

Soaring MSG price

BUY (unchanged)

Financial summary

| Year to Dec | 07A | 08A | 09F | 10F | 11F |
|-------------------|----------|--------|--------|--------|-------|
| Turnover (RMBm) | 2,445.73 | 585.34 | 609.66 | 114.56 | 980.7 |
| Net Profit (RMBm) | 45.1 | 294.7 | 915.31 | 017.51 | 066.8 |
| EPS (RMB) | 0.028 | 0.178 | 0.551 | 0.613 | 0.643 |
| EPS Δ% | (86.0) | 533.9 | 210.6 | 11.2 | 4.8 |
| P/E (x) | 152.1 | 24.0 | 7.7 | 6.9 | 6.6 |
| P/B (x) | 4.88 | 4.06 | 3.02 | 2.37 | 2.06 |
| EV/EBITDA (x) | 51.2 | 14.6 | 6.0 | 4.7 | 3.9 |
| Yield (%) | 0.2 | 2.1 | 7.8 | 8.6 | 9.1 |
| ROE (%) | 4.6 | 18.5 | 44.8 | 38.2 | 33.3 |
| ROCE (%) | 2.4 | 16.6 | 39.5 | 36.3 | 36.0 |
| N. Gear. (%) | 40.6 | 22.8 | 11.3 | Cash | Cash |

Source: SBI E2-Capital

Price Performance

| | 1 mth | 3 mth | 12 mth |
|--------------------------|-------|-------|--------|
| Relative to HSI (%) | +32.8 | +69.1 | +602.4 |
| Actual price changes (%) | +24.9 | +70.6 | +902.1 |

| | 09F | 10F | 11F |
|---------------------------|-------|-------|-------|
| Consensus EPS (RMB) | 0.477 | 0.463 | 0.573 |
| Previous forecasts (RMBm) | 758.4 | 464.1 | 789.2 |
| Previous EPS (RMB) | 0.457 | 0.280 | 0.475 |

Price Chart


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| | | | |
|---------|-----------------|-------------------|---------------|
| Ticker: | 0546.HK | 12 mth range: | HK\$0.39-5.43 |
| Price: | HK\$4.81 | Market cap: | US\$1,023.7m |
| Target: | HK\$5.98 (+24%) | Daily t/o, 3 mth: | US\$3.3m |
| | | Free float %: | 41.4% |

Key points:

- * MSG price surged from RMB7,719/tonne in Sep to RMB10,200 in Nov.
- * Industry-wide gross margin reached 35.0%+.
- * No major capacity expansion at this stage.
- * Earnings revised up to reflect high MSG price.
- * Target price changed from HK\$4.86 to HK\$5.98.

Soaring MSG price. MSG price has been rising gradually since Mar. This trend exacerbated in past three months and the price jumped to RMB10,200/tonne at end-Nov from RMB7,179 in Sep. Apparent reasons include: 1) stronger-than-expected corn price backed by bad weather conditions, which affected transportation, and rumored another round of governmental procurement; 2) supply constraint accompanying industry consolidation, which keeps ruling out small players. We do not take "corn cost" as a strong explanation considering that price of corn, as well as other raw materials like coal, liquid ammonia, sulphuric acid and soybean, stayed relatively flat in 4Q.

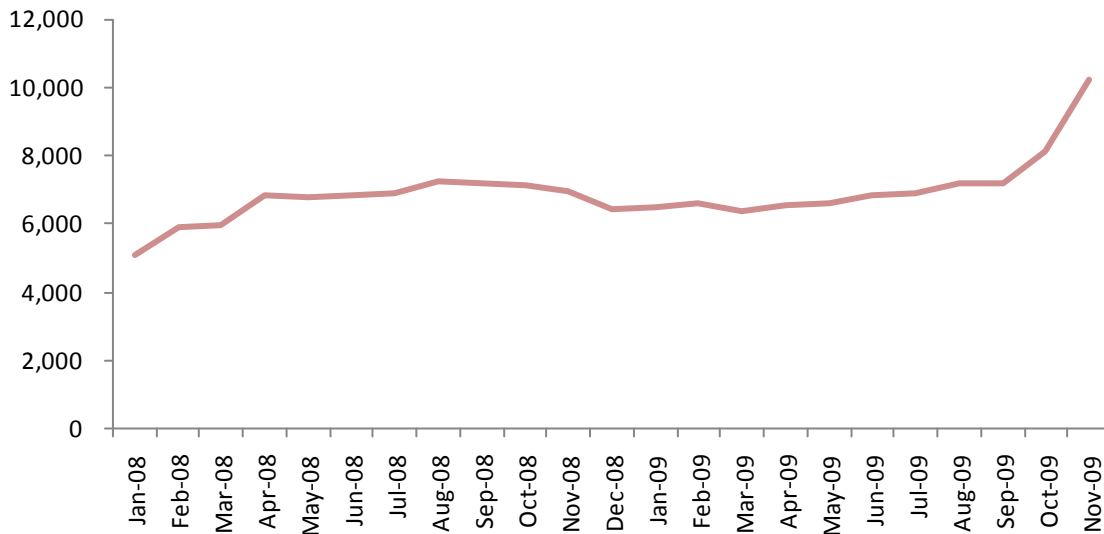
Likely bargaining power enlargement for sell side. We are also cautious towards "supply constraint" explanation. MSG price was steady at RMB6,800-7,200/tonne range from Apr 08 to Sep 09, suggesting market equilibrium. Given inelasticity of MSG demand, we find it difficult to claim insufficient supply occurs now. Instead, we reckon the price hike was probably due to enlarging bargaining power of MSG suppliers. If this was the case, it proves our previous guess about enhancing profitability following industry consolidation.

Return to normal in long term. Nevertheless, we are concerned that if this sky-high price is really sustainable. According to our channel check, there is no mass capacity expansion from major glutamic acid producers, implying MSG supply will remain at present level in coming around ten months. However, we believe the juicy gross margin (35%+ under current MSG price and cost structure) will finally attract new investment and capacity expansion.

Our view on Fufeng. For Fufeng, we re-iterate our investment theme, including:

- Explosive earnings growth in short-term initially due to soft raw material costs this year and, lately, MSG price hike, which could extend into at least 1Q FY12/10F.
- Benefit from industry consolidation, which will likely bring the company larger market share and less earnings fluctuation.

Target revised up to HK\$5.98. We have adjusted our model to reflect the unexpected MSG price surge. Earnings forecast for FY12/09F was revised up from previous RMB758.4m to RMB915.3m. As the high MSG price may remain at least in 1Q 2009, FY12/10F forecast was also penciled up from RMB464.1m to RMB1,017.5m. New capacity may come out in 2H 10, which will affect margin in 2H FY12/10F and FY12/11F. Hence, FY12/11F earnings is anticipated to be flat at RMB1,066.8m compared with FY12/10F figure. New DFCFE fair value is RMB6.56. By applying 20.0% discount, we get the new target price at HK\$5.98.

Chart 1: MSG price (RMB/tonne)


Source: www.bbcafi.com

Table 1: Raw material cost in 2009

| (RMB/tonne) | Jul | Aug | Sep | Oct | Nov |
|--------------------|-------|-------|-------|-------|--------|
| Coal (North China) | 310 | 316 | 317 | 318 | 322 |
| Corn | 1,458 | 1,526 | 1,528 | 1,491 | 1,530 |
| Liquid ammonia | 2,077 | 2,077 | 1,880 | 1,900 | 1,920 |
| Sulphuric acid | 179 | 179 | 211 | 211 | 220 |
| Soybean | 3,740 | 3,753 | 3,771 | 3,784 | 3,814 |
| MSG | 6,872 | 7,179 | 7,179 | 8,120 | 10,200 |

Source: www.ex-starch.com, www.cheminfo.gov.cn, www.chemcp.com, www.sxcoal.com, www.feedonline.cn, www.bbcafi.com

Table 2: P&L

| Year to Dec (RMBm) | 07A | 08A | 09F | 10F | 11F |
|--|-----------|-----------|-----------|-----------|-----------|
| Turnover | 2,445.7 | 3,585.3 | 4,609.6 | 6,114.5 | 6,980.7 |
| Cost of sales | (2,196.0) | (2,941.0) | (3,184.2) | (4,403.4) | (5,024.0) |
| Gross profit | 249.7 | 644.3 | 1,425.4 | 1,711.1 | 1,956.7 |
| Other income | 32.8 | 44.3 | 54.8 | 43.0 | 59.8 |
| Selling and marketing expenses | (104.2) | (166.4) | (206.8) | (271.1) | (316.8) |
| Administrative expenses | (113.7) | (142.0) | (199.7) | (252.4) | (288.1) |
| Other operating expenses | (16.7) | (12.2) | (38.7) | (23.9) | (27.3) |
| Profit from operations | 47.9 | 368.0 | 1,035.1 | 1,206.6 | 1,384.4 |
| 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 | 1,006.1 | 1,160.2 | 1,327.4 |
| Income tax expenses | (0.4) | (30.7) | (90.8) | (142.7) | (260.6) |
| Profit for the period | 45.1 | 294.7 | 915.3 | 1,017.5 | 1,066.8 |
| Attributable to: | | | | | |
| Equity holders of the Company | 45.1 | 294.7 | 915.3 | 1,017.5 | 1,066.8 |
| Minority interests | 0.0 | 0.0 | - | - | - |
| EPS - Basic (RMB) | 0.028 | 0.178 | 0.551 | 0.613 | 0.643 |
| EPS - Diluted (RMB) | 0.028 | 0.178 | 0.551 | 0.613 | 0.643 |
| Proposed DPS (RMB) | 0.008 | 0.088 | 0.331 | 0.368 | 0.386 |
| Proposed dividend | 13.5 | 146.3 | 549.2 | 610.5 | 640.1 |

Source: SBI E2-Capital

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