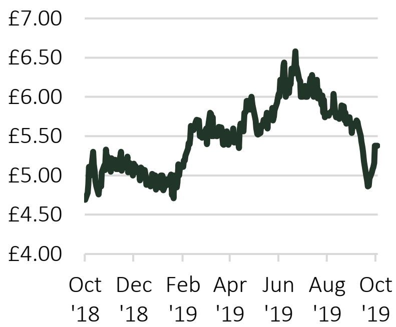
Next Fifteen Communications Group PLC

NFC | AIM | Media | 538p |£465m

Interim results in-line – Health acquisition, estimates unchanged

1 Year Chart



The NFC rating has come under pressure due to a combination of macro concerns and a 1% organic revenue decline just reported for H1 FY2109. The organic decline is largely driven by two of the seventeen portfolio businesses with organic growth elsewhere in the portfolio improving from previous data points. We expect the issues at Beyond to correct through H2 which, combined with healthy organic growth elsewhere in the portfolio and a full contribution from Health Unlimited, leads us to upgrade our FY 2020 expectations. NFC now trades at a PE discount to both the Agency and Small Cap Media peer groups despite a superior growth profile. The balance sheet remains comfortable.

- **Results:** Good overall headlines (net revenue +11%; adj. PBT +14% and a better than expected £3.6m net debt position), were overshadowed by the 1% organic revenue decline. Archetype should have been in the price as this has been well flagged but a challenging H1 for Beyond was unexpected. Beyond is back on the client win track although unlikely to fully wash through until next financial year.

- **Portfolio effect.** These interim results highlight the benefits of NFC's portfolio spread. Despite two specific agency challenges; the remaining fifteen performed well, with organic revenue growth of 11.6% excluding Beyond and Archetype. Recent acquisitions have also been performing well (Planning Inc and Activate especially so), which further underpins longer term growth prospects.

- **Health Unlimited acquisition:** NFC has announced the acquisition of Health Unlimited for an initial consideration of $27.7m ($20.8m cash and c.1.1m shares at 550p); representing an 7x EBIT multiple. This represents NFC's first material step into the attractive healthcare communications market.

- **FY 2020 Forecasts unchanged; upgrades for FY 2021:** There are two offsetting movements behind our unchanged FY 2020 estimates; a small reduction in our organic expectations for the UK and North America and the initial contribution from Health Unlimited. We have upgraded our FY 2021 estimates (+3%) to reflect progress made with Archetype and Beyond and a full contribution from Health.

- **Valuation:** NFC has de-rated somewhat since July; with the prospective PE falling from 16.0x to 14.5x. This has been driven by a combination of macro concerns and the H1 organic dip. NFC now stands at a PE discount to both Agency and Small Cap Media peers despite higher growth expectations.

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.

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	19.4	1.2
FY 2019A	224.1	36.0	33.1	7.6	-5.2	16.2	1.4
FY 2020E	*250.1*	*43.4*	*37.2*	*8.7*	*-5.3*	*14.5*	*1.6*
FY 2021E	*271.5*	*49.2*	*42.0*	*10.0*	*11.7*	*12.8*	*1.9*
FY 2022E	*286.8*	*54.8*	*46.7*	*11.5*	*36.5*	*11.5*	*2.1*

Source: Radnor Capital Partners

Interim results – Headlines

Interim results for the six months ended July 2019 were broadly **in-line** with our expectations, although weighted more heavily towards M&A contribution and FX:

- Net revenue of **£118.7m**, up 11% on a reported basis, comprising;
  - 1% decline in organic revenue (12% organic growth excluding Archetype and Beyond)
  - Acquisitions contributed 10% to group revenue growth
  - Favourable FX (ie weak sterling relative to USD) contributing 3%
- Reported EBIT margins were **14.7%** (+0.2% YoY); with pre-central overhead and IFRS 16 margins were **19.1%** (+0.3% YoY). Central costs were managed tightly in the period and came in at 3.6% of net revenue, compared to 4.4% in H1 FY 2018;
- Adjusted PBT was **£17.2m**, up 14% YoY and adjusted, diluted EPS was up 7% at **15.2p** and the interim dividend was set at **2.5p**, up 16% YoY;
- Non-operating items amounted to £14.3m, an increase on the £4.8m reported in H1 2018. Restructuring expenses relating to Archetype and Beyond totalled £2.1m and are new to the P&L. Acquisition related accounting charges totalled £11.9m, compared to £3.9m in H1 2018.
- Net debt was £3.6m; driven by near doubling of operating cashflow. Working capital generated an inflow of +£1.6m, while capex declined to a normalised £2.7m. Acquisition spend was lower in this half (-£4.2m vs -£15.5m). This improved balance sheet position has provided the flexibility to fund the Health Unlimited acquisition from internal resources.

Business segmentation

- **Brand Marketing** (54% of H1 group revenue, 59% of pre central cost EBIT)

  Brand Marketing represents the more traditional communications activities of the group. Of the three primary segments, it is the most established but with the lowest growth profile (mid-single digit organic revenue growth is a realistic expectation).

  Net revenue grew by 1% to £63.9m, although the organic revenue decline was 4.9%. Excluding Archetype, organic growth would have been a positive 4.8%. This segment is where the FX effect is most keenly felt.

  Despite the organic revenue decline, EBITA margins increased 90 basis points to 20.5%, reflecting the heavy lifting already undertaken at Archetype.

  The decision to merge the North American Text 100 and Bite agencies to create Archetype was well flagged to the market and was discussed in detail at the April finals. In that sense, the drag on organic growth from Archetype is not “new” news. The Text 100 business had been lagging the other NFC North American agencies for some time and the rationale behind the merger was founded on the need to refresh client delivery, positioning and operational management. This follows the successful integration of the Text 100 and Bite agencies in APAC and EMEA in 2018.

The margin improvement was especially encouraging in this respect as it shows the initial cost benefits of the merger flowing through, especially after the margin decline posted at the full year as the integration fully ramped up. The clear aspiration is to restore Archetype to a mid-single digit organic growth at a sustained 20%+ contribution margin. Archetype straddles both the US and the UK. The fastest restructuring progress has been made in the US and this where we expect the margin benefits to be felt soonest, as evidenced by the recovery in the overall US EBIT margin in H1. The UK will see the main costs benefits flow through in H1 FY2020.

Outside of Archetype; the rest of Brand Marketing had a solid H1, posting organic revenue growth of 4.8%. M Booth, in particular, had a good H1, growing in excess of 10% at a very healthy mid-20s operating margin. The recently announced Health Unlimited acquisition will sit within the Brand Marketing segment (under the M Booth banner) and further increase the weight of this segment towards the US.

- Creative Technology (29% of H1 group net revenue, 15% of pre central cost EBIT)

This was very much a tale of Beyond vs the Rest. Overall, net revenue growth was flat YoY at £34.0m with an organic revenue decline of 1%. Excluding Beyond, organic revenue growth was a more than healthy +19%. H1 FY2020 EBIT margins were impacted heavily by Beyond, declining 490 basis points YoY to 9.6%.

The challenges at Beyond largely revolve around the losses of Just Eat and Samsung. Just Eat, in particular, came somewhat out of the blue and has had a material impact on the bottom line. The key decision for Next Fifteen was the nature of the response. Traditional marketing agencies would normally look to immediately resize the cost base and then rebuild. However, Beyond is not a traditional agency and cutting personnel would have significantly reduced their ability to win the scale of digitally advanced, user experience mandates they have won in the past. Whilst some cost mitigation has been undertaken, the group has decided to retain much of the talent and capacity within this business.

Encouragingly, Beyond has subsequently won new mandates (Snap, RCA and Purplebricks) although the Samsung / Just Eat revenue will take time to replace. We anticipate Beyond remaining dilutive for the remainder of FY 2019, albeit at a sharply reducing rate. We expect the full effect to wash through by H2 FY2020.

Elsewhere the other agencies in this segment have been performing well. Twogether, Brandwidth, Velocity, Agent3 are generating healthy growth and margin contribution. Next Fifteen also acquired the small, digital transformation consultancy, Palladium during 2019. Palladium is a UK based specialist consultancy focused on working with private equity partners to help them accelerate the digital transformation opportunity within their portfolios. Palladium is a young business and is growing fast with run rate revenue now in excess of £4m per annum.

- Data & Analytics (18% of H1 group net revenue, 26% of pre central cost EBIT)

This segment is dominated by the digital research brand Savanta (formerly known as MIG). Recent acquisitions such as Planning Inc and Activate sit within this segment but have not been factored into the organic revenue calculation.

Overall, net revenue more than doubled YoY to £20.9m with organic revenue growth of 21%. As an interesting point of comparison; YouGov (YOU.L | AIM | £563m), the closest listed peer, has reported 17% revenue growth (10% organic) for the year ended July 2019. We also note that Savanta operating margins are materially higher than YouGov (c.29% for Savanta vs 13% for YouGov) as the two operate very different commercial models.

The two largest acquisitions in the year to date; Planning-Inc (predictive analytics and data marketing, £6.3m initial cost) and Activate (B2B demand generation, £8.8m initial cost) have both been performing well. Planning-Inc has delivered 10% organic revenue growth. Activate has been a particularly strong performer with 38% organic revenue growth at very attractive margins. The growth delivered by these businesses is not captured within the group organic revenue performance.

Geographic segmentation

The key geographic headlines are below:

- **North America.** Net revenue of £53.4m. Headline revenue growth of 6.4% with an organic revenue decline of -6.0%. Both Archetype and Beyond were negative factors here, with organic growth excluding Archetype and Beyond of +11%. The Activate acquisition contributed seven months and has not been factored into the organic numbers.

  North American EBIT margins showed a strong recovery YoY, up 350 basis points to 19.4% through a combination of Archetype restructuring benefits; higher margin Activate contribution and a good performance from M Booth.

- **UK.** Net revenue of £48.0m. Headline growth of 20.1% with organic revenue growth of 4.6%. Excluding Archetype and Beyond, organic revenue growth in the UK would have been 12%.

  UK EBIT margins were down 400 basis points to 19.7%, leading to a flat EBIT performance YoY at £9.5m. This was dominated by the lost Beyond revenue which fell straight to the bottom line. The worst of this impact was felt in H1 and we expect this effect to wash through the remainder of the year.

- **APAC and EMEA.** Combined net revenue of £11.3m. Headline growth of 3% with organic revenue growth of c.2%. Broadly speaking a solid performance.

  The combined margin performance was much more encouraging, 14.3% in H1 FY2019 compared to 10.4% in H1 FY2018, reflecting the prior benefits of the Text 100 and Bite agency merger that took place in 2018.

Cashflow & Balance Sheet – Better than expected

Next Fifteen reported particularly strong operating cashflows, which coupled with lower net M&A spend compared to H1 FY2018, resulted in a period end net debt position of £3.6m.

- Operating cashflow pre working capital was £20.7m (£17.9m vs H1 FY2018), +16% reflecting the improved profitability.

- Working capital was a positive £1.6m in compared to a net outflow of £7.0m in H1 FY2018. This is driven by a combination of tighter management but also timing differences. All other things being equal, we expect a growing agency cum consultancy business like Next Fifteen to be marginal working capital absorbers so we would expect working capital inflows to net out over the longer term.

- Capital expenditure was lower at £2.7m (£4.6m in H1 FY2018). This reflects a more normalised investment level in software and physical office assets.

- Net M&A spend was £4.2m (£15.5m in H1 FY 2018) reflecting the timing and quantum of acquisitions. The Health Unlimited initial cash consideration is $20.8m (c.£17m) will land in H2.

The overall net debt position of £3.6m has given the group the flexibility to fund the Health Unlimited acquisition from internal resources. The second half of the year is traditionally stronger for both revenue and cash generation so our revised year end net debt estimate of £5.3m implies significant further flexibility (underlying EBITDA of c.£59m).

Acquisition of Health Unlimited

Next Fifteen has announced the acquisition of Health Unlimited for a total initial consideration of $27.7m. This marks the first substantive foray into healthcare communications and will sit within the Brand Marketing segment.

- Key terms of the acquisition are initial cash consideration of $21.0m, with the balance being satisfied by the issue of 0.98m new ordinary shares. The aggregate initial consideration is deemed to be $27.7m.

- Further consideration will be payable in May 2020 and 2021 respectively and will be triggered by EBITDA targets being met. Total future consideration is capped at $17.3m (we assume c.£10m - £12m) in two equal tranches.

- For the year ended March 2019, Health Unlimited generated PBT of $5.2m on revenue of $17.4m. Taking all adjustments into account, the business is being acquired on a 7x EBIT multiple, broadly in-line with Next Fifteen's historic M&A valuation range.

Health Unlimited was previously owned by Creston PLC and is a business that Next Fifteen have known for some time. The broad spread of the business is 50% B2C (direct to patient marketing by pharmaceutical companies) and 50% B2B and lobbying. There is a degree of client concentration (70% of Health Unlimited's revenue comes from six clients) but this is not uncommon in an industry dominated by a small number of very large players. This client diversity has also improved dramatically over the last few years.

Although Health Unlimited represents the first discrete healthcare agency in the Next Fifteen portfolio; healthcare clients already represent c.5% of North American revenue and the industry has long been identified as being an attractive vertical. Health Unlimited will create a specialist platform, which is Next Fifteen's preferred approach.

The fastest growing part of Health Unlimited's business is in B2B and Policy consulting; which also fits the broader, non-consumer and specialist focus elsewhere in the broader Next Fifteen group.

Estimate Revisions – PBT unchanged for FY 2019, +3% for FY 2020

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

- A positive contribution from the Health Unlimited acquisition (four months in the current year), combined with a better than expected performance from a number of smaller agencies (Twogether and M Booth in particular) and recent acquisitions (Activate in particular).
- The negative impact from Beyond, and to a lesser extent Archetype. The impact here is most keenly felt in the current year but will still provide a drag on FY 2020, although to a lesser extent.
- The short-term margin impact from Beyond will likely offset some of the improving margin mix elsewhere in the group portfolio. Faster growing businesses such as Savanta and Activate also deliver higher margins and this trend has been in place for a number of years, driving much of the substantial margin improvement witnessed in the UK over the last four years. Fundamentally, this shape remains in place but will be impacted in the short term by Beyond. North American margins now look to be on an improving trend post the Archetype merger with the Health Unlimited acquisition also improving the overall margin mix. We still anticipate small overall margin gains for the group as a result and have ticked up our margin expectations.

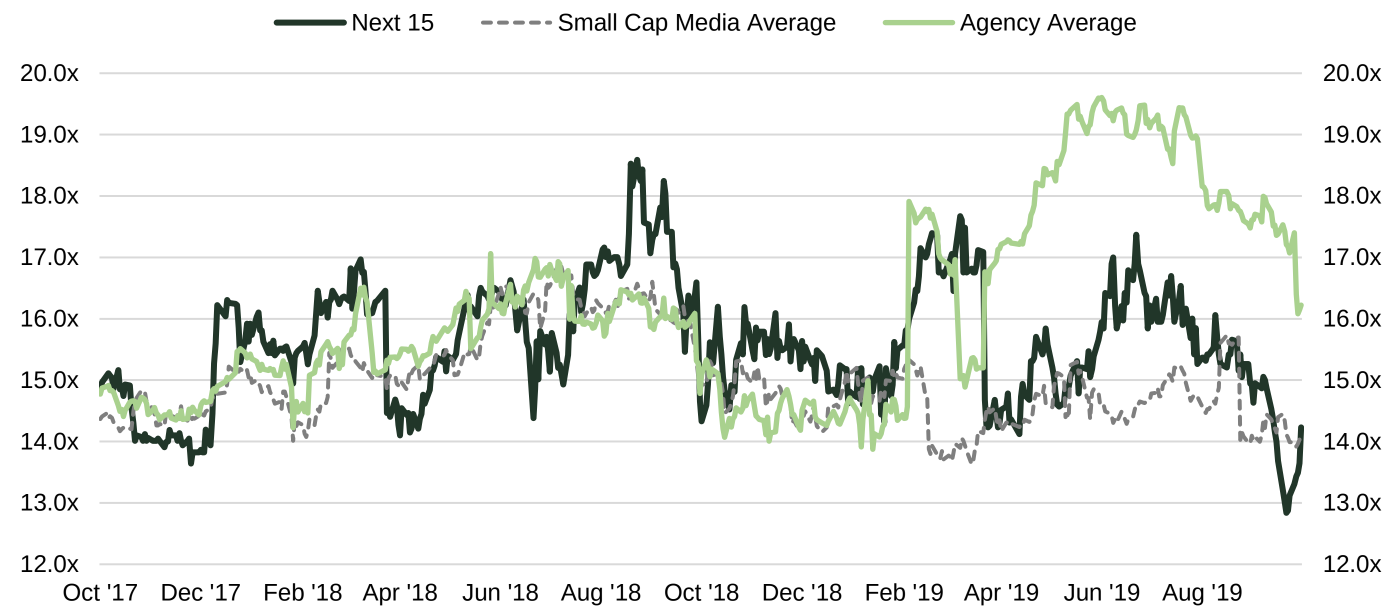
Figure 1: Radnor estimate revisions

	Previous		New		*Change, %*	
£m	2020E	2021E	2020E	2021E	2020E	2021E
UK	97.7	105.5	99.0	106.9	*1%*	*1%*
North America	127.3	133.7	127.9	140.7	*0%*	*5%*
EMEA	9.2	9.4	9.0	9.3	*-2%*	*-1%*
Asia Pacific	14.6	15.1	14.2	14.6	*-3%*	*-3%*
Revenue	**248.8**	**263.7**	**250.1**	**271.5**	***1%***	***3%***
UK	24.1	26.3	22.3	25.1	*-8%*	*-4%*
North America	26.1	28.1	27.5	31.0	*5%*	*10%*
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	-10.5	-11.1	-9.0	-10.6	*-14%*	*-5%*
EBITA	**43.6**	**47.4**	**44.7**	**49.5**	***3%***	***4%***
- margin %	*17.5%*	*18.0%*	*17.9%*	*18.2%*		
Adj. PBT	**43.4**	**47.6**	**43.4**	**49.2**	***0%***	***3%***
Adj. EPS (p)	**37.9**	**41.5**	**37.2**	**42.0**	***-2%***	***1%***
Dividend (p)	8.7	10.0	8.7	10.0	*0%*	*0%*
Net Cash (Debt)	**12.2**	**34.5**	**-5.3**	**11.7**		

Source: FactSet, Radnor

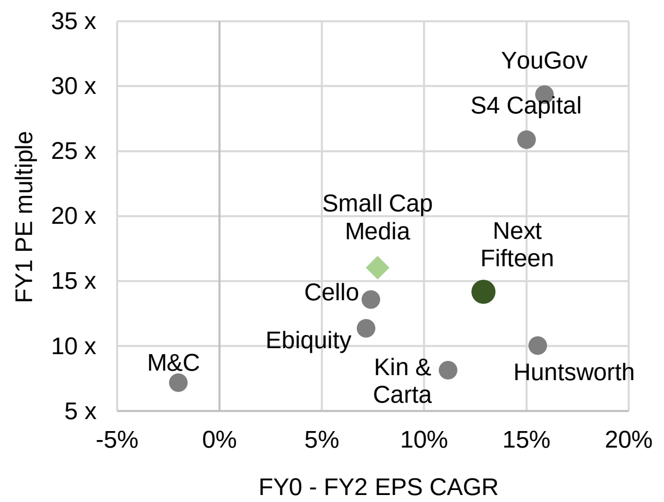
Valuation

Figure 2: Next Fifteen FY1 PE multiple vs Peers



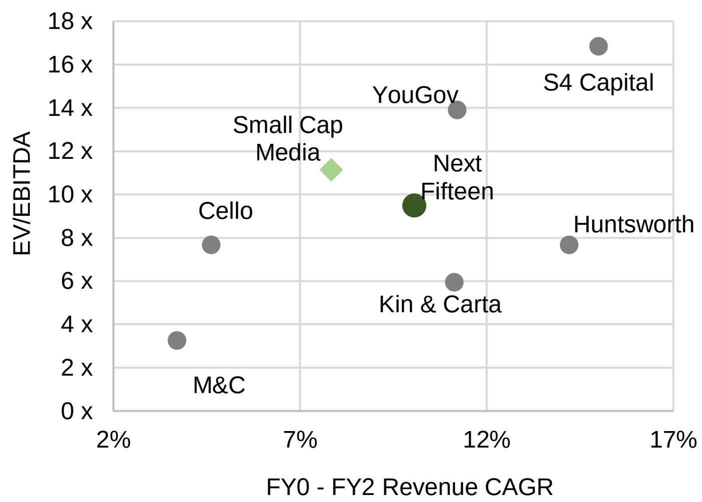
Source: FactSet, Radnor

Figure 3: Cal 2019 PER vs forward EPS growth



Source: FactSet, Radnor

Cal 2019 EV/EBITDA vs forward Revenue growth



Source: FactSet, Radnor

- We can see from the above that Next Fifteen has seen a material de-rating since July, with the current FY1 PE multiple standing near its two-year low. We believe overall macro-concerns over the resilience of marketing budgets has played a part (witness the de-rating for Agency peer group over the same period), but the market has clearly reacted to the organic revenue decline reported in H1.

- We note that even after a scaling back of near-term organic growth expectations; we still look for Next Fifteen to deliver double digit earnings growth with a comfortably secure balance sheet. The group looks well set to continue to reap the benefits of its judicious M&A strategy over the last four years. In this sense, the current de-rating looks somewhat anomalous.

Next Fifteen Communications PLC

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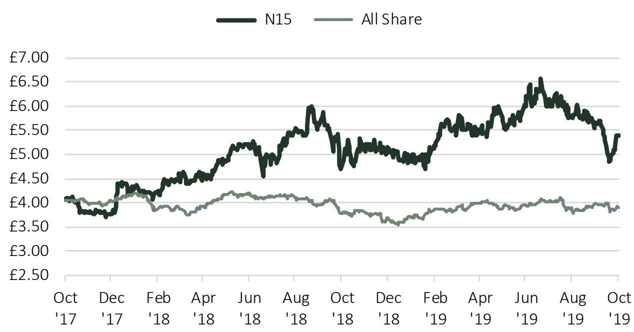
Price (p):	**538 p**
Market Cap:	465 m
EV:	477 m

PROFIT & LOSS

Year to 31 January, £m	FY17	FY18	FY19	FY20e	FY21e	FY22e
UK	*42.6*	*58.3*	*83.5*	*99.0*	*106.9*	*114.4*
North America	*107.0*	*115.9*	*117.9*	*127.9*	*140.7*	*147.8*
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**	**250.1**	**271.5**	**286.8**
UK	*8.0*	*13.0*	*20.5*	*22.3*	*25.1*	*28.6*
North America	*22.3*	*23.2*	*22.0*	*27.5*	*31.0*	*33.2*
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)*	*(9.0)*	*(10.6)*	*(11.5)*
EBITA - Adjusted	**25.0**	**30.0**	**37.0**	**44.7**	**49.5**	**54.5**
Associates & JV's	(0.3)	0.0	0.1	0.1	0.1	0.1
Net Bank Interest	(0.5)	(0.7)	(1.0)	(1.4)	(0.4)	0.2
PBT - Adjusted	**24.2**	**29.3**	**36.0**	**43.4**	**49.2**	**54.8**
Non Operating Items	(17.1)	(12.8)	(16.3)	(15.3)	(12.6)	(13.3)
Other Financial Items	(4.2)	(3.2)	(0.9)	(2.5)	(2.5)	(2.5)
PBT - IFRS	**2.9**	**13.3**	**18.8**	**25.6**	**34.1**	**39.0**
Tax	(1.2)	(4.0)	(4.3)	(5.1)	(6.8)	(7.8)
Tax - Adjusted	(5.3)	(5.9)	(7.2)	(8.7)	(9.8)	(11.0)
Tax rate - Adjusted	*22.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*
Minority interests	0.5	0.7	0.6	0.9	1.2	1.4
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	91.0	91.0	91.0
IFRS EPS (p)	1.6	11.6	17.5	23.2	30.9	35.3
Adj EPS (p), diluted	**23.4**	**27.8**	**33.1**	**37.2**	**42.0**	**46.7**
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	20.5	27.3	31.2
Depreciation & Amortisation	*9.5*	*11.4*	*13.8*	*14.4*	*15.1*	*16.2*
Net Finance costs	*4.7*	*4.0*	*1.9*	*3.9*	*2.9*	*2.3*
Tax	*1.2*	*4.0*	*4.3*	*5.1*	*6.8*	*7.8*
Working Capital	6.3	(4.2)	1.2	(5.0)	(0.2)	(0.6)
Other	9.4	4.4	2.6	0.9	0.9	0.9
Cash from Ops	**32.8**	**28.9**	**38.4**	**39.8**	**52.8**	**57.8**
Cash Tax	(2.0)	(4.3)	(6.2)	(5.1)	(6.8)	(7.8)
Tangible Capex	(8.3)	(3.0)	(5.6)	(4.0)	(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**	**29.7**	**41.0**	**45.0**
Dividends	(4.3)	(5.7)	(6.6)	(8.0)	(9.0)	(10.1)
Acquisitions & Inv.	(21.9)	(15.4)	(29.6)	(25.0)	(10.0)	(10.0)
Financing	11.1	3.8	7.7	(1.7)	(0.7)	(0.1)
Net Cashflow	**6.8**	**3.1**	**(4.4)**	**(5.1)**	**21.3**	**24.8**
Net Cash (Debt)	(11.4)	(11.6)	(5.2)	(5.3)	11.7	36.5

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%	22.6%	24.0%	24.2%
RoCE	34.2%	31.7%	28.9%	33.7%	39.3%
Asset Turnover (x)	0.6x	0.7x	0.7x	0.7x	0.6x
NWC % Revenue	16.3%	17.1%	11.9%	10.9%	10.1%
Op Cash % EBITA	96.1%	103.9%	89.0%	106.7%	106.0%
Net Debt / EBITDA	0.3x	0.1x	0.1x	-	-

BALANCE SHEET

Year to 31 January, £m	FY17	FY18	FY19	FY20e	FY21e	FY22e
Intangibles	80.0	94.8	126.1	120.7	121.3	121.2
P,P+E	15.8	13.6	15.9	16.8	16.3	15.4
Tax Asset & Other	11.7	11.7	13.0	47.4	39.4	31.4
Total Fixed Assets	**107.4**	**120.1**	**155.0**	**184.9**	**176.9**	**167.9**
Net Working Capital	(27.5)	(32.2)	(38.4)	(29.9)	(29.7)	(29.1)
Capital Employed	**79.9**	**87.9**	**116.6**	**155.0**	**147.2**	**138.9**
Net Funds	(11.4)	(11.6)	(5.2)	(5.3)	11.7	36.5
Net Assets	**68.5**	**76.3**	**111.5**	**149.7**	**158.9**	**175.3**

VALUATION

Fiscal	FY18	FY19	FY20e	FY21e	FY22e
P/E	19.4x	16.2x	14.5x	12.8x	11.5x
EV/EBITDA	10.7x	9.1x	7.8x	9.6x	8.7x
Div Yield	1.2%	1.4%	1.6%	1.9%	2.1%
FCF Yield	4.3%	5.1%	6.2%	8.6%	9.4%
EPS growth	18.6%	19.2%	12.2%	12.9%	11.2%
DPS growth	20.0%	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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