

China Rare Earth

(0769.HK)

❖ Price: HK\$2.15

❖ Mkt Cap: HK\$1.75bn

❖ Rec: HOLD

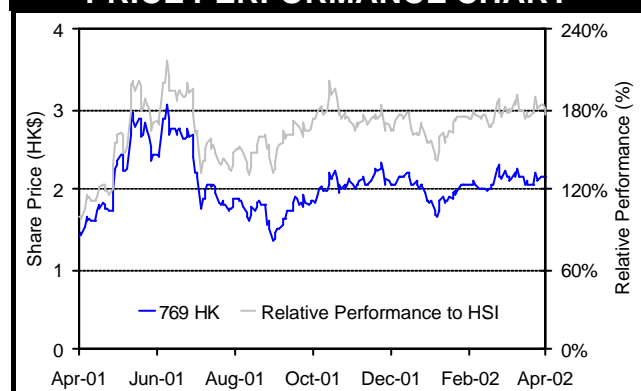
INVESTMENT SUMMARY

- Downgrade to HOLD due to CRE's earnings growth outlook, which is adversely affected by falling rare earth prices and the ending of tax holidays

VALUATIONS

| Y/E (HK\$m) | 12/99 | 12/00 | 12/01 | 12/02F | 12/03F |
|-------------|-------|-------|-------|--------|--------|
| Turnover | 448 | 558 | 618 | 759 | 1,073 |
| Net profit | 81 | 141 | 142 | 128 | 187 |
| EPS HK\$ | 0.17 | 0.23 | 0.19 | 0.16 | 0.23 |
| EPS chg. % | - | 38 | -18 | -18 | 47 |
| P/E x | 12.8 | 9.3 | 11.3 | 13.7 | 9.3 |
| DPS HK\$ | 0.02 | 0.04 | 0.04 | 0.04 | 0.06 |
| Yield % | 0.9 | 1.9 | 1.9 | 1.9 | 2.8 |

PRICE PERFORMANCE CHART



We downgrade China Rare Earth Holdings (CRE) to HOLD because of the declining price of its rare earth products and the uncertain global economic outlook. Although growth from its refractory materials business will continue to be strong, CRE's tax-free period is over. The new 12% tax rate will adversely impact net profit.

CRE's rare earth business contributed to 61% of total turnover in FY01, which was flat YoY. The overall sale price drop in its rare earth products offset the 40% surge in sales volume.

CRE has been concentrating on improving the quality and quantity of its rare earth products for years. After the completion of the new rare earth separating line for ionic ore, CRE was able to produce high purity rare earth elements and increase its annual production capacity to 6,500 tonnes (REO), strengthening its market position in the industry. With the global economic recovery, we expect the international market price for rare earth products should stabilise.

China's central government is considering consolidating the rare earth industry to improve profitability and efficiency, following the nation's entry to the World Trade Organisation. Should the consolidation plans be finalised this year, CRE will benefit from a better regulatory environment and reduced competition from smaller producers.

The refractory material business contributed 39% of CRE's turnover, up about 30% YoY in FY01. CRE sold around 45,000 tonnes of refractory products in FY01, from a production capacity of 50,000 tonnes. After the completion of its second phase expansion project in mid-2002, CRE will increase its annual production capacity to 80,000 tonnes. Given the demand for CRE's refractory materials in both its domestic and Japanese markets, we expect the strong growth to continue in FY02.

To improve its profitability, CRE will focus on high margin products this year. New production facilities for fluorescent powder will commence operation in mid-2002, with an annual production capacity of 500 tonnes. We expect the turnover to exceed HK\$50mn in FY02.

The company's profitability is also affected by its tax rate. CRE's tax holiday of the past two years is over. It will have to pay around 12% tax for the next three years. This will have an adverse impact on its net profit. We forecast a further slide in CRE's EPS this year.

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