Harbinger Research
Independent Investment Analysis

Coverage Initiation Report

The People's Republic of China
Energy Efficiency

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NF Energy Saving (OTC-BB : NFES)

Stable, Rapidly Growing Industrial Company in Sweet-Spot of Chinese Economic Development. Shares at Very Low Multiple.

Strong Buy

Recent Price: US$0.80

Market Data (closing prices, May 23, 2009)

Market Capitalization (mln)	**31.9**
Enterprise Value (mln)	**31.9**
Basic Shares Outstanding (mln)	**39.9**
Fully Diluted Shares (mln)	**39.9**
Avg. Volume (50 day, approx.)	**35,000**
Institutional Ownership (%)	**16.6**
Insider Ownership (%)	**64.7**
Exchange	**OTC Bulletin Board**

Balance Sheet Data (as of Sept 30, 2008)

Shareholders' Equity (mln)	**16.0**
Price/Book Value	**2.0x**
Cash (000s)	**1,441**
Net Working Capital (000s)	**10,893**
Long-Term Debt (000s)	**0**
Total Debt to Equity Capital	**0.24:1**

Company Overview

NF Energy Saving America Corp. is a China-based provider of energy efficiency products and services to the largest industrial and municipal organizations within China. The Company's products specifically address the power-generation and fluid/gas transport industries, and generate energy efficiency improvements of up to 20%. The Company currently employs over 220 people and is in the midst of a major manufacturing capacity expansion, to be completed in late 2009 and early 2010.

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Summary and Investment Opportunity

- **Growth in Energy Demand is Driving Global Efficiency Push**

The world is in the midst of an energy demand growth super-cycle, as billions of people in places such as China, India, Brazil, Eastern Europe, and Southeast Asia are demanding ever more energy. This ever-increasing demand has driven energy prices higher and created a new consciousness regarding energy efficiency. Developing and developed nations around the globe are being forced to focus on energy efficiency to stay competitive, and to give their citizens the growing standard of living they have come to expect and demand. Given its immense population and rapidly expanding economy, this is especially true of China.

- **China has Mandated Energy Efficiency and Pollution Control**

As part of the Chinese government's most recent Five Year Plan, Chinese companies and local governments are now highly incentivized to control pollution and increase energy efficiency across all operations. This has in turn created a high demand for energy-saving products and services, the purchase of which are being highly subsidized by the Chinese government through grants and low-interest loans.

- **NF Energy Saving is a Leader in Helping Meet Energy Efficiency Goals**

The Company's products and services are designed to make the largest industrial concerns and municipalities more energy efficient. The Company's customers include some of the largest electricity producers, petrochemical companies, water supply companies, and municipalities in China, and we see nothing to indicate its track record of steady margins and 40%+ annual revenue growth will abate within the foreseeable future. We in fact believe that it may accelerate beginning in 2010 once its new facilities become fully operational.

- **NFES is Growing, Profitable, and We Believe Highly Undervalued**

Despite the recent strength in NFES shares, the Company is still trading at just 8x its 2008 earnings per share and under 3x our 2010 EPS estimate. Given its 40%+ organic growth rate this is a very low valuation. Furthermore, the Company recently released an extremely strong backlog of 2009 revenues, giving us comfort in both our 2009 and 2010 revenue and earnings estimates. We believe a multiple of at least 15x our 2009 EPS estimate is warranted. **Therefore, we set our 12-month price target at $2.00 per share, and rate the shares of NF Energy Saving a Strong Buy.**

P&L (000s)	2007A	2008A	Q1 09E	Q2 09E	Q3 09E	Q4 09E	2009E	2010E
Revenues	**10,336**	**15,835**	**2,420**	**2,850**	**5,850**	**11,000**	**22,120**	**35,150**
Rev CAGR	*96.0%*	*53.0%*	*N.A.*	*N.A.*	*N.A.*	*N.A.*	*40.0%*	*60.0%*
Op. Exp.	1,319	922	194	327	1,213	2,852	5,300	6,200
Op. Margin	*20%*	*22%*	*20%*	*18%*	*21%*	*26%*	*8%*	*12%*
Net Income	2,069	3,653	442	534	1,233	2,872	5,081	9,395
Net Margin	20%	23%	18%	19%	21%	26%	23%	27%
Dil. EPS	**.06**	**.10**	**.011**	**.013**	**.031**	**.072**	**.127**	**.236**
Diluted Shrs	32,081	37,269	39,873	39,873	39,873	39,873	39,873	39,873

Please see analyst certification and required disclosures on page 8 of this report.

Industry Background

Energy Efficiency

As most people know, there is a large and growing focus on energy efficiency, both here in the United States, and in other developed economies such as those of Western Europe, Canada, and Japan. However, there have also been sweeping changes in regulation that have generated a strong focus on energy efficiency in China. According to McKinsey & Company, China is now the world's second largest consumer of electricity (14%), second only to the United States (22%), and due to its heavy reliance on coal, it has dangerously high levels of general air pollution and $C0_2$ emissions. Furthermore, China's consumption of energy is forecast to grow at 4.4% per year through 2020, double the world energy consumption growth rate, and its industrial use of energy is growing at double-digit rates. Because of all of these factors the Chinese government recently mandated "energy productivity" as a primary goal of all companies and municipalities, and the mandate includes a call for cleaner energy and a 20% boost in the efficiency of energy consumed.

Source: China Energy Recovery

China's new focus on "energy productivity" solutions has made its manufacturing industries highly receptive to any technology that can help reduce energy costs while also reducing harmful emissions on a cost-effective basis. In fact, the Chinese government has instituted sweeping subsidization program including outright grants and low-interest lows to encourage companies and municipalities alike to improve energy efficiency.

Energy Waste – Extra Cost and Additional Emissions

Because China's economy has rapidly developed from a largely agrarian economy into a highly industrialized one, much of China's heavy equipment is based on older technology and is highly inefficient. For example, the major source of electricity in China is based on the combustion of coal and the use of coal-fired boilers to generate it. However, the coal-burning technology prevalent in China is out-dated and only about 60%-70% efficient, vs. an efficiency level of approximately 90% in countries such as the United States. However, by retro-fitting such coal-fired generators with modern coal-burning and steam-handling equipment, NF Energy Savings can improve efficiency to the 90%+ level. This is a very large market in China alone.

Source: China Energy Recovery

Another area of great inefficiency in China involves the transport of liquids and gasses over long distances. This industry, in addition to the shipping, trucking, and railroad industries, constitutes a major portion of the nation's industrial transportation infrastructure. In liquid and gas transportation and in the power industry, which also uses fluids and gasses as a core part of the power production process, the pipe and value system is largely antiquated and inefficient. NF Energy Savings has patent-protected innovations in this field, and through installation of highly efficient flow-control systems is able to either retro-fit or build from scratch far more energy-efficient systems. These systems benefit power-generators as well as companies in the petrochemical and water utilities industries.

We believe that the market for more energy efficient products is likely to show robust growth both in China and indeed globally for the foreseeable future. Any company that can successfully compete in the business of improving existing heavy infrastructure and/or in building out new heavy infrastructure in an energy-efficient manner is likely to have extremely strong demand for its products and services. Given its strong backlog and A-list customer base, we believe that NF Energy Savings is just such a company, and as such it should experience very strong demand. This clearly indicates it has the potential to grow sales and earnings very rapidly over the coming years and even decades.

Company Analysis

Corporate Overview

NF Energy Saving specializes in helping municipalities and established industrial companies use energy more efficiently. The Company accomplishes this by:

- Producing, selling, and servicing superior flow control equipment for the gas, oil, power production and water industries
- Retrofitting and improving energy production equipment such as coal boilers and certain motors, which it does for companies operating in a broad group of energy-intensive industries
- Historically, by providing consulting "project" services to help municipalities and large organizations assess their energy usage and opportunities for more efficient use

NF Energy is based in China and sells to customers within China and in other countries including other in Asia and the United States. NF Energy came public in the United States through a reverse merger transaction, and as of this writing we believe is just now becoming more broadly known to investors. The Company trades on the over-the-counter bulletin board exchange under the symbol NFES. It may in the future seek to join a larger, more recognized exchange such as the NASDAQ Global Market.

Target Markets

In general, the Company targets a wide range of companies and municipalities that can benefit from the more efficient use of energy. However, since NF Energy Saving's historical core competency is in the production and improvement of large flow systems, which include fluid transport and steam-based power generation systems, many of its customers are in electricity generation, operate large electricity co-generation facilities, or are heavily involved in the transport of high volumes of fluids such as gas, oil, and water. The Company specifically targets municipalities for its "efficient energy" project services, and has recently begun investing in the research and development of products relating to wind energy.

Specific Industries that the Company serves including the following:

- **Any industrial company that uses one or more steam boilers.** Most of China's boilers are based on outdated technology and run at only 60% - 70% efficiency; after an overhaul by the Company these boilers usually run at 90% efficiency (or better).
- **Any company or municipality involved in fluid transport.** These companies tend to be concentrated in the petrochemical, power generation, and general water transport industries. The Company's superior, patent-protected valve and fluid control systems make fluid transport more efficient and less energy-intensive.
- **Almost any company in the primary business of generating electricity.** With the exception of some solar energy operations, all power generation comes from converting either physical energy or heat energy into electricity. Of the two, heat energy accounts for a much larger portion of total electricity generated, and heat energy is almost always used to create steam from water and use the resultant pressure to spin turbines – the Company's offerings are focused on improving the efficiency of these processes.

Although a precise estimate of the Company's total addressable market is very difficult to compute, it is clear that the market is global, growing robustly, and many orders of magnitude larger than the Company's current revenue run-rate. This large market size provides the Company with the ability to grow at high rates for many, many years to come.

Products and Services

The Company produces products and provides services in three primary areas, plus one new area of research and development.

Energy Saving "Retrofits"

The Company refits steam boilers to prevent leakage and recover and reuse heat energy that would previously have been lost from the system. The Company's retrofit products and technology also apply to industrial "cave and furnace" heating systems, lighting systems, and motor drive systems.

Flow Control Equipment.

The Company's sales literature states that its flow control equipment can help reduce the energy required to transport fluids and gases by an average of 20%, and its contract history and backlog clearly indicates that this claim is well accepted by the Company's customers, which tend to be the largest and most established class of industrial and municipal organizations.

Energy Conservation and Emissions Reduction Services

As we mentioned in our industry background section, energy efficiency and pollution control are key initiatives under China's current "Five Year Plan" – the 11th of the current government. The Company uses its broad expertise in energy efficiency to provide municipalities with comprehensive energy and emissions auditing and planning services, for which government funding is relatively plentiful in China.

Wind Energy Co-Generation Products

The Company already possesses (through acquisition) a working 1.5MW wind power system, which includes the hub, forward engine room foundation, bearing seat, and the principal axle. Although the Company plans to be more active in this market in 2010 and beyond, it recognizes that myriad competitors exist and it current has only modest expectations in wind energy.

 

Patent Protection

The Company's products are highly technical in nature, and small innovations in functionality, cost, and serviceability can lead to significant competitive and sustainable advantages for the Company. Given that the Company has superior engineering and product design capability, it is not surprising that it holds an entire family of patents covering various system components and innovations thereof. As of its most recently quarterly filing, the Company holds one "invention" patent and ten more "application use" patents.

Invention Patent

- Processing technology of butterfly valve seal (ZL2006 1 0152644.8)

Patents of New Applications

- An abrasion-resistant valve used in liquid containing solid granules (ZL2006 2 0137379.1)
- A sealing structure used in valve maintenance (ZL2006 2 0137380.4)
- Butterfly valve sealing ring instruction device (ZL2007 2 0185293.0)
- Butterfly valve with block for opening butterfly plate (ZL2007 2 0185289.4)
- Piston flow-adjusting valve with removable piston sealing ring (ZL2007 2 0185288.X)
- J-shaped large dimension butterfly valve hard sealing ring (ZL2007 2 0185292.6)
- Composite valve sealing ring (ZL2007 2 0185290.7)
- Multi-level buffering full oriented valve fuel tank (ZL2007 2 0185287.5)
- Fluid control valve on-off speed control device (ZL2007 2 0185286.0)
- T-shaped large dimension butterfly valve rubber sealing ring (ZL2007 2 0185291.1)

Growth Plan

The Company has recently completed a major financing and is now working on the completion of its new manufacturing facility. This new facility will be highly automated and will give the company immediate capacity expansion and should also significantly reduce marginal product costs. We expect this facility to come on-line in two phases beginning in late 2009. Since Chinese economic activity in the industrial sector tends to be very strong in the second half of the year and much weaker in Q1 and Q2, the Company's build-out timing is excellent and should position it for very strong sales in the second half of 2009.

In addition, the Company is investing heavily in the research and development of new products related to its current line of products and in the development of new products in the wind energy sector. We are particularly excited about this investment, as the Company continues to build product in areas that are likely to have strong "super-cycle" demand characteristics.

Key Management

Mr. Li Gang, Chairman and CEO

Mr. Gang owns approximately 50% of NFES and is highly experienced in the field. Prior to founding the operating entity owned by NFES in 1998, Mr. Gang was the Director of the Technology Innovation Dept. at the Liaoning Planning and Economy Commission. He also held the title of Director of the Economic Operation Department at the Liaoning Economic and Trade Commission. Previously, Mr. Gang was the Deputy Director of the China Energy Conservation Association.

Mrs. Wang Lihua, Director and CFO

Before joining the Company in 1998, Mrs. Wang was the Chief Financial Officer of Liaoning EMC, which is one of the three EMCs established by the World Bank. Because of this role, the World Bank formally recommended Mrs. Wang to the Chinese EMC Association as a "premier" expert.

Ms. Li Hong, Director

Ms. Hong joined the Company in 2001 and is primarily responsible for regulatory compliance and investor relationships.

Mr. Cui Jianwei, Vice President

Mr. Jianwei is a Vice President of NF Energy Savings and joined the Company in 1998. Prior to that time, Mr. Jianwei was an Associate Professor in Thermal Engineering at Northeastern University and a Chief Engineer of the Shenyang New Energy Development Company, Ltd.

Competition

In its fledgling wind-energy equipment business, the Company faces a plethora of competitors both at home and abroad; however, the demand in this industry should still allow the Company's design expertise and production capability to make it a serious content and an able competitor.

In its core business of valves and flow systems, and services related to this area, there are two primary competitors in China. Both of these trade at multiples far higher than that currently experienced by the shares of NFES, and have fairly similar product offerings.

Hubei Hongcheng General Machinery Co., Ltd.

This company specializes in the engineering and manufacturing of valves for hydro stations, dams, water transfer systems, power plants, environmental, and many other gas and water related projects. In 2008 the Company had revenues of approximately US$31.2M, gross margins of 27% and net margins of just 4%. It trades on the Shanghai Stock Exchange at a trailing P/E of over 90, more than 10x the P/E currently enjoyed by NFES.

Watts Valve (Changsha) Co., Ltd.

Watts Valve is a wholly foreign owned company specializing in manufacturing of butterfly valves, recompression valves, and air valves, making it similar in many respects to NF Energy Savings. The company is a wholly-owned subsidiary of Watts Water Technologies, Inc. (WTS – NYSE), headquartered in North Andover, Massachusetts in the United States. Watts Water designs, manufactures, and sells water safety and flow control products primarily for the water quality, water safety, water flow control, and water conservation markets in North America, Europe, and in the People's Republic of China. In 2008, Watts Water generated revenues of $1.4 billion and had net income of $46.6 million (3.3%). The shares of WTS currently trade at over 17x the company's 2008 earnings.

Risks

We do not believe that the core business or technology of the Company is at serious risk of technological obsolescence, as the Company's customers make use of industrial processes that change very slowly, if at all. However, the Company will face "standard" operational risks related to the growth of its business, as different management skills sets become necessary as an enterprise hits inflection points in its size and complexity. Given the Company's strong management and governance teams, however, we believe that this risk is both minimal and manageable.

In the near term, we think the Company faces two primary risks, although both of these are "pre-mitigated" to some extent by the shares' low trading multiple. The first and perhaps greatest risk, in our view, is that unforeseen circumstances and delays could push back the availability of the Company's new manufacturing facilities into calendar 2010. Were this to occur, 2009 sales and earnings would almost certainly come in below our expectations, and this could have a material adverse effect on the market value of NFES shares. The second and, in our view, less serious risk is that sales could simply fail to meet our estimates. Although the Company does have an impressive just-announced 2009 sales backlog of US$21.5, various unplanned for delays and other events could still cause the Company to miss our sales and earnings forecasts. Overall, however, we feel that the low valuation in the Company's shares more than offsets these risks to risk-tolerant investors.

Valuation and Investment Opinion

There are not very many publicly available valuation comparables for the company; we have listed two comparables, but neither is perfect. One of them trades on the Shanghai exchange, where multiples tend to be somewhat inflated, and the other is a mature New York Stock Exchange company with the bulk of its business in the western hemisphere.

Peer Group Analysis – NF Energy Savings (NFES – OTC-BB)

Company Name and Symbol	Price per Share*	Market-Capitalization*	P/E CY 2008A	Est. Rev. Growth	P/E Estimate CY 2009E
NF Energy Saving (NFES)	**0.80**	**$32 mln**	**8.0**	**40%+**	**6.2**
Hubei Hongcheng (Shanghai Ex.)	7.75	-	90.0**	-	-
Smart Heat (HEAT)	5.64	$136 mln	19.3	30%+	9.0
China Energy Recovery (CGYV)	1.74	$47 mln	45.0	50%+	22.0
Watts Water Technologies (WTS)	20.19	$739 mln	20.4	15% - 20%	18.7

*Market Data as of market close, 5/22/09; ** According to Company Provided Data

Conclusion

NFES is an already-proven industrial company that exhibits the growth characteristics of a young, high-growth enterprise. Furthermore, the Company is in the sweet-spot of global energy price/supply trends and the pervasive push for more efficient energy use. The Company is well-managed, well-funded, and strategically located near China's iron belt, giving it below-market price for its raw materials inputs. Given its extremely low trailing price-to-earnings multiple of just eight, we are very comfortable that NFES shares are worth considerably more than US$0.80, even if 2009 comes in slightly below our expectations. Therefore, **we rate the shares of NF Energy Savings a Strong Buy, and set our 12-month price target at $2.00 per share, with significant upside to this target possible as 2009 progresses.**

Our Rating System

We rate enrolled companies based on the appreciation potential we believe their shares represent. The performance of those companies rated "Speculative Buy" or "Strong Speculative Buy" are often highly dependent on some future event, such as FDA drug approval or the development of a new key technology.

Explanation of Ratings Issued by Harbinger Research

STRONG BUY	We believe the enrolled company will appreciate more than 20% relative to the general market for U.S. equities during the next 12 to 24 months.
BUY	We believe the enrolled company will appreciate more than 10% relative to the general market for U.S. equities during the next 12 to 24 months.
STRONG SPECULATIVE BUY	We believe the enrolled company could appreciate more than 20% relative to the general market for U.S. equities during the next 12 to 24 months, if certain assumptions about the future prove to be correct.
SPECULATIVE BUY	We believe the enrolled company could appreciate more than 10% relative to the general market for U.S. equities during the next 12 to 24 months, if certain assumptions about the future prove to be correct.
NEUTRAL	We expect the enrolled company to trade between -10% and +10% relative to the general market for U.S. equities during the following 12 to 24 months.
SELL	We expect the enrolled company to underperform the general market for U.S. equities by more than 10% during the following 12 to 24 months.

Analyst Certification

I, Brian R. Connell, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the recommendations or views expressed in this research report.

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Analyst Highlight

Brian R. Connell, CFA **Senior Research Analyst**

Mr. Connell has over 15 years' experience in the securities industry, as an equity analyst and portfolio manager, and as the founder and CEO of StreetFusion (acquired by CCBN/StreetEvents), a software company serving the institutional investment community. On the sell-side, Mr. Connell served as the technology analyst for Neovest, an Atlanta-based boutique, and as a Senior Analyst - Internet for Preferred Capital Markets, an investment bank based in San Francisco. Mr. Connell has also held the position of Executive Director of Marquis Capital Management, a technology-focused investment management organization.

Mr. Connell holds degrees in Economics and Psychology from Duke University, and is a CFA Charterholder.