

INC Research, Inc (INCR)

SMALL & MID CAP RESEARCH

Another Impressive Beat & Raise Should Sustain Momentum

■ **Bottom Line – Strong Results Matching Industry-Leading Valuation:** INCR reported 2Q15 adjusted EPS of \$0.47 vs. consensus of \$0.34 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 as revenues exceeded consensus of \$219M. The company expanded adjusted operating margins 620 bps y/y to 21.5% behind both gross margin expansion & operating expense leverage. Management is quickly building an impressive beat & raise track record, increasing both revenue & EPS guidance. Management now targets revenue of \$900-\$910M vs. consensus of \$895M and EPS of \$1.69-\$1.80 vs. consensus of \$1.53. The company's strong underlying business momentum looks poised to continue as the INCR posted a strong net book-to-bill of 1.3. While shares are up over 68% 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.

Rating **OUTPERFORM***
Price (30 Jul 15, US\$) 43.16
Target price (US\$) 38.00¹
52-week price range 43.87 - 20.49
Market cap. (US\$ m) 2,643.71
Enterprise value (US\$ m) 2,992.05

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

¹Target price is for 12 months.

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Financial and valuation metrics

Year	12/14A	12/15E	12/16E	12/17E
EPS (CS adj.) (US\$)	0.83	1.51	1.75	2.07
Prev. EPS (US\$)	—	—	—	—
P/E (x)	51.9	28.5	24.6	20.9
P/E rel. (%)	283.0	157.2	151.6	144.9
Revenue (US\$ m)	800.7	890.2	982.4	1,083.1
EBITDA (US\$ m)	145.3	180.4	198.4	225.4
OCFPS (US\$)	1.89	2.04	2.54	2.94
P/OCF (x)	13.6	21.1	17.0	14.7
EV/EBITDA (current)	20.2	16.6	14.5	12.1
Net debt (US\$ m)	293	348	224	79
ROIC (%)	11.20	15.16	17.44	20.86
Number of shares (m)	61.25	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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- **INCR Again Increases F15 Guidance:** Following the 2Q revenue and earnings beat, INCR increased its F15 guidance for revenue and EPS. The company expects net service revenue in the range of \$900M-\$910M (vs. previous guidance of \$880-\$905M) which represents growth of approximately 12.4%-13.65% y/y (inclusive of an FX headwind). This is ahead of Thomson consensus of \$894.6M. INCR is now targeting adjusted diluted EPS in the range of \$1.69-\$1.80 (vs. previous guidance of \$1.45-\$1.57) which compares to Thomson consensus of \$1.53. This raises the midpoint by \$0.235 to \$1.745. Additionally the company expects diluted GAAP EPS in the range of \$1.44-\$1.60 (vs. previous guidance of \$1.15-\$1.31). The press release noted that new guidance takes current FX rates into account, the company's expectations for tax rate, and INCR's overall outlook. We look forward to this morning's call for incremental color on any embedded assumptions within the F15 guidance range particularly around the cadence of earnings and sustainability of the current profitability levels.
- **Details on the Quarter:** INCR reported 2Q15 net service revenue growth of 14.2% to \$227.4M, higher than our forecasts, with industry leading cc revenue growth of nearly 20%. Net new business awards of \$295.9M were strong in the quarter, with INCR reporting a 1.3x book-to-bill ratio for each of the last three, six and twelve month periods. INCR reported adjusted income from operations of \$48.8M, a reported increase of 60.1% y/y, and adjusted operating margin expanded an impressive 620 bps y/y to 21.5%, 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 12.3% to \$1.7B in the quarter, which the company attributed to strength in repeated business wins as well as awards from new customers, noting particular strength in CNS, Oncology and other complex therapeutic classes.

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

INC Research, Inc (INCR.OQ, \$43.16, OUTPERFORM[V], TP \$38.0)

Disclosure Appendix

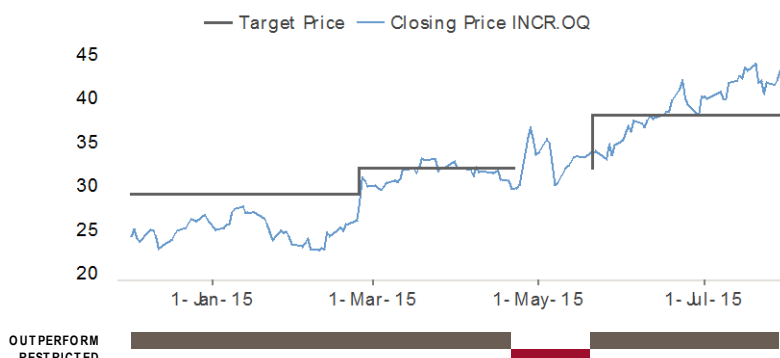
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3-Year Price and Rating History for INC Research, Inc (INCR.OQ)

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

* Asterisk signifies initiation or assumption of coverage.



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Restricted	3%	

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

Method: We arrived at our \$38 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 \$38 applying a multiple of 21.7x our F16 EPS estimate of \$1.75. Our EV/EBITDA analysis applies a roughly 13.4x multiple to our F16 EBITDA of \$198.4M. 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 \$38 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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See the *Companies Mentioned* section for full company names

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