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The Marketing Group

Ready to move forward

Initiation of coverage

Media

The Marketing Group (TMG) aims to build a major global force in marketing services, a sector characterised by a handful of major holding companies and a large number of smaller agencies. After a rapid initial acquisition phase, an entirely new board took over (Q416/Q117) with more capital markets experience and a steadier expansion strategy. A subsequent portfolio review resulted in three disposals and an impairment charge related to past acquisitions. This should give the group a firm base from which to start building organic, as well as acquisitive, progress. These moves have yet to be reflected in the market valuation.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	EV/EBITDA (x)	Yield (%)
12/16**	15.8	2.2	11.3	0.0	3.9	6.0	N/A
12/17e	24.6	1.5	3.8	0.0	11.7	8.0	N/A
12/18e	27.0	1.9	4.2	0.0	10.5	6.7	N/A
12/19e	29.5	2.3	4.9	0.0	9.0	5.6	N/A

Note: *PBT and EPS (diluted) are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Not restated for disposals.

Building blocks in place

TMG is a network of 16 agencies across eight countries, in three disciplines: brand & communications; influence & amplification; and science & performance. The growth strategy is both organic and acquisition-based, attracting agencies that want access to capital and the benefits of network effects, yet do not wish to sell out to a holding company. Management has a technology-based approach, with improved internal reporting and a new collaboration platform. Head office supports new business initiatives, with centralised media buying where needed. The newly-installed team has been joined by Mary Keane-Dawson, who adds expertise in performance media with large, global clients and who will support the acquisition strategy. Future purchases will need to be complementary and to add value.

Financials rebased

The FY16 income statement does not reflect subsequent portfolio changes, so year-on-year comparisons may not be useful. Q217 results showed a good step up on Q117, with net sales up 6% and EBITDA margin lifted from 7.3% to 10.9%. The focus is now on driving the bottom, rather than top, line, and margins should continue to improve. The company took a one-off goodwill impairment charge with the interims in August of €43.6m to reflect legacy issues with all-paper purchases at higher prices. The group had €0.9m of net cash, net assets of €31.4m at end June.

Valuation: No credit for moves to date or growth

The shares listed in June 2016 at €1.00, reaching €9.00 in August 2016. The rapid flow of paper-based deals then contributed to the falling share price, exacerbating the discrepancy between deal prices and market value. The new management team has made sensible moves to bring all under control. The current valuation is yet to reflect these moves or the enhanced growth prospects from the agencies benefiting from being part of a larger group and associated margin expansion.

27 September 2017

Price	**€0.44**
Market cap	**€15m**

Net cash (€m) as at 30 June 2017	0.9
Shares in issue	34.7m
Free float	58.4%
Code	TMG
Primary exchange	Nasdaq First North
Secondary exchange	Frankfurt

Share price performance

%	1m	3m	12m
Abs	(25.6)	8.1	(89.5)
Rel (local)	(28.4)	11.7	(90.6)
52-week high/low		€4.52	€0.37

Business description

The Marketing Group is building a global full-service marketing network. Each company within the group provides specialist marketing services brought together, within complementary communities of practice, to form an international network that can address a global market.

Next events

Q3 report	15 November 2017
FY17 report	28 February 2018

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Edison profile page

The Marketing Group is a research client of Edison Investment Research Limited

Investment summary

Company description: Growing global marketing network

TMG is building a global marketing network business. In terms of scale, it envisages sitting between the large, international holding companies and the smaller independent agencies and networks that are more likely to work in one or two geographic markets or across a limited number of competencies. Creating a federation of companies that collaborate through the use of technology (apps have already been developed and launched to facilitate this in real-time and across borders), management expects the set-up to attract good quality agencies to the network that are looking to scale up and access larger and more interesting accounts, without compromising their independent ethos. With offices in eight countries, the group has an impressive client list including Novartis, GoPro, Morgan Stanley, Renault, IBM, Universal Music, Nokia and Samsung. A new management team took over in Q416/Q117 and has conducted a thorough review of all the group businesses, a process that resulted in the disposal of three agencies in July 2017.

Financials: Rebased

- The FY16 figures are as initially reported and so are not directly comparable to the Q217/H117 numbers reported in August.
- The Q117 numbers have been adjusted to illustrate the deleterious impact from the three agencies since disposed. As a result, EBITDA for that quarter rose from the reported €125k to the restated €298k, with the EBITDA margin (to net sales) lifting from 1.7% to 7.3%.
- More progress was made in Q217, with net sales ahead 5.4% quarter-on-quarter and a further uplift in EBITDA margin to 10.9%.
- The divestment of three agencies and the review of the carrying value of other group agencies purchased for paper when the share price was considerably higher led to a substantial adjustment to the goodwill shown on the balance sheet of €43.6m. While this is a non-cash item, it resulted in a large reported loss for the period.

Valuation: Retrenched

Having listed at €1.00 and climbed rapidly to €9.00, the share price performance has since drifted, albeit with a couple of modest rallies. This reflected growing concerns over the continuing share issuance and a lack of clarity and, consequently, confidence in the pro-forma financial information. With the arrival of new management, there was a natural uncertainty over how the strategy would change, reflected in the continued downward pressure on the share price. The management changes and recent accounting write-offs should have addressed some of these underlying concerns. The current multiple-based valuation is roughly in line with other smaller and mid-cap quoted marketing groups, while a reverse DCF indicates that the current price is factoring in no improvement in margins on medium-term growth of just under 1% or even a reduction in margin on 3% mid-term net sales growth. A modest increase in EBITDA margin to 13% in the medium term, on a conservative top-line growth rate of 3%, suggests a price of €0.60.

Sensitivities: Strategy implementation

The key sensitivity is management’s ability to deliver on its growth strategy. This comprises both identifying and implementing acquisitions that complement the existing network, but also in enabling those agencies to improve returns. The focus here is on the use of technology to facilitate collaboration and to streamline process. Currency is a potential issue in translation rather than transaction. As for all peers, there will be risks stemming from client or from staff churn, as well as IT/systems risk.

Company description: Building blocks

TMG is a network of marketing communication and services businesses, operating across various geographies and operating segments. The rapid initial spate of acquisitions was followed by a change in the management team (new CEO in November 2016, new CFO and chairman in February 2017) and a subsequent thorough strategic review. As a result of this process, three disposals were announced in July 2017. TMG now consists of 16 agencies, which between them have 30 offices in eight countries (across the US, UK, Europe, Singapore and Australia/New Zealand). Australia is currently the largest single region by revenue. Between them, the group agencies cover a wide range of disciplines within the marketing communications remit, with digital and technical expertise at the core. They also address a broad range of client vertical markets. With the latest reported figures (interims to end June 2017), the group has described its activities as falling into three broad groupings: brand & communications; influence & amplification; and science & performance. The breakdown as a proportion of revenue in these groupings and by geography is shown in Exhibits 2 and 3, below.

Exhibit 1: Group agencies and activities

Practice	Brand & communications	Influence & amplification	Science & performance
Service range	Brand strategy	PR	Data
	Brand design	Social media	Insight
	Creative strategy	Content	Media
	Broadcast communications	Sponsorship	Applications
	Integrated communications	Events	Platform builds
Key agencies	Addiction Advertising (Sing)	Black Marketing (Sing)	Clickverta (UK)
(based from)	Brand Theatre (Sing)	Creative Insurgence (Sing)	Digital Virtue (UK)
	Channelzero (Aus)	Nice & Polite (UK)	Marker Studio (NZ)
	DAE (US)	One9Ninety (Sing)	Rainmakers (UK)
		Ranieri (UK)	The Lead Generation Company (Aus)
		Slingshot Sponsorship (UK)	

Source: The Marketing Group, Edison Investment Research

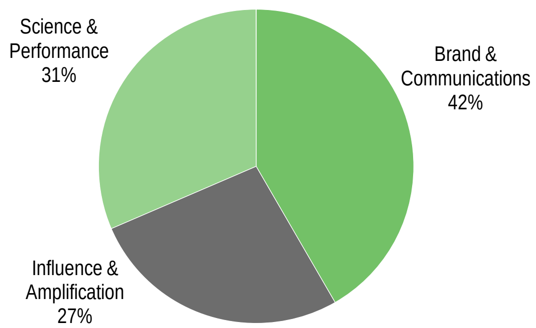
The initial concept was put together under the auspices of Unity Group, a private equity house based in Singapore, which also provided the support for the initial acquisition phase. The group listed on Nasdaq First North in June 2016 and at that stage had four agency portfolio companies. For a UK-based group founded out of Singapore with a broad initial geographic mix, and ambitions to diversify it further, there was not an obvious natural stock market on which to list. The listing on Nasdaq First North may not seem the obvious choice. However, given the scale and the global nature of the initial management team's ambitions, one of the primary objectives was to have a listing in a liquid currency – preferably the US dollar or the euro. They also wanted to be listed on an exchange where there is a culture of IPOs and an enthusiasm for retail investment. Nasdaq First North ticked those boxes. The IPO was in June 2016 at a price of €1.00, with the sale of existing shares raising €1.25m. The offer was over three times subscribed.

By the December year-end of its first financial year, the number of agencies listed as being in the group had increased to 17, located across Singapore, Australia, New Zealand, the UK and the US. The acquisition prices were paid in equity of the enlarged group, with the potential dilution theoretically negated by their a) being profitable and b) adding value to the group beyond their individual contribution. However, the exclusive use of equity for the deals distorted the balance sheet valuations of the acquired companies, due in part to the market's inability to value the stock given the lack of available and coherent financial information.

From the vendors' perspective, one of the key attractions of selling into TMG was – and remains – that it is *not* one of the major holding companies or consultancies. Selling into a global group often leads to a loss of autonomy for the vendor (if they choose to stay) and a change in the character of the business, which commonly will reflect the personality of the founder. The TMG structure should allow the acquired agency to retain key elements of its identity and ethos, while giving access to:

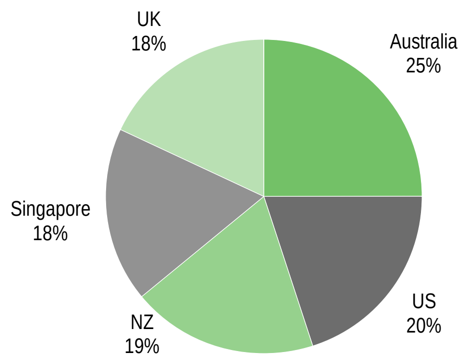
- larger pools of capital;
- technical expertise;
- economies of scale in aspects of central purchasing;
- the market experience of a group of like-minded peers;
- other marketing capabilities and skill sets within their peer companies; and
- opportunities to cross- and up-sell to clients.

Exhibit 2: H117 revenue by activity type



Source: The Marketing Group accounts

Exhibit 3: H117 revenue by geography



Source: The Marketing Group accounts

Diverse agency base

Rather than describe all of the network agencies in detail, we have chosen six key operations in order to give a flavour of the type of work they undertake and some examples of their clients. Fuller descriptions and links to the individual agency websites are available via the group website tmg-plc.com. We here include the financial information as reported at the time of each deal, with the comment that these were usually given as 'pro-forma' figures for 2015 (historic) and 2016 (current), without any further detail. All the deals are summarised in Exhibit 4, below.

DAE Advertising, Inc. (US)

DAE joined the group in November 2016, having been identified by group company Wilkin Marketing (which has, itself, now left the group). It was founded in 1990 in San Francisco and provides advertising and marketing services, strategic planning, creative development, media planning & buying, digital & social media marketing, community engagement, and event management services. It has particular understanding of the substantial and fast-growing Asian American market and its key clients include Wells Fargo, AARP, Southwest Airlines, Gilead, Kikkoman, and Cathay Pacific. At purchase, DAE's annualised revenues were running at €4.95m, earning an EBITDA margin of 19.4%. The purchase price of €7.76m represented a revenue multiple of 1.2x and an EBITDA multiple of 6.0x and was entirely met by the issue of TMG's shares at the then price of €3.69. Website: www.dae.com

The Lead Generation Company (Australia)

Lead Generation Company was established in Melbourne in 2004 and specialises in lead generation and new business acquisition strategies for B2B and B2C. Its services include strategic data provision, outbound appointment setting, social media prospecting, email marketing /

marketing automation and digital lead generation. Key current clients include Optus, Nestle, Brennan IT and Health & Co. LeadGen had projected calendar 2016 revenues of €2.48m and an anticipated EBITDA margin of 24.5% (up from €1.83m and a 13.9% EBITDA margin in 2015). It was bought together with Rainmakers in June 2016 for €7.04m at an issue price of €1.85, on historic multiples of 1.0x revenue and 13.4x EBITDA; and prospective multiples of 1.2x revenue, 8.9x EBITDA (Rainmakers was forecast to have lower 2016 revenues, but has a large element of media put-through business). Website: www.leadgeneration.com.au

Channelzero (Australia)

Sydney-based Channelzero is a creative brand agency founded in 2003, acquired in August 2016. In its own words, it seeks to connect "brands to grocery buyers with an end-to-end solution that includes packaging and positioning and sales and supply chain management alongside core creative brand strategy." It had 2015 revenues of €2.71m and an EBITDA margin of 6.5%, which were forecast to grow to €3.81m and 10.6%, respectively, for calendar 2016 at the time of the deal. The deal of which it was part was struck at 2.7x 2015 revenue; 17.5x EBITDA (on 2016 projections, 2.0x and 8.9x, respectively), using TMG's shares issued at €7.65 (shortly after they reached their peak value of €9 at the start of August 2016). Website: www.channelzero.com.au

Marker Studio (NZ)

Marker Studio is based in Auckland and is a digital product development agency, specialising in creating enterprise-quality web, cloud, tablet and mobile apps. It has a broad range of clients, including verticals such as healthcare, travel and consumer goods. It was acquired alongside Astute and Imagine Group Entertainment in August 2016. Marker had 2015 revenues of €1.73m on which it achieved an EBITDA margin of 2.0%, which was projected to increase to 20.0% in 2016 on top line growth of 4%. The combined deal was valued at 2.6x 2015 revenue, 10.3x EBITDA (on 2016 projections, 2.3x and 8.9x, respectively), using TMG's shares issued at €6.45. However, the largest constituent of this deal was the purchase of Astute, which did then not complete. Website: www.markerstudio.com

Ranieri (UK)

Ranieri was established in 2002 and specialises in media relations, social media management, influencer campaigns and content creation and is best known in the sector for consumer technology PR in the UK and, more recently, in France. It was purchased alongside Channelzero (above) and achieved a 14.5% EBITDA margin on revenues of just over €1.0m in 2015 with contemporaneous projections for 12% top line growth and an improvement in margin to 17.6% for 2016. The management team was realigned in August 2017 to meet the needs of the growing business. Website: www.raniericommunications.com

Addiction (Singapore)

Established in 2011, Addiction joined the group in September 2016 and is an advertising agency addressing both public and private sector clients. These include the Monetary Authority of Singapore, the Singapore Building and Construction Authority, Standard Chartered Bank, OCBC Bank and China Life Insurance. Addiction had revenue of €1.30m in 2015, with an EBITDA margin of 17.9%, anticipated to rise to €2.96m and 26.7% for 2016. It was purchased alongside TDA in the US in a deal struck at 2.4x historic and 1.9x prospective revenues; 11.8x and 8.7x EBITDA, respectively. Website: www.addictionadvertising.com

Working together

In order to facilitate communication and co-operation across the network, inherently difficult due to its geographical dispersion, TMG plc has built an inter-agency collaboration platform, called Temba. Launched in August 2017, Temba has been designed to enable agencies all across TMG to create teams in order to pitch for and deliver global client briefs. It allows them to identify skills, experience, sectors and specialisms from across the group, including regional breakdowns, to facilitate cross-agency co-creation for international clients. Temba also features an adaptive mobile interface and an AI powered bot that connects to Slack, a tool that all the agencies around the world are already using to communicate in real time. This is clear step to deliver the benefits to an individual agency of being part of a larger network and deliver the benefits of scale to the group performance. This cross-fertilisation is often the factor preventing buy-and-build groupings from delivering on their potential.

The need for such a system was identified in spring 2017, when the founders of the group's agencies came together in New York to get to know each other, exchange ideas and work through ideas in conjunction with the newly reconfigured board. It was designed, built and launched within six months through a global collaboration between three TMG agencies in three different countries: Nice & Polite (a UK-based creative content agency), Channelzero (an Australian creative brand agency) and Marker Studio (a New-Zealand-based digital product development agency).

New experienced management team in place

In its early quoted days, the group's executive chairman was the founder, Jeremy Harbour, also chairman (and owner) of The Unity Group, a Singapore-based private equity house that provided the group's M&A support in its early stages of development. After the first frenetic swathe of acquisitions, the management structure was put on a more conventional footing, with the previous team leaving the board.

Adam Graham was recruited and joined the company in November 2016. His most recent position was as chair of the British Interactive Marketing Association, but he is also known in the marketing services industry from his having previously run Omnicom's digital agency Weapon7 and WPP's Rainey Kelly Campbell Roalfe/Y&R digital operation, Saint. From Weapon7 he had moved to a digital marketing consultancy, Cact.us, and more recently had been working on plans for his own private equity-backed marketing roll-up. The position of CEO at TMG has allowed him to step aboard a ready-formed organisation already partway down the route he had previously identified.

The CFO is Mike McElhatton, who joined the group in February 2017. Mike has also had an extensive career within the marketing sector, mostly at Havas Media, and has a successful track record executing acquisitions for public and private companies. He also held senior roles at WPP, Splendid Unlimited (bought by Creston in April 2015) and at Zenith Media.

Alongside the appointment of Mike McElhatton, TMG also announced a new chairman: Don Elgie, well-known to the market as the founder and former CEO of Creston plc up until his 'retirement' in 2014. His long marketing services career went from McCann to Grandfield Rork Collins (subsequently bought by Saatchi & Saatchi), before founding Creston in 2001.

The most recent addition to the team is Mary Keane-Dawson, who was appointed as global CEO, performance media in July 2017. Her role is to drive the cross-agency delivery of online marketing strategy and implementation for global brands. Mary has extensive industry experience, including at a senior level within WPP, most recently at Ogilvy & Mather.

Between them this team has an enviable quantity and variety of experience in the sector, particularly in the digital space. This stems across the quoted and unquoted space and in companies of all sizes, including working knowledge of conditions within the large groups that dominate the space.

Acquisitive and organic growth strategy remains in place

As can be clearly seen over its short life, TMG's initial phase was one of rapid growth through acquisition. The deals to date are summarised in the table below.

Exhibit 4: Deal flow summary (€m unless otherwise stated)

Date	Agency name	Deal price	Strike price	2015 Revenue	2015 EBITDA	2016 Revenue	2016 EBITDA	Notes
30/06/2016	Lead Generation	7.04	€ 1.85	1.0	13.4	1.2	8.9	
	Rainmakers							
25/07/2016	Clickverta	18.58	€ 4.15	2.4	13.7	2.2	8.9	
	Wilkin Marketing							Disposed Aug 17
	Skye Multimedia							Disposed Aug 17
	Marker Metro							Merged with Marker Ltd
26/07/2016	Digital Virtue	0.22	€ 4.15	0.6	3.0			
	VOQS							
01/08/2016	Imagine Group	43.2	€ 6.47	2.6	10.3	2.3	8.9	Disposed Aug 17
	Marker Ltd							Merged with Marker Metro
	Astute							Acq. cancelled
22/08/2016	The Brand Theatre	13.7	€ 7.65	2.7	17.5	2.0	8.9	
	Channelzero							
	Ranieri							
	Slingshot Sponsorship							
26/09/2016	TDA	12.5	€ 4.22	2.4	11.8	1.9	8.8	Acq. did not complete
	Addiction Advertising							
18/11/2016	Khemistry	29.62	€ 3.69	-	-	1.0	6.6	Acq. did not complete
	McCorkell							Acq. cancelled
	Marc Edward Agency							Acq. cancelled
	Precision Marketing Gp							Acq. did not complete
21/11/2016	DAE	5.76	€ 3.69	-	-	1.2	6.0	
14/02/2017	The Content Agency	0.11	€ 1.79					
11/05/2017	Reflexion	not disclosed						

Source: Company press releases, Edison

Following the appointment of the new management team, starting from November 2016, there has been a thorough ‘state of the nation’ review, including a convention of all of the group agencies in New York in the early part of 2017. This enabled the operational and leadership teams of each of these agencies to build personal relationships on which collaboration can grow, as well as give a clearer indication to the central team of where the group’s strongest opportunities lie. Two of the acquisitions the incoming management team inherited were not proceeded with. Three deals that had completed were identified as not being core to the ongoing business and were accounted for as discontinued in the H117 figures, with their balance sheet value written down.

The structures of the deals in the initial phase have also been shown to be flawed. Being entirely for paper, the value was based on the share prices at the time that the deals were struck. Subsequent weakening of the share price has undermined the value that the vendors received for their businesses, as well as leaving them artificially highly valued in the group balance sheet. The sizeable write-down on the goodwill relating to agencies retained by the group (€30.7m) also taken with the interims aims to have addressed the technical aspect of this, while the original vendors have even more incentive to ensure that their being part of the group helps deliver a greater financial return at group level and return the share price to a growth trajectory.

The group strategy is now for a combination of:

- organic growth, particularly through encouraging and facilitating network agencies collaborating on larger and more complex projects and accounts; and
- acquisition of complementary businesses that will add value.

New phase in the marketing services sector

Active M&A environment

There has long been a high level of corporate activity within the marketing communications sector, as entrepreneurs build businesses to a sufficient size or develop an expertise that arouses the interest of the larger groups. Over the years, the larger groups have built scale that dwarves the rest of the industry, with WPP, Omnicom, Havas, Publicis, Dentsu and IPG at the head of the list. The most active holding company buyer in the sector globally in 2016 was Dentsu, which bought a total of 43 companies, with WPP buying 34. IPG had been quieter over recent periods but stepped up its acquisition programme in 2016 with 10 purchases.

More industry headlines, though, were grabbed by what might be termed 'non-traditional' buyers, in particular the purchase by Accenture of the well-known UK creative agency Karmarama. Data marketing agencies are also proving attractive to some of the larger publishers as they transfer more fully into digitally-led business models. The major global consultancy firms are reportedly still very active in their search for suitable candidates.

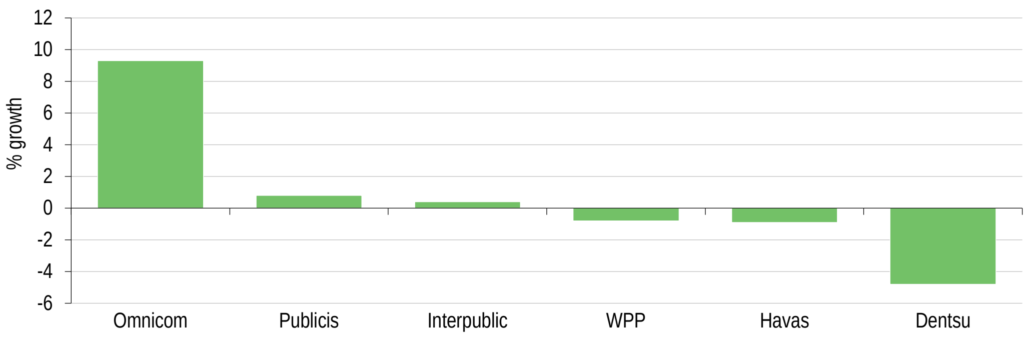
However, many smaller and mid-sized marketing communications businesses have no ambition to be absorbed into the larger groups and run the risk of losing their individual culture and autonomy, even if take-out multiples can be attractive to vendors. Private equity has continued to be prominently involved in the mix either directly through setting up and growing vehicles or through taking stakes and this is obviously an attractive option for those with ambition but lacking the funding.

Gloss coming off the largest holding companies

While the biggest players have kept up the pace of scaling up, there are questions being raised about where the influence over direction and levels of spend really lies, given the dominance of Google and Facebook within the (digital) market. These concerns are exacerbated by some of the largest consumer clients (the natural historic pool for the industry majors) taking marketing communications in-house or setting zero-based budgets.

The most recent figures from WPP were accompanied by cautionary noises concerning the state of the industry and cut its growth expectations for the year to between 0 and 1%. Havas has now sold a majority stake Vivendi and posted an organic growth decline of 0.4% in H117, with Omnicom the exception to the pattern, benefiting from large accounts won last year.

Exhibit 5: Holding companies' published organic revenue growth for Q217



Source: Companies' press releases

Sensitivities

- The new management team has shown that it is capable of taking difficult decisions in the best interests of the whole network, even if it has meant some uncomfortable financial implications in the short term. The future financial performance will reflect the degree of benefit that they achieve from building the 'network effect'.
- While the pace of M&A within the group has slowed from its initial frenetic phase, the business strategy remains focused on building a global network of agencies based on digital and tech-based marketing capabilities. Availability of suitable candidates at suitable prices will dictate the pace of expansion, with most likely to be identified by existing network agencies. Standard concerns about integration and the implementation of common reporting systems are assuaged, at least in part, by the published progress on the design and roll-out of initiatives such as Temba and Slack, referred to on page five, above.
- From the outset, TMG has been envisaged as a global network. The euro was chosen as the reporting currency not because it was the initially dominant currency in the group, but because of its liquidity. The group is currently generating most of its revenues in Singapore dollars, Australian dollars, New Zealand dollars, US dollars and sterling, broadly matched with expenses and therefore providing a natural operational hedge. Currency exposure is then purely translational.
- As for all marketing services groups, there are sensitivities covering the retention of key clients and key employees/directors for individual agencies. The loss (or recruitment) of a major client, particularly where work is being done across more than one agency, could have a noticeable impact on the financial performance.
- IT and data privacy risks are to be noted as per industry norms.
- The marketing communications industry has been in rapid transition to manage and take advantage of digital and there is no reason to expect the pace of change to slow. TMG has no 'legacy' business and should be able to focus its resources on those areas where it is able to generate good returns and be more 'fleet of foot' than the industry behemoths.
- Client spend is ultimately dependant on national and global GDP growth and consumer confidence.

Valuation

The shares were listed in June 2016 at €1.00 and by the beginning of August had climbed to €9.00 following the oversubscription of the initial offer. With the continued issue of shares for a rapid series of acquisitions as described above, the share price drifted over the summer and early autumn, down to €2.73 by mid-October. There was some rallying in November, with the appointment of Adam Graham and the reporting of the interim results, which lifted the shares back to around the €4.40 level. As the structural issues with respect to the value of the paper issued to vendors became more apparent and then with a new board and strategic review, the continuing uncertainty has led to ongoing downward pressure on the share price. As a clearer picture is emerging of the core competencies of the agencies and of the group's financial performance potential, the market should be able to take a more informed appraisal of the appropriate valuation.

It remains very early days for determining a fixed basis for valuation for TMG, given that there is very limited (and somewhat disjointed) financial history and that future projections are more conjectural in nature than for its more established peers. Nevertheless, we have used our current modelling to look at traditional valuation metrics to set a context within a peer group, divided into the industry majors and the smaller/mid capitalised stocks within the sector (the latter focused on the UK-quoted stocks simply as there is a clearer quoted peer space).

Peer group comparison

Exhibit 6: Peer group market ratings

NAME	Listing	Price	Market cap (m)	P/E, CY (x)	P/E Y1 (x)	P/E Y2 (x)	EV/sales CY (x)	EV/EBITDA CY (x)	EV/EBITDA Y1 (x)	EV/EBITDA Y2 (x)	Div yield CY, %
WPP (£)	London	1398	17,695	11.5	11.4	10.8	1.6	9.2	8.8	8.4	4.0
Omnicom (US$)	New York	74	17,129	15.5	14.6	13.7	1.4	9.1	8.9	8.5	2.9
Publicis (€)	EN Paris	58	13,312	13.0	12.4	11.5	1.6	60.6	8.9	8.3	3.2
Dentsu (¥)	Tokyo	4825	1,391,578	16.7	15.9	14.8	2.0	9.0	9.1	8.7	1.8
Interpublic (US$)	New York	21	8,200	15.3	14.6	13.0	1.2	8.8	8.0	7.6	2.9
Havas (€)	EN Paris	9	3,913	19.4	20.5	19.1	1.8	13.3	11.3	10.8	1.9
Large-cap average				15.2	14.9	13.8	1.6	18.3	9.2	8.7	2.8
Next Fifteen Comms (£)	London	426	315	79.7	15.9	14.1	1.9	18.8	9.3	8.3	1.2
Huntsworth (£)	London	78	256	20.2	14.4	12.5	1.6		10.2	9.0	2.3
M&C Saatchi (£)	London	295	235	32.7	12.5	11.5	1.1	18.8	9.1	8.1	2.8
Mission Marketing (£)	London	44	37	6.4	7.0	7.9	0.3	5.5	5.0	4.3	3.2
Jaywing (£)	London	37	32	39.9	9.7	9.5	0.8	16.7	7.2	6.9	0.0
Be Heard Gp (£)	London	3	24		14.6	14.6	0.8		10.1	8.4	0.0
Small/midcap average				35.8	12.4	11.7	1.1	15.0	8.5	7.5	1.6
The Marketing Group (€)	NASDAQ First North	0.44	15	3.9	11.7	10.5	0.9	6.0	8.0	6.7	0.0

Source: Bloomberg, Edison Investment Research. Note: Prices as at 25 September 2017.

Despite recent poorer share price performance, there is still a clear valuation differential between the larger and smaller stocks, although this is slightly less marked using the EV/EBITDA metric. The differential is readily attributable to the comparative levels of liquidity in the stocks.

Given that TMG's historic figures are not genuinely reflective of the group as it now stands, we would look at the current year (year 1 in the table above) and following year (2) to evaluate the group's comparative position. TMG is currently trading at around a 6% discount to the small/mid-cap marketing services and communications businesses for the current year and at around a 10% discount for FY18.

DCF under varying scenarios

In addition to looking at traditional multiples, we have also run DCF analyses under various scenarios of achievable EBITDA margin (to net sales rather than revenue because of the distortive effects of put-through media costs) and of different medium-term top line growth assumptions beyond our direct forecast period. This is based on a WACC of 10%.

Exhibit 7: DCF under varying margin, growth assumptions €/share

		Medium-term growth rate				
		1%	2%	3%	4%	5%
EBITDA margin	10%	0.44	0.45	0.47	0.48	0.50
	11%	0.48	0.50	0.51	0.53	0.55
	12%	0.52	0.54	0.56	0.58	0.60
	13%	0.56	0.58	0.60	0.62	0.64
	14%	0.60	0.63	0.65	0.67	0.69
	15%	0.65	0.67	0.69	0.72	0.74
	16%	0.72	0.75	0.78	0.81	0.84

Source: Edison Investment Research

On the current forecast level of EBITDA margin of 11%, the current share price is indicating that organic net sales from the existing business decrease from current levels by around 2%. On a relatively modest medium-term growth rate assumption of 3%, the current share price is implying a reduction in margin to c 9.2%, which seems unlikely. A margin in the low to mid-teens should be an achievable objective (the average forecast margin for those peers that disclose the net sales figure is around 18%, albeit that they are more established). A 3% net sales growth rate and a modest EBITDA margin expansion to 13% in the medium term would indicate a share price of €0.60, c 35% ahead of the current price. This obviously does not take any account of the management's more ambitious growth objectives.

Financials

The group is still at a very early stage of its development and there (obviously) is little financial history on which to build our model. The FY16 figures covered a period of rapid build and considerable confusion described below. There is little of value that can be gleaned from comparisons between H117 and H116. The H117 results have been presented to reflect the continuing businesses, not including those three companies sold post the end of June.

Rebasing earnings

The most prominent feature of the recent interim results is naturally the substantial goodwill impairment and divestment charge of €43.575m. Of this sum, €12.884m relates to the three agencies that were disposed of in July 2017, with the balance of €30.691m reflecting an impairment charge to the carrying value of the goodwill relating to the original acquisitions in the balance sheet, ie a non-cash item. The scale of this impairment is exacerbated by the high share price at which the shares were issued for the original deals.

While it is perfectly possible to build a picture on a pro-forma basis based on the press releases accompanying the various acquisitions that took place across 2016, we suggest that this would give a misleading impression. Most of the deals described were of two or more agencies. Simply adding up the various 2015 actual and projected 2016 revenue and EBITDA figures quoted for each deal has two issues. Firstly, not all deals that were announced had been completed; some were merely at heads of terms stage. Secondly, for those that did complete, the timing meant that only weeks or, at best, months would fall into the reporting periods.

The announcement on 27 January 2017 advised the market that the purchases of Astute (the most substantial part of the Augustus deal of 1 August 2016) and of two other agencies had been cancelled and that the shares issued in respect of consideration were being returned and cancelled. The same announcement disclosed that three further previously announced acquisitions were still pending and should not be including in the rolled up figures. Stripping these six deals out of the published pro-forma numbers made a very substantial difference. Run-rate, pro-forma revenue had previously been guided at €81.8m. In January 2017, this figure was more than halved to €37.0m, while EBITDA was reduced from €16.8m to €7.9m.

By the time of the Q117 announcement, TMG had a new board of directors and the CEO had completed his review of the group's constituent operations. This identified that, while the group had mostly good and strong agencies, there were a number that were undermining the group's consolidated results. At the time of the Q117 announcement, it was disclosed that the first category contributed €563k of EBITDA in Q117 while the poorly performing agencies lost €431k in the same period. The reported Q117 key figures were therefore revenue of €7.19m and EBITDA of €125k.

The agencies that led to the shortfall were disposed of in August 2017, so when the H117 figures were published, the Q117 figures were restated to reflect continuing business, as shown in Exhibit 8. Comparisons against the first half of 2016 are irrelevant due to the changing constituents of the group. It is, however, worth noting that there has already been an improvement in EBITDA margin between Q1 and Q2 (this is calculated against net sales rather than revenue due to the extent of put-through media costs, as is standard for this type of business).

Exhibit 8: Revenue, net sales and EBITDA summary and forecasts

€m	Revenue	Net sales	EBITDA	EBITDA margin
Q117	*7.190*	*4.832*	*0.125*	*2.6%*
Q117 restated	6.217	4.094	0.298	7.3%
Q217	6.330	4.315	0.473	11.0%
H117	12.547	8.409	0.771	9.2%
H217e	12.053	8.600	0.979	11.4%
FY17e	24.600	17.009	1.750	10.3%
FY18e	27.000	20.250	2.100	10.4%
FY19e	29.500	22.863	2.500	10.9%

Source: The Marketing Group accounts, Edison Investment Research

In making the initial projections, we have been conservative with our growth forecasts and taken no benefit from the group agencies working alongside each other to build stronger and more substantial client relationships. We are currently looking for c 10% revenue growth in FY18, followed by a 9% expansion in FY19. Our analysis of TMG's closest peer group suggests that consensus estimates assume a wide range of 2-20% medium-term top line growth. We forecast EBITDA to grow by 20% in FY18 and 19% in FY19, leading to a moderate margin expansion. If all goes to plan, we see the potential for considerably faster margin expansion. There will doubtless also be further acquisitions, which we would expect to slot into our model as and when they complete. We consider that our modelling should be effectively a base case.

Cash flow reflecting corporate level changes

The 'norm' for marketing services companies is that they are highly cash generative with strong conversion of operating profit into cash and little need for heavy capital investment. The extent of the upheaval at TMG's corporate level, including a new CFO and new reporting systems, makes it difficult to draw any meaningful conclusions from the operating cash outflow of €0.738m posted for the first half of FY17. As the business settles, there should be no structural reason why it should not perform in its cash generation as its peers.

Rebased balance sheet

As described above, the dominant feature of the interim results was the rebasing of the balance sheet valuation of the acquired companies. Goodwill at the end of 2016 stood at €73.582m. Post the goodwill impairment and divestment charge of €43.6m taken with the interim figures, and which includes the adjustment for the post period disposal, the carrying value of goodwill in the balance sheet stands at €30.5m and represents the bulk of the net assets, as would be expected in a marketing services business.

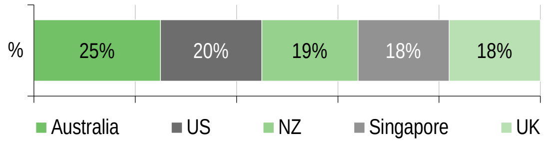
At the end of FY16, the balance sheet as published showed a net cash balance of €1.412m, but just under €0.2m of this related to the three agencies since disposed. The published net cash figure at 30 June 2017 was €0.904m, an increase on the €0.604m at the end of March 2017. We include financial liabilities in our definition of debt. Unlike many past aggregators, TMG has not loaded its balance sheet with extensive debt to fund initial considerations and earn-out. Outstanding deferred consideration is all in current liabilities and amounted to €1.703m at the half year. On 7 September 2017, the group issued additional shares for the second and third tranches of consideration for Addiction Advertising (tranche two having been delayed from its due date in February, tranche three from July). These shares were issued half at €1.62 and half at €0.41, reflecting the share prices and exchange rates at the time that they were to be issued. All are subject to 12-month lock up from the date that they were initially due to be issued.

We would expect future acquisitions to be funded from a combination of cash/debt and equity, dependent on the share price at the time and the cost of debt.

Exhibit 9: Financial summary

€'000s	2016	2017e	2018e	2019e
31-December	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT				
Revenue	15,843	24,600	27,000	29,500
Cost of Sales	(5,986)	(7,591)	(6,750)	(6,638)
Gross Profit	9,857	17,009	20,250	22,863
EBITDA	2,316	1,746	2,092	2,492
Normalised operating profit	2,210	1,608	1,892	2,292
Amortisation of acquired intangibles	(1)	0	0	0
Exceptionals	0	(43,576)	0	0
Share-based payments	0	0	0	0
Reported operating profit	2,209	(41,968)	1,892	2,292
Net Interest	(56)	(60)	(30)	(21)
Joint ventures & associates (post tax)	0	0	0	0
Exceptionals	0	0	0	0
Profit Before Tax (norm)	2,154	1,548	1,862	2,271
Profit Before Tax (reported)	2,153	(42,028)	1,862	2,271
Reported tax	(164)	(210)	(372)	(545)
Profit After Tax (norm)	1,990	1,238	1,490	1,726
Profit After Tax (reported)	1,989	(42,238)	1,490	1,726
Minority interests	0	0	0	0
Discontinued operations	0	0	0	0
Net income (normalised)	1,990	1,238	1,490	1,726
Net income (reported)	1,989	(42,238)	1,490	1,726
Basic average number of shares outstanding (m)	18	32	35	35
EPS - basic normalised (c)	11.27	3.83	4.26	4.94
EPS - diluted normalised (c)	11.27	3.76	4.19	4.85
EPS - basic reported (c)	11.26	(130.80)	4.26	4.94
Dividend (c)	0.00	0.00	0.00	0.00
Revenue growth (%)	N/A	55.3	9.8	9.3
Gross Margin (%)	62.2	69.1	75.0	77.5
EBITDA/Gross Profit Margin (%)	23.5	10.3	10.3	10.9
Normalised Operating/Gross Profit Margin	22.4	9.5	9.3	10.0
BALANCE SHEET				
Fixed Assets	74,184	30,772	30,772	30,772
Intangible Assets	73,598	30,199	30,199	30,199
Tangible Assets	540	527	527	527
Investments & other	46	46	46	46
Current Assets	9,031	8,974	14,646	17,134
Stocks	379	379	379	379
Debtors	6,234	6,308	10,652	11,638
Cash & cash equivalents	2,418	2,287	3,615	5,117
Other	0	0	0	0
Current Liabilities	(11,447)	(7,584)	(10,063)	(10,826)
Creditors	(5,749)	(4,565)	(9,047)	(9,810)
Tax and social security	(773)	(773)	(773)	(773)
Short term borrowings	(843)	(543)	(243)	(243)
Other	(4,082)	(1,703)	0	0
Long Term Liabilities	(557)	(557)	(557)	(557)
Long term borrowings	(163)	(163)	(163)	(163)
Other long term liabilities	(394)	(394)	(394)	(394)
Net Assets	71,211	31,605	34,798	36,524
Minority interests	0	0	0	0
Shareholders' equity	71,211	31,605	34,798	36,524
CASH FLOW				
Op Cash Flow before WC and tax	554	1,746	2,092	2,492
Working capital	(864)	(1,258)	138	(224)
Exceptional & other	0	0	0	0
Tax	162	(210)	(372)	(545)
Net operating cash flow	(148)	278	1,858	1,723
Capex	(136)	(125)	(200)	(200)
Acquisitions/disposals	2,410	(177)	0	0
Net interest	(56)	(60)	(30)	(21)
Equity financing	0	4	0	0
Dividends	0	0	0	0
Other	(354)	0	0	0
Net Cash Flow	1,716	(80)	1,628	1,501
Opening net debt/(cash)	0	(1,412)	(1,581)	(3,209)
FX	(306)	249	0	0
Other non-cash movements	2	0	0	0
Closing net debt/(cash)	(1,412)	(1,581)	(3,209)	(4,711)

Source: The Marketing Group accounts, Edison Investment Research

Contact details	Revenue by geography (H117)
Enterprise House, Ocean Village, Southampton, Hampshire, England SO14 3XB http://tmg-plc.com/	

Management team

Chairman: Don Elgie	CEO: Adam Graham
Don Elgie was appointed in February 2017. He has extensive experience in public companies and over 30 years' experience in the marketing industry. He was CEO of Creston Plc, an international digital marketing and communications group, from 2001 to 2014. Don is non-executive chairman of Crossrider Plc, a international media and app distribution company.	Adam has broad experience in digital marketing and advertising agencies. He was CEO of Weapon7, a digital comms agency within Omnicom's BBDO, from 2011 to 2013. Prior to that he co-founded and was MD of Saint, the digital arm of WPP's Rainey Kelly Campbell Roalfe/Y&R. Adam previously founded the e-marketing agency 3w Media and was among the pioneers of internet radio, founding iChoose Radio in 1998. He joined The Marketing Group from Cact.us, a UK-based agency growth consultancy. He is also chair of the British Interactive Media Association and has previously been a council member of the British Advertising Association and the Institute for Practitioners of Advertising.
CFO: Mike McElhatton	
Mike McElhatton, also appointed in February 2017, has more than 25 years' experience in the marketing sector and has an extensive track record of executing acquisitions for public and private companies. He is a non-executive director of Nile HQ Limited and of DBI Network, and has previously held senior roles at WPP, Splendid Unlimited, Zenith Media and Havas Media UK.	

Principal shareholders	(%)
LGT Bank Ltd	5.62
Aahgir Yadav*	4.98
ML, Pierce, Fenner & Smith Inc	4.66
CBLDN-SAXO Bank	4.50
Chris Reed*	4.41
Laurent Verrier*	3.32

*Member of operational board

Companies named in this report

WPP (LN: WPP), Omnicom (NYSE: OMC), Publicis (EPA: PUB), Interpublic (NYSE: IPG), Dentsu (TYO: 4324), Havas (EPA: HAV), Next Fifteen (LON: NFC), Huntsworth (LON: HNT), M&C Saatchi (LON: SAA), Mission Marketing (LON: TMMG), Jaywing (LON: JWNG), Be Heard (LON: BHRD)

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