



BUY

Company Update

Analyst

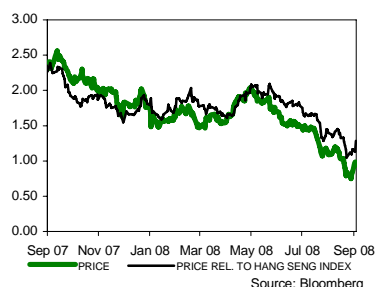
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Price **HK\$0.94**
Target **HK\$2.22**
HSI **18,872**

Historical Chart



Performance	1m	3m	6m
Absolute (%)	(10.1)	(42.4)	(36.1)
Relative (%)	(6.4)	(28.7)	(25.5)

Stock Information

Bloomberg code	769 HK
Market cap (US\$m)	171
52-week high (HK\$)	2.66
52-week low (HK\$)	0.70
Shares issued - (m)	1,421
6m avg daily volume (m)	2.35
Free float (%)	58.2
Major shareholders (%)	
	YY Holdings (41.8)

Key Indicators

ROE (%)	15.4
Net gearing (%)	Net cash
NTA (HK\$)	2.04

China Rare Earth

Incredibly Cheap

Strong bottom line, partially helped by exchange gain

Net profit for HY08 was HK\$223 million, an increase of 81% y-o-y. The result was helped by the booking of an exchange gain, amounting to HK\$49m. Turnover grew by 26% to HK\$783m and gross profit margin jumped to 36.5% from 30.7%. Interim dividend flat at HK\$0.01 per share.

Improved product mix in rare earth business

Volume of rare earth oxides and downstream products sold increased by 20% to approximately 3,000 tonnes. However, demand for high-priced rare earth oxides actually decreased y-o-y. The volume increase was boosted by low price rare earth oxides and downstream products. The net result was a flat turnover but a better gross margin. Turnover only went up by 2% but gross margin was enhanced to 27% from 24%. This is mainly due to downstream products, which are having 35% gross profit margin versus traditional rare earth oxides separation of 23%. Downstream products now represent 35% of total rare earth turnover.

Remarkable growth in refractory business

For refractory material, volume growth was 36% to around 83,300 tonnes. Estimated gross margins were up from 38.8% to around 44.2%. ASP for various products recorded a growth of around 10-20%. The strong growth was on back of a strong macroeconomic environment in China for 1H08, which saw high demand particularly in steel and glass industries. The company is cautious on the outlook in 2H08. Having said that, the Phase 1 of high purity magnesium grains, which commenced business after the Beijing Olympics, should be an additional growth driver.

Incredibly cheap, Maintain BUY

We raise our FY08 forecast by 9.4% to reflect the exchange gain but lower our FY09 forecast marginally on slower growth assumptions. Overall, we believe China Rare Earth can still post a decent growth in the coming years with the help of increase downstream rare earth production and the new refractory project. Potential acquisitions can also be a swing factor to earnings. China Rare Earth is now trading at 3X our estimated FY08 PER and less than 0.5X P/B. Net cash per share is at HK\$0.57. Maintain BUY with a conservative target of HK\$2.22, 6X FY09 PER.

Year end Dec 31	2006	2007	2008F	2009F	2010F
Sales (HK\$)	1,031	1,385	1,740	2,090	2,432
Pre-tax (HK\$)	274	396	594	689	770
Net profit (HK\$)	209	295	453	525	587
EPS (HK\$)	0.15	0.21	0.32	0.37	0.41
EPS growth (%)	11.6	41.0	53.4	16.0	11.8
PER (x)	6.4	4.5	3.0	2.5	2.3
EV/EBITDA (x)	2.1	1.5	0.6	0.1	(0.4)
Yield (%)	4.8	5.3	7.4	8.5	9.6

Profit and loss

YE Dec (HK\$m)	2006	2007	2008F	2009F	2010F
Sales	1,031	1,385	1,740	2,090	2,432
Cost of goods sold	(661)	(849)	(997)	(1,159)	(1,331)
Gross profit	370	536	743	932	1,102
Operating expenses	(118)	(160)	(209)	(257)	(290)
Operating profit	252	376	534	674	811
Net interest	7	12	1	3	3
Interest income	10	17	8	11	11
Interest expense	(3)	(5)	(7)	(8)	(8)
Net investment income/(loss)	15	8	58	12	(44)
Net other non-op. JV+Assoc.	0	0	0	0	0
Net extraordinaries	0	0	0	0	0
Pretax profit	274	396	594	689	770
Income taxes	(62)	(97)	(135)	(156)	(175)
Minority interests	(2)	(4)	(6)	(7)	(8)
Net profit	209	295	453	525	587
EBITDA	323	458	643	812	965
EPS (HK\$)	0.15	0.21	0.32	0.37	0.41

Source: Company data, Kim Eng Securities estimates

Balance sheet

YE Dec (HK\$m)	2006	2007	2008F	2009F	2010F
Total assets	2,465	2,798	3,241	3,700	4,205
Current assets	1,385	1,536	1,938	2,383	2,892
Cash & ST investment	661	652	929	1,269	1,688
Inventories	231	296	316	323	319
Accounts receivable	345	382	479	576	670
Others	148	206	213	216	214
Other assets	1,081	1,262	1,304	1,316	1,313
LT investments	0	0	0	0	0
Net fixed assets	569	744	1,072	1,085	1,081
Others	512	518	232	232	232
Total liabilities	227	248	304	329	353
Current liabilities	227	248	304	329	353
Accounts payable	50	62	74	85	93
ST borrowings	95	101	130	130	130
Others	82	85	100	115	130
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	2,238	2,550	2,938	3,370	3,852
Paid-in capital	142	142	142	142	142
Reserve	2,075	2,380	2,761	3,187	3,661
Minority interests	21	28	34	41	49

Source: Company data, Kim Eng Securities estimates

Cash flow

YE Dec (HK\$m)	2006	2007	2008F	2009F	2010F
Operating cash flow	320	346	594	732	842
Operating profit	274	396	594	689	770
Depreciation & amortization	71	82	109	137	153
Change in working capital	(15)	(168)	(107)	(91)	(78)
Others	(10)	37	(1)	(3)	(3)
ROI and Service of Fin.	(119)	(149)	(195)	(242)	(274)
Investment cash flow	(400)	(242)	(150)	(150)	(150)
Net capex	(48)	(250)	(150)	(150)	(150)
Change in LT investment	(352)	8	0	0	0
Change in other assets	0	0	0	0	0
Cash flow after invt.	(198)	(45)	248	340	419
Financing cash flow	690	0	29	0	0
Change in share capital	595	0	0	0	0
Net change in debt	95	0	29	0	0
Change in other LT liab.	0	0	0	0	0
Net cash flow	492	(45)	277	340	419

Source: Company data, Kim Eng Securities estimates

Key ratios

YE Dec	2006	2007	2008F	2009F	2010F
Growth (% YoY)					
Sales	34.0	34.4	25.6	20.1	16.4
Operating profit	50.6	49.2	42.0	26.2	20.4
EBITDA	41.6	41.6	40.4	26.2	18.9
Net profit	60.7	41.0	53.4	16.0	11.8
EPS	11.6	41.0	53.4	16.0	11.8
Profitability (%)					
Gross margin	35.9	38.7	42.7	44.6	45.3
Operating margin	24.4	27.2	30.7	32.3	33.4
EBITDA margin	31.4	33.1	37.0	38.8	39.7
Net margin	20.3	21.3	26.0	25.1	24.1
ROA	8.5	10.5	14.0	14.2	14.0
ROE	9.4	11.6	15.4	15.6	15.2
Stability					
Gross debt/equity (%)	4.3	4.0	4.5	3.9	3.4
Net debt/equity (%)	0.0	0.0	0.0	0.0	0.0
Int. coverage (X)	107.9	87.6	88.2	99.1	117.8
Int. & ST debt coverage (X)	3.3	4.3	4.7	5.9	7.0
Cash flow int. coverage (X)	107	66	5	5.9	7.0
Cash flow int. & ST debt (X)	3.3	3.2	4.3	5.9	7.0
Current ratio (X)	6.1	6.2	6.4	7.2	8.2
Quick ratio (X)	5.1	5.0	5.3	6.3	7.3
Net cash/(debt) (HK\$m)	661	652	929	1,269	1,688
Per share data (HK\$)					
EPS	0.15	0.21	0.32	0.37	0.41
CFPS	0.23	0.24	0.42	0.52	0.59
BVPS	1.56	1.77	2.04	2.34	2.68
SPS	0.73	0.97	1.22	1.47	1.71
EBITDA/share	0.23	0.32	0.45	0.57	0.68
DPS	0.05	0.05	0.07	0.08	0.09

Source: Company data, Kim Eng Securities estimates

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Recommendation definitions

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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