WPP 2020 Interim Results

Afternoon Teleconference Transcript

Thursday, 27th August 2020

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Overview

Mark Read

Chief Executive Officer, WPP

Thank you very much, and good morning, everyone, and welcome to our US interim results call. As in previous calls, we're assuming that you've had a chance to watch the presentation online. So I'm going to focus this call really on your questions. I'm here in London in our office, with John Rogers and Peregrine Riviere. So I think hopefully, you've all had a chance, and you will see online, to read our safe harbor statement at the beginning of the presentation.

And I'll just make a few introductory remarks before I turn over to questions. I think if we had to describe our first half, I think we'd say that we had a resilient performance in a challenging environment. Our second quarter, was sort of slightly better, maybe a bit more than slightly better than we had expected. And certainly significantly better than some of the worst-case scenarios that we had looked at back in March.

So we ended the first half with like-for-like revenue less pass-through costs down 9.5% or -15.1% in the second quarter. And you can really see the impact and spread of COVID-19 and the lockdowns on our business as we go through the months of January and February, down 0.6%. We actually grew outside of China by 0.4%, down 7.9% in March, in some ways, half a month of impact and then the full impact in the second quarter of -15.1%.

And within the quarter, May was the -- we're not going to give the revenues by month, but May was the toughest month followed by June. And we saw a slight improvement in July to minus 9.2%.

And the other pattern that we can see in our revenues is the impact of the sectors that we're working. If we take our top 200 clients, representing around 64% of our business, just over half of them come from consumer package goods, technology pharmaceuticals, they were down only 0.7% in the first half versus -9.5% for the Group overall, whereas automotive, luxury and travel, which are much more impacted by the pandemic, were down 11.7%.

So I think you see a natural impact on our business of the lockdown and the decline in economic activity. And I think you can see in those sectors that were more resilient continued -- level of continued work that we do for those clients. And I think that bodes well for the recovery that will no doubt follow. We are confident in the recovery, but cautious in the pace of which that will take us over the balance of this year.

I think the second point is that we've worked in a very different way with our clients over the last six months, both in terms of increased focus on the types of services they want from technology to e-commerce, our public relations businesses performed significantly better than the rest of the Group, down only 4.5%. And actually, their profitability was higher in the second quarter of this year than the second quarter of last year on a margin basis.

We've had very, very strong new business track record, won roughly $4 billion in new business billings. It's a market-leading performance, including winning from Intel, HSBC, Unilever's media business in China and a number of other major companies.

Our people, I think, have performed fantastically in a very challenging environment. We had a lot of

commentary from the numbers we gave the people that are working from home today. Around 3% of our staff are working in the office in the UK, around 1% of our people in the United States and 0% in India. So while we're largely back to sort of business as normal in China, I think our people have demonstrated an ability to go above and beyond, both working collaboratively with their clients and looking after each other.

From a financial perspective, we made really solid progress on cost savings. We're ahead of the targets. Well, on a full year basis, we expect to be at the upper end of the target that we set. We had very strong liquidity at GBP4.7 billion at year-end. And our net debt is down significantly year-on-year and from its peak of GBP5.7 billion in September 2017.

We're able to reinstate the interim dividend, which I think reflects the degree of confidence we have in the business moving forward. And we did take a goodwill impairment of about GBP2.5 billion largely related to Y&R Group, a company we acquired in a stock transaction in 2000.

I think the final point to make is that over the last six months, we've seen an acceleration of the changes in our industry and in society more broadly brought on by COVID. I don't think we see those changes as new things. In the main, they're really an acceleration of trends that were already happening in our business.

And just as WPP set out a new strategy in 2018, we continue to believe that, that is the right strategy, but the change has called for us to accelerate. And indeed, we have started to accelerate. We haven't stood still. Over the last six months, we've continued to invest in the business, in people, in creativity, in technology and in continuing to simplify our offer. So we had a productive six months in a challenging environment, and we look forward to the future with confidence.

I think that's what I'd like to say by way of opening remarks. I think we'll give you a chance now to ask us questions. So operator, we'd like to take the first question.

Q&A

Q - Tim Nollen (Macquarie)

Thanks a lot. Hi, Mark. Hi, John. I've been through your slides and the transcript from the 4 a.m. our time in New York call this morning.

A - Mark Read

Yeah. I'm sorry about that.

Q - Tim Nollen

No, no, that's how it is, and I'm glad there are transcripts I can read. So I'll focus on some other things beyond those questions that you took there. One is the Y&R impairment, which after 20 years, is kind of surprising, you're taking such a big hit on it now. Just curious why now? And then you also mentioned VMLY&R was your best performer. I know it was not up, but just kind of to reconcile the big impairment charge there with the performance of VMLY&R now. And then -- yes, so maybe go ahead with that first then I'll follow-up the next.

A - Mark Read

Yeah. Look, I think -- I mean John should explain the impairment charge. I'd just remind you that Y&R Group, when we acquired it, consisted of Y&R Advertising, Wunderman, Burson-Marsteller, Cohn & Wolfe, Sudler & Hennessey and Landor. So a number of the businesses that were impacted. And the impairment is not really to do with the current -- it's not connected solely to the current performance of VMLY&R, is more primarily related to the Y&R Group. John?

A - John Rogers

Yeah. I mean the first observation I would make is that the Y&R Group was acquired back in 2000 in a stock-for-stock transaction, I think Mark highlighted, and it was done so at the peak of the market, the WPP stock was high end though with the stock of Y&R, it's a stock-stock transaction. But obviously, it then comes on to our books, so what could be said is a relatively high valuation.

And then your question said, well, why now? Why is it obviously own that for 20 years? And the reality is that we wouldn't normally do, of course, impairment test at the half. It's normally done at the year-end. But because of COVID-19 and the clear impact that, that's had on the market, not just for our sector, but for all industrial sectors, frankly, that triggers the impairment test at the half.

And the movement in the goodwill impairment, the GBP2.5 billion, it's really comprised of three components. One of which is a change in the discount rate, which frankly accounts for the vast majority of that GBP2.5 billion, say, GBP2 billion to GBP2.1 billion of that GBP2.5 billion is accounted for as a consequence of a change in the discount rate. About GBP300 million is down to a lowering in the longer-term terminal growth rate of 3% to 2%. And about GBP100 million is down to the fact that we expect slightly lower profits in 2020. And obviously, sometimes recover from COVID-19. The vast majority of it is down to the technical issue of the discount rate. And the reason discount rate has risen so much is just because all the factors in the capital asset pricing model has increased. So cost of equity has gone up because the beta for the sector has gone up because the market seems more volatile. The risk-free rate has gone up because markets overall have seen it riskier. The cost of our debt has gone up because, again, market is riskier. So actually, most of it is down to the increase in discount factor. That explains away the vast majority of that impairment charge.

And so we very much see it as being a technical non-cash accounting adjustment. And in a way, I don't think it even necessarily reflects on our future cash earning potential because those had relatively nominal impact on that GBP2.5 billion. It's mainly the adjustment to the discount factor that's causing that impairment charge to be made. And as I said, it's treated by the events of COVID-19, which is why we're taking that impairment now. And we obviously haven't taken it previously because there hasn't been the need to.

Q - Tim Nollen

Fine. Fair enough. Could I get one or two more in then?

You've spoken many, many times on previous earnings calls about your programmatic work in Xaxis. It's possible I missed it, but I didn't see a mention of Xaxis. Anything to speak on there, any numbers to provide? And any commentary on the sort of ongoing fear that a lot of people have had about in-housing at advertisers by using programmatic services directly, which seems to counter what companies like The Trade Desk have been talking about, where they very much rely on you and align with the agencies to bring them business. So any commentary on the programmatic business?

A - Mark Read

I'll talk about in-housing and programmatic, and maybe John can give you the numbers for Xaxis. Look, I think more broadly on in-housing, it's going both ways. I think you see clients that are in-housing, you see clients that are moving the other way. I think it's hard to perceive a real trend, but there's no doubt that I think there was a desire for clients to work flexible and more agile ways with their agency partners, and there are areas where we can grow.

I make one observation at a time when no one is working in the office, then they should have happen to have things in house, I'd say is slightly ironic. So I think that we will continue to see more flexible arrangements between agencies and clients until we have many people that work inside our clients.

I think specifically on programmatic media, I don't see a lot of in-housing or programmatic media in large clients. I think there are two or three examples that are trotted out, but I don't think that many large clients are in housing their programmatic media, notwithstanding that there have been some, but I don't think there's enough to call it a trend. I think if anything, clients want an integrated approach to their media across all channels, including programmatic, and I think that mitigates against them just taking programmatic media in-house.

John, do you want to give the Xaxis numbers?

A - John Rogers

Yeah. Just on Xaxis trading for the first half, we saw overall sort of sales level down about 21% or so in the half, which is, as it happens, pretty much exactly in line with the reduction we've seen in our overall trading income and actually broadly in line with the reduction that we've seen in media spend. So my observation would be, we haven't seen any sort of structural change in that business. It's nearly down year-on-year, in line with the overall reductions that we've seen in media spend. So it's much more driven by the broader trend in the market than any structural change in relation to how people use the Xaxis services, for example.

Q - Tim Nollen

Okay. If I could just squeeze one last one in then, please.

You mentioned on the call this morning earlier about e-commerce, and you talked about that. And I think you mentioned, Mark, about 8% of your total sales is coming from e-commerce. I just wonder if that or any of the other activities you're doing that you talked about at your Investor Day back in January about IT integration work and so forth. Is this -- are compensation methods changing? Are you being perhaps with e-commerce more tied to actual product sales? Or is there any other sort of performance compensation that's changing versus how things have always been?

A - Mark Read

I think there are some examples where we have incentive structures linked to sales. I think that we are exploring with a number of clients whether we can move to more directly sales-related compensation trends. And I think we will be very open and interested in doing that, indeed keen to do that. But we tend to work on a fee basis in these parts of our business, particularly in the e-commerce building.

Our e-commerce business is very broad. It encompasses building websites. We recently replatformed all of Yoox Net-à-Porter. We actually built the sainsburys.co.uk site, where John has come from many years ago. A piece of business we actually took over from Accenture at the time. We build websites for traditional retailers and e-commerce websites. We build direct-to-consumer propositions for clients. And we do a lot of work supporting clients in marketplaces like Amazon or Alibaba or Lazada, and then we do all the media

that drives consumers to those sites.

So I think in the main, our work is commission based. Now clearly, as volumes increase, so does the amount of work that we need to do. But we're not yet moving to sort of more direct compensation basis. So I think it is interesting for us to do it in Xaxis, and I think we are exploring ways in which we can do that for clients.

A - John Rogers

Yeah. I mean, it's one of the things I've been in my first six months or so in the business started to explore with the commercial team because we have a strong faith in our ability to add value for our clients. And therefore, we should be, all else being equal, very willing to adopt commercial models that are based on the value that we add, so a contingency based model. I think Mark is obviously absolutely right. It's fair to say today that still the vast majority of our income comes from fixed fee-type models. But going forward, look after -- maybe see an increase in much more value-based billing. And I think that's a positive sign for our business, given that we're comfortable and confident in the value that we can deliver to our clients.

Q - Tim Nollen

Okay. Thanks very much.

Q - Dan Solomon (BMO)

Hi, good afternoon, everyone. Thanks for taking the questions as usual.

Mark, could you talk a little bit about the level of review activity at the moment? It certainly seems to be picking up. Do you think it's more a reversion to the mean after a little bit of a lull? Do you think COVID is driving it or maybe a little bit of both? And then any color you can add to your risk or your opportunity in currently public reviews? That would be great.

And then perhaps for both Mark and John, could you walk us through both the Board and your own views on reinstating the dividend a little bit more initially at this lower level? And what investors should expect the path for that payment over the mid-to-long term?

A - Mark Read

Okay. Well, I'll let John take the dividend question. Let me address the question on reviews. I think if we started the year with, let's say, reviews running at about 100, I'd say by April, May, our pipeline was about 80. I think gradually, it's crept up to sort of 105. So I think it didn't dip by as much as we expected. And it's going to come back to where it was, if not a little bit higher at the beginning of the year.

We now track our pipeline and all opportunities more than $1 million really pretty accurately now centrally. We have good visibility on what we've got. We have got, I'd say, little revenue at risk. We always have in the nature of our business, the good part of our business, the value chain part of business, we always have some revenue at risk. The key piece of business we're defending loans is WBA, which is up for a three-year statutory review, and we're putting everything that we have into that.

I saw reported in the press that Sanofi will be reviewing their media arrangements and we have a part of that business, but not all of it, so that's both an opportunity and a risk to us. And really, those are the only major public reviews or indeed the only major reviews that we're aware of at the moment. But as you know, as part of this business is, these things do happen.

I think that we have really done a very good job in the first half of the year from a new business perspective. We included in the presentation the best independent review w we have of that from R3. And I think if you go back two years to 2018, with all of the turmoil at the time, we were in a very different situation. I think we lost seven or eight pieces of business over the six-month period, which was a challenge for us going into 2019.

So I think that we're very pleased both with the competitiveness of our offer, with our ability to convert business and with the work that we're doing to retain our clients. And indeed, our customer satisfaction scores have increased significantly over the last six months despite all the disruption in our business caused by pandemic, which illustrates the good work that our people are doing.

John, on the dividend?

A - John Rogers

Dan, let me take you through the Board's thinking on the reinstatement of the dividend, so based on a number of factors. First, a stronger-than-expected performance in the first half of the year demonstrates that particularly through Q2.

Number two, better visibility on our future. We're not saying it's perfect visibility, but the visibility of our performance over the next six months is clearer now than it certainly was three or four months ago at the start of the pandemic.

I think the third factor is, obviously, the strength of the balance sheet and the overall liquidity. Liquidity has improved since the start of the outbreak. So GBP4.7 billion today compared to GBP4.4 billion in March. So we've got plenty of liquidity. And therefore, I think the Board felt, obviously, the key is that the dividend is affordable, but also wanted to signal to the market a confidence in our future going forward.

All of that said, I wouldn't draw any conclusions about what the payment of an interim dividend means for any final dividend for the year. Clearly, we stated that our dividend policy is under review, and it's something that we'll come back to at the end of the financial year when we update the market at our Capital Markets Day. So I wouldn't draw any inferences one way or other in terms of our longer-term distribution strategy. But clearly, it reflects a confidence in our ability to manage the business and the cash flows going forward.

Q - Dan Solomon

Thank you very much to both of you. That's helpful.

Q - Doug Arthur (Huber Research)

Yeah. Thank you.

A couple of questions. Is there anything to call out in Greater China in July? I mean, I think you mentioned in the release that you actually had some growth in China, I think, in the second quarter. So I'm just trying to understand the -- is that just sort of a one-off comparison in the month? Or is there anything else going on there?

A - John Rogers

Maybe I'll pick that one up. I mean, I think it is -- when you look at the numbers, you're right to highlight, it does look slightly unusual. So the second quarter, I think we outturned -- we were down about 3%, just

over 3%. And in July, we were down about 18%. So it looks like the business is going backwards, but there's a couple of qualifiers that are important to note here. First and foremost, there were some one-off adjustments in our revenue line in the second quarter, but rather flatter the second quarter outturn at minus 3. And when you strip out those one-off adjustments would be more like minus 15 in China.

And then the second point to note is that the minus 18 in July, first and foremost, it's a month, and it's always dangerous to look at things just on a monthly basis because obviously it can be quite volatile on a monthly basis. But secondly, if you look at how we performed this time last year, we were up against very tough comps.

So that I think we were about plus 9% in July for China last year. So, when you strip out those two effects on an underlying basis, we're probably really shifting from minus 15 to about minus 10 in China. In fact, I would expect while it's difficult to forecast, but expect our performance in the second half in China to deliver somewhere between minus 5, minus 10 in that type of order.

So I feel reasonably okay with our performance across the board. It's just the headline numbers look a little bit off because of those adjustments I've just talked you through.

Q - Doug Arthur

Makes total sense. And obviously, North America is trending a lot better. And I'm wondering, I'm looking at the Slide 24, and Mark, you made reference to this in your remarks about the mix of your business. And it's a really interesting slide in terms of your exposures and what's worse and/or more essentially impacted right now and not. And I'm wondering how much of the improvement in North America is a function of mix as opposed to a function of the changes you've made and the integration you've done in your agencies? Or is this sort of a combination of two?

A - Mark Read

I think on a two-year basis, it's largely a result of the changes that we've made to the leadership in terms of -- in North America, it’s leadership, investments in creative talent, integration of the companies. If I look particularly at the performance of VMLY&R, the performance of Geometry, indeed, the performance of GroupM, now those businesses have no doubt been impacted by pandemic since March. But I think in the first two months of the year, our performance in North America was close to flat, having been down 9% in the first quarter of last year.

So I think that it is much more a factor of improvements to the business than it is anything to do with specific sectoral trends. Indeed, we have a number of clients in the automotive sector in the US just as we have in packaged goods. So I don't think there's any real difference in terms of client mix that's driven the performance.

A - John Rogers

And just to build on that, if you looked at the performance of the some of the global integrated agencies in North America in the second quarter, VMLY&R was actually positive in the second quarter, which I think is an outstanding performance, frankly, in the context of the market backdrop, but also a reflection, as Mark has said, of I think the success in bringing these businesses together and operating -- offering a much more integrated offer to our clients. A very, very positive performance there.

Q - Doug Arthur

Okay. Great. Thank you very much.

Q - Michael (MoffettNathanson)

Thanks. Hey, good morning. I'm sorry. Good afternoon. Following on what Doug said, I think he asked a really good question. And the flipside of that is, if you look at the European markets, which have been pretty resilient for you guys over the years, they're definitely weaker than North America. Then you go to your slides about e-commerce accelerating and media mix changing, and I kind of wonder where you guys sit.

Is Europe -- from someone who observes the markets like you guys do, is Europe behind the US in the shift to e-commerce and the shift to digital? Is that possibly explaining why they've maybe been hit harder? And what do you see maybe changing on the content end to maybe accelerate those trends that could benefit you guys?

A - Mark Read

Yeah. Look, I think from an e-commerce perspective, I hate to say this is only in America, but the UK is ahead of America in terms of e-commerce. In terms of sophistication, it's sort of South Korea, China, the UK, and then I'd say the US, Germany, France are pretty much at the same level.

I think the trends you see in Europe are much more to do with the severity of the lockdowns. And actually, if you look at the worst quarter or the toughest quarter for our countries, it's really pretty closely related to the severity of the lockdown. In India and Spain, close to 30%; the UK, slightly less severe, 23%; Germany, less than the UK; and the US, the US is less than that. So I think that, really, the impact on a quarterly basis pretty closely correlates to the severity of the lockdown.

Now the other correlation of that is the longevity of the lockdown. And we can have a debate about the economics of is it better to have a severe lockdown for a faster recovery or a more extended lockdown, not as severe, but lasts longer.

A - John Rogers

And just to maybe just to sort of reinforce that point with some data. I mean, if you look at the US market, it's predicted in 2020, about 53% of total media spend will be digital. Let's assume that's a surrogate for the penetration of e-commerce. And the equivalent number in the UK is actually 66%. So the UK has significantly higher penetration of digital spend in its media. And yet, as Mark just highlighted, its performance is clearly down a lot more than the US.

And equally, if you look at the German market, the German market is projected to be a 46.7% digital spend. And yet, that was the best-performing market in Europe by far. And so there is no correlation between digital penetration and market performance. The correlations that Mark has just outlined, which is very much more driven by the effectiveness through which these different economies have COVID with lockdown. And so if you look at the European data, it's very clear that Germany was much more effective at dealing with lockdown, for example, than the UK because of its more efficient track-and-trace system. And therefore, its performance over the period has been much less marked than the UK performance. So it's much more down to the way we've dealt with lockdown than any other factor.

Q - Michael Nathanson

Okay. Thanks so much guys. Thank you.

A - Mark Read

Thanks very much, operator, and thanks very much for everyone for listening. I think it's been a challenging few months for us as indeed it has been for everybody. I hope you see in our numbers the resilience of our business model, our commitment to taking action both to address any issues we face but as well as the opportunities in our business and to ensure that the Company is financially resilient. We remain of the view that those companies that are the most financially resilient will come out of the current situation in the strongest position, and that's where we want WPP very much to be.

So thank you, all, for listening, and we hope to see you soon.

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