

May 6, 2015

**CTLT**

## EBITDA Guidance Down on FX and Modest Base Business Headwind; Margin Expansion and M&A Thesis Remains

Industry View

Stock Rating

**In-Line****Overweight**

A solid 3FQ on constant currency; but EBITDA guidance reduced to reflect continued currency headwind and modest base business slowdown. Favorable industry dynamics, continued margin expansion and M&A opportunities keep the thesis intact.

**3FQ15 revenues at \$447 mil were down 1.4% y/y (up 8% constant currency) and 3FQ adj. EBITDA of \$110.5 mil grew 4% y/y and came in ahead of consensus' \$106 million and in-line with MS.** Gross margins/EBITDA margins expanded ~60/130 bps respectively, reflecting operating leverage in the model despite currency and mix headwinds.

**Solid performance in Oral Technologies (OT) and Development & Clinical Services (DCS) offset by weakness in Medication Delivery Solutions (MDS).** The **OT** segment grew revenues 10% y/y and EBITDA 20% y/y on a constant currency basis, reflecting favorable mix in modified release as softgels continued to see a headwind from the prescription to consumer health mix shift. **DCS** revenue was up 4% and EBITDA 8% on constant currency basis despite some slowing in European clinical services activity and an unfavorable mix in analytic services. **MDS** segment revenues were up 2% but EBITDA was down 26% y/y constant currency behind a slow sterile injectables business and a tough y/y comp. Of note, biologics revenue grew ~70% (biologics is ~1% or ~\$18 million of annual revenue).

**Revenue and EBITDA guidance taken down to reflect currency and some weakness in the base business.** Implied 4FQ revenue of \$479 to \$509 million compares to consensus/MS at \$516/\$507 prior to the call, while implied EBITDA of \$121 to \$129 million compares to consensus/MS at \$140/\$126 million. Of the guidance change, ~37% of the revenue variance is driven by FX offset by acquisitions, with ~63% due to a reduction in the base business, primarily a decline in low margin comparator sourcing. Of the EBITDA change, ~57% is due to FX offset by acquisitions, with ~43% from base business due to some softness in European clinical services. **Of note, however, after raising EBITDA guidance of the base business by \$5 to \$10 million in 2FQ, guidance that the \$1 to \$2 million headwind in 3FQ guidance still means overall base business growth, though down since guidance was given in 2Q.**

**M&A activity continues on the small side, but options remain open.** In the quarter, Catalent acquired PharmaPak, an Australian packaging business to serve the local market, marking the 3rd acquisition since the IPO following

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**Catalent, Inc. ( CTLT.N, CTLT US )****Healthcare Services & Distribution** / United States of America**Stock Rating****Overweight****Industry View****In-Line**

Shr price, close (May 5, 2015)

\$29.18

Mkt cap, curr (mm)

\$4,148

52-Week Range

\$31.65-19.30

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# Morgan Stanley

Redwood Biosciences and Micron. Micron is already making an impact on new business, driving 5 to 10 potential new products into the pipeline and Redwood continues to gain client interest. Management views the market as favorable and is open to M&A large & small.

**Model update.** We now model FY15 revenue of ~\$1.82 billion (from ~\$1.85 billion) vs. cons' \$1.85 billion and guidance of \$1.80-\$1.83 billion, reflecting currency headwinds and a slowdown in DCS. Our updated FY15 adj. EBITDA is \$433 million from \$442 million vs. cons' \$442 million & guidance of \$428-\$436 million also reflecting FX and DCS. For FY16 we now model revenue/EBITDA of \$1.95 billion/\$472 million from \$1.97 billion/\$476 million vs. cons \$1.93 billion/\$476 million.

## Updated Guidance

### Exhibit 1: Updated FY15 Guidance

Guidance Period	FY15			FY15			FY15			midpt y/y growth
Timing	1FQ15			2FQ15			3FQ15			
	Low	High	Mid	Low	High	Mid	Low	High	Mid	
Revenue	\$1,890	\$1,915	\$1,903	\$1,820	\$1,860	\$1,840	\$1,800	\$1,825	\$1,813	-1%
adj. EBITDA	\$450	\$460	\$455	\$434	\$444	\$439	\$428	\$436	\$432	0%
adj. Net Income	\$215	\$225	\$220	\$204	\$214	\$209	\$197	\$205	\$201	41%
Share Count				122 mn	124 mn	123 mn	122 mn	124 mn	123 mn	n/a
CapEx	\$115	\$125	\$120	\$120	\$130	\$125	\$120	\$130	\$125	2%

Source: Company Data, MS Research

## Exhibit 2: CTLT Income Statement, FY12A-FY17E

INCOME STATEMENT (In millions, except per share)	2012A	2013A	2014A	Fiscal Year End, June 30 2015				2015E	Fiscal Year End, June 30 2016				2016E	2017E
				1QA	2QA	3QA	4QE		1QE	2QE	3QE	4QE		
<b>Net revenue</b>	1,694.8	1,800.3	1,827.7	418.3	455.8	446.6	506.7	1,822.7	445.1	485.1	477.2	547.2	1,954.5	2,052.4
Cost of Sales (reported)	1,136.2	1,231.7	1,229.1	293.0	299.7	294.4	322.0	1,209.1	314.7	334.6	312.5	326.8	1,288.5	1,323.0
Gross Profit (reported)	558.6	568.6	598.6	125.3	156.1	152.2	184.7	613.6	130.4	150.5	164.7	220.4	666.0	729.4
<b>Operating Expenses</b>														
Total Operating Expenses (Reported)	328.9	331.7	331.9	82.8	93.7	86.4	103.1	366.0	74.4	92.2	88.2	78.1	332.9	352.6
Income from operations, reported	198.0	204.4	240.9	42.5	62.4	65.8	81.6	252.3	48.0	72.8	76.0	112.9	309.6	336.9
Interest expense, net	183.2	203.2	163.1	35.5	23.9	23.0	22.1	104.5	22.1	22.1	22.1	22.1	88.3	85.7
Other (income) expense, net	(3.8)	25.1	10.4	41.3	(3.6)	0.8	-	38.5	-	-	-	-	-	-
Income from continuing operations before income taxes	18.6	(23.9)	67.4	(34.3)	42.1	42.0	59.5	109.3	25.9	50.7	53.9	90.8	221.4	251.3
Income tax expense (benefit)	16.5	24.1	49.5	(14.0)	(4.1)	11.2	16.1	9.2	7.8	15.2	16.2	27.3	66.4	75.4
Earnings/(loss) from continuing operations	2.1	(48.0)	17.9	(20.3)	46.2	30.8	43.4	100.1	18.1	35.5	37.7	63.6	155.0	175.9
Net Income from discontinued operations, net of tax	(41.3)	1.2	(2.7)	-	-	-	-	-	-	-	-	-	-	-
Noncontrolling interest	1.2	(0.1)	(1.0)	(0.4)	0.2	(0.7)	(0.7)	(1.6)	(0.7)	(0.7)	(0.7)	(0.7)	(2.8)	(2.8)
<b>Net Income attributable to Catalent</b>	<b>(38.0)</b>	<b>(46.7)</b>	<b>16.2</b>	<b>(19.9)</b>	<b>46.0</b>	<b>31.5</b>	<b>44.1</b>	<b>101.7</b>	<b>18.8</b>	<b>36.2</b>	<b>38.4</b>	<b>64.3</b>	<b>157.8</b>	<b>178.7</b>
<b>Adj. Net Income</b>	<b>81.2</b>	<b>82.4</b>	<b>142.4</b>	<b>13.4</b>	<b>55.9</b>	<b>57.6</b>	<b>76.3</b>	<b>203.2</b>	<b>37.3</b>	<b>59.6</b>	<b>57.8</b>	<b>88.7</b>	<b>243.5</b>	<b>264.0</b>
EPS (adjusted)		\$1.10	\$1.87	\$0.13	\$0.44	\$0.46	\$0.60	\$1.67	\$0.30	\$0.47	\$0.46	\$0.70	\$1.93	\$2.08
Average Diluted shares outstanding	ND	75.0	76.2	105.5	126.6	126.3	128.0	121.6	126.1	126.3	126.5	126.7	126.4	127.2
<b>EBIT and EBITDA</b>														
EBIT	203.0	179.2	229.9	1.6	65.8	65.7	81.6	215.4	48.0	72.8	76.0	112.9	309.6	336.9
Depreciation and amortization	129.8	152.2	144.5	35.0	35.2	34.4	34.3	138.9	35.3	35.2	35.0	34.9	140.5	138.3
EBITDA	331.6	331.5	374.4	36.6	101.7	100.1	115.9	354.3	83.3	108.0	111.0	147.8	450.1	475.2
<b>Adj. EBITDA</b>	<b>389.7</b>	<b>412.6</b>	<b>432.3</b>	<b>83.4</b>	<b>112.9</b>	<b>110.5</b>	<b>125.8</b>	<b>432.6</b>	<b>88.3</b>	<b>113.5</b>	<b>116.5</b>	<b>153.3</b>	<b>471.6</b>	<b>501.2</b>
<b>Margins</b>														
Gross profit	33.0%	31.6%	32.8%	30.0%	34.2%	34.1%	36.5%	33.7%	29.3%	31.0%	34.5%	40.3%	34.1%	35.5%
Adj. EBITDA	23.0%	22.9%	23.7%	19.9%	24.8%	24.7%	24.8%	23.7%	19.8%	23.4%	24.4%	28.0%	24.1%	24.4%
Adj. Net Income	-2.2%	-2.6%	7.8%	3.2%	12.3%	12.9%	15.1%	11.1%	8.4%	12.3%	12.1%	16.2%	12.5%	12.9%
<b>Expenses</b>														
Cost of sales	67.0%	68.4%	67.2%	70.0%	65.8%	65.9%	63.5%	66.3%	70.7%	69.0%	65.5%	59.7%	65.9%	64.5%
SG&A (reported)	19.4%	18.9%	18.3%	19.5%	19.1%	18.6%	14.4%	19.1%	19.4%	19.0%	18.5%	14.3%	17.6%	18.5%
Adj. Tax Rate		7.7%	16.9%	76.7%	15.2%	10.5%	10.1%	16.2%	14.6%	12.5%	20.2%	18.7%	17.1%	19.5%
<b>Y/Y Growth</b>														
Net Revenue	10.6%	6.2%	1.5%	1.0%	3.4%	-1.4%	-2.5%	-0.3%	6.4%	6.4%	6.9%	8.0%	7.2%	5.0%
Gross profit	11.3%	1.8%	5.3%	5.1%	13.6%	0.3%	-2.9%	2.5%	4.0%	-3.6%	8.2%	19.3%	8.5%	9.5%
Adj. EBITDA	8.9%	5.9%	4.8%	1.5%	20.9%	4.2%	-16.6%	0.1%	5.9%	0.5%	5.4%	21.9%	9.0%	6.3%
EPS (adjusted)								-10.5%	132.9%	6.9%	0.2%	17.5%	15.3%	7.7%

Source: Company Data, MS Estimates

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## INDUSTRY COVERAGE: Healthcare Services & Distribution

COMPANY (TICKER)	RATING (AS OF)	PRICE* (05/05/2015)
<b>Goldwasser, Ricky R</b>		
Albany Molecular Research, Inc (AMRI.O)	O (04/09/2014)	\$18.97
Allscripts Healthcare Solutions Inc. (MDRX.O)	E (11/07/2014)	\$13.35
AmerisourceBergen Corp. (ABC.N)	E (04/13/2012)	\$114.70
athenahealth Inc (ATHN.O)	O (04/23/2014)	\$113.46
Cardinal Health Inc (CAH.N)	E (02/02/2015)	\$84.57
Catalent, Inc. (CTLT.N)	O (09/09/2014)	\$29.18
Catamaran Corp (CTRX.O)	++	\$59.60
Cerner Corporation (CERN.O)	E (08/17/2012)	\$72.08
Charles River Laboratories International (CRL.N)	E (03/03/2010)	\$70.39
CVS Health Corp (CVS.N)	O (11/04/2011)	\$98.74
Diplomat Pharmacy Inc (DPLO.N)	O (04/23/2015)	\$34.90
Express Scripts, Inc. (ESRX.O)	O (01/07/2010)	\$84.61
Inovalon Holdings Inc (INOV.O)	E (03/09/2015)	\$25.28
Laboratory Corp. of America Holdings (LH.N)	O (02/23/2015)	\$117.30
McKesson Corporation (MCK.N)	O (10/25/2013)	\$222.78
Quality Systems Inc (QSI.O)	U (04/23/2014)	\$15.46
Quest Diagnostics Inc. (DGX.N)	U (07/09/2013)	\$69.89
Quintiles Transnational Holdings Inc (Q.N)	O (06/18/2013)	\$64.59
Walgreens Boots Alliance Inc (WBAO)	O (09/23/2013)	\$83.14

Stock Ratings are subject to change. Please see latest research for each company.

\* Historical prices are not split adjusted.