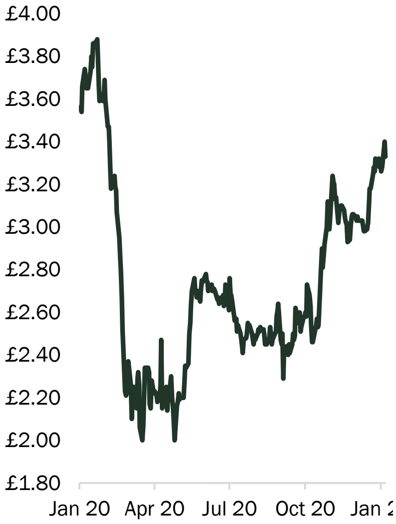
SThree PLC

STEM | Small Cap | Support Services | 333p | £452m

FY'20 final results

1 Year Chart



The Q4 trading update had already flagged a better than expected net fee and profitability performance and these results have put more meat on the bone. Beyond the resilience SThree has shown in what has been an extraordinary year; the key questions looking forward are going to revolve around the maintenance / acceleration of Q4 productivity improvements and the pace of any recovery in net fees. Progress on either is likely to see further upward pressure on estimates. As it is, we are following our November upgrades with a further upgrade today to reflect the non-recurrence of certain costs in FY21.

With a clearer picture now in place from the peer group; there is no doubt that SThree has significantly outperformed from a net fee perspective and profitability. SThree has come out of this crisis with their strategic commitment to STEM roles and flexible working firmly vindicated.

Despite the clear water between SThree and its peers, we have yet to see a disconnect in share price performance. Despite recent strength, SThree still offers good value compared to the more volatile peer group. Cyclical recovery hopes are benefiting all the UK staffing plays, even if SThree is the only one that looks to be exiting 2020 on a substantive high.

SThree PLC is a research client of Radnor Capital Partners Ltd.

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

- **Full year highlights:** Given the extremes of 2020, a net fee decline of -8% will be viewed as a resilient performance. Combined with a better than expected cash performance, this sets the scene for a more promising 2021.
- **Productivity and Q4 momentum:** The story of 2020 has been a strong sequential recovery as H2 has progressed. Not only have key markets like the US delivered YoY growth but the critical productivity measure has also begun to show material improvements and ended Q4 +12% YoY.
- **Strategic focus vindicated:** SThree responded to this crisis in a different fashion to its peers and the comparative strength of these results suggests management should feel vindicated. The focus on key growth markets; flexible working and technical specialisms have all combined to protect SThree from the worst effects of the pandemic.
- **Proof will be in the pudding:** SThree is the first of the peer group to report but it seems clear that they will outperform not only on net fee resilience but also protecting profitability. Adjusted EPS down 58% may not feel like a positive result in isolation but the permanent and generalist heavy peers are likely to report EPS declines of c.80% - 90%. Our sense is that SThree will be heading into 2021 with a degree of optimism.

27th January 2021

Iain Daly

id@radnorcp.com

+44 (0) 203 897 1832

November, £m	Net Fees	PBT adj	EPS (p)	Div (p)	Net Cash	Fiscal PER x	Yield %
FY 2018A	321.1	53.3	29.6	14.5	-4.1	11.2	4.4
FY 2019A	338.0	59.1	32.3	5.1	10.6	10.3	1.5
FY 2020A	308.6	30.1	13.5	5.0	49.9	24.7	1.5
FY 2021E	*312.7*	*36.1*	*17.7*	*6.6*	*51.0*	*18.8*	*2.0*
FY 2022E	*330.1*	*45.4*	*22.3*	*8.3*	*62.0*	*14.9*	*2.5*

Source: Radnor Capital Partners

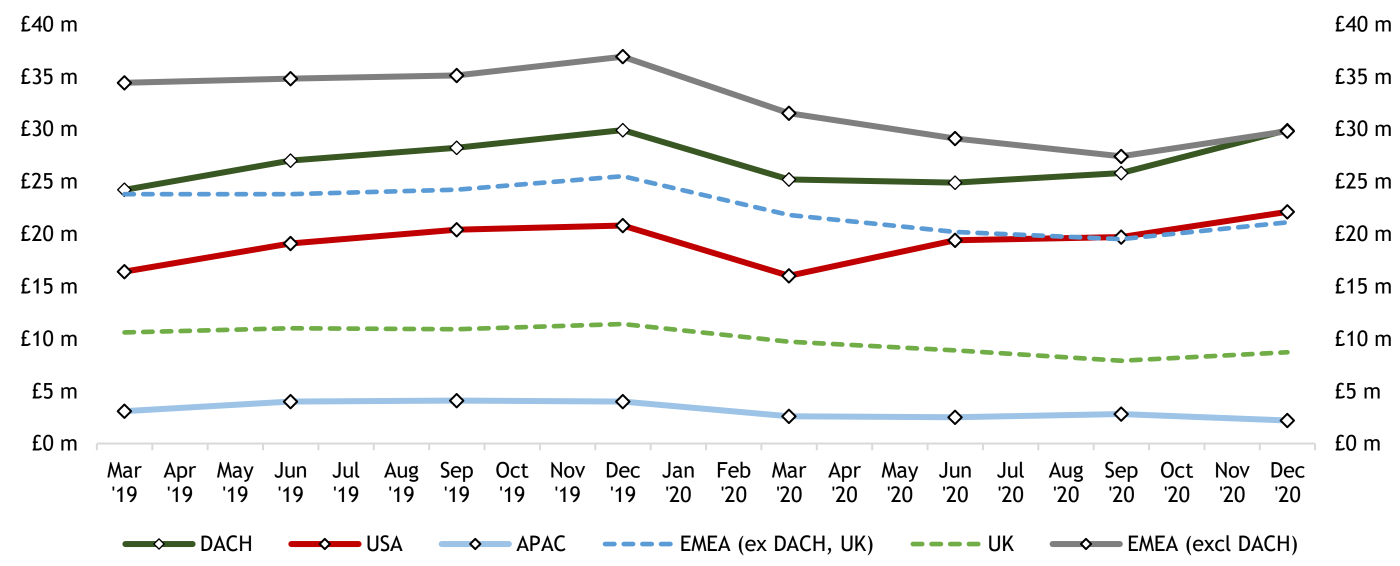
Full Year Results

Below are the key highlights for the year ended 30th November 2020. These results have come in ahead of consensus, which had been upgraded post the positive trading update.

- Full year net fees of £308.6m (-8% YoY), with quarterly net fees showing a clear sequential improvement through the second half;
- Contract net fees were down 7% YoY (Q4 -6%), while Permanent net fees were down 13% YoY (Q4 -10%). Contract net fees now account for 76% of the group (FY'19 74%). Net fees generated outside the UK improved to 85% (FY'19 82%);
- Conversion ratio (EBIT / net fees) was 10.1% (FY'19 17.8%), although this marks an improvement from the 9.1% reported at the half year.
- Q3 and Q4 has seen a marked improvement in consultant productivity (+12% YoY in Q4 and +4% in H2); alongside a stabilisation in the contract order book and a quarter on quarter improvement in the contractor retention rate;
- Full year adjusted PBT of £30.1m includes £3.3m of non-recurring costs (not recognised as exceptional items) relating to a number of restructuring exercises, the largest of which was the closure of the Australian business;
- Adjusted EPS of 13.9p is down 58% YoY
- SThree will resume dividend payments with a proposed final dividend of 5.0p (dividend cover of 2.7x).
- Year end net cash of £49.9m was materially better than expected, driven by a combination of improved profitability and working capital inflows. Total available liquidity at the year end was £154.9m with £100m of undrawn debt facilities available (£50m RCF and £50m CBILS facility available until March 2021)

Net Fee breakdown

Figure 1: Quarterly Net Fee performance for SThree, £m



Source: SThree, Radnor

In Figure 1 above, we break down quarterly net fees over the last two years. The solid lines represent the headline reporting segments. SThree also discloses the performance of their Top 5 individual markets, which include the UK, so we are able to break out the individual performance of the UK and, by inference, Europe (excluding DACH and the UK), both of which are represented by the dashed lines.

Q4 is typically SThree's strongest trading quarter, so although the sequential quarterly performance has demonstrated a consistent and improving trend through the second half of the year, there is a natural degree of seasonality to take into account. However, if we compare the sequential Q4-Q3 FY'20 growth (+13%) to the sequential Q4-Q3 FY'19 growth (+5%), we can see how this sequential growth has accelerated.

- **DACH** has now almost recovered to pre-pandemic levels with Q4 FY'20 net fee income only 3% below Q4 FY'19. Both Life Sciences (strong Q1 and strong Q3 and Q4) and Technology have been the prime drivers of what is, undoubtedly, a highly resilient performance. SThree's German business has outperformed the broader market suggesting that further market share gains have been made.

- The **US** has been the stand-out performer, with a weak Q1 turning around sharply as Life Sciences (+16% YoY, with an especially strong second half) and Technology (+9%), drove +2% overall net fee growth for the year. Given the pandemic context here; a positive YoY net fee outcome is impressive. It is also clear that SThree has been able to strengthen its position in this strategically important market and will have seen material market share gains.

  The benefit of the specialist nature of much of SThree's individual agency positioning has come to the fore this year. The group has highlighted areas such as Product Development, Quality Assurance and Clinical Operations in Life Sciences and Mobile Applications and Software Development within Technology as being especially robust.

- **EMEA** (excluding DACH) was heavily impacted through the course of the pandemic, although recovered in Q4. Overall, FY'20 net fees were down 16% vs FY'19, with Q4 down 19% YoY, an improvement on the -22% YoY reported for Q3. The two largest markets in this segment are the **Netherlands** (-10% for FY'20 YoY and -13% YoY for Q4 vs -12% YoY for Q3) and the **UK** (-20% for FY'20 and -24% for Q4 YoY vs -28% for Q3 YoY). Despite the headline weakness in the Netherlands, SThree has seen market share gains in this territory as it outperformed a weaker overall market.

- **APAC** was the weakest geography, driven by the earlier onset of the pandemic and the focus on permanent recruitment in Japan. Overall, APAC FY'20 net fees were down 26% YoY. The decision was made during FY'20 to exit the Australian business. This decision was in line with the strategy outlined at the CMD of focusing the group on a core group of target markets where structural growth opportunities exist and where the potential to drive market share gains are the strongest. The costs of closure have been fully recognised in FY'20.

One of the most encouraging aspects of the FY'20 performance has been the continued growth of the Employed Contractor Model business, which grew 11% YoY and now represents 28% of total group net fees (FY'19 23% of group net fees). This growth is important at a number of levels; not least it delivers both a higher margin (40% higher than typical contract placements) and a degree of "stickiness" with the end client that is hard to replicate elsewhere in the recruitment model.

Margins, Cashflow & Balance Sheet

We had previously upgraded our FY'20 PBT estimate by +53% post the Q4 trading update in November 2020. This upgrade was after factoring c.£2m of Australian closure costs). The key drivers behind this stronger than expected profit recovery have been two-fold:

- **Cost management**. Initial cost actions early in the pandemic were swiftly taken but were not uniform across all geographies. For example; sales headcount in the US was only down 1% over the course of FY'20. At the headline level, period end headcount was down 17% YoY and down 6% YoY on an average basis.

  It is worth highlighting that the YoY headcount comparison is distorted by the fact that, heading into the pandemic, SThree was the only one of its immediate peer group to be actively growing headcount. Despite the 17% YoY period end headcount reduction; the sequential decline in headcount between Q4 and Q3 was significantly smaller.

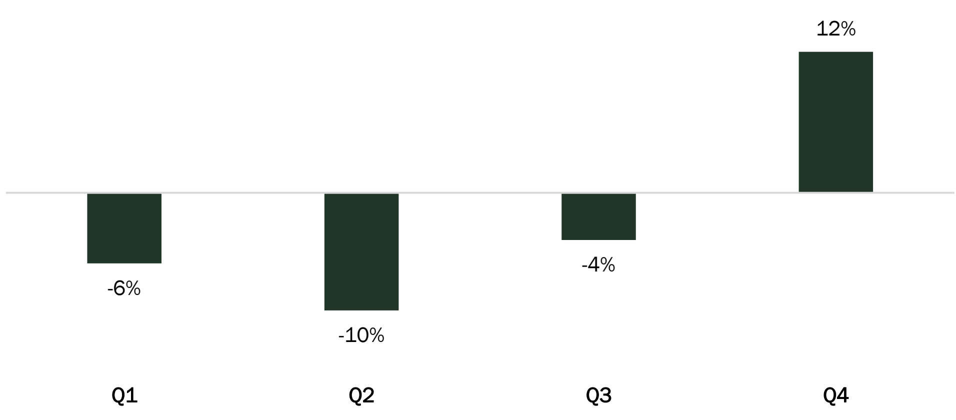
- **Critical capacity retained**. This more considered approach to cost management has resulted in critical capacity being maintained as activity levels have shown signs of recovery. This is crucial as this capacity retention will be fundamental to continued net fee growth and consultant productivity through FY'21 and beyond.

In our eyes, this is the critical point behind the near term investment case for SThree. The ambitions outlined at the November 2019 Capital Markets Day have not been derailed by the pandemic. The focus on value creation is driven by two key drivers, market share gains and margin improvement. Both of these are intertwined.

SThree is an investment led business in terms of headcount; IT systems and working capital support for the contract business. By focusing on the right markets where SThree can gain share as well as benefit from underlying market growth will be the fundamental driver of net fee growth over the medium term. The aim is to deliver this net fee growth without scaling costs in a proportionate fashion and here investments in IT, new working patterns and the growth in intrinsically higher margin business models such as ECM.

A key measure here is productivity (crudely this is net fee income divided by average headcount). The picture through the course of FY'20 has been one of sequential improvement.

Figure 2: Quarterly productivity growth YoY in FY'20, %



Source: SThree, Radnor

A key measure of progress through FY'21 will be the extent to which this productivity improvement can be maintained. Our sense is that if the Q4 run rate of 12% productivity growth were to be maintained through the course of FY'21 then current expectations for margin gains in FY'21 (currently we are looking for a 1.4% improvement to 11.8%) could prove cautious.

The year end net cash position of £49.9m is also materially better than we, or the market had been expecting (consensus was net cash of £37.2m). The principal driver of the better than expected cash generation has been the release of working capital invested in the contract business. FY'20 saw a £25.3m release of cash from working capital as overall net fee growth went into decline. The Contract business model is cash consumptive as it grows (contract net fees are earned over the life of a placement and not up front as in Permanent recruitment). The flip side side are materially higher overall candidate lifetime values and revenue visibility and quality of earnings.

Overall, net working capital as a percentage of gross revenue declined to 4.8% in FY'20 compared to 6.7% in FY'19. One area of focus has been the efficiency of the working capital management sitting behind these natural working capital flows. A significant driver of future value will be the ability to achieve net fee growth without absorbing equivalent levels of working capital. The 2018 / 2019 move of the group's support and back office functions to Glasgow had been motivated by the desire to upskill and improve this critical element of the business. The effects of the pandemic have clouded the progress that has been made here but keeping net working capital below historic levels as a percentage of gross revenue will be a key yardstick.

We also note the proposed final dividend of 5.0p, which is a natural response to the strength of the performance delivered through the year. The dividend cover is 2.7x and in the absence of any further specific guidance we have assumed a similar level of cover moving forward.

Estimate changes: Cost driven upgrade to FY'21 PBT and EPS (+16% / +14%)

In Figure 3 below, we detail our estimate changes post these final results. We also publish our FY'22 estimates for the first time.

Figure 3: Radnor estimate changes

		Previous		New		*Change, %*
£m	FY'20A	FY'21E	FY'22E	FY'21E	FY'22E	FY'21E
Group Gross Revenue	1,202.6	1,250.8	-	1,226.3	1,320.6	- 2%
Group Net Fees	**308.6**	**312.7**	-	**312.7**	**330.1**	*+ 0%*
EBITA	**31.3**	**33.1**	-	**36.9**	**46.2**	*+ 11%*
- margin %	*10.1%*	*10.6%*	-	*11.8%*	*14.0%*	
Adj. PBT	**30.1**	**32.6**	-	**36.1**	**45.4**	*+ 16%*
Adj. EPS (p)	**13.5**	**16.8**	-	**17.7**	**22.3**	*+ 5%*
Dividend (p)	5.0	6.0	-	6.6	8.3	*+ 9%*
Net Cash (Debt)	**49.9**	**45.4**	-	**51.0**	**62.0**	*+ 12%*

Source: Radnor

At the headline level we are leaving our FY'21 net fees estimate unchanged at this stage and will wait for further clarity at the Q1 trading update on whether the Q4 exit momentum has been maintained. We are currently looking for +3% growth in DACH (ahead of Q4) and +6% growth in the USA (in-line with Q4).

However, further down the P&L we are upgrading our profit expectations by c.£3.5m; primarily driven by two key factors:

- **One off costs non-recurring in FY'21.** Although they have not been recognised as exceptional items, SThree incurred c.£3m of costs relating to the pandemic response and the closure of the Australian business. These costs will not be repeated in FY'21,

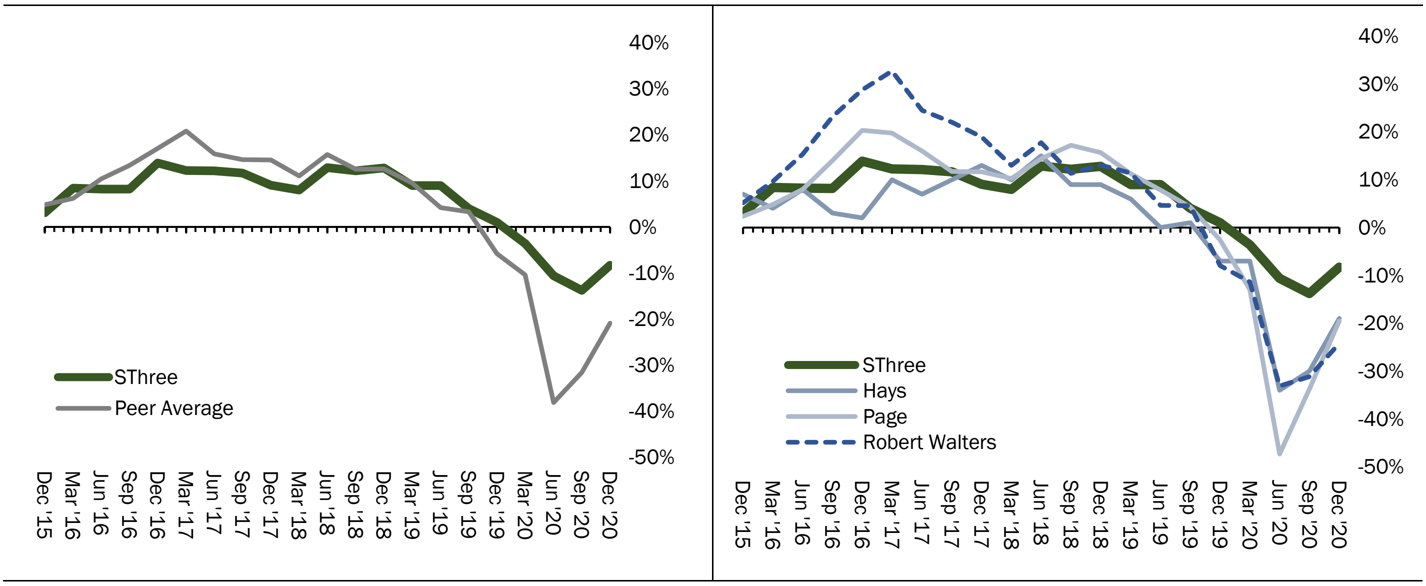
- **Productivity momentum.** Q4 saw a material improvement in overall productivity, above and beyond the natural drop through effect from a more stable net fee performance. The growth in the ECM business (which is inherently higher margin) and a refocusing of headcount behind areas of relative strength also point to a better margin outcome than we had previously been anticipating.

We have also factored the better than expected net cash outcome for FY'20. Whilst we expect a degree of working capital absorption as net fees continue to stabilise and even return to growth in some areas, this will not full offset the working capital gains achieved in FY'20.

Performance relative to the peer group

Below, we update our peer group comparison charts following the December quarter updates from the rest of the peer group.

Figure 4 & 5: Quarterly Net Fee trends, YoY growth – SThree vs UK Staffing peer group



Source: Company announcements, Radnor

In Figures 6 and 7 below, we compare SThree's contract and permanent YoY net fee trends with Hays and Page (for whom quarterly perm / temp splits are available).

Figure 6: Contract Net Fees, YoY growth

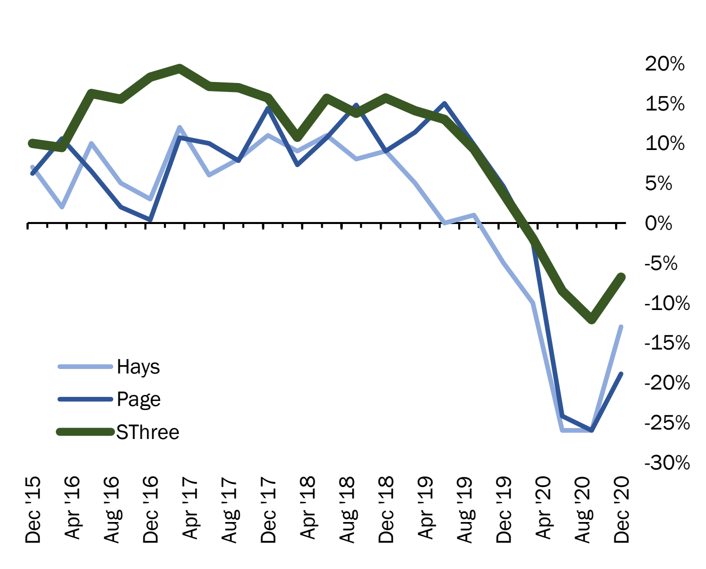
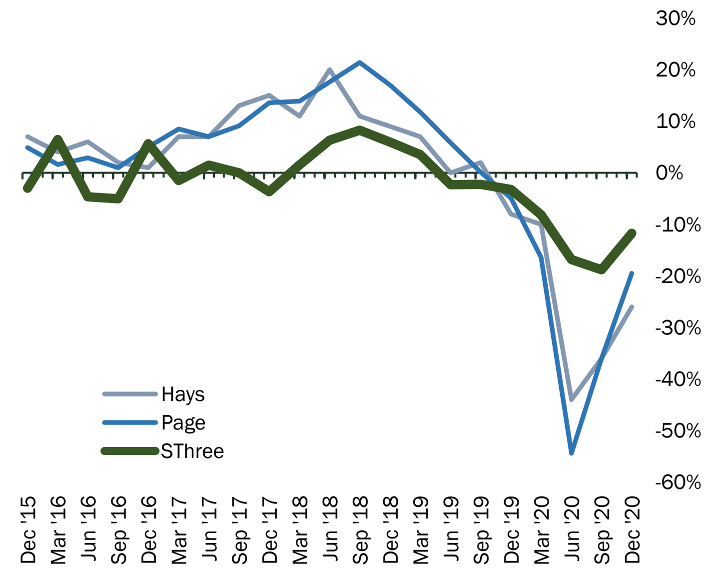


Figure 7: Perm Net Fees, YoY growth



Source: Company announcements, Radnor

Unsurprisingly, SThree has seen its most pronounced outperformance in the Contract business. However, we do note that peer trading commentary have highlighted Technology, Engineering and Life Sciences as being areas of relative strength in their own businesses; although their own Contract net fee trends remain significantly worse than SThree's.

The Permanent picture is perhaps more surprising with SThree also outperforming the peer group in an area that is not the company's primary strategic focus. We would make two key observations here:

1. Firstly, both Germany and the US are the largest perm businesses for SThree and have benefited from the relative strength of these specific labour markets through the pandemic.

2. Secondly, SThree's strategic focus on STEM industries and roles is equally applicable within their Permanent businesses and will have provided a degree of protection from the worst cyclical effects of the downturn as these industries have, by and large, outperformed their domestic economies.

In Figures 8 and 9 below, we show the quarterly YoY net fee growth for the USA (compared to Hays and Page) and the UK.

Figure 8: USA Net Fees, YoY growth

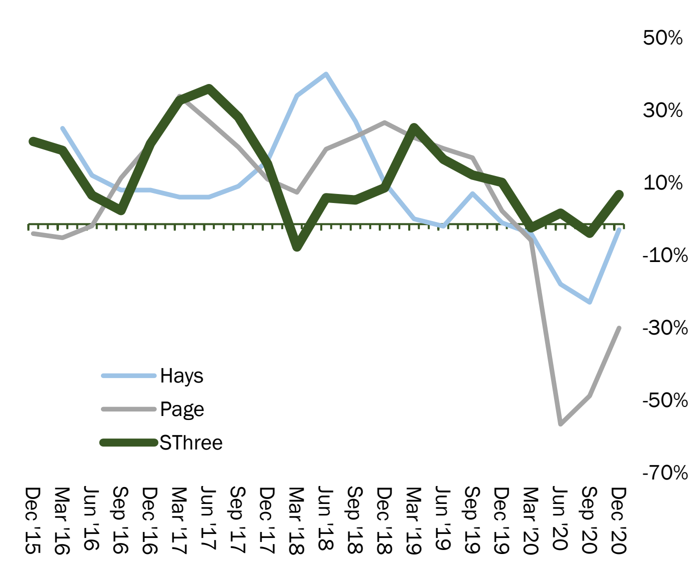
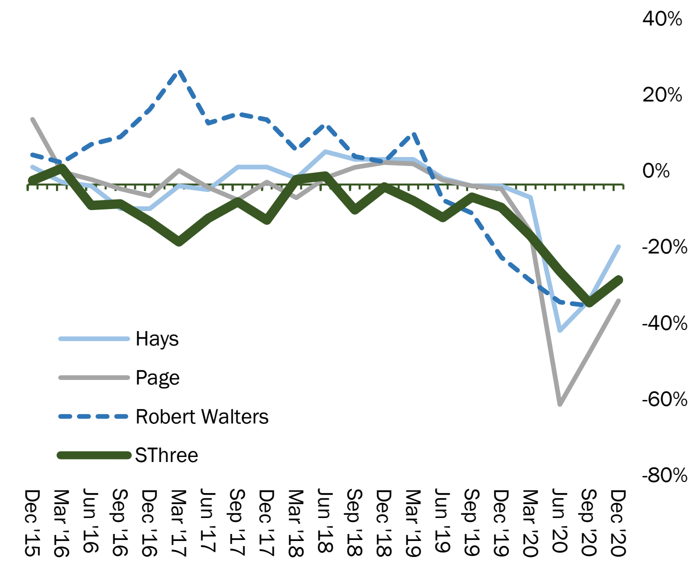


Figure 9: UK Net Fees, YoY growth



Source: Company announcements, Radnor

The UK performance is especially notable as this is a market that has historically been seen as a source of comparative weakness for SThree. Indeed, we can see that through 2016 to 2019, SThree did underperform in the UK compared to the peers. However, since Q3 2019, SThree's UK business has actually held up better than its peers (only Hays has seen a sharper recovery out of the pandemic trough). In a similar fashion to SThree's experience in other markets; the combined emphasis on contract roles and technical end niches has held the UK business in relatively good stead.

The US is the market that shows perhaps the largest disconnect to the UK peer group; with SThree exiting 2020 with positive growth year on year. At the lowest point; Page saw their US business decline by 57% year on year, while Hays was down 23% YoY. The lowest point for SThree was Q3 2020 which was down 4% YoY.

SThree PLC

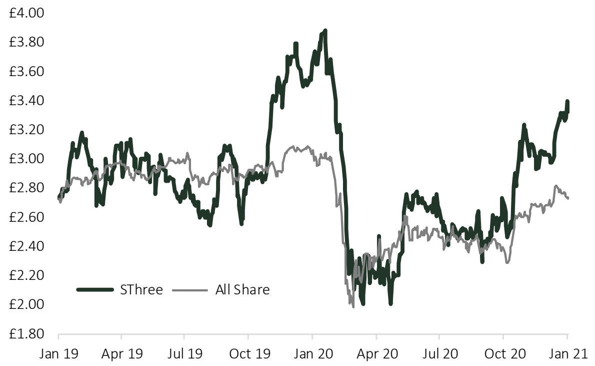
Iain Daly
+44 203 897 1832
id@radnorcp.com

Price (p):	**333 p**
Market Cap:	452 m
EV:	402 m

PROFIT & LOSS

Year to 31 November, £m	2017	2018	2019	2020	2021E	2022E
Group Sales	**1,114.5**	**1,258.2**	**1,324.7**	**1,202.6**	**1,226.3**	**1,320.6**
EMEA (ex DACH)	*129.0*	*142.0*	*141.2*	*117.6*	*115.3*	*121.0*
DACH	*80.9*	*99.3*	*109.3*	*105.8*	*108.9*	*114.4*
USA	*64.4*	*66.6*	*76.7*	*77.2*	*80.2*	*86.0*
APAC	*13.3*	*13.2*	*10.8*	*7.9*	*8.3*	*8.8*
Group Net Fees	**287.6**	**321.1**	**338.0**	**308.6**	**312.7**	**330.1**
Op. Exp.	(236.9)	(261.0)	(275.2)	(257.8)	(257.2)	(266.3)
EBITDA	**50.7**	**60.1**	**62.8**	**50.7**	**55.5**	**63.8**
Depr & Amort	(5.7)	(6.1)	(6.0)	(6.4)	(6.6)	(6.6)
Lease Depreciation				(13.0)	(12.0)	(11.0)
EBITA - Adjusted	**44.9**	**53.9**	**60.0**	**31.3**	**36.9**	**46.2**
Associates & JV's	(0.1)	0.1	-	-	-	-
Net Bank Interest	(0.3)	(0.7)	(1.0)	(1.2)	(0.8)	(0.8)
PBT - Adjusted	**44.5**	**53.3**	**59.1**	**30.1**	**36.1**	**45.4**
Non Operating Items	(6.7)	(6.4)	(2.3)	(1.3)	-	-
Other Financial Items	-	-	-	-	-	
PBT - IFRS	**37.8**	**46.9**	**56.8**	**28.8**	**36.1**	**45.4**
Tax - Adjusted	(11.4)	(13.9)	(15.9)	(11.7)	(11.9)	(15.0)
Tax rate - Adjusted	*25.6%*	*26.0%*	*26.9%*	*39.0%*	*33.0%*	*33.0%*
Minority interests	-	-	-	-	-	-
No. shares m, diluted	132.6	133.1	133.6	136.4	136.4	136.4
Adj EPS (p), diluted	**24.9**	**29.6**	**32.3**	**13.5**	**17.7**	**22.3**
Total DPS (p)	14.0	14.5	5.1	5.0	6.6	8.3

PRICE CHART - 2 YEAR ABSOLUTE vs FTSE ALL SHARE



Source: FactSet

SHAREHOLDERS

	% of ord. Share capital
JO Hambro Cap Mgmt	8.9%
SThree Founders	7.6%
Fidelity	5.7%
Harris Associates	4.7%
Kempen Cap Mgmt	4.6%
Allianz Global	4.4%
BlackRock	3.8%
	39.7%

CASH FLOW

Year to 31 November, £m	2017	2018	2019	2020	2021E	2022E
EBITDA	50.7	60.1	62.8	50.7	55.5	63.8
Working Capital	(16.4)	(25.3)	(13.3)	25.3	(13.7)	(9.8)
Provisions / Exceptionals	5.8	(4.7)	3.6	0.8	(0.8)	(0.8)
Gross Op Cashflow	**40.1**	**30.1**	**53.2**	**76.9**	**41.0**	**53.2**
Cash Tax	(10.9)	(14.4)	(13.0)	(10.5)	(11.7)	(11.9)
Cash Intererest	(0.3)	(0.5)	0.0	0.1	(0.8)	(0.8)
Net Op Cashflow	**28.9**	**15.2**	**40.2**	**66.5**	**28.5**	**40.5**
Capex	(5.8)	(5.2)	(4.6)	(5.3)	(5.3)	(5.3)
Free Cashflow	**23.1**	**10.0**	**35.7**	**61.2**	**23.2**	**35.2**
Dividends	(18.0)	(18.0)	(18.8)	(6.7)	(6.8)	(8.9)
Acquisitions & Inv.	(1.2)	-	-	-	-	-
Other Non Operating	(8.3)	(0.2)	0.4	(13.3)	(13.3)	(13.3)
Net Cashflow	**(4.4)**	**(8.2)**	**17.3**	**41.3**	**3.1**	**13.0**
Net Cash (Debt)	**5.6**	**(4.1)**	**10.6**	**49.9**	**51.0**	**62.0**

Announcements

Date	Event
14 December 2020	Q4 trading update
23 November 2020	Positive trading update
14 September 2020	Q3 trading update
20 July 2020	Interim results
15 June 2020	Q2 trading update
20 May 2020	Access to CCFF and Covid-19 update

RATIOS

	2018	2019	2020	2021E	2022E
RoE	38.8%	36.9%	14.3%	16.7%	18.3%
RoCE	51.1%	56.5%	39.8%	39.4%	44.1%
Asset Turnover (x)	0.1x	0.1x	0.2x	0.2x	0.1x
NWC % Revenue	6.8%	6.7%	4.8%	5.8%	6.2%
Op Cash % EBITA	55.8%	88.5%	245.7%	111.2%	115.1%
Net Debt / EBITDA	0.1x	-0.1x	0.2x	1.0x	0.9x

BALANCE SHEET

Year to 31 November, £m	2017	2018	2019	2020	2021E	2022E
Intangibles	11.4	9.6	8.0	4.4	4.4	4.4
P,P+E	6.7	6.9	6.8	40.8	42.1	43.5
Tax Asset & Other	6.0	4.7	4.2	1.5	1.5	1.5
Total Fixed Assets	**24.1**	**21.3**	**19.0**	**46.7**	**48.0**	**49.4**
Current Assets	228.1	288.4	271.0	237.4	246.9	268.5
Current Liabilities	(174.9)	(202.3)	(182.3)	(179.5)	(175.3)	(187.1)
Net Current Assets	**53.2**	**86.1**	**88.6**	**57.9**	**71.6**	**81.4**
Long Term Liabilities	(2.2)	(1.6)	(1.4)	(26.0)	(26.0)	(26.0)
Net Cash (Debt)	5.6	(4.1)	10.6	49.9	51.0	62.0
Net Assets	**80.7**	**101.6**	**116.9**	**128.5**	**144.6**	**166.7**

VALUATION

Fiscal	2018	2019	2020	2021E	2022E
P/E	11.2x	10.3x	24.7x	18.8x	14.9x
EV/EBITDA	6.7x	6.4x	7.9x	7.2x	6.3x
Div Yield	4.4%	1.5%	1.5%	2.0%	2.5%
FCF Yield	2.5%	8.9%	15.2%	5.8%	8.8%
Net Fees growth	11.6%	5.3%	-8.7%	1.3%	5.6%
EPS growth	18.9%	9.0%	-58.3%	31.5%	25.9%
DPS growth	3.6%	-64.8%	-2.0%	31.2%	25.9%

REGULATORY DISCLOSURES

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

Radnor Capital Partners Ltd
1 King Street
London
EC2V 8AU

www.radnorcp.com

DISCLAIMER

 *This report has been commissioned by **SThree PLC** and prepared and issued by **Radnor Capital Partners Ltd**. All information used in this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report. Opinions contained in this report represent those of the analyst at the time of publication. The securities described in the report may not be eligible for sale in all jurisdictions or to certain categories of investors.*

This report is not intended as a solicitation or inducement to buy, sell, subscribe or underwrite any securities mentioned or in the topic of this document. A marketing communication under FCA Rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. However, Radnor Capital Partners Ltd does have strict rules relating to personal dealings by individuals employed or instructed to help prepare investment research. A copy of these rules is available upon request. Radnor Capital Partners Ltd does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contracted persons or entities may have a position in any or related securities mentioned in this report. Radnor Capital Partners Ltd, or its affiliates, may perform services or solicit business from any of the companies mentioned in this report. The value of securities mentioned in this report can fall as well as rise and can be subject to volatility. In addition, it may be difficult to or not possible to buy, sell or obtain accurate information about the value of securities mentioned in this report. Past performance is not necessarily a guide to future performance. Forward looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations. To the maximum extent permitted by law, Radnor Capital Partners Ltd, or its affiliates and their respective directors, officers and employees will not be held liable for any loss or damage as a result of reliance being placed on any of the information contained in this report and do not guarantee the returns on investments in the products discussed in this publication.