

INC Research Holdings, Inc.

INCR: Financial Engineering to Be Accretive, but Share Price Run-Up Remains a Concern

We maintain our SW rating on INC Research (INCR-NASDAQ) due to valuation. In our view, INCR remains an attractive long-term investment opportunity. However, INCR's shares have appreciated ~60% since the Company's IPO in November 2014 (vs. CRO average: ~30%), and are trading at 19.2x our updated 2016 EPS of \$1.77 (vs. CRO average: 17.6x).

Key Investment Points

We are raising our EPS estimates for INCR following the completion of the Company's previously announced debt refinancing and the repurchase of ~5M shares from the Company's private equity investors, Avista Capital Partners and the Ontario Teachers' Pension Plan (OTPP), as part of a 7M secondary. Following this repurchase, Avista and OTPP will own ~68% of the Class A and Class B shares (down from ~83% previously). Of note, the secondary will increase the trading liquidity (public float) for INCR's shares by ~2M shares.

Our updated EPS estimates are \$1.52 for 2015 (from \$1.47; management's revised guidance: \$1.45-\$1.57) and \$1.77 for 2016. Our revenue and operating profits remain unchanged. On INCR's 1Q15 conference call (April 27), management had indicated that these financial actions were pending and would be accretive for shareholders. However, the timing and the extent of the share repurchase was not specifically known at that time.

We model the share repurchase to be ~\$0.11 accretive to EPS on a run-rate basis (or ~\$0.05 for the rest of 2015). This includes the repurchase of ~5M shares at \$29.68 (adjusted for transaction fees) offset partially by ~\$2.4M of incremental net interest expense related to \$102M of additional debt and reduced cash to fund the buyback.

This transaction materially increases balance sheet indebtedness to ~2.3x (net debt-to-LTM EBITDA), but we see INCR having no difficulty rapidly reducing this debt ratio to under 1.0x over the next 24 months. INCR tends to generate strong free cash flow with one of the best working capital turnover ratios in our CRO coverage universe and limited capital spending requirements.

Estimates

FY ends 12/31	F2014A	1Q15A	2Q15E	3Q15E	4Q15E	F2015E	F2016E
EPS (Net)	0.83	0.42	0.31	0.38	0.41	1.52	1.77
Cons. EPS	--	\$0.42	\$0.32	\$0.35	\$0.37	\$1.40	\$1.64
Previous	--	--	0.30	0.36	0.39	1.47	1.66
Revenue (M)	\$809.7	\$211.5	\$218.2	\$227.5	\$236.2	\$893.4	\$980.5
Cons. Revenue	--	\$211.5	\$219.8	\$225.7	\$234.9	\$892.0	\$993.0
EBITDA (M)	\$145.3	\$51.2	\$41.5	\$44.7	\$46.6	\$184.0	\$197.2
Cons. EBITDA	--	\$46.9	\$43.4	\$43.3	\$45.3	\$177.0	\$195.5
Previous	--	--	--	--	--	--	\$196.2

Sources: Company reports, FactSet, KeyBanc Capital Markets Inc.

For analyst certification and important disclosures, please refer to the Disclosure Appendix.

KeyBanc Capital Markets Inc. | Member NYSE/FINRA/SIPC

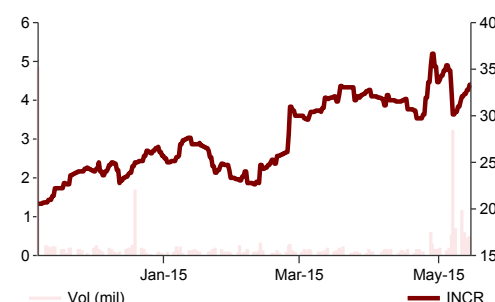
Donald Hooker, CFA / (917) 368-2378
donald.hooker@key.com

Jack Wallace / (917) 368-2345
jack.wallace@key.com

John Gagliardi, CFA / (917) 368-2372
john.gagliardi@key.com

NASDAQ: INCR

Rating: **Sector Weight**
Price Target: **NA**
Price: **\$33.28**



Sources: Company reports, FactSet, KeyBanc Capital Markets Inc.

Company Data

52-week range	\$20 - \$39
Market Cap. (M)	\$2,036.7
Shares Out. (M)	61.20
Enterprise Value (M)	\$2,330.2
Avg. Daily Volume (30D)	349,014.0
SI as % of Float	2.2%
SI % Chg. from Last Per.	64.2%
Book Value/Share	\$7.32

Sources: Company reports, FactSet, KeyBanc Capital Markets Inc.

Valuation

INCR's current intra-day trading price implies an 18.8x multiple of our revised 2016 adjusted EPS estimate of \$1.77, which is a ~4% premium to the current CRO group average (~18.0x). In our opinion, this premium multiple fairly reflects INCR's recent EBITDA growth momentum -- offset by higher bookings volatility and balance sheet indebtedness.

Investment Risks

INCR operates in a competitive industry against other providers that have similar services. The Company's ability to generate revenue and earnings growth is contingent on trends in global biopharmaceutical R&D spending and the propensity of biopharmaceutical firms to outsource R&D and sales activities to third parties. Furthermore, a significant portion of INCR's revenues are generated from clinical trials in central nervous system (CNS) disorders and oncology.

FINANCIAL MODELS

Figure 1: Projected Income Statement

INCR -- GAAP Income Statements (in millions)	2013A	Fiscal Year End, December 2014				2014A	Fiscal Year End, December 2015				2015E	2016E
		1QA	2QA	3QA	4QA		1QA	2QE	3QE	4QE		
Net Service Revenue	\$652.4	\$184.7	\$203.5	\$207.8	\$213.7	\$809.7	\$211.5	\$218.2	\$227.5	\$236.2	\$893.4	\$980.5
Year-Over-Year Growth, % (Services)	12.7%	17.0%	12.3%	15.4%	29.0%	24.1%	15.8%	7.2%	9.5%	10.5%	10.3%	9.8%
Less: Direct Costs	(432.3)	(120.8)	(130.8)	(129.6)	(134.0)	(515.1)	(125.4)	(140.3)	(146.3)	(151.9)	(563.9)	(628.5)
Gross Income	\$220.2	\$63.9	\$72.8	\$78.2	\$79.8	\$294.7	\$86.1	\$77.9	\$81.2	\$84.3	\$329.5	\$352.0
Gross Margin, % (Services)	33.7%	34.6%	35.7%	37.6%	37.3%	36.4%	40.7%	35.7%	35.7%	35.7%	36.9%	35.9%
less: Selling, General, and Admin	(117.9)	(32.2)	(34.0)	(38.2)	(40.8)	(145.1)	(35.8)	(37.3)	(37.5)	(38.7)	(149.4)	(159.1)
less: Depreciation	(19.2)	(6.9)	(5.0)	(4.7)	(5.0)	(21.6)	(4.8)	(4.9)	(5.0)	(5.0)	(19.6)	(20.6)
less: Amortization	(39.3)	(7.5)	(6.2)	(9.6)	(9.6)	(32.9)	(9.5)	(9.5)	(9.5)	(9.5)	(37.9)	(37.9)
less: Other	(12.3)	(2.8)	(19.7)	(3.0)	(5.9)	(31.3)	(3.6)	-	-	-	(3.6)	-
Operating Income	\$31.5	\$14.6	\$7.9	\$22.7	\$18.5	\$63.6	\$32.4	\$26.2	\$29.2	\$31.1	\$118.9	\$134.5
Operating Margin % (Services)	4.8%	7.9%	3.9%	10.9%	8.6%	7.9%	15.3%	12.0%	12.8%	13.2%	13.3%	13.7%
plus: Interest Income	0.3	0.2	0.0	0.0	0.0	0.2	0.1	0.1	0.1	0.1	0.4	0.6
less: Interest Expense	(60.8)	(16.1)	(12.8)	(12.9)	(11.2)	(53.0)	(5.4)	(4.9)	(3.9)	(3.9)	(18.1)	(15.0)
plus: Other Income (expense)	(1.6)	1.4	(0.3)	5.1	(45.2)	(39.1)	3.5	(4.9)	(4.9)	(4.9)	(11.2)	-
Pretax Income	(\$30.7)	\$0.1	(\$5.3)	\$15.0	(\$37.9)	(\$28.2)	\$30.5	\$16.5	\$20.5	\$22.5	\$90.0	\$120.1
less: Provision for Income Taxes	(10.8)	(1.6)	20.6	(2.4)	(11.8)	4.7	(5.3)	(2.5)	(3.1)	(3.4)	(14.2)	(43.2)
Net Earnings	(\$41.5)	(\$1.6)	\$15.3	\$12.6	(\$49.8)	(\$23.5)	\$25.3	\$14.0	\$17.4	\$19.1	\$75.8	\$76.8
less: Class C Stock Dividends	(0.5)	(0.1)	(0.1)	(0.1)	(3.4)	(3.8)	-	-	-	-	-	-
Net Earnings to Class A and B Shares	(\$42.0)	(\$1.7)	\$15.2	\$12.4	(\$53.2)	(\$27.2)	\$25.3	\$14.0	\$17.4	\$19.1	\$75.8	\$76.8
Diluted EPS (GAAP)	(\$0.81)	(\$0.03)	\$0.29	\$0.24	(\$0.92)	(\$0.51)	\$0.40	\$0.23	\$0.30	\$0.33	\$1.26	\$1.32
Diluted Share Count	52.0	51.9	52.2	52.5	57.5	53.5	63.1	60.3	58.2	58.2	60.0	58.2
Non-GAAP Metrics												
Net Services Revenue	\$652.4	\$184.7	\$203.5	\$207.8	\$213.7	\$809.7	\$211.5	\$218.2	\$227.5	\$236.2	\$893.4	\$980.5
Year-Over-Year Growth, % (Period)	12.7%	23.3%	27.9%	22.9%	22.6%	24.1%	14.5%	7.2%	9.5%	10.5%	10.3%	9.8%
Year-Over-Year Growth, % (R4Q)	12.7%	17.0%	21.0%	22.2%	24.1%	24.1%	21.7%	16.3%	13.1%	10.3%	10.3%	9.8%
Adjusted EBITDA	\$105.5	\$32.6	\$35.5	\$36.8	\$40.3	\$145.3	\$51.2	\$41.5	\$44.7	\$46.6	\$184.0	\$197.2
Adjusted EBITDA Margin %	16.2%	17.6%	17.5%	17.7%	18.9%	17.9%	24.2%	19.0%	19.6%	19.7%	20.6%	20.1%
Year-Over-Year Growth, % (Period)	25.1%	80.8%	43.5%	11.9%	35.2%	37.7%	57.1%	16.8%	21.3%	15.5%	26.6%	7.2%
Adjusted EPS	\$0.30	\$0.14	\$0.18	\$0.26	\$0.26	\$0.83	\$0.42	\$0.31	\$0.38	\$0.41	\$1.52	\$1.77
Year-Over-Year Growth, % (Period)	460.6%	-591.4%	182.2%	62.3%	159.0%	181.6%	207.1%	75.3%	46.5%	58.5%	82.6%	16.2%

Source: Company reports and KeyBanc Capital Markets

Disclosure Appendix

INC Research Holdings, Inc. - INCR

We expect to receive or intend to seek compensation for investment banking services from INC Research Holdings, Inc. within the next three months.

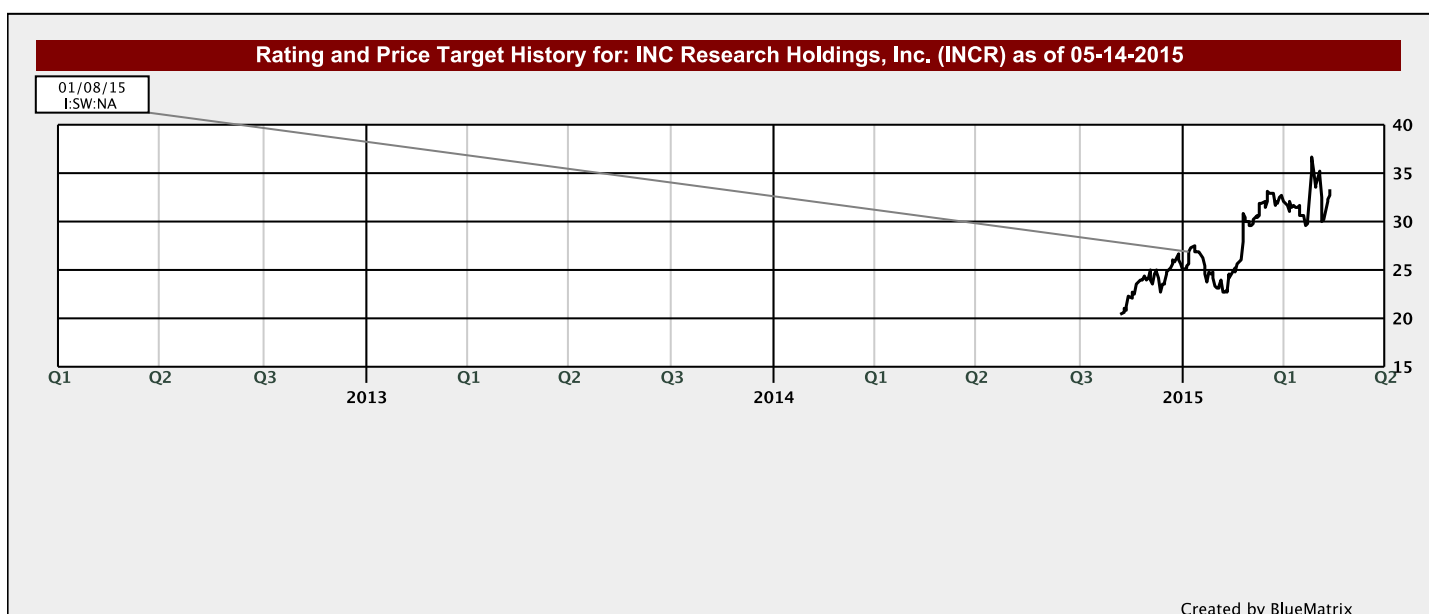
During the past 12 months, INC Research Holdings, Inc. has been a client of the firm or its affiliates for non-securities related services.

As of the date of this report, we make a market in INC Research Holdings, Inc..

Reg A/C Certification

The research analyst(s) responsible for the preparation of this research report certifies that:(1) all the views expressed in this research report accurately reflect the research analyst's personal views about any and all of the subject securities or issuers; and (2) no part of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this research report.

Three-Year Rating and Price Target History



Rating Disclosures

Distribution of Ratings/IB Services KeyBanc Capital Markets

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
Overweight [OW]	350	45.75	75	21.43
Sector Weight [SW]	393	51.37	65	16.54
Underweight [UW]	22	2.88	2	9.09

Disclosure Appendix (cont'd)

Rating System

Overweight - We expect the stock to outperform the analyst's coverage sector over the coming 6-12 months.

Sector Weight - We expect the stock to perform in line with the analyst's coverage sector over the coming 6-12 months.

Underweight - We expect the stock to underperform the analyst's coverage sector over the coming 6-12 months.

Note: KeyBanc Capital Markets changed its rating system after market close on February 27, 2015. The previous ratings were Buy, Hold and Underweight. Additionally, Pacific Crest Securities changed its rating system to match KeyBanc Capital Markets' rating system after market close on April 10, 2015, in conjunction with the merger of the broker dealers. The previous ratings were Outperform, Sector Perform and Underperform.

Other Disclosures

KeyBanc Capital Markets is a trade name under which corporate and investment banking products and services of KeyCorp and its subsidiaries, KeyBanc Capital Markets Inc., Member NYSE/FINRA/SIPC ("KBCMI"), and KeyBank National Association ("KeyBank N.A."), are marketed. Pacific Crest Securities is a division of KeyBanc Capital Markets Inc.

KeyBanc Capital Markets Inc. ("KBCMI") does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

This report has been prepared by KBCMI. The material contained herein is based on data from sources considered to be reliable; however, KBCMI does not guarantee or warrant the accuracy or completeness of the information. It is published for informational purposes only and should not be used as the primary basis of investment decisions. Neither the information nor any opinion expressed constitutes an offer, or the solicitation of an offer, to buy or sell any security. The opinions and estimates expressed reflect the current judgment of KBCMI and are subject to change without notice. This report may contain forward-looking statements, which involve risk and uncertainty. Actual results may differ significantly from the forward-looking statements. This report is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the specific needs of any person or entity.

No portion of an analyst's compensation is based on a specific banking transaction; however, part of his/her compensation may be based upon overall firm revenue and profitability, of which investment banking is a component. Individuals associated with KBCMI (other than the research analyst(s) listed on page 1 of this research report) may have a position (long or short) in the securities covered in this research report and may make purchases and/or sales of those securities in the open market or otherwise without notice. As required by NASD Rule 2711(h)(1)(A), financial interest, if any, by any research analysts listed on page 1 of this report will be disclosed in Important Disclosures, Company-specific regulatory disclosures located above in the Disclosure Appendix. KBCMI itself may have a position (long or short) in the securities covered in this research report and may make purchases and/or sales of those securities in the open market or otherwise without notice. As required by NASD Rule 2711(h)(1)(B), if KBCMI beneficially owns 1% or more of any class of common equity securities of the subject company(ies) in this research report as of the end of the month immediately preceding the date of publication of this research report will be disclosed in Important Disclosures, Company-specific regulatory disclosures located above in the Disclosures Appendix. This communication is intended solely for use by KBCMI clients. The recipient agrees not to forward or copy the information to any other person without the express written consent of KBCMI.