EDISON

Dentsu Group

Q222 results

Edging forecasts to higher end of range

Media

Dentsu has had a strong Q222, reporting organic revenue growth of 8.2% (7.9% including Russia). Customer Transformation & Technology (CT&T) is the main engine of growth and represents 32.3% of group net revenue, up from 31.5% in Q122. We would expect this segment to be more resilient should a deteriorating H222 macro environment stall advertising momentum. Management is now guiding to the top end of the previously cited 4–5% revenue growth range and we have edged our forecasts ahead, with earnings also set to benefit from a lower tax charge than expected. The shares have outperformed the peer set in the year-to-date, narrowing the discount at which they trade to 12% on current year EV/EBITDA.

Year end	Net revenue (¥bn)	PBT* (¥bn)	EPS* (¥)	DPS (¥)	P/E (x)	Yield (%)
12/20	835.0	123.5	249	71	18.9	1.5
12/21	976.6	146.0	389	118	12.1	2.5
12/22e	1,100.0	172.8	440	141	10.7	3.0
12/23e	1,135.5	181.4	470	158	10.0	3.4

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

Good underlying progress boosted by currency

Overall group H122 net revenue was up 17.8%, boosted from 11.5% by favourable shifts in currencies. This was made up of +14.6% at Dentsu Japan Network (DJN), of which 9.0% was organic, and a gain of 20.2% (+9.5% at constant currency) at Dentsu International (DI), where organic growth was 7.6%, or 8.2% excluding Russia. The focus on organisational simplification and the increasing use of off- and near-shoring underpins the operating margin, where guidance remains for 17.7% for the year (FY21: 18.3%) despite the dilutive impact of Russia, which is now set to be sold to local partners. A lower tax charge at DI is further benefits EPS, leading to a 6% increase in our expected FY22 dividend given a pay-out ratio of 32%.

M&A focus firmly on CT&T

Dentsu continues to make acquisitions to bolster and broaden its CT&T proposition. While individually modest, they contributed ¥14.4m of net revenue in H122. Ignition Point, a DJN subsidiary from May, grew 30% in Q222, winning new clients and with a strong pipeline. Two CT&T acquisitions for DI are announced with these results, strengthening Dentsu's position as Salesforce's largest agency partner. The M&A pipeline remains strong and the group had net cash of ¥47.1m at end June. Management's medium-term target is leverage of 1.0–1.5x underlying EBITDA.

Valuation: Discount persists

While the other large marketing service companies have underperformed the market year-to-date, retrenching by 18% on average, Dentsu's share price has increased by 13% over the same period. Nevertheless, across FY21–23e, the shares still sit at a valuation discount to the peer set of 12% on EV/EBITDA and 4% on P/E. Given the improving quality of business with more emphasis on digital transformation, we still believe this differential remains overstated.

15 August 2022

Price	**¥4,700**
Market cap	**¥1,277,930m**
	US$1:¥133.32
Net cash (¥bn) at end June 2022	47.1
Shares in issue	271.9m
Free float	77.8%
Code	DENN
Primary exchange	TSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	15.6	5.8	13.1
Rel (local)	10.4	(1.9)	11.9
52-week high/low		¥5,020	¥3,550

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

Q322 results	November 2022

Analysts

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

Max Hayes +44 (0)20 3077 5700

media@edisongroup.com

Edison profile page

Dentsu Group is a research client of Edison Investment Research Limited

Summary performance and estimate revisions

Having edged our numbers up with the full year report in February, and again in May, we now do so again, buoyed by the good performance in Q222. The revisions, though, are modest and assume that like-for-like net revenue growth across H222 will be lower, reflecting the tougher comparatives for DJN against the period including the Tokyo Olympics.

An interim dividend of ¥70.25 has been declared, up 8% on prior year, with guidance for the year at ¥130 -140.5. Our estimate is at the top end of this range, up from our previous forecast of ¥133.

Exhibit 1: Summary revisions to numbers

	Net revenue (¥bn)			Underlying operating profit (¥bn)			EPS (¥)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2022e	1,080.0	1,100.0	+2	191.2	194.7	+2	414	442	+7
2023e	1,123.0	1,135.5	+1	198.6	201.9	+2	445	473	+6

Source: Edison Investment Research

DJN (42% of group net revenue)

Organic growth was 9.0% in H122 (7.9% in Q222). The largest constituent, DENTSU Inc., posted 4.2% organic improvement in net revenue, reflecting a good Japanese advertising market. CT&T advanced to 27.5% of segmental revenues, which will be boosted in H222 by the inclusion of revenues from Ignition Point.

DJN's digital advertising market presence has been scaled up with the addition of Septeni, bought in Q122 and which reported H122 organic growth of 11.9%.

The continuing programme of rationalisation and simplification, as well as the shift in mix, helped to deliver an improvement in operating margin up 3.6% to 26.5% for the half year.

DI (58% of group revenue)

Organic growth of 7.0% in Q222 resulted in H122 progress of 7.6%, which would have been 8.48 not including Russia. The strongest performance was in the Americas, where H122 organic growth was 11.4%, with both the Media offering and CT&T reporting in double digits.

Media grew by 5.8% in the half-year, benefiting from its exposure to larger clients with substantial budgets. Management reports that it has a robust pipeline, which is 75% offensive (ie not re-pitching for existing clients). Creative, which is around 17% of the segmental revenues, is still struggling to find its way back to growth. This should be more likely now it has been reshaped into a unified offering under new leadership.

The CXM offering continues to be the main growth driver, with organic growth of 13.6% and in double digits across all three regional elements: Americas; Europe, Middle East and Africa (EMEA); and Asia-Pacific (ex Japan).

The operating margin was down 0.3% at 11.9% against H121, again diluted by Russia, without which it would have increased by 0.3% to 12.5%.

M&A, buybacks set to continue

With a maintained target of a mid-term range for net debt/EBITDA of 1.0–1.5x, there is plenty of scope for continued M&A activity to drive the CT&T contribution up towards the 50% level 'over time', despite a progressive dividend policy (35% pay-out by FY24) and share buybacks. By the

end of July, Dentsu Group had bought back just below 8.0m shares, spending ¥35.4bn of the ¥40bn indicated for the programme.

The M&A market is clearly competitive, and management is not afraid to walk away from deals where the economics do not stack up. Within Japan, DJN has a clear advantage, being an incumbent of scale and with over 6k clients as potential referral partners. With this announcement, Dentsu has also announced two further acquisitions in CT&T for DI (a UK and Ireland Salesforce consultancy), Pexlify, and a global consultancy delivering solutions in mobile, cloud and experience, Extentia (prices undisclosed). Management reports that the M&A pipeline remains strong.

Net cash at end Q222 was ¥47.1bn (end Q122 ¥36.7bn), down from ¥144.4bn at the FY21 year-end.

Valuation: Discount to peers despite outperformance

Exhibit 2: Valuation of global major marketing service companies

	Market cap	Share price change ytd	EV/sales (x)	EV/EBITDA (x)			P/E (x)			Dividend yield
Company	**(US$m)**	**(%)**	**CY21**	**CY21**	**CY22**	**CY23**	**CY21**	**CY22**	**CY23**	**(%)**
Omnicom	14.420	-2	1.3	6.8	7.5	7.5	11.5	10.7	10.5	3.8
WPP	10,670	-28	1.3	8.5	7.1	6.9	21.3	8.6	8.0	2.8
Interpublic	11,360	-21	1.4	8.4	6.9	6.9	15.7	10.7	10.8	2.9
Publicis	13,244	-10	1.4	7.0	5.9	5.8	13.9	8.6	8.4	0.6
Hakuhodo	3,931	-30	0.6	5.8	6.2	5.9	10.5	16.7	15.5	2.1
Peer average		**-18**	**1.2**	**7.3**	**6.7**	**6.6**	**14.6**	**11.1**	**10.6**	**2.4**
Dentsu	9,783	13	1.1	6.4	5.9	5.7	12.1	10.7	10.0	2.5
Premium/(discount)		***31%***	***-3%***	***-12%***	***-12%***	***-13%***	***-17%***	***-4%***	***-6%***	***4%***

Source: Refinitiv, Edison Investment Research. Note: Prices as at 11 August 2022, based on $1:¥133.3.

The better share price performance compared to peers has narrowed the valuation gap further from 24% to 12% on EV/EBITDA since our May report. On a P/E basis, the valuation is close to the peer set.

Exhibit 3: Financial summary

¥'m	2020	2021	2022e	2023e	2024e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT					
Revenue	939,243	1,085,592	1,250,000	1,300,000	1,325,000
Cost of Sales	(104,201)	(109,015)	(150,000)	(164,501)	(167,676)
Net revenue	835,042	976,577	1,100,000	1,135,499	1,157,324
EBITDA	90,063	195,006	210,726	217,909	223,750
Operating profit (before amort. and excepts.)	123,979	179,028	194,748	201,931	207,772
Amortisation of acquired intangibles	(31,877)	(29,409)	(31,379)	(31,379)	(31,379)
Exceptionals	(229,631)	94,368	0	0	0
Share-based payments	(3,094)	0	0	0	0
Reported operating profit	(140,625)	241,841	163,369	170,551	176,393
Net Interest	(1,419)	(35,491)	(32,139)	(30,924)	(30,573)
Joint ventures & associates (post tax)	910	2,484	10,200	10,404	10,612
Exceptionals	0	0	0	0	0
Profit Before Tax (norm)	123,470	146,021	172,809	181,411	187,812
Profit Before Tax (reported)	(141,134)	208,834	141,430	150,031	156,432
Reported tax	(11,162)	(93,979)	(37,055)	(42,009)	(43,801)
Profit After Tax (norm)	78,177	116,256	127,533	130,616	135,224
Profit After Tax (reported)	(152,296)	114,855	104,375	108,023	112,631
Minority interests	(7,299)	(6,463)	(7,014)	(7,184)	(7,437)
Discontinued operations	0	0	0	0	0
Net income (normalised)	69,891	109,205	118,776	123,432	127,787
Net income (reported)	(159,595)	108,392	97,361	100,839	105,194
Average Number of Shares Outstanding (m)	279	279	268	261	261
EPS - normalised (sen)	250	392	442	473	490
EPS - normalised fully diluted (sen)	249	389	440	470	487
EPS - basic reported (¥)	(571)	389	363	386	403
Dividend (¥)	71	118	141	158	170
Net revenue growth (%)	(10.4)	16.9	12.6	3.2	1.9
EBITDA Margin to revenue less pass-through costs (%)	10.8	20.0	19.2	19.2	19.3
Normalised operating margin to revenue less pass-through costs (%)	14.8	18.3	17.7	17.8	18.0
BALANCE SHEET					
Fixed Assets	1,439,542	1,305,203	1,438,225	1,448,247	1,454,031
Intangible Assets	784,502	858,748	994,254	1,006,760	1,015,028
Tangible Assets	280,196	88,682	86,198	83,714	81,230
Investments & other	374,844	357,773	357,773	357,773	357,773
Current Assets	1,924,816	2,214,088	2,433,328	2,553,772	2,654,154
Stocks	23,848	26,880	36,986	42,741	43,566
Debtors	1,293,370	1,386,767	1,596,787	1,660,658	1,692,594
Cash & cash equivalents	530,692	723,541	722,656	773,473	841,095
Other	76,906	76,899	76,899	76,899	76,899
Current Liabilities	(1,759,071)	(1,883,417)	(2,097,372)	(2,162,441)	(2,194,975)
Creditors	(1,247,172)	(1,412,757)	(1,626,712)	(1,691,781)	(1,724,315)
Tax and social security	(71,228)	(71,228)	(71,228)	(71,228)	(71,228)
Short term borrowings	(72,533)	(72,533)	(72,533)	(72,533)	(72,533)
Other	(368,138)	(326,899)	(326,899)	(326,899)	(326,899)
Long Term Liabilities	(800,985)	(726,400)	(720,783)	(715,166)	(709,549)
Long term borrowings	(512,274)	(506,657)	(501,040)	(495,423)	(489,806)
Other long term liabilities	(288,711)	(219,743)	(219,743)	(219,743)	(219,743)
Net Assets	804,302	909,474	1,053,397	1,124,412	1,203,661
Minority interests	(63,483)	(64,440)	(71,454)	(78,638)	(86,076)
Shareholders' equity	740,819	845,034	981,943	1,045,774	1,117,586
CASH FLOW					
Operating Cash Flow	(55,166)	254,221	188,787	197,389	203,790
Working capital	(22,538)	69,155	(6,170)	(4,558)	(226)
Exceptional & other	213,845	(59,307)	2,730	1,515	1,568
Tax	(47,828)	(149,880)	(69,194)	(72,933)	(74,374)
Net operating cash flow	88,313	114,189	116,154	121,413	130,757
Capex	(19,948)	305,200	(932)	(11,000)	(11,000)
Acquisitions/disposals	(26,585)	(49,672)	(13,725)	(15,000)	(10,762)
Net interest	0	0	0	0	0
Equity financing	(10,004)	(30,010)	(40,000)	0	0
Dividends	(29,574)	(23,473)	(34,577)	(38,978)	(35,322)
Other	141,820	(108,773)	(10,043)	0	0
Net Cash Flow	144,022	207,461	16,877	56,435	73,673
Opening net debt/(cash)	209,870	54,115	(144,351)	(149,083)	(205,517)
FX	(12,071)	(8,995)	(12,145)	0	0
Other non-cash movements	23,804	0	0	0	(435)
Closing net debt/(cash)	54,115	(144,351)	(149,083)	(205,517)	(278,756)

Source: Company accounts, Edison Investment Research

EDISON

General disclaimer and copyright

This report has been commissioned by Dentsu Group and prepared and issued by Edison, in consideration of a fee payable by Dentsu Group. Edison Investment Research standard fees are £60,000 pa for the production and broad dissemination of a detailed note (Outlook) following by regular (typically quarterly) update notes. Fees are paid upfront in cash without recourse. Edison may seek additional fees for the provision of roadshows and related IR services for the client but does not get remunerated for any investment banking services. We never take payment in stock, options or warrants for any of our services.

Accuracy of content: All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report and have not sought for this information to be independently verified. Opinions contained in this report represent those of the research department of Edison at the time of publication. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations.

Exclusion of Liability: To the fullest extent allowed by law, Edison shall not be liable for any direct, indirect or consequential losses, loss of profits, damages, costs or expenses incurred or suffered by you arising out or in connection with the access to, use of or reliance on any information contained on this note.

No personalised advice: The information that we provide should not be construed in any manner whatsoever as, personalised advice. Also, the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The securities described in the report may not be eligible for sale in all jurisdictions or to certain categories of investors.

Investment in securities mentioned: Edison has a restrictive policy relating to personal dealing and conflicts of interest. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report, subject to Edison's policies on personal dealing and conflicts of interest.

Australia

Edison Investment Research Pty Ltd (Edison AU) is the Australian subsidiary of Edison. Edison AU is a Corporate Authorised Representative (1252501) of Crown Wealth Group Pty Ltd who holds an Australian Financial Services Licence (Number: 494274). This research is issued in Australia by Edison AU and any access to it, is intended only for "wholesale clients" within the meaning of the Corporations Act 2001 of Australia. Any advice given by Edison AU is general advice only and does not take into account your personal circumstances, needs or objectives. You should, before acting on this advice, consider the appropriateness of the advice, having regard to your objectives, financial situation and needs. If our advice relates to the acquisition, or possible acquisition, of a particular financial product you should read any relevant Product Disclosure Statement or like instrument.

New Zealand

The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are "wholesale clients" for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a "personalised service" and, to the extent that it contains any financial advice, is intended only as a "class service" provided by Edison within the meaning of the FAA (i.e. without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision.

United Kingdom

This document is prepared and provided by Edison for information purposes only and should not be construed as an offer or solicitation for investment in any securities mentioned or in the topic of this document. A marketing communication under FCA Rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This Communication is being distributed in the United Kingdom and is directed only at (i) persons having professional experience in matters relating to investments, i.e. investment professionals within the meaning of Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the "FPO") (ii) high net-worth companies, unincorporated associations or other bodies within the meaning of Article 49 of the FPO and (iii) persons to whom it is otherwise lawful to distribute it. The investment or investment activity to which this document relates is available only to such persons. It is not intended that this document be distributed or passed on, directly or indirectly, to any other class of persons and in any event and under no circumstances should persons of any other description rely on or act upon the contents of this document.

This Communication is being supplied to you solely for your information and may not be reproduced by, further distributed to or published in whole or in part by, any other person.

United States

Edison relies upon the "publishers' exclusion" from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940 and corresponding state securities laws. This report is a bona fide publication of general and regular circulation offering impersonal investment-related advice, not tailored to a specific investment portfolio or the needs of current and/or prospective subscribers. As such, Edison does not offer or provide personal advice and the research provided is for informational purposes only. No mention of a particular security in this report constitutes a recommendation to buy, sell or hold that or any security, or that any particular security, portfolio of securities, transaction or investment strategy is suitable for any specific person.

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
1185 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