

United Laboratories (3933.HK)

Rapid Future Growth in Insulin Business

Hong Kong | Pharmaceutical | Company report

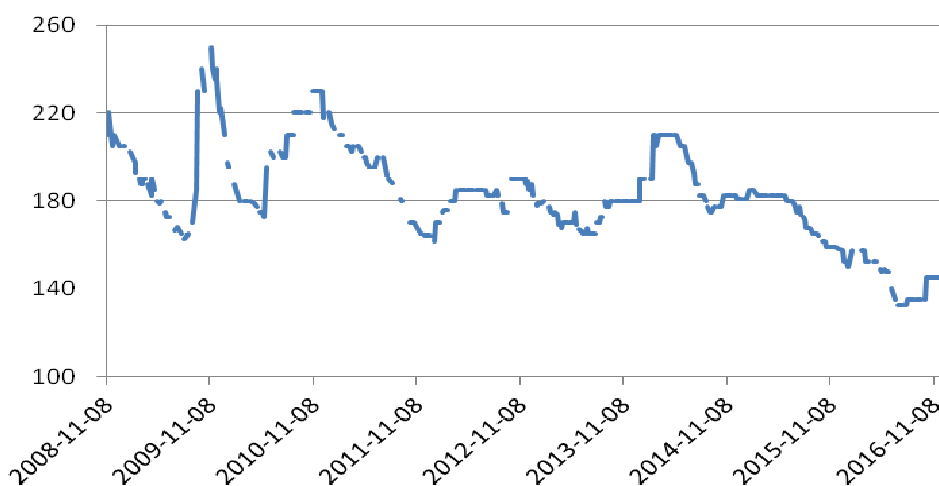
9 December 2016

Expected Return to Profits in 2H

The United Laboratories (TUL) mainly engages in the production and sales of pharmaceutical preparations, raw materials, pharmaceutical intermediates and capsules. In 1H 2016, the company's revenue dropped by 8.6% to HK\$3.5 billion, recording a loss of HK\$15.1 million, due to the decrease in sales volume and price of the main products. First, the price of the company's main intermediate 6APA and part of the APIs fell. Second, in 1H 2016, TUL's raw material plant in Zhuhai City expanded and upgraded a by-product recovery system starting from March, leading to the decline in amoxicillin production, from 700 ton/month to 200 ton/month. Eventually, the company's sales of 6APA and semi-synthetic penicillin were down by 8.7% and 18.1% Y-o-Y, respectively.

Nevertheless, relevant projects in Q3 have been completed, and some of the previous orders have not been fulfilled. With the gradual release of production capacity, the main product sales will be back on track. At the same time, after more than five years of falling, the recent prices of 6APA, amoxicillin and cephalosporin antibiotics have indicated a slower downtrend, and some varieties even showed signs of recovery. Thus, we expect that the company's intermediates and APIs will gradually return to profits.

ASP of 6-APA (RMB/Kg)



Source: Wind, Phillip Securities (HK) Research

Accumulate (Initially)

CMP: HKD 4.46

(Closing price as at 7 Dec 2016)

TARGET: HKD 5.14 (+15.2%)

COMPANY DATA

O/S SHARES (MN) :	1,627
MARKET CAP (HKDMN) :	7,272
52 - WK HI/LO (HKD):	4.78/ 2.70

SHARE HOLDING PATTERN, %

Heren Far East Limited:	61.85
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PRICE PERFORMANCE, %

	1M	3M	1Y
TUL	7.97	14.91	3.23
HSI	8.52	19.40	1.11

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

HK\$ mn	FY14	FY15	FY16E	FY17E
Net Sales	8030	7695	7207	7910
Net Profit	681	110	132	418
EPS, HK\$	0.14	0.27	0.08	0.26
PER, x	31.0	16.5	54.9	17.3
BVPS, HK\$	4.28	4.13	4.21	4.47
P/BV, x	1.04	1.08	1.06	1.00
ROE, %	10.1	1.6	1.9	5.9
Debt/Equity (%)	171.5	159.1	150.0	150.0

Source: Company reports, Phillip Securities Est.

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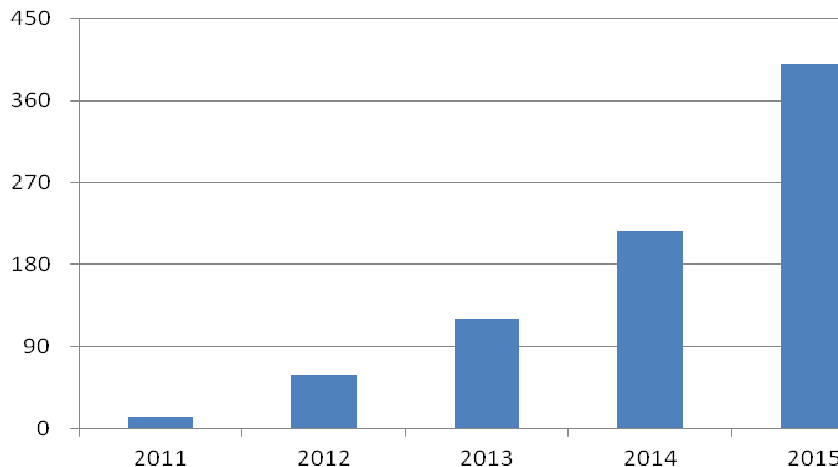
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Rapid Future Growth in Insulin Business

TUL established the production base of insulin APIs and preparations in Zhuhai in 2010, the largest in China so far, and a total of eight new production plants as of June 2016. Currently, the production scale of the insulin API is up to 3 ton/year, including one ton of second generation insulin, one ton of insulin glargine and one ton of insulin aspart, and 300 million preparations can be produced each year. The diabetes segment is expected to be the company's future focus of development and layout. Moreover, the proportion of Chinese patients with diabetes using insulin to control blood glucose is much lower than 30%, the proportion of developed countries. In addition, the foreign-funded companies have dominated the China's market of the second and third generations of insulin. With the consideration of China's medical insurance control, broad prospects lie before import substitutes of insulin.

In addition, TUL is also expected to become the first domestic enterprise providing both second and third generations of insulin. The company has passed One-in-Three Review (production on-site inspection report, production site sampling inspection report and technical review report for comprehensive views), and is expected to be China's second enterprise producing insulin glargine, contributing to the revenue in 2017. Meanwhile, the aspart insulin has completed clinical trials and is submitting for the production approval. The company's growth rate of insulin sales and revenue was up to 57.8% and 84.3%, respectively, in 2015, and we expect that the rapid growth will continue, being the company's main growth driver.

Rapidly increased Revenue from insulin (HK\$: mn)



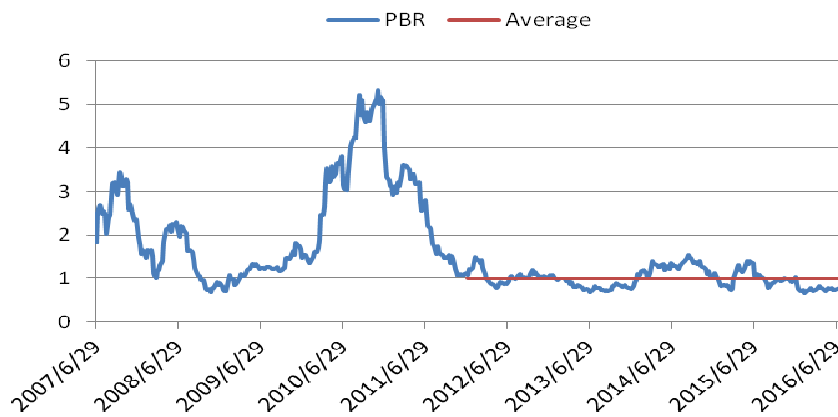
Source: Bloomberg, Phillip Securities (HK) Research

Cost of Capital May Reduce by Issuing Convertible Bonds

The company recently proposed to issue a USD130 million of convertible bonds with an initial conversion price of HK\$5.35. The bonds represent 10.38% of the enlarged share capital if fully converted to the new shares. This move is to provide lower financing costs for the company because the company's short-term debts were due, which have higher financing costs.

In short, with the stabilization of the antibiotic business and the rapid growth of the insulin business, we expect the company's performance to be significantly improved. We give an estimation of 1.15x BVPS in 2017 and the target price of HK\$5.14, with the "Accumulate" rating initially. (Closing price as at 7 Dec 2016)

Historical P/B Valuation



Source: Bloomberg, Phillip Securities (HK) Research

Risks

Fluctuations in the API prices;
Risks of approval policies.

Financials

FYE	2013	2014	2015	2016F	2017F
Valuation Ratios					
Price Earnings	148.67	30.97	16.46	54.92	17.34
Price to Book	1.12	1.04	1.08	1.06	1.00
Per share data(HK\$)					
EPS Adjusted	0.03	0.14	0.27	0.08	0.26
Book Value Per Share	3.98	4.28	4.13	4.21	4.47
Growth& Margin					
Revenue growth	-	5.0%	-4.2%	-6.3%	9.8%
Gross Profit growth	-	22.4%	-8.3%	-8.5%	15.6%
Net Profit growth	-	1317.8%	-83.8%	19.7%	216.7%
Profitability Ratios					
Gross Margin	34.5%	40.2%	38.5%	37.6%	39.6%
Net Profit Margin	0.6%	8.5%	1.4%	1.8%	5.3%
Key Ratios					
Return on Assets	0.3%	3.5%	0.6%	0.8%	2.4%
Return on Equity	0.8%	10.1%	1.6%	1.9%	5.9%
Effective Tax Rate	94.7%	0.0%	53.1%	55.0%	30.0%
Liability ratio	66.9%	63.2%	61.4%	60.0%	60.0%
Income Statement(HK\$: mn)					
Revenue	7,648	8,030	7,695	7,207	7,910
- Cost of Goods Sold	5,011	4,801	4,733	4,497	4,778
Gross Income	2,638	3,228	2,961	2,710	3,133
- Selling, General & Admin Expense	1,651	2,701	2,436	2,180	2,373
Operating Income	1,065	1,010	637	644	923
- Interest Expense	201	372	350	290	300
- Net Non-Operating Losses (Gains)	-25	-32	-44	-30	-35
Pretax Income	901	664	235	294	598
- Income Tax Expense	853	-18	125	161	179
Income Before XO Items	48	681	110	132	418
Net Profit	48	681	110	132	418

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 7 Dec 2016)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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