SThree has announced a strong Q4 update. Net fee momentum has been maintained through H2 with the group comfortably ahead of the pre Covid comparative. Today we are upgrading our estimates (albeit marginally) for the fifth time this year. Productivity gains are the key feature of FY21 as internal investment lags net fee growth. FY22 will see some (but by no means all) of these productivity gains revert.

We believe the market should take the news that Mark Dorman is stepping aside as CEO in its stride. Performance through the pandemic has been impressive and speaks to management depth throughout the group. Timo Lehne, the interim CEO, is a well-respected leader of the German business, itself a strong performer over the last few years.

The challenges posed by the pandemic, and the subsequent response of SThree to those challenges, reinforce the fundamental SThree proposition. STEM specialization and flexible working feel increasingly more resonant as time progresses. The focus shown by others towards these themes is indicative of how apt they are.

- **Net fee momentum maintained**: 2021 has been story of strong recovery execution and better than expected net fee momentum. Q4 is no exception, with SThree coming in +3% ahead of our previously upgraded estimate.

- **Productivity gains are the key story**: Productivity gains have been a key theme in 2021 and the company has always been clear that an element of these gains would normalise as the group re-invests to drive growth. We were already looking for a relatively flat margin performance looking ahead to FY22 and the Q4 update remains consistent with that.

- **Minor upgrades**: We are ticking up our net fee estimates for FY21 and FY22 by c.3%. The drop through to PBT and EPS is more muted as the group re-invests and our FY21 and FY22 PBT / EPS moves ahead by +1%.

- **Market reactions feels overdone.** The decline in the share price feels like an overly harsh reaction to the Q4 update, especially so given the extent of upgrades already delivered through 2021 (+48% over five upgrades). The giving back of some productivity gains is also not new news, with the company clearly flagging the FY21 / FY22 margin transition through the course of the year. The CEO change is perhaps the biggest unknown and many will want to see further news on the transition. We do note Timo Lehne’s experience and track record at the helm of SThree’s strongest performing territory over the last five years.

<table>
<thead>
<tr>
<th>November, £m</th>
<th>Net Fees</th>
<th>PBT adj</th>
<th>EPS (p)</th>
<th>Div (p)</th>
<th>Net Cash</th>
<th>Fiscal PER x</th>
<th>Yield %</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 2019A</td>
<td>338.0</td>
<td>59.1</td>
<td>32.3</td>
<td>5.1</td>
<td>10.6</td>
<td>14.7</td>
<td>1.1</td>
</tr>
<tr>
<td>FY 2020A</td>
<td>308.6</td>
<td>30.1</td>
<td>13.5</td>
<td>5.0</td>
<td>49.9</td>
<td>35.2</td>
<td>1.1</td>
</tr>
<tr>
<td>FY 2021E</td>
<td>355.7</td>
<td>59.3</td>
<td>30.0</td>
<td>11.1</td>
<td>57.9</td>
<td>15.8</td>
<td>2.3</td>
</tr>
<tr>
<td>FY 2022E</td>
<td>374.2</td>
<td>62.1</td>
<td>30.8</td>
<td>11.4</td>
<td>67.9</td>
<td>15.4</td>
<td>2.4</td>
</tr>
<tr>
<td>FY 2023E</td>
<td>394.5</td>
<td>68.1</td>
<td>33.2</td>
<td>12.3</td>
<td>81.2</td>
<td>14.3</td>
<td>2.6</td>
</tr>
</tbody>
</table>

Source: Radnor Capital Partners
Q4 Trading Update

Key headlines from the Q4 trading update were:

- Full year net fee income +19% YoY with Q4 net fees +25%
- Compared to the pre-Covid 2019, group net fees are now +9% with FY21 net fees representing a new high-water mark for the firm
- The Contractor Order Book (the single best measure for forward visibility) ended FY21 +43%, accelerating from the +41% reported for Q3
- By region:
  - DACH (36% of group net fees) +24% for the year, +30% in Q4
  - EMEA (36% of group net fees) +9% for the year, +24% in Q4
  - USA (25% of group net fees) +24% for the year, +18% in Q4
  - APAC (3% of group net fees) +34% for the year, +64% in Q4
- By business type:
  - Contract (75% of group net fees) +17% for the year, +26% in Q4
  - Permanent (25% of group net fees) +24% for the year, +25% in Q4
- Good cash generation with net cash of £58m (FY20: £49.9m) despite positive net fee growth

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

Although cost efficiencies were more targeted than seen by many in the peer group, SThree did see an absolute reduction in consultant heads through the course of 2020 and early 2021. Clearly, the pace of recovery across the industry has been stronger than expected and SThree has not been alone in flagging their intent to bring new sales capacity into the business.

The exit run rate for headcount growth was mid-single digit for SThree in Q4 and the company has guided to a +10% headcount growth target for FY22.

Although the picture is more nuanced than pure headcount (the group is also investing in internal systems and marketing propositions), this interplay between the timing of cost growth and net fee momentum is the key driver behind forward margin expectations.

The group has been consistent and clear since the interim results that a degree of cost catch up was going to be inevitable. Our estimates have reflected this for much of the year where we had already been looking for a flat FY22 margin vs FY21 before stepping up again in FY23.
The comparison of drop through rates between the contract heavy SThree and the perm heavy peer group is not wholly fair due to the different net fee dynamics and timing of recovery, where SThree was earlier to recover than its peers having not fallen as far.

The last area of note was in the cash-flow performance. Headline net cash at the year end came in at £58m and compares to £49.9m for FY20. Typically, SThree’s contract model would see net fee growth reflected in working capital investment. We understand that the £8m of incremental cash generated in the year has been despite £20m of contract cash investment and reflects both profit growth and strong cash collections through the year.

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

**Figure 1:** SThree quarterly net fee evolution since Q1 2016

![Quarterly Net Fee Evolution Chart]

*Source: FactSet, Radnor*
Estimate revisions and broader consensus

Figure 2: Radnor estimate changes

<table>
<thead>
<tr>
<th></th>
<th>Previous FY20A</th>
<th>Previous FY21E</th>
<th>Previous FY22E</th>
<th>New FY21E</th>
<th>New FY22E</th>
<th>Change, % FY21E</th>
<th>Change, % FY22E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group Gross Revenue</td>
<td>1,202.6</td>
<td>1,352.8</td>
<td>1,456.7</td>
<td>1,394.9</td>
<td>1,496.9</td>
<td>+ 3%</td>
<td>+ 3%</td>
</tr>
<tr>
<td>EMEA (ex DACH)</td>
<td>127.1</td>
<td>133.5</td>
<td></td>
<td>127.2</td>
<td>132.3</td>
<td>+ 0%</td>
<td>- 1%</td>
</tr>
<tr>
<td>DACH</td>
<td>121.6</td>
<td>127.7</td>
<td></td>
<td>129.4</td>
<td>135.9</td>
<td>+ 6%</td>
<td>+ 6%</td>
</tr>
<tr>
<td>USA</td>
<td>87.8</td>
<td>94.1</td>
<td></td>
<td>89.3</td>
<td>95.8</td>
<td>+ 2%</td>
<td>+ 2%</td>
</tr>
<tr>
<td>APAC</td>
<td>8.5</td>
<td>8.9</td>
<td></td>
<td>9.8</td>
<td>10.3</td>
<td>+ 15%</td>
<td>+ 15%</td>
</tr>
<tr>
<td>Group Net Fees</td>
<td>308.6</td>
<td>345.0</td>
<td>364.2</td>
<td>355.7</td>
<td>374.2</td>
<td>+ 3%</td>
<td>+ 3%</td>
</tr>
<tr>
<td>EBITA</td>
<td>31.3</td>
<td>59.3</td>
<td>62.6</td>
<td>60.1</td>
<td>63.0</td>
<td>+ 1%</td>
<td>+ 1%</td>
</tr>
<tr>
<td>- margin %</td>
<td>10.1%</td>
<td>17.2%</td>
<td>17.2%</td>
<td>16.9%</td>
<td>16.8%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adj. PBT</td>
<td>30.1</td>
<td>58.5</td>
<td>61.7</td>
<td>59.3</td>
<td>62.1</td>
<td>+ 1%</td>
<td>+ 1%</td>
</tr>
<tr>
<td>Adj. EPS (p)</td>
<td>13.5</td>
<td>29.6</td>
<td>30.6</td>
<td>30.0</td>
<td>30.8</td>
<td>+ 1%</td>
<td>+ 1%</td>
</tr>
<tr>
<td>Dividend (p)</td>
<td>5.0</td>
<td>11.0</td>
<td>11.3</td>
<td>11.1</td>
<td>11.4</td>
<td>+ 1%</td>
<td>+ 1%</td>
</tr>
<tr>
<td>Net Cash (Debt)</td>
<td>49.9</td>
<td>59.7</td>
<td>70.5</td>
<td>57.9</td>
<td>67.9</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Radnor

We are making some small FY21 and FY22 net fee upgrades to reflect an FY21 outcome ahead of our expectations. DACH continues to show real strength and we see no signs of this diminishing. The US performance was also impressive but here we were already factoring a strong FY22 as SThree executes well in a highly fragmented market.

As discussed above, we have long seen FY22 as a year where costs were likely to catch up with net fees and the group commentary remains consistent with that. We continue to look for flat margins in FY22 vs FY21 before the full cost effect washes through in FY23.

In Figure 3 below, we show the evolution of the consensus SThree FY21 PBT relative to the UK staffing peer group. This shows how SThree has performed broadly in line with the peer group in terms of upgrade momentum. The extent to which SThree has kept in touch with its perm heavy peers is quite an achievement given that it is, in effect, coming off a higher base as the peers materially underperformed SThree in FY20.

Figure 3: SThree FY21 PBT consensus vs Peer group (rebased)

Source: FactSet, Radnor
A contributory factor to the negative share price reaction to the Q4 update has been a sense that there was an implicit downgrade baked into the company’s wording around the margin outlook for FY22. We would make the following observations:

- **Margin progression.** The company has been consistent in its guidance around cost recovery and internal investment likely to be most heavily felt in FY22. We can see this play out through the evolution of our estimates over the course of 2021.

**Figure 4:** Evolution of Radnor FY21 and FY22 EBIT / NFI margin expectations

<table>
<thead>
<tr>
<th></th>
<th>2021 - Radnor estimates YTD</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>March</td>
</tr>
<tr>
<td>FY21 Net Fees, £m</td>
<td>316.0</td>
</tr>
<tr>
<td>FY22 Net Fees, £m</td>
<td>333.6</td>
</tr>
<tr>
<td>FY21 Margin</td>
<td>12.9%</td>
</tr>
<tr>
<td>FY22 Margin</td>
<td>14.8%</td>
</tr>
</tbody>
</table>

**Source:** FactSet, Radnor

We can see from Figure 4 that throughout FY21 we have seen a steady narrowing of the margin differential between FY21 and FY22 as the timing of cost re-investment has become clearer. A large part of this is due to the pace of headcount additions (mid single digit growth in FY21, accelerating to c.10% in FY22).

Given the consistency of the message here through the course of 2021, we do not subscribe to the view that this margin transition is “new” news. It is also worth making the point that of the eight contributors to consensus, only two (who both happen to be, by some distance, top of the estimate range) had been looking for a material increase in margins between FY21 and FY22. We also note that this marks the fifth upgrade to our numbers that we have made through 2021.

- **Estimate reaction to the Q4 update.** We now have a clearer picture of how market estimates have changed following the results. Unfortunately for SThree, there had been an unusually wide range with two top end outliers offsetting six contributors who were more closely clustered at the bottom end of the range (ourselves included) and more closely in-line with company commentary.

If we look at the company guidance that FY21 PBT will be in-line with consensus expectations for £59.3m, we can see that the company has actually beaten expectations for five of the eight contributors (ourselves included), in-line with one and a -2% and -6% miss respectively for the two sitting at the top of the range.

On balance, if the share price reaction is being driven by a sense of a “miss” and a downgrade to FY22 margin expectations explicitly, then we do not recognise this as a consensus view.
In Figure 5 & 6 below, we show the evolution of the two-year prospective PE multiple for both SThree and the Recruitment peer group in the UK (Hays, Page, Robert Walters). We also show the evolution of the SThree PE discount / premium to the same peer group.

**Figure 5:** 2 Year prospective PE multiple

**Figure 6:** SThree PE discount / premium

*Source: FactSet, Radnor*
SThree PLC
Iain Daly
+44 203 897 1932
id@radnorcp.com

PROFIT & LOSS
Year to 31 November, £m 2018 2019 2020 2021E 2022E 2023E
Group Sales 1,259.2 1,324.7 1,202.8 1,294.9 1,496.9 1,577.9
EMEA (ex DACH) 142.0 141.2 117.6 127.2 132.3 137.6
DACH 99.3 109.3 105.8 129.4 135.9 142.7
USA 66.6 76.7 77.2 89.3 95.8 103.4
APAC 7.2 10.1 7.9 9.0 10.3 11.8
Group Net Fees 321.2 338.0 308.6 355.7 374.2 394.5
Op. Exp. (261.0) (275.2) (257.9) (277.0) (293.6) (308.7)
EBITDA 60.1 62.8 50.7 78.7 80.6 85.7
Dep & Amort (6.1) (6.0) (6.4) (6.8) (6.6) (6.6)
Lease Depreciation (13.0) (12.0) (11.0) (10.0)
EBITDA - Adjusted 53.9 60.0 31.3 60.1 63.0 69.1
Associates & JV's 0.1 - - - -
Net Bank Interest (0.7) (1.0) (1.2) (0.8) (0.9) (1.0)
PBT - Adjusted 53.3 59.1 30.1 59.3 62.1 68.1
Non Operating Items (6.4) (2.3) (1.3) - - -
Other Financial Items - - - - - -
PBT - IFRS 46.9 56.8 28.8 59.3 62.1 68.1
Tax - Adjusted (13.9) (15.9) (11.7) (18.4) (19.9) (22.5)
Tax rate - Adjusted 26.0% 26.9% 39.0% 31.0% 32.0% 33.0%
Minority interests - - - - - -
No. shares m, diluted 133.1 133.6 136.4 136.4 137.0 137.5
Adj EPS (p), diluted 29.6 32.3 13.5 30.0 30.8 33.2
Total EPS (p) 14.5 15.1 5.0 11.1 11.4 12.5

CASH FLOW
Year to 31 November, £m 2018 2019 2020 2021E 2022E 2023E
Working Capital (25.3) (13.3) 25.3 (30.0) (14.7) (14.6)
Provisions / Exceptional (4.7) 3.6 0.8 (0.8) (0.8) (0.8)
Group Op Cashflow 30.1 53.2 76.9 47.9 65.1 70.3
Cash Tax (14.4) (13.0) (10.5) (11.7) (18.4) (19.9)
Cash Interest (0.5) 0.0 0.1 (0.8) (0.9) (1.0)
Net Op Cashflow 15.2 40.2 66.5 35.4 45.8 49.5
Capex (5.2) (4.6) (5.3) (5.3) (5.3) (5.3)
Free Cashflow 10.0 35.7 61.2 30.1 40.5 44.2
Dividends (18.0) (18.8) (6.7) (6.8) (15.2) (15.6)
Acquisitions & Inv. - - - - - -
Other Non Operating (0.2) 0.4 (13.3) (13.3) (13.3) (13.3)
Net Cashflow (8.2) 17.3 41.3 10.0 12.1 15.2
Net Cash (Debt) (4.1) 10.6 49.9 57.9 67.9 81.2

BALANCE SHEET
Year to 31 November, £m 2018 2019 2020 2021E 2022E 2023E
Intangibles 9.6 8.0 4.4 4.4 4.4 4.4
PPE 6.9 6.8 40.8 42.1 43.5 44.8
Tax Asset & Other 4.7 4.2 1.5 1.5 1.5 1.5
Total Fixed Assets 21.3 19.0 46.7 48.0 48.4 50.7
Current Assets 286.4 271.0 237.4 285.6 313.2 333.3
Current Liabilities (202.3) (182.3) (179.6) (197.8) (210.6) (216.1)
Net Current Assets 86.1 88.6 57.9 87.9 102.6 117.2
Long Term Liabilities (1.6) (1.4) (20.0) (20.0) (20.0) (20.0)
Net Debt (Cash) (4.1) 10.6 49.9 57.9 67.9 81.2
Net Assets 101.6 116.9 128.5 167.8 193.9 223.1

PRICE CHART - 2 YEAR ABSOLUTE vs FTSE ALL SHARE

SHAREHOLDERS
% of ord. Share capital
Kempen Cap Mgmt 7.0%
JO Hambro Cap Mgmt 6.7%
Fidelity 5.7%
BlackRock 4.9%
Littlejohn & Co 4.3%
JPMorgan Asset Mgmt 4.0%
Harris Associates 3.7%

RATIOS

TRADEMARKS
Fiscal 2019 2020 2021E 2022E 2023E
Fiscal 14.7x 35.2x 15.8x 15.4x 14.3x
EV/EBITDA 9.2x 11.4x 7.3x 7.2x 6.7x
Div Yield 1.1% 1.1% 2.3% 2.4% 2.6%
FCF Yield 6.2% 10.6% 5.2% 7.0% 7.6%

COLHER
Net Fees growth 5.3% -8.7% 15.3% 5.2% 5.4%
EPS growth 9.0% -58.5% 122.6% 2.8% 7.7%
DPS growth -64.8% -2.0% 122.2% 2.8% 7.7%

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