Kellan Group plc

Half year interim report 2010

Kellan Group is a market leading recruitment business operating across a wide range of functional disciplines and industry sectors. The Group's stated strategy is to grow into a significant business in the UK market, achieved both by acquisition and organic growth.

Kellan Group currently comprises **17** UK offices,
7 businesses and **3** brands.

Offices in:

- Altrincham
- Birmingham
- Bristol
- Chester
- Elland
- Glasgow
- Guildford
- Leeds
- Liverpool
- London (2)
- Manchester (2)
- Milton Keynes
- Preston
- Sheffield
- Warrington

Highlights

Financial summary

- Sequential improvement in both Revenue and NFI of 3% from H2-2009
- Revenue of £14.4m to 30 June 2010 (June 2009: £15.2m) and a loss for the period of £0.7m (June 2009: loss £3.2m)
- Administrative expenses excluding amortisation, onerous leases and restructuring costs of £6.4m, 21.9% below H1-09 and 2.8% down on H2-09
- Adjusted EBITA Loss of £0.2m (June 2009: Loss £1.6m) with the second quarter 2010 seeing business break even
- Basic Loss per Share of 0.8p (June 2009: Loss 3.7p)
- Cash out flow from operating activities £0.2m showing sequential improvement quarter on quarter (June 2009 £1.0m)

Operational highlights

- Seeing early stages of the recovery in key markets
- Berkeley Scott our speciality hospitality business seeing strong recovery in chef and temporary markets
- RK Accountancy permanent placement business recovering more rapidly than the temporary placement business. Introduced new line of business focusing on qualified finance staff in 3 locations.
- Quantica Technology executing plan of organic growth opening a business in London
- Fee earner levels increasing with total staff numbers increasing from 180 to 188 year on year
- Continued focus on consolidation and cost base rationalisation with like for like costs decreasing sequentially despite investment in additional staff
- New CFO appointed at the beginning of June

Chief Executive Officer's statement

Summary

Following a tough trading climate in 2009, improving macro economic signs as we entered 2010 together with feedback from our clients indicate we are at the early stages of a recovery in the recruitment cycle. However the majority of our clients continue to be cautious in terms of staff investments making it difficult to predict how this recovery will impact the traditional cycles of temporary and permanent recruitment. As a result forward visibility remains low and demand unpredictable.

We continue to focus on the core principles of our strategy, investing in key brands and selected specialisms where we act as a trusted advisor to our clients and candidates thereby enabling us to clearly differentiate from our competitors by the service we offer. Our investment in experienced consultants passionate to execute this strategy continues with staff numbers increasing to 188 and further investments identified as we enter the second half of the year.

We have great opportunities to increase market share in existing geographies as well as leverage our office infrastructure to develop existing specialisms in new geographies. With 28% of Net Fee Income ("NFI"; being revenue less the cost of wages and fees paid to temporary workers and contractors) derived from offices in London & South East we are looking to expand our focus in this area. In line with this strategy Quantica IT opened a business in our existing London office during the first half of 2010 focusing on the Banking and Finance markets and RK Search and Selection opened a business focusing on procurement and logistics.

With permanent fee income representing 68% of group NFI we are looking to grow our temporary and contract lines of business at a faster pace than our permanent business so we can move the balance towards 50/50. We believe a more balanced income stream will better protect the group against the impact of economic cycles. With this in mind staff investment has been predominantly in temporary and contract fee earners.

Our overheads remain well controlled with a focus on working with suppliers to maximise value for money from all expenditure. As is inevitable with the group reducing headcount from over 300 in the first half of 2009 to below 180 in late 2009 we continue to carry office space in excess of requirements. Where it is unlikely this space will be filled in the near term we continue to look to exit from those properties in the most cost effective manner.

In June I was delighted to team up again with John Melbourne who joined the Group as CFO. John is one of the most talented finance executives working within the recruitment industry and in joining Kellan Group, John has shown just how highly regarded the business is and the strength of our strategy. His track record in acquisitions and expanding companies is exemplary, and I am confident that he will be an invaluable addition to the team.

As the outlook across our key markets improves we continue to invest in our people and strengthen our management team so the business is best positioned to capitalise on the opportunities increasingly present in our markets.

Financial Highlights

The Group's revenue for the six months to 30 June 2010 was £14.4m representing a decrease of 5.2% on June 2009 (£15.2m) but an improvement of 3.0% on the six months to December 2009 (£14.0m). This produced NFI of £6.2m for the six months to 30 June 2010 a decline of 7.1% on June 2009 (£6.6m) but an improvement of 2.8% on the six months to December 2009 (£6.0m).

Administrative expenses have reduced from £9.7m for the six months to 30 June 2009 to £6.7m in this half year, a reduction of 31.2%. Adjusting the cost base for exceptional items relating to onerous leases and restructuring costs together with amortisation of goodwill like for like costs have reduced by 21.9% year on year and 2.8% sequentially to £6.4m. Continued cost reductions have been achieved in the first half of this year despite the increase in consultant headcount.

Sequential growth in NFI combined with continued cost control translated to a significantly reduced loss for the six months of £0.7m (June 2009 £3.2m) with the group nearing a break even position at EBITDA level in the period.

Net cash outflow for the 6 months to 30 June 2010 was £0.5m (£0.8m, 6 months 30 June 2009). With costs reduced and trading increasing the operational cash flow has improved significantly on the six months to 30 June 2009 from an outflow of £1.0m to an outflow of £0.2m. The repayment schedules for loans and servicing of debt have been maintained throughout the period and in February 2010 the group raised £1.0m before expenses via the issue of a convertible loan note with the funds being used to strengthen the groups balance sheet.

Chief Executive Officer's statement

Despite the improvement in trading, in light of our current working capital position it is expected that further funding will be required to meet the Group's working capital requirements over the next six months.

The plan for the remainder of 2010 is to focus the majority of our efforts on organic growth; especially in the execution of the H2 business plans as we continue to invest in our people to ensure that we are best positioned to capitalise on market opportunities.

I would like to thank our management and staff as well as business associates and investors for their continued confidence in our Group and for helping us to move forward ahead of expectations, particularly during such a difficult time. We will continue to move forwards and grow the business whilst achieving new successes.

Ross Eades
Chief Executive Officer

Consolidated Statement of Comprehensive Income

for the 6 months ended 30 June 2010

	Note	**Unaudited 6 months ended 30 June 2010 £000**	Unaudited 6 months ended 30 June 2009 £000	Audited 12 months ended 31 December 2009 £000
Revenue		**14,440**	15,226	29,249
Cost of sales		**(8,266)**	(8,579)	(16,599)
Net Fee Income		**6,174**	6,647	12,650
Administrative expenses		**(6,700)**	(9,744)	(17,094)
Operating loss	3	**(526)**	(3,097)	(4,444)
Financial income		**16**	10	44
Financial expenses		**(219)**	(159)	(359)
Loss before tax		**(729)**	(3,246)	(4,759)
Tax credit	2	**62**	62	336
Loss for the period		**(667)**	(3,184)	(4,423)
Attributable to:				
Equity holders of the parent		**(667)**	(3,184)	(4,423)
Basic loss per share in pence	4	**(0.8)**	(3.7)	(5.1)
Diluted loss per share in pence	4	**(0.8)**	(3.7)	(5.1)

The above results relate to continuing operations.

There are no adjustments between the loss for the period and the total comprehensive expense for the period or the comparative periods.

Consolidated Statement of Financial Position

at 30 June 2010

	Note	**Unaudited 30 June 2010 £000**	Unaudited 30 June 2009 £000	Audited 31 December 2009 £000
Non-current assets				
Property, plant and equipment		**688**	1,057	803
Intangible assets	7	**22,981**	23,423	23,202
		23,669	24,480	24,005
Current assets				
Trade and other receivables	5	**5,425**	5,024	5,232
Cash and cash equivalents		**191**	570	641
		5,616	5,594	5,873
Total assets		**29,285**	30,074	29,878
Current liabilities				
Loans and borrowings		**3,896**	3,820	4,871
Trade and other payables	6	**3,599**	2,997	3,237
Corporation tax payable		—	207	—
Other financial liabilities		**87**	124	102
Provisions		**491**	511	368
		8,073	7,659	8,578
Non-current liabilities				
Loans and borrowings		**934**	—	—
Provisions		**279**	462	625
Deferred tax liabilities		**925**	1,048	986
		2,138	1,510	1,611
Total liabilities		**10,211**	9,169	10,189
Net assets		**19,074**	20,905	19,689
Equity attributable to equity holders of the parent				
Share capital		**1,742**	1,742	1,742
Share premium		**13,728**	13,728	13,728
Merger reserve		**16,081**	16,081	16,081
Warrant reserve		**35**	—	—
Convertible option reserve		**17**	—	—
Capital redemption reserve		**2**	2	2
Retained earnings		**(12,531)**	(10,648)	(11,864)
Total equity		**19,074**	20,905	19,689

Consolidated Statement of changes in equity

for the 6 months ended 30 June 2010

	Unaudited Share capital £000	Unaudited Share premium £000	Unaudited Merger reserve £000	Unaudited Warrant reserve £000	Unaudited Convertible reserve £000	Unaudited Redemption reserve £000	Unaudited Retained earnings £000	Unaudited Total equity £000
Balance at 1 January 2009	**1,742**	**13,728**	**16,081**	—	—	**2**	**(7,374)**	**24,179**
Loss for the period	—	—	—	—	—	—	(3,184)	(3,184)
Total comprehensive income for the 6 month period ended 30 June 2009	—	—	—	—	—	—	(3,184)	(3,184)
Share-based payment adjustment	—	—	—	—	—	—	(90)	(90)
Balance at 30 June 2009	**1,742**	**13,728**	**16,081**	—	—	**2**	**(10,648)**	**20,905**
Loss for the period	—	—	—	—	—	—	(1,239)	(1,239)
Total comprehensive income for the 6 month period ended 31 December 2009	—	—	—	—	—	—	(1,239)	(1,239)
Share-based payment adjustment	—	—	—	—	—	—	23	23
Balance at 31 December 2009	**1,742**	**13,728**	**16,081**	—	—	**2**	**(11,864)**	**19,689**
Loss for the period	—	—	—	—	—	—	(667)	(667)
Total comprehensive income for the 6 month period ended 30 June 2010	—	—	—	—	—	—	(667)	(667)
Warrant valuation adjustment	—	—	—	35	—	—	—	35
Convertible option adjustment	—	—	—	—	17	—	—	17
Balance at 30 June 2010	**1,742**	**13,728**	**16,081**	**35**	**17**	**2**	**(12,531)**	**19,074**

Consolidated Statement of Cash Flows

for the 6 months ended 30 June 2010

	Note	**Unaudited 6 months ended 30 June 2010 £000**	Unaudited 6 months ended 30 June 2009 £000	Audited 12 months ended 31 December 2009 £000
Cash flows from operating activities				
Loss for the period		**(667)**	(3,184)	(4,423)
Adjustments for:				
Depreciation, amortisation and impairment		**393**	455	886
Financial income		**(1)**	(10)	(10)
Financial expense		**162**	134	286
Amortisation of loan cost		**41**	36	73
Net profit on measurement of interest rate swap to fair value		**(15)**	(11)	(34)
Loss on sale of property, plant and equipment		**—**	18	95
Equity settled convertible loan interest		**17**	—	—
Equity settled share-based payment		**—**	(90)	(67)
Taxation		**(62)**	(62)	(336)
		(132)	(2,714)	(3,530)
(Decrease) / increase in trade and other receivables		**(194)**	2,072	1,865
Decrease / (increase) in trade and other payables		**362**	(989)	(749)
(Decrease)/increase in provisions		**(222)**	588	608
		(186)	(1,043)	(1,806)
Tax receivable		—	—	5
Net cash outflow from operating activities		**(186)**	(1,043)	(1,801)
Cash flows from investing activities				
Interest received		**1**	10	10
Acquisition of property, plant and equipment		**(58)**	(339)	(372)
Net cash outflow from investing activities		**(57)**	(329)	(362)
Cash flows from financing activities				
Drawdown/(repayment) of invoice discounting balances		**(591)**	1,117	2,551
Interest paid and loan costs		**(162)**	(134)	(286)
Repayment of borrowings		**(420)**	(420)	(840)
Net proceeds of Convertible Loan notes	**8**	**966**	—	—
Net cash inflow/(outflow) from financing activities		**(207)**	563	1,425
Net decrease in cash and cash equivalents		**(450)**	(809)	(738)
Cash and cash equivalents at the beginning of the period		**641**	1,379	1,379
Cash and cash equivalents at the end of the period		**191**	570	641

Notes

(forming part of the financial statements)

1 Accounting policies

Accounting periods

The accounting reference date of the Group is 31 December. The current half year interim results are for the six months ended 30 June 2010. The comparative half year interim results are for the six months ended 30 June 2009. The comparative period end's results are for the twelve months ended 31 December 2009.

Financial information

The financial information for the six months ended 30 June 2010 and the six months ended 30 June 2009 are unaudited and unreviewed and do not constitute the Group's statutory financial statements for those periods. The comparative financial information for the full year ended 31 December 2009 has, however, been derived from the audited statutory financial statements for that period. A copy of those statutory accounts for that period has been delivered to the Registrar of Companies. The auditors report on those accounts was not qualified and did not contain statements under Chapter 3 of Part 16 of the Companies Act 2006, but did include an emphasis of matter paragraph as a result of the Group being in breach of the financial covenants contained in its borrowing agreement with its lender and the expectation that further funding would be required. These conditions indicated the existence of material uncertainties which may have cast doubt about the Group's ability to continue as a going concern.

Basis of preparation

The half year interim financial statements have been prepared on a going concern basis using the recognition and measurement principles of IFRS as endorsed for use in the European Union.

The accounting policies used in the preparation of these condensed financial statements are set out in the statutory financial statements for the period ended 31 December 2009 which are also the policies that are expected to be applicable at 31 December 2010.

The accounts for the 12 month period ended 31 December 2009 highlighted that due to the continuing downturn in the UK recruitment market, the Group breached some of the financial covenants contained in its borrowing agreement with its lender during the first half of 2009. Covenants on these borrowings, which comprise a term loan taken out to acquire Quantica Plc in September 2007 and an invoice discounting facility used for working capital, are tested quarterly using the 12 month period to the date of the respective test. Whilst some of the covenants remain breached during the current period, the facilities themselves have not been breached.

The Group's lender continues to be supportive. Positive discussions around future banking terms and the Group's existing and projected working capital requirements are ongoing. However, if the Group is unable to agree amended terms the lender could request early repayment of all outstanding borrowing.

At an EGM of the Company on 18 January 2010 resolutions to remove authorised share capital restrictions as well as grant the Directors authority to allot new shares and to disapply statutory pre-emption rights (in respect of such an allotment) were passed. Consequent to the resolutions above, on 5 February 2010, the Group raised £1million before expenses of £34,000, via the issue of a convertible loan note, with warrants attached, to eight existing shareholders. The funds were used to strengthen the Group's balance sheet and to enable it to continue to meet repayment obligations on the Group's outstanding long term debt whilst also maintaining sufficient working capital for day to day requirements. However it is expected that further funding will be required to meet the Group's working capital requirements in the foreseeable future. The Directors are confident that sufficient additional funding will be obtained as and when required although this cannot be guaranteed.

Having assessed the position of the bank and the ability to obtain additional funding, the Directors consider that there is a reasonable expectation that the Group will be able to meet its liabilities as they fall due for the foreseeable future. It is on this basis that the Directors consider it appropriate to prepare the Group's financial statements on a going concern basis.

However for the reasons described above, the Directors recognise that there are material uncertainties that may cast significant doubt about the Group's ability to continue as a going concern, and therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business. These material uncertainties comprise the ongoing availability of the existing facilities given the covenant breaches and the ability to obtain additional funding from alternative sources. The financial statements do not include the adjustments that would result if the Group was unable to continue as a going concern.

Notes

(forming part of the financial statements)

2 Taxation

Recognised in the income statement

	Unaudited 6 month period ended 30 June 2010 £000	Unaudited 6 month period ended 30 June 2009 £000	Audited 12 month period ended 31 December 2009 £000
Current tax expense			
Current period			
Adjustment for prior periods	**—**	—	(212)
Deferred tax expense			
Origination and reversal of temporary differences	**(62)**	(62)	(124)
Tax credit	**(62)**	(62)	(336)

3 Reconciliation of operating loss to adjusted EBITA and adjusted EBITDA

	Unaudited 6 month period ended 30 June 2010 £000	Unaudited 6 month period ended 30 June 2009 £000	Audited 12 month period ended 31 December 2009 £000
Operating loss as per accounts	**(526)**	(3,097)	(4,444)
Add back			
Amortisation of intangible assets	**221**	221	442
Share-based payments release	—	(90)	(67)
Onerous leases	**(114)**	726	945
Restructuring costs	**188**	594	913
Adjusted EBITA	**(231)**	(1,646)	(2,211)
Depreciation of assets	**172**	234	444
Adjusted EBITDA	**(59)**	(1,412)	(1,767)

4 Earnings per share

Basic earnings per share

The calculation of basic earnings per share is as follows:

Weighted average number of shares	**Unaudited June 2010**	Unaudited June 2009	Audited December 2009
Issued ordinary shares brought forward	**87,086,336**	87,086,336	87,086,336
Weighted average number of shares at end of period	**87,086,336**	87,086,336	87,086,336
Dilutive effect of potential shares	**—**	—	—
Diluted weighted average number of shares at end of period	**87,086,336**	87,086,336	87,086,336
Loss for the period	**(667,000)**	(3,184,000)	(4,423,000)
Basic loss per share in pence	**(0.8)**	(3.7)	(5.1)
Diluted loss per share in pence	**(0.8)**	(3.7)	(5.1)

Notes

(forming part of the financial statements)

5 Trade and other receivables

	Unaudited 30 June 2010 £000	Unaudited 30 June 2009 £000	Audited 31 December 2009 £000
Trade receivables	**3,753**	3,635	3,879
Other receivables	**18**	168	175
Prepayments and accrued income	**1,654**	1,221	1,178
	5,425	5,024	5,232

6 Trade and other payables

	Unaudited 30 June 2010 £000	Unaudited 30 June 2009 £000	Audited 31 December 2009 £000
Trade payables	**476**	410	386
Social security and other taxes	**867**	673	823
Other creditors	**917**	435	374
Accruals and deferred income	**1,339**	1,479	1,654
	3,599	2,997	3,237

7 Intangible Assets

The intangible assets balance at the period ended 30 June 2010 of £22,981,000 includes an amount of £19,668,000 relating to goodwill acquired through business combinations. Impairment of this balance has been assessed as at 30 June 2010 and no adjustment was considered necessary. The Directors believe the assumptions used in testing impairment at 31 December 2009 are still valid and have not materially changed. These assumptions will continue to be reassessed on a six monthly basis.

8 Convertible Loan Notes

On 5 February 2010, the Group raised £1million before expenses of £34,000, via the issue of a convertible loan note, with warrants attached, to eight existing shareholders. The funds were used to strengthen the Group's balance sheet and to enable it to continue to meet repayment obligations on the Group's outstanding long term debt whilst also maintaining sufficient working capital for day to day requirements. However it is expected that further funding will be required to meet the Group's working capital requirements in the foreseeable future.

Advisers, financial calendar and shareholder information

Directors

J Bowmer – Co-Chairman

A Reeves – Co-Chairman

R Eades – Chief Executive Officer

W Coker– Chief Financial Officer (resigned 04/06/10)

J Melbourne – Chief Financial Officer (appointed 07/06/10)

M Jackson – Non-executive Director

J McHugh– Non-executive Director

Advisers

Broker/Nomad

Strand Hanson Ltd
26 Mount Row
London W1K 3SQ

Bank

Barclays Bank plc

1 Churchill Place
London E14 5HP

Auditors

BDO LLP

Emerald House
East Street
Epsom KT17 1HS

Solicitor/Company Secretary

Irwin Mitchell/IMCO Secretary Ltd

2 Wellington Place
Leeds LS1 4BZ

Registrar

Capita Registrars

Northern House
Woodsome Park
Fenay Bridge
Huddersfield HD8 0LA

Registered office

4th Floor
27 Mortimer Street
London W1T 3BL

Registered number

2228050

Shareholder information

London Stock Exchange

The ordinary shares of the Company are traded on the Alternative Investment Market of the London Stock Exchange with the code KLN.L.

Website

The Group operate a website which can be found at www.kellangroup.co.uk.

This site is regularly updated to provide information about the Group. In particular, all of the Group's press releases and announcements can be found on this site.

Financial calendar

Announcement of interim results	30 September 2010
Financial year end	31 December 2010
Announcement of final results	March 2011
Annual report posted to shareholders	April 2011
Annual General Meeting	May 2011

Advisers, financial calendar and shareholder information