

PRA Health Sciences (PRAH)

3Q15 First Thoughts

BUY

Price target \$48.00

Price \$37.75

Key Takeaway

PRAH once again posted solid revenue growth, margin expansion, and net bookings. 3Q has been the quarter of the mid-tier CRO, as PRAH and INCR have both posted strong book-to-bills and EPS growth. Despite trading up 7.7% this afternoon, PRAH remains down -18.5% from its 9/17 close versus late-stage peers, down -13% in the same period.

Best Bookings from the Small Guys. 3Q bookings have favored smaller late-stage CROs, PRAH (1.25x) and INCR (1.4x), compared 1.2x or below for the larger players. 3Q15 was the 6th consecutive quarter PRAH's book-to-bill has been above 1.19x. Strategic Solutions (FSP) business wins are booked on a rolling 4Q basis and trend ~1.05-1.10x. By our calculation, programmatic business (~65% of revenue) generated ~1.34x book-to-bill. Relationship opportunities among non-Top 20 pharma are beginning to ripen, and PRAH is well-placed to win these types of awards.

Margin Continuing to Move Up. Adj. EBITDA margins increased 190 bps YoY and 40 bps sequentially. Investors have tended to get hung up on the "lower profitability" of the FSP business. Management branded this segment Strategic Solutions. We agreed that margins were lower, but have repeatedly highlighted that those margins weren't permanently depressed at sub-10% (even sub-8%). We believe management has increased profitability in both FSP and programmatic work. On the programmatic side, we believe management has achieved the improvements without the full benefit of labor rate "clawback" from the programmer inflation in 2014, which means that can provide tailwind into next year.

Revenue Acceleration According to Our Expectation. Another knock on PRAH's outlook was the structurally slower growth from the Strategic Solutions business. Management predicted that revenue growth should re-accelerate in that business after a year of cleaning out dead wood (our words, not theirs), cross-introducing the businesses, and winning new contracts. Revenue growth was 12% constant dollar in 3Q, continuing the double-digit, consolidated performance in 2015. We believe that growth reflects fairly similar growth performances from both programmatic and Strategic Solutions businesses.

Leverage Ratio Remains Flat Sequentially. On the 2Q call, management indicated cash collections have historically been stronger in the back half and called out \$10M debt repayment citing strong collections in early July. That said, we expected further senior debt reduction in August/September. An additional \$20M revolver debt also remained outstanding, leaving net debt change at +\$10M in 3Q. The higher debt is most likely attributable to an increased JV investment (\$23M). A higher TTM EBITDA offset increased debt leaving PRAH with a flat leverage ratio at 3.8x.

David Windley, CFA, CPA *Equity Analyst
(615) 963-8313 dwindley@jefferies.com**Jared Meggison ***Equity Associate
(615) 963-8316 jmeggison@jefferies.com

* Jefferies LLC

Chart 1: Summary of PRA's Results

PRA Health Sciences (PRAH)

3Q15 Earnings Summary

Sources: Company filings and Jefferies LLC

Reports 11/02/2015 AMC

FY ending December 31 in thousands except EPS	Reported		Estimate	Actual	Consensus	Percentage Change		Difference		
	3Q14	2Q15	3Q15	3Q15	3Q15	Seq	Y/Y	Seq	Y/Y	Est.
Net revenue	\$ 320,063	\$ 336,518	\$ 344,522	\$ 345,096	\$ 346,100	2.5%	7.8%	\$ 8,578	\$ 25,033	\$ 574
Direct costs	215,746	219,877	226,721	220,919		0.5%	2.4%	1,042	5,173	(5,802)
SG&A	58,739	57,489	59,783	60,479		5.2%	3.0%	2,990	1,740	696
FOREX	(10,658)	3,966	-	(3,697)		<u>(193.2%)</u>	<u>(65.3%)</u>	<u>(7,663)</u>	<u>6,961</u>	<u>(3,697)</u>
Adj EBITDA	56,236	55,186	58,019	67,395	59,700	22.1%	19.8%	12,209	11,159	9,376
Depreciation	5,989	5,085	5,254	5,432		<u>6.8%</u>	<u>(9.3%)</u>	<u>347</u>	<u>(557)</u>	<u>178</u>
Total expenses	269,816	286,417	291,758	283,133		(1.1%)	4.9%	(3,284)	13,317	(8,625)
Adj EBITA	50,247	50,101	52,764	61,963		23.7%	23.3%	11,862	11,716	9,199
Interest income (expense)	(19,541)	(13,779)	(13,369)	(13,719)		(0.4%)	(29.8%)	60	5,822	(350)
Other income (expense)	(532)	(96)	-	(947)		<u>886.5%</u>	<u>78.0%</u>	<u>(851)</u>	<u>(415)</u>	<u>(947)</u>
Pretax income	30,174	(36,226)	39,396	47,297		(230.6%)	56.7%	83,523	17,123	7,901
Taxes	10,259	10,868	11,819	14,189		<u>30.6%</u>	<u>38.3%</u>	<u>3,321</u>	<u>3,930</u>	<u>2,370</u>
Adj Net income	19,915	25,358	27,577	33,108		30.6%	66.2%	7,750	13,193	5,531
Adj EPS b/f charges	\$ 0.49	\$ 0.40	\$ 0.44	\$ 0.52	\$ 0.45	29.4%	5.5%	\$ 0.12	\$ 0.03	\$ 0.08
Diluted shares	40,286	62,951	62,988	63,504		0.9%	57.6%	553	23,218	516
COMMON SIZE										
Net revenue	100.0%	100.0%	100.0%	100.0%				-	-	-
Direct costs	<u>67.4%</u>	<u>66.0%</u>	<u>65.8%</u>	<u>64.0%</u>				<u>(190)</u>	<u>(340)</u>	<u>(180)</u>
Gross margin	32.6%	34.0%	34.2%	36.0%				190	340	180
SG&A	<u>18.4%</u>	<u>17.7%</u>	<u>17.4%</u>	<u>17.5%</u>				<u>(20)</u>	<u>(80)</u>	<u>20</u>
Adj EBITDA	17.6%	19.1%	16.8%	19.5%				40	200	270
Adj EBITDA ex-FOREX	14.2%	16.4%	16.8%	18.5%						
Depreciation	<u>1.9%</u>	<u>1.5%</u>	<u>1.5%</u>	<u>1.6%</u>				<u>-</u>	<u>(30)</u>	<u>-</u>
Total expenses	84.3%	82.5%	84.7%	82.0%				(40)	(230)	(260)
Adj EBITA	15.7%	17.5%	15.3%	18.0%				40	230	260
Interest income (expense)	(6.1%)	(4.1%)	(3.9%)	(4.0%)				20	210	(10)
Other income (expense)	<u>(0.2%)</u>	<u>(0.1%)</u>	<u>0.0%</u>	<u>(0.3%)</u>				<u>(10)</u>	<u>(10)</u>	<u>(30)</u>
Pretax income	9.4%	13.3%	11.4%	13.7%				40	430	230
Taxes	<u>34.0%</u>	<u>30.0%</u>	<u>30.0%</u>	<u>30.0%</u>				-	(400)	-
Adjusted net income	6.2%	9.3%	8.0%	9.6%				30	340	160
Gross new busines	442,000	407,800	513,828							
Cancellations	(59,900)	-	(82,212)							
% of backlog	2.8%	0.0%	3.5%							
Net new business	382,100	407,800	431,616	431,400				5.8%	12.9%	-0.1%
Book-to-bill	1.19x	1.21x	1.25x	1.25x						

Source: Company data and Jefferies LLC

Company Description

PRA Health Sciences is a leading global contract research organization. The company provides outsourced clinical development services to the biotechnology and pharmaceutical industries. PRA's global clinical development platform spans 80 countries and employs more than 10,000 individuals worldwide. Since 2000, the company has performed approximately 2,300 clinical trials worldwide and has worked on more than 100 marketed drugs across several therapeutic areas.

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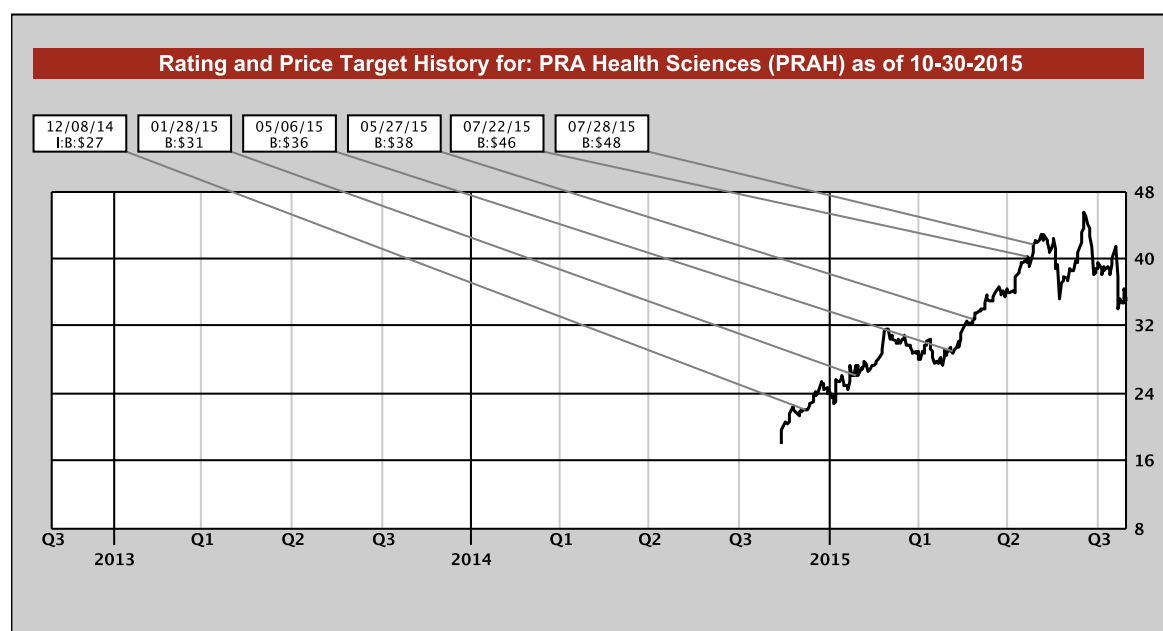
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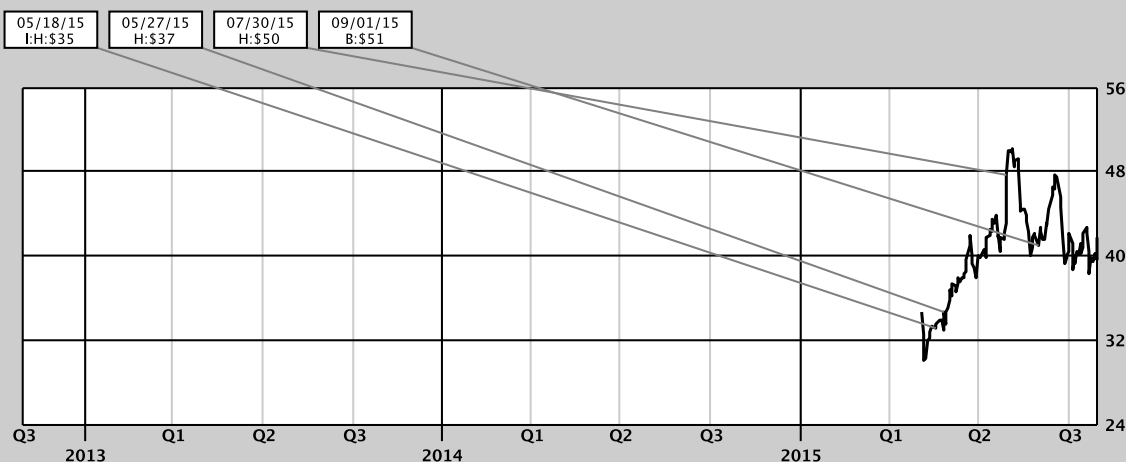
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- PRA Health Sciences (PRAH: \$37.75, BUY)



Rating and Price Target History for: INC Research Holdings, Inc. (INCR) as of 10-30-2015



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			Count	Percent
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