

Equity Research

PRA Health Sciences, Inc.

PRAH: Q4 2014 Earnings Full Analysis

• **What to do from here.** PRAH has strong momentum following its first quarter as a public company. Revenue, EPS, and bookings all beat consensus, and the company issued 2015 guidance with a mid-point above consensus. With a conservative coverage ratio, the outlook for continued high-single digit revenue growth and 20%+ EPS growth seems realistic, which we believe offers support for the current valuation. We are raising our valuation range to \$32-34 from \$27-28 and increasing our 2015E EPS to \$1.34 from \$1.31. Establishing our 2016E EPS of \$1.73.

• **Financial highlights.** Revenue of \$324MM beat consensus of \$320MM. EPS of \$0.31 beat our estimate of \$0.29 (recall that we include stock comp, JV, and non-cash rent, which the company excludes, making consensus EPS somewhat unreliable). Book-to-bill of 1.20x beat our estimate of 1.16x. The stand-out line item driving the EPS beat was gross margin, which came in 100 bps above our estimate on better utilization.

• **Guidance highlights.** The company issued 2015 EPS guidance of \$1.35-1.45 on revenue of \$1.35-1.40B. The revenue guidance assumes 8-12% constant currency growth and uses "first of January" FX rates. We note that rates have since deteriorated, so our revenue estimate is toward the low end of the range. However, we think a stronger USD can offer a margin benefit, so our EPS estimate (when adjusted for about \$0.06 of stock comp, JV, and non-cash rent) would be at the mid-point of the range. Management indicated the current backlog covers 88% of 2015 revenue guidance, which compares favorably to the other two companies that give this metric (Q and ICLR), causing us to view guidance as relatively conservative.

Valuation Range: \$32.00 to \$34.00 from \$27.00 to \$28.00

Our valuation range is DCF-based (WACC = 8.5%; terminal NOPLAT growth = 2%) and represents 18.8x our 2016E EPS estimate. Risks include: (1) project cancellations or delays due to client M&A, economic weakness, pipeline reprioritization, or compound failure; (2) a reversal in the trend toward increased outsourcing; (3) regulatory risks; (4) significant financial leverage; (5) integration risks, and (6) controlled company status.

Investment Thesis:

Between high-single digit revenue growth, ongoing margin expansion, and a reduction in interest expense, we believe the company will be able to generate solid 20%+ earnings growth for several years, which we believe is attractive growth at current valuation levels.

Outperform / V

Sector: Pharmaceutical Services

Overweight

Earnings Estimates Revised Up

EPS	2014A	2015E		2016E	
		Curr.	Prior	Curr.	Prior
Q1 (Mar.)	\$0.18	\$0.31	0.29	\$0.41	
Q2 (June)	0.34	0.32	NC	0.42	
Q3 (Sep.)	0.30	0.34	NC	0.44	
Q4 (Dec.)	0.31	0.37	0.36	0.46	
FY	\$1.12	\$1.34	1.31	\$1.73	
CY	\$1.12	\$1.34		\$1.73	
FY P/EPS	25.0x	20.9x		16.2x	
Rev.(MM)	\$1,267	\$1,357		\$1,476	

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters
NA = Not Available, NC = No Change, NE = No Estimate, NM = Not Meaningful
V = Volatile, * = Company is on the Priority Stock List

Non-GAAP EPS excludes amortization of purchased intangibles and certain non-recurring items

Ticker	PRAH
Price (02/19/2015)	\$28.04
52-Week Range:	\$18-29
Shares Outstanding: (MM)	57.3
Market Cap.: (MM)	\$1,606.7
S&P 500:	2,097.45
Avg. Daily Vol.:	169,071
Dividend/Yield:	\$0.00/0.0%
LT Debt: (MM)	\$949.0
LT Debt/Total Cap.:	58.0%
ROE:	30.0%
3-5 Yr. Est. Growth Rate:	22.0%
CY 2015 Est. P/EPS-to-Growth:	1.0x
Last Reporting Date:	02/18/2015

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters

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Please see page 4 for rating definitions, important disclosures and required analyst certifications

All estimates/forecasts are as of 02/19/15 unless otherwise stated.

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Together we'll go far



Exhibit 1. Variance Table

FY ending December	Actual		Est	Actual	Cons	Yr / Yr	Seq
In millions except EPS	Q4 2013	Q3 2014	Q4 2014	Q4 2014	Q4 2014	change	change
Total revenues	\$ 299	\$ 320	\$ 322	\$ 324	\$ 320	8.4%	1.2%
Cost of revenues	205	216	217	215		4.8%	(0.4%)
Gross profit	94	104	105	109		16.1%	4.3%
Selling, general & administrative	59	59	59	60		1.4%	2.0%
Depreciation	5	6	6	5		(1.3%)	(9.5%)
Operating income	29	40	40	43		49.2%	9.9%
Interest expense and other, net	20	20	16	17		(16.5%)	(13.2%)
Pretax income	9	20	24	27		200.2%	32.3%
Provision for income taxes	(1)	7	8	9		NA	30.5%
Income before equity in affiliates	10	13	\$ 16	\$ 17		73.1%	33.3%
Equity in earnings from JV	(1)	(0)	(0)	(1)		67.4%	118.6%
Net income	9	12	\$ 16	\$ 16		73.5%	30.1%
Non-GAAP EPS	\$ 0.24	\$ 0.30	\$ 0.29	\$ 0.31			3.3%
Non-GAAP EPS (company method)	\$ 0.26	\$ 0.34	\$ 0.31	\$ 0.35			4.3%
Diluted shares outstanding	39	42	53	53			
EBITDA	\$ 35	\$ 46	\$ 46	\$ 49	\$ 47	41.2%	7.3%
MARGIN ANALYSIS							
Cost of revenue	68.6%	67.4%	67.4%	66.4%		(220) bps	(100) bps
Gross margin	31.4%	32.6%	32.6%	33.6%		220 bps	100 bps
SG&A / revenue	19.8%	18.4%	18.3%	18.5%		(130) bps	10 bps
Depreciation / revenue	1.8%	1.9%	1.8%	1.7%		(20) bps	(20) bps
Operating margin	9.8%	12.4%	12.5%	13.4%		370 bps	110 bps
Tax rate	(13.0%)	35.3%	34.0%	34.8%		4780 bps	(50) bps
Net margin	3.3%	4.1%	5.0%	5.3%		200 bps	130 bps
EBITDA margin	11.6%	14.2%	14.3%	15.1%		350 bps	90 bps
REVENUE ANALYSIS							
Total revenues	\$ 299	\$ 320	\$ 322	\$ 324		8.4%	1.2%
Growth: core	17.6%	10.4%	8.4%	8.3%			
Growth: FX	0.0%	0.2%	(3.1%)	(1.6%)			
Growth: acquisitions	74.1%	59.5%	2.3%	1.7%			
Growth: total	91.7%	70.1%	7.7%	8.4%			
BOOKINGS & BACKLOG							
Beginning backlog	\$ 1,466	\$ 2,045	\$ 2,091	\$ 2,091		42.7%	2.3%
Revenue	(299)	(320)	(322)	(324)			
Gross bookings	270	442	435	457			
Cancellations	(68)	(60)	(61)	(68)			
Other adjustments	571	(15)	(9)	(15)			
Ending backlog	\$ 1,940	\$ 2,091	\$ 2,135	\$ 2,141		10.4%	2.4%
Total net bookings	\$ 202	\$ 382	\$ 374	\$ 388		92.3%	1.6%
Gross book-to-bill	0.90	1.38	1.35	1.41			
Net book-to-bill	0.68	1.19	1.16	1.20			
Backlog burn rate	20.4%	15.7%	15.4%	15.5%			

Source: FactSet; Company data; Wells Fargo Securities, LLC estimates

Exhibit 2. Guidance Table

Guidance	Q1 2015	Q2 2015	Q3 2015	Q4 2015	2015	Notes
Consolidated Revenue (MM)						
2/19/2015					\$1,350-1,400	8-12% cc growth; Assumes first of January FX rates
Taxes (MM)						
2/19/2015					30%	
Adjusted EPS						
2/19/2015					\$1.35-1.45	

Source: Company data; Wells Fargo Securities, LLC

Exhibit 3. Earnings Model

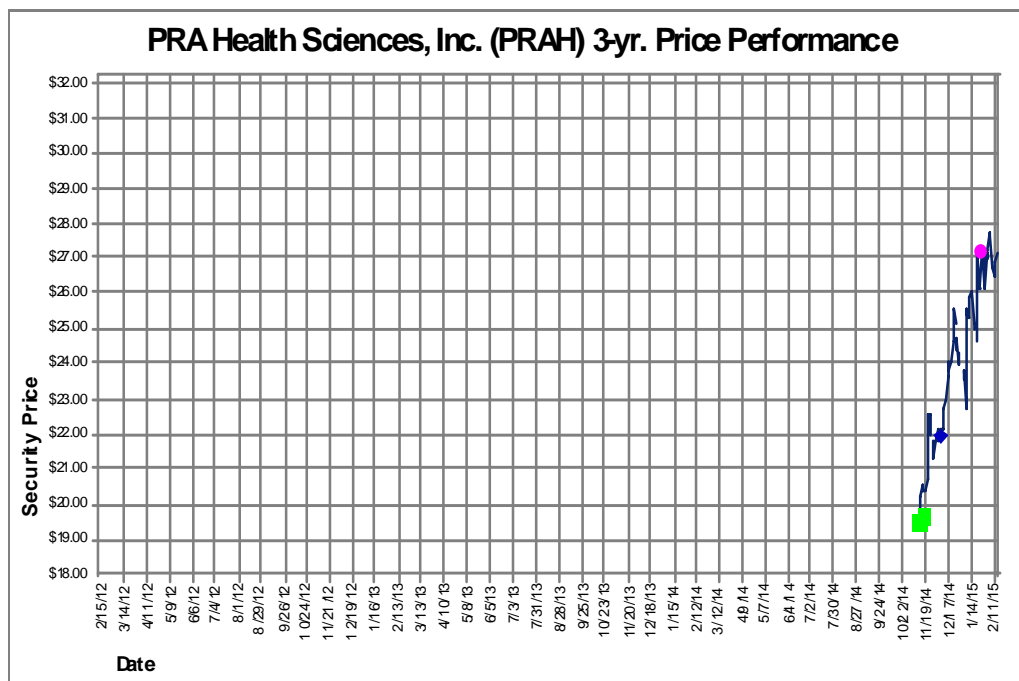
In millions, except per share

INCOME STATEMENT	2011	2012	2013	Q1	Q2	Q3	Q4	2014	Q1E	Q2E	Q3E	Q4E	2015E	2016E
Total revenues	\$ 548	\$ 597	\$ 833	\$ 311	\$ 311	\$ 320	\$ 324	\$ 1,267	\$ 330	\$ 336	\$ 341	\$ 350	\$ 1,357	\$ 1,476
Cost of revenues	321	359	527	215	213	216	215	859	223	229	232	237	920	999
Gross profit	226	239	306	96	98	104	109	407	107	108	109	113	437	477
Selling, general & administrative	135	154	201	58	54	59	60	230	59	59	60	62	240	255
Depreciation	13	15	18	6	5	6	5	22	6	6	6	6	23	26
Operating income	78	70	87	32	39	40	43	155	42	43	43	45	173	196
Interest expense and other, net	31	28	53	20	19	20	17	76	13	13	13	13	53	48
Pretax income	47	41	34	12	20	20	27	79	29	29	30	32	120	148
Provision for income taxes	15	16	24	5	6	7	9	27	9	9	9	10	36	42
Income before equity in affiliate	\$ 32	\$ 25	\$ 10	\$ 7	\$ 14	\$ 13	\$ 17	\$ 52	\$ 20	\$ 20	\$ 21	\$ 23	\$ 84	\$ 106
Equity in earnings from unconsolidated subsidiaries	-	-	(1)	(0)	(0)	(0)	(1)	(2)	(1)	(1)	-	1	(1)	3
Net income	\$ 32	\$ 25	\$ 9	\$ 7	\$ 14	\$ 12	\$ 16	\$ 50	\$ 19	\$ 20	\$ 21	\$ 23	\$ 83	\$ 109
Non-GAAP EPS	\$ 0.78	\$ 0.63	\$ 0.22	\$ 0.18	\$ 0.34	\$ 0.30	\$ 0.31	\$ 1.12	\$ 0.31	\$ 0.32	\$ 0.34	\$ 0.37	\$ 1.34	\$ 1.73
Non-GAAP EPS (company method)	\$ 0.84	\$ 0.80	\$ 0.63	\$ 0.20	\$ 0.36	\$ 0.34	\$ 0.35	\$ 1.26	\$ 0.33	\$ 0.34	\$ 0.35	\$ 0.38	\$ 1.40	\$ 1.73
Diluted shares outstanding	41	40	40	40	40	42	53	44	62	62	62	62	62	63
EBITDA	\$ 92	\$ 85	\$ 105	\$ 38	\$ 44	\$ 46	\$ 49	\$ 177	\$ 48	\$ 48	\$ 49	\$ 51	\$ 197	\$ 221
MARGIN ANALYSIS														
Cost of revenue	58.7%	60.1%	63.3%	69.1%	68.5%	67.4%	66.4%	67.8%	67.6%	68.0%	68.0%	67.7%	67.8%	67.7%
Gross margin	41.3%	39.9%	36.7%	30.9%	31.5%	32.6%	33.6%	32.2%	32.4%	32.0%	32.0%	32.3%	32.2%	32.3%
SG&A / revenue	24.6%	25.8%	24.1%	18.6%	17.3%	18.4%	18.5%	18.2%	17.9%	17.6%	17.6%	17.6%	17.7%	17.3%
Depreciation / revenue	2.4%	2.5%	2.2%	1.9%	1.6%	1.9%	1.7%	1.8%	1.7%	1.7%	1.7%	1.7%	1.7%	1.8%
Operating margin	14.3%	11.6%	10.5%	10.4%	12.6%	12.4%	13.4%	12.2%	12.8%	12.7%	12.7%	13.0%	12.8%	13.2%
Tax rate	32.3%	39.4%	70.5%	38.9%	30.4%	35.3%	34.8%	34.4%	30.0%	30.0%	30.0%	30.0%	30.0%	28.5%
Net margin	5.8%	4.2%	1.2%	2.4%	4.5%	4.1%	5.3%	4.1%	6.1%	6.1%	6.1%	6.5%	6.2%	7.2%
EBITDA margin	16.7%	14.2%	12.6%	12.3%	14.2%	14.2%	15.1%	14.0%	14.5%	14.4%	14.4%	14.7%	14.5%	15.0%
CHANGE ANALYSIS YR / YR														
Total revenues	21.4%	9.0%	39.5%	87.0%	73.5%	70.1%	8.4%	52.1%	5.9%	8.0%	6.6%	8.0%	7.1%	8.8%
Gross profit	11.7%	5.3%	28.3%	45.0%	33.6%	43.7%	16.1%	33.1%	11.1%	9.7%	4.7%	3.8%	7.2%	9.2%
SG&A	15.9%	14.1%	30.4%	12.3%	29.4%	21.1%	1.4%	14.7%	2.0%	10.1%	2.2%	2.7%	4.1%	6.5%
Depreciation	9.9%	13.6%	20.0%	42.3%	23.4%	34.7%	(1.3%)	23.0%	(6.0%)	17.1%	(0.8%)	12.9%	5.1%	10.7%
Operating income	5.4%	(11.2%)	25.5%	204.7%	41.4%	101.7%	49.2%	77.5%	30.2%	8.4%	9.2%	4.1%	12.0%	12.8%
Net income	51.5%	(21.8%)	(64.1%)	2669.9%	15.9%	NA	73.1%	455.2%	164.9%	47.0%	67.9%	42.6%	68.0%	30.6%
EPS	47.8%	(19.9%)	(64.7%)					406.7%	71.6%	(4.9%)	13.4%	21.3%	19.1%	29.5%
Diluted shares outstanding	2.5%	(2.4%)	1.6%					9.6%	54.4%	54.5%	48.0%	17.5%	41.1%	0.8%
EBITDA	6.0%	(7.6%)	24.5%	159.2%	39.1%	89.3%	41.2%	68.1%	24.7%	9.3%	7.8%	5.1%	11.1%	12.5%
REVENUE ANALYSIS														
Total revenues	\$ 548	\$ 597	\$ 833	\$ 311	\$ 311	\$ 320	\$ 324	\$ 1,267	\$ 330	\$ 336	\$ 341	\$ 350	\$ 1,357	\$ 1,476
Growth: core	19.1%	10.2%	15.2%	11.7%	4.1%	10.4%	8.3%	8.5%	10.1%	12.2%	10.1%	10.0%	10.6%	8.8%
Growth: FX	2.3%	(1.2%)	(0.4%)	2.5%	3.7%	0.2%	(1.6%)	0.8%	(4.2%)	(4.3%)	(3.5%)	(2.0%)	(3.5%)	0.0%
Growth: acquisitions	0.0%	0.0%	24.7%	72.8%	65.7%	59.5%	1.7%	42.8%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Growth: total	21.4%	9.0%	39.5%	87.0%	73.5%	70.1%	8.4%	52.1%	5.9%	8.0%	6.6%	8.0%	7.1%	8.8%
BOOKINGS & BACKLOG														
Beginning backlog		\$ 1,314	\$ 1,383	\$ 1,940	\$ 1,987	\$ 2,045	\$ 2,091	\$ 1,940	\$ 2,141	\$ 2,176	\$ 2,231	\$ 2,285	\$ 2,141	\$ 2,342
Revenue		(597)	(833)	(311)	(311)	(320)	(324)	(1,267)	(330)	(336)	(341)	(350)	(1,357)	(1,476)
Gross bookings		948	998	423	424	442	457	1,745	447	454	461	472	1,833	1,993
Cancellations		(294)	(223)	(72)	(52)	(60)	(68)	(252)	(62)	(63)	(65)	(66)	(256)	(282)
Other adjustments		12	615	8	(3)	(15)	(15)	(26)	(20)	-	-	-	(20)	-
Ending backlog	\$ 1,314	\$ 1,383	\$ 1,940	\$ 1,987	\$ 2,045	\$ 2,091	\$ 2,141	\$ 2,141	\$ 2,176	\$ 2,231	\$ 2,285	2,342	\$ 2,342	\$ 2,577
Total net bookings		653.50	774	\$ 351	\$ 372	\$ 382	\$ 388	1,494	\$ 385	\$ 391	\$ 396	\$ 406	\$ 1,577	\$ 1,711
Gross book-to-bill		1.59	1.20	1.36	1.36	1.38	1.41	1.38	1.36	1.35	1.35	1.35	1.35	1.35
Net book-to-bill		1.09	0.93	1.13	1.19	1.19	1.20	1.18	1.17	1.16	1.16	1.16	1.16	1.16
Backlog burn rate		45.4%	60.2%	16.1%	15.7%	15.7%	15.5%	65.3%	15.4%	15.5%	15.3%	15.3%	63.4%	63.0%
OTHER														
Cash and equivalents		\$ 109	\$ 72	\$ 58	\$ 58	\$ 49	\$ 85	\$ 85	\$ 83	\$ 86	\$ 88	\$ 90	\$ 90	\$ 95
Total debt		454	1,265	1,283	1,251	1,249	949	949	950	926	902	878	878	782
Net cash (debt)		\$ (345)	\$ (1,193)	\$ (1,225)	\$ (1,194)	\$ (1,200)	\$ (863)	\$ (863)	\$ (866)	\$ (839)	\$ (813)	\$ (787)	\$ (787)	\$ (686)
Debt to TTM EBITDA		4.1x	11.3x	9.5x	8.4x	7.4x	4.9x	4.9x	4.6x	4.4x	4.2x	4.0x	4.0x	3.1x
Cash flow from operations		\$ 99	\$ 25	\$ (40)	\$ 37	\$ 5	\$ 21	\$ 23	\$ 6	\$ 36	\$ 36	\$ 35	\$ 113	\$ 137
Capital expenditures		(18)	(20)	(6)	(6)	(7)	(8)	(27)	(8)	(8)	(8)	(8)	(33)	(32)
Free cash flow		\$ 81	\$ 6	\$ (46)	\$ 31	\$ (2)	\$ 13	\$ (5)	\$ (2)	\$ 28	\$ 27	\$ 27	\$ 80	\$ 105

Source for all: Company reports and Wells Fargo Securities, LLC estimates

Company Description:

Raleigh, North Carolina-based PRA Health Sciences, Inc. (NASDAQ: PRAH) is a top-five clinical contract research organization by revenue. The company is a pure play in clinical (phase I-IV) development and is differentiated by a large footprint in non-programmatic outsourcing (e.g., functional outsourcing). It operates in one segment.

Required Disclosures

	Date	Publication Price (\$)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price (\$)
■	11/13/2014		IPO at \$18.00			
	12/8/2014		Evans			
◆	12/8/2014	22.06	1	25.00	26.00	21.92
●	1/22/2015	25.35	1	27.00	28.00	27.25

Source: Wells Fargo Securities, LLC estimates and Reuters data

Symbol Key

▼ Rating Downgrade

▲ Rating Upgrade

● Valuation Range Change

◆ Initiation, Resumption, Drop or Suspend

■ Analyst Change

□ Split Adjustment

Rating Code Key

1 Outperform/Buy

2 Market Perform/Hold

3 Underperform/Sell

SR Suspended

NR Not Rated

NE No Estimate

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PRA Health Sciences, Inc.

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PRAH: Risks include: (1) project cancellations or delays due to client M&A, economic weakness, pipeline reprioritization, or compound failure; (2) a reversal in the trend toward increased outsourcing; (3) regulatory risks; (4) significant financial leverage; (5) integration risks, and (6) controlled company status.

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2=Market Perform: The stock appears appropriately valued, and we believe the stock's total return will be in line with the market over the next 12 months. HOLD

3=Underperform: The stock appears overvalued, and we believe the stock's total return will be below the market over the next 12 months. SELL

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O=Overweight: Industry expected to outperform the relevant broad market benchmark over the next 12 months.

M=Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.

U=Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.

VOLATILITY RATING

V = A stock is defined as volatile if the stock price has fluctuated by +/-20% or greater in at least 8 of the past 24 months or if the analyst expects significant volatility. All IPO stocks are automatically rated volatile within the first 24 months of trading.

As of: February 19, 2015

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