



Merchant Securities

16 SEPTEMBER 2010

BUY (prev. Hold 14/12/09)

The ReThink Group plc

Good progress in H1 augurs well for full year outturn

ReThink, which specialises in IT recruitment and consultancy, reported a strong recovery in profits in H1 as a result of higher demand for permanent placements and the strength of its recruitment process outsourcing business. Growth in private sector demand more than outweighed the effects of a weaker public sector and we are encouraged with the progress being made in the fledgling consulting division, even though this reported a modest loss for the first half. Our rather ambitious PBT target for 2010, set in December 2009, still looks achievable but given the uncertain UK economic backdrop we are fine tuning our expectations for 2010 down by £0.1m. This will still be a huge improvement on the 2009 result and consequently we are upgrading our recommendation from Hold to Buy which acknowledges the strong progress already achieved and the earnings growth anticipated for 2011. Our price target has been raised from 5.5p to 9p.

Key points:

- ReThink specialises in the recruitment of IT contractors and permanent staff and has a growing position in business and IT consultancy. In the half year to June 2010 the group made encouraging progress in both the recruitment and consultancy divisions. Although the latter reported a modest loss for the half year due to additional investment and new customer development we expect a profit to be achieved in this business in the second half. 2011 should see strong revenue growth on the back of the earlier investment.
- Strong demand for permanent hires was reflected in an increase in placements from 277 to 364 resulting in net fee income (NFI) improving by 43% y-o-y while the number of contractors on billing rose strongly from 458 to 536 in spite of some public sector weakness. Management anticipates this improving trend continuing to a record high by the end of 2010.
- As already stated the Business & IT Consultancy division has been subject to some significant investment as the business is developed from a single customer site to one where the group now has multiple customers. Additional hires have seen the cost base rise in anticipation of higher revenues in 2011.
- Our 2010 forecast has remained at £1m PBT since initiating on the company in December 2009, a level that we always considered to be ambitious, but achievable. While this remain the case, the uncertain UK economic backdrop has prompted us to fine tune our adjusted PBT forecast for 2010 and 2011. For 2010 we are reducing our forecast by £0.1m to £0.9m and 2011 by the same amount to £1.6m. Net debt has risen from £4.2m at the year end to £4.5m and we expect this to rise to £4.9m by the year end as working capital increases to fund growth.
- However, in recognition of the strong progress already achieved and the progress we anticipate for 2011 we are raising our recommendation on the stock from Hold to Buy and our price target has been raised from 5.5p to 9p.

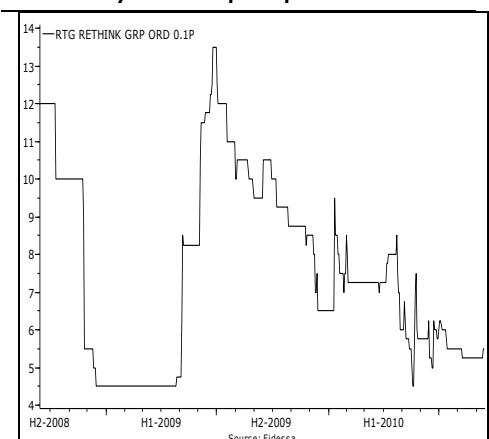
Price:	6.5p
Ticker:	RTG.L
Asset class:	AIM
Website :	www.therethink-group.com
1 yr High/Low:	10.5p – 4.5p
Sector:	Support Services
Market Cap:	£6.1m
Net (debt)/cash:	(£4.9m) E
EV:	£10.9m E
Shares priced intraday 16 September 2010	

Forecasts

YE Dec (£m)	09A	10E	11E
Revenue	49.7	55.0	62.0
Gross Profit	10.9	12.9	14.8
EBITDA	0.8	1.4	2.1
PBT as stated	0.3	0.8	1.5
PBT adj	0.3	0.9	1.6
EPS FD adj (p)	0.22	0.66	1.16
DPS (p)	0.0	0.11	0.20
Yield (%)	-	1.7	3.1
EV/EBITDA (x)	12.5	7.9	5.3
PE Ratio (x)	29.4	9.8	5.6
Gearing (%)	182.3	202.4	170.2

Source: Merchant Securities Limited

Two-year share-price performance



**Merchant Securities Limited act as
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Background & Activities

The ReThink Group was founded in March 2005 gaining its AIM listing in June 2008. Although a relatively new addition to the ranks of UK staffing companies the founder members of the board had previously worked together at Best International, an IT staffing business that was ultimately sold to Spring Group in June 2003.

The recruitment activities are undertaken through six UK offices, London, Manchester, Leeds, Birmingham, Bristol and Southend, and an office in Dubai, the latter being the result of the acquisition of Proveya MEA FZCO which services the whole of the Middle East region.

The group has developed an additional revenue channel through the provision of a Business and IT Consultancy division which provides feasibility studies, implementation and support of third party software installation in areas of Sales Performance Management, Business Intelligence and Enterprise Content Management.

Good progress in H1

Table 1: Interim results summary

£m	H1 10	H1 09	% chge
Revenue	26.96	24.64	9.4%
NFI	5.95	5.33	11.7%
NFI margin	22.1%	21.6%	2.1%
Admin expenses	-5.59	-5.22	6.9%
EBITDA	0.47	0.22	115.1%
EBITDA margin	1.7%	0.9%	96.6%

Source: ReThink Group

ReThink made progress across the board in the first half of 2010 and in the process increased EBITDA by 115% to £0.469m (£0.218m) with EBITDA margin of 1.7% from 0.9%.

Revenue increased by a more modest degree at 9.4% to £27m and NFI improved by 11.7% to £5.9m with the NFI margin showing a 50bps improvement due to a strong performance in permanent placement activities but moderated by lower contract margins and a reduction in NFI from the Consultancy division.

Strict control of costs in the recruitment division resulted in an improved conversion ratio which rose from a very depressed 0.6% to 9.4%. With average conversion rates in the quoted recruitment sector upward of 20% there is plenty more operational gearing to be extracted from this business.

Net debt rose in line with increased business activity from £4.2m at the year end to £4.5m and we are expecting this to rise to £4.9m still well within the group's facilities of £10.7m.

The group also declared an inaugural dividend of 0.0564p and we would at this stage anticipate a similar final dividend making a total of 0.1128p.

Recruitment division

Table 2: Recruitment division half year summary

£m	H1 10	H1 09	% chge
Revenue	25.93	23.65	9.6%
NFI	5.20	4.49	15.8%
NFI margin	20.1%	19.0%	5.7%
Admin expenses	-4.71	-4.46	5.6%
EBITDA	0.49	0.03	1650.0%
EBITDA margin	1.9%	0.1%	1496.3%

Source: ReThink Group



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The Recruitment division grew revenues by 9.6% to £25.9m and NFI by 15.8% to £5.2m. NFI margin improved by 110bps to 20.1% reflecting a stronger recruitment environment in the UK with increasing customer confidence finding expression in a significant rise in permanent placement activity. During the first half the group placed 364 candidates against 277 in H1 2009 with an average fee per placement of £5,701 versus £5,227.

This strength in perm demand has also been noted by most of the group's peers and reflects unusually strong levels of client and candidate confidence so early into an economic recovery.

The group also reported a good performance in the placement of contractors with some weakness in the public sector being more than compensated by renewed strength in the private sector. Contractors on billing rose from 475 at the end of 2009 to 536 at the end of June (458 in the comparative period) and the pick up from the normal year end hiatus has been strong.

RPO & MS

Management has confidence that the improving trend in contract runners will continue with the number of contractors on assignment reaching record levels by the year end. The rise in number of contractors has also been influenced by the success of the group's recruitment process outsourcing (RPO) and managed service (MS) models.

In the MS offering ReThink is awarded a contract to manage a client's total IT recruitment requirements and this is achieved by having a dedicated recruitment manager on the client's own premises. RPO differs in that it includes additional services such as recruitment campaign planning, payroll services, dispute management and a host of other services related to the management of the recruitment process.

Last year ReThink was awarded a contract to manage the entire IT recruitment requirements of a very large high street retailer and while this contract continues the group has also successfully won a three year contract with Boots UK Limited. We are aware of another significant contract win with another well known high street brand but the client wishes to remain anonymous at this stage.

We estimate that in the first half some 16% of recruitment revenue was applicable to RPO and MS activities but this should rise in H2 and into 2011 as the group benefits from the newer contract wins.

It is important to note that while RPO and MS contracts do not attract the same margins as spot placement of contractors the margin is still respectable at around 12%.

In the first half the recruitment division's exposure to the public sector was believed to be around 15% of NFI and while it lost a contract with the public sector that saw the elimination of 70 onsite contractors, growth in the private sector has more than compensated.

Table 3: Recruitment division - summary metrics

Years to December	2005	2006	2007	2008	2009	2010E	2011E
Revenue (£m)							
Temp	1.49	11.08	22.71	35.76	44.51	48.00	53.00
Perm	0.91	1.81	3.05	4.83	3.40	4.50	5.00
Total recruitment revenue	2.40	12.89	25.76	40.59	47.91	52.50	58.00
NFI (£m)							
Temp	0.25	1.70	3.29	5.16	5.97	6.30	7.00
Temp margin	16.5%	15.3%	14.5%	14.4%	13.4%	13.1%	13.2%
Perm	0.91	1.81	3.05	4.83	3.40	4.50	5.00
Perm margin	100.0%	100.0%	100.0%	100.0%	200.0%	300.0%	400.0%
Total recruitment NFI	1.16	3.50	6.34	9.99	9.37	10.80	12.00
Recruitment NFI margin	48.1%	27.2%	24.6%	24.6%	19.6%	20.6%	20.7%
Operating profit (£m)	-0.74	0.29	0.46	0.86	0.65	0.85	0.85
Operating margin	-30.8%	2.2%	1.8%	2.1%	1.6%	1.9%	1.9%

Source: ReThink Group; Merchant Securities Limited



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Business and IT Consultancy Division

Table 4: Recruitment division half year summary

£m	HI 10	HI 09	% chge
Revenue	1.03	0.99	4.3%
Gross profit	0.75	0.84	-10.8%
Gross profit margin	72.1%	84.3%	-14.5%
Admin expenses	-0.87	-0.76	14.8%
EBITDA	-0.13	-0.07	74.3%
EBITDA margin	-12.5%	-7.5%	67.1%

Source: ReThink Group

The Consultancy division is still a fledgling business in our view. It has grown from a business where the group had just one customer and since that contract finished management has invested in the business and client development to the stage where it now has around 15 customers, 10 of which have been added in the past twelve months. Client sectors include telecommunications, financial services, retail, pharma and local government.

The consultancy business is branded Aiimi and it specialises in Business Intelligence and Sales Performance Management and Enterprise Content Management technologies and has formal partnership agreements with Merced, Open Text, SAP, Practique, Xactly, nGenra and other software vendors.

Investment in headcount has increased staff numbers by 20% to 23 and we would now look for management to increase the capacity utilisation and billing rates of its consultants and drive the top line with little or no further increase in the cost base.

In the first half losses have increased by 74% to £0.129m as a direct result of the increase in headcount and customer development. However, management is confident that this investment will now lead to higher revenues and hence a resumption of profitability in the second half and more fully in 2011.

Financials

Cash Flow

In the first half the group generated a (pre-working capital) £0.5m from operations and even after funding stronger growth rates through higher working capital demands in the recruitment business still retained a positive cash inflow from operations. The net working capital outflow was £431,000 versus £213,000 for the comparative and after modest capex, repayment of borrowings and interest the group increased its level of net debt from £4.2m at the end of 2009 to £4.5m which we consider a robust performance.

In the second half we anticipate activity levels in the recruitment division to remain robust and expect a pickup in activity in the consultancy division leading to a further working capital outflow and an increase in net debt to around £4.9m. This is still high in relation to our forecast EBITDA of £1.4m but well within the group's agreed facilities of £10.7m while interest on the debt is covered 4.6 times.

Dividends

The group has reflected its confidence in both the first half results and its expectations for the full year by inaugurating its first dividend. Consequently it has declared an interim dividend of 0.054p and we suspect will declare a similar level of dividend for the final payment making a total of 0.108p and covered 6.1x by our revised EPS forecast.



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Forecasts

In December 2009, when we initiated coverage on ReThink and obviously before the group had finished its financial year to 31 December 2009, we forecast an adjusted PBT for 2010 of £1m, an ambitious target in relation to our target of £0.25m for 2009. In the event the group achieved a 2009 PBT of £0.3m and we retained our forecast for 2010 while projecting a PBT of £1.7m for 2011.

However, in light of the continuing uncertain UK economic environment and the difficulty in estimating the degree of initial turnaround in the consultancy division we believe that we should take this opportunity to fine tune our estimates and reduce our PBT target by £0.1m.

Consequently our 2010 PBT and EPS forecasts are reduced from £1.0m/0.74p to £0.9m/0.66p and for 2011 from £1.7m/1.3p to £1.6m/1.2p. We would emphasise that there are no negative connotations in this reduction in forecasts and that a rise from £0.3m to £0.9m PBT is still an exceptionally strong performance reflecting a year of very strong progress.

Valuation and recommendation

Despite our modest reduction in expectations for the 2010 outcome the fact that the company should get very close to our original, quite punchy, forecast is reason enough in our view to move the stock from a Hold to a Buy.

We had previously hesitated to change our recommendation given the level of macro uncertainty as we entered 2010 but with just four months left of the year we can be more confident of the eventual outcome. In addition, ReThink's share price has declined from a 2010 peak of 9.5p to just 6.5p making them more attractive both against the sector's smaller company PER average of 7.1x and with respect to our revised forecasts.

The shares now sell on a PER of 5.6x 2011 earnings and in our view offer excellent value and an inaugural yield of 1.7% that could rise to 3.1% next year.



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RETHINK GROUP plc - Recommendation BUY (Prev. Hold (14/12/09))

Summary Income Statement (£m)	YE Dec	2008	2009	2010E	2011E
Sales		43.4	49.7	55.0	62.0
Cost of sales		-31.3	-38.8	-42.1	-47.2
Gross profit (net fee income (NFI))		12.1	10.9	12.9	14.8
Operating expenses		-11.2	-10.3	-11.8	-12.9
EBITDA		1.1	0.8	1.4	2.1
Depreciation		-0.2	-0.2	-0.2	-0.2
EBITA		0.9	0.6	1.2	1.9
Amortisation		0.0	-0.0	-0.0	-0.0
EBIT		0.9	0.6	1.2	1.9
Seperately disclosed items		-0.4	0.0	0.0	0.0
Associates		0.0	0.0	0.0	0.0
Net interest		-0.3	-0.3	-0.3	-0.4
PBT as reported		0.2	0.3	0.8	1.5
Amortisation of acquired intangible assets		0.0	0.0	0.0	0.0
Seperately disclosed items		0.4	0.0	0.0	0.0
PBT adjusted		0.6	0.3	0.9	1.6
Tax		-0.1	-0.1	-0.3	-0.4
Tax rate (%)		17.7%	28.9%	28.0%	28.0%
Minorities		0.0	0.0	0.0	0.0
Reported earnings		0.1	0.2	0.6	1.1

Summary Cash Flow (£m)	YE Dec	2008	2009	2010E	2011E
Net cash from operating activities		0.7	0.8	1.4	2.1
Working capital movement		-0.3	0.1	-1.0	-1.3
Tax		-0.2	-0.1	-0.3	-0.3
Other		-0.3	-0.3	-0.3	-0.4
Operating cash flow		-0.1	0.5	-0.2	0.2
Capex		-0.2	-0.1	-0.2	-0.2
Dividends		-0.1	0.0	-0.1	-0.1
Free cash flow		-0.4	0.4	-0.4	-0.1
Disposals		0.0	1.0	2.0	3.0
Acquisitions		0.0	-0.1	0.0	0.0
Equity finance		0.8	0.0	0.0	0.0
Other		-0.3	-0.3	-0.3	-0.3
Change in cash and cash equivalents		0.4	-0.1	-0.3	-0.4

Ratios	YE Dec	2008	2009	2010E	2011E
Sales growth		54.2%	14.7%	10.6%	12.7%
EBITDA growth		-21.0%	-25.5%	72.0%	54.0%
EPS growth		-48.7%	-53.6%	199.2%	76.0%
Gross margin		27.9%	22.0%	23.5%	23.9%
EBITDA margin		2.5%	1.6%	2.5%	3.5%
EBIT margin		2.1%	1.2%	2.1%	3.1%
Net debt/ equity		281.9%	182.3%	202.3%	170.0%
Interest cover		3.5x	2.6x	4.6x	6.1x
Dividend cover		-	-	6.1x	5.8x
RoE		52.3%	35.1%	58.0%	69.1%
RoCE		12.9%	11.4%	17.7%	24.1%
Equity / total assets		16.1%	18.4%	14.7%	15.9%
Net WC / sales		13.6%	8.6%	9.6%	10.6%
Operating CF / sales		-0.3%	1.0%	-0.3%	0.3%
Capex / sales		0.4%	0.3%	0.3%	0.2%
FCF / sales		-0.9%	0.7%	-0.7%	-0.2%
Capex / D&A		91.0%	73.5%	71.4%	71.4%
Current ratio		1.1x	1.1x	1.1x	1.1x

Summary Balance Sheet (£m)	YE Dec	2008	2009	2010E	2011E
PP&E		0.5	0.4	0.5	0.5
Goodwill		0.7	0.9	0.9	0.9
Other intangibles		0.0	0.0	0.1	0.1
Other		0.1	0.0	0.0	0.0
Non-current assets		1.0	1.2	1.4	1.5
Inventories		0.0	0.0	0.0	0.0
Trade receivables		10.3	9.6	13.4	16.7
Cash		0.5	0.6	0.6	0.5
Other		0.9	0.9	0.8	0.8
Current assets		8.7	11.7	11.1	14.8
Total Assets		12.9	12.5	16.3	19.5
Trade payables		-4.3	-5.3	-8.1	-10.1
Short-term debt		-6.1	-4.7	-5.3	-5.8
Provisions		0.0	0.0	0.0	0.0
Other		-0.1	-0.1	-0.3	-0.4
Current liabilities		-8.2	-10.5	-10.1	-13.7
Long-term debt		-0.3	-0.1	-0.2	0.0
Provisions		0.0	0.0	0.0	0.0
Other		0.0	0.0	-0.0	0.0
Non-current liabilities					
Total liabilities		-10.8	-10.2	-13.9	-16.4
Net Assets		2.1	2.3	2.4	3.1
NET CASH/(DEBT)		-5.8	-4.2	-4.9	-5.3
Net working capital		5.9	4.3	5.3	6.6
Capital employed		8.4	7.1	7.9	8.9
Year end shares in issue (m)		90.907	91.057	93.223	93.223
Average diluted no. of shares (m)		104.080	97.204	98.000	99.000

Per Share (p)	YE Dec	2008	2009	2010E	2011E
Share Price		6.50			
EPS fully diluted and adjusted		0.48	0.22	0.66	1.16
DPS		0.00	0.00	0.11	0.20
BVPS		2.0	2.4	2.4	3.1
FCFPS		-0.4	0.4	-0.4	-0.1
Net cash/(debt) PS		-5.6	-4.3	-5.0	-5.3

Valuation	YE Dec	2008	2009	2010E	2011E
PER		13.6x	29.4x	9.8x	5.6x
Dividend yield		0.0%	0.0%	1.7%	3.1%
Market capitalisation (£m)		5.9	5.9	6.1	6.1
Enterprise value (£m)		11.8	10.1	10.9	11.3
FCF yield		-5.7%	5.7%	-5.7%	-1.6%
EV / sales		0.3x	0.2x	0.2x	0.2x
EV / NFI		1.0x	0.9x	0.8x	0.8x
EV / EBITDA		10.8x	12.5x	7.9x	5.3x
EV / EBITA		12.8x	16.6x	9.1x	5.8x
EV / Capital employed		1.4x	1.4x	1.4x	1.3x

Source: Company accounts; Merchant Securities Limited



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BUY	Share price appreciation of 15% or more in absolute terms over 12 months
HOLD	Share price appreciation or depreciation of less than 15% in absolute terms over 12 months
SELL	Share price depreciation of 15% or more in absolute terms over 12 months

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