Allenby CAPITAL

Company Note

Interims

12 August 2020

Corporate

Current price	**40.5p**
Sector	**Support Services**
Code	**EMR.L**
AIM	**AIM**

Share Performance

	1m	3m	12m
EMR.L	+14%	+19%	-38%

Source: Thomson Reuters, Allenby Capital

Share Data

Market Cap (£m)		**19.8**
Shares in issue (m)		**48.9**
52 weeks	High	Low
	65.5p	**29.5p**
Financial year end		**December**

Source: Company Data, Allenby Capital

Key Shareholders

Anthony Martin (Chair)	28.41%
Close Brothers AM	12.97%
HM van Heijst	11.24%
Hof Hoorneman FM	9.08%
Beleggingsclub 't Stockpaert	6.13%
The Ramsey Partnership Fund	4.98%
Allianz Global Investors	3.14%

Source: Company Data, Allenby Capital

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Empresaria Group plc (EMR.L)

Resilience in challenging times

As noted in our last note accompanying the trading update on 22 July, we view Empresaria's interim results as encouraging given the current market conditions. The Group has shown significant resilience - highlighting the benefits of its newly adopted *"Stronger Together"* culture and its historic operational diversity. Profitability was achieved in both Q1 and Q2 on an adjusted basis, with the latter quarter warranting particular note given that NFI was down 39% in that period. We would also highlight the significant improvement in net debt which has fallen from £19.1m to £8.9m, while financing headroom has increased from £11.5m to £18.1m. The short-term outlook remains unclear, but we believe that Empresaria, by virtue of its broad diversity, strong culture and financial flexibility, remains well placed to exploit any recovery in demand.

- **Profitability retained despite COVID-19** – Empresaria started the year well. In each month of Q1 it achieved year on year (yoy) growth in operating profit, in part due to the operational initiatives established during 2019. However, NFI for the period declined by 5% primarily due to the impact of Covid-19 in March. In Q2, reflecting the full impact of the pandemic, NFI fell by 39%, yet the Group remained profitable due partly to a successful cost reduction exercise which saw costs 30% lower yoy in Q2 and from the progress made in its *"Stronger Together"* initiative. Key investment plans were unaffected.

- **NFI lower in five of the Group's six sectors** – As might be expected, the impact of Covid-19 resulted in a NFI reduction in five of the Group's six sectors, with the most impactful decline being in the Professional sector which evidenced a 35% decline in constant currency from £13.7m to £8.8m. The aviation business was worst affected and this business has been right-sized as a recovery in the short-term is deemed unlikely. IT was resilient with NFI falling by just 2% to £6.7m helped by a strong performance in the US. The Commercial segment declined by 10% to £8m, as higher demand in the German logistics' operations was offset by continued weakness in the German automotive sector. Offshore Recruitment Services experienced a significant decline in demand yet still posted an 8% increase in NFI and increased underlying operating profit from £1.3m to £1.4m.

- **Financial position strengthened** – In a downturn staffing companies tend to experience an element of negative working capital as temp debtors unwind and Empresaria has been no exception. At the end of the period net debt had fallen from £19.1m (at December 2019) to £8.9m. As well as the working capital inflows, the Group has taken advantage of various government initiatives to delay payment of taxes such as VAT in the UK. The deferrals total £3.5m and will start to be repaid through H2. The Group has also agreed a £2.5m increase in its UK overdraft facility with the result that at June 2020 its financing headroom had increased to £18.1m against £11.5m at December 2019, excluding IDF). In our opinion these results confirm that Empresaria remains very well placed to exploit any recovery in demand.

Year End: December					
(£m)	**2018**	**2019**	**2020E**	**2021E**	**2022E**
NET FEE INCOME	72.3	74.5			
ADJ. PBT	11.4	9.3	Forecasts	Forecasts	Forecasts
ADJ. FD EPS (p)	12.1	8.5	temporarily	temporarily	temporarily
DIVIDEND (p)	2.00	-	withdrawn	withdrawn	withdrawn
NET DEBT (pre pilot bonds)	17.1	19.1			

Empresaria is a research client of Allenby Capital.

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Equity Research

Interim results summary

EXHIBIT 1: SUMMARY OF INTERIM INCOME STATEMENT

6 months to June	2020	2019	% change (CC)
	£m	£m	
Revenue	136.1	175.5	*-22.5%*
NFI	**28.2**	**36.3**	*-22.3%*
NFI margin	20.7%	20.7%	*0.2%*
Admin costs	-25.2	-32	*-21.3%*
as a % of NFI	-89.4%	-88.2%	*1.4%*
Underlying operating profit	**3.0**	**4.3**	*-30.2%*
Interest	-0.6	-0.6	*0.0%*
Underlying profit before tax	**2.4**	**3.7**	*-35.1%*
Exceptional items	0.0	-0.5	
Impairment	-2.6	0.0	
Fair value charge	-0.1	0.0	
Amortisation of intangibles	-0.9	-0.9	
Statutory (loss)/profit before tax	**-1.2**	**2.3**	
Tax	-0.2	-1.0	
(Loss)/profit for period	**-1.4**	**1.3**	
Minority interests	0.0	-0.6	
Net (loss)/profit after minority	**-1.4**	**0.7**	

Source: Empresaria Group

Empresaria started the year well and in each month of Q1 it achieved year on year (yoy) growth in operating profit, in part due to the operational initiatives established during 2019. However, net fee income (NFI) for the period declined by 5% primarily due to the impact of Covid-19 in March.

In Q2, reflecting the full impact of the pandemic, NFI fell by 39%, yet the Group remained profitable due partly to a successful cost reduction exercise which saw costs 30% lower yoy in Q2 and from the progress made in its *"Stronger Together"* initiative. Key investment plans were unaffected.

At the end of the period net debt had fallen from £19.1m (at December 2019) to £8.9m. As well as the working capital inflows, the Group has taken advantage of various government initiatives to delay payment of taxes such as VAT in the UK.

The deferrals total £3.5m and will start to be repaid through H2. The Group has also agreed a £2.5m increase in its UK overdraft facility with the result that at June 2020 its financing headroom had increased to £18.1m against £11.5m at December 2019, excluding IDF).

Segmental analysis

As might be expected, the impact of Covid-19 resulted in a NFI reduction in five of the Group's six sectors:

EXHIBIT 2: PROFESSIONAL SEGMENT

£m	H1 2020	H1 2019	*Change*
Revenue	35.3	62.0	*-43%*
NFI	8.8	13.7	*-36%*
margin	*24.9%*	*22.1%*	*13%*
Adjusted operating profit	0.5	1.7	*-71%*
Conversion ratio	*5.7%*	*12.4%*	*-54%*

Source: Empresaria Group

The largest segment in the Group by NFI, accounting for 31% of Group NFI (pre-intragroup eliminations) in the first half reported a reduction in revenue of 43% to £35.3m but with NFI falling by just 36% to £8.8m. However, after costs, adjusted PBT fell by 71% to £0.5m with a reduction in the conversion of NFI into adjusted operating profit falling from 12.4% to 5.7%.

With a circa 60% exposure to perm, the Professional segment was particularly impacted by the COVID-19 pandemic. In addition, the aviation business was hardest hit with a significant reduction in demand and element of the business has been right-sized as a recovery in the short-term is deemed unlikely. However, management is keen to note that the business offers good growth potential in the medium and long term and is well placed to respond as demand returns.

EXHIBIT 3: IT SEGMENT

£m	H1 2020	H1 2019	*Change*
Revenue	22.1	21.4	*3%*
NFI	6.7	6.8	*-1%*
margin	*30.3%*	*31.8%*	*-5%*
Adjusted operating profit	1.2	1.3	*-8%*
Conversion ratio	*17.9%*	*19.1%*	*-6%*

Source: Empresaria Group

The IT segment, accounting for around 24% of Group NFI in the period, proved to be the most resilient with NFI falling by just 1% to £6.7m on revenues up by 3% at £22.1m. Once again the US proved to be the more resilient of the two main territories with the UK facing particular challenges, and here actions have been taken to improve performance. The conversion ratio held up fairly well slipping by 102bps from 19.1% to 17.9%.

EXHIBIT 4: HEALTHCARE SEGMENT

£m	H1 2020	H1 2019	*Change*
Revenue	5.9	5.1	*16%*
NFI	1.2	1.4	*-14%*
margin	*20.3%*	*27.5%*	*-26%*
Adjusted operating profit	0.1	0.2	*-50%*
Conversion ratio	*8.3%*	*14.3%*	*-42%*

Source: Empresaria Group

Temp volumes in the US started the year strongly which contributed to the yoy increase in revenue for the sector in H1. However reduced margins from key clients, combined with the impact of COVID-19 in Q2 across the sector, resulted in the reduction in NFI for H1. Accounting for just 4% of Group NFI, the Healthcare segment reported a 26% fall in NFI margin from 27.5% to 20.3% reflecting a substantial hit to perm revenues in the US (NFI margin is typically 100%) although the fall in NFI at £1.2m was restricted to just 14%. As might be expected COVID-19 also had a significant impact in the UK reducing the demand for temps.

EXHIBIT 5: PROPERTY, CONSTRUCTION & ENGINEERING SEGMENT

£m	H1 2020	H1 2019	*Change*
Revenue	1.8	13.0	*-86%*
NFI	0.4	2.3	*-83%*
margin	*22.2%*	*17.7%*	*26%*
Adjusted operating profit	-0.1	-0.2	*-50%*
Conversion ratio	*-25.0%*	*-8.7%*	

Source: Empresaria Group

Although headline numbers suggest a very significant fall in revenues and NFI, it should be remembered that the segment last year included the Engineering business, a substantial part of which was closed in late 2019. While a minor loss of £0.1m was reported, management emphasise that the segmental cost base is low and when any improvement to underlying demand is seen, the segment is expected to respond accordingly and quickly return to profitability.

EXHIBIT 6: COMMERCIAL SEGMENT

£m	H1 2020	H1 2019	*Change*
Revenue	65.5	68.4	*-4%*
NFI	8.0	9.1	*-12%*
margin	*12.2%*	*13.3%*	*-8%*
Adjusted operating profit	1.5	1.9	*-21%*
Conversion ratio	*18.8%*	*20.9%*	*-10%*

Source: Empresaria Group

This segment accounted for 28% of Group NFI in the period. NFI fell by 12% on revenue down by 4% resulting in a reduction in NFI margin of 110bps to 12.2%. Nevertheless, a good level of profitability was attained with adjusted operating profit of £1.5m being reported with just a modest reduction in the conversion ratio to 18.8%. The German logistics' operation actually benefitted from the impact of COVID-19 with increased demand from supermarkets as consumers elected for deliveries at the expense of physically travelling to shops.

EXHIBIT 7: OFFSHORE RECRUITMENT SERVICES SEGMENT

£m	H1 2020	H1 2019	*Change*
Revenue	5.8	5.8	*0%*
NFI	3.4	3.2	*6%*
margin	*58.6%*	*55.2%*	*6%*
Adjusted operating profit	1.4	1.3	*8%*
Conversion ratio	*41.2%*	*40.6%*	*1%*

Source: Empresaria Group

Finally, the Offshore Recruitment Services segment put in a very robust performance with NFI rising by 6% to £3.4m on static revenues, resulting a in a rise in NFI margin to 58.6% and an improvement in the conversion ratio to an impressive 41.2%. Adjusted operating profit rose by 8% to £1.4m. The results were also logistically impressive with the Q2 impact of COVID-19 resulting in hundreds of staff in India being very effectively moved to home working in a very short period of time. Although the business was hard hit by the pandemic the segment responded well and costs were cut accordingly.

Finances and outlook

In a downturn staffing companies tend to experience an element of negative working capital as temp debtors unwind and Empresaria has been no exception.

At the end of the period adjusted net debt had fallen from £19.1m (at December 2019) to £8.9m. The Group has also taken advantage of government initiatives to delay payment of taxes with total deferrals of £3.5m which will start to be repaid through H2.

The Group has also agreed a £2.5m increase in its UK overdraft facility with the result that at June 2020 its financing headroom had increased to £18.1m against £11.5m at December 2019, excluding IDF).

Recruitment companies, even in normal times, have only a limited amount of revenue visibility and the advent of COVID-19 on its customer base makes forecasting even more problematic. Therefore, we will continue our stance of not offering forecasts until the outlook becomes clearer.

However, in the medium term we believe that Empresaria is very well placed to grow its revenue and profitability having already proven that its business model of diversification offers a robust strategy, even in the most difficult of times.

Thus, in our opinion, Empresaria remains very well placed to exploit any recovery in demand.

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