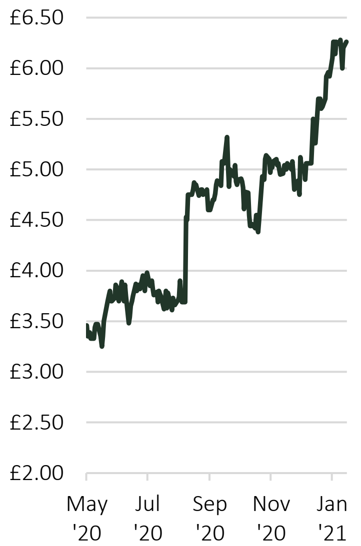
Next Fifteen Communications Group PLC

NFC | AIM | Media | 632p | £564m

Q4 trading update – Organic growth & margin strength

1 Year Chart



2nd February 2021

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Next Fifteen Communications Group PLC is a research client of Radnor Capital Partners Ltd.

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

Despite the strong run in the share price since the start of the year (+19%), with the shares now trading at / near record highs, Next Fifteen still trades at a material discount to its peer group. This is against the context of a steadily improving trading backdrop, culminating in this latest trading update and the third earnings upgrade since September. Next Fifteen now finds itself in a position where it will deliver +7% / +21% revenue / PBT growth in what should have been a negative year. Next Fifteen is also one of only two stocks in the peer group whose FY2 estimates are higher now than at any point over the last year.

Three key factors have combined to deliver this better than expected outcome. Firstly, the group's B2B technology agencies have maintained and, in some cases, even accelerated their momentum through the year. Secondly, the B2C agencies, which saw the greatest initial squeeze on client marketing budgets, have staged a stronger than expected recovery in Q4. Thirdly, and most importantly; costs have been rebased driving much higher incremental margins through the second half.

Coupled with a better than expected £10m net cash position, Next Fifteen has entered the new financial year in good shape. The current FY'22 PE of 14.9x does not look overly demanding.

- **Welcome return to organic growth:** The key drivers behind this upgrade have been a continued strong performance from the B2B technology focused agencies and critically, a return to positive organic growth for the more traditional B2C agencies. As a result, headline group revenue growth was +9% in Q4, with organic growth of c.1% - 2%. This compares to an organic revenue decline of 7% in H1 and 4% in Q3.
- **Margin gains maintained:** One features of Next Fifteen's response to the pandemic was a swiftness in cost response; not least through actions on the group's physical office footprint where a material lease impairment charge was taken at the half year. The revenue recovery has not been matched by equivalent costs increases and this has resulted in a materially higher incremental margin.
- **Estimate upgrades:** In response to the trading update we have upgraded both our current year and FY22 adjusted PBT estimates by **+7%** / **+4%** respectively. This marks the third material upgrade we have made since September. We note that our FY'22 PBT estimate of £52.1m is now ahead of the £51.5m we had been forecasting at the same time last year. Although we are mindful that FY'22 will almost certainly see some degree of cost investment, the structural savings made in FY'21 are likely to ease the path to further margin expansion, albeit at a slower rate than the 210 basis points we expect for FY'21.

January, £m	Sales	PBT adj	EPS (p)	Div (p)	Net Cash	Fiscal PER x	Yield %
FY 2019A	224.1	36.0	33.1	7.6	-5.2	19.1	1.2
FY 2020A	248.5	40.2	34.8	2.5	-9.4	18.2	0.4
FY 2021E	*265.2*	*48.6*	*39.9*	*6.7*	*10.3*	*15.8*	*1.1*
FY 2022E	*287.9*	*52.1*	*42.5*	*9.5*	*25.8*	*14.9*	*1.5*
FY 2023E	*304.7*	*56.4*	*46.0*	*10.2*	*45.9*	*13.7*	*1.6*

Source: Radnor Capital Partners

Q4 Trading update:

The Q4 trading update highlights were:

- Trading in the final quarter ended 31st January 2021 has been ahead of management expectations. As a result, the outcome for the full year will be ahead of current market consensus.

- Q4 YoY net revenue growth of 9% with organic growth in Q4 moving back into positive territory, albeit modestly.

- B2B technology agencies (such as Activate, Twogether and Agent 3) have continued their strong momentum which was referenced in earlier trading updates.

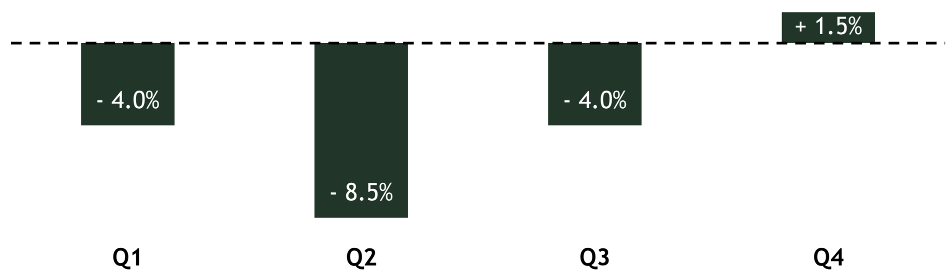
- However, the B2C focused agencies (Savanta and M Booth in particular) have seen a much stronger than anticipated recovery in the final quarter, following a more challenging middle period to the year.

- The net result is that the YoY organic revenue decline of 6.6% reported at the half year has narrowed to a 1.5% decline in H2 with Q4 posting posting positive organic growth of between 1% - 2%.

- Net cash is reported at £10m, materially better than expectations (we had been looking for net debt of £2m) even after the repayment of VAT deferrals from earlier in the year. This has cleared the decks for a resumption of the dividend.

In Figure 1 below, we show the quarterly progression of organic revenue growth by quarter through the course of FY'21.

Figure 1: Fiscal Quarterly revenue growth through FY'21



Source: Company, Radnor

We can see from the above that the pandemic induced organic revenue decline peaked in fiscal Q2 at -8.5%, following a -4% decline in Q1 and have subsequently showed a material recovery. We would make the following observations:

- Fiscal Q1 (ended April 2020) captured approximately one month of the full effect of the initial lockdowns and client responses. Prior to this, Next Fifteen had been reporting a mixed organic growth performance.

- For the preceding full year ended Jan 2020, Next Fifteen had reported an overall organic revenue decline of 2%, which was driven entirely by the **Beyond** (specific client challenges) and **Archetype** (portfolio restructuring post the merging of Text

100 and Bite) agencies. Outside of these two, group organic growth would have been +10.5%, reflecting the strength in trading at the B2B technology agencies such as **M Booth**, **Twogether**, **ODD** and **Activate**, which have subsequently seen their growth accelerate through the rest of the year.

- The more recently acquired **M Booth Health** has also had a strong period with its North American Life Science focus.

- The largest intra year negative impact was in the UK, with the online market research business, **Savanta** (focus on B2C marketing spend), seeing client marketing budgets coming under short term pressure during Q2.

- However, in Q4 the B2C agencies, such as **Savanta** have seen a sharp rebound from the mid year lows. It is still yet unclear to what extent this is simply a function of deferred spend catching up, but we do note that Next Fifteen has referenced a good level of new business activity across the group.

Estimate Revisions: PBT +7% for FY 2021, +4% for FY 2022

Following the trading update, we have revisited our forecast model and have made the following changes:

Figure 2: Radnor estimate revisions

		Previous		New		*Change, %*	
£m	FY20A	2021E	2022E	**2021E**	**2022E**	**2021E**	**2022E**
Brand Marketing	135.0	145.4	158.5	144.5	157.5	*- 1%*	*- 1%*
Data + Analytics	45.1	48.9	53.8	49.6	55.0	*+ 1%*	*+ 2%*
Creative Technology	68.4	66.3	70.3	71.1	75.4	*+ 7%*	*+ 7%*
Revenue	**248.5**	**260.6**	**282.6**	**265.1**	**287.9**	***+ 2%***	***+ 2%***
Brand Marketing	30.8	34.5	38.0	35.7	38.9	*+ 4%*	*+ 2%*
Data + Analytics	12.7	13.7	15.2	14.3	15.6	*+ 4%*	*+ 3%*
Creative Technology	8.0	8.0	8.8	8.7	9.6	*+ 9%*	*+ 9%*
Central Overhead	-9.1	-8.9	-10.5	-8.5	-10.7	*- 4%*	*+ 2%*
EBITA	**42.5**	**45.8**	**50.1**	**49.1**	**52.4**	***+ 7%***	***+ 4%***
margin %	*17.1%*	*17.6%*	*17.7%*	*18.5%*	*18.2%*		
Adj. PBT	**40.2**	**45.2**	**49.9**	**48.6**	**52.1**	***+ 8%***	***+ 4%***
Adj. EPS (p)	**34.8**	**38.3**	**42.0**	**39.9**	**42.5**	***+ 4%***	***+ 1%***
Dividend (p)	2.5	6.4	9.3	6.7	9.5	*+ 4%*	*+ 1%*
Net Cash (Debt)	**-9.4**	**-2.3**	**20.7**	**10.3**	**25.8**		

Source: Radnor

The core drivers of our estimate revisions are as follows;

- **Revenue** – We are upgrading our revenue expectations for both FY'21E and FY'22E by 2% respectively. This reflects a general improvement in the trading background for each of the group's primary segments. We had previously upgraded our revenue expectations for Brand Marketing and Data & Analytics at the time of the Q3 update when it became clear that momentum was being maintained.

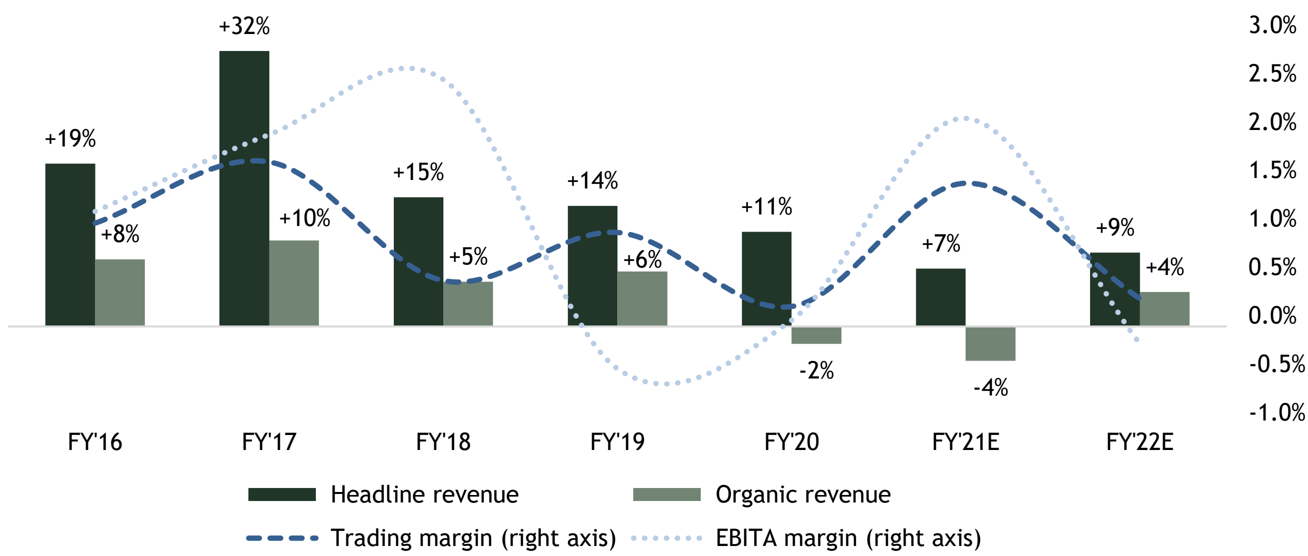
- **Margins** – The biggest change to our short-term expectations comes at the margin level with the group benefiting from a much better than anticipated drop through rate driven by a combination of property cost savings; overall cost discipline and incremental revenue. Looking forward, we believe that these margin gains can be maintained above historic levels; although we do recognise that some degree of cost investment will be likely as the trading environment normalises.

- **Balance Sheet & Liquidity** – FY'21 has been much better than expected in terms of working capital management especially. We are now looking for a working capital inflow of c.£8m. We believe this is likely to unwind through the course of FY'22, which alongside the resumption of dividend payments means that our FY'22 net cash estimate of £24.1m, is only a £3.4m increase from our existing estimate.

In Figure 3 below, we show the YoY growth in headline vs organic revenue for group as well as the annual change in both trading margins (pre central overheads) and EBITA margins. This chart shows that FY'21 is likely to show the strongest trading margin increase since FY'17 and this during a year that is likely to show the biggest overall organic revenue decline due to the pandemic.

We also show our margin expectations for FY'22, we still anticipate a pre-central overhead margin expansion but at a more normalised level (revenue mix combined with growth) with a small contraction in post central overhead margins as some PLC costs normalise.

Figure 3: Next Fifteen Headline & Organic revenue growth vs Change in Margin



Source: FactSet, Radnor

Valuation

Figure 4: Next Fifteen FY2 **PE**

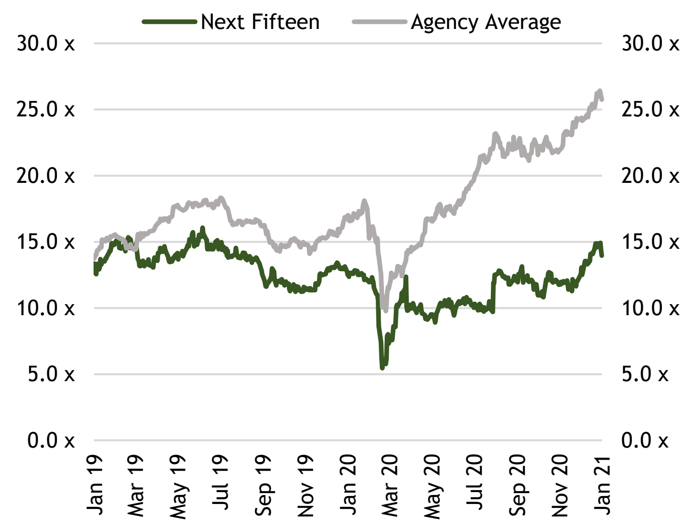


Figure 5: Next Fifteen FY2 **EV/EBITDA**

Source: FactSet, Radnor

- In Figures 4 & 5 above, we show the evolution of the Next Fifteen FY2 PE and EV/EBITDA multiple over the last two years, compared to the Small Cap Agency average. We have focused on FY2 earnings as short-term earnings volatility is clearly pronounced in the current year and we believe investors have now moved beyond their initial focus on near term security and are looking through to the FY21 earnings outlook.

- Despite a significant recovery in the Next Fifteen forward rating (across both metrics), and the shares now trading at / near historic highs, the discount to the peer group continues to be significant. We have explored this theme in previous notes and continue to believe this level of discount is unwarranted.

  - Three of Next Fifteen's peers (**S4 Capital**, **YouGov** and **DotDigital**) currently command materially higher valuation multiples despite representing themes (M&A led growth; focus on data & analytics and non-traditional advertising exposure) that are all key drivers for Next Fifteen.

  - The sharp peer group multiple expansion witnessed since the Covid-19 nadir **has not been** supported by consistent earnings upgrades. We also examine this in more detail below, but Next Fifteen has delivered a materially more positive and consistent earnings revision outlook than the immediate peer group.

- We believe there are a number of "optical" factors driving this disconnect.

  - Firstly, Next Fifteen is not solely focused on one digital marketing theme with its portfolio of agencies offering exposure to a broad range of digital and non-traditional marketing businesses and technologies.

  - Next Fifteen, we believe, has the best M&A track record in the peer group in terms of value creation and protection. However, Next Fifteen's focus on value and their disciplined approach to M&A has come at the expense of absolute pace and scale. We remain cautious on purely M&A led models where value is a secondary consideration.

– Next Fifteen has a long history on the market and started life as a predominantly public relations led business, albeit with a distinct technology bias. Old perceptions linger and we believe investors have not appreciated the extent to which the group mix has evolved and the breadth of the digital capabilities within the current portfolio.

Figure 6: Next Fifteen FY2 EPS vs Peer Group

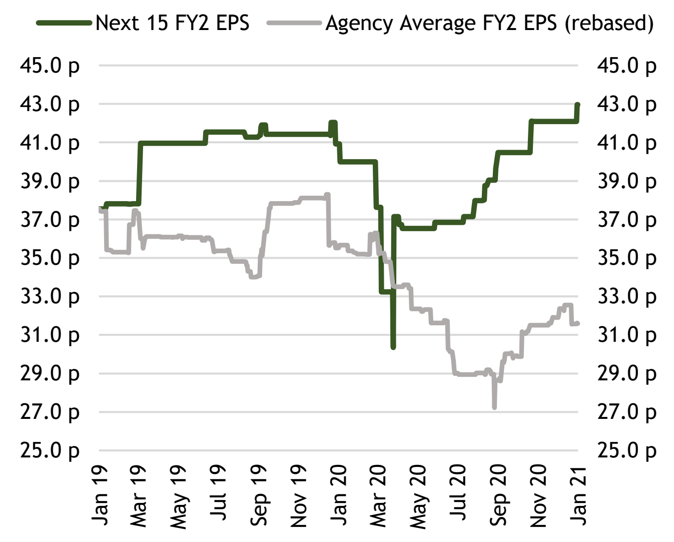
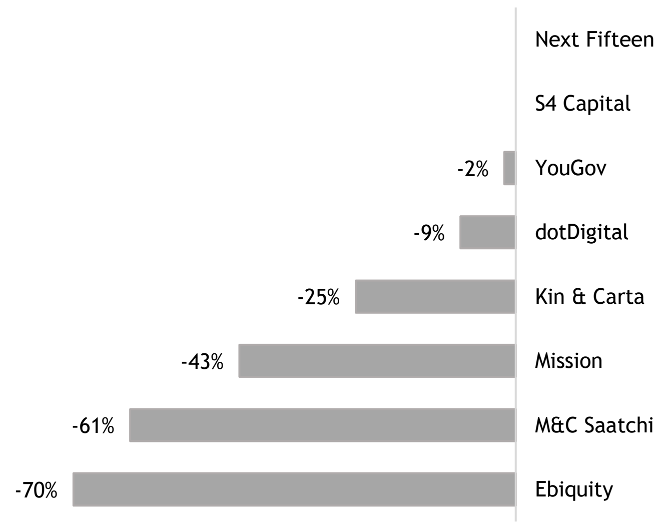


Figure 7: Current FY2 EPS consensus vs Peak



Source: FactSet, Radnor

In **Figure 6** above, we show Next Fifteen's FY2 consensus EPS estimate over the last two years, as sourced from FactSet. We have taken the same data for the Agency peer group; averaged and rebased to Next Fifteen. This demonstrates the extent to which Next Fifteen earnings expectations are now higher than at any point since January 2019. **Figure 7** shows that of the peer group, only S4 Capital has shown a similar level of recover in forward estimates.

Figure 8: Peer Group PE vs earnings growth

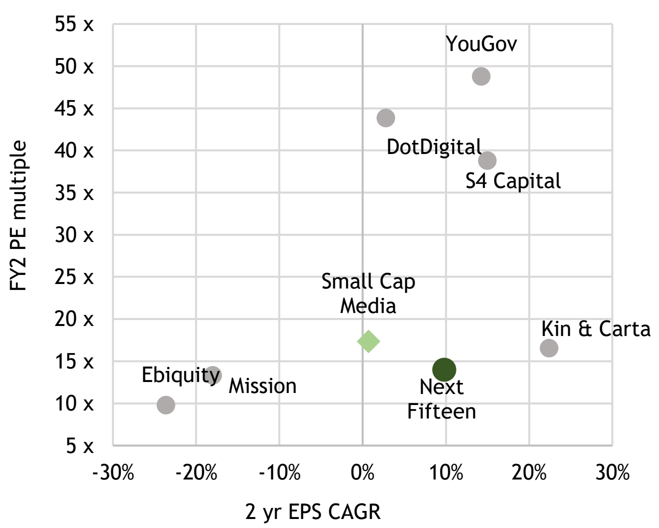
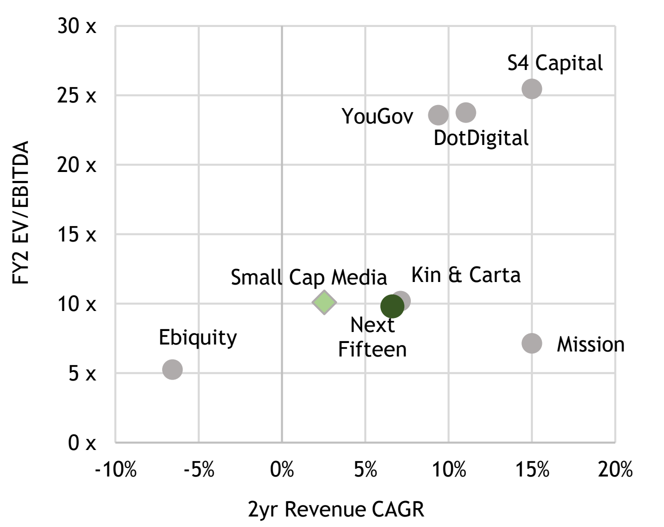


Figure 9: Peer group EV/EBITDA vs revenue growth



Source: FactSet, Radnor

Next Fifteen Communications PLC

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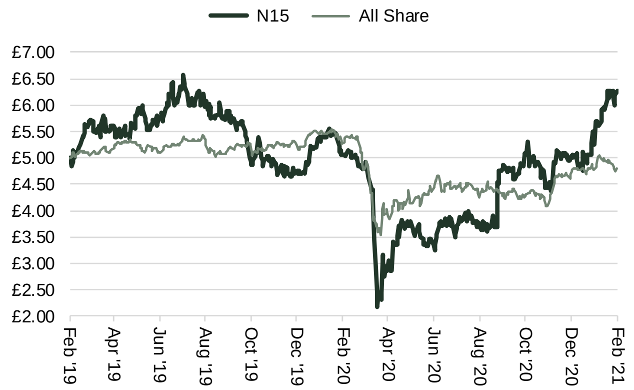
Price (p): **632 p**
Market Cap: 564 m
EV: 554 m

PROFIT & LOSS

Year to 31 January, £m	FY18	FY19	FY20	FY21e	FY22e	FY23
Brand Marketing	*134.7*	*133.2*	*135.0*	*144.5*	*157.5*	*165.4*
Data & Analytics	*13.9*	*23.2*	*45.1*	*49.6*	*55.0*	*59.4*
Creative Technology	*48.3*	*67.7*	*68.4*	*71.1*	*75.4*	*79.9*
Group Net Revenue	**196.8**	**224.1**	**248.5**	**265.2**	**287.9**	**304.7**
Brand Marketing	*27.5*	*29.6*	*30.8*	*35.7*	*38.9*	*41.3*
Data & Analytics	*3.5*	*7.2*	*12.7*	*14.3*	*15.6*	*17.1*
Creative Technology	*7.9*	*9.5*	*8.0*	*8.7*	*9.6*	*10.4*
Head Office	*(8.9)*	*(9.3)*	*(9.1)*	*(8.5)*	*(10.7)*	*(11.3)*
EBITA - Adjusted	**30.0**	**37.0**	**42.5**	**50.2**	**53.4**	**57.6**
Associates & JV's	0.0	0.1	0.2	0.3	0.3	0.4
Lease interest			(1.6)	(1.1)	(1.1)	(1.0)
Net Bank Interest	(0.7)	(1.0)	(0.8)	(0.7)	(0.6)	(0.6)
PBT - Adjusted	**32.8**	**36.0**	**40.2**	**48.6**	**52.1**	**56.4**
Non Operating Items	(12.8)	(16.3)	(23.0)	(17.7)	(13.8)	(14.7)
Other Financial Items	(3.2)	(0.9)	(11.6)	(2.5)	(2.5)	(2.5)
PBT - IFRS	**13.3**	**18.8**	**5.6**	**28.4**	**35.7**	**39.2**
Tax	(4.0)	(4.3)	(2.7)	(5.7)	(7.1)	(7.8)
Tax - Adjusted	(5.9)	(7.2)	(8.0)	(9.7)	(10.4)	(11.3)
Tax rate - Adjusted	*17.9%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*
Minority interests	0.7	0.6	0.6	1.0	1.3	1.4
No. shares m	74.3	79.2	85.3	85.3	85.3	85.3
No. shares m, diluted	82.1	85.0	90.9	95.0	95.0	95.0
IFRS EPS (p)	11.6	17.5	2.7	25.5	32.1	35.1
Adj EPS (p), diluted	**32.1**	**33.1**	**34.8**	**39.9**	**42.5**	**46.0**
Total DPS (p)	6.3	7.6	2.5	6.7	9.5	10.2

PRICE CHART - 1 YEAR ABSOLUTE vs FTSE ALL SHARE



Source: FactSet

SHAREHOLDERS

	% of ord. Share capital
Octopus Investments	13.4%
Liontrust Investment Partners	11.8%
Aviva Investors	9.3%
Aberdeen Stan Life	8.1%
Directors	6.5%
BlackRock	6.2%
Canaccord Wealth	4.9%
Herald Inv Mgmt	4.5%
	64.7%

CASH FLOW

Year to 31 January, £m	FY18	FY19	FY20	FY21e	FY22e	FY23
Net Profit: (add back)	9.3	14.5	2.8	22.7	28.6	31.3
Depreciation & Amortisation	*11.4*	*13.8*	*26.4*	*25.4*	*25.8*	*26.2*
Net Finance costs	*4.0*	*1.9*	*12.5*	*3.2*	*3.1*	*3.1*
Tax	*4.0*	*4.3*	*2.7*	*5.7*	*7.1*	*7.8*
Working Capital	(4.2)	1.2	1.7	5.9	(7.1)	(3.2)
Other	4.4	2.6	1.8	0.8	0.7	0.7
Cash from Ops	**28.9**	**38.4**	**47.9**	**63.7**	**58.2**	**65.9**
Cash Tax	(4.3)	(6.2)	(6.0)	(5.7)	(7.1)	(7.8)
Tangible Capex	(3.0)	(5.6)	(3.5)	(4.0)	(4.0)	(4.0)
Intangible Capex	(1.2)	(2.4)	(1.8)	(2.0)	(2.0)	(2.0)
Free Cashflow	**20.4**	**24.1**	**36.6**	**52.0**	**45.1**	**52.1**
Dividends	(5.7)	(6.6)	(7.5)	(1.0)	(6.7)	(9.1)
Acquisitions & Inv.	(15.4)	(29.6)	(24.2)	(18.3)	(12.0)	(12.0)
Financing	3.8	7.7	1.8	(11.4)	(10.9)	(10.9)
Net Cashflow	**3.1**	**(4.4)**	**6.7**	**21.3**	**15.5**	**20.1**
Net Cash (Debt)	(11.6)	(5.2)	(9.4)	10.3	25.8	45.9

Announcements

Date	Event
January 2021	Trading update
September 2020	Trading update
September 2020	Acquisition of Mach49 for $2.7m
April 2020	Final results (y/e Jan 2020)
March 2020	Trading update
January 2020	Trading update
October 2019	Interim results (6m July 2019)

RATIOS

	FY19	FY20	FY21e	FY22e	FY23
RoE	25.3%	28.1%	28.1%	27.3%	27.2%
RoCE	31.7%	34.9%	40.4%	43.9%	50.5%
Asset Turnover (x)	0.7x	0.9x	0.8x	0.7x	0.7x
NWC % Revenue	17.1%	41.2%	37.1%	32.3%	30.4%
Op Cash % EBITA	103.8%	112.8%	127.0%	108.9%	114.5%
Net Debt / EBITDA	0.1x	0.1x	-	-	-

BALANCE SHEET

Year to 31 January, £m	FY18	FY19	FY20	FY21e	FY22e	FY23
Intangibles	94.8	126.1	155.4	160.7	161.7	162.7
P,P+E	13.6	15.9	14.2	15.8	15.0	13.8
Tax Asset & Other	11.7	13.0	54.7	46.7	38.7	30.7
Total Fixed Assets	**120.1**	**155.0**	**224.4**	**223.3**	**215.4**	**207.2**
Net Working Capital	(32.2)	(38.4)	(102.3)	(98.5)	(93.1)	(92.6)
Capital Employed	**87.9**	**116.6**	**122.1**	**124.8**	**122.4**	**114.6**
Net Funds	(11.6)	(5.2)	(9.4)	10.3	25.8	45.9
Net Assets	**76.3**	**111.5**	**112.7**	**135.1**	**148.2**	**160.6**

VALUATION

Fiscal	FY19	FY20	FY21e	FY22e	FY23
P/E	19.1x	18.2x	15.8x	14.9x	13.7x
EV/EBITDA	8.9x	8.1x	7.3x	10.4x	9.6x
Div Yield	1.2%	0.4%	1.1%	1.5%	1.6%
FCF Yield	4.4%	6.6%	9.4%	8.1%	9.4%
EPS growth	3.4%	4.9%	14.8%	6.6%	8.2%
DPS growth	20.0%	-66.9%	166.1%	42.1%	8.2%

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