Gattaca plc

Trading report in-line with sector peers

16th April 2024

The results for the six-months to January are robust against a backdrop of declining confidence in both clients and candidates generally. With an improvement in the contract book during early Q3 we think this highlights that the tide is starting to turn and likely to feed through to demand for permanent hires ahead of the CY24 end. With net cash accounting for over 70% of the current market capitalisation, the operating business appears undervalued.

The results for the half-year to January were broadly in line with expectations, as declining economic confidence reduced NFI by 12.8% yoy, with the UK down 10%. The decline in **perm** activity was largely responsible for the shortfall, with **contract** activity remaining robust during the period. Adjusted PBT improved modestly, with the higher interest received offsetting the decline in the conversion rate. With taxes higher due to international losses and disallowables, adj. EPS was unchanged yoy at 1.6p.

Costs have reduced further, with an emphasis on adjusting headcount, property exposure, and the Group's international footprint. Should recovery emerge as anticipated, headcount will be grown in-line with contract opportunities.

Several new contracts/renewals were awarded during the period, likely to benefit H2 onwards and reflecting a resurgent business development team. Encouragingly, the number of contractors on assignment increased modestly during the period, with further improvement into Q3. We continue to hold the view that recovery in activity levels should feed through before the end of CY24, recognising macro uncertainty of a political and economic nature. Any recovery should feed through disproportionately to profitability, in view of the operationally geared business model.

Management continues to add headcount in its targeted areas of focus, increasing dominance in such segments. The new Chair of the Board has examined, challenged and ultimately validated this strategy to improve market share within key disciplines.

Looking forward

We have taken a more conservative view of the outlook, reducing FY24 estimates in line with new guidance, albeit still anticipating meaningful growth in activity levels – including a recovery of the higher margin perm activity in FY25.

Such a recovery is not reflected in the current valuation. The operating business – on stripping out the net cash – is valued at just £10.5m. We think this makes no sense at all in view of our expected EBIT of £1.9m in FY24 and £2.5m in FY25. **As such, we set a fair value of 140p / share.**

FY estimates

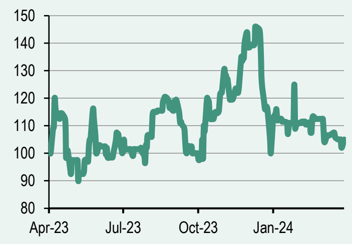
Y/e July, £m	FY21A	FY22A	FY23A	FY24E	FY25E
NFI	42.1	44.2	43.4	40.2	42.7
EBITDA	4.4	2.8	3.8	3.6	4.1
Adj. PBT	1.8	0.3	2.6	2.5	3.0
Adj. EPS (p)	5.3	0.5	4.5	4.7	6.0
DPS (p)	0.0	0.0	5.0	2.5	3.0
EV/NFI	0.3	0.3	0.3	0.3	0.3
EV/EBITDA	2.5	4.0	3.0	3.1	2.7
PER	19.8	220.3	23.2	22.0	17.5
Yield	0.0%	0.0%	4.8%	2.4%	2.9%
Net cash	19.9	12.3	21.6	19.8	19.0

Source: Company historics, ED estimates

Company Data

EPIC	AIM: GATC
Price (last close)	104p
52 weeks Hi/Lo	150p/90p
Market cap	£32.6m
ED Fair Value / share	140p
Net cash (at 31/01/24)	£22.3m

Share Price, p



Source: ADVFN

Description

Gattaca plc is a specialist STEM (Science, Technology, Engineering and Mathematics) staffing solutions business. In H1 '24 the Company delivered net fees of £18.9m – of which 76% was derived from temporary/contract placements, with the remainder comprising permanent placements.

Period end sales headcount at the end of H1 '24 amounted to 306 (down 1% from the end of FY23 and 11% lower yoy). Sales headcount represents 68% of total employee numbers.

Next news: FY trading update Aug '24

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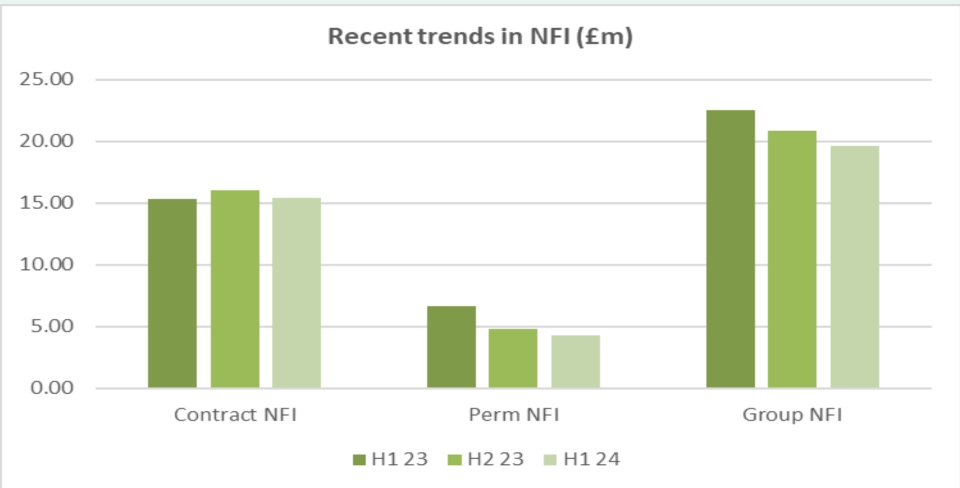
Robust results with adj. PAT/EPS unchanged

Interim results

Period to 31 Jan, £m	H1 '23A	H1 '24A	Change
UK	189.0	185.8	-1.7%
International	3.8	2.6	-30.7%
Total revenue	192.8	188.4	-2.2%
CoGS	-172.0	-168.8	-1.9%
NFI	22.5	19.7	-12.8%
NFI margin (%)	11.7%	10.4%	
NFI/Consultant	65.7	63.9	-2.8%
NFI/Headcount	45.4	44.6	-1.7%
OpEx	-21.8	-19.3	-11.5%
Adj. EBITDA	1.5	1.1	-23.5%
EBITDA (%)	6.6%	5.8%	
Adj. EBIT	0.8	0.4	-50.5%
Conversion rate (%)	3.4%	1.9%	
Net i/r	0.0	0.4	-4530.0%
Adj. PBT	0.7	0.8	9.5%
Taxation	-0.2	-0.3	36.5%
Tax (%)	29.8%	37.1%	
Adj. PAT	0.5	0.5	-1.9%
Adj. EPS (p)	1.6	1.6	0.0%
DPS (p)	0.0	0.0	
Net cash / (debt)	21.6	22.3	3.2%
Net cash / share (p)	66.2	70.7	6.9%

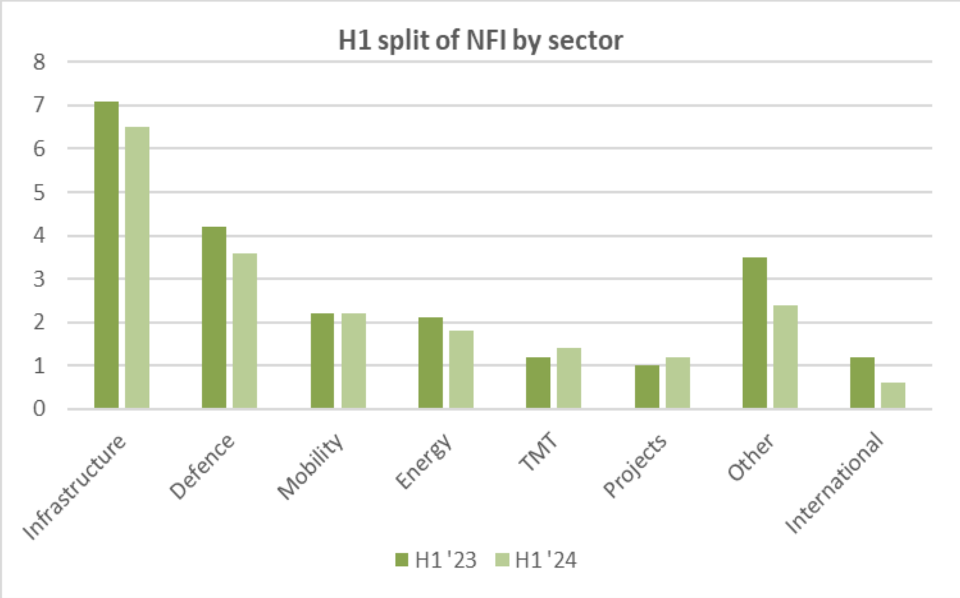
Source: Company

NFI split by Contract / Perm



Source: Company

NFI by sector



Source: Company

Sector context

Recent results from other sector incumbents have evidenced a challenging H2 '23, with levels continuing to decline during calendar Q4 and no improvement occurring in the new year. Waning confidence levels in the global economy has resulted in employment offers being rescinded, pay offers declining from previous highs and candidates staying with existing employers. As such, permanent activity has fallen markedly. However, contract has proven more resilient with market declines in low single digit percentages yoy.

Gattaca has not been immune from such trends with net fees falling 13% overall, equating to an underlying 9% decline when accounting for an RPO contract the Group decided to exit within the defence sector, reflecting uneconomic terms. Contract fee income declined 3%, albeit encouragingly the exit rate demonstrated growth yoy, reflecting new contract wins. Encouragingly, the number of contractors out with clients improved 2.5% to 4,220 during H1 '24.

Stripping out the RPO contract exited during FY23, perm fees fell 26% on an underlying basis. Temporary recruitment freezes have been introduced by several of the Group's clients regarding permanent hires.

Productivity improved on an underlying basis, with NFI/sales consultant rising 2% yoy.

On a sector-by-sector basis, underlying growth was secured within:

- **Defence** (+5%, stripping out the RPO contract), reflecting improving UK MoD commitment to defence spending
- **TMT** (+10%), led by higher contract demand particularly in digital transformation, development, cloud and cyber security
- **Projects** (+14% yoy), with project management, supply chain management and quality assurance in higher demand
- **Mobility** (+1% yoy), with Q1 witnessing higher perm demand, although in Q2 hiring freezes have crept in especially within aerospace and pockets of resilience within automotive

Other areas delivered weaker performances, including:

- **Infrastructure** (-9% yoy), despite modest growth within rail, as demand within the transportation and water sub-sectors declined, led by perm (stable in contract)
- **Energy** (-15% yoy), notwithstanding a doubling of headcount within the sector, with a targeting of opportunities within renewables, transmission and distribution, nuclear and oil & gas from H2 onwards. Candidate shortages within offshore oil & gas remained an issue during H1
- **UK Other** (-31% yoy), as demand for permanent placements within professional services, smart manufacturing and public sector reduced, albeit a new sizeable managed services project (MSP) was secured within the Smart Manufacturing sub-sector, to commence during H2 '24
- **International** (-56% yoy) following the end of a large RPO contract within the US technology sector.

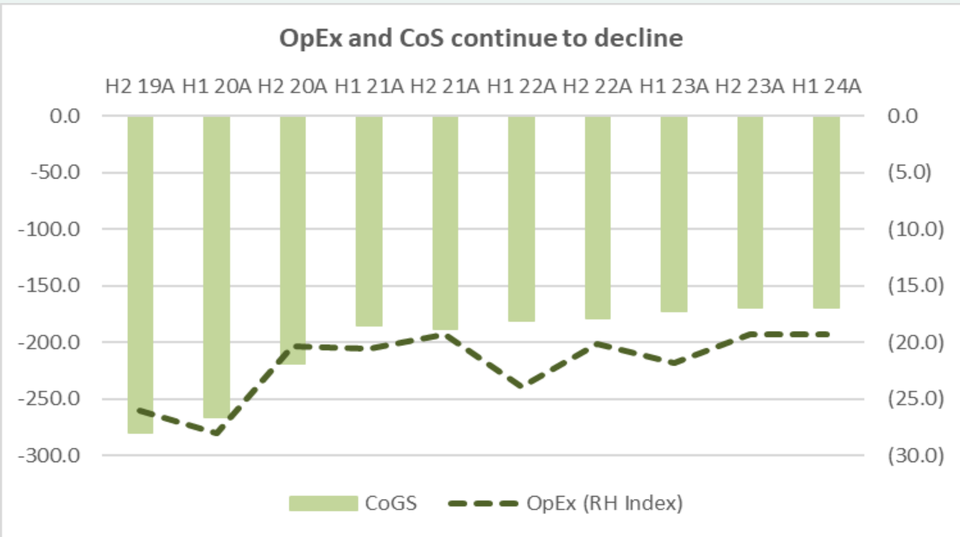
Continued focus on costs

Not surprisingly in view of the challenging environment, management have kept tight control of the cost base, with:

- Headcount declining 10% yoy to 446 yoy, with sales headcount remaining at 69% of overall numbers, notwithstanding the longer term goal of a 75:25 split in sales:support
- Property consolidation, with the process expected to complete during H2 '24
- A shrinking of the international business – with lower headcount within the technology sector in the US, the outsourcing of the support function, offset by growth within energy.

In all, costs declined 3% overall yoy to £188.1m. Significantly, in areas where the Group wish to gain market share, based on strong inherent growth drivers' management continue to add headcount (largely in contract roles). A high proportion of perm consultants have been retained, which emphasises the Board's belief that recovery is likely to feed through into volumes before the end of CY24 (albeit unfortunately, not before the July year-end).

Costs continue to decline



Source: Company

Although the conversion rate (EBIT/NFI) declined, reflecting the operationally geared nature of the business model to 1.9% (H1 '23: 3.4%), net interest increased markedly to £0.6m (H1 '23: £0.2m), resulting in a modest yoy improvement in adj. PBT to £0.8m (H1 '23: £0.7m).

The increase in the tax charge to 37.1%, reflecting international losses and disallowables saw PAT and adj. EPS unchanged at £0.5m/1.6p, respectively. In-line with 2023, no dividend has been announced at the interim stage.

Net cash

Encouragingly, net cash increased to £22.3m (H1 '23: £20.9m, FY23: £21.6m), reflecting a decline in Days Sales Outstanding to 53 days (H1 '23: 59 days), the £0.5m share buy-back programme, modest capex of £0.1m and the payment of FY23's final and special dividends.

At the period end, **net cash amounted to 71p per share**, underpinning the current share price.

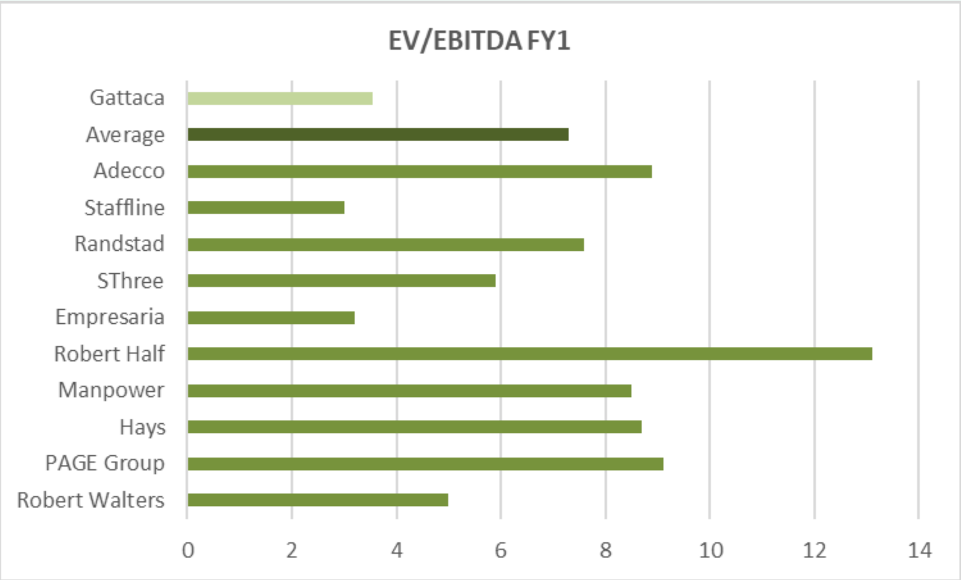
Valuation

With £22.3m of net cash on the balance sheet, equating to 70.7p/share, the operating business is significantly undervalued in our opinion. Stripping this sum from the current market capitalisation, we see likely EBIT of £1.9m in FY24, followed by £2.5m in FY25 valued at just £10.3m or a FY EBIT multiple of 5.4x in FY24 and 4.1x in FY25.

The following chart demonstrates **the significantly lower rating of Gattaca** relative to its peer group on an EV/EBITDA basis (which takes account of the varied balance sheets across the staffing sector).

On the basis of our more conservative estimates, pushing out the expected recovery in perm placements to Q4 CY24, we have reduced our fair value / share to 140p (from 175p previously). Even at this valuation, the operating business ex-cash would be trading on a FY25 EBIT multiple of just 10.5x.

Peer group comparison: FY1 EV/EBITDA (x)



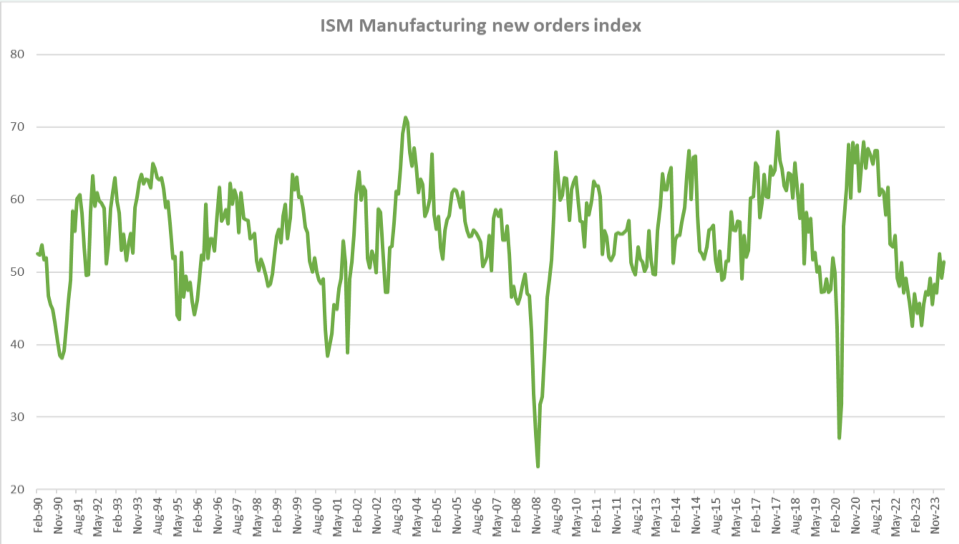
Source: Koyfin

Financials/outlook

We remain optimistic that economic confidence and consequently activity within the staffing sector will pick up by the end of the current calendar year. The longer leading indicator, the US ISM manufacturing new order index remained over the crucial 50 level in March, having recovered from recent lows in October 2023.

Typically, rising orders provides confidence for manufacturers to hire, which in turn reverberates across the remainder of the economy and ultimately globally as disposables incomes improve.

The longer leading indicator for the staffing industry



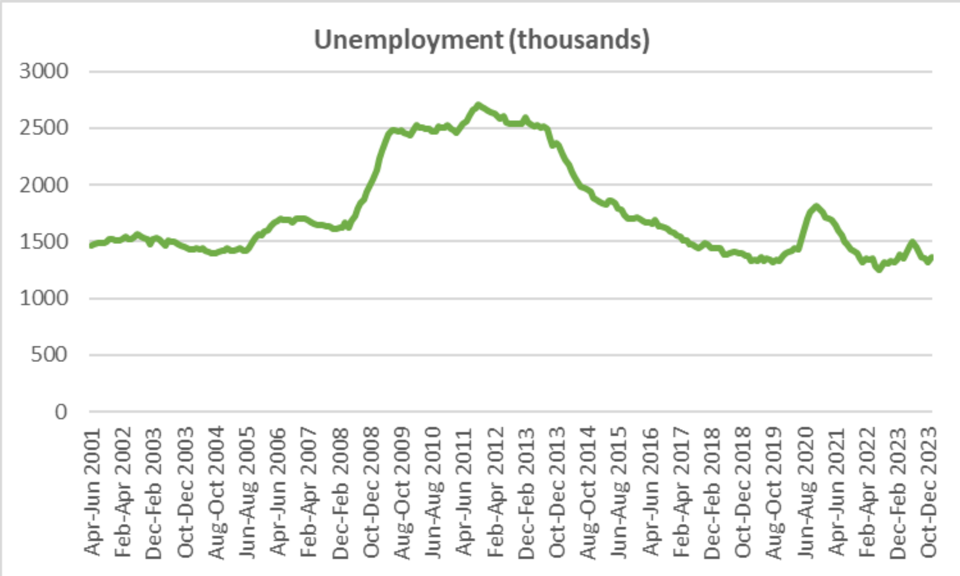
Source: Institute of Supply Management

Although vacancies have declined from the previous peaks, they remain ahead of pre-pandemic levels in the UK, with unemployment modestly ahead of the lows experienced in the last 20+ years. That suggests to us that once confidence returns staffing markets should recover rapidly given the current tight labour markets.

Vacancies in the UK economy

Source: ONS

UK unemployment



Source: ONS

We have reduced estimates in-line with guidance (adj. PBT of £2.4m to £2.7m) for FY24 and have taken a conservative view on FY25, believing the recovery is unlikely to gather much momentum ahead of Q2 '25.

In view of the operationally leveraged operating model, a return of confidence, initially with contract and then perm placements, should result in a disproportionately strong recovery in the conversion rate relative to the gain in NFI.

Changes to estimates

Year-end July, £m	Old FY24	New FY24	Change	Old FY25	New FY25	Change
NFI	40.9	40.2	-1.7%	44.0	42.7	-2.9%
Adj. EBIT	2.2	1.9	-13.0%	4.2	2.5	-40.4%
Conversion rate %	5.4%	4.8%		9.5%	5.9%	
Adj. PBT	2.8	2.5	-10.2%	4.7	3.0	-36.6%
Adj EPS (p)	6.5	4.7	-27.2%	10.8	6.0	-44.6%
DPS (p)	3.3	2.5	-24.3%	5.4	3.0	-44.6%
Post-IFRS16 net cash	21.7	19.8	-8.7%	22.8	19.0	-16.5%

Source: Equity Development

Summary Income statement					
Year to July, £m	**2021A**	**2022A**	**2023A**	**2024F**	**2025F**
Revenue	415.7	403.9	385.2	382.7	397.5
CoGS	-373.6	-359.7	-341.8	-342.5	-354.8
UK NFI	38.6	41.4	41.2	39.1	41.5
International NFI	3.5	2.8	2.2	1.1	1.3
Group NFI	42.1	44.2	43.4	40.2	42.7
NFI margin (%)	10.1%	10.9%	11.3%	10.5%	10.8%
Op costs	-39.8	-44.1	-41.1	-38.3	-40.2
EBITDA	4.4	2.8	3.8	3.6	4.1
EBITDA/NFI conversion (%)	10.5%	6.3%	8.8%	9.0%	9.7%
Adj. EBIT	2.2	0.1	2.3	1.9	2.5
Conversion rate (EBIT/NFI, %)	5.3%	0.2%	5.4%	4.8%	5.9%
Net Interest	-0.4	0.2	0.2	0.6	0.5
PBT (Adjusted)	1.8	0.3	2.6	2.5	3.0
Exceptionals	-0.1	-5.0	0.2	-0.7	-0.3
PBT (Reported)	1.8	-4.7	2.8	1.8	2.7
Tax	-0.1	-0.2	-1.1	-1.0	-1.0
PAT	1.6	-4.9	1.7	0.8	1.7
Profit from discontinued items	-1.2	-0.4	-0.5	0.0	0.0
Minority interests	0.0	0.0	0.0	0.0	0.0
Earnings	0.4	-5.2	1.1	0.8	1.7
EPS (Adjusted) (p)	5.3	0.5	4.5	4.7	6.0
DPS (p)	0.0	0.0	5.0	2.5	3.0
Ave no of shares (FD) (m)	32.4	32.5	32.7	32.4	32.4

Source: Company historics, Equity Development estimates

Summary Cash Flow

Year to July, £m	2021A	2022A	2023A	2024F	2025F
Adj. EBIT	2.2	0.1	2.3	1.9	2.5
Depn. & Amortn.	0.9	3.1	1.6	1.7	1.6
Working capital movement	-5.4	-3.4	6.7	-3.1	-3.2
Other	-4.3	-4.9	1.0	-0.7	-0.1
Operating cash flow	-6.6	-5.1	11.7	-0.2	0.8
Net Interest	-0.4	-0.2	0.2	0.6	0.5
Taxation	-0.5	0.3	-0.9	-1.0	-1.0
Net capex	-0.4	-0.4	0.0	-0.3	-0.3
Pref. dividends	0.0	0.0	0.0	0.0	0.0
Operating FCF	-7.9	-5.4	11.0	-0.8	0.0
Net (Acquisitions)/Disposals	0.0	0.0	0.0	0.0	0.0
Dividends	0.0	-0.5	-0.5	-1.3	-0.8
Share Issues	0.1	-0.1	-0.7	-0.7	0.0
Minority payment	0.0	0.0	0.0	0.0	0.0
Other financial	0.4	-1.5	-0.5	1.1	0.0
Increase Cash/(Debt)	-7.5	-7.5	9.2	-1.7	-0.8
Opening Net Cash/(Debt)	27.3	19.9	12.3	21.6	19.8
Closing Net Cash/(Debt)	19.9	12.3	21.6	19.8	19.0

Source: Company historics, Equity Development estimates

Abbreviated Balance Sheet

Year to July, £m	2021A	2022A	2023A	2024F	2025F
Intangible Assets	6.3	2.1	2.0	2.0	2.0
Tangible Assets	1.6	1.4	1.0	1.0	1.0
Right of use assets	5.7	3.1	1.9	1.7	1.5
Investments/other	1.0	0.6	0.4	0.4	0.4
Net Working Capital	6.2	11.6	4.4	7.5	10.7
Capital Employed	20.8	18.7	9.7	12.6	15.5
Deferred tax	4.3	0.0	0.1	0.1	0.1
Net Cash/(Debt)	19.9	12.3	21.6	19.8	19.0
Provisions Liabilities/Charges	1.3	0.5	0.4	0.4	0.4
Net Assets	35.1	30.5	30.8	31.9	34.1

Source: Company historics, Equity Development estimates

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