Dentsu Group

Q321 results

Strong Q3 lifts full-year guidance further

Media

Dentsu posted a very strong performance for Q321, with revenue less cost of sales (RLCoS) up 27.8% on an organic basis and a substantial uplift in operating margin to 23.5%, from 12.2% in Q221. Full-year guidance is raised, having been lifted in August, with an indication of a FY21 margin of 18.0% after greater intended investment in Q4. Proposed board changes for the new year split the chairman and CEO roles, with the existing CEO retiring and appointments of independent non-executives planned. The better performance and balance sheet strength support an uplift in DPS, with ¥113.5 now expected for the full year (previously ¥101).

Year end	Net revenue (¥bn)	PBT* (¥bn)	EPS* (¥)	DPS (¥)	P/E (x)	Yield (%)
12/19	939.4	101.3	271	95	15.3	2.3
12/20	835.0	123.5	250	71	16.7	1.7
12/21e	966.9	135.2	378	114	11.0	2.8
12/22e	1000.0	140.5	385	121	10.8	2.9

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

Japan and digital lead the way in Q3

Q321 organic growth at Dentsu Japan Network (DJN) was exceptionally strong, up 49.7%. While the Olympics/Paralympics were only mentioned in passing in the release, it seems reasonable to assume they were a significant factor in driving the quarterly performance across traditional and digital media. Over 9M21, Customer Transformation and Technology, the heart of the transformation plan, reached 23.2% of DJN RLCoS. At Dentsu International (DI), the proportion is higher at 32.9%. The medium-term target is for the proportion to reach 50% at a group level. Organic growth at DI in Q321 was 13.4%, with an operating margin of 16.2%. We have adjusted our FY21 forecasts to reflect the updated guidance. For FY22, we have edged our revenue ahead but marginally increased our assumptions on costs.

Transforming the balance sheet

The sale of the Shiodome Head Office building on the last day of the quarter (price undisclosed but reportedly around ¥300bn) boosted operating profit by ¥87.0bn and net profit by ¥49.0bn, with a slightly higher tax cost than expected. The group's cash position is also helped by the costs of transformation being lower than had been anticipated, with net cash of ¥13.1bn at end September. This supports the investment being made in transforming the business and the continuing M&A programme and the share buyback and higher dividend distribution.

Valuation: Overstated discount

The share price has recovered well from a dip during Q2, when newsflow was relatively thin, and is now 31% off those lows and up 40% year-to-date as the outlook has clarified. Across FY21 and FY22, the shares still sit at a substantial valuation discount to the peer set of 30% on EV/EBITDA and 21% on P/E. Given the anticipated margin expansion, we still believe this differential is overstated.

16 November 2021

Price	**¥4145**
Market cap	**¥1,144bn**
Net cash (¥bn) at end September 2021	13.1
Shares in issue	275.9m
Free float	74%
Code	DENN
Primary exchange	TSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(4.1)	(1.0)	32.9
Rel (local)	(5.2)	(5.4)	10.5
52-week high/low		¥4,420	¥2,919

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

FY21 results	February 2022

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Board reorganisation

Alongside the financial results for Q321, a number of changes were announced that will put the group board into a more conventional structure for a global operation. Firstly, the roles of chairman and CEO are to be separated, with Tim Andree (currently executive chairman of DI) to be appointed as Dentsu Group's first non-Japanese (non-executive) chairman from March 2022. There is to be a generational change at CEO level, where Hiroshi Igarashi, currently president and CEO of DJN, will step up after the retirement of Toshihiro Yamamoto on 1 January.

DJN will be led by Norihiro Kuretani and Wendy Clark remains in her role at DI.

The group also intends appointing four new independent outside directors who will add a wide variety of experience from different sectors including entertainment and finance. Further details will be provided nearer the time.

Quarterly progression

DJN particularly strong

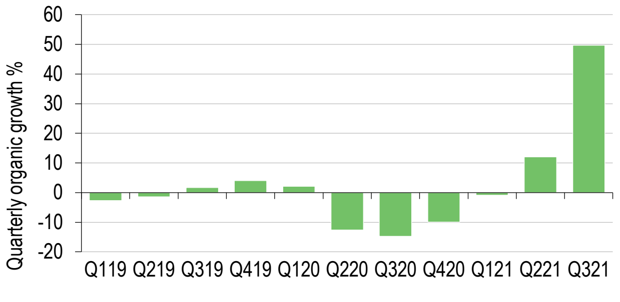
As described above, and shown clearly in the exhibit below, the performance of DJN in Q321 was clearly outstanding and the Olympics/Paralympics will likely have played a major part, on top of an improvement in Japanese consumer confidence. There has been a resurgence in TV, media and out-of-home as well as continuing progress in digital. In terms of sectors, technology, beverages, financials and luxury goods were all highlighted.

While the quarter-on-quarter and year-on-year growth is clearly strong, the two-year stack (as is also being used across the industry to sidestep the issues that severely impacted sectoral revenues during the strictest pandemic lockdowns) also shows progress, with Q321 RLCoS up 1.7% on Q319.

Overall Q1-Q321 organic growth of RLCoS was 18.2% and full year guidance is for 17%, implying a slightly lower, but still strong, rate for Q421 of 15.1%.

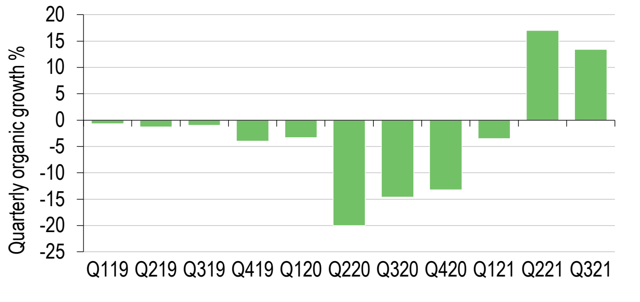
Similarly, the operating margin achieved in the nine months of 2021 to date is 26.9%. Full-year margin guidance for DJN is 23.5%. Mechanistically, this reverses out to a Q421 operating margin of 18.0%. This looks compatible with the narrative of additional investment in talent and in IT, particularly to drive the customer transformation and technology offering.

Exhibit 1: DJN quarterly RLCoS progression



Source: Company

Exhibit 2: DI quarterly RLCoS progression



Source: Company

DI good growth, with slight easing in Q3

DI reported organic growth of 13.4% in Q321, with particularly strength in Media (+17.3%) and CXM (+11.2%). Creative was slightly more challenging in EMEA and China, with live and experiential still affected by the pandemic restrictions and China affected by its exposure to the automotive industry. Operating margin for the quarter was 16.2%.

Looking at the nine-month figures, RLCoS was up 8.6%, delivering an operating margin of 13.7%. On a two-year stack, performance remains a little below FY19 levels, with APAC the most challenging region.

Full-year guidance is for DI to grow organically in 'high single digits'. It is not possible to reverse this out precisely, as there has been the acquisition of LiveArea to take into account. In terms of the operating margin, management guidance is for 15.0% for the full year. With 13.7% recorded for the first nine months, here the implication is for a stronger operating margin in Q421 of 18.9%, which again is compatible with a narrative of a stronger top line on a cost base reduced by the transformation programme.

Revisions to forecasts

We have updated our forecasts in light of the progress made in the year to date and the raised management guidance for the full year. Figures were also lifted at the interim stage.

Exhibit 3: Summary forecast changes

	Net revenue (¥bn)			Underlying operating profit (¥bn)			Underlying EPS (¥)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2020	835	835		124	124		250	250	
2021e	937	967	+3	154	174	+13	336	378	-1
2022e	978	1,000	+2	187	180	-4	376	385	+2

Source: Company, Edison Investment Research

The most notable change at this juncture is the increase in adjusted operating margin. This reflects the uplift in net revenue from the healthier trading environment delivering some operational gearing, but also the success to date of the accelerated transformation plan resulting in lower cost than had earlier been forecast, as explained in the segmental descriptions above.

Management is indicating a 30% earnings payout ratio (which will be stepped up to 35% over the next few years) and have now indicated a total dividend payment for FY21 of ¥113.5, up from the previous projection of ¥101.

Valuation

Exhibit 4: Peer group valuation

Company	Price (local ccy)	Market Cap (US$m)	YTD (%)	EV/Sales (x)	EV/EBITDA (x)			P/E (x)			Dividend yield (%)
				CY20	CY20	CY21	CY22	CY20	CY21	CY22	
Omnicom	US$70	14,794	12	1.2	7.6	6.5	6.4	14.1	11.3	10.8	3.7
WPP	1109p	17,498	39	1.5	10.2	8.8	8.2	19.3	14.5	12.8	0.0
Interpublic	US$37	14,565	57	1.9	13.3	9.0	8.8	22.2	14.2	14.1	2.8
Publicis	€59	17,118	45	1.8	8.4	7.6	7.2	15.2	12.1	11.6	3.4
Hakuhodo	¥1941	6,359	37	1.9	11.2	9.1	8.1	27.3	23.0	19.3	1.5
Peer average			**38**	**1.7**	**10.1**	**8.2**	**7.7**	**19.6**	**15.0**	**13.7**	**2.3**
Dentsu	¥4275	11,299	39	1.4	13.1	6.2	5.0	17.2	11.4	11.2	1.7
Premium/(discount)			**1%**	**-15%**	**29%**	**-24%**	**-35%**	**-12%**	**-24%**	**-19%**	**-27%**

Source: Refinitiv. Note: Priced at 12 November 2021.

We now compare Dentsu with peers on FY21e and FY22e, rather than across FY20-22e, particularly as there is such clear management guidance for FY21e. On this basis, the shares are trading on an average discount of 30% on EV/EBITDA and 21% on P/E.

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	1,068,700	1,125,000
Cost of Sales		(85,832)	(108,496)	(104,201)	(101,800)	(125,000)
Revenue less pass through costs		932,680	939,385	835,042	966,900	1,000,000
EBITDA		171,404	160,279	90,063	189,458	234,091
Normalised operating profit		153,229	140,751	123,979	174,300	180,000
Amortisation of acquired intangibles		(35,123)	(34,806)	(31,877)	(29,857)	(29,857)
Exceptionals		(2,149)	(99,733)	(229,631)	97,619	0
Share-based payments		(4,313)	(9,568)	(3,094)	0	0
Reported operating profit		111,638	(3,358)	(140,625)	243,400	150,143
Net Interest		(17,714)	(42,103)	(1,419)	(39,126)	(36,457)
Joint ventures & associates (post tax)		2,699	517	910	0	0
Exceptionals		52,128	2,175	0	(23,000)	(3,000)
Profit Before Tax (norm)		190,342	101,340	123,470	135,174	140,543
Profit Before Tax (reported)		148,751	(42,769)	(141,134)	181,274	110,686
Reported tax		(51,250)	(30,136)	(11,162)	(58,914)	(33,538)
Profit After Tax (norm)		107,321	86,653	78,177	111,131	111,894
Profit After Tax (reported)		97,501	(72,905)	(152,296)	122,360	77,148
Minority interests		(7,185)	(7,987)	(7,299)	(6,060)	(6,060)
Discontinued operations		0	0	0	0	0
Net income (normalised)		97,420	76,122	69,891	105,521	105,834
Net income (reported)		90,316	(80,892)	(159,595)	116,300	71,088
Basic average number of shares outstanding (m)		282	281	279	279	275
EPS - basic normalised (¥)		346	271	250	378	385
EPS - diluted normalised (¥)		346	271	249	376	383
EPS - basic reported (¥)		320	(288)	(571)	417	259
Dividend (¥)		90	95	71	114	121
Net revenue growth (%)		6.3	0.7	(11.1)	15.8	3.4
EBITDA Margin to revenue less pass-through costs (%)		18.4	17.1	10.8	19.6	23.4
Normalised operating margin to revenue less pass-through costs (%)		16.4	15.0	14.8	18.0	18.0
BALANCE SHEET						
Fixed Assets		1,702,899	1,862,033	1,455,591	1,326,068	1,298,723
Intangible Assets		1,036,772	1,000,313	800,551	898,288	875,681
Tangible Assets		199,207	315,116	280,196	88,682	83,944
Investments & other		466,920	546,604	374,844	339,098	339,098
Current Assets		1,935,586	1,933,691	1,924,816	2,230,565	2,370,224
Stocks		28,580	21,007	23,848	23,298	28,608
Debtors		1,368,728	1,424,127	1,293,370	1,390,774	1,464,041
Cash & cash equivalents		416,668	414,055	530,692	559,972	621,055
Other		121,610	74,502	76,906	256,520	256,520
Current Liabilities		(1,785,608)	(1,821,881)	(1,729,657)	(1,810,058)	(1,879,469)
Creditors		(1,341,461)	(1,390,778)	(1,247,172)	(1,317,575)	(1,386,986)
Tax and social security		(42,981)	(17,689)	(71,228)	(71,228)	(71,228)
Short term borrowings		(104,879)	(184,816)	(72,533)	(82,533)	(82,533)
Other		(296,287)	(228,598)	(338,724)	(338,722)	(338,722)
Long Term Liabilities		(742,129)	(883,971)	(800,985)	(752,269)	(752,269)
Long term borrowings		(433,979)	(439,110)	(512,274)	(463,558)	(463,558)
Other long term liabilities		(308,150)	(444,861)	(288,711)	(288,711)	(288,711)
Net Assets		1,110,748	1,089,872	849,765	994,305	1,037,209
Minority interests		(63,129)	(77,556)	(63,483)	(69,543)	(75,603)
Shareholders' equity		1,047,619	1,012,316	786,282	924,762	961,606
CASH FLOW						
Op Cash Flow before WC and tax		208,490	47,198	(55,166)	265,222	194,634
Working capital		7,866	(28,254)	(22,538)	(26,451)	(9,166)
Exceptional & other		(35,011)	148,452	213,845	(31,401)	4,580
Tax		(48,296)	(87,439)	(47,828)	(98,040)	(69,995)
Net operating cash flow		133,049	79,957	88,313	109,330	120,053
Capex		(31,322)	(31,000)	(19,948)	157,360	(8,746)
Acquisitions/disposals		(50,555)	(47,860)	(26,585)	(130,820)	(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)	(31,373)	(32,225)
Other		10,768	(35,674)	141,820	(669)	0
Net Cash Flow		29,873	(84,616)	144,022	73,828	61,082
Opening net debt/(cash)		154,752	122,190	209,870	54,115	(13,881)
FX		(18,281)	1,490	(12,071)	(5,832)	0
Other non-cash movements		20,970	(4,554)	23,804	0	0
Closing net debt/(cash)		122,190	209,870	54,115	(13,881)	(74,964)

Source: Dentsu, Edison Investment Research

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