

Upgrading FY21 forecasts & valuation to 280p/share

21 May 2021

It's a heady mix. Lockdown the country, pump £100bns into the economy, displace millions of workers, don't allow them to spend for 12 months, and then push the release button. Hey presto, you end up with a 'V-shaped' recovery, together with a shortage of qualified staff. Particularly anything related to technology, green power & engineering, as corporates accelerate their digitisation plans, alongside the secular expansion of renewables, electrification, defence (cyber & marine) and infrastructure (eg HS2, fibre-to-the-home, Lower Thames Crossing, etc).

Hence providing a favourable backdrop for Gattaca, which helps organisations recruit hard-to-find STEM personnel. Additionally after skilfully navigating the pandemic, the group has emerged far fitter (less cost), healthier (stronger balance sheet) and better placed to benefit from these near buoyant conditions.

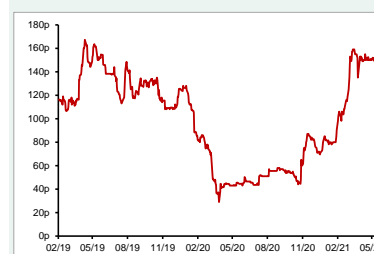
Saying today that FY21 PBT would be "**significantly ahead of expectations**", thanks to strong Q3 NFI growth (+13%) as more perms/contractors were placed, augmented by tight cost control (whilst still investing in headcount) and less disruption caused by the IR35 tax introduction in April. Meaning that **H2 NFI is also anticipated to be 10% higher sequentially** vs H1 (see below), coupled with the reinstatement of a "*modest*" dividend (ED est. of 0.5p, equivalent to a 0.3% yield, rising to 1.0% in FY22).

Similarly, **our NFI and adjusted PBT forecasts have been upgraded to £44.3m (£43.0m B4) and £2.7m (£750k) respectively** - with **net cash** (excluding £12.2m of off B/S non-recourse finance) **closing July '21 at £18m**. Providing plenty of fire power too for the group to increase resource further in sales and service delivery.

Company Data

EPIC	AIM:GATC
Price (last close)	150p
52 weeks Hi / Lo	159p/30p
Market cap	£48.4m
Est. net cash Jul'21 (incl £12.2m benefit from off B/S non-recourse debt)	£18m
Share count	32.3m
ED valuation / share	280p

Share Price, p



Source: Yahoo

Description

Gattaca is the UK's #1 specialist engineering (64% NFI) recruitment agency, providing contract, temporary and permanent staff (Source: Recruitment International). It derives 12% of NFI from overseas (10% Americas & 2% EMEA), with the remainder coming from UK Technology (24%) – overall split 75% contractors and 25% permanents.

The global engineering and technology recruitment markets are valued at circa \$26bn and \$57bn respectively (Source: Staffing Industry Analysts) – offering substantial long term potential.

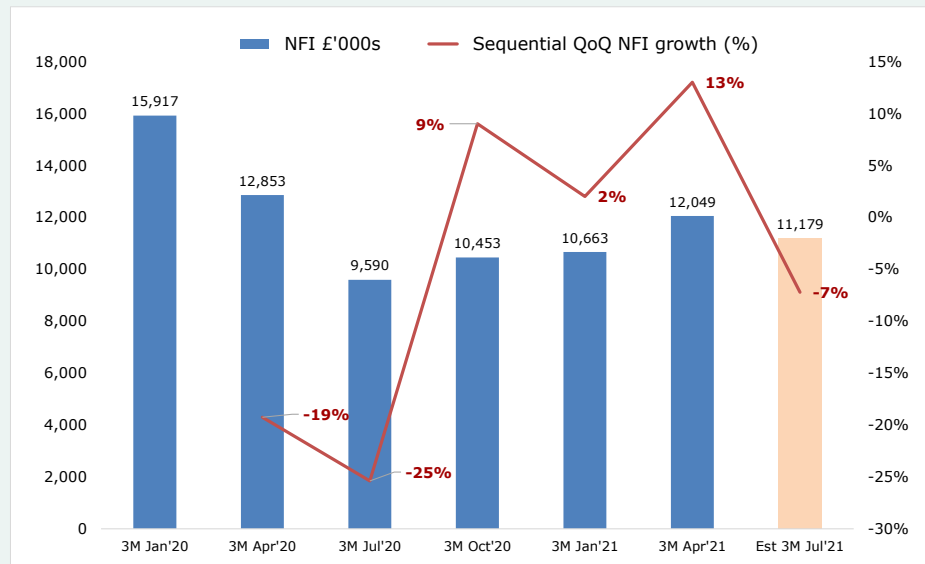
Next news: Trading update in Aug'21

Paul Hill (Analyst)

0207 065 2690

paul.hill@equitydevelopment.co.uk

Quarterly NFI is recovering strongly

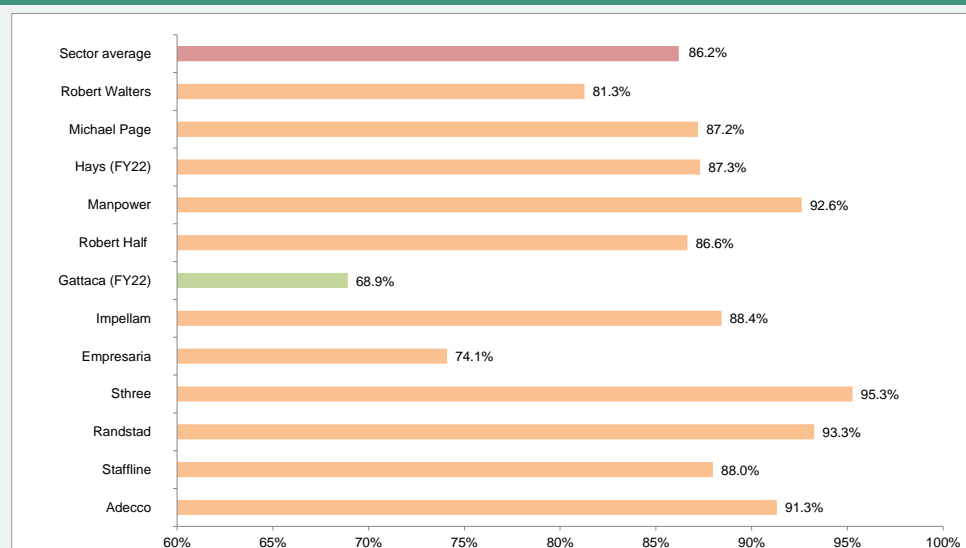


Source: Equity Development estimates

This is just the start, though. The Bank of England recently lifted its 2021 GDP growth estimates from 5% to 7.25% and to 5.25% for next year, implying the locomotive is unlikely to derail anytime soon. Plus, Gattaca was one of the sector's hardest hit by Covid, and so still has the greatest upside potential with regards to returning to pre-pandemic levels (see overleaf).

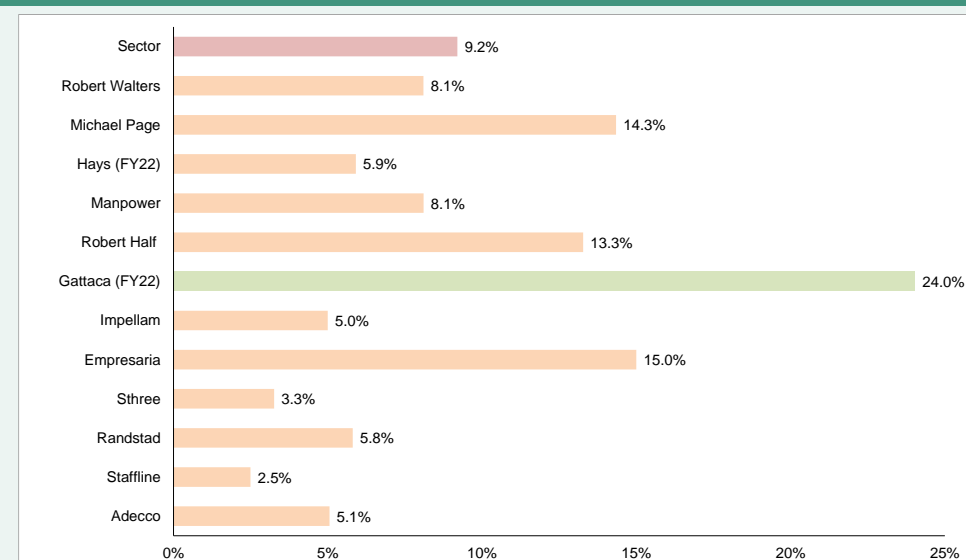
Our estimates remained conservatively biased

Current year NFI as a % of pre Covid levels



Source: Equity Development.

Expected current year NFI growth across recruitment sector

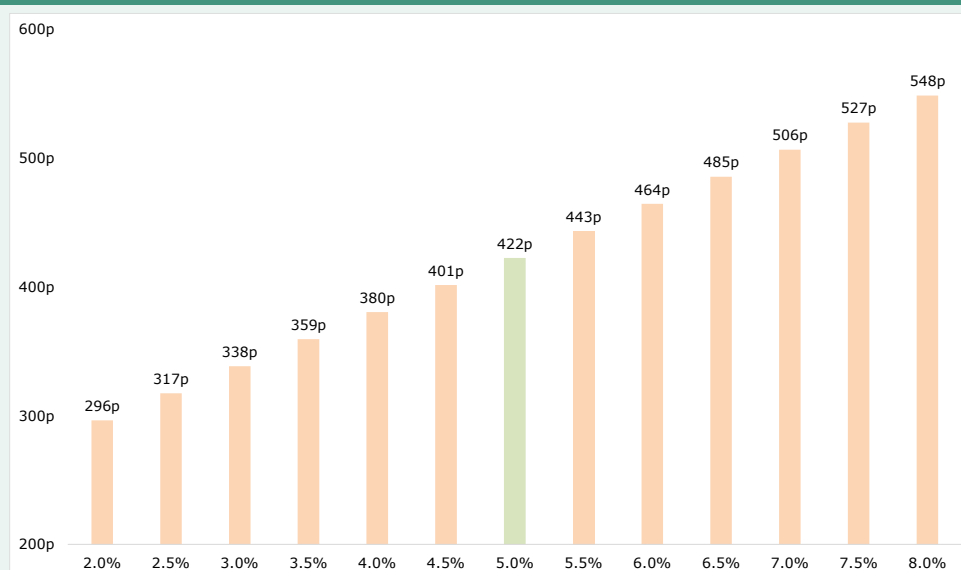


Source: Equity Development. Note: GATC FY22 NFI at 28% vs -20.8% FY21 & -21.4% FY20.

Plenty of further upside potential too

Accordingly, we have raised **our valuation from 225p to 280p per share**. Albeit ultimately, if the firm can consistently deliver NFI growth above GDP on top of mid-high teen EBIT/NFI conversion across the economic cycle, then the stock would rightly deserve at least a 10x EV/EBIT multiple. Lifting it to possibly >420p by 2024 (see below).

Possible Gattaca shareprice by 2024 at a range of LFL NFI growth rates



Source: Equity Development hypothetical price estimates

In fact, even after the recent price appreciation the **shares at 150p still trade on frugal FY22 multiples of 7.4x EV/EBIT & 11.3x PER** vs 12.8x & 20.9x for peers (see below).

FY21 valuation benchmarks vs peers



Source: Equity Development.

Double digit H2'21 NFI growth vs H1

CEO Kevin Freeguard adding: "We are pleased with our Q3 performance. Our people are capitalising on the opportunities to move us at pace as we grow beyond the pandemic. **The strategy and focus on STEM skills and Contract staffing is serving us well and we are seeing improved underlying activity across our core markets, including Infrastructure and Defence**".

Key risks

- Coronavirus induced problems which could delay the anticipated economic recovery.
- General economic downturn affecting engineering and technology recruitment.
- Greater competition, especially from new technology platforms (eg LinkedIn, Monster).
- Overseas expansion along with foreign exchange fluctuations.
- Consolidation of customer base.
- Gattaca is presently assisting the US Department of Justice in their enquiries about certain Networkers International activities prior to its 2015 acquisition.

Summary projections ('000s)

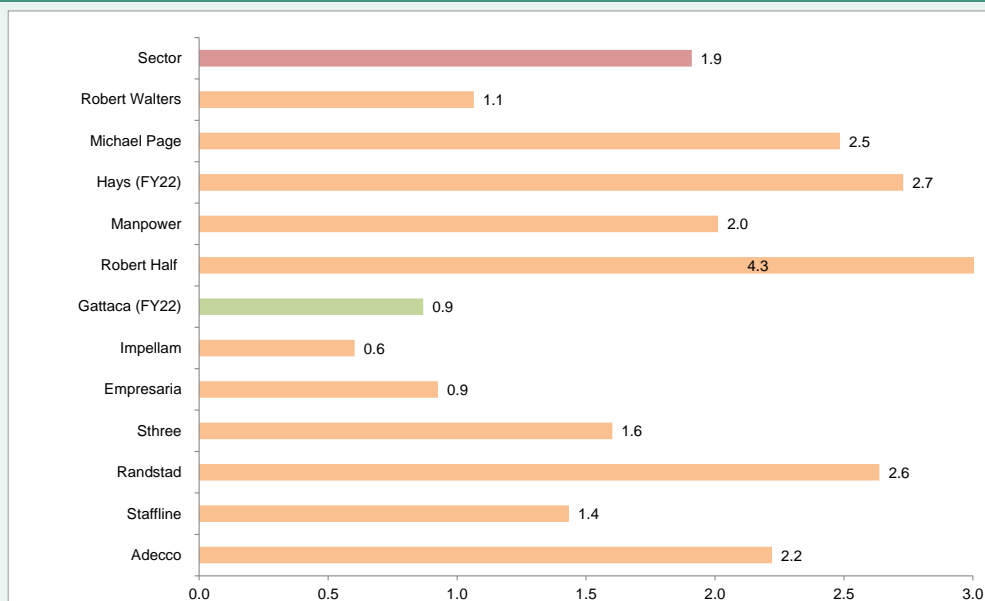
Gattaca (continuing operations) (July yearend)	2016 Act £'000s	2017 Act £'000s	2018 Act £'000s	2019 Act £'000s	2020 Act £'000s	2021 Est £'000s	2022 Est £'000s	2023 Est £'000s	2024 Est £'000s
Net Fee Income (NFI) : Gross profit			<i>Restated</i>	<i>Restated</i>					
UK Engineering	40,865	43,080	47,568	49,442	34,177	28,344	32,046	38,455	44,223
UK Technology	17,413	16,178	14,457	11,575	13,602	11,000	16,830	20,196	23,225
International	14,109	15,450	9,374	8,038	6,497	5,000	6,124	7,348	8,451
Total	72,387	74,708	71,399	69,055	54,276	44,344	55,000	66,000	75,899
NFI growth rate									
UK Engineering	8.0%	5.4%	10.4%	3.9%	-30.9%	-17.1%	13.1%	20.0%	15.0%
UK Technology	19.2%	-7.1%	-10.6%	-19.9%	17.5%	-19.1%	53.0%	20.0%	15.0%
International		9.5%	-39.3%	-14.3%	-19.2%	-23.0%	22.5%	20.0%	15.0%
Total NFI growth rate	38.0%	3.2%	-4.4%	-3.3%	-21.4%	-18.3%	24.0%	20.0%	15.0%
EBITDA	22,617	18,284	13,395	14,888	9,237	5,850	9,100	13,781	16,569
UK Engineering	23,126	23,758	26,033	27,489	20,913	15,306	16,984	20,766	23,881
UK Technology	8,229	7,061	6,610	5,902	7,061	4,400	6,732	8,280	9,522
International	6,868	5,619	2,723	1,860	1,300	1,750	2,143	2,939	3,380
Central overheads	-16,726	-19,050	-22,964	-21,565	-23,282	-18,106	-19,360	-20,909	-23,000
Adjusted EBIT	21,497	17,388	12,402	13,686	5,992	3,350	6,500	11,077	13,784
Total Opex as % NFI	-70.3%	-76.7%	-82.6%	-80.2%	-89.0%	-92.4%	-88.2%	-83.2%	-81.8%
EBIT / NFI margin	29.7%	23.3%	17.4%	19.8%	11.0%	7.6%	11.8%	16.8%	18.2%
Net interest	-1,076	-1,232	-1,540	-2,032	-1,404	-650	-500	-450	-400
Adjusted PBT	20,421	16,156	10,862	11,654	4,588	2,700	6,000	10,627	13,384
Tax	-6,306	-5,076	-3,380	-2,501	-1,271	-756	-1,680	-2,975	-3,747
Minorities	0	-172	-275	0	0	0	0	0	0
Adjusted PAT	14,115	10,908	7,207	9,153	3,317	1,944	4,320	7,651	9,636
Adjusted diluted EPS (p)	44.1	33.7	22.5	27.6	10.3	6.0	13.3	23.4	29.3
Adjusted EPS growth rate	0.5%	-23.6%	-33.3%	22.9%	-62.9%	-41.5%	121.1%	76.2%	25.3%
Dividend (p)	23.0	23.0	3.0	0.0	0.0	0.5	1.5	3.0	4.5
Dividend yield	15.3%	15.3%	2.0%	0.0%	0.0%	0.3%	1.0%	2.0%	3.0%
Dividend cover	1.9	1.5	7.5						
Valuation benchmarks									
P/E ratio (diluted)	3.4	4.5	6.7	5.4	14.6	25.0	11.3	6.4	5.1
EV/NFI	0.66	0.64	0.67	0.69	0.88	1.08	0.87	0.72	0.63
EV/EBITDA	2.1	2.6	3.6	3.2	5.2	8.2	5.3	3.5	2.9
EV/EBITA (diluted)	2.2	2.7	3.9	3.5	8.0	14.3	7.4	4.3	3.5
PEG ratio	6.54	-0.19	-0.20	0.24	-0.23	-0.60	0.09	0.08	0.20
Adjusted corporate tax rate	-30.9%	-31.4%	-31.1%	-21.5%	-27.7%	-28.0%	-28.0%	-28.0%	-28.0%
Adj ROACE	19.7%	15.6%	13.1%	18.5%	8.5%	4.8%	8.9%	14.1%	16.1%
EBITDA drop through rate as % NFI	21.3%	-186.7%	147.7%			34.1%	30.5%	42.6%	28.2%
Net recourse cash/(debt)	-25,013	-40,288	-40,874	-24,822	27,341	18,000	14,732	18,846	24,670
Non recourse invoice factoring (off Balance Sheet)					-13,800	-12,200	-12,200	-12,200	-12,200
HMRC deferred VAT					-10,300	-5,150			
Net debt : EBITDA (incl HMRC & factoring)	1.1	2.2	3.1	1.7	-0.4	1.0	0.3	0.5	0.8
Diluted sharecount (Adj for 2015)	32,040	32,392	32,079	33,144	32,353	32,416	32,578	32,740	32,904
Shareprice (p)	150p								

Source: Equity Development

Note 1: Our financial projections and valuation do not factor in any possible future DOJ redress and/or fines

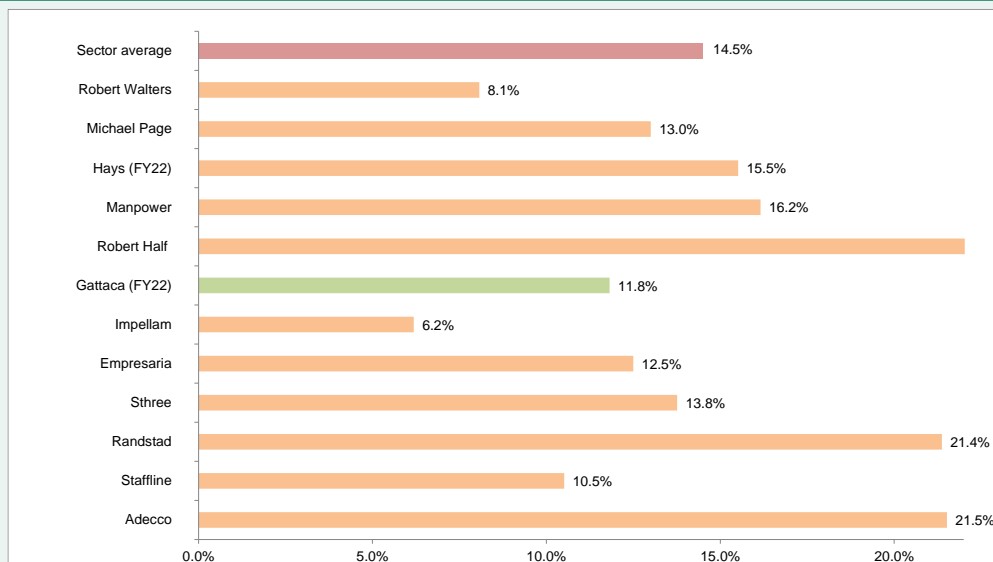
Appendices - sector valuation metrics and KPIs

Current Year (CY) EV/NFI multiples vs peers



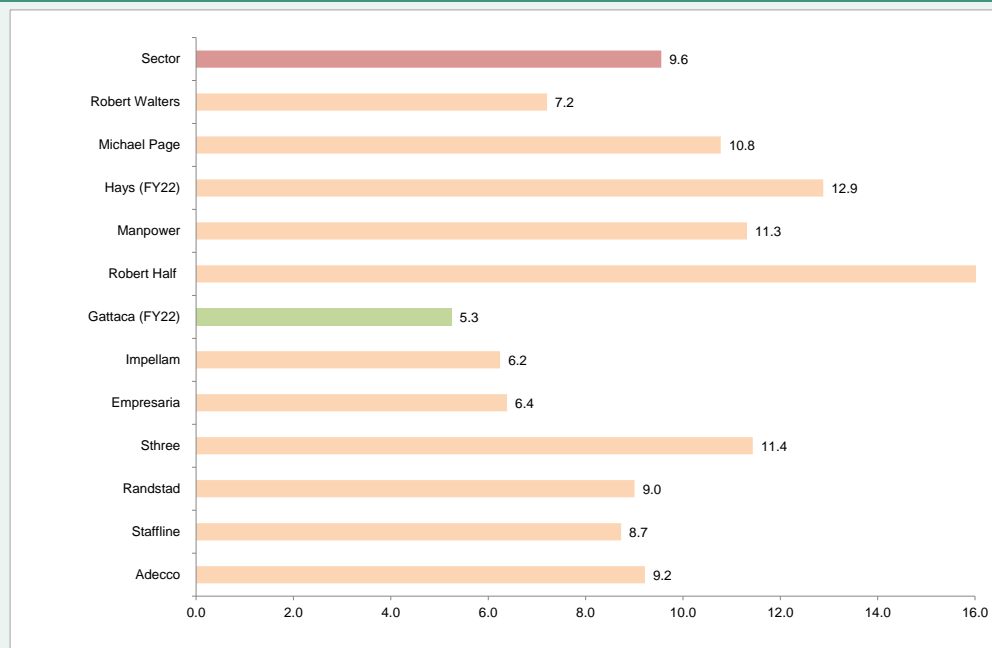
Source: Equity Development

Current Year (CY) EBIT / NFI conversion rates



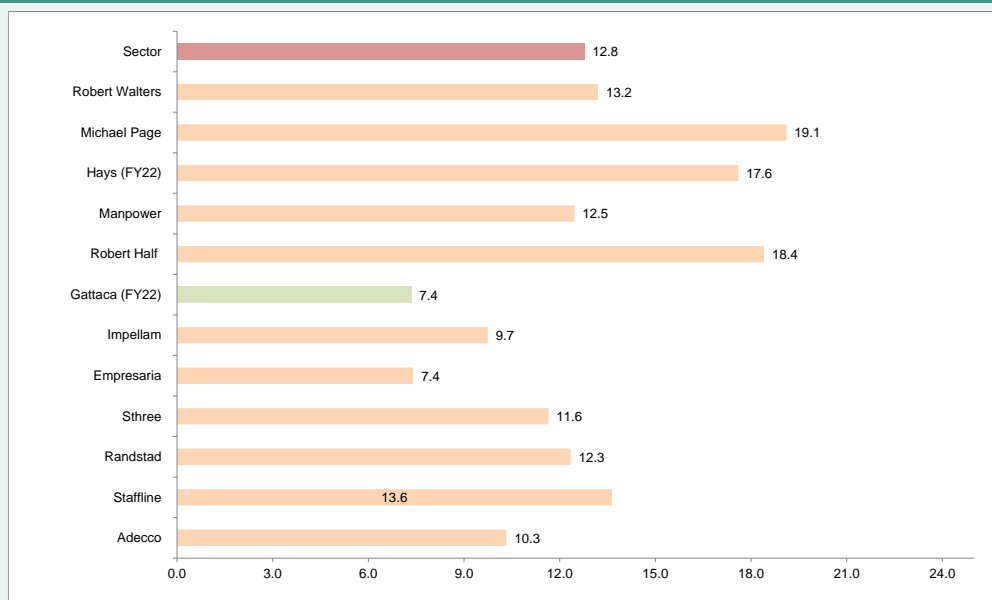
Source: Equity Development

CY EV/EBITDA multiples vs peers



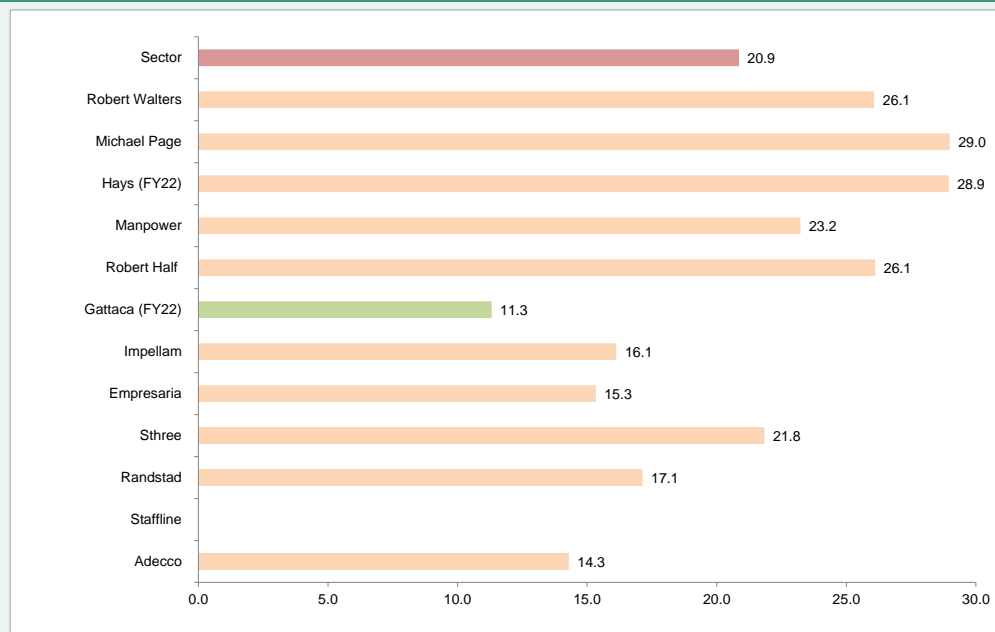
Source: Equity Development

CY EV/EBIT multiples vs peers



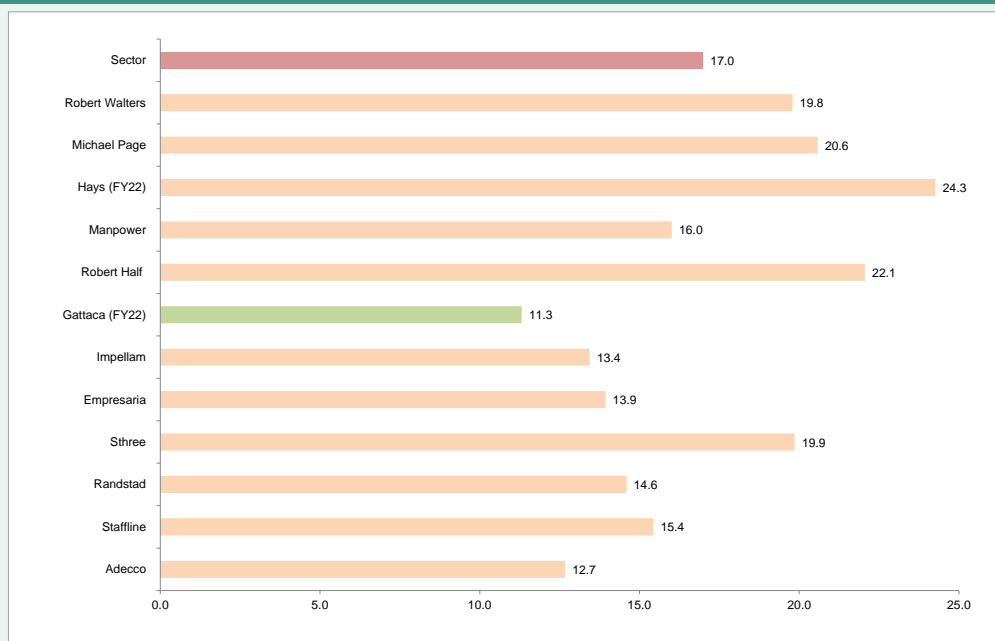
Source: Equity Development

CY PERs multiples vs peers



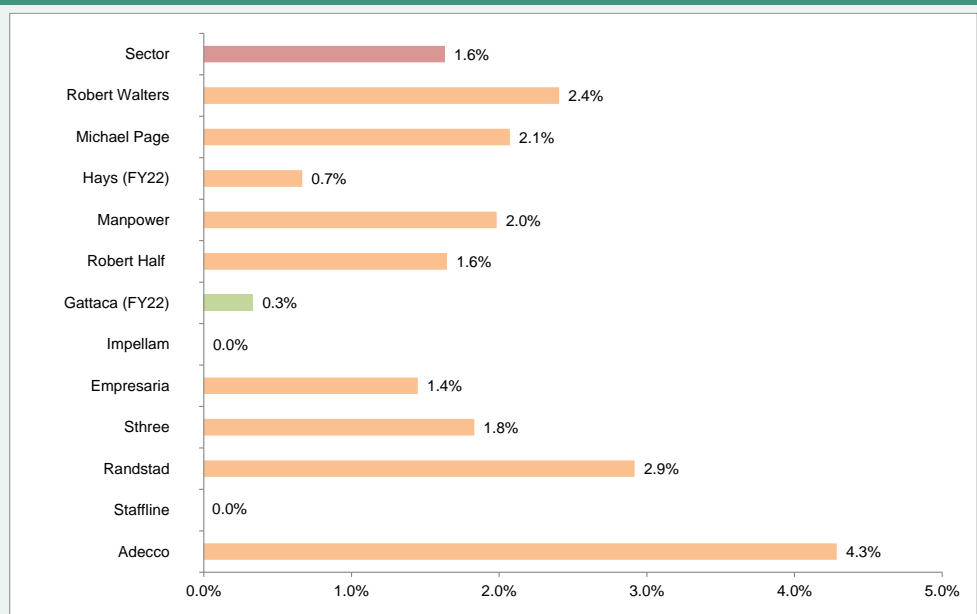
Source: Equity Development

CY+1 PERs multiples vs peers



Source: Equity Development

CY dividend yield (%)



Source: Equity Development

Market capitalisation of peers

	Shareprice	Mrk Cap (Millions)	CY net cash / (debt) Millions	Enterprise Value (Millions)
Adecco	€ 54.60	€ 9,446	€ 310	€ 9,136
Staffline	71p	£48.9	-£60.2	£109.1
Randstad	€ 61.00	€ 11,285	-€ 342	€ 11,627
Sthree	415p	£552.0	£36.2	£515.8
Empresaria	69p	£33.8	-£17.3	£51.1
Impellam	284p	£130.6	-£15.5	£146.1
Gattaca (FY22)	150p	£48.4	£0.7	£47.8
Robert Half	\$88.00	\$9,944	\$465	\$9,479
Manpower	\$118.00	\$6,844	\$554	\$6,290
Hays (FY22)	165p	£3,072	£380	£2,692
Michael Page	603p	£1,936	£82	£1,854
Robert Walters	665p	£506.1	£155.0	£351.1

Source: Equity Development



Contacts

Andy Edmond

Direct: 020 7065 2691

Tel: 020 7065 2690

andy@equitydevelopment.co.uk

Hannah Crowe

Direct: 0207 065 2692

Tel: 0207 065 2690

hannah@equitydevelopment.co.uk

Equity Development Limited is regulated by the Financial Conduct Authority

Disclaimer

Equity Development Limited ('ED') is retained to act as financial adviser for its corporate clients, some or all of whom may now or in the future have an interest in the contents of this document. ED produces and distributes research for these corporate clients to persons who are not clients of ED. In the preparation of this report ED has taken professional efforts to ensure that the facts stated herein are clear, fair and not misleading, but makes no guarantee as to the accuracy or completeness of the information or opinions contained herein.

This document has not been approved for the purposes of Section 21(2) of the Financial Services & Markets Act 2000 of the United Kingdom ('FSMA'). Any reader of this research should not act or rely on this document or any of its contents. This report is being provided by ED to provide background information about the subject of the research to relevant persons, as defined by the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005. This document does not constitute, nor form part of, and should not be construed as, any offer for sale or purchase of (or solicitation of, or invitation to make any offer to buy or sell) any Securities (which may rise and fall in value). Nor shall it, or any part of it, form the basis of, or be relied on in connection with, any contract or commitment whatsoever.

Research produced and distributed by ED on its client companies is normally commissioned and paid for by those companies themselves ('issuer financed research') and as such is not deemed to be independent as defined by the FCA, but is 'objective' in that the authors are stating their own opinions. This document is prepared for clients under UK law. In the UK, companies quoted on AIM are subject to lighter due diligence than shares quoted on the main market and are therefore more likely to carry a higher degree of risk than main market companies.

ED may in the future provide, or may have in the past provided, investment banking services to the subject of this report. ED, its Directors or persons connected may at some time in the future have, or have had in the past, a material investment in the Company. ED, its affiliates, officers, directors and employees, will not be liable for any loss or damage arising from any use of this document, to the maximum extent that the law permits.

More information is available on our website www.equitydevelopment.co.uk

Equity Development, 15 Eldon Street, London, EC2M 7LD

Contact: info@equitydevelopment.co.uk | 020 7065 2690