WPP 2022 Preliminary Results

Afternoon Teleconference Transcript

Thursday, 23 February

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Mark Read

Chief Executive Officer, WPP

Good morning, everyone. Welcome to the WPP 2022 Preliminary Results Presentation.
As you know, we now do this as more of a Q&A session. We should take the presentation as read. It's available online, rather than take up your time with that. We thought we could get straight into questions. Maybe I'll make a few preliminary remarks. I'm here with John Rogers, our CFO. So, John and I will take your questions.

Look. I think we had a good 2022. We grew 6.9% in the year. A respectable or more than respectable Q4, 6.4%, perhaps somewhat better than we'd expected after a somewhat softer Q3, but that was in part driven by comparatives. But I think the momentum we had for the year carried into Q4, and I think you'll see some of that momentum carry into next year through our guidance.

We had a very broad-based performance. Our Integrated Agencies is up 6.9%, with a 3-year growth of 9.5%. Strong performance in GroupM, Ogilvy, AKQA, Hogarth. our PR businesses were up 8.2% like-for-like with a strong performance, particularly from Hill+Knowlton, and our Specialist Agencies is up 5.6%.

So functionally, we grew strongly across all our functions. And regionally as well, North America, up 6.6%, U.K. up 7.6%. I've called out particularly resilient Western Continental Europe at 5.5% and Asia Pacific, rest of the world, up 8% last year. So, a broad-based performance across services and regions, a strong competitive performance from leading at Cannes to a new business number close to $6 billion. We continue to invest in the business. We talked a lot on the call about the impact of AI on our industry mix against the fundamentals. Our transformation savings are ahead of plan, and we're on track to deliver the GBP 70 million of savings by 2025.

Then lastly, our guidance. So, our guidance for like-for-like revenue of passing cost is 3% to 5%, and headline operating margin of around 15%. I think that's based on conversations that we have with clients, what they're telling us, what they intend to spend for the year, really driven by their continued desire to invest in their business and invest in brands. I think in part also driven by the complexity of the environment and the new media opportunities available to them on platforms like Netflix and TikTok and retail media platforms, as well as the transformation in WPP's business and expansion we've made in new areas around data, technology, and ecommerce.

So, in short, I think we had a good year. We're going into this year; I would say confident in our guidance. It is a little bit softer than 2022, but I think that's what one would expect. It's significantly ahead of analyst expectations certainly at the end of last year. So, with that as an introduction, why don't we open it up for questions. And John and I will take those as people have them.

Operator

We will now take our question from Tim Nollen from Macquarie.

Q - Timothy Nollen

I did read the transcript from your meeting this morning in London, and I noticed a lot of very specific detailed numbers questions. So, I'll spare you those this time and ask you instead two much broader, big-picture question.

Firstly, Mark, you did mention AI and Chat GPT in your opening remarks. I wanted to follow up on that and ask. I understand the role of these generative search functions in terms of creating ad copy and so forth. But my question is more, how might the search market change if Bing is to gain share over Google given these changes in search? And how might that affect ad spending in general, given how big search is in terms of total advertising spending?

I wonder if we're at the cusp of the sea change and much more than just who wins the search wars, but how this might change the overall ad market, if that's not too dramatic a statement. Maybe let's go with that and then I'll ask my second question, if that's okay.

A – Mark Read

Yes. Look. I think that it's too early to say. But if we had to hesitate a view, we discussed it a lot internally is -- I think people go to search for a number of reasons, don't they? And some of those -- most of those reasons is to answer direct questions or to find out information or to book a claim ticket or find a holiday destiny-- there's many, many reasons people go to search.

And you sometimes get vertical search engine. So, Amazon have carved off a portion of search around sort of some subsegment of products. Sometimes you might go in search in Twitter to see what's happened in the last 5 minutes that hasn't happened in -- that wouldn’t be on Google in that period of time.

So, I don't think that -- certainly, what I've seen from some of these generative AI engines is going to, by any means, replace like 100% or match 100% of what Google does, nor is it going to necessarily lead to a better answer. I asked it to write my bio and it came out with quite a large number of factual inaccuracies, upgraded my university, et cetera, etcetera.

So that's not to say that it won't have significant changes over time. But I don't think there’s going to be a dramatic shift in a very short period of time in what goes on in search. So as the engines get better and as they understand what's true and not true, and the question is, can they understand what's true and not true, we'll see different impacts.

But I don't think that there's a sort of -- there's so many different segmentations of search and questions you get through that search query box. I think it's hard to say that suddenly in every category, one search engine versus another is going to be particularly more impactful. I think all of the major technology comes investing significantly in AI. So, I think we have to wait to see.

Now from our perspective, it sort of really doesn't matter which one does better or worse. So, I don't think it impacts WPP directly. If anything, more competition is better for us and better for our clients. So that's kind of how -- I think we've talked about it.

Q - Timothy Nollen

Right. Maybe the last point is what I'm getting at, if it is -- if it does open up the search market, more participants, more activity for you. Okay that's interesting.

My second question is about the ad tech market, and we've been reading a lot about the ties that GroupM has been making with the SSPs like PubMatic and Magnite, and Magnite spoke last night on their call about expanding those relationships with GroupM as well as some other media buyers.

So, my question is, do you think we are getting toward a more efficient ad tech market, which should in turn be better for advertising clients? And also, it seems better for WPP and the agencies, given that your role seems to be more deeply tied into all these technology enhancements.

And it's quite counter to the concerns of a few years ago that ad tech was going to disrupt the agencies as concerned a lot of people had. Now it almost seems like the role of agency is even more essential, more embedded into the process. So, any comments you could give around that would be great, too.

A - Mark Read

Yes. Look. I mean I've always been -- and I think we've always been consistently of the view that much of this technology, if we embrace it properly, will help us grow, not dis-intermediate us. So, I would agree there. I think on the ad tech point, look -- it looks like the estimates I've seen of sort of the amount of money lost, the so-called ad tech tax is decreasing, which is what you'd expect as the market gets bigger and more efficient.

And what in one year is a new product becomes much more of a commodity. I expect that to continue. That's good for advertisers. It means that more of the money they invest goes in producing content. So, I think broadly speaking, it's a positive development.

Operator

Our next question comes from Michael Nathanson from MoffettNathanson.

Q - Michael Nathanson

My question is a bit more prosaic, so I apologize. The question we're struggling with is, trying to to figure out normalized cash flow, right? You have all these (inaudible)pieces, which we understand, working capital, which we've been through the (inaudible)on this.

But how do you think about just normalized maybe cash conversion when the business gets to a steady state, right? So, help us understand kind of where this business should generate cash as a percentage of EBITDA, if possible.

Then one of the things we're really struggling with is kind of the impact of foreign exchange, clearly in the U.S., for the U.S. based agencies on margin and whether or not it's a help or a hindrance. But you have a commentary on margin guidance headline, but FX is kind of neutralized. How do you help us with just the wide volatility in FX? And what does it do to your business on a reported basis on margin?

A - Mark Read

Yes. John, why don't you tackle both of those?

A – John Rogers

Just on the ForEx one. Look. The reality is that actually, we're reasonably well, if you like operationally hedged on margin because obviously most of our cost base is also in the same currency as where we bill. So in the main, we are pretty well hedged. So even though there may be swings on the net sales line, vis-a-vis in terms of margin, it generally doesn't have a huge impact.

I mean obviously we're slightly more centered in terms of our cost base in the U.K. because we're sort of the U.K. -- more sort of a U.K. headquartered business. But generally speaking, I mean say for example in 2023 we would, I think at the moment, we say it's margin neutral even though there's a slight tailwind from, sort of, currency on the top line. There may be, at today's rate, there may be a slight 10 bp headwind on margin, but it's really miniscule. I mean it's probably plus or minus 10 bps is sort of the nature unless there's big currency swings, it's really not going to move the margin that much, frankly.

On your first question on normalized cash flows. I mean look. Obviously 2022 was a challenging year from a cash flow perspective because we had two things. We had the big delta on what we described as being the non-trade working capital, which really was effectively an accrual made for a bonus payment in 2021, which is a record bonus. We paid out our highest bonus ever on the back of results in 2021 from the accounting perspective. Of course, those payments weren't made in cash terms until 2022.

So we had a big outflow of cash in 2022, which was accounted for in 2021 profitability. That's why we have the big move there. We also had an outflow at the year-end on our net working capital position, which I think was -- largely, we described as timing. But the elements that our actual creative business, which tends to be working capital consuming, actually grew better than we were expecting. Our media business, which tends to be working capital generative, actually was probably -- even though the growth was good, it’s growth was slightly less than we expected. So, we had a little bit of an outflow at the year-end.

But it's worth pointing out that we have unlocked that GBP 1.3 billion of working capital benefit over the last three years. So, all of which is, of course in theory, should drop to the bottom line, and that's what at least in part funding the buyback program, the GBP 1.5billion that we've returned to shareholders over the last two years.

I think if you were to look at what's the sort of normalised basis, I mean I think if you define your free cash flow, taking account of your CapEx, your tax, your interest, your earn-outs, your restructuring costs and closing working capital, then we should be normalising at around GBP 1 billion plus or so against top line of just over GBP 2 billion. So that would be -- and certainly, if I look to, say '23 as an example, with, if you like, headline EBITDA at GBP 2.1 billion, we're creating free cash flow of around GBP 800 million. If I look at sort of '24 and '25 and beyond, you'd see that free cash flow number increasing.

It does, of course reflect a number of items which will move over time. So, I would say CapEx was relatively -- was lower than expected in '22. It's going to be a little bit higher in'23 at GBP 300 million, but we'll probably normalize around that level going forward.

I think restructuring, we saw GBP 220 million in 2022, exactly in line as we guided. We’ll see GBP 180 million in 2023, as we've now guided for this year. Then we'll see that come off over the subsequent years. So that will be a help to the overall free cash flow.

Then in terms of net working capital, I think we largely expect to be flat going forward. We've delivered, if you like, the big one-off benefits in 2020 and 2021. I think going forward, we'll continue to make small operational improvements offsetting the outflow as a result of growing the business. So, net-net, overall, I would say neutral. But that's -- I hope that gives you a little bit of a shape in terms of what we anticipate going forward. Does that answer your question?

Q - Michael Nathanson

Yes. It does. It's really helpful.

Can I just have one more for Mark? I think I'd be remiss not to ask you about China, given your history there, given the depth of your relationships. What are you hearing on the ground, right? You have actually the text you put out, but are you seeing real signs of reawakening on spending and activation from the client side? Is that a hopeful sign for '23?

A - Mark Read

Yes. Certainly. When I talk to our people there, they're much more positive and much more optimistic about the outlook for the year and about client spending. In our case, we had a very strong Q1 last year, I think we were up 12%. So, it's going to make the comparatives this year a bit tougher for us in Q1.

So, I don't think you'll see it feed through into our growth until Q2 onwards. But I think China is 5% of our business. So, it's an important part of our business, but it's by no means delivering all of the growth that we expect this year. It's really -- it's part of the puzzle, I would say -- I would describe it as. But I think people are positive and it's definitely opening up.

Operator

Our next question comes from Doug Arthur from Huber Research.

Q - Douglas Arthur

Mark, there was a narrative in the marketplace, say 18 months ago, that Retail Media was not really incremental spending. It was sort of moving from one pile to the other. That doesn’t seem to be the case. So, I guess what is your outlook there? And what is the specific WPP agency role in facilitating the growth of retail media? Then I've got a follow-up for John.

A – Mark Read

Yes. Look. I think some of it is being displaced from analog, which may not be measured to digital, which is probably more measurable, right? And more reported by the companies. So classically a big, packaged goods company would go to Walmart and would have listing fees and promotions and advertising, and you would never see that either in -- Walmart would never disclose that, and you would never see that in the P&L of the packaged goods company either. And now that may be reported as advertising revenue, so people are starting to collect it.

So, I wouldn't say it's necessarily being displaced, but I think it's becoming more measurable. And part of it -- some part of it is incremental because you're creating new opportunities for clients to advertise, and so it's incremental. I would say from the perspective of our business, it is incremental to our business because it's money that probably would not have passed through WPP. But because it's now being spent as pure advertising is being passed through WPP. So, our job is to help our clients manage that and integrate it with the rest of their advertising.

Quite frankly, the retailers are trying to double dip, which is trying to get the trade dollars out of the manufacturers, as well as the retail advertising dollars by persuading them on different things, and then always different things. So, it's a little bit of an arm wrestle about what it is. I think our job and our role is to help clients spend it efficiently, understand where it's additive to their overall media mix and understand where it's actually incremental or replacing trade spend, and make sure that they've got the right balance there between those two activities, I guess.

Q - Douglas Arthur

Yes. That's very helpful. And just a follow-up for John. The transformation program seems ahead of schedule. Where are you getting incremental savings? Is it more on the real estate side or kind of IT? And could you eventually exceed your goal through '24, '25?

A - John Rogers

Yes. Look. I think it's across the board. I mean it's set out -- we said that in the presentation in terms of the different buckets of spend across what we describe as efficiencies and the operating model. I think it's in -- would be getting better. I think there’s a stronger savings on the real estate side, good savings coming through on procurement.

Obviously, we're making the organization a lot simpler. You've seen in the presentation, bring together a number of different parts of our overall business, cutting the number of legal entities. So, I think it comes from a number of different areas. I'd say the one area that we're just starting to tap into, and it's probably the smallest of the 3 buckets, is the rollout of the enterprise ERP, new ERP systems and economy principally in Asia and in South America 2023, and Workday in one of the (inaudible) in North America.

I think those tend to be a little bit slower given the complexity of the organization and the challenges associated with that. But probably in the longer term, over time, have high potential to unlock more value. I wouldn't want to call out higher savings than what we’re describing at the moment, the GBP 600 million. I think there's good visibility to get to the GBP 600 million. I think let's get to GBP 600 million first and then see where we can get to thereafter.

Operator

There are no further questions at this time. So I will now hand the call over to Mr. Mark Read for further closing remarks.

A - Mark Read

All right. Well thank you everyone, for your questions. Thank you for listening. We'll be in touch and speak to you soon. Thanks very much.

Operator

That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.

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