

July 30, 2015

INC Research Holdings, Inc.

Significant Estimate Increases After Excellent Quarter

- Conclusion.** We are updating our model to reflect a very strong quarterly report from INC Research. The company reported second-quarter results on Thursday morning that exceeded our expectations in terms of revenues and gross margins. The company also delivered impressive guidance on the back of strong new business wins. We believe the company's therapeutic expertise in fast-growing categories like oncology and CNS, coupled with a healthy mix of both large and small clients, position the company well to be one of the fastest growers within pharmaceutical outsourcing. With an estimated 2015 backlog coverage ratio of 96% and a trailing-12-month book-to-bill ratio of 1.3, we believe midteens constant-currency revenue growth is reasonable over the next year.
- INC also reported a sequential increase in backlog burn rate from 13% to 14% in the second quarter, despite a recent pickup in oncology as a percentage of backlog. This is reassuring given many of INC's peers have experienced slowing backlog conversion of late as the mix of business tilts toward smaller clients and more-complex oncology trials. In light a 13 cent EPS beat in the quarter and a 23-24 cent bump in full-year guidance, we are increasing our full year 2015 EPS (excluding stock based comp) estimate by 23 cents, to \$1.75 (up 87%). We are also increasing our 2016 EPS (excluding stock based comp) estimate by 29 cents, to \$2.07 (19%). We reiterate our Outperform rating despite the stock's premium valuation given the impressive earnings momentum and a favorable demand environment.
- Model Changes.** We now assume 2015 revenue for INC of \$906.5 million, up 12% from 2014 as reported and 17% constant currency, and up \$14.3 million from our previous model. We now model adjusted EBITDA margin of 22.1%, up from 20.2% previously, and earnings per share of \$1.75, excluding stock compensation expense (compared to \$1.52 previously). While we model revenue growth to be negatively impacted by 485 basis points in 2015 due to the strong dollar, we note that INC's global cost structure offsets the top-line headwind and results in a neutral impact to the operating line.
- We now assume 2016 revenue for INC of \$1.021 billion, up 12.6% from 2015 estimates, and \$16.5 million above our previous model. We estimate adjusted EBITDA margin of 22.0%, up from 20.2% previously, and earnings per share of \$2.07, excluding stock compensation expense, compared to \$1.78 previously.
- Valuation and stock thoughts.** INC now trades at 23.7 times our revised 2016 EPS estimate of \$2.01 (including stock based compensation expense). The clinical CRO peer group trades at 20.0 times (ICON [ICLR \$80.86; Outperform] at 17.4 times, Quintiles (Q \$78.75; Outperform) at 22.0 times, PRA Health Sciences (PRAH \$42.12; Outperform) at 21.1 times, and Parexel (PRXL \$68.68; Outperform) at 19.7 times), suggesting the stock is not likely to see much more in the way of multiple expansion. We maintain our Outperform rating on INC despite the premium valuation given the company's very encouraging execution and earnings momentum at present. Our updated model can be found below in exhibit 1.

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: \$47.62 (52-Wk.: \$20-\$48)
Market Value (mil.): \$2,679
Fiscal Year End: December
Long-Term EPS Growth Rate: 20%
Dividend/Yield: None

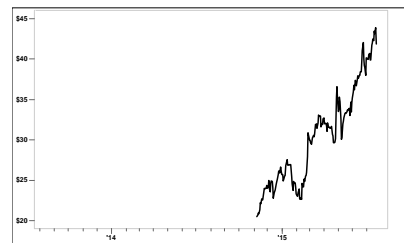
	2014A	2015E	2016E
Estimates			
EPS Q1	\$0.12	A\$0.42	NA
Q2	\$0.27	A\$0.47	NA
Q3	\$0.28	\$0.43	NA
Q4	\$0.26	\$0.42	NA
FY	\$0.93	\$1.75	\$2.07
CY		\$1.75	\$2.07

Valuation			
FY P/E	51.2x	27.2x	23.0x
CY P/E		27.2x	23.0x

Trading Data (FactSet)			
Shares Outstanding (mil.)			61
Float (mil.)			5
Average Daily Volume			311,723

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. INC Research Model Summary (2011 – 2017(E))

	2011	2012	2013	2014	Q1'15	Q2'15	Q3'15E	Q4'15E	2015E	2016E	2017E
Service revenue	\$ 437,005	\$ 579,145	\$ 652,418	\$ 809,728	211,514	227,376	231,953	235,637	\$ 906,480	\$ 1,020,983	\$ 1,123,082
Direct Costs	279,840	389,057	432,262	515,059	125,448	138,010	143,811	146,566	553,835	622,800	683,957
SG&A	92,891	106,970	117,055	143,763	35,579	37,014	42,215	43,593	158,401	173,567	184,185
Stock-based comp expense	(1,176)	(1,248)	(2,419)	(3,370)	(707)	(913)	(1,826)	(2,556)	(6,002)	(6,460)	(6,600)
Adjusted EBITDA	65,450	84,366	105,520	154,276	51,194	53,265	47,753	48,034	200,246	231,076	261,540
Adjusted EBITDA (including SBC)	\$ 64,274	\$ 83,118	\$ 103,101	\$ 150,906	\$ 50,487	\$ 52,352	\$ 45,927	\$ 45,478	\$ 194,244	\$ 224,616	\$ 254,940
Depreciation	15,700	19,915	19,175	21,619	4,766	4,420	4,871	4,948	19,005	23,483	24,708
EBITA	49,750	64,451	86,345	132,657	46,428	48,845	42,882	43,086	181,241	207,594	236,832
Interest expense	(65,482)	(62,007)	(60,489)	(52,787)	(5,305)	(4,188)	(3,788)	(3,772)	(17,053)	(12,701)	(7,435)
Pre-tax income	(15,732)	2,444	25,856	79,870	41,123	44,657	39,094	39,313	164,187	194,893	229,396
Income tax (expense) benefit	2,157	(1,653)	(9,567)	(29,553)	(14,805)	(16,077)	(14,074)	(14,153)	(59,109)	(69,187)	(80,289)
Adjusted Net Income (excluding SBC)	(13,575)	791	16,289	50,317	26,318	28,580	25,020	25,161	105,079	125,706	149,108
Net tax adjustments	(45,972)	(59,905)	(57,819)	(73,787)	(475)	(5,259)	(4,290)	(2,155)	(12,179)	(12,881)	(21,025)
As reported net income	\$ (59,547)	\$ (59,114)	\$ (41,530)	\$ (23,470)	\$ 25,391	\$ 23,321	\$ 20,730	\$ 23,006	\$ 92,447	\$ 112,824	\$ 128,082
Adjusted EPS (excluding SBC)	\$ (0.31)	\$ 0.02	\$ 0.31	\$ 0.93	\$ 0.42	\$ 0.47	\$ 0.43	\$ 0.42	\$ 1.75	\$ 2.07	\$ 2.45
Adjusted Net Income (including SBC)	\$ (14,590)	\$ (3,973)	\$ 14,765	\$ 48,194	\$ 25,866	\$ 27,996	\$ 23,851	\$ 23,525	\$ 101,237	\$ 121,539	\$ 144,818
Adjusted EPS (including SBC)	\$ (0.33)	\$ (0.08)	\$ 0.28	\$ 0.89	\$ 0.41	\$ 0.46	\$ 0.41	\$ 0.40	\$ 1.68	\$ 2.01	\$ 2.38
As reported EPS	\$ (1.36)	\$ (1.13)	\$ (0.80)	\$ (0.44)	\$ 0.40	\$ 0.39	\$ 0.36	\$ 0.39	\$ 1.54	\$ 1.86	\$ 2.10
<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>60,464</i>	<i>57,878</i>	<i>59,376</i>	<i>60,205</i>	<i>60,627</i>	<i>60,930</i>

Margin Analysis

Gross margin	36.0%	32.8%	33.7%	36.4%	40.7%	39.3%	38.0%	37.8%	38.9%	39.0%	39.1%
SG&A	21.3%	18.5%	17.9%	17.8%	16.8%	16.3%	18.2%	18.5%	17.5%	17.0%	16.4%
Adjusted EBITDA (excluding sbc)	15.0%	14.6%	16.2%	19.1%	24.2%	23.4%	20.6%	20.4%	22.1%	22.6%	23.3%
Adjusted EBITDA (including sbc)	14.7%	14.4%	15.8%	18.6%	23.9%	23.0%	19.8%	19.3%	21.4%	22.0%	22.7%
Depreciation	3.6%	3.4%	2.9%	2.7%	2.3%	1.9%	2.1%	2.1%	2.1%	2.3%	2.2%
EBITA	11.4%	11.1%	13.2%	16.4%	22.0%	21.5%	18.5%	18.3%	20.0%	20.3%	21.1%
Tax rate	13.7%	67.6%	37.0%	37.0%	36.0%	36.0%	36.0%	36.0%	36.0%	35.5%	35.0%
Net Income	-3.1%	0.1%	2.5%	6.2%	12.4%	12.6%	10.8%	10.7%	11.6%	12.3%	13.3%

Growth metrics

Total Revenue		32.5%	12.7%	24.1%	14.5%	11.7%	11.6%	10.3%	11.9%	12.6%	10.0%
Constant currency growth		34.7%	12.3%	24.2%	19.4%	17.3%	17.0%	13.5%	16.8%	12.4%	
Cost of goods sold	39.0%	11.1%	19.2%	3.9%	5.5%	11.0%	9.4%	7.5%	12.5%	9.8%	
Gross profit	20.9%	15.8%	33.8%	34.6%	22.8%	12.7%	11.7%	19.7%	12.9%	10.3%	
SG&A	15.2%	9.4%	22.8%	11.6%	10.1%	11.8%	7.7%	10.2%	9.6%	6.1%	
Adjusted EBITDA	28.9%	25.1%	46.2%	57.1%	33.0%	15.6%	19.1%	29.8%	15.4%	13.2%	
Depreciation	26.8%	-3.7%	12.7%	-30.6%	-12.0%	2.9%	-0.9%	-12.1%	23.6%	5.2%	
EBITA	29.5%	34.0%	53.6%	80.6%	39.5%	17.2%	21.9%	36.6%	14.5%	14.1%	
Net Income	-105.8%	1959.3%	208.9%	325.9%	104.5%	67.7%	65.1%	108.8%	19.6%	18.6%	
EPS	-104.9%	1967.0%	198.4%	325.9%	104.5%	67.7%	65.1%	86.8%	19%	18%	
Weighted average shares	19.0%	-0.4%	3.5%	21.5%	15.9%	10.2%	1.0%	11.8%	0.7%	0.5%	

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DOW JONES: 17,745.98

S&P 500: 2,108.63

NASDAQ: 5,128.79



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Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	66	Outperform (Buy)	15
Market Perform (Hold)	32	Market Perform (Hold)	2
Underperform (Sell)	2	Underperform (Sell)	0

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