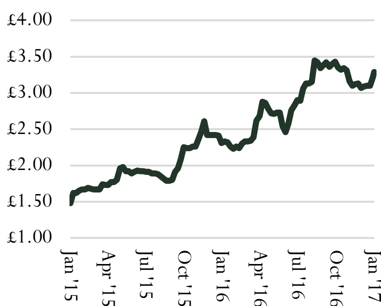
RADNOR CAPITAL PARTNERS

Next Fifteen Communications PLC

NFC | AIM | Media | 329p | £239m

2 Year Chart



Initiation of Coverage

Over the last three years the market has rewarded Next Fifteen for strong, consistent double digit North American organic growth. The high dollar exposure continues to be a positive tailwind. However, substantive progress outside the US has been overshadowed. Margins (ex US) have improved substantially and the shape of the UK business has been transformed. Even after a prolonged period of outperformance, Next Fifteen trades at a comparable rating to the more pedestrian peer group; with mid-teens earnings / dividend growth and balance sheet strength at a low teens multiple. Current trading remains in-line with a positive outlook for FY18E.

- **Client Positioning:** Next Fifteen has long been an innovator in using digital skills and channels to deliver a broad range of communication and marketing services to a global client base. North America, and the technology industry in particular, has long been a core market with a quality and tenure of client list rivalling many of the larger networks.

- **North America continues to grow:** Double digit US organic growth has been driven by historic investment and the group's deep position within the US tech industry. Dollar strength remains the icing on the cake and will continue to benefit into FY18E.

- **Other regions coming to the fore:** While the US sun has been shining, management have been fixing the roof elsewhere. Self-help has played a part, as have acquisitions. Non US earnings have grown by 130% over the last three years, resulting in a more balanced group margin.

- **M&A:** Acquisitions have transformed the growth / margin profile of the UK business in particular. The M&A strategy is to buy small, entrepreneurial, digitally focused businesses with US potential. Acquisition multiples have not been demanding, resulting in considerable balance sheet flexibility.

- **Valuation:** Next Fifteen trades broadly in-line with the peer group despite stronger earnings and dividend growth. Estimate revision momentum has been positive and we see little to change this dynamic.

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Year End January	Revenue, £m	PBT adj, £m	EPS (p)	Div (p)	Net Cash, £m	PER x	Yield %
FY 2015A	109.2	12.5	13.2	3.5	-8.6	24.9	1.1%
FY 2016A	129.8	16.1	16.9	4.2	-6.6	19.5	1.3%
FY 2017E	*168.8*	*23.6*	*22.7*	*5.1*	*-13.6*	*14.5*	*1.6%*
FY 2018E	*188.2*	*27.6*	*25.9*	*5.7*	*-3.0*	*12.7*	*1.7%*
FY 2019E	*200.6*	*30.4*	*28.0*	*6.2*	*10.0*	*11.8*	*1.9%*

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INVESTMENT CASE

Client list

The client list tells a story …

The strength of the Next Fifteen client list is fundamental to the investment case. Top 20 clients include Google / Alphabet (the group's largest client), Facebook, Dell, IBM, Amazon, Lenovo, Unilever, Novartis, GE, Adobe, Cisco and Intuit. Next Fifteen has a well-established and leading position within the US technology industry across a range of specialisms spanning traditional PR, content creation, technology design and build and research / analytics.

… as does client longevity

The duration of those client relationships is also testament to the high level of client delivery. Although the positions on the list do vary, the composition of the group's top clients has remained broadly constant over the last five / six years. Given the fast moving nature of the technology clients, in particular, this suggest that the Next Fifteen subsidiary agencies have remained innovative and relevant to their clients.

North American growth …

North American organic growth has driven the group over the last four years …

Given the strength of the client list and Next Fifteen's long standing presence in the US market, it should not be surprising that the US has been the key growth driver for the group. However, the pace of growth has surprised on the upside for much of the last three years (evidenced by the upward estimate revisions over the period). Since FY14, North American revenues have doubled, with the majority of this growth organic. Yes, there have been currency tailwinds but even on a constant currency basis, annual organic growth has averaged well in excess of 10%.

What is also impressive has been the ability to maintain a high level of margin (20% plus over the last three years), despite the need to invest in a high skill, and increasingly high cost workforce.

Demand is not the key challenge …

In our view, this last point is critical to the outlook for the US business. The pace and consistency of organic growth suggests that client demand is not the primary challenge, instead ensuring the capacity to service and execute this demand effectively. Indeed, one of the motivating factors behind the UK acquisition strategy has been to upskill the UK business and capacity to help service untapped US demand.

… is not the whole Story

Performance outside of the US could now come to the fore…

Whilst the Next Fifteen story has been dominated by the strong organic revenue growth delivered by the US businesses over the last four years; this has masked substantial changes elsewhere in the group.

Acquisitions have transformed the UK business…

The UK business has been transformed; partly through acquisitions (the effects of which are only now becoming apparent) but also through rationalising and restructuring the more established PR agencies. We discuss the acquisition strategy in more detail below, but the focus has very much been on UK based, digitally focused businesses with overseas expansion potential. The net effect of this strategy has been to reduce the reliance on more traditional marketing communication channels in favour of faster growing, higher margin revenues. The

effect on margins in particular have been dramatic with FY17E UK EBIT margins of 18% (FY14: 4%) on a revenue base that has more than doubled.

Elsewhere, the Asia Pacific business has been rationalised with the two main agencies merging. Although this has not transformed the revenue potential (mid-single digit growth), margins have (FY17E: 14% vs 2% in FY14).

If we look at the source of potential further outperformance, we believe the UK, in particular, is well positioned and could well continue to surprise on the upside.

Acquisition strategy

Acquisitions have tended to be smaller, bolt-on with attractive initial multiples …

The quoted marketing services sector in the UK has an inglorious track record when it comes to value creating M&A. Next Fifteen's track record is more encouraging. This is due to management's unwillingness to target scale at the expense of value or risk. Even after ten acquisitions over the last three years, which have radically re-shaped the UK business, group "fully costed" net debt to EBITDA is only 1.1x, with acquisition PE multiples rarely exceeding 6x.

Maintaining entrepreneurial spirit whilst leveraging the Next Fifteen platform …

Businesses are acquired with their entrepreneurial management teams remaining in place and encouraged to use the Next Fifteen platform as a secure base from which to accelerate their strategy.

Balance sheet

Although we expect Next Fifteen to report a net debt position of £13.6m for FY17E, the group is strongly cash generative. Even after factoring dividend payments and future deferred consideration payments, we anticipate the group moving into a net cash position of £10m by FY19E.

Cautious approach to leverage …

Even if we were to "fully cost" the net debt position for future acquisition related liabilities, this would move the net debt / EBITDA multiple from the current 0.5x to 1.1x. Management, have historically taken a cautious approach to balance sheet leverage with a net debt ceiling of 1.5x EBITDA.

Amongst the thirteen companies making up the Small Cap Media peer group (Agencies and others in excess of £100m market cap), only four do not carry any debt. Of the remainder, Next Fifteen is the most comfortable according to traditional measures.

Current trading and earnings momentum

Next Fifteen has delivered the strongest upgrade momentum in the peer group …

For all the reasons outlined above, Next Fifteen has been one of the strongest performers in the Small Cap Media sector in terms of both delivered performance to date and expectations for future growth.

Recent trading commentary points to a strong result in FY17E …

- Yesterday's trading update confirmed that current trading remains strong and we believe the balance of risks continues to remain positive. In particular, Next Fifteen continues to benefit from double digit US organic growth (combined with an FX tailwind) and a significant improvement in UK revenue and margins.

- Market expectations for FY17E, FY18E and FY19E have steadily increased through the course of 2016. We currently expect 34% fully diluted EPS growth for the current year and 14% growth for FY18E. We also anticipate double digit dividend growth over the period.
- This growth profile is double the peer group average.

In terms of future upgrade potential; the three key variables are likely to be

- North American organic growth
- Further GBP weakness relative to the Dollar (current rate of $1.22 sits below the FY17E average rate of $1.34)
- Performance of recently acquired businesses in the UK, which are relatively high margin and target new revenue opportunities outside of the UK market

Valuation

Despite strong performance, Next Fifteen trades in line with the peer group …

Next Fifteen has experienced a significant positive re-rating over the last three years, broadly in line with the peer group in PE and EV/EBITDA terms.

- Next Fifteen's FY17E PER is 14.5x falling to 12.7x in FY18E
- Next Fifteen currently offers a PEG ratio of 0.5x, compared to a peer group average of 1.0x, reflecting higher growth expectations over the medium term.
- Next Fifteen's FY18E dividend yield currently stands at 1.7%, with growth of 22% expected for FY17E and 12% for FY18E. The peer group average yield is 3.3% but with slower growth.

KEY RISK FACTORS

Foreign exchange

66% of group revenue comes from the USA

With 66% of revenue generated within the US Next Fifteen is a major beneficiary of Dollar strength relative to Sterling. We estimate the average GBP/USD rate for FY17E will be c.$1.34, compared to an average of $1.52 in FY16, a strengthening of 12%. Assuming no further material volatility in the USD/GBP, this implies a positive currency impact heading into FY18e with the Dollar having strengthened a further 9% relative to the FY17E average rate.

In the H1 results for FY17E (reported in September 2016), reported revenues in the US were £50.7m (+27% yoy) representing 63% of the group total. On a constant currency basis, US organic growth was 17%, implying a 10% boost, which translates into an incremental £4m revenue benefit during H1.

20% Dollar weakness would impact PBT by £1.2m …

In the FY16 annual report and accounts, the published FX sensitivity analysis suggests a 20% weakening in the Dollar relative to Sterling would impact group PBT by c.£1.2m.

Next Fifteen does not actively hedge …

Growth of UK businesses into the US may increase FX volatility

NFC does not currently hedge its FX exposure through the use of financial instruments although there are a number of natural hedges within the current group structure. The £30m loan facility with HSBC is multi-currency and approx. half of the drawn amount is held in Dollars. Group revenue is, by and large, serviced by similarly denominated costs. This is perhaps the area that is most likely to change as recently acquired UK businesses look to expand their North American presence, whilst leveraging their lower cost UK base.

Client concentration

Whilst we have already highlighted the quality and positioning of Next Fifteen's client list as a key strength of the Next Fifteen investment case there are attendant risks that are worth exploring.

A nice problem to have …

Google is currently the group's largest client, representing c.10% of group revenues, with the Top 10 accounting for 30% and the Top 30 accounting for 40%. At a headline level, client concentration risk would be an obvious concern. However, we would make the following observations:

- Next Fifteen is not alone in facing this challenge. The 80/20 rule is a common dynamic across a number of sectors and a factor that investors will be aware of. The key is how this risk can be managed or mitigated.
- Given the quality, scale and growth prospects of Next Fifteen's client list, one could argue that this is a "nice" problem to have.
- Although individual client revenues have varied (and will surely continue to vary), Next Fifteen has been successful in maintaining these client relationships over a long period of time. Client longevity in a fast moving

client landscape speaks to the depth of engagement and the success of client outcomes delivered. An example here would be Microsoft, which remains a Top 20 client having been the group's largest client back in the mid-2000s. Indeed, this is a good example of effective client diversification at work.

- Next Fifteen engages with clients through a family of individual agency brands. With each agency offering a specific area of focus, this creates the potential for multiple agency engagements with a single client, further diversifying single client risk.

Headline client exposure can mask a broad range of client engagements across multiple agencies …

Although, Google stands out in terms of size, it is worth pointing out that this is not represented by a single project, or even agency. Two of the Next Fifteen subsidiary agencies (Beyond and M Booth) account for c.80% of the Google account across a range of projects and engagements (user experience, retail support, communications and more traditional PR). As an indication of the depth of engagement; one of these agencies has upwards of 20 embedded staff, coding directly into the Google platform. Google has been a key client for a number of years and has grown steadily through a range of engagements.

Cyber security

Given the nature of Next Fifteen's client engagements and the clients themselves, cyber security is a key area of client concern and focus for Next Fifteen.

Investment in systems, security and processes is costly but critical …

Next Fifteen is not only privy to commercially sensitive client information, but in many cases, will find themselves interfacing directly with client systems and databases. This places a great of responsibility to ensure that Next Fifteen's own systems and processes are fully compliant with, or exceed, client's data security requirements.

Although the figure is not disclosed, the concrete expression of this will be the group's continuing investment in software. Group capital expenditure in the current year is expected to be c.£8m, but has been distorted by significant property rationalisation and integration costs. We estimate a more normalised figure will be c.£4m, of which a proportion will be investment in software and systems. The figure for specific capitalised software development and acquisition spend in the FY16 group balance sheet was c.£0.7m.

We believe this level of investment is likely to increase over time as cyber security concerns continue to grow in prominence. As an aside, this could also prove a point of positive differentiation for those advisers and service providers who position themselves effectively as being fully compliant.

ACQUISITIONS

Figure 1 - Next Fifteen M&A History

FY17E	Company	Initial	Cash	Revenue	PBT	P/E*	Notes
November	HPI Research	£1.3m	£1.3m	£3.4m	£0.2m	5.0 x	Market research, 85%
September	Pinnacle	£4.4m	£4.0m	£2.2m	£1.2m	4.6 x	Content marketing (25% US)
April	Twogether	£6.6m	£4.0m	£4.6m	£0.9m	8.0 x	B2B digital agency (40% US)
March	Publitek	£6.2m	£5.7m	£5.9m	£2.0m	6.0 x	Content marketing (25% US)
February	Morar	£1.9m	£1.9m				Outstanding 25%
		£20.3m	**£16.8m**	**£16.1m**	**£4.3m**	**5.9 x**	
FY16e							
December	ODD	£3.7m	£3.7m	£3.5m	£0.8m	5.8 x	Digital agency
July	IncrediBull	£1.6m	£1.3m	£2.4m	£0.5m	4.0 x	Brand marketing
April	Republic	£2.3m	£1.8m				
April	Encore	£0.7m	£0.7m	£0.4m	£0.2m	5.6 x	Advertising Tech (75%)
		£8.3m	**£7.5m**	**£6.3m**	**£1.5m**	**5.2 x**	
FY15e							
December	Morar	£1.4m	£1.4m	£1.3m	£0.5m	3.4 x	Market research (75%)
October	Story	£4.1m	£4.1m	£9.4m	£0.7m	7.3 x	US content advertising
February	Continuous Insight	£1.0m	£1.0m	£1.5m	£0.3m	4.2 x	Market research
		£6.5m	**£6.5m**	**£12.2m**	**£1.5m**	**5.4 x**	

**Adjusted for working capital*

Source: Next Fifteen, Radnor Capital Partners

The pace of acquisitions has quickened in FY17E …

Average PE of 5.3x …

In Figure 1 above, we show the acquisitions made by Next Fifteen over the last three years. In total, ten businesses have been acquired (nine based in the UK) for a total initial consideration of £35.1m (£30.8m in cash). The pace has quickened in FY17E, with four acquisitions totalling £20.3m (£16.8m in cash). We estimate the average historic PE multiple paid was 5.3x.

Acquisitions have transformed the shape of the UK business …

In the current financial year, we estimate the pro forma contribution from acquisitions will be revenue of £9.7m and EBITA of £2.8m, representing a margin in excess of 25%. These acquisitions will all contribute to the UK business and are a significant source of growth and margin uplift for the existing UK business (FY16 revenue £27.9m and EBITA margin 13.6%).

A number of consistent M&A themes have developed over the last three years.

Size is not everything

Bolt on rather than transformational …

In each of the last three years, acquisitions have not represented more than 10% of the group's equity market capitalisation. The UK marketing services sector has a history of indigestion when it comes to over ambitious M&A. As a rule of thumb, larger acquisitions have tended to carry premium valuations despite posing significant execution risks. This has often been amplified by poorly constructed and overly generous deferred consideration structures.

Cautious approach to leverage …

Next Fifteen is characterised by a reluctance to over gear the balance sheet. By refusing to bid up for larger assets in competitive auctions; the group has been able to target smaller, less risky acquisitions that are more likely to generate sustainable shareholder value. This approach may have been at the expense of sheer scale and pace but, in our view, has delivered a higher quality of earnings.

We discuss the quality of quality of earnings relative to its peers in more detail later in this note but note that, since 2010, Next Fifteen has seen consensus estimate upgrades outweigh downgrades by three to one (the second highest amongst sub £1bn market cap Media and the best amongst the immediate Agency peer group). The group's M&A strategy has been an important factor in delivering this performance.

UK base, US opportunity

Acquisitions have been focused on the UK …

It is no accident that nine of the ten acquisitions made in the last three years have been UK based. Outside of the US, the UK has developed the most dynamic, and well populated, digital marketing ecosystem in the world.

Complimentary skills from a lower cost based compared to the US …

Whilst digital skillsets and commerciality are broadly equivalent between the UK and the US, there are two key factors Next Fifteen has been active in exploiting.

- Firstly; early stage digital businesses in the US are supported by an established, and well-funded venture capital industry. This has resulted in highly inflated equity valuations, deterring a price conscious acquirer such as Next Fifteen.
- Secondly; this remains a human capital intensive industry and the cost of similarly skilled digital professionals is significantly higher in the US than in the UK.

UK to US opportunity is a key aspect to the investment case …

We believe this proven ability of Next Fifteen to secure new US growth opportunities without having to pay US multiples, or dilute operating margins, is one of the unsung strengths of the Next Fifteen investment case.

Digital, data and insight

All of the acquisitions made in the last three years have been within non-traditional areas of the marketing communications universe, reflecting the longstanding focusing on digital technologies. The UK, in particular, has been transformed over this period. In FY14, the UK business (then comprising mostly traditional PR and communications agencies) generated revenue of £18.6m at an EBIT margin of 4.1%. For FY17E, we look for revenue of £41.8m at an EBITA margin of 18.2%.

UK margins and growth have been transformed by the digital focus …

Although restructuring and self-help measures undertaken through the course of FY14 and FY15 have restored growth and profitability to the UK legacy agencies, the majority of the growth in UK profits has been delivered through the strong performance of the acquisitions made in this period.

There are two key themes underpinning this Digital M&A focus:

1. **Pace of change.** Next Fifteen has always been positioned at the heart of the tech industry; a client base itself that is fast moving and disruptive. This poses challenges and opportunities in equal measure. The challenge is remaining ahead of clients. Relevance, innovation and speed of response are critical when serving the likes of Google and Facebook. Whilst the existing agencies within Next Fifteen had always been early adopters of digital technologies; sustained internal innovation can be too narrow. Well targeted acquisitions ensure that Next Fifteen remains relevant. Small, entrepreneurial agencies are nimble by nature and Next Fifteen aims to keep this entrepreneurial culture intact post acquisition.

2. **Growth & Margin.** As a rule of thumb, traditional PR agencies do well to sustain EBIT margins above 15% and are, by nature, cyclical and operationally geared. However, margins in digital market research, content marketing and data analytics can be materially higher. If we look back to Figure 1 we can see acquired margins all well in excess of 20%. For FY17E, the average EBIT margin on acquisitions was c.25%. Growth prospects are also higher than traditional PR, not least through the targeting and servicing of clients in overseas markets. For example, three of the FY17E deals (Pinnacle, Twogether and Publitek) generated at least 25% of their revenues in the US. Next Fifteen is in ideal position to help these businesses accelerate and de-risk overseas expansion.

Front end independence, back end integration

Next Fifteen aims to retain the entrepreneurial spirit …

The aim is to identify young, but commercially proven, businesses operating in digital communication areas that are either complimentary, or new, to the group offering. Although Next Fifteen is not an incubator (all the recent acquisitions have been profitable), there are similarities. The group offers entrepreneurial management teams a stable and well capitalised platform from which to accelerate growth plans that would otherwise be too challenging or daunting. This is especially attractive for those UK based businesses who are contemplating, but have yet to make the full leap into, the US market. Integration is focused on property, administration and financial reporting; the intent is to free up management time to focus on growth and clients.

Integration is focused on admin, property and financial reporting …

Acquisition structures - balance sheet implications

Next Fifteen employs a range of earn out and long term incentive structures …

In broad terms, we do not see the shape, scale or pace of the acquisition strategy changing over the medium term. We believe the group will continue to target accretive, bolt-on acquisitions of smaller, high growth and margin, digitally focused businesses. The group is opportunistic in its approach to M&A so we cannot discount US acquisitions, but given the crowded market and inflated premia we believe the UK will remain the focus. We also believe the M&A spend in FY17E represents the top end of what to expect going forward.

Even on a "fully costed" basis the balance sheet is robust …

We discuss the impact of future M&A liabilities in more detail below. However, in broad terms, management have indicated that on a "fully costed" basis (including all future potential M&A liabilities), they do not see the group net debt/EBITDA multiple exceeding 1.5x. We estimate the FY17E "fully costed" multiple to be 1.1x, suggesting potential further headroom of £10m. Even if this

1.5x mark were to be reached, this would still leave the group with 1x EBITDA headroom to facility covenant levels.

According to our estimates, which are broadly in line with consensus and factor future cash M&A liabilities, we anticipate the group returning to an overall net cash position by FY19e.

Since January 2015, the group has twice raised fresh equity funding to ensure the balance sheet remained well within the boundaries set by management.

- **December 2015** - placing of 3.4m new ordinary shares at 240p to raise £7.8m net.

- **January 2015** - placing of 3.1m new ordinary shares at 145p to raise £4.3m net.

We also anticipate a continuation of the group's approach to deal structure, deferred consideration and long term incentive plans.

- Seven of these ten acquisitions years have been for 100% at a mid-single digit PE multiple (6x average in FY17E, 5.2x in FY16). In FY17E, of the £18.5m of initial consideration paid, £15.0m (81%) was paid in cash and the remainder in the issue of new shares.

- The three remaining acquisitions (HPI Research, Encore and Morar) involved residual minority stakes, which are subject to option acquisition agreements over a minimum three-year term with pricing determined by the financial performance of the business. Next Fifteen retains discretion over the use of cash or equity as consideration.

- For all acquisitions, a pre-determined deferred consideration structure is put in place for a minimum five-year period with multiples linked to future profitability thresholds not dissimilar to initial acquisition multiples.

Figure 2 - Breakdown of future M&A related liabilities

£m	Contingent	Share Acq.	**Jan 2016**	Contingent	Share Acq.	**July 2016**
M&A	*4.1*	*0.9*	***5.0***	*6.0*	*0.0*	***6.0***
Change in assumptions	*0.4*	*0.5*	***0.9***	*0.8*	*0.2*	***1.0***
FX	*0.2*	*0.1*	***0.3***	*0.2*	*0.1*	***0.3***
Discount unwinding	*0.9*	*0.6*	***1.5***	*0.8*	*0.2*	***1.0***
Paid	*-4.5*	*-4.2*	***-8.7***	*-1.1*	*-1.5*	***-2.6***
End Balance			**12.2**			**17.9**
- Due within 1 year			4.2			5.2
- Longer term			7.9			12.6

Source: Next Fifteen, Radnor Capital Partners

The net present value of all future M&A liabilities is currently recognised as £17.9m, of which £5.2m is due in the current financial year. If one were to take this into account when calculating the group net debt position, this would imply an adjusted net debt position of £31.5m (compared to our current estimate of £13.6m). In this scenario, our FY17E net debt/EBITDA multiple would move from 0.5x to 1.1x.

Whilst this approach gives a "fully costed" net debt position it does assume that all the future liabilities are due now, rather than staggered over a period of five years without taking into account the benefit of intervening cash generation.

Future M&A liabilities are evenly spread over the next five years …

The phasing of future payments is evenly spread over the next five years; current guidance suggests c.£5m will be due in FY18e, £3.5m in FY19e and £4.6m in FY20e.

There are two accounting notes that need to be clarified here;

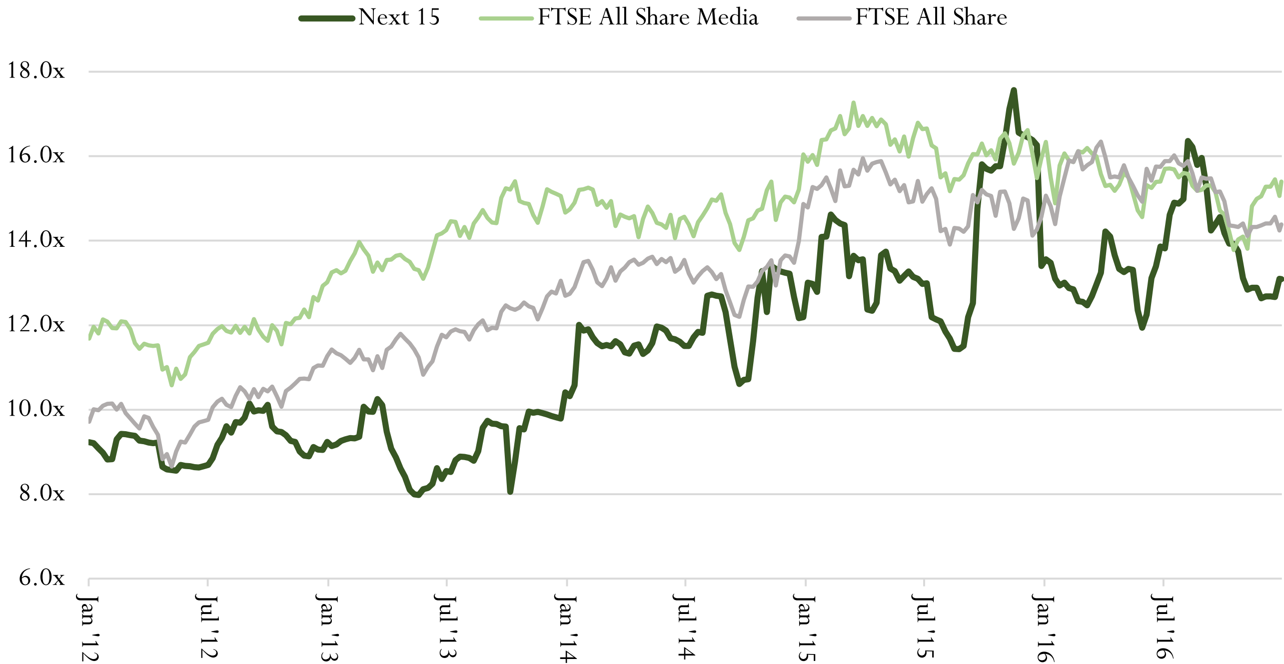
1. The accounting treatment of these future liabilities is highly subjective and based on the best estimates of the Directors as to the future performance of the acquired businesses. If these estimates change, the movement is recognised in the P&L through the Finance Cost line. In our financial model, we strip this out of our adjusted PBT/EPS estimate.

2. Given these liabilities occur at different points in the future, under current accounting rules they need to be discounted back to their present value. The group currently uses an estimated weighted average cost of capital of 14.4%. As each time period passes, this impacts the net present value calculation and this is also captured in the P&L through the Finance Cost line. As above, we exclude this impact from our adjusted PBT/EPS estimate.

VALUATION

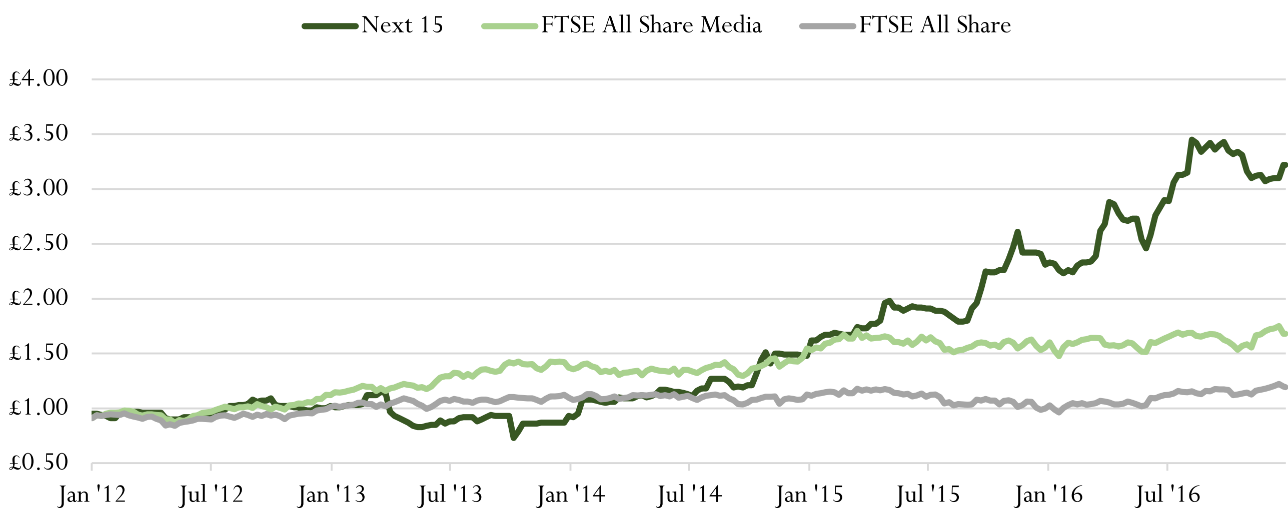
In Figure 3 below, we show the rolling 12 month prospective PE multiple for Next Fifteen, the Media sector and the broader market as sourced from FactSet. In Figure 4 below, we also show the underlying price performance for all three.

Figure 3 - Prospective 12M PER



Source: FactSet

Figure 4 - Price Performance (rebased to Next Fifteen)



Source: FactSet

Next Fifteen has outperformed both the sector and the broader market, especially over the last three years. The extent of this out-performance would normally

suggest a great deal has already been priced into the Next Fifteen valuation, however we can see that the Next Fifteen re-rating has not been dissimilar from the peer group and the broader market. This suggests the market has not placed any particular premium on Next Fifteen's operational out-performance.

Next Fifteen has delivered strong operational performance and positive earnings revisions …

At the start of 2012, Next Fifteen was trading on a prospective PE of 8.6x (towards the traditional bottom end of the Agency cyclical PE range). Since 2012, the combination of North American organic growth, UK recovery, strongly performing acquisitions and US dollar strength have driven strong earnings growth. In Jan 2012, FY1 EPS were expected to be 9.7p compared to 22.7p today (an increase of 220%).

Earnings revision momentum has been well ahead of the peer group average …

Unsurprisingly, Next Fifteen has experienced strong positive earnings revision momentum. If we compare Next Fifteen to both the Small Cap Agency peer group and other Small Cap Media stocks, it stands as the second most upgraded stock over the last three years.

In Figure 5 below, we show a breakdown of earnings revisions across the peer group since 2012. In fact, only YouGov (itself with a significant presence in the US market) has been upgraded more often (18 vs 14 for Next Fifteen), although it has also been downgraded more (nine versus five).

Figure 5 - Earnings Revisions across Small Cap Media since 2012

	Revisions				Absolute FY1
	Down > 2%	Up > 2%	Total	Net	EPS growth
Small Cap Agency					
XLMedia	3	14	17	+11	172%
Next Fifteen	**5**	**14**	**19**	**+9**	**220%**
YouGov	9	18	27	+9	113%
Ebiquity	3	8	11	+5	4%
M&C Saatchi	5	9	14	+4	45%
Cello	10	12	22	+2	32%
Chime (when listed)	9	8	17	-1	-10%
Creston (when listed)	13	10	23	-3	4%
Huntsworth	16	5	21	-11	-47%
Other Small Cap Media					
4imprint	14	27	41	+13	120%
Trinity Mirror	4	11	15	+7	37%
STV Group	8	13	21	+5	11%
Tarsus	7	11	18	+4	68%
Bloomsbury	8	11	19	+3	36%
ITE Group	10	12	22	+2	-40%

Source: FactSet

Despite growth and revision momentum ahead of the peer group, Next Fifteen trades at a slight discount …

We also show the growth in the first year prospective EPS for each company over the last three years. Here, Next Fifteen has been the strongest performer in the Small Cap media sector by some distance.

In Figure 6 below, we show the headline PE, EV/EBITDA and Dividend Yield metrics for Next Fifteen, the Small Cap Agency peer group and other Small Cap Media (greater than £100m market cap). Relative to the Agency peer group, Next Fifteen currently trades at a small discount on a FY17E and FY18E PE basis.

Given the extent of operational out-performance and the consistency of delivery over the last three years, this does beg the question of what the market is pricing in, or choosing to ignore, when it comes to the Next Fifteen valuation?

Figure 6 - Peer Group Headline Valuation Metrics

	Price (p)	Market Cap, £m	PE FY1	PE FY2	EV/EBITDA FY1	EV/EBITDA FY2	Div Yield FY1	Div Yield FY2
Cello	99p	85.8	11.7	10.9	6.7	6.4	3.4%	3.6%
Communisis	47p	98.4	8.0	7.5	4.2	4.0	5.1%	5.5%
Ebiquity	102p	79.1	9.3	10.2	15.4	14.3	0.4%	0.4%
Huntsworth	38p	124.1	11.7	10.1	7.9	6.6	4.7%	4.7%
M&C Saatchi	340p	255.1	16.6	14.8	9.9	8.4	2.4%	2.8%
YouGov	220p	229.8	22.9	20.1	15.0	12.5	0.7%	0.8%
XLMedia	111p	221.9	11.6	10.9	6.8	6.2	4.6%	5.1%
Small Cap Agencies			**13.1**	**12.1**	**9.4**	**8.3**	**3.1%**	**3.3%**
Next Fifteen	**329p**	**236.0**	**14.5**	**12.7**	**9.1**	**7.4**	**1.6%**	**1.7%**
Tarsus	279p	314.7	20.0	10.5	18.5	9.3	3.2%	3.4%
STV Group	370p	146.3	9.4	8.9	7.4	6.9	3.2%	3.8%
ITE	165p	436.3	16.7	15.3	13.5	12.5	2.8%	2.8%
Bloomsbury	167p	125.8	14.3	14.5	8.3	8.6	4.0%	4.2%
Trinity Mirror	108p	301.8	3.0	3.1	2.2	2.1	5.4%	5.7%
Wilmington	268p	233.5	13.4	12.2	9.8	8.9	3.2%	3.3%
Small Cap Media			**12.8**	**10.8**	**9.9**	**8.0**	**3.6%**	**3.9%**

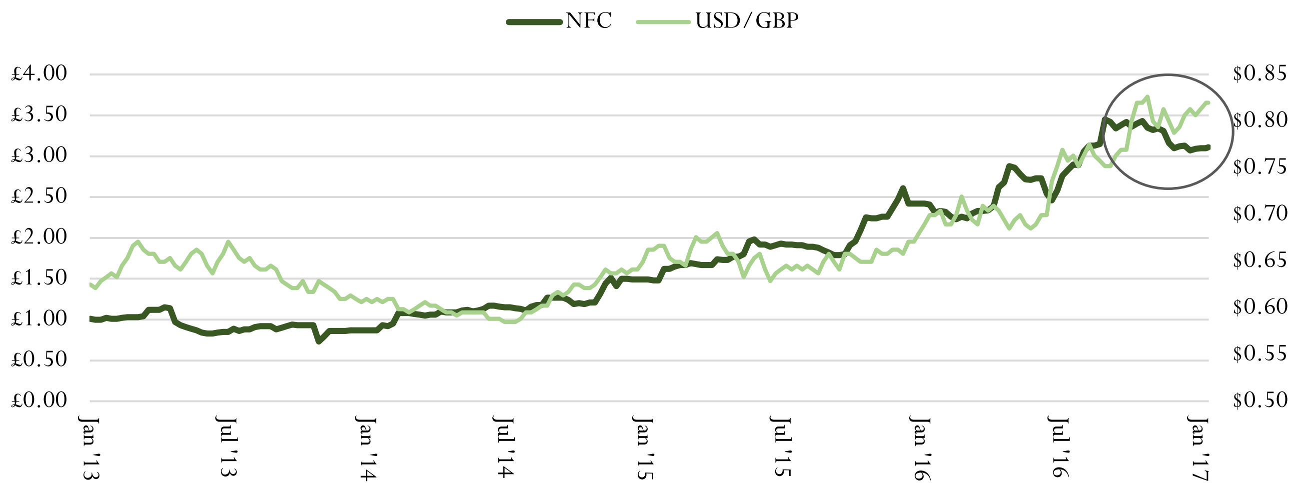
Source: FactSet. Radnor Capital Partners

What is in the price? - FX

Next Fifteen is a direct beneficiary of Sterling weakness relative to the Dollar …

Unsurprisingly, US Dollar earners have been under the spotlight post Brexit, with all such companies experiencing a significant tailwind to their underlying operational performance. We have discussed the impact on Next Fifteen's sterling performance earlier in this note, but according to the company's own reported risk analysis, each 1% move will impact profits by £60k. For the first six months of FY17E, Next Fifteen reported a £4m revenue boost from the North American business due to Dollar strength.

Figure 7 - Next Fifteen Share Price vs USD/GBP



Source: FactSet

Dollar relationship appears to have broken down …

Figure 7 shows the historic correlation between Next Fifteen and US Dollar strength since July 2014. However, we also note that since November 2016, this relationship has broken down. This may be due to a period of natural profit taking for historic Next Fifteen holders who have benefited from a prolonged period of out-performance.

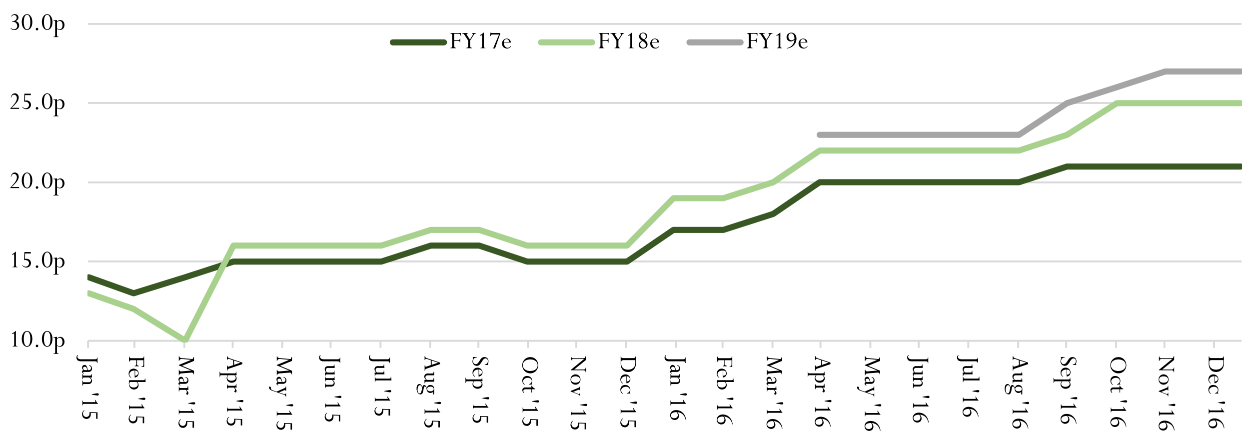
FY18E likely to benefit further …

… not factored into the current price

Whatever the reason, it is clear that recent Dollar strength has not been reflected in the Next Fifteen share price in the same way it has been over the past two years. This is especially relevant with the Dollar appreciating a further 9% relative to the average rate in FY17E. Unless the market is now looking for a deterioration in trading, and therefore a downgrade to underlying expectations, this further Dollar strength has not been factored into the current price.

What is in the Price? - Growth

Figure 8 - Progression of Consensus Estimates since Jan 2015



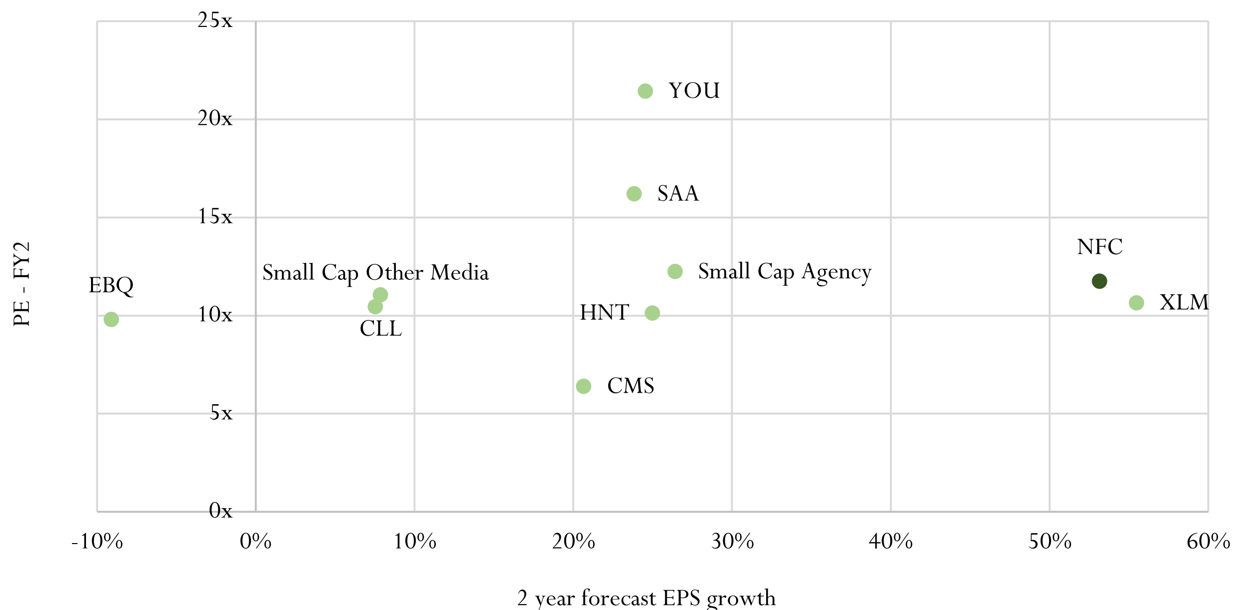
Source: FactSet

Both consensus and trading commentary suggests growth momentum remains strong …

Figure 8 above shows how market consensus expectations for Next Fifteen have evolved since January 2015. We can see that, for each of the next three forecast years, the picture is of one of strong upgrade momentum. We have already shown that, in terms of absolute and net revisions, Next Fifteen has been the second most upgraded stock in the broader Small Cap Media universe. Indeed, the tone of commentary from the company at both the half year results, and yesterday's trading update, suggests that underlying trading momentum remains strong and will benefit from continuing FX benefits.

In terms of absolute growth expectations, we are looking for c.35% fully diluted adjusted EPS growth for FY17E and 14% growth for FY18e. This translates into dividend growth of 21% for FY17E and 12% in FY18e. In Figure 9 below, we put this earnings growth into its valuation context.

Figure 9 - 2 Year Prospective PE vs 2 Year EPS Growth



Source: FactSet, Radnor Capital Partners

Next Fifteen offers the second highest level of EPS growth at a valuation equivalent to more pedestrian peers … …

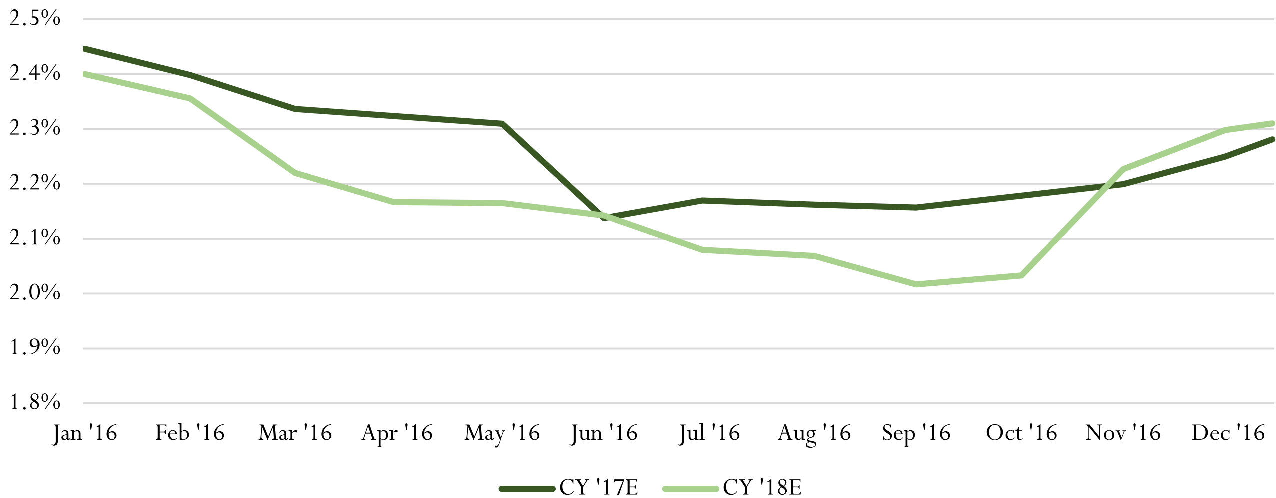
The chart above shows that Next Fifteen is expected to deliver the second highest EPS growth over the next two years within Small Cap Media and, by some distance, the highest amongst more traditional Agency names. Both **M&C Saatchi** (advertising) and **YouGov** (online market research) stand on materially higher PE multiples, yet offer EPS growth less than half that of Next Fifteen. Both M&C Saatchi and YouGov also offer broadly equivalent exposure to non UK revenues (M&C Saatchi generates c.60% outside the UK, YouGov 71% and Next Fifteen 75%) although Next Fifteen's US exposure is the highest of all three.

US GDP expectations have started to pick up …

Interestingly, both YouGov and Next Fifteen have seen recent downward pressure on their respective forward PE multiples. This might suggest that the market is beginning to take a more cautious approach to the shorter term US outlook. Despite some nervousness surrounding the immediate political environment, we have yet to see any data that suggests corporate America is beginning to slow down. If anything, short term growth expectations have started

to improve. In Figure 10 below, we show consensus US GDP expectations for 2017 and 2018. We also note that Next Fifteen's US exposure is highly focused on the US tech industry in particular, an area that remains in rude health and continues to outperform the broader, mainstream economy.

Figure 10 - US Consensus Y / Y GDP growth %



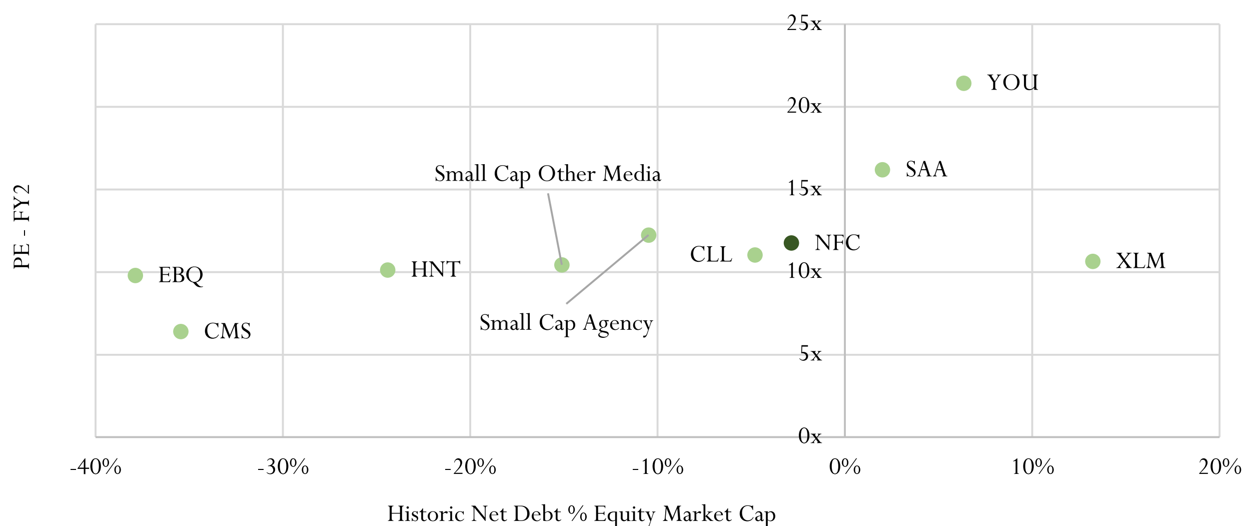
Source: FactSet

The balance of risks to earnings growth remains positive …

Given the above, we believe the visibility of above average earnings growth remains high and we discount the likelihood of earnings downgrades unless there is a sharp and wholly unexpected market slowdown, or the dollar were to weaken by 20% plus relative to Sterling within a short time frame.

What is in the price? - Balance Sheet

Figure 11 - 2 Year Prospective PE vs Net Debt



Source: FactSet, Radnor Capital Partners

Is the market discounting a higher perceived balance sheet risk? In Figure 11 above, we show the relationship between net debt (last reported as a percentage of equity market cap) and the prospective PE ratio.

Companies with net cash tend to trade at a premium …

At first glance, this would suggest a positive relationship between positive net cash and a premium PE, with both YouGov and M&C Saatchi enjoying the highest PE multiples and also being two of only four Small Cap Media stocks reporting a net cash position.

Next Fifteen's debt level is low compared to others and this is not fully reflected in relative valuations …

However, these two companies aside, the correlation between net debt and equity valuation does not seem to hold true. If we were to compare Next Fifteen to M&C Saatchi, there is less than half a Net Debt/EBITDA point between them yet M&C Saatchi trades at a 38% premium. Equally, if we compare Huntsworth to Next Fifteen, the Huntsworth Net Debt/EBITDA multiple is 1.5x vs 0.2x, yet Huntsworth only trades at a 14% discount to Next Fifteen.

ESTIMATES

Income Statement									
Y/E Jan, £m	FY15	FY16		FY17E	y/y	FY18E	y/y	FY19E	y/y
North America									
- Revenue	64.0	83.5	*+30%*	106.0	*+27%*	119.8	*+13%*	129.3	*+8%*
- EBITA	14.1	17.5	*+24%*	21.7	*+24%*	25.2	*+16%*	27.4	*+9%*
- Margin	22.0%	21.0%		20.5%		21.0%		21.2%	
UK									
- Revenue	23.8	27.9	*+17%*	41.8	*+50%*	46.8	*+12%*	49.2	*+5%*
- EBITA	2.5	3.8	*+51%*	7.6	*+100%*	8.9	*+17%*	9.4	*+6%*
- Margin	10.6%	13.6%		18.2%		19.0%		19.2%	
EMEA									
- Revenue	9.0	6.4	*-28%*	6.9	*+8%*	7.1	*+3%*	7.4	*+3%*
- EBITA	0.8	0.5	*-45%*	0.6	*+23%*	0.6	*+16%*	0.7	*+9%*
- Margin	9.2%	7.0%		8.0%		9.0%		9.5%	
APAC									
- Revenue	12.5	12.0	*-4%*	14.0	*+17%*	14.4	*+3%*	14.7	*+2%*
- EBITA	1.0	1.4	*+38%*	2.0	*+42%*	2.1	*+4%*	2.1	*+4%*
- Margin	8.0%	11.5%		14.0%		14.2%		14.5%	
Revenue	**98.7**	**109.1**	*+19%*	**129.8**	*+30%*	**168.8**	*+12%*	**188.2**	*+7%*
Central Costs	-5.7	-6.6		-7.4		-8.3		-8.8	
EBITA - Adj.	**12.7**	**16.5**	*+30%*	**24.4**	*+48%*	**28.5**	*+17%*	**30.9**	*+8%*
- Margin	11.7%	12.7%		14.5%		15.1%		15.4%	
Net Finance Costs - Adj	-0.5	-0.4		-0.7		-0.9		-0.5	
PBT - Adj	**12.5**	**16.1**	*+29%*	**23.6**	*+47%*	**27.6**	*+17%*	**30.4**	*+10%*
Goodwill	-1.7	-3.5		-4.7		-5.3		-5.4	
Non-Operating Items	-11.6	-4.6		-2.7		-2.5		-2.5	
Change in Liabilities	-2.1	-2.4		-2.8		-2.5		-2.5	
PBT - Reported	**-2.9**	**5.6**		**13.6**		**17.2**		**20.0**	
Tax - Adjusted	-3.0	-3.5		-5.4		-6.3		-7.0	
Tax - Reported	1.5	-1.1		-3.0		-4.0		-4.6	
EPS - Adj. Dil. (p)	**13.2**	**16.9**	*+27%*	**22.7**	*+35%*	**25.9**	*+14%*	**28.0**	*+8%*
EPS - Basic (p)	-3.2	6.0		13.6		16.4		18.9	
Dividend per share (p)	3.5	4.2	*+20%*	5.1	*+22%*	5.7	*+11%*	6.2	*+8%*
Diluted Shares (m)	67.6	71.6		80.0		82.0		83.5	

Source: Next Fifteen, Radnor Capital Partners

- In FY15 and FY16, non-operating items included goodwill impairment (FY15 - £7m), acquired intangible amortisation, restructuring and exceptional property costs and M&A related share option costs.
- Change in liabilities relates to the accounting treatment of future deferred consideration costs and represents a non cash item.

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Next Fifteen Communications PLC

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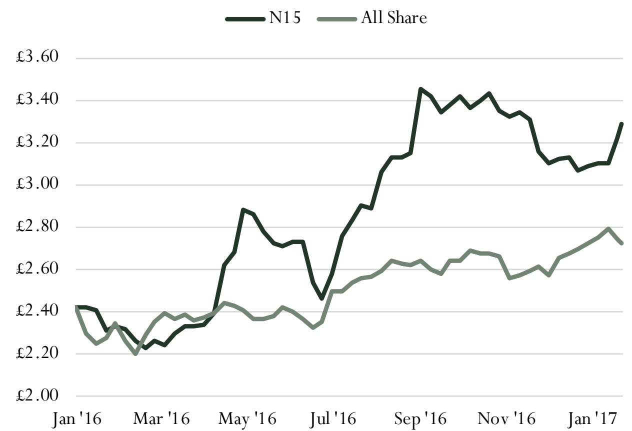
Price (p): **329 p**
Market Cap: 239 m
EV: 253 m

PROFIT & LOSS

Year to 31 January, £m	2015	2016	FY17e	FY18e	FY19e
UK	*23.8*	*27.9*	*41.8*	*46.8*	*49.2*
North America	*64.0*	*83.5*	*106.0*	*119.8*	*129.3*
EMEA	*9.0*	*6.4*	*6.9*	*7.1*	*7.4*
Asia Pacific	*12.5*	*12.0*	*14.0*	*14.4*	*14.7*
Group Net Revenue	**109.2**	**129.8**	**168.8**	**188.2**	**200.6**
UK	*2.5*	*3.8*	*7.6*	*8.9*	*9.4*
North America	*14.1*	*17.5*	*21.7*	*25.2*	*27.4*
EMEA	*0.8*	*0.5*	*0.6*	*0.6*	*0.7*
Asia Pacific	*1.0*	*1.4*	*2.0*	*2.1*	*2.1*
Head Office	*(5.7)*	*(6.6)*	*(7.4)*	*(8.3)*	*(8.8)*
EBITA - Adjusted	**12.7**	**16.5**	**24.4**	**28.5**	**30.9**
Associates & JV's	0.3	(0.0)	(0.2)	-	-
Net Bank Interest	(0.5)	(0.4)	(0.7)	(0.9)	(0.5)
PBT - Adjusted	**12.5**	**16.1**	**23.6**	**27.6**	**30.4**
Non Operating Items	(13.3)	(8.1)	(7.4)	(7.8)	(7.9)
Other Financial Items	(2.1)	(2.4)	(2.8)	(2.5)	(2.5)
PBT - IFRS	**(2.9)**	**5.6**	**13.6**	**17.2**	**20.0**
Tax	1.5	(1.1)	(3.0)	(4.0)	(4.6)
Tax - Adjusted	(3.0)	(3.5)	(5.4)	(6.3)	(7.0)
Tax rate - Adjusted	*23.9%*	*22.0%*	*23.0%*	*23.0%*	*23.0%*
Minority interests	0.6	0.5	0.8	1.0	1.0
No. shares m	60.9	66.3	72.5	74.5	76.0
No. shares m, diluted	67.6	71.6	80.0	82.0	83.5
IFRS EPS (p)	(3.2)	6.0	13.6	16.4	18.9
Adj EPS (p), diluted	**13.2**	**16.9**	**22.7**	**25.9**	**28.0**
Total DPS (p)	3.5	4.2	5.1	5.7	6.2

PRICE CHART - 2 YEAR ABSOLUTE vs FTSE ALL SHARE



SHAREHOLDERS

	% of ord. Share capital
Liontrust	14.9%
Octopus Investments	8.4%
Directors	7.3%
Standard Life	6.9%
Hargreave Hale	6.0%
Heral Inv Mgmt	5.7%
Aviva Investors	5.4%
BlackRock	5.4%
	60.0%

CASH FLOW

Year to 31 January, £m	2015	2016	FY17e	FY18e	FY19e
Net Profit: (add back)	**(1.4)**	**4.5**	**10.6**	**13.3**	**15.4**
Depreciation & Amortisation	*10.6*	*6.1*	*8.0*	*9.1*	*9.2*
Net Finance costs	*2.1*	*2.8*	*3.5*	*3.4*	*3.0*
Tax	*(1.5)*	*1.1*	*3.0*	*4.0*	*4.6*
Working Capital	5.6	0.2	(0.6)	(0.9)	(0.5)
Other	2.6	1.6	2.2	2.0	2.0
Cash from Ops	**18.0**	**16.3**	**26.7**	**30.9**	**33.7**
Cash Tax	(2.3)	(3.0)	(4.1)	(5.4)	(5.9)
Tangible Capex	(3.9)	(6.4)	(8.0)	(4.0)	(4.0)
Intangible Capex	(0.7)	(0.6)	(0.4)	(0.4)	(0.4)
Free Cashflow	**11.1**	**6.4**	**14.3**	**21.1**	**23.4**
Dividends	(3.7)	(3.0)	(4.0)	(4.4)	(4.7)
Acquisitions & Inv.	(5.5)	(13.4)	(18.7)	(5.0)	(5.0)
Financing	1.0	14.6	(0.7)	(1.0)	(0.6)
Net Cashflow	**2.9**	**4.6**	**(9.0)**	**10.7**	**13.0**
Net Cash (Debt)	(8.6)	(6.6)	(13.6)	(3.0)	10.0

Announcements

Date	Event
10th Nov 2016	Acquisition of HPI for £1.3m
27th Sep 2016	Interim results (6 months ended July 2016)
27th Sep 2016	Acquisition of Pinnacle for £4.4m
28th June 2016	Interim trading update
12th April 2016	Final results (12 months ended Jan 2016)
1st April 2016	Acquisition of Twogether for £6.6m
11th March 2016	Acquisition of Publitek for £6.2m

RATIOS

	2015	2016	FY17e	FY18e	FY19e
RoE	24.1%	22.9%	24.6%	26.2%	26.2%
RoCE	28.4%	27.8%	28.8%	35.6%	40.9%
Asset Turnover (x)	0.5x	0.6x	0.5x	0.5x	0.4x
NWC % Revenue	10.7%	9.3%	3.4%	2.6%	2.2%
Op Cash % EBITA	141.4%	98.6%	109.5%	108.4%	109.1%
Net Debt / EBITDA	0.6x	0.4x	0.5x	0.1x	-

BALANCE SHEET

Year to 31 January, £m	2015	2016	FY17e	FY18e	FY11e
Intangibles	44.9	53.6	66.6	61.5	56.3
P,P+E	5.5	10.0	15.5	15.6	15.7
Tax Asset & Other	7.1	7.9	7.9	7.9	7.9
Total Fixed Assets	**57.5**	**71.4**	**90.0**	**85.0**	**79.8**
Net Working Capital	(11.7)	(12.0)	(5.8)	(4.9)	(4.4)
Capital Employed	**45.8**	**59.4**	**84.2**	**80.1**	**75.5**
Net Funds	(8.6)	(6.6)	(13.6)	(3.0)	10.0
Net Assets	**37.2**	**52.8**	**70.6**	**77.1**	**85.5**

VALUATION

Fiscal	2015	2016	FY17e	FY18e	FY19e
P/E	24.9x	19.5x	14.5x	12.7x	11.8x
EV/EBITDA	17.6x	13.4x	9.2x	7.9x	7.4x
Div Yield	1.1%	1.3%	1.6%	1.7%	1.9%
FCF Yield	4.4%	2.5%	5.7%	8.3%	9.2%
EPS growth		27.5%	34.6%	14.0%	8.1%
DPS growth		20.0%	21.7%	11.5%	7.9%