

May 07, 2015

PRA Health Sciences, Inc.

First-Quarter Summary; Foreign Exchange Drives Guidance Increase; Expectations Have Potential For Upside

- Conclusions.** PRA reported strong first-quarter results on May 6, with EPS \$0.11 above our expectations. Foreign exchange drove \$0.07 of outperformance (mainly in the form of higher gross margins), with the remaining \$0.03 driven by faster backlog conversion leading to higher revenues. As a result of the solid quarterly results, guidance for the year was increased by \$0.27 at the midpoint to a revised range of \$1.62 to \$1.72 (excluding \$0.07 of stock option expense). Given that \$0.07 of the \$0.10 outperformance in the quarter is related to currency and that currency movement will continue to be a major tailwind to EPS, we believe that most—if not all—of the guidance increase is related to foreign exchange. As such, we believe that there may be some conservatism built into expectations considering strong revenues and bookings in the quarter. We now model 2015 EPS of \$1.60 (including \$0.07 of stock compensation expense), up \$0.24 from \$1.36 previously. In 2016, we now model EPS of \$1.86, up \$0.22 from \$1.64 previously. We reiterate our Outperform rating on PRA, particularly given the stock's lack of reaction to the guidance increase.
- Group Fundamentals Remain Strong.** The first-quarter's net book-to-bill ratio was a strong 1.20 times, continuing the strong bookings trend in the quarter for the clinical CROs. The group's book-to-bill was 1.28 times in the first quarter. This ratio is down sequentially, but continues a strong upward trend in the metric over the past four quarters (see exhibit 1). We believe that this improvement has been driven by a return to R&D spending growth by large pharma and record funding for the biotech industry. In addition, better leverage of technology, closer relationship with clients, and foreign-exchange movement have driven group adjusted operating margin to the highest level since 2009. As illustrated in exhibit 2, the group's average EBIT margin increased 96 basis points sequentially and 240 basis points from a year ago. While we acknowledge that foreign exchange is likely contributing significantly to this improvement in margin, we believe that fundamentals in the space are quite strong at present. We believe that this makes it increasingly likely that the group can maintain its high-single-digit revenue growth and midteens earnings growth for the next year.
- PRA Model changes.** Following the better quarter and increased guidance, we have made the following changes to our model:
 - We now model 2015 revenue of \$1.36 billion (up 7.1%), adjusted EBITDA margin of 16.1%, and EPS of \$1.60 (up 33%). This compares with our previous estimates of \$1.34 billion (up 5.7%), adjusted EBITDA margin of 14.9%, and EPS of \$1.36.

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

Symbol: PRAH (NASDAQ)
Price: \$28.86 (52-Wk.: \$18-\$32)
Market Value (mil.): \$1,735
Fiscal Year End: December
Long-Term EPS Growth Rate: 17%
Dividend/Yield: None

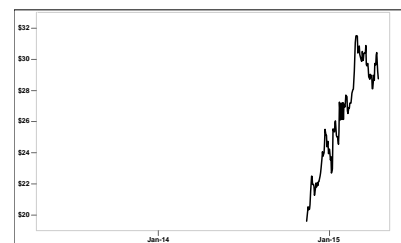
	2014A	2015E	2016E
Estimates			
EPS Q1	\$0.18	A\$0.40	NA
Q2	\$0.34	\$0.39	NA
Q3	\$0.33	\$0.40	NA
Q4	\$0.34	\$0.40	NA
FY	\$1.20	\$1.60	\$1.86
CY		\$1.60	\$1.86

Valuation			
FY P/E	24.1x	18.0x	15.5x
CY P/E		18.0x	15.5x

Trading Data (FactSet)			
Shares Outstanding (mil.)			51
Float (mil.)			21
Average Daily Volume			190,989

Financial Data (FactSet)			
Book Value Per Share (MRQ)			11.3
Return on Equity (TTM)			-6.2

Two-Year Price Performance Chart



Sources: FactSet, William Blair & Company estimates

- For 2016, we now model revenue of \$1.46 billion (up 7.7%), adjusted EBITDA margin of 16.4%, and EPS of \$1.86 (up 16%). This compares with our previous estimates of \$1.44 billion (up 7.7%), adjusted EBITDA margin of 15.6%, and EPS of \$1.64 (up 21%).

- **Valuation and Stock Thoughts.** PRA now trades at 15.5 times our revised 2016 EPS estimate of \$1.86 (up 16%). Currently the clinical CRO peer group trades at 17.5 times (ICON [ICLR \$65.47; Outperform] at 16.0 times, Quintiles [Q \$64.86; Outperform] at 18.9 times, INC Research [INC \$30.06; Outperform] at 17.6 times, and Parexel [PRXL \$64.26; Outperform] at 17.8 times). Given the significant upside to guidance, we are surprised that the stock did not react favorably on May 7, suggesting sentiment is cooling on the space at present. Given that the group multiple has declined from the low 20s to about 17 at present, despite strong underlying fundamentals, we believe that the outlook is strong for PRA and its peers to outperform in the coming year. Our updated model is included on the following page.

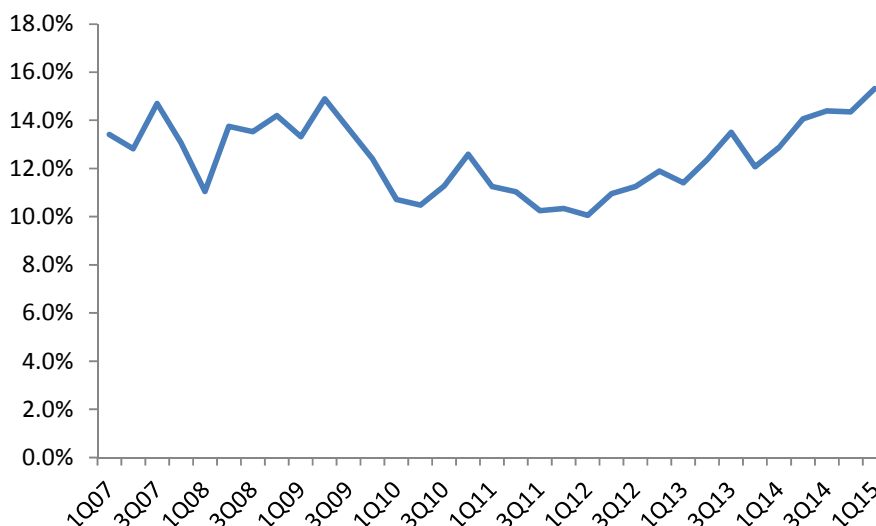
Exhibit 1. CRO Group Average Net Book-to-Bill Ratio, 2007 to Present



Note: Group includes CVD, ICLR, INCR, PRXL, PRA, and Q.

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

Exhibit 2. CRO Group Average Operating Margin, 2007 to Present



Note: Group includes CRL, CVD, ICLR, INCR, PRXL, PRA, and Q.

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

Exhibit 3: Updated Income Statement for PRA Health Sciences, 2012 to 2017 (E)

	2012	2013	2014	Q1'15	Q2'15E	Q3'15E	Q4'15E	2015E	2016E	2017E
Net revenue	\$597,072	\$832,901	\$1,266,596	\$331,968	\$333,322	\$341,125	\$349,912	\$1,356,326.5	\$1,460,118	\$1,571,884
Cost of revenue	357,812	525,488	858,493	218,786	221,659	226,848	233,391	900,684	978,318	1,050,445
Gross profit	239,260	307,413	408,103	113,182	111,663	114,277	116,521	455,642	481,800	521,439
Selling, general and administrative expense	143,077	177,338	226,494	57,440	56,331	57,991	59,485	231,248	236,536	251,114
Stock comp	1,010	1,141	3,467	775	1,500	1,774	1,925	5,973	6,425	6,445
EBITDA	95,173	128,934	178,142	54,967	53,831	54,512	55,111	218,421	238,840	263,881
Depreciation	15,041	18,053	22,211	5,128	5,000	5,117	5,249	20,493	21,902	23,418
Operating income (including options beg Q105)	80,132	110,881	155,931	49,839	48,832	49,395	49,862	197,928	216,938	240,462
Interest and other income (expense), net	(28,499)	(52,898)	(76,202)	(13,744)	(13,687)	(13,656)	(13,638)	(54,725)	(50,149)	(43,949)
Pretax income	51,633	57,983	79,729	36,095	35,144	35,739	36,225	143,203	166,789	196,514
Income tax expense	20,347	33,556	27,188	10,829	10,543	10,722	10,867	42,961	50,037	58,954
Net income (excl. nonrecurring items, excl. amort., incl. options and deferred rent)	31,286	24,427	52,541	25,267	24,601	25,017	25,357	100,242	116,752	137,560
				233						
Nonrecurring items	(56,188)	(185,581)	(123,626)	(10,886)	(\$21,280)	(\$21,280)	(\$21,290)	(74,736)	(50,044)	(37,632)
Tax adjustment	22,195	72,821	35,343	2,806	6,384	6,384	6,387	21,961	15,013	11,290
Nonrecurring items (net of tax)	(33,993)	(112,760)	(88,283)	(8,080)	(14,896)	(14,896)	(14,903)	(52,775)	(35,031)	(26,342)
Net income (GAAP)	(\$2,707)	(\$88,333)	(\$35,742)	\$17,187	\$9,705	\$10,121	\$10,454	\$47,467	\$81,722	\$111,217
EPS (excl. nonrecurring items, excl. amort. incl. options and def rent)	\$0.79	\$0.62	\$1.20	\$0.40	\$0.39	\$0.40	\$0.40	\$1.60	\$1.86	\$2.18
EPS (excl. nonrecurring items, excl. amort. incl. options and def rent)										
EPS (as reported)	(\$0.07)	(\$2.25)	(\$0.75)	\$0.27	\$0.15	\$0.16	\$0.17	\$0.76	\$1.30	\$1.76
Weighted average shares outstanding (diluted)	39,641	39,337	43,457	62,777	62,802	62,827	62,852	62,815	62,915	63,015
MARGIN ANALYSIS:										
Gross profit	40.1%	36.9%	32.2%	34.1%	33.5%	33.5%	33.3%	33.6%	33.0%	33.2%
SG&A	24.0%	21.3%	17.9%	17.3%	16.9%	17.0%	17.0%	17.0%	16.2%	16.0%
Stock comp	0.2%	0.1%	0.3%	0.2%	0.5%	0.5%	0.6%	0.4%	0.4%	0.4%
Total SG&A	24.1%	21.4%	18.2%	17.5%	17.4%	17.5%	17.6%	17.5%	16.6%	16.4%
EBITDA	15.9%	15.5%	14.1%	16.6%	16.2%	16.0%	15.8%	16.1%	16.4%	16.8%
Depreciation & amortization	2.5%	2.2%	1.8%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
Operating income	13.4%	13.3%	12.31%	15.0%	14.7%	14.5%	14.3%	14.59%	14.9%	15.3%
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%	7.4%	7.3%	7.2%	7.4%	8.0%	8.8%
GROWTH RATES:										
Revenue		39.5%	52.1%	6.6%	7%	7%	8%	7.1%	7.7%	7.7%
Revenue (excl. foreign exchange effect)				9.8%	10%	9%	9%	9.4%		
Revenue (organic)		17.2%	10.0%	9.8%	10%	9%	9%	9.4%	8%	8%
Gross profit		28%	33%	18%	14%	9%	7%	12%	6%	8%
SG&A		24%	28%	1%	6%	0%	2%	2%	2%	6%
EBITDA		35%	38%	43%	22%	20%	10%	23%	9%	10%
Operating income		38%	41%	54%	24%	25%	12%	27%	10%	11%
Net income (excl. non-recurring items)		-22%	115%	248%	78%	88%	40%	91%	16%	18%
EPS (excl. non-recurring items, incl. options)		-21%	92.6%	123%	14%	20%	18%	33%	16%	18%
EPS (as reported)		3188%	-67%	NM	NM	NM	NM	NM	72%	36%
Diluted shares outstanding		-1%	10%	56%	56%	56%	19%	45%	0%	0%

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

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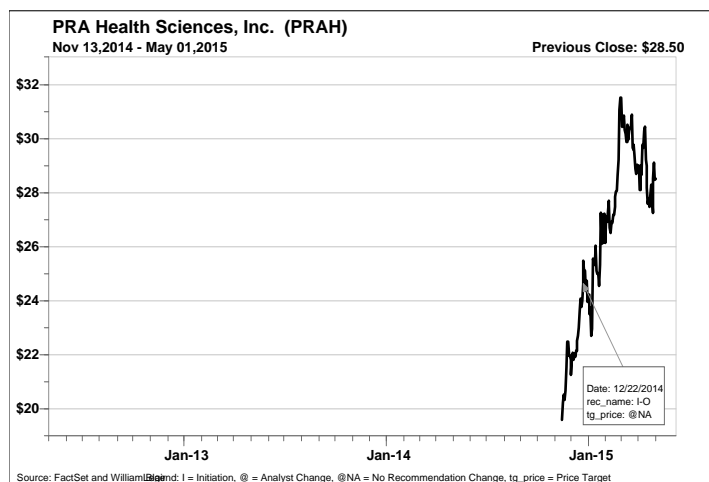
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DOW JONES: 17,841.98

S&P 500: 2,080.15

NASDAQ: 4,919.65



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Outperform (Buy)	65	Outperform (Buy)	14
Market Perform (Hold)	32	Market Perform (Hold)	2
Underperform (Sell)	2	Underperform (Sell)	0

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