

November 02, 2015

## PRA Health Sciences, Inc.

### Third-Quarter Analysis; Guidance Raised After Another Excellent Quarter

- Results Overview.** PRA reported impressive third-quarter results on Monday evening, with adjusted EPS that were 8 cents above our model (including stock-based compensation expense) and 7 cents ahead of consensus. Relative to our expectations, a stronger gross margin drove 5 cents of the outperformance, with higher revenues and lower SG&A spend contributing the other 3 cents (see exhibit 1 below). We assume a favorable foreign-exchange impact was the primary driver of the better gross margin, which increased 171 basis points from a year ago and exceeded our model by 138 basis points.

#### Exhibit 1. PRA Health EPS Outperformance Relative To Our Expectations

Revenues	\$ 0.007
Gross Profit	\$ 0.053
SG&A	\$ 0.023
Depreciation	\$ (0.003)
Interest	\$ 0.000
Taxes	\$ 0.000
Share Count	\$ (0.004)
<b>Total</b>	<b>\$ 0.076</b>

Source: Company reports and William Blair & Company, L.L.C. estimates

- Following another impressive quarter, management increased EPS guidance for the year by 10.5 cents at the midpoint to a revised range of \$1.89 to \$1.92 (excluding roughly six cents of stock option expense). See exhibit 2 below for more detail on the guidance change. Solid bookings and strong revenue growth of 12% constant currency confirm that underlying business trends are strong for PRA and the broader clinical CRO group. As a result, we are increasing our 2015 EPS target for PRAH by 11 cents, to \$1.84 (including 6 cents of stock compensation expense), up from \$1.73 previously. In 2016, we now model EPS of \$2.11, up from \$2.00 previously. We maintain our Outperform rating on PRAH and expect the stock to react favorably considering its 17% correction from recent highs.

#### Exhibit 2. PRA Guidance Changes for 2015

	2015 - Guidance		2015 - Previous	
	Current	Previous	WB - est.	Consensus - est.
Revenue	\$1,365 to \$1,370	\$1,340 to \$1,390	\$ 1,356	\$ 1,367
% growth	7.8% to 8.2%	5.8% to 9.7%	7.1%	7.9%
Adjusted EPS (excl. SBC)	\$1.89 to \$1.92	\$1.75 to \$1.85	\$ 1.80	\$1.79
% growth	50% to 52%	39% to 47%	42.9%	42.1%
<b>Adjusted EPS (incl. SBC)</b>	<b>\$1.83 to \$1.86</b>	<b>\$1.68 to \$1.78</b>	<b>\$ 1.73</b>	<b>NA</b>
<b>% growth</b>	<b>53% to 55%</b>	<b>40% to 48%</b>	<b>44.2%</b>	

Source: Company reports and William Blair & Company, L.L.C. estimates

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Stock Rating: **Outperform**  
Company Profile: **Aggressive Growth**

Symbol: PRAH (NASDAQ)  
Price: \$37.75 (52-Wk.: \$18-\$46)  
Market Value (mil.): \$2,108  
Long-Term EPS Growth Rate: 17%  
Dividend/Yield: None  
Fiscal Year End: December

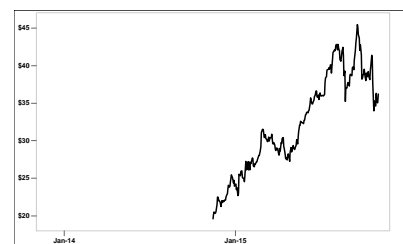
	2014A	2015E	2016E
<b>Estimates</b>			
EPS Q1	\$0.18	A\$0.40	NA
Q2	\$0.34	A\$0.46	NA
Q3	\$0.33	A\$0.51	NA
Q4	\$0.34	\$0.48	NA
FY	\$1.20	\$1.84	\$2.11
CY		\$1.84	\$2.11

<b>Valuation</b>			
FY P/E	31.5x	20.5x	17.9x
CY P/E		20.5x	17.9x

<b>Trading Data (FactSet)</b>	
Shares Outstanding (mil.)	60
Float (mil.)	20
Average Daily Volume	196,511

<b>Financial Data (FactSet)</b>	
Book Value Per Share (MRQ)	11.6
Return on Equity (TTM)	-6.2

#### Two-Year Price Performance Chart



Sources: FactSet, William Blair & Company estimates

PRA Health Sciences is one of the largest clinical CROs in the world, serving both the pharmaceutical and biotechnology industries. The company has a revenue base of \$1.2 billion and more than 10,000 employees serving clients across 80 countries.

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**Exhibit 3. CRO Group Quarterly Operating Performance Comparison, Second and Third Quarters of 2015**

	<u>Third Quarter</u>					<u>Average</u>
	<u>ICLR</u>	<u>INCR</u>	<u>PRAH</u>	<u>PRXL</u>	<u>Q*</u>	
Revenue (reported)	2%	15%	8%	4%	5%	7%
Revenue Est. (constant dollar, organic)	8%	20%	12%	7%	4%	10%
EBITDA Margin Est. (incl. options)	21.7%	25.0%	18.8%	15.4%	23.0%	20.8%
Net book-to-bill	1.2x	1.4x	1.3x	1.2x	1.2x	1.25x
<u>Second Quarter</u>						
Revenue (reported)	3%	14%	8%	2%	1%	6%
Revenue Est. (constant dollar, organic)	9%	20%	12%	4%	5%	10%
EBITDA Margin Est. (incl. options)	21.2%	23.0%	17.9%	15.1%	22.4%	19.9%
Net book-to-bill	1.25	1.3	1.21	1.19	1.23	1.24x

\*Est. PDEV data

Source: Company reports and William Blair estimates

- Group Remains Fundamentally Sound.** Now that all of the leading clinical CROs have reported, we can look across the group for any signs of inflection points. As outlined in exhibit 3, the clinical CRO group's fundamentals were stable to slightly improved in the third quarter compared to the second quarter. Net bookings (as measured by book-to-bill ratio) and constant-dollar revenue growth in the third quarter were in line with second-quarter levels, while EBITDA margins improved 90 basis points on average. We suspect that as foreign-exchange rates normalize, margin gains will moderate and organic revenue should be sustained in the high single digits. We believe these metrics suggests that, to date, biotech clients have not altered their spending patterns on drug development.
- Net New Business and Revenue Growth Ahead of our Target.** PRA's net book-to-bill ratio was a strong 1.25 times. The net award total was up 13% from a year ago and \$39 million above our \$392 million estimate. We believe bookings are being driven by a return to R&D spending growth by large pharma and yet another extremely strong quarter of capital flows into the biotech industry. We look for additional commentary regarding biotech activity, given the recent funding reductions, but given comments from other clinical CROs, we suspect RFP flow out of smaller clients is robust at present. Revenue growth in the quarter was 12% constant currency and about 250 basis points ahead of our 8.7% estimate.
- Margins Well Above Our Model.** Better leverage of technology, efficiency initiatives, and foreign-exchange movement all appeared to drive adjusted EBITDA margin to an impressive 18.8% in the quarter, 190 basis points above our estimate and up more than 460 basis points from a year ago. We suspect foreign exchange contributed a large portion of this beat, and we look for additional comments regarding the sustainability of this margin on tomorrow's call.
- Model changes.** Following the better quarter and increased guidance, we have made the following changes to our model:
  - We now model 2015 revenue of \$1.367 billion (up 7.9%), adjusted EBITDA margin of 17.8%, and EPS of \$1.84 (up 54%). This compares to our previous estimates of \$1.360 billion (up 7.3%), adjusted EBITDA margin of 17.0%, and EPS of \$1.73 (up 45%).
  - For 2016, we now model revenue of \$1.472 billion (up 7.7%), adjusted EBITDA margin of 18.2%, and EPS of \$2.11 (up 15%). This compares to our previous estimates of \$1.468 billion (up 8.0%), adjusted EBITDA margin of 17.3%, and EPS of \$2.00 (up 16%).
- Valuation and stock thoughts.** PRA now trades at 17.9 times our revised 2016 EPS estimate of \$2.11 (up 15%). This multiple is right in line with the clinical CRO peer group average of 17.9 times—Icon (ICLR \$67.68; Outperform) at 14.6 times, Quintiles (Q \$66.05; Outperform) at 18.6 times, INC Research (INCR \$44.75; Outperform) at 20.6 times, and Parexel (PRXL \$65.85; Outperform) at 18.0 times. Given its broad client mix, double-digit revenue growth, and respectable bookings, we view the stock's relative valuation as reasonable and believe the group's fundamentals remain robust. We maintain our Outperform rating on PRA given the group's solid demand trends, and the company's

upward bias to estimates. Exhibits 4 and 5 below compare PRA's third-quarter performance to our estimates and summarize our updated model.

#### Exhibit 4. PRA Health Third Quarter Variance Analysis

November 2, 2015	<b>3Q 2015 (Actual)</b>	<b>3Q 2014 (Actual)</b>	<b>Year/Year % Change</b>	<b>3Q 2015 (Estimate)</b>	<b>Year/Year % Change</b>	<b>Act.-Est. Difference</b>
Total Net Revenue	\$345,096	\$320,063	7.8%	\$341,125	6.6%	\$3,971
Direct Costs	220,919	215,591	2.5%	223,096	3.5%	(2,177)
Selling, general and administrative	59,193	58,862	0.6%	60,550	2.9%	(1,357)
Depreciation	5,432	5,988	-9.3%	5,117	-14.5%	315
Total operating expenses	285,544	280,441	1.8%	288,762	3.0%	(3,218)
Operating income	59,552	39,622	50.3%	52,363	32.2%	7,189
Interest and other income (net)	(13,719)	(19,541)	-29.8%	(13,743)	NM	24
Earnings before tax	45,833	20,081	128.2%	38,620	92.3%	7,213
Income taxes	13,750	6,751	103.7%	11,586	71.6%	2,164
<b>Net income (excl. extraod, incl. options)</b>	<b>32,083</b>	<b>13,330</b>	<b>140.7%</b>	<b>27,034</b>	<b>102.8%</b>	<b>5,049</b>
Extraordinary item, net of tax	(8,424)	(12,155)		(14,896)		
Net income (incl. extraord. and options)	\$23,659	\$1,175	1913.5%	\$12,138	933.0%	11,521
Shares outstanding	63,504	40,284	57.6%	62,976	56.3%	528
<b>EPS (excl. extraord., incl options)</b>	<b>\$0.51</b>	<b>\$0.33</b>	<b>52.7%</b>	<b>\$0.43</b>	<b>29.7%</b>	<b>\$0.0759</b>
EPS (incl. extraord. and options)	\$0.37	\$0.03	1177.3%	\$0.19	560.8%	\$0.18
% of Net Revenue:			<u>Change</u>		<u>Change</u>	
Direct costs	64.02	67.36	(3.34)	65.40	(2.0)	(1.38)
Gross profit	35.98	32.64	3.34	34.60	2.0	1.38
SG&A	17.15	18.39	(1.24)	17.75	(0.6)	(0.60)
Depreciation and amortization	1.57	1.87	(0.30)	1.50	(0.4)	0.07
<b>Operating income (incl. options)</b>	<b>17.26</b>	<b>12.38</b>	<b>4.88</b>	<b>15.35</b>	<b>3.0</b>	<b>1.91</b>
Net income	9.30	4.16	5.13	7.92	3.8	1.37
Effective tax rate	30.00	33.62	(3.62)	30.00	(3.6)	(0.00)

#### New Business Awards

Adjusted Net New Business Awards	\$431,400	\$382,200	12.9%	\$392,294	2.6%	\$39,106
Adjusted Net Book-to-Bill Ratio	1.25	1.19		1.15		

Source: Company reports and William Blair & Company, L.L.C. estimates

**Exhibit 5: Updated Income Statement for PRA Health Sciences, 2012 to 2017(E)**

	2012	2013	2014	Q1'15	Q2'15	Q3'15	Q4'15E	2015E	2016E	2017E
<b>Net revenue</b>	<b>\$597,072</b>	<b>\$832,901</b>	<b>\$1,266,596</b>	<b>\$331,968</b>	<b>\$336,518</b>	<b>\$345,096</b>	<b>\$353,583</b>	<b>\$1,367,165.3</b>	<b>\$1,471,839</b>	<b>\$1,584,557</b>
Cost of revenue	357,812	525,488	858,493	218,786	219,626	220,919	229,829	889,160	955,152	1,027,666
Gross profit	239,260	307,413	408,103	113,182	116,892	124,177	123,754	478,005	516,687	556,891
Selling, general and administrative expense	143,077	177,338	226,494	57,440	55,573	57,579	59,190	229,782	241,158	257,083
Stock comp	1,010	1,141	3,467	775	1,245	1,614	1,768	5,402	7,359	7,923
<b>EBITDA</b>	<b>95,173</b>	<b>128,934</b>	<b>178,142</b>	<b>54,967</b>	<b>60,074</b>	<b>64,984</b>	<b>62,796</b>	<b>242,821</b>	<b>268,169</b>	<b>291,885</b>
Depreciation	15,041	18,053	22,211	5,128	5,085	5,432	5,657	21,302	23,248	24,158
Operating income (including options beg Q105)	80,132	110,881	155,931	49,839	54,989	59,552	57,139	221,519	244,922	267,728
Interest and other income (expense), net	(28,499)	(52,898)	(76,202)	(13,744)	(13,779)	(13,719)	(13,695)	(54,937)	(52,974)	(46,774)
Pretax income	51,633	57,983	79,729	36,095	41,210	45,833	43,444	166,582	191,947	220,953
Income tax expense	20,347	33,556	27,188	10,829	12,364	13,750	13,033	49,976	57,584	66,286
<b>Net income (excl. nonrecurring items, excl. amort., incl. options and deferred rent)</b>	<b>31,286</b>	<b>24,427</b>	<b>52,541</b>	<b>25,267</b>	<b>28,846</b>	<b>32,083</b>	<b>30,411</b>	<b>116,607</b>	<b>134,363</b>	<b>154,667</b>
				233						
Nonrecurring items	(56,188)	(185,581)	(123,626)	(10,886)	(24,417)	(11,478)	(\$21,290)	(68,071)	(50,044)	(37,632)
Tax adjustment	22,195	72,821	35,343	2,806	7,114	3,054	6,387	19,361	15,013	11,290
Nonrecurring items (net of tax)	(33,993)	(112,760)	(88,283)	(8,080)	(17,303)	(8,424)	(14,903)	(48,710)	(35,031)	(26,342)
<b>Net income (GAAP)</b>	<b>(\$2,707)</b>	<b>(\$88,333)</b>	<b>(\$35,742)</b>	<b>\$17,187</b>	<b>\$11,543</b>	<b>\$23,659</b>	<b>\$15,508</b>	<b>\$67,896</b>	<b>\$99,332</b>	<b>\$128,325</b>
<b>EPS (excl. nonrecurring items, excl. amort. incl. options and def rent)</b>	<b>\$0.79</b>	<b>\$0.62</b>	<b>\$1.20</b>	<b>\$0.40</b>	<b>\$0.46</b>	<b>\$0.51</b>	<b>\$0.48</b>	<b>\$1.84</b>	<b>\$2.11</b>	<b>\$2.43</b>
<b>EPS (excl. nonrecurring items, excl. amort. incl. options and def rent)</b>										
<b>EPS (as reported)</b>	<b>(\$0.07)</b>	<b>(\$2.25)</b>	<b>(\$0.75)</b>	<b>\$0.27</b>	<b>\$0.18</b>	<b>\$0.37</b>	<b>\$0.24</b>	<b>\$1.07</b>	<b>\$1.56</b>	<b>\$2.01</b>
Weighted average shares outstanding (diluted)	39,641	39,337	43,457	62,777	62,951	63,504	63,529	63,190	63,592	63,692
<b>MARGIN ANALYSIS:</b>										
Gross profit	40.1%	36.9%	32.2%	34.1%	34.7%	36.0%	35.0%	35.0%	35.1%	35.1%
SG&A	24.0%	21.3%	17.9%	17.3%	16.5%	16.7%	16.8%	16.8%	16.4%	16.2%
Stock comp	0.2%	0.1%	0.3%	0.2%	0.4%	0.5%	0.4%	0.4%	0.5%	0.5%
Total SG&A	24.1%	21.4%	18.2%	17.5%	16.9%	17.2%	17.2%	17.2%	16.9%	16.7%
EBITDA	15.9%	15.5%	14.1%	16.6%	17.9%	18.8%	17.8%	17.8%	18.2%	18.4%
Depreciation & amortization	2.5%	2.2%	1.8%	1.5%	1.5%	1.6%	1.6%	1.6%	1.6%	1.5%
Operating income	13.4%	13.3%	12.31%	15.0%	16.3%	17.3%	16.2%	16.20%	16.6%	16.9%
Tax rate	39.4%	57.9%	34.1%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%
Net income	5.2%	2.9%	4.1%	7.6%	8.6%	9.3%	8.6%	8.5%	9.1%	9.8%
<b>GROWTH RATES:</b>										
<b>Revenue</b>		<b>39.5%</b>	<b>52.1%</b>	<b>6.6%</b>	<b>8%</b>	<b>8%</b>	<b>9%</b>	<b>7.9%</b>	<b>7.7%</b>	<b>7.7%</b>
Revenue (excl. foreign exchange effect)				<b>9.8%</b>	<b>12.0%</b>	<b>11.6%</b>	<b>11%</b>	<b>11.0%</b>		
Revenue (organic)		17.2%	10.0%	9.8%	12.0%	11.6%	11%	11.0%	8%	8%
Gross profit		28%	33%	18%	19%	19%	13%	17%	8%	8%
SG&A		24%	28%	1%	5%	-1%	1%	1%	5%	7%
EBITDA		35%	38%	43%	36%	42%	26%	36%	10%	9%
<b>Operating income</b>		<b>38%</b>	<b>41%</b>	<b>54%</b>	<b>40%</b>	<b>50%</b>	<b>28%</b>	<b>42%</b>	<b>11%</b>	<b>9%</b>
Net income (excl. non-recurring items)		-22%	115%	248%	109%	141%	67%	122%	15%	15%
<b>EPS (excl. non-recurring items, incl. options)</b>		<b>-21%</b>	<b>92.6%</b>	<b>123%</b>	<b>34%</b>	<b>53%</b>	<b>40%</b>	<b>54%</b>	<b>15%</b>	<b>15%</b>
EPS (as reported)		3188%	-67%	NM	NM	NM	NM	NM	45%	29%
Diluted shares outstanding		-1%	10%	56%	56%	58%	20%	45%	1%	0%

E=William Blair &amp; Company, L.L.C. estimate

Source: Company reports, and William Blair &amp; Company, L.L.C. estimates

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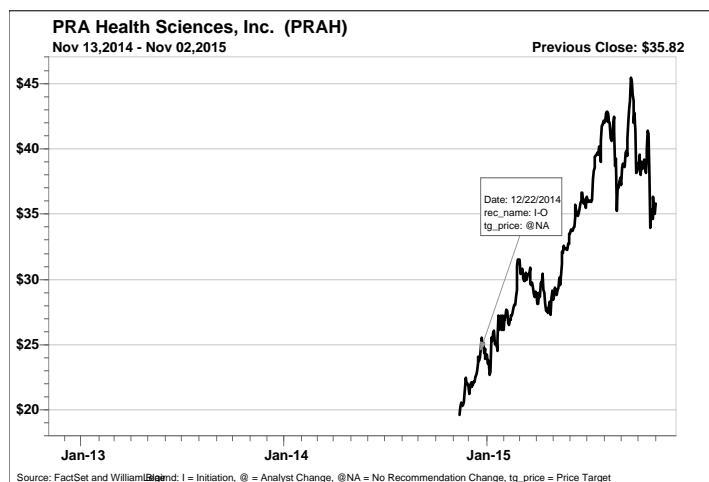
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DOW JONES: 17,663.54

S&P 500: 2,079.36

NASDAQ: 5,053.75



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Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	67	Outperform (Buy)	15
Market Perform (Hold)	31	Market Perform (Hold)	3
Underperform (Sell)	2	Underperform (Sell)	0

\*Percentage of companies in each rating category that are investment banking clients, defined as companies for which William Blair has received compensation for investment banking services within the past 12 months.

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