

## INC Research Holdings, Inc.

### INCR: Can It Get Better Than This?

We reiterate our Sector Weight rating on INC Research Holdings (INCR) after *yet another* beat-and-raise quarter in 3Q15. Since February, mgmt has increased the midpoint of its EBITDA and EPS guidance by 32% and 57%, respectively. INCR has clearly developed a unique business model that is gaining market share. However, the fact that the shares did not move materially higher on the latest guidance raise concerns us that the market is now anticipating beats-and-raises. INCR is trading at a 12% premium on consensus EBITDA and EPS, and INCR's share price is up 22% over the past 6 months, well above its late-stage CRO peer group average (up 3%).

### Key Investment Points

We are materially increasing our EPS estimates for INCR -- *again* -- to **\$1.97 in 2015 (from \$1.80)** and to **\$2.43 in 2016 (from \$2.14)**. Our increased outlook reflects an ongoing streak of strong book-to-bills ratios (1.35x R4Q; 1.40x in 3Q15), which is particularly impressive given the backdrop of a 19.7% revenue growth (R4Q, constant currency). INCR reported an adj. EBITDA margin of 25.7%, above its publicly traded peer group (19.2%) and mgmt's own "long-term" target of 20% (given in February). Finally, the quality of INCR's revenue profile has improved, with now only 33% of its revenues from its top 5 clients (vs. 36% last year) and 69% of its backlog aligned with faster-growing therapeutic areas, including central nervous system disorders and oncology. This protects INCR against any one large project cancellation.

**Mgmt's 2015 guidance seems low.** The high end of mgmt's revenue guidance (\$914M) implies a backlog burn of 13.6%, down significantly from 14.0% in 3Q15 and 14.2% in 4Q14. Even the implied high end of the 4Q15 adj. EBITDA guidance (\$55.2M; 23.0% margin on high end of revenue guidance) is down sequentially from 3Q15 adj. EBITDA of \$55.4M (23.6% margin; excluding \$4.9M of one-time items). Facility utilization is at ~80% (~70% last year) and mgmt now expects to have streamlined 3 of its 5 CTMS systems by year-end (above target). Mgmt is asking the market to expect a sequential margin decline due to a normalized level of bad debt, year-end public company costs and hiring.

Looking ahead, **we think that a 12% constant currency revenue growth rate in 2016 is comfortably achievable.** INCR ended September with almost \$1.8B in backlog, up 20% YOY constant currency. Based on historical experience, this amply covers our (again) upwardly revised revenue outlook. Extrapolating the high end of mgmt's 4Q15 EBITDA margin guidance, we model EBITDA margin expansion to ~24.8% in 2016, calculating to an adj. EBITDA of \$254M and an adj. EPS of \$2.43, by our models.

### Estimates

FY ends 12/31	F2014A	1Q15A	2Q15A	3Q15A	4Q15E	F2015E	F2016E
EPS (Net)	0.83	0.42	0.47	0.58	0.51	1.97	2.43
Previous	--	--	--	0.41	0.50	1.80	2.14
EBITDA (M)	\$145.3	\$51.2	\$53.3	\$60.3	\$58.1	\$222.9	\$254.1
Previous	--	--	--	\$46.0	\$52.3	\$202.7	\$228.9
<b>Valuation</b>							
P/E	47.8x	--	--	--	--	20.1x	16.3x

Sources: Company reports, FactSet, KeyBanc Capital Markets Inc.

For analyst certification and important disclosures, please refer to the Disclosure Appendix.

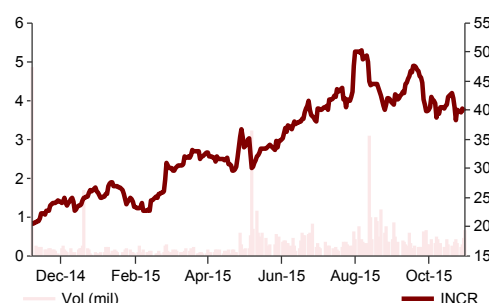
KeyBanc Capital Markets Inc. | Member NYSE/FINRA/SIPC

Donald Hooker, CFA / (917) 368-2378  
[donald.hooker@key.com](mailto:donald.hooker@key.com)

Jack Wallace / (917) 368-2345  
[jack.wallace@key.com](mailto:jack.wallace@key.com)

### NASDAQ: INCR

<b>Rating:</b>	<b>Sector Weight</b>
<b>Price Target:</b>	<b>NA</b>
<b>Price:</b>	<b>\$39.67</b>



Sources: Company reports, FactSet, KeyBanc Capital Markets Inc.

### Company Data

52-week range	\$20 - \$52
Market Cap. (M)	\$2,332.6
Shares Out. (M)	58.80
Enterprise Value (M)	\$2,671.5
Avg. Daily Volume (30D)	330,816.0
SI as % of Float	3.4%
SI % Chg. from Last Per.	0.1%
Book Value/Share	\$7.32

Sources: Company reports, FactSet, KeyBanc Capital Markets Inc.

---

**Valuation**

INCR current trading price implies a 16x multiple of our 2016 adjusted EPS estimate of \$2.43, which is in line with the CRO group average. In our opinion, this peer average multiple is appropriate given INCR's strong bookings momentum in recent quarters and alignment with fast-growing therapeutic categories such as central nervous system disorders and oncology. INCR currently trades at ~19x consensus 2016 adjusted EPS of \$2.21.

---

**Investment Risks**

INCR operates in a competitive industry against other providers that have similar services. The Company's ability to generate revenue and earnings growth is contingent on trends in global biopharmaceutical R&D spending and the propensity of biopharmaceutical firms to outsource R&D and sales activities to third parties. Furthermore, a significant portion of INCR's revenues are generated from clinical trials in central nervous system (CNS) disorders and oncology.

---

## FINANCIAL MODELS

Figure 1: Projected Income Statement

INCR -- GAAP Income Statements (in millions)	2013A	2014A	Fiscal Year End, December 2015				2015E	Fiscal Year End, December 2016				2016E
			1QA	2QA	3QA	4QE		1QE	2QE	3QE	4QE	
<b>Net Service Revenue</b>	<b>\$652.4</b>	<b>\$809.7</b>	<b>\$211.5</b>	<b>\$227.4</b>	<b>\$234.5</b>	<b>\$240.7</b>	<b>\$914.0</b>	<b>\$247.9</b>	<b>\$252.4</b>	<b>\$259.1</b>	<b>\$264.7</b>	<b>\$1,024.1</b>
Year-Over-Year Growth, % (Services)	12.7%	24.1%	14.5%	11.7%	12.9%	12.6%	12.9%	17.2%	11.0%	10.5%	10.0%	12.0%
Less: Direct Costs	(432.3)	(515.1)	(125.4)	(138.0)	(135.5)	(143.4)	(542.4)	(146.3)	(148.9)	(152.9)	(156.2)	(604.2)
Gross Income	\$220.2	\$294.7	\$86.1	\$89.4	\$99.0	\$97.2	\$371.6	\$101.6	\$103.5	\$106.2	\$108.5	\$419.9
Gross Margin, % (Services)	33.7%	36.4%	40.7%	39.3%	42.2%	40.4%	40.7%	41.0%	41.0%	41.0%	41.0%	41.0%
less: Selling, General, and Admin	(117.9)	(145.1)	(35.8)	(37.1)	(40.4)	(41.5)	(154.9)	(42.1)	(42.9)	(43.5)	(44.5)	(173.1)
less: Depreciation	(19.2)	(21.6)	(4.8)	(4.4)	(4.4)	(4.5)	(18.0)	(4.6)	(4.7)	(4.8)	(4.9)	(19.0)
less: Amortization	(39.3)	(32.9)	(9.5)	(9.5)	(9.5)	(9.5)	(37.9)	(9.5)	(9.5)	(9.5)	(9.5)	(37.8)
less: Other	(12.3)	(31.3)	(3.6)	(2.4)	(0.4)	(0.5)	(6.9)	-	-	-	-	-
<b>Operating Income</b>	<b>\$31.5</b>	<b>\$63.6</b>	<b>\$32.4</b>	<b>\$35.9</b>	<b>\$44.3</b>	<b>\$41.3</b>	<b>\$153.9</b>	<b>\$45.4</b>	<b>\$46.4</b>	<b>\$48.4</b>	<b>\$49.7</b>	<b>\$190.0</b>
Operating Margin % (Services)	4.8%	7.9%	15.3%	15.8%	18.9%	17.2%	16.8%	18.3%	18.4%	18.7%	18.8%	18.5%
plus: Interest Income	0.3	0.2	0.1	0.0	0.0	0.0	0.2	0.0	0.0	0.1	0.1	0.2
less: Interest Expense	(60.8)	(53.0)	(5.4)	(4.2)	(3.1)	(3.1)	(15.8)	(3.0)	(3.0)	(2.9)	(2.9)	(11.8)
plus: Other Income (expense)	(1.6)	(39.1)	3.5	(8.1)	(1.0)	(1.2)	(6.9)	-	-	-	-	-
Pretax Income	(\$30.7)	(\$28.2)	\$30.5	\$23.6	\$40.3	\$37.0	\$131.5	\$42.4	\$43.5	\$45.6	\$46.9	\$178.4
less: Provision for Income Taxes	(10.8)	4.7	(5.3)	(0.3)	(2.5)	(7.4)	(15.5)	(15.3)	(15.7)	(16.4)	(16.9)	(64.2)
Net Earnings	(\$41.5)	(\$23.5)	\$25.3	\$23.3	\$37.8	\$29.6	\$116.0	\$27.2	\$27.8	\$29.2	\$30.0	\$114.2
less: Class C Stock Dividends	(0.5)	(3.8)	-	-	-	-	-	-	-	-	-	-
Net Earnings to Class A and B Shares	(\$42.0)	(\$27.2)	\$25.3	\$23.3	\$37.8	\$29.6	\$116.0	\$27.2	\$27.8	\$29.2	\$30.0	\$114.2
<b>Diluted EPS (GAAP)</b>	<b>(\$0.81)</b>	<b>(\$0.51)</b>	<b>\$0.40</b>	<b>\$0.39</b>	<b>\$0.64</b>	<b>\$0.50</b>	<b>\$1.92</b>	<b>\$0.46</b>	<b>\$0.47</b>	<b>\$0.50</b>	<b>\$0.51</b>	<b>\$1.94</b>
Diluted Share Count	52.0	53.5	63.1	60.5	58.8	58.8	60.3	58.8	58.8	58.8	58.8	58.8
<b>Non-GAAP Metrics</b>												
<b>Net Services Revenue</b>	<b>\$652.4</b>	<b>\$809.7</b>	<b>\$211.5</b>	<b>\$227.4</b>	<b>\$234.5</b>	<b>\$240.7</b>	<b>\$914.0</b>	<b>\$247.9</b>	<b>\$252.4</b>	<b>\$259.1</b>	<b>\$264.7</b>	<b>\$1,024.1</b>
Year-Over-Year Growth, % (Period)	12.7%	24.1%	14.5%	11.7%	12.9%	12.6%	12.9%	17.2%	11.0%	10.5%	10.0%	12.0%
Year-Over-Year Growth, % (R4Q)	12.7%	24.1%	21.7%	17.6%	15.2%	12.9%	12.9%	13.6%	13.4%	12.7%	12.0%	12.0%
<b>Adjusted EBITDA</b>	<b>\$105.5</b>	<b>\$145.3</b>	<b>\$51.2</b>	<b>\$53.3</b>	<b>\$60.3</b>	<b>\$58.1</b>	<b>\$222.9</b>	<b>\$61.3</b>	<b>\$62.4</b>	<b>\$64.5</b>	<b>\$65.9</b>	<b>\$254.1</b>
Adjusted EBITDA Margin %	16.2%	17.9%	24.2%	23.4%	25.7%	24.2%	24.4%	24.7%	24.7%	24.9%	24.9%	24.8%
Year-Over-Year Growth, % (Period)	25.1%	37.7%	57.1%	49.9%	63.8%	44.1%	53.4%	19.7%	17.1%	7.0%	13.4%	14.0%
<b>Adjusted EPS</b>	<b>\$0.30</b>	<b>\$0.83</b>	<b>\$0.42</b>	<b>\$0.47</b>	<b>\$0.58</b>	<b>\$0.51</b>	<b>\$1.97</b>	<b>\$0.58</b>	<b>\$0.60</b>	<b>\$0.62</b>	<b>\$0.63</b>	<b>\$2.43</b>
Year-Over-Year Growth, % (Period)	460.6%	181.6%	207.1%	166.2%	121.6%	95.2%	136.9%	40.1%	26.1%	7.5%	25.4%	23.4%

Source: Company reports and KeyBanc Capital Markets

## Disclosure Appendix

### INC Research Holdings, Inc. - INCR

We expect to receive or intend to seek compensation for investment banking services from INC Research Holdings, Inc. within the next three months.

During the past 12 months, INC Research Holdings, Inc. has been a client of the firm or its affiliates for non-securities related services.

As of the date of this report, we make a market in INC Research Holdings, Inc..

### Reg A/C Certification

The research analyst(s) responsible for the preparation of this research report certifies that:(1) all the views expressed in this research report accurately reflect the research analyst's personal views about any and all of the subject securities or issuers; and (2) no part of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this research report.

### Three-Year Rating and Price Target History



### Rating Disclosures

Distribution of Ratings/IB Services Firmwide and by Sector									
KeyBanc Capital Markets					HEALTHCARE				
Rating	Count	Percent	IB Serv/Past 12 Mos.		Rating	Count	Percent	IB Serv/Past 12 Mos.	
			Count	Percent				Count	Percent
Overweight [OW]	348	45.61	75	21.55	Overweight [OW]	20	45.45	4	20.00
Sector Weight [SW]	404	52.95	66	16.34	Sector Weight [SW]	22	50.00	3	13.64
Underweight [UW]	11	1.44	0	0.00	Underweight [UW]	2	4.55	0	0.00

## Disclosure Appendix (cont'd)

---

### Rating System

**Overweight** - We expect the stock to outperform the analyst's coverage sector over the coming 6-12 months.

**Sector Weight** - We expect the stock to perform in line with the analyst's coverage sector over the coming 6-12 months.

**Underweight** - We expect the stock to underperform the analyst's coverage sector over the coming 6-12 months.

*Note: KeyBanc Capital Markets changed its rating system after market close on February 27, 2015. The previous ratings were Buy, Hold and Underweight. Additionally, Pacific Crest Securities changed its rating system to match KeyBanc Capital Markets' rating system after market close on April 10, 2015, in conjunction with the merger of the broker dealers. The previous ratings were Outperform, Sector Perform and Underperform.*

### Other Disclosures

KeyBanc Capital Markets is a trade name under which corporate and investment banking products and services of KeyCorp and its subsidiaries, KeyBanc Capital Markets Inc., Member NYSE/FINRA/SIPC ("KBCMI"), and KeyBank National Association ("KeyBank N.A."), are marketed. Pacific Crest Securities is a division of KeyBanc Capital Markets Inc.

KeyBanc Capital Markets Inc. ("KBCMI") does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

This report has been prepared by KBCMI. The material contained herein is based on data from sources considered to be reliable; however, KBCMI does not guarantee or warrant the accuracy or completeness of the information. It is published for informational purposes only and should not be used as the primary basis of investment decisions. Neither the information nor any opinion expressed constitutes an offer, or the solicitation of an offer, to buy or sell any security. The opinions and estimates expressed reflect the current judgment of KBCMI and are subject to change without notice. This report may contain forward-looking statements, which involve risk and uncertainty. Actual results may differ significantly from the forward-looking statements. This report is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the specific needs of any person or entity.

No portion of an analyst's compensation is based on a specific banking transaction; however, part of his/her compensation may be based upon overall firm revenue and profitability, of which investment banking is a component. Individuals associated with KBCMI (other than the research analyst(s) listed on page 1 of this research report) may have a position (long or short) in the securities covered in this research report and may make purchases and/or sales of those securities in the open market or otherwise without notice. As required by NASD Rule 2711(h)(1)(A), financial interest, if any, by any research analysts listed on page 1 of this report will be disclosed in Important Disclosures, Company-specific regulatory disclosures located above in the Disclosure Appendix. KBCMI itself may have a position (long or short) in the securities covered in this research report and may make purchases and/or sales of those securities in the open market or otherwise without notice. As required by NASD Rule 2711(h)(1)(B), if KBCMI beneficially owns 1% or more of any class of common equity securities of the subject company(ies) in this research report as of the end of the month immediately preceding the date of publication of this research report will be disclosed in Important Disclosures, Company-specific regulatory disclosures located above in the Disclosures Appendix. This communication is intended solely for use by KBCMI clients. The recipient agrees not to forward or copy the information to any other person without the express written consent of KBCMI.