

United Laboratories



BUY (unchanged)

Domestic demand solid, but 6-APA prices weak on exports

Key points:

- 6-APA price remains weak as ULI's overseas customers feel the impact of credit tightening
- Defensive fundamentals of China's pharmaceutical sector remain intact. We estimate that ULI could get 35.9% top line growth in ULI's finished products is achievable
- Capex peaks in this year. Net gearing expected to fall to 34.3% by end-FY12/09F (from 51.1% at 1H FY12/08A)
- Net profit estimate cut to HK\$535.3m for FY12/08F and HK\$665.8m for FY12/09F
- Maintain BUY call; our sum-of-parts target price cut to HK\$4.30, representing 7.8x FY12/09F P/E

6-APA price remains weak. The 6-APA price in November remains weak at around RMB180/kg (ex-VAT), due to the weak overseas market, in contrast with the historical trend of high ASPs in 4Q. ULI exports around 50.0% of its 6-APA output and its export market has been affected by: 1) tighter credit conditions resulting in some customers scaling back orders and others carrying less inventory; 2) competitive pricing for substitute penicillin salt; 3) competition from Indian producers. In the current tough environment, domestic antibiotic producers have also reduced their 6-APA inventories in anticipation prices would not rise significantly in the short term. ULI's 6-APA production utilization is currently 50-60%.

Defensive fundamentals intact. China's pharmaceutical sector's defensive fundamentals remain intact. Demand for ULI's amoxicillin raw materials and finished products remains robust. We believe that ULI could get 35.9% top line growth in finished products, driven by the company's enlarged sales network (2,200 strong) and increasing medical insurance coverage in urban and rural areas. We also expect a slight gross margin improvement, given the current moderate 6-APA prices. The price of amoxicillin raw materials, which is correlated to 6-APA prices, was around RMB215/kg in November (flat from October) and the company's production capacity is currently fully utilized.

New product registration. In Sep 2008, the company obtained State Food and Drug Administration approval for its new product Imipenem Cilastatin Sodium for injection, which is used for the treatment of serious infections. The product is expected to be launched in early-2009 and the company expects it to contribute around RMB100m a year in revenue in three years. While the contribution is not significant (~5.0% of FY12/10F finished products revenue), it rounds out the company's antibiotic portfolio.

China Pharmaceuticals

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Stock data

Price	HK\$1.71
Target price	HK\$4.3 (+151%)
12 mth range	HK\$1.68-6.20
Market cap.	US\$263.2m
Daily t/o, 3 mth	US\$0.7m
Free float %	27.9%
Ticker	3933.HK/3933 HK

Financial summary

Year to Dec	06A	07A	08F	09F	10F
Turnover (HK\$m)	2080.5	2594.9	3540.8	3618.6	3945.8
Net Profit (HK\$m)	173.8	510.5	535.3	665.8	768.4
EPS (HK\$m)	0.145	0.425	0.446	0.555	0.640
EPS Δ %	49.1	193.6	4.9	24.4	15.4
P/E (x)	11.8	4.0	3.8	3.1	2.7
P/B (x)	1.6	0.8	0.8	0.7	0.6
EV/EBITDA (x)	28.3	5.9	6.6	4.6	3.4
Yield (%)	-	10.0	9.1	11.4	13.1
ROE (%)	15.0	27.1	21.2	23.5	24.1
ROCE (%)	18.3	26.9	24.1	26.9	28.4
N. Gear. (%)	80.8	33.0	50.2	34.3	16.9

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	(16.4)	(29.6)	(40.1)
Actual price changes (%)	(26.0)	(55.7)	(71.9)

	08F	09F	10F
Consensus EPS (HK\$)	0.555	0.650	0.790
Previous forecasts (HK\$m)	681.5	796.8	896.1
Previous EPS (HK\$)	0.568	0.664	0.747

Price Chart



Net gearing to come down in FY12/09. ULI's net gearing of 51.1% at 1H FY12/08A is relatively high. However, capex peaks in this current financial year (RMB800.0m). Next year, the company's capex will drop to RMB300.0m. We expect the company's net gearing level to fall to 34.3% by the end of FY12/09F.

Earnings forecast cut, maintain BUY. We have cut our earnings estimate to reflect weaker 6-APA and amoxicillin raw material prices. We have revised down our sales estimate for FY12/08F and FY12/09F to HK\$3,540.8m and HK\$3,618.6m (previously: HK\$3,962.3m and HK\$4,195.7m) and net profit estimates to HK\$535.3m and HK\$665.8m (previously: HK\$681.5m and HK\$796.8m). We are being extremely conservative in our 6-APA price assumptions for FY12/09F, factoring in only a mild increase in ASPs from the current level. We maintain our BUY call on the counter but adjust down our target price to HK\$4.30, representing 7.8x FY12/09 P/E (10.0x for finished product and 5.0x for medical raw materials).

Table 1: P&L

Year to Dec (HK\$m)	06A	07A	08F	09F	10F
Turnover	2,080.5	2,594.9	3,540.8	3,618.6	3,945.8
Cost of sales	(1,344.2)	(1,389.2)	(2,029.3)	(1,805.0)	(1,857.1)
Gross profit	736.3	1,205.8	1,511.5	1,813.7	2,088.7
Other income and gains	9.9	25.8	32.5	32.0	19.2
Selling and distribution costs	(284.1)	(381.5)	(529.2)	(613.6)	(718.4)
Administrative expenses	(123.0)	(173.3)	(233.4)	(263.0)	(307.9)
Other operating expenses	(37.8)	(38.4)	(10.0)	(20.0)	(20.0)
Operating profit	301.3	638.3	771.4	949.1	1,061.6
Finance costs, net	(85.5)	(80.0)	(116.6)	(116.8)	(76.6)
Share of results of an associate	(2.7)	-	-	-	-
Gain on disposal of an associate	8.6	-	-	-	-
Profit before taxation	221.8	558.3	654.9	832.3	985.1
Taxation	(47.9)	(47.9)	(119.6)	(166.5)	(216.7)
Profit after tax	173.8	510.5	535.3	665.8	768.4
Minority interests	-	-	-	-	-
Profit attributable to shareholders	173.8	510.5	535.3	665.8	768.4

Source: Company data, SBI E2-Capital

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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

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