Gattaca plc

Decisive action being taken

4th September 2018

As indicated at the August pre-close trading update, the Board are wasting no time to turnaround the less profitable and/or loss making parts of the group. First on the list are those activities/territories that possess insufficient critical mass, deteriorating fundamentals and/or unattractive cash generation.

Consequently this morning the company announced it was exiting from its Contract Telecoms Infrastructure interests in Africa, Asia and Latin America (some of which is UK sourced) as well as Dubai, Kuala Lumpur and Qatar. What's more, in line with the lower associated NFI (contributing c. £7m in FY18) GATC's London and Bromley offices are to be consolidated into the London Cotton Centre site to trim central overheads. All affected staff and customers will be notified shortly.

Much improved cash generation

We think today's news makes perfect sense, since it not only **provides a substantial working capital boost (c.£7m)**, but also **reduces the effective tax rate from c.35% FY18 to c.25% thanks to the reduction in non-recoverable withholding tax.** Which, on top of a better than expected July'18 closing net debt position of £41m (vs £46m before), means that £4m of positive cashflow is forecast to be generated in FY19 alone - despite absorbing £3m of one-off restructuring costs.

Elsewhere, we have reduced our FY19 NFI and adjusted PBT expectations by £7.5m to £72.1m and £1.7m to £10.9m respectively, **but held diluted EPS broadly flat at 25.0p** (vs 25.1p before). **With our valuation nudging up slightly from 175p to 180p per share**.

Increased valuation from 175p to 180p/share

As regards the big picture: "***Gattaca remains fully committed to [both] its Technology and International divisions****, which offer the opportunity to achieve significant, sustainable and scalable profits*". Indeed a new sales hub has recently been opened in Atlanta (Georgia, US) alongside its fast growing Dallas office. In China too, the Board hopes to replicate this success, as management focus more on cash generative Engineering & IT permanent recruitment activities without now having to also chase legacy Telco business.

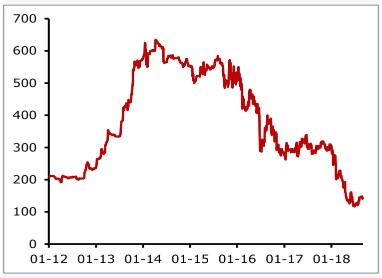
We look forward to hearing greater detail at the prelims on 8th November, along with an update on the new CEO appointment. In the meantime, **we note that the shares are attractively priced** - trading on FY19 multiples of 6.9x EV/EBIT and 5.7x PE vs sector averages of 9.6x and 12.1x (see below).

Chairman Patrick Shanley adding "***The steps we are announcing today will place Gattaca on a firm footing for future growth****. The withdrawal from these territories and Telco Infrastructure operations remove some very low margin business, which was tying up significant working capital and diluting the strength of our core operations. Following this review, Gattaca can now focus on our strong core and growing businesses, in particular within UK Engineering, UK IT, and North America as well China and our recently acquired RSL Rail business.*"

Company Data

EPIC	AIM:GATC
Price (last close)	143p
52 week Hi/Lo	320p/117p
Market cap	£45.5m
ED valuation/share	180p

Share Price, p



Source: Web Financial

Description

Gattaca, employing c.870 staff, is the UK's #1 specialist engineering and #5 technology recruitment agency, providing contract, temporary and permanent staff (Source: Recruitment International). It derives 19% of NFI overseas (excluding international placements supplied from the UK), and circa 72% from temporary contractors with the remaining 28% 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: Prelims 8th November

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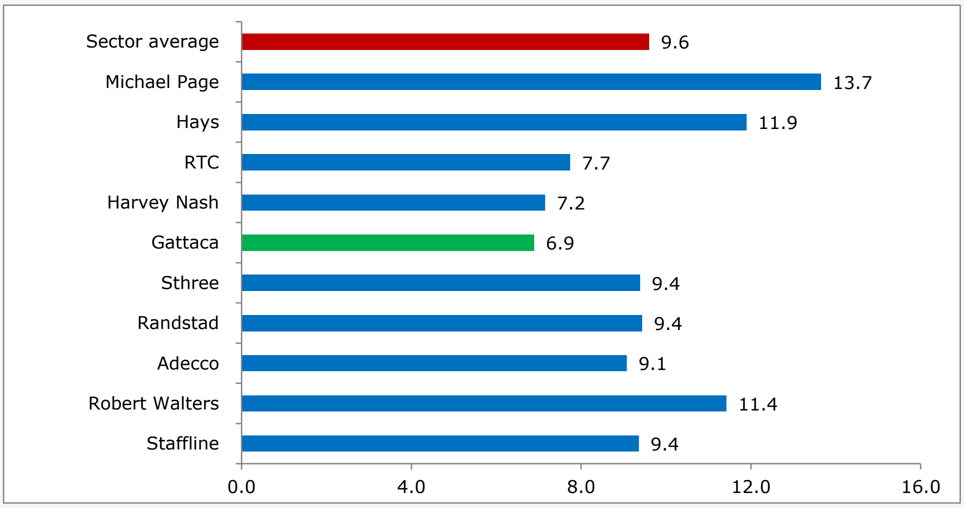
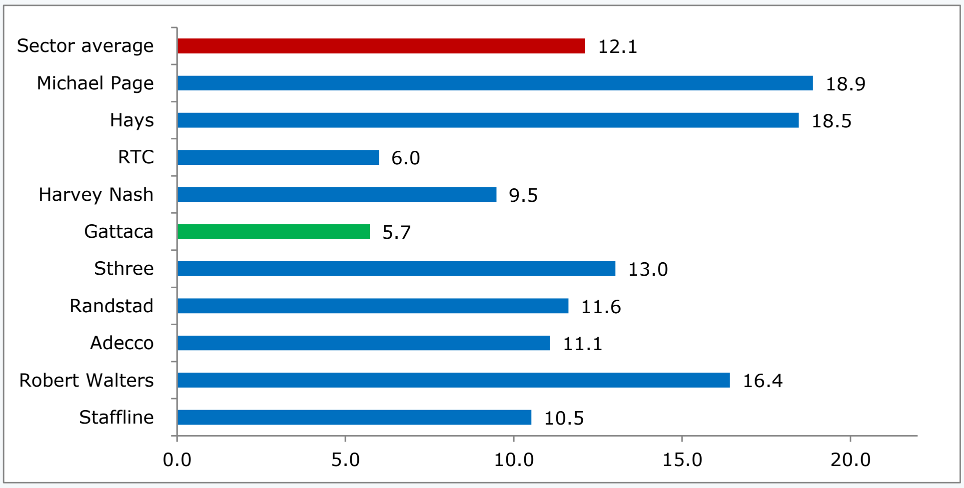
Current Year EV/EBIT ratios – sector



Source: Equity Development. Prices as per 3rd September 2018

CY PERs – sector



Source: Equity Development. Prices as per 3rd September 2018

Lastly, we have **prudently** modelled that the dividend could be temporarily suspended - albeit any decision will be made by the Board in November, with the official pay-out policy unchanged at the moment. Namely "to distribute 50% of through-cycle statutory earnings, assuming a sustainable reduction in net debt." However, in due course we expect to see a resumption of shareholder payments when the time is right.

Summary financials

Gattaca (continuing operations) (July yearend)	2014 Act £'000s	2015 Act £'000s	2016 Act £'000s	2017 Act £'000s	2018 Est £'000s	2019 Est £'000s	2020 Est £'000s	2021 Est £'000s	2022 Est £'000s
Net Fee Income (NFI) : Gross profit									
UK Engineering	27,077	37,853	40,865	43,080	46,774	47,242	49,131	51,097	53,141
UK Technology	17,905	14,605	17,413	16,178	15,359	13,392	13,392	13,928	14,485
International			14,109	15,450	16,667	11,520	12,096	12,701	13,336
Total	**44,982**	**52,458**	**72,387**	**74,708**	**78,800**	**72,154**	**74,620**	**77,726**	**80,962**
NFI growth rate									
UK Engineering	*13.2%*	*39.8%*	*8.0%*	*5.4%*	*8.6%*	*1.0%*	*4.0%*	*4.0%*	*4.0%*
UK Technology	*23.9%*	*-18.4%*	*19.2%*	*-7.1%*	*-5.1%*	*-12.8%*	*0.0%*	*4.0%*	*4.0%*
International				*9.5%*	*7.9%*	*-30.9%*	*5.0%*	*5.0%*	*5.0%*
Total NFI growth rate	***17.2%***	***16.6%***	***38.0%***	***3.2%***	***5.5%***	***-8.4%***	***3.4%***	***4.2%***	***4.2%***
UK Engineering	10,548	13,105	23,126	23,758	24,710	23,147	24,350	25,393	26,478
UK Technology	3,073	4,242	8,229	7,061	5,990	5,357	5,491	5,850	6,228
International			6,868	5,619	5,317	4,378	4,839	5,081	5,335
Central overheads			-16,726	-19,050	-21,794	-20,344	-21,001	-21,856	-22,746
Adjusted EBIT	**13,621**	**17,347**	**21,497**	**17,388**	**14,223**	**12,537**	**13,678**	**14,467**	**15,295**
Total Opex as % NFI	*-69.7%*	*-66.9%*	*-70.3%*	*-76.7%*	*-82.0%*	*-82.6%*	*-81.7%*	*-81.4%*	*-81.1%*
NFI / EBITA conversion	*30.3%*	*33.1%*	*29.7%*	*23.3%*	*18.0%*	*17.4%*	*18.3%*	*18.6%*	*18.9%*
Net interest	-1,015	-1,074	-1,076	-1,196	-1,600	-1,650	-1,450	-1,250	-1,050
Adjusted PBT	**12,606**	**16,273**	**20,421**	**16,192**	**12,623**	**10,887**	**12,228**	**13,217**	**14,245**
Adjusted diluted EPS (p) - post minorities	**37.1**	**43.8**	**44.1**	**33.8**	**23.8**	**25.0**	**27.9**	**30.0**	**32.2**
Adjusted EPS growth rate	*17.5%*	*18.2%*	*0.5%*	*-23.4%*	*-29.4%*	*4.8%*	*11.8%*	*7.6%*	*7.2%*
Dividend (p)	**20.0**	**22.0**	**23.0**	**23.0**	**3.0**	**0.0**	**0.0**	**0.0**	**0.0**
Dividend yield	*14.0%*	*15.4%*	*16.1%*	*16.1%*	*2.1%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Dividend cover	*1.9*	*2.0*	*1.9*	*1.5*	*7.9*				
Valuation benchmarks									
P/E ratio (diluted)	*3.9*	*3.3*	*3.2*	*4.2*	*6.0*	*5.7*	*5.1*	*4.8*	*4.4*
EV/NFI	*1.9*	*1.6*	*1.2*	*1.2*	*1.1*	*1.2*	*1.2*	*1.1*	*1.1*
EV/EBITA (diluted)	*6.3*	*5.0*	*4.0*	*5.0*	*6.1*	*6.9*	*6.3*	*6.0*	*5.7*
PEG ratio	*0.22*	*0.18*	*6.23*	*-0.18*	*-0.20*	*1.20*	*0.44*	*0.63*	*0.61*
Adjusted corporate tax rate	*-23.3%*	*-14.5%*	*-30.9%*	*-31.4%*	*-35.0%*	*-25.0%*	*-25.0%*	*-25.0%*	*-25.0%*
Adj ROACE	*30.6%*	*21.5%*	*19.7%*	*15.6%*	*13.3%*	*11.9%*	*12.0%*	*11.7%*	*11.4%*
EBITDA drop through rate as % NFI	*48.9%*	*53.8%*	*21.3%*	*-186.7%*	*-72.4%*	*26.2%*	*47.7%*	*26.8%*	*27.0%*
Cash conversion (EBITDA - Capex - W/Cap)/EBIT	*103%*	*109%*	*93%*	*68%*	*73%*	*118%*	*73%*	*69%*	*69%*
Unlevered/adj. free cashflow yield	6.3%	19.0%	18.2%	7.7%	7.0%	14.0%	7.9%	7.7%	8.2%
Net cash/(debt)	**-3,109**	**-33,644**	**-25,013**	**-40,288**	**-41,000**	**-37,000**	**-31,582**	**-26,166**	**-20,163**
Net debt : EBITDA	*0.22*	*1.83*	*1.11*	*2.20*	*2.68*	*2.72*	*2.14*	*1.68*	*1.22*
Diluted sharecount (Adj for 2015)	*26,073*	*31,730*	*32,040*	*32,392*	*32,522*	*32,682*	*32,843*	*33,004*	*33,167*
Shareprice (p)	*143*								

Source: Equity Development estimates, Company historic data

Key risks

- Economic downturn affecting engineering and technology recruitment.
- Greater competition, especially from new technology platforms (eg LinkedIn, Monster).
- Overseas expansion along with foreign exchange fluctuations.
- Acquisition integration, albeit management have a decent batting average.
- Consolidation of customer base (eg takeovers of Atkins:SNC-Lavalin and CH2M:Jacobs).
- Political interference which could impact UK infrastructure spend (eg cancellation of rail electrification projects).

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