

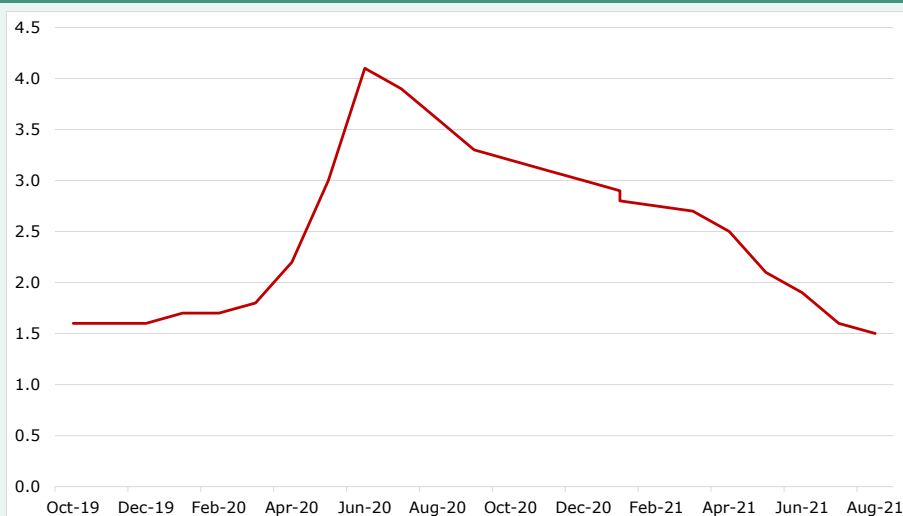
Buoyant jobs market, bullish outlook

4 November 2021

Like a gigantic game of musical chairs, UK employers are scrambling to backfill 1.1m positions displaced by the pandemic, amidst a tightening resource pool. Exacerbated by low unemployment (4.5%), rising salaries (4.1%-5.6% underlying), greater staff churn & many people (eg aged 55+) simply opting for a lifestyle change.

Indeed there are now on average just 1.5 unemployed people per job vacancy (see below). Plus according to [Randstad](#), candidate confidence is rebounding with 24% of employees planning to switch companies in the next 3-6 months vs 11% normally.

Ratio of UK unemployed per job vacancy



Source: ONS

These acute labour shortages are not only prevalent in healthcare, leisure (eg waiters) & transport (HGV drivers). But also software, digitisation, renewables (eg Off-shore wind & hydrogen), electrification, defence (cyber & marine), engineering and infrastructure (eg HS2, fibre-to-the-home, Lower Thames Crossing, etc).

Core competencies of STEM recruiter Gattaca, who today posted **'in line' FY21 results**. Adding that currently **"demand was very high"**, with corporates finding it increasingly difficult to **"identify & secure specialist talent"**. In turn, providing a major tailwind for **GATC**, particularly after completing a successful turn-around (eg Mexican/South African exits) whilst simultaneously rolling out a new fulfilment function and technology platform (ie PBS). Both of which should enhance productivity and generate significant operating leverage as the business continues to hire fee-earners (up 16% Jan-July'21) in order to restore NFI and profit margins back to pre-pandemic levels.

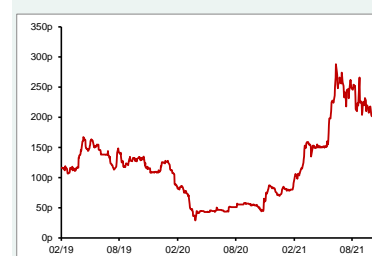
Scope for future upgrades

In fact, we are tempted to upgrade our FY22 forecasts (see quarterly NFI chart below) & 285p/share valuation, but instead have erred on the side of caution. Preferring to keep our powder dry, until there's little risk of a new dominant strain pushing the recovery to the right over the winter months, &/or disrupting client recruitment plans.

Company Data

EPIC	AIM:GATC
Price (last close)	210p
52 week Hi / Lo	285p/45p
Market cap	£68m
Jul'21 net cash (excl £14.2m of off B/S non-recourse finance & £5.6m VAT deferrals)	£19.9m
Share count	32.3m
ED valuation / share	285p

Share Price, p



Source: Yahoo

Description

Gattaca is the UK's #1 specialist engineering (69% H2'21 NFI) recruitment agency, providing contract, temporary and permanent staff (Source: Recruitment International). It derives 7% of NFI from overseas, with the remainder coming from UK Technology (24%) – overall split 74% contractors and 26% permanents.

The global engineering and technology recruitment markets are valued at circa \$26bn and \$57bn respectively.

Headcount ended July 2021 at 512 of which 73% are sales related.

Next news: Trading update Feb'22

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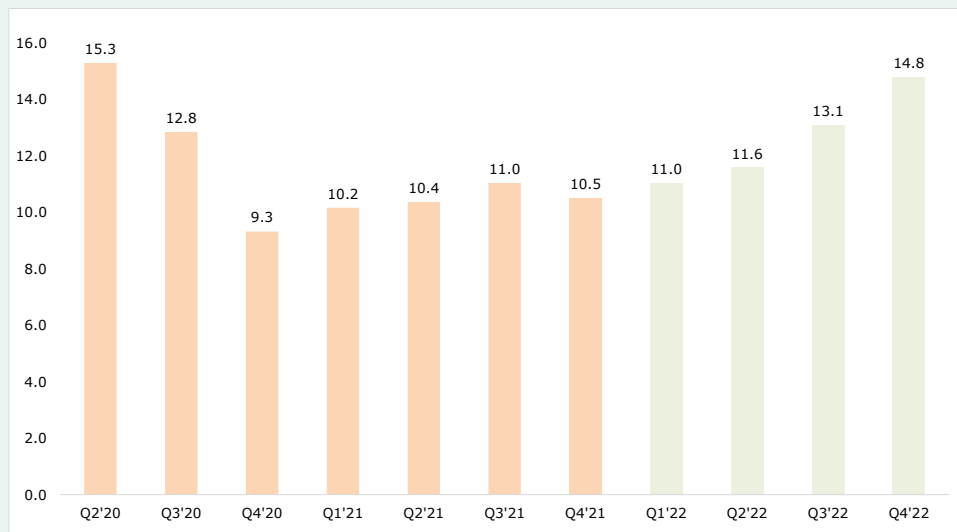
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NFI set to rebound strongly in FY22 & beyond

Nonetheless, the macro outlook appears positive underpinned by a buoyant tech/software scene and robust defence & infrastructure spend. Meaning either way, the direction of travel for the stock should be higher over the next a 2-3 years with the shares (210p) presently trading on a modest FY23 EV/EBIT multiple of 7.0x.

CEO Kevin Freeguard commenting: “*Since July 2021, we have continued to invest in sales headcount [thanks to] high demand for STEM skills, and clients finding it more challenging to identify and secure specialist talent. [Moreover] we have seen increasing optimism and significant investment in major infrastructure projects in the UK.*”

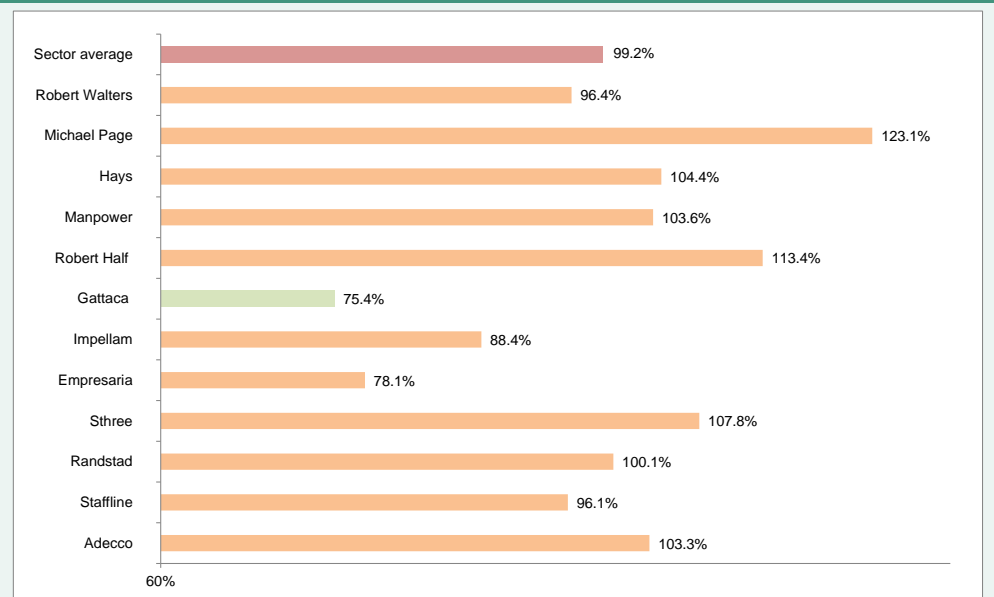
Estimated quarterly NFI (£ms) - post exiting Mexico & South Africa



Source: Equity Development estimates

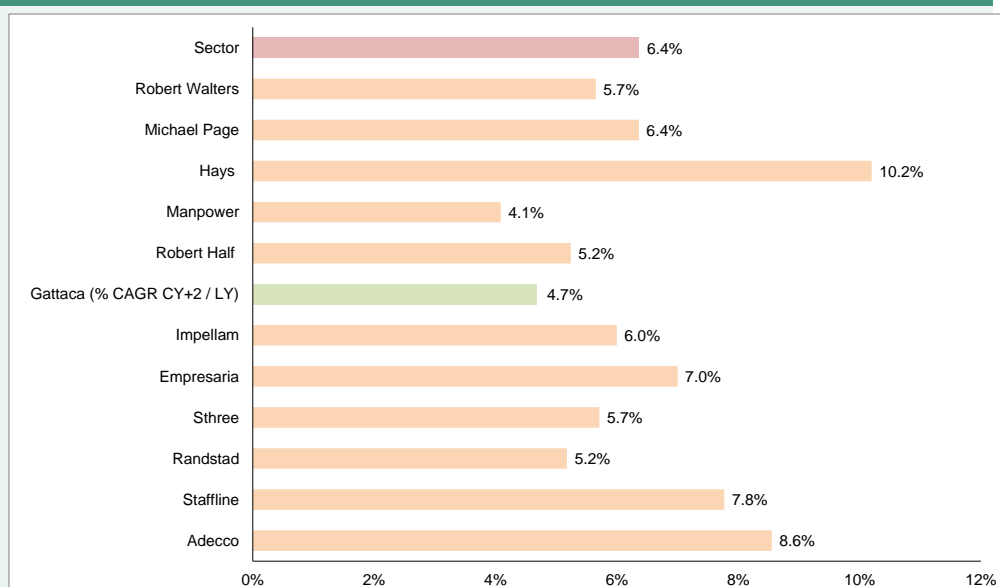
Additionally as an indication of the ‘coiled spring’ potential, Gattaca was one of the hardest hit by Covid, and hence still has the greatest upside with regards to returning to pre-pandemic levels.

Current year NFI as a % of pre Covid levels



Source: Equity Development.

Expected current year NFI growth across recruitment sector



Source: Equity Development.

So what about the numbers?

Well despite headline FY'21 PBT falling -41% to £3.2m on NFI down -20% to £42.1m (see below), adjusted **H2'21 NFI climbed 5% sequentially to £21.6m vs H1**, due to favourable permanent placement, technology, solutions (29% NFI) and RPO activity. Boosting H2 PBT to £2.8m (vs £0.4m H1) on the back of tight cost control, improving conditions, economies of scale and an estimated £3.3m of annualised savings (net) derived from the 'Improvement Plan'.

Substantial rebound in H2 vs H1'21 alongside robust cashflow

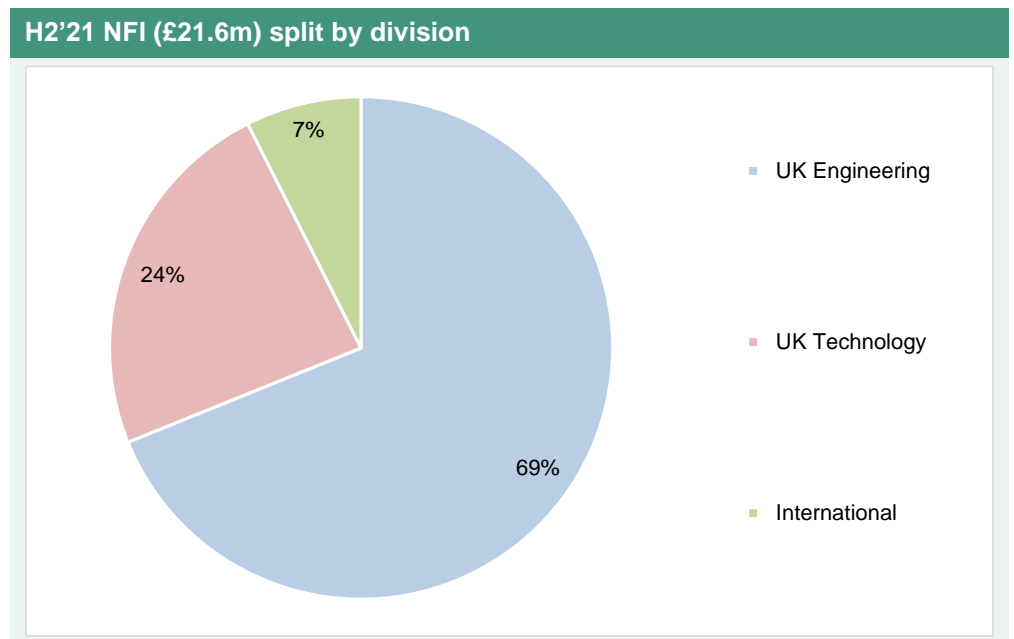
£'000s (continuing) - July y/e	Est H1'20	Est H2'20	Act FY20	Est H1'21	Est H2'21	Act FY21
UK Engineering	-7.9%	-34.5%	-21.0%	-33.1%	6.6%	0.0%
UK Technology	-16.2%	-31.8%	-23.5%	-35.4%	-10.4%	0.0%
International	-9.6%	-22.6%	-15.9%	-32.5%	-27.5%	0.0%
Total underlying NFI	-10.3%	-32.8%	-21.2%	-33.6%	-1.3%	0.0%
NFI	30,908	21,848	52,756	20,519	21,561	52,756
Adjusted EBITDA	5,685	3,728	9,413	1,963	4,143	6,106
Adjusted EBIT	4,145	2,023	6,168	772	2,867	3,639
<i>EBIT/NFI margin</i>	13.4%	9.3%	11.7%	3.8%	13.3%	6.9%
Underlying overheads	26,763	19,825	46,588	19,747	29,370	49,117
U/L admin as % NFI	86.6%	90.7%	88.3%	96.2%	136.2%	93.1%
Adjusted PBT	3,282	1,497	4,779	442	2,785	3,227
Tax	-899	-96	-995	-93	-413	-506
Minorities	0	0	0	0	0	0
Underlying PAT	2,383	1,401	3,784	349	2,372	2,721
Adjusted EPS (diluted)	7.2p	4.3p	11.7p	1.1p	7.3p	8.4p
NFI (LTM) / head (£ks)	93.1	133.5	79.3			90.2
Overheads / head (£Ks)			70.1			84.0
Headcount	681	665	665			585
<i>Net debt : EBITDA</i>	0.25	-1.47	-0.34			0.93
<i>U/L tax rate</i>	-27.4%	-6.4%	-20.8%			-15.7%
Non-recourse invoice discounting	-16,000	-13,800	-13,800	-12,200	-14,200	-14,200
Deferred VAT			-10,300	-10,300	-5,600	-5,600
Cash /(recourse debt)	-3,075	27,341	27,341	22,744	19,890	19,890

Source: Equity Development. (Nb: Half yearly figs based on estimated Mexican & South African H1/H2 splits)

Elsewhere, **daily contractor rates held up well**, helping to deliver 10.1% FY'21 gross margins vs 9.9% LY. Whilst underlying administrative expenses reduced by -17.5% to £38.4m (£46.6m LY), reflecting UK & international staff/office savings, and leaving y/e headcount at 512 vs 587 LY (73% fee earners). Partly offset by a £1.4m bad debt (£0.8m pre-provided) because of the NMCN bankruptcy.

Resumption of a progressive dividend

In terms of the balance sheet, **Gattaca generated approx. £1.5m of incremental cash and repaid its RCF in full** (£15m in Oct'20). Meaning it's now entirely **covenant free, sporting ample liquidity to pay a 1.5p dividend** (£484k) from **net funds** (pre IFRS16) of **£19.9m** - excluding £5.6m of deferred VAT (to be settled by Feb'22) and £14.2m of non-recourse finance. Debtor days ended the period at 43.9 (vs 35.3 LY), due to longer collection times as a result of disruption incurred by the new IT system implementation.

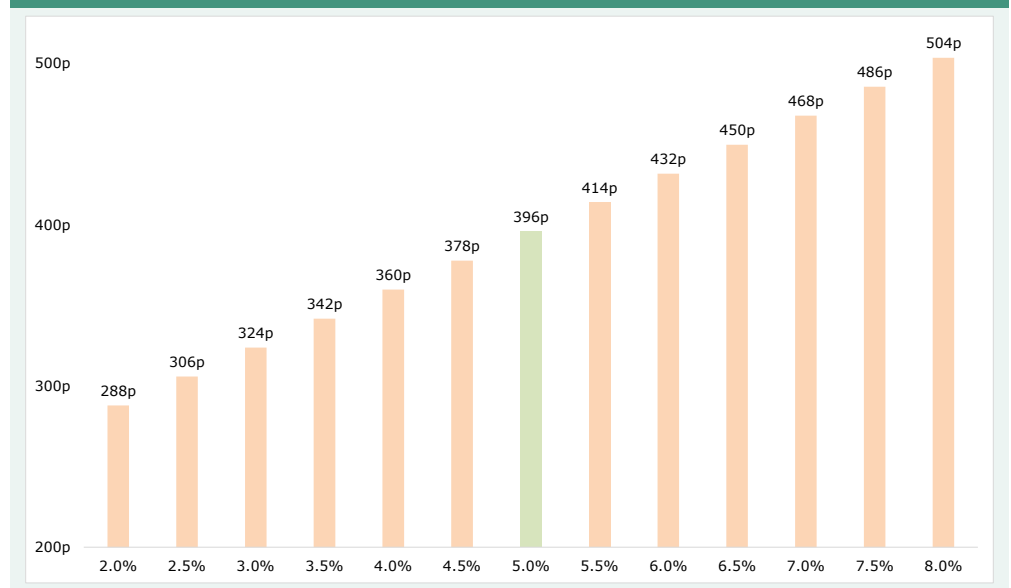


Source: Equity Development

Shares could climb another 85% over next 3 years

Lastly irrespective of the recent price appreciation, we think there's still plenty more upside potential for investors. For example, if hypothetically Gattaca could consistently achieve GDP+ NFI growth coupled with mid-high teen EBIT/NFI conversion rates across the economic cycle. Then we believe the stock would rightly deserve at least a 11x EV/EBIT multiple - lifting it to almost £4/share by 2024 (see below).

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



Source: Equity Development hypothetical price estimates

At 210p, GATC trades on undemanding FY22 multiples of 10.4x EV/EBIT and 14.5x PER vs 11.4x & 16.8x for peers (see below).

FY21 valuation benchmarks vs peers



Source: Equity Development.

Key risks

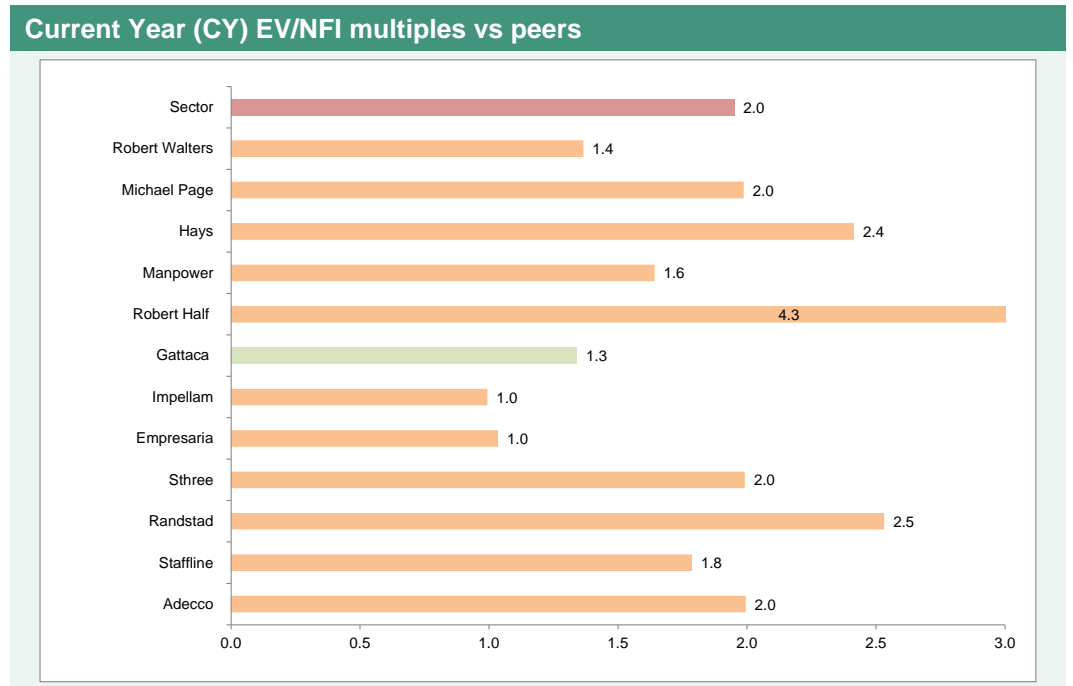
- Coronavirus induced problems which could delay the anticipated economic recovery.
- General economic downturn affecting engineering and technology recruitment.
- Greater competition, especially from new technology platforms (eg LinkedIn, Monster).
- Remote risk of US Department of Justice action relating to certain Networkers International activities prior to its 2015 acquisition.

Summary projections (£'000s)

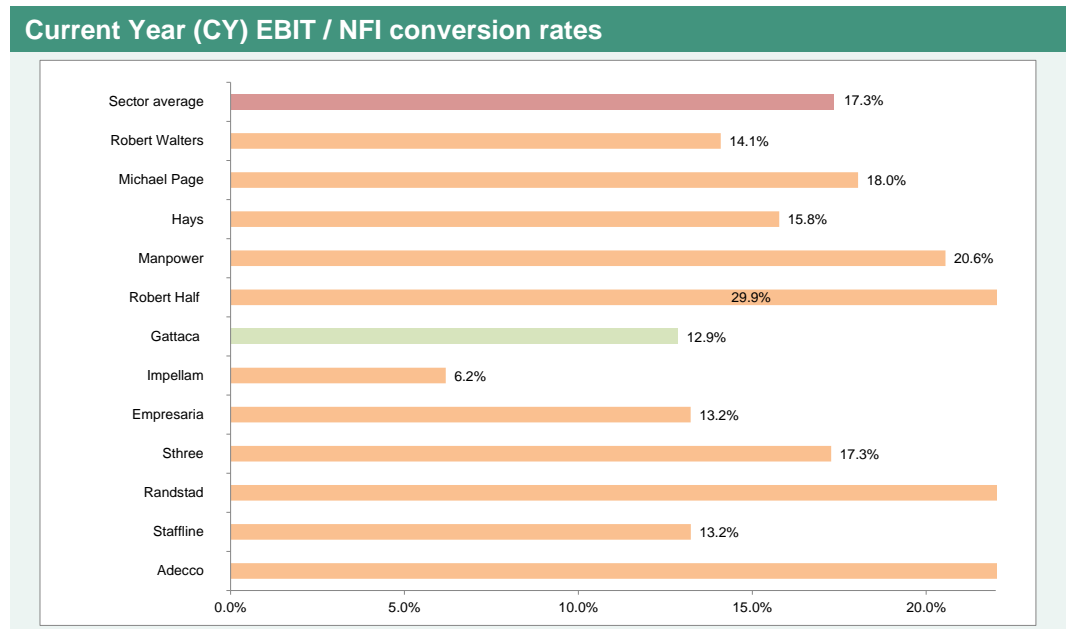
Gattaca (continuing operations) (July yearend)	2020 Act £'000s	2021 Act £'000s	2022 Est £'000s	2023 Est £'000s	2024 Est £'000s
Net Fee Income (NFI) : Gross profit					
UK Engineering	34,177	34,177	32,790	39,248	43,283
UK Technology	13,602	13,602	13,692	16,431	18,074
International	4,977	4,977	4,017	4,833	5,316
Total	52,756	52,756	50,500	60,512	66,673
NFI growth rate					
<i>UK Engineering</i>	-21.0%	0.0%	-4.1%	19.7%	10.3%
<i>UK Technology</i>	-23.5%	0.0%	0.7%	20.0%	10.0%
<i>International</i>	-15.9%	0.0%	-19.3%	20.3%	10.0%
Total NFI growth rate	-21.2%	0.0%	-4.3%	19.8%	10.2%
EBITDA	9,413	6,106	9,047	12,328	14,489
UK Engineering	20,913	17,324	19,674	23,549	25,970
UK Technology	7,061	5,163	6,983	8,380	9,218
International	1,319	1,247	1,607	1,933	2,126
Central overheads	-23,125	-20,095	-21,764	-24,182	-25,525
Adjusted EBIT	6,168	3,639	6,500	9,680	11,788
<i>Total Opex as % NFI</i>	-88.3%	-93.1%	-87.1%	-84.0%	-82.3%
<i>EBIT / NFI margin</i>	11.7%	6.9%	12.9%	16.0%	17.7%
Net interest	-1,389	-412	-400	-350	-300
Adjusted PBT	4,779	3,227	6,100	9,330	11,488
Tax	-995	-506	-1,403	-2,332	-3,102
Minorities	0	0	0	0	0
Adjusted PAT	3,784	2,721	4,697	6,997	8,387
Adjusted diluted EPS (p)	11.7	8.4	14.4	21.4	25.5
<i>Adjusted EPS growth rate</i>	-57.6%	-28.1%	71.8%	48.2%	19.3%
Dividend (p)	0.0	1.5	3.0	5.0	7.0
<i>Dividend yield</i>	0.0%	0.7%	1.4%	2.4%	3.3%
<i>Dividend cover</i>					
Valuation benchmarks					
<i>P/E ratio (diluted)</i>	18.0	25.0	14.5	9.8	8.2
<i>EV/NFI</i>	1.28	1.28	1.34	1.12	1.02
<i>EV/EBITDA</i>	7.2	11.1	7.5	5.5	4.7
<i>EV/EBITA (diluted)</i>	11.0	18.6	10.4	7.0	5.7
<i>PEG ratio</i>	-0.31	-0.89	0.20	0.20	0.43
<i>Adjusted corporate tax rate</i>	-20.8%	-15.7%	-23.0%	-25.0%	-27.0%
<i>Adj ROACE</i>	8.7%	5.2%	9.0%	12.6%	14.3%
<i>EBITDA drop through rate as % NFI</i>				32.8%	35.1%
Net recourse cash/(debt)	27,341	19,890	17,127	18,817	22,716
Non recourse invoice factoring (off Balance Sheet)	-13,800	-14,200	-14,200	-14,200	-14,200
HMRC deferred VAT	-10,300	-5,600			
<i>Net debt : EBITDA (incl HMRC & factoring)</i>	-0.3	0.9	0.3	0.4	0.6
<i>Diluted sharecount (Adj for 2015)</i>	32,353	32,358	32,519	32,682	32,845
Shareprice (p)	210p				

Source: Equity Development

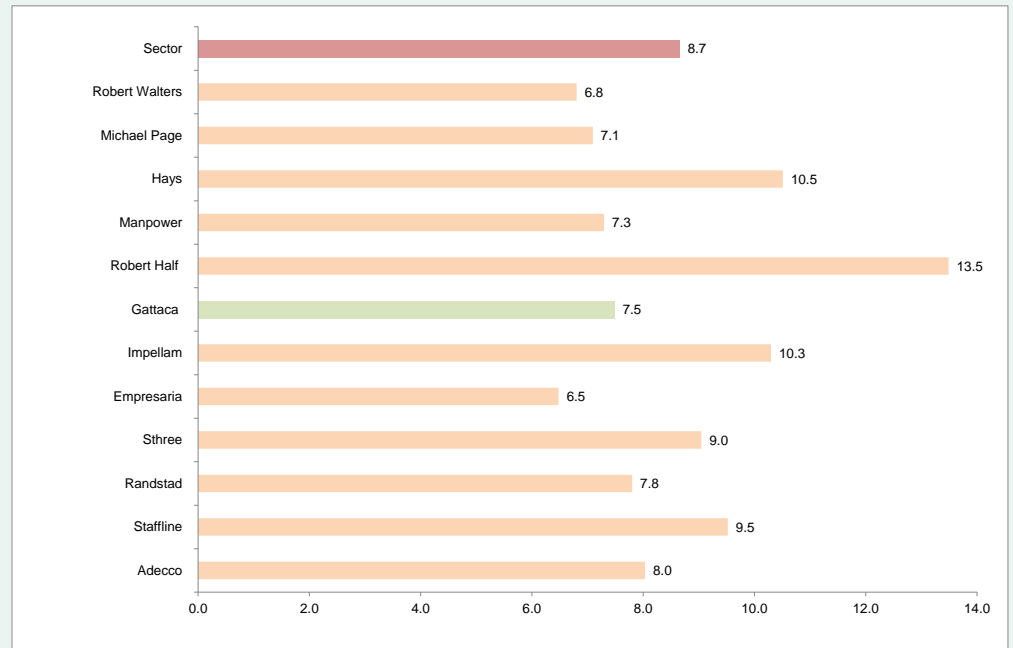
Appendices - sector valuation metrics and KPIs



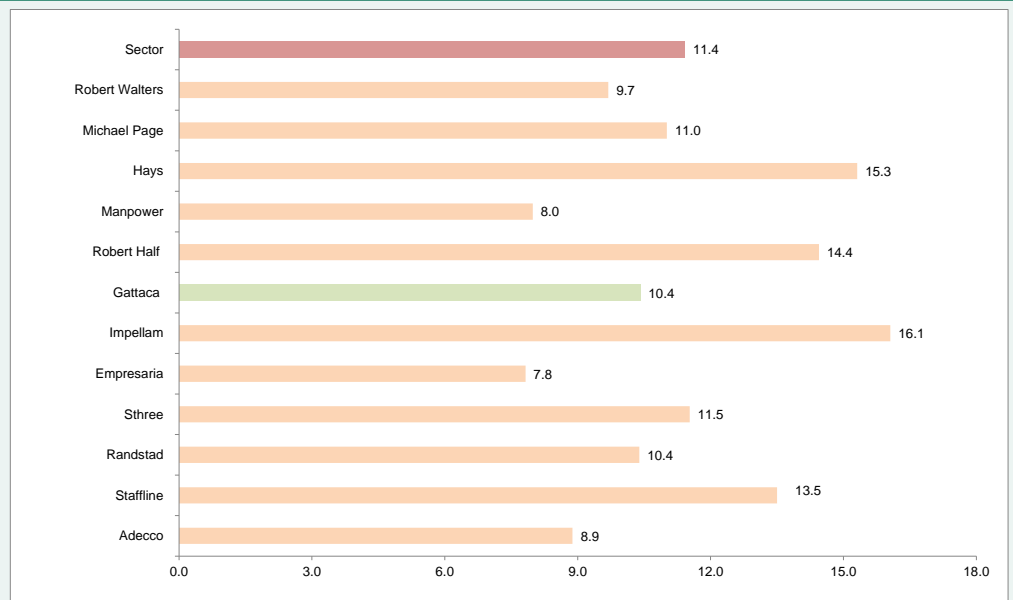
Source: Equity Development



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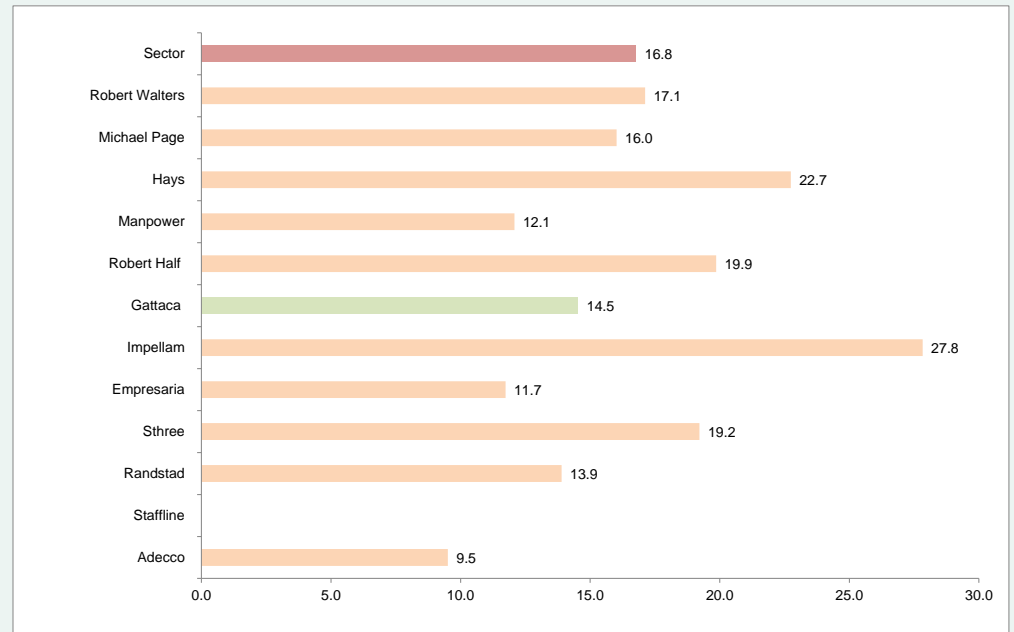
CY EV/EBITDA multiples vs peers


Source: Equity Development

CY EV/EBIT multiples vs peers


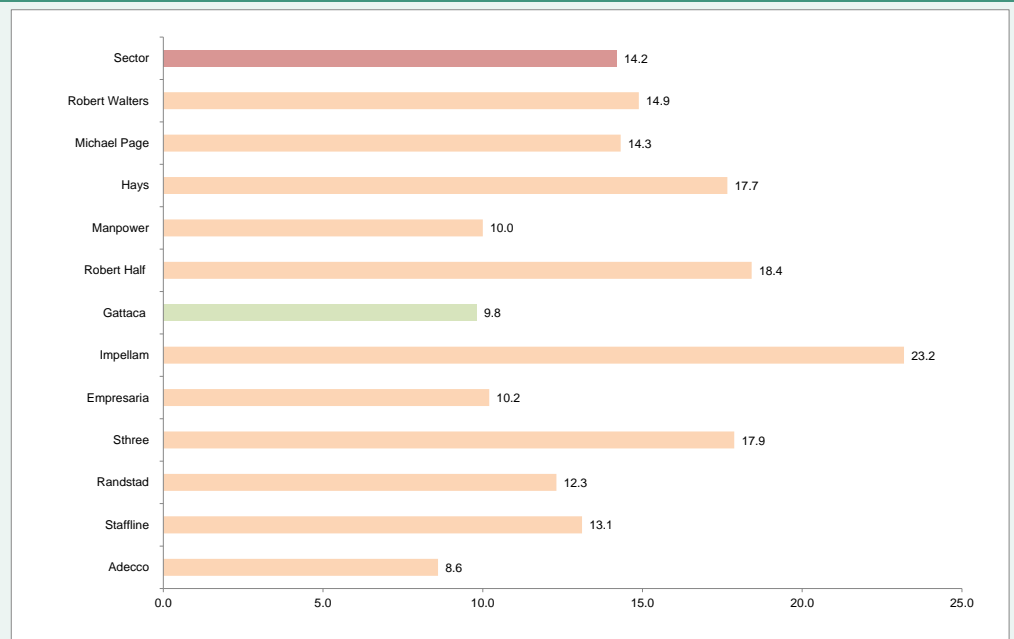
Source: Equity Development

CY PERs multiples vs peers



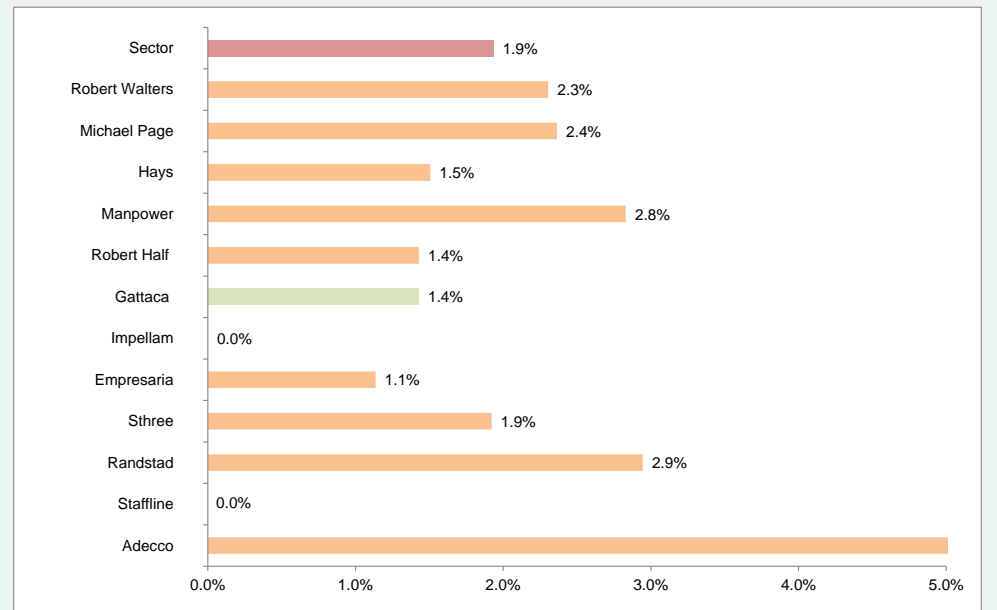
Source: Equity Development

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	€ 43.85	€ 7,586	-€ 1,698	€ 9,284
Staffline	70p	£116.2	-£32.3	£148.5
Randstad	€ 63.50	€ 11,652	-€ 329	€ 11,981
Sthree	588p	£785.0	£59.7	£725.3
Empresaria	88p	£43.7	-£16.5	£60.2
Impellam	490p	£225.4	-£15.5	£240.9
Gattaca	210p	£67.8	£0.1	£67.7
Robert Half	\$114.00	\$12,882	\$501	\$12,381
Manpower	\$100.00	\$5,800	\$58	\$5,742
Hays	166p	£2,955	£107	£2,848
Michael Page	660p	£2,119	£26	£2,093
Robert Walters	820p	£624.0	£90.0	£534.0

Source: Equity Development



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