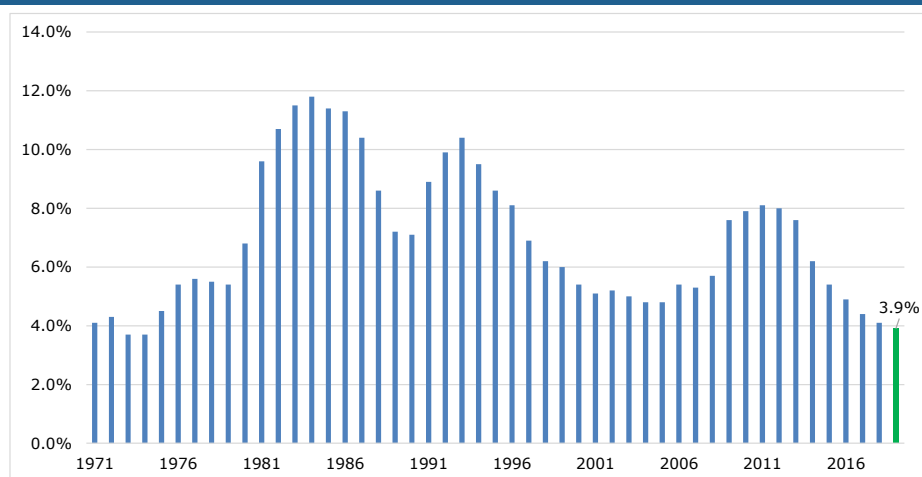


Strong cash generation after upbeat H1

3rd April 2019

With only 9 days to go before possibly 'crashing out the EU', it is no wonder many investors have donned 'tin hats', and are temporarily sheltering in low risk assets. Nobody knows how this will play out. Albeit as is often the case, an environment of 'unadulterated fear' is often the best recipe for future equity returns. Particularly in 'perceived' cyclical areas like staffing. The fundamentals here though are still in decent shape. UK unemployment (at 3.9% - see below) remains at levels not seen since 1975, while consumers continue to spend thanks to record low interest rates, rising wages and modest inflation.

UK unemployment hits 43 year low



Source: Office of National Statistics

In fact this morning, STEM recruitment specialist Gattaca reported **another positive set of numbers** (see below), delivering **H1'19 NFI up 1.5% to £36.5m**, a **14% jump in EBITDA to £8.4m**, diluted **adjusted EPS up 13% to 15.8p** and a **spectacular reduction in net debt** to £27.8m vs £40.9m in Jul'18 & £36.2m 12 months' ago.

Derisked H2'19 forecasts after encouraging 1st half

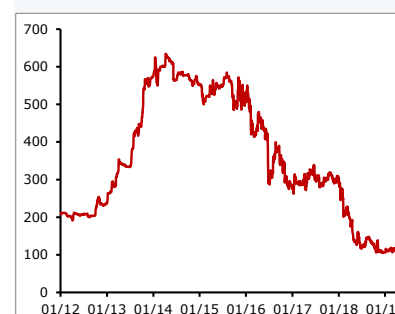
'000s - continuing	Act H1	Act H2	Act FY18	Act H1	Est H2	Est FY19	Est FY20	Est FY21
UK Engineering	3.0%	-0.2%	1.4%	3.6%	1.1%	2.4%	3.0%	3.0%
UK Technology	-4.0%	-2.0%	-3.0%	-13.4%	-12.6%	-13.0%	0.0%	2.0%
International	5.0%	5.0%	5.0%	15.0%	9.3%	12.0%	6.0%	6.0%
Total underlying NFI	2.0%	0.0%	1.0%	1.5%	0.1%	0.8%	3.0%	3.3%
NFI	35,987	35,412	71,399	36,543	35,457	72,000	74,139	76,585
Adjusted EBITDA	7,360	6,032	13,392	8,382	5,718	14,100	15,016	15,580
Adjusted EBIT	6,853	5,546	12,399	7,860	5,240	13,100	13,988	14,514
<i>EBIT/NFI margin</i>	19.0%	15.7%	17.4%	21.5%	14.8%	19.0%	19.1%	19.3%
Underlying overheads	29,134	29,866	59,000	28,683	30,217	58,900	60,151	62,071
U/L admin as % NFI	81.0%	84.3%	82.6%	78.5%	85.2%	81.8%	81.1%	81.0%
Adjusted PBT	6,100	4,845	10,945	6,817	4,083	10,900	11,788	12,514
Tax	-1,335	-2,128	-3,463	-1,662	-1,608	-3,270	-3,242	-3,128
Minorities	-219	-56	-275	0	0	0	0	0
Underlying PAT	4,546	2,661	7,207	5,155	2,475	7,630	8,546	9,385
Adjusted EPS (diluted)	14.0p	8.3p	22.5p	15.8p	7.4p	23.2p	25.8p	28.2p
NFI (LTM) / head (£ks)	86.6		88.1	97.8				
Headcount	870		810	736				
<i>Net debt : EBITDA</i>			3.05	1.93		2.73	2.08	1.51
Net debt	-36,180		-40,874	-27,755		-38,500	-31,306	-23,581

Source: Equity Development.

Company Data

EPIC	AIM:GATC
Price (last close)	118p
52 week Hi / Lo	195p / 100p
Market cap	£38.1m
Share count	32.3m
ED valuation / share	185p

Share Price, p



Source: Web Financial

Description

Gattaca is the UK's #1 specialist engineering (69% NFI) and #6 technology (31%) recruitment agency, providing contract, temporary and permanent staff (Source: Recruitment International). It derives 14% 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: pre close trading update Aug'19

Paul Hill (Analyst)

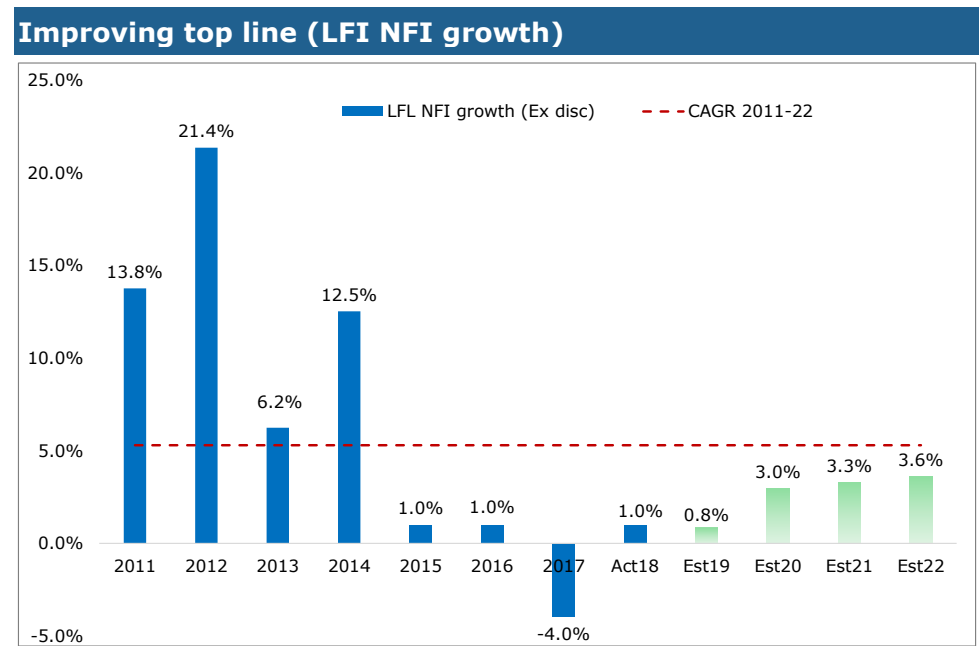
0207 065 2690

paul.hill@equitydevelopment.co.uk

Our FY19 estimates are conservatively biased

The latter driven by **excellent cash generation due to tight working capital management** (+£6.5m - debtor days at 46 vs 52 LY), seasonality, £0.4m lower opex (staff & property), £3.5m unwind from discontinued operations, **efficient tax planning** (re £0.1m WHT vs £1.4m LY) and **higher NFI conversion at 21.5%** vs 19.0% LY. Likewise, there was **a significant decline in headcount** to 736 (vs 810 July'18 & 870 Jan'18) - further improving NFI/employee and **de-risking our estimates** for the rest of the year & beyond.

Better still, despite the anticipated fall (-13.4%) in UK Technology NFI (split -38% Telco & -8% IT) reflecting the previously flagged restructuring, the division's profit contribution rose 15% to £2.7m after benefitting from **increased fee earner productivity and reduced overheads**.



Source: Equity Development.

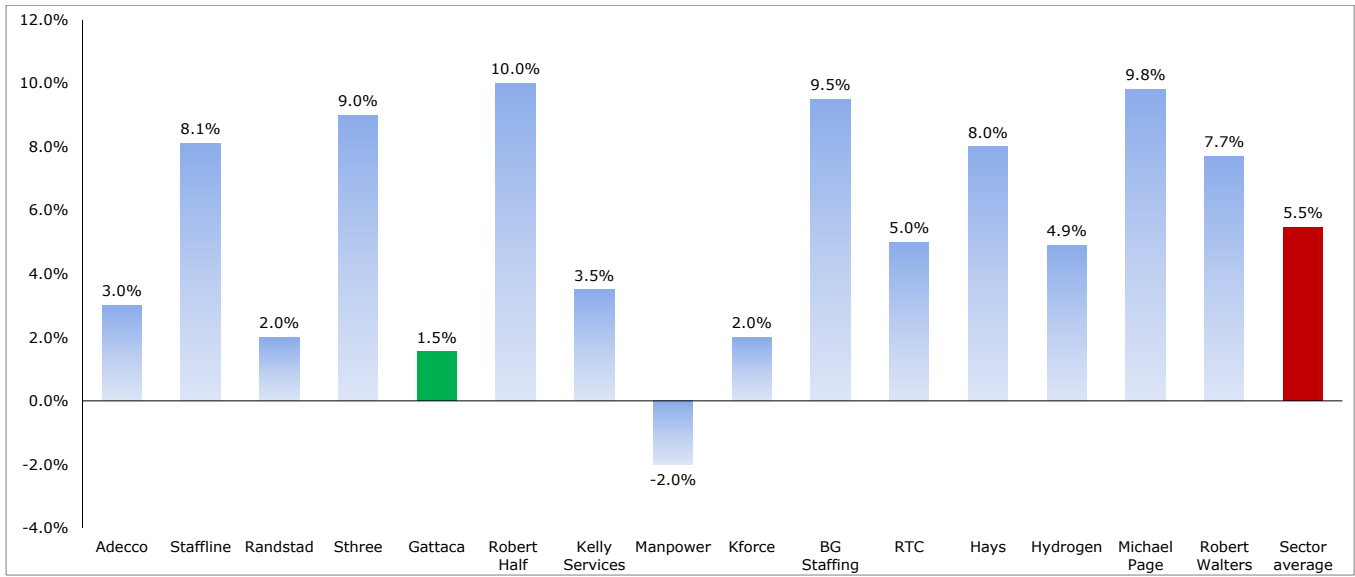
Elsewhere, both **UK Engineering and International saw NFI climb +3.6% and 15%** respectively, with impressive results from Maritime (+25%), EngTech (+11%), Infrastructure (+7%) and the Americas (+6%). Partly offset by Engineering projects (lumpy orders) and Auto (-20%), which was impacted by subdued new car volumes (eg diesel), extended plant shutdowns and reduced overseas demand.

New organic growth initiatives taking shape

Ok, but how does this compare with the rest of the recruitment industry? Not surprisingly there is still work to be done - ie in order to return to historical LFL norms and in line with peers (see below). Yet nonetheless, **1.5% NFI growth is the best performance for more than 4 years**, and **momentum is undoubtedly ticking up**.

Indeed, **CEO Kevin Freeguard has forged ahead with a new Improvement Plan**, focussing on growth and sales & market effectiveness, whilst also enhancing delivery capability and extending the company's portfolio of solutions.

Current year / latest LFL NFI growth

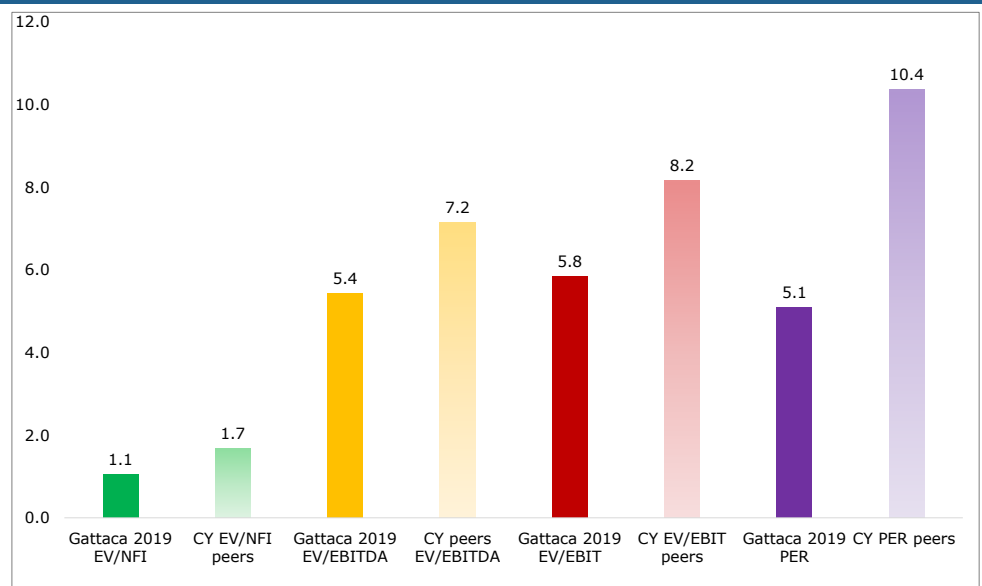


Source: Equity Development.

Material stock price appreciation is possible...

Importantly too from an investor perspective, **most** (if not all) **of this upside appears to be in the share price 'for free'**, providing a favourable risk-reward profile. Plus, if NFI continues its upwards trajectory, we could see the sizeable discount vs peers (see below) close relatively quickly. In fact, push the clock forward 12 months – and using an 8x EV/EBIT multiple for FY20 – then this would theoretically generate into a share price of more than double today’s level.

2019 valuation benchmarks vs peers

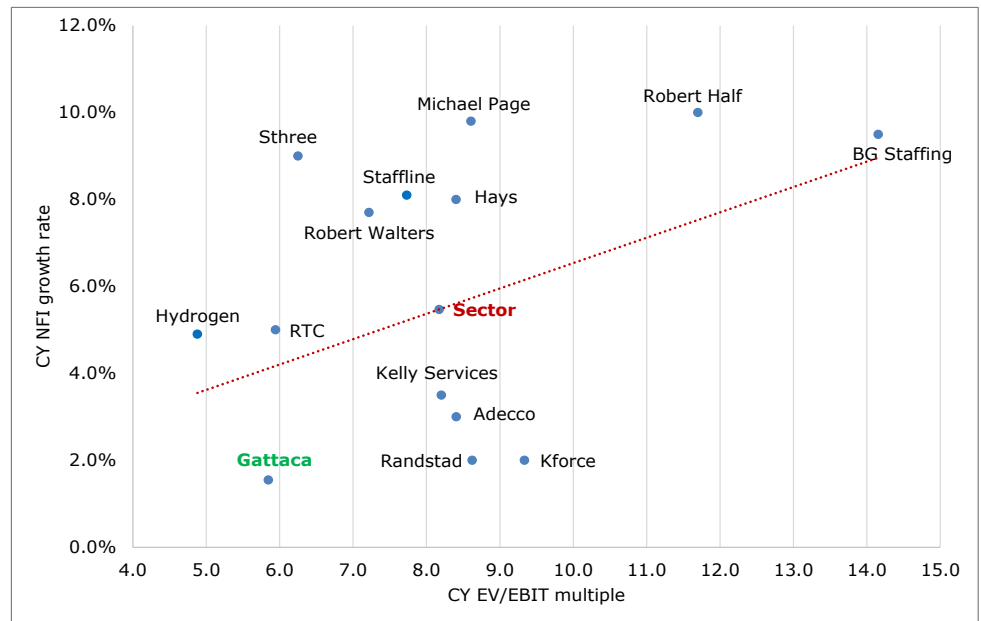


Source: Equity Development

...especially if NFI acceleration continues

What’s more, in light of GATC’s **attractive EBITDA drop-through rates** and **expanding international footprint**, we suspect there could even be a chance of re-introducing the dividend sometime over the next 1-3 years – ie once net debt:EBITDA has fallen below 2x.

Current year EV/EBIT multiples vs LFL NFI growth



Source: Equity Development.

Q3'19 trading in line with expectations

So what about our substantially de-risked forecasts? Well for the moment, **we’ve decided to ‘keep our powder dry’ and hold the FY19 estimates intact** - cognisant of the wider economic uncertainties (eg trade tariffs, Brexit, slowing EU output, etc).

Equally though, we recognise that the FY19 NFI, adjusted EBIT and PBT targets of £72m, £13.m and £10.9m respectively (rising to £74.1m, £14.0m & £11.8m in FY20), are undeniably conservative. Meaning there may be a chance to upgrade as the year progresses – ie in the absence of any macro induced wobbles and/or other adverse events. Similarly, **we reiterate GATC’s 185p/share valuation.**

Increased air of optimism

CEO Kevin Freeguard concluding “H1’19 has been a period of progress for the Group and **we are pleased to be reporting NFI and PBT growth in our continuing operations.** Our core UK Engineering business delivered continued growth and the restructuring work we undertook in our UK Technology operations in Q1 has begun to feed through into an improved year-on-year operating contribution. Our restructured and refocused International operations continued to grow strongly and **we are pleased with our progress in reducing net debt.**

The Board notes that economic uncertainty, which can impact our industry, has increased over the last six months. Notwithstanding this, **trading so far in the third quarter is as expected and we remain confident in our outlook for the full year; we expect results to be in line with the Board’s expectations at this time.**”

Moreover longer term, the staffing sector **continues 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.

Indeed, nowadays just about all walks of life are being turned upside down by disruptive technology – with companies 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**.

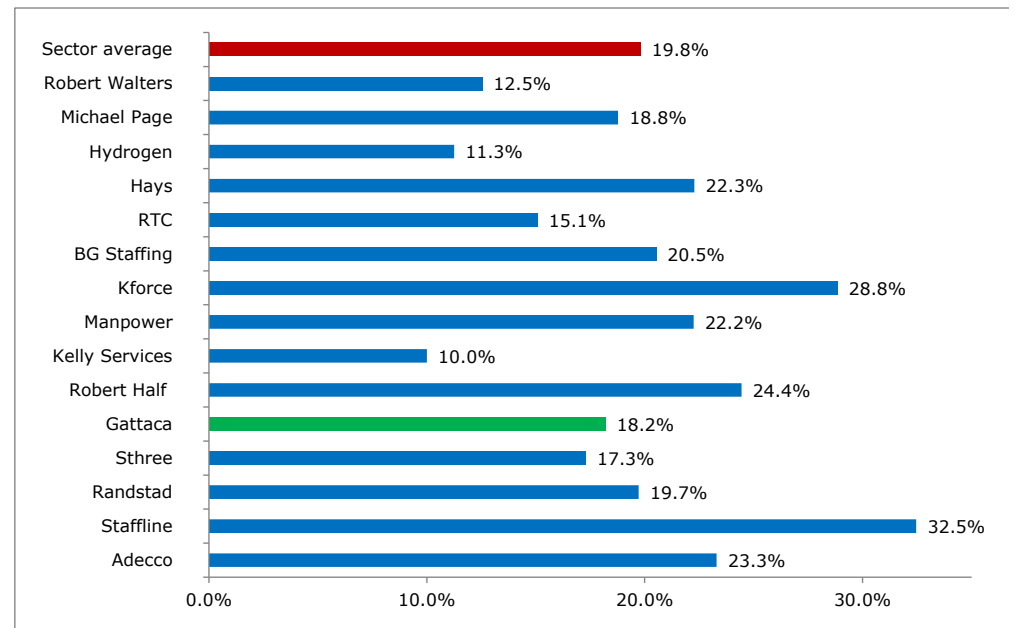
Summary financials

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
Net Fee Income (NFI) : Gross profit					<i>Restated</i>			
UK Engineering	27,077	37,853	40,865	43,080	49,144	50,300	51,809	53,364
UK Technology	17,905	14,605	17,413	16,178	12,881	11,201	11,201	11,425
International			14,109	15,450	9,374	10,499	11,129	11,797
Total	44,982	52,458	72,387	74,708	71,399	72,000	74,139	76,585
NFI growth rate								
UK Engineering	13.2%	39.8%	8.0%	5.4%	14.1%	2.4%	3.0%	3.0%
UK Technology	23.9%	-18.4%	19.2%	-7.1%	-20.4%	-13.0%	0.0%	2.0%
International				9.5%	-39.3%	12.0%	6.0%	6.0%
Total NFI growth rate	17.2%	16.6%	38.0%	3.2%	-4.4%	0.8%	3.0%	3.3%
EBITDA	14,343	18,363	22,617	18,284	13,392	14,100	15,016	15,580
UK Engineering	10,548	13,105	23,126	23,758	25,472	25,695	26,729	27,587
UK Technology	3,073	4,242	8,229	7,061	5,100	5,488	5,600	5,827
International			6,868	5,619	2,723	4,620	5,008	5,308
Central overheads			-16,726	-19,050	-20,896	-22,703	-23,349	-24,209
Adjusted EBIT	13,621	17,347	21,497	17,388	12,399	13,100	13,988	14,514
Total Opex as % NFI	-69.7%	-66.9%	-70.3%	-76.7%	-82.6%	-81.8%	-81.1%	-81.0%
EBIT / NFI margin	30.3%	33.1%	29.7%	23.3%	17.4%	18.2%	18.9%	19.0%
Net interest	-1,015	-1,074	-1,076	-1,232	-1,454	-2,200	-2,200	-2,000
Adjusted PBT	12,606	16,273	20,421	16,156	10,945	10,900	11,788	12,514
Tax	-2,937	-2,367	-6,306	-5,076	-3,463	-3,270	-3,242	-3,128
Minorities	0	0	0	-172	-275	0	0	0
Adjusted PAT	9,669	13,906	14,115	10,908	7,207	7,630	8,546	9,385
Adjusted diluted EPS (p)	37.1	43.8	44.1	33.7	22.5	23.2	25.8	28.2
Adjusted EPS growth rate	17.5%	18.2%	0.5%	-23.6%	-33.3%	3.1%	11.5%	9.3%
Dividend (p)	20.0	22.0	23.0	23.0	3.0	0.0	0.0	0.0
Dividend yield	16.9%	18.6%	19.5%	19.5%	2.5%	0.0%	0.0%	0.0%
Dividend cover	1.9	2.0	1.9	1.5	7.5			
Valuation benchmarks								
P/E ratio (diluted)	3.2	2.7	2.7	3.5	5.3	5.1	4.6	4.2
EV/NFI	1.70	1.46	1.06	1.03	1.07	1.06	1.03	1.00
EV/EBITA (diluted)	5.6	4.4	3.6	4.4	6.2	5.8	5.5	5.3
PEG ratio	0.18	0.15	5.14	-0.15	-0.16	1.62	0.40	0.45
Adjusted corporate tax rate	-23.3%	-14.5%	-30.9%	-31.4%	-31.6%	-30.0%	-27.5%	-25.0%
Adj ROACE	30.6%	21.5%	19.7%	15.6%	13.1%	16.3%	15.8%	14.9%
EBITDA drop through rate as % NFI	48.9%	53.8%	21.3%	-186.7%	147.8%	117.8%	42.8%	23.1%
Cash conversion (EBITDA - Capex - W/Cap)/EBIT	103%	109%	93%	63%	128%	100%	90%	89%
Unlevered/adj. free cashflow yield	7.2%		20.5%	8.7%	9.9%	12.8%	12.3%	12.7%
Net cash/(debt)	-3,109	-33,644	-25,013	-40,288	-40,874	-38,500	-31,306	-23,581
Net debt : EBITDA	0.22	1.83	1.11	2.20	3.05	2.73	2.08	1.51
Diluted sharecount (Adj for 2015)	26,073	31,730	32,040	32,392	32,079	32,929	33,090	33,253
Shareprice (p)	118							

Source: Equity Development estimates, Company historic data

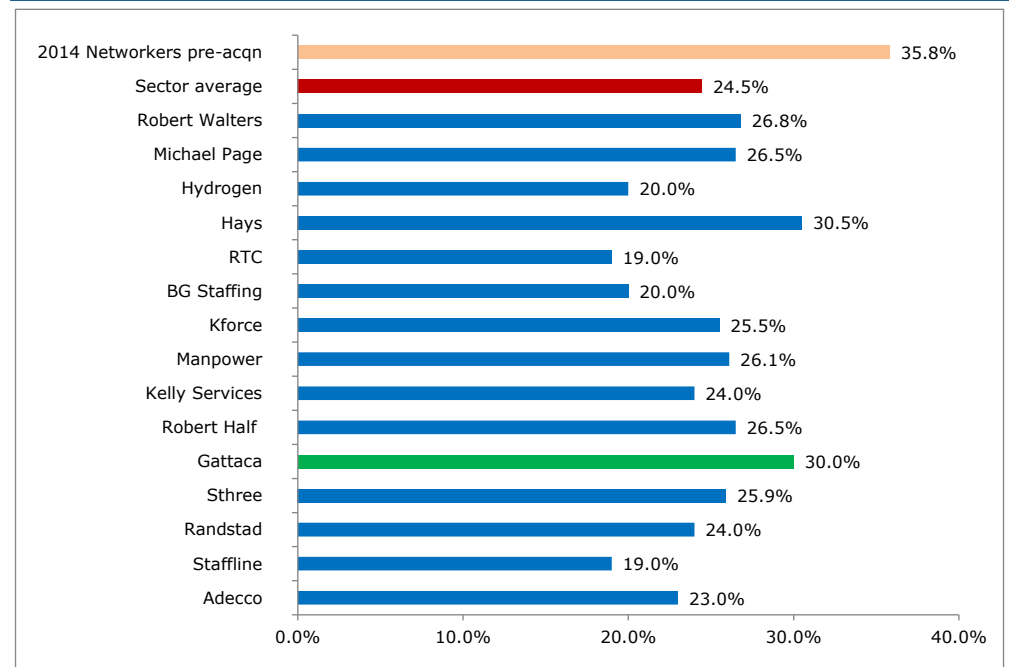
Appendices - sector valuation metrics and KPIs

Current Year (CY) EBIT / NFI conversion rates



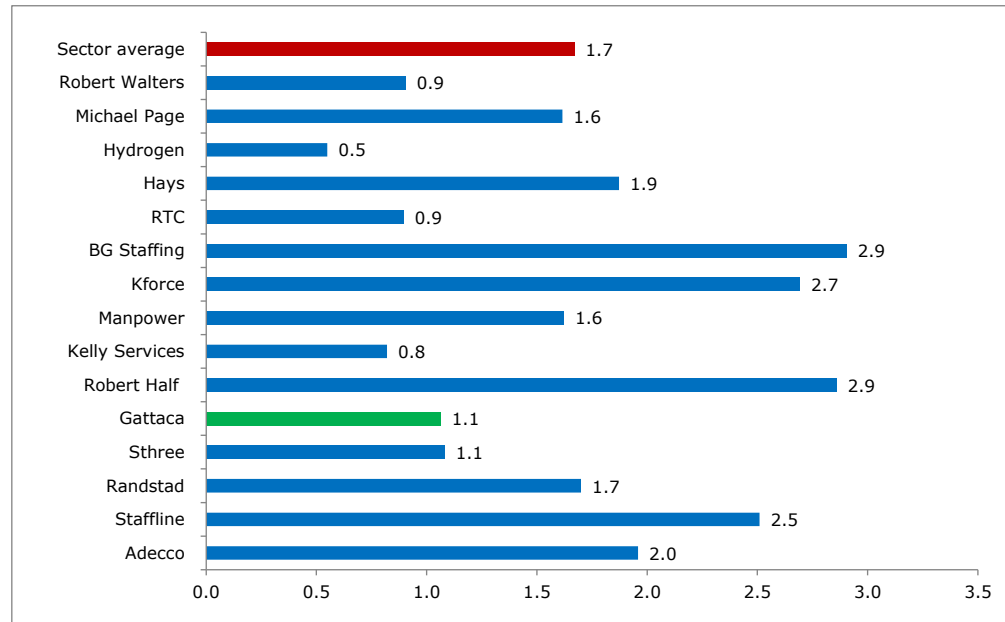
Source: Equity Development : arithmetic average for sector

CY Effective tax rates



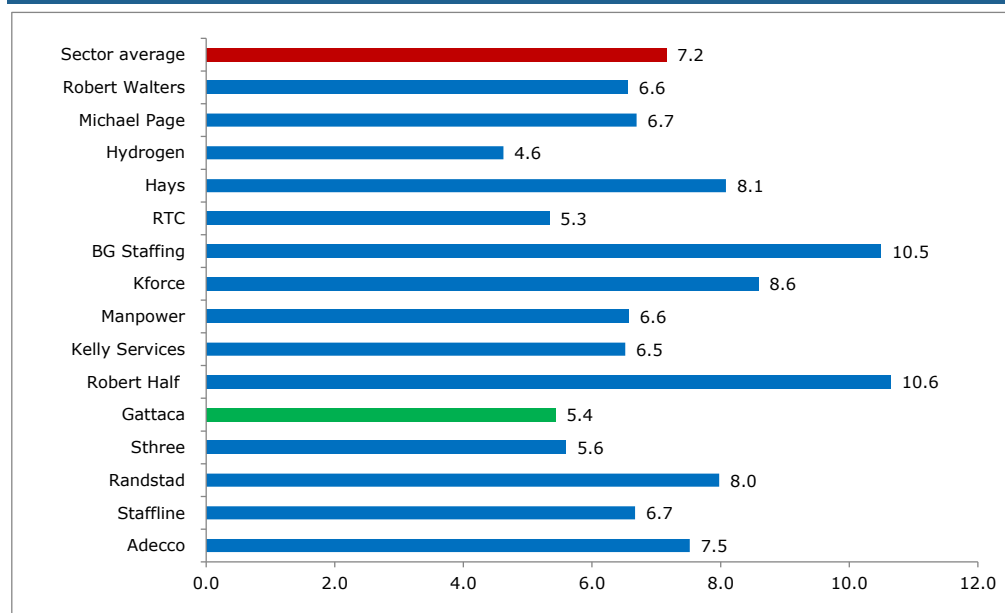
Source: Equity Development, arithmetic average for sector

CY EV/NFI multiples vs peers



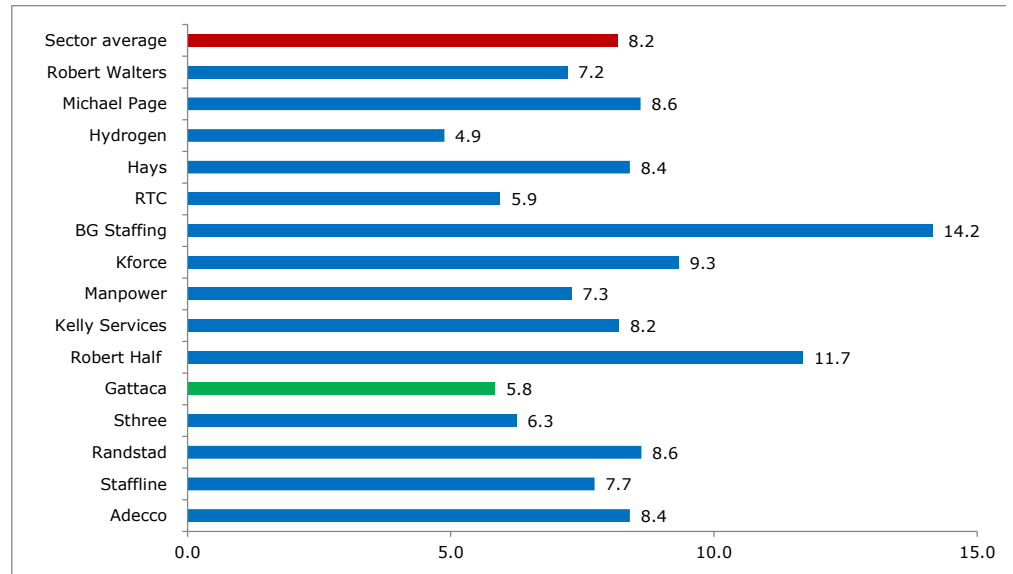
Source: Equity Development : arithmetic average for sector

CY EV/EBITDA multiples vs peers



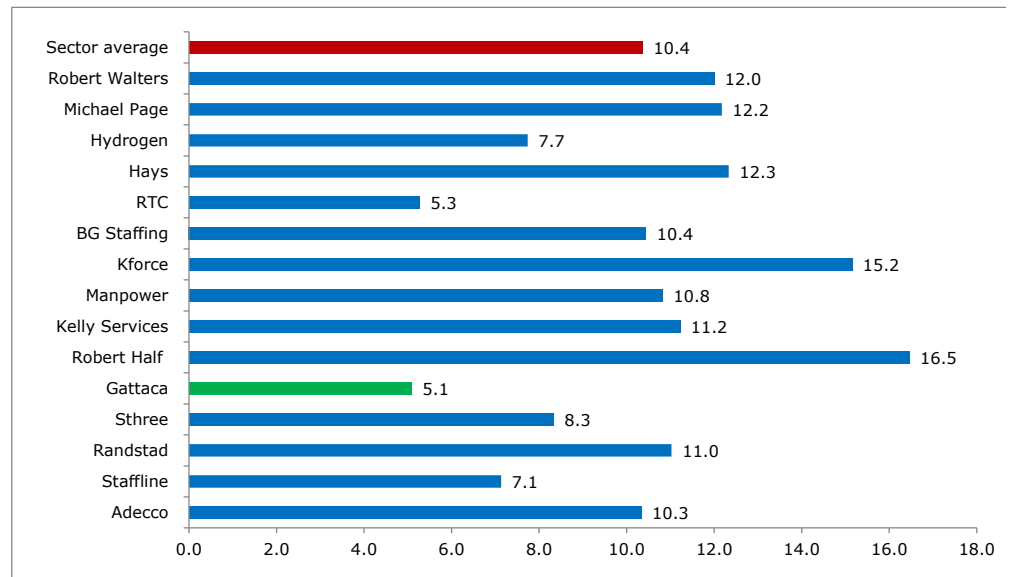
Source: Equity Development : arithmetic average for sector

CY EV/EBIT multiples vs peers



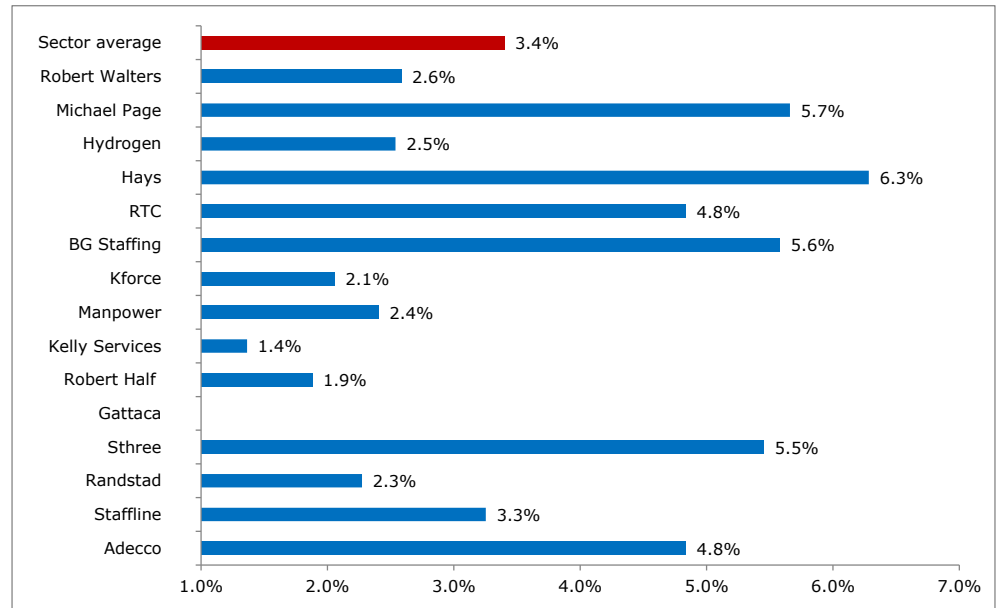
Source: Equity Development : arithmetic average for sector

CY PER multiples vs peers



Source: Equity Development : arithmetic average for sector

CY dividend yield vs peers



Source: Equity Development : arithmetic average for sector

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 2.7x as at July 2019.
- Consolidation of customer base.
- Political interference which could impact UK infrastructure spend (eg cancellation of rail electrification projects).
- Gattaca is presently assisting the US Department of Justice in their enquiries about an article published by Reuters in Feb'19 regarding Chinese Telco equipment manufacturer Huawei, and separately referencing Networkers International. It is not possible at this stage to determine what the conclusion (if any) of the DoJ's work will be.



Investor Access

Hannah Crowe

Direct: 0207 065 2692

Tel: 0207 065 2690

hannah@equitydevelopment.co.uk

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