

China Rare Earth

Growth Is On Track

◆ FY06 results and highlights

Net profit increased 60.6% to HK\$ 209m, in line with our forecast, while EPS grew was 36% due to the dilution from placements. The strong growth was attributable to an increase in rare earth prices, an improved product mix, more diversification into downstream products and steady growth in refractory products. Processing volume was maintained at 4,400 tonnes while turnover surged by 54%. The average price of rare earth ores increased by 20% to 80%, but the Company transferred most of these cost hikes to customers. Downstream products (which are not subject to quotas and have a higher margin), such as fluorescent material, went up by about 50%. Overall, the gross margin was enhanced marginally to 19%. Turnover for refractory materials increased by 20% mainly driven by a 37% growth in sales volume. Gross profit margin also rose to 38%. Final dividend maintained at HK\$ 0.04 per share.

◆ Prospects

Due to the diversification into downstream products, we are estimating the total sales volume of rare earth products will increase to around 5,000 tonnes. Due to the strong demand for rare earth products, prices are likely to stay high and gross margin should be stable. The construction of new high purity magnesium grains is on its way and production is targeted to commence from Nov 07 onwards. The development will be divided into 3 phases and full completion is scheduled to complete by end of 2008. The current selling price is Rmb 2,800 per tonnes and manufacturing cost is around Rmb 1,000 per tonnes. Thus, significant earnings growth is expected in FY08.

◆ 27% growth for FY07 and 58% growth in FY08, maintain BUY

We lower our FY07 net profit forecast by 10.2% to HK\$264m due to a much later completion time for the first phase of the magnesium grain facility but raise our FY08 net profit forecast by 4.4% to factor in a lower tax rate. DCF target adjusts slightly upwards from HK\$2.49 to HK\$2.68. Trading at 10.7X FY07 PER and 6.8X FY08 PER respectively, value remains undemanding. **BUY**.

Year to Dec 31	2004	2005	2006	2007E	2008E
Sales (HK\$m)	665	769	1,031	1,283	1,656
Pre-tax profit (HK\$m)	139	172	274	352	543
Net profit (HK\$m)	120	130	209	264	419
EPS (HK\$)	0.12	0.13	0.15	0.19	0.29
EPS growth (%)	48.3	8.8	11.6	26.4	58.4
PER (x)	16.5	15.2	13.6	10.7	6.8
EV/EBITDA (x)	14.0	11.8	6.8	5.8	3.7
Yield (%)	1.0	2.0	2.3	3.0	4.3

Hong Kong Materials

20 April 2007

BUY

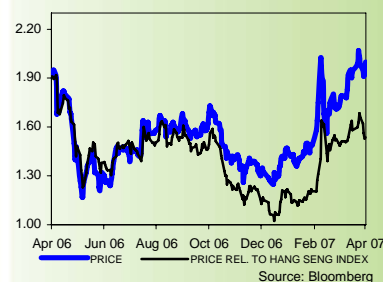
Company Update

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Price	HK\$2.00
Target	HK\$2.68
HSI	20,299

Historical Chart



Performance	1m	3m	6m
Absolute (%)	12.3	30.6	18.3
Relative (%)	2.7	28.1	5.5

Stock Information

Bloomberg code	769 HK
Market Cap (US\$m)	364
52-week high (\$)	2.10
52-week low (\$)	1.08
Shares issued (m)	1,421
6M avg. daily turnover (US\$m)	3.7
Free float (%)	58.2
Major shareholders (%)	
	YY Holdings Limited (41.8%)

Key Indicators

ROE (%)	10.8
Net gearing (%)	Net cash
NTA (HK\$)	1.70
Interest cover (x)	107

Profit and loss

YE Dec (HKm)	2004	2005	2006	2007E	2008E
Sales	665	769	1,031	1,283	1,656
Cost of goods sold	(434)	(504)	(665)	(826)	(995)
Gross profit	231	265	366	457	661
Operating expenses	(94)	(98)	(114)	(130)	(151)
Operating profit	137	167	252	327	509
Net interest	(0)	2	7	6	10
Interest income	2	2	10	9	10
Interest expense	(2)	(0)	(3)	(3)	0
Net investment income/(loss)	2	3	15	19	24
Net other non-op. JV+Assoc.	0	0	0	0	0
Net extraordinary	0	0	0	0	0
Pretax profit	139	172	274	352	543
Income taxes	(18)	(40)	(62)	(84)	(119)
Minority interests	(2)	(1)	(2)	(3)	(5)
Net profit	120	130	209	264	419
EBITDA	187	228	320	400	589
EPS (HK\$)	0.12	0.13	0.15	0.19	0.29

Source: Company data, Kim Eng Securities estimates

Balance sheet

YE Dec (HKm)	2004	2005	2006	2007E	2008E
Total assets	1,427	1,594	2,465	2,606	3,000
Current assets	731	812	1,555	1,412	1,660
Cash & ST investment	227	153	661	507	656
Inventories	225	228	231	245	268
Accounts receivable	204	339	345	343	398
Others	75	92	318	317	338
Other assets	696	782	911	1,195	1,340
LT investments	0	0	0	0	1
Net fixed assets	550	570	569	853	997
Others	147	212	342	342	342
Total liabilities	108	145	227	165	221
Current liabilities	108	145	227	165	221
Accounts payable	56	56	50	50	58
ST borrowings	0	0	0	0	1
Others	52	89	177	115	161
Long-term liabilities	0	0	0	0	0
Long-term debts	0	0	0	0	0
Others	0	0	0	0	0
Shareholder's equity	1,320	1,449	2,238	2,442	2,780
Paid-in capital	99	99	142	142	142
Reserve	1,204	1,331	2,075	2,275	2,608
Minority interests	17	19	21	24	29

Source: Company data, Kim Eng Securities estimates

Cash flow

YE Dec (HKm)	2004	2005	2006	2007E	2008E
Operating cash flow	153	106	181	412	528
Operating profit	139	172	274	352	543
Depreciation & amortization	50	61	68	73	79
Change in working capital	(43)	(125)	(150)	(7)	(85)
Others	7	(1)	(11)	(6)	(10)
ROI, Serv. of Fin. and tax	(36)	(44)	(74)	(114)	(155)
Investment cash flow	(95)	(143)	(296)	(357)	(223)
Net capex	(126)	(29)	(28)	(328)	(200)
Change in LT investment	31	(114)	(268)	(29)	(24)
Change in other assets	0	0	0	0	1
Cash flow after invt.	21	(81)	(189)	(59)	150
Financing cash flow	(48)	0	697	(95)	1
Change in share capital	(1)	0	602	0	0
Net change in debt	(47)	0	95	(95)	0
Change in other LT liab.	0	0	0	0	1
Net cash flow	(27)	(81)	508	(154)	151

Source: Company data, Kim Eng Securities estimates

Key ratios

YE Dec	2004	2005	2006	2007E	2008E
Growth (% YoY)					
Sales	45.6	15.6	34.0	24.5	29.0
Operating profit	90.7	22.1	50.6	29.8	55.7
EBITDA	73.7	22.0	40.0	25.2	47.0
Net profit	79.7	8.8	60.7	26.4	58.4
EPS	48.3	8.8	11.6	26.4	58.4
Profitability (%)					
Gross margin	34.7	34.4	35.5	35.6	39.9
Operating margin	20.6	21.8	24.4	25.5	30.8
EBITDA margin	28.1	29.7	31.0	31.2	35.6
Net margin	18.0	16.9	20.3	20.6	25.3
ROA	8.4	8.2	8.5	10.1	14.0
ROE	9.1	9.0	9.4	10.8	15.1
Stability					
Gross debt/equity (%)	0.0	0.0	0.0	0.0	0.0
Net debt/equity (%)	0.0	0.0	0.0	0.0	0.0
Int. coverage (X)	88	N/A	107	134	N/A
Int. & ST debt coverage (X)	88	N/A	107	134	N/A
Cash flow int. coverage (X)	72	5,057	60	138	N/A
Cash flow int. & ST debt (X)	72	5,057	60	138	N/A
Current ratio (X)	6.8	5.6	6.8	8.6	7.5
Quick ratio (X)	4.7	4.0	5.8	7.1	6.3
Net cash/(debt) (HK\$m)	227	153	661	507	656
Per share data (HK\$)					
EPS	0.12	0.13	0.15	0.19	0.29
CFPS	0.15	0.11	0.13	0.29	0.37
BVPS	1.32	1.45	1.56	1.70	1.94
SPS	0.67	0.78	0.73	0.90	1.17
EBITDA/share	0.19	0.23	0.22	0.28	0.41
DPS	0.02	0.04	0.05	0.06	0.09

Source: Company data, Kim Eng Securities estimates

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