

## Whitman Howard Research

## Hydrogen\*

Small Cap Growth | 2 April 2019

**BUY****2018 Prelims** | PBT in-line. Dividend up 88%

Following a series of upgrades in 2018, Hydrogen reported an 'in-line' adjusted PBT of £3m for the year to December 2018, up from £0.8m. Net cash improved to £4.9m following a period of indebtedness and the full year dividend grew by 88% (DPS cover 5x) to 1.5p. While keeping our 2019 PBT and net cash estimates unchanged we note that Hydrogen states it is 'in a strong position to accelerate growth through selective acquisitions and is actively reviewing opportunities'. Should the same discipline be employed as in the Argyll Scott acquisition, we believe, M&A activity will be a source of further upgrades and value creation. With organic PBT growth of 20% in 2019, a 2019 PE rating of 8x and dividend yield of 2.5%, we re-iterate our buy recommendation and price target of 100p.

**Investment is creating a resilient platform.** In 2018 productivity per head increased 15% to £91K despite headcount increasing by 32 to 345. These gains were due to a number of factors (see below) and will support our growth expectations in 2019. Key staff hires in Australia and the US now mean that for the first time the majority (i.e. 54%) of net fees are generated outside the UK; development of an 'incubator model' to identify new STEM related growth markets; introduction of CRM systems to increase client facing time; and the launch of a minority interest scheme to attract and retain key staff all assist in building a more resilient company exposed to numerous sectors and regions.

**Significant growth in net fees and the conversion rate.** All three divisions in 2018 (EMEA, APAC and US), reported net fee growth of 19%, 55% and 110% respectively (on a lfl basis, net fee growth was 14%) and the conversion ratio improved from 3.6% to 9.7%. That said, with the peer group reporting mid-teen conversion ratio's, there is still significant potential for organic upside.

**Balance sheet supports M&A activity.** Hydrogen is looking to acquire companies in regions where it is under represented and have a contract book (net fees are split 58%/42% between perm and contract). We believe, it is looking at companies generating net fees of c£5m, EBITDA of c£1m and will structure the deals to enhance the EPS and create value. Thus, with the prospect of further upside from both organic and M&A activities our price target of 100p is justified as the resulting 2019 PE rating is 12x.

**\*Whitman Howard acts as Joint Broker to Hydrogen****TARGET PRICE**

100p

**PREVIOUS TARGET**

100p

**SHARE PRICE**

67.1p

**UPSIDE**

49%

**Market Data**

Ticker	HYDG.L
Market Cap	22.8m
52 Week High/Low	76.5p – 32.5p
Avg. Daily Volume – 90 days	14K
Shares in issue	34.1m
Free Float	75%

**Whitman Howard Estimates**

Year end Dec	2018	2019E	2020E	2021E
Net fees (£m)	30.5	31.8	32.5	33.1
Adj. PBT (£m)	3.0	3.6	3.9	4.3
Adj. EPS (p) - FD	7.4	8.4	9.0	9.9
P/E (x)	9.0	7.9	7.4	6.7
Dividend (p)	1.5	1.7	2.0	2.3
Dividend Yield (%)	2.2%	2.5%	2.9%	3.4%
Net cash (£m)	4.9	5.9	8.5	11.2

**Next Event****AGM – 23rd May 2019**

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## Financials and Valuations

Year to December (£m)					Cash Flow (£m)				
	2018	2019E	2020E	2021E	2018	2019E	2020E	2021E	
<b>Income Statement</b>					<b>Cash Flow (£m)</b>				
Perm	17.9	18.2	18.6	18.9	EBITDA - recruitment	2.9	3.6	3.7	4.1
Contract	<u>12.6</u>	<u>13.6</u>	<u>13.9</u>	<u>14.2</u>	Other income	0.6	0.5	0.6	0.6
<b>Net fees</b>	<b>30.5</b>	<b>31.8</b>	<b>32.5</b>	<b>33.1</b>	Share based payment	0.0	0.0	0.0	0.0
Rent received	0.5	0.4	0.4	0.4	Working capital	2.7	(1.7)	(0.1)	(0.1)
Income from investments	0.1	0.1	0.2	0.2	Cash - exceptional items	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>
Operating costs	<u>(28.0)</u>	<u>(28.7)</u>	<u>(29.2)</u>	<u>(29.5)</u>	<b>Gross Op. cashflow</b>	<b>6.2</b>	<b>2.4</b>	<b>4.2</b>	<b>4.6</b>
<b>Operating profit</b>	<b>3.1</b>	<b>3.6</b>	<b>3.8</b>	<b>4.2</b>	Interest expense	(0.1)	(0.0)	0.0	0.0
Interest expense	(0.1)	(0.0)	0.0	0.0	Interest income	0.0	0.0	0.0	0.0
Interest income	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	Tax	<u>0.0</u>	<u>(0.4)</u>	<u>(0.6)</u>	<u>(0.6)</u>
<b>Adjusted Pre-Tax profit</b>	<b>3.0</b>	<b>3.6</b>	<b>3.9</b>	<b>4.3</b>	<b>Net Op. cashflow</b>	<b>6.1</b>	<b>2.1</b>	<b>3.6</b>	<b>4.0</b>
Exceptional expense	<u>(0.2)</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	Capex	<u>(0.4)</u>	<u>(0.5)</u>	<u>(0.5)</u>	<u>(0.5)</u>
<b>Profit before tax</b>	<b>2.8</b>	<b>3.6</b>	<b>3.9</b>	<b>4.3</b>	<b>Free cash flow</b>	<b>5.7</b>	<b>1.6</b>	<b>3.1</b>	<b>3.5</b>
Tax	<u>(0.4)</u>	<u>(0.6)</u>	<u>(0.6)</u>	<u>(0.7)</u>	Other	(0.2)	0.0	0.0	0.0
<b>Retained profit</b>	<b>2.5</b>	<b>3.0</b>	<b>3.2</b>	<b>3.6</b>	Acquisitions	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>
<b>Balance Sheet (£m)</b>					<b>Cashflow from investing</b>				
<b>Fixed assets</b>	<b>14.4</b>	<b>14.4</b>	<b>14.4</b>	<b>14.4</b>	Dividends	(0.4)	(0.5)	(0.6)	(0.7)
Receivables	19.7	21.9	22.4	22.8	Share buyback	(0.2)	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	Other	0.3	0.0	0.0	0.0
Prepayments	0.0	0.0	0.0	0.0	Share issues	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>
Cash	<u>5.2</u>	<u>5.9</u>	<u>8.5</u>	<u>11.2</u>	<b>Cashflow from financing</b>	<b>(0.3)</b>	<b>(0.5)</b>	<b>(0.6)</b>	<b>(0.7)</b>
<b>Total current assets</b>	<b>24.9</b>	<b>27.9</b>	<b>30.8</b>	<b>34.1</b>	<b>Inc/(Dec) in net cash</b>	<b>5.2</b>	<b>1.0</b>	<b>2.5</b>	<b>2.8</b>
<b>Total assets</b>	<b>39.3</b>	<b>42.3</b>	<b>45.2</b>	<b>48.5</b>	Opening net (debt)/cash	<u>(0.3)</u>	<u>4.9</u>	<u>5.9</u>	<u>8.5</u>
Payables	14.7	15.2	15.6	15.9	<b>Closing net (debt)/cash</b>	<b>4.9</b>	<b>5.9</b>	<b>8.5</b>	<b>11.2</b>
Provisions	0.6	0.6	0.6	0.6					
Other	0.0	0.2	0.3	0.3					
Current portion debt	<u>0.3</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>					
<b>Total current liabilities</b>	<b>15.6</b>	<b>16.0</b>	<b>16.5</b>	<b>16.8</b>					
Long term debt	0.0	0.0	0.0	0.0					
Redemption liability	1.7	1.7	1.7	1.7					
Provisions	0.8	0.8	0.8	0.8					
Other	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>					
<b>Total long-term liabilities</b>	<b>2.6</b>	<b>2.6</b>	<b>2.6</b>	<b>2.6</b>					
<b>Shareholders' funds</b>	<b>21.1</b>	<b>23.6</b>	<b>26.2</b>	<b>29.1</b>					
<b>Total liabilities and equity</b>	<b>39.3</b>	<b>42.3</b>	<b>45.3</b>	<b>48.4</b>					

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