

INC Research, Inc (INCR)

SMALL & MID CAP RESEARCH

Strong 3Q Beat & Raise Match Industry Leading Valuation



Rating	OUTPERFORM* [V]
Price (29 Oct 15, US\$)	39.98
Target price (US\$)	54.00 ¹
52-week price range	50.15 - 20.49
Market cap. (US\$ m)	2,249.00
Enterprise value (US\$ m)	2,580.30

*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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■ **Bottom Line:** INCR reported 3Q15 adjusted EPS of \$0.58 vs. consensus of \$0.44 paced by better than expected results across the board as revenues, margins, and bookings came in ahead of expectations. INCR grew cc revenues 20% y/y to \$234.5M, exceeding consensus estimates of \$230.6M. The company expanded adjusted operating margins 810 bps y/y to 23.9% behind both gross margin expansion & operating expense leverage. Management continues to build an impressive beat & raise track record, increasing both revenue & EPS guidance with this morning's results. Management now targets revenue of \$910-\$914M vs. consensus of \$907.6M and EPS of \$1.91-\$1.97 vs. consensus of \$1.77. The company's strong underlying business momentum looks poised to continue as INCR posted a strong net book-to-bill of 1.4. While shares are up over 55% YTD and command the highest EV/EBITDA valuation in the group, we would highlight that the company's conservative track record around guidance suggests that forward consensus expectations are likely to prove conservative. Consequently, despite the high expectations, we believe this morning's results should sustain the momentum in the shares and expect continued strong performance in the stock. We will look to this morning's call to assess the sustainability or any one-time factors that might have impacted profitability or the quarter, as well as any update around key customer relationships.

Financial and valuation metrics

Year	12/14A	12/15E	12/16E	12/17E
EPS (CS adj.) (US\$)	0.83	1.76	2.08	2.43
Prev. EPS (US\$)	—	—	—	—
P/E (x)	48.1	22.7	19.2	16.4
P/E rel. (%)	279.8	132.9	122.3	117.8
Revenue (US\$ m)	800.7	907.9	1,007.8	1,113.6
EBITDA (US\$ m)	145.3	202.3	226.2	257.8
OCFPS (US\$)	1.89	2.33	3.02	3.37
P/OCF (x)	13.6	17.1	13.2	11.9
EV/EBITDA (current)	17.5	12.8	10.8	8.8
Net debt (US\$ m)	293	331	186	16
ROIC (%)	11.20	17.66	20.85	25.06
Number of shares (m)	56.25	IC (current, US\$ m)		685.28
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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Other Considerations

- **INCR Raised F15 Guidance:** Following the 3Q revenue and earnings beat, INCR raised F15 guidance. The company now expects net service revenue in the range of \$910M-\$914M (inclusive of FX headwinds) vs. prior guidance of \$900-\$910M. The updated guidance range compares with FactSet consensus of \$907.6M and represents approximately 13.7%-14.2% y/y growth. Following a beat of \$0.14 in the quarter, the company raised its adjusted EPS guidance by ~\$0.20 which includes one-time tax-benefit of ~\$0.08, realized over the previous three quarters. INCR now targets F15 adjusted EPS of \$1.91-\$1.97, up from the previous range of \$1.69-\$1.80 and ahead of the FactSet consensus of \$1.77. Additionally, company now expects GAAP EPS of \$1.84-\$1.93 vs. previous guidance of \$1.44-\$1.60. The press release highlighted that company continues to target long term net service revenue growth of 10%-12%, adjusted EBITDA growth of 13%-15%, and ~20% EPS growth. We will look to this morning's conference call for incremental color on any embedded assumptions within the F15 guidance range, exchange rate, and any initial commentary on F16.
- **Details on the Quarter:** INCR reported 3Q15 adjusted EPS of \$0.58 well above FactSet consensus of \$0.44, characterized by higher than expected revenues and margins. INCR delivered 3Q15 net service revenue growth of 15.4% to \$234.5M, higher than our forecasts, with industry leading cc revenue growth of nearly 20% driven by revenue growth across all therapeutic areas. Net new business awards of \$327.7M were strong in the quarter, with INCR reporting a 1.4x book-to-bill ratio. INCR reported adjusted income from operations of \$56.0M, a reported increase of 74.4% y/y, and adjusted operating margin expanded an impressive 810 bps y/y to 23.9%, well above expectations and previous management commentary. We will look to this morning's earnings call for any further color around the strong margin expansion in the quarter and the trajectory from here. Backlog increased 17.3% to \$1.8B in the quarter.

Companies Mentioned (Price as of 29-Oct-2015)

INC Research, Inc (INCR.OQ, \$39.98, OUTPERFORM[V], TP \$54.0)

Disclosure Appendix

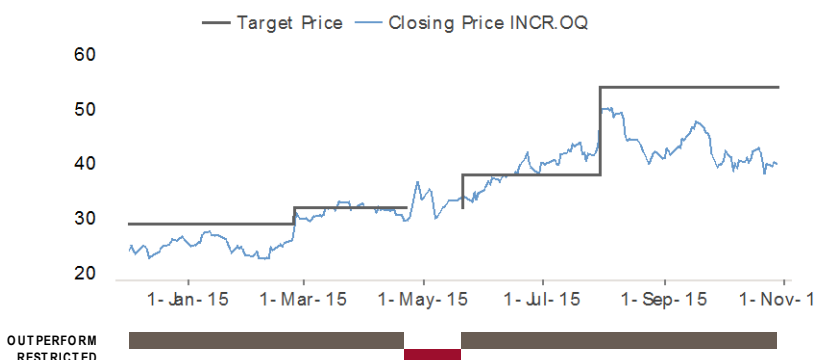
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3-Year Price and Rating History for INC Research, Inc (INCR.OQ)

INCR.OQ	Closing Price	Target Price	
Date	(US\$)	(US\$)	Rating
02-Dec-14	24.20	29.00	O *
24-Feb-15	27.93	32.00	
22-Apr-15	29.64		R
21-May-15	33.65	38.00	O
30-Jul-15	47.62	54.00	
13-Aug-15	44.25	54.00	*

* Asterisk signifies initiation or assumption of coverage.



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Underperform/Sell*	13%	(23% banking clients)
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Price Target: (12 months) for INC Research, Inc (INCR.OQ)

Method: We arrived at our \$54 target price for INC Research using P/E valuation. Our price to earnings valuation yields a price target of \$38 applying a multiple of 26x our F16 EPS estimate of \$2.08. Our target valuation multiples are slightly above target multiples at clinical peers in light of the company's above-market growth profile. In valuing the contract research organization (CRO) stocks and INC Research, we primarily utilize P/E 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 \$54 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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