



Next Fifteen Communications Group PLC

NFC | AIM | Media | 396p | £302m

1 Year Chart



Interim Results – Solid H1; good start to H2

Given poor news-flow from elsewhere in the peer group (a WPP online advertising wobble is never helpful for sentiment, despite very little direct read across for NFC); these interim results were reassuringly solid. The key North American business continues to deliver healthy organic growth whilst the UK is experiencing both organic growth and M&A contribution. The second half has started well and management tone can best be described as cautiously optimistic. NFC has been a beneficiary of Dollar strength in recent years and the outlook here is mixed. NFC now trades at a 3% PE discount to the Small Cap Agency peer group despite a superior growth outlook and solid balance sheet.

- Continued growth despite tough comparatives:** NFC reported headline revenue growth of 16% in H1, with headline organic growth of 2%. In North America, the comparative H1 FY17 was itself up 27% y/y, mostly organic, and contained project work that has not repeated. Adjusting for this suggests c.5% underlying growth in H1 FY18E.
- Encouraging start to H2:** Despite the understandable management caution over North America (political instability does not lend itself to corporate discretionary spend), NFC has experienced a strong start to the second half. North America continues to grow and the UK is set to benefit from higher growth / margin contribution from recent acquisitions.
- Forecast revisions:** We have made some marginal upgrades (c.1%) to our FY18E / FY19E estimates; driven primarily by M&A. We now look for FY18E net debt of £14.3m reflecting increased M&A spend. This represents a net debt to EBITDA multiple of 0.4x. We continue to look for a net cash position in FY19E in the absence of further M&A.
- Valuation:** Based on our new estimates, NFC trades on a FY18E PE of 14.6x and a yield of 1.6%. With the shares 12% off recent highs, and following our incremental upgrades, the rating now stands at a 3% discount to the Small Cap Agency peer group despite a superior growth/balance sheet outlook.

4th October 2017

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Year End	Revenue, £m	PBT adj, £m	EPS (p)	Div (p)	Net Cash, £m	PER x	Yield %
January							
FY 2016A	129.8	16.1	16.9	4.2	-6.6	23.7	1.1%
FY 2017A	171.0	24.2	23.4	5.3	-11.4	17.1	1.3%
FY 2018E	196.3	29.7	27.2	6.3	-14.3	14.6	1.6%
FY 2019E	215.2	33.8	30.7	7.1	6.1	12.9	1.8%
FY 2012E	227.4	36.8	33.1	7.7	24.2	12.0	1.9%

Source: Radnor Capital Partners

H1 – Key Headlines

NFC delivered growth across all the key P&L metrics ...

Reported revenue growth **+16%** to £93.5m, adjusted PBT **+13%** to £12.0m, adjusted EPS **+9%** to 11.4p,

- Interim dividend **+20%** to 1.8p,
- Half year net debt of £20.8m (£11.4m at the last year end),

North American revenue growth was slower than in recent periods ...

Compared to the headline revenue growth of 16%; organic revenue growth (stripping out acquisitions from both periods) was 2%. This number is lower than in the last few reporting periods and is driven primarily by two factors, both emanating from **North America**:

1. The comparative period was itself very strong (+27% organic growth in North America compared to H1 FY016) and was buoyed by c.\$10m of project work that has not repeated. Adjusting for this effect, North American underlying revenue growth was a healthier +5%.
2. The first half also witnessed a high degree political volatility surrounding the new Trump presidency. Such a volatile backdrop was unhelpful for the US tech industry and undoubtedly dampened marginal discretionary demand.

... but has recovered well into H2

Management commentary on more recent trading patterns suggests the initial impact on client activity levels has now largely worked its way through the system. NFC has witnessed a good return to form in North America, with the first two months of the second half showing much improved organic growth. Notwithstanding the four months remaining in H2, management have pointed to an H2 EBIT margin in excess of 20% (18.1% in H1).

... EBIT margins are also expected to recover

A key part of NFC's strategy is to accelerate the US expansion of the UK agencies, especially those acquired over the last two to three years. As a result, NFC has been investing in US infrastructure, which depressed H1 margins. The weighting of this investment has been weighted towards H1 and is expected to unwind relative to revenue growth in H2. NFC has also been investing heavily in data security, which is a growing theme across the client list, not just tech industry participants.

... UK saw good revenue and margin growth

In the **UK**, the group continues to benefit from the impact of recent acquisitions. UK revenue growth was +27.9%, with EBIT margins continuing to improve (20.2% vs 17.8%). This was driven by a combination of higher margin acquisitions (the average margin of UK acquisitions in the last two years has been 26%) but also operational improvements in the pre-existing agencies.

Elsewhere, both the **Asia Pacific** and **EMEA** regions saw revenue growth of 10% and 13.6% respectively. Asia Pacific margins were lower than expected at 8.5% and were impacted by cost investment timing issues. These are expected to unwind in H2, returning this region to a more normalised mid teen EBIT margin.

Two further acquisitions

Both acquisitions in line with M&A strategy ...

Elvis Communications (an integrated creative agency) was acquired for £5.5m in cash (£5.0m initial consideration). The EBITDA multiple paid was 5.5x on adjusted EBITDA of £0.75m and net revenue of £4.7m. The EBITDA margin at 16.0% is low relative to other recent UK acquisitions, however growth opportunities are high and Elvis will be able to leverage the UK platform to generate margin gains moving forward.

Elvis is what is known in the trade as an integrated creative agency. It is not a specialist in any particular media (ie, TV ads), but instead takes the customer brand as the starting point and uses creativity across a range of media and platforms to achieve the marketing result.

Charterhouse Research (market research consultancy) has been acquired for an initial £2.75m (£1.7m for the business and £1.0m for the balance sheet). Deferred consideration will be payable in FY19E and FY20E and will be settled in cash. The headline PE multiple was 5.8x. Charterhouse has been acquired by NFC's fast-growing market research subsidiary MIG (formerly known as Morar).

Charterhouse is a specialist market research consultancy focused on the UK financial services industry. The core of the business is a bespoke, multi-methodology research approach based on a long-standing expertise and specialism within UK financial services. Charterhouse produces a number of well-known syndicated research products such as the *Business Banking Survey*, the *Mortgage Intermediary Survey* and the *SME Finance and Banking Report*.

Both these acquisitions fit the NFC M&A template. They are active in non-traditional areas of marketing communications; the senior management teams are ambitious and remaining in place, and the businesses have been acquired for single digit multiples.

Overpaying is a common investor concern ...

This last point remains critical to the NFC investment case. By not overpaying for acquisitions, NFC de-risks the strategy and should generate significant shareholder returns if the acquisitions perform anywhere near expectations. People based businesses are notoriously fickle and by remaining disciplined on price, NFC only acquires those businesses where the vendors want to be bought by NFC. This is a subtle but powerful point.

Quality and lower risk at the expense of pace and scale ...

The flip side of this value discipline is that NFC is unlikely to be involved in competitive auction situations or where the target business sits above a certain size and draws the attention of the larger marketing groups. Scale is a well-known holding company aphrodisiac where risk becomes secondary to pace and size. Although good news from a quality / risk perspective; this does mean that each incremental acquisition for NFC moves the needle by a smaller amount.

Estimate Upgrades

Following the acquisitions of Elvis and Charterhouse, we have updated our estimates for the Group. The detail of our estimate revisions can be seen in Figure 1 below.

Figure 1: Radnor Estimates Changes for Next Fifteen Communications

	Previous		Revised		Change, %		Change, £m	
	2018E	2019E	2018E	2019E	2018E	2019E	2018E	2019E
UK	52.4	60.3	54.6	66.6	4%	10%	2.1	6.3
North America	119.8	129.4	118.8	128.3	-1%	-1%	-1.1	-1.2
EMEA	7.6	7.8	7.6	7.8	0%	0%	0.0	0.0
Asia Pacific	15.3	15.8	15.3	15.8	0%	0%	0.0	0.0
Revenue	195.2	213.4	196.3	218.5	1%	2%	1.1	5.1
UK	11.4	13.0	11.7	14.5	3%	11%	0.3	1.5
North America	25.0	27.7	24.3	26.9	-3%	-3%	-0.7	-0.8
EMEA	0.8	0.8	0.8	0.8	0%	0%	0.0	0.0
Asia Pacific	2.5	2.5	2.3	2.5	-6%	0%	-0.2	0.0
Central Overhead	-9.4	-10.2	-9.0	-10.1	-4%	-2%	0.3	0.2
EBITA	30.3	33.8	30.1	34.8	-1%	3%	-0.2	0.9
- margin %	15.5%	15.9%	15.3%	15.9%				
Adj. PBT	29.6	33.4	29.7	34.3	0%	3%	0.1	1.0
Adj. EPS (p)	26.6	30.0	27.2	31.2	2%	4%	0.6	1.3
Dividend (p)	6.2	7.0	6.3	7.3	2%	4%	0.1	0.3
Net Cash (Debt)	-8.7	6.0	-14.3	6.1			-5.5	0.1

Source: Radnor Capital Partners, Company

Valuation

Recent weakness has removed the valuation premium to the peer group ...

For much of the last year, NFC has been trading at a premium to the Small Cap Agency peer group. With the shares some 12% off their recent highs, NFC now finds itself trading at a small discount. Interestingly, the conditions driving the premium historic premium rating remain largely in place:

NFC is growing faster and has been upgraded more often than the peer group ...

- **Superior earning growth outlook** – we are currently looking for EPS growth (not including any further M&A contribution) of **+16%** in FY18E and **+15%** in FY19E; this compares to an Agency peer group average of 8% and 5% respectively.
- **Superior earning revisions trend** – NFC remains the most consistently upgraded stock in the peer group over the last year with consensus EPS estimates increasing by 18% over the last year. Only **Huntsworth** has been upgraded more as it recovers from a low base. In fact, over the last 3 months alone, NFC is the only Small Cap Agency stock to have seen positive EPS upgrades at all.
- **Conservative Balance Sheet** – NFC carries a modest net debt position relative to forecast EBITDA (0.4x). Although a number of the peer group enjoy net cash positions, of those that do employ net debt, NFC has the lowest gearing. In the absence of any further M&A, we anticipate NFC moving into net cash territory in FY19E.

Figure 2: Key valuation metrics for the Small Cap Agency peer group

	Price (p)	Market Cap, £m	PE		EV/EBITDA		Div Yield	
			FY1	FY2	FY1	FY2	FY1	FY2
Cello	130p	131.4	16.1	15.8	9.7	9.1	2.7%	2.9%
Ebiquity	115p	116.3	11.2	12.3	7.7	8.2	0.6%	0.7%
Huntsworth	76p	294.9	14.1	12.3	10.1	9.0	2.5%	2.7%
M&C Saatchi	317p	253.0	13.4	12.4			3.0%	3.5%
System1	530p	55.0	15.4	14.4	8.3	7.5	1.7%	1.9%
YouGov	286p	279.1	26.7	23.5	18.6	15.9	0.6%	0.6%
Small Cap Agencies			15.0	14.2	9.7	9.0	1.8%	2.0%
Next Fifteen	396p	302.0	14.6	12.7	9.4	8.2	1.6%	1.8%

Source: FactSet, Radnor Capital Partners

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Price (p): 396 p
Market Cap: 302 m
EV: 316 m

PROFIT & LOSS

Year to 31 January, £m	2016	2017	FY18e	FY19e	FY20e
UK	27.9	42.6	54.6	66.6	69.2
North America	83.5	107.0	118.8	128.3	137.3
EMEA	6.4	7.2	7.6	7.8	8.1
Asia Pacific	12.0	14.2	15.3	15.8	16.3
Group Net Revenue	129.8	171.0	196.3	218.5	230.8
UK	3.8	8.0	11.7	14.5	15.2
North America	17.5	22.3	24.3	26.9	29.2
EMEA	0.5	0.6	0.8	0.8	0.9
Asia Pacific	1.4	2.2	2.3	2.5	2.6
Head Office	(6.6)	(8.2)	(9.0)	(10.1)	(10.6)
EBITA - Adjusted	16.5	25.0	30.1	34.8	37.3
Associates & JV's	(0.0)	(0.3)	0.1	0.2	0.2
Net Bank Interest	(0.4)	(0.5)	(0.5)	(0.6)	(0.1)
PBT - Adjusted	16.1	24.2	29.7	34.3	37.4
Non Operating Items	(8.1)	(17.1)	(9.8)	(10.1)	(10.4)
Other Financial Items	(2.4)	(4.2)	(2.5)	(2.5)	(2.5)
PBT - IFRS	5.6	2.9	17.3	21.6	24.3
Tax	(1.1)	(1.2)	(3.5)	(4.3)	(4.9)
Tax - Adjusted	(3.5)	(5.3)	(6.1)	(6.9)	(7.5)
Tax rate - Adjusted	22.0%	22.0%	20.5%	20.0%	20.0%
Minority interests	0.5	0.5	1.2	1.4	1.6
No. shares m	66.3	72.3	73.8	74.8	75.8
No. shares m, diluted	71.6	78.3	82.4	83.4	84.4
IFRS EPS (p)	6.0	1.6	17.1	21.2	23.6
Adj EPS (p), diluted	16.9	23.4	27.2	31.2	33.6
Total DPS (p)	4.2	5.3	6.3	7.3	7.8

CASH FLOW

Year to 31 January, £m	2016	2017	FY18e	FY19e	FY20e
Net Profit: (add back)	4.5	1.7	13.9	17.3	19.4
Depreciation & Amortisation	6.1	9.5	9.9	11.0	11.5
Net Finance costs	2.8	4.7	3.0	3.1	2.6
Tax	1.1	1.2	3.5	4.3	4.9
Working Capital	0.2	6.3	(8.0)	4.2	(0.4)
Other	1.6	9.4	2.7	0.9	0.8
Cash from Ops	16.3	32.8	24.9	40.7	38.7
Cash Tax	(3.0)	(2.0)	(5.2)	(3.2)	(3.6)
Tangible Capex	(6.4)	(8.3)	(4.0)	(4.0)	(4.0)
Intangible Capex	(0.6)	(0.6)	(0.8)	(0.8)	(0.8)
Free Cashflow	6.4	22.0	14.9	32.7	30.3
Dividends	(3.0)	(4.3)	(5.8)	(6.4)	(6.8)
Acquisitions & Inv.	(13.4)	(21.9)	(12.8)	(5.0)	(5.0)
Financing	14.6	11.1	(0.8)	(0.9)	(0.4)
Net Cashflow	4.6	6.8	(4.5)	20.4	18.1
Net Cash (Debt)	(6.6)	(11.4)	(14.3)	6.1	24.2

BALANCE SHEET

Year to 31 January, £m	2016	2017	FY18e	FY19e	FY20e
Intangibles	53.6	80.0	89.8	88.7	87.3
P,P+E	10.0	15.8	16.1	16.1	16.1
Tax Asset & Other	7.9	11.7	11.2	11.2	11.2
Total Fixed Assets	71.4	107.4	117.0	116.0	114.5
Net Working Capital	(12.0)	(27.5)	(21.2)	(29.4)	(36.4)
Capital Employed	59.4	79.9	95.8	86.6	78.2
Net Funds	(6.6)	(11.4)	(14.3)	6.1	24.2
Net Assets	52.8	68.5	81.6	92.8	102.4

PRICE CHART - 2 YEAR ABSOLUTE vs FTSE ALL SHARE



Source: FactSet

SHAREHOLDERS

	% of ord. Share capital
Liontrust	14.0%
Octopus Investments	11.0%
Aviva Investors	9.5%
Standard Life	8.7%
Directors	7.2%
Herald Inv Mgmt	5.7%
BlackRock	5.0%
Hargreave Hale	4.1%
	65.2%

Announcements

Date	Event
26th Sep 2017	Interim results (y/e Jan 2018)
26th Sep 2017	Acquisition of Charterhouse Research for £2.75m
15th Sep 2017	Acquisition of Elvis Communications for £5.5m
12th July 2017	Acquisition of Circle Research for a net £3.0m
11th July 2017	Acquisition of Velocity Partners for £5.9m
4th April 2017	Final results (y/e Jan 2017)
10th Nov 2016	Acquisition of HPI for £1.3m

RATIOS

	2016	2017	FY18e	FY19e	FY20e
RoE	22.9%	26.8%	27.5%	28.1%	27.7%
RoCE	27.8%	30.9%	31.5%	40.3%	47.9%
Asset Turnover (x)	0.6x	0.6x	0.6x	0.5x	0.5x
NWC % Revenue	9.3%	16.1%	10.8%	13.4%	15.8%
Op Cash % EBITA	98.6%	131.5%	82.7%	117.1%	103.9%
Net Debt / EBITDA	0.4x	0.4x	0.4x	-	-

VALUATION

Fiscal	2016	2017	FY18e	FY19e	FY20e
P/E	23.5x	16.9x	14.6x	12.7x	11.8x
EV/EBITDA	16.8x	11.1x	9.4x	8.2x	8.5x
Div Yield	1.1%	1.3%	1.6%	1.8%	2.0%
FCF Yield	2.0%	6.9%	4.7%	10.3%	9.6%
EPS growth	27.5%	38.9%	16.1%	14.8%	7.6%
DPS growth	20.0%	25.0%	20.6%	14.6%	7.4%