EDISON

Dentsu Group

Q1 update

Progressive quarterly improvements

Media

Dentsu's Q1 update shows a third successive quarter of improvement (a reducing decline in organic revenue), with Dentsu Japan down 0.9% on Q120 and Dentsu International 3.5% below prior year. Operating margins were considerably stronger in both segments as the transformation plan has kicked in. Q221 has started very strongly, and we leave our FY21 and FY22 revenue and margin estimates unchanged, but note that if trading continues to improve, there may be scope to move numbers later in the year, subject to the status of the planned Olympics. FY22 should be a stronger year of margin growth as permanent cost reductions contribute.

Year end	Net revenue (¥bn)	PBT* (¥bn)	EPS* (¥)	DPS (¥)	P/E (x)	Yield (%)
12/19	939.4	101.3	271	95	12.8	2.7
12/20	835.0	123.5	250	71	13.9	2.0
12/21e	850.0	124.7	271	77	12.8	2.2
12/22e	900.0	149.7	337	100	10.3	2.9

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

Better prospects for Q221

Performance improved across the quarter, with March returning to organic growth, with a 2.5% increase. Q221 looks likely to be notably stronger, with April organic revenue growth at Dentsu International (DI) up 17%, albeit against weaker comparatives. Margin performance in Q1 was particularly strong: up 350bp to 32.8% at Dentsu Japan Network (DJN) and up 360bp to 10.3% for DI (at constant currency). For H221, the comparatives will be tougher (with H220 spending having been reined in) and much of this gain is likely to be whittled away. For FY21, guidance is for group margin to be broadly flat. Our modelling indicates 14.7% for normalised group operating profit to revenue less cost of sales, against 14.8% in FY20. Meaningful progress is more likely in FY22 as the permanent cost savings kick in and we are looking for an uplift at group level to 16.7%. Group targets are for DI to reach 15% and for DJN to post 20%. Progress on the transformation plan looks to be on track, with the planned share buyback on hold while the group engages in the possible sale and leaseback of the Shiodome head office building.

Olympic uncertainty

The big unknown currently is over the planned Tokyo Olympics, which our forecast assumes proceeds as planned. Management is sensibly withholding formal guidance until the interim results in August, by which time the die will be cast.

Valuation: FY22 discount to peers widened

The share price has drifted since February's finals, reflecting uncertainty over the Olympics and relatively thin news flow. Looking out to FY22, we expect the benefits of restructuring and the impact of the simplification programme to be more pronounced. With a stronger share price performance by the peer group, the valuation gap has grown, with Dentsu trading at a 21% discount on EV/EBITDA and 29% on P/E. Given the anticipated margin expansion, we view this differential as overstated.

18 May 2021

Price	**¥3,480**
Market cap	**¥980bn**
Net debt (¥bn) at end Mar 21	169.4
Shares in issue	281.3m
Free float	76.7%
Code	4324
Primary exchange	TSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	1.2	(7.6)	54.2
Rel (local)	5.6	(3.5)	19.3
52-week high/low		¥4,065	¥2,231

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

Interims	August 2021

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Comprehensive review remains on track

There has been progress across all four pillars of the comprehensive review during Q121, described in detail in our February initiation.

Simplification

DJN (46% of Q121 revenue less cost of sales) is being organised into four domains: Advertising Transformation (AX); Business Transformation (BX); Customer Experience Transformation (CX); and Digital Transformation (DX). Two of its largest agencies, Dentsu Digital and Dentsu Isobar, are being merged as of 1 July, bringing a creative angle to the digital mix as well as building scale. Dentsu Direct is another new entity, with the direct marketing and search specialists being brought together.

In DI, the ambitious programme to consolidate 160 brands down to six is well underway, with 56 agencies already brought together, ahead of plan. This has the potential to be both highly disruptive internally and unsettling to clients but looks to be being handled well. Master service set schedules have been drawn up to clarify centres of expertise and limit duplication of services, and client input has been an embedded part of the process. The largest combination to date has been Vizeum and iProspect, and there has been no client attrition as a result. At the end of the process, DI anticipates being the most integrated of the major global agency groups.

Lower operating expenses

There is no change to management guidance for annualised group cost savings of ¥75bn from FY22 (of which ¥50bn will fall into FY21). The associated cost in FY21 is guided to ¥56bn (also unchanged), with a further spend in DJN of ¥3bn the following year.

For DJN, the uplift to operating margins in Q121 was primarily from lower operating costs, ¥3.7bn lower than prior year, with a small contribution from the permanent cost reductions from the early retirement programme. As the market reopens, those variable costs would be expected to rise, across Q2-Q421, hence management guidance to broadly flat operating margin FY21 vs. FY20 (at constant currency).

At DI, progress has been good, with over half of planned cost savings already achieved, including renegotiating more than 50 property leases. Better use is being made of near-shoring and off-shoring opportunities, and further incremental gains are being made through automation, where appropriate.

Balance sheet efficiency

The group has disposed of two properties in Japan in Q121 for ¥30bn, but news is still awaited on the possible sale and leaseback of the head office building in Shiodome, which could be transformative for the balance sheet (press reports suggest it could be worth around ¥300bn ($2.7bn). Net debt at the quarter end was ¥169bn, up from ¥54bn at the year end, with working capital absorption (as would be expected) in the quarter.

Shareholder value

The ¥30bn share buyback, announced in February, has not been commenced due to the Shiodome potential disposal. Management has repeatedly referred to the potential for further returns following exceptional asset disposals. However, the commitment to growing the Customer Transformation and Technology proportion of the business towards the 50% target (from 29% in Q121) will require further investment in people and technology. Management targets a progressive dividend policy, with a pay-out ratio of 35% of basic EPS.

Exhibit 1: 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	955,045	1,010,768
Cost of Sales	(85,832)	(108,496)	(104,201)	(109,526)	(115,689)
Revenue less pass through costs	932,680	939,385	835,042	845,520	895,079
EBITDA	171,404	160,279	90,061	61,486	154,945
Normalised operating profit	153,229	140,751	123,979	125,000	150,000
Amortisation of acquired intangibles	(35,123)	(34,806)	(31,877)	(31,877)	(31,877)
Exceptionals	(2,149)	(99,733)	(229,629)	(54,500)	(3,000)
Share-based payments	(4,313)	(9,568)	(3,094)	0	0
Reported operating profit	111,638	(3,358)	(140,625)	(24,480)	68,979
Net Interest	(17,714)	(42,103)	(1,419)	(290)	(290)
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	124,710	149,710
Profit Before Tax (reported)	148,751	(42,769)	(141,134)	(24,770)	68,689
Reported tax	(51,250)	(30,136)	(11,162)	8,917	(24,041)
Profit After Tax (norm)	107,321	86,653	78,177	79,814	97,312
Profit After Tax (reported)	97,501	(72,905)	(152,296)	(15,853)	44,648
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	76,314	94,812
Net income (reported)	90,316	(80,892)	(159,595)	(18,353)	42,148
Basic average number of shares outstanding (m)	282	281	279	282	282
EPS - basic normalised (¥)	346	271	250	271	337
EPS - diluted normalised (¥)	346	271	249	269	335
EPS - basic reported (¥)	320	(288)	(571)	(65)	150
Dividend (¥)	90	95	71	77	100
Net revenue growth (%)	6.3	0.7	(11.1)	1.3	5.9
EBITDA Margin to revenue less pass-through costs (%)	18.4	17.1	10.8	7.3	17.3
Normalised operating margin to revenue less pass-through costs (%)	16.4	15.0	14.8	14.8	16.8
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	1,924,813	1,796,474	1,782,097
Stocks	28,580	21,007	23,848	25,067	26,477
Debtors	1,368,728	1,424,127	1,293,370	1,242,867	1,291,924
Cash & cash equivalents	416,668	414,055	530,692	451,639	386,794
Other	121,610	74,502	76,903	76,901	76,901
Current Liabilities	(1,785,608)	(1,859,224)	(1,759,071)	(1,648,153)	(1,596,568)
Creditors	(1,341,461)	(1,390,778)	(1,247,172)	(1,221,466)	(1,169,881)
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	820,346	717,909	708,625
Minority interests	63,129	77,556	63,483	65,983	68,483
Shareholders' equity	1,173,877	1,130,085	883,829	783,892	777,108
CASH FLOW					
Op Cash Flow before WC and tax	208,490	47,198	(55,166)	61,196	154,655
Working capital	7,866	(28,254)	(22,538)	23,578	(102,053)
Exceptional & other	(35,011)	148,452	213,845	290	3,290
Tax	(48,296)	(87,439)	(47,828)	8,627	(24,331)
Net operating cash flow	133,049	79,957	88,313	93,691	31,561
Capex	(31,322)	(31,000)	(19,948)	(21,474)	(21,474)
Acquisitions/disposals	(50,555)	(47,860)	(26,585)	(73,210)	(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)	(18,110)	(24,932)
Other	10,768	(35,674)	141,820	(29,950)	(32,000)
Net Cash Flow	29,873	(84,616)	144,022	(79,053)	(64,845)
Opening net debt/(cash)	154,752	122,190	209,870	54,115	133,168
FX	(18,281)	1,490	(12,071)	0	0
Other non-cash movements	20,970	(4,554)	23,804	0	0
Closing net debt/(cash)	122,190	209,870	54,115	133,168	198,013

Source: Company accounts, Edison Investment Research

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