

1 Year Chart



Today's scheduled Q4 trading update provides a fuller net fee performance picture, following the November update that prompted material upgrades to consensus forecasts for FY'20. The key headline is one of good resilience across much of the group and two areas of notable strength in the US and Germany. The US stands out in terms of delivering positive net fee growth (+2%) against such a challenging backdrop.

There is no doubt in our mind, that SThree has come out of this crisis with their strategic commitment to STEM roles and flexible working firmly vindicated. Of all the UK staffing peer group, SThree has had the "best" crisis. Not only is this clear from SThree's net fee outperformance (consistent across both Contract and Permanent business lines) but we also believe this will be demonstrated through SThree's profitability. We expect SThree to show the lowest peak to trough profitability decline across the peer group, as the group has cut costs in a more considered fashion than elsewhere. Critically, though we believe that core capacity has been maintained that will allow the group to continue to leverage the areas of specialist strength that clearly do exist.

Despite the sharp recovery (+27%) in the share price post the September lows (last week's Brexit induced wobble notwithstanding); the shares continue to offer the best value in the peer group; backed by the strongest operational delivery.

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

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

14th December 2020

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- **Full year net fee outcome:** FY'20 net fees have declined 8% YoY, which is a materially better outcome than most would have expected heading into the pandemic. The combined focus on highly technical roles and flexible working has allowed SThree to weather this storm in far better shape than its peers.
- **H2 has seen a good recovery:** SThree has seen activity levels steadily improving across many of its key markets through H2. However, the US and Germany stand out in particular, with Life Sciences and Technology proving particular areas of strength in those markets.
- **Growth strategy and capacity has not been diminished:** Critically, SThree has stuck to its strategic guns. Headcount has been reduced and cost actions taken, but not at the expense of the ability of the business to grow. This leaves the group well positioned heading into FY'21.
- **Margin tailwinds:** The combination of a more efficient central platform; improving consultant productivity and market growth opportunities does make for an interesting question around whether medium term group margin aspirations could be higher than previously thought.

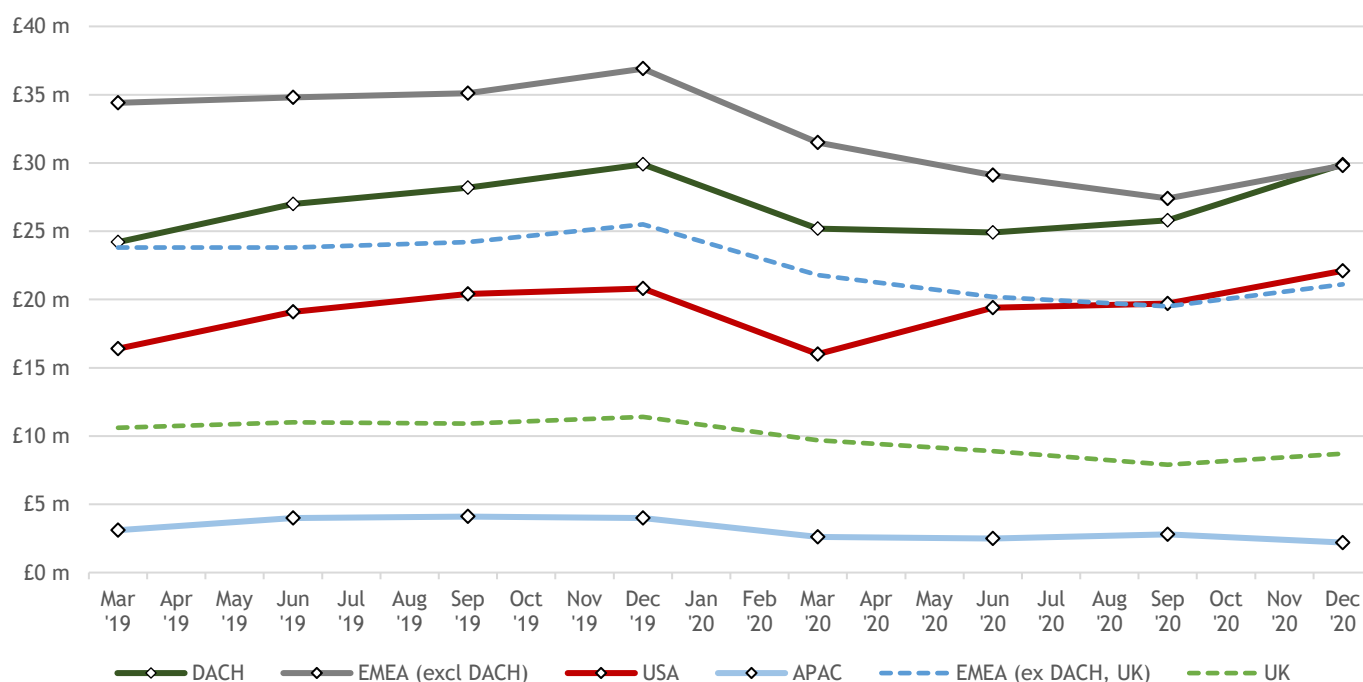
November, £m	Net Fees	PBT adj	EPS (p)	Div (p)	Net Cash	Fiscal PER x	Yield %
FY 2017A	287.7	44.5	24.9	14.0	5.6	11.7	4.8
FY 2018A	321.1	53.3	29.6	14.5	-4.1	9.9	4.9
FY 2019A	342.4	59.2	32.3	5.1	10.6	9.1	1.7
FY 2020E	306.2	28.1	13.3	3.0	39.4	22.1	1.0
FY 2021E	312.7	32.6	16.8	6.0	45.4	17.4	2.0

Source: Radnor Capital Partners

## Q4 Trading Update

So how has the pandemic actually played out in terms of absolute net fee levels? In Figure 2 below, we break down the quarterly net fees as disclosed by SThree under their new reporting structure. 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 below.

**Figure 1:** Absolute Quarterly Net Fee performance for SThree



Source: FactSet, Radnor

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 performance turning around sharply as investment in Life Sciences (+16% YoY, with an especially strong second half) and Technology (+9%), driving +2% overall net fee growth for the year. Given the overall pandemic context here; a positive year on year net fee outcome is highly impressive. It is also clear that SThree has been able to strengthen its position in this strategically important market and will have seen some 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 has experienced a recovery 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 for the group, driven by the earlier onset of the pandemic and the focus on permanent recruitment in Japan. Overall, APAC net fees for FY'20 were down 26% YoY.

Although SThree is not alone in having to navigate an operating environment disrupted by remote working; it is worth noting that this strong Q4 result has been delivered with c.95% of the global SThree headcount home working. This speaks volumes to the quality of the management platform and internal systems.

In-line with other scheduled, quarterly trading updates, the focus is on net fee performance with no specific mention of profitability. However, SThree has already indicated (trading update on 24<sup>th</sup> November), that the profit performance for the year was going to be materially better than had originally been anticipated. We upgraded our FY'20 PBT estimate by +53% as a result (even after factoring c.£2m of Australian closure costs), and are now looking for adjusted PBT of £28.1m. 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 indiscriminate. Throughout this period, SThree has remained consistent with the strategy outlined at the November 2019 Capital Markets Day; namely to focus its efforts on those markets and niches where it already has leading positions. Although the group is reporting headcount reductions (period end headcount was down 17% YoY, down 6% YoY on an average basis), these reductions have not been uniform across the group.

It is also 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 (we estimate low single digits).

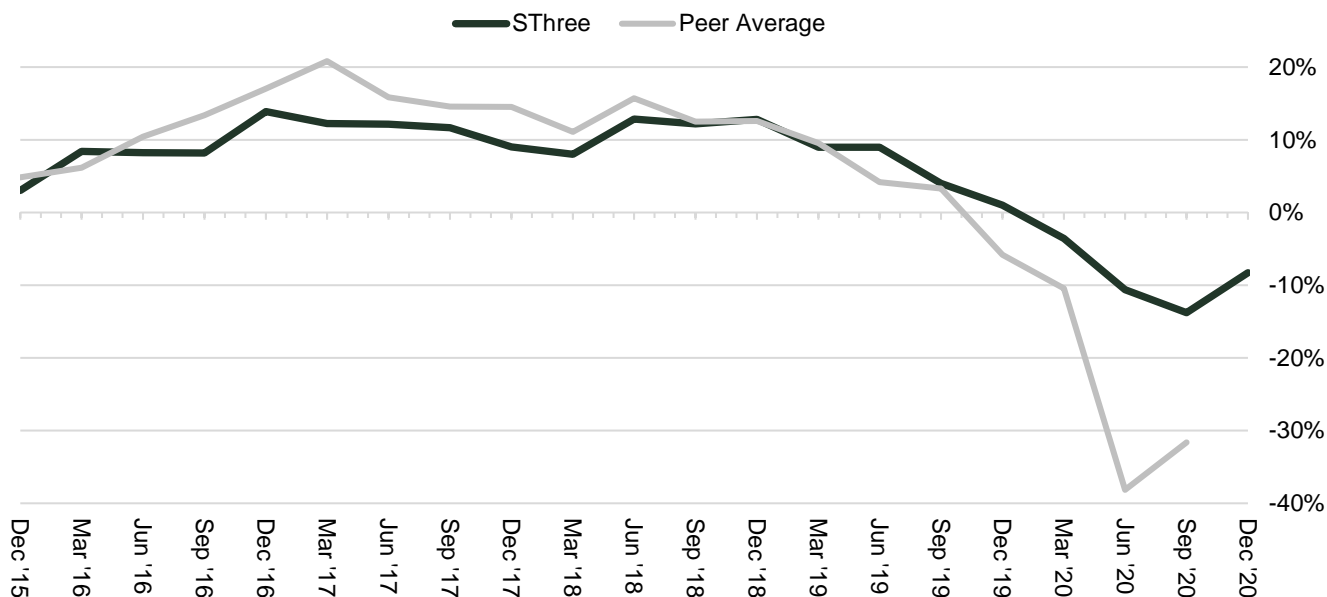
- **Critical capacity retained.** This more considered approach to cost management has resulted in critical capacity being maintained as activity levels have shown signs of recovery. This is crucial as this capacity retention will be fundamental to continued net fee growth and consultant productivity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

The net result of this is likely to be a more cost-efficient group platform, supporting a higher level of underlying consultant productivity. Although the outlook for FY'21 and beyond remains uncertain, we believe this is likely to provide a tailwind to further underlying margin expansion, above and beyond our original pre-pandemic expectations.

## Performance relative to the peer group

Below, we update our peer group comparison chart looking at total net fee trends and perm. This chart shows comparative data back to Q4 2015 and averages the quarterly net fee growth reported by Hays, PageGroup and Robert Walters. SThree is the first of the cohort to report (hence the lack of Q4 data for the peers), however the gap between SThree and its peers remains notable.

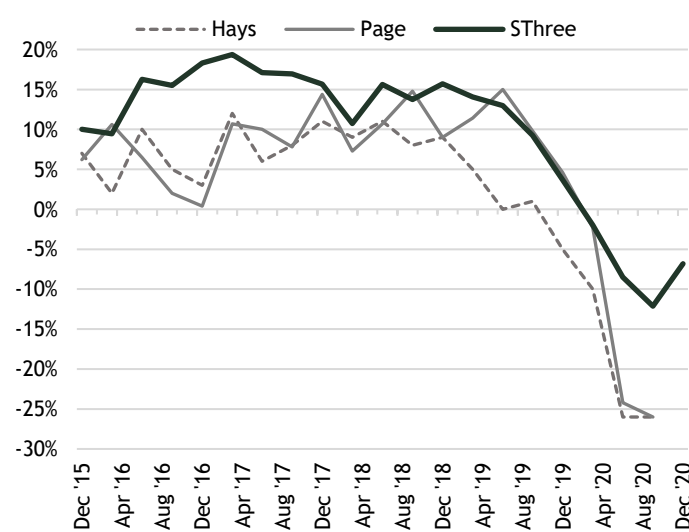
**Figure 2:** Quarterly Net Fee trends, YoY growth – SThree vs UK Staffing peer group average



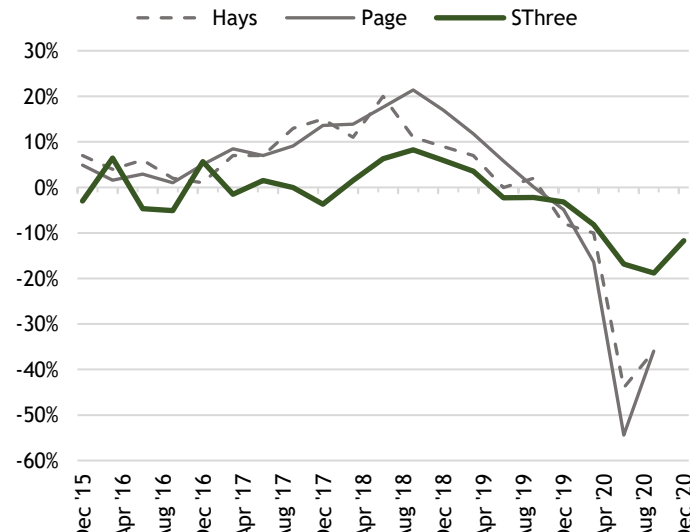
Source: FactSet, Radnor

In Figures 3 and 4 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 3:** Contract Net Fees, YoY growth



**Figure 4:** Perm Net Fees, YoY growth



Source: FactSet, 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 in the group and have benefited from the relative robustness of those markets.
2. Secondly, SThree's strategic focus on STEM industries and roles will have provided the Permanent businesses with a degree of protection from the worst cyclical effects of the downturn as these industries have, by and large, outperformed their domestic economies.

## SThree PLC

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Price (p): 293 p  
Market Cap: 389 m  
EV: 350 m

## PROFIT &amp; LOSS

Year to 31 November, £m	2016	2017	2018	2019	2020E	2021E
<b>Group Sales</b>	<b>960.0</b>	<b>1,114.5</b>	<b>1,258.2</b>	<b>1,345.0</b>	<b>1,224.6</b>	<b>1,250.8</b>
<b>Group Net Fees</b>	<b>258.7</b>	<b>287.7</b>	<b>321.1</b>	<b>342.4</b>	<b>306.2</b>	<b>312.7</b>
Op. Exp.	(214.8)	(237.0)	(261.1)	(276.3)	(271.0)	(273.0)
<b>EBITDA</b>	<b>43.9</b>	<b>50.7</b>	<b>60.1</b>	<b>66.1</b>	<b>35.2</b>	<b>39.7</b>
Depr & Amort	(5.7)	(5.7)	(6.1)	(6.0)	(6.4)	(6.6)
<b>EBITA - Adjusted</b>	<b>38.2</b>	<b>44.9</b>	<b>53.9</b>	<b>60.1</b>	<b>28.8</b>	<b>33.1</b>
Associates & JV's	-	(0.1)	0.1	0.1	0.1	0.1
Net Bank Interest	(0.5)	(0.3)	(0.7)	(1.0)	(0.8)	(0.6)
<b>PBT - Adjusted</b>	<b>37.7</b>	<b>44.5</b>	<b>53.3</b>	<b>59.2</b>	<b>28.1</b>	<b>32.6</b>
Non Operating Items	-	(6.7)	(8.3)	-	-	-
Other Financial Items	-	-	-	-	-	-
<b>PBT - IFRS</b>	<b>37.7</b>	<b>37.8</b>	<b>45.0</b>	<b>59.2</b>	<b>28.1</b>	<b>32.6</b>
Tax - Adjusted	(9.9)	(11.4)	(13.9)	(15.9)	(10.4)	(10.1)
<b>Tax rate - Adjusted</b>	<b>26.3%</b>	<b>25.6%</b>	<b>26.0%</b>	<b>26.9%</b>	<b>37.0%</b>	<b>31.0%</b>
Minority interests	-	-	-	-	-	-
No. shares m, diluted	132.0	132.6	133.1	133.6	133.6	133.6
<b>Adj EPS (p), diluted</b>	<b>21.1</b>	<b>24.9</b>	<b>29.6</b>	<b>32.3</b>	<b>13.3</b>	<b>16.8</b>
Total DPS (p)	14.0	14.0	14.5	5.1	3.0	6.0

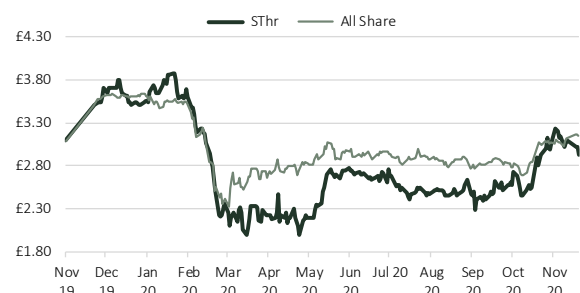
## CASH FLOW

Year to 31 November, £m	2016	2017	2018	2019	2020E	2021E
EBITDA	43.9	50.7	60.1	66.1	35.2	39.7
Working Capital	(4.3)	(16.4)	(25.3)	(11.7)	18.4	(8.0)
Provisions / Exceptionals	2.6	5.8	(4.7)	(1.3)	(1.5)	(1.5)
<b>Gross Op Cashflow</b>	<b>42.2</b>	<b>40.1</b>	<b>30.1</b>	<b>53.1</b>	<b>52.1</b>	<b>30.3</b>
Cash Tax	(8.5)	(10.9)	(14.4)	(13.0)	(11.1)	(15.2)
Cash Intererest	(0.5)	(0.3)	(0.5)	(1.0)	(0.8)	(0.6)
<b>Net Op Cashflow</b>	<b>33.2</b>	<b>28.9</b>	<b>15.2</b>	<b>39.1</b>	<b>40.2</b>	<b>14.5</b>
Capex	(6.1)	(5.8)	(5.2)	(4.5)	(4.5)	(4.5)
<b>Free Cashflow</b>	<b>27.1</b>	<b>23.1</b>	<b>10.0</b>	<b>34.6</b>	<b>35.7</b>	<b>10.0</b>
Dividends	(18.0)	(18.0)	(18.0)	(18.8)	(6.8)	(4.0)
Acquisitions & Inv.	(0.7)	(1.2)	-	-	-	-
Other Non Operating	(4.6)	(8.3)	(0.2)	1.4	-	-
<b>Net Cashflow</b>	<b>3.8</b>	<b>(4.4)</b>	<b>(8.2)</b>	<b>17.2</b>	<b>28.9</b>	<b>6.0</b>
<b>Net Cash (Debt)</b>	<b>10.0</b>	<b>5.6</b>	<b>(4.1)</b>	<b>10.6</b>	<b>39.4</b>	<b>45.4</b>

## BALANCE SHEET

Year to 31 November, £m	2016	2017	2018	2019	2020E	2021E
Intangibles	11.6	11.4	9.6	8.0	8.0	8.0
P,P+E	7.1	6.7	6.9	6.8	8.7	10.8
Tax Asset & Other	3.2	6.0	4.7	4.2	4.2	4.2
<b>Total Fixed Assets</b>	<b>21.9</b>	<b>24.1</b>	<b>21.3</b>	<b>19.0</b>	<b>20.9</b>	<b>23.0</b>
Current Assets	193.9	228.1	288.4	271.0	239.4	244.5
Current Liabilities	(149.2)	(174.9)	(202.3)	(182.4)	(169.2)	(166.3)
<b>Net Current Assets</b>	<b>44.7</b>	<b>53.2</b>	<b>86.1</b>	<b>88.6</b>	<b>70.2</b>	<b>78.2</b>
Long Term Liabilities	(0.9)	(2.2)	(1.6)	(1.4)	(1.4)	(1.4)
Net Cash (Debt)	10.0	5.6	(4.1)	10.6	39.4	45.4
<b>Net Assets</b>	<b>75.7</b>	<b>80.7</b>	<b>101.6</b>	<b>116.8</b>	<b>129.1</b>	<b>145.1</b>

## PRICE CHART - 1 YEAR ABSOLUTE vs FTSE ALL SHARE



Source: FactSet

## SHAREHOLDERS

	% of ord. Share capital
JO Hambro Cap Mgmt	9.1%
SThree Founders	7.6%
Harris Assoc	5.0%
M&G	4.8%
Allianz Global	4.2%
Premier Miton	3.6%
Littlejohn & Co	3.5%
	<b>37.8%</b>

## Announcements

Date	Event
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
06 April 2020	Covid-19 update
16 March 2020	Q1 trading update

## RATIOS

	2017	2018	2019	2020E	2021E
RoE	41.0%	38.8%	37.1%	13.7%	15.5%
RoCE	59.6%	51.1%	56.7%	32.2%	33.3%
Asset Turnover (x)	0.1x	0.1x	0.1x	0.1x	0.1x
NWC % Revenue	16.5%	28.1%	22.8%	10.1%	10.5%
Op Cash % EBITA	89.2%	55.8%	88.4%	180.9%	91.4%
Net Debt / EBITDA	0.2x	0.1x	-0.1x	0.2x	1.1x

## VALUATION

Fiscal	2017	2018	2019	2020E	2021E
P/E	11.7x	9.9x	9.1x	22.1x	17.4x
EV/EBITDA	6.9x	5.8x	5.3x	9.9x	8.8x
Div Yield	4.8%	4.9%	1.7%	1.0%	2.0%
FCF Yield	6.6%	2.9%	9.9%	10.2%	2.8%
Net Fees growth	11.2%	11.6%	6.6%	-10.6%	2.1%
EPS growth	18.4%	18.9%	9.1%	-59.0%	27.1%
DPS growth	0.0%	3.6%	-64.8%	-41.2%	100.0%

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