

Intact picture

BUY (unchanged)

Financial summary

Year to Dec	07A	08A	09F	10F	11F
Turnover (RMBm)	2,445.73	585.34	390.95	363.16	432.2
Net Profit (RMBm)	45.1	294.7	621.2	440.0	715.1
EPS (RMB)	0.028	0.178	0.374	0.265	0.431
EPS Δ %	(86.0)	533.9	110.8	(29.2)	62.5
P/E (x)	98.6	15.6	7.4	10.4	6.4
P/B (x)	3.16	2.63	2.23	2.01	1.68
EV/EBITDA (x)	34.0	9.7	5.6	6.1	3.7
Yield (%)	0.3	3.2	8.1	5.8	9.4
ROE (%)	4.6	18.5	32.8	20.3	28.5
ROCE (%)	2.4	16.6	28.8	19.2	29.8
N. Gear. (%)	40.6	22.8	24.3	17.8	Cash

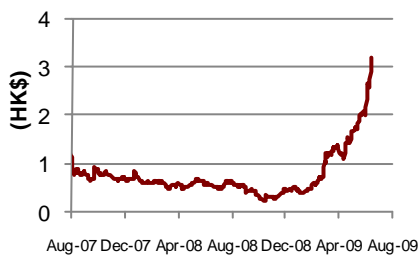
Source: SBI E2-Capital

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	+0.6	+69.3	+423.7
Actual price changes (%)	+8.6	+101.9	+408.1

	09F	10F	11F
Consensus EPS (RMB)	0.380	0.360	0.435
Previous forecasts (RMBm)	603.2	439.7	692.9
Previous EPS (RMB)	0.363	0.265	0.417

Price Chart



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portion of the incremental part was borne by users, witnessed by the increased glutamic acid and MSG prices in Jul, which, we believe, was due to: 1) relatively balanced supply/demand at the moment; 2) Fufeng's leading position and cost advantage.

Ticker:	0546.HK	12 mth range:	HK\$0.21-3.35
Price:	HK\$3.15	Market cap:	US\$670.4m
Target:	HK\$4.51 (+43%)	Daily t/o, 3 mth:	US\$1.7m
		Free float %:	40.2%

Key points:

- * 1H results broadly in line.
- * Margin widened on lower raw materials costs.
- * Cut price to expand xanthan gum market share in 2H.
- * More capacity expansion in plan.
- * Potential procure of corn from government to bring down cost.
- * Forecasts penciled up.
- * Target unchanged at HK\$4.51.

Soaring earnings in 1H. Turnover increased 26.1% in 1H FY12/09A to RMB2,055.4m, boosted mainly by the enlarged MSG operation scale. Sales volume of MSG increased from 46,825 tonnes one year ago to 131,417 tonnes and associated revenue surged 203.1% to RM905.6m. As discussed in our previous reports, blended gross margin improved significantly by 13.5pcp to 28.1%, thanks to softened raw materials costs as well as improved operation efficiency. As a result, net profit jumped 312.2% to RMB353.9m.

Table 1: Raw materials costs

Year to Dec (RMB/tonne)	1H 09A	1H 08A	Change (%)
MSG segment			
Corn kernels	1,284	1,415	(9.3)
Liquid ammonia	2,200	2,505	(12.2)
Sulphuric acid	241	1,068	(77.4)
Coal	247	315	(21.6)
Gross margin (%)	27.4	12.3	15.1
Xanthan gum segment			
Corn kernels	1,290	1,383	(6.7)
Starch	1,685	1,906	(11.6)
Coal	221	324	(31.8)
Soybean	3,444	4,577	(24.8)
Gross margin (%)	35.1	33.9	1.2

Source: Company data

Intact trend in Jul. Such solid performance of the MSG segment has extended into Jul. Although corn price in China has been rising due to the central government's protective procurement in 1H, a largely

Table 2: Prices trend in 2009

Year to Dec (RMB/tonne)	1Q	2Q	Jul
Glutamic acid	6,797	6,762	7,182
MSG	6,962	6,817	7,037
Xanthum gum	21,622	21,853	19,937
Corn (excl. tax)	1,223	1,341	1,475

Source: Company data

To grab more xanthan gum market share in 2H. Xanthan gum market contracted in 1H due to global economy slowdown, which substantially reduced demand from oil industry. However, a mild recovery in 2H is possible, in our view, considering the strengthening crude oil price. Nevertheless, the main driver for Fufeng still stands on its apparent cost advantage (lower than its major competitor). The company has cut its selling price by ~10% (~RMB20,000/tonne) since Jun. We estimate another 10-15% reduction (RMB17,000-18,000/tonne) will largely squeeze out competitor's profitability and, therefore, secure sufficient orders for Fufeng in 2H to absorb increased capacity. The management estimates present production cost is ~RMB10,000/tonne in the Inner Mongolia plant and ~RMB18,000/tonne in the Junan plant (blended at ~RMB12,000/tonne), suggesting an adequate gross margin even after the expected price cut.

Potential procurement from the government to lower corn cost. According to the management, corn's spot price (incl. tax) has reached ~RMB1,800/tonne, which is ~15% higher than the company's purchase cost in 2Q. Although the company is able to pass on a large part of incremental cost to its customers, the trend is surely unfavorable, especially after new glutamic acid / MSG capacities come out. Good news is that Fufeng has applied for procurement of total 260,000 tonnes corn from the government at RMB1,570/tonne (as part of China's plan to rotate its strategic corn stock) and now is waiting for the approval. We estimate the said procurement volume is equivalent to ~50% of the company's total need in 2H, which, therefore, will apparently bring down corn cost.

More capacity expansion. A 70,000-tonne glutamic acid line and a 100,000-tonne fertilizer line (both in Baoji) have been added to its original plan. And the new 100,000-tonne MSG line in the Inner Mongolia plant will also be revised to 150,000 tonnes. Accordingly, capex budget for FY12/09F has increased to RMB600m from RMB380m.

Table 3: Capex budget for FY12/09F

Projects	Amount (RMBm)
70,000 tonnes glutamic acid and 100,000 tonnes fertilizer	200
150,000 tonnes MSG	70
12,000 tonnes xanthan gum	200
5,000 tonnes threonine	40
1,000 tonnes BCAA	30
Environmental protection facilities	60
Total	600

Source: Company data

Target price unchanged at HK\$4.51 after forecast fine-tune. The interim results and new capacity expansion are broadly in line with our expectation. We adjust our forecasts only slightly. The pending corn procurement from the government has not been factored in, which could generate an earnings surprise for 2H FY12/09F. The MSG industry will probably suffer another round of over-supply in 2010 as multiple companies are reportedly expanding their capacities. Although this will hurt the whole industry's profitability in short term, we re-iterate our view that it will also accelerate industry consolidation by ruling out weak players and reward leading ones in long term. The rising market concentration, consequently, will smooth down the industry's profit volatility. As discussed in our initial coverage report ("**Lower costs to fuel earnings growth**", 11 Jun 09), this has only tiny impact on Fufeng's fair value. Our new fair value for the counter is HK\$4.85. At this stage, we maintain our target price at HK\$4.51, representing 7.0% discount to the fair value.

Table 4: P&L

Year to Dec (RMBm)	07A	08A	09F	10F	11F
Turnover	2,445.7	3,585.3	4,390.9	5,363.1	6,432.2
Cost of sales	(2,196.0)	(2,941.0)	(3,309.7)	(4,361.7)	(4,974.4)
Gross profit	249.7	644.3	1,081.2	1,001.3	1,457.8
Other income	32.8	44.3	52.7	38.9	56.8
Selling and marketing expenses	(104.2)	(166.4)	(197.6)	(245.8)	(286.8)
Administrative expenses	(113.7)	(142.0)	(183.9)	(225.5)	(261.4)
Other operating expenses	(16.7)	(12.2)	(38.9)	(23.9)	(27.3)
Profit from operations	47.9	368.0	713.4	545.0	939.1
Interest income from IPO subscription deposits	42.8	-	-	-	-
Finance costs	(45.2)	(42.7)	(28.9)	(46.4)	(57.0)
Profit before income tax	45.5	325.4	684.4	498.6	882.1
Income tax expenses	(0.4)	(30.7)	(63.3)	(58.5)	(167.0)
Profit for the period	45.1	294.7	621.2	440.0	715.1
Attributable to:					
Equity holders of the Company	45.1	294.7	621.2	440.0	715.1
Minority interests	-	-	-	-	-
EPS - Basic (RMB)	0.028	0.178	0.374	0.265	0.431
EPS - Diluted (RMB)	0.028	0.178	0.374	0.265	0.431
Proposed DPS (RMB)	0.008	0.088	0.225	0.159	0.258
Proposed dividend	13.5	146.3	372.7	264.0	429.1

Source: SBI E2-Capital

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