

This is the good time

Not Rated

Financial summary

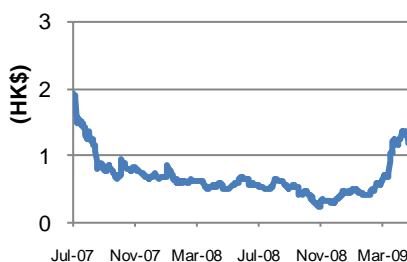
Year to Dec	06A	07A	08A
Turnover (RMBm)	1,787.2	2,445.7	3,585.3
Net Profit (RMBm)	240.5	45.1	294.6
EPS (RMB)	0.200	0.028	0.178
EPS Δ %		(86.0)	533.9
P/E (x)	5.3	38.2	6.0
P/B (x)	0.35	0.18	1.02
EV/EBITDA (x)	6.6	13.3	4.0
Yield (%)	0.0	0.8	9.3
ROE (%)	91.4	4.6	18.5
ROCE (%)	110.1	4.8	25.3
N. Gear. (%)	260.3	36.3	20.1

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	-2.4	+198.8	+295.8
Actual price changes (%)	-2.4	+198.8	+132.7

	09F	10F	11F
Consensus EPS (RMB)	0.120	n.a.	n.a.
Previous forecasts (RMBm)	n.a.	n.a.	n.a.
Previous EPS (RMB)	n.a.	n.a.	n.a.

Price Chart



Norman Zhang

(852) 2533 3715

normanzhang@sbie2capital.com

Ticker:	0546.HK	12 mth range:	HK\$0.21-1.45
Price:	HK\$1.21	Market cap:	US\$257.5m
Target:	n.a.	Daily t/o, 3 mth:	US\$0.7m
		Free float %:	40.3%

Key points:

- * Relative defensive MSG consumption.
- * Corn / coal prices down to favor margins.
- * Established cost advantage against peers.
- * Expanding market occupancy for major products.
- * Optimistic growth picture for FY12/09F.

Apparent advantage on coal cost. Coal accounted for 10.9% and 42.3% of Fufeng's production cost at MSG and xanthan gum segments, respectively, in FY12/08A. Inner Mongolia has abundant coal resource and local coal price is considerably lower than the national level. In IQ 2009, the average price of thermal coal was ~RMB230/tonne, versus RMB400-600 in Qinghuangdao. Fufeng is one of first enterprise, who realized this difference and moved into Inner Mongolia. The company built its plant there in 2006 and completed phase II in 2008, which, after taking into account higher transportation expense, brings it apparent cost advantage against other peers located mainly in Shandong province, especially for xanthan gum (e.g. according to Fufeng's experience, unit production cost of xanthan gum can be as low as ~RMB10,000/tonne in Inner Mongolia but ~RMB17,000 in Shandong). Thus, the company can use this cost advantage to secure solid market positions:

- Glutamic acid: Number of producers reduced from 31 in 2007 to 21 in 2008. The largest 8 players dominate ~80% market. Fufeng and Meihua, which also owns production facilities in Inner Mongolia, are the top two and each has ~25% market share.
- MSG: Similar to glutamic acid, MSG industry is under consolidation and number of producers reduced by 28 in 2008 to 35, of which top 10 controls ~80% market. Fufeng is one of the largest player with ~20% market share.
- Xanthan gum: Fufeng is one of the 3 largest suppliers in the world (aggregate: 70-80% market share, Fufeng: ~30%) and the other two are Deosen (Shandong province) and CP Kleco (US).

Growth mainly from market consolidation. Demand for Fufeng's three major products is relatively steady, growing at low-middle single-digit organically each year. Nevertheless, aided by its cost advantage, we expect the company to consolidate the markets and gain

market share from weak players. In particular for FY12/09F,

- Glutamic acid / MSG: Gross margin hiked in 4.Ipcp to 19.9% in 4Q FY12/08A, following the correction in corn and coal prices. We expect selling prices to be dragged down further by enlarging supply this year given that eased cost pressure will encourage small plants to resume operation, resulting in squeezing gross margin from 4Q FY12/08A level. Nevertheless, full FY12/09F gross margin should improve somewhat from 15.6% in FY12/08A, in our view, due to lower raw materials costs.
- Xanthan gum: The company plans to capture more market share this year by adopting an aggressive pricing strategy based on its cost advantage, which might depress gross margin. In IQ FY12/09F, selling price dipped slightly but gross margin managed to stay flat compared with 37.0% in 4Q FY12/08A (FY12/08A: 34.4%), thanks to enlarged operating scale.

Expanding capacity in Inner Mongolia. The company intends to further expand its capacity in Inner Mongolia. Production facilities for 100,000tonne MSG and 12,000tonne xanthan gum have been planned for 2009. The prior project will enable the company to fully convert its own glutamic acid output into MSG, enhancing both the effective ASP and gross margin of MSG segment. In addition, the company will build capacity for 5,000tonne threonine and 1,000tonne branched chain amino acid (BCAA), which both are newly developed by Fufeng to extend and enrich its product line. Aggregately, capex for FY12/098F are budged at RMB380m, which will be fulfilled by cash reserve (RMB267.6m at end-FY12/08A) and operating cash inflow (FY12/08A: RMB448.9m), according to the management.

Table 1: Capacity expansion

(tonnes)	Effective in 2007	Effective in 2008	Actual at end-2008	Target at end-2009
Glutamic acid	280,000	275,000	350,000	350,000
MSG	75,000	171,667	280,000	380,000
Xanthan gum	11,333	21,000	32,000	44,000
Fertilizers	490,000	405,000	460,000	460,000
Sweetener	100,000	100,000	100,000	100,000

Source: Company data

Table 2: Capex budegt for FY12/09F

Projects	Amount (RMBm)
12,000tonne xanthan gum	200
100,000tonne MSG	50
5,000tonne threonine	40
1,000tonne BCAA	30
Environmental protection facilities	60
Total	380

Source: Company data

Undemanding valuation on decent outlook. We are optimistic towards the company's earnings in FY12/09F, given: 1) relatively inelastic demand for glutamic acid / MSG; 2) decline in raw materials costs; 3) xanthan gum capacity expansion combined with cost advantage. The management guided a ~10% top-line growth and ~30% at bottom line. Comparably, its present valuation (historical 6.0x) seems undemanding, in our view.

Table 3: P & L

Year to Dec (RMBm)	06A	07A	08A
Revenue	1,787.2	2,445.7	3,585.3
Cost of sales	(1,432.1)	(2,196.0)	(2,941.0)
Gross profit	355.1	249.7	644.3
Other income	19.2	75.6	44.3
Selling and marketing expenses	(61.8)	(104.2)	(166.4)
Administrative expenses	(40.5)	(113.7)	(142.0)
Other operating expenses	(7.4)	(16.7)	(12.3)
Profit from operation	264.7	90.7	367.9
Finance costs	(14.8)	(45.2)	(42.7)
Profit before taxation	249.8	45.5	325.3
Income tax	(9.3)	(0.4)	(30.7)
Profit for the period	240.5	45.1	294.6
Attributable to:			
Equity holders of the Company	240.5	45.1	294.6
Minority interests	-	-	-
EPS - Basic (RMB)	0.200	0.028	0.178
Proposed DPS (RMB)	-	0.009	0.100

Source: Company data

SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. Find our research on: sbie2capital.com, thomsononeanalytics.com, factset.com and multex.com

SBI E2-Capital stock ratings:

STRONG BUY : absolute upside of >50% over the next three months

BUY : absolute upside of >10% over the next six months

HOLD : absolute return of -10% to +10% over the next six months

SELL : absolute downside of >10% over the next six months

Investors should assume that SBI E2-Capital is seeking or will seek investment banking or other related businesses with the companies in this report.

Analyst certification: The views expressed in this report accurately reflect the analyst's personal views of the subject securities and that the analyst has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Disclaimer: This research report is not an offer to sell or the solicitation of an offer to buy or subscribe for any securities. The securities referred to in this report may not be eligible for sale in some jurisdictions. The information contained in this report has been compiled by the Research Department of SBI E2-Capital Securities Limited ('SBI E2-Capital') from sources that it believes to be reliable but no representation, warranty or guarantee is made or given by SBI E2-Capital or any other person as to its accuracy or completeness. All opinions and estimates expressed in this report are (unless otherwise indicated) entirely those of SBI E2-Capital as of the date of this report only and are subject to change without notice. Neither SBI E2-Capital nor any other person, accepts any liability whatsoever for any loss howsoever arising from any use of this report or its contents or otherwise arising in connection therewith. Each recipient of this report shall be solely responsible for making its own independent investigation of the business, financial condition and prospects of the companies referred to in this report. SBI E2-Capital and their respective officers, directors and employees, including persons involved in the preparation or issuance of this report, may from time to time (1) have positions in, and buy or sell, the securities of companies referred to in this report (or related investments); (2) have a consulting, investment banking or broking relationship with any company referred to in this report; and (3) to the extent permitted under applicable law, have acted upon or used the information contained or referred to in this report including effecting transactions for their own account in an investment (or related investment) in respect of any company referred to in this report, prior to or immediately following its publication. This report may not have been distributed to all recipients at the same time. This report is issued only for the information of and may only be distributed to professional investors and dealers in securities and must not be copied, published, reproduced or redistributed (in whole or in part) by any recipient for any purpose. This report is distributed in Hong Kong by SBI E2-Capital. Any recipient of this report who requires further information regarding any securities referred to in this report should contact the relevant office of SBI E2-Capital located in such recipient's home jurisdiction.

Copyright © SBI E2-Capital Securities Limited 2008. All rights reserved.