

April 27, 2015

INC Research Holdings, Inc.

First Look at Strong First-Quarter Results; Gross Margin Excellent While Bookings Were in Line

- Quarterly result overview.** INC reported strong first-quarter results on Monday morning, April 27—the company’s second earnings release since its initial public offering. EPS exceeded our target by 16 cents on slightly better revenues and much better margins. EBITDA margin was 615 basis points above our target, driven mainly by gross margins that were 569 basis points better than our target. We note that the adjusted EPS total of \$0.42 reported by the company excludes stock compensation expenses, and thus enhances quarter performance by roughly 1 cent. Relative to our model, better revenue (less than 1 cent) and gross margin (12 cents) drove the outperformance. While foreign exchange rates had a negative impact on net service revenues (roughly \$9.1 million), INC also realizes a margin benefit as a higher percentage of costs are denominated in local currencies as compared with revenue. Management noted that the bottom-line impact of currency fluctuations was not significant (we would assume a small positive). Net revenue increased 19.4% on a constant-currency basis, compared with our 18% estimate.
- Bookings were \$4.6 million better.** Net new business was \$255.5 million, producing a book-to-bill ratio of 1.21 times. We had modeled \$250.8 million in bookings and a book-to-bill ratio of 1.20 times. According to the release, growth continues to be strong within CNS, oncology, and other complex therapeutic areas. This level of bookings should support management’s expectation for low-double-digit revenue growth in 2015.
- Updated 2015 guidance.** Given strong quarterly results, management updated calendar 2015 guidance, calling for revenues of \$880 million to \$905 million, which implies an increase of 8.7% to 11.8% despite several points of currency-related headwind. Management’s guidance is roughly \$6.4 million and \$5 million above our estimate and consensus at the midpoint, respectively, and is \$5 million-\$10 million above prior guidance despite the headwind from a stronger dollar. Management also adjusted its 2015 EPS target to a range of \$1.40 to \$1.52 (up 69% to 83%). At the midpoint, guidance was increased an impressive 22 cents.
- Valuation and stock thoughts.** As of Friday’s close, INC trades at 25.0 times our current 2015 EPS estimate of \$1.20 (up 34.5%), which includes stock-based comp. Currently, the clinical CRO peer group trades at 21.3 times (Icon [ICLR \$69.85; Outperform] at 19.8 times, Quintiles [Q \$69.09; Outperform] at 22.5 times, PRA Health Sciences [PRAH \$27.75; Outperform] at 20.4 times, and Parexel [PRXL \$67.49; Outperform] at 22.4 times). While revenues continue to be hampered by currency headwinds, we maintain our Outperform rating on INC given the company’s industry-leading organic growth profile and impressive margin improvement of late. We will update our model following Monday’s earnings call, and expect to increase our overall 2015 EPS estimate by 20 to 22 cents. Exhibits 1 and 3, on the following pages, break down the first quarter versus our expectations.

INC Research is one of the top 10 largest CROs, with an annual revenue base exceeding \$800 million. Founded in 1985 as a niche CRO focused on central nervous system disorders, INC now employs 5,400 associates across 50 countries, and its focus has broadened to include oncology and other complex diseases.

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William Blair

John Kreger +1 312 364 8597
jkreger@williamblair.com

Roberto Fatta +1 312 364 8797
rfatta@williamblair.com

Matt Bacso, CFA +1 312 364 8996
mbacso@williamblair.com

Stock Rating: **Outperform**
Company Profile: **Aggressive Growth**

Symbol: INCR (NASDAQ)
Price: \$30.12 (52-Wk.: \$20-\$35)
Market Value (mil.): \$1,859
Fiscal Year End: December
Long-Term EPS Growth Rate: 20%
Dividend/Yield: None

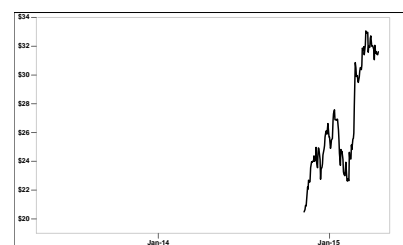
	2014A	2015E	2016E
Estimates			
EPS Q1	\$0.12	\$0.26	NA
Q2	\$0.27	\$0.30	NA
Q3	\$0.28	\$0.32	NA
Q4	\$0.26	\$0.36	NA
FY	\$0.93	\$1.24	\$1.49
CY		\$1.24	\$1.49

Valuation			
FY P/E	32.4x	24.3x	20.2x
CY P/E		24.3x	20.2x

Trading Data (FactSet)	
Shares Outstanding (mil.)	58
Float (mil.)	25
Average Daily Volume	131,937

Financial Data (FactSet)	
Long-Term Debt/Total Capital (MRQ)	0.0
Book Value Per Share (MRQ)	6.4
Return on Equity (TTM)	-8.1

Two-Year Price Performance Chart



Sources: FactSet, William Blair & Company estimates

Exhibit 1. First-Quarter EPS Performance Relative to William Blair Estimates

Revenues	\$ 0.004
Gross Profit	\$ 0.121
Selling & Marketing	\$ 0.012
Depreciation	\$ 0.027
Interest	\$ (0.003)
Taxes	\$ -
Share Count	\$ 0.003
Total	\$ 0.164

Sources: Company reports and William Blair & Company, L.L.C. estimates

Exhibit 2. Current 2015 Guidance Relative to William Blair Estimates and Consensus

	2015 Guidance	2015 Guidance	2015 Estimates	
	Updated	Prior to Call	WB - Prior to Call	Consensus - Prior to Call
Revenue (\$M)	\$880 to 905	\$870 to 900	\$886	\$888
Growth	8.7% to 11.8%	7.4% to 11.1%	8.5%	10.0%
Adjusted EPS (excl. SBC)	\$1.40 to \$1.52	\$1.19 to \$1.29	\$1.24	\$1.25
Growth (decline)	69% to 83%	42% to 55%	21.1%	38.9%
Adjusted EPS (incl. SBC)	\$1.35 to \$1.47	\$1.14 to \$1.24	\$1.20	NA
Growth (decline)	71% to 86%	44% to 57%	21.4%	

Sources: Company reports, FactSet, and William Blair & Company, L.L.C. estimates

Exhibit 3. First Quarter 2015 EPS Variance Analysis

April 27, 2015	1Q 2015 (Actual)	1Q 2014 (Actual)	Year/Year % Change	1Q 2015 (Estimate)	Year/Year % Change	Act.-Est. Difference
Total Net Revenue	211,514	184,700	14.5%	209,004	13.2%	2,510
Direct Costs	125,448	120,764	3.9%	135,853	12.5%	(10,405)
Selling, general, and administrative (incl options)	35,579	31,890	11.6%	36,367	14.0%	(788)
Stock-based comp expense	(707)	(531)	33.1%	(950)	78.9%	243
Total operating expenses	160,320	152,123	5.4%	171,270	12.6%	(10,950)
EBITDA (excluding SBC)	51,194	32,577	57.1%	37,735	15.8%	13,459
Depreciation	4,766	6,869	-30.6%	7,315	6.5%	(2,549)
Operating income (excluding SBC)	46,428	25,708	80.6%	30,420	18.3%	16,008
Interest and other income (expense)	(5,305)	(15,901)	-66.6%	(5,022)	-68.4%	(283)
Earnings before tax	41,123	9,807	319.3%	25,398	159.0%	15,725
Income taxes (expense) benefit	(14,805)	(3,628)	308.1%	(9,143)	152.0%	(5,662)
Adjusted net income (excluding SBC)	26,318	6,179	326%	16,255	163.1%	10,063
Shares outstanding	63,103	51,947	21.5%	63,600	22.4%	(497)
EPS (excluding SBC)	\$0.42	\$0.12	251%	\$0.26	114.9%	0.16
EPS (including SBC)	\$0.41	\$0.11	264%	\$0.25	118.7%	0.16
% of Net Revenue:	Change			Difference		
Gross profit	40.69	34.62	6.07	35.00	0.38	5.69
Selling, general and administrative	16.82	17.27	(0.44)	17.40	0.13	(0.58)
Stock-based comp expense	0.33	0.29	0.05	0.45	0.17	(0.12)
EBITDA	24.20	17.64	6.57	18.05	0.42	6.15
Depreciation	2.25	3.72	(1.47)	3.50	(0.22)	(1.25)
EBITA	21.95	13.92	8.03	14.55	0.64	7.40
Tax rate	36.00	36.99	(0.99)	36.00	(0.99)	0.00
Net Income	12.44	3.35	9.10	7.78	4.43	4.67
Bookings						
Net new business	255,500	280,900	(25,400)	250,805	(30,095)	4,695
Net Book-to-Bill	1.21	1.52		1.20		

Sources: Company reports, FactSet, and William Blair & Company, L.L.C. estimates

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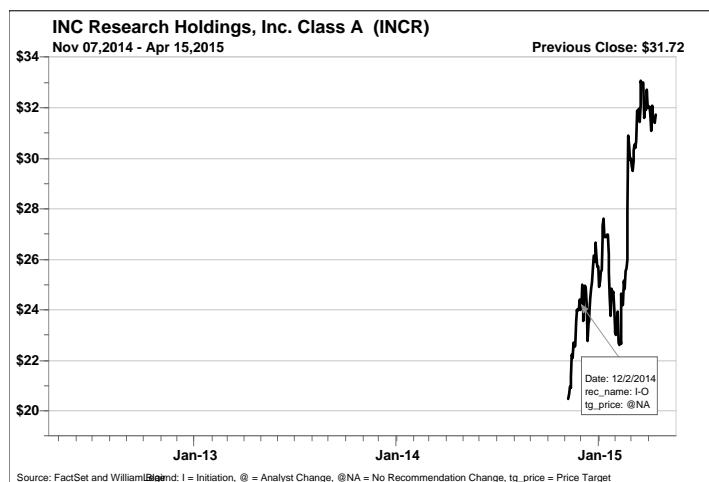
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DOW JONES: 18,080.14

S&P 500: 2,117.69

NASDAQ: 5,092.09



Current Rating Distribution (as of 03/31/15)

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	65	Outperform (Buy)	16
Market Perform (Hold)	33	Market Perform (Hold)	3
Underperform (Sell)	2	Underperform (Sell)	0

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