

546 HK

FUFENG GROUP

HONG KONG / MATERIALS

BUY

TARGET	HKD6.10
PRIOR TP	N/A
CLOSE	HKD4.13
UP/DOWNSIDE	+47.7%

HOW WE DIFFER FROM THE STREET

	BNPP	Consensus	% Diff
Target Price (HKD)	6.1	6.27	(2.8)
EPS 2011 (RMB)	0.46	0.53	(13.3)
EPS 2012 (RMB)	0.70	0.66	6
	Positive	Neutral	Negative
Market Recs	11	0	0

INDUSTRY OUTLOOK ↔

Vital ingredients in flat market

↓↑ CHANGE

Industry consolidation leads to rising pricing power

Cost pressure and industry leaders aggressive pricing strategy leads to 16% MSG capacity reduction in China YTD. As the largest MSG maker in China, Fufeng expands its market share and pricing power utilizing its competitive advantages in cost, scale, product diversification and effective working capital management. Initiate with BUY and HKD6.20 TP.



CATALYST

ASP hike leads to expanded gross margin

While we expect weak 2011E results (~20% EPS decline y-y), the aggressive pricing strategy did drive out small players. Fufeng hiked ASP's by 5-6% in 4Q11 and we believe another 5% hike is possible; 4Q is normally the peak season for MSG consumption. We expect to see gross margin improvement from this point on.

↗ VALUATION

Currently trading at a 22.6% discount to historical average

The stock is trading at 4.8x 2012E P/E with 28.1% ROE, 23.8% gearing, and 5.2% yield. This implies a 22.6% discount to its historical average of 6.2x 12-month forward earnings. Our TP HKD6.1 is set at 7.2x 2012E P/E implying 48% upside. We believe Fufeng deserves a re-rating considering its more stable margin outlook after industry consolidation.



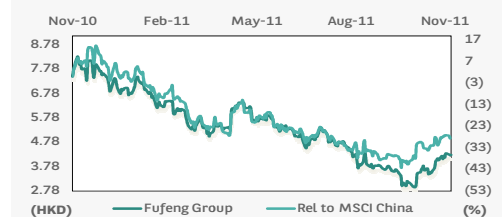
COMMENT

Proxy to consumer play with very attractive valuation

MSG market achieved 12.2% volume CAGR in the past decade. We conservatively forecast 5% volume CAGR for the next five years. The demand for MSG is resilient and industry consolidation provides opportunities for further margin expansion. Fufeng plans to promote other amino acid products and collaborate with other foreign food additive companies to promote its own brand. With continuous product mix upgrade, market share expansion and gross margin improvement, we believe that the company deserves a re-rating.

KEY STOCK DATA

YE Dec (RMB m)	2011E	2012E	2013E
Revenue	8,340	10,548	13,023
Rec. net profit	773	1,169	1,493
Recurring EPS (RMB)	0.46	0.70	0.89
Prior rec. EPS (RMB)	-	-	-
Chg. In EPS est. (%)	N/A	N/A	N/A
EPS growth (%)	(20.0)	51.3	27.7
Recurring P/E (x)	7.3	4.8	3.8
Dividend yield (%)	3.4	5.2	6.6
EV/EBITDA (x)	5.5	3.9	2.9
Price/book (x)	1.5	1.2	1.0
Net debt/Equity (%)	35.2	23.8	7.9
ROE (%)	22.5	28.1	28.9



Share price performance	1 Month	3 Month	12 Month
Absolute (%)	15.7	10.4	(48.4)
Relative to country (%)	4.1	15.2	(24.6)
Next results	April 2012		
Mkt cap (USD m)	889		
3m avg daily turnover (USD m)	1.7		
Free float (%)	27		
Major shareholder	Li Xue Chun (47%)		
12m high/low (HKD)	8.16/2.96		
3m historic vol. (%)	59.8		
ADR ticker	-		
ADR closing price (USD)	-		
Issued shares (m)	1,673		

Sources: Bloomberg consensus; BNP Paribas estimates



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RISK EXPERTS

Key Earnings Drivers & Sensitivity

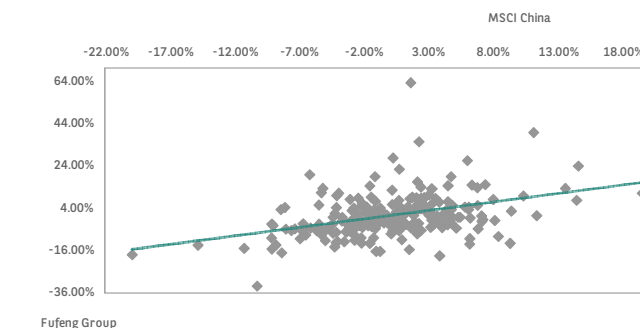
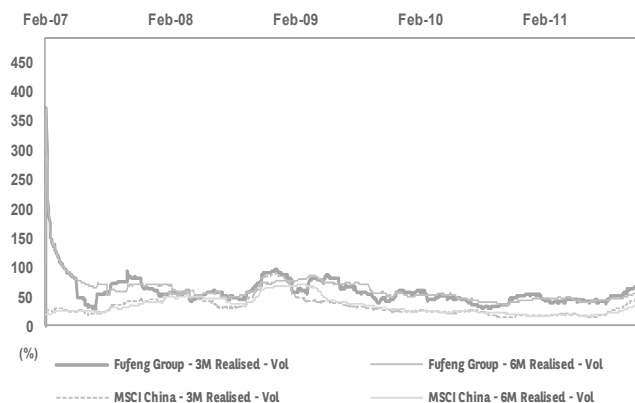
- Every 10% ASP hike can improve gross margin by 4ppt
- Every 10% cost hike of corn can decrease company MSG gross margin by 5.4ppt and every 10% cost hike of coal can decrease company MSG gross margin by 1.1ppt;

Year-end 31 Dec (RMB m)	2011E	2012E	2013E
MSG	5,198	6,806	8,612
Fertilizer	504	544	589
Xanthan Gum	823	1,059	1,091
Starch sweetener	525	552	580
Corn refined products	1,055	1,086	1,231
Threonine	156	420	840
Others	80	80	80
Total	8,340	10,548	13,023

Source: BNP Paribas estimates

Fufeng Group and MSCI Index (3M and 6M Realised-Vol)

Regression – Fufeng Group to MSCI Index



Fufeng Group = 0 + 0.0417 * MSCI Index
 R Square = 0.1559
 Regression based on 248 observations of 5 years weekly data. Please refer to Appendix 1 for the explanation of R-square
 Sources: Bloomberg; BNP Paribas

Sources: Bloomberg; BNP Paribas

China Sector Correlation Matrix at 25 July 2011

	Banks	Insurance	Metal & mining	Oil & Gas	Property	Telecom	Utilities	Coal
Banks	1.00	0.74	0.77	0.79	0.72	0.68	0.60	0.75
Insurance		1.00	0.73	0.75	0.62	0.64	0.54	0.70
Metal & mining			1.00	0.81	0.68	0.65	0.62	0.81
Oil & Gas				1.00	0.61	0.74	0.61	0.79
Property					1.00	0.51	0.52	0.62
Telecom						1.00	0.57	0.63
Utilities							1.00	0.51
Coal								1.00

Source: BNPP Paribas Sector Strategy

The Risk Experts

- Our starting point for this page is a recognition of the macro factors that can have a significant impact on stock-price performance, sometimes independently of bottom-up factors.
- With our Risk Expert page, we identify the key macro risks that can impact stock performance.
- This analysis enhances the fundamental work laid out in the rest of this report, giving investors yet another resource to use in their decision-making process

Long/Short Chart



Sources: Bloomberg; BNPP Paribas

Sources: Bloomberg, BNPP Paribas

Competitive advantages drive market share expansion

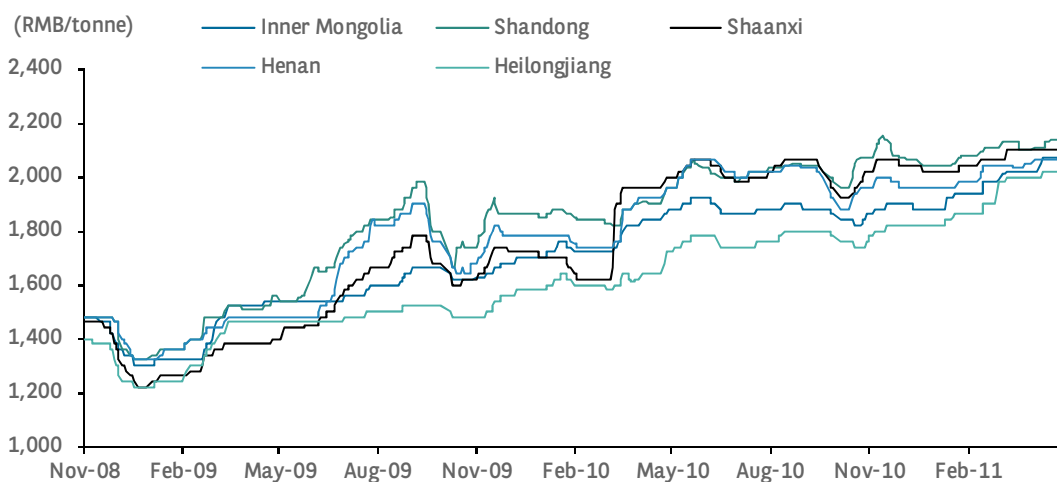
Fufeng Group is the biggest MSG producer in China, accounting for a 30% market share and 25% market share in the rest of the world at the end of 2011, according to management's estimate. Customers are mainly food processing producers, catering businesses and super markets in China. Besides its main product MSG, in the last few years the company is putting more efforts into promoting its Xanthan Gum – another product using fermentation technology and it plans to continue to promote a new ammonia product – Threonine over the next three years. We like Fufeng due to its scale advantage, strengthened leading position in the MSG industry and strong execution ability of management. In terms of earnings growth, we forecast that the company will grow by 51% in 2012 supported by its capacity expansion and more stable margin outlook.

Cost advantage comparison with industry peers

Monosodium glutamate (MSG) uses fermentation technology. For the fermentation industry, we believe the company's earnings ability is related closely to its cost advantage as corn and coal account for a major part of raw materials. For Fufeng, corn and coal accounted for more than 50% of its total raw materials.

We believe Fufeng has a strong cost advantage due to its better locations. Fufeng's competitors' production bases are located mostly in Shandong and Henan provinces. Fufeng, as the biggest MSG producer in the world, it strategically locates its major production bases near lower-cost areas in China, such as Shaanxi, Northeast China (where corn price is RMB200/tonne cheaper than central China-Henan Province) and Inner Mongolia (where coal cost is only 1/3 of that of Shandong province). The company is not in a labour intensive industry, though labour costs in Northeast China and West China are also lower than in the coastal cities.

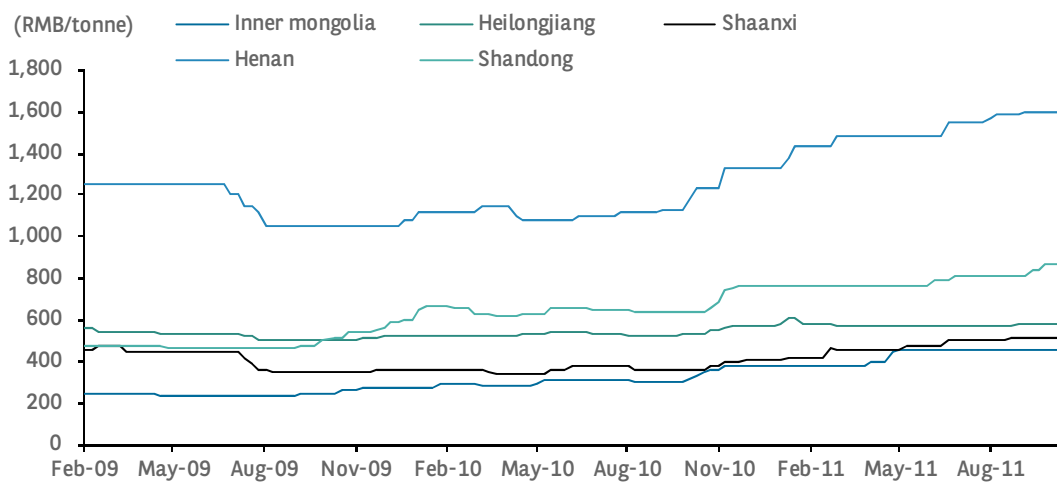
EXHIBIT 1: Corn price of different places in China



Corn price for Fufeng's Northeast production base is RMB200/tonne cheaper than that of Shandong and Henan provinces

Sources: Bloomberg; BNP Paribas

EXHIBIT 2: Coal price of different places in China



Coal price in Inner Mongolia is 1/3 of that of Shandong and 1/6 of Henan

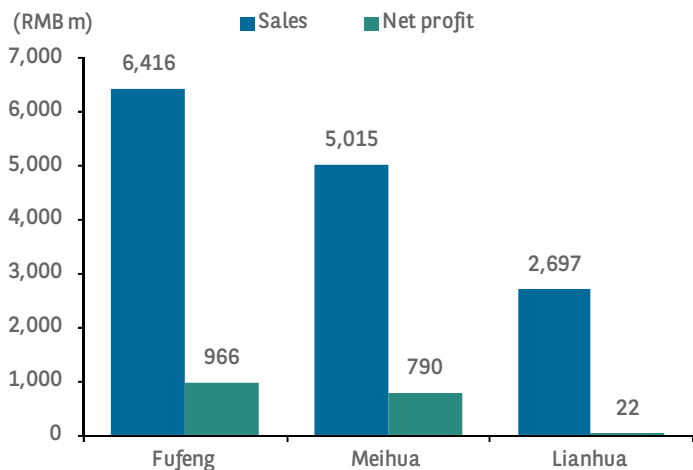
Sources: Bloomberg; BNP Paribas

Another cost advantage Fufeng has its scale advantage. The company is the largest MSG producer in China: sales in 2010 amounted to RMB6,416m, 27.9% higher than the second biggest player Meihua, it can also

make full use of its by-products during the production process. It sells its corn refined products – chicken powder, corn oil, even coal dust and waste water emission could be produced into fertilizer. With a scale advantage and complete production chain, we view the company as better than its peers in terms of earnings quality.

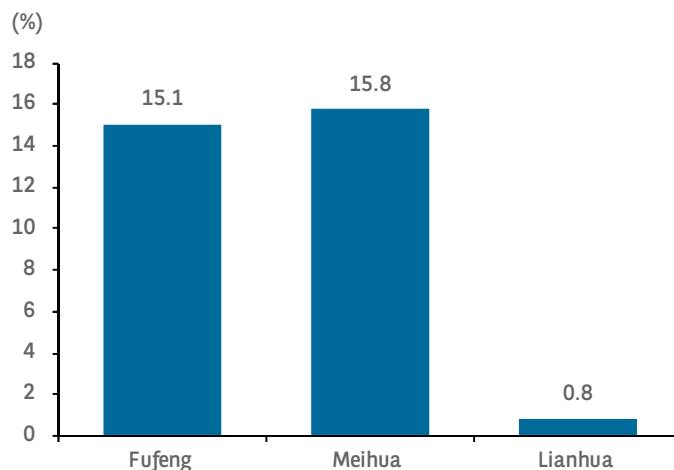
For example, 95% of Fufeng’s products are sold to food processing companies and catering businesses, only 5% are sold to supermarkets and end retailers (small package products are sold to the end retailers). Meihua (A-share) is the second largest player in the MSG industry in China with 1/3 sales from the end consumer market, 1/3 sales from exports and only 1/3 from manufacturers. Although whole sale prices for small package products (currently, around RMB15,000/tonne) are higher than the price to manufacturers (RMB8, 400/tonne), with greater sales and marketing expenses, Meihua’s net margin is 15.8% in 2010, only 0.7ppt higher than that of Fufeng in 2010. Besides, Fufeng’s ROE in 2010 is 34.9%, much higher than Meihua’s 17.9% due to Fufeng’s more focused business.

EXHIBIT 3: Sales and net profit comparison (2010)



Note: Fufeng Group, Meihua and Lianhua are the three Chinese MSG companies listed in Hong Kong market and A-share market
Sources: Fufeng Group; Meihua; Lianhua; BNP Paribas

EXHIBIT 4: Net profit margin comparison (2010)

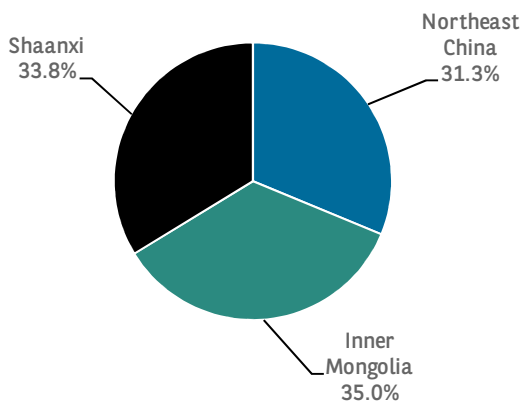


Sources: Fufeng Group; Meihua; Lianhua; BNP Paribas

Pricing power strengthened on industry consolidation

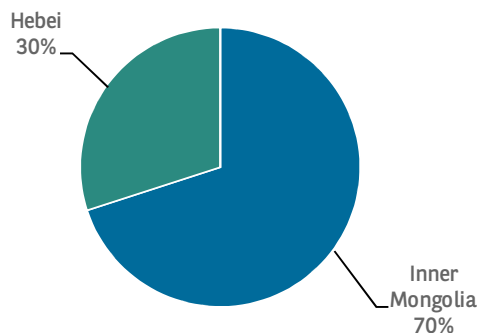
We believe Fufeng has stronger pricing power than its peers; firstly, its scale advantage and better location ensures a relative lower cost and its equal capacity distribution in Shaanxi, Inner Mongolia and Northeast China after the Phase 2 production base commences production in June 2012: Fufeng’s previous Shandong production base is now used for small production of packaged MSG. The second largest player Meihua, has 70% of capacity located in Inner Mongolia and 30% of capacity located in higher cost Hebei province and other small players (nearly 50% of the total capacity) are located in much higher cost Henan and Shandong province.

EXHIBIT 5: Fufeng capacity location (2012E)



Sources: Fufeng Group; BNP Paribas estimates

EXHIBIT 6: Meihua capacity location (2012E)



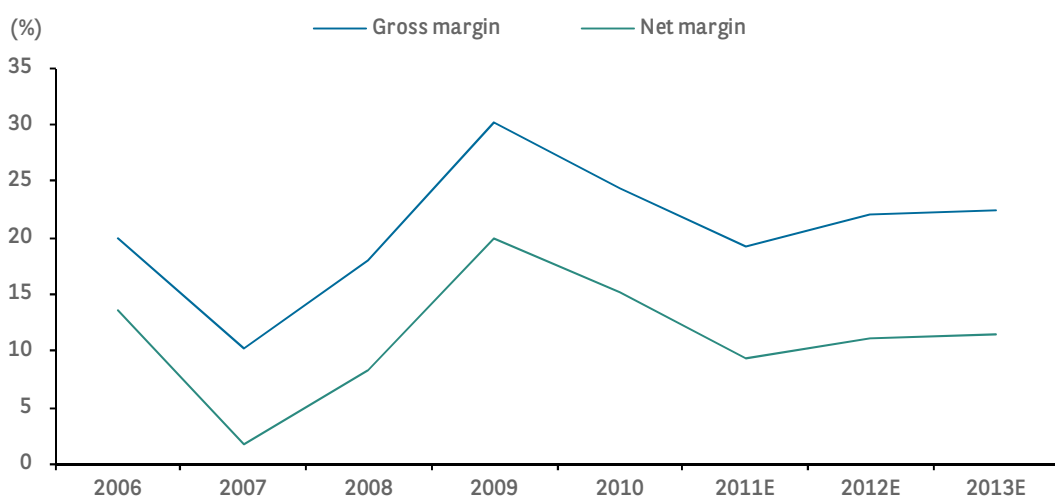
Sources: Meihua; BNP Paribas estimates

Secondly, due to its lower costs, the company uses a lower price strategy to phase out competitors; for example, in 2007 the MSG industry faced over capacity problem while the cost of corn increased by 30% y-y, the overall industry faced huge margin pressure. The company lowered its ASP in 2007 to squeeze the

higher cost competitors out of the industry, at the sacrifice of gross margin which eroded to 10% in 2007. After this round of industry consolidation, the total number of the MSG producer was reduced to around 20 in 2009 from around 100 in 2007 according to management's estimate.

Thirdly, we believe the company's pricing power strengthened from industry consolidation. In October 2007, the government targeted to close down MSG producers with capacity under 30000 tonnes, thus 30-40% of the producers ceased production; in 2009, the government led another round of MSG industry consolidation, restraining the development of MSG capacities under 100,000 tonnes. After two rounds of industry consolidation, small players are out of the market while Fufeng and the second largest player Meihua account for about 50% of total market share. In 4Q09, the company raised its ASP significantly to a historical high level of RMB12,000/tonne as the market was in short supply of MSG. The company's gross margin expanded to 30% in 2009. However, we believe this was only a one-off effect and that after the industry consolidation, it would be reasonable for the company to maintain its gross margin around 25% longer term. In 3Q11, under cost pressures 30-40% of capacity in Shandong province ceased production, because Fufeng maintained a relative stable price under that environment.

EXHIBIT 7: Fufeng's gross margin and net margin trend



Sources: Fufeng Group; BNP Paribas estimates

In 2007, the company's gross margin eroded to 10% by its intention to lower its ASP to phase out competitors; in 2009, its gross margin increased to a historical high level of 30% due to a shortage of MSG in the market

A pioneer in environmental protection of MSG industry

MSG is produced from Glutamic acid. In the process of producing Glutamic acid, there will be a large amount of polluted water and gas emissions: to deal with every 100,000 tonnes of polluted water needs RMB50m-60m capex in environmental protection facilities. Small producers are reluctant to spend large amounts on environment protection. The Chinese government has been dealing with the water and gas pollution issues of the MSG industry since 1996: in 2007 the Chinese government announced the plan of phasing out four disadvantaged capacities including the MSG industry. Fufeng is a pioneer in dealing with gas and water emission issues: it had spent RMB100m-200m to deal with the gas emission problem in its Shaanxi Baoji factory. Fufeng is benefitting from the government policy and gaining market share accordingly.

EXHIBIT 8: Policies regarding MSG environmental pollution

Year	Policy	
1996	GB8978:comprehensive water pollution standard	Set the standard for water pollution for MSG
2004	GB19431-2004:MSG pollution emission standard	To manage the MSG pollution
2007	NDRC to announce the energy saving plan	To phase out the disadvantaged capacities of related industry
2007	NDRC and environment authority to announce the plan of phase out the disadvantaged capacities	To phase out the capacities unable to meet the emission standard

Source: Fufeng Group

Strong execution ability of management team

Fufeng was established in 1999 in Shandong province. After 10 years' development and transfer of the three most important production bases, the company grew from a small factory to an industry leader. The impressive growth rate was mainly due to the strong execution ability of the management team. With a focus on a lower cost strategy and a vision to capture domestic MSG demand, the company targets to expand its capacity to 1m tonnes in 2013 from 60,000 tonnes in 1999. There are a few historical milestones for this company.

EXHIBIT 9: Company milestones

Year	Events
1999-03	Established in Shandong, the company ranked in the top 10 MSG producers with capacity around 60,000 tonnes
2004-05	The company commenced its production in Shaanxi Baoji, with capacity totalling about 120,000 tonnes and ranked first in the market
2006 till present	The key production base is transferred to Inner Mongolia and the Northeast as the company is eyeing the lowest cost areas in China.
February 2007	The company was listed in Hong Kong main board, raising about HKD1b. The company president Li Xue Chun takes about 47% of the company stake and 29 strong management team takes about 21.19% of the total stakes.
2010	The company promoted its own brand "U Fresh Series" includes small packages of MSG, Chicken powder and compound seasoning formula products and establish its sales network through 2000 end retailers.
March 2010	The company became a constituent of the Hang Seng Composite Index Series.
September 2010	The company was ranked as one of the annual "Forbes Top 200 SMEs in the Asia-Pacific Region"

Sources: Fufeng Group; BNP Paribas

Short cash conversion cycle days

Due to the strong demand of its customers, the company requires distributors and other customers to pay the company in advance; over 60% of the company's receivables are notes receivables, while the second largest player Meihua, only has 24% as notes receivables. Besides, it also has a very low inventory level due to strong demand from the market; all in all, the company has very strong cash conversion cycle. In 2010, the company's inventory days were about 49.4, debtor days 35.5 and creditor days 38.7. We believe the cash conversion cycle will continue to improve.

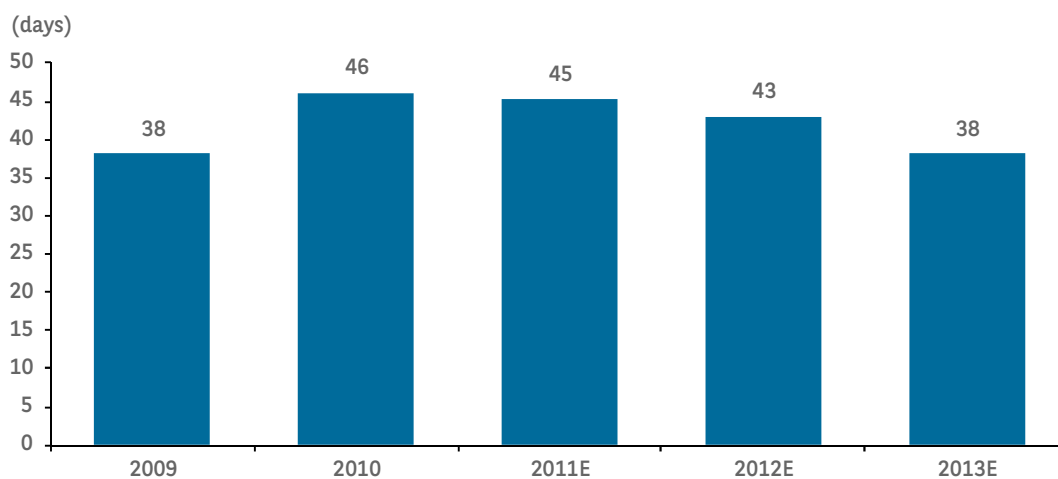
EXHIBIT 10: Company's inventory days, debtor days and creditor days

Year-end 31 Dec	2009	2010	2011E	2012E	2013E
Inventory days	53.7	49.4	45.3	44.7	41.2
Debtor days	43.7	35.5	32.7	32.7	31.2
Creditor days	59.3	38.7	32.9	34.5	34.4

Notes: Over 60% of company's receivables are notes receivable

Sources: Fufeng Group; BNP Paribas estimates

EXHIBIT 11: Cash conversion cycle



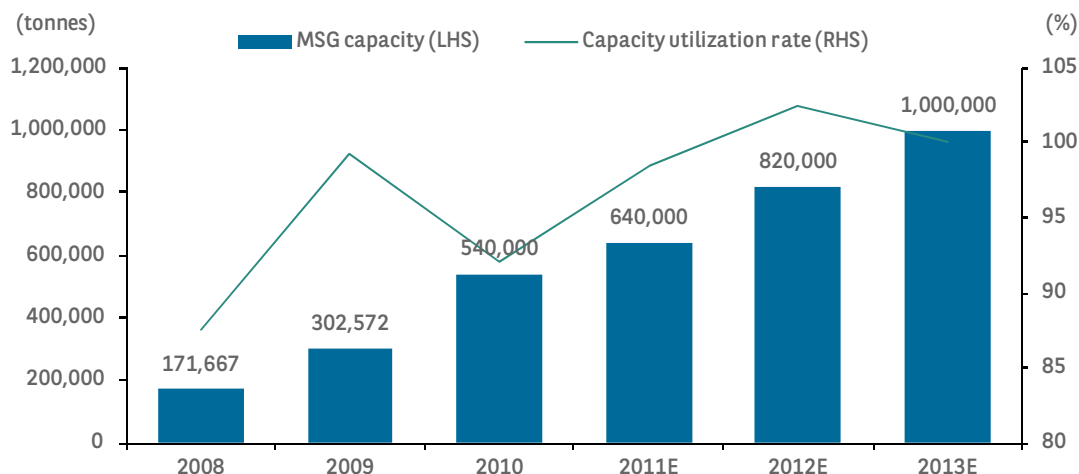
Sources: Fufeng Group; BNP Paribas estimates

Market share expansion resulted from its competitiveness

Historically, Fufeng expanded its capacity aggressively. Capacity grew at a CAGR of 77.3% from 2008 to 2010 and capacity is expected to grow at a CAGR of 25% from 2011E to 2013E according to management. The company is also maintaining a very high capacity utilization rate due to strong demand from its customers. Utilization rate from 2008-10 maintained above 88%; in 1H2011 the MSG utilization rate reached 103.5%. We believe the company can maintain its capacity utilization rate above 90% over the next three years.

Backed by its capacity expansion, the company posted very strong financials: its sales grew at a CAGR of 37.6% from 2006-10, while net profit grew at a CAGR of 41.6%. The Northeast plant phase 1 (250,000 tonnes of capacity) has commenced production from September 2011 and we estimate that overall yearly production volume will reach 640,000 tonnes and that total capacity will reach 820,000 tonnes in 2012 after the Northeast phase 2 plant commences production and the company's capacity reaches 1m tonnes in 2013.

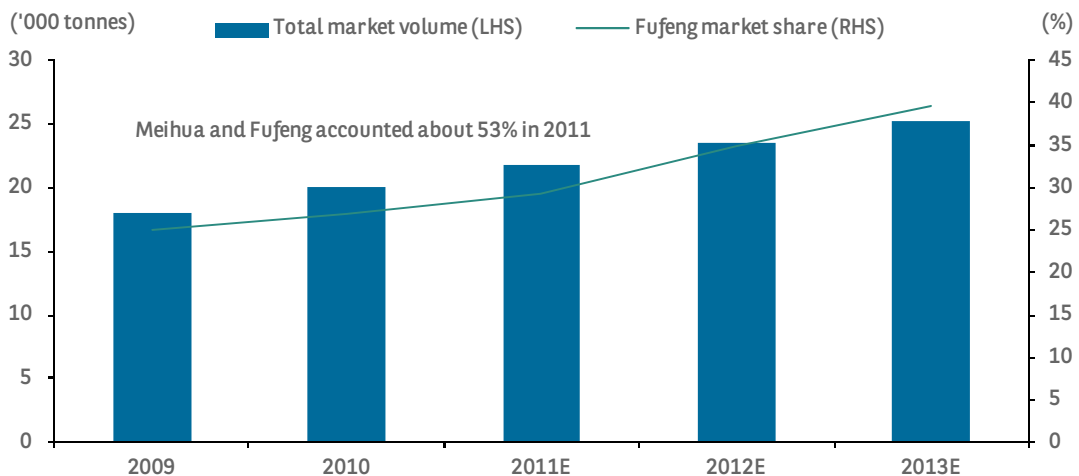
EXHIBIT 12: MSG capacity expansion



Sources: Fufeng Group; BNP Paribas estimates

The company has maintained its leading position in the MSG market since 2004. The company's leading market share position should be strengthened as a result of its capacity expansion. Its market share will improve from 25% in 2009 to 40% in 2013 according to our estimates. The second biggest player Meihua, only accounted for about 18% of total market share in 2009 and the third largest player Xuehua accounted for about 9% of total market share. We contacted the management of Meihua and learned that they are currently focused on promotion of amino products and will not expand aggressively in terms of MSG. Their capacity will reach about 500,000 tonnes at the end of 2011 and they only target to increase their capacity to 600,000 tonnes, eventually. We estimate that at the end of 2013, Meihua and Fufeng's combined market share will increase to 64% from 52% in 2011.

EXHIBIT 13: Fufeng market share improvement



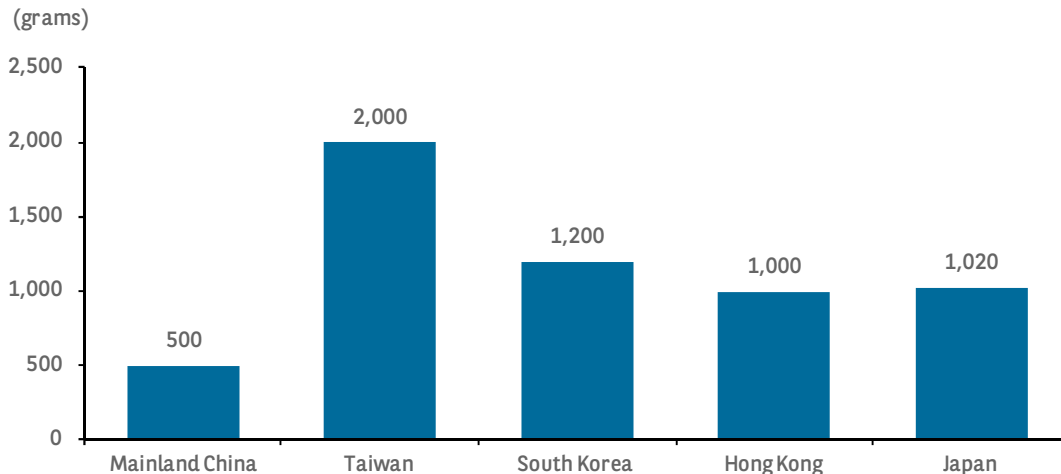
Sources: Fufeng Group; BNP Paribas estimates

Global demand on MSG remains solid with no sign of decline

Low per capital consumption of MSG in China

China supplies 70% of the world's MSG, while Asia is the major consumption market for MSG. According to *Japan Fermentation Association* estimates, China mainland per capital consumption of MSG is only 500 grams per year, far behind that of South Korea, Japan, Taiwan and Hong Kong. China MSG is mainly sold through food processors and catering businesses, with only 20% sold through supermarket and end retailers. The low per capital consumption level should provide room for MSG consumption growth in our view.

EXHIBIT 14: MSG per capital consumption volume

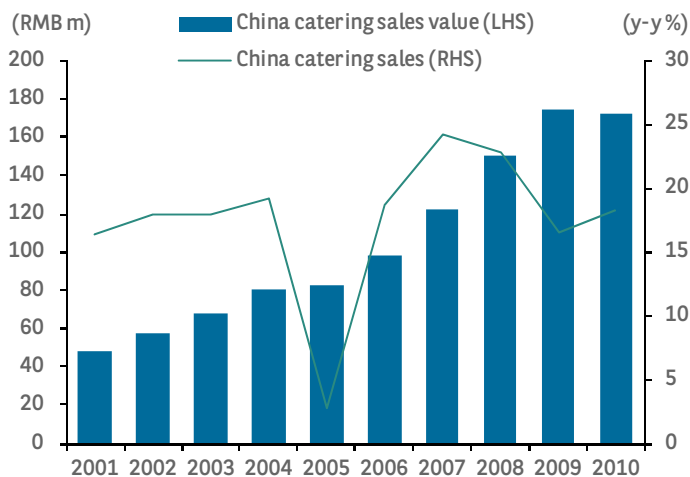


Sources: Fufeng Group; BNP Paribas

Demand is resilient due to growth of catering and food processing industries in China

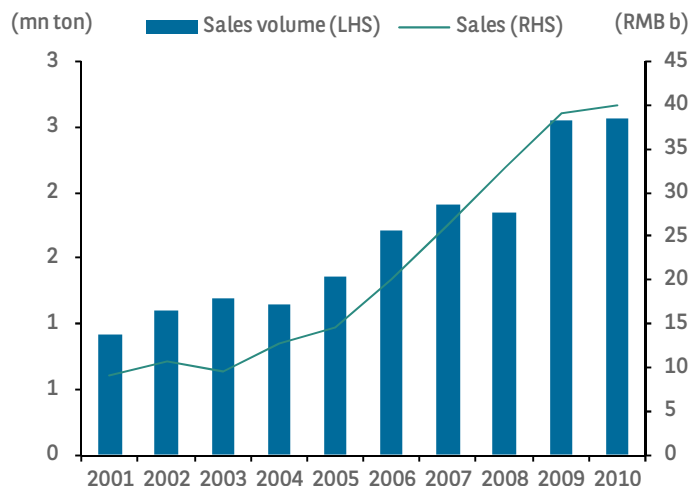
MSG is widely used in the food processing industry and catering business. China's catering business sales grew at a CAGR of 15% from 2000-10, while MSG sales value grew at a CAGR of 18% from 2001 to 2010: MSG production volume grew at a CAGR of 12.2% during the same time. According to management, the MSG industry sale volume will still grow at around 5% CAGR in the next 3-5years. We believe global demand for MSG remains stable as it is a daily use food additive.

EXHIBIT 15: China catering sales value and growth rate



Sources: NDRC; BNP Paribas

EXHIBIT 16: China MSG sales volume and value



Sources: NDRC; BNP Paribas

More contribution from new products in the future

More contribution from Threonine and branched-chain amino acid products

We believe the company will have a new growth driver in the future besides MSG. The company every year spends RMB50m-60m in research and has strong technical backing. Historically, it successfully promoted its new product Xanthan Gum in 2006 after three years' research. In 2010, Xanthan Gum has grown to 11% of its total revenue and 17% of its total gross profit. The company also acquired Shenhua Pharmacy in 2008 and expects in the future it will contribute to company revenues.

Considering its successful historical launch of new products, we believe the company's Threonine will be a new growth driver in the next three years. The company produced Threonine and other branched-chain amino acid products starting in 2010. These products enjoy the same production chain as other products, but with more sophisticated fermentation technology. Threonine is mainly used in pharmacy and in food additives. The global demand for Threonine grew from 4,000 tonnes in 1993 to 400,000 tonnes in 2011, a CAGR of 25%. The Chinese market demand for Threonine is around 120,000 tonnes and grew at a CAGR of 30% in the last 10 years. Management expects that growth of Threonine in the future can still maintain at around 20% in China. In terms of capacity, the company's Threonine capacity totalled about 10,000 tonnes in 2010 and should reach 30,000 tonnes in 2011, 70,000 tonnes in 2012 and 100,000 tonnes in 2013: ASP is around RMB13,000/tonne in 2011. The company also signed a contract with Ajinomoto; some of the Threonine will be sold through Ajinomoto's network in Japan in the next three years.

Expanded sales from the consumer channel

The company also cooperated with some food additive producers in China, and promoted its U Fresh series such as soy oil and MSG. With a sales team of around 400-500 persons, the company will sell its products to 2,000 end retailers in China. The brand sales currently account for about 5% of its total sales. Management are also in discussions with foreign food additive producers, and it is likely that in 2012, the company will sell foreign producers' food additive products.

EXHIBIT 17: Company capacity forecast

Year-end 31 Dec (tonnes)	2008	2009	2010	2011E	2012E	2013E
MSG	171,670	305,000	540,000	640,000	820,000	1,000,000
Fertilisers	405,000	460,000	560,000	660,000	810,000	1,000,000
Starch sweeteners	100,000	100,000	100,000	100,000	140,000	140,000
Corn oil		17,500	35,000	35,000	35,000	35,000
Chicken powder		5,000	10,000	10,000	10,000	10,000
Fructose			2,500	5,000	5,000	5,000
Branched-chain amino acid			750	1,000	1,000	1,000
Threonine			10,000	10,000	40,000	70,000
Xanthan Gum	21,000	32,000	38,000	40,000	50,000	55,000

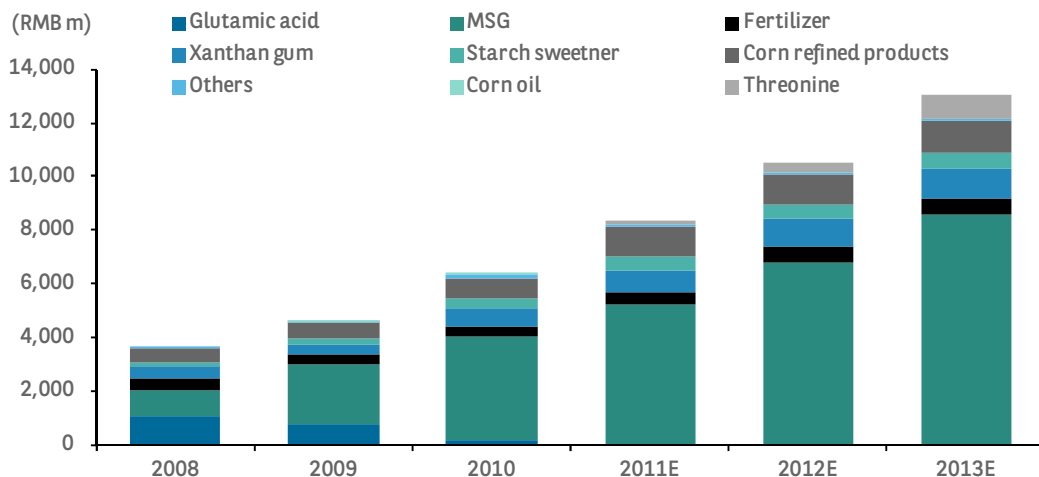
Sources: Fufeng Group; BNP Paribas estimates

Financial forecast

MSG will still be the major growth driver

We believe sales growth will be driven by capacity expansion and ASP hikes. Currently, the MSG price is around RMB8,400/tonne, a 5% increase since 1H11, and we estimate that the price will see another 5% hike in 4Q11 as the peak season arrives. We estimate that 2011 full year ASP would be RMB8,250/tonne, and we forecast that MSG will see a 5% ASP hike every year as the company gains more pricing power after industry consolidation. For volume growth, we forecast a CAGR of 25.9% from 2011 to 2013. The company targets gross margin at around 25% longer term.

EXHIBIT 18: Sales forecast

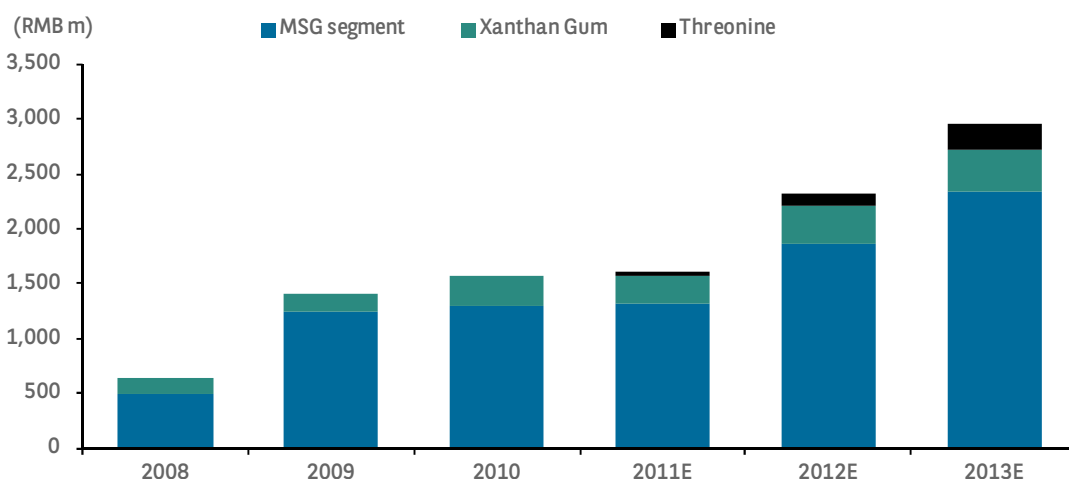


MSG increased from 28% of its total sales in 2008 to 67% of its total sales according to our estimate

Sources: Fufeng Group; BNP Paribas estimates

We also forecast that MSG gross profit contribution will increase to 87% of total sales in 2013E from 76% of total sales in 2008. Xanthan Gum – a higher margin product (gross margin around 36%) will see volume growth at a CAGR of 17.2% from 2011 to 2013. Gross profit contribution will maintain around 17% in 2011E and be around 13% in 2013E, as we forecast that ASP will be relatively stable as the company is also gaining market share using its lower cost strategy. We also forecast that Threonine will contribute to 8% of its total gross profit in 2013E.

EXHIBIT 19: Gross profit forecast

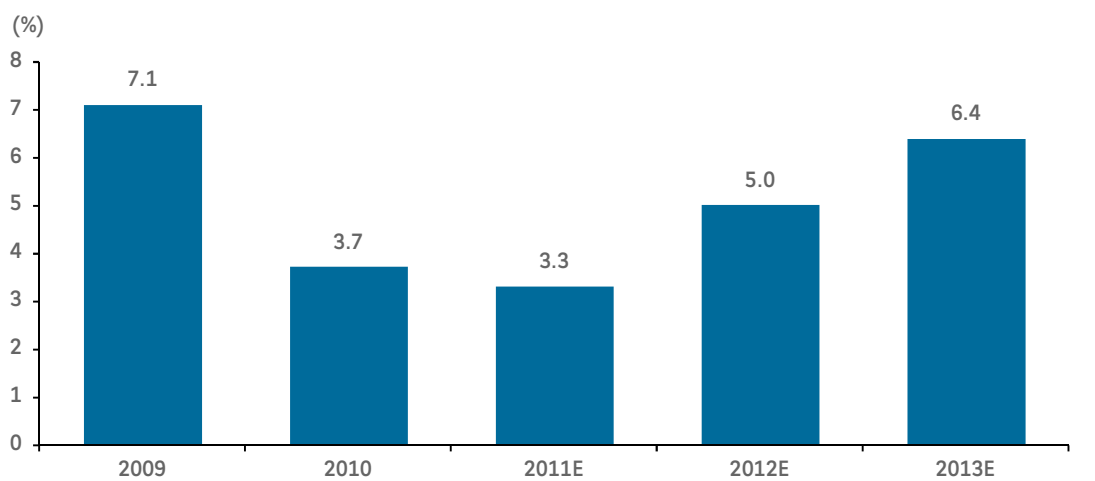


Sources: Fufeng Group; BNP Paribas estimates

Strong balance sheet with high dividend yield

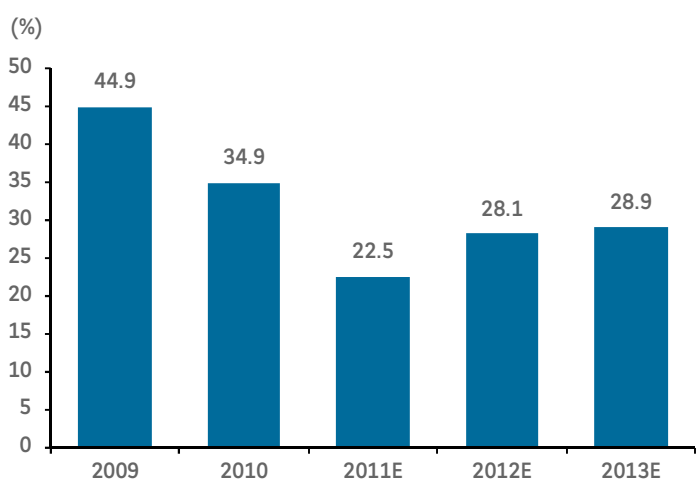
The company has maintained around a 20-25% dividend payout ratio historically, implying a 3.3% dividend yield in 2011E. We believe the company has a very strong balance sheet due to its quick cash conversion days, lower net gearing ratio and high ROE.

EXHIBIT 20: Dividend yield



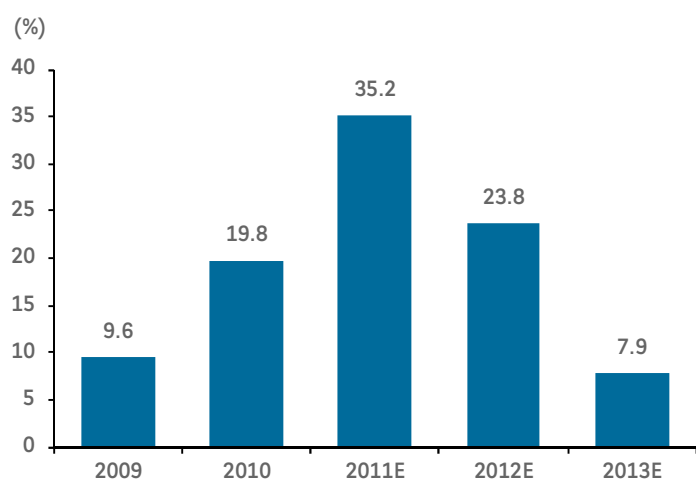
Sources: Fufeng Group; BNP Paribas estimates

EXHIBIT 21: ROE



Sources: Fufeng Group; BNP Paribas estimates

EXHIBIT 22: Net gearing



Sources: Fufeng Group; BNP Paribas estimates

CB and senior US bonds issued to support its Capex needs

On 25 March 2011, the company issued a CB for RMB820m and option bonds of RMB205m due in 2015, at a 4.5% interest rate and conversion price of HKD7.03: if exercised can be converted into 165.7m shares. The proceeds raised from the bonds are mainly being used as capital expenditures for its Inner Mongolia plant and Hulunbeir Plant. The company also issued USD300m 7.625% senior notes due 2016 on 6 April 2011. The proceeds are mainly being used to construct Northeast Plant Phase I and Phase 2. With sufficient cash, we expect the company can expand its product capacity faster than its competitors.

Intensive Capex keeping small players away

MSG is produced from Glutamic acid. Every 100,000 tonnes of Glutamic acid needs capex of RMB500m-600m; and every 100,000 tonnes of MSG needs another RMB100m in capex. In China, industry peers are reluctant to expand their capacities due to restraints on capital and lack of scale advantage. Fufeng expects capex of RMB1,200m in 2011 and RMB500m-600m in 2012.

EXHIBIT 23: Sales forecast

	2008	2009	2010	2011E	2012E	2013E
	(RMB m)	(RMB m)	(RMB m)	(RMB m)	(RMB m)	(RMB m)
Sales						
Glutamic acid	1,053	721	154	0	0	0
MSG	1,004	2,245	3,893	5,198	6,806	8,612
Fertilizer	380	361	370	504	544	589
Xanthan gum	452	408	682	823	1,059	1,091
starch sweetner	163	245	357	525	552	580
corn refined products	510	558	774	1,055	1,086	1,231
corn oil	0	62	104	0	0	0
Threonine	0	0	0	156	420	840
Others	23	33	85	80	80	80
Total	3,585	4,633	6,416	8,340	10,548	13,023
Volume ('000 tonnes)						
Glutamic acid	163	101	20	0	0	0
MSG	146	292	500	630	820	1,000
Fertilizer	370	497	533	700	720	756
Xanthan gum	21	19	35	44	55	55
Starch sweetner	88	118	127	150	150	150
Corn refined products	186	199	274	360	360	396
Threonine	0	0	5	12	30	60
ASP (RMB/tonne)						
Glutamic acid	6,474	7,135	7,706	0	0	0
MSG	6,865	7,680	7,903	8,250	8,300	8,612
Fertilizer	1,026	727	693	720	756	779
Xanthan gum	21,596	20,989	19,579	18,700	19,261	19,839
Starch sweetner	1,842	2,080	2,816	3,500	3,675	3,859
corn refined products	2,735	2,800	2,828	2,930	3,018	3,108
Threonine	0	0	1	1	3	6
Gross profit						
MSG	489	1,251	1,300	1,271	1,826	2310
Xanthan gum	155	149	265	338	495	620
Gross profit margin (%)	18.0	30.2	24.4	19.3	22.0	22.5

Sources: Fufeng Group; BNP Paribas estimates

Valuation

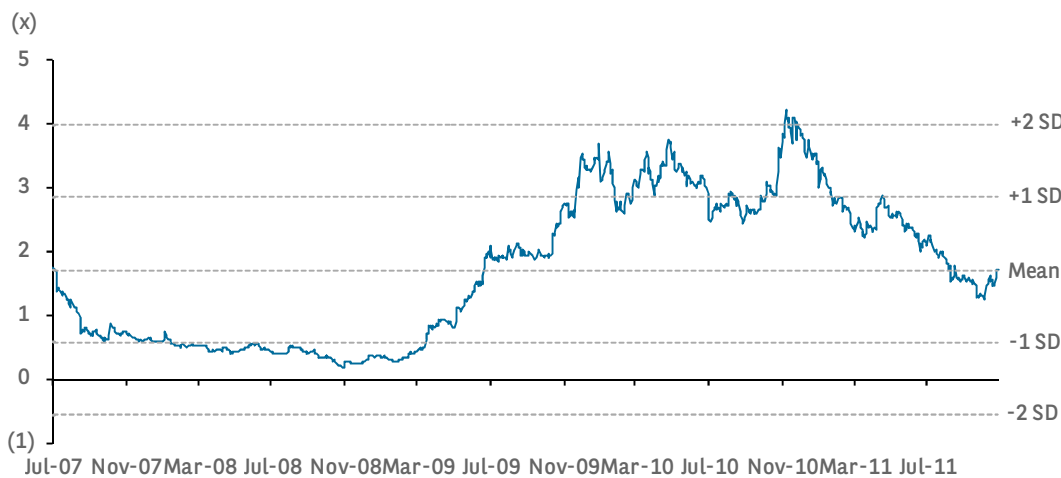
The company historically trades at 6.2x forward P/E and 1.9x forward P/BV on average; currently the company is trading at 4.8x 2012E P/E, a 22.6% discount to its historic valuation. International producers like Ajinomoto are valued at 15.0x 2012E P/E, based on Bloomberg consensus estimates. Also, the second largest domestic player Meihua (600873 CH), listed in the A-share market, is trading at around 23x 2012E P/E based on Bloomberg consensus estimates. We think Fufeng is a proxy on consumer play. On the other hand, amongst the Hong Kong soft commodity players valued at 5.3 x 2012E P/E based on Bloomberg consensus estimates, most of them have lower ROE, around 10%. We think Fufeng deserves a 7.2x 2012E P/E valuation considering its strengthened leading position in the industry and stable margin outlook. Our TP is HKD6.20, we initiate with a BUY rating, implying 48% upside.

EXHIBIT 24: P/E band chart



Sources: Fufeng Group; BNP Paribas

EXHIBIT 25: P/BV band chart



Sources: Fufeng Group; BNP Paribas

EXHIBIT 26: Peer comparison

	BBG code	Mkt cap (USD m)	Share price (LC)	----- P/E -----			----- P/BV -----		EV/EBITDA 2011E (x)	ROE 2011E (%)	ROA 2011E (%)	--- Div yield ---	
				2010 (x)	2011E (x)	2012E (x)	2011E (x)	2012E (x)				2010 (%)	2011E (%)
Overseas market													
Ajinomoto	2802 JP	8,208	871	16.6	16.2	15.0	0.8	0.8	5.4	6.2	4.7	1.8	1.9
China a share													
Henan Lianhua Gourmet Powder	600186 CH	689	4.1	na	na	na	na	na	na	na	na	0.0	na
Meihua Monosodium Glutamat	600873 CH	4,362	10.0	14.9	na	na	na	na	na	na	na	1.9	na
Hong Kong Market													
Vedan international	2317 HK	91	0.5	13.3	n.a	n.a	na	na	na	na	na	0.5	na
Fufeng Holdings	546 HK	951	4.1	6.4	6.6	5.3	1.6	1.6	5.9	27.7	11.9	5.3	4.9
Global Bio-Chem Technology	809 HK	804	1.9	7.2	5.3	5.5	0.4	0.4	4.7	12.3	9.1	0.5	4.5
China Starch Holdings	3838 HK	224	0.3	6.9	n.a	n.a	na	na	na	na	na	1.8	n.a
Global Sweeteners Holdings	3889 HK	159	1.0	9.6	5.9	4.7	0.4	0.4	4.0	8.8	na	0.0	3.1
Xiwang Sugar	2088 HK	210	1.5	6.0	5.9	4.5	0.6	0.6	5.4	10.1	6.5	0.0	3.1
HK market simple average				8.2	5.9	5.0	0.7	0.7					
HK market mkt cap weighted average				7.1	6.0	5.3	1.0	1.0					

Share price as of 10 November 2011

Sources: Fufeng Group; Bloomberg consensus; BNP Paribas estimates

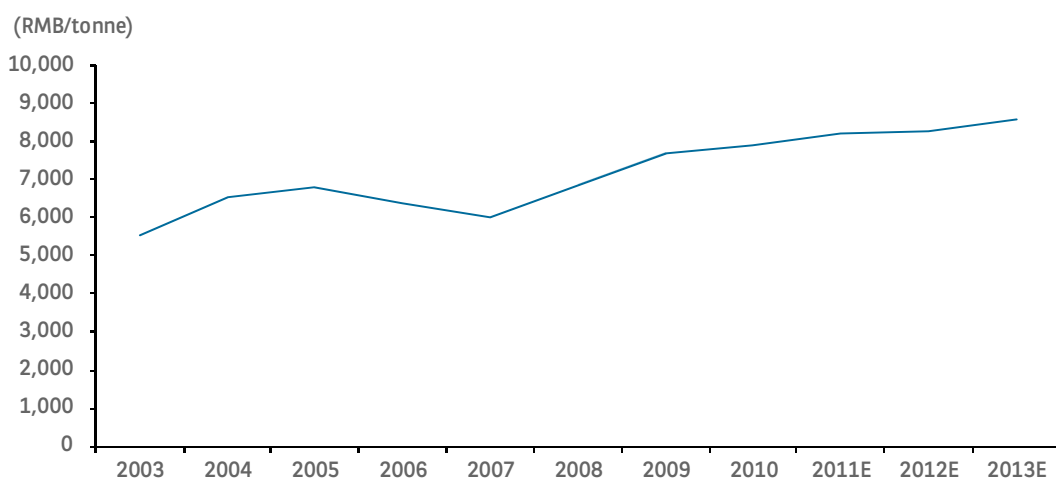
Catalyst and risks

ASP hike in MSG would be a near-term catalyst

4Q is usually the peak season for MSG consumption. From 2003 to 2010; it is very obvious to us that the MSG price is increasing at a very stable rate, around 5.1% every year. Currently the MSG price already increased by 5% to RMB8,400/tonne since October, and as the peak season for consumption comes in 4Q11; we estimate that there would be continuous ASP hike in 4Q. It is very possible that ASP would be raised to RMB 8,600-8800/ton this year. We estimate every 10% ASP hike could improve gross margin by 4ppt, assuming the cost remain the same.

In the long run, we believe gross margin is likely to remain above 25% due to increased pricing power. As the company has a complete production chain in the ferment industry, the scale advantage will be more obvious with the new synthetic ammonia and sulphuric acid plants put into production from September 2011: the cost saving would be RMB100m for the Inner Mongolia factory according to our estimate.

EXHIBIT 27: MSG price



Sources: Fufeng Group; BNP Paribas estimates

Raw material price hikes should hurt Fufeng's gross margin

The company's main raw materials are coal and corn kernel: price hikes in its raw materials will impair gross margins. With a 10% cost hike in coal, the company's MSG gross margin will decrease by 1.1ppt; with a 10% cost hike in corn, gross margin will decrease by 5.4%, as for Xanthan Gum, every 10% coal price hike will decrease margin by 3.5ppt, while every 10% corn price hike will decrease gross margin by 3.7ppt.

Poor 2H11 results, but already factored in the stock price

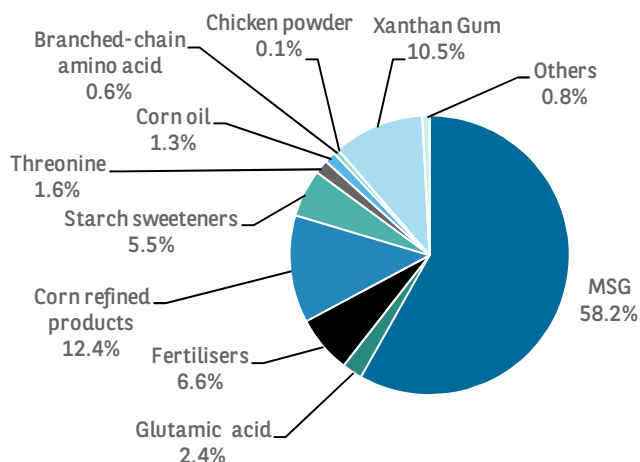
3Q is usually the low season for MSG sales and the company's gross margin reached its lowest level in 3Q this year, eroding to 16.8% from 21.7% in 1H11 due to high corn prices. But we believe the worst is already over and we also believe poor 2H11 results are already factored in the share price. The share price has come down 50% since its highest level of HKD8.33, from the end of last year. Our 2011E EPS is 13.3% lower than Bloomberg consensus and we believe is well justified by its turnaround story and attractive valuation.

Company background

Biggest MSG and Xanthan Gum producer in the world

The company products include MSG, Xanthan Gum, Threonine, Fertilizer and starch sweetener. In 1H11, MSG and Xanthan Gum accounted about 58.2% and 10.5% of total sales.

EXHIBIT 28: Company sales mix (1H11)

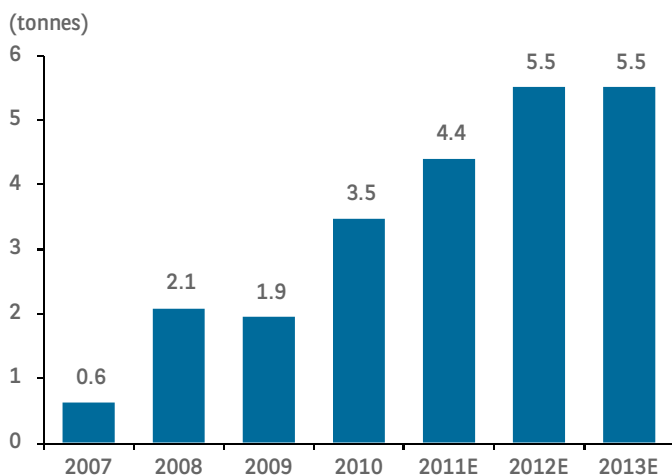


Sources: Fufeng Group; BNP Paribas

Besides MSG, the company is also the biggest Xanthan Gum producer in the world. The company has 45,000 tonnes of capacity and accounted for about 31% of global market share. Xanthan Gum is mainly used in oil exploration and food additives. Currently the demand is mainly coming from overseas markets. In the oil exploration area, Xanthan gum can be easily decomposed and will not pollute the environment, and it is widely used in the Middle East, Russia and South America. Xanthan Gum can also be used as a food additive. The selling price for Xanthan Gum in food additives is higher than in oil exploration areas and demand in the future should come from the domestic market according to management. Xanthan Gum has higher entry barriers due to its sophisticated technology used in the fermentation industry. Every 100,000 tonnes production capacity needs capex expenditures about RMB200m.

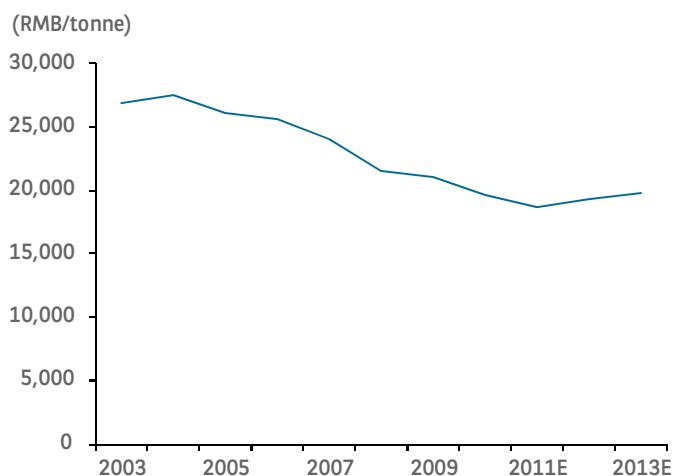
Xanthan Gum is a higher margin product, with gross margin around 36% and its major producers are Cpkelco, Zhongxuan Group and Fufeng. Fufeng has the biggest cost advantage as its production bases are in Northeast and Inner Mongolia, where coal and corn kernels are abundant. The company started research of Xanthan Gum in 2003 and from 2006 sees profit contribution.

EXHIBIT 29: Xanthan Gum production volume



Sources: Fufeng Group; BNP Paribas estimates

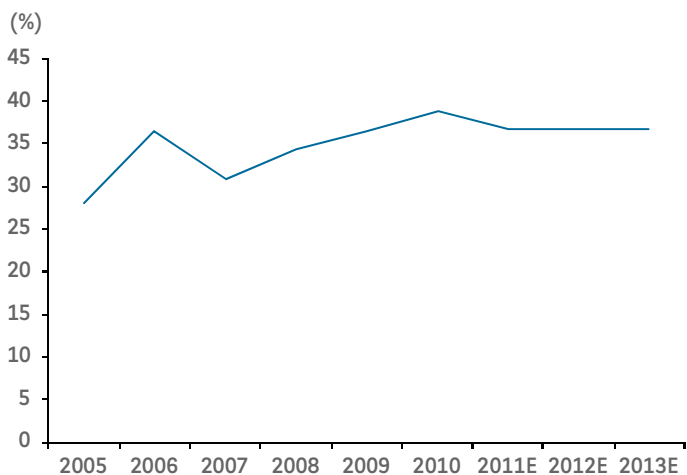
EXHIBIT 30: Xanthan Gum ASP



Sources: Fufeng Group; BNP Paribas estimates

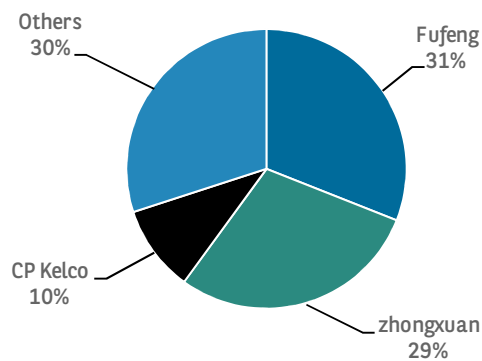
Xanthan Gum volume grew at a CAGR of 55.4% from 2007 to 2010, with ASP sliding to RMB19,579/tonne from RMB24,049/tonne. However, the company maintained its gross margin due to its lower cost advantage; in addition the company as the market leader relies on its lower price strategy to squeeze other players. In 1H11, Xanthan Gum sales were about 21,537 tonnes, with ASP at RMB18,545/tonne.

EXHIBIT 31: Gross margin of Xanthan Gum



Sources: Fufeng Group; BNP Paribas estimates

EXHIBIT 32: Xanthan Gum market share

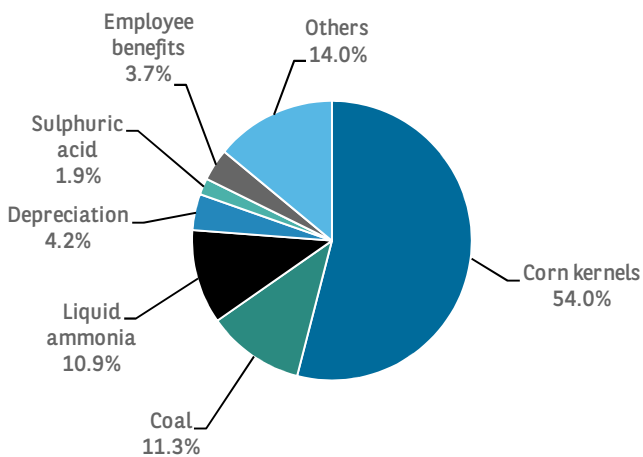


Sources: Fufeng Group; BNP Paribas estimates

Cost analysis

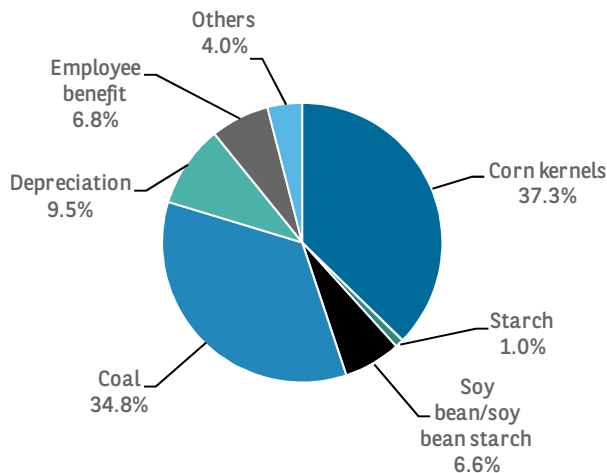
The cost contributions are: 54% for corn kernels, 11.3% for coal, 10.9% for liquid ammonia and sulphuric acid at 1.9%; as for Xanthan Gum, corn kernels, coal and soybeans accounted about 37.3%, 34.8% and 6.6% of its total costs respectively. Corn experienced a price hike in IH11 and currently the corn price decreased 6.8% in Shannxi Baoji since October and Inner Mongolia also experienced a corn price decrease as 4Q11 is the harvest season. The China Grain website estimated that the 2011-12 harvest season will see the corn planting area grow by 2.77% y-y and production volume grow by 3.49% to 178m tonnes. We estimate corn prices will be in a stable growth trend in 2012. The company currently has self-built Sulphuric acid plants and liquid ammonia plants in its Inner Mongolia production base and Northeast China production base, and both plants can save costs of around RMB100m per year. This is also an advantage for the company in the MSG industry as small players can only purchase those raw materials from others.

EXHIBIT 33: MSG segment cost analysis (1H11)



Sources: Fufeng Group; BNP Paribas

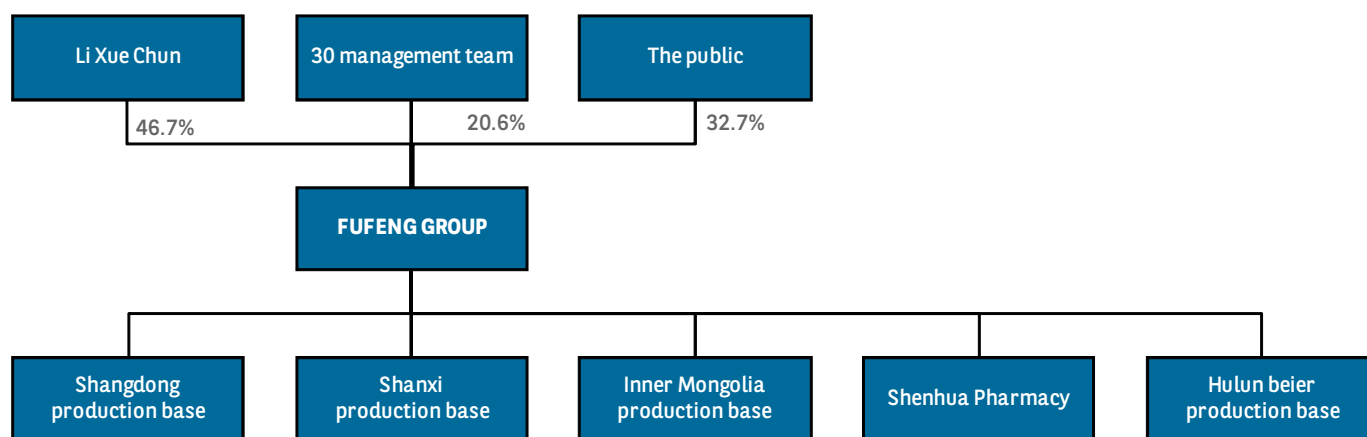
EXHIBIT 34: Xanthan Gum cost analysis (1H11)



Sources: Fufeng Group; BNP Paribas

Management and company structure

EXHIBIT 35: Shareholder structure



Source: Fufeng Group

EXHIBIT 36: directors and senior management

Management	Responsibility
Li Xue Chun	Aged 59, principal founder of the Group, the chairman of the company and an executive director. Mr Li is responsible for the strategic planning and formulation of overall corporate development policy of the Group. He has 29 years of experience in the fermentation industry. Mr Li is the sole director of and is beneficially interested in the entire issued share capital of Motivator Enterprises Ltd which in turn is interested in 45.96% of the issued share capital of the company and is a controlling shareholder of the company. He is the father of Li Guangyu and brother-in-law of Li Deheng.
Wang Longxiang	Aged 49 is an executive director and the general manager of the Group. Mr Wang is responsible for the overall management of the Group's daily operations. Mr Wang joined the group in 2005 and has over 19 years of experience in the fermentation industry. Mr Wang was granted an option to subscribe for 16,000,000 shares pursuant to the Pre-IPO share option scheme. At the end of 2010, the remaining balance of share option, which was held by Mr Wang, is 5,910,000 shares, representing 0.34% of the issued share capital of the company.
Feng Zhenquan	Aged 41, is an executive director and vice general manager of the group. Mr Feng is also a director of Shandong Fufeng, Baoji Fufeng and IM Fufeng. He is in charge of the operations of Hulunbeier Fufeng. Mr Feng was appointed as a director of Shandong Fufeng in May 2002 and has over 17 years of experience in the fermentation industry. He was one of the initial management shareholders. Mr Feng is interested in 15% of the issued share capital of Ever Soar, which in turn is interested in 185,112,000 shares, representing 10.77% of the issued share capital of the company.
Xu Guohua	Aged 42, is an executive director and vice general manager of the group who is responsible for the production and research and development of the group. Mr Xu is also a director of Shandong Fufeng, Baoji Fufeng and IM Fufeng. Mr Xu has been elected to stand as the executive council member of the China Fermentation Industry Association in 2004 and prior to that was invited in 2002 to be a member of the Amino Acid Technology Committee under the China fermentation Industry Association. Mr Xu joined the group in June 1999 and has over 20 years of experience in the fermentation industry. He was also one of the initial management shareholders. Mr Xu was appointed a director of Shandong Fufeng in May 2002. Mr Xu is interested in 15% of the issued share capital of Ever Soar, which in turn is interested in 185,112,000 shares, representing 10.77% of the issued share capital of the company.
Li Deheng	Aged 42, is an executive director and a vice manager of the group who is responsible for the business operations of IM Fufeng. He is also a director of Shandong Fufeng, Baoji Fufeng and IM Fufeng. Mr Li joined the Group in January 2001 and was appointed as director of Shandong Fufeng in November 2003 and has over 10 years of experience in business management. Mr Li is the brother-in-law of Mr Li Xue Chun. Mr Li is interested in 15% of the issued share capital of Ever Soar, which in turn is interested in 185,112,000 shares, representing 10.77% of the issued share capital of the company.
Chen Yuan	Aged 41, is an executive director and a vice general manager of the group. Mr Chen is responsible for the Group in the sectors of capital markets, corporate development and investor relations matters, and assist the Group to develop strategic planning and long-term development plan. Mr Chen joined the Group in September 2010 and has over 18 years of experience in the corporate finance, corporate development and investor relation sector. Mr Chen was granted an option to subscribe for 5,000,000 shares pursuant to the post-IPO share option scheme, representing 0.29% of the issued share capital of the company.

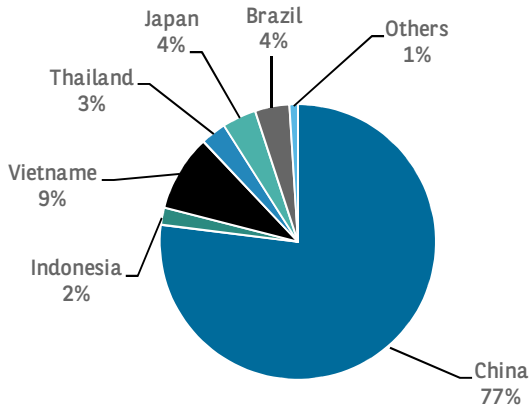
Sources: Fufeng Group; BNP Paribas

Industry background

China is the largest supplier of MSG in the world

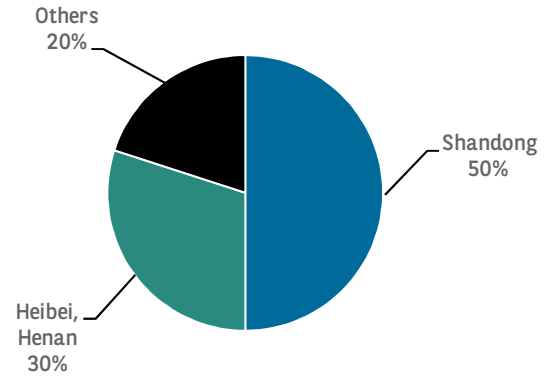
China MSG capacity accounted about 77% of total world supply with the second largest, Vietnam, only accounting for about 9%. We believe China will maintain its leading position in the MSG market due to its cost advantages. Historically, Chinese MSG capacities had transferred from east coast area to Shandong, Northeast and Inner Mongolia where coal and corn are very productive. Currently, Shandong production capacities account for about 50% of China's total MSG capacities. But Fufeng as the industry leader, had already noticed a lower cost place- Inner Mongolia and Northeast China and transferred most of their capacities to these lower cost areas.

EXHIBIT 37: World MSG capacity location



Sources: Fufeng Group; BNP Paribas

EXHIBIT 38: China MSG capacity location



Sources: Fufeng Group; BNP Paribas

International players have limited sales channels in China

The MSG industry grows about 5% every year globally. As well as major China players, Ajinomoto and Vedan are the major international producers. Due to higher costs domestically, these two companies have transferred their production bases to lower cost Southeast Asia. Ajinomoto owned 650,000 tonnes of MSG production capacity: due to higher production cost in Japan, the company currently transferred its production base to Indonesia. In addition, the leading companies are undergoing product diversification. Ajinomoto also produces amino acid, soy sauce and other compound seasoning powders besides MSG. Lastly, the international companies have limited sales in China: Vedan China sales amounted to USD52m, or about 18.9% of its total sales.

Financial statements

Fufeng Group

Profit and Loss (RMB m) Year Ending Dec	2009A	2010A	2011E	2012E	2013E
Revenue	4,633	6,416	8,340	10,548	13,023
Cost of sales ex depreciation	(3,081)	(4,661)	(6,479)	(7,908)	(9,721)
Gross profit ex depreciation	1,552	1,755	1,861	2,640	3,302
Other operating income	64	111	109	116	122
Operating costs	(415)	(572)	(759)	(1,002)	(1,237)
Operating EBITDA	1,201	1,294	1,211	1,754	2,186
Depreciation	(153)	(190)	(251)	(320)	(372)
Goodwill amortisation	0	0	0	0	0
Operating EBIT	1,049	1,104	960	1,435	1,815
Net financing costs	(25)	(32)	(87)	(91)	(79)
Associates	0	0	0	0	0
Recurring non operating income	0	0	0	0	0
Non recurring items	0	0	0	0	0
Profit before tax	1,024	1,071	873	1,344	1,736
Tax	(95)	(105)	(100)	(175)	(243)
Profit after tax	928	966	773	1,169	1,493
Minority interests	0	0	0	0	0
Preferred dividends	0	0	0	0	0
Other items	0	0	0	0	0
Reported net profit	928	966	773	1,169	1,493
Non recurring items & goodwill (net)	0	0	0	0	0
Recurring net profit	928	966	773	1,169	1,493
Per share (RMB)					
Recurring EPS *	0.56	0.58	0.46	0.70	0.89
Reported EPS	0.56	0.58	0.46	0.70	0.89
DPS	0.25	0.13	0.12	0.17	0.22
Growth					
Revenue (%)	29.2	38.5	30.0	26.5	23.5
Operating EBITDA (%)	147.7	7.7	(6.4)	44.8	24.6
Operating EBIT (%)	185.0	5.2	(13.0)	49.5	26.5
Recurring EPS (%)	214.8	3.3	(20.0)	51.3	27.7
Reported EPS (%)	214.8	3.3	(20.0)	51.3	27.7
Operating performance					
Gross margin inc depreciation (%)	39.0	33.8	25.1	27.8	27.8
Operating EBITDA margin (%)	33.5	27.9	18.9	21.0	20.7
Operating EBIT margin (%)	29.3	23.8	15.0	17.2	17.2
Net margin (%)	25.9	20.9	12.0	14.0	14.2
Effective tax rate (%)	9.3	9.8	11.5	13.0	14.0
Dividend payout on recurring profit (%)	44.7	22.5	25.0	25.0	25.0
Interest cover (x)	41.5	34.1	11.1	15.8	23.0
Inventory days	53.7	49.4	45.3	44.7	41.2
Debtor days	43.7	35.5	32.7	32.7	31.2
Creditor days	59.3	38.7	32.9	34.5	34.4
Operating ROIC (%)	43.4	33.2	21.1	26.0	29.8
Operating ROIC - WACC (%)	-	-	-	-	-
ROIC (%)	43.3	33.0	21.0	25.9	29.7
ROIC - WACC (%)	-	-	-	-	-
ROE (%)	44.9	34.9	22.5	28.1	28.9
ROA (%)	25.3	18.2	11.2	14.0	15.7
*Pre exceptional, pre-goodwill and fully diluted					
Revenue By Division (RMB m)					
Glutamic acid	721	154	0	0	0
MSG	2,245	3,893	5,198	6,806	8,612
Fertilizer	361	370	504	544	589
Xanthan gum	408	682	823	1,059	1,091
starch sweetner	245	357	525	552	580
Others	95	189	80	80	80
	-	-	-	0	0
Threonine	0	0	156	420	840

Net profit growth will grow
51% in 2012

Sources: Fufeng Group; BNP Paribas estimates

Fufeng Group

Cash Flow (RMB m) Year Ending Dec	2009A	2010A	2011E	2012E	2013E
Recurring net profit	928	966	773	1,169	1,493
Depreciation	153	190	251	320	372
Associates & minorities	0	0	0	0	0
Other non-cash items	0	0	0	0	0
Recurring cash flow	1,081	1,156	1,024	1,489	1,865
Change in working capital	(82)	398	(291)	(29)	129
Capex - maintenance	(745)	(1,856)	(1,300)	(1,000)	(1,000)
Capex - new investment	0	0	0	0	0
Free cash flow to equity	254	(302)	(567)	459	993
Net acquisitions & disposals	0	0	0	0	0
Dividends paid	(219)	(217)	(193)	(292)	(373)
Non recurring cash flows	64	9	0	0	0
Net cash flow	99	(509)	(760)	167	620
Equity finance	0	5	0	0	0
Debt finance	10	938	1,257	(393)	(300)
Movement in cash	109	434	497	(226)	320

Per share (RMB)					
Recurring cash flow per share	0.65	0.69	0.61	0.89	1.11
FCF to equity per share	0.15	(0.18)	(0.34)	0.27	0.59

Balance Sheet (RMBm) Year Ending Dec	2009A	2010A	2011E	2012E	2013E
Working capital assets	1,379	1,697	2,022	2,401	2,658
Working capital liabilities	(1,154)	(1,870)	(1,904)	(2,253)	(2,640)
Net working capital	225	(173)	118	147	18
Tangible fixed assets	2,508	4,088	5,068	5,697	6,305
Operating invested capital	2,733	3,915	5,186	5,844	6,324
Goodwill	0	0	0	0	0
Other intangible assets	0	0	0	0	0
Investments	0	0	0	0	0
Other assets	5	21	21	21	21
Invested capital	2,738	3,936	5,207	5,865	6,345
Cash & equivalents	(369)	(915)	(1,481)	(1,306)	(1,646)
Short term debt	418	555	300	300	200
Long term debt *	180	981	2,493	2,100	1,900
Net debt	229	621	1,313	1,094	454
Deferred tax	24	27	27	27	27
Other liabilities	0	0	0	0	0
Total equity	2,394	3,145	3,725	4,602	5,721
Minority interests	0	0	0	0	0
Invested capital	2,738	3,935	5,207	5,865	6,345

* includes convertibles and preferred stock which is being treated as debt

Per share (RMB)					
Book value per share	1.44	1.88	2.23	2.75	3.42
Tangible book value per share	1.44	1.88	2.23	2.75	3.42

Financial strength					
Net debt/equity (%)	9.6	19.8	35.2	23.8	7.9
Net debt/total assets (%)	5.4	9.2	15.3	11.6	4.3
Current ratio (x)	1.1	1.1	1.6	1.5	1.5
CF interest cover (x)	11.1	(8.3)	(5.5)	6.1	13.6

Valuation	2009A	2010A	2011E	2012E	2013E
Recurring P/E (x) *	6.0	5.8	7.3	4.8	3.8
Recurring P/E @ target price (x) *	8.9	8.6	10.8	7.1	5.6
Reported P/E (x)	6.0	5.8	7.3	4.8	3.8
Dividend yield (%)	7.4	3.9	3.4	5.2	6.6
P/CF (x)	5.2	4.9	5.5	3.8	3.0
P/FCF (x)	22.0	(18.7)	(9.9)	12.3	5.7
Price/book (x)	2.3	1.8	1.5	1.2	1.0
Price/tangible book (x)	2.3	1.8	1.5	1.2	1.0
EV/EBITDA (x) **	4.9	4.7	5.5	3.9	2.9
EV/EBITDA @ target price (x) **	6.5	6.1	6.9	4.9	3.8
EV/invested capital (x)	2.1	1.6	1.3	1.1	1.0

* Pre exceptional, pre-goodwill and fully diluted

** EBITDA includes associate income and recurring non-operating income

Sources: Fufeng Group; BNP Paribas estimates

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-	-

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