RADNOR
CAPITAL PARTNERS

# Next Fifteen Communications Group PLC

NFC | AIM | Media |457p |£355m

1 Year Chart


## Final Results – Strong H2 organic growth; good start to the new year

*NFC's full year results did not contain any surprises following the January trading update. The key point was the continuation of the H2 high single digit organic revenue growth into the first two months of the new year. Whilst this by no means guarantees the full year outcome; it is a good start and underpins current year expectations. If this momentum is maintained and barring no further material FX volatility this suggests current year estimates could be conservative. NFC shares are currently trading near all time highs, which is no great surprise given the strength of the group's performance over the last four years. Yet, the valuation does not look stretched relative to the peer group despite a superior track record and future growth outlook.*

- **H2 momentum maintained:** The key data point for us in the final results was confirmation of the H2 group organic revenue growth rate at 8%, marking a good acceleration from the 3% reported in H1. The fact this has been maintained into the first two months of the new year is key and marks a return to the underlying growth delivered over the last three years.

- **UK outperforming North America.** The UK outstripped North America not just in terms of reported and organic revenue growth (+37% / +8% respectively vs +8% / +5% in the US) but also in EBITA margin terms (22.3% in the UK vs 20.0% in the US). Although the US remains the group's largest market (home to the majority of Next Fifteen's technology clients), the UK has seen the majority of recent M&A; focusing on higher growth and higher margin digital agencies with the potential to grow in to the US. We continue to expect solid revenue growth and incremental margin gains out of the US but the real driver of short term growth will be the UK.

- **Forecast revisions.** We have tweaked our estimates post the final results. We had already pencilled in a 2% EPS upgrade in January and today are nudging this up by a further 1%. The broad shape of our estimates remains largely unchanged. We continue to look for a single figure net debt position (excluding any further M&A), underlining balance sheet strength.

- **Valuation:** NFC trades on a FY19E PE of 14.2x, a small premium to the Agency peer group (13.7x), and a yield of 1.6%. Next Fifteen is by no means the most highly rated stock in the peer group despite having a superior track record and offering a better growth outlook.

*Next Fifteen Communications Group PLC is a research client of Radnor Capital Partners Ltd.*


20th April 2018

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| Year End January | Revenue, £m | PBT adj, £m | EPS (p) | Div (p) | Net Cash, £m | PER x | Yield % |
|---|---|---|---|---|---|---|---|
| FY 2017A | 171.0 | 24.2 | 23.4 | 5.3 | -11.4 | 19.5 | 1.1% |
| FY 2018A | 196.8 | 29.3 | 27.8 | 6.3 | -11.6 | 16.4 | 1.4% |
| *FY 2019E* | *223.6* | *35.2* | *32.2* | *7.2* | *-5.3* | *14.2* | *1.6%* |
| *FY 2020E* | *236.7* | *38.3* | *35.0* | *8.3* | *12.4* | *13.0* | *1.8%* |
| *FY 2021E* | *249.8* | *41.7* | *38.1* | *9.6* | *27.1* | *12.0* | *2.1%* |

*Source: Radnor Capital Partners*

# Final Results

Next Fifteen released final results for the year ended 31st January 2018 on 4th April. The key highlights are below:

*H2 organic run rate was the key data point …*

- Group revenue increased by 15% to £196.8m, organic revenue growth of 5%;
- Organic growth accelerated in H2 to +8% y/y, compared to 2% in H1;
- Pre-central overhead EBITA margins increased to 19.8% (19.4%) and post central overhead margins increased by 60 bps to 15.3%;
- Adjusted PBT and EPS grew by 21% / 19% respectively;
- The final dividend was set at 4.5p, making a total of 6.3p for the year, representing +20% growth on FY2017;

*Operating and free cash-flow remained strong …*

- Operating cashflow was £33.1m (FY2017: £26.5m) before a £4.2m working capital outflow and £19.4m of investing outflows;
- Operating cash conversion (post working capital) to EBITDA was 85%, in-line with historic ranges
- Net debt came in at £11.6m, broadly flat y/y, representing 0.3x EBITDA

Overall, the detail behind the results came as no great surprise following the January trading update. The key new news was the commentary regrading current trading.

- The H2 organic growth run rate of c.8% has been maintained into the first two months of the new year;
- The businesses acquired in H2 have traded well and will make a full contribution to the FY2019 results.

Below we run through the geographic segments, and the acquired businesses, in more detail.

## NORTH AMERICA

| £m | FY2018 | FY2017 | FY2016 | FY2015 |
|---|---|---|---|---|
| Revenue | 115.9 | 107.0 | 83.5 | 64.0 |
| EBITA | 23.2 | 22.3 | 17.5 | 14.1 |
| Margin % | 20.0% | 20.9% | 21.0% | 22.0% |

*The US normalised in H2 after an H1 impacted by strong comps and some client nervousness …*

The key news in North America was the return to a more normalised organic revenue growth in H2 in the mid to high single digit range. This was driven by a combination of overall activity levels and new client wins.

US organic growth rate in the first half came in at 2% with this lower than normal rate affected by a combination of unrepeated project work boosting H1 FY2017 and political uncertainty relating to the Trump presidency taking the edge of client discretionary demand. At the time of the interim results, management indicated that these revenue effects had largely worked themselves out of the system and this has proven to be the case.

*US margins recovered in H2 but remain below recent historic averages …*

Another factor impacting H1 FY2018 had been the cost impact of putting in place the infrastructure to support the US growth opportunities for the UK businesses acquired over the last three years. Similarly to revenue performance, management indicated this was going to a six month specific issue and this has proven to be the case with H2 EBITA margins recovering sharply to 21.8% (18.1% in H1).

We continue to look to a return to margin expansion in the US for the current financial year. This will be an important data point for the group as the declining US EBITA margins over the last three years have been the only blemish on an otherwise stellar track record.

## UNITED KINGDOM

| *£m* | *FY2018* | *FY2017* | *FY2016* | *FY2015* |
|---|---|---|---|---|
| *Revenue* | 58.3 | 42.6 | 27.9 | 23.8 |
| *EBITA* | 13.0 | 8.0 | 3.8 | 2.5 |
| *Margin %* | 22.3% | 18.9% | 13.6% | 10.6% |

The UK has been the stand-out performer for Next Fifteen over the last two years. This has been driven primarily by the contribution from newly acquired business, which themselves have been faster growing and higher margin.

*The UK is not just about M&A with organic growth the highest in the group …*

It is worth pointing out that Next Fifteen employs a strict definition of organic performance with acquisitions only included for organic purposes when they have completed a full year of ownership. On this basis, the organic revenue growth rate reported in FY2018 was doubly impressive at 8% as it did only includes acquisitions made before Jan 2017.

The organic revenue growth run rate accelerated through FY2018; H1 organic growth was 3.5%, moving into double digits in H2. EBITA margins were also strong through the course of FY2018; H1 EBITA margin was 20.2%, rising to 23.8% in H2 resulting in 22.3% for the year as a whole.

On the agency front, Beyond and Publitek had a very strong year, with Beyond in particular winning some very material new business from the likes of Samsung. However, the group has also been active in addressing those agencies where performance has been lagging. This has been a particular feature of the group's "fix the roof while the sun is shining" strategy over the last four years. FY2018 saw the consumer PR agency, Lexis merged into Text 100, while the digital agency BDA has been merged into Twogether.

## EMEA & ASIA PACIFIC

| *£m* | *FY2018* | *FY2017* | *FY2016* | *FY2015* |
|---|---|---|---|---|
| *Revenue* | 22.5 | 21.4 | 18.4 | 21.5 |
| *EBITA* | 2.8 | 2.8 | 1.8 | 1.8 |
| *Margin %* | 12.4% | 13.1% | 9.8% | 8.4% |

EMEA and APAC remain important contributors to the group; especially in terms of global client delivery, although they are not material contributors to growth.

- EMEA delivered 10% revenue growth and an improved margin.

- APAC delivered 3% revenue growth but saw margins decline as the group invested in new IT infrastructure following the agency rationalisation in FY2017.

## ACQUISITIONS

FY2018 was a busy year for acquisitions, especially in the UK, with four acquisitions. In total, since FY2016 has now made fifteen bolt-on acquisitions. In Figure 1 below, we show the acquisitions made in FY2018 and more recently.

*Figure 1 – M&A track record*

| FY18e | Company | Initial | Cash | Revenue | PBT | Notes |
|---|---|---|---|---|---|---|
| July | Velocity Partners | £5.9m | £4.9m | £5.2m | £1.4m | B2B content marketing (70% US) |
| July | Circle Research | £5.2m | £4.9m | £2.2m | £1.0m | Market research |
| September | Charterhouse Research | £2.8m | £2.6m | £2.7m | £0.6m | Specialist market research |
| September | Elvis Communications | £5.5m | £5.5m | £4.7m | £0.8m | Integrated digital agency |
| | | **£19.4m** | **£17.9m** | **£14.8m** | **£3.7m** | |
| February | Brandwidth | £6.2m | £4.9m | £7.3m | £1.9m | Digital innovation agency |

*Source: Company, Radnor Capital Partners*

FY2018 saw £19.4m of acquisition investment. Including the more recent Brandwidth deal, this increases to £25.6m (7% of NFC's market cap) and, on a fully annualised basis, a likely contribution of at least £5.6m, which will mostly land in the UK. Next Fifteen has stuck to its guns on valuation with all the acquisitions taking place at mid-single digit EBITA multiples.

*NFC has acquired well over the last three years …*

We see no reason for the M&A trend established over the last few years to change materially. Next Fifteen remain wedded to their strict acquisition criteria, especially when it comes to price. Detractors will point to the law of diminishing returns and the ability of acquisitions to continue to move the group dial. However, we view Next Fifteen's approach as being inherently less risky with a far greater emphasis on generating shareholder value.

*The UK is likely to remain the focus of M&A …*

The fact that all Next Fifteen's acquisitions over the last two years have been made in the UK has not been an accident. The UK digital marketing universe is vibrant and relatively well populated. Next Fifteen is also able to offer potential acquiree companies a de-risked route to the US market, which has been a powerful negotiating tool in Next Fifteen's favour. Fundamentally, these acquisitions are about acquiring talent as much as they are about the financial contribution. The fact remains that the UK offers similar skill levels to the US at a lower relative cost. The capital gains tax environment is also more beneficial in the UK which lowers the overall acquisition price relative to the US.

## Where does this leave the Next Fifteen valuation?

*Valuation does not look stretched despite the shares testing all time highs …*

All in all, a good place. Despite recently testing all-time highs, the Next Fifteen share price does not appear overly stretched in valuation terms.

The FY2019E PE ratio is 14.2x, falling to 13.2x for FY2020E. The dividend yield is modest, at 1.6%, but the dividend is growing at double digits, in line with earnings.

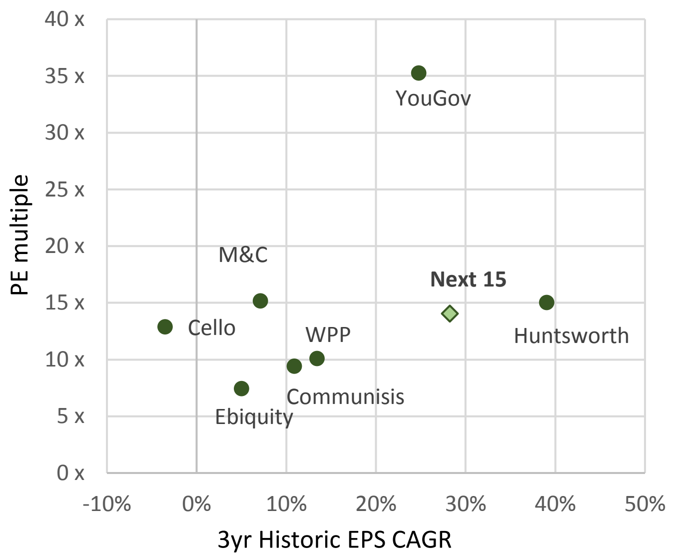
The Next Fifteen rating is by no means the highest in the quoted Small Cap Agency peer group; that particular honour goes to YouGov (YOU.L) on 35.3x. We note that YouGov forecast EPS growth is expected to be c.8% in 2018, compared to 14% for Next Fifteen.

All in, the Small Cap Agency peer group is trading on a one-year forecast PE ratio of 13.7x and is expected to deliver, in aggregate, earning growth of 7%. Next Fifteen trades on a prospective PE of 14.3x and is expected to deliver twice the level of earnings growth.

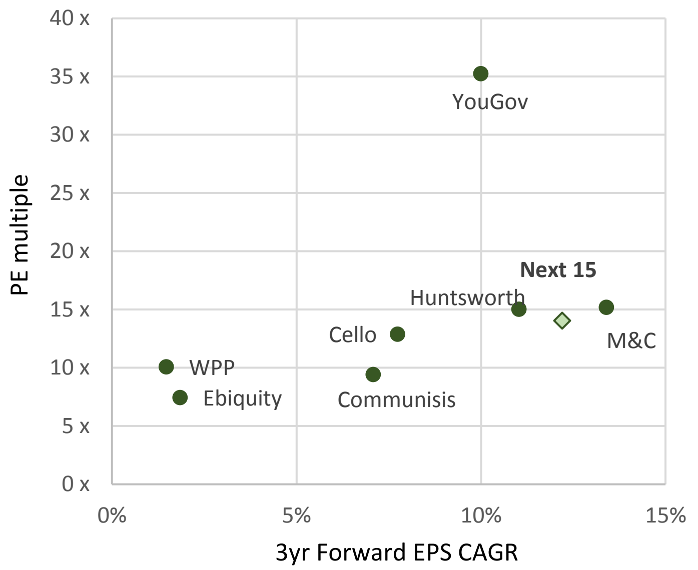
In Figure 2 below, we compare the broad Agency peer group in terms of current prospective PE and EV/EBITDA multiples set against historic and future EPS and EBITDA growth rates (forecast data is taken from FactSet).

*Figure 2: Agency Peer Group – PE vs Historic and Future EPS Growth*

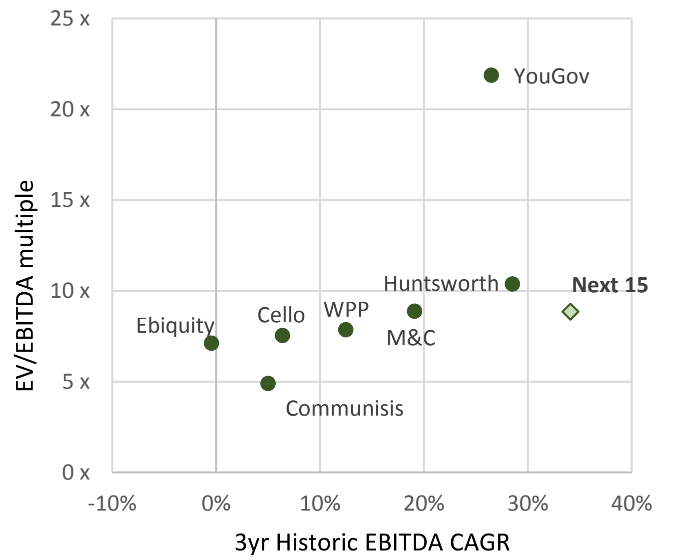
*PE vs 3 Year **Historic** EPS CAGR*



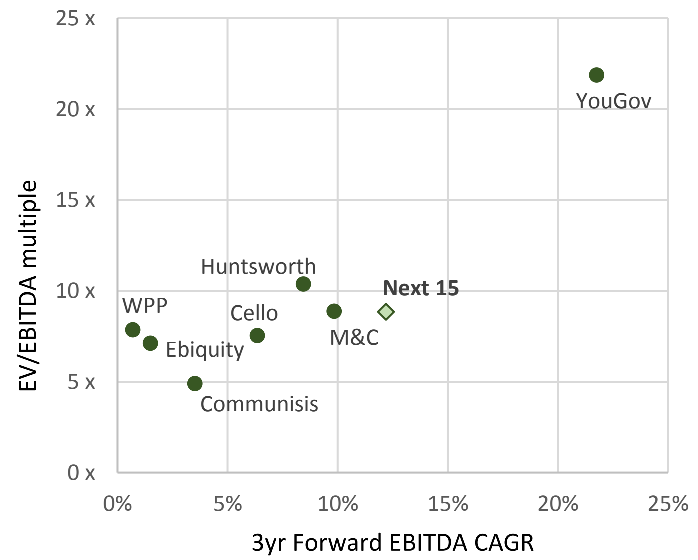

*PE vs 3 Year **Future** EPS CAGR*




*EV/EBITDA vs 3 Year **Historic** EBITDA CAGR*




*EV/EBITDA vs 3 Year **Future** EBITDA CAGR*




*Source: Radnor Capital Partners, FactSet*

This shows how Next Fifteen outscores the peer group in terms of delivered, and prospective earnings and EBITDA growth, yet sits well within the peer group valuation range.

## Estimate Changes

We had previously amended our estimates post the January trading update. At that point we upgraded our FY2019E EPS estimate by 2%.

There are a number of moving parts but overall, our Adj PBT estimate of £35.2m remains unchanged and our Adj EPS (fully diluted) is upgraded by 1% to 32.2p.

- We are reducing our headline revenue estimate by 1% to £223.6m, driven primarily by the timing of acquisition contribution in the UK and FX effects in the US;
- This is not due to a general scaling back of underlying growth expectations; the commentary surrounding the strong start to the current year suggests underlying client demand remains robust;
- However, we do not expect this to drop all the way through to EBITA. We anticipate further improvement in UK margins (driven by mix and the full benefits of the Lexis / Text100 merger) and a have also scaled back our expectations for central costs;
- The net result is that our headline EBITA and PBT estimates remain unchanged;
- The combination of reduced minority interests and a slightly lower fully diluted share count drives a marginal 1% uptick in fully diluted, adjusted EPS to 32.2p (31.8p).

*Figure 2: Radnor Estimate Changes for Next Fifteen Communications*

| | Previous 2019E | Revised 2019E | *Change, % 2019E* | *Change, £m 2019E* |
|---|---|---|---|---|
| UK | 81.3 | 79.9 | *-2%* | *-1.4* |
| North America | 121.1 | 120.6 | *-1%* | *-0.5* |
| EMEA | 7.8 | 8.0 | *+3%* | *+0.2* |
| Asia Pacific | 15.4 | 15.1 | *-2%* | *-0.3* |
| **Revenue** | **225.5** | **223.6** | ***-1%*** | ***-1.9*** |
| UK | 18.0 | 18.3 | *+2%* | *+0.3* |
| North America | 25.0 | 24.6 | *-2%* | *-0.4* |
| EMEA | 0.8 | 0.8 | - | - |
| Asia Pacific | 2.5 | 2.3 | *-8%* | *-0.2* |
| Central Overhead | -10.4 | -10.1 | *+3%* | *+0.3* |
| **EBITA** | **35.9** | **35.9** | **-** | **-** |
| *- margin %* | *15.9%* | *16.1%* | | |
| **Adj. PBT** | **35.2** | **35.2** | **-** | **-** |
| **Adj. EPS (p)** | **31.8** | **32.2** | ***+1%*** | |
| Dividend (p) | 7.5 | 7.2 | *-4%* | |
| **Net Cash (Debt)** | **-3.3** | **-5.3** | | |

*Source: Radnor Capital Partners*

## Next Fifteen Communications PLC

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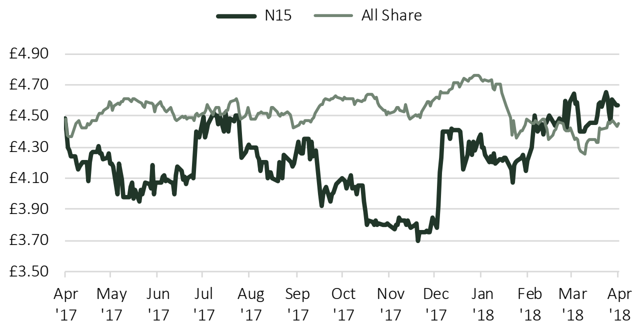
| | |
|---|---|
| Price (p): | 457 p |
| Market Cap: | 355 m |
| EV: | 367 m |

### PROFIT & LOSS

| Year to 31 January, £m | 2016 | 2017 | FY18 | FY19e | FY20e | FY21e |
|---|---|---|---|---|---|---|
| *UK* | *27.9* | *42.6* | *58.3* | *79.9* | *86.3* | *92.3* |
| *North America* | *83.5* | *107.0* | *115.9* | *120.6* | *126.6* | *132.9* |
| *EMEA* | *6.4* | *7.2* | *7.9* | *8.0* | *8.2* | *8.5* |
| *Asia Pacific* | *12.0* | *14.2* | *14.7* | *15.1* | *15.6* | *16.1* |
| **Group Net Revenue** | **129.8** | **171.0** | **196.8** | **223.6** | **236.7** | **249.8** |
| *UK* | *3.8* | *8.0* | *13.0* | *18.3* | *19.8* | *21.2* |
| *North America* | *17.5* | *22.3* | *23.2* | *24.6* | *26.6* | *28.6* |
| *EMEA* | *0.5* | *0.6* | *0.8* | *0.8* | *0.9* | *0.9* |
| *Asia Pacific* | *1.4* | *2.2* | *2.0* | *2.3* | *2.5* | *2.6* |
| *Head Office* | *(6.6)* | *(8.2)* | *(8.9)* | *(10.1)* | *(10.9)* | *(11.5)* |
| **EBITA - Adjusted** | **16.5** | **25.0** | **30.0** | **35.9** | **38.9** | **41.8** |
| Associates & JV's | (0.0) | (0.3) | 0.0 | - | - | - |
| Net Bank Interest | (0.4) | (0.5) | (0.7) | (0.8) | (0.6) | (0.1) |
| **PBT - Adjusted** | **16.1** | **24.2** | **29.3** | **35.2** | **38.3** | **41.7** |
| Non Operating Items | (8.1) | (17.1) | (12.8) | (10.1) | (10.6) | (10.9) |
| Other Financial Items | (2.4) | (4.2) | (3.2) | (2.5) | (2.5) | (2.5) |
| **PBT - IFRS** | **5.6** | **2.9** | **13.3** | **22.5** | **25.2** | **28.3** |
| Tax | (1.1) | (1.2) | (4.0) | (4.5) | (5.0) | (5.7) |
| Tax - Adjusted | (3.5) | (5.3) | (5.9) | (7.0) | (7.7) | (8.3) |
| *Tax rate - Adjusted* | *22.0%* | *22.0%* | *20.0%* | *20.0%* | *20.0%* | *20.0%* |
| Minority interests | 0.5 | 0.5 | 0.7 | 0.8 | 0.9 | 1.0 |
| No. shares m | 66.3 | 72.3 | 74.3 | 75.8 | 75.8 | 75.8 |
| No. shares m, diluted | 71.6 | 78.3 | 82.1 | 85.0 | 85.0 | 85.0 |
| IFRS EPS (p) | 6.0 | 1.6 | 11.6 | 22.7 | 25.4 | 28.6 |
| **Adj EPS (p), diluted** | **16.9** | **23.4** | **27.8** | **32.2** | **35.0** | **38.1** |
| Total DPS (p) | 4.2 | 5.3 | 6.3 | 7.2 | 8.3 | 9.6 |

### PRICE CHART - 1 YEAR ABSOLUTE vs FTSE ALL SHARE




*Source: FactSet*

### SHAREHOLDERS

| | % of ord. Share capital |
|---|---|
| Liontrust | 13.5% |
| Octopus Investments | 11.3% |
| Aviva Investors | 9.6% |
| Aberdeen Stan Life | 8.5% |
| Directors | 7.1% |
| Herald Inv Mgmt | 5.5% |
| BlackRock | 4.9% |
| Hargreave Hale | 4.5% |
| | 64.9% |

### CASH FLOW

| Year to 31 January, £m | 2016 | 2017 | FY18 | FY19e | FY20e | FY21e |
|---|---|---|---|---|---|---|
| **Net Profit: (add back)** | **4.5** | **1.7** | **9.3** | **18.0** | **20.2** | **22.6** |
| *Depreciation & Amortisation* | *6.1* | *9.5* | *11.4* | *10.9* | *11.5* | *12.2* |
| *Net Finance costs* | *2.8* | *4.7* | *4.0* | *3.3* | *3.1* | *2.6* |
| *Tax* | *1.1* | *1.2* | *4.0* | *4.5* | *5.0* | *5.7* |
| Working Capital | 0.2 | 6.3 | (4.2) | (2.2) | (1.7) | (1.8) |
| Other | 1.6 | 9.4 | 4.4 | 1.0 | 1.0 | 1.0 |
| **Cash from Ops** | **16.3** | **32.8** | **28.9** | **35.5** | **39.2** | **42.3** |
| Cash Tax | (3.0) | (2.0) | (4.3) | (5.5) | (5.0) | (5.7) |
| Tangible Capex | (6.4) | (8.3) | (3.0) | (4.0) | (4.0) | (4.0) |
| Intangible Capex | (0.6) | (0.6) | (1.2) | (0.8) | (0.8) | (0.8) |
| **Free Cashflow** | **6.4** | **22.0** | **20.4** | **25.2** | **29.3** | **31.8** |
| Dividends | (3.0) | (4.3) | (5.7) | (6.5) | (7.2) | (8.0) |
| Acquisitions & Inv. | (13.4) | (21.9) | (15.4) | (12.9) | (3.6) | (8.9) |
| Financing | 14.6 | 11.1 | 3.8 | (1.0) | (0.8) | (0.3) |
| **Net Cashflow** | **4.6** | **6.8** | **3.1** | **4.9** | **17.7** | **14.6** |
| Net Cash (Debt) | (6.6) | (11.4) | (11.6) | (5.3) | 12.4 | 27.1 |

### Announcements

| Date | Event |
|---|---|
| 7th February 2018 | Acquisition of Brandwidth for max £10.3m |
| 26th Sep 2017 | Interim results (y/e Jan 2018) |
| 26th Sep 2017 | Acquisition of Charterhouse Research for £2.75m |
| 15th Sep 2017 | Acquisition of Elvis Communications for £5.5m |
| 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) |

### RATIOS

| | 2017 | FY18 | FY19e | FY20e | FY21e |
|---|---|---|---|---|---|
| RoE | 26.8% | 29.9% | 32.8% | 32.2% | 29.2% |
| RoCE | 30.9% | 34.2% | 40.5% | 48.6% | 50.0% |
| Asset Turnover (x) | 0.6x | 0.6x | 0.5x | 0.5x | 0.5x |
| NWC % Revenue | 16.1% | 16.3% | 13.0% | 14.7% | 13.2% |
| Op Cash % EBITA | 131.5% | 96.1% | 98.8% | 100.5% | 101.1% |
| Net Debt / EBITDA | 0.4x | 0.3x | 0.1x | - | - |

### BALANCE SHEET

| Year to 31 January, £m | 2016 | 2017 | FY18 | FY19e | FY20e | FY21e |
|---|---|---|---|---|---|---|
| Intangibles | 53.6 | 80.0 | 94.8 | 90.8 | 87.8 | 89.9 |
| P,P+E | 10.0 | 15.8 | 13.6 | 15.3 | 15.4 | 15.1 |
| Tax Asset & Other | 7.9 | 11.7 | 11.7 | 11.7 | 11.7 | 11.7 |
| **Total Fixed Assets** | **71.4** | **107.4** | **120.1** | **117.8** | **114.9** | **116.6** |
| Net Working Capital | (12.0) | (27.5) | (32.2) | (29.0) | (34.7) | (32.9) |
| **Capital Employed** | **59.4** | **79.9** | **87.9** | **88.8** | **80.1** | **83.7** |
| Net Funds | (6.6) | (11.4) | (11.6) | (5.3) | 12.4 | 27.1 |
| **Net Assets** | **52.8** | **68.5** | **76.3** | **83.5** | **92.6** | **110.8** |

### VALUATION

| Fiscal | 2017 | FY18 | FY19e | FY20e | FY21e |
|---|---|---|---|---|---|
| P/E | 19.5x | 16.4x | 14.2x | 13.0x | 12.0x |
| EV/EBITDA | 12.9x | 10.8x | 9.2x | 9.4x | 8.8x |
| Div Yield | 1.1% | 1.4% | 1.6% | 1.8% | 2.1% |
| FCF Yield | 6.0% | 5.6% | 6.9% | 8.0% | 8.7% |
| | | | | | |
| EPS growth | 38.9% | 18.6% | 15.7% | 8.9% | 8.7% |
| DPS growth | 25.0% | 20.0% | 15.0% | 15.0% | 15.0% |

# REGULATORY DISCLOSURES

*Radnor Capital Partners Ltd is authorised and regulated by the Financial Conduct Authority.*

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