Next Fifteen Communications Group PLC

NFC | AIM | Media |568p |£441m

H1 Results – Ahead of Expectations; Further Upgrades

Next Fifteen ("NFC") has released good H1 results; delivering healthy 9% group organic revenue growth, 25% EBITA and EPS growth and a 20% hike in the interim dividend. The UK has replaced North America as the prime driver of group growth, especially at the profit line, where performance was ahead of our expectations. North America was more subdued, although organic revenue growth was still a healthy 7%. The interims underline the importance of the UK restructuring and refocusing that has taken place over the last four years. The acquisition of fast growing, higher margin innovative and digitally focused businesses are now making a material contribution to the group bottom line. The NFC share price has continued to perform well through 2018 yet the valuation still does not feel stretched at a PEG of c.1x.

1 Year Chart

- **Organic growth strong:** Perhaps the key message coming out of the H1 numbers is the strong level of organic revenue growth compared to FY2018. Group organic revenue growth of 9% in H1 2019 compared to 5% for the last financial year and a slight acceleration on H2 2018.

- **UK outperforming North America.** This is a continuation of a theme that has developed over the last two years. The UK performance was impressive, driven by M&A on top of strong organic growth (+15% in H1). The US had a less impressive H1; held back through a combination of FX, the Story disposal and client losses in Text 100. Yet, despite this, US organic growth was still 7% in H1, with most of the US agencies growing. US margins were weaker but these are expected to recover in H2 as Beyond, in particular, moves on from the onboarding of a recent, substantial client win.

- **Forecast revisions.** We have re-assessed our expectations following this better than expected H1 performance. The strength of the UK more than outweighs the softer US, with H2 also likely to benefit from an unwinding of H1 FX headwinds and a normalising of US margins. We have upgraded our FY19E and FY20E EPS by 2% and 4% respectively.

- **Valuation:** NFC trades on a Jan 2019E PE of 17.5x, falling to 15.7x for Jan 2020E, and a yield of 1.3%. Next Fifteen is by no means the most highly rated stock in the Small Cap Media peer group despite having a superior track record and offering a superior growth outlook (trading on a PEG of c.1x).

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

25th September 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	24.2	0.9%
FY 2018A	196.8	29.3	27.8	6.3	-11.6	20.4	1.1%
FY 2019E	*224.0*	*35.4*	*32.7*	*7.4*	*-9.9*	*17.4*	*1.3%*
FY 2020E	*239.0*	*39.3*	*36.3*	*8.7*	*10.9*	*15.7*	*1.5%*
FY 2021E	*253.2*	*43.1*	*39.7*	*10.0*	*28.9*	*14.3*	*1.8%*

Source: Radnor Capital Partners

H1 Results

H1 organic run rate increased compared to H2 of the prior year …

The key highlights are below:

- Group revenue increased by 14% to £106.8m, with organic revenue growth of 9% (+15% in the UK and 7% in the US), compared to 8% for H2 FY18;
- Pre-central overhead EBITA increased by 22% to £20.0m, with margins increasing to 18.8% (H1 FY18: 17.5%) and post central overhead margins increased by 120 bps to 14.4% (H1 FY18: 13.2%);
- Adjusted PBT and EPS grew by 25% respectively;
- The interim dividend has been set at 2.16p, representing +20% growth on H1 FY18;
- Operating cashflow was £17.9m (H1 FY18: £14.5m) before a £7.0m working capital outflow and £19.9m of investing outflows (net capex of £4.6m and net M&A of £15.5m);

Cash conversion was strong in the seasonally weaker half …

- Operating cash conversion (post working capital) to EBITDA was 62%, a significant improvement on the 45% reported for H1 FY18, although it should be noted that the first half is historically the seasonally weaker half from a cash-flow perspective;
- Net debt was £25.6m, c.£4.8m higher than H1 FY18, driven primarily by M&A related payments (£6.9m on acquisitions and £8.6m on deferred consideration payments on historic acquisitions), representing 0.8x FY18 EBITDA and 0.6x FY19E EBITDA.

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

UNITED KINGDOM

£m	*H1 2019*	*H1 2018*	*% Δ*	*FY 2018*
Revenue	40.0	25.5	+56%	58.3
EBITA	9.5	5.2	+83%	13.0
Margin %	23.7%	20.2%		22.3%

The UK performed ahead of our expectations for both revenue growth and margin expansion …

This was a better than expected performance from the UK at both the revenue and EBITA lines. Stripping out the impact of recent acquisitions; organic revenue growth was 15%, which is well ahead of UK marketing industry averages and peer group comparators. Contribution to growth was evenly spready across the portfolio of subsidiary agencies, although MIG and Beyond were notable performers.

The impact on UK margins and operating profit was marked, with UK EBITA near doubling y/y. There are multiple factors at play here:

- Nearly all the businesses acquired over the last three years in the UK enjoy structurally higher margins than the original PR agencies that made up the historic UK business. Individual margin ranges between 30% and 50% have not been unusual.
- The acquired businesses have all joined NFC at relatively early stages of maturity as well as being exposed to newer, non-traditional and faster growth areas of the marketing universe such as niche content marketing, online market research/analytics, creative digital and design. Critically though, all the acquired businesses have been profitable and commercially proven.

- Lastly, but by no means least, the UK is benefiting from the prior restructuring of the more traditional agencies, which created a more sustainable operating cost base and a central cost and property platform which the newer businesses have been able to leverage.

Comparing the US and UK businesses is not comparing apples with apples; there are significant differences …

It is important to note that a notable difference between the UK and US businesses within NFC is the relative scale of the respective subsidiary agencies. The UK is best characterised as being a group of entrepreneurial, fast moving but relatively small, niche businesses. The US, on the other hand, is made up of fewer, larger scale agencies, some of whom have been operating for twenty years plus.

NORTH AMERICA

£m	*H1 2019*	*H1 2018*	*% Δ*	*FY 2018*
Revenue	55.8	57.0	-2%	115.9
EBITA	9.4	10.3	-9%	23.2
Margin %	16.9%	18.1%		20.0%

At a headline level, this has not been a great H1 for the US business. However, there are a number of moving parts that are worth exploring.

- FX played a significant part in these results with Sterling strength vs the dollar a feature of the first half. Taken in US dollar terms, the US actually grew revenue by 5% from $72.5m in H1 FY18 to $76.2m.

- During the period, the Story business was fully closed. Netting this revenue out of both periods results in the US organic revenue growth increasing from 5% to 7%.

- This 7% growth would have been even higher were it not for two major client losses within Text 100 (IBM and Lenovo) which is the most mature, and the lowest growth of the US businesses. We discuss Text 100 in more detail below.

- Despite the dollar growth in revenue, overall US operating margins came under pressure due to:

    - cost investments made by Beyond as it kicked off a significant client engagement

    - broader costs incurred in taking some of the other UK businesses into the US. This transatlantic migration is a key plank of the NFC strategy and is a major plus for NFC in the M&A process. The ability of NFC to de-risk and accelerate expansion into the US is a major draw for vendor management teams.

    - The client losses and restructuring at Text 100

In the round, we expect the first two of these points to unwind in H2 as revenues catch up with the cost investment incurred. NFC has provided explicit guidance in the results statement that it expects US operating margins to improve.

Just prior to these results, NFC announced that the long serving Text 100 CEO is stepping down, to be replaced by the CEO of the smaller agency Bite, Helena Maus. These two agencies will combine in the US, mirroring the merger of Bite and Text 100 that occurred two years ago outside the US.

This is a significant moment for NFC.

- Firstly, it demonstrates that group management are not afraid of making bold decisions, in a similar fashion to the restructuring of the UK businesses which started four years ago.

The changes at Text 100 send a clear message about the direction of travel …

- Secondly, it sends a very clear message about the direction of travel for the group. Text 100 is the most mature of the US businesses and was the closest to "old" school PR in its core offering. The client base was dominated by the first wave of enterprise technology clients such as IBM, Lenovo and HP. It is no surprise that the newer wave of tech clients (Google, Slack etc) have been won in the newer, and less legacy-centric US businesses. The new management team will undoubtedly take time to deliver change and a turn around in Text performance but this is the first and most critical step.

EMEA & ASIA PACIFIC

£m	*H1 2019*	*H1 2018*	*% Δ*	*FY 2018*
Revenue	11.0	10.9	1%	22.5
EBITA	1.1	0.9	22%	2.7
Margin %	10.0%	8.2%		12.0%

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 continued the steady improvement it delivered in FY18 (H1 and H2) with 11% revenue growth and a significantly improved margin (14.9% vs 7.6% in H1 FY18).

- APAC was more volatile following a number of client losses, with revenue down by 4% to £6.8m and margins falling by c.100 bps to 7.6%..

Estimate Changes

In a similar fashion to the final results, we are taking this opportunity to pencil some small upgrades to our expectations for the current year (+2% for EPS) and FY20E (+4%).

Clearly, the £:$ has the potential to be a moving feast for H2 but for the purposes of these estimates, we assume rates remain constant at current levels. We detail our estimate changes in Figure 1 below, but the key headlines are

- A material upgrade to our expectations for UK revenue and EBITA for the current year and FY20E;

- We are scaling back our expectations for the US although not at the level of the UK upgrade. Beyond FX movements, any appreciable recovery resulting from the Text/Bite combination is likely to be accretive;

- In-line with the interim dividend increase, we now look for 20% dividend growth for the year compared to our previous estimate of 15%;

- Due to the phasing of deferred consideration payments we now look for £9.9m of net debt vs our previous estimate of £5.3m;

Figure 1: Radnor Estimate Changes for Next Fifteen Communications

	Previous 2019E	Revised 2019E	*Δ, % 2019E*	Previous 2020E	Revised 2020E	*Δ, % 2020E*
UK	79.9	84.0	*+5%*	86.3	92.4	*+7%*
North America	120.6	117.1	*-3%*	126.6	123.0	*-3%*
EMEA	8.0	8.4	*+5%*	8.2	8.7	*+5%*
Asia Pacific	15.1	14.5	*-4%*	15.6	15.0	*-4%*
Revenue	**223.6**	**224.0**	***+0%***	**236.7**	**239.0**	***+1%***
UK	18.3	19.9	*+9%*	19.8	22.2	*+12%*
North America	24.6	22.8	*-7%*	26.6	24.6	*-8%*
EMEA	0.8	1.3	*+60%*	0.9	1.5	*+62%*
Asia Pacific	2.3	1.7	*-23%*	2.5	2.4	*-4%*
Central Overhead	-10.1	-9.9	*-2%*	-10.9	-10.8	*-1%*
EBITA	**35.9**	**36.0**	***+0%***	**38.9**	**39.9**	***+2%***
- margin %	*16.1%*	*16.1%*		*16.5%*	*16.7%*	
Adj. PBT	**35.2**	**35.4**	***+1%***	**38.3**	**39.3**	***+2%***
Adj. EPS (p)	**32.2**	**32.7**	***+2%***	**35.0**	**36.3**	***+4%***
Dividend (p)	7.2	7.6	*+4%*	8.3	8.7	*+4%*
Net Cash (Debt)	**-5.3**	**-9.9**		**12.4**	**10.9**	

Source: Radnor Capital Partners

Next Fifteen Communications PLC

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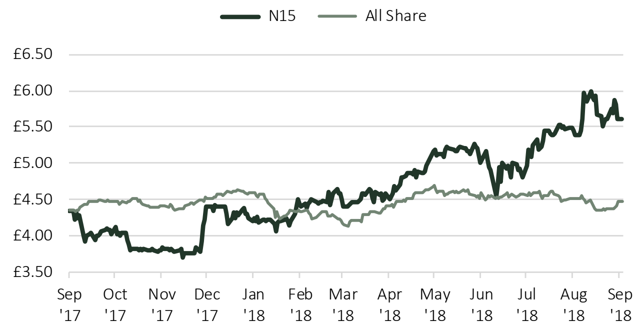
Price (p):	568 p
Market Cap:	441 m
EV:	453 m

PROFIT & LOSS

Year to 31 January, £m	2016	2017	FY18	FY19e	FY20e	FY21e
UK	*27.9*	*42.6*	*58.3*	*84.0*	*92.4*	*99.8*
North America	*83.5*	*107.0*	*115.9*	*117.1*	*123.0*	*129.1*
EMEA	*6.4*	*7.2*	*7.9*	*8.4*	*8.7*	*8.9*
Asia Pacific	*12.0*	*14.2*	*14.7*	*14.5*	*15.0*	*15.4*
Group Net Revenue	**129.8**	**171.0**	**196.8**	**224.0**	**239.0**	**253.2**
UK	*3.8*	*8.0*	*13.0*	*19.9*	*22.2*	*23.9*
North America	*17.5*	*22.3*	*23.2*	*22.8*	*24.6*	*26.5*
EMEA	*0.5*	*0.6*	*0.8*	*1.3*	*1.5*	*1.6*
Asia Pacific	*1.4*	*2.2*	*2.0*	*1.7*	*2.4*	*2.5*
Head Office	*(6.6)*	*(8.2)*	*(8.9)*	*(9.9)*	*(10.8)*	*(11.4)*
EBITA - Adjusted	**16.5**	**25.0**	**30.0**	**36.0**	**39.9**	**43.1**
Associates & JV's	(0.0)	(0.3)	0.0	0.0	-	-
Net Bank Interest	(0.4)	(0.5)	(0.7)	(0.6)	(0.6)	(0.0)
PBT - Adjusted	**16.1**	**24.2**	**29.3**	**35.4**	**39.3**	**43.1**
Non Operating Items	(8.1)	(17.1)	(12.8)	(9.8)	(9.9)	(10.2)
Other Financial Items	(2.4)	(4.2)	(3.2)	(1.5)	(2.5)	(2.5)
PBT - IFRS	**5.6**	**2.9**	**13.3**	**24.1**	**26.9**	**30.3**
Tax	(1.1)	(1.2)	(4.0)	(4.8)	(5.4)	(6.1)
Tax - Adjusted	(3.5)	(5.3)	(5.9)	(7.1)	(7.9)	(8.6)
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	1.1
No. shares m	66.3	72.3	74.3	78.0	78.0	78.0
No. shares m, diluted	71.6	78.3	82.1	84.0	84.0	84.0
IFRS EPS (p)	6.0	1.6	11.6	23.6	26.3	29.8
Adj EPS (p), diluted	**16.9**	**23.4**	**27.8**	**32.7**	**36.3**	**39.7**
Total DPS (p)	4.2	5.3	6.3	7.6	8.7	10.0

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**	**19.2**	**21.5**	**24.3**
Depreciation & Amortisation	*6.1*	*9.5*	*11.4*	*11.7*	*13.1*	*13.8*
Net Finance costs	*2.8*	*4.7*	*4.0*	*2.1*	*3.1*	*2.5*
Tax	*1.1*	*1.2*	*4.0*	*4.8*	*5.4*	*6.1*
Working Capital	0.2	6.3	(4.2)	(2.2)	(1.8)	(1.9)
Other	1.6	9.4	4.4	2.3	2.0	2.0
Cash from Ops	**16.3**	**32.8**	**28.9**	**37.9**	**43.3**	**46.7**
Cash Tax	(3.0)	(2.0)	(4.3)	(5.9)	(5.4)	(6.1)
Tangible Capex	(6.4)	(8.3)	(3.0)	(6.0)	(4.0)	(4.0)
Intangible Capex	(0.6)	(0.6)	(1.2)	(1.8)	(1.0)	(1.0)
Free Cashflow	**6.4**	**22.0**	**20.4**	**24.3**	**32.9**	**35.7**
Dividends	(3.0)	(4.3)	(5.7)	(6.8)	(7.6)	(8.4)
Acquisitions & Inv.	(13.4)	(21.9)	(15.4)	(16.5)	(3.6)	(8.9)
Financing	14.6	11.1	3.8	(0.7)	(0.9)	(0.4)
Net Cashflow	**4.6**	**6.8**	**3.1**	**0.3**	**20.8**	**18.0**
Net Cash (Debt)	(6.6)	(11.4)	(11.6)	(9.9)	10.9	28.9

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%	28.6%	28.1%	26.0%
RoCE	30.9%	34.2%	34.0%	40.9%	43.2%
Asset Turnover (x)	0.6x	0.6x	0.6x	0.5x	0.5x
NWC % Revenue	16.1%	16.3%	12.0%	13.0%	11.6%
Op Cash % EBITA	131.5%	96.1%	105.5%	108.5%	108.5%
Net Debt / EBITDA	0.4x	0.3x	0.2x	-	-

BALANCE SHEET

Year to 31 January, £m	2016	2017	FY18	FY19e	FY20e	FY21e
Intangibles	53.6	80.0	94.8	103.9	99.8	100.7
P,P+E	10.0	15.8	13.6	17.3	17.1	16.5
Tax Asset & Other	7.9	11.7	11.7	11.7	11.7	11.7
Total Fixed Assets	**71.4**	**107.4**	**120.1**	**132.9**	**128.6**	**128.9**
Net Working Capital	(12.0)	(27.5)	(32.2)	(26.9)	(31.1)	(29.3)
Capital Employed	**59.4**	**79.9**	**87.9**	**106.0**	**97.4**	**99.7**
Net Funds	(6.6)	(11.4)	(11.6)	(9.9)	10.9	28.9
Net Assets	**52.8**	**68.5**	**76.3**	**96.1**	**108.4**	**128.6**

VALUATION

Fiscal	2017	FY18	FY19e	FY20e	FY21e
P/E	24.2x	20.4x	17.4x	15.7x	14.3x
EV/EBITDA	15.9x	13.3x	11.4x	11.3x	10.5x
Div Yield	0.9%	1.1%	1.3%	1.5%	1.8%
FCF Yield	4.9%	4.5%	5.4%	7.3%	7.9%
EPS growth	38.9%	18.6%	17.6%	11.1%	9.5%
DPS growth	25.0%	20.0%	20.0%	15.0%	15.0%

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