

# Better-than-expected profitability improvement

## Raise price objective to ¥252,000, reiterate Buy rating

On 28 April, EPS announced a revision of guidance for 1H FY9/10 that surpasses our forecasts. We lift our estimates by about 10%, based on better-than-expected profitability improvement for the core business, and raise our price objective from ¥217,000 to ¥252,000 using a FY9/10E P/E of 18x, based on a range of 15-20x for global CRO companies.

## Improved core business productivity driving profit growth

The company raised 1H targets to ¥14.5bn in sales (by 4%) and ¥2.44bn in operating profit (by 43%; vs our ¥2.1bn previous estimate). The core clinical data management business has retained healthy momentum from 1Q. SMO (site management organization) business also appears to be ahead of plan, despite concerns about a negative impact from expanded activities by peers. We think broader facility coverage is accelerating the pace of case enrollment for SMO. While the upside factors are not particularly new, profit upside from a higher employee utilization rate comes as a positive surprise.

## Strong likelihood of upward revision for full-year guidance

This release only covers revisions to 1H guidance. However, updated 1H targets without a change in the existing full-year plan would result in just flat YoY growth for 2H and a drop in OPM to 12% (from 1H's 17%). We expect EPS to generate profits above existing guidance in 2H, judging from the past 1H/2H OPM balance, upbeat orders, and profitability improvements. EPS will announce 1H results on 30 April and hold a briefing on 13 May.

### Estimates

(¥)	9/08A	9/09A	9/10E	9/11E	9/12E
EPS	9,549.78	9,586.13	13,982.10	15,995.53	18,120.81
EPS Change (YoY)	23.3%	0.4%	45.9%	14.4%	13.3%
Dividend / Share	2,700	3,000	6,400	6,400	6,400
BPS	55,033.6	61,135.4	73,210.3	82,830.0	94,574.9

### Valuation

	9/08A	9/09A	9/10E	9/11E	9/12E
P/E	23.3x	23.3x	15.9x	13.9x	12.3x
Dividend Yield*	1.2%	1.3%	2.9%	2.9%	2.9%
PBR	4.1x	3.6x	3.0x	2.7x	2.4x
EV/ EBITDA*	3.7x	3.1x	2.7x	2.4x	2.1x
Free Cash Flow Yield*	8.3%	9.3%	4.0%	11.0%	12.7%

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 5.

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### Stock Data

Common Stock	
Price	¥222,900
Price Objective	¥252,000
Date Established	28-Apr-2010
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	¥156,000-235,800
Market Value (mn)	¥19,927
Shares Outstanding (mn)	0.1
Free Float	41.4%
Average Daily Volume	769
BofAML Ticker / Exchange	EPLYF / TYO
Bloomberg / Reuters	4282 JP / 4282.T
ROE (2010E)	20.8%
Net Debt/Equity (Sep-2009A)	-51.7%
Est. 5-Yr EPS / DPS Growth	20.4% / 16.4%

### Key Changes

(¥)	Previous	Current
Price Obj.	217,000	252,000
2010E EPS	12,752	13,982
2011E EPS	14,485	15,996
2012E EPS	16,331	18,121
2010E EBITDA (m)	4,630	5,050
2011E EBITDA (m)	5,210	5,720
2012E EBITDA (m)	5,840	6,440
2010E DPS	3,200	6,400

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## iQprofile<sup>SM</sup> EPS (4282)

Key Income Statement Data	9/08A	9/09A	9/10E	9/11E	9/12E
<b>(¥ Millions)</b>					
Sales	21,182	23,568	30,900	33,750	36,800
% Change	17.8%	11.3%	31.1%	9.2%	9.0%
Gross Profit	6,804	7,537	9,650	10,720	11,840
EBITDA	3,704	4,405	5,050	5,720	6,440
<b>Operating Profit</b>	<b>3,487</b>	<b>4,009</b>	<b>4,850</b>	<b>5,520</b>	<b>6,240</b>
% Change	17.0%	15.0%	21.0%	13.8%	13.0%
Net Interest & Other Income	32	24	25	25	25
<b>Recurring Profit</b>	<b>3,562</b>	<b>4,051</b>	<b>4,890</b>	<b>5,560</b>	<b>6,280</b>
% Change	17.1%	13.7%	20.7%	13.7%	12.9%
<b>Net Income</b>	<b>1,708</b>	<b>1,714</b>	<b>2,500</b>	<b>2,860</b>	<b>3,240</b>

### Key Cash Flow Statement Data

Net Income from Cont Operations (GAAP)	2,066	2,012	2,500	2,860	3,240
Depreciation & Amortization	217	396	200	200	200
Change in Working Capital	(587)	(581)	(1,700)	(670)	(700)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Net Adjustments from Operations	299	236	0	0	0
Capital Expenditure	(331)	(204)	(200)	(200)	(200)
<b>Free Cash Flow</b>	<b>1,664</b>	<b>1,859</b>	<b>800</b>	<b>2,190</b>	<b>2,540</b>
Share Issue / (Repurchase)	0	0	0	0	0
Cost of Dividends Paid	(447)	(519)	(270)	(1,140)	(1,140)
Net Debt	(5,583)	(6,257)	(6,510)	(7,450)	(8,740)
Change in Net Debt	(456)	(1,241)	(530)	(1,050)	(1,400)

### Key Balance Sheet Data

Cash & Equivalents	6,138	6,607	6,860	7,650	8,940
Trade Receivables	4,601	5,211	6,830	7,460	8,130
Other Current Assets	1,568	1,624	1,870	2,030	2,190
Property, Plant & Equipment	419	445	450	450	450
Other Non-Current Assets	3,454	3,419	3,720	4,020	4,320
<b>Total Assets</b>	<b>16,180</b>	<b>17,306</b>	<b>19,730</b>	<b>21,610</b>	<b>24,030</b>
Short-Term Debt	355	350	350	200	200
Other Current Liabilities	4,172	4,269	4,440	4,660	4,890
Long-Term Debt	200	0	0	0	0
Other Non-Current Liabilities	504	579	580	580	580
<b>Total Liabilities</b>	<b>5,231</b>	<b>5,198</b>	<b>5,370</b>	<b>5,440</b>	<b>5,670</b>
<b>Total Equity</b>	<b>10,949</b>	<b>12,107</b>	<b>14,360</b>	<b>16,170</b>	<b>18,360</b>
<b>Total Equity &amp; Liabilities</b>	<b>16,180</b>	<b>17,305</b>	<b>19,730</b>	<b>21,610</b>	<b>24,030</b>

### Key Metrics

#### iQmethod<sup>SM</sup> – Business Performance\*

Return On Capital Employed	19.4%	16.7%	18.2%	18.3%	18.4%
Return On Equity	18.4%	16.5%	20.8%	20.5%	20.4%
Operating Margin	16.5%	17.0%	15.7%	16.4%	17.0%

#### iQmethod<sup>SM</sup> – Quality of Earnings\*

Cash Realization Ratio	1.2x	1.2x	0.4x	0.8x	0.8x
Asset Replacement Ratio	1.5x	0.5x	1.0x	1.0x	1.0x
Tax Rate (Reported)	37.4%	48.1%	47.0%	46.9%	47.0%
Net Debt-to-Equity Ratio	-51.0%	-51.7%	-45.3%	-46.1%	-47.6%
Interest Cover	348.7x	445.4x	970.0x	1,104.0x	1,248.0x

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 5.

### 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 the 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, 15% earnings growth is likely in the medium term.

28 April 2010

**Exhibit 1: Consolidated earnings summary**

Full year earnings		Sales (¥mn)	YoY (%)	OP (¥mn)	YoY (%)	RP (¥mn)	YoY (%)	NP (¥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	22.4
FY9/08 actual		21,182	17.8%	3,487	17.0%	3,563	17.1%	1,708	23.4%	19,105	18.2
FY9/09 actual		23,568	11.3%	4,008	14.9%	3,563	0.0%	1,713	0.3%	19,161	11.6
FY9/10 Company estimate		29,438	24.9%	4,222	5.3%	4,245	19.2%	2,070	20.8%	23,162	9.6
FY9/10 BofAML estimate	Revised	30,900	31.1%	4,850	21.0%	4,890	37.3%	2,500	45.9%	13,982	15.9
	Previous	30,900	31.1%	4,430	10.5%	4,470	25.5%	2,280	33.1%	25,503	8.7
FY9/11 BofAML estimate	Revised	33,750	9.2%	5,520	13.8%	5,560	13.7%	2,860	14.4%	15,996	13.9
	Previous	33,750	9.2%	5,010	13.1%	5,050	13.0%	2,590	13.6%	28,971	7.7
FY9/12 BofAML estimate	Revised	36,800	9.0%	6,240	13.0%	6,280	12.9%	3,240	13.3%	18,121	12.3
	Previous	36,800	9.0%	5,640	12.6%	5,680	12.5%	2,920	12.7%	33,949	6.6

Note: The company conducted a stock split from one share to two shares on 1 April, 2010

Source: Company, BofA Merrill Lynch Global Research estimates

## Price objective basis & risk

### EPS (4282)

Our price objective for EPS is JPY252,000, based on 18x P/E on FY9/10E EPS, a premium to the average for domestic peers, in light of the valuation range for global CRO companies. 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 labor shortage and clinical trial accidents or leakage of personal data. Other risks are lower software development business easily affected by the economy.

## Link to Definitions

### Healthcare

Click [here](#) for definitions of commonly used terms.

## Analyst Certification

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Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Cmic	CMICF	2309 JP	Ritsuo Watanabe
	EPS	EPLYF	4282 JP	Ritsuo Watanabe
	Hogy Medical	HGYMF	3593 JP	Ritsuo Watanabe
	Kissei Pharm.	KSPHF	4547 JP	Ritsuo Watanabe
	Nipro	NISOF	8086 JP	Ritsuo Watanabe
	Santen Pharm.	SNPHF	4536 JP	Ritsuo Watanabe
	Shionogi	SGIOF	4507 JP	Ritsuo Watanabe
	SHIP Healthcare Holdings	GHSPF	3360 JP	Ritsuo Watanabe
	Sogo Medical	SGOOF	4775 JP	Ritsuo Watanabe
	Takeda Pharm.	TKPHF	4502 JP	Ritsuo Watanabe
	Towa Pharmaceutical	TWAPF	4553 JP	Akinori Ueda
<b>NEUTRAL</b>				
	Astellas Pharma	ALPMF	4503 JP	Ritsuo Watanabe
	Chugai Pharm.	CHGCF	4519 JP	Ritsuo Watanabe
	Kyowa Hakko Kirin	KYKOF	4151 JP	Ritsuo Watanabe
	Mitsubishi Tanabe Pharma	MTZXY	4508 JP	Ritsuo Watanabe
	Nichi-Iko Pharmaceutical	NHKFF	4541 JP	Akinori Ueda
	Sawai Pharma	SWPIF	4555 JP	Akinori Ueda
	Taisho Pharm.	TSOPF	4535 JP	Ritsuo Watanabe
	Terumo	TRUMF	4543 JP	Ritsuo Watanabe
<b>UNDERPERFORM</b>				
	Alfresa	ARHCF	2784 JP	Ritsuo Watanabe
	Daiichi Sankyo	DSKYF	4568 JP	Ritsuo Watanabe
	Dainippon Sumitomo Pharma	DNPUF	4506 JP	Ritsuo Watanabe
	Eisai	ESALY	ESALY US	Ritsuo Watanabe
	Eisai	ESALF	4523 JP	Ritsuo Watanabe
	Kyorin	KYRNF	4569 JP	Ritsuo Watanabe
	Medipal Holdings	MEPDF	7459 JP	Ritsuo Watanabe
	Ono Pharm.	OPHLF	4528 JP	Ritsuo Watanabe
	Suzuken	SZUKF	9987 JP	Ritsuo Watanabe

**iQmethod<sup>SM</sup> Measures Definitions**

<b>Business Performance</b>	<b>Numerator</b>	<b>Denominator</b>
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
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
<b>Quality of Earnings</b>		
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
<b>Valuation Toolkit</b>		
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	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

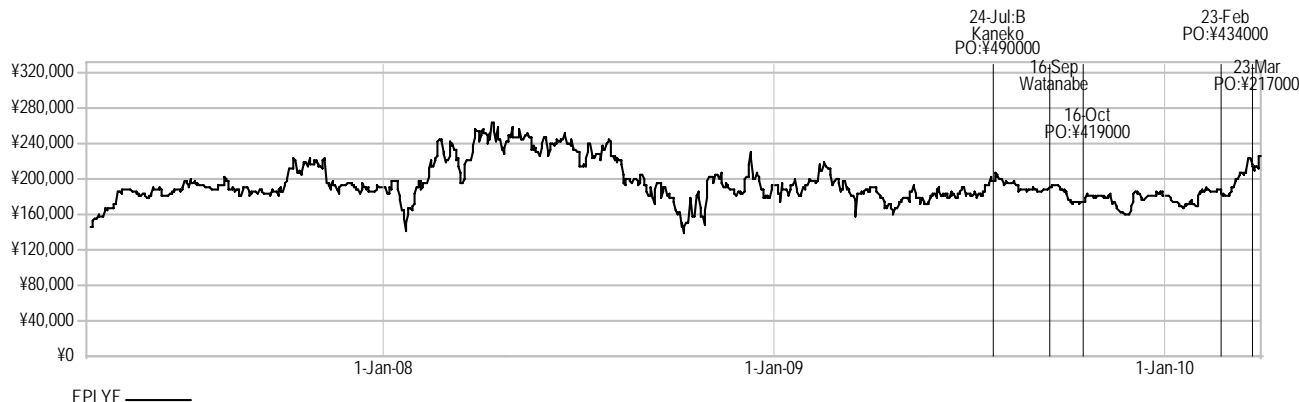
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B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

\*Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of March 31, 2010 or such later date as indicated.

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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	104	50.98%	Buy	60	60.61%
Neutral	55	26.96%	Neutral	33	66.00%
Sell	45	22.06%	Sell	27	62.79%

### Investment Rating Distribution: Global Group (as of 01 Apr 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1818	52.41%	Buy	952	58.01%
Neutral	873	25.17%	Neutral	490	61.95%
Sell	778	22.43%	Sell	355	49.72%

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