



July 2011

Quarton Partners is one of North America's premier specialty investment banking firms. Quarton Partners provides a complete portfolio of services, including:

- Merger & Acquisition Advisory Services
- Private Capital Raising
- Restructuring & Recapitalizations
- Financial Advisory Services

QUARTON PARTNERS

300 Park Street, Suite 480
Birmingham, MI 48009
248-594-0400
www.quartonpartners.com

15/F, China World Tower
No.1 Jianguomenwai Ave
Beijing, China 100004
(86)-10-5737-2429

J. David Whittingham
Director of Asian Markets
dwhittingham@quartonpartners.com



QUARTON CHINA PERSPECTIVE

Thirty-years ago, after Deng Xiaoping's Open Door Policy began, China's economy took off on a trajectory that seemed unstoppable. Recently, China has hit some major bumps in its growth story causing many to question its future. Rising inflation, a rocky real-estate market and large levels of municipal debt are just some of the escalating problems that the Beijing regime is facing this year. In the following paragraphs, we take a look at each one of these issues to better understand their impact on China's future.

At the top of the Chinese government's agenda this year has been a continuing battle against rising inflation. Despite six successive months of raising the banks' capital reserve ratio and multiple interest rate hikes, inflation has continued to rise. The Beijing regime points to the latest CPI numbers of 5.5% annually, but the underlying issue is food price inflation, which topped an annual rate of 11.7% in May. Capital controls, a credit crunch, and an appreciating RMB all point to reduced inflationary pressures in the second half of the year, but China's middle and lower classes will continue to feel the pain of rising prices and reduced purchasing power for the foreseeable future.

China's red-hot real estate market has continued to stagnate during the first half of 2011. Turning back the clock to the financial crisis of 2008 and 2009, there has been growing realization that much of China's massive \$3 trillion stimulus package which was supposed to be earmarked for infrastructure projects and state owned enterprises ended up being redirected to real-estate deals driving up land prices. Over the past year, the Chinese government has put in place measures to temper real-estate sales, including raising the minimum down payment for mortgages on second homes to 60%, limiting real-estate purchases in certain cities and enacting China's first property tax. These measures collectively have helped to cool an overheated market, but the bigger fear lies in a continued downward trend.

Municipal governments have the greatest fears of slowing real estate markets because they rely upon them for a majority of their revenue. Beijing has directed lofty goals towards China's local governments, but has been reluctant to backstop them with government funding. As a result, municipalities strapped for revenue have pledged land as collateral for debt. Much of the borrowed money is directed towards infrastructure projects with very long payback periods. As a result, local governments are often forced to sell off land at auction to pay down their debts. As reserve ratios increase and real estate prices decrease, local governments are beginning to feel the burden of being overleveraged.

Beijing has addressed these issues head-on first by combating inflation aggressively through capital controls and appreciating the RMB. Although the results have not been as fast as expected, all indicators point to improvement in the second half of the year. Real estate prices have trended downward in a welcome sign to the cash strapped lower classes, but the net impact to the overall economy has not been positive. UBS estimates that property construction contributed as much as 13% to the overall Chinese GDP. As much as the Beijing government is focused on central planning and a heavy hand in the economy, it is still no match for market forces. Despite Chinese meteoric rise, it is still susceptible to the economic gravity that regulates the markets. Though many have called for a hard landing in the coming years, the underlying economy in China is strong. Though the bumps in the road are a wake up call, they are hardly an indication of an impending crash.



CHINA BRIEFING HEADLINES

6/27 - The National Audit Office said Monday that local-government debts total some 10.7 trillion yuan (\$1.65 trillion), or 27% of China's gross domestic product last year signaling the first time the Chinese Central Government has quantified the extent of the issue. Many experts believe that the report released Monday was billed as a comprehensive tally of such debt, much of which was incurred during a two-year stimulus spending binge ordered by Beijing to fight the effects of the global recession, but failed to account for many of the off balance sheet loans banks made to local governments. As inflation and interest rates rise, municipalities will find it increasingly difficult to service this debt.

6/20 - The RMB hit a new record of 6.4988 per US dollar in May dropping below the 6.5 floor. The rapidly appreciating currency is being used to fight domestic Chinese inflation as well as dealing with an increasingly weak U.S. dollar.

6/15 - The People's Bank of China (PBOC) announced it would increase the amount of capital banks must keep on reserve by half a percentage point to 21.5%. This is the sixth reserve hike this year driven by data showing the country's consumer price index rose 5.5% in May from a year earlier, a 34-month high. Experts expect to see a rise in the interest rate in July.

6/13 - According to statistics by the China Association of Automobile Manufacturers, the booming Chinese automobile sales market has been witnessing rare decreases since April. Both production and sales have decreased by 12.14 percent and 10.9 percent respectively from a month earlier, and 4.89 percent and 3.98 percent respectively from a year earlier. The slowdown in sales can be attributed to the lack of tax incentives for car purchases this year, rising fuel costs, and the purchase limits in some cities that strive to address traffic congestion.

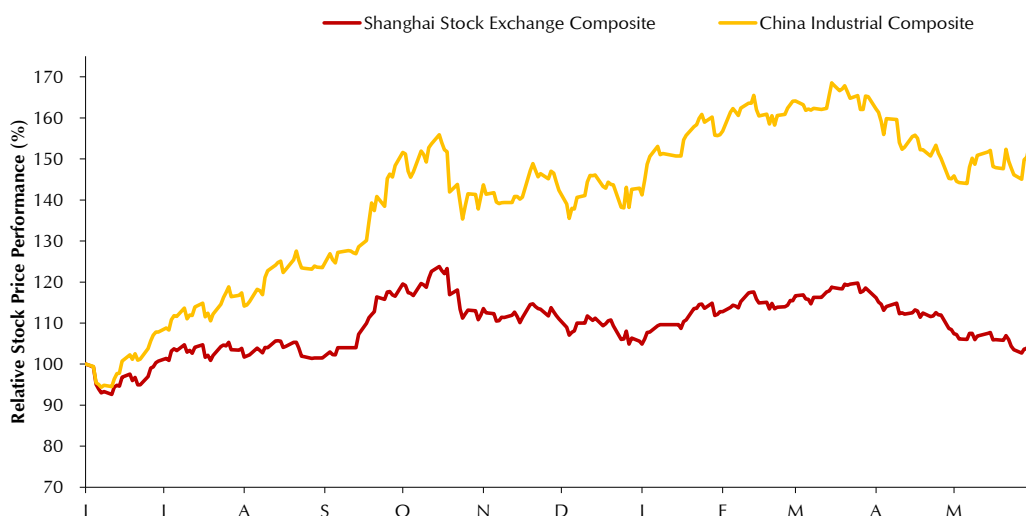
5/24 - Goldman Sachs revised its previous GDP growth forecasts for China to 9.4 percent this year, from 10 percent previously, citing inflation, high oil prices and sluggish industrial output as reasons for the change.

5/13 - For the fifth time in 2011, the PBOC rose the reserve requirement to 21% for China's largest banks after inflation rose to 5.3% in April. In comparison, the reserve requirement for banks in the U.S. is 10%.

4/17 - China's central bank (PBOC) announced Sunday that it would raise the required reserve ratio of the country's lenders by 50 basis points for the fourth time this year, in the latest effort to curb stubbornly high inflation.

4/11 - For the first time in seven years, China reported a quarterly trade deficit of US\$1.02 billion according to the General Administration of Customs (GAC). Several factors including rising commodity prices, RMB appreciation (part of the government's efforts to cool inflation) and decreased production during the Lunar New Year holiday in February all decreased exports numbers. Most experts see the numbers as an anomaly and argue that historic trends should continue on an annualized basis this year.

CHINA INDUSTRIAL EQUITY COMPOSITE PERFORMANCE ⁽¹⁾



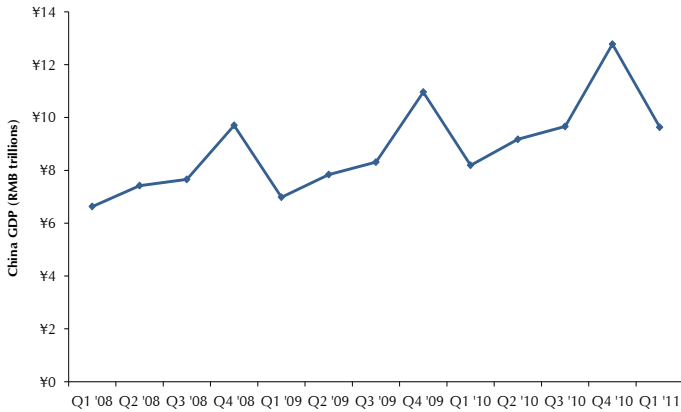
China Industrial Composite	
12-month change (LTM):	57.3%
One-month change:	10.0%

Shanghai Stock Exchange Composite	
12-month change (LTM):	7.6%
One-month change:	0.0%

⁽¹⁾ Refer to page 4 for list of companies included in composite.
Source: Capital IQ, 6/24/11

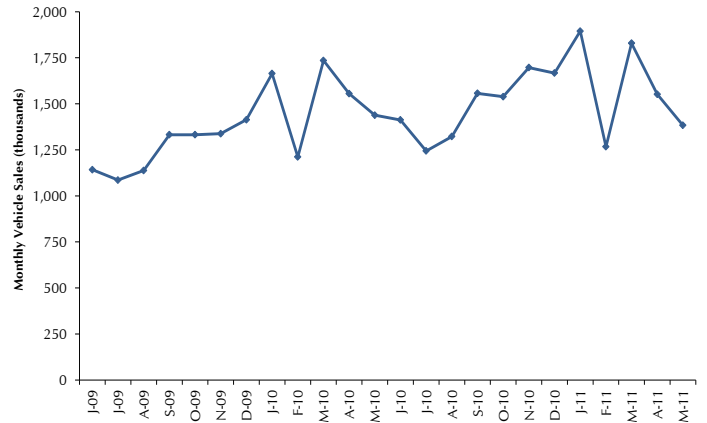


CHINA GROSS DOMESTIC PRODUCT (RMB)



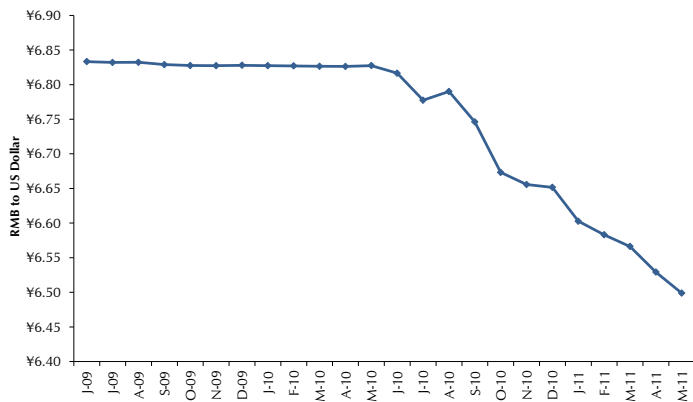
Source: National Bureau of Statistics of China

CHINA DOMESTIC AUTOMOTIVE SALES (UNITS)



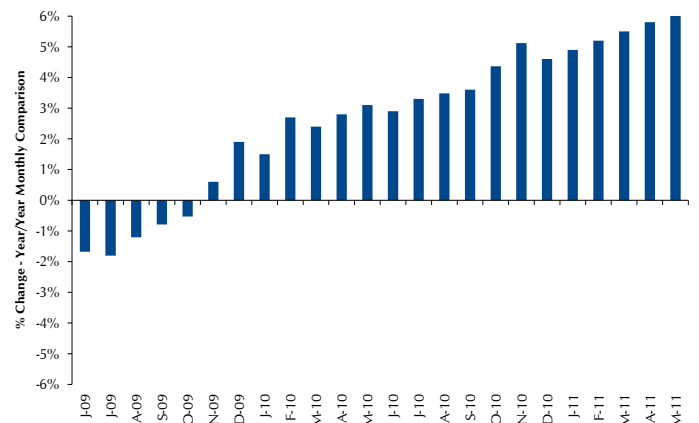
Source: Chinese Association of Automobile Manufacturers (CAAM)

RMB vs. US DOLLAR



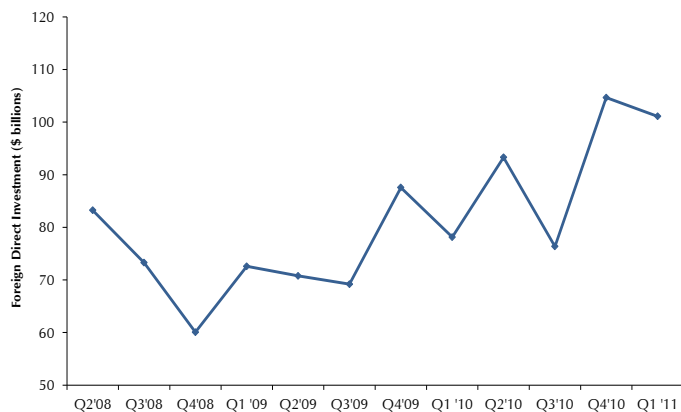
Source: State Administration of Foreign Exchange

CHINA CONSUMER PRICE INDEX



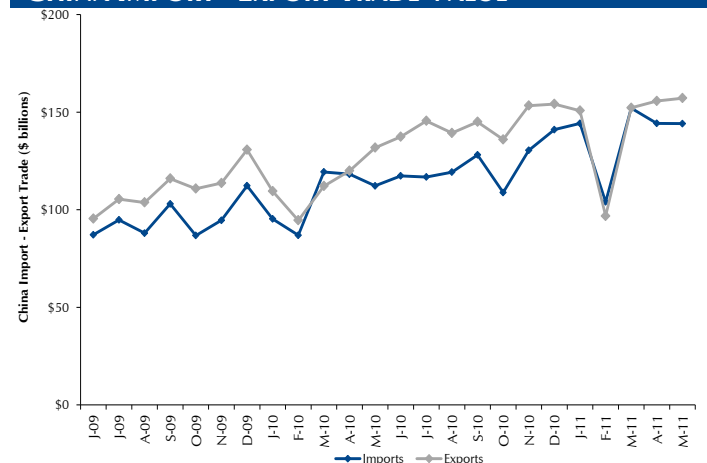
Source: National Bureau of Statistics of China

CHINA FOREIGN DIRECT INVESTMENT



Source: Ministry of Commerce of the PRC

CHINA IMPORT - EXPORT TRADE VALUE



Source: Ministry of Commerce of the PRC



CROSS BORDER M&A MONITOR

- 6/28** - U.K. spirit manufacture **Diageo** was approved by Chinese regulators to take a controlling interest in the Chinese spirit producer **Sichuan Chengdu Quanxing Group Co. Ltd.**, increasing its stake from 49% to 53%. Quanxing has a 40% stake in the luxury baijiu brand Shui Jing Fang which is listed on the Shanghai exchange.
- 6/13** - Swedish car maker **Saab** has agreed to a rescue package from two Chinese car companies. **Zhejiang Youngman Lotus Automobile Co.** will take a 29.9% stake in Saab and Chinese car distributor **Pangda** (SH: 601258) will take a 24% stake for a combined \$352 million investment. The deal includes Youngman setting up a distribution joint venture and a manufacturing venture for Saab models in China. The deal still requires Chinese government approval.
- 5/4** - **Liu Gong**, the mainland China based heavy machinery manufacturer, announced plans to acquire a stake in Poland's state owned **HSW Stalowa Wola** which produces bulldozers, backhoe loaders and pipe layers. The deal is valued at US\$94 million, but is still subject to union negotiations.
- 5/4** - U.S.-based agricultural machinery manufacturer **ARCO Corp.** will acquire a majority stake in **Shandong Dafeng Machinery Co. Ltd.**
- 4/29** - **Beijing Hainachuan Automotive Parts Co. Ltd.** (Hainachuan) announced the acquisition of the Netherlands' **Inalfa Roof Systems Group (IRS)**, one of the world's largest providers of vehicle roof systems. **Beijing Automotive Industry Corp.**, or **BAIC** holds a 60% stake in Beijing Hainachuan Automotive Parts.
- 4/22** - China's **AVIC International Holding Corporation** completed the acquisition of **Teledyne Continental Motors, Inc.** and **Teledyne Mattituck Services, Inc.** from their parent Teledyne Technologies Incorporated for a reported \$186 million. This is AVIC's second acquisition in the U.S. aerospace industry in 2011.
- 4/19** - US-based **SciClone Pharmaceuticals, Inc.** has acquired **NovaMed Pharmaceuticals Inc.**, a China-based specialty pharmaceutical company, for \$104.6 million.
- 4/18** - **Nestle**, the world's biggest food company, agreed to acquire the majority of Chinese food firm **Yinlu Food Group**
- 4/13** - **Toyo Tire & Rubber** is to acquire a 75% equity interest in China-based tyre manufacturer **Shandong Silverstone Luhe Rubber & Tyre** at the price of \$21.59 million.
- 4/6** - US fibre optical solutions provider **Sino Fibre Communications, Inc.** closed an acquisition to acquire Chinese waste conversion firm **Torino Resources Limited** for \$69.35 million.
- 3/30** - **China National Chemical Corp. (ChemChina)**, China's second-largest chemical manufacturer, has received approval from the National Development and Reform Commission (NDRC), for its acquisition of a majority stake in Israel-based **Makhteshim-Agan Industries Ltd.**, the world's seventh- largest agrochemical company. ChemChina still needs approval for the \$1.44 billion deal from China's Ministry of Commerce and the State Administration of Foreign Exchange.

CHINA INDUSTRIAL COMPOSITE – EQUITY MARKET PERFORMANCE METRICS

(\$ in millions, except per share data)

Company	Stock Price 6/24/2011	Trading			Size		Profitability LTM EBITDA %	Three-Year Growth (CAGR)		Leverage Debt / LTM EBITDA
		% of LTM High	TEV / LTM Sales	TEV / LTM EBITDA	Market Cap	LTM Sales		Sales	EBITDA	
Anhui Conch Cement Co. Ltd.	\$4.61	94.5%	4.3x	13.1x	\$24,415	\$5,838	32.5%	24.1%	33.1%	1.1x
Anhui Jianghuai Automobile Co., Ltd.	1.71	75.3%	0.5x	7.6x	2,204	4,809	6.4%	27.4%	43.2%	2.5x
Baoding Tianwei Baobian Electric Co., Ltd.	2.79	57.8%	4.4x	NM	3,837	1,137	9.2%	29.2%	6.0%	12.2x
Beiqi Foton Motor Company Limited	1.33	58.9%	0.3x	7.2x	2,796	8,402	4.5%	22.3%	47.4%	1.5x
China Erzhong Group (Deyang) Heavy	1.41	56.3%	3.3x	28.2x	2,378	1,019	11.6%	NA	NA	11.4x
China First Heavy Industries	0.68	57.2%	3.7x	22.7x	4,439	1,310	16.2%	NA	NA	3.7x
China Shipbuilding Industry Corporation	1.97	86.9%	2.7x	22.8x	18,033	4,470	11.7%	NA	NA	9.1x
CSR Corporation Limited	1.07	75.6%	1.3x	17.8x	12,689	11,221	7.4%	38.5%	38.4%	3.6x
Dalian Daxian Enterprises Holdings Co.,Ltd.	1.24	81.7%	16.4x	NM	1,315	89	9.6%	-15.3%	-31.4%	20.4x
Founder Technology Group Corp.	0.55	69.4%	1.0x	23.8x	1,215	1,145	4.1%	-4.6%	-6.6%	4.0x
Fuyao Glass Industry Group Co., Ltd.	1.60	73.1%	2.7x	8.9x	3,206	1,390	30.0%	18.5%	19.3%	1.6x
HUAYU Automotive Systems Company,	1.73	75.0%	0.5x	5.8x	4,462	7,274	9.5%	104.1%	67.8%	0.5x
Long March Launch Vehicle Technology	1.83	68.5%	3.7x	NM	1,485	469	11.4%	13.6%	-6.9%	6.1x
Qingdao Haier Co., Ltd.	4.27	87.3%	0.5x	10.1x	5,724	9,859	5.4%	26.5%	38.1%	1.8x
SAIC Motor Corporation Limited	2.93	84.5%	0.4x	4.7x	27,115	53,569	8.9%	48.0%	138.7%	0.6x
Sany Heavy Industry Co. Ltd.	2.80	90.2%	3.6x	15.6x	21,268	6,281	23.3%	60.1%	72.5%	2.1x
Shanghai Zhenhua Heavy Industry (Group)	0.54	75.8%	2.9x	NM	2,349	2,572	3.0%	-8.4%	-45.3%	47.2x
Shuangliang Eco Energy Systems Co Ltd	2.19	68.3%	2.9x	27.2x	1,778	665	10.6%	12.3%	14.6%	4.0x
Yantai Wanhua Polyurethanes Co., Ltd.	2.89	84.8%	4.3x	20.1x	6,250	1,634	21.4%	9.5%	-4.2%	2.4x
Median	\$1.73	75.3%	2.9x	15.6x	\$3,837	\$2,572	9.6%	23.2%	26.2%	3.6x
Mean	\$2.01	74.8%	3.1x	15.7x	\$7,735	\$6,482	12.5%	25.4%	26.5%	7.1x