Robert Half International (RHI)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

<table>
<thead>
<tr>
<th>Price ($) (5/21/20):</th>
<th>48.50</th>
</tr>
</thead>
<tbody>
<tr>
<td>52WK H-L ($) :</td>
<td>64 - 32</td>
</tr>
<tr>
<td>Market Cap (mil):</td>
<td>5,524</td>
</tr>
<tr>
<td>Shares Out (mil):</td>
<td>113.9</td>
</tr>
<tr>
<td>Float (mil):</td>
<td>111.4</td>
</tr>
<tr>
<td>Avg. Daily Vol (mil):</td>
<td>1.68</td>
</tr>
<tr>
<td>Dividend ($) :</td>
<td>1.36</td>
</tr>
<tr>
<td>Yield (%):</td>
<td>2.8</td>
</tr>
<tr>
<td>Rating:</td>
<td>Outperform</td>
</tr>
<tr>
<td>Suitability:</td>
<td>Higher Risk</td>
</tr>
<tr>
<td>Price Target ($) :</td>
<td>49</td>
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<tr>
<td>L-Term Rev. Gr Rate Est:</td>
<td>7%</td>
</tr>
<tr>
<td>L-Term EPS Gr Rate Est:</td>
<td>8%</td>
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<tr>
<td>Debt/Cap:</td>
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<tr>
<td>ROE:</td>
<td>39.4%</td>
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<tr>
<td>FY Dec</td>
<td>2019A</td>
</tr>
<tr>
<td>Revenue (Mil)</td>
<td>6,074.4</td>
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<tr>
<td>% Growth</td>
<td>4.7%</td>
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<tr>
<td>Operating Margin</td>
<td>10.2%</td>
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<tr>
<td>Gross Margin</td>
<td>41.8%</td>
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<tr>
<td>Temp Gross Mgn</td>
<td>38.2%</td>
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<tr>
<td>FY P/E</td>
<td>12.4x</td>
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</table>

Company Description
Robert Half, headquartered in Menlo Park, CA, is the world's largest specialized staffing service, and the ninth-largest staffing company in the world by revenue. RHI operates six divisions:
- Accountemps (32% of revenue) – temporary placement of finance & accounting professionals;
- OfficeTeam (17%) – high-end office and administrative personnel;
- RH Technology (12%) – IT professionals on a contract or project basis;
- RHI Management Resources (12%) – high-end finance and accounting personnel;
- Robert Half Finance and Accounting (9%) – permanent placement of finance & accounting professionals;
- Protiviti (18%) – risk consulting and independent internal audit services.

RHI operates roughly 400 branches in 27 countries, has approx. 17,000 FTEs (including ~5,500 Protiviti employees).

Revenue Profile

Source: Company Reports, Baird Estimates

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May 22, 2020

Competition
- Staffing – Adecco (Ajilon, Accounting Principals, Badenoch & Clark, Special Counsel, MPS), Allegis (Aerotek), HAYS Plc, Kelly Services (Kelly Financial Resources), Kforce, ManpowerGroup, PageGroup, Randstad, and Resources Connection.
- Protiviti and RH Management Resources – compete with the Big Four and regional accounting and consulting firms, and Resources Connection (including Resources Audit Solutions).

Quick Summary
Well-positioned, well-run firm with an attractive mix of business within professional services -- a history of creating value for shareholders. RHI’s portfolio of services should support sustainable growth over the long term given several key offerings with sizable opportunities. Historically, RHI has been known for its sizable presence in the Finance and Accounting vertical for small and mid-size companies which represents ~50% of revenue. Less appreciated by investors are its exposure to the rapidly growing IT vertical and its consulting practice (Protiviti) as a lower cost, more flexible alternative to the Big 4. Both offerings have TAMs 3-4x the size of Finance and Accounting with faster growth rates and plenty of runway for future growth.

Prior to the pandemic, RHI was experiencing strong growth in its Protiviti unit and single digit revenue growth in core staffing as the tight labor market only recently translated to bill rate growth in excess of 4% with hours/volume constrained by supply. In prior cycles, bill rates exceeded 5% for several years, but the Covid-19 impact will serve as a headwind in the near term as wage deflation is a result of unprecedented layoffs. However, tech investments are beginning to drive better productivity and Protiviti + Staffing go-to-market approach is gaining traction, which strengthens RHI’s position coming out of the downturn.

Lastly, we note management continues to allocate capital for the benefit of shareholders returning the majority of FCF in the form of dividends and buybacks (92% in 2019) and a strong balance sheet (40.2% ROE on an unlevered balance sheet) supports additional capital returns in the future under normal market conditions. RHI will preserve cash due to the uncertainty of the pandemic, however RHI has the highest margins in the industry with a gross margin of 41.8% in 2019. Margins will be depressed in 2020 due to mix and deleveraging but are still projected to remain solid (in the 5-6% range). RHI’s strong balance sheet and natural FCF generation during periods of contraction will enable RHI to maintain its dividend during the pandemic. We expect revenue growth and margins to rebound nicely once the economy recovers from the pandemic.

Investment Thesis
Well positioned to serve under-penetrated small and medium-sized businesses. RHI is currently well positioned to sell to small and medium-sized businesses, which are generally at earlier stages of adopting temporary professional staffing, are becoming increasingly focused on internal controls, has been the area where employment growth has been concentrated, and are generally less price-sensitive than large companies that have greater purchasing power.

Protiviti presents significant long-term growth opportunity. Protiviti represents <1% of its roughly $150bn TAM, providing significant runway for long-term growth. Go-to-market approach with staffing (RH Management and RH Technology) presents a lower cost alternative to the Big 4 and regional accounting/consulting firms and is seeing good traction in the market and is still in the very early innings of adoption.

Strong brand name, favorable demographic trends. We consider Robert Half the pioneer and leader in the specialized staffing space. The company has successfully leveraged its powerful brand equity in the finance and accounting marketplace to broaden its specialized staffing services, establishing a proven formula for success. The slowing growth of the U.S. labor force should provide substantial growth opportunities for RHI for many years.

Significant international opportunity. Robert Half has been expanding its international branch network (including Protiviti branches) and currently has roughly 100 offices in 26 countries outside of the U.S. which account for ~24% of the company’s staffing revenue. We believe that the company is capable of strong revenue growth during expansionary economic environments over the intermediate term as it further expands its branch network and existing branches mature.

Significant opportunity in IT. Historically, Robert Half has been primarily associated with the finance and accounting temp and perm placement markets. The finance and accounting specialties currently account for roughly 53% of revenue, while only 12% is derived from the IT market. We believe that over the long term, RHI has a tremendous opportunity to expand its IT business. The specialty is roughly three times as large as finance and accounting, and currently has a higher growth rate. In addition, most national competitors in the space are more focused on servicing larger enterprises, while RHI is more focused on small and medium-sized client companies.

Experienced, high-quality management team. We believe the internal health of the organization remains strong with a solid balance sheet and a very high quality management team. Management is the most disciplined and effective capital allocator in the industry.

Risks & Caveats

COVID-19 impacts on global macroeconomic environment. Mandatory lock downs are dealing an unprecedented shock to the overall economy. The effectiveness of stimulus and timeline of the virus will determine the severity and longevity of the downturn. We believe RHI is well positioned given their strong net cash position, high margins, flexible compensation structure, tenured management, and strong FCF generation during contraction periods.

Economic sensitivity. Staffing usage is generally reduced during periods of slower economic growth or economic contraction, making a portion of the company's revenue particularly responsive to changes in the general economy. There are some fears that current Covid-19 pandemic could have a greater adverse impact on RHI's core smb market, though some believe recent legislation may better insulate small companies during this recession.

Legislation. Legislative changes such as health care legislation, overtime rules, and SUTA increases can pressure demand for RHI's services and its gross margin.

FX exposure. Roughly 24% of RHI's revenue is generated internationally, with material exposure to the Euro, British pound, Canadian dollar, Australian dollar, and various other currencies.

Disintermediating technologies. There is the potential for a portion of RHI's addressable market (and/or value add) to be disintermediated by newer solutions like LinkedIn (which makes it easier for companies to access talent without the need of an agency) or online staffing models (such as Upwork). In addition, lower end finance and accounting positions can be disintermediated by automation. RPA has been cited as a growing risk factor by many, though not visible at current time in RHI's small to medium sized client base.

Supply of internal staff. Robert Half's growth depends largely on its ability to constantly attract, develop, and retain account managers with sufficient depth and experience to capitalize on the growth opportunities facing the company. An inability to do so could have an adverse effect on the company's operating or financial results. The candidate market is particularly scarce for accountants with 3-7 years of Big 4 experience.

Supplemental Information

$49 price target reflects EV/EBITDA of 9.6x normalized EBITDA using an average EBITDA from '14-19 then discounted 10%. An EV/EBITDA of 9.6x is equal to the 10-year average for EV/FY2 EBITDA. We believe RHI's consistently high returns on capital and clean balance sheet deserve a premium valuation.

Revenue Model

- Temporary Staffing – services are billed by the hour for the number of hours worked. Bill rates are often determined as a mark-up over pay.
- Perm Placement – billing is based on a percentage of first-year compensation (typically 20-33%) for the candidate placed.
- Protiviti – provided on either a time-and-material or fixed-fee basis, and recognized proportionally as hours are incurred relative to the estimated engagement length.

Management Compensation Structure

- Compensation has three main components: base salary, annual cash bonus and annual performance share awards.
- Annual cash bonus subject to two performance criteria: Net Income (80% weighting) and Revenue (20% weighting).
- Annual performance share awards cliff vest after a three-years and are subject to two performance criteria: three-year ROIC and three-year TSR relative to industry GICS.

Management Experience

- Max Messmer joined the company in 1985 and has served as Chairman since 1988.
- Keith Waddell joined the company in 1986 and has served as CFO since 1988, Vice Chairman since 1999, President since 2004, and CEO since 2019.
- Paul Gentzkow joined the company in 1986 and has served as President and COO of Staffing Services since 2004 and CEO of Staffing Services since 2019.
- Robert Glass joined the company in 1987 and has served as the head of Corporate Development since 1993 with a promotion to EVP of Corporate Development in 2004.
- Michael Buckley joined the company in 1995 and has served as CFO since 2019.
Appendix - Important Disclosures and Analyst Certification

Approved on 22 May 2020 15:15EDT/ Published on 22 May 2020 15:20EDT.

Rating and Price Target History for: Robert Half International (RHI) as of 05-21-2020

1 Robert W. Baird & Co. Incorporated makes a market in the securities of RHI.

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