

Analyst: Vincent Leung

Main Board Listing – Research

Fufeng Group Limited [Stock Code: 0546] 阜豐集團有限公司

Sole Sponsor : Goldbond Capital (Asia) Limited
Joint Global Coordinators, Joint Bookrunners and Joint Lead Managers : Goldbond Securities Limited ABN AMRO Rothschild

Sector : Food, Beverage & Tobacco

Business : Manufacture and sale of corn-based biochemical products in the PRC

<p>Total share offer: <u>400,000,000</u> shares (25% of the enlarged share capital)</p> <p>Public Offer: 40,000,000 shares (10%)</p> <p>Placing: 360,000,000 shares (90%)</p> <p>Greenshoe: 60,000,000 shares</p>	<p><u>Business of Fufeng Group</u></p> <p>Founded in 1999, Fufeng Group is one of the leading vertically integrated manufacturers of corn-based biochemical products principally utilising fermentation technology in the PRC. In 2005 and for the 8 months ended 31st August 2006, the Group is the largest glutamic acid (谷氨酸) manufacturer and the 2nd largest xanthan gum (黃原膠) manufacturer in the PRC in terms of production volume.</p> <p>The principal products of the Group, which are derived from different stages of corn processing, include glutamic acid, MSG, xanthan gum, fertiliser and starch sweeteners. The Group's products are used in various industries including food, healthcare, agriculture, pharmaceuticals as well as petroleum exploration. The Group's MSG is marketed under the brandnames of “雪梅” and “福瑞” while its glutamic acid, xanthan gum and fertilisers are marketed under the brandname of “阜豐”.</p> <p>The Group's 5 production plants are strategically located in the major corn growing and/or coal mining reserve regions in Shandong and Shaanxi provinces as well as the Inner Mongolia autonomous region. As of 19th January 2007, the Group's production plants has combined annual design production capacities of 280,000 metric tonnes of glutamic acid, 75,000 metric tonnes of MSG, 8,000 metric tonnes of xanthan gum, 490,000 metric tonnes of fertilisers and 140,000 metric tonnes of starch sweeteners.</p>
<p>Price: HK\$1.72 – HK\$2.23 per share</p> <p>Market Cap: HK\$2,752 million – HK\$3,568 million</p> <p>Pro-forma FY2006E P/E: 12.36x – 16.02x</p> <p>Adjusted NTA per share: HK\$0.66 – HK\$0.79</p> <p>Staffing: 1,140 (as of 19th January 2007)</p>	
<p>Bookbuilding Period: 18th January 2007 – 30th January 2007</p> <p>HK Public Offer period: 25th January 2007 – 30th January 2007 noon</p> <p>Receiving bank: Hang Seng Bank</p>	
<p>Share registrar: Tricor Investor Services Limited</p> <p>Listing date: 8th February 2007</p>	

This report has been prepared solely for information purposes and we are not soliciting any action based upon it. Neither this document nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information, which we consider reliable, but accuracy or completeness is not guaranteed. Opinions expressed herein are subject to change without notice. At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein, while its group companies may from time to time have interests in securities of the company or companies mentioned herein.

Shareholding Structure after Listing (Assuming the over-allotment option is not exercised)

Mr. Li Xuechun (Main founder, chairman and executive director of the Group) (Note 1)	49.13%
Ever Soar Enterprises Ltd (held by 6 Directors and Original Shareholders of the Group) (Note 2)	12.85%
23 Other Original Shareholders and Senior Management of the Group	13.02%
Value Partners Limited (Note 3)	5.00%
Other public shareholders	20.00%
	<u>100.00%</u>

Notes:

1. Shares held by Mr. Li Xuechun are subject to a lock-up period of 12 months from the listing date.
2. Being an executive director and vice general manager of the Group, Li Deheng is the brother-in-law of the chairman and is interested in 15% of the issued share capital of Ever Soar.
3. As part of the Placing, Value Partners has agreed to subscribe for 80,000,000 offer shares, representing 5% of the enlarged share capital of Fufeng Group or 20% of the total offer shares. Shares subscribed by Value Partners pursuant to the Placing are subject to a lock-up period of 6 months from the listing date.

Use of Proceeds

Net proceeds from the offer are estimated to be HK\$730 million (Assuming the over-allotment option is not exercised, and at an issue price of HK\$1.98 each, being the midpoint of the indicative price range)

	HK\$ million
For the construction of the Inner Mongolia Plant Phase II and the purchase & installation of production equipment & facilities thereat	330
For enhancement of the sales and marketing function of the Group	10
For improving the Group's research and development capabilities	30
For the acquisition of potential related business and facilities or for financing the construction of the Inner Mongolia Plant Phase II	30
For the repayment of the ABN AMRO Loan*	312
For general working capital	18

Remark (): The loan amounted to US\$40 million borrowed by Fufeng Group from the ABN AMRO Bank N.V., Beijing Branch pursuant to a facility agreement entered into between the two parties on 24th July 2006.*

Financial Highlights

	Year ended 31 st December			8 months ended 31 st August
	2003	2004	2005	2006
	RMB'000	RMB'000	RMB'000	RMB'000
Turnover	449,224	625,313	1,296,408	1,071,338
Gross profit	72,171	108,475	317,616	216,865
Operating profit	54,579	80,938	245,617	158,643
Attributable profit	35,710	70,957	236,167	142,456
Gross margin	16.1%	17.3%	24.5%	20.2%
Operating margin	12.1%	12.9%	18.9%	14.8%
Net margin	7.9%	11.3%	18.2%	13.3%

Turnover Breakdown (% of Total Turnover)

	Year ended 31 st December			8 months ended 31 st August
	2003	2004	2005	2006
Corn-based biochemical products				
▪ Glutamic acid	46.5%	45.5%	58.2%	59.6%
▪ MSG	29.9%	29.1%	13.7%	11.0%
▪ Fertilisers	11.3%	10.6%	8.8%	8.8%
▪ Xanthan gum	0.2%	2.8%	5.1%	6.7%
▪ Starch sweeteners	-	-	-	0.8%
Corn refined products	12.1	12.0%	14.2%	13.1%
Total	100.0%	100.0%	100.0%	100.0%

**Strengths/Opportunities**

- ✓ The Group is the largest glutamic acid manufacturer and the 2nd largest xanthan gum manufacturer in the PRC in terms of production volume in 2005 and for the 8 months ended 31st August 2006, providing the bargaining power with raw-material suppliers and stronger customer loyalty.
- ✓ The Group's Inner Mongolia Plant Phase I, which accounted for 43% of the Group's glutamic acid production capacity, commenced commercial production in December 2006. This further enhances the scale and market share of the Group.
- ✓ The Group has a highly vertically integrated production process, starting from the production of cornstarch to the production of corn-based biochemical products including glutamic acid, MSG, xanthan gum and starch sweeteners. This contributes to the Group's high production efficiency and improving margins in 2003-2005. Shifting of its product base to lower-cost Inner Mongolia should enhance profitability.
- ✓ The Group intends to pay out not less than 30% of its net profit as dividends.
- ✓ Based on the indicative price range of HK\$1.72-HK\$2.23, Fufeng's valuation FY2006E P/E 12.4x-16.0x appears higher than other Hong Kong-listed corn-based processors, Global Bio-chem Technology (stock code: 0809) and Xiwang Sugar (stock code: 2088). Global Bio-chem (focuses on amino-acids) and Xiwang Sugar (focuses on crystallised glucose and glucose syrup), which have different product mixes from that of Fufeng. Global Bio-chem and Xiwang Sugar are trading at FY2006E P/E of 10.3x and 11x respectively. Meanwhile, MSG producer Vedan International (stock code: 2317) is trading at FY2006E P/E of 15.7x. Taking into consideration of Fufeng's market leading status in glutamic acid and the contribution from its Inner Mongolia Plant, Fufeng's valuation is not very demanding.

Weaknesses/Threats

- × Price volatilities of corn-kernel (the major raw material for the Group's products and accounted for 52.1% of the total cost of production for the eight months ended 31st August 2006) and glutamic acid (the Group's major product and accounted for 59.6% of the total turnover for the eight months ended 31st August 2006) are the major risks given the Group's high sensitivity of net profit to these prices.
- × Some of Fufeng's operating subsidiaries were established as foreign-owned enterprises with limited liabilities, which currently enjoys preferential tax treatments. Any changes in the government policy or law in the future may have an adverse impact on the Group's tax liabilities and hence its bottom line.
- × As a result of significant financial outlay amid capacity expansion in the past few years, the Group's net debt-to-equity ratio jumped from 50.1% as of the end of 2005 to 105.9% as of 31st August 2006. The net-debt situation following the IPO would be improved as a portion of the IPO proceeds will be used for loan repayment.

Recommendation: Trading Buy



Important Disclosure / Analyst Certification / Disclaimer

This document is published by East Asia Securities Company Limited, a wholly-owned subsidiary of The Bank of East Asia, Limited (BEA). At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein the report, while BEA and / its associated or affiliated companies may from time to time have interests in securities of the company or companies mentioned herein.

The research analyst primarily responsible for the content of this report, in part or in whole certifies that the views on the companies and their securities mentioned in this report accurately reflect his/her personal views. The analyst also certifies that no part of his/her compensation was, is, or will be, directly, or indirectly, related to specific recommendations or views expressed in this report.

This report has been prepared solely for information purposes and has no intention whatsoever to solicit any action based upon it. Neither this report nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information, which East Asia Securities Company Limited considers reliable, but accuracy or completeness is not guaranteed. Opinions expressed herein are subject to change without notice. Any recommendation contained in this report does not have regard to the specific investment objectives, financial situation and the particular needs of any specific addressee. This report is not to be taken in substitution for the exercise of judgment by respective readers of this report, who should obtain separate legal or financial advice. East Asia Securities Company Limited and / or The BEA Group accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or further communication given in relation to this report.

At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein the report, while BEA along with its affiliates and/or persons associated with any of them may from time to time have interests in the securities mentioned in this report. BEA and its associates, its directors, and/or employees may have positions in, and may effect transactions in securities mentioned herein and may also perform or seek to perform broking, investment banking and other banking services for these companies.

BEA and/or any of its affiliates may beneficially own a total of 1% or more of any class of common equity securities of the subject company or companies mentioned in this report and may, within the past 12 months, have received compensation and/or within the next 3 months seek to obtain compensation for investment banking services from the subject company or companies mentioned in the report.