EDISON

Dentsu Group

FY21 results

Upgrade to organic growth guidance

Media

A strong Q4 performance in recovering markets means Dentsu has posted good figures for FY21 and enters FY22 with positive momentum, particularly in the Customer Transformation and Technology (CT&T) activities. The strategic plan remains to build this area to 50% of revenue less cost of sales (RLCoS), from 29.1% in FY21. Medium-term guidance for group organic growth in RLCoS is upgraded from 3–4% to 4–5%, with 4% guided for FY22. A ¥40bn share buyback is planned, funded from year-end net cash following September's sale (and leaseback) of the Shiodome building. The share price remains at a substantial discount to peers.

Year end	Net revenue (¥bn)	PBT* (¥bn)	EPS* (¥)	DPS (¥)	P/E (x)	Yield (%)
12/20	835.0	123.5	250	71	17.2	1.6
12/21	976.6	146.0	389	118	11.1	2.7
12/22e	1,059.2	165.4	404	130	10.7	3.0
12/23e	1,102.2	173.2	423	141	10.2	3.3

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

Broad-based strength in Q421

The good performance in Q421 was across both Dentsu Japan Network (DJN) and Dentsu International (DI), with the former posting organic progress at the RLCoS level of 17.3% and the latter 12.1%. Within DI, a very strong Media performance in the Americas in December lifted Q421 organic revenue growth there to 15.4%, despite tougher comparatives in Customer Experience Management (CXM). The cyclical recovery across the year delivered group FY21 organic RLCoS growth of 13.1%, with an underlying operating margin of 18.3%, up 350bp on the prior year. We have set our FY22 forecasts to match management guidance (an upgrade of 4% at the underlying operating profit level, with a margin of 17.7%) and initiated forecasts for FY23, with RLCoS up 4% year-on-year.

Acquisition fund to drive medium-term growth

A transformed balance sheet (year-end net cash of ¥144.4bn) allows management to drive investment to deliver growth, with an upper limit on leverage at 1.5x year-end net debt/EBITDA (medium-term target range of 1.0–1.5x). The top priority is capex, where ¥70bn of spend is identified across FY22–24. Second, a fund of ¥250–300bn for M&A is allocated over the same period, prioritising development in CT&T, alongside capability and geographic infill. As guided, the dividend payout ratio is set to lift from 30% in FY21, to 32% in FY22e and to 35% by FY24e. ¥40bn is also earmarked for a share buyback across FY22, with a maximum of 20m shares.

Valuation: Overstated discount

The share price has recovered from the dip in November last year and is now 21% off the low hit in early December. Across FY21–23e, the shares still sit at a substantial valuation discount to the peer set of 27% on EV/EBITDA and 23% on P/E. Given the improving quality of business with the increased emphasis on digital transformation, we still believe this differential is overstated.

15 February 2022

Price	**¥4,305**
Market cap	**¥1,189,472m**

Net cash (¥bn) at end December 2021	144
Shares in issue	276.3m
Free float	77.8%
Code	DENN
Primary exchange	TSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	9.6	3.6	17.1
Rel (local)	11.0	6.3	15.2
52-week high/low		¥4,420	¥3,170

Business description

Dentsu Group is a holding company with two operational networks: Dentsu Japan Network and Dentsu International. Operating in over 145 countries, Dentsu Group provides a wide range of client-centric integrated communications, media and digital services.

Next events

AGM	May 2022
Q1 update	May 2022

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Edison profile page

Progress along planned lines

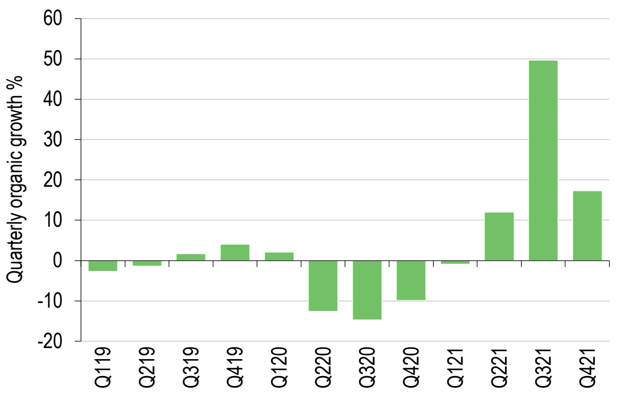
Q421 closed strongly for DJN and DI, with the group in much better shape given the simplification of the structure and costs that have been taken out of the business under the accelerated transformation plan (described in detail in our initiation report). These cost savings were previously guided at the group level of ¥75bn annualised from FY22 (of which ¥50bn falling in FY21).

The operational changes carried out in FY21 across the group should enable Dentsu to benefit to a greater extent from the structural shifts in the global market, with the burgeoning demand from corporate clients to transform their businesses to enhance and upscale their digital approach. The proportion of RLCoS from CT&T rose to 29.1% for the year, from 27.5% in FY20. The percentage at DJN was flat at 24.4% but rose to 32.6% at DI (FY20: 29.7%), helped by favourable currency movements. The reorientation of the group is regarded as a continuing process, with the structural trend given an additional impetus by the effects of the pandemic, highlighting the importance of businesses having a multi-dimensional understanding of their own customers. The marriage of data with creativity and technology is regarded as key.

The objective is to build CT&T to half of the group revenue base over (unspecified) time, fuelled by internal organic growth and supplemented by M&A, with the hypothecation of a fund of ¥250–300bn to be applied across FY22–24e. We would anticipate that average deal size would be ahead of the ¥25–30bn region typical historically. LiveArea, bought in Q321, and already rebranded as part of Merkle within DI, has been reported to have cost around ¥250m, although the price has not been formally disclosed. LiveArea registered an impressive organic growth rate of over 30% in Q421. Acquisitions of ¥50bn and subsidiary investments of ¥107bn are disclosed in the FY21 summary cash flow statement.

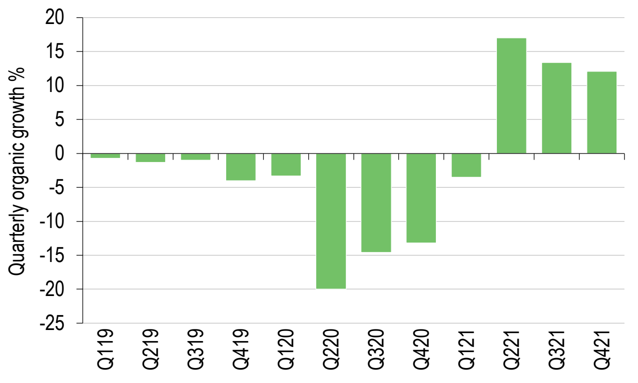
The proportion of RLCoS from the digital domain was 35.7% (+0.9%) for DJN but decreased to 61.8% for DI (-5.7%), with the proportion diluted by a particularly strong showing from the Media segment as confidence stepped up more sharply towards the close of the year.

Exhibit 1: DJN quarterly RLCoS progression



Source: Dentsu Group

Exhibit 2: DI quarterly RLCoS progression



Source: Dentsu Group

Upgrade to FY22 forecast, new FY23e figures

We upgraded on the back of increased management guidance at the time of the Q321 figures in November, but, as described above, the fourth quarter performance was also better than had earlier been anticipated.

Exhibit 3: Summary changes to forecasts

	Revenue LCoS (¥bn)			Underlying operating profit (¥bn)			EPS (¥)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2021	966.9	976.6	+1	174.3	179.0	+3	378	389	+3
2022e	1,000.0	1,059.2	+6	180.0	187.9	+4	385	404	+5
2023e	-	1,102.2	N/A	-	195.2	N/A	-	423	N/A

Source: Dentsu Group accounts, Edison Investment Research

We now move our FY22e RLCoS forecast up to the level guided by management at ¥1,059bn, which represents an increase over the prior year of 8.5%. At the organic growth level, this equates to 4% for the group, being a blend of 2–3% at DJN and 4-5% at DI.

The new guided underlying operating profit of ¥187.9bn, is a 5% improvement over that achieved in FY21, so a slight diminution of underlying operating margin to 17.7% from 18.3%. This is the impact of the additional investment being made over the medium term to position the group to take advantage of these longer-term growth opportunities. Management anticipates a flat underlying operating margin at DI (15.9% in FY21), and a more pronounced dip for DJN from 22.9% to 22.0%.

We are now publishing our FY23e figures, which we base on a conservative growth assumption for RLCoS of 4.1%, at the lower end of the newly increased medium-term guided range of 4–5%, and with a reasonably stable underlying operating margin. The dividend payout ratio is set to increase towards 35% in FY24e, so we have set our modelling for FY23e at 33.3%, following 32% for FY22e (as guided), up from 30% for FY21.

Cash and leverage give plenty of M&A firepower

The group bought back ¥30bn of shares in FY21. While we have built the FY22e planned ¥40bn share buyback into our cashflow modelling, we will only include acquisitions as and when they complete.

The end-FY21 balance sheet shows total debt of ¥579.2bn, with cash and cash equivalents if ¥723.5bn. The proceeds from the sale and leaseback of the Shiodome headquarters building comprised ¥305.2bn. Further asset sales are possible but are not likely to be on the same scale.

With ¥144.4bn in net cash on the balance sheet at end FY21, there is obviously plenty of scope for M&A spend over and above the fund being set aside specifically to support the expansion in CT&T.

Valuation: Discount remains substantial

We consider Dentsu's valuation in the context of the major global marketing services holding companies. Omnicom, Publicis and Interpublic have all published their FY21 figures and the upswing in demand has been apparent across the board. WPP is set to publish its figures on 24 February.

From the table below, it is clear that Dentsu's valuation remains at a marked discount to global peers, averaging 27% across EV/EBITDA and 23% on a P/E basis across FY21–23e.

Exhibit 4: Peer valuation, performance

	Price	Market cap	YTD	EV/sales (x)	EV/EBITDA (x)			P/E (x)			Dividend yield	FY21 organic growth
Company	**(local ccy)**	**(US$m)**	**(%)**	**CY21**	**CY21**	**CY22**	**CY23**	**CY21**	**CY22**	**CY23**	**(%)**	**(%)**
Omnicom	US$86	18,047	17	1.5	8.8	8.7	8.4	14.1	13.8	12.8	3.1	8.5
WPP	1214p	18,829	9	1.6	9.6	8.9	8.3	16.1	14.1	12.4	2.5	
Interpublic	US$36	15,530	5	1.8	9.4	8.8	8.6	15.2	15.0	14.2	2.7	11.9
Publicis	€65	18,846	10	1.8	8.0	7.4	7.2	13.0	12.1	11.7	4.6	10.0
Hakuhodo	¥1,589	5,361	-19	0.5	7.4	6.9	6.5	16.5	14.9	13.9	1.6	
Peer average			4	1.4	8.6	8.1	7.8	15.0	14.0	13.0	2.9	10.1
Dentsu	¥4,380	10,938	7	1.4	6.2	5.9	5.7	11.2	10.8	10.4	2.7	13.1
Premium/(discount)			2%	2%	-28%	-27%	-27%	-25%	-23%	-20%	-7%	30%

Source: company accounts, Refinitiv. Note: Prices at 11 February.

Exhibit 5: Financial summary

¥m	2019	2020	2021e	2022e	2023e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT					
Revenue	1,047,881	939,243	1,085,592	1,200,000	1,250,000
Cost of Sales	(108,496)	(104,201)	(109,015)	(140,800)	(147,700)
Revenue less pass through costs	939,385	835,042	976,577	1,059,200	1,102,224
EBITDA	160,279	90,063	195,006	203,878	211,153
Normalised operating profit	140,751	123,979	179,028	187,900	195,175
Amortisation of acquired intangibles	(34,806)	(31,877)	(29,409)	(31,379)	(31,379)
Exceptionals	(99,733)	(229,631)	94,368	0	0
Share-based payments	(9,568)	(3,094)	0	0	0
Reported operating profit	(3,358)	(140,625)	241,841	156,521	163,796
Net Interest	(42,103)	(1,419)	(35,491)	(32,716)	(32,351)
Joint ventures & associates (post tax)	517	910	2,484	10,200	10,404
Exceptionals	2,175	0	0	0	0
Profit Before Tax (norm)	101,340	123,470	146,021	165,385	173,229
Profit Before Tax (reported)	(42,769)	(141,134)	208,834	134,005	141,849
Reported tax	(30,136)	(11,162)	(93,979)	(34,528)	(46,243)
Profit After Tax (norm)	86,653	78,177	116,254	117,778	121,260
Profit After Tax (reported)	(72,905)	(152,296)	114,853	99,477	95,606
Minority interests	(7,987)	(7,299)	(6,463)	(6,478)	(6,669)
Discontinued operations	0	0	0	0	0
Net income (normalised)	76,122	69,891	109,203	109,557	114,591
Net income (reported)	(80,892)	(159,595)	108,390	93,000	88,937
Average Number of Shares Outstanding (m)	281	279	279	269	269
EPS - normalised (¥)	271	250	392	407	425
EPS - normalised fully diluted (¥)	271	249	389	404	423
EPS - basic reported (¥)	(288)	(571)	389	345	330
Dividend (¥)	95	71	118	130	141
Net revenue growth (%)	0.7	(11.1)	16.9	8.5	3.3
EBITDA Margin to revenue less pass-through costs (%)	17.1	10.8	20.0	19.2	19.3
Normalised operating margin to revenue less pass-through costs (%)	15.0	14.8	18.3	17.7	17.8
BALANCE SHEET					
Fixed Assets	1,862,033	1,439,542	1,305,203	1,315,971	1,323,739
Intangible Assets	1,000,313	784,502	858,748	874,254	886,760
Tangible Assets	315,116	280,196	88,682	83,944	79,206
Investments & other	546,604	374,844	357,773	357,773	357,773
Current Assets	1,933,691	1,924,816	2,214,088	2,374,745	2,487,498
Stocks	21,007	23,848	26,880	34,718	38,392
Debtors	1,424,127	1,293,370	1,386,767	1,532,915	1,596,787
Cash & cash equivalents	414,055	530,692	723,541	730,213	777,374
Other	74,502	76,906	76,899	76,899	76,899
Current Liabilities	(1,821,881)	(1,759,071)	(1,883,417)	(2,032,303)	(2,097,372)
Creditors	(1,390,778)	(1,247,172)	(1,412,757)	(1,561,643)	(1,626,712)
Tax and social security	(17,689)	(71,228)	(71,228)	(71,228)	(71,228)
Short term borrowings	(184,816)	(72,533)	(72,533)	(72,533)	(72,533)
Other	(228,598)	(368,138)	(326,899)	(326,899)	(326,899)
Long Term Liabilities	(883,971)	(800,985)	(726,400)	(720,783)	(715,166)
Long term borrowings	(439,110)	(512,274)	(506,657)	(501,040)	(495,423)
Other long term liabilities	(444,861)	(288,711)	(219,743)	(219,743)	(219,743)
Net Assets	1,089,872	804,302	909,474	937,629	998,858
Minority interests	(77,556)	(63,483)	(64,440)	(70,918)	(77,587)
Shareholders' equity	1,012,316	740,819	845,034	866,711	921,111
CASH FLOW					
Operating Cash Flow	47,198	(55,166)	254,221	181,363	189,207
Working capital	(28,254)	(22,538)	69,155	(5,098)	(2,481)
Exceptional & other	148,452	213,845	(59,307)	3,307	2,942
Tax	(87,439)	(47,828)	(149,880)	(67,244)	(78,594)
Net operating cash flow	79,957	88,313	114,189	112,327	111,074
Capex	(31,000)	(19,948)	305,200	(8,746)	(8,746)
Acquisitions/disposals	(47,860)	(26,585)	(49,672)	(18,000)	(15,000)
Net interest	0	0	0	0	0
Equity financing	(20,008)	(10,004)	(30,010)	(40,000)	0
Dividends	(30,031)	(29,574)	(23,473)	(33,293)	(36,508)
Other	(35,674)	141,820	(108,773)	0	0
Net Cash Flow	(84,616)	144,022	207,461	12,369	50,820
Opening net debt/(cash)	122,190	209,870	54,115	(144,351)	(156,640)
FX	1,490	(12,071)	(8,995)	0	0
Other non-cash movements	(4,554)	23,804	0	0	0
Closing net debt/(cash)	209,870	54,115	(144,351)	(156,640)	(207,460)

Source: Company accounts, Edison Investment Research

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