

COMPANY BACKGROUND

Founded in 1999, Fufeng Group (Fufeng) is the largest manufacturer of glutamic acid (GA) (raw material for monosodium glutamate, or MSG) with a 30% market share in China, and one of the largest manufacturers of xanthan gum in the nation. Its xanthan gum (XG) is exported to over 34 countries. Chairman, LI Xuechun, and other management owns 47% and 8% of the company, respectively.

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Piper Jaffray Asia Securities Limited

Reason for Report:

Company Update

Changes	Previous	Current	
Rating	--	Overweight	
Price Tgt (HK\$)	--	6.70	
FY10E Rev (Rmb m)	6,821.00	6,939.00	
FY11E Rev (Rmb m)	8,066.00	8,130.00	
FY10E EPS (Rmb)	--	0.63	
FY11E EPS (Rmb)	--	0.82	
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Price (HK\$):		5.84	
52 Week High (HK\$):		6.88	
52 Week Low (HK\$):		1.39	
12-Month Price Target (HK\$):		6.70	
(9.4x FY10E EPS of HK\$0.72)			
Shares Out (mil):		1,660.0	
Market Cap. (HK\$m):		9,694.4	
Market Cap. (US\$m):		1,245.9	
Free Float Market Cap (US\$m):		516.0	
Div (ann HK\$):		0.25	
Avg Daily Vol (000):		5,973.0	
Book Value/Share (Rmb) :		1.8	
Net debt to equity :		19%	
Est LT EPS Growth :		15%	
P/E to LT EPS Growth (FY10):		0.5x	
Est Next Rep Date :		Aug 2010	
Fiscal Year End:		Dec	
Auditor:		PWC	
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Rev (Rmb m)	FY09A	FY10E	FY11E
H1	2,055.00A	3,300.00E	3,948.00E
H2	2,578.00A	3,639.00E	4,181.00E
FY	4,633.00A	6,939.00E	8,130.00E

EPS (Rmb)	FY09A	FY10E	FY11E
H1	0.21A	0.27E	0.39E
H2	0.35A	0.36E	0.42E
FY	0.56A	0.63E	0.82E
FY P/E	9.2x	8.1x	6.3x

Fufeng Group

阜丰集团

Overweight**(546 HK - HK\$5.84)****ASP Sustains Well at High Level; Reiterate OW****CONCLUSION:**

We reiterate our Overweight rating on Fufeng after its release of 1Q10 operation updates. Thanks to healthy ASP trends and capacity expansion, Fufeng's profit margin and revenue growth are on track to deliver our earnings estimates (+11%/30% in FY10E/11E). Fufeng further raised its ASP on April 10 to pass on the continuously rising corn cost. Our PT of HK\$6.70 (9.4x FY10E) is still below the initial conversion price of the CB issued recently (HK\$7.03).

- **1Q10 margin and ASP trends on track.** (1) Revenue +42% YoY to Rmb1,431 million, representing ~43% of our 1H10E estimates. (2) GPM stood at 24%, largely in line with our 1H10E estimates. It was down 3.9ppt YoY and 11.9ppt QoQ, widely anticipated as a result of ASP normalization, but still remaining at a high level. MSG and XG segments reported a gross margin of 21.8% (-6.3ppt YoY) and 40.1% (+9.2ppt), respectively. (3) In 1Q10, Fufeng's unit corn cost reached Rmb1,645/tonne, (+34% YoY/7% QoQ). Admittedly, this put pressure on Fufeng's GPM in 1Q, but was offset by an ASP hike. We estimate the ASPs of MSG and XG were up approximately 11% and down -7% YoY, respectively, in line with our estimates.
- **Cost surges demonstrated Fufeng's resilience.** (1) Corn price has increased by more than 10% YTD and 18% YoY in the Inner Mongolian spot market. The MSG price has gone up further (~4%-5% in April); hence we believe our GPM and earnings estimates for FY10E-11E are well intact. We have slightly raised our revenue estimates for FY10E-11E and are assuming the corn cost to rise 8% YoY for FY10E to reflect the latest changes. (2) According to management, some competitors had halted production in 1Q10 due to the surge in cost while Fufeng's GPM had once fallen below 20% for a month. We believe this demonstrated the superiority of Fufeng's cost-saving technology and measures. We also believe the increasing corn cost will cushion the MSG price and boost our confidence in Fufeng's ability to sustain its GPM at ~25% in FY10E.
- **New initiatives to diversify revenue sources.** (1) Production of new products, such as fructose, threonine and other amino acids, is scheduled to commence in 2Q-3Q10. We have not included them in our model but expect from them less than 1% accretion in revenue for FY10E. (2) Fufeng is gradually building up its consumer brand for its retail chicken powder and MSG products, and related marketing expenses are to remain below 1% of its revenue.

INVESTMENT RECOMMENDATION:

We maintain OW on Fufeng and our PT of HK\$6.70 (9.4x FY10E EPS of Rmb0.63/HK\$0.72). Our target P/E represents a 7% discount to peers (previous: 15%), which reflects the lower near-term refinancing risk after the CB issue.

RISKS TO ACHIEVEMENT OF TARGET PRICE:

Major risks include: (1) a return of smaller competitors in the MSG market; (2) disappointing xanthan gum sales volumes; and (3) changing environmental and industry regulations that may affect corn or other costs.

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Exhibit 1: Key Operation Parameters for 1Q10

Rmb mil	1Q10	YoY	QoQ	4Q09	3Q09	2Q09	1Q09	4Q08	3Q08
Revenue	1,431	42	0	1,431	1,147	1,050	1,005	1,011	944
MSG segment	1,259	39	-3	1,299	1,056	960	909	866	806
XG segment	172	79	30	132	90	90	96	145	138
Gross profit	343	23	-33	510	313	297	280	230	177
GPM (%)	1Q10	ppt	+/-ppt	4Q09	3Q09	2Q09	1Q09	4Q08	3Q08
MSG segment	21.8	-6.3	-8.6	30.4	26.1	26.7	28.1	21.5	15.8
XG segment	40.1	9.2	4.8	35.4	40.9	39.5	31.0	33.8	32.3
Average	24.0	-3.9	-11.6	35.6	27.3	28.3	27.9	22.7	18.8

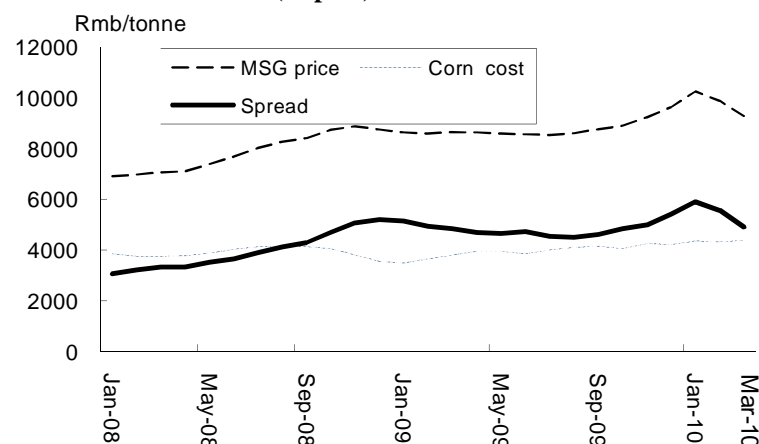
Sources: Company, Piper Jaffray Asia Securities

Exhibit 2: 1Q10 Revenue Breakdown

	Revenue (Rmb mil)			Volume (000 tonnes)			ASP (Rmb / tonne)		
	1Q10	1Q09	YoY %	1Q10	1Q09	YoY %	1Q10	1Q09	YoY %
MSG	822	435	89	115	68	70	7,122	6,394	11
Glutamic acid	64	185	-66	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Corn refined products	183	121	52	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Fertilizers	86	125	-31	107	141	-24	800	884	-9
Starch Sweeteners	76	37	107	26	18	48	2,863	2,042	40
Xanthan Gum	172	96	79	8,561	4,443	93	20,079	21,583	-7
Others	29	7	326	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Company, Piper Jaffray Asia estimates for Volume and ASPs

Exhibit 3: China MSG (Export) Price Trend



Sources: CEIC

Exhibit 4: Valuation Comparisons

	Bloomberg code	Rec.	Mkt Cap (HK\$ mil)	Price 12/5/10	PER (x)	P/B	ROE (%)	EPS growth (%)	OP margin (%)
FUFENG GROUP	546 HK	HK\$ OW	9,694	5.84	FY09 9.2 FY10E 8.1 FY11E 6.3	2.8	34.4 33.9	FY09 215 FY10E 13 FY11E 29	FY09 22.6 FY10E 18.1 FY11E 20.1
China Corn processing									
GLOBAL BIO-CHEM	809 HK	HK\$ N	3,571	1.54	15.4 5.4 4.3	0.4	6.2 6.9	-103 186 22	16.0 11.7 4.6
XIWANG SUGAR	2088 HK	HK\$ N	2,041	2.11	17.0 8.0 6.9	0.9	12.1 12.1	60 124 10	6.9 13.9 13.4
GLOBAL SWEETENER	3889 HK	HK\$ OW	1,724	1.50	19.0 8.4 7.1	0.9	5.1 10.1	-37 123 16	2.2 3.5 11.5
CHINA AGRI-INDUS	606 HK	HK\$ NR	38,062	9.86	19.1 14.0 11.3	1.9	16.3 16.7	38 23 23	6.2 6.3 n.a.
CHINA STARCH HLD	3838 HK	HK\$ NR	4,624	1.60	28.9 15.6 12.8	n.a.	16.4 17.2	86 22 22	n.a. n.a. n.a.
Average					19.9 10.3 8.5	1.0	11.2 12.6	9 96 19	7.8 8.8 9.8
Int'l corn processors	Bloomberg code	Rec.	Mkt Cap (mil)	Price 12/5/10	PER (x)	P/B	ROE (%)	EPS growth (%)	OP margin (%)
ARCHER-DANIELS	ADM US	USD NR	17,375	27.02	10.6 9.4 9.0	1.1	12.8 12.0	8 2 4	3.6 3.7 4.1
BUNGE LTD	BG US	USD NR	7,387	51.24	14.4 9.4 8.1	0.7	8.0 7.7	142 7 16	2.7 2.7 2.9
CORN PRODUCTS	CPO US	USD NR	2,646	35.16	15.0 13.8 12.1	1.4	10.5 10.6	364 10 14	8.3 8.6 8.8
TATE & LYLE	TATE LN	GBp NR	2,028	440.80	21.0 11.9 9.6	1.6	13.4 15.2	161 12 24	8.0 8.6 9.3
Average					15.2 11.1 9.7	1.2	11.2 11.4	169 8 15	5.6 5.9 6.2

Sources: Bloomberg, *Piper Jaffray Asia Securities Limited earnings estimates for stocks under coverage

Year ending Dec (RMB mil)	1H09A	2H09A	1H10E	2H10E	1H11E	2H11E	2007A	2008A	2009A	2010E	2011E	2012E
Volume ('000 tonnes)												
Glutamic acid	62	39	70	53	85	58	179	163	101	123	143	143
MSG	131	162	200	255	260	295	92	146	292	455	555	655
Fertilizers	217	280	285	285	310	310	419	370	497	570	620	684
Xanthan gum	8	12	14	16	20	20	6	21	19	30	40	40
ASP (Rmb/ tonne)												
Glutamic acid	6,777	7,716	7,100	6,685	6,650	7,319	5,872	6,474	7,135	6,921	6,921	6,921
MSG	6,886	8,323	7,600	7,195	7,125	7,175	5,997	6,865	7,680	7,373	7,152	6,794
Fertilizers	862	623	700	812	700	755	467	1,026	727	800	800	800
Xanthan gum	24,265	19,023	19,500	20,438	19,500	19,500	24,049	21,941	21,099	20,000	19,500	19,500
ASP growth (%)												
Glutamic acid	12	7	5	-13	-6	9	-4	10	10	-3	0	0
MSG	10	14	10	-14	-6	0	-6	14	12	-4	-3	-5
Fertilizers	-15	-40	-19	30	0	-7	-14	120	-29	10	0	0
Xanthan gum	13	-14	-20	7	0	-5	-9	-9	-4	-5	-3	0
Glutamic acid	423	297	497	354	565	425	1,049	1,053	721	851	990	990
MSG	906	1,340	1,520	1,835	1,853	2,117	551	1,004	2,245	3,355	3,969	4,450
Fertilizers	187	174	200	232	217	234	196	380	361	431	451	498
Xanthan gum	186	222	273	327	390	390	149	452	408	600	780	780
Others	259	544	811	892	924	1,016	500	696	897	1,702	1,940	2,150
Revenue	2,055	2,578	3,300	3,639	3,948	4,181	2,446	3,585	4,633	6,939	8,130	8,868
Turnover growth (%)	26	32	61	41	20	-2	37	47	29	50	17	9
Cost of sales	-1,478	-1,755	-2,503	-2,677	-2,883	-3,057	-2,196	-2,941	-3,233	-5,180	-5,940	-6,468
Gross Profit	577	823	797	962	1,066	1,124	250	644	1,400	1,759	2,190	2,399
Other income	24	40	10	36	10	64	76	44	64	46	74	79
Selling and marketing costs	-96	-120	-154	-169	-169	-210	-104	-166	-216	-323	-379	-413
Administrative expenses	-87	-108	-107	-118	-110	-137	-114	-142	-195	-224	-247	-271
Other operating expenses	-17	13	-5	0	-10	4	-17	-12	-4	-5	-6	-7
Operating profit	401	648	541	711	787	845	91	368	1,049	1,253	1,633	1,787
Finance costs	-14	-12	-35	-35	-19	-19	-45	-43	-25	-71	-38	-33
Profit before tax	388	636	506	676	768	826	45	325	1,024	1,182	1,594	1,754
Taxation	-34	-61	-56	-74	-115	-124	0	-31	-95	-130	-239	-351
Profit attributable to shareholders	354	574	451	602	653	702	45	295	928	1,052	1,355	1,403
EPS (Rmb)	0.213	0.346	0.271	0.362	0.393	0.423	0.028	0.178	0.559	0.634	0.816	0.845
	1H09A	2H09A	1H10E	2H10E	1H10E	2H11E	2007A	2008A	2009A	2010E	2011E	2012E
Revenue breakdown												
Glutamic acid	21	12	15	10	14	10	43	29	16	12	12	11
MSG	44	52	46	50	47	51	23	28	48	48	49	50
Fertilizers	9	7	6	6	5	6	8	11	8	6	6	6
Xanthan gum	9	9	8	9	10	9	6	13	9	9	10	9
Sweeteners	5	6	4	4	4	4	3	5	5	4	4	3
Others	13	15	20	20	20	21	17	15	14	20	20	21
COGS breakdown(%)												
Corn kernels	52	57	57	57	61	57	55	46	55	57	60	62
Utilities	13	12	9	9	10	9	13	14	12	9	9	10
Other raw materials	12	14	13	12	11	10	22	19	13	12	10	9
Others	23	17	22	23	18	24	9	20	20	22	21	19
Gross margins(%)												
MSG segment	27.4	29.5	22.1	24.4	24.9	25.5	8.6	15.0	28.0	23.3	25.2	25.5
Xanthan gum	35.1	37.6	35.0	36.1	37.0	30.8	30.9	33.4	36.5	35.6	33.9	33.9
Company's average	28.1	31.9	24.1	26.4	27.0	26.9	10.2	18.0	30.2	25.4	26.9	27.1
SG&A as % of revenue	8.9	8.8	7.9	7.9	7.0	8.3	8.9	8.6	8.9	7.9	7.7	7.7
Operating margin(%)	19.5	25.1	16.4	19.5	19.9	20.2	3.7	10.3	22.6	18.1	20.1	20.1
Growth (%)												
Revenue	26	32	61	41	20	15	37	47	29	50	17	9
Net profit	312	175	27	5	45	17	(81)	554	215	13	29	4
Gross profit contribution (%)												
MSG segment	90	90	89	87	87	88	82	76	89	88	88	89
Xanthan gum	10	10	11	13	13	12	18	24	11	12	12	11
Effective tax rate	8.7	9.7	11.0	11.0	15.0	15.0	0.9	9.4	9.3	11.0	15.0	20.0

Source: Company, Piper Jaffray Asia Securities

For up-to-date disclosure information on this company, please visit www.piperjaffray.com/researchdisclosures.

Fufeng Group Limited (00546.HK)

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Balance sheet

As of 31 December (RMB mil)	2008A	2009A	2010E	2011E	2012E	Jun-09
Current assets						
Inventories	356	551	971	1,138	1,241	326
Trade and other receivables	548	688	1,030	1,207	1,316	582
Amounts due from related parties	3	0	0	0	0	0
Restricted bank deposits	43	26	0	0	0	15
Cash & equivalent	225	343	612	1,154	771	285
	1,175	1,608	2,614	3,499	3,329	1,208
Non-current assets						
Property, plant and equipment	1,955	2,508	3,469	3,687	3,880	2,024
Leasehold payments	132	140	139	138	137	142
Others	0	5,162	0	0	0	6
	2,088	2,653	3,608	3,825	4,017	2,171
Total assets	3,262	4,261	6,222	7,324	7,346	3,379
Current liabilities						
Trade and other payables	888	1,140	1,827	2,095	2,282	842
Tax payable	0	14	14	14	14	4
Current portion of deferred income	7	0	0	0	0	10
Borrowings	276	418	0	0	0	198
Derivative financial instruments	0	0	0	0	0	0
	1,170	1,572	1,841	2,109	2,295	1,054
Non current liabilities						
Bank loans	312	180	180	80	80	300
Bank loans	0	0	1,025	1,025	1,025	0
Deferred income tax liabilities	11	24	24	24	24	19
Deferred income	28	91	91	91	91	52
Amounts due to related parties	0	0	0	0	0	0
	351	295	1,320	1,220	1,220	371
Shareholders' funds	1,742	2,394	3,061	3,995	4,856	1,954
Total liabilities and equity	3,262	4,261	6,222	7,324	8,371	3,379
Net cash	-320	-229	-593	49	-334	-198
Net debt to equity (%)	18	10	19	net cash	7	10
BVPS (Rmb)	1.05	1.44	1.84	2.41	2.93	1.18

Source: Company, Piper Jaffray Asia Securities

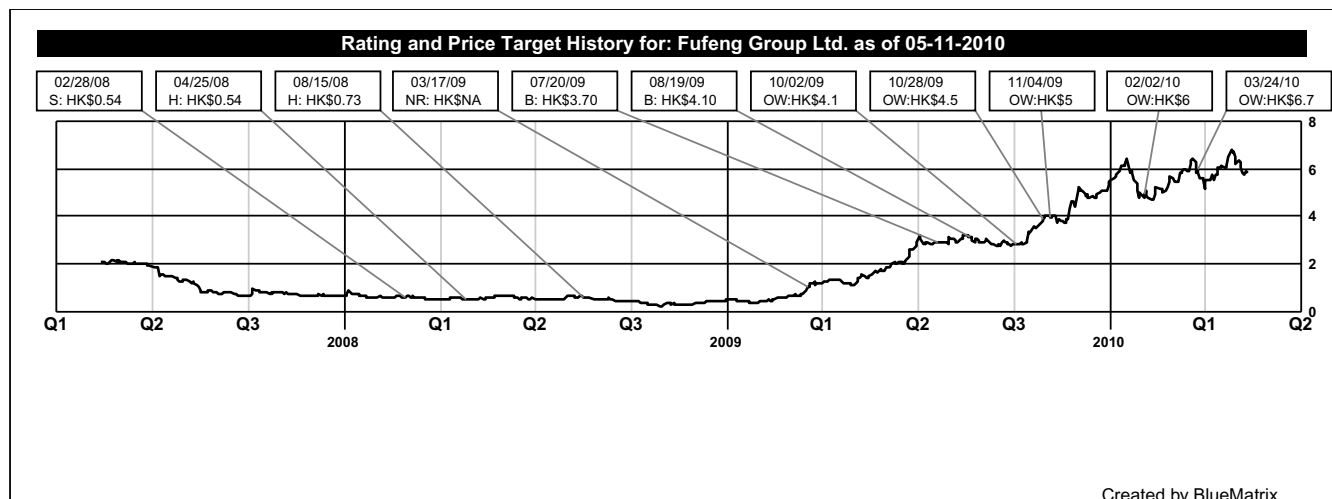
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Cash flow Statement

5/12/2010

Year ending Dec (RMB mil)	2008A	2009A	2010E	2011E	2012E
Operating					
EBIT	368	1,049	1,253	1,633	1,787
Depreciation	153	190	239	282	307
Amortization	2	3	3	3	3
Decrease/(increase) in working capital	77	-72	-76	-75	-26
Total operating cashflow	599	1,171	1,419	1,842	2,070
Investing					
Capex	-579	-756	-1,200	-500	-500
Total investing	-579	-756	-1,200	-500	-500
Financing					
Interest charges	-43	-25	-71	-38	-33
Share issues/exercise of warrants	0	0	0	0	0
Dividends received/(paid)	0	-293	-385	-421	-542
Tax paid	-31	-95	-130	-239	-351
Others	92	90	3	-2	-2
Total financing	18	-324	-583	-700	-928
Net cash flow	39	91	-364	642	642
Net cash/(debt) at beginning	-359	-320	-229	-593	49
Net cash/(debt) at end	-320	-229	-593	49	691
Ratio analysis					
	2008A	2009A	2010E	2011E	2012E
P/B (x)	4.9	3.6	2.8	2.1	1.8
ROE (%)	16.9	38.8	34.4	33.9	28.9
Inventory days	44	62	68	70	70
Receivable days	56	54	54	54	54
Payable days	110	129	129	129	129
Current ratio (x)	3.3	5.4	2.0	2.9	2.7
Quick ratio (x)	3.0	5.1	1.5	2.3	2.2
Asset equity(x)	1.9	1.8	2.0	1.8	1.5
EBITDA/interest expense(x)	12	49	21	50	64

Important Research Disclosures



Notes: The boxes on the Rating and Price Target History chart above indicate the date of the Research Note, the rating, and the price target. Each box represents a date on which an analyst made a change to a rating or price target, except for the first box, which may only represent the first Note written during the past three years.

Legend:

I: Initiating Coverage

R: Resuming Coverage

T: Transferring Coverage

D: Discontinuing Coverage

S: Suspending Coverage

OW: Overweight

N: Neutral

UW: Underweight

B: Buy (Piper Jaffray discontinued use of the B, N, and S ratings on June 30, 2009)

N: Neutral

S: Sell

OP: Outperform (Piper Jaffray discontinued use of the OP, MP and UP ratings on November 15, 2007)

MP: Market Perform

UP: Underperform

AL On/AL Off: Placed on/removed from the Alpha List maintained by Piper Jaffray (AL use discontinued March 2010)

NA: Not Available

UR: Under Review

Distribution of Ratings/IB Services Piper Jaffray				
Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
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SELL [UW]	70	10.40	1	1.43

Note: Distribution of Ratings/IB Services shows the number of companies currently in each rating category from which Piper Jaffray and its affiliates received compensation for investment banking services within the past 12 months. FINRA rules require disclosure of which ratings most closely correspond with "buy," "hold," and "sell" recommendations. Piper Jaffray ratings are not the equivalent of buy, hold or sell, but instead represent recommended relative weightings. Nevertheless, Overweight corresponds most closely with buy, Neutral with hold and Underweight with sell. See Stock Rating definitions below.

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