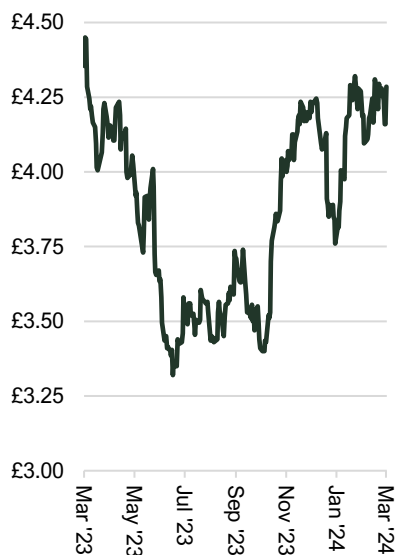


## Q1'24 update – trends similar to the end of FY23

**1 Year Chart**


SThree PLC is a research client of H2 Radnor Ltd.

**MiFID II – this research is deemed to be a minor, non-monetary benefit.**

22nd March 2024

**Robert Plant**

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In Q124 (Dec to Feb), Group net fees were down 6% YoY (all changes at constant currency), reflecting both a strong comparator (with a record level of net fees in Q123) and the ongoing challenging backdrop. The 6% net fee decline would have been 5% excluding restructured businesses.

Timo Lehne, CEO, said “Once again, we have delivered a good performance against a strong comparative and within a market environment that remains difficult from a new business perspective. Whilst the sentiment we are reporting is much the same as the prior period, the strength of our Contract extensions continues to be a particular highlight, demonstrating our clients’ need to retain critical STEM skills and flexible talent”.

SThree said that performance for FY24 is “currently expected to be in line with market expectations” adding that company compiled consensus for PBT is £71.9m. We have nudged down our estimates as we were ahead of consensus as we had forecast FY24 PBT of £72.2m, and we have reduced this, and FY25 and FY26, by 2%.

- **Peer group trading;** we note that SThree is the first of the four largest UK companies to issue a calendar Q1 statement but its comments about the market environment echo those that we heard recently from the results outlooks at Hays, Page and Robert Walters, when all three pointed to fairly sluggish market conditions at the start of 2024.
- **The Technology Improvement Programme (TIP)** remains on budget and on plan, with half of the Group’s cities in Germany now initiated, having gone live with the first country, the USA, last year. Post Germany, the roll-out will shift to the UK and then the Netherlands with the majority of SThree’s staff likely to be on the new platforms by end of year. We believe that the TIP has the potential to increase SThree’s already sector leading conversion margin.
- **SThree’s share price** has outperformed the UK Staffing peer group YTD (SThree **+2%** vs **-11%** for the peer group). We continue to see SThree trade at a material, and in our view, unjustified 33% PE multiple discount to the peer group as the market continues to ignore the material downgrades delivered elsewhere in the peer group.

| Nov, £m  | Net Fees | PBT adj | EPS (p) | Div (p) | Net Cash | PE x | Yield % |
|----------|----------|---------|---------|---------|----------|------|---------|
| FY 2022A | 430.6    | 77.0    | 39.9    | 16.0    | 65.4     | 10.7 | 3.8     |
| FY 2023A | 418.8    | 77.9    | 41.5    | 16.6    | 83.2     | 10.2 | 3.9     |
| FY 2024E | 408.9    | 70.5    | 36.7    | 14.7    | 100.1    | 11.6 | 3.5     |
| FY 2025E | 431.6    | 82.6    | 42.3    | 16.9    | 116.2    | 10.0 | 4.0     |
| FY 2026E | 455.1    | 90.2    | 45.6    | 18.2    | 125.7    | 9.3  | 4.3     |

Source: h2Radnor

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## Main additional points of interest from the Q1 update and analyst call

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- **The main trading trends** were similar to the end of last year. In terms of new business, Permanent new job incomings are still in decline but Contract is beginning to see the first positive signs of stabilisation. In the USA, in Contract, some clients are giving the Group good signs they are about to start new programmes of hiring flexible employees.
- **Mix**; it sounds to us as though, as last year, the reduction in net fees was all due to lower volume. There was good salary inflation in roles placed, of 4% in Contract and 8% in Permanent. Inflation was led by Engineering and regionally by the Netherlands and Germany. Net fee margins were also up modestly in both Contract and Permanent, with a slightly larger rise in the latter. We believe that salary inflation and positive net fees may in part reflect a structural shortage of good candidates in some markets, especially post Covid.
- **Segment**; SThree continues to benefit, relatively, from its large exposure to the more defensive Contract segment. Contract (84% of net fees) declined by 2%, having declined by the same amount in Q423, whereas Permanent (16% of net fees) saw a decline of 21% after 17% in Q423. Within Contract, the rate of reduction in Employed Contractor Model (ECM) was slightly lower and in Independent Contractors (IC) slightly higher. ECM is now 45% of Contract's net fees.
- The Contractor order book was down 1% YoY to £184m, representing sector-leading visibility with the equivalent of c.4 months of net fees. The continued softness in new business was largely offset by strong contract extensions across all sectors, especially in Engineering and Energy. SThree now has over 55% visibility of FY24 revenue, based on consensus estimates, which we believe is higher than for other recruitment companies.
- **By sector**, Engineering rose 16%, driven by Energy and specifically Renewables (which increased by 30% and now represents 12% of Group net fees). Demand for Life Sciences (down 19%) and Technology (down 9%) roles continued to reflect ongoing market conditions and record comparatives for Technology. Life Sciences performance is still above pre-covid levels.
- **Of the five regions**, Middle East and Asia (6% of Group net fees), had the best outcome with 20% growth (after growth of 16% in Q423 and 19% in Q123), led by a very strong performance from Japan (3% of Group net fees), which saw growth of 41% (after 24% in Q423 and 7% in Q123).
- **Germany**, SThree's main country, (29% of Group net fees), had the weakest performance of the top five countries, declining by 14% (after a decline of 6% in Q423 and growth of 7% in Q123), with a decline in Technology offsetting growth in Engineering and Life Sciences. Germany was partly impacted by its greater exposure to SMEs who are more macro sensitive than enterprise clients. On the macro, management said that the economy is still being impacted by the energy crisis and higher interest rates. Over the last 18 months, SThree has been repositioning in Germany towards Energy and Enterprise.
- **USA**, the Group's second largest country, (23% of Group net fees), saw a decline of 10% (after declines of 14% in Q423 and 6% in Q123), due to Life

Sciences (where it is the most heavily exposed region) and Technology, partially offset by an improving Engineering performance. Encouragingly we thought, the USA showed the 2nd quarter of sequential improvement as comps softened.

- **Netherlands**, SThree's third largest country, (20% of Group net fees), continued to trade well with growth of 6% (after 2% in Q423 and 4% in Q123), with growth led by Engineering and Technology.
- **Period end headcount** was flat versus Q423 and average headcount for the quarter was down 12% YoY. Productivity remains elevated above pre-pandemic levels achieved in FY19. Management said that headcount is being maintained so that the Group can respond as the market recovers, reiterating the point they had made on the FY23 call. The Group has completed its headcount pivot from Permanent to Contract.
- **Net cash** was £97m at the end of Q124, an increase on both the £64m of Q123 and £83m at the end of FY23, due to the counter cyclical nature of working capital. For us, a building net cash position provides interesting options for acquisitions or capital returns.

**Figure 1:** h2Radnor estimate revisions

| November year end<br>£m | Previous     |              |              | New          |              | Revision    |             |
|-------------------------|--------------|--------------|--------------|--------------|--------------|-------------|-------------|
|                         | FY'23A       | FY'24E       | FY'25E       | FY'24E       | FY'25E       | FY'24E      | FY'25E      |
| Gross Revenue           | 1,663.2      | 1,666.3      | 1,754.5      | 1,628.6      | 1,716.2      | (2%)        | (2%)        |
| <b>Net fees</b>         |              |              |              |              |              |             |             |
| DACH                    | 148.9        | 144.7        | 152.3        | 136.7        | 144.0        | (5%)        | (5%)        |
| Netherlands inc. Spain  | 82.1         | 84.9         | 89.9         | 84.9         | 89.9         | 0%          | 0%          |
| Rest of Europe          | 70.4         | 71.2         | 73.7         | 70.4         | 72.9         | (1%)        | (1%)        |
| USA                     | 96.4         | 96.5         | 102.9        | 94.3         | 101.0        | (2%)        | (2%)        |
| Middle East, Asia       | 20.9         | 21.7         | 22.8         | 22.6         | 23.7         | 4%          | 4%          |
| <b>Total Net Fees</b>   | <b>418.8</b> | <b>418.8</b> | <b>441.6</b> | <b>408.9</b> | <b>431.6</b> | <b>(2%)</b> | <b>(2%)</b> |
| EBITA                   | 76.4         | 71.2         | 83.5         | 69.5         | 81.6         | (2%)        | (2%)        |
| <i>Margin (%)</i>       | <i>18.2%</i> | <i>17.0%</i> | <i>18.9%</i> | <i>17.0%</i> | <i>18.9%</i> |             |             |
| <b>Adj. PBT</b>         | <b>77.9</b>  | <b>72.2</b>  | <b>84.5</b>  | <b>70.5</b>  | <b>82.6</b>  | <b>(2%)</b> | <b>(2%)</b> |
| Adj. EPS (p)            | 41.5         | 37.6         | 43.3         | 36.7         | 42.3         | (2%)        | (2%)        |
| DPS (p)                 | 16.6         | 15.0         | 17.3         | 14.7         | 16.9         | (2%)        | (2%)        |
| Net cash (debt)         | 83.2         | 96.5         | 112.8        | 100.1        | 116.2        |             |             |

Source: h2Radnor

## SThree’s continuing relative outperformance not reflected in valuation

In what are undoubtedly tricky trading conditions, the dual aspect of SThree’s business model continues to stand out relative to UK listed peers. SThree’s net fee generation is a function of two elements:

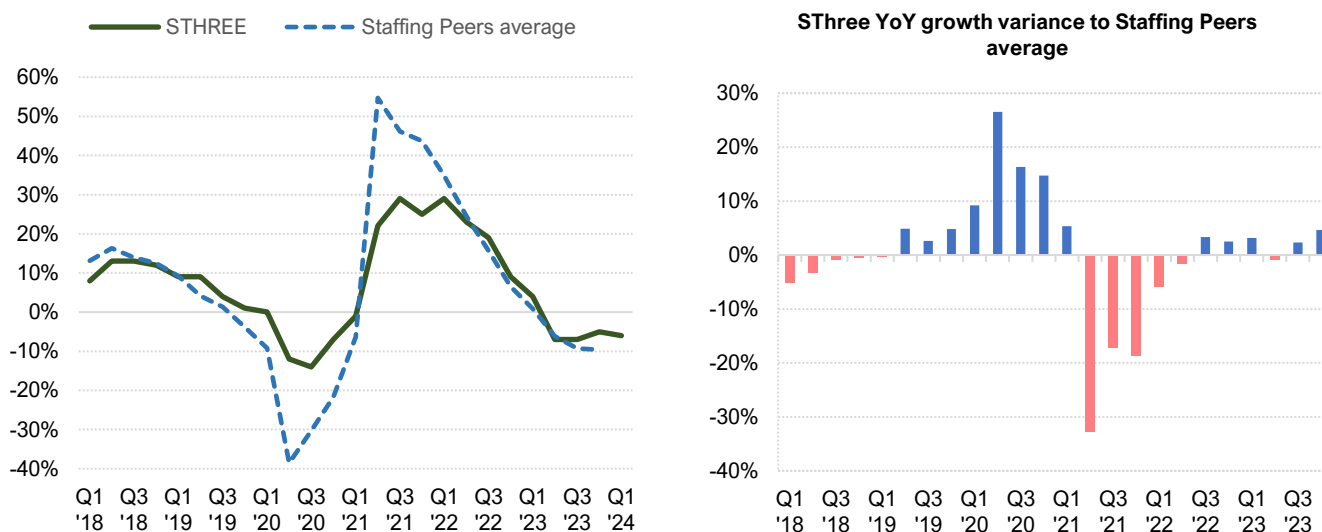
- **Contract extensions and renewals** have proven resilient with performance here at least in-line, if not marginally better than initial expectations. We note the material increase in average Contract lengths and also continuing wage inflation, which all point to a positive demand / supply imbalance. SThree has also seen overall pricing holding up well, further supports this underlying demand dynamic.
- **New business** has been weaker, a point that the company has been explicit around throughout FY23. Lead macro indicators, despite improving sentiment, are yet to show any meaningful improvement.

We have highlighted in previous research notes that this interplay between the existing Contractor base and the new business pipeline is a feature of SThree that marks it out from UK listed peers; none of whom enjoy the same weighting towards Contract and the net fee duration and visibility that the SThree flavour of Contract enjoys.

The key point here is not that SThree is immune from cyclical pressures that affect all recruitment businesses; but that the SThree net fee and margin curves should be flatter and significantly less volatile than others. The extent of estimate downgrades across the peer group bear this out.

In Figure 2 & 3 below we show the extent to which SThree’s quarterly net fee YoY growth has varied from the UK staffing peer group average. This shows SThree’s material outperformance through the pandemic and more recently since Q3 2022. We can see a similar shape take form when we look at how one year forecast estimates have evolved across the peer group over the course of the last year (Fig 4 and 5).

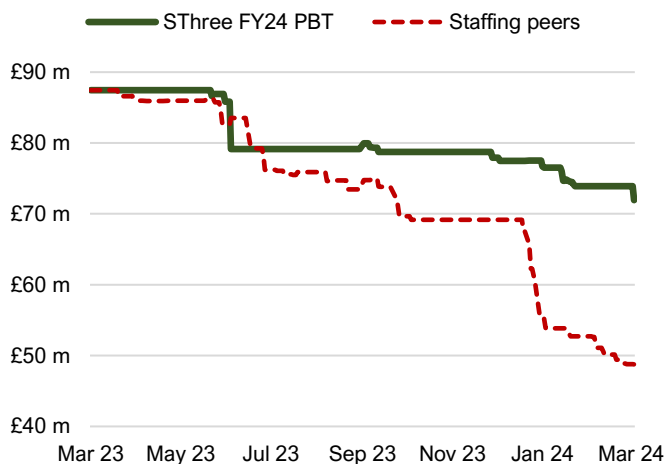
**Figure 2 & 3:** SThree Quarterly YoY Net Fee Growth relative to UK Staffing Peer Group average



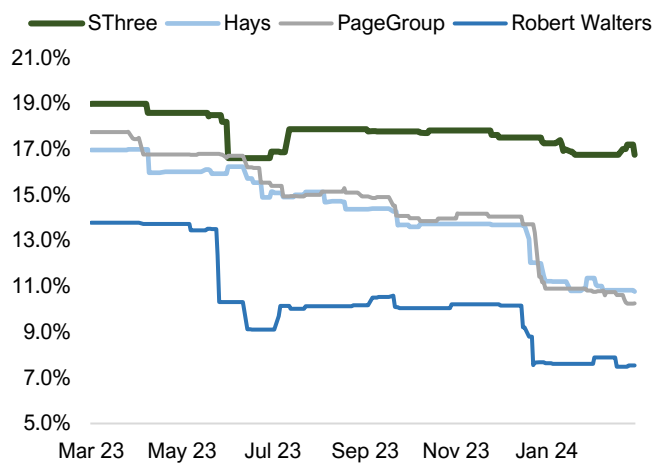
Source: Radnor

Below in Figure 4 we show the evolution of consensus FY1 PBT estimates for SThree and the peer group, rebased to SThree, over the last year. In Figure 5 we show the evolution of consensus FY1 EBIT margins for each member of the peer group.

**Figure 4: SThree vs Peers – Consensus PBT**



**Figure 5: SThree vs Peers – Margin expectations**

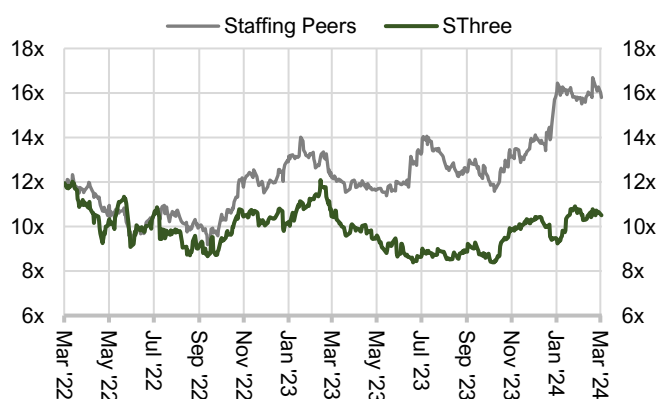


Source: h2Radnor, FactSet

- Over the last six months, the peer group has seen FY24 PBT consensus expectations downgraded in aggregate by **-35%**.
- By contrast, SThree has seen FY24 PBT consensus decline by **-9%**.
- SThree’s margin expectations are taken **after** the TIP P&L cost, which has been guided between £6m - £8m in FY24E. On an underlying basis, we estimate FY24 EBIT margins would be c**18.7%** versus our current expectation of 17.0%, which is still some distance ahead of the peer group.

Despite this clear net fee and margin outperformance, the valuation gap between SThree and its peers remains material and has widened back out in recent months as extensive peer group downgrades have not fed through into share price performance. In Figure 6 & 7 below, we show the evolution of the one-year prospective PE multiple for both SThree and the UK listed staffing Peer group (Hays, Page, Robert Walters).

**Figure 6: 1 Year prospective PE multiple**



**Figure 7: SThree PE discount / premium**



Source: h2Radnor, FactSet

## SThree PLC

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Price (p): 425 p  
Market Cap: 570 m  
EV: 486 m

## PROFIT &amp; LOSS

| Year to 31 November, £m     | 2022           | 2023           | 2024E          | 2025E          | 2026E          |
|-----------------------------|----------------|----------------|----------------|----------------|----------------|
| <b>Group Sales</b>          | <b>1,639.4</b> | <b>1,663.2</b> | <b>1,628.6</b> | <b>1,716.2</b> | <b>1,807.3</b> |
| DACH                        | 148.9          | 148.9          | 136.7          | 144.0          | 151.5          |
| Netherlands                 | 75.7           | 82.1           | 84.9           | 89.9           | 95.2           |
| Rest of Europe              | 73.1           | 70.4           | 70.4           | 72.9           | 75.5           |
| USA                         | 111.5          | 96.4           | 94.3           | 101.0          | 107.9          |
| ME & Asia                   | 21.4           | 20.9           | 22.6           | 23.7           | 24.9           |
| <b>Group Net Fees</b>       | <b>430.6</b>   | <b>418.8</b>   | <b>408.9</b>   | <b>431.6</b>   | <b>455.1</b>   |
| Op. Exp.                    | (334.2)        | (326.5)        | (323.9)        | (333.6)        | (349.1)        |
| <b>EBITDA</b>               | <b>96.5</b>    | <b>92.3</b>    | <b>85.1</b>    | <b>98.0</b>    | <b>106.0</b>   |
| Depr & Amort (incl lease)   | (18.9)         | (15.9)         | (15.5)         | (16.4)         | (17.3)         |
| <b>EBITA - Adjusted</b>     | <b>77.6</b>    | <b>76.4</b>    | <b>69.5</b>    | <b>81.6</b>    | <b>88.7</b>    |
| <b>EBITA conversion %</b>   | <b>18.0%</b>   | <b>18.2%</b>   | <b>17.0%</b>   | <b>18.9%</b>   | <b>19.5%</b>   |
| Associates & JV's           | -              | -              | -              | -              | -              |
| Net Bank Interest           | (0.5)          | 1.6            | 1.0            | 1.0            | 1.5            |
| <b>PBT - Adjusted</b>       | <b>77.0</b>    | <b>77.9</b>    | <b>70.5</b>    | <b>82.6</b>    | <b>90.2</b>    |
| Non Operating Items         | -              | -              | -              | -              | -              |
| Other Financial Items       | -              | -              | -              | -              | -              |
| <b>PBT - IFRS</b>           | <b>77.0</b>    | <b>77.9</b>    | <b>70.5</b>    | <b>82.6</b>    | <b>90.2</b>    |
| Tax - Adjusted              | (22.8)         | (21.9)         | (20.5)         | (24.4)         | (27.1)         |
| <i>Tax rate - Adjusted</i>  | <i>29.6%</i>   | <i>28.1%</i>   | <i>29.0%</i>   | <i>29.5%</i>   | <i>30.0%</i>   |
| Minority interests          | -              | -              | -              | -              | -              |
| No. shares m, diluted       | 135.9          | 135.0          | 136.5          | 137.5          | 138.5          |
| <b>Adj EPS (p), diluted</b> | <b>39.9</b>    | <b>41.5</b>    | <b>36.7</b>    | <b>42.3</b>    | <b>45.6</b>    |
| Total DPS (p)               | 16.0           | 16.6           | 14.7           | 16.9           | 18.2           |

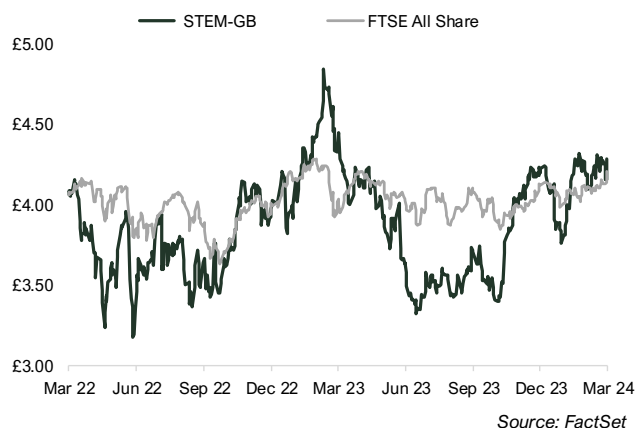
## CASH FLOW

| Year to 31 November, £m  | 2022        | 2023        | 2024E        | 2025E        | 2026E        |
|--------------------------|-------------|-------------|--------------|--------------|--------------|
| EBITDA                   | 96.5        | 92.3        | 85.1         | 98.0         | 106.0        |
| Working Capital          | (38.6)      | (4.0)       | (0.4)        | (13.8)       | (24.1)       |
| Exceptionals / Other     | 6.5         | 5.0         | (0.6)        | (0.6)        | (0.1)        |
| <b>Gross Op Cashflow</b> | <b>64.4</b> | <b>93.3</b> | <b>84.1</b>  | <b>83.6</b>  | <b>81.9</b>  |
| Cash Tax                 | (18.9)      | (19.5)      | (18.4)       | (21.9)       | (24.4)       |
| Cash Intererest          | (0.7)       | (0.7)       | 1.0          | 1.0          | 1.5          |
| <b>Net Op Cashflow</b>   | <b>44.8</b> | <b>73.1</b> | <b>66.7</b>  | <b>62.7</b>  | <b>59.0</b>  |
| Capex                    | (3.7)       | (8.2)       | (5.7)        | (2.6)        | (1.8)        |
| Lease                    | (13.7)      | (14.3)      | (13.1)       | (13.8)       | (14.6)       |
| <b>Free Cashflow</b>     | <b>27.4</b> | <b>50.6</b> | <b>47.9</b>  | <b>46.3</b>  | <b>42.6</b>  |
| Dividends                | (14.7)      | (27.4)      | (22.3)       | (21.1)       | (23.9)       |
| Acquisitions & Inv.      | -           | -           | -            | -            | -            |
| Lease / EBT              | (9.4)       | (7.6)       | (8.6)        | (9.1)        | (9.2)        |
| <b>Net Cashflow</b>      | <b>3.4</b>  | <b>15.7</b> | <b>16.9</b>  | <b>16.0</b>  | <b>9.5</b>   |
| <b>Net Cash (Debt)</b>   | <b>65.4</b> | <b>83.2</b> | <b>100.1</b> | <b>116.2</b> | <b>125.7</b> |

## BALANCE SHEET

| Year to 31 November, £m   | 2022         | 2023         | 2024E        | 2025E        | 2026E        |
|---------------------------|--------------|--------------|--------------|--------------|--------------|
| Intangibles               | 0.8          | 7.1          | 0.8          | 0.8          | 0.8          |
| P,P+E                     | 35.2         | 31.1         | 34.6         | 34.8         | 34.1         |
| Tax Asset & Other         | 4.6          | 5.8          | 5.8          | 5.8          | 5.8          |
| <b>Total Fixed Assets</b> | <b>40.7</b>  | <b>44.0</b>  | <b>47.0</b>  | <b>46.8</b>  | <b>45.6</b>  |
| Current Assets            | 363.9        | 345.1        | 366.0        | 401.4        | 448.2        |
| Current Liabilities       | 243.6        | 229.5        | 250.0        | 271.6        | 294.3        |
| <b>Net Current Assets</b> | <b>120.3</b> | <b>115.6</b> | <b>116.0</b> | <b>129.8</b> | <b>153.9</b> |
| Long Term Liabilities     | 14.8         | 24.1         | 27.2         | 26.9         | 25.8         |
| Net Cash (Debt)           | 65.4         | 83.2         | 100.1        | 116.2        | 125.7        |
| <b>Net Assets</b>         | <b>200.4</b> | <b>222.9</b> | <b>243.3</b> | <b>272.9</b> | <b>305.3</b> |

## PRICE CHART - 2 YEAR ABSOLUTE vs FTSE ALL SHARE



## SHAREHOLDERS

|                 | % of ord. Share capital |
|-----------------|-------------------------|
| Kempen Cap Mgmt | 11.6%                   |
| JPMorgan AM     | 6.4%                    |
| JO Hambro       | 5.7%                    |
| Littlejohn      | 5.1%                    |
| Allianz         | 4.9%                    |
| BlackRock       | 4.8%                    |
| Montanaro       | 3.7%                    |
|                 | <b>42.2%</b>            |

## Announcements

| Date              | Event      |
|-------------------|------------|
| 19 March 2024     | Q1 update  |
| 30 January 2024   | FY results |
| 14 December 2023  | Q4 update  |
| 19 September 2023 | Q3 update  |
| 25 July 2023      | H1 results |
| 20 June 2023      | Q2 update  |

## RATIOS

|                    | 2022  | 2023   | 2024E  | 2025E  | 2026E |
|--------------------|-------|--------|--------|--------|-------|
| RoE                | 27.0% | 25.1%  | 20.6%  | 21.3%  | 20.7% |
| RoCE               | 57.4% | 54.7%  | 48.6%  | 52.0%  | 49.4% |
| Asset Turnover (x) | 0.1x  | 0.1x   | 0.1x   | 0.1x   | 0.1x  |
| NWC % Revenue      | 37.1% | 34.6%  | 37.8%  | 39.2%  | 41.1% |
| Op Cash % EBITA    | 83.0% | 122.2% | 121.0% | 102.5% | 92.2% |
| Net Debt / EBITDA  | -0.7x | -0.9x  | -1.2x  | -1.2x  | -1.2x |

## VALUATION

| Fiscal    | 2022  | 2023  | 2024E | 2025E | 2026E |
|-----------|-------|-------|-------|-------|-------|
| P/E       | 10.7x | 10.2x | 11.6x | 10.0x | 9.3x  |
| EV/EBITDA | 5.0x  | 5.3x  | 5.7x  | 5.0x  | 4.6x  |
| Div Yield | 3.8%  | 3.9%  | 3.5%  | 4.0%  | 4.3%  |
| FCF Yield | 5.6%  | 10.4% | 9.8%  | 9.5%  | 8.8%  |

## YoY growth

|          |       |       |        |       |      |
|----------|-------|-------|--------|-------|------|
| Net Fees | 21.1% | -2.7% | -2.3%  | 5.5%  | 5.5% |
| EPS      | 29.9% | 4.1%  | -11.7% | 15.4% | 7.7% |
| DPS      | 45.5% | 3.8%  | -11.6% | 15.4% | 7.7% |

## REGULATORY DISCLOSURES

H2 Radnor Ltd is authorised and regulated by the Financial Conduct Authority.

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