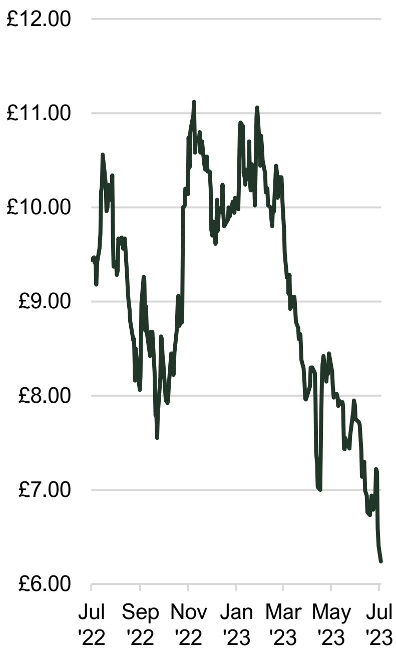
Next 15 Group PLC

NFG | AIM | Media | 624p | £609m

AGM trading update – Profit outlook in-line

1 Year Chart



12th July 2023

Iain Daly

id@radnorcp.com
+44 (0) 203 897 1832

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MiFID II – this research is deemed to be a minor, non-monetary benefit.

The AGM trading update has underscored the breadth and resilience of Next 15's portfolio. Three of Next 15's four core segments are continuing to deliver healthy organic revenue growth although the more mature Customer Engagement segment has dipped into negative territory. Overall, Next 15 is still expecting to deliver mid to high single digit revenue growth and improved margins in FY24. Not that an investor could tell that from the share price graph.

If the share price is to be believed, and a 10 year low valuation justified, then either the market is discounting a very severe earnings shock (for which there is no discernible evidence), or it is choosing to ignore entire segments.

With enough balance sheet strength to entertain a return of cash to shareholders (the first mention of this by Next 15 that this analyst can recall), Next 15 offers significant optionality at the current valuation. We find it extraordinary that Next 15 can see such value in their current share price that they would rather buy back shares than re-invest free cashflow when they have such a proven track record of delivering growth and value through M&A.

Next 15 trades at a 10 year valuation low and lagging a peer group that it has consistently outperformed for a number of years. Unwarranted in our view for a growth company with such a strong track record of delivery.

- **FY results ahead of expectations:** Reported revenue growth of +56% and organic revenue growth +21% had already been flagged in earlier updates. However, adjusted PBT of £112.5m has beaten our estimate by 2%. Net cash of £26.1m was also comfortably ahead of our expectations.
- **Outlook still suggests growth:** Against a challenging macro backdrop, Next 15 has confirmed that it expects to deliver mid to high single digit revenue growth and improved margins. Revenue pressures are apparent but are mostly focused in the group's lower margin Engage segment. We have pulled back our revenue estimates in response but have upped our margin expectations.
- **Historically attractive valuation:** We believe the Next 15 valuation, which now stands at a clear 10 year low, offers startling value for one of the better, most consistent growth stories in the UK Small Cap universe. We believe the current valuation is discounting a severe profit decline for which we can see no evidence. The minor estimate revisions we have made today (-3% revenue and -1% for EBITA) still show a company delivering high single digit revenue growth and improved margins against a tricky backdrop. A mid single digit PE feels more of statement about the market than the company.

Y/E January, £m	Sales	PBT adj	EPS (p)	Div (p)	Net Cash	PE x	Yield %
FY 2022A	362.1	79.3	59.7	12.0	35.7	10.4	1.9
FY 2023A	563.8	112.5	80.4	14.6	26.1	7.8	2.3
FY 2024E	*603.8*	*125.8*	*87.3*	*17.5*	*39.9*	*7.2*	*2.8*
FY 2025E	*652.1*	*138.3*	*97.2*	*19.4*	*56.1*	*6.4*	*3.1*
FY 2026E	*710.7*	*151.6*	*106.5*	*21.3*	*131.0*	*5.9*	*3.4*

Source: Radnor Capital Partners

AGM trading update – Key points

Below are the key headlines from the AGM trading update:

- Resilient performance across the first five months of the fiscal year (to 30th June)
  - → **Organic** revenue growth remains positive despite a very strong comparative H1 FY22 which itself delivered +31% organic revenue growth vs HY 21.
  - → Broken down by division; **Customer Insight**, **Customer Delivery** and **Business Transformation** have all continued to deliver organic growth. **Customer Engagement** has posted a small organic revenue decline, in part due to project timing deferrals and also partly due to client spending shifts away from the more traditional services within Engage to the more data-centric and outcome oriented Delivery and Insight businesses.
  - → Revenue performance in the first five months is consistent with 5% - 8% reported revenue growth for the full year.
- Even though NFG is guiding a to a marginally softer revenue outlook for the full year, the outlook for margins is better than had previously been anticipated.
  - → Despite inflationary pressures across the group (staff costs in particular), NFG have been able to drive margin expansion through a combination of broad cost discipline; further property cost savings and, perhaps most importantly, a better than originally expected cost outcome from the Engine acquisition.
  - → Although the motivation behind the Engine acquisition was driven primarily by the attractiveness and broader group fit of the three component parts, the ability to secure cost savings was clearly identified up front. Engine was running an over invested central cost platform and much of NFG's focus post acquisition has been on reducing and optimising this central layer to allow the subsidiary businesses to accelerate their growth and delivery.
  - → At the time of acquisition, the initial cost savings guidance for Engine was c.£3m - £4m and we believe this has been comfortably exceeded.
- NFG has always enjoyed a strong balance sheet and this remains the case, which provides the group with a range of flexibility around capital allocation. Another feature of NFG's approach to risk management is around the optionality to settle deferred consideration through equity or cash at NFG's discretion. The group has chosen to settle an extra £10m of deferred consideration in the current year in cash rather than issuing fresh equity at the current depressed share price level, protecting existing shareholders from unnecessary dilution.
- It is also notable that, for the first time, NFG has raised the possibility of returning surplus cash to shareholders. We believe this is a very direct reference to the current valuation of the group which remains at historically depressed levels despite the very material progress and growth the group has delivered over the last five years. We await to see further details on this if the share price remains near current levels.

Outlook Commentary and changes to Radnor estimates

At the headline level, we are marginally reducing our FY24E revenue estimates (by c.-3%) but leave our EBITA estimates broadly unchanged (down less than 1%) with an increased EBITA margin expectation to 21.2% for FY24E (compared to previous estimate of 20.8%.

Further down the P&L we have increased our net interest cost assumptions to reflect the higher interest rate environment with underlying net interest expense increasing from £1.8m to £2.5m. We are also factoring a small increase in the underlying effective tax rate to 26% (previous estimate 25%).

The net effect on EPS is a -3% reduction from our prior estimate to 87.3p.

On our revised estimates, we are still looking for:

- YoY revenue growth of **+7.1%**
- YoY EBITA growth of **+12.1%**
- YoY PBT growth of **+11.8%**
- YoY EPS growth of **+8.6%**

We take a slightly more cautious view on cash conversion with a more challenging revenue backdrop likely to drive a longer working capital cycle. We also include the £10m of cash settled deferred consideration. We look for a year end net cash position of £39.9m. Below, we provide further detail on our estimate revisions.

Figure 1: Radnor estimate revisions

		Previous		**New**		***Revision, %***	
£m	FY23A	2024E	2025E	**2024E**	**2025E**	**2024E**	**2025E**
Customer Engagement	275.0	283.2	297.4	275.0	288.7	- 3%	- 3%
Customer Delivery	102.1	117.4	132.1	113.3	127.5	- 3%	- 3%
Customer Insight	52.0	55.1	59.0	55.1	59.5	+ 0%	+ 1%
Business Transformation	134.8	164.4	180.9	160.4	176.4	- 2%	- 2%
Revenue	**563.8**	**620.1**	**669.4**	**603.8**	**652.1**	**- 3%**	**- 3%**
Customer Engagement	55.4	61.2	64.5	59.9	63.8	- 2%	- 1%
Customer Delivery	30.2	36.4	41.2	35.4	40.2	- 3%	- 3%
Customer Insight	11.0	11.8	13.0	11.8	12.8	+ 0%	- 2%
Business Transformation	43.9	47.7	50.6	48.1	50.3	+ 1%	- 1%
Central Overhead	-26.4	-27.9	-30.8	-27.2	-28.0	- 3%	- 9%
EBITA	**114.2**	**129.2**	**138.6**	**128.1**	**139.0**	**- 1%**	**+ 0%**
- margin %	20.2%	20.8%	20.7%	21.2%	21.3%		
Adj. PBT	**112.5**	**128.4**	**138.4**	**125.8**	**138.3**	**- 2%**	**- 0%**
Adj. EPS (p)	**80.4**	**90.3**	**97.2**	**87.3**	**97.2**	**- 3%**	**- 0%**
Dividend (p)	14.6	18.1	19.4	17.5	19.4	- 4%	+ 0%
Net Cash (Debt)	**26.1**	**62.1**	**87.4**	**39.9**	**56.1**		

Source: Radnor

Valuation Opportunity

In Figures 2 & 3 below we show the 2 year forward PE multiple for both Next 15 and the Agency peer group. We also show this in relative terms.

Figure 2: Next 15 FY2 PE

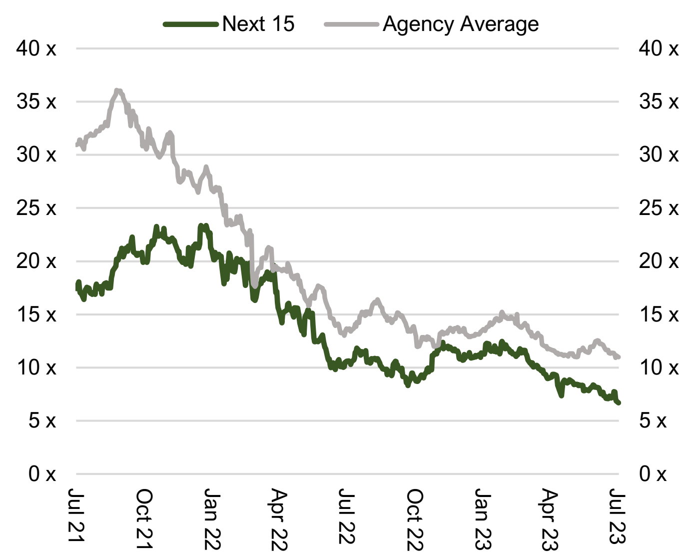
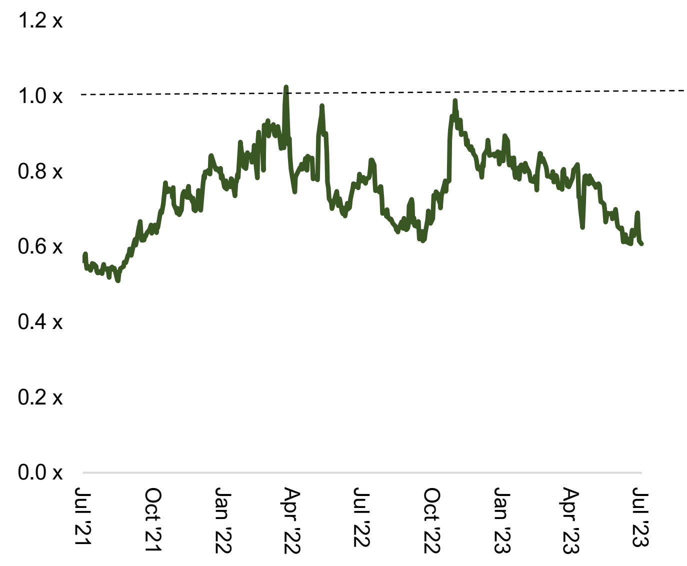


Figure 3: Next 15 FY2 PE relative to Peer Group

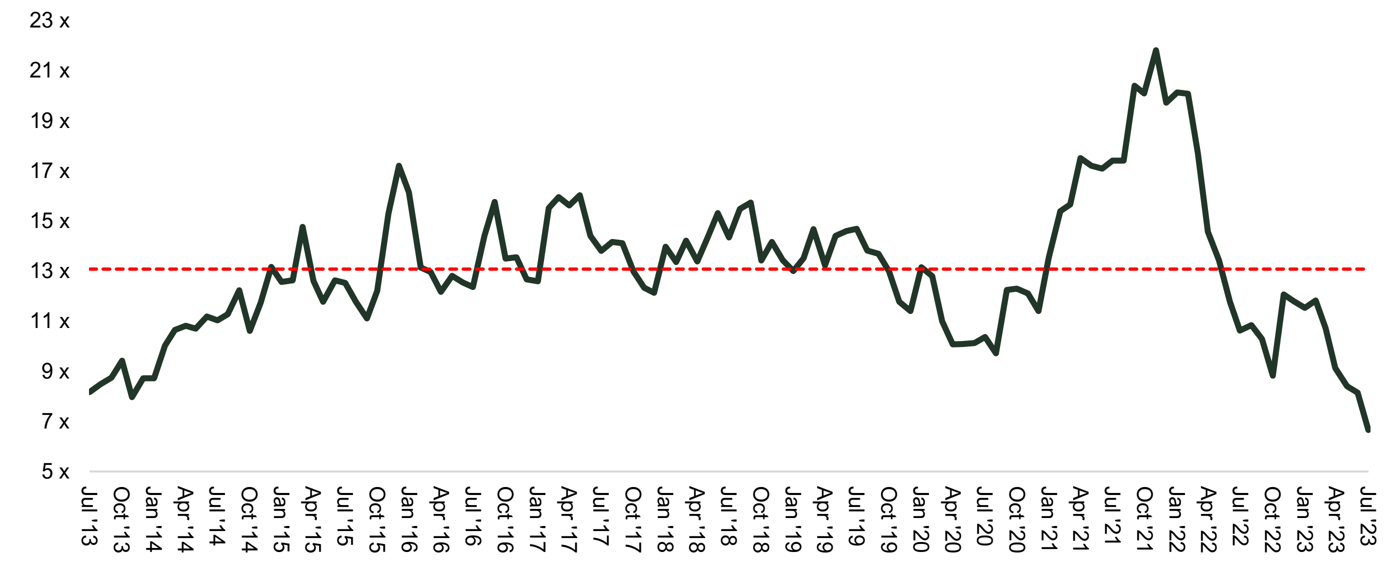


Source: FactSet, Radnor

Since the start of 2023, Next 15's share price has come under pressure (YTD -37% vs -3% for the FTSE All Share) despite the resilience of results and trading commentary. We have also seen Next 15's PE discount to the UK Agency peer group widen out to c.39%.

We have written extensively around Next 15's superior growth track record compared to the UK peer group and nothing in our fundamental assessment of Next 15's clear differentiation to its peers has changed. We continue to believe the market rating to be anomalous.

Figure 4: Next 15 FY2 **PE** over the last 10 years



Source: FactSet, Radnor

In Figure 4 above we show the 2 year prospective PE multiple for Next 15 over the last 10 years. We can see that the current level (disregarding the short-lived pandemic shock in March 2020) is now the lowest for 10 years.

Since FY14, Next 15's 2 year prospective PE has ranged typically between 11x and 17x. although peaked as high as 23x at the end of 2021. The average PE multiple through this 10 year period has been 13.1x.

The M&A distractions of 2023 are now comfortably in the rear view mirror. Even if one were to exclude the Mach 49 contract (which we estimate will contribute c.£15m of EBIT in FY24, or c.10p of EPS), this would still leave the shares trading on a sub 8x PE.

Next 15 Group PLC

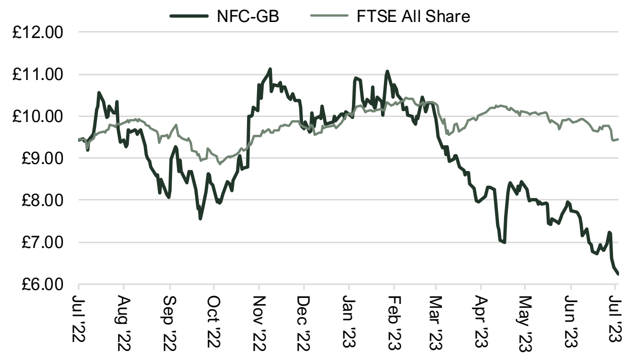
Iain Daly
+44 203 897 1832
id@radnorcp.com

Price (p): **624 p**
Market Cap: 609 m
EV: 583 m

PROFIT & LOSS

Year to 31 January, £m	FY21	FY22	FY23	FY24e	FY25e	FY26e
Customer Engagement	*166.5*	*187.6*	*275.0*	*275.0*	*288.7*	*308.9*
Customer Delivery	*49.6*	*80.0*	*102.1*	*113.3*	*127.5*	*143.4*
Customer Insight	*33.1*	*42.1*	*52.0*	*55.1*	*59.5*	*64.3*
Business Transformation	*17.7*	*52.5*	*134.8*	*160.4*	*176.4*	*194.1*
Group Net Revenue	**266.9**	**362.1**	**563.8**	**603.8**	**652.1**	**710.7**
Customer Engagement	*36.9*	*40.4*	*55.4*	*59.9*	*63.8*	*68.6*
Customer Delivery	*15.2*	*28.5*	*30.2*	*35.4*	*40.2*	*45.2*
Customer Insight	*4.9*	*9.0*	*11.0*	*11.8*	*12.8*	*13.8*
Business Transformation	*3.9*	*15.2*	*43.9*	*48.1*	*50.3*	*55.3*
Head Office	*(11.4)*	*(13.8)*	*(26.4)*	*(27.2)*	*(28.0)*	*(30.6)*
EBITA - Adjusted	**49.5**	**79.3**	**114.2**	**128.1**	**139.0**	**152.3**
Associates & JV's	0.4	0.2	-	-	-	-
Net Bank Interest	(0.8)	(0.3)	(1.6)	(2.3)	(0.7)	(0.7)
PBT - Adjusted	**49.1**	**79.3**	**112.5**	**125.8**	**138.3**	**151.6**
Non Operating Items	(37.2)	(40.4)	(48.3)	(30.0)	(30.0)	(30.0)
Other Financial Items	(13.2)	(119.0)	(54.1)	(10.0)	(10.0)	(10.0)
PBT - IFRS	**(1.3)**	**(80.1)**	**8.7**	**84.5**	**96.9**	**110.3**
Tax	(2.6)	14.5	(7.1)	(21.1)	(24.2)	(27.6)
Tax - Adjusted	(9.9)	(17.2)	(26.3)	(32.7)	(34.6)	(37.9)
Tax rate - Adjusted	*20.2%*	*21.6%*	*23.3%*	*26.0%*	*25.0%*	*25.0%*
Minority interests	1.0	3.6	1.4	2.2	2.4	2.7
No. shares m	89.4	92.4	97.6	97.6	97.6	97.6
No. shares m, diluted	93.8	98.1	105.7	104.2	104.2	104.2
IFRS EPS (p)	(5.5)	(74.9)	0.3	62.6	72.0	81.9
Adj EPS (p), diluted	**40.7**	**59.7**	**80.4**	**87.3**	**97.2**	**106.5**
Total DPS (p)	7.0	12.0	14.6	17.5	19.4	21.3

PRICE CHART - 1 YEAR ABSOLUTE vs FTSE ALL SHARE



Source: FactSet

SHAREHOLDERS

	% of ord. Share capital
Octopus Investments	12.0%
Liontrust Investment Partners	11.3%
Aviva Investors	10.5%
Slater Investments	6.6%
Directors	5.5%
BlackRock	5.4%
abrdn	5.0%
JPMorgan AM	3.7%
	60.0%

CASH FLOW

Year to 31 January, £m	FY21	FY22	FY23	FY24e	FY25e	FY26e
Net Profit: (add back)	(3.9)	(65.6)	3.0	63.4	72.7	82.7
Depreciation & Amortisation	*28.0*	*28.8*	*37.2*	*38.0*	*39.0*	*40.0*
Net Finance costs	*15.4*	*120.3*	*57.1*	*13.6*	*12.1*	*12.1*
Tax	*2.6*	*(14.5)*	*7.1*	*21.1*	*24.2*	*27.6*
Working Capital	6.6	0.2	(24.4)	(14.0)	(8.6)	(6.3)
Other	24.3	19.6	15.1	6.3	6.3	6.3
Cash from Ops	**72.9**	**88.8**	**95.2**	**128.4**	**145.7**	**162.3**
Cash Tax	(8.4)	(14.1)	(20.3)	(21.1)	(24.2)	(27.6)
Tangible Capex	(2.0)	(3.1)	(3.5)	(4.0)	(4.0)	(4.0)
Intangible Capex	(2.1)	(2.7)	(3.5)	(4.0)	(4.0)	(4.0)
Free Cashflow	**60.4**	**68.9**	**67.9**	**99.3**	**113.5**	**126.8**
Dividends	(0.7)	(12.4)	(15.3)	(17.8)	(21.0)	(23.0)
Acquisitions & Inv.	(23.6)	(24.0)	(104.9)	(57.2)	(67.3)	(20.0)
Financing	(37.7)	(1.1)	38.6	(10.5)	(9.0)	(9.0)
Net Cashflow	**(1.6)**	**31.4**	**(13.7)**	**13.9**	**16.2**	**74.9**
Net Cash (Debt)	14.0	35.7	26.1	39.9	56.1	131.0

Announcements

Date	Event
April 2023	Final results
January 2023	Trading update
September 2022	H1 results
May 2022	Recommend Offer for M&C Saatchi
March 2022	Engine acquisition & £50m placing
February 2022	Mach49 $400m contract win
September 2021	H1 results

RATIOS

	FY22	FY23	FY24e	FY25e	FY26e
RoE	95.3%	74.2%	52.1%	39.1%	33.3%
RoCE	37.1%	37.4%	40.7%	42.6%	52.9%
Asset Turnover (x)	0.7x	0.7x	0.6x	0.6x	0.5x
NWC % Revenue	14.3%	13.6%	11.9%	8.9%	10.9%
Op Cash % EBITA	111.9%	83.4%	100.2%	104.8%	106.6%
Net Debt / EBITDA	-	-	-	-	-

BALANCE SHEET

Year to 31 January, £m	FY21	FY22	FY23	FY24e	FY25e	FY26e
Intangibles	163.8	183.1	274.1	281.7	283.1	268.8
P,P+E	8.9	7.5	10.9	10.5	9.9	8.9
Tax Asset & Other	43.4	75.6	97.2	94.2	91.2	88.2
Total Fixed Assets	**216.1**	**266.2**	**382.1**	**386.4**	**384.1**	**365.8**
Net Working Capital	(48.6)	(51.6)	(76.8)	(71.8)	(58.2)	(77.8)
Capital Employed	**167.5**	**214.5**	**305.3**	**314.6**	**325.9**	**288.1**
Earn Out Liabilities	(64.6)	(188.8)	(217.0)	(180.0)	(122.8)	(85.8)
Net Funds	14.0	35.7	26.1	39.9	56.1	131.0
Net Assets	**116.9**	**61.5**	**114.4**	**174.5**	**259.2**	**333.2**

VALUATION

Fiscal	FY22	FY23	FY24e	FY25e	FY26e
P/E	10.4x	7.8x	7.2x	6.4x	5.9x
EV/EBITDA	7.3x	5.1x	4.6x	4.2x	3.8x
Div Yield	1.9%	2.3%	2.8%	3.1%	3.4%
FCF Yield	11.8%	11.6%	17.0%	19.5%	21.7%
EPS growth	46.6%	34.5%	8.6%	11.4%	9.6%
DPS growth	71.4%	21.7%	19.5%	11.4%	9.6%

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Radnor Capital Partners Ltd
1 King Street
London
EC2V 8AU

www.radnorcp.com

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