Gattaca plc

2% LFL NFI growth albeit at lower margins

8th February 2018

Like many Premiership football managers, equity analysts sometimes lead a slightly masochistic life - trying to precisely forecast company results given numerous different competing variables, many of which are uncontrollable and externally dependent.

Take yesterday's trading update from Gattaca (1 day earlier than expected), which revealed **healthy cash inflow** with net debt closing Jan'18 at £37m (vs £40.3m in July) alongside **encouraging overall NFI progression**, up +2% to £39.8m vs -4% FY17 (constant currency). The latter driven by UK Engineering (+3%, £24.1m), International (+7%, £7.3m - eg Texas/Hong Kong) and permanents – but partially offset by continued weakness in Technology (-5%, £8.4m) especially Telecoms infrastructure.

15% cut to FY18 PBT estimates

Gross margins however dipped mainly due to competitive pressures which, on top of higher staff/support expenses, means that we estimate H1'18 adjusted PBT broadly declined to around £6.5m-£7.0m (vs £7.4m LY). As a result, the Board is now **right-sizing operations** and **resetting the bar in terms of FY18 PBT** – predicted to come in at "*15% below* (or £14.8m) *previous expectations*" of £17.4m (vs £16.2 LY) on NFI of approx £80.5m.

Some of these cost reductions will benefit H2, with the aim of ultimately saving perhaps north of £2.0m pa, at a one-off cost of ~£1m. Similarly the **dividend payout is being re-aligned to reflect a more sustainable yield** (CY 5.3%) - equivalent to 2x cover (vs 1x statutory EPS LY) to help trim net borrowings (estimated y/e July'18 at £42m).

CEO steps down from the board

With regards to personnel, CEO Brian Wilkinson has resigned with immediate effect, with a successor now being sought from in/outside the organisation. In the meantime, Chairman Patrick Shanley is working closely with COO Keith Lewis, CFO Salar Farzad and the wider Executive team, to ensure the NFI momentum is maintained.

Factoring all this in, **our valuation decreases from 380p to 295p/share –** nonetheless still offering considerable potential upside, both on an absolute and relative basis (see below). We look forward in hearing further details at the interims on 19th April.

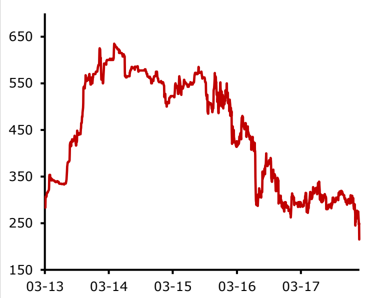
Mr Shanley adding "*We delivered an improvement in NFI in H1, with our* ***core UK Engineering business returning to growth****, albeit somewhat tempered by continued challenges seen in UK Technology.* ***Our International business is growing strongly****, and it is pleasing to see our investments in the US delivering double digit growth. However,* ***our cost base and expenditures for the full year now need to be reconsidered****.*

"***The Board is also taking the pre-emptive step of addressing the dividend*** *which has become burdensome and which prudence dictates should be brought into alignment with the financial position and future prospects of the business*."

Company Data

EPIC	AIM:GATC
Price (last close)	215p
52 week Hi/Lo	310p/210p
Market cap	£68m
ED valuation / share	295p

Share Price, p



Source: Digitallook.com

Description

Gattaca is the UK's #1 specialist engineering and #5 technology recruitment agency, providing contract, temporary and permanent staff (Source: Recruitment International). It derives 18% of NFI overseas (excluding international placements supplied from the UK), and circa 72% from temporary contractors (9,500 on assignment), with the remaining 28% coming from permanents.

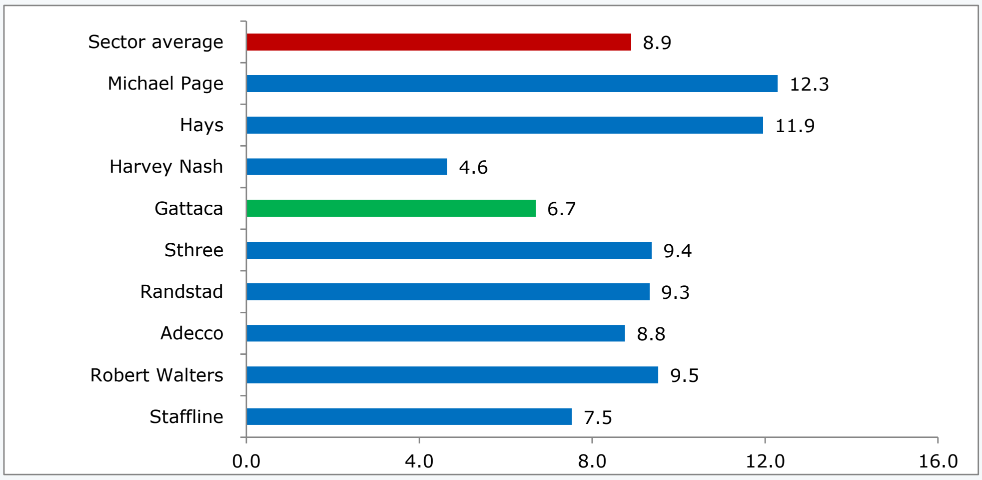
The global engineering and technology recruitment markets are valued at circa $26bn and $57bn respectively (Source: Staffing Industry Analysts) – offering substantial long term potential.

Next News: Interims 19th April

Paul Hill (Analyst)
0207 065 2690
paul.hill@equitydevelopment.co.uk

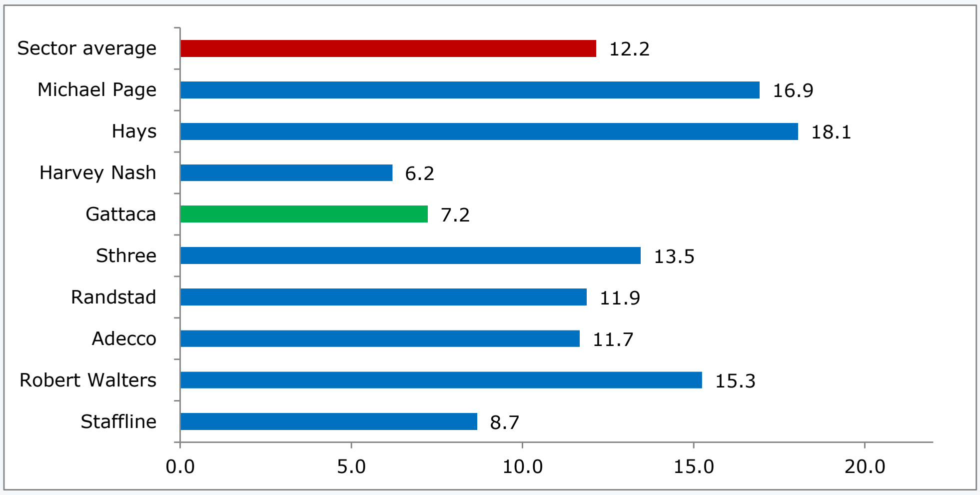
Andy Edmond
0207 065 2691
andy@equitydevelopment.co.uk

Current year EV/EBITA multiples



Source: ED – closing prices as per 7th February, and based on GATC EV reported sharecount

CY PERs



Source: ED – closing prices as per 7th February, and based on GATC EV diluted sharecount

Summary financials

Gattaca (continuing operations) (July yearend)	2014 Act £'000s	2015 Act £'000s	2016 Act £'000s	2017 Act £'000s	2018 Est £'000s	2019 Est £'000s	2020 Est £'000s
Net Fee Income (NFI) : Gross profit							
UK Engineering	27,077	37,853	40,865	43,080	48,545	50,487	52,506
UK Technology	17,905	14,605	17,413	16,178	15,046	15,046	15,647
International			14,109	15,450	16,908	17,754	18,642
Total	**44,982**	**52,458**	**72,387**	**74,708**	**80,499**	**83,286**	**86,795**
NFI growth rate							
UK Engineering	*13.2%*	*39.8%*	*8.0%*	*5.4%*	*12.7%*	*4.0%*	*4.0%*
UK Technology	*23.9%*	*-18.4%*	*19.2%*	*-7.1%*	*-7.0%*	*0.0%*	*4.0%*
International				*9.5%*	*9.4%*	*5.0%*	*5.0%*
Total NFI growth rate	***17.2%***	***16.6%***	***38.0%***	***3.2%***	***7.8%***	***3.5%***	***4.2%***
NFI margin	*10.0%*	*10.6%*	*11.7%*	*11.6%*	*11.9%*	*11.9%*	*11.9%*
UK Engineering	10,548	13,105	23,126	23,758	24,004	25,033	26,103
UK Technology	3,073	4,242	8,229	7,061	5,868	6,018	6,415
International			6,868	5,619	6,679	7,368	8,109
Central overheads			-16,726	-19,050	-20,150	-20,797	-21,650
Adjusted EBIT	**13,621**	**17,347**	**21,497**	**17,388**	**16,401**	**17,622**	**18,978**
Adj NFI / EBITA conversion	*30.3%*	*33.1%*	*29.7%*	*23.3%*	*20.4%*	*21.2%*	*21.9%*
Net interest	-1,015	-1,074	-1,076	-1,196	-1,600	-1,650	-1,600
Adjusted PBT	**12,606**	**16,273**	**20,421**	**16,192**	**14,801**	**15,972**	**17,378**
Adjusted diluted EPS (p) - excl. minorities	**37.1**	**43.8**	**44.1**	**33.8**	**29.7**	**33.2**	**36.0**
Adjusted EPS growth rate	*17.5%*	*18.2%*	*0.5%*	*-23.4%*	*-12.1%*	*11.8%*	*8.3%*
Dividend (p)	**20.0**	**22.0**	**23.0**	**23.0**	**11.5**	**12.9**	**13.9**
Dividend yield	*9.3%*	*10.2%*	*10.7%*	*10.7%*	*5.3%*	*6.0%*	*6.5%*
Dividend cover	*1.9*	*2.0*	*1.9*	*1.5*	*2.6*	*2.6*	*2.6*
Valuation benchmarks							
P/E ratio (diluted)	*5.8*	*4.9*	*4.9*	*6.4*	*7.2*	*6.5*	*6.0*
EV/NFI	*2.5*	*2.1*	*1.5*	*1.5*	*1.4*	*1.3*	*1.3*
EV/EBITA (diluted)	*8.2*	*6.5*	*5.2*	*6.4*	*6.8*	*6.4*	*5.9*
PEG ratio	*0.33*	*0.27*	*9.37*	*-0.27*	*-0.60*	*0.55*	*0.72*
Adjusted corporate tax rate	*-23.3%*	*-14.5%*	*-30.9%*	*-31.4%*	*-32.0%*	*-32.0%*	*-32.0%*
Adj ROACE	*30.6%*	*21.5%*	*19.7%*	*15.6%*	*14.2%*	*14.5%*	*14.8%*
EBITDA drop through rate as % NFI	*48.9%*	*53.8%*	*21.3%*	*-186.7%*	*-16.6%*	*44.9%*	*39.7%*
Cash conversion (EBITDA - Capex - W/Cap)/EBIT	*103%*	*109%*	*93%*	*68%*	*67%*	*75%*	*72%*
Unlevered/adj. free cashflow yield	4.9%	14.7%	14.1%	6.0%	5.6%	7.2%	7.3%
Net cash/(debt)	**-3,109**	**-33,644**	**-25,013**	**-40,288**	**-42,000**	**-37,982**	**-34,263**
Net debt : EBITDA	*0.22*	*1.83*	*1.11*	*2.20*	*2.42*	*2.04*	*1.72*
Diluted sharecount (Adj for 2015)	*26,073*	*31,730*	*32,040*	*32,392*	*32,549*	*32,707*	*32,866*
Shareprice (p)	*215*						

Source: Equity Development estimates, Company historic data

Key risks

- Economic downturn affecting engineering and technology recruitment.
- Greater competition, especially from new technology platforms (eg LinkedIn, Monster).
- Overseas expansion along with foreign exchange fluctuations.
- Acquisition integration, albeit management have a decent batting average.
- Consolidation of customer base (eg takeovers of Atkins:SNC-Lavalin and CH2M:Jabobs).
- Political interference which could impact UK infrastructure spend (eg cancellation of rail electrification projects).

Head of Corporate

Gilbert Ellacombe
Direct: 0207 065 2698
Tel: 0207 065 2690
gilbert@equitydevelopment.co.uk

Investor Access

Hannah Crowe
Direct: 0207 065 2692
Tel: 0207 065 2690
hannah@equitydevelopment.co.uk

Justin Langen
Direct: 0207 065 2693
Tel: 0207 065 2690
justin@equitydevelopment.co.uk

More information is available on our website

www.equitydevelopment.co.uk

Equity Development, 15 Eldon Street, London, EC2M 7LD. Contact: info@equitydevelopment.co.uk 0207 065 2690