

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, owns 47% of the company.

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Piper Jaffray Asia Securities Limited

Reason for Report:

Change in Price Target

Changes	Previous	Current	
Rating	--	Overweight	
Price Tgt (HK\$)	5.00	6.00	
FY09E Rev (Rmb m)	4,287.00	4,388.00	
FY10E Rev (Rmb m)	5,231.00	5,512.00	
FY09E EPS (Rmb)	0.46	0.51	
FY10E EPS (Rmb)	0.51	0.56	
Price (HK\$):		4.90	
52 Week High (HK\$):		6.47	
52 Week Low (HK\$):		0.41	
12-Month Price Target (HK\$):		6.00	
(9.4x FY10E EPS of HK\$0.64)			
Shares Out (mil):		1,660.0	
Market Cap. (HK\$m):		8,134.0	
Market Cap. (US\$m):		1,047.6	
Free Float Market Cap (US\$m):		280.0	
Div (ann HK\$):		0.25	
Avg Daily Vol (000):		6,795.0	
Book Value/Share (Rmb) :		1.4	
Net debt to equity :		19%	
Est LT EPS Growth :		50%	
P/E to LT EPS Growth (FY10):		0.2x	
Est Next Rep Date :		Mar 2010	
Fiscal Year End:		Dec	
Auditor:		PWC	
Rev (Rmb m)	FY08A	FY09E	FY10E
H1	1,630.00A	2,055.00A	2,558.00E
H2	1,955.00A	2,333.00E	2,954.00E
FY	3,585.00A	4,388.00E	5,512.00E
EPS (Rmb)	FY08A	FY09E	FY10E
H1	0.05A	0.21A	0.26E
H2	0.13A	0.30E	0.30E
FY	0.18A	0.51E	0.56E
FY P/E	23.9x	8.4x	7.7x

Fufeng Group

阜丰集团

Overweight**(546 HK - HK\$4.90)****Better-than-Expected Supply/Demand Balance****CONCLUSION:**

We reiterate our Overweight rating on Fufeng and raise our PT from HK\$5.0 to HK\$6.0 on improved earnings estimates (by 10%-11% in FY09E-11E). Better-than-expected MSG export prices and balanced supply/demand outlook make us believe Fufeng has enough pricing power to protect its margins in FY10E. We also expect strong growth in its xanthan gum business based on the recovery of the export market and capacity expansion.

- **Higher Earnings on Raised ASP:** We have revised up our FY09E-11E earnings estimates by 10%-11% as we have increased our ASP assumptions for MSG for 4Q09E and FY10E by 6% and 6%, respectively. These imply a 3% QoQ increase in ASP for 4Q09E (previous: flat) and -2% YoY for FY10E (previous: same). Our belief in a more positive ASP outlook is supported by the latest export price trend. According to CEIC, MSG export prices were up 2% MoM and 7% YoY in Dec-09, better than our previous expectation of a downward trend. We have also increased our ASP assumptions for glutamic acid by 2% for FY10E. Hence we lift our operating margin expectations by 1.5ppt to 20.2% for FY10E.
- **Supply and Demand Turn Balanced in FY10E:** (1) China: We expect the overall MSG and glutamic acid market to switch from under-supply to supply-demand balance in FY10E, according to the latest capacity expansion plans announced by other major Chinese MSG producers and reported in the media (details on page 2). Out of the Top 5 suppliers in China, only two of them have planned to increase their MSG capacities, and we also see little addition in glutamic acid (raw materials for MSG) supply. (2) Global: Due to rising raw material costs (corn, sugar cane or other starch sources) worldwide, the global MSG price is also trending up, which we believe will help support the domestic MSG and glutamic acid prices in China. We estimate 15%-20% of the MSG produced in China was exported in 2009E.
- **Strong Recovery in Xanthan Gum Division:** We expect a 40%/35% YoY volume growth in FY10E/11E due to improving demand by the international oil-drilling industry (about 50% of sales) and capacity addition (+30%-plus in FY09E). Thanks to better economies of scale, we believe Fufeng can maintain the segment margin at 37%-40% in FY09E-11E, despite the potential hike in corn costs and its plan to lower pricing for gaining market shares. We estimate xanthan gum to account for about 20%-30% of the company's profit in FY10E-11E, up from ~15% in FY09E.

INVESTMENT RECOMMENDATION:

Our PT of HK\$6.0 (previous HK\$5.0) is 9.4x FY10E EPS (previous 8.7x) of Rmb0.56. Our target P/E remains a roughly 15% discount to the sector average.

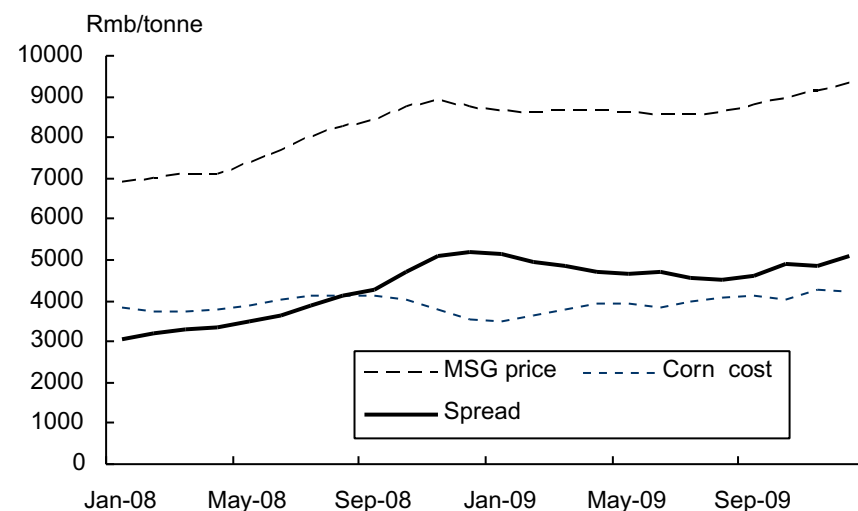
RISKS TO ACHIEVEMENT OF TARGET PRICE:

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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Exhibit 1: MSG Price and Corn Cost Trends



Sources: CEIC, Piper Jaffray Asia Securities estimates

Exhibit 2: China MSG and Glutamic Acid Capacity (000 tpa)

	2009E	MSG addition	2010E	Glutamic acid 2009E	Addition	2010E
Fufeng	280	150	430	350	75	425
Yipin	100	120	220	100	120	220
Meihua	350	50	400	300	0	300
Linhua	140	0	140	100	0	100
Lianhua	300	0	300	120	0	120
Qilu	150	0	150	n.a.	n.a.	n.a.
Lexin	170	0	170	n.a.	n.a.	n.a.
Others#	510	0	510	630	45	675
Stated capacity*	2,000	320	2,320	1,600	240	1,840
Domestic Demand (E)	1,800	90	1,890	n.a.	n.a.	n.a.
Export^	206	n.a.	206			
Demand/ stated capacity (x)	1.0	n.a.	0.90			

Sources: *China Fermentation Association, ^CEIC, Company, Piper Jaffray Asia Securities estimates

Utilization rate estimated at below 50% due to pollution, high production costs and other issues; hence we believe the market was in under-supply situation in FY09E but should improve in FY10E.

Meihua aims to re-open its 50K tpa plant in FY10E after upgrade.

Exhibit 3: Valuation Comparisons

Corn processing & additives	Bloomberg code	Curr	Mkt Cap (HK\$ mil)	Price 29/1/10	PER (x)			P/B(x)	ROE (%)			EPS growth (%)			OP margin (%)	
					FY09E	FY10E	FY11E		FY09E	FY10E	FY11E	FY09E	FY10E	FY11E	FY09E	FY10E
FUFENG GROUP LTD*	546 HK	HK\$	8,134	4.90	8.5	7.7	7.2	3.2	33.2	33.2		189	10	6	22.2	19.8
GLOBAL BIO-CHEM*	809 HK	HK\$	5,032	2.17	20.9	7.4	6.0	0.7	8.4	9.4		-60	184	23	7.2	10.9
XIWANG SUGAR*	2088 HK	HK\$	2,033	2.40	21.2	8.9	7.3	1.1	13.4	12.0		52	150	20	5.4	11.2
GLOBAL SWEETENER*	3889 HK	HK\$	1,762	1.68	21.0	8.8	7.6	1.1	11.2	11.3		-39	122	16	5.8	11.1
CHINA AGRI-INDUS	606 HK	HK\$	41,305	10.66	18.5	15.1	12.9	2.6	14.4	15.9		-21	23	17	6.6	7.3
CHINA STARCH HLD	3838 HK	HK\$	4,180	1.63	28.6	15.9	14.8	n.a.	13.3	16.4		33	80	7	n.a.	n.a.
					22.1	11.2	9.7	1.4	12.1	13.0		-7	112	17	6.2	10.1

Int'l corn processors	Bloomberg code	Currency	Mkt Cap (US\$ mil)	Price	PER (x)			P/B(x)	ROE (%)			EPS growth (%)			OP margin (%)	
					FY09E	FY10E	FY11E		FY09E	FY10E	FY11E	FY09E	FY10E	FY11E	FY09E	FY10E
ARCHER-DANIELS	adm us	USD	19,110	29.75	10.5	10.0	10.2	1.3	11.9	11.6		6	6	0	4.0	4.1
CORN PRODUCTS	cpo us	USD	2,238	29.90	15.7	12.2	11.6	1.5	10.5	11.0		-47	29	5	7.4	8.4
TATE & LYLE	Tate In	GBP	1,806	392.80	10.4	9.5	8.6	1.7	13.6	15.3		165	10	10	8.1	8.5
Average					12.2	10.5	10.1	1.5	12.0	12.6		42	15	5	6.5	7.0

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

Year ending Dec (RMB mil)	1H08A	2H08A	1H09A	2H09E	1H10E	2H10E	2007A	2008A	2009E	2010E	2011E
Volume (000 tonnes)											
Glutamic acid	102	60	62	53	30	44	179	163	115	74	72
MSG	49	97	131	144	170	225	92	146	275	395	435
Fertilizers	195	175	217	183	215	215	419	370	400	430	430
Xanthan gum	8	13	8	10	13	13	6	21	18	26	35
ASP (Rmb/ tonne)											
Glutamic acid	6,048	7,198	6,777	8,359	6,950	7,244	5,872	6,474	7,500	7,125	7,125
MSG	6,257	7,274	6,886	7,676	7,350	7,262	5,997	6,865	7,300	7,300	7,300
Fertilizers	1,009	1,045	862	563	650	750	467	1,026	700	700	700
Xanthan gum	21,547	22,183	24,265	17,187	19,500	19,500	24,049	21,941	20,200	19,500	19,500
Glutamic acid	619	434	423	439	209	319	1,049	1,053	863	527	513
MSG	299	706	906	1,102	1,250	1,634	551	1,004	2,008	2,884	3,176
Fertilizers	197	183	187	103	140	161	196	380	290	301	301
Xanthan gum	169	283	186	178	254	254	149	452	364	507	683
Others	346	349	259	511	590	703	500	696	864	1,293	1,386
Turnover	1,630	1,955	2,055	2,333	2,558	2,954	2,446	3,585	4,388	5,512	6,058
Cost of sales	-1,393	-1,548	-1,478	-1,566	-1,817	-2,125	-2,196	-2,941	-3,045	-3,943	-4,353
Gross Profit	238	407	577	766	741	829	250	644	1,343	1,569	1,706
Other income	28	16	24	14	10	39	76	44	38	49	63
Selling and marketing costs	-78	-88	-96	-108	-137	-158	-104	-166	-204	-294	-323
Administrative expenses	-63	-78	-87	-91	-95	-109	-114	-142	-177	-204	-224
Other operating expenses	-7	-6	-17	-7	-10	-19	-17	-12	-24	-29	-35
Operating profit	117	251	401	575	510	581	91	368	976	1,091	1,185
Finance costs	-22	-20	-14	-25	-8	-8	-45	-43	-39	-16	-7
Profit before tax	95	231	388	549	502	573	45	325	937	1,075	1,178
Taxation	-9	-22	-34	-52	-65	-75	0	-31	-86	-140	-188
Profit attributable to shareholders	86	209	354	497	436	499	45	295	851	935	990
EPS (Rmb)	0.052	0.126	0.213	0.299	0.263	0.300	0.028	0.178	0.513	0.563	0.596
	1H08A	2H08A	1H09A	2H09E	1H10E	2H10E	2007A	2008A	2009E	2010E	2011E
Sales analysis											
Glutamic acid	38	22	21	19	8	11	43	29	20	10	8
MSG	18	36	44	47	49	55	23	28	46	52	52
Fertilizers	12	9	9	4	5	5	8	11	7	5	5
Xanthan gum	10	14	9	8	10	9	6	13	8	9	11
Sweeteners	4	5	5	4	5	4	3	5	4	4	4
Others	17	13	13	18	23	16	17	15	15	19	19
Total	100	100	100	100	100	100	100	100	100	100	100
Profit growth YoY	162	1,604	312	138	23	0	-81	554	189	10	6
COGS breakdown(%)											
Corn kernels	49	43	52	62	56	57	55	46	57	54	54
Utilities	11	17	13	10	11	10	13	14	11	10	11
Other raw materials	21	18	12	11	11	9	22	19	12	10	10
Others	19	22	23	17	22	24	9	20	20	25	25
Gross margins(%)											
MSG segment	11.8	17.7	27.4	30.7	28.1	25.0	8.6	15.0	28.5	26.4	25.9
Xanthan gum	33.9	33.0	35.1	42.4	37.0	37.0	30.9	33.4	38.7	37.0	37.0
Blended GPM	14.6	20.8	28.1	32.9	29.0	28.1	10.2	18.0	30.6	28.5	28.2
SG&A as % of revenue	8.7	8.5	8.9	8.5	9.0	9.0	8.9	8.6	8.7	9.0	9.0
Operating margin(%)	7.2	12.8	19.5	24.6	19.9	19.7	3.7	10.3	22.2	19.8	19.6
Growth (%)											
Sales	46	47	26	19	24	27	37	47	22	26	10
Net profit	162	1,604	312	138	23	0	(81)	554	189	10	6
Gross profit contribution (%)											
MSG segment	76	73	90	90	88	88	82	76	90	88	85
Xanthan gum	24	27	10	10	12	12	18	24	10	12	15
Effective tax rate	9.4	9.4	8.7	9.5	13.0	13.0	0.9	9.4	9.2	13.0	16.0

Source: Company, Piper Jaffray

For up-to-date disclosure information on this company, please visit www.piperjaffray.com/researchdisclosures.

Fufeng Group Limited (00546.HK)

Balance sheet

As of 31 December (RMB mil)	2007A	2008A	2009E	2010E	2011E	Jun-09	Jun-08
Current assets							
Inventories	326	356	439	551	606	326	344
Trade and other receivables	541	548	671	843	927	582	630
Amounts due from related parties	0	3	0	0	0	0	0
Restricted bank deposits	42	43	0	0	0	15	45
Cash & equivalent	229	225	81	509	695	285	223
	1,138	1,175	1,191	1,903	2,227	1,208	1,243
Non-current assets							
Property, plant and equipment	1,674	1,955	2,375	2,375	2,365	2,024	1,776
Leasehold payments	63	132	131	130	129	142	99
Others	6	0	0	0	0	6	6
	1,743	2,088	2,506	2,505	2,494	2,171	1,882
Total assets	2,882	3,262	3,697	4,408	4,721	3,379	3,124
Current liabilities							
Trade and other payables	771	888	888	1,149	1,269	842	890
Tax payable	1	0	0	0	0	4	0
Current portion of deferred income	5	7	7	7	7	10	5
Borrowings	318	276	200	200	0	198	315
Derivative financial instruments	0	0	0	0	0	0	0
	1,095	1,170	1,094	1,356	1,276	1,054	1,211
Non current liabilities							
Bank loans	312	312	312	200	0	300	362
Deferred income tax liabilities	1	11	11	11	11	19	1
Deferred income	25	28	28	28	28	52	22
Amounts due to related parties	0	0	0	0	0	0	0
	338	351	351	239	39	371	385
Shareholders' funds	1,449	1,742	2,252	2,813	3,407	1,954	1,528
Total liabilities and equity	2,882	3,262	3,697	4,408	4,721	3,379	3,124
Net cash	-359	-320	-431	109	695	-198	-408
Net debt to equity (%)	25	18	19	net cash	net cash	10	27
BVPS (Rmb)	0.87	1.05	1.36	1.69	2.05	1.18	0.92

Source: Company, Piper Jaffray

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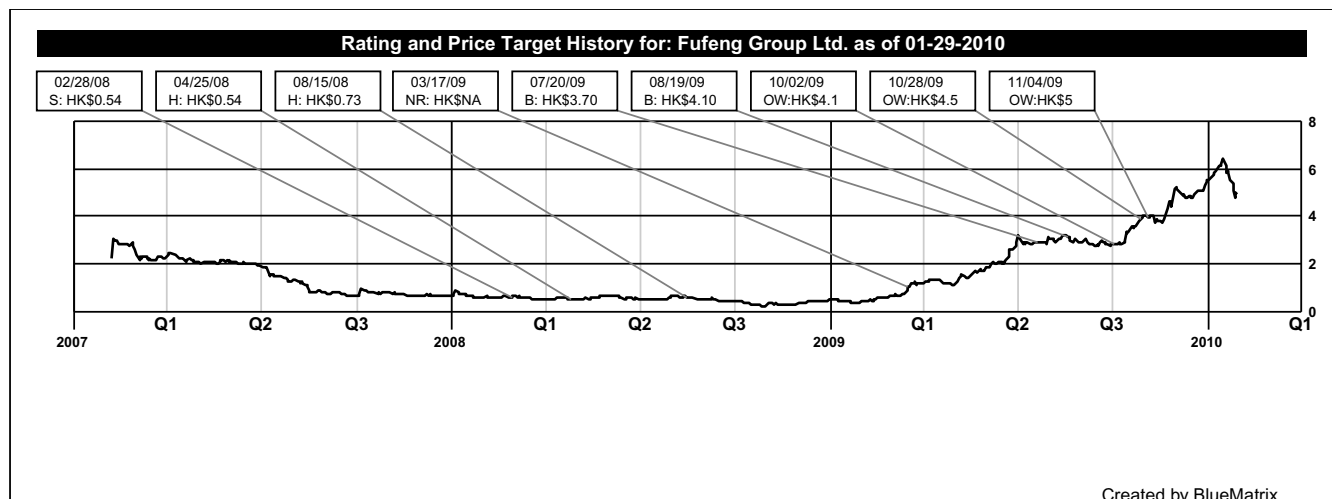
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Last updated: 1/27/2010

Cash flow Statement

Year ending Dec (RMB mil)	2007A	2008A	2009E	2010E	2011E
Operating					
EBIT	91	368	976	1,091	1,185
Depreciation	117	153	180	200	210
Amortization	2	2	2	2	2
Decrease/(increase) in working capital	-204	77	-203	-23	-19
Total operating cashflow	5	599	955	1,270	1,378
Investing					
Capex	-503	-397	-600	-200	-200
Total investing	-503	-397	-600	-200	-200
Financing					
Interest charges	-45	-43	-39	-16	-7
Share issues/exercise of warrants	975	0	0	0	0
Dividends received/(paid)	-69	0	-293	-326	-324
Tax paid	0	-31	-86	-140	-188
Others	-35	-90	-48	-48	-72
Total financing	824	-164	-465	-530	-592
Net cash flow	326	39	-111	540	586
Net cash/(debt) at beginning	-685	-359	-320	-431	109
Net cash/(debt) at end	-359	-320	-431	109	695
Ratio analysis					
	2007	2008A	2009E	2010E	2011E
P/B (x)	5.3	4.0	3.1	2.5	2.0
ROE (%)	3.1	16.9	37.8	33.2	29.0
Inventory days	54	44	53	51	51
Receivable days	81	56	56	56	56
Payable days	128	110	106	106	106
Current ratio (x)	3.4	3.3	3.4	8.0	57.5
Quick ratio (x)	3.1	3.0	3.0	7.6	57.0
Asset equity(x)	2.0	1.9	1.6	1.6	1.4
EBITDA/interest expense(x)	5	12	30	82	201

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

NA: Not Available

UR: Under Review

Distribution of Ratings/IB Services Piper Jaffray				
Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [OW]	321	47.00	62	19.31
HOLD [N]	269	39.40	17	6.32
SELL [UW]	93	13.60	1	1.08

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Analyst Certification — Anson Chan, Sr Research Analyst

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- **Overweight (OW):** Anticipated to outperform relative to the median of the group of stocks covered by the analyst.
- **Neutral (N):** Anticipated to perform in line relative to the median of the group of stocks covered by the analyst.
- **Underweight (UW):** Anticipated to underperform relative to the median of the group of stocks covered by the analyst.

An industry outlook represents the analyst's view of the industry represented by the stocks in the analyst's coverage group. A Favorable industry outlook generally means that the analyst expects the fundamentals and/or valuations of the industry to improve over the investment time horizon. A Neutral industry outlook generally means that the analyst does not expect the fundamentals and/or valuations of the industry to either improve or deteriorate meaningfully from its current state. An Unfavorable industry outlook generally means that the analyst expects the fundamentals and/or valuations of the industry to deteriorate meaningfully over the investment time horizon.

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