SIENAcollege

BJORKLUND FUND

April 28th, 2017

ICON plc: ICLR

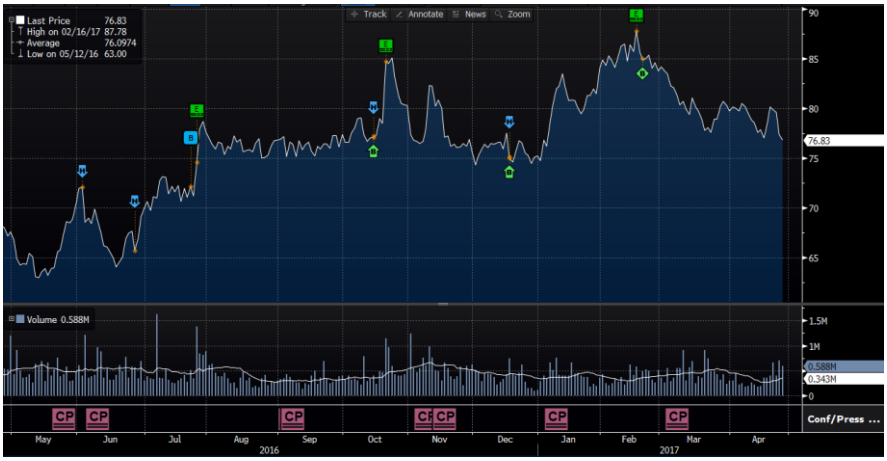
Mateo Valdivieso

Sector: **Healthcare**
Industry: **Life Sciences Tools and Services**
Current Price: **$76.83**
Target Price: **$94.38**

ICON plc is a contract research organization ("CRO"), incorporated in 1990, which provides outsourced development services on a global basis to the pharmaceutical, biotechnology and medical device industries. They specialize in the strategic development, management and analysis of programs that support all stages of the clinical development process - from compound selection to Phase I-IV clinical studies. The company earns revenues by providing several different services to its customers. These services, which are integral elements of the clinical development process, include clinical trials management, biometric activities, consulting, imaging, contract staffing, informatics and laboratory services. The company has the expertise and capability to conduct clinical trials in most major therapeutic areas on a global basis and has the operational flexibility to provide development services on a stand-alone basis or as part of an integrated "full service" solution. They have expanded predominately through organic growth, together with several strategic acquisitions to enhance its expertise and capabilities in certain areas of the clinical development process. ICON plc mission is to accelerate the development of drugs and devices that save lives and improve the quality of life. ICON plc vision is to be the Global CRO partner of choice in drug development by delivering best in class information, solutions and performance in clinical and outcomes research.

LONG

Current Price:	$76.83
Target Price:	$94.38
Market Cap:	4.34B
Beta:	.98



Thesis:

ICON is well positioned to benefit from drug makers continued increase in outsourcing their R&D to CROs. This is a long-term trend that ICON can only benefit from. ICON also has plans to continue its acquisitions strategy that has helped them grow tremendously. Icon has also achieved further operational improvements and has been successful in the reduction of its customer revenue concentration.

Catalysts:

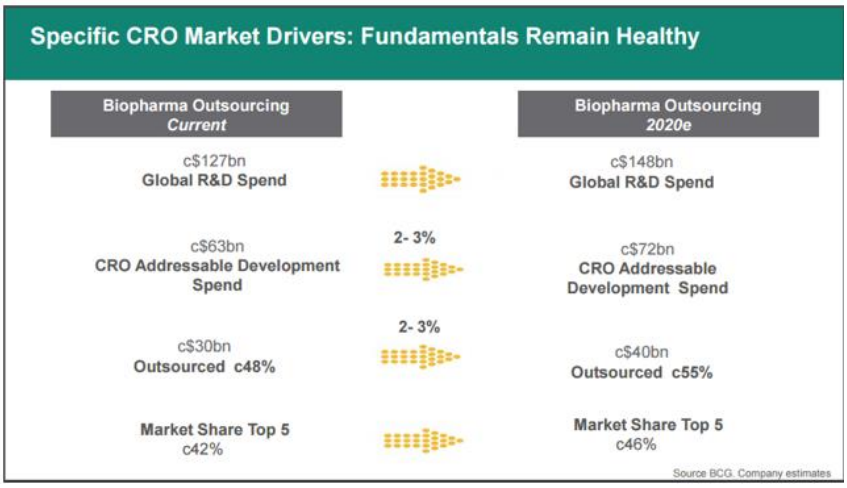
- **Steady continued growth prospect**
- **Continued outsourcing of R&D from drug makers.**
- **Potential acquisitions**

Business Overview:

Founded in 1990, ICON's core business is the planning, management, execution, and analysis of Phase I to IV clinical trials, ranging from small projects to complex, multinational mega-studies. This business, specifically the late-stage Phase III and IV business, which accounts for well over half the company's revenue, benefits from substantial competitive advantages. Looking at Phase III trials; these trials usually require thousands of patients and usually trials take place across many geographic locations. The scale of these studies really limit the completion allowing for an oligopoly of large CROs to really compete. ICON thus has competitive advantage when being able to access enormous patient datasets. This because of its key partnerships and established relationships it has with trial sites. This has allowed the company to enroll patients a lot faster than a small competitor could be able to. In terms of how contracts are awarded; it's based on the CRO's brand and reputation it has. This has given ICON and additional advantage as they are already established players. However, these contracts could be lost at any time if there is even a slight error or abnormality through the clinical trial, this can cause regulators to reject the drug or even require a new trial. Thus, drug makers want to see a successful track record from a CRO before putting a potential multi-billion-dollar drug into the CRO's hand. In this regard, ICON has done exceptionally well in having a good reputation of success. As of recent large and medium drug manufactures have shifted from outsourcing clinical research on project by project basis to partnering one or two CROs to handle the entire pipeline. What this creates is longer contracts between CROs and drug manufactures. This also allows CROs to dive deeper into their client's drug development process but also create strong relationships and a higher switching cost. ICON has continued to prove itself through the industry and it has Pfizer, its oldest and largest client to prove it, as Pfizer has been with ICON for over a decade.

Outsourcing opportunities brief:

Biopharma outsourcing spending is the single biggest driver for the company. I believe this will continue for the foreseeable future. ICON identifies growth opportunities across all phases of drug development. The fastest growth is expected to come from mid-sized and specialty biotech companies. Asia Pacific is expected to produce the fastest growth rate regarding regions. Biopharma outsourcing spending trends are shown in chart below.



Research and Development spending and outsourcing is the key to growth:

Revenue since 1998 has increase from $45m to $1.8B in 2016 this is a CAGR of 22% and 12% on an organic basis. This tremendous increase is due to a combination of synergistic acquisitions and organic growth. Over the course of time this growth as naturally decreased as ICON has grown and other competitors have entered but also new regulations have come into existence. This doesn't take away the fact that ICON revenue CAGR is still higher than the industry average of 5-7%. Considering future growth, we can expect steady growth. excluding any potential M&A. ICON can increase its revenues at least by 7% CAGR for the upcoming years which will predominantly be driven by favorable outsourcing trends. To fully understand these trends let's take into consideration $145.1B drug makers spent on R&D in the year 2016. When excluding cost that won't get outsourced, around $74.5B can be directly addressed by CROs. As shown in chart 1 below only $33.9B was outsourced which is less than half. The outsourced R&D is expected to grow 5.6% annually which would accumulate to $41.2B by the year 2020, as shown in Chart 1. Looking on a segment basis, late-stage clinical trial outsourcing is expected to grow 5.8% per annum. Moreover, the complex clinical trial outsourcing sub-segment which is not broken out in Chart 1 is projected to grow at 10+% annually, which will greatly benefit ICON given its significant revenue concentration in this area. Looking furtherer, around one-third of ICON's new trials come from oncology. These studies normally require more complicated and longer testing protocols than other disease indications. This however requires CROs to have complex trial design expertise, which only Paraxel and INC Research have just to name a few. This creates a high demand for ICON's services and will continue to grow throughout the future. Taking all of this into account ICON will continue its growth and could outpace the overall industry growth moving forward.

(Data is in $M)

	Total R&D Spend	Addressable R&D	Outsourced R&D	Early-Stage Clinical	Late-Stage Clinical	Other
2005	85,323	40,454	14,143	2,944	5,698	5,501
2006	99,986	48,289	16,916	3,587	6,742	6,587
2007	112,537	55,313	19,609	4,272	7,731	7,606
2008	122,833	61,076	22,089	4,647	9,032	8,410
2009	116,077	57,958	21,703	4,248	9,579	7,876
2010	121,442	61,516	22,879	4,356	10,391	8,132
2011	122,457	62,719	24,008	4,302	11,427	8,279
2012	125,499	64,538	25,628	4,350	12,677	8,601
2013	130,303	67,515	27,905	4,606	14,229	9,070
2014	135,787	70,281	30,206	4,855	15,696	9,655
2015	137,824	70,963	31,320	5,058	16,320	9,942
2016E	145,106	74,497	33,947	5,364	17,800	10,783
2017E	150,443	77,325	35,863	5,585	18,823	11,455
2018E	155,472	79,981	37,792	5,820	19,851	12,121
2019E	159,497	82,155	39,471	6,045	20,732	12,694
2020E	163,417	84,285	41,183	6,268	21,620	13,295
CAGR (05 - 10):	7.3%	8.7%	10.1%	8.2%	12.8%	8.1%
CAGR (10 - 15):	2.6%	2.9%	6.5%	3.0%	9.4%	4.1%
CAGR (15 - 20):	3.5%	3.5%	5.6%	4.4%	5.8%	6.0%

Source: *A North Investments and Jefferies* *Chart 1*

Operational Overview:

When comparing ICON operational efficiency to the same quarter from the previous year, net revenue in the fourth quarter rose to $435 million. This represents 7.9 percent year-on-year growth and 8.4 percent growth on a constant currency basis. Looking on the other income statement lines, one can quickly notice some improvements in the operational section. Although gross margin seems to have flatten out last year due to competitive pricing pressures, operating profit margin continues its path within its growth channel. A noteworthy progress in Icon's operations is also obvious from the sum of Selling, General & Administrative Expenses, which, as percentage of revenue, decreased from 20.7 percent to 19.2 percent. This can be seen in the graph below which was provided by ICON investor presentation.

Quarterly YOY Comparison

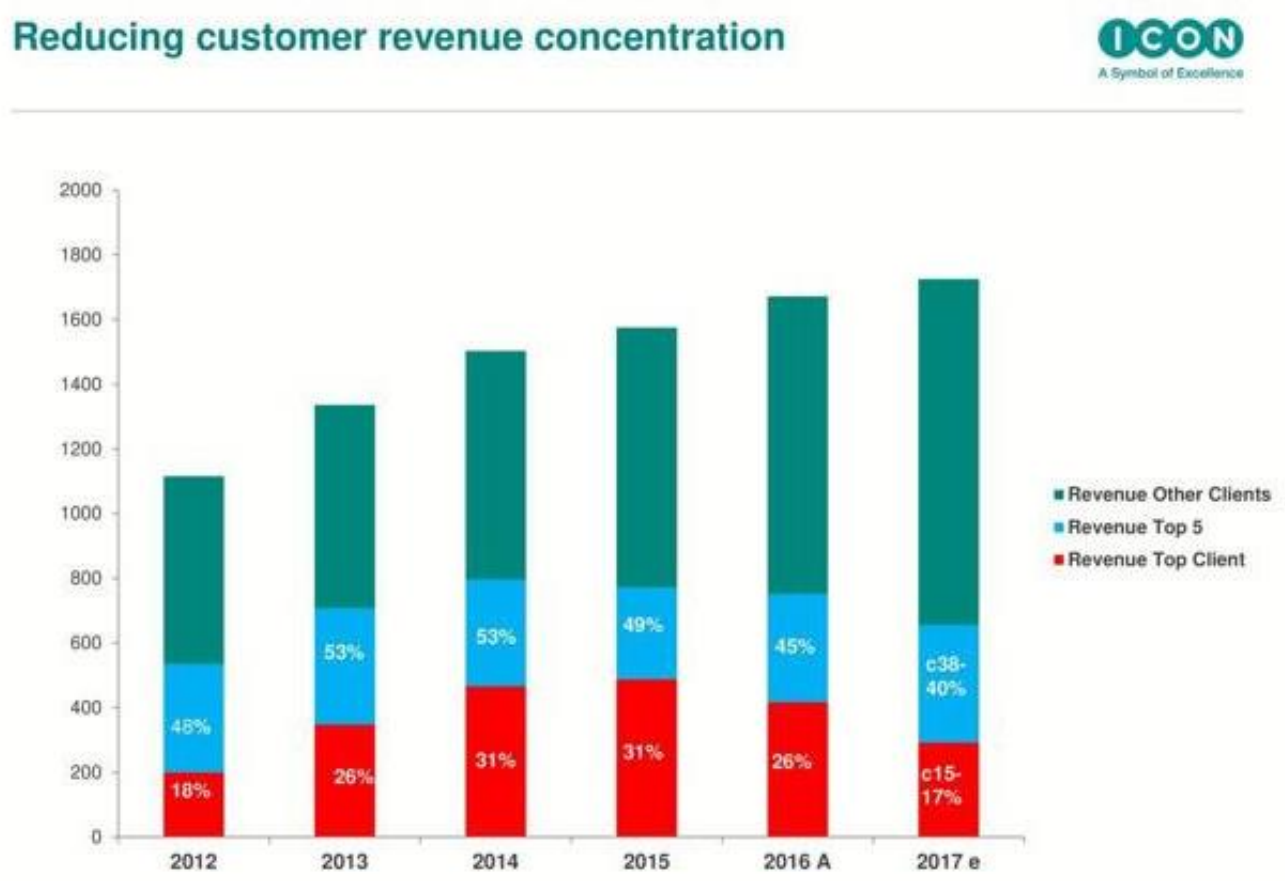
ICON A Symbol of Excellence

	Q4 2015	Q4 2016	Variance
Net Revenue	$403m	$435m	↑ 7.9% (constant currency 8.4%)
Gross Margin	43.1%	42.2%	↓ 90 bps
SG&A (% of revenue)	20.7%	19.2%	↓ 150 bps
Operating Margin	18.7%	19.5%	↑ 80 bps
Net Income Margin	15.7%	17.1%	↑ 140 bps
EPS	$1.11	$1.33	↑ 19.8%

Customer base revenue reduced:

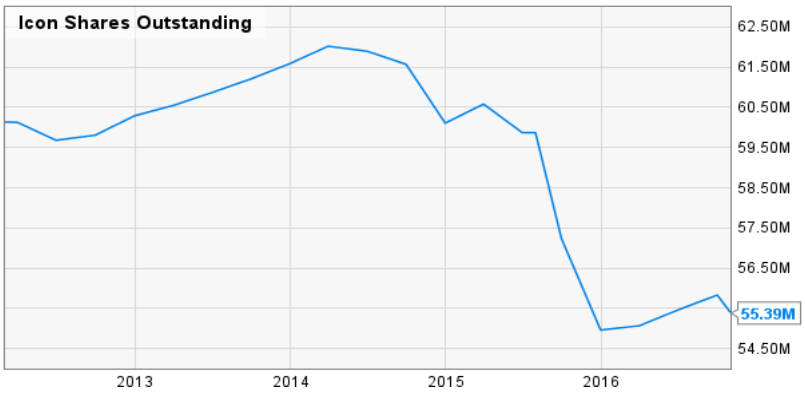
ICON saw financial statements improvements but it also had considerable advances in terms of the number of customers they depend for their revenue. For the full-year 2016, Icon's top client Pfizer; Pfizer represented 26 percent of revenue compared to 31 percent last year. In the fourth quarter, Pfizer's business accounted for just 24 percent of ICON's total revenue and is expected to decrease even further to about 15 to 17 percent by the end of 2017 as shown in the graph below. In 2016, Icon's top five customers represented 45 percent of revenue compared to 49 percent last year, top 10 represented 58 percent compared to 63 percent last year and top 25 accounted for 75 percent compared to 78 percent last year. This decrease in Customer base is beneficial to ICON because of its reduction in risk associated with customer concentration. The man risk is that if anything

happens to one of ICON's major clients, ICON revenue would also be negatively affected. However, ICON has been doing well in reducing this issue and will continue to do so for the upcoming year.



Stock buyback initiated while share outstanding continues to decrease:

October 1st, 2016 ICON had commenced a $400m buyback program to be able to provide continued value to shareholders. During the fourth quarter ICON used $110m of its current $400m. The remaining $290m according ICON's management will be spent "opportunistically" as there are a lot of assets ICON would want to acquire, but does not always succeed do some pricing issues or other business factors that cause an impediment. Thus, it's important to note since 2013 we have a steady shrinkage of shares outstanding for ICON, as demonstrated by the graph below.



M&A:

ICON has performed a good amount of M&A throughout years 2008 –2016. Spending roughly $650m on mergers and acquisitions. It identifies medical devices, late phase services, among others as future areas for M&A investment. As of 2016 ICON continues its strategy of "tuck in" smaller CRO businesses. Management believe larger scale deals tend to be more value destroying rather than value creating. In September 2016, Icon acquired Clinical Research Management Inc., which ICON believes will bring significant experience when operating within government markets and NGO sponsored research markets. Ciaran Murray, former CEO stated "ClinicalRM has a strong track record of partnering successfully with government agencies and NGOs. They will provide a platform for ICON to further penetrate this significant market segment as we continue to grow and diversify our customer base. ClinicalRM's work in the area of global vaccine development will further enhance our capabilities in this important area to the benefit of customers and patients globally." This acquisition will only further develop and ICON customer base will also helping reduce is customer risk concentration. ICON is hopeful to continue acquiring smaller end CROs when it sees the opportunity rise, but has yet to mention any potential acquisitions. It's important to note that when ICON acquired ClinicalRM stock price increased 11.6% so it's possible the market could react in shareholder's benefit should ICON find another company to acquire.

Leading EBIT Margins with a share upside:

Late-stage clinical research is a relatively asset-light business. Unlike pre-clinical trials and some early-stage clinical trials, which normally involve extensive laboratory and animal testing, late-stage human studies require relatively minimal infrastructure investment. ICON essentially serves as a consultant, advising and helping its clients plan, set up, run, and evaluate their trials. Due to this, it's easy to understand why ICON is so profitable among being one if not the best CRO. Looking at its EBIT margin for 2016 it was a record high of 18.7% excluding the one-time $8.2 million restructuring charge, EBIT was 19.2%. The industry median EBIT margin

($M except per share data)

Company	Ticker	Price	Mkt Cap	EV	EBIT	EV/EBIT
Quintiles	Q	77.42	18,248	24,405	642	38.0x
Qiagen	QGEN	27.20	6,145	6,679	167	40.0x
West Pharmaceutical	WST	77.02	5,642	5,668	197	28.8x
Parexel	PRXL	59.47	3,030	3,490	312	11.2x
Charles River	CRL	85.12	4,032	5,087	237	21.4x
PRA Health Sciences	PRAH	62.38	3,846	4,530	162	28.0x
Patheon	PTHN	24.63	3,574	5,592	212	26.4x
Bio-Techne	TECH	98.09	3,660	3,893	125	31.1x
Catalent	CTLT	27.11	3,383	5,151	195	26.4x
INC Research	INCR	41.68	2,251	2,580	171	15.1x
Ligand Pharmaceuticals	LGND	102.03	2,134	2,206	44	50.1x
Medpace	MEDP	28.18	1,148	1,274	52	24.5x
High			18,248	24,405	642	50.1x
Median			3,617	4,808	183	27.2x
Low			1,148	1,274	44	11.2x
ICON	**ICLR**	**75.09**	**4,095**	**4,118**	**320**	**12.9x**

around 12%. Even the "most high margin CROs" ever break the 15% barrier. This margin discrepancy between ICON and its peers should continue to widen over time. A 20-22% EBIT margin is a very conservative long-term target, assuming the company continues successfully leveraging its costs over a growing top line and it continues its M&A strategy. Looking at the graph below which also shows some of its competitors. ICON has an enterprise value to EBIT short of 13x, when compared to 27x for the media peer, ICON is at the cheaper end of CROs currently available. Though this is small discount which can be justified to account for the ICON's significant customer concentration. The current 50+% discount in comparison to the median is absurd as it completely ignores the company's robust growth prospects, industry-leading margins, and numerous competitive advantages like global economies of scale, barriers to entry, customer switching costs to name a few. Taking both the positives and negatives into consideration, I believe ICON can comfortably support a 20x EV/EBIT multiple which is 25% discount to peers. This would translate to a higher share value that could be beneficial to investors looking to buy into ICON.

Source: A North Investments, company reports

Conclusion:

In conclusion, I believe that Icon is an outstanding company. That's has an ongoing M&A appetite, relative high predictability of the business and bright outlook for the CRO industry. Also, ICON ability in diversifying customer base and having capable management are strong catalysts for the future. Overall, Icon remains one of the most profitable companies in the global CRO industry and well-poised to seize any additional opportunities as they arise.

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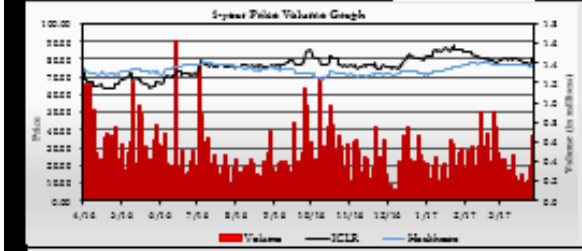
ICON Public Limited Company (ICLR)

CENTER FOR GLOBAL FINANCIAL STUDIES

BULLISH

Analyzed by	**Current Price:**	$77.07	**Intrinsic Value**	$87.19	Target 1 year Return: 22.74%
4/25/2017	**Dividend Yield:**	0.3%	**Target Price**	$94.38	Probability of Price Increase: 9



Description

ICON Public Limited Company, a contract research organization, provides outsourced development services to the pharmaceutical, biotechnology, and medical device industries in Ireland, rest of Europe, the United States, and internationally.

General Information

Sector	Healthcare
Industry	Life Sciences Tools and Services
Last Guidance	November 3, 2016
Next earnings date	April 27, 2017
Estimated Country Risk Premium	0.48%
Effective Tax rate	15%
Effective Operating Tax rate	15%

Market Data

Market Capitalization	$4,555.82
Daily volume (mil)	0.58
Shares outstanding (mil)	59.59
Diluted shares outstanding (mil)	58.44
% shares held by institutions	79%
% shares held by insurance Managers	89%
% shares held by hedge funds	9%
% shares held by insiders	1.55%
Short interest	3.31%
Days to cover short interest	5.52
52 week high	$88.58
52-week low	$62.31
Levered Beta	0.61
Volatility	26.29%

Past Earning Surprises

Quarter ending	Revenue	EBITDA
12/31/2015	-2.86%	-1.92%
3/31/2016	-5.59%	-2.74%
6/30/2016	-0.84%	-3.67%
9/30/2016	-1.13%	-3.31%
12/31/2016	-2.88%	-3.25%
Mean	-2.31%	-2.36%
Standard error	0.8%	0.4%

Peers

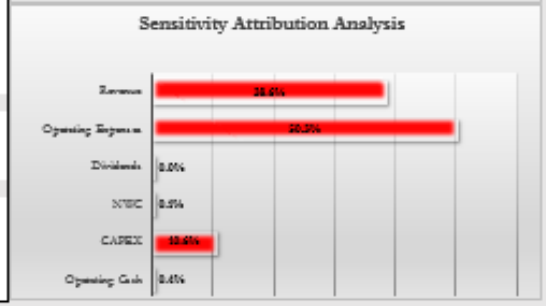
Charles River Laboratories International, Inc.
PAREXEL International Corporation
PRA Health Sciences, Inc.
IMC Research Holdings, Inc.
Pathera N.V.
Quintiles IMS Holdings, Inc.
Medpace Holdings, Inc.

Management	Position	Total compensation year	Total return to shareholders
Murray, Ciaran	Executive Chairman	57.85X per annum over 5y	-2.85X per annum over 5y
Brennan, Brendan	Chief Financial Officer	6.36X per annum over 4y	13.82X per annum over 4y
Collier, Steven	Chief Executive Officer and	55.36X per annum over 2y	21.44X per annum over 2y
O'Leary, Thomas	Chief Information Officer	N/M	N/M
Cunningham, Diarmaid	Chief Administrative Officer	N/M	N/M
Holmes, Simon	Executive Vice President of	N/M	N/M

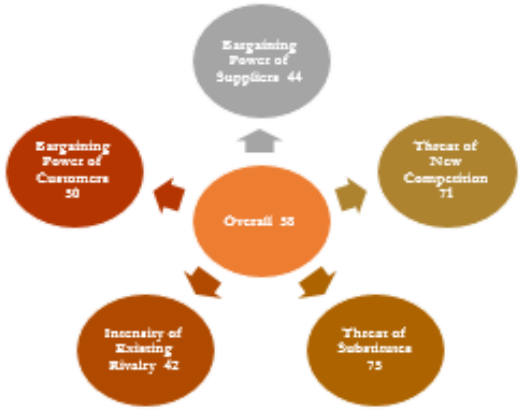
Profitability	ICLR (LTM)	ICLR (5 years historical a	Industry (LTM)
ROIC	56.2X	28.55X	14.52X
NOPAT Margin	21X	14.65X	13.7X
Revenue/Invested Capital	1.63	1.33	0.74
ROE	37.8X	26.41X	16.84X
Adjusted net margin	28X	13.74X	10.8X
Revenue/Adjusted Book Value	4.85	1.33	0.85

Invested Funds	ICLR (LTM)	ICLR (5 years historical a	Industry (LTM)
Total Cash/Total Capital	13.3X	14.8X	23X
Estimated Operating Cash/Total Capital	8.4X	7.3X	N/A
Non-cash working Capital/Total Capital	18.4X	5.8X	5X
Invested Capital/Total Capital	61.8X	58.3X	78X

Capital Structure	ICLR (LTM)	ICLR (5 years historical a	Industry (LTM)
Total Debt/Common Equity (LTM)	0.47	0.46	0.43
Cost of Existing Debt	4.85X	4.72X	5.72X
Estimated Cost of new Borrowing	4.38X	4.37X	5.72X
CGFS Risk Rating	CCC	CCC	BB
Unlevered Beta (LTM)	0.53	0.44	0.86
WACC	5.72X	5.48X	6.73X



Porter's 5 forces (scores out of 100)



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	5.8%	21.4%	5.32
12/31/2017	4.7%	20.8%	5.47
12/31/2018	5.5%	21.5%	5.73
12/31/2019	6.8%	21.8%	5.74
12/31/2020	14.4%	22.4%	5.42
12/31/2021	12.5%	20.8%	5.38
12/31/2022	11.4%	17.5%	5.35
12/31/2023	9.3%	15.7%	4.67
12/31/2024	8.4%	13.5%	3.35
12/31/2025	7.8%	11.5%	3.32
12/31/2026	5.5%	9.4%	2.64
Continuing Period	4.0%	5.3%	1.64

Period	Invested Capital	Net Claims	Price per share
Base Year	$811.41	$738.14	$87.14
12/31/2017	$845.35	$264.31	$34.28
12/31/2018	$858.34	-$127.86	$101.53
12/31/2019	$838.44	-$561.38	$108.55
12/31/2020	$886.18	-$371.43	$115.33
12/31/2021	$1,138.78	-$1,328.33	$121.67
12/31/2022	$1,152.73	-$1,555.84	$127.58
12/31/2023	$1,232.36	-$1,933.13	$132.64
12/31/2024	$1,273.57	-$2,135.88	$136.86
12/31/2025	$1,404.38	-$2,267.77	$140.42
12/31/2026	$1,558.13	-$2,318.52	$143.34
Continuing Period			