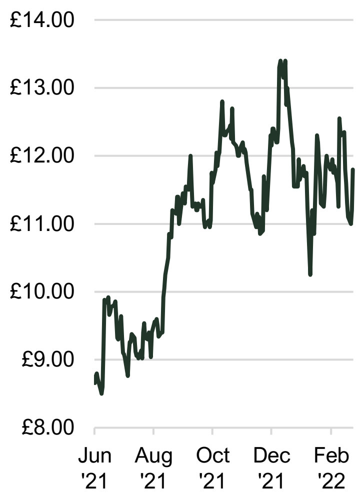
Next Fifteen Communications Group PLC

NFC | AIM | Media | 1180p | £1,148m

Estimate upgrade - Engine UK acquisition & Mach49

1 Year Chart



11 March 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.

The first two months of 2022 have been busy for Next 15. Firstly, the full year trading update pointed to a strong finish to the year resulting in a further upgrade to estimates. More recently, Mach49 secured the largest single contract win in Next 15's history ($400m over five years). Finally, Next 15 has announced its largest acquisition to date, Engine UK, for a maximum value of £77m (£62m of initial cash consideration part funded by the successful placing of 4.5m new ordinary shares at 1110p raising £50m gross).

Both the Mach49 and Engine announcements are very material, not least for the significant impact on FY23 estimates, where we upgrade PBT / EPS by 24% / 16% respectively. The scale of the Mach49 contract win is extraordinary and leaves the tantalizing question of what else could be out there. The Engine acquisition is somewhat of a departure from the Next 15 norm in terms of scale and private equity as the vendor. However, the valuation is compelling, and the acquired businesses are well aligned with the existing N15 portfolio. On our revised estimates the shares are now trading on FY23 PE of 16.3x. Hardly demanding for a company showing such positive earnings momentum.

- **Engine acquisition:** Next Fifteen has acquired Engine UK from Lake Capital. The maximum EV of the deal is £77m, of which £62m was satisfied in cash. The headline EBITDA multiple is 6.7x. This deal is a departure from the Next 15 norm in terms of scale and vendor. However, the acquisition multiple is very attractive, comes with no earn out liabilities and offers the potential for material cost savings. We see the £3m costs savings target as being conservative over the medium term.
- **Mach49 contract win:** US corporate venturing / incubation business, Mach49, has entered into a five year deal with an unnamed client. This represents the biggest ever single contract win for Next 15 and is worth at least $400m over five years with an estimated 20% contribution margin.
- **Full year results:** The final results for the year ended Jan 2022 are expected in early April. The recent Q4 update confirmed that H2 trading had been better than expected with full year organic revenue growth of 24% and headline revenue growth of 34%, with +15% organic growth being delivered across all the group's main segments.
- **Estimate upgrades:** Our FY22e estimates remain unchanged, however we are making some material upgrades to our FY23e and FY24e estimates in response to the Engine acquisition and the Mach49 contract win. Our FY23e PBT / EPS increases by 24% / 16% respectively. Approximately a third of our FY23e upgrade is driven by Mach49, although we do note that the full revenue and profit impact of this contract will not be felt until FY24e.

Y/E 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	33.9	0.2
FY 2021A	266.9	49.1	40.7	7.0	14.0	29.0	0.6
FY 2022E	*357.0*	*75.0*	*55.9*	*11.6*	*33.2*	*21.1*	*1.0*
FY 2023E	*513.7*	*99.1*	*67.3*	*15.0*	*46.5*	*17.5*	*1.3*
FY 2024E	*604.3*	*115.6*	*77.7*	*17.3*	*81.8*	*15.2*	*1.5*

Source: Radnor Capital Partners

Estimate Revisions: PBT / EPS +24% / +16% for FY 2023

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

Figure 1: Radnor estimate revisions

		Previous		**New**		***Revision, %***	
£m	FY21A	2022E	2023E	**2022E**	**2023E**	**2022E**	**2023E**
Customer Engagement	166.5	196.5	212.2	196.5	269.4	-	*+ 27%*
Customer Delivery	49.6	79.3	87.2	79.3	87.2	-	-
Customer Insight	33.1	41.3	44.6	41.3	44.6	-	-
Business Transformation	17.7	39.9	45.9	39.9	112.4	-	*+ 145%*
Revenue	**266.9**	**357.0**	**389.9**	**357.0**	**513.7**	**-**	***+ 32%***
Customer Engagement	36.9	46.2	49.9	46.2	64.5	-	*+ 29%*
Customer Delivery	15.2	27.8	30.8	27.8	30.8	-	-
Customer Insight	4.9	7.9	8.7	7.9	8.7	-	-
Business Transformation	3.9	9.6	10.5	9.6	22.5	-	*+ 114%*
Central Overhead	-11.4	-16.1	-19.5	-16.1	-26.7	-	*+ 37%*
EBITA	**49.5**	**75.4**	**80.4**	**75.3**	**99.7**	**-**	***+ 24%***
- margin %	*18.5%*	*21.1%*	*20.6%*	*21.1%*	*19.4%*		
Adj. PBT	**49.1**	**75.0**	**80.4**	**75.0**	**99.1**	**-**	***+ 24%***
Adj. EPS (p)	**40.7**	**55.9**	**58.0**	**55.9**	**67.3**	**-**	***+ 16%***
Dividend (p)	7.0	11.6	12.9	11.6	15.0	-	*+ 16%*
Net Cash (Debt)	**14.0**	**33.2**	**64.0**	**33.2**	**46.5**		

Source: Radnor

These estimate revisions factor both the acquisition of Engine UK and the $400m Mach49 contract win. We cover off the moving parts here in more detail below.

We had previously upgraded our estimates in response the Q4 trading update (please see our last note here) announced on 31st January 2022. We are, in effect, leaving our core estimates unchanged for FY22 and focus instead on FY23 and beyond.

Engine UK

On 2nd March 2022, Next 15 announced the acquisition of Engine UK from PE owner, Lake Capital. The initial cash consideration was £62.1m paid on completion, with up to £15m of further consideration payable at the end of March subject to a range of balance sheet and completion adjustments. The acquisition has been part funded from Next 15's own balance sheet and also the proceeds of a successful placing of new ordinary shares (4.5m shares @ 1110p raising £50m gross).

The acquisition of Engine UK is notable on a number of fronts. It is the largest acquisition to date for Next 15 in terms of initial consideration and is only the second material acquisition where private equity is the vendor (US healthcare communications specialist, Health Unlimited, was acquired in October 2019 for $28m out of PE ownership).

Engine UK is a multi-disciplinary, UK marketing services group itself built largely through M&A over a 10 year plus history. The key financial headlines for FY21 are as follows:

- FY21 revenue of £88.6m, split broadly equally across three distinct legs all of which are well aligned with Next 15's existing reporting segmentation.
  - **Communications** operating under the MHP Mischief brand is a full service communications business encompassing strategic, financial and corporate PR and messaging;
  - **Creative** is focused around design, brand and user experience solutions
  - Both of these Engine businesses are likely to contribute to Next 15's **Customer Engagement** segment;
  - **Transform** is focused on business transformation services, implementation and consultancy across a predominantly public sector client base. This segment will contribute to Next 15's **Business Transformation** segment.

In FY21, Engine generated £88.6m of revenue with a trading margin (before allocated central costs) of 34.8%. Net of allocated central costs, the operating contribution was £19.2m or 21.7%. This compares to our estimate of c.23.5% for the combined **Engage** and **Transform** segments within Next 15. Below the operating line there are a further £7.4m of head office costs, driving an all in EBITDA margin of 13%.

Next 15 has highlighted an initial estimate for c.£3m of cost savings to be delivered by FY24. Given the scale of the embedded costs within the Engine business outside of the three core legs, we see this estimate as conservative. Even without assuming revenue or margin growth and based solely on the £3m cost savings target this implies the initial acquisition multiple of **6.1x** (based on a total consideration of £72m) falling to **4.8x**.

- Our base case assumptions underpinning our revised estimates for FY23 are for 5% revenue growth for the Engine businesses and flat operating margins. If we assume £5m of cost savings instead of the £3m initial target, this implies the initial acquisition multiple falling to **4.0x**.

For us, this cost saving opportunity alone is significant enough to make the acquisition highly attractive to Next 15, which has already established a sector leading track record in making well priced acquisitions.

Our clear sense is that Next 15 will seek to manage the three component legs within the Engine combination as separate entities. Next 15 has a well-established track record of supporting and incentivising entrepreneurial management teams who are looking to de-risk and accelerate new phases of growth. Although the Engine acquisition does not involve a vendor management team; "liberating" the business unit management teams is clearly going to be a short-term priority.

The other attraction of this deal is the lack of a traditional earn out structure. Although this materially reduces the amount of future, contingent cash cost to Next 15 which we would typically have to factor into future cash-flow forecasts, we would expect new equity-based incentive structures to be put in place. This will inevitably result in a degree of future equity dilution although this will be linked to future profit growth in a similar fashion to existing equity incentive structures employed by Next 15.

Mach49

On 23rd February, Next 15 announced that its business transformation / growth incubation subsidiary, Mach49 (acquired in September 2020), has entered into a five year strategic partnership with an unnamed global technology company.

The value of this partnership is expected to be at least $400m in revenue to be recognised over the 5 year period. We are assuming a net contribution margin of 20%.

This is, by some distance, the largest ever client "win" for Next 15. The revenue and profit build will be phased; we assume $50m revenue recognised in FY23 delivering $10m of incremental EBIT, climbing to $90m revenue in FY24 and FY25 delivering $18m of incremental EBIT respectively.

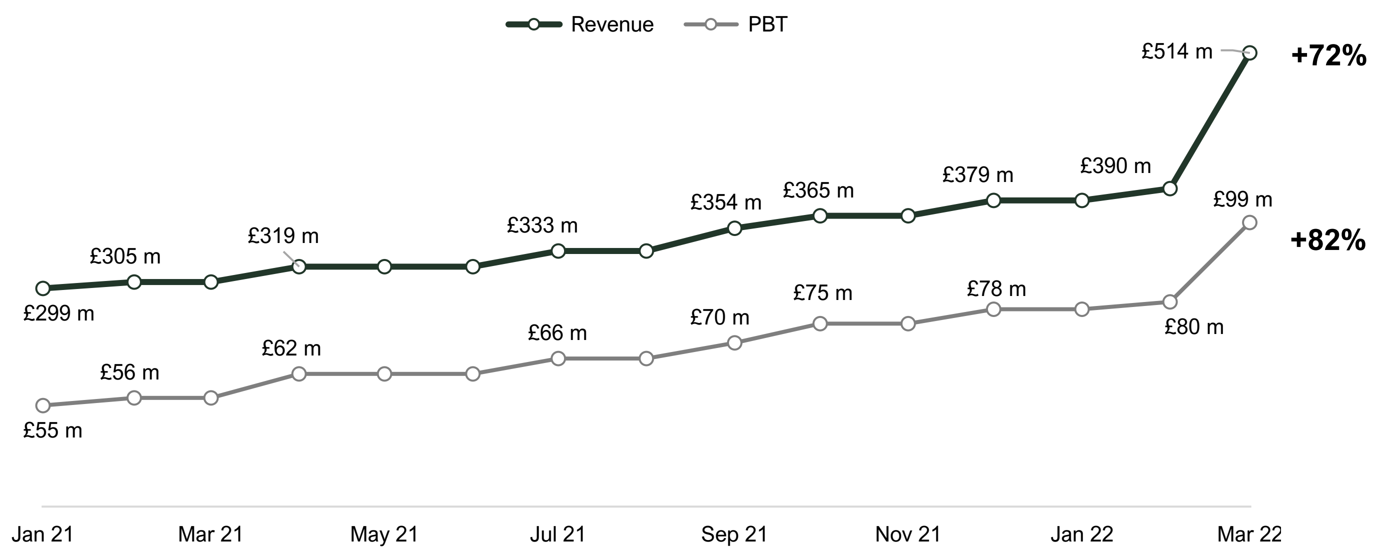
The 20% assumed contribution margin is likely to be marginally dilutive to overall group margins as the revenue profile builds although this is clearly more than offset by the overall level of incremental profit contribution.

In coming to our revised estimates for FY23 and FY24 we have factored the following:

- Engine's revenue and EBIT contribution with 5% revenue growth in FY23, rising to 10% in FY24
- The initial absorption of Engine's full central costs with £5m of cost savings delivered by FY24
- Mach49 contract revenue and EBIT contribution translated at current £/$ levels
- Issue of 4.05m new ordinary shares and a subsequent 1m increase in potentially dilutive new shares under expanded equity incentive plans from FY24 onwards
- FY23 cash based earn out payments unchanged with FY24 increased (on a preliminary basis) to reflect the likely increase in the Mach49 earn out arrangement. Full details of this will be disclosed at the upcoming final results.

In Figure 2 below, we show the evolution of the Radnor FY23E revenue and PBT estimate since the start of 2021. We can see that, in total, we have upgraded revenue expectations by +72% and PBT by +82% over the period.

Figure 2: Evolution of Radnor FY23 Revenue and PBT estimate



Source: Radnor

Valuation

Figure 3: Next Fifteen FY2 **PE**

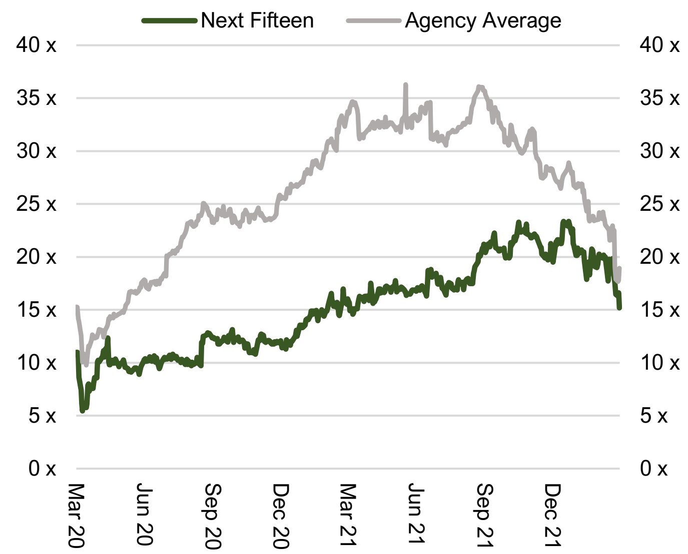
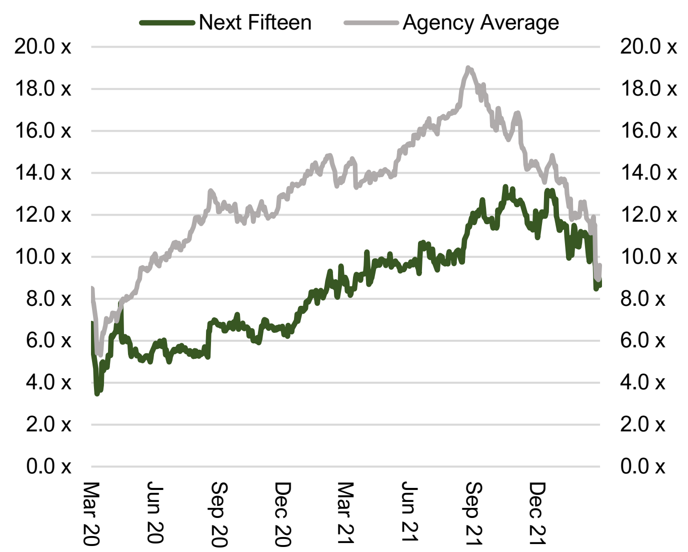


Figure 4: Next Fifteen FY2 **EV/EBITDA**



Source: FactSet, Radnor

In Figures 3 & 4 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 4 and 5 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. On both measures, Next Fifteen sits well ahead of the peer group averages in terms of both growth and margin, yet does not command the premium multiples shown by a number of peers.

Figure 4: Next Fifteen FY2 PE vs Growth

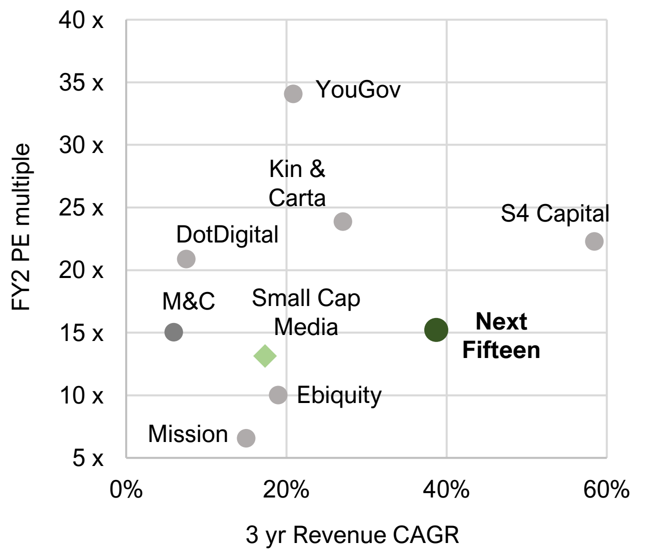
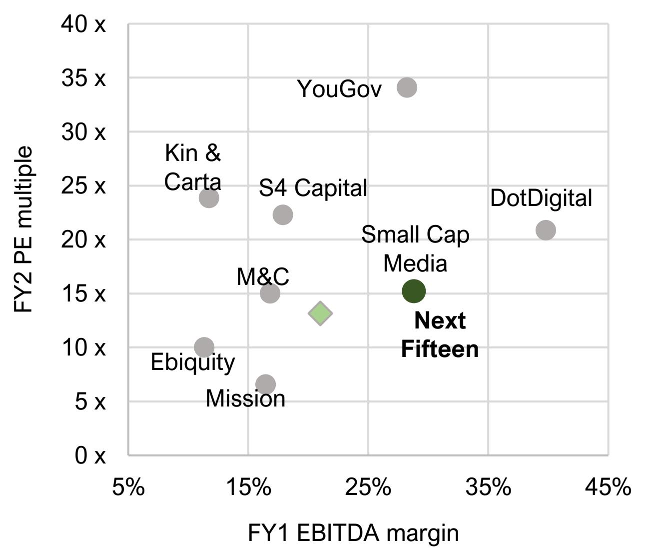


Figure 5: Next Fifteen FY2 PE vs Margin



Source: FactSet, Radnor

Next Fifteen Communications PLC

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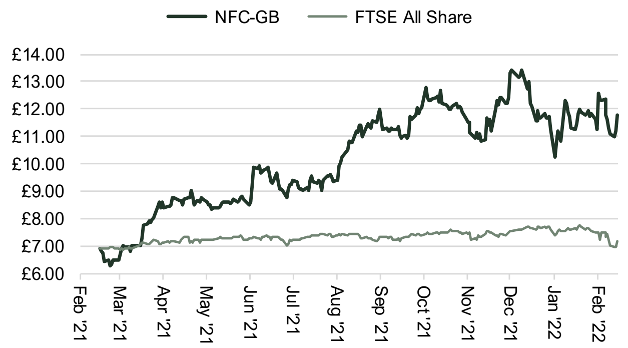
Price (p): **1180 p**
Market Cap: 1,148 m
EV: 1,134 m

PROFIT & LOSS

Year to 31 January, £m	FY19	FY20	FY21	FY22e	FY23e	FY24e
Customer Engagement			*166.5*	*196.5*	*269.4*	*305.2*
Customer Delivery			*49.6*	*79.3*	*87.2*	*95.9*
Customer Insight			*33.1*	*41.3*	*44.6*	*48.2*
Business Transformation			*17.7*	*39.9*	*112.4*	*154.9*
Group Net Revenue	**224.1**	**248.5**	**266.9**	**357.0**	**513.7**	**604.3**
Customer Engagement			*36.9*	*46.2*	*64.5*	*72.1*
Customer Delivery			*15.2*	*27.8*	*30.8*	*34.1*
Customer Insight			*4.9*	*7.9*	*8.7*	*9.6*
Business Transformation			*3.9*	*9.6*	*22.5*	*30.6*
Head Office	*(9.3)*	*(9.5)*	*(11.4)*	*(16.1)*	*(26.7)*	*(30.2)*
EBITA - Adjusted	**37.0**	**40.9**	**49.5**	**75.3**	**99.7**	**116.2**
Associates & JV's	0.1	0.2	0.4	0.2	-	-
Net Bank Interest	(1.0)	(0.8)	(0.8)	(0.5)	(0.6)	(0.6)
PBT - Adjusted	**36.0**	**40.2**	**49.1**	**75.0**	**99.1**	**115.6**
Non Operating Items	(16.3)	(23.0)	(37.2)	(29.6)	(33.3)	(32.3)
Other Financial Items	(0.9)	(11.6)	(13.2)	(16.5)	(10.0)	(10.0)
PBT - IFRS	**18.8**	**5.6**	**(1.3)**	**27.8**	**54.7**	**72.2**
Tax	(4.3)	(2.7)	(2.6)	(5.7)	(13.7)	(18.0)
Tax - Adjusted	(7.2)	(8.0)	(9.9)	(17.6)	(24.8)	(28.9)
Tax rate - Adjusted	*20.0%*	*20.0%*	*20.2%*	*23.5%*	*25.0%*	*25.0%*
Minority interests	0.6	0.6	1.0	3.4	6.0	7.0
No. shares m	79.2	85.3	89.4	92.0	96.5	96.5
No. shares m, diluted	85.0	90.9	93.8	96.4	101.5	102.5
IFRS EPS (p)	17.5	2.7	(5.5)	20.3	36.3	48.9
Adj EPS (p), diluted	**33.1**	**34.8**	**40.7**	**55.9**	**67.3**	**77.7**
Total DPS (p)	7.6	2.5	7.0	11.6	15.0	17.3

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	FY19	FY20	FY21	FY22e	FY23e	FY24e
Net Profit: (add back)	14.5	2.8	(3.9)	22.1	41.0	54.1
Depreciation & Amortisation	*13.8*	*26.4*	*28.0*	*27.6*	*27.8*	*28.5*
Net Finance costs	*1.9*	*14.1*	*15.4*	*18.1*	*11.7*	*11.7*
Tax	*4.3*	*2.7*	*2.6*	*5.7*	*13.7*	*18.0*
Working Capital	1.2	(3.3)	6.6	(6.3)	(5.5)	(1.9)
Other	2.6	6.8	24.3	8.8	9.0	9.0
Cash from Ops	**38.4**	**49.5**	**72.9**	**76.0**	**97.8**	**119.5**
Cash Tax	(6.2)	(6.0)	(8.4)	(10.0)	(13.7)	(18.0)
Tangible Capex	(5.6)	(3.5)	(2.0)	(3.0)	(6.0)	(6.0)
Intangible Capex	(2.4)	(1.8)	(2.1)	(2.0)	(4.0)	(4.0)
Free Cashflow	**24.1**	**38.2**	**60.4**	**61.0**	**74.1**	**91.4**
Dividends	(6.6)	(7.5)	(0.7)	(7.3)	(11.7)	(15.4)
Acquisitions & Inv.	(29.6)	(24.2)	(23.6)	(25.0)	(88.0)	(31.0)
Financing	7.7	1.8	(37.7)	(9.6)	38.9	(9.7)
Net Cashflow	**(4.4)**	**8.3**	**(1.6)**	**19.2**	**13.2**	**35.3**
Net Cash (Debt)	(5.2)	(9.4)	14.0	33.2	46.5	81.8

Announcements

Date	Event
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
September 2020	Trading update
September 2020	Acquisition of Mach49 for $2.7m

RATIOS

	FY20	FY21	FY22e	FY23e	FY24e
RoE	28.1%	32.7%	37.4%	27.2%	26.5%
RoCE	33.6%	48.5%	68.1%	48.6%	52.9%
Asset Turnover (x)	0.9x	0.8x	0.6x	0.6x	0.5x
NWC % Revenue	41.2%	42.4%	31.5%	17.3%	14.3%
Op Cash % EBITA	121.2%	147.4%	101.0%	98.1%	102.9%
Net Debt / EBITDA	0.1x	-	-	-	-

BALANCE SHEET

Year to 31 January, £m	FY19	FY20	FY21	FY22e	FY23e	FY24e
Intangibles	126.1	155.4	163.8	175.8	252.8	272.8
P,P+E	15.9	14.2	8.9	12.3	13.4	14.0
Tax Asset & Other	13.0	54.7	43.4	35.4	27.4	19.4
Total Fixed Assets	**155.0**	**224.4**	**216.1**	**223.4**	**293.6**	**306.1**
Net Working Capital	(38.4)	(102.3)	(113.2)	(112.5)	(88.6)	(86.7)
Capital Employed	**116.6**	**122.1**	**102.9**	**110.9**	**205.0**	**219.4**
Net Funds	(5.2)	(9.4)	14.0	33.2	46.5	81.8
Net Assets	**111.5**	**112.7**	**116.9**	**144.1**	**251.4**	**301.2**

VALUATION

Fiscal	FY20	FY21	FY22e	FY23e	FY24e
P/E	33.9x	29.0x	21.1x	17.5x	15.2x
EV/EBITDA	16.6x	14.7x	15.1x	11.4x	9.8x
Div Yield	0.2%	0.6%	1.0%	1.3%	1.5%
FCF Yield	3.4%	5.3%	5.4%	6.5%	8.1%
EPS growth	4.9%	17.1%	37.3%	20.4%	15.4%
DPS growth	-66.9%	180.0%	66.4%	28.5%	15.4%

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