

China Rare Earth

Prepare For The Growth In 2008

◆ 1H07 results in line with expectations

Net profit for 1H07 increased 29.7% to HK\$123m, in line with our forecast of HK\$120m. Dilution from 2 placements during 2006, however, caused EPS to decline by 1.7% to HK\$ 0.086. Interim dividend was maintained at HK\$0.01 per share.

◆ Operating highlights

Turnover for rare earth compounds increased by 46% due to robust prices and an improved product mix from increased downstream processing. Sales of fluorescent powder increased by 67% on the back of strong demand for energy-saving lighting, accounting for 22% of overall rare earth sales with gross profit margin increased to 35%. This helped to improve the segment gross margin from 20% to 24%. On the refractory side, turnover increased by 18% through organic growth. The removal of export tax rebate on certain products caused the gross profit margin for ordinary refractory materials to decline slightly to 32% as prices remained static. The gross profit margin for high temperature ceramics and fused magnesium grains remained high at over 40% and 50%, respectively. Overall gross margin for refractory products was down only marginally.

◆ High-purity magnesium grain project starts contribution in 2008

The construction of the high-purity magnesium grains project is progressing smoothly with Phase 1's 50,000 tonnes capacity set to come on-stream in 4Q07. With a gross profit margin of over 50%, phase 1 alone is estimated to add HK\$50m to the bottom line for 2008. The contribution from this project and better penetration on downstream products on the rare earth sides prompt to keep earnings growth.

◆ Price target revised up on improved product mix, maintain BUY

We revise up our net profit forecast by 10% and 3% for FY07 and FY08 respectively, on the assumption of a stronger rare earth product mix. DCF target is also revised up from HK\$ 2.68 to HK\$ 3.21. Our target price implies forward PER of 16.0x and 10.7x for FY07 and FY08, respectively. Maintain **BUY**.

Year to Dec 31	2004A	2005A	2006F	2007F	2008F
Sales (HK\$m)	665	769	1,031	1,367	1,792
Pre-tax profit (HK\$m)	139	172	274	392	591
Net profit (HK\$m)	120	130	209	291	432
EPS (HK\$)	0.12	0.13	0.15	0.20	0.30
EPS growth (%)	48.3	8.8	11.6	38.9	48.7
PER (x)	18.9	17.4	15.6	11.2	7.5
EV/EBITDA (x)	16.2	13.6	8.1	6.2	3.9
Yield (%)	0.9	1.7	2.0	2.6	3.7

Hong Kong Materials

17 September 2007

BUY

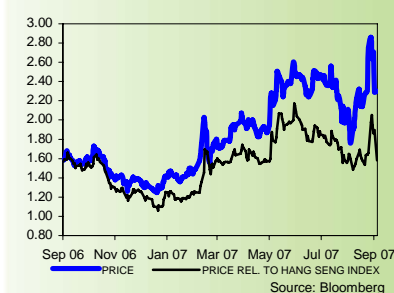
Company Update

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Price	HK\$2.29
Target	HK\$3.21
HSI	24,898

Historical Chart



Performance	1m	3m	6m
Absolute (%)	8.5	(7.3)	33.1
Relative (%)	(4.6)	(26.6)	1.0

Stock Information

Bloomberg code	769 HK
Market Cap (US\$m)	417
52-week high (\$)	2.94
52-week low (\$)	1.25
Shares issued (m)	1,421
6M avg. daily turnover (US\$m)	3.5
Free float (%)	59.2
Major shareholders (%)	
	YY Holdings Limited (41.8%)

Key Indicators

ROE (%)	11.8
Net gearing (%)	Net Cash
NTA (HK\$)	1.72
Interest cover (x)	86.0

Profit and loss

YE Dec (HK\$m)	2004A	2005A	2006F	2007F	2008F
Sales	665	769	1,031	1,367	1,792
Cost of goods sold	(434)	(504)	(665)	(877)	(1,088)
Gross profit	231	265	366	490	704
Operating expenses	(94)	(98)	(114)	(132)	(155)
Operating profit	137	167	252	358	550
Net interest	(0)	2	7	14	15
Interest income	2	2	10	19	20
Interest expense	(2)	(0)	(3)	(5)	(5)
Net investment income/(loss)	2	3	15	20	26
Net other non-op. JV+Assoc.	0	0	0	0	0
Net extraordinaries	0	0	0	0	0
Pretax profit	139	172	274	392	591
Income taxes	(18)	(40)	(62)	(98)	(154)
Minority interests	(2)	(1)	(2)	(3)	(5)
Net profit	120	130	209	291	432
EBITDA	187	228	320	430	626
EPS (HK\$)	0.12	0.13	0.15	0.20	0.30

Source: Company data, Kim Eng Securities estimates

Balance sheet

YE Dec (HK\$m)	2004A	2005A	2006F	2007F	2008F
Total assets	1,427	1,594	2,465	2,742	3,164
Current assets	731	812	1,555	1,546	1,869
Cash & ST investment	227	153	661	589	791
Inventories	225	228	231	260	290
Accounts receivable	204	339	345	365	431
Others	75	92	318	331	357
Other assets	696	782	911	1,196	1,295
LT investments	0	0	0	0	1
Net fixed assets	550	570	569	854	952
Others	147	212	342	342	342
Total liabilities	108	145	227	274	343
Current liabilities	108	145	227	274	343
Accounts payable	56	56	50	53	63
ST borrowings	0	0	95	98	98
Others	52	89	82	122	181
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	2,468	2,820
Paid-in capital	99	99	142	142	142
Reserve	1,204	1,331	2,075	2,301	2,648
Minority interests	17	19	21	25	30

Source: Company data, Kim Eng Securities estimates

Cash flow

YE Dec (HK\$m)	2004A	2005A	2006F	2007F	2008F
Operating cash flow	153	106	181	397	548
Operating profit	139	172	274	392	591
Depreciation & amortization	50	61	68	72	77
Change in working capital	(43)	(125)	(150)	(53)	(104)
Others	7	(1)	(11)	(14)	(15)
ROI, Serv. of Fin. and Tax	(36)	(44)	(74)	(115)	(172)
Investment cash flow	(95)	(143)	(296)	(357)	(173)
Net capex	(126)	(29)	(28)	(328)	(150)
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)	(75)	203
Financing cash flow	(48)	0	697	3	1
Change in share capital	(1)	0	602	0	0
Net change in debt	(47)	0	95	3	0
Change in other LT liab.	0	0	0	0	1
Net cash flow	(27)	(81)	508	(72)	204

Source: Company data, Kim Eng Securities estimates

Key ratios

YE Dec	2004A	2005A	2006F	2007F	2008F
Growth (% YoY)					
Sales	45.6	15.6	34.0	32.5	31.1
Operating profit	90.7	22.1	50.6	42.2	53.4
EBITDA	73.7	22.0	40.0	34.5	45.7
Net profit	79.7	8.8	60.7	38.9	48.7
EPS	48.3	8.8	11.6	38.9	48.7
Profitability (%)					
Gross margin	34.7	34.4	35.5	35.9	39.3
Operating margin	20.6	21.8	24.4	26.2	30.7
EBITDA margin	28.1	29.7	31.0	31.5	35.0
Net margin	18.0	16.9	20.3	21.3	24.1
ROA	8.4	8.2	8.5	10.6	13.7
ROE	9.1	9.0	9.4	11.8	15.3
Stability					
Gross debt/equity (%)	0.0	0.0	4.3	4.0	3.5
Net debt/equity (%)	0.0	0.0	0.0	0.0	0.0
Int. coverage (X)	88	N/A	106.7	86.0	125.2
Int. & ST debt coverage (X)	88	N/A	3.3	4.2	6.1
Cash flow int. coverage (X)	72	5,057	60	79	6.1
Cash flow int. & ST debt (X)	72	5,057	1.8	3.8	5.3
Current ratio (X)	6.8	5.6	6.8	5.6	5.5
Quick ratio (X)	4.7	4.0	5.8	4.7	4.6
Net cash/(debt) (HK\$m)	227	153	661	589	791
Per share data (HK\$)					
EPS	0.12	0.13	0.15	0.20	0.30
CFPS	0.15	0.11	0.13	0.28	0.39
BVPS	1.32	1.45	1.56	1.72	1.96
SPS	0.67	0.78	0.73	0.96	1.26
EBITDA/share	0.19	0.23	0.22	0.30	0.44
DPS	0.02	0.04	0.05	0.06	0.09

Source: Company data, Kim Eng Securities estimates

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