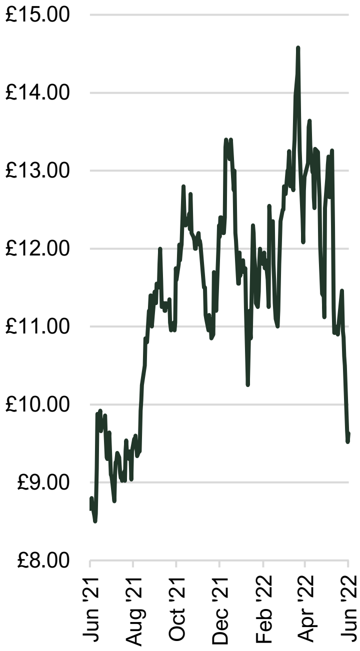
Next Fifteen Communications Group PLC

NFC | AIM | Media | 963p | £946m

Historically attractive valuation point

1 Year Chart



16th June 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.

Next Fifteen's share price, in common with many of its peers, has come under significant short-term pressure. The shares are now down -34% from their recent record high and are down -28% YTD (compared to -5% YTD for the FTSE All Share and -26% YTD for the AIM All Share).

There is no doubt that this price weakness owes much to a widespread market rotation out of "risky" and cyclical assets as investors price in a tightening interest rate environment and concerns over input cost inflation and consumer spending. External macro risks are also high on the agenda. All Next Fifteen's primary market peers have also seen material share price weakness. However, specific to Next Fifteen has also been the market response to the proposed acquisition of M&C Saatchi.

*In our eyes, the extent of the Next Fifteen share price fall has created a compelling valuation opportunity, regardless of the M&C outcome. Should the deal not complete, Next Fifteen trades on a 1 year prospective PE of 12.7x (a two year low), falling to **11.0**x on a 2 year basis. If the deal completes, on the current terms, we see the earnings enhancement for Next Fifteen dropping this 2 year prospective PE to c.**10x**, a c.40% discount to the peer group.*

*When we look across the peer group, we see Next Fifteen delivering markedly superior earnings estimate momentum and significant balance sheet strength. Excluding the initial pandemic reaction, we have to look as far back as **2014** to see such an attractive entry point into the shares.*

- **M&C deal would be earnings enhancing:** In our view, the M&C acquisition offers a number of operational attractions; good portfolio fit, lack of material client overlaps and geographic complementarity. Investor concerns are likely focused around valuation (high by Next Fifteen standards) and potential post completion integration risks. However, we believe the valuation is still attractive given the scale of the business and the potential for Next Fifteen earnings enhancement, which we estimate to be c.9% (unguided).
- **Historically attractive entry point:** If the M&C deal were not to complete, investors would lose the earnings enhancement but gain a degree of certainty. They would also see a Next Fifteen PE multiple that we last saw back in 2014.
- **Positive Earnings Momentum pre M&C Saatchi:** As recently as 20th May, we upgraded our Next Fifteen FY23 revenue / PBT estimates by **+9%** to £560.4m / £110.4m, in response to yet another positive trading update. Despite the cautious backdrop, trading momentum has been maintained (Q1 organic revenue growth +37%). Combined with the maiden contribution from the Mach49 contract, we see FY23 numbers well underpinned.

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	23.6	0.7
FY 2022A	362.1	79.3	59.7	12.0	35.7	16.1	1.2
FY 2023E	*560.4*	*110.4*	*75.6*	*15.1*	*49.6*	*12.7*	*1.6*
FY 2024E	*650.2*	*128.3*	*87.3*	*17.5*	*107.1*	*11.0*	*1.8*
FY 2025E	*706.2*	*140.5*	*95.4*	*19.1*	*156.3*	*10.1*	*2.0*

Source: Radnor Capital Partners

M&C Saatchi Offer

In our last Next Fifteen note (link to note here), we outlined our initial reaction to the proposed offer to acquire M&C Saatchi. We also explored the fit between the two businesses and gave an initial, independent and unguided assessment as to potential earnings enhancement from a Next Fifteen perspective. We update the key terms of the Offer for recent share price movements.

The key terms and highlights of the Offer, which have now been made final are below:

- Initial headline Offer price of 245p per M&C share; comprising 40p in cash and 205p in new Next Fifteen shares
- The exchange ratio of 0.1637 new Next Fifteen share for each M&C Saatchi share
- On yesterday's Next Fifteen closing price, the Offer now equates to 198p per M&C share.
- On yesterday's AdvancedAdvT closing price, both their All Share and Share plus Cash Offers equate to 205p per M&C share.

Below we show our very rough, pro forma combination of both Next Fifteen and M&C Saatchi based on our existing Next Fifteen estimates for FY23 and the published M&C Saatchi profit forecast for FY22. This pro-forma analysis has not been guided by either Next Fifteen, nor M&C Saatchi

This pro forma analysis **does not** adjust for the one month difference in year end, **nor** do we make any assumption as to potential cost or revenue synergies, both of which could prove material. We assume a 25% tax rate for the enlarged group, in-line with our current estimate for Next Fifteen. We note the underlying tax rate for M&C Saatchi in FY21 was 26%. We also assume the issue of 20m new Next Fifteen shares and fully annualise.

Figure 1: Pro Forma enlarged group – Radnor estimate

	Next Fifteen FY23	M&C Saatchi FY22	Radnor Pro Forma
Revenue	£560 m	£272 m	£832 m
PBT	£110 m	£31 m	£141 m
Net Income	£78 m	£23 m	£101 m
Shares	103 m		123 m
	75.6 p		**82.2 p**

Source: Radnor

We can see from the above, this rough pro forma analysis suggests a potential **+9%** earnings enhancement for Next Fifteen based on the current Offer terms.

Valuation Opportunity

In Figures 2 & 3 below we show the 2 year forward PE multiple for both Next Fifteen and the Agency peer group. We also show this in relative terms.

Figure 2: Next Fifteen FY2 **PE**

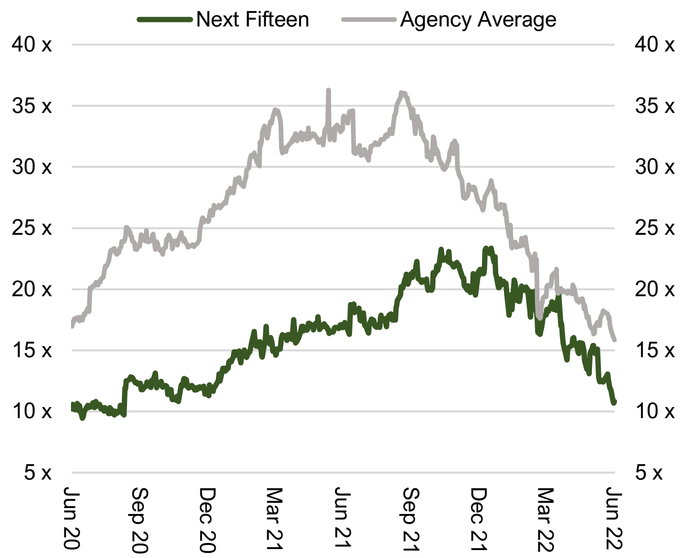
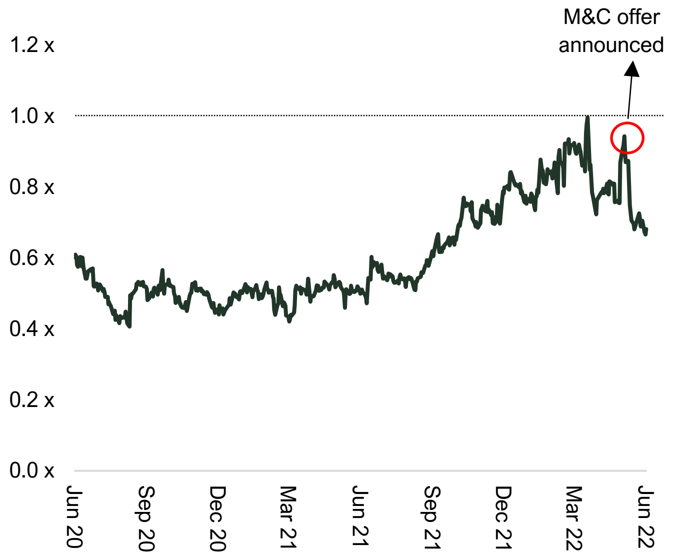


Figure 3: Next Fifteen FY2 PE relative to Peer Group



Source: FactSet, Radnor

We can see that Next Fifteen's PE discount to the peer group reached its narrowest point on 1st April 2022, before falling in line with the market response to external risks. The discount subsequently narrowed again sharply as the market digested a very strong set of final results, which triggered a further round of upgrades. The announcement of the Next Fifteen offer to acquire M&C Saatchi was made on 20th May 2022 and since then Next Fifteen's discount to the peer group has widened sharply.

Given the strength of the final results and the subsequent earnings upgrades, we can only conclude that the market has priced in a degree of uncertainty around the implications of the deal should it complete. Given the share component of the proposed transaction, we also believe that a number of technical factors have also weighed on the Next Fifteen share price; namely, some degree of merger arbitrage activity and also investors with exposure to both companies reacting to a potentially overweight position.

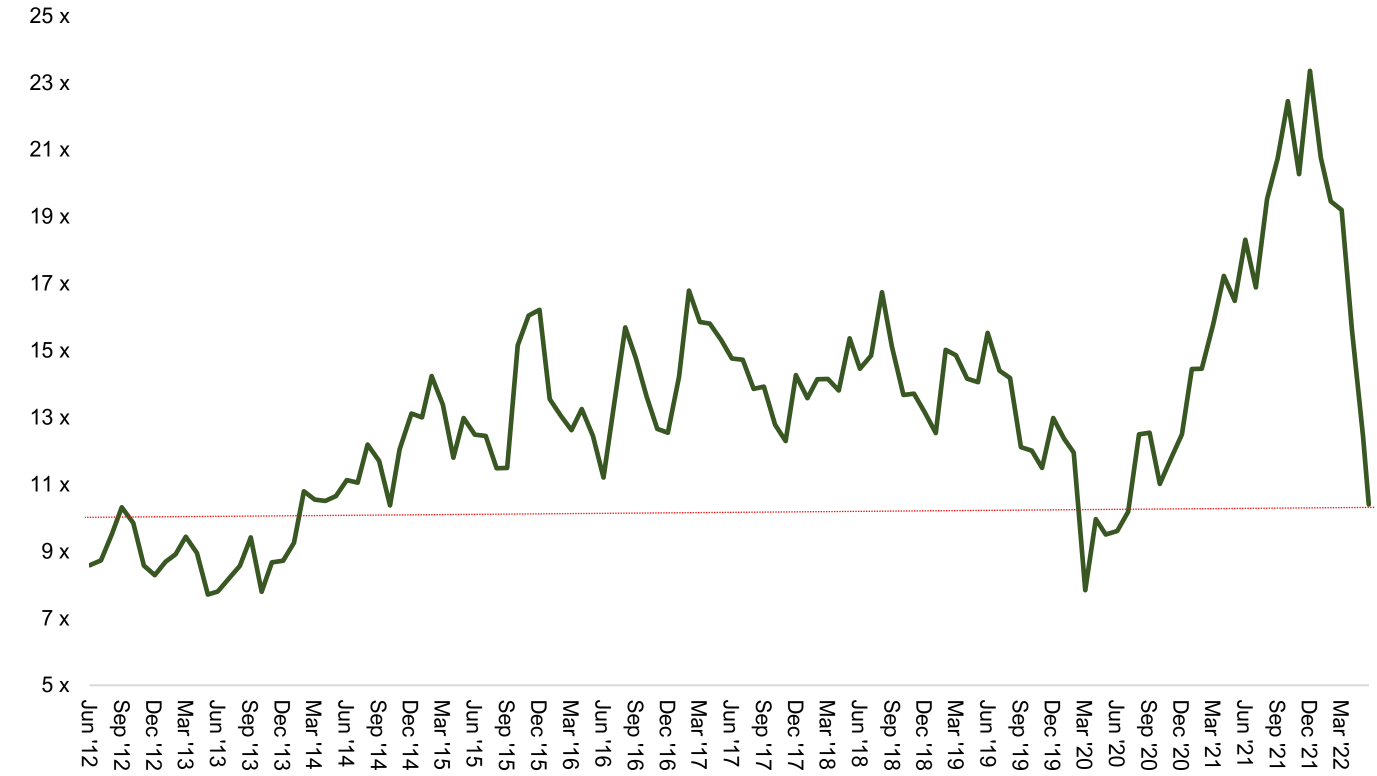
We believe the market has yet to price in the potential earnings enhancement the deal offers Next Fifteen and certainly has not factored the material top, and bottom-line synergies that the combination, with a high degree of portfolio and geographic fit, offers.

The net result is that should the deal complete; the natural EPS enhancement and the upside from cost savings is not captured in the current share price. In raw terms, and factoring our rough +9% EPS enhancement into our existing FY24 Next Fifteen EPS estimate, this suggests the post acquisition Next Fifteen FY24 PE currently stands at **10.0x.**

Although we believe the acquisition makes a great deal of financial and strategic sense for Next Fifteen, we should also consider what the implications are if the deal **does not** complete.

The short answer is that an obvious risk, in the eyes of some, will have been removed and we are left with the current valuation that, from a historical perspective, looks extremely attractive.

Figure 4: Next Fifteen FY2 **PE** over the last 10 years



Source: FactSet, Radnor

In Figure 4 above we show the 2 year prospective PE multiple for Next Fifteen over the last 10 years. We can see that the current level (disregarding the short-lived pandemic shock in March 2020) was last seen back in 2014.

Since 2014, Next Fifteen's 2 year prospective PE has ranged typically between 11x and 17x. although peaked as high as 23x at the end of 2021. The average PE multiple through this period has been **13.9x**.

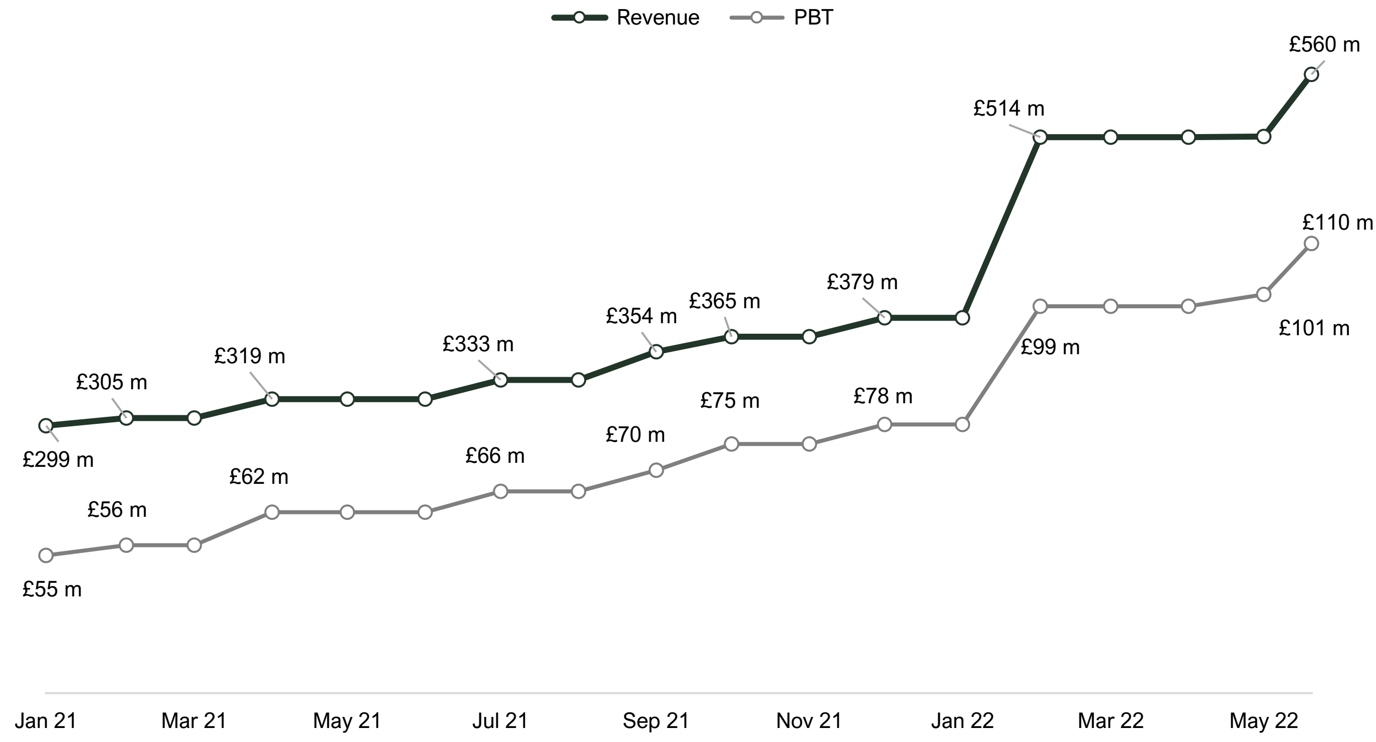
It is worth considering what has been delivered by the company since 2014 that has underpinned this average multiple.

- Revenue growth +267% (£98.7m → £362.1m) – CAGR of **+16%**
- Adjusted PBT growth +959% (£8.3m - → £79.3m) – CAGR of **+29%**
- Adjusted EPS growth +708% (7.4p → 59.7p) – CAGR of **+26%**

If we take the long run, historic average 2 year prospective PE multiple of 13.9x as a benchmark and apply to our FY24 EPS estimate, this implies a Next Fifteen share price of 1215p, or +26% ahead of current levels.

These figures are based on historic reported results and do not factor the pace of more recent upgrades.

Figure 5: Next Fifteen FY 23 estimate changes since January 2021



Source: Radnor

In Figure 5 above we show the evolution of our FY23 revenue and PBT estimate since the start of 2021. During this period, Next Fifteen has consistently delivered both results and earnings guidance ahead of expectations.

- FY23 revenue has increased by 72% to £560.4m
- FY23 adjusted PBT has increased by 82% to £110.3m

Although the largest inflection point came in February 2022 (driven by a combination of better then expected results; the acquisition of Engine UK and the announcement of the Mach49 material client win), we can see the progress has also been consistent through the period.

We believe the drivers of this outperformance against expectation has been delivered by:

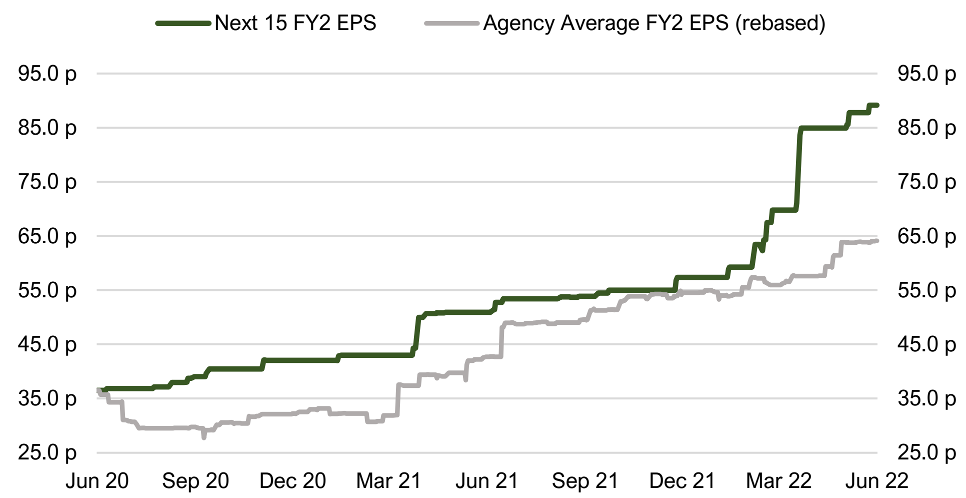
- Pandemic exposed agencies (particularly those with a B2C bias) recovering to or exceeding pre-pandemic levels
- B2B focused agencies (especially in the Customer Delivery segment) accelerating their already strong growth as the pandemic further shifted client focus onto to digital transitions and routes to market

Underpinning this momentum has been Next Fifteen's M&A strategy which has focused on high growth and high margin, entrepreneurial businesses (predominantly focused on digital marketing, content solutions and business transformation), where Next Fifteen have been able to de-risk and accelerate their growth.

Compared to the Agency peer group, Next Fifteen has materially outperformed in terms of EPS estimate upgrade momentum. In Figure 6 below, we rebase the UK Agency peer group FY2 EPS estimate history against Next Fifteen FY2 EPS estimate history.

We can see that, since June 2020, Next Fifteen has seen its FY2 EPS estimate has increased by 144%, compared to 76% for the peer group in aggregate. The two closest peers; **S4 Capital** (+111%) and **YouGov** (+84%) also lag some way behind.

Figure 6: Next Fifteen FY2 EPS estimate vs peer group rebased

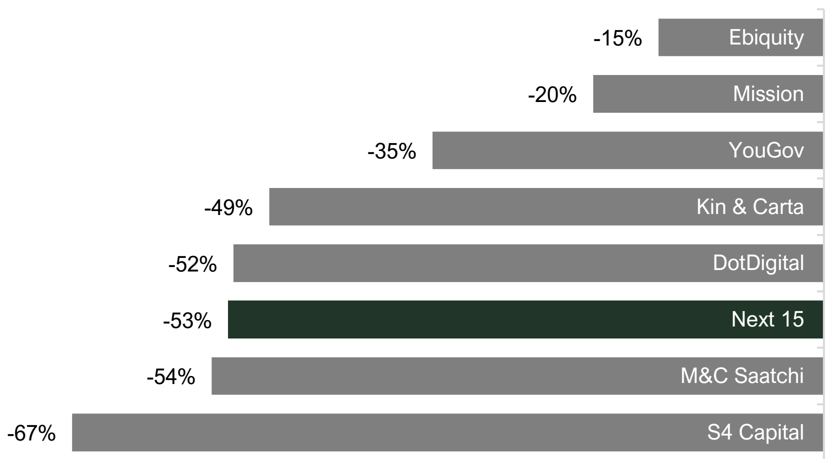


Source: FactSet, Radnor

It is worth concluding by putting the Next Fifteen share price and valuation weakness into its broader peer group context.

Next Fifteen has not been alone in seeing valuations come under material pressure over the last couple of months. In Figure 7 below, we show the UK Agency peer group through the lens of 2 year prospective PE de-rating. Specifically, we show the extent to which current 2 year prospective PE multiples have declined from their peak values since the start of 2022.

Figure 7: UK Agency PE multiple de-rating – current PE vs peak PE year to date



Source: FactSet, Radnor

Next Fifteen Communications PLC

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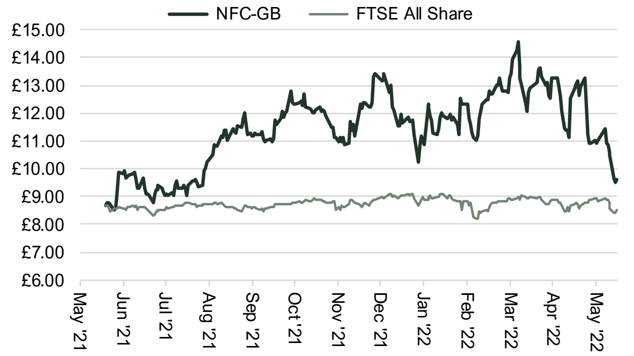
Price (p):	**963 p**
Market Cap:	946 m
EV:	896 m

PROFIT & LOSS

Year to 31 January, £m	FY20	FY21	FY22	FY23e	FY24e	FY25e
Customer Engagement		*166.5*	*187.6*	*282.3*	*311.7*	*332.1*
Customer Delivery		*49.6*	*80.0*	*99.9*	*111.9*	*123.1*
Customer Insight		*33.1*	*42.1*	*52.6*	*57.4*	*61.4*
Business Transformation		*17.7*	*52.5*	*125.6*	*169.2*	*189.5*
Group Net Revenue	**248.5**	**266.9**	**362.1**	**560.4**	**650.2**	**706.2**
Customer Engagement		*36.9*	*40.4*	*64.3*	*70.6*	*75.8*
Customer Delivery		*15.2*	*28.5*	*35.3*	*39.7*	*43.7*
Customer Insight		*4.9*	*9.0*	*11.1*	*12.0*	*12.9*
Business Transformation		*3.9*	*15.2*	*25.0*	*34.5*	*38.5*
Head Office	*(9.5)*	*(11.4)*	*(13.8)*	*(25.2)*	*(28.6)*	*(30.4)*
EBITA - Adjusted	**40.9**	**49.5**	**79.3**	**110.4**	**128.3**	**140.5**
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**	**110.3**	**128.2**	**140.4**
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)**	**67.3**	**88.2**	**100.4**
Tax	(2.7)	(2.6)	14.5	(16.8)	(22.0)	(25.1)
Tax - Adjusted	(8.0)	(9.9)	(17.2)	(27.6)	(32.1)	(35.1)
Tax rate - Adjusted	*20.0%*	*20.2%*	*21.6%*	*25.0%*	*25.0%*	*25.0%*
Minority interests	0.6	1.0	3.6	5.2	6.7	7.5
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)	46.7	61.4	69.9
Adj EPS (p), diluted	**34.8**	**40.7**	**59.7**	**75.6**	**87.3**	**95.4**
Total DPS (p)	2.5	7.0	12.0	15.1	17.5	19.1

PRICE CHART - 1 YEAR ABSOLUTE vs FTSE ALL SHARE



Source: FactSet

SHAREHOLDERS

	% of ord. Share capital
Octopus Investments	12.4%
Aviva Investors	11.8%
Liontrust Investment Partners	11.6%
Slater Investments	6.7%
BlackRock	6.3%
Aberdeen Stan Life	6.1%
Tim Dyson (CEO)	5.9%
JPMorgan AM	5.9%
	66.7%

CASH FLOW

Year to 31 January, £m	FY20	FY21	FY22	FY23e	FY24e	FY25e
Net Profit: (add back)	2.8	(3.9)	(65.6)	50.5	66.1	75.3
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)*	*16.8*	*22.0*	*25.1*
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**	**121.6**	**147.1**	**159.3**
Cash Tax	(6.0)	(8.4)	(14.1)	(16.8)	(22.0)	(25.1)
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**	**94.8**	**115.1**	**124.2**
Dividends	(7.5)	(0.7)	(12.4)	(14.1)	(18.1)	(20.9)
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**	**13.8**	**57.6**	**49.1**
Net Cash (Debt)	(9.4)	14.0	35.7	49.6	107.1	156.3

Announcements

Date	Event
May 2022	Recommend Offer for M&C Saatchi
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

RATIOS

	FY21	FY22	FY23e	FY24e	FY25e
RoE	32.7%	95.3%	45.8%	44.3%	42.5%
RoCE	29.8%	37.1%	40.7%	52.0%	62.2%
Asset Turnover (x)	0.8x	0.7x	0.6x	0.4x	0.4x
NWC % Revenue	18.2%	14.3%	7.9%	6.7%	6.2%
Op Cash % EBITA	147.4%	117.0%	110.1%	114.6%	113.4%
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	49.6	107.1	156.3
Net Assets	**112.7**	**116.9**	**61.5**	**169.2**	**202.2**	**230.1**

VALUATION

Fiscal	FY21	FY22	FY23e	FY24e	FY25e
P/E	23.6x	16.1x	12.7x	11.0x	10.1x
EV/EBITDA	10.9x	11.3x	8.1x	7.0x	6.4x
Div Yield	0.7%	1.2%	1.6%	1.8%	2.0%
FCF Yield	6.7%	8.1%	10.6%	12.8%	13.9%
EPS growth	17.1%	46.6%	26.6%	15.4%	9.3%
DPS growth	180.0%	71.4%	26.0%	15.4%	9.3%

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