Next 15 Group PLC

NFG | AIM | Media | 907p | £886m

FY24 Full Year update – Green shoots hardening

1 Year Chart

If one focused solely on the share price chart, it would appear Next 15 had experienced a near death experience in 2023 with multiple, and extensive downgrades. The reality has been somewhat different. Next 15 will exit FY24 delivering both top line growth and year on year margin progression.

We believe the market has consistently under-estimated both the defensiveness of Next 15's client and business mix, and the range of internal levers available to the group to protect margins. The de-centralised nature of the group portfolio of niche, specialist agencies is a double-edged sword. The group is undoubtedly more complex and superficially difficult to understand than many of its peers but the localised management accountability that underpins this group structure and closer proximity to clients have undoubtedly helped Next 15. Combined with a tight focus on cost efficiencies, this has resulted in Next 15 materially outperforming its peers in terms of margin and growth.

The recent share price bounce has gone some way to narrowing what was clearly an unsustainable discount to any reasonable sense of fair value. However, a 30% discount to the peer group still feels anomalous.

Next 15 Group PLC is a research client of H2 Radnor Ltd.

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

- **Full year trading in line with management expectations:** The full year trading update has confirmed that Next 15 has navigated a challenging year well. Full year revenue growth is expected to be +3% and margins are still expected to show YoY progression.
- **It is all in the margin:** In spite of a difficult revenue backdrop much of 2023, Next 15 will still deliver margin growth, a feat notably absent from many peers. We see a number of factors underpinning this, not least a more robust client / business mix and a more effective group structure for managing costs in a tough environment.
- **More positive tone to the outlook:** At the November capital markets day, Next 15 referred to early green shoots. The strength of recent client wins and a subsequent hardening of the new business pipeline has resulted in a more positive tone to the current outlook than many had been expecting.
- **Changes to estimates:** Despite this positive tone, we are taking this opportunity to make some small downgrades to our estimates, driven primarily by FX headwinds and higher net interest cost expectations. We bring back FY24E / FY25E revenue -1% and PBT by -4%.

29 January 2024

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January, £m	Revenue	PBT adj	EPS (p)	Div (p)	Net Cash	PE x	Yield %
FY 2022A	362.1	79.3	59.7	12.0	35.7	15.2	1.3
FY 2023A	563.8	112.5	80.4	14.6	26.1	11.3	1.6
FY 2024E	*577.9*	*117.5*	*80.4*	*16.1*	*(11.8)*	*11.3*	*1.8*
FY 2025E	*624.3*	*128.2*	*89.4*	*17.9*	*5.2*	*10.1*	*2.0*
FY 2026E	*663.0*	*140.2*	*97.7*	*19.5*	*71.8*	*9.3*	*2.2*

Source: h2Radnor

FY24 Full Year trading update – Key points

Next 15 Group has issued a full year trading update for the year ended January 2024. Final results for the year are expected to be released on 16th April 2024.

The key headlines are as follows:

- H2 revenue growth expected to be **+1%** YoY, driving full year revenue growth of **+3%**
- Broad cost efficiencies combined with the specific cost savings secured post the Engine acquisition have helped to protect group operating margins, which are expected to show improvement YoY
- Overall, results are expected to be **in line** with management expectations
- The balance sheet is expected to show a small net debt position at the year end
- The share buyback programme (£4.5m deployed out of a £30m upper limit) is continuing, albeit on a scaled back basis with a further £10m targeted by the end of April 2024
- Recent material client wins (Uber for Agent3 and Asda for SMG) alongside a number of expanded, existing client relationships (Salesforce and Procter & Gamble) underpin a good start to FY25.

We see the positive share price reaction to the trading update (**+11%**) being driven by a combination of factors. Firstly, the forward-looking tone is more positive than in previous updates and clearly reflects a hardening of the "green shoots" commentary that had been provided at the Capital Markets Day at the end of November.

Secondly, we also see a degree of relief in the price reaction. A notable feature of the last 12 months has been the degree of outperformance, especially at the operating margin level, that Next 15 has delivered through the year compared to others in the sector. This update confirms that this outperformance is now in the bank and will not be derailed at the last. Given the pace and scale of downgrades elsewhere in the peer group, we believe this was a genuine concern amongst many investors.

The lack of any material bad news also, to an extent, de-risks and clarifies the outlook for FY25. The short-term trading environment remains difficult, but the increasing pace of new business activity and the scale of recent client wins clearly leaves Next 15 in a better place looking forward than at the interim stage.

Changes to h2Radnor estimates

Off the back of this update, we are taking this opportunity to revisit our estimates, where we are making some small downward adjustments.

Next 15 has, without a doubt, navigated a difficult year with some aplomb. Not only has the group had to contend with a challenging new business environment, where pitch activity has remained positive but offset by deferrals in project commencement, but also FX headwinds for a business that remains heavily geared to USD budgets.

Whilst we have seen our revenue expectations for FY24 move downwards through the course of the year (-11% in aggregate), our FY24 EBIT expectation has only reduced by -6%, reflecting Next 15's ability to protect and even enhance margins even in a challenging revenue environment.

We see a number of factors driving this impressive margin performance.

1. Above and beyond the attractions of the Engine subsidiary businesses, the acquisition also provided the opportunity to secure material cost savings. The savings secured (partly through property rationalisation but also through the removal of Engine central costs) have been higher than originally expected. At the H1 results we estimated that Engine cost savings were running in excess of £4m per annum and we now see this number as cautious.

2. Within Engine, the Transform digital transformation business had been running a relatively low single digit operating margin prior to the acquisition. Under the new Next 15 management structure, this business has seen margins increase materially (well into the teens) and at a faster rate than had been originally expected.

3. Next 15 operates a much more de-centralised corporate structure than other acquisition led models in the peer group. Next 15 should be seen as a group of niche, specialist businesses that each focuses on solving a specific client problem. The PLC centre is there to knit the group together and also to provide a central group resource for functions (ie property, legal, treasury) that are significantly margin dilutive for the smaller, standalone businesses. However, each group business maintains their own finance team with local accountability for forecasting and budgeting. We believe this point is critical to understanding Next 15's ability to better manage and protect their operating margins.

4. Next 15's business mix is much less geared towards volume media (in particular digital media) than others in the peer group and is focused towards consultancy and tangible client outcomes. We believe this has resulted in much firmer client pricing and therefore visibility around margin.

When we look forward to FY24, we are mindful of the combination of FX headwinds, a still volatile trading environment, offset by the timing of material new client wins and contributions from three small bolt on acquisitions made towards the end of the year (one within Brandwidth and two within Savanta). Overall, we are dialling back our group revenue estimate for FY24E and FY25E by -1%.

On margins, we are mindful of company guidance that margins in FY24E are expected to still show good YoY progression vs FY23. Nonetheless, the majority of the Engine cost savings have now been delivered. On balance, we are taking a cautious view and reducing our FY24E operating margin estimate by 60 basis points to 20.8%, which itself is still 60 basis points ahead of the comparative figure for FY23.

Given the tougher new business environment, the pressure on working capital, and in particular debtor days, is likely to grow and we are looking for a working capital outflow in FY24. Coupled with the bolt on acquisitions made in H2 (c.£10m of initial consideration), we now look for a FY24 net debt position of £11.8m, which also feeds into a higher P&L net bank interest expense in FY24E. In the absence of any material new M&A spend, Next 15 remains highly cash generative. In FY24E we forecast free cash-flow of £82m, rising to £112m in FY25E.

In Figure 1 below, we detail our key estimate revisions.

Figure 1: h2Radnor estmate revisions

		Previous		New		*Change, %*	
	2023A	2024E	2025E	**2024E**	**2025E**	**2024E**	**2025E**
Customer Engagement	275.0	264.0	277.2	264.0	279.8	*- 0%*	*+ 1%*
Customer Delivery	102.1	108.2	121.7	106.7	117.4	*- 1%*	*- 4%*
Customer Insight	52.0	57.7	62.3	57.7	64.1	*+ 0%*	*+ 3%*
Business Transformation	134.8	155.0	170.5	149.6	163.1	*- 3%*	*- 4%*
Revenue	**563.8**	**584.9**	**631.7**	**577.9**	**624.3**	***- 1%***	***- 1%***
Customer Engagement	55.4	57.5	61.3	55.2	60.2	*- 4%*	*- 2%*
Customer Delivery	30.2	33.8	38.4	32.6	36.4	*- 3%*	*- 5%*
Customer Insight	11.0	12.4	13.4	12.4	13.8	*+ 0%*	*+ 3%*
Business Transformation	43.9	46.5	48.6	45.6	47.3	*- 2%*	*- 3%*
Central Overhead	-26.4	-25.1	-27.2	-25.4	-27.2	*+ 1%*	*- 0%*
EBITA	**114.2**	**125.1**	**134.4**	**120.4**	**130.4**	***- 4%***	***- 3%***
- margin %	*20.2%*	*21.4%*	*21.3%*	*20.8%*	*20.9%*		
Adj. PBT	**112.5**	**122.4**	**133.7**	**117.5**	**128.2**	***- 4%***	***- 4%***
Adj. EPS (p)	**80.4**	**83.7**	**96.4**	**80.4**	**89.4**	***- 4%***	***- 7%***
Dividend (p)	14.6	16.7	19.3	16.1	17.9	*- 4%*	*- 7%*
Net Cash (Debt)	**26.1**	**17.9**	**27.9**	**-11.8**	**5.2**		

Source: h2Radnor

Next 15 valuation and relative performance

Next 15's share price has recovered strongly from its August lows (+64%). Yet we still see the current valuation as undemanding both in absolute and relative terms. This perhaps reflects the extent to which the shares had de-rated heading into the Summer.

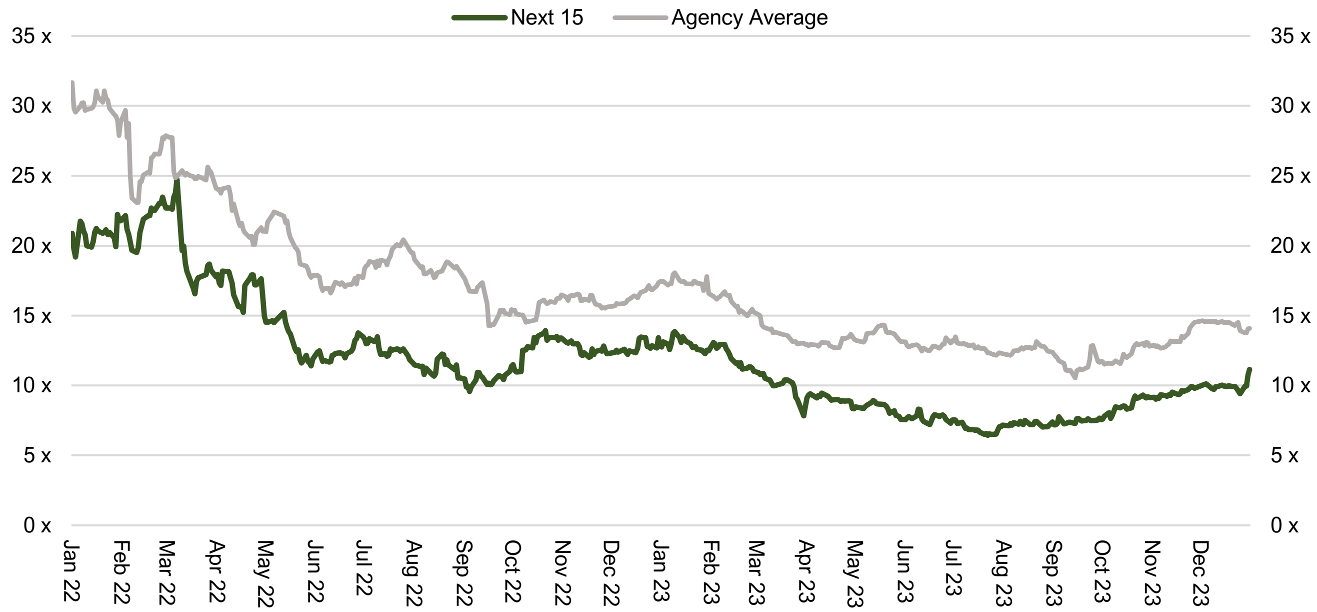
In Figure 2 below, we show the evolution of the Next 15 forward PE multiple over the last two years. We can see that from a March 2022 peak of 25x, this collapsed to the August 2023 low of 6.5x.

This compares to an Agency peer group average forward PE multiple that also hit 25x in March 2022 and bottomed out at 10.5x in October 2023.

This suggests that the market has taken a clear view around perceived underperformance or delivery by Next 15 through this period.

As we show in Figures 3 & 4 below, the opposite has been true.

Figure 2: Next 15 Forward PE multiple vs Agency Peers



Source: h2Radnor, FactSet

Figures 3 & 4 show the evolution of Next 15's FY1 consensus revenue and PBT estimate since April 2022. We can see that from a revenue perspective, Next 15 has tracked broadly in line with the peer group, with a challenging macro back drop driving similar levels of revenue estimate reductions for a peer group that is cyclically geared. Within the peer group, there have been a wide range of outcomes with Next 15 sitting in the middle of the range.

Figure 3: Next 15 vs Peers – Consensus Revenue

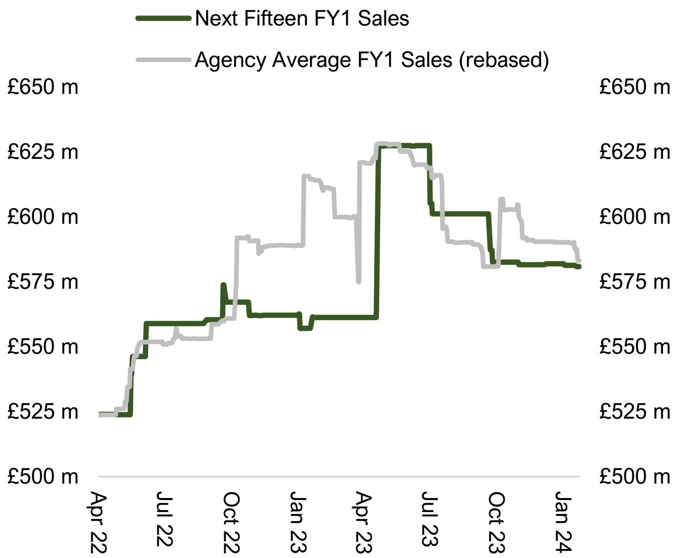
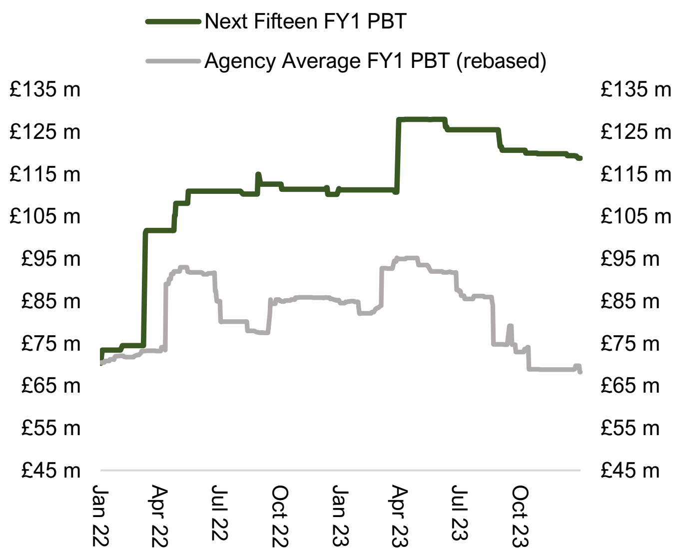


Figure 4: Next 15 vs Peers – Consensus PBT



Source: h2Radnor, FactSet

Figure 4 shows the evolution of PBT estimates for Next 15 and the peer group and here the difference is stark. We can see the extent to which Next 15 has:

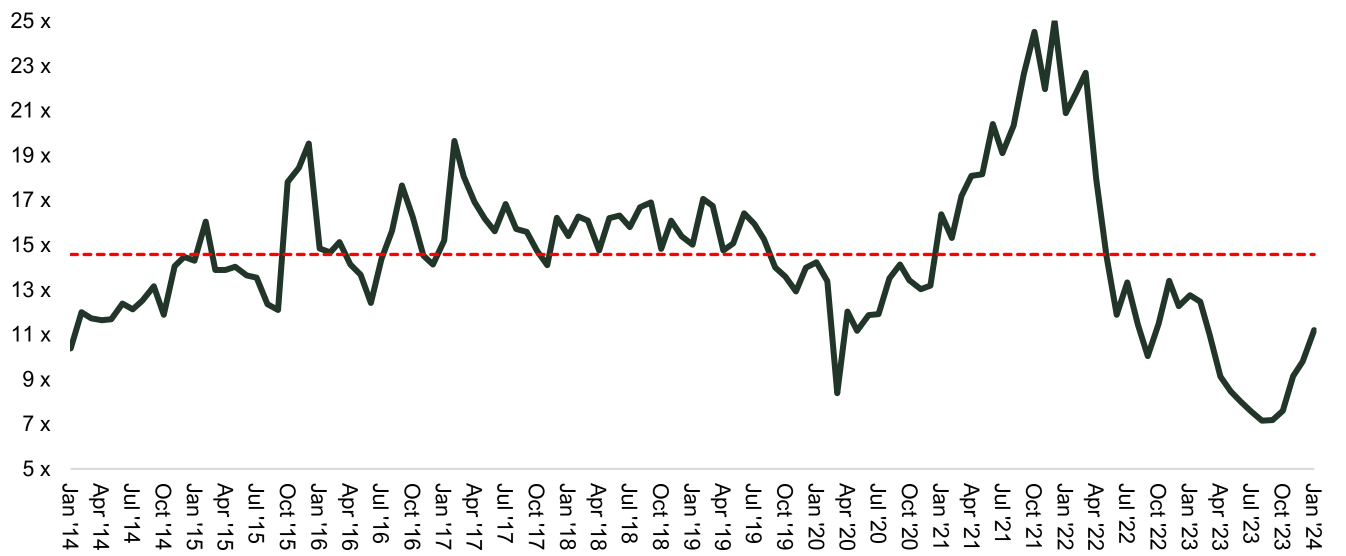
a) Held on to the majority of the earlier profit growth upgrades that had flowed through 2022 and early 2023 (driven by M&A and material new contract wins). In contrast the peer group, in aggregate, has seen an absolute contraction in expected profit growth with FY1 estimates now standing below where they were in April 2022.

b) The peak FY1 PBT estimate for Next 15 was £127.9m in April 2023 and now stands at £118.8m – a net -7% reduction. This compares to an equivalent reduction of -28% for the peer group.

This material pullback in estimates for the peer group, and Next 15's clear relative outperformance has clearly not been recognised by the market, which has consistently priced Next 15 at a discount. We find this hard to justify.

Finally, to put this into its proper historic context, in Figure 5 below, we show the evolution of Next 15's FY1 PE multiple across a longer timeframe. Since January 2014, Next 15's average FY1 multiple was **14.6x** (including both the pandemic trough and early 2022 peak). If we were to apply this average (which is broadly equivalent to the current PE multiple for the Agency peer group) this would suggest a Next 15 share price of **£11.73**, or 30% upside to the current price.

Figure 4: Long term evolution of Next 15's FY1 PE multiple



Source: FactSet, h2Radnor

Next 15 Group PLC

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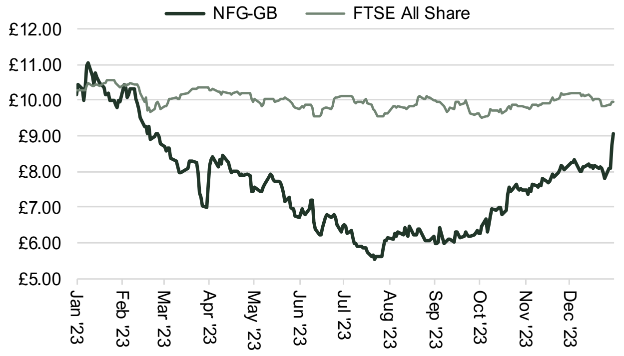
Price (p): **907 p**
Market Cap: 886 m
EV: 859 m

PROFIT & LOSS

Year to 31 January, £m	FY21	FY22	FY23	FY24e	FY25e	FY26e
Customer Engagement	*166.5*	*187.6*	*275.0*	*264.0*	*279.8*	*293.8*
Customer Delivery	*49.6*	*80.0*	*102.1*	*106.7*	*117.4*	*125.6*
Customer Insight	*33.1*	*42.1*	*52.0*	*57.7*	*64.1*	*69.2*
Business Transformation	*17.7*	*52.5*	*134.8*	*149.6*	*163.1*	*174.5*
Group Net Revenue	**266.9**	**362.1**	**563.8**	**577.9**	**624.3**	**663.0**
Customer Engagement	*36.9*	*40.4*	*55.4*	*55.2*	*60.2*	*65.2*
Customer Delivery	*15.2*	*28.5*	*30.2*	*32.6*	*36.4*	*39.6*
Customer Insight	*4.9*	*9.0*	*11.0*	*12.4*	*13.8*	*14.9*
Business Transformation	*3.9*	*15.2*	*43.9*	*45.6*	*47.3*	*49.7*
Head Office	*(11.4)*	*(13.8)*	*(26.4)*	*(25.4)*	*(27.2)*	*(28.5)*
EBITA - Adjusted	**49.5**	**79.3**	**114.2**	**120.4**	**130.4**	**140.9**
Associates & JV's	0.4	0.2	-	-	-	-
Net Bank Interest	(0.8)	(0.3)	(1.6)	(3.0)	(2.2)	(0.7)
PBT - Adjusted	**49.1**	**79.3**	**112.5**	**117.5**	**128.2**	**140.2**
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**	**56.2**	**87.0**	**99.0**
Tax	(2.6)	14.5	(7.1)	(15.2)	(23.5)	(26.7)
Tax - Adjusted	(9.9)	(17.2)	(26.3)	(31.7)	(34.6)	(37.8)
Tax rate - Adjusted	*20.2%*	*21.6%*	*23.3%*	*27.0%*	*27.0%*	*27.0%*
Minority interests	1.0	3.6	1.4	1.6	2.7	3.0
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	39.9	61.5	70.1
Adj EPS (p), diluted	**40.7**	**59.7**	**80.4**	**80.4**	**89.4**	**97.7**
Total DPS (p)	7.0	12.0	14.6	16.1	17.9	19.5

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%

CASH FLOW

Year to 31 January, £m	FY21	FY22	FY23	FY24e	FY25e	FY26e
Net Profit: (add back)	(2.5)	(64.6)	3.0	41.1	63.5	72.2
Depreciation & Amortisation	*28.0*	*28.8*	*37.2*	*37.0*	*39.0*	*40.0*
Net Finance costs	*15.4*	*120.3*	*57.1*	*30.7*	*13.4*	*11.9*
Tax	*2.6*	*(14.5)*	*7.1*	*15.2*	*23.5*	*26.7*
Working Capital	6.6	0.2	(24.4)	(19.6)	(1.9)	(5.2)
Other	24.3	19.6	15.1	8.8	6.3	6.3
Cash from Ops	**74.3**	**89.8**	**95.2**	**113.1**	**143.9**	**152.0**
Cash Tax	(8.4)	(14.1)	(20.3)	(22.8)	(23.5)	(26.7)
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**	**82.4**	**112.4**	**117.2**
Dividends	(0.7)	(12.4)	(15.3)	(17.3)	(19.9)	(21.7)
Acquisitions & Inv.	(23.6)	(24.0)	(104.9)	(91.0)	(65.0)	(20.0)
Financing	(37.7)	(1.1)	38.6	(16.0)	(10.5)	(9.0)
Net Cashflow	**(0.2)**	**32.4**	**(13.7)**	**(41.9)**	**17.0**	**66.6**
Net Cash (Debt)	14.0	35.7	26.1	(11.8)	5.2	71.8

Announcements

Date	Event
January 2024	Trading update
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

RATIOS

	FY22	FY23	FY24e	FY25e	FY26e
RoE	95.3%	74.2%	56.6%	37.2%	34.1%
RoCE	37.1%	37.4%	35.4%	37.9%	46.1%
Asset Turnover (x)	0.7x	0.7x	0.7x	0.6x	0.6x
NWC % Revenue	14.3%	13.6%	11.5%	9.5%	12.1%
Op Cash % EBITA	113.2%	83.4%	94.0%	110.3%	107.9%
Net Debt / EBITDA	-	-	-	0.1x	-

BALANCE SHEET

Year to 31 January, £m	FY21	FY22	FY23	FY24e	FY25e	FY26e
Intangibles	163.8	183.1	274.1	301.6	302.2	287.9
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**	**406.6**	**403.6**	**385.3**
Net Working Capital	(48.6)	(51.6)	(76.8)	(66.3)	(59.4)	(80.0)
Capital Employed	**167.5**	**214.5**	**305.3**	**340.4**	**344.3**	**305.3**
Earn Out Liabilities	(64.6)	(188.8)	(217.0)	(180.0)	(105.0)	(85.8)
Net Funds	14.0	35.7	26.1	(11.8)	5.2	71.8
Net Assets	**116.9**	**61.5**	**114.4**	**148.5**	**244.5**	**291.4**

VALUATION

Fiscal	FY22	FY23	FY24e	FY25e	FY26e
P/E	15.2x	11.3x	11.3x	10.1x	9.3x
EV/EBITDA	10.8x	7.5x	7.1x	6.6x	6.1x
Div Yield	1.3%	1.6%	1.8%	2.0%	2.2%
FCF Yield	8.1%	7.9%	9.6%	13.1%	13.6%
EPS growth	46.6%	34.5%	0.0%	11.2%	9.3%
DPS growth	71.4%	21.7%	10.1%	11.2%	9.3%

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