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November, 04, 2017

Prestige Brands Holdings Inc.: PBH

Ryan Rosmarin

Sector: Healthcare
Industry: Specialty Pharmaceuticals
Current Price: $42.30
Target Price: $60.94

Company Description: Prestige Brands Holdings Inc. is a leading provider of over-the-counter (OTC) healthcare and household cleaning products. Through its subsidiaries, Prestige markets, sells, manufactures, and distributes its products primarily in North America and Australia with its large portfolio of top performing brands. With an established retail distribution network and low-cost operating model, Prestige delivers #1 products to mass merchandisers, drug, food, convenience, and club stores on a global scale.

BUY

Current Price:	$46.90
Target Price:	$60.94
Market Cap:	2.48B
52 Week Range:	$42.30-$59.63
Average Volume:	630,000
D/E Ratio:	2.66
EBITDA Margin:	34.2%
12M Total Return:	2.36%
ROIC:	10.4%
WACC:	9.0%

Catalysts:

- **Short-Term** (within the year): Organic growth opportunity & Q218 Earnings announcement
- **Mid-Term** (1-2 years): Growth potential within the Healthcare sector along with economic optimism under Trump administration
- **Long-Term** (3+years): Innovation and development of top line products and brand expansion

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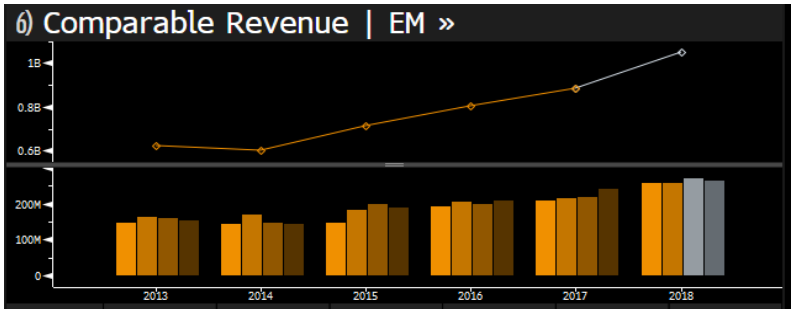
Thesis:

Prestige Brands Holdings Inc. is a global distributer of industry leading OTC healthcare and household products. In a recovering healthcare industry, Prestige is currently undervalued trading near its 52-week low of $42.30, presenting a great buy opportunity for stock appreciation. Consistently driving bottom line performance and generating strong free cash flow, Prestige is well aligned with their long-term growth targets. Industry leading margins along with the effective use of financial leverage allows Prestige to grow organically and create value for shareholders. With a current bull market environment, Prestige is an attractive short-term/mid-term investment opportunity.

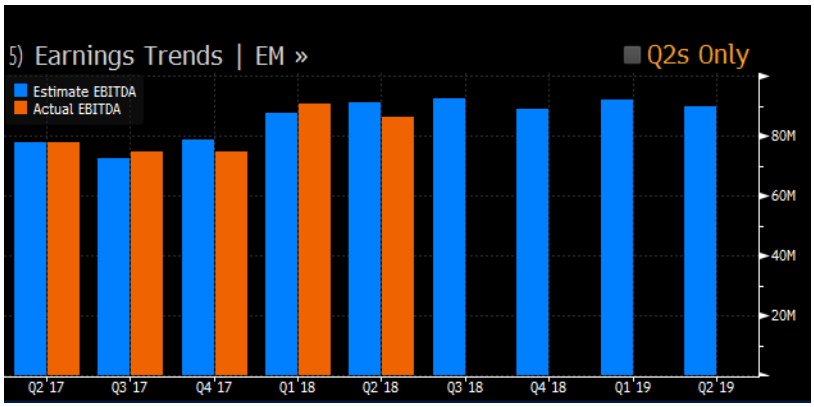


(USD)	2013	2014	2015	2016	2017	2018
FY	623.6M	601.9M	714.6M	806.2M	882.1M	1.0B
Q1	147.0M	143.0M	145.7M	192.1M	209.6M	256.6M
Q2	161.9M	168.4M	181.3M	206.1M	215.1M	258.0M
Q3	160.2M	146.2M	197.6M	200.2M	216.8M	270.2M
Q4	154.5M	144.3M	190.0M	207.9M	240.7M	262.2M

Business Overview:

Prestige Brands Holdings Inc. is engaged in the marketing, sales, manufacturing, and distribution of well-known, brand name OTC healthcare and household cleaning products primarily in North America and other international markets. With a strong brand portfolio and an established retail distribution network, Prestige is able to operate with high margins and a low-cost operating model. Prestige's operating model provides them with a competitive advantage over its competitors with their ability to integrate acquired brands, innovate new ones, and respond to technological advances in the pharmaceuticals industry. Prestige distributes leading brands across all market segments of the specialty pharmaceuticals industry, including Chloraseptic, Clear Eyes, Compound W, Dramamine, Efferdent, Luden's, and many others. North American and International OTC healthcare products accounted for 78.9% of Prestige's net revenues for 2017. In addition, Prestige's portfolio of brands includes Comet, the #1 abrasive tub and tile cleaner in the household cleaning products industry. Prestige continues investing in new product lines to grow its portfolio organically and through the completion of strategic acquisitions. Prestige creates value through acquiring previous "non-core" products at discount and reviving their post-acquisition performance with management expertise. Prestige then increases its sales, market share and distribution in both new and exisiting markets through its established network of retail distribution. Prestige achieves this through increased spending on advertising, new marketing strategies, improved packaging, and the development of brand extensions. Products are sold through multiple channels such as mass merchandisers, drug, food, club, and convenience store across three business segments. Large customers include Walmart, Target, CVS, Walgreens, BJ's, Sam's Club, and many others. Prestige operates in three business segments; North American OTC, International OTC, and Household Cleaning.

Q2 2018 Earnings Performance:



Prestige Brands Holdings Inc. missed earnings estimates by $0.05 EPS due to the heavy impacts from the timing of quarter end shipments. Despite shipping headwinds, Prestige increased revenue 20% year-over-year to $258mn. Timing of customer deliveries hindered top line performance by $8.0mn, but factors delaying shipment time are expected to be only temporary. Prestige's newly acquired Fleet brand contributed $51.7mn in Q2, which has grown 7.5% yoy adjusted for the timing of deliveries. As customer deliveries normalize, the pro forma revenue growth rate is likely to be higher in the second half. Adjusted gross margins were in line with expectations at 56.3%, down 1.3% from Q217 due to the acquisition of Fleet. Adjusted EBITDA margins increased 10.7% to 33.5% ($86.5mn) and Operating Margins increased 8.1% to 30.2% ($78.0mn). Q2 Adjusted A&P expense was 15.3% of revenue and 14.8% YTD, as Prestige increasingly shifts focus towards their invest for growth brands and continue to invest in long-term brand building. Adjusted G&A costs came in at 8% of total revenue, in line with expectations. Depreciation and amortization expense increased 19.4% yoy to $35mn as well. Q2 adjusted free cash flow came in at $54.8mn, increasing 10.5% yoy from $49.6mn. Prestige has generated free cash flow of $2.08 per share, attributable to their industry leading financial profile, low CAPEX requirements, and cash tax benefits from previous structured acquisition deals. Prestige's industry leading FCF conversion of 164% helped reduce net debt by $105mn in the first half, with an expected reduction of the leverage ratio to 5.0x by year end. Earnings per share for Q2 decreased $0.02 to $0.61 and is expected to be $2.62 by FY18.

Growth Strategy & FY18 Outlook:

Prestige plans to continually drive organic growth through its long-term brand building strategy. Leading the industry in margins, Prestige can expect an increase in sales and reduction in costs as delivery patterns normalize over the next few months. To enhance brand recognition and customer sales, Prestige invests heavily in advertising and promotion to drive the growth of their core brands. Prestige also gains market share by developing new products to expand existing successful brand lines. With the success of Summer's Eve *Simply* and Nix's *Ultra*, Prestige looks to expand its product line extension across all segments. Innovation is driven by the macro health & wellness trends and the desire to fulfill unmet consumer needs. Sales are also being driven online as Prestige invests in e-commerce with the growing trends of the online shopping industry. Although e-commerce is currently a small source of revenues in the OTC industry, consumers are gradually adding OTC products in their online shopping patterns. Prestige plans to increase its international presence beyond North American borders by developing products for specific foreign markets in addition to its DenTek and Hydralyte brands. Prestige will also continue to take advantage of strategic acquisition

opportunities, as M&A has led to valuable growth in its history. Prestige creates value for shareholders as they invest in companies the will enhance their portfolio, and reduce costs by selling products that are unsuccessful.

Prestige's FY18 outlook remains unchanged as they expect continued solid consumption trends in their largest category leading brands and expansion of new product lines. Although the consumer retail market remains challenging, Prestige is cautious in expenditures and will continue to win customers in the industry. FY18 revenue is expected to grow 20% to $1.06bn, driven by their invest for growth portfolio. Normalization in the delivery market should increase earnings between 3.5-4% and free cash flow is anticipated to be $205mn, equating $3.83 per share. Prestige will create value by sticking to their three business pillars of winning customers, growing market share, and reducing interest expense to provide resources for M&A.

Industry Analysis:

The overall forecast for the Healthcare sector on the Russell 2000 index continues to look promising as recent underperformance has left a significant opportunity for growth as the industry heads into recovery. Underpricing within the sector was largely due to volatility and uncertainties in healthcare reform leading up to the U.S. Presidential election of Donald Trump. This volatility creates growth opportunity for single-stock picks, as intra-sector correlations in healthcare tend to be low. Through the end of October, pharmaceuticals have been trading around 4% below the market. Investors readily await upcoming Q3 earnings with expectations of underperformance and the belief in a potential relief rally due to the relatively cheap prices of healthcare compared historically to other sectors. Investors remain uneasy with reoccurring themes in the industry such as high leverage and an inflationary U.S. generic pricing environment. Specialty pharmaceuticals continue to trade at a significant discount of 35% compared to major pharmaceuticals YTD. With a growth rate of 18.36% YTD in the Russell 2000 Pharmaceuticals Index (RGUSHSPH), the pharma index has traded

at a discount compared to the RTY Index as well. The underperformance of the RGUSHSPH vs the RTY creates growth potential for Prestige as the index recovers. Another driver of the industry is the economic optimism under the Trump Administration. Markets continue to act bullish despite geopolitical concerns and a projected increasing rate environment. Trump's pro-growth strategy, tax-cuts, and deregulation should have a positive influence on Prestige, enabling them easier access to new products and patents.

Competitors:

Compared to its competitors, Prestige Brands Holdings leads the industry in sales growth and margins, making them a high growth opportunity for potential investors. Prestige has grown its sales and EBITDA 16.74% and 9.65% respectively TTM, much larger than the industry medians of 0.14% and -9.95%. EBITDA and Operating margins were 33.69% and 21.8% respectively with a Net Profit margin of 12.59%. Prestige's dominance in industry margins is a result of management ability to effectively manage costs, shown by their low CAPEX/Sales ratio of 0.34%. Margins are slightly down in Fiscal Year 2018 for Prestige due to their acquisition of Fleet, but are forecasted to return to normal levels as costs in the segment decrease. Prestige currently trading at a P/E ratio of 18.82, compared to the industry median of 14.46, showing that it is underpriced relative to the industry.

	Name	Sales Growth (%)	EBITDA Growth (%)	EBITDA Margin	Operating Income Margin	Net Profit Margin	Net Income	Capex/Sales (%)
	Median	0.14%	-9.95%	31.41%	21.80%	11.34%	-10.38%	4.20%
100)	PRESTIGE BRANDS HOLDI...	16.74%	9.65%	33.69%	30.61%	12.59%	1.72%	0.34%
101)	JOHNSON & JOHNSON	3.86%	8.98%	35.83%	29.34%	23.77%	1.67%	4.49%
102)	COLGATE-PALMOLIVE CO	-0.59%	0.32%	28.90%	25.84%	16.70%	1.71%	3.90%
103)	AKORN INC	-15.68%	-37.43%	31.41%	22.27%	11.34%	-51.78%	6.71%
104)	PROCTER & GAMBLE CO/...	-0.15%	-0.96%	26.07%	21.80%	16.27%	0.64%	5.20%
105)	MALLINCKRODT PLC	0.42%	--	41.66%	17.24%	11.06%	-10.38%	13.12%
106)	VALEANT PHARMACEUTIC...	-11.02%	-30.86%	36.97%	9.60%	-8.40%	-428.60%	2.43%
107)	HORIZON PHARMA PLC	10.32%	-18.94%	23.10%	-2.39%	-9.95%	-13.75k%	1.60%

Financial Leverage:

Although the use of debt financing is common within the HC specialty pharmaceuticals industry, Prestige carries a large amount compared to its competition with net debt totaling $2.07bn. At Q218 end, net debt consisted of cash, term loans, and bonds of $43mn, $1.36bn, and $750mn respectively. This adds a large degree of financial risk to Prestige's operations, as they are currently levered 5.5x. Prestige consistently works to reduce their debt financing as they have paid down $105mn in the first half and expect to reduce their leverage ratio to 5.0x by the end of fiscal year 2018. Prestige has consistently been able to operate with their leveraged capital structure due to their large levels of free cash flow, and will reduce its level of debt financing if it becomes necessary. In the current macro-environment, Prestige feels that being 5x levered is the optimal capital structure that will create operational efficiency. With an ROIC of 10.4% and WACC of 9%, Prestige is effectively creating value with its financing.

Conclusion:

Forecasts of recovery within the Healthcare sector provide a positive outlook for Prestige Brands Holdings Inc., one of the leading distributers of specialty pharmaceuticals. Growth opportunity looks especially promising within specialty pharmaceuticals as they are trading around 35% below major pharma YTD. With a portfolio of several industry-leading brands, Prestige continues to win customers in an industry that is highly unlikely to lose demand due to the necessity of its products. Low operating costs and consistent sales growth allow Prestige to operate on high margins, creating higher profits relative to its competitors. Currently trading at its 52-week low, Prestige is an attractive short/mid-term investment that can return near 30% as the stock price appreciates back to normal levels.

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Prestige Brands Holdings, Inc. (PBH)

CENTER FOR GLOBAL FINANCIAL STUDIES

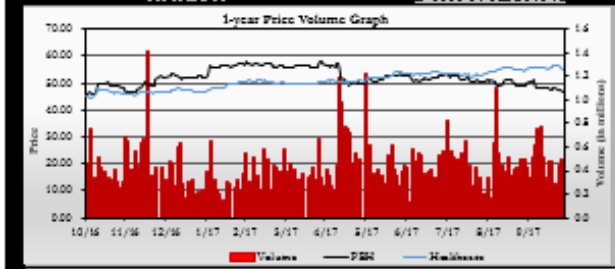
BULLISH

Analysis by RYAN ROSMARIN

11/1/2017

Current Price:	$46.90	Intrinsic Value	$53.15
Dividend Yield:	0.0%	Target Price	$60.94

Target 1 year Return: 29.95%
Probability of Price Increase: 10



Description

Prestige Brands Holdings, Inc., through its subsidiaries, markets, sells, manufactures, and distributes over-the-counter (OTC) healthcare and household cleaning products in North America, Australia, and internationally.

General Information

Sector	Healthcare
Industry	Pharmaceuticals
Last Guidance	November 3, 2015
Next earnings date	November 2, 2017
Estimated Country Risk Premium	6.51%
Effective Tax rate	21%
Effective Operating Tax rate	21%

Market Data

Market Capitalization	$2,485.71
Daily volume (mil)	0.63
Shares outstanding (mil)	53.00
Diluted shares outstanding (mil)	53.52
% shares held by institutions	116%
% shares held by investments Managers	90%
% shares held by hedge funds	11%
% shares held by insiders	0.29%
Short interest	11.53%
Days to cover short interest	13.92
52 week high	$59.63
52-week low	$44.64
Volatility	26.77%

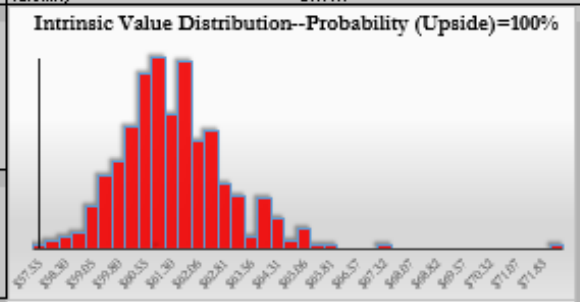
Past Earning Surprises

Quarter ending	Revenue	EBITDA
6/30/2016	0.44%	-3.08%
9/30/2016	-0.87%	-2.43%
12/31/2016	2.73%	-1.46%
3/31/2017	2.13%	4.30%
6/30/2017	0.76%	-0.41%
Mean	1.04%	-0.62%
Standard error	0.6%	1.3%

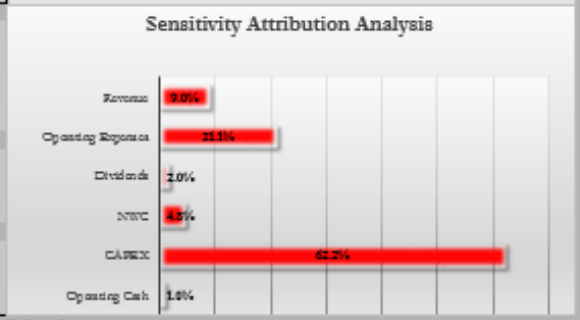
Peers

Akorn, Inc.
Impax Laboratories, Inc.
Inter Parfums, Inc.
Church & Dwight Co., Inc.
Taro Pharmaceutical Industries Ltd.

Management	Position	Total compensation qrs	Total return to shareholders
Lombardi, Ronald	Chairman, President & CEO	40.39% per annum over 6y	8.83% per annum over 6y
Sacco, Christine	Chief Financial Officer	N/M	N/M
Connors, Timothy	Executive Vice President of	1.84% per annum over 6y	8.83% per annum over 6y
Parkinson, John	Senior Vice President of Int	2.55% per annum over 6y	8.83% per annum over 6y
Hoye, Christopher	Senior Vice President of Con	N/M	N/M
Hochuli, Thomas	Vice President of Operations	N/M	N/M



Profitability	PBH (LTM)	PBH (5 years historical a	Peers' Median (LTM)
Return on Capital (GAAP)	5.4%	7.02%	198.57%
Operating Margin	14%	14.90%	11.41%
Revenue/Capital (GAAP)	0.39	0.47	17.41
ROE (GAAP)	16.1%	14.3%	-47.9%
Net margin	13.4%	10.2%	13.7%
Revenue/Book Value (GAAP)	1.20	1.40	-3.50
Invested Funds	**PBH (LTM)**	**PBH (5 years historical a**	**Peers' Median (LTM)**
Cash/Capital	1.4%	1.3%	41.7%
NWC/Capital	4.3%	7.1%	-5.3%
Operating Assets/Capital	74.4%	77.6%	53.5%
Goodwill/Capital	19.8%	14.0%	10.0%
Capital Structure	**PBH (LTM)**	**PBH (5 years historical a**	**Peers' Median (LTM)**
Total Debt/Market Capitalization	0.69	0.68	0.37
Cost of Existing Debt	5.3%	6.5%	4.6%
CGFS Rating (F-score, Z-score, and default Prob	CCC	BB	BBB
WACC	9.0%	9.2%	9.6%



Porter's 5 Forces (scores are out of 100)

Valuation

Period	Revenue Growth Forecast	NOPAT Margin Forecast	Revenue to Capital Forecast
Base Year	13%	27.6%	0.37
6/30/2018	15%	-37.7%	0.34
6/30/2019	2%	-36.1%	0.40
6/30/2020	3%	-33.8%	0.50
6/30/2021	3%	-31.8%	0.63
6/30/2022	2%	28.4%	0.84
6/30/2023	2%	25.9%	0.72
6/30/2024	2%	23.4%	0.64
6/30/2025	2%	20.9%	0.59
6/30/2026	2%	18.4%	0.55
6/30/2027	2%	15.9%	0.53
Continuing Period	3%	13.4%	0.51

Period	Return on Capital Forecast	WACC Forecast	Price per share Forecast
Base Year	10.4%	9.0%	$50.72
6/30/2018	-12.8%	8.0%	$58.46
6/30/2019	-14.4%	7.6%	$64.08
6/30/2020	-16.7%	7.2%	$69.31
6/30/2021	-20.1%	6.7%	$74.03
6/30/2022	23.9%	6.6%	$78.54
6/30/2023	18.6%	6.4%	$82.84
6/30/2024	15.0%	6.2%	$86.99
6/30/2025	12.3%	6.2%	$91.15
6/30/2026	10.2%	6.1%	$95.24
6/30/2027	8.4%	5.9%	$99.30
Continuing Period	6.9%	5.8%	