

Quintiles Transnational

1Q14 Review: Strong Quarter with Record Bookings; Reiterate Overweight and \$60 PT

Quintiles (Q) reported strong 1Q results, with the top and bottom line coming in above expectations, led by strength in Product Development. The company also raised FY14 sales and adj. EPS guidance above consensus to \$4.13-4.19B (+8.4%-10.0% cc growth) and \$2.45-\$2.58, respectfully, while also posting solid book-to-bill metrics across both Product Development and Integrated Healthcare Services and reporting a record +\$10.1B backlog. On the call, management cited optimism in its ability to capitalize on recent consolidation trends in pharma as well as the recently-announced strategic partnership with Biogen Idec. We are encouraged by the return to growth in IHS and the company's ability to drive cost out of the model, with scale and the global footprint. With little to change the investment debate, we maintain our Overweight rating and December 2014 price target of \$60.

- **Top-line beat led by Product Development, while IHS returns to growth.**

1Q service revenues of \$1,005M (+8.4% cc growth y/y including a ~\$33M contribution from the Novella acquisition) came in above the Street (\$996M) and JPMe (\$989M), with strength in both Product Development and Integrated Health Services. By segment, Product Development revenue grew +8.6% cc to \$771M (vs. JPMe \$759M), due to growth in core clinical services volumes in NA, clinical trial support services, global labs volumes, and the Novella acquisition, partially offset by the conclusion of a large clinical solutions project. Integrated Health revenue grew +7.9% cc to \$234M (vs. JPMe \$230M), due to increases in Japan and NA, as well as growth in real-world and late phase research services. On the bottom line, adjusted EPS of \$0.68 came in well above both consensus (\$0.55) and JPMe (\$0.50).

- **New backlog milestone and strong cross-segment book-to-bills extend rationale for optimism.**

Net new business and book-to-bill ratios were healthy across both segments, with Product Development at 1.30x and IHS at 1.15x. The company reached a new milestone with a record backlog of \$10.1B at the end of the quarter. On the call, management noted that it continues to see significant demand for observational real world and late-phase research services in HIS, marked by a third consecutive quarter of strong bookings in the segment. Notably, the strength in observational studies has been seen among both traditional customers (i.e. pharma), but increasingly, from non-traditional ones as well (for example, Quintiles recently oversaw the NFL concussion study).

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

FYE Dec	2013A	2014E (Prev)	2014E (Curr)	2015E (Prev)	2015E (Curr)
EPS (\$)					
Q1 (Mar)	0.49	0.50	0.68A	0.55	0.65
Q2 (Jun)	0.50	0.55	0.62	0.61	0.70
Q3 (Sep)	0.54	0.63	0.62	0.71	0.70
Q4 (Dec)	0.58	0.71	0.65	0.79	0.74
FY	2.11	2.39	2.56	2.67	2.78

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

See page 8 for analyst certification and important disclosures.

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Overweight

Q, Q US

Price: \$48.76

Price Target: \$60.00

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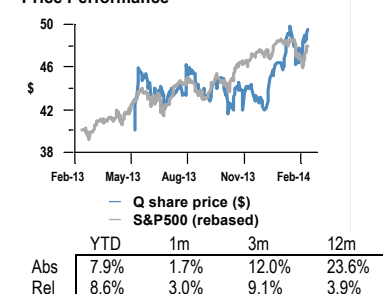
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Price Performance



Company Data

Price (\$)	48.76
Date Of Price	01-May-14
52-week Range (\$)	55.00-40.00
Market Cap (\$ mn)	6,487.03
Fiscal Year End	Dec
Shares O/S (mn)	133
Price Target (\$)	60.00
Price Target End Date	31-Dec-14

- **Consolidation considerations and a new strategic partner...** Management was upfront about its position in regards to the recent consolidation announcements in the pharmaceutical industry, as like most companies, Quintiles believes that it maintains a position of strength from the diversified customer base (in this case, >500 biopharma companies with no customer accounting for more than 10% of sales). Management also sees cost preservation as a motivation of M&A, and believes this will result in further outsourcing to capable CROs such as Quintiles. Along those lines, the company used the call to highlight a recently-announced strategic partnership with Biogen Idec, while noting that such partnerships utilize a broad range of development services and capabilities from planning and design through clinical execution, as well as observational research.
- **2014 guidance comes in above consensus.** Quintiles updated 2014 service revenue guidance from \$4.09-4.15B to \$4.13-4.19B (vs. consensus of \$4.12B), with the majority of the increase attributable to a return to growth in the IHS segment. Margins are expected to continue to expand due to continuing progress with productivity improvement, resource management, geographical positioning in low cost countries, and risk-based monitoring initiatives, while the tax rate is expected to be ~30%. The company also updated 2014 adjusted EPS guidance from \$2.33-\$2.46 to \$2.45-\$2.58 (vs. consensus of \$2.42), while GAAP EPS is now expected to be in the range of \$2.38-\$2.52, due to \$12-14M in restructuring expense and a ~\$4M tax adjustment.
- **Maintain Overweight rating.** We are updating our model for the quarter and increasing estimates for the return to growth in IHS and other commentary from the quarter. We continue to believe the company is in position to grow through strategic partnerships and to drive cost out of the model with its scale, technical capabilities, and global footprint. As such, we reiterate our Overweight rating and December 2014 price target of \$60 (based on a CAPM-derived WACC of 8.2% and terminal growth of 1%). For additional thoughts on the investment thesis, please see our initiation [report](#).

Figure 1: Q: 1Q14 Variance

	Figure 1: Q1, Q4 Variance												
	1Q13A		1Q14E				1Q14A				Variance		Notes
	Actual		JPM Estimate		Consensus		Actual		Change y/y		vs. JPM Est.		
	\$ M	%	\$ M	%	\$ M	%	\$ M	%	Δ \$	Δ margin	\$ M	%	
Product Development	706		759				771		9.1%		12		- +8.9% constant currency
Integrated Health	221		230				234		6.0%		5		- +7.9% constant currency
Total Revenue	927		989		996		1,005		8.4%		16		- +8.4% constant currency
Gross Profit	316	34.1%	340	34.3%			362	36.0%	14.3%	184 bp	22	162 bp	
SG&A	(198)	21.4%	(221)	22.4%			(219)	21.8%	10.6%	44 bp	2	-58 bp	
Adj. Operating Income	118	12.8%	118	12.0%			142	14.2%	20.3%	140 bp	24	220 bp	
Income Tax	(26)	30.3%	(28)	30.0%			(38)	30.4%	44.8%	9 bp	(10)	42 bp	
Adjusted Net Income	58	6.3%	66	6.7%			91	9.0%	56.3%	277 bp	25	233 bp	
Diluted Shares	118.7M		133.5M				133.0M		12.0%		-0.4M		
GAAP EPS	\$0.41		\$0.48				\$0.68		66.6%		\$0.20		
Adjusted Diluted EPS	\$0.49		\$0.50		\$0.55		\$0.68		39.5%		\$0.19		
2014 Annual Guidance											Other Topics		

2014 Guidance

Revenue: \$4.13-4.19B (8.4-10.0% cc growth) [Raised]

Adjusted EPS: \$2.45-2.58 (16.7%-22.9% y/y) [Raised]

GAAP EPS: \$2.38-2.52

Tax rate: ~30%

- Estimates assume 4Q13 ending FX rates

- Increase in sales guidance driven by IHS growth

1Q14 Book-to-Bill:

- Overall B2B: 1.27x

- Product Development - 1.30x

- Integrated Healthcare Services: 1.15x

- Ending Backlog: \$10.1B; Record and largest in the industry

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

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

We are maintaining our December 2014 price target of \$60 based on a 10-year discounted cash flow analysis, with a CAPM-derived WACC discount rate of 8.2% and terminal growth of 1.0% (see Figure 3).

Risks to 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			1QA	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		771	797	793	829	3,189	3,429	9.1%
Integrated Healthcare Services	857	964		221	220	218	229	889		234	239	238	251	962	1,041	6.1%
Total Revenue	3,295	3,692		927	944	933	1,004	3,808		1,005	1,035	1,031	1,080	4,152	4,470	8.3%
Book-to-Bill	1.23	1.22		1.37	1	1	1	1		1						
Gross Profit	1,142	1,233		316	327	332	362	1,337		362	379	376	393	1,509	1,626	9.0%
SG&A	(744)	(788)		(198)	(202)	(200)	(233)	(833)		(219)	(227)	(224)	(235)	(906)	(966)	0.0%
EBIT (Operating Income)	398	445		118	124	132	129	504		142	151	152	158	603	660	10.6%
EBITDA	490	544		143	149	160	160	612		171	176	177	185	710	780	10.1%
Pre-Tax Income	296	318		86	92	102	106	385		124	127	127	134	512	570	
Income Taxes	(102)	(112)		(26)	(30)	(29)	(30)	(115)		(38)	(38)	(38)	(40)	(154)	(172)	
Net Income	191	209		58	63	72	76	270		91	90	90	94	365	402	17.4%
Diluted Shares Outstanding	117.9	117.8		118.7	126.6	133.3	132.9	127.9		133.0	145.1	145.6	145.3	142.3	144.3	4.1%
GAAP Diluted EPS	\$ 2.05	\$ 1.51		\$ 0.41	\$ 0.30	\$ 0.50	\$ 0.55	\$ 1.77		\$ 0.68	\$ 0.60	\$ 0.60	\$ 0.63	\$ 2.51	\$ 2.78	
Adjusted Diluted EPS (non-GAAP)	\$ 1.62	\$ 1.77		\$ 0.49	\$ 0.50	\$ 0.54	\$ 0.58	\$ 2.11		\$ 0.68	\$ 0.62	\$ 0.62	\$ 0.65	\$ 2.56	\$ 2.78	12.7%
Gross Margin	34.7%	33.4%		34.1%	34.6%	35.6%	36.1%	35.1%		36.0%	36.6%	36.5%	36.4%	36.3%	36.4%	
change in gross margin (y/y, bp)	-55	-127		+62	+107	+260	+251	+172		+184	+199	+85	+32	+124	+4	
SG&A	22.6%	21.3%		21.4%	21.4%	21.4%	23.2%	21.9%		21.8%	22.0%	21.8%	21.8%	21.8%	21.6%	
Operating Margin	12.1%	12.1%		12.8%	13.1%	14.2%	12.9%	13.2%		14.1%	14.6%	14.7%	14.5%	14.5%	14.8%	
change in op margin (y/y, bp)	-122	-3		+78	+103	+216	+76	+117		+140	+148	+50	+173	+129	+25	
EBITDA Margin	14.9%	14.7%		15.4%	15.8%	17.1%	15.9%	16.1%		17.1%	17.0%	17.2%	17.1%	17.1%	17.5%	
Tax Rate	34.5%	34.9%		39.2%	18.9%	29.1%	27.5%	29.7%		30.5%	30.0%	30.0%	30.0%	30.1%	30.1%	
Profit Margin	5.8%	5.7%		6.3%	6.7%	7.7%	7.6%	7.1%		9.0%	8.7%	8.7%	8.7%	8.8%	9.0%	
Reported Revenue Growth y/y	10.0%	12.1%		4.4%	-0.1%	2.1%	6.2%	3.1%		8.4%	9.7%	10.5%	7.6%	9.0%	7.7%	
EBITDA Growth y/y	1.5%	10.9%		10.3%	7.9%	17.7%	14.0%	12.5%		19.9%	18.1%	11.0%	15.6%	16.0%	10.0%	
EPS Growth y/y	6.0%	9.5%		10.8%	4.8%	20.8%	40.3%	18.8%		39.5%	24.2%	14.4%	12.9%	21.7%	8.5%	

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

Figure 3: Q: DCF Analysis

Target Period: **Dec 2014**

Projected FY Ending Dec	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Revenue (\$M)	3,808	4,152	4,470	4,783	5,099	5,431	5,784	6,138	6,506	6,847	7,205	7,528
growth y/y		9%	8%	7%	7%	6%	6%	6%	6%	5%	5%	4%
EBIT (\$M)	453	590	660	705	764	826	894	962	1,036	1,104	1,177	1,243
EBIT margin	12%	14%	15%	15%	15%	15%	15%	16%	16%	16%	16%	17%
Tax-affected EBIT (\$M)	318	412	461	493	534	578	625	673	724	772	822	869
Free Cash Flow	318	387	423	465	511	523	559	614	665	721	771	819
growth y/y		22%	9%	10%	10%	2%	7%	10%	8%	8%	7%	6%

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%
7.2%	4,074	6,037	6,518	7,076	7,732	8,512	10,111	10,592	11,150	11,806	12,586	7.5x	7.8x	8.3x	8.7x	9.3x
7.7%	3,974	5,415	5,819	6,282	6,820	7,451	9,389	9,792	10,256	10,793	11,425	7.0x	7.3x	7.6x	8.0x	8.5x
8.2%	3,877	4,879	5,220	5,609	6,055	6,574	8,756	9,097	9,486	9,932	10,450	6.5x	6.7x	7.0x	7.4x	7.7x
8.7%	3,784	4,413	4,704	5,033	5,408	5,838	8,196	8,488	8,817	9,191	9,622	6.1x	6.3x	6.5x	6.8x	7.1x
9.2%	3,694	4,005	4,255	4,536	4,854	5,215	7,699	7,949	8,230	8,547	8,908	5.7x	5.9x	6.1x	6.3x	6.6x
	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%
	926	9,186	9,667	10,224	10,880	11,660	\$64.57	\$67.95	\$71.87	\$76.48	\$81.97	60%	62%	63%	65%	68%
	926	8,463	8,867	9,330	9,867	10,499	\$59.49	\$62.33	\$65.58	\$69.36	\$73.80	58%	59%	61%	63%	65%
	926	7,830	8,171	8,560	9,007	9,525	\$55.04	\$57.44	\$60.17	\$63.31	\$66.95	56%	57%	59%	61%	63%
	926	7,271	7,562	7,891	8,266	8,696	\$51.11	\$53.16	\$55.47	\$58.10	\$61.13	54%	55%	57%	59%	61%
	926	6,773	7,023	7,304	7,622	7,983	\$47.61	\$49.37	\$51.35	\$53.58	\$56.11	52%	54%	55%	57%	59%

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

Quintiles Transnational: Summary of Financials

Income Statement - Annual	FY13A	FY14E	FY15E	FY16E	Income Statement - Quarterly	1Q14A	2Q14E	3Q14E	4Q14E
Revenues	3,808	4,152	4,470	4,783	Revenues	1,005A	1,035	1,031	1,080
Cost of products sold	(2,471)	(2,643)	(2,844)	(3,043)	Cost of products sold	(644)A	(657)	(655)	(687)
Gross profit	1,337	1,509	1,626	1,740	Gross profit	362A	379	376	393
SG&A	(833)	(906)	(966)	(1,023)	SG&A	(219)A	(227)	(224)	(235)
R&D	-	-	-	-	R&D	-	-	-	-
Operating income	504	603	660	717	Operating income	142A	151	152	158
EBITDA	612	710	780	854	EBITDA	171A	176	177	185
Net interest (income) / expense	-	-	-	-	Net interest (income) / expense	-	-	-	-
Other income / (expense)	(119)	(91)	(90)	(79)	Other income / (expense)	(19)A	(25)	(24)	(24)
Income taxes	(116)	(147)	(168)	(189)	Income taxes	(33)A	(37)	(37)	(39)
Net income	270	365	402	449	Net income	91A	90	90	94
Diluted shares outstanding	128	142	144	143	Diluted shares outstanding	133A	145	146	145
Diluted EPS	2.11	2.56	2.78	3.13	Diluted EPS	0.68A	0.62	0.62	0.65
Balance Sheet and Cash Flow Data	FY13A	FY14E	FY15E	FY16E	Ratio Analysis	FY13A	FY14E	FY15E	FY16E
Cash and cash equivalents	778	1,005	1,112	1,343	Sales growth	3.1%	9.0%	7.7%	7.0%
Accounts receivable	924	898	966	1,034	EBIT growth	13.2%	19.6%	9.5%	8.6%
Inventories	0	0	0	0	EPS growth	18.8%	21.7%	8.5%	12.4%
Other current assets	241	255	255	255	Gross margin	35.1%	36.3%	36.4%	36.4%
Current assets	1,946	2,161	2,337	2,635	EBIT margin	13.2%	14.5%	14.8%	15.0%
PP&E	200	267	356	433	EBITDA margin	16.1%	17.1%	17.5%	17.9%
Total assets	3,067	3,308	3,520	3,844	Tax rate	30.0%	28.7%	29.5%	29.6%
Total debt	2,046	1,972	1,772	1,572	Net margin	7.1%	8.8%	9.0%	9.4%
Total liabilities	3,734	3,641	3,508	3,373	Net Debt / EBITDA	207.3%	136.2%	84.6%	26.8%
Shareholders' equity	(667)	(333)	12	471	Net Debt / Capital (book)	211.1%	152.6%	98.2%	32.7%
Net income (including charges)	226	355	400	448	Return on assets (ROA)	9.7%	11.4%	11.8%	12.2%
D&A	108	107	120	137	Return on equity (ROE)	(26.6%)	(72.9%)	(250.1%)	185.7%
Change in working capital	60	6	(2)	(3)	Enterprise value / sales	-	-	-	-
Other	4	(1)	11	11	Enterprise value / EBITDA	-	-	-	-
Cash flow from operations	397	468	529	594	Free cash flow yield	4.9%	4.9%	5.3%	6.2%
Capex	(92)	(128)	(156)	(163)					
Free cash flow	305	340	373	431					
Cash flow from investing activities	(240)	(124)	(156)	(163)					
Cash flow from financing activities	71	(117)	(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

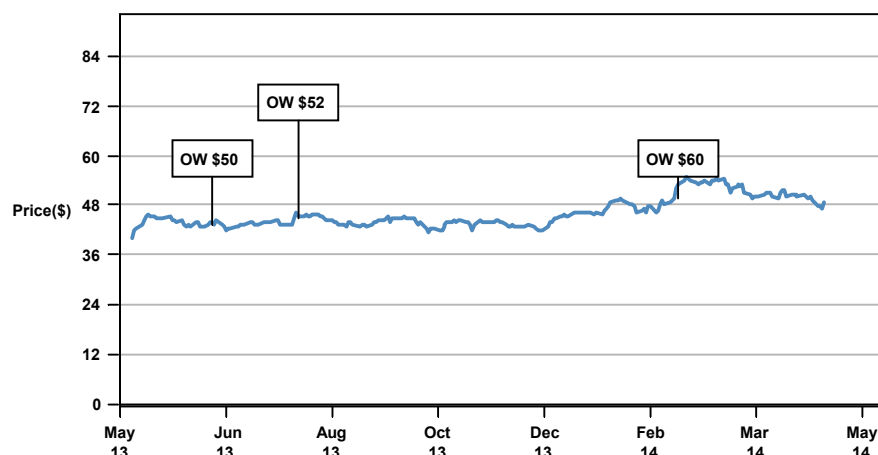
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Quintiles Transnational (Q, Q US) Price Chart



Date	Rating	Share Price (\$)	Price Target (\$)
18-Jun-13	OW	43.53	50.00
01-Aug-13	OW	44.85	52.00
13-Feb-14	OW	49.44	60.00

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

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