Dentsu Group

Interim results

Growth and margin progress ahead of plan

Media

Dentsu Group's interim results show a strong recovery in Q221 for both Dentsu Japan (DJN) and Dentsu International (DI), with organic revenue less cost of sales (LCoS) up 15.0% in Q221, giving an increase of 5.4% for H121. The pick-up in operating margins is well ahead of expectations and the targets for FY22e (20% for DJN and 15% for DI) may even be achieved in FY21 as the transformation plan kicks in. Management has issued new guidance for FY21, including a good uplift in the planned dividend.

Year end	Net revenue (¥bn)	PBT* (¥bn)	EPS* (¥)	DPS (¥)	P/E (x)	Yield (%)
12/19	939.4	101.3	271	95	15.0	2.3
12/20	835.0	123.5	250	71	16.8	1.7
12/21e	937.0	117.8	336	101	12.5	2.4
12/22e	978.4	151.4	376	112	11.2	2.7

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

Step up in operating margins

The statement describes the group as having 'line of sight' to achieving the FY22 target operating margins a year ahead of plan. This reflects three factors; the first benefits of the accelerated transformation programme helping with cost reduction; operational leverage from greater throughput; and further shifts in the mix towards the customer transformation and technology (CT&T), which accounted for 29.4% of first half revenue LCoS. The business transformation is well underway, with around 20 of the DJN operating companies moving into the Shiodome Head Office building and increasing centralisation of corporate functions. For DI, management estimates that around one third of the plan is implemented. 160 brands are already down to 100 and there has been a reduction of around 300 legal entities. The costs of implementation have been lower than anticipated, as greater attrition has reduced the severance bill. With a payback of around 11 months, some benefit falls into FY21, with the balance driving further margin improvement in FY22.

Balance sheet robust

Negotiations for the sale (and leaseback) of the Shiodome building are not yet complete but must be well advanced given that the financial benefit is built into management's full year guidance. The acquisition of LiveArea, announced in July, and the share buyback, which has now started, will absorb cash in H221, with the end June net debt figure ¥71bn benefiting from the sale of two smaller properties in Japan. Net debt is clearly well within the mid-term target of 1.5x EBITDA.

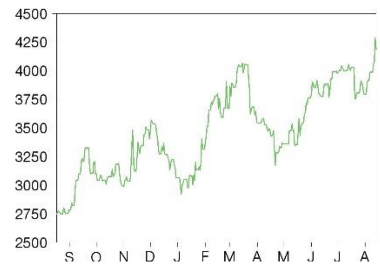
Valuation: Discount narrowed but still unjustified

The share price has recovered well from a dip during Q2, when news flow was relatively thin news and is now 35% off those lows and up 53% over the last twelve months as the outlook has clarified. This has narrowed the valuation gap to a 14% discount on EV/EBITDA and 10% on P/E, from 21% and 29% respectively at the time of our last note. Given the anticipated margin expansion, we still retain the view that this differential as overstated.

16 August 2021

Price	**¥4,185**
Market cap	**¥1,168bn**
Net debt at end June 21 (¥bn)	71
Shares in issue	281.7m
Free float	77.5%
Code	4324
Primary exchange	TSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	3.2	25.1	49.0
Rel (local)	3.8	18.3	23.7
52-week high/low		¥4,185	¥2,745

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

Q3 earnings	Nov 21

Analysts

Fiona Orford-Williams	+44 (0)20 3077 5739
Max Hayes	+44 (0)20 3077 5700

media@edisongroup.com

Edison profile page

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Progress on revenues and margins

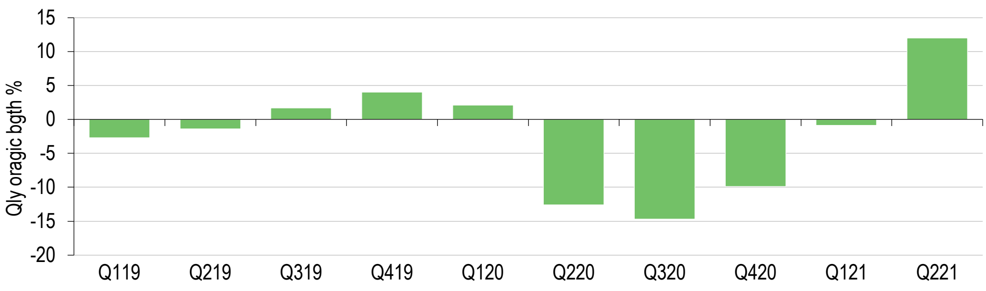
The group had a particularly good Q2, in common with the other global marketing holding companies, with 15.0% organic growth and an increase of 370 bps in operating margin to 12.2%. Overall Q2 revenue LCoS was ¥218bn.

The simplification of both parts of the group should results in greater efficiency and lower costs. The real future potential gains, though, are to be achieved in greater up and cross-sell through offering an increased number of service lines to individual clients and driving up average revenues.

DJN (43% H1 revenue LCoS) - integration evolving

Organic growth for DJN overall was 4.5% in H121, although the agencies had divergent performances dependent on the nature of their activities. The largest, DENTSU Inc, posted organic growth of 3.1%, benefiting from its exposure to better performing economic sectors such as technology and food and beverage.

Exhibit 1: Quarterly organic growth, DJN Q119-Q221



Source: Company

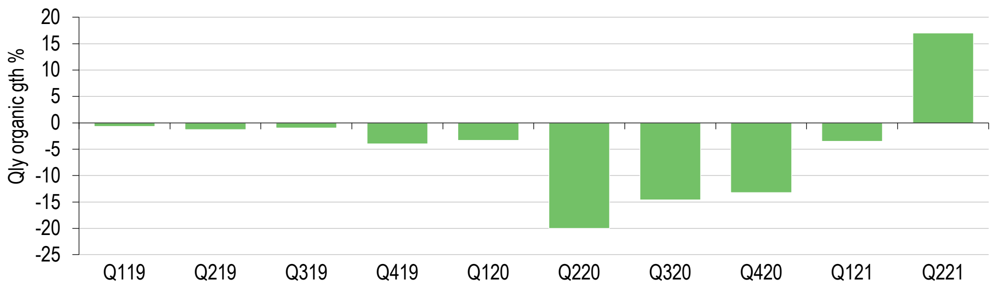
The progress in delivering the accelerated transformation plan for DJN is clearest in the operating margin, which was 22.9% on revenue less cost of sales for the first half and is implicitly targeted at 20% for the full year. The fastest growth was, unsurprisingly, in the digital domain, which accounted for 36.7% of segmental revenue LCoS, up from 32.1% in H120. The proportion of revenue LCoS derived from the Customer Transformation and Technology (CT&T) offering was 24.6%, up 0.8% on H120 and making inroads towards the structural target of 50% over time. More details on the underlying businesses and the group's transformation plan can be found in our February initiation note.

DI (57% group) not losing sight of its growth and margin goals

The scale of the project to drive simplification and improve returns at DI is clearly substantial and it would be easy for the interests of clients to get somewhat lost in the process. However, management is currently tacking both fronts and there has been a strong pick up in organic revenues in Q2, albeit against weak comparatives and in common with the other major global marketing holding companies.

The blended organic growth figure for revenue LCoS for DI is 6.2% in H121, with EMEA currently outperforming other regions, at +8.7%. This reflects both the economic recovery but also DI's improving record of cross-selling service lines, a process made more efficient by the business simplification. The North American organic performance of +5.1% was boosted by strong demand for media. Digital represented 63.6% of revenue LCoS, slightly down on prior year reflecting that media rebound, while CT&T was up 2.4% at 33.0%.

Exhibit 2: Quarterly organic growth, DI Q119-Q221



Source: Company

The acquisition of LiveArea (reported to be for around $250m), which focuses on commerce solutions, will accelerate the increase in the CT&T proportion. It also increases the group's resource in near and offshore locations, allowing for grater flexibility in the cost base. We believe that around half of its revenues are recurring, helping improve the quality as well as the quantum of earnings.

The DI segment's new business performance and pipeline looks healthy, with management reporting $8bn of new business in the pipeline, of which 87% is described as offensive, i.e. not repatching for existing accounts.

DI's first half operating margin of 12.3% compares with 7.7% in H120 as the first (earlier than expected) benefits come through at a lower cost than had been built into previous forecasts.

Revisions to forecasts

We have updated our forecasts in light of the progress made year-to-date and with an eye to management guidance for the full year.

Exhibit 3: Summary forecast changes

	Net revenue			Underlying operating profit			Underlying EPS		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2020	835	835		124	124		250	250	
2021e	846	937	+11	125	154	+23	271	336	+24
2022e	895	978	+9	150	187	+25	337	376	+12

Source: Company, Edison Investment Research

The improvement in the anticipated operating margin reflects the success to date of the accelerated transformation plan resulting in lower cost than had been forecast, coupled with a healthier trading environment.

Management is indicating a 30% earnings payout ratio, and have confirmed a FY21 dividend of ¥101, to be paid 50:50 as an interim and a final.

Exhibit 3: Financial summary

¥'m	2018	2019	2020	2021e	2022e
31-December	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT					
Revenue	1,018,512	1,047,881	939,243	1,039,276	1,104,632
Cost of Sales	(85,832)	(108,496)	(104,201)	(102,270)	(126,227)
Revenue less pass through costs	932,680	939,385	835,042	937,006	978,405
EBITDA	171,404	160,279	90,061	204,649	240,271
Normalised operating profit	153,229	140,751	123,979	153,560	187,182
Amortisation of acquired intangibles	(35,123)	(34,806)	(31,877)	(31,877)	(31,877)
Exceptionals	(2,149)	(99,733)	(229,631)	80,594	(1,000)
Share-based payments	(4,313)	(9,568)	(3,094)	0	0
Reported operating profit	111,638	(3,358)	(140,625)	202,277	154,305
Net Interest	(17,714)	(42,103)	(1,419)	(35,750)	(35,750)
Joint ventures & associates (post tax)	2,699	517	910	0	0
Exceptionals	52,128	2,175	0	0	0
Profit Before Tax (norm)	190,342	101,340	123,470	117,810	151,432
Profit Before Tax (reported)	148,751	(42,769)	(141,134)	166,527	118,555
Reported tax	(51,250)	(30,136)	(11,162)	(55,453)	(41,494)
Profit After Tax (norm)	107,321	86,653	78,177	98,329	108,431
Profit After Tax (reported)	97,501	(72,905)	(152,296)	111,074	77,061
Minority interests	(7,185)	(7,987)	(7,299)	(2,500)	(2,500)
Discontinued operations	0	0	0	0	0
Net income (normalised)	97,420	76,122	69,891	94,829	105,931
Net income (reported)	90,316	(80,892)	(159,595)	108,574	74,561
Basic average number of shares outstanding (m)	282	281	279	282	282
EPS - basic normalised (¥)	346	271	250	336	376
EPS - diluted normalised (¥)	346	271	249	334	374
EPS - basic reported (¥)	320	(288)	(571)	385	265
Dividend (¥)	90	95	71	101	112
Net revenue growth (%)	6.3	0.7	(11.1)	12.2	4.4
EBITDA Margin to revenue less pass-through costs (%)	18.4	17.1	10.8	21.8	24.6
Normalised operating margin to revenue less pass-through costs (%)	16.4	15.0	14.8	16.4	19.1
BALANCE SHEET					
Fixed Assets	1,702,899	1,862,033	1,455,591	1,370,575	1,324,083
Intangible Assets	1,036,772	1,000,313	800,551	768,150	744,273
Tangible Assets	199,207	315,116	280,196	227,581	204,966
Investments & other	466,920	546,604	374,844	374,844	374,844
Current Assets	1,935,586	1,933,691	1,924,816	1,975,401	2,123,004
Stocks	28,580	21,007	23,848	23,406	28,889
Debtors	1,368,728	1,424,127	1,293,370	1,352,482	1,411,898
Cash & cash equivalents	416,668	414,055	530,692	522,612	605,316
Other	121,610	74,502	76,906	76,901	76,901
Current Liabilities	(1,785,608)	(1,859,224)	(1,759,071)	(1,779,169)	(1,864,222)
Creditors	(1,341,461)	(1,390,778)	(1,247,172)	(1,352,482)	(1,437,535)
Tax and social security	(42,981)	(17,689)	(71,228)	(71,228)	(71,228)
Short term borrowings	(104,879)	(184,816)	(72,533)	(72,533)	(72,533)
Other	(296,287)	(265,941)	(368,138)	(282,926)	(282,926)
Long Term Liabilities	(742,129)	(883,971)	(800,987)	(800,987)	(800,987)
Long term borrowings	(433,979)	(439,110)	(512,274)	(512,274)	(512,274)
Other long term liabilities	(308,150)	(444,861)	(288,713)	(288,713)	(288,713)
Net Assets	1,110,748	1,052,529	820,349	765,820	781,878
Minority interests	(63,129)	(77,556)	(63,483)	(65,983)	(68,483)
Shareholders' equity	1,047,619	974,973	756,866	699,837	713,395
CASH FLOW					
Op Cash Flow before WC and tax	208,490	47,198	(55,166)	252,493	204,521
Working capital	7,866	(28,254)	(22,538)	46,640	20,154
Exceptional & other	(35,011)	148,452	213,845	35,750	36,750
Tax	(48,296)	(87,439)	(47,828)	(91,203)	(77,244)
Net operating cash flow	133,049	79,957	88,313	243,680	184,181
Capex	(31,322)	(31,000)	(19,948)	(21,474)	(21,474)
Acquisitions/disposals	(50,555)	(47,860)	(26,585)	(100,820)	(18,000)
Net interest	0	0	0	0	0
Equity financing	(12)	(20,008)	(10,004)	(30,000)	0
Dividends	(32,055)	(30,031)	(29,574)	(20,799)	(30,003)
Other	10,768	(35,674)	141,820	(29,950)	(32,000)
Net Cash Flow	29,873	(84,616)	144,022	40,636	82,704
Opening net debt/(cash)	154,752	122,190	209,870	54,115	62,195
FX	(18,281)	1,490	(12,071)	0	0
Other non-cash movements	20,970	(4,554)	23,804	(48,716)	0
Closing net debt/(cash)	122,190	209,870	54,115	62,195	(20,509)

Source: Company accounts, Edison Investment Research

EDISON

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1,185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia