

## Light of Market Equilibrium

## BUY (unchanged)

### Financial summary

Year to Dec	07A	08A	09F	10F	11F
Turnover (RMBm)	2,445.73	585.34	568.45	457.46	603.9
Net Profit (RMBm)	45.1	294.7	758.4	464.1	789.2
EPS (RMB)	0.028	0.178	0.457	0.280	0.475
EPS Δ%	(86.0)	533.9	157.4	(38.8)	70.1
P/E (x)	126.7	20.0	7.8	12.7	7.5
P/B (x)	4.07	3.38	2.69	2.49	2.05
EV/EBITDA (x)	43.1	12.2	6.0	7.4	4.3
Yield (%)	0.2	2.5	7.7	4.7	8.0
ROE (%)	4.6	18.5	38.6	20.4	30.1
ROCE (%)	2.4	16.6	33.9	19.5	31.7
N. Gear. (%)	40.6	22.8	18.2	14.0	Cash

Source: SBI E2-Capital

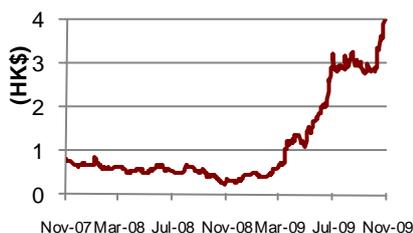
### Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	+36.3	+28.0	+659.8
Actual price changes (%)	+42.1	+30.6	+1025.0

	09F	10F	11F
Consensus EPS (RMB)	0.403	0.443	0.553
Previous forecasts (RMBm)	621.2	440.0	715.1
Previous EPS (RMB)	0.374	0.265	0.431

### Price Chart


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Ticker:	0546.HK	12 mth range:	HK\$0.28-4.10
Price:	HK\$4.05	Market cap:	US\$861.9m
Target:	HK\$4.86 (+20%)	Daily t/o, 3 mth:	US\$1.8m
		Free float %:	40.2%

### Key points:

- \* 250,000 tonne corn procurement from government approved with potential gain of RMB57.5m in 4Q.
- \* Sulphuric acid, ammonia and coal cost dropped in 3Q.
- \* MSG price driven by corn price.
- \* Earnings estimates penciled up 22.1% for FY12/09F.
- \* New target at HK\$4.86.
- \* Fair value at HK\$5.74 under new market-equilibrium scenario.

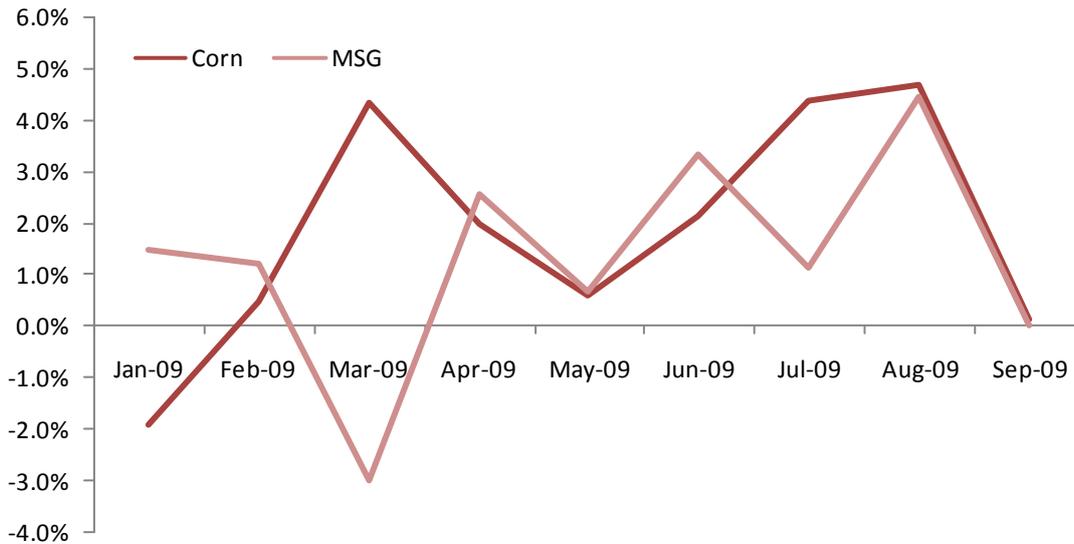
### Procurement from government to lock in corn cost in 4Q.

The company has received approval for procurement of 250,000 tonnes corn from the government. Purchase price is fixed at RMB1,570/tonne, which is ~RMB180 lower than the spot average in Jun-Oct. In addition, the central government offers subsidy at RMB150/tonne for the purchase, which will be shared by multiple parties including local government, warehouse/logistics operators and end-buyers. We estimate the potential gain will be as much as RMB230 per tonne or RMB57.5m in total for Fufeng.

**Other raw materials costs remain low.** Despite the gradual improving macros, most raw materials costs, surprisingly, dipped again in 3Q. According to our channel checking, the average price of sulphuric acid (1.3% of COGS), ammonia (10.0% of COGS) and coal (11.7% of COGS) dropped 40.0%, 8.0% and 1.8% QoQ, respectively, in 3Q, though soybean price edged up by 1.4%.

**Strengthening MSG price reflecting more balanced supply-demand.** MSG price has been moving up since beginning of the year. Reasons behind should include: 1) industry consolidation, which has somewhat curbed entire capacity expansion; 2) rising corn cost (50.7% of COGS), which increased from RMB1,273/tonne in Jan to RMB1,491/tonne in Oct. Although we have captured this trend in our estimates, the enhancement in MSG price is slightly ahead of our expectation (after adjusted to decline other raw materials costs), which partly suggests a batter-than-expected supply-demand balance at present. This fact could be a critical signal, in our view, as one of major investment themes towards Fufeng is the potential benefit from market consolidation, which will bring down the industry's profitability volatility, enabling participate yield a more steady profit flow.

Chart 1: MoM price movement



Source: Company data

**Earnings projection revised up to contain lower-than-expected cost.** Overall, we raise our FY12/09F earnings forecast for the counter by 22.1% to RMB759.4m. We remain our concern on the potential over-expansion of the industry on this stage, which might lead a new round of keen industry consolidation and squeeze gross margin in short term. Consequently, net profit in FY12/10F and FY12/11F has been lifted slightly by 5.5% and 10.4%, respectively, to RMB464.1m and RMB789.2m. The new DFCFE fair value is HK\$5.40 per share. After applying a 10.0% discount as valuation buffer, we get our new target at HK\$4.86.

**New scenario with potential fair value at HK\$5.74.** We re-iterate that our major theme towards Fufeng is its enhancing and stabilizing profitability following industry consolidation. We are cautious in our base-case scenario with concern on irrational capacity expansion encouraged by relatively high MSG price and low raw materials costs (excl. corn). Nevertheless, the recent price trend of MSG and corn likely suggests that the incremental cost has been largely transferred to end-consumers, i.e. supply-demand at equilibrium. In addition, according to our discussion with management, major glutamic acid capacity expansion industry wide includes only Fufeng's 70,000 tonne (complete in 2010) and Eppen's +100,000 tonnes (to complete by end-2010). Hence, it is possible that the MSG market in 2010 will be more stable than we expected in our base-case scenario. Accordingly, we have constructed a new market-equilibrium scenario, assuming gross margin industry wise will narrow moderately to a long-term sustainable level (8% in our assumption). Under this scenario, Fufeng will earn RMB735.9m in FY12/10F and RMB886.3m in FY12/11F. Its fair value, thus, will be HK\$5.74 per share.

**Table 1: P&L**

Year to Dec (RMBm)	07A	08A	09F	10F	11F
Turnover	2,445.7	3,585.3	4,568.4	5,457.4	6,603.9
Cost of sales	(2,196.0)	(2,941.0)	(3,301.3)	(4,384.4)	(5,001.0)
Gross profit	249.7	644.3	1,267.1	1,073.0	1,602.9
Other income	32.8	44.3	53.8	39.4	57.7
Selling and marketing expenses	(104.2)	(166.4)	(218.3)	(271.5)	(316.8)
Administrative expenses	(113.7)	(142.0)	(200.1)	(243.7)	(282.9)
Other operating expenses	(16.7)	(12.2)	(38.9)	(23.9)	(27.3)
Profit from operations	47.9	368.0	863.5	573.3	1,033.7
Interest income from IPO subscription deposits	42.8	0.0			
Finance costs	(45.2)	(42.7)	(28.9)	(46.4)	(57.0)
Profit before income tax	45.5	325.4	834.6	526.9	976.7
Income tax expenses	(0.4)	(30.7)	(76.2)	(62.8)	(187.5)
Profit for the period	45.1	294.7	758.4	464.1	789.2
Attributable to:					
Equity holders of the Company	45.1	294.7	758.4	464.1	789.2
Minority interests	0.0	0.0			
EPS - Basic (RMB)	0.028	0.178	0.457	0.280	0.475
EPS - Diluted (RMB)	0.028	0.178	0.457	0.280	0.475
Proposed DPS (RMB)	0.008	0.088	0.274	0.168	0.285
Proposed dividend	13.5	146.3	455.0	278.5	473.5

Source: SBI E2-Capital

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