

The shares appear oversold

31 March 2022

Successful investing is all about spotting opportunities and being prepared to hold through thick & thin.

Take Gattaca, the UK's largest specialist engineering/tech recruitment agency. Its shares have fallen >70% (vs c. -25% sector) from their 52 week high of 285p - principally due to January's profit warning. There is work to be done, but even so we believe the scale of the sell-off looks totally disproportionate to the issues involved (Re temporary disruption from a major IT system implementation, staff turnover/culture, etc).

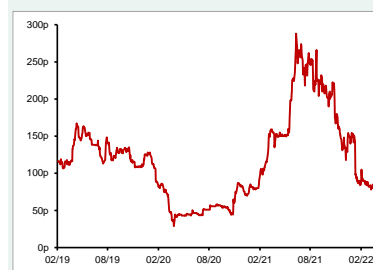
The economic backdrop remains healthy

Indeed one might argue that - despite fears surrounding the cost of living crisis, geopolitics & a flattening yield curve - the macro environment for UK staffing firms (especially STEM related) is actually pretty robust. Characterised by demand far outstripping supply, increasing salaries, low unemployment (UK at 3.9%) and plentiful job vacancies for those seeking work (see below).

Company Data

EPIC	AIM:GATC
Price (last close)	78p
52 week Hi / Lo	285p/75p
Market cap	£25.2m
Est Jul'22 net cash (excl £10.4m of off B/S non-recourse finance)	£5.0m
Share count	32.3m
ED valuation / share	145p

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.

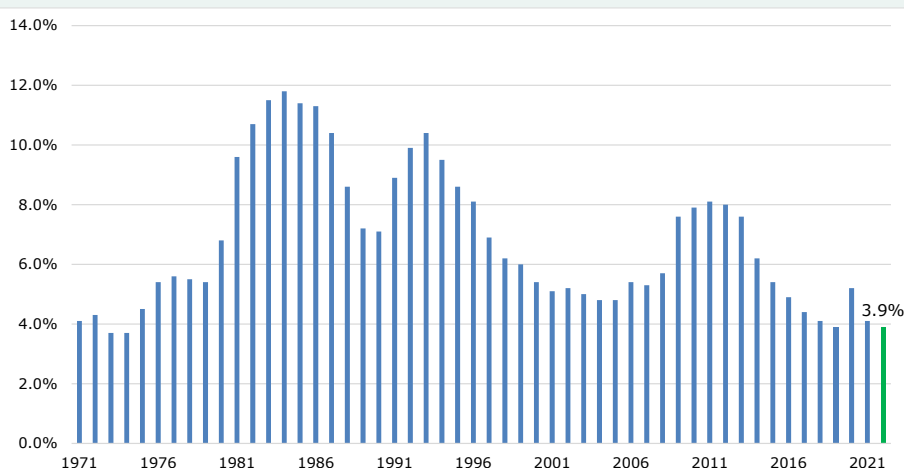
Headcount ended July 2021 at 512 of which 73% are sales related.

Next news: Y/E trading update Aug'22

Paul Hill (Analyst)

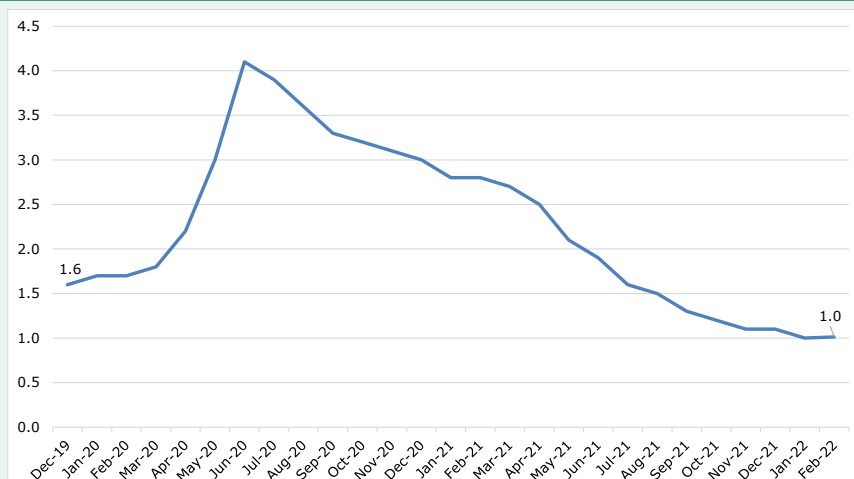
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UK unemployment rate falls to 3.9% in Feb'22



Source: ONS

Number of UK job vacancies per unemployed person



Source: ONS

A 'rising tide' should ultimately lift all boats

What's more, STEM rival Sthree reported UK LFL NFI growth of 29% in Q1'22 – driven by strong demand for software developers, project/construction managers, process engineers and H&S experts.

Granted Gattaca has a different business mix with greater engineering exposure and less life sciences. Yet nonetheless, GATC still grew LFL NFI 5.3% in H1'22 to £21.6m (see below) - with a slightly slower pace of expansion (+2.9%) expected in H2, after absorbing the loss of 3 key accounts (2 in infrastructure & 1 energy) in H1.

Gattaca H1 vs H2 results						
£'000s (continuing) - July y/e	Act H1'21	Act H2'21	Act FY21	Act H1'22	Est H2'22	Est FY22
UK	-8.1%	43.2%	12.8%	8.9%	4.0%	6.3%
International	-30.8%	-27.1%	-29.1%	-29.8%	-9.9%	-20.6%
Total underlying NFI	-33.6%	-1.3%	-20.2%	5.3%	3.0%	4.1%
NFI	20,522	21,558	42,080	21,606	22,194	43,800
Adjusted EBITDA	1,384	3,048	4,432	887	1,413	2,300
Adjusted EBIT	295	1,952	2,247	-108	408	300
<i>EBIT/NFI margin</i>	<i>1.4%</i>	<i>9.1%</i>	<i>5.3%</i>	<i>-0.5%</i>	<i>1.8%</i>	<i>0.7%</i>
Underlying overheads	20,227	19,606	39,833	21,714	21,786	43,500
U/L admin as % NFI	98.6%	90.9%	94.7%	100.5%	98.2%	99.3%
Adjusted PBT	-40	1,875	1,835	-261	261	0
Tax	40	-172	-132	0	0	0
Minorities	0	0	0	0	0	0
Underlying PAT	0	1,703	1,703	-261	261	0
Adjusted EPS (diluted)	0.0p	5.3p	5.3p	-0.8p	0.8p	0.0p
NFI (LTM) / head (£ks)			82.2			81.1
Overheads / head (£Ks)			77.8			80.6
Headcount	437		512	540		540
<i>Net debt : EBITDA</i>			1.28			-2.35
<i>U/L tax rate</i>			-7.2%			
Non-recourse invoice discounting	-12,200	-14,200	-14,200	-10,400	-10,400	-10,400
Deferred VAT	-10,300	-5,600	-5,600	0	0	0
Cash /(recourse debt)	22,744	19,890	19,890	4,841	5,000	5,000

Source: Equity Development.

Green shoots tentatively appearing

The good news is following the recent appointment of [Matthew Wragg](#) as CEO - a highly capable & experienced industry professional with 'sales' running through his veins. The early signs of a successful turnaround are tentatively taking shape, with productivity levels inching up anecdotally MoM since January. Furthermore the company is "seeing encouraging trends across many of its sectors".

Sure this won't translate into the financials over-night, yet equally we suspect patient investors will be richly rewarded in the fullness of time.

Ok, so what's the outlook for FY'22?

Well, near term the Board are guiding to a "breakeven" adjusted PBT. But expect FY'23 to "deliver a return to profitable and sustainable growth", as the benefits of higher & more productive fee-earners drive the top line.

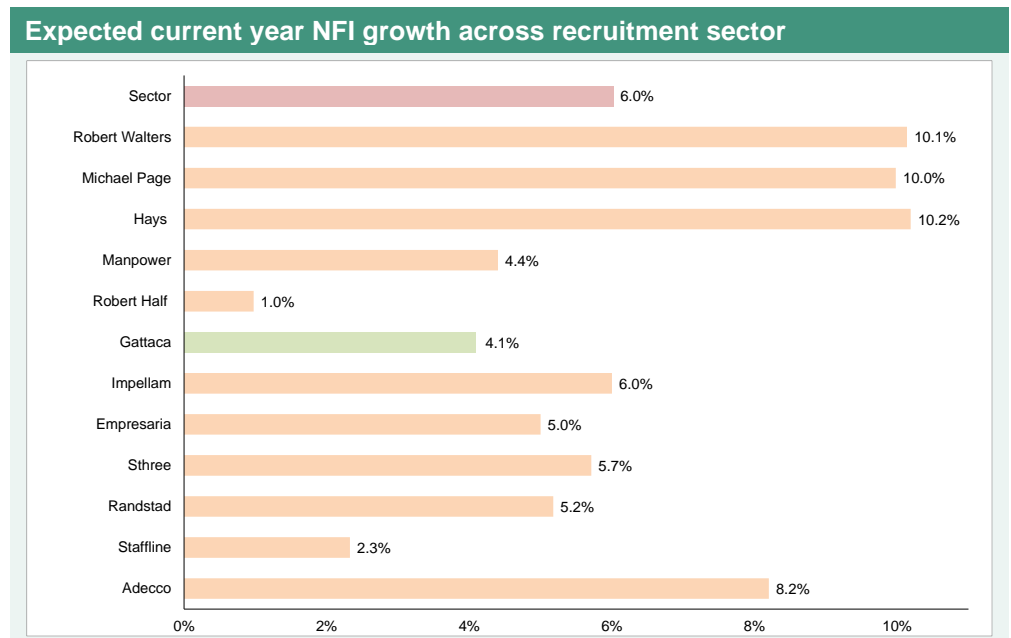
Longer term too, the **fundamentals are positive**, especially for Gattaca's sweet spots of software, digitisation, renewables (eg Off-shore wind & hydrogen), electrification, defence (cyber & marine), engineering and infrastructure (eg HS2, fibre-to-the-home, Lower Thames Crossing, etc).

Our conservative forecasts still justify a 145p/share fair value

Hence in this context, **we have pencilled in FY23 PBT of £2.5m on NFI of £49.1m with a 145p/share fair value**. Albeit these estimates are prudent, & we would ultimately hope to upgrade as key milestones are met. Similarly, **we assume the FY22 dividend will be temporarily suspended**, leaving net funds (pre IFRS16) of £5.0m as at Jul'22 (excluding £10.4m of non-recourse finance).

Confident of driving future growth

CEO Matthew Wragg adding: *"We are in a strong position to focus our energy once again on our STEM markets, helping our customers with their talent challenges during a period of particularly high demand. It is against this backdrop that I am optimistic for the future and excited for everyone in the team."*



Source: Equity Development.

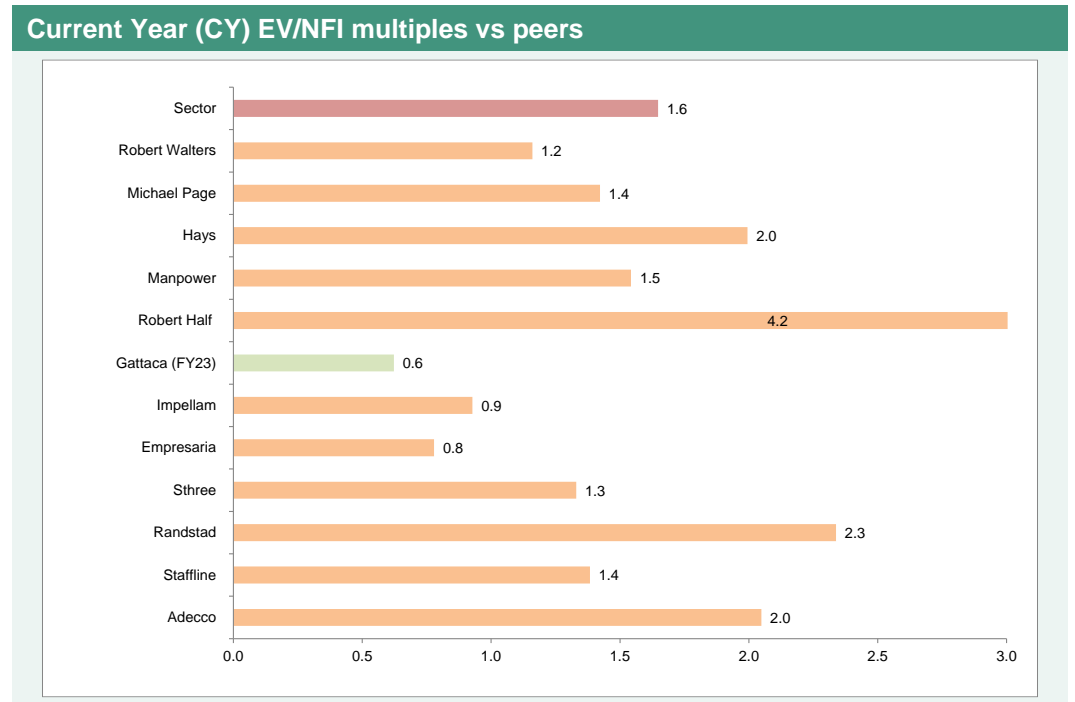
Key risks

- 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).

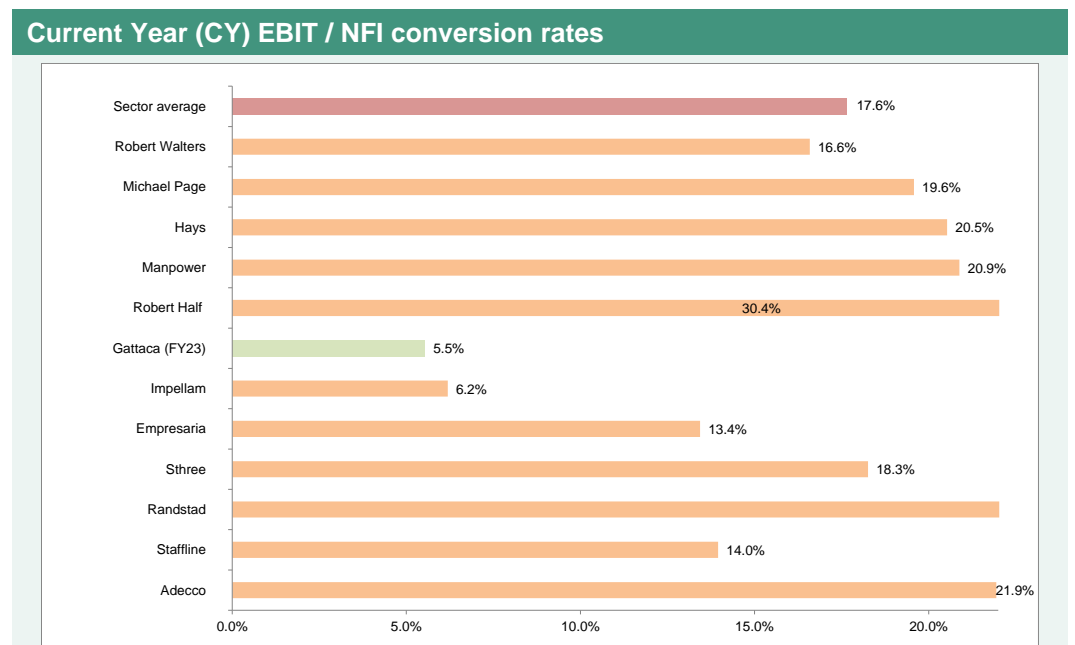
Summary projections (£'000s)						
Gattaca (continuing operations)	2020 Act	2021 Act	2022 Est	2023 Est	2024 Est	2025 Est
(July yearend)	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s
Net Fee Income (NFI) : Gross profit						
UK Engineering & Technology	34,177	38,552	41,000	46,044	51,696	57,687
UK Technology	13,602					
International	4,977	3,528	2,800	3,080	3,485	3,940
Total	52,756	42,080	43,800	49,124	55,181	61,627
NFI growth rate						
<i>UK Engineering & Technology</i>	-21.0%	12.8%	6.3%	12.3%	12.3%	11.6%
<i>UK Technology</i>	-23.5%					
<i>International</i>	-15.9%	-29.1%	-20.6%	10.0%	13.1%	13.1%
Total NFI growth rate	-21.2%	-20.2%	4.1%	12.2%	12.3%	11.7%
EBITDA	9,413	4,432	2,300	4,734	8,043	11,047
UK Engineering & Technology	20,913	10,827	15,580	17,957	20,937	24,229
UK Technology	7,061					
International	1,319	-572	-280	0	697	788
Central overheads	-23,125	-12,502	-15,000	-15,235	-15,624	-16,023
Adjusted EBIT	6,168	2,247	300	2,722	6,010	8,993
<i>Total Opex as % NFI</i>	-88.3%	-94.7%	-99.3%	-94.5%	-89.1%	-85.4%
<i>EBIT / NFI margin</i>	11.7%	5.3%	0.7%	5.5%	10.9%	14.6%
Net interest	-1,389	-412	-300	-250	-200	-150
Adjusted PBT	4,779	1,835	0	2,472	5,810	8,843
Tax	-995	-132	0	-618	-1,569	-2,388
Minorities	0	0	0	0	0	0
Adjusted PAT	3,784	1,703	0	1,854	4,241	6,456
Adjusted diluted EPS (p)	11.7	5.3	0.0	5.7	12.9	19.6
<i>Adjusted EPS growth rate</i>	-57.6%	-55.0%			127.6%	51.5%
Dividend (p)	0.0	1.5	0.0	3.0	5.0	7.0
<i>Dividend yield</i>	0.0%	1.9%	0.0%	3.8%	6.4%	9.0%
<i>Dividend cover</i>						
Valuation benchmarks						
<i>P/E ratio (diluted)</i>	6.7	14.8		13.8	6.0	4.0
<i>EV/NFI</i>	0.58	0.73	0.70	0.62	0.55	0.50
<i>EV/EBITDA</i>	3.2	6.9	13.3	6.5	3.8	2.8
<i>EV/EBITA (diluted)</i>	5.0	13.6		11.2	5.1	3.4
<i>PEG ratio</i>	-0.12	-0.27			0.05	0.08
<i>Adjusted corporate tax rate</i>	-20.8%	-7.2%		-25.0%	-27.0%	-27.0%
<i>Adj ROACE</i>	8.7%	3.3%	0.5%	4.4%	9.5%	13.5%
<i>EBITDA drop through rate as % NFI</i>				45.7%	54.6%	46.6%
Net recourse cash/(debt)	27,341	19,890	5,000	5,748	7,309	9,883
Non recourse invoice factoring (off Balance Sheet)	-13,800	-14,200	-10,400	-10,400	-10,400	-10,400
HMRC deferred VAT	-10,300	-5,600				
<i>Net debt : EBITDA (incl HMRC & factoring)</i>	-0.3	1.3	-2.3	-1.0	-0.4	0.0
<i>Diluted sharecount (Adj for 2015)</i>	32,353	32,358	32,519	32,682	32,845	33,009
<i>Shareprice (p)</i>	78p					

Source: Equity Development

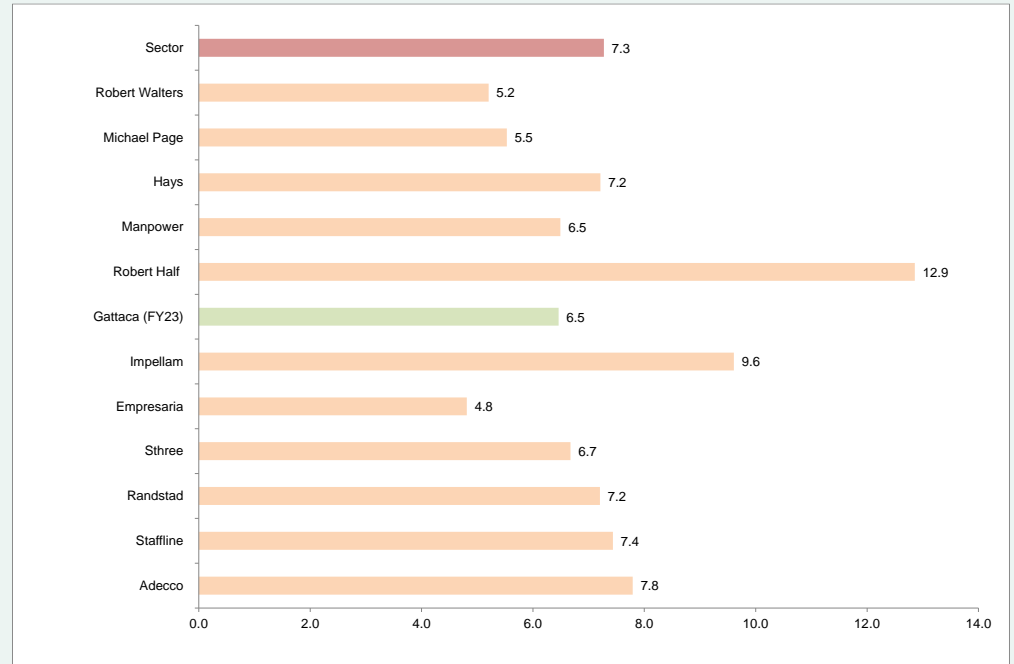
Appendices - sector valuation metrics and KPIs



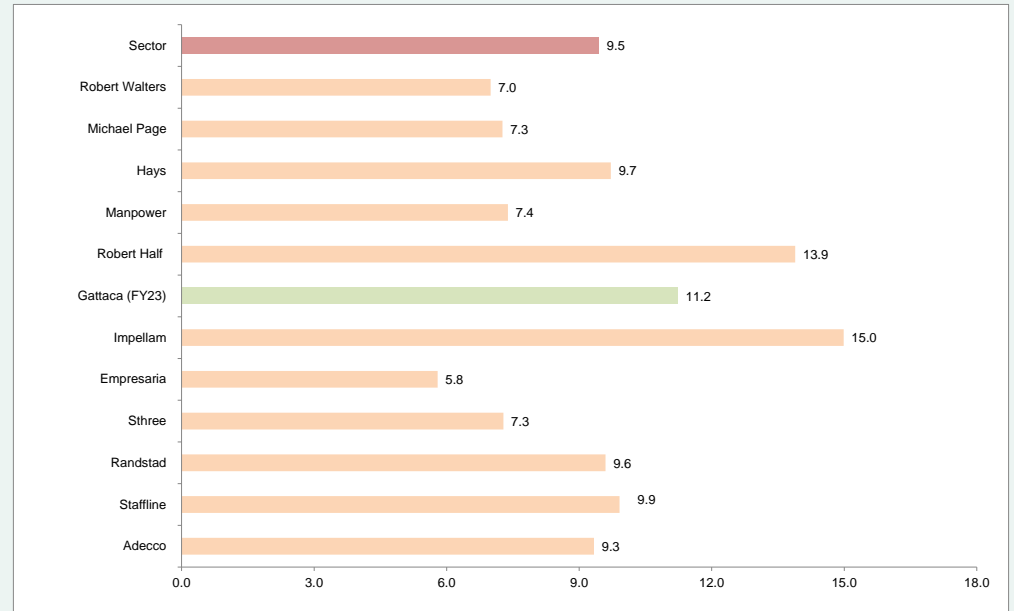
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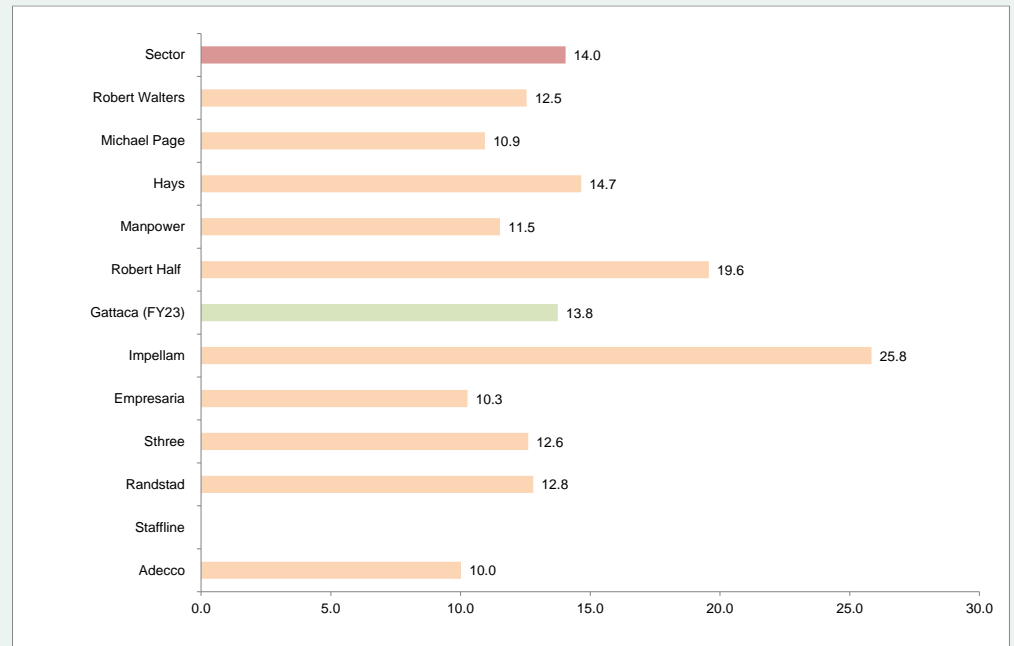
CY EV/EBITDA multiples vs peers


Source: Equity Development

CY EV/EBIT multiples vs peers


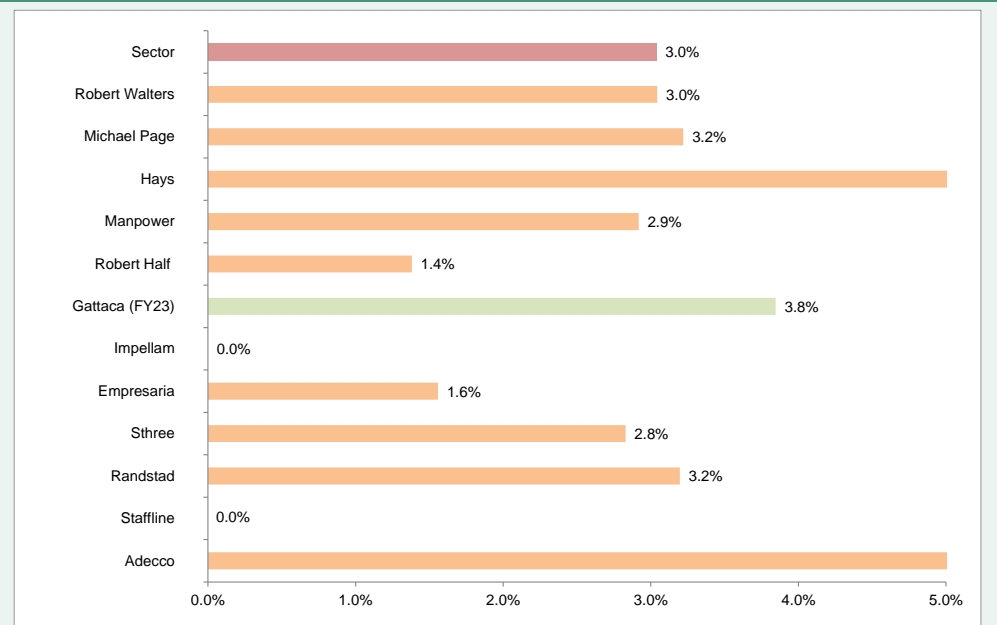
Source: Equity Development

CY PERs multiples vs peers



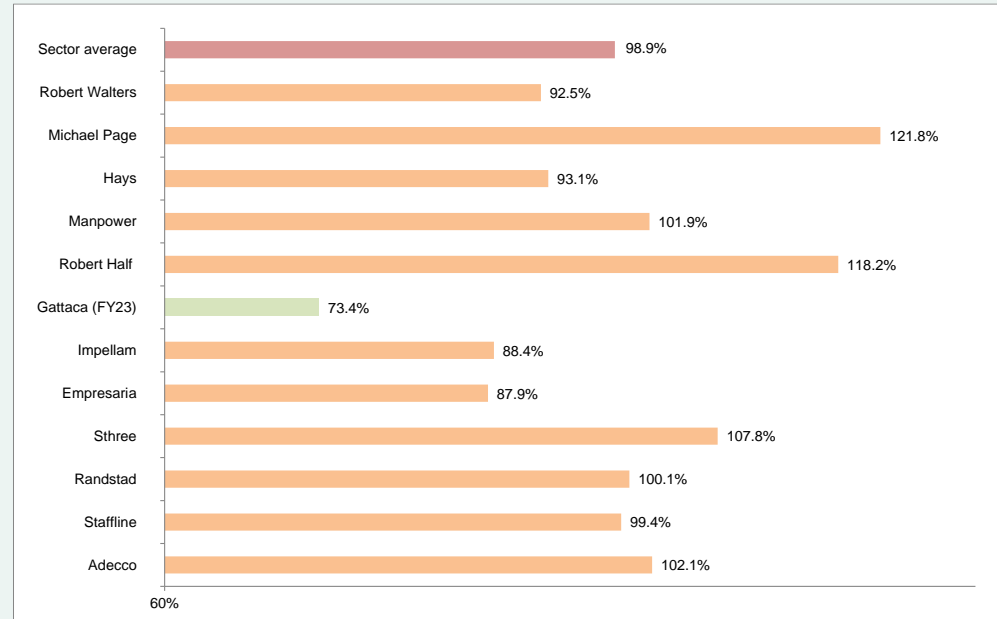
Source: Equity Development

CY dividend yield (%)



Source: Equity Development

Current year NFI as a % of pre Covid levels



Source: Equity Development.

Market capitalisation of peers

	Shareprice	Mrk Cap (Millions)	CY net cash / (debt) Millions	Enterprise Value (Millions)
Adecco	€ 41.87	€ 7,243	-€ 2,175	€ 9,418
Staffline	62p	£104.2	-£14.8	£119.0
Randstad	€ 58.50	€ 10,735	-€ 329	€ 11,064
Sthree	410p	£547.4	£62.9	£484.5
Empresaria	77p	£38.5	-£12.5	£51.0
Impellam	455p	£209.3	-£15.5	£224.8
Gattaca (FY23)	78p	£25.2	-£5.4	£30.6
Robert Half	\$118.00	\$13,334	\$735	\$12,599
Manpower	\$97.00	\$5,626	\$321	\$5,305
Hays	126p	£2,255	£157	£2,098
Michael Page	500p	£1,605	£123	£1,482
Robert Walters	690p	£525.1	£90.0	£435.1

Source: Equity Development



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