

Company's FY9/11 OP forecast far lower than expected

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.

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Stock Data

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Investment Opinion	C-1-7
Volatility Risk	HIGH
BofAML Ticker / Exchange	EPLYF / TYO
Bloomberg / Reuters	4282 JP / 4282.T

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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

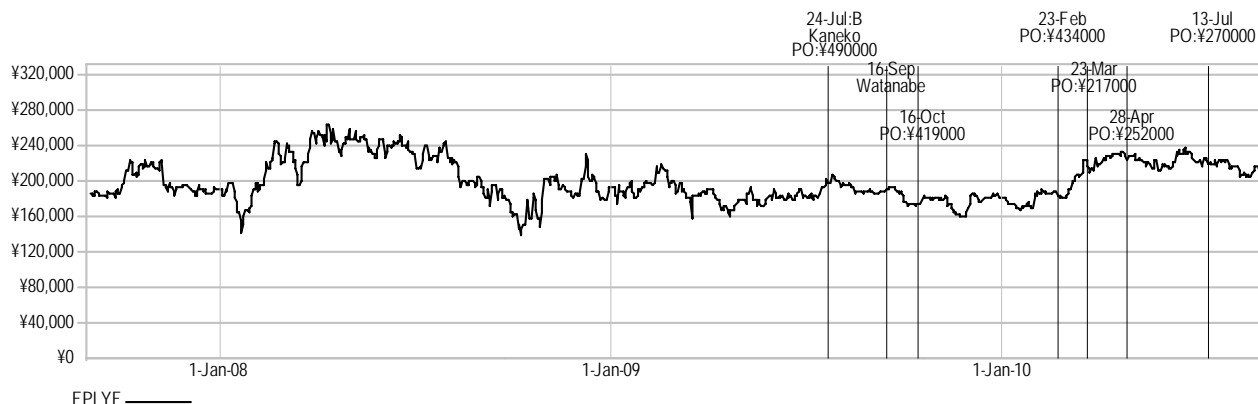
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EPLYF Price Chart



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Sell	51	22.37%	Sell	16	32.00%

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

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