EDISON

Next Fifteen Communications

Interim results

Accelerating digital investment; Bite hiccup

Media

Next Fifteen's interim results are slightly shy of our expectation, with the most significant impact being on diluted adjusted EPS, which came in at 4.2p (H112: 4.35p) versus our 4.6p estimate. Most of the group's agencies performed well. However, the group's Bite subsidiary is experiencing a disappointing performance through the loss of a number of significant clients at the same time as it undergoes transition to a global marketing services agency. For this reason, we are revising downwards our FY13 and FY14 estimates, and the shares in the short term now look fairly fully valued. To improve growth prospects in the medium term, the group is implementing a £2m 'Digital Transition Plan' to accelerate towards more pure and hybrid digital services.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
07/11	86.0	8.4	8.7	2.05	13.0	1.8
07/12	91.6	9.6	10.1	2.30	11.2	2.0
07/13e	96.5	10.0	9.3	2.55	12.2	2.2
07/14e	103.0	11.2	10.3	2.85	11.0	2.5

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

FY13 interims slightly shy; EPS FY13/FY14e lowered

H113 revenue rose 3% to £46.6m. Overall organic growth was 1%, with 5% in the US (over 50% of revenues) indicating tough conditions elsewhere. Pure digital services were steady at 11% of revenue, while hybrid digital services (communications using social and digital channels) rose to 32% (H112: 30%). Although adjusted pre-tax profit rose 6% to £4.5m (H112: £4.2m), a higher tax charge and higher minorities led to the decline in diluted adjusted EPS. Reflecting the softness at Bite, plus on-going higher tax and minorities, we are reducing our adjusted EPS estimates for FY13 (by 1.3p to 9.3p) and FY14 (by 1.0p to 10.3p).

'Digital Transition Plan' to boost growth prospects

In response to the rapidly changing client requirements, Next Fifteen is implementing a 'Digital Transition Plan' to accelerate the group's transition towards more pure and hybrid digital services. Management anticipates a £2m investment over a two year period, of which c £0.4m fell in H113. The costs of this plan are being treated as non-recurring restructure costs and as such are excluded in the adjusted P&L data.

Valuation: Fairly fully valued, awaiting digital returns

The importance of digital to medium term growth prospects should not be underestimated and we concur with management that increased focus on digital is the right course for the group. However, the reduction in our FY13 and FY14 EPS estimates outlined above raises the group's higher relative rating versus our selected peer comparators (Exhibit 4), suggesting that the current valuation is fairly fully valued particularly in view of the short term costs, and as investors await the improved growth prospects following, the completion of the 'Digital Transition Plan'.

23 April 2013

Price	**113.50p**
Market cap	**£68m**

Net debt (£m) at 31 January 2012	5.2
Shares in issue	59.7m
Free float	86%
Code	NFC
Primary exchange	AIM

Share price performance

%	1m	3m	12m
Abs	1.8	12.9	18.2
Rel (local)	3.7	10.6	7.2
52-week high/low		112.50p	89.50p

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.

Next events

Preliminary results	October 2013
AGM	January 2014

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Edison profile page

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

Investment summary: Accelerating digital investment

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 (FY12: 66.1%), consumer (16.5%), digital/research consultancy (10.2%) and corporate communications (7.2%) sectors, with world-leading and autonomous PR, research, digital, investor relations and policy communications subsidiaries. Over the past eight years, a series of acquisitions has been successfully integrated into the group, which now has 53 offices across 17 countries. Top 10 clients represented around 26% of revenues in FY12 (30% in FY11). Since late 2009, Next Fifteen has been transitioning its business model from traditional PR to digital marketing services, driving this by organic expansion and targeted acquisitions, and now via its two year 'Digital Transition Plan'.

The group has two segmented divisions:

- Integrated Communications (H113: 83% of 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.
- Specialist Agencies (H113: 17% of revenues), which contains the group's marketing and communications operations (primarily 51% owned Beyond, plus Redshift Research), as well as the group's corporate communications segment, which provides policy communications (including 76% owned 463 Communications and the April 2013 acquisition of 80% stake in Connections Media), and the group's 85% owned investor relations business, The Blueshirt Group.

Valuation: Fairly fully valued, awaiting digital returns

The importance of digital to medium term growth prospects should not be underestimated and we concur with management that increased focus on digital is the right course for the group. However, the reduction in our FY13 and FY14 EPS estimates outlined above raises the group's higher relative rating versus our selected peer comparators (Exhibit 4), suggesting that the current valuation is fairly fully valued, particularly in view of the short term costs, and as investors await the improved growth prospects following, the completion of the 'Digital Transition Plan'.

Financials: Modest gearing; deal liabilities covered by cash flow

At 31 January 2013, the group's net debt was £5.2m (net debt/equity: 13.2%). With the benefit of higher operating cash flow in H213, we anticipate net debt to fall to £2.9m by FY13 year-end and to negligible debt by FY14 year-end. There were also balance sheet liabilities for £1.2m deferred consideration, plus outstanding £4.1m for contingent consideration and £4.2m for share purchase obligations - these amounts being calculated based on the group's discounted estimates of the most likely outcome for the profitability of each of the acquired businesses.

Sensitivities

Our base case scenario makes five key assumptions, on which 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 marginally less than global GDP;
- key employees are retained; and
- The 'Digital Transition Plan' is successfully implemented.

Interim results for the six months to 31 January 2013

Next Fifteen's interim results are slightly shy of our expectation, with the most significant impact being on diluted adjusted EPS, which came in at 4.2p (H112: 4.35p) versus our 4.6p estimate. Although adjusted pre-tax profit rose 6% to £4.5m (H112: £4.2m), this decline in EPS was affected primarily by a higher tax charge (31.0%; H112: 26.6%) and higher minorities (£0.4m; H112: £0.3m). Nevertheless, the board has the confidence to declare an 11% increase in the interim dividend, which continues the group's strategy of double digit dividend growth.

Reporting segments redefined

Management has redefined its reporting segments to reflect the group's transition from traditional public relations businesses to a broader range of communications services, particularly through digital channels. In addition, management says that it is no longer relevant to segment between industry sector and audiences. Integrated Communications (IC) segment includes the technology and consumer PR businesses, while the group's other businesses, marketing/communications operations and investor relations, are placed in Specialist Agencies (SA).

H113 revenue: Up 3%, organic growth 1%

H113 revenue rose 3% to £46.6m (H112: £45.3m). Overall organic growth was 1%, with 5% in the US indicating tough conditions in other geographical areas. The IC segment contributed 83% of group revenues in H113 (H112: 85%), while the SA segment was 17% of revenues (H112: 15%). While most of the group's agencies did perform well, its Bite subsidiary (IC segment) experienced a disappointing operating performance through the loss of a number of significant clients at the same time as it undergoes transition to a global marketing services agency. Organically, SA grew revenue by 20%, and IC fell 2%. Group adjusted operating margin declined to 14.6% (H112: 14.9%). Exhibit 1 shows the segmental margin trend over the past three and a half years. Head office expenses of £2.1m fell from £2.2m in H112 coming in at 4.5% of revenue (HI12: 4.9%; FY12: 4.6%).

Exhibit 1: Analysis of revenue by reporting segment

	Integrated Communications			Specialised Agencies		
£000s	**HI12**	**H212**	**H113**	**HI12**	**H212**	**H113**
Revenues	38,703	39,397	39,415	6,661	6,822	7,206
Adjusted operating profit	5,669	6,503	5,501	1,071	990	1,314
Adjusted operating profit margin (%)	14.6	16.5	14.0	16.1	14.5	18.2

Source: Company FY13 interim results, Edison Investment Research. Note: Adjusted operating profit is before head office expenses, intangible amortisation, exceptional items and acquisitional share based payments.

US: 5% organic growth and best margins

North America contributed 52.2% (H112: 51.8%) to group revenue, with the US showing 5% organic growth. Not only being the largest geographic segment, North America also continued to deliver the best operating margin at 20.9% (H112: 20.0%). Exhibit 2 summarises geographic operating margins, which (H113 v H112) fell in the UK and Asia Pacific, though improved in Europe.

Exhibit 2: Revenue and adjusted operating margin analysis by geography

	Revenues % by geography			Adjusted operating profit margin %		
	HI12	**H212**	**H113**	**HI12**	**H212**	**H113**
US & Canada	51.8	51.1	52.2	20.0	19.5	20.9
UK	20.8	22.3	21.8	16.0	17.8	11.4
Asia Pacific	15.7	15.4	14.5	3.3	6.0	3.2
Europe & Africa	11.7	11.2	11.5	5.4	12.0	6.6

Source: Company FY13 interim results, Edison Investment Research. Note: Adjusted operating profit is before head office expenses, intangible amortisation, exceptional items and acquisitional share based payments.

Analysis of FY13 and FY14 estimate revisions

Exhibit 3 summarises the revisions to our FY13 and FY14 estimates. These are before the non-recurring cost of the Digital Transition Plan.

The primary adjustments are due to:

- The lower than expected overall organic growth in H113, as demand for traditional public relations continues to erode in many markets;
- The loss of a number of significant clients at Bite;
- Operating costs continue to be kept under control;
- The inclusion of the April 2013 acquisition of an 80% stake in Connections Media, which had $2.65m revenues and profit before tax of $0.85m in CY12. The initial consideration for this stake was $1.85m cash. Deferred consideration may become payable over the next five years dependent on the achievement of performance targets;
- An increase in minorities, following the acquisition of the 80% stake in Connections Media. This is in addition to the already included impact of the establishment of a long-term equity based incentive scheme at Outcast, whereby 15% of this subsidiary was allotted to Outcast's senior management for nil consideration on 1 August 2012; and
- The effective 31% tax rate for H113, which is based by management on the forecast effective tax rate for FY13. Our old estimates of effective tax rate were 28.1% for FY13 and 27.7% for FY14; these compared with the actual effective tax rate of 27.9% in FY12.

Exhibit 3: Analysis of FY13 and FY14 estimate revisions

	FY13 estimate			FY14 estimate		
£000s	Old	New	Change	Old	New	Change
Revenues	97,000	96,500	(500)	103,500	103,000	(500)
Adjusted operating profit	11,000	10,500	(500)	11,880	11,530	(350)
Adjusted pre-tax profit	10,500	10,000	(500)	11,600	11,220	(380)
Tax	(2,950)	(3,095)	(145)	(3,210)	(3,470)	(260)
Adjusted post-tax profit	7,550	6,905	(645)	8,390	7,750	(640)
Minorities	(625)	(800)	(175)	(750)	(900)	(150)
Adjusted net income	6,925	6,105	(820)	7,640	6,850	(790)
Adjusted diluted EPS (p)	10.6	9.3	(1.3)	11.3	10.3	(1.0)

Source: Edison Investment Research

Peer comparison table

Exhibit 4: Peer comparison table

	Ticker	Price	Mkt Cap	Hist	Hist	Hist	P/E	P/E	Yield
		p/$	£m/$m	YE	EV/Rev	EV/EBITDA	Jul-13*	Year2	Jul-13*
Chime	CHW	243.0	207	Dec-12	1.3	9.2	11.1	9.9	3.0
Creston	CRE	86.3	53	Mar-12	0.7	3.3	7.5	7.2	4.5
Huntsworth	HNT	49.1	124	Dec-11	1.1	6.4	7.0	6.9	7.1
Omnicom (US)	OMC	58.6	15,305	Dec-12	1.2	8.2	15.4	13.3	2.2
WPP	WPP	1,034.0	13,069	Dec-12	1.5	9.1	13.3	11.8	2.8
				Average	1.2	7.3	10.9	9.8	3.9
Next Fifteen	NFC	113.5	68	Jul-12	0.8	7.4	12.2	11.0	2.2

Note: Prices as at close on 22 April 2013. * Straight line adjustment to 31 July 2013 year-end
Source: Thomson Reuters, Edison Investment Research

Exhibit 5: Financial summary

Year-ending 31 July	£'000s	2009	2010	2011	2012	2013e	2014e
Accounting basis		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Billings		77,287	91,175	105,163	108,453	113,000	120,600
Revenues		65,394	72,328	86,035	91,583	96,500	103,000
EBITDA		7,272	8,930	11,518	12,858	13,500	14,680
Operating Profit (before GW and except.)		5,591	6,992	8,823	10,047	10,500	11,530
Goodwill Amortisation		0	0	0	0	0	0
Exceptionals		(2,091)	(1,308)	(871)	(3,630)	(3,395)	(2,320)
Other		0	0	0	14	0	0
Operating Profit		3,500	5,684	7,952	6,431	7,105	9,210
Net Interest		(342)	(380)	(425)	(472)	(500)	(310)
Profit Before Tax (norm)		5,249	6,612	8,398	9,589	10,000	11,220
Profit Before Tax (FRS 3)		3,158	5,304	7,527	5,959	6,605	8,900
Tax		(884)	(1,591)	(2,260)	(1,652)	(1,750)	(2,350)
Profit After Tax (norm)		3,750	4,638	5,854	6,914	6,905	7,750
Profit After Tax (FRS 3)		2,274	3,713	5,267	4,307	4,855	6,550
Average Number of Shares Outstanding (m)		52.6	54.4	54.9	57.0	59.4	59.8
EPS - normalised (p)		6.5	8.4	10.2	11.4	10.3	11.5
EPS - normalised fully diluted (p)		6.5	7.5	8.7	10.1	9.3	10.3
EPS - FRS 3 (p)		3.7	6.7	9.1	6.8	6.8	9.5
Dividend per share (p)		1.70	1.85	2.05	2.30	2.55	2.85
EBITDA Margin		9%	10%	11%	12%	12%	12%
Operating Margin (before GW and except.)		9%	10%	10%	11%	11%	11%
BALANCE SHEET							
Non-current assets		22,618	31,919	44,336	48,227	49,027	49,577
Intangible Assets		18,441	27,111	37,926	41,019	41,819	42,669
Tangible Assets		1,949	2,269	3,067	2,721	2,721	2,421
Other non-current assets		2,228	2,539	3,343	4,487	4,487	4,487
Current Assets		22,840	29,470	34,769	33,337	35,761	40,181
Debtors		15,710	22,174	26,252	24,901	27,650	29,150
Cash		7,130	7,296	8,517	8,436	8,111	11,031
Current Liabilities		(15,237)	(25,248)	(26,095)	(24,230)	(24,199)	(24,349)
Creditors		(14,887)	(20,009)	(25,767)	(23,946)	(23,915)	(24,065)
Short term borrowings		(350)	(5,239)	(328)	(284)	(284)	(284)
Long Term Liabilities		(5,319)	(8,562)	(20,677)	(20,106)	(19,106)	(18,606)
Long term borrowings		(4,995)	(2,908)	(9,760)	(10,756)	(10,756)	(10,756)
Other long term liabilities		(324)	(5,654)	(10,917)	(9,350)	(8,350)	(7,850)
Net Assets		24,902	27,579	32,333	37,228	41,483	46,803
CASH FLOW							
Operating Cash Flow		6,261	6,572	11,905	10,052	9,125	12,330
Net Interest		(342)	(380)	(417)	(470)	(500)	(310)
Tax		(1,476)	(1,465)	(2,618)	(2,520)	(1,750)	(2,350)
Capex		(307)	(1,936)	(2,202)	(957)	(1,800)	(1,700)
Acquisitions/disposals *		(4,549)	(4,251)	(6,078)	(5,664)	(4,000)	(3,500)
Financing		(1,941)	2,263	1,927	719	0	0
Dividends		(900)	(932)	(1,045)	(1,208)	(1,400)	(1,550)
Other		0	0	0	0	0	0
Net Cash Flow		(3,254)	(129)	1,472	(48)	(325)	2,920
Opening net debt/(cash)		(3,410)	(1,785)	851	1,571	2,604	2,929
Finance leases		(225)	(150)	(90)	(72)	0	0
Other		1,854	(2,357)	(2,101)	(913)	0	0
Closing net debt/(cash)		(1,785)	851	1,570	2,604	2,929	9

Source: Next Fifteen Communications, Edison Investment Research

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