

## Fortrea

# 4Q23 review: Divestiture focuses story, but still cautious on FY24 execution

Reiterate Rating: UNDERPERFORM | PO: 33.00 USD | Price: 36.41 USD

## 4Q results & FY24 guide fall short on sales, adj. EBITDA

Fortrea (FTRE) reported 4Q revenues of \$775mn -1% and Adj EBITDA -7% below the Street, respectively. Initial FY24 guidance also came in below, with sales of \$3,172.5mn -1% below and Adj EBITDA of \$300mn -6% below. See our [First Look](#) for color.

## Divestiture helps reduce leverage, but a bit surprising

FTRE also announced the divestiture of its Endpoint Clinical & Patient Access businesses for \$345mn. With estimated FY24 revenues of \$250mn and Adj EBITDA of ~\$30mn, these franchises comprise the bulk of the Enabling Services segment. As the FY24 guide excludes the impact of the divestiture, estimates will need to come down once the deal is completed in 2Q24. We think the deal will help focus the business and reduce leverage (FTRE's covenants require the company to use ~60% of the proceeds to pay-down debt, implying est. pro forma leverage of ~4.8x vs. 5.7x in 4Q23). However, we were a bit surprised to see it given that these offerings were initially pitched as a differentiating factor for the company as it seeks to distinguish itself from peers.

## Adj. EBITDA margins pressured near-term; ~13% '25 goal

FTRE is making progress on transition service agreements (TSAs) with its former parent company LabCorp (LH), now having exited ~40%, and expects to exit the remaining TSAs by year end. In the near-term, costs related to TSAs as well as personnel expenses, growth investments, and incremental marketing spend would continue to pressure margins, and only a third of the FY24's adj. EBITDA will be generated in 1H24, weighted towards 2Q. However, Mgmt. reiterated its target to exit FY24 with a margin level similar to FY22 (i.e., ~13%). Post TSA exits, in FY25, Mgmt. looks to grow in line with the market and reduce SG&A expenses to achieve adj. EBITDA margin of ~13% for the year. FTRE expects to further expand margins into the "upper mid-teens".

## Lowering ests, FTRE a work in progress

We lower our 2024-206 ests. However, our new \$33 PO (was \$29) is now based on ~11x BofAe 2025 EV/EBITDA (was ~10x 2025E) as the CRO peer group multiple has expanded, but it remains at a discount given FTRE's lower margin profile. Overall, FTRE is making progress, but it remains to be seen how quickly it will rebound to be on par with peers. As such, we reiterate our Underperform rating.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	3.55	1.40	0.96	2.00	2.45
GAAP EPS	2.12	(0.03)	0.11	1.10	1.48
EPS Change (YoY)	36.5%	-60.6%	-31.4%	108.3%	22.5%
Consensus EPS (Bloomberg)			0.95	1.93	2.36
DPS	0	0	0	0	0
Valuation (Dec)					
P/E	10.3x	26.0x	37.9x	18.2x	14.9x
GAAP P/E	17.2x	NM	331.0x	33.1x	24.6x
EV / EBITDA*	12.4x	18.8x	17.2x	11.9x	10.7x
Free Cash Flow Yield*	1.0%	3.9%	-1.3%	1.4%	2.5%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 4.

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Timestamp: 11 March 2024 06:43PM EDT

11 March 2024

### Equity

#### Key Changes

(US\$)	Previous	Current
Price Obj.	29.00	33.00
2024E Rev (m)	3,210.0	3,170.3
2025E Rev (m)	3,350.0	3,310.3
2026E Rev (m)	3,525.0	3,485.0
2024E EPS	1.08	0.96
2025E EPS	2.14	2.00
2026E EPS	2.69	2.45

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### Stock Data

Price	36.41 USD
Price Objective	33.00 USD
Date Established	11-Mar-2024
Investment Opinion	C-3-9
52-Week Range	24.93 USD - 38.47 USD
Mrkt Val (mn) / Shares Out (mn)	3,219 USD / 88.4
Free Float	99.8%
Average Daily Value (mn)	27.27 USD
BofA Ticker / Exchange	FTRE / NAS
Bloomberg / Reuters	FTRE US / FTRE.OQ
ROE (2024E)	5.0%
Net Dbt to Eqty (Dec-2023A)	88.8%

# iQprofile<sup>SM</sup> Fortrea

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

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	5.9%	1.6%	3.6%	6.5%	7.2%
Return on Equity	9.8%	5.7%	5.0%	10.2%	11.8%
Operating Margin	7.6%	2.0%	4.6%	8.1%	8.8%
Free Cash Flow	33	127	(43)	44	81

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

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	0.3x	1.1x	0x	0.6x	0.6x
Asset Replacement Ratio	2.0x	1.2x	1.2x	1.5x	1.4x
Tax Rate	NM	NM	NM	NM	NM
Net Debt-to-Equity Ratio	-1.5%	88.8%	90.7%	83.4%	73.6%
Interest Cover	NA	0.9x	1.1x	2.1x	2.5x

## Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	3,096	3,109	3,170	3,310	3,485
% Change	1.3%	0.4%	2.0%	4.4%	5.3%
Gross Profit	649	520	551	649	699
% Change	7.3%	-19.8%	5.8%	17.9%	7.7%
EBITDA	405	267	292	421	467
% Change	15.8%	-34.0%	9.2%	44.1%	10.9%
Net Interest & Other Income	1	(62)	(130)	(127)	(124)
<b>Net Income (Adjusted)</b>	<b>323</b>	<b>146</b>	<b>88</b>	<b>183</b>	<b>226</b>
<b>% Change</b>	<b>27.6%</b>	<b>-55.0%</b>	<b>-39.9%</b>	<b>109.4%</b>	<b>23.1%</b>

## Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	281	6	19	180	227
Depreciation & Amortization	93	96	103	107	113
Change in Working Capital	(246)	46	(53)	(50)	(55)
Deferred Taxation Charge	(17)	(40)	(111)	(111)	(111)
Other Adjustments, Net	(24)	60	44	(24)	(34)
Capital Expenditure	(54)	(40)	(44)	(58)	(59)
<b>Free Cash Flow</b>	<b>33</b>	<b>127</b>	<b>-43</b>	<b>44</b>	<b>81</b>
<b>% Change</b>	<b>-76.9%</b>	<b>284.0%</b>	<b>NM</b>	<b>NM</b>	<b>83.0%</b>
Share / Issue Repurchase	(9)	(1,729)	0	0	0
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	0	1,616	0	0	0

## Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	112	109	65	109	190
Trade Receivables	1,022	1,052	1,107	1,159	1,220
Other Current Assets	113	92	92	92	92
Property, Plant & Equipment	NA	NA	NA	NA	NA
Other Non-Current Assets	3,041	3,104	3,105	3,112	3,113
<b>Total Assets</b>	<b>4,288</b>	<b>4,357</b>	<b>4,369</b>	<b>4,473</b>	<b>4,615</b>
Short-Term Debt	23	20	20	20	20
Other Current Liabilities	676	730	732	734	741
Long-Term Debt	40	1,632	1,632	1,632	1,632
Other Non-Current Liabilities	206	210	210	210	210
<b>Total Liabilities</b>	<b>945</b>	<b>2,592</b>	<b>2,594</b>	<b>2,596</b>	<b>2,603</b>
<b>Total Equity</b>	<b>3,343</b>	<b>1,739</b>	<b>1,749</b>	<b>1,850</b>	<b>1,986</b>
<b>Total Equity &amp; Liabilities</b>	<b>4,288</b>	<b>4,331</b>	<b>4,343</b>	<b>4,446</b>	<b>4,589</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 4.

## Company Sector

Healthcare Technology & Distribution

## Company Description

FTRE is a mid-sized, clinical stage contract research organization (CRO) providing outsourced Phase I-IV research and development services to sponsors in the biopharma and medical device industries. FTRE's services and solutions are intended to help customers quickly and safely bring their drugs and products to market while maximizing their returns on their outsourced R&D spend.

## Investment Rationale

While we think FTRE is better positioned as a standalone company, we remain cautious due to its unclear differentiation, historical underperformance, and lack of visibility. Beyond that, the broader Contract Research Organization industry is facing several largely transitory headwinds in the form of weak biotech funding, potential softening pharma R&D spend, as well as continued consolidation largely to the benefit of the largest CRO's.

## Stock Data

Average Daily Volume 748,995

## Quarterly Earnings Estimates

	2023	2024
Q1	0.45A	0.01E
Q2	0.51A	0.09E
Q3	0.24A	0.36E
Q4	0.19A	0.50E

## Price objective basis & risk

### Fortrea (FTRE)

Our \$33 PO is based on 11x BofAe 2025 EV/EBITDA reflecting a discount to CRO peers. We believe that this multiple is warranted given the company's lower growth and margin profiles, as well as its lack of recent track record as a standalone entity. Upside risks are better than expected sales growth and margin expansion, and the acquisition of the company. Downside risks are lower sponsor R&D spending, competition, inflationary pressures, execution risks, and regulatory risks.

## Analyst Certification

I, Derik de Bruin, 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.

### US - Life Science, Diagnostic Tools and Animal Health Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Avantor, Inc.	AVTR	AVTR US	Michael Ryskin
	Bruker Corporation	BRKR	BRKR US	Michael Ryskin
	Certara	CERT	CERT US	Michael Ryskin
	Charles River Laboratories	CRL	CRL US	Michael Ryskin
	Elanco Animal Health	ELAN	ELAN US	Michael Ryskin
	Exact Sciences	EXAS	EXAS US	Derik de Bruin
	Guardant Health	GH	GH US	Derik de Bruin
	ICON plc	ICLR	ICLR US	Derik de Bruin
	IQVIA Holdings Inc	IQV	IQV US	Derik de Bruin
	LabCorp	LH	LH US	Michael Ryskin
	Marava	MRVI	MRVI US	Michael Ryskin
	Qiagen	QGEN	QGEN US	Michael Ryskin
	Qiagen N.V.	XQGNF	QIA GY	Michael Ryskin
	Quest Diagnostics	DGX	DGX US	Michael Ryskin
	Stevanato Group S.p.A.	STVN	STVN US	Michael Ryskin
	Thermo Fisher Scientific	TMO	TMO US	Michael Ryskin
	West Pharmaceutical Services	WST	WST US	Michael Ryskin
	Zoetis Inc.	ZTS	ZTS US	Michael Ryskin
<b>NEUTRAL</b>				
	10x Genomics, Inc.	TXG	TXG US	Michael Ryskin
	Agilent Technologies	A	A US	Michael Ryskin
	Danaher Corporation	DHR	DHR US	Michael Ryskin
	Evotec SE	EVO	EVO US	Michael Ryskin
	Hologic, Inc.	HOLX	HOLX US	Derik de Bruin
	IDEXX Laboratories	IDXX	IDXX US	Michael Ryskin
	Mettler-Toledo	MTD	MTD US	Michael Ryskin
	NeoGenomics Inc.	NEO	NEO US	Derik de Bruin
	Revvity Inc	RVTY	RVTY US	Michael Ryskin
	Schrodinger, Inc.	SDGR	SDGR US	Michael Ryskin
	Waters Corp.	WAT	WAT US	Michael Ryskin
<b>UNDERPERFORM</b>				
	Align Technology	ALGN	ALGN US	Michael Ryskin
	Fortrea	FTRE	FTRE US	Derik de Bruin
	Ginkgo Bioworks Holdings, Inc	DNA	DNA US	Derik de Bruin
	Illumina, Inc.	ILMN	ILMN US	Michael Ryskin
	Myriad Genetics	MYGN	MYGN US	Derik de Bruin
	Phibro Animal Health	PAHC	PAHC US	Michael Ryskin



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

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

**Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

**Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

**Quality of Earnings**

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

**Numerator**

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash &amp; Equivalents

EBIT

**Denominator**

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

**Valuation Toolkit**

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

**Numerator**

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

**Denominator**

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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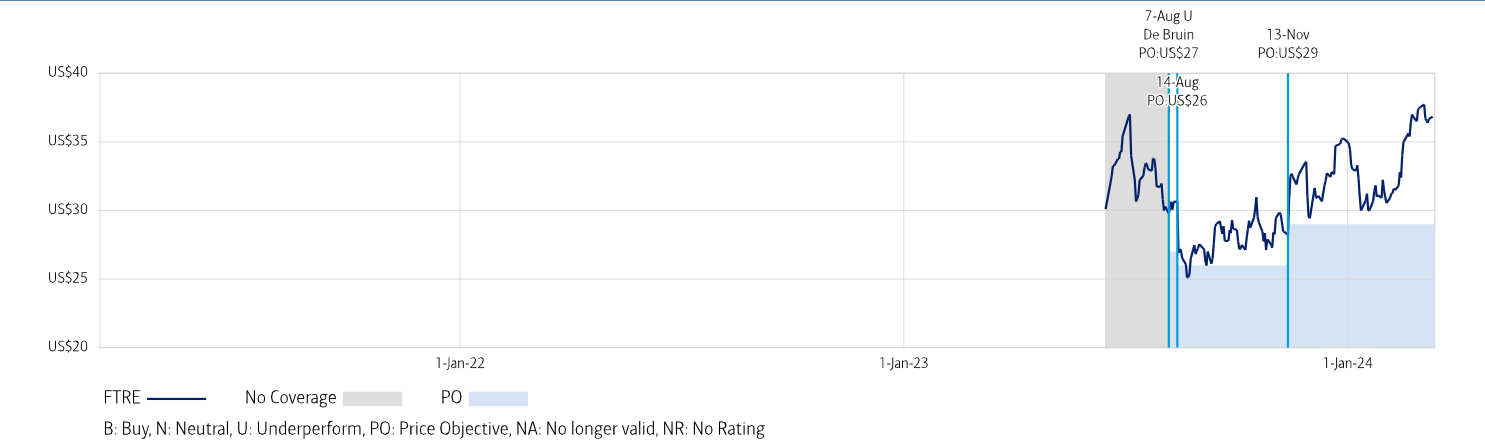
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Fortrea (FTRE) Price Chart



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Equity Investment Rating Distribution: Health Care Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	234	60.94%	Buy	115	49.15%
Hold	80	20.83%	Hold	36	45.00%
Sell	70	18.23%	Sell	29	41.43%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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