Update

Edison investment research

24 April 2012

Next Fifteen Communications

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
07/10	72.3	6.6	7.5	1.85	12.8	1.9
07/11	86.0	8.4	8.7	2.05	11.0	2.1
07/12e	93.0	9.5	9.5	2.25	10.5	2.3
07/13e	99.0	10.7	10.6	2.50	9.1	2.6

Note: *PBT and EPS (diluted) are normalised, ex intangible amortisation and exceptionals.

Investment summary: Strong digital showing

Next Fifteen's interim results showed good revenue growth of 11%, with adjusted pre-tax up 15% and EPS up 12%. As anticipated, digital marketing is leading the way with organic growth of 39%. Overall organic growth of 4% reflects the strong growth in a number of the group's agencies, offset by weakness in Europe and the group's UK consumer business. Management is addressing the latter by accelerating digital capabilities across the UK consumer activities, which should reap benefit in FY13 and beyond. The balance sheet is modestly geared at 12% and, excluding any further acquisitions, the group should return to a net cash position in FY13.

Solid start to FY12

H112 revenues of £45.3m were up 11% on H111. Overall organic growth of 4% reflects the strong growth in a number of the group's agencies, offset by weakness in Europe and the group's UK consumer business. Management's strategy of focusing on digital marketing is delivering results, with strong organic growth of 39% from the group's dedicated digital agencies. Profitability is in line with our expectations and we are maintaining both our FY12 and FY13 estimates. The interim dividend is up 10%.

Bourne 20% minority bought this month

On 5 April, the group acquired the remaining 20% minority of Bourne, a global full-service digital agency – the initial 80% was purchased in May 2011. This supports the group's focus on the digital arena, which is delivering positive results. Last October, the group also formed Animo, a specialised marketing agency addressing the mobile technology market.

Valuation: Digital expertise supports current rating

Our estimated FY13 P/E of 9.1x for Next Fifteen is marginally higher than July 2013 adjusted P/Es of similar sized peers and considerably lower than the larger sector peer comparators WPP and Omnicom. We continue to contend that the group's expertise and strong growth in the digital arena, supported by its 30-year specialisation in the tech sector, adds some justification to the current premium P/E rating to similar-sized peers.

Price	96p
Market Cap	£55m

Share price graph

Share details

Code	NFC
Listing	AIM
Sector	Media
Shares in issue	57.8m

Price

52 week	High	Low
	97p	73p

Balance Sheet as at 31 January 2012

Debt/Equity (%)	12
NAV per share (p)	62
Net borrowings (£m)	4.4

Business

Next Fifteen Communications is a worldwide 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.

Valuation

	2011	2012e	2013e
P/E relative	85%	80%	78%
P/CF	3.8	4.2	3.6
EV/Sales	0.5	0.5	0.5
ROE	17%	19%	18%

Geography based on revenues (H112)

UK	Europe	US	Other
20%	12%	52%	16%

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

Investment summary: Strong digital showing

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 (H112 revenues: 66.5%), consumer (16.6%) and digital/research consultancy (9.7%) and corporate (7.2%) sectors, with world leading and autonomous PR, research, digital, investor relations and policy communications subsidiaries. Over the past nine years, a series of acquisitions has been successfully integrated into the group. The group has 51 offices across 18 countries and employs over 1,000 staff. Top 10 clients represented around 30% of revenues in FY11 (32% in FY10).

Addressing the technology industry, Next Fifteen has three principal PR subsidiaries, Text 100, Bite and OutCast, and an 85% stake in The Blueshirt Group, an investor relations company that services the technology market. On 5 October 2011, the group, via Bite, acquired 80% of German PR and consulting firm Trademark. On the non-technology front, Next Fifteen owns Lexis, which primarily addresses the consumer sector, mostly in the UK, and M Booth, a leading New York-based consumer and B2B agency. In September 2010, Next Fifteen set up a 51% owned digital agency, Beyond, which combined the group's existing digital start-up and its Context Analytics businesses with Type 3, a digital agency acquired that month. In May 2011, the group acquired an 80% stake and, in April 2012, the remaining 20% minority of Bourne, a global digital agency.

Valuation: Digital expertise supports current rating

Our estimated FY13 P/E of 9.1x for Next Fifteen is marginally higher than July 2013 adjusted P/Es of similar sized peers and considerably lower than the larger sector peer comparators WPP and Omnicom (see Exhibit 3). We continue to contend that the group's expertise and strong growth in the digital arena, supported by its 30-year specialisation in the tech sector, adds some justification to the current premium P/E rating to similar-sized peers.

Sensitivities

Our base case scenario makes four key assumptions:

- major clients are retained;
- the US dollar does not weaken or strengthen significantly;
- the technology industry continues to grow slightly ahead of global GDP; and
- key employees are retained.

A material change in any of these could surprise either on the upside or on the downside.

Financials: Modest gearing now/FY13 net cash (ex new deals)

Next Fifteen has a long record of positive cash flow from operations. During FY11 this amounted to £11.9m and in the first half of FY12 a total of £4.9m was generated. After £5.4m of acquisition-related payments during H112, net debt rose from £1.6m to £4.4m at 31 January 2012, representing a modest 12% net debt/equity. For H212, we are currently estimating £6.6m cash inflow from operations and that net debt should fall to £1.5m by FY12 year-end. In the absence of any further acquisitions, the group should return to a net cash position in FY13.

Interim results for the six months to 31 January 2012

Overall strong first half dampened by UK consumer and Europe

The first half of FY12 produced 11% revenue growth. Overall organic growth of 4% reflects the strong growth in a number of the group's agencies, offset by weakness in Europe and the group's UK consumer business. Management's strategy of focusing on digital marketing is delivering results, with strong organic growth of 39% from the group's dedicated digital agencies. However, the group's UK consumer business, Lexis PR, has been slower to adapt to the digital marketing world. This business has been rebranded as Lexis, the recommendation agency, and is being restructured to accelerate its transition to digital at a cost of c £0.4m in FY12 for benefit in 2013 and beyond.

Exhibit 1: Revenue by sector and geography

% by Sector	FY10	FY11	H1 FY12	% by Geography	FY10	FY11	H1 FY12
Technology	74.9	69.0	66.5	US & Canada	51.5	52.5	51.8
Consumer	19.9	18.7	16.6	UK	20.9	20.9	20.8
Digital/Research	2.3	6.5	9.7	Asia Pacific	14.1	15.3	15.7
Corporate	2.9	5.8	7.2	Europe & Africa	13.5	11.3	11.7

Source: Company interim report FY12

Segment adjusted operating profit (AOP), which excludes primarily acquired intangible amortisation and £0.25m UK consumer business reorganisation costs, rose 15.7% in H112. AOP margin for H112 was 10.0%, versus H111 9.6% and FY11 10.3%. The group's largest contributors – technology and North America – improved their AOP margins. Both consumer and Europe AOP margins declined significantly due to the reasons identified above. We expect that the UK consumer segment to recover in FY13 following the rebranding and restructure.

Exhibit 2: Adjusted operating profit margin by sector and geography

% by Sector	FY10	FY11	H1 FY12	% by Geography	FY10	FY11	H1 FY12
Technology	14.9	13.5	14.6	US & Canada	19.7	19.3	20.0
Consumer	16.6	17.9	15.6	UK	15.8	16.3	16.0
Digital/Research	7.3	12.0	10.2	Asia Pacific	1.5	1.8	3.3
Corporate	25.7	22.8	22.2	Europe & Africa	12.7	8.8	5.4
Head Office	(5.7)	(4.5)	(4.9)	Head Office	(5.7)	(4.5)	(4.9)
Adj operating profit	9.7	10.3	10.0	Adj operating profit	9.7	10.3	10.0

Source: Company interim report FY12

Peer comparison

Exhibit 3: Peer comparison table

Note: Prices as at close on 20 April 2012. * Based on normalised and fully diluted EPS.

	Ticker	Price p/$	Mkt Cap £m/$m	Hist YE	Hist EV/Rev	Hist EV/EBITDA	P/E Jul-13*	Yield Jul-13*
Chime	CHW	218	178	Dec-11	1.1	5.4	7.9	3.4
Creston	CRE	64	39	Mar-11	0.6	3.3	4.5	5.6
Huntsworth	HNT	48	119	Dec-11	1.1	6.3	6.4	7.4
Omnicom (US)	OMC (US)	50	13,654	Dec-11	1.1	6.9	12.8	2.5
WPP	WPP	843	10,624	Dec-11	1.2	5.0	10.7	3.6
				Average	1.0	5.4	8.5	4.5
Next Fifteen	NFC	96	55	Jul-11	0.7	5.3	9.1	2.3

Source: Thomson Reuters, Edison Investment Research

Exhibit 4: Financials

Year-ending 31 July	£'000s	2007	2008	2009	2010	2011	2012e	2013e
Accounting basis		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS								
Billings		69,422	73,916	77,287	91,175	105,163	112,000	119,000
Revenues		59,268	63,107	65,394	72,328	86,035	93,000	99,000
EBITDA		7,007	7,433	5,531	8,446	10,712	12,314	14,400
Operating Profit (before GW and except.)		5,837	6,706	5,591	6,992	8,823	10,040	11,050
Goodwill Amortisation		0	0	0	0	0	0	0
Exceptionals		(458)	(1,066)	(2,091)	(1,308)	(870)	(1,713)	0
Other		56	117	0	0	0	0	0
Operating Profit		5,435	5,757	3,500	5,684	7,953	8,327	11,050
Net Interest		(313)	(241)	(342)	(380)	(426)	(500)	(320)
Profit Before Tax (norm)		5,580	6,582	5,249	6,612	8,397	9,540	10,730
Profit Before Tax (FRS 3)		5,122	5,516	3,158	5,304	7,527	7,827	10,730
Tax		(1,781)	(1,655)	(884)	(1,591)	(2,260)	(2,510)	(3,130)
Profit After Tax (norm)		3,713	4,657	3,750	4,638	5,854	6,677	7,600
Profit After Tax (FRS 3)		3,341	3,861	2,274	3,713	5,267	5,317	7,600
Average Number of Shares Outstanding (m)		49.0	51.7	52.6	54.4	54.9	57.2	57.8
EPS - normalised (p)		7.1	8.6	6.5	8.4	10.2	11.0	12.3
EPS - normalised fully diluted (p)		7.0	8.5	6.5	7.5	8.7	9.5	10.6
EPS - FRS 3 (p)		6.3	7.1	3.7	6.7	9.1	8.6	12.3
Dividend per share (p)		1.50	1.70	1.70	1.85	2.05	2.25	2.50
EBITDA Margin		10%	10%	7%	9%	10%	11%	12%
Operating Margin (before GW and except.)		10%	11%	9%	10%	10%	11%	11%
BALANCE SHEET								
Non-current assets		18,442	20,206	22,618	31,919	44,336	46,686	46,586
Intangible Assets		13,507	15,462	18,441	27,111	37,926	40,276	40,076
Tangible Assets		2,162	2,435	1,949	2,269	3,067	3,067	3,167
Other non-current assets		2,773	2,309	2,228	2,539	3,343	3,343	3,343
Current Assets		20,894	25,946	22,840	29,470	34,769	36,812	42,142
Debtors		15,060	16,421	15,710	22,174	26,252	28,200	30,800
Cash		5,834	9,525	7,130	7,296	8,517	8,612	11,342
Current Liabilities		(15,670)	(20,643)	(15,237)	(25,248)	(26,095)	(25,571)	(25,771)
Creditors		(14,958)	(20,228)	(14,887)	(20,009)	(25,767)	(25,243)	(25,443)
Short term borrowings		(712)	(415)	(350)	(5,239)	(328)	(328)	(328)
Long Term Liabilities		(8,684)	(5,871)	(5,319)	(8,562)	(20,677)	(20,977)	(19,077)
Long term borrowings		(5,190)	(5,700)	(4,995)	(2,908)	(9,760)	(9,760)	(9,760)
Other long term liabilities		(3,494)	(171)	(324)	(5,654)	(10,917)	(11,217)	(9,317)
Net Assets		14,982	19,638	24,902	27,579	32,333	36,950	43,880
CASH FLOW								
Operating Cash Flow		7,203	9,599	6,261	6,572	11,905	11,505	13,600
Net Interest		(311)	(240)	(342)	(380)	(418)	(500)	(320)
Tax		(1,992)	(1,090)	(1,476)	(1,465)	(2,618)	(2,510)	(3,130)
Capex		(1,246)	(2,153)	(307)	(1,936)	(2,202)	(1,550)	(1,750)
Acquisitions/disposals		(1,959)	(829)	(4,549)	(4,251)	(6,078)	(5,700)	(4,400)
Financing		953	(994)	(1,941)	2,263	1,927	0	0
Dividends		(691)	(807)	(900)	(932)	(1,045)	(1,150)	(1,270)
Other		0	0	0	0	0	0	0
Net Cash Flow		1,957	3,486	(3,254)	(129)	1,471	95	2,730
Opening net debt/(cash)		1,439	68	(3,410)	(1,785)	851	1,571	1,476
Finance leases		(299)	(217)	(225)	(150)	(90)	0	0
Other		(287)	209	1,854	(2,357)	(2,101)	0	0
Closing net debt/(cash)		68	(3,410)	(1,785)	851	1,571	1,476	(1,254)

Source: Edison Investment Research, company accounts