

Dentsu Group

Interim results

Growth and margin progress ahead of plan

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.

Media

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

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Progress on revenues and margins

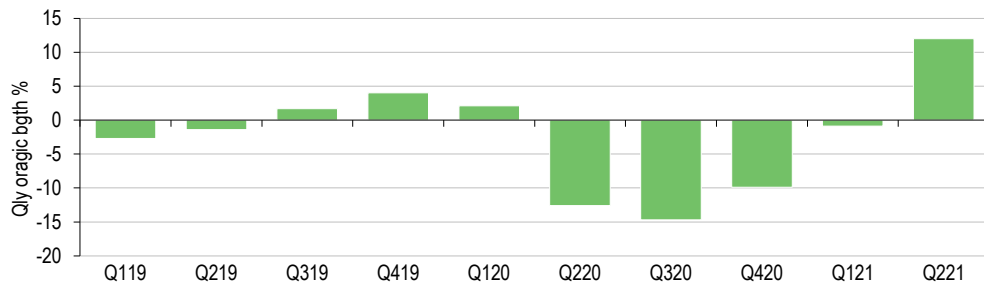
The group had a particularly good Q2, in common with the other global marketing holding companies, with 15.0% organic growth and an increase of 370 bps in operating margin to 12.2%. Overall Q2 revenue LCoS was ¥218bn.

The simplification of both parts of the group should result 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

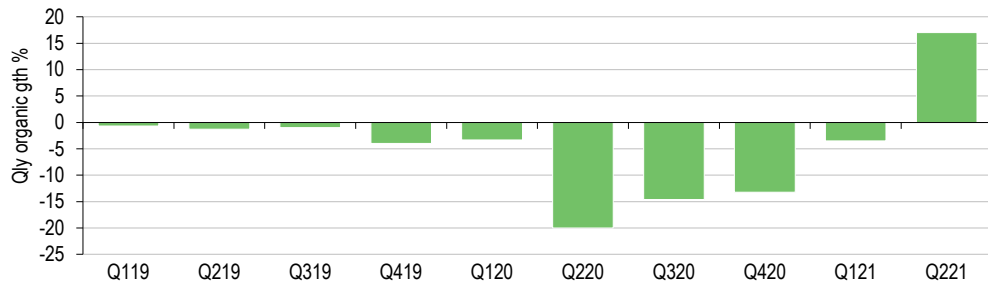
The progress in delivering the accelerated transformation plan for DJN is clearest in the operating margin, which was 22.9% on revenue less cost of sales for the first half and is implicitly targeted at 20% for the full year. The fastest growth was, unsurprisingly, in the digital domain, which accounted 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 greater 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

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