


**STEEL**

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**Company Update**

Private Circulation Only

**China Oriental Group Co Ltd (581.HK)**

**BUY**                      **Maintain**  
**Price**                    **HKD2.81**  
**Target**                   **HKD4.25**  
                                  (from HKD4.25)

**An Opportunity to Accumulate**

We think the recent sell-down in China Oriental shares is unwarranted as the company's fundamentals are unchanged. Also, the company's upcoming results, scheduled for release on 21 March 2011, are likely to stand out among its peers although its profit is expected to be lower h-o-h. Together with the stock's undemanding valuation of only 6.6x FY10 EPS and 4.4x FY11 EPS, we reiterate our BUY recommendation with our fair value maintained at HKD4.25.

**Stock Profile/Statistics**

Bloomberg ticker	581 HK Equity
Hang Seng Index	23,338.02
Issued share capital (m)	2,929.73
Market capitalization (HK\$m)	8,232.53
52 week H   L price (HK\$)	4.11
Average volume (3m) '000	193.48
YTD returns	-11.36
Net gearing (x)	0.39
Altman Z-Score	2.89
ROCE/WACC	1.58
Beta (x)	0.88
Book value/share (RMB)	2.45

**Major Shareholders (%)**

Mr HanJingyuan	45.1
ArcelorMittal	29.6
Deutsche Bank & ING Bank	17.4

**Share Performance (%)**

Month	Absolute	Relative
1m	-29.8	-29.1
3m	-6.0	-6.7
6m	14.2	0.1
12m	-2.0	-13.8

**12-month Share Price Performance**


**Volatile share price movement.** China Oriental had recently undergone severe market volatility. Its share price enjoyed a good run after we initiated coverage on 2 Dec 2010, touching a peak of HKD4.11 on 25 Jan 2011, but subsequently took a beating amid the recent market and industry-wide correction. Yesterday, the share price was bashed down, losing some 12.5% in market value in a single day.

**2HFY10 numbers likely to stand out.** Major steel mills like Angang (347.HK) and Magang (323.HK) had issued loss alerts for their upcoming 4QFY10 results. However, others including China Oriental, did not provide any profit guidance. While we are surprised at the loss warning, we think China Oriental's FY10 results are likely to match our projection given its production efficiency and market leadership in the niche products. Already, China Iron and Steel Association (CISA) has rated the company's key production base in Qianxi as the most efficient steel mill in terms of productivity per employee in 1HCY10. Meanwhile, we are projecting for about a quarter of the 1HFY10 numbers in 2H, but believe this is commendable as most of its peers may have slipped into the red over the same period.

**Fundamentally intact.** We reckon that sentiment on steel counters may have been dampened by the government's recent tightening measures on bank reserves, interest rate and the nation's housing policy. Furthermore, Premier Wen Jiabao set a lower GDP target of 7% over the weekend. Nonetheless, we think the realised growth may eventually exceed our base case assumption of 8%. Also, niche players like China Oriental have bright prospects, particularly from the low usage of H-sections at only 1% of industry usage in China. The recently issued Senior Notes also put the company on the right footing to make any good investment.

FYE Dec (RMBm)	2008A	2009A	2010F	2011F	2012F
Total Revenue	19,388.2	20,589.1	30,414.4	35,340.8	36,231.1
Core Net Profit	44.0	884.3	1,062.0	1,501.6	1,645.0
% chg YoY	-96.2	1,908.4	20.1	41.4	9.5
Consensus Net Profit	-	-	1,319.0	1,588.0	1,442.0
Core EPS (sen)	0.015	0.302	0.363	0.513	0.562
Gross DPS (sen)	0.057	0.076	0.073	0.122	0.112
Gross Div. Yield (%)	2.3	3.1	3.0	5.4	5.0
PER (x)	164.4	8.2	6.6	4.4	4.0
P/BV (x)	1.2	1.0	0.9	0.7	0.6
EV/EBITDA (x)	12.0	4.3	3.5	2.2	1.6
ROE (%)	0.7	13.2	14.0	17.2	16.3
ROA (%)	0.4	6.0	5.6	6.3	6.4

## Financial Summary (FYE 31 December)

Valuation and Growth						Financial Ratios					
	2008A	2009A	2010F	2011F	2012F		2008A	2009A	2010F	2011F	2012F
<b>Valuation Ratios</b>						<b>Profitability Ratios</b>					
PER (Basic) (x)	164.4	8.2	6.6	4.4	4.0	Gross margin	5.8	14.0	10.2	11.2	11.6
Dividend yield	2.3	3.1	3.0	5.4	5.0	EBITDA margin	4.0	11.2	8.5	9.5	9.9
P/BV (x)	1.2	1.0	0.9	0.7	0.6	Core net margin	0.2	4.3	3.5	4.2	4.5
<b>Growth</b>						<b>Balance Sheet Ratios</b>					
Revenue (%)	43.6	6.2	47.7	16.2	2.5	Current ratio	0.9	1.0	1.2	1.2	1.2
EBITDA (%)	-60.5	195.9	12.4	30.3	6.7	Gross debt/equity	0.3	0.4	0.7	0.6	0.5
Core Net profit (%)	-96.2	1908.4	20.1	41.4	9.5	Net debt/equity	0.2	0.2	0.1	-0.1	-0.2
<b>Per Share Data</b>						<b>Inventory Days</b>					
<b>(RMB)</b>						<b>Receivable Days</b>					
EPS (Basic)	0.015	0.302	0.363	0.513	0.562	Payable Days	44.3	35.6	34.2	34.2	34.2
DPS	0.057	0.076	0.073	0.122	0.112	<b>Balance Sheet</b>					
Payout ratio	380.3	25.1	20.0	20.0	20.0	<b>(RMBm)</b>					
BV/S	2.14	2.45	2.74	3.22	3.67	<b>Fixed Asset</b>					
<b>Income Statement</b>						<b>Property, plant &amp; equipments</b>					
<b>(RMBm)</b>						<b>Investment</b>					
Total revenue	19,388.2	20,589.1	30,414.4	35,340.8	36,231.1	<b>Intangible assets</b>					
Cost of sales	-18,273.2	-17,699.8	-27,313.7	-31,373.9	-32,024.2	<b>Others</b>					
Gross profit	1,115.0	2,889.3	3,100.8	3,966.8	4,206.8	<b>Total fixed assets</b>					
Selling & distribution costs	-80.3	-57.0	-91.2	-106.0	-108.7	<b>Current Asset</b>					
General and administrative	-281.9	-283.5	-456.2	-530.1	-543.5	<b>Cash and cash equivalents</b>					
Operating profit/expenses	24.0	-250.6	30.4	35.3	36.2	<b>Amount due from related cos</b>					
EBITDA	776.7	2,298.2	2,583.7	3,366.0	3,590.9	<b>Inventories</b>					
Depreciation & amortisation	-573.5	-847.5	-870.4	-907.9	-945.4	<b>Trade receivables</b>					
Finance costs	-91.6	-137.1	-268.0	-406.8	-406.8	<b>Others</b>					
Exceptional items	0.0	0.0	0.0	280.0	0.0	<b>Total current assets</b>					
Associate / JV's contribution	2.0	0.2	0.2	0.2	0.2	<b>Current Liabilities</b>					
Pre-tax profit	113.6	1,313.7	1,445.4	2,331.5	2,238.8	<b>Trade payables</b>					
Taxation	-70.6	-341.3	-361.3	-512.8	-559.7	<b>Short-term loans</b>					
Minority interests	1.1	-88.1	-22.1	-37.0	-34.2	<b>Amount due to related cos</b>					
Reported net profit	44.0	884.3	1,062.0	1,781.6	1,645.0	<b>Others</b>					
Core net profit	44.0	884.3	1,062.0	1,501.6	1,645.0	<b>Total current liabilities</b>					
<b>Cashflow Statement</b>						<b>Long-Term Liabilities</b>					
<b>(RMBm)</b>						<b>Borrowings</b>					
<b>Operating cashflow</b>						<b>Others</b>					
Pre-tax profit	113.6	1,313.7	1,445.4	2,331.5	2,238.8	<b>Total long term liabilities</b>					
Depreciation & amortisation	573.5	847.9	870.4	907.9	945.4	<b>Shareholders' funds</b>					
Others	2,280.5	246.6	267.8	406.6	406.6	<b>Share Capital</b>					
Change in working capital	-2,391.8	-2,140.7	-420.2	-245.4	-55.1	<b>Reserves</b>					
Tax paid	-427.8	-16.0	-361.3	-512.8	-559.7	<b>Equity attributable to owner</b>					
Total operating cashflow	147.9	251.6	1,802.2	2,887.8	2,976.1	<b>Minority interests</b>					
<b>Investing cashflow</b>						<b>Equity raised</b>					
Capex	-953.6	-930.9	-500.0	-500.0	-500.0	<b>Debt raised / paid</b>					
Investments	-247.0	207.3	0.0	0.0	0.0	<b>Dividend paid</b>					
Others	-309.8	48.7	0.0	0.0	0.0	<b>Others</b>					
Total investing cashflow	-1,510.4	-674.8	-500.0	-500.0	-500.0	<b>Total financing cashflow</b>					
<b>Financing cashflow</b>						<b>Net cash inflow / (outflow)</b>					
Equity raised	0.0	0.0	0.0	0.0	0.0	<b>Cash - beg</b>					
Debt raised / paid	982.2	361.4	0.0	0.0	0.0	<b>Others</b>					
Dividend paid	0.0	0.0	-268.0	-406.8	-406.8	<b>Cash - end</b>					
Others	427.5	-22.6	3,174.6	-636.3	-329.0						
Total financing cashflow	1,409.7	338.8	2,906.6	-1,043.1	-735.8						
Net cash inflow / (outflow)	47.2	-84.4	4,208.8	1,344.7	1,740.3						
Cash - beg	689.6	728.8	644.0	4,852.8	6,197.5						
Others	-8.0	-0.4	0.0	0.0	0.0						
Cash - end	728.8	644.0	4,852.8	6,197.5	7,937.8						

Source: Company data, OSK Securities Hong Kong Limited

### OSK Research Guide to Investment Ratings

**Buy:** Share price may exceed 10% over the next 12 months

**Trading Buy:** Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

**Neutral:** Share price may fall within the range of +/- 10% over the next 12 months

**Take Profit:** Target price has been attained. Look to accumulate at lower levels

**Sell:** Share price may fall by more than 10% over the next 12 months

**Not Rated:** Stock is not within regular research coverage

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