Next Fifteen Communications

Interim results

Strong North America performance in H114

Media

With comparative H114 revenues up 6%, adjusted pre-tax profit up 13% and diluted adjusted EPS up 17%, Next Fifteen's interim results show that the group is returning to the growth tack, and we expect the group to report record profits in FY14. This performance was led by strong organic revenue growth of 13% in North America, the group's largest geographic area. We are increasing our FY14e EPS by 0.1p to 9.4p and initiate FY15e EPS of 10.0p. The group is changing its fiscal year end to 31 January to better align with its client budgeting cycle. Last month, Peter Harris was appointed group CFO following four months as interim CFO. The group remains solidly financed at 13.5% debt/equity, which we estimate will fall to 5.7% by financial year-end.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
07/12	91.6	9.6	10.1	2.30	10.4	2.2
07/13	96.1	7.7	6.6	2.55	16.0	2.4
07/14e	100.0	10.1	9.4	2.80	11.2	2.7
07/15e	108.0	11.3	10.0	3.00	10.6	2.8

Note: *Adjusted PBT and diluted EPS exclude intangible amortisation and exceptionals.

FY14 interims show group back on growth tack

Group revenues of £49.3m were up 6%, comprising 4.1% organic growth and 2.6% acquisition-related, less 0.8% from the impact of sterling strength. The star of the show was 13% organic revenue growth in North America, where the transition from traditional marketing to content-based social and digital marketing is helping drive business there in both tech and non-tech sectors. However, tough market conditions elsewhere, especially in Europe, held back overall organic growth to 4%. Management says that a strong start, including the UK returning to growth, has been made to H214 despite sterling strength.

Transition to digital and social continues apace

In line with its 'Digital Transition Plan', initiated in H113, the group continues to transition its core business away from traditional communications services towards social and digital communications. Supporting this plan, the group acquired 51% of content marketing business Republic Publishing in January 2014, and the group's now 54% owned grassroots developed digital marketing consultancy, Agent3, acquired B2B insight business Continuous Insight in February 2014. Management says that digital and social capabilities are increasingly key to pitch success.

Valuation: Potential upside as back on growth tack

The group would appear to be well placed to take advantage within the radically changing marketing sector as it transitions its business model to increased focus on digital marketing services. With its high exposure to the US market, the group should benefit from the growth in the US digital advertising market, which grew 14.9% in 2013 (source: eMarketer). We believe that the group's historical premium P/E rating to similar-sized peers can be re-achieved in the medium term now that the group is returning to the growth tack.

8 April 2014

Price	**105.50p**
Market cap	**£64m**

Net debt (£m) at 31 January 2014	5.4
Shares in issue	60.8m
Free float	86%
Code	NFC
Primary exchange	AIM

Share price performance

%	1m	3m	12m
Abs	(0.9)	22.0	(5.4)
Rel (local)	0.5	23.7	(12.7)
52-week high/low		115.00p	71.50p

Business description

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

Next events

Second interim results (12 months)	October 2014
Preliminary results (18 months)	April 2015
AGM	June 2015

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Edison profile page

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

Investment summary: Strong North America in H114

Company description: Global digital and PR consultancy 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 48 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 has two segmented divisions:

- Integrated Communications (H114: 82% of net revenues), which contains the group's PR agencies primarily servicing clients in the technology (including Text 100, Bite and 85% owned Outcast) and consumer (including Lexis and M Booth) sectors. In January 2014, the group bought 51% of content marketing specialist Republic Publishing.
- Specialist Agencies (H114: 18% of net revenues), which contains the group's marketing and communications operations (primarily 51% of Beyond, plus Redshift Research), and the group's corporate communications segment, which provides policy communications (including 76% of 463 Communications and 80% of Connections Media), 85% of investor relations business The Blueshirt Group, and 54% of digital marketing consultancy Agent3. In February 2014, Agent 3 acquired B2B insight business Continuous Insight.

Valuation: Potential upside as back on growth tack

Next Fifteen's prospective 11.2x P/E for the year to 31 July 2014 compares favourably with our proxy comparators (Exhibit 3). We contend that the group's expertise in the digital arena, supported by its 30-year specialisation in the tech sector, provides some encouragement that the group's historical premium P/E rating to similar-sized peers can be re-achieved in the medium term, now that the group is returning to the growth tack.

Financials: Solidly financed

The rise in net debt from £1.8m at FY13 year-end to £5.4m (net debt to equity of 13.5%) at 31 January 2014 reflects £2.8m of acquisition-related payments and £4.7m adverse working capital movement due to timing differences between H114 and FY13. We expect the group to report strong positive operating cash flow in H214 (£8.8m) and for it to continue to increase beyond, which should comfortably cover its current M&A commitments of £1.5m in H214, and £7.7m thereafter. The group is renegotiating its revolving credit facilities, which are currently shown as current liabilities.

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.

Interim results for the six months to 31 January 2014

Group revenue of £49.3m in H114 increased 5.7%, comprising 4.1% organic growth and 2.6% acquisition-related, less 0.8% from the impact of sterling strength. Group adjusted operating margin improved to 10.6% (H113: 10.1%). Adjusted pre-tax profit rose 13% to £5.1m (H113: £4.5m) and diluted adjusted EPS grew 17% to 4.9p (H113: 4.2p). The interim dividend is increased by 12%.

Improved operating margins in both reporting segments

Both reporting segments produced improved adjusted operating margins in H114 (Exhibit 1). Integrated Communications recovered with the aid of Bite US returning to profitability and Specialist Agencies benefited from strong organic growth. Following the accounting issues and fraud at Bite in the past two years, the group has expanded finance, treasury, internal audit and management information system resources, increasing the ongoing impact of head office expenses.

Exhibit 1: Analysis by reporting segment

	H113	H213	H114	H214e	FY12	FY13	FY14e	FY15e
Integrated Communications								
Revenues (£000s)	39,415	41,155	40,191	41,809	78,101	80,570	82,000	86,700
Segmental adjusted operating profit (£000s)	5,501	4,669	5,812	6,188	11,934	10,170	12,000	12,700
Segmental adjusted operating margin (%)	14.0	11.3	14.5	14.8	15.3	12.6	14.6	14.6
Specialist Agencies								
Revenues (£000s)	7,206	8,293	9,110	8,890	13,482	15,499	18,000	21,300
Segmental adjusted operating profit (£000s)	1,314	1,514	1,875	1,925	2,299	2,828	3,800	4,500
Segmental adjusted operating margin (%)	18.2	18.3	20.6	21.7	17.1	18.2	21.1	21.1
Group								
Revenues (£000s)	46,621	49,448	49,301	50,699	91,583	96,069	100,000	108,000
Segmental adjusted operating profit (£000s)	6,815	6,183	7,687	8,113	14,233	12,998	15,800	17,200
Head office costs (£000s)	(2,118)	(2,660)	(2,454)	(2,916)	(4,186)	(4,778)	(5,370)	(5,670)
Group adjusted operating profit (£000s)	4,697	3,523	5,233	5,197	10,047	8,220	10,430	11,530
Group adjusted operating margin (%)	10.1	7.1	10.6	10.3	11.0	8.6	10.4	10.7

Source: Company data, Edison Investment Research. Note: Segmental adjusted operating profit is before head office expenses, intangible amortisation, exceptional items and acquisitional share-based payments.

Strong performance in North America – key to growth

The star of the show was 17% (13% organic) revenue growth in North America, which now represents over 57% of group revenue and 90% of adjusted operating profit before head office expenses in H114. This is the area that is benefiting the most from the group's transition from traditional marketing to content-based social and digital marketing in both tech and non-tech sectors. However, tough market conditions led to negative organic revenue growth in the UK (by 7%) and Europe (by 13%). UK adjusted operating margin improved substantially from H213, which was affected by material client losses. Management is actively reviewing how to improve the trading performance in Europe, which has suffered operating losses in both H213 and H114.

Exhibit 2: Analysis by geography

	H113	H213	H114	H214e	FY12	FY13	FY14e	FY15e
Revenue by geography %								
US and Canada	52.2	56.9	57.6	57.4	51.4	54.6	57.5	57.2
UK	21.8	18.1	19.7	20.1	21.6	19.9	19.9	21.9
Asia-Pacific	14.5	14.6	13.0	13.0	15.6	14.5	13.0	12.0
Europe and Africa	11.5	10.4	9.8	9.5	11.4	10.9	9.6	8.9
Adjusted operating profit margin %								
US and Canada	20.9	23.9	24.5	24.2	19.8	22.5	24.3	24.3
UK	11.4	(0.2)	8.0	10.1	16.9	6.0	9.0	9.5
Asia-Pacific	3.2	0.7	3.3	2.9	4.7	1.9	3.1	3.1
Europe and Africa	6.6	(11.1)	(5.0)	(3.4)	8.7	(2.1)	(4.2)	(4.7)

Source: Company data, Edison Investment Research. Note: Adjusted operating profit is before head office expenses, intangible amortisation, exceptional items and acquisitional share based payments.

Increasing FY14e to 9.4p EPS; initiating FY15e 10.0p EPS

We are increasing our FY14 adjusted diluted EPS estimate by 0.1p to 9.4p. We have increased our pre-tax profit estimate to £10.1m (up £0.3m) to take account of the February 2014 move to a majority stake in Agent3. In addition, we have increased the deduction for minorities by £0.35m to reflect the strength in non-wholly owned subsidiaries and the January 2014 acquisition of the 51% stake in Republic Publishing.

Notwithstanding the forthcoming change of financial year-end to 31 January in 2015, we initiate an FY15 estimate to 31 July 2015. Group revenue growth of 8% over our FY14e incorporates continued good growth in North America (up 7.5%e) and a full year contribution from recent acquisition Republic Publishing plus estimated improved trading in the UK (up 18.6%e), while we expect Europe and Asia-Pacific to remain flat. We anticipate group adjusted operating profit margin to rise 0.3% to 10.7% (FY14e: 10.4%), primarily due to head office costs economies of scale. After increases in minorities, we estimate FY15 adjusted diluted EPS of 10.0p, up 6.4% on FY14e.

Assumptions for our FY14 and FY15 estimates are set out in Exhibits 1 and 2 above.

Valuation

The group would appear to be well placed to take advantage within the radically changing marketing sector as it transitions its business model to increased focus on digital marketing services. With the its high exposure to the US market, the group should benefit from the growth in the US digital adverting market, which grew 14.9% in 2013 (source: eMarketer).

Next Fifteen's prospective 11.2x P/E for the year to 31 July 2014 compares with consensus P/Es of 14.7x for Chime, 11.7x for Huntsworth and 8.9x for Creston. The lower rating for the latter primarily reflects its current earning plateau. Mega advertising group comparators Omnicom (which is in the process of a 'merger of equals' with Publicis) and WPP trade at higher prospective P/Es of 18.6x and 15.4x. In addition, Next Fifteen's historic EV/EBITDA and EV/revenue are both significantly lower than all but Creston of the companies in our comparison table (Exhibit 3).

We contend that the group's expertise in the digital arena, supported by its 30-year specialisation in the tech sector, provides some encouragement that the group's historical premium P/E rating to similar-sized peers can be re-achieved in the medium term, now that the group is returning to the growth tack.

Exhibit 3: Proxy comparison table

R	Ticker	Price	Mkt cap	Hist	Hist	Hist	P/E	P/E	Yield
		p/$	£m/$m	YE	EV/Rev	EV/EBITDA	Jul-14*	Year2	Jul-14*
Chime	CHW	346.0	340	Dec-13	2.2	12.6	14.7	12.7	2.2
Creston	CRE	102.5	62	Mar-13	0.7	4.3	8.9	8.4	3.9
Huntsworth	HNT	67.8	219	Dec-12	1.7	9.9	11.7	11.4	5.2
Omnicom (US)	OMC	72.1	18,608	Dec-13	1.4	9.4	18.6	16.0	2.3
WPP	WPP	1,261.0	16,853	Dec-13	1.7	10.1	15.4	13.7	2.9
Average					1.5	9.2	13.9	12.4	3.3
Next Fifteen	NFC	105.5	64	Jul-13	0.7	5.8	11.2	10.6	2.8

Source: Thomson Reuters, Edison Investment Research. Note: Prices as at close on 4 April 2014. *Straight-line adjustment to 31 July 2014 year-end.

Investors should note that during the summer of 2009, Next Fifteen's management rebuffed takeover approaches from both Chime and Huntsworth.

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Exhibit 4: Financial summary

Year-ending 31 July	£000s	2009	2010	2011	2012	2013	2014e	2015e
Accounting basis		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS								
Billings		77,287	91,175	105,163	108,453	113,360	120,000	127,000
Revenues		65,394	72,328	86,035	91,583	96,069	100,000	108,000
EBITDA		7,272	8,930	11,518	12,858	11,349	13,580	14,780
Operating Profit (before GW and except.)		5,591	6,992	8,823	10,047	8,220	10,430	11,530
Goodwill Amortisation		0	0	0	0	0	0	0
Exceptionals		(2,091)	(1,308)	(871)	(3,630)	(5,621)	(2,557)	(1,320)
Other		0	0	0	14	(79)	0	0
Operating Profit		3,500	5,684	7,952	6,431	2,520	7,873	10,210
Net Interest		(342)	(380)	(425)	(472)	(435)	(330)	(280)
Profit Before Tax (norm)		5,249	6,612	8,398	9,589	7,706	10,100	11,250
Profit Before Tax (FRS 3)		3,158	5,304	7,527	5,959	2,085	7,543	9,930
Tax		(884)	(1,591)	(2,260)	(1,652)	(1,364)	(2,020)	(2,680)
Profit After Tax (norm)		3,750	4,638	5,854	6,914	4,820	7,273	8,100
Profit After Tax (FRS 3)		2,274	3,713	5,267	4,307	721	5,523	7,250
Minorities		(342)	(38)	(270)	(401)	(393)	(950)	(1,250)
Net income (normalised)		3,408	4,600	5,584	6,513	4,427	6,323	6,850
Net income (FRS3)		1,932	3,675	4,997	3,906	328	4,573	6,000
Average Number of Shares Outstanding (m)		52.6	54.4	54.9	57.0	59.1	60.4	60.8
EPS - normalised (p)		6.5	8.4	10.2	11.4	7.5	10.4	11.3
EPS - normalised fully diluted (p)		6.5	7.5	8.7	10.1	6.6	9.4	10.0
EPS - FRS 3 (p)		3.7	6.7	9.1	6.8	0.6	7.5	9.9
Dividend per share (p)		1.70	1.85	2.05	2.30	2.55	2.80	3.00
EBITDA Margin		9%	10%	11%	12%	10%	11%	12%
Operating Margin (before GW and except.)		9%	10%	10%	11%	9%	10%	11%
BALANCE SHEET								
Non-current assets		22,618	31,919	44,336	48,227	49,457	54,707	54,457
Intangible Assets		18,441	27,111	37,926	41,019	41,369	46,219	46,019
Tangible Assets		1,949	2,269	3,067	2,721	3,165	3,565	3,515
Other non-current assets		2,228	2,539	3,343	4,487	4,923	4,923	4,923
Current Assets		22,840	29,470	34,769	33,337	37,593	36,970	41,090
Debtors		15,710	22,174	26,252	24,901	29,529	29,500	30,500
Cash		7,130	7,296	8,517	8,436	8,064	7,470	10,590
Current Liabilities		(15,237)	(25,248)	(26,095)	(24,230)	(30,390)	(32,024)	(32,024)
Creditors		(14,887)	(20,009)	(25,767)	(23,946)	(29,674)	(31,308)	(31,308)
Short term borrowings		(350)	(5,239)	(328)	(284)	(716)	(716)	(716)
Long Term Liabilities		(5,319)	(8,562)	(20,677)	(20,106)	(18,467)	(17,167)	(15,167)
Long term borrowings		(4,995)	(2,908)	(9,760)	(10,756)	(9,157)	(9,157)	(9,157)
Other long term liabilities		(324)	(5,654)	(10,917)	(9,350)	(9,310)	(8,010)	(6,010)
Net Assets		24,902	27,579	32,333	37,228	38,193	42,486	48,356
CASH FLOW								
Operating Cash Flow		6,261	6,572	11,905	10,052	11,188	10,006	13,780
Net Interest		(342)	(380)	(417)	(470)	(435)	(330)	(280)
Tax		(1,476)	(1,465)	(2,618)	(2,520)	(2,686)	(2,020)	(2,680)
Capex		(307)	(1,936)	(2,202)	(957)	(2,113)	(2,400)	(2,000)
Acquisitions/disposals		(4,549)	(4,251)	(6,078)	(5,664)	(3,020)	(4,300)	(4,000)
Financing		(479)	(296)	(66)	(264)	(693)	0	0
Dividends		(900)	(932)	(1,045)	(1,208)	(1,409)	(1,550)	(1,700)
Other		0	0	0	0	0	0	0
Net Cash Flow		(1,792)	(2,688)	(521)	(1,031)	832	(594)	3,120
Opening net debt/(cash)		(3,410)	(1,785)	851	1,571	2,604	1,809	2,403
Finance leases		(225)	(150)	(90)	(72)	(59)	0	0
Other		392	202	(109)	70	22	0	0
Closing net debt/(cash)		(1,785)	851	1,571	2,604	1,809	2,403	(717)

Source: Company data, Edison Investment Research

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