



# Rare-earth Information Center

# Insight

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## *YBM Magnex International, Inc.*

On December 8, 1998, YBM Magnex International, Inc. (YBM), a public holding company with operating subsidiaries in the United States, United Kingdom and Hungary, announced the appointment of Ernst & Young YBM Inc. (E&Y) as receiver and manager of the assets and operations of YBM. The appointment was the result of an application from the company to the Alberta Court of Queen's Bench. E&Y confirmed that, pending completion of its preliminary assessment, the subsidiaries continue under existing management while reporting to E&Y.

YBM's problems first became public on May 13, 1998, when the Ontario Securities Commission issued a temporary cease trading order in respect of the securities of YBM. Also on May 13, 1998, the head office of YBM in Newtown, Pennsylvania was the subject of a search and seizure warrant by representatives of the U.S. Attorney's Office, the Federal Bureau of Investigation, the Internal Revenue Service, the Immigration and Naturalization Service, the U.S. Customs Office and others under the umbrella of the Organized Crime Strike Force (OSC). As a result of press coverage of the investigations and the public announcements of YBM, the uncertainty surrounding the company resulted in deterioration in the business and financial condition of YBM. Because of an application from a substantial group of YBM's shareholders, on September 22, 1998, the Alberta Court issued an order replacing the majority of the then existing board of directors. Since that time, the new board of directors has attempted to review the major issues affecting YBM in order to protect shareholder interests. This includes cooperation with the regulatory authorities. On September 23, 1998, the new board of directors formed a special committee. The mandate of this committee was to independently identify and assess the principal issues affecting YBM and to consider all alternatives available to protect the interests of all shareholders. Counsel for YBM retained Miller, Tate & Co. ("Miller Tate"), a Philadelphia-based forensic accounting firm, to conduct a forensic investigation.

The new board of directors of YBM has had continuing difficulties in securing compliance with new strict controls over YBM's activities, particularly in Eastern Europe. YBM's Eastern European business operations have generated a majority of YBM's reported profits and revenues in the past. Reports to the board indicated that there is a substantial risk that such operations, or a substantial portion of them, may not be sustainable in the future. The board concluded that the overall ongoing operations of YBM, on any reasonable set of assumptions, will likely continue to generate negative cash flow. The issues facing YBM

have resulted in the resignation of YBM's President and Chief Executive Officer and have created a set of circumstances such that it will be virtually impossible to find a suitable replacement for him.

Based on the results of the forensic investigation conducted by Miller Tate, there is no realistic possibility of YBM obtaining audited financial statements for 1997. It appears that YBM is certain to be indicted by a grand jury in the United States, and YBM may well not be able to defend a criminal indictment.

On December 4, 1998, Miller Tate provided an interim report to the board, which stated that they were unable to assemble the necessary evidence required to provide a satisfactory explanation of the transactions, which were challenged by both the OSC and Deloitte & Touche. In fact, Miller Tate's review of the documentation has raised additional concerns regarding transactions entered into by United Trade, a YBM subsidiary. Miller Tate stated that while YBM's management insisted that supporting documentation exists in Hungary, they did not fully cooperate with Miller Tate's investigation. During the course of the investigation, Miller Tate became aware of several transactions involving the movement of substantial amounts of money through bank accounts controlled by United Trade. These transactions, which have several indicia of money laundering, were never adequately explained by YBM's management. During 1996 and 1997, United Trade conducted business with parties with apparent inter-relationships including shared addresses. Significant amounts of money flowed between these apparently related parties through United Trade's bank accounts.

Miller Tate reported that during 1996 and 1997, United Trade effected substantial purchases and resales of samarium and neodymium magnets and diesel oil. These transactions played a greater and greater role in YBM's revenues and profits in 1996 and 1997. Miller Tate was unable to obtain adequate third-party documentation to demonstrate the legitimacy of these purchases and resale transactions, or adequate evidence of the existence of the diesel oil. Miller Tate was also not provided with adequate supporting documentation to establish the legitimacy of technology contracts, equipment upgrades, repair and maintenance contracts, plant acquisition agreements and other capital contracts entered into by United Trade during 1997. Further concerns have been raised by the nature and extent of the apparent inter-relationships among the parties to these transactions.

The YBM board reached the conclusion that if the major elements of the status quo continue, the assets of YBM will be exhausted. The directors have tendered their resignations as directors of YBM, conditional upon E&Y's appointment as receiver and manager of YBM.

The complete press release is available at <http://www.newswire.ca>



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