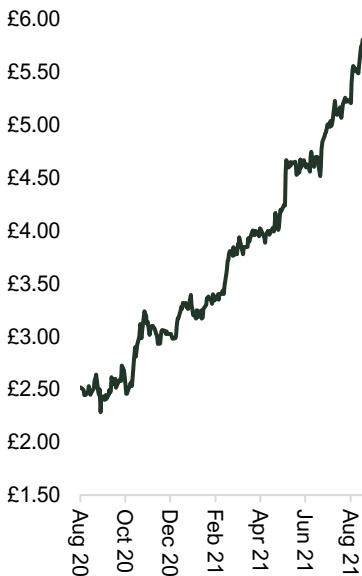


1 Year Chart



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

20th September 2021

Iain Daly

id@radnorcp.com

+44 (0) 203 897 1832

SThree's exit from the pandemic continues to lead the peer group and this has been reflected by the share price which is now trading at all-time highs. A combination of strong execution through the pandemic and SThree's positioning at a powerful nexus of scarce technical skills and flexible working are the key drivers. In our view, SThree's fundamental drivers have been re-inforced by the pandemic and leave the group well positioned looking into FY22 and beyond.

This now marks our fourth upgrade in 2021, underlining the extent of the net fee recovery (now ahead of 2019 on a YTD basis) and productivity boost as costs recover at a slower pace than net fees. There are timing issues at play here; not least with the full effect of sequential headcount growth unlikely to be fully felt until FY22. The current drop through rate implied by these upgrades (+70%) will not be sustainable. Although we are upgrading our outer year estimates, the gap between net fee and PBT upgrades is narrower than FY21.

In share price terms, SThree has been the strongest performer in the peer group as the market has responded to clear trading outperformance by re-rating SThree through the year. On the flip side, the more cyclical peers have seen a de-rating as share prices have waited for earnings upgrades to catch up. The historic PE discount for SThree has now largely disappeared suggesting a more profound re-assessment of the SThree equity story is taking place.

- **Net fees:** On a LFL and constant FX basis, Q3 was +29% versus Q3 2020 (the hardest hit by the pandemic) and +11% vs Q3 2019. On a reported basis and year to date, SThree is up +13% on FY20 and +2% on FY19.
- **Margin boost welcome but unlikely to be sustainable:** More so than net fee momentum, productivity gains have been the real story behind the pace of upgrades in the current year. Despite SThree actively re-investing back into headcount, the timing and pace has not matched net fees. The full effect will not be fully felt until FY22 which will mean the 700 plus basis point improvement in margins is unlikely to be repeated.
- **Estimate upgrades:** We upgrade our FY21 net fee / PBT estimates by +6% / +26% respectively. Our FY22E estimates increase by +6% / +19% respectively.
- **Valuation:** On a two-year prospective PE basis (ignoring current year earnings volatility), SThree trades at a 5% discount to the peer group. This as much reflects a material positive re-rating for SThree as it does a de-rating for the peer group as share prices elsewhere have paused to let earnings catch up. We would argue this narrowing of a historically consistent discount marks a sea change in the market perception towards SThree and the clear differentiation to the peer group the last 18 months have demonstrated.

November, £m	Net Fees	PBT adj	EPS (p)	Div (p)	Net Cash	Fiscal PER x	Yield %
FY 2019A	338.0	59.1	32.3	5.1	10.6	18.0	0.9
FY 2020A	308.6	30.1	13.5	5.0	49.9	43.1	0.9
FY 2021E	345.0	58.5	29.6	11.0	59.7	19.6	1.9
FY 2022E	364.2	61.7	30.6	11.3	70.5	19.0	2.0
FY 2023E	385.2	67.5	32.9	12.2	83.3	17.7	2.1

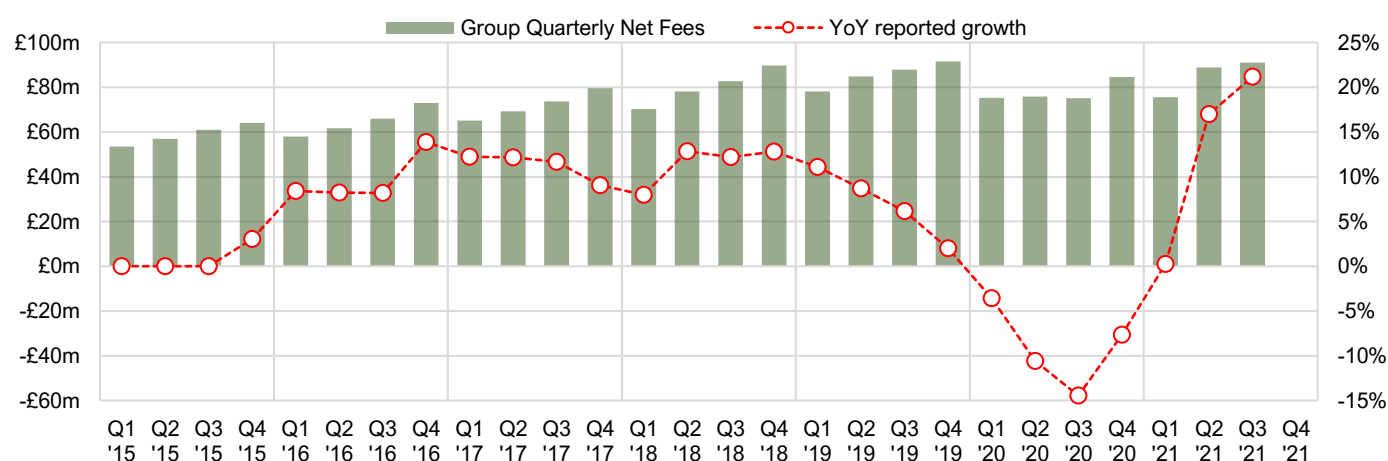
Source: Radnor Capital Partners

Q3 trading Update – Key Highlights: Q3 net fees +11% vs 2019

On 13th September, SThree released its scheduled Q3 trading update, which confirmed that the positive trading trends referenced earlier through the year have been maintained. As a result, the full year outcome is now expected to be “significantly” ahead of market consensus. This marks the fourth upgrade so far in FY21.

- Total net fee Q3 net fee growth **+29%** (like for like and constant FX) YoY to £91.0m
 - DACH **+35%** YoY to £33.2m
 - EMEA ex DACH **+21%** to £31.7m
 - USA **+31%** to £23.4m
 - APAC **+33%** to £2.7m
- The contract share of group net fees has declined slightly to 76% as Contract growth +27% was outstripped by Permanent +36%.
- Q3 2020 was the period most significantly impacted by Covid-19. Not only has SThree delivered a strong recovery against the weak comparative but Q3 2021 was +11% (like for like and constant FX basis) ahead of the pre-pandemic Q3 2019 and +4% on a reported basis.
- Year to date (on a reported, not LFL and constant currency basis), SThree is now 2% ahead of FY 2019. Even though Hays does not break out its quarterly net fees, we believe that SThree is the only member of the peer group to be ahead of 2019 on this basis. Year to date, Page is down -7% on 2019 and Robert Walters is down -18%. In Figure 1 we show SThree quarterly net fees since Q1 2015.

Figure 1: SThree quarterly net fee progression since Q1 2015



Source: Radnor

- As net fees recover at a faster pace than costs, short term productivity remains elevated +38% YoY. We discuss the forward margin outlook in more detail below.
- Life Sciences remains in a purple patch across all the key territories with strength also in a number of technology and engineering verticals.

Radnor Estimate Upgrades: Net Fees +6%, PBT +27%

In response to the commentary around sustained productivity improvements alongside continuing net fee progress, we are making material upgrades to our FY21 estimates. We are also upgrading our estimates in the outer years, albeit we are not fully rolling forward our FY21 upgrades. We discuss this in more detail below. Figure 2 shows the detail in the estimate changes.

Figure 2: Radnor estimate changes

	FY'20A	Previous		New		Estimate Change, %	
		FY'21E	FY'22E	FY'21E	FY'22E	FY'21E	FY'22E
Group Gross Revenue	1,202.6	1,271.9	1369.9	1,352.8	1,456.7	+ 6%	+ 6%
EMEA (ex DACH)		121.3	127.4	127.1	133.5	+ 5%	+ 5%
DACH		109.1	114.6	121.6	127.7	+ 11%	+ 11%
USA		85.5	91.7	87.8	94.1	+ 3%	+ 3%
APAC		8.3	8.8	8.5	8.9	+ 2%	+ 2%
Group Net Fees	308.6	324.3	342.5	345.0	364.2	+ 6%	+ 6%
EBITA	31.3	46.9	52.6	59.3	62.6	+ 26%	+ 19%
- margin %	10.1%	14.5%	15.4%	17.2%	17.2%		
Adj. PBT	30.1	46.1	51.8	58.5	61.7	+ 27%	+ 19%
Adj. EPS (p)	13.5	22.0	24.7	29.6	30.6	+ 35%	+ 24%
Dividend (p)	5.0	8.1	9.2	11.0	11.3	+ 35%	+ 24%
Net Cash (Debt)	49.9	55.0	60.0	59.7	70.5	+ 9%	+ 18%

Source: Radnor

There are multiple moving parts driving the FY21 upgrades:

- Net fee momentum has been maintained. At the start of 2021 (our note published 27th January 2021, we had been looking for FY21 net fees of £312.7m, a number that has been steadily improved through the course of the year as SThree has seen consistent recovery momentum across its key markets, with the US and DACH leading the way. Our revised net fee estimate for FY21 now stands +10% ahead of our expectations at the start of the year.

At the Q2 trading update, SThree was the first of the UK staffing peer group to show that the net fee recovery had actually moved into full growth versus the 2019 (pre Covid) comparative (+8%). However, there were notes of caution about reading too much into what was still a volatile trading environment. Q2 was a seasonally quiet quarter and there were concerns around growing annual leave backlogs.

The Q3 update has clearly indicated that Q2 was not a flash in the pan with net fees accelerating (+11%) their growth against the pre Covid comparative quarter. It is also clear that the annual leave backlog has still yet to fully materialise as a brake on net fee growth. We believe that the backlog remains a potential headwind to net fees, although the natural unwinding of this backlog is being more than offset by buoyancy in contractor rates and pricing

For FY22E and FY23E, we are maintaining our core view that organic net fee growth is likely to remain in the comfortable mid-single digit percentage range for the group as a whole. Within this we continue to expect the US and, to a lesser extent, DACH to lead the way.

Despite the strength of the contract STEM markets that SThree is focused on, we do remain conscious of the potential headwinds resulting from annual leave backlogs. Beyond this, the underlying talent supply constraints within an area of material demand growth remain an attractive driver of growth that is likely to continue to exceed staffing industry averages.

- Beyond net fees, the real story in FY21 has been the pronounced productivity boost. Put simply, the incremental drop through rate from net fee recovery and now absolute growth has not been matched, anywhere close, by cost recovery.

If we look at this in the context of our estimates at the start of year, the effect is stark. In Figure 3 below, we show the changes to our estimates through the course of the 2021 in terms of net fees, EBITA and drop through rates.

Figure 3: Change in Radnor net fee & EBITA estimates

Date of estimate	FY21E			FY22E		
	Jan 2021	Now	Change	Jan 2021	Now	Change
Net Fees	312.7	345.0	+ 32.3	330.1	364.2	+ 34.1
EBITA	36.9	59.3	+ 22.4	46.2	62.6	+ 16.4
Conversion %	11.8%	17.2%	69.4%	14.0%	17.2%	48.1%

Source: Radnor

We can see from the above that the implied incremental drop through margin in the current year (assuming that our numbers are close to the eventual outcome) is approaching 70%. This has resulted in a 10% growth in our net fee estimate for FY21 driving a 61% growth in our EBIT estimate.

The group has been clear that post the immediate Covid cost reduction exercises which were implemented at the outset of the pandemic, there would be an inevitable process of cost rebuilding. The opportunity for the group was to rebuild costs in such a way that investing in further capacity to deliver was achieved at a lower level of cost than had historically been required. The evidence to date is encouraging. The current level of net fees (which is ahead of the 2019 equivalent) is being delivered against a lower cost base. However:

-
- Although initial headcount reductions had been highly targeted to protect core, higher opportunity markets, further growth on pre Covid levels will require incremental headcount expansion in those markets;
 - SThree is not the only staffing company seeking to expand which is likely to result in inbound cost inflation;
 - Headcount is already expanding on a sequential basis (Q3 headcount is +3% on Q2) and we anticipate this rate at the very least to be maintained or exceeded as the year progresses. This rate of headcount growth is likely to remain below the peer group average and is indicative of SThree's ability to drive net fee growth in a more efficient manner;
 - It is a well established feature of the staffing industry that new headcount (especially client facing) takes time to become fully productive. Although SThree has spoken to improved internal processes and platforms that will see this productivity lag improve, it is still likely to remain a feature.
 - The full cost of this headcount investment will not fully annualise until FY22E

The net result of this is that the margin expansion we are witnessing in FY21 is not a "normalised" effect and we believe it would be unrealistic to roll this forward fully into FY22E. SThree has also flagged a number of further internal investment initiatives around internal systems and a range of go to market propositions, many of which were put on hold during the pandemic and which are integral to securing and delivering the medium strategic growth ambitions which remain broadly unchanged despite the disruption posed by the pandemic.

The combination of the inevitable timing catch-up of current headcount investments, alongside the flagged internal investments underpins our current expectations for a flat margin profile between FY21 and FY22. The recent EBITA margin high watermark of 17.8% (delivered in FY18), we see being reached or exceeded in FY23.

Comparative Valuation: Crossing a rubicon

In recent weeks, and unsurprisingly given the strength of the group's trading performance, SThree shares have been trading at all time highs. The extent of the share price recovery has seen the historic valuation discount to the immediate UK staffing peer group, largely disappear. There are two effects that have combined here:

- As the broad recovery that has benefited all the peer group has become more entrenched the initial recovery driven P/E multiples for the others in the peer group have deflated as share prices have not kept pace with earnings upgrades. Looking out at the 2 year prospective PE multiple the peer group high of 20x FY2 earnings hit in February has normalised to 17.2x.
- For SThree, we can see a very different dynamic as the shares have steadily re-rated upwards in response to the group's outperformance through the pandemic and a re-appraisal of the group's differentiated model and strategic positioning and optionality.

In Figure 4 & 5 below, we show the evolution of the two-year prospective PE multiple for both SThree and the Recruitment peer group in the UK (Hays, Page, Robert Walters). We also show the evolution of the SThree PE discount / premium. These charts are based on market consensus sourced from FactSet.

What can be read into this break from a well established historic trend? Clearly investors are rating SThree's performance through the pandemic and exit growth positioning in a different manner to the peer group. We have long argued that SThree offers investors a fundamentally differentiated model compared to its more transactional and highly cyclical peers. It may still be too early to tell whether this has become the consensus view but the evidence suggests that market perceptions have begun to evolve.

Figure 4: 2 Year prospective PE multiple

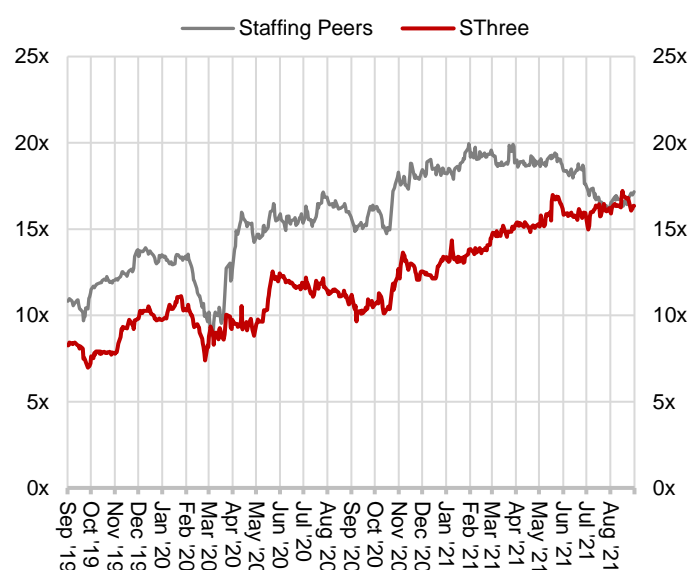
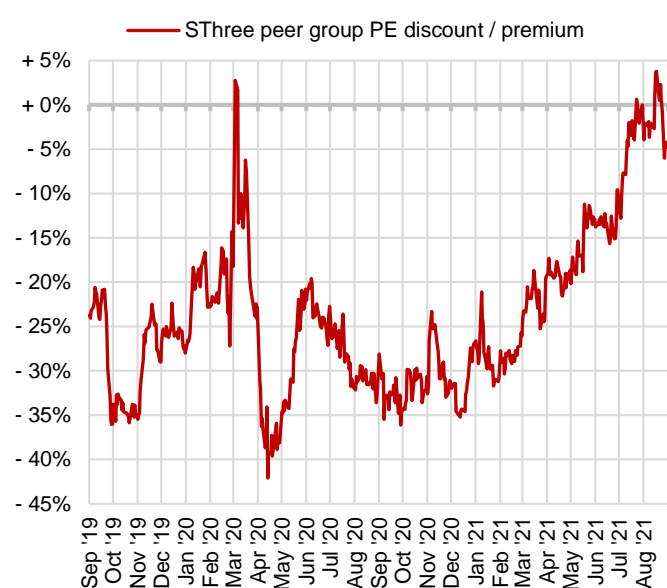


Figure 5: SThree PE discount / premium



Source: FactSet, Radnor

SThree PLC

Iain Daly
+44 203 897 1832
id@radnorp.com

Price (p): 580 p
Market Cap: 768 m
EV: 718 m

PROFIT & LOSS

Year to 31 November, £m	2018	2019	2020	2021E	2022E	2023E
Group Sales	1,258.2	1,324.7	1,202.6	1,352.8	1,456.7	1,540.9
EMEA (ex DACH)	142.0	141.2	117.6	127.1	133.5	140.2
DACH	99.3	109.3	105.8	121.6	127.7	134.0
USA	66.6	76.7	77.2	87.8	94.1	101.7
APAC	13.2	10.8	7.9	8.5	8.9	9.4
Group Net Fees	321.1	338.0	308.6	345.0	364.2	385.2
Op. Exp.	(261.0)	(275.2)	(257.8)	(267.1)	(284.0)	(300.1)
EBITDA	60.1	62.8	50.7	77.9	80.2	85.1
Depr & Amort	(6.1)	(6.0)	(6.4)	(6.6)	(6.6)	(6.6)
Lease Depreciation	-	-	(13.0)	(12.0)	(11.0)	(10.0)
EBITA - Adjusted	53.9	60.0	31.3	59.3	62.6	68.5
Associates & JV's	0.1	-	-	-	-	-
Net Bank Interest	(0.7)	(1.0)	(1.2)	(0.8)	(0.9)	(1.0)
PBT - Adjusted	53.3	59.1	30.1	58.5	61.7	67.5
Non Operating Items	(6.4)	(2.3)	(1.3)	-	-	-
Other Financial Items	-	-	-	-	-	-
PBT - IFRS	46.9	56.8	28.8	58.5	61.7	67.5
Tax - Adjusted	(13.9)	(15.9)	(11.7)	(18.1)	(19.7)	(22.3)
Tax rate - Adjusted	26.0%	26.9%	39.0%	31.0%	32.0%	33.0%
Minority interests	-	-	-	-	-	-
No. shares m, diluted	133.1	133.6	136.4	136.4	137.0	137.5
Adj EPS (p), diluted	29.6	32.3	13.5	29.6	30.6	32.9
Total DPS (p)	14.5	5.1	5.0	11.0	11.3	12.2

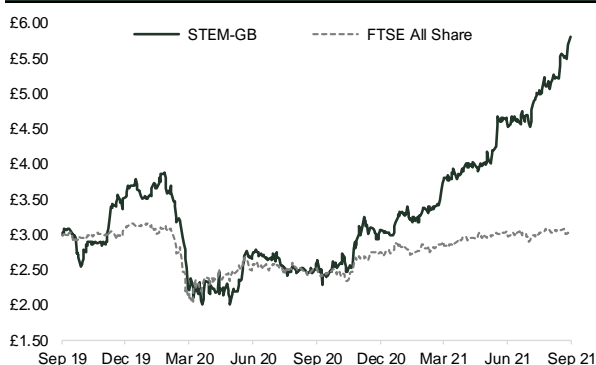
CASH FLOW

Year to 31 November, £m	2018	2019	2020	2021E	2022E	2023E
EBITDA	60.1	62.8	50.7	77.9	80.2	85.1
Working Capital	(25.3)	(13.3)	25.3	(27.3)	(14.0)	(14.7)
Provisions / Exceptionals	(4.7)	3.6	0.8	(0.8)	(0.8)	(0.8)
Gross Op Cashflow	30.1	53.2	76.9	49.8	65.4	69.6
Cash Tax	(14.4)	(13.0)	(10.5)	(11.7)	(18.1)	(19.7)
Cash Intererest	(0.5)	0.0	0.1	(0.8)	(0.9)	(1.0)
Net Op Cashflow	15.2	40.2	66.5	37.2	46.3	48.9
Capex	(5.2)	(4.6)	(5.3)	(5.3)	(5.3)	(5.3)
Free Cashflow	10.0	35.7	61.2	31.9	41.0	43.6
Dividends	(18.0)	(18.8)	(6.7)	(6.8)	(14.9)	(15.5)
Acquisitions & Inv.	-	-	-	-	-	-
Other Non Operating	(0.2)	0.4	(13.3)	(13.3)	(13.3)	(13.3)
Net Cashflow	(8.2)	17.3	41.3	11.8	12.8	14.8
Net Cash (Debt)	(4.1)	10.6	49.9	59.7	70.5	83.3

BALANCE SHEET

Year to 31 November, £m	2018	2019	2020	2021E	2022E	2023E
Intangibles	9.6	8.0	4.4	4.4	4.4	4.4
P,P+E	6.9	6.8	40.8	42.1	43.5	44.8
Tax Asset & Other	4.7	4.2	1.5	1.5	1.5	1.5
Total Fixed Assets	21.3	19.0	46.7	48.0	49.4	50.7
Current Assets	288.4	271.0	237.4	277.7	304.8	325.5
Current Liabilities	(202.3)	(182.3)	(179.5)	(192.4)	(205.5)	(211.5)
Net Current Assets	86.1	88.6	57.9	85.3	99.3	114.0
Long Term Liabilities	(1.6)	(1.4)	(26.0)	(26.0)	(26.0)	(26.0)
Net Cash (Debt)	(4.1)	10.6	49.9	59.7	70.5	83.3
Net Assets	101.6	116.9	128.5	167.0	193.1	221.9

PRICE CHART - 2 YEAR ABSOLUTE vs FTSE ALL SHARE



Source: FactSet

SHAREHOLDERS

	% of ord. Share capital
Kempen Cap Mgmt	7.0%
JO Hambro Cap Mgmt	6.7%
Fidelity	5.7%
BlackRock	4.9%
Littlejohn & Co	4.3%
JPMorgan Asset Mgmt	4.0%
Harris Associates	3.7%
Total	36.3%

Announcements

Date	Event
13 September 2021	Q3 trading update
19 July 2021	H1 FY21 results
03 June 2021	Trading update
15 March 2021	Q1 trading update
14 December 2020	Q4 trading update
23 November 2020	Positive trading update

RATIOS

	2019	2020	2021E	2022E	2023E
RoE	36.9%	14.3%	24.2%	21.7%	20.4%
RoCE	56.5%	39.8%	55.3%	51.0%	49.4%
Asset Turnover (x)	0.1x	0.2x	0.1x	0.1x	0.1x
NWC % Revenue	6.7%	4.8%	6.3%	6.8%	7.4%
Op Cash % EBITA	88.5%	245.7%	83.9%	104.4%	101.6%
Net Debt / EBITDA	0.2x	1.0x	0.8x	0.9x	1.0x

VALUATION

Fiscal	2019	2020	2021E	2022E	2023E
P/E	18.0x	43.0x	19.6x	18.9x	17.6x
EV/EBITDA	11.4x	14.2x	9.2x	9.0x	8.4x
Div Yield	0.9%	0.9%	1.9%	2.0%	2.1%
FCF Yield	5.0%	8.5%	4.4%	5.7%	6.1%

Net Fees growth	5.3%	-8.7%	11.8%	5.6%	5.8%
EPS growth	9.0%	-58.3%	119.5%	3.5%	7.4%
DPS growth	-64.8%	-2.0%	119.2%	3.5%	7.4%

REGULATORY DISCLOSURES

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Radnor Capital Partners Ltd
1 King Street
London
EC2V 8AU

www.radnorcp.com

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