

## Severe share price fall offers opportunity to buy structural growth business at reasonable valuations

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EPS's core CRO business (contract research organisation, 73% of sales) involves conducting clinical trials on contracts for pharmaceutical companies and it continues to enjoy structural growth. The R&D budgets at most drug companies rising – generating more new business opportunities – as is the ratio of trials done by CROs. While 40-50% of trials are routinely contracted out in Europe and the US, the figure in Japan is still less than 20%. EPS's top-line growth has been in the range of 20% in recent years. This may decelerate as the base grows, but we expect it to remain in the mid- to high-teens. EPS has been building a CRO platform in China, and we anticipate that the MHLW will, in autumn 2007, move to full acceptance of clinical data generated in Chinese subjects for domestic drug approvals. The Japanese regulators like to see safety data in Asians, which has led the MHLW to hold reservations about clinical data generated in western countries, but no such genetic barrier exists with the Chinese population. EPS's China business is still small, but it is the best-positioned CRO in Japan if the MHLW makes the change. EPS's profit margins have suffered during FY9/06 due to problems in the other main part of the business, namely site management organisation (SMO, 18% of sales). This is a service business involving coordination and administrative aspects of the clinical trial (as opposed to the scientific aspects such as trial design, patient recruitment, drug administration, safety and efficacy monitoring, and follow-up handled by the CRO segment). SMO revenues are impacted if patient recruitment falls below target, which has been the case in FY9/06. In addition, one subsidiary in particular, the Kyushu-based EP Mint, recorded a small operating loss at the interim stage. A ¥2bn moving strike convertible bond (MSCB) issue in April damaged sentiment. However, EPS's Q3 FY9/06 balance sheet showed ¥0.9bn of the recent MSCB issue still outstanding, but we have confirmed today that the issue was, in fact, fully redeemed in July, shortly after the balance sheet date. The shares have rallied in anticipation of a move to the TSE first section and now trade on 22x our estimated FY9/06 earnings and 18x for FY9/07, levels we still believe offer good value relative to the growth rate.

