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Reaction to TRE Q1 Earnings Call

The selloff in TRE shares following this morning's call illustrates our overall feelings about management's responses to questions. The highlights are:

- Ernst & Young has been unable to complete its review of TRE's Q1 numbers.
- Chairman / CEO Allen Chan personally guarantees that TRE has disclosed all related party transactions. However at no time did management address TRE's relationship with Lei Guangyu, the only disclosed AI. Mr. Chan stated that Mr. Lei is a major AI.
- TRE's suppliers (agents) and buyers (AIs) are two different parties. As shown by our analysis of five suppliers, none of which were capable of selling nearly the volume of timber TRE claims, TRE had made this point clearly before.
- TRE added an odd twist to its disclosed business model. AIs now apparently do not pay TRE directly (see our discussion of the various problems in doing so). Rather they pay TRE indirectly by paying TRE's "designated purchasing agents", which then purchase more parcels. As we wrote in our initial report, a consistent theme of TRE's stated business practices is that they are unnecessary, overly complicated, and risky for a legitimate business.

Is the designated purchasing agent an AI-squared? We look forward to more detail on this new facet so that we can analyze the legal and practical issues.

- Mr. Chan explained that the AI model came into being because TRE could not form WFOEs in the 1990s to conduct this business. As we pointed out in our report, after TRE's EJV with the Leizhou Forestry Bureau terminated (due to TRE's failure to contribute its capital), TRE had a WFOE that had a business scope that permitted it to do business directly. Aside from that point, management did not explain why it continues to use an AI model today. Thus the AI model makes no more sense now than it did before this explanation.
- TRE still refuses to disclose its AIs' identities for "competitive reasons." It cited an example from the 1990s when an AI's identity was disclosed, and then smaller competitors undercut TRE's prices and won business. This explanation strikes us once again as TRE relying on everybody in the chain (e.g., the farmers) being ignorant.

We do not dispute that TRE's AIs are overpaying TRE (allowing TRE a 55% gross margin on standing timber). However, TRE's AIs would be among the largest buyers of timber in China – we do not understand how revealing their identities could subject them to any greater information about the extent of this overpayment than they are currently in a position to receive.

- It will apparently take PWC two to three months to complete its investigation. In our experience with much smaller frauds / companies, this is an aggressive timeline.
- CFO David Horsley stated that TRE can not confirm whether the AIs actually make TRE's tax payments. He said they “just don't know” whether the payments are made. Again, the AI model is unnecessary, overly complicated, and risky for a legitimate business.
- Allen Chan did not answer a question about how much replanting TRE did in the quarter, other than to say that TRE is progressing with the program. He later responded to a question about whether TRE is in compliance with PRC replanting regulations by stating that TRE would have heard from the authorities if it were not.

We believe that investors underappreciate the replanting metric (or lack thereof). China has in the past experienced devastating floods due to harvesting without sufficient replanting. If TRE were not fulfilling its obligations to replant, this would complicate the ability of either TRE or its AIs to obtain harvesting permits for the standing timber.

- Management stated something to the effect that it could remit its cash out of China by closing or selling the BVI entities, and then remitting the cash. This was not a confident or clear explanation, and it raises more questions than it answers. Along those lines, when TRE was asked to clarify this statement during the Q&A, nobody answered and the questioner was mysteriously dropped.
- TRE had some notable blocks / drops of other awkward questions. TRE cut off the Nomura analyst Anissa Lee rather than answering her question asking for more details on where the cash balances are kept.

Management also failed to attempt to answer a question about whether its banks are uncomfortable with extending credit. Instead of answering, there was a death ray type of sound toward the end of the question, and the questioner was no longer there. In true memory hole fashion, management moved onto the next questioner without making any statement in response to the question.

- William Ardell stated that PWC is going to check balances in every PRC bank account at the branch level. As LFT, CCME, and other frauds show us, such

confirmation should also take place at the central level of the banks – branches are easily corrupted.

- Regarding the dearth of information in the data room, Allen Chan said that he would have to check with “our people” about putting more information online. We advise investors to take note of this delay.

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