

Quintiles Transnational Holdings (Q)

Overweight

Record-Breaking Backlog, More Growth to Come

CONCLUSION

The confidence of a backlog that just broke \$10B, along with strong cost management and market-expanding innovation, keep us optimistic that Quintiles is the leading stock in the CRO industry. The recent M&A activity in the pharma industry should not have an adverse impact on Quintiles, in our view. We maintain our Overweight rating and raise our PT to \$61 (from \$58).

- **The Numbers.** Q's revenue of \$1,005.8M was in line with our estimates, 1% above consensus, and 8% over Q113. Adjusted net income and EPS were \$90.9M and \$0.68, and increased y/y by 55% and 38%, respectively. The increase was driven largely by increased service revenues, changes in effective tax rate, improved margins, and lowered interest rates due to lowered debt. Backlog rose to an all-time high of \$10.1B. Product Development revenue and gross margin were \$770.8M and 42%, which increased y/y by 9% and 228bps, respectively. Both organic growth and Novella contributed to this growth, and offset the wind-down of a large project that took place through 2013. IHS revenue of \$234.5 increased 6% y/y, while gross margin of 18% remained flat.
- **Unlikely to lose momentum due to recent pharma M&A activity.** With involvement in over 70% of all new drug approvals in the last decade, and the largest global footprint in the industry, there's a good chance that when two pharmaceutical companies merge, at least one of them is a client of Quintiles, and will remain so post merger. Their \$10.1B backlog provides a high degree of confidence on future operations, despite of clientele strategic initiatives. Once a contract has been committed to, there's a significant penalty on the client's part, both financial and ethical, to cancel trials.
- **"Real world" late phase opportunities expand the market.** Quintiles has expanded their market by branching outside of their traditional pharmaceutical segments and into the "real world" to conduct non Rx studies. Past partnerships include the NFL, and the American Diabetes Association. We believe this exemplifies the trend of the closing gap between drug development and consumer use, and Quintiles will be one of the companies to pioneer this movement.

RISKS TO ACHIEVEMENT OF PRICE TARGET

Changes in the pharma industry impacting R&D spending in drug research, reversal to the current increasing R&D outsourcing trend by pharma, and above industry average leverage in the balance sheet impacting opportunities.

COMPANY DESCRIPTION

Quintiles is the largest CRO in the industry with expertise across all major therapeutics and with operations in about 100 countries.

PRICE: US\$48.76

Note: Price as of the close May 1, 2014.

TARGET: US\$61.00

22x CY15E EPS of \$2.78 (a 20% premium to the peer median P/E)

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Changes	Previous	Current
Rating	—	Overweight
Price Tgt	US\$58.00	US\$61.00
FY14E Rev (mil)	US\$4,124.8	US\$4,124.3
FY15E Rev (mil)	US\$4,488.4	US\$4,487.7
FY14E EPS	US\$2.44	US\$2.53
FY15E EPS	—	US\$2.78
52-Week High / Low	US\$55.00 / US\$40.00	
Shares Out (mil)	133.0	
Market Cap. (mil)	US\$6,485.1	
Avg Daily Vol (ooo)	890	
Book Value/Share	US\$(4.21)	
Net Cash Per Share	US\$(11.15)	
Debt to Total Capital	1%	
Yield	0.00%	
Fiscal Year End	Dec	

Price Performance - 1 Year



Source: Bloomberg

YEAR	REVENUE (US\$ m)						EARNINGS PER SHARE (US\$)					
	Mar	Jun	Sep	Dec	FY	FY RM	Mar	Jun	Sep	Dec	FY	FY P/E
2013E	927.4A	944.2A	932.7A	1,003.9A	3,808.3A	1.7x	0.49A	0.50A	0.54A	0.58A	2.10A	23.2x
2014E	1,005.3A	1,018.2	1,007.9	1,092.9	4,124.3	1.6x	0.68A	0.60	0.59	0.65	2.53	19.3x
2015E	1,098.8	1,105.3	1,086.3	1,197.4	4,487.7	1.4x	0.63	0.69	0.69	0.77	2.78	17.5x

Non GAAP EPS

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Exhibit 1

Variance Analysis	Mar-14A				
	PJC Est.	Actual	% Difference	Y/Y Change	Seq. Change
Total revenue	1,005,769	1,005,288	0.0%	8%	0%
Cost of sales	662,401	643,722	-3%	5%	0%
Gross profit	343,368	361,566	5%	14%	0%
Selling, general & administrative	237,712	219,242	-8%	10%	-6%
EBITDA	139,656	171,412	23%	19%	7%
GAAP net earnings	59,878	90,214	51%	87%	24%
GAAP EPS	\$0.45	0.68	51%	67%	24%

Source: Company documents and Piper Jaffray & Co.

PT Increased

Our PT goes to \$61 (from \$58) based on 22x CY15E EPS of \$2.78 (was CY14E EPS of \$2.44); the multiple reflects a ~20% premium to the peer median P/E (same as prior).

Quintiles																
Historical and Projected Income Statement																
(\$ 000's, Except per Share Data)																
Last update: 5/1/14																
Revenues:																
Product Dev	2,728,695	706,300	724,170	714,244	775,009	2,919,723	770,828	789,345	778,526	852,510	3,191,209	847,911	860,386	840,808	937,761	3,486,866
Integrated Healthcare Services (IHS)	963,603	221,100	220,068	218,483	228,931	888,582	234,460	228,871	229,407	240,378	933,115	250,872	244,892	245,466	259,608	1,000,837
Total Service Revenues	3,692,298	927,435	944,238	932,727	1,003,940	3,808,340	1,005,288	1,018,216	1,007,933	1,092,887	4,124,325	1,098,783	1,105,278	1,086,274	1,197,369	4,487,703
Cost of Sales																
Product Dev	1,683,305	428,900	441,895	426,094	455,804	1,752,693	450,483	465,714	459,330	502,981	1,878,508	499,123	506,467	490,738	547,325	2,043,654
Integrated Healthcare Services (IHS)	776,027	182,100	175,771	174,600	186,153	718,624	193,239	185,385	185,820	194,706	759,150	203,206	198,362	198,827	210,282	810,678
Corporate Expenses	0	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total COGS	2,459,332	611,000	617,666	600,694	641,957	2,471,317	643,722	651,099	645,150	697,687	2,637,658	702,330	704,829	689,565	757,607	2,854,332
Gross Profit																
Product Dev	1,045,390	277,400	282,275	288,150	319,205	1,167,030	320,345	323,632	319,196	349,529	1,312,701	348,787	353,919	350,070	390,436	1,443,212
Integrated Healthcare Services (IHS)	187,576	39,000	44,297	43,883	42,778	169,958	41,221	43,485	43,587	45,672	173,966	47,666	46,529	46,638	49,325	190,159
Total Gross Profit	1,232,966	316,400	326,572	332,033	361,983	1,336,988	361,566	367,117	362,783	395,201	1,486,667	396,453	400,449	396,708	439,761	1,633,371
Expenses																
SG&A - Product Dev	567,535	144,700	146,182	147,534	166,322	604,738	159,685	163,789	159,598	174,765	657,837	178,061	172,077	168,162	187,552	705,852
SG&A - IHS	127,067	32,800	31,790	32,221	31,068	32,279	32,276	34,331	34,411	36,057	137,074	37,631	34,285	34,365	36,345	142,626
Corporate SG&A	123,153	(177,301)	50,866	23,585	(35,407)	(138,257)	27,281	30,546	30,238	32,787	120,852	32,963	33,158	32,588	35,921	134,631
Total SG&A	817,755	199,300	228,838	199,573	232,797	860,508	219,242	228,666	224,247	243,608	915,763	248,656	239,520	235,115	259,819	983,109
Restructuring Expense	18,741	1,859	2,837	7,201	2,174	14,071	1,008	3,008	4,512	4,963	13,491	1,686	1,686	1,686	1,686	6,746
Impairment Charge	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Income from operations	396,470	115,165	94,897	125,259	127,012	462,333	141,316	135,443	134,024	146,630	557,413	146,111	159,242	159,907	178,257	643,516
Product Dev Operating Income	477,855	132,700	136,093	140,616	152,883	562,292	160,660	159,842	159,598	174,765	654,865	170,726	181,842	181,908	202,884	737,360
IHS Operating Income	60,509	6,200	12,507	11,662	11,710	42,079	8,945	9,155	9,176	9,615	36,891	10,035	12,245	12,273	12,980	47,533
General corporate and unallocated expenses	-	-	-	-	-	(27,281)	-	-	-	-	-	-	-	-	-	-
EBITDA (Non-GAAP)	543,753	144,140	155,702	159,784	159,740	619,367	171,412	169,539	170,624	183,681	695,256	177,886	191,016	191,681	210,031	770,614
D&A	98,288	25,765	25,026	27,324	30,554	108,669	29,088	30,088	30,088	30,088	118,352	30,088	30,088	30,088	30,088	120,352
Stock Comp	13,637	-	6,591	-	-	6,591	-	2,000	2,000	2,000	6,000	-	-	-	-	-
One-Time Comp	11,308	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Management Fee	5,309	1,351	26,351	-	-	27,702	-	-	-	-	-	-	-	-	-	-
Interest income	-	-	(785)	(1,119)	(1,581)	(3,485)	(1,255)	-	-	-	-	-	-	-	-	-
Interest expense	-	-	31,884	28,756	26,826	87,466	24,703	24,703	24,703	24,703	98,812	24,703	24,703	24,703	24,703	-
Net interest expense	131,304	36,042	-	-	-	36,042	-	-	-	-	-	-	-	-	-	-
Loss on extinguishment of debt	1,275	(452)	16,543	-	3,288	19,379	-	-	-	-	-	-	-	-	-	-
Other Expense (Income), net	(3,572)	(2,380)	536	3,224	(1,563)	(183)	(4,844)	-	-	-	(4,844)	-	-	-	-	-
Gain on sale of business	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Income before taxes	398,767	117,997	46,719	94,398	100,042	359,156	122,712	110,740	109,321	121,927	464,700	121,408	134,539	135,204	153,554	544,704
Taxes on income	93,364	32,118	8,830	27,459	27,558	95,965	37,389	33,222	32,796	36,578	139,985	36,573	40,528	40,729	46,256	164,086
Net Income	305,403	85,879	37,889	66,939	72,484	263,191	85,323	77,518	76,525	85,349	324,714	84,835	94,011	94,475	107,297	380,619
Income from unconsolidated Affiliates	2,567	(1,683)	464	(355)	450	(1,124)	4,891	-	-	-	4,891	-	-	-	-	-
GAAP Net Income	307,970	48,156	38,353	66,584	72,934	226,027	90,214	77,518	76,525	85,349	329,605	84,835	94,011	94,475	107,297	380,619
GAAP EPS	2.61	0.41	0.30	0.50	0.55	1.77	0.68	0.58	0.57	0.63	2.46	0.62	0.69	0.69	0.77	2.77
Gain from sale of discontinued Ops	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Loss/(Income) from non-controlling interests	915	153	164	185	62	564	(31)	125	125	125	344	300	300	300	300	1,200
Net Income attributable to QTHI	308,885	48,309	38,517	66,769	72,996	226,591	90,183	77,643	76,650	85,474	329,949	85,135	94,311	94,775	107,597	381,819
Non GAAP Net Income	333,830	58,650	62,761	71,938	76,457	269,806	90,944	79,748	79,808	88,948	339,449	85,135	94,311	94,775	107,597	381,819
Restructuring Expense	18,741.4	1,859	2,837	7,201	2,174	14,071	1,008	3,008	4,512	4,963	13,491	1,686	1,686	1,686	1,686	6,746
Management Fee	5,309.0	1,334	26,360	-	-	27,694	-	-	-	-	-	-	-	-	-	-
Loss on extinguishment of Debt	1,275.0	-	16,543	-	3,288	19,831	-	-	-	-	-	-	-	-	-	-
Tax Impact	(18,886.0)	-	(17,088)	(2,032)	(2,001)	(21,121)	(247)	(902)	(1,354)	(1,489)	(3,992)	(508)	(508)	(508)	(508)	(2,032)
Other income tax adjustments	-	7,301	(4,244)	-	-	3,057	-	-	-	-	-	-	-	-	-	-
Stock Comp	13,637.0	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
One-Time Comp	11,308.0	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gain on sale of Business	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Impairment Charges	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Interest rate swap term fee	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Pre-Tax Adjustment	24,945	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Loss/(Income) from non-controlling interests	915	-	-	-	62	62	(31.0)	-	-	-	(31.0)	-	-	-	-	-
Total Adjustment	25,860	10,494	24,408	5,169	3,461	43,532	761	2,106	3,158	3,474	9,499	-	-	-	-	-
Non GAAP EPS	2.83	0.49	0.50	0.54	0.58	2.10	0.68	0.60	0.59	0.65	2.53	0.63	0.69	0.69	0.77	2.78
Diluted SO	117,825	118,740	126,578	133,267	132,861	127,862	133,040	133,173	134,505	135,850	134,142	135,986	136,122	137,483	138,858	137,112
% of Revenue																
Gross Margin	33.4%	34.1%	34.6%	35.6%	36.1%	35.1%	36.0%	36.1%	36.0%	36.2%	36.0%	36.1%	36.2%	36.5%	36.7%	36.4%
GM% - Product Dev	38%	39%	39%	40.3%	41.2%	40%	39%	41%	41.0%	41.0%	41%	41%	41%	41.6%	41.6%	41%
GM% - IHS	19%	18%	20%	20.1%	18.7%	19%	18%	19%	19.0%	19.0%	19%	19.0%	19%	19.0%	19.0%	19%
SG&A	22%	21%	24%	21.4%	23.2%	23%	22%	22%	22.2%	22.3%	22%	23%	22%	21.6%	21.7%	22%
SG&A - Product Dev	21%	20%	20%	20.7%	21.5%	21%	21%	20.8%	20.5%	20.5%	21%	21%	20%	20.0%	20.0%	20%
SG&A - IHS	13%	15%	14%	14.7%	13.6%	14%	15%	15%	15.0%	15.0%	15%	15%	14%	14.0%	14.0%	14%
SG&A Corporate	3.3%	19%	5%	2.5%	-3.5%	-3.6%	4%	3%	3.0%	3.0%	2.9%	3.0%	3.0%	3.0%	3.0%	3.0%
Operating Margin	11%	12%	10%	13%	13%	12%	14%	13%	13%	13%	14%	13%	14%	15%	15%	14%
OM% - Product Dev	18%	19%	19%	20%	20%	19%	21%	20%	21%	21%	21%	20%	21%	22%	22%	21%
OM% - IHS	6%	3%	6%	5%	5%	5%	4%	4%	4%	4%	4%	4%	5%	5%	5%	5%
Incremental Operating Margin	13%	59%	887%	84%	56%	57%	34%	55%	12%	22%	30%	5%	27%	33%	30%	24%
EBITDA Margin	14.7%	15.5%	16.5%	17.1%	15.9%	16.3%	17.1%	16.7%	16.8%	16.8%	16.9%	16.2%	17.3%	17.6%	17.5%	17.2%
Tax Rate	23%	27%	19%	29%	28%	27%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%
ly Growth:	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Product Dev	11.9%	7.6%	4.6%	5.5%	10.2%	7.0%	9.1%	9.0%	9.0%	10.0%	9.3%	10.0%	9.0%	8.0%	10.0%	9.3%
IHS	12.4%	-4.6%	-12.9%	-7.6%	-5.7%	-7.8%	6.0%	4.0%	5.0%	5.0%	5.0%	7.0%	7.0%	7.0%	8.0%	7.3%
Total Revenues	12%	4%	-	-2%	-5.7%	-7.8%	6%	8%	8%	8%	8%	9%	9%	8%	10%	9%
SG&A	7%	-3%	12%	4%	8%	5%	10%	0%	0%	12%	5%	6%	13%	5%	5%	7%
Income from Operations	15%	25%	-6%	15%	35%	17%	23%	43%	7%	15%	21%	3%	18%	19%	22%	15%
EBITDA	11%	11%	13%	18%	14%	14%	19%	9%	7%	15%	12%	4%	13%	12%	14%	11%
Net Income (Non GAAP)	8%	-31%	-22%	-15%	-8%	-19%	55%	27%	11%	16%	26%	-6%	18%	19%	21%	12%
EPS (Non GAAP)	8%	-32%	-27%	-25%	-18%	-26%	38%	21%	10%	14%	21%	-8%	16%	16%	18%	10%

IMPORTANT RESEARCH DISCLOSURES



Notes: The boxes on the Rating and Price Target History chart above indicate the date of the Research Note, the rating, and the price target. Each box represents a date on which an analyst made a change to a rating or price target, except for the first box, which may only represent the first Note written during the past three years.

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R: Resuming Coverage
T: Transferring Coverage
D: Discontinuing Coverage
S: Suspending Coverage
OW: Overweight
N: Neutral
UW: Underweight
NA: Not Available
UR: Under Review

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Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [OW]	352	61.65	86	24.43
HOLD [N]	201	35.20	20	9.95
SELL [UW]	18	3.15	0	0.00

Note: Distribution of Ratings/IB Services shows the number of companies currently in each rating category from which Piper Jaffray and its affiliates received compensation for investment banking services within the past 12 months. FINRA rules require disclosure of which ratings most closely correspond with "buy," "hold," and "sell" recommendations. Piper Jaffray ratings are not the equivalent of buy, hold or sell, but instead represent recommended relative weightings. Nevertheless, Overweight corresponds most closely with buy, Neutral with hold and Underweight with sell. See Stock Rating definitions below.

Analyst Certification — Sean W. Wieland, Sr Research Analyst — Nina Dekka

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