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30 January 2009

Report no. 09-266

BUY

(PREVIOUS: Buy)

Target price
¥540,000

Price (30 January close)
¥388,000

52-week	high	**529,000**
	low	**263,100**
Market cap (¥bn)		**35.0**

Off to a smooth start on strong demand for data management services

Why now?

On 30 January, EPS announced results for 09/9 Q1 (Oct–Dec 2008). We make no change to our estimates and target price, but comment on recent business results and operating conditions.

Investment perspective

The domestic market for clinical trial contracts remains favorable and EPS has been boosting its presence in the market as a major contract research organization (CRO). The company is particularly strong in data management for drug development and has a strong track record and reputation in cancer-related research. We see EPS as a defensive stock owing to the favorable conditions surrounding its business.

Valuation

Our target price is based on a P/E range of 21–23x our 09/9 EPS estimate, which is a premium to the equivalent P/E for the NOMURA 400 (ex financials), reflecting our expectation for average annual EPS growth of 13% over the next three years. Risk factors include the possibility that earnings will be squeezed by a reduction in capacity utilization rates owing to customer-driven delays in the launch of trials in the mainstay CRO business and a shortfall in earnings owing to sluggish growth in the software development business.

Sector theme

CROs play an essential role in the development of drugs by pharmaceutical makers. Conditions for receiving orders in the clinical trial contract market remain favorable as the number of clinical trials being conducted in Japan rises owing to an increase in joint international efforts. We think drug companies will increase their reliance on EPS and other CROs that can provide high value-added services.

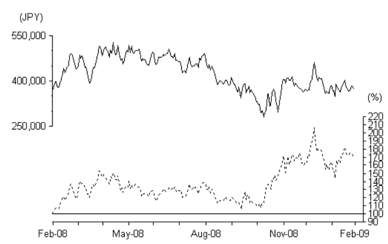
- ***Better-than-expected start to 09/9:*** Results for Q1 (Oct–Dec 2008) exceeded our expectations. Sales rose 12% y-y to ¥5.5bn and operating profits advanced 9% to ¥940mn. We had expected a decline in profits as earnings in the year-earlier period were boosted by the booking of projects that spilled over from Jul–Sep 2007. Ultimately, the results were better than we expected because the CRO segment booked some sales previously scheduled for later quarters and because expenditures were under budget. We leave our estimates at a higher level than management's forecasts as we do not expect spending aimed at improving the work environment to exceed 08/9 levels by as much as management does.
- ***Data management business doing well:*** The strength of the data management (DM) business stood out in Q1 results. DM sales rose 17% y-y to ¥1.4bn, putting them on pace to beat company targets. Work done in the past by the DM business has led to stable order receipts. While other companies in the data management segment have been booking operating losses, EPS has been able to take on work with higher margins, and thus make its DM business a source of earnings, as it provides high quality services backed by a strong track record. The monitoring business boosted sales by 8% y-y. Conditions for receiving orders remain favorable in the domestic clinical trial contract market. As such, we expect stable earnings expansion over the medium term driven by the DM and monitoring operations of the CRO business.
- ***Weak performance in the software development segment:*** The software development business acquired the software development and visual communications (mainly TV conferencing systems) operations from Digital Technology in October 2008. As such, Q1 sales rose 36% y-y, but we think

Estimates and financial data

Cons		08/9	09/9E	10/9E	11/9E
Sales (¥mn)		21,183	25,210	29,160	33,070
	% y-y	17.8	19.0	15.7	13.4
	Prev	-	25,210	29,160	33,070
	Co's	-	25,013	-	-
Ope profits (¥mn)		3,487	4,040	4,640	5,200
	% y-y	17.0	15.9	14.9	12.1
	Prev	-	4,040	4,640	5,200
	Co's	-	3,784	-	-
Rec profits (¥mn)		3,563	4,090	4,690	5,250
	Prev	-	4,090	4,690	5,250
Net profits (¥mn)		1,708	2,210	2,560	2,880
	Prev	-	2,210	2,560	2,880
EPS (¥)		19,111	24,447	28,319	31,858
	Prev	-	24,447	28,319	31,858
BPS (¥)		110,068	-	-	-
ROE (%)		16.5	-	-	-
D/E ratio (x)		0.1	-	-	-
P/E (x)		-	15.9	13.7	12.2
EV/EBITDA (x)		-	7.0	5.9	5.1
P/B (x)		3.5	-	-	-
Dividend yield (%)		-	1.5	1.9	2.1

Company data, Nomura estimates except where noted.

Share price chart: EPS [4282]



Solid line: Price adjusted for corporate action
Dotted line: Price relative to TOPIX
Source: Nomura

Please read the important disclosures and analyst certifications on pp. 4–7. gl domestic operations and software development work in China have been affected by the recession. The contribution to earnings from the software development business is small, but we plan to monitor order receipt trends. (NW)

1. EPS [4282]: consolidated financial data (¥mn, except where noted)

	07/9	08/9	09/9				10/9E	11/9E	12/9E	13/9E
			Q1	H1E	H2E	Full E				
Income statement										
Sales	**17,981**	**21,183**	**5,542**	**11,780**	**13,430**	**25,210**	**29,160**	**33,070**	**37,150**	**41,270**
CRO	12,233	15,195	3,912	8,030	9,380	17,410	20,330	22,820	25,530	28,200
Data management	4,908	5,878	1,903	3,660	3,220	6,880	7,660	8,730	9,770	10,790
Monitoring	5,993	7,310	1,437	3,170	4,820	7,990	9,520	10,360	11,340	12,400
CRO/other	1,332	2,007	573	1,200	1,340	2,540	3,150	3,720	4,420	5,010
SMO	3,315	3,491	801	1,870	2,020	3,890	4,390	5,100	5,820	6,580
Preclinical services	1,251	1,088	318	540	590	1,130	1,190	1,250	1,310	1,370
Software development business	1,182	1,409	511	1,340	1,440	2,780	3,250	3,900	4,490	5,120
COGS	12,047	14,378	3,765	8,140	9,250	17,390	20,210	22,980	25,870	28,800
Gross profits	5,934	6,805	1,776	3,640	4,180	7,820	8,950	10,090	11,280	12,480
SG&A expenses	2,953	3,317	838	1,850	1,930	3,780	4,310	4,890	5,530	6,250
Operating profits	**2,981**	**3,487**	**938**	**1,790**	**2,250**	**4,040**	**4,640**	**5,200**	**5,750**	**6,230**
CRO	2,157	2,662	805	1,330	1,740	3,070	3,500	3,850	4,260	4,520
SMO	643	695	83	350	390	740	790	890	950	1,080
Preclinical services	77	-1	38	30	40	70	80	100	110	130
System development	90	136	9	70	80	150	260	350	420	510
Eliminations/companywide	13	-5	4	10	0	10	10	10	10	10
Nonoperating income	94	90	35	50	50	100	100	100	100	100
Nonoperating expenses	32	15	4	30	30	50	50	50	50	50
Recurring profits	**3,042**	**3,563**	**970**	**1,810**	**2,270**	**4,090**	**4,690**	**5,250**	**5,800**	**6,280**
Extraordinary gains	113	66	8	0	0	0	0	0	0	0
Extraordinary losses	433	425	74	0	0	0	0	0	0	0
Pretax profits	2,722	3,204	902	1,810	2,270	4,090	4,690	5,250	5,800	6,280
Tax, etc	1,154	1,331	340	760	950	1,720	1,970	2,210	2,440	2,640
Minority interests	184	165	30	80	80	160	160	160	160	160
Net profits	**1,384**	**1,708**	**533**	**970**	**1,240**	**2,210**	**2,560**	**2,880**	**3,200**	**3,480**
Capex	179	216	47	100	100	200	200	200	200	200
Depreciation	109	149	43	75	75	150	150	150	150	150
Shares out	90,400	90,400	90,400	90,400	90,400	90,400	90,400	90,400	90,400	90,400
EPS (¥)	15,486	19,111	5,959	10,730	13,717	24,447	28,319	31,858	35,398	38,978
% y-y										
Sales	17.8	17.8	11.8	12.5	25.4	19.0	15.7	13.4	12.3	11.1
Gross profits	35.9	14.7	7.0	7.9	21.8	14.9	14.5	12.7	11.8	10.6
SG&A expenses	22.7	12.3	4.6	13.3	14.5	13.9	14.0	13.5	13.1	13.0
Operating profits	52.2	17.0	9.2	2.8	28.8	15.8	14.9	12.1	10.6	8.3
Recurring profits	53.7	17.1	10.4	1.8	27.2	14.8	14.7	11.9	10.5	8.3
Pretax profits	47.9	17.7	1.4	6.5	50.8	27.6	14.7	11.9	10.5	8.3
Net profits	28.3	23.4	12.8	8.3	52.6	29.4	15.8	12.5	11.1	8.8
As % of sales										
COGS	67.0	67.9	67.9	69.1	68.9	69.0	69.3	69.5	69.6	69.8
Gross profits	33.0	32.1	32.0	30.9	31.1	31.0	30.7	30.5	30.4	30.2
SG&A expenses	16.4	15.7	15.1	15.7	14.4	15.0	14.8	14.8	14.9	15.1
Operating profits	16.6	16.5	16.9	15.2	16.8	16.0	15.9	15.7	15.5	15.1
Recurring profits	16.9	16.8	17.5	15.4	16.9	16.2	16.1	15.9	15.6	15.2
Pretax profits	15.1	15.1	16.3	15.4	16.9	16.2	16.1	15.9	15.6	15.2
Net profits	7.7	8.1	9.6	8.2	9.2	8.8	8.8	8.7	8.6	8.4
Effective tax rate (%)	42.4	41.5	37.7	42.0	41.9	42.1	42.0	42.1	42.1	42.0

Source: Nomura

2. EPS [4282]: consolidated financial data (¥mn)

	07/9	08/9	09/9E	10/9E	11/9E	12/9E	13/9E
Balance sheet							
Current assets	10,955	12,316	13,770	15,650	17,950	20,430	23,090
Cash & deposits	5,260	5,647	5,800	6,630	7,870	9,250	10,800
Bills and receivables	4,127	4,602	5,480	6,330	7,180	8,070	8,970
Inventory assets	438	562	670	770	880	990	1,100
Other	1,130	1,505	1,820	1,920	2,020	2,120	2,220
Long-term assets	3,583	3,873	4,050	4,240	4,440	4,690	4,940
Property, plant and equipment	376	419	470	520	570	620	670
Intangible long-term assets	345	381	310	250	200	200	200
Investments, other assets	2,861	3,073	3,270	3,470	3,670	3,870	4,070
Total assets	**14,537**	**16,189**	**17,820**	**19,890**	**22,390**	**25,120**	**28,030**
Current liabilities	3,991	4,528	4,510	4,460	4,600	4,750	4,890
Accounts payable	202	233	280	320	360	410	450
Short-term borrowings	0	150	0	0	0	0	0
Current portion of long-term borrowings	214	206	190	0	0	0	0
Other	3,575	3,939	4,040	4,140	4,240	4,340	4,440
Long-term liabilities	836	704	560	610	680	740	810
Long-term borrowings	406	200	0	0	0	0	0
Retirement benefit reserves	258	282	310	340	380	410	450
Directors' retirement bonus reserves	155	209	230	250	280	310	340
Other	17	13	20	20	20	20	20
Total liabilities	4,827	5,232	5,070	5,070	5,280	5,490	5,700
Net assets	9,710	10,957	12,750	14,820	17,110	19,630	22,330
Total liabilities and net assets	**14,537**	**16,189**	**17,820**	**19,890**	**22,390**	**25,120**	**28,030**

Source: Nomura

3. EPS [4282]: consolidated financial data (¥mn, except where noted)

	07/9	08/9	09/9E	10/9E	11/9E	12/9E	13/9E
Cash flow							
Operating cash flow	**2,710**	**1,991**	**1,333**	**1,910**	**2,250**	**2,470**	**2,730**
Net profits before taxes	2,722	3,204	4,090	4,690	5,250	5,800	6,280
Depreciation	109	149	150	150	150	150	150
Change in working capital	-566	-588	-940	-920	-910	-950	-960
Other	445	-774	-1,967	-2,010	-2,240	-2,530	-2,740
Investment cash flow	**-605**	**-1,061**	**-300**	**-300**	**-300**	**-300**	**-300**
Capex	-179	-216	-200	-200	-200	-200	-200
Other	-426	-845	-100	-100	-100	-100	-100
Financial cash flow	**-637**	**-543**	**-880**	**-780**	**-710**	**-790**	**-880**
Dividends paid	-357	-447	-520	-590	-710	-790	-880
Change in borrowings	-263	-64	-360	-190	0	0	0
Other	-17	-31	0	0	0	0	0
Foreign currency translation difference in cash & equivalents	13	-12	0	0	0	0	0
Change in cash & equivalents	1,468	387	153	830	1,240	1,380	1,550
Cash & equivalents at FY-start	3,792	5,260	5,647	5,800	6,630	7,870	9,250
Cash & equivalents at FY-end	**5,260**	**5,647**	**5,800**	**6,630**	**7,870**	**9,250**	**10,800**

Source: Nomura

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EPS	4282 JP	388000.00 JPY	30 Jan 2009	Buy	12,49,50,81

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EPS	No Rating	06 Jan 2009

Three-year stock price and rating history

Not Available for EPS

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