



Merchant Securities

The ReThink Group * (RTG.L)

Berkley acquisition enhances growth prospects

ReThink is rapidly moving from a micro-cap business into a more substantial operation. Properly valued, we believe the group would be capitalised at £15m rather than the current £10.2m and should be of increasing interest to investors. Its management is highly experienced and is ambitious to grow ReThink into a leading player in the global recruitment market. To reflect the earnings accretive acquisition and further organic growth opportunities we have increased our price target from 11p to 15p while retaining our strong Buy recommendation.

- Initial cost equivalent to 5.5x historic EBITDA** – Berkley is being acquired for an initial €2.65m which equates to 5.5x its EBITDA for the year to December 2010. There is a performance related deferred element of up to €4.125m payable in April 2012 based on Berkley's profits for the year ending December 2011.
- New disciplines and geographies** – Berkley satisfies the board's strategy to expand its recruitment activities into new sector disciplines and new territories. Berkley specialises in the provision of recruitment services primarily to clients in the pharmaceutical, life sciences and IT markets in Europe and Asia.
- Well known to management** - Berkley is well known to ReThink's management and is believed to have a culture and management style which should fit in well with the group and make the integration process as seamless as possible. The two primary vendors of Berkley are joining the ReThink board and will have a combined equity holding of 6.78%.
- Upgraded forecasts:** We are increasing ReThink's 2011 earnings by 20% to 1.31p and for 2012 by 18% to 1.55p. ReThink is growing strongly and in our opinion the addition of Berkley significantly reinforces the value proposition.
- Strong Buy:** We consider the shares very attractive at current levels and we have raised our price target from 11p to 15p to reflect both the benefits of the acquisition and the group's prospects for organic growth. We retain our strong Buy recommendation and believe the shares have upside potential of 48%.

*Merchant Securities acts as joint broker and NOMAD to The ReThink Group plc

Y/E Dec	Revenue (£m)	EBITDA (£m)	PBT Adj (£m)	Tax (%)	EPS FD Adj (p)	PER (x)	DPS (p)	Yield (%)	Net Cash/ (Debt) (£m)	EV/ EBITDA (x)
2010A	56.4	1.5	1.0	29.1	0.73	13.9	0.188	1.9	(5.2)	10.0
2011E	64.9	2.5	1.9	28.0	1.31	7.7	0.250	2.5	(6.6)	6.8
2012E	76.5	3.1	2.5	28.0	1.55	6.5	0.300	3.0	(6.7)	5.6

Source: Company (actual), Merchant Securities (forecasts)

Recommendation

BUY

Previously: (BUY) (13 Apr 2011)

Data

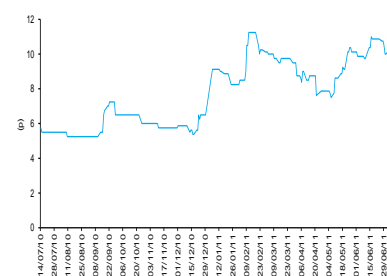
Price	10.125p
Target price	15p
Upside / downside	48%
Free float	28%
Market cap	£10.24m
Shares outstanding	101.17m
Daily volume	23,935
Enterprise value	£16.8m
52 week high / low	11.25p / 5.25p
Share price at close	12 July 2011

Description

ReThink specialises in recruitment services and business transformation & technology consultancy

www.therethink-group.com

Performance



Source: Fidessa

Performance (%)	1m	3m	12m
Absolute	+3.8	+13.9	+70.8
Relative	+2.1	+17.5	+27.1

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Berkley Recruitment

Activities

Berkley Recruitment Group (Berkley) was established in 1995 and specialises in the recruitment of staff for clients in the IT, pharmaceutical & life sciences, engineering and commercial markets. It provides staff to clients on a global basis with a primary focus on Europe and Asia. Through its offices in Cork, Dublin and Singapore it services clients in Ireland, UK, Switzerland, Holland, France, Singapore, China, Taiwan, Malaysia, Australia, Fiji and India.

Specialises in the supply of staff to IT, pharma & life sciences etc. to clients in Europe and Asia

Services range from the placement of permanent and temporary/contract staff to Interim Management, Executive Search, Recruitment Process Outsourcing (RPO) and Managed Service solutions.

Temp, perm, interim management, executive search etc.

Berkley currently has 28 employees with two further staff due to commence employment shortly. Of the 28, 17 are based in the two offices in Ireland and eight in Singapore. Of the 17 staff in Ireland, 15 are sales consultants while six of the eight in Singapore are involved in the sales function.

28 employees in Ireland and Singapore

In 2010, 74% of Berkley's NFI was generated in Ireland and 26% in Singapore. The Singapore office was established in 2009 and, as one would expect, has been loss making as the business has gradually grown its revenue base. However, we anticipate a move into profitability in 2011.

74% of NFI from Ireland, 26% from Singapore

As the business in Singapore is solely concerned with the placement of permanent staff and is expected to grow strongly in 2011, this is likely to move Berkley's perm/temp split of NFI up from the 65% / 35% seen in 2010 to nearer 75% / 25% in the current year. Given the high operational gearing inherent in perm much of the additional revenue should drop through to the bottom line.

Perm/temp split likely to increase in favour of perm in 2011

Consequently we expect the percentage of group NFI generated by the Singapore office to rise to around 40% (26%) of the total in 2011.

Singapore to generate around 40% of NFI this year

Historic financial performance

Details on the past financial performance of Berkley is limited, the press release merely stated that audited accounts for the year ended 31 December 2010 showed EBITDA of €479,000 and a profit before tax of €410,000 from revenues of €5.6m. Audited net assets were €645,000.

€410,000 PBT in 2010

Acquisition terms

Berkley was acquired by ReThink Acquisitions Limited (RAL), a newly formed, wholly owned subsidiary of ReThink. It was acquired for an initial consideration of €2.65m (£2.34m at £1 = €1.13) with additional deferred consideration of up to €4.125m (£3.65m) dependent upon the aggregate EBITDA achieved by Berkley in the year ending 31 December 2011. Thus the initial consideration represents 0.5x Berkley's historic revenue, 5.5x EBITDA and 6.5x PBT.

Berkley acquired by RAL for initial €2.65m and up to €4.125m deferred

Initial consideration

The initial consideration of €2.65m was satisfied by the payment of €1.425m cash, €0.25m of 3.6% redeemable preference shares 2013 in RAL and the issue of 7,946,055 ordinary shares worth €976,471.

Initial consideration part cash, part ordinary shares, part preference shares

Berkley Recruitment

Deferred consideration

ReThink may pay up to €4.125m in deferred consideration dependent upon the aggregate EBITDA achieved by Berkley in the year ending 31 December 2011. This is calculated on a ratchet basis as shown in Table 1 below.

Deferred consideration calculated on a ratchet basis

Table 1: Ratchet formula for deferred consideration

EBITDA	Formula
€0 - €499,999	€1 for €1 EBITDA
€500,000 - €999,999	€0.50m + €2.25 for every €1 of EBITDA over €0.5m
€1,000,000 - €1,349,999	€1.73m + €2.04 for every €1 of EBITDA over €1m
€1,350,000 - €1,650,000	€2.75m
€1,650,001 - €2,000,000	€2.75m + €2.25 for every €1 of EBITDA over €1.5m

Source: Company (actual)

Any deferred consideration will be payable three months after Berkley's December year end and will be payable as to 40.91% in cash, 30% in ReThink ordinary shares (to be issued at a price of €0.1038) and 29.09% in RAL preference shares. In addition, deferred consideration of €0.33 nominal of preference shares will be payable for every €1 of aggregate EBITDA achieved by Berkley over €0.5m up to €1.25m.

40.91% in cash, 30% in ordinary shares and 29.09% in preference shares

Our forecast for Berkley assumes profits sufficient to warrant the payment of €2.25m which would be satisfied by the payment of €0.83m in cash, €0.61m in ordinary ReThink shares (5.884m shares) and €0.81m in preference shares.

Our forecast assumes profits sufficient to warrant the payment of €2.25m of defd consideration

Therefore, on this basis, as well as funding the €0.84m in cash the group would need to be in a position to redeem €0.81m preference shares in 2013. We believe that such payments could be financed through ReThink's internal resources and cash flow.

Any liability for deferred payments can be met from internal resources and cash flow

Strategic rationale

ReThink has developed a strong franchise as a provider of IT and Business staff to clients based in the UK and Middle East and has supplemented this with Aiimi, its small but growing business transformation and technology consultancy.

ReThink has built up a strong business in IT staffing and business consultancy

However, we believe that the main strategic impetus within the group will continue to be focused on recruitment services and in that respect it is important for the group to expand both its range of specialist disciplines and increase the number of markets served. In this way it builds an element of defensiveness against a slowdown in any one sector or territory. Of course in a general global economic downturn the reduction in demand and lower levels of corporate and candidate confidence affects most territories and most sector disciplines and impacts all recruitment companies to one degree or another.

Important for ReThink to build on its capabilities and geographic reach

While the group could buy-in the required skills piecemeal, to gain traction more quickly it is sometimes worth considering the purchase of an existing operation much as it has done with Berkley. The downside is that in a people business the culture and modus operandi of the acquiree could be found to be incompatible with that of the acquiror which ultimately leads to staff attrition and ultimately pressure on revenues.

Acquisitions require care in a people business

Berkley Recruitment

In the case of Berkley, this company has been known to the ReThink board for some time and management are confident that the cultures are well-matched. In addition, and in keeping with ReThink's philosophy of sharing equity with its business leaders, the senior management of Berkley will be incentivised through an initial aggregate interest in ReThink equity of 7.85% which is expected to increase following the satisfaction of the deferred consideration.

Prior to the acquisition ReThink was in the process of establishing its own office in Singapore and this will now be rolled into Berkley's existing facility which will subsequently offer IT staffing services as well as pharma and life sciences. By the same token it is expected that Berkley will begin to build a presence in the UK through additional desks in ReThink's offices in London.

Forecasts, valuation and recommendation

ReThink delivered strong growth in 2010 in all of its service lines, especially permanent placement which generated a 42% rise in NFI and in RPO where NFI rose by 27%. Overall, the group's operating profit doubled from £0.610m to £1.219m and its adjusted PBT more than trebled from £0.302m to £0.977m. Following the release of the preliminary results in April 2011 we forecast further organic growth in operating profit of 48% to £1.8m and a 53% increase in PBT to £1.5m.

The group released a positive trading update on 13 July stating that revenues in the first half were up 27% and NFI up 30%. This is in line with our expectations which call for organic growth in NFI of 30% for the year.

As stated earlier, we anticipate Berkley producing good growth in 2011, principally through the move into profit of its Singapore office but while still showing growth in its home market of Ireland. The recruitment market in Singapore is principally perm based and growth in this territory in 2011 will mean a consequent rise in the proportion of permanent fees against fees from contract placements for the enlarged group. This in turn should provide attractive operational gearing with much of the increase in NFI falling through into operating profit.

For the year to December 2011 we are forecasting Berkley's EBITDA to rise from €0.479m to €0.8m and for this to be consolidated into ReThink's results to December 2011 for approximately 28 weeks. At an exchange rate of £1 = €1.1 this equates to an additional £0.4m contribution to ReThink's adjusted PBT.

We anticipate a modest element of exceptional costs in the current year arising from the acquisition and the write off of expenses previously incurred in the aborted launch of its Singapore office given that it will now roll its business in that area into Berkley's already established facility.

Thus, the changes to our forecasts to reflect the acquisition can be summarised in Table 2. Our 2012 forecasts are cautious at this early stage and assume some additional investment in expansion of the brand, consequently we are forecasting Berkley to produce a net €0.770m adding an additional £0.7m to ReThink's profits in that year.

The acquisition is expected to be significantly earnings enhancing and the accretion based on our forecasts for 2011 and 2012 is 20% and 18% respectively.

Berkley has been known to ReThink for some time and the cultures are believed to be well matched...

...also Berkley management hold 8% of ReThink shares

ReThink's Singapore operations to be rolled into Berkley's

Strong growth from ReThink last year and further organic growth forecast for 2011

H1 trading update is positive

Berkley looks set to produce encouraging growth in 2011 helped by a move into profit for its Singapore office

Berkley EBITDA forecast to grow from €0.479m to €0.8m adding an additional £0.4m to ReThink's results for 2011

Expect some exceptional costs in 2011 relating to the acquisition

Upgrade to forecasts

Earnings accretion in 2011 and 2012

Berkley Recruitment

Table 2: Previous and updated forecasts

	2010 A	2011 E		2012 E	
		OLD	NEW	OLD	NEW
Revenue (£m)	56.378	62.000	64.900	68.500	76.500
NFI (£m)	12.820	17.000	18.000	19.000	22.500
Operating profit (pre exceptionals) (£m)	1.219	1.800	2.250	2.100	2.900
Adj PBT (£m)	0.977	1.500	1.900	1.800	2.500
EPS (p)	0.73	1.09	1.31	1.31	1.55
EPS accretion (%)	-	-	20.2	-	18.3

Source: Company (actual); Merchant Securities (forecasts)

On 22 June ReThink announced that it had issued 2,404,500 options over ordinary shares in the group to each of Stephen Greenwood and Fergal Brosnan, executive directors of Berkley. The options, totalling 4,809,000 in aggregate and representing 4.5% of the share capital as enlarged by the options, have an exercise price of 11p, vest on 21 June 2014 and are exercisable until 21 June 2021.

New options to inflate fully diluted shares

Conclusion

ReThink is rapidly moving from a micro-cap business into a much more substantial operation. Properly valued, we believe the group would be capitalised at £15m rather than the current £10.2m and because of this potential we think it will be of increasing interest to investors. Its management is highly experienced and knowledgeable of the industry and more importantly is ambitious to grow ReThink into a leading player in the global recruitment market.

ReThink is a fast growing business that we feel will be of increasing interest to investors

We anticipate further opportunistic earnings enhancing acquisitions being concluded that will supplement the strong organic growth that the group has already demonstrated and (bar macro-economic shocks) should continue to deliver.

Further acquisition likely to add to continued organic growth

We therefore retain a strong Buy on the shares with a price target of 15p offering a 48% upside from the current price.

Strong Buy – target price raised to 15p

Financial Summary

The ReThink Group

Financials

Year end Dec (£m)	2010A	2011E	2012E
Revenue	56.4	64.9	76.5
Gross profit	12.8	17.0	19.0
EBITDA	1.5	2.5	3.1
Operating profit	1.2	2.3	2.9
Adj PBT	1.0	1.9	2.5
Adj. EPS (FD) (p)	0.73	1.31	1.55
DPS (p)	0.188	0.250	0.300
Net cash / (debt)	(5.2)	(6.6)	(6.7)
Net asset value (p)	3.2	4.3	7.8
Interest cover(x)	4.9	6.2	6.9
Dividend cover (x)	3.9	5.2	5.2

Valuation

P/E (adjusted) (x)	13.9	7.7	6.5
Sector P/E (x)	-	9.7	7.6
Premium/ Discount (%)	-	(21)	(14)
EV/EBITDA (x)	10.0	6.8	5.6
Free cash flow yield (%)	9.4	(1.7)	(7.6)
Price / Sales (x)	0.18	0.16	0.13
Yield (%)	1.9	2.5	3.0
Net debt / EBITDA (x)	3.5	2.6	2.2

Growth and Margin Data (%)

Net sales growth	13.3	15.1	17.9
Adj. operating profit growth	100	85	29
Adj. PBT growth	224	91	32
Gross margin	22.7	27.7	28.8
Operating margin	2.2	3.5	3.8

Source: Company (actual); Merchant Securities (forecasts)

Key Data

Description

ReThink specialises in recruitment services and business transformation & technology consultancy

Website

www.therethink-group.com

Management

Chairman	John Sadiq
CEO	Jon Butterfield
FD	Patrick Dundon

Key Shareholders (%)

J Butterfield	11.96%
A Lord	11.96%
M Bennett	11.96%
I Blair	11.96%
Free float	28.39%

Upcoming News

Interims	Sep 2011
Trading update	Feb 2012
Prelims	Apr 2012

Market Data

Share price	10.125p
Target price	15p
Market cap.	£10.2m
Enterprise value	£16.8m

Return on Data

ROCE (A)	15.5%
ROE (A)	48.5%

13 July 2011

Disclosures and Disclaimers

Disclosure Checklist

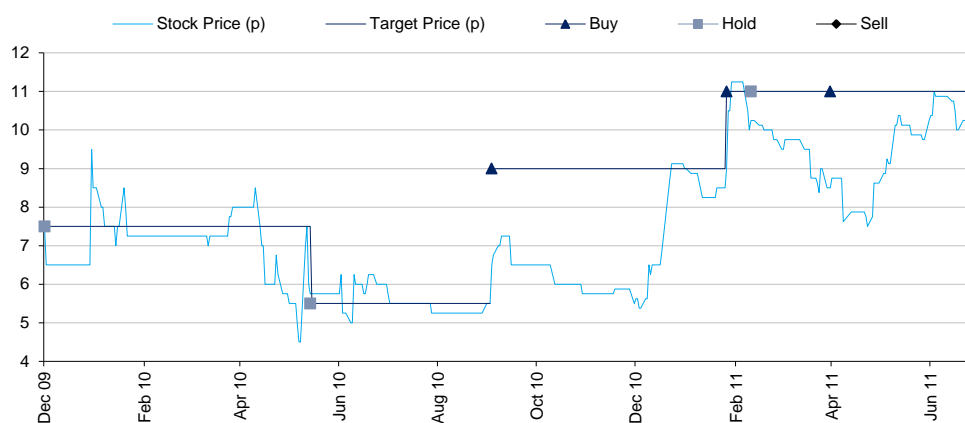
Company	Relevant disclosure
The ReThink Group (RTG.L)	1 2 3 5

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2. MSL acts as a nominated or financial adviser to the company.
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Recommendation definitions

BUY	Share price appreciation of 10% or more in absolute terms over 12 months
HOLD	Share price appreciation or depreciation of less than 10% in absolute terms over 12 months
SELL	Share price depreciation of 10% or more in absolute terms over 12 months

Recommendation history



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