

FY21 final results – Ahead of upgraded expectations

1 Year Chart



Although the record net fee outcome (£355.7m, +19% pre FX) had already been announced at the last trading update; final results today show a better than expected outcome further down the P&L with PBT coming in ahead of our upgraded expectations (PBT £60.0m vs Radnor £59.3m).

Top line trading performance continues to be strong, and SThree has raised net fee growth expectations for FY22 to double digits (consensus had been looking for c.8%). Margin performance in FY21 was better than we had been expecting and we take FY21 margins as our new baseline for FY22. We note the continuing and consistent guidance around internal investment building in FY22 (1% - 2% of net fees) and we therefore continue to expect flat margins in FY22 before expansion in FY23. Net net, we upgrade our estimates by c.5%.

Since November, SThree's share price has been under pressure as the market has reacted to CEO change and a misunderstanding around the shape of margin progression as the group invests internally in line with its stated strategy and ambitions. The market has also seen the perm heavy peer group accelerating hard out of their deeper pandemic troughs. None of these factors, we believe, should detract from the standalone SThree growth story which remains intact.

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

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

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- **FY21 a record year:** Both net fees (+19% pre FX) and PBT came in at all time highs for SThree driven by strong net fee momentum, good commercial execution and significant productivity gains
- **Productivity gains in FY21 – Investment in FY22:** The margin rebound for SThree in FY21 has been significant. Company guidance has been consistent around the need to accelerate internal investment in order to secure the structural margin improvements underpinning the group medium term strategy. This investment (1%-2% of net fees) will limit the scope for material margin gains in FY22, although we do note the implication that pre-investment margins in FY22 (18% - 19%) are likely to show continuing improvement.
- **Positive outlook driving upgrades:** The combination of contractor order book growth and the strength of trading through December / January leads us to upgrade our net fee / PBT estimates for FY22 and FY23 by c.5% respectively. The FY21 margin outcome was better than we had expected at 17.1% and we roll that through FY22 and tick up margins in FY23.
- **Growth narrative maintained.** We believe SThree's share price underperformance since November, driven by a combination of CEO change; a confused market reaction to FY22 margin guidance and the pace of earnings upgrades elsewhere in the peer group, has diverted attention away from the continued delivery of the core structural growth story.

November, £m	Net Fees	PBT adj	EPS (p)	Div (p)	Net Cash	Fiscal PER x	Yield %
FY 2020A	308.6	30.1	13.5	5.0	49.9	31.0	1.2
FY 2021A	355.7	60.0	30.8	11.4	57.5	13.6	2.+
FY 2022E	390.4	66.1	32.8	12.2	71.8	12.7	2.9
FY 2023E	415.9	72.6	35.4	13.1	84.2	11.8	3.1

Source: Radnor Capital Partners

Final results – Record net fees and PBT

- Full year constant currency net fee income £355.7m (+19% YoY) with Q4 net fees +25%
- Adjusted PBT £60.0m (Radnor estimate £59.3m) +111% YoY (pre FX)
- Basic EPS of 31.8p (+143% YoY)
- Compared to pre-Covid 2019, net fees and PBT are now +9% / +7% respectively.
- The Contractor Order Book (the single best measure for forward visibility) ended FY21 +43%, accelerating from the +41% reported for Q3
- By region:
 - **DACH** (36% of group net fees) +24% for the year, +30% in Q4
 - **EMEA** (36% of group net fees) +9% for the year, +24% in Q4
 - **USA** (25% of group net fees) +24% for the year, +18% in Q4
 - **APAC** (3% of group net fees) +34% for the year, +64% in Q4
- By business type:
 - **Contract** (75% of group net fees) +17% for the year, +26% in Q4
 - **Permanent** (25% of group net fees) +24% for the year. +25% in Q4
- Final dividend of 8.0p declared, making 11.0p for the year +120% YoY. Dividend cover of 2.9x, within guided range of 2.5x to 3.0x.
- Good cash generation with net cash of £58m (FY20: £49.9m) despite working capital absorption driven by positive net fee growth.

The group has also referenced a better than anticipated start to FY22, with the combination of the strong contractor order book coupled with positive trading in December and January. Net fee growth expectations for the full year have been raised to double digit, compared to current consensus expectations for c.8% net fee growth for FY22.

The net fee recovery momentum that has been a particular feature of SThree through the course of 2021 has been maintained. The group has benefited two-fold from the positioning of the business in sectors where client demand has remained strong and a measured response to the initial pandemic impacts in terms of headcount reductions.

Technology and Life Sciences remain the key growth drivers in terms of end client vertical. The pandemic has accelerated already long-standing growth trends in both of these areas across a range of SThree's key markets. Taken together Tech and Life Sciences now account for 71% of SThree's total net fee income (FY20 68%). It is no surprise that in SThree's two fastest growing regions; DACH and USA, these were the key verticals.

Figure 1: Technology + Life Science YoY net fee growth, FY21 vs FY20

Region	Technology	Life Sciences
DACH	+34%	+25%
USA	+35%	+25%
Group	+23%	+25%

Source: SThree, Radnor

Although cost efficiencies were more targeted than seen by many in the peer group SThree did see an absolute reduction in consultant heads through the course of 2020 and early 2021. Clearly, the pace of recovery across the industry has been stronger than expected and SThree has not been alone in flagging their intent to bring new sales capacity into the business. The exit run rate for headcount growth was mid-single digit for SThree in Q4 and the company has guided to a +10% headcount growth target for FY22.

Headcount / productivity is one of two primary drivers behind FY22 and FY23 margin expectations. The second is the scale and pace of internal investment. SThree is not the only staffing company to identify internal investment as being critical to maintain competitive positioning; enhance client service and sales productivity.

At the 2019 Capital Markets Day, SThree outlined ambitions to drive operating margins towards a 21% - 24% range by 2024. Implicit within this ambition were significant internal investments in front and middle office systems and technology.

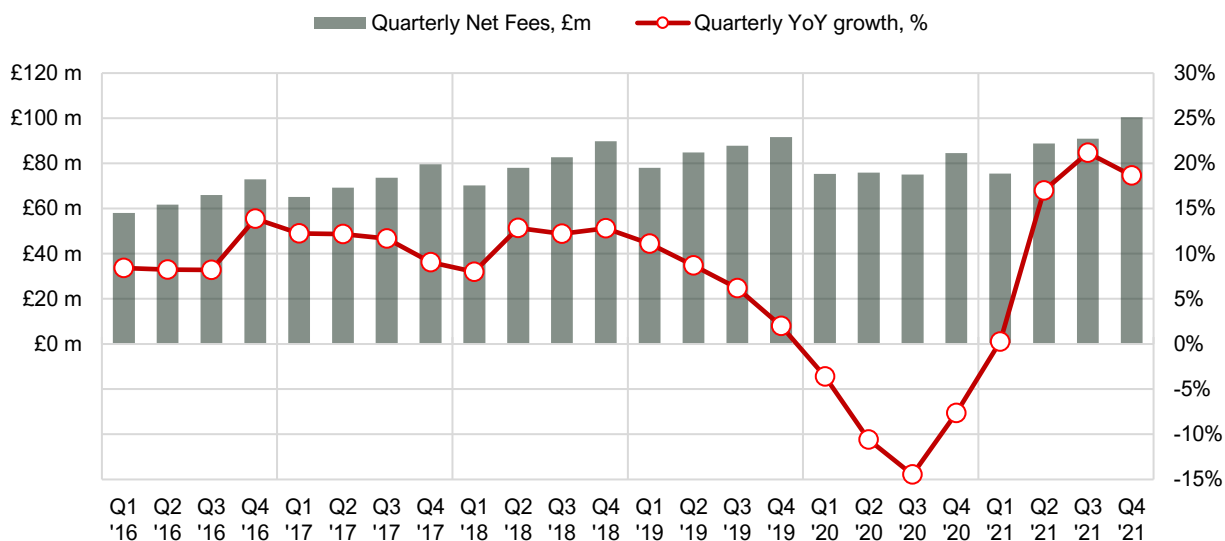
The disruption caused by the pandemic, where short term focus shifted towards clients/candidates and securing near term market share opportunities, was clearly not in the forward plan back in 2019. This has meant that the smoother phasing of the anticipated strategic investments has not been possible with FY22 seeing a steeper initial investment cost impact as a result.

The critical point here, in our eyes, is to look at the path of underlying margins pre investment costs. The company has been explicit in providing a range of these investment costs of between 1% and 2% of net fees in FY22.

Based on our FY22 net fee estimate of £390.4m, this suggests incremental opex of £4m - £8m. Taking a £6m mid-point, this points to an underlying pre-investment margin of 18.6% for FY22.

In Figure 2, overleaf, we show the quarterly net fee track record for SThree since Q1 2016 on an absolute and YoY growth basis. This shows the last three quarters of 2021 coming in ahead of the pre-Covid 2019 comparative, with Q4 2021 breaking the £100m barrier for the first time.

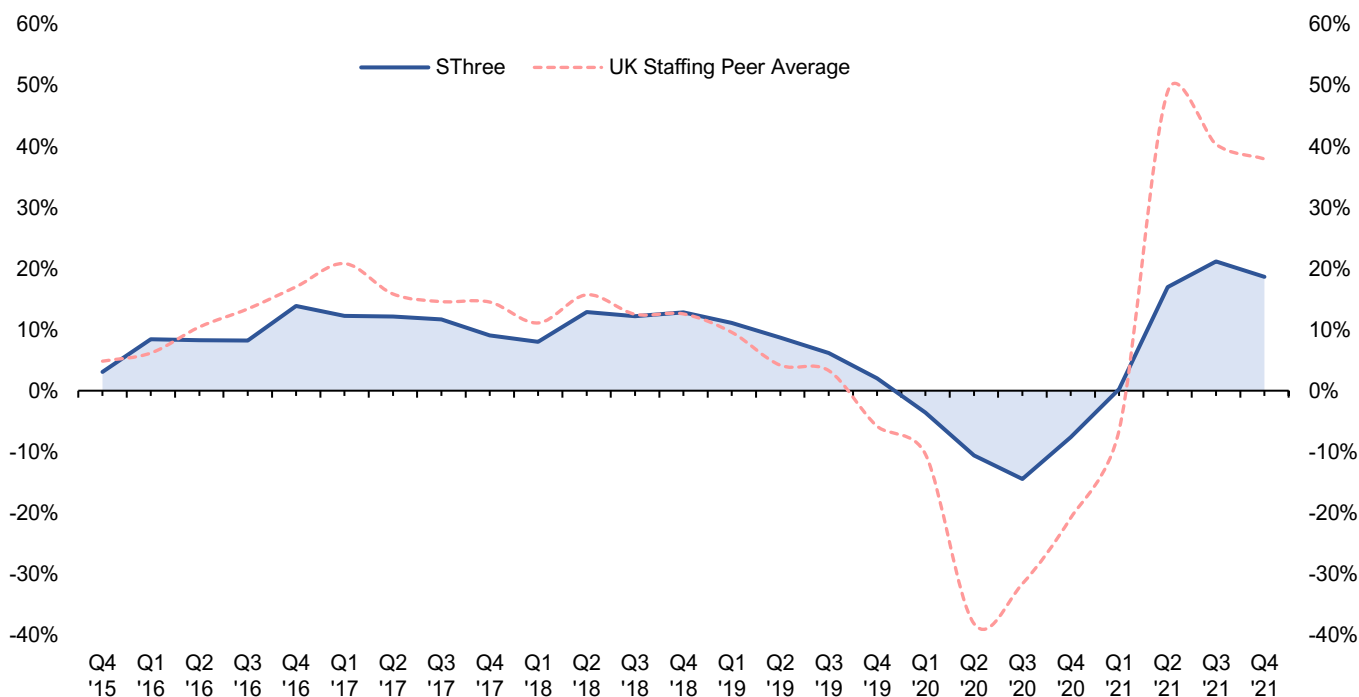
Figure 2: SThree quarterly net fee evolution since Q1 2016



Source: FactSet, Radnor

We also believe that the comparison of drop through rates between the contract heavy SThree and the perm heavy peer group is not wholly fair due to the different net fee dynamics and timing of recovery, where SThree was earlier to recover than its peers, having not fallen as far. In Figure 3 below we show SThree's quarterly net fee YoY growth versus the UK staffing peer group average.

Figure 3: SThree quarterly YoY net fee growth versus UK Staffing peer group average



Source: FactSet, Radnor

Estimate revisions and relative valuation

Figure 4: Radnor estimate revisions

	FY'21A	Previous		New		Revision, %	
		FY'22E	FY'23E	FY'22E	FY'23E	FY'22E	FY'23E
Group Gross Revenue	1,330.7	1,496.9	1577.9	1,561.8	1,663.6	+ 4%	+ 5%
EMEA (ex DACH)	127.2	132.3	137.6	136.1	141.5	+ 3%	+ 3%
DACH	129.4	135.9	142.7	144.9	156.5	+ 7%	+ 10%
USA	89.3	95.8	103.4	98.4	106.3	+ 3%	+ 3%
APAC	9.8	10.3	10.8	11.0	11.5	+ 7%	+ 7%
Group Net Fees	355.7	374.2	394.5	390.4	415.9	+ 4%	+ 5%
EBITA	60.8	63.0	69.1	66.8	73.3	+ 8%	+ 6%
- margin %	17.1%	16.8%	17.5%	17.1%	17.6%		
Adj. PBT	60.0	62.1	68.1	66.1	72.6	+ 6%	+ 6%
Adj. EPS (p)	30.8	30.8	33.2	32.8	35.4	+ 6%	+ 6%
Dividend (p)	11.0	11.4	12.3	12.2	13.1	+ 6%	+ 6%
Net Cash (Debt)	57.5	67.9	81.2	71.8	84.2	+ 6%	+ 4%

Source: Radnor

Figure 5: Evolution of Radnor FY22 NFI, PBT and Margin expectations

	Radnor estimates since start of 2021						Total change
	Mar 21	Jun 21	Jul 21	Sep 21	Dec 21	Jan 22	
FY22 Net Fees, £m	333.6	342.5	355.1	364.2	374.2	390.4	+ 17%
FY22 Margin	14.8%	15.4%	15.5%	17.2%	16.8%	17.1%	+ 231 bps
FY22 PBT, £m	48.6	51.8	54.4	61.7	62.1	66.1	+ 36%
PBT Upgrade	+ 11%	+ 7%	+ 5%	+ 13%	+ 1%	+ 6%	

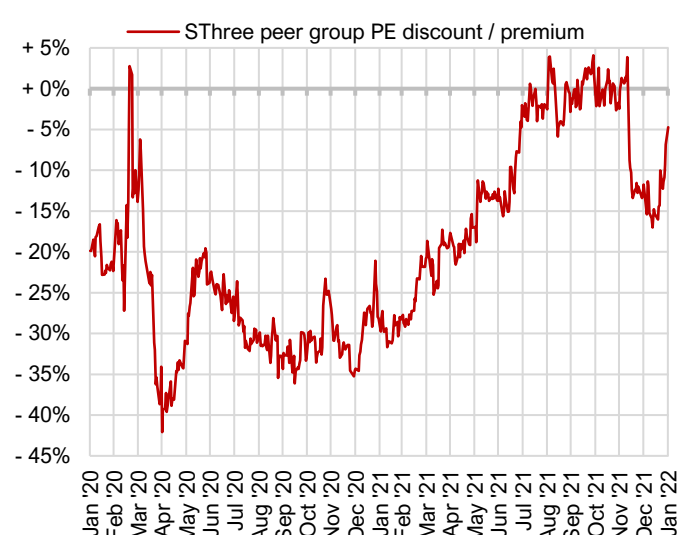
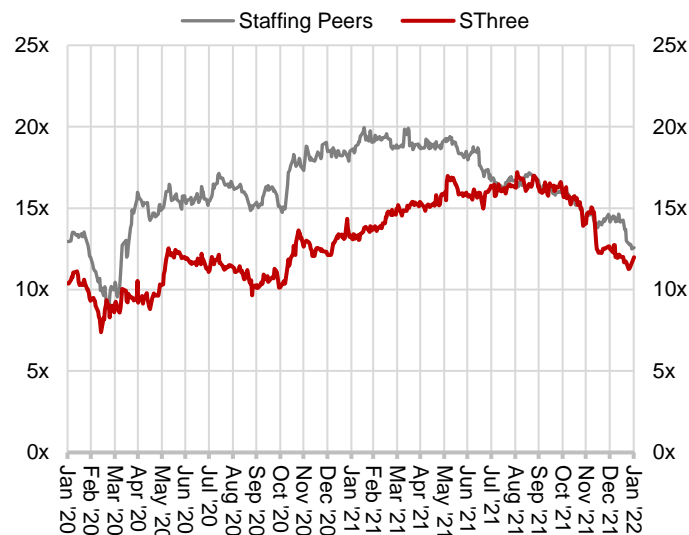
Source: FactSet, Radnor

- Margin progression.** The company has been consistent in its guidance around cost recovery and internal investment likely to be most heavily felt in FY22. We can see this play out through the evolution of our estimates over the course of 2021 as the timing of cost growth has become clearer. A large part of this is due to the pace of headcount additions (mid-single digit growth in FY21, accelerating to c.10% in FY22).

In Figure 6 & 7 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 to the same peer group.

Figure 6: 2 Year prospective PE multiple

Figure 7: SThree PE discount / premium



Source: FactSet, Radnor

We can see from the above that SThree’s forward valuation has been moving in line with the UK Staffing peer group average through much of the second half of 2021 to date. We note the pace and extent of upgrades from the perm heavy peer group (where SThree was always likely to outperform through a downturn and then lag the immediate recovery) which have not fed through into an upward re-rating for the peer group.

With the shares now standing on a FY22 / FY23 PE of 12.7x / 11.8x respectively and a dividend yield of 2.9% / 3.1% we can see an attractive combination of solid top line growth and underlying margin progression at a sub 15x multiple and a solid yield.

SThree PLC

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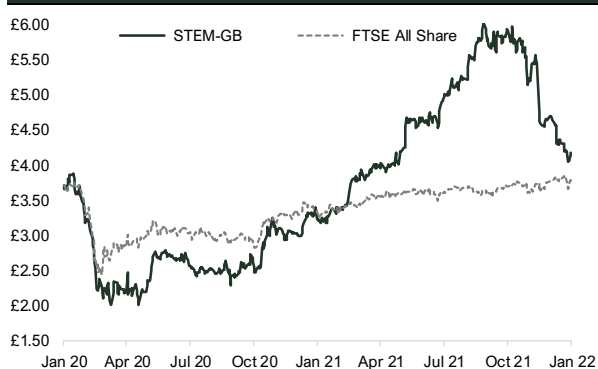
Price (p): 417 1/2 p
Market Cap: 553 m
EV: 503 m

PROFIT & LOSS						
Year to 31 November, £m	2019	2020	2021	2022E	2023E	2024E
Group Sales	1,324.7	1,202.6	1,330.7	1,561.8	1,663.6	1,772.7
EMEA (ex DACH)	141.2	117.6	127.2	136.1	141.5	147.2
DACH	109.3	105.8	129.4	144.9	156.5	169.0
USA	76.7	77.2	89.3	98.4	106.3	114.8
APAC	10.8	7.9	9.8	11.0	11.5	12.1
Group Net Fees	338.0	308.6	355.7	390.4	415.9	443.2
Op. Exp.	(275.2)	(257.8)	(276.6)	(306.0)	(326.1)	(345.9)
EBITDA	62.8	50.7	79.1	84.4	89.9	97.3
Depr & Amort	(6.0)	(6.4)	(6.3)	(6.6)	(6.6)	(6.6)
Lease Depreciation	-	(13.0)	(12.0)	(11.0)	(10.0)	(10.0)
EBITA - Adjusted	60.0	31.3	60.8	66.8	73.3	80.7
Associates & JV's	-	-	-	-	-	-
Net Bank Interest	(1.0)	(1.2)	(0.8)	(0.7)	(0.7)	(0.6)
PBT - Adjusted	59.1	30.1	60.0	66.1	72.6	80.1
Non Operating Items	(2.3)	(1.3)	-	-	-	-
Other Financial Items	-	-	-	-	-	-
PBT - IFRS	56.8	28.8	60.0	66.1	72.6	80.1
Tax - Adjusted	(15.9)	(11.7)	(17.9)	(21.2)	(23.9)	(26.4)
Tax rate - Adjusted	26.9%	39.0%	29.8%	32.0%	33.0%	33.0%
Minority interests	-	-	-	-	-	-
No. shares m, diluted	133.6	136.4	136.7	137.0	137.5	138.0
Adj EPS (p), diluted	32.3	13.5	30.8	32.8	35.4	38.9
Total DPS (p)	5.1	5.0	11.0	12.2	13.1	14.4

CASH FLOW						
Year to 31 November, £m	2019	2020	2021	2022E	2023E	2024E
EBITDA	62.8	50.7	79.1	84.4	89.9	97.3
Working Capital	(13.3)	25.3	(26.6)	(15.2)	(17.6)	(15.9)
Provisions / Exceptionals	3.6	0.8	2.0	(0.8)	(0.8)	(0.8)
Gross Op Cashflow	53.2	76.9	54.5	68.4	71.4	80.6
Cash Tax	(13.0)	(10.5)	(16.8)	(17.9)	(21.2)	(23.9)
Cash Intererest	0.0	0.1	(0.9)	(0.7)	(0.7)	(0.6)
Net Op Cashflow	40.2	66.5	36.9	49.8	49.6	56.0
Capex	(4.6)	(5.3)	(2.6)	(6.0)	(6.0)	(4.0)
Free Cashflow	35.7	61.2	34.2	43.8	43.6	52.0
Dividends	(18.8)	(6.7)	(6.7)	(15.0)	(16.6)	(18.0)
Acquisitions & Inv.	-	-	-	-	-	-
Other Non Operating	0.4	(13.3)	(12.5)	(12.5)	(12.5)	(12.5)
Net Cashflow	17.3	41.3	15.1	16.3	14.5	21.6
Net Cash (Debt)	10.6	49.9	57.5	71.8	84.2	103.8

BALANCE SHEET						
Year to 31 November, £m	2019	2020	2021e	2022E	2023E	2024E
Intangibles	8.0	4.4	2.5	2.5	2.5	2.5
P,P+E	6.8	40.8	38.1	38.7	39.3	41.9
Tax Asset & Other	4.2	1.5	4.5	4.5	4.5	4.5
Total Fixed Assets	19.0	46.7	45.0	45.6	46.2	48.8
Current Assets	271.0	237.4	298.0	335.8	357.7	381.1
Current Liabilities	(182.3)	(179.5)	(218.4)	(241.0)	(245.3)	(252.8)
Net Current Assets	88.6	57.9	79.6	94.8	112.4	128.4
Long Term Liabilities	(1.4)	(26.0)	(24.0)	(24.0)	(24.0)	(24.0)
Net Cash (Debt)	10.6	49.9	57.5	71.8	84.2	103.8
Net Assets	116.9	128.5	158.1	188.2	218.9	257.0

PRICE CHART - 2 YEAR ABSOLUTE vs FTSE ALL SHARE



SHAREHOLDERS

	% of ord. Share capital
Kempen Cap Mgmt	7.5%
JPMorgan Asset Mgmt	5.9%
JO Hambro Cap Mgmt	5.4%
BlackRock	5.0%
Littlejohn & Co	4.0%
Allianz Global	3.6%
Polar Capital	3.2%
	34.6%

Announcements

Date	Event
31 January 2021	FY results
13 December 2021	Q4 trading update
13 September 2021	Q3 trading update
19 July 2021	H1 FY21 results
03 June 2021	Trading update
15 March 2021	Q1 trading update

RATIOS

	2020	2021	2022E	2023E	2024E
RoE	14.3%	26.6%	23.9%	22.2%	20.9%
RoCE	39.8%	60.4%	57.4%	54.4%	52.7%
Asset Turnover (x)	0.2x	0.1x	0.1x	0.1x	0.1x
NWC % Revenue	4.8%	6.0%	6.1%	6.8%	7.2%
Op Cash % EBITA	245.7%	89.6%	102.4%	97.5%	99.8%
Net Debt / EBITDA	1.0x	0.7x	0.9x	0.9x	1.1x

VALUATION

Fiscal	2020	2021	2022E	2023E	2024E
P/E	31.0x	13.6x	12.7x	11.8x	10.7x
EV/EBITDA	9.9x	6.4x	6.0x	5.6x	5.2x
Div Yield	1.2%	2.6%	2.9%	3.1%	3.5%
FCF Yield	12.2%	6.8%	8.7%	8.7%	10.3%

Net Fees growth	-8.7%	15.3%	9.8%	6.5%	6.6%
EPS growth	-58.3%	128.6%	6.5%	7.8%	10.0%
DPS growth	-2.0%	120.0%	10.5%	7.8%	10.0%

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