

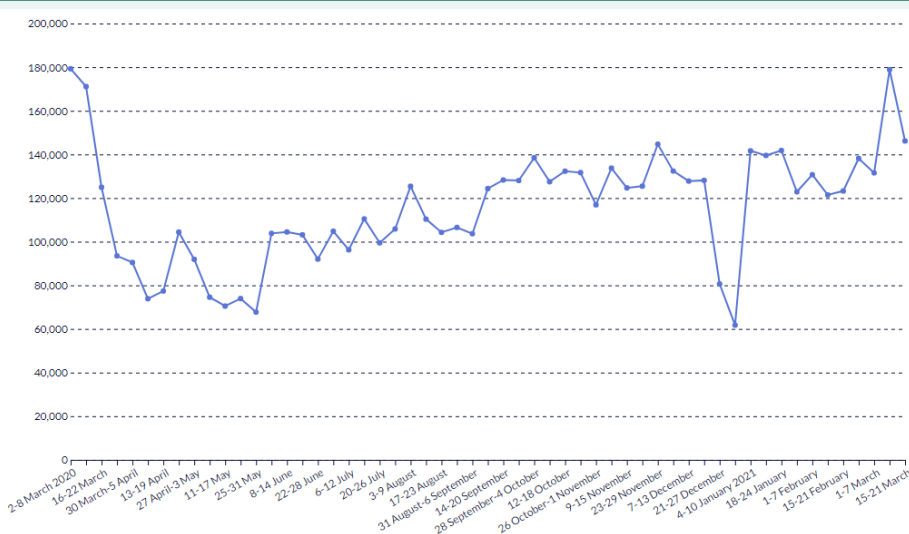
Leading indicators all point towards major rebound

31 March 2021

Looking to book a nice meal-out, UK holiday or even a pint down the pub? Good luck with that. In fact so strong is consumer pent up demand, that Andy Haldane (Bank of England Chief Economist) reckons there will be a 'rip-roaring' recovery later in 2021. As households splurge on 'much-missed' experiences using the £150bn of extra savings they've squirreled away over the last 12 months.

This optimism is also feeding through into the jobs market (see below), house prices, bank stocks and equities. Concrete evidence that people are itching to get back to work, socialise, party hard & exercise thanks to the country's successful vaccination program.

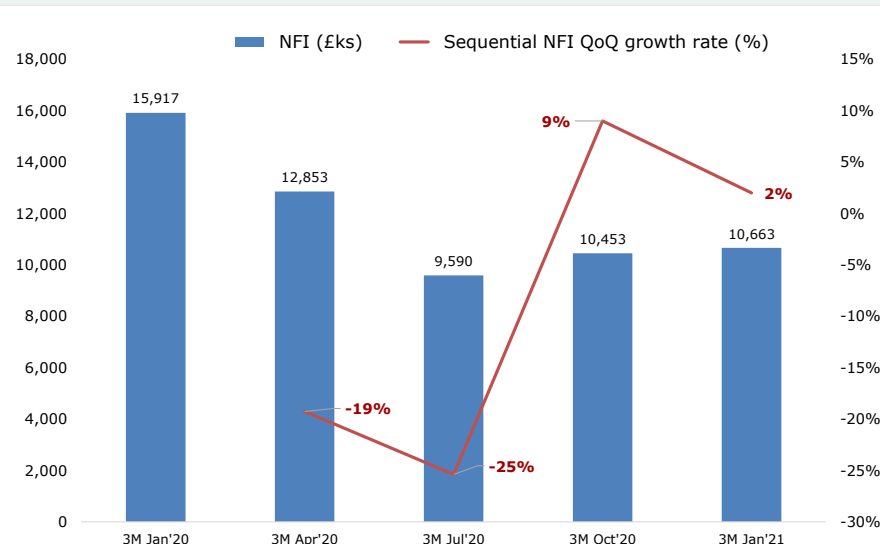
Weekly new job postings



Source: UK Jobs Recovery Tracker - Recruitment and Employment Confederation

Specialist STEM recruiter Gattaca is seeing similar vibes too. Today reporting **sequential LFL NFI growth** over the past 2 quarters (see below), alongside **"improving activity rates"**. Particularly in relation to hiring talent in renewable energy (eg offshore wind), defence & all things tech related.

Quarterly NFI is recovering

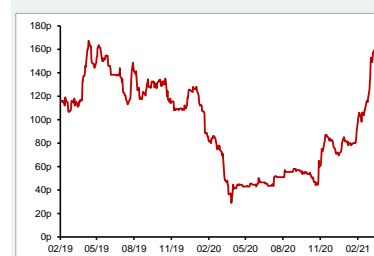


Source: Equity Development estimates

Company Data

EPIC	AIM:GATC
Price (last close)	152p
52 week Hi / Lo	159p / 30p
Market cap	£49.1m
Net cash Jan'21 (incl £12.2m benefit from off B/S non-recourse debt)	£22.7m
Share count	32.3m
ED valuation / share	225p

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

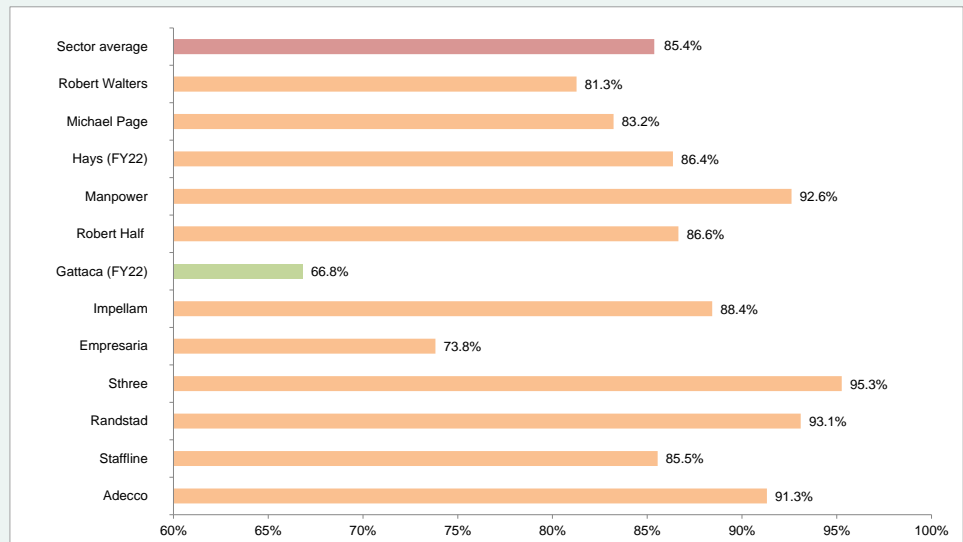
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Set for potentially ‘rip-roaring’ FY22

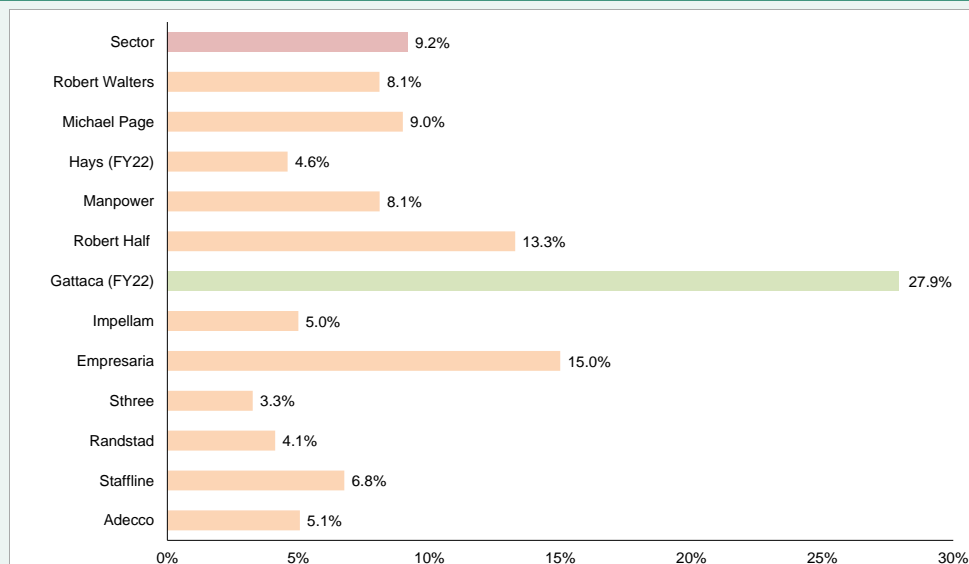
Elsewhere, infrastructure projects (eg HS2, fibre-to-the-home, Lower Thames Crossing, EVs, etc) are starting to gain traction, augmented by buoyant demand for cloud, m-commerce, cybersecurity and AI expertise. All positive tailwinds in light of Gattaca’s rich STEM, contractor (75% of H1’21 NFI - flexible working) and UK heritage. Plus, the firm was one of the sector’s hardest hit by Covid, and hence still has the greatest upside potential with regards to returning to pre-pandemic levels.

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.

So what does this mean about the numbers?

Well, in light of the favourable backdrop and solid H1’21 performance, we are tempted to upgrade our FY21 estimates (see below). Albeit instead have prudently chosen to wait until the next trading update, due to possible disruption caused by Britain’s new private sector IR35 regulations that are being introduced on 6th April.

Nonetheless, **Q2'21 NFI climbed 2% sequentially vs Q1**, which itself was **9% higher than Q4'20**. All told **H1'21 NFI came in at £21.1m** (-34% vs £31.8m LY) with Solutions accounting for 25% (28% LY) - delivering **adjusted PBT of £442k**. Consistent with our FY21 forecasts of £750k, reflecting tight cost control & £4m of annualised savings thanks to the 'Improvement Plan'.

Indeed, underlying administrative costs reduced by 27% to £20.3m (£27.7m LY), mirroring lower headcount (477 vs 681 LY - of which 70% are fee earners) and enhanced productivity. Furthermore the upgrade of GATC's global technology platform (ie PBS) is almost complete. This group-wide platform should not only enable faster/better decision making, but also generate additional efficiencies by replacing a whole host of legacy systems. **Daily contractor rates held up well too**, delivering 7.9% H1 NFI margins in line with LY.

Elsewhere a big 'pat on the back' must go to the finance team. On a LFL basis, we estimate **the company generated £19.3m of incremental cash** between Jan'20 & Jan'21. Leaving **net funds** (pre IFRS16) at a **healthy £22.7m**, excluding £10.2m of deferred VAT (to be repaid equally over 11 months beginning Mar'21) and £12.2m of non-recourse debt (see below) provided by HSBC. So when added to the early repayment of the £15m RCF in Oct'20, **Gattaca is now totally covenant free**.

All the same, the Board has sensibly decided to pass the dividend in light of the residual economic uncertainty, & to provide flexibility for organic growth opportunities that lie ahead.

FY22 should enjoy a major rebound in NFI

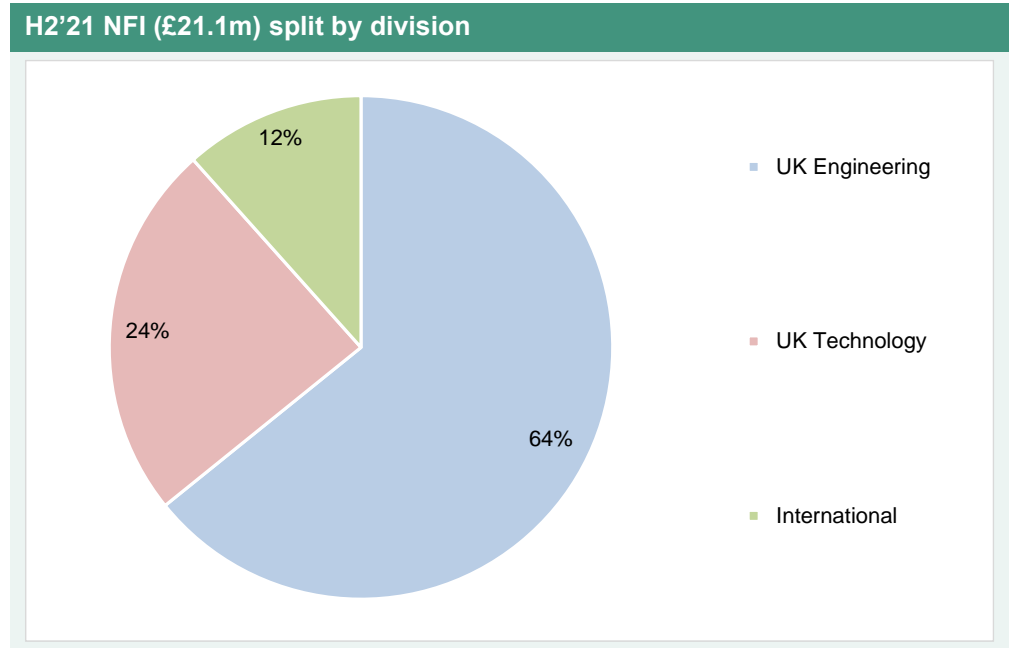
£'000s (continuing) - July y/e	Act H1'20	Act H2	Act FY20	Act H1'21	Est H2'21	Est FY21
UK Engineering	-19.2%	-42.9%	-30.9%	-33.1%	0.2%	-19.5%
UK Technology	23.5%	10.1%	17.5%	-35.4%	-5.4%	-22.8%
International	-27.7%	-4.5%	-19.2%	-33.2%	-9.8%	-23.0%
Total underlying NFI	-12.9%	-31.0%	-21.4%	-33.7%	-2.5%	-20.8%
NFI	31,833	22,443	54,276	21,116	21,884	43,000
Adjusted EBITDA	5,685	3,552	9,237	1,963	1,987	3,950
Adjusted EBIT	4,145	1,847	5,992	772	678	1,450
<i>EBIT/NFI margin</i>	<i>13.0%</i>	<i>8.2%</i>	<i>11.0%</i>	<i>3.7%</i>	<i>3.1%</i>	<i>3.4%</i>
Underlying overheads	27,688	20,596	48,284	20,344	21,206	41,550
U/L admin as % NFI	87.0%	91.8%	89.0%	96.3%	96.9%	96.6%
Adjusted PBT	3,282	1,306	4,588	442	308	750
Tax	-899	-372	-1,271	-93	-117	-210
Minorities	0	0	0	0	0	0
Underlying PAT	2,383	934	3,317	349	191	540
Adjusted EPS (diluted)	7.2p	2.9p	10.3p	1.1p	0.6p	1.7p
NFI (LTM) / head (£ks)	94.5	137.6	81.6			73.5
Overheads / head (£Ks)			72.6			71.0
Headcount	681	665	665			585
<i>Net debt : EBITDA</i>	<i>0.25</i>	<i>-1.48</i>	<i>-0.35</i>			<i>1.22</i>
<i>U/L tax rate</i>	<i>-27.4%</i>	<i>-28.5%</i>	<i>-27.7%</i>			<i>-28.0%</i>
Non-recourse invoice discounting	-16,000	-13,800	-13,800	-12,200	-12,200	-12,200
Deferred VAT			-10,300	-10,300	-5,150	-5,150
Cash /(recourse debt)	-3,075	27,341	27,341	22,744	17,000	17,000

Source: Equity Development. (Nb: Reclassification of Engineering Tech from UK Eng to Tech)

Fine, but how should investors think about H2'21 & beyond

The good news is that despite any short term challenges that Covid might pose to the economy (eg new variants, lockdowns, etc), **the direction of travel is up**. As evidenced by a **6% increase in contractors** to 5,300 (vs 7,200 pre pandemic), and **an 84% jump in average daily new permanent starters** since 1st Jan'21.

Equally, technology skills remain a key growth engine. With extra consultants being hired to target specific verticals - alongside 'fulfilment' staff, which should free up resource for fee-earners to secure new clients.

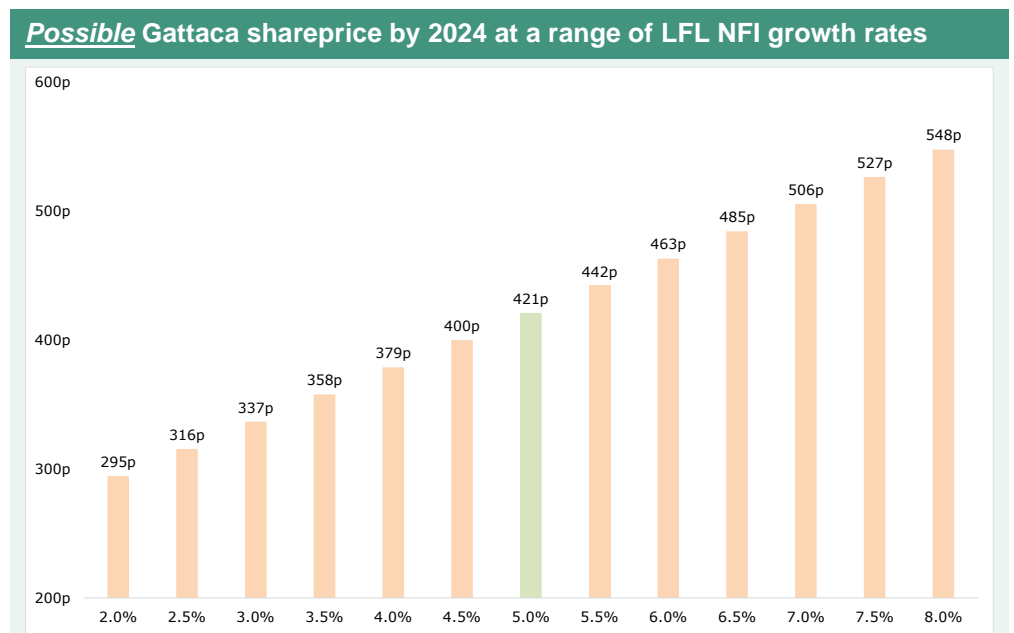


Source: Equity Development

Upgrading valuation from 140p to 225p/share

Thus putting this altogether, we can now see both 'light at the end of the tunnel', and clear blue sky thereafter. In turn, **upgrading our valuation from 140p to 225p per share** – after factoring in a lower risk premium, greater clarity and a UK government that is committed to driving employment & infrastructure investment.

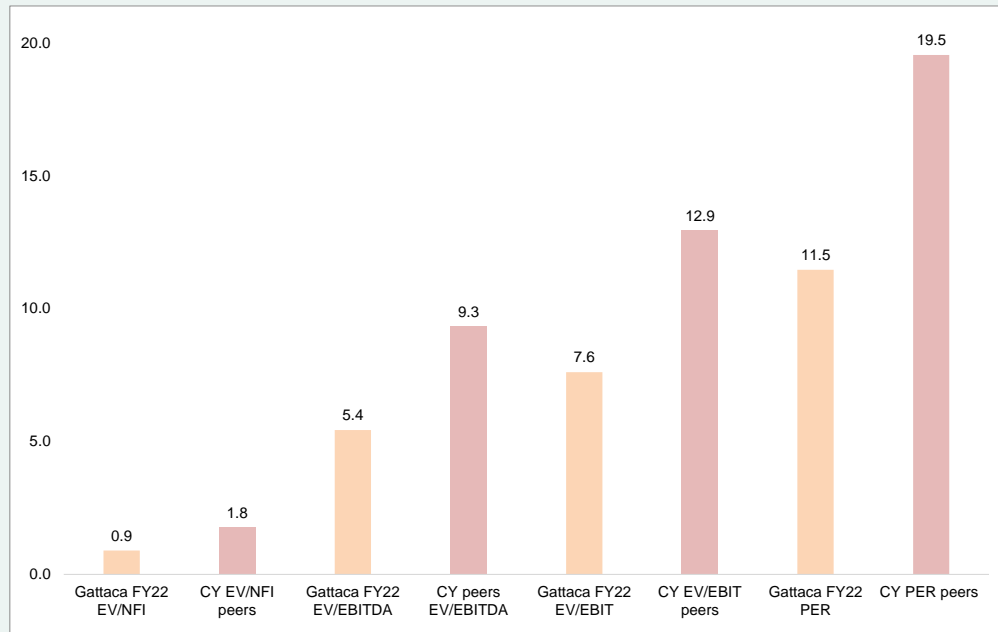
However ultimately, if Gattaca can recapture its 'Mojo' by consistently achieving GDP+ NFI growth coupled with mid-high teen EBIT/NFI conversion across the economic cycle - then the stock would rightly deserve at least a 10x EV/EBIT multiple. Lifting it to possibly >400p by 2024 (see below).



Source: Equity Development hypothetical price estimates

In fact, even after the recent price appreciation, the **shares at 152p still trade on modest FY22 multiples of 7.6x EV/EBIT & 11.5x PER** vs 12.9x & 19.5x for peers (see below).

FY21 valuation benchmarks vs peers



Source: Equity Development.

Higher NFI & lower costs could turbo-charge future profits

CEO Kevin Freeguard adding: “Whilst the pace of the recovery remains uncertain, **we are seeing more encouraging signs in the market and improving activity rates**. Over the coming year we will continue to invest in our people and technology, and the **Board remains confident on the outlook**.”

We expect full year 2021 underlying PBT to be in line with expectations. As demand improves we are making targeted headcount investment in those markets offering the best opportunity for returns, with consultant hiring underway and will be further accelerated in Q4 2021

Gattaca’s focus on STEM skills and Contract staffing, combined with the resilience of our core markets, including Infrastructure and Defence, together with our strong cash position underpins our resilience and positions us well for growth”.

Key risks

- Coronavirus induced problems which could delay the anticipated economic recovery.
- General economic downturn affecting engineering and technology recruitment.
- Possible disruption from the new IR35 rules being introduced across the private sector (re self-employed persons) on 6th April 2021.
- 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.

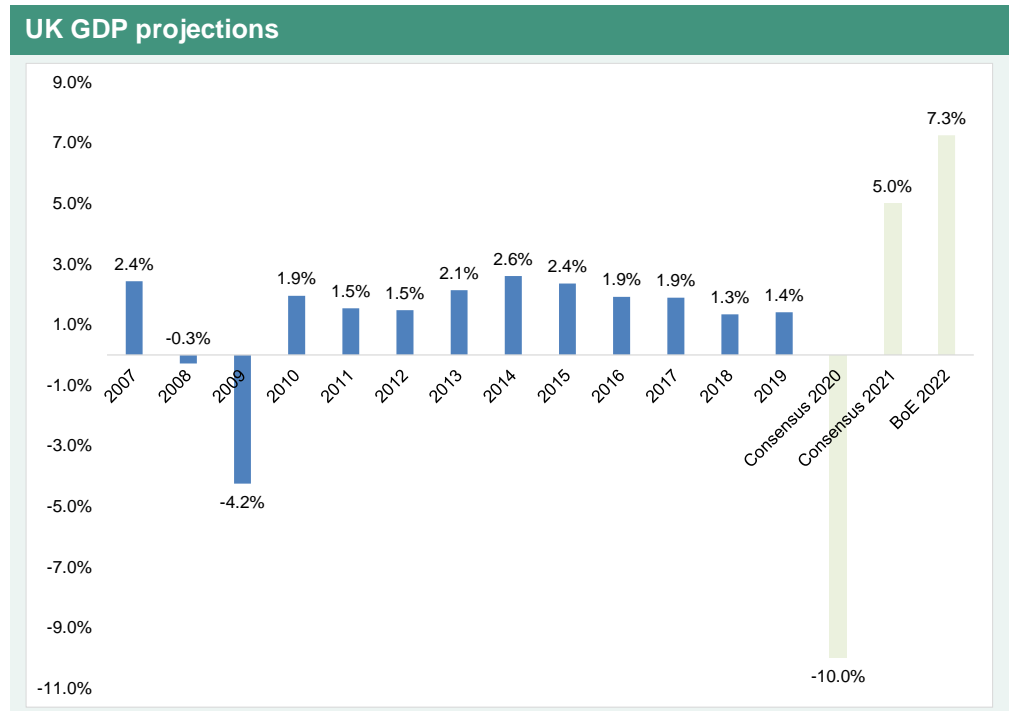
Summary projections

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	27,500	32,046	38,455	44,223
UK Technology	17,413	16,178	14,457	11,575	13,602	10,500	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	43,000	55,000	66,000	75,899
NFI growth rate									
UK Engineering	8.0%	5.4%	10.4%	3.9%	-30.9%	-19.5%	16.5%	20.0%	15.0%
UK Technology	19.2%	-7.1%	-10.6%	-19.9%	17.5%	-22.8%	60.3%	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%	-20.8%	27.9%	20.0%	15.0%
EBITDA	22,617	18,284	13,395	14,888	9,237	3,950	9,100	13,821	16,633
UK Engineering	23,126	23,758	26,033	27,489	20,913	14,300	16,984	20,766	23,881
UK Technology	8,229	7,061	6,610	5,902	7,061	3,990	7,069	8,684	9,987
International	6,868	5,619	2,723	1,860	1,300	1,650	2,143	2,939	3,380
Central overheads	-16,726	-19,050	-22,964	-21,565	-23,282	-18,490	-19,697	-21,272	-23,400
Adjusted EBIT	21,497	17,388	12,402	13,686	5,992	1,450	6,500	11,117	13,848
Total Opex as % NFI	-70.3%	-76.7%	-82.6%	-80.2%	-89.0%	-96.6%	-88.2%	-83.2%	-81.8%
EBIT / NFI margin	29.7%	23.3%	17.4%	19.8%	11.0%	3.4%	11.8%	16.8%	18.2%
Net interest	-1,076	-1,232	-1,540	-2,032	-1,404	-700	-500	-450	-400
Adjusted PBT	20,421	16,156	10,862	11,654	4,588	750	6,000	10,667	13,448
Tax	-6,306	-5,076	-3,380	-2,501	-1,271	-210	-1,680	-2,987	-3,765
Minorities	0	-172	-275	0	0	0	0	0	0
Adjusted PAT	14,115	10,908	7,207	9,153	3,317	540	4,320	7,680	9,683
Adjusted diluted EPS (p)	44.1	33.7	22.5	27.6	10.3	1.7	13.3	23.5	29.4
Adjusted EPS growth rate	0.5%	-23.6%	-33.3%	22.9%	-62.9%	-83.8%	696.0%	76.9%	25.4%
Dividend (p)	23.0	23.0	3.0	0.0	0.0	0.0	0.0	0.0	0.0
Dividend yield	15.1%	15.1%	2.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Dividend cover	1.9	1.5	7.5						
Valuation benchmarks									
P/E ratio (diluted)	3.5	4.5	6.8	5.5	14.8	91.2	11.5	6.5	5.2
EV/NFI	0.68	0.66	0.69	0.72	0.91	1.15	0.90	0.75	0.65
EV/EBITDA	2.2	2.7	3.7	3.3	5.4	12.5	5.4	3.6	3.0
EV/EBIT (diluted)	2.3	2.8	4.0	3.6	8.2	34.1	7.6	4.4	3.6
PEG ratio	6.62	-0.19	-0.20	0.24	-0.24	-1.09	0.02	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%	2.1%	9.0%	14.2%	16.0%
EBITDA drop through rate as % NFI	21.3%	-186.7%	147.7%			46.9%	42.9%	42.9%	28.4%
Net recourse cash/(debt)	-25,013	-40,288	-40,874	-24,822	27,341	17,000	14,220	19,344	26,693
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	1.2	0.2	0.5	0.9
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)	152p								

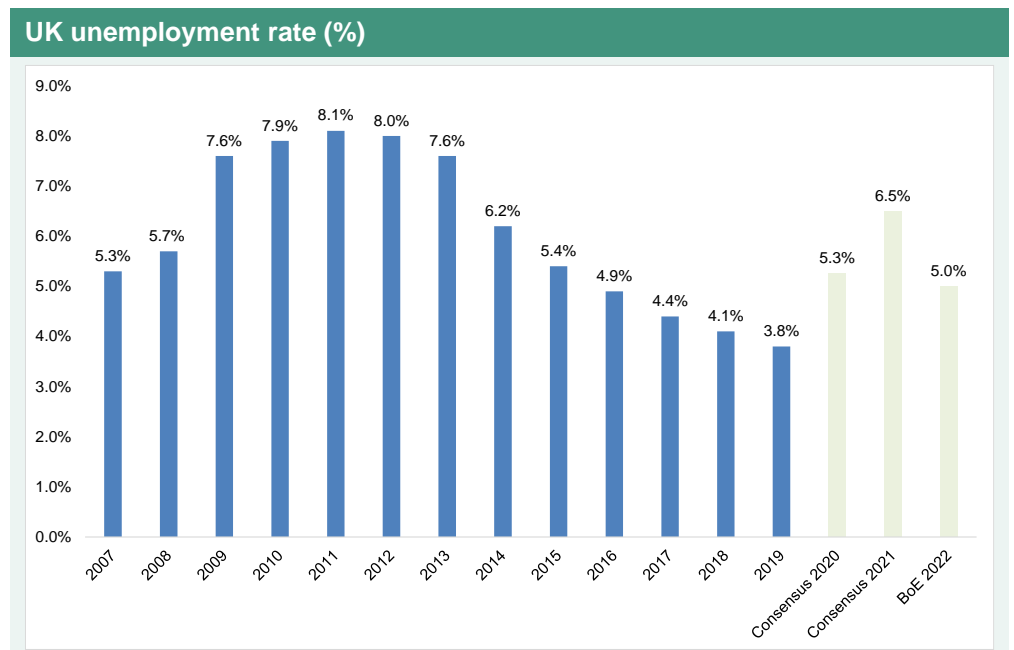
Source: Equity Development

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

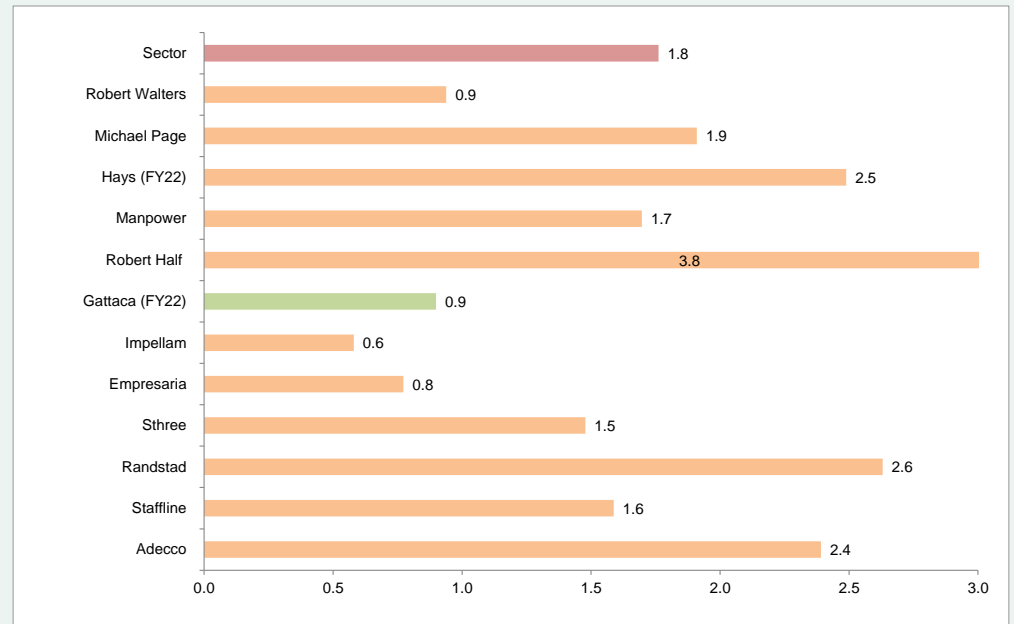


Source: Bank of England



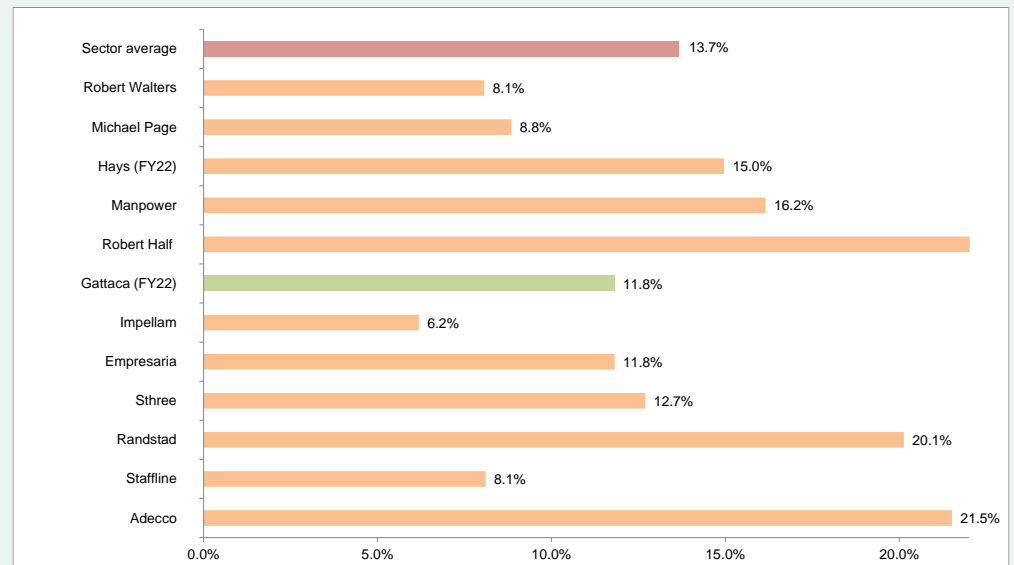
Source: Bank of England

Current Year (CY) EV/NFI multiples vs peers

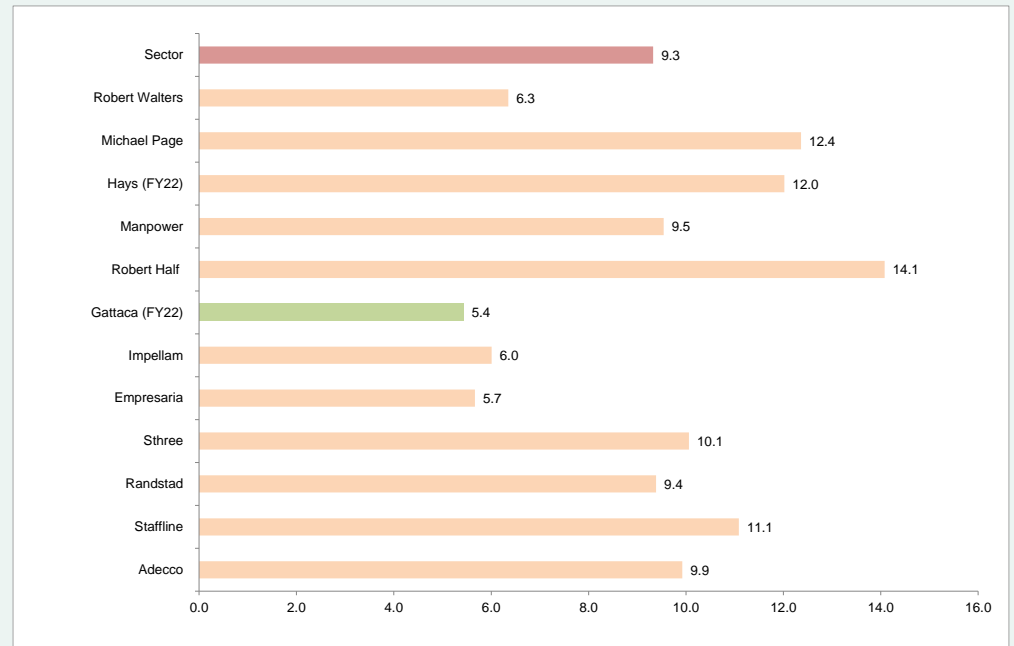


Source: Equity Development

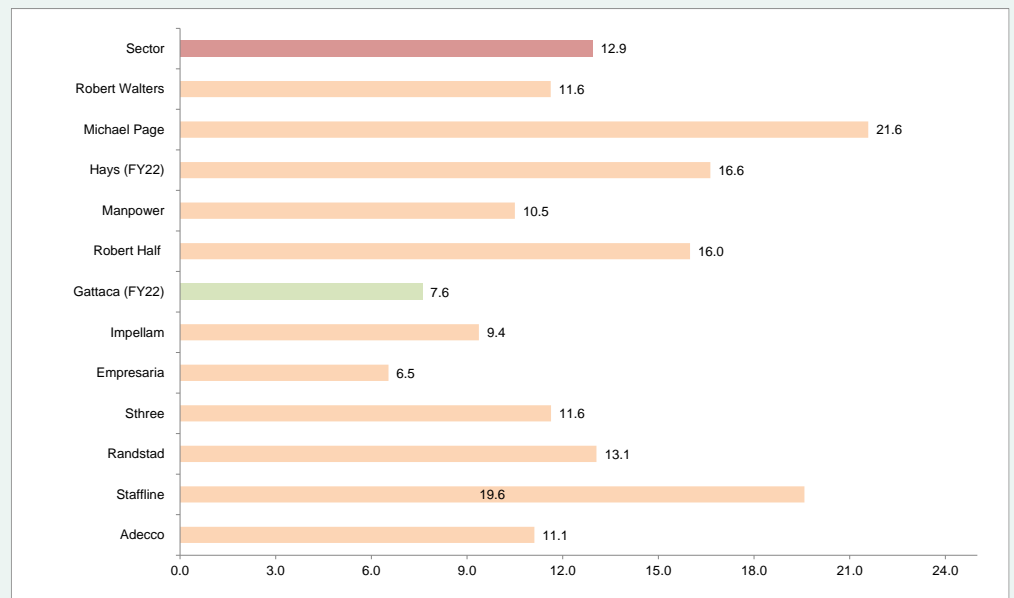
Current Year (CY) EBIT / NFI conversion rates



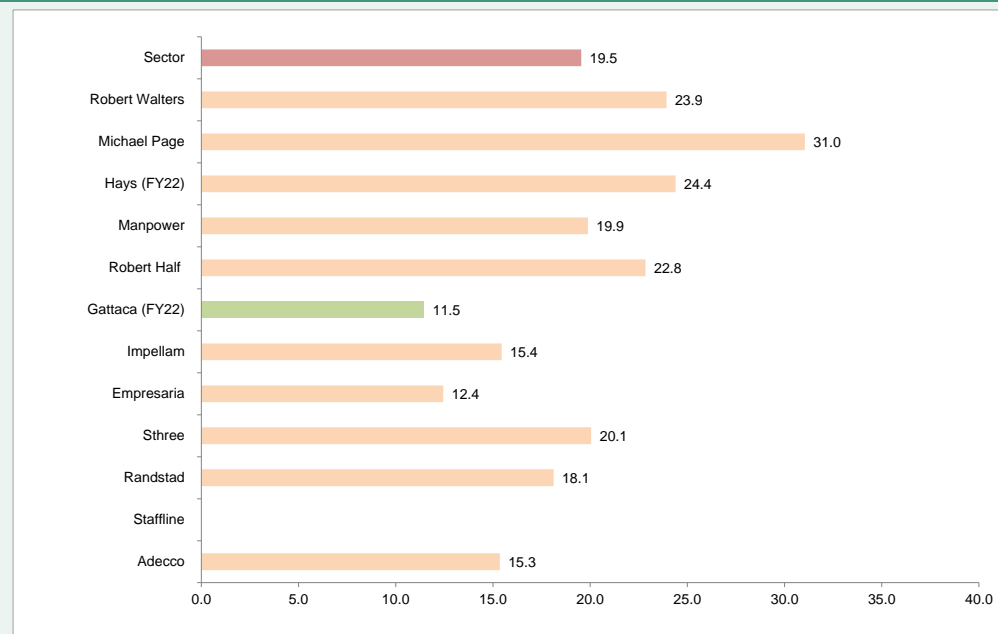
Source: Equity Development

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

Market capitalisation of peers

	Shareprice	Mrk Cap (Millions)	CY net cash / (debt) Millions	Enterprise Value (Millions)
Adecco	€ 58.64	€ 10,144	€ 310	€ 9,834
Staffline	65p	£44.8	-£72.7	£117.5
Randstad	€ 60.50	€ 11,193	-€ 380	€ 11,573
Sthree	385p	£512.1	£36.2	£475.9
Empresaria	51p	£25.0	-£17.5	£42.5
Impellam	272p	£125.1	-£15.5	£140.6
Gattaca (FY22)	152p	£49.1	-£0.4	£49.4
Robert Half	\$77.00	\$8,701	\$465	\$8,236
Manpower	\$101.00	\$5,858	\$554	\$5,304
Hays (FY22)	150p	£2,793	£365	£2,428
Michael Page	475p	£1,525	£165	£1,360
Robert Walters	610p	£464.2	£155.0	£309.2

Source: Equity Development

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