September 9, 2014

WELLS FARGO SECURITIES

Equity Research

Catalent, Inc.

CTLT: Initiating Coverage At Outperform

Outperform / V

Sector: Pharmaceutical Services
Market Weight

Initiation of Coverage

- **Summary.** We are initiating coverage of Catalent, Inc. with an Outperform rating and a 12-month valuation range of $25-27. We believe the pharmaceutical services sector has favorable long-term trends, and within that space, Catalent is positioned relative to peers with a stable and diversified business model, although one with certain company-specific challenges that we project will keep growth at the lower-end of the industry range (5-10% organic growth for most public pharmaceutical services companies). Considering these factors, we view CTLT's valuation as reasonably attractive, with room for expanding multiples if Catalent successfully executes on growth opportunities to move its long-term growth profile higher. We set our FY2015E/2016E EPS at $1.90/2.08.

- **Stability and visibility.** Within the pharmaceutical services sector, we believe Catalent has better-than-average long-term visibility for more than 70% of its business, which is a result of long-term supply contracts with generally predictable revenue recognition. Because Catalent is often included in customers' regulatory filings, commercial business tends to be extremely sticky.

- **Diversity.** Catalent's diverse client list helps offset the risk of any individual project, in our view. Each year, Catalent produces doses for nearly 7,000 products owned by approximately 1,000 customers, with no single product greater than 3% and no single customer greater than 10%. In our view, these metrics compare favorably to the broader pharmaceutical services industry.

- **Regulatory and operational excellence.** The contract manufacturing space is highly regulated, but also highly fragmented, a situation that has allowed high-profile mistakes by lower-quality players to create negative publicity for the industry. We believe Catalent's stellar regulatory track record allows the company to command some degree of pricing premium, creating a moat around Catalent's strong high-teens operating margin.

- **Possibility of accelerating growth.** While we are not forecasting additional acceleration beyond Catalent's 5% revenue growth guidance, we believe the company has some upside potential from a growing portfolio of proprietary technologies, including delivery solutions for biologics, geographic expansion, additional client penetration, and the pursuit of adjacent markets (e.g., animal health.

Valuation Range: $25.00 to $27.00 from NE to NE

Our valuation range is DCF-based (WACC = 9.0%; terminal NOPLAT growth = 2%) and represents 13x our CY2015 EPS estimate. Risks include (1) short-term volatility, due to general order lumpiness; (2) potential for regulatory missteps; (3) weak product sales by customers; (4) control company status; (5) high leverage; and (6) FX volatility.

Investment Thesis:

We believe the Pharma Services sector has favorable long-term trends, and within that space, Catalent is positioned relative to peers with a stable and diversified business model, although one with lower growth. Considering these factors, we view CTLT's valuation as reasonably attractive, with room for expanding multiples if Catalent successfully executes on growth opportunities to move its long-term growth profile higher.

	2014A	2015E		2016E	
EPS		**Curr.**	**Prior**	**Curr.**	**Prior**
Q1 (Sep.)	NA	**0.20**	**NE**	**0.26**	**NE**
Q2 (Dec.)	NA	**0.35**	**NE**	**0.39**	**NE**
Q3 (Mar.)	NA	**0.50**	**NE**	**0.55**	**NE**
Q4 (June)	NA	**0.81**	**NE**	**0.87**	**NE**
FY	1.86	**1.90**	**NE**	**2.08**	**NE**
CY	$1.86	$1.96		$2.16	
FY P/EPS	12.1x	11.8x		10.8x	
Rev.(MM)	$1,828	$1,908		$2,016	

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

Excludes amortization of acquired intangible assets

Ticker	CTLT
Price (09/08/2014)	$22.50
52-Week Range:	$19-23
Shares Outstanding: (MM)	123.7
Market Cap.: (MM)	$2,783.3
S&P 500:	2,001.54
Avg. Daily Vol.:	664,324
Dividend/Yield:	$0.00/0.0%
LT Debt: (MM)	$2,711.0
LT Debt/Total Cap.:	4.4%
ROE:	NE
3-5 Yr. Est. Growth Rate:	7.0%
CY 2014 Est. P/EPS-to-Growth:	1.7x
Last Reporting Date:	09/04/2014 After Close

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 09/09/14 unless otherwise stated.

Company Description:

Somerset, New Jersey-based Catalent, Inc. (NYSE: CTLT) leverages its proprietary drug delivery technologies to provide contract manufacturing services of final dose form pharmaceutical and consumer health products. Catalent also offers logistics and chemistry, manufacturing, and control (CMC) services for drugs in development.

The company has three segments: Oral Technologies (OT), Medication Delivery Solutions (MDS), and Development and Clinical Services (DCS). OT and MDS are sometimes referred to jointly as the Advanced Delivery Technologies (ADT) business. The OT segment primarily provides oral dose form manufacturing leveraging Catelent's softgel and modified release technologies. The MDS segment primarily provides dose form manufacturing for drugs administered via injection, inhalation, and ophthalmic routes, leveraging both traditional and advanced technologies. The DCS business provides manufacturing and logistics services for drugs in clinical trials as well as analytical testing for drug development.

Please see our full report for complete details

Investment Thesis

Summary. We are initiating coverage of Catalent, Inc. with an Outperform rating and a 12-month valuation range of $25-27. We believe the pharmaceutical services sector has favorable long-term trends, and within that space, Catalent is positioned relative to peers with a stable and diversified business model, although one with certain company-specific challenges that we project will keep growth at the lower-end of the industry range (5-10% organic growth for most public pharmaceuticalceutical services companies). Considering these factors, we view CTLT's valuation as reasonably attractive, with room for expanding multiples if Catalent successfully executes on growth opportunities to move its long-term growth profile higher.

Stability and visibility. Within the pharmaceutical services sector, we believe Catalent has better-than-average long-term visibility for more than 70% of its business, which is a result of long-term supply contracts with generally predictable revenue recognition. Catalent calls its strategy “follow the molecule,” meaning the company strives to become involved with a molecule early in its life cycle by providing formulation and analytical services, which may then lead to a contract for clinical trial supplies and subsequently, a contract for commercial dose form manufacturing incorporating Catalent’s drug delivery technology. Because Catalent is often included in customers’ regulatory filings, commercial business tends to be extremely sticky and often allows the company to continue following the molecule from branded to generic to over-the-counter status. With this strategy, the company has cultivated some relationships that are more than two decades long.

Diversity. Catalent’s diverse client list also helps offset the risk of any individual project, in our view. Each year, Catalent produces doses for nearly 7,000 products owned by approximately 1,000 customers. In its FY2013, Catalent did business with more than 80% of the top 200 global biopharmaceutical, generic, and consumer health companies. Similarly, over the past three years, Catalent earned revenue with respect to 80% of the 200 top-selling compounds globally. From a concentration standpoint, Catalent's top 20 products represented about 25% of revenue in FY2013, with no single product greater than 3% and no single customer greater than 10%. In our view, these metrics compare favorably to those of the broader pharmaceutical services industry.

Regulatory and operational excellence. The contract manufacturing space is highly regulated, but also highly fragmented, a situation that has allowed high-profile mistakes by lower-quality players to create negative publicity for the industry. Catalent has more than 1,000 employees focused on quality and regulatory compliance and has successfully completed 239 regulatory audits over the past five years, in addition to hundreds of customer audits annually. Operationally, the company boasts 99% on-time delivery. We believe Catalent’s stellar regulatory track record allows the company to command some degree of pricing premium. While price is certainly a consideration in almost any contract, it is hard for us to imagine the contract manufacturing space becoming commoditized to the point that pharmaceutical sponsors regularly forego operational excellence in favor of price concessions. Catalent’s high-teens operating margin compares favorably to peers’ in any segment of the pharmaceutical services sector, and we believe the company’s operational and regulatory track record, creates a moat around this margin.

Possibility of accelerating growth. Catalent’s long-term organic revenue growth guidance of 5% implies a modest acceleration from the 4% average constant dollar organic growth the company has seen over the past five years. While we are not forecasting additional acceleration beyond Catalent’s guidance, we believe the company has some upside potential from a growing portfolio of proprietary technologies, including delivery solutions for biologics (such as Gene Product Expression, or GPEx, and SMARTag) and the recently launched

ADVASEPT solution for glass-free injectable products. Catalent gives the number of new product introductions each year, and while that metric comes with heavy caveats (i.e., products can have widely varying economic profiles), it is notable that Catalent's new product introductions expanded by 80%, to 175 in FY2014 from 97 in FY2013. Other potential drivers of accelerating growth include geographic expansion (recent investments in Brazil and market entry into China), additional client penetration (of Catalent's top 50 customers, nearly 75% use less than half of Catlent's service offerings), and the pursuit of adjacent markets (e.g., animal health).

Optimized capital structure. Catalent's stability and client diversity allow a greater capacity for leverage, in our view, which can be an important differentiator relative to pharmaceutical services peers. The company has a 4.4x pro forma leverage ratio following the initial public offering, which is above those of public peers. Many pharmaceutical services peers have shown an aversion to leverage, often citing client concentration or bookings volatility as a risk. Because those risks are lower for Catalent, in our view, we believe the company can benefit from a more-optimal capital structure.

Investment Risks

Short-term volatility is common. While Catalent has a high degree of long-term visibility, deliveries can be lumpy, sometimes causing revenue slippage or unexpected mix shifts on a quarter-to-quarter basis. In order to smooth out short-term volatility over multiquarter periods, we believe management will need to manage near-term Street expectations carefully. Management's experience with expectations management in the public markets is less robust than its operational experience, prompting us to adopt a wait-and-see view regarding management's ability to consistently meet its own guidance.

Maintaining a stellar regulatory and operational track record is not easy. Despite Catalent's outstanding regulatory track record, regulatory excellence is not easy or inexpensive to maintain, and the risk of a slip-up is nearly impossible to entirely mitigate. Such a regulatory mistake could have severe financial consequences, both in terms of investment requirements for remediation and in terms of lost revenue and earnings.

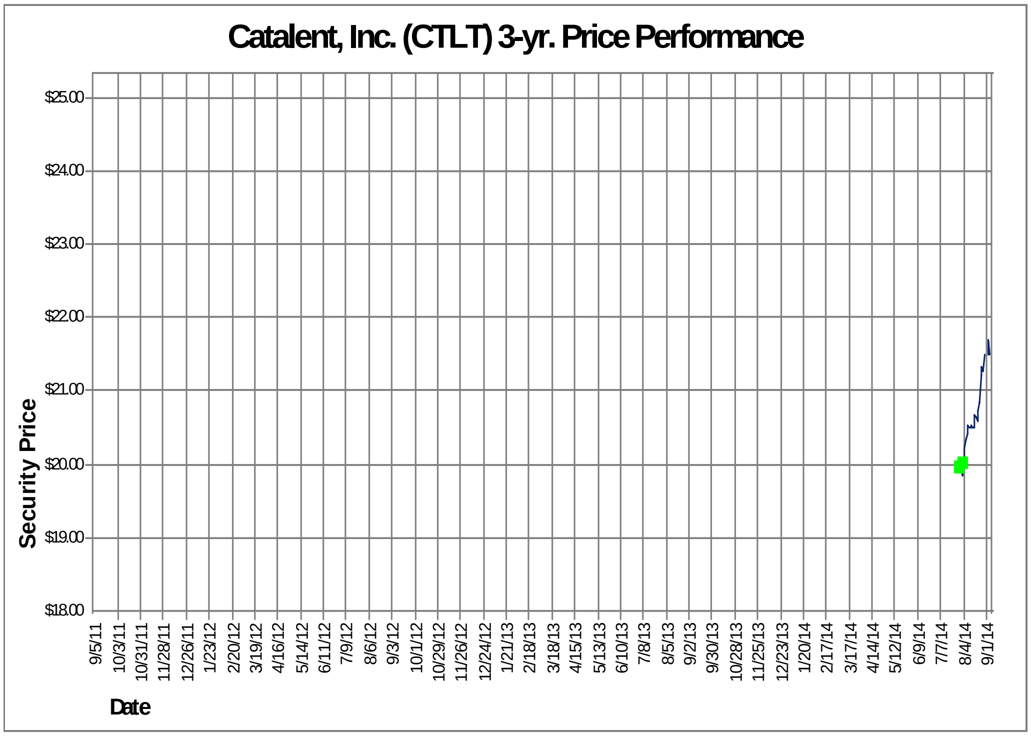
Sales volume of drug products is beyond Catalent's control. Catalent's revenue performance depends on end-user sales of the products Catalent manufacturers, although Catalent is unable to substantially influence those sales. To illustrate this risk, Catalent has highlighted a central nervous system (CNS) product launch that substantially missed the customer's forecast sales target and caused a headwind for Catalent in FY2013.

Catalent may remain a controlled company. All shares issued in the initial public offering were primary shares. Consequently, affiliates of Blackstone may continue to own more than 50% of shares for some period of time, making Catalent a "controlled company" under corporate governance standards. As a controlled company, Catalent may elect not to comply with certain corporate governance standards pertaining to director independence. It is also possible that Blackstone will want to exit all or part of its position in one or more secondary offerings, which could affect the stock price.

Risks of operating with high leverage. Catalent's large debt load creates certain risks, such as constraints on raising capital, paying dividends, and the ability to invest to adapt to changing industry demands.

Risks of operation in foreign jurisdictions. Catalent receives more than 60% of its revenue from jurisdictions outside the United States. Risks of operating in international jurisdictions include foreign exchange risk, the challenges of complying with numerous regulatory regimes, and tax consequences, as well as increased risk of disruption due to conflicts.

Required Disclosures



	Date	Publication Price ($)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price ($)
❒	7/31/2014		IPO at $20.50			

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	SR	Suspended
2	Market Perform/Hold	NR	Not Rated
3	Underperform/Sell	NE	No Estimate

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CTLT: Risks include (1) short-term volatility, due to general order lumpiness; (2) potential for regulatory missteps; (3) weak product sales by customers; (4) control company status; (5) high leverage; and (6) FX volatility.

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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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M=Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.
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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: September 9, 2014

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