

Catalent, Inc. (CTLT)

F2Q Better, but a Mixed Blessing

BUY

Price target \$28.50

Price \$29.32

Key Takeaway

CTLT's results support our thesis of long-term moderate growth, topped off by the potential step-function contributions from M&A. 2Q offered a glimpse of M&A contributions with Micron bringing a plethora of cross-sell/up-sell opportunities already being pursued. The 2Q results were better, but mostly due to pull-forwards, and guidance declined for the stiff FX headwind. We expect some weakness in the stock.

Guidance Lower, but Constant Dollar (Organic) Outlook Improving.

Management adjusted the midpoint of its FY15 revenue guidance lower by \$62.5M; the range now stands at \$1.82-1.86B. A stiffer FX headwind accounted for \$90-100M of this, and was partially offset by \$10-15M benefit from improving organic trends and another \$15-20M from the closing of the F2Q acquisitions.

Shifting Mix - Several Pockets, Mostly Positive. DevClin is benefiting from rising long-cycle manufacturing. Oddly placed, yes, but the Kansas City site is leveraging expertise in orphan drugs and the time pressure associated with fast-track approvals. This benefit should continue. In MDS, the product line-up has moved toward branded and higher value generic blow-fill-seal, while biologics benefited from incremental revenue helping to offset the heavy fixed cost investment. Finally, Oral Tech/Softgel is the one area seeing a shift away from higher margin product - Prescription to Consumer Health. However, even in that instance, management indicates that the margin degradation has been less than expected.

Redwood Acquisition Already Paying Off. Landed Sanofi development deal on the heels of the Redwood acquisition. Redwood's technology is still immature, and votes of confidence like this one help to validate it and advertise its availability to a broader customer audience. Management expects this to bolster growth in its biologics business in the long-term.

Micron Integration Offers Near-term, Long-term Opps. Management has quickly triaged Micron's client compound portfolio to identify: 1) opportunities for DevClin services on molecules still in early development, and 2) opportunities for advanced formulation manufacturing of compounds that have moved downstream in development. DevClin bookings and backlog should benefit in the next couple of quarters. Manufacturing payoffs would be further out.

No Need For Hedging Because FX Impact is Translational Only. Despite the volatility CTLT has struggled with recently in terms of FX headwinds, management does not intend to engage in any sort of hedging activity. Its rationale is pretty simple. All of the FX noise only creates translational issues (i.e. only an issue when financial statements are generated). Most of its foreign activities are naturally hedged, meaning revenue and costs are denominated in the same local currency. Said differently, there is not a lot of FX exchanging CTLT has to do, so FX does not have any (transactional) cash consequences. There would be no sense to pay cash for an FX hedge that would not save CTLT any cash.

Forward Looking Metrics. Catalent's business has a high recurring component via long-term manufacturing contracts on a majority of its business. However, those revenue streams do experience a natural decay over time, and visibility on the growth drivers is rather limited. Management is providing some directional indicators in the form of: 1) \$62M in development revenue, which reflects pre-commercial activities to help clients clear hurdles on the path to commerciality, and 2) 88 new product introductions YTD, which shows the number that are clearing the finish line though doesn't quantify the revenue value of those. The NPIs are about flat YoY, while development work is up 30%.

Site Visit. We are hosting an HQ site visit and manufacturing tour on Friday, Feb 13, which we will incorporate into our forecast and valuation update.

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Chart 1: Summary of the Quarter
Catalent, Inc.
F2Q15 (Dec) Earnings Summary

Source: Company filings and Jefferies LLC

Reports 2/11/2015 AMC

FY ending June 30 in thousands except EPS	Reported		Estimate	Actual	Consensus	Percentage Change		Difference		
	F2Q14	F1Q15	F2Q15	F2Q15		Seq	Y/Y	Seq	Y/Y	Est.
Net revenue	\$ 440.7	\$ 418.3	\$ 454.3	\$ 455.8	451	9.0%	3.4%	\$ 37.5	\$ 15.1	\$ 1.5
Cost of products sold	303.3	293.0	309.8	299.7		2.3%	(1.2%)	6.7	(3.6)	(10.1)
Gross Profit	137.4	125.3	144.5	156.1		24.6%	13.6%	30.8	18.7	11.6
SG&A	87.5	81.4	90.1	88.1		8.2%	0.7%	6.7	0.6	(2.0)
EBIT ex-nonrecurring	49.9	43.9	54.4	68.0		54.9%	36.3%	24.1	18.1	13.6
Impairments (gains on asset sales)	-	-	-	3.5		NA	NA	3.5	3.5	3.5
Non-recurring items	5.4	1.4	-	2.1		50.0%	(61.1%)	0.7	(3.3)	2.1
EBIT	44.5	42.5	54.4	62.4		46.8%	40.2%	19.9	17.9	8.0
Interest expense (income)	41.5	35.5	23.6	23.9		(32.7%)	(42.4%)	(11.6)	(17.6)	0.3
Other expense (income)	(1.4)	41.3	-	(3.6)		(108.7%)	157.1%	(44.9)	(2.2)	(3.6)
Pre-tax income	4.4	(34.3)	30.8	42.1		(222.7%)	856.8%	76.4	37.7	11.3
Taxes	23.3	(14.0)	9.2	(4.1)		(70.7%)	(117.6%)	9.9	(27.4)	(13.3)
Net income	(18.9)	(20.3)	21.6	46.2		(327.6%)	(344.4%)	66.5	65.1	24.6
Comparable NI	15.9	(9.6)	26.3	33.9		(452.4%)	112.9%	43.5	18.0	7.6
Adjusted NI	27.9	13.4	42.3	55.9		317.2%	100.4%	42.5	28.0	13.6
GAAP EPS	(0.25)	(0.19)	0.17	0.37	0.18	(290.6%)	(247.3%)	0.56	0.62	0.20
Comparable EPS	0.21	(0.09)	0.21	0.27		(395.1%)	28.3%	0.36	0.06	0.06
Adjusted EPS	0.37	0.13	0.33	0.44	0.34	249.3%	20.8%	0.32	0.08	0.11
Diluted shares	75.9	105.5	127.6	126.0		19.4%	65.9%	20.5	50.1	(1.6)
EBITDA	83.4	36.6	92.5	101.7		177.9%	21.9%	65.1	18.3	9.2
Comparable EBITDA	91.9	82.4	92.5	105.3		27.8%	14.6%	22.9	13.4	12.8
Adjusted EBITDA	93.3	83.4	97.8	112.9	96	35.4%	21.0%	29.5	19.6	15.1
COMMON SIZE										
Cost of products sold	68.8%	70.0%	68.2%	65.8%				(430 bps)	(310 bps)	(240 bps)
Gross margin	31.2%	30.0%	31.8%	34.2%				430 bps	310 bps	240 bps
SG&A	19.9%	19.5%	19.8%	19.3%				(10 bps)	(50 bps)	(50 bps)
EBIT ex-nonrecurring	11.3%	10.5%	12.0%	14.9%				440 bps	360 bps	290 bps
One-time charges	1.2%	0.3%	0.0%	1.2%				90 bps	0 bps	120 bps
EBIT	10.1%	10.2%	12.0%	13.7%				350 bps	360 bps	170 bps
Interest expense (income)	9.4%	8.5%	5.2%	5.2%				(320 bps)	(420 bps)	10 bps
Other expense (income)	(0.3%)	9.9%	0.0%	(0.8%)				(1,070 bps)	(50 bps)	(80 bps)
Pre-tax income	1.0%	(8.2%)	6.8%	9.2%				1,740 bps	820 bps	250 bps
Income taxes	529.5%	40.8%	30.0%	(9.7%)				(5,060 bps)	(53,930 bps)	(3,970 bps)
Net income	(4.3%)	(4.9%)	4.7%	10.1%				1,500 bps	1,440 bps	540 bps
Comparable NI	3.6%	(2.3%)	5.8%	7.4%				970 bps	380 bps	160 bps
Adjusted NI	6.3%	3.2%	9.3%	12.3%				910 bps	590 bps	300 bps
EBITDA	18.9%	8.7%	20.4%	22.3%				1,360 bps	340 bps	190 bps
Comparable EBITDA	20.9%	19.7%	20.4%	23.1%				340 bps	220 bps	270 bps
Adjusted EBITDA	21.2%	19.9%	21.5%	24.8%				480 bps	360 bps	320 bps
SEGMENTS										
Oral Technologies										
Revenue	285.9	261.1	294.5	277.2		6.2%	(3.0%)	16.1	(8.7)	(17.3)
% of total	64.9%	62.4%	64.8%	60.8%				(160 bps)	(410 bps)	(400 bps)
EBITDA	74.7	57.7	77.5	74.7		29.5%	0.0%	17.0	-	(2.8)
Margin	26.1%	22.1%	26.3%	26.9%				480 bps	80 bps	60 bps
Medication Delivery & Solutions										
Revenue	55.3	56.9	56.4	73.7		29.5%	33.3%	16.8	18.4	17.3
% of total	12.5%	13.6%	12.4%	16.2%				260 bps	360 bps	380 bps
EBITDA	6.9	9.9	7.3	18.1		82.8%	162.3%	8.2	11.2	10.8
Margin	12.5%	17.4%	13.0%	24.6%				720 bps	1,210 bps	1,160 bps
Development & Clinical Services										
Revenue	102.1	103.1	106.2	107.8		4.6%	5.6%	4.7	5.7	1.6
% of total	23.2%	24.6%	23.4%	23.7%				(100 bps)	50 bps	30 bps
EBITDA	18.5	21.4	19.8	21.9		2.3%	18.4%	0.5	3.4	2.1
Margin	18.1%	20.8%	18.6%	20.3%				(40 bps)	220 bps	170 bps
FY15 GUIDANCE										
Revenue	Previous		Prior JEF	Revised	Prior Cons.					
EBITDA	\$1,890-1,915M		\$1,912M	\$1,820-1,860M	\$1,899M					
Net Income	\$450-460M		\$460M	\$434-444M	\$456M					
	\$215-225M			\$204-214M						

Source: Company data and Jefferies LLC

Company Description

Catalent, Inc. is the leading global provider of advanced delivery technologies and development solutions for drugs, biologics and consumer health products. With over 80 years serving the industry, Catalent has proven expertise in bringing more customer products to market faster, enhancing product performance and ensuring reliable clinical and commercial product supply. Catalent employs approximately 8,000 people, including over 1,000 scientists, at nearly 30 facilities across 5 continents.

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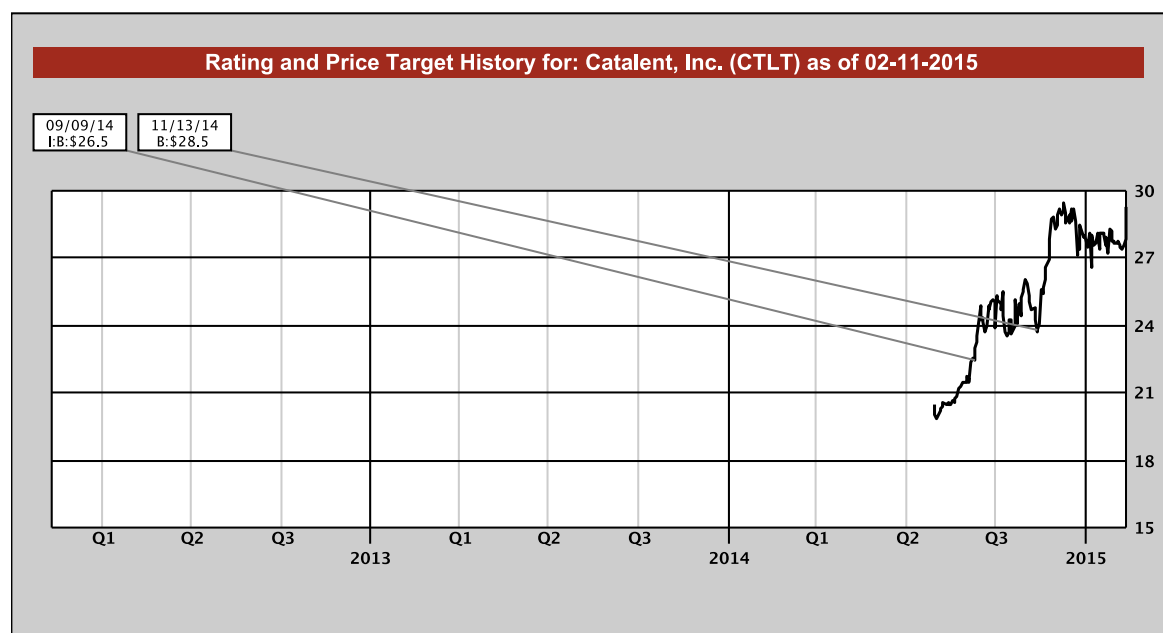
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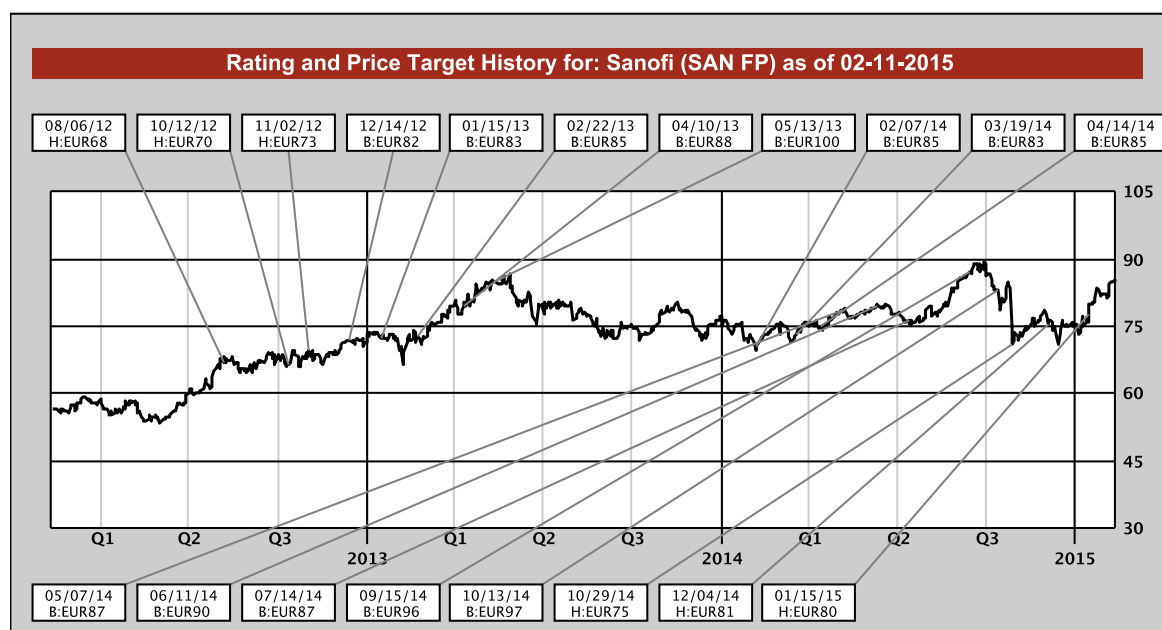
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			Count	Percent
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