

Yongye International, Inc (YONG) – Questionable Acquisitions, Suppliers and Accounting Treatment

Company Update

This report discusses several significant issues we've uncovered during our due diligence on YONG. Based on our research, we believe the following: 1) YONG's major supplier, Wuchuan Shuntong, is a shell company that was set up by YONG; 2) YONG spent a total of \$67 million, acquiring assets from sellers that do not exist; 3) YONG has been capitalizing certain sales/marketing expenses as assets, thereby overstating net profits. The fact that YONG's major supplier and sellers of its acquisitions cannot be independently verified concerns us.

Consequently, we believe YONG's reported financials (including cost of revenue and net profits) as well as its use of shareholders' capital should be called into question.

- **Issue #1: Our research indicates that YONG's major supplier, Wuchuan Shuntong, is a shell company that was set up by YONG.** Wuchuan Shuntong accounted for 58% or \$64 million in YONG's raw material purchase in 2010. Based on our checks, **Wuchuan Shuntong is nowhere to be found in any business directories and is completely unknown to its competitors** in the humic acid industry of Inner Mongolia. We called the phone number listed on Wuchuan Shuntong's AIC filing; surprisingly, it led us to YONG. We also found that Wuchuan Shuntong's address is the same as that of Wuchuan Sanda (another supplier of YONG), but the general manager of Wuchuan Sanda is not aware of a direct competitor named Wuchuan Shuntong, supposedly with a factory located at the same address.
- **Issue #2: Our research indicates that YONG spent a total of \$67 million, acquiring assets from sellers that do not exist.**
 - **Acquisition of Hebei province customer list for \$32 million:** Management stated that the acquisition is solely comprised of a customer list, which is expected to contribute \$5 million in annual net income simply by eliminating the middleman. However, management never disclosed the name of "Hebei provincial distributor", citing customer confidentiality. We believe YONG **concocted this \$32 million acquisition from itself or a related party, obtaining customers with whom it already does business directly.** Based on our checks with YONG's sub-distributors, there is no independent "Hebei provincial distributor" that used to be a customer of YONG. In fact, YONG's sub-distributors were managed by Mr. WANG Yibing, the general manager of YONG's Hebei sales center. Furthermore, it is no secret that YONG entered Hebei market on its own early in its life cycle and that sub-distributors in Hebei province attended events hosted by YONG Hebei sales center prior to this acquisition. **The above points to the fact that YONG had direct business relationships with local distributors on the customer list long before the acquisition.**
 - **Acquisition of coal mine rights for \$35 million:** YONG acquired coal mine rights from Wuchuan Shuntong, YONG's major supplier. Our findings discussed above in Issue #1 led us to believe that Wuchuan Shuntong was created and operated by YONG. We believe **Wuchuan Shuntong was simply a front for YONG, acting as the seller in this bogus acquisition, in which YONG essentially acquired the coal mine rights from itself.**
- **Issue #3: YONG has been capitalizing certain sales/marketing expenses as assets, thereby overstating net profits.** In addition to normal sales and marketing expenses, we believe there are additional items that should have been accounted for as expenses in YONG's income statement.
 - YONG capitalizes cost of free vehicles given to distributors and depreciates over a longer period to minimize expenses for the current period. In addition, it appears that YONG has not fully accounted for the costs of all vehicles given to distributors.
 - YONG keeps distributor loans as long-term liability, inflating the company's operating cash flow and net profits for the current period.

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Share Price	\$5.16
52-Week Range	\$4.42 - \$9.49
Shares Outstanding	49.4 million
Market Cap (\$ Mil)	\$255
Avg. Daily Volume ('000s)	1,102

Company Description

Yongye International, Inc. (YONG): Headquartered in Beijing, YONG manufactures and sells fulvic acid based liquid and powder nutrient compounds for plant and animal use in China's agricultural industry. The company manufactures its products in its facility in Inner Mongolia and sells its core product Shengmingsu through a distribution network. According to the company, there are 24,000+ YONG branded stores as of December 31, 2010. The company became publicly in the U.S. through a reverse merger and is now trading on Nasdaq.

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* Supporting Documents Available Upon Request

ISSUE #1: SUPPLIER

Our due diligence shows that YONG's major supplier, Wuchuan Shuntong, legally exists but is completely unknown to peers doing business in the humic acid industry in Inner Mongolia. We believe Wuchuan Shuntong was set up and is likely operated by YONG. Our findings led us to believe that Wuchuan Shuntong is simply a shell company with no business activities.

- **Our call to YONG's major supplier, Wuchuan Shuntong, led us to YONG.**
 - **When we called Wuchuan Shuntong, we reached YONG instead.** The contact phone number of the seller, Wuchuan Shuntong is 3395767, shown on AIC record and verified by AIC as of March 12, 2008. We called this number and the person we spoke to is a female employee, who confirmed with us that we have reached YONG. She was able to provide YONG's Beijing office phone number upon our request.
 - **Wuchuan Shuntong and YONG share the same phone numbers on AIC records.** Based on AIC record we obtained from Inner Mongolia province, the contact phone number of Yongye Nongfeng (subsidiary of YONG) is the same 3395767, shown on AIC record, verified by AIC as of January 7, 2010.
- **Wuchuan Shuntong is nowhere to be found in any business directories.** We have conducted an extensive search in an effort to confirm the address and phone number of Wuchuan Shuntong. While we are able to find lists of humic acid companies in Inner Mongolia and their respective business addresses/contact names/phone numbers, Wuchuan Shuntong is nowhere to be found. In addition, local telephone directories do not have Wuchuan Shuntong's telephone number on record. While Wuchuan Shuntong legally exists, our research indicates that it is virtually invisible in the humic acid industry of Inner Mongolia.
- **Other suppliers in humic acid industry in Inner Mongolia have never heard of Wuchuan Shuntong.** We conducted telephone interviews with three humic acid manufacturers/suppliers in Wuchuan county area of Inner Mongolia. All of them provided us with quotes on the pricing and the availability of humic acid. However, none of them has ever heard of Wuchuan Shuntong, or its involvement in Wuchuan lignite coal resource development project.
- **Wuchuan Sanda, located at the same address as Wuchuan Shuntong, is not aware of Wuchuan Shuntong.** One of the suppliers we interviewed is Wuchuan Sanda Humic Acid Factory. Wuchuan Sanda is a supplier that YONG does business with, although it supplies very little to YONG. Wuchuan Sanda's record shows that it has the same registered address as Wuchuan Shuntong. We spoke to Mr. XIAO, the general manager, legal representative and the sole owner of Wuchuan Sanda. Mr. XIAO is not aware of Wuchuan Shuntong, a company that is supposedly located at the same address, supplying humic acid to the same customer (YONG) and generates \$64 million in annual revenue.
- **Wuchuan Shuntong is owned by two farmers.** Based on Wuchuan Shuntong's AIC records, it is a 3-year old company owned by a couple, who are farmers. Wuchuan Shuntong was incorporated in Inner Mongolia province on March 12, 2008 and the address listed is "inside of Wuchuan County Riverside Food Company Courtyard". Total registered capital for Wuchuan Shuntong is RMB 200,000; the company is 75% owned by Mr. GUO Chunjiang and his wife, Ms. WANG Yumei owns the remaining 25%. Mr. GUO serves as legal representative of Wuchuan Shuntong.
- **Wuchuan Shuntong's financial records indicate that it is a shell company with no business activities.** Wuchuan Shuntong's audited financial statement is not publicly available. However, AIC records show that total asset in 2008 was RMB 186K, with net loss of RMB 13K. Total asset in 2009 was RMB 70K, with net loss of RMB 115K. We note that these reported financials, while unaudited, makes sense. The numbers appear to imply a small shell company that has never generated any revenue, but incurred RMB 13K and RMB 115K operating expenses in 2008 and 2009, respectively. As a result, its total assets were reduced accordingly after two years of operations. **In contrast, YONG's SEC filings state that it paid Wuchuan Shuntong \$64 million for supplying raw materials in 2010, which represents a discrepancy of epic proportion.**

ISSUE #2: ACQUISITIONS

YONG's acquisition practice has been widely questioned by the investment community. However, management refused to provide disclosures regarding the identity of the sellers.

- **Acquisition of Customer List in Hebei Province:** In June 2010, YONG entered into an agreement to acquire the Shengmingsu distribution network from its provincial level distributor in Hebei Province. The acquisition is solely comprised of a customer list and was completed in July 2010. YONG has issued 3.6 million shares of common stock (6-month lockup) and will pay an additional \$3.0 million in cash to the seller on or before March 2011. The total acquisition price is \$31.8 million, based on YONG's share price at the time. Management stated that the acquisition of customer list in Hebei will contribute to \$5 million in annual net income simply by eliminating the middleman. YONG never disclosed the name of "Hebei provincial distributor", citing customer confidentiality.

Our research indicates that there has been no provincial-level distributor in Hebei province. We believe there was no independent "Hebei provincial distributor" that used to place orders from YONG. Based on our checks with sub-distributors in Hebei province, we were told that the person in charge of distributor sales is Mr. WANG Yibin (王一兵). No sub-distributor has ever mentioned any other individual's name; some clearly stated that there was no provincial-level distributor in Hebei, except for General Manager WANG, who is a YONG employee in charge of overseeing sales and marketing in Hebei province.

Additional data points corroborate our belief that no provincial level distributor exists in Hebei province.

- **YONG entered Hebei market early in its life cycle.** In fact, YONG's Hebei sales center was set up in September 2008. In an interview discussing YONG's sales and marketing strategy with a local reporter, Mr. XU Nan (YONG's head of sales/marketing) described how the company developed its market in Hebei province and the success of the demonstration site in Leping county.
- **500+ local distributors attended an event hosted by YONG's Hebei sales center prior to the acquisition, indicating that YONG's existing working relationships with local distributors.** On March 13, 2010 (before YONG's acquisition of customer list), Hebei province sales center hosted 1st half 2010 Strategic Plan Announcement Summit. Over 500 distributors from Hebei and Shanxi provinces participated in the summit. This is yet another indication that YONG had previously owned the list information of sub-provincial distributors in Hebei province.
- **Acquisition of Coal Mine Rights:** On March 1, 2010, Yongye Nongfeng entered into an agreement with Wuchuan Shuntong Humic Acid Company Ltd ("Wuchuan Shuntong") to acquire from Wuchuan Shuntong the right to develop certain lignite coal resources in Wuchuan area for a cash consideration of approximately \$35 million. Although the legal procedures for the transfer of the right to develop certain lignite coal resources in Wuchuan area have not been completed, **prepayment of \$34.2 million has been sent to Wuchuan Shuntong** as of December 31, 2010.

While YONG did not explicitly state in its announcement that the seller of coal mine rights, Wuchuan Shuntong, is the same company that supplies the majority of YONG's raw materials, we confirmed through our checks with AIC records that there is no other humic acid company under the name of Wuchuan Shuntong in Inner Mongolia. As we detailed in our discussion regarding YONG's major supplier, Wuchuan Shuntong, records show that although this company legally exists, it is not known by anyone doing business in the humic acid industry. We believe Wuchuan Shuntong was set up and is likely operated by YONG. As a result, we believe that YONG and its management have been behind the coal mine development project from the very beginning. **We believe Wuchuan Shuntong was simply a front for YONG, acting as the seller in a bogus acquisition YONG created for itself, in which YONG essentially acquired the coal mine rights from itself.**

ISSUE #3: EXPENSES

There is virtually no discussion of expense recognition in YONG's SEC filings. In addition to normal sales and marketing expenses (including advertising and other promotional activities), we believe there are additional items that should have been accounted for in the income statement. Due to limited disclosure from YONG, we are unclear as to whether these items should be classified as revenue rebate, compensation expenses or sales and marketing. **However, we believe YONG's current accounting practice allows the company to capitalize certain operating expenses as assets, essentially overstating net income during the current period.**

- **Capitalizing cost of free vehicle given to distributors, depreciating over a longer period to minimize expense in current period.** In our view, the cost of vehicle that YONG gives to distributors should be recognized as part of sales/marketing expenses. YONG's SEC disclosure stated that for distributors who signed five-year agreements, **"(t)he cost of these vehicles has been recorded as "Other assets" which is expensed over a five-year period."** However, we believe most distributors have signed **three-year** agreements and it appears that vehicle incentives are quite prevalent among YONG's distributors, including sub-distributors. YONG reported other assets of \$7.3 million as of December 31, 2010. Based on our estimates, we do not believe YONG has fully accounted for the costs of all vehicles given to distributors in other assets and expensed throughout the appropriate time period.
- **Keeping distributor loans as long-term liability artificially inflates YONG's operating cash flow.** For the loans that distributors obtained by securing their vehicles that were registered under the distributors' name, YONG would repay the full amount of bank loans on behalf of these distributors, if the distributors meet certain sales goals. The loans are recorded as "long-term loans" on YONG's balance sheet. We believe these loans (to be repaid by YONG, not the distributors) are sales/marketing expenses in nature, and should be accounted as such in the period it was incurred. YONG reported \$525,739 in vehicle loans to distributors as of December 31, 2010. **By keeping these distributor loans as YONG's long-term debt, YONG artificially inflates its operating cash flow and net profits in the current period.**

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