

COMPANY NOTE

Target | Estimate Change

USA | Healthcare | Pharmaceutical Svcs.

January 21, 2014

Jefferies

Quintiles Inc. (Q) Quintiles Update: Emphasis on Leadership

Key Takeaway

We raise our PT, but maintain our Hold rating. We previously commented on Q's improving risk/reward. That opportunity window closed quite quickly. Q is up 20% from the lows on the 3Q13 report. Q's visibility to faster revenue growth remains. EPS should follow, but not necessarily at a much higher rate. Margins should be stable to slightly up, and below-the-line items should be neutral also.

Size, Breadth, Science. Management described significant progress in workforce efficiency and globalization (including offshoring). Q believes it is ahead of competitors on these curves. Deep resources both by geography and by therapeutic area are added benefits to being the industry's biggest player. Keep in mind that Q's revenue mix does not include preclinical. Thus, \$2.9B in Clinical and Central Lab revenue does make Q 2x larger than the next closest (PPDI-private).

Upside to PDEV Margins? Margins have expanded the last couple quarters. Yet, Q is redeploying efficiency gains to opportunistically reduce its price premium to competitors. Those share gains have been reflected in recent book-to-bills. Unless management really is sandbagging, higher revenue growth should come with flattening margin trends.

Big Clients, Still Low Concentration. Management discussed its strategic relationships and robust account management structure. Being able to support the latter is supremely important, as all global CROs highlight change management challenges in strategic relationships. Q has 10 clients >\$100M, 3 >\$200M, and discussed two sole-source deals. Still, no customer is over 10% of revenue. Large deals are slowing the backlog burn rate.

Third for Pfizer? Discussions with Pfizer (see separate 1/21/14 note) do point toward adding a third Alliance vendor. Important attributes include: nimbleness, flexibility, low cost, and Asian coverage. Q's strongest suit in this list is global coverage. Quintiles and QLABS is currently doing PFE work, but then so is inVentiv (private). PPDI's new CEO is from PFE. So, penciling this work into Q's backlog already is hasty. Because PFE won't do "rescue" project transitions as it did with ICLR and PRXL, this revenue - whoever wins it - will ramp slowly.

Valuation/Risks

Our \$49 PT is based on a 19x multiple of our 2015 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	--	3,772.0	4,084.8	4,080.2	4,447.0	4,442.3
EBITDA (MM)	--	543.7	--	604.2	667.6	668.9	741.2	742.7
Cons. EPS	--	--	--	2.07	--	2.30	--	2.62
EPS								
Mar	--	0.44	--	0.49A	--	0.53	--	--
Jun	--	0.47	--	0.50A	--	0.55	--	--
Sep	--	0.45	--	0.54A	--	0.59	--	--
Dec	--	0.41	--	0.54	--	0.62	--	--
FY Dec	--	1.77	--	2.01	2.28	2.30	2.58	2.60
FY P/E		27.7x		24.4x		21.3x		18.8x

HOLD

Price target \$49.00

(from \$45.00)

Price \$48.98

Financial Summary

Book Value (MM):	(\$712.0)
Net Debt (MM):	\$1,439.7
Long-Term Debt (MM):	\$2,046.1
Cash & ST Invest. (MM):	\$613.0

Market Data

52 Week Range:	\$50.49 - \$40.00
Total Entprs. Value (MM):	\$7,968.7
Market Cap. (MM):	\$6,529.0
Shares Out. (MM):	133.3
Float (MM):	43.9
Avg. Daily Vol.:	482,425

David Windley, CFA, CPA *

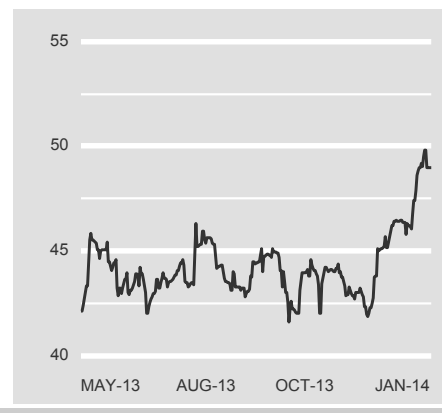
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Price Performance



Quintiles (Q): Market Leader, but Slower Grower

Hold: \$49.00 Price Target**Scenarios****Target Investment Thesis**

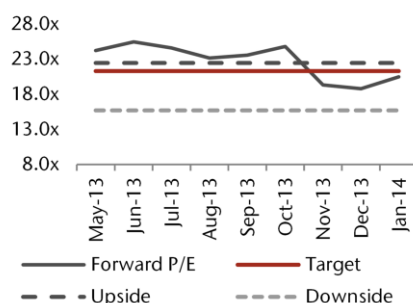
- PDEV revenue growth approximates 9%
- IHS revenue grows ~6%
- EBIT margins improve slightly
- Net interest expense declining with debt repayment from IPO proceeds and cash flow
- Cash builds on balance sheet; both share buybacks and debt repayment are modest
- 2015 EPS: \$2.60; Target Multiple: 19x; Target Price \$49.00

Upside Scenario

- Additional 'preferred vendor' deals are signed; PDEV revenue growth exceeds 10%
- IHS revenue growth also accelerates driven by additional Commercial engagements
- EBITDA margin improves to 17% on fixed leverage and cost control
- Free cash flow is used for tuck-in acquisitions
- 2015 EPS: \$2.75; Target Multiple: 20x; Target Price \$55.00

Downside Scenario

- Pricing pressures intensify; consolidated revenue growth slows to sub-6%
- Few new deals are signed; growth in late-stage clinical flattens
- Soft pricing drives margin deterioration; costs tightly controlled to mitigate impact
- Free cash is used to repurchase shares
- 2015 EPS: \$2.40; Target Multiple: 41x Target Price: \$33.00

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

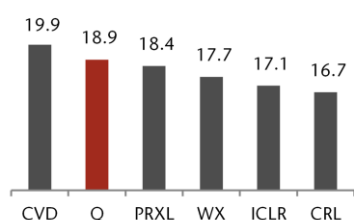
Source: FactSet and Jefferies LLC

Long Term Financial Model Drivers

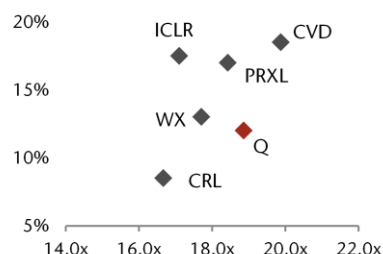
LT EPS CAGR	11-13%
Revenue Growth	7-9%
Operating Margin	12-14%
Effective Tax Rate	32%

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 slower forward EPS growth rate relative to its peers. Q already boasts industry-leading margins, and therefore, is likely to see small 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	\$64.00
CVD	HOLD	\$105.00
ICLR	BUY	\$46.00
PRXL	HOLD	\$47.00
Q	HOLD	\$49.00
WX	BUY	\$42.00

Catalysts

- Increased clinical trial starts, especially large global studies
- Signing of additional 'strategic' 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.

Quintiles

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

Jefferies

01/20/14

Non-GAAP Income Statement	1Q12	2Q12	3Q12	4Q12	2012A	1Q13	2Q13	3Q13	4Q13	2013E	1Q14	2Q14	3Q14	4Q14	2014E	2015E
Total Service Revenue	888,035	944,914	913,588	945,761	3,692,298	927,435	944,238	932,727	967,559	3,771,959	992,785	1,017,896	1,012,303	1,057,183	4,080,166	4,442,268
YoY Growth	13.7%	14.9%	11.5%	8.4%	12.1%	4.4%	(0.1%)	2.1%	2.3%	2.2%	7.0%	7.8%	8.5%	9.3%	8.2%	8.9%
Cost of revenue	590,563	628,222	612,106	628,476	2,459,367	611,109	617,666	600,694	626,381	2,455,675	647,997	664,361	650,797	683,563	2,646,717	2,870,979
SG&A	191,118	202,210	191,445	202,728	787,501	197,968	202,478	199,573	207,977	815,197	212,762	217,584	216,356	223,883	870,585	944,084
Operating income	106,354	114,482	110,037	114,557	445,430	118,358	124,094	132,460	133,200	501,086	132,026	135,952	145,150	149,736	562,863	627,204
Adjusted EBITDA	129,625	138,201	135,764	140,128	543,718	142,998	149,080	159,784	159,325	604,161	157,838	162,417	171,469	177,223	668,948	742,703
YoY Growth	21.4%	18.1%	12.5%	(4.0%)	10.9%	10.3%	7.9%	17.7%	13.7%	11.1%	10.4%	8.9%	7.3%	11.2%	10.7%	11.0%
Net interest expense	28,920	32,808	32,665	36,911	131,304	35,590	31,099	27,637	27,946	122,272	27,831	27,831	27,831	27,831	111,323	110,498
Other expense (income), net	(2,419)	(6,159)	3,850	1,156	(3,572)	(2,382)	536	3,224	(9)	1,369	-	-	-	-	-	-
Pre-tax income	79,853	87,833	73,522	76,490	317,698	85,150	92,459	101,599	105,263	377,445	104,195	108,121	117,319	121,905	451,540	516,706
Income taxes	29,790	32,486	21,900	28,074	112,250	26,000	30,162	29,491	33,684	119,337	33,370	34,627	37,570	39,036	144,603	165,346
Income from unconsolidated affiliates	1,573	334	896	(236)	2,567	(1,683)	464	(355)	200	(1,374)	200	464	(355)	200	509	509
Loss from noncontrolling interest/minority interest	465	189	123	138	915	153	164	185	273	775	273	273	273	273	1,092	1,092
Non-GAAP net income	52,101	55,870	52,641	48,318	208,930	57,620	62,925	71,938	72,052	257,509	71,298	74,231	79,667	83,342	308,538	352,961
Non-GAAP EPS	0.44	0.47	0.45	0.41	1.77	0.49	0.50	0.54	0.54	2.01	0.53	0.55	0.59	0.62	2.30	2.60
YoY Growth	51.5%	34.7%	40.4%	(37.7%)	9.6%	9.5%	4.7%	20.8%	31.6%	13.3%	9.6%	11.2%	9.7%	15.0%	14.2%	13.1%
Diluted shares outstanding	117,551	117,706	117,835	118,150	117,811	118,740	126,578	133,267	133,892	128,119	134,092	134,292	134,492	134,692	134,392	135,942
COMMON SIZE:																
Cost of revenue	66.5%	66.5%	67.0%	66.5%	66.6%	65.9%	65.4%	64.4%	64.7%	65.1%	65.3%	65.3%	64.3%	64.7%	64.9%	64.6%
SG&A	21.5%	21.4%	21.0%	21.4%	21.3%	21.3%	21.4%	21.4%	21.5%	21.6%	21.4%	21.4%	21.4%	21.2%	21.3%	21.3%
Operating income	12.0%	12.1%	12.0%	12.1%	12.1%	12.8%	13.1%	14.2%	13.8%	13.3%	13.3%	13.4%	14.3%	14.2%	13.8%	14.1%
Adjusted EBITDA	14.6%	14.6%	14.9%	14.8%	14.7%	15.4%	15.8%	17.1%	16.5%	16.0%	15.9%	16.0%	16.9%	16.8%	16.4%	16.7%
Net Interest Expense	3.3%	3.5%	3.6%	3.9%	3.6%	3.8%	3.3%	3.0%	2.9%	3.2%	2.8%	2.7%	2.7%	2.6%	2.7%	2.5%
Other Expense (Income), net	(0.3%)	(0.7%)	0.4%	0.1%	(0.1%)	(0.3%)	0.1%	0.3%	(0.0%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Pre-tax income	9.0%	9.3%	8.0%	8.1%	8.6%	9.2%	9.8%	10.9%	10.9%	10.0%	10.5%	10.6%	11.6%	11.5%	11.1%	11.6%
Income taxes	37.3%	37.0%	29.8%	36.7%	35.3%	30.5%	32.6%	29.0%	32.0%	31.6%	32.0%	32.0%	32.0%	32.0%	32.0%	32.0%
Non-GAAP net income	5.9%	5.9%	5.8%	5.1%	5.7%	6.2%	6.7%	7.7%	7.4%	6.8%	7.2%	7.3%	7.9%	7.9%	7.6%	7.9%
GROWTH (YoY):																
Total Service Revenue	13.7%	14.9%	11.5%	8.4%	12.1%	4.4%	(0.1%)	2.1%	2.3%	2.2%	7.0%	7.8%	8.5%	9.3%	8.2%	8.9%
Cost of revenue	15.1%	16.4%	13.4%	12.1%	14.2%	3.5%	(1.7%)	(1.9%)	(0.3%)	(0.2%)	6.0%	7.6%	8.3%	9.1%	7.8%	8.5%
SG&A	4.8%	7.4%	4.9%	6.5%	5.9%	3.6%	0.1%	4.2%	2.6%	3.5%	7.5%	7.5%	8.4%	7.6%	6.8%	8.4%
Operating income	24.4%	21.0%	13.3%	(5.5%)	11.8%	11.3%	8.4%	20.4%	16.3%	12.5%	11.5%	9.6%	9.6%	12.4%	12.3%	11.4%
Adjusted EBITDA	21.4%	18.1%	12.5%	(4.0%)	10.9%	10.3%	7.9%	17.7%	13.7%	11.1%	10.4%	8.9%	7.3%	11.2%	10.7%	11.0%
Net Interest Expense	17.2%	22.7%	21.7%	37.4%	24.9%	23.1%	(5.2%)	(15.4%)	(24.3%)	(6.9%)	(21.8%)	(10.5%)	0.7%	(0.4%)	(9.0%)	(0.7%)
Other Expense (Income), net	(263.3%)	3321.7%	(279.9%)	(167.3%)	39.7%	(1.5%)	(108.7%)	(16.3%)	(100.7%)	(138.3%)	(100.0%)	(100.0%)	(100.0%)	(100.0%)	(100.0%)	nm
Pre-tax income	34.6%	29.0%	1.5%	(20.4%)	7.4%	6.6%	5.3%	38.2%	37.6%	18.8%	22.4%	16.9%	15.5%	15.8%	19.6%	14.4%
Income taxes	27.4%	32.4%	(33.6%)	32.0%	9.9%	(12.7%)	(7.2%)	34.7%	20.0%	6.3%	28.3%	14.8%	27.4%	15.9%	21.2%	14.3%
Non-GAAP net income	50.6%	34.1%	40.3%	(37.4%)	9.4%	10.6%	12.6%	36.7%	49.1%	23.3%	23.7%	18.0%	10.7%	15.7%	19.8%	14.4%
Non-GAAP EPS	51.5%	34.7%	40.4%	(37.7%)	9.6%	9.5%	4.7%	20.8%	31.6%	13.3%	9.6%	11.2%	9.7%	15.0%	14.2%	13.1%

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.

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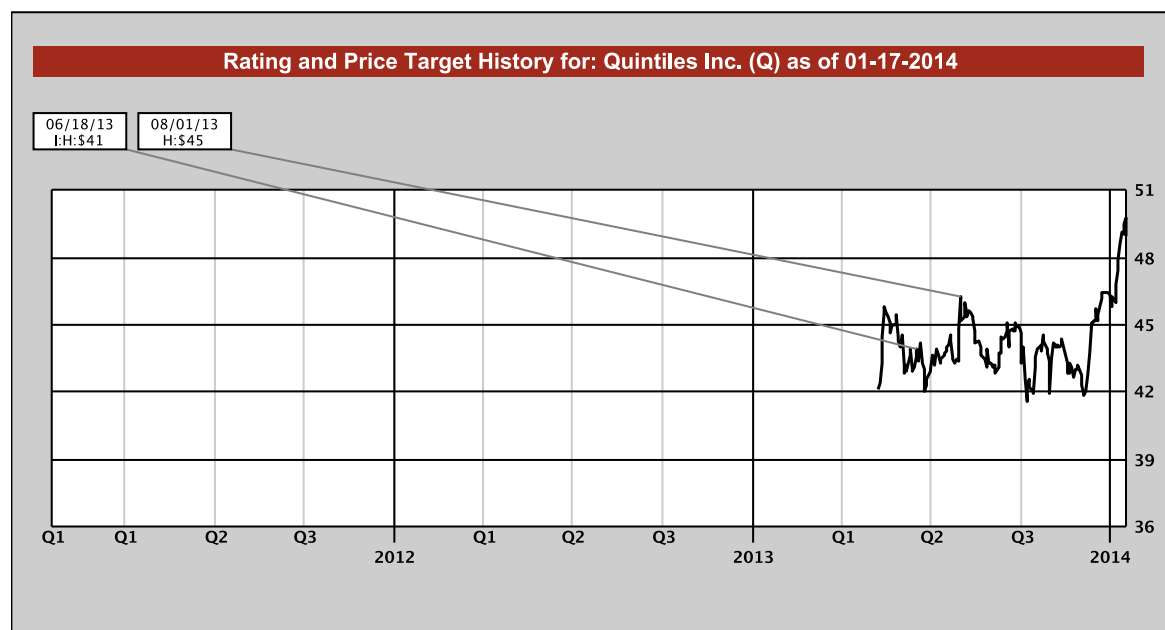
Risk which may impede the achievement of our Price Target

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Other Companies Mentioned in This Report

- Charles River Laboratories, Inc. (CRL: \$58.70, BUY)
- Covance Inc. (CVD: \$95.80, BUY)
- ICON plc (ICLR: \$41.00, BUY)
- PAREXEL International Corporation (PRXL: \$45.91, HOLD)
- Quintiles Inc. (Q: \$48.98, HOLD)
- WuXi PharmaTech Inc. (WX: \$37.97, BUY)



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			Count	Percent
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