

## COMPANY NOTE

Target | Estimate Change

USA | Healthcare | Pharmaceutical Svcs.

August 1, 2013

# Jefferies

## Quintiles Inc. (Q)

### Bookings and Revenue Not Quite Up to Par

#### Key Takeaway

**Upon deeper analysis, lower tax rate and FX drove a meaningful portion of 2Q's upside and higher guidance. Relative to plan, higher EBIT margin from cost control, FX, and mix shift to PDEV has offset weaker revenue. 2Q bookings were below expectations with and without the large IHS contract in July. Q's market leadership premium is offset by its slower growth rate. As such, we remain hesitant to give it a premium valuation. PT to \$45.**

**Signed Strategic Partnership in May; Ready to Add More.** To date, Q has largely avoided chasing the more price-competitive "strategic deals" with pharma. It did enter into a unique partnership in May utilizing Q's full range of capabilities, thus likely sidestepping deep pricing discounts.

**Experience With Large Partnerships Should Enable a Quicker Ramp.** While the deal appears similar to the strategy other late-stage vendors have been pursuing for several years now, management was confident its experience with large client partnerships would allow for a quicker ramp than its peers were able to achieve (i.e., less upfront margin pressure).

**Deal Slippage Creates Blip in IHS Bookings.** During 2Q, the company signed \$142.2M of new business (BtB of 0.65, vs. JEF at 1.12). The miss was driven by another cancellation hit and slippage of a \$100M deal into 3Q. Had that deal been signed in June, bookings would have been roughly in line. Management noted that IHS sales are lumpy and characterized the medium-term backdrop as 'promising'.

**Guidance Includes Tax Assertion and 1H13 Outperformance.** The tax assertion is worth ~\$0.04 for the year. FX is worth close to \$0.03 in 1H13. Adding those to the \$1.93 target in management's original model bridges to the mid-point of management's \$1.95-2.05 EPS range. Said differently, the 2H13 targets are unchanged.

**IPO Proceeds Reduce Debt, Bolster Cash.** Q ended 2Q with \$586M in cash and \$2,045M in debt—leverage stands at 3.6x, or 2.6x net of cash. The company used \$350M of its \$490M IPO proceeds to repay debt. It also retained \$106M, bolstering its cash position.

#### Valuation/Risks

Our \$45 PT is based on a 20x multiple of our 2014 EPS estimate. This valuation places it near the high-end of its peer range. Risks include: contract cancellations and/or bookings volatility; client consolidation; short IHS visibility; and increasingly competitive pricing.

USD	Prev.	2012A	Prev.	2013E	Prev.	2014E	Prev.	2015E
Rev. (MM)	--	3,692.3	3,793.9	3,803.1	4,062.3	4,100.7	4,336.2	4,377.5
EBITDA (MM)	--	543.7	581.9	595.0	628.7	655.7	688.4	717.2
Consensus	--	--	--	1.88	--	2.16	--	--
<b>EPS</b>								
Mar	--	0.44	0.42A	0.49A	--	--	--	--
Jun	--	0.47	0.45	0.50A	--	--	--	--
Sep	--	0.45	--	0.48	--	--	--	--
Dec	--	0.41	--	0.53	--	--	--	--
FY Dec	--	1.77	1.88	1.98	2.16	2.23	2.40	2.47
FY P/E		26.2x		23.4x		20.8x		18.7x

**HOLD**

Price target \$45.00

(from \$41.00)

Price \$46.29

#### Financial Summary

Book Value (MM):	(\$797.9)
Net Debt (MM):	\$1,457.3
Long-Term Debt (MM):	\$2,045.3
Cash & ST Invest. (MM):	\$588.0

#### Market Data

52 Week Range:	\$47.50 - \$40.00
Total Entprs. Value (MM):	\$7,317.6
Market Cap. (MM):	\$5,860.3
Shares Out. (MM):	126.6
Float (MM):	27.2
Avg. Daily Vol.:	NA

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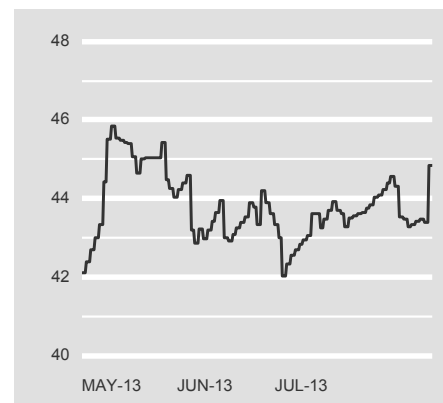
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#### Price Performance



## Quintiles (Q): Market Leader, but Slower Grower

**Hold: \$45.00 Price Target****Scenarios****Target Investment Thesis**

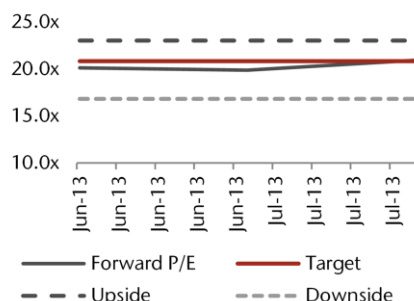
- PDEV revenue growth approximates 8%
- IHS revenue grows < 7%
- EBIT margins improve slightly
- Net interest expense lower YoY due to debt repayment with proceeds from IPO
- Cash remains on balance sheet; both share buybacks and debt repayment are minimal
- 2014 EPS: \$2.23; Target Multiple: 20x; Target Price \$45.00

**Upside Scenario**

- Additional 'preferred vendor' deals are signed; PDEV revenue growth exceeds 10%
- IHS revenue growth also accelerates driven by additional contract sales engagements
- Margins improve to >13.5% on fixed cost leverage and cost control
- Free cash flow is used for tuck-in acquisitions
- 2014 EPS: \$2.40; Target Multiple: 22x; Target Price \$53.00

**Downside Scenario**

- Pricing pressures intensify; consolidated revenue growth slows to sub-6%
- Few new deals are signed; scope of existing deals fails to grow as expected
- Soft pricing drives margin deterioration; costs tightly controlled to mitigate impact
- Free cash is used to repurchase shares
- 2014 EPS: \$2.05; Target Multiple: 16x Target Price: \$33.00

**Long Term Analysis****1 Year Forward P/E**

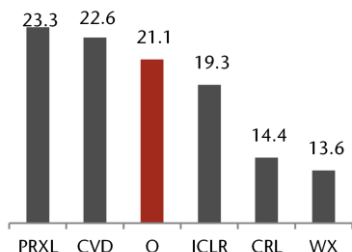
Source: FactSet and Jefferies LLC

**Long Term Financial Model Drivers**

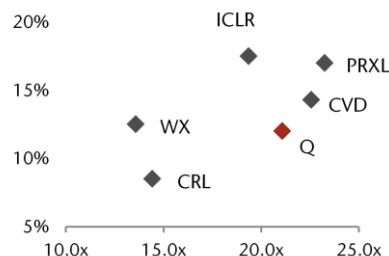
<b>LT EPS CAGR</b>	<b>11-13%</b>
Revenue Growth	<b>7-9%</b>
Operating Margin	<b>12-14%</b>
Effective Tax Rate	<b>32%</b>

**Other Considerations**

Q certainly deserves some valuation premium based on its industry leadership status and the benefits this affords. We believe this should be balanced against Q's markedly slower forward EPS growth rate relative to its peers. Q already boasts industry-leading margins, and therefore, is likely to see smaller amounts of margin expansion going forward. Slower revenue growth and lower margin expansion means slower EPS growth.

**Peer Group****Group NTM P/Es**

Source: FactSet and Jefferies estimates

**Earnings Growth vs P/E**

Source: FactSet and Jefferies estimates

**Recommendation / Price Target**

Ticker	Rec.	PT
CRL	BUY	\$52.00
CVD	HOLD	\$74.00
ICLR	BUY	\$46.00
PRXL	HOLD	\$43.00
<b>Q</b>	<b>HOLD</b>	<b>\$45.00</b>
WX	BUY	\$24.00

**Catalysts**

- Increased clinical trial starts, especially large global studies
- Signing of additional 'preferred provider' agreements
- Growth in pharma R&D budgets and/or the amount of work being outsourced
- Pick-up in Central Lab kit volumes
- Increase in FDA drug approvals

**Company Description**

Quintiles provides biopharmaceutical development and commercial outsourcing services in the Americas, Europe and Africa, and the Asia-Pacific. The company operates in two segments—Product Development and Integrated Healthcare Services—and primarily serves biopharmaceutical companies, as well as other healthcare companies. It was founded in 1982 and is based in Durham, North Carolina.

## Chart 1: Summary of Quintiles Results

## Quintiles

## 2Q13 Earnings Summary

Source: Company filings and Jefferies LLC

Reports 8/1/2013 BMO

FY ending December 31 in thousands except EPS	Reported		Estimate	Actual	Consensus	Percentage Change		Difference		
	2Q12	1Q13	2Q13	2Q13		Seq	Y/Y	Seq	Y/Y	Est.
<b>Total Service Revenue</b>	<b>944,914</b>	<b>927,435</b>	<b>935,343</b>	<b>944,238</b>	<b>942,000</b>	<b>1.8%</b>	<b>(0.1%)</b>	<b>16,803</b>	<b>(676)</b>	<b>8,895</b>
Direct costs	628,222	611,109	617,776	617,666		1.1%	(1.7%)	6,557	(10,556)	(110)
SG&A	202,210	197,968	202,059	202,478		2.3%	0.1%	4,510	268	419
Operating income	114,482	118,358	115,508	124,094		4.8%	8.4%	5,736	9,612	8,586
Adjusted EBITDA	138,201	142,998	141,165	149,080		4.3%	7.9%	6,082	10,879	7,915
Interest expense (income)	32,808	35,590	34,330	31,099		(12.6%)	(5.2%)	(4,491)	(1,709)	(3,231)
Other expense, net	(6,159)	(2,382)	(256)	536		(122.5%)	(108.7%)	2,918	6,695	792
Pre-tax income	87,833	85,150	81,434	92,459		8.6%	5.3%	7,309	4,626	11,025
Income taxes	32,486	26,000	26,005	30,162		16.0%	(7.2%)	4,162	(2,324)	4,157
Income from unconsolidated affiliates	334	(1,683)	200	464		(127.6%)	38.9%	2,147	130	264
Loss from noncontrolling interest	189	153	273	164		7.2%	(13.2%)	11	(25)	(109)
Non-GAAP net income	55,870	57,620	55,902	62,925		9.2%	12.6%	5,305	7,055	7,023
<b>Non-GAAP EPS</b>	<b>\$ 0.47</b>	<b>\$ 0.49</b>	<b>\$ 0.45</b>	<b>\$ 0.50</b>	<b>\$ 0.46</b>	<b>2.4%</b>	<b>4.7%</b>	<b>\$ 0.01</b>	<b>\$ 0.02</b>	<b>\$ 0.05</b>
Diluted shares	117,706	118,740	125,564	126,578		6.6%	7.5%	7,838	8,872	1,014
GAAP net income	47,201	48,309	27,667	38,517		(20.3%)	(18.4%)	(9,792)	(8,684)	10,850
GAAP EPS	0.40	0.41	0.22	0.30		(25.2%)	(24.1%)	(0.10)	(0.10)	0.08
<b>COMMON SIZE</b>										
Direct costs	<u>66.5%</u>	<u>65.9%</u>	<u>66.0%</u>	<u>65.4%</u>				<u>(50 bps)</u>	<u>(110 bps)</u>	<u>(60 bps)</u>
Gross margin	33.5%	34.1%	34.0%	34.6%				50 bps	110 bps	60 bps
SG&A	<u>21.4%</u>	<u>21.3%</u>	<u>21.6%</u>	<u>21.4%</u>				<u>10 bps</u>	<u>0 bps</u>	<u>(20 bps)</u>
Operating income	12.1%	12.8%	12.3%	13.1%				40 bps	100 bps	80 bps
Adjusted EBITDA	14.6%	15.4%	15.1%	15.8%				40 bps	120 bps	70 bps
Interest expense (income)	3.5%	3.8%	3.7%	3.3%				(50 bps)	(20 bps)	(40 bps)
Other expense, net	<u>(0.7%)</u>	<u>(0.3%)</u>	<u>(0.0%)</u>	<u>0.1%</u>				<u>30 bps</u>	<u>70 bps</u>	<u>10 bps</u>
Pre-tax income	9.3%	9.2%	8.7%	9.8%				60 bps	50 bps	110 bps
Income taxes	37.0%	30.5%	31.9%	32.6%				210 bps	(440 bps)	70 bps
Income from unconsolidated affiliates	0.0%	(0.2%)	0.0%	0.0%				20 bps	0 bps	0 bps
Loss from noncontrolling interest	<u>0.0%</u>	<u>0.0%</u>	<u>0.0%</u>	<u>0.0%</u>				<u>0 bps</u>	<u>0 bps</u>	<u>0 bps</u>
Non-GAAP net income	5.9%	6.2%	6.0%	6.7%				50 bps	80 bps	70 bps
<b>SEGMENTS</b>										
<b>Product Development</b>										
Revenue	\$ 692,123	\$ 706,307	\$ 712,887	\$ 724,170	\$ 718,000	2.5%	4.6%	\$ 17,863	\$ 32,047	\$ 11,283
% of total	73.2%	76.2%	76.2%	76.7%				50 bps	340 bps	50 bps
Operating profit	119,144	132,707	128,869	136,093		2.6%	14.2%	3,386	16,949	7,224
Margin	17.2%	18.8%	18.1%	18.8%				0 bps	160 bps	70 bps
<b>Integrated Healthcare Services</b>										
Revenue	252,791	221,128	222,456	220,068	\$ 223,000	(0.5%)	(12.9%)	(1,060)	(32,723)	(2,388)
% of total	26.8%	23.8%	23.8%	23.3%				(50 bps)	(340 bps)	(50 bps)
Operating profit	20,329	6,228	8,935	12,507		100.8%	(38.5%)	6,279	(7,822)	3,572
Margin	8.0%	2.8%	4.0%	5.7%				290 bps	(240 bps)	170 bps

Source: Company data and Jefferies LLC

## Quintiles

Income Statement  
December Fiscal Year  
(\$ in Millions, except for EPS)

## Jefferies

08/01/13

Non-GAAP Income Statement	2011A	1Q12	2Q12	3Q12	4Q12	2012A	1Q13	2Q13	3Q13	4Q13	2013E	2014E	2015E
<b>Total Service Revenue</b>	<b>3,294,966</b>	<b>888,035</b>	<b>944,914</b>	<b>913,588</b>	<b>945,761</b>	<b>3,692,298</b>	<b>927,435</b>	<b>944,238</b>	<b>945,404</b>	<b>986,019</b>	<b>3,803,096</b>	<b>4,100,737</b>	<b>4,377,540</b>
YoY Growth	10.0%	13.7%	14.9%	11.5%	8.4%	12.1%	4.4%	(0.1%)	3.5%	4.3%	3.0%	7.8%	6.8%
Cost of revenue	2,153,005	590,563	628,222	612,106	628,476	2,459,367	611,109	617,666	620,987	644,128	2,493,715	2,674,136	2,845,352
<b>SG&amp;A</b>	<b>743,541</b>	<b>191,118</b>	<b>202,210</b>	<b>191,445</b>	<b>202,728</b>	<b>787,501</b>	<b>197,968</b>	<b>202,478</b>	<b>203,349</b>	<b>209,420</b>	<b>816,171</b>	<b>877,552</b>	<b>928,779</b>
Operating income	398,420	106,354	114,482	110,037	114,557	445,430	118,358	124,094	121,068	132,471	493,210	549,049	603,409
<b>Adjusted EBITDA</b>	<b>490,424</b>	<b>129,625</b>	<b>138,201</b>	<b>135,764</b>	<b>140,128</b>	<b>543,718</b>	<b>142,998</b>	<b>149,080</b>	<b>146,594</b>	<b>159,094</b>	<b>594,985</b>	<b>655,668</b>	<b>717,225</b>
YoY Growth	6.0%	21.4%	18.1%	12.5%	(4.0%)	10.9%	10.3%	7.9%	8.0%	13.5%	9.4%	10.2%	9.4%
Net interest expense	105,126	28,920	32,808	32,665	36,911	131,304	35,590	31,099	27,977	27,977	122,643	111,446	110,621
<b>Other expense (income), net</b>	<b>(2,557)</b>	<b>(2,419)</b>	<b>(6,159)</b>	<b>3,850</b>	<b>1,156</b>	<b>(3,572)</b>	<b>(2,382)</b>	<b>536</b>	<b>(24)</b>	<b>(9)</b>	<b>(1,879)</b>	<b>-</b>	<b>-</b>
Pre-tax income	295,851	79,853	87,833	73,522	76,490	317,698	85,150	92,459	93,115	104,503	372,446	437,603	492,788
Income taxes	102,168	29,790	32,486	21,900	28,074	112,250	26,000	30,162	29,797	33,441	119,400	140,143	157,692
Income from unconsolidated affiliates	(4,123)	1,573	334	896	(236)	2,567	(1,683)	464	200	200	(819)	1,064	1,064
<b>Loss from noncontrolling interest/minority interest</b>	<b>1,445</b>	<b>465</b>	<b>189</b>	<b>123</b>	<b>138</b>	<b>915</b>	<b>153</b>	<b>164</b>	<b>273</b>	<b>273</b>	<b>863</b>	<b>1,092</b>	<b>1,092</b>
Non-GAAP net income	191,005	52,101	55,870	52,641	48,318	208,930	57,620	62,925	63,791	71,535	253,090	299,616	337,252
<b>Non-GAAP EPS</b>	<b>1.62</b>	<b>0.44</b>	<b>0.47</b>	<b>0.45</b>	<b>0.41</b>	<b>1.77</b>	<b>0.49</b>	<b>0.50</b>	<b>0.48</b>	<b>0.53</b>	<b>1.98</b>	<b>2.23</b>	<b>2.47</b>
YoY Growth	18.1%	51.5%	34.7%	40.4%	(37.7%)	9.6%	9.5%	4.7%	7.4%	30.6%	11.5%	12.6%	11.2%
Diluted shares outstanding	117,993	117,551	117,706	117,835	118,150	117,811	118,740	126,578	132,965	133,892	128,044	134,642	136,342
<b>COMMON SIZE:</b>													
Cost of revenue	65.3%	66.5%	66.5%	67.0%	66.5%	66.6%	65.9%	65.4%	65.7%	65.3%	65.6%	65.2%	65.0%
<b>SG&amp;A</b>	<b>22.6%</b>	<b>21.5%</b>	<b>21.4%</b>	<b>21.0%</b>	<b>21.4%</b>	<b>21.3%</b>	<b>21.3%</b>	<b>21.4%</b>	<b>21.5%</b>	<b>21.2%</b>	<b>21.5%</b>	<b>21.4%</b>	<b>21.2%</b>
Operating income	12.1%	12.0%	12.1%	12.0%	12.1%	12.1%	12.8%	13.1%	12.8%	13.4%	13.0%	13.4%	13.8%
Adjusted EBITDA	14.9%	14.6%	14.6%	14.9%	14.8%	14.7%	15.4%	15.8%	15.5%	16.1%	15.6%	16.0%	16.4%
Net Interest Expense	3.2%	3.3%	3.5%	3.6%	3.9%	3.6%	3.8%	3.3%	3.0%	2.8%	3.2%	2.7%	2.5%
<b>Other Expense (Income), net</b>	<b>(0.1%)</b>	<b>(0.3%)</b>	<b>(0.7%)</b>	<b>0.4%</b>	<b>0.1%</b>	<b>(0.1%)</b>	<b>(0.3%)</b>	<b>0.1%</b>	<b>(0.0%)</b>	<b>(0.0%)</b>	<b>(0.0%)</b>	<b>0.0%</b>	<b>0.0%</b>
Pre-tax income	9.0%	9.0%	9.3%	8.0%	8.1%	8.6%	9.2%	9.8%	9.8%	10.6%	9.8%	10.7%	11.3%
<b>Income taxes</b>	<b>34.5%</b>	<b>37.3%</b>	<b>37.0%</b>	<b>29.8%</b>	<b>36.7%</b>	<b>35.3%</b>	<b>30.5%</b>	<b>32.6%</b>	<b>32.0%</b>	<b>32.0%</b>	<b>32.1%</b>	<b>32.0%</b>	<b>32.0%</b>
Non-GAAP net income	5.8%	5.9%	5.9%	5.8%	5.1%	5.7%	6.2%	6.7%	6.7%	7.3%	6.7%	7.3%	7.7%
<b>GROWTH (YoY):</b>													
Total Service Revenue	na	13.7%	14.9%	11.5%	8.4%	12.1%	4.4%	(0.1%)	3.5%	4.3%	3.0%	7.8%	6.8%
Cost of revenue	na	15.1%	16.4%	13.4%	12.1%	14.2%	3.5%	(1.7%)	1.5%	2.5%	1.4%	7.2%	6.4%
<b>SG&amp;A</b>	<b>na</b>	<b>4.8%</b>	<b>7.4%</b>	<b>4.9%</b>	<b>6.5%</b>	<b>5.9%</b>	<b>3.6%</b>	<b>0.1%</b>	<b>6.2%</b>	<b>3.3%</b>	<b>3.6%</b>	<b>7.5%</b>	<b>5.8%</b>
Operating income	na	24.4%	21.0%	13.3%	(5.5%)	11.8%	11.3%	8.4%	10.0%	15.6%	10.7%	11.3%	9.9%
Adjusted EBITDA	na	21.4%	18.1%	12.5%	(4.0%)	10.9%	10.3%	7.9%	8.0%	13.5%	9.4%	10.2%	9.4%
Net Interest Expense	na	17.2%	22.7%	21.7%	37.4%	24.9%	23.1%	(5.2%)	(14.4%)	(24.2%)	(6.6%)	(9.1%)	(0.7%)
<b>Other Expense (Income), net</b>	<b>na</b>	<b>(263.3%)</b>	<b>332.1%</b>	<b>(279.9%)</b>	<b>(167.3%)</b>	<b>39.7%</b>	<b>(1.5%)</b>	<b>(108.7%)</b>	<b>(100.6%)</b>	<b>(100.7%)</b>	<b>(47.4%)</b>	<b>(100.0%)</b>	<b>nm</b>
Pre-tax income	na	34.6%	29.0%	1.5%	(20.4%)	7.4%	6.6%	5.3%	26.6%	36.6%	17.2%	17.5%	12.6%
<b>Income taxes</b>	<b>na</b>	<b>27.4%</b>	<b>32.4%</b>	<b>(33.6%)</b>	<b>32.0%</b>	<b>9.9%</b>	<b>(12.7%)</b>	<b>(7.2%)</b>	<b>36.1%</b>	<b>19.1%</b>	<b>6.4%</b>	<b>17.4%</b>	<b>12.5%</b>
Non-GAAP net income	na	50.6%	34.1%	40.3%	(37.4%)	9.4%	10.6%	12.6%	21.2%	48.1%	21.1%	18.4%	12.6%
Non-GAAP EPS	na	51.5%	34.7%	40.4%	(37.7%)	9.6%	9.5%	4.7%	7.4%	30.6%	11.5%	12.6%	11.2%

Sources: Company data and Jefferies LLC

## Company Description

Quintiles Transnational provides biopharmaceutical development and commercial outsourcing services in the Americas, Europe and Africa, and the Asia-Pacific. The company operates in two segments—Product Development and Integrated Healthcare Services—and primarily serves biopharmaceutical companies, as well as other healthcare companies. It was founded in 1982 and is based in Durham, North Carolina.

## Analyst Certification

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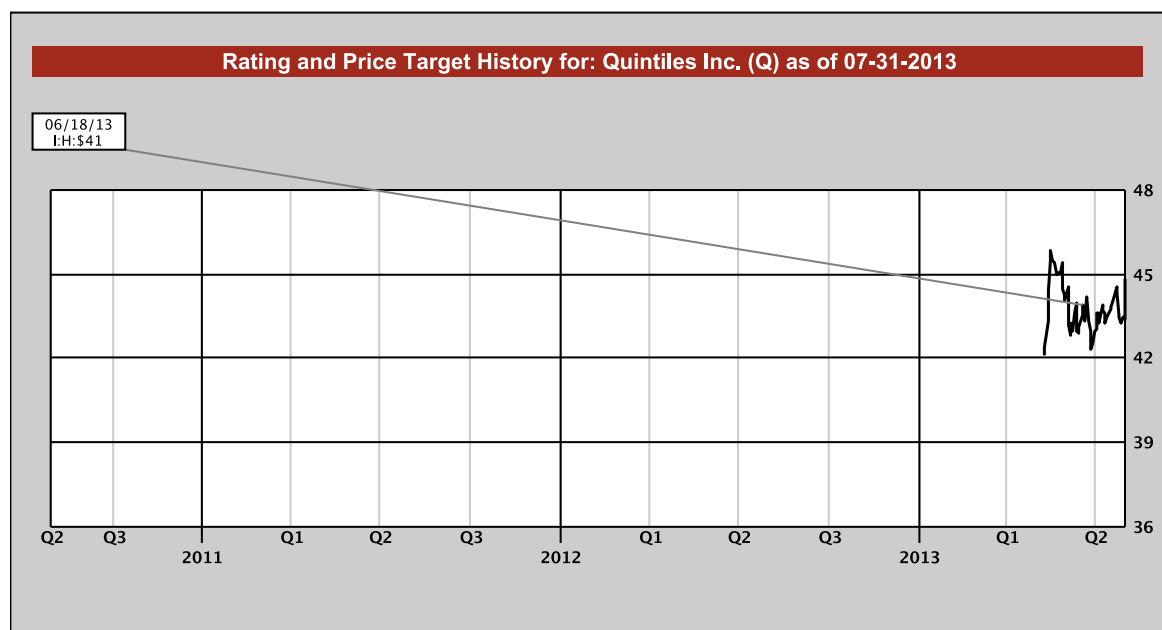
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7. Performance is calculated in US dollars on an equally weighted basis and is compared to MSCI World AC US\$.
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10. All corporate actions are taken into account.

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- Covance Inc. (CVD: \$84.13, HOLD)
- ICON plc (ICLR: \$39.71, BUY)
- PAREXEL International Corporation (PRXL: \$50.43, HOLD)
- WuXi PharmaTech Inc. (WX: \$22.52, BUY)



## Distribution of Ratings

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
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HOLD	749	44.72%	114	15.22%
UNDERPERFORM	139	8.30%	1	0.72%



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