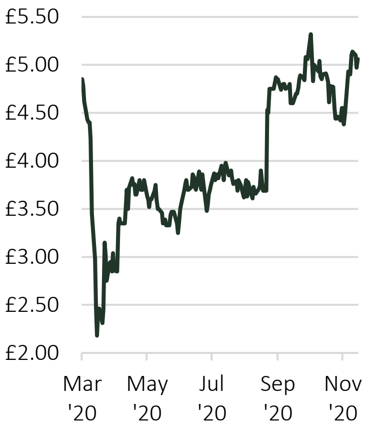
Next Fifteen Communications Group PLC

NFC | AIM | Media | 506p | £460m

Q3 trading update – Recovery momentum continues

1 Year Chart



Following on from the well-received interim results (29th September), Next Fifteen has provided a further Q3 trading update. The key headlines are that positive recent trading trends continue and, allied to strong cost control measures taken throughout the year, have resulted in profit expectations being raised for the current year. We have upgraded our estimates accordingly; marking the second material upgrade we have made since September.

Initial concerns that the pandemic would materially disrupt client demand and spending patterns have proven largely overstated. The speed at which revenue has been recovered has been matched by impressive cost actions; not least around the fixed property overhead within the group, which has resulted in higher drop through rates than the group has experienced in the past. The key question looking forward is whether the legacy of the pandemic will be a lower fixed cost base for the group. Revenue mix effects are likely to continue to cloud the answer but our sense is that Next Fifteen has been successful in laying the foundations for structurally higher margins looking forward.

Despite a strong recent run (+37% since late August), Next Fifteen still trades a material PE discount to its immediate peer group. Given the positive trading and margin momentum evidenced today, this looks harder to justify.

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.

- **Trading update:** Revenue growth for the 3 months ended October are expected to be up 7% YoY. Beneath the surface, the organic revenue decline was -3% (an improvement on the -7% reported for H1) with acquisitions and FX contributing +10%. The recent trend of B2B outperformance has been maintained, although the revenue recovery in the B2C agencies has been better than expected.
- **Margins are the real story:** Next Fifteen was quick to react to the pandemic and addressed costs early. This was the catalyst to review the fixed overhead in the group, notably the property footprint and the interim results saw a charge taken against lease impairments. The resulting cost savings and are a significant part of the profit outperformance today. However, costs have addressed elsewhere and the better than expected revenue recovery has not been matched by cost investment, resulting in higher than expected drop through rates.
- **Estimate upgrades:** In response to the trading update we have upgraded both our current year and FY22 adjusted PBT estimates by **+10%** / **+5%** respectively. This marks the second material upgrade we have made since September. It is also worth noting that Next Fifteen has now recovered nearly all of the previous Covid inspired downgrades with our FY22 estimates now less than 1% off their previous highs.

19th November 2020

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January, £m	Sales	PBT adj	EPS (p)	Div (p)	Net Cash	Fiscal PER x	Yield %
FY 2019A	224.1	36.0	33.1	7.6	-5.2	15.3	1.5
FY 2020A	248.5	40.2	34.8	2.5	-9.4	14.6	0.5
FY 2021E	*260.6*	*45.2*	*38.3*	*6.4*	*-2.3*	*13.2*	*1.3*
FY 2022E	*282.6*	*49.9*	*42.0*	*9.3*	*20.7*	*12.1*	*1.8*
FY 2023E	*299.0*	*54.6*	*45.9*	*10.2*	*46.0*	*11.0*	*2.0*

Source: Radnor Capital Partners

Estimate Revisions: PBT +10% for FY 2021, +5% for FY 2022

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

Figure 1: Radnor estimate revisions

		Previous		New		*Change, %*	
£m	FY20A	2021E	2022E	**2021E**	**2022E**	**2021E**	**2022E**
Brand Marketing	135.0	143.1	156.0	145.4	158.5	*+ 2%*	*+ 2%*
Data + Analytics	45.1	47.3	52.0	48.9	53.8	*+ 3%*	*+ 3%*
Creative Technology	68.4	65.0	68.9	66.3	70.3	*+ 2%*	*+ 2%*
UK	97.4	101.5	104.3	100.1	107.2	*- 1%*	*+ 3%*
North America	127.6	123.8	147.7	136.5	150.1	*+ 10%*	*+ 2%*
EMEA	8.8	8.8	9.4	9.0	9.4	*+ 2%*	*+ 1%*
Asia Pacific	14.7	14.6	15.6	15.0	15.8	*+ 3%*	*+ 1%*
Revenue	**248.5**	**255.4**	**276.9**	**260.6**	**282.6**	***+ 2%***	***+ 2%***
Brand Marketing	30.8	32.9	36.8	34.5	38.0	*+ 5%*	*+ 3%*
Data + Analytics	12.7	12.5	14.3	13.7	15.2	*+ 9%*	*+ 6%*
Creative Technology	8.0	6.8	8.3	8.0	8.8	*+ 17%*	*+ 6%*
UK	20.4	18.7	21.1	20.5	22.4	*+ 10%*	*+ 6%*
North America	27.2	29.7	33.8	31.4	35.1	*+ 6%*	*+ 4%*
EMEA	1.6	1.6	1.7	1.7	1.7	*+ 4%*	*+ 1%*
Asia Pacific	2.4	2.4	2.6	2.5	2.6	*+ 4%*	*+ 1%*
Central Overhead	-9.1	-8.9	-10.2	-8.9	-10.5	*- 1%*	*+ 2%*
EBITA	**42.5**	**43.3**	**48.9**	**47.2**	**51.4**	***+ 9%***	***+ 5%***
margin %	*17.1%*	*17.0%*	*17.7%*	*18.1%*	*18.2%*		
Adj. PBT	**40.2**	**41.0**	**47.5**	**45.2**	**49.9**	***+ 10%***	***+ 5%***
Adj. EPS (p)	**34.8**	**34.7**	**39.9**	**38.3**	**42.0**	***+ 10%***	***+ 5%***
Dividend (p)	2.5	5.3	8.3	6.4	9.3	*+ 19%*	*+ 12%*
Net Cash (Debt)	**-9.4**	**-2.6**	**20.5**	**-2.3**	**20.7**		

Source: Radnor

The core drivers of our estimate revisions are as follows;

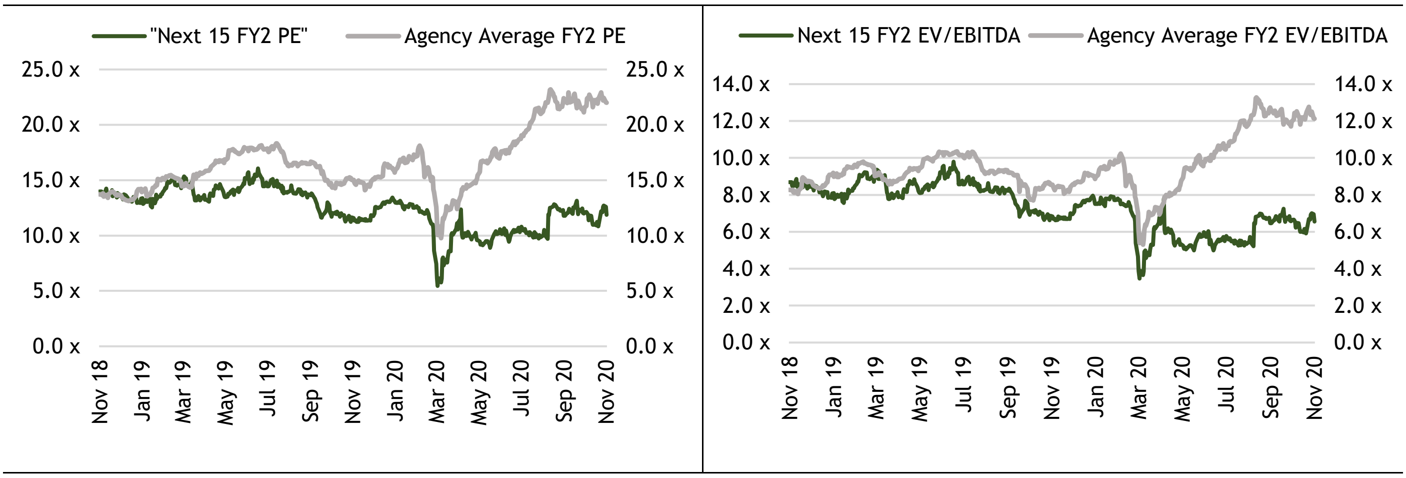
- **Revenue** – a 2% upgrade to our FY21 / 22 expectations respectively, with the impacts being felt across the group, albeit the largest revenue upgrade is in the Data & Analytics segment where recent strength has been most pronounced. The Brand Marketing segment in the US has been boosted by the performance of the M Booth whilst the Data & Analytics segment has been boosted by the B2B lead generation specialist, Activate. This business has enjoyed a particularly strong year with the pandemic playing well to its competitive strengths in the absence of more traditional face to face B2B marketing formats such as events.

- **Margins** – This really is the story of the trading update with a number of revenue mix benefits combining with higher drop through rates as revenue has been secured without seeing additional increments to the cost base. It is also becoming clearer now, the extent to which the group has been able to rebase the fixed operating overhead through property rationalisation.

- **Balance Sheet & Liquidity** - Our net debt expectations for the full year have improved slightly to £2.3m. Tight working capital management has been a feature of the current year as have various tax and capex deferrals. This marginal net debt position underscores the balance sheet flexibility and strength the group enjoys with a £40m revolving credit facility in place until July 2022. We currently do not anticipate as material a year in FY22 for acquisition related payments (£10m expected vs £18m in FY21) and therefore, in the absence of new M&A, see the group building a health net cash position of £20.7m in FY22.

Valuation

Figure 2: Next Fifteen FY2 PE and EV/EBITDA multiple vs Agency average



Source: FactSet, Radnor

- In the chart 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 FY21 earnings outlook.

- Despite recent share price strength (NFC +37% since August trading update), Next Fifteen continues to trade at a sustained discount to its immediate peer group. We have explored this theme in previous notes and continue to believe this level of discount is unwarranted.
  - Three of Next Fifteen's peers (**S4 Capital**, **YouGov** and **DotDigital**) currently command materially higher valuation multiples. However, all the themes these companies variously represent; namely, M&A led growth and a focus on data & analytics and non-traditional advertising exposure are all key drivers for Next Fifteen.
  - The sharp peer group multiple expansion witnessed since the Covid-19 nadir **has not been** supported by consistent earnings upgrades. We also examine this in more detail below, but Next Fifteen has delivered a

materially more positive and consistent earnings revision outlook than the immediate peer group.

- 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's centre of gravity has always been the North American technology industry and as such, UK based investors can sometimes feel distanced from the client base that Next Fifteen serves.
  - 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. For us, we see Next Fifteen as a balance between organic and M&A led growth.
  - 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 fully appreciated the extent to which the mix of the group has evolved and the sheer breadth of the digital capabilities within the current portfolio.

Figure 3: Next Fifteen FY2 EPS vs Peer Group

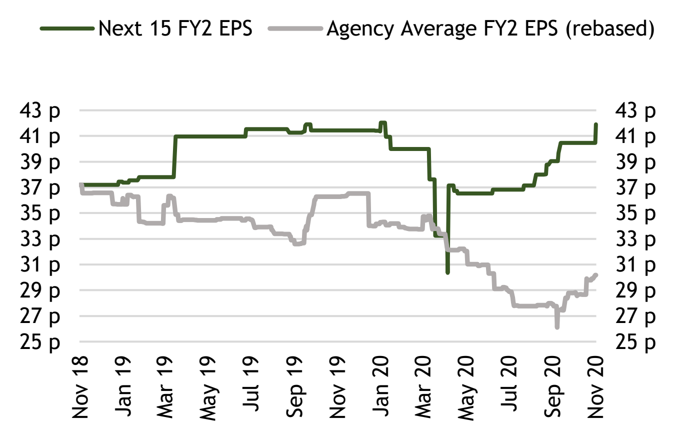
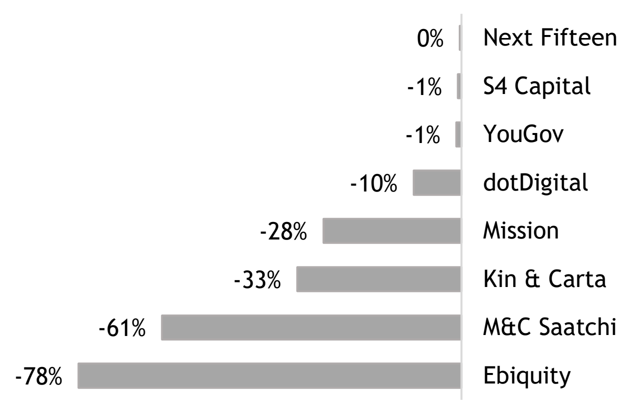


Figure 4: Current FY2 EPS consensus vs Peak



Source: FactSet, Radnor

In **Figure 3** above, we show the evolution of the current Next Fifteen FY2 consensus EPS estimate over the last two years, as sourced from FactSet. We have also taken the same data for the Agency peer group; averaged and rebased to Next Fifteen. This chart demonstrates the extent to which Next Fifteen earnings expectations have recovered almost all of the lost ground through the middle of the current year.

Figure 3 demonstrates how Next Fifteen's forward earnings estimates have rebounded in a fashion not matched by peers. In fact, only **S4 Capital**, has outpaced Next Fifteen in terms of recent estimate momentum, driven almost entirely by acquisitions undertaken since the start of the year. Next Fifteen, on the other hand, has had a quiet period on the M&A front with only one material acquisition, the digital transformation agency Mach49, announced in the second half.

Figure 4 above also shows the extent to which earnings estimates have recovered towards historic levels. Here, it is clear the extent to which Next Fifteen has recovered from the Covid-19 with profit expectations for FY Jan 22 now standing at less than 1% below pre pandemic levels. It is no surprise to see the three most highly rated stocks in the peer group (**S4 Capital**, **YouGov** and **dotDigital**) following up behind given their exposure to the themes that have been driving Next Fifteen's resilience. The valuation discrepancy between Next Fifteen and these names is somewhat more surprising.

Figure 5: Peer Group PE vs earnings growth

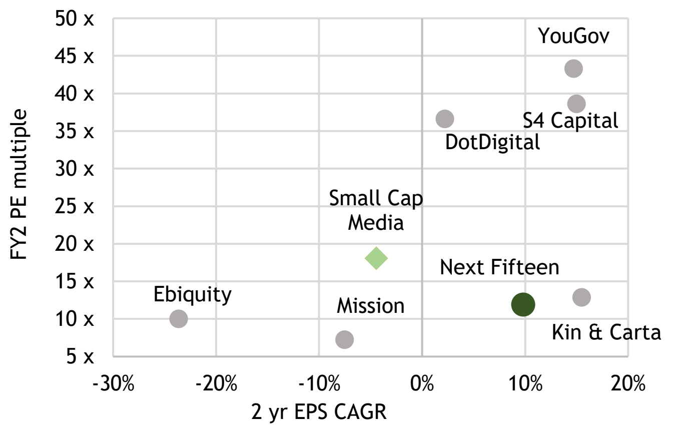
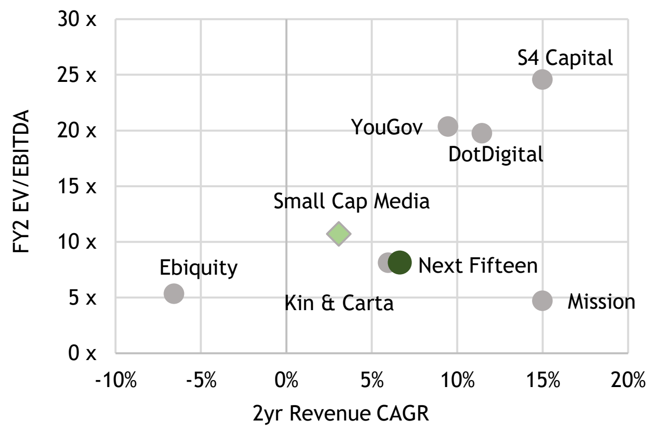


Figure 6: Peer group EV/EBITDA vs revenue growth



Source: FactSet, Radnor

In **Figures 5** and **6** above, we show the spread of valuation multiples within the Agency peer group, as well as the broader Media peer group and benchmark these against both revenue and earnings growth expectations.

Whilst it is not overly surprising to see Next Fifteen trading at a valuation discount (unwarranted on fundamentals, in our view) to **S4 Capital** and **YouGov**, given their singular positioning and, in the case of **S4**, aggressive M&A led expansion, we do find it perplexing to see Next Fifteen trading at a discount to the broader Small Cap Media sector.

We continue to see Next Fifteen as offering a unique exposure to the strongest performing sub sector within Media (digital marketing) combined with a strong balance sheet; a low risk exposure to M&A led growth and a higher structural operating margin as a result of post Covid management actions.

Next Fifteen Communications PLC

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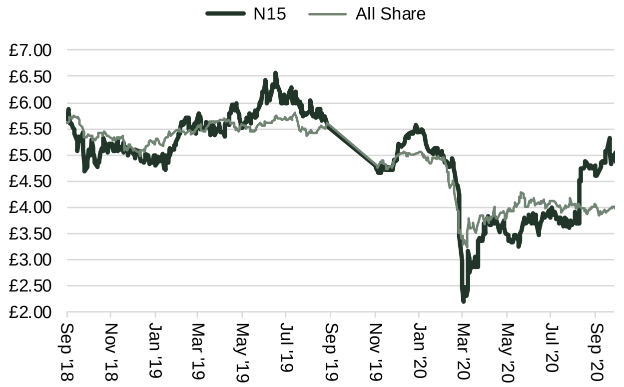
Price (p):	**506 p**
Market Cap:	460 m
EV:	465 m

PROFIT & LOSS

Year to 31 January, £m	FY18	FY19	FY20	FY21e	FY22e	FY23
Brand Marketing	*134.7*	*133.2*	*135.0*	*145.4*	*158.5*	*166.4*
Data & Analytics	*13.9*	*23.2*	*45.1*	*48.9*	*53.8*	*58.1*
Creative Technology	*48.3*	*67.7*	*68.4*	*66.3*	*70.3*	*74.5*
Group Net Revenue	**196.8**	**224.1**	**248.5**	**260.6**	**282.6**	**299.0**
Brand Marketing	*27.5*	*29.6*	*30.8*	*34.5*	*38.0*	*40.9*
Data & Analytics	*3.5*	*7.2*	*12.7*	*13.7*	*15.2*	*16.6*
Creative Technology	*7.9*	*9.5*	*8.0*	*8.0*	*8.8*	*9.5*
Head Office	*(8.9)*	*(9.3)*	*(9.1)*	*(8.9)*	*(10.5)*	*(11.1)*
EBITA - Adjusted	**30.0**	**37.0**	**42.5**	**47.2**	**51.5**	**56.0**
Associates & JV's	0.0	0.1	0.2	0.3	0.3	0.4
Lease interest			(1.6)	(1.4)	(1.4)	(1.2)
Net Bank Interest	(0.7)	(1.0)	(0.8)	(0.9)	(0.6)	(0.6)
PBT - Adjusted	**32.8**	**36.0**	**40.2**	**45.2**	**49.9**	**54.6**
Non Operating Items	(12.8)	(16.3)	(23.0)	(17.7)	(13.8)	(14.6)
Other Financial Items	(3.2)	(0.9)	(11.6)	(2.5)	(2.5)	(2.5)
PBT - IFRS	**13.3**	**18.8**	**5.6**	**25.0**	**33.5**	**37.5**
Tax	(4.0)	(4.3)	(2.7)	(5.0)	(6.7)	(7.5)
Tax - Adjusted	(5.9)	(7.2)	(8.0)	(9.0)	(10.0)	(10.9)
Tax rate - Adjusted	*17.9%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*
Minority interests	0.7	0.6	0.6	0.9	1.2	1.3
No. shares m	74.3	79.2	85.3	85.3	85.3	85.3
No. shares m, diluted	82.1	85.0	90.9	92.3	92.3	92.3
IFRS EPS (p)	11.6	17.5	2.7	22.4	30.1	33.6
Adj EPS (p), diluted	**32.1**	**33.1**	**34.8**	**38.3**	**42.0**	**45.9**
Total DPS (p)	6.3	7.6	2.5	6.4	9.3	10.2

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	FY21e	FY22e	FY23
Net Profit: (add back)	9.3	14.5	2.8	20.0	26.8	30.0
Depreciation & Amortisation	*11.4*	*13.8*	*26.4*	*25.4*	*25.8*	*26.2*
Net Finance costs	*4.0*	*1.9*	*12.5*	*3.4*	*3.1*	*3.1*
Tax	*4.0*	*4.3*	*2.7*	*5.0*	*6.7*	*7.5*
Working Capital	(4.2)	1.2	1.7	(2.2)	(1.1)	(0.8)
Other	4.4	2.6	1.8	0.8	0.7	0.6
Cash from Ops	**28.9**	**38.4**	**47.9**	**52.3**	**62.0**	**66.6**
Cash Tax	(4.3)	(6.2)	(6.0)	(5.0)	(6.7)	(7.5)
Tangible Capex	(3.0)	(5.6)	(3.5)	(4.0)	(4.0)	(4.0)
Intangible Capex	(1.2)	(2.4)	(1.8)	(2.0)	(2.0)	(2.0)
Free Cashflow	**20.4**	**24.1**	**36.6**	**41.3**	**49.3**	**53.1**
Dividends	(5.7)	(6.6)	(7.5)	(3.1)	(6.4)	(9.0)
Acquisitions & Inv.	(15.4)	(29.6)	(24.2)	(18.3)	(10.0)	(10.0)
Financing	3.8	7.7	1.8	(11.2)	(9.9)	(8.9)
Net Cashflow	**3.1**	**(4.4)**	**6.7**	**8.7**	**23.0**	**25.3**
Net Cash (Debt)	(11.6)	(5.2)	(9.4)	(2.3)	20.7	46.0

Announcements

Date	Event
September 2020	Trading update
September 2020	Acquisition of Mach49 for $2.7m
April 2020	Final results (y/e Jan 2020)
March 2020	Trading update
January 2020	Trading update
October 2019	Interim results (6m July 2019)
October 2019	Acquisition of Health Unlimited for $27.7m initial

RATIOS

	FY19	FY20	FY21e	FY22e	FY23
RoE	25.3%	28.1%	27.0%	27.0%	27.1%
RoCE	31.7%	34.9%	35.7%	42.3%	51.0%
Asset Turnover (x)	0.7x	0.9x	0.9x	0.8x	0.7x
NWC % Revenue	17.1%	41.2%	34.7%	32.2%	31.1%
Op Cash % EBITA	103.8%	112.8%	110.8%	120.4%	119.0%
Net Debt / EBITDA	0.1x	0.1x	0.0x	-	-

BALANCE SHEET

Year to 31 January, £m	FY18	FY19	FY20	FY21e	FY22e	FY23
Intangibles	94.8	126.1	155.4	160.7	159.7	158.7
P,P+E	13.6	15.9	14.2	15.8	15.0	13.8
Tax Asset & Other	11.7	13.0	54.7	46.7	38.7	30.7
Total Fixed Assets	**120.1**	**155.0**	**224.4**	**223.3**	**213.4**	**203.2**
Net Working Capital	(32.2)	(38.4)	(102.3)	(90.4)	(91.0)	(92.9)
Capital Employed	**87.9**	**116.6**	**122.1**	**132.9**	**122.5**	**110.4**
Net Funds	(11.6)	(5.2)	(9.4)	(2.3)	20.7	46.0
Net Assets	**76.3**	**111.5**	**112.7**	**130.6**	**143.2**	**156.3**

VALUATION

Fiscal	FY19	FY20	FY21e	FY22e	FY23
P/E	15.3x	14.6x	13.2x	12.1x	11.0x
EV/EBITDA	7.5x	6.8x	6.3x	9.0x	8.3x
Div Yield	1.5%	0.5%	1.3%	1.8%	2.0%
FCF Yield	5.2%	7.9%	8.9%	10.6%	11.4%
EPS growth	3.4%	4.9%	10.1%	9.7%	9.3%
DPS growth	20.0%	-66.9%	155.1%	46.2%	9.3%

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