Human Capital Market Review Q3 2020

Introduction

With much to contemplate during this uncertain time, this edition of Gambit's Human Capital market review sets out the key trends, considerations and areas of focus that companies in the sector should be aware of to, once again, adjust and adapt. A marginal decline in deal volumes was evident in Q320 although deal values were buoyed by significant interest in sub-sectors where assets have shown a demonstrable competency in servicing in-demand niches and Covid-19 resilience. Financial acquirers also continued to deploy capital into the sector, encouraged by promising trends and levels of demand in areas of the market which have proven their resilience, despite the significant exogenous factors at play.

Despite near term uncertainty, a number of trends are emerging which could pose significant upside for Human Capital recruiters. With optimistic hiring forecasts, an emergence of regional activity and spiking sectoral demand, recruiters should, as ever, be alert to opportunities amidst the uncertainty. Beyond navigating the current trading environment, companies also have a number of important practical considerations which require due care and attention. The Chancellor's change of course in cancelling a much-anticipated Autumn Budget delays the announcement of the significant Capital Gains Tax changes expected to Spring 2021. With IR35 changes also set to take effect in April 2021, recruiters should ensure that the practicalities and implications of these changes are fully understood well in advance to ensure optimal value preservation and realisation.

Geraint Rowe
Partner, Human Capital

Q320 Summary

- An encouraging level of optimism continues to exist around the Human Capital sector, with recent statistical forecasts highlighting that hiring activity could be back at 'normal' levels as early as January 2021, buoying the sector's prospects.
- Market confidence in the sector has risen on the back of its demonstrable Covid-19 resilience, with public company EV/EBITDA multiples in the Gambit Human Capital Index rising for the second consecutive quarter, increasing by 25% to pre-Covid-19 levels.
- Sellers will be encouraged by the resilience shown in terms of improving EV/EBITDA multiples of companies in the Gambit Human Capital Index, which we expect will act as a catalyst for business owners to consider initiating a value realisation process in the near term.
- The decision by the Treasury to cancel the Autumn Budget has delayed potentially significant changes to Capital Gains Tax into Spring 2021, providing renewed impetus for business owners that are considering an exit to expedite their plans in order to ensure optimal, tax efficient value realisation.
- Although the pandemic has continued to suppress Human Capital sector deal volumes in Q320, average deal value has risen, sustained by financial acquirer appetite and premium valuations for niche assets with a clear core competency in servicing in-demand, Covid-19 resilient sub-sectors.
- Q320 saw a continued rise in Online, Engineering and Education sub-sector transactions as a result of the fundamental shift towards increased digitisation, greater focus on infrastructure projects and the rising prominence of reskilling initiatives, driving respective deal volumes upwards, with high quality assets attracting premium valuations.
- As the implementation of IR35 draws nearer, renewed concerns surrounding the technicalities of the regulations have arisen and companies affected need to ensure that the latest developments are understood to minimise impact on trading activity and maximise commercial opportunities as they arise.
- The valuation prospects of recruiters with a strong regional presence will be further enhanced as less densely populated economic hubs gain domestic prominence and importance, attracting the attention of both strategic and financial acquirers.

Simon Marsden
Director, Human Capital

"Recruiters should, as ever, be alert to opportunities amidst the uncertainty"

Key Issues & Practical Considerations

Capital Gains Tax

- Following the Treasury's decision to cancel a much-anticipated Autumn Budget in which changes to Capital Gains Tax (CGT) in its current form were expected, business owners must once again adjust and adapt in these times of uncertainty.
- With the next formal Budget expected in Spring 2021, Human Capital business owners are faced with the potential for both an overhaul of CGT and the implementation of IR35 in the private sector in short order.
- With the Conservative manifesto vowing not to raise income tax, National Insurance or VAT, there are few options left for the Chancellor to offset a proportion of the Government's emergency Covid-19 spending.

£2tn — **UK national debt has exceeded £2tn for the first time, driven by the cost of the Covid-19 economic response**

Source: ONS

>100% — **Government borrowing as a percentage of GDP has risen above 100%, the highest level since the 1960s**

Source: ONS

Practical Considerations

- The implications of changes to CGT are likely to realign vendors' priorities and, therefore, it is of paramount importance that companies fully consider and analyse the effects of the potential changes with expert advisors.
- The envisaged changes to CGT may lead to an acceleration of sellers in the market, creating a value maximisation opportunity for sellers to benefit from tax relief and buyers to capitalise on a rise in available assets.
- Business owners should adopt a proactive view of the rumoured changes, by for instance, ensuring that any tax point of a potential transaction is crystalised well in advance of Spring 2021 to ensure optimal value realisation.

IR35

- The decision to delay the implementation of IR35 (Off-Payroll) legislation in the private sector for 12 months until April 2021 has helped unprepared companies avoid further, potentially significant disruption to their operations.
- HMRC is due to clarify an "errant clause" in the IR35 legislation which effectively redefines intermediaries and makes the recruitment agency a 'fee-payer' and therefore responsible for the processing of tax deductions.
- With just under six months to go before the legislation takes effect, IR35 remains the dominant legislative and regulatory concern of UK staffing firms, ranking above Brexit.

43% — **Of staffing firms named IR35 as the most concerning compliance issue that they currently face**

Source: SIA

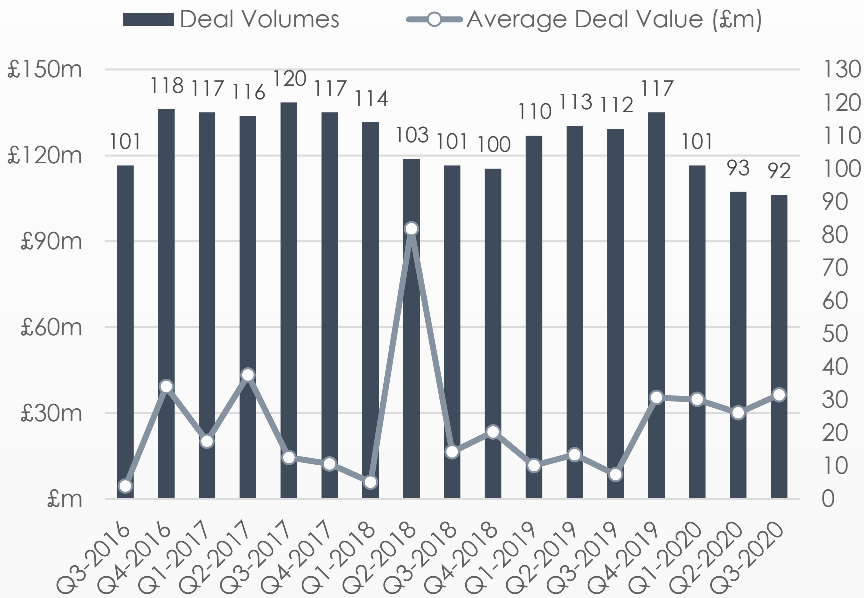
45% — **Of private sector contractors intend to keep contracting via their Personal Service Company after IR35 is implemented**

Source: Contractor UK

Practical Considerations

- Exposed companies should ensure that the latest key developments surrounding technical issues are both understood and factored into strategic plans to ensure compliance and minimise the potential impact on trading.
- As temporary staff hiring activity continues to increase amidst the current domestic backdrop, it is important that companies in the sector fully understand the rights and benefits that flexible workers are entitled to avoid additional issues.
- Given the level of uncertainty that surrounds IR35 and its effect on market activity, it is key that Human Capital companies liaise with their wider advisory network to inform decision making and ensure that a best practice approach has been implemented.

Global M&A: Activity



Company Name	EV/EBITDA Q4 2019	Q1 2020	Q2 2020	Q3 2020
Adecco S.A. (SWX)	9.2x	6.3x	7.5x	9.7x
Brunel International NV (ENXTAM)	9.2x	10.3x	13.9x	15.3x
CPL Resources PLC (LSE)	6.2x	4.4x	5.4x	5.3x
Empresaria Group PLC (AIM)	4.4x	4.3x	4.5x	4.2x
Gattaca PLC (AIM)	4.4x	2.0x	2.3x	2.5x
Hays PLC (LSE)	9.6x	8.0x	9.3x	10.9x
Impellam Group PLC (AIM)	9.6x	8.1x	7.7x	5.8x
ManpowerGroup Inc (NYSE)	7.2x	4.8x	6.0x	7.4x
Page Group PLC (LSE)	10.7x	7.4x	7.9x	14.1x
Prime People PLC (AIM)	4.5x	1.7x	2.3x	1.7x
Randstad Holding NV (ENXTAM)	10.7x	7.5x	9.3x	12.4x
Robert Half International Inc (NYSE)	9.7x	6.6x	9.0x	9.7x
Robert Walters PLC (LSE)	7.6x	3.6x	5.0x	6.2x
Staffline Group PLC (AIM)	5.9x	4.1x	N/A	N/A
SThree PLC (LSE)	8.1x	4.5x	5.5x	6.3x
Gambit Human Capital Index	**9.2x**	**6.5x**	**8.0x**	**10.0x**

Overview

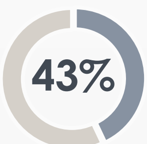
- Despite a small drop in activity volumes, deal values held up well in Q320, driven by financial acquirers who continued to deploy dry powder into quality niche assets where hiring activity remains buoyant and relatively unaffected by market uncertainty.
- A notable 30% reduction in North American deal volumes was evident in Q320, with a degree of hesitation hindering activity as the market awaits the outcome of the US Presidential election before considering further opportunities in the region.
- UK M&A activity was buoyed by an increase in HRO & RPO transactions, with financial acquirers showing particular interest in the sub-sector during Q320 given the growing importance of regulatory compliance, particularly as the implications of IR35, Brexit and 'Furlough Fraud', come into view.
- Public company EV/EBITDA multiples in the Gambit Human Capital Index rose for the second consecutive quarter, increasing by 25% and returning to pre-Covid-19 levels, indicating a growing sense of market optimism towards the level of Covid-19 resilience that companies in the sector have shown.
- EV/EBITDA valuations improved for ten of the fifteen companies in the Gambit Human Capital Index, although a degree of polarity is evident, with Impellam reporting a decrease in H120 revenues of 10% on a like-for-like basis when compared to H119, negatively affecting its multiple.
- The rise in the multiple of SThree PLC was driven by a significant uptick in general sales activity levels across most regions, improving contractor retention levels and a stabilisation of the contractor order book shown in its Q320 results.
- Sellers will be encouraged by the market's resilience in view of improving valuation data, with those that were considering an exit at short notice prior to the pandemic perhaps now actively considering initiating a transaction.

Sub-Sectors in Focus

Online

44% 25%

The year on year (YoY) rise in deal volumes in the Online sub-sector is underpinned by an accelerated shift towards greater digitisation in the Human Capital sector. Covid-19 has radically changed the addressable digital audience that recruiters have access to, widening both the talent pool size and demographic reach. In Q320, appetite for Online staffing solutions was driven by both Strategic and Financial acquirers both seeking to capitaliise on this structural shift, driving a 44% YoY increase in deal volumes. With recent data indicating that large staffing buyers foresee an increase in their usage of online staffing solutions in the next 10 years, we expect this rise to be sustained, driving both deal volumes and values upwards.



Of large companies that use staffing agencies foresee an increase in their usage of online staffing solutions in the next 10 years

Source: SIA

Education

250% 11%

In view of near term labour market volatility, public and private sector emphasis has been placed on reskilling and retooling initiatives both domestically and internationally. The heightening of sub-sector M&A activity on a YoY basis indicates a growing impetus for private enterprises to meet this demand. As fears of a potential unemployment wave grow, so will market appetite for quality assets in the Education subsector. Furthermore, 70% of Education sub-sector transactions were domestic, indicating private sector willingness to collaborate and consolidate locally to support ongoing labour market initiatives. As the end of the Job Retention Scheme nears, we expect Education staffing businesses to experience ever greater importance and appeal.

£2.5bn

Has been made available as part of the National Skills Fund to support retraining initiatives

Source: GOV.UK

Engineering

20% 7%

Despite the significant impact of national lockdowns on the Engineering sub-sector, M&A activity has been robust, in line with successful post-lockdown reanimation initiatives. In Q320, sub-sector activity largely consisted of domestic activity, in line with a greater shift towards 'reshoring' or 'near-shoring' as a result of Covid-19 related supply chain disruptions. Acquirers will continue to seek assets servicing projects with longer assignment lengths, providing revenue stability. The UK government's willingness to invest in infrastructure projects has improved the prospects of the domestic market, confirmed by the sharp rise in September Engineering recruitment activity as highlighted by the REC. We expect such investment and talent demand to lead to sustained investor appetite for UK assets.

£37bn

Total contract value of the UK National Infrastructure and Construction Pipeline

Source: GOV.UK

General Staffing

51% 21%

As the appeal of niche assets with defined sub-sector competencies has risen, the growth of deal volumes in General Staffing has tempered. Larger companies continue to review existing business models to meet the future demand of high-growth sub-sectors, therefore reducing the level of growth in activity for companies with a less defined value proposition. Despite this, the General Staffing sub-sector continues to feature prominently in our quarterly data, representing over a fifth of overall activity. Over 50% of General Staffing deals concerned European assets, of which 11% were domestic UK transactions. As the potential for an upcoming unemployment wave rises, we expect that growth in General Staffing transactions will return as general candidate availability numbers rise.

In August, staff availability grew at the fastest rate since December 2008

Source: REC

% % % change in deal volume from Q319 to Q320

% % total deal volume in Q320

Hiring Activity Trends

The effect of Covid-19 on the Human Capital sector continues to be felt, with fears of a 'second wave' disrupting a fragile period of initial economic recovery. As concerns around the UK employment market rise, it is important for Human Capital companies to maintain a sense of perspective through regular monitoring of hiring activity trends. Despite significant headwinds in the near term, there are areas that are turning into 'green shoots' for the sector, which are serving to buoy current trading performance and enhance short term prospects. As companies prepare to enter a crucial fourth quarter in which significant challenges and opportunities will arise, we have set out below four hiring activity trends that we would advise companies in the sector to proactively monitor in the short to medium term.

Forecasts

- Despite the current near term uncertainty posed by a potential 'second wave' of Covid-19, recent statistical forecasts (e.g. Onrec – October 2020) highlight that hiring activity could be back at 'normal' levels as early as January 2021.
- Such forecasts are predicated on the positive trends in hiring activity such as those set out below and opposite, which have developed since the UK came out of national lockdown.
- The Gambit Human Capital Index indicates that these positive trends are translating into enhanced valuations, as companies in the sector contend with and increase their tolerance of significant near term external headwinds.
- As we enter Q4, forecasts will inevitably be revised, however an encouraging level of optimism continues to exist around the Human Capital sector, with a significant market opportunity existing for those that can best adapt in line with a period of heightened volatility.

Emerging Regions

- Increasing decentralisation is prompting greater geographic disbursement from central areas (e.g. London), with regional recruiters benefitting from an increase in quality talent.
- While London has seen the slowest rate of recovery in hiring activity in the UK, on a regional basis, the North East, East Midlands and the South West have seen sustained hiring growth since May.
- The pandemic's enforced shift towards remote working has accelerated the prominence of regional recruiters, who are likely to act as a catalyst for more evenly spread employment opportunities across the UK as economic recovery continues.
- The valuation prospects of recruiters with a strong regional presence will become further enhanced as less densely populated economic hubs gain domestic prominence and importance.

Rising Temporary Work

- As would be expected at this stage of the economic cycle, an increased reliance on temporary workers has emerged recently as a result of hirers' difficulty in planning for the long term amidst the significant near term uncertainty caused by Covid-19.
- According to the REC, in September, hiring activity and billings for temporary workers showed the strongest month-on-month improvement in almost two years,
- Demand for temporary/agency staff was driven by stronger hiring in areas such as IT, Engineering and temporary blue-collar roles. In contrast, demand for permanent staff deteriorated in all ten of the REC's monitored sectors.
- With 50% of management heads and HR leaders stating a lack of familiarity with the rights and benefits that flexible workers are entitled to, Human Capital companies can add significant value to both new and existing clients' talent management procedures.

Sector Variations

- There is a significant variation in hiring data on a sectoral basis, with a polarity in activity evident based on a number of factors, including the ease with which remote working can be facilitated, Covid-19 resilience and areas of national importance.
- The IT sector has been consistent in providing the most job opportunities for remote workers following the UK lockdown, aided by the acceleration of hirers' respective digitisation journeys.
- Despite a turbulent general jobs market, Healthcare vacancies, unsurprisingly, have risen in line with a heightened level of demand for key workers, which is likely to be sustained by additional government investment into public health initiatives.
- Construction jobs have also seen increased demand, with job postings up 6.7% from February, indicative of the level of domestic infrastructural investment that has been committed to by both the public and private sector.

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Gambit Corporate Finance

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