

INC Research, Inc (INCR)

SMALL & MID CAP RESEARCH

Strong First Public Quarter With Revenues/EPS Beat & Better '15 Guidance

■ **Bottom Line:** INCR reported 4Q14 adjusted EPS of \$0.26 paced by better than expected results across the board as revenues, margins, and bookings came in ahead of expectations. INCR grew cc revenues over 25% y/y in the fourth quarter as revenues exceeded consensus of \$207M. The company expanded adjusted operating margins 240 bps y/y to 16.5% behind both gross margin expansion & operating expense leverage. Importantly, management provided initial F15 targets, with revenues bracketing consensus (despite likely absorbing a greater-than-forecast FX headwind) and adjusted EPS of \$1.19-\$1.29 coming in ahead of FactSet consensus of \$1.20. The company's strong underlying business momentum looks poised to continue as the INCR posted a strong net book-to-bill of 1.48. With four of the five public clinical CROs having reported, we have seen generally healthy bookings across the group, underscoring the health of end markets. While shares have rebounded in recent weeks, we would note INCR has still underperformed the peers YTD, and despite faster organic growth than most, INCR commands a valuation slightly below peer averages. Consequently, we anticipate the strong first quarter & guidance out of the gate should help push shares higher.

Rating **OUTPERFORM* [V]**
Price (23 Feb 15, US\$) 25.99
Target price (US\$) 29.00¹
52-week price range 27.59 - 20.49
Market cap. (US\$ m) 1,591.47
Enterprise value (US\$ m) 1,915.54

*Stock ratings are relative to the coverage universe in each analyst's or each team's respective sector.

¹Target price is for 12 months.

[V] = Stock considered volatile (see Disclosure Appendix).

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Financial and valuation metrics

Year	12/13A	12/14E	12/15E	12/16E
EPS (CS adj.) (US\$)	0.24	0.77	1.20	1.45
Prev. EPS (US\$)	—	—	—	—
P/E (x)	107.5	33.6	21.7	17.9
P/E rel. (%)	595.8	190.2	138.9	128.6
Revenue (US\$ m)	648.4	792.8	875.3	967.2
EBITDA (US\$ m)	101.5	141.8	162.3	183.7
OCFPS (US\$)	0.71	1.76	1.82	2.32
P/OCF (x)	—	14.7	14.3	11.2
EV/EBITDA (current)	20.6	13.5	11.3	9.3
Net debt (US\$ m)	495	324	239	117
ROIC (%)	6.75	10.23	12.64	15.55
Number of shares (m)	61.23	IC (current, US\$ m)		771.15
BV/share (Next Qtr., US\$)	—	EV/IC (x)		—
Net debt (Next Qtr., US\$ m)	—	Dividend (current, US\$)		—
Net debt/tot eq (Next Qtr., %)	—	Dividend yield (%)		—

Source: Company data, Credit Suisse estimates

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- **Provides Initial F15 Guidance Ahead of Consensus:** With today's 4Q14 earnings release, INCR provided initial F15 full year guidance for revenue and EPS. The company expects net service revenue in the range of \$870M-\$900M which represents growth of approximately 7.4%-11.1% y/y. While this essentially brackets consensus of \$878.7M, we anticipate F15 targets embed a FX headwind and we will look to this morning's call for additional details. INCR is also targeting adjusted diluted EPS in the range of \$1.19-\$1.29 which compares to FactSet consensus of \$1.20. Additionally the company expects diluted GAAP EPS in the range of \$1.00-\$1.17. We look forward to this morning's call for incremental color on any embedded assumptions within the initial F15 guidance range particularly around the cadence of earnings and profitability improvements.
- **Details on the Quarter:** INCR reported 4Q14 net service revenue growth of 22.6% to \$213.7M, higher than our forecasts, characterized by an increase in new business awards over the last 18 months and a lower cancellation rate during 2014 mitigated slightly by \$4.7M due to FX. Constant-currency revenue growth was 25.3% for the year. Net new business wins of \$316.3M were particularly robust in the quarter, with INCR reporting a 1.48x book-to-bill ratio. INCR reported adjusted income from operations of \$35.3M, a reported increase of 43.7% y/y, and adjusted operating margin expanded a solid 240 bps y/y to 16.5% above Street Account consensus of 15.4%. We would note that INCR's operating margin was likely positively impacted by FX and we look to this morning's earnings call for any further color around the strong margin expansion in the quarter. Despite a negative currency impact of \$44.5M, backlog increased 6.6% to \$1.6B in the quarter. Following the company's 11/13/14 IPO and new \$525M credit agreement INCR refinanced its previous debt and redeemed its \$300M of 11.5% senior notes.

Companies Mentioned (Price as of 23-Feb-2015)

INC Research, Inc (INCR.OQ, \$25.99, OUTPERFORM[V], TP \$29.0)

Disclosure Appendix

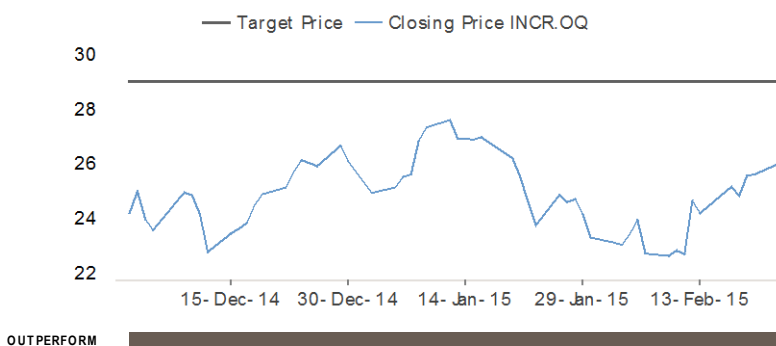
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3-Year Price and Rating History for INC Research, Inc (INCR.OQ)

INCR.OQ	Closing Price	Target Price	
Date	(US\$)	(US\$)	Rating
02-Dec-14	24.20	29.00	O *

* Asterisk signifies initiation or assumption of coverage.



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Price Target: (12 months) for INC Research, Inc (INCR.OQ)

Method: We arrived at our \$29 target price for INC Research using an equal weighting of P/E & EV/EBITDA valuation. Our price to earnings valuation yields a price target of \$29 applying a multiple of 20x our F16 EPS estimate of \$1.45. Our EV/EBITDA analysis applies a roughly 11.7x multiple to our F16 EBITDA of \$183.7M. Our target valuation multiples are roughly in-line with target multiples at industry-leading clinical peers in light of slightly smaller scale & shorter public history balanced by a healthy growth outlook at the high end of industry growth rates. In valuing the contract research organization (CRO) stocks and INC Research, we primarily utilize P/E & EV/EBITDA multiples to assess the risk/reward profile of the individual stocks and the group as a whole since multiples provide both a historical and relative perspective. We evaluate multiples relative to historic averages to ensure that the stocks are trading in-line with our assessment of how current fundamentals fit into historical context. Multiples relative to a benchmark or to other industry peers sheds light on competitive positioning and performance.

Risk: Risks to INC Research's achievement of our \$29 target price: 1) favorable biotech funding environment could moderate; 2) smaller revenue footprint and scale; 3) controlled company status & PE ownership could represent overhang; and 4) high expectations for CRO group. With the CROs trading at elevated valuations we would acknowledge that earnings disappointments could result in contraction in group valuation multiples. Similarly, strong biotech funding environment has been viewed as a tailwind and to the extent that moderates it could impact sentiment as well as pose a revenue headwind. Finally, with a smaller revenue footprint & scale INC could be exposed to greater volatility due to the cancellation of individual trials relative to peers which could in turn negatively impact sentiment.

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