China Oriental Group Company, Inc.

Rating Change **NEUTRAL**

Equity | China | Steels
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Product mix shift offset the low steel price

Merrill Lynch

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The worst is behind us, Up to Neutral

China Oriental reported CY05 EPS 18.6% below our expectations, due to a price trough in 4Q. However we believe the worst is behind us. We expect EPS to improve to Rmb0.32 in 06 from Rmb0.08 in 2H 05, with price recovery and higher margin new products bring to market. Also, with capex peaking out last year, free cash flow will turn positive and gradually grow. The stock has underperformed the market by >30% and sector's best performer by 80% in the past 3 months. It is now trading at 17% discount to APR ex Japanese peers, we believe it is fairly valued.

Low-end steel price recovery unsustainable

Steel prices have recovered by nearly 15% from December's low driven by cost push, production growth slowdown and demand recovery. We expect the price rebound to be sustained through 1H06. However, improved prices will encourage more production to hit the market especially for low end products China Oriental produces. We expect to see prices again under pressure in 2H06, but with limited downside, as the current price is only 10% above industry average cost.

Earnings stabilized at low level

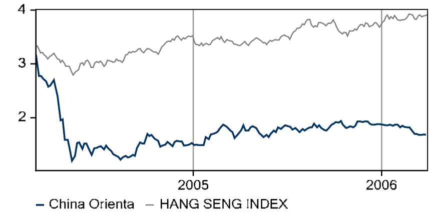
Management expects to achieve much progress in 2006 in product mix shifting, by adding higher margin products of 450kt H-beam, 220kt CRC and 500kt strips. The company has also replaced two small blast furnaces with a new larger one recently which should boost overall steel production by 20%. We expect capacity expansion and product mix shift to offset the low steel price, and thus leave our 06E earnings unchanged and expect a stable earnings outlook for 06 and 07. .

Key issues to Watch for

1) Steel industry consolidation and opportunities and risks for China Oriental on M&A; 2) how successful will government efforts be on shutting down small older steel mills; 3) Potential policy/tax changes to discourage steel exports.

Stock Data

Price	HK$1.70
Investment Opinion	C-3-7 to C-2-7
Volatility Risk	HIGH
52-Week Range	HK$1.60-HK$2.00
Mrkt Val / Shares Out (mn)	US$636 / 2,905.0
Average Daily Volume	674,500
ML Symbol / Exchange	CUGCF / HKG
Bloomberg / Reuters	581 HK / 0581.HK
ROE (2006E)	18.5%
Net Dbt to Eqty (Dec-2005A)	19.4%
Est. 5-Yr EPS / DPS Growth	4.0% / 4.0%
Free Float	24.2%



Estimates (Dec)

(CNY)	2004A	2005A	2006E	2007E	2008E
Net Income (Adjusted - mn)	1,181	847	920	948	952
EPS	0.426	0.291	0.317	0.326	0.328
EPS Change (YoY)	-16.8%	-31.7%	8.7%	3.0%	0.3%
Dividend / Share	0.215	0.047	0.051	0.049	0.049
Free Cash Flow / Share	(0.018)	(0.246)	0.328	0.364	0.387

Valuation (Dec)

	2004A	2005A	2006E	2007E	2008E
P/E	4.12x	6.03x	5.54x	5.38x	5.36x
Dividend Yield	12.26%	2.67%	2.90%	2.79%	2.80%
EV / EBITDA*	4.73x	4.89x	4.53x	4.36x	4.22x
Free Cash Flow Yield*	-0.991%	-14.01%	18.68%	20.75%	22.02%

* For full definitions of ***iQmethod*** SM measures, see page 11.

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iQprofile SM China Oriental Group Company, Inc.

Key Income Statement Data (Dec)	2004A	2005A	2006E	2007E	2008E
(CNY Millions)					
Sales	9,119	9,182	10,620	10,618	11,200
Gross Profit	1,311	1,223	1,315	1,343	1,352
Sell General & Admin Expense	(155)	(159)	(184)	(184)	(194)
Operating Profit	1,156	1,064	1,131	1,159	1,158
Net Interest & Other Income	20	(60)	(5)	22	53
Associates	---	---	---	---	---
Pretax Income	1,176	1,004	1,126	1,181	1,210
Tax (expense) / Benefit	34	(157)	(169)	(177)	(182)
Net Income (Adjusted)	1,181	847	920	948	952
Average Fully Diluted Shares Outstanding	2,770	2,905	2,905	2,905	2,905
Key Cash Flow Statement Data					
Net Income (Reported)	1,181	847	920	948	952
Depreciation & Amortization	150	199	234	257	307
Change in Working Capital	0	268	(38)	(2)	(13)
Deferred Taxation Charge	---	---	---	---	---
Other Adjustments, Net	(980)	3	36	56	77
Cash Flow from Operations	351	1,316	1,153	1,259	1,323
Capital Expenditure	(401)	(2,031)	(200)	(200)	(200)
(Acquisition) / Disposal of Investments	---	---	---	---	---
Other Cash Inflow / (Outflow)	(49)	(101)	0	0	0
Cash Flow from Investing	(450)	(2,132)	(200)	(200)	(200)
Shares Issue / (Repurchase)	0	0	0	0	0
Cost of Dividends Paid	0	(136)	(148)	(142)	(143)
Cash Flow from Financing	0	307	(148)	(142)	(143)
Free Cash Flow	(51)	(715)	953	1,059	1,123
Net Debt	661	920	115	(801)	(1,782)
Change in Net Debt	102	259	(805)	(916)	(981)
Key Balance Sheet Data					
Property, Plant & Equipment	2,404	4,236	4,202	4,145	4,038
Other Non-Current Assets	0	103	103	103	103
Trade Receivables	828	714	826	826	871
Cash & Equivalents	1,218	710	1,515	2,432	3,412
Other Current Assets	2,119	1,268	1,308	1,308	1,324
Total Assets	7,482	8,153	9,262	10,117	11,131
Long-Term Debt	459	294	294	294	294
Other Non-Current Liabilities	25	15	15	15	15
Short-Term Debt	1,420	1,336	1,336	1,336	1,336
Other Current Liabilities	1,159	1,143	1,337	1,332	1,415
Total Liabilities	3,481	3,421	3,721	3,714	3,842
Total Equity	4,001	4,732	5,541	6,403	7,289
Total Equity & Liabilities	7,482	8,153	9,262	10,117	11,131
iQmethod SM **- Bus Performance***					
Return On Capital Employed	26.6%	15.5%	15.0%	14.0%	12.9%
Return On Equity	48.9%	20.0%	18.5%	16.4%	14.5%
Operating Margin	12.7%	11.6%	10.6%	10.9%	10.3%
EBITDA Margin	14.3%	13.8%	12.9%	13.3%	13.1%
iQmethod SM **- Quality of Earnings***					
Cash Realization Ratio	0.3x	1.6x	1.3x	1.3x	1.4x
Asset Replacement Ratio	2.7x	10.2x	0.9x	0.8x	0.7x
Tax Rate (Reported)	NM	15.6%	15.0%	15.0%	15.0%
Net Debt-to-Equity Ratio	16.5%	19.4%	2.1%	-12.5%	-24.4%
Interest Cover	18.0x	14.3x	15.4x	15.8x	15.8x
Key Metrics					

* For full definitions of *iQmethod* SM measures, see page 11.

Company Description

China Oriental Group Co. Ltd. (COGCL) was incorporated in Nov. 2003 and listed on the Hong Kong stock market in March 2004. Its major operating asset is its 97.6% interest in Hebei Jinxi Iron & Steel Co., Ltd (Jinxi Steel), which is the 7th-largest integrated steel maker in northern China. It was ranked No. 24 in China in terms of steel output in 2003. COGCL's 2 major products are steel billets & hot-rolled strips (68% & 31% of total revenues, re

Stock Data

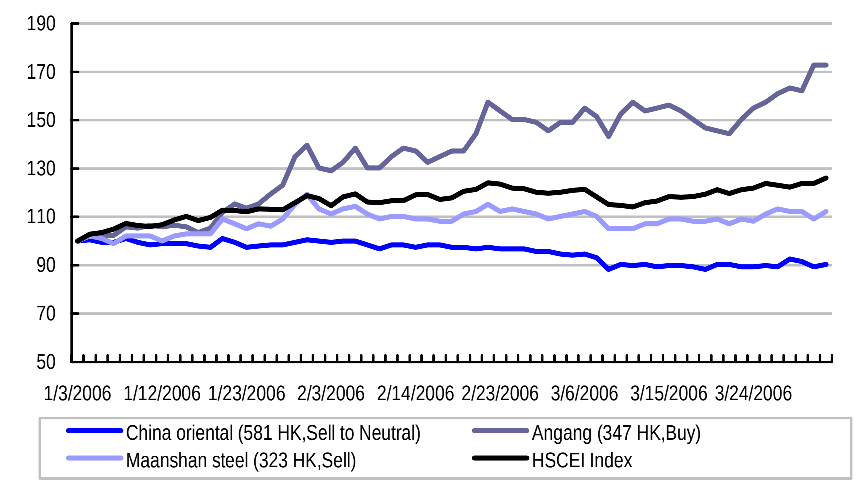
Price to Book Value	1.0x

Up to Neutral

China Oriental reported CY05 EPS 18.6% below our expectations, due to a price trough in 4Q. However, with prices recovering and higher margin new products being brought to market this year, we believe the company is already through the most difficult period. We expect EPS to improve to Rmb0.32 in 06E from Rmb0.08 in 2H 05.

The stock has underperformed H-share index by 38% and sector's best performer Angang Newsteel (347 HK, Buy) by 80% in the past 3 months. It is currently trading at 18% discount to APR ex Japan peers, we believe it is fairly valued now.

Chart 1: China Oriental underperformed market index and peers



Source: Bloomberg

Table 1: Asia Pacific Steel Comps

ML ticker	Company	Price	Mkt Cap	Rating	Price/Earnings Ratio			EV/EBITDA			Dividend Yield			Price/Book Value		
		Mar 31 2006	mn US$		2005A	2006E	2007E	2005A	2006E	2007E	2005A	2006E	2007E	2005A	2006E	2007E
ANGGF	Angang	7.30	2,787	B-1-7	10.1	7.2		7.0	2.6		4.6	6.0		2.0	0.8	
BAOSF	Baosteel	4.20	9,174	C-2-7	5.1	6.0	6.1	3.1	3.2	3.2	7.8	7.6	7.6	1.0	0.9	0.8
BLSFF	BlueScope Steel	7.18	3,749	C-1-7	7.0	9.7	8.7	5.3	6.5	5.7	5.8	6.2	6.7	1.6	1.6	1.5
CUGCF	China Oriental	1.68	629	C-3-8	6.0	5.5	5.3	4.7	4.4	4.2	2.7	2.9	2.8	1.1	0.9	0.8
CEESF	China Steel	30.40	9,116	C-1-7	5.8	7.0	7.4	3.9	4.4	4.6	13.2	10.9	10.2	1.5	1.5	1.4
MISCF	Maanshan I & S	2.68	2,225	C-3-8	5.5	6.6	5.6	4.6	4.9	3.9	7.2	5.4	5.4	0.9	0.9	0.8
OSTLF	OneSteel	4.12	1,656	C-2-7	14.2	12.3	10.4	7.9	7.1	6.4	3.4	3.5	3.5	1.7	1.6	1.4
PKXFF	POSCO	250,500	22,478	B-2-7	5.0	6.4	8.0	2.6	3.0	3.3	3.7	3.5	3.5	1.1	1.0	0.9
SMUPF	Sims Group	17.52	1,194	B-1-7	10.2	9.2	7.2	6.2	4.7	3.8	7.3	7.5	8.2	2.0	1.4	1.3
SRGNF	Smorgon Steel	1.37	844	B-1-7	10.8	9.6	8.3	6.6	6.3	6.1	6.4	6.9	7.7	1.4	1.3	1.2
SLAUF	Steel Authority	83.30	7,720	C-2-7	4.8	5.5	6.5	2.3	2.7	3.2	4.2	3.7	3.1	2.4	1.8	1.5
WHNIF	Wuhan Steel	2.80	2,737	C-2-7	4.5	5.0	5.1	1.8	1.8	1.8	11.4	10.0	9.6	1.1	1.0	0.9
APR ex Japan Weighted Average					5.8	6.7	7.0	3.5	3.6	3.6	6.4	5.9	5.5	1.4	1.2	1.1

Source: Company data, Merrill Lynch Estimates

Our blended valuation for China Oriental currently is about HK$1.65, which is very close to the current share price. We use a combination of PER, EB/EBITDA and PB and apply a 15% discount to APR (ex Japan) steel sector given its lower-end product mix and higher earnings volatility compare with peers. .

Table 2: Blended Valuation of China Oriental

	APR (ex Japan) avg	discount	net multiple	valuation
P/E	6.7	15%	5.7	1.75
EV/EBITDA	3.6	15%	3.0	1.39
P/B	1.2	15%	1.0	1.82
				1.65

Source: Merrill Lynch estimates

2005 results-the worst behind us

China oriental reported 2005 net profit of Rmb847mn, a decline of 28.3% YoY and 18.6% below our forecast. The company announced a Rmb0.05/share dividend, also lower than our expectations.

The top line actually is quite close to our forecasts. We found the average realized price is only 0.9% below our estimates, and unit cost was 1% higher. However, due to high earnings sensitivity to price and cost, gross profit is 14.3% below estimates, which together with other loss of Rmb81mn in assets disposal and foreign exchange, resulted in a 18.6% lower bottom line.

Table 3: 2005 results vs. ML estimates

	2005A	2004A	YoY Chg	2005 ML	Variance
Sales volume	3,305	3,354	1.5%	3,400	-2.8%
Billets	1,458	2,025	39.0%	1,580	-7.7%
Strips	833	807	-3.2%	820	1.6%
mid width strips	1,014	522	-48.5%	1,000	1.4%
Average price	2,739	2,684	-2.0%	2,765	-0.9%
Billets	2,491	2,599	4.3%	2,521	-1.2%
Strips	2,817	2,659	-5.6%	2,823	-0.2%
mid width strips	2,999	3,051	1.8%	3,042	-1.4%
Unit cost/ton	2,386	2,307	-3.3%	2,363	1.0%
Revenue	9,182	9,119	0.7%	9,556	-3.9%
COGS	-7,959	-7,808	1.9%	-8,128	-2.1%
Gross Profit	1,223	1,311	-6.7%	1,427	-14.3%
SG&A	-159	-155	2.4%	-155	2.7%
EBIT	1,064	1,156	-7.9%	1,273	-16.4%
Net financing cost	-8	-31	-74.9%	-27	-71.0%
Others	-52	52	-201.0%	1	-5315.5%
PBT	1,004	1,176	-14.6%	1,247	-19.4%
Tax	-157	34	-566.3%	-186	-15.5%
Effective Tax rate	16%	-3%	-646.0%	15%	4.9%
Profit attribute to minorities	-1	-29	-98.1%	-21	-97.5%
Reported NPAT	847	1,181	-28.3%	1,040	-18.6%
Reported EPS (Rmb$)	0.29	0.43	-31.7%	0.36	-18.6%
DPS (Rmb$)	0.05	0.22	-78.2%	0.07	-34.6%

Source: Company data, Merrill Lynch estimates

As we expected, there was a big drop in earnings in 2H05, from Rmb613mn in 1H05 to Rmb233mn, due to 16.7% HoH decline in steel price. A simultaneous decline in spot iron ore & coke prices has provided some cost relief, but the decline in steel prices has been greater causing margins to compress. Average realized per ton gross profit declined from Rmb520 in 1H05 to Rmb205 in 2H05.

Table 4: Per ton Gross profit for major products

Rmb/ton	2000A	2001A	2002A	2003A	1H04A	2H04A	1H05	2H05
Billets	400	338	440	455	307	357	318	151
Strips	786	370	471	616	326	506	534	337
Mid-width strips					119	562	801	252
Average	421	348	448	498	304	441	520	205

Source: Company data

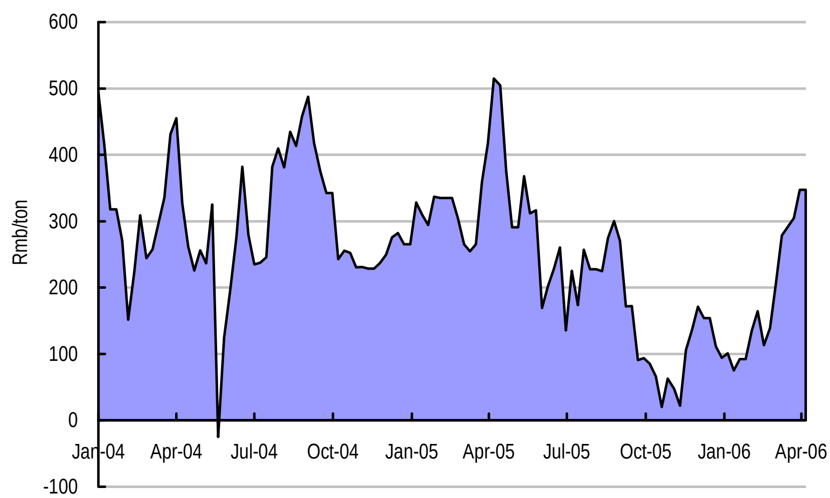
However, we believe the most difficult period was already behind us for China oriental, due to:

1) Steel price recovered near 15% from Dec 05 low, and raw material costs remain unchanged, the profitability of China Oriental has been back to its normal level.

2) We believe the current price recovery will sustain through the 1H06. There might be some pressure on price since 2H06, but downside room is limited.

3) Increasing contribution from new higher margin products will offset the lower steel price in 2006.

Chart 2: Per ton gross profit back to normal level in Mar from 4Q trough



Source: CUsteel.com; Merrill Lynch estimates

Earnings stabilize at low level

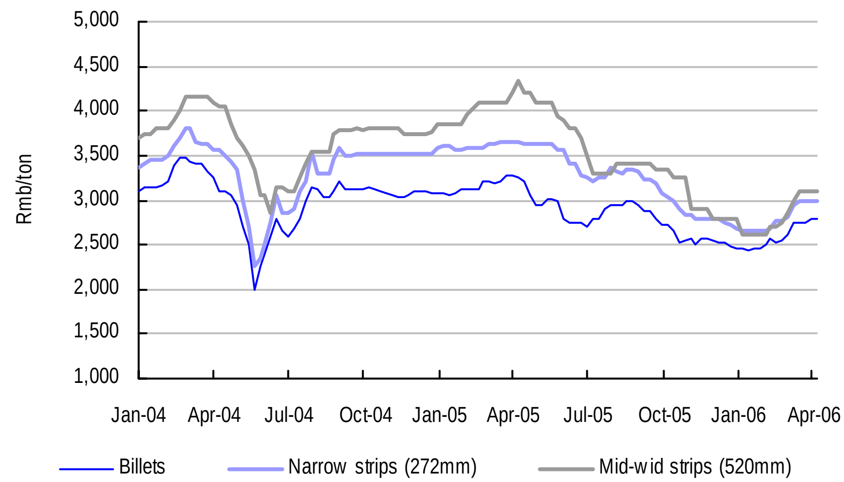
We expect a stable earning outlook for China Oriental in the next 12-24 months, with capacity expansion and product mix shifting offset the lower steel price. We expect EPS to stabilize at Rmb0.32 to Rmb0.33 for 2006-2008.

Prices recover but unsustainable

After 20%-25% price drop from Apr 05 to Dec 05, steel price in China spot market has recovered by near 15% since the year beginning, driven by cost push, slowdown of production growth and demand recovery.

The spot market price recovery is further confirmed by price hike following by major steel mills. We believe the seasonal stronger demand together with the likely iron ore price hike in April will continue push price up and make the recovery sustain through the next 3 Moths.

Chart 3: Steel price for billets & strips is recovering



Source: Custeel.com

However improved prices will encourage more production to hit the market in the next several months, especially for low end products which suffered significant overcapacity in China, like billets & strips, which is what China Oriental produces. We expect to see prices again under pressure in 2H06.

But on the other hand, we believe the downsideis also not great. We currently forecast prices to decline by 5%-8% in average for 2H06 from current level. This is based on the assumption that current price is only 10% above industry average cost. We estimate the current average cost for steel billets is about US$270/ton vs. the current market price of US$300/ton.

Product mix shift offset

China oriental has realized the overcapacity problems in low end steel market, and has made big investment in upgrading its product mix by introducing higher value added products since 2004. Management expected to achieve big progress on this in 2006 through the following efforts:

1) H-beam: Will commence production in June 2006 with designed annual capacity of 1mn tonnes. We expect production to reach 450k tones in 2006 with gross margin >Rmb400/ton, contributing around 13% net profit in 2006.

2) Cold rolled coils: Commenced production mid 2005. We expect production to ramp up from 30kt last year to 250kt in 2006, with gross margin near Rmb380/ton, higher than other products. Phase II with another 500k ton capacity for mid-width cold rolled strips is under construction and we expect to start production next year.

3) 500kt more hot rolled strips: The company will introduce a new hot rolled strips production line this year, to boost its strips capacity from 800kt to 1300kt. Management expect total production for strips and mid width strips(1mt capacity) to reach 2.2mt.

As a result the proportion of flat steel among its total products will rise from 45% last year to around 60% in 2006, and further improved to about 75% in 2007.

In the meantime, the company has also replaced two small old blast furnaces with a new larger one recently, which should boost its overall steel production by 20% from 3.3mn tonnes to 4.0mn tonnes in 2006E.

Earnings outlook

Despite the 18.6% below-expectation earnings in 2005, we leave our 06 EPS forecast unchanged at Rmb0.32, based on the view that capacity expansion and product mix shifting is to offset the lower steel prices in 2006. We have lowered our 2007 EPS forecast by 10% to Rmb0.33/share, to incorporate a slightly higher raw material price assumption. We now expect earnings to stabilize at current level for the next 12-24 months.

Table 5: Estimates Chage, is vs. was

Earnings	2004A	2005A	2006E	2007E
NPAT (RMB m) - is	1181	847	921	950
NPAT (RMB m) - was	1217	1040	924	1050
% change	-3%	-19%	0%	-10%
Sales volume				
Sales volume (kt)-is	3,385	3,305	4,000	4,000
Sales volume (kt)-was	3,385	3,400	3,600	3,800
Change (%)	0%	-3%	11%	5%
Growth (%)	40%	-2%	21%	0%
breakdown				
Billets	2,025	1,458	1,350	1,000
Strips	807	833	1,200	1,200
Mid-width strips	522	1,014	1,000	1,000
H-beam	0	0	450	800
CR-JV	0	31	250	360
Prices (Rmb/ton)				
Average selling price-is	2,684	2,739	2,488	2,425
Average selling price-was	2,684	2,765	2,453	2,380
Change (%)	0%	-1%	1%	2%
Growth (%)	24%	2%	-9%	-3%
Billets	2,599	2,491	2,283	2,169
Strips	2,659	2,817	2,418	2,298
Mid-width strips	3,051	2,999	2,416	2,295
H-beam			2,696	2,595
CR-JV		3,831	3,855	3,546
Cost (Rmb/ton)				
Average cost (rmb/ton)-is	2,307	2,386	2,190	2,127
Average Cost (rmb/ton)-is	2,307	2,363	2,121	2,040
Change (%)	0%	1%	3%	4%
Growth (%)	38%	3%	-8%	-3%
Iron Ore (rmb/ton)		665	559	520
Coke (rmb/ton)		951	814	780

Source: Company data, Merrill Lynch estimates

Earnings sensitivity

Due to comparatively low margin, the earnings sensitivity to steel price and raw material price is very big, which increase the volatility and uncertainties to its earnings forecast. This is also part of the reason we believe it should trade discount to its peers.

We estimates for 1% change in steel price, earnings will rise by xx%, while for every 1% change in iron ore and coke cost, earnings will change by x% and x% respectively.

Table 6: Earnings sensitivity to steel price

	2006E			2007E		
	Revenue	EBITDA	Net profit	Revenue	EBITDA	Net profit
Base case	10,620	1,365	921	10,618	1,416	949
Up 1%	10,737	1,471	1,012	10,791	1,575	1,087
Variance from base	1.1%	7.8%	9.9%	1.6%	11.2%	14.5%
Down 1%	10,504	1,259	830	10,446	1,259	812
Variance from base	-1.1%	-7.7%	-9.8%	-1.6%	-11.1%	-14.4%

Source: Merrill Lynch estimates

Table 7: Earnings sensitivity to iron ore price

	2006E			2007E		
	COGS	EBITDA	Net profit	COGS	EBITDA	Net profit
Base case	-9,306	1,365	921	-9,275	1,416	949
Up 1%	-9,340	1,331	892	-9,306	1,384	922
Variance from base	0.4%	-2.5%	-3.2%	0.3%	-2.2%	-2.9%
Down 1%	-9,272	1,399	950	-9,243	1,447	976
Variance from base	-0.4%	2.5%	3.2%	-0.3%	2.2%	2.9%

Source: Merrill Lynch estimates

Table 8: Earnings sensitivity to coke

	2004E			2005E		
	COGS	EBITDA	Net profit	COGS	EBITDA	Net profit
Base case	-9,306	1,365	921	-9,275	1,416	949
Up 1%	-9,322	1,349	907	-9,290	1,400	936
Variance from base	0.2%	-1.2%	-1.5%	0.2%	-1.1%	-1.4%
Down 5%	-9,290	1,381	935	-9,259	1,432	962
Variance from base	-0.2%	1.2%	1.5%	-0.2%	1.1%	1.4%

Source: Merrill Lynch estimates

Key issues to watch for

The Chinese government has decided to encourage industry consolidation through M&A and the closure of 80mt small old steel capacity over the next couple of years.

On M&A:

We have already seen a lot of M&A happening in the China Steel sector in the past several months. Although there is still a long way to go for the M&A to become a real industry consolidation –we think It should be a long term positive. improving industry structure and supply side discipline.

For China Oriental, management believes it is unlikely to become a target of a buy out given the local government support. The company so far does not have any plans to acquire other companies. But there will likely be both opportunities and risks during the industry restructuring.

Shutting down of small steel mills

Government plan to shut down 80mt small old steel mill in the next five years, and this year's target is to first close down all the small blast furnace with scale below 200 cubic meters and next year for those below 300 cubic meters. If the policy do achieve the expected results, it will be a positive for China oriental because lots of its competitors will be on the restriction list.

Further policy on export

China's steel price currently is at big discount to global market, which encourages steel exports and helps domestic price recovery. However, it is possible that government will introduce some new tax policies to discourage steel exports due to political pressure from trading partners and domestic energy saving consideration. In that case, domestic price will be at risk again.

Financial Statement

Table 9: Profit & Loss

(mn Rmb)	2004A	2005A	2006E	2007E	2008E
Revenue	9,119	9,182	10,620	10,618	11,200
YoY Chg	*73%*	*1%*	*16%*	*0%*	*5%*
Billets	5,215	3,632	3,082	2,169	0
Strips	3,871	5,389	5,318	5,052	0
CRC JV-60% equities	0	117	964	1,277	0
H-beam	0	0	1,213	2,076	0
Others	33	45	45	45	11,200
COGS	-7,808	-7,959	-9,306	-9,275	-9,848
Gross Profit	1,311	1,223	1,315	1,343	1,352
Gross margin	*14%*	*13%*	*12%*	*13%*	*12%*
SG&A	-155	-159	-184	-184	-194
EBITDA	1,156	1,263	1,365	1,416	1,465
EBITDA margin	*13%*	*14%*	*13%*	*13%*	*13%*
EBIT	1,156	1,064	1,131	1,159	1,158
EBIT margin	*13%*	*12%*	*11%*	*11%*	*10%*
Net financing cost	-31	-8	-5	22	53
Others	52	-52	-0	0	0
PBT	1,176	1,004	1,126	1,181	1,210
Tax	34	-157	-169	-177	-182
Effective Tax rate	*-3%*	*16%*	*15%*	*15%*	*15%*
Profit attribute to minorities	-29	-1	-36	-56	-77
Reported NPAT	1,181	847	920	948	952
NPAT Growth	*10%*	*-28%*	*9%*	*3%*	*0%*
Net margin	*13%*	*9%*	*9%*	*9%*	*8%*
Reported EPS (Rmb$)	0.43	0.29	0.32	0.33	0.33
Adjusted EPS (Rmb$)	0.41	0.29	0.32	0.33	0.33
P/E (x)	4.3	6.1	5.6	5.4	5.4
DPS (Rmb$)	0.22	0.05	0.05	0.05	0.05
Yield (%)	12.2	2.6	2.9	2.8	2.8
Interst coverage (x)	36.9	135.3	214.8	-52.0	-22.0
Payout ratio	50%	16%	16%	15%	15%

Source: Company data, Merrill Lynch estimates

Table 10: Balance Sheet

(mn Rmb)	2004A	2005E	2006E	2007E	2008E
Cash and cash equivalents	1,218	710	1,515	2,432	3,412
Restricted bank balance	1,708	1,015	1,015	1,015	1,015
Accouts receivable	828	714	826	826	871
Inventories	900	1,103	1,290	1,286	1,365
Other current assets	411	253	292	292	308
Current Assets	5,065	3,796	4,939	5,851	6,972
Fixed Assets	2,404	4,236	4,202	4,145	4,038
Other long-term assets	12	121	121	121	121
Non-current Assets	2,417	4,357	4,323	4,266	4,159
Total Assets	7,482	8,153	9,262	10,117	11,131
Short-term debt	1,420	1,336	1,336	1,336	1,336
Accounts payables	418	632	739	737	783
Other current Liabilities	1,159	1,143	1,337	1,332	1,415
Current Liabilities	2,997	3,112	3,412	3,405	3,533
Long-term Debt	459	294	294	294	294
Defered tax, others	25	15	15	15	15
Total Liabilities	3,481	3,421	3,721	3,714	3,842
Minorities interest	116	139	175	231	308
Equities=Net Assets	3,885	4,593	5,366	6,172	6,981
Book Value per share	1.40	1.58	1.85	2.12	2.40
Net Debt/(Net Cash)	661	920	115	-801	-1,782
Net Debt/Equity	17%	20%	2%	-13%	-26%
ROAA	20.8	10.8	10.6	10.3	9.4
ROAE	48.9	20.0	18.5	17.6	15.4
Inventory days (days)	37	46	47	51	49
Acc receivable days (days)	22	31	26	28	28
Acc payable days (days)	17	24	27	29	28
Share at Year end	2,905	2,905	2,905	2,905	2,905

Source: Company data, Merrill Lynch estimates

Table 11: Cashflow Statement

Cash flow (mn Rmb)	2004A	2005A	2006E	2007E	2008E
PBT	1,176	1,004	1,126	1,181	1,210
D&A	0	199	234	257	307
Changes in WC	0	268	-38	-2	-13
Other adjustments	-825	-155	-169	-177	-182
Operating cashflow	351	1,316	1,153	1,259	1,323
Capex	-401	-2,031	-200	-200	-200
Others	-49	-101	0	0	0
Investing cashflow	-450	-2,132	-200	-200	-200
Dividends Paid	0	-136	-148	-142	-143
Increase in ST & LT Debt	0	-249	0	0	0
Increase in Capital Stocks	0	0	0	0	0
Other Financing Activities	1,168	693	0	0	0
Financing cash flow	1,168	307	-148	-142	-143
Increase in cash	1,068	-508	805	916	981
Free Cash Flow	-100	-816	953	1,059	1,123
CFPS (Rmb)	0.12	0.45	0.40	0.43	0.46
FCFPS (Rmb)	-0.03	-0.28	0.33	0.36	0.39

Source: Company data, Merrill Lynch estimates

Analyst Certification

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

iQmethod SM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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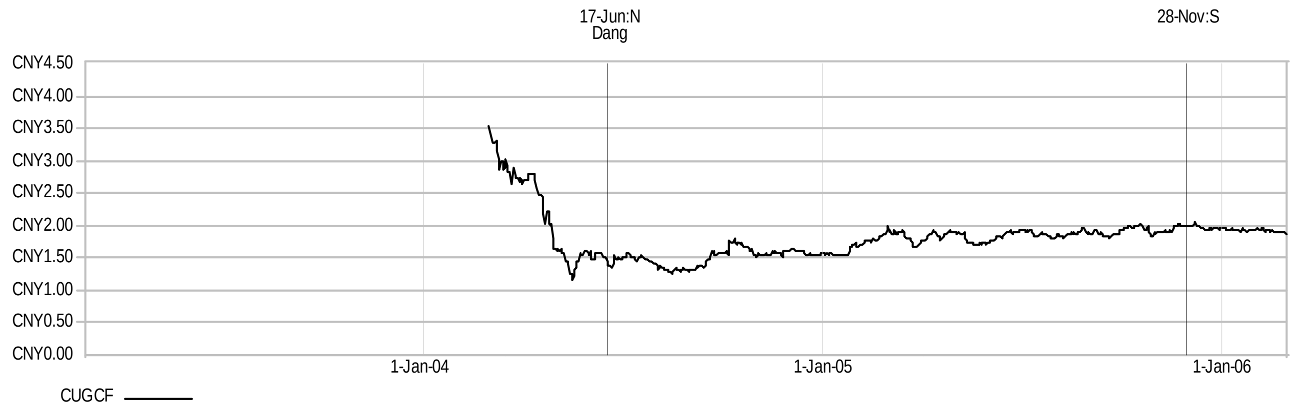
CUGCF Price Chart



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The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of February 28, 2006.

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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	12	37.50%	Buy	2	16.67%
Neutral	18	56.25%	Neutral	3	16.67%
Sell	2	6.25%	Sell	0	0.00%

Investment Rating Distribution: Global Group(as of 31 Dec 2005)

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Neutral	1429	51.64%	Neutral	401	28.06%
Sell	219	7.91%	Sell	44	20.09%

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