

CHINA VALVES TECHNOLOGY, INC  
Form 10-KT  
November 21, 2011

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 10-K**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the fiscal year ended \_\_\_\_\_

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the transition period from January 1, 2011 to September 30, 2011

Commission File Number: 001-34542

**CHINA VALVES TECHNOLOGY, INC.**

*(Exact name of registrant as specified in its charter)*

**NEVADA**

*(State or other jurisdiction of  
incorporation or organization)*

**86-0891931**

*(I.R.S. Employer  
Identification Number)*

**21F Kineer Plaza**

**226 Jinshui Road**

**Zhengzhou, Henan Province 450008**

**People's Republic of China**

**(86) 371-8612-7222**

*(Address, including zip code, and telephone number,  
including area code, of registrant's principal executive offices)*

**Securities Registered Pursuant to Section 12(b) of the Act:**

**(Title of Class)**  
Common Stock, \$.001 par value

**(Name of each exchange on which registered)**  
NASDAQ Global Market

**Securities Registered Pursuant to Section 12(g) of the Act:**

**None**

*(Title Of Class)*

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes [ ] No [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes [ ] No [X]

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

On November 15, 2011, there were 35,869,654 shares of the registrant's common stock outstanding.

The aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates of the registrant based on the closing sale price of the registrant's common stock as reported on the NASDAQ Global Market was approximately \$67.64 million as of June 30, 2011 (the last business day of the registrant's most recently completed second fiscal quarter). Shares of common stock held by each executive officer and director of the registrant and each person who beneficially owns 10% or more of the registrant's outstanding common stock has been excluded from the calculation. This determination of affiliated status may not be conclusive for other purposes.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Documents Incorporated by Reference: Portions of the registrant's proxy statement for its 2011 annual meeting of stockholders, which the registrant expects to file with the Securities and Exchange Commission within 120 days after September 30, 2011, are incorporated by reference into Part III of this report.

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## INTRODUCTORY NOTE

**Use of Terms** In this report, unless indicated otherwise, references to

- Changsha Valve are references to China Valves Technology (Changsha) Valve Co., Ltd., incorporated in the People's Republic of China;
- China Valves Holdings are references to China Valves Technology Holdings Limited, incorporated in Hong Kong;
- China Valves, the Company, , CVVT , we, us and our are references to the combined business of China Valves Technology, Inc. and our PRC and other subsidiaries;
- China Valve Samoa are references to China Valve Holdings Limited, incorporated in Samoa;
- China and PRC are references to the People's Republic of China;
- \$ are references to the legal currency of the United States.
- Hanwei Valve are references to Shanghai Pudong Hanwei Valve Co., Ltd., incorporated in People's Republic of China;
- Henan Tonghai Fluid are references to Henan Tonghai Fluid Equipment Co., Ltd.;
- HKD are references to the Hong Kong Dollar;
- Kaifeng Valve are references to Henan Kaifeng High Pressure Valve Co., Ltd.;
- Operating Subsidiaries are references to ZD Valve, Kaifeng Valve, Yangzhou Rock, Taide Valve, Changsha Valve and Hanwei Valve;
- RMB are references to Renminbi, the legal currency of China;
- Taide Valve are references to Taizhou Taide Valve Co., Ltd.;
- The Casting Company are references to Kaifeng High Pressure Valve Steel Casting Limited Liabilities Company;
- Yangzhou Rock are references to Yangzhou Rock Valve Lock Technology Co., Ltd.; and
- ZD Valve are references to Zhengzhou City ZD Valve Co., Ltd.

### Forward-Looking Statements

*The statements contained in this Report that are not historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to our financial condition, results of operations and business, which can be identified by the use of forward-looking terminology, such as estimates, projects, plans, believes, expects, anticipates, intends, or the negative thereof or other variations thereof, discussions of strategy that involve risks and uncertainties. Management wishes to caution the reader of the forward-looking statements that such statements, which are contained in this Report, reflect our current beliefs with respect to future events and involve known and unknown risks, uncertainties and other factors, including, but not limited to, economic, competitive, regulatory, technological, key employee, and general business factors affecting our operations, markets, growth, services, products, licenses and other factors discussed in our other filings with the Securities and Exchange Commission, and that these statements are only estimates or predictions. No assurances can be given regarding the achievement of future results, as actual results may differ materially as a result of risks facing us, and actual events may differ from the assumptions underlying the statements that have been made regarding anticipated events.*

*These forward-looking statements are subject to numerous assumptions, risks and uncertainties that may cause our actual results to be materially different from any future results expressed or implied by us in those statements. Some of these risks are described in Risk Factors in Item 1A of this Report.*

**PART I****Item 1. Business.****OVERVIEW**

China Valves Technology Inc. is a leading developer, manufacturer and after market service provider of comprehensive flow management products and services in China. Our flow service solutions help customers resolve any problems and questions they may have in critical industries around the world.

As a recognized leader in supplying valves, actuators, forging and castings, valve locks and related services, we support global infrastructure industries, including nuclear power, fossil power, hydropower, oil and gas, chemical and petrochemical, water treatment, mining and metal, as well as general industrial markets where our products and services add value. With approximately 1,900 employees in China and more than 50 distributors in more than 30 countries, we can provide convenient services with a local presence.

China Valves has evolved through organic growth and strategic acquisitions. The Company was created in 2007 with the merger of two leading fluid motion and control companies - ZD Valve and Kaifeng Valve. We continually evaluate acquisitions and other strategic investment opportunities to broaden our product portfolio, service capabilities, geographic presence and/or operational capabilities to meet the growing needs of our customers. Presently, China Valves has six wholly-owned subsidiaries, six heritage brands, and a comprehensive product line including over 800 models and 10,000 series.

Our industry is usually categorized into the following five major distinct industries; our sales mix by industry in the fiscal year 2011 consisted of:

Power Supply	30.2%
Petrochemical and Oil	31.6%
Water Supply	20.7%
Metallurgy	4.1%
Other	13.4 %

Our sales revenue and net income were \$161.4 million and \$29.6 million, respectively, for the nine months ended September 30, 2011, and \$131.4 million and \$36.8 million, respectively, for the nine months ended September 30, 2010. Our sales revenue and net income were \$183.7 million and \$43.2 million, respectively, for the year ended December 31, 2010 and \$95.4 million and \$23.4 million, respectively, for the year ended December 31, 2009.

**CHANGE IN FISCAL YEAR**

As previously announced, in 2011, we changed our fiscal year end to September 30 from December 31. We made this change because the first quarter of the calendar year is inefficient for the audit work due to the Chinese New Year holidays. This Transition Report on Form 10-K reports our financial results for the nine-month period from January 1, 2011 through September 30, 2011, which we refer to as *fiscal year 2011* throughout this report. Following fiscal year 2011, we will report on a twelve-month fiscal year beginning on October 1 and ending on September 30 of each year. The years ended December 31, 2010 and 2009 reflect the twelve-month results of the respective calendar years.

## **HISTORY AND DEVELOPMENT**

Our heritage trademark dates back to the 1959 founding of Kaifeng High Pressure Valve Factory, later to be Kaifeng Valve. ZD Valve was established in 1993.

Under the name of a predecessor entity, China Valves was incorporated in Nevada on August 1<sup>st</sup>, 1997. Kaifeng Valve and ZD Valve merged together in 2007 and then China Valves Holdings was established in Hong Kong in September 2007.

In April 2009, China Valves finalized the acquisition of Taide Valve., a gate and butterfly valves manufacturer whose products are mainly used in the water supply industry.

In January 2010, China Valves acquired Yangzhou Rock., a mechanical interlock safety system and triple offset butterfly valves maker.

In February 2010, China Valves announced the acquisition of former Watts Valve (Changsha) Co., Ltd., now renamed as China Valves Technology (Changsha) Co., Ltd, or Changsha Valve. Changsha Valve is one of the main valve suppliers of China's hydropower and fossil power industries.

In April 2010, China Valves acquired Hanwei Valves., a joint venture of PRC and Hong Kong and a famous high-tech valves supplier of oil and gas, petrochemical industries.

## **SUBSIDIARIES**

China Valves owns six operations in China. Below is the current business information of each. In addition to the business operations information presented below, please see the Consolidated Financial Statements of this annual report for more information on our business.

### **Kaifeng Valve**

Kaifeng Valve was founded in 1959, and is located in Kaifeng city (one of the seven ancient capitals of China), Henan province. It used to be a large state-owned valve factory in China. The dominant products include supercritical or ultra critical thermal power plant high pressure and temperature valves, abrasive and corrosive media refinery & petrochemical valves. As a leading valve supplier in the energy industry, the "KF" brand is a leader in the Chinese valve industry, and was awarded "the most competitive valve brand" by the Chinese Ministry of Commerce in 2006.

### **Products and services**

Kaifeng Valve is a famous valve supplier for the fossil power industry in China. Its products are used in a wide variety of applications in power plants from high temperature steam isolation and high pressure feed water isolation, to the most severe pressure-difference steam extraction duty in turbine.

Its products are used in high levels of corrosion, abrasion, extremely high temperature and high pressure, zero fugitive emissions, and nuclear power plant isolations. The Company believes it makes most reliable domestic high pressure isolation valve in China.

Kaifeng Valve provides engineering, design, inspection, maintenance and repair services for its valves and related products. It sells its products and services in most geographic regions in China directly through the Company's internal sales force as well as through a network of independent distributors.

### **Product Types**

- High temperature and high pressure casting gate, globe, check valves
- High temperature and high pressure forged steel gate, globe, check valves
- API standard casting gate, globe, check valves
- Bleed steam check valves
- High pressure Y-globe, Y-globe check valves
- High vacuum gate, globe, check valves
- Automatic recirculation control valve
- Multi-stage steam control valve
- Feed water heater 3-way isolation valve
- Through way and straight way plunger valve



## **Customers**

Besides fossil power plants, Kaifeng Valve products are widely used in refinery, petrochemical, mining and metal, pulp and paper industries. Kaifeng Valve signed a Strategic Cooperation Agreement with China Dongfang Electric Corporation (“DEC”), the biggest power equipment supplier in the world. Kaifeng Valve is the sole supplier of the pipeline pressure control valve for Shanghai Electric Power Generation Group. Kaifeng Valve is a Tier 1 supplier of China’s top 5 power generation companies.

Kaifeng Valve is a qualified supplier of China National Nuclear Corporation (“CNNC”) and China Guangdong Nuclear Power Holding Co., Ltd. (“CGNPC”). It provides numerous high pressure, high temperature steam and water isolation valves to nuclear power plants every year.

## **ZD Valve**

ZD Valve is a leading manufacturer of low pressure butterfly valves, eccentric semi-ball valves, non-return valves with damping systems, and valves applied in water treatment and drainage pipelines. Its brand ‘ZD’ is a leading butterfly valve brand in the water treatment industry of China. ZD Valve occupies a significant market share of butterfly valves in the municipal water treatment of China. ZD Valve is located in Zhengzhou city, the capital of Henan province.

## **Products and services**

ZD Valve is one of the largest low pressure butterfly valve suppliers in China. Besides manufacturing butterfly valves, ZD Valve provides a wide product range for applications in water treatment, petrochemical, mining and metal, and fossil power industries.

ZD Valve provides a complete package of flow control solutions to water treatment customers. In addition to these products, it also offers engineering, design, inspection, installation, commissioning, and repair services.

ZD Valve provides after sale services through its network of sales representatives who cover most of the capital cities and all of the five municipals in China. After sales services are carried out through its production facility, and include 24-hour onsite services, in-house repair, and return manufacturing services.

## **Product Types**

- Resilient seated gate valve
- Multi-functional damping check valve
- Hydraulic damping tilting check valves
- Ventilating butterfly valve
- Triple eccentric metal seated butterfly valve
- High performance metal seated butterfly valve
- Soft seated butterfly valve
- Hydropower station hydraulic and pneumatic butterfly valve
- Eccentric semi-ball valve
- Floating ball air release valve
- 3-way control valve
- Sluice gate valve

## **Customers**

The customer mix of ZD Valve spans several industries, including fossil power, hydropower, petrochemical, mining and metal, pulp and paper and food. However, water treatment is still the biggest market of ZD Valve, and its products are well known in the major city water treatment companies in China.

ZD Valve has an extensive network of sales and distributors in Europe, Middle East and Southeast Asia to support our global customers.

## **Changsha Valve**

Changsha Valve's predecessor was founded in 1958. Its leading products include large diameter hydraulic operated butterfly valves, flow control valves, and spherical valves in large size. Changsha Valve is a leading butterfly valves supplier for the hydropower industry in China. It has accumulated abundant experiences in fossil power, hydropower, nuclear and water treatment industries. Changsha Valve established the Chinese industrial standard for metal seated butterfly valves and power plant butterfly valves. Its brand "CSV" has more than fifty years of history and occupies significant market share of butterfly valves in the hydropower industry

## **Products and services**

Changsha Valves is well known for its large size butterfly valve and large size water control valve. It manufactures the most substantial butterfly valve (DN5500mm) in all of China. As one of the main valve suppliers in China's hydropower industry, Changsha Valve provides a broad range of industrial valves, including on/off valves, control valves, and other specialty valves.

As the standard setter of metal seated butterfly valves and power plant butterfly valves, Changsha Valve provides extensive after sales services and strong technical support to our customers.

## **Product types**

- Large size vacuum butterfly valve
- Butt weld butterfly valve
- Hydropower station metal seated butterfly valve
- Hydraulic and pneumatic operated butterfly valve
- TRT Coal gas dust exhaust butterfly valve
- Spherical water control valve
- Top entry trunnion mounted ball valve
- Inline type sleeve water control valve
- Submerged type sleeve control valve
- Y-type and Straight way type sleeve control valve

## **Customers**

Changsha Valve supplies the hydropower stations in China. Its products are widely used in the recycled water systems in fossil power plants, especially in 1000MW ultra-critical power plants. Its products are increasingly used in metal, refinery and chemical plants due to their reliability and excellent after sale services.

## **Hanwei Valve**

Hanwei Valve is a high-tech enterprise located in the Pudong Airport area of Shanghai. It was founded in 1992 as a joint venture between Hong Kong Get Success Investment Limited and Shanghai Hanhuang Valve Co., Ltd. Hanwei Valve is recognized for its advanced R&D capabilities and its strong engineering capabilities. Different from Kaifeng Valve, ZD Valve and Changsha Valve, Hanwei Valve is committed to development in the oil and gas, petrochemical and chemical markets. "Han Wei" is considered to be a leading brand in China's valve industry.

## **Products and services**

Hanwei Valve is one of the top suppliers in the world that can provide a 24-way rotary valve. The 24-way rotary valve is applied in the simulated moving bed adsorption-separation unit and chromatogram separation unit of petrochemical and biological engineering. Its fully welded pipeline ball valve is widely used in China's oil & gas industry, and has penetrated markets in the Middle East, Southeast Asia and Central Asia. It has several patented products such as the 24-way rotary valve, district heating ball valve, full welded pipeline ball valve etc.

Hanwei Valve provides design, engineering, commissioning, diagnostic, installation, inspection and repair services to its customers. We believe its ability to offer design and engineering services provides us with a unique competitive advantage.

## **Product Types**

- Axial-flow check valve
- Dual plate check valve
- Parallel slide gate valve
- High performance metal seated butterfly valve
- Trunnion mounted ball valve
- Full welded pipeline ball valve
- Fully welded district heating ball valve
- Top entry trunnion mounted ball valve
- Floating ball valve
- 24-way rotary valve
- Tank bottom valve
- Knife gate valve

## **Customers**

Hanwei Valve is a tier one valve supplier of China National Petroleum Corporation (CNPC). It provides a large amount of fully welded pipeline ball valves and axial-flow check valves to oil and gas pipelines, most of which were key national projects. Hanwei Valve has earned a strong reputation from its services to Sinopec and UOP.

In addition to the Chinese market, Hanwei Valve provides its products to the national petroleum companies of the Middle East, Southeast Asia and Central Asia, and it also provides district heating ball valves to Russia and Eastern Europe through its long-term partners.

## **Taide Valve**

Taide Valve is located in Taizhou city, Jiangsu province. It was initially founded in the 1950s as an agricultural machinery plant, and later became a supplier of castings and valves in the 1990s.

Taide Valve provides resilient seated gate valves, soft seated butterfly valves and metal seated butterfly valves to water treatment and public works.

## **Product Types**

- Resilient seated gate valve
- Soft seated butterfly valve
- Metal seated butterfly valve

## **Customers**

Taide Valve is a qualified supplier for Shanghai Municipal Water Group, KSB China and Fushun Qilong Petrochemical, Shandong Zibo Municipal Water Co. Ltd. and so forth for water industry and petrochemical industry,

## **Yangzhou Rock**

Yangzhou Rock is a high-tech enterprise located in Yangzhou city (one of seven ancient capitals of China), Jiangsu province. It has four registered patents for its valve mechanical interlock device. Yangzhou Rock is the only valve mechanical interlock manufacturer in China, and it is considered to be a safe and environmentally friendly company. Yangzhou Rock is gradually emerging in the area of mechanical interlock, intelligent alarm linkage, remote flexible control and mechanical latch delay, etc.

Besides the valve mechanical interlock, it has recently developed a triple-eccentric metal seated cryogenic butterfly, which can be widely used in air separation, liquefied natural gas, and cryogenic treatment industries.

Yangzhou Lock has also developed triple-eccentric metal seated butterfly valve for turbine steam pipe up to 570 centigrade temperature, which is a sole producer in China.

## **Product Types**

- Quarter-turn valve interlock
- Multi-turn valve interlock
- Vessel closure lock
- Actuated valve interlock
- Anti-tamper lock in oil pipeline
- Cryogenic and high temperature triple-offset butterfly valves



**Customers**

Yangzhou Rock customers include many famous multi-national companies like Air Product, Air Liquid, Linde, DSM, and BASF. It is also a qualified supplier for CNPC, CNOOC. With its strong engineering and advanced equipment, Yangzhou Rock can provide comprehensive aftermarket services.

**ORGANIZATIONAL STRUCTURE**

The following chart reflects our organizational structure for our active subsidiaries as of the date of this Annual Report.

(1) Shanghai Hanhuang Valve Co., Ltd. and Get Success Investment Limited, which was formally disclosed as Hong Kong Hanxi Investment Co., Ltd. based on its Chinese name, were former shareholders of Hanwei Valve, both of which were acquired during the acquisition of Hanwei Valve by the Company and were shell companies without any active operations. Shanghai Hanhuang Valve Co., Ltd. was dissolved on October 19, 2011 and Get Success Investment Limited, was dissolved on September 16, 2011.

## **OUR INDUSTRY**

The Chinese valve market is expected to increase at an annual rate of nearly 20% for the next few years according to “2010-2015 China Valve Industry Investment Analysis and Perspective Guidance Report” by China Social Economic Investigation & Research Center. We believe that demand for valves will be driven primarily by energy demand and water treatment system investment and upgrading. We intend to focus our efforts on utilizing our tangible and intangible resources to expand and strengthen our products and increase our market share in response to industry demands.

The other driving force is that China’s central government strongly promotes localization of major equipment. The proportion of domestic use in nuclear power, fossil power and chemical plants has increased quickly, so that China Valves will now have more opportunities to enter into the high-end valves areas, which have been occupied by international companies.

As a supplier to customers in a variety of industries, our performance is largely dependent upon the overall economic conditions and the growth and performance of industries, and companies operating in those industries which purchase our valve products. The following provides a brief overview of the historical and projected performance and growth of the four largest industries in which our customers operate.

### **Our Involvement in the Power Industry**

#### ***Fossil power***

The Chinese government continues to improve installation of capacity of fossil power plants to meet the growing electricity demand for both industrial and residential uses. Many ultra-critical fossil power plants are either under construction or are being engineered, and smaller sub-critical fossil power plants have either been shut down or are being upgraded to improve energy efficiency and improve the environment.

Kaifeng Valve is the only valve supplier in China to provide main stream isolation valves and main feed water isolation valves in ultra-critical fossil power plants. Benefiting from the government requirement of localization, Kaifeng Valve expects to have an extensive market share in this area.

The increased use of the fossil power demands more and more large size butterfly valves and control valves for circulating the water system. ZD Valve and Changsha Valve expect to receive more orders from ultra-critical fossil power plants

Kaifeng Valve is the initiator of the localization project of high end fossil power application high end valves approved by state council. .

#### ***Nuclear power***

Nuclear power plants normally demand more valves than the same capacity fossil power plants, and purchase prices and amounts are much greater than for traditional power plants due to higher safety and security requirements. That is the reason why our main competitors invest a large amount of human and financial resources in nuclear power.

As one of the main suppliers of high pressure, high temperature valves in China's nuclear power industry, Kaifeng Valve has been cooperating with the two biggest nuclear investment companies in China-CNNC and CGNPC. In 2004, Kaifang Valve was completed a multi-stage and rigorous certification process that resulted in it becoming a qualified nuclear valve supplier for both companies.

Both Changsha Valve and ZD Valve are qualified suppliers of butterfly valves for nuclear power plants. They seek to steadily expand their market share in the nuclear power industry.



### Our Involvement in the Petrochemical, Oil and Gas Industries

Energy preservation is the top priority of the Chinese government in recent years. Long distance oil and gas pipelines, huge LNG and LPG tank farms, and large-scale ethylene and refinery plants will be built in the near future to ensure safe and efficient transportation of energy. In addition, national oil companies like CNPC, Sinopec and CNOOC have increased their investment in overseas oilfields and refineries.

As one of the main valve suppliers of the oil and gas industry, Hanwei Valve will benefit from a large demand for pipeline ball valves, check valves and gate valves. Kaifeng Valve expects to receive more orders due to an increasingly large demand for high pressure valves in ethylene and refinery plants. Yangzhou Rock strives to compete with imported cryogenic butterfly valves in LNG and LPG tank farms with its reliable products and services.

### Our Involvement in the Water Treatment Sector

The Chinese government stably increases its investment to upgrade public facilities, including its water pipe network and sewage treatment, in thousands of cities and municipals. The total annual demand for valves in the water treatment industry is about 17 billion RMB in 2010 with further increase as presented in the following table.

2005~2010 China Water Treatment Valve Production and Market size

Year	2005	2006	2007	2008	2009	2010E
Production/in 10K Tons	19.4	23.5	29.7	37.3	45.2	54.7
Market Size/in Billion RMB	5.33	7.78	10.27	13.50	14.98	17.36

Resource: <http://china.toocle.com/cbna/item/2011-04-11/5731083.html>

Resource: <http://china.toocle.com/cbna/item/2011-04-11/5731083.html>

As the main valve suppliers in water treatment, ZD Valve and Changsha Valve will improve their production capacities to meet the rapid growth of demand. In addition, we will work closely with our customers and research institutes to develop high quality products to compete with imported products.



## OUR COMPETITIVE STRENGTHS

- **Broad range of products and leading brands.** From the extreme high/low temperature, extreme high pressure, and extreme abrasion and corrosion, to the most complex smart valves, we believe that we have the most comprehensive range of valve products in our industry. Additionally, we enjoy leading market positions based on the estimated market share of our key products, broad brand recognition, and strong reputation for quality and service within the markets we serve.
- **Low-cost and high quality manufacturing capabilities.** We believe our historical capital investment in manufacturing technologies helps us reduce the costs of producing our products. We focus on manufacturing and selling high quality valves at competitive prices. We believe we have a price advantage over most of our competitors.
- **Highly experienced and incentivized research and development team.** Our R&D department is composed of engineers with many years of experience; some of them are the most professional engineers in China's valve industry. We are committed to developing new products and we have, in recent months, generally launched a new model every two months. We have cooperated with universities and institutions to improve and develop products.
- **Highly experienced, proven management team.** We are led by an experienced management team with a long and successful track record, enabling us to recognize and capitalize on attractive opportunities in our key markets. Our senior management members have an average of over 18 years of experience in the valve industry; our top management team, including the CEO and CFO, either came from an international valves group or has international management experience.

## OUR STRATEGY

Our objective is to increase profitability, cash flow and revenue while developing and enhancing our position as the leading valve manufacturer in China. Our strategy for achieving these objectives includes the following key elements:

**Pursue Strategic Acquisitions.** China's valve market is very fragmented. According to the China Valve Industry Association's statistics, there are more than 6,000 local valve manufacturers in the market. The top ten local valve manufactures have an aggregate Chinese market share of only 12.1% . We anticipate that the fragmented nature of the Chinese valve market will continue to provide opportunities for growth through strategic acquisitions. Our acquisition strategy will continue to focus on entities with products that provide opportunities for us to expand and products that can be marketed through our existing distribution channels or provide us with new distribution channels for our existing products, thereby increasing marketing and distribution efficiency. Furthermore, we seek acquisition candidates that demonstrate a combination of good profit margins, strong cash flow, leading positions in the local markets and products that generate recurring revenue. We will use our brand advantage to consolidate China's valve market and to increase our market share.

In 2010, we finalized the acquisition of Yangzhou Rock, Changsha Valve and Hanwei Valve. These acquisitions enabled us to expand the product lines and advanced technologies we offer to the growing oil and gas, hydropower and fossil power markets.

**Further Penetrate Existing Market Segments.** We plan to further penetrate existing market segments to drive sustainable growth by strengthening our existing customer relationships and attracting new customers. We intend to further penetrate existing customers by continuing to:

- provide quality products;
- fulfill logistical requirements and volume demands efficiently and consistently;
- provide comprehensive product support from design to after-market customer service;
- cross-sell our brands across various business segments to our customers;
- leverage strong, established distribution channels.

***Enter New Market Segments.*** To drive organic growth from our existing businesses, we will continue to leverage our customer relationships to develop or acquire new products and product extensions to enter into new market segments. In 2010, we signed a Strategic Cooperation Agreement with China Dongfang Electric Corporation (DEC), the biggest power generation equipment manufacturer of the world. The first order with DEC was over \$8 million. We were awarded as qualified nuclear safety grade valve supplier by National Energy Board. Besides the traditional local market, we have established sales headquarter in Shanghai to strengthen our market share in multi-national chemical companies and overseas oil and gas markets.

**Focus on High End Products.** We will keep focusing on high end, more sophisticated valve products, including high-parameter and special usage valves. The majority of valve companies in China focus only on low end products at lower prices. Because of our technology and R&D strength, we will continue focusing on high end valve products and pursuing higher margins than the industry average. Our 24-way rotary valves have been successfully used in PX, MX, petrochemical plants, and will now be used in chromatogram separation units of biological engineering. Our deep-water ball valve was put into production in 2011, and will be widely used in the deep-sea drilling platform. We also focus on exploring and commercializing new technologies in smart control, like intelligent interlock, remote flexible control, and intelligent alarm link. In many of our research areas, we are working with universities, institutes and experts in the appropriate fields to ensure that the latest technologies will be applied in our products and services.

**Strengthen Overseas Market.** We have integrated our direct sales teams and distributors in Europe, Russia, the Middle East, Central Asia and Southeast Asia, so that they will represent all of China Valves' products and services versus exclusively representing the products of ZD Valve or Hanwei Valve. We have participated in an increasing number of flow control exhibitions, and have upgraded our website so that overseas customers can reach us easily.

## OUR MANUFACTURING PROCESS

Our manufacturing process is a multi-step process involving the following tasks:

- purchasing and depositing of raw materials;
- raw material processing and analysis;
- production of inventory of semi-finished products (or transporting to the next step directly);
- product assembling;
- Painting; and
- product inspection and testing, and placing finished products in inventory.

Our modern computer aided design ("CAD") center can assist in the design of new products. We closely monitor and test the quality of raw materials, including casting steel blank parts, forging steel blank parts and steel. We use a high-speed direct reading spectrograph (32 channels) for the analysis of the chemical components of raw materials. We have cobalt 60y flaw detectors, high-power magnetic particle flaw detectors and ultrasonic flaw detectors, as well as non-destructive equipment that helps to ensure the internal quality of forging blank parts. We have a metal material test room for physical and chemical analysis and the mechanical testing of raw materials. In order to ensure a product's structural capability, we utilize high-precision equipment, including high-precision computer numerical control ("CNC") lathes and advanced welding equipment to satisfy the requirements of our product designs. We have modern product-processing workshops consisting mainly of CNC lathes and approximately 20 units of large-scale, high-precision equipment, including 4 m CNC vertical lathes, CNC horizontal lathes and CNC boring and milling machines. In addition, we have pressure equipment to conduct pressure testing for finished products in accordance with appropriate standards.

We have set up a comprehensive and reliable quality management system with strict material manufacturing procedures and standards of inspection. We have been adhering to a lean production principle. By continuously seeking to improve production, we eliminate non-value added activities, such as excessive waiting time throughout each manufacturing process, and improve design code standards, thus making the production cycle more efficient and reducing the time of products' delivery to our customers. Order-based productions reduce inventory and improve cash flow. In addition, workplace monitoring and certain rules to follow improve the manufacturing efficiency. Because of increasing efficiencies in our production cycle, we have quicker feedback from our customers about our products allowing us to make improvements for their next order.

We also purchased certain lower end valves from third parties produced under our technical specification in order to make up for under-capacity in our manufacturing facilities.

## **WARRANTIES**

We typically warranty all of our products and provide replacement or credit to our customers who are not satisfied with our products for a period of one year from the date of shipment. When we receive an indication that a product did not perform as expected, our quality control specialists and laboratory personnel test the product to determine if our process was correct for the specifications submitted by the customer and if the manufacturing process was completed as planned. If we failed to produce the product according to the customer's specifications or if the manufacturing process was flawed, we provide immediate credit to the customer. If we produced the product to the customer's specifications and if the manufacturing process was not flawed, we send a team to the customer's facilities to see if we can assist the customer in correcting his or her process. Typically a team consists of at least one engineer, at least one experienced production person and the customer's sales representative. If the product was manufactured to the proper specifications, our team works with the customer in developing corrective action to solve his or her problem.

We have not established reserve funds for potential customer claims because, historically, we have not experienced significant customer complaints about our products and none of our customers have requested damages for any loss incurred due to product quality problems. We believe that our customer support teams, our quality assurance and manufacturing monitoring procedures will continue to keep claims at a level that does not support a need for a reserve. We review customer returns on a monthly basis and may establish a reserve as we expand our business by volume and products. If we were to experience a significant increase in warranty claims, our financial results could be adversely affected. Please refer to "Risk Factors - Risks Related to Our Business". We do not maintain a reserve for warranty or defective products claims. Our costs could substantially increase if we experience a significant number of warranty claims.

## **SUPPLIERS OF OUR RAW MATERIALS**

The primary raw materials that are used in the production of these valves include carbon steel, stainless steel, low temperature steel and heat resistant steel, casting blank parts and actuating devices. The prices for such materials fluctuate depending upon market conditions. However, because we have long-term suppliers and clients, the influence of price fluctuations are not currently material to the Company.

We have established long-term relationships with key suppliers. However, we do not exclusively rely on our key suppliers. We have adopted a dual supplier system for raw materials. Therefore, if our primary suppliers cannot supply us with our raw material for any reason, we are able to seamlessly acquire the raw material from another supplier. All of our suppliers must meet our quality standards and delivery requirements consistently in order to remain on our approved supplier list. If deliveries are delayed repeatedly, we terminate the partnership with such supplier.

These flexible sourcing arrangements are designed to ensure the stable supply of raw material and promote healthy competition among our suppliers. We believe our supplier arrangements encourage our suppliers to provide advanced technology and high quality products.

## **SALES, MARKETING AND DISTRIBUTION**

We market our products through regional agents. We provide periodic training to our sales staff. Because we have direct communication with clients and participate in trade exhibitions, our sales staff has produced successful results. As a major supplier of valve products in China, we believe we have established a good reputation in our industry.

We market our products through various ways. Our six operating subsidiaries distribute their valves through two methods: (1) sell our valves directly to our customers through regional agents after winning project contracts through public bids. We provide periodic training to our sales staff with whom we have direct communication, and participate in trade exhibitions; (2) market our valves through approximately 50 distributors across the PRC and marketing headquarters in Shanghai which was set up in 2010. We hired experienced sales personnel who have significant sales and marketing experience from multinational valves companies such as Tyco and Flowserve. Moreover, a professional technical support team was established to enhance after-market service.

Each of the subsidiaries has similar types of customers. Valves produced by the six operating subsidiaries can be used in various industries, including but not limited to water supply, power supply, petrochemical and oil, and metallurgy. Each of the six operating subsidiaries has similar customer base with different industry focus. For instance, Kaifeng Valves sold 40%, 42%, 3% and 15% of their valves to customers in power supply industry, chemical industry, metallurgy industry and others respectively for the nine months ended September 30, 2011. ZD Valves sold 64%, 11%, 7%, 7%, and 11% of their valves to customers in water supply industry, petroleum and oil industry, power supply industry, metallurgy, and others respectively in the same period. Other four operating subsidiaries have the similar but different proportion components in term of customer industry.

Our sales revenue was approximately \$161.4 million for the nine months ended September 30, 2011.

## **OUR RESEARCH AND DEVELOPMENT EFFORTS**

China Valves' business is dependent on constantly improving the technology associated with developing and manufacturing valves. Therefore, China Valves has committed itself to the research and development of new valves and developing state of the art valves that improve and advance the valve industry. For the nine months ended September 30, 2011 and 2010, we invested a total of \$286,204 and \$181,861, respectively, to research and development efforts. For the years ended December 31, 2010 and 2009, we invested a total of \$228,858 and \$126,750 to research and development efforts, respectively. We also intend to increase the amount of resources we allocate to research and development as the Company continues to grow.

The Company currently has 303 engineering and support technicians and researchers dedicated to actively researching and developing new valves and participating in valve production and improvement. China Valves operates a research and development laboratory with Lanzhou Science and Engineering University (the only university in China that offers a major in valve development and manufacturing). We have also partnered with the Department of Valves Study of Hefei General Mechanical Institute to work to improve the development, manufacturing and quality of valves produced in China. In addition, we focus on the development of valves for nuclear power stations.

## **COMPETITORS**

We compete against a number of international and local valve manufacturers as well as specialized manufacturers on the basis of product capacity, product quality, breadth of product line, delivery, and price. Our major competitors vary by industry and region.

The following is a list of our major competitors in the valve industry:

- Hong Cheng Machinery Co., Ltd. – a manufacturer of medium pressure, big diameter butterfly valves for the water supply industry. We compete with them in the hydropower and fossil power industry.
- Sufa Technology Industry, Co., Ltd. – a leading manufacturer of nuclear safety grade valves. It has a broad product line, which includes on/off valves, control valves and specialized valves. We compete with them in nuclear power, petrochemical and refinery industries.
- Suzhou Neway Valve Co., Ltd. – a leading manufacturer of pipeline ball valves, API gate, globe, check and ball valves in China. Neway is a famous valve brand in the international market. We compete with them in oil and gas, petrochemical and chemical industries.
- Dalian DV Valve Co. Ltd. – a leading manufacturer of high pressure gate, globe and check valves. We compete with them in fossil and nuclear power industries.

There are, however, certain factors that we believe set us apart from all of our competitors, including the following:





- We are the first manufacturer of main stream gate valves for 300MW and main water supply gate valves for 600MW power stations in China;
- We are the sole domestic designer and manufacturer in China of valves that are used for ultra-critical units of 1000MW power stations;
- We are the first manufacturer of high pressure, large diameter oil pipeline valves in China;
- We are the first domestic manufacturer of 2,500lb high pressure gate valves for hydrogenation in chemical lines, which replace imported products;
- We are the first domestic manufacturer of high pressure, large diameter gate valves for the coal chemical industry;
- We are the sole manufacturer in China that produces all of the following: blowtorch valves, water pressure testing valves, steam controlling valves for high parameter power stations and bypass valves for high pressure heaters;
- We are one of the two suppliers in the world who can provide 24-way rotary; and
- We manufacture the most sizeable butterfly valve in China.

## **INTELLECTUAL PROPERTY**

We own the following six trademarks:

Our six operating subsidiaries own more than 50 patents for water supply and drainage pipes, supply and disposal pipes for water and gas, sewage disposal used for water and gas supply and drainage pipes, etc. The expiration dates for these patents range from 2011 to 2018.

We cannot give any assurance that the protection afforded our intellectual property will be adequate. It may be possible for third parties to obtain and use, without our consent, intellectual property that we own or are licensed to use. Unauthorized use of our intellectual property by third parties, and the expenses incurred in protecting our intellectual property rights, may adversely affect our business.

## **REGULATION**

Because our six operating subsidiaries are located in the PRC, we are regulated by the national and local laws of the PRC.

There is no private ownership of land in China and all land ownership is held by the government of the PRC, its agencies and collectives. Land use rights can be obtained from the government for a period up to 70 years and are typically renewable. Land use rights can be transferred upon approval by the land administrative authorities of the PRC (State Land Administration Bureau) upon payment of the required land transfer fee.

We are also subject to the PRC's foreign currency regulations. The PRC government has control over Renminbi reserves through, among other things, direct regulation of the conversion of Renminbi into other foreign currencies. Although foreign currencies that are required for current account transactions can be bought freely at authorized Chinese banks, the proper procedural requirements prescribed by Chinese law must be met. At the same time, Chinese

companies are also required to sell their foreign exchange earnings to authorized Chinese banks, and the purchase of foreign currencies for capital account transactions still requires prior approval of the Chinese government.

We do not face any significant government regulation in connection with the production of our products. We do not require any special government permits to produce our products other than those permits that are required of all corporations in China, such as those products used in nuclear power generation sector.

## OUR ADDRESS

The address of China Valves' principal executive office in China is No. 93 West Xinsong Road, Kaifeng City, Henan Province, People's Republic of China 475002 and our telephone number is (86) 378-2925211. Our head office in China is 21 F Kineer Plaza, 226 Jinshui Road, Zhengzhou City, Henan Province and our telephone number is (86) 371 65673777. We maintain a website at [www.cvalve.com](http://www.cvalve.com) that contains information about us, but that information is not a part of this Annual Report.

### **Item 1A. Risk Factors.**

*These risk factors should be considered in connection with any subsequent written or oral forward-looking statements that we or persons acting on our behalf may issue. All written and oral forward looking statements made in connection with this Report that are attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. Given these uncertainties, we caution investors not to unduly rely on our forward-looking statements. We do not undertake any obligation to review or confirm analysts' expectations or estimates or to release publicly any revisions to any forward-looking statements to reflect events or circumstances after the date of this document or to reflect the occurrence of unanticipated events. Further, the information about our intentions contained in this document is a statement of our intention as of the date of this document and is based upon, among other things, the existing regulatory environment, industry conditions, market conditions and prices, the economy in general and our assumptions as of such date. We may change our intentions, at any time and without notice, based upon any changes in such factors, in our assumptions or otherwise.*

## RISKS RELATED TO OUR BUSINESS

*Our business would be adversely affected by a downturn in government spending related to infrastructure upgrades, repairs and replacements, or by reduced demand in the power, petrochemical, oil or water supply industries.*

Our business is primarily dependent upon spending on new infrastructure projects, as well as infrastructure upgrades, repairs and replacement, in the power, petrochemical, oil and water supply industries. We are also subject to general economic conditions, the need for large-scale projects, interest rates and government incentives provided for public work projects. It is not unusual for projects in power, petrochemical, oil or water supply industries to be delayed and rescheduled for a number of reasons, including changes in project priorities and difficulties in complying with environmental and other government regulations. We cannot assure you that economic growth experienced by China will continue or that if it does, state and local governments will address deferred infrastructure needs. Any significant decline in the project spending in the key industries or governmental spending on infrastructure could have a material adverse effect on our financial condition and results of operations.

*Our industry is very competitive in China.*

The domestic market for valve products is fragmented and highly competitive. We compete with over 160 medium-sized, local Chinese valve manufacturers, although we are aware of only two that have similar manufacturing capacities as our company. The number of these companies varies from time to time. While we may have greater resources than our smaller competitors, it is possible that these competitors have better access in certain local markets to customers and prospects and lower production and raw material costs. Some of our valve products compete on the basis of price and are sold in fragmented markets with low barriers to entry, allowing less expensive domestic producers to gain market share and reduce our margins.

*Our revenue will decrease if the industries in which our customers operate experience a protracted slowdown.*

Our products mainly serve as key components in projects and machines operated by our customers which are mostly in the oil, power, water supply, petrochemical, and metallurgy industries. Therefore, we are subject to the general changes in economic conditions affecting those industry segments of the economy. If the industry segments in which our customers operate do not grow or if there is a contraction in those industries, demand for our valve products will decrease. Demand for our products is typically affected by a number of overarching economic factors, including, but not limited to, interest rates, the availability and magnitude of private and governmental investment in infrastructure projects and the health of the overall global economy. If there is a decline in economic activity in China and the other markets in which we operate or a protracted slowdown in industries on which we rely for our sales, demand for our products and our revenue will likewise decrease.

***Foreign competition is intense and could have a material adverse effect on our financial condition and results of operations.***

In addition to domestic competition, we face intense competition from foreign competitors. The intensity of foreign competition is affected significantly by fluctuations in the value of the U.S. dollar against Chinese currency and by the level of import duties imposed by the Chinese government on certain products. Our major international competitors are Velan Inc., KSB Group and Tyco Flow Inc. Many of our competitors have more resources and greater brand recognition than we enjoy. If our competitors are able to gain greater market share or improve their sales efforts, our sales may decrease, we may be forced to lower our prices, or our marketing costs may increase, all of which could negatively impact our financial results.

***Any decline in the availability, or increase in the costs of raw materials could materially affect our earnings.***

Our valve manufacturing operations depend heavily on the availability of various raw materials and energy resources. The mix of raw materials used in the production of valves is mainly composed of casting steel blank parts, forging steel blank parts and steel, which represent 60% of all raw materials used in the production of valves. The fuel costs in our manufacturing operations, particularly heavy oil and electricity, account for over 2% of total manufacturing costs. The availability of raw materials and energy resources may decline and their prices may fluctuate greatly. We have long-term relationships with several suppliers; however, we do not have long term supply contracts and if our suppliers are unable or unwilling to provide us with raw materials on terms favorable to us, we may be unable to produce certain products. This could result in a decrease in profit and damage to our reputation in our industry. In the event our raw material and energy costs increase, we may not be able to pass these higher costs on to our customers in full or at all. Any increase in the prices for raw materials or energy resources could materially increase our costs and therefore lower our earnings.

***We depend on a group of major distributors for a significant portion of our sales; any loss of these distributors could reduce our sales and continuing consolidation of distributors could cause price pressure.***

In 2011, approximately 76% of our sales revenue was generated from our direct sales teams throughout China and 24% was generated from our distributors. Sales through distributors were highly concentrated in a few distributors, with 60% of distributor sales coming from our ten largest distributors, and 40% from the three largest distributors. Our business relationships with most of our major distributor branches may be terminated at the option of either party upon 30 days' notice.

Although our relationships with our ten largest distributors have been long-lasting, distributors in our industry have experienced significant consolidation in recent years, and we cannot assure you that our distributors will not be acquired by other distributors who buy products from our competitors. Our ability to retain these customers in the face of other competitors generally depends on a variety of factors, including the quality and price of our products and our ability to market these products effectively. We cannot assure you that, as consolidation among distributors continues, distributors will not be able to force us to lower our prices, which would have an adverse impact on our financial condition or results of operations.

***Any disruption in the supply chain of raw materials and our products could adversely impact our ability to produce and deliver products.***

As a manufacturing company, we face serious challenges in supply chain management for raw materials and delivery of our products. Supply chain fragmentation and local protectionism within China further complicates supply chain disruption risks. Local administrative bodies and physical infrastructure built to protect local interests pose transportation challenges for raw material transportation as well as product delivery. In addition, profitability and volume could be negatively impacted by limitations inherent within the supply chain, including competitive, governmental, legal, natural disasters, and other events that could impact both supply and price. Any of these

occurrences could cause significant disruptions to our supply chain, manufacturing capability and distribution system that could adversely impact our ability to produce and deliver products.

***We do not maintain a reserve for warranty or defective products claims. Our costs could substantially increase if we experience a significant number of warranty claims.***

We typically warrant all of our products and provide replacement or credit to our customers who are not satisfied with our products for a period of one year from the date of shipment. We have not established a reserve for potential customer claims because, historically, we have not experienced significant customer complaints about our products and none of our customers have requested damages for any loss incurred due to product quality problems.

We believe that our customer support teams, our quality assurance and manufacturing monitoring procedures will continue to keep claims at a level that does not support a need for a reserve. However, if we were to experience a significant increase in warranty claims, our financial results could be adversely affected.

***Our rapid expansion could significantly strain our resources, management and operational infrastructure which could impair our ability to meet increased demand for our products and hurt our business results***

To accommodate our anticipated growth, we will need to expend capital resources and dedicate personnel to implement and upgrade our accounting, operational and internal management systems and enhance our record keeping and contract tracking system. Such measures will require us to dedicate additional financial resources and personnel to optimize our operational infrastructure and to recruit more personnel to train and manage our growing employee base. If we cannot successfully implement these measures efficiently and cost-effectively, we will be unable to satisfy the demand for our products, which will impair our revenue growth and hurt our overall financial performance.

***We must manage growth in operations to maximize our potential growth and achieve our expected revenues and any failure to manage growth will cause a disruption of our operations and impair our ability to generate revenue.***

In order to maximize potential growth in our current and potential markets, we believe that we must expand the scope of our valve manufacturing and production facilities and capabilities and continue to develop new and improved valves. This expansion will place a significant strain on our management and our operational, accounting, and information systems. We expect that we will need to continue to improve our financial controls, operating procedures and management information systems. We will also need to effectively train, motivate and manage our employees. Our failure to manage our growth could disrupt our operations and ultimately prevent us from generating the revenues we expect.

***We cannot assure you that our internal growth strategy will be successful, which may result in a negative impact on our growth, financial condition, results of operations and cash flow.***

One of our strategies is to grow internally through increasing the development of new products, as we continue to improve the quality of existing products. However, many obstacles to this expansion exist, including, but not limited to, increased competition from similar businesses, our ability to improve our products and product mix to realize the benefits of our research and development efforts, international trade and tariff barriers, unexpected costs, costs associated with marketing efforts abroad and maintaining attractive foreign exchange rates. We cannot, therefore, assure you that we will be able to successfully overcome such obstacles and establish our services in any additional markets. Our inability to implement this internal growth strategy successfully may have a negative impact on our growth, future financial condition, results of operations or cash flows.

***We cannot assure you that our acquisition growth strategy will be successful, resulting in our failure to meet growth and revenue expectations.***

In addition to our internal growth strategy, we have also explored the possibility of growing through strategic acquisitions. We intend to pursue opportunities to acquire businesses in the PRC that are complementary or related in product lines and business structure to us. We may not be able to locate suitable acquisition candidates at prices that we consider appropriate or to finance acquisitions on terms that are satisfactory to us. If we do identify an appropriate acquisition candidate, we may not be able to negotiate successfully the terms of an acquisition, or, if the acquisition occurs, integrate the acquired business into our existing business. Acquisitions of businesses or other material operations may require debt financing or additional equity financing, resulting in leverage or dilution of ownership. Integration of acquired business operations could disrupt our business by diverting management away from day-to-day operations. The difficulties of integration may be increased by the necessity of coordinating geographically dispersed organizations, integrating personnel with disparate business backgrounds and combining different corporate cultures.



We also may not be able to retain key employees or customers of an acquired business or realize cost efficiencies or synergies or other benefits we anticipated when selecting our acquisition candidates. In addition, we may need to record write-downs from future impairments of intangible assets, which could reduce our future reported earnings. At times, acquisition candidates may have liabilities or adverse operating issues that we fail to discover through due diligence prior to the acquisition. In addition to the above, acquisitions in the PRC, including state owned businesses, will be required to comply with the laws of the PRC, to the extent applicable. There can be no assurance that any given proposed acquisition will be able to comply with PRC requirements, rules and/or regulations, or that we will successfully obtain governmental approvals that are necessary to consummate such acquisitions, to the extent required. If our acquisition strategy is unsuccessful, we will not grow our operations and revenues at the rate that we anticipate.

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***We may have difficulty defending our intellectual property rights from infringement, resulting in lawsuits requiring us to devote financial and management resources that would have a negative impact on our operating results.***

We regard our service marks, trademarks, trade secrets, patents and similar intellectual property as critical to our success. We rely on trademark, patent and trade secret law, as well as confidentiality and license agreements with certain of our employees, customers and others to protect our proprietary rights. We have received patent protection for certain of our products in the PRC. No assurance can be given that our patents, trademarks and licenses will not be challenged, invalidated, infringed or circumvented, or that our intellectual property rights will provide competitive advantages to us. There can be no assurance that we will be able to obtain a license from a third-party for technology that we may need to conduct our business or that such technology can be licensed at a reasonable cost.

Presently, we provide our valves mainly in the PRC. To date, no trademark or patent filings have been made other than in the PRC. To the extent that we market our services in other countries, we may have to take additional action to protect our intellectual property. The measures we take to protect our proprietary rights may be inadequate and we cannot give you any assurance that our competitors will not independently develop formulations, processes and services that are substantially equivalent or superior to our own or copy our products.

***We depend on our key management personnel and the loss of their services could adversely affect our business.***

We place substantial reliance upon the efforts and abilities of our executive officers. The loss of the services of any of our executive officers could have a material adverse effect on our business, operations, revenues or prospects. We do not maintain key man life insurance on the lives of these individuals.

***We may incur significant costs to ensure compliance with United States corporate governance and accounting requirements.***

We may incur significant costs associated with our public company reporting requirements, costs associated with corporate governance requirements, including requirements under the Sarbanes-Oxley Act of 2002 and other rules implemented by the Securities and Exchange Commission. We expect all of these applicable rules and regulations to significantly increase our legal and financial compliance costs and to make some activities more time consuming and costly. We also expect that these applicable rules and regulations may make it more difficult and more expensive for us to obtain director and officer liability insurance and we may be required to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. As a result, it may be more difficult for us to attract and retain qualified individuals to serve on our board of directors or as executive officers. We are currently evaluating and monitoring developments with respect to these rules and regulations, and we cannot predict or estimate the amount of additional costs we may incur or the timing of such costs.

***We may not be able to meet the accelerated filing and internal control reporting requirements imposed by the Securities and Exchange Commission, resulting in a possible decline in the price of our common stock and our inability to obtain future financing.***

Companies that file reports with the SEC, including us, are subject to the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, or SOX 404. SOX 404 requires management to establish and maintain a system of internal control over financial reporting and annual reports on Form 10-K filed under the Exchange Act to contain a report from management assessing the effectiveness of a company's internal control over financial reporting. Separately, under SOX 404, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, public companies that are large accelerated or accelerated filers must include in their annual reports on Form 10-K an attestation report of their regular auditors attesting to and reporting on management's assessment of internal control over financial reporting.

Although we continue to expend significant resources in developing the necessary documentation and testing procedures required by Section 404 of the Sarbanes-Oxley Act, there is a risk that we may not be able to comply timely with all of the requirements imposed by this rule. In the event that we are unable to receive a positive attestation from our independent registered public accounting firm with respect to our internal controls, investors and others may lose confidence in the reliability of our financial statements and our stock price and ability to obtain equity or debt financing as needed could suffer.

In addition, in the event that our independent registered public accounting firm is unable to rely on our internal controls in connection with its audit of our financial statements, and in the further event that it is unable to devise alternative procedures in order to satisfy itself as to the material accuracy of our financial statements and related disclosures, it is possible that we would be unable to file our Annual Report on Form 10-K with the Securities and Exchange Commission, which could also adversely affect the market price of our common stock and our ability to secure additional financing as needed.

***We may have difficulty raising necessary capital to fund operations as a result of market price volatility for our shares of common stock.***

In recent years, the securities markets in the United States have experienced a high level of price and volume volatility, and the market price of securities of many companies has experienced wide fluctuations that have not necessarily been related to the operations, performance, underlying asset values or prospects of such companies. For these reasons, our shares of common stock can also be expected to be subject to volatility resulting from purely market forces over which we will have no control. If our business development plans are successful, we may require additional financing to continue to develop and exploit existing and new products and services related to our industries and to expand into new markets. The expansion of our products and services may, therefore, be dependent upon our ability to obtain financing through debt and equity or other means.

***Failure to comply with the United States Foreign Corrupt Practices Act and Chinese anti-corruption laws could subject us to penalties and other adverse consequences.***

We are subject to the United States Foreign Corrupt Practices Act, or FCPA, which generally prohibits U.S. companies and their intermediaries from engaging in bribery or other prohibited payments to foreign officials for the purpose of obtaining or retaining business or otherwise obtaining favorable treatment. In addition, we are required to maintain records that accurately and fairly represent our transactions and have an adequate system of internal accounting controls. The PRC also strictly prohibits bribery of government officials. Our activities in China create the risk of unauthorized payments or offers of payments by our employees, independent contractors, subcontractors or agents of our Company, even though they may not always be subject to our control.

We are currently in the process of developing and implementing formal controls and procedures to ensure that we are in compliance with the FCPA, China's anti-corruption laws, and similar sanctions, laws and regulations. The implementation of such procedures may be time consuming and expensive, and could result in the discovery of issues or violations with respect to the foregoing by us or our employees, independent contractors, subcontractors or agents of which we were previously unaware. If our employees, independent contractors, subcontractors or agents are found to have engaged in such practices, we could suffer severe penalties and other consequences that may have a material adverse effect on our business, financial condition and results of operations. In addition, our brand and reputation, our sales activities or our stock price could be adversely affected if we become the target of any negative publicity as a result of actions taken by our employees or other agents.

## **RISKS RELATED TO DOING BUSINESS IN CHINA**

***Adverse changes in political and economic policies of the PRC government could impede the overall economic growth of China, which could reduce the demand for our products and damage our business.***

We conduct substantially all of our operations and generate most of our revenue in China. Accordingly, our business, financial condition, results of operations and prospects are affected significantly by economic, political and legal developments in China. The PRC economy differs from the economies of most developed countries in many respects, including:

- a higher level of government involvement;

- an early stage of development of the market-oriented sector of the economy;
- a rapid growth rate;
- a higher level of control over foreign exchange; and
- the control over the allocation of resources.

As the PRC economy has been transitioning from a planned economy to a more market-oriented economy, the PRC government has implemented various measures to encourage economic growth and guide the allocation of resources. Although these measures may benefit the overall PRC economy, they may also have a negative effect on us.

Although the PRC government has in recent years implemented measures emphasizing the utilization of market forces for economic reform, the PRC government continues to exercise significant control over economic growth in China through the allocation of resources, controlling the payment of foreign currency-denominated obligations, setting monetary policy and imposing policies that impact particular industries or companies in different ways.

Any adverse change in economic conditions or government policies in China could have a material adverse effect on the overall economic growth in China, which in turn could lead to a reduction in demand for our products and services and consequently have a material adverse effect on our business and prospects.

***Uncertainties with respect to the PRC legal system could limit the legal protections available to you and us.***

We conduct substantially all of our business through our operating subsidiaries in the PRC. Our operating subsidiaries are generally subject to laws and regulations applicable to foreign investments in China and, in particular, laws applicable to foreign-invested enterprises. The PRC legal system is based on written statutes, and prior court decisions may be cited for reference but have limited precedential value. Since 1979, a series of new PRC laws and regulations have significantly enhanced the protections afforded to various forms of foreign investments in China. However, since the PRC legal system continues to rapidly evolve, the interpretations of many laws, regulations and rules are not always uniform and enforcement of these laws, regulations and rules involve uncertainties, which may limit legal protections available to you and us. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention. In addition, all of our executive officers and all of our directors are residents of China and not of the United States, and substantially all the assets of these persons are located outside the United States.

As a result, it could be difficult for investors to effect service of process in the United States or to enforce a judgment obtained in the United States against our Chinese operations and subsidiaries.

***If we are found to have failed to comply with applicable laws, we may incur additional expenditures or be subject to significant fines and penalties.***

Our operations are subject to PRC laws and regulations applicable to us. However, many PRC laws and regulations are uncertain in their scope, and the implementation of such laws and regulations in different localities could have significant differences. In certain instances, local implementation rules and/or the actual implementation are not necessarily consistent with the regulations at the national level. Although we strive to comply with all the applicable PRC laws and regulations, we cannot assure you that the relevant PRC government authorities will not later determine that we have not been in compliance with certain laws or regulations.

Our failure to comply with the applicable laws and regulations in China could subject us to administrative penalties and injunctive relief, as well as civil remedies, including fines, injunctions and recalls of our products. It is possible that changes to such laws or more rigorous enforcement of such laws or with respect to our current or past practices could have a material adverse effect on our business, operating results and financial condition. Further, additional environmental, health or safety issues relating to matters that are not currently known to management may result in unanticipated liabilities and expenditures.

***The PRC government exerts substantial influence over the manner in which we must conduct our business activities.***

The PRC government has exercised and continues to exercise substantial control over virtually every sector of the Chinese economy through regulation and state ownership. Our ability to operate in China may be harmed by changes in its laws and regulations, including those relating to taxation, import and export tariffs, environmental regulations, land use rights, property and other matters. We believe that our operations in China are in material compliance with all applicable legal and regulatory requirements. However, the central or local governments of the jurisdictions in which we operate may impose new, stricter regulations or interpretations of existing regulations that would require additional expenditures and efforts on our part to ensure our compliance with such regulations or interpretations. Accordingly, government actions in the future, including any decision not to continue to support recent economic reforms and to return to a more centrally planned economy or regional or local variations in the implementation of economic policies, could have a significant effect on economic conditions in China or particular regions thereof and could require us to divest ourselves of any interest we then hold in Chinese properties or joint ventures.

***Restrictions on currency exchange may limit our ability to receive and use our sales revenue effectively.***

All our sales revenue and expenses are denominated in RMB. Under PRC law, the RMB is currently convertible under the “current account” which includes dividends and trade and service-related foreign exchange transactions, but not under the “capital account” which includes foreign direct investment and loans. Currently, our PRC operating subsidiary may purchase foreign currencies for settlement of current account transactions, including payments of dividends to us, without the approval of the State Administration of Foreign Exchange (“SAFE”) by complying with certain procedural requirements. However, the relevant PRC government authorities may limit or eliminate our ability to purchase foreign currencies in the future. Because a significant amount of our future revenue will be denominated in RMB, any existing and future restrictions on currency exchange may limit our ability to utilize revenue generated in RMB to fund our business activities outside China that are denominated in foreign currencies.

Foreign exchange transactions by PRC operating subsidiaries under the capital account continue to be subject to significant foreign exchange controls and require the approval of or need to register with PRC government authorities, including SAFE. In particular, if our PRC operating subsidiaries borrow foreign currency through loans from us or other foreign lenders, these loans must be registered with SAFE, and if we finance the subsidiaries by means of additional capital contributions, these capital contributions must be approved by certain government authorities, including the Ministry of Commerce (“MOFCOM”) or their respective local counterparts. These limitations could affect our ability to obtain foreign exchange through debt or equity financing.

***Fluctuations in exchange rates could adversely affect our business and the value of our securities.***

The value of our common stock will be indirectly affected by the foreign exchange rate between U.S. dollars and RMB and between those currencies and other currencies in which our sales may be denominated. Because substantially all of our earnings and cash assets are denominated in RMB and the net proceeds from our August 2008 private placement were, and the proceeds we receive from the exercise of warrants we have issued if and when those warrants are exercised for cash will be, denominated in U.S. dollars, fluctuations in the exchange rate between the U.S. dollar and the RMB will affect the relative purchasing power of these proceeds, our balance sheet and our earnings per share in U.S. dollars. In addition, appreciation or depreciation in the value of the RMB relative to the U.S. dollar would affect our financial results reported in U.S. dollar terms without giving effect to any underlying change in our business or results of operations. Although we have no current intention to pay any dividends in the foreseeable future, fluctuations in the exchange rate would also affect the relative value of any dividend we issue that will be exchanged into U.S. dollars as well as earnings from, and the value of, any U.S. dollar-denominated investments we make in the future.

Since July 2005, the RMB has no longer been pegged to the U.S. dollar. Although the People’s Bank of China regularly intervenes in the foreign exchange market to prevent significant short-term fluctuations in the exchange rate, the RMB may appreciate or depreciate significantly in value against the U.S. dollar in the medium to long term. Moreover, it is possible that in the future PRC authorities may lift restrictions on fluctuations in the RMB exchange rate and lessen intervention in the foreign exchange market.

Very limited hedging transactions are available in China to reduce our exposure to exchange rate fluctuations. To date, we have not entered into any hedging transactions. Although we may enter into hedging transactions in the future, the availability and effectiveness of these transactions may be limited, and we may not be able to successfully hedge our exposure at all. In addition, our foreign currency exchange losses may be magnified by PRC exchange control regulations that restrict our ability to convert RMB into foreign currencies.

Currently, some of our raw materials and major equipment are imported. In the event that the U.S. dollar appreciates against the RMB, our costs will increase. If we cannot pass the resulting cost increases on to our customers, our profitability and operating results will suffer. In addition, because our sales to international customers are growing rapidly, we are increasingly subject to the risk of foreign currency depreciation.





***Future inflation in China may inhibit our ability to conduct business in China.***

In recent years, the Chinese economy has experienced periods of rapid expansion and highly fluctuating rates of inflation. During the past ten years, the rate of inflation in China has been as high as 5.9% and as low as -0.8% . These factors have led the Chinese government to adopt, from time to time, various corrective measures designed to restrict the availability of credit or regulate growth and contain inflation. High inflation may in the future cause the Chinese government to impose controls on credit and/or prices, or to take other action, which could inhibit economic activity in China, and thereby harm the market for our products and our company.

***Restrictions under PRC law on our PRC subsidiaries' ability to make dividends and other distributions could materially and adversely affect our ability to grow, make investments or acquisitions that could benefit our business, pay dividends to our shareholders, and otherwise fund and conduct our businesses.***

Substantially all of our revenues are earned by our PRC subsidiaries. However, PRC regulations restrict the ability of our PRC subsidiaries to make dividends and other payments to their offshore parent company. PRC legal restrictions permit payments of dividends by our PRC subsidiaries only out of their accumulated after-tax profits, if any, determined in accordance with PRC accounting standards and regulations. Each of our PRC subsidiaries is also required under PRC laws and regulations to allocate at least 10% of its annual after-tax profits, determined in accordance with PRC GAAP, to a statutory general reserve fund until the amounts in said fund reaches 50% of our registered capital. Allocations to these statutory reserve funds can only be used for specific purposes and are not transferable to us in the form of loans, advances or cash dividends.

Any limitations on the ability of our PRC subsidiaries to transfer funds to us could materially and adversely limit our ability to grow, make investments or acquisitions that could be beneficial to our business, pay dividends and otherwise fund and conduct our business.

***Under the New EIT Law, China Valves Technology Inc. and its subsidiaries China Fluid Equipment and Henan Tonghai Fluid may be classified as a "resident enterprise" of China. Such a classification would likely result in unfavorable tax consequences to us and our non-PRC stockholders.***

China passed a new Enterprise Income Tax Law, or the New EIT Law. The new law and its implementing rules both became effective on January 1, 2008. Under the New EIT Law, an enterprise established outside of China with "de facto management bodies" within China is considered a "resident enterprise" meaning that it can be treated in a manner similar to a Chinese enterprise for enterprise income tax purposes. The implementing rules of the New EIT Law define de facto management as "substantial and overall management and control over the production and operations, personnel, accounting, and properties" of the enterprise. Because the New EIT Law and its implementing rules are new, no official interpretation or application of this new "resident enterprise" classification is available. Therefore, it is unclear how tax authorities will determine tax residency based on the facts of each case.

Our operating subsidiaries Kaifeng Valve, ZD Valve, Taizhou Taide Valve, Yangzhou Valve, Changsha Valve, and Shanghai Hanwei Valve are already designated as "resident enterprises" for PRC enterprise income tax purposes. However, if the PRC tax authorities determine that China Valves Technology Inc. and its subsidiaries China Fluid Equipment and Henan Tonghai Fluid are also "resident enterprises" for PRC enterprise income tax purposes, a number of unfavorable PRC tax consequences could follow. First, we may be subject to the enterprise income tax at a rate of 25% on our worldwide taxable income as well as PRC enterprise income tax reporting obligations. In our case, this would mean that income such as interest on offering proceeds and non-China source income would be subject to PRC enterprise income tax at a rate of 25%. Second, although under the New EIT Law and its implementing rules dividends paid to us from our PRC subsidiaries would qualify as "tax-exempt income," we cannot guarantee that such dividends will not be subject to a 10% withholding tax, as the PRC foreign exchange control authorities, which enforce the withholding tax, have not yet issued guidance with respect to the processing of outbound remittances to entities that are treated as resident enterprises for PRC enterprise income tax purposes. Finally, it is possible that

future guidance issued with respect to the new “resident enterprise” classification could result in a situation in which a 10% withholding tax is imposed on dividends we pay to our non-PRC stockholders and with respect to gains derived by our non-PRC stockholders from transferring our shares. We are actively monitoring the possibility of “resident enterprise” treatment for the 2011 tax year and are evaluating appropriate organizational changes to avoid this treatment, to the extent possible.

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If we were treated as a “resident enterprise” by PRC tax authorities, we would be subject to taxation in both the U.S. and China, and our PRC tax may not be credited against our U.S. tax.

***If the China Securities Regulatory Commission, or CSRC, or another PRC regulatory agency determines that CSRC approval is required in connection with our 2007 reverse acquisition, the reverse acquisition may be cancelled, or we may become subject to penalties.***

On August 8, 2006, six PRC regulatory agencies, including the CSRC, promulgated the Provisions Regarding Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (the “M&A Rule”) which became effective on September 8, 2006. The M&A Rule, among other things, requires that an offshore company controlled by PRC companies or individuals that have acquired a PRC domestic company for the purpose of listing the PRC domestic company’s equity interest on an overseas stock exchange must obtain the approval of the CSRC prior to the listing and trading of such offshore company’s securities on an overseas stock exchange. On September 21, 2006, the CSRC, pursuant to the M&A Rule, published on its official website procedures specifying documents and materials required to be submitted to it by offshore companies seeking CSRC approval of their overseas listings.

Because we did not obtain authorities approval for our 2007 reverse acquisition, if the CSRC or another PRC governmental agency subsequently determines that we must obtain CSRC approval of the reverse acquisition, we may face regulatory actions or other sanctions from the CSRC or other PRC regulatory agencies. These regulatory agencies may impose fines and penalties on our operations in China and limit our operating privileges in China, or take other actions that could have a material adverse effect on our business, financial condition, results of operations, reputation and prospects, as well as the trading price of our shares.

***The M&A Rule establishes more complex procedures for some acquisitions of Chinese companies by foreign investors, which could make it more difficult for us to pursue growth through acquisitions in China.***

The M&A Rule establishes additional procedures and requirements that could make some acquisitions of Chinese companies by foreign investors more time-consuming and complex, including requirements in some instances that the PRC Ministry of Commerce be notified in advance of any change-of-control transaction and in some situations, require approval of the PRC Ministry of Commerce when a foreign investor takes control of a Chinese domestic enterprise. In the future, we may grow our business in part by acquiring complementary businesses, although we do not have any plans to do so at this time. The M&A Rule also requires PRC Ministry of Commerce anti-trust review of any change-of-control transactions involving certain types of foreign acquirers. Complying with the requirements of the M&A Rule to complete such transactions could be time-consuming, and any required approval processes, including obtaining approval from the PRC Ministry of Commerce, may delay or inhibit our ability to complete such transactions, which could affect our ability to expand our business or maintain our market share.

***You may have difficulty enforcing judgments against us.***

We are a Nevada holding company and most of our assets are located outside of the United States. All of our current operations are conducted in the PRC. In addition, nearly all of our directors and officers are nationals and residents of countries other than the United States. A substantial portion of the assets of these persons is located outside the United States. As a result, it may be difficult for you to effect service of process within the United States upon these persons. It may also be difficult for you to enforce in U.S. courts judgments on the civil liability provisions of the U.S. federal securities laws against us and our officers and directors, most of whom are not residents in the United States and the substantial majority of whose assets are located outside of the United States. In addition, there is uncertainty as to whether the courts of the PRC would recognize or enforce judgments of U.S. courts. Courts in China may recognize and enforce foreign judgments in accordance with the requirements of the PRC Civil Procedures Law based on treaties between China and the country where the judgment is made or on reciprocity between jurisdictions. China does not have any treaties or other arrangements that provide for the reciprocal recognition and enforcement of foreign judgments with the United States. In addition, according to the PRC Civil Procedures Law, courts in the PRC will not

enforce a foreign judgment against us or our directors and officers if they decide that the judgment violates basic principles of PRC law or national sovereignty, security or the public interest. Accordingly, it is uncertain whether a PRC court would enforce a judgment rendered by a court in the United States.

## **RISKS RELATED TO THE MARKET FOR OUR STOCK**

*Although publicly traded, the trading market in our common stock has been substantially less liquid than the average trading market for a stock quoted on the Nasdaq Stock Market and this low trading volume may adversely affect the price of our common stock.*

Our common stock started trading on the Nasdaq Global Market under the symbol “CVVT” in November 2009. The trading volume of our common stock has been comparatively low to other companies listed on Nasdaq. Limited trading volume will subject our shares of common stock to greater price volatility and may make it difficult for you to sell your shares of common stock at a price that is attractive to you.

*The market price of our common stock is volatile, leading to the possibility of its value being depressed at a time when you want to sell your holdings.*

The market price of our common stock is volatile, and this volatility may continue. Numerous factors, many of which are beyond our control, may cause the market price of our common stock to fluctuate significantly. These factors include:

- our earnings releases, actual or anticipated changes in our earnings, fluctuations in our operating results or our failure to meet the expectations of financial market analysts and investors;
- changes in financial estimates by us or by any securities analysts who might cover our stock;
- speculation about our business in the press or the investment community;
- significant developments relating to our relationships with our customers or suppliers;
- stock market price and volume fluctuations of other publicly traded companies and, in particular, those that are in the steel industries;
- customer demand for our products;
- investor perceptions of the steel industries in general and our company in particular;

Securities class action litigation is often instituted against companies following periods of volatility in their stock price. This type of litigation could result in substantial costs to us and divert our management’s attention and resources. Moreover, securities markets may from time to time experience significant price and volume fluctuations for reasons unrelated to operating performance of particular companies. These market fluctuations may adversely affect the price of our common stock and other interests in our company at a time when you want to sell your interest in us.

*We do not intend to pay dividends for the foreseeable future.*

For the foreseeable future, we intend to retain any earnings to finance the development and expansion of our business, and we do not anticipate paying any cash dividends on our common stock. Accordingly, investors must be prepared to rely on sales of their common stock after price appreciation to earn an investment return, which may never occur. Investors seeking cash dividends should not purchase our common stock. Any determination to pay dividends in the future will be made at the discretion of our board of directors and will depend on our results of operations, financial condition, contractual restrictions, restrictions imposed by applicable law and other factors our board deems relevant such as:

- the operating and stock performance of comparable companies;
- general economic conditions and trends;
- major catastrophic events;
- announcements by us or our competitors of new products, significant acquisitions, strategic partnerships or divestitures;
- changes in accounting standards, policies, guidance, interpretation or principles;
- loss of external funding sources;

- sales of our common stock, including sales by our directors, officers or significant stockholders; and
- additions or departures of key personnel.

***Techniques Employed by Manipulative Short Sellers on Chinese Stocks May Drive Down the Market Price of Our Common Stock***

Short selling is the practice of selling securities that the seller does not own but rather has, supposedly, borrowed from a third party with the intention of buying identical securities back at a later date to return to the lender. The short seller hopes to profit from a decline in the value of the securities between the sale of the borrowed securities and the purchase of the replacement shares, as the short seller expects to pay less in that purchase than it received in the sale. As it is therefore in the short seller's best interests for the price of the stock to decline, a number of short sellers (sometimes known as "disclosed shorts") publish, or arrange for the publication of, negative opinions regarding the relevant issuer and its business prospects in order to create negative market momentum and generate profits for themselves after selling a stock short. While traditionally these disclosed shorts were limited in their ability to access mainstream business media or to otherwise create negative market rumors, the rise of the Internet and technological advancements regarding document creation, videotaping and publication by weblog ("blogging") have allowed many disclosed shorts to publicly attack a company's credibility, strategy and veracity by means of so-called research reports that mimic the type of investment analysis performed by large Wall Street firms and independent research analysts. These short attacks have, in the past, led to selling of shares in the market, on occasion in large scale and broad base. Issuers with business operations based in the PRC and who have limited trading volumes and are susceptible to higher volatility levels than U.S. domestic large-cap stocks, can be particularly vulnerable to such short attacks.

These short seller publications are not regulated by any governmental, self-regulatory organization or other official authority in the U.S., are not subject to the certification requirements imposed by the Securities and Exchange Commission in Regulation AC (Regulation Analyst Certification) and, accordingly, the opinions they express may be based on distortions of actual facts or, in some cases, fabrications of facts. In light of the limited risks involved in publishing such information, and the enormous profit that can be made from running just one successful short attack, unless the short sellers become subject to significant penalties, it is more likely than not that disclosed shorts will continue to issue such reports.

While we intend to strongly defend our public filings against any such short seller attacks, oftentimes we are constrained, either by principles of freedom of speech, applicable state law (often called "Anti-SLAPP statutes"), or issues of commercial confidentiality, in the manner in which we can proceed against the relevant short seller. You should be aware that in light of the relative freedom to operate that such persons enjoy—oftentimes blogging from outside the U.S. with little or no assets or identity requirements—should we be targeted for such an attack, our stock will likely suffer from a temporary, or possibly long term, decline in market price should the rumors created not be dismissed by market participants.

**Item 1B. Unresolved Staff Comments.**

Not applicable.

**Item 2. Properties.**

There is no private ownership of land in China and all land ownership is held by the government of the PRC, its agencies and collectives. Land use rights can be obtained from the government for a period up to 70 years and are typically renewable. Land use rights can be transferred upon approval by the land administrative authorities of the PRC (State Land Administration Bureau) upon payment of the required land transfer fee.

We did not previously own the building and land of Kaifeng Valve we operate on. Those buildings and the land use rights were owned by the Casting Company, one of our major suppliers and the land use rights and the buildings from which Kaifeng Valve operates were leased from the Casting Company. The Casting Company is located on the same piece of land. As a condition precedent to the consummation of the Securities Purchase Agreement related to the private placement of our common stock, on August 26, 2008, Kaifeng Valve and the Casting Company entered into an



Agreement for the Transfer of Land Use Right and Housing Titles (the Real Estate Transfer Agreement ) for the transfer of the land use rights for all the land and all the buildings on the land to Kaifeng Valve (the Real Estate ). As the transfer was expected to take up to ten months to complete with relevant Chinese government agencies, on August 26, 2008, Kaifeng Valve and the Casting Company also entered into a Lease Agreement (the Lease Agreement ) pursuant to which the Casting Company agreed to lease the Real Estate to Kaifeng Valve until the latter acquires title to the Real Estate. In addition, Kaifeng Valve and the Casting Company entered into a Leaseback Agreement (the Leaseback Agreement ) pursuant to which Kaifeng Valve agreed to lease back to the Casting Company the portion of the Real Estate and the buildings used by the Casting Company, for a period of one year starting on the date of the acquisition of title to the Real Estate by Kaifeng Valve.

In connection with the Real Estate Transfer Agreement, on August 26, 2008, the Company entered into a Real Estate Share Escrow Agreement with the shareholder of the Casting Company, Mr. Bin Fang, Brean Murray, Carret & Co., LLC and Escrow, LLC (the Real Estate Escrow Agreement), pursuant to which the Company issued and placed in escrow, for the benefit of Mr. Fang or his designee, 2,750,000 shares of the Company's common stock in exchange for Mr. Fang's agreement to cause the Casting Company to transfer the Real Estate under the Real Estate Transfer Agreement. On March 6, 2009, the land use right for the Real Estate was transferred from the Casting Company to Kaifeng Valve and the 2,750,000 shares were released to Mr. Bin Fang.

All the onsite buildings and workplaces are utilized for manufacturing, R&D and administrative purposes. In addition, there is land available onsite for future expansion of Kaifeng Valve.

The Company owns land use rights at Changsha Valve, Hanwei Valve, Yangzhou Valve and Taide Valve. The following lease expenses were incurred in 2011 and 2010 with respect to the operating entities: Nine Months Ended September 30, 2011

Usage	ZD Valve US \$	Henan Tonghai Fluid US \$
Office	\$ 58,867	167,947
Production & Operation Facilities	179,965	-
Total Cost	\$ 238,832	167,947

Nine Months Ended September 30, 2010 (Unaudited)

Usage	ZD Valve US \$	Henan Tonghai Fluid US \$
Office	\$ 56,266	\$ 48,570
Production & Operation Facilities	221,161	-
Total Cost (Unaudited)	\$ 277,427	\$ 48,570

### Item 3. *Legal Proceedings.*

On February 4, 2011, a plaintiff filed a purported class action naming the Company, its Chairman and certain present and former senior executives as defendants, asserting claims for certain violations of the securities laws and seeking unspecified damages. The complaint, which was styled Donald Foster, et al. v. China Valves Technology, Inc., et al., was filed in the U.S. District Court for the Southern District of New York. Several substantially identical complaints were subsequently filed in the same court. On or about June 29, 2011, the Court consolidated the three cases referenced above and appointed Bristol Investment Fund, LTD ( Bristol ) as lead plaintiff. In the consolidation order the Court renamed the case In re China Valves Technology Securities Litigation. On August 29, 2011, Bristol filed a consolidated class action complaint, which named additional defendants including an individual shareholder of the Company and the Company's auditor.

The consolidated complaint purports to assert claims on behalf of a purported class of persons and entities who purchased shares of the Company's common stock at allegedly artificially high prices during the period between December 1, 2009 and January 13, 2011 and who suffered damages as a result of such purchases. The allegations in the consolidated complaint relate to the Company's acquisitions of Able Delight and Hanwei Valves and include allegations regarding the Company's financial statements and press releases. The complaint alleges, among other things, that the Company's statements about the nature and quality of the Company's acquisition of Able Delight were materially false and misleading and that the Company's statements failed to describe the role in the transaction of an alleged related party. In addition, the complaint alleges that the Company's statements about the Hanwei Valves acquisition were materially false and misleading because they failed to disclose the alleged involvement of certain related parties and allegedly misdescribed the transaction as a purchase of assets rather than as a purchase of an entity. The Company intends to contest the allegations and to defend itself vigorously.

On September 14, 2011, a plaintiff filed an action, derivatively and on behalf of the Company, naming its Chairman and certain senior executives as defendants, and naming the Company as a nominal defendant. The complaint, which is styled *Gervat v. Fang et al.*, was filed in the U.S. District Court for the Southern District of New York, and asserts claims for breach of fiduciary duty, gross mismanagement, and other common law claims, and seeks unspecified damages. On October 11, 2011, the plaintiff filed an Amended Complaint with substantially similar claims. The parties have stipulated to a scheduling order that would stay all proceedings in the derivative action pending resolution by the Court of the defendants' motion to dismiss the class action consolidated complaint.

The Company and the individual defendants intend to file a motion to dismiss the consolidated complaint on November 21, 2011.

The Company intends to contest the allegations and to defend itself vigorously.

**Item 4.** *(Removed and reserved).*

## PART II

**Item 5.** *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.*

### Market for our Common Stock

Our common stock, having \$0.001 par value per share ("Common Stock"), is traded on Nasdaq Global Market under the symbol "CVVT". On July 24, 2009, the Company amended its articles of incorporation with the State of Nevada to effect a one-for-two reverse stock split (the Reverse Split). The Reverse Split affects all issued and outstanding shares of the Company's common stock immediately prior to the effectiveness of the Reverse Split with any fractional shares rounded up to the next highest whole share. The Reverse Split took effect on August 13, 2009.

The following table sets forth, for the periods indicated, the high and low closing prices of our common stock as reported by [www.nasdaq.com](http://www.nasdaq.com) and [www.quotemedia.com](http://www.quotemedia.com). These prices reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not represent actual transactions.

	Closing Prices			
		High		Low
<i>Nine months Ending September 30, 2011</i>				
3rd Quarter	\$	3.99	\$	2.01
2nd Quarter	\$	4.83	\$	2.89
1st Quarter	\$	10.57	\$	4.39



	Closing Prices	
	High	Low
<b>Year Ending December 31, 2010</b>		
4th Quarter	\$ 12.64	\$ 7.08
3rd Quarter	\$ 11.45	\$ 7.44
2nd Quarter	\$ 13.75	\$ 7.53
1st Quarter	\$ 14.85	\$ 9.14

**Reports to Stockholders**

We plan to furnish our stockholders with an annual report for each fiscal year containing financial statements audited by our independent certified public accountants. Additionally, we may, in our sole discretion, issue unaudited quarterly or other interim reports to our stockholders when we deem appropriate. We intend to maintain compliance with the periodic reporting requirements of the Exchange Act.

**Approximate Number of Holders of Our Common Stock**

On November 15, 2011, there were 89 stockholders of record of our common stock.

**Dividend Policy**

We have never declared dividends or paid cash dividends. Our board of directors will make any future decisions regarding dividends. We currently intend to retain and use any future earnings for the development and expansion of our business and do not anticipate paying any cash dividends in the near future.

**Item 6. Selected Financial Data.**

The selected Consolidated Statement of Earnings data for the nine months ended September 30, 2011 and 2010, and the years ended December 31, 2010 and 2009 and the Consolidated Balance Sheet data as of September 30, 2011 and December 31, 2010 should be read in conjunction with the audited financial statements, Management's Discussion and Analysis of Results of Operations and Financial Condition ( MD&A ) and other financial information presented elsewhere in this transition report. The selected Consolidated Statement of Earnings data for the years ended December 31, 2008 and 2007 and the Consolidated Balance Sheet data as of December 31, 2009, 2008 and 2007 have been derived from audited financial statements not included herein.

**CONSOLIDATED STATEMENT OF EARNINGS DATA**

	Nine Months Ended		Years Ended December 31,			
	2011	September 30, 2010 (Unaudited)	2010	2009	2008	2007
<b>(In thousands, except per share amounts)</b>						
<b>Selected Income Statement Data:</b>						
Net Sales	\$ 161,395	\$ 131,367	\$ 183,696	\$ 95,370	\$ 66,555	\$ 37,036
Gross Profit	65,642	61,972	80,419	46,843	26,473	14,986
	37,703	46,054	54,156	33,039	(9)	8,637

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Income From Operations (Loss)							
Net Income (Loss)	\$ 29,558	\$ 36,789	\$ 43,198	\$ 23,353	\$ (4,237)	\$ 7,143	
Net Income per Common Share:							
Basic	\$ 0.83	\$ 1.07	\$ 1.25	\$ 0.76	\$ (0.18)	\$ 0.18	
Diluted	\$ 0.83	\$ 1.06	\$ 1.25	\$ 0.75	\$ (0.18)	\$ 0.18	

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## CONSOLIDATED BALANCE SHEET DATA

	September 30, 2011 (In thousands)		Years Ended December 31, 2010		2009		2008		2007	
<b>Selected Balance Sheet Data:</b>										
Total Assets	\$	293,446	\$	238,508	\$	140,103	\$	108,744	\$	64,767
Total Liabilities	\$	58,750	\$	49,901	\$	26,674	\$	32,094	\$	27,593
Total Equity	\$	234,696	\$	188,607	\$	113,429	\$	76,650	\$	37,174

	Nine Months Ended September 30, 2011 (In thousands)		2010 (Unaudited)		Years Ended December 31, 2010		2009		2008		2007	
<b>Selected Operating Data:</b>												
Gate Valves	\$	28,595	\$	21,408	\$	32,771	\$	26,559	\$	18,478	\$	10,593
Check Valves		8,111		6,972		9,778		6,840		5,488		3,355
Globe Valves		6,011		5,646		8,037		5,073		3,058		2,387
Safety Valves		3,948		1,539		2,307		1,915		859		1,013
Butterfly Valves		66,777		57,983		77,213		36,998		22,841		12,390
Ball Valves		30,824		22,066		30,477		5,960		3,155		1,473
Vent Valves		335		418		487		325		1,927		567
Other		16,793		15,335		22,626		11,700		10,749		5,258
Total Sales Revenue	\$	161,395	\$	131,367	\$	183,696	\$	95,370	\$	66,555	\$	37,036

	Nine Months Ended September 30, 2010		Years Ended December 31,			
	2011	(Unaudited)	2010 (In thousands)	2009	2008	2007
<b>Selected Operating Data:</b>						
Power Supply	\$ 48,814	\$ 38,798	\$ 51,964	\$ 28,206	\$ 16,263	\$ 11,462
Petrochemical and Oil	51,007	37,346	55,635	16,250	14,808	9,728
Water Supply	33,408	34,548	43,626	28,301	19,506	8,190
Metallurgy	6,581	6,236	8,998	6,173	6,460	3,858
Other	21,585	14,439	23,473	16,440	9,518	3,798
Total						
Sales Revenue	\$ 161,395	\$ 131,367	\$ 183,696	\$ 95,370	\$ 66,555	\$ 37,036

**Item 7. Management's Discussion and Analysis of Results of Operations and Financial Condition.**

The following discussion is an overview of the important factors that management focuses on in evaluating our business, financial condition and operating performance, and should be read in conjunction with the financial statements included in this Annual Report. This discussion contains forward-looking statements that involve risks and uncertainties. Actual results could differ materially from those anticipated in these forward looking statements as a result of any number of factors, including those set forth under the section entitled "Risk Factors" and elsewhere in this Annual Report.

**Executive Summary**

The following executive summary is intended to provide significant highlights of the discussion and analysis that follows.

- **Sales:** Sales increased \$30.0 million, or 22.9%, to \$161.4 million for the nine months ended September 30, 2011, from \$131.4 million for the same period in 2010.
- **Gross profit:** Gross profit increased \$3.7 million, or 5.9%, to \$65.6 million for the nine months ended September 30, 2011, from \$62.0 million for the same period in 2010.
- **Income from operations:** Income from operations decreased \$8.4 million, or 18.1%, to \$37.7 million for the nine months ended September 30, 2011, from \$46.1 million for the same period in 2010.
- **Net income:** Net income decreased \$7.2 million, or 19.7%, to \$30.0 million for the nine months ended September 30, 2011, from \$36.8 million for the same period in 2010.
- **Fully diluted net income per share:** Fully diluted net income per share was \$0.83 for the nine months ended September 30, 2011, as compared to \$1.06 for the same period in 2010.

**OVERVIEW Summary**

Through our subsidiaries and commercial and contractual relationships and arrangements with other Chinese companies, we operate companies in China that develop, manufacture and distribute high quality metal valves for a variety of different industries. We are headquartered in Zhengzhou, Henan Province and do business throughout



China, Southeast Asia, the Middle-East and Europe. We produce over 800 models of valves and service numerous industries, including the thermal power, water supply, municipal construction, sewage disposal, oil and chemical, metallurgy, heat power, and nuclear power industries. We are the leader in valve sales for the thermal power, water supply industries, oil and chemical, and valve lock markets in China.

### **Change in Fiscal Year**

As previously announced, in 2011, we changed our fiscal year end to September 30 from December 31. We made this change to better align with our financial reporting periods, as well as our annual planning and budgeting process. This Transition Report on Form 10-K reports our financial results for the nine-month period from January 1, 2011 through September 30, 2011, which we refer to as "fiscal year 2011" throughout this report. Following fiscal year 2011, we will report on a twelve-month fiscal year beginning on October 1 and ending on September 30 of each year. The years ended December 31, 2010 and 2009 reflect the twelve-month results of the respective calendar years.

**RESULTS OF OPERATIONS****Comparison of Nine Months Ended September 30, 2011 and September 30, 2010**

Our summary consolidated results of operations are presented below for the nine months ended September 30, 2011 and 2010.

(In thousands)	Nine Months Ended		\$	% Change
	2011	September 30, 2010 (Unaudited)		
SALES	\$ 161,395	\$ 131,367	\$ 30,028	22.9%
COST OF GOODS SOLD	95,753	69,395	26,358	38.0%
GROSS PROFIT	65,642	61,972	3,670	5.9%
OPERATING EXPENSES:				
Selling Expenses	10,134	6,651	3,483	52.4%
General and Administrative Expenses	17,519	9,086	8,433	92.8%
Research and Development Expenses	286	182	104	57.1%
Total Operating Expenses	27,939	15,919	12,020	75.5%
INCOME FROM OPERATIONS	37,703	46,053	(8,350)	(18.1)%
OTHER (INCOME) EXPENSES:				
Other Income, net	(522)	(491)	(31)	6.3%
Gain from Acquisition	-	(1,016)	1,016	(100.0)%
Interest and Finance Expenses, Net	208	82	126	153.7%
Change in Fair Value of Warrant Liabilities	(990)	263	(1,253)	(476.4)%
Total Other Income, Net	(1,304)	(1,162)	(142)	12.2%
INCOME BEFORE PROVISION FOR INCOME TAXES	39,007	47,215	(8,208)	(17.4)%
PROVISION FOR INCOME TAXES	9,449	10,426	(977)	(9.4)%
NET INCOME	\$ 29,558	\$ 36,789	\$ (7,231)	(19.7)%

**Sales Revenue.** Our sales revenue for the nine months ended September 30, 2011 amounted to \$161.4 million, which is approximately \$30.0 million, or 22.9%, more than that of the same period in 2010, when we had revenue of \$131.4 million. In aggregate, Hanwei Valve and Changsha Valve contributed 7.1%, or approximately \$9.3 million to our sales revenue increase from the nine months ended September 30, 2011 to the same period in 2010. The increase was attributed to Hanwei Valve which contributed \$6.6 million to our sales revenue. On April 8, 2010, we acquired Hanwei Valve, which operated fully under our control during the nine months ended September 30, 2011, as compared with only 176 days operation in the same period of 2010. Meanwhile, Changsha Valves contributed \$2.8 million to our sales revenue. Changsha Valve was acquired on February 3, 2010, and operated fully during the nine months ended September 30, 2011, while it operated eight months in the same period in 2010. Organic growth in sales for the nine months ended September 30, 2011 was 15.8% compared with the same period in 2010. Strong demand for products in the petrochemical and oil sector, and the power supply sector also contributed to the growth in sales. Sales increases in both sectors for the nine months ended September 30, 2011 were 36.6 % and 25.8%, respectively, as compared with the same period in 2010. Sales of ball valves, gate valves and butterfly valves for the nine months ended September 30, 2011 increased by 39.7%, 33.6% and 15.2%, respectively, compared to the same period in 2010. The following tables set forth our sales by valve types, in terms of sales revenues for the nine months ended September 30, 2011 and 2010.



(All amounts in thousands of U.S. dollars)	Nine Months Ended September 30,		Change	% of Change
	2011	2010 (Unaudited)		
Gate valves	\$ 28,595	\$ 21,408	\$ 7,187	33.6%
Check valves	8,111	6,972	1,139	16.3%
Globe valves	6,011	5,646	365	6.5%
Safety valves	3,948	1,539	2,409	156.5%
Butterfly valves	66,777	57,983	8,794	15.2%
Ball valves	30,824	22,066	8,758	39.7%
Vent valves	335	418	(83)	(19.9)%
Other valves and accessories	16,794	15,335	1,458	9.5%
Total sales revenue	\$ 161,395	\$ 131,367	\$ 30,208	22.9%

The China Valve Industry Association divides the valve market into five primary segments; (i) power; (ii) petrochemical; (iii) oil; (iv) water supply; and (v) metallurgy. Our revenues in these markets are as follows:

(All amounts in thousands of U.S. dollars)	Nine Months Ended September 30,		% of Change
	2011	2010 (Unaudited)	
Power Supply	\$ 48,184	\$ 38,798	25.8%
Petrochemical and Oil	51,007	37,346	36.6%
Water Supply	33,408	34,548	(3.3)%
Metallurgy	6,581	6,236	5.5%
Other	21,585	14,439	49.5%
Total sales revenue	\$ 161,395	\$ 131,367	22.9%

The following table sets forth the impact of Changsha Valve and Hanwei Valve on the overall operation.

## INCOME STATEMENT ITEMS

## Operation for the periods ended

(\$ in thousands)	February 3, 2011		April 8, 2011		CVVT other operation 2011 (3)	% of 2011 operation	Operation for the nine months ended September 30, 2011 2010		
	Changsha Valve	(1)	Hanwei Valve	(2)			Total I ncremental	% of 2011 operation	G
	A		B		C = A+B	D = C/G	E = G-C	F = E/G	
REVENUE	2,760		6,565		9,325	5.8%	152,070	94.2%	161,395 131,367
COST OF GOODS SOLD	1,500		4,657		6,157	6.4%	89,596	93.6%	95,753 69,395
GROSS PROFIT	1,261		1,908		3,169	4.8%	62,473	95.2%	65,642 61,972
GROSS PROFIT RATE	45.7%		29.1%		34.0%		41.1%		40.7% 47.2%
GENERAL AND ADMINISTRATIVE EXPENSES	311		352		663	3.8%	16,856	96.2%	17,519 9,267
SELLING EXPENSES	234		94		329	3.2%	9,805	96.8%	10,134 6,651
INCOME FROM OPERATIONS	715		1,462		2,177	5.8%	35,812	95.0%	37,703 46,054
OTHER (INCOME) EXPENSES, NET	4		(7)		(3)	0.2%	(1,301)	99.8%	(1,304) (1,162)
NET INCOME	534		1,196		1,730	5.9%	27,828	94.1%	29,558 36,789

(1) Changsha valves was acquired on Feb. 3, 2010. Therefore, it contributed one more month operation under CVVT's control for nine months ended Septem compared with the same period in 2010.

(2) Hanwei valves was acquired on Apr. 8, 2010. Therefore, it contributed 98 days more operation under CVVT's control for nine months ended September 3 with the same period in 2010.

(3) Represented operation result for the organization structure of the Company as the same one as of September 30, 2010 for comparative purpose.

**Cost of sales.** Our cost of sales was \$95.8 million for the nine month period ended September 30, 2011, an increase of \$26.4 million, or 38.0%, as compared with \$69.4 million for the nine month period ended September 30, 2010. Cost of sales as a percentage of total sales were 59.3% and 52.8% for the nine month periods ended on September 30, 2011 and 2010, respectively. The increase was mainly due to the incremental operation of Hanwei Valve and Changsha Valve for the nine months ended September 30, 2011, which contributed an aggregate of \$6.2 million, 8.9% of the increase in the cost of sales. The rest increase was in line with the increase in sales revenues and was also attributable to higher raw material and labor costs.

**Gross profit and gross margin.** Gross profit was \$65.6 million for the nine months ended September 30, 2011, an increase of \$3.7 million, or 5.9%, as compared with \$62.0 million for the nine month period ended September 30, 2010. Our gross profit margin decreased to 40.7% as compared to 47.2% in the same period of 2010. The decrease in gross margin was Hanwei Valve, had a lower gross profit margin of 33.8% . Specially, the products sold by Hanwei Valve, such as gate valves and ball valves, had lower gross profit margins than those of the butterfly valves and highpressure valves sold by ZD Valve and Kaifeng Valve. In addition, the costs increased in the range of 5% to 20%

for raw materials such as purchase prices of casting and forging steel, steel bars, shafts, bolts and nuts, resulting in a lower overall gross profit margin which generally accounts for around 70% of the unit cost of our valves during the period. Labor cost for the nine months ended September 30, 2011 increased more than 10% compared with the same period in 2010. Furthermore, during the period we sold more medium to low pressure valves, with lower sales prices, which also contributed to the decrease in gross profit margin.

**Operating expenses.** Our total operating expenses increased by \$12.0 million, or 75.5%, to \$27.9 million for the nine months ended September 30, 2011, from \$15.9 million for the same period in 2010. The increase was primarily attributable to a 52.4% increase in our selling expenses and a 92.8% increase in our general and administrative expenses during the 2011 period. Total expenses as a percentage of sales increased to 17.3% for the nine months ended September 30, 2011 from 12.1% for the same period in 2010.

**Selling expenses.** Our selling expenses were \$10.1 million for the nine month period ended September 30, 2011, compared with \$6.7 million for the period ended September 30, 2010, an increase of \$3.5 million, or approximately 52.4%, while, incremental operation of Hanwei Valve and Changsha Valve, contributed an aggregate of \$0.3 million or 8.6% of the increase. As overall sales increased, sales commissions and marketing and promotion expenses have increased as well. Sales commission and related expenses increased from \$4.1 million for the nine month period ended September 30, 2010 to \$5.0 million for the same period in 2011. As a percentage of sales, total selling expenses increased to 6.3% for the nine months ended September 30, 2011 from 5.1% for the same period in 2010.

**General and administrative expenses.** Our general and administrative expenses were \$17.5 million for the nine month period ended September 30, 2011, compared with \$9.1 million for the period ended September 30, 2010, an increase of \$8.4 million, or approximately 92.8% . The increase was primarily due to an increase of \$2.8 million in bad debt expenses from \$0.2 million for the period ended September 30, 2010 to \$3.0 million for the nine month period ended September 30, 2011. Higher labor costs also contributed to higher general and administrative expenses. Salary and welfare expenses were \$3.8 million for the nine month period ended September 30, 2011, compared with \$2.5 million for the period ended September 30, 2010, an increase of \$1.3 million. In addition, we had \$0.8 million stock-based compensation expense for the shares granted to directors and officers for the nine months ended September 30, 2011, as compared with \$0.04 million for the same period in 2010. Incremental operation of Hanwei Valve and Changsha Valve for the nine months ended September 30, 2011, contributed an aggregate of \$0.7 million to the general and administrative expenses.

**Income from Operations.** Income from operations was \$37.7 million for the nine month period ended September 30, 2011, compared with \$46.1 million for the period ended September 30, 2010. The decrease was primarily attributable to lower gross margin, higher selling expenses and general and administrative expenses in the 2011 period.

**Income taxes.** We incurred income taxes of \$9.4 million for the nine month period ended September 30, 2011. This is a decrease of \$1.0 million, or 9.4%, from the taxes we incurred in the 2010 period, which were \$10.4 million. This is in line with the decrease of income from operations.

**Net income.** As a result of the foregoing factors, our net income decreased by \$7.2 million, or 19.7%, to \$29.6 million for the nine month period ended September 30, 2011, from \$36.8 million for the same period in 2010. Net income as a percentage of sales was 18.3% and 28.0% for the nine month periods ended September 30, 2011 and 2010, respectively.

### Comparison of Year Ended December 31, 2010 and December 31, 2009

Our summary consolidated results of operations are presented below for the year ended December 31, 2010 and 2009.

(In thousands)	Years Ended December 31,		\$	%
	2010	2009		
SALES	\$ 183,696	\$ 95,370	\$ 88,326	92.6%
COST OF GOODS SOLD	103,277	48,527	54,750	112.8%
GROSS PROFIT	80,419	46,843	33,576	71.7%
OPERATING EXPENSES:				
Selling Expenses	10,414	6,318	4,096	64.8%
General and Administrative Expenses	15,620	7,359	8,261	112.3%
Research and Development Expenses	229	127	102	80.3%
Total Operating Expenses	26,263	13,804	12,459	90.3%
INCOME FROM OPERATIONS	54,156	33,039	21,117	63.9%
OTHER (INCOME) EXPENSES:				
Other Income, net	(669)	(511)	(158)	30.9%
Gain from Acquisition	(3,715)	-	(3,715)	0.0%

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Interest and Finance Expenses, Net	101	129	(28)	-21.7%
Change in Fair Value of Warrant Liabilities	785	1,509	(724)	-48.0%
Total Other Income, Net	(3,498)	1,127	(4,625)	-410.4%
INCOME BEFORE PROVISION FOR INCOME TAXES				
TAXES	57,654	31,912	25,742	80.7%
PROVISION FOR INCOME TAXES	14,457	8,559	5,898	68.9%
NET INCOME	\$ 43,197	\$ 23,353	\$ 19,844	85.0%

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The following tables set forth our sales by valve types, in terms of sales revenues for the periods indicated.

	Years Ended December 31,	
	2010	2009
Sales revenue	(in thousands)	
Gate valves	\$ 32,771	\$ 26,559
Check valves	9,778	6,840
Globe valves	8,037	5,073
Safety valves	2,307	1,915
Butterfly valves	77,213	36,998
Ball valves	30,477	5,960
Vent valves	487	325
Other	22,626	11,700
Total sales revenue	\$ 183,696	\$ 95,370

The China Valve Industry Association divides the valve market into five primary segments: (i) power; (ii) petrochemical and oil; (iii) water supply; (iv) metallurgy; and (v) other areas. Our revenues in these markets are as follows:

	Years Ended December 31,	
	2010	2009
	(in thousands)	
Power Supply	\$ 51,964	\$ 28,206
Petrochemical and Oil	55,635	16,250
Water Supply	43,626	28,301
Metallurgy	8,998	6,173
Other	23,473	16,440
Total sales revenue	\$ 183,696	\$ 95,370

**Sales Revenue** Sales revenue increased \$88.3 million, or 92.6%, to \$183.7 million in 2010 from \$95.4 million in 2009. The strong sales growth resulted from the following factors: 1) The three equity acquisitions of Yangzhou Valve, Changsha Valve and Hanwei Valve (the New Subsidiaries ) contributed \$68.4 million, or 77.4% to the total sales growth. Among the 77.4% growth rate, Changsha Valve and Hanwei Valve contributed 32.8% and 32.6% to our sales increase, respectively. 2) \$20.0 million in organic sales growth was generated through ordinary operation of the original operating subsidiaries during the year ended December 31, 2010, and was attributable to increased demand for our products fueled by rapid industrialization and governmental capital expenditure on China's infrastructure. In addition, our innovations in high temperature, high pressure power station gate valves and two-way metal sealing butterfly valves, which are popular among our customers, also contributed to sales volume increases as compared to sales in the same period last year. We also made efforts to expand sales in the petrochemical, oil and nuclear areas, while strengthening the current thermal power and hydro-power market for our products. Our success in adding new types of valves, such as the large diameter, high pressure valves used in power stations, for nuclear power plants, and other large governmental water-pipe projects requiring supplies of 3.5+ meter diameter valves, also helped fuel demand for our products and contributed to our sales increase.

In 2010, revenues from butterfly valves, gate valves and ball valves constituted 76.5% of our total revenues.

Revenue from butterfly valves for 2010 amounted to \$77.2 million, which was \$40.2 million or 108.7% more than revenue for the same period ended December 31, 2009. This increase was mainly attributable to Changsha Valve whose key product is the butterfly valve. The increase was also attributable to the fact that we are the sole manufacturer and distributor for the integrated two-way metal sealed butterfly valves used to control municipal water and sewage flow. These new generation butterfly valves have achieved around 90% market share in the ten largest cities in China.

Revenue from gate valves for 2010 amounted to \$32.8 million, which was \$6.2 million, or 23.4%, more than that of 2009. These increases were attributable to the large increase in power station construction projects in China. By the end of 2007, the Company had developed the capability to manufacture high quality, technology intensive forged steel valves for use in ultra supercritical thermal power generators in 1,000MW power stations. The Company is the sole designer and manufacturer in China for this type of valve, which can replace the imported valves used in the thermal power industry. The newly developed, high-margin valves perform as well as the comparable overseas products and brought in a large amount of orders in 2010. Continued extensive use of gate valves in the petro-chemical and nuclear power industries also contributed to our sales increase in 2010.

Revenue from ball valves for 2010 amounted to \$30.5 million, which was \$24.5 million or 411.4% more than that for 2009. This increase was attributable to Hanwei Valve.

INCOME STATEMENT  
FOR THE YEARS ENDED DECEMBER 31, 2010

REVENUE	YZ	% contributed to overall	CS	% contributed to overall	HW	% contributed to overall	Consolidated 2010
Total Revenue	5,983,351	3.3%	31,265,638	17.0%	31,116,982	16.9%	183,696,126
COST OF GOODS SOLD	3,282,485	3.2%	18,139,730	17.6%	19,023,043	18.4%	103,276,910
GROSS PROFIT	2,700,866	3.4%	13,125,908	16.3%	12,093,939	15.0%	80,419,216
EXPENSES:							
Selling expense	98,479	0.9%	2,608,774	25.0%	514,005	4.9%	10,414,293
G&A expense	504,593	3.2%	2,976,715	19.1%	809,797	5.2%	15,563,906
Other expense							284,877
Total Operating Expenses	603,072	2.3%	5,585,489	21.3%	1,323,802	5.0%	26,263,076
INCOME FROM OPERATIONS	2,097,794	3.9%	7,540,419	13.9%	10,770,137	19.9%	54,156,140
OTHER (INCOME) EXPENSE:							
Other income, net	(966,108)	144.3%	(3,188,752)	476.3%	7,260	-1.1%	(669,462)
Gain from acquisition							(3,714,840)
Interest expense, net	54	0.1%	(1,263)	-1.3%	(16,646)	-16.5%	100,997
Change in fair value of derivative instruments							785,350
Total Other (Income) Expense, net	(966,054)	27.6%	(3,190,015)	91.2%	(9,386)	0.3%	(3,497,955)
INCOME BEFORE PROVISION	3,063,848	5.3%	10,730,434	18.6%	10,779,523	18.7%	57,654,095

FOR INCOME TAXES							
PROVISION FOR INCOME TAXES	814,603	5.6%	1,836,442	12.7%	1,616,929	11.2%	14,456,566
NET INCOME	2,249,245	5.2%	8,893,992	20.6%	9,162,594	21.2%	43,197,529

Note: YZ stands for Yangzhou Valve, CS for Changsha Valve and HW for Hanwei Valve. Same for the table below.

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BALANCE SHEETS ITEMS  
AS OF DECEMBER 31, 2010

ASSETS	YZ	% contributed to overall	CS	% contributed to overall	HW	% contributed to overall	Consolidated December 31, 2010
<b>CURRENT ASSETS:</b>							
Cash and cash equivalents& Restrict cash	56,533	0.2%	2,784,729	10.3%	3,395,184	12.6%	26,985,205
Accounts receivables, net	3,746,234	4.4%	13,281,036	15.7%	12,346,307	14.6%	84,347,311
Inventories, net	338,833	2.1%	3,918,745	24.1%	2,018,153	12.4%	16,251,938
Other current assets	314,471	3.7%	751,355	8.8%	729,826	8.6%	8,515,991
Total current assets	4,456,071	3.3%	20,735,865	15.2%	18,489,470	13.6%	136,100,445
<b>PLANT AND EQUIPMENT, net</b>	3,435,765	8.4%	4,542,538	11.1%	4,607,399	11.3%	40,773,562
<b>OTHER ASSETS:</b>							
Intangibles, net	3,080,085	13.4%	6,169,258	26.8%	4,161,934	18.1%	23,027,880
Other non-current assets	-	0.0%	-	0.0%	-	0.0%	38,605,775
Total other assets	3,080,085	5.0%	6,169,258	10.0%	4,161,934	6.8%	61,633,655
Total assets	10,971,921	4.6%	31,447,661	13.2%	27,258,803	11.4%	238,507,662
<b>LIABILITIES</b>							
<b>CURRENT LIABILITIES:</b>							
Accounts payable - trade	87,638	0.4%	2,697,113	12.3%	5,688,991	26.0%	21,913,247
Short-term loans	-	0.0%	758,500	13.4%	-	0.0%	5,648,794
Taxes payable	95,053	1.4%	912,969	13.4%	993,446	14.5%	6,828,118
Other current liabilities	768,390	5.0%	5,294,570	34.1%	2,397,517	15.5%	15,510,786
Total current liabilities	951,081	1.9%	9,663,152	19.4%	9,079,954	18.2%	49,900,945

INCOME STATEMENT ITEMS  
FOR THE YEARS ENDED DECEMBER 31,

(in thousands)	Yangzhou Valve	Changsha Valve	Hanwei Valve	Total revenue from acquisitions	% of consolidation	CVVT original <sup>(1)</sup>	% of consolidation	Con 2010
REVENUE	5,983	31,266	31,117	68,366	37.2%	115,330	62.8%	
COST OF GOODS SOLD	3,282	18,140	19,023	40,445	39.2%	62,832	60.8%	
GROSS PROFIT	2,701	13,126	12,094	27,921	34.7%	52,498	65.3%	
GROSS PROFIT RATE	45.1%	42.0%	38.9%	40.8%		45.5%		
GENERAL AND ADMINISTRATIVE EXPENSES	505	2,976	810	4,291	16.3%	21,972	83.7%	
SELLING EXPENSES	98	2,609	514	3,221	30.9%	7,193	69.1%	
INCOME FROM OPERATIONS	2,196	10,150	11,284	23,630	43.6%	30,526	56.4%	
OTHER INCOME (EXPENSES), NET	(966)	(3,190)	(9)	(4,165)	-1919.4%	4,382	2019.4%	
GAIN FROM ACQUISITIONS	-	-	-	(3,715) <sup>(2)</sup>	100.0%	-	0.0%	
NET INCOME	2,249	8,894	9,163	24,021	55.6%	19,176,858	44.4%	

(1) Represented operation result for the organization structure of the Company as disclosed in the Annual Report on Form 10-K for fiscal year ended December 31, 2009 for comparative purpose.

(2) Gain from acquisition was accounted under total revenue generated from acquisitions according its nature.

**Cost of Sales** Our cost of sales increased \$54.8 million or 112.8% to \$103.3 million in 2010 from \$48.5 million in 2009. The cost of sales, as a percentage of sales revenue, increased from 50.9% in 2009 to 56.2% in 2010. The New Subsidiaries contributed 6.8%, 37.4% and 39.2%, or an aggregate percentage of 83.3% to the increase of cost of sales, only 29.5% of the increase was incurred by Kaifeng Valve and ZD Valve in 2010. The increase was in line with the increase in sales revenues due to higher labor, management costs of those newly acquired entities and an increase in cost of sales.

**Gross Profit** Our gross profit increased by \$33.6 million or 71.7% to \$80.4 million in 2010 from \$46.8 million in 2009. The New Subsidiaries contributed 59.6% to our gross profit for the year ended December 31, 2010. However, gross profit as a percentage of net sales revenue decreased to 43.8% from 49.1% for the same period in 2009. The decrease in gross profit percentage was mainly due to the fact that: 1) the New Subsidiaries had 40.8% overall gross profit margin, as the products sold by the New subsidiaries during the period, such as gate valves and ball valves, had lower gross profit than that of the butterfly valves and high pressure valves sold by ZD Valve and Kaifeng Valve. In addition, the higher labor and management costs of the New Subsidiaries resulted in higher fixed costs per unit and lower overall gross profit percentage. Changsha Valve and Hanwei Valve had 42.0% and 38.9% average gross margin

for the year ended December 31, 2010, respectively. Furthermore, the Company sold more medium to low pressure valves in 2010, which generally have lower selling prices and thus contributed to the decrease in gross profit percentage. The Company is currently standardizing Production methodology and techniques at the New Subsidiaries in order to optimize their production capacity.

***General and Administrative Expenses*** Our general and administrative expenses were \$15.6 million for 2010, compared with \$7.3 million for 2009, an increase of \$8.3 million or approximately 112.8% .The increase was primarily due to increases in salary expenses for the New Subsidiaries, as well as the hiring of more educated, entry-level administrative and technological personnel with higher education. Professional fees, travel expense and meal and entertainment expenses also increased due to our business acquisition activities. Depreciation expenses increased as result of increased fixed asset purchases. General and administrative expenses as percentage of total revenue are 8.5% in 2010 as compared to 7.7% in 2009. The increase was primarily due to the increased expenses added by the New Subsidiaries.

**Selling Expenses** Selling expenses were \$10.4 million for 2010, compared to \$6.3 million for 2009, an increase of \$4.1 million or 64.8%, which is in line with the sales revenue increase. However, the implementation of the strengthened cost control policy and the establishment of the department of sales and marketing in Shanghai resulted in significantly improved marketing activities and brought in more large sales contracts with relatively lower sales and marketing expenses in 2010. The sales and marketing expenses as a percentage of sales was 5.7%, compared to 6.6% in 2009.

**Total Operating Expenses** Our total operating expenses increased by \$12.5 million, or 90.6%, to \$26.3 million in 2010 from \$13.8 million in 2009, which is in line with the sales revenue increase and mainly attributable to newly acquired subsidiaries.

**Income Before Income Taxes** Income before income taxes increased \$25.7 million, or 80.7%, to \$57.6 million in 2010 from \$31.9 million in 2009. Income before income taxes as a percentage of revenue decreased to 31.4% in 2010 from 33.5% in 2009.

**Net Income** Net income increased by \$19.8 Million, or 85.0%, to \$43.2 million in 2010 from \$23.4 million in 2009 as result of a 92.6% increase in sales revenue and a lower effective income tax rate in 2010. Among other things, net income of the three acquired subsidiaries contributed 102.9% of total net income for the year ended December 31, 2010.

#### **Foreign Currency Translation Gains**

We had a foreign currency translation gain of \$6.5 million for the nine months ended September 30, 2011 as compared to a \$3.6 million currency translation gain in the same period of 2010. In July 2005, China reformed its foreign currency exchange policy and allowed the Renminbi to fluctuate as much as 0.3 percent per day against the U.S. dollar. We use period-end exchange rates in translating our assets and liabilities denominated in Renminbi into U.S. dollars and average exchange rates for the period to translate our income and expenses. As of September 30, 2011, the period end exchange rate was RMB1 to US\$0.15640 and the average exchange rate for fiscal year of 2011 was RMB1 to US\$0.15390. The average exchange rate for the nine months ended September 30, 2010 was RMB1 to US\$0.14710. RMB appreciated approximately 4.6% in 2011 in terms of the period-end exchange rate of 2011 compared with that of 2010.

Our sales revenue for the nine months ended September 30, 2011 increased by RMB 155.4 million or 17.4% compared with the same period in 2010, and our operating expenses increased by RMB 73.4 million or 67.9% compared with the same period in 2010. As the Renminbi appreciated against the U.S. dollar during the period, our reported sales revenues and operating expenses were affected, increasing 22.9% and 75.5%, respectively, in U.S. dollar terms, as follows:



(in millions)	Nine Months Ended September 30, 2011			2010			Change		%	
	US\$	Average Rate	RMB	(Unaudited)			US\$	RMB	US\$	RMB
	US\$	Average Rate	RMB	US\$	Average Rate	RMB	US\$	RMB	US\$	RMB
Revenue	161.4	0.15390	1,048.7	131.4	0.14710	893.3	30.0	155.4	22.9%	17.4%
Total operating expenses	27.9	0.15390	181.5	15.9	0.14710	108.1	12.0	73.4	75.5%	67.9%

We had a foreign currency translation gain of \$6.1 million in 2010 as compared to a \$0.007 million currency translation loss in 2009. As of December 31, 2010, the period end exchange rate was RMB1 to US\$0.1517 and the average exchange rate for 2010 was RMB1 to US\$0.14760. On December 31, 2009, the period end exchange rate was RMB1 to US\$0.1467 and the average exchange rate for 2009 was RMB1 to US\$0.14661. RMB appreciated approximately 3.4% in 2010 in terms of the period-end exchange rate of 2010 compared with that of 2009.

Our sales revenue for the year ended December 31, 2010 increased by RMB 594.1 million or 91.3% compared with the same period in 2009 and our operating expenses increased by RMB 84.0 million or 91.4% compared with the same period in 2009. As the Renminbi appreciated against the U.S. dollar during the period, our reported sales revenues and operating expenses were affected, increasing 92.6% and 90.6%, respectively, in U.S. dollar terms, as follows:

(in million)	Years Ended December 31, 2010			2009			Change		%	
	US\$	Average Rate	RMB	US\$	Average Rate	RMB	US\$	RMB	US\$	RMB
	US\$	Average Rate	RMB	US\$	Average Rate	RMB	US\$	RMB	US\$	RMB
Revenue	183.7	0.14760	1,244.6	95.4	0.14661	650.5	88.3	594.1	92.6%	91.3%
Total operating expenses	26.3	0.14760	178.2	13.8	0.14661	94.2	12.5	84.0	90.6%	89.2%

#### **Allowance for Doubtful Accounts**

Our trade receivables net of allowance for doubtful accounts were \$124.5 million as of September 30, 2011, an increase of \$40.4 million, or 48.0%, from \$84.1 million as of December 31, 2010. Our allowance for doubtful accounts totaled \$4,052,398 as of September 30, 2011, compared with \$998,739 at December 31, 2010.

Management reviewed accounts receivable balances periodically based on an assessment of historical bad debts rate, individual customer receivable balances and aging, customers' financial conditions, project status in which our valves used, retainage and current economic trends. Generally we consider a trade receivable as a doubtful account if it remains uncollected for more than one year from the due date or as specific events occurred to our customers which may require us to reserve allowance even if trade balance is below one year. Due to specificities of our industry, collectability of accounts receivable with aging more than one year was assessed case by case. Before our customers projects in which our valves installed are completed and/or the corresponding retainage is due, the customers receivable with aging more than one year is generally considered to be recoverable.

Further, our allowance for doubtful debts accounted an insignificant portion of the receivable balance in spite of the increasing trade receivable balance throughout the reporting periods. Many of our customers who have long-time business relationships have good settlement histories. In the absence of significant bad debt experience, we consider the existing provisioning policy as adequate.



For the nine months ended September 30, 2011, management decided there would be a higher possibility of failure to make collection from several customers due to unfavorable national macro-control and poor market liquidity based on individual collectability assessment, including aging analysis, irregular customer visiting, background research and interviews, and \$4.1 million allowance has been reserved against their accounts receivable.

### Liquidity and Capital Resources

To date, we have financed our operations primarily through cash flows from operations, augmented by short-term bank borrowings and equity contributions by our stockholders. As of September 30, 2011, we had cash and cash equivalents of \$28.1 million. The following table sets forth a summary of our cash flows for the periods indicated:

(in thousands)	<b>Nine Months Ended September 30,</b>		<b>Year ended December 31,</b>	
	<b>2011</b>	<b>2010</b>	<b>2010</b>	<b>2009</b>
		(Unaudited)		
Net cash (used in) provided by operating activities \$	(5,262,657)	\$ 6,579,896	\$ 18,064,391	\$ 24,725,412
Net cash used in investing activities	(3,306,714)	(32,928,623)	(30,679,353)	(23,587,433)
Net cash provided by financing activities	10,070,457	20,049,756	23,375,117	(3,261,029)
Effect of exchange rate changes on cash and cash equivalents	754,999	201,209	575,044	180,575
Net increase (decrease) in cash and cash equivalents	2,256,085	(6,097,762)	11,335,199	(1,942,475)
Cash and cash equivalents at beginning of the period	25,820,607	14,485,408	14,485,408	16,427,883
Cash and cash equivalent at end of the period	\$ 28,076,692	\$ 8,387,646	\$ 25,820,607	\$ 14,485,408

#### *Operating Activities*

Net cash used in operating activities was \$5.3 million in the nine months ended September 30, 2011, compared with net cash provided by operating activities of \$6.6 million in the same period in 2010. The decrease was primarily attributable to the increase in accounts receivable and inventory.

In the fiscal year ended December 31, 2010, our net cash flow provided by operating activities was \$18.1 million, a decrease of \$6.6 million from the net cash flow provided by operating activities of \$24.7 million for the same period in 2009. The three acquired subsidiaries and other subsidiaries operating activities contributed \$3.1 million and \$14.1 million net cash for the year ended December 31, 2010, respectively. This was attributed to an increase in accounts receivables of \$44.6 million, which offsets a strong increase in net profit of \$19.8 million compared with 2009.

#### *Investing Activities*

Net cash used in investing activities decreased to \$3.3 million in the nine months ended September 30, 2011, compared to \$32.9 million in the same period in 2010, which was used primarily for the acquisitions of Hanwei Valve, Changsha Valve and Yangzhou Rock. The net cash used in investing activities during the period ended September 30, 2011 was primarily used for the purchase of equipment, intangible assets, payments made for construction in progress and cash deposit due to notes payable and sales covenant. We invested \$25.6 million in 2010 in the acquisitions of the New Subsidiaries. In addition, we spent another \$4.3 million on plant and equipment purchases as well as building improvements. Net cash used in investing activities in 2010 was \$30.7 million, as compared to \$23.6 million in 2009.

#### *Financing Activities*

Net cash provided by financing activities was \$10.1 million in the nine months ended September 30, 2011, compared to net cash provided by financing activities of \$20.0 million in the same period in 2010, as we received less net proceeds from the January 2011 registered direct offering than those from the January 2010 registered direct offering. As of September 30, 2011, we had \$4.7 million short-term bank loans outstanding under our credit facilities and lines of credit.

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In January 2011, we conducted a registered direct offering of an aggregate of 1,000,000 shares of our common stock to several accredited institutional investors at a price of \$10.00 per share for gross proceeds of approximately \$10 million. In addition, we issued the investors warrants to purchase an aggregate of 250,000 shares of common stock, in the aggregate, at a price of \$10.00 per share, exercisable for 180 days beginning on the date of the initial issuance of the warrants. The proceeds of the financing have been used for working capital.

Net cash provided by financing activities in 2010 totaled \$23.4 million. On January 5, 2010, we completed a registered direct offering of our common shares to certain accredited investors resulting in \$23.9 million in net proceeds. Our debt to equity ratio was 0.26 as of December 31, 2010 as compared to 0.24 as of December 31, 2009. We believe we have greatly improved our company's position by decreasing our borrowings.

As of September 30, 2011 and December 31, 2010, the maturities for our bank loans were all below one year.

We believe that we maintain good relationships with the banks with which we deal, and our current available working capital, after receiving the aggregate proceeds of the capital raising activities and bank loans, should be adequate to sustain our operations at our current levels through at least the next twelve months.

### *Capital Expenditures*

The capital expenditures in the nine months ended September 30, 2011 and 2010 are set out as below. Our capital expenditures were used primarily for plant construction and the purchase of equipment to expand our production capacity. The table below sets forth the breakdown of our capital expenditures by use for the periods indicated.

(In thousands)	Nine Months Ended September 30,	
	2011	2010 (Unaudited)
Advance on equipment purchases	\$ (322)	\$ (618)
Purchase of equipment and intangible assets	(1,860)	(29,628)
Acquisition and investment	-	(2,439)
Total capital expenditures	\$ (2,182)	\$ (32,685)

We believe that our current available working capital, after receiving the aggregate proceeds of capital raising activities and bank loans, should be adequate to sustain our operations at our current levels through at least the next twelve months.

Our depreciation and amortization expense for the nine months ended September 30, 2011 and 2010, and the income statement line items in which it is included, was as follows:

	Nine Months Ended September 30,	
	2011	2010 (Unaudited)
	(in thousands)	
Cost of goods sold	\$ 2,956	\$ 1,698
General and administrative expenses	1,281	1,410
Total depreciation and amortization expense	\$ 4,237	\$ 3,108

***Obligations under Material Contracts***

Below is a table setting forth our contractual obligations as of September 30, 2011:

<b>Contractual Obligations</b>	<b>Total</b>	<b>Payments Due by Period</b>			
		<b>Less than 1 year</b>	<b>1-3 years</b>	<b>3-5 years</b>	<b>More than 5 years</b>
Operating lease obligations	\$ 1,388,349	\$ 609,059	\$ 608,628	\$ 170,662	\$ -

***Business Combinations*****Yangzhou Rock**

On January 13, 2010, the Company acquired 100% equity interests of Yangzhou Rock for a total cash consideration of \$7.2 million. Yangzhou Valve designs, manufactures and distributes interlock valves, valve block devices, magnetic valves, and mechanical interlocking machines.

**Changsha Valve**

In February 2010, the Company acquired all the equity interests in Able Delight (Changsha) Valve Co, Ltd., formerly an indirect subsidiary of Watts Water Technologies, Inc. ( Watts ), and later known as Changsha Valve, for a purchase price of \$12.12 million plus certain assumed obligations and acquisition expenses of \$2.81 million, or an aggregate expenditure of approximately \$15 million. Changsha Valve was purchased from Able Delight Investment, Ltd. ( Able Delight ), which had acquired Changsha Valve from Watts in January 2010 with \$6.07 million from funds loaned to it by the Company. The Company directly paid the balance of \$8.93 million to other parties as disclosed in 8-KA released on November 18, 2010.

Able Delight. had been formed in November 2009 by Qing Lu, the wife of Bin Li, a 34% stockholder of the Company, in order to facilitate the Company's purchase of Changsha Valve. The Company's purchase price included the discharge of the loan, payments to certain of Watt's subsidiaries, and certain other financial obligations of Changsha Valve.

The formation of Able Delight was required by Watts Regulator. Watts Regulator required, as a condition of the sale of Changsha Valve, that the purchasing party be a company whose registered owner was not the Company, a direct competitor of Watts Regulator. It also required the purchasing party to be a wholly foreign owned entity outside China to ensure that Changsha Valve would maintain its status as a wholly foreign owned enterprise in China after the acquisition. Mr. Siping Fang, the then CEO of the Company asked Qing Lu to form Able Delight because Qing Lu is a Canadian citizen and would be qualified to set up such a wholly foreign owned entity, be it in Hong Kong or the British Virgin Islands, or somewhere else outside China. In addition, Qing Lu is a trusted relative of Mr. Siping Fang. Therefore, Able Delight was formed in November 2009 after we entered into serious negotiations with Watts Regulator to facilitate the acquisition of Changsha Valve. Changsha Valve is a manufacturer of butterfly and other valves used by hydro, thermal and nuclear power plants and in water and sewage treatment applications.

The acquisition of Changsha Valve was a two step process. Because Watts (the owner of Changsha Valve) preferred not to sell Changsha Valve to a public company, Able Delight was set up as an intermediary to facilitate the transaction. Able Delight signed a loan agreement with the Company to acquire Changsha Valve from Watts. Then Able Delight acquired Changsha Valve on behalf of the Company, and then transferred its ownership to the Company on February 3, 2010. Pursuant to the purchase agreement between Able Delight and Watts, Able Delight paid \$6 million to Watts. Pursuant to email communications, Able Delight, the Company and Watts agreed that as a

post-closing condition to the agreement between Watts and Able Delight, the Company would pay \$8.93 million to Watts in order to settle certain liabilities of Changsha Valve concurrently, including vendor payables, unpaid salaries and sales commissions, severance payments and etc, besides the cash consideration paid by the Company through Able Delight to Watts.

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Although the Company purchased Changsha Valve through Able Delight, the essence of the transaction was that the Company purchased Changsha Valve from Watts in an arm-length transaction. As mentioned above, the acquisition was a two step process to satisfy the seller requirement that Changsha Valve would not be sold to a publicly traded company.

The Company acquired Changsha Valves through the formation of a new corporation, Able Delight. Although in form the creation of a new company to effect the business combination is different than a business combination between the separate companies, in substance the transaction is no different from a transaction in which one of the combining entities directly acquires the other. Therefore, the transaction should be accounted for as if one of the combining entities directly acquires the other and the acquisition method is applied to each of the combining entities.

### **Hanwei Valve**

On April 8, 2010, the Company acquired, from certain unaffiliated individuals, 100% of equity interests in the two entities that were owners of the joint venture that in turn owned Hanwei Valve; together, with certain intangible assets used in the operation of Hanwei Valve, Hanwei Valve was acquired for an aggregate of \$19.5 million. Hanwei Valve is a manufacturer of various valve products and the sole producer in China of the fully-welded ball valve used in long distance gas pipelines and the 24-way rotary valve used in the petrochemical industry.

The acquisitions of Yangzhou Valve, Changsha Valve and Hanwei Valve contributed, in the aggregate, \$68.4 million to the Company's 2010 sales revenues, representing 37.2% of such revenues, and contributed significantly to the Company's 85.0% increase in net income for 2010. They contributed \$59.0 million to the Company's fiscal year 2011 sales revenues, representing 36.6% of such revenues.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

In August 2011, the Company changed its fiscal year end to September 30 from December 31. The Company made this change to better align its financial reporting period, as well as its annual planning and budgeting process. As a result of this change, the Consolidated Financial Statements include the Company's financial results for the nine months transition period of January 1, 2011 through September 30, 2011 and the unaudited comparative information for the nine months ended September 30, 2010. The years ended December 31, 2010 and 2009 reflect the twelve-month results of the respective calendar year.

Our consolidated financial information has been prepared in accordance with U.S. GAAP, which requires us to make judgments, estimates and assumptions that affect (1) the reported amounts of our assets and liabilities, (2) the disclosure of our contingent assets and liabilities at the end of each fiscal period and (3) the reported amounts of revenues and expenses during each fiscal period. We continually evaluate these estimates based on our own historical experience, knowledge and assessment of current business and other conditions, and our expectations regarding the future based on available information and reasonable assumptions, which together form our basis for making judgments about matters that are not readily apparent from other sources. Since the use of estimates is an integral component of the financial reporting process, our actual results could differ from those estimates. Some of our accounting policies require a higher degree of judgment than others in their application.

When reviewing our financial statements, the following should also be considered: (1) our selection of critical accounting policies, (2) the judgment and other uncertainties affecting the application of those policies, and (3) the sensitivity of reported results to changes in conditions and assumptions. We believe the following accounting policies involve the most significant judgment and estimates used in the preparation of our financial statements.

### ***Revenue Recognition***



The Company's revenue recognition policies are in accordance with U.S. generally accepted accounting principles regarding revenue recognition. Sales revenue is recognized when all of the following have occurred: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the price is fixed or determinable, and (iv) the ability to collect is reasonably assured. These criteria are generally satisfied at the time of delivery for domestic sales when risk of loss and title passes to the customer. For international sales, the revenue recognition criteria are generally satisfied under Free on Board ("FOB") terms, in which the Company's responsibility ends once the goods clear the port of shipment.

The Company recognizes revenue when the goods are delivered and title has passed. Sales revenue represents the invoiced value of goods, net of a value-added tax (“VAT”). All of the Company’s products that are sold in the PRC are subject to a Chinese value-added tax at a rate of 17% of the gross sales price or at a rate approved by the Chinese local government. This VAT may be offset by the VAT paid by the Company on raw materials and other materials included in the cost of producing their finished product.

The Company allows its customers to retain 5% to 10% of the contract prices as retainage during the warranty period, usually 12 or 24 months, to guarantee product quality. Historically, the Company has experienced insignificant warranty claims resulting in the Company having to repair or exchange a defective product. Due to the infrequency and insignificant amount of warranty claims, the ability to collect retainage is reasonably assured and is recognized at the time of shipment.

The Company also provides services to some of its sales agents and distributors. The Company recognizes revenue on these services once a contract is signed and the services have been rendered.

### ***Foreign Currency Translation and Other Comprehensive Income***

The reporting currency of the Company is the US dollar. The functional currency of our Chinese operating entities Kaifeng Valve, ZD Valve, Taizhou Taide Valve, Yangzhou Valve, Changsha Valve and Hanwei Valve is the Renminbi (RMB).

For the subsidiaries whose functional currencies are other than the US dollar, all assets and liabilities accounts were translated at the exchange rate on the balance sheet date; shareholders’ equity is translated at the historical rates and items in the income and cash flow statements are translated at the average rate for the year. Because cash flows are calculated based on the average translation rate, amounts related to assets and liabilities reported on the statement of cash flows, they will not necessarily agree with changes in the corresponding balances on the balance sheet. Translation adjustments resulting from this process are included in the accumulated other comprehensive income, in the statement of shareholders’ equity. The resulting translation gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the functional currency are included in the results of operations as incurred.

The balance sheet amounts with the exception of equity at September 30, 2011 and December 31, 2010 were translated at 6.39 and 6.59 RMB to \$1.00. The average translation rates applied to the statements of operations and cash flows were 6.50 RMB and 6.80 RMB to \$1.00 for the nine months ended September 30, 2011 and 2010, respectively, and 6.78 RMB and 6.82 RMB to \$1.00 for the years ended December 31, 2010 and 2009.

### ***Income Taxes***

The Company applies the accounting standard regarding accounting for income taxes and the accounting standard regarding accounting for uncertainty in income taxes for income taxes. This accounting standard requires recognition of deferred income tax liabilities and assets for the expected future tax consequences of temporary differences between the income tax basis and financial reporting basis of assets and liabilities. Provisions for income taxes consist of taxes currently due plus deferred taxes. The charge for taxation is based on the results for the year as adjusted for items that are non-assessable or disallowed. It is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date. Deferred taxes are accounted for using the balance sheet liability method in respect to temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and that of the corresponding tax basis used in the computation of assessable tax profit. In principle, deferred tax liabilities are recognized for all taxable temporary differences, and deferred tax assets are recognized to the extent that it is probable that taxable profit will be available against which deductible temporary differences can be utilized.

Under the accounting standard, regarding accounting for uncertainty in income taxes, a tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit, that which is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. Penalties and interest incurred related to underpayment of income tax are classified as income tax expense in the year incurred. No significant penalties or interest relating to income taxes have been incurred during the nine months ended September 30, 2011. GAAP also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

### ***Warranties***

We typically warranty all of our products. It is the Company's policy to replace parts if they become defective within one year after deployment at no additional charge. Historically, failure of product parts due to materials or workmanship is rare. Therefore, at September 30, 2011 and December 31, 2010, the Company made no provision for warranty claims for our products. Management continuously evaluates the potential warranty obligation. Management will record the expenses related to the warranty obligation if the estimated amount becomes material at the time revenue is recorded.

### ***Concentration Risks***

The Company's operations are carried out in the PRC. Accordingly, the Company's business, financial condition and results of operations may be influenced by the political, economic and legal environment in the PRC, and by the general state of the PRC's economy. The Company's operations in the PRC are subject to specific considerations and significant risks not typically associated with companies in North America and Western Europe. The Company's results may be adversely affected by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things.

Certain financial instruments may subject the Company to concentration of credit risk. The Company maintains bank deposits within state-owned banks within the PRC, Hong Kong and the United States. Balances at financial institutions of state owned banks within the PRC are not covered by insurance. As of September 30, 2011 and December 31, 2010, the Company's cash and restricted cash balances, totaling \$29,508,367 and \$26,596,872 respectively at those dates, were not covered by insurance. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant risks on its cash in bank accounts.

Five major customers represented approximately 14% of the Company's total sales for the nine months ended September 30, 2011. Five major customers represented approximately 9% and 11% of the Company's total sales for the years ended December 31, 2010 and 2009, respectively.

Five major suppliers, including one related party, Kaifeng High-Pressure Valve Steel Casting Co., Ltd, represented approximately 18% of the Company's total purchases for the nine months ended September 30, 2011. Five major suppliers, including a related party, represented approximately 24% and 17% of the Company's total purchases for the years ended December 31, 2010 and 2009, respectively.

### ***Accounts Receivable and Allowance for Doubtful Accounts***

The Company's business operations are conducted in the PRC. During the normal course of business, the Company extends unsecured credit to its customers by selling on various credit terms. Management reviews its accounts receivable on a quarterly basis to determine if the allowance for doubtful accounts is adequate. An estimate for doubtful accounts is recorded when collection of the full amount is no longer probable. The Company's existing reserve is consistent with its historical experience and is considered adequate by the management.

### ***Fair Value of Financial Instruments***

The Company adopted SFAS No. 157, "Fair Value Measurements" on January 1, 2008. SFAS No. 157 defines fair value, establishes a three-level valuation hierarchy for disclosures of fair value measurement and enhances disclosure requirements for fair value measures. The carrying amounts reported in the balance sheets for receivables and payables qualify as financial instruments and are a reasonable estimate of fair value because of the short period of time between the origination of such instruments and their expected realization and their current market rate of interest. The three levels are defined as follows:

Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

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Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the assets or liability, either directly or indirectly, for substantially the full term of the financial instruments.

Level 3 inputs to the valuation methodology are unobservable and significant to the fair value.

The Company analyzes all financial instruments, with features of both liabilities and equity, under the accounting standards regarding accounting for certain financial instruments with characteristics of both liabilities and equity, accounting for derivative instruments and hedging activities, accounting for derivative financial instruments indexed to, and potentially settled in, a company's own stock, and the accounting standard regarding determining whether an instrument (or embedded feature) is indexed to an entity's own stock. The accounting standard specifies that a contract that would otherwise meet the definition of a derivative but is both (a) indexed to the Company's own stock and (b) classified in stockholders' equity in the statement of financial position, would not be considered a derivative financial instrument. This standard provides a two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer's own stock and thus able to qualify for this accounting standard scope exception. All warrants issued by the Company are denominated in USD; because the Company's functional currency is the RMB, the Company accounts for these warrants as derivative instrument liabilities and marks them to market each period. Because there is no quoted or observable market price for the warrants, the Company used level 3 inputs for its valuation methodology.

#### ***Long-lived Assets***

Long lived assets, including buildings and improvements, equipment and intangible assets, are reviewed, if events and changes in circumstances indicate that its carrying amount may not be recoverable, to determine whether their carrying value has become impaired. The Company considers assets to be impaired if the carrying value exceeds the future projected cash flows from related operations. The Company also re-evaluates the periods of depreciation and amortization to determine whether subsequent events and circumstances warrant revised estimates of useful lives. For the nine months ended September 30, 2011, the Company impaired equipment in the amount of \$110,096, which was included in general and administrative expenses. It is because that the products manufactured by certain equipments did not meet the customer's needs any more. The Company determined that the equipments were technically obsolete and needed to be replaced with new equipments to meet the customer's current and future needs

#### ***Goodwill***

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Goodwill is not amortized, but is instead tested for impairment. Goodwill is reviewed for impairment annually at internal reporting unit - individual operating subsidiary basis in accordance with U.S. GAAP. The Company determines the reporting units based on following factors: a. it engages in business activities from which it may earn revenues and incur expenses; b. its operating results are regularly reviewed by the Company's chief operating decision makers to make decisions about resources to be allocated to the segment and assess its performance; and c. its discrete financial information is available.

A significant amount of judgment is involved in determining if an indicator of impairment has occurred. Such indicators may include current period operating or cash flow losses combined with a historical of operating or cash flow losses, a projection or forecast that demonstrates continuing operating or cash flow losses, a significant adverse change in AR collection and unanticipated technology revolution in valves industry, among others. The Company performs its annual impairment review of goodwill every year at September 30 and when a triggering event occurs between annual impairment tests. The goodwill impairment test is a two-step test. Under the first step, the fair value of the reporting unit is compared with its carrying value (including goodwill). If the fair value of the reporting unit is less than its carrying value, an indication of goodwill impairment exists for the reporting unit, and the Company must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any

excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed. In addition to cash flow projection, management also considers the change of stock price representing of a triggering event for an impairment evaluation. The Company believes that the current decline in its stock price is temporary due to the negative publicity about Chinese companies going public in the United States through reverse merger transactions. The fundamentals of the Company's business remain strong as evidenced by over \$30.0 Million of net income over the past nine months. The Company does not believe impairing its goodwill is necessary at this time just because its stock price has temporarily dropped while the fundamental of the business remain strong.

The Company has acquired several entities resulting in the recording of intangible assets, including goodwill, which represents the excess of the purchase price over the fair value of the net assets of businesses acquired.

No impairment loss was incurred for the nine months ended September 30, 2011 and 2010 based on the Company's annual impairment test.

### ***Stock Based Compensation***

The Company applies Statement of Financial Accounting Standards on "Accounting for Stock-Based Compensation", which defines a fair-value-based method of accounting for stock based employee compensation and transactions in which an entity issues its equity instruments to acquire goods and services from non-employees. Stock compensation for stock granted to non-employees has been determined in accordance with the standard and the "Accounting for Equity Instruments that are issued to Other than Employees for Acquiring, or in Conjunction with Selling Goods or Services" standard, as the fair value of the consideration received or the fair value of equity instruments issued, whichever is more reliably measured. The standard allows the "simplified" method to determine the term of employee options when other information is not available.

### **Recently issued accounting pronouncements**

In April 2011, the FASB issued ASU No. 2011-03, *Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements* (ASU 2011-03), intended to improve financial reporting of repurchase agreements and refocus the assessment of effective control on a transferor's contractual rights and obligations rather than practical ability to perform those rights and obligations. The guidance in ASU 2011-03 is effective for the first interim or annual period beginning on or after December 15, 2011. The Company does not expect the adoption of ASU 2011-03 to have a significant impact on its consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04). ASU 2011-04 represents the converged guidance of the FASB and the International Accounting Standards Board (IASB) on fair value measurement. A variety of measures are included in the update intended to either clarify existing fair value measurement requirements, change particular principles requirements for measuring fair value or for disclosing information about fair value measurements. For many of requirements, the FASB does not intend to change the application of existing requirements under Accounting Standards Codification (ASC) Topic 820, Fair Value Measurements. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011 and early application is not permitted. The Company is evaluating the impact adoption of ASU 2011-04 and does not expect the adoption of ASU 2011-04 will have significant impact on its financial statements.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income* (ASU 2011-05), intended to increase the prominence of items reported in other comprehensive income and to facilitate convergence of accounting guidance in this area with that of the IASB. The amendments require that all non-owner changes in stockholders' equity be presented in a single continuous statement of comprehensive income or in two separate but consecutive statements. Amendments under ASU 2011-05 for public entities should be applied retrospectively for fiscal years, and interim periods within those years, beginning December 15, 2011. The Company is evaluating the impact adoption of ASU 2011-05 and does not expect the adoption of ASU 2011-05 will have significant impact on its financial statements.

In July 2011, the FASB issued accounting guidance on disclosures about the credit quality of financing receivables and the allowance for credit losses. The guidance expands disclosures for the allowance for credit losses and financing receivables by requiring entities to disclose information at disaggregated levels. It also requires disclosure of credit quality indicators, past due information and modifications of financing receivables. The Company does not expect the adoption of this guidance to have a significant impact on its consolidated financial statements.





In September 2011, the FASB issued Intangibles – Goodwill and Other (Topic 350) – Testing Goodwill for Impairment (ASU No. 2011-08), which amends ASC 350 to first assess qualitative factors before performing the quantitative goodwill impairment testing. The ASU provides the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the results of the qualitative analysis indicate it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, the quantitative two-step impairment test, which is required under current U.S. GAAP, would not be necessary. The ASU is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The implementation of the ASU is not expected to have a material impact on the Company's financial statements.

### **Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements.

### **Seasonality**

Our operating results and operating cash flows historically have not been subject to seasonal variations. This pattern may change, however, as a result of new market opportunities or new product introductions.

### **Item 7A. *Quantitative and Qualitative Disclosures about Market Risk.***

We may be exposed to changes in financial market conditions in the normal course of business. Market risk generally represents the risk that losses may occur as a result of movements in interest rates and equity prices. We currently do not use financial instruments in the normal course of business that are subject to changes in financial market conditions.

#### **Interest Rate Risk**

We are exposed to interest rate risk primarily with respect to our short-term bank loans and long-term bank loans. Although the interest rates, which are based on the banks' prime rates with respect to our short-term loans, are fixed for the terms of the loans, the terms are typically three to twelve months for short-term bank loans and interest rates are subject to change upon renewal. There were no material changes in interest rates for short-term bank loans renewed during the nine months ended September 30, 2011.

We have \$4.7 million in short-term bank loans and no long-term bank loans outstanding as of September 30, 2011, and we have not used any derivative financial instruments or engaged in any interest rate hedging activities to manage our interest rate risk exposure. Our future interest expense on short-term or long-term bank loans may increase or decrease due to changes in market interest rates. We monitor interest rates in conjunction with our cash requirements to determine the appropriate level of bank loans relative to other sources of funds.

#### **Foreign Exchange Risk**

While our reporting currency is the U.S. Dollar, all of our consolidated sales and consolidated costs and expenses are denominated in the RMB. All of our assets are denominated in the RMB except for cash. As a result, we are exposed to foreign exchange risk as our sales and results of operations may be affected by fluctuations in the exchange rate between the U.S. Dollar and the RMB. If the RMB depreciates against the U.S. Dollar, the value of our RMB sales, earnings and assets as expressed in our U.S. Dollar financial statements will decline. Assets and liabilities are translated at exchange rates at the balance sheet dates and revenue and expenses are translated at the average exchange rates and stockholders' equity is translated at historical exchange rates. Any resulting translation adjustments are not included in determining net income but are included in determining other comprehensive income, a component of stockholders' equity. We have not entered into any hedging transactions in an effort to reduce our exposure to foreign

exchange risk.

The value of the RMB against the U.S. dollar and other currencies is affected by, among other things, changes in China's political and economic conditions. Since July 2005, the RMB has not been pegged to the U.S. dollar. Although the People's Bank of China regularly intervenes in the foreign exchange market to prevent significant short-term fluctuations in the exchange rate, the RMB may appreciate or depreciate significantly in value against the U.S. dollar or the Euro in the medium to long term. Moreover, it is possible that in the future, PRC authorities may lift restrictions on fluctuations in RMB exchange rate and lessen intervention in the foreign exchange market.

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## **Inflation**

Inflationary factors such as increases in the cost of our product and overhead costs may adversely affect our operating results. Although we do not believe that inflation has had a material effect on our financial position or results of operations to date, a high rate of inflation in the future may have an adverse effect on our ability to maintain current levels of gross profit and selling, general and administrative expenses as a percentage of net sales if the selling prices of our products do not increase with these increased costs.

## **Item 8. Financial Statements and Supplementary Data.**

The following consolidated financial statements, notes thereto, and the related independent auditors' reports contained on pages F-1 and F-2 of our consolidated financial statements are herein incorporated:

Consolidated Statements of Earnings for the nine months ended September 30, 2011 and 2010 (unaudited), and the years ended December 31, 2010 and 2009.

Consolidated Balance Sheets as of September 30, 2011 and December 31, 2010

Consolidated Statements of Cash Flows for the nine months ended September 30, 2011 and 2010 (unaudited), and the years ended December 31, 2010 and 2009.

Consolidated Statements of Stockholders' Equity and Comprehensive Income for the nine months ended September 30, 2011 and the years ended December 31, 2010 and 2009

Notes to Consolidated Financial Statements

## **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None

## **Item 9A. CONTROLS AND PROCEDURES**

### ***(a) Evaluation of Disclosure Controls and Procedures***

Our management, with the participation of our chief executive officer and chief financial officer, Mr. Jianbao Wang and Mr. Gang Wei, respectively, evaluated the effectiveness of our disclosure controls and procedures. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports, such as this report, that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on our assessment, the CEO and the CFO determined that, as of September 30, 2011, and as of the date that the evaluation of the effectiveness of our disclosure controls and procedures was completed, because of the material weaknesses in our internal control over financial reporting described below, our disclosure controls and procedures were not effective to satisfy all objectives for which they are intended.



***(b) Management's annual report on internal control over financial reporting***

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting refers to the process designed by, or under the supervision of, our chief executive officer and chief financial officer, and effected by our Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP, and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that our receipts and expenditures are being made only in accordance with the authorization of our management and directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

During our assessment of the effectiveness of internal control over financial reporting as of September 30, 2011, our management identified material weakness related to the following:

*Lack of Internal Audit System* – The Company lacks qualified resources to perform the internal audit function properly, which renders ineffective the ability to prevent and detect control lapses of certain areas in accordance with the Company's internal control design.

*Accounting and Finance Personnel Weaknesses* – The Company did not maintain a sufficient complement of personnel with an appropriate level of accounting knowledge, experience and training in the application of generally accepted accounting principles commensurate with the Company's financial reporting requirements, and did not implement adequate supervisory review to ensure the financial statements were prepared in conformity with generally accepted accounting principles in the United States of America. Additionally, we identified numerous internal control deficiencies that were identified as being significant. The number and nature of these significant deficiencies, when aggregated, was determined to be a material weakness. In the aggregate, these significant deficiencies could result in a misstatement of the Company's account balances or disclosures which could cause a material misstatement of the consolidated financial statements that would not be prevented or detected.

As disclosed in our Annual Report on Internal Control over Financial Reporting filed with the 2010 Form 10-K, the Company's management has identified the steps necessary to address the material weaknesses described above and in 2011, we continued to implement these remedial procedures.

- a. Involved both internal accounting and operations personnel and outside contractors with technical accounting expertise early in the evaluation of our complex, non-routine transactions to obtain additional guidance as to the application of generally accepted accounting principles to such transactions;
- b. Required that our senior accounting personnel and the principal accounting officer review our complex, non-routine transactions to evaluate and approve the accounting treatment for such transactions. We also consulted experts in the event that transactions were beyond our comprehension;
- c. Trained internal accounting personnel in generally accepted accounting principles in the United States; and
- d. Strengthened our internal audit function by hiring an experienced internal audit manager.

Our management is not aware that any of the material weakness in our internal control over financial reporting is cause to believe that any material inaccuracies or errors existed in our financial statement as of September 30, 2011. The reportable conditions and other areas of our internal control over financial reporting identified by us as needing improvement have not resulted in a material restatement of our financial statements. Nor are we aware of any instance where such reportable conditions or other identified areas of weakness have resulted in a material misstatement or omission in any report we have filed with or submitted to the Commission.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Management remains committed to improving its internal controls and will continue to work to put effective controls in place. The Company is actively recruiting more staff with good knowledge of U.S. GAAP to assist in the Company's financial reporting.

The Company's independent public accounting firm has audited and issued a report on the Company's internal control over financial reporting which is included in this Annual Report on Form 10-K and incorporated by reference herein.

*(c) Changes in internal control over financial reporting*

We regularly review our system of internal control over financial reporting and make changes to our processes and systems to improve controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient systems, consolidating activities, and migrating processes.



## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and  
Stockholders of China Valves Technologies, Inc

We have audited China Valves Technologies, Inc.'s and Subsidiaries' (the "Company's") internal control over financial reporting as of September 30, 2011, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weakness has been identified and included in management's assessment.

*Lack of Internal Audit System* – The Company is lack qualified resources to perform the internal audit function properly, which renders ineffective the ability to prevent and detect control lapses of certain key areas in accordance with the Company's internal control design.



Accounting and Finance Personnel Weaknesses – The Company did not maintain a sufficient complement of personnel with an appropriate level of accounting knowledge, experience and training in the application of generally accepted accounting principles commensurate with the Company’s financial reporting requirements, and did not implement adequate supervisory review to ensure the financial statements were prepared in conformity with generally accepted accounting principles in the United States of America. Additionally, we identified numerous internal control deficiencies that were identified as being significant. The number and nature of these significant deficiencies, when aggregated, was determined to be a material weakness. In the aggregate, these significant deficiencies could result in a misstatement of the Company’s account balances or disclosures which could cause a material misstatement of the consolidated financial statements that would not be prevented or detected.

This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2011 financial statements, and this report does not affect our report dated November 18, 2011 on those financial statements.

In our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of September 30, 2011, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of September 30, 2011 and the related statements of income and other comprehensive income, shareholders’ equity, and cash flows of China Valves Technology, inc and Subsidiaries for the nine months ended September 30, 2011. , These two material weaknesses stated above were considered in determining the nature, timing, and extent of audit tests applied in our audit of those consolidated financial statements, and this report does not affect our report dated November 18, 2011, which expressed an unqualified opinion on those consolidated financial statements.

/s/ Frazer Frost, LLP  
Brea, California  
November 18, 2011

**Item 9B. OTHER INFORMATION**

None.

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**PART III****Item 10. Directors, Executive Officers and Corporate Governance**

The information required by this Item is incorporated by reference to the information contained in our Proxy Statement for our 2012 Annual Meeting of Stockholders, which we will file with the Commission within 120 days after the end of the fiscal year 2011.

**Item 11. Executive Compensation**

The information required by this Item is incorporated by reference to the information contained in our Proxy Statement for our 2012 Annual Meeting of Stockholders, which we will file with the Commission within 120 days after the end of fiscal year 2011.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required by this Item is incorporated by reference to the information contained in our Proxy Statement for our 2012 Annual Meeting of Stockholders, which we will file with the Commission within 120 days after the end of fiscal year 2011.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

The information required by this Item is incorporated by reference to the information contained in our Proxy Statement for our 2012 Annual Meeting of Stockholders, which we will file with the Commission within 120 days after the end of fiscal year 2011.

**Item 14. Principal Accounting Fees and Services**

The information required by this Item is incorporated by reference to the information contained in our Proxy Statement for our 2012 Annual Meeting of Stockholders, which we will file with the Commission within 120 days after the end of fiscal year 2011.

**PART IV****Item 15. EXHIBITS, FINANCIAL STATEMENT AND SCHEDULES.**

(a) The following documents are filed as part of this Report:

(1) Financial Statements are set forth beginning on page F-1 of this Report

Section 1.	Report of Independent Registered Public Accounting Firm	F-2
Section 2.	Consolidated Balance Sheets	F-3
Section 3.	Consolidated Statements of Income and Other Comprehensive Income	F-4
Section 4.	Consolidated Statement of Stockholders Equity	F-5
Section 5.	Consolidated Statements of Cash Flows	F-6
Section 6.	Notes to Consolidated Financial Statements	F-7-F-25

(2) Financial Statement Schedules: All Schedules are omitted because the information called for is not applicable, is not required, or because the financial information is set forth in the financial statements or notes thereto.

(3) Exhibits



**Exhibits (Including Those Incorporated By Reference).  
Exhibit Index**

**Exhibit**

<b>No.</b>	<b>Description</b>
2.1	Share Exchange Agreement, dated December 18, 2007, among the Company, the stockholders of the Company, China Valves and the China Valves Shareholder (incorporated herein by reference to Exhibit 2.1 to the registrant's current report on Form 8-K filed on December 21, 2007).
3.1	Articles of Incorporation of the Company as filed with the Secretary of State of Nevada on August 1, 1997 (incorporated herein by reference to Exhibit 3.1 to the SB-2 Registration Statement filed on November 1, 2001)
3.2	Certificate of Amendment to Certificate of Incorporation changing the corporate name filed with the Secretary of State of Nevada (incorporated herein by reference to Exhibit 3.2 to the registrant's current report on Form 8-K filed on December 21, 2007).
3.3	Bylaws of the registrant, as amended to date, (incorporated herein by reference to Exhibit 3.2 to the SB-2 Registration Statement filed on November 1, 2001).
3.4	Certificate to Accompany Restated Articles or Amended and Restated Articles of China Valves Technology, Inc. (incorporated herein by reference to Exhibit 3.1 to the registrant's current report on Form 8-K filed on July 30, 2009).
4.1	Form of warrants, (incorporated herein by reference to Exhibit 10.1 to the registrant's current report on Form 8-K filed on December 31, 2009).
4.2	Form of warrants, (incorporated herein by reference to Exhibit 10.1 to the registrant's current report on Form 8-K filed on December 29, 2009).
10.1	Form of Securities Purchase Agreement, dated August 26, 2008 (incorporated herein by reference to Exhibit 10.1 to the registrant's current report on Form 8-K filed on August 27, 2008).
10.2	Form of Registration Rights Agreement, dated August 26, 2008 (incorporated herein by reference to Exhibit 4.1 to the registrant's current report on Form 8-K filed on August 27, 2008).
10.3	Escrow Agreement, dated August 26, 2008, by and among the Company, Brean Murray, Carret & Co., LLC, The Pinnacle Fund, LLC, Pinnacle China Fund, LLC and Escrow, LLC. (incorporated herein by reference to Exhibit 10.4 to the registrant's current report on Form 8-K filed on August 27, 2008).

- 10.4 Form of Holdback Escrow Agreement, dated August 26, 2008 (incorporated herein by reference to Exhibit 10.2 to the registrant's current report on Form 8-K filed on August 27, 2008).
- 10.5 Form of Make Good Escrow Agreement, dated August 26, 2008 (incorporated herein by reference to Exhibit 10.3 to the registrant's current report on Form 8-K filed on August 27, 2008).
- 10.6 Form of Lockup Agreement, dated August 26, 2008 by and between the Company and the stockholders listed therein (incorporated herein by reference to Exhibit 4.2 to the registrant's current report on Form 8-K filed on August 27, 2008).
- 10.7 Form of Warrant (incorporated herein by reference to Exhibit 4.3 to the registrant's current report on Form 8-K filed on August 27, 2008).
- 10.8 English version of Agreement for Transfer of Land Use Right and Housing Titles, dated August 26, 2008, by and between the Company's wholly owned subsidiary Kaifeng High Pressure Valve Co., Ltd. and Kaifeng High Pressure Valve Steel Casting Limited Liabilities Company (incorporated herein by reference to Exhibit 10.5 to the registrant's current report on Form 8-K filed on August 27, 2008).
- 10.9 English version of Premises Lease Agreement, dated August 26, 2008, by and between the Company's wholly owned subsidiary Kaifeng High Pressure Valve Co., Ltd. and Kaifeng High Pressure Valve Steel Casting Limited Liabilities Company (incorporated herein by reference to Exhibit 10.6 to the registrant's current report on Form 8-K filed on August 27, 2008).
- 10.10 English version of Premises Leaseback Agreement, dated August 26, 2008, by and between the Company's wholly owned subsidiary Kaifeng High Pressure Valve Co., Ltd. and Kaifeng High Pressure Valve Steel Casting Limited Liabilities Company (incorporated herein by reference to Exhibit 10.7 to the registrant's current report on Form 8-K filed on August 27, 2008).
- 10.11 English version of Manufacturing and Supply Agreement, dated August 26, 2008, by and between the Company's wholly owned subsidiary Kaifeng High Pressure Valve Co., Ltd. and Kaifeng High Pressure Valve Steel Casting Limited Liabilities Company (incorporated herein by reference to Exhibit 10.9 to the registrant's current report on Form 8-K filed on August 27, 2008).
- 10.12 Placement Agency Agreement between the Company and Rodman & Renshaw, LLC, effective as of December 27, 2009 (Incorporated by reference to Exhibit 10.2 to the Company's current report on Form 8-K filed on December 27, 2009)
- 10.13 Amendment Agreement between the Company and Rodman & Renshaw, LLC, effective as of December 30, 2009 (incorporated herein by reference to Exhibit 10.3 to the registrant's current report on Form 8-K filed on December 31, 2009.)
- 10.14 Form of Securities Purchase Agreement (incorporated herein by reference to Exhibit 10.1 to the registrant's current report on Form 8-K filed on December 29, 2009)
- 10.15 Placement Agency Agreement between the Company and Rodman & Renshaw, LLC, effective as of December 27, 2009 (incorporated herein by reference to Exhibit 10.2 to the registrant's current report on Form 8-K filed on December 29, 2009)

- 10.16 Asset Purchase Agreement, dated as of February 15, 2009, by and between Taizhou Taide Valve Co., Ltd. and Taizhou Wote Valve Co., Ltd. (incorporated by reference to Exhibit 10.1 to the registrant's current report on Form 8-K filed on April, 21, 2009).
- 10.17 Amendment to Registration Rights Agreement, dated March 4, 2009, among China Valves Technology, Inc. and the purchasers identified therein. (incorporated by reference to Exhibit 10.1 to the registrant's current report on Form 8-K filed on March 9, 2009).
- 10.18 English Translation of Asset Purchase Agreement, dated January 13, 2010, by and among Henan Tonghai Fluid Equipment Co., Ltd., Guichun Xie, Lizhen Huang and Lanzhou Sufa Technology Co., Ltd. (incorporated by reference to Exhibit 10.1 to the registrant's current report on Form 8-K filed on January 19, 2010)
- 10.19 English Translation of Asset Purchase Agreement, dated February 3, 2010, by and between China Fluid Equipment Limited and Able Delight Investment Limited. (incorporated by reference to Exhibit 10.1 to the registrant's current report on Form 8-K filed on February 8, 2010) English translation of Asset Transfer Agreement, dated as of April 8, 2010, by and among Henan Tonghai Fluid Equipment
- 10.20 Co., Ltd., Shanghai Pudong Hanwei Valve Co., Ltd., Shanghai Hanhuang Valve Co., Ltd. and Hong Kong Get Success Investment Limited (incorporated by reference to Exhibit 10.1 to the registrant's current report on Form 8-K filed on April 9, 2010)
- 10.21 English translation of Loan Agreement by and between China Fluid Equipment Holdings Limited and Able Delight Investment Limited, dated December 10, 2009. (incorporated by reference to Exhibit 10.1 to the registrant's current report on Form 8-K/A filed on November 18, 2010)
- 10.22 English Translation of Employment Agreement with Gang Wei dated December 15, 2010 (incorporated by reference to Exhibit 10.1 to the registrant's current report on Form 8-K filed on December 16, 2010).
- 10.23 Form of Securities Purchase Agreement (incorporated by reference to Exhibit 10.1 to the registrant's current report on Form 8-K filed on January 6, 2011).
- 10.24 Form of Securities Purchase Agreement (incorporated by reference to Exhibit 10.2 to the registrant's current report on Form 8-K filed on January 6, 2011).
- 21 List of Subsidiary \*
- 31.1 Certification of Chief Executive Officer, pursuant to Rule 13a-14(a). \*
- 31.2 Certification of Chief Financial Officer, pursuant to Rule 13a-14(a). \*
- 32.1 Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. \*
- 32.2 Certification of Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. \*

\* filed herein.



**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**CHINA VALVES TECHNOLOGY, INC.**

November 18, 2011

(Date Signed)

By /s/ Jianbao Wang

Jianbao Wang, Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company in the capacities and on the dates indicated.

Each person whose signature appears below hereby authorizes Siping Fang as attorney-in-fact to sign on his behalf, individually, and in each capacity stated below, and to file all amendments and/or supplements to this annual report on Form 10-K.

<b>Signature</b>	<b>Capacity</b>	<b>Date</b>
<i>/s/ Siping Fang</i> Siping Fang	President, Director	November 18, 2011
<i>/s/ Jianbao Wang</i> Jianbao Wang	Chief Executive Officer (Principal Executive Officer)	November 18, 2011
<i>/s/ Gang Wei</i> Gang Wei	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	November 18, 2011
<i>/s/ Peter Li</i> Peter Li	Director	November 18, 2011
<i>/s/ William Haus</i> William Haus	Director	November 18, 2011
<i>/s/ Zengbiao Yu</i> Zengbiao Yu	Director	November 18, 2011
<i>/s/ Binjie Fang</i> Binjie Fang	Chief Operating Officer and Director	November 18, 2011

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of China Valves Technologies, Inc

We have audited the accompanying consolidated balance sheets of China Valves Technologies, Inc and Subsidiaries (the “Company”) as of September 30, 2011 and December 31, 2010, and the related statements of income and other comprehensive income, shareholders’ equity, and cash flows for the nine months ended September 30, 2011 and the years ended December 31, 2010 and 2009. The Company’s management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of September 30, 2011 and December 31, 2010, and the results of its operations and its cash flows for the nine months ended September 30, 2011 and the years ended December 31, 2010 and 2009 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of September 30, 2011, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated November 18, 2011 expressed an adverse opinion on the Company’s internal control over financial reporting because of material weaknesses.

/s/ Frazer Frost, LLP

Brea, CA

November 18, 2011

## CHINA VALVES TECHNOLOGY INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

ASSETS

	September 30, 2011	December 31, 2010
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 28,076,692	\$ 25,820,600
Restricted cash	2,344,276	1,164,599
Notes receivable	1,465,369	2,815,930
Accounts receivable, net of allowance for doubtful accounts of \$4,052,398 and \$998,739 as of September 30, 2011 and December 31, 2010, respectively	124,514,274	84,147,120
Accounts receivable - related party	-	200,180
Other receivables	5,106,572	3,176,640
Other receivable -related party	-	152,170
Inventories, net of allowance of \$2,394,319 and \$1,148,663 as of September 30, 2011 and December 31, 2010, respectively.	23,868,885	16,251,930
Advances on inventory purchases	2,421,390	1,094,670
Advance on inventory purchase - related party	1,552,123	917,200
Prepaid expenses and other current assets	79,295	359,350
Total current assets	189,428,876	136,100,440
PLANT AND EQUIPMENT, net	40,192,636	40,773,560
<b>OTHER ASSETS:</b>		
Accounts receivables - retainage, long term	5,724,024	4,751,600
Goodwill	33,976,186	32,955,160
Intangibles, net of accumulated amortization	22,914,008	23,027,880
Other investments, cost	815,066	790,570
Other non-current assets	395,514	108,430
Total other assets	63,824,798	61,633,650
Total assets	\$ 293,446,310	\$ 238,507,660

LIABILITIES AND SHAREHOLDERS' EQUITY

<b>CURRENT LIABILITIES:</b>		
Accounts payable - trade	\$ 24,575,461	\$ 19,530,340
Accounts payable - related parties	786,471	2,382,900
Short-term loans	6,513,810	5,648,790
Other payables	5,287,964	3,405,200
Other payables - related parties	94,226	1,899,620
Notes payable	469,200	
Accrued liabilities	4,091,998	2,825,560
Customer deposits	11,139,936	6,499,830
Taxes payable	5,791,440	6,828,110
Warrant liabilities	-	880,560
Total current liabilities	58,750,506	49,900,940

## COMMITMENTS AND CONTINGENCIES

## SHAREHOLDERS' EQUITY:

Common stock, \$0.001 par value; 300,000,000 shares authorized; 35,869,654 and 34,664,654 shares issued and outstanding as of September 30, 2011 and December 31, 2010, respectively	35,869	34,664
Additional paid-in capital	106,508,099	96,433,310
Statutory reserves	11,224,490	10,046,710
Retained earnings	98,242,189	69,861,610
Accumulated other comprehensive income	18,685,157	12,230,400
Total shareholders' equity	234,695,804	188,606,710
Total liabilities and shareholders' equity	\$ 293,446,310	\$ 238,507,660

See report of independent registered public accounting firm.

The accompanying notes are an integral part of these consolidated financial statements.

CHINA VALVES TECHNOLOGY INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME AND OTHER COMPREHENSIVE INCOME

	Nine months ended		Year ended	Year ended
	September 30, 2011	September 30, 2010 (Unaudited)	December 31, 2010	December 31, 2009
SALES	\$ 161,296,932	\$ 131,366,951	\$ 183,077,333	\$ 95,370,012
SALES - RELATED PARTIES	97,643	-	618,793	-
Total sales	161,394,575	131,366,951	183,696,126	95,370,012
COST OF GOODS SOLD	95,752,849	69,394,665	103,276,910	48,527,336
GROSS PROFIT	65,641,726	61,972,286	80,419,216	46,842,676
OPERATING EXPENSES:				
Selling	10,133,474	6,650,841	10,414,293	6,317,766
General and administrative	17,518,864	9,085,894	15,619,925	7,359,496
Research and development	286,204	181,861	228,858	126,750
Total operating expenses	27,938,542	15,918,596	26,263,076	13,804,012
INCOME FROM OPERATIONS	37,703,184	46,053,690	54,156,140	33,038,664
OTHER INCOME (EXPENSE):				
Other income, net	(522,015)	(490,768)	(669,462)	(258,509)
Gain from acquisition	-	(1,016,198)	(3,714,840)	(252,183)
Interest and finance expense, net	207,926	82,289	100,997	128,518
Change in fair value of warrant liabilities	(990,031)	262,633	785,350	1,508,997
Total other income (expenses), net	(1,304,120)	(1,162,044)	(3,497,955)	1,126,823
INCOME BEFORE PROVISION FOR INCOME TAXES	39,007,304	47,215,734	57,654,095	31,911,841
PROVISION FOR INCOME TAXES	9,448,956	10,426,364	14,456,566	8,558,748

NET INCOME	29,558,348	36,789,370	43,197,529	23,353,093
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OTHER  
COMPREHENSIVE  
INCOME:

Foreign currency translation gain (loss)	6,454,751	3,597,068	6,078,504	(7,075)
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COMPREHENSIVE INCOME	\$ 36,013,099	\$ 40,386,438	\$ 49,276,033	\$ 23,346,018
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BASIC EARNINGS  
PER SHARE:

Weighted average number of shares	35,654,398	34,513,314	34,547,224	30,771,356
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Earnings per share	\$ 0.83	\$ 1.07	\$ 1.25	\$ 0.76
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DILUTED  
EARNINGS PER  
SHARE:

Weighted average number of shares	35,677,873	34,727,623	34,695,639	30,946,392
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Earnings per share	\$ 0.83	\$ 1.06	\$ 1.25	\$ 0.75
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See report of independent registered public accounting firm.

The accompanying notes are an integral part of these consolidated financial statements.

## CHINA VALVES TECHNOLOGY INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

	Common Stock Number of shares	Par Value	Additional Paid-in capital	Common Stock Subscription Receivable	Retained Earnings Statutory reserves	Un
BALANCE, December 31, 2008	31,192,552	\$ 31,192	\$ 66,935,968	\$ (9,834,000)	\$ 2,958,659	\$ 10
Cashless exercise of warrants	201,326	201	755,811			
Release of shares in escrow for shares issued for real estate acquisition				9,834,000		
Stock based compensation			47,057			
Common stock issuance for cash at \$9.01	333,334	333	2,796,107			
Net income						23
Adjustment to statutory reserve					2,575,916	(2)
Foreign currency translation adjustment						
BALANCE, December 31, 2009	31,727,212	31,726	70,534,943	-	5,534,575	31
Exercised warrants	523,329	524	5,304,102			
Stock-based compensation			56,019			
Common stock issuance for cash at \$9.00	2,414,113	2,414	20,538,252			
Net income						43
Adjustment to statutory reserve					4,512,138	(4)
Foreign currency translation adjustment						
BALANCE, DECEMBER 31, 2010	34,664,654	34,664	96,433,316	-	10,046,713	69
Stock-based compensation	205,000	205	793,767			
Reclassification of warrant liabilities			(109,466)			
Common stock issuance for cash at \$10.00	1,000,000	1,000	9,390,482			
Net income						29
Adjustment to statutory reserve					1,177,777	(1)
Foreign currency translation adjustment						
BALANCE, September 30, 2011	35,869,654	\$ 35,869	\$ 106,508,099	\$ -	\$ 11,224,490	\$ 98

See report of independent registered public accounting firm.

The accompanying notes are an integral part of these consolidated financial statements.



**CHINA VALVES TECHNOLOGY INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Nine months ended September 30, 2011	September 30, 2010	Year ended December 31, 2010	Year ended December 31, 2009
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net income	\$ 29,558,348	\$ 36,789,370	\$ 43,197,529	\$ 23,353,093
Adjustments to reconcile net income to cash (used in) provided by operating activities:				
Depreciation and amortization	4,236,618	3,107,769	4,870,172	1,955,724
Bad debt provision (recovery)	2,974,399	187,768	57,836	(254,963)
Gain on acquisition	-	(1,016,198)	(3,714,840)	(252,183)
Gain (loss) on disposal of fixed assets	173,286	(1,564)	343,333	87,876
Impairment of equipments	110,096	-	-	-
Stock compensation	793,972	44,095	56,019	47,057
Change in fair value of warrant liabilities	(990,031)	262,633	785,350	1,508,997
Inventory allowance and write-off	1,262,246		1,859,681	432,707
Change in operating assets and liabilities:				
Notes receivable	1,414,831	(224,086)	(2,323,098)	465,721
Accounts receivable - trade and retainage, short term	(40,130,902)	(40,886,982)	(44,986,649)	(4,009,629)
Accounts receivable - related parties	209,248	-	-	-
Other receivables and	(1,535,314)	(230,878)	1,992,250	269,749

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prepaid expenses				
Other				
receivables -				
related parties	158,451	(147,100)	(149,669)	-
Inventories, net	(8,261,967)	(2,054,795)	198,527	1,563,708
Advances on				
inventory				
purchases	(1,272,140)	(429,052)	264,940	(213,271)
Advances on				
inventory				
purchases - related				
parties	(610,203)	14,702	(490,053)	966,947
Long-term				
receivable	-	-	442,800	(57,513)
Accounts				
receivable -				
retainage, long				
term	(812,013)	(4,092,665)	(4,623,183)	(1,031,325)
Accounts				
payable - trade	4,399,697	6,057,959	10,188,249	322,728
Accounts				
payable - trade -				
related parties	(1,177,131)	-	2,303,572	14,832
Other payables	1,755,247	756,683	1,079,284	(1,552,141)
Other payables				
- related parties	(1,852,908)	(29,002)	235,194	(471,648)
Accrued				
liabilities	1,194,301	1,030,155	(1,005,589)	317,514
Customer				
deposits	4,367,772	3,795,995	2,959,823	196,078
Customer				
deposits - related				
party	-	147,100	-	-
Taxes payable	(1,228,560)	3,497,989	4,522,913	1,065,354
Net cash				
(used in) provided				
by operating				
activities	(5,262,657)	6,579,896	18,064,391	24,725,412
<b>CASH FLOWS</b>				
<b>FROM</b>				
<b>INVESTING</b>				
<b>ACTIVITIES:</b>				
Restricted cash				
due to escrow				
covenant	-	105,616	105,616	-
Restricted cash				
due to notes				
payable	(461,700)	735,500	738,000	2,199,183
Restricted cash	(663,616)	(1,089,637)	(923,572)	(56,652)
due to sales				

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covenant				
Acquisition of intangible assets	-	(220,650)	(573,142)	(1,524,071)
Advances on equipment purchases	(321,574)	(617,694)	(124,895)	(654,530)
Purchases of equipment and intangible assets	(1,860,092)	(29,407,280)	(4,299,998)	(9,738,815)
Cash paid for acquisitions	-	(2,439,388)	(25,606,289)	-
Cash proceeds from sale of equipment	17,368	-	4,927	11,729
Advance on lease	(17,100)	4,910	-	(614,882)
Investment deposit	-	-	-	(13,209,395)
Net cash (used in) investing activities	(3,306,714)	(32,928,623)	(30,679,353)	(23,587,433)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>				
Repayments of short-term notes payable	-	(735,500)	(1,033,200)	(2,199,150)
Proceeds from short-term loans	923,400	1,891,434	4,018,346	3,232,751
Repayments of short term loans	(244,425)	(4,888,065)	(3,391,577)	(6,982,848)
Repayments of short term loans - related parties	-	(99,971)	(100,310)	(161,782)
Proceeds from private placement financing	9,391,482	23,881,858	23,881,858	2,850,000
Net cash provided by (used in) financing activities	10,070,457	20,049,756	23,375,117	(3,261,029)
<b>EFFECTS OF EXCHANGE RATE CHANGES ON CASH</b>	754,999	201,209	575,044	180,575
<b>INCREASE (DECREASE) IN</b>	2,256,085	(6,097,762)	11,335,199	(1,942,475)

## CASH

CASH and CASH EQUIVALENTS, beginning of period	25,820,607	14,485,408	14,485,408	16,427,883
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CASH and CASH EQUIVALENTS, ending of period	\$ 28,076,692	\$ 8,387,646	\$ 25,820,607	\$ 14,485,408
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SUPPLEMENTAL  
DISCLOSURE OF  
CASH FLOW  
INFORMATION:

Cash paid for interest	\$ 261,184	\$ 169,710	\$ 178,441	\$ 302,058
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Cash paid for income taxes	\$ 9,308,801	\$ 8,180,186	\$ 11,961,017	\$ 8,020,771
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Additional  
non-cash investing  
and financing  
activities

Cashless exercise of warrants	\$ -	\$ -	\$ 231,500	\$ 756,012
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Common stock issued for real estate acquisition	\$ -	\$ -	\$ -	\$ 9,834,000
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See report of independent registered public accounting firm.

The accompanying notes are an integral part of these consolidated financial statements.

**CHINA VALVES TECHNOLOGY, INC AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2011**

**Note 1 Description of Business and Basis of Presentation**

*DESCRIPTION OF BUSINESS*

China Valves Technology, Inc. (the Company), was incorporated in Nevada in August 1997. Through its direct and indirect subsidiaries, the Company focuses primarily on the development, manufacture and sale of high-quality metal valves for the electricity, petroleum, chemical, water, gas and metal industries in the People's Republic of China (the PRC). The Company's operations are headquartered in Zhengzhou, Henan Province, PRC.

*THE REPORTING ENTITIES*

The accompanying consolidated financial statements include the following subsidiaries:

Name of entity	Place of incorporation	Ownership	Principle business
China Valves Technology (Changsha) Valve Co., Ltd.	PRC	100% Indirectly	Manufacturing
Yangzhou Rock Valve Lock Technology Co., Ltd. ( Yangzhou Rock )	PRC	100% Indirectly	Manufacturing
Henan Kai Feng High Pressure Valve Co., Ltd. ( Kaifeng Valve )	PRC	100% Indirectly	Manufacturing
Zhengzhou City ZhengDie Valve., Ltd. ( ZD Valve )	PRC	100% Indirectly	Manufacturing
Tai Zhou Tai De Valve Co., Ltd. ( Taide Valve )	PRC	100% Indirectly	Manufacturing
Shanghai Pudong Hanwei Valve Co., Ltd. ( Hanwei Valve )	PRC	100% Indirectly	Manufacturing
Henan Tonghai Fluid Equipment Co., Ltd.	PRC	100% Indirectly	Holding Company
Shanghai Hanhuang Valve Co., Ltd. *	PRC	100% Indirectly	Holding Company
Get Success Investment Limited *	Hong Kong	100% Indirectly	Holding Company
China Valves Technology Holdings Co., Ltd. (formerly China Fluid Equipment Holdings Limited) ( Changsha Valve )	Hong Kong	100% Directly	Holding Company

\* Shanghai Han Huang Valve Co., Ltd. was dissolved on October 19, 2011 and Get Success Investment Limited was dissolved on September 16, 2011.

*CHANGE IN FISCAL YEAR*

In August 2011, the Company changed its fiscal year end to September 30 from December 31. The Company made this change to better align its financial reporting period, as well as its annual planning and budgeting process. As a result of this change, the Consolidated Financial Statements include the Company's financial results for the nine months transition period of January 1, 2011 through September 30, 2011 and the unaudited comparative information for the nine months ended September 30, 2010. The years ended December 31, 2010 and 2009 reflect the twelve-month results of the respective calendar year.

*BASIS OF PRESENTATION*

The consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States of America ("US GAAP"). In the opinion of management, the accompanying balance sheets, and statements of income and other comprehensive income, shareholders' equity and cash flows include all adjustments, consisting only of normal recurring items, considered necessary to give a fair presentation of operating results for the periods presented. All material inter-company transactions and balances have been eliminated in consolidation.

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**CHINA VALVES TECHNOLOGY, INC AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2011**

The Renminbi ( RMB ) of the People's Republic of China has been determined to be the Company's functional currency. The balance sheets were translated at year end exchange rates. Expenses were translated at moving average exchange rates in effect during the periods. The effects of rate changes on assets and liabilities are recorded as accumulated other comprehensive income.

**Note 2 Summary of significant accounting policies**

*PRINCIPLES OF CONSOLIDATION*

China Valves Technology, Inc. is a holding company which conducts its business through its operating subsidiaries. The consolidated financial statements include the accounts of the Company and the Company's wholly indirectly owned subsidiaries. All intercompany transactions have been eliminated. The results of companies acquired or disposed of during the year are included in the consolidated financial statements from the effective date of acquisition.

*USE OF ESTIMATES*

The preparation of consolidated financial statements in conformity with US GAAP requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the useful lives of fixed assets; the allowance for doubtful accounts; the fair value determination of financial and equity instruments, realizability of inventories; the recoverability of goodwill, intangible assets, land use right, plant and equipment; and accruals for income tax uncertainties and other contingencies. The current economic environment has increased the degree of uncertainty inherent in those estimates and assumptions.

*REVENUE RECOGNITION*

The Company's revenue recognition policies are in accordance with U.S. generally accepted accounting principles regarding revenue recognition. Sales revenue is recognized when all of the following have occurred: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the price is fixed or determinable, and (iv) the ability to collect is reasonably assured. These criteria are generally satisfied at the time of delivery for domestic sales when risk of loss and title passes to the customer. For international sales, the revenue recognition criteria are generally satisfied under Free on Board ( FOB ) terms, in which the Company's responsibility ends once the goods clear the port of shipment.

The Company recognizes revenue when the goods are delivered and title has passed. Sales revenue represents the invoiced value of goods, net of a value-added tax ( VAT ). All of the Company's products that are sold in the PRC are subject to a Chinese value-added tax at a rate of 17% of the gross sales price or at a rate approved by the Chinese local government. This VAT may be offset by the VAT paid by the Company on raw materials and other materials included in the cost of producing their finished product.

The Company allows its customers to retain 5% to 10% of the contract prices as retainage during the warranty period, usually 12 or 24 months, to guarantee product quality. Retainage is considered as a payment term included as a part of the contract price, and recognized as revenue based upon shipment of products. Due to nature of the retainage, the Company's policy is to take into revenue the full value of the contract without VAT, including any retainage, as it performs against the contract since the Company has experienced insignificant warranty claims historically resulting in

the Company having to repair or exchange a defective product. Due to the infrequency and insignificant amount of warranty claims, the ability to collect retainage is reasonably assured and is recognized at the time of shipment.

The Company also provides services to some of its sales agents and distributors. The Company recognizes revenue on these services once a contract is signed and the services have been rendered.

*WARRANTIES*

The Company typically provides warranty for all of its products and provides replacement or credit to its customers who are not satisfied with the products for a period of one year from the date of shipment. The Company has not established reserve funds for potential customer claims because, historically, the Company has not experienced significant customer complaints about its products. The Company believes that its customer support teams, quality assurance team and manufacturing monitoring procedures will continue to keep claims at a level that does not support a need for a reserve. The Company reviews customer returns on a monthly basis and may establish a reserve when necessary.

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**CHINA VALVES TECHNOLOGY, INC AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2011**

*COST OF GOODS SOLD*

Cost of goods sold consists primarily of direct material costs, direct labor costs, direct depreciation and related direct expenses attributable to the production of the products. Inbound shipping and handling costs and purchasing are included in direct material costs. Manufacturing overhead includes expenses such as indirect labor, depreciation as it relates to the cost of production, rent, utilities, receiving costs, and equipment maintenance and repairs.

*SHIPPING AND HANDLING*

Shipping and handling costs incurred for shipping of valves and other products to customers are included in selling expense and totaled \$529,756 for the nine months ended September 30, 2011, and \$1,131,575 and \$386,929 for the years ended December 31, 2010 and 2009, respectively.

*SELLING EXPENSE*

Selling expense includes transportation expense, advertising, salaries, conference fees, sales commissions, and shipping and handling.

*GENERAL AND ADMINISTRATIVE EXPENSE*

General and administrative expenses include insurance expense, administrative and management salaries, bad debt expense, depreciation, rent, travel expense, welfare expense, office expenses, meal and entertainment expense, conference expense, and repairs and maintenance expense.

*ADVERTISING*

Advertising costs are expensed when incurred and are included in selling, general and administrative expenses, which amounted to \$53,991 for the nine months ended September 30, 2011, and \$153,159 and \$36,834 for the years ended December 31, 2010 and 2009, respectively.

*FOREIGN CURRENCY TRANSLATION AND OTHER COMPREHENSIVE INCOME*

The reporting currency of the Company is the US dollar. The functional currency of the Company and the local currency of its operating subsidiaries is RMB.

For those entities whose currency is other than the US dollar, all assets and liabilities are translated into U.S. dollars at the exchange rate on the balance sheet date; shareholders' equity is translated at historical rates and items in the statements of income and of cash flows are translated at the average rate for the period. Because cash flows are translated based on the average translation rate, amounts related to assets and liabilities reported in the statement of cash flows will not necessarily agree with changes in the corresponding balances in the balance sheet. Translation adjustments resulting from this process are included in accumulated other comprehensive income in the statement of shareholders' equity. Transaction gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the functional currency are included in the results of operations as incurred.

The balance sheet amounts with the exception of equity at September 30, 2011 and December 31, 2010 were translated at 6.39 and 6.59 RMB to \$1.00. The average translation rates applied to the statements of operations and cash flows were 6.50 RMB to \$1.00 for the nine months ended September 30, 2011, and 6.78 RMB and 6.82 RMB to

\$1.00 for the years ended December 31, 2010 and 2009, respectively.

*PLANT AND EQUIPMENT*

Plant and equipment are stated at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated life of the asset, ranging from five to thirty years.

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**CHINA VALVES TECHNOLOGY, INC AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2011**

Construction in progress represents direct costs of construction as well as acquisition and design fees incurred. Capitalization of these costs ceases and the construction in progress is transferred to plant and equipment when substantially all the activities necessary to prepare the assets for their intended use are completed. Interest incurred during the period required to complete the construction is capitalized into construction in progress. All other interest is expensed as incurred. No depreciation is provided until construction is completed and the asset is ready for its intended use. Maintenance, repairs and minor renewals are charged directly to expenses as incurred. Major additions and betterments to property and equipment are capitalized.

*INTANGIBLE ASSETS*

Intangible assets consist of patents, software and land use rights. Patents are being amortized over 5-20 years as management believes those are the estimated useful life of the patents currently owned by the Company. Land use rights are carried at cost and charged to expense on a straight-line basis over the period the rights are granted, 46.4 50.0 years. Software is amortized over 10 years, its estimated useful life.

*GOODWILL*

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Goodwill is not amortized, but is instead tested for impairment. Goodwill is reviewed for impairment at internal reporting unit - individual operating subsidiary basis in accordance with U.S. GAAP. The Company determines the reporting units based on following factors: a. it engages in business activities from which it may earn revenues and incur expenses; b. its operating results are regularly reviewed by the Company's chief operating decision makers to make decisions about resources to be allocated to the segment and assess its performance; and c. its discrete financial information is available.

A significant amount of judgment is involved in determining if an indicator of impairment has occurred. Such indicators may include current period operating or cash flow losses combined with a historical of operating or cash flow losses, a projection or forecast that demonstrates continuing operating or cash flow losses, a significant adverse change in AR collection and unanticipated technology revolution in valves industry, among others. The Company performs its annual impairment review of goodwill every year at September 30 and when a triggering event occurs between annual impairment tests. The goodwill impairment test is a two-step test. Under the first step, the fair value of the reporting unit is compared with its carrying value (including goodwill). If the fair value of the reporting unit is less than its carrying value, an indication of goodwill impairment exists for the reporting unit, and the Company must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed. In addition to cash flow projections, management also considers if the change of stock price representing of a triggering event for an impairment evaluation. The Company believes that the current decline in its stock price is temporary due to the negative publicity about Chinese companies going public in the United States through reverse merger transactions. The fundamentals of the Company's business remain strong as evidenced by over \$30.0 million of net income over the past nine months. The Company does not believe impairing its goodwill is necessary at this time just because its stock price has temporarily dropped while the fundamentals of the business remain strong.

The Company has acquired several entities resulting in the recording of intangible assets, including goodwill, which represents the excess of the purchase price over the fair value of the net assets of businesses acquired.

The Company has six operating subsidiaries as reporting units included in continuing operations as of September 30, 2011, among which three reporting units had goodwill. The following table represents goodwill of the three subsidiaries as of September 30, 2011 and December 31, 2010, respectively.

(in thousands)	<b>September 30, 2011</b>	<b>December 31, 2010</b>
Kaifeng Valve	\$ 10,783	\$ 10,783
Zhengdie Valve	10,029	10,029
Hanwei Valve	11,046	11,046
Foreign currency translation adjustment	2,118	1,097
<b>Total</b>	<b>\$ 33,976</b>	<b>\$ 32,955</b>

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No impairment loss was incurred for the nine months ended September 30, 2011 and for the years ended December 31, 2010 and 2009 based on the Company's annual impairment test.

*LONG-LIVED ASSETS*

Long lived assets, including buildings and improvements, equipment and intangible assets are reviewed if events and changes in circumstances indicate that its carrying amount may not be recoverable, to determine whether their carrying value has become impaired. The Company considers assets to be impaired if the carrying value exceeds the future projected cash flows from related operations. The Company also re-evaluates the periods of depreciation and amortization to determine whether subsequent events and circumstances warrant revised estimates of useful lives. For the nine months ended September 30, 2011, the Company determined that \$110,096 equipment was impaired due to the carrying value could not be recoverable. This is because the products manufactured by certain equipment did not meet the customer's needs any more. The Company determined that the equipment was technically obsolete and needed to be replaced with new equipment to meet the customer's current and future needs.

*INVENTORIES*

The Company's aggregate inventories are carried at cost or, if lower, net realizable value determined on the weighted average method. The Company provides a reserve for estimated inventory obsolescence or excess quantities on hand equal to the difference between the cost of the inventory and its estimated realizable value. The future estimated realizable value of inventory is generally based on the historical usage of such inventory. The Company ages its inventory with no recent demand and applies various valuation factors based on the last demand from customers for such material. If future conditions cause a reduction in the Company's current estimate of realizable value, due to a decrease in customer demand, a drop in commodity prices or other market-related factors that may influence demand for particular products, additional provisions may be required. In addition, the Company also reviews most recent quotes from vendors and compares with the carrying value of its inventory. If carrying amount of raw materials exceeds prices available at the balance sheet date, then the excess amount is directly written off and included in cost of the goods sold.

As of September 30, 2011 and December 31, 2010, the Company reserved \$2,394,319 and \$1,148,663 in allowance due to slow moving inventory, most of which are commodity valves whose technical specification no longer matched customer's demand. Commodity valves are universal products we produce to meet general needs.

\$71,521, \$1,177,692 and \$0 were directly written off and included in cost of goods sold after comparing the carrying value of inventory and recent market prices for the nine months ended September 30, 2011 and for the years ended December 31, 2010 and 2009, respectively.

Semi-finished products are work-in-process ( WIP ) inventory at the finishing stages of production. These products that are awaiting final assembly have similar physical shape to finished goods. The Company differentiates these products from WIP for inventory management purposes.

*RESEARCH AND DEVELOPMENT COSTS*

Research and development costs are expensed as incurred. The costs of material and equipment that are acquired or constructed for research and development activities and which have alternative future uses, either in research and development, marketing, or sales, are classified as property and equipment and depreciated over their estimated useful lives.

*RETIREMENT BENEFIT COSTS*

Amounts payable to the PRC state managed retirement benefit programs are expensed in the financial statements following the accrual basis of accounting.

*INCOME TAXES*

The Company applies the accounting standard regarding accounting for income taxes and the accounting standard regarding accounting for uncertainty in income taxes for income taxes. This accounting standard requires recognition of deferred income tax liabilities and assets for the expected future tax consequences of temporary differences between the income tax basis and financial reporting basis of assets and liabilities. Provision for income taxes consist of taxes currently due plus deferred taxes. The charge for taxation is based on the results for the year as adjusted for items that are non-assessable or disallowed. It is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date. Deferred taxes are accounted for using the balance sheet liability method in respect of temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of assessable tax profit. In principle, deferred tax liabilities are recognized for all taxable temporary differences, and deferred tax assets are recognized to the extent that it is probable that taxable profit will be available against which deductible temporary differences can be utilized.

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**CHINA VALVES TECHNOLOGY, INC AND SUBSIDIARIES**  
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Under the accounting standard regarding accounting for uncertainty in income taxes, a tax position is recognized as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the more likely than not test, no tax benefit is recorded. Penalties and interest incurred related to underpayment of income tax are classified as income tax expense in the year incurred. No significant penalties or interest relating to income taxes have been incurred during the nine months ended September 30, 2011. U.S. GAAP also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

*CASH AND CASH EQUIVALENTS*

Cash and cash equivalents are comprised of cash in banks and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

*RESTRICTED CASH*

The Company's restricted cash consists of cash in the bank as security for its exported products, security deposits for contract performance, notes payable and cash held in escrow to pay for certain investor relations expenses. For restricted cash held in bank, the restriction is released after the customers have received and inspected the products. The Company has notes payable outstanding with various banks and is required to keep certain amounts on deposit that are subject to withdrawal restrictions. Cash held in escrow is expensed as incurred. Restricted cash amounted to \$2,344,276 and \$1,164,598 as of September 30, 2011 and December 31, 2010, respectively.

	September 30, 2011		December 31, 2010
Employee housing fund	\$ 163,936	\$	153,278
Cash held for sales covenants	2,180,340		1,011,320
Total restricted cash	\$ 2,344,276	\$	1,164,598

*CONCENTRATION RISKS*

The Company's operations are carried out in the PRC. Accordingly, the Company's business, financial condition and results of operations may be influenced by the political, economic and legal environment in the PRC, and by the general state of the PRC's economy. The Company's operations in the PRC are subject to specific considerations and significant risks not typically associated with companies in North America and Western Europe. The Company's results may be adversely affected by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, restrictions on currency conversion and remittance abroad, and rates and methods of taxation, among other things.

Certain financial instruments may subject the Company to concentration of credit risk. The Company maintains bank deposits within state-owned banks within the PRC, Hong Kong and the United States. Balances at financial institutions of state owned banks within the PRC are not covered by insurance. As of September 30, 2011 and December 31, 2010, the Company's cash and restricted cash balances, totaling \$29,508,367 and \$26,596,872 respectively at those dates, were not covered by insurance. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant risks on its cash in bank accounts.

Five major customers represented approximately 14%, 9% and 11% of the Company's total sales for the nine months ended September 30, 2011 and for the years ended December 31, 2010 and 2009, respectively. The five major customers accounted for 6% and 5% of total accounts receivable as of September 30, 2011 and December 31, 2010, respectively

Five major suppliers, including one related party, represented approximately 18%, 24% and 17% the Company's total purchases for the nine months ended September 30, 2011 and for the years ended December 31, 2010 and 2009, respectively, and accounted 5% and 13% of total accounts payable as of September 30, 2011 and December 31, 2010, respectively.

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*FAIR VALUE OF FINANCIAL INSTRUMENTS*

The accounting standards regarding disclosures about fair value of financial instruments defines financial instruments and required fair value disclosure of those instruments. This accounting standard defines fair value, establishes a three-level valuation hierarchy for disclosures of fair value measurement and enhances disclosure requirements for fair value measures. Receivables, investments, payables, short and long term debt and warrant liabilities qualified as financial instruments. Management believes the carrying amounts of receivables, payables and debt are a reasonable estimate of fair value because of the short period of time between the origination of such instruments, their expected realization, and if applicable, their stated interest rate is equivalent to interest rates currently available. The three levels are defined as follows:

Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the assets or liability, either directly or indirectly, for substantially the full term of the financial instruments.

Level 3 inputs to the valuation methodology are unobservable and significant to the fair value.

The Company analyzes all financial instruments with features of both liabilities and equity under the accounting standards regarding accounting for certain financial instruments with characteristics of both liabilities and equity, accounting for derivative instruments and hedging activities, accounting for derivative financial instruments indexed to, and potentially settled in, a company's own stock, and the accounting standard regarding determining whether an instrument (or embedded feature) is indexed to an entity's own stock. The accounting standard specifies that a contract that would otherwise meet the definition of a derivative but is both (a) indexed to the Company's own stock and (b) classified in stockholders' equity in the statement of financial position would not be considered a derivative financial instrument. This standard provides a two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer's own stock and thus able to qualify for this accounting standard scope exception. All warrants issued by the Company are denominated in USD; because the Company's functional currency is the RMB, the Company accounts for these warrants as derivative instrument liabilities and marks them to market each period. Because there is no quoted or observable market price for the warrants, the Company used level 3 inputs for its valuation methodology.

A discussion of the valuation technique used to measure the fair value of the warrant liabilities is provided in Note 13.

Carrying Value as of September 30, 2011	Fair Value Measurements at September 30, 2011 using Fair Value Hierarchy		
	Level 1	Level 2	Level 3
Warrant liabilities \$	-		\$ -

Except for the warrant liabilities, the Company did not identify any other asset and liability that are measured at fair value on a recurring basis in accordance with the accounting standard.

Level 3 Valuation Reconciliations:

Warrant

## liabilities

Balance, December 31, 2010	\$	880,565
Issuance of new warrants		110,815
Warrants expired reclassified to APIC		(1,349)
Current period fair value change of exercised warrants		-
Current period fair value change		(990,031)
Balance, September 30, 2011	\$	-

*RECEIVABLES*

The Company's business operations are conducted in the PRC by selling on various credit terms. Management reviews its receivables on a quarterly basis to determine if the allowance for doubtful accounts is adequate. An estimate for doubtful accounts is recorded when collection of the full amount is no longer probable. Known bad debts are written off against the allowance for doubtful accounts when identified. The Company's existing reserve is consistent with its historical experience and considered adequate by management.

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**CHINA VALVES TECHNOLOGY, INC AND SUBSIDIARIES**  
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*EARNINGS PER SHARE*

The Company reports earnings per share in accordance with the provisions of the accounting standard regarding "Earnings per Share." This accounting standard requires presentation of basic and diluted earnings per share in conjunction with the disclosure of the methodology used in computing such earnings per share. Basic earnings per share excludes dilution and is computed by dividing income available to common stockholders by the weighted average common shares outstanding during the period. Diluted earnings per share takes into account the potential dilution (using the treasury stock method) that could occur if securities or other contracts to issue common stock were exercised and converted into common stock.

Common stock equivalents represent the dilutive effect of the assumed exercise of the outstanding stock options and warrants, using the treasury stock method, at either the beginning of the respective period presented or the date of issuance, whichever is later, and only if the common stock equivalents are considered dilutive based upon the Company's net income (loss) position at the calculation date.

*OTHER INVESTMENTS*

The Company invested in China Perfect Machinery Industry Co., Ltd. in 1996 and Kaifeng Commercial Bank in 1997. The Company owns approximately 0.0955% of China Perfect Machinery Industry Co. Ltd. and approximately 1.6% of Kaifeng Commercial Bank. The Company does not have the ability to exercise control over the investee companies and the investments have been recorded under the cost method. These long-term investments amounted to \$815,066 and \$790,572 as of September 30, 2011 and December 31, 2010, respectively. There has been no change in the carrying value since initial investment, other than the effects of translation difference.

The Company evaluates potential impairment whenever events or changes in circumstances indicate that the carrying amount of the investments may not be recoverable. For investments carried at cost, the Company recognizes impairment in the event that the carrying value of the investment exceeds the Company's proportionate share of the net book value of the investee. As of September 30, 2011, management believes no impairment charge is necessary.

*CUSTOMER DEPOSITS*

Customer deposits represent amounts advanced by customers on product orders. The product normally is shipped within six months after receipt of the advance payment and the related sale is recognized in accordance with the Company's revenue recognition policy. As of September 30, 2011 and December 31, 2010, customer deposits amounted to \$11,139,936 and \$6,499,833, respectively.

*STOCK COMPENSATION*

The Company applies the accounting standard regarding accounting for stock-based compensation, which defines a fair-value-based method of accounting for stock based employee compensation and transactions in which an entity issues its equity instruments to acquire goods and services from employees and non-employees. Stock compensation for stock granted to non-employees has been determined in accordance with this accounting standard and the accounting standard regarding accounting for equity instruments that are issued to non-employees for acquiring, or in conjunction with selling goods or services, as the fair value of the consideration received or the fair value of equity instruments issued, whichever is more reliably measured. This accounting standard allows the simplified method to determine the term of employee options when other information is not available.

*RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS*

In April 2011, the FASB issued ASU No. 2011-03, *Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements* (ASU 2011-03), intended to improve financial reporting of repurchase agreements and refocus the assessment of effective control on a transferor's contractual rights and obligations rather than practical ability to perform those rights and obligations. The guidance in ASU 2011-03 is effective for the first interim or annual period beginning on or after December 15, 2011. The Company does not expect the adoption of ASU 2011-03 to have a significant impact on its consolidated financial statements.

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In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04). ASU 2011-04 represents the converged guidance of the FASB and the International Accounting Standards Board (IASB) on fair value measurement. A variety of measures are included in the update intended to either clarify existing fair value measurement requirements, change particular principles requirements for measuring fair value or for disclosing information about fair value measurements. For many of requirements, the FASB does not intend to change the application of existing requirements under Accounting Standards Codification (ASC) Topic 820, Fair Value Measurements. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011 and early application is not permitted. The Company is evaluating the impact adoption of ASU 2011-04 and does not expect the adoption of ASU 2011-04 will have significant impact on its consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income* (ASU 2011-05), intended to increase the prominence of items reported in other comprehensive income and to facilitate convergence of accounting guidance in this area with that of the IASB. The amendments require that all non-owner changes in stockholders' equity be presented in a single continuous statement of comprehensive income or in two separate but consecutive statements. Amendments under ASU 2011-05 for public entities should be applied retrospectively for fiscal years, and interim periods within those years, beginning December 15, 2011. The Company is evaluating the impact adoption of ASU 2011-05 and does not expect the adoption of ASU 2011-05 will have significant impact on its consolidated financial statements.

In July 2011, the FASB issued accounting guidance on disclosures about the credit quality of financing receivables and the allowance for credit losses. The guidance expands disclosures for the allowance for credit losses and financing receivables by requiring entities to disclose information at disaggregated levels. It also requires disclosure of credit quality indicators, past due information and modifications of financing receivables. The Company does not expect the adoption of this guidance to have a significant impact on its consolidated financial statements.

In September 2011, the FASB issued Intangibles - Goodwill and Other (Topic 350) - Testing Goodwill for Impairment (ASU No. 2011-08), which amends ASC 350 to first assess qualitative factors before performing the quantitative goodwill impairment testing. The ASU provides the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the results of the qualitative analysis indicate it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, the quantitative two-step impairment test, which is required under current U.S. GAAP, would not be necessary. The ASU is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The implementation of the ASU is not expected to have a material impact on the Company's financial statements.

**RECLASSIFICATIONS**

Certain prior period amounts have been reclassified to conform to the current period presentation. These classifications have no effect on net income.

**Note 3 Accounts receivable, net**

Accounts receivable consists of the following:

	September 30, 2011	December 31, 2010
Total accounts receivable	\$ 134,290,696	\$ 89,897,470

Accounts receivable related party	-	200,185
Allowance for bad debts	(4,052,398)	(998,739)
Accounts receivable, net	130,238,298	89,098,916
Accounts receivable non-current retainage	(5,724,024)	(4,751,605)
Accounts receivable (including related party) current	\$ 124,514,274	\$ 84,347,311

Retainage represents 5% to 10% of the contract prices held by customers to guarantee product quality ranging from 12-18 months after shipment of products. Retainage is considered as a payment term included as a part of the contract price, and recognized as revenue based upon shipment of products. Due to the nature of the retainage, the Company's policy is to take into revenue the full value of the contract, including any retainage, as it performs against the contract since the Company has experienced insignificant warranty claims historically resulting in the Company having to repair or exchange a defective product. Due to the infrequency and insignificant amount of warranty claims, the ability to collect retainage is reasonably assured and is recognized at the time of shipment. As of September 30, 2011 and December 31, 2010, retainage held by customers included in the Company's accounts receivable is as follows:

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	September 30, 2011	December 31, 2010
Retainage		
Current	\$ 13,854,814	\$ 7,754,714
Non-current	5,724,024	4,751,605
Total retainage	\$ 19,578,838	\$ 12,506,319

The following represents the changes in the allowance for doubtful accounts:

	September 30, 2011	December 31, 2010
Balance, beginning of the period	\$ 998,739	\$ 908,338
Additions to the allowance	2,974,399	353,036
Recovery of amounts previously reserved	-	(295,200)
Foreign currency translation adjustment	79,260	32,565
Balance, end of the period	\$ 4,052,398	\$ 998,739

**Note 4 Inventories, net**

	September 30, 2011	December 31, 2010
Raw materials	\$ 5,438,464	\$ 4,742,643
Work-in-progress	9,088,975	3,764,667
Finished goods	8,613,573	7,810,526
Semi-finished products	1,417,185	1,082,765
Inventory in transit	1,705,007	-
Total	26,263,204	17,440,601
Less: Inventory Allowance	(2,394,319)	(1,148,663)
Inventories, net	\$ 23,868,885	\$ 16,251,938

The Company values its inventories at the lower of cost or market, determined on a weighted average method, or net realizable value. Management determined the carrying amount of inventory exceeded net realizable value; therefore, \$71,521, \$1,177,692 and \$0 have been written down and included in cost of goods sold for the nine months ended September 30, 2011 and for the years ended December 31, 2010 and 2009, respectively.

Management reviews inventories for obsolescence and cost in excess of net realizable value at least annually and records a reserve against the inventory and additional costs of goods sold. The Company recorded additional \$1,190,725 and \$681,989 inventory allowance for the nine months ended September 30, 2011 and for the year ended December 31, 2010 respectively. Inventory allowance amounted to \$2,394,319 and \$1,148,663 as of September 30, 2011 and December 31, 2010, respectively.

**Note 5 Plant and equipment, net**

Plant and equipment consist of the following:

	September 30, 2011	December 31, 2010
Buildings and improvements	\$ 23,592,085	\$ 22,043,897
Machinery and equipment	27,934,105	26,569,403
Motor vehicles	2,925,919	2,701,563
Office equipment	1,665,384	1,473,776
Construction in progress	165,511	497,652

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Total	56,283,004	53,286,291
Less: Accumulated depreciation	(16,090,368)	(12,512,729)
Plant and equipment, net	\$ 40,192,636	\$ 40,773,562

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**CHINA VALVES TECHNOLOGY, INC AND SUBSIDIARIES**  
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**September 30, 2011**

The Company has no major capital commitments as of September 30, 2011. Depreciation expenses were \$3,644,599, \$4,167,004 and \$1,694,674 for the nine months ended September 30, 2011 and for the years ended December 31, 2010 and 2009, respectively. Capitalized interest amounted to \$8,292, \$60,152 and \$147,537 for the nine months ended September 30, 2011 and for the years ended December 31, 2010 and 2009, respectively.

For the nine months ended September 30, 2011, the Company impaired long lived assets in the amount of \$110,096 which was included in Other Expense. This is because the products manufactured by certain equipment did not meet customer needs any more. The Company determined that the equipment was technically obsolete and needed to be replaced with new equipment to meet customer's current and future needs. For the year ended December 31, 2010, the Company changed estimate of useful lives for certain equipment and recorded additional depreciation amounted \$1,341,962, which was included in cost of goods sold.

**Note 6 Goodwill**

The Company accounts for business combinations using the purchase method of accounting. The total consideration paid in an acquisition is allocated to the fair value of the acquired company's identifiable assets and liabilities. Any excess of the purchase price over the estimated fair values of the net assets acquired is recorded as goodwill.

In 2004, the Company acquired two companies engaged in the production of valves. The Company recorded goodwill representing the fair value of the assets acquired over the cost of the assets acquired.

On April 8, 2010, the Company acquired 100% of Hanwei Valve with a total cash consideration of approximately \$19.5 million. The fair value of the assets of Hanwei Valve was valued at approximately \$8.5 million on the acquisition date; the Company recognized approximately \$11.0 million goodwill through said acquisition.

The goodwill recognized in conjunction with the acquisition of Hanwei Valve represents intangible values that Hanwei Valve has built over its more than 16 years of history, which do not qualify for separate recognition. These values include but are not limited to:

- i) Expected synergies from combining operations of the Company's operating subsidiaries and Hanwei Valve;
- ii) The experienced work force;
- iii) Proprietary technologies related to certain products; and
- iv) The proprietary manufacturing processes.

As of September 30, 2011 and December 31, 2010, the carrying value of goodwill amounted to \$33,976,186 and \$32,955,163, respectively.

The following table reconciles the beginning and ending balance of goodwill:

	Goodwill
Balance, December 31, 2009	\$ 20,811,767
Goodwill purchased	11,046,074
Foreign currency translation adjustment	1,097,322
Balance, December 31, 2010	\$ 32,955,163
Goodwill purchased	-

Foreign currency translation adjustment	1,021,023
Balance, September 30, 2011	\$ 33,976,186

**Note 7 - Intangible assets, net**

Intangible assets consist of the following:

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**September 30, 2011**

	September 30, 2011	December 31, 2010
Patents	\$ 2,765,836	\$ 2,682,719
Software	1,850,982	2,014,267
Land use rights*	20,019,196	19,417,596
Total	24,636,014	24,114,582
Less: Accumulated amortization	(1,722,006)	(1,086,702)
Intangibles, net	\$ 22,914,008	\$ 23,027,880

\* Land use rights consist of land use rights of \$817,567 acquired as part of the acquisition of Taide Valve; \$1,129,427 was acquired as part of the acquisition of Yangzhou Rock, \$6,104,542, acquired as part of the acquisition of Changsha Valve, \$3,903,744 acquired as part of the acquisition of Hanwei Valve and land use rights of \$8,063,916 acquired by Kaifeng Valve by issuing 2,750,000 shares of common stock of the Company.

The gross amount of the intangible assets amounted to \$24,636,014 and \$ 24,114,582 as of September 30, 2011 and December 31, 2010, respectively. The remaining weighted average amortization period is 38.3 years.

Amortization expense was \$592,019, \$703,168 and \$261,050 for the nine months ended September 30, 2011 and for the years ended December 31, 2010 and 2009, respectively.

The estimated aggregate amortization expense for each of the five succeeding fiscal years is as follows:

For the years ended September 30,	<b>Estimated Amortization Expense</b>	<b>Net carrying Amount</b>
2012	\$ 789,359	\$ 22,124,649
2013	789,359	21,335,290
2014	789,359	20,545,931
2015	789,359	19,956,572
2016	789,359	18,967,213
Thereafter	18,967,213	\$ -
Total	\$ 22,914,008	

**Note 8 Loans**

**SHORT TERM LOANS:**

September 30, 2011    December 31, 2010

Communications Bank of China, Changsha branch, due December 2011, annum interest at 6.1% , pledged by Changsha Valve s land use rights	\$ 625,600	\$ 758,000
China Everbright Bank Changsha branch, due June 2012, 7.6% annum interest rate, pledged by Changsha Valve s land use rights	938,400	
China Citic Bank, Zhengzhou branch Due December 2011 annum interest at 6.7%, , guaranteed by Kaifeng Cast Iron Co., Ltd.	3,128,000	3,034,000
Unrelated third parties, due on demand, non-interest bearing and unsecured	982,511	1,017,000
Local Bureau of Finance, Kaifeng City, due on demand, non-interest bearing and unsecured	839,299	838,000
Total short term loans	\$ 6,513,810	\$ 5,648,000

Interest expense incurred for the nine months ended September 30, 2011 and for the years ended December 31, 2010 and 2009 amounted to \$216,203, \$127,113 and \$138,562, respectively. Capitalized interest amounted to \$8,292, \$60,152 and \$147,537 for the nine months ended September 30, 2011 and for the years ended December 31, 2010 and 2009, respectively.

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(1) The 1.3% , 7.1% and 1.8% represents net expenses incurred by the Company that are not deductible for PRC income tax purpose for the nine months ended September 30, 2011 and for the years ended December 31, 2010 and 2009, respectively.

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**CHINA VALVES TECHNOLOGY, INC AND SUBSIDIARIES**  
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**September 30, 2011**

The estimated tax savings due to the reduced tax rate are \$2,177,023, \$1,827,508 and \$0 for the nine months ended September 30, 2011 and for the years ended December 31, 2010 and 2009, respectively. The net effect on basic and diluted earnings per share if the income tax had been applied would decrease earnings per dilutive share by \$0.06, \$0.05 and \$0 for the nine months ended September 30, 2011 and for the years ended December 31, 2010 and 2009, respectively.

The Company has cumulative undistributed earnings of foreign subsidiaries of around \$142.3 million as of September 30, 2011, is included in consolidated retained earnings and will continue to be indefinitely reinvested in international operations. Accordingly, no provision has been made for U.S. deferred taxes related to future repatriation of these earnings, nor is it practicable to estimate the amount of income taxes that would have to be provided if we concluded that such earnings will be remitted in the future.

**Value Added Tax**

VAT on sales and VAT on purchases in the PRC amounted to \$26,225,634 and \$15,656,180 for the nine months ended September 30, 2011, respectively. VAT on sales and VAT on purchases in China amounted to \$30,738,159 and \$9,119,027 for the year ended December 30, 2010, and \$14,902,035 and \$5,870,603 for the year ended December 31, 2009, respectively. Sales and purchases are recorded net of VAT collected and paid as the Company acts as an agent for the government. VAT taxes are not impacted by the income tax holiday.

Taxes payable consisted of the following:

	September 30, 2011	December 31, 2010
VAT	\$ 1,775,373	\$ 2,505,802
Income tax	3,694,160	4,013,347
Other taxes	321,907	308,969
Total taxes payable	\$ 5,791,440	\$ 6,828,118

**Note 10 Statutory reserves**

The laws and regulations of the PRC require that before a foreign invested enterprise can legally distribute profits, it must first satisfy all tax liabilities, provide for losses in previous years, and make allocations, in proportions determined at the discretion of the board of directors, to the statutory reserve. The statutory reserves include the surplus reserve fund.

The Company is required to transfer 10% of its net income, as determined in accordance with the PRC accounting rules and regulations, to a statutory surplus reserve fund until such reserve balance reaches 50% of the Company's registered capital. The transfer to this reserve must be made before distribution of any dividends to shareholders. The Company had \$11,224,490 and \$10,046,713 statutory reserves as of September 30, 2011 and December 31, 2010, respectively, and the remaining reserve to fulfill the 50% registered capital requirement amounted approximately \$27.0 million and \$27.8 million.

The surplus reserve fund is non-distributable other than during liquidation and can be used to fund previous years losses, if any, and may be utilized for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholding or by increasing the par value of the shares currently held by them, provided that the remaining reserve balance after such issue is not less than 50% of the registered capital.

**Note 11 Commitments and contingencies**

The Company's subsidiary, ZhengDie Valve entered into a lease agreement for a manufacturing plant and office space with ZhengZhou Cheng Long Corporation, a related party, from January 1, 2008 to December 31, 2008. The lease agreement was subsequently extended to December 31, 2012. In 2009, ZhengDie Valve made leasehold improvements to its leased manufacturing plant in the amount of \$615,260, which is used as rental payments for the following two years. As of September 30, 2011, prepaid rental of \$19,941 remains to be amortized as rental expense.

The Company's subsidiary, Tonghai entered into a lease agreement for an office space with Jia Hong Yao, an unrelated party, from September 20, 2009 to September 19, 2014 with annual lease payments of \$227,549.

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For the nine months ended September 30, 2011, total lease expense, including rental expense under cost of sales, was \$406,778. Total lease expense, including expense under cost of sales, for the years ended December 31, 2010 and 2009 was \$482,030 and \$350,336, respectively.

The future minimum lease payments at September 30, 2011, are as follows:

For the years ended September 30,	Amount
2012	\$ 609,059
2013	350,061
2014	258,567
2015	170,662
Thereafter	-
<b>Total</b>	<b>\$ 1,388,349</b>

Make Good Escrow Agreement

In connection with the Company's private placement on August 26, 2008, the Company entered into a Make Good Escrow Agreement (the "Escrow Agreement"), under which the 12,583,032 shares of the Company's common stock held by Bin Li, the Company's major shareholder, were placed in escrow. Of these shares, 12,150,000 are the subject of the Earn-In Agreement between Bin Li and Siping Fang and Bin Li entered into the Escrow Agreement on behalf of Siping Fang. For each of the calendar years 2008, 2009 and 2010, 4,194,344 shares would be released to the investors or returned to Bin Li, depending on the fulfillment of specified earnings targets. The specified earnings target for calendar 2008 was net income of \$10,500,000, for calendar 2009 the target is net income of \$23,000,000 and fully diluted earnings per share of \$0.738 and for calendar 2010 the target is net income of \$31,000,000 and fully diluted earnings per share of \$0.994. On August 14, 2009, the parties to the Escrow Agreement entered into an amendment pursuant to which for calendar 2009 the target was amended to \$21,000,000 and fully diluted earnings per share of \$0.668 and for calendar 2010 the target was amended to net income of \$34,000,000 and fully diluted earnings per share of \$1.082. The Company met the specified earnings targets and accordingly, 4,194,344 shares were released from escrow and returned to Bin Li for each of the years ended December 31, 2009 and 2008, respectively. The Company has also met the specified earnings target for the year ended December 31, 2010 and thus 4,194,344 was released from escrow on March 24, 2011.

Net income target required by the Escrow Agreement for calendar year of 2010 was \$34,000,000, and the target for fully diluted earnings per share was \$1.082. If the Company had not acquired Changsha Valve, the consolidated net income for the calendar year 2010 would be \$34,303,537, which was slightly higher than the net income target; the fully diluted earnings per share would be \$0.99, \$0.092 less than the target. If the Company had not acquired Hanwei Valve, the consolidated net income for the calendar year of 2010 would be \$34,034,935, which was also slightly higher than the net income target, and fully diluted earnings per share would be \$0.98, \$0.102 less than the target. If the Company had not acquired Changsha Valve and Hanwei Valve, the Company would not be able to meet the targets for net income and fully diluted earnings per share.

Please also refer to the table below for the impacts of the acquisitions of Changsha Valve and Hanwei Valve.

US\$	
2010 Net income target pursuant to the Escrow Agreement	34,000,000
2010 Diluted Earnings Per Share target pursuant to the Escrow Agreement	1.082

Consolidated net income for the calendar year of 2010	43,197,529
Weighted average number of shares	34,695,639
Diluted Earnings Per Share	1.25
Net income of Changsha Valve for the calendar year of 2010	8,893,992
Consolidated net income for the calendar year of 2010 without Changsha Valve	34,303,537
Diluted Earnings Per Share without Changsha Valve	0.99
Net income of Hanwei Valve for the calendar year of 2010	9,162,594
Consolidated net income for the calendar year of 2010 without Hanwei Valve	34,034,935
Diluted Earnings Per Share without Hanwei Valve for the calendar year of 2010	0.98
Consolidated net income for the calendar year of 2010 without Changsha Valve and Hanwei Valve	25,140,943
Diluted Earnings Per Share without Changsha Valve and Hanwei Valve	0.72

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Restricted Share Grant Agreements

On May 16, 2011, the Company entered into Restricted Stock Grant Agreements (the "Stock Grant Agreement") with three officers of the Company. Pursuant to the Stock Grant Agreement, the Company granted 500,000 shares of restricted stock to Mr. Jianbao Wang, the Company's Chief Executive Officer, 250,000 shares to Mr. Gang Wei, the Company's Chief Financial Officer, and 125,000 shares to Mr. Renrui Tang, the Company's Vice President of Finance.

125,000 shares of Mr. Jianbao Wang's restricted stock vested immediately on May 16, 2011. The remaining shares for Mr. Jianbao Wang and all restricted shares for Mr. Gang Wei and Mr. Renrui Tang will vest in three equal installments over a three-year period starting from January 1, 2012, subject to performance criteria set forth by the Board and the Compensation Committee.

Contingency

On February 4, 2011, a plaintiff filed a purported class action naming the Company, its Chairman and certain present and former senior executives as defendants, asserting claims for certain violations of the securities laws and seeking unspecified damages. The complaint, which was styled *Donald Foster, et al. v. China Valves Technology, Inc., et al.*, was filed in the U.S. District Court for the Southern District of New York. Several substantially identical complaints were subsequently filed in the same court. On or about June 29, 2011, the Court consolidated the three cases referenced above and appointed Bristol Investment Fund, LTD ("Bristol") as lead plaintiff. In the consolidation order the Court renamed the case *In re China Valves Technology Securities Litigation*. On August 29, 2011, Bristol filed a consolidated class action complaint, which named additional defendants including an individual shareholder of the Company and the Company's auditor. The Company and the individual defendants intend to file a motion to dismiss the consolidated complaint on November 21, 2011.

The consolidated complaint purports to assert claims on behalf of a purported class of persons and entities who purchased shares of the Company's common stock at allegedly artificially high prices during the period between December 1, 2009 and January 13, 2011 and who suffered damages as a result of such purchases. The allegations in the consolidated complaint relate to the Company's acquisitions of Able Delight and Hanwei Valves and include allegations regarding the Company's financial statements and press releases. The complaint alleges, among other things, that the Company's statements about the nature and quality of the Company's acquisition of Able Delight were materially false and misleading and that the Company's statements failed to describe the role in the transaction of an alleged related party. In addition, the complaint alleges that the Company's statements about the Hanwei Valves acquisition were materially false and misleading because they failed to disclose the alleged involvement of certain related parties and allegedly misdescribed the transaction as a purchase of assets rather than as a purchase of an entity. The Company intends to contest the allegations and to defend itself vigorously.

On September 14, 2011, a plaintiff filed an action, derivatively and on behalf of the Company, naming its Chairman and certain senior executives as defendants, and naming the Company as a nominal defendant. The complaint, which is styled *Gervat v. Fang et al.*, was filed in the U.S. District Court for the Southern District of New York, and asserts claims for breach of fiduciary duty, gross mismanagement, and other common law claims, and seeks unspecified damages. On October 11, 2011, the plaintiff filed an Amended Complaint with substantially similar claims. The parties have stipulated to a scheduling order that would stay all proceedings in the derivative action pending resolution by the Court of the defendants' motion to dismiss the class action consolidated complaint.

Nevertheless, there is possibility that a loss may have been incurred from above class actions. In accordance with ASC Topic 450, no loss contingency was accrued as of September 30, 2011 since the possible loss or range of loss cannot be reasonable estimated.

## Note 12 Related party transactions

The Company had the following significant related party balances as of September 30, 2011 and December 31, 2010, respectively:

	September 30, 2011	December 31, 2010
Accounts Receivable related party; receivable from Zhengzhou Tonghai Trade (2)	\$ -	\$ 200,185
Other receivable related party: receivable from Zhengzhou Tonghai Trade, unsecured, interest-free.	-	152,179
Advance to inventory purchase related party, the Casting Company (1)	1,552,123	917,202
Accounts payable related party, payable to Zhengzhou Tonghai Trade (2)	(783,148)	(2,382,906)
Accounts payable related party: Kaifeng Zhenghe Northern Song Porcelain Art Co., Ltd. (3)	(3,323)	-
Other payables related parties: cash advance from officers, unsecured, interest-free, due on demand (4)	(94,226)	(1,899,627)
Total	\$ 671,426	\$ (3,012,967)

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**CHINA VALVES TECHNOLOGY, INC AND SUBSIDIARIES**  
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- (1) On August 26, 2008, Kaifeng Valve purchased some land use rights and real estate from Kaifeng High-Pressure Valve Steel Casting Co., Ltd, a company controlled by the Company's chairmen, Mr. Siping Fang, through the issuance of 2,750,000 shares of the Company's common stock at \$3.576 per share. On April 11, 2009, Kaifeng Valve and the Casting Company entered into a leasing agreement pursuant to which the Casting Company leased back the portion of the Real Estate used at an annual rental of \$400,000 for a period of two years starting on April 1, 2009. The lease agreement was automatically extended for one more year when no disagreement was raised as of April 1, 2011. For the nine months ended September 30, 2011, total rental income from the Casting Company amount to \$300,000. For the years ended December 31, 2010 and 2009, total rental income from the Casting Company amount to \$400,000 and \$400,000, respectively. The Company also purchases raw material, such as castings, from and sells scrap metals and valves to the Casting Company. Total raw material purchases from the related party amounted to \$2.5 million for the nine months ended September 30, 2011, and \$4.1 million and \$4.4 million for the years ended December 30, 2010 and 2009, respectively. The Company also sold a total of \$0.1 million scrap metals valves to the Casting Company for the nine months ended September 30, 2011, and sold a total of \$0.15 million of valves to the related party for the year ended December 31, 2010. For the nine months ended September 31, 2011, the Company also received \$12.1 million from the Casting Company in excess of the sales related cash receipts for cash flow purposes and made payments to the related party in the amount of \$ 15.5 million. As of September 30, 2011 and December 31, 2010, the Company's advance for purchase to the Casting Company amounted to \$1.6 million and \$0.9 million, respectively.
- (2) The Company makes finished goods and raw material purchases from and valve sales to related party -Zhengzhou Tonghai Trade Co., Ltd, which is established by an officer. Total purchases from Zhengzhou Tonghai Trade Co., Ltd amounted to \$2.5 million for the nine months ended September 30, 2011, and \$4.6 million and \$0.02 for the years ended December 31, 2010 and 2009, respectively. Total valve sales to Zhengzhou Tonghai Trade Co., Ltd amounted to \$0.03 million and \$0.47 million for the nine months ended September 30, 2011 and for the year ended December 31, 2010, respectively. During the nine months ended September 30, 2011, the Company also received \$0.86 million from Zhengzhou Tonghai Trade in excess of the sales related cash receipts for cash flow purposes and made payments to Zhengzhou Tonghai Trade in the amount of \$ 4.6 million. As of September 30, 2011 and December 31, 2010, the Company had payable to the related party in the amount of \$0.8 million and \$2.2 million (net of accounts receivable balance as of December 31, 2010), respectively.
- (3) Kaifeng Zhenghe Northern Song Porcelain Art Co., Ltd. is a related party established by the Company's Chairman, Mr. Siping Fang. For the nine months ended September 30, 2011, the Company purchased porcelain from the related party in the amount of \$0.02 million and made payment of \$0.02 million. The Company did not have any transaction with the related party in 2010 or 2009. As of September 30, 2011 and December 31, 2010, the Company had payable to the related party in the amount of \$3,323 and \$0, respectively.
- (4) Other payable to officers are expenses the officers paid on Company's behalf or the Company sometimes make short term advances to the officers for business purposes. For the nine months ended September 30, 2011, the Company repaid the amount owed to officers in the amount of \$1.9 million that was outstanding as of December 31, 2010. The Company also made short term advances to officers in the amounts of \$2.3 million of which \$0.6 million was for business reimbursements and \$1.7 million was paid back by the

officers.

As discussed in note 11 above, the Company's subsidiary, ZD Valve leases its manufacturing plant and office space from ZhengZhou Cheng Long Corporation, a company owned by relatives of the Company's chairman. ZD Valve made leasehold improvements to its leased manufacturing plant in the amount of \$615,260, which is used as rental payments for the two years ended December 31, 2011. As of September 30, 2011, prepaid rental of \$19,941 remains to be amortized as rental expense and the Company has incurred \$238,832 rental expense associated with the lease agreement. During the nine months ended September 30, 2011, the Company also made advance to and received repayment from Cheng Long in the amount of \$0.9 million. As of September 30, 2011 and December 31, 2010, the Company did not have remaining balances with the related party.

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**CHINA VALVES TECHNOLOGY, INC AND SUBSIDIARIES**  
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**Note 13 Shareholders' equity**

Registered Direct Offerings

In January 2011, the Company entered into a Securities Purchase Agreement with certain purchasers pursuant to which the Company sold a total of 1,000,000 shares of common stock, par value \$0.001 per share, for an aggregate purchase price of \$10,000,000. Subtracting placement agent fees, legal and other expenses, net proceeds amounted to \$9,391,482. The shares were priced at \$10.00 per share. The Purchasers also received warrants to purchase an aggregate of 250,000 shares of Common Stock (subject to adjustment in certain circumstances) at an exercise price of \$10.00 per share. The Warrant was exercisable for 180 days beginning on the date of the initial issuance of the Warrant.

Warrants

In January 2011, the Company issued common stock purchase warrants to acquire 250,000 shares of common stock. The warrants have a strike price equal to \$10.00 and a term of 180 days. The shares underlying the warrants will have registration rights. The warrants contain a standard anti-dilution provision for stock dividends, stock splits, stock combination, recapitalization and a change of control transaction. Because the warrants are denominated in U.S. dollars and the Company's functional currency is the Renminbi, they do not meet the requirements of the accounting standard to be indexed only to the Company's stock. Accordingly, they are accounted for at fair value as derivative liabilities and marked to market each period. The initial value of the warrants was determined using the Cox-Ross-Rubinstein binomial model using the following assumptions:

- Expected volatility of 34.03%
- Expected dividend yield of 0%
- Risk-free interest rate of 0.190%
- Expected lives of 180 days
- Market price at issuance date of \$8.85
- Strike price of \$10.00

The value of the warrants was based on the Company's common stock price of \$8.85 on the date the warrants were issued. The warrants were valued at \$110,815 when they were issued on January 11, 2011 and expired on July 10, 2011.

	Warrants Outstanding	Average Exercise Price	Average Remaining Contractual Life
Balance, December 31, 2010	142,131	\$ 4.29	0.66
Granted	250,000	10.00	0.50
Expired	(392,131)	-	-
Exercised	-	-	-
Balance, September 30, 2011	-	\$ -	-

No warrants were outstanding as of September 30, 2011. 142,131 shares of warrants issued to placement agent in connection with the 2008 securities purchase agreement and 250,000 shares of warrants issued in connection with the 2011 registered direct offering were expired in July 2011 and August 2011, respectively \$1,349 warrant liability as of June 30, 2011 was reclassified back to additional paid-in capital upon expiration of the warrants.

As of September 30, 2011 and December 31, 2010, warrant liabilities amount to null and \$880,565, respectively. The Company recorded a total income of \$990,031 and a total loss of \$785,350 and \$1,508,997 in the Company's statements of income related to the change in fair value of warrants for the nine months ended September 30, 2011 and for the years ended December 31, 2010 and 2009, respectively.

Stock Compensation

On May 28, 2010, the Company's CFO resigned and the 50,000 options granted to her were forfeited.

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In February, 2011, the Company issued 5,000 vested shares of common stock to a director pursuant to his Stock Grant Agreement dated June 29, 2009.

On April 27, 2011, the Compensation Committee of the Board of Directors approved the grant of restricted stock to three directors and three officers of the Company. On May 1, 2011, the Company entered into a restricted stock grant agreement with each of the directors. Pursuant to the Stock Grant Agreement, the Company granted 25,000 shares of restricted stock to each of Mr. William Haus, Mr. Peter Li and Mr. Zengbiao Yu, independent directors of the Company. The restricted stock granted vested immediately on May 1, 2011.

On May 16, 2011, the Company entered into the Stock Grant Agreement with three officers of the Company. Pursuant to the Stock Grant Agreement, the Company granted 500,000 shares of restricted stock to Mr. Jianbao Wang, the Company's Chief Executive Officer, 250,000 shares to Mr. Gang Wei, the Company's Chief Financial Officer, and 125,000 shares to Mr. Renrui Tang, the Company's Vice President of Finance. 125,000 shares of Mr. Jianbao Wang's restricted stock vested immediately on May 16, 2011. The remaining shares for Mr. Jianbao Wang and all restricted shares for Mr. Gang Wei and Mr. Renrui Tang will vest in three equal installments over a three-year period starting from January 1, 2012, subject to performance criteria set forth by the Board and the Compensation Committee.

For the nine months ended September 30, 2011 and for the years ended December 31, 2010 and 2009, \$793,972, \$56,019 and \$47,057 were recorded as compensation expense in the Company's income statements, respectively.

The following is a summary of the stock options activity:

	Number of Options Outstanding	Weighted- Average Exercise Price	Aggre- Intrin Val
Balance, January 1, 2011	50,000	\$ 6.90	\$ 179
Granted	-		
Forfeited	-		
Exercised	-		
Balance, September 30, 2011	50,000	6.90	

Following is a summary of the status of options outstanding at September 30, 2011:

Outstanding Options			Exercisable Options		
Exercise Price	Number	Average Remaining Contractual Life	Average Exercise Price	Number	Average Remaining Contractual Life
\$6.00	27,500	2.75	\$ 6.00	27,500	1.51
\$8.00	22,500	2.15	\$ 8.00	22,500	0.97
Total	50,000			50,000	2.48

There is no aggregate intrinsic value of exercisable shares as of September 30, 2011.

**Note 14 - Earnings per Share**

The following is a reconciliation of the basic and diluted earnings per share computation for:

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**CHINA VALVES TECHNOLOGY, INC AND SUBSIDIARIES**  
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<b>Basic earnings per share</b>	Nine months ended September 30,		Years ended December 31,	
	2011	2010	2010	2009
		(Unaudited)		
Net income attributable to holders of common shares	\$ 29,558,348	\$ 36,789,370	\$ 43,197,529	\$ 23,353,093
Basic weighted average number of common shares outstanding	35,654,398	34,513,314	34,547,224	30,771,356
Basic earnings per share	\$ 0.83	\$ 1.07	\$ 1.25	\$ 0.76
<b>Dilutive earnings per share</b>	Nine months ended September 30,		Years ended December 31,	
	2011	2010	2010	2009
		(Unaudited)		
Net income attributable to holders of common shares	\$ 29,558,348	\$ 36,789,370	\$ 43,197,529	\$ 23,353,093
Basic weighted average number of common shares outstanding	35,654,398	34,513,314	34,547,224	30,771,356
Warrants	23,475	180,004	118,821	160,110
Stock compensation	-	34,305	29,594	14,926
Dilutive weighted average number of common shares outstanding	35,677,873	34,727,623	34,695,639	30,946,392
Dilutive earnings per share	\$ 0.83	\$ 1.06	\$ 1.25	\$ 0.75

The Company granted its independent directors and officer restricted common stocks of 5,000 shares vesting in 2011 and 100,000 option shares on June, 2009. The stock compensation is included in the diluted earnings per share for the periods ended December 31, 2010 and 2009 due to its dilutive nature. The 50,000 option shares granted to its independent directors was anti-dilutive for the nine months ended September 30, 2011.

The warrants issued in 2008 with an exercise price of \$4.29 and expired on August 2011 was included in the diluted earnings per share for the period ended September 30, 2011. The warrants issued in 2008 with an exercise price of \$4.29, 50,000 warrants issued in 2007 with an exercise price of \$6.00, and investor warrants issued in 2009 and 2010 have been included in the diluted earnings per share calculation for the period ended September 30, 2011 and for the year ended December 31, 2010, and warrants issued in 2008 and 2009 have been included in the diluted earnings per share calculation for the year ended December 31, 2009 due to their dilutive nature.

**Note 15 - Geographic and product lines**

The Company sells valves which are used by customers in various industries. The production process, class of customer, selling practice and distribution process are the same for all valves. The Company's chief operating decision-makers (i.e. chief executive officer and his direct reports) review financial information presented on a consolidated basis, accompanied by disaggregated information about revenues by product lines for purposes of allocating resources and evaluating financial performance. There are no segment managers who are held accountable for operations, operating results and plans for levels or components below the consolidated unit level. Based on qualitative and quantitative criteria established by the accounting standard regarding Disclosures about Segments of an Enterprise and Related Information, the Company considers itself to be operating within one reportable segment.

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In accordance with the enterprise-wide disclosure requirements of the accounting standard, the Company's net revenue from external customers by main product lines (based upon primary markets defined by the Chinese Valve Industry Association) and by geographic areas is as follows:

(in thousands)	Nine Months Ended September 30,		Years Ended December 31,	
	2011	2010	2010	2009
	(Unaudited)			
Power Supply	\$ 48,814	\$ 38,798	\$ 51,963	\$ 28,206
Petrochemical and Oil	51,007	37,346	55,635	16,250
Water Supply	33,408	34,548	43,626	28,301
Metallurgy	6,581	6,236	8,999	6,173
Other	21,585	14,439	23,473	16,440
Total sales revenue	\$ 161,395	\$ 131,367	\$ 183,696	\$ 95,370

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**September 30, 2011**

(in thousands)	Nine Months Ended September 30,		Years Ended December 31,	
	2011	2010	2010	2009
	(Unaudited)			
Domestic sales in the PRC	\$ 153,223	\$ 126,856	\$ 177,006	\$ 89,538
International sales	8,172	4,511	6,690	5,832
Total sales revenue	\$ 161,395	\$ 131,367	\$ 183,696	\$ 95,370

**Note 16 Business combinations**

Effective January 1, 2009, the Company adopted the accounting standard regarding business combinations. This standard retains the fundamental requirements that the acquisition method of accounting (which this standard called the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. This standard requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions. This replaces the old accounting standard's cost-allocation process, which required the cost of an acquisition to be allocated to the individual assets acquired and liabilities assumed based on their estimated fair values. If the fair value of the identifiable assets and liabilities is still greater than the consideration transferred, then the acquirer is to recognize a gain for the difference on the acquisition date.

China's valve industry is highly fragmented in terms of geography and industries served. The Company has been planning to consolidate the industry and expand its products portfolio. Yangzhou Rock is the only Chinese company to produce valve locks. It has a number of invention patents. Changsha Valve produces large size butterfly valves for the hydropower industry. Hanwei valve manufactures ball valves for the petro-chemical industry, and is also one of only two companies in the world that can produce the 24-way rotary valve.

Yangzhou Rock acquisition

In January, 2010, a subsidiary of the Company completed the acquisition of Yangzhou Rock for a total cash consideration of \$7.2 million from an unaffiliated third party. The acquisition was accounted as a business combination in accordance to the terms of the purchase agreement and no contingent consideration arrangements were associated with the acquisition. The Company assumed the following net assets:

Yangzhou Rock	Fair Value	Assumed by the Company
Inventory	\$ 1,734,593	\$ 1,734,593
Buildings and Equipment	3,350,119	3,350,119
Intangible Assets	3,111,580	3,111,580
Total assets	8,196,292	8,196,292
Total liabilities	-	-
Net assets	\$ 8,196,292	\$ 8,196,292

The Company allocated the purchase price based on the fair value of the assets acquired and recorded a gain of approximately \$1.0 million in other income in the current period.

Changsha Valve acquisition

In February 2010, the Company acquired all the equity interests in Able Delight (Changsha) Valve Co, Ltd., formerly an indirect subsidiary of Watts Water Technologies, Inc. ( Watts ), and later known as Changsha Valve, for a purchase price of \$12.12 million plus certain assumed obligations and acquisition expenses of \$2.81 million, or an aggregate

expenditure of approximately \$15 million. Changsha Valve was purchased from Able Delight Investment, Ltd.( Able Delight ), which had acquired Changsha Valve from Watts in January 2010 with \$6.07 million from funds loaned to it by the Company. The Company directly paid the balance of \$8.93 million to other parties as disclosed in 8-KA released on November 18, 2010.

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**CHINA VALVES TECHNOLOGY, INC AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2011**

Able Delight had been formed in November 2009 by Qing Lu, the wife of Bin Li, a 34% stockholder of the Company, in order to facilitate the Company's purchase of Changsha Valve. The Company's purchase price included the discharge of the loan, payments to certain of Watts subsidiaries, and certain other financial obligations of Changsha Valve.

The formation of Able Delight Investment was required by Watts Regulator. Watts Regulator required, as a condition of the sale of Changsha Valve, that the purchasing party be a company whose registered owner was not the Company, a direct competitor of Watts Regulator. It also required the purchasing party to be a wholly foreign owned entity outside China to ensure that Changsha Valve would maintain its status as a wholly foreign owned enterprise in China after the acquisition. Mr. Siping Fang, the then CEO of the Company asked Qing Lu to form Able Delight because Qing Lu is a Canadian citizen and would be qualified to set up such a wholly foreign owned entity, be it in Hong Kong or the British Virgin Islands, or somewhere else outside China. In addition, Qing Lu is a trusted relative of Mr. Siping Fang. Therefore, Able Delight was formed in November 2009 after the Company entered into serious negotiations with Watts Regulator to facilitate the acquisition of Changsha Valve. Changsha Valve is a manufacturer of butterfly and other valves used by hydro, thermal and nuclear power plants and in water and sewage treatment applications.

The acquisition of Changsha Valve was a two step process. Because Watts (the owner of Changsha Valve) preferred not to sell Changsha Valve to a public company, Able Delight was set up as an intermediary to facilitate the transaction. Able Delight signed a loan agreement with the Company to acquire Changsha Valve from Watts. Then Able Delight acquired Changsha Valve on behalf of the Company, and then transferred its ownership to the Company on February 3, 2010. Pursuant to the purchase agreement between Able Delight and Watts, Able Delight paid \$6 million to Watts. Pursuant to email communications, Able Delight, the Company and Watts agreed that as a post-closing condition to the agreement between Watts and Able Delight, the Company would pay \$8.93 million to Watts in order to settle certain liabilities of Changsha Valve concurrently, including vendor payables, unpaid salaries and sales commissions, severance payments and etc, besides the cash consideration paid by the Company through Able Delight to Watts.

Although the Company purchased Changsha Valve through Able Delight, the essence of the transaction was that the Company purchased Changsha Valve from Watts in an arm-length transaction. As mentioned above, the acquisition was a two step process to satisfy the seller requirement that Changsha Valve would not be sold to a publicly traded company.

The Company acquired Changsha Valves through the formation of a new corporation, Able Delight. Although in form the creation of a new company to effect the business combination is different than a business combination between the separate companies, in substance the transaction is no different from a transaction in which one of the combining entities directly acquires the other. Therefore, the transaction should be accounted for as if one of the combining entities directly acquires the other and the acquisition method is applied to each of the combining entities.

Net assets acquired included the following:

Changsha Valve	Fair Value	Assumed by the Company
Cash	\$ 8,740	\$ 8,740
Receivables	3,454,156	3,454,156
Inventory	4,954,596	4,954,596
Buildings and equipment	4,595,254	4,595,254
Intangible Assets	5,490,873	5,490,873
Total assets	18,503,619	18,503,619

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Payables	3,703,845	3,703,845
Total liabilities	3,703,845	3,703,845
Net assets	\$ 14,799,774	\$ 14,799,774

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The Company allocated the purchase price based on the fair value of the assets acquired and liabilities assumed and recorded a gain of approximately \$2.68 million in other income in the current period.

Hanwei Valve acquisition

On April 8, 2010, the Company acquired, from certain unaffiliated individuals, 100% of equity interests in the two entities that were owners of the joint venture that in turn owned Hanwei Valve. Together with certain intangible assets used in the operation of Hanwei Valve, Hanwei Valve was acquired for an aggregate of \$19.5 million. Hanwei Valve is a manufacturer of various valve products and the sole producer in China of the fully-welded ball valve used in long distance gas pipelines and the 24-way rotary valve used in the petrochemical industry.

Net assets of Hanwei Valve acquired at the acquisition date were as follows:

Hanwei Valve	Fair Value	Assumed by the Company
Inventory	\$ 1,802,490	\$ 1,802,490
Buildings and Equipment	2,526,087	2,526,087
Intangible Assets	4,121,271	4,121,271
Total assets	8,449,848	8,449,848
Total liabilities	-	-
Net assets	\$ 8,449,848	\$ 8,449,848
Consideration paid	19,495,922	19,495,922
Goodwill	\$ 11,046,074	\$ 11,046,074

The Company allocated the purchase price based on the fair value of the assets acquired and recorded goodwill of approximately \$11.0 million in the current period. The goodwill recognized in conjunction with the acquisition of Hanwei represents intangible values that Hanwei has built over its more than 16 years of history, which do not qualify for separate recognitions. These values include, but are not limited to:

- v) Expected synergies from combining operations of the Company's operating subsidiaries and Hanwei Valve;
- vi) The experienced work force;
- vii) Proprietary technologies related to certain products; and
- viii) The proprietary manufacturing processes.

Pursuant to Regulation Section 197(c)(1), amortization under Section 197 is not available for the cost of acquiring stock. Thus, no goodwill would be deductible for tax purposes in connection with the Hanwei acquisition.

**Pro Forma**

The following unaudited pro forma condensed income statement for the fiscal years ended, September 30, 2011 and December 31, 2010 were prepared under generally accepted accounting principles, as if the acquisitions of Hanwei Valve, Yangzhou Rock and Changsha Valve had occurred as of the first day of the respective periods. The pro forma information may not be indicative of the results that actually would have occurred if the acquisition had been in effect from and on the date indicated.



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	<b>Pro forma</b>	
	<b>For the nine months ended September 30, 2011</b>	<b>For the years ended, December 31 2010</b>
Revenue	\$ 245,684,743	\$ 186,157,313
Net income	\$ 53,835,263	\$ 43,284,793

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