

YOU'RE HIRED!



A publication on the UK recruitment sector

Contents

■ SECTOR PERFORMANCE	Page 4
■ BALANCE SHEET HEALTH CHECK	Page 5
■ CONSOLIDATION	Page 6
■ THE UK UNIVERSE	Page 7
■ SHARE PRICE PERFORMANCE	Page 8
■ VALUATION METRICS	Page 10
■ THE COMPANIES:	Page 11
■ HEALTHCARE LOCUMS	Page 12
■ IMPELLAM	Page 19
■ PENNA CONSULTING	Page 27
■ SPRING GROUP	Page 36

You're hired!

A publication on the UK recruitment sector

Key points:

- **The JEP Recruitment Index has fallen by 58% since peaking in mid July 2007** against a decline of just 38% in the FTS All Share. This early anticipation of worsening economic conditions ahead of the market in general and indeed well ahead of reducing fee income that is only now being reported by a growing number of companies runs counter to the experience at the top of the last up-cycle (2000) when wide-spread profit warnings precipitated the collapse of share prices in the sector.
- **Conversely, share prices anticipated the last up-cycle (2004-2008) by a full twelve months** and hopefully a similar scenario will play out as we approach the next staffing up-cycle. However, we are still some way off this event; net fee income (NFI) among companies is likely to fall significantly in 2009, reflecting recessionary conditions in most developed economies, a general freeze on hiring and a lack of candidate churn. It is quite possible, indeed probable, that the downturn will be more severe than 2000-2003 when the majority of global economies still maintained positive GDP growth.
- **However, we expect the majority of share prices to remain resilient in the face of profit warnings** as they are already factoring in a substantial fall in earnings. A good example being Michael Page where in spite of a profit warning on 4th December 2008 the shares currently stand 28% higher than they were on the day prior to the warning (248p Vs 193p).
- **Many companies enjoy strengthening balance sheets and cash reserves.** We expect cash generation to be strong through the current down-cycle as slowing demand for staff reduces the need for working capital; the cash build possibly providing an environment for some M&A activity which has been sadly lacking in the sector over the past few years (Randstad/Vedior aside).
- **In general we remain negative on prospects for the sector** but given the already depressed valuations believe that there are some attractive investment opportunities for investors willing to take a 12 to 18 month view. Whilst we are aware of the importance of monitoring bellwether stocks Hays and Michael Page these, in our opinion, are already well researched and we will therefore concentrate the majority of our resource on the lesser known companies in the sector that perhaps don't receive the same amount of attention and hence may offer some attractive valuation anomalies. **In this first issue we initiate coverage on Healthcare Locums (HLD.L), Impellam (IPEL.L), Penna Consulting (PNA.L) and Spring Group (SRG.L)** and will increase the number of companies followed over the coming months. HLD and PNA are both experiencing significant top line growth (very rare in the sector) while SRG could use its £40m of cash to help fund earnings enhancing acquisitions. IPEL has some defensive qualities and sells on a very modest valuation but needs to reduce its debt, probably through selective asset sales.
- **Healthcare Locums** is now the fourth largest company in the staffing sector by market cap and largely immune from current economic and financial weakness. HCL is demonstrating strong organic earnings growth while still selling on a modest PER. Although we initiate coverage on **Impellam** with a Hold recommendation, this could prove an attractive investment if management is successful in converting sizeable NFI (at an estimated £187m the third largest in the sector) into reasonable profit and can reduce the high level of debt. **Penna Consulting** is afforded a Buy recommendation as we consider that the group is exceptionally well placed to benefit from the current boom in demand for outplacement services. Finally we initiate on **Spring Group** which, by virtue of its estimated £40m of net cash (25p per share) is well placed to acquire earnings enhancing businesses which will extend its geography and range of disciplines. While facing difficult market conditions its business model, in our opinion, is now more robust than at any time in its history.
- We hope readers find this and future publications useful in identifying some of the winners in a market which is currently suffering from reduced demand for staff in most disciplines and geographies. However, we remain of the opinion that the sector also offers investors secular growth across economic cycles and on a long term view an attractive investment proposition, especially amongst the lesser known smaller cap companies.

Sector high (base 100 - 01/01/03):	295 (18/07/2007)
Sector low: (base 100 - 01/01/03):	77 (26/02/2003)
Sector now (base 100 - 01/01/03):	121 (06/02/2009)
Sector fall since 2007 peak:	58%
Maximum fall since 2007 peak:	70%
Duration of last up-cycle:	53 months
Duration of last down-cycle:	38 months
This down cycle so far:	19 months
Constituent companies:	30
Companies on full list:	8
Companies on AIM:	22
Worst performer in 2008:	Parity (down 85%)
Best performer in 2008:	Savile Grp (up 145%)
Priced at close of business:	06/02/09

Companies featured in this issue

- **Healthcare Locums (HLD.L) - BUY**
- **Impellam (IPEL.L) - HOLD**
- **Penna Consulting (PNA.L) - BUY**
- **Spring Group (SRG.L) - BUY**

John East & Partners Limited
 www.johneastpartners.com
 +44 (0)20 7628 2200

Analyst
 Ian Jermin
 +44 (0)20 7382 0941
 research@johneastpartners.com

Sector performance

The JEP Recruitment Index

Chart 1: The JEP Recruitment Index



Note:

The JEP Recruitment Index is an index comprising all of the UK-quoted recruitment-facing stocks. There are 30 component companies and these are listed on page 7. They range from Hays at £1bn market cap to the far more modest Highams Systems with a market cap of just £0.9m. Although included in our index we do not anticipate providing research coverage at the bottom end of the market cap range of these stocks; neither do we intend to add to the already voluminous research already published on the largest players although we will of course make reference to and offer some analysis on results and trading statements from these companies.

It is clear from the above chart that the JEP Recruitment index began to decline from mid July 2007, coincident with the first inklings of a sub-prime crisis in the USA. The downtrend in the index was acute, as was its earlier rise, especially when judged against the broader UK indices such as the FTSE All Share.

The question at the time was that if things were going to be that bad for the staffing companies why wasn't this being reflected in the prices of other securities, particularly as recruitment companies are seen as bell-weather for the broader economy. The fact is that the Recruitment sector significantly outperformed the market on the way up and naturally enough fell more quickly than the broader market when uncertainty increased.

Since the beginning of 2003 – the start of the last staffing up-cycle – to its mid July 2007 peak The JEP Recruitment index had outperformed the All Share by 65% but has now lost practically all of that gain to stand just 10% higher than the All Share.

Recruitment index has been weakening since mid July 2007

The index outperformed by 65% at its mid July 07 peak with most of the rise now dissipated

Balance Sheet Health Check

Broadly speaking the working capital characteristics of contract or temporary recruitment specialists is that when business activity levels decline there is a reduction in the requirement for working capital and a subsequent decrease in cash outflow. In fact, the opposite of what one might expect during periods of business expansion.

General Staffing agencies mostly pay their contractors on a weekly basis while professional service staffing companies tend to pay monthly. On receipt of a time sheet signed off by the end user the client company is then invoiced with the payroll charge together with the agency's margin, with payment usually being received by the agency within 45 days although in some instances under managed service or recruitment process outsourcing contracts payment terms can be much shorter. But generally speaking, an agency with, say, 1,000 contractors on billing (on assignments with client companies), a weekly wage per contractor of £1,100 and a five week average collection period may have working capital tied up of £5.5m at any one time, and very substantially more if candidates are on a monthly wage.

Other things being equal, if the number of contractors on billing reduces to 500 the company will see a reduction in its debtor book of £2.75m with a corresponding beneficial impact on cash generation. Thus, as we move into a cyclical downturn in the recruitment sector providers of contract and temp services will enjoy a strengthening of cash flows commensurate with the reduction in activity levels. In a cyclical upturn the reverse is true and the demand on working capital and cash increases.

In retained Executive Search cash generation is always positive, whatever the stage of the cycle as the agency is normally paid in advance of costs being incurred and a fee of up to 30% of the candidates' annual salary is payable in three tranches; tranche one on acceptance of the mandate, another third on delivery to the client of a short list of candidates and the final third on the commencement by the candidate in his or her new job. Contingent search and selection is typically working capital negative with the agency being paid around 45 to 60 days after the candidate begins work. Again any reduction in activity should result in a lower requirement for working capital.

At the peak of the last cycle we believe that companies were rather more indebted than they are this time around although mergers, exits and the incompatibility of some comparisons (i.e. Hays, Michael Page) makes it difficult to be precise.

We have initiated a balance sheet health check of the sector to ascertain how many companies at the time of their last announcements enjoyed a net cash position and how many were still encumbered by debt. Of the 30 listed companies in the sector 13 were in a net cash position and 17 in net debt. Aggregate net cash balances were £114m with Michael Page (£22m), CPL (£34m) and Spring (£26m) making significant contributions to the total while aggregate net debt stood at £290m of which over half was accounted for by net debt of £81m at Hays, £65m at Impellam and £32m at Healthcare Locums.

A year earlier there were only 10 companies reporting net cash balances with the total being £77m against 20 companies with a total net debt of £358m so there has been significant improvement in the intervening twelve months and we predict this trend will continue. This is given some substance by the fact that Page has stated that its cash at the end of 2008 was expected to be around £85m (up from £22m at the half year).

Of course this is a picture at a single point in time and can be volatile depending on the particular point in the working capital cycle and will also be influenced by exchange rates. But if, as we suspect, activity levels for staffing companies continue to contract through 2009 we would expect many more companies to move to a net cash position and those companies already in net cash to increase their funds.

Declining activity levels = lower working capital requirements and increased cash generation – for temp/contract specialists

Substantial working capital tied up in financing contractors and temps

Working capital can decline relatively quickly when requirements for staff reduce

Of the 30 companies in the sector, 17 were in net debt to the tune of £290m while 13 enjoyed net cash of £114m. Expect the number of companies with net cash to increase over the coming down-cycle

A year earlier the picture was much worse

Consolidation

Consolidation has been sparse in the sector and although much needed in the UK given the number of small sub-scale quoted entities, very little merger activity has actually occurred over the past couple of years. Globally of course the Randstad takeover of Vedior to form the world's second largest staffing group is an obvious anomaly but in the UK M&A activity has been limited. Those deals that have been consummated are as follows:

M&A activity very modest over past couple of years (aside from Randstad/Vedior)

Table 1: Recent M&A activity

Date	Offeree	Offeror	Exit price	Pre bid price	Premium
Sep 2006	MSB	Networkers	73p	48p	52%
Sep 2006	Whitehead Mann	MBO	42p	35p	20%
Sep 2006	SHL	MBO	180p	145p	24%
Jun 2007	Glotel	Spring	70p	55p	27%
Jul 2007	Quantica	Kellan	47.5p	41.5p	14%
Aug 2007	Lorien	Contracting Solutions	100p	81.5p	23%
Dec 2007	Imprint	Premier	115p	86p	34%
Mar 2008	Corporate Services	Carlisle	merger	-	-

Source: JEP

All of these acquisitions/mergers were consummated during a period of strong earnings growth for the sector and only the merger of Carlisle and Corporate Services and perhaps the acquisition of Imprint were effected while sector share prices were in decline. As a result, the carrying value of the goodwill created in the balance sheets will have to be tested leading in most cases we suspect to goodwill impairment charges. Undoubtedly there will be more to come as we move further into the down-cycle.

Those that consummated deals during the up-cycle now face the prospect of goodwill impairment charges

Nevertheless, we would repeat our proposition of the previous page that the increasing cash balances enjoyed by a growing number of companies, coupled with declining valuations of some potential acquisition targets could lead to a resumption of merger activity within the quoted universe but also involving private firms that may be suffering from the credit crisis and reduced volumes. Alternatively companies may wait to buy the assets from the receiver although given that the main assets are the consultants it may be more sensible to buy the people.

However, increasing cash reserves could precipitate some M&A activity during the coming downturn

In our opinion one of the prime targets within the UK quoted universe must be **Healthcare Locums (HCL)**, a company featured in this publication. HCL has a leading share of the UK healthcare and social care markets and an embryonic, yet potentially significant, activity supplying nurses into the Middle East and the USA. The company enjoys strong revenue growth, high margins, very high conversion rates of NFI into EBITA and is strongly cash generative. Its NFI is expected to be around £64m for 2009 and its market cap at £148m is now the fourth largest behind Hays (£1.0bn), Page (£689m) and SThree (£189m) but unlike those companies its earnings are expected to rise strongly over the next several years reflecting the fact that the company is practically immune from the current global economic volatility.

In our opinion HCL is the prime takeover target

The UK universe

Table 2: The UK staffing universe by market cap

The UK Quoted Universe Market Cap > £50 m

	Company	Market Cap £m
1	Hays	1,162.5
2	Michael Page	780.4
3	SThree	228.8
4	Healthcare Locums	144.9
5	Robert Walters	96.2
6	Spring	54.6
Total		2,467.5

Top 6 stocks account for 89% of sector market cap.

Hays by itself represents 42% of the sector market cap

The UK Quoted Universe £10m - £50m

	Company	Market Cap £m
7	Matchtech	42.8
8	Penna Consulting	42.1
9	CPL	38.1
10	Morson	24.3
11	Harvey Nash	23.1
12	FDM Group	18.8
13	Network Group	17.4
14	OPD	13.0
15	Impellam	10.3
Total		229.9

9 companies between £10m and £50m market cap

The UK Quoted Universe < £10m

	Company	Market Cap £m
16	Hydrogen	9.8
17	Empresaria	9.2
18	Interquest	9.2
19	World Careers	9.1
20	Kellan	8.5
21	Hexagon	7.7
22	Networkers	6.9
23	Staffline	6.4
24	Savile Group	5.0
25	Parity	3.4
26	RTC Group	2.5
27	Work	1.9
28	Prime People	1.6
29	Pinnacle Staffing	1.3
30	Higham Systems	0.9
Total		83.2

15 companies below £10m market cap

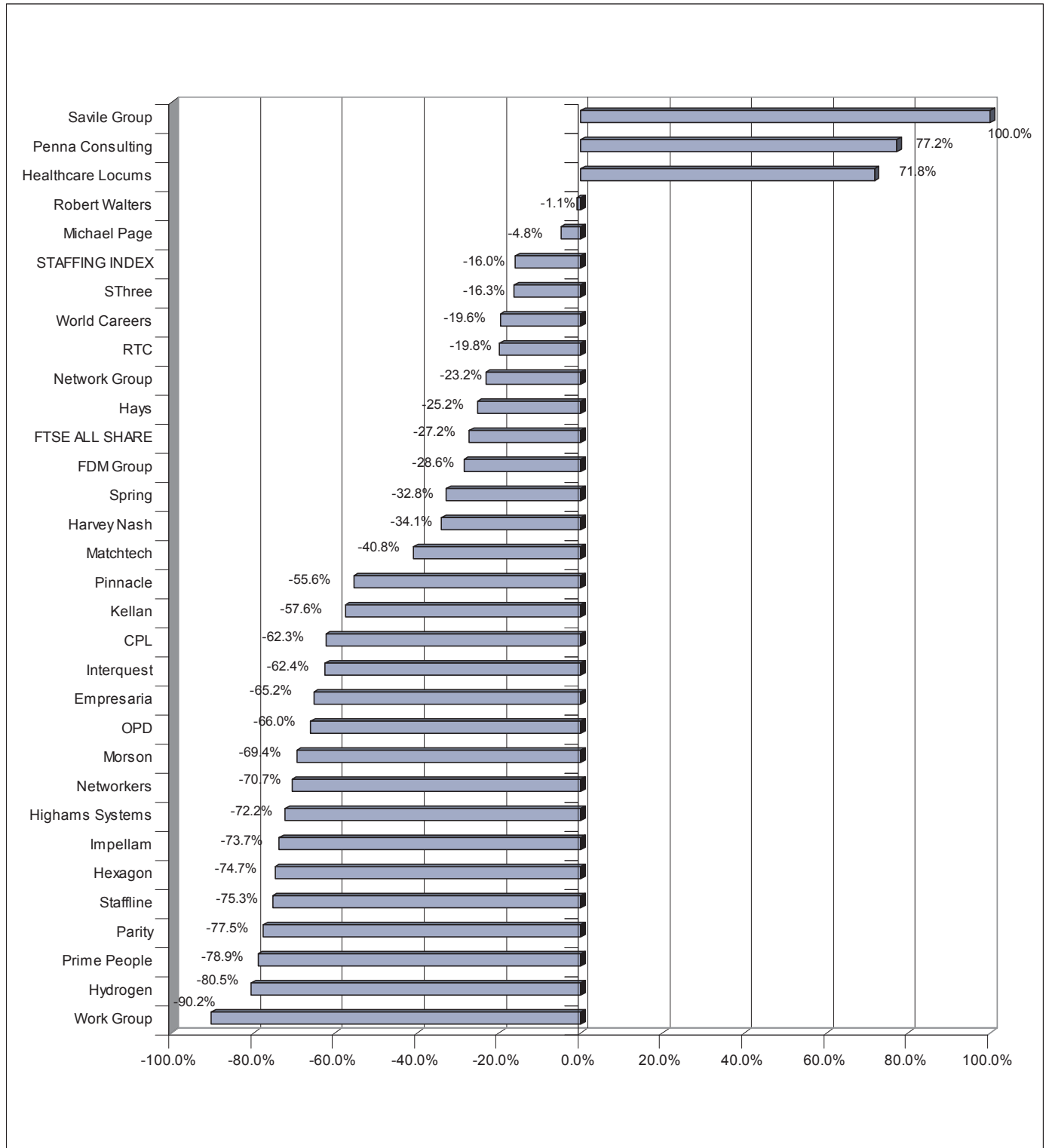
Sector Market Cap	2,788.2
--------------------------	----------------

Sector Market Cap £2.8bn

Source: JEP

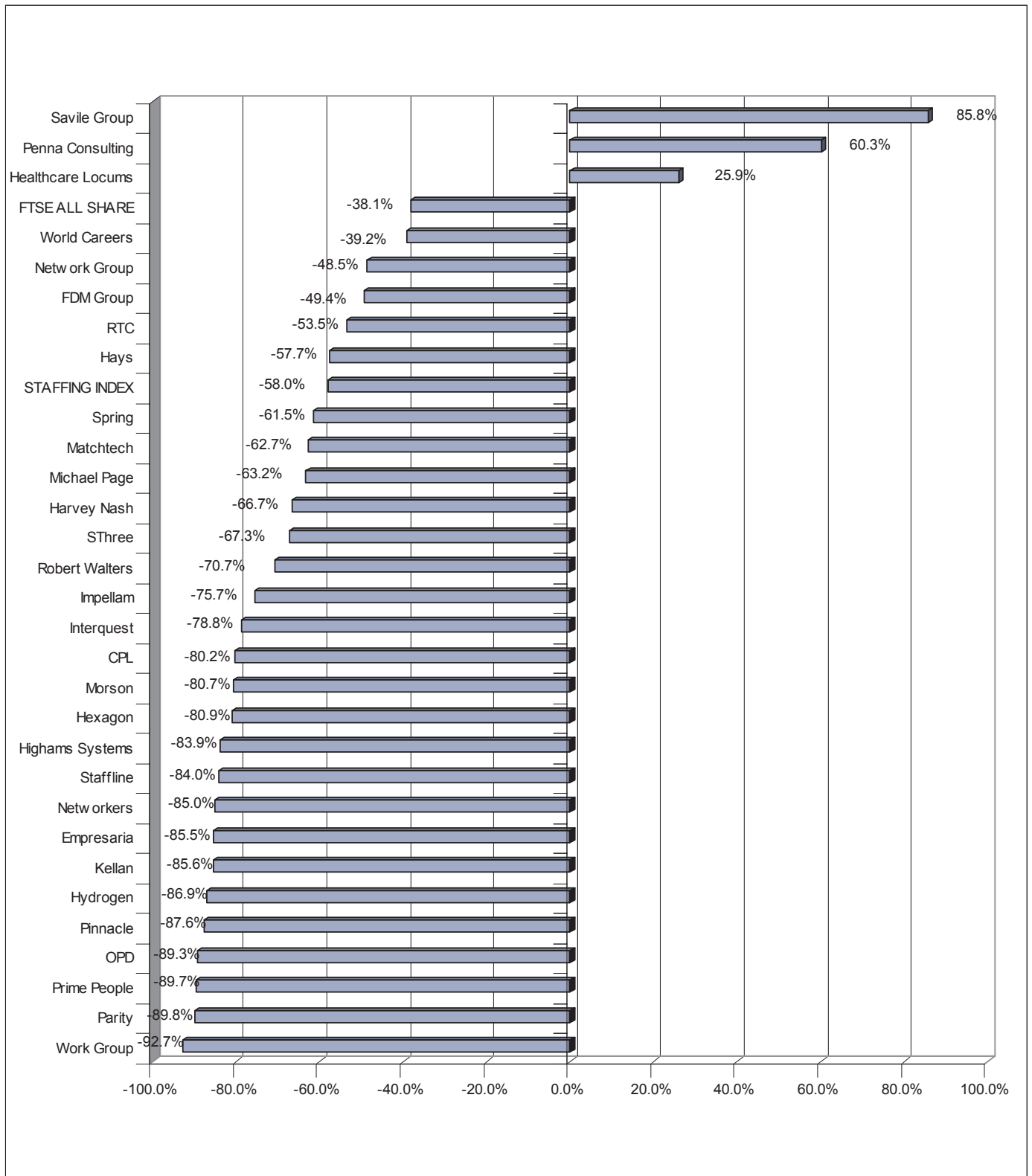
Share Price Performance

Chart 2: 12 month share price change



Source: JEP

Chart 3: Share price change since 2007 peak



Source: JEP

Valuation Metrics

Company	Price	PER	
		2008 E	2009 E
	(p)	(x)	(x)
Empresaria*	27.0	3.1	4.6
FDM*	81.0	5.4	4.8
Harvey Nash*	31.5	3.7	3.3
Hays*	85.5	9.2	10.7
Healthcare Locums	138.5	11.4	6.4
Hydrogen*	42.5	3.9	8.5
Impellam	22.0	1.1	1.6
Matchtech*	184.5	4.6	4.7
Morson*	53.5	3.0	2.8
Michael Page*	248.5	8.4	16.6
OPD*	49.0	2.3	5.4
Penna	165.5	12.6	9.8
Robert Walters*	125.0	8.1	25.1
Spring	33.25	10.4	13.3
Staffline*	30.0	2.6	2.9
SThree*	182.25	#6.2	10.1
Average		6.1	8.2

Individual valuations are evidencing very little correlation and the degree of divergence seems to be widening

Source: JEP

* Denotes consensus earnings estimates taken from Hemscott Group

Denotes based on actual results to Nov 2008

The Companies

We have initiated coverage of the following companies in this issue:

- **HEALTHCARE LOCUMS (HLO.LN) – BUY**
- **IMPELLAM (IPEL.LN) – HOLD**
- **PENNA CONSULTING (PNA.LN) – BUY**
- **SPRING GROUP (SRG.LN) – BUY**

Note: It is our intention to add additional companies to our coverage list as rapidly as possible.

Healthcare Locums

A defensive niche in healthcare recruitment

If there was one stock likely to outperform both the general market and the staffing sector over the next two to three years then HCL would be up amongst the top picks. With its specialisation in the placement of temporary and permanent health and social care staff in the UK and overseas the group is benefiting from the structural global shortage of skilled talent which is being further exacerbated by an ageing population that are living longer and all that that brings in terms of increased pressure on limited health resources. The World Health Organisation estimates that from 2000 to 2050 the world's population aged 60 and over will more than triple from 600 million to 2 billion. HCL has reported record results in each year since it floated in 2005 and we expect this record to continue.

Investment case:

- HCL was founded in 2003 and floated in 2005 and since formation has achieved record results in each year. We expect this trend to continue. HCL offers investors strong organic growth that is driven by a fundamental and structural imbalance between supply and demand in the global health and social care markets and the increasing longevity of an ageing population demographic.
- If this structural imbalance is to be rectified it is unlikely to be achieved in anything but the very long term as management believes there are no signs of increased training programmes for health or social care professionals either in the UK or elsewhere that could fundamentally alter things in the short to medium term.
- HCL is the UK market leader in each of its three specialisations, Doctors' Locums, Allied Health Professionals (AHP) and Qualified Social Workers (QSW). Even so we expect its market share to continue to rise as smaller, sub-scale, providers leave the industry while the market itself is expected to evidence growth at around 10% per annum.
- Over the past two years HCL's management has been building up its supplier and client base in the Middle East and USA where the shortage of permanent nurses is exceptionally acute. In 2009, for the first time, the group will enjoy significant income from the volume placement of these nurses and this will be the primary driver for what we expect to be organic earnings growth of around 80%, on top of the anticipated circa 40% growth for 2008.
- Conversion of operating profit to cash flow is exceptionally strong (50%+) and the rapidly increasing revenue stream will allow net debt (which was built up during the group's acquisition phase) to be paid down quickly. Thus net debt of £35m in 2007 is expected to be totally eliminated by 2010. This strong cash generation is forecast to be achieved after anticipating a doubling of the dividend payout in each of the next three years from 1p in 2007 to 2p in 2008, 4p in 2009 and 8p in 2010. Further out we can envisage continued progressive dividend payments and initiation of share buy backs.
- HCL is a rare example of a buy and build strategy that has worked; management are intimately acquainted with their markets and have delivered the strategy put in place in 2003. The decoupling of HCL's share price relative to the staffing sector has been such that the group is now the fourth largest UK staffing company by market cap behind Hays, Michael Page and STthree. Its success, pre-eminent UK market position and strongly expanding overseas activity is unlikely to go unnoticed in the broader recruitment industry and in our opinion would represent an exceptionally good acquisition for a global recruitment group such as Adecco, Randstad, Manpower or Hays.
- We still consider that risks to forecasts are very much on the upside and therefore commence coverage with a Buy recommendation and 12 month share price target of 225p.

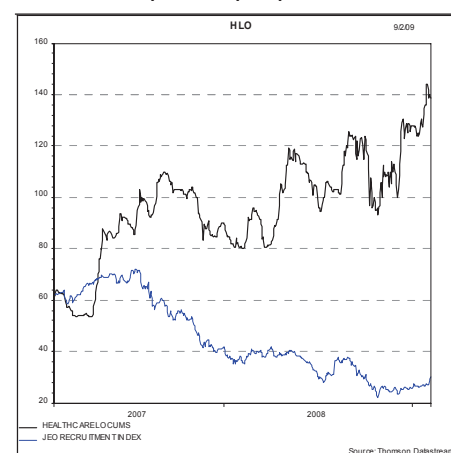
BUY

Recent price	138.5
Tickers	HLO.LN
Asset class:	AIM
Website:	www.hclplc.com
12 month price change	+72%
52-week range	High 138.5p - Low 80.75p
Sector	Support Services
Market Cap	£144.5m
Net (debt)/cash	(£27m) E
EV	£171.5m E
Dividend yield	1.4% E
Next earnings	Prelims: 3 rd week March 2009

Estimates *Source: John East & Partners Limited*

Year to Dec (£m)	07	08 E	09 E
Revenue	134.9	171.0	220.0
NFI	31.2	45.0	63.6
EBITDA	16.4	22.4	35.7
Conv. Ratio (%)	50.5	48.1	55.0
PBT as stated	7.3	16.7	31.2
PBT adjusted	11.8	18.2	32.4
EPS FD (p)	5.3	11.2	20.6
EPS FD Adj (p)	8.8	12.2	21.7
EV/EBITDA (x)		7.7	4.4
EV/NFI (x)		3.8	2.5
PE ratio (x)		11.4	6.4
Debt/EBITDA		1.2	0.3

Two-year share-price performance



Background

Table 3: Healthcare Locums historic and prospective revenue

Years to Dec (£m)	2006	2007	2008 E	2009 E
Revenue:				
Doctor's Locums	22.1	52.6	70.0	87.0
Qualified Social Workers	8.3	44.2	48.0	70.0
Allied Health Professionals	34.2	38.1	53.0	63.0
Revenue total	64.6	134.9	171.0	220.0

Source: JEP estimates

Table 4: Healthcare Locums historic and prospective NFI

Years to Dec (£m)	2006	2007	2008 E	2009 E
NFI:				
Doctor's Locums	4.6	9.5	16.0	22.6
Qualified Social Workers	2.2	10.3	11.5	18.9
Allied Health Professionals	9.1	11.4	17.5	22.1
NFI total	15.9	31.2	45.0	63.6

Source: JEP estimates

HCL was formed in 2003 by the current Executive Vice Chairman (previously CEO), Kate Bleasdale, on a buy and build strategy. With substantial previous experience in the UK healthcare market Kate and the HCL management team saw the attractions of building a group with the expertise and drive to gain a market leading position in locum doctors, allied health professionals (therapists, radiographers etc.) and qualified social workers in the UK. With target companies already identified the group embarked upon a four-year campaign encompassing thirteen acquisitions and culminating in the purchase of locum specialist JCI which was concluded in April 2007.

JCI completed the acquisition phase of the group's growth and since then growth has, and will continue to be, solely organic. Whereas the NHS (the group's major customer) has sought to minimise the cost of locum doctors through fairly onerous national framework agreements which effectively put a cap on margins for those agencies appointed, HCL instead chooses to transact its business outside of the framework agreements. This strategy, while having some initial negative effects on volume, offers a much higher gross margin of up to twice the level available on-framework. Volumes have in fact now recovered to previous levels.

There is an acute shortage of qualified health and social care workers worldwide and this factor, combined with an ageing population and greater longevity, intensifies the need for skilled staff. Thus HCL operates in a market where the principal constraint to growth is not a lack of demand but the finding of suitable skilled staff. In this respect being the UK's largest supplier of locums is a virtuous circle where successful placement encourages new locums to join the database thus improving growth prospects still further.

International

More recently the group has identified a need for and a suitable supply of qualified nurses for positions in overseas markets. Sourcing nurses from over 60 different countries, but in particular South Korea, Sri Lanka and Nepal, HCL has been awarded contracts with Emaar Healthcare and Bumrungrad in the Asia Pacific area and a number of hospitals in the USA for the long term supply of qualified nurses. This new stream of revenue generation is still relatively new and we do not anticipate significant revenues being generated until 2009. However, with a potential pool of nurses of around 40,000 in South Korea and 20,000 in both Sri Lanka and Nepal, HCL is well positioned to supply the requirements of its major overseas clients for the foreseeable future.

4 year, 13 acquisition buy and build programme completed in 2007

Organic growth the only driver now. Margins maximised by conducting business off-framework

Demand driven by acute shortage of health and social care workers on a global basis

Substantial additional revenues now being achieved in the placement of permanent nursing staff in the Middle East and USA

Although initially qualified to a degree sufficient to be placed in hospitals in the Middle East for a fee of around \$5,000, nurses still have to train and sit the NCLEX conversion examination in order to be registered and work in the USA. After a period of around 18 months such training will be complete and the nurses moved into new positions in US hospitals at a fee of up to \$15,000, their positions in the Middle East being taken by new recruits. Thus HCL typically earns two fees from the same nurse.

HCL achieves two placement fees for the same nurse

In order to facilitate the growing demand for overseas placements HCL is upgrading its office in the USA. Currently based in Florida and employing three people, in Q1 2009 the group plans to move its facilities to New York and raise the number of staff to 20 to deal with the increased level of activity. In addition the UK-based support for its overseas operations will also be expanded from three to 20 staff. This will increase capital expenditure in 2009 although such expenditure is still expected to be modest.

International business supported by dedicated staff in the USA and UK

Doctors

First Half Sales +49%; NFI +69%; NFI margin +110 bps

Doctors' Locums division showed good top line growth supported by an improvement in gross margin as a consequence of higher returns from JGJ as it moved its business off the national framework agreement. Initially volumes suffered as a result but at the time of writing previous volume levels have been regained. The business remains operationally geared due to its call centre model and additional business can be accommodated for little in the way of additional resources.

First half showed strong growth and benefitted from operational leverage

Qualified Social Workers

First Half Sales +5%; NFI +6%; NFI margin +30 bps

Growth in the first half had been held back by management issues. The previous head of this business was on an earn-out and so it was difficult for the board to take the necessary action needed to bring this business into line with other parts of the group. The management has now been changed. Kate Bleasdale, until very recently, group Chief Executive, had been taking responsibility for this division and a new appointment is expected shortly. Demand for QSWs in the UK has doubled over the past two years and the market currently stands at around £400m but there is still a vacancy rate of around 25%. This business is moving off-framework and is currently achieving NFI of around £0.25m per week with the target of £0.3m by Q1 2009 so there is a lot of upside still to come in this division.

HI growth held back by management issues which have now been resolved. Revenues now moving ahead strongly

Allied Health Professionals

First Half Sales +53%; NFI +80%; NFI margin +480 bps

Demand continues to outstrip supply and fill rates are consistently high at 70%. NHS PASA has recently completed a tendering process for a new framework agreement (NFA) for AHPs. HCL's brands that tendered have been accepted onto the new framework which commences 1st April 2009. So the status quo will be maintained with HCL Healthcare and Medical Technical operating on-contract but with most of the business still being conducted through its off-contract brand Allied Health Professionals Ltd.

Admitted to new framework agreement but majority of business will still be conducted off-framework

Financials

HCL is not a capital intensive business, its primary cost being that of staff which represented 65% of total costs in 2007. Working capital increases in line with the underlying growth in activity but debtor days are kept under strict control and indeed the previous Finance Director was partially remunerated on whether internal targets are met.

Debt set to reduce quickly even after an aggressive dividend policy that will see a doubling of the payout in each of the next three years

As a legacy of the thirteen acquisitions acquired through 2003 – 2007 the group had net debt of £35.3m at the end of 2007. Now that the acquisition programme is complete cash generation is expected to be strong and we are anticipating the level reducing by around £8m in 2008. Even after a fairly aggressive dividend policy which sees an estimated 2p payment for 2008 increased to a forecast 4p in 2009 and 8p in 2010 net debt should continue to fall as a result of growth in profits, control of working capital and minimal capex requirements.

We thus anticipate net debt falling still further in 2009 to £11m and in 2010 we foresee the group moving into a net cash position of around £5.5m which would enable the company to commence an earnings accretive share buy-back programme. Interest rates attached to borrowings have been reduced during the year as the group hit agreed targets with its lenders. It now enjoys a rate of 1.25% over base on its invoice discount facilities and 1.75% over LIBOR on its term loan.

Ignoring potential buy-backs we are forecasting fully diluted earnings growth of 38.6% in 2008, 78.6% in 2009 and 22% in 2010. This growth will be completely organic and in 2009 in particular will reflect the ramp up of overseas placements. While the global economic and financial environment is currently fragile HCL's market dynamics and inherent supply/demand imbalance means that the company is relatively insulated from these macro effects.

Trading update and board changes

In January the group provided a trading update which confirmed robust trading conditions in December and January with management confident of the continuing financial progress of the business. Perhaps of more interest was the news of some major changes to the composition of the board:

Kate Bleasdale, founder and CEO has moved to the newly created position of Executive Vice Chairman.

Diane Jarvis, Finance Director, has been appointed Group Managing Director.

Mo Dedat, Commercial Director, has been appointed Finance Director.

Andy McRae, MD of international operations, has been appointed to the board as COO, while Carol Hepburn, previously director of operations has resigned from the board with immediate effect.

While these changes are superficially significant we still believe that Kate Bleasdale will continue to be intimately involved in the group's progress especially as HCL moves more fully into the internationalisation of the business. It is probable that her role will evolve into one of strategic direction and investor relations thus leaving the operational management under the very capable hands of Diane Jarvis.

Valuation and recommendation

If HCL achieves our targeted EPS growth in 2008 and 2009 (we actually expect the company to exceed these forecasts) it will have delivered CAGR in earnings of 25% over a four year period HCL. It is already poised to deliver a four year CAGR in EPS of 32% in 2008 and in spite of this achievement currently sells on a 2008E PER of 11.4x falling to 6.4x in 2009E. This is substantially below the valuation metrics of the larger professional service recruitment companies such as Michael Page, Hays and SThree (see page 10) whose earnings are expected to fall over the currency of this down-cycle which historically has lasted for around three years.

We have made the point before that HCL's market is non-cyclical in a global sense and while demand can be affected by changes in government policy we feel that this is highly unlikely to impinge upon the requirement for skilled talent, the war for which is no greater than within the global healthcare market. We therefore consider an investment in HCL to be relatively low risk and capable of providing strong capital appreciation while holders are also likely to enjoy the income from an aggressive dividend policy.

Its success, pre-eminent UK market position and strongly expanding overseas activity is unlikely to go unnoticed in the broader recruitment industry and in our opinion HCL would represent an exceptional acquisition for a global recruitment group such as Adecco, Randstad, Manpower or Hays all of whom are seeking to enhance their higher margin professional staffing activities with acquisitions, and frankly there are not that many suitable targets around. So shareholders can expect an end game which is likely to see HCL being acquired at a substantial premium to the current share price. We therefore have a Buy recommendation on the stock and a twelve month price target of 225p offering an upside of 62% from the current share price.

We anticipate a net cash position by end 2010 which will facilitate earnings accretive share buy backs

Exceptionally strong growth forecast in 2009 which will be purely organic

Substantial board changes with the CEO moving to Executive Vice Chairman but still being intimately involved in the strategy and performance of the group

Group poised to deliver CAGR in earnings of 32% in 2008 and 25% in 2009 yet sells on a multiple substantially less than its larger peers whose earnings are expected to decline sharply over the coming years

A prime target for acquisition by one of the major staffing companies

Price target 225p

Summary P&L

Years ended December	2006	2007	2008 E	2009 E
	£m	£m	£m	£m
Revenue	64.6	134.9	171.0	220.0
Gross profit (NFI)	15.9	31.2	45.0	63.6
Administration expenses	-7.8	-16.1	-23.4	-29.3
Associates	0.0	0.0	0.0	0.0
Operating Profit	2.9	10.3	19.5	32.5
Exceptionals	-2.9	-3.7	-0.5	0.0
Finance income	0.0	0.0	0.0	0.0
Finance charge	-1.7	-3.0	-2.8	-1.3
Profit before tax as stated	1.2	7.3	16.7	31.2
Adjustment for amortisation of intangibles	2.2	0.7	0.7	0.7
Adjustment for exceptionals	2.9	3.7	0.5	0.0
Adjustment for share based payments	0.1	0.1	0.3	0.5
Adjusted Profit before tax	6.4	11.8	18.2	32.4
Tax	-0.4	-2.1	-5.0	-9.4
Post tax profit	0.8	5.2	11.7	21.8
Minorities	0.0	0.0	0.0	0.0
Net Profit	0.8	5.2	11.7	21.8
Adjusted Net Profit	5.9	9.7	13.2	23.0
EBITDA	8.4	16.4	22.4	35.7
Depreciation	-0.2	-0.6	-0.7	-0.7
EBITA	8.2	15.8	21.7	35.0
Amortisation of intangibles	-2.2	-1.0	-1.3	-1.3
EBIT	6.0	14.7	20.4	33.7
Equity				
Weighted average shares (m)	63.510	96.909	103.000	105.000
Weighted average shares FD (m)	65.574	97.392	104.000	106.000
Year end shares in issue (m)	96.242	100.473	104.273	104.273
EPS				
EPS FD (p)	1.2	5.3	11.2	20.6
EPS FD and adjusted (p)	8.9	8.8	12.2	21.7
Dividend				
Interim dividend (p)	0	0.00	0.80	1.30
Final dividend (p)	0	1.00	1.20	2.70
Total dividend (p)	0	1.00	2.00	4.00

P&L Analysis

	2006	2007	2008 E	2009 E
	£m	£m	£m	£m
Analysis of revenue				
Doctors Locums	22.1	52.6	70.0	87.0
Qualified Social Workers	8.3	44.2	48.0	70.0
Allied Health Professionals	34.2	38.1	53.0	63.0
Total Revenue	64.6	134.9	171.0	220.0
Analysis of NFI				
Doctors Locums	4.6	9.5	16.0	22.6
Qualified Social Workers	2.2	10.3	11.5	18.9
Allied Health Professionals	9.1	11.4	17.5	22.1
Total NFI	15.9	31.2	45.0	63.6
NFI Margin				
Doctors Locums	20.8%	18.0%	22.9%	26.0%
Qualified Social Workers	26.5%	23.3%	24.0%	27.0%
Allied Health Professionals	26.6%	30.0%	33.0%	35.0%
Group NFI margin	24.6%	23.1%	26.3%	28.9%
Key Ratios				
EBITA margin	12.7%	11.7%	12.7%	15.9%
Administration costs as a % of revenue	12.1%	12.0%	13.7%	13.3%
Conversion of NFI into EBITA	51.4%	50.5%	48.1%	55.0%
Effective tax rate	6.1%	17.9%	27.5%	28.9%
Net interest cover by EBITDA (x)	4.8	5.6	8.0	27.5
Dividend cover by adjusted EPS (x)	n/a	8.8	6.1	5.4

Summary Cash Flow				
Years ended December	2006	2007	2008 E	2009 E
	£m	£m	£m	£m
Net cash from operating activities		12.1	21.8	35.0
Increase in trade and other receivables		-5.8	-6.0	-5.0
Increase in trade and other payables		0.0	0.8	-0.6
Other		0.0	1.0	2.0
Cash generated by operations		6.2	17.5	31.4
Taxation paid		-0.5	-1.0	-8.0
Net cash generated by operating activities		5.7	15.5	21.4
Cash flow from investing activities:				
Interest received		0.0	0.0	0.0
Acquisition of subsidiaries (net of cash acquired)		-15.8	-3.3	0.0
Proceeds from the sale of subsidiary (net of cash disposed)		0.0	0.0	0.0
Purchase of PP&E		-0.6	-0.5	-0.5
Purchase of intangible assets		-3.6	-1.7	-1.0
Proceeds from sale of PP&E		0.0	0.0	0.0
Decrease/(increase) in short term deposits		0.0	0.0	0.0
Other		0.0	0.0	0.0
Net cash used in investing activities		-19.9	-5.5	-1.5
Financing activities:				
Purchase of own shares		0.0	2.9	0.0
Net movement in borrowings		4.0	-2.0	-3.0
Dividends paid		0.0	-1.8	-2.6
Interest paid		-2.9	-2.8	-1.3
Issue of shares (net)		4.6	0.0	0.0
Capital element of finance lease rentals		0.0	0.0	0.0
Other		0.0	0.0	0.0
Net cash inflow from financing activities		5.7	-3.7	-6.9
Net cash increase in cash and cash equivalents		-8.5	6.3	13.0
Cash at start of year		-7.4	-15.9	-9.6
FX changes		0.0	0.0	0.0
Cash and cash equivalents at end of year		-15.9	-9.6	3.4
Reconciliation of cash flow to net debt				
Net (debt)/cash at start of the year		-22.8	-35.3	-27.0
Net increase in cash and cash equivalents		-8.5	6.3	13.0
Net change in borrowings during the year		-4.0	2.0	3.0
Net (debt)/cash at end of the year		-35.3	-27.0	-11.0
Key Ratios				
Free Cash Flow (£m)		2.8	10.9	17.5
Free Cash Flow per share (p)		2.9	10.6	16.7

Free Cash Flow:

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

Summary Balance Sheet				
Years ended December				
	2006	2007	2008 E	2009 E
	£m	£m	£m	£m
Assets				
Non-current assets				
PP&E		1.6	1.5	1.6
Goodwill		60.2	60.5	61.0
Other intangible assets		8.4	9.5	9.5
Other		0.0	1.0	2.0
Total non-current assets		70.2	71.5	72.1
Current assets				
Trade and other receivables		31.2	35.0	40.0
Deferred tax assets		0.0	0.0	0.0
Other		0.0	0.0	0.0
Cash and short term deposits		1.1	1.5	5.0
Total current assets		32.3	36.5	45.0
Liabilities				
Current liabilities				
Trade and other payables		-9.9	-11.0	-13.0
Taxation liabilities		-1.3	-5.0	-9.4
Bank overdrafts and other short term borrowings		-20.7	-16.0	-11.0
Provisions		-4.9	-2.5	-2.0
Other		-0.1	-2.5	-2.5
Total current liabilities		-36.9	-37.0	-37.9
Non-current liabilities				
Long term borrowings		-15.7	-12.5	-5.0
Provisions		-0.9	0.0	0.0
Other		-1.8	-2.0	-2.0
Total non-current liabilities		-18.4	-14.5	-7.0
Total liabilities		-55.3	-51.5	-44.9
Net Assets		47.2	56.5	72.2
Key Ratios				
Net cash/(debt) (£m)		-35.3	-27.0	-11.0
Net debt/shareholders funds		74.8%	47.8%	15.2%
Capital employed (£m)		89.4	87.5	90.2
ROCE		3.2%	11.7%	21.6%
Current ratio		-0.87	-0.99	1.19

Capital employed:

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

ROCE

Operating profit/CE

Impellam Group

Mixed trading outlook

Impellam Group, the result of a merger between Corporate Services and Carlisle in March 2008, has a mixture of staffing and support service companies in its portfolio. Within this portfolio it has a number of defensive activities, countered by other more cyclical areas, primarily commercial staffing and permanent placement, which, in common with most other recruitment companies, are being affected by pressures on rates and margins and greater competition for a reduced volume of work. In its favour the majority of Impellam's staffing business operates in the temp/contract space and so should prove to be more resilient in a downturn than perm and it also has its non-staffing activities that are possibly not as cyclical as the staffing model. It enjoys one of the highest gross profits of any UK quoted staffing company but its conversion of this into operating profit is relatively poor and is currently being addressed by management. We also look forward to a resolution of the uncomfortably high level of debt in the balance sheet through possible asset disposals which, if achieved, would provide the group (economic conditions allowing) with the financial flexibility to enable it to reposition its activities into higher growth/margin activities.

Key investment points:

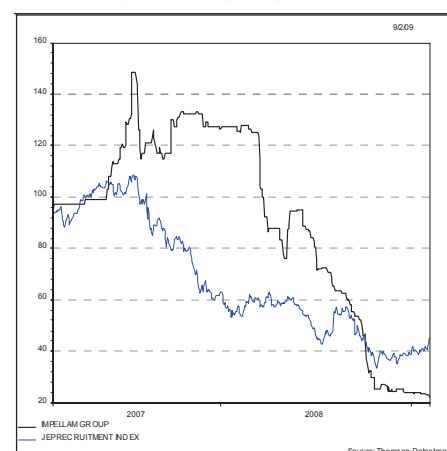
- Following the merger between Corporate Services Group (CSG) and Carlisle Group, Impellam can boast sales of over £1bn and NFI of around £200m putting the group amongst the leaders of UK staffing companies. Unfortunately the conversion of this fee income into operating profit is currently poor at an estimated 4% for 2008 on a group pro forma basis. Nevertheless, the company (in its previous guise of CSG) has made substantial progress over the past three years turning around serial losses into sustainable profit and achieving this without the benefit of the buoyant market conditions enjoyed by many of its peers.
- Impellam is primarily a temp/contract business specialising in the provision of staff in the professional/technical and commercial industrial fields but with some exposure to the broader financial services sector and permanent placement markets. This albeit limited exposure prompted a trading update in December 2008 warning that because of weakness in the banking, accounting and legal markets and in its UK and US Commercial staffing segments earnings, on a pro forma basis, would be moderately below market expectations.
- We also have to be concerned about the high level of debt within the group which at a forecasted £65m is equivalent to around three times estimated EBITDA for 2008. However, last year's merger of CSG and Carlisle results in an asset rich group, which even in the current difficult economic environment, should provide room for the disposal of some non-core businesses. Management has often stated that it runs a portfolio of businesses with each component continually assessed as to its suitability for inclusion within the group. We are hopeful that if consummated such disposals could result in a very much reduced level or even elimination of debt. So while Impellam is, in common with most other staffing companies, under some market related pressures we are hopeful that action will be taken to better position the group to be able to weather the current weakness in the UK and US economies.
- As a consequence of the merger management identified a number of cost saving measures that will have some effect on 2008 results but will more fully benefit the cost base in 2009. At the end of the first half annualised cost savings of £2.9m had been identified with a further £2m that was probably actioned in the second half. We expect additional cost saving measures to be taken during 2009.
- The shares are relatively depressed having fallen by 77% since reaching a high of 95p in May 2008 shortly after the group's formation. The valuation metrics point to a security that is being understandably affected by investor perception of weak market conditions but with an added concern relating to its high debt levels. Until the latter problem is resolved we doubt whether there is much upside in the shares and so commence coverage with a Hold recommendation. However, the valuation is so depressed that we also believe there is significant upside in the shares if and when the debt can be significantly reduced.

HOLD

Recent price	22p
Tickers	IPEL.LN
Asset class:	AIM
Website:	www.impellam.com
12 month price change	-74% (from May 2008)
52-week range	High 95p - Low 22p
Sector	Support Services
Market Cap	£10.3m
Net (debt)/cash	(£65m) £
EV	£74.9m £
Dividend yield	-
Next earnings	Prelims early March 2009

Estimates		Source: John East & Partners Limited		
Year to Dec (£m)	07 pro forma	08 E pro forma	09 E	
Revenue	977.7	1,060.0	1,000.0	
NFI	188.7	186.8	170.4	
EBITDA	3.5	19.5	16.1	
Conv. Ratio (%)	9.5	7.9	7.3	
PBT as stated	(7.6)	(0.6)	6.8	
PBT adjusted	(6.5)	10.0	7.0	
EPS FD (p)	(15.6p)	(3.6)	12.9	
EPS FD Adj (p)	29.5	19.6	13.4	
EV/EBITDA (x)		3.8	4.3	
EV/NFI (x)		0.4	0.4	
PE ratio (x)		1.1	1.6	
Debt/EBITDA		3.3	3.7	

Two-year share-price performance



Background

Impellam has two principal operating divisions: Staffing Services and Support Services. Based on first half 2008 pro forma data the group derived 14% of NFI and 31% of operating profit from the Support Services division against 13% and 26% respectively for the comparative period in 2007. We believe the relative increase especially in operating profits from the division is a function of a deteriorating staffing market coupled with a more robust market for support service activities.

14% of NFI and 31% of operating profit from Support Services, the balance from Staffing

Table 5: NFI by division (pro forma)

Years to Dec (£m)	H1 2008	H 1 2007	FULL YEAR 2007
NFI:			
UK Commercial Staffing	38.2	34.5	75.1
UK Professional & Technical Staffing	17.5	15.4	31.9
UK Healthcare Staffing	10.0	9.3	19.1
US Commercial Staffing	17.6	18.3	37.6
Support Services	13.1	11.7	25.0
Total NFI	96.4	89.2	188.7

Table 6: Operating profit by division (pro forma)

Years to Dec (£m)	H1 2008	H 1 2007	FULL YEAR 2007
Operating Profit:			
UK Commercial Staffing	1.4	1.7	6.3
UK Professional & Technical Staffing	1.8	1.2	3.0
UK Healthcare Staffing	2.2	1.8	3.8
US Commercial Staffing	0.8	1.8	4.7
Support Services	2.8	2.3	5.9
Corporate costs	-2.7	-2.7	-5.8
Amortisation of goodwill	-0.7	-	-18.9
Exceptional items	-4.1	0.2	-
Total Operating Profit	1.5	6.1	-1.0

Table 7: Conversion ratio by division (pro forma)

Years to Dec	H1 2008	H 1 2007	FULL YEAR 2007
Conversion Ratio:			
UK Commercial Staffing	3.7%	4.9%	8.4%
UK Professional & Technical Staffing	10.3%	7.8%	9.4%
UK Healthcare Staffing	22.0%	19.4%	19.9%
US Commercial Staffing	4.5%	9.8%	12.5%
Support Services	21.4%	19.7%	23.6%
Group Conversion Ratio	6.5%	6.8%	9.5%

Source: JEP

As stated earlier we consider the conversion of NFI into operating profit to be very low compared to the group's peers, Hays for instance has a deserved reputation for keeping costs firmly under control and its conversion ratio is in the 30s. Nevertheless it would be churlish not to acknowledge Impellam's strong performance in Healthcare Staffing which in the first half of 2008 achieved a conversion ratio of 22%. However, other areas still need addressing and the current weakness in the staffing markets will make any improvement in operating efficiencies more difficult to attain.

With the exception of UK Healthcare Staffing conversion ratio is very low

Half-Year analysis by division

UK Commercial Staffing

Sales +19.2% to £216.2m; NFI +10.6% to £38.2m; NFI margin 17.7% (19.0%); EBITAE* -17.6% to £1.4m, EBITAE margin 0.6% (0.9%); CR 3.7% (4.9%).

* Denotes EBITA and before exceptional items

Demand for temporary staff was more robust than perm in an increasingly difficult market, Q1 growth being better than Q2. However, within the detail we note that while demand for driving and construction workers was, as one might expect, under some pressure, other disciplines such as catering, premium office, on-site managed services and managed solutions continued to experience good y-o-y growth.

A mixed performance

However, with the UK economy weakening and unemployment increasing, it is a moot point as to how long the 'better' disciplines can buck the trend. This point was highlighted in the recent trading update which noted weakness extending into catering, which failed to experience its usual traditionally strong final quarter to the year. Managed Services continued to perform well. The perm activities which include the Austin Benn and Blend brands were weaker, but at 19.6% of NFI (21.1%) represented quite a small percentage of the group's business. The reduction in activity here was partly responsible for the division's lower NFI margin.

Weaker perm reduced NFI margin but is relatively small

UK Technical & Professional Staffing

Sales +14.1% to £88.7m; NFI +13.7% to £17.5m; NFI margin 19.7% (19.8%); EBITAE +55.7% to £1.8m; EBITAE margin 2.0% (1.5%); CR 10.5% (7.7%).

An impressive performance from this division, with a 56% jump in EBITAE, with a good performance in education, technical and scientific disciplines more than offsetting weakness in the legal, banking and accounting areas. Investment in additional staff has been made to support a healthy number of contract wins, particularly in the aviation sector. Since the end of the half year the weakness in the broader financial services sector has intensified as noted by luminaries such as Michael Page and DPD. It is therefore entirely possible a weakening demand for perm (which accounts for around 38% of divisional NFI) coupled with continued softness in financials will put some pressure on second half results.

Did well to advance in the face of weakening financial services but this is bound to have a negative effect in H2

UK Healthcare Staffing

Sales +24.7% to £64.7m; NFI + 7.8% to £10m; NFI margin 15.5% (17.9%); EBITAE +19.4% to £2.2m; EBITAE margin 3.4% (3.55%); CR 21.7% (19.6%).

This sector was influenced by strong demand for healthcare workers generally, albeit margins were impacted by continued pricing pressures within the NHS framework agreement for medical locums and a decline in demand for perms. New frameworks for nursing and allied health professionals have been put out to tender and we understand that Impellam have been selected for both.

Strong demand continues. IPEL successfully retendered for new frameworks

US Commercial Staffing

Sales -8.4% to £87.2m; NFI -3.9% to £17.6m; NFI margin 20.1% (19.2%); EBITAE -55.6% to £0.8m; EBITAE margin 0.9% (1.9%); CR 4.7% (10.2%).

With the US experiencing recessionary conditions, it is little surprise that sales, NFI and EBITAE all declined y-o-y. A brighter note was that NFI margins rose from 19.2% to 20.1% as a result of a change in the mix favouring the higher-margin IT, utilities and technical niches, together with an increase in permanent placements, which accounted for 7.6% of NFI (2007: 6.7%). There should be some help from the strengthening dollar in the final months of the year, but the outlook for the US in general is uncertain.

A mixed bag with a good performance from the utilities, IT and technical segments but weaker in financial services, admin and sales and marketing

Support Services

Sales +5.5% to £60.4m; NFI +12.4% to £13.1m; NFI margin 21.8% (20.4%); EBITAE +17.1% to £2.8m; EBITAE margin 4.6% (4.0%); CR 21.0% (20.2%).

A good performance from Support Services, reflecting a number of contract wins, particularly cleaning contracts at a number of UK airports, with Comensura also adding new clients as well as retaining other contracts on re-bid. Unsurprisingly, the retail-facing activities are seeing reduced demand for their services and this does not bode well for the second half or for 2009. We suspect that appropriate action will need to be taken to reduce costs in this area.

A good H1 result but pressure is building in the division's retail-facing activities

Finances

Net debt increased marginally from £63.3m at the year end to £64.7m in the first half and we currently anticipate a level of £65m at the end of December 2008. New banking facilities were arranged post the merger and the group continues to operate within its financial and operational covenants. Management consider it a priority to reduce the group's level of debt to no more than two times EBITDA over the medium term. To effect this goal the board is seeking to divest certain businesses with the proceeds being utilised to pay down debt.

Debt needs to be reduced to no more than 2x EBITDA

Outlook

The outlook is uncertain. Impellam, in common with other staffing companies, is operating within a cyclical industry whose cycle now appears to be in decline. How steep this decline will be is also unclear, although in our view Impellam does have the strength of a wide portfolio of businesses covering a broad range of disciplines in a number of territories. In addition a high proportion of its income is generated from temporary or contract placements, which tend to be more resilient. Many of its activities offer resilience to macro economic volatility while some are more exposed. It also has a focus on the UK, which accounts for 80% of its NFI and 91% of EBITA, so it is inextricably linked to the health of the UK economy.

An uncertain outlook but some comfort may be taken from the high level of temp/contract placement which tends to be more resilient

In a recent trading update management stated that the group had not seen the normal seasonal growth in its traditional marketplace and consequently profits will be moderately below market expectations which we take to mean adjusted profit before tax of around £10m against a loss of £4.5m for 2007.

Trading statement in December 2008 warned profits would be moderately below market expectations

As a consequence of the merger management identified a number of cost saving measures that will have some effect on 2008 results but will more fully benefit the cost base in 2009. At the end of the first half annualised cost savings of £2.9m had been identified with a further £2m that was probably actioned in the second half. We expect additional cost saving measures to be taken during 2009

Cost savings will help support 2009 results

Valuation and Recommendation

We maintain that Impellam is a sizeable staffing business that needs to translate its substantial NFI of circa £200m into a sustainable operating profit. In the first half of 2008 its conversion of NFI into EBITA was 6.5% after central costs, which leaves an awful lot of upside potential if management can improve throughput and productivity. However, in the current weakening economic environment with demand for staff reducing rapidly we doubt if much progress can be made on this front until market conditions improve.

Lots of upside for the conversion ratio but will be difficult to effect in the current climate

On the forecast PBT of £10m for 2008 EPS are 19.6p assuming a low tax charge of £1m. The PE ratio is a very modest 1.1x which we feel partly reflects the high gearing and uncertainty in the business. Assuming a notional tax charge of 30% EPS falls to 15.2p and the PE rises to a still modest 1.4x. It is probable that 2009 will represent an even more difficult year for the group – 2008 after all benefitted from a relatively strong first quarter – and at the moment we are looking for a reduction in PBT to £7m although the efficacy of this forecast is questionable; the benefits of cost savings being countered by weaker markets. As a consequence we still see the possibility of a downside risk to forecasts through 2009. Therefore we do not see much potential for share price recovery in the short term but would consider reviewing our recommendation if meaningful asset sales were to be consummated.

Very modest valuation but 2009 will be difficult

Summary P&L			
Years ended December	2007*	2008 E*	2009 E
<i>*Denotes pro forma figures</i>	£m	£m	£m
Revenue	977.7	1,060.0	1,000.0
Gross profit (NFI)	188.7	186.8	170.4
Administration expenses	-189.7	-182.0	-159.0
Associates	0.00	0.00	0.00
Operating Profit	-1.0	4.8	11.4
Exceptionals	-19.8	-10.4	0.00
Finance income	0.5	0.5	0.4
Finance charge	-6.2	-5.5	-5.0
Profit before tax as stated	-7.6	-0.6	6.8
Adjustment for amortisation of intangibles	0.0	0.0	0.0
Adjustment for exceptionals	19.8	10.4	0.0
Adjustment for share based payments	0.2	0.2	0.2
Adjusted Profit before tax	12.4	10.0	7.0
Tax	0.6	-1.0	-1.0
Post tax profit	-7.0	-1.6	5.8
Minorities	0.0	0.0	0.0
Net Profit	-7.0	-1.6	5.8
Adjusted Net Profit	13.0	9.0	6.0
EBITDA	3.5	19.5	16.1
Depreciation	-4.7	-4.5	-4.5
EBITA	-1.2	15.0	11.6
Amortisation of intangibles	0.0	0.0	0.0
EBIT	-1.2	15.0	11.6
Equity			
Weighted average shares (m)	44.804	44.804	44.804
Weighted average shares FD (m)	44.804	44.804	44.804
Year end shares in issue (m)	44.999	44.999	44.999
EPS			
EPS FD (p)	-15.6	-3.6	12.9
EPS FD and adjusted (p)	29.5	19.6	13.4
Dividend			
Interim dividend (p)	0.00	0.00	0.00
Final dividend (p)	0.00	0.00	0.00
Total dividend (p)	0.00	0.00	0.00

Summary P&L Analysis			
Year ended December	2007*	2008 E*	2009 E
<i>*Denotes pro forma figures</i>	£m	£m	£m
Analysis of revenue			
UK Commercial Staffing	407.4	458.0	420.0
UK Professional & Technical Staffing	151.4	170.0	160.0
UK Healthcare Staffing	110.1	130.0	145.0
US Commercial Staffing	187.8	172.0	140.0
Support Services	121.7	130.0	135.0
Inter company revenue	-0.7	0.0	0.0
Total Revenue	977.7	1,060.0	1,000.0
Analysis of NFI			
UK Commercial Staffing	75.1	67.8	58.9
UK Professional & Technical Staffing	31.9	35.0	32.0
UK Healthcare Staffing	19.1	21.0	23.5
US Commercial Staffing	37.7	35.0	28.0
Support Services	25.0	28.0	28.0
Total NFI	188.8	186.8	170.4
Analysis of operating profit			
UK Commercial Staffing	6.3	4.0	3.5
UK Professional & Technical Staffing	3.0	3.9	3.7
UK Healthcare Staffing	3.8	4.7	5.0
US Commercial Staffing	4.7	0.5	-1.5
Support Services	5.9	6.5	6.1
Central costs	-5.8	-4.8	-4.4
Total Operating Profit	17.9	14.8	12.4
NFI margin			
UK Commercial Staffing	18.4%	14.8%	14.0%
UK Professional & Technical Staffing	21.1%	20.6%	20.0%
UK Healthcare Staffing	17.3%	16.2%	16.2%
US Commercial Staffing	20.1%	20.3%	20.0%
Support Services	20.5%	21.5%	20.7%
Group NFI margin	19.3%	17.6%	17.0%
Operating margin			
UK Commercial Staffing	1.5%	0.9%	0.8%
UK Professional & Technical Staffing	2.0%	2.3%	2.3%
UK Healthcare Staffing	3.5%	3.6%	3.4%
US Commercial Staffing	2.5%	0.3%	-1.1%
Support Services	4.8%	5.0%	4.5%
Group Operating margin	1.8%	1.4%	1.2%
Key Ratios			
Administration costs as a % of revenue	19.4%	17.2%	15.9%
Conversion of NFI into operating profit	9.5%	7.7%	8.0%
Effective tax rate	Cr	10.0%	14.3%
Net interest cover by EBITDA (x)	0.6	3.9	3.5
Dividend cover by adjusted EPS (x)	n/a	n/a	n/a

Summary Cash Flow			
Years ended December	2007*	2008 E*	2009 E
<i>*Denotes pro forma figures</i>	£m	£m	£m
Net cash from operating activities	22.9	9.8	16.1
Increase in trade and other receivables	-35.0	11.7	-7.0
Increase in trade and other payables	27.5	-5.0	5.3
Decrease in provisions for liabilities and charges	-1.1	-1.0	-3.0
Cash generated by operations	14.3	15.5	11.4
Taxation paid	-0.6	0.0	0.0
Net cash generated by operating activities	13.7	15.5	11.4
Cash flow from investing activities:			
Interest received	0.3	0.5	0.4
Acquisition of subsidiaries (net of cash acquired)	-3.1	0.0	0.0
Proceeds from the sale of subsidiary (net of cash disposed)	0.4	0.0	0.0
Purchase of PP&E	-3.6	-4.5	-1.5
Purchase of intangible assets	-1.6	-1.6	0.0
Proceeds from sale of PP&E	0.1	0.0	0.0
Decrease/(increase) in short term deposits	0.5	0.0	0.0
Other	-0.3	-1.8	0.0
Net cash used in investing activities	-7.3	-7.4	-1.1
Financing activities:			
Purchase of own shares	-0.3	0.0	0.0
Net movement in other long term borrowings	-2.4	-10.0	0.0
Net movement in short term borrowings	6.4	10.0	0.0
Dividends paid	-3.0	-4.0	0.0
Interest paid	-5.6	-5.5	-5.0
Issue of shares (net)	0.0	0.0	0.0
Capital element of finance lease rentals	-0.3	-0.3	-0.3
Other	-0.8	0.0	0.0
Net cash inflow from financing activities	-6.0	-9.8	-5.3
Net cash increase in cash and cash equivalents	0.4	-1.7	5.0
Cash at start of year	5.5	5.9	5.5
FX changes	0.00	0.00	0.00
Cash and cash equivalents at end of year	5.9	-4.2	10.5
Reconciliation of cash flow to net debt			
Net (debt)/cash at start of the year		-63.3	-65.0
Net increase in cash and cash equivalents		-1.7	5.0
Net change in borrowings during the year		0.0	0.0
Net (debt)/cash at end of the year	-63.3	-65.0	-60.0
Key Ratios			
Free Cash Flow (£m)	10.7	11.5	11.4
Free Cash Flow per share (p)	23.9	25.7	25.4

Free Cash Flow:

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

Summary Balance Sheet			
Years ended December	2007*	2007	2008 E
	£m	£m	£m
<i>*Denotes pro forma figures</i>			
Assets			
Non-current assets			
PP&E	10.0	10.5	10.5
Goodwill	83.7	65.0	65.0
Other intangible assets	3.0	55.0	55.0
Deferred tax asset	1.3	1.0	1.0
Financial assets	4.8	5.0	5.0
Other	0.0	0.0	0.0
Total non-current assets	102.8	136.5	136.5
Current assets			
Trade and other receivables	192.1	190.0	185.0
Deferred tax assets	0.2	1.0	1.0
Other	0.0	0.0	0.0
Cash and short term deposits	8.3	7.0	7.0
Total current assets	200.6	198.0	193.0
Assets held for sale	0.0	5.0	0.0
Total assets	303.4	339.5	329.5
Liabilities			
Current liabilities			
Trade and other payables	-141.4	-135.0	-130.0
Taxation liabilities	-1.0	-1.0	-1.0
Bank overdrafts and other short term borrowings	-39.6	-50.0	-47.0
Derivative financial instruments	-0.1	0.0	0.0
Provisions	-2.0	-6.0	-5.0
Other	0.0	0.0	0.0
Total current liabilities	-184.1	-192.0	-183.0
Liabilities associated with assets held for sale	0.0	-1.4	0.0
Non-current liabilities			
Long term borrowings	-32.0	-22.0	-20.0
Other payables due in greater than one year	-1.3	-1.3	-1.0
Provisions	-1.2	-6.5	-6.0
Deferred taxation liability	0.0	-10.5	-10.5
Other	0.0	0.0	0.0
Total non-current liabilities	-34.5	-40.3	-37.5
Total liabilities	-218.6	-233.7	-220.5
Net Assets	84.8	105.8	109.0
Key Ratios			
Net cash/(debt) (£m)	-63.3	-65.0	-60.0
Net debt/shareholders funds	74.6%	61.4%	55.0%
Capital employed (£m)	159.6	190.3	187.0
ROCE	-0.6%	2.5%	6.1%
Current ratio	1.09	1.03	1.05

Capital employed:

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

ROCE

Operating profit/CE

Penna Consulting

Market leader in a cyclical upturn

Penna's principal activity, accounting for an estimated 64% of NFI, is the provision of outplacement services, it also has smaller and still sub-scale activities in Executive Recruitment, Interim Management, Recruitment Communications, Board & Executive Coaching and Leadership & Performance Consulting. After a number of years of weak demand for outplacement Penna is enjoying a resurgence as the UK economy moves into recession and financial and commercial organisations initiate significant redundancy programmes designed to reduce overheads. As market leader in the provision of outplacement services we believe Penna could be on the verge of an unprecedented upturn in fortunes leading to record profits being achieved in the year to March 2010. Its net cash position of £3m at the end of the last financial year is also expected to improve even after an acceleration in dividend payments and cash tax. This will position the group favourably to better balance the various business streams through selective, strategic acquisitions.

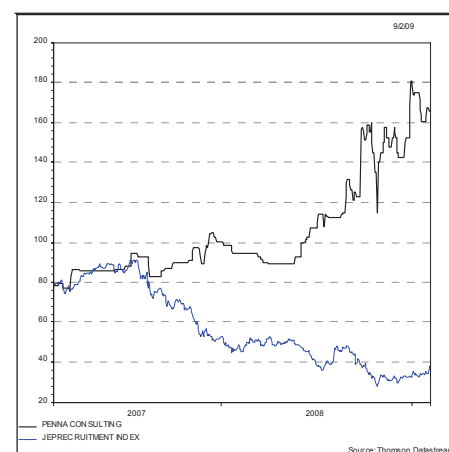
- Penna is seeing the first signs of resurgence in demand for outplacement services following five years of NFI decline in this activity. Restructuring by financial service companies has increased the demand for this service and we expect this to be followed increasing demand from organisations within the UK commercial and industrial sectors.
- At the peak of the last outplacement cycle Penna achieved a 25% operating profit margin on its Career Transition division and the group is confident that similar returns can be achieved in this cycle. Indeed, we believe that it is not at all ambitious to assume that historic record operating profits of £9.2m achieved in FY 2001/02 from this division cannot be surpassed (unfortunately Penna no longer breaks out operating profit by segment).
- In 2001/02 stellar outplacement profits were undermined by significant losses from its Executive Recruitment division which in those days was significantly larger than it is now. The group at that time had a much larger headcount and a significant property portfolio which hampered the timely restructuring of the division. Today the non-outplacement activities are much smaller and should not dilute the progress that we anticipate for the outplacement segment.
- Currently Penna is generating around 25-30% of its outplacement revenues from City clients illustrating that, important as this market is, the bulk of its outplacement activity is within the wider economy and by its own reckoning demand within this element of the business is still lagging behind the City which suggests to us that there is very substantial growth in revenues still to come from this division.
- We see good cash generation over the coming years adding to the group's already strong balance sheet and enabling the prospect of some selective strategic acquisitions that might ultimately allow the group to better balance its various service lines.
- Our forecast for the current year to March 2009 calls for an adjusted PBT increase of 135% to £4.7m (£2.0m) and a currently prudent forecasted increase in FY 2009/10 of 28% to £6m giving, respectively, adjusted EPS of 13.2p and 16.8p. While the PER is still a forward looking 12.6x falling to 9.8x we still believe there is significant potential to raise forecasts further, especially for 2009/10. In our opinion the rating is fully justified given that Penna is probably only at the beginning of an unprecedented cyclical upturn in demand that could last for three to four years.
- We have no hesitation in recommending purchases of Penna shares and initiate coverage with a Buy recommendation. With the risk to forecasts very firmly to the upside we have a twelve-month target price of 220p, which is based on the expectation of upgrades to forecasts as we progress through 2009.

BUY

Recent price	165.5p
Tickers	PNA.LN
Asset class:	AIM
Website:	www.e-penna.com
12 month price change	+77%
52-week range	High 180.5p - Low 94.5p
Sector	Support Services
Market Cap	£41.8m
Net (debt)/cash	£5m £
EV	£36.8m £
Dividend yield	2.5% £
Next earnings	Prelims June 2009

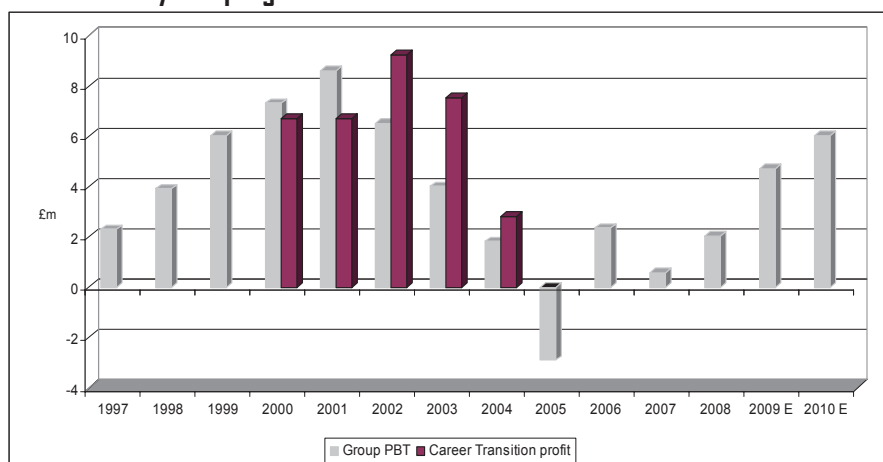
Estimates			
Source: John East & Partners Limited			
Year to Mar (£m)	08	09(e)	10(e)
Revenue	49.1	64.0	75.0
NFI	32.3	41.2	48.0
EBITDA	2.6	5.0	6.3
Conv. Ratio (%)	n/a	n/a	n/a
PBT as stated	2.0	4.6	5.9
PBT adjusted	2.0	4.7	6.0
EPS FD (p)	5.4	12.8	16.4
EPS adj FD (p)	5.7	13.2	16.8
EV/EBITDA (x)		7.4	5.4
EV/NFI (x)		0.9	0.7
PE ratio (x)		12.6	9.8
Debt/EBITDA	Cash	Cash	Cash

Two-year share-price performance



Background

Chart 4: Yearly PBT progression



Source: Company

Chart 4 above illustrates the cyclical nature of Penna's earnings. Through the 2000-2003 cyclical downturn in the recruitment sector, Penna's Career Transition (Outplacement) activity increased its operating profit to over £9m with the operating margin peaking at 25% only to fall off sharply as demand for outplacement services declined and those for recruitment increased. Unfortunately, Penna ceased segmenting profits by service lines in 2005 making it impossible to track progress at this level of detail. The premature reversal of growth for the group as a whole from 2002 onwards was in part due to the failure of the previous management to deal with the poor performance of the Executive Recruitment and Change Consulting activities which variously lost money through the 2000 - 2004 period.

New management, namely the appointment of Stephen Rowlinson (previously CEO of Penna in the early 1990's when it was called Sanders & Sidney) in December 2004 as non-executive director and in February 2005 as Chairman marked the turning point. Mr Rowlinson had been increasing his personal stake in the company prior to his appointment and by the end of 2004 had a holding of 29.2%. Also in February 2005 Gary Browning, who joined Penna in 2002, was appointed Managing Director of the company and is now CEO. In October 2006 the group moved from the Official List to AIM. Substantial costs were subsequently taken out of the business to enable the company to better weather periods of reduced demand.

Since the restructuring of the board Penna has expanded its activities into Recruitment Advertising and employee communication activities to today's position where it segments its activities into six divisions. In Table 8 below we show the NFI record of these activities, unfortunately, management does not offer a breakdown of its activities by operating profit.

Table 8: Historic analysis of NFI

Years to Mar (£m)	2000	2001	2002	2003	2004	2005	2006	2007	2008
NFI:									
Career Transition	28.4	26.8	37.3	35.4	25.3	18.9	19.2	16.2	17.7
Executive Recruitment	10.1	14.2	7.6	7.3	7.8	7.8	5.6	4.8	3.6
Executive Interim					0.9	2.6	3.1	2.5	3.1
Recruitment Communication							0.2	0.7	0.9
Board & Exec Coaching	1.8	6.9	8.2	6.4	2.1	2.4	2.3	2.8	3.6
Leadership & Performance Consulting					4.2	2.7	2.3	4.0	3.3

Source: Company

Outplacement runs counter to the recruitment cycle so 2000 - 2003 was a period of strong trading with margins peaking at 25%

New management helped reduce the cost base

Group now split into 6 service lines

A number of the above divisions are not strictly comparable y-o-y as some have been split into components of other divisions. However, the last two years are comparable and Career Transition, which is the major segment, is comparable throughout the above history.

Career Transition revenues increased markedly towards the end of the year to March 2008 hence the 9% y-o-y increase is rather misleading. A better representation of progress in this important division can be gauged by reference to the interim results to September 2008 in Table 9 below where not only Career Transition, but some other divisions made strong headway, thus further cementing the group's progress.

Outplacement activity rose sharply in H1

Table 9: Half yearly progression of NFI by division

Half years to September	2008	2007	% change
NFI:	£m	£m	
Career Transition	11.301	8.111	+39%
Executive Recruitment	1.843	1.842	0%
Executive Interim	1.659	1.411	+18%
Recruitment Communications	0.587	0.384	+53%
Board & Executive Coaching	0.989	0.997	0%
Leadership & Performance Consulting	2.713	2.247	+21%

Source: Company

We discuss the divisions in more detail below:

Career Transition (Outplacement)

Penna enjoys a market leading position in its Career Transition activities in the UK with a market share believed to be 30% suggesting that currently the market, in terms of net fees, is worth around £100m. Outplacement services help clients to plan an effective downsizing strategy including upfront planning, communications strategy, project planning, career transitioning and workforce productivity which ensures that those employees retained remain incentivised, productive and focused.

UK market leader

In its last cyclical upturn (1998-2003) Penna's Career Transition division peaked in FY 2001/02 with operating profit of £9.2m on NFI of £37.3m resulting in margins of 24.7%. In fact the previous FY year saw margins of 25% on lower NFI and profit. Through the period 2001 to 2008 the UK outplacement industry experienced a 30% erosion in pricing reflecting depressed demand for services, competitive pricing and the fact that procurement executives had become increasingly involved in the purchasing decisions resulting in a lengthening of the decision making process.

Margins peaked at 25% during the last up-cycle but since then pricing has been under pressure

Management now believes that this trend is reversing with demand increasing and outplacement now deemed to be a necessary element of the remuneration package and not a luxury or discretionary spend as perhaps it had been in the past. In addition demand for the service is currently rising almost exponentially as the UK and global economies face a lengthy recession. The only residual downward pressure on pricing may reside from the tougher conditions being felt by clients creating pressure on margins but not on volumes.

Pricing pressure now easing

In the first half year NFI grew by a very respectable 39% with Penna operating across all sectors of the UK economy. Clearly, the bulk of current demand is centred on the financial services industry and here Penna has a footprint that covers some 60% of the market. Almost daily news of large scale redundancy programmes is meat and drink for Penna but even so the City only accounts for around 30% of its total revenue. Non-City markets traditionally follow City trends with a lag of up to a year which suggests that there is plenty of revenue growth still to come from all sectors of the economy. This is supported by the fact that Penna's Career Transition division not only benefits from client headcount reduction programmes but by the effects of M&A activity and business restructuring.

Demand being driven by the financial services sector but this only accounts for 30% of division's market. Non-financial demand expected to increase sharply in 2009

Demand only began to pick up in the group's second half (from September 2008) but is now accelerating strongly. As a consequence of the (still early) increase in activity levels the group has had to supplement its existing physical capacity for interviews and consultation with clients' ex-employees by entering into a number of short term property rentals for specific projects. In addition, since the beginning of 2009 it has added 60 more associates or councillors in order to accommodate the increase in demand with a total councillor headcount now of around 400. These people are paid on a per meeting basis and are not in short supply, in the main being ex HR personnel.

For some years Penna has enjoyed a long term partnership with US-based Lee Hecht Harrison (LHH), one of the world's largest outplacement specialist and a subsidiary of Adecco. In situations where there is a client requirement for global outsourcing Penna and LHH will present their capabilities as one team with Penna undertaking the UK end of any business won and LHH the overseas element of the contract.

Useful partnership established with LHH

As mentioned earlier, Penna is the UK market leader in outplacement with Right Management (Manpower) and DBM (private) respectively numbers two and three with, possibly, Fairplace Consulting (Savile Group) in fourth position. However, Fairplace is significantly smaller than Penna.

Our forecasts for this division call for a 47% increase in NFI in FY 2008/09 to £26m and a 23% increase in 2009/10 to £32m and although not divulged by the company we expect margins to continue to improve with the prospect of hitting or exceeding the previous peak of 25%.

47% increase in NFI expected for 2008/09

Other divisions

The five other divisions within the group are currently relatively small. Over time they will be enlarged organically or more likely through acquisition.

Executive Recruitment

With its main focus on mid-management search and selection at a salary level of between £100k and £150k this division will inevitably be affected by the general slow down in recruitment activity while having little or no exposure to the, perhaps, more robust area of board level executive search.

Nevertheless, the Executive Recruitment division is very much smaller than it was in the early 2000's and although creating some major problems for previous management at that time it is now highly unlikely to be capable of jeopardising results for the group as a whole. As stated earlier, it has been slimmed down considerably since then and has far fewer offices and consultants. What is more around 60% of its business is now generated from the more defensive and robust UK public sector with some residual exposure to the retail and telco sectors. Importantly it has no exposure to the troubled financial services sector.

Executive recruitment expected to suffer from the economic downturn but has been substantially slimmed down from the early 2000s and no longer poses a threat to group results.

The division is currently enjoying additional revenues from several large contracts with government agencies decentralising out of London. Penna has been commissioned to recruit management and executives under these schemes which are expected to last for another eighteen months.

Excluding these contracts we do not envisage this division showing much growth in the current environment and could actually report modest losses. It is likely to remain sub-scale relative to the rest of the group until suitable acquisitions can be found to bolster and expand its size.

Executive Interim

Penna operates the UK's second largest Interim Management (IM) business behind quoted company Hexagon. In the six months to September 2008 Hexagon reported £4.8m of NFI from IM (9% organic growth) against Penna's £1.7m and 18% organic growth over the same period. Compared to other service lines this division is relatively free from cyclicality with 40% of its NFI being generated from the Public Sector and with no exposure to financial services. Rates continue to hold up well with margins of 20-25% being generated on day rates of around £820. Again, we anticipate this division growing through acquisition to supplement its organic growth.

2nd in the market behind Hexagon. Growing well and margins holding up

Recruitment Communications

Like most recruitment advertising businesses we believe that Penna's operations in this area are losing money, reflecting the depressed nature of recruitment demand and hence a lower volume of job advertising. This situation is likely to persist in spite of the 53% rise in NFI from this division during the first half of the current financial year. Nevertheless any loss is expected to be small as the business represented just 3% of the group's £19m of NFI in H1.

Recruitment advertising demand remains depressed in spite of the 53% rise in H1 NFI

Board & Executive Coaching

CEO and senior board level coaching is a growing activity in a sector dominated by companies such as Deloitte, Accenture and Praesta. In the first half revenues were maintained at £1m representing around 5% of group NFI. While current focus is on board level the group needs to scale up the business by offering coaching services to senior and middle management and this is most likely to be achieved through acquisition over the next few years.

Revenues maintained in H1 but Penna needs to expand its services into senior/middle management

Leadership & Performance Consulting

This division offers four main services: assessment, HR effectiveness, organisational change and employer reputation including internal communications, employer branding and engagement. In the first half the division generated 21% growth in NFI to £2.7m or 14% of group NFI. Much of this growth was due to an assessment contract with EMI which concluded in July 2008.

H1 growth partly due to a one-off assessment contract

Finances

Penna ended its last financial year with net cash of £3m which had risen to £5m by the end of the first half 2008/09. After larger cash tax payments and the enhanced maiden interim dividend, both due to be paid in the second half we expect net cash to rise to around £6m by the end of March 2009. We anticipate further strong cash generation for the foreseeable future as revenues and profits continue to build in the Career Transition division and the requirement for capital expenditure remains very modest. We anticipate net cash balances rising to £9m by the end of the 2009/10 financial year.

Expect net cash of £6m for 2008/09 rising to £9m in 2009/10

Dividend payout expected to be raised to 5p for 2008/09 and 6p for 2009/10

In last year's Annual Report the board recommended a 2p dividend in respect of 2007/08 and an expectation that the board would be able to recommend a 1p interim (nil) and a 2p final dividend in the current year. In the event however, the group's performance in the first half exceeded the board's expectations and in consequence an interim dividend of 2p was declared. This leads the way to a total dividend of 5p for 2008/09 and potentially 6p for the following year.

Very positive statement at the halfway stage

Outlook

In the Interim results the Chairman stated that *"The developed world has embarked upon a period of major restructuring which will have profound effects on every branch of employment. Experience of previous periods of dislocation and recession suggests that many millions of people will be caught up in a process of change as some major sectors of employment decline and others develop and grow. This period may well last for three to four years and possibly much longer"*. The Chairman went on to say that *".....all indications are that our Career Transition division, which accounts for 59% of the group's net revenues, will experience further major expansion in the demand for its services in the coming months and years and we expect this to drive continuing growth of Penna's scale and profitability"*.

Penna well set for major growth

We agree and have no hesitation in believing that the group is set for major growth over the coming few years; a period that should see strong cash build while offering an interlude that management must use to develop other service lines which for the most part are still sub scale. It is crucial that the business is better balanced in the future so that it can continue to build revenues across all stages of the recruitment cycle.

Share price has risen by 88% over past nine months against a 33% fall in the All Share

Valuation and Recommendation

Given the group's well known exposure to the outplacement market it is unsurprising that Penna's share price has anticipated improving trading conditions and has risen strongly over the past nine months moving from 89p to the current 167.5p, a rise of 88% compared to a 33% fall in the FT All Share index.

The respective multiples are forward looking and certainly seem to be anticipating upgrades to consensus forecasts. According to Hemscott, consensus EPS for the year to March 2009 is 12.1p rising by 28% to 15.6p in 2009/10. However, we believe these forecasts understate the potential in the business and in particular do not adequately factor in the exceptionally strong growth now being enjoyed in the Career Transition division.

As a consequence we are initiating coverage with a Buy recommendation and an adjusted PBT increase in 2008/09 of 135% to £4.7m (£2.0m) and a currently prudent increase in FY 2009/10 of 28% to £6m giving, respectively, adjusted EPS of 13.2p and 16.8p, 9% and 8% ahead of consensus.

While the PER is still a relatively high 12.6x falling to 9.8x we believe there is significant potential to raise forecasts further, especially for 2009/10. In our opinion the current rating is fully justified given that Penna is probably only at the beginning of an unprecedented cyclical upturn in demand for outplacement services that could last for three to four years. We have a twelve-month price target of 220p, which assumes further upgrades during 2009.

Consensus forecasts too low in our opinion

We initiate with a Buy recommendation

Risk to forecasts still on the upside

Price target 220p

Summary P&L

Years ended March	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
Revenue	43.4	49.1	64.0	75.0
Gross profit (NFI)	31.0	32.3	41.2	48.0
Administration expenses	-30.3	-30.3	-36.8	-42.3
Associates	0.0	0.0	0.0	0.0
Operating Profit	0.7	2.0	4.4	5.7
Exceptionals	0.0	0.0	0.0	0.0
Finance income	0.0	0.0	0.2	0.2
Finance charge	-0.2	0.0	0.0	0.0
Profit before tax as stated	0.6	2.0	4.6	5.9
Adjustment for amortisation of intangibles	0.0	0.0	0.0	0.0
Adjustment for exceptionals	0.0	0.0	0.0	0.0
Adjustment for share based payments	0.0	0.1	0.1	0.1
Adjusted Profit before tax	0.6	2.0	4.7	6.0
Tax	0.0	-0.6	-1.3	-1.7
Post tax profit	0.6	1.4	3.3	4.2
Minorities	0.0	0.0	0.0	0.0
Net Profit	0.6	1.4	3.3	4.2
Adjusted Net Profit	0.6	1.4	3.4	4.3
EBITDA	1.2	2.6	5.0	6.3
Depreciation	-0.5	-0.5	-0.6	-0.6
EBITA	0.7	2.1	4.4	5.7
Amortisation of intangibles	0.0	0.0	0.0	0.0
EBIT	0.7	2.1	4.4	5.7
Equity				
Weighted average shares (m)	22.152	25.173	25.173	25.173
Weighted average shares FD (m)	22.152	25.188	25.689	25.689
Year end shares in issue (m)	25.273	25.273	25.275	25.275
EPS				
EPS FD (p)	2.58	5.5	12.8	16.4
EPS FD and adjusted (p)	2.60	5.7	13.2	16.8
Dividend				
Interim dividend (p)	0.00	0.00	2.00	2.50
Final dividend (p)	0.00	2.00	3.00	3.50
Total dividend (p)	0.00	2.00	5.00	6.00

P&L Analysis

Years ended March	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
Analysis of NFI				
Career Transition	16.2	17.7	26.0	32.0
Executive Recruitment	4.8	3.6	3.0	3.3
Executive Interim	2.5	3.1	3.5	3.5
Recruitment Communications	0.7	0.9	1.2	1.2
Leadership Development	2.8	3.6	3.5	3.7
HR Consulting	4.0	3.3	4.0	4.3
Intercompany sales	0.0	0.0	0.0	0.0
Total NFI	31.0	32.3	41.2	48.0
Key Ratios				
EBITA margin	1.7%	4.2%	6.9%	7.6%
Administration costs as a % of revenue	69.7%	61.7%	57.5%	56.4%
Conversion of NFI into EBITA	2.4%	6.4%	10.7%	11.9%
Effective tax rate	0.0%	29.1%	28.0%	28.0%
Net interest cover by EBITDA (x)	7.8	81.3	n/a	n/a
Dividend cover by adjusted EPS (x)	n/a	2.9	2.6	2.8

Summary Cash Flow				
Years ended March	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
Net cash from operating activities	1.3	2.6	5.1	6.4
Increase in trade and other receivables	1.0	-1.2	-1.5	-1.5
Increase in trade and other payables	0.1	1.2	1.9	2.0
Decrease in provisions for liabilities and charges	-0.2	-0.1	0.0	0.0
Cash generated by operations	2.2	2.5	5.5	6.9
Taxation paid	0.0	-0.4	-1.3	-1.7
Net cash generated by operating activities	2.3	2.1	4.2	5.2
Cash flow from investing activities:				
Interest received	0.0	0.0	0.2	0.2
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	-0.3	-0.4	-0.3	-0.3
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	0.8	0.0	0.0	0.0
Net cash used in investing activities	0.5	-0.4	-0.1	-0.1
Financing activities:				
Purchase of own shares	0.0	0.0	0.0	0.0
Net movement in other long term borrowings	-0.5	-1.8	0.0	0.0
Dividends paid	0.0	0.0	-1.0	-1.9
Interest paid	-0.1	0.0	0.0	0.0
Issue of shares (net)	3.5	0.0	0.0	0.0
Capital element of finance lease rentals	0.0	1.0	2.0	3.0
Other	-0.1	-0.1	-0.1	-0.1
Net cash inflow from financing activities	2.7	-2.0	-1.1	-2.0
Net cash increase in cash and cash equivalents	5.5	-0.3	3.0	3.1
Cash at start of year	-2.3	3.2	3.0	5.9
FX changes	0.0	0.0	0.0	0.0
Cash and cash equivalents at end of year	3.2	3.0	5.9	9.0
Reconciliation of cash flow to net debt				
Net (debt)/cash at start of the year		3.2	3.0	5.9
Net increase in cash and cash equivalents		-0.3	3.0	3.1
Net change in borrowings during the year		-	-	-
Net (debt)/cash at end of the year	3.2	3.0	5.9	9.0
Key Ratios				
Free Cash Flow (£m)	2.1	2.1	3.4	3.5
Free Cash Flow per share (p)	9.7	8.3	13.4	14.0

Free Cash Flow:

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

Summary Balance Sheet				
Years ended March	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
Assets				
Non-current assets				
PP&E	2.0	1.9	1.7	1.7
Goodwill	14.0	14.0	14.0	14.0
Other intangible assets	0.1	0.0	0.0	0.0
Deferred tax assets	0.1	0.0	0.0	0.0
Financial assets	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Total non-current assets	16.1	15.9	15.8	15.8
Current assets				
Trade and other receivables	10.0	11.3	13.3	15.7
Deferred tax assets	0.0	0.0	0.0	0.0
Other	1.9	1.8	2.4	2.4
Cash and short term deposits	3.2	3.0	6.0	9.0
Total current assets	15.1	16.0	21.7	27.1
Total assets	31.2	32.0	37.5	42.9
Liabilities				
Current liabilities				
Trade and other payables	-2.7	-2.4	-4.2	-6.2
Taxation liabilities	0.0	-0.2	-1.5	-2.0
Bank overdrafts and other short term borrowings	-1.6	-0.1	-0.1	-0.1
Derivative financial instruments	0.0	0.0	0.0	0.0
Provisions	-0.2	-0.2	-0.2	-0.2
Other	-8.0	-9.5	-9.6	-10.0
Total current liabilities	-12.5	-12.3	-15.5	-18.5
Non-current liabilities				
Long term borrowings	-0.3	0.0	0.0	0.0
Other payables due in greater than one year	0.0	1.0	2.0	3.0
Provisions	-0.4	-0.4	-0.4	-0.4
Deferred taxation liability	0.0	0.0	0.0	0.0
Other	-0.1	0.0	0.0	0.0
Total non-current liabilities	-0.8	-0.4	-0.4	-0.4
Total liabilities	-13.3	-12.6	-15.9	-18.9
Net Assets	17.9	19.3	21.6	24.0
Key Ratios				
Net cash/(debt) (£m)	1.3	2.9	5.9	8.9
Net debt/shareholders funds	n/a	n/a	n/a	n/a
Capital employed (£m)	20.5	19.9	22.2	24.7
ROCE	3.6%	10.0%	19.8%	23.1%
Current ratio	1.21	1.30	1.40	-1.47

Capital employed:

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

ROCE

Operating profit/CE

Spring Group

Strong balance sheet - strong management

Spring derives the majority of its profits from placing IT professionals in temporary, contract and permanent positions in the UK and overseas. In 2007 it added to its capabilities in this area by acquiring Glotel, a specialist telecommunications staffing business with a significant element of its operations in the USA. Spring also has a General Staffing division that specialises in the placement of temporary and permanent candidates in secretarial/personal assistant and general roles. For some years the group has enjoyed an exceptionally strong balance sheet which at the half year 2008 had net cash balances of £26m. Although this was lower than the £35m reported at end 2007 the group reports that balances have grown strongly in H2 to end the year at around £40m. This represents cash per share of 25p leaving the operations, net of cash, selling on a fully taxed PER for 2009 of just 3.3x, significantly lower than most of its peer group. Given the dominance of its temp/contract book and revised business model we believe Spring is more robust than at any time in its history, this is certainly not reflected in its share price and we initiate with a strong Buy recommendation.

Key investment points:

- Spring is increasingly diversifying its business portfolio both in terms of disciplines, its mix between temporary/contract and permanent placements and its geographic footprint. The acquisition of Glotel in 2007 for £27m enhanced this diversity and was in line with the strategy of expanding the group's activities both organically and by acquisition.
- In common with most staffing companies Spring added to its cost base during 2007 and 2008, principally through increased consultant headcount and new office openings as it took advantage of a benign global economic environment. As a consequence operating profit grew by 52% in the first half of 2008 but since the advent of the credit crisis and growing recessionary conditions in many economies the group has felt it prudent to reverse this expansion and 2008 will see a £1m impact to the P&L in relation to exceptional costs for redundancy and back office automation the benefits of which will be seen in 2009.
- Historically, Spring has specialised in the temp/contract market and while it has recently pursued a more balanced business through increasing the amount of perm work undertaken this highly operationally geared service offering is not an ideal area to be operating in during market downturns.
- The fact that the group still derives around 80% of net fee income (NFI) from the generally more robust temp/contract segment provides some degree of revenue visibility for management and some comfort for investors although we believe that the increasingly bleak economic outlook will inevitably impact on all the group's activities, as it will most other staffing companies.
- Spring of course benefits from a strong cash position (estimated to account for 74% of the share price) which is set to improve further if activity levels deteriorate. This will highlight not only the inherent value in the group but also position it very well in terms of embarking upon a selective, strategic acquisition programme.
- We initiate coverage on Spring with a Buy recommendation on the basis that we believe the current share price does little but discount the group's cash reserves leaving the valuation of the staffing business on an exceptionally low EV/NFI of 0.3x for 2009E and an ex cash PER of 3.3x, which is well below the staffing sector average.
- Our initial price target is 40p.

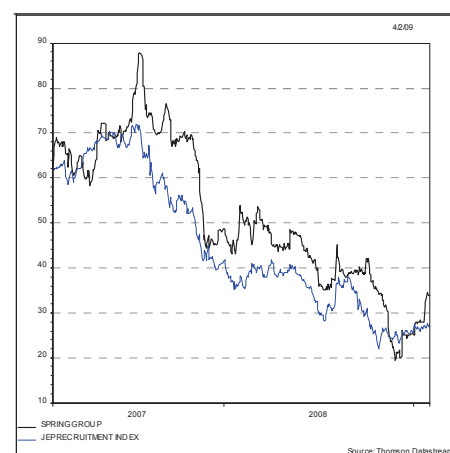
BUY

Recent price	33.25p
Tickers	SRG.LN
Asset class:	FULL
Website:	www.spring.com
12 mth price change	-33%
52-week range	High 53.75p - Low 20.25p
Sector	Support Services
Market Cap	£54.6m
Net (debt)/cash	£40m E
EV	£14.6m E
Dividend yield	0.9% E
Next earnings	Prelims 26 February 2009

Estimates *Source: John East & Partners Limited*

Year to Dec (£m)	07	08(e)	09(e)
Revenue	432.8	520.0	490.0
NFI	56.1	67.2	59.2
EBITDA	8.4	9.5	7.8
Conv. Ratio (%)	11.2	10.2	8.8
PBT as stated	7.1	5.8	4.4
PBT adjusted	7.4	7.0	5.5
EPS FD(p)	3.8	2.4	1.8
EPS FD Adj (p)	4.0	3.2	2.5
EV/EBITDA (x)		1.5	2.0
EV/NFI (x)		0.2	0.3
PE ratio (x)		10.4	13.3
Debt/EBITDA	Cash	Cash	Cash

Two-year share-price performance



Background

Spring publishes its results under a three division format: **Professional Staffing**, **Managed Solutions** and **General Staffing**. Tables 10 and 11 below provide historic information on revenues and operating profit from each division together with our forecasts for financial years ending December 2008 and 2009.

Three division structure

Table 10: Spring Group historic and prospective revenue

Years to Dec (£m)	2006	2007	2008 E	2009 E
Revenue:				
Professional Staffing	226.5	227.4	297.0	256.0
Managed Solutions	140.2	153.1	170.0	186.0
General Staffing	54.9	54.6	55.0	50.0
Inter-company segment	-9.0	-2.2	-2.0	-2.0
Revenue total	407.3	432.8	520.0	490.0

Source: JEP estimates

Table 11: Spring Group historic and prospective operating profit

Years to Dec (£m)	2006	2007	2008 E	2009 E
Operating Profit:				
Professional Staffing	5.568	6.005	7.000	5.000
Managed Solutions	2.717	3.279	3.500	2.600
General Staffing	-0.110	0.606	-1.800	-0.500
Central costs	-3.554	-3.980	-3.000	-3.000
Operating profit total	4.621	5.910	5.700	4.100

Source: JEP estimates

The reduction in estimated revenue and operating profit for 2009 reflects our concern that demand for all categories of staff will be depressed during what we expect will be a difficult year for all staffing companies. We do however anticipate a reduction in losses within the General Staffing division as new office openings begin to make a contribution to revenues.

2009 likely to be a difficult year for Spring given the global recession

As a group, Spring has about 25% of its NFI exposed to the global financial services sector in its broadest sense and the weakness in this market has and will continue to have a negative effect on its sales and returns. In its most recent trading update (January 2009) Spring stated that due to weakening economic conditions and a softening in some of its markets it has taken steps to reduce its cost base and will deliver a material headcount saving in 2008. This will result in an exceptional cost of around £1m in 2008 but will deliver annualised cost savings of between £4m - £5m

25% exposure to financial services adds additional pressure and has encouraged some cost cutting which could reduce overheads by £4-5m in 2009

We discuss each division in more detail below:

Professional Staffing

The Professional Staffing division offers traditional temporary, contract and permanent staffing solutions to a wide variety of clients in the UK, and as a result of the Glotel acquisition and new office openings, increasingly in overseas markets. We estimate the split in NFI to be around 85% temp/contract and 15% perm which offers some element of resilience and revenue visibility as demand for temp/contract staff tends to be more robust than that for perm during periods of tight cost controls within client companies.

Professional Staffing 85% temp; 15% perm. Provides some limited revenue visibility while we see temp as being more robust than perm

Brands within this division include **Spring Technology**, a leading technology staffing provider specialising in the recruitment of IT professionals at all levels from first line support staff to IT directors. **Best** offers project-based staff aligned to vertical markets while **Glotel**, purchased for £27m in 2007, is a specialist supplier of telecommunication staff in the UK, USA, Australasia and other countries.

Table 12: Professional Staffing – margin analysis

Years to Dec	2006	2007	2008 E	2009 E
NFI margin	n/a	13.3%	13.4%	13.2%
Operating margin	2.5%	2.6%	2.4%	2.0%
Conversion ratio	n/a	19.9%	17.6%	14.8%

Source: JEP estimates

Over the past eighteen months Spring has developed and initiated a strategy designed to lift gross margins in this division by concentrating on higher value work and, where possible, renegotiating contracts as they come up for renewal. These initiatives, together with the acquisition of the higher margin Glotel business, helped to improve NFI margin in H1 2008 from 13.3% to 14.6% but we have some doubt whether the group will be able to sustain the improvement into 2009 as trading conditions deteriorate and competition for business increases. Deteriorating demand for permanent placement, which is in effect a 100% gross margin activity, will also combine to create further pressure on margins even though only accounting for around 15% of divisional sales.

The division's conversion of NFI into operating profit ratio was a reasonable 20% in 2007 but fell off in H1 2008 to 18.1% reflecting investment in headcount and new offices and while we expect the ratio to improve in H2 2008 as these investments begin to make some contribution we expect the ratio to deteriorate in 2009 due to the lag between lower demand and headcount/cost reductions.

Nevertheless, given the division's bias towards temp/contract, its broader reach by discipline and greater geographic reach, we feel that this division is much better placed to withstand the cyclical downturn than it was previously.

Managed Solutions

Managed Solutions specialises in placing candidates with major blue chip clients under a Recruitment Process Outsourcing (RPO) model whereby Spring is the exclusive provider of staffing services to its clients and usually operates on-site under typically three-year contracts. The group had seven RPO contracts up for renewal in 2008 and all bar one were renewed, the exception being a client that was subject to a merger during the year.

Successful rebids can occasionally result in a deterioration in contract terms for the supplier, especially in more difficult trading conditions. However this has not been the case with Spring's Managed Solutions division. In its rebid conversations Spring seeks to at least maintain its return on capital employed and in instances where rebid negotiations may involve a reduction in margin this would normally only be considered where some compensation is offered. This may take the form of a broader scope to the contract, higher volumes, a lengthening of the contract life or other initiatives that improve or preserve the group's working capital ratios.

Currently Managed Solutions has six clients with in excess of 100 contractors/temps, two smaller contracts and one new client, Aviva, that is currently ramping up its business and will be in the >100 category in Q1 2009. It also has six clients to whom it provides permanent recruitment services and a number of contracts under which it offers consultancy, audits, reviews, discreet projects etc.

Table 13: Managed Solutions – margin analysis

Years to Dec	2006	2007	2008 E	2009 E
NFI margin	n/a	8.7%	7.9%	6.7%
Operating margin	1.9%	2.1%	2.1%	1.4%
Conversion ratio	n/a	24.7%	25.9%	20.8%

Source: JEP estimates

Table 13 shows the margin analysis for the division and it is worth noting that while the NFI and operating margin on sales seems to be rather thin, the sales line is grossly inflated by the pass through payroll of temps/contractors (equally true of the Professional Staffing division) so it is probably a better guide to look at the return on NFI which is in effect a more representative statement of revenue.

Strategy to raise gross margins was succeeding but further progress may be difficult to achieve while the group seeks to balance costs with falling revenues

Six out of seven rebids were successful in 2008

ROCE and working capital requirements generally protected on rebids although gross margin may be vulnerable

Further revenue growth anticipated in 2009 with Aviva scheduled to become the largest RPO client

Sales substantially inflated by payroll pass-through

Principal competition in this part of the group's business is limited to those players that are of sufficient size and that have the expertise to be able to offer efficient services to high volume clients and include Adecco, Manpower, Hays and Alexander Mann.

Limited competition in RPD

General Staffing

Table 14: General Staffing – margin analysis

Years to Dec	2006	2007	2008 E	2009 E
NFI margin	n/a	23.1%	25.5%	26.0%
Operating margin	-0.2%	1.1%	-3.3%	-1.0%
Conversion ratio	n/a	4.8%	n/a	n/a

Source: JEP estimates

The final division is General Staffing which encompasses the placement of a wide variety of low/medium skilled temporary and permanent office-based and industrial staff under four brands, **Spring Personnel**, **Elizabeth Hunt**, **Spring Direct** and **Tact Personnel**.

The division has had a mixed history within the group, having reported operating losses in 2005 and 2006 and we believe that it is not an obvious fit with Spring's longer term ambitions. Nevertheless the business has been the subject of some reasonably significant investment to build up the scale of the operation and since June 2007 the number of UK offices has increased from 38 to 52. This investment does not have immediate paybacks as it takes new consultants time to build up their billing potential hence the business made a loss of £0.5m in H1 2008 against a profit of £0.2m for the comparative and £0.6m for the whole of 2007.

A mixed history for General Staffing which has been subject to expansion of office network. Expect some payback in 2009 but still likely to incur losses.

We anticipate the losses will continue into the second half year and perhaps begin to be impacted by the slowing UK economy. We are also projecting a loss for 2009 but this may prove to be unreasonably pessimistic.

Recent trading and forecasts

As we mentioned earlier in this report the group has initiated a cost cutting programme better to align overheads with weakening revenues. However, this exercise usually and necessarily lags falling revenue and so can only be reactive.

For recruitment companies in general we do not anticipate any improvement in demand for staff through 2009 although the like-for-like reduction in demand could begin to flatten out towards Q4 2009 and Q1 2010. At this stage there is no way of knowing to what depths recruitment company profits could suffer. However, when demand does pick up it will do so initially in the temporary/contract market first, so in this respect Spring, with an 80/20 skew towards temp is well placed to benefit.

Outlook poor for all recruitment companies, bar a couple of exceptions. Spring no different but emphasis on temp/contract should position it well for the upturn.

Currently, our projections for 2009 err on the side of caution and probably represent the lowest forecasts in the market, but that is not to say that they are incapable of being downgraded further as we progress through 2009. Indeed memories of 2000-2003 would suggest that this is entirely possible, especially when one considers that during that cyclical downturn the developed economies continued to enjoy positive GDP growth. In summary we still see risks to forecasts on the downside for Spring and for that matter for most other staffing companies. Nevertheless, following changes to the board and restructuring in 2007 management remain very ambitious and optimistic regarding Spring's ability to ride out the current down-cycle in recruitment and we believe that the group is probably better positioned to weather the downturn now than at any time in its history.

Risks to forecasts still probably on the downside but strategically Spring is now better positioned to weather the downturn than at any time in its history.

Cash

Spring has for a number of years had the benefit of a substantial cash balance, the legacy of some judicious asset disposals in 2001, which has fluctuated at around the £35m level and we are forecasting a net cash balance for end 2008 of £40m, equivalent to 25p per share.

£40m of net cash = 25pps...

In the current market where demand is likely to remain weak we would anticipate this cash balance increasing as working capital requirements reduce in line with a fall in the top line. However, the group has been successful in negotiating some advantageous payment terms on some of its RPO contracts and if any of these contracts were to be a part of the revenue reduction the impact on working capital could be detrimental to cash generation.

On balance we are projecting net cash for end 2009 at or around the 2008 level of £40m. Nevertheless the cash is a comfort for management and investors alike and positions the company well to consider making opportunistic, earnings accretive acquisitions, designed to increase the range of disciplines and geographic footprint and hence increasing the group's diversity of service offering.

Valuation and Recommendation

Spring's share price currently stands at 33.25p, some 34% lower than a year ago with the group's cash balances representing 74% of its share price leaving the balance of 8.3p representing just 3.3x 2009 fully taxed forecast earnings. For this reason we are initiating coverage with a Buy recommendation in spite of the fact that earnings will be under some pressure throughout 2009. We set our twelve month price target at 40p which offers an upside of 20% from the current share price.

...and likely to increase still further in 2009-2010

Cash positions the group well to contemplate strategic acquisitions

40p share price target

Summary P&L				
Years ended December	2006	2007	2008 E	2009 E
	£m	£m	£m	£m
Revenue	407.3	432.8	520.0	490.0
Gross profit (NFI)	45.8	56.1	67.2	59.2
Administration expenses	-41.1	-50.2	-61.5	-55.1
Associates	0.0	0.0	0.0	0.0
Operating Profit	4.6	5.9	5.7	4.1
Exceptionals	0.0	0.0	0.0	0.0
Finance income	0.9	1.4	1.1	1.3
Finance charge	-0.2	-0.2	-1.0	-1.0
Profit before tax as stated	5.4	7.1	5.8	4.4
Adjustment for amortisation of intangibles	0.0	0.0	0.4	0.4
Adjustment for exceptionals	0.0	0.0	0.0	0.0
Adjustment for share based payments	0.2	0.4	0.8	0.7
Adjusted Profit before tax	5.6	7.4	7.0	5.5
Tax	-0.5	-1.1	-2.0	-1.5
Post tax profit	4.8	5.9	3.8	2.9
Minorities	0.0	0.0	0.0	0.0
Net Profit	4.8	5.9	3.8	2.9
Adjusted Net Profit	5.1	6.3	5.0	4.0
EBITDA	6.3	8.4	9.5	7.8
Depreciation	-1.4	-2.1	-2.6	-2.6
EBITA	4.9	6.3	6.9	5.2
Amortisation of intangibles	0.0	0.0	-0.4	-0.4
EBIT	4.9	6.3	6.5	4.8
Equity				
Weighted average shares (m)	156.562	156.886	156.886	156.886
Weighted average shares FD (m)	156.772	158.226	158.226	158.226
Year end shares in issue (m)	156.886	159.848	159.848	159.848
EPS				
EPS FD (p)	3.08	3.8	2.4	1.8
EPS FD and adjusted (p)	3.24	4.0	3.2	2.5
Dividend				
Interim dividend (p)	0.10	0.10	0.10	0.10
Final dividend (p)	0.20	0.20	0.20	0.20
Total dividend (p)	0.30	0.30	0.30	0.30

P&L Analysis				
Years ended December	2006	2007	2008 E	2009 E
	£m	£m	£m	£m
Analysis of revenue by Geography				
UK	396.2	393.0	445.0	401.0
Rest of Europe	8.0	13.3	15.0	14.5
North America	0.0	19.3	52.0	66.0
Rest of World	3.1	7.2	8.0	8.5
Total Revenue	407.3	432.8	520.0	490.0
Analysis of revenue by division				
Professional Staffing	226.5	227.4	297.0	256.0
Managed Solutions	140.2	153.1	170.0	186.0
General Staffing	49.6	54.6	55.0	50.0
Inter-company	-9.0	-2.2	-2.0	-2.0
Total Revenue	407.3	432.8	520.0	490.0
Analysis of NFI				
Professional Staffing	0.0	30.2	39.7	33.7
Managed Solutions	0.0	13.3	13.5	12.5
General Staffing	0.0	12.6	14.0	13.0
Total NFI	0.0	56.1	67.2	59.2
Analysis of operating profit				
Professional Staffing	5.6	6.0	7.0	5.0
Managed Solutions	2.7	3.3	3.5	2.6
General Staffing	-0.1	0.6	-1.8	-0.5
Central costs	-3.6	-4.0	-3.0	-3.0
Total Operating Profit	4.6	5.9	5.7	4.1
NFI margin				
Professional Staffing	0.0%	13.3%	13.4%	13.2%
Managed Solutions	0.0%	8.7%	7.9%	6.7%
General Staffing	0.0%	23.1%	25.5%	26.0%
Group NFI margin	11.2%	13.0%	12.9%	12.1%
Operating margin				
Professional Staffing	2.5%	2.6%	2.4%	2.0%
Managed Solutions	1.9%	2.1%	2.1%	1.4%
General Staffing	-0.2%	1.1%	-3.3%	-1.0%
Group operating margin	1.1%	1.4%	1.1%	0.8%
Key Ratios				
Administration costs as a % of revenue	10.1%	11.6%	11.8%	11.2%
Conversion of NFI into EBITA	10.6%	11.2%	10.3%	8.8%
Effective tax rate	9.7%	15.0%	28.0%	28.0%
Net interest cover by EBITDA (x)	n/a	n/a	n/a	n/a
Dividend cover by adjusted EPS (x)	10.8	13.3	10.6	8.3

Summary Cash Flow				
Years ended December	2006	2007	2008 E	2009 E
	£m	£m	£m	£m
Net cash from operating activities	6.3	8.4	9.1	7.4
Increase in trade and other receivables	13.0	13.9	5.0	1.6
Increase in trade and other payables	-4.4	-2.5	-4.3	-6.0
Decrease in provisions for liabilities and charges	-1.1	-0.6	-0.5	-0.7
Cash generated by operations	13.9	19.2	9.3	2.3
Taxation paid	-0.6	-0.6	-2.0	-1.5
Net cash generated by operating activities	13.3	18.6	7.3	0.8
Cash flow from investing activities:				
Interest received	1.0	1.4	1.1	1.3
Acquisition of subsidiaries (net of cash acquired)	0.0	-30.8	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	-0.8	-0.7	-0.7	-0.7
Purchase of intangible assets	-1.6	-1.1	-0.8	-0.8
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	-0.2	0.0	0.0	0.0
Net cash used in investing activities	-1.6	-31.1	-0.4	-0.2
Financing activities:				
Purchase of own shares	0.0	0.0	0.0	0.0
Net movement in borrowings	-3.0	-0.2	-8.0	0.0
Dividends paid	-0.5	-0.5	-0.5	-0.5
Interest paid	-0.1	-0.2	-1.0	-1.0
Issue of shares (net)	0.2	2.1	0.1	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
Net cash inflow from financing activities	-3.4	1.0	-9.4	-1.5
Net cash increase in cash and cash equivalents	8.3	-11.4	-2.5	-0.9
Cash at start of year	42.9	51.2	39.7	37.3
FX changes	0.0	0.0	0.0	0.0
Cash and cash equivalents at end of year	51.2	39.7	37.3	36.4
Reconciliation of cash flow to net debt				
Net (debt)/cash at start of the year		45.6	34.4	39.9
Net increase in cash and cash equivalents		-11.5	-2.5	-0.9
Net change in borrowings during the year		0.3	8.0	0.0
Net (debt)/cash at end of the year	45.6	34.4	39.9	39.0
Key Ratios				
Free Cash Flow (£m)	13.8	19.4	6.9	0.6
Free Cash Flow per share (p)	8.8	12.4	4.4	0.4

Free Cash Flow

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

Summary Balance Sheet				
Years ended December	2006	2007	2008 E	2009 E
	£m	£m	£m	£m
Assets				
Non-current assets				
PP&E	2.1	2.6	2.6	2.6
Goodwill	13.6	26.3	26.0	26.0
Deferred tax asset	5.2	6.0	5.5	5.5
Other	0.0	0.0	0.0	0.0
Total non-current assets	20.8	34.9	34.1	34.1
Current assets				
Trade and other receivables	67.5	83.7	88.0	75.0
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	51.2	39.7	45.5	44.0
Total current assets	118.7	123.4	133.5	119.0
Total assets	139.5	158.3	167.6	153.1
Liabilities				
Current liabilities				
Trade and other payables	-57.4	-66.6	-66.0	-60.0
Taxation liabilities	0.0	-0.9	-2.5	-2.5
Bank overdrafts and other short term borrowings	-5.1	-5.4	-5.6	-5.0
Provisions	-0.7	-0.3	-0.2	-0.2
Other	0.0	0.0	0.0	0.0
Total current liabilities	-63.2	-73.2	-74.3	-67.7
Non-current liabilities				
Long term borrowings	-0.7	0.0	0.0	0.0
Provisions	-0.7	-0.5	-0.4	-0.4
Deferred taxation liability	-0.3	-1.5	-2.0	-2.0
Other	0.0	0.0	0.0	0.0
Total non-current liabilities	-1.6	-2.0	-2.4	-2.4
Total liabilities	-64.8	-75.2	-76.7	-70.1
Net Assets	74.7	83.1	90.9	83.0
Key Ratios				
Net cash/(debt) (£m)	45.5	34.4	39.9	39.0
Net debt/shareholders funds	n/a	n/a	n/a	n/a
Capital employed (£m)	81.8	89.2	97.1	88.6
ROCE	5.7%	6.6%	5.9%	4.6%
Current ratio	1.9	1.7	1.8	1.8

Capital employed:

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

ROCE

Operating profit/CE

Disclaimers

By receiving this document, you will not be deemed a client, or provided with the protections afforded to clients, of John East and Partners Limited ("JEP") as defined in the Financial Services Authority Conduct of Business Sourcebook (the "Rules"). When distributing this document, JEP is not acting for any recipient of this document and will not be responsible for providing advice to any recipient in relation to this document. Accordingly, JEP will not be responsible to any recipient for providing the protections afforded to its clients. If you are in the UK, you are a person to whom Articles 19 or 49 of the Financial Services and Markets 2000 (Financial Promotion) Order 2005 apply.

This document is not an offer to buy or sell any security. This document does not provide individually tailored investment advice. It has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. The appropriateness of a particular investment will depend on an investor's individual circumstances and objectives. The investments referred to in this document may not be suitable for all investors.

Past performance is not a guarantee of future performance. Investments may go down in value as well as up and you may not get back the full amount invested. Equities are high-risk investments if bought separately and the downside risk to your investment could be significant. By their nature, AIM stocks tend to have more volatile share prices and may be vulnerable to greater capital losses. AIM shares tend to be relatively illiquid and therefore may be difficult to deal in. It may also be difficult to obtain reliable information as to the value and the risks to which the shares may be exposed.

This document is based on certain publicly available reports and industry sources. JEP may not have verified all of this information with third parties. JEP cannot guarantee the accuracy, reasonableness or completeness of the information received from sources consulted for this publication, and JEP accepts no liability whatsoever (in negligence or otherwise) for any loss howsoever arising from any use of this document or its contents or otherwise arising in connection with this document (except in respect of wilful default and to the extent that any such liability cannot be excluded by the applicable law). This document is not to be relied upon and should not be used in substitution for the exercise of independent judgment.

This document includes certain statements, estimates and projections with respect to the anticipated future performance of Healthcare Locums plc, Penna Consulting Plc, Impellam Group plc and Spring Group Plc. Such statements, estimates and projections are based on information that we consider reliable and may reflect various assumptions made concerning anticipated results, which may or may not prove correct. No representation or warranty is made as to the accuracy of such statements, estimates and projections or as to its fitness for the purpose intended and it should not be relied upon as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update the material in this report on a timely basis, but regulatory compliance or other reasons may prevent us from doing so. JEP or other third parties may have issued other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them.

The information contained in this document is confidential and is solely for use of those persons to whom it is addressed and may not be reproduced, further distributed to any other person or published, in whole or in part, for any purpose. Other persons who receive this document should not rely on it. JEP, its officers and employees may have positions in the securities mentioned herein. This document is issued by JEP which is authorised and regulated by the Financial Services Authority.