

August 21, 2015

PRA Health Sciences, Inc.

Observations From a Recent Company Visit; Predictivv and RPS Opportunities Still Ahead

- Conclusions.** We had the opportunity to meet with PRA management this week and came away encouraged with the opportunities still in front of the company to drive improving returns. The company's historical focus on midsize and small biopharma places it in the sweet spot in terms of industry demand at present. Conversely, the company's purchase of RPS in 2013 has yielded significant cost synergies, but the opportunity to cross-sell traditional outsourcing services into RPS's large pharma client base is in the early stages. The company's recently announced Predictivv IT platform is another interesting opportunity over the next two to three years to further optimize operations and drive share gains. With a favorable macro environment and the upside potential from Predictivv and large pharma cross-selling, we believe PRA is well positioned to generate high-teens or better earnings growth in 2016 and 2017. We reiterate our Outperform rating on PRA—particularly in the wake of a 6% correction in the stock on Thursday, August 20.
- Strong Demand Trends.** Like other CROs, PRA is benefiting from the current strong macro environment for drug development. Large pharma companies are seeing R&D budgets grow again, midsize clients are maturing and entering strategic agreements that include increased outsourcing rates, and emerging biotech clients have raised record levels of capital (see exhibits 1 and 2, on the following page). We believe PRA is particularly well positioned as it increased its focus on small and midsize clients in 2008, when many other CROs were cultivating relationships with large pharma. According to management commentary, the bolus of funding raised by biotech companies in 2007 lasted for several years. Given that the current funding environment has far exceeded the previous highs, we expect a long tail on the duration of the demand impact from this funding and we expect PRA to be a beneficiary of this trend given that 15%-20% of the company's backlog is from emerging clients.

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

Symbol: PRAH (NASDAQ)
Price: \$38.69 (52-Wk.: \$18-\$44)
Market Value (mil.): \$2,328
Long-Term EPS Growth Rate: 17%
Dividend/Yield: None
Fiscal Year End: December

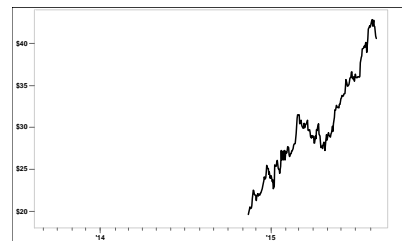
	2014A	2015E	2016E
Estimates			
EPS Q1	\$0.18	A\$0.40	NA
Q2	\$0.34	A\$0.46	NA
Q3	\$0.33	\$0.43	NA
Q4	\$0.34	\$0.44	NA
FY	\$1.20	\$1.73	\$2.00
CY		\$1.73	\$2.00

Valuation			
FY P/E	32.2x	22.4x	19.3x
CY P/E		22.4x	19.3x

Trading Data (FactSet)			
Shares Outstanding (mil.)			60
Float (mil.)			20
Average Daily Volume			187,881

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

Two-Year Price Performance Chart

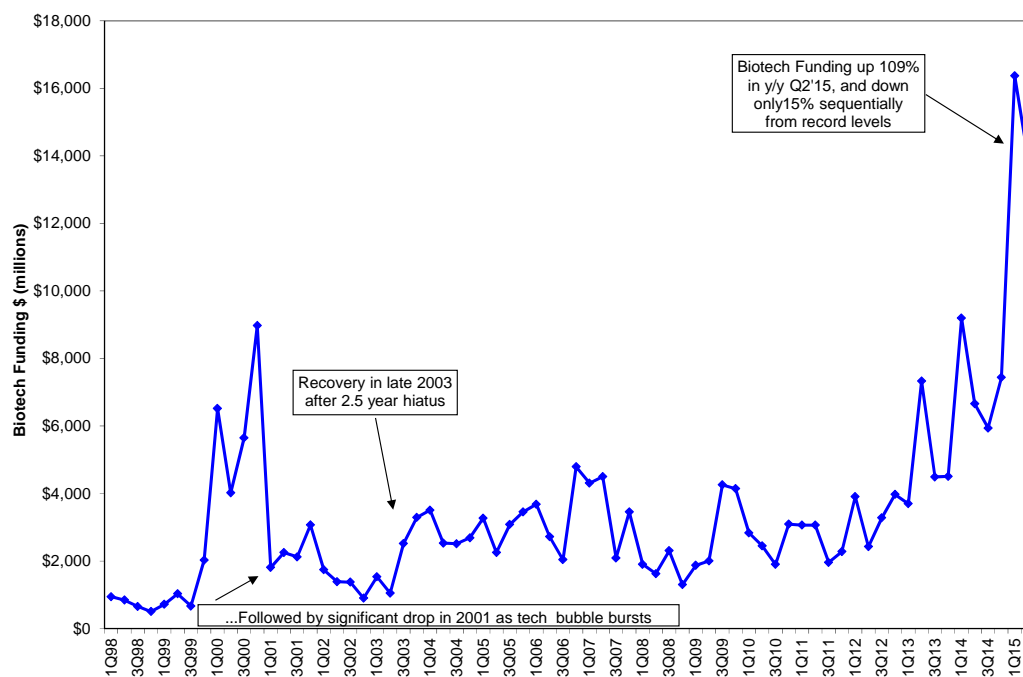


Sources: FactSet, William Blair & Company estimates

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.

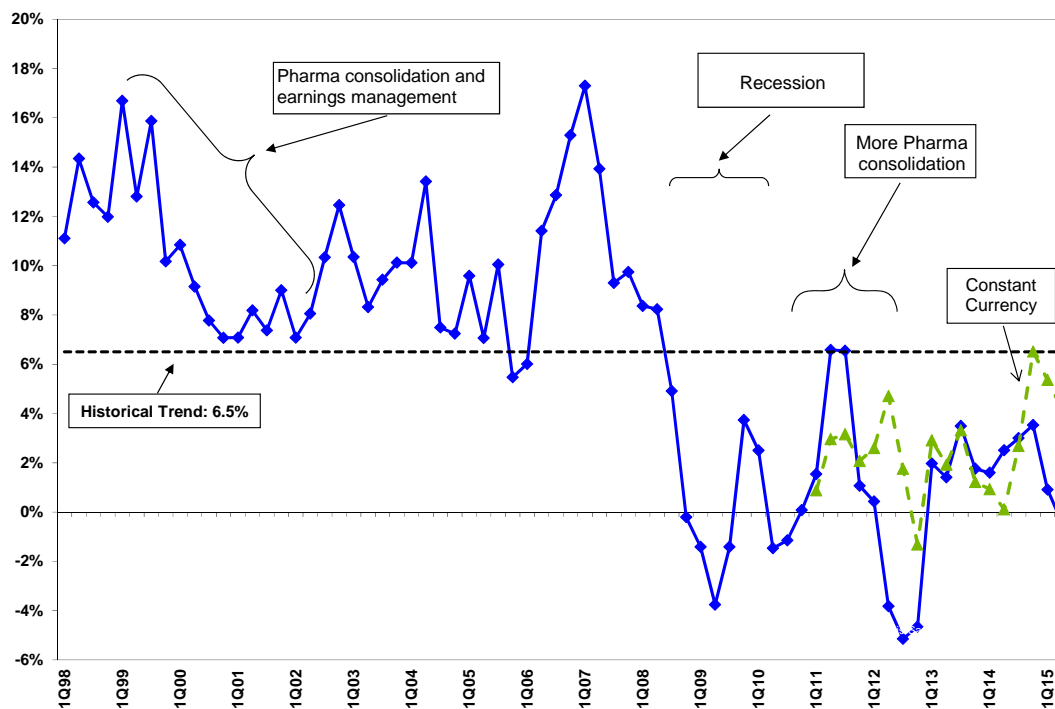
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Exhibit 1. Quarterly Biotechnology Industry Funding, 1998 to Present



Source: Biocentury

Exhibit 2. Quarterly Biopharmaceutical Industry Average R&D Spending Growth, 1998 to Present

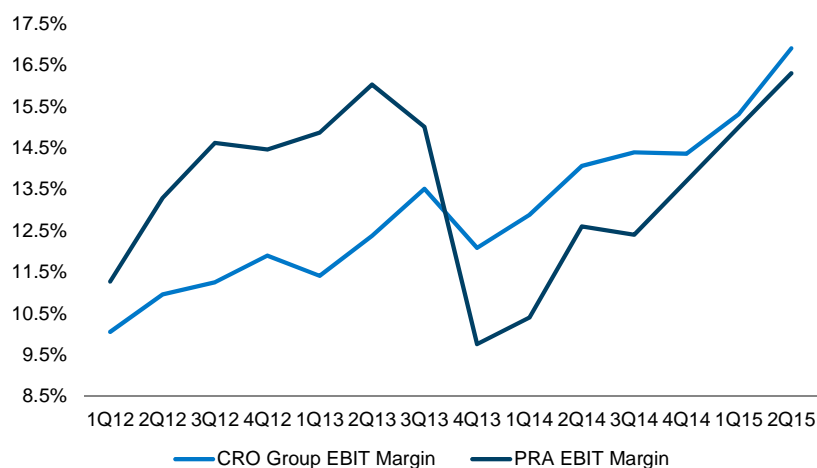


Source: Company reports

- **Excellent Execution.** Since returning to the public market late in 2014, PRA has executed very well. The integration of RPS seems to have gone very well given strong client retention (no major legacy RPS clients were lost) and significant increases in profitability. We estimate RPS's EBIT margin increased from the midsingle digits to the low double digits, although management does not break out results for the Strategic Solutions business. We believe the effort to cross-sell traditional CRO services into RPS's client base—which consisted almost entirely of large pharma companies and had virtually no overlap with PRA's legacy client base—is still in its early stages and could allow for above-market growth with large pharma clients for years to come.

In recent quarters, PRA has generated respectable bookings with a 1.2 trailing-12-month book-to-bill ratio. This implies roughly 1.3 for the legacy PRA business given Strategic Solutions generally books a 1.0 ratio each quarter and accounts for about 35% of revenues. Furthermore, backlog conversion has been relatively stable at 15%, in contrast to many of its peers, which have seen some conversion slippage. Perhaps most impressive, the company's margin improvement trends since purchasing RPS have been excellent, with the company quickly narrowing the gap with its peers. As illustrated in exhibit 3, PRA saw a steep margin hit in the second half of 2013 when it consolidated RPS, but has returned to record EBIT margin levels two years later.

Exhibit 3. PRA EBIT Margin Relative to CRO Group Average, 2012 to Present



Source: Company reports

- **Predictivv Technology Platform.** A consensus is now forming in the biopharmaceutical industry (and the CRO industry) that technology solutions will be critical to increase trial efficiency, improve R&D returns, and ultimately allow drugs to reach the market at a lower cost (and thus a lower price to the consumer). We believe technology is beginning to re-define the CRO business model as well, automating functions that had been labor intensive like monitoring. It is difficult for investors to differentiate which CRO has the best technology approach. We believe all should benefit, but also suspect the benefits of scale will be amplified from this important shift. The model that PRA has created with its Predictivv platform seems promising.
- The company embarked on a total IT re-build four years ago when the company was much smaller and privately owned. Over the past three years, the company has been rolling key functions onto the salesforce-based platform, and expects the entire internal operations to be converted within another year or two. In June the company branded the platform as Predictivv and began beta testing it with clients. Management is very enthusiastic about the impact and flexibility of the new platform, noting significant improvements to date in contract management, resource management, project management, and predictive analytics that identify problems with a given trial much earlier.
- Considering Predictivv will be rolled out more broadly to existing and prospective clients in the coming one to two years, and considering the company has just begun trying to cross-sell into RPS's legacy client base, we like PRA's ability to outpace the broader clinical CRO market in 2016 and 2017.
- **Valuation and stock thoughts.** PRA now trades at 19.3 times our 2016 EPS estimate of \$2.00 (up 16% year-over-year). This multiple is right in line with the clinical CRO peer group average of 19.6 times (ICON [ICLR \$78.25; Outperform] 16.8

times, Quintiles [Q \$74.04; Outperform] 20.7 times, INC Research [INCR \$43.21; Outperform] 21.5 times, and Parexel [PRXL \$70.60; Outperform] 19.6 times). We note the whole group has traded down over the past few weeks due to investor capital flowing out of biotechnology stocks and further weakness is likely if this rotation continues (CRO stocks have shown a tight correlation with biotech indices in the past year). But importantly, we do not view such a change in sentiment as having a fundamental impact on the CROs unless the capital flows into biotech decline dramatically. Given PRA's 6% correction on Thursday, broad client mix, high-single-digit organic revenue growth, and respectable bookings, we encourage investors to take a close look at this name in the event of further weakness in the group. We view the stock's relative and absolute valuation as reasonable by historical standards and believe the group's fundamentals remain robust. We reiterate our Outperform rating on PRA. Our unchanged model is summarized in exhibit 4, on the following page.

Exhibit 4: Unchanged Income Statement for PRA Health Sciences, 2012 to 2017(E)

	2012	2013	2014	Q1'15	Q2'15	Q3'15E	Q4'15E	2015E	2016E	2017E
Net revenue	\$597,072	\$832,901	\$1,266,596	\$331,968	\$336,518	\$341,125	\$349,912	\$1,359,522.8	\$1,468,455	\$1,580,863
Cost of revenue	357,812	525,488	858,493	218,786	219,626	223,096	229,192	890,700	969,278	1,040,208
Gross profit	239,260	307,413	408,103	113,182	116,892	118,029	120,720	468,823	499,177	540,655
Selling, general and administrative expense	143,077	177,338	226,494	57,440	55,573	58,674	59,835	231,521	238,962	254,904
Stock comp	1,010	1,141	3,467	775	1,245	1,876	2,099	5,996	6,261	7,202
EBITDA	95,173	128,934	178,142	54,967	60,074	57,480	58,785	231,306	253,955	278,549
Depreciation	15,041	18,053	22,211	5,128	5,085	5,117	5,249	20,579	22,771	24,514
Operating income (including options beg Q105)	80,132	110,881	155,931	49,839	54,989	52,363	53,536	210,727	231,184	254,035
Interest and other income (expense), net	(28,499)	(52,898)	(76,202)	(13,744)	(13,779)	(13,743)	(13,723)	(54,989)	(50,788)	(44,588)
Pretax income	51,633	57,983	79,729	36,095	41,210	38,620	39,814	155,739	180,396	209,448
Income tax expense	20,347	33,556	27,188	10,829	12,364	11,586	11,944	46,723	54,119	62,834
Net income (excl. nonrecurring items, excl. amort., incl. options and deferred rent)	31,286	24,427	52,541	25,267	28,846	27,034	27,870	109,016	126,277	146,613
Nonrecurring items	(56,188)	(185,581)	(123,626)	(10,886)	(24,417)	(\$21,280)	(\$21,290)	(77,873)	(50,044)	(37,632)
Tax adjustment	22,195	72,821	35,343	2,806	7,114	6,384	6,387	22,691	15,013	11,290
Nonrecurring items (net of tax)	(33,993)	(112,760)	(88,283)	(8,080)	(17,303)	(14,896)	(14,903)	(55,182)	(35,031)	(26,342)
Net income (GAAP)	(\$2,707)	(\$88,333)	(\$35,742)	\$17,187	\$11,543	\$12,138	\$12,967	\$53,834	\$91,246	\$120,271
EPS (excl. nonrecurring items, excl. amort. incl. options and def rent)	\$0.79	\$0.62	\$1.20	\$0.40	\$0.46	\$0.43	\$0.44	\$1.73	\$2.00	\$2.32
EPS (excl. nonrecurring items, excl. amort. incl. options and def rent)	(\$0.07)	(\$2.25)	(\$0.75)	\$0.27	\$0.18	\$0.19	\$0.21	\$0.86	\$1.45	\$1.90
EPS (as reported)	(\$0.07)	(\$2.25)	(\$0.75)	\$0.27	\$0.18	\$0.19	\$0.21	\$0.86	\$1.45	\$1.90
Weighted average shares outstanding (diluted)	39,641	39,337	43,457	62,777	62,951	62,976	63,001	62,926	63,064	63,164
MARGIN ANALYSIS:										
Gross profit	40.1%	36.9%	32.2%	34.1%	34.7%	34.6%	34.5%	34.5%	34.0%	34.2%
SG&A	24.0%	21.3%	17.9%	17.3%	16.5%	17.2%	17.1%	17.0%	16.3%	16.1%
Stock comp	0.2%	0.1%	0.3%	0.2%	0.4%	0.6%	0.6%	0.4%	0.4%	0.5%
Total SG&A	24.1%	21.4%	18.2%	17.5%	16.9%	17.8%	17.7%	17.5%	16.7%	16.6%
EBITDA	15.9%	15.5%	14.1%	16.6%	17.9%	16.9%	16.8%	17.0%	17.3%	17.6%
Depreciation & amortization	2.5%	2.2%	1.8%	1.5%	1.5%	1.5%	1.5%	1.5%	1.6%	1.6%
Operating income	13.4%	13.3%	12.31%	15.0%	16.3%	15.4%	15.3%	15.50%	15.7%	16.1%
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%	7.9%	8.0%	8.0%	8.6%	9.3%
GROWTH RATES:										
Revenue		39.5%	52.1%	6.6%	8%	7%	8%	7.3%	8.0%	7.7%
Revenue (excl. foreign exchange effect)				9.8%	12%	9%	9%	10.0%		
Revenue (organic)		17.2%	10.0%	9.8%	12%	9%	9%	10.0%	8%	8%
Gross profit		28%	33%	18%	19%	13%	11%	15%	6%	8%
SG&A		24%	28%	1%	5%	1%	2%	2%	3%	7%
EBITDA		35%	38%	43%	36%	26%	18%	30%	10%	10%
Operating income		38%	41%	54%	40%	32%	20%	35%	10%	10%
Net income (excl. non-recurring items)		-22%	115%	248%	109%	103%	53%	107%	16%	16%
EPS (excl. non-recurring items, incl. options)		-21%	92.6%	123%	34%	30%	29%	45%	16%	16%
EPS (as reported)		3188%	-67%	NM	NM	NM	NM	NM	69%	32%
Diluted shares outstanding		-1%	10%	56%	56%	56%	19%	45%	0%	0%

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

Sources: Company reports and William Blair estimates

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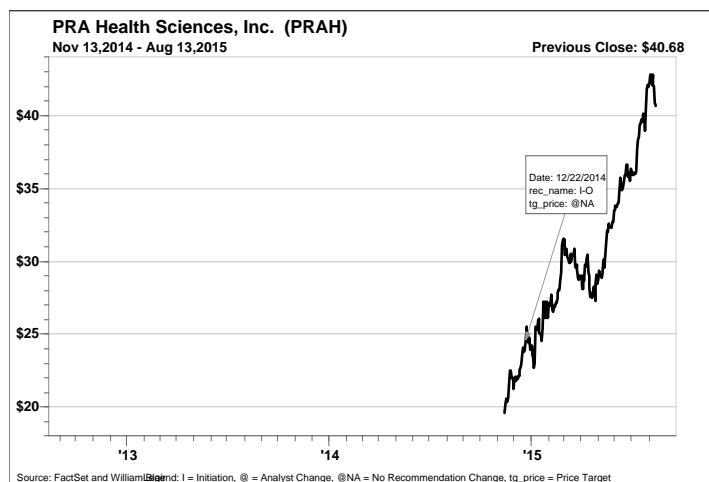
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DOW JONES: 16,990.69

S&P 500: 2,035.73

NASDAQ: 4,877.49



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Coverage Universe	Percent	Inv. Banking Relationships*	Percent
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Market Perform (Hold)	32	Market Perform (Hold)	3
Underperform (Sell)	2	Underperform (Sell)	0

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