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China

Materials

Reuters 0769.HK
Bloomberg 769 HK

Priced on 18 April 2002
CLSA ChinaW 658.7

Market cap
HK\$1,751m (US\$225m)

Shares in issue
814.5m

Est free float
0.5

Major shareholder
YY Hldgs (51.0%)

3M average daily volume
HK\$7.9m (US\$1.0m)

12M high/low
HK\$3.05/1.35

49.0%

Stock performance (%)

	1M	3M	12M
Absolute	(3.4)	15.6	52.5
Rel	(4.5)	6.2	54.8
Abs (US\$)	(3.4)	15.6	52.5

Source: Reuters

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FY01 result review

2001 was a difficult year for commodity plays like China Rare Earth. Weak industrial demand from the US, especially in 4Q01, has led to a significant decline in rare earth product prices and completely offset China Rare Earth's 40% growth in sales volume. Having incorporated a 5% pick-up in unit price from 2001's trough, on the back of the anticipated US recovery, our new pricing assumptions are still 30% below original forecasts. O2CL, O3CL net profit forecasts were cut by 18-30% accordingly. New target price of HK\$2.50 represents 8x O3CL EPS, at par to regional metals and mining plays. BUY

FY01 profit growth eroded by massive price decline

China Rare Earth reported a flat FY01 net profit of HK\$142mn, below consensus and our forecast by 16% and 22% respectively. Negative surprise mainly come from the massive price decline in the rare earth products in 4Q01, which dragged down the overall average selling price by 29%, well below our original forecast of 5% decline.

2002 outlook – a better tomorrow

With a full 2002 order book for both rare earth products and refractory materials under its belt, we expect the company to resume its growth momentum on the back of recovery in US industrial demands, which will bring a 5% YoY growth in both O2CL and O3CL average prices. Recent oligopoly formed with a major raw material supplier further support our positive view.

O2CL and O3CL earnings downgrade

While we are confident that China Rare Earth will resume its growth momentum, we cut our forecast by 18% for O2CL and 30% for O3CL to reflect our more conservative assumptions on unit price.

New target price = HK\$2.50

As a result of our earnings downgrade, we cut our target price to HK\$2.50, or 8x O3CL EPS, which is at par to the weighted average of regional metals and mining plays (Yanzhou Coal, Hindalco, Chalco etc)

Financials

Year to 31 Dec	99A	00A	O1CL	O2CL	O3CL
Revenue (HK\$m)	448	558	618	845	1,048
Net profit (HK\$m)	81	141	142	197	251
Actual/forecast (%)			(22.1)		
EPS (HK¢)	16.72	23.10	19.08	24.23	30.85
EPS forecast change(%)				(18.5)	(29.9)
EPS (%YoY)	21.3	38.1	(17.4)	27.0	27.3
PEX (@HK\$2.15)	12.9	9.3	11.3	8.9	7.0
CLSA/consensus (%)	-	-	-	98.00	105.00
DPS (HK¢)	4.0	4.0	4.0	6.1	7.7
Dividend yield (%)	1.9	1.9	1.9	2.8	3.6
ROAE (%)	38.2	34.9	25.1	27.9	28.7

Source: CLSA Emerging Markets

FY01 result shows no growth

Negative surprise comes from weakness in rare earth product prices

Satisfactory volume growth

Healthy growth for refractory materials business

Earnings growth should be back on track

Flat FY01 result

China Rare Earth reported a flat FY01 net profit of HK\$142mn, 16% below consensus and 22% below our forecast.

Negative surprise mainly comes from the steeper-than-expected decline in the price of rare earth products. Weak industrial demand in the US, especially in 4Q01, has dragged down the average selling price by 29% for the full year. This is well above our forecast of 5% decline yoy for FY01.

During the year, the company sold 5,900 tonnes of rare earth products, up 40% yoy. However, the decline in price, and hence the gross margin (25% vs 32% in FY00), have eaten up all the gains.

For refractory materials, the company also noted a 40% yoy growth in volume to 45,000 tonnes in 2001. Product pricing remained largely stable, with gross margin stayed at about 37.0% (FY00: 37.4%).

Figure 1

FY01 revenue mix

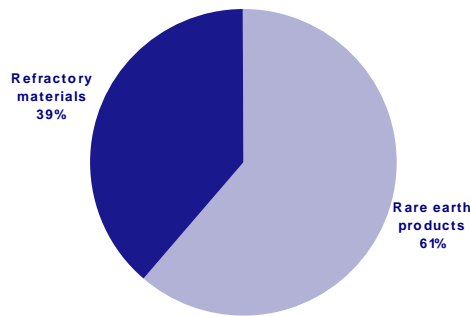
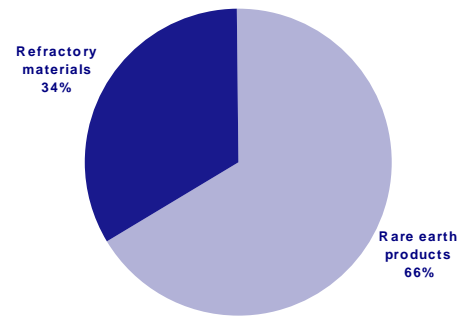


Figure 2

FY02 revenue mix



Source: CLSA Emerging Markets

Positive 2002 outlook

2002 should see the earnings growth back on track as prices stabilise and new capacity begins to contribute.

Not only will the new rare earth separating line make a 12 month contribution as compared to 3 months in 2001, but also the 2 new refractory material workshops (mainly supplying Nippon Steel) will start contribution by May 2002 and that will double existing refractory material capacity. In addition, the new 500-ton fluorescent power factory will commence operation in 2H02.

We believe the US industrial demand will continue to recover. A 5% pick-up in average selling price for rare earth products from the low base of FY01 is expected. This view is also supported by the company's recently formed oligopoly with Inner Mongolia Rare-Earth Hi-Tech (600111.SS) to halt the slide in rare earth product prices.

02CL, 03CL earnings
down 18-30%

02CL, 03CL earnings downgrade

While we are confident that China Rare Earth will resume its growth momentum, we cut our forecast by 18% for 02CL and 30% for 03CL to reflect the following changes:

- For 02CL, we downgraded the unit price for rare earth product by 30% while upgraded the sales volume by 15% to reflect the pick-up in demand.
- For 03CL, we also downgraded the unit price assumption for rare earth products by 30%.

After such downgrades, our unit price assumption for rare earth products still shows a 5% YoY growth for both 02CL and 03CL to reflect the expected pick-up in US industrial demand.

New target = HK\$2.50

As a result of our earnings downgrade, we cut our target price to HK\$2.50, or 8x 03CL EPS, which is at par to the weighted average of regional metals and mining plays (Yanzhou Coal, Hindalco, Chalco etc)

Note: In the interests of timeliness, this document was not edited.

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