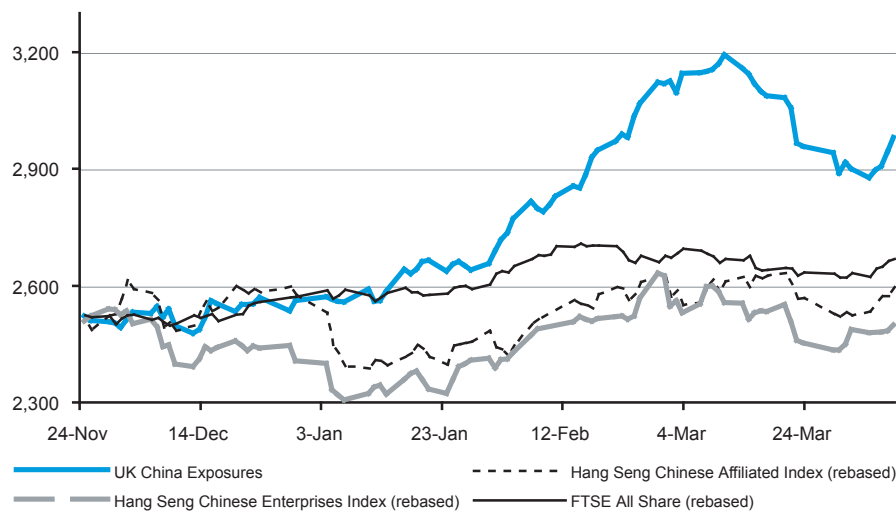


China-related stocks

Opportunities for growth are enormous in China – but with commensurate risk. As with the goldrush, it's not always direct investments that are the best opportunity. In this report we explore UK listed exposures to the "China story"

UK China proxies best performers against FTSE over 6-mths (rebased)



Hang Seng v. FTSE (rebased)



- Recent growth rates, if continued, could take the Chinese economy to number three in the world by the end of this decade
- Inflation risks appear muted especially after the lessons learned at the end of the 1980s
- We expect China to typify other emerging economies with the early sector focus on inward investment and exports. In due course we expect domestic demand and consumer cyclicals to dominate
- Risk factors include weak financial and legal systems, perceptions over human rights and currency revaluation. In the long run, the mis-match of growing personal wealth, and political freedom and the "politically bankrupt" communist system are an unpredictable brew. Not to mention the potential for social unrest from those dispossessed by the new economic order and the almost insoluble issue of Taiwan – or at least by peaceful means. At least in the next decade, external measures through bond yields suggest to us a so far benign interpretation of these issues, particularly since accession to the WTO

Companies included in this report

Company	Symbol	Recent Price (p)
Croda	CRDA	393.5
D1 Oils	DOO	427.5
Elementis	ELM	50.0
Griffin Mining	GM	35.3
London Asia Group	LDC	21.3
Scapa Group	SCPA	31.3
Stadium Group	SDM	83.5
Swallowfield	SWL	94.0
Virotec	VTAI	25.5
Wolfson Microelectronics	WLF	156.5

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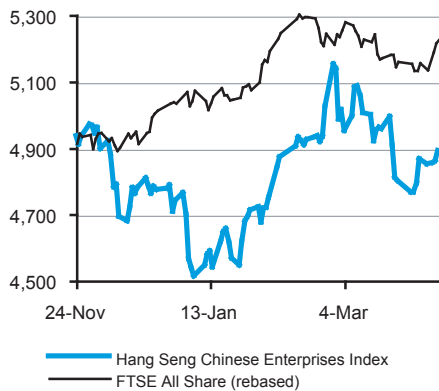
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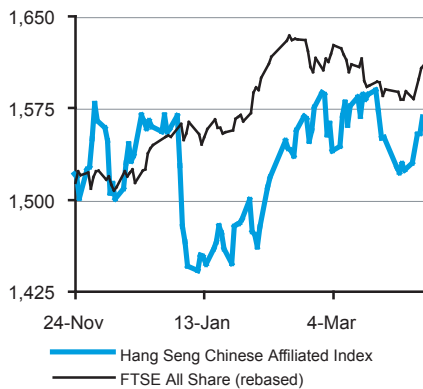
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HK H-shares v. FTSE (rebased)



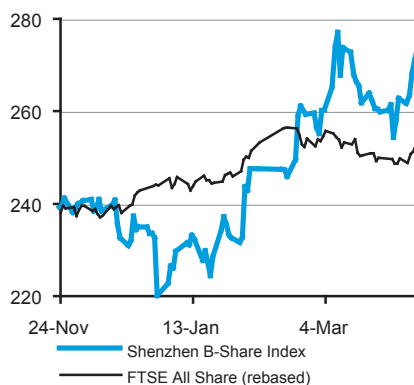
HK Red chips v. FTSE (rebased)



Shanghai B-share v. FTSE (rebased)



Shenzhen B-share v. FTSE (rebased)



The arguments for investment in China are well rehearsed. At the risk of gilding the lily we will briefly quantify and put into some context the opportunity as we see it. Ultimately, almost every company will be affected either by China's role as the "workshop of the world", the world's largest emerging consumer market or its impact on commodity markets.

Despite "teething troubles" in the 1980s the economic policy changes of the 1970s have produced an economy whose value has grown four-fold. Many commentators believe that China will overtake the UK as the world's fourth largest economy sometime this year. With GDP growing at the "reduced" rate of some 6% or 7% a year, Germany's number three position is vulnerable before this decade is out. And, by way of an aside perhaps, a demographic (as measured by the CIA) less hindered by the Western pension problem: the proportion of population over 65 in China is, on this measure, 7.5%. The equivalent numbers in the USA, UK and Europe are 12.4%, 15.7% and 16.6% respectively (*source: CIA World Factbook*).

As China grows so an increasing proportion of its GDP will be driven by personal consumption. As a measure of that, consider electricity consumption, one of the indicators of a "consumer society". In 2001 (latest data available) the USA consumed 3.6 trillion kilowatt hours – some 12,000 kWh per capita. The equivalent number for China is 1,000 kWh per capita – potential for a 12-fold increase in consumption over the long-term.

So much for the growth prospects, what about the attendant risks? They range from external concerns over human rights through policy issues to currency risks. In the long run, the mis-match of growing personal wealth, and the "politically bankrupt" communist system is an unpredictable brew. Not to mention the potential for social unrest from those dispossessed by the new economic order and the almost insoluble issue of Taiwan – or at least by peaceful means.

One measure (admittedly inexact) of the perceived risk is the difference in bond yields between China and the equivalent US duration bond – inexact because neither the Chinese currency nor her bonds are yet fully freely traded.

That said we note that a study by the Bank of International Settlement published in September 2004 showed Chinese nominal bond yields at a 1% discount to their US equivalent suggesting a risk perception similar to that of Singapore and Taiwan – at least for the next few years. By contrast the same report showed Indonesia with an 8% premium.

Selection of UK-listed companies benefitting from a China exposure

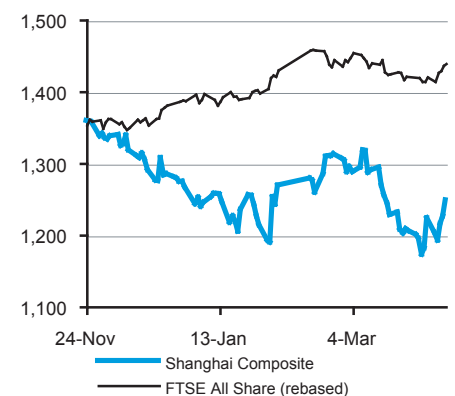
Company	Symbol	Business Segment	Recent Price (p)	Mkt Cap (£m)
Commodity & Energy Exposures				
Caledon Resources	CDN	Mining (gold)	4.5	15
D1 Oils	DOO	Bio-diesel (alternative energy)	427.5	93
Griffin Mining	GFM	Mining (zinc and gold)	35.3	63
Investment				
London Asia Capital	LDC	Specialist investment company	21.3	28
Cheaper Sourcing & Manufacturing				
Maelor	MLR	Healthcare for chronic ailments	10.3	3
Stadium Group	SDM	Manufactures electronics products	83.5	24
Voller Energy	VLR	Fuel-cells (alternative energy)	69.0	16
Swallowfield plc	SWL	Contract toiletries manufacturer	94.0	10
SDL International	SDL	Translation software	119.0	65
Elementis	ELM	Pigments manufacturer	50.0	216
Reflec	REF	Reflective chemicals	1.2	7
Exposures to Chinese Consumer & Industrial Demand				
Virotec	VTI	Environmental remediation	25.5	49
BioProgress	BPRG	Healthcare (eg sugar coated pills!)	53.0	62
Pacific Media	PCM	TV shopping in China	0.2	26
Wolfson Microelectronics	WLF	Mixed-signal microchips	156.5	159
Millbrook Scientific	MBK	Scientific instruments	7.8	3
Spirient	SPT	Communications technology	62.5	594
Croda	CRDA	Speciality/industrial chemicals	393.5	527
Scapa Group	SCPA	Specialist technical tapes/cable compounds	31.3	45
Aricom	TIO	Mining	29.0	28
Clearstream	CTN	Medical devices	80.0	13
Osmetech	OMH	Diagnostic medical devices	2.5	17

As for the currency risk we, alongside a number of commentators, believe that were the renminbi to be freely-floated the likely reaction would be a revaluation upwards (reflecting strong real growth). But that prospect appears to be some way off yet. Chinese authorities, and external commentators, argue persuasively that they cannot undertake currency reform unless and until they have reformed the financial system – a process already started but with some way yet to go. To paraphrase an old Chinese proverb, you cross a stream carefully.

As with the goldrush, it's not always the direct investment that is the best opportunity as the performance of the main Chinese indices shows. For investors, the opportunities are in companies who are beneficiaries of:

- selling directly to the growing Chinese market;
- reform and deregulation lead by the WTO process;
- continuing infrastructure development;
- cheaper sourcing and manufacturing opportunities (the “workshop of the world”);
- or, more indirectly, the impact of Chinese demand on energy and commodity prices;
- and ultimately Chinese enterprises looking to develop their own brands, and global distribution as they move up the “value” curve.

Shanghai Composite v. FTSE (rebased)



These opportunities are not without risk, as the recent announcements by Wolfson Microelectronics, Molins plc, and PZ Cussons' difficulties with developing a profitable distribution network demonstrate. The conundrum for investors is that a direct exposure is not always the best way to play an investment idea.

Evidently there is a balance to be struck by investors between perceived growth opportunities and their own risk tolerance. A myriad of collective direct investment vehicles exists for those of sufficient risk appetite. For others we identify in the table on the previous page a number of smaller companies and one active investment fund.

Each of them is London listed and demonstrates the diversity of the opportunities China offers. Some, unsurprisingly, are mining companies. But others include UK manufacturers with local Chinese production plants and UK suppliers into the Chinese economy. It ranges from sugar-coating pills to bio-diesel and environmental remediation. The list is by no means exhaustive nor necessarily recommended.

Company Thumbnails

With the MG Rover discussions clearly in mind, we provide thumbnail sketches of a number of UK-listed AIM companies through which investors may take advantage of the undoubted future growth potential of China. The list is not exhaustive nor is it prescriptive. Rather it is intended as a useful starting point from which readers may wish to conduct their own more detailed research. As always there is the caveat that China is still at a relatively early stage of development as a global economic powerhouse. Her growth will not be without attendant risks.

We have classified the list of companies according to our own description of four broad investment themes: Commodity and Energy; Investment; Cheaper Sourcing; Consumer and Industrial Demand. There should be no surprise that many of the companies come from the Chemicals and Mining sectors. The characteristic reflects firstly the clearly developmental stage of the Chinese economy and so supports our thesis that western investors looking for "traditional" cyclical growth opportunities increasingly will have to look towards the East.

Commodity and Energy

D1 Oils (DOO)

Sector: Chemicals

D1 Oils produces biodiesel – an alternative to the hydrocarbon-based diesel with which most people are familiar. Biodiesel is produced from “energy crops” such as the *Jatropha Curcas* seed over which the company has secured substantial plantation rights around the world. Given the source of the fuel, the use of biodiesel can help to reduce the generation of greenhouse gases. The company has developed and is commissioning refineries which are set to commence production this year. Its plantations are largely throughout SE Asia from where it supplies local and international markets. The Chinese government has shown interest in the technology and D1 Oils is a co-sponsor, with BP, of an alternative energy conference in China.

D1 Oils was listed on AIM at the end of October 2004. The share price enjoyed a strong rally during February 2005 reflecting, inter alia, the announcement of a joint venture deal in Saudi Arabia. Although the price has more recently consolidated at lower levels (390p) the market capitalisation is, at the time of writing, around £93m – more than double its value at the end of 2004.

Griffin Mining (GM)

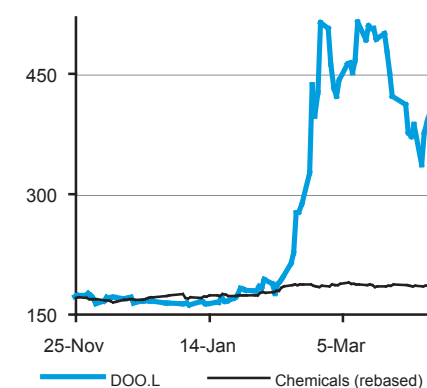
Sector: Mining

Griffin Mining (GM) is a Bermuda company whose shares are traded on AIM. Its principal business is developing the Caijiaying zinc gold mine in the Hebei Province, some 200km north west of Beijing. The project represents the first foreign-owned and operated mine in China for the last 100 years. GM announced recently that dry commissioning of the Caijiaying plant will be completed by the end of April – in line with its original schedule and budget. The news follows a successful drilling report issued in January confirming high grade zinc deposits and the basis for proceeding with a drilling programme to quantify the size of expected gold reserves.

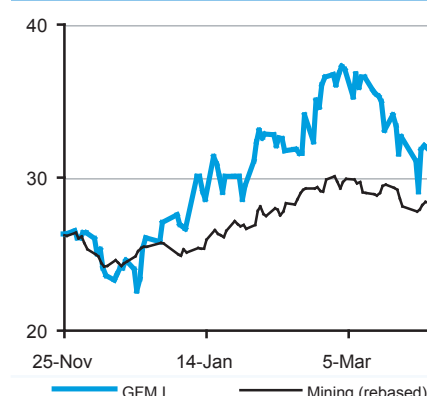
The last set of financial results was for the year ending December 2003—published in May 2004. Results for the year-ended December 2004 are expected on a similar timescale. As of December 2003 the company showed an increasing net operating expense of almost US\$600,000 and a surprisingly large foreign exchange gain of US\$476,000 to produce a marginal loss for the year as a whole. The rise in the operating expense is not of itself surprising, but investors will look closely at the 2004 results for movements in the foreign currency line.

At the end of 2003 net assets stood at some US\$13m, almost equally split between intangible assets and cash/ short term deposits. The intangible assets represent expenditures on licences, concessions, exploration and development work. Investors should also be aware that 6 million warrants were granted in 2003 exercisable at 20p at anytime up to 31st August 2005. We are aware that warrants over 1 million shares were exercised at 20p in February of 2005.

DOO v. Chemicals (rebased)

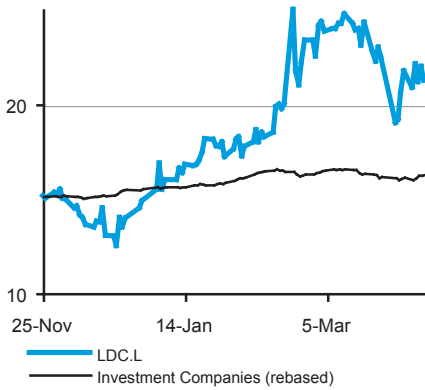


GM v. Mining (rebased)



Investment

LDC v. Investment Co. (rebased)



London Asia Capital (LDC)

Sector: Investment Companies

London Asia Capital (LDC) is a merchant banking group based in London and focuses on investment opportunities in Greater China. Within that focus it specialises in Small and Medium Enterprises (SMEs) in media, energy/environment, financial services and IT/ telecom. It has offices and partners across China rather than concentrating only on the more developed and coastal regions.

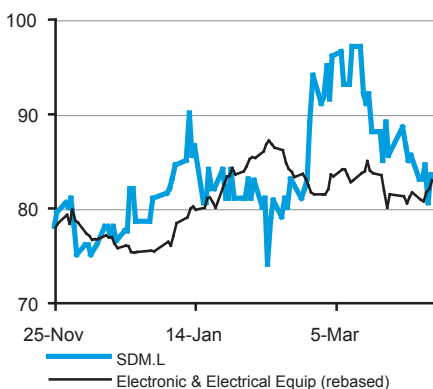
LDC listed on AIM in early 2003. Institutional shareholders include Throgmorton Trust, Framlington, ISIS and Gartmore.

The company year-end is December and the latest results are the interims for 2004, released in September. Those showed a move into operating profit and positive EPS. Fixed assets, almost entirely company investments, rose by some 67% to £4.9m. Cash rose to around £2.8m and total net assets rose to £8.2m. "Consensus" forecasts suggest that the move into profit should continue with eps forecasts of 0.2p for the year-ended 2004 and almost 0.5p for 2005. At the recent price of just below 22p the market cap was around £30m.

The history of the share price suggests that the dark days following the collapse of 2000 (which saw the share price down to 2p) are now behind LDC. 2003 marked the beginning of the recent recovery and the widely anticipated growth of the Chinese economy bodes well.

Cheaper Sourcing

SDM v. Elect. & Elec. Equip. (rebased)



Stadium Group (SDM)

Sector: Electronic and Electrical Equipment

The Stadium Group (SDM) manufactures electrical transformers, coils and other components. Products typically are used in the automotive and telecoms industries. It has manufacturing facilities in the UK and, since April 2000, in China. The manufacturing facility in China now supplies major customers such as Alcatel, Sagem and Black & Decker for their markets in France and globally respectively.

The share price history has been net positive since the 24.5p lows of 2001. The recent share price of 84p values the company at some £24m. Consensus estimates suggest eps rising to 7.7p (7.3p) for the year-ending December 2005 and to 8.4p next year. Operating margin in 2004 rose to 7.1% (5.6%).

Evidently the benefit in using manufacturing facilities in China to supply external markets rests in part on the current characteristics of the labour market and of the Chinese currency. Investors will be aware of the potential risks that may be presented were the Chinese labour market to tighten towards western standards or the currency to be floated higher as many commentators expect.

Swallowfield (SWL)

Sector: Personal Care

Swallowfield formulates, manufactures and packages fine quality household goods, toiletries and cosmetics across the whole spectrum of consumer markets for own label and brand names. It recently announced a contract to supply product to fill the next three years of aerosol requirements for PZ Cussons as from July of 2005. That is later than originally envisaged and the same announcement described the weakening consumer market place and stock overhang at retailers. The share price has recently weakened to 94p, valuing the company at a little over £10m. Consensus estimates suggest continued growth in eps to 9p (7.2p) for the year ended June 2005 rising again to 13p next year.

Elementis (ELM)

Sector: Chemicals

The company began life trading coffee and tea. It has evolved since those times (via the name of Harrisons and Crosfield) to today where it sells pigments and coatings for use in the paint, ink and metal finishing businesses. It operates four divisions; Specialities (surface chemistry); Pigments; Chromium products and Speciality rubber. So far this year the share price has risen by some 60% to 50p, valuing the company at £216m. Consensus estimates indicate further recovery in eps to 3.2p (1.4p) and then, next year, to 4.1p.

Elementis has developed production facilities in China to supply (not exclusively) each of its divisions. The latest of those was due to commence operations in the Spring of this year. As well as providing support worldwide, these facilities will also supply the local Chinese market: although still small (less than 5% of group turnover) the growth rate is high – well over 100% in the year to December 2004.

Consumer and Industrial Demand

Virotec (VTI)

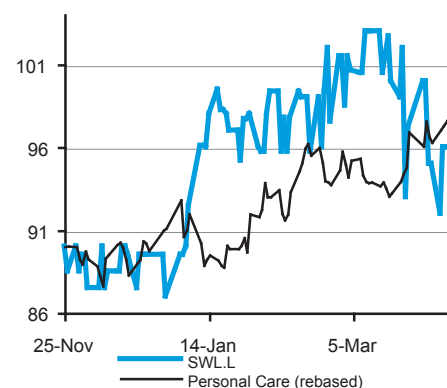
Sector: Chemicals

Virotec is an Australian company listed on AIM. It specialises in developing new technologies to tackle “environmental degradation” in industries as diverse as mining and sewage treatment. Revenues and revenue growth rates remain low – unsurprising in a company still in the developmental phase. Nonetheless cash at bank (as at end-year June 2004) was some A\$7.7m out of total assets of A\$10.6m.

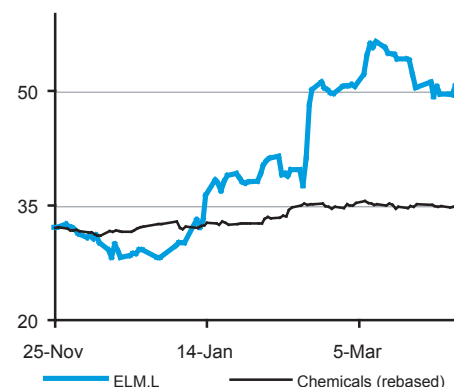
The share price recovered sharply from the lows of below 8p in 2003. That recovery however has, since early 2004, continued at a slower and more volatile pace. At the recent price of 25.5p the company was valued at £47m.

Recent corporate events include the sale of its analytical laboratory services business, part of a corporate strategy to dispose non-core activities.

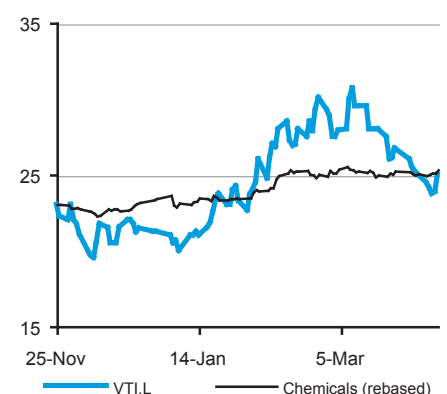
SWL v. Personal Care (rebased)



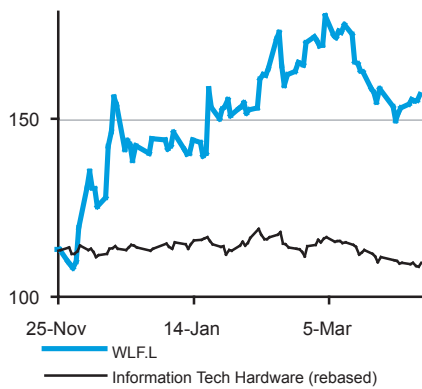
ELM v. Chemicals (rebased)



VTI v. Chemicals (rebased)



WLF v. Info Tech Hardware (rebased)



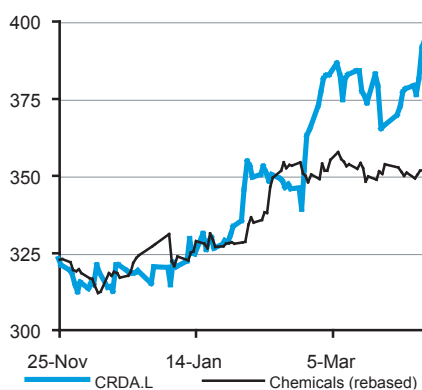
Wolfson Microelectronics (WLF) Sector: Info Tech Hardware

The company is a leader in the technology necessary to enable many of today's revolutionary communication and personal entertainment products. Each of those requires a device to translate between the real world of "wave-like" signals such as radio, television and cellular telephony (so-called analogue) and the digital world of the computer chip.

Its recent results (for the year-ended Dec 2004) showed a 58% increase in turnover accompanied by a 2% improvement in gross margin. Consensus estimates suggest eps for 2005 of 6.8p to 7.3p in 2006. The share price has made steady recovery from the October 2004 lows of 98.5p. The current price has eased off from the March 2005 high of 178.5p. Sentiment has been helped by the recently announced settlement of a patent dispute with Cirrus Logic Inc – albeit on undisclosed terms. The company also received the Award for Innovation and for Best Mid-Cap Company at the 2005 Scottish plc awards dinner.

The company does not break out its exposure directly to China. However Asia represented 65% of group revenues in 2004 and grew in value terms by some 32% over 2003. We believe that China represented a significant proportion of that result. Although Chinese DVD sales were disappointing in 2004, Wolfson still appears well positioned for the long-term growth expected in Chinese personal consumption.

CRDA v. Chemicals (rebased)



Croda (CRDA) Sector: Chemicals

Croda is a speciality chemicals company with interests ranging from Health Care to Personal Care, Home Care, Industrial applications and Polymer additives. By far the largest group is Personal and Health Care which, in 2004, represented 60% of the £294m group turnover. Health Care products include ingredients for the nutritional, pharmaceutical and animal healthcare businesses. In Personal Care the group was originally begun with the production of lanolin for the skin care market. It now has developed other formulations to complement that.

It has operations globally including wholly owned subsidiaries in Shanghai and Hong Kong. By geography, Asia represented some 14% of the total turnover.

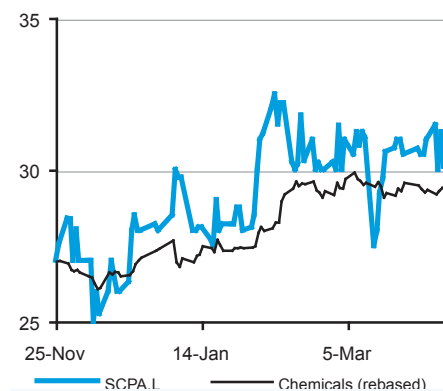
Consensus estimates suggest eps rising to 25p for the year-ending December 2005 (22.2p) rising to 27p in 2006. The share price has been rising strongly since the lows of early 2003 outperforming the FTSE-100 and, over the last year, the FTSE-250 and Chemicals sector indices. At recent levels (393.5p) the company is valued at over £500m – one of the largest smaller companies that we have highlighted but one which we believe can also capture the growth in Chinese domestic demand from a position of strength.

The Scapa Group makes technical adhesive tapes and films used by the automotive, aerospace, graphic arts, sports, electronics, industrial assembly, and medical markets. Scapa's commercial customers use its technical tapes for assembly and repair, protection, insulation, and identification. Specific uses range from medical bandages to shin guard protection for hockey players to electronic component assembly.

The Acutek International subsidiary is a medical products manufacturer specializing in adhesive components. Scapa has sold most of its non-core operations to focus on tapes. The company has operations worldwide, with roughly half of its sales in Europe. Its Asian business is still small but turnover doubled in the half-year to September 2004.

The share price has outperformed the sector over the last two years although has made slower progress since the middle of 2004. At recent levels around 31p, the company is valued at some £45m. The company recently warned of the negative impacts of the falling US\$ and rising raw material prices. The share price fell sharply on the announcement but has since recovered its previous level. The company has also been voluntarily removed from an asbestos-related class action in the USA.

SCPA v. Chemicals (rebased)



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