RADNOR CAPITAL PARTNERS

Next Fifteen Communications PLC

NFC | AIM | Media | 390p | £287m

1 Year Chart

Final results ahead of expectations

Final results were ahead of our, and market, expectations at several levels reflecting strong organic growth; a good performance from acquisitions; US dollar benefit and, not least, operational efficiencies across the group. Whilst North American growth captured most of the headlines; the contribution from the UK, EMEA and APAC was significant. The balance sheet was stronger than expected leaving the group well positioned to capitalise on further M&A opportunities. The key question for investors is whether the current FY18E PE of 15.1x fully captures growth prospects (we look for 11% EPS growth); current or future upgrades; benefit from future acquisitions or continuing US dollar strength.

- **North America continues to drive organic growth:** North America delivered 13% organic growth (group average 10%) with nearly all the agency brands growing well and maintaining margins (one exception, which we discuss later).
- **Margin uplift from other territories:** Although all the non-US territories delivered positive organic growth; the real story here is the improvement in margins, which were driven primarily outside of the US.
- **Outlook:** The tone is optimistic although recognising that FY17A was an exceptional year (dollar strength and non-US improvements). The underlying agencies are performing well and client demand remains buoyant.
- **Forecast revisions:** We have upgraded our forecasts reflecting the better than expected performance in FY17A and the improving outlook for some of the non-US businesses. Our FY18E adjusted PBT/EPS estimates have increased by 5%/1% respectively, with the PBT upgrade largely offset by an increase in the fully diluted share count.
- **Valuation:** Based on our new estimates, Next Fifteen trades on a FY18E PE of 15.0x and a yield of 1.6%. This remains at a discount to the broader market and the Small Cap Media peer group, despite offering faster growth and better than average balance sheet flexibility.

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Year End January	Revenue, £m	PBT adj, £m	EPS (p)	Div (p)	Net Cash, £m	PER x	Yield %
FY 2016A	129.8	16.1	16.9	4.2	-6.6	23.2	1.1%
FY 2017A	171.0	24.2	23.4	5.3	-11.4	16.8	1.3%
FY 2018E	*191.4*	*28.9*	*26.0*	*6.1*	*-1.2*	*15.0*	*1.6%*
FY 2019E	*204.1*	*31.8*	*28.6*	*6.6*	*12.5*	*13.6*	*1.7%*
FY 2012E	*215.9*	*34.5*	*30.7*	*7.1*	*37.9*	*12.7*	*1.8%*

Results – Key Headlines

Results were ahead of our, and market, expectations …

- **Revenue of £171.0m (+32% y/y)** – Radnor estimate of £168.8m. Growth breaks down as 10% organic, 10% acquisitions and 12% from currency gains (primarily US Dollar strength relative to Sterling).
- **Adjusted EBIT margin of 14.6% (FY16A: 12.7%)** – Radnor estimate of 14.5%. The margin gains came from outside the US, where margins were flat y/y at 21%.
- **Adjusted PBT of £24.2m (+50% y/y)** – Radnor estimate of £23.6m. Underlying net interest cost unchanged at £0.5m
- **Adjusted EPS of 23.4p (+39% y/y) –** Radnor estimate of 22.7p. Fully diluted share count of 78.3m shares lower than our estimate of 80.0m.
- **Full year dividend of 5.25p (+25% y/y) –** Radnor estimate of 5.1p.
- **Operating cashflow of £32.8m (+101% y/y)** – Radnor estimate of £26.7m. Working capital generated a cash inflow of £6.3m due to timing and tight management.
- **Acquisition spend of £21.9m –** Radnor estimate of £18.7m. This breaks down into £14.5m of initial consideration, £6.6m of deferred consideration relating to prior year acquisitions and a £0.8m minority investment.
- **Net debt of £11.4m** – Radnor estimate of £13.6m. Headline net debt / EBITDA multiple of 0.4x, compared to bank covenant of 1.75x.
- **Exceptional & Adjusted Items of £21.3m** – Radnor estimate of £10.2m. Largest point of variance was a £10.5m charge relating to the grant of equity participation units to a number of senior agency management teams. We discuss this in more detail below.

Elsewhere, a £0.7m restructuring charge was taken relating to Story in the US (the only fly in the US ointment). Acquired intangible amortisation was £5.5m and the accounting charge relating to timing and value movements in the outstanding deferred consideration was £4.2m (Radnor estimate £2.8m). Other than the £0.7m restructuring charge, all were non-cash items.

What has changed?

In our January 2017 initiation of coverage, we identified the following as key components of the Next Fifteen investment case. Have the final results made us reassess any of these points? The short answer is no.

Organic Growth

North America continues to lead the way but all regions delivered organic revenue growth …

North America (+13% y/y) remains the key driver of group organic revenue growth, although we note that all the group's key geographical segments posted solid organic revenue growth in FY17. In broad terms, we expect this picture to be maintained with organic growth in the UK accelerating as the full impact of the recent acquisitions years feeds fully into like for like calculations.

Given the very strong first half in FY17; US comparatives could look challenging in H1 FY18E. However, client demand remains strong and we retain our double-digit growth expectation for North America in FY18E.

Margin Gains

Profit growth in North America is largely a function of revenue growth, with segment margins running at c.21%. We do not anticipate significant expansion from these levels.

Margin expansion was delivered outside of the US …

The picture is different elsewhere, especially in the UK, where a combination of self-help and higher margin acquisitions could drive margins towards and potentially beyond North America. The UK saw FY17 margins increase 530 basis points to 18.9% and we currently look for FY18E margins to reach 21%. Although unlikely to reach US and UK margin levels, both EMEA and APAC offer further margin recovery potential.

UK Acquisitions – US Opportunity

Recent M&A has focused on the UK, where Next Fifteen has targeted differentiated, growing and technology focused agencies which have the potential to leverage into North America where most of Next Fifteen's largest clients are based. This strategy allows Next Fifteen to take advantage of lower acquisition multiples, whilst enhancing internal IP and innovation. This enables the group to stay ahead of a fast-moving client base. We see no indication that this strategy is likely to change over the short to medium term.

Portfolio Approach

Fundamental to the Next Fifteen model is a "portfolio manager" approach to group structure, management and, crucially, incentivisation. Centralising and fully integrating the individual agencies is not the Next Fifteen way. Instead, the group acts as a platform for growing, entrepreneurial, technology focused businesses to accelerate and de-risk their own development plans through capital allocation and logistical support.

Agency management incentivisation is intended to enhance entrepreneurial impetus …

This devolved structure also allows Next Fifteen the flexibility to ensure management teams are appropriately incentivised through direct participation in their own success. This incentivisation approach can be seen in the exceptional items, where a £10.5m share option charge was taken. This was perhaps the only material surprise in the results and is worth exploring in more detail.

… although this results in lumpy, non-cash share option charges …

£8.0m of the £10.5m share option charge relates to growth shares, which enables agency management teams to share in the uplift in value delivered by the growth of their businesses. These growth shares are typically structured to vest after a five-year period and are satisfied by the issue of new Next Fifteen shares, or shares purchased in the market by the EBT. The current charge reflects the best estimate as to the current, discounted value of the awards. Although Next Fifteen treats these as an adjusted item (they are non-recurring once granted and are non-cash items), the cost is captured within the fully diluted, adjusted EPS, which is the key EPS measure used by the company.

Other share option charges are treated as exceptional …

Interestingly, the cost of PLC management LTIPs are not adjusted out of the core results as these are deemed to be recurring (c.£1m pa).

Balance Sheet Strength

Strong balance sheet supported by operational cash generation …

Net debt at the year-end was £11.4m (better than our £13.6m forecast). This represents a net debt / EBITDA multiple of 0.4x, offering ample headroom to the 1.75x bank covenant limit. Even on a "fully costed" basis, fully factoring the estimated cost of all deferred consideration liabilities outstanding (£19.4m over the next five years), the net debt / EBITDA multiple comes in at 1.1x.

Next Fifteen is a highly cash generative business. In FY17A, even before favourable working capital movements, the group generated £26.5m of operating cash-flow (rising to £32.8m after working capital), representing 106% underlying conversion of adjusted EBIT. We assume some of the working capital in-flows reverse in FY18E, but even so we look for £31.8m of underlying operating cash-flow (falling to £28.7m post working capital).

Valuation

	Price (p)	Market Cap, £m	PE		EV/EBITDA		Div Yield	
			FY1	FY2	FY1	FY2	FY1	FY2
Cello	126p	130.1	15.0	14.5	9.4	8.5	2.8%	2.9%
Ebiquity	161p	86.1	15.6	16.9	9.7	7.2	0.4%	0.5%
Huntsworth	48p	156.9	11.7	10.7	7.4	6.2	3.8%	3.8%
M&C Saatchi	345p	262.7	15.1	14.0	9.0	8.1	2.7%	3.0%
YouGov	263p	275.8	25.5	23.1	20.0	17.3	0.6%	0.7%
XLMedia	108p	216.4	10.5	9.6	6.2	5.5	5.6%	6.0%
Small Cap Agencies			**15.5**	**14.6**	**10.0**	**8.6**	**2.5%**	**2.7%**
Next Fifteen	**390p**	**286.9**	**15.0**	**13.6**	**8.7**	**7.6**	**1.6%**	**1.7%**

Source: FactSet. Radnor Capital Partners

Despite the strong run in the share price over the last three months, Next Fifteen currently trades at a small discount to the Small Cap Agency peer group in terms of both forward PE and EV/EBITDA. However, Next Fifteen offers faster EPS growth over the next two years, underpinned by a healthy balance sheet and strong, operational cash-flow generation.

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Next Fifteen Communications PLC

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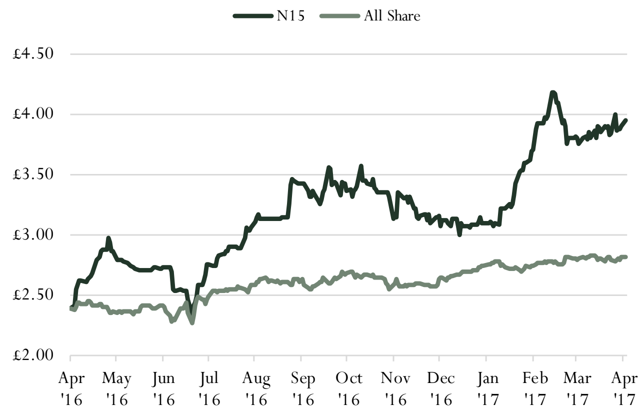
Price (p):	**390 p**
Market Cap:	287 m
EV:	288 m

PROFIT & LOSS

Year to 31 January, £m	2016	2017	FY18e	FY19e	FY20e
UK	*27.9*	*42.6*	*48.6*	*51.0*	*53.1*
North America	*83.5*	*107.0*	*119.8*	*129.4*	*138.5*
EMEA	*6.4*	*7.2*	*7.6*	*7.8*	*8.1*
Asia Pacific	*12.0*	*14.2*	*15.3*	*15.8*	*16.3*
Group Net Revenue	**129.8**	**171.0**	**191.4**	**204.1**	**215.9**
UK	*3.8*	*8.0*	*10.2*	*10.8*	*11.3*
North America	*17.5*	*22.3*	*25.4*	*27.7*	*29.9*
EMEA	*0.5*	*0.6*	*0.8*	*0.8*	*0.9*
Asia Pacific	*1.4*	*2.2*	*2.5*	*2.5*	*2.6*
Head Office	*(6.6)*	*(8.2)*	*(9.2)*	*(9.8)*	*(10.4)*
EBITA - Adjusted	**16.5**	**25.0**	**29.6**	**32.1**	**34.3**
Associates & JV's	(0.0)	(0.3)	(0.2)	-	-
Net Bank Interest	(0.4)	(0.5)	(0.5)	(0.3)	0.1
PBT - Adjusted	**16.1**	**24.2**	**28.9**	**31.8**	**34.4**
Non Operating Items	(8.1)	(17.1)	(10.8)	(11.1)	(11.4)
Other Financial Items	(2.4)	(4.2)	(2.5)	(2.5)	(2.5)
PBT - IFRS	**5.6**	**2.9**	**15.9**	**18.2**	**20.5**
Tax	(1.1)	(1.2)	(3.2)	(3.6)	(4.1)
Tax - Adjusted	(3.5)	(5.3)	(6.5)	(7.0)	(7.6)
Tax rate - Adjusted	*22.0%*	*22.0%*	*22.5%*	*22.0%*	*22.0%*
Minority interests	0.5	0.5	1.0	1.0	1.0
No. shares m	66.3	72.3	73.6	74.5	75.5
No. shares m, diluted	71.6	78.3	82.2	83.1	84.1
IFRS EPS (p)	6.0	1.6	15.8	18.2	20.4
Adj EPS (p), diluted	**16.9**	**23.4**	**26.0**	**28.6**	**30.7**
Total DPS (p)	4.2	5.3	6.1	6.6	7.1

PRICE CHART - 2 YEAR ABSOLUTE vs FTSE ALL SHARE



Source: FactSet

SHAREHOLDERS

	% of ord. Share capital
Liontrust	14.9%
Octopus Investments	8.4%
Directors	7.3%
Standard Life	6.9%
Hargreave Hale	6.0%
Herald Inv Mgmt	5.7%
Aviva Investors	5.4%
BlackRock	5.4%
	60.0%

CASH FLOW

Year to 31 January, £m	2016	2017	FY18e	FY19e	FY20e
Net Profit: (add back)	**4.5**	**1.7**	**12.7**	**14.6**	**16.4**
Depreciation & Amortisation	*6.1*	*9.5*	*9.9*	*10.5*	*10.9*
Net Finance costs	*2.8*	*4.7*	*3.0*	*2.8*	*2.4*
Tax	*1.1*	*1.2*	*3.2*	*3.6*	*4.1*
Working Capital	0.2	6.3	(3.0)	(0.4)	(0.4)
Other	1.6	9.4	3.0	1.0	1.0
Cash from Ops	**16.3**	**32.8**	**28.7**	**32.1**	**34.5**
Cash Tax	(3.0)	(2.0)	(4.8)	(2.7)	(3.1)
Tangible Capex	(6.4)	(8.3)	(4.0)	(4.0)	(4.0)
Intangible Capex	(0.6)	(0.6)	(0.8)	(0.8)	(0.8)
Free Cashflow	**6.4**	**22.0**	**19.2**	**24.5**	**26.6**
Dividends	(3.0)	(4.3)	(4.8)	(5.2)	(5.6)
Acquisitions & Inv.	(13.4)	(21.9)	(5.0)	(5.0)	(5.0)
Financing	14.6	11.1	(0.8)	(0.6)	(0.2)
Net Cashflow	**4.6**	**6.8**	**8.6**	**13.8**	**15.8**
Net Cash (Debt)	(6.6)	(11.4)	(1.2)	12.5	37.9

Announcements

Date	Event
4th April 2017	Final results (y/e Jan 2017)
10th Nov 2016	Acquisition of HPI for £1.3m
27th Sep 2016	Interim results (6 months ended July 2016)
27th Sep 2016	Acquisition of Pinnacle for £4.4m
28th June 2016	Interim trading update
12th April 2016	Final results (y/e Jan 2016)
1st April 2016	Acquisition of Twogether for £6.6m

RATIOS

	2016	2017	FY18e	FY19e	FY20e
RoE	22.9%	26.8%	26.9%	25.5%	21.7%
RoCE	27.8%	30.9%	36.4%	39.7%	42.4%
Asset Turnover (x)	0.6x	0.6x	0.6x	0.5x	0.5x
NWC % Revenue	9.3%	16.1%	13.7%	12.6%	11.4%
Op Cash % EBITA	98.6%	131.5%	97.0%	100.0%	100.5%
Net Debt / EBITDA	0.4x	0.4x	0.0x	-	-

BALANCE SHEET

Year to 31 January, £m	2016	2017	FY18e	FY19e	FY20e
Intangibles	53.6	80.0	79.8	79.3	78.4
P,P+E	10.0	15.8	16.1	16.1	16.1
Tax Asset & Other	7.9	11.7	11.2	11.2	11.2
Total Fixed Assets	**71.4**	**107.4**	**107.0**	**106.6**	**105.7**
Net Working Capital	(12.0)	(27.5)	(26.2)	(25.8)	(24.6)
Capital Employed	**59.4**	**79.9**	**80.8**	**80.8**	**81.0**
Net Funds	(6.6)	(11.4)	(1.2)	12.5	37.9
Net Assets	**52.8**	**68.5**	**79.6**	**93.3**	**118.9**

VALUATION

Fiscal	2016	2017	FY18e	FY19e	FY20e
P/E	23.1x	16.6x	15.0x	13.6x	12.7x
EV/EBITDA	15.3x	10.1x	8.6x	8.0x	8.4x
Div Yield	1.1%	1.3%	1.6%	1.7%	1.8%
FCF Yield	2.2%	7.6%	6.7%	8.5%	9.2%
EPS growth	27.5%	38.9%	11.1%	9.9%	7.2%
DPS growth	20.0%	25.0%	15.3%	9.8%	7.1%