18-Apr-2023

Omnicom Group, Inc. (OMC)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and welcome to the Omnicom First Quarter 2023 Earnings Release Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. [Operator Instructions] As a reminder, this conference call is being recorded.

At this time, I'd like to introduce you to your host for today's conference, Senior Vice President of Investor Relations, Gregory Lundberg. Please go ahead.

Gregory Lundberg
Senior Vice President-Investor Relations, Omnicom Group, Inc.

Thank you for joining our first quarter 2023 earnings call. With me today are John Wren, Chairman and Chief Executive Officer; and Phil Angelastro, Executive Vice President and Chief Financial Officer.

On our website, omnicomgroup.com, we've posted a press release, along with a presentation covering the information we'll review today, as well as a webcast of this call. An archived version will be available when today's call concludes.

Before we start, I would like to remind everyone to read the forward-looking statements and non-GAAP financial and other information that we have included at the end of our investor presentation. Certain of the statements made today may constitute forward-looking statements, and these statements represent our present expectations. Relevant factors that could cause actual results to differ materially are listed in our earnings materials and in our SEC filings, including our 2022 Form 10-K.

During the course of today's call, we will also discuss certain non-GAAP measures. You can find the reconciliation of these to the nearest comparable GAAP measures in the presentation materials.

We will begin the call with an overview of our business from John. Then Phil will review our financial results for the quarter. After our prepared remarks, we will open the line for your questions.

I'll now hand the call over to John.

John D. Wren

Chairman & Chief Executive Officer, Omnicom Group, Inc.

Thank you, Greg. Good afternoon, everyone, and thank you all for joining us today. We're pleased to share our first quarter results.

As we discussed on our last call, we entered 2023 extremely confident in our strategic and financial position. I'm pleased to report that for the first three months of the year, we met our internal revenue and margin targets.

Organic growth in the first quarter was 5.2%. Our growth was broad-based across disciplines, geographic regions and client sectors. Advertising & Media, Precision Marketing and Public Relations were the largest contributors in the quarter.

Adjusted operating profit margin for the quarter was 13.5%. Non-GAAP adjusted earnings per share was $1.56, up 12.2% versus non-GAAP adjusted EPS for Q1 2022. Our cash flow and balance sheet remain very strong and support our primary uses of free cash flow: dividends, acquisitions and share repurchases.

We're pleased with our results for the quarter and remain on track to achieve our full-year targets of 3% to 5% organic growth and 15% to 15.4% operating margin. Strategically, we continue to invest in our creative leadership with TBWA's recent acquisition of Dark Horses, a London-based award-winning sports marketing agency. Dark Horses operates in a high growth area and works with a strong roster of global clients and influential sports organizations.

While creativity remains a core part of our culture and organization, we continue to be recognized for our integrated suite of services across precision marketing, data, ecommerce and other disciplines. Most recently, our capabilities were highlighted by Ad Age, who named us their 2023 Holding Company of the Year. The publication noted that while still creative, Omnicom is a data-driven powerhouse, enabling marketers to transform their businesses using capabilities in ecommerce, consumer experience management, CRM and more.

Our ability to deliver increasingly specialized integrated services enables us to expand the work we do for our clients and remained a trusted advisor to them. In fact, in 2022 100 of our largest clients were served on average by more than 50 of our agencies across different disciplines and geographies.

As we move ahead, we continue to look for ways to strengthen our portfolio through acquisitions and investments in high-growth areas such as precision marketing, healthcare, e-commerce, media and PR, as well as in our core creative services.

I'd like to now turn to how we are approaching the new way our people work, which has resulted in changes in our real estate. We created a plan that underlies our belief that our physical offices play a critical role in maintaining culture, inspiring creativity and innovation and promoting professional development. Our approach also recognizes that providing flexibility creates benefits for the health and well-being of our people.

With this in mind, we recently announced we are requiring our people to work in our offices a minimum three days a week. In practice, many of our agencies are already at or well ahead of this requirement. Many are working a full week in the office. Based on this plan during the quarter, we made the decision to exit over 1.6 million square feet of office space around the world.

Since 2018, we reduced our office footprint by 35% while our employee head count has increased by approximately 4,000. We are also experimenting with different approaches to make it easier for our people to return to the office. One example is in the New York metro area, where we are opening three satellite offices in Long Island, Connecticut and New Jersey.

We are also opening new Omnicom campuses in three cities in India: Chennai, Gurgaon and Hyderabad, as the number of employees in India continues to grow at a significant pace. Phil will cover the financial impact of our real estate actions during his remarks.

Going forward, we continue to invest in new modern workplaces that provides the type of environments most effective for collaboration and in-office work. We are also rapidly charting a path of how we use new technologies for the future of work.

In the area of generative AI, through our large-scale relationship with Microsoft, we have established a dedicated Azure environment with secure enterprise access to the latest open AI GPT model. This unique setup is allowing us to responsibly develop new custom and version-controlled models against various use cases within Omni, as well as supporting overall automation and transformation efforts. The development includes careful consideration related to all aspects of generative AI, from confidentiality to intellectual property rights, privacy, biases and ethics.

In conclusion, we are pleased with how the year has started and remain on track to meet the targets we set for the year. At the same time, we remain cautious as to how inflation, interest rates, the war in Ukraine, increasing tensions in the Middle East, and the recent banking and credit events in the United States could impact the economy and our operations. Many of these risks have been evident for quite some time, and we have developed plans to appropriately respond to any potential headwinds and minimize the effect on our financial performance.

I will now turn the call over to Phil for a closer look at the financials. Phil?

Philip J. Angelastro

Executive Vice President & Chief Financial Officer, Omnicom Group, Inc.

Thanks, John. 2023 is off to a solid start in what remains an uncertain year. All of our disciplines and geographies grew organically in the first quarter, and we continue to invest in our operations and took strategic steps to reduce our real estate footprint. And we continued our balanced capital allocation of dividends, acquisitions and share repurchases.

Let's begin with a high-level review of the quarter on slide 3. As John mentioned, the transition to a flexible working environment, with a hybrid model which allows for partial remote work, has resulted in changes to our real estate strategy, and we made the decision to exit certain leases and reduce our office space. While there will be some investments we will be making in existing and new locations, the net impact over time will result in lower rent and occupancy cost.

In the first quarter of 2023, we took a charge of $119 million related to this reduction in our office lease portfolio. The charge is primarily related to the non-cash impairment of a portion of our operating lease right-of-use asset and the write-off of the net book value of leasehold improvements at the affected locations. As a result, rent and occupancy expense will be reduced in the future and substantially all of the charges will be paid out of the remaining lease terms over the next few years.

This slide shows our reported results, followed by certain adjustments which make the periods comparable, and the resulting non-GAAP adjusted amounts for both periods. In addition to the real estate charge I just discussed for 2023, operating expenses in the first quarter of 2022 include a $113 million charge arising from the effects of the war in Ukraine. In summary, reported revenues were up 1% and non-GAAP adjusted operating income was flat. Both were negatively impacted by foreign currency translations.

Moving down the income statement, net interest expense improved due to higher interest income than we expected. In Q2, we estimate that interest expense will increase a bit, primarily due to an increase in the interest rate applied to our pension and post-retirement obligations. This will be offset by an expected increase in interest income in Q2 of 2023 relative to Q2 of 2022, although we do not expect as much interest income in Q2 of 2023 as we had in Q1 of 2023 due to our working capital cycle. For the second half of 2023, we expect that net interest expense will be flat to up slightly, relative to the second half of 2022.

In Q1 of 2023, the effective tax rate was somewhat lower than our annual guidance of 27% due to a lower effective tax rate related to the real estate repositioning charge, and the realization of certain tax benefits and NOLs. We still expect a tax rate of 27% for the balance of the year, as indicated on our February 2023 call.

Non-GAAP adjusted net income increased 9%. As a result of share repurchases, our diluted share count declined by 2.5%, and non-GAAP diluted EPS was up 12.2% on an adjusted basis. Without the headwind from negative foreign currency translation, non-GAAP diluted EPS for the quarter increased by approximately 16%.

Now let's review the quarter in more detail, beginning with the components of our revenue change on slide 4. Our organic growth was 5.2%. The impact from foreign currency translation was negative and reduced reported revenue by 3.2%, which once again was a bit less than the preceding quarter.

Looking forward, we still estimate that the impact will moderate for the remainder of 2023 and will be approximately flat for the year. The impact of acquisition and disposition revenue was negative 1%, primarily reflecting the disposition of our businesses in Russia announced near the end of the first quarter of 2022.

Given the recent disposition of our small research businesses earlier in April, we expect a similar reduction of about 1% for the balance of the year, prior to any acquisitions we expect to complete later this year.

Moving on to slide 5, let's review our revenue growth by discipline. During the first quarter, Advertising & Media posted 5.1% organic growth, once again led by strong performance in our Media businesses. Precision Marketing had strong growth of 7% organically, continue to invest in this area, and we see opportunities for future growth in the market for digital customer experience, data analytics, and digital transformation services.

Commerce & Brand Consulting grew organically by 3.3%, primarily on the strength of our branding and design agencies. Experiential organic growth was 8.4%, led by Europe, the UK, and the Middle East. Execution & Support returned to growth of 3.6%, led by our merchandising and support businesses and offset by a reduction in our research businesses.

Public Relations was strong at 5.8%, coming off a challenging double-digit growth comparable in Q1 of 2022. Finally, Healthcare grew 4.8% and we continue to see good growth trends in this business, with 2023 supported by new client wins last year.

Please note that we made some adjustments to reclassify certain agencies among our disciplines to reflect changes where an agency's current and future capabilities better aligns with our new disciplines. Prior periods have been restated to the current presentation. No changes were made to total revenues or total organic growth.

For your reference, we've included a slide in the appendix of updated 2022 quarterly and annual revenue by discipline. The impact of the changes on the 2022 presentation by discipline was minor, with the only notable change resulting from reclassifying our digital communities agency, which has been more closely aligned with our research capabilities from the Commerce & Brand Consulting discipline to our Execution & Support discipline.

Turning to slide 6 for revenue by region. You can see that growth was above 5% everywhere except Asia Pacific, where we saw some regional performance challenges impact results. In the US, our 5.1% quarterly organic growth was led by Advertising & Media, Precision Marketing, and Public Relations. International organic growth of 5.4% was led by Advertising & Media, Precision Marketing, and our Experiential businesses had strong growth outside the US.

International organic growth of 5.4% was led by Advertising & Media, Precision Marketing, and our Experiential businesses had strong growth outside the US, but were flat in the US. Regionally, we had positive growth across our top 10 countries with the exception of China.

Looking at revenue by industry sector on slide 7, compared to the first quarter of 2022, we had higher relative weights in food and beverage and auto, offset by a lower relative weight in technology. Other categories were broadly stable.

Let's now move down the income statement and look at expenses on slide 8. Our total operating expenses were flat at $3.1 billion. Salary and related service costs were flat. The increase resulting from organic revenue growth and additional head count was offset by the effects of foreign currency translation. As a percentage of revenue, these costs decreased 1% year-over-year.

Third-party service costs, which include third-party supplier costs when we act as principal, providing services to our clients, increased due to an increase in organic revenue. These costs are an integral part of our service offering to our clients.

We provided an additional operating expense detail this quarter, with the addition of the third-party incidental cost line, which primarily consist of client-related travel and incidental out-of-pocket costs that we bill back to clients directly at our cost and we are required to include in revenue.

These costs were previously included in the third-party service cost line, and they tend to increase when revenue increases and decrease when revenue decreases. In Q1, they increased due to an increase in revenues. We hope this incremental disclosure will assist in your analysis of our results.

Occupancy and other costs were down a bit. They increased slightly due to growth in general office expenses as our workforce continues to return to the office, which was offset by the effects of foreign currency translation. SG&A expenses decreased primarily due to lower professional fees and the effects of foreign currency translations. For your reference, slide 16 in the appendix presents our operating expense detail on a constant currency basis.

Similar to the income statement highlights slide we discussed earlier, slide 9 presents both the reported and non-GAAP adjusted results 2023 and 2022 by removing the Q1 2023 real estate repositioning charges and the Q1 2022 charges arising from the effects of the war in Ukraine.

Our first quarter 2023 adjusted operating income of $466 million was flat with the first quarter of last year. The related adjusted operating income margin was 13.5%, compared to 13.7% in the first quarter of last year.

Please turn now to slide 10 for our cash flow performance. We define free cash flow as net cash provided by operating activities, excluding changes in operating capital. Free cash flow for the first quarter of 2023 was $429 million, up 26.3% from last year, which included the cash impact of charges arising from the war in Ukraine.

Changes in operating capital are typically negative in the first quarter, and the level for the first quarter of 2023 was similar to the last few years. As we look forward for the full year 2023, we continue to expect changes in operating capital to be a source of cash again.

Regarding our uses of cash, we used the $142 million of cash to pay dividends to common shareholders and another $13 million for dividends to non-controlling interest shareholders, both similar to last year.

Our capital expenditures of $23 million were at normal levels and flat with last year. Acquisition spend, net of dispositions and other items, was $38 million and related to the acquisition of additional non-controlling interests. And lastly, our net stock repurchases for the quarter were $279 million, roughly in line with last year's first quarter level and well on the way toward our annual expectation of $500 million to $600 million.

Slide 11 is an overview of our credit, liquidity, and debt maturities. At the end of the first quarter of 2023, the book value of our outstanding debt was relatively flat at $5.6 billion, compared to the same period last year. There were no changes in outstanding balances during the quarter and our $2.5 billion revolving credit facility, which backstops our $2 billion US commercial paper program, remains undrawn. And our cash and cash equivalents were $3.3 billion.

Turning to slide 12, our operating capital discipline consistently drives above-average returns on both invested capital and equity. For the 12 months ended March 31, 2023, we generated a solid return on invested capital of 24% and a strong return on equity of 45%. The strength of our business delivers attractive returns on a relative basis in both strong and weaker macroeconomic environments.

In closing, as 2023 begins, we continue to review our costs to better align with our estimated revenues in an uncertain economy, and our decision to exit certain real estate in Q1 is consistent with this approach. Our Q1 performance was solid and a first step toward delivering on our full-year guidance of an operating income margin between 15% and 15.4%, excluding the impact of the real estate repositioning charge.

We expect to be at or close to the top of that range. Our approach always includes the opportunity for strategic and accretive acquisitions, and if those opportunities are not immediately available, we will continue to use our free cash flow to boost total shareholder returns through dividends and share repurchases.

Operator, please open the lines up for questions and answers. Thank you.

QUESTION AND ANSWER SECTION

Operator: Thank you [Operator Instructions] And the first question comes from the line of David Karnovsky with JPMorgan. Please go ahead.

David Karnovsky
Analyst, JPMorgan Securities LLC

Q

Hi, thank you. John, just wanted to see if you could provide any additional context around the organic guide. I think last quarter, you said you were extremely comfortable with the low end of 3% to 5%. Just given the performance at the top end of the range in Q1, has that level of comfort moved higher at all? Thanks.

John D. Wren
Chairman & Chief Executive Officer, Omnicom Group, Inc.

A

Not yet. We're still comfortable with the 3% and our stretch target remains 5% for the year. We'll know more, certainly, by the time we get to the second quarter's call in July, but the – and the reason for that is, in my experience, it's just common sense not to fight the Fed. And so we're not going to fight the Fed. And whereas our clients continue to spend, and we continue to win new business, it's all very positive. Clients are getting cautious and they're trying where they can to avoid long-term commitments and create as much flexibility in their spending as possible. Therefore, we're doing the same.

David Karnovsky
Analyst, JPMorgan Securities LLC

Q

Okay. And then, Phil, can you just confirm, I think you said for the margin guide at the higher end of the range, and then how should we think about the benefit of those real estate actions maybe flowing through to future years?

Philip J. Angelastro
Executive Vice President & Chief Financial Officer, Omnicom Group, Inc.

A

So in terms of the higher end, I think we're comfortable that we're going to close the year out closer to 15.4% than 15%, and we're pretty confident. Given the real estate actions that we took and our conservative approach to managing the cost structure, especially in this kind of an environment, that we're going to close the year – even though it's early, we'll close the year between the midpoint and the high end of the range.

David Karnovsky
Analyst, JPMorgan Securities LLC

Q

Anything on future years for the real estate actions?

Philip J. Angelastro
Executive Vice President & Chief Financial Officer, Omnicom Group, Inc.

A

In terms of the real estate actions, I think that's part of what gives us confidence in getting to the high end of the range. But what you need to keep in mind is that there's a number of other factors in our cost structure that are going to have an impact.

And specifically with respect to real estate, as people come back to work, more frequently come back to the office, we're going to have to deal with a little bit of an increase in our occupancy costs. We're going to manage through that. We're also making some investments, as John had referenced, with some – a trial with some satellite offices.

We need to do a little work on the space that we have. So there's a bunch of moving parts just within the rent and occupancy line, but we do expect it to be a benefit and a benefit in 2023 and beyond, for sure.

David Karnovsky
Analyst, JPMorgan Securities LLC

Q

Thanks a lot.

Philip J. Angelastro
Executive Vice President & Chief Financial Officer, Omnicom Group, Inc.

A

Sure.

Operator: Next, go to the line of Ben Swinburne with Morgan Stanley. Please go ahead.

Benjamin Swinburne
Analyst, Morgan Stanley & Co. LLC

Q

Thanks. Good afternoon. I had a question first on sort of the impact from net new business wins on your performance, yeah, including the L'Oréal win late last year. Was net new business big enough to call out in Q1? And should we be thinking about further benefits from L'Oréal kicking in later in the year? I realize existing client spend kind of dwarfs net new business, but you guys did mention it on the last earning call. So I wanted to see if we'd get an update on sort of the tailwinds you're seeing and any magnitude you can help us think about. That's my first question.

John D. Wren
Chairman & Chief Executive Officer, Omnicom Group, Inc.

A

Yeah, Ben, we take all that into consideration. We're giving you the estimate of what we think is happening in the revenue in the aggregate. But L'Oréal specifically, we were ramping up costs in the first quarter. The revenue didn't start until April 1.

Benjamin Swinburne
Analyst, Morgan Stanley & Co. LLC

Q

Got it. That's helpful. Thank you, John. And then I'm wondering how you guys thought about competition for talent as you reintroduced – or I guess introduced the sort of back to work three days, any concerns there about how you compete and position working at Omnicom versus other opportunities. And what's sort of the reaction internally to that message, given what we've been through over the last couple of years, you guys feel pretty confident that it's net additive to the overall operation in the business?

John D. Wren
Chairman & Chief Executive Officer, Omnicom Group, Inc.

A

We certainly – not only I think the leadership of our groups believe that it's necessary and will therefore be effectively additive in the long run. Where we benefit is the Great Resignation, at last, is over. You see it in the layoffs that the tech industry is doing and some other areas. So we believe that we'll be just fine. Naturally, there'll be individual cases where people won't want to come back, and they'll seek other alternatives. But in the scheme of things, it's not going to be significant.

As we've implemented this policy, if you go around the world, we needed to put out a minimum of three days a week, principally for the United States. Once you get outside the United States, people have been back in the office like in Asia for about five days a week, and most of Europe, at least four.

So people – our managers also know that, at first when people come back, we're going to invest a little money, making it an event to come back just to reintroduce people to having to come back. But I think we're also doing other smart things. If you lived in Long Island or Connecticut or New Jersey, and if we say come back to the New York office, it would take you two hours and cost you a fortune, tolls and whatever else. We, I think, very wisely have put satellite locations so people can have that as their permanent location, and only on occasion going in the course of a month will they have to come back to the city.

So we're trying every sensible thing to look at for the benefit and the welfare of our employees. And it's time for them to come back, because we're a creative service company, and we work better when we're together.

Benjamin Swinburne
Analyst, Morgan Stanley & Co. LLC

Q

Thanks, John.

John D. Wren
Chairman & Chief Executive Officer, Omnicom Group, Inc.

A

Okay.

Operator: Next, we'll go to the line of Tim Nollen with Macquarie. Please go ahead.

Tim Nollen
Analyst, Macquarie Capital (USA), Inc.

Q

Hi. Thanks very much. John, could I follow up on the comment that you have in the press release and you mentioned in your prepared remarks about taking operational steps and some plans in place to mitigate macro headwinds. Just to clarify if that's anything incremental or if that's just basically the same message that you've been giving for some time now? And then I have a follow-up as well.

John D. Wren
Chairman & Chief Executive Officer, Omnicom Group, Inc.

A

Sure. I'd probably say it's pretty consistent to what we've been saying for the last 100 conference calls that I've been on. There's – one thing that will benefit us is we continue to ramp up in the hiring, say, in places like India, have increased in order for us to become cost-efficient for the benefit of our clients as well as for our shareholders. And that will continue to grow. That's why I've mentioned that we're opening up three campuses, which in the past, that's what tech companies did as opposed to advertising agencies.

So we have some plans, and we are cautiously introducing them just in the normal course of business to mitigate costs. And we also have it in our ability to accelerate that if we find that we have to adjust for something. So the plans vary. The scenarios vary. I think Phil had some statistics about how quickly we recovered from very serious recessions in the past. I don't know if that would add any color to it or not.

Philip J. Angelastro
Executive Vice President & Chief Financial Officer, Omnicom Group, Inc.

A

I think the commentary or the prepared remarks, certainly we're more focused on what we've typically done in the past, and we're not waiting around as we didn't in the past for the serious headwinds to arrive. We're making sure we take a more sensible, conservative review – or sensible and conservative view, so that we keep our cost structure in line with the current and anticipated revenue base. I think if you look at our performance coming out of the last couple business either recessions or challenging times, we've been able to manage through pretty successfully and bounced back pretty quickly. And I don't think you should expect anything different this time around either.

Tim Nollen
Analyst, Macquarie Capital (USA), Inc.

Q

Okay. Great. Thanks. And then could I follow up on the comment on the Microsoft and the generative AI relationship? I think it was last call that I asked the question about what might ChatGPT do to the business. And I wonder if you can maybe elaborate a bit further. I mean there's a lot of discussion around this replacing people over time and changing the creative process and so forth. I think your answer then last quarter, John, was that it's just – it's a matter of improving workflows and making various things more efficient. Could you just elaborate a bit more now that you have an actual, formal relationship with Microsoft in place now?

John D. Wren
Chairman & Chief Executive Officer, Omnicom Group, Inc.

A

Sure. I think there may be more now. We were the second company, I think, Microsoft entered into such a relationship with. I think the first company was Disney. It's a unique deal. And what we're using it for at this point is we're taking all of Omnicom's historical data on top of what GPT can do. And we're running a lot of projects. I'll come to that in a second. We think for clients that want to participate in this, they'll add their data and we'll create new models of how we do things to identify consumers.

So we're putting it all together, and I think presently, we have in excess of 20 projects going on, testing different things. I'd say good five of them are directed at the back office, and the balance of them are directed at the client side, the revenue side of the business. And it has a lot of potential to positively impact the business.

I don't think you'll see that in 2023 because, as I also said in my comments, you have to be very careful with this. And maybe one of the reasons Microsoft picked us is because we are very careful. There's a lot of ethical questions and there's a lot of privacy questions. There's a lot that this incredibly powerful tool can do, but you have to get the guidelines and the rules in place before you can actually use it efficiently.

In the long term – and this is just my belief – in the long term, I think our creative, what I'd call knowledge workers will only find their jobs enhanced by the way that we'll utilize this five years from now. And so, we're very optimistic. And we're testing it, playing with it, but we're certainly not deploying it in a way that – to the full extent of the power that it has.

The other thing that I would point out, I mean, you probably – this may sound like I've said it before, but we've built Omni over the last decade. And we've built it in such a way that is very, very flexible and connected to an awful lot of databases and put in plumbing that was really appropriate for what – playing with and adding generative AI is going to do.

So we have the installation, we have the system, it's deployed for us worldwide. And now, we're entering into an environment where we're going to be able to make pretty quick progress, I think, in terms of what works and what doesn't work as people develop these rules, look at the ethics of it and understand what biases can be affected.

Tim Nollen
Analyst, Macquarie Capital (USA), Inc.

Q

Okay. That's very helpful. Thank you.

Operator: Next, we go to the line of Steven Cahall with Wells Fargo. Please go ahead.

Steven Cahall
Analyst, Wells Fargo Securities LLC

Q

Thank you. So John, you said that you don't want to fight the Fed. It seems like maybe the Fed is winning the fight with inflation. That usually means either a weaker consumer or higher unemployment. So, I'm just wondering if that's your subsequent expectation. And what does that translate to in terms of any growth implications for the company or how you're thinking about managing the business through that? And then, I have a couple follow-ups for Phil.

John D. Wren
Chairman & Chief Executive Officer, Omnicom Group, Inc.

A

Sure. Well, the Fed hasn't stopped. So, the world is still fighting it. And with the employment numbers, they don't look as bad maybe as they could. But the jury is still out about if the Fed is going to be able to get us into a recession, they're certainly trying to slow growth. If they do – as I said, we've been playing game theory here for quite a number of years in terms of how we would respond to it when we see it, when we believe it's going to occur.

We do, though, have the philosophy that when long-term partner-type clients suffer, we're going to suffer a little with them. And that's proved to be a very sensible investment in the past when we faced, I think, more severe circumstances because clients don't forget that, and as they recover, you benefit from it as well.

So at this point, we're comfortable with – we're certainly now comfortable with the low end of the range that we gave you last quarter. We'll strive very hard to get to the top end, but there's too many uncertainties as we sit here today for me to be promising that to you. As soon as we can, we will. So again – maybe I didn't quite answer all of your questions.

Steven Cahall
Analyst, Wells Fargo Securities LLC

Q

No, that's helpful. And then maybe, Phil, just first on the margin comment, with the tighter end of the range, is that fully due to the real estate repositioning or are there sort of general operating aspects that drove that as well?

And also, your net interest was quite low in Q1. I'm sure that's just the rate that you're getting on your deposits. So, good to see the Fed is helping there. Should we use that as a decent run rate for kind of net interest going forward? Thank you.

Philip J. Angelastro
Executive Vice President & Chief Financial Officer, Omnicom Group, Inc.

A

Sure. So on the margin front, it's certainly – it's not just real estate. I think it's a whole combination of things. I mean, we've got a number of factors that impact our margins. And trying to balance them all is something we do every day at the lowest level.

So while we maybe have experienced some wage inflation like everybody else has in the recent past, we've got a number of initiatives that we've been pursuing and continue to pursue in the areas of offshoring and automation. We continue to push those and have made a lot of progress on that front and expect to continue to make more progress through the rest of this year and beyond, especially with automation.

At the same time, we've taken some actions, obviously, in the area of real estate and occupancy costs. We do expect there to be a reduction on that front, although at the same time, we'll have some incremental occupancy costs as well due to the – more people back in the office and/or some of the investments that we touched on earlier.

So, it's all of those factors. But certainly, the real estate moves we've made this quarter are going to put us in a better position where we feel more confident that we're going to finish the year at the high end of that range, no question.

On the interest front, I would say certainly, it's mostly rate. And in Q2 of 2023, we expect interest income to increase again year-on-year relative to Q2 of 2022, probably not by the same amount as in Q1 because our working capital cycle is such that we'll have less cash available to invest relative to Q1. So, we expect interest income to go up. We expect interest expense to go up just a bit as well largely because the interest rate used on our pension and post-employment benefits, that rate has gone up as well. It's a rate issue, not a volume issue going the other way. And the rest of our debt portfolio is relatively fixed.

When you get to the second half, I think we had a considerable amount of interest income increases in the second half of 2022. So, I think you could expect net interest expense in the second half to kind of be flat to maybe a little bit of incremental interest expense, depending again on what happens with rates primarily.

Steven Cahall
Analyst, Wells Fargo Securities LLC

Q

Got it. Thank you.

Philip J. Angelastro
Executive Vice President & Chief Financial Officer, Omnicom Group, Inc.

A

Sure.

Operator: Next, we'll go to the line of Jason Bazinet with Citi. Please go ahead.

Jason Boisvert Bazinet
Analyst, Citigroup Global Markets, Inc.

Q

I just had a question on buybacks. I heard you reiterate that $500 million to $600 million for the full year. But I just noticed you did a decent – or maybe half of that in the first quarter, and I was just looking back at the prior years and sometimes your buybacks are front end-loaded and sometimes are back end-loaded. Is there any sort of algorithm that you guys have? Is that just a function of your view of the value of the shares, is it working capital related, or what is it that causes your buybacks to be more [indiscernible] (44:56)?

Philip J. Angelastro
Executive Vice President & Chief Financial Officer, Omnicom Group, Inc.

A

No. I think if you go back over a longer period of time, you probably even go back 10 years, you'll see that most of the volume of buybacks has occurred in the past, in the first quarter and the second quarter, usually the first quarter a little more than the second quarter, so the first half of the year, and then we tend to have less activity in Q3 and Q4.

I think there have been a couple of anomalies, recently given COVID, certainly for one, and probably the economic slowdown prior to that, which is probably close to 8 to 10 years ago. So there might be a blip here or there, but it's not due to price sensitivity or anything similar to that. We largely return cash to shareholders through the buyback, and we tend to do that more so in the first half of the year.

John D. Wren
Chairman & Chief Executive Officer, Omnicom Group, Inc.

A

And if I could just add one thing, our capital policy is, first, to pay dividends, next to do acquisitions, and then finally, to do share repurchases with that free cash flow. And there's a number of tuck-in acquisitions that we're looking at currently, which when we get completed with our due diligence and if we get across the finish line, cash will be used for that, and that might change it. So, there's no – excuse me, there's no formula for we're going to do this in January, we're going to do this in July. That's not how it works. We use our judgment to get to these forecasts to be as transparent and as consistent as we can with you.

Jason Boisvert Bazinet
Analyst, Citigroup Global Markets, Inc.

Q

That's very helpful. Thank you.

Operator: And the last questioner will be Craig Huber with Huber Research Partners. Please go ahead.

Craig Huber
Analyst, Huber Research Partners LLC

Q

Great. Thank you. My first question, historically, your company and your peers' pricing has not been much of a factor in your organic revenue growth year-to-year on a like-for-like basis on the services you guys provide. I'm just curious, in this higher interest rate environment, are you able to raise prices any more aggressively now versus what you've done in the past?

John D. Wren
Chairman & Chief Executive Officer, Omnicom Group, Inc.

A

Well, our people are always trying to get paid fairly for the services that we provide. And – but we do live in a competitive environment. So, there's a lot of – many clients have given us increases and many clients are not in a position to give us increases. And to offset and to pay for salary inflation, as Phil mentioned earlier, we've sped up and we're doing a much more professional job with offshoring than I can say we've done at any point in the past. That isn't necessarily to create extra income. That's to create extra resource so we can continue to attract the best talent there is in the marketplace.

Craig Huber
Analyst, Huber Research Partners LLC

Q

And then also, John, your conversation with your clients, has your thought on this year changed materially since the last time you spoke to us 2.5 months ago in terms of the outlook for what you're hearing from clients? I mean, a lot changed on the macro side, I think, with all the banking issues, et cetera, over the last couple of months and stuff. But it sounds like you're obviously keeping organic revenue growth outlook the same. But I'm just curious, client for client, are you – sense any more cautiousness now versus what you were thinking 2.5 months ago? Thank you.

John D. Wren
Chairman & Chief Executive Officer, Omnicom Group, Inc.

A

On a macro basis, no. Prior to this call, I was talking to the CEO of Adobe. And one of the things he is saying is I wish people would stop talking the economy down because business is great. And so, it's a mix. I don't think anybody expected the banking situation to occur that came out of left field. But I think everybody that I speak to is – ends up being – I'd have to say the conclusion I reach is cautiously optimistic, but in a very sophisticated way, expecting that there's still going to be a lot more uncertainty until the Fed and its partners around the world think that they're done. And so, people are looking to create flexibility without abandoning the commitments they've made to grow their brands.

Craig Huber
Analyst, Huber Research Partners LLC

Q

That's it. Thanks, John.

John D. Wren
Chairman & Chief Executive Officer, Omnicom Group, Inc.

A

You're welcome.

Philip J. Angelastro
Executive Vice President & Chief Financial Officer, Omnicom Group, Inc.

A

Thank you.

Operator: And with that, that does conclude our conference for today. Thank you for your participation and for using AT&T Conferencing Service. You may now disconnect.