

## INC Research Holdings, Inc.

### Post-Call Model Changes

- Conclusion.** On Tuesday morning, February 24, INC reported strong fourth-quarter results that exceeded our expectations for revenues and gross margin. The company also delivered impressive guidance on the back of strong new business wins. We believe INC's therapeutic expertise in fast-growing categories like oncology and CNS, coupled with a healthy mix of both large and small clients, positions the company well to outperform the broader CRO market in the near to intermediate term. Given a very healthy backlog coverage ratio of nearly 90%, and conservative expectations for cancellations, we believe the 2015 outlook has upside potential. We are increasing our full year 2015 EPS estimate by 11 cents, to \$1.24 (up 24% year-over-year), and we reiterate our Outperform rating despite the stock's premium valuation.
- Demand trend is strong at present and INC outperformed the group.** Continuing the trend of strong bookings across the clinical CRO sector, INC reported a very strong 1.5-times net book-to-bill ratio (1.2-times trailing book-to-bill ratio for the year). We believe the robust awards set the company up well for roughly 10% organic revenue growth in 2015. We believe the consistently good bookings across the clinical group this quarter have been driven by consistent demand from large pharma and more aggressive spending from small biopharma, which is benefiting from record capital inflows. Bookings were reportedly balanced across both client segments for INC in the quarter. The consistent award success across the group suggests that pricing should also be holding up, which bodes well for the potential for margin leverage. We look to ICON plc (ICON \$61.94; Outperform) results Wednesday morning as the final indicator of the clinical group's demand trends.
- Model changes.** We now assume 2015 revenue for INC of \$886 million, up 9.4% from 2014 and up \$16 million from our previous model. We expected adjusted EBITDA margin of 18.3%, up from 17.7% previously, and earnings per share of \$1.24 excluding stock compensation expense (compared with \$1.13 previously). We continue to model stock option expense of four cents. While we model revenue to be negatively affected by 420 basis points in 2015 by unfavorable exchange rates, we note that INC's global cost structure offsets the top-line headwind and results in a neutral impact to the operating line.
- Valuation and stock thoughts.** Following these positive results, INC trades at 22.8 times our revised 2015 EPS estimate. The clinical CRO peer group trades at 20.9 times—19.7 times for ICLR, 21.0 times for Quintiles (Q \$64.99; Outperform), 21.2 times for PRA Health (PRAH \$28.65; Outperform), and 21.7 times for Parexel (PRXL \$64.75; Outperform)—suggesting that the stock is not likely to see much more in the way of multiple expansion. We remain constructive on the CRO group and maintain our Outperform rating on INC despite the premium valuation given the company's encouraging execution and earnings growth profile in the 20% range. Our revised model is shown on the following page.

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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February 24, 2015

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

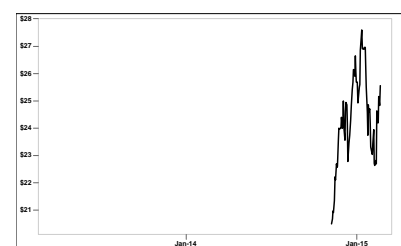
Symbol: INCR (NASDAQ)  
Price: \$25.99 (52-Wk.: \$20-\$29)  
Market Value (mil.): \$1,560  
Fiscal Year End: December  
Long-Term EPS Growth Rate: 20%  
Dividend/Yield: None

	2014A	2015E	2016E
<b>Estimates</b>			
EPS FY	\$0.93	\$1.24	\$1.50
CY		\$1.24	\$1.50
<b>Valuation</b>			
FY P/E	27.9x	21.0x	17.3x
CY P/E		21.0x	17.3x

<b>Trading Data (FactSet)</b>	
Shares Outstanding (mil.)	60
Float (mil.)	23
Average Daily Volume	213,333

<b>Financial Data (FactSet)</b>	
Long-Term Debt/Total Capital (MRQ)	0.0
Book Value Per Share (MRQ)	0.0
Return on Equity (TTM)	-14.2

#### Two-Year Price Performance Chart



Sources: FactSet, William Blair & Company estimates

**Exhibit 1. Model Summary (Calendar 2011–2016)**

	2011	2012	2013	2014	Q1'15E	Q2'15E	Q3'15E	Q4'15E	2015E	2016E
<b>Service revenue</b>	<b>\$ 437,005</b>	<b>\$ 579,145</b>	<b>\$ 652,418</b>	<b>\$ 809,728</b>	<b>213,622</b>	<b>215,728</b>	<b>222,880</b>	<b>233,789</b>	<b>\$ 886,019</b>	<b>\$ 975,911</b>
Direct Costs	279,840	389,057	432,262	515,059	138,854	138,713	143,312	148,690	569,569	624,095
SG&A	92,891	106,970	117,055	143,763	37,170	37,968	38,670	40,562	154,370	168,345
Stock-based comp expense	(1,176)	(1,248)	(2,419)	(3,370)	(950)	(950)	(950)	(950)	(3,800)	(4,210)
<b>Adjusted EBITDA</b>	<b>65,450</b>	<b>84,366</b>	<b>105,520</b>	<b>154,276</b>	<b>38,547</b>	<b>39,997</b>	<b>41,849</b>	<b>45,487</b>	<b>165,880</b>	<b>187,681</b>
Depreciation	15,700	19,915	19,175	21,619	7,477	5,177	5,349	5,611	23,614	24,886
<b>EBITA</b>	<b>49,750</b>	<b>64,451</b>	<b>86,345</b>	<b>132,657</b>	<b>31,071</b>	<b>34,819</b>	<b>36,499</b>	<b>39,876</b>	<b>142,265</b>	<b>162,796</b>
Interest expense	(65,482)	(62,007)	(60,489)	(52,787)	(5,022)	(4,852)	(4,683)	(4,514)	(19,071)	(14,330)
<b>Pre-tax income</b>	<b>(15,732)</b>	<b>2,444</b>	<b>25,856</b>	<b>79,870</b>	<b>26,049</b>	<b>29,967</b>	<b>31,816</b>	<b>35,362</b>	<b>123,195</b>	<b>148,466</b>
Income tax (expense) benefit	2,157	(1,653)	(9,567)	(29,553)	(9,378)	(10,788)	(11,454)	(12,730)	(44,350)	(52,705)
<b>Adjusted Net Income (excluding SBC)</b>	<b>(13,575)</b>	<b>791</b>	<b>16,289</b>	<b>50,317</b>	<b>16,671</b>	<b>19,179</b>	<b>20,363</b>	<b>22,632</b>	<b>78,845</b>	<b>95,760</b>
Net tax adjustments	(45,972)	(59,905)	(57,819)	(73,787)	(1,922)	(2,011)	(2,311)	(2,769)	(9,013)	(10,988)
<b>As reported net income</b>	<b>\$ (59,547)</b>	<b>\$ (59,114)</b>	<b>\$ (41,530)</b>	<b>\$ (23,470)</b>	<b>\$ 14,749</b>	<b>\$ 17,168</b>	<b>\$ 18,052</b>	<b>\$ 19,863</b>	<b>\$ 69,832</b>	<b>\$ 84,772</b>
Adjusted EPS (excluding SBC)	\$ (0.31)	\$ 0.02	\$ 0.31	\$ 0.93	\$ 0.27	\$ 0.30	\$ 0.32	\$ 0.35	\$ 1.24	\$ 1.50
<b>As reported EPS</b>	<b>\$ (1.36)</b>	<b>\$ (1.13)</b>	<b>\$ (0.80)</b>	<b>\$ (0.44)</b>	<b>\$ 0.24</b>	<b>\$ 0.27</b>	<b>\$ 0.28</b>	<b>\$ 0.31</b>	<b>\$ 1.10</b>	<b>\$ 1.33</b>
<i>Diluted Class A common shares outstanding (in thousands)</i>	43,874	52,228	52,033	53,859	61,300	63,927	64,067	64,079	63,343	63,660

**Margin Analysis**

<b>Gross margin</b>	36.0%	32.8%	33.7%	36.4%	35.0%	35.7%	35.7%	36.4%	35.7%	36.1%
SG&A	21.3%	18.5%	17.9%	17.8%	17.4%	17.6%	17.4%	17.4%	17.4%	17.3%
Adjusted EBITDA (excluding sbc)	15.0%	14.6%	16.2%	19.1%	18.0%	18.5%	18.8%	19.5%	18.7%	19.2%
<b>Adjusted EBITDA (including sbc)</b>	<b>14.7%</b>	<b>14.4%</b>	<b>15.8%</b>	<b>18.6%</b>	<b>17.6%</b>	<b>18.1%</b>	<b>18.4%</b>	<b>19.1%</b>	<b>18.3%</b>	<b>18.8%</b>
Depreciation	3.6%	3.4%	2.9%	2.7%	3.5%	2.4%	2.4%	2.4%	2.7%	2.6%
<b>EBITA</b>	<b>11.4%</b>	<b>11.1%</b>	<b>13.2%</b>	<b>16.4%</b>	<b>14.5%</b>	<b>16.1%</b>	<b>16.4%</b>	<b>17.1%</b>	<b>16.1%</b>	<b>16.7%</b>
Tax rate	13.7%	67.6%	37.0%	37.0%	36.0%	36.0%	36.0%	36.0%	36.0%	35.5%
<b>Net Income</b>	<b>-3.1%</b>	<b>0.1%</b>	<b>2.5%</b>	<b>6.2%</b>	<b>7.8%</b>	<b>8.9%</b>	<b>9.1%</b>	<b>9.7%</b>	<b>8.9%</b>	<b>9.8%</b>

**Growth metrics**

Total Revenue		32.5%	12.7%	24.1%	15.7%	6.0%	7.3%	9.4%	9.4%	10.1%
<i>Constant currency growth</i>		34.7%	12.3%	24.2%	20.5%	11.0%	11.5%	11.5%	13.6%	
Cost of goods sold		39.0%	11.1%	19.2%	15.0%	6.1%	10.6%	11.0%	10.6%	9.6%
Gross profit		20.9%	15.8%	33.8%	16.9%	5.8%	1.7%	6.7%	7.4%	11.2%
SG&A		15.2%	9.4%	22.8%	16.6%	12.9%	2.4%	0.2%	7.4%	9.1%
<b>Adjusted EBITDA</b>		<b>28.9%</b>	<b>25.1%</b>	<b>46.2%</b>	<b>18.3%</b>	<b>-0.1%</b>	<b>1.3%</b>	<b>12.8%</b>	<b>7.5%</b>	<b>13.1%</b>
Depreciation		26.8%	-3.7%	12.7%	8.8%	3.0%	13.0%	12.4%	9.2%	5.4%
<b>EBITA</b>		<b>29.5%</b>	<b>34.0%</b>	<b>53.6%</b>	<b>20.9%</b>	<b>-0.5%</b>	<b>-0.2%</b>	<b>12.8%</b>	<b>7.2%</b>	<b>14.4%</b>
Net Income		-105.8%	1959.3%	208.9%	169.8%	37.2%	36.5%	48.5%	56.7%	21.5%
EPS		-104.9%	1967.0%	198.4%	169.8%	37.2%	36.5%	48.5%	33.2%	20.9%
Weighted average shares		19.0%	-0.4%	3.5%	18.0%	22.5%	22.0%	9.0%	17.6%	0.5%

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DOW JONES: 18,116.84

S&P 500: 2,109.66

NASDAQ: 4,960.97



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Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	64	Outperform (Buy)	16
Market Perform (Hold)	32	Market Perform (Hold)	2
Underperform (Sell)	2	Underperform (Sell)	0

\*Percentage of companies in each rating category that are investment banking clients, defined as companies for which William Blair has received compensation for investment banking services within the past 12 months.

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