

# China Should Extend Investigation of Huarong Chairman Lai Xiaomin to Include Fantasia Holdings

## Executive Summary

In April 2018, Chinese authorities placed Lai Xiaomin under investigation for corruption. Lai, who had served as Party Secretary and Chairman of the Board of China Huarong Asset Management (Huarong), had pumped assets into failing companies according to press reports. Before and since his investigation, several associates of his at Huarong and elsewhere have also been placed under investigation and arrested. Press reports have indicated that Huarong partner Ningxia Tianyuan Manganese Industry Group (Ningxia Tianyuan) is central to the basis for Lai's investigation.

Huarong and Ningxia Tianyuan have a relationship with a company called HKBridge, which Huarong reportedly used to help cover up bad debts. HKBridge is an investor in multiple Huarong subsidiaries, and Ningxia Tianyuan is a significant shareholder in HKBridge. What has not been widely reported is that HKBridge (under its previous name, Topsearch International) had a relationship with property developer Fantasia Holdings. Over a period of four years, Topsearch continually reported losses with two exceptions: after Fantasia made major transactions with Topsearch subsidiaries, each of which lead Topsearch to announce profitability.

UNITE HERE, the North American hotel workers' union, examined Huarong and Fantasia because of each company's relationship with Marriott International. Both companies are controlling stakeholders of Marriott hotels in China, and in June 2012, Fantasia signed a strategic alliance memorandum with Starwood, which subsequently merged with Marriott.

The interlocking relationships between Fantasia, HKBridge, Huarong, and Ningxia Tianyuan raise concerns about Fantasia's investments in HKBridge and how HKBridge became imbricated in Huarong's web of businesses. We call on Chinese authorities to extend the investigation of Lai to include Fantasia.

## Background

### *Investigation of Lai Xiaomin reportedly connected to Ningxia Tianyuan*

The state-owned China Huarong Asset Management was set up in 1999 to handle distressed assets, including nonperforming loans from state-owned banks.<sup>1</sup> Lai Xiaomin was named Party Secretary and Chairman of the Board in September 2012 after serving as the company's President.<sup>2</sup>

In April 2018, Lai was placed under investigation for suspected "serious discipline violations" – which the South China Morning Post identified as a euphemism for graft.<sup>3</sup> In August, Caixin reported that graft

investigators found the equivalent of US\$39.6 million in various currencies stashed in Lai's various houses; the cash found weighed over 3 tons.<sup>4</sup>

Chinese authorities have not definitively stated the basis for their investigation of Lai. However, reporting by the magazine Caixin has implicated Huarong's financial backing of Ningxia Tianyuan Manganese Industry Group, a privately-owned electrolytic manganese producer. Huarong provided it consistent financial support since 2014, which allegedly served to cover up Huarong's investment failures, according to a Caixin source.<sup>5</sup>

Caixin further described the relationship between Huarong and Ningxia Tianyuan:<sup>6</sup>

According to business records and sources, Huarong and Ningxia Tianyuan hold stakes in each other's subsidiaries through a complicated web of transactions. Lai put many of his close associates in Huarong in positions at Ningxia Tianyuan's financial service subsidiaries and fed the companies with capital injections. In return, Ningxia Tianyuan acted in concert with Huarong to help cover up the latter company's failed investments, Caixin learned from sources with knowledge.

Three associates of Lai were reported to be under arrest as part of the investigation.<sup>7</sup> Jia Tianjiang, chairman of Ningxia Tianyuan, was detained in April 2018.<sup>8</sup> One of the arrestees, Liu Ting'an, chairman of China HKBridge, was a classmate of Lai from Jiangxi.<sup>9</sup>

Huarong is the controlling stakeholder in one Marriott hotel in China, the Renaissance Shanghai Pudong East.

#### *Fantasia Holdings and the Zeng family*

According to the company's corporate webpage, Fantasia Holdings is a property developer in China.<sup>10</sup> Zeng Jie (also known as Zeng Baobao<sup>11</sup>) is Fantasia's majority stakeholder and serves as an executive director.<sup>12</sup> She is the niece of Zeng Qinghong,<sup>13</sup> vice-president of the PRC from 2003 to 2008.<sup>14</sup>

Zeng Qinghong is reputed as a "kingmaker" in Chinese politics.<sup>15</sup> The Financial Times characterized him as the right-hand man of Jiang Zemin and one of the most powerful politicians of modern China.<sup>16</sup>

Zeng's family members control significant wealth. As of September 28, 2018, Zeng Jie's Fantasia had a market cap of around HKD\$5.5 billion.<sup>17</sup> Zeng Qinghong's son, Zeng Wei, purchased a 1920s house in Australia for AUD\$32.4 million – the third-most expensive house ever sold in the country – and then applied to demolish and replace it with another home.<sup>18</sup>

Fantasia is the owner of three Marriott properties. In June 2012, Fantasia and Starwood (now merged with Marriott) signed a strategic alliance memorandum, which announced a long-term partnership in hotel development, construction, and management.<sup>19</sup>

*Pre-existing relationship between Lai/Huarong and Zeng family/Fantasia included purchase of shell companies*

Before Huarong's involvement in Topsearch/HKBridge, the company had already established relationships with the Zeng Family. According to Caixin, "During Lai's tenure, he recruited and promoted many people from his hometown in China's southern Jiangxi province and created a close network surrounding himself, sources close to Huarong said."<sup>20</sup> Zeng Qinghong is from Jiangxi.<sup>21</sup>

In 2014 and 2016, Huarong acquired two Hong Kong-listed companies that had been backed by Tomorrow Holdings, which was founded by Xiao Jianhua. Caixin described the acquired companies as shell companies purchased to facilitate Huarong's expansion in Hong Kong.<sup>22</sup> Zeng Wei, son of Zeng Qinghong, executed the privatization of Luneng, the state-owned power company of Shandong province, through a series of corporate shells owned by Xiao.<sup>23</sup>

## **Fantasia's investments in Topsearch pushed the company into profitability after string of losses**

In November 2012, Fantasia announced it and an unrelated partner, Yuxing, had purchased 70% of Topsearch Shenzhen, a printed circuit boards company that was a subsidiary of Topsearch; Fantasia received 61% of the company.<sup>24</sup> Earlier that year, Topsearch had announced that it expected to record losses for both 2010 and 2011, and that it expected to record a loss for the six months ending June 30, 2012.<sup>25</sup>

Following the announcement of the sale, Topsearch's stock price jumped by 10.6% in one day.<sup>26</sup> On March 5th, 2013, Topsearch issued a profit alert, announcing an expected significant increase in profit primarily attributable to the sale of 70% of Topsearch Shenzhen.<sup>27</sup>

In January 2015, Topsearch announced the proposed sale of Topsearch Shenzhen to a third party, Huatuo. The sale included a supplemental agreement wherein Huatuo would sell Topsearch Sky, a subsidiary, back to Fantasia, Topsearch, and Yuxing; Fantasia would own a majority stake in Topsearch Sky.<sup>28</sup> Less than two weeks later, Topsearch again announced anticipated losses to shareholders.<sup>29</sup>

When the Topsearch Shenzhen sale was completed in July, Topsearch issued a positive profit alert. The turnaround was attributed to the Topsearch Shenzhen sale.<sup>30</sup> Topsearch had otherwise expected losses for fiscal years 2013 and 2014.<sup>31</sup>

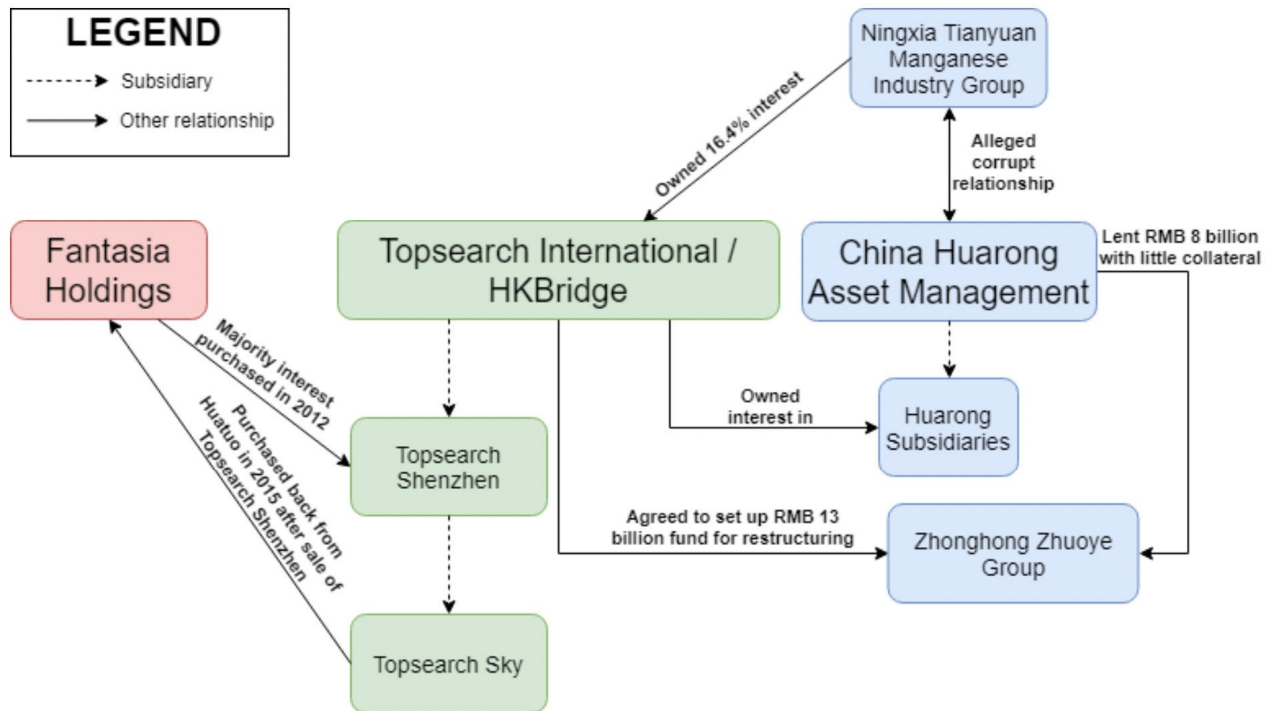


Figure 1: Relationships between Fantasia, Huarong, and Topsearch/HKBridge

## Topsearch developed interlocking relationship with Huarong and Ningxia Tianyuan

In 2015, in the aftermath of the Fantasia investments, a majority of Topsearch stock was sold to a new set of owners. While not officially owned or controlled by Huarong, Topsearch developed an interlocking relationship with Huarong and its key partner Ningxia Tianyuan.

*New owners and board member of Topsearch connected to Ningxia Tianyuan*

In November 2015, Zhisheng Enterprise and Youfu Investment made an agreement to jointly acquire 51.025% of Topsearch's shares. Zhisheng was solely owned by He Yeqin, and Youfu was solely owned by Sun Mingwen, brother-in-law of He.<sup>32</sup>

Journalists at NetEase Finance investigated the identities of He and Sun but found few public documents regarding their background.<sup>33</sup> However, they identified individuals with the same name who had business connections with Ningxia Tianyuan.<sup>34</sup> In the second half of 2016, Ningxia Tianyuan became a shareholder of Topsearch.<sup>35</sup> As of April 2018, Ningxia Tianyuan held 16.4% of the company's stock.<sup>36</sup>

In March 2016, Topsearch announced the appointment of Liu Ting'an, Lai's former classmate, as chairman of the board.<sup>37</sup> Later that year, Zhou Rongrong, described by NetEase Finance as a protégé of Lai, joined the board; Zhou concurrently held a director position at Ningxia Tianyuan.<sup>38</sup>

*HKBridge participated in restructuring for company which had borrowed billions from Huarong*

Topsearch was renamed HKBridge in February 2017.<sup>39</sup> HKBridge became a shareholder in multiple subsidiaries of Huarong.<sup>40</sup>

In February 2018, HKBridge signed a memorandum of understanding with troubled real estate developer Zhonghong Zhuoye Group. The deal would see HKBridge set up an RMB 13 billion fund to help restructure Zhonghong.<sup>41</sup> As of April, Zhonghong had overdue debt of 2.27 billion yuan.<sup>42</sup> Zhonghong, which had defaulted on its bonds several times in recent years, had previously borrowed about 8 billion yuan from Huarong with little collateral.<sup>43</sup>

Liu was arrested in 2018; the arrest was denied by HKBridge, which stated that Liu was on a business trip instead.<sup>44</sup> However, as the Financial Times commented after the arrest of Xiao Jianhua, “It is common for Chinese businesspeople and others detained by China’s powerful security apparatus to be pressed to release messages through social media, email or via their families insisting that all is fine.”<sup>45</sup>

## **Does Fantasia maintain a role with Topsearch Sky?**

In August 2018, documents filed with China’s State Administration for Industry and Commerce stated that Fantasia’s stake in Topsearch Sky had been transferred to an entity named Shenzhen Lexing Corporate Consulting (深圳市乐兴企业咨询有限公司).<sup>46</sup> According to the AIC, Shenzhen Lexing is owned by two people: Gong Lei (龚磊) and Huang Jie (黄杰). Fantasia did not make an announcement to its shareholders regarding the transfer.<sup>47</sup>

While Fantasia currently has no ownership stake in Topsearch Sky, the CEO of Fantasia, Pan Jun (潘军), is still listed as the legal representative of Topsearch Sky.<sup>48</sup> There is almost no public information available regarding Lexing and the two individual owners. However, Gong Lei is also the name of an executive at Shenzhen Fantasia,<sup>49</sup> and Huang Jie is the name of an employee of Fantasia.<sup>50</sup>

## **Conclusion: China should extend investigation to examine Fantasia**

The interlocking relationships between Fantasia, HKBridge, Huarong, and Ningxia Tianyuan raise concerns about Fantasia’s investments in HKBridge and how HKBridge became imbricated in Huarong’s web of businesses. A thorough investigation of the role Fantasia and HKBridge played in Huarong’s activities is necessary.

There may be political impediments to an investigation solely because of the political power and wealth of Zeng Qinghong and his family. However, we urge authorities to rely on their mandate to root out corruption to extend the investigation of Lai Xiaomin to include Fantasia.

## Endnotes

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