

Equity Research

Quintiles Transnational Holdings, Inc.

Q: Q4 2013 Earnings Full Analysis

• **What to do from here.** Quintiles' strong Q4 results and guidance validate our conviction in the robust health of the pharma outsourcing industry. We believe the company is well-positioned for outperformance in 2014, and we continue recommending owning the stock. Raising our 2014E EPS to \$2.39 from \$2.30 and establishing 2015E EPS of \$2.68. Raising our valuation range to \$56-60 from \$52-54.

• **Financial highlights.** Quintiles reported a strong Q4, beating both revenue and EPS consensus by 2% and 5% respectively. Organic, constant currency growth in the PDEV segment was the primary driver of the revenue outperformance. Consolidated margin was in-line with expectations, with very strong margin performance in the PDEV segment offsetting weaker IHS margins and higher corporate overhead. Lower-than-expected interest expense also contributed to the EPS beat. Bookings also beat expectations in both segments, bringing the consolidated book-to-bill to a strong 1.29, and positioning Q for a strong 2014.

• **Guidance highlights.** The company issued 2014 EPS guidance of \$2.33-2.46 on revenues of \$4.09-4.15B. We believe the revenue guidance may be a bit conservative as it seems to imply a further reduction in backlog conversion (assuming a 2014 book-to-bill of 1.21, in-line with recent years), and the company has 85% of revenue already in backlog (compared to 81% this time last year). Margin expansion will likely be more limited in 2014 (we estimate 20 bps), compared to 2013 (110 bps), but deleveraging should also help EPS growth.

• **Read-throughs.** By virtue of its size and diversity, Quintiles is a bellwether for the clinical CRO industry. The strength seen in Q4 and the relatively robust 2014 guidance give us conviction that clinical CROs (PRXL, ICLR, CVD) should continue to outperform over the next twelve months.

Valuation Range: \$56.00 to \$60.00 from \$52.00 to \$54.00

Our valuation range is DCF-based (WACC = 8.0%; terminal NOPLAT growth = 2%) and represents 24x our 2014 EPS estimate. Risks include: (1) project cancellations or delays due to client M&A, economic weakness, pipeline reprioritization, or compound failure; (2) a reversal in the trend toward increased outsourcing; (3) lack of improvement in the IHS segment; (4) margin pressure from strategic relationships; (5) foreign exchange volatility; and (6) large insider ownership.

Investment Thesis:

We believe Quintiles is a leader in several capacities (size, operational efficiency, strategic savvy) in a secular growth industry, creating a favorable risk/reward profile for long-term holders.

Outperform / V

Sector: Outsourced Services

Market Weight

Earnings Estimates Revised Up

EPS	2013A	2014E		2015E	
		Curr.	Prior	Curr.	Prior
Q1 (Mar.)	\$0.49	\$0.57	0.56	\$0.65	
Q2 (June)	0.50	0.59	0.56	0.67	
Q3 (Sep.)	0.54	0.61	0.57	0.68	
Q4 (Dec.)	0.58	0.61	NC	0.69	
FY	\$2.10	\$2.39	2.30	\$2.68	
CY	\$2.10	\$2.39		\$2.68	
FY P/E	24.6x	21.6x		19.2x	
Rev.(MM)	\$3,808	\$4,123		\$4,418	

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters
 NA = Not Available, NC = No Change, NE = No Estimate, NM = Not Meaningful
 V = Volatile, * = Company is on the Priority Stock List

Ticker	Q
Price (02/13/2014)	\$51.55
52-Week Range:	\$40-52
Shares Outstanding: (MM)	128.9
Market Cap.: (MM)	\$6,644.8
S&P 500:	1,823.98
Avg. Daily Vol.:	438,308
Dividend/Yield:	\$0.00/0.0%
LT Debt: (MM)	\$2,046.0
LT Debt/Total Cap.:	NM
ROE:	NM
3-5 Yr. Est. Growth Rate:	11.0%
CY 2014 Est. P/E-to-Growth:	2.0x
Last Reporting Date:	02/13/2014

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters

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Please see page 5 for rating definitions, important disclosures and required analyst certifications

All estimates/forecasts are as of 02/13/14 unless otherwise stated.

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Together we'll go far



Company Description:

Based in Durham, North Carolina, Quintiles Transnational Holdings, Inc. is the largest contract research organization by revenue, providing both clinical trial management services and contract sales services to pharmaceutical and biotechnology clients. The company operates in two segments: Product Development (PDEV) and Integrated Health Services (IHS). PDEV provides a range of clinical trial services including study design, investigator recruitment, site start-up, patient recruitment, clinical monitoring, project management, phase I, bioanalytical services, biostatics, central lab, genomics services, strategic planning, and a range of consulting services. The vast majority of the IHS business consists of contract sales and related commercial services, but the segment also contains peri-approval clinical trial services as well as services provided to payers and healthcare providers. In addition to being the industry's largest CRO, Quintiles is differentiated from peers by its exposure to the contract sales business.

Exhibit 1. Quintiles Stat Tracker

Bookings & Backlog (MM)	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13
Beginning backlog	\$ 8,088	\$ 8,028	\$ 8,153	\$ 8,704	\$ 9,000	\$ 9,034	\$ 9,583
PDEV net bookings	746	790	1,086	1,075	871	862	964
IHS net bookings	154	252	421	170	143	479	335
Ending backlog	\$ 8,028	\$ 8,153	\$ 8,704	\$ 9,000	\$ 9,034	\$ 9,583	\$ 9,900
PDEV book-to-bill	1.08	1.17	1.54	1.52	1.20	1.21	1.24
IHS book-to-bill	0.61	1.07	1.74	0.77	0.65	2.19	1.46
Total book-to-bill	0.95	1.14	1.59	1.34	1.07	1.44	1.29

Source: Company filings; Wells Fargo Securities, LLC

Exhibit 2. Guidance Table

Guidance	Q1 2013	Q2 2013	Q3 2013	Q4 2013	CY 2013	Notes
Revenue (B)						
8/1/2013					\$3.76-3.81	4.1-4.9% CC
10/31/2013					\$3.77-3.80	
Tax rate						
8/1/2013					30-32%	
10/31/2013					30%	
Non-GAAP EPS						
8/1/2013					\$1.95-2.05	
10/31/2013					\$2.03-2.09	

Source: Company press releases and transcripts; Wells Fargo Securities, LLC

Exhibit 3. Q4 2013 Variance Table

FY ending December In millions except EPS	Actual		Est	Actual	Cons	Yr / Yr change	Seq change
	Q4 2012	Q3 2013	Q4 2013	Q4 2013	Q4 2013		
Total revenue	946	\$ 933	\$ 983	\$ 1,004	\$ 982	6.2%	7.6%
Cost of products and services	628	601	633	642		2.1%	6.9%
Gross profit	317	332	350	362		14.1%	9.0%
Selling, general & administrative	203	200	223	233		14.8%	16.6%
Operating income	115	132	127	129		12.8%	(2.5%)
Interest expense (income)	37	28	28	25		(31.6%)	(8.7%)
Other expense (income)	1	3	-	(2)			
Pretax income	76	102	100	106		37.9%	3.8%
Taxes	28	29	28	30		5.3%	0.2%
Income before equity earnings	48	72	71	76		56.9%	5.3%
Equity earnings	(0)	(0)	-	0			
Net income (continuing ops)	48	72	71	76		58.6%	6.5%
Noncont. interests income (loss)	0	0	-	(0)			
NI to common	\$ 48	\$ 72	\$ 71	\$ 76		58.2%	6.3%
Non-GAAP EPS	\$ 0.41	\$0.54	\$0.54	\$ 0.58	\$ 0.55	40.7%	6.6%
Diluted shares outstanding	118	133	132	133		12.5%	(0.3%)
EBITDA	\$ 140	\$ 160	\$ 152	\$ 160		14.0%	(0.0%)
MARGIN ANALYSIS						Yr / Yr	Seq
Cost of sales / net revenue	66.5%	64.4%	64.4%	63.9%		(250) bps	(50) bps
Gross margin	33.5%	35.6%	35.6%	36.1%		250 bps	50 bps
SG&A / net revenue	21.4%	21.4%	22.7%	23.2%		180 bps	180 bps
EBIT margin	12.1%	14.2%	12.9%	12.9%		80 bps	(130) bps
Pretax margin	8.1%	10.9%	10.1%	10.5%		240 bps	(40) bps
Tax rate	36.7%	29.0%	28.6%	28.0%		(870) bps	(100) bps
Net margin from continuing ops	5.1%	7.7%	7.2%	7.6%		250 bps	(10) bps
EBITDA margin	14.8%	17.1%	15.5%	15.9%		110 bps	(120) bps
SEGMENT ANALYSIS						Yr / Yr	Seq
PDEV Segment Revenue	\$ 703	\$ 714	\$ 756	\$ 775	\$ 744	10.2%	8.5%
Growth: core		5.0%	4.5%	7.0%			
Growth: FX		(0.8%)	(0.7%)	(0.5%)			
Growth: acq/div/other		1.3%	3.7%	3.7%			
Revenue growth: total	8.3%	5.5%	7.5%	10.2%			
Gross profit	\$ 272	\$ 288	305	\$ 319		17.4%	10.8%
Gross margin	38.7%	40.3%	40.3%	41.2%		250 bps	80 bps
Operating income	\$ 125	\$ 141	\$ 142	\$ 153		21.9%	8.7%
Operating margin	17.8%	19.7%	18.8%	19.7%		190 bps	0 bps
IHS Segment Revenue	\$ 243	\$ 218	\$ 227	\$ 229	\$ 240	(5.7%)	4.8%
Growth: core		(2.3%)	(2.0%)	(1.1%)			
Growth: FX		(5.2%)	(4.5%)	(4.6%)			
Growth: acq/div/other		0.0%	0.0%	0.0%			
Revenue growth: total	8.8%	(7.6%)	(6.5%)	(5.7%)			
Gross profit	\$ 45	\$ 44	\$ 45	\$ 43		(5.5%)	(2.5%)
Gross margin	18.7%	20.1%	20.0%	18.7%		0 bps	(140) bps
Operating income	\$ 14	\$ 12	\$ 12	\$ 12		(13.8%)	0.4%
Operating margin	5.6%	5.3%	5.5%	5.1%		(50) bps	(20) bps
Consolidated Revenue	\$ 946	\$ 933	\$ 983	\$ 1,004	\$ 982	6.2%	7.6%
Growth: core		3.1%	2.8%	5.0%			
Growth: FX		(1.9%)	(1.7%)	(1.5%)			
Growth: acq/div/other		1.0%	2.7%	2.7%			
Revenue growth: total	8.4%	2.1%	3.9%	6.2%			
Corp. overhead, non-GAAP	\$ (37)	\$ (20)	\$ (28)	\$ (35)		(5.3%)	78.7%
% of total revenue	(4.0%)	(2.1%)	(2.8%)	(3.5%)		(40) bps	140 bps
BOOKINGS & BACKLOG						Yr / Yr	Seq
Ending backlog	\$ 8,704	\$ 9,583	\$ 9,776	\$ 9,900	\$ 9,700	13.7%	3.3%
PDEV net bookings	\$ 1,086	\$ 862	\$ 923	\$ 964		(11.2%)	11.8%
IHS net bookings	\$ 421	\$ 479	\$ 253	\$ 335		(20.5%)	(30.1%)
Total net bookings	\$ 1,507	\$ 1,341	\$ 1,176	\$ 1,299	\$ 1,210	(13.8%)	(3.1%)
PDEV book-to-bill	1.54	1.21	1.22	1.24			
IHS book-to-bill	1.74	2.19	1.11	1.46			
Total net book-to-bill	1.59	1.44	1.20	1.29	1.23		

Source: FactSet (consensus); Company data; Wells Fargo Securities, LLC estimates

Exhibit 4. Earnings Model

Quintiles Quarterly Data (Year Ending December)

In millions, except EPS

NON-GAAP INCOME STATEMENT	2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013	Q1 2014E	Q2 2014E	Q3 2014E	Q4 2014E	2014E	2015E
Total net revenue	\$ 3,692	\$ 927	\$ 944	\$ 933	\$ 1,004	\$ 3,808	\$ 1,001	\$ 1,030	\$ 1,042	\$ 1,050	\$ 4,123	\$ 4,418
Direct costs	2,459	611	618	601	642	2,471	644	662	669	675	2,649	2,832
Gross profit	1,233	316	327	332	362	1,337	357	368	373	375	1,473	1,586
SG&A	788	198	202	200	233	833	224	230	233	235	922	980
Operating income	445	118	124	132	129	504	134	138	140	141	552	606
Interest expense (income), net	131	36	31	28	25	120	24	24	24	24	97	92
Other expense (income), net	(4)	(2)	1	3	(2)	(0)	-	-	-	-	-	-
Pretax income	318	85	92	102	106	385	109	113	116	117	455	514
Provision for income taxes	112	26	30	29	30	115	33	34	35	35	136	154
Income before equity earnings	\$ 205	\$ 59	\$ 62	\$ 72	\$ 76	\$ 270	\$ 77	\$ 79	\$ 81	\$ 82	\$ 318	\$ 360
Equity earnings	3	(2)	0	(0)	0	(1)	-	-	-	-	-	-
NI from continuing ops	\$ 208	\$ 57	\$ 63	\$ 72	\$ 76	\$ 268	\$ 77	\$ 79	\$ 81	\$ 82	\$ 318	\$ 360
Loss (income) to noncont. interests	1	0	0	0	0	1	-	-	-	-	-	-
NI to common	\$ 209	\$ 58	\$ 63	\$ 72	\$ 76	\$ 269	\$ 77	\$ 79	\$ 81	\$ 82	\$ 318	\$ 360
Non-GAAP EPS	\$ 1.77	\$ 0.49	\$ 0.50	\$ 0.54	\$ 0.58	\$ 2.10	\$ 0.57	\$ 0.59	\$ 0.61	\$ 0.61	\$ 2.39	\$ 2.68
Diluted shares outstanding	118	119	127	133	133	128	133	133	133	134	133	134
EBITDA	\$ 544	\$ 143	\$ 149	\$ 160	\$ 160	\$ 612	\$ 162	\$ 166	\$ 169	\$ 170	\$ 666	\$ 716

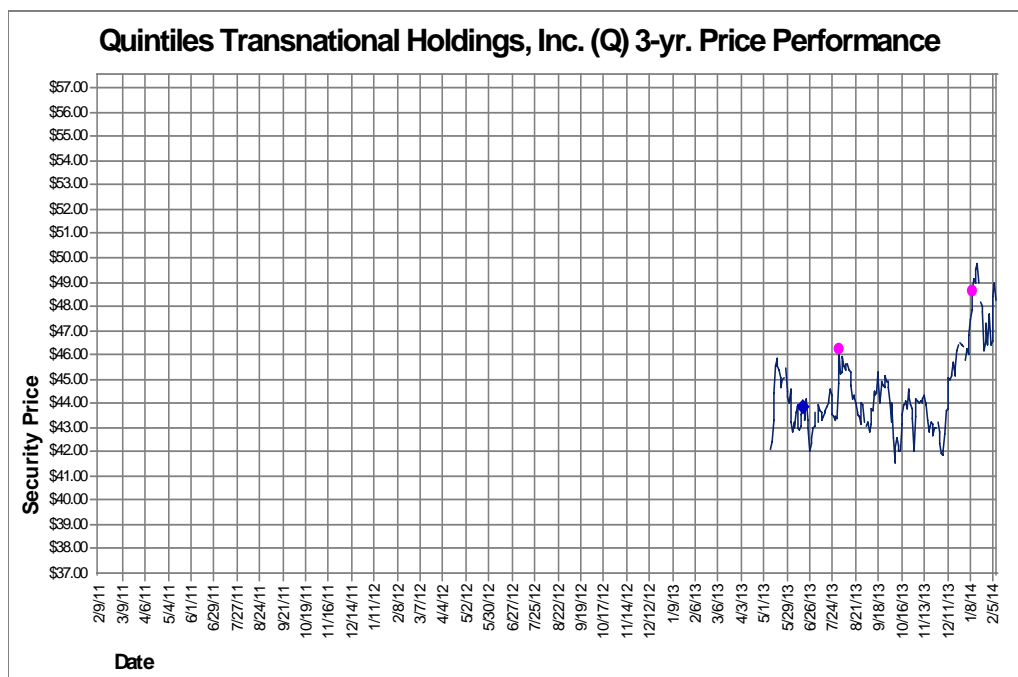
MARGIN ANALYSIS												
Direct costs	66.6%	65.9%	65.4%	64.4%	63.9%	64.9%	64.3%	64.3%	64.2%	64.3%	64.3%	64.1%
Gross margin	33.4%	34.1%	34.6%	35.6%	36.1%	35.1%	35.7%	35.7%	35.8%	35.7%	35.7%	35.9%
SG&A / revenue	21.3%	21.3%	21.4%	21.4%	23.2%	21.9%	22.3%	22.3%	22.4%	22.4%	22.4%	22.2%
Operating margin	12.1%	12.8%	13.1%	14.2%	12.9%	13.2%	13.4%	13.4%	13.4%	13.4%	13.4%	13.7%
Pretax margin	8.6%	9.2%	9.8%	10.9%	10.5%	10.1%	10.9%	11.0%	11.1%	11.1%	11.0%	11.6%
Tax rate	35.3%	30.5%	32.6%	29.0%	28.0%	29.9%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%
Net margin	5.7%	6.2%	6.7%	7.7%	7.6%	7.1%	7.6%	7.7%	7.8%	7.8%	7.7%	8.1%
EBITDA margin	14.7%	15.4%	15.8%	17.1%	15.9%	16.1%	16.1%	16.1%	16.2%	16.2%	16.2%	16.2%

SEGMENT ANALYSIS												
PDEV	\$2,729	\$ 706	\$ 724	\$ 714	\$ 775	\$2,920	\$ 773	\$ 795	\$ 812	\$ 813	\$3,193	\$3,432
PDEV growth: core	12.1%	7.8%	4.9%	5.2%	6.1%	6.0%	5.0%	5.0%	9.5%	5.0%	6.1%	7.5%
PDEV growth: FX	(1.5%)	(1.0%)	(1.2%)	(0.8%)	(0.4%)	(0.9%)	(0.1%)	0.4%	0.2%	(0.1%)	0.1%	0.0%
PDEV growth: acquisitions	1.4%	0.9%	0.9%	1.1%	4.6%	1.9%	4.5%	4.4%	3.9%	0.0%	3.2%	0.0%
PDEV growth: total	11.9%	7.6%	4.6%	5.5%	10.2%	7.0%	9.4%	9.8%	13.6%	4.9%	9.4%	7.5%
Gross profit	\$ 1,045	\$ 277	\$ 295	\$ 288	\$ 319	\$ 1,180	\$ 313	\$ 322	\$ 329	\$ 329	\$ 1,293	\$ 1,393
Gross margin	38.3%	39.3%	40.8%	40.3%	41.2%	40.4%	40.5%	40.5%	40.5%	40.5%	40.5%	40.6%
Operating income	\$ 478	\$ 133	\$ 136	\$ 141	\$ 153	\$ 562	\$ 150	\$ 154	\$ 157	\$ 158	\$ 619	\$ 673
Operating margin	17.5%	18.8%	18.8%	19.7%	19.7%	19.3%	19.4%	19.4%	19.4%	19.4%	19.4%	19.6%
IHS	\$ 964	\$ 221	\$ 220	\$ 218	\$ 229	\$ 889	\$ 228	\$ 235	\$ 230	\$ 237	\$ 930	\$ 986
IHS growth: core	9.4%	(0.3%)	(7.6%)	(2.3%)	(1.0%)	(2.9%)	4.0%	4.0%	4.0%	4.0%	4.0%	6.0%
IHS growth: FX	(2.8%)	(4.2%)	(5.3%)	(5.2%)	(4.7%)	(4.9%)	(0.7%)	2.6%	1.4%	(0.6%)	0.7%	0.0%
IHS growth: acquisitions	5.8%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
IHS growth: total	12.4%	(4.6%)	(12.9%)	(7.6%)	(5.7%)	(7.8%)	3.3%	6.6%	5.4%	3.4%	4.7%	6.0%
Gross profit	\$ 188	\$ 39	\$ 44	\$ 44	\$ 43	\$ 170	\$ 44	\$ 46	\$ 45	\$ 46	\$ 180	\$ 192
Gross margin	19.5%	17.6%	20.2%	20.1%	18.7%	19.1%	19.4%	19.4%	19.4%	19.4%	19.4%	19.5%
Operating income	\$ 61	\$ 6	\$ 13	\$ 12	\$ 12	\$ 42	\$ 13	\$ 13	\$ 13	\$ 13	\$ 52	\$ 57
Operating margin	6.3%	2.8%	5.7%	5.3%	5.1%	4.7%	5.6%	5.6%	5.6%	5.6%	5.6%	5.8%
Total Revenue	\$3,692	\$ 927	\$ 944	\$ 933	\$ 1,004	\$3,808	\$ 1,001	\$ 1,030	\$ 1,042	\$ 1,050	\$4,123	\$4,418
Growth: core	11.4%	5.7%	1.6%	3.2%	4.3%	3.7%	4.8%	4.8%	8.2%	4.8%	5.6%	7.2%
Growth: FX	(1.9%)	(1.9%)	(2.3%)	(1.9%)	(1.5%)	(1.9%)	(0.3%)	0.9%	0.5%	(0.2%)	0.2%	0.0%
Growth: acquisitions	2.6%	0.6%	0.7%	0.8%	3.4%	1.4%	3.5%	3.4%	3.0%	0.0%	2.4%	0.0%
Growth: total	12.1%	4.4%	(0.1%)	2.1%	6.2%	3.1%	7.9%	9.1%	11.7%	4.6%	8.3%	7.2%
Corporate OH	\$ (123)	\$ (22)	\$ (51)	\$ (20)	\$ (35)	\$ (128)	\$ (29)	\$ (30)	\$ (30)	\$ (30)	\$ (120)	\$ (124)
Corporate OH as % of total revenue	(3.3%)	(2.4%)	(5.4%)	(2.1%)	(3.5%)	(3.4%)	(2.9%)	(2.9%)	(2.9%)	(2.9%)	(2.9%)	(2.8%)

BOOKINGS & BACKLOG												
Ending backlog	\$ 8,704	\$ 9,000	\$ 9,034	\$ 9,583	\$ 9,855	\$ 9,855	\$ 10,069	\$ 10,284	\$ 10,477	\$ 10,741	\$10,741	\$11,682
PDEV net bookings	\$ 3,472	\$ 1,075	\$ 871	\$ 862	\$ 964	\$ 3,772	\$ 968	\$ 1,002	\$ 948	\$ 1,012	\$ 3,930	\$ 4,205
IHS net bookings	\$ 1,030	\$ 170	\$ 143	\$ 479	\$ 335	\$ 1,127	\$ 247	\$ 243	\$ 287	\$ 302	\$ 1,079	\$ 1,155
Total net bookings	\$ 4,502	\$ 1,246	\$ 1,014	\$ 1,341	\$ 1,299	\$ 4,900	\$ 1,215	\$ 1,245	\$ 1,236	\$ 1,314	\$ 5,009	\$ 5,359
PDEV book-to-bill	1.27	1.52	1.20	1.21	1.24	1.29	1.25	1.26	1.17	1.24	1.23	1.23
IHS book-to-bill	1.07	0.77	0.65	2.19	1.46	1.27	1.08	1.04	1.25	1.27	1.16	1.17
Total book-to-bill	1.22	1.34	1.07	1.44	1.29	1.29	1.21	1.21	1.19	1.25	1.21	1.21

Source: Company reports and Wells Fargo Securities, LLC estimates

Required Disclosures



	Date	Publication Price (\$)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price (\$)
	6/18/2013		Evans			
◆	6/18/2013	43.53	1	48.00	50.00	43.89
◆	8/1/2013	46.29	1	50.00	52.00	46.29
◆	1/10/2014	47.84	1	52.00	54.00	48.61

Source: Wells Fargo Securities, LLC estimates and Reuters data

Symbol Key

- ▼ Rating Downgrade
- ▲ Rating Upgrade
- ◆ Valuation Range Change
- ◆ Initiation, Resumption, Drop or Suspend
- Analyst Change
- Split Adjustment

Rating Code Key

- 1 Outperform/Buy
- 2 Market Perform/Hold
- 3 Underperform/Sell
- SR Suspended
- NR Not Rated
- NE No Estimate

Additional Information Available Upon Request

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- Wells Fargo Securities, LLC or its affiliates intends to seek or expects to receive compensation for investment banking services in the next three months from an affiliate of Quintiles Transnational Holdings, Inc.

Q: Risks include: (1) project cancellations or delays due to client M&A, economic weakness, pipeline reprioritization, or compound failure; (2) a reversal in the trend toward increased outsourcing; (3) lack of improvement in the IHS segment; (4) margin pressure from strategic relationships; (5) foreign exchange volatility; and (6) large insider ownership.

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2=Market Perform: The stock appears appropriately valued, and we believe the stock's total return will be in line with the market over the next 12 months. HOLD

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SECTOR RATING

O=Overweight: Industry expected to outperform the relevant broad market benchmark over the next 12 months.

M=Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.

U=Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.

VOLATILITY RATING

V = A stock is defined as volatile if the stock price has fluctuated by +/-20% or greater in at least 8 of the past 24 months or if the analyst expects significant volatility. All IPO stocks are automatically rated volatile within the first 24 months of trading.

As of: February 13, 2014

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