

Finished products strength emerging

BUY (unchanged)

Financial summary

Year to Dec	07A	08A	09F	10F	11F
Turnover (HK\$m)	2,594.93	755.93	948.64	261.04	720.2
Net Profit (HK\$m)	510.5	430.2	501.8	611.0	720.2
EPS (HK\$)	0.425	0.358	0.418	0.509	0.600
EPS Δ%	193.6	(15.7)	16.6	21.8	17.9
P/E (x)	6.3	7.5	6.5	5.3	4.5
P/B (x)	1.17	1.15	1.16	1.05	0.96
EV/EBITDA (x)	5.0	4.7	4.1	3.4	2.9
Yield (%)	6.3	5.6	5.4	6.6	7.8
ROE (%)	27.1	16.3	17.9	20.8	22.3
ROCE (%)	26.9	20.7	22.7	26.2	28.4
N. Gear. (%)	33.0	50.3	40.7	29.9	17.8

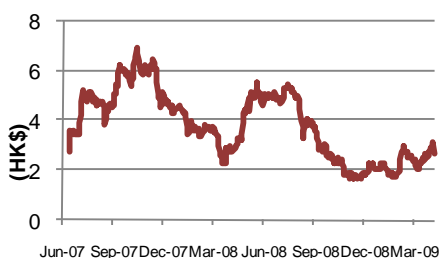
Source: SBI E2-Capital

Price performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	1.2	26.5	55.3
Actual price changes (%)	29.2	27.4	-6.3

	09F	10F	11F
Consensus EPS (HK\$)	0.512	0.632	0.980
Previous forecasts (HK\$m)	514.0	609.0	
Previous EPS (HK\$)	0.428	0.508	

Price chart



Kennedy Tsang / Helena Qiu

(852) 2533 3713/ 3709

kennedytsang/ helenaqiu@sbi2capital.com

net gearing ratio is 50.3%, in line with our expectations.

2H FY12/08A analysis. For 2H FY12/08A, the revenue increased 29.4% YoY to HK\$1,784.1m with a net profit drop of 61.3% YoY to HK\$130.1m. Our investment thesis that ULI's strength is in its finished products line remained intact. Sales of finished products recorded 27.4% YoY growth to HK\$658.5m and operating profit increased 44.5% YoY to HK\$192.2m, helped by lowering raw material prices. Sales of bulk medicine increased 10.4% YoY to HK\$801.6m and operating profit increased 81.8% YoY to HK\$78.4m. Intermediate products recorded an EBIT loss of HK\$6.2m compared with an operating profit of HK\$207.1m a year ago.

Balance sheet. ULI's inventory and receivable days fell to 104 days and 102 days respectively (from 117 days and 120 days in FY12/07A), mainly due to slightly better cash flow management and lower carrying costs for 6-APA

Ticker: 3933.HK
Price: HK\$2.70
Target: HK\$3.40 (+26%)

12 mth range: HK\$1.68-5.58
Market cap: US\$415.7m
Daily t/o, 3 mth: US\$2.2m
Free float %: 27.8%

Key points:

- * FY12/08A net profit of HK\$430.2m was in line with our expectations but down on market consensus which was dragged up by several over aggressive street estimates
- * EBIT margins improved for both finished products (up 2.5pcp YoY to 26.8%) and bulk medicines (up 0.8pcp to 11.4%). Finished products line a key contributor, accounting for 50.7% of total EBIT
- * We project finish products top line to grow 20.1% in FY12/09F, leveraging government initiatives, 2,200 strong sales force and new products
- * Maintain our conservative outlook for 6-APA. Our earnings model suggest this segment will only be a slightly better than breakeven business in FY12/09F
- * Market had too high of an expectations for ULI's FY12/08A results and weakness over the next couple of trading sessions may potentially present good entry points for investors
- * Maintain our BUY call on the counter, lifting our SOTP target price to HK\$3.40, representing 8.1x blended FY12/09F P/E

FY12/08A results as expected – in line with our estimates, but below market consensus. As expected (see our post "[Time to take profits](#)"), United Laboratories (ULI)'s FY12/08A net profit of HK\$430.2m (down 15.7% YoY) was in line with our expectation, but well below the market consensus of HK\$544.2m (consensus estimates were lifted by several abnormally aggressive forecasts in our view). Turnover rose 44.7% YoY to HK\$3,755.9m though gross margin fell 8.4pcp to 38.1% as 6-APA and amoxicillin bulk medicine prices normalized in FY12/08A (FY12/07 prices were boosted due to tight production supply and shutdowns across the industry to accommodate environmental system upgrades). Top line increase was broad based. On a segmental basis, finished products up 34.6% YoY, intermediate products was up 23.6% YoY (on higher volumes) and bulk medicine up 25.6% YoY. We liked the fact that EBIT margins improved for both finished products (up 2.5pcp YoY to 26.8%) and bulk medicines (up 0.8pcp to 11.4%). The company relieved a key market concern by paying a dividend for FY12/08A. Dividend of HK\$180.0m represents a payout ratio of 41.8%, representing 5.6% yield. At end-FY12/08, ULI's

related products in our view. Payable days also decreased to 188 days (from 235 days) but the absolute amount increased by 69.5% YoY to HK\$1,509.9m. However, HK\$455.4m of the payables amount was capex related. The company had HK\$451.5m cash, offset by HK\$1,350.9m short term and HK\$424.7m long term debt.

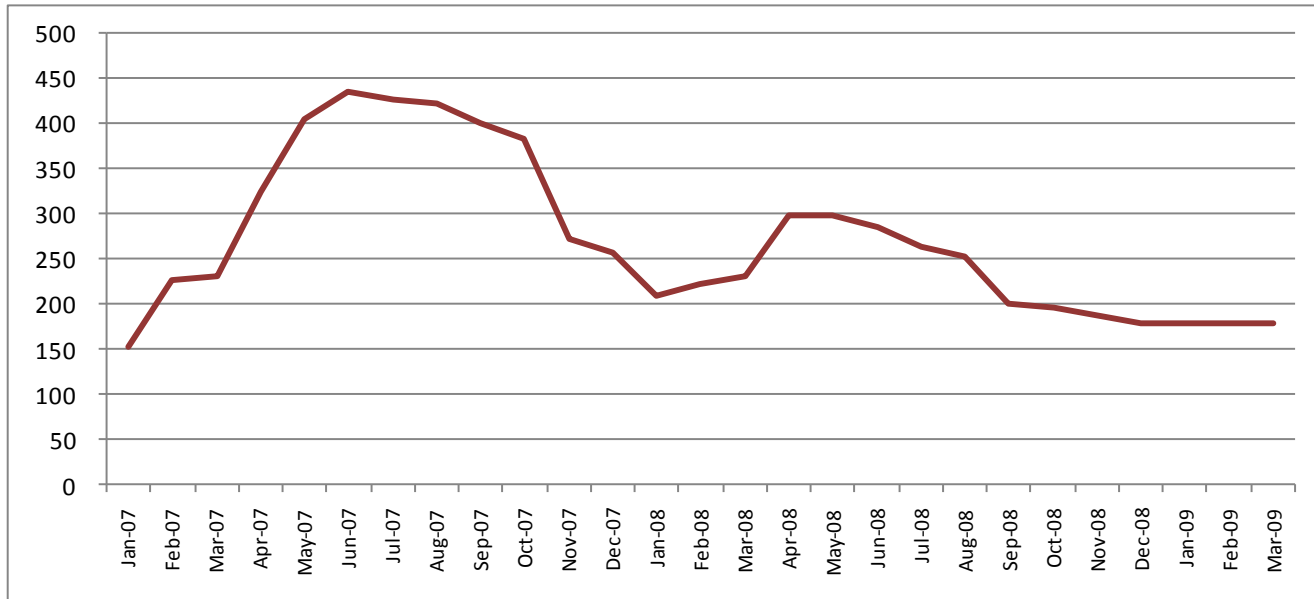
Finished products is key driver. ULI's finished products contributed 50.7% of total EBIT up 48.4% YoY. It was mainly driven by the expansion to rural market (increased 40% to around HK\$400m) and some newly launched products (such as Tazobactam sodium/Piperacillin sodium for injections, Adefovir capsules) with 40%+ YoY growth. Management is still confident of achieving a 20% YoY growth in FY12/09F from: 1) benefiting from the increasing government expenditure on healthcare; 2) further expansion in rural market and 3) leveraging their strong sales force (2,200 strong at end-FY12/08A), which had been under establishment over the past 2 years. At the end of 2009, ULI plans to launch Isophane protamine human insulin injection for treatment of type I & II diabetics, which would expect to be a blockbuster product (sales over HK\$100m a year) in three years time. ULI will launch another two new products (Imipenem cilastatin sodium for injection and Acetaminophen and Dextromethorphan Hydrobromide oral solution), though the main role of these two products is to plug exiting gaps in its product portfolio and is not expected to make significant contribution to ULI. In terms of expansion, management aims to increase production capacity by 50% by 2010 from 2008 levels.

Expect 6-APA prices to be moderate in 2009. We continue to be conservative in 6-APA prices for FY12/09F, factoring in an average price of RMB197.6/kg (ex-VAT), implying only a slight rebound from current prices of RMB180.0/kg. Volumes sold will increase however and management has indicated that volumes sold have been up ~20.0% year-to-date. The company's 6-APA production capacity will remain at 8,500 tonnes in FY12/09F FY12/10F. Our earnings model suggests that the intermediates segment will largely be a slightly better than breakeven business for FY12/09F.

Medical reform would be a good news. The newly issued "Opinion on the healthcare reform" targets reform of the medical insurance system to cover all residents in China by 2011 and for the basic healthcare service system to cover all residents in China by 2020. Government subsidies will increase to RMB120 per person per year by 2010 (from currently RMB80) and individual out-of-pocket expenditure would be reduced to 20% (from 50%) in 3 years. The government initiative would be a key driver of industry growth over the next few years and ULI stands to be a key beneficiary.

Raising target price to HK\$3.40, maintain BUY call. We slightly revised our earnings estimate for FY12/09F to HK\$501.8m (from 514.0m) and FY12/10F to HK\$611.0m (from HK\$609.0m) to build in slight cost structure adjustments. ULI continues to be one of our key picks in the pharmaceutical sector as we maintain our view that the market will gradually recognize the leading position of ULI's finished products in China (in terms of market share and price concessions) and hence re-rate the stock's valuation. The market had too high of an expectations for ULI's FY12/08A results and the stock price fell 13.7% yesterday as anticipated. We think that think that the pressure on the stock over the next couple of trading sessions may potentially present good entry points for investors. We maintain our BUY call on the counter, lifting our target price to HK\$3.40, representing 10.0x FY12/09F P/E in finished products and 4.0x in medical raw materials (8.1x blended P/E).

Chart 1: 6-APA price trend



Source: www.healthoo.com, SBI E2-Capital

Table 2: P & L

Year to Dec (HK\$m)	07A	08A	09F	10F	11F
Turnover*					
Intermediates	265.7	742.4	571.5	581.5	708.7
Bulk Medicines	1,362.3	1,712.2	1,814.4	1,851.2	1,909.0
Finished Product	967.0	1,301.3	1,562.6	1,828.3	2,102.5
	2,594.9	3,755.9	3,948.6	4,261.0	4,720.2
Cost of sales	(1,389.2)	(2,326.3)	(2,365.1)	(2,422.4)	(2,623.9)
Gross profit	1,205.8	1,429.6	1,583.5	1,838.6	2,096.3
Other income and gains	25.8	63.0	20.0	20.0	20.0
Selling and distribution costs	(381.5)	(554.5)	(596.1)	(686.4)	(781.2)
Administrative expenses	(173.3)	(247.6)	(255.5)	(294.2)	(334.8)
Other operating expenses	(38.4)	(40.9)	(20.0)	(20.0)	(20.0)
Operating profit	638.3	649.7	732.0	858.0	980.4
Finance costs, net	(80.0)	(117.2)	(104.8)	(94.3)	(80.2)
Profit before taxation	558.3	532.5	627.2	763.7	900.2
Taxation	(47.9)	(102.4)	(125.4)	(152.7)	(180.0)
Net profit	510.5	430.2	501.8	611.0	720.2

Source: Company data and SBI E2-Capital

*External sales only

SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. Find our research on: sbie2capital.com, thomsononeanalytics.com, factset.com and multex.com

SBI E2-Capital stock ratings:

STRONG BUY : absolute upside of >50% over the next three months
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

Investors should assume that SBI E2-Capital is seeking or will seek investment banking or other related businesses with the companies in this report.

Analyst certification: The views expressed in this report accurately reflect the analyst's personal views of the subject securities and that the analyst has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Disclaimer: This research report is not an offer to sell or the solicitation of an offer to buy or subscribe for any securities. The securities referred to in this report may not be eligible for sale in some jurisdictions. The information contained in this report has been compiled by the Research Department of SBI E2-Capital Securities Limited ('SBI E2-Capital') from sources that it believes to be reliable but no representation, warranty or guarantee is made or given by SBI E2-Capital or any other person as to its accuracy or completeness. All opinions and estimates expressed in this report are (unless otherwise indicated) entirely those of SBI E2-Capital as of the date of this report only and are subject to change without notice. Neither SBI E2-Capital nor any other person, accepts any liability whatsoever for any loss howsoever arising from any use of this report or its contents or otherwise arising in connection therewith. Each recipient of this report shall be solely responsible for making its own independent investigation of the business, financial condition and prospects of the companies referred to in this report. SBI E2-Capital and their respective officers, directors and employees, including persons involved in the preparation or issuance of this report, may from time to time (1) have positions in, and buy or sell, the securities of companies referred to in this report (or related investments); (2) have a consulting, investment banking or broking relationship with any company referred to in this report; and (3) to the extent permitted under applicable law, have acted upon or used the information contained or referred to in this report including effecting transactions for their own account in an investment (or related investment) in respect of any company referred to in this report, prior to or immediately following its publication. This report may not have been distributed to all recipients at the same time. This report is issued only for the information of and may only be distributed to professional investors and dealers in securities and must not be copied, published, reproduced or redistributed (in whole or in part) by any recipient for any purpose. This report is distributed in Hong Kong by SBI E2-Capital. Any recipient of this report who requires further information regarding any securities referred to in this report should contact the relevant office of SBI E2-Capital located in such recipient's home jurisdiction.

Copyright © SBI E2-Capital Securities Limited 2008. All rights reserved.