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ORANGE COUNTY BUSINESS JOURNAL
Vol. 41, No. 17 THE COMMUNITY OF BUSINESS™ April 23-29, 2018 • $1.50

Film on Chinese Reverse Mergers Hits Roth Capital

REVIEW: 'China Hustle' incorrect on key points

■ By PETER J. BRENNAN

Recently distributed documentary "China Hustle" slams Newport Beach-based **Roth Capital Partners LLC** for its role in raising capital for Chinese companies in U.S. markets.

While the documentary makes a few valid points, it violates two core tenets of journalism: It's inaccurate on key points, and it isn't fair.

The 85-minute film describes the efforts of Chinese companies to scam Americans by trading on U.S. markets through "reverse mergers," essentially off-the-shelf American companies already registered to trade, what are commonly known as shell companies.

An estimated 400 Chinese companies eventually joined U.S. exchanges through the technique as American investors snapped up shares, believing they could invest in China's future without having to trade on Chinese exchanges.

Which of the companies lied about their revenue and profit to American investors became a high-stakes game among short traders, who bet on falling shares. Some short traders, including **Carson Block** of **Muddy Waters Research LLC**, gained fame.

In the documentary, **Matt Wiechert**, a trader who left Roth in 2010, describes the firm as a frat house with wild parties and suggests it intentionally pumped up Chinese shell companies. The film also blasts retired five-star general **Wesley Clark**, who was chairman of Rodman & Renshaw, a now-bankrupt investment banker that also raised capital.

China Sky

I first came across such deals in 2009 as a reporter for Bloomberg News when I covered China Sky One Medical Inc., which promised consumers its patch placed on one's navel would help him or her lose weight overnight.


Rothstein: director said he spent about $1 million making film

If the product sounds idiotic, it was. The U.S. Food and Drug Administration prohibited China Sky's products from entering the U.S. But the company began trading on the Nasdaq after a reverse merger, and its market cap reached as high as $400 million before it collapsed.

Bloomberg didn't run my story for internal bureaucratic reasons; however, when I met the education secretary of the Securities and Exchange Commission in 2010, I suggested the agency investigate Chinese reverse mergers for potential fraud. Much to my surprise, that year the SEC began issuing warnings about them.

The Mistakes

"China Hustle" Director **Jed Rothstein** should be congratulated for tackling a notorious subject and one I thought was long forgotten. He told me in an interview that he first became aware of the topic in 2015 and spent about $1 million making the film. It's being distributed in about 20 U.S. cities and on iTunes and Amazon.com by **Magnolia Pictures**, which is co-owned by billionaire **Mark Cuban**.

He got some things right, such as the lack of punishment of Chinese executives who lied about their revenue and profit. It's a shame the filmmaker doesn't have a Wall Street background; the documentary makes many critical mistakes and omissions that include:

■ It said Roth "used a back-door process called a reverse merger," when in fact it's never done reverse mergers. It raised capital for the Chinese companies after they'd already gone public in the U.S. through the reverse-merger process. The raises are commonly known as follow-on investments.

■ Roth sought capital from sophisticated institutional investors, not naive retail investors, as portrayed in the documentary.

■ The documentary criticizes Chinese company **Orient Paper Inc.** as fraudulent and blasts Roth for raising capital for it. However, the New York Stock Exchange still believes Orient is legitimate because it permits the company (Ticker: ONP) to continue trading, with an average daily volume of 72,858 and a stock price above $1.

■ Roth stopped raising capital eight years ago for those types of Chinese companies, a fact the documentary fails to mention.

■ The film indicates "public pension and retirement funds lost an estimated $14 billion" on the Chinese reverse mergers. The director couldn't explain to me how he calculated the losses, i.e., were they realized losses investors actually reported or unrealized losses after the stocks hit their peak prices?

■ The director told me the SEC declined to speak with the filmmakers. That's hard to believe. When I contacted the SEC press office, a spokesperson sent to me at least a dozen press releases and investor bulletins warning about Chinese companies trading through reverse mergers. The SEC and China also had a major confrontation over accounting practices of publicly traded companies, a subject that was partially resolved in 2015. The film doesn't mention those SEC actions.

■ The SEC never accused Roth Capital of wrongdoing, a pertinent fact the documentary omits.

The film is unfair because it excludes Roth Capital's viewpoints. Director Rothstein said he tried to contact Roth for its views but was ignored. He should have tried harder, because its views would have provided a far more accurate, fair and interesting story about what it's like to do business with Chinese companies.

To put it in perspective, Roth Capital has raised almost $50 billion for small-cap and private companies in its 30-year history. That includes $1.6 billion raised for 40 Chinese companies from 2003 to 2010. Of that, about half was returned to investors through sales to private equity or shares bought back.

If Roth Capital acted the way it's portrayed in the documentary, it wouldn't have attracted almost 5,000 investors, analysts and executives to its annual conference in March at the Ritz Carlton in Dana Point.

When I challenged Rothstein on the mistakes, he asked me, "Do you work for Roth?"

Obviously not. But I do believe in fairness and accuracy. I've watched too many Hollywood movies that criticize business without knowing what they're talking about. ■

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