

INC Research Holdings, Inc.

INCR: Updated 2015 Preview (Pre-1Q15)

We reiterate our SW rating on INCR. INCR's shares have increased ~50% since IPO in late 2014 (group average ~20%), and appear fully priced at ~20.6x 2016 EPS (group average of ~18.9x). In our view, INCR can comfortably generate a ~1.2x+ BTB over time. However, given bookings volatility, we think investors can opportunistically wait for any share price weakness associated with a weak bookings quarter.

Key Investment Points

- We model **14.1% constant currency growth in 2015**, excluding ~\$32 million of currency headwind due to an elevated backlog burn rate. A large portion of INCR's backlog consists of projects that are past their start-up phases (e.g., country level approvals and site initiations). Backlog conversion is typically faster during patient enrollment and clinical trial monitoring.
- However, **we are modestly reducing our 1Q15 revenue estimate from \$212 million to \$209 million (shifting difference to 2H15)** based on specific guidance provided by management on prior earnings call. This also results in a modestly lower 1Q15 adjusted EPS estimate (from \$0.29 to \$0.27). Our full-year estimates for both revenue and adjusted EPS remain unchanged.
- Critical to revenue growth are INCR's two largest clients: **Otsuka Holdings** (~14% of revenues in 2014) and **Astellas Pharma** (~12%). INCR's FSP relationship with Astellas expires in April 2015. We expect to hear more commentary on status of this relationship. Otsuka has also been undergoing a period of reinvestment as its primary drug product is losing patent protection in April.

Conference Call Details. INCR is scheduled to release its 1Q15 results pre-market on April 27, and management will host a conference call at 8AM EDT. Dial-in: 1-877-930-8058 (conference ID: 31138881).

Estimates

FY ends 12/31	F2014A	1Q15E	2Q15E	3Q15E	4Q15E	F2015E	F2016E
EPS (Net)	0.83	0.27	0.30	0.32	0.34	1.23	1.44
Cons. EPS	--	\$0.28	\$0.30	\$0.32	\$0.34	\$1.25	\$1.49
Previous	--	0.29	--	0.31	0.33	--	--
Revenue (M)	\$809.7	\$208.7	\$218.2	\$227.7	\$237.0	\$891.6	\$980.7
Cons. Revenue	--	\$211.8	\$217.9	\$224.1	\$233.8	\$887.5	\$984.2
Previous	--	\$212.4	\$217.8	\$226.5	\$235.1	--	--
EBITDA (M)	\$145.3	\$37.8	\$39.7	\$41.4	\$43.1	\$162.0	\$183.1
Cons. EBITDA	--	38.5	40.6	42.4	44.3	165.7	188.1
Previous	--	\$39.0	\$40.0	\$41.6	--	\$163.6	\$184.9
Valuation							
P/E	36.8x	--	--	--	--	24.8x	21.2x

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

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

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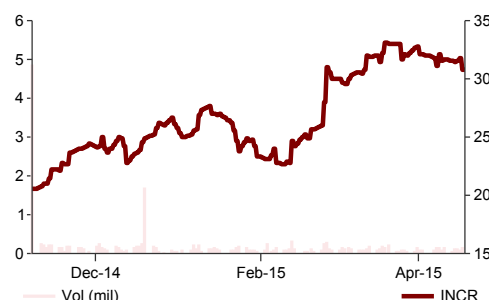
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NASDAQ: INCR

Rating: **Sector Weight**
Price Target: **NA**
Price: **\$30.53**



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

Company Data

52-week range	\$20 - \$35
Market Cap. (M)	\$1,868.4
Shares Out. (M)	61.20
Enterprise Value (M)	2,161.9
Avg. Daily Volume (30D)	106,700.0
SI as % of Float	1.4%
SI % Chg. from Last Per.	96.4%
Book Value/Share	\$7.32

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

Valuation

INCR's current intra-day trading price implies a 20.6x multiple of our 2016 adjusted EPS estimate of \$1.44 (consensus \$1.49), which is roughly in line with the current CRO group average (~18.9x). In our opinion, an in line trading multiple fairly reflects the balance of a higher growth offset by higher bookings volatility and balance sheet indebtedness.

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.

INCR: Updated 2015 Preview (Pre-1Q)

We reiterate our Sector Weight rating on INC Research Holdings, Inc. (NASDAQ: INCR) on valuation. INCR shares have increased ~50% since the Company's IPO in November 2014 (group average ~20%), and the shares appear fully priced at ~20.6x 2016 EPS (group average ~18.9x). We believe INCR can comfortably generate a ~1.2x book-to-bill over time. However, given the Company's history of bookings volatility, we think investors can opportunistically wait for a weak bookings quarter to take advantage of potential stock weakness.

- We model 14.1% constant currency growth in 2015, excluding \$32 million of currency headwind due to an elevated backlog burn rate. A large portion of INCR's backlog consists of projects that are past start-up (e.g., country level approvals and site initiations), and backlog conversion is typically faster during the patient enrollment and clinical trial monitoring phases.
- However, we are modestly reducing our 1Q15 revenue estimate from \$212 million to \$209 million (shifting the difference to 2H15) based on specific guidance provided by management on the prior earnings call. This also results in a modestly lower 1Q15 adjusted EPS estimate (from \$0.29 to \$0.27). Our full-year estimates for both revenue and adjusted EPS remain unchanged.
- Critical to revenue growth are INCR's two largest clients: Otsuka Holdings (~14% of revenues in 2014) and Astellas Pharma (~12%). INCR's FSP relationship with Astellas expires in April 2015. We expect to hear more commentary on the status of this relationship. Otsuka has also been undergoing a period of reinvestment as its primary drug product is losing patent protection in April.

We expect organic, constant currency revenue growth of 14.1% in 2015, excluding \$32 million of currency headwind. This calculates to reported revenue of \$892 million (guidance \$870 million-\$900 million). This is well above the mid- to high-single-digit average growth for the other late-stage CROs because of a higher than normal backlog burn rate. INC Research ended 2014 with \$1.589 billion of backlog. A large portion of backlog now consists of projects that are past startup (e.g., country level approvals and site initiations). Backlog conversion is faster during the patient enrollment and clinical trial monitoring phases. We anticipate bookings growth to be ~10% annually over the next three years (implying an average book-to-bill of ~1.2x).

We are modestly reducing our 1Q15 revenue estimate from \$212 million to \$209 million and shifting the difference to 2H15. This is based on specific guidance provided by management on the prior earnings conference call. This also results in a modestly lower 1Q15 adjusted EPS estimate (from \$0.29 to \$0.27). Our full-year estimates for both revenue and adjusted EPS remain unchanged.

Critical to growth are INCR's two largest clients: Otsuka Holdings (~14% of revenues in 2014) and Astellas Pharma (~12%). INCR's relationship with Astellas consists of a five-year FSP arrangement that expires in April 2015 (this month). We expect to hear more commentary on the status of this relationship, although management seemed positive on the last conference call. Also, management referenced a new strategic relationship with a large European sponsor in 2013 that has since grown to become a top five client as a percentage of backlog.

Aside from Otsuka and Astellas, **INCR continues to benefit from client diversity.** Bookings in 2014 came from a wide variety of sponsors, which will reduce INCR's revenue concentration (top five clients: 34% of revenues in 2013 and 37% in 2014) going forward. Two of INCR's top five clients in 2014 were not among the top five clients in 2013. Management commented that the composition of its top five clients will likely change again in 2015.

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FINANCIAL MODELS

Figure 1: Projected Income Statements

INCR -- GAAP Income Statements (in millions)	Fiscal Year End, December 2014					Fiscal Year End, December 2015						
	2013A	1QA	2QA	3QA	4QA	2014A	1QE	2QE	3QE	4QE	2015E	2016E
Net Service Revenue	\$652.4	\$184.7	\$203.5	\$207.8	\$213.7	\$809.7	\$208.7	\$218.2	\$227.7	\$237.0	\$891.6	\$980.7
Year-Over-Year Growth, % (Services)	12.7%	17.0%	12.3%	15.4%	29.0%	24.1%	13.0%	7.2%	9.6%	10.9%	10.1%	10.0%
Less: Direct Costs	(432.3)	(120.8)	(130.8)	(129.6)	(134.0)	(515.1)	(134.4)	(140.4)	(146.5)	(152.5)	(573.9)	(629.2)
Gross Income	\$220.2	\$63.9	\$72.8	\$78.2	\$79.8	\$294.7	\$74.3	\$77.8	\$81.2	\$84.5	\$317.8	\$351.5
Gross Margin, % (Services)	33.7%	34.6%	35.7%	37.6%	37.3%	36.4%	35.6%	35.7%	35.7%	35.7%	35.6%	35.8%
less: Selling, General, and Admin	(117.9)	(32.2)	(34.0)	(38.2)	(40.8)	(145.1)	(37.4)	(39.1)	(40.8)	(42.4)	(159.6)	(172.6)
less: Depreciation	(19.2)	(6.9)	(5.0)	(4.7)	(5.0)	(21.6)	(5.2)	(5.5)	(5.7)	(5.9)	(22.3)	(23.5)
less: Amortization	(39.3)	(7.5)	(6.2)	(9.6)	(9.6)	(32.9)	(9.5)	(9.5)	(9.5)	(9.5)	(38.0)	(38.0)
less: Other	(12.3)	(2.8)	(19.7)	(3.0)	(5.9)	(31.3)	-	-	-	-	-	-
Operating Income	\$31.5	\$14.6	\$7.9	\$22.7	\$18.5	\$63.6	\$22.2	\$23.8	\$25.2	\$26.6	\$97.9	\$117.3
Operating Margin % (Services)	4.8%	7.9%	3.9%	10.9%	8.6%	7.9%	10.6%	10.9%	11.1%	11.2%	11.0%	12.0%
plus: Interest Income	0.3	0.2	0.0	0.0	0.0	0.2	0.1	0.1	0.1	0.1	0.5	0.8
less: Interest Expense	(60.8)	(16.1)	(12.8)	(12.9)	(11.2)	(53.0)	(5.2)	(5.2)	(5.2)	(5.2)	(21.0)	(21.0)
plus: Other Income (expense)	(1.6)	1.4	(0.3)	5.1	(45.2)	(39.1)	-	-	-	-	-	-
Pretax Income	(\$30.7)	\$0.1	(\$5.3)	\$15.0	(\$37.9)	(\$28.2)	\$17.1	\$18.6	\$20.1	\$21.5	\$77.4	\$97.1
less: Provision for Income Taxes	(10.8)	(1.6)	20.6	(2.4)	(11.8)	4.7	(2.6)	(2.8)	(3.0)	(3.2)	(11.6)	(35.0)
Net Earnings	(\$41.5)	(\$1.6)	\$15.3	\$12.6	(\$49.8)	(\$23.5)	\$14.5	\$15.8	\$17.1	\$18.3	\$65.8	\$62.1
less: Class C Stock Dividends	(0.5)	(0.1)	(0.1)	(0.1)	(3.4)	(3.8)	-	-	-	-	-	-
Net Earnings to Class A and B Shares	(\$42.0)	(\$1.7)	\$15.2	\$12.4	(\$53.2)	(\$27.2)	\$14.5	\$15.8	\$17.1	\$18.3	\$65.8	\$62.1
Diluted EPS (GAAP)	(\$0.81)	(\$0.03)	\$0.29	\$0.24	(\$0.92)	(\$0.51)	\$0.24	\$0.26	\$0.28	\$0.30	\$1.07	\$1.02
Diluted Share Count	52.0	51.9	52.2	52.5	57.5	53.5	61.2	61.2	61.2	61.2	61.2	61.2
Non-GAAP Metrics												
Net Services Revenue	\$652.4	\$184.7	\$203.5	\$207.8	\$213.7	\$809.7	\$208.7	\$218.2	\$227.7	\$237.0	\$891.6	\$980.7
Year-Over-Year Growth, % (Period)	12.7%	23.3%	27.9%	22.9%	22.6%	24.1%	13.0%	7.2%	9.6%	10.9%	10.1%	10.0%
Year-Over-Year Growth, % (R4Q)	12.7%	17.0%	21.0%	22.2%	24.1%	24.1%	21.3%	15.9%	12.7%	10.1%	10.1%	10.0%
Adjusted EBITDA	\$105.5	\$32.6	\$35.5	\$36.8	\$40.3	\$145.3	\$37.8	\$39.7	\$41.4	\$43.1	\$162.0	\$183.1
Adjusted EBITDA Margin %	16.2%	17.6%	17.5%	17.7%	18.9%	17.9%	18.1%	18.2%	18.2%	18.2%	18.2%	18.7%
Year-Over-Year Growth, % (Period)	25.1%	80.8%	43.5%	11.9%	35.2%	37.7%	16.2%	11.6%	12.4%	6.8%	11.5%	13.0%
Adjusted EPS	\$0.30	\$0.14	\$0.18	\$0.26	\$0.26	\$0.83	\$0.27	\$0.30	\$0.32	\$0.34	\$1.23	\$1.44
Year-Over-Year Growth, % (Period)	460.6%	-591.4%	182.2%	62.3%	159.0%	181.6%	102.4%	67.4%	22.4%	30.8%	47.7%	17.2%

Source: Company reports and KeyBanc Capital Markets Inc.

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.

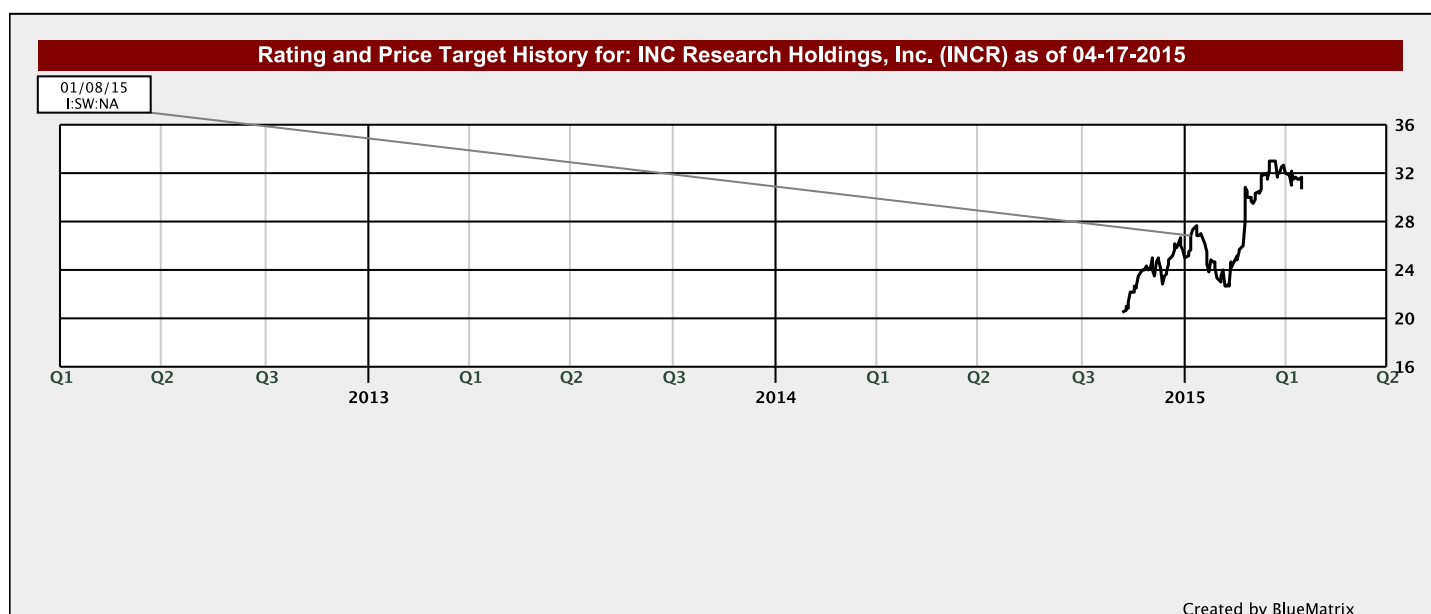
During the past 12 months, INC Research Holdings, Inc. has been a client of the firm or its affiliates for non-securities related services.

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 KeyBanc Capital Markets

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
Overweight [OW]	355	46.28	74	20.84
Sector Weight [SW]	390	50.85	78	20.00
Underweight [UW]	22	2.87	3	13.64

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

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