

Quintiles Transnational

4Q13 Review: Outlook Looks Solid For 2014; Reiterate Overweight and Increase PT to \$60

Quintiles (Q) reported solid 4Q results, coming in above revenue expectations (led by strength in Product Development) and beating on the bottom line. More importantly, the company issued above-consensus top-line guidance of \$4.09-\$4.15B (7.4% - 9% cc growth) and adjusted EPS of \$2.33-\$2.46, with solid book-to-bill metrics across both Product Development and Integrated Healthcare Services. We view the quarter as an operationally sound finish to the year, with the 2014 outlook embedding potentially conservative assumptions in light of the strong book-to-bill ratio and record backlog (~2.5x service revenue). As such, we reiterate our Overweight rating, while increasing our December 2014 price target from \$52 to \$60.

- Solid all-round beat led by Product Development.** 4Q13 service revenues of \$1,004M (+7.7% cc growth y/y, including a ~\$30M contribution from the Novella acquisition) came in above the Street (\$981M) and JPMe (\$986M) led by strength in Product Development. By segment, Product Development revenue grew 10.7% c.c. to \$775M, significantly above our estimate of \$756M, as the business benefited from a volume-related increase in clinical services (primarily in the Americas and Europe) and global labs along with the Novella acquisition, partially offset by the continuing wind down of two large projects. Integrated Healthcare Services revenue of \$229M came in slightly below JPMe (\$231M) and declined 1.1% c.c. due to lower net new business in 1H13, and negative scope modifications and cancellations in 4Q12 and 2Q13. Adjusted EPS of \$0.58 came in above consensus of \$0.55 and JPMe of \$0.53, driven by strong operating margin performance in Product Development, coupled with a lower tax rate, as a result of indefinite reinvestment of foreign subsidiary income outside the U.S.
- Strong book-to-bill across both segments and record backlog bodes well for 2014.** Net new business and book-to-bill ratios were healthy across both segments, with Product Development at 1.24x and IHS at 1.47x for the fourth quarter, above historical norms. The company ended 2013 with a record backlog of \$9.9B, of which they expect to record ~\$3.5B as revenue in 2014. On the call, management highlighted that within IHS, revenue from two large customer orders will begin to ramp through 2014 helping the segment return to positive growth. That said, the business is likely to remain lumpy (especially on margins, with 1H lower than 2H) from quarter to quarter. Within Product Development, Quintiles announced the deepening of a couple of key client relationships (in addition to the 2 new sole-provider partnerships announced in 2013), and noted that this would likely result in additional net new business and backlog in future quarters.

Quintiles Transnational Holdings, Inc. (Q;Q US)

FYE Dec	2013A	2014E (Prev)	2014E (Curr)	2015E (Prev)	2015E (Curr)
EPS (\$)					
Q1 (Mar)	0.49	0.51	0.50	0.56	0.55
Q2 (Jun)	0.50	0.56	0.55	0.62	0.61
Q3 (Sep)	0.54	0.58	0.63	0.65	0.71
Q4 (Dec)	0.58	0.56	0.71	0.63	0.79
FY	2.11	2.20	2.39	2.45	2.67

Source: Company data, Bloomberg, J.P. Morgan estimates.

Overweight

Q, Q US

Price: \$51.24 (intraday - 02:20 PM)

▲ **Price Target: \$60.00**
Previous: \$52.00

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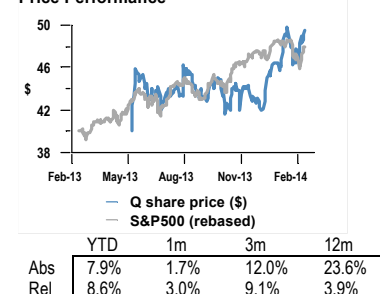
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Price Performance



Company Data

Price (\$)	51.24
Date Of Price	13-Feb-14
52-week Range (\$)	52.00-40.00
Market Cap (\$ mn)	6,551.65
Fiscal Year End	Dec
Shares O/S (mn)	128
Price Target (\$)	60.00
Price Target End Date	31-Dec-14

See page 8 for analyst certification and important disclosures.

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- **2014 guidance comes in above consensus.** Quintiles provided 2014 service revenue guidance of \$4.09-4.15B (vs. consensus of \$4.09B), including impact from the ongoing wind-down of two large clinical and consulting projects, with a sequential increase expected through the year as new larger projects ramp. Margins are forecasted to improve modestly, particularly in the second half of 2014, as recent contract wins ramp and benefit/other costs decline over the course of the year, while the tax rate is expected to be ~30%. Moving down the P&L, the company guided for 2014 adjusted EPS of \$2.33-\$2.46, with the range coming in above consensus expectations at \$2.32. GAAP EPS is expected to be in the \$2.26-\$2.40 range, due to \$12-14M in restructuring expense as a result of a head count reduction (~400 positions) in Product Development.
- **Adjusting estimates, reiterate Overweight.** We are making modest changes to our revenue and margin assumptions for commentary from the quarter, while increasing our December 2014 price target from \$52 to \$60 (based on a CAPM-derived WACC of 8.1% and terminal growth of 1%). We view the results as an operationally sound finish to the year, with the 2014 outlook embedding potentially conservative assumptions in light of the strong book-to-bill ratio across the business and record backlog (~2.5x service revenue). For additional thoughts on the investment thesis, please see our initiation [report](#).

Figure 1: Q: 4Q13 Variance

	4Q12A		4Q13E				4Q13A				Variance		Notes
	Actual		JPM Estimate		Consensus		Actual		Change y/y		vs. JPM Est.		
	\$ M	%	\$ M	%	\$ M	%	\$ M	%	Δ \$	Δ margin	\$ M	%	
Product Development	703		756				775	10.2%			19		- +10.7% constant currency
Integrated Health	243		231				229	-5.7%			(2)		- -1.1% constant currency
Total Revenue	946		986		981		1,004	6.2%			18		- +7.7% constant currency
Gross Profit	317	33.5%	341	34.6%	340	34.7%	362	36.1%	14.1%	251 bp	21	150 bp	
SG&A	(203)	21.4%	(217)	22.0%			(233)	23.2%	14.8%	175 bp	(16)	119 bp	
Adj. Operating Income	115	12.1%	124	12.6%	130	13.3%	129	12.9%	12.8%	76 bp	5	31 bp	
Adj. EBITDA	140	14.8%	148	15.0%	156	15.9%	160	15.9%	14.0%	109 bp	12	91 bp	
Income Tax	(28)	36.7%	(29)	29.3%			(30)	28.0%	5.3%	-869 bp	(1)	-128 bp	- Lower due to indef. reinv. of foreign income
Adjusted Net Income	48	5.1%	71	7.2%			76	7.6%	58.2%	251 bp	6	43 bp	
Diluted Shares	117.8M		133.5M				132.9M	12.8%			-0.6M		
GAAP EPS	\$0.30		\$0.53				\$0.55	85.0%			\$0.02		
Adjusted Diluted EPS	\$0.41		\$0.53		\$0.55		\$0.58	40.3%			\$0.04		
2014 Annual Guidance											Other Topics		

2014 Guidance

Revenue: \$4.09-4.15B (7.4-9.0% cc growth)

Adjusted EPS: \$2.33-2.46

Tax rate: ~30%

Source: J.P. Morgan estimates, Company data.

4Q13 Book-to-bill: Product Development - 1.24x, Integrated Healthcare Services: 1.47x (Overall B2B: 1.29x, highest in 6 years); 2013 Ending backlog: \$9.9B, of which \$3.5B expected to be recognized in 2014

Estimate market growth in both Product Development and IHS to be ~6-8% over next few years

Investment Thesis, Valuation, and Risks

Investment thesis

We are Overweight on shares of Quintiles. We believe that stable biopharmaceutical R&D budgets, coupled with increasing CRO penetration rates, should bode well for Quintiles. Industry dynamics continue to favor larger CROs with broad therapeutic expertise and late-stage exposure – giving Quintiles an edge over competition. New value-added service offerings for the company (DNA sequencing/expression, outcome analytics) present future opportunities for growth that other CROs do not have. The financial deleveraging following the IPO should provide a path to years of double-digit EPS growth that is well above that of peers.

Valuation

Our December 2014 price target of \$60 is derived from 10-year discounted cash flow analysis, with a CAPM-derived WACC discount rate of 8.1% and terminal growth of 1.0% (see Figure 3).

Risks to our rating and price target

We believe downside risks to our Overweight rating include: (1) biopharma research budgets coming under more pressure; (2) additional biopharma consolidation which could prove disruptive to the CRO industry; and (3) the continued emphasis on larger, strategic contracts could drive additional pricing pressure.

Figure 2: Q: Model

Income Statement				1QA	2QA	3QA	4QA			1QE	2QE	3QE	4QE			CAGR
USD \$M	2011A	2012A		Mar	Jun	Sep	Dec	2013A		Mar	Jun	Sep	Dec	2014E	2015E	10-15E
Product Development	2,438	2,729		706	724	714	775	2,920		759	782	793	845	3,179	3,370	8.7%
Integrated Healthcare Services	857	964		221	220	218	229	889		230	232	235	243	940	977	4.8%
Total Revenue	3,295	3,692		927	944	933	1,004	3,808		989	1,014	1,028	1,087	4,119	4,347	7.7%
Book-to-Bill	1.23	1.22		1.37	1	1	1	1								
Gross Profit	1,142	1,233		316	327	332	362	1,337		340	353	369	396	1,458	1,542	7.9%
SG&A	(744)	(788)		(198)	(202)	(200)	(233)	(833)		(221)	(225)	(225)	(238)	(909)	(950)	0.0%
EBIT (Operating Income)	398	445		118	124	132	129	504		118	128	144	159	549	592	8.2%
EBITDA	490	544		143	149	160	160	612		143	154	171	187	655	715	8.2%
Pre-Tax Income	296	318		86	92	102	106	385		94	104	120	135	453	503	
Income Taxes	(102)	(112)		(26)	(30)	(29)	(30)	(115)		(28)	(31)	(36)	(40)	(136)	(151)	
Net Income	191	209		58	63	72	76	270		66	74	85	95	320	355	14.5%
Diluted Shares Outstanding	117.9	117.8		118.7	126.6	133.3	132.9	127.9		133.5	134.0	134.5	134.2	134.0	133.2	2.5%
GAAP Diluted EPS	\$ 2.05	\$ 1.51		\$ 0.41	\$ 0.30	\$ 0.50	\$ 0.55	\$ 1.77		\$ 0.48	\$ 0.53	\$ 0.61	\$ 0.69	\$ 2.32	\$ 2.67	
Adjusted Diluted EPS (non-GAAP)	\$ 1.62	\$ 1.77		\$ 0.49	\$ 0.50	\$ 0.54	\$ 0.58	\$ 2.11		\$ 0.50	\$ 0.55	\$ 0.63	\$ 0.71	\$ 2.39	\$ 2.67	11.8%
Gross Margin	34.7%	33.4%		34.1%	34.6%	35.6%	36.1%	35.1%		34.3%	34.8%	35.9%	36.4%	35.4%	35.5%	
change in gross margin (y/y, bp)	-55	-127		+62	+107	+260	+251	+172		+22	+25	+29	+37	+29	+7	
SG&A	22.6%	21.3%		21.4%	21.4%	21.4%	23.2%	21.9%		22.4%	22.2%	21.9%	21.8%	22.1%	21.9%	
Operating Margin	12.1%	12.1%		12.8%	13.1%	14.2%	12.9%	13.2%		12.0%	12.7%	14.0%	14.6%	13.3%	13.6%	
change in op margin (y/y, bp)	-122	-3		+78	+103	+216	+76	+117		-80	-48	-20	+171	+10	+28	
EBITDA Margin	14.9%	14.7%		15.4%	15.8%	17.1%	15.9%	16.1%		14.5%	15.2%	16.6%	17.2%	15.9%	16.5%	
Tax Rate	34.5%	34.9%		39.2%	18.9%	29.1%	27.5%	29.7%		30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	
Profit Margin	5.8%	5.7%		6.3%	6.7%	7.7%	7.6%	7.1%		6.7%	7.3%	8.2%	8.8%	7.8%	8.2%	
Reported Revenue Growth y/y	10.0%	12.1%		4.4%	-0.1%	2.1%	6.2%	3.1%		6.7%	7.4%	10.2%	8.3%	8.1%	5.5%	
EBITDA Growth y/y	1.5%	10.9%		10.3%	7.9%	17.7%	14.0%	12.5%		0.0%	3.5%	7.0%	16.9%	7.1%	9.2%	
EPS Growth y/y	6.0%	9.5%		10.8%	4.8%	20.8%	40.3%	18.8%		1.5%	10.7%	16.7%	23.3%	13.3%	11.6%	

Source: J.P. Morgan estimates, Company data.

Figure 3: Q: DCF Analysis

Projected FY Ending Dec	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Revenue (\$M)	3,808	4,119	4,347	4,632	4,946	5,281	5,639	6,022	6,430	6,867	7,333	7,830
growth y/y		8%	6%	7%	7%	7%	7%	7%	7%	7%	7%	7%
EBIT (\$M)	453	536	592	631	687	748	814	885	962	1,046	1,136	1,234
EBIT margin	12%	13%	14%	14%	14%	14%	14%	15%	15%	15%	15%	16%
Tax-affected EBIT (\$M)	318	375	414	442	481	524	570	620	674	732	795	864
Free Cash Flow	318	364	383	416	459	465	500	550	603	660	721	786
growth y/y		15%	5%	9%	10%	1%	7%	10%	10%	9%	9%	9%

Discount Rate	Discounted Cash Flows (\$M)	PV of Terminal Value (\$M) at a Perpetual Growth Rate of					Enterprise Value (\$M)					Equivalent Terminal EBITDA Multiple (forward 12 mos)				
	2015-2024	0.0%	0.5%	1.0%	1.5%	2.0%	0.0%	0.5%	1.0%	1.5%	2.0%	0.0%	0.5%	1.0%	1.5%	2.0%
7.1%	3,723	5,926	6,404	6,961	7,616	8,399	9,649	10,128	10,684	11,339	12,122	7.3x	7.7x	8.1x	8.6x	9.2x
7.6%	3,630	5,311	5,711	6,172	6,708	7,340	8,941	9,341	9,802	10,339	10,970	6.8x	7.1x	7.4x	7.8x	8.3x
8.1%	3,541	4,781	5,119	5,505	5,949	6,466	8,321	8,660	9,046	9,490	10,007	6.3x	6.5x	6.8x	7.2x	7.6x
8.6%	3,455	4,321	4,609	4,935	5,307	5,736	7,775	8,064	8,390	8,762	9,190	5.9x	6.1x	6.3x	6.6x	6.9x
9.1%	3,372	3,919	4,166	4,444	4,759	5,118	7,290	7,538	7,816	8,131	8,489	5.5x	5.7x	5.9x	6.1x	6.4x
	Net Debt (Cash) (\$M)	Equity Value (\$M)					Equity Value per Share					Terminal Value as a % of Enterprise Value				
		0.0%	0.5%	1.0%	1.5%	2.0%	0.0%	0.5%	1.0%	1.5%	2.0%	0.0%	0.5%	1.0%	1.5%	2.0%
	978	8,671	9,150	9,706	10,362	11,145	\$64.69	\$68.26	\$72.42	\$77.30	\$83.15	61%	63%	65%	67%	69%
	978	7,963	8,364	8,825	9,361	9,992	\$59.41	\$62.40	\$65.84	\$69.84	\$74.55	59%	61%	63%	65%	67%
-	978	7,344	7,682	8,068	8,512	9,029	\$54.79	\$57.31	\$60.19	\$63.51	\$67.36	57%	59%	61%	63%	65%
	978	6,797	7,086	7,412	7,784	8,212	\$50.71	\$52.87	\$55.30	\$58.08	\$61.27	56%	57%	59%	61%	62%
	978	6,313	6,560	6,838	7,153	7,511	\$47.10	\$48.94	\$51.02	\$53.36	\$56.04	54%	55%	57%	59%	60%

Source: J.P. Morgan estimates, Company data.

Quintiles Transnational: Summary of Financials

Income Statement - Annual	FY13A	FY14E	FY15E	FY16E	Income Statement - Quarterly	1Q14E	2Q14E	3Q14E	4Q14E
Revenues	3,808	4,119	4,347	4,632	Revenues	989	1,014	1,028	1,087
Cost of products sold	(2,471)	(2,661)	(2,805)	(2,986)	Cost of products sold	(649)	(661)	(659)	(691)
Gross profit	1,337	1,458	1,542	1,646	Gross profit	340	353	369	396
SG&A	(833)	(909)	(950)	(1,003)	SG&A	(221)	(225)	(225)	(238)
R&D	-	-	-	-	R&D	-	-	-	-
Operating income	504	549	592	643	Operating income	118	128	144	159
EBITDA	612	655	715	783	EBITDA	143	154	171	187
Net interest (income) / expense	-	-	-	-	Net interest (income) / expense	-	-	-	-
Other income / (expense)	(119)	(96)	(89)	(78)	Other income / (expense)	(25)	(24)	(24)	(24)
Income taxes	(116)	(133)	(148)	(166)	Income taxes	(27)	(30)	(35)	(40)
Net income	270	320	355	399	Net income	66	74	85	95
Diluted shares outstanding	128	134	133	132	Diluted shares outstanding	133	134	134	134
Diluted EPS	2.11	2.39	2.67	3.01	Diluted EPS	0.50	0.55	0.63	0.71
Balance Sheet and Cash Flow Data	FY13A	FY14E	FY15E	FY16E	Ratio Analysis	FY13A	FY14E	FY15E	FY16E
Cash and cash equivalents	778	925	993	1,175	Sales growth	3.1%	8.1%	5.5%	6.6%
Accounts receivable	924	904	954	1,017	EBIT growth	13.2%	9.0%	7.7%	8.7%
Inventories	0	0	0	0	EPS growth	18.8%	13.3%	11.6%	12.9%
Other current assets	241	241	241	241	Gross margin	35.1%	35.4%	35.5%	35.5%
Current assets	1,946	2,073	2,191	2,436	EBIT margin	13.2%	13.3%	13.6%	13.9%
PP&E	200	290	370	445	EBITDA margin	16.1%	15.9%	16.5%	16.9%
Total assets	3,067	3,232	3,379	3,646	Tax rate	30.0%	29.3%	29.4%	29.4%
Total debt	2,046	1,946	1,746	1,546	Net margin	7.1%	7.8%	8.2%	8.6%
Total liabilities	3,734	3,641	3,489	3,348	Net Debt / EBITDA	207.3%	155.8%	105.3%	47.4%
Shareholders' equity	(667)	(409)	(110)	298	Net Debt / Capital (book)	211.1%	166.9%	117.1%	55.4%
Net income (including charges)	226	310	354	397	Return on assets (ROA)	9.7%	10.2%	10.7%	11.3%
D&A	108	106	124	140	Return on equity (ROE)	(26.6%)	(59.5%)	(136.7%)	423.7%
Change in working capital	60	27	(3)	(4)	Enterprise value / sales	-	-	-	-
Other	4	11	11	11	Enterprise value / EBITDA	-	-	-	-
Cash flow from operations	397	454	486	545	Free cash flow yield	4.7%	4.5%	4.9%	5.6%
Capex	(92)	(144)	(152)	(162)					
Free cash flow	305	310	333	382					
Cash flow from investing activities	(240)	(144)	(152)	(162)					
Cash flow from financing activities	71	(163)	(266)	(200)					
Dividends	0	0	0	0					
Dividend yield	-	-	-	-					

Source: Company reports and J.P. Morgan estimates.

Note: \$ in millions (except per-share data). Fiscal year ends Dec

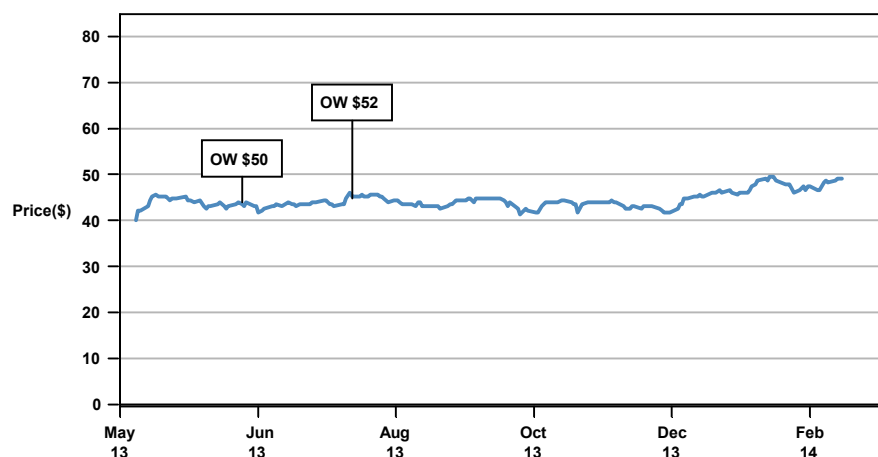
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Quintiles Transnational (Q, Q US) Price Chart



Date	Rating	Share Price (\$)	Price Target (\$)
18-Jun-13	OW	43.89	50.00
01-Aug-13	OW	44.85	52.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Jun 18, 2013.

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

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