

China Rare Earth

Still a rare gem

◆ FY07 results – in brief

Net profit increased 41% to HK\$295m, in line with our forecast of HK\$291m. EPS was at HK\$0.208, an increase of 15.6% mainly due to share placements dilution. Final dividend at HK\$0.04, same as last year. Turnover for the period increased by 34.3% to HK\$1,385m while gross margin increased from 28.9% to 32.7%. Breaking down the results, turnover for rare earth business increased by 37% to HK\$714m. On volume, it increased by around 9% to 4,800 tonnes. Gross profit margin jumped to 27% (24% in HY07 and 20% in FY06). Turnover for refractory business increased by 32% to HK\$672m. Volume increased by around 30% to ~143,000 tonnes. Gross profit margin maintained steady at 39%.

◆ Growth in downstream products gathering pace

The highlight of the FY07 results was that we see healthy growth in downstream rare earth products. The fluorescent materials sold recorded a 50% growth in volume and 55% growth in value. Proportion of sales to total turnover of rare earth business also increased to 23%. The company is expecting the mix can further improve to around 50% in coming years and with a much higher gross margin (35% versus rare earth separation of around 25%), growth prospect remains healthy.

◆ Slight delay in new magnesium grain project

On the refractory side, phase 1 of the high purity magnesium grains business will commence operation in 1H08 with annual capacity reaching 50,000 tonnes. This is about 6 months behind schedule due to snowstorm and other reasons. The rest of the phases (2 & 3) will start work once phase 1 is completed and 150,000 tonnes of total capacity is anticipated with all 3 phases complete.

◆ Maintain BUY, new target price HK\$3.15

Taking into account the delay of the magnesium grain project and offset partially by the Rmb appreciation, we lower our FY08 forecast by 4%. DCF target also lower by 2% to HK\$ 3.15. Management indicated that they are still seeking opportunities in upstream project and hence keeping dividend flat. Trading at 6.1X FY08 PER and 1X P/B, stock looks cheap on its growth profile. Maintain BUY

Year to Dec 31	2005	2006	2007E	2008F	2009F
Sales (HK\$m)	769	1,031	1,385	1,851	2,267
Pre-tax profit (HK\$m)	172	274	396	545	703
Net profit (HK\$m)	130	209	295	414	534
EPS (HK\$)	0.13	0.15	0.21	0.29	0.38
EPS growth (%)	8.8	11.6	41.0	40.5	28.8
PER (x)	13.4	12.0	8.5	6.1	4.7
EV/EBITDA (x)	10.3	5.7	4.1	2.9	1.8
Yield (%)	2.3	2.5	2.8	4.0	4.5

Hong Kong Materials

2 May 2008

BUY

Company Update

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Price	HK\$1.77
Target	HK\$3.15
HSI	25,755

Historical Chart



Performance	1m	3m	6m
Absolute (%)	9.9	18.0	(20.6)
Relative (%)	(0.7)	9.1	(2.1)

Stock Information

Bloomberg code	769 HK
Market Cap (US\$m)	322
52-week high (\$)	2.94
52-week low (\$)	1.43
Shares issued (m)	1,421
6M avg. daily turnover (US\$m)	0.7
Free float (%)	58.1
Major shareholders (%)	
	YY Holdngs Limited (41.9%)

Key Indicators

ROE (%)	14.3
Net gearing (%)	Net Cash
NTA (HK\$)	1.89
Interest cover (x)	233

Profit and loss

YE Dec (HK\$m)	2005	2006	2007E	2008F	2009F
Sales	769	1,031	1,385	1,851	2,267
Cost of goods sold	(504)	(661)	(849)	(1,120)	(1,338)
Gross profit	265	370	536	731	930
Operating expenses	(98)	(118)	(160)	(212)	(262)
Operating profit	167	252	376	519	667
Net interest	2	7	12	15	22
Interest income	2	10	17	18	22
Interest expense	(0)	(3)	(5)	(3)	0
Net investment income/(loss)	3	15	8	11	13
Net other non-op. JV+Assoc.	0	0	0	0	0
Net extraordinaries	0	0	0	0	0
Pretax profit	172	274	396	545	703
Income taxes	(40)	(62)	(97)	(125)	(162)
Minority interests	(1)	(2)	(4)	(6)	(7)
Net profit	130	209	295	414	534
EBITDA	228	323	458	628	804
EPS (HK\$)	0.13	0.15	0.21	0.29	0.38

Source: Company data, Kim Eng Securities estimates

Balance sheet

YE Dec (HK\$m)	2005	2006	2007E	2008F	2009F
Total assets	1,594	2,465	2,798	3,080	3,551
Current assets	812	1,385	1,536	1,776	2,235
Cash & ST investment	153	661	652	710	1,035
Inventories	228	231	296	336	350
Accounts receivable	339	345	382	510	625
Others	92	148	206	220	225
Other assets	782	1,081	1,262	1,304	1,316
LT investments	0	0	0	0	0
Net fixed assets	570	569	744	1,072	1,085
Others	212	512	518	232	232
Total liabilities	145	227	248	181	211
Current liabilities	145	227	248	181	211
Accounts payable	56	50	62	79	92
ST borrowings	0	95	101	0	0
Others	89	82	85	102	119
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	1,449	2,238	2,550	2,899	3,340
Paid-in capital	99	142	142	142	142
Reserve	1,331	2,075	2,380	2,723	3,157
Minority interests	19	21	28	34	41

Source: Company data, Kim Eng Securities estimates

Cash flow

YE Dec (HK\$m)	2005	2006	2007E	2008F	2009F
Operating cash flow	106	320	346	482	703
Operating profit	172	274	396	545	703
Depreciation & amortization	61	71	82	109	137
Change in working capital	(125)	(15)	(168)	(157)	(115)
Others	(1)	(10)	37	(15)	(22)
ROI, Ser. Of Fin. And Tax	(44)	(119)	(149)	(172)	(227)
Investment cash flow	(143)	(400)	(242)	(150)	(150)
Net capex	(29)	(48)	(250)	(150)	(150)
Change in LT investment	(114)	(352)	8	0	0
Change in other assets	0	0	0	0	0
Cash flow after invt.	(81)	(198)	(45)	159	325
Financing cash flow	0	690	0	(101)	0
Change in share capital	0	595	0	0	0
Net change in debt	0	95	0	(101)	0
Change in other LT liab.	0	0	0	0	0
Net cash flow	(81)	492	(45)	58	325

Source: Company data, Kim Eng Securities estimates

Key ratios

YE Dec	2005	2006	2007E	2008F	2009F
Growth (% YoY)					
Sales	15.6	34.0	34.4	33.6	22.5
Operating profit	22.1	50.6	49.2	38.1	28.4
EBITDA	22.0	41.6	41.6	37.1	28.1
Net profit	8.8	60.7	41.0	40.5	28.8
EPS	8.8	11.6	41.0	40.5	28.8
Profitability (%)					
Gross margin	34.4	35.9	38.7	39.5	41.0
Operating margin	21.8	24.4	27.2	28.1	29.4
EBITDA margin	29.7	31.4	33.1	33.9	35.5
Net margin	16.9	20.3	21.3	22.4	23.5
ROA	8.2	8.5	10.5	13.5	15.0
ROE	9.0	9.4	11.6	14.3	16.0
Stability					
Gross debt/equity (%)	0.0	4.3	4.0	0.0	0.0
Net debt/equity (%)	0.0	0.0	0.0	0.0	0.0
Int. coverage (X)	N/A	107.9	87.6	232.6	N/A
Int. & ST debt coverage (X)	N/A	3.3	4.3	232.6	N/A
Cash flow int. coverage (X)	5,057	107	66	233	N/A
Cash flow int. & ST debt (X)	5,057	3.3	3.2	178.4	N/A
Current ratio (X)	5.6	6.1	6.2	9.8	10.6
Quick ratio (X)	4.0	5.1	5.0	8.0	8.9
Net cash/(debt) (HK\$m)	153	661	652	710	1,035
Per share data (HK\$)					
EPS	0.13	0.15	0.21	0.29	0.38
CFPS	0.11	0.23	0.24	0.34	0.49
BVPS	1.45	1.56	1.77	2.02	2.32
SPS	0.78	0.73	0.97	1.30	1.60
EBITDA/share	0.23	0.23	0.32	0.44	0.57
DPS	0.04	0.05	0.05	0.07	0.08

Source: Company data, Kim Eng Securities estimates

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Our recommendation is based on the following expected price performance within 12 months:

+15% and above: BUY

-15% to +15%: HOLD

-15% or worse: SELL

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