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*Securities*

# YOU'RE HIRED!



INITIATION OF COVERAGE ON: **HAYS; RETHINK; STHREE**  
RECOMMENDATION CHANGE ON: **HARVEY NASH**

FINANCIAL SUMMARIES ON:  
**EMPRESARIA; HEALTHCARE LOCUMS; IMPELLAM; INTERQUEST;  
MICHAEL PAGE; PENNA; ROBERT WALTERS AND STAFFLINE**

**A publication on the UK recruitment sector**



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# You're Hired! No. 4

## Major stocks continue to discount a suspect recovery

We are still dubious regarding the longevity of the UK's climb out of recession. Once the artificial QE stimulus stops drip-feeding liquidity into the economy will there be enough demand within the private sector to sustain the growth impetus or will we experience a double dip recession? These concerns are highly relevant to the recruitment sector as are the macro effects of the fiscal measures that are likely to have to be taken next year to address the large public sector deficit.

Meanwhile the share prices of the larger players in the sector continue to forge way ahead of any likely short-term earnings targets, movements which we consider precipitate and possibly unsustainable given the fragility and dubious strength of the "recovery". We still believe the shares in these companies, namely Hays, Michael Page, SThree and Robert Walters are likely, at best, to become range bound through 2010 and 2011 as earnings catch up with the already implied discounts. History supports this view and we suggest investors take a look at Chart 3 on page 8 of this document. We currently have a Sell recommendation on all four companies and believe that better value is available within the smaller cap companies in the sector.

### Summary:

- The latest quarterly UK GDP data merely served to confuse those looking for signs of life in the recruitment sector. Q3 GDP data showed that the economy continued in recessionary mode (-0.3% q-o-q or -5.2% y-o-y) when most commentators had predicted a move into positive territory.
- Q4 2009 data should show a return to GDP growth (albeit weak) for the first time in 6 quarters and potentially also reveal the first drop in the unemployment rate for 6 quarters. Two such positive data releases would undoubtedly be bullish for the stock market in general and for recruitment companies in particular.
- However, recent history has shown that recessions typically result in prolonged periods of rising unemployment (up to 20 quarters in 1979-81) and it would thus seem logical that such a deep recession as we are just emerging from should have a greater impact than just 6 quarters of rising unemployment.
- At the coal face recruitment companies are being understandably cautious about calling the turn in demand with most, at best, reporting some signs of stabilisation over calendar Q3 but very much being a situation of "not getting any worse" rather than any clear signs of sequential or y-o-y recovery.
- Chart 4 on page 7 shows nonfarm payroll data from the US and offers an interesting perspective on the timing of any recovery. The point at which the absolute and six month rolling averages converge marks an inflexion point in the trend of absolute data. Past inflexion points occurred in April 2001, September 2003 and January 2008, and the chart currently indicates that another convergence is imminent. However this does not necessarily mean that a clear bullish signal will be immediate or unequivocal. The crossover in mid 2002 proved to be a false dawn with a clear upside signal not evident for a further twelve months.
- Seemingly replicating the situation that occurred in 2003, share prices in the major stocks in the sector have risen to the extent that when profits begin to improve the shares, instead of reacting positively will at best move sideways as earnings play catch-up. Only when this has been achieved will shares move ahead strongly on the back of rising earnings.
- This issue of You're Hired! introduces coverage of Hays, ReThink and SThree and brings the total coverage to twelve.

### IN THIS ISSUE:

#### Recommendation change on:

Harvey Nash Group

#### Initiation of coverage on:

Hays

ReThink Group\*

SThree

#### Current coverage on:

Empresaria Group

Harvey Nash Group

Hays

Healthcare Locums

Impellam Group

InterQuest Group

Michael Page International

Penna Consulting

ReThink Group\*

Robert Walters

Staffline Group

SThree

\* MJES acts as NOMAD and Joint Broker to ReThink Group plc

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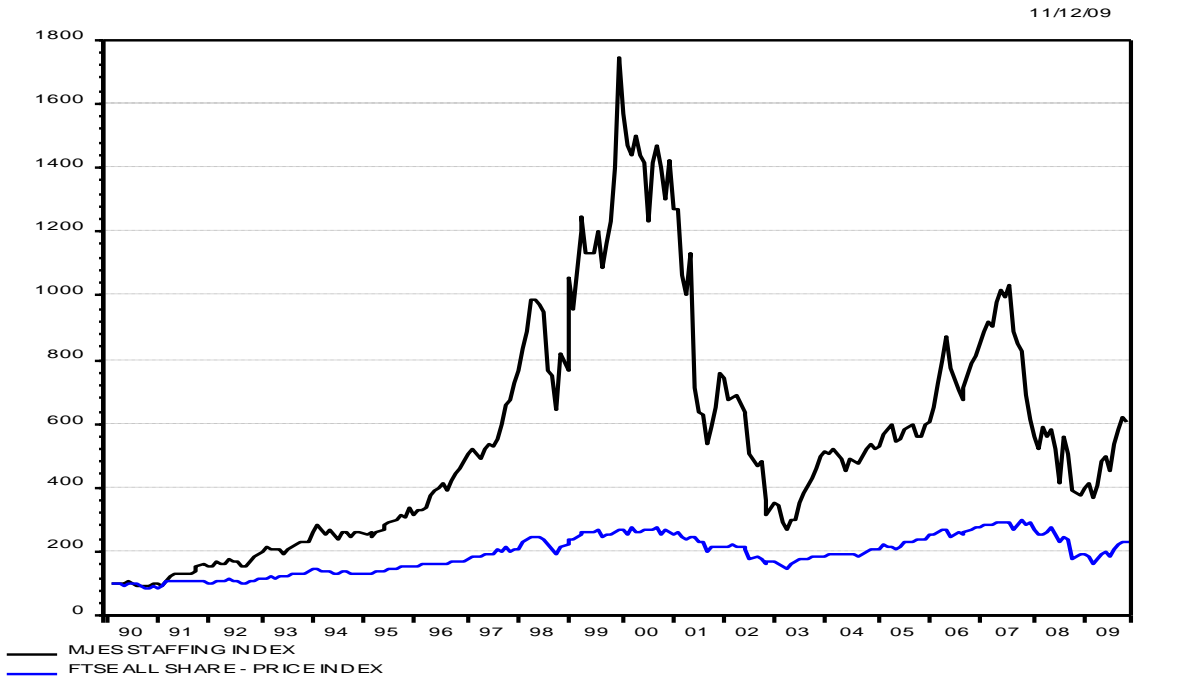
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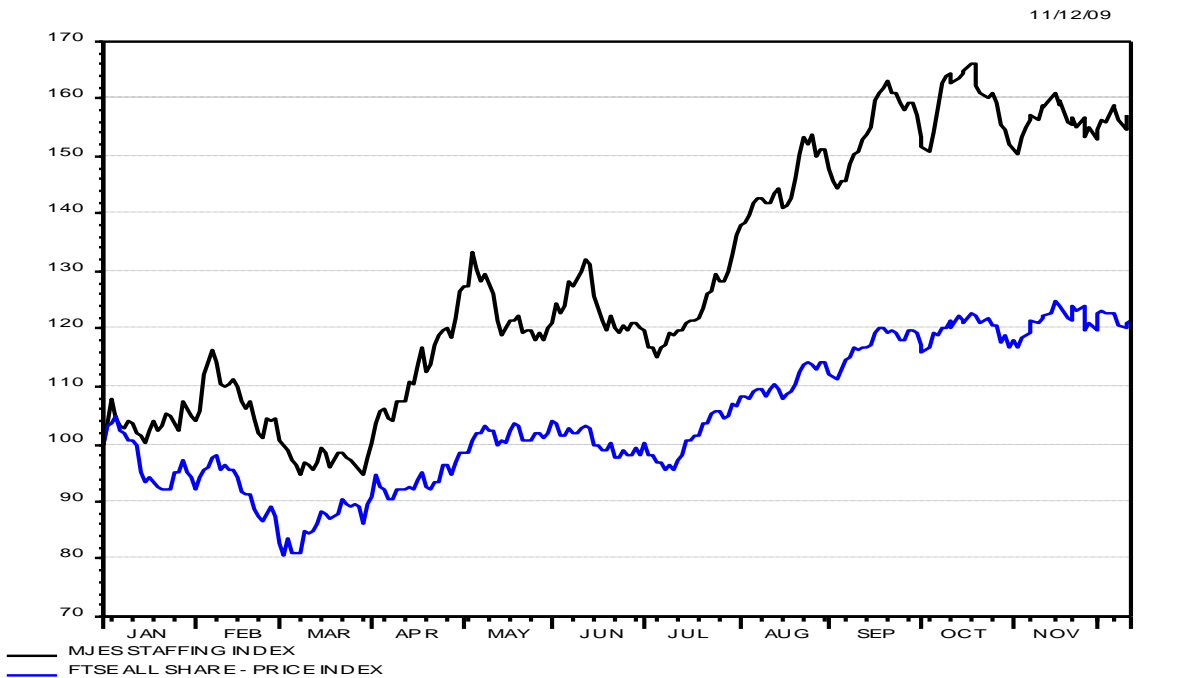
# Sector performance

Chart 1: MJES Staffing Index (1990 – 2009)



Source: Thomson Datastream

Chart 2: MJES Staffing Index 2009



Source: Thomson Datastream



# Through a glass darkly

## UK GDP and unemployment giving conflicting signals

The latest quarterly UK GDP data merely served to confuse those looking for signs of life in the recruitment sector. Q3 GDP data showed that the economy continued in recessionary mode (-0.4% q-o-q or -5.2% y-o-y) when most commentators had predicted a move into positive territory.

Our opinion is that the expected move into positive territory has only been delayed by one quarter and that Q4 GDP will show sequential growth over Q3, albeit still evidencing negative growth on a year-on-year basis.

Chart 3 below illustrates the long term trend and current position regarding GDP growth and the unemployment rate with data going back to 1971 and clearly showing the 1979-81, 1990-92 and current recessions. The interesting point to note is the rise in the unemployment rate during and following the two earlier recessions.

The 1979-81 recession resulted in a 20-quarter or five year period of q-o-q sequentially rising unemployment (Q3 1979 – Q2 1984 inclusive).

The less intensive 1990-92 recession, produced 12 consecutive quarters or three years of rising unemployment (Q2 1990 – Q1 1993 inclusive).

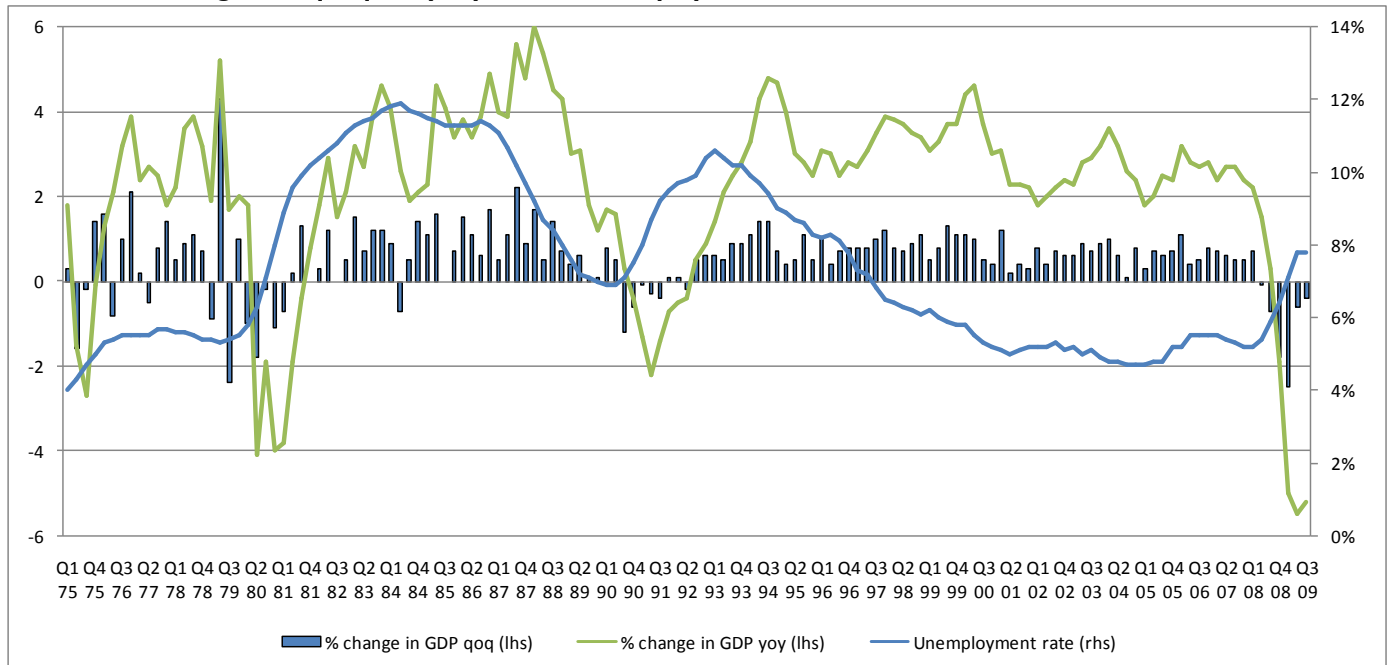
In the current recession the UK has so far experienced just 6 quarters of rising unemployment (Q2 2008 – Q3 2009 inclusive). Q3 2009 data showed a modest rise in the number of unemployed people but a stabilisation in the unemployment rate at 7.8%. Q4 data may or may not provide a sign of a change in the trend.

*A return to economic growth postponed*

*Previous recessions were followed by varying periods of rising unemployment*

*Q4 data may signal a change in the upward trend*

Chart 3: UK GDP growth q-o-q and y-o-y and UK unemployment rate



Source: ONS

Q4 2009 data should show a return to GDP growth (albeit weak) for the first time in 6 quarters and potentially also reveal the first drop in the unemployment rate for 6 quarters. Two such positive data releases would undoubtedly be bullish for the stock market in general and for recruitment companies in particular.



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However, we would advise an element of caution. Recent history has shown that recessions typically result in prolonged periods of rising unemployment and it would thus seem logical that such a deep recession as we are just emerging from should have a greater effect than just 6 quarters of rising unemployment.

We therefore believe that there is at least a possibility that even if unemployment dips in Q4 it could just as easily revert to a rising trend again in 2010, especially if external fiscal stimuli to the economy are withdrawn and private sector growth is found to be insufficient to sustain demand on its own. We are thus far from convinced that the worst is over.

### **At the coal face**

At the coal face recruitment companies are being understandably cautious about calling the turn in demand with most, at best, reporting some signs of stabilisation over the summer months but very much being a situation of “not getting any worse” rather than any clear signs of absolute sequential or y-o-y recovery.

Recent comments from the leading companies are probably worth restating:

**Hays**<sup>1</sup>: “We are seeing early signs of stability in the UK and broader signs of stability in Asia Pacific, although at present no indications of recovery in either market. The Continental European markets, which entered into the downturn later than other regions are still experiencing deteriorating conditions although the rate of decline has moderated”.

**Michael Page**<sup>2</sup>: “...as the third quarter progressed market conditions in an increasing number of the countries in which we operate began to show signs of stabilisation...”

**Robert Walters**<sup>3</sup> “Whilst trading conditions remain challenging there have been signs of improvement within certain disciplines such as banking, and in certain geographies, particularly Asia”.

**SThree**<sup>4</sup> “Although market sentiment has yet to undergo anything like a paradigm shift, we have nonetheless seen recent signs that indicate most market have stabilised and some are showing improvement”.

That said, we expect Q4 2009 to reveal a significant improvement in y-o-y decline of net fee income (NFI) as the comparatives for start getting easier, and the same will be true as we progress through 2010.

To emphasise the positive, costs have been cut to better accommodate falling revenue and taking up the slack in productivity will allow an initial sharp recovery in profits when demand begins to turn positive. After this companies will need to balance prudence in adding further consultant headcount with the need to accommodate the prospect of increasing volumes further out.

### **US nonfarm data an important indicator to watch**

The writer of this article is neither an economist nor a chartist but believes that Chart 4 below it is at least of passing interest and quite possibly could represent an important indicator for a change in economic direction. The chart shows the monthly movement in nonfarm payrolls (NFP) together with the six month rolling average.

*However, even if unemployment dips in Q4 there can be no guarantee that this will not reverse in quick order*

*Recent comments from the leading players are suggesting some sequential stability has returned to the market*

*Additions to the collective cost base will need to be prudent*

*Chart 4 could provide an important indicator of a change in economic direction*

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<sup>1</sup> 11th November 2009: Hays AGM statement

<sup>2</sup> 7th October 2009: Michael Page Third Quarter Trading Update

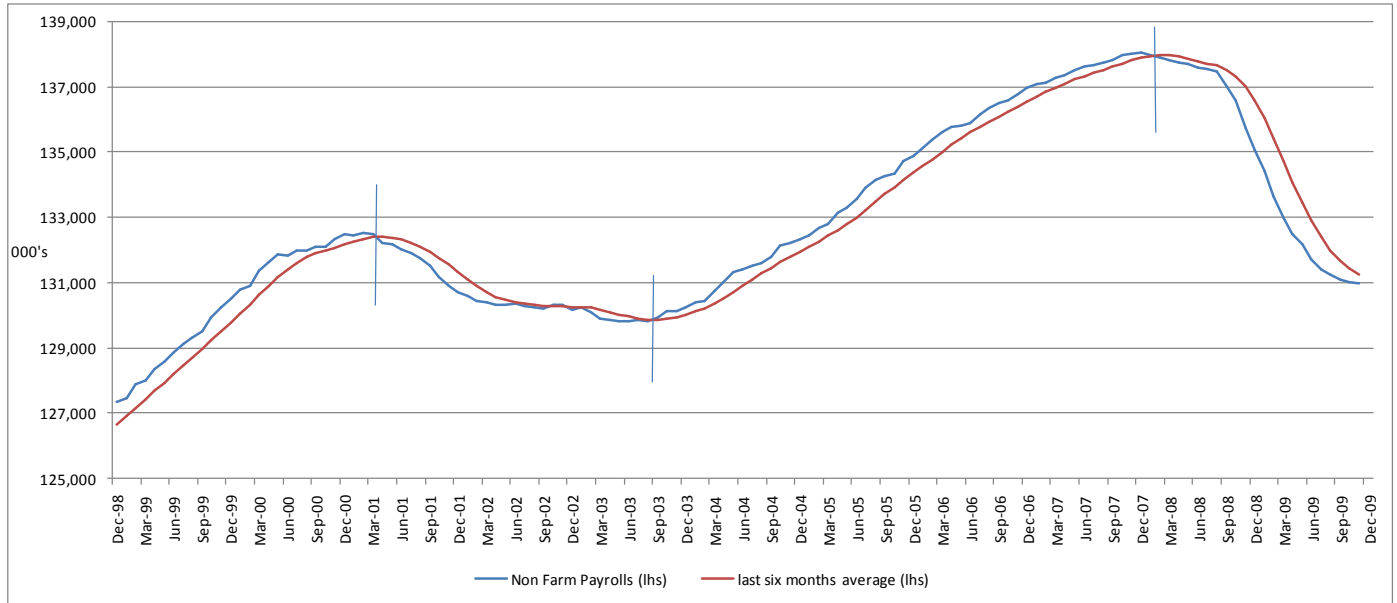
<sup>3</sup> 9th October 2009: Robert Walters Interim Management Statement

<sup>4</sup> 4th December 2009: SThree Trading update



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**Chart 4: Nonfarm payroll employment with 6 month rolling average**



Source: Bureau of Labor Statistics

It can be seen that the point at which the absolute and six month average crosses, marks the inflexion point in the trend of absolute data, past inflexion points occurring in April 2001, September 2003 and January 2008. Given the above and the strong recovery in the S&P 500 Index since March 2009 we should be expecting a change in direction in the above chart very soon. If not one could reasonably argue that the stock market has moved ahead too soon.

*Crossovers between absolute and rolling average may indicate inflexion points*

### Larger caps already discounting growth to c. 40% of previous peak

We have stated many times before that we believe a significant element of earnings recovery is already factored into share prices, at least for **Hays**, **Michael Page**, **SThree** and **Robert Walters**.

Seemingly replicating the situation that occurred in 2003, share prices have risen to the extent that when the outlook for these companies begins to improve the shares, instead of reacting positively will at best move sideways as earnings play catch-up with the share prices that are already discounting such growth.

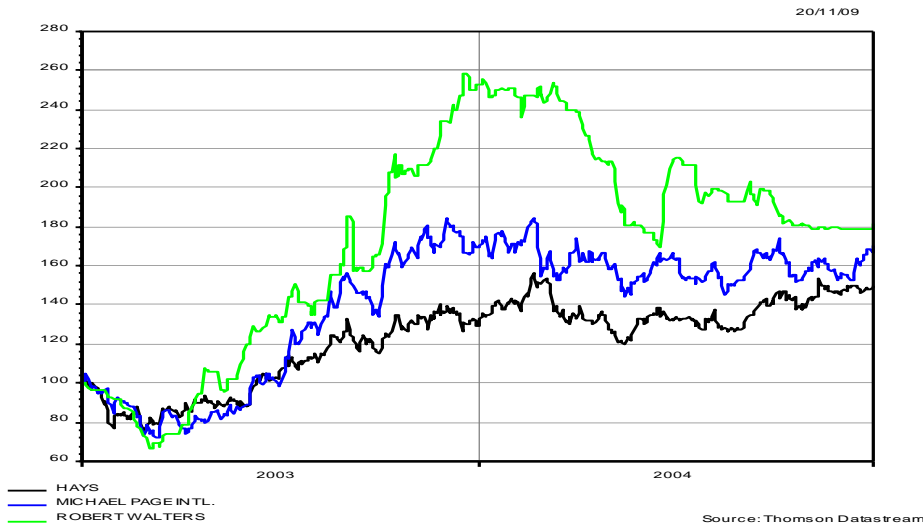
*We reiterate that in our opinion the share price growth of leading players at least discounts two years of future earnings and paints the prospect of share price stagnation in 2010-11*

Chart 3 below illustrates what we mean, showing the share price performance of Hays, Page and Walters during 2003 recovery and the twelve months or more of severely range-bound share prices that followed in some cases into 2005, even though earnings were moving ahead strongly. While Walters suffered the longest period of share price stagnation similar patterns can be attributed to both Hays and Page (SThree was not quoted until 2005).



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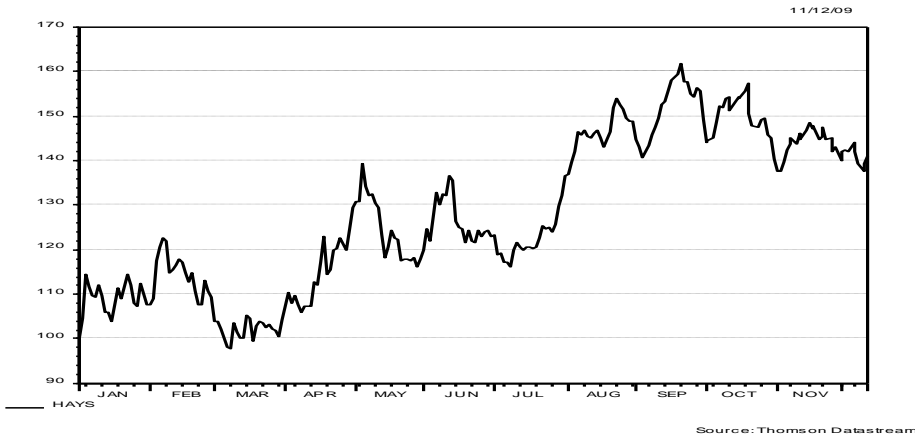
**Chart 3: Historic share prices of HAS, MPI, RWA (2003 to 2005)**



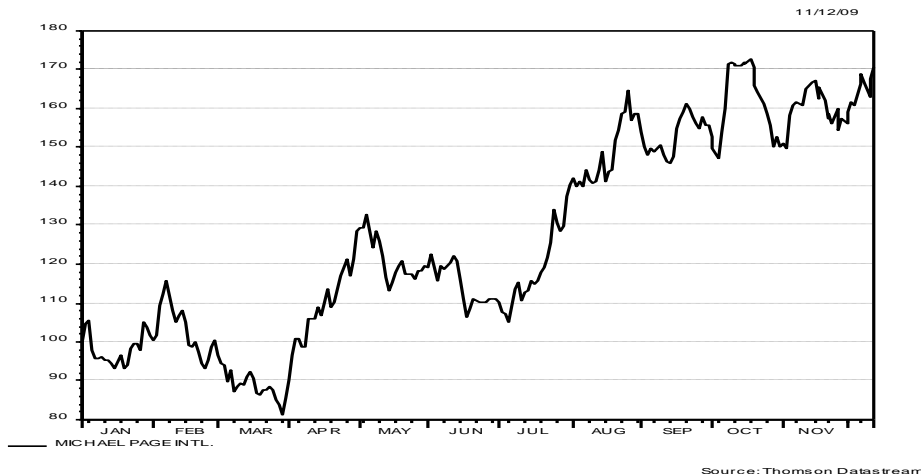
*2003 saw a similar strong rise in shares only to be followed by sideways movement for the following year or two*

Chart 4 below shows the current situation including the March 2009 recovery and a subsequent levelling off in share prices which may presage the possibility that the share prices of these companies have completed their initial recovery phase and are even now experiencing the early stages of a sustained period of neutral growth.

**Chart 4: Déjà vu (Historic share prices of HAS, MPI and RWA 2009 to date)**



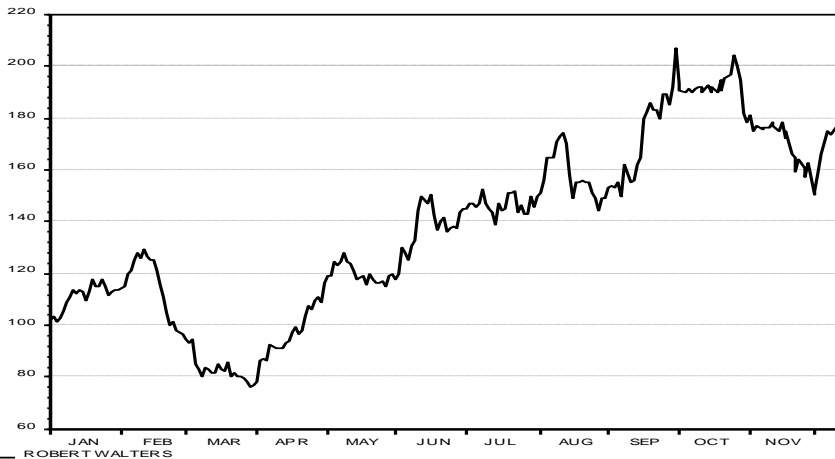
*2009 shows a similar pattern to 2003 with a similar prospect in store for share prices in 2010 – which may already be happening – see below*





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Source: Thomson Datastream

**So shares already discounting a substantial recovery**

Based on peak EPS of 20x FY2 earnings we calculate that share prices of the four companies above are already discounting a return to around 40% of previous peak profits and who knows how long it will take the companies to regain that much lost ground? Currently Hays sells on a FY2 PER of 34.7x, Page 36.2x and SThree 33.7x. Walters is forecasted to make a loss. While we can't predict if there is further short-term upside in these shares we can be more certain that these companies will experience share price stagnation for between one and two years.

**Table 1: Implied discount assuming 20x Yr1 EPS**

Company	Current share price (p)	Implied PBT PBT (£m) *	Peak PBT# (£m)	Implied PBT to peak PBT
Hays	98.25	97.1	250.8	38.7%
Page	366.8	85.3	147.4	57.9%
Walters	184.5	9.3	24.9	37.3%
Sthree	254.1	22.0	56.0	39.2%
* Based on 20x FY1 EPS			average	43.3%
# Peak PBT in last up cycle				

Source: MJES

We see more value in the smaller cap universe where average FY2 are just 8x earnings. These companies in the main have strong balance sheets with little or no debt, have compelling business models and are as well placed as their larger peers to generate strong growth through the next up-cycle. We accept that liquidity can be a problem but a decent holding can be accumulated over time.

*We see more value in the lower cap companies although of course liquidity is much tighter*

We would direct readers to the valuation metrics on page x for respective valuations for PER and EV.EBITA.



## The UK quoted universe

THE UK QUOTED UNIVERSE MC >£50m					
Company	Market Cap £m	Full list or AIM	Year end	Next results #	
1 Hays	1,357.9	FULL	Jun-10	25/02/2010 (I)*	
2 Michael Page	1,184.3	FULL	Dec-09	Mar-10 (F)	
3 SThree	309.4	FULL	Nov-09	01/02/2010 (F)*	
4 Healthcare Locums	276.1	AIM	Dec-09	Mar-10 (F)	
5 Robert Walters	141.4	FULL	Dec-09	Mar-10 (F)	
6 CPL	66.6	AIM	Jun-10	Feb-10 (I)	
7 Penna Consulting	60.7	AIM	Mar-10	Jun-10 (F)	
8 Matchtech	59.1	AIM	Jul-10	Apr-10 (I)	
9 Morson	55.1	AIM	Dec-09	Mar-10 (F)	
Total	3,510.6				

THE UK QUOTED UNIVERSE MC £10m - £50m					
Company	Market Cap £m	Full list or AIM	Year end	Next results #	
10 FDM Group	32.2	AIM	Dec-09	Mar-10 (F)	
11 Impellam	29.9	AIM	Dec-09	May-10 (F)	
12 Networkers	24.1	AIM	Dec-09	Apr-10 (F)	
13 Harvey Nash	23.5	FULL	Jan-10	Apr-10 (F)	
14 OPD	21.0	FULL	Dec-09	Mar-10 (F)	
15 Servoca	19.5	AIM	Sep-09	Jan-10 (F)*	
16 Hydrogen	18.6	AIM	Dec-09	Mar-10 (F)	
17 Empresaria	15.8	AIM	Dec-09	Mar-10 (F)	
18 Staffline	15.6	AIM	Dec-09	Mar-10 (F)	
19 Interquest	14.2	AIM	Dec-09	Mar-10 (F)	
20 Network Group	10.6	AIM	Nov-09	May-10 (F)	
Total	225.0				

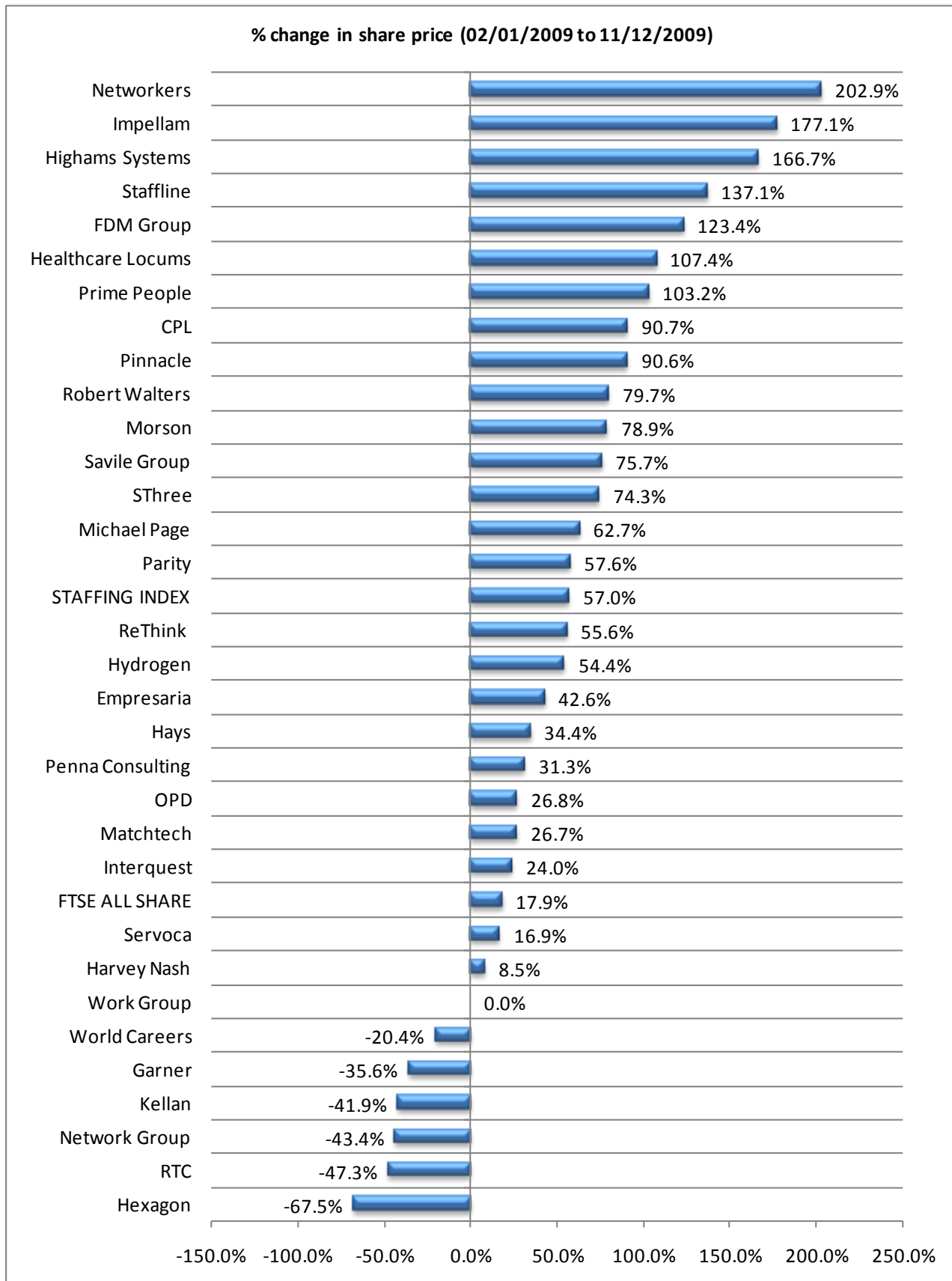
THE UK QUOTED UNIVERSE < £10m					
Company	Market Cap £m	Full list or AIM	Year end	Next results #	
21 Savile Group	9.8	AIM	Jun-10	Feb-10 (I)	
22 World Careers	6.9	AIM	Jul-10	Apr-10 (I)	
23 ReThink	6.4	AIM	Dec-09	Apr-10 (F)	
24 Parity	4.9	FULL	Dec-09	Mar-10 (F)	
25 Kellan	4.7	AIM	Dec-09	Apr-10 (F)	
26 Prime People	3.8	AIM	Mar-10	Jun-10 (F)	
27 Work	3.6	AIM	Dec-09	Mar-10 (F)	
28 Hexagon	3.0	AIM	Mar-10	Nov-09 (I)	
29 Pinnacle Staffing	2.4	AIM	Dec-09	Mar-10 (F)	
30 Higham Systems	2.1	AIM	Mar-10	Jul-10 (F)	
31 RTC Group	1.3	AIM	Dec-09	Mar-10 (F)	
32 Garner International	1.2	AIM	Dec-09	Jun-10 (F)	
Total	50.1				

# based on previous year's date unless specified(\*)



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### Share Price Performance (2/1/09 – 11/12/09)

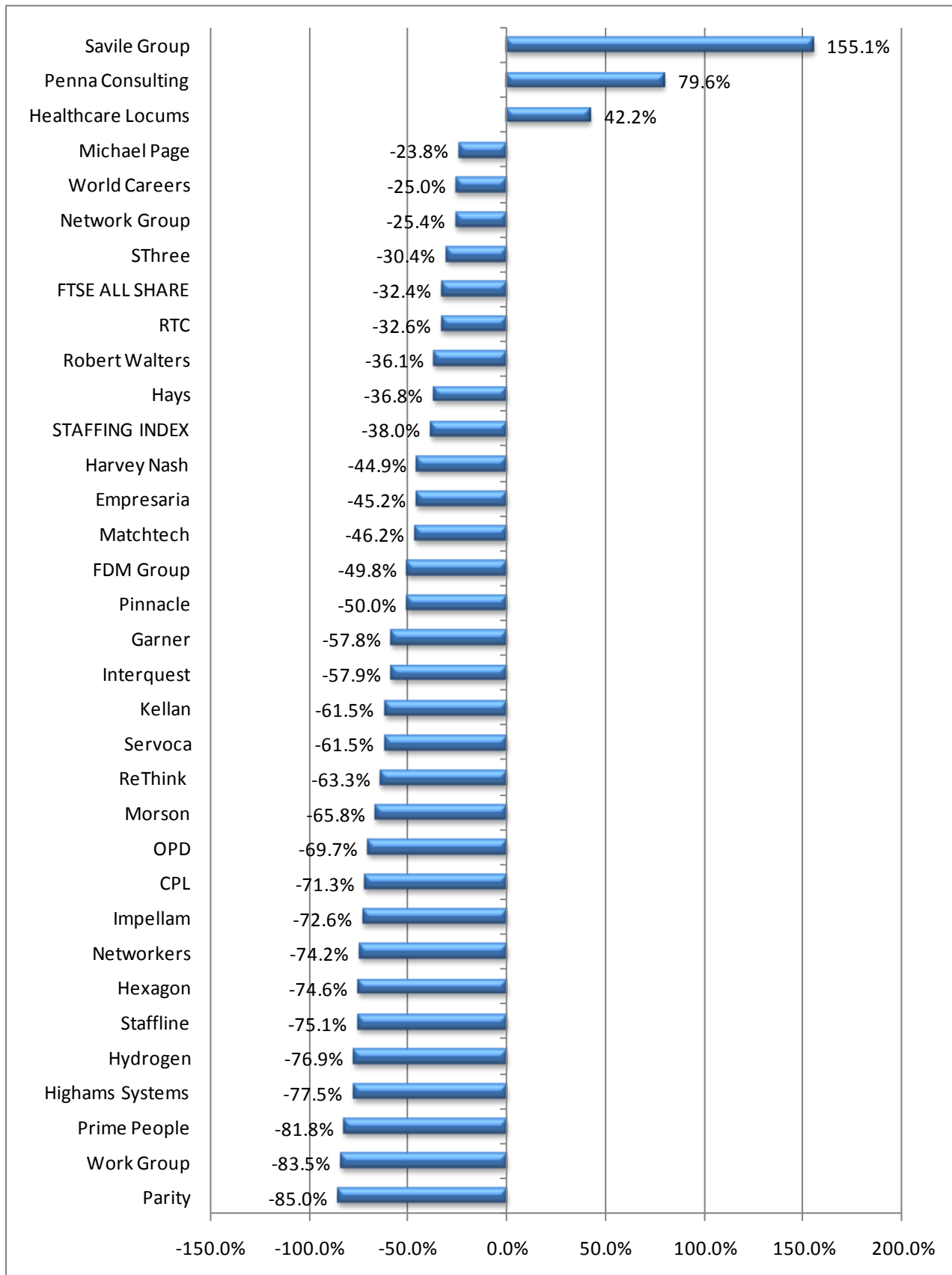


Source: Fidessa



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Share Price Performance – (Jan – Dec 2008)



Source: Fidessa



## Valuation Metrics

Table I: Valuation metrics on currently covered companies

Company	Year End	Price (p)	Market Cap (£m)	Cash/(Debt) (£m)		EV (£m)		NFI (£m)		EBITDA (£m)		EBITA (£m)		EPS (p)	
				Yr 1 E	Yr 2 E	Yr 1 E	Yr 2 E	Yr 1 E	Yr 2 E	Yr 1 E	Yr 2 E	Yr 1 E	Yr 2 E	Yr 1 E	Yr 2 E
Empresaria	Dec-09	35.50	15.8	-9.2	-8.6	25.0	24.4	39.0	39.3	5.2	5.4	4.2	4.4	3.1	4.3
Harvey Nash	Jan-10	32.00	23.5	5.7	7.3	17.8	16.2	53.0	54.3	5.7	6.4	4.5	5.1	3.4	4.0
Hays	Jun-10	98.25	1,357.9	-98.4	-137.8	1,456.3	1,495.7	500.0	525.0	76.0	91.0	61.0	74.0	1.7	2.8
Healthcare Locums	Dec-09	263.75	276.1	-14.0	5.9	290.1	270.2	63.6	75.6	35.1	45.5	34.4	44.8	21.5	28.3
Impellam	Dec-09	66.50	29.9	-54.6	-45.2	84.5	75.1	164.9	167.3	19.0	20.9	15.3	17.3	12.0	15.8
Interquest	Dec-09	46.50	14.2	-2.1	0.2	16.3	14.0	11.7	11.5	3.6	3.6	3.4	3.4	7.6	7.8
Michael Page	Dec-09	366.80	1,184.3	129.7	125.4	1,054.6	1,058.9	347.1	376.0	39.0	48.2	28.5	37.5	4.0	6.1
Penna	Mar-10	235.50	60.7	6.3	9.5	54.4	51.2	n/a	n/a	8.0	10.6	7.3	9.9	18.4	26.1
ReThink	Dec-09	7.00	6.4	-6.1	-5.9	12.5	12.3	11.3	12.7	0.7	1.5	0.5	1.4	0.2	0.7
Robert Walters	Dec-09	184.50	141.4	23.8	22.0	117.6	119.4	100.0	98.5	-1.1	1.4	-4.0	-1.5	-5.8	-2.1
Staffline	Dec-09	73.50	15.6	-6.2	-5.8	21.8	21.4	15.4	17.7	4.0	4.9	3.8	4.7	11.2	13.7
SThree	Nov-09	254.10	309.4	37.9	20.3	271.5	289.1	170.0	145.5	23.0	16.5	17.0	10.5	9.4	5.9

Company	DPS (p)		PER (x)		YIELD (%)		EV/NFI (x)		EV/EBITDA (x)		EV/EBITA (x)		Temp/Perm NFI split	UK/O'seas NFI split
	Yr 1 E	Yr 2 E	Yr 1 E	Yr 2 E	Yr 1 E	Yr 2 E	Yr 1 E	Yr 2 E	Yr 1 E	Yr 2 E	Yr 1 E	Yr 2 E		
Empresaria	0.35	0.35	11.3	8.4	1.0	1.0	0.6	0.6	4.8	4.5	6.0	5.6	76:24	41:59
Harvey Nash	2.20	2.25	9.5	8.1	6.9	7.0	0.3	0.3	3.2	2.5	4.0	3.2	62:38	45:55
Hays	5.80	5.80	56.7	34.7	5.9	5.9	2.9	2.8	19.2	16.4	23.9	20.2	56:44	59:41
Healthcare Locums	4.00	8.00	12.3	9.3	1.5	3.0	4.6	3.6	8.3	5.9	8.4	6.0	90:10	93:07
Impellam	0.00	0.00	5.6	4.2	0.0	0.0	0.5	0.4	4.4	3.6	5.5	4.3	85:15	81:19
Interquest	2.00	2.00	6.1	5.9	4.3	4.3	1.4	1.2	4.5	3.9	4.8	4.1	68:32	90:10
Michael Page	8.00	8.00	91.8	60.3	2.2	2.2	3.0	2.8	27.0	22.0	37.0	28.2	30:70	32:68
Penna	8.00	10.00	12.8	9.0	3.4	4.2	n/a	n/a	6.8	4.9	7.4	5.2	n/a	100:0
ReThink	0.00	0.00	42.1	10.5	0.0	0.0	1.1	1.0	18.7	8.0	25.0	9.1	52:48	95:05
Robert Walters	4.75	4.75	n/a	n/a	2.6	2.6	1.2	1.2	-106.9	85.3	-29.4	-79.6	35:65	33:67
Staffline	3.00	3.30	6.6	5.3	4.1	4.5	1.4	1.2	5.4	4.4	5.8	4.5	95:05	100:0
SThree	12.00	12.00	26.9	42.8	4.7	4.7	1.6	2.0	11.8	17.5	16.0	27.5	60:40	47:53
<b>Averages</b>			<b>9.2</b>	<b>7.6</b>	<b>2.9</b>	<b>3.2</b>	<b>1.7</b>	<b>1.5</b>	<b>5.3</b>	<b>4.7</b>	<b>6.0</b>	<b>5.3</b>		

Source: MJES estimates

Note: PER, EV/EBITDA and EV/EBITA Yr 1 E averages exclude the ratios for Hays, Page, ReThink and Walters. Yr 2 E exclude Hays, Page and Walters



## Company Commentary

### Harvey Nash plc – change of recommendation from Sell to Hold

- Harvey Nash (HNG) issued a severe profit warning on 25 November 2009 which was somewhat surprising, given that most companies had already guided for much lower expectations for 2009 and 2010 earlier in the year. In our view this indicated that the HNG board was overly confident in its expectation of a recovery in demand in calendar Q3 2009. In addition, the defensive qualities that we highlighted in previous notes have proved more ephemeral than we had suspected. In a note dated 25 November our PBT forecasts for the year to January 2010 were cut by a substantial 42% with our projections for 2010/11 lowered by 38%. We reduced our target price from 55p to 30p and given that the shares have now fallen to 32p we are switching the recommendation from Sell to Hold.

### Hays plc – initiated with a Sell recommendation

- We consider Hays, along with Michael Page to be one of the best positioned staffing companies in the world. It has a good balance between temp and perm which provides both defensive qualities and growth potential and has a growing presence in overseas markets that in its last financial year accounted for 51% of NFI. By virtue of its strong temp base Hays' earnings across the recruitment cycle are likely to be less volatile than Page and while it may not accelerate as quickly into the upturn its growth rate tends to compare well with Page over the whole cycle. However, in common with Page and other larger cap companies in the sector Hays is already discounting significant growth in 2010 and 2011. As a consequence of this and some question marks regarding the maintenance of the dividend we start coverage with a Sell recommendation and target price of 80p

### ReThink Group plc – initiated with a Hold recommendation

- The ReThink Group gained its AIM listing in June 2008 although the founder members of the board had previously worked together at Best International, an IT staffing business sold to Spring Group in June 2003. ReThink also specialises in IT recruitment but also has a second business which focuses on the delivery of business and technology solutions under the Aiimi brand. First half group profits have been badly impacted by the economic downturn but there will be some recovery in H2 if current market improvements continue. We anticipate a strong recovery in 2010 on the back of a modest improvement in demand for staff, a flat cost base and higher levels of activity in Aiimi. However we consider that the share price already discounts this recovery and so we commence coverage on ReThink with a Hold recommendation.

### SThree plc – initiated with a Sell recommendation

- SThree's management has achieved a great deal since the company was floated in November 2005. Current economic conditions aside the group is positioned exceptionally well for the upturn with an increasing percentage of NFI being generated from overseas activities while non-ICT business is also on a steady increase. We start coverage with a Sell recommendation which merely reflects the very forward looking valuation which is currently a common feature among the larger market caps in the sector. Fundamentally we like the business model, have confidence in management's capabilities and believe the shares are worth buying for the long term. However, in the short/medium term the shares are discounting growth that may take a year or two to achieve hence our Sell recommendation and target price of 200p.



# Harvey Nash Group plc

Recommendation change from Sell to Hold

**HOLD** (prev Sell 25/11/09)

**Harvey Nash (HNG) issued a severe profit warning on 25 November 2009 which was somewhat surprising, given that most companies had already guided for much lower expectations for 2009 and 2010 earlier in the year. In our view this indicated that the HNG board was overly confident in its expectation of a recovery in demand in calendar Q3 2009. In addition, the defensive qualities that we highlighted in previous notes have proved more ephemeral than we had suspected. In a note dated 25 November our PBT forecasts for the year to January 2010 were cut by a substantial 42% with our projections for 2010/11 lowered by 38%. We reduced our target price from 55p to 30p and given that the shares have now fallen to 32p we are switching the recommendation from Sell to Hold with a maintained target price of 30p.**

## Investment case

- The HNG profit warning was exceptional both in its severity and its timing. Profit expectations were cut from £7m to £4m for the year to January 2010 and from £7.2m to £4.5m in 2010/11. Even allowing for some built-in contingency such a heavy cut in guidance suggests that the board were overly optimistic with regard to a prospective Q3 and Q4 improvement in demand, particularly in Europe which was last into the recession.
- It would appear that any increase in European manufacturing output has for the moment been accommodated through working the existing labour force harder and increasing productivity rather than resorting to new hiring. In addition the implementation of new IT projects would appear to have been deferred and expected additional work from one of the group's principal outsourcing customers had been subject to more onerous terms than was the case or the indication a year earlier.
- In H1 NFI was down 5% at £31.7m, operating profit was down 42% at £2.5m and adjusted PBT down 41% at £2.3m. The group's seasonality in revenue normally favours the second half of the year with a pickup in demand expected from October onwards. This does not appear to have happened with the anticipated increase in activity failing to occur in both permanent and contract placement. HNG in fact has reported that Q3 trading to October 2009 saw revenues down 23% y-o-y and a decline of 72% in adjusted PBT which was surprising given that H1 revenues were stable.
- The group is now guiding for an H2 outturn being broadly similar to H1 which would translate to adjusted PBT of £4m. In our model this would put the European operation very close to just breakeven in the second half. However, at the moment the group is not looking at further headcount reductions.
- As a result we cut back our forecasts sharply. Current year PBT and EPS expectations were reduced from £7m/6.3p to £4m/3.4p and for the year to January 2011 from £7.2m/6.6p to £4.5m/4p. We had forecast net cash rising from £4.5m to £5.7m and still do not see this being adversely affected by the profit warning; reduced levels of activity normally having a beneficial impact on working capital.
- Now that the shares have fallen to a level commensurate with our revised price target we are moving our recommendation from Sell to Hold. In the group's favour it has a comfortable level of cash on its balance sheet, it remains profitable and a yield of 7% offers some support from here.

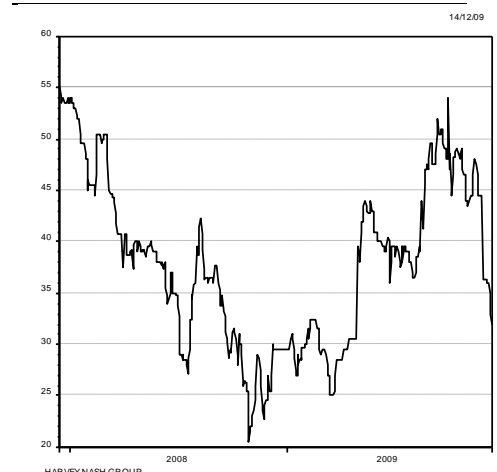
Price:	32p
Ticker:	HVN.LN
Asset class:	AIM
Website:	<a href="http://www.harveynashgroup.com">www.harveynashgroup.com</a>
12 mth Hi/Low:	54p – 25p
Sector:	Support Services
Market Cap:	£23.5m
Net (debt)/cash:	£5.7m E
EV:	£17.8 E
Next earnings:	April 2010 (F)

## Forecasts:

Yr to Jan (£m)	09	10 E	11 E
Revenue	420.1	365.0	380.0
NFI	69.2	53.0	54.3
Temp : Perm	70:30	75:25	75:25
EBITA	10.6	4.5	5.1
Conv. Ratio %	15.2	8.0	8.9
PBT as stated	9.5	3.4	4.4
PBT adjusted	9.6	4.0	4.5
EPS FD Adj (p)	9.0	3.4	4.0
DPS (p)	2.0	2.2	2.25
EV/EBITA (x)	1.8	4.0	3.2
EV/NFI (x)	0.3	0.3	0.3
PE ratio (x)	3.6	9.5	8.1
Yield (%)	6.3	6.9	7.0
Debt/EBITDA	-	-	-

Source: Merchant John East Securities Ltd.

## Two-year share-price performance





# Merchant John East Securities

## HARVEY NASH - Recommendation HOLD (prev Sell 25/11/09)

Summary P&L				
Years to January	2008	2009	2010 E	2011 E
	£m	£m	£m	£m
<b>Revenue</b>	<b>318.6</b>	<b>420.1</b>	<b>365.0</b>	<b>380.0</b>
<b>Net Fee Income (NFI)</b>	<b>58.5</b>	<b>69.2</b>	<b>53.0</b>	<b>54.3</b>
Administration expenses	-50.0	-58.8	-48.8	-49.5
Associates	0.0	0.0	0.0	0.0
<b>Operating Profit</b>	<b>8.5</b>	<b>10.4</b>	<b>4.2</b>	<b>4.8</b>
Separately disclosed items (SDI)	0.0	0.0	0.0	0.0
Finance income	0.9	0.1	0.2	0.2
Finance charge	-1.8	-0.9	-0.5	-0.6
<b>Profit before tax as stated</b>	<b>7.6</b>	<b>9.5</b>	<b>3.4</b>	<b>4.4</b>
IFRS 3 adjustment for amortisation of intangibles	0.0	0.0	0.1	0.1
Adjustment for SDIs	0.0	0.0	0.0	0.0
<b>Adjusted Profit before tax</b>	<b>7.6</b>	<b>9.6</b>	<b>4.0</b>	<b>4.5</b>
Tax	-2.2	-2.6	-1.1	-1.3
Post tax profit	5.4	6.9	2.3	3.1
Minorities	-0.1	-0.4	-0.2	-0.3
<b>Net Profit</b>	<b>5.3</b>	<b>6.5</b>	<b>2.0</b>	<b>2.8</b>
<b>Adjusted Net Profit</b>	<b>5.3</b>	<b>6.6</b>	<b>2.1</b>	<b>2.9</b>
<b>EBITDA</b>	<b>9.5</b>	<b>11.4</b>	<b>5.7</b>	<b>6.4</b>
Depreciation	-0.8	-0.8	-1.2	-1.3
<b>EBITA</b>	<b>8.7</b>	<b>10.6</b>	<b>4.5</b>	<b>5.1</b>
Amortisation of intangibles	0.0	-0.1	-0.1	-0.1
<b>EBIT</b>	<b>8.7</b>	<b>10.5</b>	<b>4.5</b>	<b>5.1</b>
<b>Equity</b>				
Weighted average shares (m)	70.340	72.471	73.435	73.450
Weighted average shares FD (m)	72.405	73.118	73.549	73.549
Year end shares in issue (m)	72.440	73.435	73.450	73.450
<b>EPS</b>				
EPS FD (p)	7.33	8.89	2.77	3.83
<b>EPS FD and adjusted (p)</b>	<b>7.33</b>	<b>9.00</b>	<b>3.37</b>	<b>3.97</b>
<b>Dividend</b>				
Interim dividend (p)	0.70	0.80	0.85	0.90
Final dividend (p)	1.10	1.20	1.35	1.35
<b>Total dividend (p)</b>	<b>1.80</b>	<b>2.00</b>	<b>2.20</b>	<b>2.25</b>
<b>Key ratios</b>				
Market cap (£m)	23.5	23.5	23.5	23.5
Enterprise value (EV) (£m)	19.3	19.0	17.8	16.2
EV/NFI (x)	0.3	0.3	0.3	0.3
EV/EBITA (x)	2.2	1.8	4.0	3.2
Share price (p)	32.0			
PER (x)	4.4	3.6	9.5	8.1
Yield (%)	5.6	6.3	6.9	7.0

Source: Company accounts; MJES estimates

P&L Analysis				
Years to January	2008	2009	2010 E	2011 E
<b>Analysis of Revenue</b>				
UK & Ireland	105.8	118.3	100.0	105.0
Continental Europe	189.1	273.2	241.0	250.0
USA	23.7	28.6	24.0	25.0
<b>Total Revenue</b>	<b>318.6</b>	<b>420.1</b>	<b>365.0</b>	<b>380.0</b>
<b>Analysis of NFI</b>				
UK & Ireland	28.2	30.6	22.0	23.0
Continental Europe	22.0	29.2	22.0	22.4
USA	8.4	9.4	9.0	9.0
<b>Total NFI</b>	<b>58.6</b>	<b>69.2</b>	<b>53.0</b>	<b>54.4</b>
<b>Analysis of operating profit</b>				
UK & Ireland	4.7	4.9	2.8	3.2
Continental Europe	3.0	4.3	1.1	1.3
USA	0.8	1.3	0.3	0.4
<b>Total Operating Profit</b>	<b>8.5</b>	<b>10.5</b>	<b>4.2</b>	<b>4.9</b>
<b>NFI margin</b>				
UK & Ireland	26.7%	25.9%	22.0%	21.9%
Continental Europe	11.6%	10.7%	9.1%	8.9%
USA	35.4%	32.9%	37.5%	36.0%
<b>Group NFI margin</b>	<b>18.4%</b>	<b>16.5%</b>	<b>14.5%</b>	<b>14.3%</b>
<b>Operating margin</b>				
UK & Ireland	4.4%	4.1%	2.8%	3.0%
Continental Europe	1.6%	1.6%	0.5%	0.5%
USA	3.4%	4.5%	1.3%	1.4%
<b>Group Operating margin</b>	<b>2.7%</b>	<b>2.5%</b>	<b>1.2%</b>	<b>1.3%</b>
<b>Key Ratios</b>				
EBITA margin	2.7%	2.5%	1.2%	1.3%
Administration costs as a % of revenue	15.7%	14.0%	13.4%	13.0%
Conversion of NFI into EBITA	14.5%	15.2%	8.0%	8.9%
Effective tax rate	29.3%	27.5%	28.5%	28.5%
Net interest cover by EBITDA (x)	10.6	13.8	17.1	14.2
Dividend cover by adjusted EPS (x)	4.1	4.5	1.5	1.8

Source: Company accounts; MJES estimates

Summary Cash Flow				
Years to January	2008	2009	2010 E	2011 E
	£m	£m	£m	£m
Net cash from operating activities	9.5	11.4	5.2	6.4
(Increase)/Decrease in trade and other receivables	-21.5	-19.9	-16.9	-20.0
(Decrease)/ Increase in trade and other payables	29.2	18.0	18.0	19.0
Increase/(Decrease) in provisions for liabilities and charges	-0.3	0.0	0.1	0.0
<b>Cash generated by operations</b>	<b>16.9</b>	<b>9.5</b>	<b>6.4</b>	<b>5.4</b>
Taxation paid	-2.3	-2.2	-1.1	-1.3
<b>Net cash generated by operating activities</b>	<b>14.6</b>	<b>7.3</b>	<b>5.3</b>	<b>4.1</b>
<b>Cash flow from investing activities:</b>				
Interest received	0.9	0.1	0.2	0.2
Acquisition of subsidiaries (net of cash acquired)	-5.2	-4.9	0.0	0.0
Proceeds from the sale of subsidiary (net of cash disposed)	0.0	0.0	0.0	0.0
Purchase of PP&E	-0.6	-0.4	-2.0	-0.5
Purchase of intangible assets	0.0	0.0	0.0	0.0
Proceeds from sale of PP&E	0.0	0.0	0.0	0.0
Decrease/(Increase) in short term deposits	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Net cash used in investing activities</b>	<b>-4.9</b>	<b>-5.2</b>	<b>-1.9</b>	<b>-0.3</b>
<b>Financing activities:</b>				
Purchase of own shares	0.0	0.0	-0.4	0.0
Net movement in borrowings	-2.0	0.0	0.0	0.0
Dividends paid	-1.2	-1.4	-1.5	-1.7
Interest paid	-1.8	-0.9	-0.5	-0.6
Issue of shares (net)	0.1	0.0	0.0	0.0
Capital element of finance lease rentals	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Net cash inflow from financing activities</b>	<b>-4.9</b>	<b>-2.3</b>	<b>-2.4</b>	<b>-2.3</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>4.7</b>	<b>-0.3</b>	<b>1.0</b>	<b>1.6</b>
Cash and cash equivalents at start of year	-0.8	4.2	4.5	5.7
FX changes	0.2	0.5	0.2	0.0
<b>Cash and cash equivalents at end of year</b>	<b>4.2</b>	<b>4.5</b>	<b>5.7</b>	<b>7.3</b>
<b>Reconciliation of cash flow to net debt</b>				
Net (debt)/cash at start of the year	-2.6	4.2	4.5	5.7
Net increase/(decrease) in cash and cash equivalents	4.7	-0.3	1.0	1.6
FX changes	0.1	0.5	0.2	0.0
Net change in borrowings during the year	2.0	0.0	0.0	0.0
<b>Net (debt)/cash at end of the year</b>	<b>4.2</b>	<b>4.5</b>	<b>5.7</b>	<b>7.3</b>

Key Ratios				
	2008	2009	2010 E	2011 E
Free Cash Flow (£m)	11.6	5.0	3.3	1.9
Free Cash Flow per share (p)	16.0	6.8	4.5	2.5

Source: Company accounts; MJES estimates

### Free Cash Flow:

Cash flow from operating activities, less interest paid, less tax paid, less equity divs paid

Summary Balance Sheet				
Years to January	2008	2009	2010 E	2011 E
	£m	£m	£m	£m
<b>Assets</b>				
<b>Non-current assets</b>				
PP&E	1.7	2.3	2.5	2.5
Goodwill	41.8	47.8	47.8	47.8
Other intangible assets	0.0	1.0	2.0	3.0
Deferred tax asset	1.3	1.6	1.7	1.5
Other	0.0	1.0	2.0	3.0
<b>Total non-current assets</b>	<b>44.8</b>	<b>51.7</b>	<b>52.0</b>	<b>51.8</b>
<b>Current assets</b>				
Trade and other receivables	70.6	104.0	120.8	140.8
Deferred tax assets	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Cash and short term deposits	4.2	4.5	5.7	7.3
<b>Total current assets</b>	<b>74.7</b>	<b>108.4</b>	<b>126.5</b>	<b>148.1</b>
<b>Total assets</b>	<b>119.5</b>	<b>160.1</b>	<b>178.5</b>	<b>199.9</b>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Trade and other payables	-66.5	-97.5	-115.5	-134.5
Taxation liabilities	-1.9	-2.9	-1.1	-1.3
Bank overdrafts and other short term borrowings	0.0	0.0	0.0	0.0
Provisions	0.0	0.0	0.0	0.0
Other	-2.1	-0.0	-0.1	0.0
<b>Total current liabilities</b>	<b>-70.5</b>	<b>-100.4</b>	<b>-116.7</b>	<b>-135.8</b>
<b>Non-current liabilities</b>				
Long term borrowings	0.0	0.0	0.0	0.0
Provisions	0.0	0.0	0.0	0.0
Deferred taxation liability	-0.1	-0.3	0.0	0.0
Other	-0.7	-0.0	0.0	0.0
<b>Total non-current liabilities</b>	<b>-0.8</b>	<b>-0.3</b>	<b>0.0</b>	<b>0.0</b>
<b>Total liabilities</b>	<b>-71.3</b>	<b>-100.7</b>	<b>-116.7</b>	<b>-135.8</b>
<b>Net Assets</b>	<b>48.2</b>	<b>59.4</b>	<b>61.8</b>	<b>64.1</b>
<b>Key Ratios</b>				
Net cash/(debt) (£m)	4.2	4.5	5.7	7.3
Net debt/shareholders funds	n/a	n/a	n/a	n/a
Capital employed (£m)	48.2	59.4	61.8	64.1
ROCE	17.7%	17.4%	6.8%	7.6%
Current ratio	1.06	1.08	1.08	1.09

Source: Company accounts; MJES estimates

### Capital Employed:

Shareholders funds, add debt, add obligations under finance leases, add minorities, add provisions, less associates, less investments

### ROCE:

Operating profit / Capital Employed

Source: Company accounts; MJES estimates



# Hays Group plc

## Initiation of coverage

We consider Hays, along with Michael Page to be one of the best positioned staffing companies in the world. It has a good balance between temp and perm which provides both defensive qualities and growth potential and has a growing presence in overseas markets that in its last financial year accounted for 51% of NFI. By virtue of its strong temp base Hays' earnings across the recruitment cycle are likely to be less volatile than Page and while it may not accelerate as quickly into the upturn its growth rate tends to compare well with Page over the whole cycle. However, in common with Page and other larger cap companies in the sector Hays is already discounting significant growth in 2010 and 2011. As a consequence of this and some question marks regarding the maintenance of the dividend we start coverage with a Sell recommendation and target price of 80.0p.

## Investment case

- In our opinion Hays is, along with Michael Page, one of the best managed and best positioned professional service staffing companies in the world. Much of its pedigree can be laid at the door of the recently retired CEO and founder of the business, Denis Waxman. However we believe the current management team have the quality and experience to take the group to new levels of profitability through expansion into new industry verticals and new territories.
- Hays is not immune to the current recessionary conditions and its impact is considerably worse than that experienced in the previous recruitment down cycle. In the quarter to September 2009 NFI was down 40% in constant currency terms and fee income from permanent placement was down 52% on the same basis.
- Our view is that for Hays and its peers the severity of the recession has been so brutal that it may mean the negative impact on profits, although substantial, will be brief, lasting no more than four or five quarters. However the question still remains, as it does for all companies in the sector, as to when real growth will resume and how strong will it be. At least the initial signs are promising.
- Already the shares of Hays and its other large cap peers are discounting a significant and seemingly early recovery and we are unsure if this is appropriate given the lack of visibility. This is one reason why we are not buyers of the shares at the current price. We also have some concerns regarding the strength of demand within the UK public sector in 2010 which last year accounted for 33% of UK NFI which in turn represented 42% of group NFI.
- The other reason revolves around the expected rise in group debt levels through the current financial year which could be aggravated if a sharp recovery does take place in 2010 (which we doubt) and demand for working capital rises. At the end of June 2009 the group had net cash of £0.7m but payment of the final dividend, pension deficit funding, higher capital expenditure supporting a new IT platform and a £30.4m OFT fine will see net debt rise to an estimated £98m and possibly rising to near £140m in 2010/11. This is well within its facilities but does pose a question mark on maintenance of the dividend although our view is that it will be held.
- Therefore we commence coverage with a Sell recommendation which is principally a reflection of the group's high valuation; we have similar recommendations for Michael Page, SThree and Robert Walters. However we have no doubt that as and when demand within the recruitment sector picks up Hays will be a major beneficiary and we also have no doubt that previous levels of profit will be exceeded in the same manner as past cycles.
- For the moment however, the shares are discounting a lot of good news to come which, given the lack of visibility in this industry, owes a lot to blind faith.

SELL

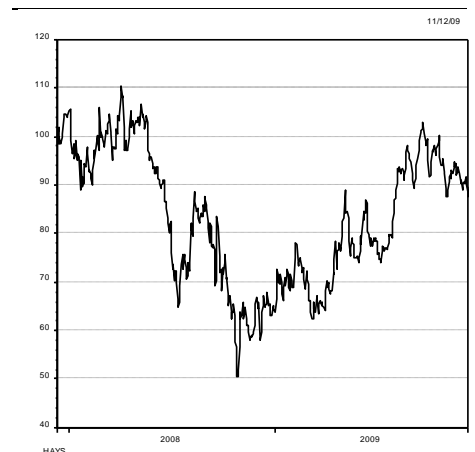
Price:	98.25p
Ticker:	HAS.LN
Asset class:	FULL LIST
Website:	<a href="http://www.haysplc.com">www.haysplc.com</a>
12 mth Hi/Low:	112.8p – 68.5p
Sector:	Support Services
Market Cap:	£1,357.9m
Net (debt)/cash:	(£98.4m) E
EV:	£1,456.3 E
Next earnings:	March 2010 (I)

## Forecasts:

Yr to Jun (£m)	09	10 E	11 E
Revenue	2,447.7	2,218.0	2,315.0
NFI	670.8	500.0	525.0
Temp : Perm	56:44	64:36	64:36
EBITA	159.2	61.0	74.0
Conv. Ratio %	23.7	12.2	14.1
PBT as stated	151.0	21.0	57.5
PBT adjusted	152.2	47.0	58.5
EPS FD Adj (p)	7.8	2.3	2.8
DPS (p)	5.8	5.8	5.8
EV/EBITA (x)	8.5	23.9	20.2
EV/NFI (x)	2.1	3.1	3.0
PE ratio (x)	12.6	43.2	34.7
Yield (%)	5.9	5.9	5.9
Debt/EBITDA	-	1.5	1.8

Source: Merchant John East Securities Ltd.

## Two-year share-price performance



Source: Thomson Datastream



## Background

Prior to 2003 Hays was a diversified group with four divisions; Commercial, Mail & Express, Logistics and Personnel. Between November 2002 and February 2003, as a consequence of “the most volatile and uncertain economic conditions of the last ten years” (Hays Annual Report 2002), the Hays board undertook a strategic review of its business. This review resulted in the decision to focus exclusively on the development of a strong specialist recruitment business which at the time accounted for 60% of overall group profits.

The non-recruitment activities were sold during calendar 2003 and 2004 and surplus cash from the proceeds were distributed to shareholders via a share buy-back programme that looked to return at least £200m to shareholders.

In the event, between the financial years 2004/05 – 2008/09, inclusive, Hays returned some £489m in share buy-backs with net debt at the end of the year to June 2008 rising to £81.1m from a net cash position of £77.4m in the year to June 2004. The group returned to a net cash position by the end of June 2009.

The recruitment business can boast a long and distinguished pedigree with much of its success having been achieved by the now retired group CEO Denis Waxman who founded the Career Care Group recruitment business in 1969 before it was acquired by Hays in 1986 and formed the basis of its Personnel division. Denis was responsible for the development of the recruitment activities from the company’s foundation until his retirement in November 2007.

Today Hays has a market capitalisation of £1.4bn and by market cap is the largest quoted recruitment group in the UK ahead of Michael Page at £1.2bn. As large as it is, it is still dwarfed by its larger European and US peers: Adecco at £6.2bn, Randstad at £4.5bn and Manpower £2.7bn. In terms of net fee income (NFI) the group falls to fifth behind Randstad (pro forma) £3.2bn, Manpower £2.6bn, Adecco £2.2bn and USG People £0.9m against a calendarised £0.8bn for Hays and £0.6bn for Page.

### Long term performance

In the past and particularly through the 2001-2003 downturn Hays has been recognised as having a resilience unmatched by its UK peers and the logic would assume that since then, as the group has diversified by geography and discipline, its resilience would if anything be greater. However Chart 1 illustrates that in the last financial year to June 2009 the group’s EBITA had fallen by 37% against a total fall in the 2001-2203 downturn of just 22%.

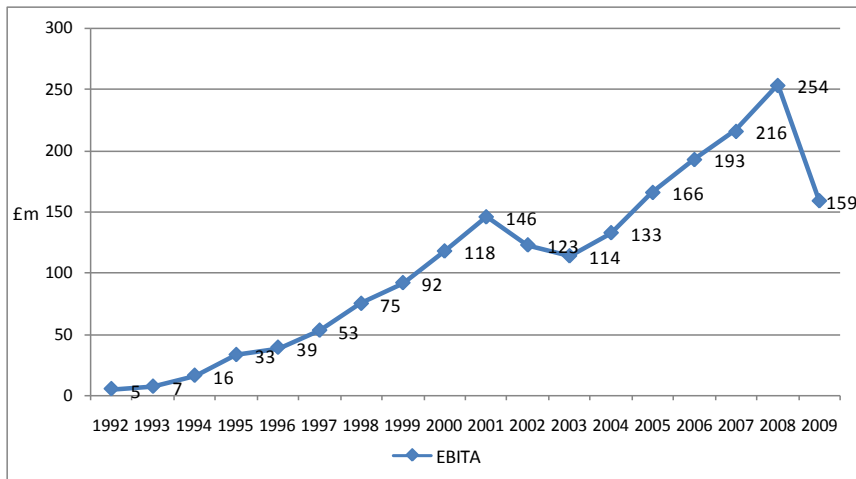
*Fully focussed on recruitment from 2005*

*Sale of non-core businesses resulted in a return of £489m to shareholders*

*The largest UK player but still dwarfed by Adecco, Randstad and Manpower*

*Historic resilience to market downturns severely tested in 2009*

Chart 1: EBITA from 1992 to 2009



Source: Company



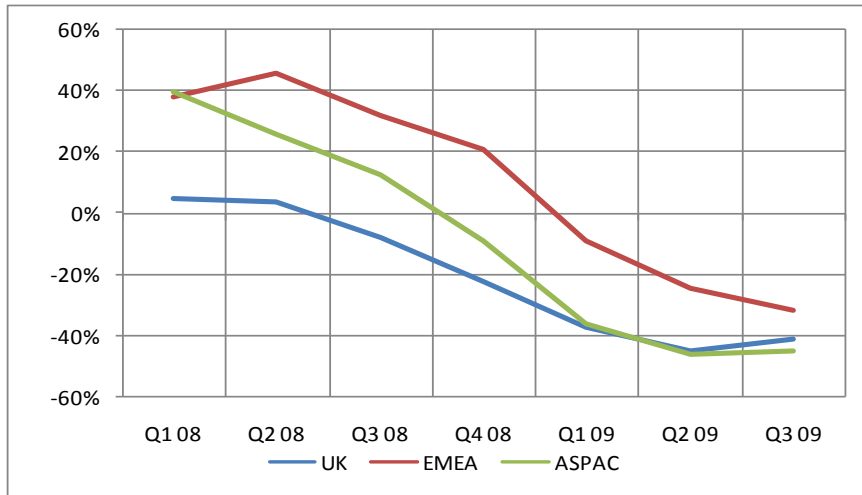
This gives some indication of the severity of the current recession against the earlier downturn during which unemployment was still falling and GDP remained positive. In addition, as we have written before, it could also mean that the decline may be short-lived; lasting just the single year in comparison to the less severe but more prolonged 2001-2003 downturn. Having said that there is still no clarity regarding the degree or timing of a recovery in demand which is still very much an unknown quantity.

**Short-term performance**

The recession began to impact Hays in calendar Q2 2008 although at that time EMEA was still showing y-o-y growth of 46%. From Q3 2008 all territories were showing NFI decline but there was increasing evidence of a slowing down in the rate of decline in Q2 2009 and recent Q3 2009 data clearly shows this trend continuing, as comps get easier. EMEA was the exception; being the last into the downturn it is still experiencing y-o-y revenue decline (Chart 2).

*EMEA was last into the downturn and was still experiencing y-o-y declines in revenue in calendar Q3*

**Chart2: Quarterly changes to NFI by territory (constant currency)**

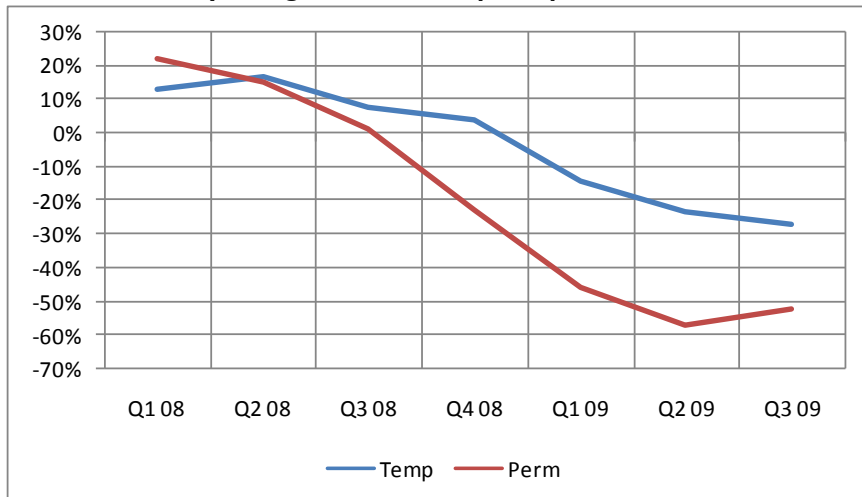


Source: Company

Chart 3 below shows the quarterly movement in NFI between temp and perm. Temp, as expected, has been more resilient than perm falling in calendar Q3 2009 by 27% while the decline in perm fees of 52% slowed modestly against the 57% decline in Q2 2009. Once again we would expect calendar Q4 to show a continuing moderation in the rate of decline as the comps get progressively easier and business stabilises across more of the group’s global footprint.

*Chart 3 shows the quarterly decline in perm and temp*

**Chart 3: Quarterly change in NFI in temp and perm**

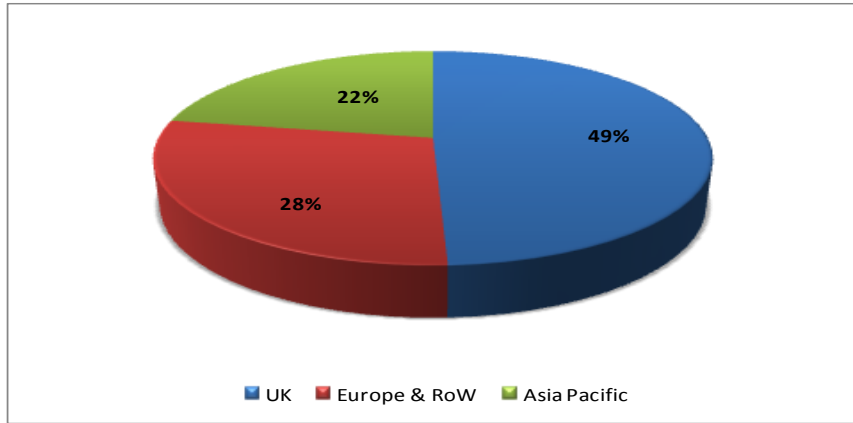




Source: Company

## The business

Chart 4: Distribution of NFI by territory (year to June 2009)



Source: Company

Hays segments its business by territory: UK & Ireland (UK&I), Continental Europe & Rest of the World and Asia Pacific while the UK is further segmented by discipline. In the last financial year the UK&I accounted for 49.3% of NFI and 40.2% of operating profit, Continental Europe 28.5% and 20.9% and Asia Pacific and 22.2% and 38.8% respectively.

Distribution of NFI by territory

UK&I still the largest contributor to revenue, NFI and operating profit

Table 1: Summary NFI and operating profit FY 06/2009 and 06/2008

	Year to June 2009				Year to June 2008			
	UK&I	Europe	AsPac	Total	UK&I	Europe	AsPac	Total
Revenue	1,395.7	587.9	464.1	2,447.7	1,571.5	486.3	482.2	2,540.0
NFI	330.7	191.0	149.1	670.8	452.9	157.7	176.2	786.8
NFI margin	23.7%	32.5%	32.1%	27.4%	28.8%	32.4%	36.5%	31.0%
Operating profit	63.5	33.1	61.4	158.0	137.3	33.1	83.4	253.8
Operating profit margin	4.5%	5.6%	13.2%	6.5%	8.7%	6.8%	17.3%	10.0%
Conversion ratio	19.2%	17.3%	41.2%	23.6%	30.3%	21.0%	47.3%	32.3%

Source: Company

Group revenue in the financial year to June 2009 fell by 3.6% with NFI falling by 14.7% and operating profit by 37.7%. Net debt fell from £81m to a net cash position of £0.7m although the net interest charge rose from £4.7m to £7m due to an IAS 19 pension charge of £2.4m against a credit of £3m in the comparative period. Adjusted PBT fell by 35% to £152.2m and EPS after a full tax charge was 7.8p against 12.5p for prior year.

### UK & Ireland (UK&I)

In the financial year to June 2009 the UK&I posted a 27% decline in NFI to £330.7m with the NFI margin falling 510bps to 23.7%, in the main reflecting a 40% fall in perm NFI and a 15% fall in temp. Temp margins were calculated as falling from 17.2% to 15.7% reflecting a mixture of lower volume, fewer hours booked and margin pressure.

Operating profit fell 53.8% to £63.5m with the operating margin dropping from 8.7% to 4.5%. The conversion of NFI into operating profit fell by 42% to 11.1% reflecting the lag between falling revenue and actions taken to reduce costs. Consultant headcount fell by 26% during the year to 2,315 with a similar rate of decline in support and administrative costs while the office network was cut from 253 to 212.

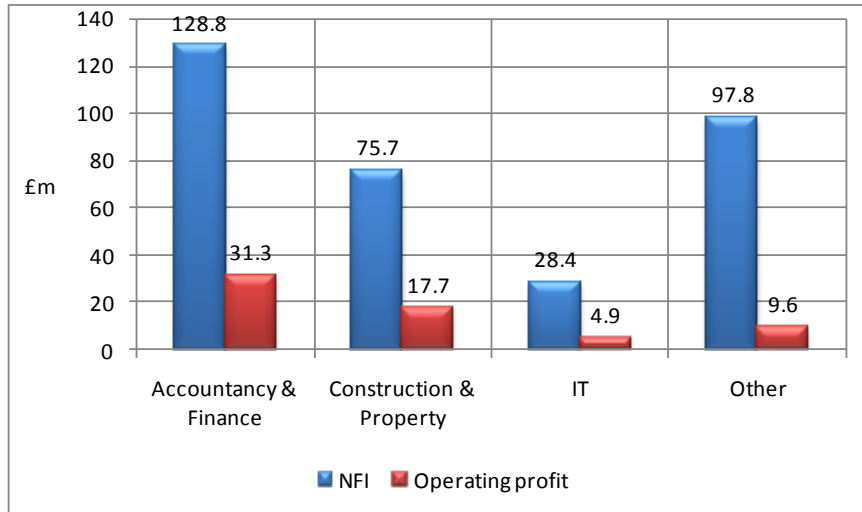
Substantial decline in UK&I NFI and profit in the year to June 2009 – in common with the rest of the market

Costs reduced accordingly



## Merchant John East Securities

**Chart 5: Distribution of UK NFI and operating profit (2008/09)**



Source: Company

The strategy to increase the group's exposure to the more resilient public sector was a success with NFI rising by 5% in the year against a fall of 37% in fees from the private sector. Overall UK NFI was split 67/33 in favour of private sector over public.

*Some resilience from the public sector*

**Table 2: UK&I statistics (2008/09)**

2008/09		% chg
Sales (£m)	1,395.7	-11%
NFI (£m)	330.7	-27%
margin	23.7%	-18%
Operating Profit (£m)	63.5	-54%
margin	4.5%	-48%
Conversion ratio	19.2%	-37%
Average consultants	2,722	-13%
NFI/average consultant (£m)	0.122	-16%
Operating profit/average consultant (£m)	0.023	-47%
Average offices	234	-9%
NFI/average office (£m)	1.4	-20%
Average consultants/average office	12	-5%

Source: Company; MJES estimates

## Forecasts for UK&I

### Current trading

Q1 FY 09/10 trading (to September 2009) has seen a slight slowing in the rate of sequential decline in NFI from 45% in Q4 2008/09 to 41% with signs of a stabilisation in some markets although no recovery. Offices, which had been cut by 43 to 212 in FY 08/09, were further reduced to 203 in the quarter while headcount fell by a further 4% (approximately 92) to around 2,223 which compares to a peak of 3,134 in 2006/07.

The public sector, which accounted for around 33% of UK NFI in FY 08/09 and had such a positive influence on results, is now beginning to show signs of slowing demand with NFI falling 11% in the first quarter. This weakening was characterised by management as feeling similar to that of the private sector some eighteen months earlier. This decline has in the main been limited to the general administrative sector. Frontline services in Education and Health are still strong markets within the public sector.

*Signs of stabilisation in some markets but no recovery*

*Strength of public sector in 2008/9 may become a burden in 2009/10 although we are encouraged that so far front line services will be protected*



## Merchant John East Securities

Our forecasts for the UK assume a slowdown in the rate of decline for temp and perm as trading conditions stabilise and comps become less onerous. The outcome for the two halves is expected to be very different. In the six months to December 2009 we expect a continued y-o-y fall in NFI of 36% to £123m but a much more moderate decline of 10% in the second half to £125m making a year's total of £248m against a comparative of £330.7m.

We expect the ratio between temp and perm to widen further from the 60/40 reported last year to something nearer 65/35 and to stabilise at that ratio before moving very gradually back in favour of perm from 2011/12 onwards. However, the timing and speed of this movement is difficult to forecast.

The UK NFI margin fell in the last financial year from 28.8% to 23.7%, actually falling to 20.4% in H2, principally reflecting the 40% reduction in perm fees which are in effect 100% NFI margin business, together with some pressure on temp fees. We expect NFI margins to weaken further in 2009/10 in recognition of the increasingly challenging public sector market and a noted recent weakening in temp gross margins referred to in the group's Q1 update in October 2009.

*Forecasts for current year assumes a slowdown in the rate of decline and a bias towards H2*

*Expect temp/perm ratio to widen*

*NFI margin will continue to be under pressure in 2009/10*

**Table 3: Historic and prospective metrics for UK & Ireland**

Year to June	2008	2009	% chge	2010 E	% chge	2011 E	% chge
<b>Sales</b>							
Temp sales	1,351.5	1,263.4	-6.5%	1,253.2	-0.8%	1,309.0	4.5%
Perm sales	220.0	132.3	-39.9%	86.8	-34.4%	91.0	4.8%
<b>Total sales</b>	<b>1,571.5</b>	<b>1,395.7</b>	<b>-11.2%</b>	<b>1,340.0</b>	<b>-4.0%</b>	<b>1,400.0</b>	<b>4.5%</b>
<b>NFI by temp/perm</b>							
Temp NFI	232.9	198.4	-14.8%	161.2	-18.8%	170.0	5.5%
Temp margin	17.2%	15.7%	-8.9%	12.9%	-18.1%	13.0%	1.0%
Perm NFI	220.0	132.3	-39.9%	86.8	-34.4%	91.0	4.8%
<b>Total NFI</b>	<b>452.9</b>	<b>330.7</b>	<b>-27.0%</b>	<b>248.0</b>	<b>-25.0%</b>	<b>261.0</b>	<b>5.2%</b>
NFI margin	28.8%	23.7%	-17.8%	18.5%	-21.9%	18.6%	0.7%
<b>NFI by discipline</b>							
UK Accountancy & Finance	178.0	128.8	-27.6%	102.0	-20.8%	106.0	3.9%
UK Construction & Property	118.6	75.7	-36.2%	58.0	-23.4%	60.0	3.4%
UK IT	33.3	28.4	-14.7%	22.0	-22.5%	25.0	13.6%
UK Other professions	123.0	97.8	-20.5%	66.0	-32.5%	70.0	6.1%
<b>Total NFI</b>	<b>452.9</b>	<b>330.7</b>	<b>-27.0%</b>	<b>248.0</b>	<b>-25.0%</b>	<b>261.0</b>	<b>5.2%</b>
<b>Operating profit by discipline</b>							
UK Accountancy & Finance	65.6	31.3	-52.3%	15.0	-52.1%	17.0	13.3%
UK Construction & Property	41.0	17.7	-56.8%	9.0	-49.2%	11.0	22.2%
UK IT	11.2	4.9	-56.3%	3.0	-38.8%	5.0	66.7%
UK Other professions	19.5	9.6	-50.8%	6.0	-37.5%	9.0	50.0%
<b>Total Operating profit</b>	<b>137.3</b>	<b>63.5</b>	<b>-53.8%</b>	<b>33.0</b>	<b>-48.0%</b>	<b>42.0</b>	<b>27.3%</b>
<b>Conversion rate</b>							
UK Accountancy & Finance	36.9%	24.3%	-34.1%	14.7%	-39.5%	16.0%	9.1%
UK Construction & Property	34.6%	23.4%	-32.4%	15.5%	-33.6%	18.3%	18.1%
UK IT	33.6%	17.3%	-48.7%	13.6%	-21.0%	20.0%	46.7%
UK Other professions	15.9%	9.8%	-38.1%	9.1%	-7.4%	12.9%	41.4%
<b>UK &amp; Ireland conversion rate</b>	<b>30.3%</b>	<b>19.2%</b>	<b>-36.7%</b>	<b>13.3%</b>	<b>-30.7%</b>	<b>16.1%</b>	<b>20.9%</b>

Source: Company; MJES estimates

### Asia Pacific

In the year to June 2009 net fees in the Asia Pacific region fell by 15.4% to £149.1m although in constant currency (CC), due to the weakness of sterling against the Australian \$, the fall was 20%. At the operating profit level the decline was 26% at £61.4m but again like-for-like the decline was greater at 29%. Continued weakness of sterling in the year to date suggests that there may be a further benefit to the income statement on translation at average exchange rates.

*Further weakening in Asia Pacific but continued benefit from weaker £*

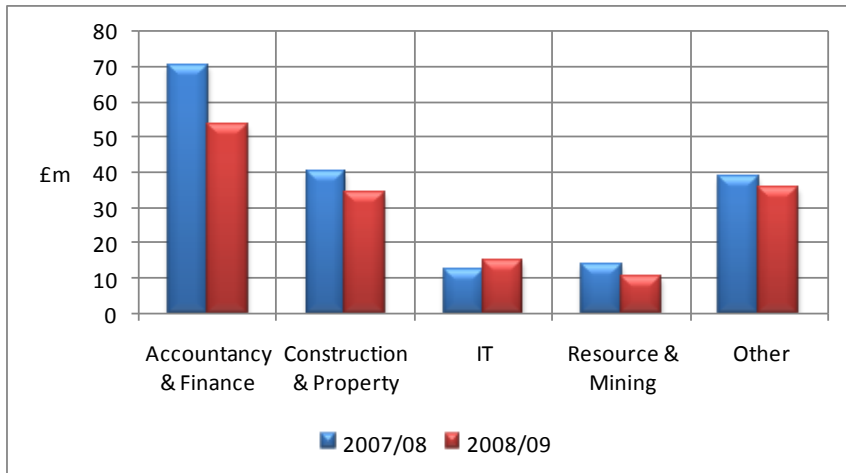


## Merchant John East Securities

Australia and New Zealand accounted for 91% of the region's NFI in the last financial year with the balance generated from Asia, namely Japan, Hong Kong, China and Singapore. In Australia there was a 35% (CC) reduction in permanent fees and a 3% (CC) reduction in temp fees, helped by resilience in the public sector element of its business.

*A&NZ contributes the bulk of revenue*

**Chart 6: Distribution of Asia Pacific NFI by discipline (2007/08 and 2008/09)**



Source: Company

Consultant headcount reduced by 36% in the year to 771 (1,255) and working on the average number of consultant employed during the period the fee generated per consultant fell by 9% from £162,000 to £147,000. Operating profit per consultant on the same basis fell 21% from £77,000 to £61,000.

*Profit/Consultant fell 21% last FY*

**Table 4: Asia Pacific stats**

2008/09		% chg
Sales (£m)	464.1	-4%
NFI (£m)	149.1	-15%
margin	32.1%	-12%
Operating Profit (£m)	61.4	-26%
margin	13.2%	-24%
Conversion ratio	41.2%	-13%
Average consultants	1,013	-7%
NFI/average consultant (£m)	0.147	-9%
Operating profit/average consultant (£m)	0.061	-21%
Average offices	51	2%
NFI/average office (£m)	2.9	-17%
Average consultants/average office	20	-8%

Source: Company; MJES

### Forecasts for Asia Pacific

Conditions in Asia Pacific remain weak and the decline in NFI of 45% (CC) in Q1 2009/10 was little changed from the Q4 2008/09 decline of 46%. On translation this converted to a NFI decline of 40% against 43% in Q4. The group reported some signs of stabilisation in its markets but mirroring the UK it has seen a deterioration in demand within the public sector of 16% (CC). Overall the decline was led by reduced demand for permanent placements against a more resilient temp market.

*Some signs of stabilisation but demand in public sector weakening*



## Merchant John East Securities

Our assumption for the first half of the current year is for a decline in NFI of around 40% (CC) or 36% on translation, with the rate of decline slowing significantly in H2, as the comps get very much easier. So overall we are anticipating NFI from the Asia Pacific region for the year to June 2010 of around £112m a 25% decline in translated terms.

*Expect rate of decline in NFI to slow in 09/10 of 40%*

**Table 5: Historic and prospective metrics for Asia Pacific**

Year to June	2008	2009	% chge	2010 E	% chge	2011 E	% chge
<b>Sales</b>							
Temp sales	383.5	394.0	2.7%	365.8	-7.2%	392.0	7.2%
Perm sales	98.7	70.1	-29.0%	44.2	-36.9%	48.0	8.6%
<b>Total sales</b>	<b>482.2</b>	<b>464.1</b>	<b>-3.8%</b>	<b>410.0</b>	<b>-11.7%</b>	<b>440.0</b>	<b>7.3%</b>
<b>NFI by temp/perm</b>							
Temp NFI	77.5	79.0	2.0%	67.8	-14.2%	72.0	6.2%
Temp margin	36.9%	24.3%	-34.1%	12.3%	-49.6%	14.2%	15.5%
Perm NFI	98.7	70.1	-29.0%	44.2	-36.9%	48.0	8.6%
<b>Total NFI</b>	<b>176.2</b>	<b>149.1</b>	<b>-15.4%</b>	<b>112.0</b>	<b>-24.9%</b>	<b>120.0</b>	<b>7.1%</b>
NFI margin	36.5%	32.1%	-12.1%	27.3%	-15.0%	27.3%	-0.2%
<b>NFI by discipline</b>							
Accountancy & Finance	70.5	53.7	-23.8%	42.0	-21.8%	45.0	7.1%
Construction & Property	40.5	34.3	-15.4%	26.0	-24.2%	27.0	3.8%
IT	12.3	14.9	20.9%	10.0	-32.9%	12.0	20.0%
Resource & Mining	14.1	10.4	-26.0%	6.0	-42.5%	7.0	16.7%
Other	38.8	35.8	-7.7%	28.0	-21.8%	29.0	3.6%
<b>Total NFI</b>	<b>176.2</b>	<b>149.1</b>	<b>-15.4%</b>	<b>112.0</b>	<b>-24.9%</b>	<b>120.0</b>	<b>7.1%</b>
Operating profit	83.4	61.4	-26.4%	24.5	-60.1%	28.0	14.3%
Conversion rate	47.3%	41.2%	-13.0%	21.9%	-46.9%	23.3%	6.7%

Source: Company; MJES estimates

## Continental Europe & Rest of World

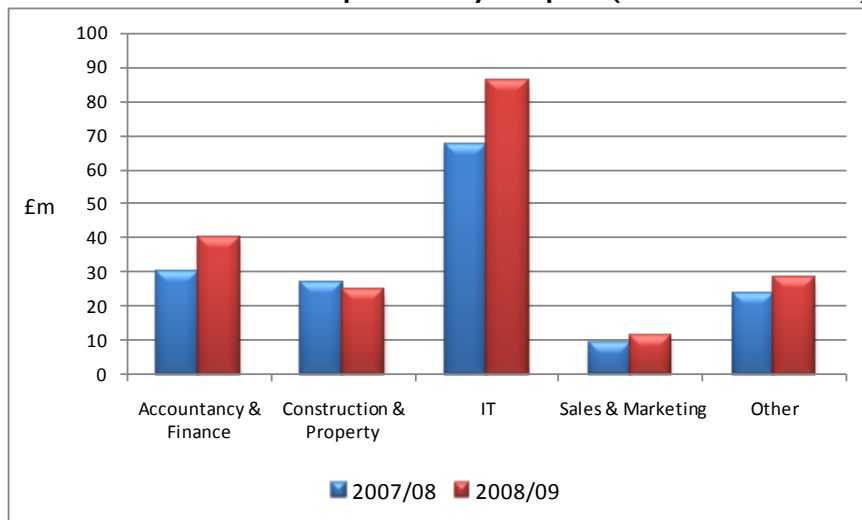
Continental Europe and the Rest of the World (Europe) is the smallest of the group's three territories accounting for 28.5% of NFI in the year to June 2009 and just 20% in the previous year. Likewise it accounted for 20.9% of operating profit against 13% the year before. The reason for the increase in percentage contribution in 2008/09 against 2007/08 is twofold: firstly Europe was the last into the downturn with NFI growth still strong at 27% (CC) in H1 2008/09 and secondly this relative strength was against a generally weakening market in non-European territories.

*Last into the downturn with growth still strong in H1 08/09*

NFI was split equally between temp and perm last year with 95% of the business being conducted with the private sector, the public sector only representing 5% of NFI against 33% for the UK and 21% for Asia Pacific.

*Equal split between temp and perm*

**Chart 7: Distribution of European NFI by discipline (2007/08 and 2008/09)**



Source: Company



## Merchant John East Securities

Consultant headcount reduced by 17% in the last financial year to 1,173 with the average headcount falling by 8% to 1,294. During Q1 of the current FY a further 8% reduction in headcount occurred (around 94 consultants) bringing the total down to 1,079 against a peak of 1,415 in the 2007/08 financial year. Again the fact that this territory was the last into the downturn is evidenced by the Q1 headcount reduction which is greater than that within the UK (5%) and Asia Pacific (5%)

*Headcount reduction increase in Q1 09/10*

**Table 6: Continental Europe & RoW statistics**

2008/09		% chg
Sales (£m)	587.9	21%
NFI (£m)	191	21%
margin	32.5%	0%
Operating Profit (£m)	33.1	0%
margin	5.6%	-17%
Conversion ratio	17%	-17%
Average consultants	1,294	8%
NFI/average consultant (£m)	0.148	12%
Operating profit/average consultant (£m)	0.026	-8%
Average offices	85	8%
NFI/average office (£m)	2.3	13%
Average consultants/average office	15	1%

Source: Company; MJES estimates

### Forecasts for Continental Europe & RoW

In Q1 of the current financial year NFI fell by 32% (CC), still relatively resilient against falls of 41% for the UK and 45% (CC) for Asia Pacific. However, excluding Germany which is focused on the IT contracting market and last year accounted for 46% of European NFI, NFI from other disciplines fell by 42% (CC) and we expect further weakening in Q2 before some signs of stability appear, possibly in Q3 or, more likely, Q4 2009/10. Therefore, our assumption for the first half of the current year is for a decline of around 40% (CC) or 36% on translation, with the rate of decline slowing significantly in the second half, as the comps get much easier. Overall we are anticipating NFI from the Continental Europe and RoW region for the year to June 2010 of around £112m a 25% decline in translated terms.

*A weaker 2009/10 in prospect with some signs of stability expected in Q3 or more likely Q4*

**Table 7: Historic and prospective metrics for Continental Europe & RoW**

Year to June	2008	2009	% chge	2010 E	% chge	2011 E	% chge
<b>Sales</b>							
Temp sales	402.7	492.4	22.3%	419.0	-14.9%	424.0	1.2%
Perm sales	83.6	95.5	14.2%	49.0	-48.7%	51.0	4.1%
<b>Total sales</b>	<b>486.3</b>	<b>587.9</b>	20.9%	<b>468.0</b>	-20.4%	<b>475.0</b>	1.5%
<b>NFI by temp/perm</b>							
Temp NFI	74.1	95.5	28.8%	91.0	-4.7%	94.0	3.3%
Temp margin	18.4%	19.4%	5.4%	21.7%	12.0%	22.2%	2.1%
Perm NFI	83.6	95.5	14.3%	49.0	-48.7%	51.0	4.1%
<b>Total NFI</b>	<b>157.7</b>	<b>191.0</b>	21.1%	<b>140.0</b>	-26.7%	<b>145.0</b>	3.6%
NFI margin	32.4%	32.5%	0.2%	29.9%	-7.9%	30.5%	2.0%
<b>NFI by discipline</b>							
Accountancy & Finance		40.1	#DIV/0!	30.0	-25.2%	32.0	6.7%
Construction & Property		24.8	#DIV/0!	15.0	-39.6%	14.0	-6.7%
IT		86.0	#DIV/0!	64.0	-25.5%	67.0	4.7%
Sales & Marketing		11.5	#DIV/0!	9.0	-21.5%	9.0	0.0%
Other		28.7		22.0	-23.2%	23.0	4.5%
<b>Total NFI</b>	<b>157.7</b>	<b>191.0</b>	21.1%	<b>140.0</b>	-26.7%	<b>145.0</b>	3.6%
Operating profit	33.1	33.1	0.0%	11.0	-66.8%	13.0	18.2%
Conversion rate	21.0%	17.3%	-17.4%	7.9%	-54.7%	9.0%	14.1%

Source: Company; MJES estimates



## Financials

### Cash flow

In common with all recruitment companies, as activity levels decline there is a corresponding inflow of working capital previously tied up with higher levels of contractors and temps. Thus, Hays last year reported a working capital inflow of £90m which in turn had a significant influence in reducing the level of net debt from £81.1m at the end of June 2008 to a net cash position of £0.7m at the end of June 2009. The group also benefited from a reduction in trade debtor days from 39 to 35.

In the current year we do not anticipate such an inflow from working capital although we believe an inflow is still likely. In addition we feel it unlikely that debtor days can be reduced much further and indeed may rise slightly if the public sector contribution to NFI falls relative to last year. In addition the group has had to pass on last year's one-time £20m cash inflow resulting from the withdrawal of the staff hire concession to other agencies in the first quarter of the current year.

Capital expenditure rose last year to £37m reflecting expenditure on the group's key IT projects and although this should fall to £25m this year and thereafter reverts to historic levels of around £10-15m we still see a significant net debt position arising this year.

The Office of Fair Trading imposed a fine of £30.4m on Hays relating to the breaching of competition laws in its Construction & Property business and an exceptional charge will be taken in the group accounts this year in the region of £25m (£5m having previously been provided for). The group however will be appealing the decision. The cash flow will suffer the full effect of the £30.4m.

The group has guided to expect a £10m to £20m cash outflow relating to funding of the pension deficit.

### Dividend

The other major cash outflow relates to the dividend which absorbs around £80m per annum. If the dividend is maintained this year then we foresee net debt rising to £96m and to £142m in 2010/11, again on a maintained dividend.

Our view is that the group will wish to maintain the dividend if at all possible and that a cut will only be envisaged if trading conditions at the time of the preliminary announcement in September 2010 are still very weak. However, the irony is that if trading conditions do show an improvement (particularly in temp and contract) then this may signal an increase in working capital requirements which will have an adverse effect on cash flows and debt.

The expected increase in net debt and other liabilities in the current financial year is forecast to lead to a reduction in net assets from £154.4m to £65.9m and at the moment we are projecting the position to fall to just £25.5m in the year to June 2011. In addition we see the current ratio falling to 1.1x in 2009/10 and free cash flow moving to a negative for both the current and subsequent financial year.

Net debt therefore looks to be on a sharp rise over the next two to three years and while the group has plenty of headroom in terms of its debt facilities it does pose a question on the future level of the dividend. Therefore we believe there is a small, but real, risk of a dividend cut. However, our view on balance is that the dividend will be held.

*Last FY saw a benefit of £90m working capital inflow leading to a neutral cash position*

*This year the inflow is expected to be much more modest and no further improvement in DSO. Group also has to pass on the £20m of staff hire concessions*

*Cap ex lower but net debt expected to rise*

*£30.4m fine imposed by OoFT...*

*...and a £10-20m cash outflow on pensions*

*Net debt to rise to £142m in 10/11 if div is maintained*

*We still expect a maintained dividend unless Sep 10 trading is still weak*

*Net assets also forecast to fall significantly*



## Forecasts

Of all the major UK quoted staffing companies, Hays has the weakest finances on our estimates for the current financial year. Net assets are forecast to fall from £154.4m to just £65.9m, Net (debt)/cash is forecast to move from a positive £0.7m to net debt of £98.4m while free cash flow is expected to turn negative this year. What is more, it is difficult to envisage things improving much in the near term, especially as we begin to see some improvement in demand for temps which will then suck in working capital.

*Hays forecast to have the worst finances of the three majors, which could get worse on any improvement in trading*

Table 8 below provides a snapshot of the key metrics of the five larger professional staffing companies.

**Table 8: Comparison of key metrics**

Company	Share Price (p)	Market Cap (£m)	Net (debt)/cash (£m)	Dividend Cover (x)	Current Ratio (x)	Free cash Flow (£m)	Net Assets (£m)	Gearing (%)	PER (x)	EV/EBITA (x)
Hays	98	1,358	-98	0.4	1.1	-41.7	65.9	149%	43.2	23.9
Healthcare Locums	264	276	-13	5.4	1.1	20.6	70.2	18%	12.0	8.3
Michael Page	220	1,184	130	0.5	1.9	35.4	224.3	-	92.3	37.2
Robert Walters	185	141	24	-1.2	1.8	4.1	56.8	-	-2.1	5.7
SThree	200	309	48	0.8	1.9	27.2	83.4	-	21.2	15.4

Source: MJES estimates

Our current year profit forecast for Hays calls for a decline in NFI of 25% to £500m, a 14% decline in administrative costs after amortisation and depreciation to £440m and a net income charge of £14m leading to a profit before tax of £21m (£151m). Adding back the one-off exceptional charge relating to the OFT fine brings adjusted PBT up to £47m (a fall of 69%) and after a 33% tax charge, EPS of 2.3p.

*Expect a 25% decline in NFI and 69% fall in adjusted PBT*

For the year to June 2011 we are predicting some modest improvement in trading conditions leading to an adjusted PTP of £58.5m and EPS of 2.8p. However, any forecasting in the current environment carries a higher degree of risk than normal in an industry that in the best of times is renowned for its lack of visibility. Although we are encouraged by increasing signs of stability in certain of the group's territories and disciplines it is just stability, with little or no signs of a recovery on the near horizon.

*We anticipate modest improvement in 2010/11 but with a heavy caveat*

In this respect valuations amongst the larger UK recruiters, and here we include Page, Walters and SThree along with Hays, look to us to be excessive, discounting a significant recovery in earnings with no allowance built in for a more modest outcome.

During the peak of the last cycle the top companies were selling on PERs of around 20x current year earnings and so, on a 33% effective tax rate, Hays on this basis is discounting adjusted profits before tax of £106m which it certainly will not earn this year and very probably will not earn the following year either.

*Still too expensive and discounting much of the growth to be achieved in 2010/11*

Therefore we believe that Hays' share price, along with that of Page and Walters, is simply looking too far ahead. It is possible that a profit of £106m could be disclosed for the year to June 2012 but this will not be reported, if achieved, before September 2012 which is still nearly three years away!

**All of the above companies (bar Healthcare Locums which in our opinion still offers excellent value) are offering the prospect of at best stagnant share prices for one or two years or at worst a sharp downward correction. We therefore commence coverage on Hays with a Sell recommendation in line with our stance on Page and Walters. There is better value at the smaller end of the market - but of course less liquidity.**



## Merchant John East Securities

Summary P&L				
Years to June	2008	2009	2010 E	2011 E
	£m	£m	£m	£m
<b>Revenue</b>	<b>2,540.0</b>	<b>2,447.7</b>	<b>2,218.0</b>	<b>2,315.0</b>
<b>Net Fee Income (NFI)</b>	<b>786.8</b>	<b>670.8</b>	<b>500.0</b>	<b>525.0</b>
Administration expenses	-533.0	-512.8	-440.0	-452.0
Associates	0.0	0.0	0.0	0.0
<b>Operating Profit</b>	<b>253.8</b>	<b>158.0</b>	<b>60.0</b>	<b>73.0</b>
Separately disclosed items (SDI)	15.3	0.0	-25.0	0.0
Finance income	3.2	1.9	1.0	1.5
Finance charge	-7.9	-8.9	-15.0	-17.0
<b>Profit before tax as stated</b>	<b>264.4</b>	<b>151.0</b>	<b>21.0</b>	<b>57.5</b>
IFRS 3 adjustment for amortisation of intangibles	1.7	1.2	1.0	1.0
Adjustment for SDIs	-15.3	0.0	25.0	0.0
<b>Adjusted Profit before tax</b>	<b>250.8</b>	<b>152.2</b>	<b>47.0</b>	<b>58.5</b>
Tax	-76.6	-45.6	-15.5	-19.3
Post tax profit	187.8	105.4	5.5	38.2
Discontinued activities	0.4	0.0	0.0	0.0
Net Profit	188.2	105.4	5.5	38.2
<b>Adjusted Net Profit</b>	<b>176.8</b>	<b>106.6</b>	<b>6.5</b>	<b>39.2</b>
<b>EBITDA</b>	<b>265.1</b>	<b>169.6</b>	<b>76.0</b>	<b>91.0</b>
Depreciation	-9.6	-10.4	-15.0	-17.0
<b>EBITA</b>	<b>255.5</b>	<b>159.2</b>	<b>61.0</b>	<b>74.0</b>
Amortisation of intangibles	-1.7	-1.2	-1.0	-1.0
<b>EBIT</b>	<b>253.8</b>	<b>158.0</b>	<b>60.0</b>	<b>73.0</b>
<b>Equity</b>				
Weighted average shares (m)	1,404.1	1,370.5	1,382.1	1,382.1
Weighted average shares FD (m)	1,411.5	1,371.6	1,384.0	1,385.0
Year end shares in issue (m)	1,464.1	1,382.1	1,382.1	1,382.1
<b>EPS</b>				
EPS FD (p)	12.6	7.7	0.4	2.8
<b>EPS FD and adjusted (p)</b>	<b>12.5</b>	<b>7.8</b>	<b>2.3</b>	<b>2.8</b>
<b>Dividend</b>				
Interim dividend (p)	1.85	1.85	1.85	1.85
Final dividend (p)	3.95	3.95	3.95	3.95
<b>Total dividend (p)</b>	<b>5.80</b>	<b>5.80</b>	<b>5.80</b>	<b>5.80</b>
<b>Key ratios</b>				
Market cap (£m)	1,358.0	1,358.0	1,358.0	1,358.0
Enterprise value (EV) (£m)	1,439.1	1,357.3	1,456.4	1,495.8
EV/NFI (x)	1.8	2.0	2.9	2.8
EV/EBITA (x)	5.6	8.5	23.9	20.2
Share price (p)	<b>98.3</b>			
PER (x)	7.8	12.6	43.2	34.7
Yield (%)	5.9	5.9	5.9	5.9

Source: Company accounts; Merchant John East Securities



Merchant John East  
Securities

P&L Analysis				
Years to June	2008	2009	2010 E	2011 E
<b>Analysis of revenue</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
UK & Ireland	1,571.5	1,395.7	1,340.0	1,400.0
Asia Pacific	482.2	464.1	410.0	440.0
Continental Europe & Rest of World	486.3	587.9	468.0	475.0
<b>Total Revenue</b>	<b>2,540.0</b>	<b>2,447.7</b>	<b>2,218.0</b>	<b>2,315.0</b>
<b>Analysis of NFI</b>				
UK & Ireland	452.9	330.7	248.0	260.0
Asia Pacific	176.2	149.1	112.0	120.0
Continental Europe & Rest of World	157.7	191.0	140.0	145.0
<b>Total NFI</b>	<b>786.8</b>	<b>670.8</b>	<b>500.0</b>	<b>525.0</b>
<b>Analysis of operating profit</b>				
UK & Ireland	137.3	63.5	24.5	32.0
Asia Pacific	83.4	61.4	24.5	28.0
Continental Europe & Rest of World	33.1	33.1	11.0	13.0
<b>Total Operating Profit</b>	<b>253.8</b>	<b>158.0</b>	<b>60.0</b>	<b>73.0</b>
<b>NFI margin</b>				
UK & Ireland	28.8%	23.7%	18.5%	18.6%
Asia Pacific	36.5%	32.1%	27.3%	27.3%
Continental Europe & Rest of World	32.4%	32.5%	29.9%	30.5%
<b>Group NFI margin</b>	<b>31.0%</b>	<b>27.4%</b>	<b>22.5%</b>	<b>22.7%</b>
<b>Operating margin</b>				
UK & Ireland	8.7%	4.5%	1.8%	2.3%
Asia Pacific	17.3%	13.2%	6.0%	6.4%
Continental Europe & Rest of World	6.8%	5.6%	2.4%	2.7%
<b>Group Operating margin</b>	<b>10.0%</b>	<b>6.5%</b>	<b>2.7%</b>	<b>3.2%</b>
<b>Key Ratios</b>				
EBITA margin	10.1%	6.5%	2.8%	3.2%
Administration costs as a % of revenue	21.0%	21.0%	19.8%	19.5%
Conversion of NFI into EBITA	32.5%	23.7%	12.2%	14.1%
Effective tax rate	29.0%	30.0%	33.0%	33.0%
Net interest cover by EBITDA (x)	56.4	24.2	5.4	5.9
Dividend cover by adjusted EPS (x)	2.2	1.3	0.4	0.5

Source: Company accounts; Merchant John East Securities



Merchant John East  
Securities

Summary Cash Flow				
Years to June	2008	2009	2010 E	2011 E
	£m	£m	£m	£m
Net cash from operating activities	271.1	170.9	76.5	91.5
(Increase)/Decrease in trade and other receivables	-42.6	99.0	5.0	-3.0
(Decrease)/ Increase in trade and other payables	27.5	-9.0	0.0	-1.0
Increase/(Decrease) in provisions for liabilities and charges	0.0	0.0	0.0	0.0
<b>Cash generated by operations</b>	<b>256.0</b>	<b>260.9</b>	<b>81.5</b>	<b>87.5</b>
Taxation paid	-74.1	-56.5	-35.0	-19.3
<b>Net cash generated by operating activities</b>	<b>181.9</b>	<b>204.4</b>	<b>46.5</b>	<b>68.2</b>
<b>Cash flow from investing activities:</b>				
Interest received	3.2	1.9	1.0	1.5
Acquisition of subsidiaries (net of cash acquired)	0.0	-5.4	-4.0	0.0
Proceeds from the sale of subsidiary (net of cash disposed)	0.6	0.0	0.0	0.0
Purchase of PP&E	-14.8	-8.2	-8.0	-8.0
Purchase of intangible assets	-6.7	-28.8	-17.0	-12.0
Proceeds from sale of PP&E	0.1	0.0	0.0	0.0
Decrease/(increase) in short term deposits	0.0	0.0	0.0	0.0
Other	0.0	0.0	-30.4	0.0
<b>Net cash used in investing activities</b>	<b>-17.6</b>	<b>-40.5</b>	<b>-58.4</b>	<b>-18.5</b>
<b>Financing activities:</b>				
Purchase of own shares	-91.8	-2.1	0.0	0.0
Net movement in borrowings	-9.5	-82.1	-50.0	-30.0
Dividends paid	-74.0	-79.3	-80.2	-80.2
Interest paid	-10.4	-4.6	-8.0	-10.0
Issue of shares (net)	0.0	5.4	0.0	0.0
Additional Pension scheme funding	-2.5	-2.7	-15.0	0.0
Other	2.8	0.0	0.0	0.0
<b>Net cash inflow from financing activities</b>	<b>-185.4</b>	<b>-165.4</b>	<b>-138.2</b>	<b>-120.2</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>-21.1</b>	<b>-1.5</b>	<b>-150.1</b>	<b>-70.5</b>
Cash and cash equivalents at start of year	68.4	54.0	55.0	-94.1
FX changes	6.7	2.5	1.0	0.0
<b>Cash and cash equivalents at end of year</b>	<b>54.0</b>	<b>55.0</b>	<b>-94.1</b>	<b>-164.5</b>

Reconciliation of cash flow to net debt				
Net (debt)/cash at start of the year	-76.2	-81.1	0.7	-98.4
Net increase in cash and cash equivalents	-21.1	-1.5	-150.1	-70.5
FX movement	6.7	2.5	1.0	1.0
Net change in borrowings during the year	9.5	80.8	50.0	30.0
<b>Net (debt)/cash at end of the year</b>	<b>-81.1</b>	<b>0.7</b>	<b>-98.4</b>	<b>-137.8</b>

Key Ratios				
Free Cash Flow (£m)	97.5	120.5	-41.7	-22.0
Free Cash Flow per share (p)	6.7	8.7	-3.0	-1.6

Source: Company accounts; Merchant John East Securities

**Free Cash Flow:**

Cash flow from operating activities, less interest paid, less tax paid, less equity divs paid



## Merchant John East Securities

Summary Balance Sheet				
Years to June	2008	2009	2010 E	2011 E
<b>Assets</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Non-current assets</b>				
PP&E	32.2	29.1	30.0	32.0
Goodwill	168.9	174.9	178.0	180.0
Other intangible assets	5.4	38.6	45.0	47.0
Deferred tax asset	38.7	42.9	44.0	45.0
Other	0.0	0.0	0.0	0.0
<b>Total non-current assets</b>	<b>245.2</b>	<b>285.5</b>	<b>297.0</b>	<b>304.0</b>
<b>Current assets</b>				
Trade and other receivables	442.3	352.4	347.4	350.4
Deferred tax assets	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Cash and short term deposits	54.0	55.0	10.0	20.0
<b>Total current assets</b>	<b>496.3</b>	<b>407.4</b>	<b>357.4</b>	<b>370.4</b>
<b>Total assets</b>	<b>741.5</b>	<b>692.9</b>	<b>654.4</b>	<b>674.4</b>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Trade and other payables	-306.5	-312.5	-312.5	-311.5
Taxation liabilities	-29.7	-16.3	-15.0	-20.0
Bank overdrafts and other short term borrowings	0.0	0.0	0.0	0.0
Provisions	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Total current liabilities</b>	<b>-336.2</b>	<b>-328.8</b>	<b>-327.5</b>	<b>-331.5</b>
<b>Non-current liabilities</b>				
Long term borrowings	-135.1	-54.3	-106.0	-162.4
Provisions	-45.5	-46.2	-45.0	-40.0
Retirement benefit obligations	-88.1	-109.2	-110.0	-115.0
Trade & other payables	-13.6	0.0	0.0	0.0
<b>Total non-current liabilities</b>	<b>-282.3</b>	<b>-209.7</b>	<b>-261.0</b>	<b>-317.4</b>
<b>Total liabilities</b>	<b>-618.5</b>	<b>-538.5</b>	<b>-588.5</b>	<b>-648.9</b>
<b>Net Assets</b>	<b>123.0</b>	<b>154.4</b>	<b>65.9</b>	<b>25.5</b>
<b>Key Ratios</b>				
Net cash/(debt) (£m)	-81.1	0.7	-98.4	-137.8
Net debt/shareholders funds	65.9%	-	149.3%	540.5%
Capital employed (£m)	249.6	199.9	209.3	203.3
ROCE	101.7%	79.0%	28.7%	35.9%
Current ratio	1.48	1.24	1.09	1.12

Source: Company accounts; Merchant John East Securities

### Capital Employed:

Shareholders funds, add debt, add obligations under finance leases, add minorities, add provisions, less associates, less investments

### ROCE:

Operating profit / Capital Employed



## The ReThink Group plc

### Initiation of coverage

The ReThink Group gained its AIM listing in June 2008 although the founder members of the board had previously worked together at Best International, an IT staffing business sold to Spring Group in June 2003. ReThink also specialises in IT recruitment but also has a second business which focuses on the delivery of business and technology solutions under the Aiimi brand. First half group profits have been badly impacted by the economic downturn but there will be some recovery in H2 if current market improvements continue. We anticipate a strong recovery in 2010 on the back of a modest improvement in demand for staff, a flat cost base and higher levels of activity in Aiimi. However we consider that the share price already discounts this recovery and so we commence coverage on ReThink with a Hold recommendation and fair value at around 6.5p.

### Investment case:

- Founded in 2005 and floated on AIM in 2008, ReThink specialises in the provision of IT contract and permanent staff to blue chip and SME businesses in the UK.
- In March 2007 it moved into the provision of business and technology solutions (branded Aiimi) and in December of that year concluded the acquisition of IT recruitment specialist KeyPower Consultants (KPC). It also has representation in the Middle East via the acquisition of Proveya MEA FZCO.
- At the time of float, ReThink's recruitment activities accounted for 79% of gross profit or net fee income (NFI) and of this some 49% was generated by perm placements. In its Interim results to June 2009 ReThink reported that recruitment contributed 83% of NFI with perm contributing an estimated 32.2% (51.3%) and contract 67.8% (48.7%).
- So while perm NFI reduced by 43% in the first half of 2009 NFI from contract was ahead by 27% partly as a result of a number of successful contract wins, especially an exclusive deal with a major high street retailer for the provision of its entire IT staff in the UK.
- In 2007 the group launched ReThink Professional Services, a new business channel focusing on the provision of business and technology solutions. To differentiate the business from the recruitment division RPS was renamed Aiimi whose core offering is the management of the delivery of IT projects on behalf of its clients through the deployment of teams who manage the feasibility, implementation and support of the project. In so doing it utilises its own staff supplemented by staff recruited for its clients by the group's recruitment division.
- Our forecast for 2010 calls for a profit of £1m against just £0.25m in 2009 and much of the impetus behind this recovery will be driven by the Consultancy division which in 2008 and 2009 had been impacted by necessary investment in the business which should pay back significantly next year. With regard to the recruitment activities we are assuming a modest recovery in demand for permanent hires of around 10% and continued stability in contract demand.
- In conclusion therefore, as much as we like the business model and rate highly the experienced management we believe that 7p the shares are currently up with events and are already discounting the projected rise in earnings for 2010 which is by no means a given at this early stage. We therefore commence coverage with a Hold recommendation and fair value of around 6.5p.

HOLD

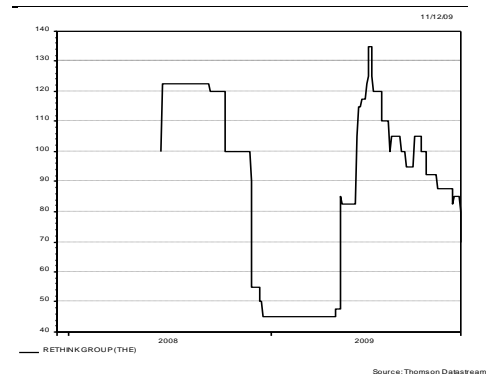
Price:	7p
Ticker:	RTG.L
Asset class:	AIM
Website:	<a href="http://www.therethink-group.com">www.therethink-group.com</a>
12 mth Hi/Low:	13.5p – 4.5p
Sector:	Support Services
Market Cap:	£6.4m
Net (debt)/cash:	(£6.1m) E
EV:	£12.5m E
Next earnings:	Mar 2010 (Prelims)

### Forecasts:

Yr to Dec (£m)	08	09 E	10 E
Revenue	43.39	48.00	54.00
NFI	12.09	11.25	12.70
Temp : Perm	52:48	60:40	59:41
EBITA	0.92	0.50	1.35
Conv Ratio (%)	7.6	4.4	10.6
PBT as stated	0.2	0.25	1.00
PBT adjusted	0.6	0.25	1.00
EPS FD Adj (p)	0.48	0.17	0.66
DPS (p)	0.0	0.0	0.0
EV/EBITA (x)	13.3	25.0	9.1
EV/NFI (x)	1.0	1.1	1.0
PE ratio (x)	14.7	42.1	10.5
Yield (%)	-	-	-
Debt/EBITDA	5.4	9.1	3.9

Source: Merchant John East Securities Ltd.

### Two-year share-price performance



Merchant John East Securities Ltd  
acts as NOMAD and joint broker to  
ReThink Group plc



## Background

Although historically born from a successful IT recruitment consultancy The ReThink Group has developed an additional revenue channel through the provision of a Business and Consulting division which provides feasibility studies, implementation and support of third party software installation in areas of Sales Performance Management, Business Intelligence and Enterprise Content Management.

These two separate revenue channels provide investors with an element of protection from the cyclical traditional staffing model and some element of defence in weaker economic conditions such as are now being experienced through the UK.

The ReThink Group was founded in March 2005 gaining its AIM listing in June 2008. Although a relatively new addition to the ranks of UK staffing companies the founder members of the board had previously worked together at Best International, an IT staffing business that was ultimately sold to Spring Group in June 2003.

The float on AIM in June 2008 coincided with the start of the cyclical downturn in the global recruitment industry and EBITDA, which had grown substantially in the financial year to December 2007, experienced a 21% decline in 2008. However, this setback was the result of a sharp one-off reversal of profits from the consultancy division rather than the effects of the recession on the recruitment activities which, with partial support from an acquisition at the end of 2007, enjoyed an 88% rise in operating profit.

*IT staffing supported by Business Consultancy offering an element of earnings protection*

*Founded in 2005 by ex Best International directors*

*Floated on AIM in 2009 just as the cycle turned down, but some initial resilience seen in staffing*

**Table 1: Historic performance (2005-2008)**

Years to December	2005	2006	2007	2008
Revenue (£m)	2.40	12.88	28.14	43.39
NFI (£m)	1.15	3.50	7.92	12.09
EBITDA (£m)	-0.73	0.31	1.37	1.08
PBT (adj) (£m)	-0.77	0.15	1.07	0.60
EPS (p)	-	-	0.93	0.48

Source: Company

However, the recession finally caught up with the company in the current financial year with profits in the first six months being practically eliminated. An element of stability is anticipated for the second six months reflecting our belief that market conditions are getting no worse sequentially and while visibility remains limited we are forecasting an adjusted PBT of £0.25m for the full year which compares to the £0.6m achieved in 2008.

While the expected outcome for 2009 is likely to be disappointing it is not substantially different from the outturn of many staffing companies this year with one or two actually reporting a first half loss. ReThink is anticipating a significant recovery in 2010 reflecting the benefits of substantial investment during 2009 in the Consultancy division and a modest improvement in demand for permanent placements. With a flat cost base the operational gearing could be substantial.

*The downturn hit revenues in the first half of 2009 but with some stability being seen in H2*

*So 2009 will prove a difficult year but not uncharacteristic of other recruitment firms*

## The Recruitment division

The recruitment activities are undertaken through six UK offices, London, Manchester, Leeds, Birmingham, Bristol and Southend, and an office in Dubai; the latter being the result of the acquisition of Proveya MEA FZCO which services the whole of the Middle East region.

Although the group launched a new brand, ReBuild, focused on the construction and property sector, the timing was unfortunate as it was shortly followed by the recession-led cyclical downturn. While the brand still exists and makes a profit it has been substantially downsized with only around 25 contractors on billing and therefore nearly all of the recruitment revenue is earned from the placement of contractors and permanent placements into the IT sector.

*Recruitment from 6 UK offices and one in the Middle East*

*The Rebuild brand focused on Construction is profitable but effectively mothballed until markets improve*



## Merchant John East Securities

As mentioned earlier in this report the founders have amassed a great deal of experience in the IT sector and in 2005 set out to establish ReThink quickly with three founders each having responsibility for opening and establishing three regional offices in London, Manchester and Bristol. The founder directors were; Jon Butterfield, Andy Lord, Michael Bennett and Iain Blair. Patrick Dundon, initially employed in a consultancy role, was subsequently appointed FD. John Sadiq and John O'Sullivan provided support as non-executive directors.

For nearly two years this status quo remained and the group grew revenues to nearly £13m in 2006 on which it delivered NFI of £3.5m and made a profit before tax of £0.15m. At this stage the group was still a pure IT recruitment business.

In January 2007 Simon Church joined as Business Development director and in February of that year Robert O'Callaghan was recruited to set up and run an office in Birmingham. In July 2007 ReBuild was launched. As stated earlier this activity has been severely downsized in a difficult market but it makes a profit and can be expanded as and when market conditions allow.

At the end of 2007 the group embarked upon its first acquisition, that of Key-Power Consultants (KPC), an IT staffing business based in Southend. KPC's Lancashire and London offices were absorbed into ReThink's Manchester and London offices with KPC's head office remaining in Southend which became a satellite office.

In March 2008 the group opened a satellite office in Exeter and from this location launched Integris, a new brand which utilises a different recruitment model but one that is unsuited to current market conditions. As a result the brand is currently mothballed.

At the outset ReThink concentrated on permanent placements, which in 2005 represented nearly 80% of recruitment NFI. As the contract book expanded the proportion of perm gradually reduced to the position last year when perm accounted for 48% of NFI and in the first half of 2009, just 32%.

As a consequence of the reduction of perm, which is in effect a 100% gross margin activity, the gross margin from recruitment has steadily reduced from 48% in 2005 to 24.6% in 2008. In the current year the steep downturn in demand for perm will exacerbate the historic trend and thus we see the contract/perm ratio moving closer to 70%/30%.

*The founder directors bring with them a great deal of IT staffing experience*

*KPS acquired in 2007*

*Integris launched in 2008*

*Perm making way for contract activity*

*Hence reduction in gross margin as the mix changed*

**Table 2: Summary Recruitment revenue, NFI and operating profit**

Years to December	2005	2006	2007	2008
<b>Revenue (£m)</b>				
Temp	1.49	11.08	22.71	35.76
Perm	0.91	1.81	3.05	4.83
<b>Total recruitment revenue</b>	<b>2.40</b>	<b>12.89</b>	<b>25.76</b>	<b>40.59</b>
<b>NFI (£m)</b>				
Temp	0.25	1.70	3.29	5.16
Temp margin	16.5%	15.3%	14.5%	14.4%
Perm	0.91	1.81	3.05	4.83
Perm margin	100.0%	100.0%	100.0%	100.0%
<b>Total recruitment NFI</b>	<b>1.16</b>	<b>3.50</b>	<b>6.34</b>	<b>9.99</b>
Recruitment NFI margin	48.1%	27.2%	24.6%	24.6%
<b>Operating profit (£m)</b>	<b>-0.74</b>	<b>0.29</b>	<b>0.46</b>	<b>0.86</b>
Operating margin	-30.8%	2.2%	1.8%	2.1%

Source: Company



## Merchant John East Securities

Overall the performance of the division has been good with last year's outturn being helped by the inclusion of KPC which, being acquired at the end of 2007, was in for a full twelve months against a zero contribution in the comparative year. While the contribution from KPC was not stripped out as the business was fully integrated within ReThink's own operations, we believe that the existing ReThink business delivered good organic growth with good growth in contractors on billing.

The gradual reduction in NFI margin since formation is as stated earlier, predominantly a result of the increasing incidence of contract into the mix; the reduction in temp/contract placement margin can be explained by an increase in lower margin services. Within this area we include managed service, recruitment process outsourcing and managed vendor services where a proportion of margin is sacrificed to higher volumes, exclusivity and a closer relationship with the customer.

A prime example is a contract won over a year ago with a major national retail chain under which ReThink is responsible for the exclusive supply of all its IT recruitment requirements, both contract and permanent. It is a rolling twelve month contract and is worth around £7m per annum with the margin dependent upon the mix of perm and temp. At the moment, given the current recession the requirement is mostly for contractors but management still believes margins to be around 13%. Similar but smaller non-exclusive volume contract have been won with other clients including RR Donnelley and the NHS.

Unlike many IT staffing companies demand for contractors has remained strong as witnessed by the number of group contractors on billing which increased by 37% in the first half to June 2009 with 478 contract runners against just 348 a year earlier and 419 at the end of December 2008.

In the six months to June 2009 recruitment revenues increased by 24% from £19.1m to £23.7m, albeit at the NFI level there was a reduction of 8% from £4.9m to £4.5m reflecting margin pressure and a greater proportion of contractors versus higher margin permanent placements than a year earlier.

However, we are encouraged that, along with other peer group recruitment companies, the group has seen "a small but nevertheless discernable increase in levels of permanent placements in recent months which, combined with a continued increase in contractor levels, has given cause for cautious optimism".

## The Consultancy division

In March 2007 ReThink recruited Stephen Salvin to head up ReThink Professional Services, a new business channel focusing on the provision of business and technology solutions. To differentiate the business from the Recruitment division RPS was renamed Aiimi whose core offering is the management of the delivery of IT projects on behalf of its clients through the deployment of teams who manage the feasibility, implementation and support of the project. In so doing it utilises its own staff supplemented by staff recruited for its clients by the group's recruitment division.

**Table 3: Summary - Consultancy revenue, NFI and operating profit**

Years to December	2005	2006	2007	2008
<b>Revenue (£m)</b>	-	-	<b>2.39</b>	<b>2.80</b>
<b>NFI (£m)</b>	-	-	<b>1.58</b>	<b>2.10</b>
NFI margin	-	-	66.4%	75.0%
<b>Operating profit (£m)</b>	-	-	<b>0.85</b>	<b>0.05</b>
Operating margin	-	-	35.6%	1.9%

Source: Company

From the outset the division was highly successful, being awarded a three-year contract with Barclays Bank to provide implementation and operational support for their internal employee incentive programme.

*All in all a good performance in 2008*

*Margin decline due to more contract and more managed services*

*A good contract won with a major chain of retail stores worth around £7m pa at good margins*

*Contractors on billing show good growth unlike some other IT staffers*

*8% reduction in HI NFI*

*Some recent increase in the demand for perm is a positive*

*2007 saw the formation of the Aiimi brand to manage the feasibility, implementation and support of IT projects*

*3-year contract awarded by Barclays Bank...*



## Merchant John East Securities

This contract involved the delivery of a team of people with expertise in sales performance management with specific knowledge of Callidus, the global leading software company in this sector. After two and a half years the contract was taken in-house by Barclays but other contracts have been signed since then and the current client base totals 18 including high quality names such as Xerox, CapGemini, Skype, Southwark Council and The States of Jersey.

Profit contributions in 2007 and 2008 are not strictly comparable as 2007 reflected the fixed implementation fee from the Barclays contract. 2008 represented support service work which as well as being on a lower margin coincided with a significant investment to build the business, its capabilities and personnel.

Aiimi is a non-exclusive licensed partner for a number of producers of business technology software including Callidus, SAP, Merced Systems & Xactly Corporation in Sales Performance Management and IBM (Cognos), Microsoft & Microstrategy in Business Intelligence (software to transform operational data into actionable information).

Most recently the group has become a platinum partner for Open Text, the US-based provider of Enterprise Content Management (tools to capture, manage, store and deliver content and documents related to organisational processes).

*... to support a sales management performance project based on Callidus*

*Major investment in 2008 reduced profits from this division*

*Licensed partner for Callidus, SAP, Xactly, IBM, Microsoft and Microstrategy*

*And more recently Open Text*

## Financials

In common with most staffing companies ReThink has recourse to an invoice discount facility (IDF) provided by Lloyds Bank to a maximum of £10m and a much smaller facility with Royal Bank of Scotland of £0.75m.

At the end of the last financial year the group reported that it had utilised £5.9m of advances on its IDF which was shown as a separate item in Trade & Other Payables. This is a revolving facility which will fluctuate significantly over the month. It has been as high as £7m and as low as £3m and is a relatively high figure by virtue of the fact that the group invoices monthly rather than weekly. Net of £0.5m cash and £0.5m of other borrowings year end debt stood at £5.9m (£3.1m).

*IDF with Lloyds Bank*

*Net debt currently £5.9m*

## Forecast and valuation

ReThink fits our criteria of having significant exposure to contract work and a differentiated model courtesy of its Consultancy division. Both areas offer greater visibility than permanent placement activity and both sides of the business are trading well under difficult conditions with management confident of a strong recovery in 2010.

Our forecast for 2010 calls for a profit of £1m against just £0.25m in 2009 and much of the impetus behind this recovery will be driven by the Consultancy division which in 2008 and 2009 had been impacted by necessary investment in the business which should pay back significantly next year. With regard to the recruitment activities we are assuming a modest recovery in demand for permanent hires of around 10% and continued stability in contract demand.

*Strong recovery expected in 2010*

*PBT forecast to rise from £0.25m in 2009 to £1m in 2010*

On a full tax charge this results in EPS of 0.66p putting the shares at 7p on a PER of 10.5x which is up with events at this early stage and at the top end of the range for smaller cap companies in the sector (4.2x to 9x). Reflecting the level of debt, EV/EBITDA for 2010 comes in at a hefty 8x against a smaller cap sector average of 4.7x.

**In conclusion therefore, as much as we like the business model and rate highly the experienced management we believe that at 6.5p the shares are currently up with events and are already discounting the projected rise in earnings for 2010 which is by no means a given at this early stage. We therefore commence coverage with a Hold recommendation with fair value at around 7.5p.**



## Merchant John East Securities

Summary P&L				
Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Revenue</b>	<b>28.14</b>	<b>43.39</b>	<b>48.00</b>	<b>54.00</b>
<b>Net Fee Income (NFI)</b>	<b>7.92</b>	<b>12.09</b>	<b>11.25</b>	<b>12.70</b>
Administration expenses	-6.61	-11.17	-10.75	-11.35
Associates	0.00	0.00	0.00	0.00
<b>Operating Profit</b>	<b>1.31</b>	<b>0.92</b>	<b>0.50</b>	<b>1.35</b>
Separately disclosed items (SDI)	0.00	-0.41	0.00	0.00
Finance income	0.01	0.03	0.00	0.00
Finance charge	-0.25	-0.34	-0.25	-0.35
<b>Profit before tax as stated</b>	<b>1.07</b>	<b>0.19</b>	<b>0.25</b>	<b>1.00</b>
IFRS 3 adjustment for amortisation of intangibles	0.00	0.00	0.00	0.00
Adjustment for SDIs	0.00	0.41	0.00	0.00
<b>Adjusted Profit before tax</b>	<b>1.07</b>	<b>0.60</b>	<b>0.25</b>	<b>1.00</b>
Tax	-0.23	-0.11	-0.07	-0.28
Post tax profit	0.84	0.08	0.18	0.72
Minorities	0.00	0.00	0.00	0.00
Net Profit	0.84	0.08	0.18	0.72
<b>Adjusted Net Profit</b>	<b>0.84</b>	<b>0.50</b>	<b>0.18</b>	<b>0.72</b>
<b>EBITDA</b>	<b>1.37</b>	<b>1.08</b>	<b>0.67</b>	<b>1.53</b>
Depreciation	-0.06	-0.17	-0.17	-0.18
<b>EBITA</b>	<b>1.31</b>	<b>0.92</b>	<b>0.50</b>	<b>1.35</b>
Amortisation of intangibles	0.00	0.00	0.00	0.00
<b>EBIT</b>	<b>1.31</b>	<b>0.92</b>	<b>0.50</b>	<b>1.35</b>
<b>Equity</b>				
Weighted average shares (m)	75.57	86.60	90.98	91.06
Weighted average shares FD (m)	90.20	104.08	108.28	108.36
Year end shares in issue (m)	90.91	90.91	91.06	91.06
<b>EPS</b>				
EPS FD (p)	0.93	0.08	0.17	0.66
<b>EPS FD and adjusted (p)</b>	<b>0.93</b>	<b>0.48</b>	<b>0.17</b>	<b>0.66</b>
<b>Dividend</b>				
Interim dividend (p)	0.00	0.00	0.00	0.00
Final dividend (p)	0.00	0.00	0.00	0.00
<b>Total dividend (p)</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>

Key ratios				
Market cap (£m)	6.37	6.37	6.37	6.37
Enterprise value (EV) (£m)	9.48	12.22	12.49	12.28
EV/NFI (x)	1.20	1.01	1.11	0.97
EV/EBITA (x)	7.3	13.3	25.0	9.1
Share price (p)	<b>7.00</b>			
PER (x)	7.5	14.7	42.1	10.5
Yield (%)	-	-	-	-

Source: Company accounts; MJES

P&L Analysis				
Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Analysis of revenue</b>				
Recruitment	25.76	40.59	41.70	44.00
Consultancy	2.39	2.80	3.30	4.00
<b>Total Revenue</b>	<b>28.14</b>	<b>43.39</b>	<b>45.00</b>	<b>48.00</b>
<b>Analysis of operating profit</b>				
Recruitment	0.46	0.86	0.65	0.85
Consultancy	0.85	0.05	0.50	0.60
<b>Total Operating Profit</b>	<b>1.31</b>	<b>0.92</b>	<b>1.15</b>	<b>1.45</b>
<b>Operating margin</b>				
Recruitment	1.8%	2.1%	1.6%	1.9%
Consultancy	35.6%	1.9%	15.2%	15.0%
<b>Group Operating margin</b>	<b>4.6%</b>	<b>2.1%</b>	<b>1.0%</b>	<b>2.5%</b>
<b>Key Ratios</b>				
EBITA margin	4.6%	2.1%	1.0%	2.5%
Administration costs as a % of revenue	23.5%	25.7%	22.4%	21.0%
Conversion of NFI into EBITA	16.5%	7.6%	4.4%	10.6%
Effective tax rate	21.5%	17.7%	28.0%	28.0%
Net interest cover by EBITDA (x)	5.7	3.5	2.7	4.4
Dividend cover by adjusted EPS (x)	n/a	n/a	n/a	n/a

Source: Company accounts; MJES



## Merchant John East Securities

Summary Cash Flow				
Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
Net cash from operating activities	1.40	0.70	0.70	1.56
(Increase)/Decrease in trade and other receivables	-2.64	-2.79	-3.00	-3.30
(Decrease)/ Increase in trade and other payables	1.67	2.53	2.60	2.80
Increase/(Decrease) in provisions for liabilities and charges	0.00	0.00	0.00	0.00
<b>Cash generated by operations</b>	<b>1.40</b>	<b>0.70</b>	<b>0.70</b>	<b>1.56</b>
Finance costs paid	-0.25	-0.34	-0.25	-0.35
Taxation paid	0.00	-0.23	-0.07	-0.25
<b>Net cash generated by operating activities</b>	<b>0.18</b>	<b>-0.13</b>	<b>-0.02</b>	<b>0.46</b>
<b>Cash flow from investing activities:</b>				
Interest received	0.01	0.03	0.00	0.00
Acquisition of subsidiaries (net of cash acquired)	0.10	0.00	0.00	0.00
Proceeds from the sale of subsidiary (net of cash disposed)	0.00	0.00	0.00	0.00
Purchase of PP&E	-0.20	-0.15	-0.10	-0.10
Purchase of intangible assets	0.00	0.00	0.00	0.00
Proceeds from sale of PP&E	0.04	0.00	0.00	0.00
Decrease/(increase) in short term deposits	0.00	0.00	0.00	0.00
Other	0.00	0.00	0.00	0.00
<b>Net cash used in investing activities</b>	<b>-0.06</b>	<b>-0.12</b>	<b>-0.10</b>	<b>-0.10</b>
<b>Financing activities:</b>				
Purchase of own shares	0.00	0.00	0.00	0.00
Net movement in borrowings	-0.15	-0.33	-0.15	-0.15
Dividends paid	0.00	-0.10	0.00	0.00
Issue of shares (net)	0.25	0.83	0.00	0.00
Capital element of finance lease rentals	0.00	0.00	0.00	0.00
Other	0.00	0.00	0.00	0.00
<b>Net cash inflow from financing activities</b>	<b>0.10</b>	<b>0.40</b>	<b>-0.15</b>	<b>-0.15</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>0.23</b>	<b>0.14</b>	<b>-0.27</b>	<b>0.21</b>
Cash and cash equivalents at start of year	0.15	0.37	0.51	0.24
FX changes	0.00	0.00	0.00	0.00
<b>Cash and cash equivalents at end of year</b>	<b>0.37</b>	<b>0.51</b>	<b>0.24</b>	<b>0.45</b>
<b>Reconciliation of cash flow to net debt</b>				
Net (debt)/cash at start of the year	-1.78	-3.11	-5.85	-6.12
Net increase in cash and cash equivalents	0.23	0.14	-0.27	0.21
Net change in borrowings during the year	-1.56	-2.88	0.00	0.00
<b>Net (debt)/cash at end of the year</b>	<b>-3.11</b>	<b>-5.85</b>	<b>-6.12</b>	<b>-5.91</b>
<b>Key Ratios</b>				
Net debt/EBITDA	2.26	5.39	9.13	3.86
Free Cash Flow (£m)	0.18	-0.13	-0.02	0.46
Free Cash Flow per share (p)	0.20	-0.13	-0.02	0.42

Source: Company accounts; MJES

### Free Cash Flow:

Cash flow from operating activities, less interest paid, less tax paid, less equity divs paid



## Merchant John East Securities

Summary Balance Sheet				
Years to December	2007	2008	2009 E	2010 E
<b>Assets</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Non-current assets</b>				
PP&E	0.21	0.50	0.55	0.65
Goodwill	0.70	0.68	0.68	0.68
Other intangible assets	0.00	0.00	0.00	0.00
Deferred tax asset	0.10	0.06	0.03	0.00
Other	0.00	0.00	0.00	0.00
<b>Total non-current assets</b>	<b>1.01</b>	<b>1.23</b>	<b>1.26</b>	<b>1.33</b>
<b>Current assets</b>				
Trade and other receivables	7.74	10.27	13.27	16.57
Deferred tax assets	0.00	0.00	0.00	0.00
Other	0.61	0.88	0.80	0.80
Cash and short term deposits	0.37	0.51	0.50	0.80
<b>Total current assets</b>	<b>8.72</b>	<b>11.66</b>	<b>14.57</b>	<b>18.17</b>
<b>Total assets</b>	<b>9.72</b>	<b>12.89</b>	<b>15.83</b>	<b>19.50</b>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Trade and other payables	-4.85	-4.35	-6.95	-9.75
Taxation liabilities	-0.23	-0.11	-0.07	-0.28
Bank overdrafts, IDF and other short term borrowings	-3.15	-6.07	-6.40	-6.51
Provisions	0.00	0.00	0.00	0.00
Other	0.00	0.00	0.00	0.00
<b>Total current liabilities</b>	<b>-8.24</b>	<b>-10.53</b>	<b>-13.42</b>	<b>-16.53</b>
<b>Non-current liabilities</b>				
Long term borrowings	-0.33	-0.29	-0.22	0.00
Provisions	0.00	0.00	0.00	0.00
Deferred taxation liability	0.00	0.00	0.00	0.00
Other	0.00	0.00	0.00	0.00
<b>Total non-current liabilities</b>	<b>-0.33</b>	<b>-0.29</b>	<b>-0.22</b>	<b>0.00</b>
<b>Total liabilities</b>	<b>-8.56</b>	<b>-10.82</b>	<b>-13.64</b>	<b>-16.53</b>
<b>Net Assets</b>	<b>1.16</b>	<b>2.07</b>	<b>2.19</b>	<b>2.96</b>
<b>Key Ratios</b>				
Net cash/(debt) (£m)	-3.11	-5.85	-6.12	-5.71
Net debt/shareholders funds	168%	182%	179%	93%
Capital employed (£m)	4.27	7.92	8.31	8.67
ROCE	30.6%	11.6%	6.0%	15.6%
Current ratio	1.06	1.11	1.09	1.10

Source: Company accounts; MJES

#### Capital Employed:

Shareholders funds, add debt, add obligations under finance leases, add minorities, add provisions, less associates, less investments

#### ROCE:

Operating profit / Capital Employed



## SThree plc

### Initiation of coverage

SThree's management has achieved a great deal since the company was floated in November 2005. Current economic conditions aside the group is positioned exceptionally well for the upturn with an increasing percentage of NFI being generated from overseas activities while non-ICT business is also on a steady increase. We start coverage with a Sell recommendation which merely reflects the very forward looking valuation which is currently a common feature among the larger market caps in the sector. Fundamentally we like the business model, have confidence in management's capabilities and believe the shares are worth buying for the long term. However, in the short/medium term the shares are discounting growth that may take a year or two to achieve hence our Sell recommendation and target price of 200p.

### Investment case:

- Since 1997 SThree has grown its net fee income (NFI) from £43m to £219m. Significantly it has achieved this growth solely through organic expansion. As far as we are aware internal growth of this scale is only surpassed by Michael Page in the sector. The difference in the two business models being that Page is philosophically opposed to growth via acquisition while SThree would in theory contemplate such a strategy.
- From inception, SThree has built its business around the provision of skilled professional staff into the SME market. Crucially it has focused its business model on maximizing gross margins rather than emphasising sales, volumes or market share. As a result margins have been remarkably stable during the peaks and troughs of the recruitment cycle.
- Another of SThree's strategic mantras has been its multi-branded approach. This has been a function of the group's development almost from the outset and in management's opinion is one of the reasons it has not had to resort to growth through acquisition and has a relatively low turnover of key management. Following some organisational restructuring the group now has four brand "families", offering professional staff to clients in Information, Communication and Technology (ICT) and non-ICT disciplines in the UK and overseas.
- SThree has expanded outside its core ICT market into areas including banking & finance, accountancy, human resources, engineering etc. In the half year to May 2009, NFI from non-ICT sectors grew to 25.3% (21.2%) of the total and actually grew year on year by 8.6% against a fall in ICT NFI of 13.7%. We expect the non-ICT sectors to continue to increase their percentage contribution to group NFI (if not in actual NFI) and for the group to explore opportunities in other specialist industry verticals, but only where these sectors offer similar high growth market opportunities and high margins, and where the group's existing model works.
- SThree's interim results showed remarkable resilience, still posting double digit NFI growth in its overseas markets although this is now declining sharply (Q3 NFI down 29%). This relatively late deterioration could mean that eventual recovery will lag that of its immediate peers. As a consequence at this stage we are anticipating flat earnings for the group in 2010 with overall stability not being evidenced until mid year and with any global recovery unlikely to be apparent until Q4 2010.
- In consequence we initiate coverage with a Sell recommendation. We are obviously encouraged by the recent trading update but equally believe this and more to be already reflected in the share price. Our price target is set at 200p some xx% lower than the current price.

SELL

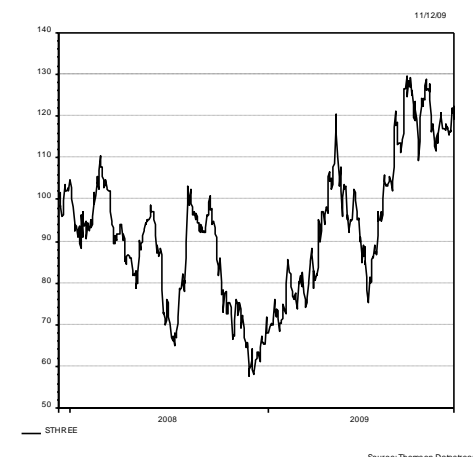
Price:	254p
Ticker:	STHR.L
Asset class:	FULL
Website:	<a href="http://www.sthree.com">www.sthree.com</a>
12 mth Hi/Low:	276.3p – 130p
Sector:	Support Services
Market Cap:	£309.4m
Net (debt)/cash:	£47.9m E
EV:	£261.5m E
Next earnings:	Feb 2010 (Prelims)

### Forecasts:

Yr to Nov (£m)	08	09 E	10 E
Revenue	631.5	525.0	460.0
NFI	218.9	170.0	145.5
Temp : Perm	52:48	60:40	64:36
EBITA	56.8	17.0	10.5
Conv. Ratio %	25.9	10.0	7.2
PBT as stated	54.1	8.9	11.0
PBT adjusted	56.0	17.4	11.0
EPS FD Adj (p)	29.2	9.4	5.9
DPS (p)	12.0	12.0	12.0
EV/EBITA (x)	5.0	15.4	26.6
EV/NFI (x)	1.3	1.5	1.9
PE ratio (x)	8.7	26.9	42.8
Yield (%)	4.7	4.7	4.7
Debt/EBITDA	-	-	-

Source: Merchant John East Securities Ltd.

### Two-year share-price performance





## Background

### A successful business model

Founded in 1986, STthree has grown from a small one-office IT recruitment specialist to a substantial broad-based recruitment business operating on a worldwide basis with 32 UK offices and 25 offices overseas. It now operates in 11 countries, has circa 1,650 staff and a client base of over 7,000, typically SME, customers. Since 1997 NFI has grown from £43m to a peak of £219m in 2008.

Significantly, it has achieved this growth solely through organic expansion. As far as we are aware internal growth of this scale is only surpassed by Michael Page in the sector. The difference in the two business models being that Page is philosophically opposed to growth via acquisition while STthree would in theory contemplate such a route to growth. The caveat being that such an acquisition would enable a position to be established in a discipline or territory where to do so organically would be problematic or unduly time consuming.

STthree was a fairly recent entrant to the UK quoted recruitment universe only having gained a listing in November 2005 and in 2007 it launched a US Level I ADR facility. At £309m, STthree is the third largest company in the sector by market capitalisation behind Hays £1.3bn and Michael Page £1.2bn

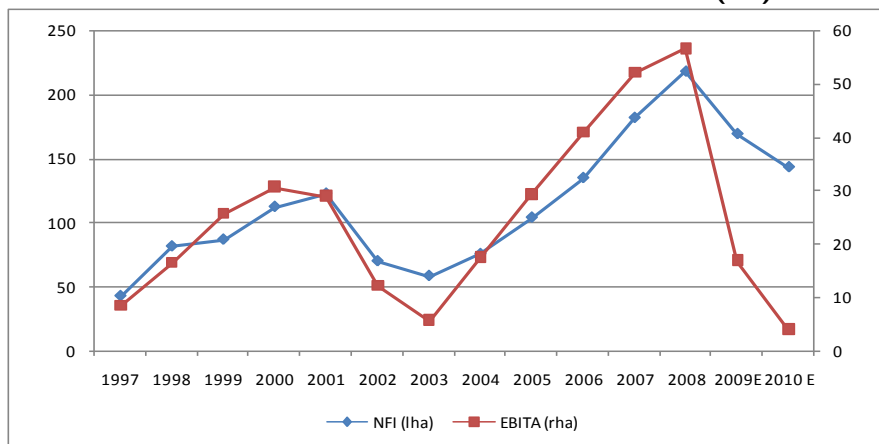
The group utilises a multi-branded approach and each subsidiary is autonomous and in certain circumstances group subsidiaries will compete with other group companies in the market place. More recently the group has undergone some operational restructuring which has seen some senior managers being given responsibilities across a number of brands within a geographical territory. This slimmed down approach has saved cost in the short term and is expected to result in improved efficiencies going forward.

While STthree clearly operates in a cyclical industry, we would contend that, along with certain other larger quality staffing companies, it offers investors long-term secular growth that is from time to time affected by shorter-term cyclical trends. In addition, while the group has been trading for 23 years, prior to the current global recession the business had sustained NFI reductions in only two of those years (2002 and 2003, which arguably were excessively poor markets for IT services generally).

### Cyclical resilience over the downturn

This relatively strong performance across the cycle can be mirrored in the larger cap companies by **Hays**, **Michael Page** and **Robert Walters**. They all have one factor in common: investment risk management through diversification. This diversification in the UK is provided by involvement in a wide range of industry verticals, and internationally by a broad geographic operational footprint. Chart 1 below illustrates STthree's NFI and EBITA performance prior to, during and post the 2001-2003 recruitment downturn, together with our forecasts for 2009 and 2010.

Chart 1: Historic and forecast movement in NFI and EBITA (£m)



Source: Company; MJES

*Founded in 1986 from modest beginnings  
STthree is now a very substantial business*

*All growth has been organic but company  
not philosophically opposed to acquisitions*

*Multi-branded approach*

*Long-term secular growth...*

*...as depicted in Chart 1*



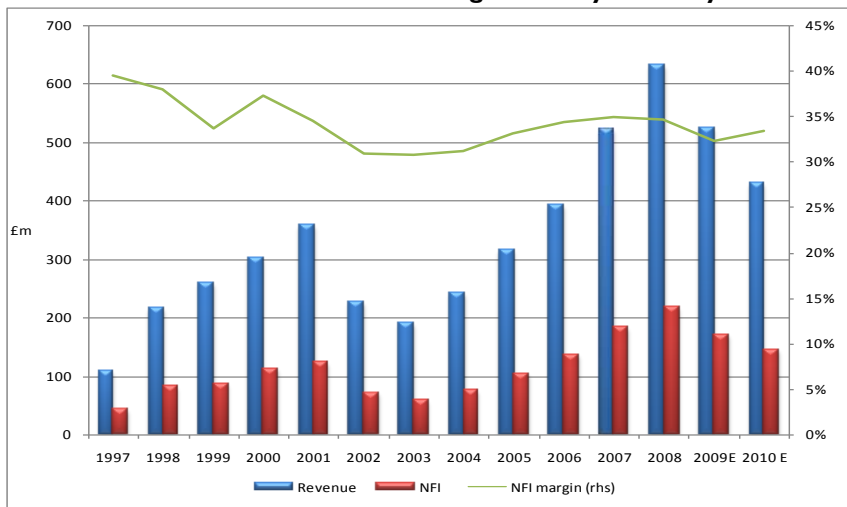
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While NFI halved over the previous downturn, the recovery was rapid. Within two years of the cycle turning positive, STthree had matched its previous operating profit peak and went on to record three more years of growth before the current global recession which has impacted severely on profitability.

In the 2000–2003 downturn, it was noticeable that while sales declined, gross margin was pretty much unaffected. This indicated that even though volumes of permanent placements were naturally lower, temporary placements were more resilient and importantly, the gross margin on temps was effectively unchanged due to the company’s ability to pass most of the pricing and margin pressures on to contractors.

*Gross margin relatively stable during the 2000-2003 downturn*

**Chart 2: Illustration of relative NFI margin stability across cycles**



Source: Company; MJES

As a general comment, as long as a staffing company’s infrastructure is not radically compromised during a period of weakening demand, the investment undertaken during the previous up-cycle should drive profits ahead of the previous peak as the new up cycle progresses. Once infrastructure investment peaks, productivity and operational efficiencies (in other words operational leverage) kick in more fully to maximise the conversion of NFI into EBIT and the operation becomes mature.

We judge that STthree’s business model is sound and well proven while still evolving; in our opinion this is reflected in the company’s resilience over the past down cycles and its ability to regain traction once the current demand lethargy reverses.

In the following pages we discuss the group’s philosophy, its markets and trading, with particular emphasis on the group’s medium-term prospects.

### High margin v high volume

From inception, STthree has built its business around the provision of skilled professional staff into the SME market. Crucially it has focused its business model on maximizing gross margins rather than emphasising sales, volumes or market share. In this respect the company has a model very similar to that of Michael Page.

*Focus on the SME market and maximising margins*

As a consequence of this strategy it avoids, where possible, dealing with clients under framework agreements such as preferred supplier agreements (PSA) or managed agency work which, by design, offer agencies high levels of volume (although never guaranteed volumes) in return for generally lower gross margins. STthree prefers to deal on an open market, ad hoc or spot basis, and normally this means offering a non-commoditised, high service level business proposition to its clients.

*Avoids low margin, high volume work*

This may mean working the candidate database harder (being hunters rather than just farmers) in significantly lower volumes than under PSAs. As a consequence of this strategy, STthree’s gross margin on temporary/contract staff last year was a credible 21.5%; this compares very favourably with its peer group and is surpassed only by

*Contract margin in 2008 was a credible 21.5%*



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Michael Page at 24.2% with Hays at 19.4% and Robert Walters 19.6%. SThree makes the point that although its margin of temps may appear lower than those of Page the actual quantum or margin will be much higher (what it calls its gross profit per day rate) which in the first half of the current year was £87.67 per day per contractor.

Not only is SThree's gross margin percentage superior to most of its competitors, but this level of margin has been sustained for a number of years (Chart 2 above) and, according to management, can be sustained into the future. Management makes the observation that gross margins at these levels are not untypical of many smaller staffing companies operating in the private sector where it would be typically uneconomic for them to supply candidates on anything other than top-end margins.

Margins tend to become depressed as agencies get larger and enter into higher volume, lower-margin contracts with bigger clients in an effort to get closer to customers and/or to gain additional work through such enhanced relationships. Typically, throughout much of the fragmented private sector staffing market, relationships are more arms-length and transactional rather than relationship-driven and tend to be concentrated on the SME market. This is SThree's primary market place, where it is a large player with over 7,000 clients.

In instances where SThree has little choice but to operate within frameworks (i.e. for larger investment banks), it is not obliged to provide a set volume of candidates and has no obligation to fill advertised positions. However, it does place high-salaried individuals where the gross cash margin is substantial, even if the gross margin percentage is lower than that available on an open market basis.

### The pros and cons of multi-branding

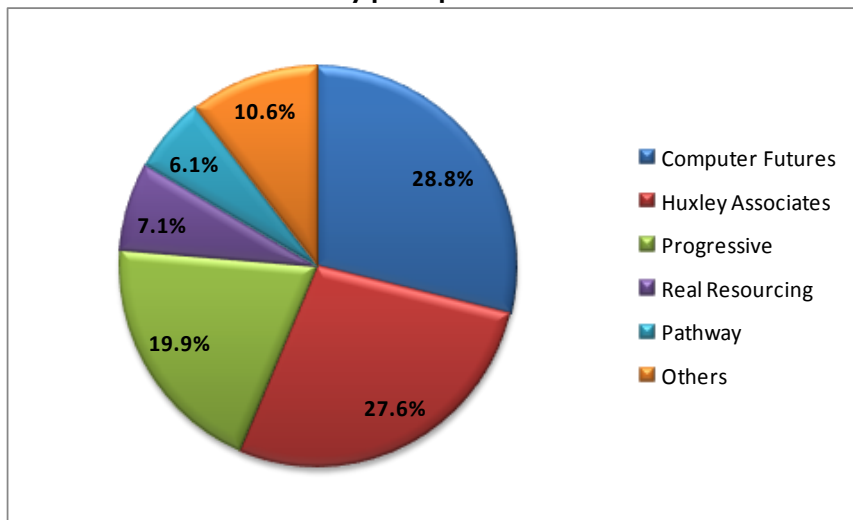
Another of SThree's strategic mantras is its multi-branded approach. This has been a function of the group's development almost from the outset and in management's opinion is one of the reasons it has not had to resort to growth through acquisition and has a relatively low turnover of key management. The group now has eight distinct brands, offering professional staff to clients in ICT and non-ICT disciplines in the UK and overseas.

*Good progress in gross profit per day rate*

*Gross margins believed to be sustainable over the longer term*

*Multi-branding seen as a driver of internal growth*

**Chart 3: Distribution of NFI by principal brands**



Source: Company

The original brand was **Computer Futures**, established in 1986, and this has since grown organically to fifteen offices, six of which are based in the UK, while nine are overseas. In 2008 Computer Futures was rebranded FS Group.

*Computer Futures was the original trading brand*



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As operational management teams or individuals develop skills within the group and identify new niches or business opportunities, they are encouraged to open up new businesses where it is deemed that demand is sufficient to support a stand-alone operation.

In this manner, **Progressive** was established in 1990 to exploit opportunities in regions largely, but not exclusively, outside the South East; it now has eight offices in the UK and seven overseas. As well as addressing the ICT sector Progressive has also expanded into the engineering, oil & gas, pharma and healthcare sectors.

**Huxley** was established in 1995 to address the market for permanent and contract staff in the ITC, banking, finance, global markets, engineering, oil & gas, HR, energy and sales & marketing sectors and has expanded to five UK offices and six overseas..

**Real Resourcing** operates in the accountancy & finance, global markets, ICT, pharma and the public sector in the UK and three overseas locations.

**Orgtel** focuses on banking technology, global markets and ICT in the UK and three offices overseas.

**Pathway** specialises in the ICT, finance and engineering sectors adding HR and legal to the list in 2008. It has offices in the UK and Dubai.

**Madison Black** is a pure perm and contract ICT specialist with offices in the UK and Netherlands.

**JP Gray** is the only non-ICT brand and specialises in the placement of finance and corporate governance recruitment with offices in the UK eight overseas.

The group also runs **The IT Job Board** which regularly advertises around 12,000 live IT vacancy positions from internal and external staffing agencies.

On the positive side, such brand development encourages operational management to 'think outside the box', to develop new niches and business opportunities while remaining within the holding company structure, rather than leaving to start up these operations on their own.

While the respective subsidiaries do not share candidate databases or consultants, they do share the holding company KPIs, such as margin targets with common systems and infrastructure.

The downside is that individual brands are effectively stand-alone operations that can, and do at times, compete with other SThree brands, so there can be an element of cannibalisation of customers. However, management considers this is relatively rare in practice; nevertheless, this is carefully monitored and managed and therefore not a major concern for investors.

As stated earlier the group has undergone some significant organisational restructuring which means that operational management are now likely to have responsibilities across a number of brands within a geographical territory. While this resulted in some senior managers moving off the payroll it has created efficiencies that will benefit the company in both the short and longer term. According to management the group now has four brand "families" with a more centralised support structure which should lead to a better conversion of NFI into EBIT when volumes recover.

### Development of new industry verticals

It can be a concern when a company is over-reliant on any one market or territory or indeed overly biased towards temp or perm. We are therefore encouraged in SThree's case by its expansion into non-ICT industry verticals and overseas markets (more of the latter later in this document).

As noted in the brand analysis above SThree has expanded outside its core ICT market into areas including banking & finance, accountancy, human resources, engineering etc. The progression of NFI contribution from these non-ICT sectors is shown in Chart 4 below.

*Other trading brands have been founded over the years to target specific markets sectors or territories*

*Brand development encourages management to think outside the box*

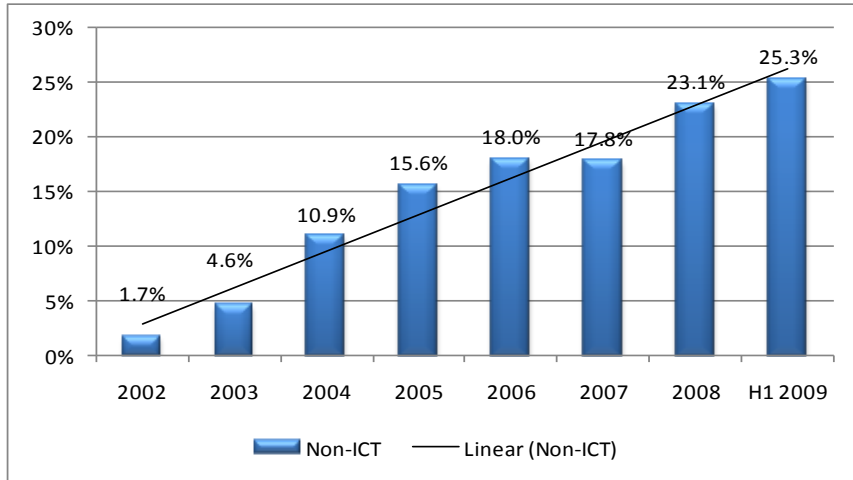
*But individual brands can and do competed with each other*

*Some rationalisation of the brand portfolio has been undertaken to form brand families*

*Successful expansion into other sectors and overseas markets*



**Chart 4: NFI contribution from non-ICT placements**



Source: Company

Chart 4 above illustrates the increase percentage contribution from non-ICT NFI up to the financial year to November 2008. In the half year to May 2009, NFI from non-ICT sectors grew to 25.3% (21.2%) and actually grew year on year by 8.6% against a fall in ICT NFI of 13.7%. For the full year to November 2009 the group has stated that non-ICT NFI rose to 28%.

*Steady increase in NFI contributions from non-ICT placement*

We expect the non-ICT sectors to continue to increase their percentage contribution to group NFI (if not in actual NFI) and to explore opportunities in other specialist industry verticals, but only where these sectors offer similar high growth market opportunities and high margins, and where the group’s existing model works.

*Which is expected to continue*

For all its expansion into non-ICT sectors, we believe SThree will always have a predisposition towards ICT and we do not expect the non-ICT segment to represent the bulk of revenues any time in the foreseeable future.

**Temporary/Contract vs. Permanent placement**

Over the recruitment cycle demand for contract/temporary staff and permanent staff will vary. At the bottom of the cycle, when corporate confidence is low, demand for contractors is high, relative to permanent placements, as their employment is of short term duration and can be dispensed with easily and relatively cheaply if necessary.

*Demand for contract and perm fluctuate depending on point in cycle*

As the cycle turns upwards there is a slight increase in demand for permanent staff, and this accelerates as the cycle gains momentum, corporate confidence increases and, ultimately, as skill shortages start to arise. At the peak demand for permanent hires is strong, operational gearing kicks in strongly and profit growth outstrips that of NFI.

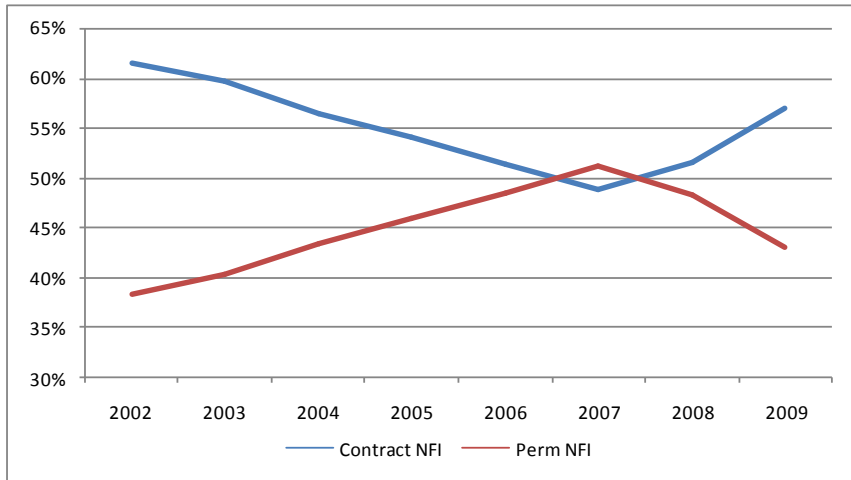
In the year to November 2008 52% of SThree’s NFI was derived from contract placements and 48% from perm, a ratio that, due to the current global recession, has and will increasingly favour contract placements. In the six months to May 2009 this was confirmed with contract accounting for 58% of NFI and for the full year the group estimates that figure to be maintained.

A certain amount of flexibility is built into the system because demand for permanent placements will be increasingly strong through the up-cycle and this gives the business operational leverage while contract provides a degree of revenue visibility when economic uncertainty rises and demand for perm decreases. This trend can be clearly seen in the following chart, which tracks the NFI split between temp and perm since FY2002 through to the first half of 2008/09.



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**Chart 5: Movement in NFI contribution from contract and perm**



Source: Company

As well as achieving a relatively high gross margin on its contract placements, the group also benefits from movements in the average gross profit per day rate which is positively affected by increased hours worked and higher pay rates.

In the FY 2008/09 the number of permanent placements had declined by 41% to 6,060, although average fees remained strong with some sequential improvement in Q4 over Q3. For the year the number of active contractors on billing declined by 27.7% to 4,157, with average gross profit per day rates stable in Q4 over Q3.

In perm we expect demand to continue to deteriorate for the next six months albeit at a reduced rate as the effect of the weakening overseas markets have their full effect but is tempered by a more resilient performance in the UK.

*Perm placement declined by 41% in the year to Nov 2009 and contractors on billing were down 27.7%*

*Weakening overseas markets will be tempered by more stability in UK*

### Overseas expansion offers growth opportunities

Almost from the outset STthree has provided ICT staff to clients outside the UK, but it is only in recent years that the group has considered overseas expansion to be a major plank of its overall strategy. In the year to November 2004, by location of client, £58m of sales and £19.4m of NFI was derived from overseas markets (France, Germany, Ireland, the Netherlands and Belgium), representing some 24% of sales and 26% of NFI. This had grown to 39% and 45% respectively by FY 2008, the latter figure being boosted by a 64% increase in NFI from overseas business during the year against a 1.4% fall in UK NFI. In the year to November 2009 overseas sales had grown to 55% of group revenue.

*Overseas sales have responded well to a concerted effort to spread the business to a wider geographic footprint*

Generally, for most companies servicing the professional end of the staffing market, overseas growth has tended to outstrip that in the UK, and we expect this trend to resume through the next up-cycle. STthree is no exception; we would anticipate the absolute and proportional contribution of overseas revenues to sales and NFI to grow strongly over the coming years as macroeconomic factors, together with growing liberalisation of European labour markets, encourages further growth.

*Overseas sales expected to drive growth in the next up cycle*

Physical overseas expansion continued into the year ended November 2009, with new offices opened in Frankfurt, Dusseldorf, Hamburg, Stuttgart, Marseille and Singapore. Typically, new overseas offices are quickly profitable as business has already been conducted in that country remotely from the UK. When revenues are sufficient to warrant the opening of dedicated office in the locality, there is already a base level of business that will contribute to covering overheads.

As a general observation overseas business is initially dominated by permanent placement revenue which tends to exaggerate the gross margin being achieved overseas (by reference to client location), as shown in Chart 6 below:

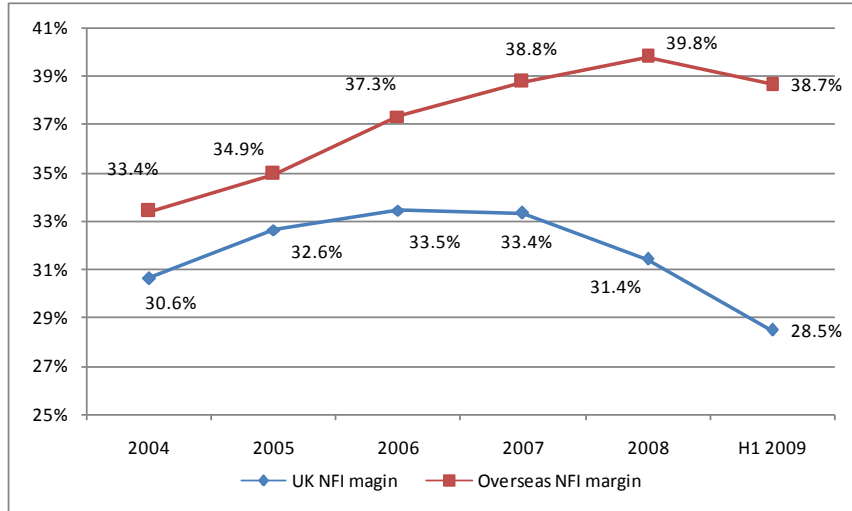


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We expect further growth overseas; in fact most of the expansion within the group's core ICT markets will now be overseas as the UK is a relatively mature market. Growth rates are far stronger overseas and the markets are, potentially, less developed. The group is already proposing to open ten new overseas offices in 2010/11 representing a total investment of around £3-4m with a payback over 9-18 months.

*More growth expected from overseas in years to come*

**Chart 6: Comparison of NFI margins between UK and overseas**



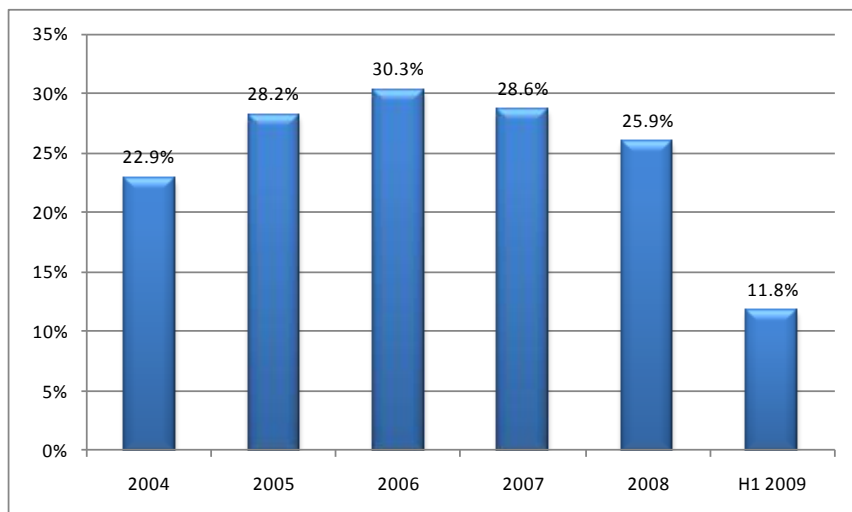
Source: Company

### Conversion ratio

The group's ability to convert NFI into operating profit (the conversion ratio) is a measure of internal operational efficiency and consultant productivity, while also being affected by ongoing investment in the business. However, in the current slowdown the impact of falling permanent and contract fees on gross profit and the obvious lag in adjusting the cost base to expected revenues will have a significant if temporary impact on the conversion rate.

*Conversion ratio being affected by the lag in revenue decline and the adjustment of the cost base*

**Chart 7: Historic conversion ratio**



Source: Company



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The peak ratio at 30.3% achieved in 2006 compares well to the group's larger peers in the UK and while in the current business climate the ratio will remain weak previous peaks are a good guide to what can be achieved during the next up-cycle. Indeed, as demand increases the fee income per consultant should increase strongly before additional heads have to be added, thus we see the potential for a sharp recovery in the ratio as and when demand improves.

*Some improvement in productivity envisaged as the upturn develops and before additional investment is required*

## Financials

SThree enjoys a very strong balance sheet with net cash at the end of November 2009 of £48m which compares to £24.6m at the end of November 2008 and £40m at the end of August.

*Substantial cash balances*

The inevitable reduction in working capital required as a consequence of the decline in demand helped to achieve a £27.3m working capital inflow in the half year while an improvement in DSO from 51 to 39 also contributed to the cash inflow. The latter achievement was in a large part a function of the full implementation of a previously installed new Enterprise Resource Planning (ERP) system. The latest information suggests that the DSO figure has again improved to 37 which has to represent a figure close to the peak that is likely to be achieved.

*Strong working capital management but probably now at a peak*

With demand beginning to stabilise or rise, sequentially, in the UK in certain sectors, we suspect that the working capital inflow will be minimal in the second half to November 2009 as the increase in activity levels absorbs working capital. Overseas markets which were later into the recession will weaken further in the second half but there is more of a bias towards perm in these territories, again supporting our view that working capital will be nearer neutral in the second half.

In the first half of 2009 the group reported a restructuring charge of £8.5m relating to redundancies and office rationalisation costs which was taken as an exceptional item. The benefits of the cost reductions are expected to pay back within the current financial year.

## Forecasts and valuation

The first half saw a reduction in revenue of just 5% and reflecting largely sustained gross margins, a NFI reduction of 9%. The lag effect of overhead reductions resulted in a fall in operating profit of 55%. In the full year the group has estimated that NFI fell by around 23% to £168m which implies a 36% reduction in H2.

*NFI fall of 23% for the year and 36% for H2*

The group stated in its interim report of July 2009 that "very recently there have been indications that the UK market may be showing some signs of stability". In the December 2009 trading update that the group stated that "Although market sentiment has yet to undergo anything like a paradigm shift, we have nonetheless seen recent signs that indicate most market have stabilised and some are showing improvement". This is clearly encouraging but it is too early to suggest recovery, particularly as the overseas operations will have a major influence on the outcome for 2009/10.

*Increasingly positive statements do not mean a recovery is imminent*

Our assumptions for the year to November 2009 is for a fall in revenue of 17% to £525m, a fall in NFI of 22% to £170m (which has been largely confirmed by the recent trading update) and a fall in operating profit (before exceptionals) of 70% to £17m. Net finance income of around £0.4m should see profit before tax of around £9m, or excluding exceptional costs, £17.4m. The effective tax rate is expected to be around 31% or £5.4m less the adjustment for the exceptional costs bringing the figure down to £3m and giving adjusted EPS of 9.4p

*We are anticipating EPS of 9.4p putting the shares on a PER of 27.1x but 2010 could be worse.*

This puts the shares on a PER at 254p of 26.9x 2009 earnings. Given the financial health of the balance sheet we anticipate the dividend being maintained at last year's level of 12p offering a yield of 4.7%.

Investors have already largely written off 2009 and accept that it will probably reflect the worst period of trading in this economic downturn. The question therefore remains what to expect in 2010.



## Merchant John East *Securities*

In some respects STthree has lagged behind others in its peer group in the sense that its first half numbers, certainly at the NFI level, were not that bad relatively speaking due to a robust result from overseas markets. It follows that STthree could be one of the last to show signs of recovery; a view that is underpinned by the late deterioration in overseas activity compared to the UK.

As a consequence at this stage we do not envisage a recovery in the results for the group in 2010 with overall stability not being evidenced until mid year and with any global improvement unlikely to be apparent until Q4.

*Given the late cycle downturn in Europe STthree could be last into a recovery so we are not envisaging a recovery until Q4 of 2009/10*

### **Conclusion**

In consequence we initiate coverage with a Sell recommendation also reflecting the fact that in common with its large cap peers, the share price is already discounting a recovery, the quantum of which may still be two years away. Our price target is 200p.



Merchant John East  
Securities

Summary P&L				
Years to November	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Revenue</b>	<b>522.7</b>	<b>631.5</b>	<b>525.0</b>	<b>460.0</b>
<b>Net Fee Income (NFI)</b>	<b>182.7</b>	<b>218.9</b>	<b>170.0</b>	<b>145.5</b>
Administration expenses	-130.4	-162.1	-153.0	-135.0
Associates	0.0	0.0	0.0	0.0
<b>Operating Profit</b>	<b>52.3</b>	<b>56.8</b>	<b>17.0</b>	<b>10.5</b>
Separately disclosed items (SDI)	0.0	-2.0	-8.5	0.0
Finance income	0.0	0.0	0.6	0.6
Finance charge	-2.0	-0.8	-0.2	-0.1
<b>Profit before tax as stated</b>	<b>50.3</b>	<b>54.1</b>	<b>8.9</b>	<b>11.0</b>
IFRS 3 adjustment for amortisation of intangibles	0.0	0.0	0.0	0.0
Adjustment for SDIs	0.0	2.0	8.5	0.0
<b>Adjusted Profit before tax</b>	<b>50.3</b>	<b>56.0</b>	<b>17.4</b>	<b>11.0</b>
Tax	-16.5	-16.2	-3.0	-3.4
Post tax profit	33.8	37.8	5.9	7.6
Minorities	-1.2	-2.0	-0.5	-0.4
Net Profit	32.6	35.9	5.4	7.2
<b>Adjusted Net Profit</b>	<b>32.6</b>	<b>37.3</b>	<b>11.4</b>	<b>7.2</b>
<b>EBITDA</b>	<b>56.0</b>	<b>62.7</b>	<b>23.0</b>	<b>16.5</b>
Depreciation	-3.8	-5.9	-6.0	-6.0
<b>EBITA</b>	<b>52.3</b>	<b>56.8</b>	<b>17.0</b>	<b>10.5</b>
Amortisation of intangibles	0.0	0.0	0.0	0.0
<b>EBIT</b>	<b>52.3</b>	<b>56.8</b>	<b>17.0</b>	<b>10.5</b>
<b>Equity</b>				
Weighted average shares (m)	129.8	124.7	117.7	117.7
Weighted average shares FD (m)	135.7	127.7	121.1	121.1
Year end shares in issue (m)	138.3	121.7	121.7	121.7
<b>EPS</b>				
EPS FD (p)	24.1	28.1	4.5	5.9
<b>EPS FD and adjusted (p)</b>	<b>24.1</b>	<b>29.2</b>	<b>9.4</b>	<b>5.9</b>
<b>Dividend</b>				
Interim dividend (p)	3.1	4.0	4.0	4.0
Final dividend (p)	6.2	8.0	8.0	8.0
<b>Total dividend (p)</b>	<b>9.3</b>	<b>12.0</b>	<b>12.0</b>	<b>12.0</b>
<b>Key ratios</b>				
Market cap (£m)	309.4	309.4	309.4	309.4
Enterprise value (EV) (£m)	305.9	284.8	261.5	279.1
EV/NFI (x)	1.7	1.3	1.5	1.9
EV/EBITA (x)	5.9	5.0	15.4	26.6
Share price (p)	<b>254.0</b>			
PER (x)	10.6	8.7	26.9	42.8
Yield (%)	3.7	4.7	4.7	4.7

Source: Company accounts; MJES



Merchant John East  
Securities

P&L Analysis				
Years to November	2007	2008	2009 E	2010 E
<b>Analysis of revenue (by location of client)</b>				
	£m	£m	£m	£m
UK	369.7	386.9	290.0	275.0
Europe & RoW	153.0	244.6	235.0	185.0
ICT	469.9	535.2	425.0	380.0
Non-ICT	52.8	96.4	100.0	80.0
Contract	429.1	525.5	457.0	408.0
Perm	93.6	106.0	68.0	52.0
<b>Total Revenue</b>	<b>522.7</b>	<b>631.5</b>	<b>525.0</b>	<b>460.0</b>
<b>Analysis of NFI</b>				
UK	123.3	121.6	80.0	77.5
Europe & RoW	59.3	97.4	90.0	68.0
ICT	150.1	168.5	125.0	110.5
Non-ICT	32.5	50.5	45.0	35.0
Contract	89.1	113.1	102.0	93.5
Perm	93.5	105.8	68.0	52.0
<b>Total NFI</b>	<b>182.7</b>	<b>218.9</b>	<b>170.0</b>	<b>145.5</b>
<b>Analysis of operating profit</b>				
UK	44.5	27.4	8.0	7.5
Europe & RoW	7.8	29.4	9.0	3.0
<b>Total Operating Profit</b>	<b>52.3</b>	<b>56.8</b>	<b>17.0</b>	<b>10.5</b>
<b>NFI margin</b>				
UK	33.4%	31.4%	27.6%	28.2%
Europe & RoW	38.8%	39.8%	38.3%	36.8%
ICT	32.0%	31.5%	29.4%	29.1%
Non-ICT	61.6%	52.4%	45.0%	43.8%
Contract	20.8%	21.5%	22.3%	22.9%
Perm	99.9%	99.9%	100.0%	100.0%
<b>Group NFI margin</b>	<b>34.9%</b>	<b>34.7%</b>	<b>32.4%</b>	<b>31.6%</b>
<b>Operating margin</b>				
UK	12.0%	7.1%	1.5%	1.6%
Europe & RoW	5.1%	12.0%	6.3%	2.3%
<b>Group Operating margin</b>	<b>10.0%</b>	<b>9.0%</b>	<b>3.2%</b>	<b>2.3%</b>
<b>Key Ratios</b>				
EBITA margin	10.0%	9.0%	3.2%	2.3%
Administration costs as a % of revenue	24.9%	25.7%	29.1%	29.3%
Conversion of NFI into EBITA	28.6%	25.9%	10.0%	7.2%
Effective tax rate	32.8%	29.0%	31.0%	31.0%
Net interest cover by EBITDA (x)	-	-	-	-
Dividend cover by adjusted EPS (x)	2.6	2.4	0.8	0.5

Source: Company accounts; MJES



Merchant John East  
Securities

Summary Cash Flow				
Years to November	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
Net cash from operating activities	56.6	63.5	15.0	17.0
(Increase)/Decrease in trade and other receivables	-58.5	16.5	52.0	-5.0
(Decrease)/ Increase in trade and other payables	33.4	6.7	-15.0	-2.0
Increase/(Decrease) in provisions for liabilities and charges	-2.1	0.3	4.0	2.0
<b>Cash generated by operations</b>	<b>29.3</b>	<b>87.0</b>	<b>56.0</b>	<b>12.0</b>
Taxation paid	-2.1	-11.4	-14.0	-11.0
<b>Net cash generated by operating activities</b>	<b>27.2</b>	<b>75.5</b>	<b>42.0</b>	<b>1.0</b>
<b>Cash flow from investing activities:</b>				
Acquisition of subsidiaries (net of cash acquired)	0.0	0.0	0.0	0.0
Proceeds from the sale of subsidiary (net of cash disposed)	0.0	0.0	0.0	0.0
Purchase of PP&E	-5.2	-2.3	-2.5	-2.5
Purchase of intangible assets	-8.9	-3.9	-1.5	-2.0
Proceeds from sale of PP&E	0.0	0.0	0.0	0.0
Decrease/(increase) in short term deposits	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Net cash used in investing activities</b>	<b>-14.0</b>	<b>-6.2</b>	<b>-4.0</b>	<b>-4.5</b>
<b>Financing activities:</b>				
Purchase of own shares	-0.4	-31.3	0.0	0.0
Net movement in borrowings	0.0	-1.0	0.0	0.0
Dividends paid	-6.4	-12.1	-14.6	-14.6
Interest income	0.0	0.0	0.6	0.6
Interest paid	-2.0	-0.8	-0.2	-0.1
Issue of shares (net)	1.8	0.0	0.1	0.0
Capital element of finance lease rentals	0.0	0.0	0.0	0.0
Other	-0.0	-4.0	-0.6	0.0
<b>Net cash inflow from financing activities</b>	<b>-7.0</b>	<b>-49.2</b>	<b>-14.7</b>	<b>-14.1</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>6.2</b>	<b>20.1</b>	<b>23.3</b>	<b>-17.6</b>
Cash and cash equivalents at start of year	-1.8	4.5	24.6	47.9
FX changes	0.1	-0.1	0.0	0.0
<b>Cash and cash equivalents at end of year</b>	<b>4.5</b>	<b>24.6</b>	<b>47.9</b>	<b>30.3</b>
<b>Reconciliation of cash flow to net debt</b>				
Net (debt)/cash at start of the year	-2.8	3.5	24.6	47.9
Net increase in cash and cash equivalents	6.2	20.1	23.3	-17.6
Exchange losses on cash and cash equivalents	0.1	-0.1	0.0	0.0
Net change in borrowings during the year	0.0	1.0	0.0	0.0
<b>Net (debt)/cash at end of the year</b>	<b>3.5</b>	<b>24.6</b>	<b>47.9</b>	<b>30.3</b>
<b>Key Ratios</b>				
Free Cash Flow (£m)	18.8	62.6	27.2	-13.7
Free Cash Flow per share (p)	13.9	49.0	22.5	-11.3

Source: Company accounts; MJES

**Free Cash Flow:**

Cash flow from operating activities, less interest paid, less tax paid, less equity divs paid



Merchant John East  
Securities

Summary Balance Sheet				
Years to November	2007	2008	2009 E	2010 E
<b>Assets</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Non-current assets</b>				
PP&E	6.5	6.6	6.6	6.6
Goodwill	0.0	0.0	0.0	0.0
Other intangible assets	10.8	12.3	11.2	11.0
Deferred tax asset	3.1	3.1	6.0	5.0
Other	0.1	0.0	0.0	0.0
<b>Total non-current assets</b>	<b>20.4</b>	<b>22.0</b>	<b>23.8</b>	<b>22.6</b>
<b>Current assets</b>				
Trade and other receivables	151.1	139.9	87.9	92.9
Deferred tax assets	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Cash and short term deposits	4.8	24.6	47.9	30.3
<b>Total current assets</b>	<b>155.9</b>	<b>164.5</b>	<b>135.9</b>	<b>123.2</b>
<b>Total assets</b>	<b>176.3</b>	<b>186.5</b>	<b>159.7</b>	<b>145.8</b>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Trade and other payables	-73.2	-81.2	-66.2	-64.2
Taxation liabilities	-4.9	-10.8	-5.0	-3.0
Bank overdrafts and other short term borrowings	-1.3	0.0	0.0	0.0
Provisions	-0.3	-0.3	-1.5	-1.5
Other	0.0	0.0	0.0	0.0
<b>Total current liabilities</b>	<b>-79.6</b>	<b>-92.4</b>	<b>-72.7</b>	<b>-68.7</b>
<b>Non-current liabilities</b>				
Long term borrowings	0.0	1.0	2.0	3.0
Provisions	-3.3	-3.5	-3.5	-3.0
Deferred taxation liability	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Total non-current liabilities</b>	<b>-3.3</b>	<b>-3.5</b>	<b>-3.5</b>	<b>-3.0</b>
<b>Total liabilities</b>	<b>-82.9</b>	<b>-95.9</b>	<b>-76.2</b>	<b>-71.7</b>
<b>Net Assets</b>	<b>93.4</b>	<b>90.6</b>	<b>83.4</b>	<b>74.1</b>
<b>Key Ratios</b>				
Net cash/(debt) (£m)	3.5	24.6	47.9	30.3
Net debt/shareholders funds	-	-	-	-
Capital employed (£m)	99.3	98.5	92.4	82.6
ROCE	52.6%	57.7%	18.4%	12.7%
Current ratio	2.0	1.8	1.9	1.8

Source: Company accounts; MJES

**Capital Employed:**

Shareholders funds, add debt, add obligations under finance leases, add minorities, add provisions, less associates, less investments

**ROCE:**

Operating profit / Capital Employed



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# Merchant John East Securities

## EMPRESARIA GROUP PLC - Recommendation HOLD (28/05/09)

### Summary P&L

Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Revenue</b>	147.8	207.7	192.0	196.0
<b>NFI (Gross profit)</b>	42.4	51.5	39.0	39.3
Administration expenses	-35.5	-44.3	-35.2	-35.3
<b>Operating Profit</b>	6.9	7.2	3.8	4.0
Separately disclosed items (SDI)	-0.2	-4.8	-2.0	0.0
Finance income	0.3	0.3	0.1	0.1
Finance charge	-0.9	-1.3	-1.3	-1.0
Associates	-0.1	-0.1	0.0	0.0
<b>Profit before tax as stated</b>	6.0	1.3	0.6	3.1
IFRS 3 adjustment for amortisation of intangibles	0.1	0.3	0.4	0.4
Adjustment for SDIs	0.2	4.8	2.0	0.0
<b>Adjusted Profit before tax</b>	6.3	6.4	3.0	3.5
Tax	-1.9	-1.8	-0.9	-1.1
Post tax profit	4.1	-0.5	-0.3	2.0
Minorities	-1.6	-1.1	-0.5	-0.5
Net Profit	2.5	-1.6	-0.8	1.5
<b>Adjusted Net Profit</b>	2.8	3.5	1.6	1.9
<b>EBITDA</b>	7.7	8.3	5.2	5.4
Depreciation	-0.7	-0.8	-1.0	-1.0
<b>EBITA</b>	7.0	7.5	4.2	4.4
Amortisation of intangibles	-0.1	-0.3	-0.4	-0.4
<b>EBIT</b>	6.9	7.2	3.8	4.0
<b>Equity</b>				
Weighted average shares (m)	30,192	33,595	40,527	44,563
Weighted average shares FD (m)	30,192	33,595	40,527	44,563
Year end shares in issue (m)	33,369	34,277	44,563	44,563
<b>EPS</b>				
EPS FD (p)	8.4	-4.8	-2.0	3.4
<b>EPS FD and adjusted (p)</b>	9.4	8.6	3.1	4.3
<b>Dividend</b>				
Interim dividend (p)	0.00	0.00	0.00	0.00
Final dividend (p)	0.55	0.35	0.35	0.35
<b>Total dividend (p)</b>	0.55	0.35	0.35	0.35
<b>Key ratios</b>				
Market cap (£m)	15.8	15.8	15.8	15.8
Enterprise value (EV) (£m)	20.0	24.9	25.1	24.4
EV/NFI (x)	0.47	0.48	0.64	0.62
EV/EBITA (x)	2.87	3.32	5.97	5.59
<b>Share price (p)</b>	35.5			
PER (x)	3.8	4.1	11.3	8.4
Yield (%)	1.5%	1.0%	1.0%	1.0%

### P&L Analysis

Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Analysis of revenue</b>				
UK	81.2	83.6	80.0	77.0
Europe	52.4	92.1	87.0	85.0
Rest of the World	14.2	32.0	31.0	30.0
<b>Total Revenue</b>	147.8	207.7	198.0	192.0
<b>Analysis of NFI</b>				
UK	21.0	20.9	17.0	16.5
Europe	16.8	22.9	18.9	18.5
Rest of the World	4.6	7.7	6.5	6.2
<b>Total NFI</b>	42.4	51.5	42.4	41.2
<b>Analysis of operating profit</b>				
UK	4.0	3.8	2.3	1.9
Europe	2.5	3.0	2.0	1.8
Rest of the World	0.4	0.7	0.4	0.4
<b>Total Operating Profit</b>	6.9	7.5	4.7	4.1
<b>NFI margin</b>				
UK	25.8%	25.0%	21.3%	21.4%
Europe	32.1%	24.9%	21.7%	21.8%
Rest of the World	32.1%	24.1%	21.0%	20.7%
<b>Group NFI margin</b>	28.6%	24.8%	21.4%	21.5%
<b>Operating margin</b>				
UK	4.9%	4.5%	2.9%	2.5%
Europe	4.8%	3.3%	2.3%	2.1%
Rest of the World	2.8%	2.2%	1.3%	1.3%
<b>Group Operating margin</b>	4.7%	3.6%	2.4%	2.1%
<b>Conversion ratio</b>				
UK	19.1%	18.2%	13.5%	11.5%
Europe	14.9%	13.1%	10.6%	9.7%
Rest of the World	8.8%	9.1%	6.2%	6.5%
<b>Group conversion ratio</b>	16.3%	14.6%	11.1%	10.0%
<b>Key Ratios</b>				
EBITA margin	4.7%	3.6%	2.2%	2.2%
Administration costs as a % of revenue	24.0%	21.3%	18.3%	18.0%
Conversion of NFI into EBITA	16.5%	14.6%	10.8%	11.1%
Effective tax rate	29.9%	28.1%	31.0%	31.0%
Net interest cover by EBITDA (x)	13.4	8.3	4.3	6.0
Dividend cover by adjusted EPS (x)	17.0	24.7	9.0	12.1

### Summary Cash Flow

Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
Net cash from operating activities	7.6	7.0	4.2	5.4
(Increase)/Decrease in trade and other receivables	-5.1	1.1	0.0	1.0
(Decrease)/Increase in trade and other payables	-0.1	-4.3	-2.0	-2.5
Decrease in provisions for liabilities and charges	0.0	0.0	0.0	0.0
<b>Cash generated by operations</b>	2.4	3.8	2.2	3.9
Taxation paid	-1.4	-1.8	-0.9	-1.1
<b>Net cash generated by operating activities</b>	1.0	2.0	1.3	2.8
<b>Cash flow from investing activities:</b>				
Interest received	0.1	0.3	0.1	0.1
Acquisition of subsidiaries (net of cash acquired)	-9.7	-1.5	-0.6	-0.2
Proceeds from the sale of subsidiary (net of cash disposed)	0.0	0.0	0.0	0.0
Purchase of PP&E	-1.1	-0.5	-0.6	-0.5
Purchase of intangible assets	0.0	0.0	0.0	0.0
Proceeds from sale of PP&E	0.0	0.0	0.0	0.0
Decrease/(increase) in short term deposits	-0.4	-0.8	0.0	0.0
Other	-1.8	-4.3	-0.2	0.0
<b>Net cash used in investing activities</b>	-12.9	-6.8	-1.3	-0.6
<b>Financing activities:</b>				
Purchase of own shares	0.0	0.0	0.0	0.0
Net movement in borrowings	2.5	7.6	-0.2	-0.3
Dividends paid	-0.6	-1.0	-0.5	-0.6
Interest paid	-0.8	-1.3	-1.3	-1.0
Issue of shares (net)	11.5	0.0	2.7	0.0
Capital element of finance lease rentals	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Net cash inflow from financing activities</b>	12.6	5.3	0.7	-1.9
<b>Net increase in cash and cash equivalents</b>	0.8	0.5	0.7	0.3
Cash and cash equivalents at start of year	3.3	4.1	5.7	5.4
FX changes	0.0	1.1	-1.0	0.0
<b>Cash and cash equivalents at end of year</b>	4.1	5.7	5.4	5.7
<b>Reconciliation of cash flow to net debt</b>				
Net (debt)/cash at start of the year	-1.4	-4.2	-9.1	-9.2
Net increase in cash and cash equivalents	0.8	0.5	0.7	0.3
Net change in borrowings during the year	-3.6	-5.9	0.2	0.3
<b>Net (debt)/cash at end of the year</b>	-4.2	-9.1	-9.2	-8.6
<b>Key Ratios</b>				
Free Cash Flow (£m)	-0.4	-0.3	-0.5	1.2
Free Cash Flow per share (p)	-1.2	-0.9	-1.4	2.8

### Free Cash Flow:

Cash flow from operating activities, less interest paid, less tax paid, less equity divs paid

### Summary Balance Sheet

Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>ASSETS</b>				
<b>Non-current assets</b>				
PP&E	1.9	2.3	2.0	2.3
Goodwill	22.0	30.6	31.9	28.0
Other intangible assets	2.7	3.2	3.0	3.0
Deferred tax asset	0.9	0.4	0.4	0.4
Other	1.0	0.1	0.1	0.1
<b>Total non-current assets</b>	28.5	36.6	37.4	33.8
<b>Current assets</b>				
Trade and other receivables	32.5	33.5	33.5	32.5
Deferred tax assets	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Cash and short term deposits	4.1	5.7	5.4	5.4
<b>Total current assets</b>	36.6	39.2	38.9	37.9
<b>Total assets</b>	65.1	75.8	76.3	71.7
<b>LIABILITIES</b>				
<b>Current liabilities</b>				
Trade and other payables	-24.8	-25.6	-23.6	-21.1
Taxation liabilities	-2.1	-2.6	-2.0	-2.0
Bank overdrafts and other short term borrowings	-6.2	-5.4	-5.3	-5.0
Provisions	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Total current liabilities</b>	-33.1	-33.6	-30.9	-28.1
<b>Non-current liabilities</b>				
Long term borrowings	-2.1	-9.4	-9.3	-9.0
Provisions	0.0	0.0	0.0	0.0
Deferred taxation liability	-0.9	-0.6	-0.6	-0.6
Other	0.0	0.0	0.0	0.0
<b>Total non-current liabilities</b>	-3.0	-10.0	-9.9	-9.6
<b>Total liabilities</b>	-36.0	-43.6	-40.8	-37.7
<b>Net Assets</b>	29.1	32.2	35.5	34.0
<b>Key Ratios</b>				
Net cash/(debt) (£m)	-4.2	-9.1	-9.2	-8.6
Net debt/shareholders funds	14.5%	28.3%	26.1%	25.3%
Capital employed (£m)	36.3	44.2	47.5	45.3
ROCE	19.0%	16.3%	8.0%	8.8%
Current ratio	1.1	1.2	1.3	1.3

### Capital Employed:

Shareholders funds, add debt, add obligations under finance leases, add minorities, add provisions, less associates, less investments

### ROCE:

Operating profit / Capital Employed



# Merchant John East Securities

## HEALTHCARE LOCUMS plc - Recommendation Buy (06/02/09)

### Summary P&L

Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Revenue</b>	<b>134.9</b>	<b>166.4</b>	<b>202.0</b>	<b>224.0</b>
<b>Gross profit (NFI)</b>	<b>31.2</b>	<b>45.0</b>	<b>63.6</b>	<b>75.6</b>
Administration expenses	-17.2	-25.0	-31.0	-32.7
Share based payments	-0.1	-0.4	-0.5	-0.6
<b>Operating Profit</b>	<b>14.0</b>	<b>20.0</b>	<b>32.6</b>	<b>42.9</b>
Exceptionals	-3.7	-1.4	-0.6	0.0
Finance income	0.0	0.1	0.0	0.0
Finance charge	-3.0	-2.9	-1.3	-0.5
<b>Profit before tax as stated</b>	<b>7.4</b>	<b>15.8</b>	<b>30.7</b>	<b>42.4</b>
IFRS3 Adjustment for amortisation of intangibles	1.0	1.6	1.3	1.3
Adjustment for exceptionals	3.7	1.4	0.6	0.0
<b>Adjusted Profit before tax</b>	<b>12.1</b>	<b>18.7</b>	<b>32.0</b>	<b>43.0</b>
Tax	-2.1	-4.2	-9.2	-12.7
Post tax profit	5.3	11.6	21.5	29.7
Minorities	0.0	0.0	0.0	0.0
<b>Net Profit</b>	<b>5.3</b>	<b>11.6</b>	<b>21.5</b>	<b>29.7</b>
<b>Adjusted Net Profit</b>				
<b>EBITDA</b>	<b>15.8</b>	<b>22.6</b>	<b>35.1</b>	<b>45.5</b>
Depreciation	-0.6	-0.6	-0.7	-0.7
<b>EBITA</b>	<b>15.2</b>	<b>22.0</b>	<b>34.4</b>	<b>44.8</b>
Amortisation	-1.0	-1.6	-1.3	-1.3
<b>EBIT</b>	<b>14.1</b>	<b>20.4</b>	<b>33.1</b>	<b>43.5</b>
<b>Equity</b>				
Weighted average shares	96,909	103,310	104,400	105,000
Weighted average shares FD	97,392	103,621	106,000	107,000
Year end shares in issue	100,473	104,272	104,668	105,000
<b>EPS</b>				
EPS FD (p)	5.4	11.2	20.3	27.7
<b>EPS FD and adjusted (p)</b>	<b>8.5</b>	<b>12.6</b>	<b>21.5</b>	<b>28.3</b>
<b>Dividend</b>				
Interim dividend (p)	0.00	0.80	1.30	2.60
Final dividend (p)	1.00	1.20	2.70	5.40
<b>Total dividend (p)</b>	<b>1.00</b>	<b>2.00</b>	<b>4.00</b>	<b>8.00</b>
<b>Key ratios</b>				
Market cap (£m)	276.1	276.1	276.1	276.1
Enterprise value (EV) (£m)	311.4	303.0	290.1	270.1
EV/NFI (x)	10.0	6.7	4.6	3.6
EV/EBITA (x)	20.5	13.8	8.4	6.0
<b>Share price (p)</b>	<b>263.75</b>			
PER (x)	31.1	20.9	12.3	9.3
Yield (%)	0.4	0.8	1.5	3.0

Source: Company accounts; MJES estimates

### P&L Analysis

Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Analysis of revenue</b>				
Doctors Locums	50.4	55.6	65.0	70.0
Qualified Social Workers	43.1	46.1	52.0	56.0
Allied Health Professionals	37.4	59.4	71.0	75.0
UK Permanent Placement	1.5	1.4	2.0	2.0
International Permanent Placement	2.5	3.9	12.0	21.0
<b>Total Revenue</b>	<b>134.9</b>	<b>166.4</b>	<b>202.0</b>	<b>224.0</b>
<b>Analysis of NFI</b>				
Doctors Locums	7.5	12.6	15.0	16.2
Qualified Social Workers	9.3	9.8	12.0	13.0
Allied Health Professionals	10.8	18.1	25.0	26.5
UK Permanent Placement	1.5	1.4	2.0	2.0
International Permanent Placement	2.1	3.1	9.6	18.0
<b>Total NFI</b>	<b>31.2</b>	<b>45.0</b>	<b>63.6</b>	<b>75.6</b>
<b>NFI margin</b>				
Doctors Locums	14.9%	22.7%	23.1%	23.1%
Qualified Social Workers	21.6%	21.3%	23.1%	23.1%
Allied Health Professionals	28.9%	30.5%	35.2%	35.3%
UK Permanent Placement	100.0%	100.0%	100.0%	100.0%
International Permanent Placement	84.0%	79.5%	80.0%	85.7%
<b>Group NFI margin</b>	<b>23.1%</b>	<b>27.1%</b>	<b>31.5%</b>	<b>33.8%</b>
<b>Key Ratios</b>				
EBITA margin	11.2%	13.2%	17.0%	20.0%
Administration costs as a % of revenue	12.8%	15.0%	15.3%	14.6%
Conversion of NFI into EBITA	48.6%	48.8%	54.1%	59.3%
Effective tax rate	17.7%	22.3%	28.8%	29.6%
Net interest cover by EBITDA (x)	5.4	7.9	27.0	91.0
Dividend cover by adjusted EPS (x)	8.5	6.3	5.4	3.5

Source: Company accounts; MJES estimates

### Summary Cash Flow

Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
Net cash from operating activities	12.1	21.2	34.5	45.5
Increase in trade and other receivables	-5.8	-2.2	-2.0	-3.0
Increase in trade and other payables	-0.0	-1.2	-1.0	-2.0
Other	0.0	0.0	0.0	0.0
<b>Cash generated by operations</b>	<b>6.2</b>	<b>17.8</b>	<b>31.5</b>	<b>38.5</b>
Taxation paid	-0.5	-0.1	-8.7	-9.0
<b>Net cash generated by operating activities</b>	<b>5.7</b>	<b>17.6</b>	<b>22.8</b>	<b>29.5</b>
<b>Cash flow from investing activities:</b>				
Interest received	0.0	0.0	0.0	0.0
Acquisition of subsidiaries (net of cash acquired)	-15.8	-3.7	0.0	0.0
Proceeds from the sale of subsidiary (net of cash disposed)	0.0	0.0	0.0	0.0
Purchase of PP&E	-0.6	-0.4	-0.5	-0.5
Purchase of intangible assets	-3.6	-4.6	-6.0	-3.0
Proceeds from sale of PP&E	0.0	0.2	0.0	0.0
Decrease/(increase) in short term deposits	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Net cash used in investing activities</b>	<b>-19.9</b>	<b>-8.4</b>	<b>-6.5</b>	<b>-3.5</b>
<b>Financing activities:</b>				
Purchase of own shares	0.0	3.1	0.0	0.0
Net movement in borrowings	4.0	-3.6	-3.0	-3.0
Dividends paid	0.0	-1.0	-2.1	-5.6
Interest paid	-2.9	-2.9	-1.3	-0.5
Issue of shares (net)	4.6	0.0	0.0	0.0
Capital element of finance lease rentals	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Net cash inflow from financing activities</b>	<b>5.7</b>	<b>-4.5</b>	<b>-6.4</b>	<b>-9.1</b>
<b>Net increase in cash and cash equivalents</b>	<b>-8.5</b>	<b>4.8</b>	<b>9.9</b>	<b>16.9</b>
Cash at start of year	-7.4	-15.9	-11.1	-1.2
FX changes	0.0	0.0	0.0	0.0
<b>Cash and cash equivalents at end of year</b>	<b>-15.9</b>	<b>-11.1</b>	<b>-1.2</b>	<b>15.7</b>
<b>Reconciliation of cash flow to net debt</b>				
Net debt at start of the year	-22.8	-35.3	-26.9	-14.0
Net increase/(decrease) in cash and cash equivalents	-8.5	4.8	9.9	16.9
Net change in borrowings	-4.0	3.6	3.0	3.0
<b>Net debt at end of the year</b>	<b>-35.3</b>	<b>-26.9</b>	<b>-14.0</b>	<b>5.9</b>
<b>Key Ratios</b>				
Free Cash Flow (£m)	2.8	13.7	19.4	23.4
Free Cash Flow per share (p)	2.8	13.3	18.3	21.9

Source: Company accounts; MJES estimates

### Free Cash Flow:

Cash flow from operating activities, less interest paid, less tax paid, less equity divs paid

### Summary Balance Sheet

Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>ASSETS</b>				
<b>Non-current assets</b>				
PP&E	1.6	1.2	1.6	1.6
Goodwill	60.2	60.3	61.0	61.0
Other intangible assets	8.4	11.4	9.5	9.5
Other	0.0	0.2	0.0	0.0
<b>Total non-current assets</b>	<b>70.2</b>	<b>73.0</b>	<b>72.1</b>	<b>72.1</b>
<b>Current assets</b>				
Trade and other receivables	31.2	33.4	35.4	40.4
Deferred tax assets	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Cash and short term deposits	1.1	0.5	3.0	10.6
<b>Total current assets</b>	<b>32.3</b>	<b>33.9</b>	<b>38.4</b>	<b>51.0</b>
<b>Total Assets</b>	<b>102.5</b>	<b>106.9</b>	<b>110.5</b>	<b>123.1</b>
<b>LIABILITIES</b>				
<b>Current liabilities</b>				
Trade and other payables	-9.9	-10.0	-9.0	-7.0
Taxation liabilities	-1.3	-5.1	-9.2	-12.7
Bank overdrafts and other short term borrowings	-20.8	-16.9	-13.5	-6.0
Provisions	-4.9	-1.2	-2.0	-2.0
Other	0.0	0.0	0.0	0.0
<b>Total current liabilities</b>	<b>-36.9</b>	<b>-33.2</b>	<b>-33.8</b>	<b>-27.8</b>
<b>Non-current liabilities</b>				
Long term borrowings	-15.7	-11.5	-5.0	-3.2
Provisions	-0.9	0.0	0.0	0.0
Other	-1.8	-1.8	-2.0	-2.0
<b>Total non-current liabilities</b>	<b>-18.4</b>	<b>-13.3</b>	<b>-7.0</b>	<b>-5.2</b>
<b>Total liabilities</b>	<b>-55.3</b>	<b>-46.5</b>	<b>-40.8</b>	<b>-32.9</b>
<b>Net Assets</b>	<b>47.2</b>	<b>60.4</b>	<b>69.7</b>	<b>90.2</b>
<b>Key Ratios</b>				
Net cash/(debt) (£m)	-35.3	-26.9	-14.0	5.9
Net debt/shareholders funds	74.8%	44.6%	20.1%	-
Capital employed (£m)	88.3	88.5	85.7	86.2
ROCE	15.9%	22.6%	38.0%	49.7%
Current ratio	0.87	1.02	1.14	1.84

Source: Company accounts; MJES estimates

### Capital Employed:

Shareholders funds, add debt, add obligations under finance leases, add minorities, add provisions, less associates, less investments

### ROCE:

Operating profit / Capital Employed



# Merchant John East Securities

## IMPELLAM GROUP PLC - Recommendation BUY (25/8/09)

Summary P&L	pro forma	pro forma	2009 E	2010 E
Years to December	2007	2008	2009 E	2010 E
* Denotes pro forma figures	£m	£m	£m	£m
<b>Revenue</b>	<b>975.3</b>	<b>1,070.0</b>	<b>1,015.0</b>	<b>1,033.0</b>
<b>Gross profit (NFI)</b>	<b>186.3</b>	<b>189.6</b>	<b>164.9</b>	<b>167.3</b>
Administration expenses	-170.8	-177.7	-153.0	-153.0
Associates	0.0	0.0	0.0	0.0
<b>Operating Profit</b>	<b>15.5</b>	<b>11.9</b>	<b>11.9</b>	<b>14.3</b>
Exceptionals	-19.8	-12.0	-4.3	0.0
Amortisation of customer relationships	0.0	-2.7	-3.4	-3.0
Finance income	0.5	0.5	0.8	0.8
Finance charge	-6.2	-5.7	-5.0	-5.0
<b>Profit before tax as stated</b>	<b>-12.4</b>	<b>-12.1</b>	<b>0.0</b>	<b>7.1</b>
IFRS3 Adjustment for amortisation of intangibles	0.0	2.7	3.4	3.0
Adjustment for exceptional	19.8	12.0	4.3	0.0
<b>Adjusted Profit before tax</b>	<b>9.7</b>	<b>6.7</b>	<b>7.7</b>	<b>10.1</b>
Tax	1.0	-1.0	-2.3	-3.0
Post tax profit	-11.4	-13.1	-2.3	4.1
Minorities	0.0	0.0	0.0	0.0
<b>Net Profit</b>	<b>-11.4</b>	<b>-13.1</b>	<b>-2.3</b>	<b>4.1</b>
<b>Adjusted Net Profit</b>	<b>8.4</b>	<b>1.6</b>	<b>5.4</b>	<b>7.1</b>
<b>EBITDA</b>	<b>20.2</b>	<b>19.7</b>	<b>19.0</b>	<b>20.9</b>
Depreciation	-3.1	-3.7	-3.7	-3.6
<b>EBITA</b>	<b>17.1</b>	<b>16.0</b>	<b>15.3</b>	<b>17.3</b>
Amortisation	-1.6	-4.1	-3.4	-3.0
<b>EBIT</b>	<b>15.5</b>	<b>11.9</b>	<b>11.9</b>	<b>14.3</b>
<b>Equity</b>				
Weighted average shares	45,000	45,000	45,000	45,000
Weighted average shares FD	45,000	45,000	45,000	45,000
Year end shares in issue	45,000	45,000	45,000	45,000
<b>EPS</b>				
EPS FD (p)	-25.3	-29.1	-5.1	9.1
<b>EPS FD and adjusted (p)</b>	<b>19.6</b>	<b>3.8</b>	<b>12.0</b>	<b>15.8</b>
<b>Dividend</b>				
Interim dividend (p)	0.00	0.00	0.00	0.00
Final dividend (p)	0.00	0.00	0.00	0.00
<b>Total dividend (p)</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>
<b>Key ratios</b>				
Market cap (£m)	29.9	29.9	29.9	29.9
Enterprise value (EV) (£m)	93.2	91.7	84.5	75.1
EV/NFI (x)	0.5	0.5	0.5	0.4
EV/EBITA (x)	5.5	5.7	5.5	4.3
<b>Share price (p)</b>	<b>66.5</b>			
PER (x)	3.4	17.6	5.6	4.2
Yield (%)	0.0	0.0	0.0	0.0

Summary P&L Analysis	pro forma	pro forma	2009 E	2010 E
Years to December	2007	2008	2009 E	2010 E
* Denotes pro forma figures	£m	£m	£m	£m
<b>Analysis of revenue</b>				
UK Commercial Staffing	407.4	457.4	440.0	427.0
UK Professional & Technical Staffing	151.4	177.1	160.0	155.0
UK Healthcare Staffing	110.1	143.9	148.0	155.0
US Commercial Staffing	187.8	175.8	140.0	135.0
Support Services	119.3	116.9	120.0	115.0
Inter company revenue	-0.7	-1.1	0.0	0.0
<b>Total Revenue</b>	<b>975.3</b>	<b>1,070.0</b>	<b>1,008.0</b>	<b>987.0</b>
<b>Analysis of NFI</b>				
UK Commercial Staffing	75.0	77.0	70.0	67.0
UK Professional & Technical Staffing	31.9	33.1	28.0	27.0
UK Healthcare Staffing	19.1	22.3	23.5	25.0
US Commercial Staffing	37.7	35.9	22.1	20.0
Support Services	22.6	21.3	18.0	17.0
<b>Total NFI</b>	<b>186.3</b>	<b>189.6</b>	<b>161.6</b>	<b>156.7</b>
<b>Analysis of operating profit</b>				
UK Commercial Staffing	6.3	6.8	3.9	3.0
UK Professional & Technical Staffing	3.0	2.1	2.0	1.8
UK Healthcare Staffing	3.8	5.8	6.2	6.4
US Commercial Staffing	4.7	0.7	-1.5	-1.0
Support Services	3.5	1.4	1.0	0.6
Central costs	-5.8	-4.9	-3.0	-2.5
<b>Total Operating Profit</b>	<b>15.5</b>	<b>11.9</b>	<b>8.6</b>	<b>8.3</b>
<b>NFI margin</b>				
UK Commercial Staffing	18.4%	16.8%	15.9%	15.9%
UK Professional & Technical Staffing	21.1%	18.7%	17.5%	17.4%
UK Healthcare Staffing	17.3%	15.5%	15.9%	16.1%
US Commercial Staffing	20.1%	20.4%	15.8%	14.8%
Support Services	18.9%	18.2%	15.0%	14.8%
<b>Group NFI margin</b>	<b>19.1%</b>	<b>17.7%</b>	<b>16.0%</b>	<b>15.9%</b>
<b>Operating margin</b>				
UK Commercial Staffing	1.5%	1.5%	0.9%	0.7%
UK Professional & Technical Staffing	2.0%	1.2%	1.3%	1.1%
UK Healthcare Staffing	3.5%	4.0%	4.2%	4.1%
US Commercial Staffing	2.5%	0.4%	-1.1%	-0.7%
Support Services	2.9%	1.2%	0.8%	0.5%
<b>Group Operating margin</b>	<b>1.6%</b>	<b>1.1%</b>	<b>0.9%</b>	<b>0.8%</b>
<b>Key Ratios</b>				
EBITA margin	1.8%	1.5%	1.5%	1.7%
Administration costs as a % of revenue	17.5%	16.6%	15.1%	14.8%
Conversion of NFI into EBITA	9.2%	8.4%	9.3%	10.4%
Effective tax rate	G	14.9%	30.0%	30.0%
Net interest cover by EBITDA (x)	3.5	3.8	4.5	5.0
Dividend cover by adjusted EPS (x)	n/a	n/a	n/a	n/a

Summary Cash Flow	pro forma	pro forma	2009 E	2010 E
Years to December	2007	2008	2009 E	2010 E
* Denotes pro forma figures	£m	£m	£m	£m
<b>Net cash from operating activities</b>	<b>20.5</b>	<b>5.0</b>	<b>16.1</b>	<b>22.3</b>
Increase in trade and other receivables	-32.4	16.7	5.0	3.0
Increase in trade and other payables	27.3	-6.8	-3.0	-5.0
Decrease in provisions for liabilities and charges	-1.1	-1.0	-2.0	-2.0
<b>Cash generated by operations</b>	<b>14.3</b>	<b>13.9</b>	<b>16.1</b>	<b>18.3</b>
Taxation paid	-0.6	-0.6	-1.0	-1.0
<b>Net cash generated by operating activities</b>	<b>13.7</b>	<b>13.3</b>	<b>15.1</b>	<b>17.3</b>
<b>Cash flow from investing activities:</b>				
Interest received	0.3	0.4	0.8	0.8
Acquisition of subsidiaries (net of cash acquired)	-3.1	-1.9	0.0	0.0
Proceeds from the sale of subsidiary (net of cash disposed)	0.4	0.0	0.0	0.0
Purchase of PP&E	-3.6	-3.8	-2.5	-2.5
Purchase of intangible assets	-1.6	-2.4	-1.0	-1.0
Proceeds from sale of PP&E	0.1	0.0	0.0	0.0
Decrease/(increase) in short term deposits	0.2	0.4	0.0	0.0
Other				
<b>Net cash used in investing activities</b>	<b>-7.3</b>	<b>-9.8</b>	<b>-2.7</b>	<b>-2.7</b>
<b>Financing activities:</b>				
Purchase of own shares	-0.3	0.0	0.0	0.0
Net movement in other long term borrowings	-2.4	-10.9	0.0	0.0
Net movement in short term borrowings	6.4	10.8	-9.0	-8.0
Dividends paid	-3.0	-4.0	0.0	0.0
Interest paid	-5.6	-4.8	-5.0	-5.0
Issue of shares (net)	0.0	0.0	0.0	0.0
Capital element of finance lease rentals	-0.3	-0.2	-0.2	-0.2
Other	-0.8	0.0	0.0	0.0
<b>Net cash inflow from financing activities</b>	<b>-6.0</b>	<b>-9.1</b>	<b>-14.2</b>	<b>-13.2</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>0.4</b>	<b>-5.6</b>	<b>-1.8</b>	<b>1.4</b>
Cash at start of year	5.5	5.9	5.5	5.5
FX changes	0.0	4.2	0.0	0.0
<b>Cash and cash equivalents at end of year</b>	<b>5.9</b>	<b>4.5</b>	<b>3.7</b>	<b>6.9</b>
<b>Reconciliation of cash flow to net debt</b>				
Net debt at start of year	-59.7	-63.3	-61.8	-54.6
Net cash increase in cash and cash equivalents	0.4	-5.5	-1.8	1.4
Net change in borrowings	-4.0	7.0	9.0	8.0
<b>Net debt at end of year</b>	<b>-63.3</b>	<b>-61.8</b>	<b>-54.6</b>	<b>-45.2</b>
<b>Key Ratios</b>				
Free Cash Flow (£m)	8.1	8.5	10.1	12.3
Free Cash Flow per share (p)	0.2	0.2	0.2	0.3

**Free Cash Flow:**  
Net cash flow from operating activities, less interest paid, less tax paid, less equity divs paid

Summary Balance Sheet	pro forma	pro forma	2009 E	2010 E
Years to December	2007	2008	2009 E	2010 E
* Denotes pro forma figures	£m	£m	£m	£m
<b>Assets</b>				
<b>Non-current assets</b>				
PP&E	10.0	8.6	7.9	8.6
Goodwill	83.7	59.9	59.9	59.9
Other intangible assets	3.0	55.0	53.4	51.1
Deferred tax asset	1.3	4.0	4.3	4.0
Financial assets	4.8	4.8	4.2	4.8
Other	0.0	0.0	0.0	0.0
<b>Total non-current assets</b>	<b>102.8</b>	<b>132.3</b>	<b>129.7</b>	<b>128.4</b>
<b>Current assets</b>				
Trade and other receivables	189.5	185.4	180.4	177.4
Deferred tax assets	0.2	0.3	0.0	0.0
Other	0.0	0.0	0.0	0.0
Cash and short term deposits	8.3	11.3	11.0	15.0
<b>Total current assets</b>	<b>198.0</b>	<b>197.0</b>	<b>191.4</b>	<b>192.4</b>
<b>Total assets</b>	<b>300.8</b>	<b>329.3</b>	<b>321.1</b>	<b>320.8</b>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Trade and other payables	-141.2	-147.5	-144.5	-139.5
Taxation liabilities	-0.6	-0.3	0.0	0.0
Bank overdrafts and other short term borrowings	-39.6	-51.5	-48.0	-45.5
Derivative financial instruments	-0.1	-0.5	0.5	0.0
Provisions	0.0	-6.3	-4.7	-0.3
Other	0.0	0.0	0.0	0.0
<b>Total current liabilities</b>	<b>-181.5</b>	<b>-207.1</b>	<b>-196.7</b>	<b>-185.3</b>
<b>Non-current liabilities</b>				
Long term borrowings	-32.0	-21.6	-17.6	-14.7
Other payables due in greater than one year	-1.3	-2.0	-0.6	0.0
Provisions	-1.2	-8.4	-9.0	0.0
Deferred taxation liability	0.0	-15.0	-15.0	-15.0
Other	0.0	0.0	0.0	0.0
<b>Total non-current liabilities</b>	<b>-34.5</b>	<b>-47.0</b>	<b>-42.2</b>	<b>-29.7</b>
<b>Total liabilities</b>	<b>-216.0</b>	<b>-254.1</b>	<b>-238.9</b>	<b>-215.0</b>
<b>Net Assets</b>	<b>84.8</b>	<b>75.2</b>	<b>82.2</b>	<b>105.8</b>
<b>Key Ratios</b>				
Net cash/(debt) (£m)	-63.3	-61.8	-54.6	-45.2
Net debt/shareholders funds	76.4%	82.2%	66.4%	42.7%
Capital employed (£m)	147.3	151.7	150.5	151.3
ROCE	10.5%	7.8%	7.9%	9.5%
Current ratio	1.08	0.95	0.97	1.04

**Capital Employed:**  
Shareholders funds, add debt, add obligations under finance leases, add  
**ROCE:**  
Operating profit / Capital Employed

Source: Company accounts; MJES estimates



# Merchant John East Securities

## INTERQUEST GROUP PLC - Recommendation HOLD (28/5/09)

### Summary P&L

Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Revenue</b>	<b>86.8</b>	<b>105.5</b>	<b>93.9</b>	<b>95.5</b>
<b>NFI (Gross profit)</b>	<b>12.9</b>	<b>15.3</b>	<b>11.7</b>	<b>11.5</b>
Administration expenses	-9.2	-11.0	-9.4	-9.2
Associates	0.0	0.0	0.0	0.0
<b>Operating Profit</b>	<b>3.7</b>	<b>4.3</b>	<b>2.3</b>	<b>2.3</b>
Exceptionals	0.0	0.0	0.0	0.0
Finance income	0.0	0.0	0.0	0.0
Finance charge	-0.5	-0.6	-0.2	-0.1
<b>Profit before tax as stated</b>	<b>3.1</b>	<b>3.7</b>	<b>2.1</b>	<b>2.2</b>
Adjustment for amortisation of intangibles	0.7	1.0	1.0	1.0
Adjustment for exceptionals	0.0	0.0	0.0	0.0
<b>Adjusted Profit before tax</b>	<b>3.9</b>	<b>4.7</b>	<b>3.1</b>	<b>3.2</b>
Tax	-0.7	-1.0	-0.6	-0.7
Post tax profit	2.4	2.7	1.5	1.5
Minorities	0.0	0.0	0.0	0.0
Net Profit	2.4	2.7	1.5	1.5
<b>Adjusted Net Profit</b>	<b>3.2</b>	<b>3.7</b>	<b>2.5</b>	<b>2.5</b>
<b>EBITDA</b>	<b>4.7</b>	<b>5.6</b>	<b>3.6</b>	<b>3.6</b>
Depreciation	-0.2	-0.2	-0.2	-0.2
<b>EBITA</b>	<b>4.5</b>	<b>5.4</b>	<b>3.4</b>	<b>3.4</b>
Amortisation of intangibles	-0.7	-1.0	-1.0	-1.0
<b>EBIT</b>	<b>3.8</b>	<b>4.4</b>	<b>2.4</b>	<b>2.4</b>
<b>Equity</b>				
Weighted average shares (m)	29.299	30.439	30.439	30.600
Weighted average shares FD (m)	32.359	32.303	32.303	32.500
Year end shares in issue (m)	30.103	30.103	30.578	30.578
<b>EPS</b>				
EPS FD (p)	7.5	8.5	4.5	4.7
<b>EPS FD and adjusted (p)</b>	<b>9.8</b>	<b>11.6</b>	<b>7.6</b>	<b>7.8</b>
<b>Dividend</b>				
Interim dividend (p)	0.00	0.00	1.00	1.00
Final dividend (p)	0.00	1.00	1.00	1.00
<b>Total dividend (p)</b>	<b>0.00</b>	<b>1.00</b>	<b>2.00</b>	<b>2.00</b>

Key ratios	2007	2008	2009 E	2010 E
Market cap (£m)	14.2	14.2	14.2	14.2
Enterprise value (EV) (£m)	23.5	19.8	16.3	14.0
EV/NFI (x)	1.8	1.3	1.4	1.2
EV/EBITA (x)	5.2	3.7	4.8	4.1
<b>Share price (p)</b>	<b>46.5</b>			
PER (x)	4.8	4.0	6.1	5.9
Yield (%)	0.0	2.2	4.3	4.3

Key Ratios	2007	2008	2009 E	2010 E
NFI margin	14.9%	14.5%	12.5%	12.0%
EBITA margin	5.2%	5.1%	3.6%	3.6%
Administration costs as a % of revenue	10.6%	10.5%	10.0%	9.6%
Conversion of NFI into EBITA	34.9%	35.2%	29.1%	29.6%
Effective tax rate	18.7%	20.9%	20.5%	20.5%
Net interest cover by EBITDA (x)	8.7	10.2	18.0	36.0
Dividend cover by adjusted EPS (x)	n/a	11.6	3.8	3.9

### Summary Cash Flow

Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
Net cash from operating activities	4.7	5.6	3.6	3.6
Decrease/(Increase) in trade and other receivables	-2.2	1.6	2.5	1.5
Increase/(Decrease) in trade and other payables	0.9	-1.0	0.1	-0.5
Decrease in provisions for liabilities and charges	0.0	0.0	0.0	0.0
<b>Cash generated by operations</b>	<b>3.3</b>	<b>6.3</b>	<b>6.2</b>	<b>4.6</b>
Taxation paid	-0.6	-1.4	-1.3	-1.3
<b>Net cash generated by operating activities</b>	<b>2.7</b>	<b>4.9</b>	<b>4.9</b>	<b>3.3</b>
<b>Cash flow from investing activities:</b>				
Interest received	0.0	0.0	0.0	0.0
Acquisition of subsidiaries (net of cash acquired)	-5.8	-0.0	0.0	0.0
Proceeds from the sale of subsidiary (net of cash disposed)	0.0	0.0	0.0	0.0
Purchase of PP&E	-0.4	-0.2	-0.1	-0.1
Purchase of intangible assets	0.0	0.0	0.0	0.0
Proceeds from sale of PP&E	0.0	0.0	0.0	0.0
Decrease/(increase) in short term deposits	0.0	0.0	0.0	0.0
Other	-0.6	-0.6	-0.5	-0.2
<b>Net cash used in investing activities</b>	<b>-6.8</b>	<b>-0.8</b>	<b>-0.6</b>	<b>-0.3</b>
<b>Financing activities:</b>				
Purchase of own shares	0.0	0.0	0.0	0.0
Net movement in borrowings	3.9	-3.0	-3.0	-2.8
Dividends paid	0.0	0.0	-0.6	-0.6
Interest paid	-0.5	-0.6	-0.2	-0.1
Issue of shares (net)	0.3	0.1	0.0	0.0
Capital element of finance lease rentals	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Net cash inflow from financing activities</b>	<b>3.7</b>	<b>-3.4</b>	<b>-3.8</b>	<b>-3.5</b>
<b>Net increase in cash and cash equivalents</b>	<b>-0.3</b>	<b>0.7</b>	<b>0.5</b>	<b>-0.5</b>
Cash at start of year	-0.6	-0.9	-0.2	0.3
FX changes	0.0	0.0	0.0	0.0
<b>Cash and cash equivalents at end of year</b>	<b>-0.9</b>	<b>-0.2</b>	<b>0.3</b>	<b>-0.1</b>
<b>Reconciliation of cash flow to net debt</b>				
Net (debt)/cash at start of the year	-5.0	-9.3	-5.6	-2.1
Net increase in cash and cash equivalents	-0.3	0.7	0.5	-0.5
Net change in borrowings during the year	-3.9	3.0	3.0	2.8
<b>Net (debt)/cash at end of the year</b>	<b>-9.3</b>	<b>-5.5</b>	<b>-2.1</b>	<b>0.2</b>

Key Ratios	2007	2008	2009 E	2010 E
Free Cash Flow (£m)	2.2	4.3	4.1	2.6
Free Cash Flow per share (p)	6.8	13.4	12.7	8.0

### Free Cash Flow:

Cash flow from operating activities, less interest paid, less tax paid, less equity divs paid

### Summary Balance Sheet

Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Assets</b>				
<b>Non-current assets</b>				
PP&E	0.5	0.4	0.4	0.4
Goodwill	15.2	14.6	14.6	14.6
Other intangible assets	3.9	2.9	2.9	2.9
Deferred tax asset	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Total non-current assets</b>	<b>19.6</b>	<b>17.9</b>	<b>17.9</b>	<b>17.9</b>
<b>Current assets</b>				
Trade and other receivables	18.7	17.0	14.5	13.0
Deferred tax assets	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Cash and short term deposits	0.1	0.0	1.0	0.9
<b>Total current assets</b>	<b>18.8</b>	<b>17.0</b>	<b>15.5</b>	<b>13.9</b>
<b>Total assets</b>	<b>38.4</b>	<b>34.9</b>	<b>33.4</b>	<b>31.8</b>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Trade and other payables	-9.4	-8.4	-8.5	-8.0
Taxation liabilities	-0.8	-0.7	-0.6	-0.5
Bank overdrafts and other short term borrowings	-9.4	-5.5	-3.0	-0.7
Provisions	-0.7	-0.7	-0.5	-0.2
Other	0.0	0.0	0.0	0.0
<b>Total current liabilities</b>	<b>-20.3</b>	<b>-15.4</b>	<b>-12.6</b>	<b>-9.4</b>
<b>Non-current liabilities</b>				
Long term borrowings	0.0	0.0	0.0	0.0
Provisions	-1.5	-0.2	-0.2	0.0
Deferred taxation liability	-0.8	-0.7	-0.5	-0.3
Other	0.0	0.0	0.0	0.0
<b>Total non-current liabilities</b>	<b>-2.3</b>	<b>-0.9</b>	<b>-0.7</b>	<b>-0.3</b>
<b>Total liabilities</b>	<b>-22.5</b>	<b>-16.3</b>	<b>-13.3</b>	<b>-9.7</b>
<b>Net Assets</b>	<b>15.8</b>	<b>18.6</b>	<b>20.0</b>	<b>22.1</b>

Key Ratios	2007	2008	2009 E	2010 E
Net cash/(debt) (£m)	-9.3	-5.5	-2.1	0.2
Net debt/shareholders funds	58%	30%	10%	-1%
Capital employed (£m)	25.1	24.2	22.1	21.9
ROCE	14.6%	17.7%	10.4%	10.5%
Current ratio	0.9	1.1	1.2	1.5

### Capital Employed:

Shareholders funds, add debt, add obligations under finance leases, add minorities, add provisions, less associates.

### ROCE:

Operating profit / Capital Employed

Source: Company accounts; JEP estimates



# Merchant John East Securities

## MICHAEL PAGE INTERNATIONAL plc - Recommendation SELL (25/08/09)

Summary P&L				
Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Revenue</b>	<b>831.6</b>	<b>972.8</b>	<b>725.0</b>	<b>773.0</b>
<b>Net Fee Income (NFI)</b>	<b>478.1</b>	<b>552.7</b>	<b>347.1</b>	<b>376.0</b>
Administration expenses	-328.7	-412.2	-326.6	-346.5
Associates	0.0	0.0	0.0	0.0
<b>Operating Profit</b>	<b>149.4</b>	<b>140.5</b>	<b>20.5</b>	<b>29.5</b>
Separately disclosed items (SDI)	0.0	0.0	0.0	0.0
Finance income	1.2	3.9	2.5	3.0
Finance charge	-3.2	-4.3	-2.0	-2.5
<b>Profit before tax as stated</b>	<b>147.4</b>	<b>140.1</b>	<b>21.0</b>	<b>30.0</b>
IFRS 3 adjustment for amortisation of intangibles	0.0	0.0	0.0	0.0
Adjustment for SDIs	0.0	0.0	0.0	0.0
<b>Adjusted Profit before tax</b>	<b>147.4</b>	<b>140.1</b>	<b>21.0</b>	<b>30.0</b>
Tax	-45.7	-42.7	-18.4	-10.2
Post tax profit	101.7	97.3	39.7	19.8
Minorities	0.0	0.0	0.0	0.0
Net Profit	101.7	97.3	39.7	19.8
<b>Adjusted Net Profit</b>	<b>101.7</b>	<b>97.3</b>	<b>39.7</b>	<b>19.8</b>
<b>EBITDA</b>	<b>164.3</b>	<b>158.8</b>	<b>39.0</b>	<b>48.2</b>
Depreciation	-7.7	-10.3	-10.5	-10.7
<b>EBITA</b>	<b>156.6</b>	<b>148.5</b>	<b>28.5</b>	<b>37.5</b>
Amortisation of intangibles	0.0	0.0	0.0	0.0
<b>EBIT</b>	<b>156.6</b>	<b>148.5</b>	<b>28.5</b>	<b>37.5</b>
<b>Equity</b>				
Weighted average shares (m)	327.5	321.5	322.0	322.6
Weighted average shares FD (m)	332.9	325.7	325.5	325.5
Year end shares in issue (m)	323.9	322.0	322.6	322.6
<b>EPS</b>				
EPS FD (p)	30.6	29.9	12.2	6.1
<b>EPS FD and adjusted (p)</b>	<b>30.6</b>	<b>29.9</b>	<b>4.0</b>	<b>6.1</b>
<b>Dividend</b>				
Interim dividend (p)	2.40	2.88	2.88	2.88
Final dividend (p)	5.60	5.12	5.12	5.12
<b>Total dividend (p)</b>	<b>8.00</b>	<b>8.00</b>	<b>8.00</b>	<b>8.00</b>
<b>Key ratios</b>				
Market cap (£m)	1,184.3	1,184.3	1,184.3	1,184.3
Enterprise value (EV) (£m)	1,174.0	1,090.0	1,054.6	1,058.9
EV/NFI (x)	2.5	2.0	3.0	2.8
EV/EBITA (x)	7.5	7.3	37.0	28.2
Share price (p)	366.80			
PER (x)	12.0	12.3	91.8	60.3
Yield (%)	2.2	2.2	2.2	2.2

P&L Analysis				
Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Analysis of revenue</b>				
EMEA	321.1	426.4	330.0	360.0
UK	360.4	365.6	270.0	280.0
Asia Pacific	97.8	111.4	73.0	78.0
Americas	52.4	69.3	52.0	55.0
<b>Total Revenue</b>	<b>929.4</b>	<b>1,084.2</b>	<b>725.0</b>	<b>773.0</b>
<b>Analysis of NFI</b>				
EMEA	196.4	258.8	159.6	175.0
UK	186.0	176.7	112.3	120.0
Asia Pacific	57.2	66.8	40.9	44.0
Americas	38.4	50.5	34.3	37.0
<b>Total NFI</b>	<b>478.1</b>	<b>552.7</b>	<b>347.1</b>	<b>376.0</b>
<b>Analysis of operating profit</b>				
EMEA	63.0	66.3	1.5	5.0
UK	59.4	46.6	14.0	20.0
Asia Pacific	20.8	22.4	4.5	7.0
Americas	6.2	5.3	0.5	2.0
<b>Total Operating Profit</b>	<b>149.4</b>	<b>140.5</b>	<b>20.5</b>	<b>34.0</b>
<b>NFI margin</b>				
EMEA	61.2%	60.7%	48.4%	48.6%
UK	51.6%	48.3%	41.6%	42.9%
Asia Pacific	58.5%	59.9%	56.0%	56.4%
Americas	73.4%	72.8%	66.0%	67.3%
<b>Group NFI margin</b>	<b>57.5%</b>	<b>56.8%</b>	<b>47.9%</b>	<b>48.6%</b>
<b>Operating margin</b>				
EMEA	19.6%	15.5%	0.5%	1.4%
UK	16.5%	12.7%	5.2%	7.1%
Asia Pacific	21.3%	20.1%	6.2%	9.0%
Americas	11.8%	7.7%	1.0%	3.6%
<b>Group Operating margin</b>	<b>18.8%</b>	<b>15.3%</b>	<b>3.9%</b>	<b>4.9%</b>
<b>Key Ratios</b>				
EBITA margin	18.8%	15.3%	3.9%	4.9%
Administration costs as a % of revenue	39.5%	42.4%	45.0%	44.8%
Conversion of NFI into EBITA	32.8%	26.9%	8.2%	10.0%
Effective tax rate	31.0%	30.5%	34.5%	34.0%
Net interest cover by EBITDA (x)	82.5	n/a	n/a	n/a
Dividend cover by adjusted EPS (x)	3.82	3.74	0.50	0.76

Summary Cash Flow				
Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
Net cash from operating activities	163.9	158.1	39.0	48.2
(Increase)/Decrease in trade and other receivables	-40.9	25.0	15.0	-5.0
(Decrease)/ Increase in trade and other payables	25.8	2.2	1.0	1.0
Increase/(Decrease) in provisions for liabilities and charges	-0.2	0.0	0.0	0.0
<b>Cash generated by operations</b>	<b>148.7</b>	<b>185.2</b>	<b>55.0</b>	<b>44.2</b>
Taxation paid	-36.5	-53.4	-18.4	-10.2
<b>Net cash generated by operating activities</b>	<b>112.1</b>	<b>131.8</b>	<b>73.7</b>	<b>34.0</b>
<b>Cash flow from investing activities:</b>				
Interest received	1.2	3.9	2.5	3.0
Acquisition of subsidiaries (net of cash acquired)	0.0	0.0	0.0	0.0
Proceeds from the sale of subsidiary (net of cash disposed)	0.0	0.0	0.0	0.0
Purchase of PP&E	-11.9	-17.2	-4.5	-5.0
Purchase of intangible assets	-1.6	-10.3	-8.5	-8.0
Proceeds from sale of PP&E	0.7	1.0	1.0	0.0
Decrease/(increase) in short term deposits	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Net cash used in investing activities</b>	<b>-11.6</b>	<b>-22.5</b>	<b>-9.5</b>	<b>-10.0</b>
<b>Financing activities:</b>				
Purchase of own shares	-74.9	-16.8	-2.0	0.0
Net movement in borrowings	-13.9	-25.3	0.0	0.0
Dividends paid	-21.8	-27.3	-25.8	-25.8
Interest paid	-2.7	-4.8	-2.0	-2.5
Issue of shares (net)	8.7	2.2	0.0	0.0
Capital element of finance lease rentals	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Net cash inflow from financing activities</b>	<b>-104.5</b>	<b>-72.0</b>	<b>-28.8</b>	<b>-28.3</b>
<b>Net increase in cash and cash equivalents</b>	<b>-4.0</b>	<b>37.3</b>	<b>35.4</b>	<b>-4.3</b>
Cash and cash equivalents at start of year	35.5	35.6	94.3	129.7
FX changes	4.0	21.4	0.0	0.0
<b>Cash and cash equivalents at end of year</b>	<b>35.6</b>	<b>94.3</b>	<b>129.7</b>	<b>125.4</b>
<b>Reconciliation of cash flow to net debt</b>				
Net (debt)/cash at start of the year	-3.6	10.3	94.3	129.7
FX gains on cash & cash equivalents	4.0	21.4	0.0	0.0
Net increase in cash and cash equivalents	-4.0	37.3	35.4	-4.3
Net change in borrowings during the year	13.9	25.3	0.0	0.0
<b>Net (debt)/cash at end of the year</b>	<b>10.3</b>	<b>94.3</b>	<b>129.7</b>	<b>125.4</b>
<b>Key Ratios</b>				
Free Cash Flow (£m)	80.0	89.4	35.4	-5.0
Free Cash Flow per share (p)	24.0	27.5	10.9	-1.5

### Free Cash Flow:

Cash flow from operating activities, less interest paid, less tax paid, less equity divs paid, less maintenance capex

Summary Balance Sheet				
Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Assets</b>				
<b>Non-current assets</b>				
PP&E	27.1	39.1	39.0	40.0
Intangibles	4.3	13.9	16.0	18.0
Other intangible assets	0.0	0.0	0.0	0.0
Deferred tax asset	5.0	6.5	3.0	0.0
Other	2.3	2.0	0.0	0.0
<b>Total non-current assets</b>	<b>38.7</b>	<b>61.4</b>	<b>58.0</b>	<b>58.0</b>
<b>Current assets</b>				
Trade and other receivables	192.8	203.8	193.0	198.0
Deferred tax assets	0.0	0.0	0.0	0.0
Other	0.0	5.4	0.0	0.0
Cash and short term deposits	83.0	157.0	154.7	109.5
<b>Total current assets</b>	<b>275.8</b>	<b>366.2</b>	<b>347.7</b>	<b>307.5</b>
<b>Total assets</b>	<b>314.5</b>	<b>427.6</b>	<b>405.7</b>	<b>365.5</b>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Trade and other payables	-115.4	-137.0	-138.0	-139.0
Taxation liabilities	-17.9	-14.9	-18.4	-10.2
Bank overdrafts and other short term borrowings	-72.7	-62.7	-25.0	0.0
Provisions	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Total current liabilities</b>	<b>-206.0</b>	<b>-214.7</b>	<b>-181.4</b>	<b>-149.2</b>
<b>Non-current liabilities</b>				
Long term borrowings	0.0	0.0	0.0	0.0
Provisions	0.0	0.0	0.0	0.0
Deferred taxation liability	-0.0	-0.9	0.0	0.0
Other	-0.7	-1.3	0.0	0.0
<b>Total non-current liabilities</b>	<b>-0.7</b>	<b>-2.2</b>	<b>0.0</b>	<b>0.0</b>
<b>Total liabilities</b>	<b>-206.7</b>	<b>-216.9</b>	<b>-181.4</b>	<b>-149.2</b>
<b>Net Assets</b>	<b>107.9</b>	<b>210.7</b>	<b>224.3</b>	<b>216.3</b>
<b>Key Ratios</b>				
Net cash/(debt) (£m)	10.3	94.3	129.7	125.4
Net debt/shareholders funds	n/a	n/a	n/a	n/a
Capital employed (£m)	387.3	490.3	430.7	365.5
ROCE	38.6%	28.7%	4.8%	8.1%
Current ratio	1.34	1.71	1.92	2.06

### Capital Employed:

Shareholders funds, add debt, add obligations under finance leases, add minorities, add provisions, less associates, less investments

### ROCE:

Operating profit / Capital Employed



# Merchant John East Securities

## PENNA CONSULTING PLC - Recommendation BUY (prev. Buy 6/2/09)

### Summary P&L

Years to March	2008	2009	2010 E	2011 E
	£m	£m	£m	£m
<b>Revenue</b>	<b>49.10</b>	<b>63.16</b>	<b>117.00</b>	<b>138.50</b>
Administration expenses	-46.33	-57.28	-109.65	-128.60
Associates	0.00	0.00	0.00	0.00
<b>Operating Profit</b>	<b>2.21</b>	<b>5.89</b>	<b>7.35</b>	<b>9.90</b>
Exceptionals	0.00	0.00	-2.00	0.00
Finance income	0.02	0.14	0.00	0.00
Finance charge	-0.05	-0.02	0.00	0.00
<b>Profit before tax as stated</b>	<b>2.18</b>	<b>6.00</b>	<b>5.35</b>	<b>9.90</b>
IFRS3 Adjustment for amortisation of intangibles	0.00	0.00	0.00	0.00
Adjustment for exceptionals	0.00	0.00	2.00	0.00
<b>Adjusted Profit before tax</b>	<b>2.18</b>	<b>6.00</b>	<b>7.35</b>	<b>9.90</b>
Tax	-0.65	-1.50	-1.78	-2.77
Post tax profit	1.38	3.72	3.57	7.13
Minorities	0.00	0.00	0.00	0.00
Net Profit	1.38	3.72	3.57	7.13
<b>Adjusted Net Profit</b>	<b>1.38</b>	<b>3.72</b>	<b>5.57</b>	<b>7.13</b>
<b>EBITDA</b>	<b>2.74</b>	<b>6.38</b>	<b>8.00</b>	<b>10.55</b>
Depreciation	-0.53	-0.50	-0.65	-0.65
<b>EBITA</b>	<b>2.21</b>	<b>5.89</b>	<b>7.35</b>	<b>9.90</b>
Amortisation	0.00	0.00	0.00	0.00
<b>EBIT</b>	<b>2.21</b>	<b>5.89</b>	<b>7.35</b>	<b>9.90</b>
<b>Equity</b>				
Weighted average shares	25,173	25,184	25,184	25,184
Weighted average shares FD	25,188	26,278	27,300	27,300
Year end shares in issue	25,273	25,275	25,275	25,275
<b>EPS</b>				
EPS FD	5.47	14.15	13.08	26.11
<b>EPS FD and adjusted</b>	<b>6.04</b>	<b>17.15</b>	<b>18.36</b>	<b>26.11</b>
<b>Dividend</b>				
Interim dividend	0.00	2.00	3.00	4.00
Final dividend	2.00	4.00	5.00	6.00
<b>Total dividend</b>	<b>2.00</b>	<b>6.00</b>	<b>8.00</b>	<b>10.00</b>
<b>Key ratios</b>				
Market cap (£m)	60.7	60.7	60.7	60.7
Enterprise value (EV) (£m)	57.7	51.9	54.4	51.2
EV/EBITA (x)	26.2	8.8	7.4	5.2
Share price (p)	<b>235.5</b>			
PER (x)	39.0	13.7	12.8	9.0
Yield (%)	0.0	2.5	3.4	4.2

### P&L Analysis

Years to March	2008	2009	2010 E	2011 E
	£m	£m	£m	£m
<b>Analysis of revenue</b>				
Recruitment & Marketing Communications	4.8	5.3	47.0	64.0
Resourcing	0.0	3.4	13.0	16.0
Executive recruitment and Interim	18.4	18.8	16.0	16.5
HR Consulting	25.9	35.7	41.0	42.0
<b>Total Revenue</b>	<b>49.1</b>	<b>63.2</b>	<b>117.0</b>	<b>138.5</b>
<b>Key Ratios</b>				
EBITA margin	4.5%	9.3%	6.3%	7.1%
Administration costs as a % of revenue	94.4%	90.7%	93.7%	92.9%
Effective tax rate	30.1%	24.9%	24.2%	28.0%
Net interest cover by EBITDA (x)	n/a	n/a	n/a	n/a
Dividend cover by adjusted EPS (x)	3.0	2.9	2.3	2.6

Source: Company accounts; MJES

### Summary Cash Flow

Years to March	2008	2009	2010 E	2011 E
	£m	£m	£m	£m
Net cash from operating activities	2.8	6.5	6.1	10.7
Increase in trade and other receivables	-1.2	-2.0	3.0	-3.0
Increase in trade and other payables	1.0	3.4	3.0	1.0
Decrease in provisions for liabilities and charges	-0.1	0.0	0.0	0.0
<b>Cash generated by operations</b>	<b>2.5</b>	<b>7.9</b>	<b>12.1</b>	<b>8.7</b>
Taxation paid	-0.4	-0.6	-1.8	-2.8
<b>Net cash generated by operating activities</b>	<b>2.1</b>	<b>7.3</b>	<b>10.4</b>	<b>5.9</b>
<b>Cash flow from investing activities:</b>				
Interest received	0.0	0.1	0.0	0.0
Acquisition of subsidiaries (net of cash acquired)	0.0	0.0	0.0	0.0
Proceeds from the sale of subsidiary (net of cash disposed)	0.0	0.0	0.0	0.0
Purchase of PP&E	-0.4	-0.4	-2.5	-0.5
Purchase of intangible assets	0.0	0.0	0.0	0.0
Proceeds from sale of PP&E	0.0	0.0	0.0	0.0
Decrease/(increase) in short term deposits	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Net cash used in investing activities</b>	<b>-0.4</b>	<b>-0.3</b>	<b>-2.5</b>	<b>-0.5</b>
<b>Financing activities:</b>				
Purchase of own shares	0.0	0.0	0.0	0.0
Net movement in other long term borrowings	-1.8	-0.1	0.0	0.0
Dividends paid	0.0	-1.0	-1.8	-2.3
Interest paid	-0.0	-0.0	0.0	0.0
Issue of shares (net)	0.0	0.1	0.0	0.0
Capital element of finance lease rentals	0.0	0.0	0.0	0.0
Other	-0.1	-0.1	0.0	0.0
<b>Net cash inflow from financing activities</b>	<b>-2.0</b>	<b>-1.1</b>	<b>-1.8</b>	<b>-2.3</b>
<b>Net increase in cash and cash equivalents</b>	<b>-0.2</b>	<b>5.9</b>	<b>6.1</b>	<b>3.2</b>
Cash at start of year	3.2	3.0	8.9	6.4
FX changes	0.0	0.0	0.0	1.0
<b>Cash and cash equivalents at end of year</b>	<b>3.0</b>	<b>8.9</b>	<b>6.4</b>	<b>9.5</b>
<b>Reconciliation of cash flow to net debt</b>				
Net debt at start of the year	3.2	3.0	8.8	6.3
Net cash increase in cash and cash equivalents	-0.3	5.9	-2.5	3.2
Net change in borrowings	0.0	-0.0	0.0	0.0
<b>Net debt at end of the year</b>	<b>3.0</b>	<b>8.8</b>	<b>6.3</b>	<b>9.5</b>
<b>Key Ratios</b>				
Free Cash Flow (£m)	2.1	6.4	8.6	3.7
Free Cash Flow per share (p)	8.3	25.5	34.2	14.5

Source: Company accounts; MJES

### Free Cash Flow:

Net cash flow from operating activities, less interest paid, less tax paid, less equity divs paid

### Summary Balance Sheet

Years to March	2008	2009	2010 E	2011 E
	£m	£m	£m	£m
<b>Assets</b>				
<b>Non-current assets</b>				
PP&E	1.9	1.8	3.0	2.2
Goodwill	14.0	14.0	18.0	22.0
Other intangible assets	0.0	0.0	0.0	0.0
Deferred tax asset	0.0	0.1	0.0	0.0
Financial assets	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Total non-current assets</b>	<b>15.9</b>	<b>16.0</b>	<b>21.0</b>	<b>24.2</b>
<b>Current assets</b>				
Trade and other receivables	11.3	12.7	18.0	21.0
Deferred tax assets	0.0	0.0	0.0	0.0
Other	1.8	2.4	3.5	2.4
Cash and short term deposits	3.0	8.9	6.4	9.8
<b>Total current assets</b>	<b>16.0</b>	<b>24.0</b>	<b>27.9</b>	<b>33.2</b>
<b>Total assets</b>	<b>32.0</b>	<b>39.9</b>	<b>49.0</b>	<b>57.5</b>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Trade and other payables	-2.4	-2.5	-5.0	-6.0
Taxation liabilities	-0.2	-0.8	-1.8	-2.8
Bank overdrafts and other short term borrowings	-0.1	-0.0	0.0	0.0
Derivative financial instruments	0.0	0.0	0.0	0.0
Provisions	-0.2	-0.1	-0.1	0.0
Other	-9.5	-13.8	-15.0	-10.0
<b>Total current liabilities</b>	<b>-12.3</b>	<b>-17.3</b>	<b>-21.8</b>	<b>-18.8</b>
<b>Non-current liabilities</b>				
Long term borrowings	0.0	0.0	0.0	0.0
Other payables due in greater than one year	0.0	0.0	0.0	0.0
Provisions	-0.4	-0.5	-0.4	-0.2
Deferred taxation liability	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Total non-current liabilities</b>	<b>-0.4</b>	<b>-0.5</b>	<b>-0.4</b>	<b>-0.2</b>
<b>Total liabilities</b>	<b>-12.6</b>	<b>-17.8</b>	<b>-22.2</b>	<b>-19.0</b>
<b>Net Assets</b>	<b>19.3</b>	<b>22.1</b>	<b>26.7</b>	<b>38.5</b>
<b>Key Ratios</b>				
Net cash/(debt) (£m)	3.0	8.8	6.3	9.5
Net debt/shareholders funds	n/a	n/a	n/a	n/a
Capital employed (£m)	19.9	22.7	27.2	38.7
ROCE	11.1%	25.9%	27.0%	25.6%
Current ratio	1.30	1.38	1.28	1.77

Source: Company accounts; MJES

### Capital employed:

Shareholders funds, add debt, add obligations under finance leases, add minorities, add provisions, less associates, less investments

### ROCE:

Operating profit / Capital Employed



# Merchant John East Securities

## ROBERT WALTERS plc - Recommendation SELL (prev. Sell 28/5/09)

Summary P&L				
Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
Revenue	319.8	337.3	295.0	305.0
<b>NFI (Gross profit)</b>	<b>128.9</b>	<b>138.6</b>	<b>103.0</b>	<b>110.7</b>
Administration expenses	-102.8	-119.9	-100.9	-103.7
Associates	0.0	0.0	0.0	0.0
<b>Operating Profit</b>	<b>26.1</b>	<b>18.6</b>	<b>2.1</b>	<b>7.0</b>
Separately disclosed items (SDI)	0.0	0.0	0.0	0.0
Finance income	0.3	0.5	0.1	0.3
Finance charge	-0.8	-0.8	-0.4	-0.3
<b>Profit before tax as stated</b>	<b>24.9</b>	<b>18.2</b>	<b>1.9</b>	<b>7.0</b>
IFRS 3 adjustment for amortisation of intangibles	0.0	0.0	0.0	0.0
(Profit)/loss on FX	0.7	0.2	0.0	0.0
Adjustment for SDIs	0.0	0.0	0.0	0.0
<b>Adjusted Profit before tax</b>	<b>24.9</b>	<b>18.2</b>	<b>1.9</b>	<b>7.0</b>
Tax	-7.5	-6.0	0.1	-2.3
Post tax profit	17.4	12.2	2.0	4.7
Minorities	0.0	0.0	0.0	0.0
Net Profit	17.4	12.2	2.0	4.7
<b>Adjusted Net Profit</b>	<b>17.4</b>	<b>12.2</b>	<b>2.0</b>	<b>4.7</b>
<b>EBITDA</b>	<b>28.1</b>	<b>21.6</b>	<b>5.0</b>	<b>9.9</b>
Depreciation	-2.0	-2.9	-2.9	-2.9
<b>EBITA</b>	<b>26.1</b>	<b>18.6</b>	<b>2.1</b>	<b>7.0</b>
Amortisation of intangibles	0.0	0.0	0.0	0.0
<b>EBIT</b>	<b>26.1</b>	<b>18.6</b>	<b>2.1</b>	<b>7.0</b>
<b>Equity</b>				
Weighted average shares (m)	74,949	70,889	70,406	70,406
Weighted average shares FD (m)	79,853	73,438	70,406	70,406
Year end shares in issue (m)	85,429	85,169	85,169	85,169
<b>EPS</b>				
EPS FD (p)	21.8	16.6	2.8	6.7
<b>EPS FD and adjusted (p)</b>	<b>21.8</b>	<b>16.7</b>	<b>2.8</b>	<b>6.7</b>
<b>Dividend</b>				
Interim dividend (p)	1.35	1.40	1.40	1.40
Final dividend (p)	3.35	3.35	3.35	3.35
<b>Total dividend (p)</b>	<b>4.70</b>	<b>4.75</b>	<b>4.75</b>	<b>4.75</b>
<b>Key ratios</b>				
Market cap (£m)	141.4	141.4	141.4	141.4
Enterprise value (EV) (£m)	125.8	119.2	111.5	107.1
EV/NFI (x)	0.98	0.86	1.08	0.97
EV/EBITA (x)	4.8	6.4	52.9	15.3
Share price (p)	184.50			
PER (x)	8.5	11.1	64.9	27.7
Yield (%)	2.5%	2.6%	2.6%	2.6%

P&L Analysis				
Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Analysis of revenue</b>				
UK	148.7	133.2	115.0	118.5
Continental Europe	44.4	64.9	61.0	60.0
Asia Pacific	124.1	137.1	117.5	125.0
USA & South Africa	2.5	2.1	1.5	1.5
<b>Total Revenue</b>	<b>319.8</b>	<b>337.3</b>	<b>295.0</b>	<b>305.0</b>
<b>Analysis of NFI</b>				
UK	48.6	45.4	33.5	34.0
Continental Europe	25.8	33.0	26.0	26.7
Asia Pacific	52.1	58.1	42.0	48.0
USA & South Africa	2.4	2.1	1.5	2.0
<b>Total NFI</b>	<b>128.9</b>	<b>138.6</b>	<b>103.0</b>	<b>110.7</b>
<b>Analysis of operating profit</b>				
UK	5.0	1.9	0.5	2.0
Continental Europe	5.1	4.5	0.4	1.0
Asia Pacific	15.9	12.3	1.0	3.9
USA & South Africa	0.1	-0.1	0.3	0.1
<b>Total Operating Profit</b>	<b>26.1</b>	<b>18.6</b>	<b>2.1</b>	<b>7.0</b>
<b>NFI margin</b>				
UK	32.7%	34.1%	29.1%	28.7%
Continental Europe	58.0%	50.8%	42.6%	44.5%
Asia Pacific	42.0%	42.3%	35.7%	38.4%
USA & South Africa	98.1%	99.7%	100.0%	133.3%
<b>Group NFI margin</b>	<b>40.3%</b>	<b>41.1%</b>	<b>34.9%</b>	<b>36.3%</b>
<b>Operating margin</b>				
UK	3.4%	1.4%	0.4%	1.7%
Continental Europe	11.5%	6.9%	0.6%	1.7%
Asia Pacific	12.8%	9.0%	0.9%	3.1%
USA & South Africa	3.9%	-4.9%	17.3%	6.7%
<b>Group Operating margin</b>	<b>8.2%</b>	<b>5.5%</b>	<b>0.7%</b>	<b>2.3%</b>
<b>Conversion ratio</b>				
UK	10.3%	4.2%	1.5%	5.9%
Continental Europe	19.8%	13.7%	1.3%	3.7%
Asia Pacific	30.6%	21.3%	2.4%	8.1%
USA & South Africa	3.9%	-5.0%	17.3%	5.0%
<b>Group conversion ratio</b>	<b>20.3%</b>	<b>13.5%</b>	<b>2.0%</b>	<b>6.3%</b>
<b>Key Ratios</b>				
EBITA margin	8.2%	5.5%	0.7%	2.3%
Administration costs as a % of revenue	32.2%	35.6%	34.2%	34.0%
Conversion of NFI into EBITA	20.3%	13.5%	2.0%	6.3%
Effective tax rate	30.1%	32.8%	Cr	0.0%
Net interest cover by EBITDA (x)	56.3	74.1	n/a	n/a
Dividend cover by adjusted EPS (x)	4.6	3.5	0.6	1.4

Source: Company accounts; MJES estimates

Summary Cash Flow				
Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
Net cash from operating activities	30.4	25.2	5.5	10.4
(Increase)/Decrease in trade and other receivables	-4.3	10.4	7.0	2.0
(Decrease)/ Increase in trade and other payables	6.2	-6.0	1.0	0.0
Increase/(Decrease) in provisions for liabilities and charges	0.0	0.0	0.0	0.0
<b>Cash generated by operations</b>	<b>30.4</b>	<b>29.5</b>	<b>13.5</b>	<b>12.4</b>
Taxation paid	-6.6	-9.1	0.1	-2.3
<b>Net cash generated by operating activities</b>	<b>23.8</b>	<b>20.4</b>	<b>13.6</b>	<b>10.1</b>
<b>Cash flow from investing activities:</b>				
Interest received	-0.5	-0.3	-0.4	-0.3
Acquisition of subsidiaries (net of cash acquired)	0.0	-0.2	0.0	0.0
Proceeds from the sale of subsidiary (net of cash disposed)	0.0	0.0	0.0	0.0
Purchase of PP&E	-2.1	-2.4	-1.2	-1.0
Purchase of intangible assets	-0.7	-1.7	-1.0	-1.0
Proceeds from sale of PP&E	0.3	0.1	0.0	0.0
Decrease/(increase) in short term deposits	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Net cash used in investing activities</b>	<b>-3.0</b>	<b>-4.6</b>	<b>-2.6</b>	<b>-2.3</b>
<b>Financing activities:</b>				
Purchase of own shares	-12.8	-10.1	0.0	0.0
Net movement in borrowings	-4.7	-3.8	0.0	0.0
Dividends paid	-3.1	-3.3	-3.4	-3.4
Interest paid	0.0	0.0	0.0	0.0
Issue of shares (net)	3.2	0.0	0.0	0.0
Capital element of finance lease rentals	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Net cash inflow from financing activities</b>	<b>-17.4</b>	<b>-17.1</b>	<b>-3.4</b>	<b>-3.4</b>
<b>Net increase in cash and cash equivalents</b>	<b>3.3</b>	<b>-1.2</b>	<b>7.7</b>	<b>4.4</b>
Cash and cash equivalents at start of year	19.6	24.0	28.5	36.2
FX changes	1.0	5.8	0.0	0.0
<b>Cash and cash equivalents at end of year</b>	<b>24.0</b>	<b>28.5</b>	<b>36.2</b>	<b>40.6</b>
<b>Reconciliation of cash flow to net debt</b>				
Net (debt)/cash at start of the year	7.0	15.6	22.2	29.9
Net increase in cash and cash equivalents	3.3	-1.2	7.7	4.4
FX translation differences	0.6	4.0	0.0	0.0
Net change in borrowings during the year	4.7	3.8	0.0	0.0
<b>Net (debt)/cash at end of the year</b>	<b>15.6</b>	<b>22.2</b>	<b>29.9</b>	<b>34.3</b>
<b>Key Ratios</b>				
Free Cash Flow (£m)	20.6	17.1	10.2	6.7
Free Cash Flow per share (p)	25.8	23.3	14.5	9.5

Free Cash Flow: Cash flow from operating activities, less interest paid, less tax paid, less equity divs paid

Summary Balance Sheet				
Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Assets</b>				
<b>Non-current assets</b>				
PP&E	4.7	6.2	6.3	6.3
Goodwill	7.8	9.6	9.6	9.6
Other intangible assets	0.0	0.0	0.0	0.0
Deferred tax asset	3.7	2.8	2.2	1.5
Other	0.0	0.0	0.0	0.0
<b>Total non-current assets</b>	<b>16.3</b>	<b>18.6</b>	<b>18.1</b>	<b>17.4</b>
<b>Current assets</b>				
Trade and other receivables	69.7	68.4	61.4	56.4
Deferred tax assets	1.4	0.6	0.3	0.0
Other	0.0	0.0	0.0	0.0
Cash and short term deposits	24.0	28.5	26.8	23.0
<b>Total current assets</b>	<b>95.1</b>	<b>97.5</b>	<b>88.5</b>	<b>79.4</b>
<b>Total assets</b>	<b>111.4</b>	<b>116.2</b>	<b>106.6</b>	<b>96.8</b>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Trade and other payables	-47.8	-47.6	-48.6	-48.6
Taxation liabilities	-4.9	-2.0	0.1	-2.3
Bank overdrafts and other short term borrowings	-4.6	-4.8	-1.0	-1.0
Provisions	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Total current liabilities</b>	<b>-57.3</b>	<b>-54.5</b>	<b>-49.5</b>	<b>-51.9</b>
<b>Non-current liabilities</b>				
Long term borrowings	-3.7	-1.5	0.0	0.0
Provisions	0.0	0.0	0.0	0.0
Deferred taxation liability	-0.7	-0.5	-0.3	0.0
Other	0.0	0.0	0.0	0.0
<b>Total non-current liabilities</b>	<b>-4.4</b>	<b>-2.0</b>	<b>-0.3</b>	<b>0.0</b>
<b>Total liabilities</b>	<b>-61.7</b>	<b>-56.5</b>	<b>-49.8</b>	<b>-51.9</b>
<b>Net Assets</b>	<b>49.7</b>	<b>59.7</b>	<b>56.8</b>	<b>44.9</b>
<b>Key Ratios</b>				
Net cash/(debt) (£m)	15.6	22.2	29.9	34.3
Net debt/shareholders funds	n/a	n/a	n/a	n/a
Capital employed (£m)	58.1	66.0	57.8	45.9
ROCE	45.0%	28.2%	3.7%	15.3%
Current ratio	1.7	1.8	1.8	1.5

Capital Employed: Shareholders funds, add debt, add obligations under finance leases, add minorities, add provisions, less associates.

ROCE: Operating profit / Capital Employed



# Merchant John East Securities

## STAFFLINE GROUP PLC - Recommendation Buy (25/08/09)

### Summary P&L

Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Revenue</b>	<b>119.9</b>	<b>120.8</b>	<b>115.0</b>	<b>128.5</b>
<b>Net Fee Income (NFI)</b>	<b>18.2</b>	<b>16.7</b>	<b>15.4</b>	<b>17.7</b>
Administration expenses	-13.3	-13.0	-11.7	-13.0
Associates	0.0	0.0	0.0	0.0
<b>Operating Profit</b>	<b>4.9</b>	<b>3.7</b>	<b>3.7</b>	<b>4.6</b>
Separately disclosed items (SDI)	0.0	0.0	0.0	0.0
Finance income	0.0	0.0	0.0	0.0
Finance charge	-0.5	-0.4	-0.2	-0.4
<b>Profit before tax as stated</b>	<b>4.4</b>	<b>3.4</b>	<b>3.5</b>	<b>4.3</b>
IFRS 3 adjustment for amortisation of intangibles	0.0	0.0	0.0	0.0
Adjustment for SDIs	0.0	0.0	0.0	0.0
<b>Adjusted Profit before tax</b>	<b>4.4</b>	<b>3.4</b>	<b>3.5</b>	<b>4.3</b>
Tax	-1.4	-1.0	-1.0	-1.3
Post tax profit	3.0	2.4	2.5	3.0
Minorities	0.0	0.0	0.0	0.0
Net Profit	3.0	2.4	2.5	3.0
<b>Adjusted Net Profit</b>	<b>3.0</b>	<b>2.4</b>	<b>2.5</b>	<b>3.0</b>
<b>EBITDA</b>	<b>5.2</b>	<b>4.2</b>	<b>4.0</b>	<b>4.9</b>
Depreciation	-0.3	-0.4	-0.3	-0.2
<b>EBITA</b>	<b>4.9</b>	<b>3.8</b>	<b>3.8</b>	<b>4.7</b>
Amortisation of intangibles	0.0	0.0	0.0	0.0
<b>EBIT</b>	<b>4.9</b>	<b>3.8</b>	<b>3.8</b>	<b>4.7</b>
<b>Equity</b>				
Weighted average shares (m)	21,084	21,190	21,229	21,229
Weighted average shares FD (m)	21,952	21,865	21,900	21,900
Year end shares in issue (m)	21,124	21,229	21,229	21,229
<b>EPS</b>				
EPS FD (p)	13.68	10.81	11.19	13.75
<b>EPS FD and adjusted (p)</b>	<b>13.68</b>	<b>10.81</b>	<b>11.19</b>	<b>13.75</b>
<b>Dividend</b>				
Interim dividend (p)	1.30	1.40	1.40	1.55
Final dividend (p)	2.50	1.50	1.60	1.75
<b>Total dividend (p)</b>	<b>3.80</b>	<b>2.90</b>	<b>3.00</b>	<b>3.30</b>
<b>Key ratios</b>				
Market cap (£m)	15.6	15.6	15.6	15.6
Enterprise value (EV) (£m)	21.7	21.5	21.8	21.4
EV/NFI (x)	1.2	1.3	1.4	1.2
EV/EBITA (x)	4.5	5.7	5.8	4.5
Share price (p)	<b>73.5</b>			
PER (x)	5.4	6.8	6.6	5.3
Yield (%)	5.2	3.9	4.1	4.5
<b>Key Ratios</b>				
EBITA margin	4.0%	3.2%	3.3%	3.7%
Administration costs as a % of revenue	11.1%	10.8%	10.2%	10.2%
Conversion of NFI into EBITA	26.7%	22.8%	24.4%	26.6%
Effective tax rate	31.2%	30.0%	30.0%	30.0%
Net interest cover by EBITDA (x)	9.9	10.3	18.8	13.5
Dividend cover by adjusted EPS (x)	3.6	3.7	3.7	4.2

Source: Company accounts; MJES

### Summary Cash Flow

Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
Net cash from operating activities	5.2	4.1	3.9	4.8
(Increase)/Decrease in trade and other receivables	-2.6	0.8	-1.0	-2.5
(Decrease)/ Increase in trade and other payables	2.1	-2.1	-0.5	0.5
Other	0.1	0.1	0.1	0.1
<b>Cash generated by operations</b>	<b>4.7</b>	<b>2.9</b>	<b>2.5</b>	<b>2.9</b>
Taxation paid	-1.1	-1.4	-1.0	-1.3
<b>Net cash generated by operating activities</b>	<b>3.6</b>	<b>1.5</b>	<b>1.5</b>	<b>1.6</b>
<b>Cash flow from investing activities:</b>				
Interest received	0.0	0.0	0.0	0.0
Acquisition of subsidiaries (net of cash acquired)	-2.1	0.0	-0.8	0.0
Proceeds from the sale of subsidiary (net of cash disposed)	0.0	0.0	0.0	0.0
Purchase of PP&E	-1.7	-0.2	-0.2	-0.2
Purchase of intangible assets	0.0	0.0	0.0	0.0
Proceeds from sale of PP&E	-1.7	-0.2	-0.2	-0.2
Decrease/(increase) in short term deposits	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Net cash used in investing activities</b>	<b>-2.2</b>	<b>-0.2</b>	<b>-1.0</b>	<b>-0.2</b>
<b>Financing activities:</b>				
Purchase of own shares	0.0	0.0	0.0	0.0
Net movement in borrowings	1.1	-0.9	-0.9	-0.9
Dividends paid	-0.6	-0.8	-0.6	-0.7
Interest paid	-0.5	-0.3	-0.2	-0.4
Issue of shares (net)	0.2	0.1	0.0	0.0
<b>Net cash inflow from financing activities</b>	<b>0.2</b>	<b>-2.0</b>	<b>-1.7</b>	<b>-1.9</b>
<b>Net increase in cash and cash equivalents</b>	<b>1.6</b>	<b>-0.7</b>	<b>-1.2</b>	<b>-0.5</b>
Cash and cash equivalents at start of year	-2.4	-0.8	-1.5	-2.7
FX changes	0.0	0.0	0.0	0.0
<b>Cash and cash equivalents at end of year</b>	<b>-0.8</b>	<b>-1.5</b>	<b>-2.7</b>	<b>-3.2</b>
<b>Reconciliation of cash flow to net debt</b>				
Net (debt)/cash at start of the year	-6.1	-6.1	-5.9	-6.2
Net increase in cash and cash equivalents	1.6	-0.7	-1.2	-0.5
Net change in borrowings during the year	-1.6	0.9	0.9	0.9
<b>Net (debt)/cash at end of the year</b>	<b>-6.1</b>	<b>-5.9</b>	<b>-6.2</b>	<b>-5.8</b>
<b>Key Ratios</b>				
Free Cash Flow (£m)	2.5	0.4	0.6	0.6
Free Cash Flow per share (p)	11.8	1.8	3.0	2.8

Source: Company accounts; MJES

### Free Cash Flow:

Cash flow from operating activities, less interest paid, less tax paid, less equity divs paid

### Summary Balance Sheet

Years to December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Assets</b>				
<b>Non-current assets</b>				
PP&E	0.9	0.9	1.0	1.1
Goodwill	24.2	24.2	26.2	26.2
Other intangible assets	0.1	0.0	0.0	0.0
Deferred tax asset	0.0	0.0	0.0	0.0
<b>Total non-current assets</b>	<b>25.2</b>	<b>25.1</b>	<b>27.2</b>	<b>27.3</b>
<b>Current assets</b>				
Trade and other receivables	16.6	15.8	16.8	19.3
Cash and short term deposits	0.8	0.9	0.2	0.2
<b>Total current assets</b>	<b>17.5</b>	<b>16.7</b>	<b>17.0</b>	<b>19.5</b>
<b>Total assets</b>	<b>42.7</b>	<b>41.8</b>	<b>44.2</b>	<b>46.8</b>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Trade and other payables	-12.2	-10.2	-9.7	-10.2
Taxation liabilities	-0.7	-0.4	-1.0	-1.3
Bank overdrafts and other short term borrowings	-2.5	-3.3	-2.4	-2.0
<b>Total current liabilities</b>	<b>-15.5</b>	<b>-13.8</b>	<b>-13.1</b>	<b>-13.5</b>
<b>Non-current liabilities</b>				
Long term borrowings	-4.5	-3.6	-4.0	-4.0
Other	-0.2	-0.1	-0.2	-0.2
<b>Total non-current liabilities</b>	<b>-4.6</b>	<b>-3.7</b>	<b>-4.2</b>	<b>-4.2</b>
<b>Total liabilities</b>	<b>-20.1</b>	<b>-17.5</b>	<b>-17.3</b>	<b>-17.6</b>
<b>Net Assets</b>	<b>22.6</b>	<b>24.3</b>	<b>26.9</b>	<b>29.2</b>
<b>Key Ratios</b>				
Net cash/(debt) (£m)	-6.1	-5.9	-6.2	-5.8
Net debt/shareholders funds	27.1%	24.4%	23.2%	20.0%
Net debt/EBITA	1.26	1.56	1.66	1.24
Capital employed (£m)	28.8	30.2	33.1	35.0
ROCE	16.9%	12.4%	11.2%	13.3%
Current ratio	1.13	1.21	1.29	1.45

Source: Company accounts; MJES

### Capital Employed:

Shareholders funds, add debt, add obligations under finance leases, add minorities, add provisions, less associates, less investments

### ROCE:

Operating profit / Capital Employed



## Merchant John East Securities

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<b>BUY</b>	Share price appreciation of 15% or more in absolute terms over 12 months
<b>HOLD</b>	Share price appreciation or depreciation of less than 15% in absolute terms over 12 months
<b>SELL</b>	Share price depreciation of 15% or more in absolute terms over 12 months



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