



Sector: small caps

China Rare Earth (HK\$2.30)

BUY(Unchg)

Company visit – order flow picks up

Target price: HK\$2.60

- Sales of rare earth products pick up in 1Q02.
- Refractory materials and fluorescent powders to drive growth.
- BUY on expected industry consolidation.

Price	HK\$2.30	Year to	Earnings	EPS	EPS	CFPS	DPS	PE	PE rel	P/CF	Yield	ROE
HS Index	11,273.86	31 Dec	HK\$m	HK\$	%	HK\$	HK\$	x	%	x	%	%
Range 12 mth	HK\$1.17-3.13	1999A	81.2	0.168	113.9	0.191	0.032	13.7	143	12.1	1.4	38.9
Market cap.	US\$240.16m	2000A	140.9	0.232	38.0	0.250	0.039	9.9	65	9.2	1.7	34.9
Daily t/o, 3 mth	US\$1.12m	2001F	169.5	0.227	(1.9)	0.266	0.042	10.1	56	8.6	1.8	22.9
Free float est.	39%	2002F	211.7	0.260	14.3	0.343	0.052	8.8	53	6.7	2.3	19.9
Reuters/Bloom.	0769.HK/769 HK	2003F	236.5	0.290	11.7	0.368	0.058	7.9	52	6.2	2.5	19.0

Previous earnings estimates: 2001 HK\$173m, EPS HK\$0.23, GDPS HK\$0.04; 2002 HK\$210m, HK\$0.26, HK\$0.05; 2003 HK\$237m, HK\$0.29, HK\$0.06.
Actual price performance = 1 mth: 12.2%; 3 mth: 3.4%; 12 mth: 90.1%. Relative to Index = 1 mth: 7.8%; 3 mth: 8.6%; 12 mth: 132.3%.

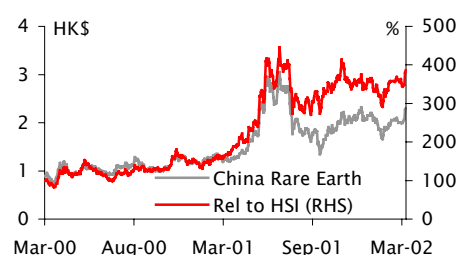
Sales of rare earth products pick up in 1Q02. China Rare Earth's (CREH) sales of rare earth products tumbled in 4Q01, down 20% YoY. We believe this was due to two factors. First, the global economic slowdown has adversely affected IT spending/manufacturing and this in turn has dampened demand for rare earth products mostly used in the electronics/technology industry. Second, some domestic players have cut prices in order to capture market share.

Our recent talks with management, however, confirmed that the sales volume of rare earth products picked up strongly in 1Q02, indicating that the worst might be over. All production lines are now running at full utilisation (>95%). However, selling prices for rare earth products remain soft (c.10-15% drop YoY). But this should be partly offset by lower raw materials (i.e. rare earth ores) cost. Last year, CREH forged a strategic alliance with Inner Mongolia Rare-Earth Hi-Tech (600111.SS) to secure a steady supply of low-priced rare earth ores.

We expect average product prices to trend up slightly on the back of improved demand. We have already factored in a 6% increase in prices for 2002 (vs a 10% price decline in 2001). For 2002, we project sales of rare earth products will climb 24% YoY, driven by volume growth on the full-year contribution of additional capacity (of 1,550t) in May 2001.

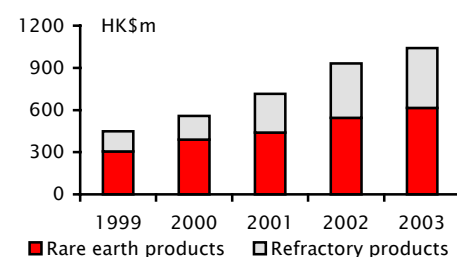
Refractory materials and fluorescent powders to drive growth. Refractory materials, which make up c. 40% of total sales and which are characterised by stable product pricing and higher margins (GM: 30-35%), continue to register robust growth. This is in line with our forecast of a 60% sales increase in 2001. CREH targets the high-end of the market, such as steel/metal tundishes in steel mills in China. Increased demand from Japanese customers should boost export sales. We expect sales of refractory materials to grow 40% in 2002, driven by upgraded capacity (30,000t) in Jun 2002. An overseas client has already reserved 80% of the new capacity. We believe steady growth momentum from refractory products will act as a buffer to the volatile rare earth product earnings. Separately, CREH plans to produce more high-value-added fluorescent powders (GM: 40%) in 2002. The start of the 500t fluorescent powder plant, supplying Philips and Foshan Lighting, should also boost earnings in 2002.

Price and rel performance chart



Source: Datastream and SG Research

Product sales trend going forward



Sources: Company and SG Research

BUY on expected industry consolidation. We have lowered our 2001 earnings estimate by 2% and raised it for 2002 by 1% to HK\$169.5m and HK\$211.7m, respectively. Our target price of HK\$2.60 is based on 10x 2002 EPS. We maintain our BUY rating on the counter, on the back of its well-established market position in high-value-added rare earth products. Also, the Chinese government has indicated it would like to consolidate the rare earth industry into a few key players. We believe CREH, already one of the major processors of high-purity northern and southern rare earth ores in China, will benefit from this development and will remain a key player in the long run.

See infopage overleaf

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Profit and loss account (consolidated)

Y/E Dec (HK\$m)	99A	00A	01F	02F	03F
Turnover	448	558	715	930	1,040
EBITDA (ex-assoc)	130	165	201	272	310
Depreciation	(9)	(14)	(27)	(42)	(53)
EBIT (ex-assoc)	121	150	174	230	257
Net interest inc/(exp)	(4)	(5)	1	7	8
Associates' profits	-	-	-	-	-
Exceptional items	-	-	-	-	-
Pre-tax profit	117	146	175	237	265
Tax	(33)	-	-	(18)	(20)
Minority interest	(3)	(5)	(6)	(8)	(9)
Preference dividends	-	-	-	-	-
Net profit	81	141	169	212	237
Others	-	-	-	-	-
Dividends	(18)	(26)	(34)	(42)	(47)
Retained earnings	63	115	136	169	189

Cash flow

Y/E Dec (HK\$m)	99A	00A	01F	02F	03F
Pre-tax profit	117	146	175	237	265
Taxes paid	(34)	(8)	(4)	-	(18)
Depreciation/amort'n	9	14	27	42	53
Associates' adj.	-	-	-	-	-
Exceptional items	-	-	-	-	-
Gross cash flow	92	152	198	280	300
Capex	(28)	(105)	(200)	(250)	(200)
Change in working cap	(17)	(124)	(103)	18	(27)
Free cash flow	47	(76)	(105)	47	73
Dividends	(17)	(18)	(36)	(38)	(45)
Investments	-	-	-	-	-
Disposals	0	-	-	-	-
Share issues	140	74	343	-	-
Others	(64)	22	-	-	-
Net cash flow	106	1	202	9	28
Net cash (debt) start	(34)	72	73	275	284
Adj. for FX valuation	-	-	-	-	-
Net cash (debt) at Y/E	72	73	275	284	312
S'holders' funds + MI	313	512	996	1,173	1,371
Net gearing (%)	<i>Cash</i>	<i>Cash</i>	<i>Cash</i>	<i>Cash</i>	<i>Cash</i>

Key statistics and ratios

Y/E Dec	99A	00A	01F	02F	03F
Growth (%)					
Turnover	7	25	28	30	12
EBITDA (ex-assoc)	(27)	27	22	35	14
EBIT (ex-assoc)	(29)	24	16	32	12
Net profit	(31)	74	20	25	12
Fully diluted EPS	(114)	38	(2)	14	12
Margins (%)					
EBITDA (ex-assoc)	29	30	28	29	30
EBIT (ex-assoc)	27	27	24	25	25
Others (%)					
Effective tax rate	28	-	-	8	8
Payout ratio	23	19	20	20	20
EBIT ROCE	50	35	23	22	21
Net ROE	39	35	23	20	19
Net gearing	<i>Cash</i>	<i>Cash</i>	<i>Cash</i>	<i>Cash</i>	<i>Cash</i>
ROA	23	26	19	18	17
Interest cover (x)	30	32	n/a	n/a	n/a
Debtors (days)	69	63	51	48	52
Creditors (days)	80	57	45	46	49
Stock (days)	61	77	116	111	99

Dividend data

Net dividend (HK\$)	Amount	Ex-date	Books close	Payment
Interim 00	0.01	14 Sep 00	15 Sep 00	27 Sep 00
Final 00	0.03	11 May 01	14 May 01	28 May 01
Interim 01	0.02	25 Sep 01	26 Sep 01	10 Oct 01

Balance sheet (consolidated)

Y/E Dec (HK\$m)	99A	00A	01F	02F	03F
Cash & deposits	124	150	318	327	355
ST marketable sec's	-	-	-	-	-
Trade debtors	100	91	107	140	156
Other debtors	-	-	-	-	-
Inventories	55	111	214	186	208
Other current assets	44	101	101	101	101
Intangible assets	-	-	-	-	-
Other LT assets	-	-	-	-	-
Fixed assets	133	217	389	597	744
Total assets	456	669	1,129	1,350	1,564
Trade creditors	(68)	(55)	(71)	(93)	(104)
Other creditors	-	-	-	-	-
ST debt	(12)	(43)	(43)	(43)	(43)
Other current liab's	(24)	(25)	(19)	(41)	(46)
LT borrowings	(39)	(34)	-	-	-
Deferred taxation	-	-	-	-	-
Other LT liabilities	-	-	-	-	-
Total liabilities	(144)	(157)	(133)	(177)	(193)
Share capital	60	68	79	79	79
Reserves	246	433	900	1,069	1,258
S'holders' funds	306	501	979	1,148	1,337
Minorities	6	12	17	25	34
Total	456	669	1,129	1,350	1,564
Net cash (debt)	72	73	275	284	312
Total cap employed	313	512	996	1,173	1,371
W. cap (inv+dtrs-ctrs)	88	147	250	233	260

Half-yearly breakdown

Y/E Dec (HK\$m)	1H00	2H00	1H01	2H01
Turnover	242	316	333	382
Operating profit	59	87	82	94
Associates	-	-	-	-
Exceptional items	-	-	-	-
Pre-tax profit	59	87	82	94
Tax	-	-	-	-
Preference dividends	-	-	-	-
Minority interest	(2)	(3)	(3)	(3)
Net profit	57	84	79	91
EPS (HK\$, adj)	0.095	0.137	0.115	0.113
DPS (HK\$, adj)	0.010	0.029	0.020	0.022

Share data

Y/E Dec	99A	00A	01F	02F	03F
EPS (HK\$, adj)	0.17	0.23	0.23	0.26	0.29
FD EPS (HK\$, adj)	0.17	0.23	0.23	0.26	0.29
CFPS (HK\$, adj)	0.19	0.25	0.27	0.34	0.37
FD CFPS (HK\$, adj)	0.19	0.25	0.27	0.34	0.37
Net DPS (HK\$, adj)	0.03	0.04	0.04	0.05	0.06
NBVPs (HK\$, adj)	0.51	0.74	1.20	1.41	1.64
Y/E shares adj (m)	600	675	814	814	814
Adj av shares (m)	483	608	745	814	814
Enlarged shares (m)	483	608	745	814	814

Capital structure and miscellaneous

Ordinary shares (m):	814.5			
Board lot:	2,000.0			
Capital changes:				
Date	Type	Shares after, m	Adj.	
Jan-Jun 01	Ex. Of convertible bonds	709.3	34	
Jul 01	Placement @ HK\$2.45	814.5	105	
Major shareholders:	YY Holdings Ltd - 50.95%			
Results due:	Interims - September; Finals - March			

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