

China Rare Earth (769 HK)

12 April 2013

Looking for a better year in 2013

China Rare Earth (CRE) posted a net loss of HK\$680m in 2012 mainly hurt by the slump in rare earth product prices. With stabilizing product prices and profitability improvement of start-ups, it expects to achieve a better year in 2013.

- Reversed to a net loss of HK\$680m in 2012.** CRE reported a net loss of HK\$680m in 2012 primarily due to a HK\$370m net inventory write-off as a result of price plunge of rare earth products. Included in the net loss were impairment losses on goodwill and intangible assets for its rare earth business totalling HK\$53m. Stripping out all these non-cash items, CRE's net loss would have been HK\$256m. In 2011, CRE made a net profit of HK\$509m for continuing operations (HK\$523m if including the discontinued operation).
- Weakness in rare earth business being the culprit.** Rare earth business reported a segment loss of HK\$631m, hurt mainly by sharp price decline of rare earth oxides in weak economies and increased unit production costs caused by yield reduction. Segment revenue was down 8% YoY, reducing rare earth sales exposure from 80% in 2011 to 77% in 2012. The growth in volume sales (+40% YoY for rare earth oxides and three-fold increase in rare earth metals) was offset by the price plummet of 20-70% YoY for rare earth oxides and the product mix adjustment of its rare earth metals from praseodymium-neodymium alloy to lanthanum metals with ASP >80% lower than the former. The tight supply of raw materials arising from national restrictions on rare earth mining rights and annual capacity of smelters put further margin pressure on rare earth products. Rare earth mineral prices were down 15-25% YoY only.
- Refractory products stayed profitable.** Refractory materials business, which posted a 6% YoY turnover growth, stayed profitable with gross profit margin of 17%. The JV for the production of shaped and sintered refractory materials for application in the cement industry has commenced trial production in 2012. Focus of the year will be on yield improvement.
- Worst is over.** Rare earth product prices are expected to stabilize at current level this year on back of moderate recovery of Chinese and global economies. Management expects to have a better year in 2013 through (1) operational efficiency improvement; (2) the fluorescent materials JV turning to breakeven upon commencement of mass production in 2013; and (3) the completion of trial run of the new self-developed rare earth polishing powder production line in mid-2013.
- Solid balance sheet.** Maintenance capex of <HK\$10m is planned this year. With net cash of HK\$1.2bn or net cash per share of HK\$0.71, CRE does not rule out the possibility of resuming dividend payment to enhance shareholders' return should there be profitability improvement. CRE is trading at 0.6x historical P/B.

Investment Summary

FY-end Dec	2008	2009	2010	2011	2012
Turnover (HK\$ m)	1,365	1,212	1,117	2,213	2,102
Growth (%)	(1.5)	(11.2)	(7.8)	98.2	(5.0)
Net Profit (HK\$ m)	(171)	85	133	523	(680)
Growth (%)	(157.9)	(149.5)	57.6	292.5	(229.8)
EPS (HK\$ cents)	(12.03)	5.75	8.48	30.41	(40.64)
Growth (%)	(157.9)	(147.8)	47.5	258.6	(233.6)
PER (x)	(10.8)	22.6	15.3	4.3	(3.2)
P/B (x)	0.8	0.7	0.6	0.5	0.6
EV/EBITDA (x)	(63.6)	4.0	3.8	1.2	(1.8)
DPS (HK\$ cents)	10.00	-	-	20.00	-
Yield (%)	7.7	-	-	15.4	-

Source: Company data

China / Basic Materials

Not Rated

Share Price	Target Price	Upside / Downside
HK\$1.30	NA	NA

(as of 11 April 2013)

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52 Range (HK\$)	1.13-2.25
DVD yield %	1.54

Latest Key Data

FF no of shares (m)	1,110
FF (%)	66.37
FF market cap (HK\$ m)	1,443
12M daily turnover (HK\$ m)	9.45
12M volatility (%)	46.16
12M Hi/Lo (HK\$)	1.13-2.25
RoE 2012 (%)	(18.17)
P/B 2012 (x)	0.6
Net debt/equity 2012 (%)	NC

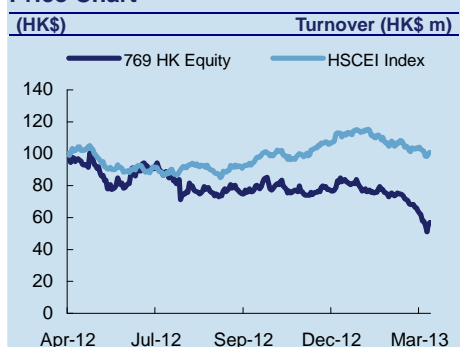
Performance (%)

	1M	YTD	12M
Absolute	(20.7)	(24.4)	(38.4)
Relative to HSCEI	(15.6)	(18.1)	(38.8)

Major Shareholders (%)

YY Holdings Ltd	33.63
Free float	66.37

Price Chart



Source: Bloomberg, CER

Results of first batch of rare earth export quota in 2013

The Ministry of Commerce of China has just released the first batch of rare earth export quota for 2013. Yixing Xinwei Leeshing Rare Earth Co. Limited, a wholly-owned subsidiary of CRE has obtained quotas of 576 tonnes of light weight rare earth and 109 tonnes of medium to heavy weight rare earth, representing 4.2% and 5.6% of respective total quotas.

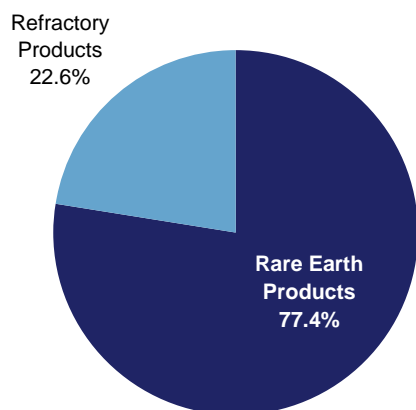
Figure 1: First batch of Rare Earth export quota in 2013 (tonnes)

Company	Quota	
	Light	Medium to Heavy
1 Gao Gang Group	1,696	115
2 Baotou Rhodia Limited	1,090	81
3 China Minmetals Corporation	856	207
4 Gansu Rare Earth New Material Limited	814	88
5 China Metallurgical Import & Export Jiangsu Company	776	166
6 Grirem Advanced Materials Co.,Ltd.	722	158
7 Zibo Jiahua Advanced Materials Resources Co. Ltd	671	24
8 Leshan Shenghe Rare Earth	624	69
9 Yiyang Hongyuan Rare Earth Co., Ltd	581	25
10 Yixing Xinwei Leeshing Rare Earth Co., Ltd	576	109
11 Others	5,155	896
Total	13,561	1,938

Source: Ministry of Commerce, Association of China Rare Earth Industry, CER estimates

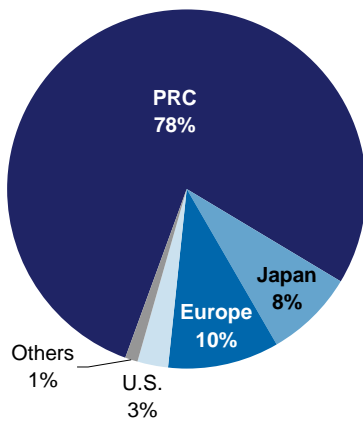
Snapshot of 2012 operation performance

Figure 2: Revenue breakdown in 2012



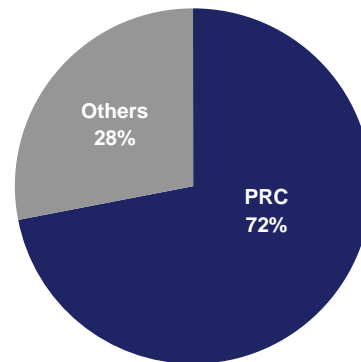
Source: Company data, CER estimates

Figure 3: 2012 rare earth products turnover breakdown by geographical segment



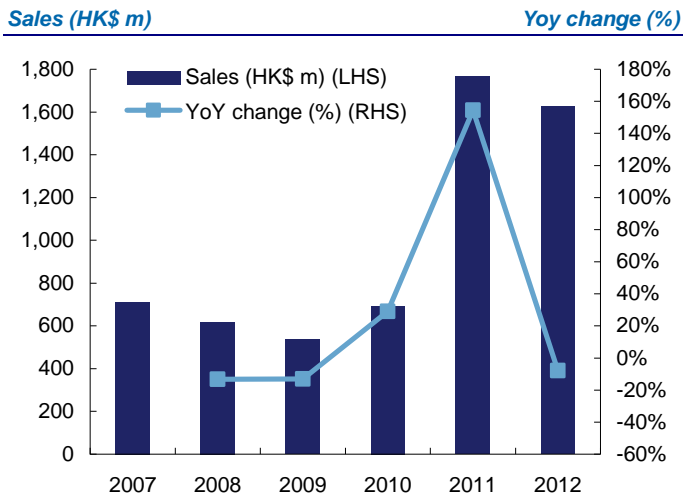
Source: Company data, CER estimates

Figure 4: 2012 refractory products turnover breakdown by geographical segment



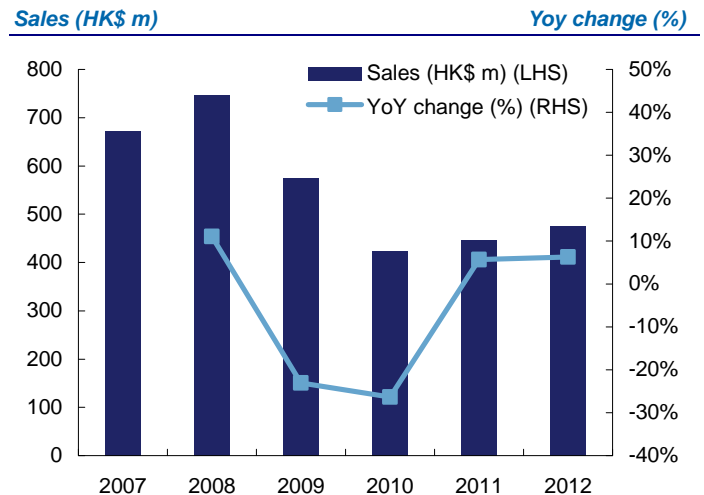
Source: Company data, CER estimates

Figure 5: Sales trend of rare earth products



Source: Company data, CER estimates

Figure 6: Sales trend of refractory products



Source: Company data, CER estimates

Overview of China rare earth market

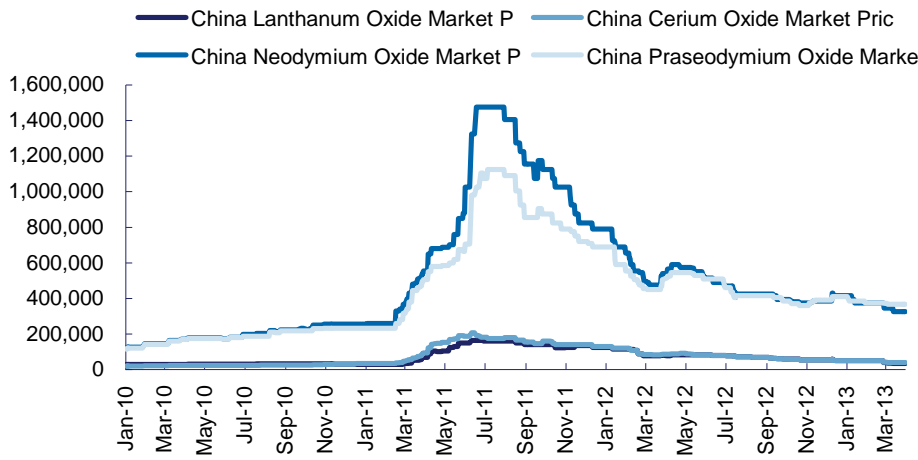
Rare earth oxide product prices experienced significant fluctuation during the past two years. The prices surged in 2011 due to the strict control of rare earth export in China.

According to the survey by the Ministry of Land and Resources of China, the rare earth reserve in China dropped sharply to 1,859tn tonnes in 2009, with the share of the global reserves down from >40% previously to 23%. The central government has then taken strict control on rare earth production and export since 2011 to protect the resources. The control measures include tax adjustment in Apr 2011; promulgation of pollutants control standard and regulation in Jan 2011; and the establishment of rare earth dedicated invoice in May 2011 and industry entry requirements in Jul 2012.

The price strength of rare earth products however was not sustainable on the weakened global economics, especially in China, in 2012. As China consumes about half of the global consumption of rare earth products, the weak economy in China last year had a hard hit on the rare earth oxide prices.

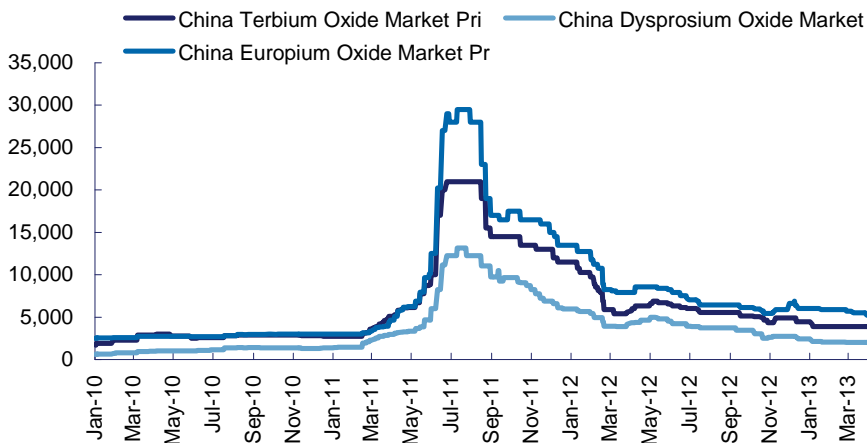
On back of moderate recovery of Chinese and global economies, rare earth prices are expected to stabilize at the current level.

Figure 7: Prices of light weight rare earth oxide (Rmb/tonne)



Source: Bloomberg

Figure 8: Prices of selected medium to high weight rare earth oxide (Rmb/kg)



Source: Bloomberg

COMPANY DESCRIPTION

CRE is the leading and respected rare earth and refractory products manufacturer in China. It was founded in 1987 in Yixing City, Jiangsu Province and became listed on the main board of HKEX in 1999. The company has two major business segments, namely the manufacture and sales of rare earth products and refractory material products. Rare earth and refractory material segments contributed 77% and 23% of CRE's total revenue in 2012. China is CRE's largest market contributing 77% of total revenue in 2012. As at April 2013, Mr Jiang's family is the largest shareholder of the company holding 33.63% interest in CRE.

Income Statement (Consolidated)

FY-end 31 Dec (HK\$ m)	2008	2009	2010	2011	2012
Sales	1,365	1,212	1,117	2,213	2,102
Cost of sales	(1,016)	(980)	(864)	(1,160)	(2,545)
Gross profit	349	231	253	1,053	(443)
Other income/(expenses)	(292)	27	35	34	(43)
Operating expenses	(165)	(97)	(109)	(338)	(173)
Operating profit	(108)	162	179	750	(659)
Finance cost, net	(10)	(18)	(8)	(6)	(3)
Share of P/L of asso. & JCE	-	-	(1)	(12)	(26)
Pre-tax profit	(119)	144	170	732	(687)
Tax	(54)	(60)	(31)	(176)	(12)
Minorities	(1)	0	6	32	(20)
Net profit	(171)	85	133	523	(680)
EBITDA	(16)	257	270	837	(585)
EBIT	(108)	162	179	750	(659)
EPS (HK\$ cents)	(12)	6	8	30	(41)
DPS (HK\$ cents)	10	-	-	20	-

Source: Company

Cash Flow (Consolidated)

FY-end 31 Dec (HK\$ m)	2008	2009	2010	2011	2012
Operating cash flow	252	171	(48)	(124)	na
Net profit	(171)	85	133	523	na
Depreciation & amortization	92	95	91	87	na
Change in working capital	(16)	(318)	(307)	(909)	na
Others	348	310	35	174	na
Investment cash flow	(331)	10	(181)	350	na
Net Capex	(37)	(14)	(16)	(28)	na
Disposal	0	0	0	59	na
Change in LT investment	-	-	-	-	na
Change in other assets	(294)	24	(165)	319	na
Free Cash Flow	215	157	(64)	(152)	na
Financing cash flow	106	117	301	(10)	na
Change in share capital	-	186	456	1	na
Net change in debt	187	(51)	(146)	(6)	na
Dividend paid	(71)	-	-	-	na
Net impact of exchange	(10)	(18)	(8)	(6)	na
Net cash flow	26	298	72	215	na

Source: Company

Balance Sheet (Consolidated)

FY-end 31 Dec (HK\$ m)	2008	2009	2010	2011	2012
Total assets	3,214	3,240	3,766	4,554	3,641
Current assets	1,714	1,867	2,276	3,590	2,865
Cash & ST investments	765	1,065	1,193	1,530	1,236
Marketable securities & ST inv	-	-	-	-	-
Account & notes receivable	412	467	370	603	479
Inventories	309	235	606	1,296	975
Others	228	100	107	160	175
Non-current assets	1,501	1,373	1,490	964	777
LT investments	-	-	-	-	-
Net fixed assets	715	636	601	470	405
Others	785	737	889	494	371
Total liabilities	741	491	325	389	205
Current liabilities	479	258	230	358	179
Account payable	116	77	81	95	95
ST borrowings	140	108	99	99	49
Others	223	73	50	164	35
Non-current liabilities	261	234	95	32	26
Long-term debts	155	136	-	-	-
Others	106	98	95	32	26
Total equities	2,474	2,748	3,441	4,165	3,436
Shareholders' equity	2,444	2,719	3,404	4,095	3,386
Minority shareholders	29	29	37	70	50
Total liabilities + Total equities	3,214	3,240	3,766	4,554	3,641
Net cash / (debt)	470	821	1,093	1,431	1,187
Working capital	605	625	895	1,805	1,359
Total capital employed	2,003	1,927	2,348	2,734	2,249
Shareholders' equity + Minorities	2,474	2,748	3,441	4,165	3,436
Net gearing (%)	NC	NC	NC	NC	NC

Source: Company

Financial Summary

FY-end 31 Dec	2008	2009	2010	2011	2012
Growth (%)					
Revenue	(1)	(11)	(8)	98	(5)
EBITDA	(103)	na	5	210	(170)
EBIT	(127)	(250)	10	319	(188)
Net profit	(158)	(149)	58	293	(230)
EPS	(158)	(148)	47	259	(234)
Margins (%)					
Gross	26	19	23	48	(21)
EBITDA	(1)	21	24	38	(28)
EBIT	(8)	13	16	34	(31)
Net	(13)	7	12	24	(32)
Others (%)					
Effective tax rate	(45)	41	18	24	(2)
RoCE	(5)	8	8	30	(26)
Average RoE	(7)	3	4	14	(18)
Average RoA	(6)	3	4	13	(17)
Interest cover (x)	(11)	9	21	132	(233)

Source: Company

Everbright Research Limited Rating System

Buy	Expected to outperform the benchmark index by >15% over the next six months
Accumulate	Expected to outperform the benchmark index by 5 - 15% over the next six months
Hold	Expected to outperform or underperform the benchmark index by <5% over the next six months
Reduce	Expected to underperform the benchmark index by 5 - 15% over the next six months
Sell	Expected to underperform the benchmark index by >15% over the next six months

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