

COMPANY NOTE

Target Change

USA | Healthcare | Pharmaceutical Svcs.

July 30, 2015

Jefferies

INC Research (INCR) Great Results, Expensive Stock: Three Key Insights

Key Takeaway

Impressive 2Q results and raised guidance prompt our 13% EPSe raise for '15 and 16% for '16. Despite this, INCR's valuation remains well above its peers (22x '16E EPS vs. 18x group avg). On the positive side, strong bookings (1.3x BtB) should support revenue growth above the 10-12% target range. The high YTD margin seems like a tougher comp. In our view, INCR's risk/reward is not favorable enough to recommend purchase.

Astellas Migration Complete, New MSA Signed. INCR's relationship with Astellas began as a functional provider arrangement with four separate service agreements. Astellas' studies have now transitioned into a traditional, project-based 3-yr master service agreement formalized in 2Q15. In addition to migrating the existing budget, INCR won additional work, further expanding the size of the relationship. Notably, management expects comparable profitability pre- and post-, after considering pricing and volume-based rebates (10% of INC revenue YTD).

Revenue, Margin Continue to Surge Higher. 2Q revenue of \$227.4M exceeded consensus by \$8M (or 3.6%). Operating margin improved 620 bps YoY to 21.5% and exceeded our estimate by 320 bps. A trailing-12 month BtB of 1.3x is driving the strong revenue growth, while diligent cost control, FOREX (135 bps tailwind in 2Q) and cost leverage are helping margin. Notably, the company remains on track to eliminate 2 of its 5 CTMS systems by year-end, which should drive further cost savings in the back-half of the year and into '16.

Sustainability is Key. The market is valuing small-cap CROs for high growth. INCR and PRAH are both growing revenue double-digits, INCR higher. They are augmenting that growth with margin expansion. On that point, PRAH and ICLR seem to have more runway left than INCR. Our recent work suggests solid growth in late-stage remains with bias to post-approval work where ICLR and Q are meaningful players, but INCR is not. INCR will need to outperform its 10-12% revenue growth target to maintain the high EPS growth that the stock's valuation requires.

Valuation/Risks

Our 12-month PT of \$50 reflects a 23x P/E on our \$2.17 2016 EPSe. Peer comparability requires normalizing for add-backs across the group. INCR's higher recent growth is reflected in a 13% premium to the CRO average P/E multiple. Moreover, management's guidance reflects a moderation of that growth. Risks: 1) Project cancellations, 2) Failure to penetrate new clients, 3) Pricing pressure from new or existing clients, 4) Scale investments.

USD	Prev.	2013A	Prev.	2014A	Prev.	2015E	Prev.	2016E
Rev. (MM)	--	652.4	--	809.7	902.6	907.0	1,012.9	1,032.3
EBITDA (MM)	--	103.1	--	150.9	190.8	202.7	219.6	231.2
Cons. EPS	--	--	--	--	1.53	1.62	1.77	1.90
EPS Non-GAAP								
Mar	--	(0.03)	--	0.13	--	0.41A	--	--
Jun	--	0.06	--	0.25	0.35	0.46A	--	--
Sep	--	0.15	--	0.33	0.39	0.47	--	--
Dec	--	0.07	--	0.26	0.42	0.46	--	--
FY Dec	--	0.25	--	0.97	1.57	1.78	1.87	2.17
EV/Rev		4.8x		3.9x		3.5x		3.0x

HOLD

Price target \$50.00

(from \$37.00)

Price \$47.62

Financial Summary

Book Value (MM):	\$280.4
Net Debt (MM):	\$376.5
Long-Term Debt (MM):	\$475.0
Cash & ST Invest. (MM):	\$98.5
Backlog:	1,700

Market Data

52 Week Range:	\$48.18 - \$18.50
Total Entprs. Value (MM):	\$3,143.2
Market Cap. (MM):	\$2,766.7
Shares Out. (MM):	58.1
Float (MM):	24.9
Avg. Daily Vol.:	383,884

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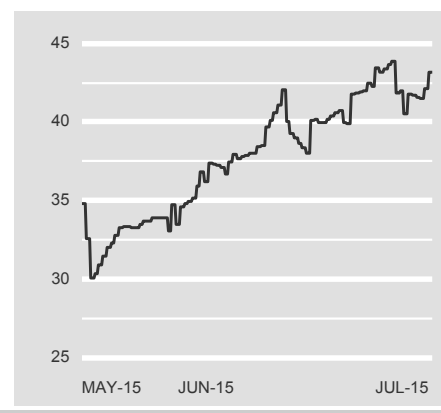
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Price Performance



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EQUITY RESEARCH AMERICAS

Scenarios

Target Investment Thesis

- Bookings growth accelerates slightly; BtB averages 1.20x for the rest of 2015; averages 1.23x for 2016
- Revenue grows 12-14%
- Disciplined approach to trial management and fixed-cost leverage drive '16 EBITDA margin to over 22%
- INCR is successful at expanding client base to drive LT backlog and revenue growth
- 2016 EPS: \$2.17; Target Multiple: 23x; Target Price \$50.00

Upside Scenario

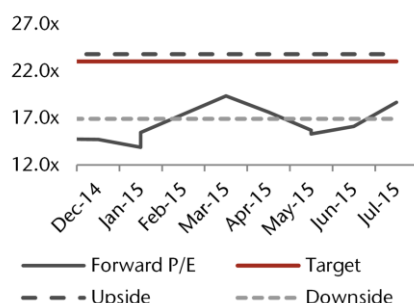
- Bookings growth accelerates; BtB exceeds 1.30x for remainder of 2015 and 2016
- Astellas relationship leads to increased share of wallet; Otsuka returns to low-teens % of revenue
- Revenue grows >15%
- Facility utilization and other SG&A goals achieved quickly
- EBITDA margin improves to >23%
- 2016 EPS: \$2.27; Target Multiple: 24x; Target Price \$54.00

Downside Scenario

- New business wins slow, BtB averages ~1.1x in 2016
- Slower backlog growth continues to trail peers
- INCR experiences the lengthening backlog duration that is common in the sector; burn rate slows, revenue grows sub-8%
- Slower revenue growth limits margin improvements; costs tightly controlled to mitigate impact
- 2016 EPS: \$1.95; Target Multiple: 17x Target Price: \$33.00

Long Term Analysis

1 Year Forward P/E



Source: FactSet and Jefferies LLC

Long Term Financial Model Drivers

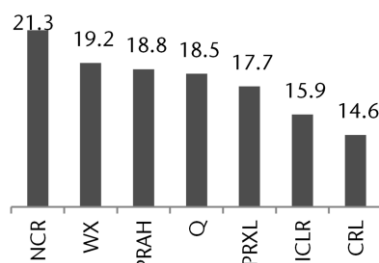
LT EPS CAGR	14-16%
Revenue Growth	10-12%
Operating Margin	21-23%
Effective Tax Rate	36%
Leverage Ratio	<2.5x

Other Considerations

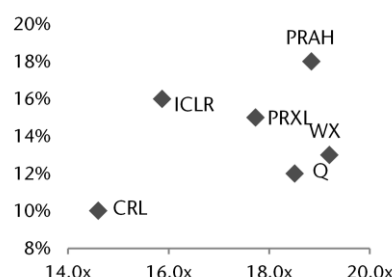
INCR has been very successful at acquiring, integrating and turning around lagging competitors. MDS and KNDL are examples. We would view the announcement of a similar, large transaction as an opportunity for the company to diversify its currently-narrow therapeutic focus and lengthen its revenue growth runway.

Peer Group

Group 2016 P/Es



Earnings Growth vs P/E



Recommendation / Price Target

Ticker	Rec.	PT
CRL	BUY	\$82.00
ICLR	BUY	\$89.00
INCR	HOLD	\$50.00
PRAH	BUY	\$48.00
PRXL	HOLD	\$70.00
Q	BUY	\$87.50
WX	HOLD	\$46.00

Catalysts

- Announcement of additional large acquisitions
- Growth in pharma R&D budgets and/or the amount of clinical work being outsourced
- Additional margin improvement
- Signing of strategic partnerships

Company Description

INC Research is a contract research organization (CRO) that provides various clinical development services for the biopharmaceutical and medical device industries. The company offers a range of services focusing on Phase I to Phase IV clinical trials in the areas of central nervous system, oncology, and other complex diseases, such as genetic disorders and infectious diseases. INC was incorporated in 1998 and is headquartered in Raleigh, North Carolina.

Chart 1: Summary of INC's Results

INC Research
Quarterly Results Comparison
2Q15

FY December (\$ in 000s, except for EPS)	2014	2015	2015E	2015	Consensus	Percentage Change		Difference		
	Q2	Q1	Q2-E	Q2-A		Seq	Y/Y	Seq	Y/Y	Est.
Net service revenue	\$ 203,540	\$ 211,514	\$ 217,985	\$ 227,376	\$ 219,400	7.5%	11.7%	15,862	23,836	9,391
Direct costs	130,781	125,448	136,792	138,010		10.0%	5.5%	12,562	7,229	1,218
SG&A	33,616	35,579	37,310	37,014		4.0%	10.1%	1,435	3,398	(296)
FOREX	-	-	-	-		NA	NA	-	-	-
Adj EBITDA	39,143	50,487	43,883	52,352	42,300	3.7%	33.7%	1,865	13,209	8,469
Depreciation	5,025	4,766	4,934	4,420		(7.3%)	(12.0%)	(346)	(605)	(514)
Total expenses	169,422	165,793	179,036	179,444		8.2%	5.9%	13,651	10,022	408
Adj EBITA	34,118	45,721	38,949	47,932		4.8%	40.5%	2,211	13,814	8,983
Interest income (expense)	(12,823)	(5,305)	(5,150)	(4,188)		(21.1%)	(67.3%)	1,117	8,635	962
Other income (expense)	(337)	-	-	-		NA	(100.0%)	-	337	-
Pretax income	20,958	40,416	33,798	43,744		8.2%	108.7%	3,328	22,786	9,946
Taxes	8,085	14,805	12,167	16,077		8.6%	98.8%	1,272	7,992	3,910
Adj Net income	12,873	25,611	21,631	27,667		8.0%	114.9%	2,056	14,794	6,036
Adj EPS b/f charges	\$ 0.25	\$ 0.41	\$ 0.35	\$ 0.46	\$ 0.34	12.7%	85.5%	\$ 0.05	\$ 0.21	\$ 0.10
Diluted shares	52,185	63,103	61,160	60,464		(4.2%)	15.9%	(2,639)	8,279	(696)
Common Size:										
Net revenue	100.0%	100.0%	100.0%	100.0%				0 bps	0 bps	0 bps
Grow th										
Direct costs	64.3%	59.3%	62.8%	60.7%				140 bps	(360 bps)	(210 bps)
Gross margin	35.7%	40.7%	37.2%	39.3%				(140 bps)	360 bps	210 bps
SG&A	16.5%	16.8%	17.1%	16.3%				(50 bps)	(20 bps)	(80 bps)
Adj EBITDA	19.2%	23.9%	20.1%	23.0%				(80 bps)	380 bps	290 bps
Depreciation	2.5%	2.3%	2.3%	1.9%				(30 bps)	(50 bps)	(30 bps)
Total expenses	83.2%	78.4%	82.1%	78.9%				50 bps	(430 bps)	(320 bps)
Adj EBITA	16.8%	21.6%	17.9%	21.1%				(50 bps)	430 bps	320 bps
Interest income (expense)	-6.3%	-2.5%	-2.4%	-1.8%				70 bps	450 bps	50 bps
Other income (expense)	-0.2%	0.0%	0.0%	0.0%				0 bps	20 bps	0 bps
Pretax income	10.3%	19.1%	15.5%	19.2%				10 bps	890 bps	370 bps
Taxes	38.6%	36.6%	36.0%	36.8%				10 bps	(180 bps)	80 bps
Adjusted net income	6.3%	12.1%	9.9%	12.2%				10 bps	580 bps	220 bps
Metrics										
Net new business	103,400	255,500	325,763	295,900		15.8%	186.2%	40,400	192,500	(29,863)
Book-to-bill	0.51x	1.21x	1.35x	1.30x						
Ending backlog	1,492,660	1,594,872	1,650,528	1,700,000		6.6%	13.9%	105,128	207,340	49,472

Source: Company data and Jefferies LLC

INC Research Holdings, Inc. and Subsidiaries
Earnings Model

Source: Jefferies & Co.

FY December

(\$ in 000s, except for EPS)

Source: Verence & Co.																
FY December	2013-A					2014-A					2015E					
(\$ in 000s, except for EPS)	Q1	Q2	Q3	Q4	2013	Q1	Q2	Q3	Q4	2014	Q1-A	Q2-A	Q3	Q4	2015	2016
Net service revenue	\$ 149,743	\$ 159,202	\$ 169,108	\$ 174,365	\$ 652,418	\$ 184,700	\$ 203,540	\$ 207,763	\$ 213,725	\$ 809,728	\$ 211,514	\$ 227,376	\$ 229,092	\$ 238,977	\$ 906,959	\$ 1,032,337
Direct costs	104,768	106,497	108,917	112,080	432,262	120,764	130,781	129,557	133,957	515,059	125,448	138,010	140,204	149,122	552,784	633,122
SG&A	27,313	28,312	27,418	34,011	117,054	31,890	33,616	37,763	40,494	143,763	35,579	37,014	38,258	40,626	151,477	167,996
FOREX	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Adj EBITDA	17,662	24,393	32,773	28,274	103,102	32,046	39,143	40,443	39,274	150,906	50,487	52,352	50,629	49,229	202,697	231,219
Depreciation	4,446	4,758	4,730	5,241	19,175	6,869	5,025	4,734	4,991	21,619	4,766	4,420	4,590	4,754	18,530	20,721
Total expenses	136,527	139,567	141,065	151,332	568,491	159,523	169,422	172,054	179,442	680,441	165,793	179,444	183,052	194,502	722,791	821,840
Adj EBITA	13,216	19,635	28,043	23,033	83,927	25,177	34,118	35,709	34,283	129,287	45,721	47,932	46,039	44,475	184,167	210,497
Interest income (expense)	(14,817)	(14,772)	(14,769)	(16,131)	(60,489)	(15,901)	(12,823)	(12,903)	(11,160)	(52,787)	(5,305)	(4,188)	(2,569)	(2,533)	(14,594)	(9,719)
Other income (expense)	(1,035)	(30)	(371)	(213)	(1,649)	1,378	(337)	5,136	1,512	7,689	-	-	-	-	-	-
Pretax income	(2,636)	4,833	12,903	6,689	21,789	10,654	20,958	27,942	24,635	84,189	40,416	43,744	43,470	41,943	169,573	200,778
Taxes	(844)	1,923	4,896	3,054	9,029	4,138	8,085	10,665	9,509	32,397	14,805	16,077	15,629	15,079	61,590	70,642
Adj Net income	(1,792)	2,910	8,007	3,635	12,760	6,516	12,873	17,277	15,126	51,792	25,611	27,667	27,842	26,863	107,983	130,136
Adj EPS b/f charges	\$ (0.03)	\$ 0.06	\$ 0.15	\$ 0.07	\$ 0.25	\$ 0.13	\$ 0.25	\$ 0.33	\$ 0.26	\$ 0.97	\$ 0.41	\$ 0.46	\$ 0.47	\$ 0.46	\$ 1.78	\$ 2.17
Diluted shares	52,008	52,038	52,017	51,973	52,009	51,947	52,185	52,514	57,504	53,538	63,103	60,464	58,774	58,835	60,677	60,000
Common Size:																
Direct costs	70.0%	66.9%	64.4%	64.3%	66.3%	65.4%	64.3%	62.4%	62.7%	63.6%	59.3%	60.7%	61.2%	62.4%	60.9%	61.3%
Gross margin	30.0%	33.1%	35.6%	35.7%	33.7%	34.6%	35.7%	37.6%	37.3%	36.4%	40.7%	39.3%	38.8%	37.6%	39.1%	38.7%
SG&A	18.2%	17.8%	16.2%	19.5%	17.9%	17.3%	16.5%	18.2%	18.9%	17.8%	16.8%	16.3%	16.7%	17.0%	16.7%	16.3%
Adj EBITDA	11.8%	15.3%	19.4%	16.2%	15.8%	17.4%	19.2%	19.5%	18.4%	18.6%	23.9%	23.0%	22.1%	20.6%	22.3%	22.4%
Depreciation	3.0%	3.0%	2.8%	3.0%	2.9%	3.7%	2.5%	2.3%	2.3%	2.7%	2.3%	1.9%	2.0%	2.0%	2.0%	2.0%
Total expenses	91.2%	87.7%	83.4%	86.8%	87.1%	86.4%	83.2%	82.8%	84.0%	84.0%	78.4%	78.9%	79.9%	81.4%	79.7%	79.6%
Adj EBITA	8.8%	12.3%	16.6%	13.2%	12.9%	13.6%	16.8%	17.2%	16.0%	16.0%	21.6%	21.1%	20.1%	18.6%	20.3%	20.4%
Interest income (expense)	-9.9%	-9.3%	-8.7%	-9.3%	-9.3%	-8.6%	-6.3%	-6.2%	-5.2%	-6.5%	-2.5%	-1.8%	-1.1%	-1.1%	-1.6%	-0.9%
Other income (expense)	-0.7%	0.0%	-0.2%	-0.1%	-0.3%	0.7%	-0.2%	2.5%	0.7%	0.9%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Pretax income	-1.8%	3.0%	7.6%	3.8%	3.3%	5.8%	10.3%	13.4%	11.5%	10.4%	19.1%	19.2%	19.0%	17.6%	18.7%	19.4%
Taxes	32.0%	39.8%	37.9%	45.7%	38.9%	38.8%	38.6%	38.2%	38.6%	38.5%	36.6%	36.8%	36.0%	36.0%	36.3%	35.2%
Adjusted net income	-1.2%	1.8%	4.7%	2.1%	2.0%	3.5%	6.3%	8.3%	7.1%	6.4%	12.1%	12.2%	12.2%	11.2%	11.9%	12.6%

Company Description

INC Research (Nasdaq:INCR) is a leading global contract research organization (CRO) providing the full range of Phase I to Phase IV clinical development services for the biopharmaceutical and medical device industries. With significant breadth of service offerings and depth of therapeutic expertise across multiple patient populations, INC Research connects customers, clinical research sites and patients to accelerate the delivery of new medicines to market. The Company was ranked "Top CRO to Work With" among large global CROs in the 2015 CenterWatch Global Investigative Site Relationship Survey. INC Research is headquartered in Raleigh, N.C., with staff in 50 countries and experience spanning more than 100 countries.

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Jefferies Franchise Picks

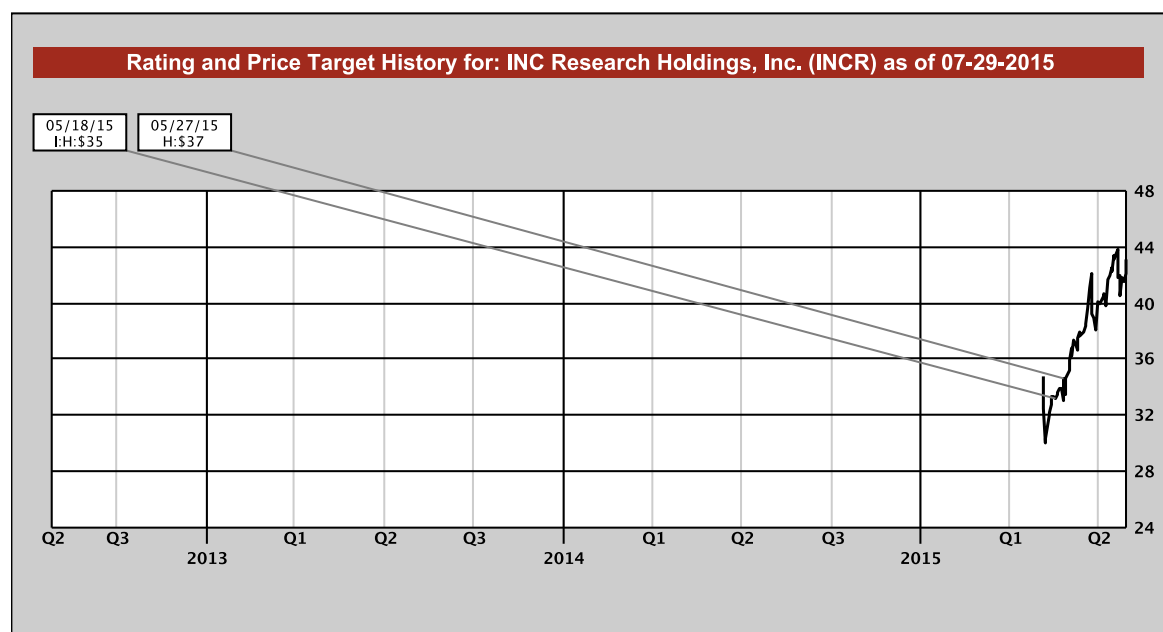
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Other Companies Mentioned in This Report

- Astellas Pharma (4503 JP: ¥1,852, BUY)
- Charles River Laboratories, Inc. (CRL: \$74.44, BUY)
- ICON plc (ICLR: \$80.86, BUY)
- PAREXEL International Corporation (PRXL: \$68.68, HOLD)
- PRA Health Sciences (PRAH: \$42.12, BUY)
- Quintiles Inc. (Q: \$78.75, BUY)
- WuXi PharmaTech Inc. (WX: \$41.50, HOLD)



Distribution of Ratings

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
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