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CORPORATE FINANCE

Human Capital Market Review H1 2021

Introduction

This edition of Gambit's Human Capital market review confirms a rebound in M&A activity in the sector in the first half of the year to pre pandemic levels. A sustained rise in valuations has also been evidenced in H121, with deal values rising as the defensive strategies of 2020 shifted towards the prioritisation of growth. Increasingly, Human Capital companies are seeing the M&A market as an effective means to achieve their goals, be it strengthening existing core competencies, diversification or driving greater levels of resilience through collaboration.

The positive trajectory of the Human Capital M&A market is unlikely to subside, as avoiding stagnation and broadening service capabilities is becoming increasingly paramount in the post-Covid-19 environment. Acquirers are placing greater emphasis on growing and driving resilience as a core value. With deal volumes and values rebounding, sellers are presented with an ideal opportunity to engage with the M&A market and Gambit continues to facilitate optimal value realisation through effective negotiation of pandemic related adjustments to maximise shareholder proceeds.

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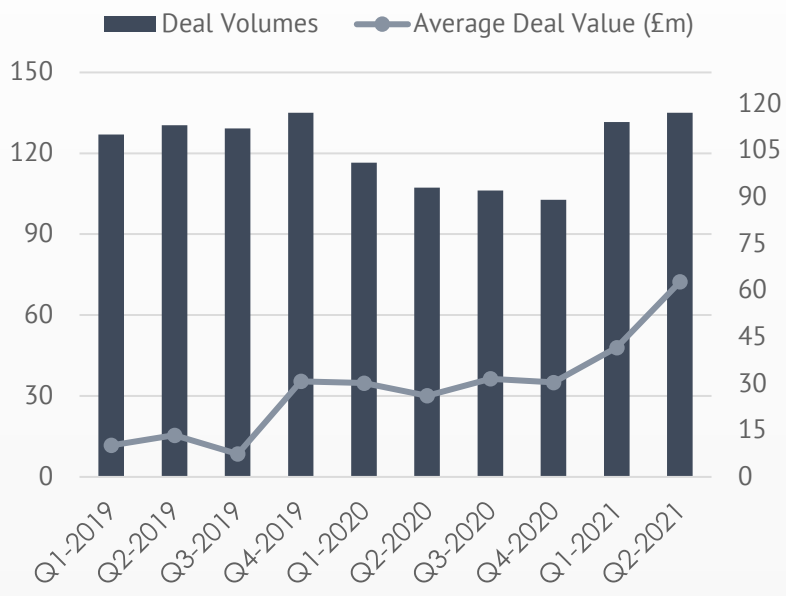
H121 Summary

- **Deal volumes rebounded to pre pandemic levels in both Q121 and Q221, buoyed by a significant level of pent up demand and a resurgence of confidence from corporate development teams to undertake M&A.**
- **UK companies have received heightened levels of attention owing to an abundance of quality assets, appetite from overseas acquirers and a perception that UK equities are trading at a discount to other major markets, such as the USA at present.**
- **In H121, deal values were also notably higher, driven by strong availability of debt to finance acquisitions, liquid corporate balance sheets and high levels of dry powder within the private equity market.**
- **H121 saw a rise in IT, Engineering, General Staffing and Education sub-sector transactions, on the back of increased digitisation, infrastructural expenditure, rising candidate availability and reskilling and retooling initiatives.**
- **Across the spectrum of Human Capital sub-sectors, acquirers have been encouraged by robust market fundamentals and the important role that Human Capital companies are playing in facilitating post-pandemic strategies through talent led solutions.**
- **A general shortage of labour presents a significant opportunity for general recruiters with strong access to talent to acquire new clients and enhance their market positions, leading to heightened levels of appetite from acquirers.**
- **Pandemic related adjustments and trading normalisation mechanisms have continued to grow in importance in the post-pandemic M&A market and expert advisors are continuing to facilitate optimal value realisation through effective negotiation of key issues to maximise shareholder proceeds.**
- **The current level of sectoral attention from investors looking to deploy record levels of capital will continue to spur an active M&A environment and this provides an opportunity for those looking to exit to do so at favourable valuations.**
- **Tax rises, including Capital Gains Tax, are firmly on the domestic political agenda at present and potential sellers should look to capitilise on the current buoyant market conditions, before potentially significant tax changes take effect.**

"Avoiding stagnation and broadening service capabilities is becoming increasingly paramount"

Global M&A: Activity



Company Name	EV/EBITDA Q3 2020	Q4 2020	Q1 2021	Q2 2021
Adecco S.A. (SWX)	9.7x	13.7x	12.0x	11.0x
Brunel International NV (ENXTAM)	15.3x	17.3x	9.2x	9.1x
Empresaria Group PLC (AIM)	4.2x	4.4x	2.8x	4.8x
Gattaca PLC (AIM)	2.5x	0.9x	12.1x	30.3x
Hays PLC (LSE)	10.9x	14.2x	27.3x	29.2x
Impellam Group PLC (AIM)	5.8x	9.4x	2.9x	3.5x
ManpowerGroup Inc (NYSE)	7.4x	10.0x	11.2x	13.2x
Page Group PLC (LSE)	14.1x	16.9x	11.6x	22.4x
Prime People PLC (AIM)	1.7x	3.6x	5.7x	6.5x
Randstad Holding NV (ENXTAM)	12.4x	15.0x	11.3x	11.7x
Robert Half International Inc (NYSE)	9.7x	12.5x	20.1x	25.5x
Robert Walters PLC (LSE)	6.2x	7.7x	7.6x	11.8x
Staffline Group PLC (AIM)	N/A	N/A	7.3x	11.8x
SThree PLC (LSE)	6.3x	7.6x	10.5x	12.6x
Gambit Human Capital Index	**10.0x**	**13.1x**	**12.4x**	**13.7x**

Overview

- **Deal volumes rebounded to pre-pandemic levels in Q121 and Q221, supported by pent up demand and the sector's demonstrable strength and resilience.**
- **In H121, UK deal values rose by 25% on H220 and 30% on H120, fueled by a significant level of domestic recruitment activity which has seen record levels of vacancies and a growing awareness of the important role that Human Capital companies are playing in facilitating post-pandemic strategies through talent led solutions.**
- **UK M&A activity has also been considerably elevated by cross border deal activity was more than double H220 levels, driven by an abundance of quality assets and a perception that UK equities are trading at a discount to other major markets, such as the USA at present.**
- **Strong UK M&A activity is likely to be sustained in view of ongoing strong labour market fundamentals and an increasingly positive growth outlook, with SIA forecasting that the UK's staffing market will grow by 13% in 2022 on a year-on-year basis.**
- EV/EBITDA valuations in the Gambit Human Capital Index are up up 37% on Q320, fueled by the strong recent trading performance of listed recruiters such as Gattaca, which has seen a strong recovery in fee income with recent quarter on quarter growth of 13% and the company is forecasting a further rise in NFI of 10% in H221 on H121.
- **The current valuation metrics indicates that there is an opportunistic window of opportunity for shareholders to explore succession strategies while transaction multiples remain at such high levels.**

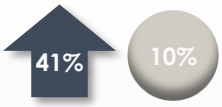
Public Company Valuation Trends

Key Points

- The graph above shows EV/EBITDA valuation multiples for the S&P Human Resources and Services Index over the last five years.
- Valuation data for Human Capital companies is highly responsive to signals of an economic 'return to normal', which often serve as a pre-cursor to sharp rebounds in the EV/EBITDA multiples, offering a clear barometer of activity for buyers and sellers.
- Analysis of the data suggests that valuation multiples have experienced a period of sharp appreciation in the last twelve months, rebounding to beyond pre-pandemic levels on the back of robust labour market fundamentals and an encouraging 2021 sectoral outlook.
- In line with the historical data, a period of valuation appreciation is a signal that the market is optimistic of the short to medium term prospects for growth, or it is indicative of a lack of organic opportunities to pursue.
- With the widely rumoured Capital Gains Tax changes set to be introduced, the data above presents a clear opportunity for sellers to engage with the M&A market during a period of sustained growth in valuation multiples.
- Deal makers have become adept at completing transactions in the current environment, with effective negotiation of Covid-19 adjustments paving the way for optimal value realisation opportunities.
- Proactive business owners should reach out to their advisory network to establish a best practice approach to maximise value realisation opportunities.

Sub-Sectors in Focus

IT

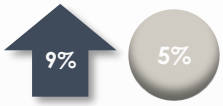


In line with the increasing prominence of corporate digitisation strategies, IT sub-sector demand has continued to be robust. The importance of establishing agile and effective IT infrastructures, has seen employers continuing to bolster internal capabilities through talent led solutions. The IT sector remains one of the UK's fastest growing employers and a well-publicised shortage of candidate availability has ensured that sub-sector deal volumes and valuations continue to be buoyant, driven by demand for specialised skillsets, such as cloud migration, cyber security and software development. The IT recruitment landscape remains highly fragmented, particularly in key jurisdictions such as the UK, where there are 30 companies with UK IT subsector staffing revenue between £20-100m, presenting ideal conditions for a sustained wave of consolidation.

30 **Companies with UK IT subsector staffing revenue between £20-100m**

Source: SIA, 2020

Engineering

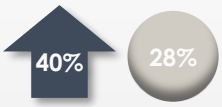


The Engineering sub-sector has continued to evidence sustained levels of M&A activity, driven by a STEM skills shortage and appetite from acquirers to gain exposure to the sector in view of increasing levels of infrastructure expenditure. Assets which have demonstrated a prominence in servicing contracts with national public sector bodies are seeing heightened levels of appetite from acquirers who are paying a premium for assets that can demonstrate quality recurring revenue streams. In the UK, the Engineering sub-sector is estimated by SIA to be the largest in the EMEA region, with further growth expected as employers continue to search for recruitment partners that can help increase their access to quality talent. These trends bode well for deal volumes and valuations in the sector in H221.

£650bn **Record UK infrastructure investment will support 425,000 jobs per year**

Source: GOV.UK, September 2021

General Staffing

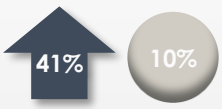


Against the backdrop of heightened recruitment activity across the spectrum, transactions concerning General Staffing recruitment companies have risen considerably in H121. In particular, cross border activity in the sub-sector increased four-fold, indicating that while companies in the sub-sector are not looking to diversify in a sectoral sense, they are doing so geographically, which will drive further levels of consolidation. Demand for workers remains high in all key jurisdictions and large numbers of candidates are finding new roles post-pandemic as economies reshape and adapt. A general shortage of labour presents a significant opportunity for general recruiters with strong access to talent to acquire new clients and enhance their market positions, leading to heightened levels of appetite from acquirers.

2m **Number of vacancies advertised on Reed's website in YTD 2021, more than the entirety of 2020**

Source: Reed, September 2021

Education



The education sub-sector emerged as one of the most active areas of Human Capital M&A activity in H121. Deal volumes rose by 41% on H220, which correlates with significant investment in reskilling and retooling initiatives from both corporates and public sector bodies. Human Capital companies with strong capabilities in training and education are attracting strong appetite and buoyant valuations and there remains an abundance of quality assets in key markets such as the UK. This is being compounded by a high number of active acquirers in the sub-sector, who continue to deploy effective buy and build strategies. We expect that these factors will continue to drive and sustain education sub-sector M&A activity in the medium term.

£42bn **Annual investment in skills and training initiatives by UK employers**

Source: Learning & Work Institute, July 2021

% change in deal volume from H220 to H121

% total deal volume in H121

H2 2021 Trends and Outlook

With significant levels of market activity in H1 2021, we set out below the most commonly cited trends that businesses in the sector are faced with and also outline how the outlook for M&A activity will be affected in the second half of 2021.

Covid-19 Consequences

- Whilst the effective delivery of the UK's vaccination programme has assisted and expedited economic recovery, the impact of Covid-19 will continue to be felt in the longer term and Human Capital companies will need to embrace trends such as remote working and the decentralisation of economic activity to maintain or enhance their market positions.
- The historical focus on the efficiency of Human Capital companies has been challenged by Covid-19 and acquirers are placing greater emphasis on growing and driving resilience as a core In the wake of the pandemic.
- 'Talent stockpiling' has grown in importance and companies that can hire and retain quality employees will attract heightened valuations as acquirers continue their pursuit of assets with experienced and dedicated teams.

Consolidation Drivers

- Recent quarters have seen a sharp rise in M&A volumes, driven by anticipated potential changes to rules around CGT and also an abundance in the availability of capital from a supportive and flexible debt market.
- Cash reserves of publicly listed Human Capital companies have more than doubled over the course of the last twelve months, possessing significant resource to undertake greater levels of strategic M&A as Covid-19 restrictions are further relaxed.
- Avoiding stagnation and broadening service capabilities will be paramount in the post-Covid-19 environment and a sense of urgency has been created to acquire quality 'bolt-on' assets to augment existing offerings and broaden technological capabilities,

37% ***Increase in the Gambit Human Capital Index between Q320 and Q221***

(Gambit Analysis, July 2021)

10x ***Expansion of the UK technology sector between 2010 and 2020***

(Digital Economy Council, May 2021)

15,000 ***Human Capital companies in the fragmented UK market***

(SIA, January 2021)

121% ***Increase in cash reserves of listed Human Capital companies over the last twelve months***

(Refinitiv, April 2021)

Technology

- There is a current sense of urgency to acquire quality 'bolt-on' assets to augment the existing offering of Human Capital companies as they seek to broaden technological capabilities in order to ensure that they continue to move up the value chain and avoid stagnation in their service offering.
- SIA anticipates that a significant level of M&A activity will be generated by the recruitment platform ecosystem in 2021 and consolidation strategies that are based around growth in this area are expected to drive increased deal volumes in the medium term.
- A sustained convergence in the portfolios of staffing firms, talent platforms and online services is also expected, increasing competitive tension and driving deal values upwards, presenting sellers with a window of opportunity to crystalise value.

Value Preservation

- With tax rises firmly on the domestic agenda at present and Capital Gains Tax changes widely expected, proactive business owners should reach out to their advisory network to establish a best practice approach to maximise value realisation.
- The current level of sectoral attention from investors looking to deploy record levels of capital will continue to spur an active M&A environment and this provides an opportunity for those looking to exit to do so at favourable valuations.
- Pandemic related adjustments and trading normalisation has continued to grow in importance in the post-pandemic M&A market and expert advisors are continuing to facilitate optimal value realisation through effective negotiation of key issues to maximise shareholder proceeds.

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Gambit Corporate Finance

Established in 1992, Gambit is an independent corporate finance advisory firm specialising in advising private and public companies on mid-market transactions in the UK and overseas. With offices in London and Cardiff, Gambit is widely recognised as a market leader in M&A advice in the Human Capital sector having built up detailed industry knowledge and an enviable track record in deal origination and execution.

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