

# United Laboratories

*Some impact, but still strong overall*

**BUY (Unchanged)**

## Financial summary

Year to Dec	06A	07A	08F	09F	10F
Turnover (HK\$m)	2,080.52	594.93	474.33	539.63	860.3
Net Profit (HK\$m)	173.8	510.5	454.2	514.0	609.0
EPS (HK\$)	0.145	0.425	0.378	0.428	0.508
EPS Δ%	49.1	193.6	(11.0)	13.2	18.5
P/E (x)	13.9	4.7	5.3	4.7	4.0
P/B (x)	1.8	1.0	0.9	0.9	0.8
EV/EBITDA (x)	31.7	6.7	9.1	7.5	5.2
Yield (%)	-	8.4	6.6	7.4	8.8
ROE (%)	15.0	27.1	17.9	18.9	20.5
ROCE (%)	18.3	26.9	20.9	21.7	24.0
N. Gear. (%)	80.8	33.0	44.8	31.6	14.6

Source: SBI E2-Capital

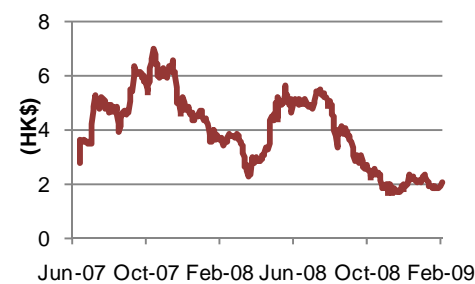
## Price performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	2.0	16.5	-28.6
Actual price changes (%)	-11.5	5.8	-58.6

	08F	09F	10F
Consensus EPS (HK\$)	0.487	0.570	0.700
Previous forecasts (HK\$m)	535.3	665.8	768.4
Previous EPS (HK\$)	0.446	0.555	0.640

## Price chart



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still be negatively impacted by the economic conditions in 4Q 2008. Several of the pharmaceutical companies under our radar have already indicated that 4Q growth was less than the first three quarters. We believe, tighter credit conditions in 4Q prompted many customers to delay inventory stocking during what is the traditionally peak season for ULI. As such, we have lowered our FY12/08F expectations for the finished products segment. We continue to be bullish on the ULI's finished products segment, backed by strong product positioning and a 2,300 strong sales force.

**Medical reforms announced supportive to ULI.** China's State Council recently passed a series of healthcare reform initiatives including: 1) investment of RMB850.0b over three years to improve the country's healthcare system and medical insurance coverage for urban and rural residents; 2) accelerate expansion of the healthcare insurance safety net to make basic medical insurance available to 90% of the population by 2011 and 3) increase

Ticker: 3933.HK  
Price: HK\$2.02  
Target: HK\$3.10 (+53%)

12 mth range: HK\$01.68-5.58  
Market cap: US\$310.7m  
Daily t/o, 3 mth: US\$0.4m  
Free float %: 27.9%

## Key points:

- \* Moderate 6-APA prices in 4Q 2008 has persisted into Jan 2009 (about RMB180/kg) due to the current economic slowdown and relaxation of environmental discharge standards by the government
- \* Though inventory re-stocking will spur 6-APA sales volume growth, we think that reactivation of non-environmental compliant capacities may prevent significant rebound in prices
- \* We continue to be bullish on ULI's finished products segment, backed by strong product positioning, 2,300 sales force and supportive government policies. Growth of finished products remains solid though we have revised down the FY12/08F growth rate slightly as the poor economic conditions in 4Q FY12/08F delayed customers' inventory stocking in the traditionally peak season
- \* We have revised down our FY12/08-10F net profit estimates to HK\$454.2m, HK\$514.0m and HK\$609m
- \* Based on our sensitivity analysis, the counter is currently trading at FY12/09F earnings of 4.7x (base case), 3.9x (bull case) and 6.0x (bear case)
- \* We maintain our BUY call but cut our SOTP target price to HK\$3.10, representing 7.3x FY12/09F P/E

**6-APA prices remain moderate.** Based on our channel checks, the moderate 6-APA price levels in 4Q 2008 has persisted to date. In Jan 2009, 6-APA price was around RMB180/kg (ex-VAT). The key reason for the price weakness in our view is: 1) government appears to have relax enforcement of the stricter environmental discharge standards amid the current economic slowdown and 2) large API manufacturers are restarting their previously non-conforming capacities. While we think that the de-stocking cycle which commenced in 4Q FY12/08 should come to an end soon and restocking should spur sales volume, we think that the increased industry production should prevent a significant rebound of 6-APA prices.

**Finish products slightly impacted by 4Q 2008 economic conditions.** Though we maintain our view that the pharmaceutical industry remains one of the most defensive, we think that it would have

government healthcare subsidies to RMB120/person by 2010 from current RMB80. News of the reform policies should stimulate the sector as a whole and ULI's finished products segment will be a key beneficiary of increased demand for pharmaceutical products in China.

**New earnings estimate.** We have revised down our FY12/08F-10F net profit estimates to HK\$454.2m, HK\$514.0m and HK\$609.0m (from HK\$535.3m, HK\$665.8m and HK\$768.4m respectively). Our new estimates factor in more conservative assumptions for 6-APA price in FY12/09F and FY12/10F and slight adjustment to finished products and depreciation. We assume that the 6-APA price will rise only 5% in FY12/09F from the weak 2H FY12/08F level of RMB190/kg and 2% in FY12/10F.

**Sensitivity analysis.** In addition, we have also undertaken a sensitivity analysis with bull and bear case scenarios, using our new estimates as a base case. The bull case calls for the 6-APA price to rise 15% in FY12/09F (from 2H FY12/08F prices) and bear case calls for a decline of a further 5%. Based on the results, ULI is currently trading at FY12/09F earnings of 4.7x (base case), 3.9x (bull case) and 6.0x (bear case).

**Valuation.** We maintain our BUY call and revise our SOTP target price to HK\$3.10 (from HK\$4.30), representing 7.3x FY12/09F P/E. The counter remains one of our favourites in the pharmaceutical/healthcare space as it is poised to benefit from China's new healthcare policies.

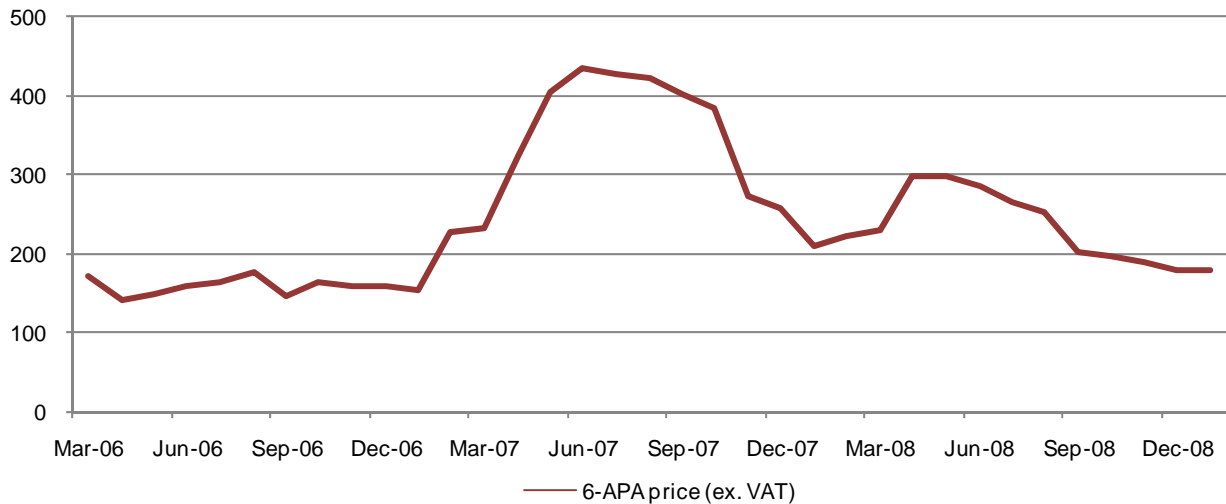
**Table 1: ULI earnings sensitivity analysis**

		08F	09F	10F
<b>Base Case</b>				
6-APA avg. price (ex. VAT)	RMB/kg	223	199.5	203.3
6-APA Sales Volume*	tonnes	5330	5927	6350
Amoxicillin Bulk avg. price (ex. VAT)	RMB/kg	249	224	228
Amoxicillin Bulk Sales Volume*	tonnes	4110	4443	4966
Operating profit (intermediates & bulk medicines)	HK\$m	377.2	364.2	416.7
Operating profit (finished drugs)	HK\$m	269.0	357.4	414.6
Net profit	HK\$m	454.2	514.0	609.0
EPS	HK\$	0.378	0.428	0.508
P/E (HK\$2.02 at 3 Feb 2008)		5.3	4.7	4.0
<b>Bull Case</b>				
6-APA avg. price (ex. VAT)	RMB/kg	223	219	224
6-APA Sales Volume*	tonnes	5330	5927	6350
Amoxicillin Bulk avg. price (ex. VAT)	RMB/kg	249	246	251
Amoxicillin Bulk Sales Volume*	tonnes	4110	4443	4966
Operating profit (intermediates & bulk medicines)	HK\$m	377.2	518.9	577.9
Operating profit (finished drugs)	HK\$m	269.0	342.4	397.1
Net profit	HK\$m	454.2	625.8	724.0
EPS	HK\$	0.378	0.521	0.603
P/E (HK\$2.02 at 3 Feb 2008)		5.3	3.9	3.3
<b>Bear Case</b>				
6-APA avg. price (ex. VAT)	RMB/kg	223	180	183
6-APA Sales Volume*	tonnes	5330	5927	6350
Amoxicillin Bulk avg. price (ex. VAT)	RMB/kg	249	201	205
Amoxicillin Bulk Sales Volume*	tonnes	4110	4443	4966
Operating profit (intermediates & bulk medicines)	HK\$m	377.2	209.6	255.5
Operating profit (finished drugs)	HK\$m	269.0	372.3	432.1
Net profit	HK\$m	454.2	402.2	494.0
EPS	HK\$	0.378	0.335	0.412
P/E (HK\$2.02 at 3 Feb 2008)		5.3	6.0	4.9

Source: SBI E2-Capital

\*Sales volume include external and internal sales

**Chart 1: 6-APA price trend**



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

**Table 2: P & L**

Year to Dec (HK\$m)	06A	07A	08F	09F	10F
Turnover*	2,080.5	2,594.9	3,474.3	3,539.6	3,860.3
Intermediates	197.4	265.7	670.1	545.0	571.1
Bulk Medicines	1,077.3	1,362.3	1,567.2	1,500.7	1,541.4
Finished Product	805.8	967.0	1,237.0	1,493.8	1,747.8
Cost of sales	(1,344.2)	(1,389.2)	(2,075.9)	(1,963.5)	(2,049.4)
Gross profit	736.3	1,205.8	1,398.3	1,576.1	1,810.9
Other income and gains	9.9	25.8	32.5	32.0	32.0
Selling and distribution costs	(284.1)	(381.5)	(529.2)	(615.2)	(724.9)
Administrative expenses	(123.0)	(173.3)	(233.3)	(239.3)	(254.7)
Other operating expenses	(37.8)	(38.4)	(10.0)	(20.0)	(20.0)
Operating profit	301.3	638.3	658.3	733.6	843.3
Finance costs, net	(85.5)	(80.0)	(102.3)	(91.1)	(82.0)
Share of results of an associate	(2.7)	-	-	-	-
Gain on disposal of an associate	8.6	-	-	-	-
Profit before taxation	221.8	558.3	556.0	642.5	761.3
Taxation	(47.9)	(47.9)	(101.8)	(128.5)	(152.3)
Profit after tax	173.8	510.5	454.2	514.0	609.0

Source: Company data and SBI E2-Capital

\*External sales only

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- BUY** : absolute upside of >10% over the next six months
- HOLD** : absolute return of -10% to +10% over the next six months
- SELL** : absolute downside of >10% over the next six months

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