Operating Results BUY

Equity | Japan | Health Care Distribution & Technology
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Company's FY9/11 OP forecast far lower than expected

Bank of America Merrill Lynch

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Announces full FY9/10 results

EPS announced FY9/10 results after the market closed on 5 November. Operating profit of ¥4.4bn (up 10.2% YoY) was ahead of the company's ¥4.2bn plan, but below our ¥5bn estimate. Management forecasts FY9/11 operating profit of ¥4.63bn (up 5%), well short of our ¥5.85bn projection. In parent earnings, which we believed would remain solid, the company expects FY9/11 operating profit to fall 2%, accounting for the divergence. We had thought that growth in the CRO market and rising market share would fuel earnings expansion, but conditions appear to be more challenging than we had envisaged. We plan to revise our earnings estimates and price objective as soon as possible in light of the 17 November results briefing and our talks with management.

Divergence with our estimates: CRO segment margins lower than expected

The mainstay CRO (clinical research outsourcing) business posted growth of 32% in revenue and 12% in operating profit, boosted by M&A. Segmental operating profit came at ¥3.95bn, but this was below our ¥4.44bn projection. The overshoot was lower-than-expected because of the 4Q operating profit margin, which dropped to 13.4%, having run at 18.4% in cumulative results through 3Q. As a result, overall 4Q operating profit fell 25% YoY. We will need to confirm details after talks with the company, but SG&A expenses increased more than we had envisaged, and expansion in the company's business domain may be driving up fixed costs, in our view.

Profit growth may slow as overheads mount

Sales and gross profit can sometimes fluctuate considerably in the CRO business based on factors such as the timing at which contracts are booked into accounts. That said, the main reason for FY9/10 profits to be lower than we had envisaged lay in SG&A, while management's FY9/11 OP plan envisages a slowdown to growth of 5%. We believe outlays on overheads are building up faster than we had expected. On the other hand, orders remained brisk, with CRO orders up 25% in FY9/10, and all-company orders also rising 20%. After the results meeting, we will have to reassess whether EPS can sustain double-digit profit growth over the medium term on the back of stable expansion in revenue, or whether it is destined to be a firm with steady single-digit growth due to rising overheads.

Stock Data

Price	¥199,200
Price Objective	¥270,000
Date Established	13-Jul-2010
Investment Opinion	C-1-7
Volatility Risk	HIGH
BofAML Ticker / Exchange	EPLYF / TYO
Bloomberg / Reuters	4282 JP / 4282.T

Refer to important disclosures on page 3 to 5. Analyst Certification on Page 2. Price Objective Basis/Risk on page 2. Link to Definitions on page 2. 10991045

Price objective basis & risk

EPS (4282)

EPS (4282): Our price objective for EPS is JPY270,000, based on 16x P/E on FY9/11E 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

I, Ritsuo Watanabe, 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.

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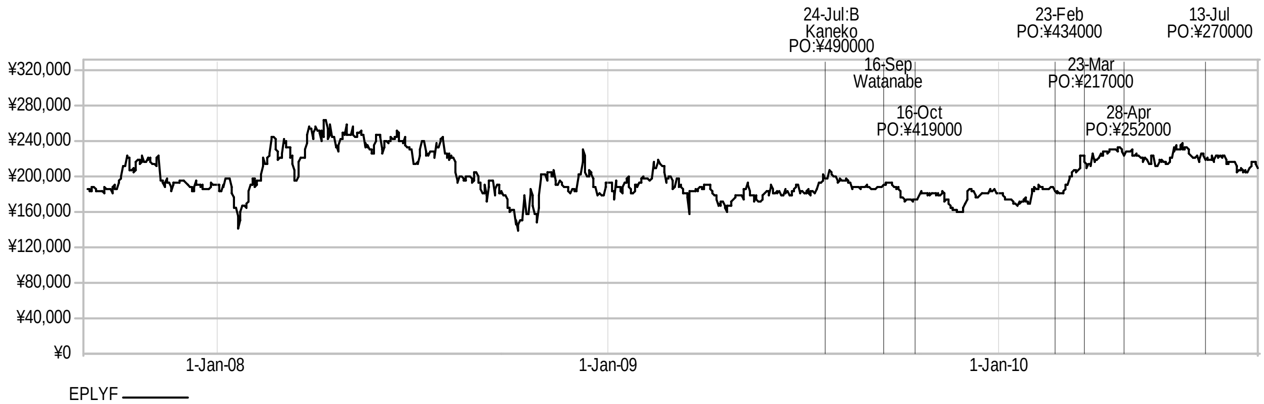
EPLYF Price Chart



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

"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 August 31, 2010 or such later date as indicated. BofA Merrill Lynch price charts do not reflect analysts' coverage of the stock at prior firms."

Investment Rating Distribution: Health Care Group (as of 01 Oct 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	122	53.51%	Buy	52	45.61%
Neutral	55	24.12%	Neutral	31	59.62%
Sell	51	22.37%	Sell	16	32.00%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1948	54.31%	Buy	821	46.73%
Neutral	891	24.84%	Neutral	397	49.07%
Sell	748	20.85%	Sell	259	37.16%

* Companies in respect of which MLPF&S or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
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Neutral	≥ 0%	≤ 30%
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