Next Fifteen Communications Group PLC

NFC | AIM | Media | 512p |£443m

Full year trading update – Moving parts

The trading update for the year ended Jan 2020, did not contain any new news as such. Both Beyond and Archetype had been well flagged to the market as likely net detractors to the group in the current year. However, it is clear that the initial client losses at Beyond have not been recovered enough by new client wins to protect the group bottom line and we are adjusting our estimates accordingly. Despite this negative, the rest of the group is performing well with a blended organic revenue growth of c.10% outside of Beyond and Archetype. The outlook statement is broadly positive, Beyond notwithstanding, with 2020 expected to be a year of growth and strategic progress.

Even after factoring a small reduction to FY 2020 and FY 2021 estimates, we still see Next Fifteen delivering 11% PBT growth in FY 2020 and 15% in FY 2021. The calendarised FY 2021 PE is 13.1x, a 16% discount to the slower growing and more highly geared peer group.

1 Year Chart

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 headlines:** Excluding Beyond and Archetype, Next Fifteen enjoyed a strong year with c.10% organic revenue growth and positive contributions from recent acquisitions. However, the pace of new client wins has not been enough to protect the Beyond margin and the result is that FY 2020 PBT will come in marginally below market expectations.

- **Good and Bad:** Next Fifteen's portfolio performance is a blend of the good, the in-line and the not so good. The last five years has mostly seen the "digital" good significantly outweighing the "analogue" not so good. But FY 2020 has seen two of the group agencies cloud what has otherwise been another good year. Archetype is a two / three year recovery play and remains in-line with expectations. Beyond has also undershot, with relatively higher fixed costs not being matched by new client wins, which are coming through but too late to insulate FY 2020 numbers.

- **FY 2020 and 2021 reduction:** Dollar weakness has also played a part but fundamentally our estimate changes are cost rather than revenue led. We take a cautious view on the pace of the Beyond and Archetype recovery during 2020. We are reducing our FY 2021 revenue by 3% and PBT / EPS by -6% / -5% respectively. We have also re-set our balance sheet forecasts on the £12m net debt for FY 2020 and, absent any further M&A, look for a £4.2m net cash position for FY 2021.

14 October 2019

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YE - January	Sales, £m	PBT adj, £m	EPS (p)	Div (p)	Net Cash, £m	Fiscal PER x	Yield %
FY 2018A	196.8	29.3	27.8	6.3	-11.6	18.4	1.2
FY 2019A	224.1	36.0	33.1	7.6	-5.2	15.5	1.5
FY 2020E	*245.4*	*40.1*	*35.0*	*8.7*	*-12.1*	*14.6*	*1.7*
FY 2021E	*266.4*	*46.0*	*40.0*	*10.0*	*4.2*	*12.8*	*2.0*
FY 2022E	*281.3*	*51.5*	*44.7*	*11.5*	*25.7*	*11.5*	*2.2*

Source: Radnor Capital Partners

Tading Update – Moving parts

Next Fifteen has released a trading update for the year ended 31 January 2020:

- Group revenue performance has been broadly in line with expectations and are consistent with the shape reported at the interim results;

- Organic revenue performance, with two exceptions, continues to be healthy with underlying revenue growth c.10%, in-line with the trends reported at the half year. The Data segment (comprising the Sevanta research business primarily), continues to deliver the fastest organic growth, +20%, in the group;

- The two businesses that have negatively impacted the group are Archetype in the US and Beyond, which straddles the UK and US.

  - The slower growth at **Archetype** has been well flagged by the company and is a function of two agencies (Text100 and Bite) merging and restructuring. This merger has always been flagged as a two to three year exercise and will result in a leaner, more flexible and upskilled core presence in the US market. We do not see any negative surprises here.

  - The issues at **Beyond** have had a more material impact on short term financial performance; primarily due to the larger scale client engagements undertaken and the relatively high fixed cost base in what is a "high skill" proposition even by Next Fifteen standards. New client win momentum is beginning to pick up; but the pace and scale of this rebound is clearly slower than had originally been anticipated. The phasing of new client wins with steeper cost reductions will be a potential source of earnings volatility over the shorter term.

- Overall, adjusted profit before tax is expected to come in marginally below expectations on a constant currency basis. We see this as cost phasing led rather than revenue led;

- Net debt is expected to come in at c.£12m. There is no doubt that Next Fifteen's balance sheet remains a source of real strength. The growth of pre M&A cash generation has been a key feature of the Next Fifteen equity story over the last five years.

  In fact, since the start of FY 2016 Next Fifteen has spent in aggregate (initial and deferred cash consideration) £105m on acquisitions, of which £32m was raised from secondary share placings. Therefore, in total a net £73m of cash investment. Yet, net debt in FY 2016 was £6.6m and is expected to be £12m in FY 2020. The majority of the Next Fifteen's acquisitions have been funded from existing cashflow and from the cashflows of the acquired businesses;

- In the broader outlook statement, the company has re-iterated confidence in the outlook and the ability to continue delivering double digit revenue and profit growth. The acquisition pipeline remains healthy and a number of transactions are expected to complete in calendar Q1 2020.

Estimate Revisions: PBT -8% for FY 2020, -6% for FY 2021

In Figure 1 below, we outline our key estimate revisions. There are a number of moving parts;

- **Revenue** – Given the commentary around Beyond and the slower pace and scale of new client wins, we have taken a more cautious approach to the UK and have reduced our UK net revenue assumptions by 3% in both FY 2020 and FY 2021. We have also factored Dollar weakness into a 1% reduction in North American revenue expectations. Other than these two factors, our underlying expectations remain unchanged.

- **Margins –** Compared to other agencies in the group, Beyond has a less variable cost base so the revenue impact will be more pronounced in the medium term in both the US and the UK. This is the primary driver behind the 7% reduction in our EBITA estimate.

- **Balance Sheet -** We have updated our balance sheet estimates for the trading update and have rolled the c.£12m net debt base figure for FY 2020 forward.

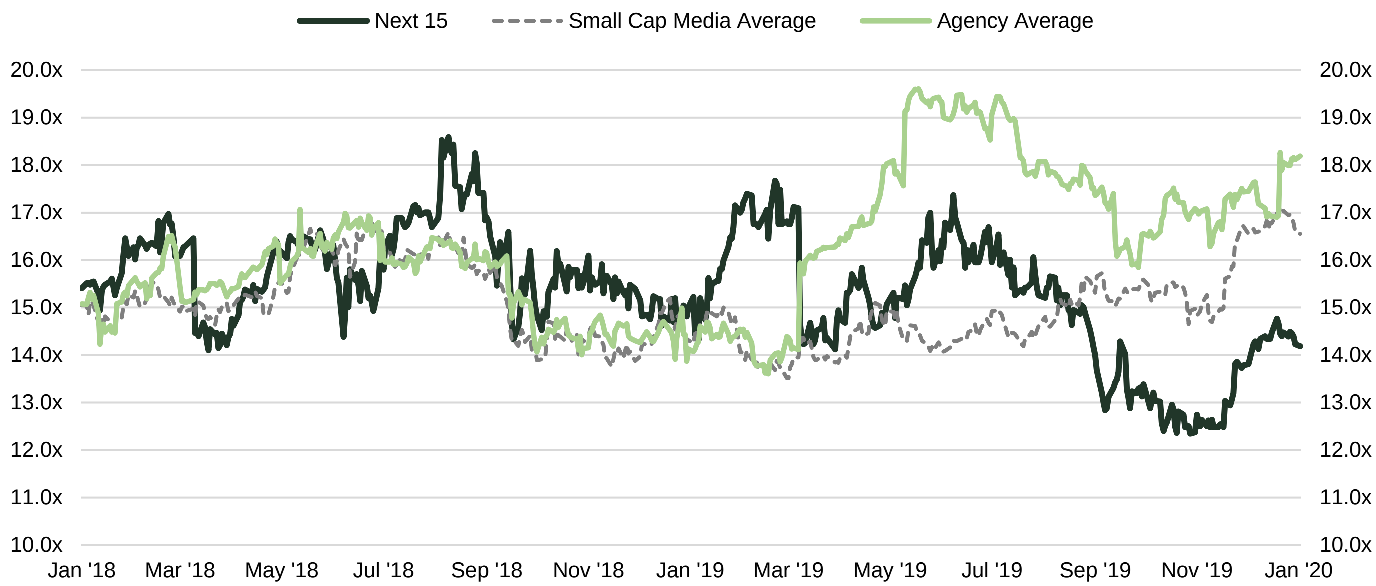
Figure 1: Radnor estimate revisions

	Previous		New		*Change, %*	
£m	2020E	2021E	2020E	2021E	2020E	2021E
UK	99.0	106.9	96.1	103.7	*-3%*	*-3%*
North America	127.9	140.7	126.2	138.8	*-1%*	*-1%*
EMEA	9.0	9.3	9.0	9.3	*0%*	*0%*
Asia Pacific	14.2	14.6	14.2	14.6	*0%*	*0%*
Revenue	**250.1**	**271.5**	**245.4**	**266.4**	***-2%***	***-2%***
UK	22.3	25.1	20.8	23.3	*-7%*	*-7%*
North America	27.5	31.0	25.6	29.1	*-7%*	*-6%*
EMEA	1.6	1.7	1.6	1.7	*1%*	*-2%*
Asia Pacific	2.3	2.4	2.3	2.4	*0%*	*-1%*
Central Overhead	-9.0	-10.6	-8.8	-10.4	*-2%*	*-2%*
EBITA	**44.7**	**49.6**	**41.5**	**46.1**	***-7%***	***-7%***
- margin %	*17.9%*	*18.3%*	*16.9%*	*17.3%*		
Adj. PBT	**43.4**	**49.2**	**40.1**	**46.0**	***-8%***	***-6%***
Adj. EPS (p)	**37.2**	**42.0**	**35.0**	**40.0**	***-6%***	***-5%***
Dividend (p)	8.7	10.0	8.7	10.0	*0%*	*0%*
Net Cash (Debt)	**-5.3**	**11.7**	**-12.1**	**4.2**		

Source: Radnor

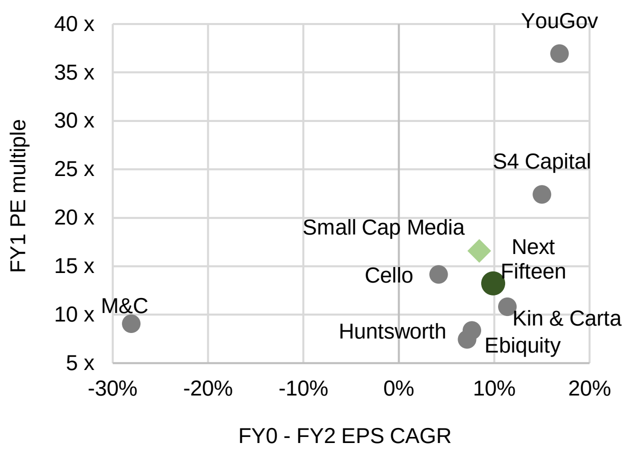
Valuation

Figure 2: Next Fifteen FY1 PE multiple vs Peers



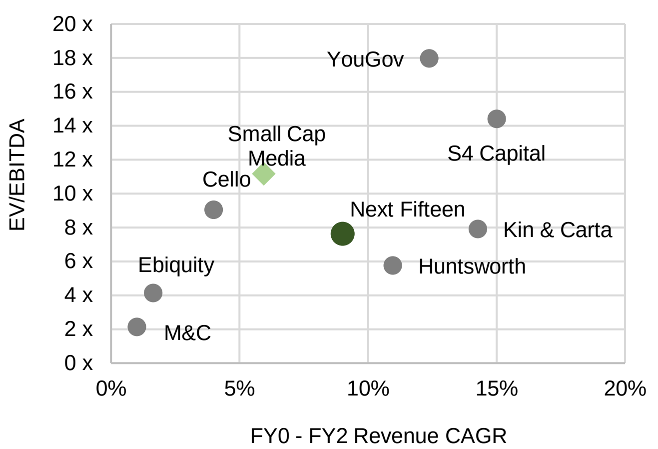
Source: FactSet, Radnor

Figure 3: Cal 2019 PER vs forward EPS growth



Source: FactSet, Radnor

Cal 2019 EV/EBITDA vs forward Revenue growth



Source: FactSet, Radnor

- Even after factoring the reduction to our PBT / EPS estimates, Next Fifteen still offers better than average earnings growth than the Small Cap Agency or the broader Small Cap Media peer group averages. The calendarised 2020 PE multiple is **13.1x** versus an average of **15.6x** for the Agency peer group, a discount of **16%**.

- The balance sheet is also a source of valuation support with Next Fifteen trading on a comfortable "mid-table" EV/EBITDA multiple of **7.6x** compared to an Agency peer group average of **8.8x** on more aggressively geared balance sheets.

Next Fifteen Communications PLC

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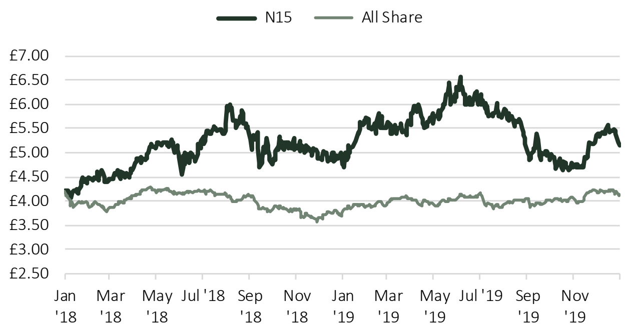
Price (p):	**512 p**
Market Cap:	443 m
EV:	455 m

PROFIT & LOSS

Year to 31 January, £m	FY17	FY18	FY19	FY20e	FY21e	FY22e
UK	*42.6*	*58.3*	*83.5*	*96.1*	*103.7*	*111.0*
North America	*107.0*	*115.9*	*117.9*	*126.2*	*138.8*	*145.7*
EMEA	*7.2*	*7.9*	*8.7*	*9.0*	*9.3*	*9.5*
Asia Pacific	*14.2*	*14.7*	*13.9*	*14.2*	*14.6*	*15.1*
Group Net Revenue	**171.0**	**196.8**	**224.1**	**245.4**	**266.4**	**281.3**
UK	*8.0*	*13.0*	*20.5*	*20.8*	*23.3*	*26.6*
North America	*22.3*	*23.2*	*22.0*	*25.6*	*29.1*	*32.1*
EMEA	*0.6*	*0.8*	*1.5*	*1.6*	*1.7*	*1.7*
Asia Pacific	*2.2*	*2.0*	*2.2*	*2.3*	*2.4*	*2.4*
Head Office	*(8.2)*	*(8.9)*	*(9.3)*	*(8.8)*	*(10.4)*	*(11.3)*
EBITA - Adjusted	**25.0**	**30.0**	**37.0**	**41.5**	**46.1**	**51.6**
Associates & JV's	(0.3)	0.0	0.1	0.1	0.1	0.1
Net Bank Interest	(0.5)	(0.7)	(1.0)	(1.5)	(0.2)	(0.2)
PBT - Adjusted	**24.2**	**29.3**	**36.0**	**40.1**	**46.0**	**51.5**
Non Operating Items	(17.1)	(12.8)	(16.3)	(15.3)	(12.8)	(13.4)
Other Financial Items	(4.2)	(3.2)	(0.9)	(2.5)	(2.5)	(2.5)
PBT - IFRS	**2.9**	**13.3**	**18.8**	**22.3**	**30.8**	**35.6**
Tax	(1.2)	(4.0)	(4.3)	(4.5)	(6.2)	(7.1)
Tax - Adjusted	(5.3)	(5.9)	(7.2)	(8.0)	(9.2)	(10.3)
Tax rate - Adjusted	*22.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*
Minority interests	0.5	0.7	0.6	0.8	1.1	1.2
No. shares m	72.3	74.3	79.2	84.5	84.5	84.5
No. shares m, diluted	78.3	82.1	85.0	89.5	89.5	89.5
IFRS EPS (p)	1.6	11.6	17.5	20.2	27.9	32.2
Adj EPS (p), diluted	**23.4**	**27.8**	**33.1**	**35.0**	**40.0**	**44.7**
Total DPS (p)	5.3	6.3	7.6	8.7	10.0	11.5

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	FY17	FY18	FY19	FY20e	FY21e	FY22e
Net Profit: (add back)	1.7	9.3	14.5	17.9	24.6	28.5
Depreciation & Amortisation	*9.5*	*11.4*	*13.8*	*14.4*	*15.3*	*16.4*
Net Finance costs	*4.7*	*4.0*	*1.9*	*4.0*	*2.7*	*2.7*
Tax	*1.2*	*4.0*	*4.3*	*4.5*	*6.2*	*7.1*
Working Capital	6.3	(4.2)	1.2	(2.1)	(3.6)	(2.2)
Other	9.4	4.4	2.6	0.9	0.9	0.9
Cash from Ops	**32.8**	**28.9**	**38.4**	**39.5**	**46.1**	**53.4**
Cash Tax	(2.0)	(4.3)	(6.2)	(4.5)	(6.2)	(7.1)
Tangible Capex	(8.3)	(3.0)	(5.6)	(4.5)	(4.0)	(4.0)
Intangible Capex	(0.6)	(1.2)	(2.4)	(1.0)	(1.0)	(1.0)
Free Cashflow	**22.0**	**20.4**	**24.1**	**29.6**	**34.9**	**41.3**
Dividends	(4.3)	(5.7)	(6.6)	(7.2)	(8.2)	(9.3)
Acquisitions & Inv.	(21.9)	(15.4)	(29.6)	(27.0)	(10.0)	(10.0)
Financing	11.1	3.8	7.7	(7.2)	(0.5)	(0.5)
Net Cashflow	**6.8**	**3.1**	**(4.4)**	**(11.9)**	**16.3**	**21.5**
Net Cash (Debt)	(11.4)	(11.6)	(5.2)	(12.1)	4.2	25.7

Announcements

Date	Event
October 2019	Interim results (6m July 2019)
October 2019	Acquisition of Health Unlimited for $27.7m initial
April 2019	Final results (y/e Jan 2019)
January 2019	Acquisition of Planning-inc for £6.3m initial
November 2018	Acquisition Activate for $9.9m initial
November 2018	Placing to raise £20m gross @ 475p
July 2018	Acquisition of Technical Associates for £2.2m

RATIOS

	FY18	FY19	FY20e	FY21e	FY22e
RoE	29.9%	25.3%	22.0%	23.8%	27.9%
RoCE	34.2%	31.7%	26.9%	31.7%	44.1%
Asset Turnover (x)	0.6x	0.7x	0.8x	0.7x	0.6x
NWC % Revenue	16.3%	17.1%	13.4%	12.5%	18.7%
Op Cash % EBITA	96.1%	103.9%	95.2%	99.9%	103.4%
Net Debt / EBITDA	0.3x	0.1x	0.2x	-	-

BALANCE SHEET

Year to 31 January, £m	FY17	FY18	FY19	FY20e	FY21e	FY22e
Intangibles	80.0	94.8	126.1	122.7	123.2	122.9
P,P+E	15.8	13.6	15.9	17.3	16.7	15.8
Tax Asset & Other	11.7	11.7	13.0	47.4	39.4	31.4
Total Fixed Assets	**107.4**	**120.1**	**155.0**	**187.4**	**179.2**	**170.0**
Net Working Capital	(27.5)	(32.2)	(38.4)	(32.8)	(33.4)	(52.7)
Capital Employed	**79.9**	**87.9**	**116.6**	**154.6**	**145.9**	**117.4**
Net Funds	(11.4)	(11.6)	(5.2)	(12.1)	4.2	25.7
Net Assets	**68.5**	**76.3**	**111.5**	**142.5**	**150.1**	**143.1**

VALUATION

Fiscal	FY18	FY19	FY20e	FY21e	FY22e
P/E	18.4x	15.5x	14.6x	12.8x	11.5x
EV/EBITDA	10.2x	8.7x	7.8x	9.9x	8.8x
Div Yield	1.2%	1.5%	1.7%	2.0%	2.2%
FCF Yield	4.5%	5.3%	6.5%	7.7%	9.1%
EPS growth	18.6%	19.2%	5.6%	14.2%	11.8%
DPS growth	20.0%	20.0%	15.0%	15.0%	15.0%

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