

Singapore Company Guide

HRNetGroup Ltd

Version 1 | Bloomberg: HRNET SP | Reuters: HRNE.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

10 May 2018

BUY

Last Traded Price (9 May 2018): S\$0.78 (STI : 3,548.54)

Price Target 12-mth: S\$0.98 (26% upside) (Prev S\$0.97)

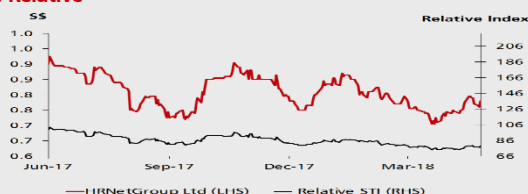
Analyst

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What's New

- 1Q18 results within expectations
- Growth driven by both organic performance in Flexible Staffing and Professional Staffing, coupled with grants, absence of IPO expenses, interest income and lower MI
- Continuing its lookout for inorganic opportunities
- Maintain BUY, TP: S\$0.98

Price Relative



Forecasts and Valuation

FY Dec (\$m)	2016A	2017A	2018F	2019F
Revenue	365	392	411	431
EBITDA	59.6	56.2	62.2	64.4
Pre-tax Profit	59.3	56.9	63.2	66.0
Net Profit	41.1	41.3	47.9	50.0
Net Pft (Pre Ex.)	41.1	41.3	47.9	50.0
Net Pft Gth (Pre-ex) (%)	7.6	0.6	16.0	4.4
EPS (S cts)	5.02	4.48	4.74	4.95
EPS Pre Ex. (S cts)	5.02	4.48	4.74	4.95
EPS Gth Pre Ex (%)	8	(11)	6	4
Diluted EPS (S cts)	5.02	4.09	4.74	4.95
Net DPS (S cts)	11.7	2.30	2.67	2.78
BV Per Share (S cts)	10.3	30.9	33.0	35.1
PE (X)	15.5	17.4	16.5	15.8
PE Pre Ex. (X)	15.5	17.4	16.5	15.8
P/Cash Flow (X)	11.9	20.4	12.7	15.2
EV/EBITDA (X)	9.1	7.7	7.9	7.6
Net Div Yield (%)	15.0	2.9	3.4	3.6
P/Book Value (X)	7.6	2.5	2.4	2.2
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	40.8	20.9	14.8	14.5
Earnings Rev (%)			1	1
Consensus EPS (S cts):			5.00	5.30
Other Broker Recs:		B: 5	S: 0	H: 0

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P

A good start

Thesis: Riding on labour market recovery. We maintain our BUY recommendation for HRnetGroup as a beneficiary of the economic and labour market improvement. The counter is currently trading at 16.5x/15.8x FY18F/19F PE. Excluding cash estimated on its balance sheet, PE (ex-cash) would be even lower at c.10.6x/10.1x our earnings estimates. The institution of the group's co-ownership model with its IPO has seen over 400 of its employees becoming shareholders. In our view, this aids in increasing motivation and bodes well for the group.

Where we differ? We believe the labour market has bottomed in Singapore, going by our economist's reading of the growth in the services sector. This should bode well for recruitment firms like HRnet. Our forecasts are below consensus at this juncture but have possible upside pending further confirmation of improvements in subsequent quarters.

Potential catalysts. Including the cash raised from its recent IPO, the group is currently sitting on c.S\$292m cash (as of 31 March 2018), representing c.35% of its market cap. Deployment of funds for inorganic and accretive acquisitions could further re-rate the counter.

Valuation:

Our TP is adjusted slightly to S\$0.98 due to a higher estimated cash balance. We peg our valuation at 15x on the ex-cash earnings in FY18F, coupled with estimated FY18F net cash balance of S\$303m. Our DCF model with WACC of 10% and terminal growth of 2.5% also implies a TP of S\$0.98.

Key Risks to Our View:

Downturn in economy leading to lower job turnover and opportunities, departure of team(s) of recruitment consultants and/or top management, competition, execution of inorganic growth opportunities particularly integration.

At A Glance

Issued Capital (m shrs)	1,011
Mkt. Cap (\$m/US\$m)	789 / 586
Major Shareholders (%)	
SIMCO Ltd	74.5
Free Float (%)	25.5
3m Avg. Daily Val (US\$m)	0.29
ICB Industry : Industrials / Support Services	

WHAT'S NEW

A good start

HRnetGroup's 1Q18 figures within expectations. 1Q18 net profit surged by 46% y-o-y to S\$16.3m, on the back of 12.2% and 11.3% improvement in revenue and gross profit to S\$107m and S\$36.4m, respectively.

Flexible Staffing and Professional Recruitment registered growth. Both these business segments helped in the growth in gross profit, though contribution from Flexible Staffing inched up to 35% (from 34%). Flexible Staffing's gross profit grew by 15% y-o-y to S\$12.8m (+\$1.7m), of which \$1.4m and \$0.2m were contributed by Singapore and Hong Kong respectively. Professional Recruitment registered gross profit growth of 9.8% y-o-y (+\$2m), contributed mainly by Hong Kong/China.

In terms of geography, North Asia and Singapore registered increases of S\$2.1m and S\$1.5m respectively, and accounted for 40% and 57% of the group's gross profit.

Net profit surged partly helped by several factors. Besides growth in the underlying operations, the surge in net profit was helped by: (i) increase in government grants (~S\$0.5m); (ii) revaluation of marketable securities (~S\$0.8m); (iii) interest income (~S\$0.5m); (iv) absence of IPO expenses (~S\$0.9m); (v) lower minority interests due to acquisition of interest during its IPO. Excluding the **effects of lower minority interests** (arising from GLOW88 scheme), net profit would have still registered a growth of **34.2% y-o-y to S\$14.9m**.

Productive headcount increase, though total headcount dipped slightly. Total permanent headcount dropped slightly to 791, from 820 a year ago. In 1Q18, there were 676 sales employees, down from 700 in 1Q17. However, the number of productive sales employees increase by 25 to 473, from 448 a year earlier. As such, the group achieved a productive headcount (PHC) ratio of 70% in 1Q18, from 64% a year earlier (PHC ratio is defined as percentage of sales staff achieving three times gross profit over their respective fixed salaries).

1Q18 accounts for 34% of our forecasts, due to government grants. This set of results is tracking within expectations. Note that 1Q tends to contribute more to the full year given the

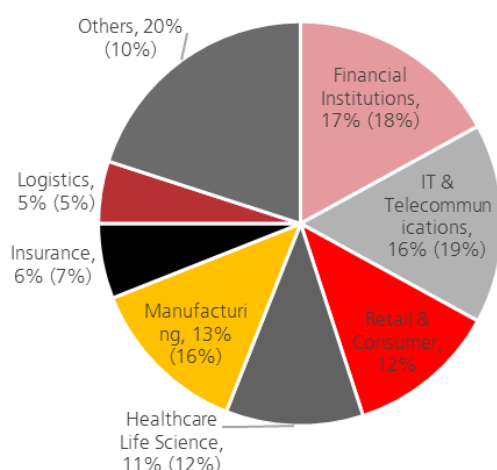
recognition of government grants in the quarter, which will largely be absent in subsequent quarters. We expect 2Q18 to continue to show strong growth y-o-y due to lower-base effects (due to IPO expenses last year) and lower MI (which came into effect only in 2H17). As such, we project growth normalising down barring significant acquisitions. We are projecting a FY18F PATMI growth of c.16% to S\$47.9m, a reversal of the 4.1% drop in FY17.

Revenue contribution by sector saw increase in "Others". The group saw lower revenue contributions from almost all its main sectors, with the largest movements on "IT & Telecommunications" and "Manufacturing" ceding 3ppts to 16% and 13% respectively in 1Q18, compared to a year ago. This was picked up by "Others" which doubled its share to 20% from a year ago. Management indicated that they saw a higher share from Professional services (e.g. audit, legal) and Education. We understand that this also partly explains its robust growth in Flexible Staffing gross profit.

Reviewing inorganic opportunities; well placed as balance sheet remains in net cash. Management indicated that they continue to pursue potential acquisitions but are unable to share more details at this juncture. Along with the current cashflow generation in 1Q18, the group's cash position improved to S\$292m, up from S\$289m as of end-December 2017. Catalysts for the group include the deployment of cash for inorganic growth opportunities, and better-than-expected operational performance on the back of an improving employment market.

Maintain BUY, TP: S\$0.98. We are maintaining our BUY recommendation as we view HRnetGroup as a beneficiary of the economic and labour market improvement. The counter is currently trading at 16.5x/15.8x FY18F/19F PE. Excluding cash estimated on its balance sheet, PE (ex-cash) would be even lower at c.10.6x/10.1x our earnings estimates. Our TP is adjusted up slightly to S\$0.98 due to a higher estimated cash balance. We peg our valuation at 15x on the ex-cash earnings in FY18F, coupled with estimated FY18F net cash balance of S\$303m.

Revenue by Sector



(% in brackets denotes 2017 figures)

Source: Company

Achieved productive headcount of 70%

	Q1 2018	Q1 2017	
Revenue/Sales Employees (\$'000)	158.2	136.2	▲ 16.2%
GP/Sales Employees (\$'000)	53.9	46.8	▲ 15.2%
	Mar-18	Mar-17	
Total Employees	1,066	1,099	
Perm Employees	791	820	
Temp/Contract	275	279	
Sales Employees	676	700	
% Sales Employees	85.5%	85.4%	
Productive Sales Employees	473	448	
% Productive Sales Employees	70.0%	64.0%	
Co-Ownership			
123Grow Co-owner Participants	348		
Productive Co-owners for 2017	337	96.8%	
Productive Co-owners for Q1 2018	327	94.0%	

Source: Company

Quarterly / Interim Income Statement (\$5m)

FY Dec	1Q2017	4Q2017	1Q2018	% chg yoy	% chg qoq	Comments
Revenue	95.3	102	107	12.2	5.2	
Cost of Goods Sold	(62.6)	(66.8)	(70.5)	12.7	5.6	
Gross Profit	32.7	34.9	36.4	11.3	4.5	
Other Oper. (Exp)/Inc	(17.2)	(20.3)	(17.8)	3.3	(12.3)	Includes govt grants in 1Q18 (\$5m); 1Q17 (\$4.5m). IPO expense (1Q17: \$0.9m)
Operating Profit	15.5	14.6	18.6	20.1	27.7	
Other Non Opg (Exp)/Inc	0.0	1.04	0.82	nm	(21.5)	\$0.8m revaluation of marked-to-market marketable securities in 1Q18
Associates & JV Inc	0.0	0.0	0.0	-	-	
Net Interest (Exp)/Inc	0.11	0.72	0.68	497.4	(5.4)	Higher cash level
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-	
Pre-tax Profit	15.6	16.4	20.1	28.8	23.1	
Tax	(2.7)	(2.8)	(2.9)	6.4	4.7	
Minority Interest	(1.8)	(1.5)	(1.0)	45.5	(33.6)	
Net Profit	11.2	12.2	16.3	46.0	34.1	
Net profit bef Except.	11.2	12.2	16.3	46.0	34.1	
EBITDA	15.7	15.9	19.7	25.0	24.0	
Margins (%)						
Gross Margins	34.3	34.3	34.1			
Opg Profit Margins	16.3	14.4	17.4			
Net Profit Margins	11.7	12.0	15.2			

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

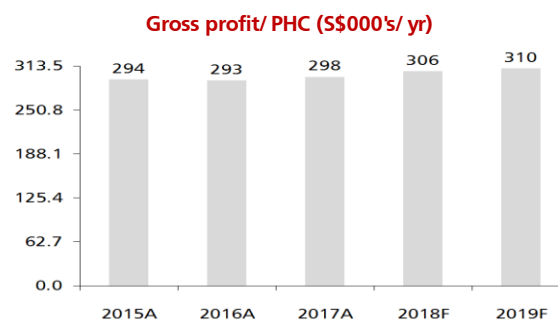
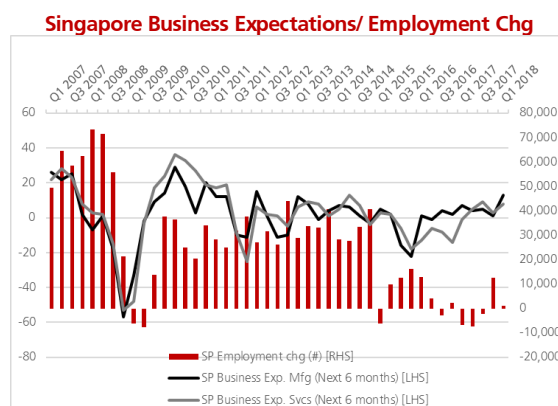
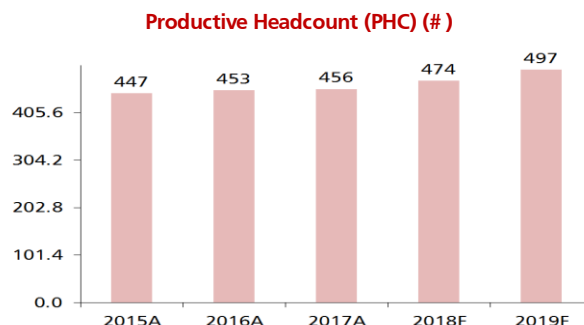
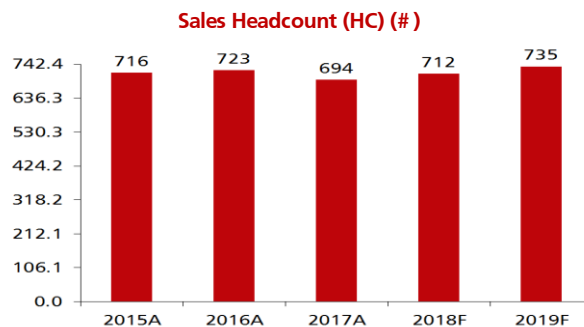
Recruitment business – professional recruitment and flexible staffing. HRnetGroup is engaged in two main segments of the recruitment market, namely Professional Recruitment and Flexible Staffing. Both segments are generally dependent on the overall economic and labour market health.

The **Professional Recruitment** business involves the permanent placement of positions for corporate clients. The recruitment consultants will need to have an in-depth understanding of the client's industry and specialisation, as well as the talent landscape to identify suitable candidates, and to facilitate the needs of the client. The group has on average closed over 8,000 placements a year, with FY17 seeing 8,200.

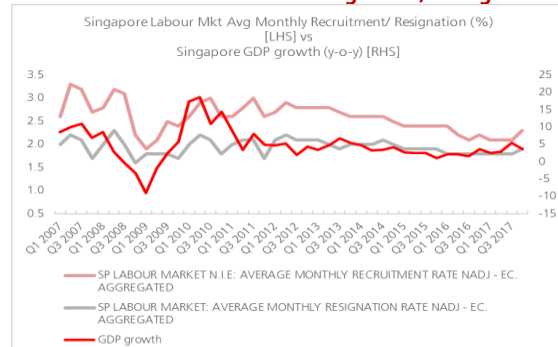
On the other hand, the **Flexible Staffing** business involves staffing solutions for corporate clients seeking variability in operating costs and talent deployment. For workers, this business solution satisfies candidates seeking less-formal, contract, temporary and part-time employment. Overall, the group has on average about 11,000 contractor employees, and the figure was 11,300 in FY17.

Sales and productive headcount. Being a recruitment agency, manpower is the largest cost, as well as asset. The business relies on sales consultants for the service of both segments. Sales headcount stood at 694 as at end-FY17. The group manages the business profitability via the measure of Productive Headcount, which refers to sales personnel who achieve gross profit of at least 3x their fixed salary. As such, the proportion of PHC/Headcount, gross profit per PHC and number of PHC are key drivers/factors for management to manage costs.

Business expectations, GDP and labour market. The group's business activities depend on the overall economic health of the market it operates in, business expectations and the availability and "churn-rate" of labour. As such, GDP growth, business expectations, and recruitment/resignation rates of the overall market are important factors to track.



SG Labour Mkt Recruitment/ Resignation; GDP growth



Source: Company, DBS Bank

Balance Sheet:

Net cash position and strong operating cashflow. Operations are cashflow generative with operating cashflows of c.\$35-53m from FY14-17. We project the group to remain in a strong net cash position in FY18F and FY19F given its cash-generative business. Operating cash flow is projected to remain at c.\$62m in FY18F, after a projected drop in FY17F due to a decrease in accounts payable post payment of accrued dividends. As at 30 March 2018, the group's cash position had improved to S\$292m, up from S\$289m as of end-December 2017.

Share Price Drivers:

Macro-economic indicators. Economic growth, business expectations and labour market condition are general overall factors impacting the industry and the company's performance. A robust and active employment market should bode well for the group on the back of more business opportunities.

Gross profit per employee. At the company level, the ability to drive better gross profit per employee will have a positive impact on the group, all else constant. The company's ability to spot and leverage on matching opportunities between candidates and companies will aid on overall performance and lead to better operating results.

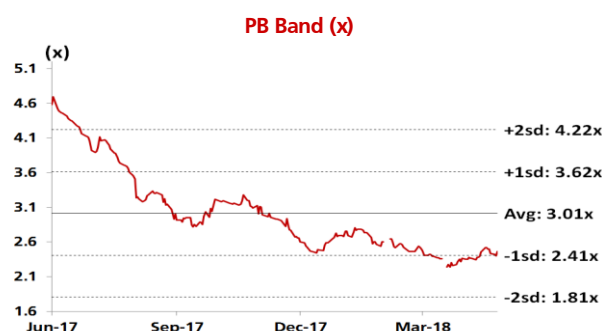
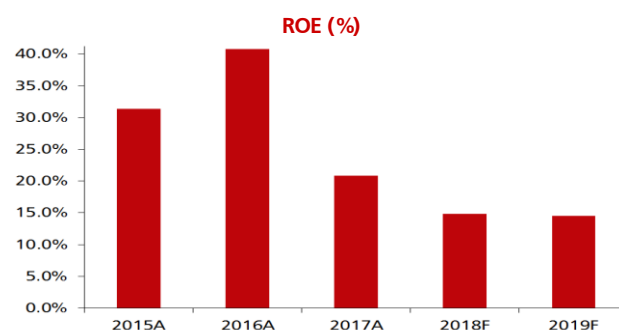
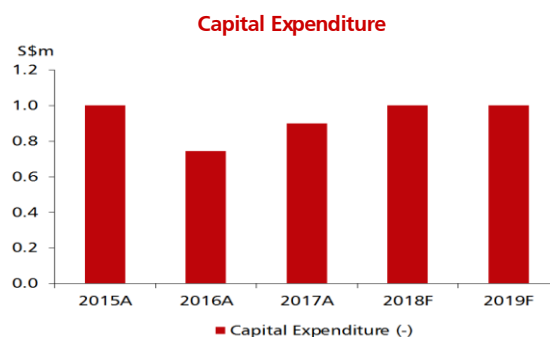
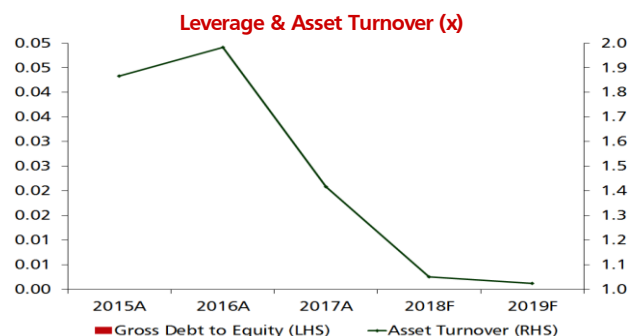
Acquisition. As mentioned above, cash for the group is at S\$292m (as of 31 March 2018), accounting for c.35% of its market cap. Deployment of this fund for acquisitions that leads to a stronger growth profile could be a catalyst for the counter.

Key Risks:

Downturn in economy leading to lower job turnover and opportunities, departure of team(s) of recruitment consultants and/or top management, competition, execution of inorganic growth opportunities particularly integration.

Company Background

HRnetGroup is the largest recruitment agency in the Asia Pacific (excluding Japan), according to Frost & Sullivan. As at 31 March 2018, the group had **791 permanent employees**, operating through **24 business entities in 10 Asian growth cities**, with its headquarters in Singapore. It has two operating segments, namely Professional Recruitment and Flexible Staffing.



Source: Company, DBS Bank

Key Assumptions

FY Dec	2015A	2016A	2017A	2018F	2019F
Sales Headcount (HC) (#)	716	723	694	712	735
Productive Headcount (PHC)	447	453	456	474	497
PHC/HC	0.62	0.63	0.66	0.67	0.68
Gross profit/ PHC (\$'000's/ yr)	294	293	298	306	310

Segmental Breakdown

FY Dec	2015A	2016A	2017A	2018F	2019F
Revenues (\$m)					
Professional recruitment	86.4	87.5	86.7	96.0	103
Flexible staffing	267	274	302	312	324
Others	2.21	3.09	3.30	3.40	3.60

Total	356	365	392	411	431
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Gross profit (\$m)

Professional recruitment	86.1	87.4	86.4	95.8	103
Flexible staffing	43.2	42.7	46.6	46.2	47.8
Others	1.91	2.78	3.03	3.03	3.20

Total	131	133	136	145	154
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Gross profit Margins (%)

Professional recruitment	99.7	99.8	99.7	99.8	99.8
Flexible staffing	16.1	15.5	15.4	14.8	14.8
Others	86.5	89.8	91.9	89.0	89.0

Total	36.9	36.4	34.7	35.3	35.8
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Income Statement (\$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Revenue	356	365	392	411	431
Cost of Goods Sold	(225)	(232)	(256)	(266)	(277)
Gross Profit	131	133	136	145	154
Other Opng (Exp)/Inc	(80.7)	(74.0)	(81.7)	(84.1)	(91.1)
Operating Profit	50.5	58.8	54.3	60.9	63.1
Other Non Opng (Exp)/Inc	0.93	0.0	1.04	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	0.69	0.56	1.56	2.31	2.89
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	52.1	59.3	56.9	63.2	66.0
Tax	(8.8)	(10.9)	(10.5)	(12.0)	(12.5)
Minority Interest	(5.2)	(7.4)	(5.1)	(3.3)	(3.4)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	38.2	41.1	41.3	47.9	50.0
Net Profit before Except.	38.2	41.1	41.3	47.9	50.0
EBITDA	52.7	59.6	56.2	62.2	64.4

Growth

Revenue Gth (%)	9.7	2.5	7.4	4.9	4.8
EBITDA Gth (%)	12.5	12.9	(5.7)	10.7	3.5
Opg Profit Gth (%)	10.7	16.4	(7.6)	12.2	3.6
Net Profit Gth (Pre-ex) (%)	14.5	7.6	0.6	16.0	4.4

Margins & Ratio

Gross Margins (%)	36.9	36.4	34.7	35.3	35.8
Opg Profit Margin (%)	14.2	16.1	13.9	14.8	14.6
Net Profit Margin (%)	10.7	11.3	10.5	11.7	11.6
ROAE (%)	31.3	40.8	20.9	14.8	14.5
ROA (%)	20.0	22.3	14.9	12.2	11.9
ROCE (%)	27.7	35.7	20.5	15.1	14.8
Div Payout Ratio (%)	123.7	232.3	56.3	56.3	56.3
Net Interest Cover (x)	NM	NM	NM	NM	NM

Source: Company, DBS Bank

Includes govt grants, but absence of IPO expenses seen in FY17 (\$3.6m)

Quarterly / Interim Income Statement (\$m)

FY Dec	1Q2017	2Q2017	3Q2017	4Q2017	1Q2018
Revenue	95.3	97.4	97.5	102	107
Cost of Goods Sold	(62.6)	(63.5)	(63.1)	(66.8)	(70.5)
Gross Profit	32.7	34.0	34.4	34.9	36.4
Other Oper. (Exp)/Inc	(17.2)	(22.8)	(21.4)	(20.3)	(17.8)
Operating Profit	15.5	11.2	13.0	14.6	18.6
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	1.04	0.82
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	0.11	0.12	0.61	0.72	0.68
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	15.6	11.3	13.7	16.4	20.1
Tax	(2.7)	(2.4)	(2.7)	(2.8)	(2.9)
Minority Interest	(1.8)	(1.6)	(0.3)	(1.5)	(1.0)
Net Profit	11.2	7.33	10.7	12.2	16.3
Net profit bef Except.	11.2	7.33	10.7	12.2	16.3
EBITDA	15.7	11.4	13.2	15.9	19.7

Revaluation of marketable securities

Lower MI due to acquisition of minority interests prior to IPO in June 2017

Growth

Revenue Gth (%)	2.7	2.2	0.0	4.3	5.2
EBITDA Gth (%)	3.9	(27.8)	16.6	19.7	24.0
Opg Profit Gth (%)	3.5	(28.1)	16.9	11.9	27.7
Net Profit Gth (Pre-ex) (%)	12.4	(34.3)	45.9	13.6	34.1

Margins

Gross Margins (%)	34.3	34.9	35.3	34.3	34.1
Opg Profit Margins (%)	16.3	11.4	13.4	14.4	17.4
Net Profit Margins (%)	11.7	7.5	11.0	12.0	15.2

Balance Sheet (\$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Net Fixed Assets	0.83	0.73	0.79	0.61	0.34
Invt in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other LT Assets	0.90	0.81	1.49	21.4	41.4
Cash & ST Invt	123	107	295	309	311
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	61.1	65.9	74.6	73.2	76.8
Other Current Assets	3.87	4.19	3.99	4.50	4.50
Total Assets	190	178	375	408	434
ST Debt	0.0	0.0	0.0	0.0	0.0
Creditor	5.26	5.70	6.15	6.28	6.53
Other Current Liab	48.2	75.4	48.6	57.0	57.5
LT Debt	0.0	0.0	0.0	0.0	0.0
Other LT Liabilities	0.01	0.01	0.0	0.0	0.0
Shareholder's Equity	118	83.9	312	333	355
Minority Interests	18.7	13.3	8.28	11.6	15.0
Total Cap. & Liab.	190	178	375	408	434
Non-Cash Wkg. Capital	11.4	(11.0)	23.9	14.5	17.2
Net Cash/(Debt)	123	107	295	309	311
Debtors Turn (avg days)	62.4	63.4	65.4	65.6	63.5
Creditors Turn (avg days)	8.2	8.6	8.5	8.6	8.5
Inventory Turn (avg days)	N/A	N/A	N/A	N/A	N/A
Asset Turnover (x)	1.9	2.0	1.4	1.0	1.0
Current Ratio (x)	3.5	2.2	6.8	6.1	6.1
Quick Ratio (x)	3.4	2.1	6.7	6.0	6.1
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	N/A	N/A	N/A	N/A	N/A
Z-Score (X)	11.7	9.1	10.9	10.9	10.4

Source: Company, DBS Bank

Cash Flow Statement (\$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Pre-Tax Profit	52.1	59.3	56.9	63.2	66.0
Dep. & Amort.	1.30	0.82	0.82	1.27	1.28
Tax Paid	(8.3)	(4.9)	(14.1)	(8.8)	(12.0)
Assoc. & JV Inc/(loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	5.26	(2.3)	(8.8)	6.15	(3.3)
Other Operating CF	(0.9)	0.42	0.33	0.0	0.0
Net Operating CF	49.6	53.4	35.2	61.9	52.0
Capital Exp.(net)	(1.0)	(0.7)	(0.9)	(1.0)	(1.0)
Other Invts.(net)	0.0	0.0	0.0	(20.0)	(20.0)
Invts in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	0.23	1.58	(3.9)	0.0	0.0
Net Investing CF	(0.8)	0.83	(4.8)	(21.0)	(21.0)
Div Paid	(51.9)	(84.8)	(22.1)	(27.0)	(28.2)
Chg in Gross Debt	0.0	0.0	0.0	0.0	0.0
Capital Issues	0.0	15.0	176	0.0	0.0
Other Financing CF	(0.7)	0.36	(0.6)	0.0	0.0
Net Financing CF	(52.5)	(69.5)	153	(27.0)	(28.2)
Currency Adjustments	0.96	0.51	(0.9)	0.0	0.0
Chg in Cash	(2.8)	(14.7)	183	13.9	2.85
Opg CFPS (\$ cts)	5.42	6.81	4.76	5.51	5.46
Free CFPS (\$ cts)	5.94	6.44	3.72	6.02	5.04

Source: Company, DBS Bank

Target Price & Ratings History



Note: Share price and Target price are adjusted for corporate actions.

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	03 Jan 18	0.80	0.96	BUY
2:	26 Feb 18	0.81	0.97	BUY

Source: DBS Bank

Analyst: Andy SIM, CFA
Alfie YEO

DBS Bank recommendations are based on Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

Completed Date: 10 May 2018 17:19:55 (SGT)

Dissemination Date: 10 May 2018 17:57:43 (SGT)

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