

CER Report

OTC/BB: CHGI

November 20, 2009

Rating: **Speculative Buy**
(Unchanged)

Recent Price: **\$1.35**
(11/19/09)

Price Target: **\$3.40**
(Unchanged)

MARKET DATA

52-Week High/Low	\$1.90 - \$0.11
Ave. Daily Volume (6-mos.)	18 K
Shares Outstanding	16.2 M
Inside Ownership	56%
Institutional Ownership	<1%
Float	7.1 M
Short Interest (% of float)	<1%

FINANCIAL DATA

Market Capitalization	\$21.9 M
- Cash & Equivalents	\$ 6.0 M
+ Preferred Stock	\$ 0.3 M
+ Long-term Debt	\$ 4.8 M
Enterprise Value	\$21.0 M
Book Value	\$37.7 M
Working Capital	\$10.9 M
Dividend Yield	Nil

Balance sheet figures pro forma as of 9/30/09

	SALES	INC*	CFO	EPS*
2008A	\$27.3	\$3.1	\$5.4	\$0.21
1Q09A	\$ 2.9	\$0.5	\$0.8	\$0.03
2Q09A	\$ 3.7	\$0.5	\$5.7	\$0.04
3Q09A	\$ 5.6	\$1.0	\$0.7	\$0.06
4Q09E	\$ 7.0	\$1.1		\$0.08
2009E	\$19.1	\$3.2	\$8.0	\$0.21
2010E	\$36.0	\$5.0	\$7.2	\$0.34

Dollars in millions, except EPS; Fiscal year ends Dec.
*Income and earnings available to shareholders

VALUATION

Price/Sales	1.2 X
Price/CFO	2.8 X
Price/Trailing 12-mo. Earnings	8.4 X
Price/Book Value	0.6 X
Consensus EPS Estimate 2009	NA
Forward PE	NA
Consensus EPS Estimate 2010	NA
Forward PE	NA

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China Carbon Graphite Group, Inc.

Specialty Materials

China Carbon Graphite Group is a fast growing producer of carbon graphite materials based in China. The Company is currently undertaking a major project to expand and upgrade its production facilities located in Inner Mongolia. Once completed the expansion will double production capacity and enable the Company to target new, fast growing markets with higher margin products.

HIGHLIGHTS

- Third Quarter 2009.** Sales increased 52.6% sequentially but were down 25.7% compared to the year-ago quarter as the Company returned to normal production. Sales cycles had been disrupted following a two-month shutdown in July and August 2008 to comply with government restrictions during the 2008 Olympics.
- Earnings and Cash Flows.** Net income was \$1.0 million or \$0.06 after an allowance of \$76,000 for currency translation gains. We estimate cash generation during the September 2009 quarter was \$700,000, bringing cash flow in the first nine months of 2009 to \$7.2 million.
- Balance Sheet.** China Carbon Graphite ended 3Q09 with \$6.0 million in cash. Cash balances were also supplemented by new short-term bank loans. The Company has \$3.8 million in long-term debt, of which \$1.6 million is due within the next twelve months, and \$8.5 million in short-term debt with banks.
- Rating and Price Target.** We reiterate our Speculative Buy rating on CHGI shares and maintain our price target of \$3.40. In our view, the quarter report validated our investment thesis that rests primarily on sales growth, profitability and cash flow generation.
- Valuation.** In our view, the stock is undervalued against the P&L, but the stock appears to be even a bigger bargain in view of the Company's cash balance of \$0.37 per share. The price-to-book multiple is 0.6 times.

PLEASE READ THE IMPORTANT DISCLOSURES AND DISCLAIMER ON PAGES 6 AND 7 OF THIS REPORT.

SUMMARY

Performance was largely as we had expected in the first reported quarter following our initiation of coverage of China Carbon Graphite. The Company delivered on promises to rebuild revenue levels after industrial production stoppages by the China central government in the late summer 2008 to prepare for the Olympics in Beijing in August 2008. Management continues to run a lean operation, concentrating on improving balance sheet strength.

We reiterate our Speculative Buy rating on CHGI shares and maintain our price target of \$3.40. In our view, the quarter report validated our investment thesis that rests primarily on sales growth, profitability and cash flow generation. With the stock trading at 6.4 times our projected 2009 EPS estimate (\$0.21) and 2.7 times our projected 2009 operating cash flow (\$8.0 million), we view the stock as egregiously undervalued. Our price target implies a forward earnings multiple of 10.3 times our 2010 EPS estimate (\$0.33), a valuation multiple that is lower than the Company's growth rate.

THIRD QUARTER 2009 HIGHLIGHTS

China Carbon Graphite recorded \$5.6 million in sales during the third quarter 2009, compared to our estimate for \$6.0 million. Sales increased 52.6% sequentially but were down 25.7% compared to the year-ago quarter as the Company returned to normal production. Sales cycles had been disrupted following a two-month shutdown in July and August 2008 to comply with government restrictions during the 2008 Olympics. A lengthy production cycle extended to six months or more was a factor in the protracted recovery period.

Gross margin in quarter was 27.3% compared to 28.3% in the year-ago quarter. A shift in the sales mix favoring lower margin graphite electrodes led to the short-term drop in profitability. Operating expenses totaled \$252,000 or 4.5% of total sales. This compares to a spending rate of 9.6% in the June quarter and 6.2% rate in the year-ago quarter. Net income was \$1.0 million or \$0.06 after an allowance of \$76,000 for currency translation gains.

Cash Flow and Balances

We estimate cash generation during the September 2009 quarter was \$700,000, bringing cash flow in the first nine months of 2009 to \$7.2 million. The origination of a new trade note boosted working capital accounts by \$5.8 million. Working capital at the end of the quarter was \$10.9 million. Accounts receivable increased to \$6.2 million, in-line with the growth in sales. We estimate the accounts receivable represented 138 days sales. Inventory increased to \$16.6 million at a rate well below sales growth. We estimate inventory turned 0.75 times during the first nine months of the 2009.

China Carbon Graphite ended the September 2009 quarter with \$6.0 million in cash on its balance sheet. In addition to cash flow from operations, cash balances were also supplemented by new short-term bank loans. At the end of September the Company had \$3.8 million in long-term debt, of which \$1.6 million is due within the next twelve months, and \$8.5 million in short-term debt with banks. Outstanding bank notes increased by 76% in the first nine months of 2009, from \$4.9 million at the end of December 2009.

UPDATED EARNINGS MODEL

We updated our earnings model to reflect third quarter 2009 results. We also made minor adjustments in our 4Q09 estimates, reducing our sales estimate to \$7.0 million (from \$7.2 million) and reducing our cost and expenses assumptions to reflect performance in the third quarter. The net result of these changes is a one penny increase in our 2009 EPS estimate to \$0.21 (from \$0.20) on \$19.1 million in sales (from \$19.8 million). Changes in balance sheet assumptions reduced our estimate for cash flow from operations in 2009 to \$8.0 million. Our 2010 estimates of \$0.33 EPS on \$36.0 million in sales remain unchanged.

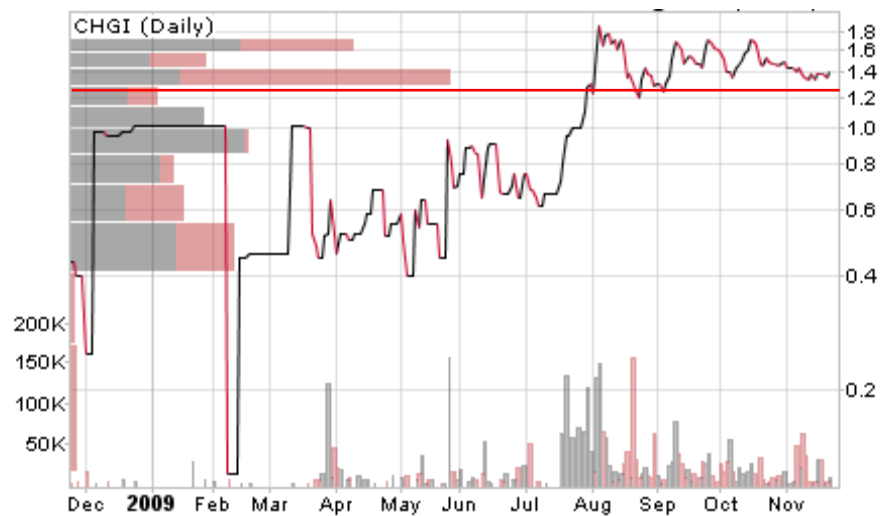
VALUATION AND OUTLOOK

Based on trailing earnings the stock is trading at 1.2 times sales, 2.8 times cash flow from operations, and 8.4 times earnings. In our view, the stock is undervalued against the P&L. The stock appears to be even a bigger bargain in view of the Company's cash balance of \$0.37 per share. The price-to-book multiple is 0.6 times.

We expect continued strong comparables in the coming quarters, which should help shore up investor confidence in the Company to deliver growth and profits. Management appears committed to interacting with the investment community to explain graphite products and their markets. The combination of strong results and increased exposure bode well for an increase in valuation metrics. A review of historic trading patterns in CHGI shares suggests a line of support may have developed near the \$1.25 price level. The stock had tested and drew back from the \$1.70 price level several times during the fall 2009. Given the limited trading history of the stock, reports on another quarter or two may be needed to drive the stock through that price level.

The Company recently added two independent directors to its board. The move should go a long way forward improving investor confidence in China Carbon's governance and leadership. We also note that the addition of independent directors is an important step toward qualifying for national market listing, a status which could also improve trading in CHGI shares.

STOCK CHART



Source: Stockcharts.com

Additional information is available upon request.

Table I: Historical and Projected Sales and Expenses

Dollars in Thousands	2006	2007	1Q08	2Q08	3Q08	4Q08	2008	1Q09	2Q09	3Q09	4Q09E	2009E	2010E
Total revenue	17,199	25,357	5,728	7,924	7,509	6,143	27,304	2,894	3,658	5,581	7,000	19,133	36,000
Cost of sales	13,234	20,447	4,366	5,817	5,384	5,039	20,606	2,053	2,804	4,056	5,180	14,093	25,605
Gross profit	3,965	4,910	1,362	2,107	2,125	1,104	6,698	841	854	1,525	1,820	5,040	10,395
Operating expenses:													
Selling	330	124	20	150	269	66	505	309	9	14	210	542	1,599
General & administrative	556	1,121	150	250	177	1,375	1,952	136	322	219	350	1,027	2,612
Depreciation & amortization	17	16	15	16	19	18	68	19	19	19	35	92	140
Total operating expenses	903	1,261	185	416	465	1,459	2,525	464	350	252	595	1,661	4,351
Operating income (loss)	3,062	3,649	1,177	1,691	1,660	(355)	4,173	377	504	1,273	1,225	3,379	6,044
Other income (expense)													
Interest expense	(422)	(495)	(133)	(136)	(144)	(168)	(581)	(198)	(206)	(357)	(255)	(1,016)	(1,021)
Other, net	41	440	199	4	12	175	390	292	232	19	250	793	-
Total other income (expense)	(381)	(55)	66	(132)	(132)	7	(191)	94	26	(338)	(5)	(223)	(1,021)
Income (loss) before income taxes	2,681	3,594	1,243	1,559	1,528	(348)	3,982	471	530	935	1,220	3,156	5,023
Preferred dividend	-	-	(854)	-	-	-	(854)	-	-	-	-	-	-
Income available to shareholders	2,681	3,594	389	1,559	1,528	(348)	3,128	471	530	935	1,220	3,156	5,023
Foreign currency translation gain		1,794	1,252	-	85	706	2,043	45	3	76	-	124	-
Total comprehensive income	2,681	5,388	2,495	1,559	1,613	358	6,025	516	533	1,011	1,220	3,280	5,023
Net earnings (loss) per share	\$ 0.26	\$ 0.34	\$ 0.07	\$ 0.08	\$ 0.08	\$ (0.02)	\$ 0.27	\$ 0.03	\$ 0.04	\$ 0.06	\$ 0.08	\$ 0.21	\$ 0.33
Net EPS (loss), shareholders	\$ 0.26	\$ 0.34	\$ 0.02	\$ 0.08	\$ 0.08	\$ (0.02)	\$ 0.21	\$ 0.03	\$ 0.04	\$ 0.06	\$ 0.08	\$ 0.21	\$ 0.33
Weighted shares outstanding, diluted	10,388	10,506	18,757	19,919	19,419	19,500	14,623	13,847	14,239	15,085	15,000	15,000	15,000

Source: Company Reports and Crystal Equity Research Estimates

Table II: Selected Measures of Historical and Projected Sales and Expenses

Dollars in Thousands	2006	2007	1Q08	2Q08	3Q08	4Q08	2008	1Q09	2Q09	3Q09	4Q09E	2009E	2010E
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Weighted shares outstanding, diluted	10,388	10,506	18,757	19,919	19,419	19,500	14,623	13,847	14,239	15,085	15,000	15,000	15,000
SELECTED MEASURES:													
Sales growth, yr/yr		47.4%					7.7%					-29.9%	88.2%
Net income growth, yr/yr		-34.1%					-10.8%					-20.8%	59.2%
EPS growth, yr/yr		-32.5%					20.4%					-22.7%	59.2%
Gross margin	23.1%	19.4%	23.8%	26.6%	28.3%	18.0%	24.5%	29.1%	23.3%	27.3%	26.0%	26.3%	28.9%
Operating margin	17.8%	14.4%	20.5%	21.3%	22.1%	-5.8%	15.3%	13.0%	13.8%	22.8%	17.5%	17.7%	16.8%
Net margin	15.6%	14.2%	21.7%	19.7%	20.3%	-5.7%	14.6%	16.3%	14.5%	16.8%	17.4%	16.5%	14.0%
Direct costs, % sales	76.9%	80.6%	76.2%	73.4%	71.7%	82.0%	75.5%	70.9%	76.7%	72.7%	74.0%	73.7%	71.1%
Selling expense, % sales	1.9%	0.5%	0.3%	1.9%	3.6%	1.1%	1.8%	10.7%	0.2%	0.3%	3.0%	2.8%	4.4%
G&A expense, % sales	3.2%	4.4%	2.6%	3.2%	2.4%	22.4%	7.1%	4.7%	8.8%	3.9%	5.0%	5.4%	7.3%
Effective tax rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
EBITDA, \$\$	4,036	4,796					5,428					4,753	7,444
EBITDA margin	23.5%	18.9%					19.9%					24.8%	20.7%

Source: Company Reports and Crystal Equity Research Estimates

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ANALYST

Debra Fiakas, CFA is a seasoned, credentialed investment professional with a diversified and successful track record as a research analyst and as an investment banker. Her decade-plus career includes solid experience in all aspects of the equity capital markets with particular emphasis on emerging growth companies operating in the technology sectors. Ms. Fiakas is also the principal member of Crystal Equity Research, LLC.

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CER REPORT RESEARCH UNIVERSE*

Speculative Buy	3	60%	Unproved business model; catalysts exist to generate higher returns
Accumulate	2	40%	Long-term return potential above 10%; near-term catalysts may not exist
Hold	0	0%	Total return potential below 10%; an acceptable long-term holding
Sell	0	0%	Potential return greater than negative 10%; take profits or stem losses
Not Rated	0	0%	No rating
Total	5	100%	

**Research universe categorized by rating only; Crystal Equity Research provides no investment banking services.*

HISTORICAL RECOMMENDATIONS AND TARGET PRICE: China Carbon Graphite / CHGI

<u>Report</u>	<u>Date</u>	<u>Price</u>	<u>Rating</u>	<u>Target Price</u>
Initial	9/8/09	\$1.30	Speculative Buy	\$3.40
Update	11/19/09	\$1.35	Speculative Buy	\$3.40

DISCLOSURES

<u>Name</u>	<u>Symbol: Exchange</u>	<u>Disclosures</u>
China Carbon Graphite Group, Inc.	CHGI: OTC/BB	D, E

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- E The company has a convertible issue outstanding.
- F The securities covered in this report can be optioned.
- G The securities covered in this report can be margined.

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