


MATERIALS

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Stock Profile/Statistics

Bloomberg ticker	581 HK
Hang Seng Index	21,079.1
Issued share capital (m)	2,929.6
Market capitalization (HK\$m)	8,554.3
52 week H L price (HK\$)	3.23 1.07
Average volume (3m) '000	440.1
YTD returns	4.7%
Net gearing (x)	
Altman Z-Score	1.79
ROCE/WACC	-42.4%
Beta (x)	0.80
Book value/share (RMB)	2.26

Major Shareholders (%)

Wellbeing Holdings	42.88%
Mittal Steel Holdings	29.62%

Share Performance (%)

Month	Absolute	Relative
1m	-5.25%	-7.94%
3m	15.14%	18.04%
6m	25.11%	28.47%
12m	153.51%	49.58%

12-month Share Price Performance

Company Update

Private Circulation Only

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

BUY	Maintain
Price	HK\$2.92
Target	HK\$3.90

Acquisition to hedge against rising cost

On 10th March, China Oriental Group's ("COG") 97.6%-owned Jinxi Iron and Steel acquired a 45% stake in its lime supplier for 2.0x PB, at total cost of Rmb14.6mn. COG will finance the acquisition out of its internal source (Rmb622mn cash on hand as of June 09). The acquisition will ensure stable and sole supply of lime to COG and guarantee share of profit and dividend from the lime plant when profitable. Lime accounts for an insignificant 1-2% of total unit cost of production. COG aims to lower its iron-making production cost by Rmb100/t in 2010, we see COG is moving one step closer toward this goal. We reiterate our BUY with target price of HK\$3.90, which is based on 1.2x PBR.

Hedging against rising cost. Lime is one of key raw material in iron-making. Lime is used to get rid of sulphur and phosphorus and other unwanted elements in the iron ore. Lime accounts for around 1-2% of total unit cost of production. Lime, together with other feedstock, has seen rising prices due to increasing demand from the steel makers. COG's acquisition of a lime plant will ensure steady supply of lime. This lime plant has annual production capacity of 0.35mt, which just meets COG's annual lime consumption. COG will enjoy profit share and dividend from its 45% stake in the lime plant.

Not cheap to acquire upstream asset. COG paid 2.0x PBR to acquire the lime plant, which looks expensive comparing with its own PBR valuation of 0.9x FY10 PBR. Besides, high-margined coking coal companies (upstream assets) like Fushan (639 HK) and Hidili (1393 HK) are valued at 1.7-2.0x FY10 PBR. Given this lime plant is not as profitable as coking coal companies (it made a loss of Rmb0.13mn in the first 10mth of 2009), we think COG paid a premium acquiring the lime assets.

Not a cash drain. Having said that, COG is rich in cash on hand. Paying a small fraction of its cash to secure upstream asset in order to hedge against rising cost is a strategic move in line with the company's long term expansion theme that spans both horizontally (through capacity expansion) and vertically (through upstream acquisitions).

FYE Dec (RMBm)	2007A	2008A	2009F	2010F	2011F
Total revenue	13,498.6	19,388.2	19,066.8	26,803.0	33,543.7
Net profit	1,159.7	44.0	767.8	1,463.9	1,790.4
% chg YoY	12.3	(96.2)	1,643.6	90.7	22.3
EPS	0.398	0.015	0.262	0.500	0.611
% chg YoY	926.8	(96.2)	1,643.6	90.7	22.3
DPS	0.124	0.065	0.039	0.075	0.092
P/E (x)	7.5	189.4	9.9	5.1	4.1
Yield (%)	4.1	2.3	1.5	2.9	3.7
P/BV (x)	1.3	1.3	1.0	0.9	0.7
EV/EBITDA (x)	4.8	14.6	4.6	2.5	1.6

Based on March 15, 2010 closing price.

Sources: Company data; OSK Securities Hong Kong Limited

Financial Summary (FYE 31 December)

Valuation and Growth	2007A	2008A	2009F	2010F	2011F
Valuation Ratios					
PER (Basic) (x)	7.5	189.4	9.9	5.1	4.1
Dividend yield	4.1%	2.3%	1.5%	2.9%	3.7%
P/BV (x)	1.3	1.3	1.0	0.9	0.7
Growth					
Revenue	38.0%	43.6%	-1.7%	40.6%	25.1%
Gross profit	34.6%	-73.0%	218.4%	70.1%	25.9%
Net profit	12.3%	-96.2%	1643.6%	90.7%	22.3%

Per Share Data (RMB)	2007A	2008A	2009F	2010F	2011F
EPS (Basic)	0.398	0.015	0.262	0.500	0.611
DPS	0.124	0.065	0.039	0.075	0.092
Payout ratio	31.1%	432.4%	15.0%	15.0%	15.0%
BV/S	2.344	2.262	2.528	2.993	3.534

Income Statement (RMBm)	2007A	2008A	2009F	2010F	2011F
Total turnover	13,499	19,388	19,067	26,803	33,544
Cost of sales	(11,581)	(18,871)	(17,420)	(24,003)	(30,018)
Gross profit	1,917	517	1,647	2,800	3,525
Selling and distribution costs	(47)	(80)	(95)	(107)	(168)
General and administrative	(373)	(282)	(305)	(402)	(604)
Operating profit	1,497	155	1,246	2,291	2,754
Interest income	12	24	22	42	71
Other income & gains	10	24	0	0	0
Finance costs	(69)	(92)	(146)	(191)	(205)
Associate	0	2	2	3	4
Jointly Controlled Entities	0	0	0	0	0
Pre-tax profit	1,450	114	1,125	2,145	2,623
Taxation	(257)	(71)	(281)	(536)	(656)
Minority interests	(34)	1	(76)	(145)	(177)
Net profit	1,160	44	768	1,464	1,790

Cashflow Statement (RMBm)	2007A	2008A	2009F	2010F	2011F
Operating cashflow					
Pre-tax profit	1,450	114	1,125	2,145	2,623
Depreciation & amortisation	445	574	778	876	957
Change in working capital	(758)	(189)	(156)	(49)	20
Tax paid	(230)	(434)	(225)	(485)	(632)
Others	147	76	(2)	(3)	(4)
Total operating cashflow	1,055	140	1,519	2,483	2,964
Investing cashflow					
Capex	(833)	(954)	(1,000)	(1,000)	(1,000)
Investments	0	0	0	0	0
Others	5	(557)	0	0	0
Total investing cashflow	(828)	(1,510)	(1,000)	(1,000)	(1,000)
Free cashflow	227	(1,371)	519	1,483	1,964
Financing cashflow					
New shares issued	37	4	0	0	0
Repurchase of shares	0	0	0	0	0
Issue of bond	0	0	0	0	0
Ordinary dividend paid	(293)	(331)	0	(115)	(220)
Others	284	1,737	200	(100)	(100)
Total financing cashflow	28	1,410	200	(215)	(320)
Change in cash	690	729	1,448	2,716	4,361

Source: Company data, OSK Securities Hong Kong Limited

Financial Ratios	2007A	2008A	2009F	2010F	2011F
Profitability Ratios					
Gross margin	14.2%	2.7%	8.6%	10.4%	10.5%
Operating margin	11.1%	0.8%	6.5%	8.5%	8.2%
Net margin	8.6%	0.2%	4.0%	5.5%	5.3%
ROA	14.3%	0.8%	7.5%	12.0%	12.5%
ROE	16.9%	0.7%	10.5%	16.8%	17.4%
Balance Sheet Ratios					
Current ratio	1.4	0.9	1.0	1.2	1.3
Gross debt/equity	17.9%	46.4%	44.3%	36.3%	29.8%
Net debt/equity	7.8%	35.4%	24.6%	5.0%	-12.7%
Inventory days	57.1	29.9	30.0	30.0	30.1
Receivable days	13.0	32.2	32.2	32.2	32.2
Payable days	22.2	42.3	42.5	42.4	42.6

Balance Sheet (RMBm)	2007A	2008A	2009F	2010F	2011F
Current assets					
Cash and cash equivalents	690	729	1,448	2,716	4,361
Available for sale	0	0	0	0	0
Inventories	1,837	1,567	1,452	1,998	2,509
Trade receivables	489	1,734	1,705	2,397	3,000
Others	634	1,382	1,370	1,662	1,917
Total current assets	3,649	5,413	5,976	8,773	11,787
Fixed assets					
Fixed assets	6,425	8,305	8,529	8,655	8,699
Intangible assets	76	82	81	79	78
Others	11	336	338	341	345
Total assets	10,162	14,136	14,924	17,848	20,909
Current liabilities					
Trade and bills payables	716	2,219	2,056	2,829	3,553
Accruals and other payables	1,371	2,035	1,885	2,593	3,257
Short-term loans	460	1,717	1,717	1,717	1,717
Others	98	210	266	317	341
Total current liabilities	2,645	6,181	5,925	7,456	8,869
Long-term loans					
Long-term loans	765	1,337	1,537	1,437	1,337
Others	56	128	128	128	128
Minority interests	147	225	301	445	622
Total liabilities	3,613	7,871	7,891	9,466	10,956
Shareholders' funds					
Share capital	311	312	312	312	313
Reserves	6,549	6,265	7,033	8,382	9,953
Total shareholders' funds	6,860	6,577	7,345	8,693	10,265
Total liabilities and equity	10,474	14,448	15,235	18,160	21,221

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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