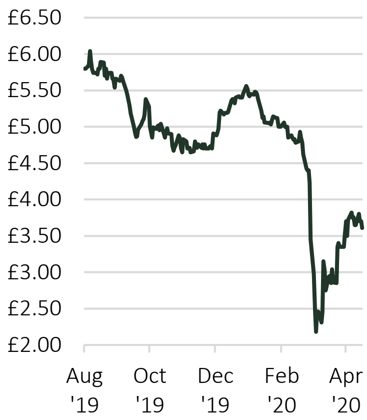
Next Fifteen Communications Group PLC

NFC | AIM | Media | 380p |£334m

FY20 final results – The calm before the storm

1 Year Chart



Next Fifteen's FY20 final results did not contain any material surprises, following the detailed trading update in March. Headline revenue growth was 11% and adjusted PBT grew 10%. Beneath the surface; we saw a small decline in organic revenue growth (well flagged) more than offset by positive contributions from recent acquisitions. Critically, Next Fifteen exited FY20 with a strong balance sheet (net debt less than 0.2x EBITDA) and significant financial headroom (we estimate c.£35m).

Next Fifteen did not shy away from the severity of the current crisis, even as far as to give an indication of the potential organic revenue impacts (-5%.to -25%) for the two thirds of the group most likely to be exposed. The key point here being that at least one third of the group will be largely unaffected and the effects elsewhere will vary considerably by agency specialisation and client industry exposure. After factoring acquisition contributions and cost reduction measures, we believe this will translate into a flat revenue performance in FY21 and a 5% decline in YoY adj. PBT. All things considered, this feels like a solid outcome from a business differentiated by the quality and positioning of its client base.

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.

- **FY20 final results:** Despite the 11% headline revenue growth; investors would have been focused on the 2% organic revenue decline. Outside of the two specific agencies (Beyond and Archetype), group organic revenue was a healthy 10%, more in keeping with Next Fifteen's well-established organic growth track record. There were no surprises elsewhere in the numbers other than a better than expected cashflow performance and net debt outcome.

- **Trading outlook:** Clearly there is much that is outside the company's immediate control but the combination of the profit recovery at Beyond and a broad range of cost reduction measures should see Next Fifteen come through FY21 in relatively good shape, despite the inevitable revenue impacts. We have revisited our estimates and have made a number of revisions, reflecting the broad indications management have given.

- **Opportunities post Covid-19:** Management are clearly looking beyond the immediate Covid-19 impacts. There is no doubt that front foot opportunities will exist for a well-capitalised group like Next Fifteen. Deeper structural trends around the adoption of new technology and ways of working will, undoubtedly be accelerated, which will play to Next Fifteen's strengths and positioning.

4th May 2020

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YE - January	Sales, £m	PBT adj, £m	EPS (p)	Div (p)	Net Cash, £m	Fiscal PER x	Yield %
FY 2019A	224.1	36.0	33.1	7.6	-5.2	11.5	2.0
FY 2020A	248.5	40.2	34.8	2.5	-9.4	10.9	0.7
FY 2021E	*248.7*	*38.0*	*32.6*	*6.5*	*0.5*	*11.6*	*1.7*
FY 2022E	*261.7*	*42.0*	*35.9*	*8.0*	*23.0*	*10.6*	*2.1*
FY 2023E	*277.1*	*46.9*	*40.0*	*8.9*	*46.4*	*9.5*	*2.3*

Source: Radnor Capital Partners

Final Results – Key Highlights

Next Fifteen has released final results for the year ended 31 January 2020. Key headlines are as follows:

- Reported net revenue growth **+11%** to £248.5m after M&A contributions and FX impacts;

- Headline, organic revenue decline of **-2%** reflecting the strong contribution from recently acquisitions and the previously flagged challenges at **Beyond** and **Archetype**.

  - Excluding the drag from Beyond and Archetype; organic growth across the remainder of the group portfolio was +10.5%, with the **M Booth**, **Twogether**, **ODD** and **Activate** agencies highlighted as stand-out performers

  - **Beyond** has been on a recovery path following a challenging year in 2019, which saw a couple of larger client losses and a scaling back of the Google relationship. Although cost reductions have been a priority; Beyond is a high skill; digital user experience specialist and cutting costs in the wrong place can be damaging in the long term. Getting the balance of this right has undoubtedly been tricky and has taken longer than originally anticipated. However, Beyond would now appear to be on the mend and is trading profitably with a number of good new client wins and a return to growth with Google.

  - **Archetype** is the new brand for two of Next Fifteen's US agencies (Bite and Text100) which were merged at the end of 2018. The rationale behind the merger had been to revitalise what had been the largest, but lowest growth, US business and has always been positioned as a two to three year recovery story as the business mix evolves away from lower margin, more traditional communications work (albeit with a tech heavy client base) to a higher margin, digitally focused mix.

- Alongside the traditional geographic revenue and EBIT analysis; Next Fifteen now provides a breakdown by business type:

  Brand Marketing (54% of group revenue); reported revenue **+1.4%** to £135.0m; organic revenue decline **-5.7%**. Excluding the impact of Archetype, organic revenue growth would have been **+2.8%**. Reported EBIT margins were up 60 basis points YoY to 22.8%.

  Creative Technology (28% of group revenue); reported revenue growth +1% to £68.4m; organic revenue decline -2.1%. Excluding the impact of Beyond, organic revenue growth would have been +20.3%. Reported EBIT margins were 11.8%, down 320 basis points YoY, driven almost entirely by **Beyond,** which is now trading profitably albeit at a reduced revenue line.

  Data & Analytics (18% of group revenue); reported revenue growth +94.1%, reflecting the contribution from recent acquisitions. Organic revenue growth came in at +19.3%. Reported EBIT margins reduced slightly YoY but remained the highest in the group at 28.2%.

- Looking at the group in the more traditional geographic breakdown:

North America (51% of group revenue); reported revenue **+8.2%** to £127.6m; organic revenue decline **-4.6%.** The organic revenue performance was impacted significantly by both Beyond and Archetype, with organic revenue growth +12.7% when Beyond and Archetype are excluded. However, despite the revenue impacts of these two agencies, North American reported EBIT margins showed a strong recovery from FY19, up 260 basis points to 21.3% and is now the highest North American EBIT margin since FY15. This material margin recovery reflects both the impact of higher margin acquisitions (ie Activate) but also a higher margin mix within Archetype and the benefits of Archetype cost reductions.

UK (39% of group revenue); reported revenue growth +16.6% to £97.4m; organic revenue was marginally positive +0.3% and would have been +7.9% excluding Beyond and Archetype. Reported EBIT margins were down 390 basis points YoY but still came in at 20.6%. The UK was most impacted in profit terms by Beyond, which more than offset a positive performance from the digital research agency, Savanta and digital creative agencies such as Twogether and ODD.

Europe & Asia Pacific (10% of group revenue); reported revenue growth (similar to organic) was +3.9%, reflecting a solid year. Margins were also broadly stable, marginally up in Europe and marginally down in Asia Pacific.

- Adjusted EBITA (post interest on IFRS16 lease liabilities) was £40.9m, +10.6% YoY, with margins broadly flay YoY at 16.4%. Group central costs fell in both absolute terms and as a proportion of sales (-50 basis points to 3.6%.)

- Adjusted PBT came in marginally ahead of expectations at £40.2m, +11.8% and adjusted diluted EPS came in at 34.8p, +4.9% YoY.

- Adjusting items excluded from Adjusted PBT included;

  - Physical restructuring expenses £4.6m (FY19: £4.4m)
  - Goodwill amortisation of £12.1m (FY19: £9.0m)
  - Share based payments and employment linked acquisition payments of £5.4m (FY19: £2.3m)
  - Unwinding of discount and change in future earn out liabilities £11.6m (FY19: £0.9m).

- FY20 was a solid year from a cash-flow perspective with year-end net debt coming in lower than expected at £9.3m. Against headline EBITDA of £56.8m, this represents a net debt / EBITDA multiple of 0.17x and underlines the balance sheet flexibility Next Fifteen enjoys.

  - Operating cash-flow pre working capital was £47.8m, an improvement of £10.5m over FY19
  - Working capital management continued to be tight with £1.7m being released from working capital compared to £1.2m in the prior year.
  - Tangible and intangible capital expenditure was also down £3m in the year to £5.3m, reflecting prior year investments.
  - M&A related cash outflows totalled £24.1m, down on the £28.5m in FY19, and broke down into £18.5m spent on initial consideration and £5.6m of deferred earn out payments.

Trading Outlook & Estimate Revisions: PBT -8% for FY 2020, -6% for FY 2021

Further to Next Fifteen's initial update to the market in response to the Covid19 outbreak (30th March, link here), the final results have seen more detail from the company on the immediate outlook;

- **Revenue** – Although Next Fifteen has yet to see any material deterioration in trading; this situation is unlikely to last and management have been clear that they anticipate a number of their agencies to come under pressure, although the outcomes are likely to vary considerably across the group.

  Since the March update, a number of broader trends have become clearer. One of the key differentiating factors for Next Fifteen over the years has been the technology bias to the client base and this is likely to show through in how the group agencies fare in the current environment.

  In the broadest sense; the clearest trend has been between clients that are predominantly business facing and those that are consumer facing; with the former likely to prove more resilient.

  Given the pace of the moving parts and the uncertainty around timings of lockdown loosening in both the US and the UK, management are not in a position to be more explicit with guidance. However, they have provided a broad-brush indication that for approximately two thirds of the group, the negative revenue impact could range between 5% and 25%, impacting primarily in Q2 to Q3 (ie, May through to October). The remaining third of the group is unlikely to be materially affected.

  Looking at the Next Fifteen customer base purely by industry vertical shows c.57% of revenue accounted for by the Software, Technology Hardware, Telecommunications and Life Science sectors. This is the historic heart of the group and where the largest clients sit (ie, Facebook, Google, Amazon, Dell, Lenovo, IBM, Sprint, VMWare, Here, Intuit, Microsoft and Salesforce). Although the range of services provided to these clients vary across B2B and B2C channels, we see the revenue impacts as being less pronounced across these names.

  We would also note that the group is becoming increasingly diversified from a client concentration perspective. In FY19, Next Fifteen had 57 clients that generated in excess of $1m each in net revenue. In FY20, this number had increased to 66. In terms of the proportion of group net revenue accounted for by the 20 largest clients; FY20 saw this come in at 30% compared to 32% in FY19.

  Consumer discretionary focused clients (Food & Beverage, Fashion & Beauty, Hotels & Transport) account for c.20% of revenue. Professional Services and Financial Services accounts for c.13% of group revenue. From a client industry perspective, we see the largest Covid-19 impacts in the consumer discretionary spend bucket, where clients are likely to come under material pressure.

- **Cost and cash actions** – Although the company has not broken out the absolute quantum of the various cost reduction and cash preservation actions that have been taken; they are extensive and include:

  – Board and senior executive pay reductions;

  – Reduced near term capital investment and discretionary operating expenditure;

– Full participation in any relevant government support mechanisms; primarily staff furloughing and tax deferrals;

– Final dividend has been suspended, although it has been highlighted that the group intends to resume dividend payments as soon as the trading environment normalises.

- **Balance Sheet & Liquidity** - Next Fifteen's balance sheet was already in good shape. Net debt at the 31st January was £9.3m, comprising gross cash balances of £28.7m; £10m outstanding on a term loan (repayable in £5m tranches by Dec 2021); and finally £28m drawn down against the RCF, which has a £40m limit (£12m of immediate headroom). Next Fifteen also has a $7m US overdraft facility. After netting off the £10m term loan against the gross cash balance, we estimate Next Fifteen has c.£35m of immediately available liquidity.

The covenant test for the RCF is maintaining net debt to EBITDA at less than 1.75x and at the 31st Jan 2020 this stood at less than 0.2x. If earn out obligations are considered, this multiple rises to 2.5x. Even if we assume that all future earns outs crystallise immediately (unlikely as they are currently phased over 5 years out to 2026), then the FY21 net debt to EBITDA multiple would rise from 0.2x to 1.0x; still well below the 2.5x limit.

Even on our revised estimates (see below), we see Next Fifteen generating £43.9m of EBITDA in FY21 and, in the absence of additional M&A, net positive cashflow resulting in a marginal net cash position of £0.5m in FY21.

Earn out payments are the largest "open" liability on the Next Fifteen balance sheet beyond the existing bank facilities. These earn out liabilities are carried in the balance sheet at the best prevailing estimate of the likely future performance of the businesses in question. As at the 31st January, the formal balance sheet, the cash element of these earn out liabilities totalled £48.9m and are phased over the next six years. Clearly, the outlook has changed materially since the 31st January and the group as provided a detailed update. The revised earn out liability as at the end of April now stands at £35.9m, a reduction of 27%.

Figure 1: Changes to future earn out cash payments

£m	31st Jan 2020	Revised - April 2020	% Change
FY 2021	16.3	5.2	-68%
FY 2022	8.5	6.9	-19%
FY 2023	9.6	9.6	
FY 2024	6.8	6.5	-4%
FY 2025	5.7	5.7	
FY 2026	2.0	2.0	
	48.9	**35.9**	

Source: Next Fifteen

In terms of our forward estimates; we are reducing both our revenue and EBIT expectations in-line with the indications provided by the company.

- We assume the worst impacts will be experienced during the company's fiscal Q2 and Q3 with a degree of recovery in Q4;

- The organic revenue impacts in the US will be partially mitigated by sterling weakness relative to the dollar;
- Fully annualised contributions from strongly performing new acquisitions will also partially offset the likely organic revenue declines in those more established group agencies with significant consumer facing clients;
- Beyond is now trading profitably, albeit on a reduced revenue line so this cost drag (a material factor in FY20) will not carry on into FY21;
- The suspension of the dividend and the reduction in near term cash earn out liabilities will provide a net cash boost of c.£10m in FY21

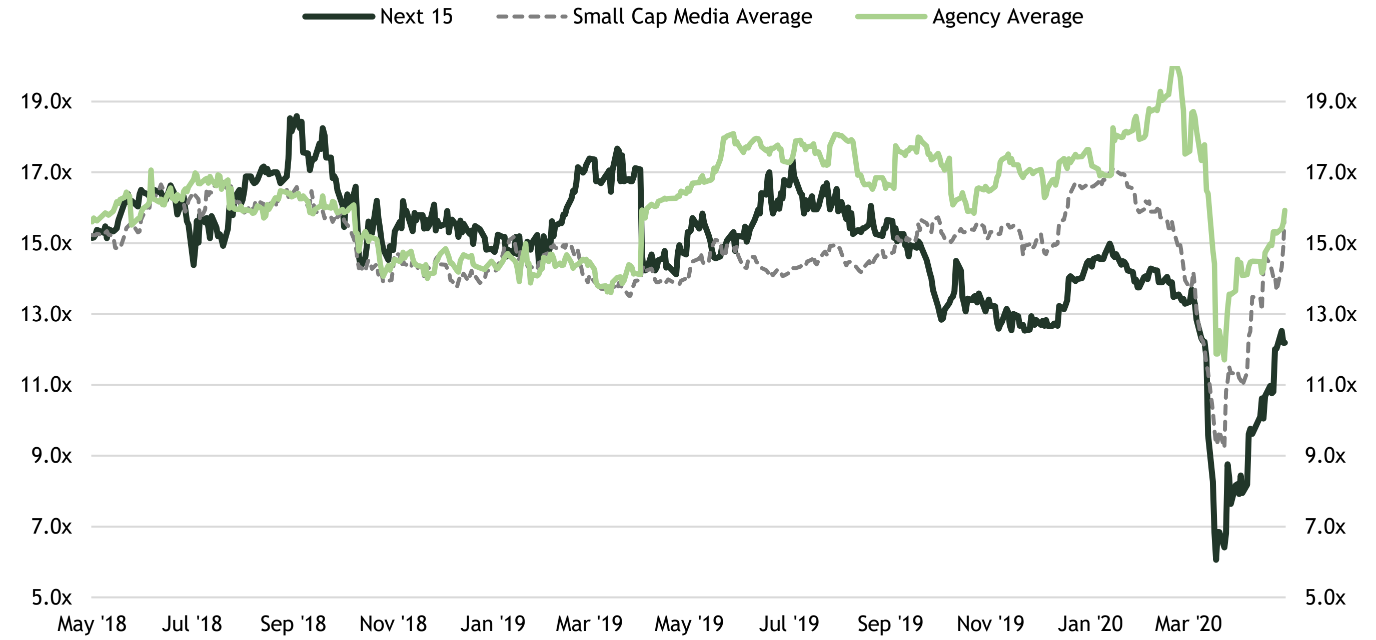
Figure 2: Radnor estimate revisions

		Previous		New		*Revision, %*	
	FY20A	2021E	2022E	2021E	2022E	2021E	2022E
Brand Marketing	135.0			132.3	137.6		
Data + Analytics	45.1			47.3	51.6		
Creative Technology	68.4			69.1	72.5		
UK	97.4	103.7	111.0	101.3	107.3	*-2%*	*-3%*
North America	127.6	138.8	145.7	123.7	129.9	*-11%*	*-11%*
EMEA	8.8	9.3	9.5	8.7	9.2	*-6%*	*-4%*
Asia Pacific	14.7	14.6	15.1	14.6	15.3	*0%*	*2%*
Revenue	**248.5**	**266.4**	**281.3**	**248.3**	**261.7**	***-7%***	***-7%***
Brand Marketing	30.8			28.6	30.3		
Data + Analytics	12.7			12.3	14.2		
Creative Technology	8.0			7.3	8.7		
UK	20.4	23.3	26.6	19.1	21.8	*-18%*	*-18%*
North America	27.2	29.1	32.1	25.1	27.3	*-14%*	*-15%*
EMEA	1.6	1.7	1.7	1.6	1.7	*-6%*	*-3%*
Asia Pacific	2.4	2.4	2.4	2.3	2.4	*-2%*	*0%*
Central Overhead	-9.1	-10.4	-11.3	-8.7	-9.7	*-16%*	*-14%*
EBITA	**42.5**	**46.1**	**51.6**	**39.4**	**43.5**	***-15%***	***-16%***
- margin %	*17.1%*	*17.3%*	*18.3%*	*15.9%*	*16.6%*		
EBITA post lease interest	**40.9**			**37.9**	**41.9**		
Adj. PBT	**40.2**	**46.0**	**51.5**	**38.0**	**42.0**	***-18%***	***-18%***
Adj. EPS (p)	**34.8**	**40.0**	**44.7**	**32.6**	**35.9**	***-18%***	***-20%***
Dividend (p)	2.5	10.0	11.5	6.5	8.0	*-35%*	*-31%*
Net Cash (Debt)	**-9.4**	**4.2**	**25.7**	**0.5**	**23.0**		

Source: Radnor

Valuation

Figure 2: Next Fifteen FY1 PE multiple vs Peers



Source: FactSet, Radnor

- We can see from the above chart that Next Fifteen has been trading at a forward PE discount against the Small Cap Agency peer group since Q1 2019. This has primarily been driven by the short term drag on organic revenue growth created by Beyond and Archetype.
- In a pre-Covid-19 world, we would have expected this discount to narrow, or even reverse, as this short term drag unwinds due to natural revenue recovery and management action on costs beginning to flow through into both reported numbers and forward estimates.
- However, the near-term impact of Covid-19 will be to depress short term earnings across the peer group regardless of internal initiatives to address specific issues. We have seen near term PE multiples contract sharply across the peer group as a result, although we do note that Next Fifteen's valuation recovery has been steeper.
- Although Next Fifteen has tried to give a broad indication as to the extent of the near term impacts, guidance has been withdrawn from across the peer group, meaning investors are largely flying blind in the short term.

Next Fifteen Communications PLC

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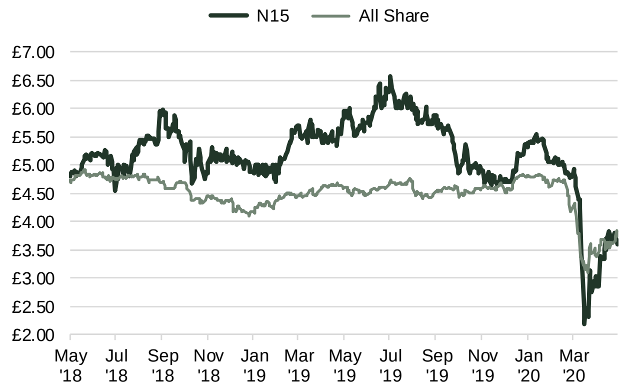
Price (p):	**380 p**
Market Cap:	334 m
EV:	339 m

PROFIT & LOSS

Year to 31 January, £m	FY18	FY19	FY20	FY21e	FY22e	FY23
UK	*58.3*	*83.5*	*97.4*	*101.3*	*107.3*	*115.9*
North America	*115.9*	*117.9*	*127.6*	*123.7*	*129.9*	*136.2*
EMEA	*7.9*	*8.7*	*8.8*	*8.7*	*9.2*	*9.4*
Asia Pacific	*14.7*	*13.9*	*14.7*	*14.6*	*15.3*	*15.6*
Group Net Revenue	**196.8**	**224.1**	**248.5**	**248.7**	**261.7**	**277.1**
UK	*13.0*	*20.5*	*20.4*	*19.1*	*21.8*	*25.5*
North America	*23.2*	*22.0*	*27.2*	*25.1*	*27.3*	*29.0*
EMEA	*0.8*	*1.5*	*1.6*	*1.6*	*1.7*	*1.7*
Asia Pacific	*2.0*	*2.2*	*2.4*	*2.3*	*2.4*	*2.5*
Head Office	*(8.9)*	*(9.3)*	*(9.1)*	*(8.7)*	*(9.7)*	*(10.5)*
EBITA - Adjusted	**30.0**	**37.0**	**42.5**	**39.5**	**43.5**	**48.3**
Associates & JV's	0.0	0.1	0.2	0.3	0.3	0.4
Net Bank Interest	(0.7)	(1.0)	(2.4)	(0.2)	(0.2)	(0.2)
PBT - Adjusted	**29.3**	**36.0**	**40.2**	**38.0**	**42.0**	**46.9**
Non Operating Items	(12.8)	(16.3)	(23.0)	(17.7)	(13.8)	(14.3)
Other Financial Items	(3.2)	(0.9)	(11.6)	(2.5)	(2.5)	(2.5)
PBT - IFRS	**13.3**	**18.8**	**5.6**	**19.3**	**27.3**	**31.7**
Tax	(4.0)	(4.3)	(2.7)	(3.9)	(5.5)	(6.3)
Tax - Adjusted	(5.9)	(7.2)	(8.0)	(7.6)	(8.4)	(9.4)
Tax rate - Adjusted	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*
Minority interests	0.7	0.6	0.6	0.7	1.0	1.1
No. shares m	74.3	79.2	85.3	85.3	85.3	85.3
No. shares m, diluted	82.1	85.0	90.9	91.0	91.0	91.0
IFRS EPS (p)	11.6	17.5	2.7	17.3	24.5	28.4
Adj EPS (p), diluted	**27.8**	**33.1**	**34.8**	**32.6**	**35.9**	**40.0**
Total DPS (p)	6.3	7.6	2.5	6.5	8.0	8.9

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	FY18	FY19	FY20	FY21e	FY22e	FY23
Net Profit: (add back)	9.3	14.5	2.8	15.5	21.9	25.4
Depreciation & Amortisation	*11.4*	*13.8*	*26.4*	*25.4*	*25.8*	*26.2*
Net Finance costs	*4.0*	*1.9*	*14.1*	*2.7*	*2.7*	*2.7*
Tax	*4.0*	*4.3*	*2.7*	*3.9*	*5.5*	*6.3*
Working Capital	(4.2)	1.2	1.7	0.4	(0.6)	(0.6)
Other	4.4	2.6	1.8	0.8	0.7	0.6
Cash from Ops	**28.9**	**38.4**	**49.5**	**48.6**	**56.0**	**60.6**
Cash Tax	(4.3)	(6.2)	(6.0)	(3.9)	(5.5)	(6.3)
Tangible Capex	(3.0)	(5.6)	(3.5)	(4.0)	(4.0)	(4.0)
Intangible Capex	(1.2)	(2.4)	(1.8)	(1.0)	(1.0)	(1.0)
Free Cashflow	**20.4**	**24.1**	**38.2**	**39.7**	**45.5**	**49.3**
Dividends	(5.7)	(6.6)	(7.5)	(3.1)	(6.6)	(7.8)
Acquisitions & Inv.	(15.4)	(29.6)	(24.2)	(16.3)	(6.9)	(9.6)
Financing	3.8	7.7	1.8	(10.5)	(9.5)	(8.5)
Net Cashflow	**3.1**	**(4.4)**	**8.3**	**9.8**	**22.5**	**23.4**
Net Cash (Debt)	(11.6)	(5.2)	(9.4)	0.5	23.0	46.4

Announcements

Date	Event
April 2020	Final results (y/e Jan 2020)
March 2020	Trading update
January 2020	Trading update
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

RATIOS

	FY19	FY20	FY21e	FY22e	FY23
RoE	25.3%	28.0%	22.9%	23.8%	24.8%
RoCE	31.7%	34.9%	30.7%	38.3%	48.4%
Asset Turnover (x)	0.7x	0.9x	0.9x	0.8x	0.7x
NWC % Revenue	17.1%	41.2%	37.4%	36.0%	34.7%
Op Cash % EBITA	103.9%	116.6%	123.1%	128.7%	125.5%
Net Debt / EBITDA	0.1x	0.1x	-	-	-

BALANCE SHEET

Year to 31 January, £m	FY18	FY19	FY20	FY21e	FY22e	FY23
Intangibles	94.8	126.1	155.4	159.7	154.6	152.2
P,P+E	13.6	15.9	14.2	15.8	15.0	13.8
Tax Asset & Other	11.7	13.0	54.7	46.7	38.7	30.7
Total Fixed Assets	**120.1**	**155.0**	**224.4**	**222.3**	**208.3**	**196.7**
Net Working Capital	(32.2)	(38.4)	(102.3)	(93.0)	(94.2)	(96.2)
Capital Employed	**87.9**	**116.6**	**122.1**	**129.3**	**114.2**	**100.5**
Net Funds	(11.6)	(5.2)	(9.4)	0.5	23.0	46.4
Net Assets	**76.3**	**111.5**	**112.7**	**129.7**	**137.2**	**146.9**

VALUATION

Fiscal	FY19	FY20	FY21e	FY22e	FY23
P/E	11.5x	10.9x	11.6x	10.6x	9.5x
EV/EBITDA	5.4x	5.0x	5.2x	7.8x	7.0x
Div Yield	2.0%	0.7%	1.7%	2.1%	2.3%
FCF Yield	7.1%	11.3%	11.7%	13.4%	14.5%
EPS growth	19.2%	4.9%	-6.1%	10.0%	11.5%
DPS growth	20.0%	-66.9%	161.1%	22.2%	11.5%

REGULATORY DISCLOSURES

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