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Next Fifteen Communications

Preliminary results

FY15's strong rebound sets good growth platform

Media

Next Fifteen's results for the 12 months (FY15) and 18 months to January 2015, following a change in the year-end, show good progress. Revenue in FY15 rose 10.6% to £109.2m, with organic growth of 6.1%. In addition to continued strong performance in the US, the group has achieved a solid recovery in operating margins in the UK, Europe and Asia, following management implementing initiatives to improve the group's profitability. Normalised FY15 PBT came in at £12.5m, nicely ahead of our estimate by £0.5m. Together with strategy focused on creating a new type of globally integrated marketing business, the group appears to have established a good future growth platform. Reflecting this and management stating that FY16 has got off to an encouraging start, we raise our FY16 normalised EPS estimate by 2.0p to 14.6p and initiate the same for FY17 at 16.1p.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
01/14	98.7	8.3	7.4	2.63	23.4	1.5
01/15	109.2	12.5	13.2	3.50	13.1	2.0
01/16e	125.4	15.0	14.6	3.75	11.8	2.2
01/17e	133.0	16.6	16.1	4.00	10.7	2.3

Note: *PBT and EPS are normalised, excluding intangible amortisation and exceptional items.

Good progress in FY15

FY15 revenue rose 10.6% to £109.2m (FY14: £98.7m), with organic growth of 6.1%. Group adjusted operating margin rose to a group record 11.7% in FY15 from the depressed 8.9% in FY14, resulting in adjusted operating profit rising 45% to £12.73m from FY14's £8.76m, which was affected by challenging trading, predominately in Europe and Asia, as well as to a lesser extent in the UK. While normalised PBT rose 51.6%, diluted EPS after a 23.9% tax charge for FY15 of 13.2p (2.2p ahead of our estimate) was up 78%, a larger percentage gain primarily due to the exceptionally high tax charge of 34.7% in FY14.

Acquisitions further the group's digital transition

During FY15, the group acquired Story Worldwide, a global content advertising business, and Morar, an international market research consultancy. After the year-end for an aggregate consideration of £4.6m and 0.5m shares, the group added a 30% stake in Animl, a specialist digital marketing consultancy, 75% of Encore, a programmatic advertising technology business, and acquired the remaining minority interests in Republic Publishing (49%) and Beyond (32.8%).

Valuation: Rating well supported by growth prospects

Next Fifteen's share price has performed strongly over the past six months and has re-established its historic premium rating to similar sized peers. We contend that the group's expertise and increased focus on the fast-growing digital marketing services space, together with its 30-year specialisation in the tech sector, supports this premium P/E rating, especially now that the group is demonstrating that it is back on the growth tack.

28 April 2015

Price	**173.0p**
Market cap	**£113m**

Net debt (£m) at end January 2015	8.6m
Shares in issue	65.4m
Free float	86%
Code	NFC
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	3.6	16.7	58.7
Rel (local)	0.0	11.1	48.2
52-week high/low		173.5p	109.0p

Business description

Next Fifteen Communications is a digital communications group. Predominately serving clients in the technology and consumer sector, it has world-leading and autonomous PR, research, digital, investor relations and policy communications subsidiaries and associates.

Next events

AGM	July 2015
Interim results	October 2015

Analysts

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Edison profile page

Next Fifteen Communications is a research client of Edison Investment Research Limited

Investment summary: Good growth platform in place

Company description: Digital communications group

Founded in 1981, Next Fifteen Communications is a worldwide digital marketing communications and public relations group, predominately serving clients in the technology, consumer, digital/research consultancy and corporate communications sectors, with world-leading and autonomous PR, research, digital, investor relations and policy communications subsidiaries. Over the past decade, a series of acquisitions has been successfully integrated into the group, which now has 35 offices across 18 countries. Since late 2009, Next Fifteen has been transitioning its business model to increased focus on digital marketing services, driving this by organic expansion and targeted acquisitions, and via a two-year Digital Transition Plan initiated in H113.

The group owns five independent communications brands: two specialising in the technology sector (Text100 and The OutCast Agency), two in the consumer space (Lexis and M Booth) and a marketing services agency (Bite). The group also owns four agencies with a focus on digital (Beyond, Agent3, Connections Media and Republic Publishing), a market research company (Redshift Research), a communications firm (463 Communications) and an investor relations consultancy (The Blueshirt Group). During FY15, the group acquired Story Worldwide and a 75% stake in Morar. Since the FY15 year-end (in April 2015), a 30% stake in Animl and 75% of Encore have been added to the group.

Valuation: Rating well supported by growth prospects

Next Fifteen's share price has performed strongly over the past six months and has re-established its historic premium rating to similar sized peers. We contend that the group's expertise and increased focus on the fast-growing digital marketing services space, together with its 30-year specialisation in the tech sector, supports this premium P/E rating, especially now that the group is demonstrating that it is back on the growth tack.

Financials: Manageable debt/equity: 23% FY15; 13% FY16e

At 31 January 2015, the group had net debt of £8.6m (31 January 2014: £5.4m), made up of £9.3m cash and borrowings of £17.9m, equating to 23.1% net debt to equity. While deferred and contingent consideration of £9.4m and capex of £3.1m is likely over the coming year, the balance sheet should remain solidly financed. Based on these payments, £4.3m share placing proceeds received in February 2015 and on continuing strong annual operating cash flow of £16.4m in FY16e, we estimate net debt to fall to £6.6m at 31 January 2016, which decreases net debt to equity to a manageable 13.3%. In December 2014, the group signed a new four-year global £20m banking facility with HSBC at a lower interest rate margin than under the group's previous arrangements with Barclays.

Sensitivities

Our base case scenario makes five key assumptions. A material change in any of these has the potential to surprise either on the upside or downside:

- major clients are retained;
- the dollar does not weaken or strengthen significantly;
- the technology market continues to grow slightly better than global GDP, and the consumer sector grows in line with global GDP;
- key employees are retained; and
- the Digital Transition Plan (initiated in H113) is successfully implemented.

Results for the 18 months and year to 31 January 2015

Next Fifteen has changed its year-end to 31 January and consequently has reported its results for the 18-month period to 31 January 2015. In addition, the group has provided results for the year to 31 January 2015 (FY15) and the comparative previous year (FY14). To understand the underlying performance of the group, we concentrate on the annual results adjusted for exceptional items, which include intangible amortisation, goodwill impairment, restructuring and reorganisation costs, plus acquisition-related share-based payments and accounting changes.

FY15 revenue rose 10.6% to £109.2m (FY14: £98.7m), with organic growth of 6.1%. Adjusted operating profit rose 45% to £12.73m from FY14's £8.76m, which was affected by challenging trading, predominately in Europe and Asia, as well as to a lesser extent in the UK. Following the appointment of the new CFO, Peter Harris, in March 2014 (following an interim position from November 2013), management has taken a series of steps to improve the performance of the group, including a greater focus on the UK business and the simplification of operations in Europe and Asia Pacific. These actions have delivered significant improvement and appear to have established a good future growth platform. Alongside these operational changes, Next Fifteen remains focused on its strategy to create a new type of integrated marketing group centred on the technology of marketing: data, insight, analytics, apps, content platforms and content itself.

Revenue driven by acquisitions and strong US organic growth

The group's US businesses continued to perform strongly led by the OutCast, M Booth, Text and Blueshirt agencies, plus the November 2014 acquisition of Story. This geographic area saw revenues rise 13% to £64.0m (FY14: £56.5m), which equated to an organic growth rate of 11.3% taking into account movements in exchange rates and acquisitions. In the UK, both Bite and Lexis produced improvement in performance. Together with investments and acquisitions that included Agent3, Morar and Republic Publishing, the UK businesses delivered revenue growth of 27.3%. The simplification of the businesses in Asia Pacific and Europe resulted in revenue in these areas each declining c 10%.

The US remains the group's largest geographic exposure at 58.6% of revenue in FY15. With the expected continuation of double-digit organic growth and acquisitions, we expect this percentage to further rise to 62.5% in FY16 and 63.7% in FY17, assuming exchange rates remaining at current levels.

Exhibit 1: Analysis of revenue by geography

	FY13	Old FY14	FY14	FY15	FY16e	FY17e
Year-end	July	July	January	January	January	January
US & Canada						
Revenue £000s	52,468	57,335	56,528	63,966	78,400	84,700
Group revenue %	54.6	56.5	57.2	58.6	62.5	63.7
UK						
Revenue £000s	19,119	21,901	18,656	23,754	25,700	26,800
Group revenue %	19.9	21.6	18.9	21.8	20.5	20.2
Asia Pacific						
Revenue £000s	13,978	12,635	13,608	12,504	12,100	12,200
Group revenue %	14.5	12.5	13.8	11.5	9.6	9.2
Europe & Africa						
Revenue £000s	10,504	9,580	9,957	8,970	9,200	9,300
Group revenue %	10.9	9.4	10.1	8.2	7.3	7.0
Group net revenues	96,069	101,451	98,749	109,194	125,400	133,000

Source: Company data, Edison Investment Research. Note: Year-end changed to 31 January in 2015.

Adjusted operating margin rebounds to record 11.7%

Adjusted operating profit rose 45% to £12.73m from FY14's £8.76m, which was affected by challenging trading, predominately in Europe and Asia, as well as to a lesser extent in the UK. This resulted in adjusted operating margin rising to a group record 11.7% in FY15 from the depressed 8.9% in FY14, 10.6% for the year to July 2014 (Old FY14) and 8.6% for the year to July 2013 (FY13), which was affected by operational challenges at its US Bite subsidiary.

In the US, operating margins have been consistently above 20%, although were affected slightly by the November 2014 acquisition of Story, which has historically achieved margins in low double digits. While revenue in both Asia Pacific and Europe declined c 10%, the simplification of these operations resulted in these businesses being more able to compete and in doing so delivering improved operating margins to more acceptable levels.

Exhibit 2: Analysis of adjusted operating profit by geography

	FY13	Old FY14	FY14	FY15	FY16e	FY17e
Year-end	July	July	January	January	January	January
US & Canada						
Adjusted operating profit £000s*	11,804	13,593	13,667	14,076	17,350	19,150
Adjusted operating profit margin %*	22.5	23.7	24.2	22.0	22.1	22.6
UK						
Adjusted operating profit £000s*	1,146	1,529	757	2,526	2,850	3,000
Adjusted operating profit margin %*	6.0	7.0	4.1	10.6	11.1	11.2
Asia Pacific						
Adjusted operating profit £000s*	265	582	257	998	1,000	1,075
Adjusted operating profit margin %*	1.9	4.6	1.9	8.0	8.3	8.8
Europe & Africa						
Adjusted operating profit £000s*	-217	248	-811	822	850	900
Adjusted operating profit margin %*	-2.1	2.6	-8.1	9.2	9.2	9.7
Head office costs £000s	4,778	5,180	5,114	5,696	6,370	7,125
Group						
Adjusted operating profit £000s	8,220	10,772	8,756	12,726	15,680	17,000
Adjusted operating profit margin %	8.6	10.6	8.9	11.7	12.5	12.8

Source: Company data, Edison Investment Research. Note: Year-end changed to 31 January in 2015. *Before head office expenses, intangible amortisation, exceptional items and acquisitional share-based payments.

Normalised EPS estimates raised for FY16 and FY17 initiated

The steps taken to improve the performance of the group over the past year appear, based on the solid rebound in profitability in FY15, to have established a good future growth platform. As estimated and analysed by geography in Exhibits 1 and 2, we anticipate (including a continuation of 6% organic growth) group revenue to rise 14.8%, boosted by late FY15 acquisitions, in FY16 and 6.1% in FY17, group adjusted operating margin to increase from 11.7% in FY15 to 12.5% for FY16e and 12.8% for FY17.

On our FY16 £125.4m revenue estimate, this results in adjusted operating profit of £15.7m, up 23% on FY15, and net income after tax and minorities of £10.8m, up 20.1% on FY15. With the weighted average number of shares outstanding primarily due to the February 2015 share placing and shares issued for acquisitions, our normalised EPS estimate for FY16 is upped by 2.0p to 14.6p.

We also initiate FY17 estimates of £133.0m revenue, adjusted operating profit of £17.0m, up 8.4% on FY16e, and net income after tax and minorities of £11.9m, up 10.7% on FY16e, resulting in a normalised EPS estimate for FY17 of 16.1p, a rise of 10.3%.

Note: We have utilised an effective tax rate of 23.9% in calculating our normalised EPS estimates for FY16 and FY17, the same as incurred in FY15. The group's effective tax rate is expected to remain higher than the standard UK rate for the foreseeable future due to the higher rate of tax that the group suffers on its overseas profits.

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Valuation: Rating well supported by growth prospects

The group would appear to be well placed to take advantage in the radically changing marketing sector as it transitions its business model to increased focus on digital marketing services and creating a new type of globally integrated marketing business. With its high exposure to the US market, the group should benefit from the growth in the US digital advertising market, which is estimated to grow c 15% pa in both 2015 and 2016 (source: eMarketer).

Next Fifteen's prospective P/E of 11.6x for the year to 31 March 2016 compares with consensus P/Es of 10.8x for Chime, 9.3x for Huntsworth and 9.5x for Creston, while the Mega advertising group comparators Omnicom and WPP trade at higher prospective P/Es of 17.3x and 16.4x (Exhibit 3). We contend that the group's expertise and increased focus on the fast-growing digital marketing services space, together with its 30-year specialisation in the tech sector, supports this premium P/E rating, especially now that the group is demonstrating that it is back on the growth tack.

Exhibit 3: Proxy comparison table

	Ticker	Price	Mkt Cap	Hist	Hist	Hist	P/E	P/E	Yield
		p/$	£m/$m	YE	EV/Rev	EV/EBITDA	Mar-16*	Year2	Mar-16*
Chime	CHW	291.3	292	Dec-14	1.7	12.0	10.8	9.5	3.2
Creston	CRE	125.0	73	Mar-14	0.9	5.8	9.5	9.5	3.5
Huntsworth	HNT	38.8	126	Dec-14	1.0	7.3	9.3	7.5	5.2
M&C Saatchi	SAA	326.5	231	Dec-14	1.2	12.7	17.8	16.2	2.2
Omnicom (US)	OMC	77.4	19,099	Dec-14	1.4	9.5	17.3	16.1	2.8
WPP	WPP	1,574.0	20,607	Dec-14	2.0	12.0	16.4	15.2	2.8
				Average	1.4	9.9	13.5	12.3	3.3
Next Fifteen	NFC	173.0	113	Jan-15	1.0	7.8	11.6	10.7	2.2

Source: Thomson Reuters, Edison Investment Research. Note: Prices as at UK close on 24 April 2015. *Straight line adjustment to year ending 31 March 2016.

Financials: FY16 acquisition payments well covered

In December 2014, the group consolidated its global banking arrangements with HSBC, which was already the group's corporate banker in the US, and has recently signed a new four-year £20m banking facility with HSBC at a lower interest rate margin than under the group's previous arrangements with Barclays. This, together with continuing strong operating cash flow, should adequately cover current prospective acquisition payments.

Prospective acquisition-related payments: £9.4m in FY16e

After more than 20 years of primarily organic growth, the group began its strategy of boosting growth through acquisition. During the past 10 years, a series of acquisitions has been integrated successfully into the group. Most of these acquisitions included performance-related payments stretching over a number of years and, for some deals, the group has also made an undertaking to acquire outstanding minorities. These payments have been structured as part cash and part shares, generally at the option of the group. These M&A liabilities are included in the balance sheet under deferred/contingent consideration and share purchase obligations.

At 31 January 2015, the group had deferred consideration of £0.1m, contingent consideration of £3.8m and share purchase obligations of £0.9m in current liabilities, plus contingent consideration of £3.3m and share purchase obligations of £5.0m in non-current liabilities. In our FY16 cash flow estimate, we show acquisition payments of £9.4m, which includes the post year-end acquisitions of the outstanding minority interests in Beyond (£2.0m) and Republic Publishing (£1.8m), plus the purchase of the 30% stake in Animl (£0.1m) and a 75% holding in Encore (£0.7m).

Exhibit 4: Financial summary

Period ending	£'000s	2012	2013	2014	2015	2014	2015	2016e	2017e
		Year	Year	Year	18 months	Year	Year	Year	Year
		31-Jul	31-Jul	31-Jul	31-Jan	31-Jan	31-Jan	31-Jan	31-Jan
		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS									
Revenue		91,583	96,069	101,451	158,495	98,749	109,194	125,400	133,000
EBITDA		11,677	9,970	12,561	20,728	10,555	14,609	17,650	19,030
Operating Profit (before GW and except.)		10,047	8,219	10,772	17,959	8,754	12,726	15,680	17,000
Goodwill Amortisation		0	0	0	0	0	0	0	0
Exceptionals		(3,630)	(5,620)	(11,450)	(17,207)	(4,991)	(15,397)	(1,500)	(1,500)
Other		14	(79)	197	334	(10)	268	0	0
Operating Profit		6,431	2,520	(481)	1,086	3,753	(2,403)	14,180	15,500
Net Interest		(472)	(435)	(472)	(681)	(440)	(459)	(690)	(440)
Profit Before Tax (norm)		9,589	7,705	10,497	17,612	8,271	12,535	14,990	16,560
Profit Before Tax (FRS 3)		5,959	2,085	(953)	405	3,313	(2,864)	13,490	15,060
Tax		(1,652)	(1,364)	(1,977)	516	(1,802)	1,486	(3,590)	(3,965)
Profit After Tax (norm)		6,914	4,820	7,420	13,237	5,404	9,537	11,400	12,595
Profit After Tax (FRS 3)		4,307	721	(2,930)	921	1,511	(1,378)	9,900	11,095
Minorities		(401)	(393)	(709)	(1,028)	(475)	(589)	(650)	(700)
Net income (normalised)		6,513	4,427	6,711	12,209	4,929	8,948	10,750	11,895
Net income (FRS3)		3,906	328	(3,639)	(107)	1,036	(1,967)	9,250	10,395
Average Number of Shares Outstanding (m)		57.0	59.1	60.3	60.8	59.8	60.9	65.3	65.4
EPS - normalised (p)		11.4	7.5	11.1	20.1	8.3	14.7	16.5	18.2
EPS - normalised fully diluted (p)		10.1	6.6	10.0	18.1	7.4	13.2	14.6	16.1
EPS - FRS 3 (p)		6.8	0.6	(6.0)	(0.2)	1.7	(3.2)	14.2	15.9
Dividend per share (p)		2.30	2.55	3.00	5.50	2.63	3.50	3.75	4.00
EBITDA Margin		12.8%	10.4%	12.4%	13.1%	10.7%	13.4%	14.1%	14.3%
Operating Margin (before GW and except.)		11.0%	8.6%	10.6%	11.3%	8.9%	11.7%	12.5%	12.8%
BALANCE SHEET									
Non-current assets		48,227	49,457	43,333	57,458	49,868	57,458	64,788	62,658
Intangible Assets		41,019	41,369	34,828	44,915	42,488	44,915	51,185	47,755
Tangible Assets		2,721	3,165	3,534	5,451	2,710	5,451	6,511	7,811
Other non-current assets		4,487	4,923	4,971	7,092	4,670	7,092	7,092	7,092
Current Assets		33,337	37,593	43,045	41,357	36,490	41,357	49,070	61,545
Debtors		24,901	29,529	32,192	32,042	30,273	32,042	37,800	39,900
Cash		8,436	8,064	10,853	9,315	6,217	9,315	11,270	21,645
Current Liabilities		(24,230)	(30,390)	(47,350)	(32,464)	(38,410)	(32,464)	(34,757)	(36,657)
Creditors		(23,946)	(29,674)	(35,227)	(32,294)	(27,102)	(32,294)	(34,587)	(36,487)
Short term borrowings		(284)	(716)	(12,123)	(170)	(11,308)	(170)	(170)	(170)
Long Term Liabilities		(20,106)	(18,467)	(7,966)	(29,149)	(8,048)	(29,149)	(29,249)	(28,549)
Long term borrowings		(10,756)	(9,157)	(100)	(17,712)	(276)	(17,712)	(17,712)	(17,712)
Other long term liabilities		(9,350)	(9,310)	(7,866)	(11,437)	(7,772)	(11,437)	(11,537)	(10,837)
Net Assets		37,228	38,193	31,062	37,202	39,900	37,202	49,852	58,997
CASH FLOW									
Operating Cash Flow		10,052	11,187	12,402	19,207	8,976	17,960	16,435	21,080
Net Interest		(470)	(435)	(468)	(681)	(367)	(534)	(690)	(440)
Tax		(2,520)	(2,686)	(2,043)	(3,031)	(1,461)	(2,316)	(3,590)	(3,965)
Capex		(957)	(2,113)	(2,136)	(4,149)	(1,267)	(3,837)	(3,100)	(3,400)
Acquisitions/disposals		(5,664)	(3,019)	(4,380)	(13,814)	(3,361)	(10,981)	(9,400)	(700)
Financing		(264)	(693)	(501)	(936)	(688)	(813)	4,300	0
Dividends		(1,208)	(1,409)	(1,585)	(3,006)	(1,409)	(3,006)	(2,000)	(2,200)
Other		0	0	0	0	0	0	0	0
Net Cash Flow		(1,031)	832	1,289	(6,410)	423	(3,527)	1,955	10,375
Opening net debt/(cash)		1,571	2,604	1,809	1,809	5,200	5,367	8,567	6,612
Finance leases		(72)	(59)	(83)	(103)	(125)	(96)	0	0
Other		70	22	(767)	(245)	(465)	423	0	0
Closing net debt/(cash)		2,604	1,809	1,370	8,567	5,367	8,567	6,612	(3,763)

Source: Company data, Edison Investment Research. Note: Year-end changed to 31 January in 2015.

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