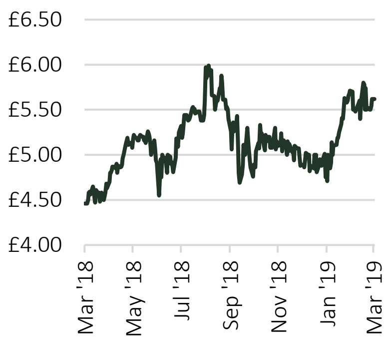
Next Fifteen Communications Group PLC

NFC | AIM | Media | 562p |£470m

Final results in-line; organic growth and margin expansion

1 Year Chart



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.

2 April 2019

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Next Fifteen ("NFC") has delivered another set of robust final results; in-line with our, and market, expectations. Consistent with prior years; revenue growth (14% headline and 6% organic) and margin expansion have been driven out of the UK. NFC has a good track record of taking advantage of strength in one part of the portfolio to address challenges elsewhere. It is now the turn of the North American roof to be fixed while the UK sun is shining; with the Text / Bite merger the main news item in North America. NFC has also taken the opportunity to disclose its performance by business line as well as geography. This added clarity should help investors better understand the key digital growth drivers. NFC continues to trade on undemanding multiples compared to the peer group and the outlook commentary speaks of confidence for FY2020.

- **Results:** 14% revenue growth; 23% EBITA growth and 19% EPS growth all underline a positive FY2019. Cash conversion was a shade over 100% and net debt came in-line with guidance at £5.2m.
- **Positive portfolio effect.** These results underscore the progress that NFC has made as an investment proposition. NFC is the sum of its parts and the good parts continue to outweigh the less positive. Most encouragingly, management have repeatedly demonstrated their willingness to take advantage of strength in one part of the portfolio to address weakness elsewhere. FY2020 will be a critical year for North America, but even a partial return to historic margin levels will deliver a material uplift to already class leading group operating margins. The new segmental analysis will also focus attention on where future growth opportunities lie.
- **Forecast revisions.** At the headline level, we have shaved our revenue expectations but have left our profit expectations largely unchanged. There are a number of moving parts beneath the surface (North America down, central costs down and UK upgraded). In the absence of further acquisitions and after £12m of deferred consideration payments, we expect FY2020E net cash to be £12.2m.
- **Valuation:** NFC trades on a Calendar 2019 PE of 14.6x, in-line with the immediate small cap agency peer group, and a small discount on an EV/EBITDA basis. This looks undemanding given balance sheet strength and a superior earnings growth profile. NFC continues to be positioned in the sweet spot of digital transformation within the marketing universe.

YE - January	Sales, £m	PBT adj, £m	EPS (p)	Div (p)	Net Cash, £m	Fiscal PER x	Yield %
FY 2018A	196.8	29.3	27.8	6.3	-11.6	20.2	1.1
FY 2019A	224.1	36.0	33.1	7.6	-5.2	17.0	1.4
FY 2020E	*248.9*	*43.4*	*37.9*	*8.7*	*12.2*	*14.8*	*1.5*
FY 2021E	*263.8*	*47.6*	*41.6*	*10.0*	*34.5*	*13.5*	*1.8*
FY 2022E	*278.6*	*51.1*	*45.0*	*11.5*	*58.0*	*12.5*	*2.0*

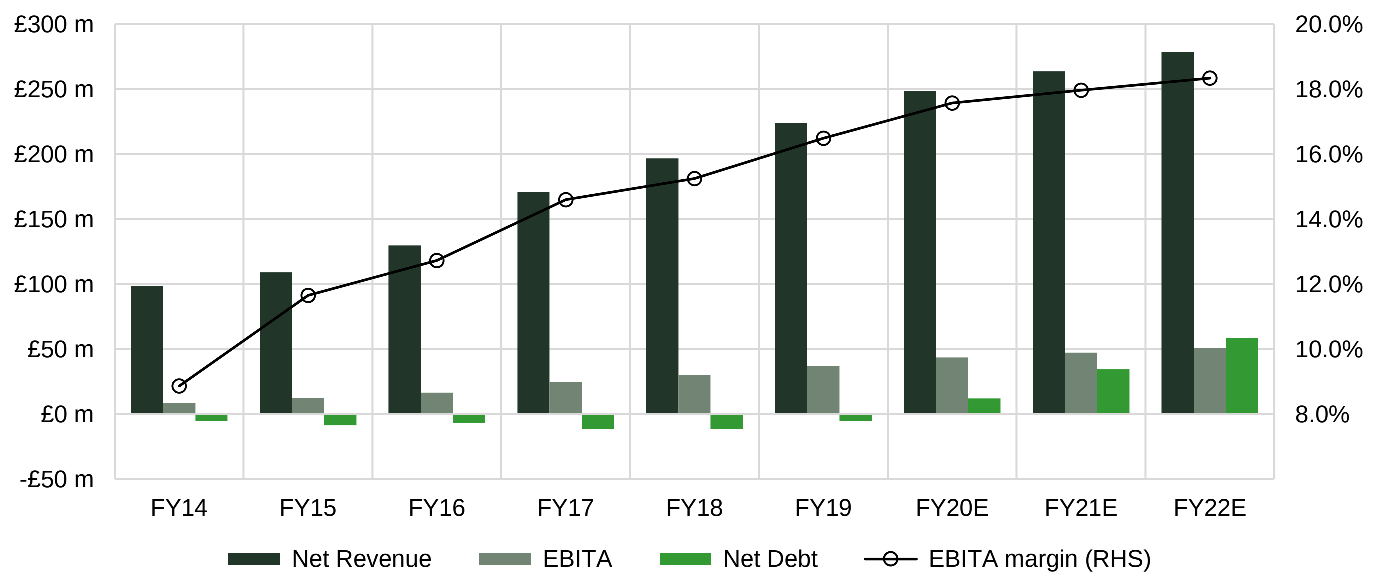
Source: Radnor

Final results - Headlines

Final results for the year ended January 2019 are **in-line** with our expectations, albeit expectations that were marginally upgraded through the course of 2018:

- Net revenue of **£224.1m**, up 14% on a reported basis and up 6.4% on a like for like basis;
- EBITA margins came in at **17.6%**, up 110 basis points on FY2018; marking the sixth consecutive year of margin improvement (EBITA margin of 8.9% in FY2014);
- Adjusted PBT was **£36.0m**, up 23% and adjusted, diluted EPS was up 19% at **33.1**p;
- Non-operating items amounted to £16.3m, an increase on the £12.8m reported in FY2018. The main items here were a £2m increase in the amortisation charge to £9.0m; and restructuring expenses of £5.1m (FY2018: £2.7m), mostly relating to the US business and M&A costs.
- The final dividend was set at 5.4p, making **7.6**p for the full year, up 20% on FY2018;
- Net debt was £5.2m; driven by £32.1m of pre-investment cashflow, £8.0m of internal investment, £29.6m of acquisition and deferred consideration payments and a November 2018 placing to raise £20m of new equity.

Figure 1: Revenue, EBITA, Margin and Net Debt, FY2014 – FY2022E



Source: Next Fifteern, Radnor

In Figure 1 above, we show the NFC track record for delivering consistent revenue, EBITA and margin growth since FY2014.

Overall since FY2014, NFC has delivered a revenue CAGR of 18% and an EBITA CAGR of 33%. The EPS CAGR is 35% over the same period despite two equity raises; reflecting a sharp reduction in the effective tax rate (more than compensating for a 5% CAGR in the fully diluted share count).

Final results – Geographical performance

- **North America –** Net revenue grew by 1.7% to £117.9m on a like for like basis (constant currency growth would have been 2.8%). EBITA margins declined by 130 basis points to 18.7%, driving a 5% decline in EBIT to £22.0m.

  Although a number of the smaller US agencies, M Booth and the recent Activate acquisition in particular, have been performing well; FY2019 was dominated by the merger of the Text and Bite agencies under the new Archetype agency brand.

  This merger was a pro-active response to the organic growth challenges faced by the Text over the last two years and has been well flagged in previous results. Text is the largest and most established of the North American businesses and has not adapted as well to the changing communications landscape as some of the smaller, nimbler agencies in the NFC portfolio. The slower rate of growth in FY2019 compared to previous years (+8% in FY2018) reflects the impact of the restructuring and a degree of managed client churn. The intent is to restore this business to more traditional mid to high single digit growth and 20% plus normalised EBIT margins through a rejuvenated senior management team and more relevant client offering.

  FY2019 also saw the first North American acquisition since FY2015, with the B2B lead generation business, Activate Marketing Services, contributing three months to these results. Activate's revenue contribution is not as high as initially expected due to the classification of pass through costs, although margins will be materially higher as a result.

- **United Kingdom** – Net revenue growth of 43% was better than expected, with an equally impressive 15% organic growth adjusting for acquisitions. The mix effect of higher margin businesses (most of which have been built or acquired over the last four years) growing strongly, drove a substantial 220 basis point improvement in EBITA margins to 24.5%. In contrast, six years ago the UK business delivered a 4.1% EBITA margin.

  Growth in the UK was broadly spread but the stand-out performers were the market research businesses (recently fully integrated into the new Savanta brand); the digital agency Twogether, and the niche tech focused content marketing agency Publitek.

  During FY2019, NFC acquired Planning-inc (a data analytics agency); Technical Associates (niche content marketing, merged with Publitek) and Brandwidth (digital innovation agency).

- **Rest of the World** – Outside of North America and the UK, performance was solid with both EMEA and Asia Pacific delivering strong margin gains and a combined EBITA growth of 34% to £3.7m; driven primarily by the benefits of prior period restructuring. Revenue performance was mixed with Asia Pacific seeing a 5% reported revenue decline and the smaller EMEA up 11%.

- **Central costs** – These came in lower than expected at £9.3m (4.1% of group net revenue compared to 4.5% in FY2018), reflecting good central cost control and efficiencies.

Operational vs Geographic segmentation

Historically, NFC has reported its segmental analysis on a geographic basis. FY2019 marks the first time the group has also reported on a business line basis. We outline the key segments below. However, it is important to note that this does not reflect the operational management structure of the group, which remains devolved down at the individual subsidiary agency level.

This devolved management structure is a deliberate part of the group strategy. The PLC centre exists as a support hub and capital allocator for the individual businesses. The entire thrust of the group is to empower and incentivise entrepreneurial management teams to accelerate their growth strategy. Creating layers of corporate hierarchy is not part of the NFC world view.

This is not to say that sub agency mergers do not occur. In fact, FY2019 saw two such exercises take place with the creation of Archetype (Text into Bite) within the **Brand Marketing** segment; and the creation of Savanta (MIG, Charterhouse, Circle and HPI) as the combined digital market research brand within **Data + Analytics**. However, these are the exceptions rather than the rule and reflect pro-active troubleshooting (Archetype) or front-foot opportunity taking (Savanta).

- **Brand Marketing (59% of net revenue, 64% of pre-central overhead EBIT)**. Brand Marketing represents the "old" core of NFC and is where most of the North American focused businesses sit. However, "old" does this segment a disservice as it contains a broad spread of communications focused agencies (Archetype, Outcast, M Booth, Blueshirt); including the newer, digitally focussed content marketing names such as Publitek. Similarly, there are a broad range of margins ranging from the high teens in the more established US agencies to 40% plus for the niche content marketeers. In the round, this segment is likely to deliver the lowest organic revenue growth in the group (mid-single digit as a broad guide) but with stable margins and cash-generation.

- **Creative Technology (30% of net revenue, 21% of pre-central overhead EBIT).** This segment captures the "design" and "building" businesses within the group. Agencies include Beyond, ODD, Brandwidth, Elvis and Twogether and activities encompass the full range of design, build, consultancy and creative strategy. The digital focus of these agencies, coupled with relative youth, means they are delivering a structurally faster rate of organic growth (30% in FY2019 and 10% - 15% over the medium term) than the more established Brand Marketing segment. Margins, at least in the short to medium term, will not be as high as Brand Marketing, reflecting the investment in growth these businesses are undertaking.

- **Data + Analytics (10% of net revenue, 16% of pre-central overhead EBIT).** Although this is the smallest segment within the group, this has received a disproportionate amount of investment, both internally and through M&A. The core focus here is on the gathering and analysis of data to help clients make better and faster decisions. This is a fast-moving sector; with digital disruptors such as YouGov and the NFC brand, Savanta, taking significant share from slower moving, analogue dominated incumbents. Currently, Data & Analytics is not only the fastest growth segment within NFC (organic growth in FY19 was just over 30%) but also the highest margin.

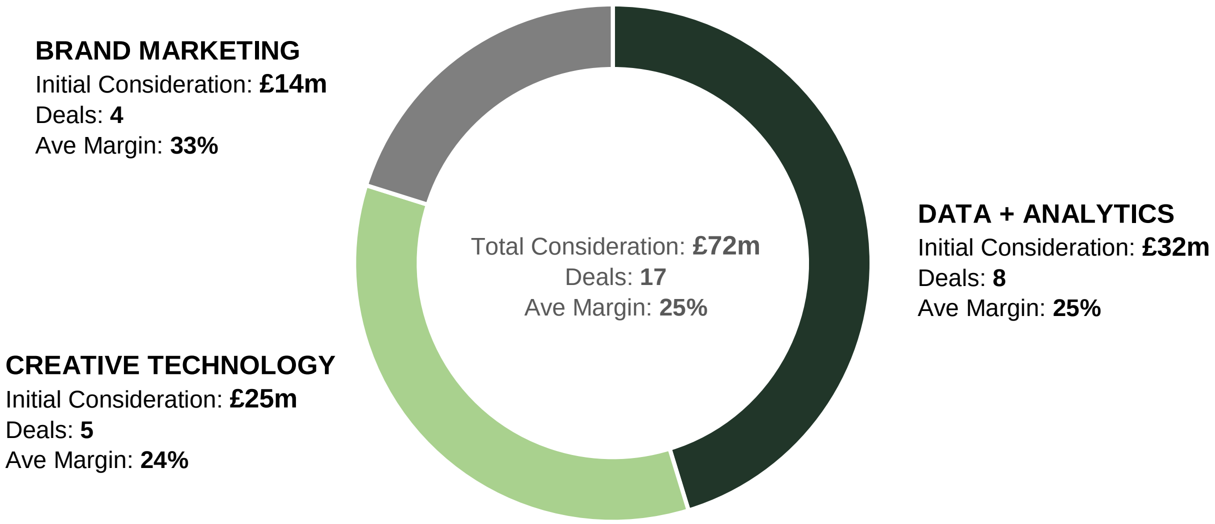
In Figure 2 below, we show the new business line segmentation in terms of net revenue, EBIT contribution and margin. NFC has also disclosed both reported and organic revenue growth across these three segments. This is important as most of the acquisitions made over the last four years have been within the **Data + Analytics** and **Creative Technology** segments. In each of these segments, c.50% of the reported revenue growth has been delivered by acquisitions made in the period.

Figure 2: New Business Line Segmentation

£m	FY2018	FY2019	Growth, FY19 vs FY18 Reported	Organic
Brand Marketing				
Revenue	134.7	133.2	-1.1%	+0.1%
EBIT	27.5	29.6	+7.7%	
Margin %	*20.4%*	*22.2%*		
Data + Analytics				
Revenue	13.9	23.2	+67.3%	+30.6%
EBIT	3.5	7.2	+104.4%	
Margin %	*25.3%*	*30.9%*		
Creative Technology				
Revenue	48.3	67.7	+40.3%	+17.0%
EBIT	7.9	9.5	+19.4%	
Margin %	*16.5%*	*14.0%*		

Source: Next Fifteen, Radnor

Figure 3: Split of M&A spend since FY2016



Source: Next Fifteen, Radnor

In Figure 3 above, we show how the £71.5m that NFC has invested in M&A since FY2016 splits across these business lines. 78% of the total initial acquisition consideration paid has been directed towards the Data + Analytics and Creative Technology segments.

It is also worth highlighting that of the £14m invested in Brand Marketing, £12m has been focused on the content marketing niche (Publitek is the key brand here, but also Pinnacle and Technical Associates), where margins are very high, reflecting the high levels of IP and target niche leadership. With one small exception, NFC has not acquired a more traditional comms agency since FY2016.

Estimate Changes

In Figure 4 below, we outline our key estimate revisions. The headline is a small reduction in FY2020 and FY2021 revenue expectations although PBT / EPS estimates are largely unchanged.

- **Revenue –** Beneath the surface, we have made several changes. We have reduced our **North American** expectations by 3%, driven primarily by a small revenue re-classification within a recent acquisition (no impact on profitability) and managed client churn within the merged Archetype agency. The **UK** businesses are performing well and we have upgraded our expectations here by c.2%.

- **Margins** – At the headline level we look for a slight improvement in margins. At the subsidiary level, mix and volume gains in the UK have been largely offset by the Archetype restructuring and lower client volumes. We still anticipate the US businesses showing good margin recovery in FY2020 (20.5% vs 18.7% in FY2019) but at a slower rate than we had originally anticipated. The UK picture is almost diametrically opposed with accelerating growth from higher margin businesses putting upward pressure on margins. Below the agency level, we also anticipate a lower level of central costs, reflecting good efficiency gains made in FY2019.

- **Cashflow and Net Cash** – FY2019 was a good year for working capital (positive £1.2m), which we do not expect to be maintained. All things being equal, NFC should be a net absorber of working capital whilst growing organically so we anticipate a £5.0m working capital reversal in FY2020E. Further down the cashflow statement we have kept most items unchanged except for the cash element of deferred consideration, which we have increased to £12m for FY2020E. In the absence of any further M&A, we now look for net cash of £12.2m in FY2020E (previous estimate of £15.5m).

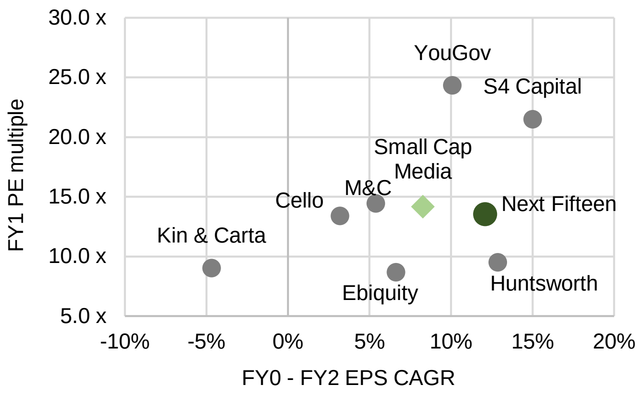
Figure 4: Radnor Estimate Changes for Next Fifteen Communications

£m	Previous 2020E	Revised 2020E	*Δ, % 2020E*	Previous 2021E	Revised 2021E	*Δ, % 2021E*
UK	96.2	97.7	*+2%*	103.1	105.5	+2%
North America	131.7	127.3	*-3%*	139.6	133.7	*-4%*
EMEA	8.7	9.2	*+6%*	8.9	9.4	*+6%*
Asia Pacific	15.0	14.6	*-2%*	15.4	15.1	*-2%*
Revenue	**251.6**	**248.9**	***-1%***	**267.0**	**263.8**	***-1%***
UK	23.3	24.1	*+4%*	24.9	26.3	+5%
North America	27.7	26.1	*-6%*	30.2	28.1	*-7%*
EMEA	1.5	1.6	*+9%*	1.6	1.7	*+6%*
Asia Pacific	2.4	2.3	*-2%*	2.5	2.4	*-2%*
Central Overhead	-11.1	-10.5	*-6%*	-11.6	-11.1	*-5%*
EBITA	**43.7**	**43.7**	-	**47.6**	**43.7**	-
- *margin %*	17.4%	17.6%		17.8%	18.0%	
Adj. PBT	**43.3**	**43.4**	-	**47.6**	**47.7**	-
Adj. EPS (p)	**37.7**	**37.9**	***+1%***	**41.5**	**41.6**	-
Dividend (p)	8.7	8.7	-	10.0	10.0	-
Net Cash (Debt)	**15.5**	**12.2**		**35.9**	**34.5**	

Source: Radnor

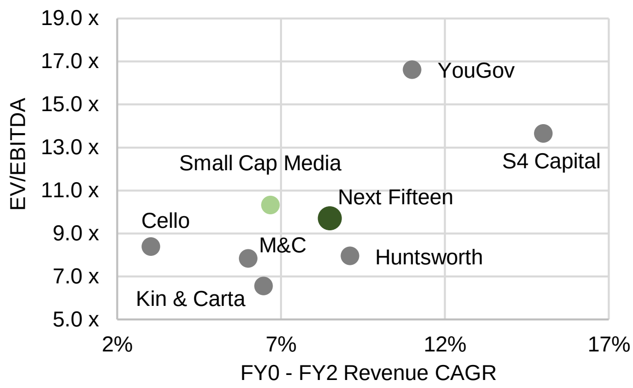
Valuation

Figure 5: Cal 2019 PER vs forward EPS growth



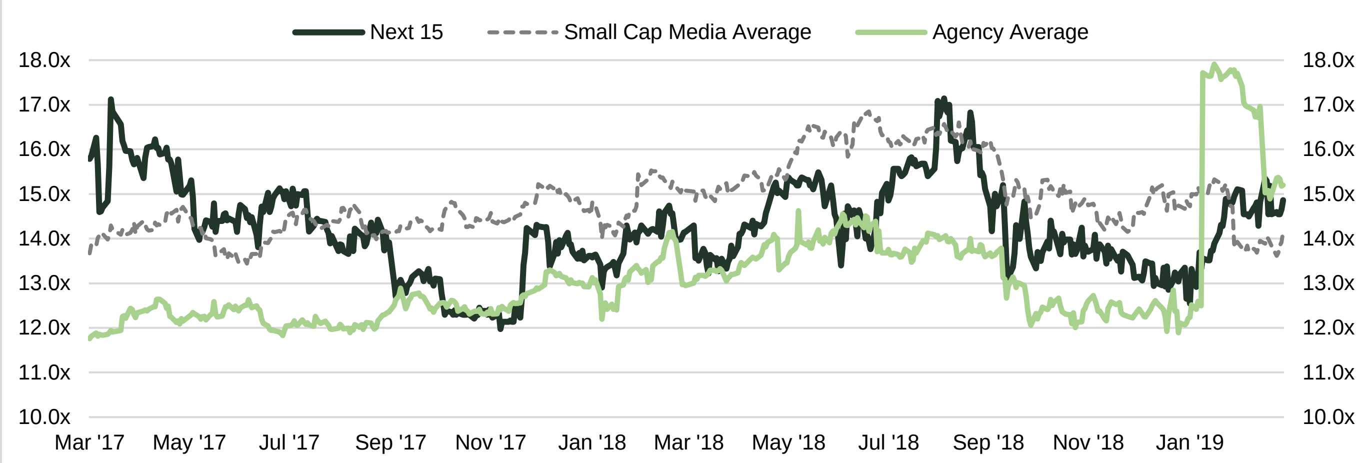
Source: FactSet, Radnor

Cal 2019 EV/EBITDA vs forward Revenue growth



Source: FactSet, Radnor

Figure 6: Rolling FY1 PE multiple – Next 15 vs Agency peer group vs Small Cap Media



Source: FactSet, Radnor

- On a Calendar 2019 basis NFC stands in-line with the Small Cap Agency peers on a PE basis(**14.6x**) and EV/EBITDA (**9.7x** vs Small Cap Agency average **9.4x**). However, NFC's expected growth is higher (NFC revenue/EPS growth CAGR of **8% / 16%** respectively vs **8% / 7%** respectively for the Small Cap Agency average);

- Looking at the individual stocks that make up Small Cap Agency peer group; two peers standout on valuation terms (**YouGov** on 24.8x FY1 PE and **S4 Capital** on 21.5x FY1 PE). Although similar in positioning, **S4** is not the best comparator as it is in the early stages of a well flagged acquisition spree. In Figure 5 above, we plot individual forward valuation multiples against consensus growth expectations. NFC offers a superior EPS growth profile to similarly valued peers, such as **M&C Saatchi** and **Cello Health**. We also note **YouGov** has traded at a consistent premium to NFC despite a lower EPS growth profile for some time now. This is perhaps reflective of **YouGov**'s sole focus on digital market research.

- In Figure 6 above, we also show the rolling FY1 PE multiple for NFC compared to the Agency peer group and the broader Smaller Cap Media peer group over the last two years. For much of the last two years, NFC has traded at a discount to the broader Small Cap media average.

Next Fifteen Communications PLC

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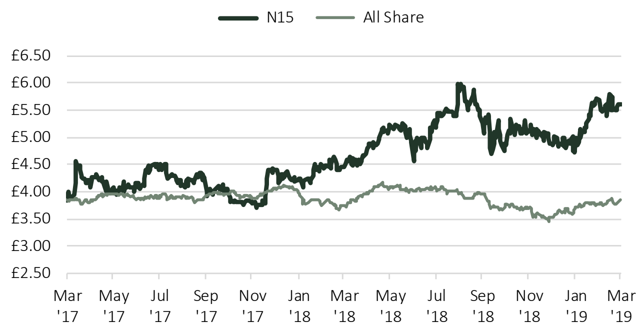
Price (p):	**562 p**
Market Cap:	470 m
EV:	482 m

PROFIT & LOSS

Year to 31 January, £m	2017	FY18	FY19	FY20e	FY21e	FY22e
UK	*42.6*	*58.3*	*83.5*	*97.7*	*105.5*	*112.9*
North America	*107.0*	*115.9*	*117.9*	*127.3*	*133.7*	*140.4*
EMEA	*7.2*	*7.9*	*8.7*	*9.2*	*9.4*	*9.7*
Asia Pacific	*14.2*	*14.7*	*13.9*	*14.6*	*15.1*	*15.5*
Group Net Revenue	**171.0**	**196.8**	**224.1**	**248.9**	**263.8**	**278.6**
UK	*8.0*	*13.0*	*20.5*	*24.1*	*26.3*	*28.2*
North America	*22.3*	*23.2*	*22.0*	*26.1*	*28.1*	*30.3*
EMEA	*0.6*	*0.8*	*1.5*	*1.6*	*1.7*	*1.8*
Asia Pacific	*2.2*	*2.0*	*2.2*	*2.3*	*2.4*	*2.5*
Head Office	*(8.2)*	*(8.9)*	*(9.3)*	*(10.5)*	*(11.1)*	*(11.7)*
EBITA - Adjusted	**25.0**	**30.0**	**37.0**	**43.7**	**47.4**	**51.1**
Associates & JV's	(0.3)	0.0	0.1	0.1	0.1	0.1
Net Bank Interest	(0.5)	(0.7)	(1.0)	(0.4)	0.1	0.4
PBT - Adjusted	**24.2**	**29.3**	**36.0**	**43.4**	**47.6**	**51.6**
Non Operating Items	(17.1)	(12.8)	(16.3)	(11.3)	(12.1)	(12.7)
Other Financial Items	(4.2)	(3.2)	(0.9)	(2.5)	(2.5)	(2.5)
PBT - IFRS	**2.9**	**13.3**	**18.8**	**29.7**	**33.0**	**36.3**
Tax	(1.2)	(4.0)	(4.3)	(5.9)	(6.6)	(7.3)
Tax - Adjusted	(5.3)	(5.9)	(7.2)	(8.7)	(9.5)	(10.3)
Tax rate - Adjusted	*22.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*
Minority interests	0.5	0.7	0.6	1.0	1.2	1.3
No. shares m	72.3	74.3	79.2	82.4	82.4	82.4
No. shares m, diluted	78.3	82.1	85.0	88.9	88.9	88.9
IFRS EPS (p)	1.6	11.6	17.5	27.5	30.6	33.7
Adj EPS (p), diluted	**23.4**	**27.8**	**33.1**	**37.9**	**41.5**	**45.0**
Total DPS (p)	5.3	6.3	7.6	8.7	10.0	11.5

PRICE CHART - 1 YEAR ABSOLUTE vs FTSE ALL SHARE



Source: FactSet

SHAREHOLDERS

	% of ord. Share capital
Octopus Investments	12.2%
Liontrust Investment Partners	12.2%
Aviva Investors	9.8%
Aberdeen Stan Life	7.2%
Directors	7.1%
BlackRock	5.1%
Herald Investment Mgmt	4.7%
Hargreave Hale	3.6%
	61.8%

CASH FLOW

Year to 31 January, £m	2017	FY18	FY19	FY20e	FY21e	FY22e
Net Profit: (add back)	1.7	9.3	14.5	23.7	26.4	29.1
Depreciation & Amortisation	*9.5*	*11.4*	*13.8*	*14.4*	*15.6*	*16.6*
Net Finance costs	*4.7*	*4.0*	*1.9*	*2.9*	*2.4*	*2.1*
Tax	*1.2*	*4.0*	*4.3*	*5.9*	*6.6*	*7.3*
Working Capital	6.3	(4.2)	1.2	(5.0)	0.1	(0.6)
Other	9.4	4.4	2.6	1.9	1.9	1.9
Cash from Ops	**32.8**	**28.9**	**38.4**	**43.9**	**53.0**	**56.4**
Cash Tax	(2.0)	(4.3)	(6.2)	(5.9)	(6.6)	(7.3)
Tangible Capex	(8.3)	(3.0)	(5.6)	(4.0)	(4.0)	(4.0)
Intangible Capex	(0.6)	(1.2)	(2.4)	(1.0)	(1.0)	(1.0)
Free Cashflow	**22.0**	**20.4**	**24.1**	**33.0**	**41.4**	**44.1**
Dividends	(4.3)	(5.7)	(6.6)	(7.9)	(8.8)	(9.9)
Acquisitions & Inv.	(21.9)	(15.4)	(29.6)	(12.0)	(10.0)	(10.0)
Financing	11.1	3.8	7.7	(0.7)	(0.2)	(0.0)
Net Cashflow	**6.8**	**3.1**	**(4.4)**	**12.4**	**22.3**	**24.3**
Net Cash (Debt)	(11.4)	(11.6)	(5.2)	12.2	34.5	58.8

Announcements

Date	Event
2nd April 2019	Final results (y/e Jan 2019)
11th January 2019	Acquisition of Planning-inc for £6.3m initial
1st November 2018	Acquisition Activate for $9.9m initial
1st November 2018	Placing to raise £20m gross @ 475p
13th July 2018	Acquisition of Technical Associates for £2.2m
7th February 2018	Acquisition of Brandwidth for max £10.3m
26th Sep 2017	Interim results (y/e Jan 2018)

RATIOS

	2017	FY18	FY19	FY20e	FY21e
RoE	26.8%	29.9%	25.3%	24.1%	22.8%
RoCE	30.9%	34.2%	31.7%	34.4%	37.3%
Asset Turnover (x)	0.6x	0.6x	0.7x	0.6x	0.6x
NWC % Revenue	16.1%	16.3%	17.1%	12.0%	11.4%
Op Cash % EBITA	131.5%	96.1%	103.9%	100.4%	111.8%
Net Debt / EBITDA	0.4x	0.3x	0.1x	-	-

BALANCE SHEET

Year to 31 January, £m	2017	FY18	FY19	FY20e	FY21e	FY22e
Intangibles	80.0	94.8	126.1	127.7	127.9	127.3
P,P+E	15.8	13.6	15.9	16.8	16.3	15.4
Tax Asset & Other	11.7	11.7	13.0	13.0	13.0	13.0
Total Fixed Assets	**107.4**	**120.1**	**155.0**	**157.5**	**157.2**	**155.7**
Net Working Capital	(27.5)	(32.2)	(38.4)	(29.9)	(30.0)	(29.4)
Capital Employed	**79.9**	**87.9**	**116.6**	**127.6**	**127.2**	**126.3**
Net Funds	(11.4)	(11.6)	(5.2)	12.2	34.5	58.8
Net Assets	**68.5**	**76.3**	**111.5**	**139.8**	**161.7**	**185.1**

VALUATION

Fiscal	2017	FY18	FY19	FY20e	FY21e
P/E	24.0x	20.2x	17.0x	14.8x	13.5x
EV/EBITDA	16.6x	14.1x	11.7x	10.0x	10.2x
Div Yield	0.9%	1.1%	1.3%	1.5%	1.8%
FCF Yield	4.6%	4.2%	5.0%	6.8%	8.6%
EPS growth	38.9%	18.6%	19.2%	14.5%	9.5%
DPS growth	25.0%	20.0%	20.0%	15.0%	15.0%

REGULATORY DISCLOSURES

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

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