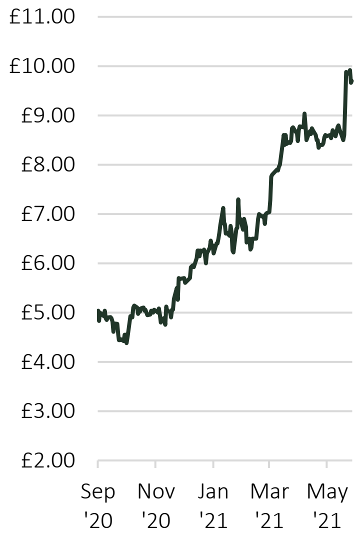
Next Fifteen Communications Group PLC

NFC | AIM | Media | 970p | £899m

AGM trading update – Firing on all cylinders

1 Year Chart



5th July 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.

It was clear from the final results that the risks to earnings estimates clearly lie on the upside and last week's AGM trading update confirmed that short term trading remains ahead of expectations. We are upgrading our estimates accordingly. Previous upgrades had been driven primarily by the outperformance of the more B2B focussed agencies relative to the underperformance of the B2C agencies. Interestingly, we are now seeing a clearly improving picture across the group with B2C catching up with B2B agencies, providing a more balanced growth picture. On a like for like basis, the group is now well ahead of the comparatives with Q1 FY22 +17% YoY compared to -4% in Q1 FY21. The current Q2 is trading ahead of Q1.

The share price has, understandably, responded by hitting all- time highs and is now +84% year to date. In terms of headline valuation, the FY1 PE multiple is 20.0x, falling to 18.9x in FY2. We note that Next Fifteen still stands at a material PE discount to the Agency peer group despite weathering the pandemic better than any of its peers. All of Next Fifteen's immediate peers are currently seeing their FY2 EPS consensus still standing below previous highs. Next Fifteen is the only member of the peer group with FY2 EPS consensus at the highest level it has ever been.

- **A more balanced growth picture:** Since the pandemic started, Next Fifteen's outperformance has been driven primarily by the strength of its more B2B focused agencies more than offsetting the inevitable weakness in the B2C portfolio. This unevenness looks now to have equalised with the B2C agencies returning to a more normalised growth profile.
- **Margin gains largley complete:** Looking beyond FY22 we see incremental margin gains being driven by growth in higher margin businesses and the contribution from acquisitions. The initial margin gains delivered through property rationalisation and pandemic cost actions have now fully washed through; leaving the company at a struturally higher margin compared to pre-pandemic levels. Looking forward, we do not ancitipate FY21 levels of margin expansion, not least as the group re-invests in headcount.
- **Organic and acquired growth:** With the addition of Shopper Media Group to the portfolio and the pandemic fast receding into the rear view mirror, we believe investor focus will return to the organic / acquired growth mix that Next Fifteen has delivered so successfully over the last five years. Value discipline remains high and remains a core plank to the investment case.
- **Estimate upgrades:** We are upgrading our revenue and adjusted PBT estimates for FY22 by +4% / +6% respectively. Minorities and tax lead to a +3% EPS upgrade.

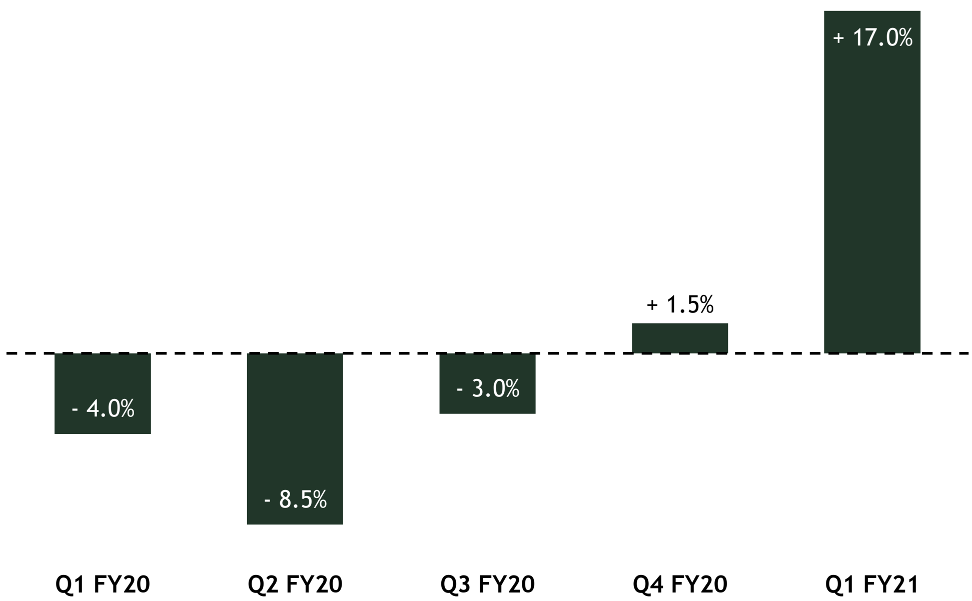
January, £m	Sales	PBT adj	EPS (p)	Div (p)	Net Cash	Fiscal PER x	Yield %
FY 2020A	248.5	40.2	34.8	2.5	-9.4	27.9	0.3
FY 2021A	266.9	49.1	40.7	7.0	14.0	23.8	0.7
FY 2022E	*314.7*	*61.7*	*48.5*	*11.0*	*18.4*	*20.0*	*1.1*
FY 2023E	*333.1*	*66.0*	*51.5*	*12.9*	*44.3*	*18.9*	*1.3*
FY 2024E	*351.4*	*70.2*	*54.5*	*13.6*	*82.2*	*17.8*	*1.4*

Source: Radnor Capital Partners

Organic growth recovery has been impressive:

In Figure 1 below, we show the quarterly progression of organic revenue growth by quarter through the course of FY'21 and into FY'22.

Figure 1: Fiscal Quarterly revenue growth through FY'21



Source: Company, Radnor

We can see from the above the extent to which the current organic growth run rate (continuing into Q2 as per the most recent trading update) has accelerated through the course of Next Fifteen's fiscal H2. The current run rate should be set against the context of the weak prior year comparative, however on an absolute basis, the group is comfortably ahead of the FY19 pre-pandemic comparative.

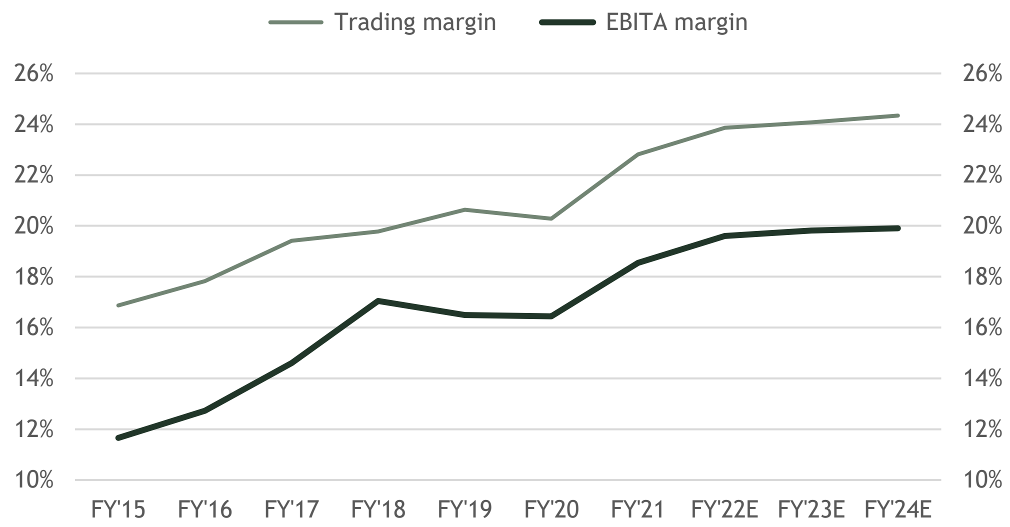
The subsidiary agencies that have been leading the charge through FY'21 all had a primarily B2B focus to them and included Activate, Twogether, Agent3, M Booth Health and Mach49.

The more B2C focused agencies (B2C in the sense that the enterprise customers themselves are consumer facing), such as the digital market research play, Savanta, had a more challenging pandemic with short term budgets coming under pressure although subsequently recovering in H2. However, that recovery has now moved beyond recapturing the ground lost during the middle part of the year.

Beyond the recovery of the group back into positive organic revenue growth in Q4; the key headline for FY21 was the sharp rebound in operating margins.

In our view, one of the issues that has held back the NFC PE multiple over the last 10 years has been a lingering suspicion that NFC would struggle to drive margins above the mid-teens percentage bracket the market has been used to seeing from Agency businesses over the years. However, as the NFC business mix has evolved through a prolonged period of M&A; we believe a very different underlying margin profile.

Figure 2: Group pre and post central overhead EBITA margins, FY15 to FY24E



Source: Company, Radnor

Although we are now taking a slightly more cautious tone on margins in our estimates; we still see Next Fifteen's response to the pandemic as having unlocked a structurally higher ongoing margin profile than the group enjoyed beforehand before considering the margin benefits driven by the group's evolving business mix. The rationalisation of the property portfolio, saving c.£6m per annum, is a structural saving alongside a proportion of employee related costs. However, the reduction in travel expenses and flexible working efficiencies will at least partially unwind as conditions continue to normalise.

Set against this structural margin gain, however, will be the need to support future organic growth through headcount investment. Pre pandemic, the available skills supply had been tight and employee cost inflation was a challenge. The jury is still out on whether the pandemic has loosened this environment, but the early indications are that the relevant skills remain well bid. If organic growth remains as strong as the group is currently enjoying then the cost to serve this growth is likely to become more pronounced.

Net net, we see Next Fifteen as a higher margin business post pandemic, however organic margin gains from this point are more likely to be incremental rather than material. M&A is more likely now to be the primary driver of further margin gains.

Business mix and profile

Next Fifteen's historic roots are in the traditional world of public relations (albeit with a heavy North American and technology bias). However, this shape has changed markedly with all the acquisitions over the last six years focused outside traditional communications and into the digital marketing and technology space; encompassing specialisms as diverse as web design & build, online market research, specialist content marketing, innovation consulting, corporate venturing, sales activation and lead generation.

Historically, Next Fifteen has segmented itself into three broad buckets; **Brand Marketing**, **Data & Analytics** and **Creative Technology**, with the former representing the broad PR and marketing core. However, this segmentation did not accurately reflect the diversity of the group's parts, nor the likely future direction of M&A investment.

At the last final results, Next Fifteen outlined a new segmental reporting structure that better outlines and articulates the breadth of the group's activities.

Figure 3: New group segmentation

Insight		Engagement		Delivery		Transformation	
Analytics, data and research led. Enabling clients to make better marketing & product decisions		*Content, strategy and message creation and delivery.*		*Sales delivery through the application of technology and data*		*Organisational value maximisation through investment and transformation*	
Revenue	**£33m**	*Revenue*	**£166m**	*Revenue*	**£50m**	*Revenue*	**£18m**
Margin	**15%**	*Margin*	**22%**	*Margin*	**31%**	*Margin*	**22%**
Organic growth	**5% - 10%**	*Organic growth*	**3% - 7%**	*Organic growth*	**10% - 15%**	*Organic growth*	**10% - 15%**

Source: Company

Although the group has unveiled the bare bones of this new segmentation, it has not been formally reflected in the group's financial statements and we await further detail through the course of FY22 on the full financial disclosure and historic reconciliations. Our forecast financial model remains based on the historic segmentation. Our key observations about this new segmentation are as follows:

- **Engagement** is most analogous to the existing **Brand Marketing** segment and includes the larger US agencies Archetype and M Booth. In FY21, Brand Marketing delivered £141m of revenue (+4% growth) and a contribution margin of 24.7%. Also included within Engagement will be the content marketing agencies such as Publitek.

- **Insight** represents the data, research and analytics businesses such as Savanta. It is worth noting here that the FY21 contribution margin of 15% is depressed by pandemic impacts, which were most pronounced on businesses like Savanta, whose clients are typically more B2C focused. We would expect more normalised Insight margins to be 20% plus.

- **Delivery** is based around the concept of demand, lead and sales generation through the use of technology or data insights. This is a fast growing area and proved to be the most insulated against the worst impacts of the pandemic. Newer businesses within the Next Fifteen portfolio such as Activate and Agent3 would sit in this segment. We believe the most recent acquisition, Shopper Media Group (itself made up of three component agencies), will also straddle across Insight and Delivery.

- **Transform** is based around the concept of transformation and corporate value enhancement and is the furthest away from the traditional marketing universe. The recent acquisition, Mach49, is a good example of this in action with its focus on helping established businesses combat disruptive threats through corporate venturing and VC style investing. Elsewhere, the IPO / IR agency, Blueshirt, will sit within this segment.

- **Future M&A focus** is likely to revolve around Insight, Delivery and Transform. These are the areas that are most data led and are most explicitly aligned with clients' own growth and value ambitions. In this sense, we do not see a marked departure from the established M&A model which has tended to focus on areas outside of the more traditional communications arena. Not only are margins structurally superior but businesses tend to be less mature and offer faster growth but, critically, more benefits for the acquired businesses in joining the established Next Fifteen platform.

- **More than just a paper reshuffle.** Segmental reorganisations can often be superficial exercises in order to flatter reported numbers. Our sense post the final results presentation is that this represents a more substantive re-appraisal of how the Next Fifteen agencies sit within the group and how they interact with each other and their customers. We await more colour on how any new internal incentive structures will operate, which will be the most significant yardstick by which investors will be able to assess the potential impact of closer agency collaboration. Next Fifteen's track record here is one of informal encouragement, with some degree of success. Despite taking a relatively light touch approach to agency collaboration, Next Fifteen has still been able to deliver healthy mid to high single digit organic growth for the best part of a decade, so the potential for greater collaboration to be materially accretive is clear to see.

Estimate Revisions: PBT +6% for FY 2022, +6% for FY 2023

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

Figure 4: Radnor estimate revisions

		Previous		New		*Change, %*	
£m	FY21A	2022E	2023E	**2022E**	**2023E**	**2022E**	**2023E**
Brand Marketing	140.5	159.5	167.5	165.8	174.1	*+ 4%*	*+ 4%*
Data + Analytics	48.4	55.2	59.6	58.1	62.8	*+ 5%*	*+ 5%*
Creative Technology	77.9	86.5	91.7	90.8	96.2	*+ 5%*	*+ 5%*
Revenue	**266.9**	**301.2**	**318.8**	**314.7**	**333.1**	***+ 4%***	***+ 4%***
Brand Marketing	34.6	39.9	42.2	42.1	44.7	*+ 6%*	*+ 6%*
Data + Analytics	13.3	16.0	17.4	16.9	18.3	*+ 6%*	*+ 5%*
Creative Technology	13.1	14.9	16.0	16.1	17.1	*+ 8%*	*+ 7%*
Central Overhead	-11.4	-12.8	-13.5	-13.4	-14.2	*+ 4%*	*+ 5%*
EBITA	**49.5**	**58.0**	**62.1**	**61.7**	**66.0**	***+ 6%***	***+ 6%***
margin %	*18.5%*	*20.1%*	*20.4%*	*19.6%*	*19.8%*		
Adj. PBT	**49.1**	**58.2**	**62.3**	**61.9**	**66.3**	***+ 6%***	***+ 6%***
Adj. EPS (p)	**40.7**	**47.0**	**48.9**	**48.5**	**51.5**	***+ 3%***	***+ 5%***
Dividend (p)	7.0	10.7	12.2	11.0	12.9	*+ 3%*	*+ 5%*
Net Cash (Debt)	**14.0**	**15.9**	**39.3**	**18.4**	**44.3**		

Source: Radnor

We had previously upgraded our FY22 PBT estimate by +12% to reflect only the strength of Q4 trading momentum but also the acquisition of Shopper Media Group. Please refer to our note of 21st April 2021 (link here) for the detail behind those upgrades.

Today we are upgrading our estimates in response to the AGM trading update. We are increasing our revenue expectations for both FY22 and FY23 by 4% and our adjusted PBT expectations by 6%.

Further down the P&L the strength of performance in some of the more recently acquired businesses is likely to result in a larger minority interest charge and we are also factoring a 1.5% higher effective tax rate than our previous estimate as result of the relative strength of the US businesses.

Valuation

Figure 5: Next Fifteen FY2 **PE**

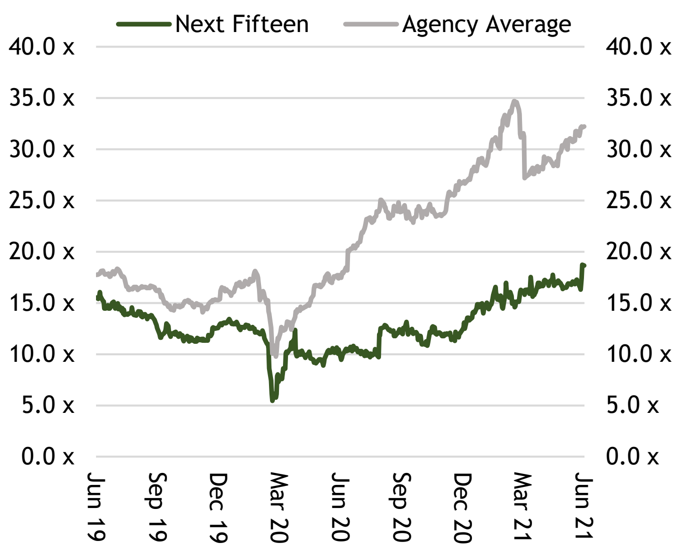
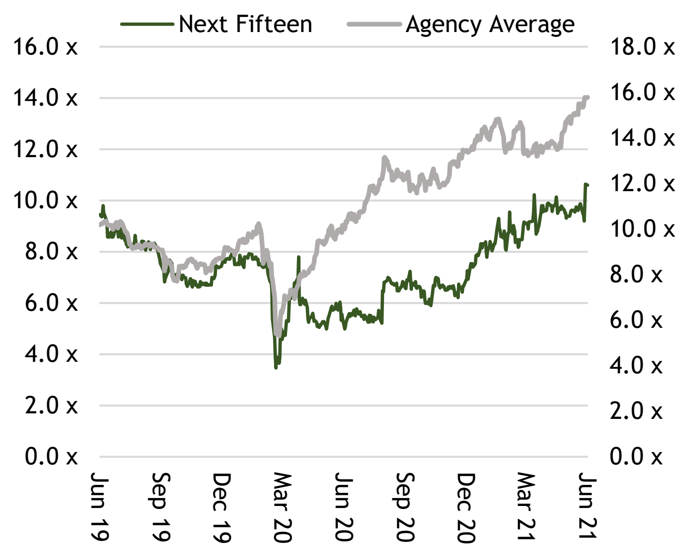


Figure 6: Next Fifteen FY2 **EV/EBITDA**



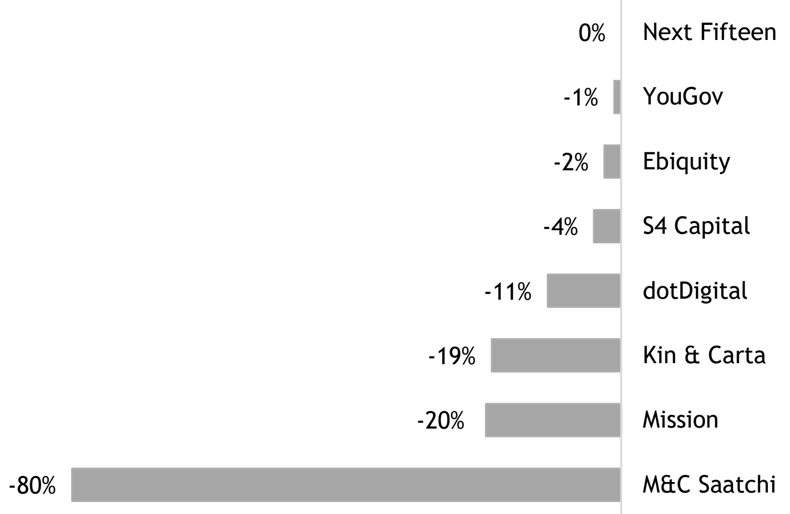
Source: FactSet, Radnor

- In Figures 5 & 6 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 2022 earnings outlook.
- Despite a significant recovery in the Next Fifteen forward rating (across both metrics), and the shares now trading at 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.
- 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 7: Current FY2 EPS consensus vs Peak



Source: FactSet, Radnor

Next Fifteen Communications PLC

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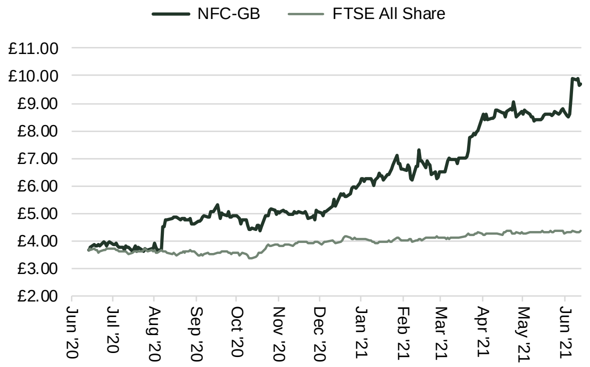
Price (p): **970 p**
Market Cap: 899 m
EV: 885 m

PROFIT & LOSS

Year to 31 January, £m	FY18	FY19	FY20	FY21	FY22e	FY23e	FY24e
Brand Marketing	*134.7*	*133.2*	*135.0*	*140.5*	*165.8*	*174.1*	*182.8*
Data & Analytics	*13.9*	*23.2*	*45.1*	*48.4*	*58.1*	*62.8*	*66.6*
Creative Technology	*48.3*	*67.7*	*68.4*	*77.9*	*90.8*	*96.2*	*102.0*
Group Net Revenue	**196.8**	**224.1**	**248.5**	**266.9**	**314.7**	**333.1**	**351.4**
Brand Marketing	*27.5*	*29.6*	*29.9*	*34.6*	*42.1*	*44.7*	*47.5*
Data & Analytics	*3.5*	*7.2*	*12.7*	*13.3*	*16.9*	*18.3*	*19.6*
Creative Technology	*7.9*	*9.5*	*7.8*	*13.1*	*16.1*	*17.1*	*18.4*
Head Office	*(8.9)*	*(9.3)*	*(9.5)*	*(11.4)*	*(13.4)*	*(14.2)*	*(15.3)*
EBITA - Adjusted	**30.0**	**37.0**	**40.9**	**49.5**	**61.7**	**66.0**	**70.2**
Associates & JV's	0.0	0.1	0.2	0.4	1.0	1.0	1.0
Lease interest			-	-	-	-	-
Net Bank Interest	(0.7)	(1.0)	(0.8)	(0.8)	(0.8)	(0.8)	(0.8)
PBT - Adjusted	**32.8**	**36.0**	**40.2**	**49.1**	**61.9**	**66.3**	**70.5**
Non Operating Items	(12.8)	(16.3)	(23.0)	(37.2)	(22.8)	(23.2)	(20.0)
Other Financial Items	(3.2)	(0.9)	(11.6)	(13.2)	(10.5)	(10.0)	(10.0)
PBT - IFRS	**13.3**	**18.8**	**5.6**	**(1.3)**	**27.2**	**31.7**	**39.0**
Tax	(4.0)	(4.3)	(2.7)	(2.6)	(5.6)	(7.9)	(9.8)
Tax - Adjusted	(5.9)	(7.2)	(8.0)	(9.9)	(14.6)	(15.9)	(16.9)
Tax rate - Adjusted	*17.9%*	*20.0%*	*20.0%*	*20.2%*	*23.5%*	*24.0%*	*24.0%*
Minority interests	0.7	0.6	0.6	1.0	1.9	2.1	2.5
No. shares m	74.3	79.2	85.3	89.4	89.4	89.4	89.4
No. shares m, diluted	82.1	85.0	90.9	93.8	93.8	93.8	93.8
IFRS EPS (p)	11.6	17.5	2.7	(5.5)	22.1	24.2	30.0
Adj EPS (p), diluted	**32.1**	**33.1**	**34.8**	**40.7**	**48.5**	**51.5**	**54.5**
Total DPS (p)	6.3	7.6	2.5	7.0	11.0	12.9	13.6

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	FY21	FY22e	FY23e	FY24e
Net Profit: (add back)	9.3	14.5	2.8	(3.9)	21.6	23.8	29.3
Depreciation & Amortisation	*11.4*	*13.8*	*26.4*	*28.0*	*27.6*	*28.0*	*28.3*
Net Finance costs	*4.0*	*1.9*	*14.1*	*15.4*	*12.7*	*12.2*	*12.2*
Tax	*4.0*	*4.3*	*2.7*	*2.6*	*5.6*	*7.9*	*9.8*
Working Capital	(4.2)	1.2	(3.3)	6.6	(8.4)	(2.3)	(0.6)
Other	4.4	2.6	6.8	24.3	8.0	8.0	8.0
Cash from Ops	**28.9**	**38.4**	**49.5**	**72.9**	**67.1**	**77.5**	**87.0**
Cash Tax	(4.3)	(6.2)	(6.0)	(8.4)	(5.6)	(7.9)	(9.8)
Tangible Capex	(3.0)	(5.6)	(3.5)	(2.0)	(4.0)	(4.0)	(4.0)
Intangible Capex	(1.2)	(2.4)	(1.8)	(2.1)	(2.0)	(2.0)	(2.0)
Free Cashflow	**20.4**	**24.1**	**38.2**	**60.4**	**55.5**	**63.6**	**71.2**
Dividends	(5.7)	(6.6)	(7.5)	(0.7)	(7.3)	(10.9)	(12.5)
Acquisitions & Inv.	(15.4)	(29.6)	(24.2)	(23.6)	(34.0)	(17.0)	(11.0)
Financing	3.8	7.7	1.8	(37.7)	(9.9)	(9.9)	(9.9)
Net Cashflow	**3.1**	**(4.4)**	**8.3**	**(1.6)**	**4.4**	**25.9**	**37.9**
Net Cash (Debt)	(11.6)	(5.2)	(9.4)	14.0	18.4	44.3	82.2

Announcements

Date	Event
April 2021	Final results (y/e Jan 2021)
April 2021	Acquisition of Shopper Media for £15m
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

RATIOS

	FY20	FY21	FY22e	FY23e	FY24e
RoE	28.1%	32.7%	33.0%	30.4%	27.5%
RoCE	33.6%	48.5%	52.4%	58.6%	68.7%
Asset Turnover (x)	0.9x	0.8x	0.7x	0.6x	0.6x
NWC % Revenue	41.2%	42.4%	29.8%	28.2%	26.6%
Op Cash % EBITA	121.2%	147.4%	108.7%	117.4%	123.8%
Net Debt / EBITDA	0.1x	-	-	-	-

BALANCE SHEET

Year to 31 January, £m	FY18	FY19	FY20	FY21	FY22e	FY23e	FY24e
Intangibles	94.8	126.1	155.4	163.8	164.8	168.8	166.8
P,P+E	13.6	15.9	14.2	8.9	13.3	12.3	11.0
Tax Asset & Other	11.7	13.0	54.7	43.4	35.4	27.4	19.4
Total Fixed Assets	**120.1**	**155.0**	**224.4**	**216.1**	**213.4**	**208.5**	**197.1**
Net Working Capital	(32.2)	(38.4)	(102.3)	(113.2)	(93.7)	(94.1)	(93.4)
Capital Employed	**87.9**	**116.6**	**122.1**	**102.9**	**119.7**	**114.4**	**103.7**
Net Funds	(11.6)	(5.2)	(9.4)	14.0	18.4	44.3	82.2
Net Assets	**76.3**	**111.5**	**112.7**	**116.9**	**138.1**	**158.7**	**185.9**

VALUATION

Fiscal	FY20	FY21	FY22e	FY23e	FY24e
P/E	27.9x	23.8x	20.0x	18.9x	17.8x
EV/EBITDA	12.9x	11.4x	14.3x	13.4x	12.6x
Div Yield	0.3%	0.7%	1.1%	1.3%	1.4%
FCF Yield	4.3%	6.8%	6.3%	7.2%	8.0%
EPS growth	4.9%	17.1%	19.1%	6.1%	5.8%
DPS growth	-66.9%	180.0%	57.5%	16.7%	5.8%

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