Gattaca Plc

'New' Gattaca on track and well positioned

24 October 2024

For Gattaca FY24 was predominantly about self-help, ensuring that the business was in good shape to take maximum advantage once the market turns and to improve its market share in the short term. The good news is that the FY24 results were in-line with revised expectations and there are positive signs in terms of initial recovery in fee income.

Net cash currently represents more than 70% of the market capitalisation, valuing the operating business at, or close to, historically low levels. With no change to estimates we retain our 140p fair value / share estimate.

Ongoing execution of strategy

Progress was made during what was a challenging year to meet many of the Board's strategic goals. This included focusing staff numbers to align with the greatest opportunities, not least in Energy (renewables/transmission/distribution), albeit at the period end the full impact of the hiring was yet to be seen. The closure of the US operations and a reduction in fee earners in non-focus areas and in back-office positions helped to reduce OpEx by 10% yoy (-£1m).

We think the refocusing of consultants to higher growth sectors is likely to pay off during the current year as productivity improves. The contract book also increased during H2, as the Group grew its market share. The lower cost base is beneficial as fee income improves (whether via productivity and/or market share gains or in due course a recovery in its markets), exacerbating the effect of the Group's inherent operational gearing.

In fact, with regards to improving NFI, good momentum was witnessed during H2 whereby fee income rose 3.8% on a half-yearly sequential basis and was at the highest level in three half-yearly periods. We highlight within the document where we think we are in the cycle, citing examples to confirm our view that the UK and contract markets are in the process of bottoming out. This appears encouraging for the recruitment sector and particularly for Gattaca.

Low ratings appear unjustified

There is little evidence yet of recovery in the Group's share price with over 70% of the market capitalisation in cash, valuing the operating business at low multiples.

With no change to financial estimates, we remain positive on the company's prospects and retain our 140p fair value per share assessment.

FY Estimates

Y/e July, £m	FY22A	FY23A	FY24A	FY25E
NFI	44.2	42.2	40.1	42.6
EBITDA	2.8	4.8	3.7	3.8
Adj. PBT	0.3	3.7	2.9	3.0
Adj. EPS (p)	0.5	10.5	2.4	6.0
DPS (p)	0.0	5.0	2.5	3.0
EV/NFI	0.2	0.2	0.2	0.2
EV/EBITDA	2.4	1.4	1.8	1.8
PER	189.9	8.6	37.5	15.0
Yield	0.0%	5.6%	2.8%	3.3%
Net cash	12.3	21.6	20.7	19.6

Source: Company historics, ED estimates

Company Data

EPIC	AIM: GATC
Price (last close)	90p
52 weeks Hi/Lo	150p/83p
Market cap	£28.4m
ED Fair Value/share	140p
Net cash (at 30/09/24)	£20.7m

Share Price, p

Source: ADVFN

Description

Gattaca plc is a specialist STEM (Science, Technology, Engineering and Mathematics) staffing solutions business.

Next news

AGM in December '24

David O'Brien (Analyst)
0207 065 2690
david@equitydevelopment.co.uk

Andy Edmond
0207 065 2691
andy@equitydevelopment.co.uk

Early signs of progress visible

Preliminary results							
£m	**H1 23A**	**H2 23A**	**FY23A**	**H1 24A**	**H2 24A**	**FY24A**	**Change, yoy**
UK	189.0	189.7	378.6	185.8	200.5	386.3	2.0%
International	3.8	-0.3	3.5	2.6	0.6	3.3	-5.4%
Total revenue	192.8	189.3	382.1	188.4	201.1	389.5	1.9%
CoGS	-172.0	-167.9	-339.9	-168.8	-180.7	-349.5	2.8%
NFI	22.5	19.7	42.2	19.7	20.4	40.1	-5.1%
NFI margin (%)	11.7%	10.4%	11.0%	10.4%	10.2%	10.3%	-6.9%
NFI/Consultant	131.5		121.7	127.8		130.1	6.9%
NFI/Employee	90.7		84.1	89.2		88.9	5.7%
OpEx	-21.8	-17.1	-38.9	-19.3	-18.6	-37.9	-2.6%
Adj. EBITDA	1.5	3.3	4.8	1.1	2.6	3.7	-21.6%
EBITDA (%)	6.6%	16.6%	11.3%	5.8%	12.7%	9.3%	
Adj. EBIT	0.8	2.6	3.3	0.4	1.8	2.2	-34.2%
Conversion rate (%)	3.4%	13.1%	7.9%	1.9%	8.9%	5.5%	
Net i/r	0.0	0.3	0.3	0.4	0.3	0.7	
Adj. PBT	0.7	2.9	3.7	0.8	2.1	2.9	-20.5%
Taxation	-0.2	-0.9	-1.1	-0.3	-0.7	-1.0	
Tax (%)	29.8%	29.9%	29.9%	37.1%	34.4%	35.2%	
Adj. PAT	0.5	2.0	2.6	0.5	1.4	1.9	-26.5%
Adj. EPS (p)	1.6	8.9	10.5	1.6	0.8	2.4	-77.1%
DPS (p)	0.0	2.5	2.5	0.0	2.5	2.5	0.0%
Net cash / (debt)	21.6		21.6	22.3		20.7	-3.7%
Net cash / share (p)	66.2		65.9	70.7		64.1	-2.9%

Source: Company

The results for the year to 31 July were in-line with revised expectations, delivering progress against previously announced strategic goals:

- External focus – built and developed a new business development team and doubled the energy team, with a focus on renewables, plus won two new Solutions projects
- Culture – delivered improvements in internal staff engagement, reduced attrition levels to 31% (FY23: 33%) and won two business awards
- Operational performance - the closure of the US operations and improvements in digital technology internally as well as productivity improvements, and
- Cost rebalancing - continued rationalisation, not least the reduction in property overheads and a slimmed down Board.

Revenues increased modestly overall (+1.9% yoy to £389.5m), although during H2 the improvement was more significant in nature, rising 6.2% up yoy. While NFI was 5.1% lower in the full year, it rose to the highest level in three half-yearly periods during H2, up 3.6% compared to H1.

Similarly, productivity improved by 7% yoy and again to the highest level in three half years during H2, as measured by NFI/sales consultant.

NFI margins declined modestly to 10.3%, mostly reflecting the shortfall in perm activity.

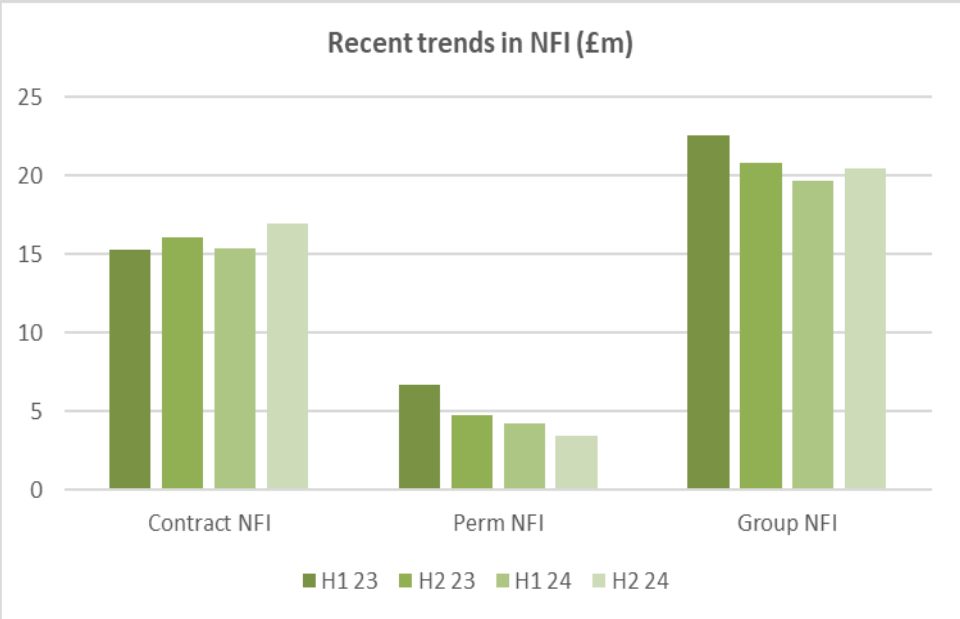
Contract NFI recovered, rising 3% yoy, aided by an increase in the contract book (8% higher than in FY23) and improved productivity levels. Although some teams have been strengthened, especially where the Group envisages above average growth (areas of strategic focus), there is the potential for further uplift as new hires deliver improvements in productivity.

Perm continued to deteriorate, reflecting the continued uncertainty within the global economy, declining 32.8%. However, the comparative period included a RPO (recruitment process outsourcing) contract which the Group chose not to renew due to its low margins. Stripping this out the decline in perm amounted to c.23% yoy, more in line with sector trends.

The most significant growth was delivered by the Gattaca Projects Statements of Work business, where NFI increased by a staggering 35% yoy. The improvement reflected a retention of two major contracts and winning two further projects.

Defence and infrastructure remained the key areas of growth, with recovery also witnessed within the TMT sector. All other areas were affected by the challenging market conditions.

Sequential improvement in NFI, led by contract in H2 '24

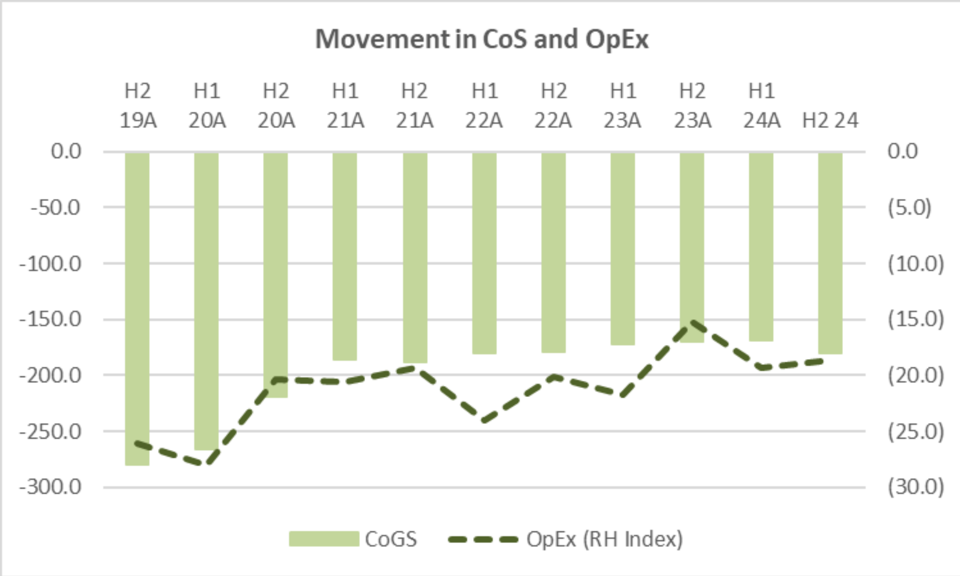


Source: Company

OpEx declined by £1m, reflecting the self-help measures introduced by the Board, with average staff levels declining by 10% and sales consultants reducing 8% during FY24. We note the closure of the Group's US operations, although the region continues to be serviced from both Canada and the UK.

We expect to witness further annualised benefits of the rationalisation programme during the new financial year, placing the Group on a better footing moving forward and enhancing the impact of operational gearing as NFI improves.

OpEx continues to decline into H2'24



Source: Company

Adj. EBIT declined 34% to £2.2m, representing a conversion rate of 5.5%, albeit this increased markedly during H2 to 8.9%. With interest reflecting the strong cash balances and rising to £0.7m versus £0.3m a year earlier, the decline in adj. PBT amounted to 20.5% to £2.9m. Notwithstanding the decline in adj. EPS, the Group maintained the 'through-the-cycle' dividend at 2.5p.

Net cash remained at high levels, notwithstanding the capital reallocation involving share buy backs, purchase for treasury shares, the ordinary and special dividends, just £0.9m lower yoy at £20.7m. Working capital fell, part reflecting a modest improvement in days sales outstanding (DSO's) to 43.

With cash representing over 70% of the Group's market capitalisation, the operating business is significantly undervalued in our opinion.

Valuation

We use both a discounted cash flow model and peer group comparison models to illustrate the degree to which we believe that Gattaca has been overlooked by investors.

Net cash continues at high levels

Perhaps most significantly, the Group's net cash at the year-end amounts to £20.7m, equating to 64.1p / share and representing 74.3% of the current market capitalisation. We think that this represents an anomaly, suggesting that the operating business is valued at just £7.6m.

With estimates left unchanged, we expect FY25 EBIT and PAT to amount to £2.5m and £1.6m, respectively. We have stripped out the impact of interest receivable to earnings.

Our workings suggest that the Group is trading on a FY25 EBIT multiple of just 3.0x and a FY25 PER of only 4.7x.

DCF

We have used conservative estimates of EBITDA, discount rate (equating to the Group's long-term WACC) and terminal growth. Although we are firmly of the view that Gattaca's markets are likely to recover during FY25 and highlight this within an earlier section of the report, we are yet to fully factor this into our financial estimates.

Gattaca: Discounted Cash Flow valuation

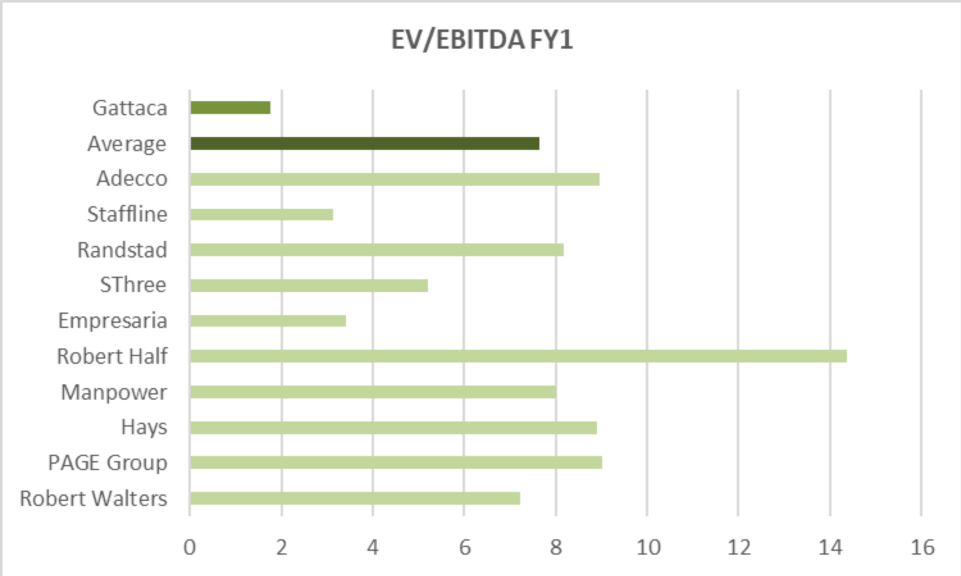
£m, unless otherwise stated	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F	2033F	2034F
Free cash flow	-1.8	0.8	0.8	0.9	0.9	0.9	0.9	0.9	1.0	1.0
WACC (%)	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0
Timing factor	0.3	1.3	2.3	3.3	4.3	5.3	6.3	7.3	8.3	9.3
Discount rate	1.0	0.9	0.8	0.8	0.7	0.6	0.6	0.5	0.5	0.5
Present value	-1.8	0.7	0.7	0.7	0.6	0.6	0.5	0.5	0.5	0.4
Sum of discounted cash flows	3.4									
Terminal growth rate (%)	2.25									
Terminal value	6.6									
Net debt	19.6									
Equity value	29.6									
Number of shares	31.4									
Value per share (p)	94.39									

Source: Equity Development

Peer group comparison models

Gattaca trades to a significant discount to its peer group on a FY1 EV/EBITDA basis, utilised as it takes account of the varied balance sheet net cash/(debt) levels across the sector.

Peer group comparison model: FY1 EV/EBITDA (x)



Source: Koyfin

Conclusion

With no change in estimates (FY25 adj. PBT expectation of £3.0m), we have left our fair value / share unchanged at 140p. This represents a premium of 56% to the current share price. At 140p the forward EBIT multiple would amount to 9.9x.

Market & Outlook

News from the sector has generally been downbeat over the last 18-24 months. The crucial question is how far are we from an inflection point? With just two per cent of NFI derived from international markets, we think it is the right thing when comparing trends to focus on the UK market and contract (which represents 83% of NFI (inclusive of Projects).

Perm is unlikely to recover in the short term but when it does it traditionally peaked at approximately one-third of Group NFI. Perm currently accounts for 19% of NFI and is generally at higher gross margins, thereby improving the margin mix of the business (plus cash generative capabilities).

For comparison purposes, we have looked at the quarterly results of the 'big four quoted UK staffers', comprising Hays, PAGE Group, SThree and Robert Walters. We first seek to determine whether UK NFI has bottomed. While NFI declines remain between 10% to 20% yoy, we think there are signs of the market stabilising on a quarterly basis. This feature is more prominent when considering the performance of PAGE and SThree, with Hays the outlier.

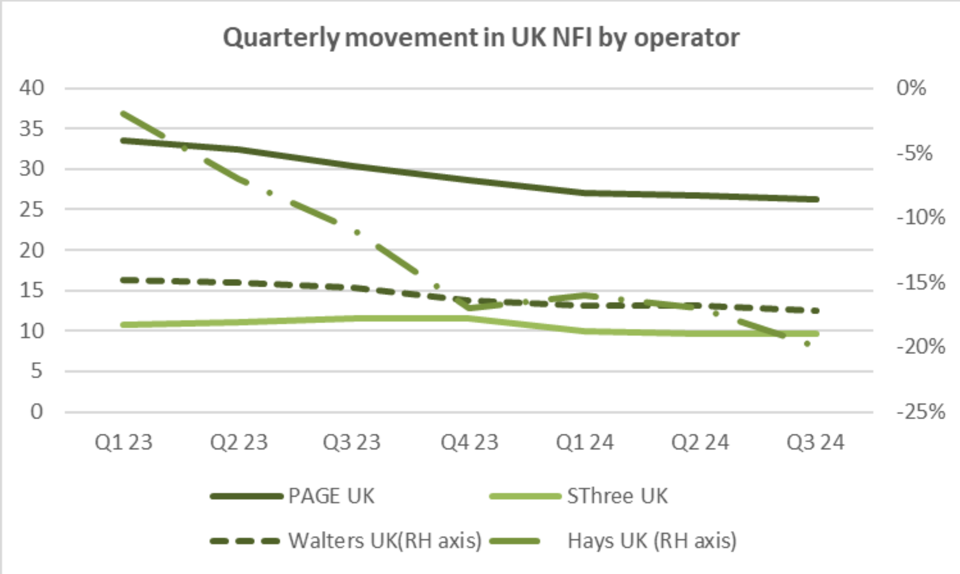
The following chart considers contract NFI revenues, which traditionally reach an inflection point ahead of perm. Here Hays appears to be ahead of its peers, seemingly already passing the inflection point, with the other three at broadly similar levels during the Q1 to Q3 periods in FY24.

On this basis, we remain relatively upbeat in the short term that recovery will begin to seep through.

The pace of recovery will undoubtedly quicken as perm recovers but we believe that we are several quarters away from this happening.

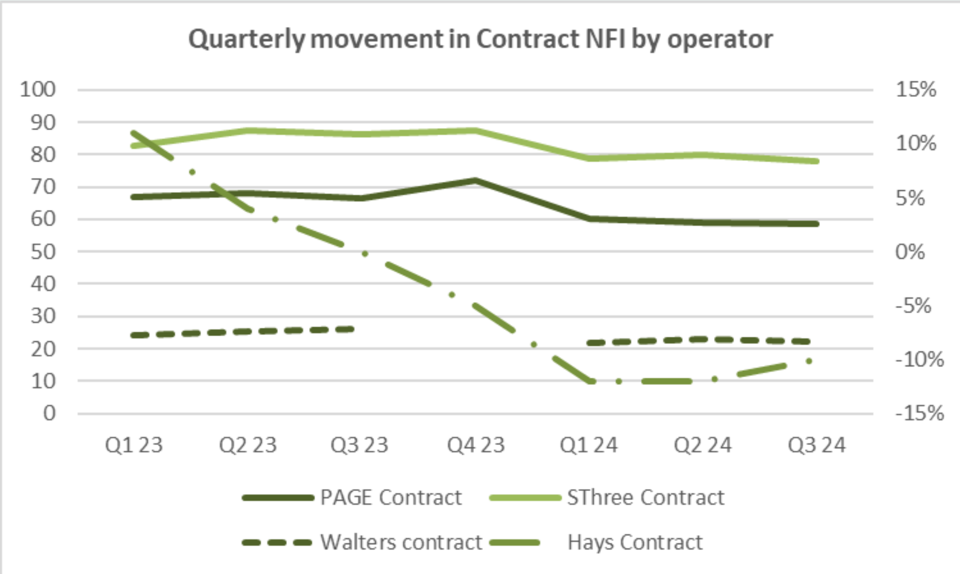
That said, we will also look at the longer-leading indicator for the staffing sector (the US PMI manufacturing new order index) and vacancies in the UK economy.

'Big UK four staffers' – Has UK fee income bottomed?



Source: Companies/ ED

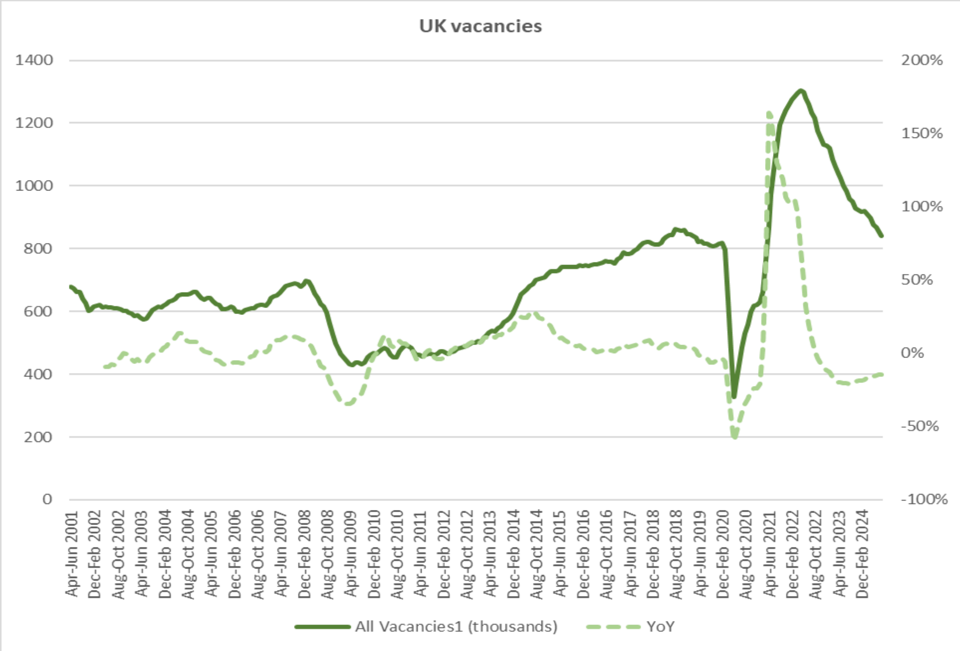
'Big UK four staffers' – Contract NFI flattening globally?



Source: Companies/ ED

While vacancies fell for 27 consecutive periods in the three months to September (*source: ONS*), the level of decline is ameliorating. We have some concerns that if the Employment Rights Bill is passed into law, then this may well have an adverse impact on permanent hiring, albeit boosting contract, as employers no longer benefit from probationary periods when hiring staff.

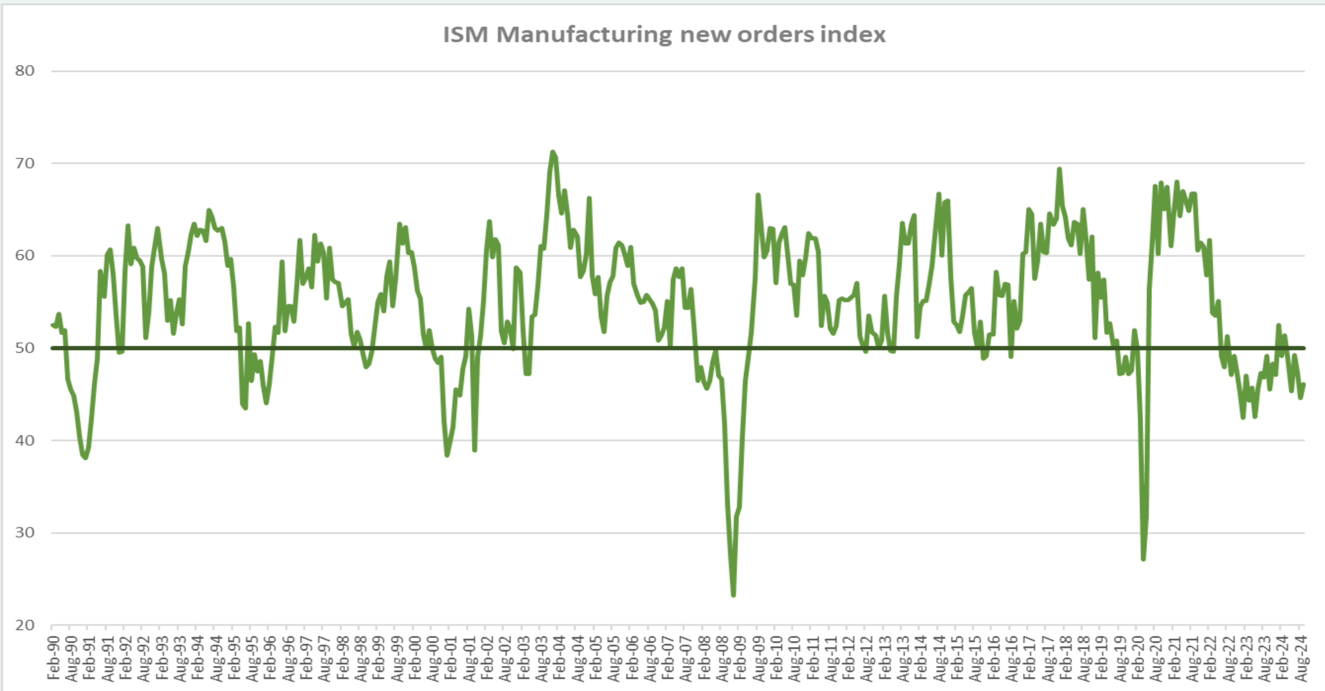
Vacancies continue to decline but remain at elevated levels



We have highlighted previously the reasons why the US manufacturing new orders PMI represents a good indicator of future hiring (new orders usually result in the confidence to hire).

What the following chart highlights, which is consistent with what we have suggested elsewhere, is that we are rapidly approaching an inflection point in hiring. While the index continues to show declines, the scale of shortfall has markedly reduced since the nadir in late 2022 / early 2023:

US PMI manufacturing new order index



Source: Investing.com

Group Financials

In the outlook statement management left guidance unchanged, with its expectation that profitability will be H2 weighted (February 2025 onwards). We think this represents a cautious but necessary approach, in view of the continued uncertainty in its markets and the effect this is having on the permanent hires, particularly with regards to the time to hire. This strongly suggests that a continuation of the self-help stratagems will be beneficial in H1, including:

- A strengthening of the sales team in preferred areas where the Group has a strong market position
- Grow market shares in preferred areas
- Further benefits of the cost rationalisation programme
- Productivity gains
- Continued contractor growth, with growth to potentially accelerate should the new worker's rights bill come into law
- Over the medium term there is scope for perm to increase to previous levels of Group NFI, representing a near doubling from current levels

Summary Income statement

Year to July, £m	2021A	2022A	2023A	2024A	2025F
Revenue	415.7	403.9	382.1	389.5	396.4
CoGS	-373.6	-359.7	-341.8	-349.5	-353.8
UK NFI	38.6	41.4	38.2	39.0	41.4
International NFI	3.5	2.8	2.2	1.1	1.3
Group NFI	42.1	44.2	40.3	40.1	42.6
NFI margin (%)	10.1%	10.9%	10.6%	10.3%	10.8%
Op costs	-39.8	-44.1	-37.0	-37.9	-40.1
EBITDA	4.4	2.8	4.8	3.7	3.8
EBITDA/NFI conversion (%)	10.5%	6.3%	11.8%	9.3%	8.9%
Adj. EBIT	2.2	0.1	3.3	2.2	2.5
Conversion rate (EBIT/NFI, %)	5.3%	0.2%	8.3%	5.5%	5.9%
Net Interest	-0.4	0.2	0.3	0.7	0.5
PBT (Adjusted)	1.8	0.3	3.7	2.9	3.0
Exceptionals	-0.1	-5.0	0.7	-1.2	-0.3
PBT (Reported)	1.8	-4.7	4.4	1.7	2.7
Tax	-0.1	-0.2	-1.1	-1.0	-1.0
PAT	1.6	-4.9	3.3	0.7	1.7
Profit from discontinued items	-1.2	-0.4	-2.2	-0.6	0.0
Minority interests	0.0	0.0	0.0	0.0	0.0
Earnings	0.4	-5.2	1.1	0.1	1.7
EPS (Adjusted) (p)	5.3	0.5	10.5	2.4	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**	**2024A**	**2025F**
Adj. EBIT	2.2	0.1	3.3	2.2	2.5
Depn. & Amortn.	0.9	3.1	1.6	0.6	1.3
Working capital movement	-5.4	-3.4	6.7	1.5	-3.2
Other	-4.3	-4.9	1.0	-1.3	-0.1
Operating cash flow	-6.6	-5.1	12.7	3.0	0.5
Net Interest	-0.4	-0.2	0.2	0.7	0.5
Taxation	-0.5	0.3	-0.9	-0.6	-1.0
Net capex	-0.4	-0.4	0.0	0.0	-0.3
Pref. dividends	0.0	0.0	0.0	0.0	0.0
Operating FCF	-7.9	-5.4	12.0	3.1	-0.3
Net (Acquisitions)/Disposals	0.0	0.0	0.0	0.0	0.0
Dividends	0.0	-0.5	-0.5	-1.6	-0.8
Share Issues	0.1	-0.1	-0.7	-0.8	0.0
Minority payment	0.0	0.0	0.0	0.0	0.0
Other financial	0.4	-1.5	-1.5	-1.5	0.0
Increase Cash/(Debt)	-7.5	-7.5	9.2	-0.8	-1.2
Opening Net Cash/(Debt)	27.3	19.9	12.3	21.6	20.7
Closing Net Cash/(Debt)	19.9	12.3	21.6	20.7	19.6

Source: Company historics, Equity Development estimates

Abbreviated Balance Sheet					
Year to July, £m	**2021A**	**2022A**	**2023A**	**2024A**	**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	20.7	19.6
Provisions Liabilities/Charges	1.3	0.5	0.4	0.4	0.4
Net Assets	35.1	30.5	30.8	31.7	33.4

Source: Company historics, Equity Development estimates

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

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Equity Development, 16-18 Finsbury Circus, London, EC2M 7EB

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