Asia Pacific Equity Research
30 November 2005

EPS (4282)

EPS Outlines Strategy for Earnings Growth; We Reiterate Overweight Rating, Look for Significant Progress from FY2006

- **FY2005 results were generally in line with plan:** Consolidated sales rose 19% YoY to ¥13,004 million, and recurring profit rose 23.6% to ¥1,811 million. New orders offset the negative effects of the end of the large-scale (approximately ¥1 billion per year in scale) clinical trial employing the hyperlipidemia drug Mevalotin, and we believe the 19% YoY increase in consolidated sales was a noteworthy result.
- **We think company's FY2006 forecasts are conservative:** We look for steady earnings growth to continue again in FY2006 in both the CRO and SMO segments. We thought there were issues in both segments that management needed to address in FY2005. Specifically, in the CRO (Contract Research Organization) segment we thought the company had to grow sales by procuring new orders sufficient to offset the decline in large-scale clinical trials. In the SMO (Site Management Organization) segment, it was necessary for the company to consolidate subsidiaries and bolster its profit margins. Regarding FY2006, we believe EPS will be able to expand sales more easily in the CRO segment because it has procured another large project to replace the Mevalotin trial. In the SMO segment as well, EPS largely completed the consolidation of its SMO subsidiaries during FY2005, and we therefore expect significant earnings growth in this segment from FY2006.
- **EPS remains on our Focus List with a fair value estimate of ¥550,000:** We have updated our earnings forecasts for EPS, although our forecasts for FY2006 and FY2007 remain largely unchanged. The stock's P/E valuation declines progressively, from 25.2x on our FY2006 forecast to 19.9x on our FY2007 forecast and 16.3x on our FY2008 forecast. However, CMIC, a company we consider to be in the same stage of growth as EPS, currently trades at a P/E valuation around 39x, and the average P/E of five CRO-related stocks in the U.S. (which is generally considered to be 10 years ahead of Japan in this field) is around 32x (IBES basis). In this light, we believe the shares of EPS are undervalued.

Overweight

¥345,000

29 November 2005
Price Target: ¥550,000

Japan
Small Cap

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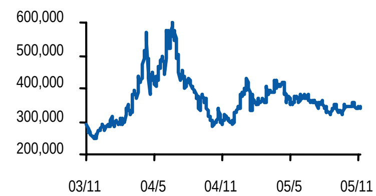
Market capitalization	¥30.0 bn
Shares outstanding	0.087 mn
52-week range	¥435,000–289,000
TOPIX	1544.57
Dividend (FY2005E)	¥3,000
Dividend yield (FY2005E)	0.9%
RoE (FY2005E)	18.4%
Average daily trading volume (past 30 days)	¥71mn
Focus List target price (Dec 06)	¥550,000

Share Price Chart
¥



Source: Datastream.

Consolidated Y/E Sep	Sales (¥mn)	YoY (%)	OP (¥mn)	YoY (%)	RP (¥mn)	YoY (%)	NP (¥mn)	YoY (%)	EPS (¥)	P/E (x)	P/CF (x)	EV/EBITDA (x)
2005	13,004	19.0	1,793	27.1	1,811	23.6	1,127	47.0	12,951.4	26.6	25.1	15.1
2006E new	16,813	29.3	2,350	31.0	2,350	29.8	1,192	5.8	13,701.1	25.2	23.8	11.7
2006E old	16,978	30.6	2,299	28.2	2,319	28.1	1,192	5.8	13,701.1	25.2	23.8	11.5
2006 Co.E	16,041	23.4	2,118	18.1	2,110	16.5	1,063	-5.7	12,218.4	28.2	NA	NA
2007E new	20,980	24.8	2,928	24.6	2,928	24.6	1,510	26.7	17,356.3	19.9	19.0	9.4
2007E old	20,624	21.5	2,778	20.8	2,798	20.7	1,451	21.7	16,678.2	20.7	19.7	9.4
2008E	25,403	21.1	3,529	20.5	3,529	20.5	1,841	21.9	21,160.9	16.3	15.7	7.8

Source: Company data and JPMorgan estimates.
Note: For details regarding the Focus List target price please refer to the October 17, 2005 report.

J.P. Morgan Securities Asia Pte. Ltd.

EPS Announces Medium-Range Earnings Targets

For FY2006, the company is projecting consolidated sales of ¥16,041 million (up 23.4% YoY) and consolidated recurring profit of ¥2,110 million (up 16.5%). Looking ahead to FY2008, management is forecasting consolidated recurring profit of ¥3.6 billion on consolidated sales of ¥26.0 billion. We also believe the company is capable of achieving strong earnings growth over the longer term, but we think there is an element of uncertainty as well. We therefore forecast consolidated sales of ¥25,403 million and recurring profit of ¥3,529 million for FY2008. Our forecasts assume the domestic CRO/SMO market (around ¥100 billion with an outsourcing ratio of 21% in 2005) will grow to around ¥147.5 billion (31% outsourcing ratio) in 2008, and that EPS's share of the CRO market will expand to 15% or so from the current 13%.

CRO Segment

With the large-scale Mevalotin clinical trials that had driven the company's growth in recent years coming to an end in FY2005, EPS had to overcome the negative impact of the loss of this large contract and also procure new orders in sufficient volume to sustain the growth of its CRO business. However, EPS was still able to achieve its projections, and the CRO segment's order backlog at end-FY2005 was actually up 22.3% YoY. From FY2006, we think new orders will directly contribute to sales growth in the CRO segment, and we therefore believe EPS should be able to achieve its FY2006 projections.

EPS is also taking steps to bolster the overseas presence of its CRO business. The company is rapidly establishing an internationally compatible clinical research system in response to the growing momentum of simultaneous international drug development and the ICH (International Conference on Harmonization of Technical Requirements for Registration of Pharmaceuticals for Human Use). EPS is particularly focused on expanding its CRO business in China, and management's plans include building an EDC (electronic data capturing)-based system of efficient clinical research and data management, and expanding its total overseas CRO sales to around ¥1 billion in FY2008 (from roughly ¥300 million in FY2005).

SMO Segment

During FY2005 the company acquired Mint Co. Ltd., an SMO vendor based in the Tohoku region, and merged Mint with existing SMO subsidiary EPLink to form the new subsidiary EP-Mint. EPS owns another SMO subsidiary (Japan SMO), and we expect this subsidiary to also be absorbed during FY2006, further solidifying the company's SMO business. We look for EPS to post SMO segment sales of ¥4.02 billion in FY2006, making it one of the top vendors in Japan's SMO market.

Establishment of SOGO Mediplus, a Joint Venture with Sogo Clinical Pharmacology (2399)

SMO subsidiary EP-Mint is slated to team up with Sogo Clinical Pharmacology (listed on TSE Mothers) to develop a CRC (clinical research coordinator) outsourcing business within the SMO segment. Sogo Clinical will own a 60% stake and EP-Mint a 40% stake in the joint venture. Within the SMO market, demand among larger hospitals for CRC outsourcing is growing, but EPS decided to enter this business via joint venture because it thinks that the short-term outsourcing CRC will generate only relatively narrow profit margins. We believe this strategy will facilitate improved profitability since the company will now be able to spin off the low-margin CRC outsourcing business from EP-Mint's SMO segment.

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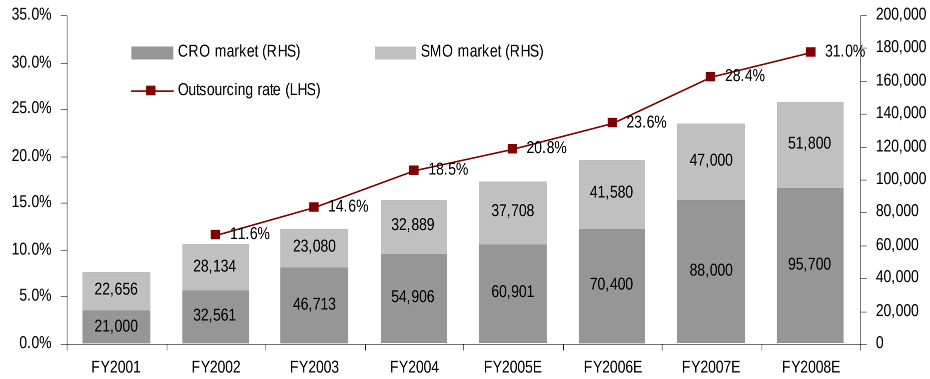
Japanese CRO/SMO Market



Source: Japanese CRO Association, Japan SMO Association and JPMorgan.

Sales and Operating Profit Breakdown (Consolidated)

¥ million

		9/03	9/04	9/05	9/06E	9/07E	9/08E
CRO							
	Sales	6,280	7,831	9,073	11,493	14,780	17,953
	YoY	29.2%	24.7%	15.9%	26.7%	28.6%	21.5%
	Operating profit	851	1,055	1,304	1,632	2,084	2,513
	Operating margin	13.6%	13.5%	14.4%	14.2%	14.1%	14.0%
SMO							
	Sales	1,482	1,874	2,597	4,020	4,800	6,000
	YoY	28.2%	26.5%	38.6%	54.8%	19.4%	25.0%
	Operating profit	101	165	266	523	634	798
	Operating margin	6.8%	8.8%	10.2%	13.0%	13.2%	13.3%
Non-clinical business							
	Sales	1,233	1,264	1,381	1,300	1,400	1,450
	YoY	-	2.5%	9.3%	-5.9%	7.7%	3.6%
	Operating profit	223	185	217	195	210	218
	Operating margin	18.1%	14.6%	15.7%	15.0%	15.0%	15.0%
Elimination		-59	-43	-47	0	0	0
	Sales						
Sales		8,936	10,927	13,004	16,813	20,980	25,403
	YoY	49.6%	22.3%	19.0%	29.3%	24.8%	21.1%
	OP	1,179	1,412	1,793	2,350	2,928	3,529
	OP margin	13.2%	12.9%	13.8%	14.0%	14.0%	13.9%

Source: Company data and JPMorgan estimates.

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Companies Recommended in This Report (as of COB 29 November 2005)
EPS (4282) (4282.T/¥345,000/Overweight)

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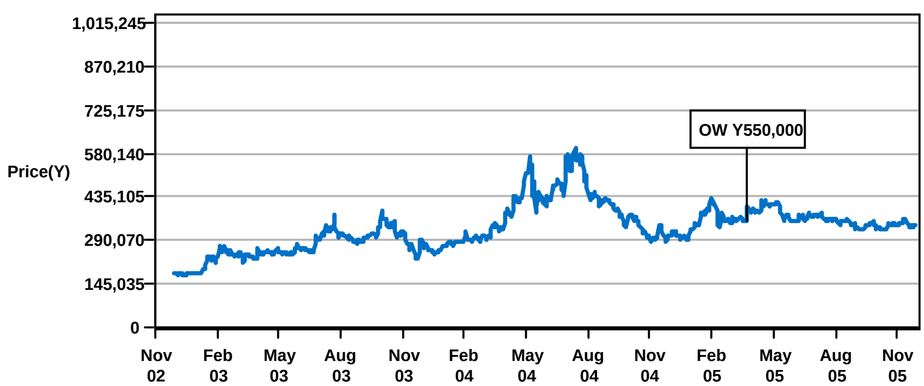
EPS (4282) (4282.T) Price Chart



Date	Rating	Share Price (Y)	Price Target (Y)
22-Mar-05	OW	358000	550000

Source: Reuters and JPMorgan; price data adjusted for stock splits and dividends.
Initiated coverage Mar 22, 2005. This chart shows JPMorgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period. As of Aug. 30, 2002, the firm discontinued price targets in all markets where they were used. They were reinstated at JPMSI as of May 19th, 2003, for Focus List (FL) and selected Latin stocks. For non-JPMSI covered stocks, price targets are required for regional FL stocks and may be set for other stocks at analysts' discretion.
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