GLAUCUS RESEARCH GROUP 格劳克斯研究

"May you live in interesting times." - **Robert Kennedy**

COMPANY: China LNG Group Limited | HK: 931
INDUSTRY: Energy

Recommendation: Strong Sell

Price (as of 7/13/2015): HKD: 1.48

Market Cap: HKD: 16.69 billion

Daily Volume: 129 million shares (Avg. 3mo)

Price Target: HKD: 0.08

These are interesting times for the Hong Kong stock market. On July 8, 2015, amid fears over plummeting PRC stocks and uncertainty over a Greek exit from the Euro, the Hang Seng Index recorded its largest single-day fall since November 2008. In such a volatile market environment, companies with unproven and speculative business models are most vulnerable to capital flight from skittish investors. We believe that we have identified a stock poised for collapse which, despite recent price depreciation, remains wildly overvalued.

China LNG Group Limited ("China LNG" or the "Company"), until recently known as a failed IT firm called Artel Solutions Group, is a Hong-Kong based business with minimal recurring revenue, limited assets and, inexplicably, an **HKD 16.69 billion (US$ 2.15 billion) market capitalization**.

Other than its name (recently changed), China LNG has virtually no connection to the natural gas industry or to mainland China. The Company's LNG business has generated only HKD 131,750 in total revenues since inception. Its operating business remains insignificant. China LNG's management team has no experience in the natural gas industry. Rather, China LNG's only meaningful source of revenue in its last fiscal year was from the appreciation of bonds, issued by a related party, which it purchased at below market price from its Chairman.

Despite an unproven and deeply speculative business model, China LNG currently trades at **33.9x price/book value**. Yet China LNG is essentially a startup without any proprietary intellectual property, a meaningful operating business or tangible experience in the industry. As such, we believe that it should be valued at or very close to book (like other energy companies), meaning we value the Company at **HKD 0.08 per share, 95% below China LNG's last traded price**.

1. **More Overvalued than Hanergy**. China LNG's shares trade at **33.9x book value**. By comparison, Hong Kong listed energy companies trade at an average of **1.84x book value**. Global leaders in the energy space cluster around a similar ratio: **1.60x**. China LNG is so overvalued that its price to book ratio is **18.99 times greater than the average of Hong Kong listed and global energy companies and almost twice as high as Hanergy's peak price to book ratio.**

    a. **Price To Sales Ratio Shows Gross Overvaluation**. Hong Kong and global energy companies currently trade for an average price to sales ratio of **1.32x**. Not China LNG. Annualizing the partial year revenue figures from May-July 2015, as reported in the Company's recent circular, we calculate that China LNG's stock is currently trading at **19,917 times annualized sales of its LNG business**. At its peak closing price, Hanergy only traded at 27x annual sales. Despite the fact that Hanergy was widely regarded as overvalued, measured on a price-to-sales ratio, its stock was a bargain compared to China LNG's.

2. **Very Little LNG, Very Little China**. In May 2014, the Company changed its name to China LNG. Since then, despite its rebranding, the Company's LNG business remains insignificant.

    a. **Insignificant Revenues, Assets and Operating Business**. As of July 13, 2015, the Company's LNG business has only generated HKD 131,750 in total revenues. Ever. At its current run rate, the Company's LNG business will generate a **paltry HKD 790,500 in revenues over the next year**. At last FYE, the Company did not own any meaningful assets related to the natural gas business.

b. **No Intellectual Property or Proprietary Technology**. Nor does China LNG possess any technology, patents, trademarks, copyrights or operating rights which would give the Company any competitive advantage in entering a crowded industry.

c. **No Experience or Expertise**. None of China LNG's senior managers appear to have any experience as an executive (or even a low level employee) working for an energy company. Rather, China LNG's senior management consists of four accountants and one former banker.

d. **Unproven and Flawed Business Plan**. To date, the sum total of China LNG's operating business consists of vague announcements and non-binding framework agreements with various established businesses, two newly formed subsidiaries, and an unproven, speculative and deeply flawed business plan.

i. **Filling Stations**. China LNG intends to enter the downstream market by setting up LNG filling stations for heavy vehicles and boats sailing along inland rivers. This field is already crowded with well-capitalized incumbents. We estimate that there are, conservatively, over 2,300 LNG/CNG refilling stations in China, many owned and operated by some of the most experienced, well-capitalized brand names in the Chinese energy space, including KunLun, CNOOC, PetroChina and Sinopec. Other companies, such as China Tian Lun Gas Holdings Limited ("CTLG") (HK: 1600), have leveraged an existing brand and network of traditional gasoline refilling stations to penetrate the LNG market. Investors should be highly skeptical of China LNG's ability to compete with established downstream energy service and delivery companies, who have the brand, balance sheet, operating experience and expertise to establish and successfully manage filling stations. Furthermore, this business requires heavy capital expenditures. Industry estimates range from HKD 11 million to HKD 15 million per heavy vehicle refilling station, a significant expenditure considering that almost all of the Company's cash balance has been allocated to lease financing.

ii. **Lease Financing for LNG Vehicles and Equipment**. China LNG has reportedly committed US$ 48 million (HKD 372 million), **representing 70% of the Company's total assets (at last FYE)**, into the Shanghai bank account of its newly formed subsidiary, China LNG Finance Leasing Co, to finance leases of LNG-equipped vehicles and vessels. But this is already a crowded and competitive market. We see no viable commercial reason to suspect that China LNG will be better at finding borrowers, evaluating credit, lending, and securing collateral than banks, truck manufacturers, dealerships and specialist-auto lenders **who are already entrenched in the lease financing market**. China LNG is in by far the worst competitive position. The Company is poorly financed (an understatement), and lacks the access to capital of bank-affiliated leasing companies. It has no specialized knowledge of the industry or LNG vehicles, and cannot leverage a leasing business off of an already established brand, salesforce or infrastructure like manufacturers or dealerships. Lease financing in the PRC is already a harsh competitive environment crowded with established and experienced competitors who are in a much better position to succeed than China LNG.

iii. **Sinopec: China LNG is NOT China Gas (HK: 384)**. On November 25, 2014, China LNG announced a **non-binding** framework agreement with Sinopec, which created investor excitement that perhaps Sinopec would cooperate with and invest in China LNG like it did with China Gas (HK: 384) in 2004. Shareholders should not hold their breadth: Sinopec invested in China Gas when its shares traded at 3.16x book value and after China Gas had developed a substantial and profitable natural gas business. By comparison, China LNG's shares are outrageously expensive (33.9x book) and it has no such operating business.

Furthermore, the details of the proposed cooperation are non-binding and fuzzy. As best we can tell, Sinopec expressed interest in designing, building and operating LNG refueling stations as well as supply LNG at a preferential price to the Company. China LNG agreed to invest "not less than 100,000 LNG heavy trucks directly and not less than 200,000 heavy trucks indirectly" and guaranteed a minimum level of retail sales of LNG to Sinopec's refueling stations. This announcement raises more questions than answers. How will China LNG supply LNG equipped trucks? The Company has a tiny balance sheet and as of last FYE, no established infrastructure or experience in the field. Even the most optimistic projections put the number of LNG-equipped vehicles in China at 800,000 by 2020 – does any investor realistically expect China LNG to finance 37% of this market? China LNG does not have the balance sheet, operating experience or infrastructure to fulfill their end of the proposed cooperation, so we have serious doubts about Sinopec's level of interest. Ultimately, the agreement with Sinopec is no agreement at all. It is simply a vague, flawed plan to talk again in the future.

iv. **History of Illusory Cooperation Agreements**. Since March 2014, China LNG has announced **20 non-binding** letters of intent or cooperation agreements with various companies, commissions and development groups. Although such cooperation agreements give investors the impression that China LNG is making significant progress in the LNG business, this impression is illusory. To our knowledge, not **a single one of the 20 non-binding agreements has led to a concrete, contractual business relationship or investment**. Nor are China LNG's promises under such announcements realistic. For example, from March 2014 through June 2014, China LNG made **five** such announcements, promising to invest **HKD 5 billion**, obviously impossible given that the Company's balance sheet recorded only HKD 549 million in total assets as of FYE 2014, (~11% of the promised investment amount). To our knowledge, such agreements have come to nothing. In total, the Company's non-binding agreements call on it to commit between **HKD 14 billion and HKD 71 billion** in investments into the LNG business, a farcical amount of capital considering the Company's tiny balance sheet and limited operating history.

e. **History of Failed New Businesses**. The Company's pivot towards natural gas represents its **fifth new business since 2007**, when Chairman Billy Albert Kan became involved. Management's repeated failure to successfully launch new businesses casts further doubt on the viability of its entry into the crowded LNG space.

3. **Related Party Junk Bonds Return 375% in 6 months**. 99% of China LNG's 2014 revenue was derived from a one-off related party bond deal with its Chairman. In January 2014, China LNG purchased from its Chairman HKD 80 million in convertible bonds issued by Warderly International (HK: 0607) (the "Warderly Bonds"), a Hong Kong listed company which was (at the time) also owned and controlled by China LNG's Chairman. The Chairman sold China LNG the Warderly Bonds at well below their market value. In June 2014, China LNG agreed to sell the Warderly Bonds to Magnolia Wealth International Limited ("Magnolia") for HKD 380 million, **a 375% profit** in just six months.

   a. **Warderly's Troubled Past**. Warderly is a Hong Kong-listed penny stock which went bankrupt in 2007 and whose shares were suspended from trading by the SFC from 2007 through until December 2013. China LNG Chairman Billy Albert Kan bought a controlling stake in Warderly in 2008, and despite repeated attempts to relist the stock, was refused by the HKEX and the SFC until he agreed to sell his interest in a reverse merger to a Chinese property developer at the end of 2013. As part of the reverse merger, Warderly issued HKD 80 million in bonds (convertible at maturity) with an HKD 0.05 strike price to Billy Albert Kan. One month later, he sold the bonds at the issue price to China LNG.

   b. **No Explanation for Bond Appreciation**. In January 2014, the Company purchased Warderly bonds convertible at HKD 0.05 per share. Given that Warderly's shares were trading at well above the strike price, the value of the bonds should theoretically have been tied to the underlying price of Warderly's stock. However, Warderly's share price **declined 34.4%** from HKD 0.38 to HKD 0.24 between the date China LNG purchased the Warderly Bonds and the date China LNG sold the bonds. The only reason that China LNG made a 375% return on the Warderly Bonds was that its Chairman sold the bonds to the Company **at well below the market price**. The most charitable explanation is that this was a sweetheart deal from the Company's Chairman which is **non-recurring revenue** and cannot be factored into the Company's valuation.

4. **Valuation**. China LNG currently trades at **33.9x price/book value**. Yet China LNG is essentially a startup without any proprietary intellectual property, a meaningful operating business or tangible experience in the industry. As such, we believe that it should be valued at or very close to 1.79x book value (the average for HK and global energy comps). **We think the Company is worth HKD 0.08 per share, 95% below China LNG's last traded price.**

Glaucus Valuation

	7/13/2015
Reported Book Value (total equity value in HK$'000) - 12/31/2014[1]	492,301
P/B Multiple (average for HK and global competitors)[2]	1.79x
Stock Price[3]	HK$ 1.48
Market Capitalization (HK$'000)[3]	16,690,000
Shares Outstanding (mms)	11,277
Value of Firm per Share	**HK$ 0.08**

[1] *China LNG 2014 Annual Report, p.25*
[2] *Calculation using Bloomberg data*
[3] *Bloomberg*

MORE OVERVALUED THAN HANERGY

China LNG Group Limited ("China LNG" or the "Company") was a longtime penny stock until a May-2014 cosmetic re-brand into a natural gas company propelled the Company's stock price up over **357%**. Despite recent price depreciation, its stock remains wildly overvalued. A comparison of price to book ratios, which is useful in the capital intensive energy business, underscores the absurdity of China LNG's current stock price.

As of the close of the market on July 13, 2015, the Company's shares trade at **33.9 times the book value of its equity**. By comparison, Hong Kong listed energy comps trade at an average of **1.84x book value**. Global leaders cluster around a similar ratio: 1.60x.

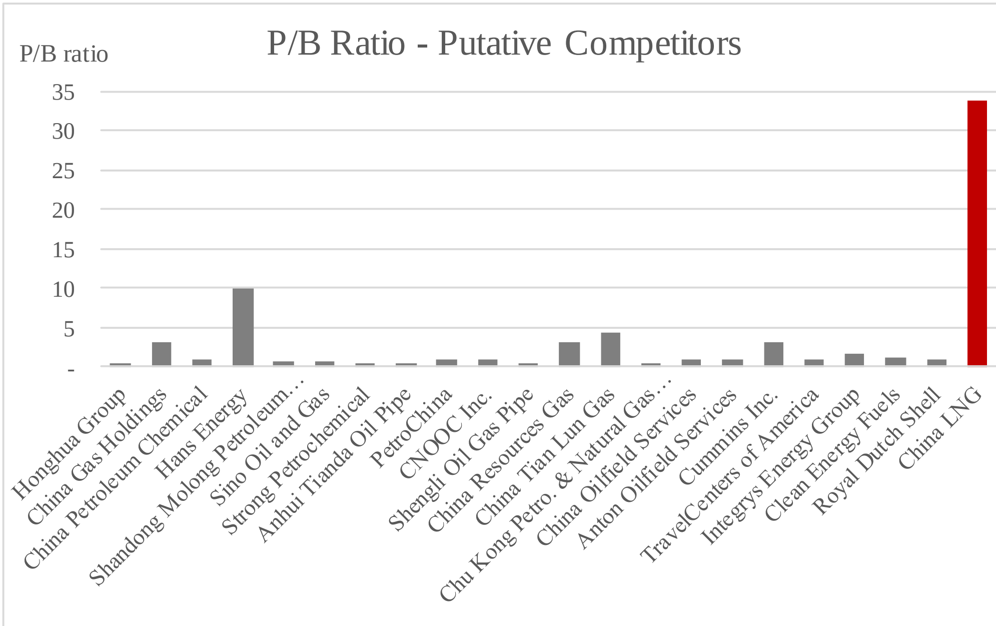
Price to Book Ratio - Putative Competitors

Ticker	Company Name	P/B Ratio
HK Comps		
0196.HK	Honghua Group	0.37
0384.HK	China Gas Holdings	3.25
0386.HK	China Petroleum Chemical	1.04
0554.HK	Hans Energy	10.02
0568.HK	Shandong Molong Petroleum Machinery	0.78
0702.HK	Sino Oil and Gas	0.77
0852.HK	Strong Petrochemical	0.48
0839.HK	Anhui Tianda Oil Pipe	0.48
0857.HK	PetroChina	1.06
0883.HK	CNOOC Inc.	1.01
1080.HK	Shengli Oil Gas Pipe	0.37
1193.HK	China Resources Gas	3.07
1600.HK	China Tian Lun Gas	4.34
1938.HK	Chu Kong Petro. & Natural Gas Steel Pipe	0.46
2883.HK	China Oilfield Services	0.92
3337.HK	Anton Oilfield Services	1.08
	Average of HK comps	1.84
Global Comps		
NYSE:CMI	Cummins Inc.	3.06
NYSE:TA	TravelCenters of America	1.07
NYSE:TEG	Integrys Energy Group	1.65
NasdaqGS:CLNE	Clean Energy Fuels	1.18
ENXTAM:RDSA	Royal Dutch Shell	1.05
	Average of global comps	1.60
	Average of all comps	**1.79**
0931.HK	**China LNG**	**33.90**
	Difference	**18.99x**

Source: Bloomberg

Note: China LNG's Price to Book ratio ("P/B Ratio") are calculated based on the latest financial information as of July 13, 2015; competitors' P/B Ratio are calculated based on the financial information as of July 6, 2015

Hong Kong and global energy companies trade at an average of 1.79x book value. By comparison, China LNG is wildly overvalued, trading at **18.99 times the average price to book ratio of this diverse basket of energy companies.**



Source: Bloomberg
Note: China LNG's Price to Book ratio ("P/B Ratio") are calculated based on the latest financial information as of July 13, 2015; competitors' P/B Ratio are calculated based on the financial information as of July 6, 2015

Remarkably, China LNG's stock price appears significantly more overvalued than the **peak stock price of Hanergy**, the poster child of wildly overvalued Hong Kong stocks. Beginning in January 2013, Hanergy's stock price rose **2006%**, making its Chairman, Li Hejun, China's richest man. Hanergy's market capitalization peaked at US$ 42 billion, despite numerous market commentators questioning the authenticity and value of its underlying business.

The holy financial trinity of the Wall St. Journal, the Financial Times and Bloomberg, each released articles questioning the legitimacy of Hanergy's business model, identifying the fundamental flaws in Hanergy's financial statements and highlighting the weaknesses of its solar technology. Yet Hanergy's stock kept rising, peaking at a price to book ratio of 17x and a price to earnings ratio of over 79x. For many market watchers, Hanergy's stock price appeared completely disconnected to the value or performance of its underlying business. And then it collapsed.

On Wednesday, May 20, Hanergy's shares plunged 47% in a matter of minutes, wiping out US$ 18 billion in Hanergy's market capitalization (and US$ 15 billion in its Chairman's personal fortune). The stock was suspended. It remains halted, suggesting that if it ever trades again, much of its market capitalization may be wiped out.

By comparison, China LNG's stock price appears even more overvalued than Hanergy's stock at its peak price.

Price to Book Ratio - Hanergy (peak) VS China LNG

Ticker	Company Name	P/B Ratio
0566.HK	Hanergy (Peak)	17.16
0931.HK	China LNG	33.90

Source: Bloomberg
Note: 1. Hanergy (peak) price used is the peak closing price achieved on April 23, 2015.
2. China LNG's P/B ratio is calculated using July 13, 2015 closing price

China LNG's price to book ratio is almost **two times higher than Hanergy's peak price to book ratio**.

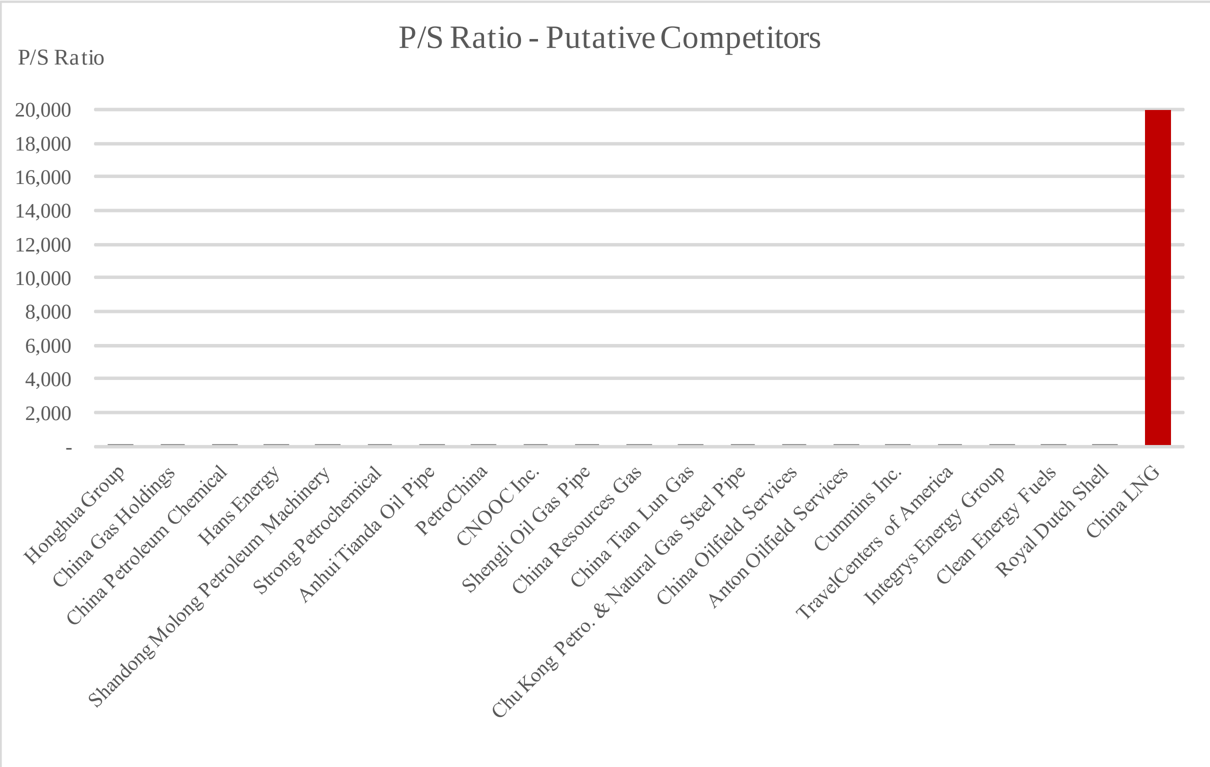
Comparing price to sales ratios tells a similar story. Hong Kong and global energy companies currently trade for an average price to sales ratio of **1.32x**. Not China LNG. Annualizing the partial year revenue figures from May-July 2015, as reported in the Company's recent circular, we calculate that China LNG's stock is currently trading at **19,917 times the annualized forward sales of its LNG business**.[1]

Price to Sales Ratio - Putative Competitors

Ticker	Company Name	P/B Ratio
HK Comps		
0196.HK	Honghua Group	0.19
0384.HK	China Gas Holdings	1.77
0386.HK	China Petroleum Chemical	0.21
0554.HK	Hans Energy	7.94
0568.HK	Shandong Molong Petroleum Machinery	0.73
0852.HK	Strong Petrochemical	0.75
0839.HK	Anhui Tianda Oil Pipe	0.34
0857.HK	PetroChina	0.54
0883.HK	CNOOC Inc.	1.37
1080.HK	Shengli Oil Gas Pipe	0.27
1193.HK	China Resources Gas	1.64
1600.HK	China Tian Lun Gas	3.59
1938.HK	Chu Kong Petro. & Natural Gas Steel Pipe	0.52
2883.HK	China Oilfield Services	1.26
3337.HK	Anton Oilfield Services	1.04
	Average of HK comps	1.48
Global Comps		
NYSE:CMI	Cummins Inc.	1.22
NYSE:TA	TravelCenters of America	0.08
NYSE:TEG	Integrys Energy Group	1.16
NasdaqGS:CLNE	Clean Energy Fuels	1.28
ENXTAM:RDSA	Royal Dutch Shell	0.45
	Average of global comps	0.84
	Average of all comps	**1.32**
0931.HK	**China LNG**	**19,917.08**
	Difference	**15,115.76x**

Source: Bloomberg
Note: China LNG's Price to Sales ratio ("P/S Ratio") are calculated based on the latest financial information as of July 13, 2015; competitors' P/S Ratio are calculated based on the financial information as of July 6, 2015

[1] Revenues from the trading segment were excluded from this calculation because all of the 2014 trading revenues were derived from a one-off bond deal in which the Company purchased related party bonds at below-issue price from the Chairman. Such revenues are non-recurring by their very nature.



Source: Bloomberg

Note: China LNG's Price to Sales ratio ("P/S Ratio") are calculated based on the latest financial information as of July 13, 2015; competitors' P/S Ratio are calculated based on the financial information as of July 6, 2015

Hong Kong and global energy companies tend to trade between 0.5-2.0x annual sales. China LNG is so overvalued relative to its tiny operating business that it trades at a price of 19,917 times its annualized LNG revenues.

At its peak closing price, Hanergy traded at 27 times annual sales. Despite the fact that Hanergy was widely regarded as overvalued, measured on a price to sales ratio, its stock was a bargain compared to China LNG's.

Price to Sales Ratio - Hanergy (peak) VS China LNG

Ticker	**Company Name**	P/S Ratio
0566.HK	Hanergy (Peak)	27.02
0931.HK	China LNG	19,917.08

Source: China LNG 2014 Annual Report, p.45
Hanergy 2014 Annual Report, p.111,189
Source: China LNG Circular 7/7/2015, p.15
Note: 1. Hanergy peak price used is the peak closing price achieved on April 23, 2015.
2. China LNG's P/S ratio is calculated using July 13, 2015 closing price

China LNG is grossly overvalued by almost any metric. We believe it is simply a matter of time before follows Hanergy over the ledge.

VERY LITTLE NATURAL GAS, VERY LITTLE CHINA

China LNG's market capitalization now exceeds HKD 16 billion, despite the fact that as of FYE 2014, it had only seventeen employees, **it had not made a dollar from the natural gas business, and had no operations in China**.

China LNG's spotty record of failed new ventures makes this recent stock price appreciation even more unlikely. China LNG used to be known as Artel Solutions Group, a failed IT firm which almost went bankrupt when it was sued by its creditors, suppliers (including Intel) and employees for failure to pay its bills. In September 2006, creditors filed a petition to wind up the Company, forcing the HKEX to suspend trading of China LNG's shares while China LNG looked for new ownership.

In 2007, Billy Albert Kan, a little known former accountant and penny stock promoter, forced out the previous Chairman and acquired a 76% controlling interest in the Company. China LNG soon abandoned its failing IT solutions business and began trading stocks and bonds of companies listed in Hong Kong until it announced in May 2014, that it was entering the natural gas business. This is the Company's **fifth business since Billy Albert Kan took over the Company**.

LNG is faddish, with perpetual pollution in China propelling investor excitement in cleaner alternatives. But investors looking to take advantage of Beijing's push towards cleaner fuels should invest elsewhere, because China LNG has virtually no connection to either China or the LNG business. Other than to sell stock to unsuspecting investors hungry for the next fad, there is no viable commercial reason for a Company with no assets, experience, or business to enter a crowded field such as LNG.

1) Insignificant Revenues, Assets and Operating Business

According to the Company's recent circular, since its March 2014 rebranding, the Company has made **HKD 131,750** in total revenues from its Chinese natural gas business. At its current run rate, the Company's LNG business will generate **HKD 790,500** in revenues over the next year.[2] Such results are unquestionably poor. China LNG has been a Chinese LNG company for over a year, yet its primary operating business is not generating more than HKD 1 million in annual revenues.

The sum total of its business operations, as of July 13, 2015, is seven agreements to finance the lease of 1,005 heavy duty LNG vehicles. It operates out of three brick-and-mortar finance lease offices in Tianjin, Zhejiang and Shenzhen. For a startup such an operating business might be respectable. For a Company with a HKD 16 billion market capitalization, such an operating business is laughable.

In our opinion, China LNG is a Potemkin village. Even the cover of its annual report is photo-shopped. The Company's 2014 annual report features a heavy truck parked at an LNG filling station bearing its Hong Kong stock ticker. But this station does not exist because LNG has no operating (or even non-operating) filling stations. It is a CGI makeup of a filling station, designed perhaps to give shareholders the false sense of security that they are investing in something tangible. They are not.

[2] The Company's circular is unclear. It states that it has been operating its lease financing business since May 2015, but then states in the same document that it has entered into seven lease agreement since February 2015. We will give the Company the benefit of the doubt, and assume that its revenues were generated in the two-month period from May to July 2015 (rather than February-July) for the purposes of calculating its annual revenue run rate.

Source: China LNG 2014 Annual Report

China LNG does not even appear to own any significant assets related to the natural gas business. In fact, at FYE 2014, it did not appear to own any meaningful tangible assets in China! As of its last FYE balance sheet, China LNG's only assets were held-for-trading securities, cash, a few Hong Kong investment properties, and HKD 2.17 million (US$ 280,000) of furniture, fixtures, vehicles and leasehold improvements.

Consolidated Statement of Financial Position

At 31 December 2014

	Notes	2014 HK$'000	2013 HK$'000
Non-current assets			
Investment properties	15	**86,700**	84,878
Plant and equipment	16	**2,171**	480
Deferred tax asset	21	**34**	21
		88,905	85,379
Current assets			
Held for trading investments	17	**212,889**	–
Prepayments and deposits	18	**1,369**	986
Bank balances and cash	19	**246,166**	170,186
		460,424	171,172
Current liabilities			
Accrued charges and other payables	20	**1,028**	461
Income tax payable		**55,776**	991
		56,804	1,452
Net current assets		**403,620**	169,720

Source: China LNG 2014 Annual Report

2) *No Intellectual Property, Proprietary Technology or Special Operating Rights.*

Nor does China LNG possess any patents, trademarks, copyrights or rights to any technology which would give the Company any technological or proprietary advantage in entering a crowded industry.

At last FYE 2014, it did not even own any exclusive operating licenses or rights in China which would give it a protected moat from which to operate filling stations.

Contrast this with China Tian Lun Gas Holdings Limited ("CTLG") (HK: 1600), a company that actually owns and operates natural gas filling stations and sells natural gas to industrial, commercial and residential users. As of FY 2014, CTLG reported **RMB 1.2 billion** in intangible assets, made up in part by exclusive operating rights and the value of acquired natural gas distribution networks.

17. INTANGIBLE ASSETS — GROUP

	Goodwill RMB'000	Exclusive operating rights RMB'000	Computer software RMB'000	Network RMB'000	Total RMB'000
Year ended 31 December 2014					
Opening net book amount	334,380	308,733	60	–	643,173
Acquisition of subsidiaries (Note 34.1)	192,818	111,350	–	316,385	620,553
Additions	–	–	162	–	162
Amortisation charge	–	(17,011)	(81)	(8,958)	(26,050)
Closing net book amount	527,198	403,072	141	307,427	1,237,838

Source: CTLG 2014 Annual Report, p. 106.

By contrast, according to its last FYE balance sheet, China LNG possessed no operating rights or any intangible asset of any kind. This raises the question of how China LNG expects to compete with companies like CTLG in a crowded natural gas space. What competitive advantage can China LNG bring to bear on a market where competitors like CTLG have a first-mover advantage and also possess significantly more tangible and intangible assets? Perhaps, it is China LNG's management team's long experience operating a comparable business in a comparable forum? Nope.

3) *No Experience or Expertise*

None of China LNG's senior managers appear to have any experience as an executive, manager or an employee at an oil and gas related business. Rather, China LNG's senior management consists of four accountants and one former branch VP of a Pudong bank.

China LNG Management: Lack of Oil & Gas Experience

Executives	Work Experience	Oil & Gas Experience
CEO and Chairman Billy Albert Kan	●Certified Public Accountant for KPMG and Deloitte Touche Tohmatsu; ● CEO/Chairman of Hong Kong listed penny stocks Greater China Holdings (HK: 431) (industrial property development; metals trading), Interchina Holdings (HK: 202) (leasing of rentail properties), Warderly (HK: 067) (trading of consumer products and electronics)	**NONE**
Executive Director Chen Li Bo	●VP of Pudong Branch of China Construction Bank (15 years); ● COO, CEO and deputy Chairman of HKC holding (HKEX:0190), a HK-based property developer (14 years); director of J.I.C.Technology (HK: 987)	**NONE**
Executive Director Li Shu Han, Eleanor Stella	●Billy Albert Kan's Niece, sister of Arthur Albert; ●Certified Public Accountant ●Director of Wealth Loyal Development Ltd.	**NONE**
Executive Director Li Kai Yien, Arthur Albert	●Billy Albert Kan's nephew, brother of Eleanor Stella; ●Certified Public Accountant; ●Concurrently Serves as a dealer representative of Phillip Securities	**NONE**
Ha Cheuk Man*	●Member of Hong Kong Institute of Certified Public Accountants	**NONE**

*Senior Manager
Source: China LNG 2014 Annual Report, pg. 7-9

Chairman and CEO Billy Albert Kan is a stock promoter. His niece and nephew comprise two of the three other executive directors, both are certified public accountants. Li Bo Chen, **65**, and appointed as vice Chairman in January 2015, has experience in banking and property.

How can shareholders expect China LNG to compete in a crowded industry against seasoned competitors when its management team does not have any experience in the oil and gas business?

4) ***Unproven and Flawed Business Model.***

To date, the sum total of China LNG's operating business consists of fluff announcements of non-binding cooperation with various established businesses, two newly formed subsidiaries, and a speculative business model.

a. LNG Filling Stations.

The first prong of the Company's business plan is to enter the downstream market by setting up **LNG filling stations** for heavy vehicles and boats sailing along inland rivers.

China LNG is likely too late to the game. Indeed, it is difficult to see any competitive advantage over the incumbents who are already grabbing market share in the space. As of May 2014, when the Company pivoted (supposedly) towards the new business, China already had over 1,500 refueling stations for vehicles running on natural gas. Today, the number is even higher.

We estimate that there are, conservatively, over 2,300 LNG/CNG refilling stations in China, many owned and operated by some of the most experienced, well-capitalized brand names in the Chinese energy space.

Public Companies Involved in LNG Filling Station business

Ticker	Name of Company	# of Stations	Type of Station	Date of Data	Source
0857.HK	PetroChina*	545+	LNG	1Q 2013	Sina Finance
0883.HK	CNOOC*	81+	LNG	1Q 2013	Sina Finance
0386.HK	China Petroleum Chemical (Sinopec)*	20+	LNG	1Q 2013	Sina Finance
2688.HK	ENN Energy Holdings	241	LNG	Dec 31 2014	ENN Energy Announcement
0135.HK	Kunlun Energy	752	LNG	Dec 31 2014	hket Article
1600.HK	Tian Lun Gas	36	LNG/CNG	Dec 31 2014	ACN News Wire
0603.HK	China Oil and Gas Group	12	LNG/L-CNG	Dec 31 2014	Link
1193.HK	China Resources Gas Group	85	LNG/L-CNG	Dec 31 2014	Lnik
0384.HK	China Gas	434	LNG/CNG	Sep. 2014	aastocks.com
600256.SS	Guanghui Energy	109	LNG/CNG	Dec 31 2014	Guanghui Energy
600207.SS	Henan Ancai Hi-tech	2	L-CNG	Dec 31 2014	Link
002682.SZ	Fujian longzhou transportation	11	LNG	Jun. 05 2014	QQ finance
	Total	2,328			

**These LNG Filling Stations of PetroChina, CNOOC, Sinopec were built in the first quarter of 2013. The current station count for these three companies has increased since 1Q 2013.*

Baidu data shows the increasing penetration of LNG refilling stations throughout China.

LNG and CNG Fueling Stations in China

Source: China LNG Automobile *(not related to the Company)*

Some of China's biggest energy companies, including KunLun, CNOOC, PetroChina and Sinopec already own and operate hundreds of LNG refilling stations. Other companies, such as CTLG, have leveraged an existing brand and network of traditional gasoline refilling stations to penetrate the LNG market.

By comparison, China LNG is undercapitalized, it has no brand name, no existing infrastructure or network of refilling stations, and no expertise or experience in establishing or operating filling stations.

Furthermore, this business requires heavy capital expenditures to purchase land and build out filling stations. Industry estimates range from HKD 11 million to HKD 15 million per heavy vehicle refilling station, a significant expenditure for a Company with a tiny balance sheet (HKD 549 million in total assets as of FYE 2014), especially considering that almost the Company's entire cash balance has been allocated to vehicle lease financing.

b. Lease Financing for LNG Vehicles and Equipment.

The second prong of the Company's proposed business plan is to provide credit to finance the leasing of LNG-equipped vehicles, vessels and equipment.

China LNG has reportedly committed US$ 48 million (HKD 372 million) into the Shanghai bank account of its newly formed subsidiary, China LNG Finance Leasing Co, to finance the purchase of LNG vehicles and vessels. This is a large commitment, representing **70%** of the Company's total assets at last FYE. As of July 13, 2015, the Company has reportedly established three vehicle leasing offices in Tianjin, Zhejiang and Shenzhen and has financed the leases of 1,005 heavy LNG-equipped vehicles.[3]

China LNG claims that the Chinese banking system will allow the Company to lever up 9 to 1, allowing it to lend **US$ 480 million**. This idea seems deeply flawed. China LNG intends to borrow from Chinese banks, only to lend out this money to end users to finance the leasing of LNG-equipped equipment and vehicles. Presumably, China LNG intends to turn a profit on this business, so it must lend out at a higher rate than it borrows. Obviously, small to medium sized businesses with good credit will go directly to the banks to obtain lower rates, meaning that China LNG will be stuck leasing to higher credit risks (firms that cannot go to the banking system) for a tiny yield (the spread between the cost of capital and the interest rate of the loans). This is akin to picking up pennies in front of a train, especially considering that China LNG has no experience evaluating credit risk of potential borrowers, or lending in general.

This is to say nothing of the likely possibility that established auto lenders and banks have a lower weighted average cost of capital, and are thus able to finance vehicle leases on better terms than China LNG.

We see no viable commercial reason to suspect that China LNG will be better at finding borrowers, evaluating credit, lending, and securing collateral than banks, manufacturers, dealerships and specialist-auto lenders **who are already active in the lease financing market**. After all, financing a lease for a heavy truck is the same business whether the truck runs on LNG, diesel or gasoline.

[3] China LNG promises that it is in the process of setting up three more leasing offices and negotiating the leasing of approximately 13,980 more heavy duty LNG-equipped trucks.

Categories of Vehicle Lease Financing Companies

Category	Examples	Features
Dedicated Vehicle Lease Financing Companies	Herald Leasing	Moderately well financed, highly specialized, highly experienced
Bank Affiliated Leasing Companies	CDB Leasing	Well financed, less specialized
Manufacturers	Ezucoo, Mercedez-Benz, Volkswagen	Promotion of new vehicles, well financed, highly specialized
Dealerships	China Grand Automotive, China Automobile Trading, eCapital, Pangda Leye Financial Leasing	Highly specialized, increased profitability from bundling financial services with sales and promotion, moderately well capitalized
New Entrant**	China LNG	Inexperienced, poorly capitalized, no specialized knowledge or experience

Source: Deloitte 2014 Auto Finance report
** Glaucus Opinion

A 2014 Deloitte study, the China Auto Financing Report, paints an ominous picture of the competitive landscape. Manufacturer-affiliated leasing companies are reportedly prospering, with Volkswagen taking over a long-term leasing service in 2013 in Beijing and Shanghai. Dealerships are "availing themselves of the existing networks on their fast track to the booming business, with fleet size and business volume outrunning those of normal-sized leasing services."[4]

Manufacturers and dealerships have obvious synergies with the leasing business: they can leverage their existing brand, infrastructure, expertise (i.e. knowledge of the vehicles), and scale to finance leasing of their vehicles. Financial services supplement their core business, and given enough size, they can borrow cheaply from China's banking system.

Bank-affiliated leasing companies have the advantage of being well financed. Their cost of capital is probably more favorable than dealerships or manufacturers, even though they may lack the specialized knowledge of the leased vehicles. CDB Leasing is the leader in this sector: it has already leased thousands of vehicles and forged partnerships worth RMB 8.4 billion with 11 premier manufacturers.[5]

Independent financial leasing firms have it more difficult, yet a few such firms (including Herald Leasing) are pushing a first mover advantage.

China LNG is in by far the worst competitive position. They are poorly financed (an understatement), and lack the access to capital of bank-affiliated leasing companies. They have no specialized knowledge of the industry or the vehicles, and cannot leverage a leasing business off of an already established brand, salesforce or infrastructure like manufacturers or dealerships. Other financial leasing companies are also way ahead of China LNG: with scale and expertise, their cost of capital is bound to be lower, and they are already establishing the brand, network and acumen to survive in a harsh competitive environment.

c. Sinopec: China LNG is NOT China Gas (HK: 384).

The bull case for China LNG, such as it is, revolves around a presumed future relationship with Sinopec. In 2004, Chairman Billy Kan apparently brokered a deal between China Gas Holdings (HK: 384) ("China Gas") and Sinopec, pursuant to which the state owned behemoth purchased a 10% stake in China Gas. For his efforts, Billy Albert Kan was awarded 180,000,000 in warrants issued by China Gas.

Apparently, Billy Albert Kan is touting his relationship with Sinopec and holding out the promise China LNG will strike a similar arrangement with the state-owned energy giant. On November 25, 2014, China LNG announced a **non-binding framework agreement** with Sinopec regarding the development of LNG refueling stations and application of LNG heavy trucks in the PRC.

4 2014 Deloitte China Auto Financing Report, p. 7.
5 2014 Deloitte China Auto Financing Report, p. 10.

But any shareholder looking to China Gas as a parallel should look elsewhere. First, Sinopec's investment in China Gas was at much more favorable price. Sinopec acquired a 10% stake in China Gas in October 2004, at a time when China Gas's stock was trading at a price to book value of 3.16x. While this price was certainly expensive (energy companies usually trade between 1-2x book value), it is nothing compared to the overvaluation of China LNG's shares today.

Price to Book Ratio - China Gas (Oct. 2004) VS China LNG

Ticker	Company Name	P/B Ratio
0384.HK	China Gas Holdings	3.16
0931.HK	**China LNG**	**33.90**

Source: Capital IQ

Note: 1 China Gas' Price to Book ratio on Oct. 2004 is from the time when Sinopec invested in the company.

2. Chinal LNG's P/B ratio is based on the latest financial information.

Just as important, Sinopec's investment in, and cooperation with, China Gas came after China Gas had **already developed a substantial and profitable operating business**. In FY 2005, at the time of Billy Kan's involvement and Sinopec's acquisition of 10% of its business, China Gas had an existing network of gas pipelines which was already servicing a wide array of residential and commercial customers. China Gas reported FY 2005 revenues of HKD 410 million, net profits of HKD 132 million, exclusive operating rights in a number of areas, and over HKD 2.7 billion in assets on its balance sheet.

By comparison, China LNG's shares are outrageously expensive (33.9x book) and it has a miniscule operating business. Also, Sinopec's involvement in China Gas came at a time when the state owned enterprise was looking to diversify into the natural gas market. Today, that market is saturated, and reports suggest Sinopec is offloading natural gas assets.

Regardless of Sinopec's long term plans in the natural gas industry, it is unclear what value, if any, China LNG could bring to the deal. Why would Sinopec be interested in teaming with a business which exists only on paper and whose officers and executives have neither the balance sheet, experience nor competitive advantage to provide any relative value to the Chinese state owned energy giant? Perhaps that is the reason that any proposed contract remains non-binding and the details of any proposed cooperation remain fuzzy.

The announcement of the **non-binding framework agreement** suggested that China LNG and Sinopec would cooperate on two pilots programs for the development of LNG refueling stations along two PRC highways. Yet China LNG's role and value add are unclear.

The announcement states that Sinopec will design and build the refueling stations as well as supply LNG at a preferential price to China LNG. By contrast, China LNG is responsible "for the provision of funding to its customers to translate their heavy trucks from using fuel to LNG and provision of finance leasing services to its customers for purchasing **new LNG heavy trucks from the Company**."[6]

Oddly, China LNG has promised to invest "not less than 100,000 LNG heavy trucks directly and not less than 200,000 heavy trucks indirectly at the end of year 2020 in order to provide long-term support" to Sinopec. China LNG has also guaranteed certain **minimum retail sales of LNG** to the refueling stations. The announcement concludes, optimistically, that "as the value of investment in 300,000 LNG heavy trucks could amount to over RMB 100 billion, the Company decided to enter" the framework agreement in relation to the cooperation in the development of LNG refueling stations with Sinopec.

[6] China LNG Sinopec Announcement, p. 3.

The most optimistic projections predict 800,000 LNG equipped vehicles in China by 2020. But even assuming that such rosy projections come true, the notion that China LNG, with no balance sheet, experience, operating business or brand will provide or finance 300,000 such vehicles (37.5%) is absurd.

In addition, how will China LNG supply LNG equipped trucks: 100,000 directly, and 200,000 indirectly? Does it intend to finance the retro-fitting of existing trucks? Finance the purchase of new trucks? Where will it find the money to do so? What competitive advantage will it have in this business over truck manufacturers, dealerships, dedicated and established vehicle leasing companies, banks, or energy companies?

Ultimately, the agreement with Sinopec is no agreement at all. It is simply a vague, flawed plan to cooperate in the future. China LNG does not have the balance sheet, operating experience or infrastructure to fulfill their end of the proposed cooperation, so we have serious doubts about Sinopec's level of interest.

d. History of Illusory Cooperation Agreements.

Since March 2014, China LNG has announced **20 non-binding**, letters of intent or cooperation agreements with various companies, commissions and development groups. Although such cooperation agreements give investors the impression that China LNG is making significant progress in the LNG business, this impression is illusory.

In an effort to hold the Company accountable for its announcements, and to demonstrate the illusory nature of its proposed investments and promises, in the following table we have listed each proposed agreement, including the date and China LNG's proposed capital investment.

History of Illusory Cooperation Agreements and Letters of Intent

Date	Counterparty	Binding / Non-Binding	China LNG's Type of Business	China LNG's Proposed Capital Investment	Link
6/23/2015	Linyi Trade City Administrative Commission 临沂商城管理委员会	Non-binding	LNG Operations and Finance Leasing	Operations: RMB 2 bn (HKD$2.53 bn) Finance Leasing: RMB 8 - 50 bn (HKD$10 - 63 bn)	Link
4/8/2015	Lianyungang Haitong Group Co., Ltd. 連雲港海通集團	Non-binding	LNG Operations	N/A (Not Announced)	Link
4/8/2015	Mongolia Genghis Khan Group 蒙古國成吉思汗集團	Non-binding	LNG Operations	N/A (Not Announced)	Link
12/19/2014	Shaanxi Automobile Holding Group Co., Ltd. ('Shaanxi Automobile') 陝西汽車	Non-binding	LNG Operations	N/A (Not Announced)	Link
12/5/2014	Beijing Sanxing Automobile., Ltd. ('Beijing Sanxing')	Non-binding	LNG Operations and Finance Leasing	N/A (Not Announced)	Link
11/27/2014	Shanghai Xin Si Yuan Logistic Co., Ltd. 新思原	Non-binding	Finance Leasing for LNG equipment	N/A (Not Announced)	Link
11/27/2014	Jiaxing Dadu New Logistic Co., Ltd. 嘉興大渡	Non-binding	Finance Leasing for LNG equipment	50 LNG vehicles, 3 LNG vessels	Link
11/25/2014	Sinopec Fuel Oil Sales Corp. Ltd. (Shanghai Branch) 中國石化銷售有限公司上海石油分公司	Non-binding	LNG Operations	100,000 heavy trucks, (200k more indirectly); total investment of RMB 100+ bn (HKD$125+ bn)	Link
10/14/2014	Tumed Right Banner Business Bureau 土默特右旗商務局	Non-binding	LNG Operations	N/A (Not Announced)	Link
10/6/2014	Baotou Rare Earth High-Tech Industrial Development Zone Committee 包頭國家稀土高新技術產業開發區管委會	Non-binding	LNG Operations and Finance Leasing	USD$80 million (~HKD 620 million)	Link
9/10/2014	Ordos Economic and Information Technology Commission 鄂爾多斯市經濟和信息化委員會	Non-binding	LNG Operations	N/A (Not Announced)	Link
9/10/2014	Inner Mongolia Hong Shun Travel Ltd. ('Hong Shun') 內蒙古紅順旅遊客運有限公司	Non-binding	LNG Operations and Finance Leasing	N/A (Not Announced)	Link
8/4/2014	Xuzhou Transportation Bureau 徐州市交通運輸局	Non-binding	LNG Operations	RMB 200 mm (~HKD 252 mm)	Link
7/29/2014	Xuzhou Construction (000425.SZ) 徐州工程	Non-binding	LNG Operations	N/A (Not Announced)	Link
7/28/2014	Shanghai Fargo Supply Chain Management (Group) Ltd. ('Shanghai Fargo') 上海遠行	Non-binding	LNG Operations and Finance Leasing	N/A (Not Announced)	Link
6/26/2014	Nantong Economic&Technologial Development Area Management Committee ('NETDA Committee')	Non-binding	LNG Operations and Finance Leasing	USD$80 mm (~HKD 620 mm)	Link
6/25/2014	Jiangsu Nantong Binhai Park Management Committtee	Non-binding	LNG Operations and Finance Leasing	total project investment USD$500 mm (~HKD 3,876mm)	Link
4/22/2014	Administrative Committee of Suzhou Zhong Lu International Logistics Technology Park	Non-binding	LNG Operations and Finance Leasing	N/A (Not Announced)	Link
3/31/2014	CNOOC Yunnan Energy Corp. Ltd. ('CNOOC Yunnan'); Yongping Business Bureau	Non-binding	LNG Operations and Finance Leasing	at least RMB 100 mm (total project investment RMB 200mm+) (HKD$124 - 250 mm)	Link
3/27/2014	Ping An Securities Ltd. ('Ping An')	Non-binding	LNG Operations and Finance Leasing	N/A (Not Announced)	Link

To our knowledge, not **a single one of the 20 non-binding agreements has led to a concrete, contractual business relationship or investment**. Nor are China LNG's promises under such announcements realistic.

For example, from March through June 2014, China LNG made five separate announcements of such non-binding framework agreements, promising to invest a total of **HKD 5 billion**, which was obviously impossible given that the Company's balance sheet recorded only HKD 549 million in total assets as of FYE 2014. It has been over a year since these five announcements, and to our knowledge not one such proposed investment has come to fruition.

The recently announced cooperation agreement with Linyi Trade City Administrative Commission is emblematic of the illusory nature of China LNG's proposed investments. In the non-binding agreement, China LNG promises to invest HKD 2.5 billion in a subsidiary to construct LNG fueling stations, portable LNG charging cars, LNG central stations, a gas pipeline and a liquefaction plant and distribution system. We are skeptical. China LNG has never purchased, operated or built a liquefaction plant or an LNG charging car – why would anyone hire them to do so now when a number of other companies have establish operations and expertise in the industry? With most of its limited capital committed to vehicle leasing, how will China LNG finance such investments?

Unbelievably, the non-binding agreement also commits China LNG to invest **HKD 10-63 billion** in a subsidiary to provide lease financing services for local logistics companies, industrial and civilian boiler operators looking to refit boilers from coal to LNG, the construction of a local LNG bus network and vehicles and equipment for the city. **Such proposed investments are laughable** considering China LNG has HKD 549 million in total assets at last FYE.

We suspect that the function of such announcements is simply to promote the illusion of progress and maintain the fiction that China LNG will develop an LNG business in China.

In total, the Company's non-binding agreements call on it to commit between **HKD 14 billion and HKD 71 billion** in investments into the LNG business, a farcical amount of capital considering the Company's tiny balance sheet and limited operating history.

5) ***History of Failed New Businesses***.

Nor does the Company's record of entrepreneurship inspire confidence. The Company's pivot towards natural gas represents its **fifth new business since 2007**, when Chairman Billy Albert Kan became involved.

Since 2006, the Company **has tried and failed at**: the distribution of computer components and IT products, provision of IT solutions, trading of securities, property development and finally, the LNG business.

China LNG - History of Failed Businesses

HKD'000		2006	2007	2008	2009	2010	2011	2012	2013	2014
Distribution of computer components and information technology products	Turnover	36,334	39,244	11,743	260	8,883	6,171	-	-	-
	Segment result	(180,303)	463	280	(423)	98	416	-	-	-
	% of Revenue	100%	98%	97%	-22%	50%	224%	-	-	-
Provision of integrated e-enabling solutions	Turnover	-	823	-	-	-	-	-	-	-
	Segment result	(2,459)	72	-	-	-	-	-	-	-
	% of Revenue	-	2%	-	-	-	-	-	-	-
Trading of securities	Turnover	-	-	399	(1,431)	8,906	(3,720)	21,098	23,991	357,053
	Segment result	-	-	344	(1,524)	8,486	(4,332)	20,309	26,312	355,224
	% of Revenue	-	-	3%	122%	50%	-135%	96%	97%	100%
Properties investment	Turnover	-	-	-	-	-	300	766	840	840
	Segment result	-	-	-	-	-	156	4,046	85	1,787
	% of Revenue	-	-	-	-	-	11%	4%	3%	0%
LNG business	Turnover	-	-	-	-	-	-	-	-	-
	Segment result	-	-	-	-	-	-	-	-	(2,895)
	% of Revenue	-	-	-	-	-	-	-	-	-
Total Revenue		36,334	40,067	12,142	(1,171)	17,789	2,751	21,864	24,831	357,893
Source:		*FY07 AR, p. 34*	*FY08 AR, p. 37*	*FY08 AR, p. 37*	*FY10 AR, p. 41*	*FY11 AR, p. 34*	*FY12 AR, p. 36*	*FY13 AR, p. 35*	*FY14 AR, p. 39*	*FY14 AR, p. 39*

Five different businesses. Four have failed to generate meaningful long-term returns for shareholders. Why would it be different this time? Management's repeated failure to successfully launch new businesses casts further doubt on the viability of its entry into the crowded LNG space.

JUNK BONDS RETURN 375% IN SIX MONTHS

99% of China LNG's 2014 revenue was derived from a **one-off related party bond deal.** [7] In January 2014, China LNG purchased from its Chairman HKD 80 million in convertible bonds issued by Warderly International (HK: 0607) (the "Warderly Bonds").

In June 2014, China LNG agreed to sell the Warderly Bonds to Magnolia Wealth International Limited ("Magnolia") for HKD 380 million, **a 375% profit** in just six months. China LNG's return on its investment was only due to the fact that the Chairman sold the Company the Warderly Bonds at well below market value. This should not be considered recurring revenue and thus should not factor into the Company's valuation.

1) Warderly's Troubled Past

Warderly is a Hong Kong-listed penny stock which went bust 2007 and whose shares were then suspended from trading until 2013.[8] But its history is critical to understanding Billy Albert Kan and the Warderly Bonds that were purportedly such a lucrative deal for China LNG.

On May 14, 2007, Securities and Futures Commission ("SFC") suspended trading in Warderly's shares amid growing speculation that the company was insolvent and had made material misrepresentations to its investors. Following the suspension, multiple directors (including the Chairman) resigned, as did Warderly's auditor, Deloitte & Touche Tomatsu. Creditors seized Warderly's factory. The SFC then pursued charges (including disqualification from future service for a public company) against six former directors, including Warderly's Chairman and founder KW Yeung, for breach of fiduciary duties and misleading disclosures.[9]

In 2008, China LNG Chairman Billy Albert Kan purchased a 36% ownership stake in Warderly and brought in his own directors. At the time, Warderly was a shell teetering on insolvency whose electronics factory had been seized and which owed significant debt to creditors. Nevertheless, in September 2008, Kan submitted a proposal to the HKEX and the SFC for the resumption of trading under the guise of a proposed restructuring.[10] Rather than an electronics manufacturer, Warderly proposed to resume business a trader and distributor of electronic products.

The SFC and the HKEX refused to relist the company, and commenced de-listing proceedings against Warderly. On May 13, 2011, despite multiple attempts by the company to resume trading and relist, the HKEX notified Warderly that it intended to delist the company because Billy Albert Kan's business had not "demonstrated with sufficiency of operation or assets required by the listing rules."[11] Warderly continued to appeal, but the HKEX and SFC continued to refuse its re-listing application. Billy Albert Kan's only choice was to sell the business (or what remained of it).

In December 2013, Warderly consummated a reverse merger with a Chinese-based residential property developer owned by Magnolia (and its Chairman Ji Changqun).[12] As part of the deal, Warderly issued HKD 500 million in convertible bonds, bearing an annual interest rate of 2% and a conversion price of HKD 0.05 per share. The bonds were **convertible only upon maturity, five years from the date of issuance (December 2018)**. HKD 420 million of the bonds were issued to Magnolia, and HKD 80

[7] China LNG owns a few properties in Hong Kong, a vestige of its attempt at property development, but such properties brought in only HKD 840,000 in revenue in FY 2014.
[8] Warderly 2008 Annual Report.
[9] http://www.sfc.hk/web/doc/EN/general/general/press_release/09/09pr131_summary.pdf
[10] Warderly 2012 Annual Report, p. 6.
[11] Warderly 2012 Annual Report, p. 6.
[12] Warderly October 2013 Prospectus, p. 2.

million were issued to Billy Albert Kan.[13] These are the bonds that would prove to be so lucrative to China LNG.

Following the reverse merger, Billy Albert Kan and his directors, all of whom also worked at China LNG, resigned:

China LNG's directors that moved from Warderly in December 2013

Name	Position at China LNG	Previous Position at Warderly
Mr. Kan Che Kin, Billy Albert	CEO&Chairman	Executive Director, Chairman and CEO
Mr. Li Kai Yien, Arthur Albert	Executive Director	Executive Director
Ms. Li Shu Han, Eleanor Stella	Executive Director	Executive Director
Mr. Li Siu Yui	Independent Non-Executive Director	Independent Non-Executive Director
Mr. Lp Woon Lai	Independent Non-Executive Director	Independent Non-Executive Director
Mr. Lee Kong Leong	Independent Non-Executive Director	Independent Non-Executive Director

Note: all of these directors resigned on 12/12/2013 from Warderly

In January 2014, just one month after the Warderly Bonds were issued to Billy Albert Kan at a conversion price of HKD 0.05, China LNG purchased the bonds from Billy Albert Kan for par value, HKD 80 million. Six months later, China LNG reportedly sold the bonds to Warderly's controlling shareholder and related party, Magnolia, for a 375% profit.

2) No Explanation for 375% Appreciation

The Warderly Bonds were convertible at HKD 0.05 per share. Given that Warderly's shares were trading at well above the strike price, the value of the bonds should theoretically have been tied to the underlying price of Warderly's stock.

But from January 20, 2014, when China LNG purchased the Warderly Bonds from its Chairman, and June 21, 2014, when China LNG agreed to sell the bonds to Magnolia, **the price of Warderly shares declined <u>34.4%</u>** from HKD 0.38 per share to HKD 0.24 per share!

Given that Warderly's share price declined 34.4% during the period in which China LNG owned the Warderly Bonds, we see no reason that the value of the bonds would increase **<u>375%</u>** during that time.

[13] Warderly October 2013 Prospectus, p. 2.

If the Warderly Bonds were truly worth HKD 380 million in June 2014, they were certainly worth more than that amount in January 2014, when China LNG's Chairman sold them to the Company for only HKD 80 million. This begs the question – why didn't China LNG's Chairman sell the bonds at their 'market' price to Magnolia in January 2014? Why did he forego an easy profit by transferring the Warderly Bonds at par value to China LNG?

The transaction raises questions given that China LNG purchased the bonds from its Chairman, and the bonds were issued as part of a reverse merger to re-list a deeply troubled Company that the SFC and HKEX refused to allow back on the exchange for seven years.

The transaction steps also raise a red flag. If China LNG was going to purchase the Warderly Bonds at par almost immediately after their issuance to its Chairman, why would China LNG not simply subscribe to the Warderly Bonds directly? It would be simpler – instead of transferring HKD 80 million to its Chairman, it could have just subscribed for the same amount of bonds directly from Warderly.

One thing is certain. For the purposes of valuing China LNG, its 2014 revenues, derived almost exclusively from a one-off related party bond deal, are not recurring and should not be factored into the Company's stock price going forward. A single sweetheart bond deal with the Chairman will not yield future earnings.

Ultimately, China LNG, as its name suggests, must therefore be valued on its natural gas business in China. Or lack thereof.

VALUATION

China LNG is a penny stock whose valuation has soared because of a cosmetic re-branding as a Chinese LNG company. The Company currently trades at 33.9x price/book value. Yet China LNG is essentially a startup without any proprietary intellectual property, a meaningful operating business or tangible experience in the industry. As such, we believe that it should be valued at or very close to 1.79x book value (the average for HK and global energy comps). We think the Company is worth HKD 0.08 per share, 95% below China LNG's last traded price.

Glaucus Valuation

	7/13/2015
Reported Book Value (total equity value in HK$'000) - 12/31/2014[1]	492,301
P/B Multiple (average for HK and global competitors)[2]	1.79x
Stock Price[3]	HK$ 1.48
Market Capitalization (HK$'000)[3]	16,690,000
Shares Outstanding (mms)	11,277
Value of Firm per Share	**HK$ 0.08**

[1] *China LNG 2014 Annual Report, p.25*
[2] *Calculation using Bloomberg data*
[3] *Bloomberg*

DISCLAIMER

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