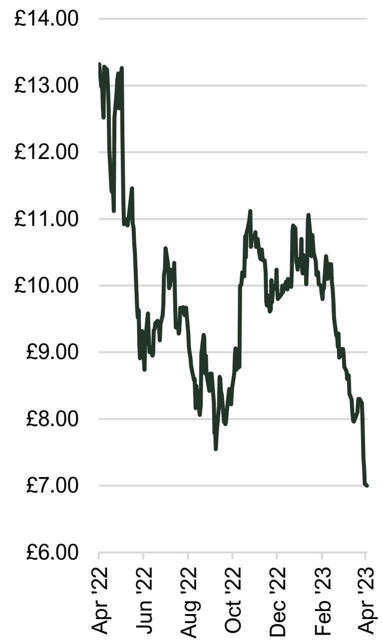
# Next 15 Group PLC

## NFG | AIM | Media | 700p | £683m

### FY results ahead of expectations – outlook maintained

1 Year Chart





25th April 2023

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*Next 15 Group PLC is a research client of Radnor Capital Partners Ltd.*

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

*Full year results to Jan 2023 are in-line with our revenue expectations but are +2% ahead for PBT. Net cash of £26.1m is also better than originally expected. Despite a clearly challenging macro backdrop; the robustness of the H2 performance and a solid start to FY24 leads us to leave our FY24E profit expectations largely unchanged, although we are marginally reducing our revenue estimate, primarily due to the likely lack of an FX tailwind.*

*Next 15's greatest strength is the sheer diversity of the business models contained within the group portfolio. FY23 is a good example of this diversity coming into play with the more traditional communications agencies within Engage seeing a softer H2 compared to a good outcome from the Delivery and Business Transformation segments. Unfortunately for a group that contains so many moving parts, this complexity can sometimes confound. The simple conclusion that Next 15 must be coming under pressure as client marketing budgets come under pressure is an easy one to make and these results will challenge this bear case.*

*This would seem to the key driver behind a weak share price that now sees Next 15 trading 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 unchanged:** Although it is still relatively early in the new financial year, the solidity of the first couple of months leads us to maintain our PBT estimate for FY24. We are ticking back our FY24 revenue estimate; primarily due to the lack of a dollar tailwind but also a degree of softness within Engage that is partially offset by strength in Delivery and Business Transformation.
- **Historically attractive valuation:** At the risk of sounding like a stuck record, Next 15's valuation is highly attractive from a historical perspective. The FY2 PE now stands at a 10 year low (excluding the pandemic) despite solid / positive outlook commentary and the best track record in the peer group. Bears may point to a lack of clarity around the Mach49 contract. We believe this is unfair but even if we were to exclude this contract, we believe the FY24 PE would still sit below 9x. For a growth company with such a strong and visible track record, this valuation feels anomalous in the extreme.

| Y/E January, £m | Sales | PBT adj | EPS (p) | Div (p) | Net Cash | Fiscal PER x | Yield % |
|---|---|---|---|---|---|---|---|
| FY 2022A | 362.1 | 79.3 | 59.7 | 12.0 | 35.7 | 11.7 | 1.7 |
| FY 2023A | 563.8 | 112.5 | 80.4 | 14.6 | 26.1 | 8.7 | 2.1 |
| *FY 2024E* | *620.1* | *129.2* | *90.3* | *18.1* | *51.4* | *7.8* | *2.6* |
| *FY 2025E* | *669.3* | *138.6* | *97.2* | *19.4* | *66.8* | *7.2* | *2.8* |
| *FY 2026E* | *725.5* | *152.0* | *106.6* | *21.3* | *141.8* | *6.6* | *3.0* |

*Source: Radnor Capital Partners*

## Final results – Year ended January 2023:

Below are the key headlines from the full year FY23 results:

- Net revenue +56% YoY to £563.8m. The company has provided a revenue bridge between FY22 and FY23
  - → **Organic** revenue growth +21% (+£75.1m). Unsurprisingly, the pace of organic growth has slowed from the 31% reported at the H1 results as the macro environment has slowed. Current client behaviour can best be characterised as cautious (booking late and with shorter lead times) and is mostly impacting one off project engagements rather than the typical retainer work that typifies much of Next 15's exposure.
  - → **Acquisitions** +25.8% (+£93.6m). Dominated by Engine in the current year, although a total of six acquisitions (mostly bolt ons to existing agency brands) have been made in the year.
  - → **FX** +9% (+£33.0m). The ave. $:£ rate in FY23 was $1.23, providing a healthy tailwind to the sterling reported numbers.
- Adjusted EBIT +44% YoY to £114.2m
- Adjusted EBIT margins -170 basis points to 20.2%
- Adjusted PBT +42% YoY to £112.5m – this is c.£2.3m (+2%) better than we had been expecting
- Statutory profit before tax of £10.1m after a number of adjusting items
  - → £33m charge driven by an increase in the estimated Mach49 earn out liability, which has now been capped at $300m
  - → £22.9m charge driven by the unwinding of the discount applied to future earn out payments
  - → £12.0m charge relating to employment linked acquisition payments
  - → £4.7m of property impairment charges
  - → £2.3m of restructuring costs (Engine related)
  - → £5.5m of deal costs (Engine and M&C Saatchi)
- Period end net cash £26.1m (FY22: net cash £35.7m), some £5m better than had been expected, driven by a combination of lower than anticipated acquisition related payments and a good H2 working capital outcome.

As had been guided at the H1 results, FY2023 was an unusual year for Next 15 with profitability more weighted than usual to H1. This was driven by the combination of a healthier market backdrop in H1 but also the initial impact of the Mach49 contract which saw early revenue recognised ahead of the planned cost investment to deliver. This Mach49 point alone represented a £10m profit swing between H1 and H2. All indications are that FY24 will present a more typical H2 weight.

Another feature of FY23 has been the growing impact of property cost savings across both the UK and North America. Whilst this has resulted in a number of property impairment charges as leases are terminated early, the longer run margin impact is a material benefit with a c.3% benefit as these savings flow through, providing a healthy margin buffer.

Below, we run through the key divisional headlines:

### Engage – 49% group revenue; organic revenue growth +9%

Headline revenue **+47%** to £275m (organic growth **+9%**). Segment EBITA margins declined 140 basis points to 29.6%.

Two of the Engine component agencies (MHP and Engine Creative) are reported within this segment with Engine Creative being rebranded as House337. Both these businesses had a good FY23.

Overall, Engage remains the largest and most mature of the segments within NFC. Against a backdrop of a worsening macro environment and the well covered challenges facing the North American technology industry, full year organic revenue growth of +9% (only down 1% from the H1 result) reflects a solid performance from the larger agencies (ie Archetype and Outcast) and a very strong performance from MBooth, MBooth Health and Brandwidth.

Two of the three Engine components (MHP and House337) are reported with Engage and have contributed well in their first year under Next 15. However, beyond the operating performance of the acquired businesses, there was a material cost saving opportunity through the elimination of central Engine costs and the opportunity to simplify and consolidate the UK property footprint for Next 15 (the majority of the group's UK businesses are now operating out of the Great Portland Street offices acquired as part of the Engine deal, creating the opportunity for savings elsewhere).

### Business Transformation – 24% group revenue; organic revenue growth +83%

Headline revenue **+156%** to £134.8m (organic growth **+83%**). Segment EBITA margins increased +350 basis points to 32.5%.

From a standing start three years ago, Business Transformation now sits as the second largest segment within the group. Of all the group segments, this is the area that is perhaps least well understood by investors. As opposed to being focused on how client companies engage with and sell to their customers; Business Transformation is more focused on the shape and value of client companies themselves.

This segment has itself been transformed by the acquisition in 2020 of Mach49, a US based growth incubator and corporate venturing consultancy. Not only has Mach49 grown its broad business significantly since being acquired, in March 2022 Mach49 announced the largest single contract win ($500m over five years) with an unnamed global client. H1 saw the first contribution from this contract win at an initially elevated margin which has subsequently normalised in H2 as the necessary cost investment has taken place, resulting in a £10m profit swing between the two halves.

Business Transformation is more than Mach49 and also includes the digital transformation business from Engine as well as private equity specialist, Palladium and the US capital markets focused Blueshirt Group. The Engine Transform business in particular has been a good performer from a margin perspective and has also bought a higher than group average exposure to public sector clients into the mix.

### Customer Delivery - 18% group revenue; organic revenue growth +12%

Headline revenue **+28%** to £102.1m (organic growth **+12%**). Segment EBITA margins decreased -600 basis points to 29.6%.

This segment is focused on using data and analytics to directly impact customer purchasing activity and generate direct new customer leads. Even though all the Next 15 segments performed materially better through the pandemic than had been originally expected, Customer Delivery was the stand-out performer with the Activate business in particular leading the way.

The more recent acquisition, Shopper Media Group, has performed well, winning Morrisons hard on the heels of Boots. The full margin impact of this client win (with a risk based contingent structure) will not be fully apparent until later in the year. Overall, The margin decline was driven by a combination of revenue mix (Activate had a particularly strong FY22) and also cost investment in the account based marketing agency, Agent3, which did not match revenue growth.

### Customer Insight - 9% group revenue; organic revenue growth +10%

Headline revenue **+23%** to £42.1m (organic growth **+10%**). Segment EBITA margins declined -10 basis points to 21.3%.

Customer Insight represents, at its core, the online market research component of the Next 15 group offer. This segment has the highest proportion of B2C customer exposure (whereas the rest of the group is predominantly B2B) and had been the hardest hit through the pandemic, although like the rest of the group, the effects here were less pronounced than first feared.

Despite some initial nervousness around B2C exposure, Savanta has actually performed very consistently in FY23 and has not seen any material impacts to it business from a weaker macro backdrop. A number of the smaller bolt on acquisitions made by Next 15 in FY23 sit within this segment.

## Outlook Commentary and changes to Radnor estimates

At the headline level, we are marginally reducing our FY24E revenue estimates (by c.2%) but are leaving our adjusted PBT estimates **unchanged**.

- Management have stated that the new financial year has started in line with their expectations with a “robust” performance across all four segments.
- Our caution around revenue is driven primarily by the likely lack of an FX tailwind to the same extent as FY23 and a small moderation to our expectations for the Engage segment, where we now look for 5% revenue growth in FY24E vs our previous expectation of 7%. Challenges to the North American tech industry notwithstanding, we do see a continuing and healthy resilience to the Engage agencies and a degree of client and industry diversification that should see organic growth maintained.
- Balancing these notes of caution, we are marginally upgrading our expectations for the Delivery and Business Transformation segments. We note in particular the comments around the strength of the underlying Mach49 performance; the solidity of Activate (despite very tough comparatives) and the outlook for Shopper Media.

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 | 292.0 | 311.1 | 283.2 | 297.4 | - 3% | - 4% |
| Customer Delivery | 102.1 | 109.9 | 120.9 | 117.4 | 132.1 | + 7% | + 9% |
| Customer Insight | 52.0 | 56.8 | 60.8 | 55.1 | 59.0 | - 3% | - 3% |
| Business Transformation | 134.8 | 172.1 | 192.7 | 164.4 | 180.9 | - 4% | - 6% |
| **Revenue** | **563.8** | **630.8** | **685.5** | **620.1** | **669.3** | **- 2%** | **- 2%** |
| Customer Engagement | 55.4 | 67.4 | 71.5 | 61.2 | 64.5 | - 9% | - 10% |
| Customer Delivery | 30.2 | 34.2 | 37.7 | 36.4 | 41.2 | + 6% | + 9% |
| Customer Insight | 11.0 | 12.2 | 13.1 | 11.8 | 13.0 | - 3% | - 1% |
| Business Transformation | 43.9 | 41.4 | 46.2 | 47.7 | 50.6 | + 15% | + 10% |
| Central Overhead | -26.4 | -27.1 | -29.5 | -27.9 | -30.8 | + 3% | + 4% |
| **EBITA** | **114.2** | **128.1** | **139.0** | **129.2** | **138.6** | **+ 1%** | **- 0%** |
| *- margin %* | 20.2% | 20.3% | 20.3% | 20.8% | 20.7% | | |
| **Adj. PBT** | **112.5** | **128.1** | **139.1** | **128.4** | **138.4** | **+ 0%** | **- 1%** |
| **Adj. EPS (p)** | **80.4** | **87.2** | **94.5** | **90.3** | **97.2** | **+ 4%** | **+ 3%** |
| Dividend (p) | 14.6 | 17.4 | 18.9 | 18.1 | 19.4 | + 4% | + 3% |
| **Net Cash (Debt)** | **26.1** | **62.1** | **87.4** | **51.4** | **66.8** | | |

*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

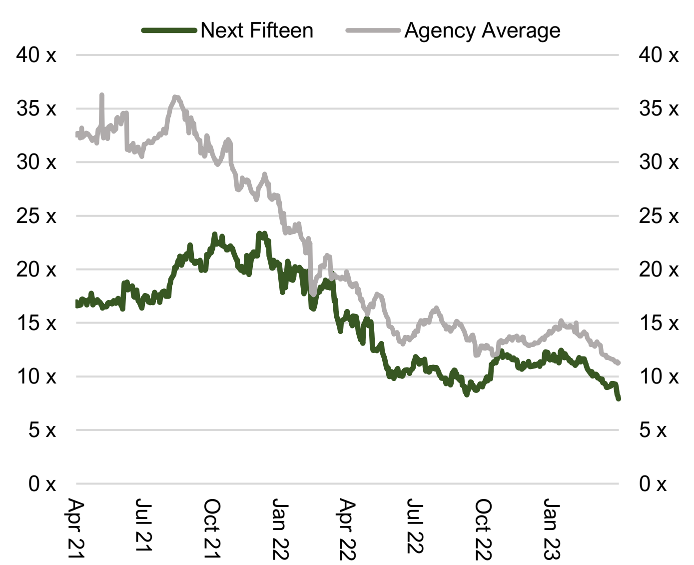
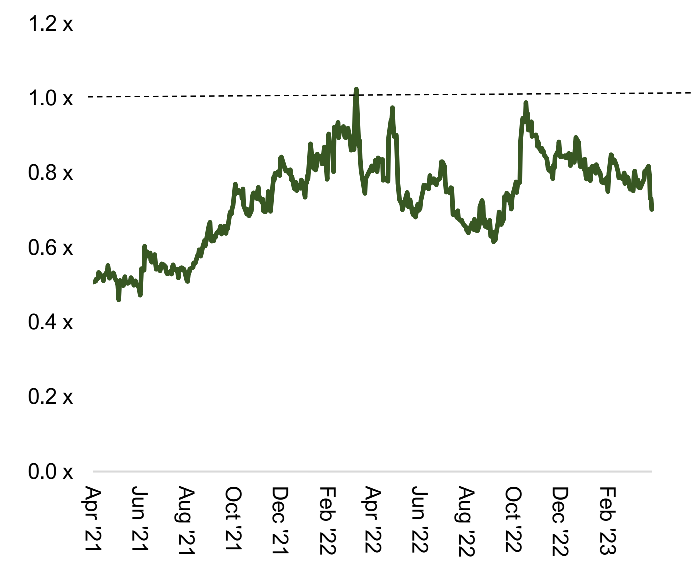



**Figure 3:** Next 15 FY2 PE relative to Peer Group




*Source: FactSet, Radnor*

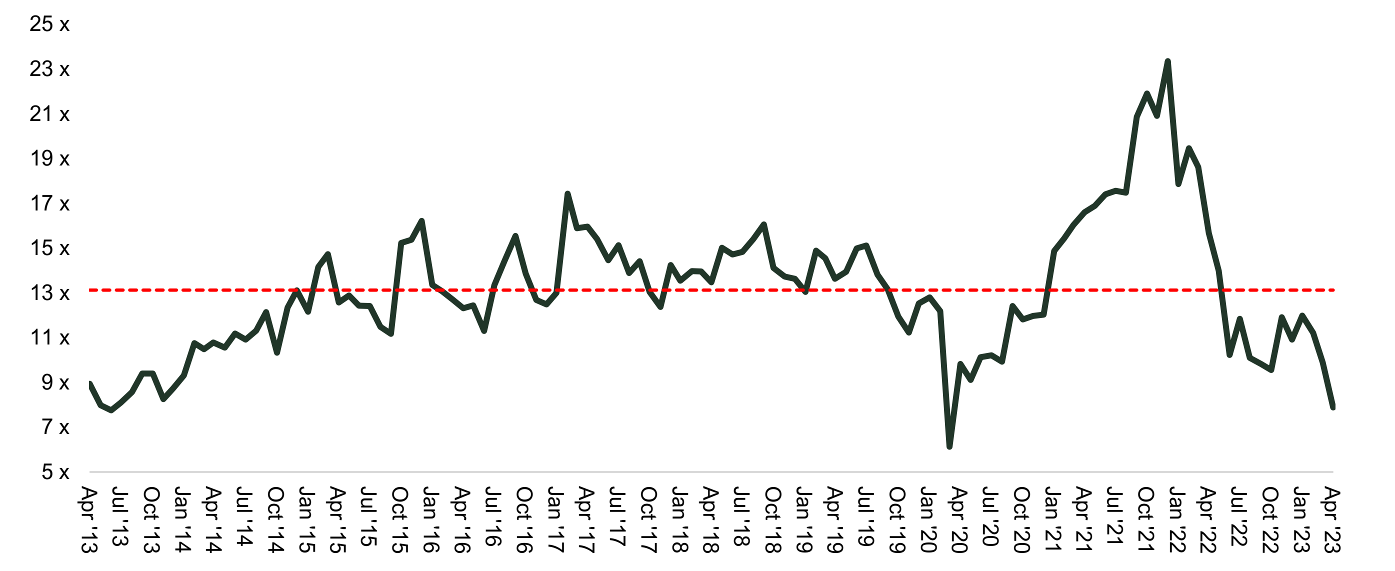
Since the start of 2023, the Next 15 share price has come under sustained pressure (YTD -29% vs +5% for the FTSE All Share) despite the absence of any meaningful earnings downgrades. We have also seen the Next 15 PE discount to the UK Agency peer group widen out to c.30%.

We have written extensively around Next 15's superior track record of both growth and positive estimate revisions compared to the UK peer group and nothing in our fundamental assessment of Next 15's clear differentiation to its peers has changed.

We believe the market is heavily discounting an earnings downgrade that has still yet to appear. Next 15 is not meaningfully exposed to UK advertising spend. The group also enjoys a breadth of underlying client and internal business model diversification that should provide a welcome degree of resilience.

In this sense, we believe these results and the solid feel to the current trading commentary should enable the market to revisit whether a sub 8x PE is a realistic assessment of value for a business with such a proven and well established growth track record.

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




*Source: FactSet, Radnor*

In Figure 3 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 9x PE.

## Next 15 Group PLC

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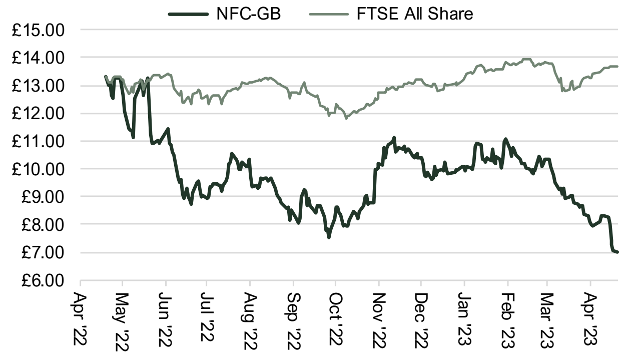
Price (p): **700 p**
Market Cap: 683 m
EV: 657 m

### PROFIT & LOSS

| Year to 31 January, £m | FY21 | FY22 | FY23 | FY24e | FY25e | FY26e |
|---|---|---|---|---|---|---|
| *Customer Engagement* | *166.5* | *187.6* | *275.0* | *283.2* | *297.4* | *318.2* |
| *Customer Delivery* | *49.6* | *80.0* | *102.1* | *117.4* | *132.1* | *145.3* |
| *Customer Insight* | *33.1* | *42.1* | *52.0* | *55.1* | *59.0* | *63.1* |
| *Business Transformation* | *17.7* | *52.5* | *134.8* | *164.4* | *180.9* | *198.9* |
| **Group Net Revenue** | **266.9** | **362.1** | **563.8** | **620.1** | **669.3** | **725.5** |
| *Customer Engagement* | *36.9* | *40.4* | *55.4* | *61.2* | *64.5* | *70.0* |
| *Customer Delivery* | *15.2* | *28.5* | *30.2* | *36.4* | *41.2* | *45.8* |
| *Customer Insight* | *4.9* | *9.0* | *11.0* | *11.8* | *13.0* | *13.9* |
| *Business Transformation* | *3.9* | *15.2* | *43.9* | *47.7* | *50.6* | *55.7* |
| *Head Office* | *(11.4)* | *(13.8)* | *(26.4)* | *(27.9)* | *(30.8)* | *(33.4)* |
| **EBITA - Adjusted** | **49.5** | **79.3** | **114.2** | **129.2** | **138.6** | **152.0** |
| Associates & JV's | 0.4 | 0.2 | - | - | - | - |
| Net Bank Interest | (0.8) | (0.3) | (1.6) | (0.8) | (0.2) | (0.2) |
| **PBT - Adjusted** | **49.1** | **79.3** | **112.5** | **128.4** | **138.4** | **151.8** |
| 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** | **87.1** | **97.0** | **110.4** |
| Tax | (2.6) | 14.5 | (7.1) | (21.8) | (24.2) | (27.6) |
| Tax - Adjusted | (9.9) | (17.2) | (26.3) | (32.1) | (34.6) | (37.9) |
| *Tax rate - Adjusted* | *20.2%* | *21.6%* | *23.3%* | *25.0%* | *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 | 64.6 | 72.0 | 82.0 |
| **Adj EPS (p), diluted** | **40.7** | **59.7** | **80.4** | **90.3** | **97.2** | **106.6** |
| Total DPS (p) | 7.0 | 12.0 | 14.6 | 18.1 | 19.4 | 21.3 |

### PRICE CHART - 1 YEAR ABSOLUTE vs FTSE ALL SHARE




*Source: FactSet*

### SHAREHOLDERS

| | % of ord. Share capital |
|---|---|
| Octopus Investments | 12.5% |
| Liontrust Investment Partners | 11.7% |
| Aviva Investors | 8.5% |
| Slater Investments | 6.7% |
| JPMorgan AM | 6.2% |
| abrdn | 6.0% |
| Directors | 5.6% |
| BlackRock | 5.1% |
| | **62.3%** |

### CASH FLOW

| Year to 31 January, £m | FY21 | FY22 | FY23 | FY24e | FY25e | FY26e |
|---|---|---|---|---|---|---|
| Net Profit: (add back) | (3.9) | (65.6) | 3.0 | 65.3 | 72.7 | 82.8 |
| *Depreciation & Amortisation* | *28.0* | *28.8* | *37.2* | *38.0* | *39.0* | *40.0* |
| *Net Finance costs* | *15.4* | *120.3* | *57.1* | *12.1* | *11.6* | *11.6* |
| *Tax* | *2.6* | *(14.5)* | *7.1* | *21.8* | *24.2* | *27.6* |
| Working Capital | 6.6 | 0.2 | (24.4) | (14.5) | (8.8) | (6.3) |
| Other | 24.3 | 19.6 | 15.1 | 6.3 | 6.3 | 6.3 |
| **Cash from Ops** | **72.9** | **88.8** | **95.2** | **129.0** | **145.1** | **162.0** |
| Cash Tax | (8.4) | (14.1) | (20.3) | (21.8) | (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** | **99.2** | **112.8** | **126.4** |
| Dividends | (0.7) | (12.4) | (15.3) | (17.8) | (21.6) | (23.0) |
| Acquisitions & Inv. | (23.6) | (24.0) | (104.9) | (47.2) | (67.3) | (20.0) |
| Financing | (37.7) | (1.1) | 38.6 | (9.0) | (8.5) | (8.5) |
| **Net Cashflow** | **(1.6)** | **31.4** | **(13.7)** | **25.3** | **15.4** | **75.0** |
| Net Cash (Debt) | 14.0 | 35.7 | 26.1 | 51.4 | 66.8 | 141.8 |

### 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% | 51.9% | 39.6% | 32.7% |
| RoCE | 37.1% | 37.4% | 41.7% | 43.1% | 53.6% |
| Asset Turnover (x) | 0.7x | 0.7x | 0.6x | 0.6x | 0.5x |
| NWC % Revenue | 14.3% | 13.6% | 11.5% | 8.6% | 10.6% |
| Op Cash % EBITA | 111.9% | 83.4% | 99.8% | 104.7% | 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 | 276.7 | 278.1 | 263.8 |
| 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** | **381.4** | **379.1** | **360.8** |
| Net Working Capital | (48.6) | (51.6) | (76.8) | (71.3) | (57.5) | (77.1) |
| **Capital Employed** | **167.5** | **214.5** | **305.3** | **310.1** | **321.6** | **283.7** |
| Earn Out Liabilities | (64.6) | (188.8) | (217.0) | (180.0) | (132.8) | (85.8) |
| Net Funds | 14.0 | 35.7 | 26.1 | 51.4 | 66.8 | 141.8 |
| **Net Assets** | **116.9** | **61.5** | **114.4** | **181.4** | **255.6** | **339.7** |

### VALUATION

| Fiscal | FY22 | FY23 | FY24e | FY25e | FY26e |
|---|---|---|---|---|---|
| P/E | 11.7x | 8.7x | 7.8x | 7.2x | 6.6x |
| EV/EBITDA | 8.3x | 5.8x | 5.1x | 4.7x | 4.3x |
| Div Yield | 1.7% | 2.1% | 2.6% | 2.8% | 3.0% |
| FCF Yield | 10.5% | 10.3% | 15.1% | 17.2% | 19.2% |
| | | | | | |
| EPS growth | 46.6% | 34.5% | 12.4% | 7.7% | 9.7% |
| DPS growth | 71.4% | 21.7% | 23.7% | 7.7% | 9.7% |

# REGULATORY DISCLOSURES

*Radnor Capital Partners Ltd is authorised and regulated by the Financial Conduct Authority.*

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