Human Capital M&A Market Review Q1 2019

gamBIT CORPORATE FINANCE

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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.

www.gambitcf.com

Corporate Finance International

Gambit is the exclusive UK shareholder of CFI, a global partnership of middle-market investment banks and corporate finance advisory firms. With over 200 professionals located in 26 offices throughout the world. CFI members specialise in cross-border acquisitions, disposals, capital raising, and related services.

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Executive Summary

Geraint Rowe
Partner, Human Capital

The 10% increase in global deal volumes in Q119, highlights the level of underlying confidence in the global market. Whilst concerns over Brexit remain and the lack of clarity is reducing activity in the UK and some European markets, if an orderly resolution can be found, we expect to see a marked increase in both domestic and cross border deal volumes.

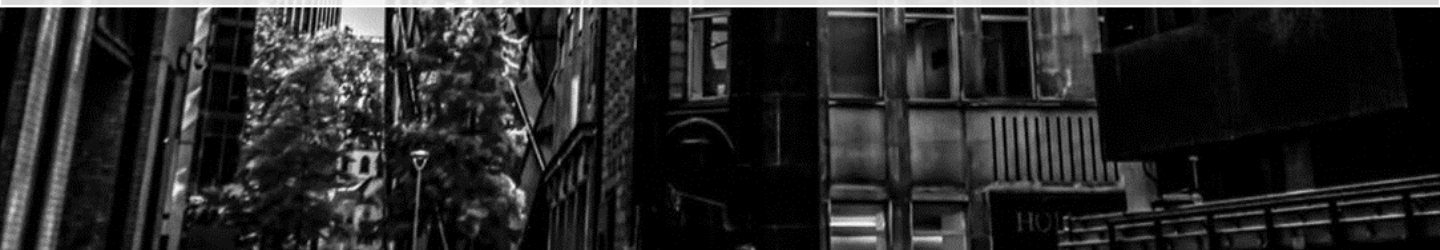
A key theme in Q119 was consolidation and investment into niche sub-sectors by strategic and financial acquirers. A number of key sectors such as engineering, IT and healthcare are struggling with candidate availability and with supply side dynamics unlikely to change in the near term, they continue to be attractive investment propositions for both strategic and financial investors. It is likely that we will see generalist staffing companies looking to acquire niche assets in order to diversify service offering and enhance market share.

Transaction activity slowed in several markets which have seen rapid recent consolidation such as healthcare and IT in Q119, however, this is not due to sectoral issues or a change in appetite of acquirers but a shortage of sellers.

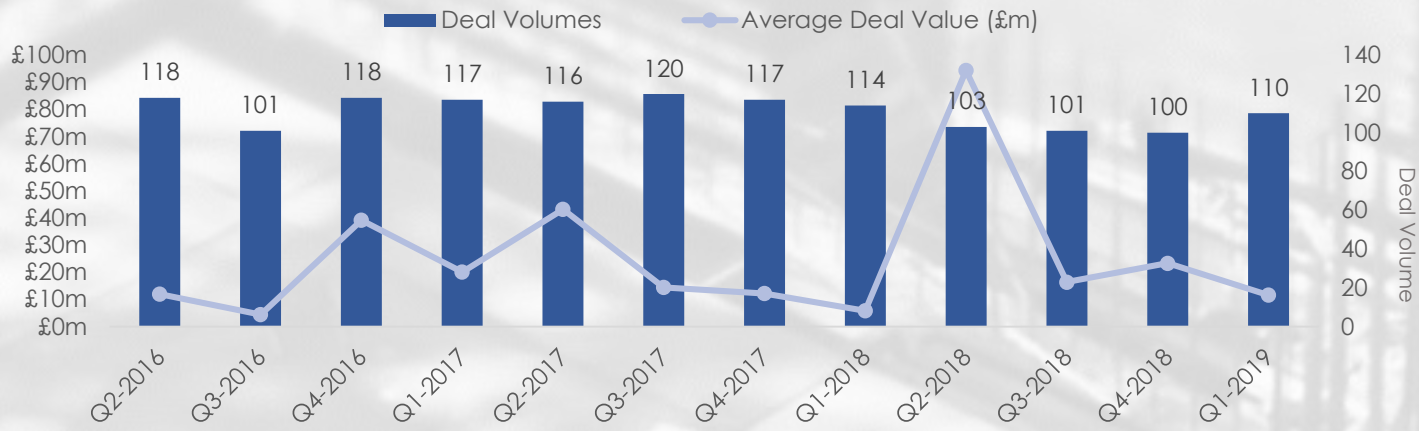
As expected the fall in valuations at the end of Q418 has not been sustained and valuations have ticked upwards during the quarter. There is still some way to go for valuations of publicly listed companies to return to previous highs. Executives will be under pressure from impatient shareholders frustrated with current market ratings to undertake value enhancing initiatives and acquisitions are likely to be a core component of this.

In Summary

- The volume of global human capital transactions increased by 10% in Q119, due to increasing activity in North America, the Middle East and Asia.
- European deal volumes declined because of continued political uncertainty. The decline in deal volumes was, in part, expected as Brexit was timetabled to occur at the end of Q119. Senior management resource has been focused on "no deal" preparations rather than value and growth enhancing strategies or acquisitions.
- Whilst Brexit has continued to cause uncertainty, with little progress being made, the "flextension" means that a "no deal" exit has been avoided at least for the near term. This may be a positive, as it will allow for further negotiations on key factors which impact the recruitment industry such as the free movement of people and right to work criteria in both the EU and the UK.
- UK unemployment continues to fall and currently stands at 3.9%. With the economy operating at close to full employment and increasing demand for staff from the majority of sectors, the outlook for the human capital sector remains strong.
- Globally cross-border activity increased in Q119, as a result of further activity within Central Europe and the Benelux regions.
- A shortage of skilled and qualified candidates in several sectors such as engineering has driven increased deal volumes. It is likely that other sectors struggling with candidate availability such as healthcare and IT will see a marked increase in deal volumes in the near term driven by further competition between strategic and financial acquirers looking to gain access to high quality candidate pools.
- The Gambit HC index shows that valuations for public interest companies increased in Q119. Whilst there is some way to go before they recover to previous highs, institutional shareholders continue to put pressure on boards to enhance market ratings at a quicker pace than is currently being achieved.



Overview



Overview

- Deal volumes increased in Q119, highlighting the resilience of the market in the face of several political and economic headwinds.
- Financial investors continue to actively invest into the market with private equity backed MBOs and platform investments undertaking buy and build strategies. Venture capitalists have also been active, investing in innovative and disruptive technologies, particularly within the online sub-sector.
- Brexit continues to impact the market with uncertainty remaining; whilst the "flextension" has averted an immediate no-deal exit, a prolonged lack of clarity over the final terms of any deal will hamper the market further.
- After a poor end to 2018, global stock markets have trended upwards. Valuations for public interest companies have recovered somewhat but they continue to look to bolster market ratings through earnings enhancing acquisitions.
- Brexit and the underperformance of global stock markets have impacted on the valuation metrics in the market. Market stability and asset availability will be key drivers of valuation for the remainder of 2019.

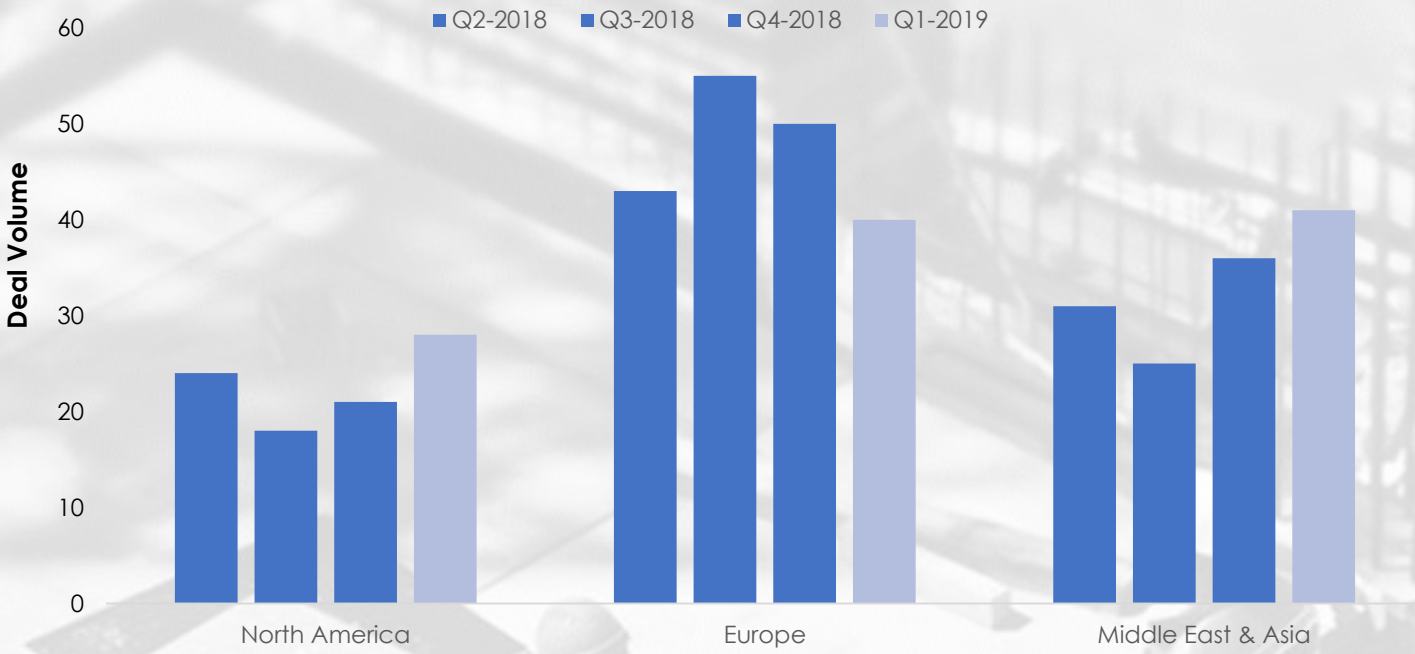
Brexit

- Whilst a "no deal" exit has been averted for the time being there is no further clarity on the likely nature of the UK's exit deal and the future trading arrangements.
- The lack of certainty will continue to impact the level of activity in the market, with ambitious companies likely to continue with opportunistic M&A rather than more wide ranging acquisition strategies.
- According to the REC, uncertainty in the UK economy is not impacting on hiring with many looking to increase hiring in the near term.
- Sectors suffering from staff shortages or relying on EU labour, may see corporate acquirers look to pursue defensive M&A strategies in order to ensure continuity of supply and defend market share.
- Once Brexit is resolved we expect to see deal volumes increase, as acquirers can invest with certainty and with a longer term perspective.

Outsource Acquires RZ Group

- **Gambit Corporate Finance acted as lead advisor to Outsource UK on its acquisition of RZ Group. The acquisition creates a market leading temporary and permanent recruitment group with revenues of over £100 million.**
- **Outsource UK is one of the largest independent recruitment companies in the UK. It specialises in supplying highly skilled contract and permanent talent in technology, change and engineering roles to clients across many sectors including financial services, defence, engineering, cyber security, logistics and supply chain and public sector.**
- **RZ Group (formerly Recruitment Zone) provides complete staffing solutions within the finance, technology, oil and gas and engineering sectors.**
- **Gambit provided strategic and financial advisory services to Outsource UK, led the commercial negotiations and managed the due diligence and legal process. The Gambit team comprised of Geraint Rowe, Simon Marsden and Sam Forman.**

Global M&A Activity



North America

- M&A activity in North America increased by 33% in Q119, driven by consolidation in the general staffing sector and financial investors playing a prominent role in deal flow in the online sector.
- US recruitment fundamentals remain positive with unemployment at 3.8% in March.
- The market continues to be dominated by private equity backed businesses such as TransForce Inc, who made a number of acquisitions in Q119, pursuing large scale buy and build strategies.
- A number of sectors including healthcare and IT are expected to continue consolidating which will drive further deal volumes in the near term.

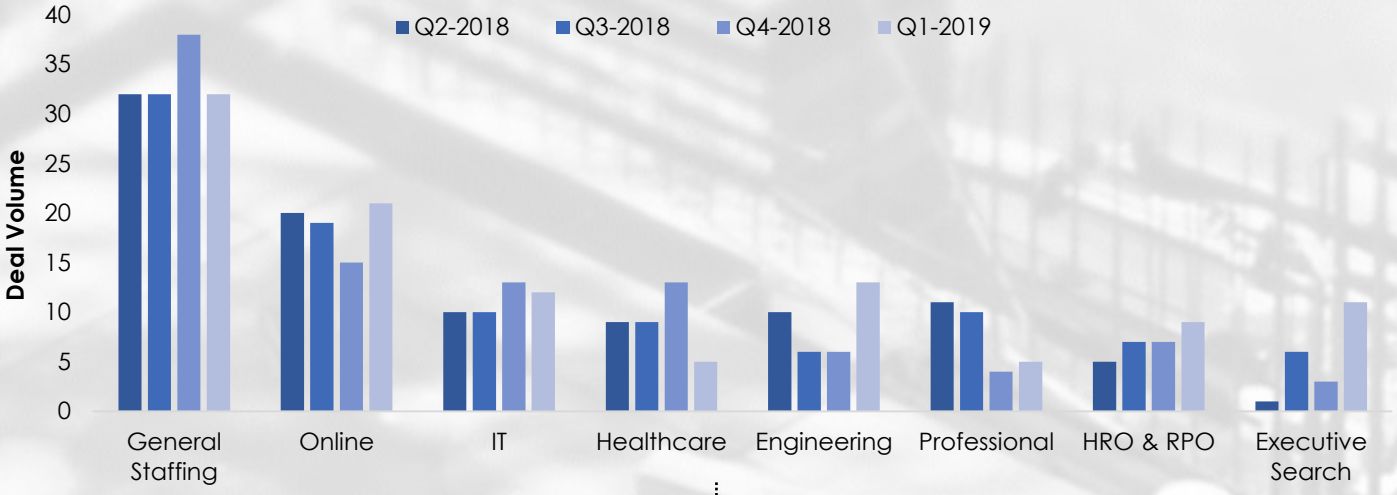
Europe

- European deal volumes fell by 20% due to continuing uncertainty surrounding Brexit.
- Brexit remains the key headwind in the region and, with no further clarity provided, this is impacting on growth and investment plans.
- Cross border activity increased within Central European and the Benelux regions. However, activity between the UK and Europe has slowed over the last few quarters, due to Brexit concerns.
- The UK is still the largest market by deal volume and recruitment fundamentals remain strong with high levels of pent up demand from both strategic and financial acquirers. We expect that once certainty emerges on Brexit, there will be a rebound in deal volumes.

Middle East & Asia

- Transaction volumes increased once again in Q119, driven by increased activity in Japan and Australia.
- Japanese strategic and financial acquirers were heavily active in the online sector, highlighting that the adoption of technology in Asian recruitment markets is a high growth area.
- M&A markets continue to focus on domestic acquisitions with very few cross-border transactions occurring.
- With spending on infrastructure expected to rise over the near term, it is expected that the region's engineering recruitment sector will see increased deal volumes in the coming months.

Sub-sector Trends



General Staffing

Activity in the general staffing sub-sector decreased during Q119, however it remained the most active subsector by deal volume. As financial investors often look to the sector for initial platform investments, and whilst pressure remains on strategic acquirers to increase activity levels, deal volumes are expected to rise in the near term.

20%

29%

Online

The online sector benefited from further consolidation from strategic acquirers looking to embrace innovative and disruptive technologies and financial investors being increasingly active. As technology is now a critical component in order to create competitive advantage in the recruitment process it is expected that deal volumes will rise further.

33%

19%

IT

The sector continues to struggle with candidate availability, which is likely to drive further activity, with strategic acquirers looking to secure candidate supply to meet demand. The decline in deal volumes is reflective of a shortage of sellers rather than any fundamental sector concerns.

8%

11%

Engineering

Increased global spend on infrastructure has led to rapid growth in demand in a sector struggling with candidate availability. Both financial and strategic acquirers are keen to acquire high quality candidate pools in order to benefit from the predicted growth in the sector.

116%

12%

Executive Search

The executive search sector has benefited from boardrooms looking to bolster talent and experience at executive levels in order to manage change and protect against uncertainties such as Brexit. The market has also seen a number of general staffing business backed by growth hungry financial investors acquire high quality, niche assets in order to expand into high value markets.

266%

10%

Healthcare

The decline in deal volumes is reflective of a market which has undergone rapid consolidation with corporates focusing on integration and a lack of high quality assets available. It is expected that deal volumes will increase in North America, Western Europe and Japan due to population demographics and a shortage of qualified candidates.

61%

5%

% % change in deal volume from Q418 to Q119

% % total deal volume in Q119

UK Debt Market Trends

Overview

- The outlook for credit is positive at present with an increase in interest rates unlikely given the uncertainty surrounding Brexit and the economy not being under inflationary pressure.
- Within the UK, corporate demand for credit has continued to slow as firms have sought to reduce leverage and strengthen their balance sheets ahead of Brexit.
- Banks and other financial institutions are still willing to lend, however some have begun to apply slightly tighter lending criteria.
- Even with the uncertainty caused by Brexit debt servicing costs remain low due to high levels of competition and low interest rates forcing lenders to be price competitive.
- The use of invoice financing and asset backed lending has increased with a marked rise of 13% in SME's with turnover of over £10m in the last year, using facilities. Invoice financing is a useful funding source for businesses looking to ease pressure on working capital and cashflow.
- Alternative lenders continue to compete with traditional high street banks, with providers offering a number of different products from peer to peer lending, invoice and asset finance, private debt and unitranche facilities.
- Their flexible approach, bespoke funding structures, less restrictive covenants and ease of use are seeing alternative lenders gain market share from traditional funders.
- The majority of lending by alternative lenders has focused on businesses backed by financial investors. This highlights the lack of awareness that the wider corporate community has on the lending options available.
- The number of non private equity backed companies using alternative funders is rising, but does remain low.
- Leverage multiples have remained at similar levels to 2018, with a number of mid-market private equity deals being syndicated at 6x EBITDA and above. This is likely to remain the case as private debt funds look to deploy investable capital and private equity maintain the use of leverage in order to boost portfolio returns.
- Increasing competition has resulted in a number of funders looking to specialise in the lower mid-market and SME markets improving the number of available funding options in the market.

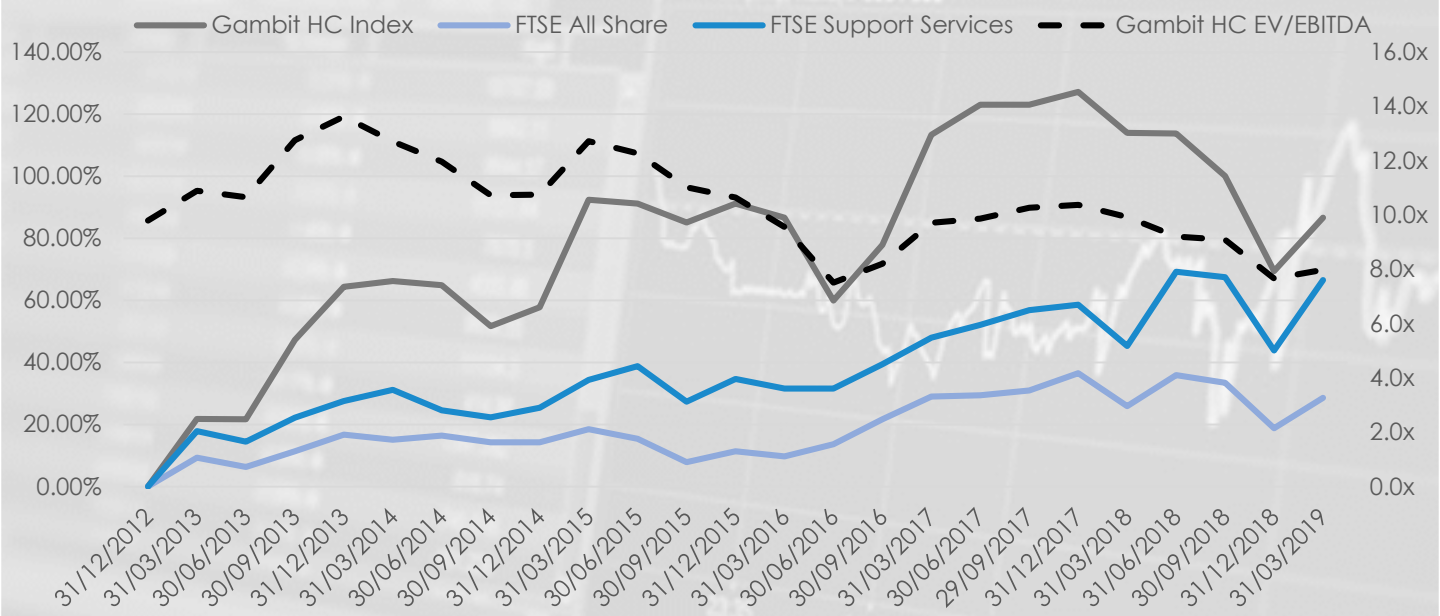
M&A Outlook

- **As private equity houses use alternative funders to leverage investments in order to protect returns, it is likely that funds deployed will continue to increase rapidly.**
- **Leverage multiples are likely to remain high as traditional and alternative lenders compete over deal flow.**
- **Whilst interest rates remain low and favourable supply side dynamics continue, it is an ideal time for those who are looking to use credit facilities for value enhancing acquisitions or investment.**
- **High levels of fundraising coupled with already high levels of 'dry powder' means that financial acquirers have significant capital to deploy into the market, which is likely to push valuation multiples upwards.**

Key Points

- **Whilst the Brexit deadline has been extended those considering refinancing may want to consider accelerating the process.**
- **Strong credit availability, increased competition between lenders and low interest rates mean it is an ideal time for those considering medium and long term funding to test the debt markets.**
- **Those considering acquisitions or MBO may wish to consider alternative lenders as a means of raising financing, as they carry a lower cost of capital than traditional private equity funders.**

Public Comparables



Company Name	EV/EBITDA Q2 2018	Q3 2018	Q4 2018	Q1 2019
Adecco S.A. (SWX)	8.5x	8.2x	7.5x	7.6x
Brunel International NV (ENXTAM)	22.4x	20.1x	17.3x	15.0x
CPL Resources PLC (LSE)	8.3x	8.0x	7.5x	6.8x
Empresaria Group PLC (AIM)	4.4x	4.7x	4.4x	4.2x
Gattaca PLC (AIM)	4.3x	4.4x	5.0x	5.0x
Hays PLC (LSE)	11.0x	11.1x	7.5x	8.1x
Impellam Group PLC (AIM)	5.7x	6.4x	7.0x	10.2x
ManpowerGroup Inc (NYSE)	6.5x	6.4x	4.9x	5.9x
Page Group PLC (LSE)	12.1x	12.4x	9.7x	8.9x
Prime People PLC (AIM)	9.0x	6.6x	3.2x	3.5x
Randstad Holding NV (ENXTAM)	9.7x	9.1x	8.1x	8.2x
Robert Half International Inc (NYSE)	11.5x	13.0x	10.5x	11.0x
Robert Walters PLC (LSE)	12.5x	8.9x	7.1x	6.6x
Staffline Group PLC (AIM)	6.2x	8.7x	8.6x	6.3x
SThree PLC (LSE)	9.5x	10.0x	7.7x	6.1x
Gambit Human Capital Index	**9.2x**	**9.1x**	**7.7x**	**8.0x**

Overview

- Valuations trended upwards in Q119, suggesting that the sharp fall in Q418 was the result of a stock market overreaction.
- Public interest companies are coming under pressure to undertake M&A and other value enhancing strategies to increase market ratings and enhance shareholder value.
- Increased activity by publicly listed companies is likely in the near term and, as they can make immediately value enhancing acquisitions due to multiple arbitrage, this will support valuations going forward.
- The Human Capital sector remains cyclical in nature, however, Brexit and the poor performance of global stock markets in 2018, mean it remains to be seen what impact these will have on the timing of the next peak in the market.
- Market stability and asset availability will be key drivers of valuation in 2019.