mean that no pulp was actually running into the machine; rather, the machine was merely looping finished product. However, because we were rushed through the building, we could not corroborate what we think we observed.

Regardless of whether that second line was working or not, ONP's operation struck as a late 20th century factory equivalent of a Potemkin village. If ONP has other production lines – particularly if they are in better shape – it is odd that we did not see them. In addition to our request to see all lines, at the time we visited, a Beijing-based correspondent from TheStreet.com was filming a video on ONP for TheStreet.com – links to the video are infra in this section. (We were not previously aware that he would be there.) One would expect ONP to put its best foot forward, and the foot we saw was poor.

The video is available on TheStreet.com and YouTube at the below URLs. (Three members of the Muddy Waters team are shown in the video, to which we did not consent.)

<http://www.thestreet.com/story/10629750/1/orient-paper-good-value-play.html>
<http://www.youtube.com/watch?v=0eS9E5vYhQ8>

The video prominently shows a dated slogan on the corrugating medium machine (the one that we think was not really working) – “求实进取” – which means “practical, aggressive, positive.” Such slogans were commonly painted on machinery and buildings of government-owned companies. We were unable to specifically date the slogan, but we believe that it went out of common usage in the early to mid-1990s.

In its 10-K, ONP claims that its “main competitors” are Shandong Chenming Paper Holdings Ltd., Nine Dragons Paper Holdings Ltd., Shandong Hua Tai Paper Co. Ltd., Shandong Sun Paper Industry Joint Stock Co. Ltd., and Zhonghua Paper Co., Ltd.³² The following comparison of pictures we took at ONP to pictures of ONP's four publicly traded “main competitors” is informative.

³² December 31, 2009 Form 10-K, p. 10.

Shandong Chenming Paper Holdings Ltd.:



Nine Dragons Paper Holdings Ltd.:



Shandong Hua Tai Paper Co. Ltd.:



Shandong Sun Paper Industry Joint Stock Co. Ltd.:



ONP – medium grade white paper line (January 5, 2010)



Note ONP's use of plastic sheeting – ONP's workshops are full of steam, which condenses and falls onto the paper. There is basic equipment that ONP could purchase to eliminate the steam problem.



More plastic sheeting.



Age and poor maintenance are apparent in this close up of the white paper production line.



Amateur Hour at ONP. Note the water on the folding tables – and even on the paper being folded. Once paper is exposed to water, it is unsuitable for printing and loses strength.

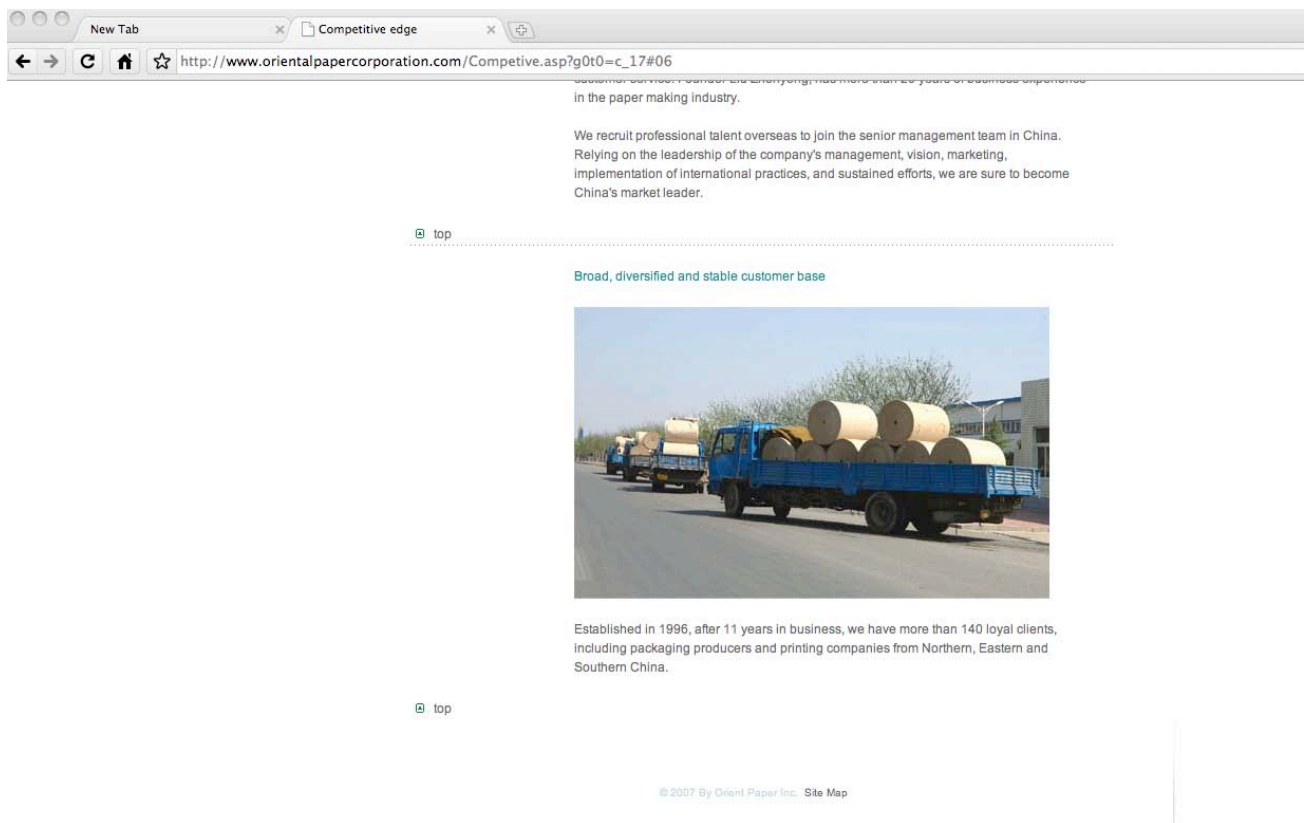


Where the water comes from – extensive steam in the workshop.



Even worse – the brown corrugating medium line that we suspect was not even producing anything.

The videos and pictures show that ONP's pitch that "Orient Paper will focus on middle and high-end products and brands, stick with 'excellent technology, superior quality and diversified products'"³³ is untrue. ONP's machinery is obviously poor and incapable of producing high quality paper. Most telling though is ONP's indifference to water and steam in the workshops. Once paper is exposed to water, it is never again level (essential for printing) or nearly as strong. The preponderance of water in the workshops shows that ONP's customers (to the extent they exist) are not in the market for good product; rather, their focus is on finding the lowest cost producer (as in one that cannot afford the basic equipment needed to clear steam). Moreover, the open bed truck method of shipping finished product (shown in the TheStreet.com video and below on ONP's website) exposes the paper to the elements. Decent quality paper selling at the prices ONP claims would rarely be shipped this way.



³³ ONP's website: http://www.orientalpapercorporation.com/introduction.asp?g0t0=c_1 (accessed June 22, 2010).

ONP Has Overstated Inventory Values by Millions of Dollars

The table below shows ONP's claimed inventory breakdown as of December 31, 2009:³⁴

ONP Claimed Inventory as of 12/31/2009 (USD)	
	<u>(USD)</u>
Recycled Paper Board	2,301,282
Recycled White Scrap Paper	1,731,170
Recycled Printed Paper	533,771
Coal	1,704,905
Pulp	12,744
Other Raw Materials	36,801
Finished Goods	605,719
Total	<u>6,926,392</u>

The most obvious problem in this table is that Chairman Liu told us categorically that ONP has no finished goods inventory because customers pick up finished product as it comes off of the lines (see *ONP Overstated 2009 Revenue by Approximately 40x*). We did not see the approximately 2,000 tons of finished goods lying around that \$605,719 would represent.

The second issue is that while ONP has a substantial amount of recycled paper board ("OCC") sitting outside, we are incredulous that it is worth anywhere close to \$2.3 million. OCC degrades if stored outside because it soaks in moisture. It would be irresponsible at the least to store such valuable paper outside. The photo on the following page shows one of our analysts climbing a heap of OCC.

³⁴ 2009 10-K p. 32.



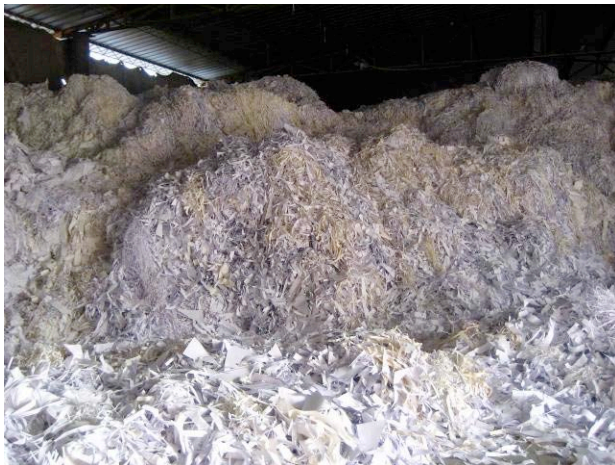
Sean Regan's comment when he climbed back down was (referring to the Q3 2009 10-Q³⁵) "If this is worth \$4.9 million, the world is a much richer place than I thought."

³⁵ September 30, 2009 Form 10-Q (filed November 13, 2009) p. F-12.

Taken together, the following three photos show the entirety of ONP's recycled white scrap paper inventory. Again, if this is worth \$1.7 million, the world is a much richer place than we knew.



Workers gleefully playing in hundreds of thousands of dollars.



Inside view of the recycled white scrap paper warehouse. The pile is about ten feet tall.



Side view of the recycled white scrap paper warehouse. The paper in view in the shed opening would have to be worth at least \$500,000 if ONP's inventory numbers are to be believed.

ONP's Claims of Inventory Turnover of 32.5x and 16.8x in 2008 and 2009 (Respectively)³⁶ are Without Credibility when Compared to those of China's Industry Leaders, which range from 4.3x to 7.7x.³⁷

The below table shows the 2009 inventory turnover statistics for ONP's four publicly traded "main competitors." These companies – whether one takes ONP's revenue numbers at face value or not – operate at a far larger scale than does ONP. The photographs of the various companies' operations strongly suggest that ONP's "main competitors" are significantly more efficient operators than is ONP. Yet, ONP claims to turn over its inventory over 10 times more rapidly than do any of the companies below. ONP likely makes this farcical statement because – as clear as it is that its inventory is worth nowhere near \$6.9 million³⁸ (see *ONP Has Overstated Inventory Values by Millions of Dollars*) – ONP would have even more trouble convincing visitors that its heaps of cardboard and shredded paper are worth around \$15 million.

Comparison of 2009 Inventory Turnover between ONP and its Publicly Traded "Main Competitors" (USD)					
Company	Exchange / Symbol	2009 COS	1/1/09 Inventory	12/31/09 Inventory	Inventory Turns
Orient Paper Corp. ⁽¹⁾	ONP	82,107,531	2,821,063	6,926,392	16.85x
Shandong Chenming Paper Holdings Ltd. ⁽²⁾	488:CH / 1812:HK	1,773,149,391	499,675,431	327,438,161	4.29x
Nine Dragons Paper Holdings Ltd. ⁽³⁾	2689:HK	1,781,451,684	195,401,318	268,937,921	7.67x
Shandong Hua Tai Paper Co. Ltd. ⁽⁴⁾	600308:CH	730,353,336	161,616,230	97,782,868	5.63x
Shandong Sun Paper Industry Joint Stock Co. Ltd. ⁽⁵⁾	002078:CH	713,206,439	121,258,349	101,829,543	6.39x

⁽¹⁾ <http://www.sec.gov>

⁽²⁾ <http://www.cninfo.com.cn/finalpage/2010-04-13/57803371.PDF>

⁽³⁾ <http://202.66.146.82/listco/hk/ndpaper/interim/2010/intrep.pdf>

⁽⁴⁾ http://www.huataipaper.com/extra/col8/600308_2009_n.pdf

⁽⁵⁾ <http://www.cninfo.com.cn/finalpage/2010-04-22/57848488.PDF>

ONP Overstates its Gross Profit Margin by Hundreds of Basis Points

ONP claims that it generated gross margins of 19.3%,³⁹ 19.6%,⁴⁰ and 18.3%⁴¹ in 2008, 2009, and Q1 2010, respectively. ONP's gross margin is almost certainly significantly lower than it reports.

We engaged a trading company to call HBOP for a quote on corrugating medium (36.4% of revenue in Q1 2010,⁴² and 41.3% of revenue in 2009⁴³) in early February 2010. HBOP quoted a price of \$264 per ton (RMB 1,800 per ton), which is 13.2% lower than the \$304 per ton ASP it claims to have generated on corrugating medium in Q1 2010.⁴⁴ We obtained from a paper manufacturing industry vendor a database of Q1 2010 per ton production costs of various corrugating medium producers in China. We removed the

³⁶ December 31, 2009 Form 10-K, p. 33.

³⁷ Infra pp. 13-17.

³⁸ Ibid. p. 32.

³⁹ December 31, 2008 Form 10-K, p. F-4.

⁴⁰ December 31, 2009 Form 10-K, p. F-5.

⁴¹ March 31, 2010 Form 10-Q, p. F-3.

⁴² Ibid. p. 4.

⁴³ December 31, 2009 Form 10-K, pp. 29-30.

⁴⁴ March 31, 2010 Form 10-Q, p. 4.

names and cities of the plants, but the plants' annual outputs (in finished metric tons) and per ton cost of production broken down into components in Q1 2010 (in USD) are shown below.

Q1 2010 China Corrugating Medium Per Ton Production Costs (USD)							
<u>Annual Capacity</u> <u>(Tons)</u>	<u>Fiber</u>	<u>Chemicals</u>	<u>Energy</u>	<u>Labor</u>	<u>Waste</u>	<u>Material</u>	<u>Production Cost / Ton</u>
199,920	188	20	44	24	(1)	30	305
332,010	256	15	58	7	(3)	24	357
49,980	251	15	54	22	(3)	24	363
249,900	268	15	63	9	(2)	23	376
249,900	265	15	56	20	(1)	25	380
449,820	275	15	61	11	(2)	23	383
1,287,342	280	15	59	7	(1)	24	384
42,840	265	16	54	30	(3)	24	386
332,367	288	15	52	7	(1)	23	384
1,122,408	278	15	59	13	(2)	24	387
299,880	273	15	55	21	(2)	25	387
279,888	272	15	66	13	(2)	23	387
349,860	272	15	71	11	(2)	24	391
149,940	278	19	61	16	(2)	22	394
199,920	274	15	66	17	(2)	27	397
169,932	275	15	69	15	1	24	399
149,940	294	15	66	13	(2)	24	410
9,282	255	15	59	53	(3)	30	409
209,559	283	15	65	26	(2)	26	413
Weighted Average						\$	383.22

The producers in this industry source's database produce a higher quality product than does HBOP (see *The Value of ONP's Production Lines is Greatly Overstated*), which would imply that they have a higher production cost. On the other hand, ONP uses less efficient machinery than do most of these companies. (The industry source confirmed this after reviewing photos and video of ONP's production equipment and process, and raw material warehousing.) To generate a 19.3% gross margin at a price of \$264 / ton, HBOP would have to produce at \$213 / ton. Based on the above production costs for other mills (albeit for higher quality products), we infer that it is unlikely to be earning such margin (lest there be any doubt about whether ONP is able to produce at a significantly lower price than the major players in the industry remaining, see again *The Value of ONP's Production Lines is Greatly Overstated*). We would not be surprised if ONP were merely brokering paper – particularly because as previously discussed we suspect that ONP's corrugating medium line does not actually make anything.

To put ONP's gross margin claims into even clearer perspective, the following table compares ONP's claimed gross margin with that of its publicly traded "main competitors." Given the differences in equipment and processes, we find it inconceivable that ONP's gross margin could compare so favorably to those of the industry leaders.

Comparison of 2009 Gross Margin between ONP and Those of its Publicly Traded "Main Competitors" (USD)				
Company	Exchange / Symbol	2009 Revenue	2009 COS	Gross Margin
Orient Paper Corp. ⁽¹⁾	ONP	102,142,828	82,107,531	19.6%
Shandong Chenming Paper Holdings Ltd. ⁽²⁾	000488:CH / 1812:HK	2,188,916,081	1,773,149,391	19.0%
Nine Dragons Paper Holdings Ltd. ⁽³⁾	2689:HK	2,268,734,553	1,781,451,684	21.5%
Shandong Hua Tai Paper Co. Ltd. ⁽⁴⁾	600308:CH	856,993,422	730,353,336	14.8%
Shandong Sun Paper Industry Joint Stock Co. Ltd. ⁽⁵⁾	002078:CH	876,578,014	713,206,439	18.6%

⁽¹⁾<http://www.sec.gov>

⁽²⁾<http://www.cninfo.com.cn/finalpage/2010-04-13/57803371.PDF>

⁽³⁾<http://202.66.146.82/listco/hk/ndpaper/interim/2010/intrep.pdf>

⁽⁴⁾http://www.huataipaper.com/extra/col8/600308_2009_n.pdf

⁽⁵⁾<http://www.cninfo.com.cn/finalpage/2010-04-22/57848488.PDF>

Our Theory as to Why ONP's Auditors Have Missed the Fraud

We'd be remiss if we didn't address the question of how the auditors could have missed such a large fraud. For one, ONP's 2007 financials were not audited, although they appear to be if one reads the 2007 Form 10-K. After ONP filed the 2007 Form 10-K, the auditor for the shell company into which HBOP "merged" (see *ONP Has a History of Deceiving Shareholders*) clarified that the unqualified opinion in the 2007 Form 10-K *incorrectly* states that it audited HBOP.⁴⁵ It is possible that the work of ONP's subsequent auditors has been affected by this error in the unqualified opinion shown in the 2007 10-K.

Regardless, the mismatch of accounting systems between China and the United States offers ways in which a Chinese company could deceive a US GAAP auditor. Most Chinese accounting records center on official product / service purchase invoices (called "fa piao"). Once a fa piao is created, it leaves a record of the transaction that is difficult to conceal because the local tax authorities keep a record of the blank fa piao that businesses order. Fa piao would be used to evidence ONP's sales to customers and purchases from its vendors.

Most accounting shenanigans in China center on inflating expenses in order to decrease tax liability. Cheating companies may succeed in keeping a portion of their sales off the books by offering lower prices to customers who don't request fa piao. However, most B2B companies aren't able to underreport revenue by too much because customers want fa piao in order to decrease their own tax liabilities.

Fraudulent fa piao are available in China. Such fa piao are effective in dealing with the PRC auditors and tax authorities, so it would not be surprising if a company used fraudulent fa piao to fool US GAAP auditors. This is of course speculation, and we do not know exactly how ONP's auditors were fooled.

⁴⁵ April 23, 2008 Form S-8 (filed April 23, 2008), exhibit 23.3.

ONP Has a History of Deceiving Shareholders in that it “Went Public” Without Disclosing for 20 Months that it had No Ownership or Legal Control of its Purported PRC Operating Subsidiary

ONP, the AMEX-listed company, has a U.S. subsidiary, Sheng De Holdings, Inc.⁴⁶ Sheng De Holdings, Inc. in turn incorporated Bao Ding Sheng De Paper Co. Ltd. (“Sheng De”) in Bao Ding City, He Bei Province, the People’s Republic of China in June 2009.⁴⁷ Outside of the purportedly acquired digital photo paper coating equipment (which Sheng De supposedly owns), all of ONP’s assets and business are contained within He Bei Oriental Paper Co. Ltd. (“HBOP”).⁴⁸ HBOP is 93.26% owned by ONP’s largest shareholder / ONP’s chairman and CEO, Mr. Zhengyong Liu. (Chairman Liu’s brother, Xiaodong Liu, owns 6.6% of HBOP, and another shareholder owns 0.13%).⁴⁹

HBOP is the primary operating company for ONP. Sheng De’s main purpose is to consolidate HBOP’s operations and assets into ONP because ONP has no ownership interest in HBOP. This type of consolidation arrangement is called a “variable interest entity” (“VIE”), and came about in the wake of off-balance sheet accounting abuses at Enron and other companies.

There are two points to make about ONP’s VIE structure. First, the VIE did not exist until June 2009, so ONP was improperly consolidating HBOP’s (misstated) assets and operations prior to that time. For over 16 months after ONP “went public” via a reverse merger on October 30, 2007⁵⁰, ONP claimed that via its wholly owned subsidiary Dong Fang Zhi Ye Holding Ltd, ONP “owns all of the issued and outstanding stock of HBOP.”⁵¹ On May 15, 2009 ONP amended that statement to say that Chairman Liu and the other two shareholders of HBOP were holding the ownership “in trust” for ONP pursuant to a “trust agreement executed as of [October 29, 2007].”⁵² In other words, ONP was now saying that it had no actual ownership of HBOP because the shares remained with the original shareholders “in trust” for ONP – but governed by a trust agreement. (Essentially ONP went public without going public.) That description changed again 45 days later when on June 30, 2009, ONP wrote that the HBOP shares are only “deemed held in trust” by Chairman Liu et al.⁵³ Apparently, there had been no formal trust instrument after all. But now that Sheng De apparently has the right to 80% of HBOP’s net income, ONP is transparent about not having any ownership interest in HBOP⁵⁴.

However, and second, after reviewing the various agreements that purport to give control of HBOP to Sheng De,⁵⁵ we see that the agreements are largely cosmetic. It would effectively be up to Chairman Liu

⁴⁶ December 31, 2009 Form 10-K, p. 5.

⁴⁷ Sheng De June 1, 2009 initial business license.

⁴⁸ December 31, 2009 Form 10-K, p. 26.

⁴⁹ HBOP April 11, 2006 business license.

⁵⁰ Carlatel, Inc. October 29, 2007 Form 8-K (filed November 2, 2007), p. 3.

⁵¹ December 31, 2008 Form 10-K, pp. 3-4.

⁵² March 31, 2009 Form 10-Q (filed May 15, 2009), p. F-6.

⁵³ June 24, 2009 Form 8-K (filed June 30, 2009), Item 2.01.

⁵⁴ December 31, 2009 Form 10-K, pp. 3-5.

⁵⁵ The translated agreements purporting to form a VIE arrangement are contained in the June 24, 2009 Form 8-K, Exhibits 10.1-10.7.

to enforce such agreements against himself. We feel that this conflict of interest is difficult for Chairman Liu to manage.

Were ONP's financial misstatements not so egregious, we would be quite troubled by ONP's lack of forthrightness about the ownership and VIE issues with HBOP. Although these issues are ancillary to ONP's fraud, the creation of Sheng De and eventual disclosure that ONP has no ownership interest in HBOP tells us that the fraud has become more sophisticated over time. The increase in sophistication is likely an attempt to stay a step ahead of investors who are better versed in the China environment.

Our Methodology

We initially approached ONP as a possible Strong Buy. However, certain red flags quickly emerged that made us suspect that there was some level of graft occurring at ONP. We accept that even many "well managed" companies in the China context often have some level of internal corruption, so we were willing to accept a thesis that there is a strong underlying business with some investor money being skimmed. Once we commenced our in depth review of SEC filings though (we have read literally every SEC filing – including all exhibits – multiple times), we saw strong indications that the company was largely a fraud.

Our on site due diligence confirmed our thesis that the company is nowhere near the scale that it claims to be. On our visit, we saw a very small operation that appeared to be formerly government owned, and probably privatized for very little money. More than anything, HBOP's plant struck us as the late 20th century factory equivalent of a Potemkin village in that it is more for show than for production.

Prior to visiting HBOP, we had requested, and received confirmation, that we would see all production lines and the digital photo paper production assets. Instead, our visit only included a ninety-minute tour of an unknown portion of the legacy HBOP assets, a two-hour lunch, and an unproductive one hour meeting at an office building nowhere near HBOP's production facility (but that we would later learn is supposedly next to the acquired – yet unseen – digital photo paper production lines).⁵⁶

HBOP claims to have six legacy paper production lines,⁵⁷ but despite our prior agreement to see all lines, it showed us only two – one for medium-grade white writing paper and one for corrugating medium. The equipment is clearly dated, and in our opinion is from the mid-1990s at newest.

During the tour, once we demonstrated knowledge of production equipment and processes, the pace of the tour sped up considerably. We were admonished to move along a number of times, and Chairman Liu appeared to call several managers to observe Sean Regan (our manufacturing expert) while he was lagging behind to closely inspect equipment.

The medium-grade white writing paper production line was operating. The second line we saw, for corrugating medium, may not have been actually producing paper. Right after walking into the workshop,

⁵⁶ Supra FN 14.

⁵⁷ Supra FN 50.

Chairman Liu explained that the machine had just restarted after a production snag, thus it was running at a slower speed than usual. As we walked along the line, we believe we saw that the drive gears at the input end of the production line were not connected by any belts. If our observation is correct, it would mean that no pulp was actually running into the machine; rather, the machine was merely looping finished product. However, because we were rushed through the building, we could not corroborate what we think we observed.

Following our site visit, we bolstered our research in a number of ways, including by searching public records, conducting online research in Chinese, consulting with an industry expert, obtaining quotations and specifications on manufacturing equipment, obtaining quotations on product from HBOP itself, and speaking with purported customers of ONP.