

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:

Change in Earnings Forecast

Changes	Previous	Current
Rating	--	Overweight
Price Tgt (HK\$)	--	6.70
FY10E Rev (Rmb m)	6,939.00	6,346.00
FY11E Rev (Rmb m)	8,130.00	7,311.00
FY10E EPS (Rmb)	0.63	0.62
FY11E EPS (Rmb)	0.82	0.77
Price (HK\$):	5.48	
52 Week High (HK\$):	6.88	
52 Week Low (HK\$):	2.72	
12-Month Price Target (HK\$):	6.70	
(7.6x FY11E EPS of HK\$0.88)		
Shares Out (mil):	1,660.0	
Market Cap. (HK\$m):	9,096.8	
Market Cap. (US\$m):	1,170.2	
Free Float Market Cap (US\$m):	516.0	
Div (ann HK\$):	0.25	
Avg Daily Vol (000):	2644	
Book Value/Share (Rmb) :	1.8	
Net debt to equity :	21%	
Est LT EPS Growth :	15%	
P/E to LT EPS Growth (FY10):	0.5x	
Est Next Rep Date :	Nov 2010	
Fiscal Year End:	Dec	
Auditor:	PWC	
Rev (Rmb m)	FY09A	FY10E
H1	2,055.00A	2,988.00A
H2	2,578.00A	3,358.00E
FY	4,633.00A	6,346.00E
FY11E		7,311.00E
EPS (Rmb)	FY09A	FY10E
H1	0.21A	0.28A
H2	0.35A	0.35E
FY	0.56A	0.62E
FY P/E	8.6x	7.7x
		6.2x

Fufeng Group

阜丰集团

Overweight

(546 HK - HK\$5.48)

In-line 1H10; OW on Undemanding Valuation

CONCLUSION:

Fufeng's 1H10 net profit increased by 30% YoY to Rmb460mil, in line with our estimate. Profit margin was largely in line with our estimate, and a higher subsidy income has offset the impact of lower-than-expected fertilizer sales. Moreover, robust volume growth in core products (xanthan gum + 127%, MSG + 80%) have boosted our confidence in Fufeng's strategy in gaining market share. We reiterate OW and maintain our PT of HK\$ 6.7 (7.5X FY11E EPS of HK\$0.9) on an undemanding valuation of 6.2x FY11 P/E (27% discount to peers).

- 1H10 net profit up 30% YoY.** (1) Revenue was up 45% on strong sales volume growth in MSG and other by-products. Management estimates Fufeng's current global MSG market share at ~25%. (2) Due to higher corn cost (+32% YoY in 1H10), OPM dropped 1.4ppt to 18.1% (vs. our estimate of 17%). That said, ASP hikes and improvement in efficiency in 2Q10 have helped lift profit margins QoQ (GPM for 1Q/2Q10: 24%/25.6%). (3) Other income increased 161% YoY to Rmb63mil (12% of before-tax-profit) mainly thanks to a non-recurring subsidy income of Rmb25mil as a result of purchasing corn from government reserves. (4) A DPS of HK\$0.11 was declared for 1H10, representing ~35% payout ratio.
- MSG price trending up.** Mainly cost-driven, MSG ASP was up 5% QoQ to ~Rmb7,500 in 2Q after a sluggish 1Q. We believe the supply/demand will continue to stay balanced for at least FY10E and 1H11E as inefficient competitors are being shut down. According to Central Government's recent announcement, another 190,000 tpa (~8% of current capacity in China) of polluting MSG capacities will be shut down or forced to upgrade by Sep-10.

- Encouraging growth from xanthan gum (XG).** XG sales volume increased by 127% YoY to 19.1K tonnes, attributable to the global recovery of the oil-drilling market and promotions in both industrial and F&B markets. GPM/OPM also improved 4.1ppt/7.6ppt YoY to 39.2% and 35.3%, respectively, due to lower coal costs at the Inner Mongolian plant. We forecast sales volume to grow 81%/14% in FY10E/11E as utilization rate picks up and market gains continue on competitive pricing, with GPM remaining at 40% as an efficiency gain offsets cost and pricing pressures.

(Continued on page 2)

INVESTMENT RECOMMENDATION:

We maintain OW on Fufeng and our PT of HK\$ 6.7 (unchanged), which is based on 7.6x FY11E EPS of Rmb0.77/HK\$0.88 (previous: 9.4x FY10 EPS of HK\$ 0.72) after rolling forward our valuation to FY11E. Our target P/E is kept at a 7% discount to peers.

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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Growth drivers beyond FY10E. (1) Construction of a new plant with 200K MSG capacity commenced in May 2010. We believe this should increase the company's MSG capacity by 37% when it is due to be completed in 2H11. (2) In-house ammonia plant is expected be completed in 1Q11 and this should enhance MSG profit margins by 1-2ppt if fully utilized, based on our estimates. (3) New products, such as threonine (10K tpa capacity) and fructose (5K tpa) are currently in trial production and not considered in our current model. They may provide upside (+2%-3% to revenue) to our numbers.

Exhibit 1: 1H10 Results Highlights

Rmb mil	1H10A	1H09A	YoY	Our 1H10 estimates	Deviation
Revenue	2,988	2,055	45	3,253	-8
Gross profit	742	577	29	800	-7
Operating profit	541	401	35	553	-2
Net profit	460	354	30	461	0
EPS (Rmb)	0.277	0.213	30	0.278	0
Margins and ratio (%)	1H10A	1H09A	+/-ppt	Our 1H10 estimates	Deviation
Gross margin	24.8	28.1	-3.2	24.6	0.3
Operating margin	18.1	19.5	-1.4	17.0	1.1
Net margin	15.4	17.2	-1.8	14.2	1.2
Effective tax rate	10.3	8.7	1.5	11.0	-0.7
SG&A /Rev	8.8	9.7	-0.9	8.0	0.8

Sources: Company, Piper Jaffray Asia estimates

Exhibit 2: 1H10 Results by Segments

	1H10A	1H09A	YoY	2H09	HoH	2009A
MSG segment						
Glutamic acid sales (000 tonnes)	12	62	-81%	39	-69%	101
MSG sales (000 tonnes)	235	131	80%	162	46%	292
Sales (Rmb mil)	2,607	1,869	39%	2,355	11%	4,225
GPM (%)	22.7	27.4	-4.7ppt	28.5	-5.7ppt	28.0
OPM (%)	16.2	19.5	-3.2ppt	24.2	-8ppt	22.1
EBIT (Rmb mil)	423	365	16%	570	-26%	934
Xanthan gum						
Sales volume (000 tonnes)	19.1	8.4	127%	11.7	63%	19.3
Sales (Rmb mil)	381	186	105%	222	72%	408
GPM (%)	39.2	35.1	-4.1ppt	37.6	+1.6ppt	36.5
OPM (%)	35.3	27.7	+7.6ppt	38.0	-2.7ppt	33.3
EBIT (Rmb mil)	135	51	162%	85	60%	136

Source: Company

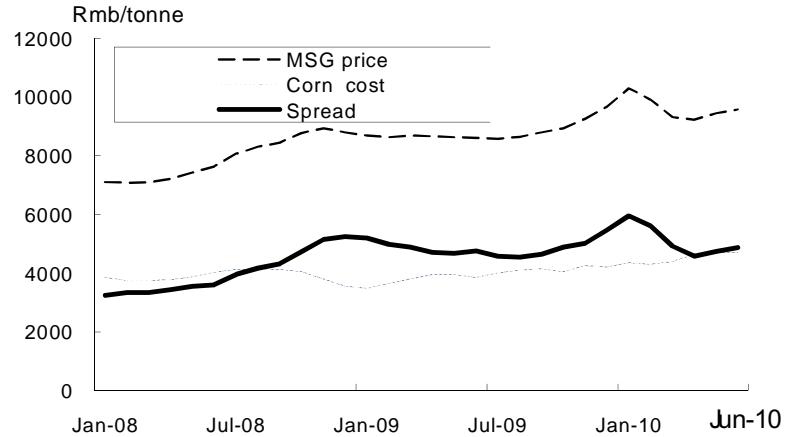
Exhibit 3: Quarterly Prices and Margin Trends

	Revenue (Rmb mil)			Volume (000 tonnes)			ASP (Rmb / tonne)		
	2Q10	2Q09	YoY %	2Q10	2Q09	YoY %	2Q10	2Q09	YoY %
MSG	941	471	100	120	63	91	7,844	7,493	5
Glutamic acid	33	238	-86	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Corn refined products	180	120	50	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Fertilizers	67	62	7	93	76	23	718	821	-13
Xanthan Gum	210	90	133	11	4	167	19,912	22,814	-13
	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	9	4	93	20,079	21,583	-7

Rmb mil	2Q10	2Q09	YoY	1Q10	QoQ
Revenue	1,557	1,050	48	1,431	9
MSG segment	1,347	960	40	1,259	7
XG segment	210	90	133	172	22
Gross profit	399	297	34	343	16
GPM (%)	2Q10	2Q09	+/-ppt	1Q10	+/-ppt
MSG segment	23.8	26.6	-2.8	21.6	2.2
XG segment	42.5	33.0	9.5	34.9	7.6
Average	25.6	28.3	-2.7	24.0	1.6

Sources: Company, Piper Jaffray Asia Securities estimates

Exhibit 4: China MSG (Export) Price Trend



Source: CEIC

Exhibit 5: Valuation Comparisons

China Corn processing	Bloomberg code	Mkt Cap (HK\$ mil)	Price 16/8/10	PER (x)		P/B(x)		ROE (%)		EPS growth (%)			OP margin (%)				
				FY09	FY10E	FY11E	FY09	FY10E	FY11E	FY09	FY10E	FY11E	FY09	FY10E	FY11E		
FUFENG GROUP LTD	546 hk	HK\$	9,097	5.48	8.6	7.6	6.2	3.4	2.6	34.5	33.0	215	14	23	22.6	19.9	21.2
Global Sweeteners	3889 HK	HK\$	1,724	1.50	19.0	8.3	7.1	1.0	0.9	5.1	10.1	-37	123	16	5.2	11.1	12.0
China New Borun	BORN US	USD	225	8.75	7.3	5.4	4.2	1.5	1.1	25.3	26.1	33	27	31	21.4	21.1	20.8
Global Bio-chem	809 HK	HK\$	3,107	1.34	13.4	8.9	7.4	0.4	0.4	6.2	6.9	-103	186	22	16.0	11.7	4.6
Xiwang Sugar	2088 HK	HK\$	2,128	2.20	17.7	8.4	7.7	1.1	0.8	12.4	12.3	75	106	9	6.9	14.0	13.4
China Starch	3838 HK	HK\$	4,913	0.85	30.7	16.5	15.8	n.a.	n.a.	n.a.	n.a.	86	4	4	n.a.	n.a.	n.a.
				Average	16.1	9.2	8.1	1.5	1.2	16.7	17.7	45	77	18	14.4	15.6	14.4
Int'l corn processors	Bloomberg code	Mkt Cap (HK\$ mil)	Price 16/8/10	PER (x)		P/B(x)		ROE (%)		EPS growth (%)			OP margin (%)				
Archers- Daniels	ADM US	USD	19,224	29.90	9.8	10.2	8.5	1.2	1.1	11.9	12.2	-2	9	19	3.7	3.8	4.1
Bunge	BG US	USD	7,571	53.97	192.8	16.1	9.0	0.8	0.8	4.5	7.2	50	59	78	2.2	2.5	2.9
Corn Products Int.	CPO US	USD	2,462	32.71	12.0	12.2	10.0	1.3	1.2	11.8	11.7	387	10	22	9.1	8.9	8.8
TATE & LYLE	TATE LN	GBp	1,951	418.60	99.7	10.2	8.5	1.8	1.7	18.2	19.1	1,148	9	19	9.3	9.9	9.3
				Average	78.5	12.2	9.0	1.3	1.2	11.6	12.5	396	22	35	6.1	6.3	6.2

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

Year ending Dec (RMB mil)	1H09A	2H09A	1H10A	2H10E	1H11E	2H11E	2007A	2008A	2009A	2010E	2011E	2012E
Volume (000 tonnes)												
Glutamic acid	62	39	12	0	0	0	179	163	101	12	0	0
MSG	131	162	235	260	270	335	92	146	292	495	605	755
Fertilizers	217	280	200	200	220	290	419	370	497	400	510	642
Xanthan gum	8	12	19	16	20	20	6	21	19	35	40	40
ASP (Rmb/ tonne)												
Glutamic acid	6,777	7,716	7,855	7,855	n.a.	n.a.	5,872	6,474	7,135	7,855	n.a.	n.a.
MSG	6,886	8,323	7,489	7,560	7,300	7,301	5,997	6,865	7,680	7,526	7,301	6,936
Fertilizers	862	623	762	688	720	757	467	1,026	727	750	800	800
Xanthan gum	24,265	19,023	19,500	20,160	19,500	20,500	24,049	21,941	21,099	19,800	20,000	20,000
ASP growth (%)												
Glutamic acid	12	7	16	2	n.a.	n.a.	-4	10	10	10	n.a.	n.a.
MSG	10	14	9	-9	-3	-3	-6	14	12	-2	-3	-5
Fertilizers	-15	-40	-12	11	-6	10	-14	120	-29	3	7	0
Xanthan gum	13	-14	-20	6	0	2	-9	-9	-4	-6	1	0
Glutamic acid	423	297	97	0	0	0	1,049	1,053	721	97	2	0
MSG	906	1,340	1,763	1,963	1,971	2,446	551	1,004	2,245	3,726	4,417	5,236
Fertilizers	187	174	152	138	158	220	196	380	361	290	378	466
Xanthan gum	186	222	372	321	390	410	149	452	408	693	800	800
Others	259	544	594	946	816	898	500	696	897	1,540	1,714	2,004
Revenue	2,055	2,578	2,988	3,358	3,335	3,975	2,446	3,585	4,633	6,346	7,311	8,507
Turnover growth (%)												
Cost of sales	26	32	45	30	12	4	37	47	29	37	15	16
-1,478	-1,755	-2,246	-2,375	-2,452	-2,869	-2,869	-2,196	-2,941	-3,233	-4,621	-5,321	-6,228
Gross Profit	577	823	742	983	884	1,106	250	644	1,400	1,725	1,990	2,278
Other income	24	40	63	4	40	61	76	44	64	67	101	113
Selling and marketing costs	-96	-120	-122	-174	-140	-166	-104	-166	-216	-295	-306	-356
Administrative expenses	-87	-108	-136	-117	-110	-143	-114	-142	-195	-253	-253	-279
Other operating expenses	-17	13	-6	0	-5	-1	-17	-12	-4	-6	-6	-6
Operating profit	401	648	541	696	669	856	91	368	1,049	1,237	1,525	1,750
Finance costs	-14	-12	-28	-42	-17	-17	-45	-43	-25	-71	-34	-27
Profit before tax	388	636	513	653	652	840	45	325	1,024	1,166	1,491	1,723
Taxation	-34	-61	-53	-76	-91	-118	0	-31	-95	-128	-209	-327
Profit attributable to shareholders	354	574	460	578	561	722	45	295	928	1,038	1,283	1,396
EPS (Rmb)	0.213	0.346	0.277	0.348	0.338	0.435	0.028	0.178	0.559	0.625	0.773	0.841
	1H09A	2H09A	1H10A	2H10E	1H10E	2H11E	2007A	2008A	2009A	2010E	2011E	2012E
Revenue breakdown												
Glutamic acid	21	12	3	0	0	0	43	29	16	2	0	0
MSG	44	52	59	58	59	62	23	28	48	59	60	62
Fertilizers	9	7	5	4	5	6	8	11	8	5	5	5
Xanthan gum	9	9	12	10	12	10	6	13	9	11	11	9
Sweeteners	5	6	6	4	5	4	3	5	5	5	4	4
Others	13	15	14	24	20	19	17	15	14	19	19	20
COGS breakdown(%)												
Corn kernels	52	57	56	57	58	57	55	46	55	59	59	62
Utilities	13	12	13	8	11	10	13	14	12	10	11	10
Other raw materials	12	14	10	13	10	9	22	19	13	12	10	8
Others	23	17	21	23	20	24	9	20	20	20	21	19
Gross margins(%)												
MSG segment	27.4	29.5	22.7	26.8	23.4	25.3	8.6	15.0	28.0	24.3	24.4	24.4
Xanthan gum	35.1	37.6	39.2	39.8	40.0	40.1	30.9	33.4	36.5	39.5	40.1	40.1
Company's average	28.1	31.9	24.8	29.3	26.5	27.8	10.2	18.0	30.2	27.2	27.2	26.8
SG&A as % of revenue	8.9	8.8	8.6	8.7	7.5	7.8	8.9	8.6	8.9	8.6	7.7	7.5
Operating margin(%)	19.5	25.1	18.1	20.7	20.0	21.5	3.7	10.3	22.6	19.5	20.9	20.6
Growth (%)												
Revenue	26	32	45	30	12	18	37	47	29	37	15	16
Net profit	312	175	30	1	22	25	(81)	554	215	12	24	9
Gross profit contribution (%)												
MSG segment	90	90	81	86	83	84	82	76	89	84	84	86
Xanthan gum	10	10	19	14	17	16	18	24	11	16	16	14
Effective tax rate	8.7	9.7	10.3	11.6	14.0	14.0	0.9	9.4	9.3	11.0	14.0	19.0

Source: Company, Piper Jaffray Asia Securities

Current disclosure information for this company can be found at <http://www.piperjaffray.com/researchdisclosures>.

Fufeng Group Limited (00546.HK)

Balance sheet

As of 31 December (RMB mil)	2008A	2009A	2010E	2011E	2012E	Jun-10
Current assets						
Inventories	356	551	888	1,024	1,191	556
Trade and other receivables	548	688	942	1,085	1,263	752
Amounts due from related parties	3	0	0	0	0	0
Restricted bank deposits	43	26	0	0	0	18
Cash & equivalent	225	343	422	888	1,559	1,087
	1,175	1,608	2,252	2,997	4,012	2,413
Non-current assets						
Property, plant and equipment	1,955	2,508	3,469	3,784	3,973	2,879
Leasehold payments	132	140	139	138	137	168
Others	0	5,162	0	0	0	2
	2,088	2,653	3,608	3,923	4,110	3,049
Total assets	3,262	4,261	5,860	6,920	8,122	5,462
Current liabilities						
Trade and other payables	888	1,140	1,630	1,877	2,197	1,225
Tax payable	0	14	14	14	14	5
Current portion of deferred income	7	0	0	0	0	0
Borrowings	276	418	0	0	0	388
Derivative financial instruments	0	0	0	0	0	0
	1,170	1,572	1,644	1,891	2,211	1,618
Non current liabilities						
Bank loans	312	180	50	0	0	50
CB	0	0	1,000	1,000	1,000	977
Deferred income tax liabilities	11	24	24	24	24	25
Deferred income	28	91	91	91	91	113
Amounts due to related parties	0	0	0	0	0	0
	351	295	1,165	1,115	1,115	1,165
Shareholders' funds	1,742	2,394	3,051	3,914	4,797	2,679
Total liabilities and equity	3,262	4,261	5,860	6,920	8,122	5,462
Net cash	-320	-229	-628	-112	559	-310
Net debt to equity (%)	18	10	21	3	net cash	12
BVPS (Rmb)	1.05	1.44	1.84	2.36	2.89	1.61

Source: Company, Piper Jaffray Asia Securities

Current disclosure information for this company can be found at <http://www.piperjaffray.com/researchdisclosures>.

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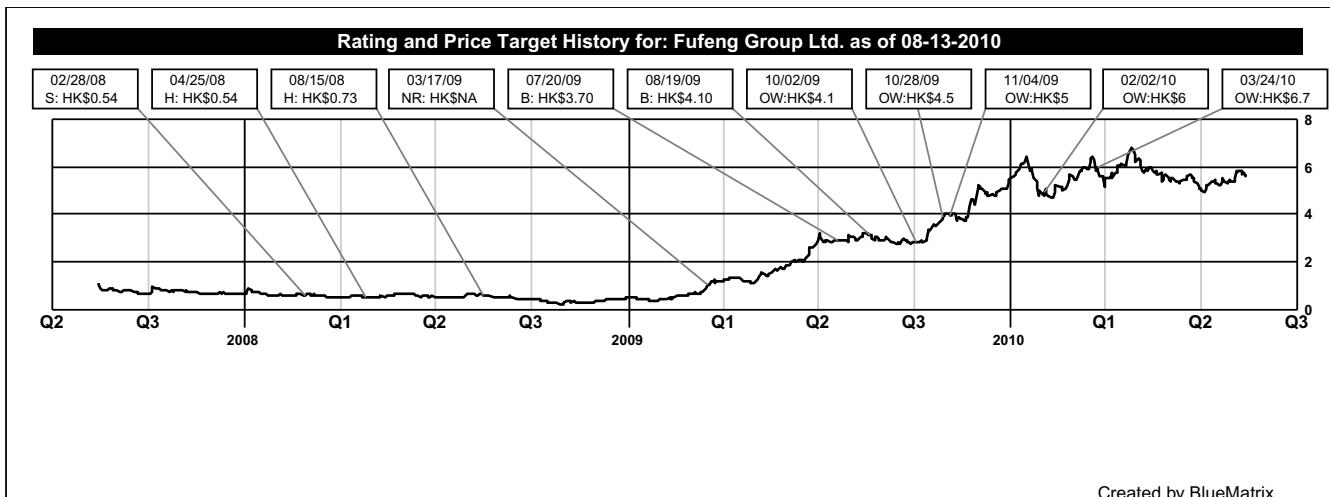
Cash flow Statement

Year ending Dec (RMB mil)	2008A	2009A	2010E	2011E	2012E
Operating					
EBIT	368	1,049	1,237	1,525	1,750
Depreciation	153	190	239	284	312
Amortization	2	3	3	3	3
Decrease/(increase) in working capital	77	-72	-102	-31	-25
Total operating cashflow	599	1,171	1,377	1,781	2,040
Investing					
Capex	-579	-756	-1,200	-600	-500
Total investing	-579	-756	-1,200	-600	-500
Financing					
Interest charges	-43	-25	-71	-34	-27
Share issues/exercise of warrants	0	0	0	0	0
Dividends received/(paid)	0	-293	-380	-420	-513
Tax paid	-31	-95	-128	-209	-327
Others	92	90	3	-2	-2
Total financing	18	-324	-576	-664	-869
Net cash flow	39	91	-399	516	671
Net cash/(debt) at beginning	-359	-320	-229	-628	-112
Net cash/(debt) at end	-320	-229	-628	-112	559

Ratio analysis

	2008A	2009A	2010E	2011E	2012E
P/B (x)	4.6	3.3	2.6	2.0	1.7
ROE (%)	16.9	38.8	34.0	32.8	29.1
Inventory days	44	62	70	70	70
Receivable days	56	54	54	54	54
Payable days	110	129	129	129	129
Current ratio (x)	3.3	5.4	1.9	2.7	3.6
Quick ratio (x)	3.0	5.1	1.4	2.1	3.1
Asset equity(x)	1.9	1.8	1.9	1.8	1.7
EBITDA/interest expense(x)	12	49	21	54	78

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

Rating	Count		Percent		IB Serv./Past 12 Mos.	
	Count	Percent	Count	Percent	Count	Percent
BUY [OW]	353	51.00	78	22.10		
HOLD [N]	274	39.60	22	8.03		
SELL [UW]	65	9.40	1	1.54		

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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Analyst Certification — Anson Chan, Sr Research Analyst

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- **Underweight (UW):** Anticipated to underperform relative to the median of the group of stocks covered by the analyst.

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