

H1 results – resilient performance and outlook

1 Year Chart



The H1 results will have come as a surprise to those expecting Next 15 to deliver the earnings shock we have seen from others in the sector and which the share price has been clearly discounting. Whilst the trading environment in H1 has been tough; Next 15 has navigated this period well. The trading outlook for H2 is not without its challenges but the breadth of the Next 15 portfolio is holding it in good stead, with three of the group’s four segments still delivering positive organic growth.

What is driving this resilience? Next 15 is not a single business that is solely reliant on a single revenue driver (ie client advertising budgets). Instead, Next 15 is a portfolio of highly specialist, niche agencies that are each focused on solving specific client problems. The group has been able to weather disruptions to client spending patterns within individual sectors such as technology. Interestingly, post the Engine acquisition, the group is now more diverse in terms of client vertical. We believe this has not been fully factored by the market.

We continue to see the current FY24E PE of 7.7x as too low for a growth company with Next 15’s track record.

3rd October 2023

Iain Daly

id@radnorcp.com
+44 (0) 203 897 1832

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

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

- **H1 results:** Reported revenue growth of +5% and organic revenue growth –1% had already been flagged in prior updates. However, like for like margins have remained resilient. Net debt of £21.6m was driven by earn out payments being settled in cash not shares and also working capital timing.
- **Resilient outlook:** This has not been an easy trading period, yet Next 15 has delivered a solid outcome, especially around margins. Three of the four segments continue to deliver positive organic growth despite the macro headwinds. Overall, the trading outlook is solid, although there do remain risks about client win lead times. We have taken a cautious view and are dialling back our FY24 revenue and PBT by -3%.
- **Core investment case has become clouded:** The combination of weak macro, Mach49 misunderstanding and a post M&C hangover have all clouded the core investment case. The resilience of the group’s operating performance should help clarify. Next 15’s portfolio of niche, specialist agencies are well positioned to maintain a track record of sector leading growth in a market where return on investment is the critical metric.
- **Valuation overdiscounting earnings risks:** We see the current valuation heavily discounting, for some time now, a material earnings downgrade that has yet to appear. Given the solidity of the trading outlook, we continue to see a significant valuation opportunity.

Y/E January, £m	Sales	PBT adj	EPS (p)	Div (p)	Net Cash	Fiscal PER x	Yield %
FY 2022A	362.1	79.3	59.7	12.0	35.7	10.7	1.9
FY 2023A	563.8	112.5	80.4	14.6	26.1	8.0	2.3
FY 2024E	584.9	122.4	83.7	16.7	17.9	7.7	2.6
FY 2025E	631.7	133.7	96.4	19.3	27.9	6.7	3.0
FY 2026E	688.4	146.6	105.6	21.1	97.0	6.1	3.3

Source: Radnor Capital Partners

H1 results – Year ended January 2024:

Below are the key headlines from the H1 FY24 results:

- Net revenue +5% YoY to £286.4m. The company has provided a revenue bridge between FY22 and FY23
 - **Organic** revenue growth -1% (-£2.9m). Although the headline organic number for the group is negative, the decline was entirely driven by the Customer Engage segment (-6.4%), with the other three segments all delivering low to mid single digit percentage organic growth.
 - **Acquisitions** +4% (+£11.9m). Mostly small add-ons to subsidiary agencies and a full contribution from Engine compared to the comparative period.
 - **FX** +1% (+£3.4m).

- Adjusted EBIT -7% YoY to £57.0m with adjusted EBIT margins -250 basis points to 19.9% (
 - The primary margin variance YoY was the timing impact of the initial Mach49 major contract win revenues being recognised in H1 FY23 before the Mach49 cost investment to support the contract had taken place. This boosted H1 FY23 EBIT by £5m.
 - This was fully disclosed at both the H1 FY23 results and again at the FY23 results, so should not come as a surprise the market. If we adjust back the FY23 H1 EBIT by £5m to make a proper like for like comparison we can see H1 FY24 EBIT actually increased +1% YoY with H1 FY23 like for like EBIT margins of 20.9%.
 - Against the context of a difficult organic revenue growth environment for the Customer Engage segment, we see a 100 basis point like for like margin decline as a solid outcome. This has been driven as much by revenue growth in the remaining segments as well as better than expected cost savings from the Engine acquisition and tight control of central costs, which reduced by £1.9m YoY (-15%).

- Adjusted PBT -8% YoY to £55.6m – would have been close to flat but for the Mach49 H1 FY23 impact discussed above.

- Statutory profit before tax of £24.3m (H1 FY23 statutory loss of £8.5m) after a reduced number of adjusting items
 - £2.4m credit (H1 FY23 £29m charge) from a reduction in the estimate of future contingent consideration and share purchase obligations
 - £13.1m (H1 FY23 £11.7m) charge driven by the unwinding of the discount applied to future earn out payments
 - £2.9m charge (H1 FY23 £6.7m) relating to employment linked acquisition payments
 - £5.2m charge for employee incentive schemes (H1 FY23 £0.4m)

- No property impairment charges (H1 FY23 £3.9m)
 - £1.4m of restructuring costs (H1 FY23 £3.1m)
 - £0.2m of deal costs (H1 FY23 £2.7m)
- Period end net debt £21.6m (FY23: net cash £26.1m), was driven primarily by the payment of £52.6m of acquisition related liabilities which were settled in cash rather than shares and the payment of staff bonuses accrued to FY23.

Against the context of a tough H1 for organic revenue growth, especially in the Customer Engage segment (which accounted for 46% of group revenue in H1 FY24) the resilience of group EBIT margins are a stand-out feature in our view, especially when considered against the backdrop of material margin downgrades delivered by sector peers during this period.

We believe there are a number of features that lie behind this resilience.

- **Group structure.** A fundamental feature of Next 15 is that the individual businesses that make up the group portfolio are just that; individual businesses. In effect, Next 15 is an aggregated group of niche, specialist businesses that focus tightly on solving very specific client problems. The PLC centre exists to support and, where possible, secure scale efficiencies that would not normally exist to the businesses on a standalone basis (ie property, legal, accounting, treasury etc). However, each individual business still retains their own CFO and are responsible, and accountable, for their own budgets and forecasting. Elsewhere in the sector, this cost layer is removed and managed solely from the centre. We believe this local accountability provides Next 15 with a better handle on margin dynamics within the group and the ability to react more quickly as those dynamics change.
- **Property savings.** The pandemic proved to be both a top and bottom line catalyst for Next 15. Post pandemic the group has been able to rationalise a large portion of its global property portfolio. The net effect has been to provide a 300 basis point boost to EBIT margins, a structural rather than a temporary saving.
- **Engine acquisition.** Next 15 flagged the potential for material cost savings when the Engine acquisition was first announced. These have been exceeded and now amount to £4m on an annualised basis. Above and beyond the cost savings from reducing the Engine centralised cost base, Next 15 has further consolidated their London property portfolio with the group now predominantly operating out of the Engine offices. Within the Engine portfolio, the Transform business has turned around quicker than originally anticipated and is now generating mid teen EBIT margins rather than the mid single digit margins of recent years.

Below, we run through the key divisional headlines:

Engage – 46% group revenue; organic revenue growth -6%

Headline revenue -2% to £131.1m (organic growth -6%). Segment EBITA margins improved 10 basis points to 20.2%.

The story of the half year was a challenging organic growth environment but a much stronger margin performance than many would have anticipated. Customer Engage is the largest segment within the group and represents the broadest church in terms of business type and client served. Although there are a number of more dynamic, data driven

business within this segment, it is the part of the group that is most exposed to the more traditional time and materials based agency economic model.

The early part of the year saw the US tech industry endure a difficult period as the post Covid tech boom waned. Both pressure on client discretionary expenditure as well as lengthened lead times on new business win commencement played a part in the 6% organic revenue decline.

Business Transformation – 27% group revenue; organic revenue growth +6%

Headline revenue **+13%** to £76.2m (organic growth **+6%**). Segment EBITA margins decreased 970 basis points to 29.7%.

This segment is now lapping the initial contribution from the Mach40 contract win, so historic growth rates were always going to be impossible to sustain. As we have already discussed, H1 FY23 segment EBIT margins were inflated by the timing of the initial revenue contribution which flowed through the P&L at a 100% margin. The margins reported in H1 FY24 reflect a more normalised level.

Beyond Mach49, which continues to deliver as expected, the real story within this segment is the Transform business that was acquired as part of the Engine acquisition. This business has bought an exposure to UK public sector clients that is a new angle for Next 15. The Transform business had a good H1, delivering a number of expanded client engagements and a material improvement in margins.

The other businesses within Business Transformation (the PE focused Palladium and the US capital markets focused Blueshirt Group) had a more difficult period but offer upside potential should their respective markets come back to life.

Customer Delivery - 18% group revenue; organic revenue growth +2%

Headline revenue **+6%** to £51.8m (organic growth **+2%**). Segment EBITA margins decreased -490 basis points to 27.3%.

This segment was the stand out performer for the group during the pandemic as data led approaches to lead and revenue generation replaced more traditional, face to face client marketing channels. Whilst post Covid normalisation has bought some of the traditional channels (ie trade shows) back into the mix, the significantly higher and more visible return on investment offered by Next 15 data businesses such as Activate and Shopper Media Group have seen them retain much of the market share won during the pandemic.

Shopper Media is worth mentioning specifically as it has continued to win new, material retail clients (including their first major retailer in the US). SMG's business model, based on a base retainer fee that covers costs and then a shared upside model means that short term margins can be diluted but offers material margin upside as client relationships mature and the full benefits of the SMG retail media proposition come into evidence.

Customer Insight - 10% group revenue; organic revenue growth +2%

Headline revenue **+10%** to £27.3m (organic growth **+2%**). Segment EBITA margins declined -410 basis points to 17.2%.

Customer Insight represents, at its core, the online market research component of the Next 15 group offer. This segment has the highest proportion of B2C customer exposure (whereas the rest of the group is predominantly B2B).

Overall, this segment had a solid H1. Savanta, the majority of the segment, continues to see organic growth and is steadily expanding its presence in the USA. Savanta also saw a number of small bolt-on acquisitions through the period, some of which were margin dilutive. The smaller Planning-inc business is undergoing a significant investment phase at the moment as it seeks to leverage a number of AI led opportunities.

Outlook Commentary and changes to Radnor estimates

We note the “broadly in line with expectations” commentary in the outlook statement. At the headline level, we marginally reduce (-3%) our FY24E revenue and PBT estimates.

- We believe Next 15 is navigating well what has been a difficult environment. However, the mood music around client spending patterns does feel more positive than earlier in the year and it is clear that Next 15 businesses are still able to win new clients as well as expanded relationships with existing clients. The unresolved short term issue is the timing of project commencement and there could still be a broader range of outcomes for the full year than would normally be the base. This is the key driver behind our revenue caution.
- We feel more confident around margin resilience, which we see as a stand-out feature of Next 15 compared to some of its UK peers. We see this as partly driven by the Next 15 group structure and individual business unit accountability, but also by the fact that most of the group businesses are not mass market, generic marketing agencies where pressure on fees and margins can be more pronounced.

Below, we provide further detail on our estimate revisions.

Figure 1: Radnor estimate revisions

£m	FY23A	Previous		New		Revision, %	
		2024E	2025E	2024E	2025E	2024E	2025E
Customer Engagement	275.0	275.0	288.7	264.0	277.2	-4%	-4%
Customer Delivery	102.1	113.3	127.5	108.2	121.7	-4%	-5%
Customer Insight	52.0	55.1	59.5	57.7	62.3	+5%	+5%
Business Transformation	134.8	160.4	176.4	155.0	170.5	-3%	-3%
Revenue	563.8	603.8	652.1	584.9	631.7	-3%	-3%
Customer Engagement	55.4	59.9	63.8	57.5	61.3	-4%	-4%
Customer Delivery	30.2	35.4	40.2	33.8	38.4	-5%	-5%
Customer Insight	11.0	11.8	12.8	12.4	13.4	+5%	+5%
Business Transformation	43.9	48.1	50.3	46.5	48.6	-3%	-3%
Central Overhead	-26.4	-27.2	-28.0	-25.1	-27.2	-8%	-3%
EBITA	114.2	129.2	138.6	125.1	134.4	-3%	-3%
- margin %	20.2%	21.4%	21.3%	21.4%	21.3%		
Adj. PBT	112.5	125.8	138.3	122.4	133.7	-3%	-3%
Adj. EPS (p)	80.4	87.3	97.2	83.7	96.4	-4%	-4%
Dividend (p)	14.6	17.5	19.4	16.7	19.3	-4%	-1%
Net Cash (Debt)	26.1	39.9	56.1	17.9	27.9		

Source: Radnor

Valuation Remains Compelling

In Figures 2 & 3 below we show the 2 year forward PE multiple for both Next 15 and the Agency peer group in absolute and relative terms.

Figure 2: 1 year forward PE

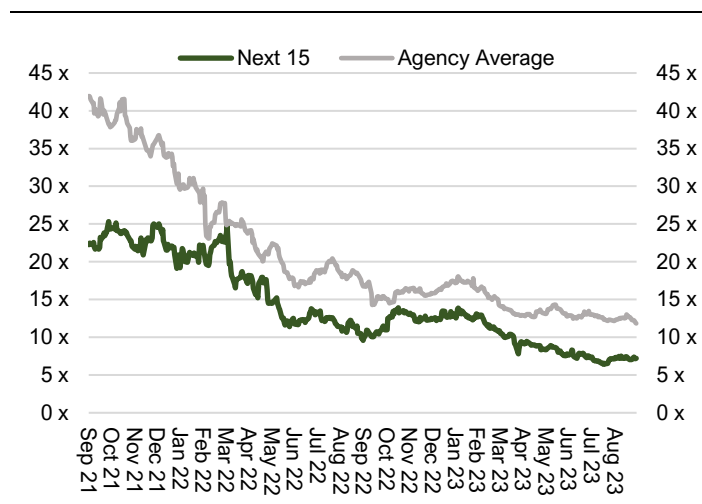
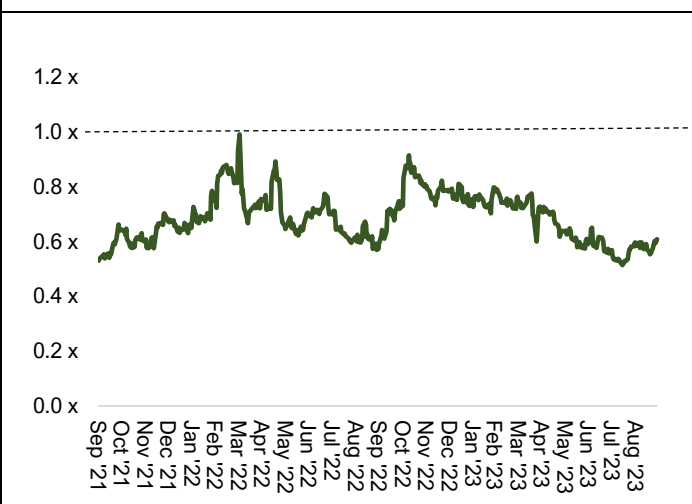


Figure 3: 1 year forward PE relative to Peer Group



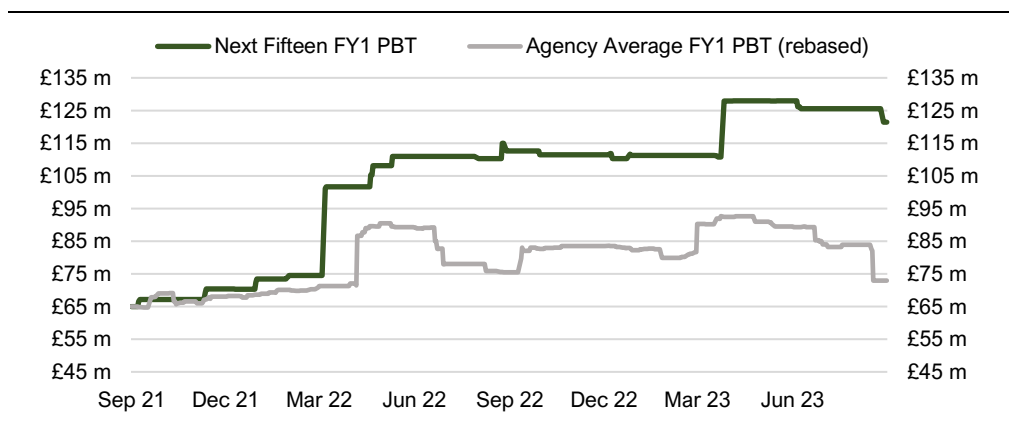
Source: FactSet, Radnor

Since the start of 2023, the Next 15 share price has come under sustained pressure (YTD -29% vs +5% for the FTSE All Share). We have also seen the Next 15 PE discount to the UK Agency peer group widen out to c.40% despite a materially better earnings outlook and estimate momentum than its peers.

We believe the market has been heavily discounting a material downgrade that has not manifested itself. Next 15 has had numerous opportunities to reset expectations, yet the robust performance of the business has always come through. Although we have marginally reduced our FY24 expectations, this nowhere near the same level of downgrade witnessed by others in the peer group. Not only is Next 15 not meaningfully exposed to UK advertising spend, but also enjoys a breadth of client and internal business model diversification that is clearly providing a welcome degree of resilience.

To put this relative resilience into its full context, below in Figure 4, we show the evolution of Next 15's FY24 adjusted PBT consensus estimate against the same metric for the Agency peer group (rebased to Next 15).

Figure 4: Next 15 FY24 adj PBT vs Agency peer group (rebased to Next 15)



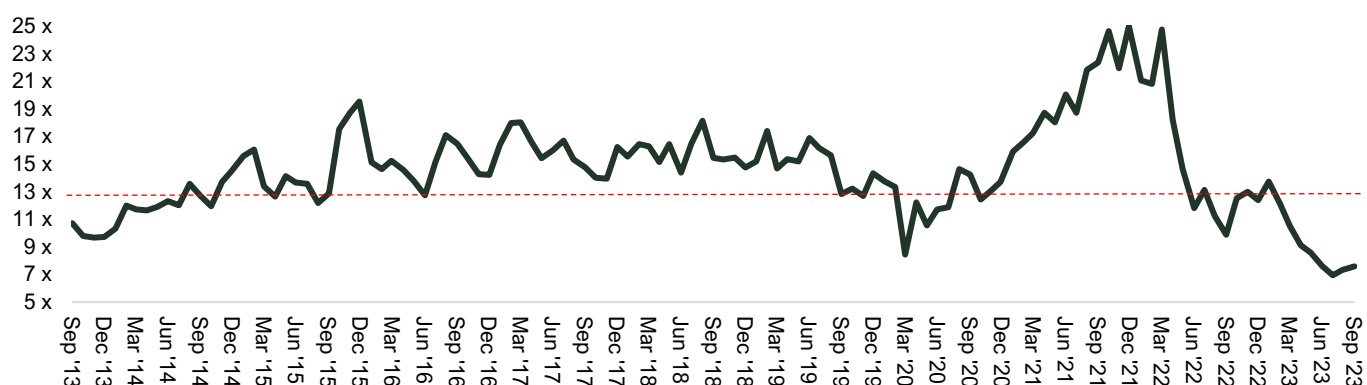
Source: FactSet, Radnor

Two key points stand out from Figure 4, which in our view capture the essence of how disconnected Next 15's current valuation appears relative to its peer group.

- Firstly, despite some marginal downgrades since April 23 (FY24 consensus PBT expectations have declined by 6% over the last six months), this consensus stills stands some **+86%** above where it was back in September 2021
- For the peer group, not only is the equivalent PBT expectation only up **+12%** from September 2021, this has declined by **-23%** over the last six months.

We believe these results and the robustness of current trading outlook should enable the market to revisit whether a sub 8x PE is a realistic assessment of value for a business with such a proven and well established growth track record.

Figure 5: Next 15 FY2 PE over the last 10 years (average in red)



Source: FactSet, Radnor

In Figure 5 above we show the 2 year prospective PE multiple for Next 15 over the last 10 years. We can see that the current level is now the lowest for 10 years, even lower than the pandemic trough in March / April 2020.

Next 15 Group PLC

Iain Daly
+44 203 897 1832
id@radnorcp.com

Price (p): 641 p
Market Cap: 626 m
EV: 600 m

PROFIT & LOSS

Year to 31 January, £m	FY21	FY22	FY23	FY24e	FY25e	FY26e
Customer Engagement	166.5	187.6	275.0	264.0	277.2	296.6
Customer Delivery	49.6	80.0	102.1	108.2	121.7	137.0
Customer Insight	33.1	42.1	52.0	57.7	62.3	67.3
Business Transformation	17.7	52.5	134.8	155.0	170.5	187.5
Group Net Revenue	266.9	362.1	563.8	584.9	631.7	688.4
Customer Engagement	36.9	40.4	55.4	57.5	61.3	65.8
Customer Delivery	15.2	28.5	30.2	33.8	38.4	43.1
Customer Insight	4.9	9.0	11.0	12.4	13.4	14.5
Business Transformation	3.9	15.2	43.9	46.5	48.6	53.4
Head Office	(11.4)	(13.8)	(26.4)	(25.1)	(27.2)	(29.6)
EBITA - Adjusted	49.5	79.3	114.2	125.1	134.4	147.3
Associates & JV's	0.4	0.2	-	-	-	-
Net Bank Interest	(0.8)	(0.3)	(1.6)	(2.7)	(0.7)	(0.7)
PBT - Adjusted	49.1	79.3	112.5	122.4	133.7	146.6
Non Operating Items	(37.2)	(40.4)	(48.3)	(34.7)	(30.0)	(30.0)
Other Financial Items	(13.2)	(119.0)	(54.1)	(26.5)	(10.0)	(10.0)
PBT - IFRS	0.1	(79.1)	10.1	61.2	92.5	105.4
Tax	(2.6)	14.5	(7.1)	(16.5)	(25.0)	(28.5)
Tax - Adjusted	(9.9)	(17.2)	(26.3)	(33.1)	(33.4)	(36.6)
Tax rate - Adjusted	20.2%	21.6%	23.3%	27.0%	25.0%	25.0%
Minority interests	1.0	3.6	1.4	1.7	2.4	2.6
No. shares m	89.4	92.4	97.6	98.8	98.8	98.8
No. shares m, diluted	93.8	98.1	105.7	104.6	101.6	101.6
IFRS EPS (p)	(3.9)	(73.8)	1.7	43.4	66.0	75.2
Adj EPS (p), diluted	40.7	59.7	80.4	83.7	96.4	105.6
Total DPS (p)	7.0	12.0	14.6	16.7	19.3	21.1

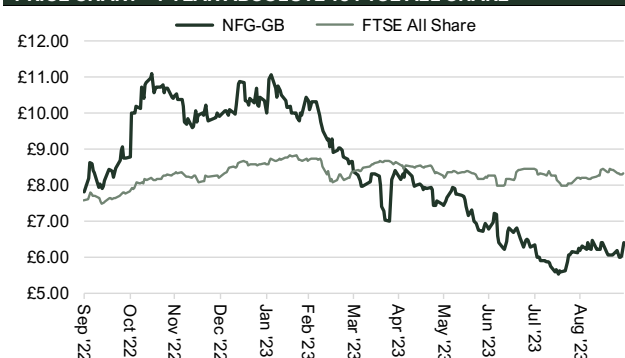
CASH FLOW

Year to 31 January, £m	FY21	FY22	FY23	FY24e	FY25e	FY26e
Net Profit: (add back)	(2.5)	(64.6)	3.0	44.7	67.5	76.9
Depreciation & Amortisation	28.0	28.8	37.2	37.0	39.0	40.0
Net Finance costs	15.4	120.3	57.1	30.4	11.9	11.9
Tax	2.6	(14.5)	7.1	16.5	25.0	28.5
Working Capital	6.6	0.2	(24.4)	(11.9)	(9.9)	(6.1)
Other	24.3	19.6	15.1	8.8	6.3	6.3
Cash from Ops	74.3	89.8	95.2	125.5	139.8	157.5
Cash Tax	(8.4)	(14.1)	(20.3)	(24.8)	(25.0)	(28.5)
Tangible Capex	(2.0)	(3.1)	(3.5)	(4.0)	(4.0)	(4.0)
Intangible Capex	(2.1)	(2.7)	(3.5)	(4.0)	(4.0)	(4.0)
Free Cashflow	61.8	69.9	67.9	92.7	106.8	121.1
Dividends	(0.7)	(12.4)	(15.3)	(17.3)	(20.6)	(23.0)
Acquisitions & Inv.	(23.6)	(24.0)	(104.9)	(77.0)	(67.3)	(20.0)
Financing	(37.7)	(1.1)	38.6	(10.7)	(9.0)	(9.0)
Net Cashflow	(0.2)	32.4	(13.7)	(12.2)	10.0	69.1
Net Cash (Debt)	14.0	35.7	26.1	17.9	27.9	97.0

BALANCE SHEET

Year to 31 January, £m	FY21	FY22	FY23	FY24e	FY25e	FY26e
Intangibles	163.8	183.1	274.1	290.1	291.5	277.2
P,P+E	8.9	7.5	10.9	10.9	10.2	9.2
Tax Asset & Other	43.4	75.6	97.2	94.2	91.2	88.2
Total Fixed Assets	216.1	266.2	382.1	395.1	392.9	374.5
Net Working Capital	(48.6)	(51.6)	(76.8)	(74.0)	(59.0)	(78.8)
Capital Employed	167.5	214.5	305.3	321.1	333.8	295.7
Earn Out Liabilities	(64.6)	(188.8)	(217.0)	(180.0)	(110.0)	(85.8)
Net Funds	14.0	35.7	26.1	17.9	27.9	97.0
Net Assets	116.9	61.5	114.4	159.0	251.7	306.9

PRICE CHART - 1 YEAR ABSOLUTE vs FTSE ALL SHARE



Source: FactSet

SHAREHOLDERS

	% of ord. Share capital
Octopus Investments	12.0%
Liontrust Investment Partners	11.3%
Aviva Investors	10.5%
Slater Investments	6.6%
Directors	5.5%
BlackRock	5.4%
abrdn	5.0%
JPMorgan AM	3.7%
	60.0%

Announcements

Date	Event
September 2023	H1 results
April 2023	Final results
January 2023	Trading update
September 2022	H1 results
May 2022	Recommend Offer for M&C Saatchi
March 2022	Engine acquisition & £50m placing
February 2022	Mach49 \$400m contract win

RATIOS

	FY22	FY23	FY24e	FY25e	FY26e
RoE	95.3%	74.2%	55.1%	38.9%	35.0%
RoCE	37.1%	37.4%	38.9%	40.3%	49.8%
Asset Turnover (x)	0.7x	0.7x	0.7x	0.6x	0.5x
NWC % Revenue	14.3%	13.6%	12.6%	9.3%	11.4%
Op Cash % EBITA	113.2%	83.4%	100.4%	104.0%	106.9%
Net Debt / EBITDA	-	-	-	-	-

VALUATION

Fiscal	FY22	FY23	FY24e	FY25e	FY26e
P/E	10.7x	8.0x	7.7x	6.7x	6.1x
EV/EBITDA	7.6x	5.3x	4.8x	4.5x	4.1x
Div Yield	1.9%	2.3%	2.6%	3.0%	3.3%
FCF Yield	11.7%	11.3%	15.5%	17.8%	20.2%
EPS growth	46.6%	34.5%	4.2%	15.1%	9.6%
DPS growth	71.4%	21.7%	14.7%	15.1%	9.6%

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Radnor Capital Partners Ltd
1 King Street
London
EC2V 8AU

www.radnorcp.com

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