EDISON

The MISSION Group

H1 trading update

Creativity pays

Media

MISSION's wide-ranging activities, efficient ability to work remotely and close, long-standing client relationships has enabled it to weather the COVID-19 crisis in relatively good shape. It has continued to win new business and run assignments throughout. Lower revenues as clients pulled or postponed campaigns mean a H120 loss of c £2.2m, but we expect this to be more than recouped in H220. A mix of entrepreneurialism and collaboration makes the post-COVID-19 outlook attractive, but this is not currently fully reflected in the share price.

Year end	Net revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/18	77.6	9.2	8.5	2.1	7.2	3.4
12/19	81.0	10.2	9.0	0.8	6.8	1.3
12/20e	62.7	0.6	0.7	0.0	87.9	0.0
12/21e	76.1	9.1	7.7	1.8	8.0	2.9

Note: *PBT and EPS are normalised (fully diluted), excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Resilience and bright spots

Group agencies have a broad spread of clients, giving a good degree of resilience, with the technology- and healthcare-facing agencies doing particularly well. April Six, a technology and mobility agency, has had some excellent new client wins in H1 in Europe and the US. Property has obviously had more severe problems but should now be set for a better H2 as developers look to market more aggressively. Integrated agency, Bray Leino, has won a significant project for INEOS for H220. Pathfindr, one of the group's incubator companies, has sold over 15k units of its wearable Safe Distancing Assistant for COVID-compliant working, and has a strong order book for H220. James Clifton, appointed CEO in April 2019, has prioritised closer collaboration across group agencies, boosting the visibility of the MISSION brand. This is bearing fruit and, perhaps counterintuitively, has been helped by remote working, which has improved internal and external accessibility. New client, my online therapy, was won having been pitched for as MISSION, using a combination of expertise from across group agencies.

Set for recovery

The good new business performance supports management's assertion that the group should report a profit for the full year, having made a first half loss of around £2.2m. Our model assumes that revenues rebuild through H2 and on into FY21e, allowing margins to recover. Our FY21e PBT estimate of £9.1m sits within management's guided range of £9-10m but is dependent on the shape of economic recovery post COVID-19. £5m of additional bank facilities have been negotiated, giving plenty of headroom on our modelled scenario.

Valuation: Discount to DCF

Improving financial performance helped double the share price to 80p over 2018 and 2019, reaching a high of 108p in February 2020. In common with other small and mid-sized marketing communications stocks, the price came back sharply as the pandemic spread. With some visibility now back in the market, the shares are trading well below levels indicated by a DCF, which derives a value of 110p based on a WACC of 10% and medium-term growth of 6%.

16 July 2020

Price	**61.5p**
Market cap	**£56m**

Estimated net debt (£m) at 30 June 2020	1.2
Shares in issue	91.0m
Free float	52.7%
Code	TMG
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(9.6)	(3.2)	(30.1)
Rel (local)	(12.5)	(14.0)	(17.4)
52-week high/low		108p	36p

Business description

The Mission Group is a collective of creative integrated and specialist agencies, employing 1,150 people in the UK, Europe, Asia and the US.

Next events

Interim results	23 September 20

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Edison profile page

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

Investment summary

Company description: Team players

MISSION is a collaborative network of creative agencies, with a broad spread of clients across multiple sectors and geographies. It has an enviable record of client retention, with 20% of revenue generated from clients who have been working with the group for over 20 years. With the appointment of a CEO in April 2019, the group has a renewed vigour and ambition. It is, for the first time, making use of the MISSION brand in some pitches where skills and services from different agencies are being delivered in concert. Some areas of the business have been heavily affected by the COVID-19 pandemic, such as property and events. Other areas have performed well, especially those involved in technology marketing and healthcare. Pathfindr, an asset-tracking business in the group's Fuse in-house incubator, has repurposed some of its technology to develop a wearable safe distancing monitor for use by businesses, which has sold over 15k units in H1 and has a strong order book for H2.

Financials: FY20 is a difficult year

Understandably, the group's hard-won growth record, with operating income increasing at a 10-year CAGR of 8.4%, will come to an end in FY20 as the impact of the pandemic hits the top line. The group has taken advantage of government support schemes, as well as reducing the working week, and management and senior staff have all taken a voluntary 20% pay reduction. The final FY19 dividend has been withdrawn and capital spending plans curtailed. Management guidance in the H120 trading update points to a pre-tax loss of c. £2.2m but, based on the current outlook for H220, suggests the full year should deliver a profit. For FY21, management is indicating that profits should be able to rebuild to near FY19 levels, of c £9–10m. Our maiden forecasts are for a PBT of £0.6m in FY20 (vs £10.2m in FY19), rising to £9.1m for FY21. We note however that these estimates assume very limited further disruption to the economy from COVID-19. Bank facilities have been increased by £5m to £20m and we expect covenants on net debt to EBITDA and total debt/EBITDA to be waived for the current year, as has been the case for others in the marketing sector.

Valuation: Reflecting current uncertainties

MISSION has the benefit of high internal share ownership, mostly from agency vendors who took shares on acquisition (the free float is 52.7%). From a stock market perspective this is also a drawback, as it has meant limited liquidity, deterring some institutional investors.

We have carried out a DCF, based on 2% terminal growth at a WACC of 10% and using a range of medium-term growth forecast assumptions beyond the explicit forecast period. Setting this at 6% derives a value of 110p. We would normally place greater emphasis on the valuation compared to the relevant peer set. However, given the lack of consistency in the assumptions behind current market forecasts for both FY20e and FY21e, these should be read with a degree of caution. On historic multiples, MISSION's shares are trading at a discount of 11% and 25% to median EV/EBIT and P/E. Parity on these multiples would indicate a share price of 75p and 89p, respectively.

Sensitivities: COVID-19 the largest unknown

The impact of the pandemic on the consumer and the corporate economy remains far from clear and how this plays out will have the greatest effect on MISSION's fortunes, particularly if there are further waves and lockdowns. The group's working model adapted to remote working with relative ease. Current projections assume the pandemic situation eases through the second half and that there is the normal seasonal uplift in Q4. The group has a remarkable record of client retention, but there may yet be corporate casualties amongst them.

Company description: Collectively creative

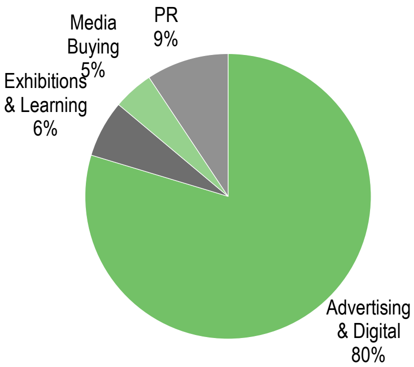
The MISSION Group is an international network of specialist and integrated agencies, providing a range of marketing, advertising, promotional and consultative services. Some are specialist agencies, operating in specific fields, such as property, healthcare, technology or automotive. Others are more integrated, but more specialist by activity rather than generalist. It employs a total of 1,150 people, mostly in the UK but also in seven other countries across Europe, Asia and the US.

The bulk of MISSION's operating income is generated in the advertising and digital space, as shown below. Operating income is used throughout as the best proxy for the true volume of business transacted, as it avoids counting put-through costs such as media buying. In any event, media buying is a much smaller contributor to activity than for most agency groupings.

The group has a particularly impressive record when it comes to client retention, with 50% of revenues coming from clients who have been with group agencies for five or more years; 30% of revenues from 10 year plus clients; and 20% from clients of at least 20 years standing.

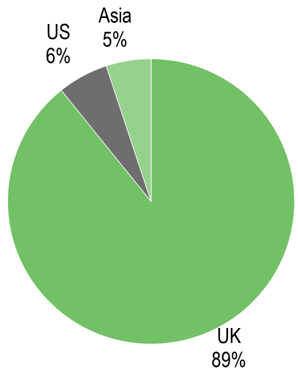
The bulk of operating income is generated in the UK.

Exhibit 1: FY19 operating income by activity



Source: Company accounts

Exhibit 2: FY19 operating income by geography



Source: Company accounts

Collaborative agency network

The group has been built over several years, as shown below, through a combination of acquisition and organic growth. Consideration payments have generally been for cash, with a share element to better align the interests of the vendors to the larger group. The agency vendors have mostly therefore stayed within the group and continued to run their own operations, avoiding the cliff edge in profitability common in the sector with post the earn-out period.

Unlike many buy-and-build organisations, MISSION has looked for its acquisitions beyond the London media hub and therefore has a strong regional presence. Acquisitions have most often been identified by recommendations stemming from within the group, with personal introductions and a knowledge of the target's work and culture. Combined with the group's ethos of aligned interests described above, this has meant the group has paid relatively modest multiples for its acquisitions, as shown in the table below.

Exhibit 3: Corporate chronology

Year	Acquisitions	Initial consideration	Initial take-out EBIT multiple	Start-ups	Events
2005	Big			-	-
2006	Bray Leino			-	IPO, raising £14.8m gross
2007	AprilSix (Mar)	£9.6m	6.0x	-	Placing to raise £5m gross (Oct)
	BDW (Mar)	£6.0m	5.5x	-	-
	Story (Sept)	£6.9m	5.4x	-	-
	RLA (Dec)	£9.5m	4.6x	-	-
2008	-		-	-	Financial Crisis
2009	-		-	-	-
2010	-		-	-	Refinancing, including £2.7m from placing
2011	-		-	-	-
2012	Balloon Dog (Sept)	£3.2m	4.6x	-	Placing raising £1.2m
2013	Solaris (Sept)		Not disclosed	-	-
2014	Proof (Aug)		Not disclosed	-	-
	Splash (Sept)	£0.3m	7.0x	-	Placing raising £2.4m
	Speed (Oct)		Not disclosed	-	-
	The Weather (Oct)		Not disclosed	-	-
2015	Chapter (Nov)	£1.3m	3.3x	Mongoose Sports (Jun)	Pathfindr launch
2016	-			Mongoose Promotions (Jun)	-
2017	RJW (Apr)	£1.8m	4.4x	-	-
2018	Krow (Apr)	£2.8m	3.0x		
					Disposal of Broadcare for £4.4m (Nov)
2019	-			-	Pathfindr incorporated
					Brexit
2020	-			-	COVID-19

Source: Company, Edison Investment Research

Corralling the agencies to leverage group

Historically, the MISSION was more of a construct than a brand in its own right. Over the last couple of years there has been a greater degree of coherence. The group now has a shared services platform to which all group agencies had been migrated by end FY19. This gives them access to centralised functions such as finance, IT and HR. The spend on this has proved particularly valuable as the COVID-19 crisis developed, helping to facilitate more effective collaboration across the network.

The MISSION name has had a far higher profile in the City than in the media industry or amongst the client base, or even within the individual agencies. The newly reinvigorated management team led by CEO James Clifton is setting about giving the group greater visibility, not just as an end in itself but to promote the range of capabilities that it is able to supply. This is also part of the remit of the new group marketing director, Cat Davis, who has stepped up the group's broader presence in industry and social media with regular newsflow and thought leadership pieces. The group also ran a reverse pitch, whereby clients could pitch ideas, with the winning entry receiving £50k worth of marketing consultancy.

During H120, the group won its first piece of business pitching as MISSION, for My Online Therapy. The team for both pitch and delivery was drawn from a number of group agencies: Bray Leino, Speed, Edinburgh-based Story (who added their expertise in behavioural change) and krow, who brought strategic insight, creative, digital and social marketing experience.

Internally, there is a drive to decrease complexity and run with fewer, but larger, agencies. Several business combinations have already taken place, with the resulting brands shown in Exhibit 4, below. The strategy includes expanding existing brands geographically and new offices were opened during FY19 in Seattle, Munich and Leeds.

MISSION has an unusual additional feature. It has a technology incubator, fuse, which develops concepts through to implementations of products and services developed to meet client needs within existing agencies but not necessarily in their direct remit. This is described in more detail below.

Key agencies

Exhibit 4: Agencies and activities

MISSION integrated agencies	MISSION industry agencies	MISSION communications	MISSION advantage
Full-range creative agencies	Industry specialists	Specialist service delivery	Shared expertise
bray leino: brand building, based Devon, Bristol, US and Asia	**April Six**: international agency supporting tech and mobility brands	Promotion and events: **bray leino**, **mongoose**	**Ethology**: customer experience
Chapter: Midlands based	**mongoose**: sports, leisure and entertainment marketing	Media and PR: **bray leino**, **Speed**, **thinkBDW**	**fuse**: emerging technologies to create transformative hardware and software products
krow: Full-service creative agency with four UK offices	**RJW&partners**: pricing and market access to pharma and medical brands	Production: **thinkBDW**	**MISSION shared services**: finance, HR, IT and premises support
Story: Scotland and Northern-England based agency working with leading consumer brands	**Solaris**: medical communications		
	thinkbdw: integrated residential property marketing		

Source: Company

Looking at a couple of these agencies in a little more detail demonstrates some of the breadth of capability.

Krow (MISSION integrated agencies) is a full-service creative agency, with offices in London, Norwich, Leicester and Belfast (currently all operating remotely). The Norwich office has Aviva as a key client (for over 25 years), for whom it works on a wide range of products, including customer communications. It is probably best known for its award-winning work with DFS using Aardman Animation, where the remit was to refocus away from the ‘perpetual sale’ perception. A more recent win has been Wilko, where krow has been brought in to rethink the brand and relaunch it back into broadcast communications, focused on customer experience. As well as ‘traditional’ creative, krow also incorporates a full digital offering, direct communications, CRM and B2B.

Krow also has an ethos of developing talent and has initiated a programme to recruit young people into the industry from different backgrounds, particularly from BAME communities, who are extremely underrepresented in the industry.

thinkBDW (MISSION communications) operates in the specific marketing property developments sector. This incorporates the whole gamut of marketing, from brochure printing and advertising, media buying, designing and erecting on-site hoardings, through physical marketing suites to virtual-reality animation and interactive touch screens. Its work is mainly through the larger national developers such as Redrow, Bellway, Persimmon and Taylor Wimpey, designed and largely fulfilled from the agency’s base in Chelmsford. Competitors tend to be locally based and/or specialise in one aspect and it is the high-quality printing suitable for an outdoors environment that is most difficult to replicate.

Exhibit 5: thinkBDW showreel

Source: Company. Note: Click on image to play video

The H120 trading update points out that, despite the pandemic, there has been continued progress in winning new business in the period. April Six has added 10 new clients, including the European Space Agency and Scania Trucks. It has also won Rimini Street and one other interesting account in the US.

Innovation hub gives further differentiation

The group's innovation initiative has had considerable success. By bringing together ideas that emerge from other work or original ideas with commercial potential but do not necessarily sit within an agency structure, they have been given the opportunity to develop and mature. Some are of obvious and direct use to group companies, such as Cortex, an integrated marketing platform that combines sales, marketing and behavioural data to facilitate micro-targeting, and easl, a services information system now in wide use across the group.

Broadcare, a healthcare SaaS product, was developed internally and contributed £0.5m of profit in FY17. It was sold for £4.4m cash in November 2018.

The most interesting fuse company is Pathfindr, which has developed a system to deliver real-time asset intelligence. This includes location (including historical movements), environmental information, such as temperature and humidity and activity monitoring (measuring and optimising utilisation and collating process insight). It has been building its commercial installed base and generating revenues from hardware and software sales, with sales growing from £0.5m in FY18 to £0.9m in FY19.

With the onset of the COVID-19 pandemic and the need for employers to guarantee social distancing in the workplace, the Pathfindr system has found a new, large market. Its bluetooth-enabled sensors can be wearable and can identify sub-2m accuracy with minimal hardware installed. Now labelled Safe Distancing Assistant, over 15k units had been sold up to the end of June 2020, with a string order book for H220.

Management strongly tied in with operations

The MISSION's history of being an ensemble of agencies naturally led to a broad management structure, with the larger agencies all represented directly on the main board, often by their founders. The concept revolved around this being a consensual management style, where issues were discussed and resolved. With these directors also being meaningful shareholders in the group, having taken shares when selling their agencies, their interests were regarded as totally aligned with external shareholders.

This structure has evolved over the last couple of years towards a more conventional arrangement. David Morgan, who founded Bray Leino in 1974, was appointed chairman in 2010. The deputy chairman, Robert Day, is founder of group property agency ThinkBDW.

James Clifton was appointed CEO in April 2019, in a role that did not previously exist. He joined the group and the board when the agency he had created, balloon dog, was acquired in October 2012. Peter Fitzwilliam, CFO, had assisted MISSION with a refinancing in April 2010 and joined the board in September that year. He is a chartered accountant with experience in private and quoted companies across a range of industry sectors and was finance director of Business Post Group from 1999 to 2006, during which time it was promoted into the FTSE 250.

There are two other newly established central roles. The first is group commercial director, as of July 2018. This is Giles Lee, who was previously also with Bray Leino and sits on the board. More recently, MISSION recruited Cat Davis as group marketing director (not a board role). She has been brought in to step up new business growth both at a group level and at krow (now merged with bigdog) and to drive MISSION’s market visibility. She was previously chief marketing officer at Grey London and chief growth officer UK and Europe at Cheil London.

There are four more executive directors, representing their agencies but acting for the group. In addition, there are two non-executive directors, who sit on the audit and remuneration committees.

Market disrupted by COVID-19

The advertising market was generally positive at the start of the year, with momentum carrying over from a reasonably good Q419 globally (with regional variations), despite the disruption in the UK from both Brexit and an unexpected General Election. The gains in digital continued to be the driving force, with ‘old media’ such as newspapers and magazines sliding and TV struggling to progress in the face of the growth of streaming platforms.

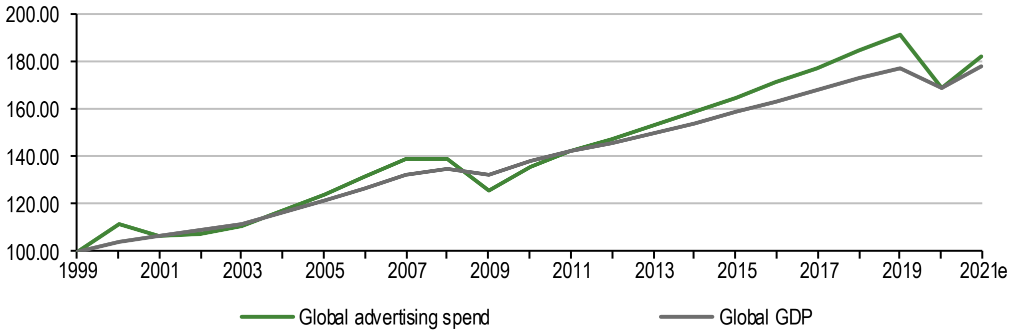
That all changed as the COVID-19 pandemic spread and lockdowns with varying degrees of rigour were implemented. With the travel, retail and hospitality sectors all hit hard early on, chief marketing officers reviewed their marketing plans and budgets and pulled or postponed many campaigns. Activation campaigns were substituted with brand awareness for many consumer-facing brands in the first instance. Agencies generally moved quickly to remote working (which has worked better than most were anticipating) and have made use of government furlough schemes to better align their overheads to reduced activity levels.

As the weeks have progressed, the worst fears of many agencies’ management teams have not been realised, but they have needed to draw heavily on coming up with innovative and creative messaging solutions. The crisis has accelerated the long-established transition to digital, with Accenture indicating ‘three years of change in three months’ in digital transformation. Digital ad spend has not been immune, particularly as paid search is heavily used by SMEs, which may have been among the most heavily affected economic participants.

With some signs of confidence re-emerging towards the end of Q220, the prospects are for an improvement in H2. However, the recovery will very much depend on the situation with the coronavirus. Any further deterioration or a second wave could significantly affect the shape of the recovery. In a long-term context, the scale of the 2020 retrenchment can be seen in the exhibit below, which maps out global advertising spend growth against GDP growth.

FY20 global ad spend is forecast to fall 11.8% (source: Statista) compared to the World Bank’s forecast for global GDP of a 4.9% drop. For FY21, both are anticipated to rebound, with ad spend increasing 8.2% against GDP progress of 5.4%. This compares to the 20Y CAGR of 3.3% and a 10Y CAGR of 4.1%.

Exhibit 6: Long-term global ad spend growth vs GDP growth



Source: Statista, World Bank

For the UK specifically, forecasts from the key commentators are in a wider range than is normally the case, with current estimates for ad spend FY20 ranging from -8.9% to -16.7%. The Advertising Association/WARC break their forecast into quarters, with Q1 up 4.6%, Q2 the most severely affected at -39.1%, and Q3 -24.3% narrowing to Q4 at -8.9% (all versus the comparative prior year quarter).

All the main forecasters are anticipating a recovery in ad spend in the UK in FY21 (helped by the delayed Olympic Games), but again the range is wide, from +7.7% to +13.6%.

Sensitivities

The standard sensitivities are minor compared to the disruption that has been wreaked by **COVID-19** on the industry and on the MISSION. The impact on the industry is outlined above. For MISSION, the transition to remote working was comparatively straightforward and, if anything, decision making accelerated without the need for travel.

Attention to **client relationships** is even more crucial than in the normal course of business. MISSION agencies have comparatively lower churn than the industry norms, with many relationships dating back decades. Churn and new business wins can both undermine operating margins, with additional work being undertaken to set up new accounts. The COVID-19 pandemic may also lead to some clients struggling financially, although most of the client roster is blue chip and likely to come through the pandemic safely and rebuild.

Geopolitical events can influence client confidence and spend, with Brexit concerns and an unexpected General Election both disrupting the market in the run up to Christmas 2019. 89% of MISSION's FY19 revenues were generated in the UK. The end of the EU withdrawal period in the UK on 31 December 2020 may lead to further disruption.

MISSION's structure has historically meant a devolved management style. However, the individual agencies are closely associated with their leaders and a change at this level can be very disruptive. Agency combinations seem to have been handled well to date, but in this industry, where personalities and personal relationships are integral, changes can be disruptive and internal and external communications are vital. With the move to more centralised leadership, key personnel at the core may present a greater concentration of risk.

With greater centralised service functions and the increased prevalence of remote working, which is likely to stay in some measure, the integrity and reliability of IT systems is central to the efficient running of the business.

MISSION has always had both organic and acquisitional expansion and the performance of acquisitions subsequent to purchase remains a core sensitivity.

Valuation

MISSION has high internal share ownership, stemming from the way the group has been built and its collaborative ethos. However, from a stock market perspective, this is also a drawback as it has meant limited liquidity in the stock, which has deterred some institutional investors that may otherwise wished to have supported its growth story. The free float is currently 52.7%. The unusual historic board structure, with the management of the operating subsidiaries sitting as full executive directors, along with an executive chairman, may also have contributed to the relative lack of institutional interest.

With the appointment of a CEO for the first time giving an increasingly normalised corporate structure and a more focused and coherent approach to external group marketing, some of these objections are starting to fall away.

To give a context for valuation, we have used two approaches. First, a DCF basis under a range of WACC and medium-term growth scenarios. Second, comparing the current valuation to a peer set across various earnings' multiples.

DCF points to higher valuation

Exhibit 7: DCF with varying WACC, medium-term growth

		Growth 2022–26				
		2%	**4%**	**6%**	**8%**	**10%**
WACC	7.0%	163	164	166	167	169
	8.0%	138	140	141	143	144
	9.0%	121	122	124	125	126
	10.0%	108	109	110	111	113
	11.0%	97	98	100	101	102
	12.0%	89	90	91	92	93
	13.0%	82	83	84	85	86

Source: Edison Investment Research

We have looked at a DCF model under varying WACC levels and with different growth scenarios for the medium term beyond our explicit forecast horizon. These growth levels are modest by the group's historic standards. Over the 13 years of historic data in our model, operating income has grown at a CAGR of 13.8%. Over the last 10 years, the rate was more modest at 8.4%; for the last five years, 8.1%. However, these growth rates are not all organic and were to a significant extent driven by acquisitions. A WACC of 10% and a 6% medium-term growth assumption generates a value per share of 110p. Under a 4% growth assumption, which is closer to the 10Y CAGR in global ad spend, the valuation dips to 109p.

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Peer comparison

Exhibit 8: Peer valuation

Name	Price	Mkt cap (m)	Ytd perf %	EV/rev (x)	EV/EBITDA 0 (x)	EV/EBITDA 1 (x)	EV/EBITDA 2 (x)	EV/EBIT 0 (x)	EV/EBIT 1 (x)	EV/EBIT 2 (x)	P/E 0 (x)	P/E 1 (x)	P/E 2 (x)
Large cap marketing peers													
Omnicom ($)	53.60	11,486	-33.8	1.0	6.2	7.9	7.0	6.9	9.1	7.9	8.8	11.8	9.9
WPP PLC (p)	576	7,053	-46.0	0.8	5.3	7.7	6.6	6.9	10.0	8.4	6.2	10.6	8.2
Publicis (€)	26.90	6,475	-33.3	1.2	5.1	5.9	5.2	6.9	9.4	7.8	5.4	7.7	6.3
Interpublic ($)	17.00	6,623	-26.4	1.1	6.8	8.6	7.5	7.9	11.2	9.6	8.8	12.6	10.3
S4 Capital (p)	308	1,510	60.0	7.0	45.3	28.2	20.0	48.6	30.1	21.1	59.7	42.2	29.2
Average			**-15.9**	**2.2**	**13.7**	**11.6**	**9.3**	**15.4**	**14.0**	**11.0**	**17.8**	**17.0**	**12.8**
Median			**-33.3**	**1.1**	**6.2**	**7.9**	**7.0**	**6.9**	**10.0**	**8.4**	**8.8**	**11.8**	**9.9**
Small and medium cap marketing peers													
HighCo (€)	3.85	86	-36.7	0.2	1.8	4.5	2.8	2.5	7.7	4.7	8.8	30.6	17.5
1000mercis (€)	17.75	52	-21.1	0.7	0.0	31.5	7.7			21.0			19.7
Syzygy (€)	5.15	70	-29.3	0.9	5.7	7.5	5.4	10.9	20.3	9.8	18.4	39.6	18.4
Antevenio (€)	7.20	30	-1.1	1.3			21.9			48.8			
MCH (€)	19.50	117	-25.3	0.6	11.5	19.9	16.1						
Next Fifteen (p)	386	348	-28.3	1.7	7.2	7.9	7.3	9.7	10.5	9.5	11.1	12.6	11.0
M&C Saatchi (p)	54	62	-56.5	0.4	2.9	3.0	2.8	3.3	4.2	3.9	2.3	4.8	4.7
Average			**-28.3**	**0.8**	**4.2**	**10.6**	**9.1**	**6.6**	**10.7**	**16.3**	**10.1**	**21.9**	**14.3**
Median			**-28.3**	**0.7**	**2.9**	**7.5**	**7.3**	**6.5**	**9.1**	**9.7**	**9.9**	**21.6**	**17.5**
Mission Group (p)	67	61	-16.5	0.8	5.1	201.6	6.8	5.7	554.8	7.7	7.4	98.7	8.7
Premium/(discount) to median SME (%)				6%	74%	2595%	-%	-11%	6012%	-20%	-25%	358%	-50%

Source: Refinitiv. Note: Priced at 7 July 2020.

Historically, the major marketing services holding companies (WPP, Omnicom, Publicis, IPG etc) traded at a substantial premium to the smaller peers. Over recent years, this premium has eroded as the larger peers have struggled to generate the growth that they historically enjoyed (mostly through acquisition). We have included them in the table below for illustrative purposes, but not used them in the comparative calculations.

We have used a cohort of smaller European SME companies within a fairly board marketing services definition, although have excluded those with little (or any) creative element, such as those operating with an adtech or data-centric approach. The pool of suitable comparator companies has shrunk over recent years as many have been taken private or subsumed into larger organisations.

The prices achieved through corporate activity are not always a true reflection of the objective value, given that many smaller agencies and groups have not traditionally been strong on independent governance.

Given there is so much market uncertainty on the performance of the sector for the current year (FY1 in the table above) and for FY21e (FY2) and no clear indication of whether market forecasts have been updated for current trading, it seems more reliable to be looking at the comparative valuations averaged for the last reported year (FY0). As there is such a wide range, we have used the median multiple rather than the mean for the average value. Parity with the small and medium-sized peers on EV/EBIT would suggest a share price of 75p; on a P/E basis this would be higher at 89p. Both these indicators suggest a level well ahead of the current share price of 61.5p.

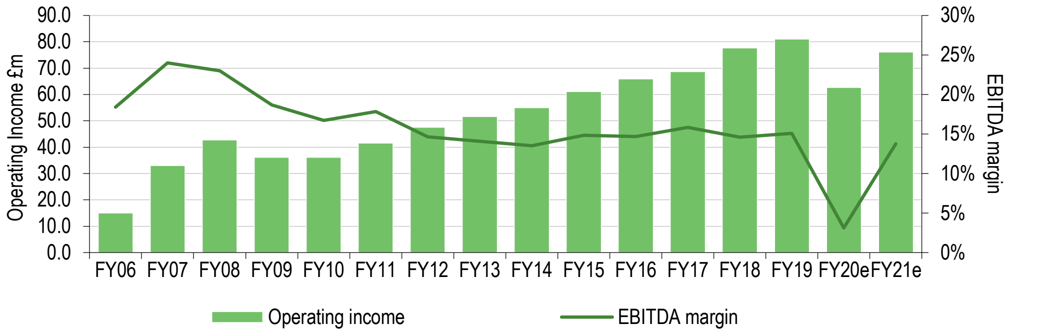
Financials

With this first piece of full research on the MISSION Group, we are initiating financial forecasts for FY20e and FY21e.

Long-term historic growth record

Prior to FY20, MISSION had delivered nine successive years of growth in operating income (which, as a reminder, is the better proxy for top line performance as it does not include third-party pass-through costs). EBITDA margin over most of this period has been around 15%. For FY19, MISSION delivered operating income growth of 4.4% y-o-y and an EBITDA margin of 15.1%. Had the COVID-19 pandemic not occurred, there is every reason to believe the progress would have continued uninterrupted.

Exhibit 9: Long-term financial performance record



Source: Company accounts, Edison Investment Research

Management's definition of adjusted EBITDA is headline operating profit before depreciation and amortisation charges and before the impact of IFRS 16. Headline operating profits are before acquisition adjustments, start-up costs and loss (or profit) on investments – acquisition adjustments being defined as amortisation of acquired intangibles plus movement in fair value of contingent consideration and acquisition transaction costs expensed. Start-up costs reflect the trading losses of businesses set up by the group for two years or until they look to be sustainably profitable, whichever comes first. Start-up costs in FY19 relate to the launches of April Six's new venture in Germany and Story's new venture in Leeds and trading losses at April Six's China operation. Start-up costs in 2018 related to April Six's venture in China and trading losses at Mongoose Promotions (now profitable).

Exhibit 10: Reconciliation of headline operating profit to reported operating profit

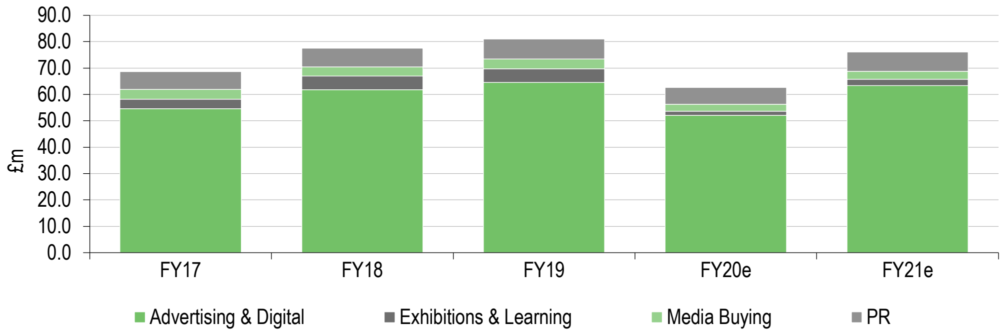
£000s		FY19		FY18
Headline operating profit		10,154		8,075
Amortisation of acquired intangibles	(870)		(915)	
Movement in fair value of contingent consideration	(433)		67	
Acquisition transaction costs expensed	(17)		(162)	
Acquisition-related items		(1,320)		(1,010)
Start-up costs		(431)		(139)
Write-off of investments and associates		(109)		(312)
Reported operating profit		8,294		6,614

Source: Company accounts

We have used the company's definitions within our modelling for ease of comparison but, as the exhibit above shows, some of these items are less common and so are worth noting.

We have modelled on a segmental basis, but as can be seen from the exhibit below, the bulk of the revenues fall within Advertising and Digital. Within this, individual agencies will have had very different experiences, particularly during the current financial year. Agencies working in the tech space, such as April Six, are reportedly trading well and continuing to pick up good new business. Others in sectors such as healthcare should also have held up well. At the other end of the scale, property marketing was effectively completely suspended during the harshest period of lockdown. Exhibitions and events have also been in abeyance.

Exhibit 11: Segmental revenue progression



Source: Company accounts, Edison Investment Research

As a general rule, the sector is particularly busy in the final few weeks of the year, both as a function of increased campaigns in the run up to Christmas and in the utilisation of corporates' marketing budgets before the end of the financial year.

COVID-19 response on costs

Staff costs are the largest element of overhead. Operating expenses for FY19 were £70.2m and staff costs accounted for £52.9m, which represented 65% of operating income (FY18: 65%).

With the onset of the pandemic this has been an obvious focus, but not at the expense of maintaining client relationships and retaining capabilities within the businesses. Staff moved to work from home, continuing to service the client base. There has been a move to four-day working weeks, or even less in areas of the business where the impact most severe. Government schemes have been utilised where appropriate.

The board and executive team have taken temporary voluntary salary cuts of 20% and capital expenditure plans have been put on hold. The final dividend for FY19 due to be approved at June's AGM was not proposed and any decision on a FY20 interim will be taken at the time of the interim results scheduled for September.

Management has also announced a further consolidation of the London-area office properties, reducing from four to two, which should realise an annualised overhead saving of £0.7m.

Full year FY20 and FY21 guidance

Management guidance is for the group to post a first-half loss in the region of £2.2m in H120. For FY20 as a whole, the expectation is for 'a profitable performance…albeit at materially lower levels than FY19'. Our underlying assumptions are that the downturn in H120 will have been substantial (the Advertising Association/WARC UK forecasts of Q1 up 4.6% year-on-year, Q2 the most severely affected at -39.1%, Q3 -24.3% narrowing in Q4 to -8.9%). We then anticipate an improvement in trading conditions as H2 progresses, always with the proviso that the impact of the pandemic on the economy eases over the next few months. All in all, we currently model a 23% y-o-y fall in FY20 revenue to £63m and normalised PBT of £0.6m vs £10.2m in FY19.

For FY21, we currently envisage a revenue recovery, again of around 20% y-o-y, regaining most of the ground against FY19 lost in FY20 on the back of the coronavirus economic disruption. While this is a higher level of growth than predicted by commentators for the UK market overall, we regard it as justified by the impetus from new business won to date and the observations that the group has been growing faster than the overall market historically. This tallies with management's observations that it 'can so no reason why in FY21, PBT cannot return to the pre-pandemic levels similar to those of 2019 of between £9m and £10m'. We note however that our FY21 estimates assume limited further disruption to the economy from COVID-19 and a relatively smooth economic recovery.

Conserving cash flow

The seasonally heavier trading in Q4 tends to result in increased working capital absorption across the year end. For FY19, there was a net cash outflow of £0.9m, post capital expenditure of £1.3m (2018: £1.0m), increased software development investment of £0.8m (2018: £0.4m), the settlement of contingent consideration obligations relating to the profits generated by previous acquisitions, totalling £2.7m (2018: £1.7m) and dividends of £1.8m (2018: £1.7m).

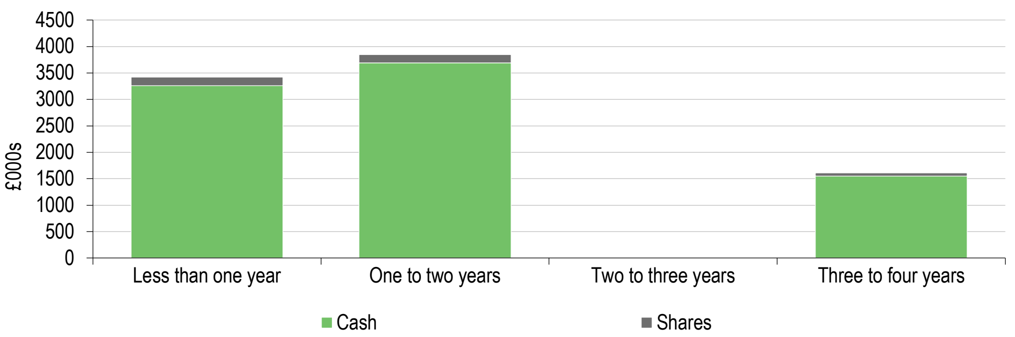
We expect the pandemic will have had an impact on the working capital position, with some clients looking to ease their own cash positions through extending their payment terms. MISSION has not looked to exploit its own strength relative to its own suppliers.

As outlined above, capital spending plans have been reined in and there will be no dividend paid during the year. Cash tax payments, including VAT and PAYE, have been deferred to FY21 under the government corporate amelioration schemes, meaning a heavier burden in that year.

The end FY19 balance sheet showed £3.4m of deferred acquisition consideration to be paid in FY20, of which £3.3m is in cash.

Exhibit 12 shows the outstanding deferred acquisition consideration at end FY19. However, part of this consideration depends on the financial performance of the acquired agencies during FY20, when it is unlikely that targets within the earn-out arrangements will be met. The figures in our model therefore represent a high-end case and the actual cash sums may be considerably lower.

Exhibit 12: Deferred acquisition consideration



Source: Company accounts

Balance sheet holding up

MISSION had expected to be net cash positive by the end of FY20e, but that was before the pandemic had taken hold. Net debt at the end of FY19 was £4.9m on a pre IFRS 16 basis. Including lease liabilities, as per IFRS 16, this rises £13.7m, but debt covenants are based on the non-IFRS 16 measure. The H120 trading update points to end-June net debt of £1.2m – a position we assume will have been flattered by the deferral of VAT, PAYE and corporation tax and working capital management.

Management has set a limit for the ratio of net bank debt to adjusted EBITDA of 1.5x and for the ratio of total debt (including both bank debt and deferred acquisition consideration, but not leases) to EBITDA of 2.0x. These multiples are more conservative than those applied by the banks under their covenants. Under our modelled scenario, net bank debt to EBITDA will be 4.2x at end FY20 and total debt to EBITDA 9.6x. However, given that bank facilities have been increased by £5m to £20m (vs 2019 net debt £5m) as a response to the COVID-19 trading position, we think it highly likely the covenant tests will be waived by the banks for the current year. The anticipated recovery in profitability for FY21e should mean the covenant issue is temporary.

Exhibit 13: Financial summary

£'000s	2018	2019	2020e	2021e
Year end December	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Turnover	159,916	171,091	136,354	159,536
Cost of Sales	(82,331)	(90,118)	(73,696)	(83,426)
Revenue	77,585	80,972	62,659	76,110
EBITDA	11,334	12,225	1,963	10,458
Operating Profit (before amort. and except.)	9,919	10,753	713	9,208
Intangible Amortisation	(1,286)	(1,980)	(1,110)	(1,110)
Headline Adjustments	(546)	(990)	(450)	(500)
Other	(1)	69	85	90
Operating Profit	8,086	7,852	28	8,468
Net Interest	(735)	(668)	(248)	(248)
Profit Before Tax (norm)	9,183	10,154	550	9,050
Profit Before Tax (FRS 3)	7,722	8,294	100	7,635
Tax	(1,710)	(1,868)	32	(1,995)
Profit After Tax (norm)	7,473	8,286	582	7,055
Profit After Tax (FRS 3)	6,012	6,426	132	5,640
Average Number of Shares Outstanding (m)	83.3	84.1	88.2	91.1
EPS - normalised (p)	8.7	9.5	0.7	7.8
EPS - normalised fully diluted (p)	8.5	9.0	0.7	7.7
EPS - (IFRS) (p)	7.1	7.5	0.0	6.1
Dividend per share (p)	2.1	0.8	0.0	1.8
Gross Margin (%)	48.5	47.3	46.0	47.7
EBITDA Margin (%)	7.1	7.1	1.4	6.6
Operating Margin (before GW and except.) (%)	6.2	6.3	0.5	5.8
BALANCE SHEET				
Fixed Assets	107,002	107,396	110,158	113,746
Intangible Assets	96,121	95,859	99,021	102,609
Tangible Assets	10,858	11,360	10,960	10,960
Investments/ other	23	177	177	177
Current Assets	46,476	47,117	38,410	42,172
Stocks	850	1,091	892	1,010
Debtors	39,727	40,998	35,863	38,463
Cash	5,899	5,028	1,654	2,699
Other	0	0	0	0
Current Liabilities	(40,986)	(40,181)	(35,070)	(39,563)
Creditors	(40,986)	(40,181)	(35,070)	(39,563)
Short term borrowings	0	0	0	0
Long Term Liabilities	(24,896)	(22,031)	(22,031)	(18,181)
Long term borrowings	(9,886)	(9,927)	(9,927)	(9,927)
Other long term liabilities	(15,010)	(12,104)	(12,104)	(8,254)
Net Assets	87,596	92,301	91,466	98,175
CASH FLOW				
Operating Cash Flow	11,684	10,454	3,308	9,110
Net Interest	(826)	(626)	(248)	(248)
Tax	(1,906)	(1,805)	32	(1,995)
Capex	(1,361)	(2,169)	(1,200)	(1,600)
Acquisitions/disposals	(670)	(2,839)	(3,424)	(3,850)
Financing/other	(1,938)	(2,096)	(1,841)	160
Dividends	(1,695)	(1,831)	0	(532)
Net Cash Flow	3,288	(912)	(3,373)	1,044
Opening net debt/(cash)	7,348	3,987	4,899	8,272
HP finance leases initiated	0	0	0	0
Other	73	0	0	0
Closing net debt/(cash)	3,987	4,899	8,272	7,227

Source: Company accounts, Edison Investment Research

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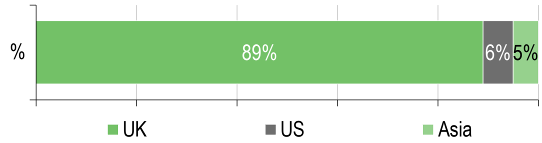
Revenue by geography



Management team

Chairman: David Morgan

David founded Bray Leino in 1974 and was its CEO until 2008. He became non-executive chairman of Bray Leino in 2008 and was appointed chairman of MISSION in April 2010. Before founding Bray Leino he worked in a number of London advertising agencies including Dorlands.

CEO: James Clifton

Previously CEO of bigdog, James began his career client side, before working for several agencies, both in the UK and internationally, within Omnicom and WPP. He created Balloon Dog in 2008, having led an MBO of Fox Murphy, and this was acquired by The MISSION Group. He joined the board in 2012 and was appointed CEO in April 2019.

CFO: Peter Fitzwilliam

Peter is a chartered accountant with 30 years' financial and management advisory experience in private and quoted companies across a range of industry sectors. As finance director of Business Post Group (now UK Mail Group) from 1999 to 2006, he helped take it into the FTSE 250. Peter supported MISSION through its refinancing in April 2010 and joined the board in September 2010.

Principal shareholders	(%)
David Morgan (director)	7.21
Herald Investment Trust	6.77
Robert Day (director)	6.04
BGF Investment Management	5.53
Objectif Investissment Microcaps PFC	4.96
Polar Capital Forager Fund	4.29
Other directors	6.46

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