

Pleasing trading performance, despite unhelpful market

We remain very encouraged by the trends Gattaca experienced during H2, as highlighted within its year-end trading update. NFI improved c.5% on a sequential half-yearly basis during H2, against a backdrop of a challenging market. The increase in fee income was driven by the first consistent rise in the contract book for eight years, resulting in rising productivity levels (+6% yoy). Net cash was a healthy £21m, ahead of expectations. Guidance is unchanged for FY25, albeit any improvement in the underlying market is likely to result in an upward revision to estimates. With cash comprising 75% of the current market capitalisation, the shares look both significantly undervalued and well supported.

Outperforming peers

- GATC is undoubtedly outperforming most of the quoted sector in NFI terms, declining by just 5% yoy during FY24, compared to a sector average of -11%. The group has benefitted from the strategy of investing in areas of structural growth, including defence (NFI +7% yoy), infrastructure (+12% yoy) and Projects (+31% yoy). The contract book grew throughout H2, suggesting Gattaca is tapping into areas enjoying early stages of recovery, with contractor numbers 4% higher yoy and underpinning the 5% improvement in fee income in H2 versus H1.
- Although perm NFI reduced 19% on a like-for-like basis (following the closure of US in-country operations) and reflected a broadly similar rate of decline to the wider market, it was encouraging to see that quarterly sequential growth returned in Q4.
- Net cash at the year end was higher than we anticipated at £21m (ED estimate of £19.8m). The net cash equates to **65p/share**. The Board has confirmed a 2.5p/share FY24 dividend, which represents no change on FY23. However, no mention of a repeat of last year's special dividend suggests either further share buy-backs, M&A activity or a combination of the two are possible.
- As its markets recover, we would expect to see further improvements in productivity, growth in perm NFI, rising NFI margins and its operationally geared model thereby producing a marked rise in conversion rates. Our longer leading indicator suggests that we are approaching the time when this cyclical sector will see much improved market conditions.

We believe Gattaca is a highly attractive recruitment stock from the point of view of valuation, particularly as the net cash equates to 75% of its market cap. With no change to our estimates, we also retain our Fair Value at 140p / share.

Summary forecasts

Y/e July, £m	FY21A	FY22A	FY23A	FY24E	FY25E
NFI	42.1	44.2	43.4	40.2	42.7
Adj. PBT	1.8	0.3	2.6	2.5	3.0
Adj. EPS (p)	5.3	0.5	4.5	4.7	6.0
DPS (p)	0.0	0.0	5.0	2.5	3.0
EV/NFI	0.1	0.1	0.1	0.1	0.1
EV/EBITDA	1.2	2.0	1.5	1.5	1.3
PER	16.4	181.9	19.1	18.2	14.4
Yield	0.0%	0.0%	5.8%	2.9%	3.5%
Net cash	19.9	12.3	21.6	21.0	20.2

Source: Company historic, ED estimates

Company Data

EPIC	AIM: GATC
Price (last close)	86p
52 weeks Hi/Lo	148p/84p
Market cap	£27.1m
ED Fair Value/share	140p
Net cash at 31/07/24	£21m

Share Price, p



Source: ADVFN

Description

Gattaca plc is a specialist STEM (Science, Technology, Engineering and Mathematics) staffing solutions business. In FY24 the Company delivered net fees of c.£40m – of which approximately 76% was derived from temporary/contract placements, with the remainder comprising permanent placements.

Period end sales headcount at the end of FY24 was 291 (down 7.6% yoy). Sales headcount typically represents more than two-thirds of total employee numbers.

Next news: Preliminary results on 24 October 2024

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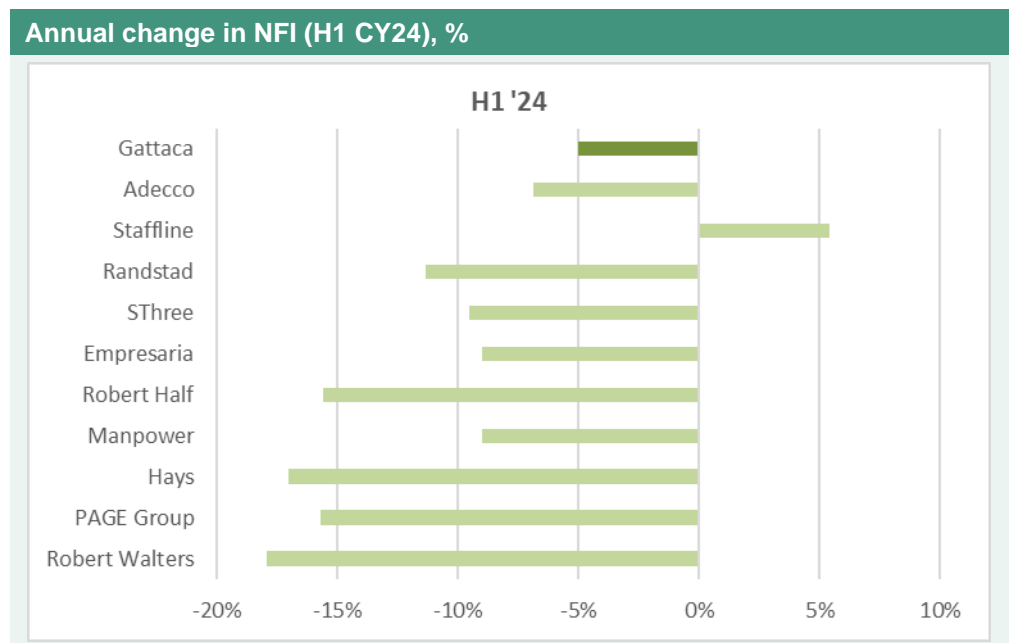
Favourable comparisons

We note the strong relative performance of fee income levels CY24 to date, comparing GATC's H2 (July year-end) and the 1H results of its peer group. Apart from Robert Walters and PAGE Group, all the other incumbents of the sector derive NFI predominantly from contract placements. Gattaca has outperformed most of its peers YTD, as highlighted in the chart below demonstrating the 5% decline yoy in fee income.

It is highly encouraging that contract NFI improved sequentially by 6% during H2 over H1, and that perm NFI stabilised ahead of delivering modest growth during Q4. The former was driven by an improvement in the number of contractors placed (+4% H2/H1) and wage inflation. The rising contract book also resulted in **improved average productivity levels** (+6%) during H2 and as the number of consultants declined yoy.

The improvement in the contract book (demonstrating consistent growth YTD in CY24) underpins our support for the Board's strategy of focusing on areas which are witnessing structural growth and where the Group can build a meaningful market share.

We expect further investment in sales headcount during FY25 as opportunities arise and its markets recover.



Source: Companies data

Valuation thoughts

Re-rating around the corner?

We remain optimistic that economic activity is likely to pick up towards the end of CY24/early CY25, following the uncertain US Presidential election. Our preference as a longer leading indicator of economic activity and in turn, hiring, is the US PMI manufacturing new order index.

Typically, the rebound from a relatively shallow recession (1993-94, 2001-02 and 2022-24) is two-fold, the initial improvement in optimism (as customers increase inventories in the expectation of improved economic activity), followed by actual green shoots emerging several months later (representing the second upwards leg). We are of the opinion that we are currently in the latter category.

Traditionally, the recovery in investor sentiment in the staffing sector tends to be ahead of stabilising NFI trends. In fact, the recent announcements of the UK 'big four' recruiters suggested that fee income had turned down at the end of H1 'CY24, with exit rates in June of -18% yoy.

We think this reflects more the uncertainty created by the UK general election than a further deterioration in economic conditions. The outlook appears consistent with a soft landing and further reductions to interest rates.

Once investor sentiment turns, the valuations of the sector's incumbents are upwards re-rated, reflecting the relative illiquidity of the shares and the highly operationally leveraged business models. One should bear in mind that costs across the sector have been cut aggressively over the last 18 months - and as NFI/productivity improvements feed through, conversion rates typically recover rapidly.

The longer leading indicator relating to the staffing sector



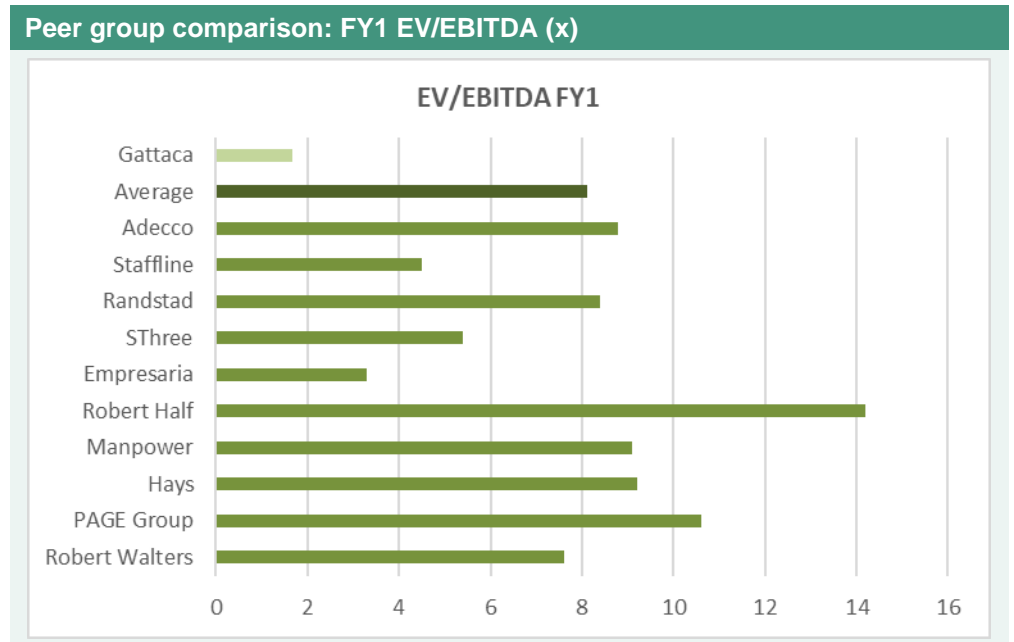
Net cash

The year end net cash was ahead of expectations at £21m and equated to 64.9p/share. On this basis, **the operating business is effectively being valued at just £6.9m**, equating to 3.6x FY24 EBIT or just 2.8x FY25 EBIT. We think the ex-cash market cap/EBIT ratios highlight how undervalued the shares are currently.

We note the mention of an unchanged dividend of 2.5p for the year. No mention was made with regards to a repeat of FY23's special dividend. On that basis, we expect that the Board is looking at other uses for cash, including M&A.

Peer group comparison valuation model

We have compared the valuation of Gattaca to its closest peers, which we believe highlights a significant anomaly on an EV/EBITDA basis, confirming our belief that GATC's shares are significantly underrated.



Source: Companies, Koyfin, ED

Conclusion

With no change to financial estimates, we maintain our 140p/share Fair Value, more than 60% above the current share price. At 140p (ex-cash) Gattaca would trade at a FY25 EBIT multiple of 9.7x.

Financials

The sole change to estimates following the trading update is a positive one and comprises the increase in year end cash of £21m (from £19.8m previously).

We believe our financial estimates for FY25 remain conservative, indicating just c.6% growth yoy in NFI. As a reminder, NFI also improved by 6% on a sequential basis from H1 '24 to H2 '24 in challenging markets. Any easing of conditions is likely to result in an acceleration of fee income levels and, importantly, a return of the higher margin perm revenues.

Summary Income statement					
Year to July, £m	2021A	2022A	2023A	2024F	2025F
Revenue	415.7	403.9	385.2	382.7	397.5
CoGS	-373.6	-359.7	-341.8	-342.5	-354.8
UK NFI	38.6	41.4	41.2	39.1	41.5
International NFI	3.5	2.8	2.2	1.1	1.3
Group NFI	42.1	44.2	43.4	40.2	42.7
NFI margin (%)	10.1%	10.9%	11.3%	10.5%	10.8%
Op costs	-39.8	-44.1	-41.1	-38.3	-40.2
EBITDA	4.4	2.8	3.8	3.6	4.1
EBITDA/NFI conversion (%)	10.5%	6.3%	8.8%	9.0%	9.7%
Adj. EBIT	2.2	0.1	2.3	1.9	2.5
Conversion rate (EBIT/NFI, %)	5.3%	0.2%	5.4%	4.8%	5.9%
Net Interest	-0.4	0.2	0.2	0.6	0.5
PBT (Adjusted)	1.8	0.3	2.6	2.5	3.0
Exceptionals	-0.1	-5.0	0.2	-0.7	-0.3
PBT (Reported)	1.8	-4.7	2.8	1.8	2.7
Tax	-0.1	-0.2	-1.1	-1.0	-1.0
PAT	1.6	-4.9	1.7	0.8	1.7
Profit from discontinued items	-1.2	-0.4	-0.5	0.0	0.0
Minority interests	0.0	0.0	0.0	0.0	0.0
Earnings	0.4	-5.2	1.1	0.8	1.7
EPS (Adjusted) (p)	5.3	0.5	4.5	4.7	6.0
DPS (p)	0.0	0.0	5.0	2.5	3.0
Ave no of shares (FD) (m)	32.4	32.5	32.7	32.4	32.4

Source: Company historics, Equity Development estimates

Summary Cash Flow

Year to July, £m	2021A	2022A	2023A	2024F	2025F
Adj. EBIT	2.2	0.1	2.3	1.9	2.5
Depn. & Amortn.	0.9	3.1	1.6	1.7	1.6
Working capital movement	-5.4	-3.4	6.7	-1.9	-3.2
Other	-4.3	-4.9	1.0	-0.7	-0.1
Operating cash flow	-6.6	-5.1	11.7	1.0	0.8
Net Interest	-0.4	-0.2	0.2	0.6	0.5
Taxation	-0.5	0.3	-0.9	-1.0	-1.0
Net capex	-0.4	-0.4	0.0	-0.3	-0.3
Pref. dividends	0.0	0.0	0.0	0.0	0.0
Operating FCF	-7.9	-5.4	11.0	0.4	0.0
Net (Acquisitions)/Disposals	0.0	0.0	0.0	0.0	0.0
Dividends	0.0	-0.5	-0.5	-1.3	-0.8
Share Issues	0.1	-0.1	-0.7	-0.7	0.0
Minority payment	0.0	0.0	0.0	0.0	0.0
Other financial	0.4	-1.5	-0.5	1.1	0.0
Increase Cash/(Debt)	-7.5	-7.5	9.2	-0.5	-0.8
Opening Net Cash/(Debt)	27.3	19.9	12.3	21.6	21.0
Closing Net Cash/(Debt)	19.9	12.3	21.6	21.0	20.2

Source: Company historic, Equity Development estimates

Abbreviated Balance Sheet

Year to July, £m	2021A	2022A	2023A	2024F	2025F
Intangible Assets	6.3	2.1	2.0	2.0	2.0
Tangible Assets	1.6	1.4	1.0	1.0	1.0
Right of use assets	5.7	3.1	1.9	1.7	1.5
Investments/other	1.0	0.6	0.4	0.4	0.4
Net Working Capital	6.2	11.6	4.4	6.3	9.5
Capital Employed	20.8	18.7	9.7	11.4	14.3
Deferred tax	4.3	0.0	0.1	0.1	0.1
Net Cash/(Debt)	19.9	12.3	21.6	21.0	20.2
Provisions Liabilities/Charges	1.3	0.5	0.4	0.4	0.4
Net Assets	35.1	30.5	30.8	31.9	34.1

Source: Company historic, Equity Development estimates



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