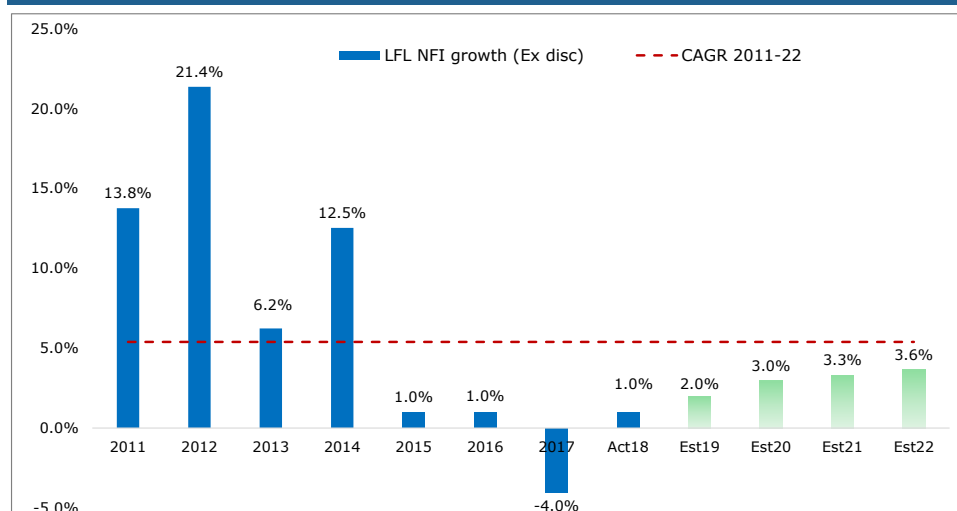


Turn-around is bang on track

7th February 2019

Given all the Brexit related rock-throwing and in-fighting at Westminster, it is a breath of fresh air to hear some positive corporate news. This morning STEM recruitment specialist Gattaca said that it's **'back to basics' turnaround plan is right on track**. Indeed, the business delivered its **highest level of LFL NFI growth** since 2014 (see below), coming in at £36.6m (+2%) for H1'19 vs £36.0m LY.

Historical and projected LFI NFI growth



Source: Equity Development.

The standout performer was **'International', up +15%** (vs 5% FY18) to £5.1m driven by **China and the Americas**. Aply supported by +3% growth (1% FY18) at UK Engineering (£24.9m), reflecting **"strong" demand within Infrastructure** (incl RSL), **Maritime** and **Engineering Technology** – partly offset by Automotive, where diesel sales declined following the introduction of tighter emission standards alongside softer consumer confidence.

Excellent H1'19 cash generation

Better still, **net debt closed Jan'19 down to £29m** from £40.9m in Jul'18 and £36.2m 12 months' ago. Some of this was simply timing/seasonal differences, yet nonetheless we are **encouraged by the deleveraging**, and have lowered our FY19 target to £38.5m (from £41m) – representing a net debt/EBITDA ratio of 2.7x. Further working capital unwind is anticipated in H2 (Re exit from Telecoms Infrastructure), albeit neutralised by higher capex on IT systems (CRM Bullhorn).

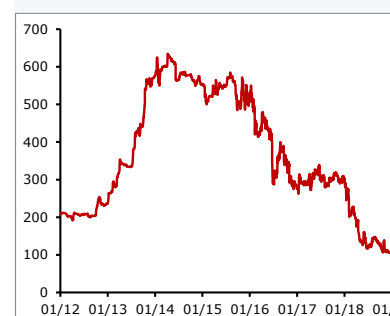
Even the perennial 'thorn', UK Technology, showed improvement. Sure (as flagged at the Nov prelims) NFI dropped -10% (vs -3% LY) to £6.6m on the back of restructuring in Q1'19 - but importantly **profits at both Telecoms & IT climbed vs FY18**. Highlighting that the firm's **'self-help medicine' is working**.

Likewise, we understand there has been **another significant headcount reduction in H1'19** (810 July'18 vs 870 Jan'18), underpinning our estimates for a modest rise in FY19 EBIT/NFI conversion to 18.2% (vs 18.1% LY).

Company Data

EPIC	AIM:GATC
Price (last close)	113p
52 week Hi / Lo	250p / 100p
Market cap	£36.5m
Share count	32.3m
ED valuation / share	185p

Share Price, p



Source: Web Financial

Description

Gattaca is the UK's #1 specialist engineering (60% NFI) and #6 technology (21%) recruitment agency, providing contract, temporary and permanent staff (Source: Recruitment International). It derives 30% of NFI from overseas (including international placements supplied from the UK), and circa 70% from temps, with the remaining 30% 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 3rd April 2019

Paul Hill (Analyst)

0207 065 2690
paul.hill@equitydevelopment.co.uk

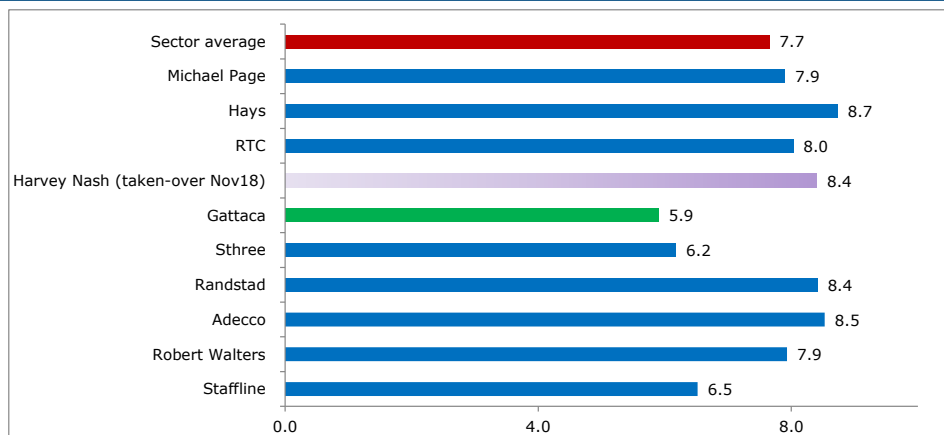
Significant improvement being made on all fronts

Kevin Freeguard, CEO concluding **"H1'19 was a period of progress for the Group, as the restructuring we undertook in Q1 began to bear fruit. The Group has performed in line with expectations, with UK Engineering delivering solid growth and our international operations continuing to grow strongly. UK Technology, particularly Telecoms, was impacted by the Q1 restructuring, however we are encouraged by the initial performance following steps taken to reposition the business during the half. The progress made on net debt is positive and our full year outlook remains in line with the Board's expectations"**.

Valuation upgraded to 185p/share from 180p

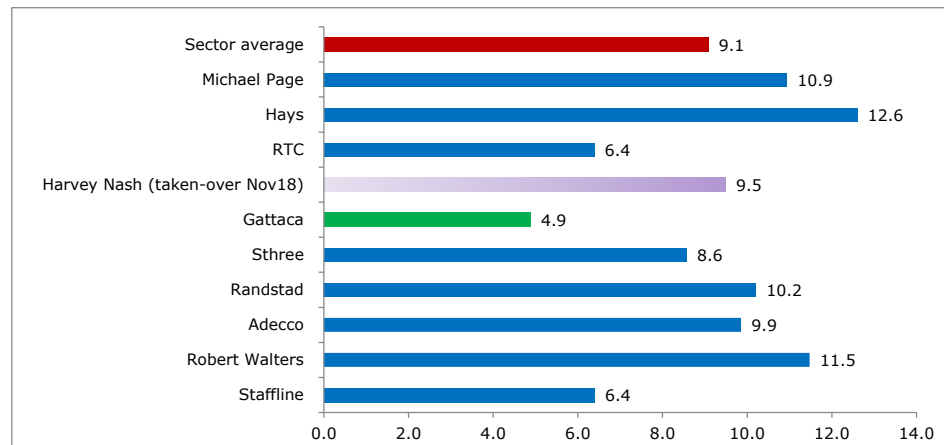
Looking ahead, **we have held our FY19 numbers for NFI, PBT and adjusted EPS (diluted) at £72.0m, £10.9m and 23.2p respectively – but nudged up the valuation to 185p/share** in light of the robust cash generation. What's more, **we think the stock at 113p is materially undervalued** - trading on FY19 EV/EBIT and PER multiples of only 5.9x and 4.9x vs 7.7x and 9.1x for the wider staffing sector.

Current Year EV/EBIT ratios – sector



Source: Equity Development. Prices as per 6th February 2019

Current Year P/E ratios – sector



Source: Equity Development. Prices as per 6th February 2019

Demand for tech talent is soaring

Similarly, the industry's **long term fundamentals continue to shift towards Gattaca's STEM expertise**. Not only benefitting from rising global spend on infrastructure (Heathrow, Hinkley Point, Crossrail 2, HS2, rail electrification, smart cities), engineering and technology (eg Cyber security, IoT, Cloud, 5G, autonomous vehicles), but also the convergence of IT/Telecoms within its other key verticals of Automotive, Aerospace, Defense, Energy and Maritime.

More broadly too, just about all walks of life are being transformed by technology – with companies today being forced to either embrace the digital age, or ultimately face extinction. Thus **expanding** the number of STEM jobs worldwide, together with Gattaca's **addressable market**.

Lastly, for the record H1'19 Permanent:Temp NFI split rose to 30:70 from 28:72 in prior year - mirroring the public sector IR35 rules, buoyant conditions in International and IT exclusivity agreements. While total group NFI (including discontinued activities) declined by 3% due to the previously announced contraction of the global footprint.

Summary financials

Gattaca (continuing operations) (July yearend)	2014 Act £'000s	2015 Act £'000s	2016 Act £'000s	2017 Act £'000s	2018 Act £'000s	2019 Est £'000s	2020 Est £'000s	2021 Est £'000s	2022 Est £'000s	2023 Est £'000s	2024 Est £'000s
Net Fee Income (NFI) : Gross profit											
UK Engineering	27,077	37,853	40,865	43,080	47,567	49,000	50,470	51,984	53,544	55,150	56,804
UK Technology	17,905	14,605	17,413	16,178	16,599	12,000	12,000	12,240	12,730	13,239	13,768
International			14,109	15,450	14,697	11,000	11,660	12,360	13,101	13,887	14,720
Total	44,982	52,458	72,387	74,708	78,863	72,000	74,130	76,584	79,374	82,276	85,293
NFI growth rate											
UK Engineering	13.2%	39.8%	8.0%	5.4%	10.4%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
UK Technology	23.9%	-18.4%	19.2%	-7.1%	2.6%	-27.7%	0.0%	2.0%	4.0%	4.0%	4.0%
International				9.5%	-4.9%	-25.2%	6.0%	6.0%	6.0%	6.0%	6.0%
Total NFI growth rate	17.2%	16.6%	38.0%	3.2%	5.6%	-8.7%	3.0%	3.3%	3.6%	3.7%	3.7%
EBITDA	14,343	18,363	22,617	18,284	15,309	14,100	15,025	15,601	16,318	17,063	17,834
UK Engineering	10,548	13,105	23,126	23,758	26,033	25,083	26,098	26,939	27,804	28,696	29,614
UK Technology	3,073	4,242	8,229	7,061	7,617	5,880	6,000	6,242	6,619	7,017	7,435
International			6,868	5,619	4,814	4,840	5,247	5,562	5,896	6,249	6,624
Central overheads			-16,726	-19,050	-24,182	-22,703	-23,349	-24,209	-25,107	-26,046	-27,030
Adjusted EBIT	13,621	17,347	21,497	17,388	14,282	13,100	13,996	14,534	15,212	15,915	16,644
Total Opex as % NFI	-69.7%	-66.9%	-70.3%	-76.7%	-81.9%	-81.8%	-81.1%	-81.0%	-80.8%	-80.7%	-80.5%
EBIT / NFI margin	30.3%	33.1%	29.7%	23.3%	18.1%	18.2%	18.9%	19.0%	19.2%	19.3%	19.5%
Net interest	-1,015	-1,074	-1,076	-1,232	-1,540	-2,200	-2,200	-2,000	-1,800	-1,600	-1,400
Adjusted PBT	12,606	16,273	20,421	16,156	12,742	10,900	11,796	12,534	13,412	14,315	15,244
Adjusted diluted EPS (p)	37.1	43.8	44.1	33.7	22.6	23.2	25.8	28.2	30.1	31.9	33.9
Adjusted EPS growth rate	17.5%	18.2%	0.5%	-23.6%	-33.0%	2.6%	11.5%	9.4%	6.5%	6.2%	6.0%
Dividend (p)	20.0	22.0	23.0	23.0	3.0	0.0	0.0	0.0	15.0	16.0	16.9
Dividend yield	17.7%	19.5%	20.4%	20.4%	2.7%	0.0%	0.0%	0.0%	13.3%	14.1%	15.0%
Dividend cover	1.9	2.0	1.9	1.5	7.5						
Valuation benchmarks											
P/E ratio (diluted)	3.0	2.6	2.6	3.4	5.0	4.9	4.4	4.0	3.8	3.5	3.3
EV/NFI	1.7	1.4	1.0	1.0	1.0	1.0	1.0	1.0	0.9	0.9	0.9
EV/EBITA (diluted)	5.5	4.3	3.5	4.3	5.2	5.7	5.4	5.2	4.9	4.7	4.5
PEG ratio	0.17	0.14	4.92	-0.14	-0.15	1.85	0.38	0.43	0.58	0.57	0.56
Adjusted corporate tax rate	-23.3%	-14.5%	-30.9%	-31.4%	-41.0%	-30.0%	-27.5%	-25.0%	-25.0%	-25.0%	-25.0%
Adj ROACE	30.6%	21.5%	19.7%	15.6%	15.1%	16.3%	15.8%	14.9%	14.5%	14.5%	14.4%
EBITDA drop through rate as % NFI	48.9%	53.8%	21.3%	-186.7%	-71.6%	17.6%	43.4%	23.5%	25.7%	25.7%	25.6%
Cash conversion (EBITDA - Capex - W/Cap)/EBIT	103%	109%	93%	63%	111%	96%	79%	76%	76%	76%	76%
Unlevered/adj. free cashflow yield	7.3%	22.0%	21.0%	8.9%	8.0%	12.4%	10.4%	10.6%	11.0%	11.4%	11.9%
Net cash/(debt)	-3,109	-33,644	-25,013	-40,288	-40,874	-38,500	-32,900	-26,973	-25,463	-23,760	-21,863
Net debt : EBITDA	0.22	1.83	1.11	2.20	2.67	2.73	2.19	1.73	1.56	1.39	1.23
Diluted sharecount (Adj for 2015)	26,073	31,730	32,040	32,392	32,120	32,956	33,117	33,280	33,443	33,607	33,771
Shareprice (p)	113										

Source: Equity Development estimates, Company historic data

Key risks

- Economic downturn affecting engineering and technology recruitment. For example, Brexit could negatively impact confidence and UK GDP.
- In the Oct'18 budget, the Chancellor stated the Government's intention to extend the IR35 rules to the private sector (re self-employed persons) in April 2020, following the 2017 implementation in the public sector.
- Greater competition, especially from new technology platforms (eg LinkedIn, Monster).
- Overseas expansion along with foreign exchange fluctuations.
- Reduction in financial gearing, given FY19 net debt:EBITDA is forecast to be circa 2.9x as at July 2019.
- Consolidation of customer base.
- Political interference which could impact UK infrastructure spend (eg cancellation of rail electrification projects).



Investor Access

Hannah Crowe

Direct: 0207 065 2692

Tel: 0207 065 2690

hannah@equitydevelopment.co.uk

Felix Grant-Rennick

Direct: 0207 065 2693

Tel: 0207 065 2690

felix@equitydevelopment.co.uk

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www.equitydevelopment.co.uk

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