EPS (4282)

Initial Opinion BUY

Equity | Japan | Health Care Distribution & Technology
24 July 2009

Bank of America Merrill Lynch

Good time to invest

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Initiating EPS with Buy

We initiate coverage of EPS with a Buy rating and a ¥490,000 price objective. Robust new orders and solid orders in hand are likely to propel growth for EPS. We base our price objectives on a P/E of 17x FY9/10 earnings, a premium to the global CRO sector average pf 16x for its competitive edge and higher growth.

CRO's medium-term industry growth to continue

Japanese pharmaceutical companies are likely to incur higher R&D expenses, and we expect the CRO (contract research organization) industry to post steady medium-term growth of 10% as these companies work to make development operations more efficient. Japan's CRO industry is still in a nascent stage compared to Europe or the US, with only a 10% outsourcing rate compared to 50% in the US, and we therefore see room for growth. With no restraints, such as officially fixed prices, in place, the segment also has good prospects for relatively stable profit growth compared with the rest of the healthcare industry, which faces risks of price cuts.

Favorable near-term outlook

EPS is the industry leader, with expertise in data management. Results for 3Q FY9/09, to be announced on 31 July, are likely to show double-digit profit growth, above management's target. With share prices in correction mode, we believe now is the time to invest in the company. Risks include the possibility of development project revisions or contract terminations due to reorganization or declining earnings among pharmaceuticals companies, and lower margins due to price competition.

Estimates

(¥)	9/07A	9/08A	9/09E	9/10E	9/11E
EPS	15,479.09	19,099.77	22,595.08	28,668.90	34,619.69
EPS Change (YoY)	-1.5%	23.4%	18.3%	26.9%	20.8%
Dividend / Share	4,300	5,400	6,000	6,600	8,000
BPS	97,516.7	110,069.6	127,262.3	149,931.2	177,950.9

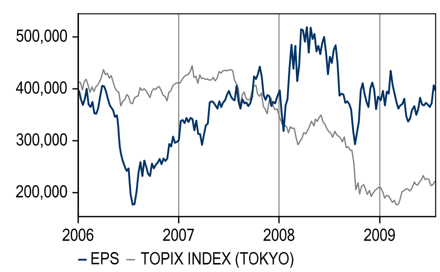
Valuation

	9/07A	9/08A	9/09E	9/10E	9/11E
P/E	25.6x	20.7x	17.5x	13.8x	11.4x
Dividend Yield*	1.1%	1.4%	1.5%	1.7%	2.0%
PBR	4.1x	3.6x	3.1x	2.6x	2.2x
EV/ EBITDA*	9.7x	8.2x	6.9x	6.0x	5.1x
Free Cash Flow Yield*	7.0%	4.7%	3.8%	5.4%	6.6%

* For full definitions of *iQmethod* SM measures, see page 11.

Stock Data

Common Stock	
Price	¥396,000
Price Objective	¥490,000
Date Established	24-Jul-2009
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	¥263,100-495,000
Market Value (¥mn)	35,402
Shares Outstanding (mn)	0.1
Free Float	41.4%
Average Daily Volume	384
ML Symbol / Exchange	EPLYF / TYO
Bloomberg / Reuters	4282 JP / 4282.T
ROE (2009E)	19.0%
Net Debt/Equity (Sep-2008A)	-51.0%
Est. 5-Yr EPS / DPS Growth	NA / NA



Refer to important disclosures on page 12 to 14. Analyst Certification on Page 10. Price Objective Basis/Risk on page 10.

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iQprofile SM EPS (4282)

Key Income Statement Data	9/07A	9/08A	9/09E	9/10E	9/11E
(¥ Millions)					
Sales	17,980	21,182	25,000	28,100	31,700
% Change	17.8%	17.8%	18.0%	12.4%	12.8%
Gross Profit	5,933	6,804	7,690	8,920	10,230
EBITDA	3,151	3,704	4,420	5,120	6,030
Operating Profit	2,980	3,487	4,090	4,920	5,830
% Change	52.2%	17.0%	17.3%	20.3%	18.5%
Net Interest & Other Income	39	32	30	33	35
Recurring Profit	3,041	3,562	4,140	4,973	5,885
% Change	53.7%	17.1%	16.2%	20.1%	18.3%
Net Income	1,384	1,708	2,020	2,563	3,095

Key Cash Flow Statement Data					
Net Income from Cont Operations (GAAP)	1,704	2,066	2,420	2,863	3,395
Depreciation & Amortization	171	217	330	200	200
Change in Working Capital	(597)	(587)	(889)	(722)	(838)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Net Adjustments from Operations	1,419	299	(313)	(230)	(230)
Capital Expenditure	(216)	(331)	(200)	(200)	(200)
Free Cash Flow	2,481	1,664	1,348	1,911	2,327
Share Issue / (Repurchase)	0	0	0	0	0
Cost of Dividends Paid	(357)	(447)	(483)	(536)	(590)
Net Debt	(4,840)	(5,583)	(6,132)	(7,207)	(8,644)
Change in Net Debt	(1,718)	(456)	(549)	(1,075)	(1,437)

Key Balance Sheet Data					
Cash & Equivalents	5,460	6,138	6,532	7,607	8,944
Trade Receivables	4,127	4,601	5,430	6,104	6,886
Other Current Assets	1,368	1,568	1,769	1,952	2,147
Property, Plant & Equipment	376	419	419	419	419
Other Non-Current Assets	3,206	3,454	3,624	3,924	4,224
Total Assets	14,537	16,180	17,774	20,005	22,620
Short-Term Debt	214	355	300	300	200
Other Current Liabilities	3,777	4,172	4,214	4,248	4,288
Long-Term Debt	406	200	100	100	100
Other Non-Current Liabilities	430	504	504	504	504
Total Liabilities	4,827	5,231	5,118	5,152	5,092
Total Equity	9,710	10,949	12,656	14,853	17,528
Total Equity & Liabilities	14,537	16,180	17,774	20,005	22,620

Key Metrics					
iQmethod SM–Business Performance*					
Return On Capital Employed	18.9%	20.0%	21.6%	21.0%	21.2%
Return On Equity	16.9%	18.4%	19.0%	20.7%	21.1%
Operating Margin	16.6%	16.5%	16.4%	17.5%	18.4%
iQmethod SM – Quality of Earnings*					
Cash Realization Ratio	1.9x	1.2x	0.8x	0.8x	0.8x
Asset Replacement Ratio	2.0x	2.2x	1.3x	1.3x	1.3x
Tax Rate (Reported)	37.9%	37.4%	37.4%	39.0%	39.4%
Net Debt-to-Equity Ratio	-49.8%	-51.0%	-48.4%	-48.5%	-49.3%
Interest Cover	189.8x	348.7x	409.0x	702.9x	1,166.0x

* For full definitions of *iQmethod* SM measures, see page 11.

Company Description

One of the largest CRO(Clinical Research Organization). Registered in Jasdaq as first CRO in Japan in 2001. The company is specialized in data management and claims high profitability. Using know-how of data management, it also operates general software development. Management aims to expand its Asian business.

Investment Thesis

Among CROs, EPS is enjoying higher order inflow backed by strong data management know-how. It has strength in cancer drug manufacturers and in Phase 4 research as well. Management is keen to expand overseas business and unless there is large investments, 20% earnings growth is likely in the medium term.

Table 1: EPS (4282) Consolidated earnings summary

Full year earnings	Sales (¥mn)	YoY (%)	OP (¥mn)	YoY (%)	RP (¥mn)	YoY (%)	NI (¥mn)	YoY (%)	EPS (¥)	PER (x)
FY9/07 actual	17,980	17.8%	2,980	52.2%	3,042	53.7%	1,384	28.3%	15,481	25.6
FY9/08 actual	21,182	17.8%	3,487	17.0%	3,563	17.1%	1,708	23.4%	19,105	20.7
FY9/09 CoE	25,013	18.1%	3,784	8.5%	3,835	7.6%	1,827	7.0%	20,436	19.4
FY9/09 BAS-ML estimate	25,000	18.0%	4,090	17.3%	4,140	16.2%	2,020	18.3%	22,595	17.5
FY9/10 BAS-ML estimate	28,100	12.4%	4,920	20.3%	4,973	20.1%	2,563	26.9%	28,669	13.8
FY9/11 BAS-ML estimate	31,700	12.8%	5,830	18.5%	5,885	18.3%	3,095	20.8%	34,620	11.4

Source: Company. Estimates by Banc of America Securities-Merrill Lynch

Summary

Initiating coverage of EPS with Buy rating

We initiate coverage of EPS with a Buy rating and a ¥490,000 price objective. We base our price objective on a FY9/10 P/E multiple of 17x, slightly higher than global CRO sector of 16x for its higher competitive edge and earnings growth.

The pharmaceuticals industry is now facing an unprecedented uphill battle. Developing new drugs is now more important than ever before as pharmaceuticals companies face industry shakeouts, mounting pressure to drop prices, patent expiries on core products, a growing generic market, and mounting international competition. Propelled by these changes in industry conditions, the CRO industry now has the potential for steady growth going forward, in our view. EPS has advanced expertise as a specialist in new drug development operations and we believe it is capable of double-digit growth. Even though Japan's CRO industry is now in its growth phase, shares do not seem overvalued compared with the European and US CRO industries, which are now past their growth phases.

CRO essential for increasing pharmaceuticals companies' competitiveness

New drug development is a crucial strategy for maintaining competitiveness, and pharmaceuticals companies now urgently need to improve the productivity of their development operations as their R&D expenses have ballooned 65% over the past five years. By contracting out the various related operations these companies conduct in house, they can shorten development lead times and change fixed costs to variable costs.

Using CRO can shorten lead times and improve development accuracy

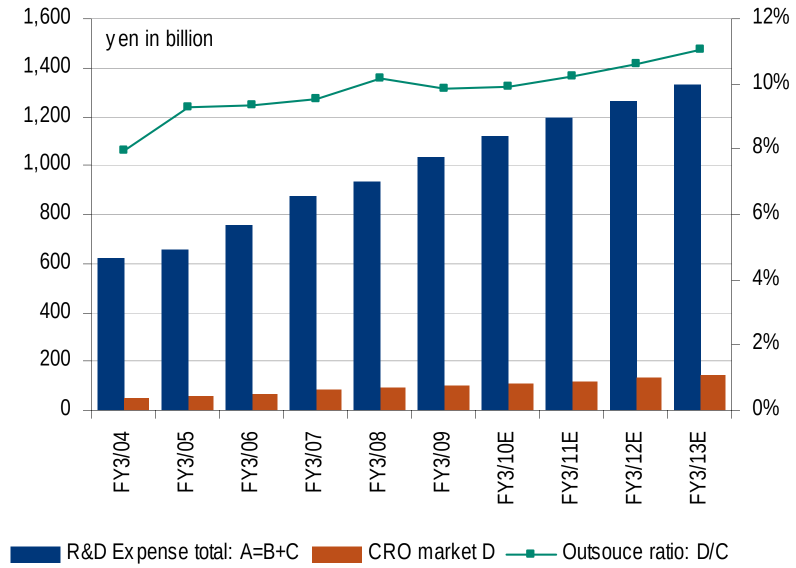
Utilizing services offered by CROs should help alleviate the drug lag. Many drugs are still unapproved in Japan even though they have already been approved in other countries and securing an approval often takes longer in Japan than in other countries. In fact, new drug launches in Japan lag behind Europe and the US by approximately four years. The lags occur at three stages: clinical trial start times, trial periods, and screening periods, with particularly large differences in start times. Earlier start times result in fewer data, which increases the risk of development being aborted, but by tying up with a CRO with an established track record in the given area and insightful ideas and suggestions right from the planning stage, pharmaceutical companies can achieve greater success rates in a shorter time period.

Bipha's (JV of Mitsubishi Tanabe Pharm and Nipro) falsification of "Medway" testing data recently made market headlines. By outsourcing to external entities such as EPS or CMIC, this sort of trouble can be averted. Japan's CRO industry is relatively new, but the growing number of listed companies and their increasing reliability are likely to promote the switch to outsourcing. Approximately 10% of

operations are currently outsourced to CROs, much smaller than the US figure of 50%, and we forecast that outsourcing will increase gradually.

The CRO industry had been growing at an annualized rate of 15%, but that growth slackened to 7% in 2008. We attribute this to domestic pharmaceuticals companies, who faced with declining earnings narrowed down new drug development to small-scale projects with high success rates as well as curtailed outsourcing and promoted in-house production to make use of excess personnel. However, in the current market situation, EPS has showed its strength, with 40% order growth in 1H FY 9/09. With no restraints such as officially fixed prices, it also has good prospects for relatively stable profit growth compared with the rest of the healthcare industry, which faces substantial risks of price declines going into next fiscal year.

Chart 1: Outlook of Japan's CRO market



Source: CRO association. Estimated by Banc of America Securities-Merrill Lynch

Valuations and risks

We use P/E multiples to set price objectives as Japan's CRO industry is still in a growth phase. Using a P/E of 17x our FY9/10 EPS forecasts, we set our price objective at ¥490,000 with a premium to global CROs such as Covance and PPDI. Backed by higher FCF, EV/EBITDA also looks undemanding. Our price objective equates to an EV/EBITDA of 7.4x.

Since CROs depend on pharmaceuticals companies' R&D expenditures, their fortunes are subject to changes in their customers' new drug development activities. It faces the risk of declines in development projects due to reorganization in the pharmaceuticals industry and increased joint development as well as postponements and cancellations due to declining earnings.

Table 2: Valuation comparison

Name	Symbol	P/E Ratio			EV/EBITDA		
		2008A	2009E	2010E	2008A	2009E	2010E
CMIC	2309	21.1	15.2	13.5	5.7	5.0	4.6
EPS	4282	19.4	17.5	13.8	8.3	7.1	5.8
Charles River	CRL	10.9	12.9	11.9	7.6	8.6	8.0
Covance Inc	CVD	16.3	18.7	16.5	8.9	9.4	8.4
Life Technologies	LIFE	14.5	16.0	13.8	15.0	8.00	7.2
Lonza	LZAGF	16.3	16.9	13.3	9.8	9.4	7.9
Millipore	MIL	19.2	17.9	15.6	12.1	11.7	10.6
Mettler-Toledo	MTD	14.5	16.8	15.3	9.6	11.2	10.4
PPDI	PPDI	12.5	15.7	15.2	6.1	7.2	6.8
Thermo Fisher	TMO	13.3	14.1	12.6	8.5	9.4	8.8
WuXi PharmaTech	WX	10.8	12.8	11.0	6.4	7.8	6.7
Divi's Lab	XXQPF	16.8	17.7	13.8	13.9	14.3	12.1

Source: Banc of America Securities-Merrill Lynch

The potential for a hollowing out of domestic clinical trials due to increased overseas clinical trials and more intense competition with overseas CROs is a risk for a downward slide in orders. Looking at internal factors, operations require specialized knowledge in medicine, pharmaceutical science, statistics, and IT, and failure to secure sufficient human resources puts the company at risk of weaker growth. Other risks include clinical trial accidents or leakage of private data. Outside the drug development area, its software development business is easily affected by the economy since it caters to financial institutions and general companies.

Earnings outlook

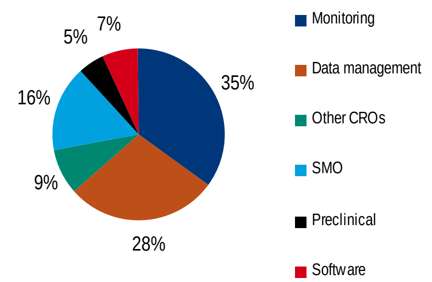
With solid performance in high-profit-margin data management, EPS's operating profit exceeded its target by ¥0.37bn in 1H FY9/09. Sales in the CRO division, which includes data management, were up 17% with profit up 40%, thus substantially outpacing market growth. One of the company's current strong points is cancer drug development, a priority area for pharmaceuticals companies, and it also enjoys firm demand for after-market studies. Current orders also appear solid, and we forecast full-year sales of ¥25bn (up 18%) and operating profit of ¥4.09bn (up 17%), beating the company's target of ¥3.8bn.

For FY9/10, we anticipate sales of ¥28.1bn (up 12%) and operating profit of ¥4.9bn (up 20%). Data management business is likely to remain brisk, and we expect 16% sales growth and 24% profit growth in the CRO division. EPS competes with CMIC in SMO operations and its software development business is affected by the economy. These two segments are therefore unlikely to contribute to profit, but we see good prospects for a higher operating profit margin due to growth in high-profit core business.

For FY9/11, we anticipate sales of ¥31.7bn (up 13%) and operating profit of ¥5.8bn (up 18%). The CRO division's growth (sales up 16% and operating profit up 19%) will contribute.

Management is eager to expand into Asia and the company has CRO subsidiaries in China, Singapore, and South Korea. These are run by EPS International, which had sales of ¥0.85bn in FY9/08 and an operating loss of ¥12mn, thus making a negligible impact on earnings. It also runs a pharmaceutical production venture in China, and we believe 20% profit growth is possible over the medium term barring a major strategic investment.

Chart 2: EPS(4282): Sales breakdown in FY9/08



Source: Company

Company overview

EPS was founded by its president, Hao Yan, a student of medical statistics, in 1991. In 2001, EPS became the first CRO company to list on Jasdaq, after which it listed on the TSE first section in 2006. EPS is the leading data management company in Japan's CRO industry. Leveraging this expertise, it also runs general software development operations.

Business content

The CRO business accounts for 72% of sales and 76% of operating profit, with the remainder comprising SMO business, non-clinical operations, and software development. The CRO business includes monitoring operations (which account for 35% of sales), data management (28%), and CRO IT and CSO (9%). CRO IT operations provide IT solutions to pharmaceuticals companies and hospitals. The CSO business provides support for pharmaceuticals sales. The company also runs an MR (medical representative) dispatch service.

Financial condition

With no fixed assets, the company's assets consist primarily of cash and accounts receivable. Net cash totals ¥5.5bn, and we estimate annual free cash flow at more than ¥1bn.

Table 3: EPS (4282): Segment analysis (million yen)

	FY9/06a	FY9/07a	FY9/08a	FY9/09e	FY9/10e	FY9/11e
Segment Sales*						
CRO	11,152	12,254	15,233	18,200	21,200	24,600
SMO	2,982	3,376	3,500	3,500	3,900	4,200
Pre-clinical	1,197	1,259	1,092	1,100	1,000	900
Software	0	1,251	1,499	2,500	2,300	2,300
Elimination, corporate	-74	-160	-142	-300	-300	-300
Consolidated sales	15,257	17,980	21,182	25,000	28,100	31,700
Segment Operating profit*						
CRO	1,788	2,157	2,661	3,340	4,140	4,950
SMO	89	643	695	700	790	890
Pre-clinical	72	77	-1	40	40	40
Software	0	90	136	10	-50	-50
Elimination, corporate	9	13	-4	0	0	0
Consolidated OP	1,958	2,980	3,487	4,090	4,920	5,830
Segment Operating profit margin						
CRO	16.00%	17.60%	17.50%	18.40%	19.50%	20.10%
SMO	3.00%	19.10%	19.90%	20.00%	20.30%	21.20%
Pre-clinical	6.00%	6.10%	-0.10%	3.60%	4.00%	4.40%
Software	n/a	7.20%	9.10%	0.40%	-2.20%	-2.20%
Elimination, corporate						
Consolidated OPM	12.80%	16.60%	16.50%	16.40%	17.50%	18.40%

Source: Company, estimates by Banc of America Securities-Merrill Lynch

Table 4: EPS - Orders and order balance (million yen)

	FY9/06	FY9/07	FY9/08			FY9/09
Order	Full yr	Full yr	H1	H2	Full yr	H1
Monitoring	4,214	9,761	2,180	7,963	10,142	3,471
Data management	4,296	5,784	2,586	10,583	13,170	3,767
Other CRO business	1,745	1,492	1,187	1,115	2,302	1,126
Software	984	n/a	n/a	n/a	n/a	n/a
CRO division	11,238	17,038	5,953	19,661	25,614	8,364
SMO division	3,134	3,483	3,492	1,555	5,047	1,910
Pre-clinical	1,172	1,219	672	415	1,087	518
Software development	n/a	1,474	689	594	1,283	814
Total	15,545	23,214	10,806	22,226	33,032	11,606
Order balance						
Monitoring	5,871	9,640	8,257	12,473	12,473	12,074
Data management	4,122	5,361	5,185	12,652	12,652	12,891
Other CRO business	590	387	626	682	682	664
Software	185	n/a	n/a	n/a	n/a	n/a
CRO division	10,768	15,388	14,068	25,808	25,808	25,629
SMO division	1,733	1,901	3,599	3,456	3,456	3,733
Pre-clinical	148	116	175	115	115	102
Software development	n/a	478	373	352	352	186
Total	12,650	17,882	18,216	29,732	29,732	29,650

Source: Company

Table 5: EPS (4282): Earnings models (million yen)

Profit/Loss Statement	FY9/06a	FY9/07a	FY9/08a	FY9/09e	FY9/10e	FY9/11e
Net sales	15,257	17,980	21,182	25,000	28,100	31,700
CoGS	10,891	12,046	14,378	17,310	19,180	21,470
Gross profit	4,366	5,934	6,804	7,690	8,920	10,230
SG&A (R&D excluded)	2,407	2,953	3,317	3,600	4,000	4,400
OP before R&D expense	1,958	2,980	3,487	4,090	4,920	5,830
R&D expense	0	0	0	0	0	0
Operating profit	1,958	2,980	3,487	4,090	4,920	5,830
Non-operating income	70	94	90	70	70	70
Non-operating expense	49	32	15	20	17	15
Recurring profit	1,979	3,042	3,563	4,140	4,973	5,885
Extraordinary income	5	113	66	0	0	0
Extraordinary loss	144	433	425	400	300	300
EBT (Pretax income)	1,840	2,722	3,204	3,740	4,673	5,585
Tax provision	392	1,154	1,331	1,550	1,940	2,320
Minority shareholders income	69	184	165	170	170	170
Net income	1,079	1,384	1,708	2,020	2,563	3,095
Margin analysis						
COGS	71.4%	67.0%	67.9%	69.2%	68.3%	67.7%
Gross margin	28.6%	33.0%	32.1%	30.8%	31.7%	32.3%
SG&A	15.8%	16.4%	15.7%	14.4%	14.2%	13.9%
Operating margin (before R&D)	12.8%	16.6%	16.5%	16.4%	17.5%	18.4%
Operating margin	12.8%	16.6%	16.5%	16.4%	17.5%	18.4%
Pretax margin	12.1%	15.1%	15.1%	15.0%	16.6%	17.6%
Effective tax rate	21.3%	42.4%	41.5%	41.4%	41.5%	41.5%
Net margin	7.1%	7.7%	8.1%	8.1%	9.1%	9.8%
% YOY change						
Net sales	17.3%	17.8%	17.8%	18.0%	12.4%	12.8%
COGS	19.0%	10.6%	19.4%	20.4%	10.8%	11.9%
Gross profit	13.4%	35.9%	14.7%	13.0%	16.0%	14.7%
SG&A	17.1%	22.7%	12.3%	8.5%	11.1%	10.0%
Operating profit	9.1%	52.2%	17.0%	17.3%	20.3%	18.5%
Recurring profit	9.3%	53.7%	17.1%	16.2%	20.1%	18.3%
EBT (Pretax income)	-17.7%	47.9%	17.7%	16.7%	24.9%	19.5%
Net income	-4.2%	28.3%	23.4%	18.3%	26.9%	20.8%
Per share data						
EPS (diluted)	12,299.9	15,481.3	19,105.4	22,595.1	28,668.9	34,619.7
CFPS	15,469.0	30,168.5	22,316.8	17,319.7	23,618.5	28,267.5
CEPS	14,046.3	17,396.9	21,530.4	26,286.4	30,906.0	36,856.8
BPS	86,013.1	97,516.7	110,069.6	127,262.3	149,931.2	177,950.9
DPS	3,300.0	4,300.0	5,400.0	6,000.0	6,600.0	8,000.0
Shares outstanding (average)	0.088	0.089	0.089	0.089	0.089	0.089
Shares outstanding (FY end)	0.089	0.089	0.089	0.089	0.089	0.089
ROE analysis						
ROE	15.7%	16.9%	18.4%	19.0%	20.7%	21.1%
Net income/Net sales	7.1%	7.7%	8.1%	8.1%	9.1%	9.8%
Net sales/Total asset	5.67	2.67	1.58	3.11	5.95	5.95
Total asset/Shareholders equity	1.57	1.62	1.62	1.56	1.52	1.45
Capital Expenditures and Depreciation (Cash Flow Statement, tangible assets), and Amortization						
Capital Expenditures	114	172	216	331	200	200
Depreciation	71	137	109	149	150	150
Amortization	64	16	62	68	180	50

Source: Company. Estimates by Banc of America Securities-Merrill Lynch

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Table 6: EPS (4282): Earnings models (million yen)

Cash Flow Statement	FY3/06a	FY3/07a	FY3/08a	FY3/09e	FY3/10e	FY3/11e
Operating cash flow	1,357	2,697	1,995	1,548	2,111	2,527
Net income before extraordinarie	1,218	1,704	2,067	2,420	2,863	3,395
Total dep & amort. CF	153	171	217	330	200	200
(Inc)/dec. in working capital	-9	-597	-587	-889	-722	-838
Other operating non-cash items	-5	1,419	299	-313	-230	-230
Investing cash flow	-1,139	-605	-1,061	-517	-500	-500
Capital expenditure	-172	-216	-331	-200	-200	-200
Other investing cash items	-967	-389	-730	-317	-300	-300
Financing cash flow	1,609	-637	-542	-638	-536	-690
Net share issue/repurchase	-1	0	0	0	0	0
Dividends paid	-231	-357	-447	-483	-536	-590
Change in debt	1,894	-263	-64	-155	0	-100
Other financing cash flow	-53	-16	-31	0	0	0

Source: Company. Estimates by Banc of America Securities-Merrill Lynch

Table 7: EPS (4282): Earnings models (million yen)

Balance Sheet	FY9/06a	FY9/07a	FY9/08a	FY9/09e	FY9/10e	FY9/11e
Total Asset	11,974	14,537	16,181	17,774	20,005	22,620
Current Asset	8,401	10,955	12,307	13,731	15,662	17,977
Cash & Equiv, Marketable securities	3,792	5,460	6,138	6,532	7,607	8,944
Account receivable	3,608	4,127	4,601	5,430	6,104	6,886
Inventory	340	438	562	663	746	841
Other current asset, net	661	931	1,006	1,106	1,206	1,306
Fixed asset	3,573	3,583	3,873	4,043	4,343	4,643
PP&E	384	376	419	419	419	419
Intangible asset	2,875	345	381	251	251	251
Other fixed asset, net	315	2,861	3,073	3,373	3,673	3,973
Total liability	3,404	4,827	5,232	5,118	5,152	5,092
Current liability	2,365	3,991	4,527	4,514	4,548	4,488
Account payable	183	202	233	275	309	349
Short term debt	213	214	355	300	300	200
Other current liability, net	1,970	3,575	3,939	3,939	3,939	3,939
Fixed liability	1,038	836	704	604	604	604
Long term debt	670	406	200	100	100	100
Other fixed liability, net	368	430	504	504	504	504
Net asset	8,570	9,710	10,949	12,656	14,853	17,528
Shareholders' equity	7,689	8,718	9,840	11,377	13,404	15,909
Contributed capital	3,701	3,701	3,701	3,701	3,701	3,701
Retained earnings	4,181	5,206	6,463	8,000	10,027	12,532
Reserves, adjustments	-192	-188	-324	-324	-324	-324
Minorities' equity	881	992	1,109	1,279	1,449	1,619
Interest bearing debt	883	620	555	400	400	300
Net debt	-2,909	-4,840	-5,583	-6,132	-7,207	-8,644
Balance Sheet analysis						
D/E ratio	0.40	0.50	0.48	0.40	0.35	0.29
A/R turnover (months)	2.87	2.58	2.47	2.41	2.46	2.46
Inventory turnover (months)	0.31	0.39	0.42	0.42	0.44	0.44
A/P turnover (months)	0.19	0.19	0.18	0.18	0.18	0.18
ROA	18.2%	22.5%	22.7%	24.1%	26.0%	27.4%

Source: Company. Estimates by Banc of America Securities-Merrill Lynch

Price objective basis & risk

EPS (4282)

Our price objective for EPS is JPY490.000. This is based on 17x P/E on FY9/2010 EPS with premium to the average for global CRO companies of 16x for its competitive edge and earnings growth. Our PO equats to 7.4x EV/EBITDA.

Risks are lower orders or cancellations in the CRO business due to lower R&D expenditure by customers, price declines due to tougher competition, growth constraints by labour shortage and clinical trial accidents or leakage of personal data. Other risks include lower software development business easily affected by the economy.

Analyst Certification

I, Eri Kaneko, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Japan-Pharmaceuticals / Healthcare Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
BUY				
	Astellas Pharma	ALPMF	4503 JP	Ritsuo Watanabe
	CMIC	CMICF	2309 JP	Eri Kaneko
	EPS	EPLYF	4282 JP	Eri Kaneko
	Nipro	NISOF	8086 JP	Ritsuo Watanabe
	Santen Pharm.	SNPHF	4536 JP	Ritsuo Watanabe
	Sawai Pharma	SWPIF	4555 JP	Ritsuo Watanabe
	Shionogi	SGIOF	4507 JP	Ritsuo Watanabe
	Takeda Pharm.	TKPHF	4502 JP	Ritsuo Watanabe
	TERUMO	TRUMF	4543 JP	Ritsuo Watanabe
NEUTRAL				
	Chugai Pharm.	CHGCF	4519 JP	Ritsuo Watanabe
	Daiichi Sankyo	DSKYF	4568 JP	Ritsuo Watanabe
	D-S Pharma	DNPUF	4506 JP	Ritsuo Watanabe
	Hogy Medical	HGYMF	3593 JP	Eri Kaneko
	Kyorin	KYRNF	4569 JP	Ritsuo Watanabe
	Taisho Pharm.	TSOPF	4535 JP	Ritsuo Watanabe
	TOWA PHARMA	TWAPF	4553 JP	Ritsuo Watanabe
UNDERPERFORM				
	Alfresa	ARHCF	2784 JP	Eri Kaneko
	Eisai	ESALF	4523 JP	Ritsuo Watanabe
	Eisai	ESALY	ESALY US	Ritsuo Watanabe
	GHS	GHSPF	3360 JP	Eri Kaneko
	Kissei Pharm.	KSPHF	4547 JP	Ritsuo Watanabe
	Mediceo Paltac	MEPDF	7459 JP	Eri Kaneko
	Mitsubishi Tanabe Pharma	MTZXY	4508 JP	Ritsuo Watanabe
	Ono Pharm.	OPHLF	4528 JP	Ritsuo Watanabe
	Sogo Medical	SGOOF	4775 JP	Eri Kaneko
	Suzuken	SZUKF	9987 JP	Eri Kaneko

iQmethod SM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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Important Disclosures

Investment Rating Distribution: Health Care Group (as of 01 Jun 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	86	52.12%	Buy	43	53.75%
Neutral	39	23.64%	Neutral	21	61.76%
Sell	40	24.24%	Sell	18	48.65%

Investment Rating Distribution: Global Group (as of 01 Jun 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1303	40.83%	Buy	602	51.10%
Neutral	807	25.29%	Neutral	362	51.49%
Sell	1081	33.88%	Sell	394	39.96%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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