Strong performance that underpins increase in final dividend to 9.8p.

Alex Smith
Chief Financial Officer

Gross profit growth
(in constant currency)

+12% to £321.1m

2017: +4% to £287.7m

Adjusted profit before tax

+20% to £53.4m

(+20% in constant currency)
2017: +9% to £44.5m

Net debt balance

£4.1m

2017: net cash £5.6m

Adjusted basic earnings per share

+19% to 30.7p

2017: +11% to 25.7p

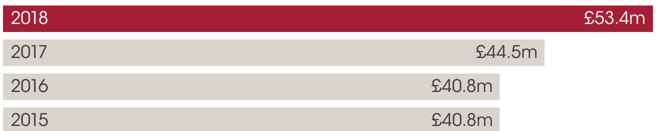
In 2018, improved operational performance delivered strong growth in gross profit and profit before tax, ahead of market expectations.

Income statement

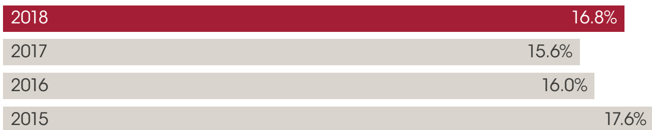
Revenue for the year was up 13% on constant currency and reported bases to £1,258.2 million (2017: £1,114.5 million). On constant currency and reported bases, gross profit ('GP') increased by 12% to £321.1 million (2017: £287.7 million). Growth in revenue exceeded the growth in GP as the business continued to remix towards Contract. Contract represented 72% of Group GP in the year (2017: 71%). This change in mix resulted in a slight decrease in the overall GP margin to 25.5% (2017: 25.8%) as Permanent revenue has no cost of sale, whereas the cost of paying the contractor is deducted to derive Contract GP. The Contract margin increased slightly to 19.9% (2017: 19.8%).

Reported profit before tax was up 25% at £47.0 million. The adjusted profit before tax ('PBT') was £53.4 million up 20% year on year (2017: adjusted £44.5 million and reported £37.7 million). The adjusted PBT excludes restructuring costs of £6.4 million that were incurred during the year in respect of the relocation of our support function to Glasgow (2017: £6.7 million). In 2018, this exceptional restructuring delivered savings which drove an increase in our operating profit conversion ratio of 1.2 percentage points to 16.8% on an adjusted basis and 1.5 percentage points to 14.8% on a reported basis (2017: adjusted 15.6% and reported 13.3%).

Adjusted profit before tax



Adjusted operating profit ('OP') conversion ratio



Restructuring costs ('adjusting items')

A strategic relocation of the majority of our central support functions away from our London headquarters to a new facility located within Glasgow was announced on 1 November 2017. The transition to the Glasgow Centre of Excellence is now substantially complete and we anticipate that this restructuring will realise cost savings ahead of expectations, in excess of £5 million per annum. In line with the project implementation timescale, benefits started to be realised in the second half of this financial year and led to the recognition of £2.6 million in savings in 2018. The trajectory of the realised savings is expected to result in additional savings of £2.9 million in support costs in 2019.

We continue to anticipate that one-off restructuring costs will be in the region of £14.0 million, with circa £12.9 million of operating expenses, including personnel costs and professional advisor fees, and circa £1.1 million of property related costs. The project is being partially funded by a grant receivable from Scottish Enterprise of circa £2.1 million which is receivable and recognisable over several years, subject to the terms of the grant being met within a fixed timeframe.

Net exceptional costs of £6.4 million have been charged to the Consolidated Income Statement during the year, bringing the total costs recognised to date to £13.1 million (2017: £6.7 million). The exceptional charge in the year included personnel costs of £4.1 million and other costs of £2.7 million (primarily professional and property costs). During the year, the grant income of £0.4 million was recognised as an offset to the exceptional costs of 10% of gross wages for each full time role created in the Centre of Excellence in the year.

Key financial information

	2018		2017		Variance[3]	
	Adjusted[1]	Reported	Adjusted[2]	Reported	Actual movement	Constant currency movement
Revenue (£ million)	1,258.2	1,258.2	1,114.5	1,114.5	13%	13%
Gross profit (£ million)	321.1	321.1	287.7	287.7	12%	12%
Operating profit (£ million)	53.9	47.5	44.9	38.2	20%	20%
OP Conversion ratio (%)	16.8%	14.8%	15.6%	13.3%	+1.2% pts	+1.2% pts
Profit before tax (£ million)	53.4	47.0	44.5	37.7	20%	20%
Basic earnings per share (pence)	30.7p	26.6p	25.7p	21.5p	19%	20%
Proposed final dividend (pence)	9.8p	9.8p	9.3p	9.3p	5%	5%
Total dividend (pence)	14.5p	14.5p	14.0p	14.0p	4%	4%
Net (debt)/cash (£ million)	(4.1)	(4.1)	5.6	5.6		

1. 2018 figures were adjusted for the impact of £6.4 million of net exceptional strategic restructuring costs.
2. 2017 figures were adjusted for the impact of £6.7 million of exceptional strategic restructuring costs.
3. All variances compare adjusted 2018 against adjusted 2017 to provide a like-for-like view.

The strategic nature and material cost of the restructuring of support functions announced in 2017 continues to be of sufficient magnitude to warrant separate disclosure as an exceptional item on the face of the Consolidated Income Statement, in line with our accounting policies. The separate disclosure of the exceptional items helps readers understand the Group's underlying results for the year ('Adjusted'). The Group adjusted profit KPIs for the year are presented in various sections of this Annual Report.

A reconciliation of 'Adjusting items' is provided below:

£ million	2018	2017
Reported profit before tax after exceptional items	47.0	37.7
Exceptional strategic restructuring costs (net of government grant)	6.4	6.7
Reported profit before tax and exceptional items ('Adjusted')	53.4	44.5

Operating costs

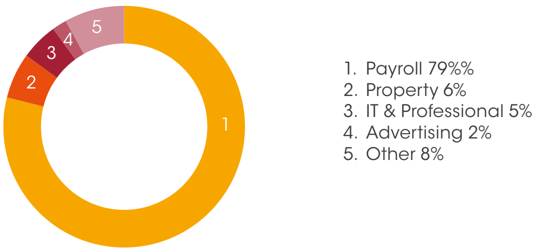
Adjusted operating costs, excluding one-off net restructuring costs of £6.4 million (2017: £6.7 million), increased by 10% to £267.2 million (2017: £242.8 million). The increase was mainly driven by additional investment in headcount (8% increase year on year), 10% increase in personnel costs (£11.0 million* increase in salaries; £3.5 million* increase in commissions and bonuses in line with the improved GP), and £0.9 million increase in property costs reflecting demand for new and modernised office space.

Payroll costs represented 79% of our cost base. Average total headcount was up by 10% at 2,926 (2017: 2,668), with average sales headcount up 8%. The increase in average sales headcount was in response to supportive market conditions across the majority of our geographies as well as improvements in consultant productivity, attributable primarily to Continental Europe (Benelux, France & Spain and DACH regions) and the USA, (headcount up 15% and 11% respectively). 2% of the average total headcount was attributable to the relocation of the support function to Glasgow. The year-end total headcount was up 4% at 2,979.

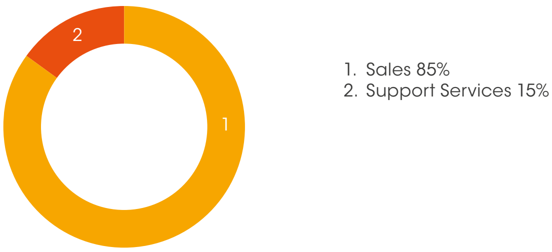
The year-end sales headcount represented 78% of the total Group headcount.

The full benefits of the restructure of our UK support function on personnel and property costs are expected to be realised from the financial year 2019 onwards.

Cost base



Payroll costs



Year-end total headcount

Investments

During the year, we continued to invest in in-house Innovation initiatives, expensing a total of £2.4 million (2017: £2.0 million) across the year. Our intent is to build a more diverse portfolio of products and services so that we capture a greater share of total customer spend on employment matters and to ensure we are well positioned to benefit from potential disruption. The bulk of the investment was made in our HireFirst and Showcaser initiatives. HireFirst, launched in October 2018, is at the beta testing stage, and no profits were generated during the year. Showcaser is progressing well and it has received encouraging feedback from the prospective clients. We do not anticipate material revenue from HireFirst or Showcaser in 2019.

We continued to hold non-controlling shareholdings in three innovation start-ups. (i) Ryalto Limited which is designing and developing a mobile application for healthcare professionals. (ii) RoboRecruiter Inc. which is building automated multichannel platforms connecting candidates with recruiters and employers in real time; and (iii) The Sandpit Limited, a privately owned group that specialises in developing early stage start-up companies within defined markets.

* In constant currency.

Taxation

The tax charge on pre-exceptional statutory profit before tax for the year was £13.9 million (2017: £11.4 million), representing an effective tax rate ('ETR') of 25.9% (2017: 25.6%). The ETR on post-exceptional statutory profit before tax was 27.1% (2017: 26.7%).

The ETR primarily reflects our geographical mix of profits and a cautious approach to recognising deferred tax assets on tax losses. USA Tax Reform legislation passed in December 2017 saw a reduction in the federal corporate tax rate from 35% to 21%. As previously indicated, this had a minimal impact on the ETR because the tax credit associated with the current year profits was largely offset by the reduction in the deferred tax asset. Whilst the Group benefited from a reduction in the USA cash tax payable in 2018, the accounting ETR benefit of this change will occur in 2019 and beyond.

Other regulatory changes which may impact the Group in future years include:

(i) If the UK leaves the European Union, the Group will no longer be able to benefit from provisions applying in certain tax treaties and in the EU Parent Subsidiary Directive. The Group is currently planning mitigating actions against this and hence we do not expect any material costs to arise.

(ii) In October 2017, the European Commission opened a state aid investigation into the Group Financing Exemption in controlled foreign company rules, introduced by the UK Government in 2013. The Group has historically relied on this exemption in certain jurisdictions and we are therefore monitoring the investigation. If the preliminary findings of the European Commission are upheld, we calculate our maximum potential liability to be £3.2 million. Our current assessment is that no provision is required in respect of this issue.

(iii) Increased transparency arising from the implementation of Country-By-Country reporting provisions in various OECD member states may result in more frequent tax audits, particularly in the area of transfer pricing. The Group is comfortable that its policies in this area are robust.

We will continue to monitor and assess the impact of any changes as they are implemented.

Earnings per share ('EPS')

On an adjusted basis, basic EPS was up by 5 pence, or 19%, at 30.7 pence (2017: adjusted 25.7 pence), due to an increase in the adjusted profit before tax, partially offset by a marginal increase in weighted average number of shares. On a reported basis, EPS increased to 26.6 pence, up 5.1 pence on the prior year (2017: 21.5 pence). The weighted average number of shares used for basic EPS remained stable at 128.7 million (2017: 128.6 million). Reported diluted EPS was 25.7 pence (2017: 20.8 pence), up 4.9 pence. Share dilution mainly results from various share options in place and expected future settlement of certain tracker shares.
The dilutive effect on EPS from tracker shares will vary in future periods depending on the profitability of the underlying tracker businesses, the volume of new tracker arrangements created and the settlement of vested arrangements.

Adjusted basic EPS

2018	30.7p*
2017	25.7p
2016	23.2p
2015	23.2p

* Excludes the impact of £6.4 million in net exceptional restructuring costs (2017: £6.7 million).

Dividends

The Board monitors the appropriate level of the dividend, taking into account, inter alia, achieved and expected trading of the Group, together with its balance sheet position. In line with the Board's strategy of targeting a dividend cover of between 2.0x and 2.5x, based on underlying EPS, over the short to medium term, the Board has proposed an increased final dividend of 9.8 pence per share (2017: 9.3 pence). Taken together with the interim dividend of 4.7 pence per share (2017: 4.7 pence), this brings the total dividend for the year to 14.5 pence per share (2017: 14.0 pence).
This represents a 4% increase in dividend per share versus the prior year. This dividend increase reflects the Board's confidence in SThree's long-term strategy, with cover now in the target range of 2.0 to 2.5 times. The final dividend, which amounts to approximately £12.8 million, will be subject to shareholder approval at the 2019 Annual General Meeting. It will be paid on 7 June 2019 to shareholders on the register on 26 April 2019.

Share options and tracker share arrangements

We recognised a share-based payment charge of £4.7 million during the year (2017: £3.3 million) for the Group's various share-based incentive schemes. The greater charge in 2018 is primarily due to improved non-market vesting conditions, such as the adjusted basic EPS driven by increased profit before tax. A portion of the annual charge also reflects the accelerated cost for all 'good leavers' who left the Group as a result of restructuring and relocation of support functions away from London.

We also operate a tracker share model to help retain and motivate our entrepreneurial management within the business. The programme gives our most senior sales colleagues a chance to invest in a business they manage with the support and economies of scale that the Group can offer them.
In 2018, 68 employees invested an equivalent of £0.6 million in 25 Group businesses.

We settled certain tracker shares during the year for a total consideration of £3.7 million (2017: £3.3 million) which was determined using a formula in the Articles of Association underpinning the tracker share businesses. We settled the consideration in SThree plc shares either by issuing new shares (398,298 new shares were issued on settlement of vested tracker shares in 2018) or treasury shares (in total 700,200 were used in settlement of vested tracker shares in 2018). Consequently, the arrangement is deemed to be an equity-settled share-based payment arrangement under IFRS 2 'Share-based payments'. There is no charge to the income statement as initially the tracker shareholders subscribed to the tracker shares at their fair value. We expect future tracker share settlements to be between £5 million to £15 million per annum. These settlements may either dilute the earnings of SThree plc's existing ordinary shareholders if funded by new issue of shares or will result in a cash outflow if funded via treasury shares. This year we purchased 411,354 of SThree plc's ordinary shares for immediate cancellation to offset a negative impact on share dilution as a result of tracker arrangements being funded via a new issue of shares.

Note 1 to the financial statements provides further details about all Group-wide discretionary share plans, including the tracker share arrangements.

Balance sheet

At 30 November 2018, the Group's net assets increased to £101.7 million (2017: £80.7 million), mainly due to the excess of net profit over the dividend payments supported by a strengthening of the Euro vs Sterling, offset by share buy backs and share cancellations during the year.

The most significant item in our statement of financial position is trade receivables (including accrued income) which increased to £274.6 million (2017: £217.7 million). The main drivers of this increase were an almost four day growth in Days Sales Outstanding ('DSOs') to 44.7 days (2017: 40.6 days), reflecting a short-term impact from the move of support functions to Glasgow, a 12% increase in Contract GP in Q4 year on year, and a £4.3 million increase due to movements in foreign exchange rates. We expect DSOs to improve during the course of 2019. Trade and other payables increased from £159.6 million to £191.7 million, with £2.5 million due to movements in foreign exchange rates, and the remainder primarily due to an increase in Contract GP. Creditor days were 17 days (2017: 18 days). Provisions decreased by £3.3 million primarily due to a £5.3 million utilisation in a provision for the relocation of central support functions from London to Glasgow.

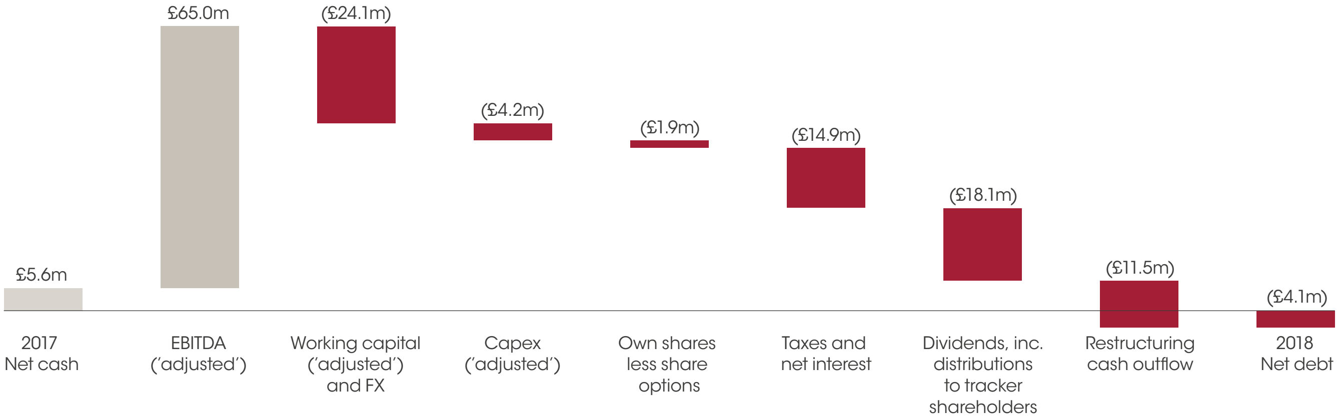
Investment in subsidiaries (Company only)

In the previous two years, an impairment charge was recognised in respect of the Company's carrying value of investments in subsidiaries. This was primarily in respect of the Group's UK operations. In 2018, we considered whether there were new indicators of impairment and did not identify any circumstances or triggers which would require a formal impairment test to be performed. However, as set out in the Risk section, at the date of signing the financial statements, there is ongoing uncertainty surrounding the potential outcomes of Brexit. This is being monitored and there remains a risk that Brexit outcome could trigger an impairment risk in 2019 or future periods.

	2018		2017	
(£ millions)	Adjusted*	Reported	Adjusted*	Reported
Operating profit	53.9	47.5	44.9	38.2
Depreciation, amortisation and impairments	6.7	6.9	6.1	6.1
Share awards charge and other non cash items	4.4	4.7	3.5	3.5
EBITDA	**65.0**	**59.1**	**54.5**	**47.8**
Working capital	(24.4)	(29.1)	(13.5)	(7.7)
Net cash generated from operations	**40.6**	**30.0**	**41.1**	**40.1**
Capex	(4.2)	(5.2)	(5.8)	(5.8)
Cash conversion ratio	**67%**	**52%**	**79%**	**90%**

* Excludes the impact of £6.4 million in net exceptional restructuring costs (2017: £6.7 million).

Cash Flow Bridge 2018



Note: EBITDA includes share based payments and other non-cash items.

On an adjusted basis, we generated net cash from operations of £40.6 million (2017: £41.1 million on an adjusted basis) due to continued growth of the Contract runner book increasing our working capital and an increase in DSOs. This resulted in a lower cash conversion ratio of 67% (2017: 79%) on an adjusted basis or 52% (2017: 90%) on a reported basis.

Capital expenditure (excluding £1.0 million in exceptional capital expenditure) reduced to £4.2 million (2017: £5.8 million), the majority of which was in relation to infrastructure investment in offices in the Netherlands, Germany and the UK, and investment in the Contractor Timesheet Portal ('Workflow') of £0.6 million. We expect capital expenditure will increase year on year in 2019, to address security, out of support systems and a number of office moves in certain European locations. Investments in available for sale financial assets were £nil (2017: £1.2 million) in the year.

During the year, SThree plc bought back shares for £1.5 million (2017: £7.8 million) to satisfy employee share schemes in future periods, and repurchased 411,354 of its ordinary shares at an average price of 357 pence for immediate cancellation. Small cash inflows were generated from share based payment schemes.

Income tax payments increased to £14.4 million (2017: £10.9 million). Small cash outflows were made for interest payments.

Dividend payments were £18.0 million (2017: £18.0 million) and there was a small cash outflow of £0.1 million representing distributions to tracker shareholders.

We started the year with net cash of £5.6 million and closed the financial year with net debt of £4.1 million. The year-on-year decrease primarily reflected increased cash absorbed in working capital as the Contract business continued to grow, increased DSOs, and the £11.5 million cash cost of the restructuring of the support functions in the UK. We expect DSOs to improve in 2019 and the restructuring cash costs to be significantly less in the first half of 2019, as the project is now substantially complete.

Treasury management

We finance the Group's operations through equity and bank borrowings. The Group's cash management policy is to minimise interest payments by closely managing Group cash balances and external borrowings. We intend to continue this strategy while maintaining a strong balance sheet position.

We maintain a committed Revolving Credit Facility ('RCF') of £50 million, along with an uncommitted £20 million accordion facility, with Citibank and HSBC, giving the Group an option to increase its total borrowings to £70 million for general corporate purposes. This facility was successfully renegotiated earlier in the year and extended to May 2023, on similar terms and conditions to the previous facility. We also have an uncommitted £5 million overdraft facility with NatWest and a £5 million overdraft facility with HSBC.

At the year end, the Group had drawn down £37.4 million (2017: £12.0 million) on these facilities.

The RCF is subject to financial covenants requiring the Group to maintain financial ratios over interest cover of at least 4.0, leverage of at least 3.0 and guarantor cover at 85% of EBITDA and gross assets. In 2018, we ended the year with significant headroom on all our covenants.

The funds borrowed under this facility bear interest at a minimum annual rate of 1.3% above three month LIBOR, giving an average interest rate of 1.8% during the year (2017: 1.5%). The finance costs for the year amounted to £0.7 million (2017: £0.4 million).

The Group's UK-based treasury function manages the Group's treasury risks in accordance with policies and procedures set by the Board, and is responsible for day-to-day cash management; the arrangement of external borrowing facilities; the investment of surplus funds; and the management of the Group's interest rate and foreign exchange risks. The treasury function does not engage in speculative transactions or operate as a profit centre.

Foreign exchange

Foreign exchange volatility continues to be a significant factor in the reporting of the overall performance of the business with the main functional currencies of the Group entities being Sterling, the Euro and the US Dollar.

For 2018, movements in exchange rates between Sterling and the Euro and the US Dollar provided a moderate net headwind to the reported performance of the Group with the highest impact coming from the Euro and US Dollar. The exchange rate movements decreased our reported 2018 GP by approximately £0.7 million and operating profit by £0.1 million.

Our financial performance KPIs remain materially sensitive to exchange rate movements. By way of illustration, each one per cent movement in annual exchange rates of the Euro and US Dollar against Sterling impacted our 2018 GP by £1.8 million and £0.7 million, respectively, and operating profit by £0.5 million and £0.2 million, respectively.

The Board considers it appropriate in certain cases to use derivative financial instruments as part of its day-to-day cash management to provide the Group with protection against adverse movements in the Euro and US dollar during the settlement period. The Group does not use derivatives to hedge translational foreign exchange exposure in its balance sheet and income statement.

Alex Smith
Chief Financial Officer