

Catalent, Inc. (CTLT)

Overweight

Shifting Product Mix Improves Margins

CONCLUSION

CTLT had in-line revenue growth, and an EPS beat. Shifts toward higher profit products among Medication Delivery Solutions and Developmental and Clinical Services boosted margins this quarter. Recent SMARTag acquisition and new packaging equipment further expanded their end-to-end product offering. Reiterate Overweight, and raise PT to \$33 as we roll our 11.9x EV/EBITDA to 2016 estimates.

- **The Numbers.** Revenues of \$456M were in line with estimates, and EPS of \$0.45 beat our estimate by 6 cents, and consensus by ten cents. Revenues grew 3% y/y, while Adjusted EBITDA grew by 21% y/y to \$113M. Shift in revenue mix to more profitable product lines, particularly within Medication Delivery Solutions, and Developmental and Clinical Services, drove this double digit growth. Despite strong performance, the company has lowered FY15 guidance due to FX headwinds. The new revenue range is \$1.82B-\$1.86B, the new Adj. EBITDA range is \$434-333M, and the new Adjusted net income range is \$215-\$225M. Finally, they noted that the typical seasonality whereby each quarter ramps through the fiscal year, is likely to appear smoother this year because FY15 growth is atypically front end loaded.
- **SMARTag acquisition adds further differentiation to CTLT's product offering.** Since the announcement of the Redwood Bioscience SMARTag acquisition during Q2, Catalent has entered into a collaboration with Sanofi-Aventis to implement Redwood's SMARTag technology in developing next generation Antibody-Drug Conjugates (ADCs.) Studies have demonstrated that developing an ADC using SMARTag has better toxicity profiles. This investment builds on CTLT's new state-of-the-art biomanufacturing facility. We believe this is a strong differentiator in the fast growing and highly competitive biologics manufacturing industry.
- **Launch of coating and blister packaging capability expands Catalent's end-to-end service offering and strengthens their one stop shop competitive advantage.** CTLT recently divested its third party packaging capability, but has recently invested in blister packaging equipment and more coating equipment in their Germany manufacturing plant to meet client demand to have their softgels coated and packaged by the softgel manufacturer. They will only coat and package the oral medication made in-house. The new equipment has time release and other features that can help improve safety and efficacy. The coating will generate commercial revenue by Q4 FY15, and the packaging by early FY16.

RISKS TO ACHIEVEMENT OF PRICE TARGET

Failure to integrate acquisitions, pharma and biotech slowdown of outsourced R&D and manufacturing, domestic and foreign regulatory constraints.

COMPANY DESCRIPTION

Catalent is a leading global provider of advanced delivery technologies and development solutions for drugs, biologics, and consumer health products.

PRICE: US\$29.32

TARGET: US\$33.00

11.9x CY16E EV/EBITDA

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Changes	Previous	Current
Rating	—	Overweight
Price Tgt	US\$28.00	US\$33.00
FY15E Rev (mil)	US\$1,914.9	US\$1,853.5
FY16E Rev (mil)	US\$2,025.3	US\$1,941.4
FY15E EPS	—	US\$1.79
FY16E EPS	—	US\$2.15
52-Week High / Low	US\$30.32 / US\$19.30	
Shares Out (mil)	126.0	
Market Cap. (mil)	US\$3,694.3	
Avg Daily Vol (ooo)	414	
Book Value/Share	US\$3.91	
Net Cash Per Share	US\$(14.68)	
Debt to Total Capital	1%	
Yield	0.00%	
Fiscal Year End	Jun	

Price Performance - 1 Year



Source: Bloomberg

YEAR	REVENUE (US\$ m)								EARNINGS PER SHARE (US\$)							
	Sep	Dec	Mar	Jun	FY	CY	FY RM	CY RM	Sep	Dec	Mar	Jun	FY	CY	FY P/E	CY P/E
2014A	414.3A	440.7A	453.1A	519.6A	1,827.7A	1,846.8A	2.0x	2.0x	—	—	—	—	—	NA	NA	NA
2015E	418.3A	455.8A	456.1	523.3	1,853.5	1,873.7	2.0x	2.0x	0.13A	0.45A	0.47	0.80	1.79	1.63	16.4x	18.0x
2016E	422.5	471.8	485.6	561.4	1,941.4	1,962.1	1.9x	1.9x	0.29	0.38	0.56	0.92	2.15	2.17	13.6x	13.5x

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Exhibit 1

	Q2A Dec-14			Y/Y	Seq.	
	PJC Est.	Actual	% Diff	Change	Change	
Revenues:						
Oral Technologies	290,189	277,200	-4%	-3%	261,100	6%
Medication Delivery Solutions	58,065	73,700	27%	33%	56,900	30%
Development and Clinical Svcs	108,226	107,800	0%	6%	103,100	5%
Total Revenue	454,400	455,800	0%	3%	418,300	9%
Gross Profit	149,952	156,100	4%	14%	125,300	25%
Expenses						
Selling, General & Administrative	87,948	88,100	0%	1%	81,400	8%
Operating Income	62,004	62,400	1%	40%	42,500	47%
Adjusted EBITDA:						
Oral Technologies	72,919	74,700	2%	0%	57,700	29%
Medication Delivery Solutions	7,826	18,100	131%	162%	9,900	83%
Development and Clinical Svcs	20,022	21,900	9%	18%	21,400	2%
Adjusted EBITDA:	96,166	112,900	17%	21%	83,400	35%
Adjusted Net Income	47,721	56,600	19%	nm	13,400	322%
Adjusted EPS	0.39	0.45	16%	nm	0.13	nm
Diluted Shares	123,600	126,000	2%	nm	105,535	19%

Source: PJC Analysis and Company Reports.

Price Target

We are increasing our price target from \$28 to \$33 based on 11.9x CY16E EV/EBITDA (previously 11.9x CY15E EV/EBITDA). Our price target assumptions include CY16 EBITDA of \$509.8M, net debt of \$1,850M, and 126M shares outstanding.

Catalent

\$ in thousands, except per share data

Income Statement

Last update: 2/11/15

	FYA 2014A	Q1A Sep-14	Q2A Dec-14	Q3E Mar-15	Q4E Jun-15	FYE 2015E	Q1E Sep-15	Q2E Dec-15	Q3E Mar-16	Q4E Jun-16	FYE 2016E
Revenue											
Oral Technologies	1,180,200	261,100	277,200	281,554	341,138	1,160,992	261,100.00	282,744	298,447	365,018	1,207,309
Medication Delivery Solutions	246,100	56,900	73,700	69,324	73,723	273,647	59,176	81,070	73,483	78,146	291,876
Development and Clinical Svcs	412,200	103,100	107,800	107,848	110,670	429,418	105,162	111,034	116,476	120,630	453,302
Revenue Elimination	(10,800)	(2,800)	(2,900)	(2,640)	(2,240)	(10,580)	(2,940)	(3,045)	(2,772)	(2,352)	(11,109)
Total Revenue	1,827,700	418,300	455,800	456,086	523,291	1,853,477	422,498	471,803	485,635	561,442	1,941,378
Cost of Sales		293,000	299,700								
Gross Profit	598,600	125,300	156,100	164,102	198,851	644,352	128,862	150,977	179,590	218,963	678,391
Selling, General & Administrative	334,800	81,400	88,100	79,815	88,959	338,275	80,104	88,834	92,271	84,216	345,425
Impairment charges and (gain)/loss on sale of assets			3,500								
Restructuring/other		1,400	2,100								
Property/casualty (gain)/loss, net	-	-	-	-	-	-	-	-	-	-	-
Operating Earnings	240,900	42,500	62,400	84,287	109,891	299,078	48,757	62,143	87,319	134,746	332,966
Segment EBITDA											
Oral Technologies	324,400	57,700	74,700	78,835	102,341	313,577	57,442	70,686	80,581	109,505	318,214
Medication Delivery Solutions	48,700	9,900	18,100	19,411	21,380	68,790	14,202	23,510	21,310	22,662	81,685
Development and Clinical Svcs	83,500	21,400	21,900	26,962	29,881	100,143	21,032	22,207	29,119	32,570	104,928
Unallocated Costs	(82,100)	(52,400)	(13,000)	-	(25,000)	(115,400)	(25,000)	(25,000)	(25,000)	(25,000)	(100,000)
EBITDA from continuing operations	374,400	36,600	101,700	100,208	128,602	367,110	67,677	91,403	106,010	139,738	404,828
EBITDA adjustments:											
Equity compensation	4,500	1,500	2,700	2,700	2,700	9,600	2,000	2,000	2,000	2,000	8,000
Impairment charges and (gain)/loss on asset sale	3,200	-	-	-	-	3,500	-	-	-	-	-
Financing related expenses and other	11,000	20,600	1,200	1,200	1,200	24,200	-	-	-	-	-
US GAAP restructuring	19,700	1,400	2,100	2,100	2,100	7,700	2,100	2,100	2,100	2,100	8,400
Acquisition, integration, and other special items	9,800	3,200	4,400	4,400	4,400	16,400	4,400	4,400	4,400	4,400	17,600
Fx loss / (gain)	(3,500)	(3,700)	500	500	500	(2,200)	500	500	500	500	2,000
Other adjustments	300	23,800	(3,200)	(2,500)	(2,500)	15,600	11,000	11,000	11,000	11,000	44,000
Sponsor monitoring fee	12,900	-	-	-	-	-	-	-	-	-	-
Total EBITDA adjustments	(24,300)	46,800	11,200	8,400	8,400	74,800	20,000	20,000	20,000	20,000	80,000
Total Adjusted EBITDA	432,300	83,400	112,900	108,608	137,002	441,910	87,677	111,403	126,010	159,738	484,828
Interest Expense	163,100	35,500	23,900	23,500	23,500	106,400	20,000	20,000	20,000	20,000	80,000
Other (income)/expense, net	67,400	41,300	(3,600)	5,200	7,600	50,500	28,757	42,143	67,319	114,746	252,966
Earnings/(loss) from continuing operations before income taxes											
Income tax expense (benefit)	49,500	(14,000)	(4,100)	16,676	23,637	22,213	11,503	16,857	26,928	45,898	101,186
Earnings/(loss) from continuing operations	17,900	(20,300)	46,200	38,911	55,154	119,965	17,254	25,286	40,392	68,848	151,779
Net earnings/(loss) from discontinued operations, net of tax	(2,700)	400	(200)	(1,700)	(1,700)	(3,200)	(400)	(600)	(1,700)	(1,700)	(4,400)
Net earnings/(loss)	15,200	(19,900)	46,000	37,211	53,454	116,765	16,854	24,686	38,692	67,148	147,379
Minority Interest	(1,000)	(400)	(600)	(400)	(400)	(1,700)	(100)	(300)	(400)	(400)	(1,200)
Net earnings/(loss) attributable to Catalent	16,200	(19,500)	46,500	37,611	53,854	118,465	16,954	24,986	39,092	67,548	148,579
Net Earnings to Adjusted Net Income:											
Net Income to Adj. Net Income Reconciliation											
Earnings / (loss) from continuing operations	17,900	(20,300)	46,200	38,911	55,154	119,965	17,254	25,286	40,392	68,848	151,779
Amortization	42,500	11,300	11,600	11,600	11,600	46,100	11,300	11,600	11,600	11,600	46,100
Income tax (benefit) / provision	49,500	(14,000)	(4,100)	16,676	23,637	22,213	11,503	16,857	26,928	45,898	101,186
Cash taxes (paid) / refunded	(21,100)	(9,900)	(8,200)	(10,068)	(14,152)	(42,288)	(5,751)	(8,429)	(13,464)	(22,949)	(50,593)
Noncontrolling interest, net of tax	1,000	400	500	400	400	1,700	100	300	400	400	1,200
Equity compensation	4,500	1,500	2,700	2,700	2,700	9,600	1,500	1,500	1,500	1,500	6,000
Impairment charges and (gain) / loss on sale of assets	3,200	-	3,500	-	-	3,500	-	-	-	-	-
Financing related expenses	11,000	20,600	1,200	1,200	1,200	24,200	-	-	-	-	-
U.S. GAAP Restructuring	19,700	1,400	2,100	1,400	1,400	6,300	-	-	-	-	-
Acquisition, integration and other special items	9,800	3,200	4,400	1,000	1,000	9,600	-	-	-	-	-
Foreign Exchange loss (gain) (included in other, net)	(3,500)	(3,700)	500	-	-	(3,200)	-	-	-	-	-
Other adjustments	300	23,800	(3,200)	-	-	20,600	-	-	-	-	-
Sponsor monitoring fee	12,900	-	-	-	-	-	-	-	-	-	-
El. Cash tax (savings)/exp. Attributable to reconciling items	(5,300)	-900	-600	-1,400	-2600	(5,500)	-700	-600	-1,400	-2600	(5,300)
Adjusted Net Income/(loss)	142,400	13,400	56,600	62,481	80,309	212,790	35,206	46,514	65,955	102,697	250,373
Adjusted EPS		0.13	0.45	0.49	0.61	1.67	0.28	0.37	0.53	0.83	2.02
Diluted shares outstanding	74,801	105,535	126,000	128,801	131,664	123,000	123,971	124,095	124,219	124,343	124,157
Calendar Year:											
Revenue	1,846,800					1,873,678					1,962,064
y/y Growth %	2%					1.5%					4.7%
EBITDA	453,100					444,690					509,810
y/y Growth %	12%					-1.9%					14.6%
Operating Earnings	266,200					305,078					340,075
Net Income	60,900					133,405					152,845
Adj Net Income	207,540					208,706					269,621
Adj EPS	na					1.63					2.17
Development and Clin Svcs Revenue	420,000					\$ 434,714					\$ 463,060
Development and Clin Svcs EBITDA	92,600					100,082					114,752
DCS EBITDA Man	22%					23%					25%
Analysis:											
Total Gross Profit	33%	30.0%	34.2%	36.0%	38.0%	35%	30.5%	32.0%	37.0%	39.000%	35%
Selling, General, & Admin Expenses	18%	19.5%	19.3%	17.5%	17.0%	18%	19.0%	18.8%	19.0%	15.0%	18%
Total Operating Expenses											
Operating Margin	13%	17%	17%	18%	21%	16%	12%	13%	18%	24%	17%
EBITDA Margin - Oral Technologies	27%	22%	27%	28%	30%	27%	22.0%	25.0%	27.0%	30.0%	26%
EBITDA Margin - Medication Delivery Solutions	20%	17%	25%	28%	29%	25%	24.0%	29.0%	29.0%	29.0%	28%
EBITDA Margin - Development and Clinical Svcs	20%	21%	20%	25%	27%	23%	20.0%	20.0%	25.0%	27.0%	23%
EBITDA Margin - Total	23.7%	20%	25%	24%	26%	23.8%	21%	24%	26%	28%	25.0%
Incremental EBITDA Margin	72%	30%	129%	30%	30%	37%	102%	9%	60%	49%	49%
Income tax rate		41%	-10%	40%	40%	16%	40%	40%	40%	40%	40%
Interest Coverage Ratio											
y/y growth:											
Revenue- Oral Technologies	-11%	1%	-3%	-2%	-2%	-2%	0%	2%	6%	7%	4%
Revenue- Medication Delivery Solutions	12%	1%	33%	6%	7%	11%	4%	10%	6%	6.00%	7%
Revenue- Development and Clinical Svcs	2%	2%	6%	4%	5%	4%	2%	3%	8%	9.00%	6%
Revenue - Total	2%	1%	3%	1%	1%	1%	1%	4%	6%	7%	5%
EBITDA - Oral Technologies	3%	-4%	0%	3%	-10%	-3%	0%	-5%	2%	7%	1%
EBITDA - Medication Delivery Solutions	55%	21%	162%	24%	20%	41%	43%	30%	10%	6%	19%
EBITDA - Development and Clinical Svcs	11%	36%	18%	17%	14%	20%	-2%	1%	8%	9%	5%
Total Adj EBITDA	12%	1%	21%	2%	-9%	-2%	5%	-1%	16%	17%	10%

Source: Company Reports, Piper Jaffray Research

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cons FY 480
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S: Suspending Coverage
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NA: Not Available
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