

We expect growth in sales and profits thanks to firm CRO business

Why now?

EPS announced 09/9 H1 results on 1 May. While the mainstay contract research organization (CRO) business performed well, we have slightly lowered our sales and profit forecasts, and have lowered our target price, to reflect sluggish growth in the software development business.

Investment perspective

EPS has built up a strong presence as a major Japanese CRO. The company is particularly strong in data management for drug development and has a strong track record in cancer-related research. We expect data management and other parts of the CRO business to see rapid profit growth over the medium term, and accordingly adopt a bullish stance toward investment in the stock.

Valuation

As we forecast average annual EPS growth of 14% over the next three years, we think the stock deserves a P/E of 21–23x our 09/9 estimate, which represents a premium to the NOMURA 400 (ex financials). We have slightly lowered our sales and profit estimates in light of 09/9 H1 results and have accordingly lowered our target price from ¥540,000 to ¥520,000. We highlight potential delays in the start of clinical trials in the CRO business and sluggish growth in the software development business as risk factors.

Sector theme

Major pharmaceutical manufacturers in North America and Europe have been overhauling their R&D operations, and there have been moves by them to cut spending on preclinical trials and other areas, particularly in those regions. In Japan, however, the market environment has remained favorable for CROs, with growth in the number of joint international clinical trials. Contracts from pharmaceutical companies in both the clinical trial and pre clinical trial subcontracting markets appear to have been firm recently.

- **Healthy performance in 09/9 H1:** Released on 1 May, 09/9 H1 results were better than we had expected, with sales up 12% y-y at ¥11.7bn and operating profits up 13% at ¥2.0bn. Strong performance at the CRO business offset weak performance at the site management organization (SMO) business and software development business. Management has retained its 09/9 full year projections, but we forecast strong earnings at the CRO business in 09/9 H2 and think there could well be some upside potential for the company's operating profit estimate. That said, we have slightly lowered our 09/9 estimates to reflect weak earnings at software operations.
- **Strong performance in CRO business:** Monitoring and data management work have been the main drivers of earnings at the mainstay CRO business, supported by a solid backlog of orders since 08/9. We have raised our full-year 09/9 earnings estimates for this business in light of H1 results. We expect the CRO business to generate sales of ¥17.9bn (up 18% y-y) and operating profits of ¥3.3bn (up 22%) in 09/9. Although 09/9 H1 results revealed slightly weak orders for monitoring contracts in Q2, we do not think there have been any major changes in trends on the CRO market. We will be keeping a close eye on orders from Q3 onwards.
- **Lackluster performance at SMO business:** The SMO business posted weak earnings in 09/9 H1 because some personnel development costs slipped from 08/9 into 09/9. We have revised our earnings estimates for the business because the current state of orders makes it unlikely that there will be a rapid

1 May 2009

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Target price
¥520,000

Target price vs current price **+47.6%**

Previous target price (30 January)
¥540,000

Price (1 May close)
¥359,000

52-week high **521,000**
 low **263,100**

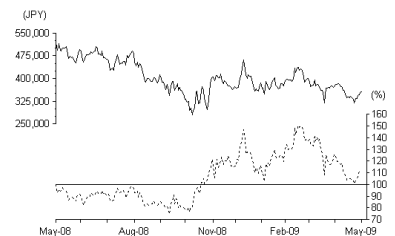
Market cap (¥bn) **32.4**
BUY (PREVIOUS: Buy)

Estimates and financial data

	Cons	08/9	09/9E	10/9E	11/9E
Sales (¥mn)		21,183	24,460	28,330	31,190
% y-y		17.8	15.5	15.8	10.1
Prev		-	25,210	29,160	33,070
Co's		-	25,013	-	-
Ope profits (¥mn)		3,487	3,970	4,530	4,950
% y-y		17.0	13.8	14.1	9.3
Prev		-	4,040	4,640	5,200
Co's		-	3,784	-	-
Rec profits (¥mn)		3,563	4,020	4,580	5,000
Prev		-	4,090	4,690	5,250
Net profits (¥mn)		1,708	2,040	2,500	2,750
Prev		-	2,210	2,560	2,880
EPS (¥)		19,111	22,819	27,964	30,761
Prev		-	24,447	28,319	31,858
BPS (¥)		110,068	-	-	-
ROE (%)		17.3	-	-	-
D/E ratio (x)		0.2	-	-	-
P/E (x)		-	15.7	12.8	11.7
EV/EBITDA (x)		-	6.6	5.5	4.8
P/B (x)		3.3	-	-	-
Dividend yield (%)		-	1.7	2.0	2.3

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. 5–9. gl

recovery in earnings from 09/9 H2. We expect the SMO business to generate sales of ¥3.5bn (up 1% y-y) and operating profits of ¥650mn (up 6%) in 09/9.

- **Weak performance at software development business:** The recession has hit software development operations in both Japan and China. Given bleak market prospects, we have lowered our 09/9 earnings estimates for the software development business, and now forecast sales of ¥2.0bn (up 38% y-y) and zero operating profits (versus profits of ¥140mn in 08/9). (PN/MS)

1. EPS [4282]: consolidated financial data

¥mn, except where noted)

	06/9	07/9	08/9	09/9					10/9E	11/9E	12/9E	13/9E
				Q1	Q2	H1	H2E	Full E				
Income statement												
Sales	15,258	17,981	21,183	5,542	6,146	11,688	12,772	24,460	28,330	31,190	34,480	37,900
CRO	10,282	12,233	15,195	3,912	4,632	8,544	9,326	17,870	20,820	22,860	25,110	27,300
Monitoring	4,886	5,993	7,310	1,903	1,967	3,870	4,380	8,250	9,440	10,460	11,270	12,200
Data management	3,973	4,908	5,878	1,437	2,092	3,529	3,691	7,220	8,500	9,090	10,070	10,850
CRO/other	1,423	1,332	2,007	573	573	1,145	1,255	2,400	2,880	3,310	3,770	4,250
SMO	2,940	3,315	3,491	801	832	1,633	1,897	3,530	4,290	4,860	5,490	6,180
Preclinical services	1,192	1,251	1,088	318	213	531	579	1,110	1,180	1,230	1,290	1,350
Software development business	844	1,182	1,409	511	469	980	970	1,950	2,040	2,240	2,590	3,070
COGS	10,892	12,047	14,378	3,765	4,201	7,966	8,834	16,800	19,490	21,350	23,600	26,000
Gross profits	4,366	5,934	6,805	1,776	1,945	3,721	3,939	7,660	8,840	9,840	10,880	11,900
SG&A expenses	2,407	2,953	3,317	838	838	1,755	1,935	3,690	4,310	4,890	5,530	6,250
Operating profits	1,959	2,981	3,487	938	1,028	1,966	2,004	3,970	4,530	4,950	5,350	5,650
CRO	1,715	2,157	2,662	805	905	1,709	1,541	3,250	3,690	3,990	4,310	4,490
SMO	89	643	695	83	125	208	442	650	700	810	860	930
Preclinical services	72	77	-1	38	0	37	23	60	50	50	50	50
Software development business	67	90	136	9	-3	6	-6	0	80	90	120	170
Eliminations/companywide	16	13	-5	4	2	6	4	10	10	10	10	10
Nonoperating income	70	94	90	35	-7	27	73	100	100	100	100	100
Nonoperating expenses	49	32	15	4	9	13	37	50	50	50	50	50
Recurring profits	1,979	3,042	3,563	970	1,010	1,981	2,039	4,020	4,580	5,000	5,400	5,700
Extraordinary gains	5	113	66	8	1	9	1	10	0	0	0	0
Extraordinary losses	144	433	425	74	182	256	4	260	0	0	0	0
Pretax profits	1,841	2,722	3,204	902	831	1,734	2,036	3,770	4,580	5,000	5,400	5,700
Tax, etc	692	1,154	1,331	340	786	1,125	455	1,580	1,930	2,100	2,270	2,390
Minority interests	69	184	165	30	17	47	103	150	150	150	150	150
Net profits	1,079	1,384	1,708	533	28	561	1,479	2,040	2,500	2,750	2,980	3,150
Capex	147	179	216	47	40	87	113	200	200	200	200	200
Depreciation	134	109	149	43	42	85	65	150	150	150	150	150
Shares out	89,398	90,400	90,400	90,400	90,400	90,400	90,400	90,400	90,400	90,400	90,400	90,400
EPS (¥)	12,301	15,486	19,111	5,961	-	6,276	16,361	22,819	27,964	30,761	33,333	35,235
% y-y												
Sales	17.3	17.8	17.8	11.8	11.4	11.6	19.3	15.5	15.8	10.1	10.5	9.9
Gross profits	13.4	35.9	14.7	7.0	13.5	10.3	14.8	12.6	15.4	11.3	10.6	9.4
SG&A expenses	17.1	22.7	12.3	4.6	0.8	7.5	14.8	11.2	16.8	13.5	13.1	13.0
Operating profits	9.2	52.2	17.0	9.2	16.5	12.9	14.8	13.8	14.1	9.3	8.1	5.6
Recurring profits	9.3	53.7	17.1	10.4	12.3	11.4	14.2	12.8	13.9	9.2	8.0	5.6
Pretax profits	-17.7	47.9	17.7	1.4	2.6	2.0	35.3	17.7	21.5	9.2	8.0	5.6
Net profits	-4.3	28.3	23.4	12.8	-93.4	-37.4	82.0	19.4	22.5	10.0	8.4	5.7
As % of sales												
COGS	71.4	67.0	67.9	67.9	68.4	68.2	69.2	68.7	68.8	68.5	68.4	68.6
Gross profits	28.6	33.0	32.1	32.0	31.6	31.8	30.8	31.3	31.2	31.5	31.6	31.4
SG&A expenses	15.8	16.4	15.7	15.1	13.6	15.0	15.2	15.1	15.2	15.7	16.0	16.5
Personnel expenses	7.2	7.1	7.0	0.0	0.0	7.1	6.8	6.9	6.8	7.0	7.1	7.2
Operating profits	12.8	16.6	16.5	16.9	16.7	16.8	15.7	16.2	16.0	15.9	15.5	14.9
Recurring profits	13.0	16.9	16.8	17.5	16.4	16.9	16.0	16.4	16.2	16.0	15.7	15.0
Pretax profits	12.1	15.1	15.1	16.3	13.5	14.8	15.9	15.4	16.2	16.0	15.7	15.0
Net profits	7.1	7.7	8.1	9.6	0.5	4.8	11.6	8.3	8.8	8.8	8.6	8.3
Effective tax rate (%)	37.6	42.4	41.5	37.7	-	64.9	22.3	41.9	42.1	42.0	42.0	41.9

Source: Company data, Nomura estimates

2. EPS [4282]: consolidated financial data

(¥mn)

	06/9	07/9	08/9	09/9E	10/9E	11/9E	12/9E	13/9E
Balance sheet								
Current assets	8,401	10,955	12,316	13,590	15,420	17,560	19,810	22,150
Cash & deposits	3,792	5,260	5,647	5,810	6,590	7,930	9,290	10,690
Bills and receivables	3,608	4,127	4,602	5,310	6,160	6,780	7,490	8,230
Inventory assets	340	438	562	650	750	830	910	1,010
Other	661	1,130	1,505	1,820	1,920	2,020	2,120	2,220
Long-term assets	3,573	3,583	3,873	4,050	4,240	4,440	4,690	4,940
Property, plant and equipment	315	376	419	470	520	570	620	670
Intangible long-term assets	384	345	381	310	250	200	200	200
Investments, other assets	2,874	2,861	3,073	3,270	3,470	3,670	3,870	4,070
Total assets	11,974	14,537	16,189	17,640	19,660	22,000	24,500	27,090
Current liabilities	2,365	3,991	4,528	4,500	4,450	4,580	4,720	4,860
Accounts payable	183	202	233	270	310	340	380	420
Short-term borrowings	0	0	150	0	0	0	0	0
Current portion of long-term borrowings	213	214	206	190	0	0	0	0
Other	1,969	3,575	3,939	4,040	4,140	4,240	4,340	4,440
Long-term liabilities	1,038	836	704	560	610	680	740	810
Long-term borrowings	670	406	200	0	0	0	0	0
Retirement benefit reserves	228	258	282	310	340	380	410	450
Directors' retirement bonus reserves	130	155	209	230	250	280	310	340
Other	10	17	13	20	20	20	20	20
Total liabilities	3,404	4,827	5,232	5,060	5,060	5,260	5,460	5,670
Net assets	8,570	9,710	10,957	12,580	14,600	16,740	19,040	21,420
Total liabilities and net assets	11,974	14,537	16,189	17,640	19,660	22,000	24,500	27,090

Source: Company data, Nomura estimates

3. EPS [4282]: consolidated financial data

(¥mn)

	06/9	07/9	08/9	09/9E	10/9E	11/9E	12/9E	13/9E
Cash flow								
Operating cash flow	1,357	2,710	1,991	1,343	1,860	2,350	2,450	2,580
Net profits before taxes	1,841	2,722	3,204	3,770	4,580	5,000	5,400	5,700
Depreciation	134	109	149	150	150	150	150	150
Change in working capital	7	-566	-588	-760	-900	-670	-760	-800
Other	-624	445	-774	-1,817	-1,970	-2,130	-2,340	-2,470
Investment cash flow	-1,139	-605	-1,061	-300	-300	-300	-300	-300
Capex	-147	-179	-216	-200	-200	-200	-200	-200
Other	-992	-426	-845	-100	-100	-100	-100	-100
Financial cash flow	1,609	-637	-543	-880	-780	-710	-790	-880
Dividends paid	-231	-357	-447	-520	-590	-710	-790	-880
Change in borrowings	796	-263	-64	-360	-190	0	0	0
Other	1,044	-17	-31	0	0	0	0	0
Foreign currency translation difference in cash & equivalents	18	13	-12	0	0	0	0	0
Change in cash & equivalents	1,845	1,468	387	163	780	1,340	1,360	1,400
Cash & equivalents at FY-start	1,947	3,792	5,260	5,647	5,810	6,590	7,930	9,290
Cash & equivalents at FY-end	3,792	5,260	5,647	5,810	6,590	7,930	9,290	10,690

Source: Company data, Nomura estimates

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Issuer	Ticker	Price (as at last close)	Closing Price	Date	Rating	Disclosures
EPS	4282 JP	359000.00 JPY	01 May 2009	Buy	12,49,50,81	

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Issuer	Previous Rating	Date of change
EPS	No Rating	06 Jan 2009

Three-year stock price and rating history

Not Available for EPS

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- A **"Strong buy"** recommendation indicates that upside is more than 20%.
- A **"Buy"** recommendation indicates that upside is between 10% and 20%.
- A **"Neutral"** recommendation indicates that upside or downside is less than 10%.
- A **"Reduce"** recommendation indicates that downside is between 10% and 20%.
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Sectors:

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A **"Neutral"** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a neutral absolute recommendation.

A **"Bearish"** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a negative absolute recommendation.

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