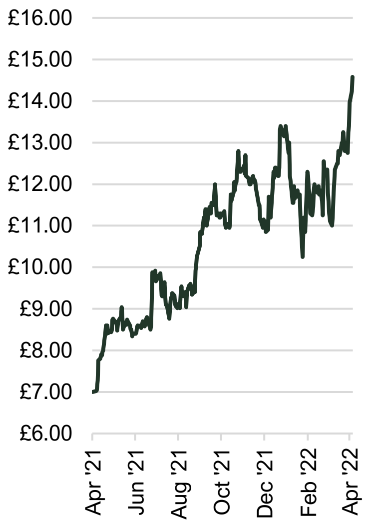
Next Fifteen Communications Group PLC

NFC | AIM | Media | 1328p | £1,334m

Final Results – Ahead of expectations + further upgrades

1 Year Chart



7th April 2022

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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.

Final results came in +6% ahead of our recently upgraded expectations, capping off a remarkable year of growth and progress for the group. On a purely organic basis, +26% revenue growth and continued margin expansion was hugely impressive. The addition of Engine UK into FY23, acquired at an attractive multiple, combined with the initial Mach49 contract win revenue means that FY23 is also likely to be another record year for the group. We upgrade our FY23 / FY24 PBT estimates by +2% / +5% respectively.

The trading outlook remains strong, with the group not witnessing any near term impacts from either client spend slowdown nor macro reactions to the Ukraine war. We see this as a testament to the positioning of the group into areas less exposed to cyclical discretionary spend volatility that has so characterised marcomms groups in the past. The outperformance through the pandemic is the clearest evidence yet of this fundamental strength. Concerns clearly persist around wage inflation although we believe this risk has been largely offset by structural cost savings elsewhere in the group.

- **Final results:** The headlines make for impressive reading and came in +6% ahead of our recently upgraded expectations. Reported revenue growth +36%, organic revenue +26%, adjusted PBT +62%. Net cash was £37.5m.
- **Adjusted vs Statutory:** The vagaries of merger accounting did muddy the waters with the group reporting a statutory loss before of £80.1m compared to an adjusted profit before tax of £79.3. The primary driver here was the non-cash charge taken to reflect the material uplift in the value of the Mach49 earn out. There were no impairment charges taken in the period.
- **Organic growth across the board:** The key feature of FY22 has been the uniformity of the trading momentum across all four legs of the group, with each delivering +15% organic revenue growth. Margins (+340 basis points to 21.9%) also benefited from good revenue drop through and structural property cost savings.
- **Mach49 & Engine:** Beyond the impressive organic performance delivered in FY22 and the positive trading outlook, recent Next 15 news has been dominated by the combination of the $400m Mach49 contract win and the Engine UK acquisition, both of which will make full contributions in FY23.
- **Estimate upgrades:** The combination of strong organic growth, Engine cost efficiencies and an uplift in expected mach49 contract margins, we are, yet again, nudging up our FY23 and FY24 adjusted PBT estimates by +2% / +5% respectively.

Y/E January, £m	Sales	PBT adj	EPS (p)	Div (p)	Net Cash	Fiscal PER x	Yield %
FY 2021A	266.9	49.1	40.7	7.0	14.0	32.6	0.5
FY 2022A	362.1	79.3	59.7	12.0	35.7	22.2	0.9
FY 2023E	*514.2*	*101.2*	*69.6*	*13.9*	*42.7*	*19.1*	*1.0*
FY 2024E	*614.7*	*121.6*	*82.9*	*16.6*	*96.5*	*16.0*	*1.2*
FY 2025E	*670.6*	*134.0*	*91.1*	*18.2*	*141.7*	*14.6*	*1.4*

Source: Radnor Capital Partners

Final Results: +6% ahead of upgraded expectations

The results for the year ended January 2022 came in **+6%** ahead of our recently upgraded expectations post the year end trading update. Key headlines as follow:

- Reported revenue **+36%** to £362.1m, up 26% on a purely organic basis
- Adjusted operating margins **+340 basis points** to 21.9%
- Adjusted profit before tax **+62%** to £79.3m
- Statutory loss before tax £80.1m
- Adjusted EPS **+47%** to 59.7p
- Final divided of 8.4p, making 12.0p for the year, with cover of 5.0x
- Net operating cashflow **+27%** to £92.9m
- Year end net cash £35.7m

The key driver of the surprise "beat" to expectations relates to the previously announced Mach49 $400m contract win. This contract was won earlier than expected, accelerating the revenue recognition of the feasibility project that Mach49 had been undertaking. This revenue was very high margin and dropped pretty much straight through the P&L.

Unhelpfully, the vagaries of merger accounting resulted in the unusual situation of the group reporting its highest ever adjusted PBT and also its largest ever statutory loss.

Figure 1: Next Fifteen adjusting items

£m	FY21	FY22
Adjusted PBT	**49.1**	**79.3**
General		
Acquired goodwill amortisation	-15.0	-17.7
Equity based incentives	-2.4	-5.9
Property & Other Restructuring	-12.8	-0.2
Furlough	1.4	-1.4
Other items	-0.4	0.0
	-29.2	**-25.2**
M&A related		
Change in earn out liability	-8.1	-110.7
Earn out discount unwinding	-5.2	-8.3
Employment linked acquisition payments	-8.0	-15.2
	-21.3	**-134.2**
Reported PBT	**-1.3**	**-80.1**

Source: FactSet, Radnor

In line with almost all its peers, Next Fifteen excludes the amortisation of acquired intangible assets from its adjusted profit before tax and this year is no different. However, in addition to the “standard” adjusting items, Next 15 has a further £134.2m of M&A specific related charges. Two of these; the change in estimated earn out liability and the unwinding of the earn out discount, are pure accounting items (non cash related) and are put through the net financing line in the income statement, rather than as standalone exceptional items. In our model, and our key estimates at the back of this note, we prefer to split down the net financing line between net bank related financing costs (ie, net interest and facility costs), which we include within adjusted PBT and accounting items relating to M&A, which we exclude.

In Figure 2 below, we show the breakdown of the group’s segmental performance.

Figure 2: Next Fifteen segmental analysis

£m	FY21	FY22	Headline YoY %	Organic YoY %
Engage				
Revenue	166.5	187.6	*+ 13%*	*+ 16%*
Contribution	36.9	40.4	*+ 10%*	-
Margin %	*22.1%*	*21.6%*		
Delivery				
Revenue	49.6	80.0	*+ 61%*	*+ 40%*
Contribution	15.2	28.5	*+ 87%*	-
Margin %	*30.7%*	*35.6%*		
Insight				
Revenue	33.1	42.1	*+ 27%*	*+ 19%*
Contribution	4.9	9.0	*+ 85%*	-
Margin %	*14.7%*	*21.4%*		
Transform				
Revenue	17.7	52.5	*+ 196%*	*+ 100%*
Contribution	3.9	15.2	*+ 290%*	-
Margin %	*22.0%*	*29.0%*		
Group				
Revenue	**266.9**	**362.1**	***+ 36%***	***+ 26%***
Contribution	60.9	93.2	*+ 53%*	-
Margin %	*22.8%*	*25.7%*		
Central Costs	-11.4	-13.8		
EBITA	**49.5**	**79.3**		
Margin %	*18.5%*	*21.9%*		

Source: FactSet, Radnor

- Organic revenue growth was +26% YoY across all segments of the group

  – **Engage** is the largest and most broadly based of the group segments. This represents the more established agency businesses. All the group agencies here delivered growth in revenue and margin but with two agencies in particular; M Booth and Brandwidth, delivered very strong performances. At the half year **Engage** delivered organic revenue growth of +14.6%, with momentum more than maintained through H2.

- **Delivery** is one of the newer parts of the group and represents agencies focused on demand and lead generation for clients. This has been one of the strongest performing segments through the group as clients pivoted marketing spend away from more traditional sales generation formats into data led models, which is where Next 15 is positioned. It is increasingly clear that this new business momentum has been maintained outside of the pandemic. Organic growth in the year was +40%. The pace of growth slowed compared to H1 (+49%) but remains impressive.

- **Insight** is the market research arm of the group, although very much geared around a digital model which continues to take share away from more traditional market research formats. This is also one of the areas of the group where the productization theme is most likely to bear fruit. This was also the area of the group that was most exposed to the short term effects of the pandemic. Full year organic growth was +19%, compared to 18% at the half year suggesting a consistent growth trajectory throughout the year. Perhaps more tellingly, FY21 saw a material recovery in profitability towards a more normalised pre-pandemic level

- **Transform** is also a relatively new leg to the group and is focused on helping clients re-engineer their business models and maximise corporate value. Mach49 is a prominent component in this segment, although Palladium (digital advisory to private equity owners) and Blueshirt (US capital markets advisory) were also significant contributors. Organic growth in the year was +100% with margins expanding towards 30%. Margins here were flattered by the strong Mach49 finish to the year, with a very high drop through rate on the final revenue contribution.

Despite the pandemic disruption, Next 15 has delivered a consistent trend of improving operating margins. In fact, over the last nine years, only one (FY19) has seen a decline in group adjusted EBITA margins. Even in the teeth of the pandemic, in FY21, group EBITA margins still increased from 16.4% to 18.5%. FY22 also saw a healthy improvement in group EBITA margins to 21.9%.

This margin delivery has been delivered in spite of broader inflationary cost pressures and internal wage inflation which we estimate is running at 4% - 5% per annum. We see two primary reasons driving this; firstly, growth in a higher margin business mix, and secondly, structural cost savings from a rationalisation of the group property portfolio. This last point is particularly important as it represents a permanent cost saving of c.300 basis points and does support the continued margin upside as the group business mix evolves.

Estimate Revisions: PBT / EPS +2% / +3% for FY 2023

We have revisited our forecast model and have made the following changes:

Figure 3: Radnor estimate revisions

		Previous		New		*Revision, %*	
£m	FY22A	2023E	2024E	**2023E**	**2024E**	**2023E**	**2024E**
Customer Engagement	187.6	269.4	305.2	257.9	293.4	- 4%	- 4%
Customer Delivery	80.0	87.2	95.9	87.9	101.1	+ 1%	+ 5%
Customer Insight	42.1	44.6	48.2	45.5	50.9	+ 2%	+ 6%
Business Transformation	52.5	112.4	154.9	123.0	169.2	+ 9%	+ 9%
Revenue	**362.1**	**513.7**	**604.3**	**514.2**	**614.7**	**+ 0%**	**+ 2%**
Customer Engagement	40.4	64.5	72.1	59.0	67.1	- 9%	- 7%
Customer Delivery	28.5	30.8	34.1	31.0	35.9	+ 1%	+ 5%
Customer Insight	9.0	8.7	9.6	9.6	10.7	+ 10%	+ 11%
Business Transformation	15.2	22.5	30.6	24.4	34.5	+ 9%	+ 13%
Central Overhead	-13.8	-26.7	-30.2	-22.6	-26.4	- 15%	- 13%
EBITA	**79.3**	**99.7**	**116.2**	**101.3**	**121.7**	**+ 2%**	**+ 5%**
- margin %	21.9%	19.4%	19.2%	19.7%	19.8%		
Adj. PBT	**79.3**	**99.1**	**115.6**	**101.2**	**121.6**	**+ 2%**	**+ 5%**
Adj. EPS (p)	**59.7**	**67.3**	**77.7**	**69.6**	**82.9**	**+ 3%**	**+ 7%**
Dividend (p)	12.0	15.0	17.3	13.9	16.6	- 7%	- 4%
Net Cash (Debt)	**35.7**	**46.5**	**81.8**	**42.7**	**96.5**		

Source: Radnor

- We are upgrading our underlying revenue / profit assumptions for three of the four group segments reflecting the strong organic growth delivered in H2 FY22. Our previous upgrades (February 2022) captured the initial impacts of both the Mach49 contract win (Transform segment) and the Engine UK acquisition (Engage and Transform segments).

- We have fine tuned some of our thinking behind both Mach49 (upgrade to contract margin assumptions) and Engine (increased cost savings which is reflected in a lower central costs estimate) alongside a reduced growth expectation (high single digit vs mid teens).

- The margin recovery in Insight was impressive in FY22 and lays the ground for continued improvement in FY23 and beyond.

- We have also updated our cash-flow forecasts for the latest guidance on expected earn out payments, which have increased materially, largely as a result of the Mach49 contract win. We note that these earn out payments are covered comfortably by free cashflow. Our current estimate for FY23 and FY24 are -£36m / -£31m respectively. Despite this uptick in earn out payments our FY23 net cash estimate only reduces by c.£4m to £42.7m. In the absence of future M&A we expect net cash to rise sharply to £96.5m in FY24.

Valuation

Figure 4: Next Fifteen FY2 **PE**

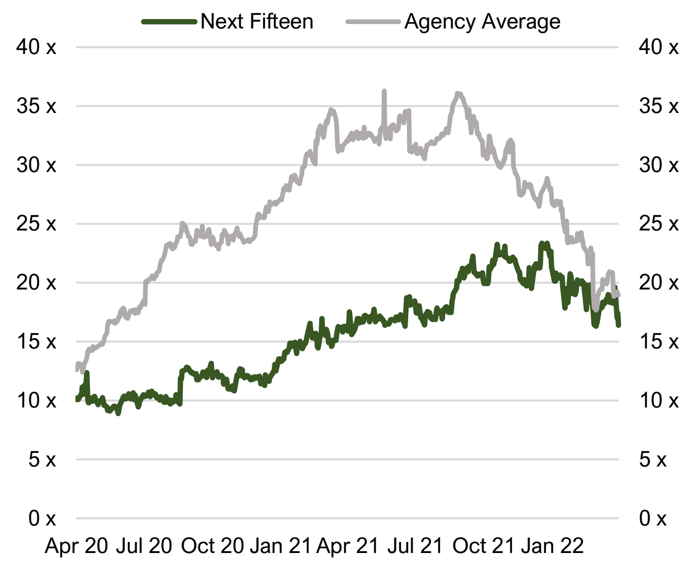
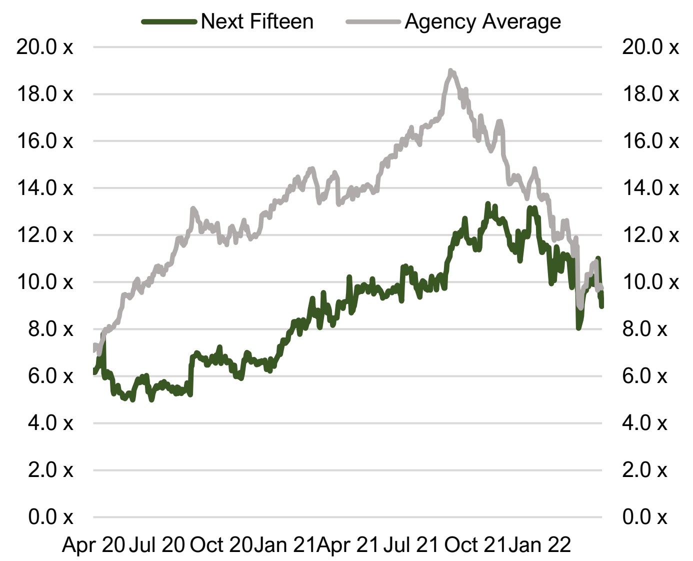


Figure 5: Next Fifteen FY2 **EV/EBITDA**



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 UK Agency average.

In Figures 6 and 7 below, we compare Next Fifteen to the peer group and Small Cap Media in terms of PE vs Revenue Growth and PE vs EBITDA margins.

Figure 6: Next Fifteen FY2 PE vs Growth

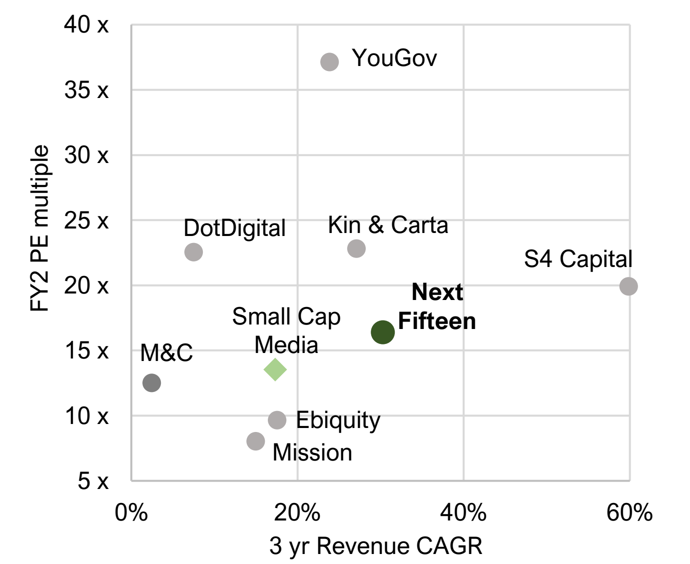
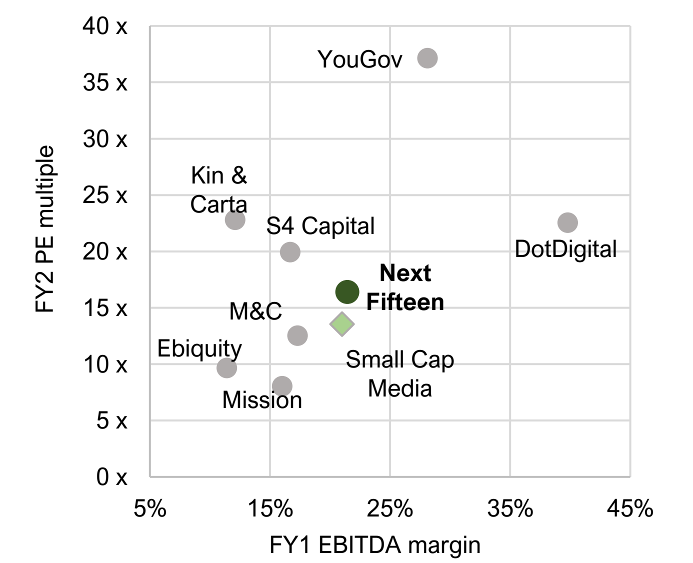


Figure 7: Next Fifteen FY2 PE vs Margin



Source: FactSet, Radnor

Next Fifteen Communications PLC

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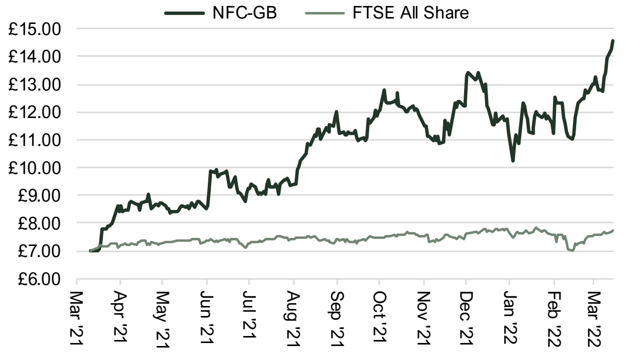
Price (p): **1328 p**
Market Cap: 1,334 m
EV: 1,291 m

PROFIT & LOSS

Year to 31 January, £m	FY20	FY21	FY22	FY23e	FY24e	FY25e
Customer Engagement		*166.5*	*187.6*	*257.9*	*293.4*	*314.8*
Customer Delivery		*49.6*	*80.0*	*87.9*	*101.1*	*111.3*
Customer Insight		*33.1*	*42.1*	*45.5*	*50.9*	*55.0*
Business Transformation		*17.7*	*52.5*	*123.0*	*169.2*	*189.5*
Group Net Revenue	**248.5**	**266.9**	**362.1**	**514.2**	**614.7**	**670.6**
Customer Engagement		*36.9*	*40.4*	*59.0*	*67.1*	*72.6*
Customer Delivery		*15.2*	*28.5*	*31.0*	*35.9*	*39.5*
Customer Insight		*4.9*	*9.0*	*9.6*	*10.7*	*11.6*
Business Transformation		*3.9*	*15.2*	*24.4*	*34.5*	*38.5*
Head Office	*(9.5)*	*(11.4)*	*(13.8)*	*(22.6)*	*(26.4)*	*(28.2)*
EBITA - Adjusted	**40.9**	**49.5**	**79.3**	**101.3**	**121.7**	**134.1**
Associates & JV's	0.2	0.4	0.2	0.2	0.2	0.2
Net Bank Interest	(0.8)	(0.8)	(0.3)	(0.3)	(0.3)	(0.3)
PBT - Adjusted	**40.2**	**49.1**	**79.3**	**101.2**	**121.6**	**134.0**
Non Operating Items	(23.0)	(37.2)	(40.4)	(32.0)	(29.0)	(29.0)
Other Financial Items	(11.6)	(13.2)	(119.0)	(10.0)	(10.0)	(10.0)
PBT - IFRS	**5.6**	**(1.3)**	**(80.1)**	**58.2**	**81.6**	**93.9**
Tax	(2.7)	(2.6)	14.5	(14.5)	(20.4)	(23.5)
Tax - Adjusted	(8.0)	(9.9)	(17.2)	(25.3)	(30.4)	(33.5)
Tax rate - Adjusted	*20.0%*	*20.2%*	*21.6%*	*25.0%*	*25.0%*	*25.0%*
Minority interests	0.6	1.0	3.6	4.6	6.2	7.1
No. shares m	85.3	89.4	92.4	96.9	96.9	96.9
No. shares m, diluted	90.9	93.8	98.1	102.6	102.6	102.6
IFRS EPS (p)	2.7	(5.5)	(74.9)	40.3	56.8	65.4
Adj EPS (p), diluted	**34.8**	**40.7**	**59.7**	**69.6**	**82.9**	**91.1**
Total DPS (p)	2.5	7.0	12.0	13.9	16.6	18.2

PRICE CHART - 1 YEAR ABSOLUTE vs FTSE ALL SHARE



Source: FactSet

SHAREHOLDERS

	% of ord. Share capital
Liontrust Investment Partners	14.1%
Octopus Investments	14.1%
Aviva Investors	11.8%
Aberdeen Stan Life	7.9%
Tim Dyson (CEO)	5.9%
BlackRock	5.1%
Canaccord Wealth	5.0%
Herald Inv Mgmt	4.4%
	68.3%

CASH FLOW

Year to 31 January, £m	FY20	FY21	FY22	FY23e	FY24e	FY25e
Net Profit: (add back)	2.8	(3.9)	(65.6)	43.6	61.2	70.4
Depreciation & Amortisation	*26.4*	*28.0*	*28.8*	*33.0*	*32.0*	*32.0*
Net Finance costs	*14.1*	*15.4*	*120.3*	*11.3*	*11.3*	*11.3*
Tax	*2.7*	*2.6*	*(14.5)*	*14.5*	*20.4*	*23.5*
Working Capital	(3.3)	6.6	0.2	(6.0)	(0.4)	(0.4)
Other	6.8	24.3	23.7	16.0	16.0	16.0
Cash from Ops	**49.5**	**72.9**	**92.9**	**112.5**	**140.5**	**152.8**
Cash Tax	(6.0)	(8.4)	(14.1)	(14.5)	(20.4)	(23.5)
Tangible Capex	(3.5)	(2.0)	(3.1)	(6.0)	(6.0)	(6.0)
Intangible Capex	(1.8)	(2.1)	(2.7)	(4.0)	(4.0)	(4.0)
Free Cashflow	**38.2**	**60.4**	**73.0**	**87.9**	**110.1**	**119.3**
Dividends	(7.5)	(0.7)	(12.4)	(14.1)	(17.0)	(20.1)
Acquisitions & Inv.	(24.2)	(23.6)	(28.1)	(107.0)	(31.0)	(45.8)
Financing	1.8	(37.7)	(1.1)	40.2	(8.4)	(8.4)
Net Cashflow	**8.3**	**(1.6)**	**31.4**	**7.0**	**53.8**	**45.1**
Net Cash (Debt)	(9.4)	14.0	35.7	42.7	96.5	141.7

Announcements

Date	Event
March 2022	Engine acquisition & £50m placing
February 2022	Mach49 $400m contract win
September 2021	H1 results
August 2021	Trading update
April 2021	Final results (y/e Jan 2021)
April 2021	Acquisition of Shopper Media for £15m
January 2021	Trading update

RATIOS

	FY21	FY22	FY23e	FY24e	FY25e
RoE	32.7%	95.3%	43.9%	44.4%	43.3%
RoCE	29.8%	37.1%	37.3%	49.3%	59.4%
Asset Turnover (x)	0.8x	0.7x	0.6x	0.5x	0.4x
NWC % Revenue	18.2%	14.3%	8.6%	7.1%	6.5%
Op Cash % EBITA	147.4%	117.0%	111.0%	115.4%	114.0%
Net Debt / EBITDA	0.1x	-	-	-	-

BALANCE SHEET

Year to 31 January, £m	FY20	FY21	FY22	FY23e	FY24e	FY25e
Intangibles	155.4	163.8	183.1	234.1	214.1	194.1
P,P+E	14.2	8.9	7.5	14.5	12.5	13.9
Tax Asset & Other	54.7	43.4	75.6	67.6	64.6	61.6
Total Fixed Assets	**224.4**	**216.1**	**266.2**	**316.2**	**291.2**	**269.6**
Net Working Capital	(42.8)	(48.6)	(51.6)	(44.2)	(43.9)	(43.5)
Capital Employed	**181.5**	**167.5**	**214.5**	**271.9**	**247.3**	**226.1**
Earn Out Liabilities	(59.5)	(64.6)	(188.8)	(152.2)	(152.2)	(152.2)
Net Funds	(9.4)	14.0	35.7	42.7	96.5	141.7
Net Assets	**112.7**	**116.9**	**61.5**	**162.4**	**191.6**	**215.5**

VALUATION

Fiscal	FY21	FY22	FY23e	FY24e	FY25e
P/E	32.6x	22.2x	19.1x	16.0x	14.6x
EV/EBITDA	15.7x	16.3x	12.7x	10.6x	9.6x
Div Yield	0.5%	0.9%	1.0%	1.2%	1.4%
FCF Yield	4.7%	5.6%	6.8%	8.5%	9.2%
EPS growth	17.1%	46.6%	16.5%	19.2%	9.9%
DPS growth	180.0%	71.4%	15.9%	19.2%	9.9%

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