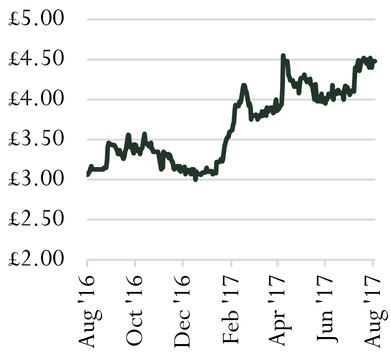
Next Fifteen Communications PLC

NFC | AIM | Media |445p |£331m

1 Year Chart



M&A strategy – Accretive, Value Focus, Lower Risk

Next Fifteen (NFC) has announced the acquisitions of Velocity Partners and Circle Research for a combined net initial consideration of £9m (£7.9m in cash). Both acquisitions are in line with the NFC M&A strategy; single digit acquisition multiple; entrepreneurial continuing management, digital focus with North American ambitions. We have argued before that NFC's M&A track record is one of the best in the peer group, with an emphasis on value, innovation and quality over scale. We have upgraded our estimates in response. NFC continues to trade on a well-deserved 6% PE premium to the Small Cap Agency peer group.

- **M&A strategy maintained:** Velocity Partners (B2B digital content agency) and Circle Research (B2B market research consultancy) are both young, growing and entrepreneurial businesses active in non-traditional areas of marketing communications. Both are UK based with North American ambitions, which the NFC "platform" will help accelerate.
- **Value and quality vs. scale and risk:** The blended initial acquisition multiple is 5.9x and both are subject to similar deferred consideration structures as other NFC acquisitions. Over the last three years, NFC has made eleven acquisitions for an aggregate £40m of initial consideration, paying a blended multiple of 6.1x. These acquisitions have focused on high growth / high margin business models and have transformed the overall UK business.
- **Forecast revisions:** Our FY18E / FY19E EPS estimates have increased by 2% / 5% respectively; with both acquisitions expected to be immediately earnings enhancing. We now look for FY18E net debt of £8.7m (less than 0.3x EBITDA), moving to a net cash position in FY19E in the absence of any further acquisitions.
- **Valuation:** Based on our new estimates, Next Fifteen trades on a FY18E PE of 16.7x and a yield of 1.4%. This represents a 6% premium to the Small Cap Agency peer group; justified by better than average growth prospects, a healthy balance sheet and continuing positive upgrade momentum.

8th August 2017

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Year End January	Revenue, £m	PBT adj, £m	EPS (p)	Div (p)	Net Cash, £m	PER x	Yield %
FY 2016A	129.8	16.1	16.9	4.2	-6.6	26.6	0.9%
FY 2017A	171.0	24.2	23.4	5.3	-11.4	19.1	1.2%
FY 2018E	*195.2*	*29.6*	*26.6*	*6.2*	*-8.7*	*16.8*	*1.4%*
FY 2019E	*213.4*	*33.4*	*30.0*	*7.0*	*6.0*	*14.9*	*1.6%*
FY 2012E	*225.6*	*36.0*	*32.1*	*7.4*	*39.1*	*14.0*	*1.7%*

Recent Acquisitions – Key Headlines

Both acquisitions in line with M&A strategy …

Next Fifteen recently announced the acquisition of Velocity Partners (£5.9m initial consideration) and Circle Research (£5.2m initial consideration, with £2.1m of net assets acquired and no debt). At a headline level, these acquisitions are in consistent with the group's M&A strategy, with both businesses:

- active in non-traditional areas of marketing communications; Velocity is a B2B focused digital content marketing agency, while Circle is a B2B market research consultancy,
- UK based but with the potential and ambition to grow their presence in North America,
- acquired at attractive, single-digit multiples with a deferred consideration structures similar to other NFC acquisitions over the last few years,
- profitable and growing with both expected to be immediately earnings enhancing to NFC,
- existing management teams will be remaining in place.

Overpaying is a common investor concern …

… clearly shared by management …

The risk of multiple inflation is a common concern raised by investors when discussing NFC (and other agency stocks). NFC's track record over the last three years is encouraging in this regard. Of the eleven acquisitions made since the start of FY2016, the highest multiple paid has been 8x and the blended multiple is 6.0x. Clearly, NFC is unwilling to get involved in competitive bidding processes where vendors are seeking a full exit at the highest possible price.

M&A strategy has delivered good results so we do not anticipate any wholesale changes … …

As the scale of the NFC platform increases, the marginal impact of sub £20m acquisitions will inevitably decrease. However, we do not anticipate wholesale changes to what has proven a successful strategy to date. We believe NFC offers a reduced risk profile to shareholders than has been the case with other M&A agency models in the past. Furthermore, smaller targets are likely to be more entrepreneurial and offer singular characteristics (ie, business model, client focus, specific technology IP) than larger, established businesses.

NFC ownership is intended to remove the barriers to growth

Also, NFC seeks to acquire entrepreneurial, growing businesses with the ambition to use the NFC "platform" to accelerate their growth. This is especially attractive for those with ambitions to target North America, which can be a very challenging and time consumptive prospect for a small UK based business.

Post-acquisition management is light touch …

NFC adopts a portfolio management approach to managing the group. Unless a problem needs to be fixed, the individual businesses are largely left alone to pursue their strategy, with the logistical and financial management heavy lifting done by group central functions. Cross-selling, or active co-operation between group agencies is not imposed and when it does occur it provides an extra layer of benefit. For vendor management teams not looking to exit their businesses, this can be a critical differentiator for NFC compared to other potential buyers.

Estimate Upgrades

Following the acquisitions of Velocity and Circle Research, we have updated our estimates for the Group. The detail of our estimate revisions can be seen in Figure 1 below. The key highlights are as follows:

Revenue, PBT and EPS estimates all moving upwards …

- Revenue / adjusted PBT for **FY18E** increased by +1% / +2% respectively to £193.9m / £26.9m,
- Revenue / adjusted PBT for **FY19E** increased by +4% / +5% respectively to £211.9m / £33.6m,
- **FY18E** adj. EPS increases by **+2%** to 26.6p;
- **FY19E** adj. EPS increases by **+5%** to 30.0p,
- **FY18E** net debt now forecast to be £8.7m (less than 0.3x net debt/EBITDA),

Figure 1: Radnor Estimates Changes for Next Fifteen Communications

	Previous		Revised		*Change, %*		*Change, £m*	
	2018E	2019E	2018E	2019E	2018E	2019E	2018E	2019E
UK	48.6	51.0	52.4	60.3	*8%*	*18%*	3.8	9.3
North America	119.8	129.4	119.8	129.4	*0%*	*0%*	0.0	0.0
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	**191.4**	**204.1**	**195.2**	**213.4**	***2%***	***5%***	3.8	9.3
UK	10.2	10.8	11.4	13.0	*12%*	*20%*	1.2	2.2
North America	25.4	27.7	25.0	27.7	*-1%*	*0%*	-0.4	0.0
EMEA	0.8	0.8	0.8	0.8	*0%*	*0%*	0.0	0.0
Asia Pacific	2.5	2.5	2.5	2.5	*0%*	*0%*	0.0	0.0
Central Overhead	-9.2	-9.8	-9.4	-10.2	*2%*	*5%*	-0.2	-0.4
EBITA	**29.6**	**32.1**	**30.3**	**33.8**	***2%***	***5%***	0.7	1.8
- margin %	*15.5%*	*15.7%*	*15.5%*	*15.9%*				
Adj. PBT	**28.9**	**31.8**	**29.6**	**33.4**	***2%***	***5%***	0.7	1.6
Adj. EPS (p)	**26.0**	**28.6**	**26.6**	**30.0**	***2%***	***5%***	0.6	1.4
Dividend (p)	6.1	6.6	6.2	7.0	*2%*	*5%*	0.1	0.3
Net Cash (Debt)	**-1.2**	**12.5**	**-8.7**	**6.0**			-7.5	-6.5

Source: Radnor Capital Partners, Company

We are in-line with consensus …

According to FactSet, we are in line with consensus expectations for FY18E EPS and marginally ahead for FY19E (30.0p vs 29.9p consensus).

Balance sheet remains healthy …

There are a number of moving parts in our estimate revisions, with the contributions from the acquired businesses being the main drivers of the upgrades. We have also factored the initial cash consideration of £7.8m after adjusting for acquired cash balances. We now look for a year end net debt position of £8.7m, moving to a net cash position of £6.0m in FY2019E.

Some caution in North America …

… although recent trading commentary has been solid …

We have taken the opportunity to inject a small note of caution into our North American expectations, reducing our FY2018E EBITA estimate by £0.4m (-1%) whilst assuming a £0.2m increase in group central overheads to £9.4m. Our caution over North America is driven by factors largely out of the immediate control of the company; namely continuing political uncertainty and FX volatility. These were both factors referenced by NFC in the AGM trading update (21st June 2017), although the update did note a "solid start" to the new financial year.

UK business has been transformed and remains likeliest source of upgrades …

Elsewhere, we have maintained our pre-existing estimates. The UK business has been transformed over the last three years through M&A and self-help measures undertaken while the North American business was delivering strong growth and margin expansion. We continue to expect FY18E and FY19E to show considerable progress in the UK in terms of revenue growth and margin expansion. We also believe the UK is the likeliest source of medium term estimate upgrades; especially if more recent acquisitions perform ahead of expectations.

Asia Pacific has also benefited from prior years' restructuring. Margin recovery here is now largely complete and we anticipate a solid contribution to the group moving forward.

Valuation

Strong NFC price momentum leaves it on a premium rating …

Year to date, NFC's share price has returned 44%, continuing the strong momentum generated over the last three years (+380%). Against such a backdrop of out-performance it is not surprising to see NFC valuation multiples heading towards the top of the peer group range.

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

	Price (p)	Market Cap, £m	PE FY1	PE FY2	EV/EBITDA FY1	EV/EBITDA FY2	Div Yield FY1	Div Yield FY2
Cello	122p	126.5	15.0	14.8	8.8	8.3	2.8%	3.0%
Ebiquity	119p	92.3	11.6	12.7			0.6%	0.7%
Huntsworth	80p	262.1	14.7	12.9	10.5	9.3	2.4%	2.6%
M&C Saatchi	321p	251.8	15.1	14.0			3.0%	3.4%
System1	833p	103.8	21.2	19.5	11.1	10.1	1.1%	1.2%
YouGov	270p	283.7	25.7	22.7	16.7	14.8	0.6%	0.7%
Small Cap Agencies			**15.9**	**15.0**	**11.8**	**10.6**	**1.7%**	**1.9%**
Next Fifteen	**445p**	**331.3**	**16.8**	**15.0**	**9.6**	**8.6**	**1.4%**	**1.6%**

Source: FactSet, Radnor Capital Partners

- Based on our revised estimates, NFC now trades on a FY2018E PE of 16.7x, a 6% premium to the Small Cap Agency peer group. The prospective dividend yield is 1.4%, compared to peer group average of 1.7%.

NFC is not the highest rated stock in the peer group …

- NFC is by no means the most highly rated company in the peer group; that honour belonging to **YouGov** on 25.7x and **System1** (aka **BrainJuicer**) on 21.2x.

NFC is a mid-teens earnings and dividend growth story …

- In terms of expected EPS growth, NFC sits towards the top end of the peer group range. In the absence of further M&A led upgrades, we see NFC as a mid-teens earnings and dividend growth story. Except for **Huntsworth** (which is coming off a low base) only the pure digital research specialists, **YouGov** and **System1**, offer equivalent or faster expected growth over the next two years, which is reflected in their higher PE multiples.

- NFC continues to see positive earnings revision momentum, a trend which has been in place for the best part of two years. In fact, if we look beyond the Agency peer group, across the broader Small Cap Media sector, there are only a handful of stocks that have demonstrated consistently positive EPS upgrade momentum over the last year. **Taptica International** (+136%), **Huntsworth** (+39%), **Next Fifteen** (+30%), **System1** (+29%) and **Euromoney** (+21%) make up the Top 5.

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Next Fifteen Communications PLC

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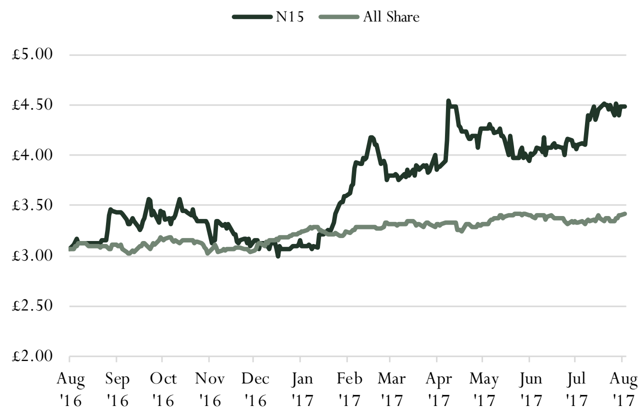
Price (p): 448 p
Market Cap: 331 m
EV: 340 m

PROFIT & LOSS

Year to 31 January, £m	2016	2017	FY18e	FY19e	FY20e
UK	*27.9*	*42.6*	*52.4*	*60.3*	*62.7*
North America	*83.5*	*107.0*	*119.8*	*129.4*	*138.5*
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**	**195.2**	**213.4**	**225.6**
UK	*3.8*	*8.0*	*11.4*	*13.0*	*13.5*
North America	*17.5*	*22.3*	*25.0*	*27.7*	*29.9*
EMEA	*0.5*	*0.6*	*0.8*	*0.8*	*0.9*
Asia Pacific	*1.4*	*2.2*	*2.5*	*2.5*	*2.6*
Head Office	*(6.6)*	*(8.2)*	*(9.4)*	*(10.2)*	*(10.8)*
EBITA - Adjusted	**16.5**	**25.0**	**30.3**	**33.8**	**36.1**
Associates & JV's	(0.0)	(0.3)	(0.2)	-	-
Net Bank Interest	(0.4)	(0.5)	(0.5)	(0.4)	(0.1)
PBT - Adjusted	**16.1**	**24.2**	**29.6**	**33.4**	**36.0**
Non Operating Items	(8.1)	(17.1)	(10.8)	(11.3)	(11.6)
Other Financial Items	(2.4)	(4.2)	(2.5)	(2.5)	(2.5)
PBT - IFRS	**5.6**	**2.9**	**16.6**	**19.6**	**21.9**
Tax	(1.1)	(1.2)	(3.3)	(3.9)	(4.4)
Tax - Adjusted	(3.5)	(5.3)	(6.7)	(7.3)	(7.9)
Tax rate - Adjusted	*22.0%*	*22.0%*	*22.5%*	*22.0%*	*22.0%*
Minority interests	0.5	0.5	1.0	1.0	1.0
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	16.5	19.5	21.7
Adj EPS (p), diluted	**16.9**	**23.4**	**26.6**	**30.0**	**32.1**
Total DPS (p)	4.2	5.3	6.2	7.0	7.4

PRICE CHART - 2 YEAR ABSOLUTE vs FTSE ALL SHARE



Source: FactSet

SHAREHOLDERS

	% of ord. Share capital
Liontrust	14.0%
Octopus Investments	10.0%
Standard Life	8.4%
Directors	7.2%
Hargreave Hale	5.8%
Aviva Investors	5.8%
Herald Inv Mgmt	5.7%
BlackRock	5.7%
	62.6%

CASH FLOW

Year to 31 January, £m	2016	2017	FY18e	FY19e	FY20e
Net Profit: (add back)	**4.5**	**1.7**	**13.2**	**15.6**	**17.5**
Depreciation & Amortisation	*6.1*	*9.5*	*9.9*	*10.7*	*11.2*
Net Finance costs	*2.8*	*4.7*	*3.0*	*2.9*	*2.6*
Tax	*1.1*	*1.2*	*3.3*	*3.9*	*4.4*
Working Capital	0.2	6.3	(3.1)	(0.5)	(0.4)
Other	1.6	9.4	3.0	1.0	1.0
Cash from Ops	**16.3**	**32.8**	**29.3**	**33.7**	**36.3**
Cash Tax	(3.0)	(2.0)	(5.0)	(2.9)	(3.3)
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**	**19.5**	**26.0**	**28.2**
Dividends	(3.0)	(4.3)	(4.9)	(5.4)	(5.8)
Acquisitions & Inv.	(13.4)	(21.9)	(12.8)	(5.0)	(5.0)
Financing	14.6	11.1	(0.8)	(0.7)	(0.4)
Net Cashflow	**4.6**	**6.8**	**1.1**	**14.8**	**17.0**
Net Cash (Debt)	(6.6)	(11.4)	(8.7)	6.0	39.1

Announcements

Date	Event
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
27th Sep 2016	Interim results (6 months ended July 2016)
27th Sep 2016	Acquisition of Pinnacle for £4.4m
28th June 2016	Interim trading update

RATIOS

	2016	2017	FY18e	FY19e	FY20e
RoE	22.9%	26.8%	28.4%	28.5%	24.0%
RoCE	27.8%	30.9%	35.0%	41.4%	49.1%
Asset Turnover (x)	0.6x	0.6x	0.6x	0.5x	0.5x
NWC % Revenue	9.3%	16.1%	13.4%	13.8%	16.2%
Op Cash % EBITA	98.6%	131.5%	96.7%	99.6%	100.5%
Net Debt / EBITDA	0.4x	0.4x	0.3x	-	-

BALANCE SHEET

Year to 31 January, £m	2016	2017	FY18e	FY19e	FY20e
Intangibles	53.6	80.0	84.8	84.0	82.8
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**	**112.0**	**111.3**	**110.1**
Net Working Capital	(12.0)	(27.5)	(26.1)	(29.5)	(36.6)
Capital Employed	**59.4**	**79.9**	**86.0**	**81.8**	**73.6**
Net Funds	(6.6)	(11.4)	(8.7)	6.0	39.1
Net Assets	**52.8**	**68.5**	**77.2**	**87.8**	**112.6**

VALUATION

Fiscal	2016	2017	FY18e	FY19e	FY20e
P/E	26.6x	19.1x	16.8x	14.9x	14.0x
EV/EBITDA	18.0x	11.9x	10.0x	9.0x	9.4x
Div Yield	0.9%	1.2%	1.4%	1.6%	1.7%
FCF Yield	1.9%	6.5%	5.8%	7.6%	8.3%
EPS growth	27.5%	38.9%	13.5%	12.7%	7.0%
DPS growth	20.0%	25.0%	17.9%	12.6%	6.8%