

May 27, 2015

INC Research Holdings, Inc.

Model Fine-Tuning Following Recent Secondary, Buyback, and Debt Refinancing

Conclusion

- Earlier this month, INC Research completed a debt refinancing, a secondary equity offering, and a \$150 million share buyback. Management also issued updated guidance to reflect the company's updated capital structure. While none of these events has a major impact on our model, we are updating our estimates in this note to reflect all three items. We now model 2015 adjusted EPS of \$1.52 (up 63%), up \$0.02 from \$1.50 previously. For 2016, we now estimate EPS of \$1.78 (up 17%), up \$0.03 from \$1.75 previously. We maintain our Outperform rating on INC Research given strong bookings and a more attractive valuation of late, and we continue to view INC Research as having the fastest growth trajectory in pharma outsourcing.

Details

- Debt refinance impact.** In mid-May, the company completed a refinancing of its debt, which increased outstanding debt by roughly \$100 million and increased the available revolver by an additional \$50 million. The debt increase was used to fund the share buyback also executed this month and will result in incremental interest expense of \$2 million this year. Following the refinance and modest increase to overall outstanding debt, the company's net debt leverage ratio is now roughly 2.24 times trailing adjusted EBITDA, up from 1.63 times as of March 31.
- Buyback impact.** As part of the 8.05 million share secondary offering completed on May 14, INC also repurchased 5.05 million shares of stock from its private equity sponsors at a price of \$29.68 per share, or \$150 million in aggregate. The buyback is being funded by the increased debt line noted above, and thus prompts the \$2 million reduction in 2015 net income guidance noted below. The repurchase reduces total shares by 8% and cuts the private equity sponsor ownership to 67%, down from 83% before the offering and buyback.
- Model changes.** While we had already adjusted for the increased debt, we are refining our estimates for share count following the final details of the offering. Thus, following these announcements, we have made the following changes to our model:
 - In 2015 we model revenue of \$892.2 million, unchanged from our previous model and representing 10.2% growth (15.2% on an organic constant-dollar basis).
 - We model EBITDA of \$177.4 million (unchanged), net interest expense of \$16.7 million (unchanged), net income of \$91.2 million (unchanged), an average annual share count of 60.0 million (down from 61.0 million), and EPS of \$1.52 (up 62.8%) up from \$1.50 previously. Our updated model can be found in exhibit 2.

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

Symbol: INCR (NASDAQ)
Price: \$33.03 (52-Wk.: \$20-\$39)
Market Value (mil.): \$1,858
Fiscal Year End: December
Long-Term EPS Growth Rate: 20%
Dividend/Yield: None

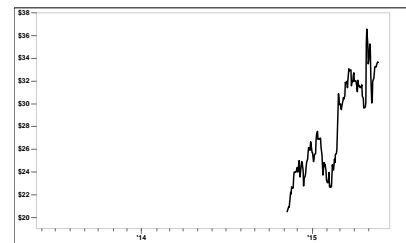
	2014A	2015E	2016E
Estimates			
EPS Q1	\$0.12	A\$0.42	NA
Q2	\$0.27	\$0.34	NA
Q3	\$0.28	\$0.37	NA
Q4	\$0.26	\$0.39	NA
FY	\$0.93	\$1.52	\$1.78
CY		\$1.52	\$1.78

Valuation			
FY P/E	35.5x	21.7x	18.6x
CY P/E		21.7x	18.6x

Trading Data (FactSet)			
Shares Outstanding (mil.)			61
Float (mil.)			31
Average Daily Volume			208,486

Financial Data (FactSet)			
Book Value Per Share (MRQ)			6.7
Return on Equity (TTM)			-8.1

Two-Year Price Performance Chart



Sources: FactSet, William Blair & Company estimates

Exhibit 1. Guidance Revision

	2015 Guidance Revised	2015 Guidance Previous	2015 Estimates	
			WB	Consensus
Revenue (\$M)	\$880 to 905	\$880 to 905	\$892.2	\$893
Growth	8.7% to 11.8%	8.7% to 11.8%	10.2%	10.3%
Adjusted Net Income	\$87.5 to \$95.0	\$89.5 to \$97.0	\$91.2	NA
Growth	73.9% to 88.8%	77.9% to 92.8%	81.3%	
Adjusted EPS (excl. SBC)	\$1.45 to \$1.57	\$1.40 to \$1.52	\$1.52	\$1.53
Growth (decline)	55.2% to 68.1%	49.9% to 62.7%	62.8%	63.8%

Sources: Company reports, FactSet, and William Blair estimates

- Valuation.** INC Research trades at 19.0 times our revised 2016 EPS estimate of \$1.78 (19.5 times if fully burdened by stock-based compensation expense), compared with its clinical peer group of 18.0 times. We believe the expertise and focus in high-growth areas of the market, diverse client base, and 20% bottom-line growth trend suggest that the company can support a valuation slightly ahead of the group. We maintain our Outperform rating on INC.

See exhibit 2, on the following page.

Exhibit 2: Updated INC Research Income Statement Summary (2011-2018E)

	2011	2012	2013	2014	Q1'15	Q2'15E	Q3'15E	Q4'15E	2015E	2016E	2017E	2018E
Service revenue	\$ 437,005	\$ 579,145	\$ 652,418	\$ 809,728	211,514	218,147	225,804	236,690	\$ 892,156	\$ 1,004,454	\$ 1,104,899	\$ 1,209,865
Direct Costs	279,840	389,057	432,262	515,059	125,448	138,524	142,821	149,115	555,907	633,144	693,899	757,512
SG&A	92,891	106,970	117,055	143,763	35,579	39,048	40,871	43,314	158,812	172,264	187,833	202,047
Stock-based comp expense	(1,176)	(1,248)	(2,419)	(3,370)	(707)	(707)	(707)	(707)	(2,828)	(4,210)	(6,600)	(7,600)
Adjusted EBITDA	65,450	84,366	105,520	154,276	51,194	41,282	42,819	44,968	180,264	203,256	229,767	257,905
Adjusted EBITDA (including SBC)	\$ 64,274	\$ 83,118	\$ 103,101	\$ 150,906	\$ 50,487	\$ 40,575	\$ 42,112	\$ 44,261	\$ 177,436	\$ 199,046	\$ 223,167	\$ 250,305
Depreciation	15,700	19,915	19,175	21,619	4,766	5,236	5,419	5,681	21,101	24,727	27,157	29,037
EBITA	49,750	64,451	86,345	132,657	46,428	36,047	37,400	39,287	159,163	178,529	202,610	228,869
Interest expense	(65,482)	(62,007)	(60,489)	(52,787)	(5,305)	(3,799)	(3,783)	(3,767)	(16,654)	(12,957)	(8,491)	(2,831)
Pre-tax income	(15,732)	2,444	25,856	79,870	41,123	32,248	33,617	35,520	142,509	165,572	194,119	226,037
Income tax (expense) benefit	2,157	(1,653)	(9,567)	(29,553)	(14,805)	(11,609)	(12,102)	(12,787)	(51,304)	(58,778)	(66,001)	(72,332)
Adjusted Net Income (excluding SBC)	(13,575)	791	16,289	50,317	26,318	20,639	21,515	22,733	91,205	106,794	128,119	153,705
As reported net income	\$ (59,547)	\$ (59,114)	\$ (41,530)	\$ (23,470)	\$ 25,843	\$ 20,701	\$ 21,255	\$ 22,016	\$ 89,815	\$ 94,607	\$ 107,822	\$ 127,194
Adjusted EPS (excluding SBC)	\$ (0.31)	\$ 0.02	\$ 0.31	\$ 0.93	\$ 0.42	\$ 0.34	\$ 0.37	\$ 0.39	\$ 1.52	\$ 1.78	\$ 2.13	\$ 2.54
As reported EPS	\$ (1.36)	\$ (1.13)	\$ (0.80)	\$ (0.44)	\$ 0.41	\$ 0.34	\$ 0.37	\$ 0.38	\$ 1.50	\$ 1.57	\$ 1.79	\$ 2.11
<i>Diluted Class A common shares outstanding (in thousands)</i>	<i>43,874</i>	<i>52,228</i>	<i>52,033</i>	<i>53,859</i>	<i>63,103</i>	<i>60,614</i>	<i>58,028</i>	<i>58,128</i>	<i>59,968</i>	<i>60,118</i>	<i>60,268</i>	<i>60,419</i>

Margin Analysis

Gross margin	36.0%	32.8%	33.7%	36.4%	40.7%	36.5%	36.8%	37.0%	37.7%	37.0%	37.2%	37.4%
SG&A	21.3%	18.5%	17.9%	17.8%	16.8%	17.9%	18.1%	18.3%	17.8%	17.2%	17.0%	16.7%
Adjusted EBITDA (excluding sbc)	15.0%	14.6%	16.2%	19.1%	24.2%	18.9%	19.0%	19.0%	20.2%	20.2%	20.8%	21.3%
Adjusted EBITDA (including sbc)	14.7%	14.4%	15.8%	18.6%	23.9%	18.6%	18.7%	18.7%	19.9%	19.8%	20.2%	20.7%
Depreciation	3.6%	3.4%	2.9%	2.7%	2.3%	2.4%	2.4%	2.4%	2.4%	2.5%	2.5%	2.4%
EBITA	11.4%	11.1%	13.2%	16.4%	22.0%	16.5%	16.6%	16.6%	17.8%	17.8%	18.3%	18.9%
Tax rate	13.7%	67.6%	37.0%	37.0%	36.0%	36.0%	36.0%	36.0%	36.0%	35.5%	34.0%	32.0%
Net Income	-3.1%	0.1%	2.5%	6.2%	12.4%	9.5%	9.5%	9.6%	10.2%	10.6%	11.6%	12.7%

Growth metrics

Total Revenue		32.5%	12.7%	24.1%	14.5%	7.2%	8.7%	10.7%	10.2%	12.6%	10.0%	9.5%
<i>Constant currency growth</i>		<i>34.7%</i>	<i>12.3%</i>	<i>24.2%</i>	<i>19.4%</i>	<i>13.3%</i>	<i>14.0%</i>	<i>14.0%</i>	<i>15.2%</i>			
Cost of goods sold		39.0%	11.1%	19.2%	3.9%	5.9%	10.2%	11.3%	7.9%	13.9%	9.6%	9.2%
Gross profit		20.9%	15.8%	33.8%	34.6%	9.4%	6.1%	9.8%	14.1%	10.4%	10.7%	10.1%
SG&A		15.2%	9.4%	22.8%	11.6%	16.2%	8.2%	7.0%	10.5%	8.5%	9.0%	7.6%
Adjusted EBITDA		28.9%	25.1%	46.2%	57.1%	3.1%	3.6%	11.5%	16.8%	12.8%	13.0%	12.2%
Depreciation		26.8%	-3.7%	12.7%	-30.6%	4.2%	14.5%	13.8%	-2.4%	17.2%	9.8%	6.9%
EBITA		29.5%	34.0%	53.6%	80.6%	3.0%	2.2%	11.1%	20.0%	12.2%	13.5%	13.0%
Net Income		-105.8%	1959.3%	208.9%	325.9%	47.7%	44.2%	49.2%	81.3%	17.1%	20.0%	20.0%
EPS		-104.9%	1967.0%	198.4%	325.9%	47.7%	44.2%	49.2%	62.8%	16.8%	19.7%	19.7%
Weighted average shares		19.0%	-0.4%	3.5%	21.5%	16.2%	10.5%	-1.1%	11.3%	0.2%	0.2%	0.2%

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DOW JONES: 18,041.54

S&P 500: 2,104.20

NASDAQ: 5,032.75



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Market Perform (Hold)	32	Market Perform (Hold)	2
Underperform (Sell)	2	Underperform (Sell)	0

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