

## United Laboratories

### Scale brings out profit

to summarize...

- The results were better than expectation with top line up of 43.9% YoY and bottom line up of 212.8% YoY for 2H FY12/09A.
- Although ASP of 6-APA for 2H FY12/09A was dropped, the external sales growth of 44.5% YoY was driven by the volume increase while the profitability improved significantly benefiting from scale effect.
- Bulk medicine segment profit increased 204.7% YoY with both volume and margin improvement.
- It is likely that 6-APA and amoxicillin bulk medicine market would be still volatile in 2010, but the downside potential would be limited.
- Finished product line development well with first two months of 2010 increased around 25.0% YoY.
- Maintain BUY call with revised target price of HK\$7.16 based on our scenario analysis.

**2HFY12/09A results.** The results were ahead of our estimate. Revenue increased 43.9% YoY to HK\$2,567.0m while the net profit increased 212.8% to HK\$407.0m for 2H FY12/09A. The better margin level in intermediate product and bulk medicine, benefiting from the scale effect from its full operation of Inner Mongolia factory, bring out good profit. The operating profit of intermediate products from loss 2H FY12/08A to profit of HK\$159.9m and bulk medicine operating profit increased 204.7% YoY to HK\$239.0m while the sales of finished product increased 28.0% YoY to HK\$842.7m with operating profit up 25.6% YoY to HK\$241.3m.

**Table 1. 2H FY12/09A results**

6 months to Dec	Turnover (HK\$m)	Gross Profit (HK\$m)	Gross margin (%)	Pre-tax profit (HK\$m)	Tax rate (%)	Net profit (HK\$m)
2H FY09	2,567.0	1,071.9	41.8	492.6	17.4	407.0
1H FY09	2,076.2	742.1	35.7	200.8	33.0	134.4
HoH(%)	23.6	44.5		145.3		202.7
2H FY08	1,784.1	640.7	35.9	164.6	20.9	130.1
YoY (%)	43.9	67.3		199.3		212.8

Source: Company data

**Scale effect for Intermediate products.** The external sales of intermediate products increased 44.5% to HK\$467.4m, which was mainly driven by the up of the sale volume of 6-APA of 126.3% YoY while the ASP dropped around 27.0% YoY for 2H FY12/09A to around HK\$173.0/kg(incl.VAT). The total segment profit (incl. both internal and external) recorded profit of HK\$159.9m from a lost in the same period last year mainly because of the margin improvement benefiting from the full operation of Inner Mongolia factory. Currently, 6-APA is RMB180/kg (incl. VAT), which is 5.9% higher than bottom level in 2009 and 25% lower than the peak level in 2009. We would expect that the ASP is still volatile in 2010 from the effect of: 1) Recommended anti-dumping duties on 6-APA originating in or exported from China in India; 2) the overcapacity in the market. However, we think that the downside would be limited give that most of 6-APA manufacturers are in loss making stage based on our channel check.

**Amoxicillin bulk medicine volume growing significantly.** For 2H FY12/09A, the external sales of bulk medicine increased 56.7% YoY to HK\$1,256.9m, which was mainly driven by the up of the sales volume of amoxicillin bulk medicine of around 200.0% while the ASP dropped around 9.0% YoY to around HK\$208.0/kg (incl. VAT). The total segment profit increased 204.7% YoY to HK\$239.0m thanks for the

Ticker	3933 HK
Rating	BUY(Unchanged)
Price (HK\$)	6.40
Target Price (HK\$)	7.16(+12%)
12m Price Range (HK\$)	2.36-6.59
Market cap. (US\$m)	984.6
Daily t/o (US\$m)	0.8
Free float (%)	27.8

#### Financial summary

Year to Dec	08A	09A	10F	11F	12F
Turnover (HK\$m)	3,755.9	4,643.2	5,177.3	5,895.6	6,175.5
Net Profit (HK\$m)	430.2	541.4	649.1	796.4	849.7
EPS (HK\$)	0.358	0.451	0.541	0.664	0.708
P/E (x)	17.9	14.2	11.8	9.6	9.0
P/B (x)	2.73	2.41	2.15	1.61	1.44
EV/EBITDA (x)	4.7	3.8	3.1	2.3	1.9
Yield (%)	2.3	3.0	3.4	3.6	3.9
ROE (%)	16.3	18.0	19.2	19.1	16.8
ROCE (%)	20.4	22.4	25.8	26.0	23.2
N. Gear. (%)	50.3	49.2	35.9	6.2	Cash

Source: SBI/Bloomberg

	10F	11F	12F
Consensus EPS (HK)	0.517	0.577	0.730
Previous earnings (HK\$m)	562.9	665.9	-
Previous EPS (HK)	0.469	0.555	-

#### Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	+51.2	+61.8	+65.3
Actual price changes (%)	+53.8	+59.2	+158.1



Source: Bloomberg

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vertically integrated model, which allowed the company to leverage its capacity from 6-APA (58.0% of 6-APA for internal use). The amoxicillin bulk medicine's ASP is RMB220/kg (incl. VAT) for now, which is 15.8% higher than bottom level in 2009 and 8.3% lower than the peak level in 2009. We would expect that the amoxicillin bulk medicine's price to be more stable than that of 6-APA in 2010 based on: 1) the less competitive; 2) the demand from India and European countries.

**Finished product growth is good.** The sales of finished product increased 28.0% YoY to HK\$842.7m for 2H FY12/09A while the segment profit increased 25.6% YoY to HK\$241.3m mainly resulting from the rapid growth in new market, such as 50.0%+ growth in rural market, and improved capability of sales force. grew at a faster speed, than its traditional distribution channels. By the end of 2009, the company had 2,700 sales staff from 2,400 in June 2009. According to our talk with the management, the finished product in first two months of 2010 increased around 25% YoY with a broad range of finish product growth. ULI will launch one "Uslin" recombinant human insulin product in 2H 2010 and there are 3 more human insulin products for different symptoms to be launched towards the end of the year or the beginning of the next year. The management is optimistic on the future of this product because: 1) ULI could leverage its current distribution channel and experience in Chinese market; 2) the quality of the product has been prove to be in the same level of overseas products while ULI would have cost advantage. We would expect that this series of the product would be the main growth driver for the company in 2011.

**Table 2. 2H FY12/09A revenue breakdown**

6 month ended to Dec (HK\$m)	2H FY12/09			2H FY12/08			YoY (%)	
	Revenue*	Segment profit	Margin(%)	Revenue	Segment profit	Margin(%)	Revenue*	Segment profit
Intermediate	467.4	159.9	34.2	323.3	(6.2)	-	44.5	-
Bulk medicine	1,256.9	239.0	19.0	802.3	78.4	9.8	56.7	204.7
Finished products	842.7	241.3	28.6	658.5	192.2	29.2	28.0	25.6
<b>Total</b>	<b>2,567.0</b>	<b>640.2</b>	<b>24.9</b>	<b>1,784.1</b>	<b>264.4</b>	<b>14.8</b>	<b>43.9</b>	<b>142.1</b>

Source: Company data

\*External sales only

**Cash flow and dividend.** The investment for the company in 2009 is HK\$839.2m, which was mainly used for capacity expansion. The net gearing ratio was 49.2% at the end of 2009. The capex plan for 2010 would be around HK\$500m with around HK\$300m for production facility of human insulin product. However, we expect the gearing ratio to decrease gradually with more cash inflow from its operation and less investment. The company paid HK\$0.19 per share for 2009, representing 42.1% dividend payout ratio. Management said that ULI would keep the current dividend payout level.

**BUY call with target price of HK\$7.16.** According to our DCF evaluation, based on the discount rate in the range between 13.0% and 16% different for each scenario and terminal growth of 0.5%, the fair price for ULI on based case would be HK\$7.34, on bull case would be HK\$9.40, and on bear case would be HK\$4.67. We apply 30% weight on bull case and bear case and 40% weight on base case to derive a fair value of HK\$7.16. We keep the BUY call on the counter. However, as the share price rallied 21.0% today with its better than expected annual results, we keep the possibility that some earlier investors are likely to take the chance to lock profit based on current market environment.

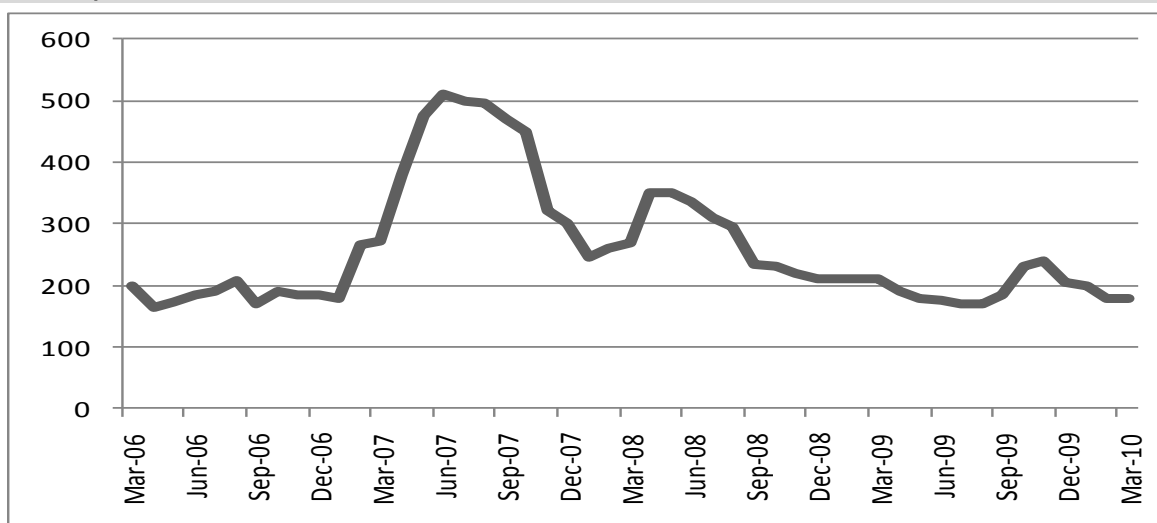
**Table 3: ULI evaluation**

Scenarios		Our 2010 Estimate
<b>Base Case</b>		
6-APA avg. price (ex. VAT)	RMB/kg	147
Amoxicillin Bulk avg. price (ex. VAT)	RMB/kg	179
Net profit	HK\$m	649.1
DCF Derived fair price	HK\$	7.34
P/E FY12/10F(based on fair price)	x	13.6
<b>Bull Case</b>		
6-APA avg. price (ex. VAT)	RMB/kg	159
Amoxicillin Bulk avg. price (ex. VAT)	RMB/kg	197
Net profit	HK\$m	807.4
DCF Derived fair price	HK\$	9.40
P/E FY12/10F(based on fair price)	x	14.0
<b>Bear Case</b>		
6-APA avg. price (ex. VAT)	RMB/kg	133
Amoxicillin Bulk avg. price (ex. VAT)	RMB/kg	164
Net profit	HK\$m	454.8
DCF Derived fair price	HK\$	4.67
P/E FY12/10F(based on fair price)	x	12.3
Price based on 30% weight ion bull and bear,40% on base	HK\$	7.16

Source: SBI E2-Capital

\*External sales only

Chart 1: 6-APA price trend



Source: [www.healthoo.com](http://www.healthoo.com), and SBI E2-Capital

Table 4: P &amp; L

Year to Dec (HK\$m)	08A	09A	10F	11F	12F
Turnover*					
Intermediates	742.4	808.1	717.0	820.8	879.4
Bulk Medicines	1,712.2	2,248.9	2,536.6	2,862.6	2,862.6
Finished Product	1,301.3	1,586.2	1,923.7	2,212.3	2,433.5
	<b>3,755.9</b>	<b>4,643.2</b>	<b>5,177.3</b>	<b>5,895.6</b>	<b>6,175.5</b>
Cost of sales	(2,326.3)	(2,829.2)	(3,022.9)	(3,426.2)	(3,506.7)
<b>Gross profit</b>	<b>1,429.6</b>	<b>1,814.0</b>	<b>2,154.3</b>	<b>2,469.5</b>	<b>2,668.8</b>
Other income and gains	63.0	22.6	8.1	8.5	8.9
Selling and distribution costs	(554.5)	(718.0)	(811.7)	(879.5)	(983.6)
Administrative expenses	(247.6)	(291.9)	(324.7)	(376.9)	(421.5)
Other operating expenses	(40.9)	(44.9)	(20.0)	(20.0)	(10.0)
<b>Operating profit</b>	<b>649.7</b>	<b>781.9</b>	<b>1,006.0</b>	<b>1,201.4</b>	<b>1,262.6</b>
Finance costs, net	(117.2)	(88.5)	(78.8)	(63.8)	(48.8)
<b>Profit before taxation</b>	<b>532.5</b>	<b>693.4</b>	<b>927.3</b>	<b>1,137.7</b>	<b>1,213.8</b>
Taxation	(102.4)	(151.9)	(278.2)	(341.3)	(364.1)
<b>Net profit</b>	<b>430.2</b>	<b>541.4</b>	<b>649.1</b>	<b>796.4</b>	<b>849.7</b>

Note: the current P&L are based on base case scenario

Source: Company data and SBI E2-Capital

\*External sales only

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