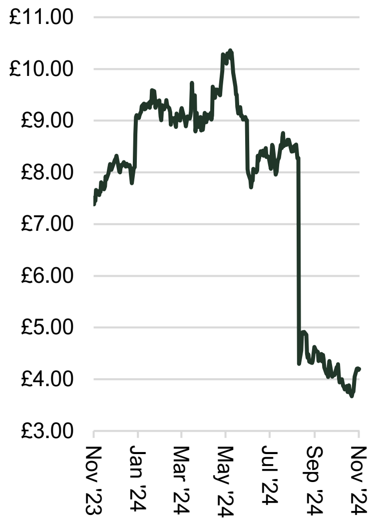
Next 15 Group PLC

NFG | AIM | Media | 420p | £424m

Can ten year valuation lows be justified?

1 Year Chart



The continuing share price weakness at Next 15 has left the valuation, FY25E PE multiple of 5.4x, at ten-year lows. Despite the understandable disappointment at the Mach49 contract loss and the tougher short term trading environment, we believe the 52% PE de-rating has gone too far. The downgrades for Next 15 have been less pronounced than for others in the sector, yet Next 15 has seen the most significant valuation impact.

The implication is that Next 15 has suddenly become a bad business. We do not subscribe to this analysis. The track record, delivered consistently over a number of years, is one of good organic growth, well priced and accretive M&A (with one exception), margin expansion and a well stewarded balance sheet. There are good reasons why Next 15 has outperformed its peers both operationally and financially and these reasons have not gone away, even if they are likely to be somewhat obscured in the short term.

Headline recovery catalysts will depend largely on the background spending environment. Until then, those investors willing to look through the short-term noise, can find a bargain.

Next 15 Group PLC is a research client of H2 Radnor Ltd.

MiFID II – this research is deemed to be a minor, non-monetary benefit.

- **H1 headlines** were dominated by the Mach49 contract loss, which has had a material impact on FY26E estimates in particular. Beyond the Mach49 contract, the H1 results spoke to a tough technology client spending environment with management not expecting a meaningful recovery in the second half. In response, management have been quick to identify £25m of annualised cost savings, with approx. 1/3 benefiting FY25E.
- **Changes to estimates:** Since the N15 H1 results, peer group trading commentary has continued to strike a negative tone and we are also conscious of FX headwinds persisting for much of the year. We are taking this opportunity to trim our FY25E revenue and PBT estimates by -2% / -4% respectively, moving us away from the top end of the consensus range.
- **Valuation Opportunity:** Next 15 now stands at 10-year valuation lows. The extent of the de-rating has significantly outpaced downgrades (52% PE de-rating vs a 38% reduction in FY26E EPS), suggesting a more existential judgement by the market. We do not agree with this assessment. Next 15 has one of the best track records in the sector for reasons that do not disappear overnight. For those willing to look beyond the Mach49 contract loss, the current valuation opportunity is compelling.

29 November 2024

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January, £m	Revenue	PBT adj	EPS (p)	Div (p)	Net Cash	PE x	Yield %
FY 2023A	563.8	112.5	80.4	14.6	26.1	4.8	3.8
FY 2024A	577.8	117.9	81.6	15.4	(1.4)	4.7	4.0
FY 2025E	*575.3*	*106.1*	*71.8*	*13.3*	*(37.5)*	*5.4*	*3.4*
FY 2026E	*531.4*	*88.7*	*61.3*	*11.1*	*(19.7)*	*6.3*	*2.9*
FY 2027E	*559.8*	*106.0*	*73.4*	*13.4*	*6.8*	*5.3*	*3.5*

Changes to h2Radnor estimates

Post the September trading update and the more recent H1 results, we made a number of changes to our estimates to reflect both the loss of the Mach49 contract and the shorter-term pressures being experienced elsewhere across the group. The significant majority of the larger, FY26E, downgrade was due to the fully annualised effect of the Mach49 contract coming washing through post the December 2024 contract expiry. Our two most recent notes can be accessed here and here).

Since the release of the Next 15 H1 results in September, we have had data points from a number of companies (**S4 Capital** Q3 update, **WPP** Q3 results and **YouGov** final results most notably) that have pointed to the lack of any meaningful short term revenue recovery for companies with client marketing budget exposure.

We are also conscious that approx. two thirds of Next 15's revenue is US Dollar denominated, which has weakened relative to Sterling through much of this year. The average $:£ rate in Next 15's current fiscal year to date is -3% versus FY24.

The consensus estimate range for Next post the release of the H1 results, has been unusually broad by N15 standards, especially at the PBT line:

- FY25E revenue range of £575m ⟶ £586m, h2Radnor: £585m
- FY25E adj PBT range of £101m ⟶ £112m, h2Radnor £110m

The combination of muted sector trading commentary and more pronounced FX impacts, leaves us feeling uncomfortable sitting towards the top end of the consensus range and we are taking this opportunity to reflect the FX impacts in particular and trim our FY25E expectations by -2% for revenue and -4% for PBT. We are leaving our FY26E estimates unchanged.

Figure 1: h2Radnor estimate revisions

		Previous		**New**		***Change, %***	
	2024A	2025E	2026E	**2025E**	**2026E**	**2025E**	**2026E**
Customer Engagement	263.1	265.8	265.8	257.9	266.9	*- 3%*	*+ 0%*
Customer Delivery	107.7	109.8	115.3	109.8	115.3	*+ 0%*	*- 0%*
Customer Insight	57.5	58.6	61.6	58.1	61.0	*- 1%*	*- 1%*
Business Transformation	149.6	151.1	87.6	149.6	88.3	*- 1%*	*+ 1%*
Revenue	**577.8**	**585.3**	**530.2**	**575.3**	**531.4**	***- 2%***	***+ 0%***
Customer Engagement	53.2	54.5	51.8	51.6	51.8	*- 5%*	*- 0%*
Customer Delivery	29.1	29.1	30.0	28.5	30.0	*- 2%*	*- 0%*
Customer Insight	10.4	11.1	11.7	10.7	11.6	*- 3%*	*- 1%*
Business Transformation	48.3	42.0	21.0	41.6	21.2	*- 1%*	*+ 1%*
Central Overhead	-19.8	-22.2	-23.9	-21.9	-23.9	*- 2%*	*+ 0%*
EBITA	**121.1**	**114.5**	**90.6**	**110.6**	**90.6**	***- 3%***	***+ 0%***
- margin %	*21.0%*	*19.6%*	*17.1%*	*19.2%*	*17.1%*		
Adj. PBT	**117.9**	**110.0**	**88.8**	**106.1**	**88.7**	***- 4%***	***- 0%***
Adj. EPS (p)	**81.6**	**74.5**	**61.4**	**71.8**	**61.3**	***- 4%***	***- 0%***
Dividend (p)	15.4	13.8	11.2	13.3	11.1	*- 4%*	*- 0%*
Net Cash (Debt)	**-1.4**	**-35.4**	**-17.3**	**-37.5**	**-19.7**		

Source: h2Radnor

The strength of the Next 15 balance sheet has been an important underpin to the equity story for a number of years. Despite the negative impact of working capital in the current year, we still expect Next 15's net debt / EBITDA multiple to be no more than 0.3x.

In Figure 2 below, we show how our estimate of how the net debt / EBITDA multiple will evolve over the next three years based on our current EBITDA expectations and the current company guidance on outstanding earn out commitments. We also assume a 100% cash payout, although this could change should the share price improve.

Figure 2: h2Radnor earn out & net debt analysis

£m	FY25E	FY26E	FY27E
Operating Cashflow	78.6	108.8	112.5
Free Cashflow	61.2	93.7	92.8
Deferred consideration payments	(60.0)	(48.6)	(42.2)
Year End Net Cash / (Debt)	**(37.5)**	**(19.7)**	**6.8**
EBITDA	123.1	103.6	120.3
Net debt / EBITDA, x	**0.3**	**0.2**	**-**
Free cashflow / Earn out cover	1.0	1.9	2.2

Source: h2Radnor

Given the phased nature of the outstanding earn out commitments, we do not believe that capitalising the full value of the earn outs now gives a fair impression of the true balance sheet picture. We can see from Fig 2 that even on our revised net debt expectations, we still expect net debt / EBITDA to not exceed 0.3x over the next three years and for free cashflow to comfortably exceed earn out liabilities in FY26E and FY27E.

Even if we were to treat the outstanding F26E and FY27E earn out commitments on an “all in” basis in the current year, then the net debt / EBITDA multiple would be 1.0x, a level we still regard as comfortable.

Valuation Opportunity

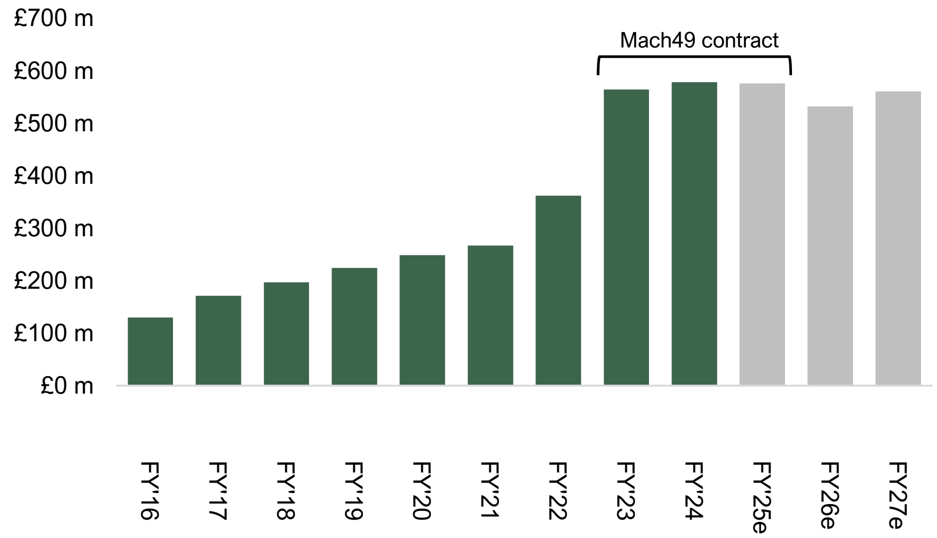
We believe the current valuation has been materially distorted by sentiment concerns around the Mach49 contract loss and a negative reaction to what was the first material downgrade for the core Next 15 business for the best part of 10 years.

We can see this distortion through the comparison between the market reaction to Next 15 and others in the peer group, who have also experienced either singular or more prolonged downgrade pressure.

Before we look at the comparative market reactions within the peer group, it is worth taking a step back and look at the broader Next 15 track record.

Figure 3: Next 15 revenue track record & CAGR

Revenue CAGRs			
FY16 → FY22	FY16 → FY24	FY16 → FY27E	FY22 → FY27
+16%	**+18%**	**+13%**	**+8%**



Source: Company, h2Radnor

Figure 3 shows the evolution of Next 15 revenue from FY16 through to the end of our current estimate period, FY27E. We can see that prior to the first full contribution from the Mach49 contract (FY23), Next 15 had delivered a FY16 – FY22 revenue CAGR of **+16%**, of which approximately half was organic and half contributed by M&A.

We can clearly see the impact of the Mach49 contract in FY23, FY24 and the current FY25E, which will be the final year of full contribution.

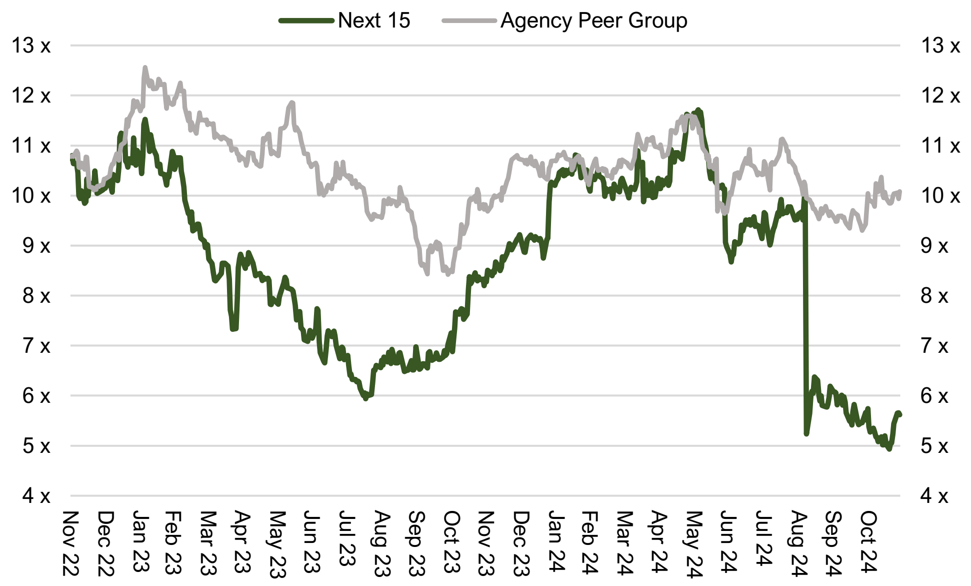
Looking through to FY27E, ie once the Mach49 contract has fully washed through, we see the FY16 to FY27E revenue CAGR fall by only 3% points to **+13%**. If we look at the more recent period of FY22 (before the full benefit of the Mach49 contract) through to FY27E, we can still see a revenue CAGR of **+8%**.

Looking back to our estimates from July 2024, pre the loss of the Mach49 contract, we had been looking at FY25E revenue of £605.1m, FY26E revenue of £642.7m and FY27E revenue of £682.6m. These all assumed a full contribution from the contract. We can therefore see a downgrade of -5%, -17% and -18% respectively. Prior to these downgrades we had been looking for a FY22 – FY27E revenue CAGR of **+11%**.

This is an important point to note. Even after we take out the contribution from the Mach49 contract, and the broader scaling back of shorter-term growth expectations to reflect the current technology driven spending squeeze, we are still expecting FY26E and FY27E revenue to be c.50% ahead of FY22. This reflects a combination of organic growth and the contributions from the Shopper Media and Engine acquisitions, both of which will have delivered good organic growth throughout the period.

So, against this context, how has the Next 15 valuation responded?

Figure 4: Next 15 FY1 PE vs Agency Peer Group



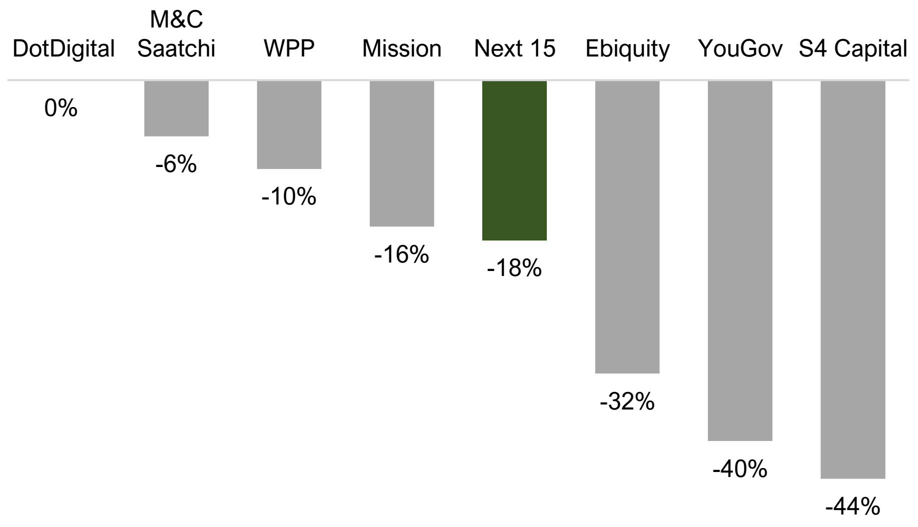
Source: h2Radnor, FactSet

We can see from Figure 4 above, the extent to which Next 15 has de-rated relative to the peer group. Year to date, we can see that both Next 15 and the Agency peer group saw FY1 PE multiples peak in early June at 11.7x.

- At the current FY1 PE multiple of 5.4x, Next 15 has seen its multiple de-rate by **-52%** from this June peak.
- At the current FY1 PE multiple of 10.1x, the Agency Peer Group has seen its multiple de-rate by **-13%** from this June peak.

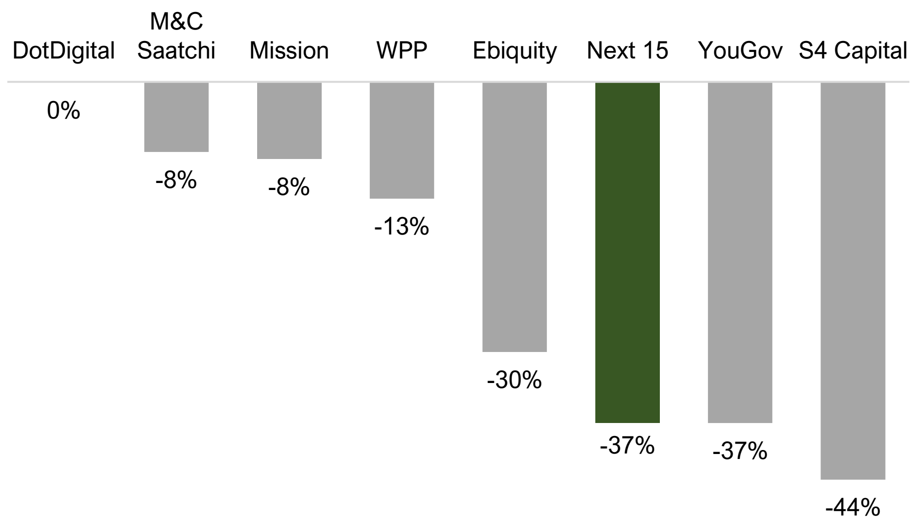
Has the extent of this Next 15 de-rating compared to its peer group been justified by materially greater downgrades? In Figures 5 and 6 below, we show the change in both FY1 and FY2 EPS estimates for all the companies in the peer group across the last 12 months.

Figure 5: Agency peer group – FY1 EPS downgrades – last 12 months



Source: h2Radnor, FactSet

Figure 6: Agency peer group – FY2 EPS downgrades – last 12 months



Source: h2Radnor, FactSet

We can see from the above that on a FY25E basis, others in the sector have seen far more significant downgrades. With the majority of the Mach49 impact falling into FY26E, Next 15 fares less well on a comparative basis, however it is still not the most downgraded stock. Even on a FY26E basis, both YouGov and S4 Capital have seen similar or more significant earnings downgrades than Next 15.

It is clear to us that the extent of the PE de-rating is less about the quantum of the downgrades and is more to do with the abrupt nature of the Mach49 contract loss. There is also no doubt that the market will have been disappointed that Next 15 has not been able to remain immune from the pressures that have been facing others in the sector for some time.

Do we think this over de-rating is justified? No, is the short answer. Other than the negative surprise factor surrounding the Mach49 contract loss, we see little in the Next 15 story that has changed on a fundamental basis.

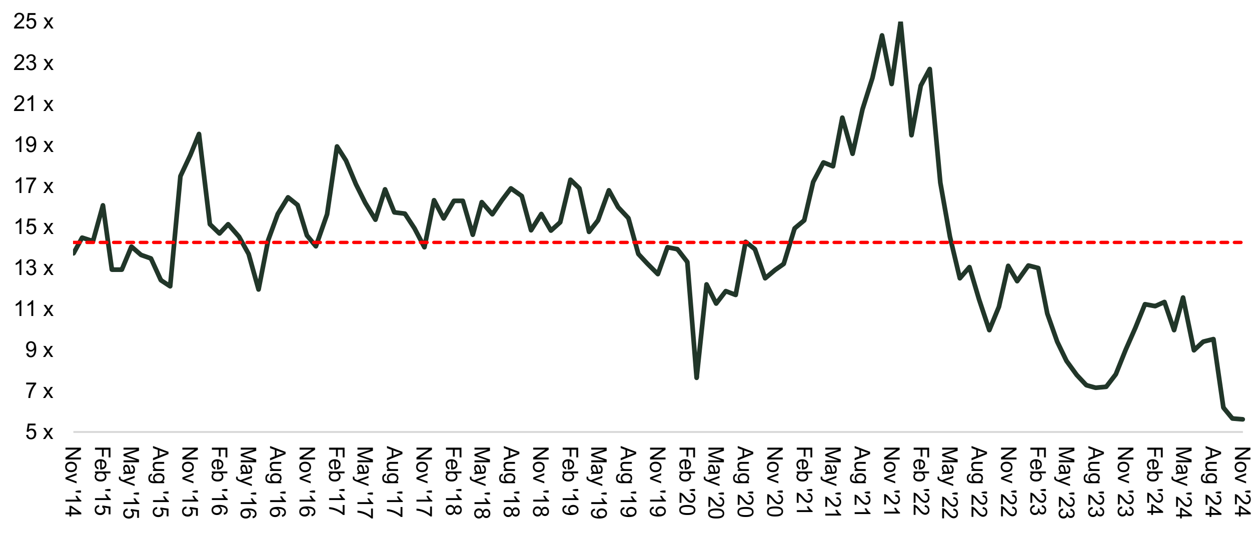
- Next 15 remains a more resilient business than many of its peers. The group portfolio effect (Next 15 is a group of multiple smaller, niche specialists) is much more significant than for others.

- The portfolio is more broadly spread now across client vertical and business discipline than at any time in the past 10 years. The historic majority exposure to the technology industry has been reduced significantly; partly through group diversification and partly through tech client spend reductions.

- Despite the recent downgrades, Next 15 is still expected to outperform its peers when it comes to margin protection. This is both a function of portfolio mix and a more decentralised approach to the group structure and an emphasis on local costs and budget accountability.

The current valuation, at 5.4x FY1 PE, represents a 10 year low (see Figure 7 below). For those investors willing to look through the Mach49 contract loss, this represents a material opportunity to gain exposure to a company that has one of the strongest track records in the sector.

Figure 7: Next 15 10 year PE multiple



Source: h2Radnor, FactSet

Next 15 Group PLC

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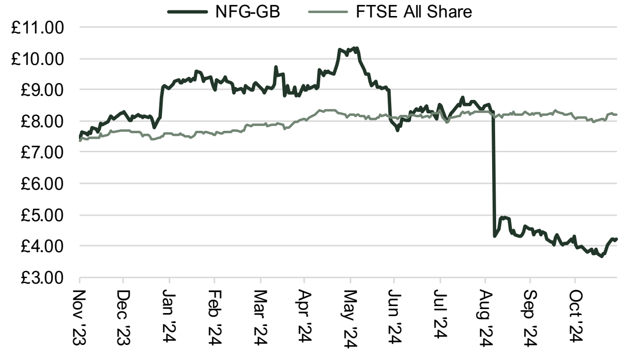
Price (p):	**420 p**
Market Cap:	424 m
EV:	428 m

PROFIT & LOSS

Year to 31 January, £m	FY22	FY23	FY24	FY25e	FY26e	FY27e
Customer Engagement	*187.6*	*275.0*	*263.1*	*257.9*	*266.9*	*280.2*
Customer Delivery	*80.0*	*102.1*	*107.7*	*109.8*	*115.3*	*121.1*
Customer Insight	*42.1*	*52.0*	*57.5*	*58.1*	*61.0*	*65.8*
Business Transformation	*52.5*	*134.8*	*149.6*	*149.6*	*88.3*	*92.7*
Group Net Revenue	**362.1**	**563.8**	**577.8**	**575.3**	**531.4**	**559.8**
Customer Engagement	*40.4*	*55.4*	*53.2*	*51.6*	*51.8*	*58.8*
Customer Delivery	*28.5*	*30.2*	*29.1*	*28.5*	*30.0*	*32.7*
Customer Insight	*9.0*	*11.0*	*10.4*	*10.7*	*11.6*	*13.2*
Business Transformation	*15.2*	*43.9*	*48.3*	*41.6*	*21.2*	*25.0*
Head Office	*(13.8)*	*(26.4)*	*(19.8)*	*(21.9)*	*(23.9)*	*(23.0)*
EBITA - Adjusted	**79.3**	**114.2**	**121.1**	**110.6**	**90.6**	**106.8**
Associates & JV's	0.2	-	-	-	-	-
Net Bank Interest	(0.3)	(1.6)	(3.1)	(4.5)	(1.9)	(0.8)
PBT - Adjusted	**79.3**	**112.5**	**117.9**	**106.1**	**88.7**	**106.0**
Non Operating Items	(40.4)	(48.3)	(45.1)	(39.0)	(30.0)	(30.0)
Other Financial Items	(119.0)	(54.1)	7.5	(29.5)	(29.5)	(29.5)
PBT - IFRS	**(79.1)**	**10.1**	**80.3**	**36.5**	**28.1**	**45.4**
Tax	14.5	(7.1)	(26.4)	(9.8)	(7.6)	(12.2)
Tax - Adjusted	(17.2)	(26.3)	(31.1)	(28.6)	(23.9)	(28.6)
Tax rate - Adjusted	*21.6%*	*23.3%*	*26.3%*	*27.0%*	*27.0%*	*27.0%*
Minority interests	3.6	1.4	1.0	2.1	1.9	2.1
No. shares m	92.4	97.6	99.2	99.0	99.0	99.0
No. shares m, diluted	98.1	105.7	105.2	104.9	102.5	102.5
IFRS EPS (p)	(73.8)	1.7	53.3	24.8	18.8	31.4
Adj EPS (p), diluted	**59.7**	**80.4**	**81.6**	**71.8**	**61.3**	**73.4**
Total DPS (p)	12.0	14.6	15.4	13.3	11.1	13.4

PRICE CHART - 1 YEAR ABSOLUTE vs FTSE ALL SHARE



Source: FactSet

SHAREHOLDERS

	% of ord. Share capital
Octopus Investments	11.9%
Liontrust Investment Partners	10.0%
Aviva Investors	9.9%
Slater Investments	6.7%
Directors	5.5%
BlackRock	4.8%
JPMorgan AM	4.1%
abrdn	3.3%
	56.2%

CASH FLOW

Year to 31 January, £m	FY22	FY23	FY24	FY25e	FY26e	FY27e
Net Profit: (add back)	(64.6)	3.0	53.9	26.6	20.5	33.1
Depreciation & Amortisation	*28.8*	*37.2*	*36.6*	*37.5*	*38.0*	*38.5*
Net Finance costs	*120.3*	*57.1*	*(3.2)*	*35.1*	*32.5*	*31.4*
Tax	*(14.5)*	*7.1*	*26.4*	*9.8*	*7.6*	*12.2*
Working Capital	0.2	(24.4)	(10.7)	(22.5)	16.2	3.3
Other	19.6	15.1	2.0	(8.0)	(6.0)	(6.0)
Cash from Ops	**89.8**	**95.2**	**105.0**	**78.6**	**108.8**	**112.5**
Cash Tax	(14.1)	(20.3)	(25.4)	(9.8)	(7.6)	(12.2)
Tangible Capex	(3.1)	(3.5)	(3.7)	(4.0)	(4.0)	(4.0)
Intangible Capex	(2.7)	(3.5)	(3.4)	(3.5)	(3.5)	(3.5)
Free Cashflow	**69.9**	**67.9**	**72.5**	**61.2**	**93.7**	**92.8**
Dividends	(12.4)	(15.3)	(16.1)	(17.2)	(15.2)	(13.0)
Acquisitions & Inv.	(24.0)	(104.9)	(60.2)	(63.0)	(48.6)	(42.2)
Financing	(1.1)	38.6	1.1	(23.0)	(12.2)	(11.1)
Net Cashflow	**32.4**	**(13.7)**	**(2.6)**	**(42.0)**	**17.8**	**26.5**
Net Cash (Debt)	35.7	26.1	(1.4)	(37.5)	(19.7)	6.8

Announcements

Date	Event
September 2024	Trading update
June 2024	AGM update
April 2024	Final results
January 2024	Trading update
September 2023	H1 results
April 2023	Final results
January 2023	Trading update
September 2022	H1 results

RATIOS

	FY23	FY24	FY25e	FY26e	FY27e
RoE	74.2%	54.9%	39.8%	40.4%	43.2%
RoCE	37.4%	36.9%	32.7%	31.5%	39.0%
Asset Turnover (x)	0.7x	0.7x	0.7x	0.7x	0.6x
NWC % Revenue	13.6%	8.6%	6.6%	15.0%	14.9%
Op Cash % EBITA	83.4%	86.8%	71.1%	120.1%	105.4%

BALANCE SHEET

Year to 31 January, £m	FY22	FY23	FY24	FY25e	FY26e	FY27e
Intangibles	183.1	274.1	279.3	280.8	275.5	268.1
P,P+E	7.5	10.9	10.1	9.9	9.6	9.1
Tax Asset & Other	75.6	97.2	88.4	85.4	82.4	79.4
Total Fixed Assets	**266.2**	**382.1**	**377.8**	**376.2**	**367.5**	**356.6**
Net Working Capital	(51.6)	(76.8)	(49.5)	(37.8)	(79.9)	(83.1)
Capital Employed	**214.5**	**305.3**	**328.4**	**338.4**	**287.7**	**273.5**
Earn Out Liabilities	(188.8)	(217.0)	(170.8)	(111.3)	(112.2)	(105.8)
Net Funds	35.7	26.1	(1.4)	(37.5)	(19.7)	6.8
Net Assets	**61.5**	**114.4**	**156.2**	**189.6**	**155.8**	**174.4**

VALUATION

Fiscal	FY23	FY24	FY25e	FY26e	FY27e
P/E	4.8x	4.7x	5.4x	6.3x	5.3x
EV/EBITDA	3.4x	3.2x	3.5x	4.1x	3.6x
Div Yield	3.8%	4.0%	3.4%	2.9%	3.5%
FCF Yield	15.9%	16.9%	14.3%	21.9%	21.7%
EPS growth	34.5%	1.5%	-11.9%	-14.7%	19.8%
DPS growth	21.7%	5.1%	-13.3%	-16.2%	19.8%

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