EDISON

# Dentsu Group

Q3 results

## Solid Q3 and new One dentsu group structure

Media

**Dentsu's Q322 results show an organic net revenue decline of 3.7% (-4.7% including Russia), reflecting a particularly tough comparative with Q321 in Japan. This masks continuing good progress in building revenues from Customer Transformation & Technology (CT&T), which grew over 20% and now constitutes 32.6% of group revenues. Alongside the figures, Dentsu announced a further restructuring from 1 January 2023 that removes the distinction between Dentsu Japan Network (DJN) and Dentsu International (DI). The reconfigured global management team will reflect the group's increasing diversity and includes the first non-Japanese CFO.**

| Year end | Net revenue (¥bn) | PBT* (¥bn) | EPS* (¥) | DPS (¥) | P/E (x) | Yield (%) |
|---|---|---|---|---|---|---|
| 12/20 | 835.0 | 123.5 | 250 | 71 | 17.7 | 1.6 |
| 12/21 | 976.6 | 146.0 | 392 | 118 | 11.3 | 2.7 |
| 12/22e | 1,098.3 | 172.6 | 440 | 140 | 10.0 | 3.2 |
| 12/23e | 1,115.0 | 183.7 | 460 | 153 | 9.6 | 3.5 |

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

## FY22 guidance unchanged; possible modest upside

Full year guidance remains for 4–5% organic revenue growth, with further benefit from currency and from prior acquisitions to build to the overall forecast progress of 12.5%. Management, as with peers, is not (yet) noticing any marked reticence on behalf of advertisers and appetite for CT&T remains particularly positive, with progress here notably strong in EMEA, which was ahead by over 20% in the first nine months of FY22 (9M22). If currencies stay at the current level, management suggests that there would be a further 10% boost to FY22 EPS at the full year. The operating margin for 9M22 was 16.4%, which is consistent with full-year guidance of 18.0% (17.7% including Russia). We expect the transition to 'One dentsu' will be a temporary drag on FY23e operating margin and have modelled 17.3%, recovering to 18.0% in FY24e.

## CT&T to remain the driver in One dentsu

The ambition to build CT&T to half of group revenues in the medium term remains intact, with continued investment to optimise and scale the offering. Within Dentsu International, the proportion is 36%, with the Americas higher still. DJN is making good progress, with CT&T now making up 27.9% of segmental revenue (up 4.6%). The combination of consultancy with media and execution is seen as a key differentiator to the global consultants offering related services.

## Valuation: Differential to peers overstated

Dentsu's shares are up 12% year-to-date, making them the best performing share of the major global marketing service holding companies, although this out-performance has tempered over the last quarter as other share prices recovered. The valuation discount has therefore increased since our last report in August, with the shares currently trading at a discount to peers of 34% on EV/EBITDA and 12% on P/E across FY22–24e. Given the improving quality of business with more emphasis on digital transformation, we still believe this differential is overstated.

**16 November 2022**

| | |
|---|---|
| **Price** | **¥4,415** |
| **Market cap** | **¥1,167bn** |
| | ¥139.00/US$ |
| Net debt (¥bn) at end September 2022 | 148.3 |
| Shares in issue | 264.42m |
| Free float | 77.8% |
| Code | DENN |
| Primary exchange | TSE |
| Secondary exchange | N/A |

### Share price performance


| % | 1m | 3m | 12m |
|---|---|---|---|
| Abs | 5.0 | (3.1) | 9.8 |
| Rel (local) | 1.9 | (2.3) | 14.5 |
| 52-week high/low | ¥5,020.0 | | ¥3,550.0 |

### Business description

Dentsu Group is a holding company, operating in over 145 countries. Dentsu Group provides a wide range of client-centric integrated communications, media and digital services.

### Next events

| | |
|---|---|
| Preliminary FY23 results | February 2023 |

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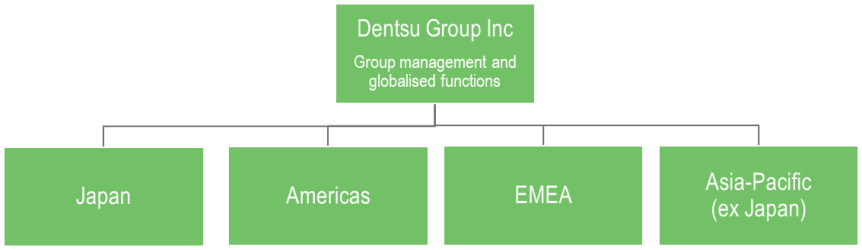
## New segmentation from 1 January 2023

For now, the reporting remains split into DJN and DI, which accounted for 40% and 60%, respectively, of group revenues over the nine months to end September. As outlined in the presentation, the intention is to operate and report with four regions, overseen, co-ordinated and supported through group functions at the centre. The key benefits outlined include:

- greater efficiency and faster decision-making,
- broader and deeper relationships with global clients,
- easier exchange of best practice, and
- the ability to offer all group capabilities across all geographies.

Under the new structure, the head office team will be headed up by the current president and CEO, Hiroshi Igarashi, with Nick Priday, currently CFO for DI, taking up the CFO role at group level – the first non-Japanese national to do so.

**Exhibit 1: Intended group structure**




Source: Dentsu Group

## 9M22 financials broadly as expected

DJN posted an organic revenue decline of 0.1%, which is, of itself, a considerable achievement given the scale of the uplift in Q321 from the Tokyo Olympics, when net revenues were up 49.7%. CT&T comprised 27.9% of the total 9M22 net revenues, up from 23.3% in the prior period and a further small advance from H122, when it accounted for 27.5%.

Underlying operating margin was softer, at 24.2% (9M21: 26.9%), again reflecting the unusual trading in the comparative period.

At DI, the performance in the Americas was perhaps a little disappointing, with quarterly growth of 0.7%, but this may have been affected by timing issues. (Other marketing service holding companies have reported strong Q3 trading in North America.)

In contrast, the performance in Europe, the Middle East and Africa (EMEA) was particularly good, with net revenues up 9.2% in the quarter. This figure is supressed by the results of the Russian business, and stripping this out, net revenue growth was an impressive 15.7%. For 9M22, organic growth was 10.1% (5.6% including Russia). DI has now agreed terms with local management for the latter to buy the Russian business and the transaction now awaits regulatory approval. The estimated total loss on the transaction is approximately ¥37.0bn (assuming the sale is completed within FY22), assuming ¥16.4bn of statutory operating income in the 9M22 numbers. CT&T had a particularly strong performance in the nine-month period, up over 20%, while both Media and Creative practices posted growth in mid-single digits.

Asia-Pacific (APAC) ex-Japan had a more difficult Q3, with net revenue down 1.1%, leaving 9M22 still ahead at +2.7%. Given the repeated lockdowns, this can be broadly attributed to China, as

management reports that Indonesia and Taiwan had high single-digit growth and India posted a notably strong performance, with organic net revenue growth over 10% as it builds scale and offers its clients a broader range of services.

The operating margin in DI was a little softer at 12.4% (13.1% ex Russia), with these figures implying some recovery in Q322 (operating margin at the half year stage was 11.9% (12.5% ex Russia)).

Overall, we have aligned our FY22 forecast to management guidance, which in effect means changes of less than one percent. For FY23 estimates, we have taken a slightly more cautious approach, given the current degree of uncertainty around possibly economic recession around the globe and have also assumed that the restructuring changes will have a modest impact on the achievable operating margin, which we have now set at 17.3% for the year, with recovery to 18.0% built into our modelling for FY24e.

**Exhibit 2: Summary adjustments to forecasts**

| | Net revenue (¥bn) | | | Underlying operating profit (¥bn) | | | EPS (¥) | | |
|---|---|---|---|---|---|---|---|---|---|
| | Old | New | % chg. | Old | New | % chg. | Old | New | % chg. |
| 2022e | 1,100 | 1,098 | 0 | 194.7 | 194.4 | 0 | 442 | 440 | 0 |
| 2023e | 1,136 | 1,115 | -2 | 201.9 | 193.1 | -4 | 473 | 460 | -3 |
| 2024e | 1,157 | 1,130 | -2 | 207.8 | 203.7 | -2 | 490 | 472 | -4 |

Source: Dentsu Group accounts, Edison Investment Research

Management has reiterated its three-year targets of a CAGR of 4–5% organic growth, an 18.0% margin and a 35% pay-out ratio.

## Valuation

There has been greater divergence between the performances of the key peer set over the year. At the time of the half year results in August, Dentsu had outperformed more strongly and the discount to the peer group had narrowed. Over recent weeks, there has been a more marked recovery in the share price performance of the peers, partly due to the US advertising market holding up better than had been previously anticipated. The discount has therefore widened again, to around 34% when measured on EV/EBITDA across FY22–24e and averaging 12% on a P/E basis.

**Exhibit 3: Valuation of major marketing service holding companies**

| | Market cap | YTD share pr perf | EV/sales (x) | EV/EBITDA (x) | | | P/E (x) | | | Dividend yield |
|---|---|---|---|---|---|---|---|---|---|---|
| Company | (US$m) | (%) | CY22 | CY22 | CY23 | CY24 | CY22 | CY23 | CY24 | (%) |
| Publicis | 16,155 | 12 | 1.5 | 6.9 | 6.8 | 6.6 | 10.2 | 10.0 | 9.6 | 4.5 |
| Omnicom | 15,810 | 6 | 1.3 | 8.0 | 8.4 | 8.0 | 11.5 | 11.9 | 11.1 | 3.7 |
| Interpublic | 12,620 | -13 | 1.5 | 9.2 | 9.6 | 9.1 | 11.9 | 12.4 | 11.3 | 3.5 |
| WPP | 11,030 | -23 | 1.2 | 7.2 | 7.1 | 6.7 | 9.1 | 8.6 | 7.9 | 4.4 |
| Hakuhodo | 3,668 | -29 | 0.4 | 6.2 | 6.1 | 5.5 | 17.2 | 16.4 | 14.3 | 2.3 |
| **Peer average** | | **-9** | **1.2** | **7.5** | **7.6** | **7.2** | **12.0** | **11.9** | **10.8** | **3.7** |
| Dentsu | 8,624 | 12 | 0.9 | 4.9 | 4.9 | 4.7 | 10.5 | 10.1 | 9.8 | 3.0 |
| Premium/(discount) | | 22% | -25% | -34% | -35% | -34% | -12% | -15% | -9% | -18% |

Source: Refinitiv, Edison Investment Research. Note: Prices as at 14 November 2022.

## Exhibit 4: Financial summary

| ¥m | 2020 | 2021 | 2022e | 2023e | 2024e |
|---|---|---|---|---|---|
| Year end 31 December | IFRS | IFRS | IFRS | IFRS | IFRS |
| **INCOME STATEMENT** | | | | | |
| Revenue | 939,242 | 1,085,592 | 1,240,000 | 1,264,862 | 1,300,000 |
| Cost of Sales | (104,200) | (109,015) | (141,700) | (149,912) | (170,293) |
| Net revenue | 835,042 | 976,577 | 1,098,300 | 1,114,950 | 1,129,707 |
| EBITDA | 91,013 | 226,326 | 221,152 | 219,840 | 230,443 |
| Operating profit (before amort. and excepts.) | 123,979 | 179,028 | 194,400 | 193,088 | 203,691 |
| Amortisation of acquired intangibles | (31,877) | (29,409) | (31,379) | (23,754) | (28,481) |
| Exceptionals | (229,631) | 93,579 | 0 | 0 | 0 |
| Share-based payments | (3,094) | 0 | 0 | 0 | 0 |
| Reported operating profit | (140,625) | 241,841 | 163,021 | 169,334 | 175,209 |
| Net Interest | (1,419) | (35,491) | (32,139) | (30,924) | (30,573) |
| Joint ventures & associates (post tax) | 910 | 2,483 | 10,200 | 10,404 | 10,612 |
| Exceptionals | 1 | 0 | 0 | 0 | 0 |
| Profit Before Tax (norm) | 123,471 | 146,020 | 172,461 | 172,569 | 183,730 |
| Profit Before Tax (reported) | (141,133) | 208,834 | 141,082 | 148,815 | 155,249 |
| Reported tax | (11,162) | (93,979) | (23,082) | (41,668) | (43,470) |
| Profit After Tax (norm) | 78,178 | 116,257 | 127,276 | 124,249 | 132,286 |
| Profit After Tax (reported)` | (152,295) | 114,855 | 118,000 | 107,146 | 111,779 |
| Minority interests | (7,299) | (6,463) | (23,500) | (6,834) | (7,276) |
| Discontinued operations | 0 | 0 | 0 | 0 | 0 |
| Net income (normalised) | 69,892 | 109,206 | 118,000 | 117,416 | 125,010 |
| Net income (reported) | (159,594) | 108,392 | 94,500 | 100,313 | 104,503 |
| Average Number of Shares Outstanding (m) | 279 | 279 | 268 | 255 | 265 |
| EPS - normalised (¥) | 250 | 392 | 440 | 460 | 472 |
| EPS - normalised fully diluted (¥) | 249 | 389 | 437 | 457 | 469 |
| EPS - basic reported (¥) | (571) | 389 | 352 | 393 | 394 |
| Dividend (¥) | 71 | 118 | 140 | 153 | 164 |
| Net revenue growth (%) | (10.4) | 16.9 | 12.5 | 1.5 | 1.3 |
| EBITDA Margin to net revenue (%) | 10.9 | 23.2 | 20.1 | 19.7 | 20.4 |
| Normalised operating margin to net revenue (%) | 14.8 | 18.3 | 17.7 | 17.3 | 18.0 |
| **BALANCE SHEET** | | | | | |
| Fixed Assets | 1,475,963 | 1,377,417 | 1,497,629 | 1,496,877 | 1,491,887 |
| Intangible Assets | 820,923 | 858,748 | 999,417 | 998,142 | 992,629 |
| Tangible Assets | 280,196 | 173,681 | 164,136 | 164,659 | 165,182 |
| Investments & other | 374,844 | 344,988 | 334,076 | 334,076 | 334,076 |
| Current Assets | 1,924,815 | 2,343,114 | 2,414,585 | 2,522,336 | 2,659,217 |
| Stocks | 23,848 | 20,661 | 26,856 | 38,951 | 44,246 |
| Debtors | 1,293,370 | 1,500,020 | 1,584,013 | 1,615,772 | 1,660,658 |
| Cash & cash equivalents | 530,691 | 723,540 | 704,827 | 768,723 | 855,422 |
| Other | 76,906 | 98,893 | 98,890 | 98,890 | 98,890 |
| Current Liabilities | (1,759,071) | (1,971,873) | (2,149,876) | (2,182,230) | (2,227,958) |
| Creditors | (1,247,172) | (1,465,110) | (1,613,699) | (1,646,053) | (1,691,781) |
| Tax and social security | (71,228) | (60,960) | (60,960) | (60,960) | (60,960) |
| Short term borrowings | (72,533) | (93,067) | (93,067) | (93,067) | (93,067) |
| Other | (368,138) | (352,736) | (382,150) | (382,150) | (382,150) |
| Long Term Liabilities | (800,987) | (839,188) | (755,542) | (749,925) | (744,308) |
| Long term borrowings | (512,274) | (486,122) | (480,505) | (474,888) | (469,271) |
| Other long term liabilities | (288,713) | (353,066) | (275,037) | (275,037) | (275,037) |
| Net Assets | 840,720 | 909,470 | 1,006,797 | 1,087,058 | 1,178,838 |
| Minority interests | (63,483) | (64,440) | (87,940) | (94,774) | (102,049) |
| Shareholders' equity | 777,237 | 845,030 | 918,857 | 992,284 | 1,076,789 |
| **CASH FLOW** | | | | | |
| Operating Cash Flow | (55,165) | 283,710 | 199,213 | 199,321 | 210,482 |
| Working capital | (22,538) | 69,156 | 58,401 | (11,500) | (4,454) |
| Exceptional & other | 213,844 | (98,760) | 2,730 | 1,515 | 1,568 |
| Tax | (47,829) | (114,388) | (55,221) | (72,592) | (74,042) |
| Net operating cash flow | 88,312 | 139,718 | 205,124 | 116,744 | 133,553 |
| Capex | (19,948) | 318,135 | (932) | (11,000) | (11,000) |
| Acquisitions/disposals | (26,585) | (49,671) | (121,725) | 1,275 | 5,513 |
| Net interest | 0 | 0 | 0 | 0 | 0 |
| Equity financing | (10,004) | (30,010) | (40,000) | 0 | 0 |
| Dividends | (29,574) | (23,472) | (33,375) | (37,505) | (35,322) |
| Other | 141,820 | (147,241) | (10,043) | 0 | 0 |
| Net Cash Flow | 144,021 | 207,459 | (951) | 69,513 | 92,744 |
| Opening net debt/(cash) | 209,870 | 54,116 | (144,353) | (131,257) | (200,770) |
| FX | (12,071) | 23,095 | (12,145) | 0 | 0 |
| Other non-cash movements | 23,804 | (32,085) | 0 | 0 | (429) |
| Closing net debt/(cash) | 54,116 | (144,353) | (131,257) | (200,770) | (293,086) |

Source: company accounts, Edison Investment Research

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