

16 August 2010

Produced by: The Royal Bank of Scotland N.V., (Hong Kong) Branch

# Fufeng Group

## Expansion into consumer pack MSG

### Buy

**Target price**  
HK\$7.10 (from HK\$7.10)

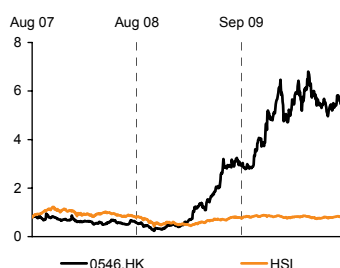
**Price**  
HK\$5.48

**Short term (0-60 days)**  
n/a

**Market view**  
Underweight

### Price performance

	(1M)	(3M)	(12M)
Price (HK\$)	5.33	5.99	3.21
Absolute (%)	2.8	-8.5	70.7
Rel market (%)	-1.4	-12.7	68.9
Rel sector (%)	1.3	-12.7	45.0



**Market capitalisation**  
HK\$9.10bn (US\$1.17bn)

**Average (12M) daily turnover**  
HK\$24.30m (US\$3.12m)

Sector: BBG AP Food Prod & Proc  
RIC: 0546.HK, 546 HK  
Priced HK\$5.48 at close 16 Aug 2010.  
Source: Bloomberg

**Fufeng's earnings grew 30% yoy in 1H10 to Rmb460m, in line with both our forecasts and Bloomberg consensus. We have fine-tuned our earnings forecasts for FY10-12. Maintain Buy, HK\$7.10 target price.**

### Key forecasts

	FY08A	FY09A	FY10F	FY11F	FY12F
Revenue (Rmbm)	3,585	4,633	6,608	8,286	10,457
EBITDA (Rmbm)	520.7	1,241	1,450	1,701	2,259
Reported net profit (Rmbm)	294.7	928.3	1,030	1,141	1,499
Normalised net profit (Rmbm) <sup>1</sup>	294.7	928.3	1,030	1,141	1,499
Normalised EPS	0.18	0.56	0.56	0.63	0.82
Dividend per share	0.01	0.22	0.25	0.27	0.36
Dividend yield (%)	0.21	4.59	5.17	5.73	7.53
Normalised PE (x)	27.00	8.58	8.50	7.67	5.84
EV/EBITDA (x)	16.00	6.62	6.03	4.98	3.48
Price/book value (x)	4.57	3.33	2.86	2.31	1.81
ROIC (%)	14.80	37.30	33.60	26.60	32.70

1. Post-goodwill amortisation and pre-exceptional items  
Accounting standard: Local GAAP  
Source: Company data, RBS forecasts

year to Dec, fully diluted

### MSG margin likely to improve hoh in 2H10

Total revenue grew 45.4% yoy in 1H10 to Rmb2,988m, slightly better than our estimate. The ASP of MSG was Rmb7,821/tonne in 2Q10, up 9.5% from Rmb7,140/tonne in 1Q, leading to a gross margin of 23.8% for the MSG segment, vs 21.6% in 1Q. The corn price was up 6.6% qoq to Rmb1,753/tonne in 2Q, and remained at this level in July. Management is guiding for a mom increase of 2-5% in the MSG selling price in August. We expect the segment's gross margin to rise hoh in 2H, owing to the rising ASP and a high corn cost base in 2H09.

### Good performance in the xanthan gum segment

Fufeng gained market share in the xanthan gum segment, with revenue growth of 105.2% yoy in 1H10. Gross margin also improved to 42.1% in 2Q from 35.4% in 1Q and 36.5% in FY09, driven by improved economies of scale and a low cost base for the company's new xanthan gum project in Inner Mongolia (that was completed in April this year). Fufeng should continue to gain market share in the segment, with the new capacity reaching full utilisation in 2H10.

### Expansion into branded MSG

In 1H10, Fufeng successfully expanded its own brand (Uo Fresh) of MSG consumer packs and chicken powder products (both launched at end-2009), having entered more than 2,000 supermarkets and retail stores. Consumer pack MSG sales volume in 1H10 was 10,000 tonnes, or 4% of the company's total MSG volume. Fufeng is targeting sales of 100,000 tonnes, or 14% of its guided total MSG volume by FY12.

### We maintain our Buy rating and our HK\$7.10 DCF-based target price

We maintain Buy for improving market shares of both MSG and xanthan gum and the apparently cheap valuation: PEs of 8.5x FY10F and 7.7x FY11F, with dividend yield of 5.2% in FY10F and 5.7% in FY11F. Our target price implies 30% potential upside and an FY11F PE of 9.9x.

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Important disclosures can be found in the Disclosures Appendix.

# Expansion into consumer pack MSG

## 1H10 revenue was slightly better than our estimate

Fufeng's reported net profit for 1H10 increased 30% yoy to Rmb460m. This was in line with both our estimates and Bloomberg consensus. Basic EPS and diluted EPS were Rmb0.28/share and Rmb0.26/share, respectively. Headline earnings accounted for 44.7% of our earnings forecast for the full year.

Revenue in 1H10 rose 45.4% yoy to Rmb2,988m, which was slightly better than our estimate mainly due to better volume growth for xanthan gum (up 127.5% yoy). Revenue from xanthan gum increased 105.2% yoy to Rmb381m, accounting for 12.8% of total revenue in 1H10 (vs 9.0% in 1H09 and 8.8% in FY09). The strong sales were backed by rising demand as the global economy recovered.

In the MSG segment, revenue rose 94.7% yoy to Rmb1,763m, accounting for 59.0% of total revenue in 1H10 (vs 44.1% in 1H09 and 48.5% in FY09), largely driven by capacity expansion in December 2009. Sales of fertilisers decreased 18.5% yoy to Rmb152m, mainly due to over-capacity in China's fertiliser industry. Fertiliser capacity utilisation fell 12.4ppt yoy to 81.6% in 1H10 and the ASP also dropped 11.6% yoy to Rmb762/tonne.

**Table 1 : Fufeng 1H10 results review**

(Rmbm)	1H10	1H09	Change	2H10F	2H09	Change	FY10F	FY09	Change
<b>Turnover</b>									
Glutamic acid	97	423	-77.2%	151	297	-49.3%	247	721	-65.7%
MSG	1763	906	94.7%	2147	1340	60.3%	3910	2245	74.1%
Fertilisers	152	187	-18.5%	145	174	-16.6%	298	361	-17.6%
Xanthan gum	381	186	105.2%	437	222	96.6%	818	408	100.5%
Starch sweeteners	177	95	86.2%	233	150	55.0%	410	245	67.1%
Others – corn refined products	418	259	61.5%	507	393	28.8%	924	652	41.8%
<b>Total turnover</b>	<b>2988</b>	<b>2055</b>	<b>45.4%</b>	<b>3620</b>	<b>2578</b>	<b>40.4%</b>	<b>6608</b>	<b>4633</b>	<b>42.6%</b>
Cost of sales	(2246)	(1478)	51.9%	(2715)	(1755)	54.7%	(4961)	(3233)	53.4%
<b>Gross profit</b>	<b>742</b>	<b>577</b>	<b>28.6%</b>	<b>905</b>	<b>823</b>	<b>10.0%</b>	<b>1647</b>	<b>1400</b>	<b>17.7%</b>
<i>Gross margin</i>	<i>25%</i>	<i>28.1%</i>	<i>-3.2%</i>	<i>25%</i>	<i>31.9%</i>	<i>-6.9%</i>	<i>24.9%</i>	<i>30.2%</i>	<i>-5.3%</i>
Other operating income	62	23	165.3%	16	39	-59.8%	78	62	24.4%
Distribution costs	(122)	(96)	26.9%	(159)	(120)	33.2%	(281)	(216)	30.4%
<i>Distribution costs as a % of net sales</i>	<i>4.1%</i>	<i>4.7%</i>	<i>-0.6%</i>	<i>4.4%</i>	<i>4.6%</i>	<i>-0.2%</i>	<i>4.3%</i>	<i>4.7%</i>	<i>-0.4%</i>
General and administrative expenses	(136)	(87)	57.3%	(115)	(108)	6.4%	(252)	(195)	29.1%
<i>G &amp; A expenses as a % of net sales</i>	<i>4.6%</i>	<i>4.2%</i>	<i>0.3%</i>	<i>3.2%</i>	<i>4.2%</i>	<i>-1.0%</i>	<i>3.8%</i>	<i>4.2%</i>	<i>-0.4%</i>
Other operating expenses	(6)	(17)	-66.3%	2	13	-88.5%	(4)	(4)	5.0%
<b>Operating profit</b>	<b>540</b>	<b>400</b>	<b>34.8%</b>	<b>648</b>	<b>647</b>	<b>0.1%</b>	<b>1187</b>	<b>1047</b>	<b>13.4%</b>
<i>Operating margin</i>	<i>18%</i>	<i>19%</i>	<i>-1.4%</i>	<i>18%</i>	<i>25%</i>	<i>-7.2%</i>	<i>18%</i>	<i>23%</i>	<i>-4.6%</i>
Share of profits of associates	0	0	NA	0	0	NA	0	0	NA
Interest income	1	1	45.7%	3	1	311.7%	4	2	166.3%
Interest expenses	(28)	(14)	109.7%	(19)	(12)	61.6%	(47)	(25)	87.4%
<b>Profit before tax</b>	<b>513</b>	<b>388</b>	<b>32.2%</b>	<b>631</b>	<b>636</b>	<b>-0.7%</b>	<b>1144</b>	<b>1024</b>	<b>11.8%</b>
Tax	(53)	(34)	55.6%	(62)	(61)	0.4%	(114)	(95)	20.0%
Minority interest	0	0	NA	0	0	NA	0	0	NA
<b>Net profit</b>	<b>460</b>	<b>354</b>	<b>30.0%</b>	<b>570</b>	<b>574</b>	<b>-0.8%</b>	<b>1030</b>	<b>928</b>	<b>10.9%</b>
<i>Pre-tax margin</i>	<i>17%</i>	<i>19%</i>	<i>-1.7%</i>	<i>17%</i>	<i>25%</i>	<i>-7.2%</i>	<i>17%</i>	<i>22%</i>	<i>-4.8%</i>
<i>Net margin</i>	<i>15%</i>	<i>17%</i>	<i>-1.8%</i>	<i>16%</i>	<i>22%</i>	<i>-6.5%</i>	<i>16%</i>	<i>20%</i>	<i>-4.5%</i>
<i>Effective tax rate</i>	<i>10%</i>	<i>9%</i>	<i>1.5%</i>	<i>10%</i>	<i>10%</i>	<i>0.1%</i>	<i>10%</i>	<i>9%</i>	<i>0.7%</i>
<b>Basic EPS (Rmb/share)</b>	<b>0.28</b>	<b>0.21</b>	<b>30.0%</b>	<b>0.34</b>	<b>0.35</b>	<b>-1.1%</b>	<b>0.62</b>	<b>0.56</b>	<b>10.8%</b>
<b>Diluted EPS (Rmb/share)</b>	<b>0.26</b>	<b>0.21</b>	<b>22.9%</b>	<b>0.30</b>	<b>0.35</b>	<b>-12.9%</b>	<b>0.56</b>	<b>0.56</b>	<b>0.7%</b>

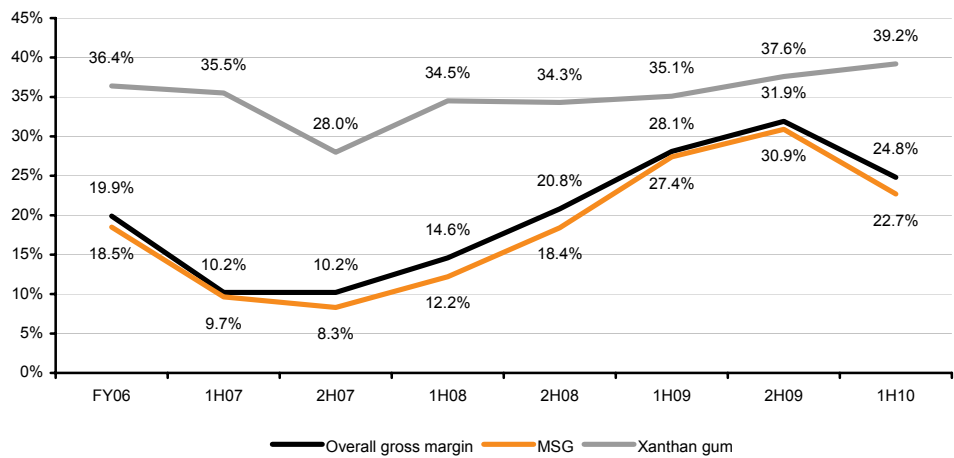
Source: Company data, RBS forecasts

## Gross margin was slightly below our expectation in 1H10

Fufeng's overall gross margin contracted 3.2ppt yoy to 24.8%, which was slightly below our estimate mainly because of surging corn costs. The average corn price rose 32.5% yoy in 1H10, resulting in a drop in the gross margin for the MSG segment of 4.7pp yoy to 22.7%. The ASP for MSG increased by just 8.8% yoy in 1H10, as Fufeng wants to squeeze out the smaller players from the market and gain market share. Management is guiding for an increase in the MSG selling

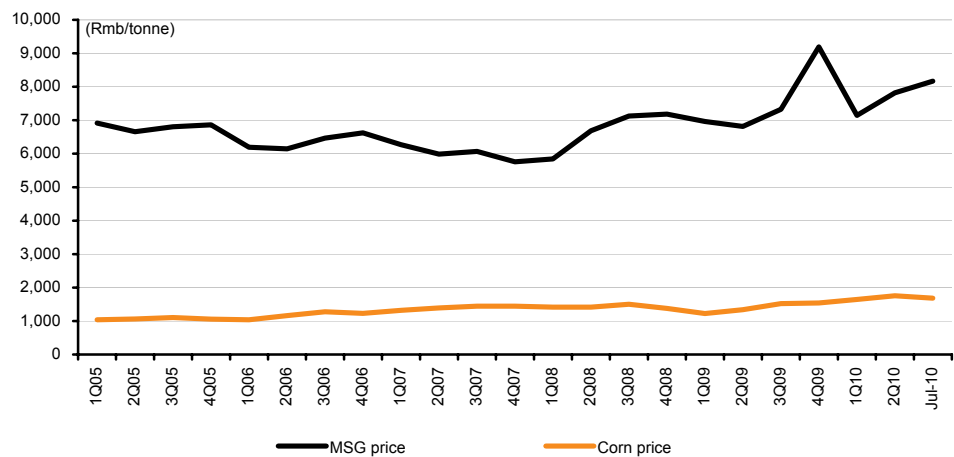
price of 2-5% mom in August. We expect MSG gross margin to improve hoh in 2H10, because of the increasing ASP and a high corn cost base in 2H09. Margin for xanthan gum improved 4.1ppt yoy to 39.2% in 1H10, as a result of low costs at the Inner Mongolia plant (that was completed in December 2009).

**Chart 1 : Gross margin trend**



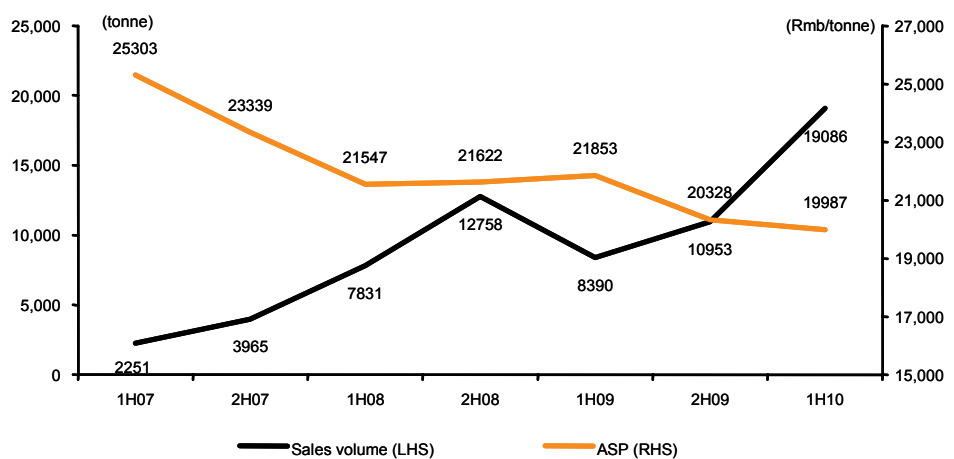
Source: Company data

**Chart 2 : MSG prices vs corn prices**



Source: Company data

**Chart 3 : Xanthan gum sales volume and ASP**



Source: Company data

### Capacity expansion on track

Fufeng completed a 40,000 tonne sweetener project (a 30% increase from the company's effective end-FY09 capacity), a 12,000 tonne xanthan gum project (a 19% increase), and a new 5,000 tonne fructose project on time in 1H10. The company plans to raise its effective MSG capacity by 77% in FY10 and 19% in FY11, as its new factories in Inner Mongolia (completed in December 2009) and northeast China (due to be completed in June 2011) start to contribute. In 2H10, Fufeng also plans to build a new fructose project with a capacity of 5,000 tonnes.

**Table 2 : Projects under development in 2010-11**

Project	Capacity	Completion/expected completion
<b>1H10</b>		
Technical transformation of starch sweeteners	40,000 tonnes	1Q10
Threonine	5,000 tonnes	Mar-10
Fructose	5,000 tonnes	Jun-10
Branched chain amino acid	Proline: 500 tonnes Valine: 400 tonnes Isoleucine: 200 tonnes	Jun-10
Phase III of xanthan gum	12,000 tonnes	Jun-10
<b>2H10</b>		
Threonine	5,000 tonnes	2H10
Synthetic ammonia project at Inner Mongolia plant	100,000 tonnes	2H10
<b>FY11</b>		
Northeast plant	MSG: 200,000 tonnes	2H11

Source: Company data

### Maintaining Buy with a HK\$7.10 target price

We maintain Buy for Fufeng's improving market shares in both MSG and xanthan gum and the stock's apparently cheap valuation. We now expect Fufeng's earnings to grow 11% yoy in both FY10 and FY11. Our DCF-based target price of HK\$7.10 implies 30% potential upside and a target FY11 PE of 9.9x. The current PEs of 8.5x FY10F and 7.7x FY11F, with dividend yield of 5.2% in FY10F and 5.7% in FY11F, seem undemanding to us.

**Table 3 : Earnings revisions**

	FY10F			FY11F			FY12F		
	Old	New	% change	Old	New	% change	Old	New	% change
Revenue (Rmbm)	6,476	6,608	2.0%	8,228	8,286	0.7%	10,407	10,457	0.5%
Gross margin (%)	25.4%	24.9%	-0.5%	22.8%	22.6%	-0.2%	24.0%	23.8%	-0.1%
Operating margin (%)	18.3%	18.0%	-0.3%	16.5%	16.4%	0.0%	17.9%	17.9%	0.1%
Reported net profit (Rmbm)	1,028	1,030	0.1%	1,136	1,141	0.5%	1,486	1,499	0.9%

Source: RBS forecasts

Our FY10 earnings estimates are in line with Bloomberg consensus, while our FY11 and FY12 earnings forecasts are 12.3% and 8.0% lower. We think this is mainly due to our more conservative assumption on gross margins, as we assume that new capacities in FY11 may temporarily weigh down on gross margins. However, we expect Fufeng's margin to revert to its normal level in FY12.

## Income statement

Rmbm	FY08A	FY09A	FY10F	FY11F	FY12F
Revenue	3585	4633	6608	8286	10457
Cost of sales	-2941	-3233	-4961	-6413	-7964
Operating costs	-123.7	-159.0	-197.1	-172.6	-234.1
<b>EBITDA</b>	<b>520.7</b>	<b>1241</b>	<b>1450</b>	<b>1701</b>	<b>2259</b>
DDA & Impairment (ex gw)	-154.8	-193.3	-262.4	-337.8	-386.2
<b>EBITA</b>	<b>365.9</b>	<b>1047</b>	<b>1187</b>	<b>1363</b>	<b>1873</b>
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
<b>EBIT</b>	<b>365.9</b>	<b>1047</b>	<b>1187</b>	<b>1363</b>	<b>1873</b>
Net interest	-40.5	-23.7	-43.3	-66.0	-67.2
Associates (pre-tax)	0.00	0.00	0.00	0.00	0.00
Forex gain / (loss)	n/a	n/a	n/a	n/a	n/a
Exceptionals (pre-tax)	0.00	0.00	0.00	0.00	0.00
Other pre-tax items	0.00	0.00	0.00	0.00	0.00
<b>Reported PTP</b>	<b>325.4</b>	<b>1024</b>	<b>1144</b>	<b>1297</b>	<b>1806</b>
Taxation	-30.7	-95.3	-114.4	-155.6	-307.0
Minority interests	n/a	n/a	n/a	n/a	n/a
Exceptionals (post-tax)	n/a	n/a	n/a	n/a	n/a
Other post-tax items	0.00	0.00	0.00	0.00	0.00
<b>Reported net profit</b>	<b>294.7</b>	<b>928.3</b>	<b>1030</b>	<b>1141</b>	<b>1499</b>
Normalised Items Excl. GW	0.00	0.00	0.00	0.00	0.00
<b>Normalised net profit</b>	<b>294.7</b>	<b>928.3</b>	<b>1030</b>	<b>1141</b>	<b>1499</b>

Source: Company data, RBS forecasts

year to Dec

## Balance sheet

Rmbm	FY08A	FY09A	FY10F	FY11F	FY12F
Cash & market secs (1)	224.7	342.7	818.3	1141	1803
Other current assets	950.2	1265	1788	2211	2740
Tangible fixed assets	1955	2508	3449	3740	3932
Intang assets (incl gw)	n/a	n/a	n/a	n/a	n/a
Oth non-curr assets	132.8	145.3	152.1	158.8	165.2
<b>Total assets</b>	<b>3262</b>	<b>4261</b>	<b>6207</b>	<b>7251</b>	<b>8641</b>
Short term debt (2)	276.0	418.0	318.0	368.0	418.0
Trade & oth current liab	894.2	1154	1431	1696	1993
Long term debt (3)	312.0	180.0	260.0	260.0	260.0
Oth non-current liab	38.7	115.1	1140	1140	1140
<b>Total liabilities</b>	<b>1521</b>	<b>1867</b>	<b>3149</b>	<b>3464</b>	<b>3811</b>
Total equity (incl min)	1742	2394	3058	3787	4830
<b>Total liab &amp; sh equity</b>	<b>3262</b>	<b>4261</b>	<b>6207</b>	<b>7251</b>	<b>8641</b>
Net debt	363.3	255.3	784.7	511.6	-100.1

Source: Company data, RBS forecasts

year ended Dec

## Cash flow statement

Rmbm	FY08A	FY09A	FY10F	FY11F	FY12F
EBITDA	520.7	1241	1450	1701	2259
Change in working capital	-2.23	-590.7	-245.9	-159.0	-231.9
Net interest (pd) / rec	-42.7	-25.3	-47.3	-70.0	-72.2
Taxes paid	-18.2	-25.1	-114.4	-155.6	-307.0
Other oper cash items	-8.62	-13.5	0.00	0.00	0.00
<b>Cash flow from ops (1)</b>	<b>448.9</b>	<b>586.2</b>	<b>1042</b>	<b>1316</b>	<b>1648</b>
Capex (2)	-355.6	-217.8	-1200	-625.0	-575.0
Disposals/(acquisitions)	1.02	4.31	0.00	0.00	0.00
Other investing cash flow	-44.7	-9.30	-6.00	-6.00	-5.00
<b>Cash flow from invest (3)</b>	<b>-399.3</b>	<b>-222.7</b>	<b>-1206</b>	<b>-631.0</b>	<b>-580.0</b>
Incr / (decr) in equity	0.00	0.00	0.00	0.00	0.00
Incr / (decr) in debt	-60.3	10.0	1005	50.0	50.0
Ordinary dividend paid	-13.5	-292.7	-365.7	-411.9	-456.5
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	20.1	37.2	0.00	0.00	0.00
<b>Cash flow from fin (5)</b>	<b>-53.8</b>	<b>-245.5</b>	<b>639.4</b>	<b>-361.9</b>	<b>-406.5</b>
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
<b>Inc/(decr) cash (1+3+5+6)</b>	<b>-4.14</b>	<b>118.0</b>	<b>475.6</b>	<b>323.1</b>	<b>661.7</b>
Equity FCF (1+2+4)	93.3	368.4	-157.8	691.0	1073

Lines in bold can be derived from the immediately preceding lines.  
Source: Company data, RBS forecasts

year to Dec

Standard ratios	Fufeng					China Agri-Industries			China Yurun Food Group		
Performance	FY08A	FY09A	FY10F	FY11F	FY12F	FY10F	FY11F	FY12F	FY10F	FY11F	FY12F
Sales growth (%)	46.6	29.2	42.6	25.4	26.2	22.9	25.7	25.0	42.0	30.2	21.4
EBITDA growth (%)	228.9	138.3	16.9	17.3	32.9	55.4	22.8	16.8	33.8	33.5	23.0
EBIT growth (%)	825.7	186.2	13.4	14.8	37.4	69.3	19.8	16.5	33.9	33.3	23.6
Normalised EPS growth (%)	12706	215.0	0.86	10.8	31.4	35.7	16.6	14.3	29.0	32.2	25.8
EBITDA margin (%)	14.5	26.8	21.9	20.5	21.6	8.23	8.05	7.52	10.6	10.9	11.0
EBIT margin (%)	10.2	22.6	18.0	16.4	17.9	6.84	6.52	6.08	9.57	9.80	9.98
Net profit margin (%)	8.22	20.0	15.6	13.8	14.3	5.15	4.77	4.37	7.84	7.96	8.25
Return on avg assets (%)	10.6	25.2	20.3	17.7	19.5	8.68	8.67	8.79	12.0	13.5	14.5
Return on avg equity (%)	18.5	44.9	37.8	33.3	34.8	15.3	14.9	15.1	17.1	19.2	20.5
ROIC (%)	14.8	37.3	33.6	26.6	32.7	12.1	10.7	10.5	18.3	18.6	19.5
ROIC - WACC (%)	2.55	25.0	21.3	14.3	20.4	3.78	2.32	2.20	7.43	7.80	8.67
	year to Dec					year to Dec			year to Dec		
Valuation	FY08A	FY09A	FY10F	FY11F	FY12F	FY08A	FY09A	FY10F	FY11F	FY12F	FY12F
EV/sales (x)	2.32	1.77	1.32	1.02	0.75	0.95	0.81	0.68	2.21	1.71	1.39
EV/EBITDA (x)	16.0	6.62	6.03	4.98	3.48	11.6	10.0	9.07	20.9	15.7	12.6
EV/EBITDA @ tgt price (x)	20.5	8.52	7.66	6.37	4.52	12.6	10.8	9.76	22.6	17.0	13.6
EV/EBIT (x)	22.8	7.85	7.37	6.22	4.20	14.0	12.4	11.2	23.1	17.4	13.9
EV/invested capital (x)	3.96	3.10	2.28	1.97	1.66	1.46	1.33	1.22	3.69	3.16	2.82
Price/book value (x)	4.57	3.33	2.86	2.31	1.81	1.93	1.71	1.52	4.47	3.77	3.21
Equity FCF yield (%)	1.17	4.63	-1.80	7.89	12.3	-15.8	-4.94	-4.46	-1.69	0.65	2.70
Normalised PE (x)	27.0	8.58	8.50	7.67	5.84	14.2	12.2	10.7	28.2	21.3	16.9
Norm PE @tgt price (x)	35.0	11.1	11.0	9.94	7.57	15.8	13.6	11.9	30.5	23.1	18.4
Dividend yield (%)	0.21	4.59	5.17	5.73	7.53	1.75	2.04	2.34	1.22	1.55	1.77
	year to Dec					year to Dec			year to Dec		
Per share data	FY08A	FY09A	FY10F	FY11F	FY12F	Solvency	FY08A	FY09A	FY10F	FY11F	FY12F
Tot adj dil sh, ave (m)	1660	1660	1826	1826	1826	Net debt to equity (%)	20.9	10.7	25.7	13.5	-2.07
Reported EPS	0.18	0.56	0.56	0.63	0.82	Net debt to tot ass (%)	11.1	5.99	12.6	7.06	-1.16
Normalised EPS	0.18	0.56	0.56	0.63	0.82	Net debt to EBITDA	0.70	0.21	0.54	0.30	-0.04
Dividend per share	0.01	0.22	0.25	0.27	0.36	Current ratio (x)	1.00	1.02	1.49	1.62	1.88
Equity FCF per share	0.06	0.22	-0.09	0.38	0.59	Operating CF int cov (x)	12.0	25.2	25.4	22.0	28.1
Book value per sh	1.05	1.44	1.68	2.07	2.65	Dividend cover (x)	2.01	2.54	2.50	2.50	2.50
	year to Dec						year to Dec				

Priced as follows: 0546.HK - HK\$5.48; 0606.HK - HK\$9.96; 1068.HK - HK\$27.10  
Source: Company data, RBS forecasts

## Valuation methodology

Economic Profit Valuation			HK\$ m	%	Discounted Cash Flow Valuation			HK\$ m	%																																																																																																																																					
Adjusted Opening Invested Capital			4204.8	33	Value of Phase 1: Explicit (2010 to 2012)			1,646.1	13.0																																																																																																																																					
NPV of Economic Profit During Explicit Period			2009.6	16	Value of Phase 2: Value Driver (2013 to 2020)			5,413.1	42.8																																																																																																																																					
NPV of Econ Profit of Remaining Business (1, 2)			4245.1	33	Value of Phase 3: Fade (2021 to 2045)			5,166.6	40.9																																																																																																																																					
NPV of Econ Profit of Net Inv (Grth Business) (1, 3)			2241.2	18	Terminal Value			409.2	3.2																																																																																																																																					
Enterprise Value			12700.8	100	Enterprise Value			12,634.9	100.0																																																																																																																																					
Plus: Other Assets			0.0	0	FCF Grth Rate at end of Phs 1 implied by DCF Valuation				3.2																																																																																																																																					
Less: Minorities			0.0	0	FCF Grth Rate at end of Phs 1 implied by Current Price				0.6																																																																																																																																					
Less: Net Debt (as at 16 Aug 2010)			893.9	7	<b>Returns, WACC and NPV of Free Cash Flow</b> <table><caption>Returns, WACC and NPV of Free Cash Flow Data</caption><thead><tr><th>Year</th><th>Phase 1 NPV of FCF (RHS)</th><th>Phase 2 NPV of FCF (RHS)</th><th>Phase 3 NPV of FCF (RHS)</th><th>Growth Business ROIC</th><th>Remaining Business ROIC</th><th>WACC</th></tr></thead><tbody><tr><td>2010</td><td>20</td><td>120</td><td>0</td><td>20</td><td>20</td><td>6</td></tr><tr><td>2012</td><td>120</td><td>120</td><td>0</td><td>30</td><td>30</td><td>10</td></tr><tr><td>2014</td><td>80</td><td>100</td><td>0</td><td>30</td><td>30</td><td>10</td></tr><tr><td>2016</td><td>80</td><td>100</td><td>0</td><td>35</td><td>35</td><td>10</td></tr><tr><td>2018</td><td>90</td><td>110</td><td>0</td><td>40</td><td>40</td><td>10</td></tr><tr><td>2020</td><td>100</td><td>120</td><td>0</td><td>45</td><td>45</td><td>10</td></tr><tr><td>2022</td><td>90</td><td>110</td><td>0</td><td>40</td><td>40</td><td>10</td></tr><tr><td>2024</td><td>80</td><td>100</td><td>0</td><td>35</td><td>35</td><td>10</td></tr><tr><td>2026</td><td>70</td><td>90</td><td>0</td><td>30</td><td>30</td><td>10</td></tr><tr><td>2028</td><td>60</td><td>80</td><td>0</td><td>25</td><td>25</td><td>10</td></tr><tr><td>2030</td><td>50</td><td>70</td><td>0</td><td>20</td><td>20</td><td>10</td></tr><tr><td>2032</td><td>40</td><td>60</td><td>0</td><td>15</td><td>15</td><td>10</td></tr><tr><td>2034</td><td>30</td><td>50</td><td>0</td><td>10</td><td>10</td><td>10</td></tr><tr><td>2036</td><td>20</td><td>40</td><td>0</td><td>5</td><td>5</td><td>10</td></tr><tr><td>2038</td><td>10</td><td>30</td><td>0</td><td>0</td><td>0</td><td>10</td></tr><tr><td>2040</td><td>5</td><td>15</td><td>0</td><td>-5</td><td>-5</td><td>10</td></tr><tr><td>2042</td><td>0</td><td>5</td><td>0</td><td>-10</td><td>-10</td><td>10</td></tr><tr><td>2044</td><td>0</td><td>0</td><td>0</td><td>-15</td><td>-15</td><td>10</td></tr></tbody></table>					Year	Phase 1 NPV of FCF (RHS)	Phase 2 NPV of FCF (RHS)	Phase 3 NPV of FCF (RHS)	Growth Business ROIC	Remaining Business ROIC	WACC	2010	20	120	0	20	20	6	2012	120	120	0	30	30	10	2014	80	100	0	30	30	10	2016	80	100	0	35	35	10	2018	90	110	0	40	40	10	2020	100	120	0	45	45	10	2022	90	110	0	40	40	10	2024	80	100	0	35	35	10	2026	70	90	0	30	30	10	2028	60	80	0	25	25	10	2030	50	70	0	20	20	10	2032	40	60	0	15	15	10	2034	30	50	0	10	10	10	2036	20	40	0	5	5	10	2038	10	30	0	0	0	10	2040	5	15	0	-5	-5	10	2042	0	5	0	-10	-10	10	2044	0	0	0	-15	-15	10
Year	Phase 1 NPV of FCF (RHS)	Phase 2 NPV of FCF (RHS)	Phase 3 NPV of FCF (RHS)	Growth Business ROIC						Remaining Business ROIC	WACC																																																																																																																																			
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Equity Value			11806.9	93																																																																																																																																										
No. Shares (millions)			1660.0																																																																																																																																											
Per Share Equity Value			7.1																																																																																																																																											
FX Rate			1.0																																																																																																																																											
Per Share Equity Value (HK\$)			7.1																																																																																																																																											
Current Share Price (HK\$)			5.48																																																																																																																																											

Sensitivity Table		No of Years in Fade Period				
		15	18	20	23	25
WACC	8%	9.76	10.19	10.46	10.84	11.08
	9%	8.84	9.18	9.38	9.67	9.85
	10%	8.04	8.30	8.46	8.68	8.82
	11%	7.33	7.54	7.66	7.83	7.93
	12%	6.71	6.87	6.96	7.09	7.17

Performance Summary				Phase 2 Avg
	2010	2011	2012	(2013 - 2020)
Invested Capital Growth (%)	44.2	12.0	12.0	6.6
Operating Margin (%)	18.0	16.4	16.4	13.9
Capital Turnover (x)	2.4	2.1	2.1	2.2

Source: Company data, RBS forecasts

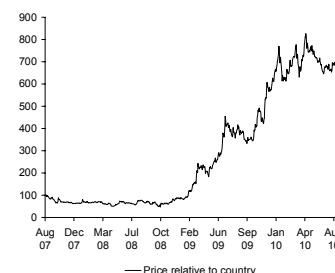
1. In periods following the Explicit Period i.e. Phase 2 and Phase 3
2. Remaining Business is defined as Capital as at the end of Phase 1 and capex = depreciation thereafter
3. Net Investment is defined as capex over and above depreciation after Phase 1

## Company description

Buy

Price relative to country

Fufeng, founded in 1999, is one of the leading vertically integrated manufacturers of corn-based biochemical products. By utilising fermentation and corn-processing technologies, the company produces glutamic acid, xanthan gum, MSG, starch sweeteners and fertilisers. According to the China Fermentation Industry Association, Fufeng was the largest glutamic acid producer and second-largest MSG producer in the PRC in terms of production volume in 2009 and the largest xanthan gum producer in the world. Fufeng began to expand further into downstream MSG production in 2008. In 2009, MSG accounted for 48% of total revenue, significantly up from 16% in 2006, while glutamic acid's contribution in total revenue decreased from 59% in 2006 to 16% in 2009.



## Strategic analysis

Average SWOT company score:

4

Revenue breakdown FY09

### Strengths

4

Fufeng's leading position in MSG and xanthan gum production will likely enhance its pricing power and will promote brand recognition. The company's vertically integrated business model helps to reduce production costs and increases productivity.

### Weaknesses

3

Fufeng may be vulnerable to a surge in corn and coal prices, as it purchases corn kernel and coal locally in the spot market. It may be unable to fully pass on increasing costs to customers.

### Opportunities

4

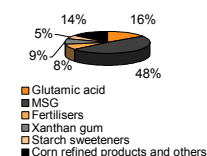
Demand for MSG should continue to grow, as China's expanding catering and food processing market benefits from strong growth in domestic consumption, rising disposable incomes and continuous urbanisation.

### Threats

3

Capacity expansions by competitors and new entrants may take some of Fufeng's market share, resulting in a price war or loss of pricing power for Fufeng.

Scoring range is 1-5 (high score is good)



Source: Company data

## Market data

### Headquarters

Suite 2207-9, Tower 2 Lippo Centre, 89 Queensway, Hong Kong.

### Website

www.furuigroup.com

### Shares in issue

1660.0m

### Free float

40%

### Majority shareholders

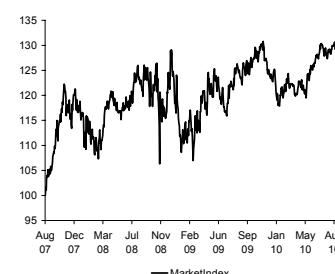
Li Xuechun, Chairman (47%)

## Country view: China

Country rel to Asia Pacific

Recent PMI and auto sales data show China's economy is heading for a slowdown, driven both by external and domestic demand moderations. We fear this will accelerate as price cuts in the property sector become prevalent. The market remains over-valued, in our view, and earnings downgrades will likely follow the Street's gradual lowering of GDP growth forecasts.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.



## Competitive position

Average competitive score:

4+

Broker recommendations

### Supplier power

4+

Fufeng has a vertically integrated business model. Its MSG production is secured by the in-house supply of glutamic acid.

### Barriers to entry

4+

Entry barriers for glutamic production are relatively high, due to capital requirements and strict environmental controls by the local government.

### Customer power

4+

Fufeng's leading market position should strengthen its pricing power and brand recognition.

### Substitute products

3+

There are few perfect substitutes, and products that use other agricultural raw materials face similar supply issues (ie, scarcity, price increases).

### Rivalry

4+

The market is relatively concentrated, with top three players - Meihua, Fufeng and Lianhua - having 35.6% of the MSG market and 51.2% of the glutamic acid market in China.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse



Source: Bloomberg



## Recommendation structure

Absolute performance, short term (trading) recommendation: A Trading Buy recommendation implies upside of 5% or more and a Trading Sell indicates downside of 5% or more. The trading recommendation time horizon is 0-60 days. For Australian coverage, a Trading Buy recommendation implies upside of 5% or more from the suggested entry price range, and a Trading Sell recommendation implies downside of 5% or more from the suggested entry price range. The trading recommendation time horizon is 0-60 days.

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and, except as follows, only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. For research produced by Nedbank Capital, a Buy implies upside in excess of 20%, a Sell implies an expected return less than 10%, and a Hold implies a return between 10% and 20%. For UK-based Investment Funds research, the recommendation structure is not based on upside/downside to the target price. Rather it is the subjective view of the analyst based on an assessment of the resources and track record of the fund management company. For research produced by Nedbank Capital and for research on Australian listed property trusts (LPT) or real estate investment trusts (REIT), the recommendation is based upon total return, ie, the estimated total return of capital gain, dividends and distributions received for any particular stock over the investment horizon.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

## Distribution of recommendations

The tables below show the distribution of recommendations (both long term and trading). The first column displays the distribution of recommendations globally and the second column shows the distribution for the region. Numbers in brackets show the percentage for each category where there is an investment banking relationship. These numbers include recommendations produced by third parties with which RBS has joint ventures or strategic alliances.

### Long term recommendations (as at 16 Aug 2010)

	Global total (IB%)	Asia Pacific total (IB%)
Buy	683 (0)	398 (0)
Add	0 (0)	0 (0)
Hold	414 (0)	231 (0)
Reduce	0 (0)	0 (0)
Sell	98 (0)	59 (0)
Total (IB%)	1195 (0)	688 (0)

Source: RBS

### Trading recommendations (as at 16 Aug 2010)

	Global total (IB%)	Asia Pacific total (IB%)
Trading Buy	2 (0)	2 (0)
Rec	00 (00)	00 (00)
Trading Sell	1 (0)	1 (0)
Total (IB%)	3 (0)	3 (0)

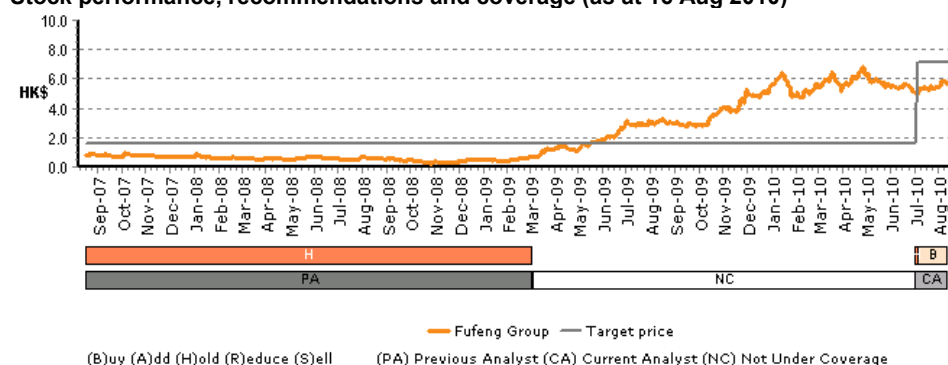
Source: RBS

## Valuation and risks to target price

**Fufeng Group (RIC: 0546.HK, Rec: Buy, CP: HK\$5.48, TP: HK\$7.10):** Key risks to our DCF-based target are: 1) a sudden increase in corn and coal prices, which may add pressure on gross margin; 2) more stringent environmental controls by the Chinese government, resulting in suspension of production or significant costs; 3) capacity expansion by competitors, who may take market share, leading to a price war or some loss of Fufeng's pricing power; 4) EPS dilution from a share placement in the event of a big acquisition; and 5) exercise of share options by senior management.

## Fufeng Group coverage data

### Stock performance, recommendations and coverage (as at 16 Aug 2010)



### Trading recommendation history (as at 16 Aug 2010)

Date	Rec	Analyst
	n/a	

Source: RBS

Lei Yang, CFA started covering this stock on 2 Jul 10

Source: RBS

## Regulatory disclosures

RBS was a lead manager of a public offering of securities for this company in the previous 12 months.: **0546.HK**

RBS beneficially own 1% or more of a class of common equity securities of this company.: **0546.HK**



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