CORPORATE FINANCE

INTERNATIONAL

Human Capital

CFI UK

M&A Market Review

Q3 2019

Contents

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Executive Summary

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In the third quarter of 2019, global deal volumes remained resilient in the Human Capital sector. Despite heightened political uncertainty and evidence of weakening recruitment fundamentals, deal volumes in Q319 trended only marginally downwards following two consecutive quarters of growth in H119. We believe this to be merely a slight hesitation in the market, which will be counteracted by the resolution of legacy issues such as an orderly Brexit and a US – China trade deal being struck.

In the UK, deal volumes increased by 36% in Q319 due to the buoyant performance of the IT and Healthcare sub-sectors which witnessed significant growth in deal activity. The effects of the markedly weaker jobs data coming out of the US and UK should be closely monitored, however. The results of the impending UK General Election will also weigh in on market activity and will perhaps provide much needed certainty to businesses.

Over the course of Q319, we observed a large increase in transaction volumes in the HRO & RPO sub-sector. This signals that the market is moving to ease the effects of potentially greater administrative burdens in line with a heightened period of legislative and regulatory change such as the impending implementation of IR35 in the private sector in April 2020. This trend indicates that businesses are managing these developments through strategic M&A activity.

In Q319, average deal values reduced following growth in H119, indicating that the risk appetite of acquirers has been curbed as they cautiously await more certain times in which to deploy 'dry powder'. Valuations also trended downwards in Q319 which is representative of the global economic slowdown and the challenging trading environment faced by companies in the CFI UK HC Index. Periods of valuation deterioration however can tend to bring opportune buyers to the surface, leading to increased M&A activity.

In Summary

- Deal volumes flatlined in Q319 following two consecutive quarters of growth. North America continued its upward trend for the fourth consecutive quarter, driven by General Staffing sub-sector activity which was twice the level recorded in Q219. Average deal values in North America were notably much lower in Q319, indicating that higher value deals are being put on hold in light of continued political and economic headwinds.
- UK deal volumes increased by 36% from Q219, driven by increased activity in the IT and Healthcare sub-sectors. The performance of the UK market has been positive throughout 2019, although the weaker recruitment fundamentals reported at the end of the quarter could affect deal activity going forward.
- Brexit continues to impact market sentiment, with a UK General Election now taking place on 12th December to break the political deadlock.
- IR35 is at the forefront of discussions, with the Treasury pledging its commitment to the regulations taking effect as planned in April 2020. As a result, businesses are acting decisively and are taking advice on how to mitigate the effects, with some utilising M&A to reduce the administrative burden.
- The IT sub-sector saw deal volumes trend upwards in Q319, despite continued challenges with candidate availability. Acquirer appetite has been driven by companies' demands for relevant staff as they find that the jobs of the future are more digital, data, and information driven.
- The CFI UK HC index shows that valuations for public interest companies reduced by 5.5% in Q319, with the global economic slowdown and the effects of the widely cited difficult trading environment in the UK negatively affecting financial results.

Key Issues in Focus

The uncertainty around Brexit and the implications of IR35 will have a direct impact on the HC Market

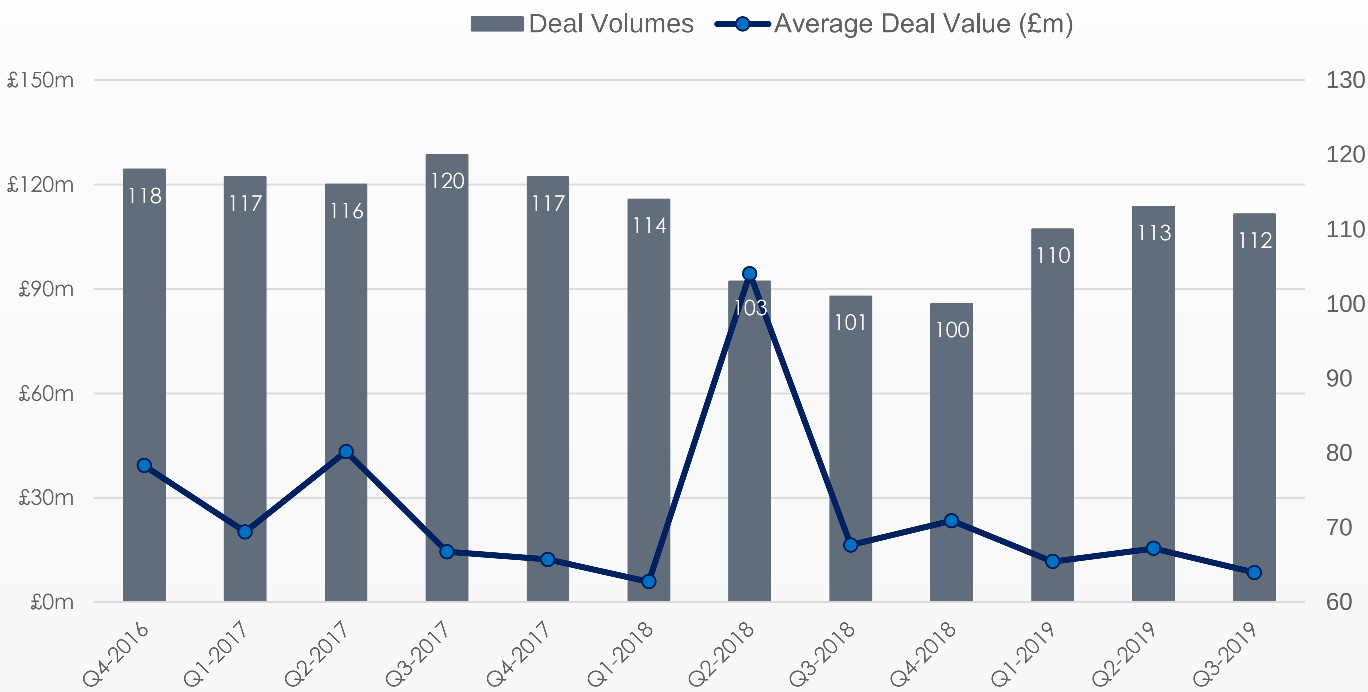
Brexit

- Whilst a new Brexit deal has been agreed in principle, the government has been forced to request and accept an extension from the EU, moving the deadline to 31st January 2020.
- Given the imposed extension, the UK government has abandoned its attempt to present its Brexit bill, instead seeking to win a majority in the upcoming General Election in an effort to break the Brexit deadlock.
- If the renegotiated withdrawal agreement is ratified, EU citizens who arrive in the UK after January 2021 will subject to the same controls as those from the rest of the world, thereby ending the free movement of people.
- Reducing the scale of EU immigration was a major policy of the 'leave' campaign, therefore, new immigration laws after Brexit could lead to a skills shortage with c.12% of the financial and business services sector's workforce being migrants.
- The number of UK permanent staff appointments fell for the seventh straight month in September, driven by subdued confidence, which has affected the hiring decisions and availability of workers
- The UK's decision to leave the EU has resulted in some businesses delaying expansion and investment in their workforce resulting in weaker demand for recruitment firms' services.
- The public sector is likely to postpone hiring additional employees as spending reductions are made in government departments.
- As a result of the uncertainty surrounding the supply of talent, we expect to see those with high levels of defendable market share and high-quality candidate pools in niche sectors attract renewed interest from both strategic and financial acquirers.
- Whatever form 'Brexit' does take it will be crucial for the recruitment industry to ensure that it can maintain access to high quality candidates on a global basis in order to meet demand for qualified and available candidates from UK corporates going forward.

IR35

- With the implementation of IR35 for the private sector planned for April 2020, regulatory compliance is becoming increasingly important for publicly listed contractors and temporary work providers.
- There is growing concern that the new rules are too broad based and compliance is complex, with HMRC guidance falling short of expectations.
- When surveyed, 59% of contractors said they would consider seeking alternative work with another business if found to be inside IR35, with just under a third stating that they would consider stopping contracting altogether.
- The contractor community has become more vocal in calling for clarity on the issue and there is potential to gain or lose new contractor talent depending on the quality of advice from HMRC.
- Major employers including Barclays and GlaxoSmithKline are increasingly informing contractors that they will only employ them as "on-payroll" employees, thereby avoiding IR35 altogether via an "all PAYE" policy.
- Given the current level of political and economic uncertainty, there are concerns that companies simply will not have the capacity to deliver significant increases to legal and HR teams to deal with IR35 processes.
- Companies, consultancies and end users who are heavily dependent on the use of contract workers will need to undertake significant planning to avoid losing talent and reduce the risk of retrospective employment tax claims.
- Recruitment agencies will need to make IR35 determinations on any flexible workers engaged from April 2020, and the responsibility will fall on the agencies to take 'reasonable care'.
- Companies are using the M&A market as a mechanism to reduce the legislative and regulatory burden, with acquisitions in the HRO space rising significantly.

Overview



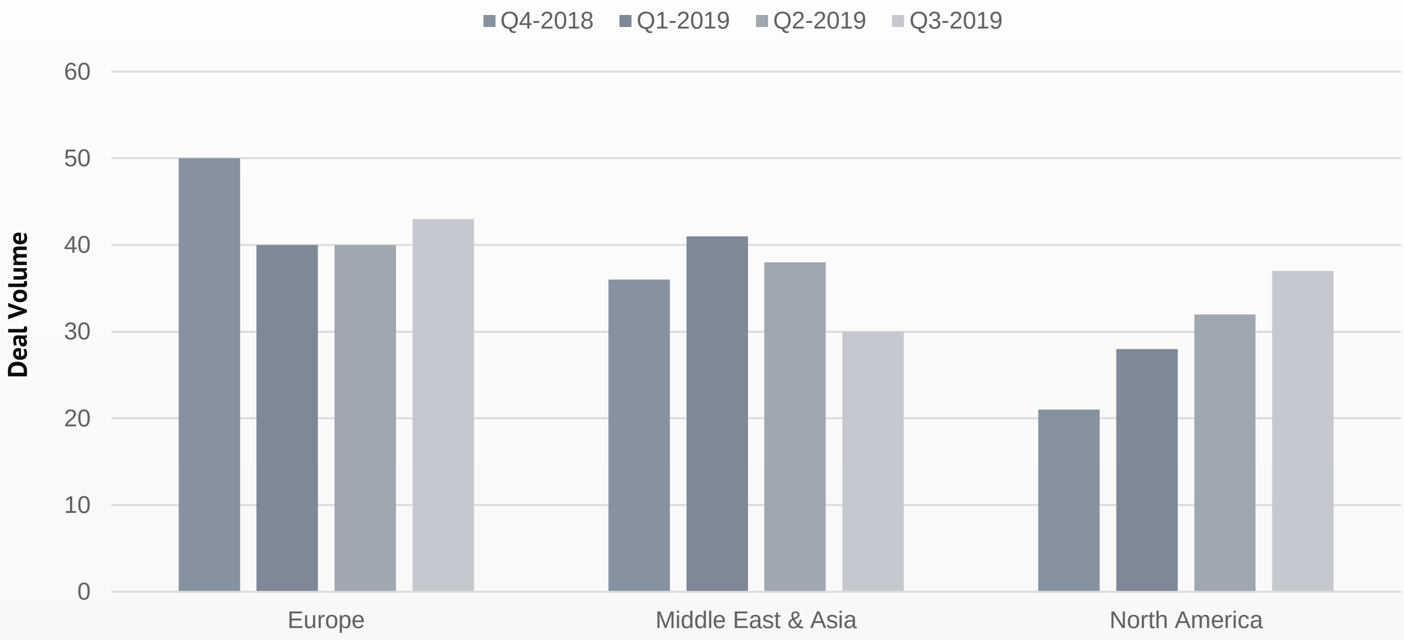
Overview

- Deal volumes in the Human Capital sector have shown resilience in Q319, despite a somewhat fragile global economic backdrop.
- The continuing political and economic uncertainty is curbing the risk appetite of companies considering larger deals, therefore impacting average deal values, which showed quarter-on-quarter contraction.
- Despite transaction volumes flatlining in Q319, several geopolitical events are coming to the forefront, such as the potential resolution of Brexit and the US and China trade negotiations. Settlement of these issues will ease some of the nervousness that has inhibited growth in volumes and valuations. Further delay will serve to prolong the uncertainty, however.
- UK deal volumes rose by 36% over the previous quarter, driven in part by increased deal flow in the IT and Healthcare sub-sectors.
- The positive performance of the UK market to date during 2019 can be attributed to the surplus of capital and the low interest rate environment, protecting mid-market M&A from the volatility normally associated with this stage of the cycle.
- The rise of transactions concerning HRO & RPO providers is apparent, with this market set to grow at an estimated CAGR of 7% between 2019-2025.

UK Recruitment Sector Outlook

- UK unemployment fell by 10bps to 3.9% between June & August and economists have warned that the latest ONS jobs data is “markedly weaker” than expected, with Brexit uncertainty starting to impact the UK’s labour market fundamentals.
- Despite IR35 legislation continuing to cause confusion and uncertainty the Treasury has pledged its commitment to the regulations taking effect, as planned, in April 2020.
- Nearly half of UK employers have expressed concerns about the lack of availability of candidates for permanent hire.
- The UK economy is expected to grow by 1.3% in 2019 and 1.3% in 2020 according to the Bank of England and, with many employers operating at full workforce capacity, temporary workers may be relied upon to service any further increases in demand.
- Labour productivity continued its weak trajectory into Q319, falling at its fastest annual pace in five years, thereby confirming the UK’s productivity challenges.

Global M&A Activity



Europe

- European deal volumes showed modest growth in Q319, also evidencing a degree of cyclicality over the last two years, with Q319 deal volumes echoing Q317 levels.
- UK deal volumes increased by 37%, with growth stemming from sustained interest in sub-sectors such as General Staffing, Healthcare and IT, which have shown durability in the face of political and economic headwinds.
- Activity within continental Europe remained strong, with the Netherlands and Spain being stand out markets in the quarter.
- Despite the clear domestic focus of European deal activity, there is still some interest from corporates in continental Europe that are looking to expand into or bolster their presence in the UK. However, we are seeing a period of hesitation amid the Brexit impasse.

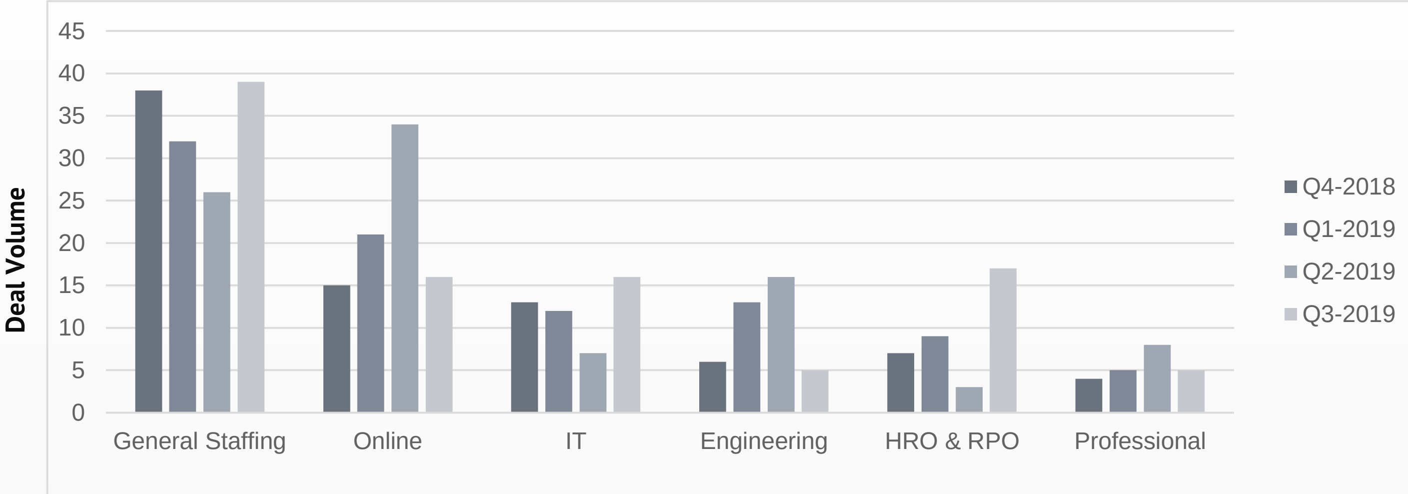
Middle East & Asia

- Transaction volumes once again declined in Q319, resulting in a slight correction from the record high volumes of the previous three quarters.
- Despite the reduction in Q3 volumes, 2019 has been highly encouraging for the Middle Eastern and Asian markets so far, with transaction volumes up 22% from the same period in 2018.
- Cross-border activity in the region surged in Q319, mainly driven by activity in Japan where firms are increasingly using M&A as a tool for growth and expansion, encouraged by the economic and fiscal reforms introduced by Prime Minister Shinzo Abe.

North America

- M&A activity in North America has continued its upward trend for the fourth consecutive quarter, increasing by 16% from Q219, with volumes at a two year high, mainly driven by General Staffing activity which doubled in Q319.
- Activity between US and Chinese corporations is virtually non-existent. The trade war continues and several transactions have been blocked by the US Committee on Foreign Investment due to national security concerns. Should there be any breakthroughs in talks, we would expect cross-border activity to rise significantly, driving overall volumes upward.
- Recruitment fundamentals in the region remain positive, with US unemployment figures for September falling to a 50 year low of 3.5%.
- US job openings fell to an 18 month low in August, suggesting that employment growth is slowing due to a reduced demand for labour in view of the economic slowdown.

Sub-sector Trends



General Staffing

Deal volumes returned to Q418 levels having trended downwards in the first half of the year. This was in part due to the activity in the North American region, where activity nearly doubled from Q219 levels. With involvement in over a quarter of transactions in Q319, financial acquirers' appetite for staffing companies is showing no signs of slowing, and is indicative of the number of high quality assets that exist in the General Staffing sector.

50%

35%

Online

The online sector saw a correction in Q319, following the six year high recorded in Q219 due to reduced activity in North America. Financial buyers continued to show that they are investing heavily into the online sector, however, Q319 indicated that there is some hesitation in sustaining Q219 levels. We expect deal volumes will rebound in line with market forces, primarily the rise of online and mobile platform usage by candidates.

53%

14%

IT

Despite continued struggles with candidate availability, deal volumes are once again buoyant following a subdued Q219. The use of temporary and contract IT roles is increasingly viewed as a means to achieve technological change within organisations, thereby increasing appetite for companies operating in the IT space. As organisations find the jobs of the future are more digital, data and information driven, we believe that IT deal volumes and valuations are likely to increase.

129%

14%

Engineering

The engineering sector has endured a turbulent Q319. A notable reduction in M&A activity in Europe and the Middle East and Asia has driven overall volumes down. The UK construction industry once again showed its vulnerability to the recent political and economic uncertainty, with output decreasing and orders falling at the fastest pace in 10 years. This has had the effect of reducing acquirer appetite until market stability is restored.

69%

4%

HRO & RPO

Deal volumes accelerated in Q319 to levels which we have not seen since Q417. The majority of these transactions were domestic, with strategic buyers leading the way. The increase in activity correlates with companies seeking to proactively outsource elements such as payroll given the increased administrative burden posed by IR35. The HRO market is expected to grow at a CAGR of over 7% through to 2025 and we expect to see deal volumes reflect this going forward.

467%

15%

Professional

The professional sector saw activity levels revert to normalised levels in Q319. The European and North American markets dominated the sector, however cross border activity was once again limited. We expect that deal volumes will increase in Europe, driven by the need for companies to maintain access to high quality candidates on a global basis in order to meet client demand for qualified and available candidates going forward.

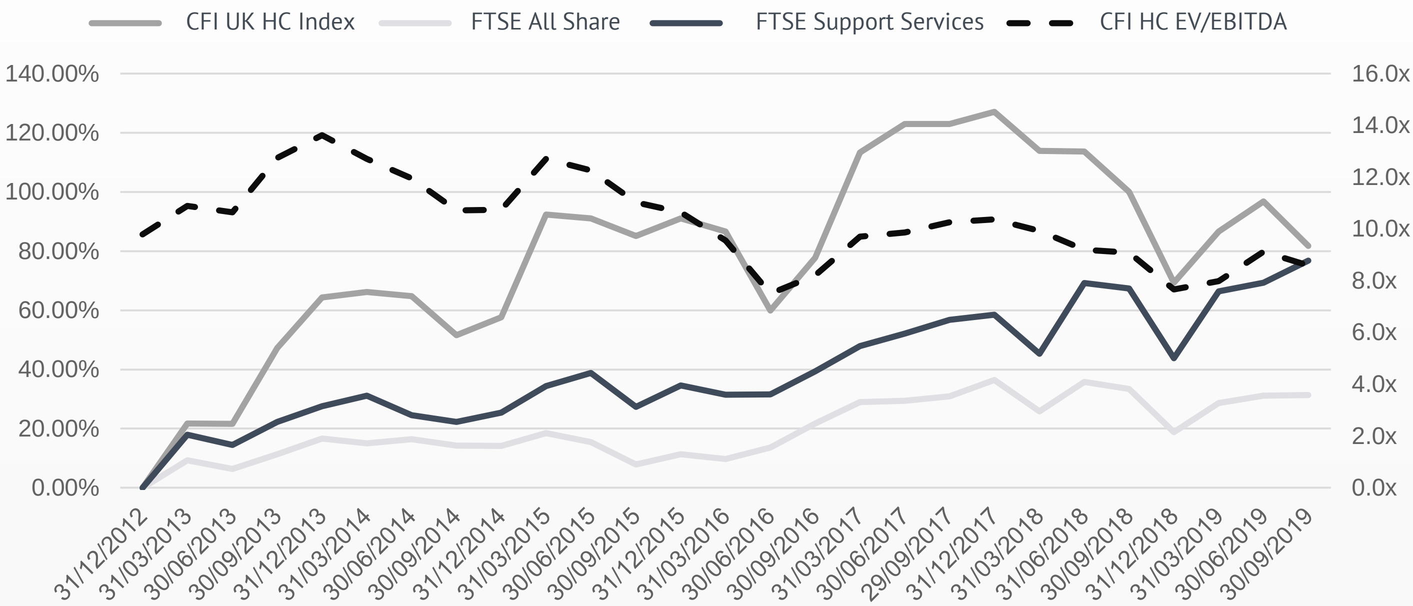
38%

4%

% — % change in deal volume from Q219 to Q319

% — % total deal volume in Q319

Public Comparables



Company Name	EV/EBITDA Q4 2018	Q1 2019	Q2 2019	Q3 2019
Adecco S.A. (SWX)	7.5x	7.6x	9.2x	8.8x
Brunel International NV (ENXTAM)	17.3x	15.0x	14.7x	11.2x
CPL Resources PLC (LSE)	7.5x	6.8x	6.8x	5.9x
Empresaria Group PLC (AIM)	4.4x	4.2x	4.2x	4.1x
Gattaca PLC (AIM)	5.0x	5.0x	4.6x	4.5x
Hays PLC (LSE)	7.5x	8.1x	8.5x	7.9x
Impellam Group PLC (AIM)	7.0x	10.2x	9.7x	10.2x
ManpowerGroup Inc (NYSE)	4.9x	5.9x	7.7x	6.9x
Page Group PLC (LSE)	9.7x	8.9x	10.1x	9.0x
Prime People PLC (AIM)	3.2x	3.5x	3.4x	3.3x
Randstad Holding NV (ENXTAM)	8.1x	8.2x	10.0x	9.4x
Robert Half International Inc (NYSE)	10.5x	11.0x	10.3x	9.9x
Robert Walters PLC (LSE)	7.1x	6.6x	7.3x	7.5x
Staffline Group PLC (AIM)	8.6x	6.3x	2.3x	6.4x
SThree PLC (LSE)	7.7x	6.1x	6.6x	6.6x
CFI UK Human Capital Index	**7.7x**	**8.0x**	**9.1x**	**8.6x**

Overview

- Public company EV/EBITDA multiples in the CFI UK Human Capital Index fell by 5.5% in Q319, reflecting a global economic slowdown and the effects of the widely cited difficult trading environment in the UK.
- In Q319, UK valuations showed vulnerability, with PageGroup issuing a profit warning and Hays reporting a fall in UK&I net fee income, which negatively affected their respective multiples.
- The effects of Brexit uncertainty on the recruitment sector are being compounded by the tightening labour market, wavering consumer confidence and slowing new contract momentum, all of which are effecting valuation multiples.
- Despite a difficult 2018, Impellam has bounced back in 2019 following a successful restructure, which has improved profitability, thereby enhancing its valuation multiple.
- Periods of valuation deterioration can often act as a catalyst to increase M&A activity, with opportune buyers seeking to leverage near term uncertainty to create a discounted entry point for long-term strategic plays.

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