

Sailing masterclass amid stormy seas

4th November 2020

Carefully selecting captains & ships has never been more important under the new Covid paradigm. Sure we've just returned to national lockdowns, yet equally there are signs of improved business confidence & multiple vaccines becoming available soon - whilst fatality rates have fallen >2/3ds vs the Spring. Hence 2021 is potentially teeing up to be a banner year.

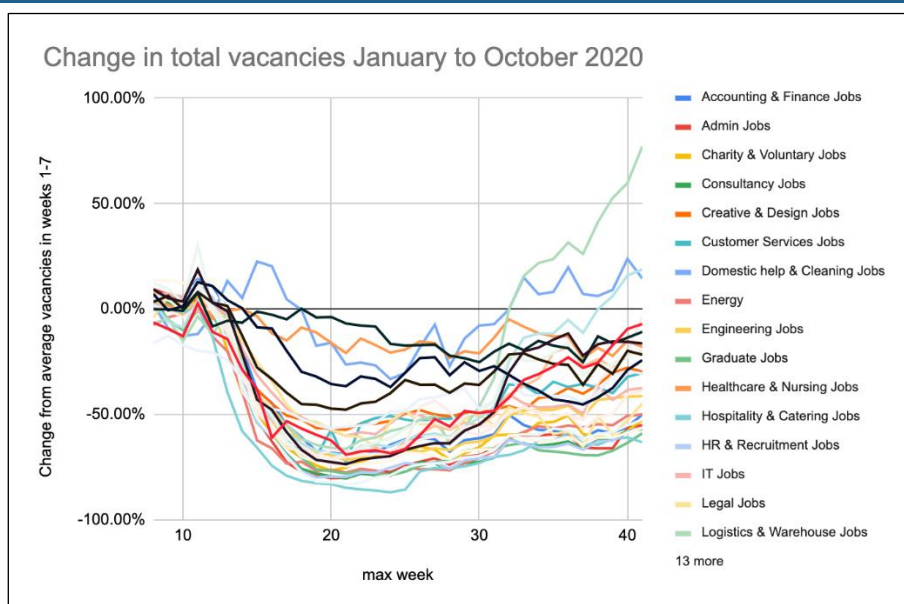
So which sectors should perform best? It's impossible to say at this stage - albeit solid, well run/funded 'recovery stocks' that still trade at wide discounts to their intrinsic worth appear attractive. Especially those like STEM recruitment specialist Gattaca, who is not only **successfully navigating these choppy waters**. But also **should receive a longer term boost** from secular tailwinds (eg infrastructure, digitisation, advanced engineering, etc), essential services & ongoing government support (eg job creation).

Outstanding cash generation

In fact today, the company posted **better than expected FY20 results**, with **net cash closing July at a robust £27.3m** (pre IFRS16 lease liabilities & including the benefit of £13.8m non-recourse off balance sheet financing) compared to -£24.8m LY (ED Est £20m). Driven by £10.3m of deferred VAT payments (payable Apr'22), improved contractor terms (£8.5m - permanent), a working capital unwind (£16.3m) & lower debtor days (41 vs 45 LY).

Altogether a **'Ben Ainslie' class performance by anyone's standards** - leaving the business **'covenant free'**, & ideally placed to increase profits as the recovery gains traction (see below). With a high proportion of incremental NFI falling straight to the bottom line, due to continued tight cost control (£4m annualised savings), more efficient processes (Improvement Plan) and positive operating leverage.

UK job vacancies are slowly improving

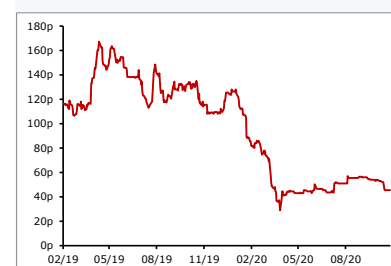


Source: Adzuna

Company Data

EPIC	AIM:GATC
Price (last close)	48p
52 week Hi / Lo	126p/29p
Market cap	£15.5m
Net cash Jul'20 (incl £13.8m benefit from off B/S non-recourse debt)	£27.3m
Share count	32.3m
ED valuation / share	140p/share

Share Price, p



Source: Share Cast

Description

Gattaca is the UK's #1 specialist engineering (70% NFI) recruitment agency, providing contract, temporary and permanent staff (Source: Recruitment International). It derives 13.6% of NFI from overseas, with the remainder coming from UK Technology (16.4%) - overall split 69.8% contractors and 30.2% 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: AGM December 2020

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Current trading in line with FY21 expectations

With regards to the headline numbers, **FY20 NFI & adjusted PBT both declined -21.4% and -60.7%** respectively to £54.3m (£69.1m LY) and £4.6m (£11.6m). Reflecting uncertainties created by the General Election, Brexit, proposed new IRS35 rules and latterly the pandemic (including a prudent £2.3m additional bad debt provision). Partly offset by a -13% contraction in overheads, thanks to restructuring (£1.7m), lower headcount (665 vs 739), furlough assistance (£1.5m) and a temporary group-wide 20% salary cut (£1.1m).

Similarly **EBIT/NFI conversion fell to 11% vs 19.8% LY**, with adjusted EPS coming in at 10.3p (-63%) vs 27.6p on the back of a higher effective tax rate (re country mix).

Elsewhere, there was a £5.8m one-off charge, split: £1.6m restructuring, £1.4m DoJ investigation, £1.2m China closure, £1.4m asset impairments & £0.2m others. No dividend was recommended, albeit the Board is keen to reinstate this at the earliest opportunity.

Solutions enhance customer lifetime values

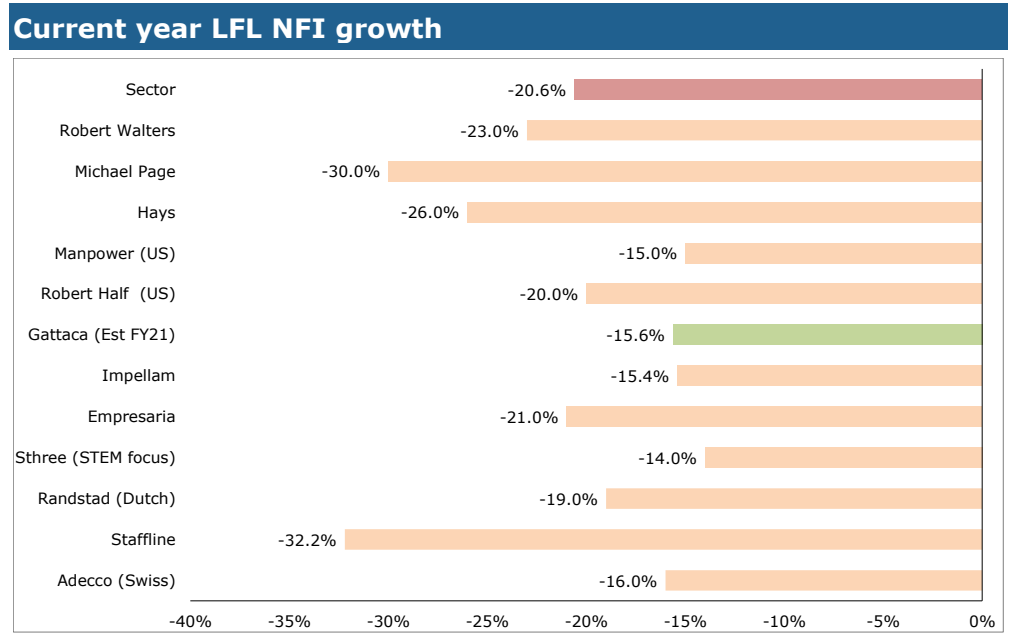
Moreover **no clients were lost by Gattaca Solutions** (29% NFI, 27% LY), which outperformed (NFI -16% at £15.7m) under challenging conditions.

Turn around remains firmly on track

£'000s (continuing) - July y/e	Act FY19	Act H1'20	Act H2	Act FY20	Est H1'21	Est H2'21	Est FY21
UK Engineering	3.9%	-6.8%	-32.5%	-19.5%			-15.6%
UK Technology	-19.9%	-25.0%	-38.7%	-31.1%			-15.3%
International	-14.3%	-20.9%	-16.1%	-19.2%			-16.0%
Total underlying NFI	-3.3%	-11.9%	-32.0%	-21.4%	-30.0%	5.3%	-15.6%
NFI	69,055	32,178	22,098	54,276	22,525	23,276	45,800
Adjusted EBITDA	14,888	5,153	4,084	9,237	1,905	2,545	4,450
Adjusted EBIT	13,686	3,610	2,382	5,992	305	945	1,250
<i>EBIT/NFI margin</i>	<i>19.8%</i>	<i>11.2%</i>	<i>10.8%</i>	<i>11.0%</i>	<i>1.4%</i>	<i>4.1%</i>	<i>2.7%</i>
Underlying overheads	55,369	28,568	19,716	48,284	22,219	22,330	44,550
U/L admin as % NFI	80.2%	88.8%	89.2%	89.0%	98.6%	95.9%	97.3%
Adjusted PBT	11,654	2,747	1,841	4,588	55	695	750
Tax	-2,501	-899	-372	-1,271	-28	-348	-375
Minorities	0	0	0	0	0	0	0
Underlying PAT	9,153	1,848	1,469	3,317	28	348	375
Adjusted EPS (diluted)	27.6p	5.5p	4.5p	10.3p	0.1p	1.1p	1.1p
NFI (LTM) / head (£ks)	93.4	95.0	137.1	81.6			78.3
Overheads / head (£Ks)	74.9			72.6			76.2
Headcount	739	681	665	665			585
<i>Net debt : EBITDA</i>	<i>1.67</i>	<i>0.26</i>	<i>-1.44</i>	<i>-0.35</i>			<i>-1.19</i>
<i>U/L tax rate</i>	<i>-21.5%</i>	<i>-32.7%</i>	<i>-20.2%</i>	<i>-27.7%</i>			<i>-50.0%</i>
Non-recourse invoice discounting		-16,000	-13,800	-13,800	-13,800	-13,800	-13,800
Cash / (recourse debt)	-24,822	-3,075	27,341	27,341	27,369	8,500	8,500

Source: Equity Development.

Indeed GATC's overall FY20 decline in NFI was not dis-similar to the rest of the staffing industry (see below), with the broader outlook now improving.



Source: Equity Development.

In the right place at the right time

CEO Kevin Freeguard adding: “*whilst we remain cautious as to the timeframe for economic recovery and the potential impact of an extended second lockdown in England, **we have been encouraged by the signs of increased activity in our core markets in the first few months of the new financial year***”.

Particularly across vital infrastructure (rail, water, etc), renewable power (wind), defence (submarines) and Artificial Intelligence, Automation, Fibre/5G, healthcare and cloud/cyber. All areas offering considerable growth potential. Moreover, there are **several frankly enormous multi-years projects** coming down the pipe - Heathrow expansion, Hinkley Point, Crossrail 2, HS2, line electrification, smart cities – which each individually could move the demand needle, whatever the weather.

Stock could take off over the next few years

In terms of possible returns, we would remind investors that sentiment can turn quickly. For instance, just look at what happened to the shares between 2012-14 after the Great Financial Crisis (see below).

Share price performance post Great Financial Crisis

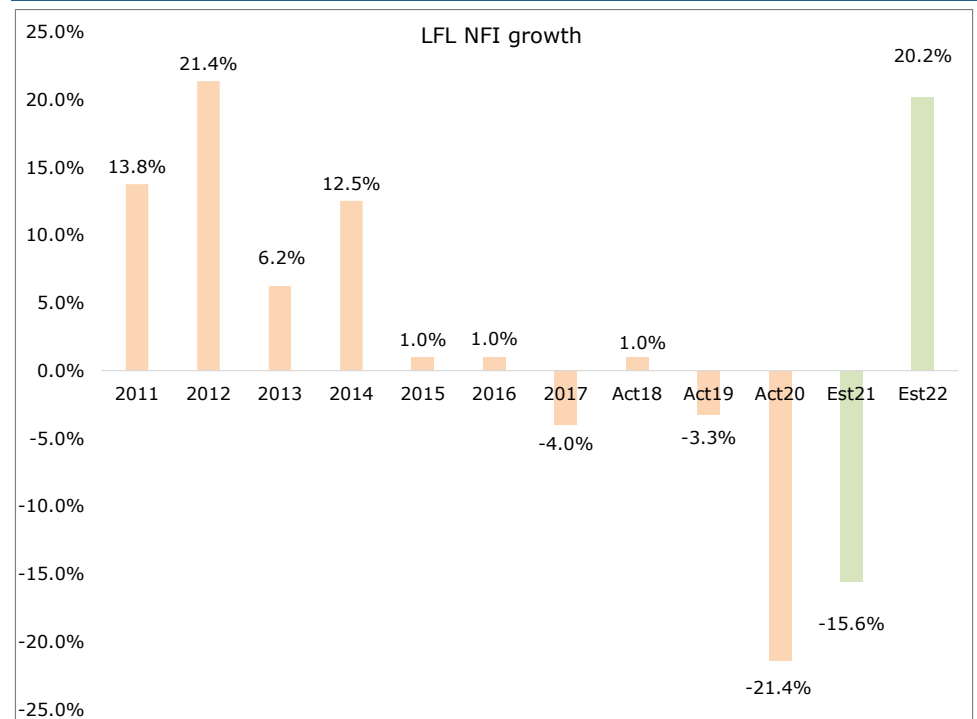


Source: ADVFN

Reiterate our FY21 forecasts

Don't get me wrong, it won't be all plain sailing. Granted, **Gattaca has turned a major corner**, but it's still not exactly sunny climes. Consequently, **we've held our FY21 numbers** - corresponding to trough adjusted EBIT and EPS estimates of £1.25m and 1.1p.

Historical and projected LFI NFI growth

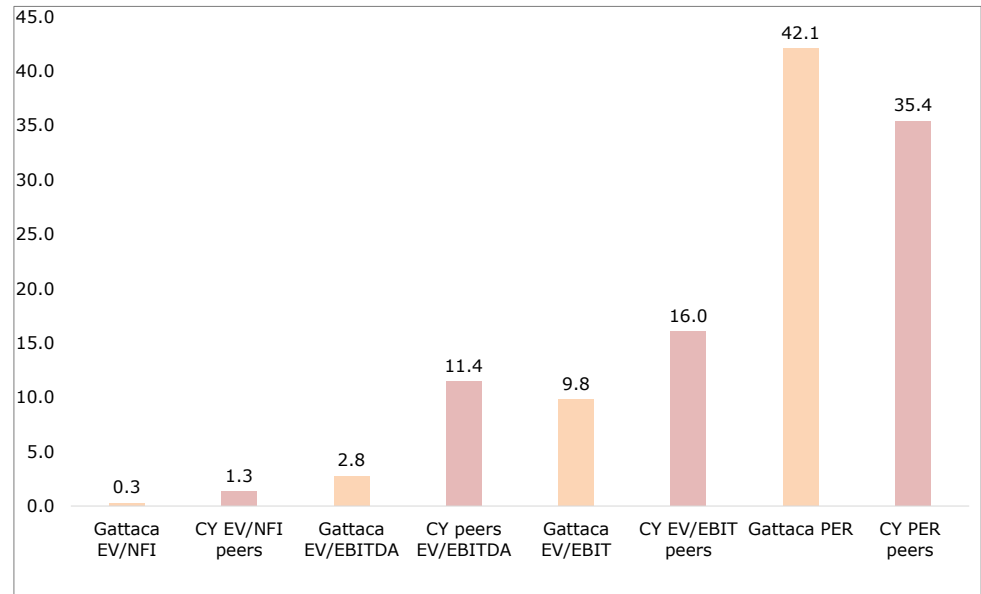


Source: Equity Development.

Valuation upgraded to 140p/share

Nonetheless, most of the heavy lifting has already been completed. Meaning that - assuming things go to plan – **we've lifted our valuation from 130p to 140p/share**

FY21 valuation benchmarks vs peers



Source: Equity Development

Key risks

- Coronavirus induced problems at some of its largest customers, which either lead to late payments and/or doubtful debts.
- Similarly the pandemic could delay the anticipated economic recovery
- General economic downturn affecting engineering and technology recruitment. For example, the cessation of the Brexit transition period in Dec'20 could knock business 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) on 6th April 2020, following the 2017 implementation in the public sector. The introduction date has apparently now been delayed by 12 months to 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 financial forecasts

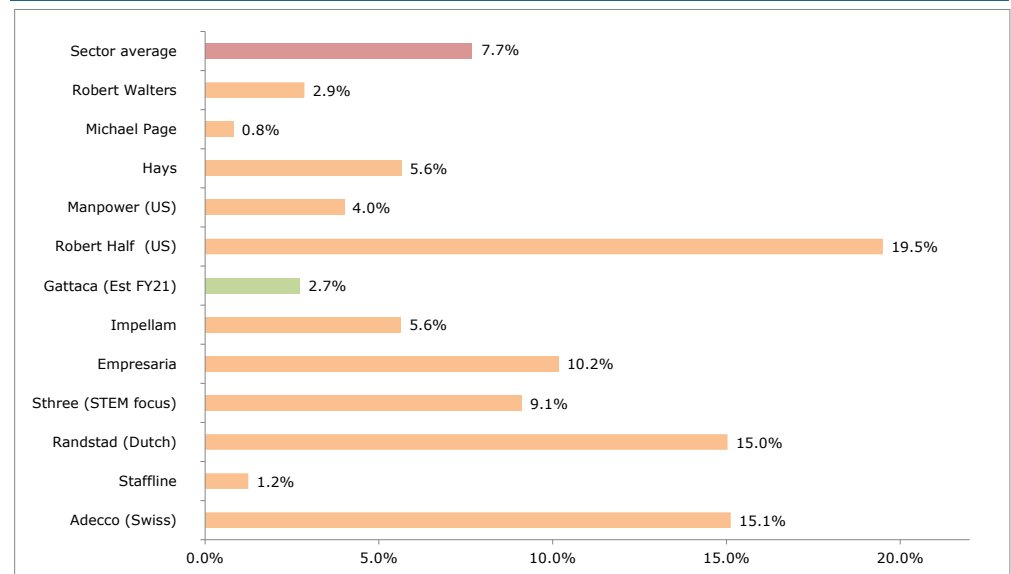
Gattaca (continuing operations) (July yearend)	2016 Act £'000s	2017 Act £'000s	2018 Act £'000s	2019 Act £'000s	2020 Act £'000s	2021 Est £'000s	2022 Est £'000s	2023 Est £'000s	2024 Est £'000s
Net Fee Income (NFI) : Gross profit			<i>Restated</i>	<i>Restated</i>					
UK Engineering	40,865	43,080	47,568	49,442	39,808	33,588	40,129	48,155	55,378
UK Technology	17,413	16,178	14,457	11,575	7,971	6,753	8,049	9,659	11,108
International	14,109	15,450	9,374	8,038	6,497	5,459	6,850	8,220	9,454
Total	72,387	74,708	71,399	69,055	54,276	45,800	55,029	66,035	75,940
NFI growth rate									
UK Engineering	8.0%	5.4%	10.4%	3.9%	-19.5%	-15.6%	19.5%	20.0%	15.0%
UK Technology	19.2%	-7.1%	-10.6%	-19.9%	-31.1%	-15.3%	19.2%	20.0%	15.0%
International		9.5%	-39.3%	-14.3%	-19.2%	-16.0%	25.5%	20.0%	15.0%
Total NFI growth rate	38.0%	3.2%	-4.4%	-3.3%	-21.4%	-15.6%	20.2%	20.0%	15.0%
EBITDA	22,617	18,284	13,395	14,888	9,237	4,450	9,590	14,393	18,536
UK Engineering	23,126	23,758	26,033	27,489	24,538	16,794	20,867	25,522	29,904
UK Technology	8,229	7,061	6,610	5,902	3,436	3,220	3,960	3,960	4,665
International	6,868	5,619	2,723	1,860	1,300	1,365	2,398	3,288	3,876
Central overheads	-16,726	-19,050	-22,964	-21,565	-23,282	-19,272	-20,184	-21,799	-23,434
Adjusted EBIT	21,497	17,388	12,402	13,686	5,992	1,250	6,300	10,972	15,012
Total Opex as % NFI	-70.3%	-76.7%	-82.6%	-80.2%	-89.0%	-97.3%	-88.6%	-83.4%	-80.2%
EBIT / NFI margin	29.7%	23.3%	17.4%	19.8%	11.0%	2.7%	11.4%	16.6%	19.8%
Net interest	-1,076	-1,232	-1,540	-2,032	-1,404	-500	-300	-250	-200
Adjusted PBT	20,421	16,156	10,862	11,654	4,588	750	6,000	10,722	14,812
Tax	-6,306	-5,076	-3,380	-2,501	-1,271	-375	-1,680	-3,002	-4,147
Minorities	0	-172	-275	0	0	0	0	0	0
Adjusted PAT	14,115	10,908	7,207	9,153	3,317	375	4,320	7,720	10,664
Adjusted diluted EPS (p)	44.1	33.7	22.5	27.6	10.3	1.1	13.1	23.3	32.0
Adjusted EPS growth rate	0.5%	-23.6%	-33.3%	22.9%	-62.9%	-88.9%	1045.8%	77.8%	37.5%
Dividend (p)	23.0	23.0	3.0	0.0	0.0	0.0	0.0	0.0	0.0
Dividend yield	47.9%	47.9%	6.3%	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)	1.1	1.4	2.1	1.7	4.7	42.1	3.7	2.1	1.5
EV/NFI	0.17	0.16	0.17	0.18	0.23	0.27	0.22	0.19	0.16
EV/EBIDA	0.5	0.7	0.9	0.8	1.3	2.8	1.3	0.9	0.7
EV/EBITA (diluted)	0.6	0.7	1.0	0.9	2.0	9.8	1.9	1.1	0.8
PEG ratio	2.09	-0.06	-0.06	0.08	-0.07	-0.47	0.00	0.03	0.04
Adjusted corporate tax rate	-30.9%	-31.4%	-31.1%	-21.5%	-27.7%	-50.0%	-28.0%	-28.0%	-28.0%
Adj ROACE	19.7%	15.6%	13.1%	18.5%	8.5%	1.8%	8.8%	14.1%	17.2%
EBITDA drop through rate as % NFI	21.3%	-186.7%	147.7%			56.5%	55.7%	43.6%	41.8%
Net recourse cash/(debt)	-25,013	-40,288	-40,874	-24,822	27,341	8,500	10,922	14,672	21,823
Non recourse invoice factoring (off Balance Sheet)					-13,800	-13,800	-13,800	-13,800	-13,800
HMRC deferred VAT					-10,300				
Net debt : EBITDA (incl HMRC & factoring)	1.1	2.2	3.1	1.7	-0.4	-1.2	-0.3	0.1	0.4
Diluted sharecount (Adj for 2015)	32,040	32,392	32,079	33,144	32,353	32,876	33,038	33,201	33,364
Shareprice (p)	48p								

Source: Equity Development

Note 1: Our financial projections and valuation do not factor in any possible future DOJ redress and/or fines.

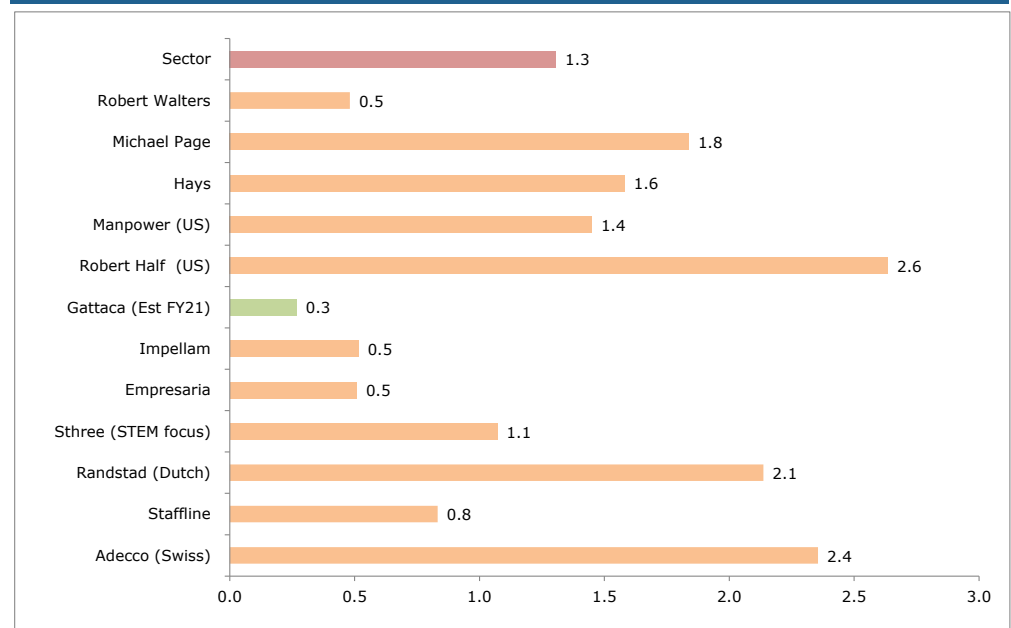
Appendices - sector valuation metrics and KPIs

Current Year (CY) EBIT / NFI conversion rates



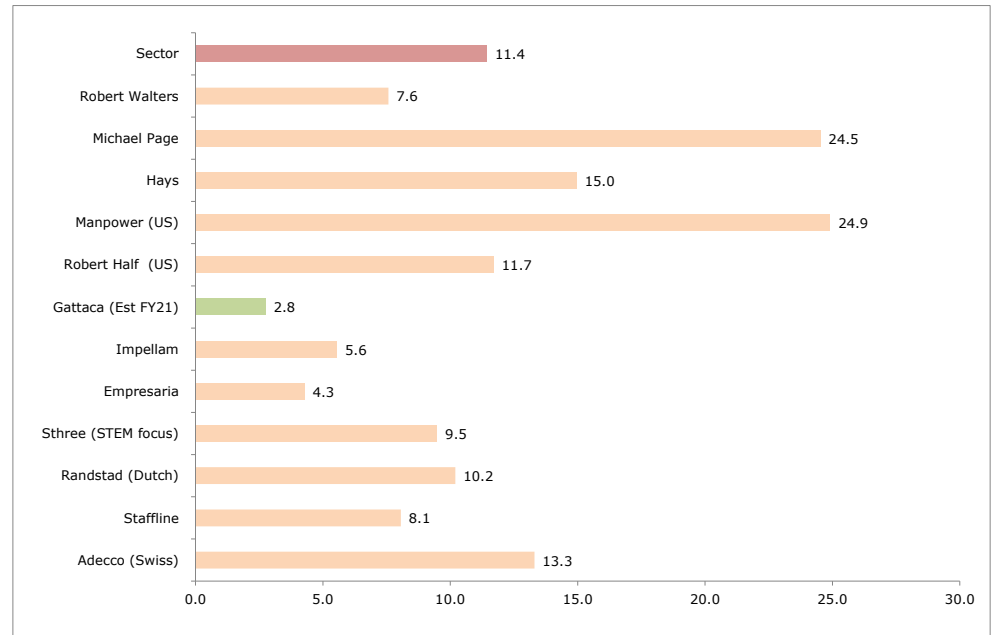
Source: Equity Development: arithmetic average for sector.

CY EV/NFI multiples vs peers



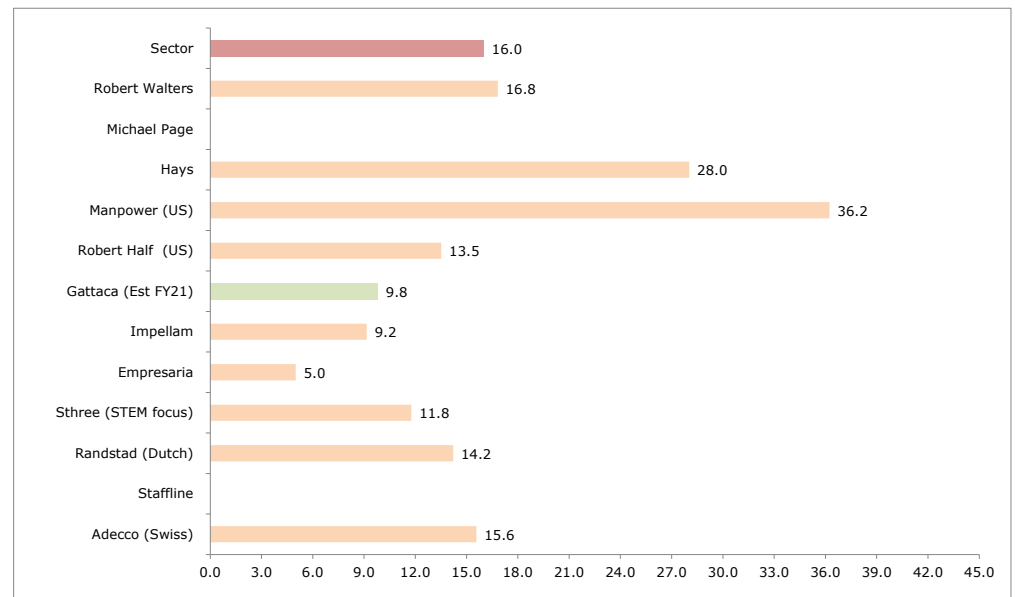
Source: Equity Development : arithmetic average for sector

CY EV/EBITDA multiples vs peers



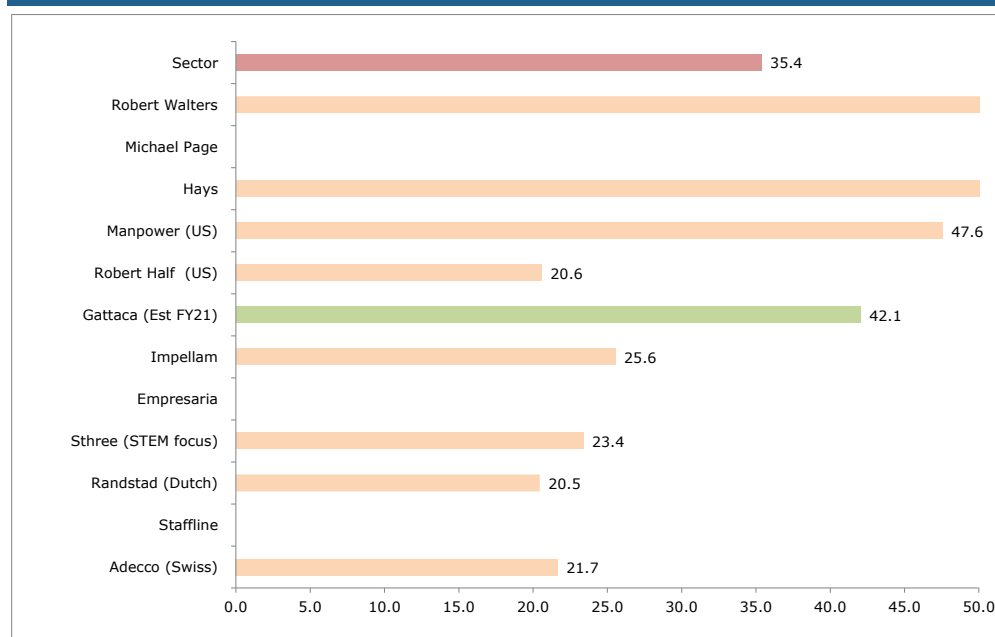
Source: Equity Development : arithmetic average for sector

CY EV/EBIT multiples vs peers



Source: Equity Development : arithmetic average for sector

CY PER multiples vs peers



Source: Equity Development : arithmetic average for sector

Market capitalisation of peers

	Shareprice	Mrk Cap (Millions)	CY net cash / (debt) Millions	Enterprise Value (Millions)
Adecco (Swiss)	€ 44.86	€ 7,761	-€ 462	€ 8,223
Staffline	26p	£17.9	-£49.0	£66.9
Randstad (Dutch)	€ 45.00	€ 8,280	-€ 391	€ 8,671
Sthree (STEM focus)	255p	£339.2	£45.0	£294.2
Empresaria	43p	£21.1	-£8.9	£30.0
Impellam	225p	£103.5	-£15.5	£119.0
Gattaca (Est FY21)	48p	£15.5	£3.2	£12.3
Robert Half (US)	\$51.50	\$5,871	\$600	\$5,271
Manpower (US)	\$68.50	\$4,042	\$55	\$3,987
Hays	107p	£1,905	£363	£1,542
Michael Page	360p	£1,156	£27	£1,129
Robert Walters	382p	£290.3	£138.9	£151.4

Source: Equity Development.



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