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Adecco SA (ADEN.CH)

Q3 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, good morning. Welcome to the Adecco Q3 Results 2015 Analyst Conference Call. I'm Selena, the Chorus Call operator. I would like to remind you that all participants will be in listen-only mode, and the conference is being recorded. After the presentation, there will be a Q&A session. [Operator Instructions] The conference must not be recorded for publication or broadcast.

At this time, it's my pleasure to hand over to Mr. David Hancock, Head of Investor Relations; accompanied by Mr. Alain Dehaze, CEO; and Mr. Hans Ploos van Amstel, CFO of the Adecco Group.

Please go ahead, gentlemen.

David J. Hancock
Head-Investor Relations

Thank you very much. Good morning and welcome to Adecco's third quarter 2015 results conference call. To present to you today, I'm joined by Alain Dehaze, Group CEO; and Hans Ploos van Amstel, Group CFO. Before we start, please have a look at the disclaimer regarding forward-looking statements in this presentation.

So, let me give you a quick overview of today's agenda. Alain will first summarize the key messages in today's press release, and then present the operational highlights, and an overview of the country performances. Then, Hans will review the financials and finally Alain will make some comments on the outlook. We will then open the lines for your questions.

With that, Alain, I hand over to you.

Alain Dehaze

Chief Executive Officer

Thank you, David and good morning ladies and gentlemen. Before I begin, I would like to welcome you all to my first analyst call as CEO. I'm also very pleased to welcome our new CFO, Hans, to his first call for Adecco.

I will begin with a quick summary of the five key points in our announcement this morning. We will then cover these in more detail during the presentation. First, we delivered a strong operating performance in Q3, 2015. We continued to see a steady revenue growth of 4%, from which we drove 12% growth in EBITDA excluding one-offs, both on an organic basis. Our EBITDA margin excluding one-offs increased by 40 bps.

Second, in Q3 2015, we recognized a €740 million impairment of goodwill relating to past acquisitions. This is a non-cash charge, and does not affect our dividend policy, but it does result in the reported loss in the quarter. Hans will give more details on this later.

Third, our revenue growth continues to be steady, but is not accelerating sufficiently for us to achieve the target of an EBITDA margin of above 5.5% in 2015.

Adecco also deliver very strong profitability in 2015 with an EBITDA margin excluding one-offs of approximately 5.2%. For 2016, we anticipate a continuation of the current organic revenue growth strength, and an EBITDA margin similar to the EBITDA margin excluding one-offs that is now expected in 2016.

Finally, we will hold an Investor Day in Zurich on January 18, 2016. The management team is currently completing a review of the medium strategic priorities. At the Investor Day, we will present further details on the evolutions of these priorities that build on our commitment to price discipline, cost leadership, tight capital management and EVA.

I will now turn to this first quarter results in more detail. On this and the following slides, I give all growth rates on an organic basis unless otherwise stated. We had revenues of €5.7 billion, an increase of 4%. Gross profit grew by 5%. The gross margin was 19%, up 60 basis points year-on-year or up 30 basis points on an organic basis.

Costs continue to be well-controlled. SG&A, excluding one-offs, was at 2% year-on-year, and down 2% sequentially driven by normal seasonality. This resulted in an EBITA, excluding one-offs, of €329 million. The EBITA margin, excluding one-offs, was 5.8%, up 40 basis points year-on-year.

When looking at our exit rates, September was in line with the quarter, showing 4% growth adjusted for trading days over the prior-year. In October, our volumes showed a similar trend with no signs of slowdown.

Let's have a look at the third quarter operating performance in more detail. I will start with the revenue development by region. In Europe, revenues grew by 3% in the quarter, the same growth as in Q2. We saw a further pickup in Benelux, while Italy and Iberia achieved double-digit growth. France and Germany showed low-single digit growth, and the UK and Ireland was flat.

In North America, growth was 1% compared to 2% in Q2. Again, growth by business line was mixed with strong performances in Industrial, Medical & Science, while Office and Engineering and Technical contracted.

Growth in the rest of the world was 10% in Q3. In Japan, revenues were up 2%. In Australia and New Zealand, revenue growth was 4%. Emerging markets grew by 16% led by double-digit growth in Latin America, Eastern Europe and India.

Looking next at the revenue development from a business line perspective, we see that the Industrial business continues to be the main driver of growth. In Q3, revenues in Industrial grew by 7%, up from 6% in the previous quarter.

In Office, revenues grew by 3% compared to 4% growth in the previous quarter. In Professional Staffing, revenues declined by 1%. Revenues grew modestly in Information Technology, Finance & Legal and in Medical & Science, while Engineering & Technical declined. Finally, within Solutions, growth remained strong in our VMS, MSP and RPO businesses.

Let's also have a look at the third quarter revenue development by service line. Temporary Staffing is our largest service line, growth here was 3% this quarter, the same as in the previous quarter. Revenues from permanent placement continued to grow strongly up 12% in Q3 compared to 13% growth in the previous quarter. In outplacement, growth was 1% this quarter compared to 5% in Q2.

Let's go through our main markets in more detail now. In France, revenues were up 1% on the prior-year. Revenues in our large Industrial segment increased by 3%. From an industry perspective, in construction, there are signs of sequential stabilization, while growth continued in logistics and automotives.

Permanent placement revenues in France were up 6% this quarter. The EBITA margin was strong at 7.3%, up 70 basis points year-on-year. Q3 2015 included a favorable one-time item, which added approximately 30 basis points. In September, revenues were up 3% adjusted for trading days.

We turn next to North America. Revenues increased by 1% with growth of 1% in General Staffing, while Professional Staffing was flat. Within General Staffing, we saw strong growth in the Industrial business at 7%, which has moderated versus previous quarters.

The Office business declined by 8% in Q3, partly due to continued weak demand from financial services customers. Within Professional Staffing, we saw growth of 14% in Medical & Science, and 5% in Finance & Legal. As in Q2, IT was up by 3% and Engineering & Technical declined by 9%.

In Perm, revenue growth strengthened to 17%. The EBITA margin was 6.4% in the quarter, up 30 basis point year-on-year compared to the margin, excluding restructuring costs in Q3 2014.

In September, revenues were down 1% adjusted for trading days, but volume trends in October showed a small positive growth.

Turning next to UK and Ireland, revenues overall were flat, Professional Staffing was down 1% with IT flat and Finance & Legal down 1%. Office was up 4%. Perm revenues were up 3% in the quarter. The EBITA margin was 2.7%, the same as in the third quarter last year. Revenues in September were down 2% adjusted for trading days.

In Germany and Austria, revenues were up 2% driven by price effects. Volumes were stable. Our Industrial business line was up 3%, while revenues in Professional Staffing were flat. Engineering & Technical, which is our largest Professional Staffing business declined by 4%, while IT grew by 12%, and Finance & Legal by 2%.

In our Perm business, revenues continued to grow and were up 11%. Q3 is a seasonally strong quarter for us. And the EBITA margin was 8.9%. This is an increase of 60 basis point, driven by the benefit of this restructuring actions we took in Q4, 2014. In September, revenues were up 1%, adjusted for trading days.

In Japan, revenues grew by 2% in Q3. Revenues were up 1% in General Staffing, where we are mainly exposed to the Office business, and up 3% in Professional Staffing. In our Perm business, revenues were up 25%. The EBITA margin was 5.8%, down 10 basis points year-on-year, impacted by the investment in the rollout of a global IT platform.

In September, revenues were up 7% adjusted for trading days. This calculation somewhat overstates there are underlying momentum in the business, which continues to be in-line with the year-to-date trend.

Finally, in terms of regional performance, I will touch briefly on some of our older markets. Growth accelerated in Benelux at 13%, and remained strong in Italy and Iberia, which we were at 18% and 13% respectively. In the Nordics, we saw a similar situation as in the previous quarter, with growth in Sweden and a decline in Norway.

In Lee Hecht Harrison, revenues declined by 1% organically, with an EBITDA margin excluding integration cost of 26.4%.

And with this, I hand over to Hans to take you through the financial in more detail.

Hans Ploos van Amstel

Chief Financial Officer

Thank you, Alain and thanks for your welcome earlier. As Alain noted already, we have had an intense first two months together. I am very happy to have joined Adecco, and I am very much looking forward to meeting with you, our Analysts and Investors over the coming weeks and months.

Moving to the business of the quarter, I will start with an overview of the P&L. Alain already mentioned the operating highlights in his introduction, with revenue of €5.7 billion, and EBITDA, excluding one-offs, of €329 million. EBITDA, excluding one-offs, increased by 18% or by 12% in constant currency. Below EBITDA, the group numbers were negatively impacted by a €740 million impairment of goodwill. This is a non-cash charge, but it resulted in a net loss of €513 million in Q3, 2015.

Based on recent and proposed regulatory changes in Germany, and the weaker macroeconomic outlook in certain markets, we concluded that an impairment test was necessary. As a result of this test, an impairment of goodwill of €740 million was recognized in Q3, 2015; of the total amount €648 million relates to Germany and Australia; €82 million relates to Australia and New Zealand; and €10 million relates to India. The impairment of goodwill is a non-cash charge and has no impact on our dividend policy.

Now, we look at our sequential revenue growth analysis. This slide shows the sequential growth adjusted for currencies, acquisitions, and trading days, for each quarter compared to the long-term trend. In this way, we show the sequential growth adjusted for seasonality. After outperforming the long-term trend in Q1 and being aligned with the trend in Q2, we underperformed in Q3, as several of our markets lost momentum.

As a result, we did not see an acceleration in the year-on-year growth in Q3, despite an easier base. This quarter, the majority of the regions were still in line with the long-term trends, but we underperformed in the Nordics, U.K. and Ireland and Germany & Austria.

Next, let's have a look at the year-on-year gross margin evolution. The group's gross margin was 19% in Q3 2015, up 60 basis points. Currency effects accounted for 20 basis points of the increase. Acquisitions had a positive effect of 10 basis points and the organic increase was 30 basis points. On an organic basis, temporary staffing had a positive 10 basis point impact on the gross margin, while permanent placement added 15 basis points, and other activities added 5 basis points.

Now, let me discuss our cost base development in the third quarter. As always, we monitor revenue developments closely and manage the cost base accordingly. SG&A, excluding one-offs, was up 2% organically compared to the prior year. This was mainly driven by a 2% increase in head count.

In Q3 2005, one-offs comprised €3 million integration cost in LHH related to the Knightsbridge acquisition. In Q3 2014, one-offs comprised €5 million restructuring cost for the headquarter consolidation in North America. Sequentially, our cost base was down 2% in constant currency and excluding one-offs in line with the normal seasonality.

Turning to the cash flow statement, in Q3 2015 cash flow from operation activities was €293 million compared to €268 million in Q3 2014. DSO in Q3 were 53 days, one day less than prior year in constant currency. This quarter, CapEx was €25 million and the group paid €95 million for treasury shares.

To-date, under our share buyback program of up to almost €250 million launched in November last year, we have acquired 2.6 million shares for a total consideration of €174 million. Net debt at the end of September 2015, decreased to €1.3 million compared to €1.4 million at the end of June. Our net debt to EBITDA ratio was at 1 at the end of Q3 2015.

As usual, we'll now give some financial guidance for your models. First the full-year 2015; corporate costs are expected to be around €125 million. Interest expenses, excluding interest income, are expected to be around €65 million. CapEx is expected to be around €90 million, and amortization of intangible assets is expected to be approximately €40 million.

For Q4, we anticipate an effective tax rate of approximately 28%. And in Q4, SG&A is expected to increase slightly compared to Q3 in constant currency and excluding one-offs, due to the seasonality of business.

And with that, I hand back to Alain for the outlook.

Alain Dehaze
Chief Executive Officer

Thank you, Hans. Let me now comment on our outlook. In the third quarter, revenue growth continued at a similar level to the second quarter. Revenue growth has accelerated in emerging market and Benelux, and remains strong in Southern Europe.

In our large markets, in Western Europe, the U.S.A. and Japan, revenue growth is still modest. Conditions in the Nordics and Switzerland continue to be challenging. In September, revenue growth for the group was similar to the third quarter in constant currency and adjusted for trading days and this trend continued in October.

As previously stated, reaching our EBITDA margin target of above 5.5% in 2015 dependent on an acceleration in revenue growth in the second half of the year. In H2 2015, our organic revenue growth continues to be steady, but is not accelerating sufficiently to achieve the EBITDA margin target.

Adecco will still deliver very strong profitability in 2015, with EBITDA margin excluding one-offs, expected to be approximately 5.2%. For 2016, economic conditions in Adecco major markets are foreseen to be similar to the 2015 ones.

Accordingly, the group anticipates the continuation of current organic revenue growth trend. With this revenue development, the 2016 EBITDA margin is anticipated to be similar to the EBITDA margin excluding one-offs now expected in 2015.

Adecco continues to be committed to price discipline, cost leadership, tight capital management and EVA. The management team is currently completing a review of the medium-term strategic priorities.

Further details on the evolution of these priorities will be provided at our Investor and Analyst Day to be held on January 18 in Zurich.

And now, I would like to open the line for questions.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] The first question comes from Mr. Paul Sullivan from Barclays. Please go ahead.

Paul D. Sullivan
Barclays Capital Securities Ltd.

Q

Yeah. Good morning, everybody. Just a couple from me. Firstly, can you provide some color on the moving parts in your margin guidance for next year between the gross margin and operating margin?

And are you signaling a need for investment in what you're saying, which dilutes the natural operating leverage of the business? That's the first question.

Alain Dehaze
Chief Executive Officer

A

Yes.

Paul D. Sullivan
Barclays Capital Securities Ltd.

Q

And then the second question, just coming back to the growth outlook in the U.S., do you think we're entering a period of potential contraction in the U.S. market? And do you think that's a reflection of just slower economic growth or is anything more sinister from a structural perspective that we should be aware of?

Alain Dehaze
Chief Executive Officer

A

I will take the second question on – I will start with the U.S. and I suggest Hans to take the first one. Regarding the U.S., yes, we had – first of all, we have to put that into context. We have, I would say, growth since now, 2010. it's almost five years of growth. I would say rather modest growth, low- to mid-single digit. We are not – actually we are not negative and we don't see the end of the cycle of North America, but going forward, we see a modest growth.

We see some segments going very well, especially, all the higher-skilled ones. We see weaker demand on the large customers, and we see some pockets of real decline, especially, in Office and all the companies which are involved in the oil and gas. The technology continue to have a strong growth, Pharma, healthcare also, overall, mid-single digit growth. So that's what I see today regarding the U.S.

Hans Ploos van Amstel
Chief Financial Officer **A**

Yes. And we should recognize that the U.S. performance was delivered on the back of a very strong second half of last year. To answer your first question on 2016, first, this is not our targets, but with all the changes, we felt it prudent to provide some guidance in view of market expectations.

So the EBITDA margin in 2016, similar for 2015, is underpinned by three things which we see at the moment. Obviously, we expect continued growth in 2016 at around that same level, and if that had a stable gross margin, that would add around 15 basis points year-over-year, if you assume a 50% dropdown ratio.

What we see also next year is that we lose 10 basis points from a drop out of favorable margin effects in 2015 in France. $10 million relates to the social security provisions, and in Germany, because of the timing of the bank holidays, which in Germany, we had a very favorable year this year, and that in the years to come, will go in a different direction.

As you have heard before, we are investing in an IT transformation, and that investment, we're still very early into that phase. We expect that that will negatively impact the margin. So if you summarize it, we are aiming to continue to grow the business in this guidance and hold on to a very strong margin.

Paul D. Sullivan
Barclays Capital Securities Ltd. **Q**

Great. Thank you very much.

Alain Dehaze
Chief Executive Officer **A**

Welcome.

Operator: The next question is from Mr. Toby Reeks from Morgan Stanley. Please go ahead.

Toby W. Reeks
Morgan Stanley & Co. International Plc **Q**

Hi, there. I've got a couple. Could you talk a little bit about the impairment charge in Germany and Austria of €648 million. Could you give us an indication of the growth rate that's changed in your calculation for that? And then also, I think at the full-year results in March, you gave the view that the regulatory environment would be unlikely to have a material impact on the business. Could you talk about how the CLA change has impacted and what you expect going forward?

And then the second question is around France. The French staffing data looks as though it's been improving on a monthly basis over the last quarter. Your organic growth is obviously below that. And if you look at your peers, it's been the same. Could you give us some context around that, please. And more specifically, around – I guess you talked about next year's margin being impacted by social security payments. But could you talk specifically about the CICE and any comments that you might have around conversations with customers, given that that could change in 2017 or 2016? Thank you.

Hans Ploos van Amstel
Chief Financial Officer

A

Shall we start with the impairment, because obviously that had a big impact and it's important we answer your questions there.

We performed a review of goodwill and that was triggered by the cumulative effect of recent and proposed regulatory changes in Germany, and what we learned from the Q3 results on the changes in the macro economic outlook in certain of the markets.

Based on these changes in conditions, we concluded that an impairment test was needed in the third quarter. As a result of the test, an impairment of goodwill was recognized in the third quarter. And a significant part of that was Germany, so let me start with explaining Germany.

We are now feeling the full effect of the changes in the regulatory environment related to the move toward equal pay, and proposed regulation would see the market continue to move in that direction.

From that perspective, we see Germany getting more in line with what we see in the balance of Europe, because in the past, Germany had benefits and we slowly see that normalizing.

The outlook for the German economy has become increasingly uncertain in the recent month, especially with the slowdown in China and the developments in the automotive sector. As you know, auto accounts for 30% of our German revenue.

The accumulation of these effects means we consider that a return towards the historical peak levels of profitability is no longer realistic. And then we're referring to the period before the financial crisis. So in the outer years at the most, there was still an assumption that we could recover to that high level of performance, that's no longer true. What we will continue to see in Germany is that it's a great market. It's a good market for us, and we'll deliver good margins.

It's not to the level of 2006-2007, but it is going to be a good level of profitability, and obviously, will continue drive the business for profitable growth, but we see an accumulation of significant changes in Germany and we saw in 2015, that we had to make that change.

If you look at Australia, we have a significant exposure to resources and industrial market, and the medium-term outlook here has been progressively reduced this year, given the ongoing fall in commodity prices and the slowdown in China.

We have a new management team there I think since 1.5 years, and because of that, haven't made the progress we probably would have hoped, and we obviously had a review of that business and concluded we need to make structural changes. We are obviously in dialogue with management to do that, but if you look at the absolute level of profitability, that required us to make the impairment. And those are explaining the key parts. Is that answering your question?

Toby W. Reeks
Morgan Stanley & Co. International Plc

Q

Yes it is. I mean I don't know whether you'd go further and actually give us the change in your sort of DCS model that you're using to calculate the goodwill, i.e., has the growth rate – is it just the margin changing or is it the growth rate changing in Germany that's made you downgrade – sorry.

Hans Ploos van Amstel
Chief Financial Officer

A

It's both.

Toby W. Reeks
Morgan Stanley & Co. International Plc

Q

Okay.

Hans Ploos van Amstel
Chief Financial Officer

A

It's both. It's, I think there is no back to the future or – and if you are seeing the German results, which we delivered the last five years, and we now added all up, that business was performing at a structurally higher level before the financial crisis. You go through the crisis, you recover, and at some stage, you conclude that the accumulation of facts has to make it reset the expectations of that business. But again, it's still going to be a good level of profitability, and it will put us on track to the margins we want to deliver.

Toby W. Reeks
Morgan Stanley & Co. International Plc

Q

Okay, great. And then, on France, please?

Alain Dehaze
Chief Executive Officer

A

Yes, on France, first of all, I would like to put France into the context. We have always said that France would be the last country to recover. And somehow, that's what we see in the figures. France turned positive during – starting from Q2 and then Q3. Yes, the Q3 we had a revenue growth of 1%, which is essentially in line with Q2. In fact, Q2 was just above 1.5%, so it was rounded up, and Q3 was just below 1.5% and it has been rounded down.

For us, we continue to maintain our pricing discipline, even if we observe that in the market, some of our competitors are passing through subsidies. And we see also some industry sectors developing very well. Automotive and logistics, we have good growth there. Manufacturing growth has turned positive, and it is still construction which is negative, but we see the rates of year-on-year decline continuing to ease.

And regarding the further top line, July minus 1%; August plus 2%, September plus 3%; and October, we expect at least plus 3%. And this has resulted in a very strong and leading profitability on the French market, 7.3%; so we are really leading there at 70 basis point. In fact, we had also a release of a provision relating to prior period regarding social [staff] with 7%, we are really the leading profitability over there.

Regarding your question on regulation, we see absolutely no change on the CICE. There will be two new events on regulations, first the so-called complementary health insurance for all the temps starting from the January 1, 2016. This will have an impact – negative impact of 40 basis points on our gross margin, and this will be partially offset a little bit later on the April 1 by a further benefit from the increase of tax – tax rebate for workers, the so called [indiscernible] subsidy. So we will have there, three months period difference, that's what I see. And again, I don't see for 2016 any change for this CICE. This will continue at the current rate going forward to 2016.

Toby W. Reeks
Morgan Stanley & Co. International Plc

Q

Okay. That's great. Thanks very much, guys.

Alain Dehaze
Chief Executive Officer

A

Next question.

Operator: The next question is from Mr. Nicholas de la Grense from Merrill Lynch. Please go ahead.

Nicholas E. de la Grense
Bank of America Merrill Lynch

Q

Morning, guys. Two questions please. And just first one with regard to the 2016 guidance. I can understand why you felt the need to explain the margin dynamics going into next year, given the one-offs and potentially higher investment. I'm just wondering, why did you feel it was necessary to give organic growth guidance as well? Because it's quite unusual at this stage to do that, given the level of visibility you have or rather don't have in the business.

And then the second question is in terms of the lack of an acceleration in growth in Q3 despite the easier comps, you're obviously underperforming in a couple of the big markets. Is it fair to assume that the focus on hitting the margin target this year perhaps means you've been a bit too aggressive in terms of pricing, or rather not being willing to negotiate on prices where competitors are?

And then I guess a follow-on to that, the message today is quite different from the one that you had in August when it was about accelerating growth and H2 potentially being good enough to hit the margin target. I mean it doesn't strike me that so much has changed in terms of the macro since then, so if you could just elaborate a bit more on the kind of the about-face in guidance, that would be helpful. Thanks.

Hans Ploos van Amstel
Chief Financial Officer

A

Yeah. Let me start with answering the first question. We looked at the market expectations and we also looked at the changes we see this year and we wanted to make sure we're not giving unrealistic expectations. Given we're in the cyclical business and these are no targets and we'll also have – that wasn't the point. The point was to make sure we set the expectations given what we saw in the market.

We believe that at this stage, continuation of what we see today is, is it first good expectation and on the margin, same thing we explained already, why we want to set that expectation. As said, we're still in the progress of finalizing the plans which we will present on January 18, including, of how we wanted to put a relative performance framework around the company, but first we wanted to reset the expectations.

If you look at the results of Q3, we indeed saw what you just said, is that we didn't see an acceleration of growth, we saw a continuation of growth. And that came on the back indeed of an easier comparison base, and that's why the expectation was there to accelerate against it, and we'll continue it.

What we have been seeing, if look across the markets, that's again a continuation of growth, but you see within the U.S., on the back of the strong growth of last year, it's a little slower. So it doesn't continue at that pace. We see good momentum in France. We see the U.K. isn't doing as well. And then in Germany, if you look at Q3, and you exclude the tariff increase, our business is essentially stable.

So if you look at the current results, the economy is that different paces. You see Southern Europe still into that growth momentum, but we see the core large markets of Europe, be it the U.K., Germany, the U.S. and Japan, which represents around two-thirds of our business, there you see still positive, but a slower and low growth. And therefore we see the continuation and it's comes on the back of – and that's why we're cautious and that's why we gave the guidance we gave.

Alain Dehaze
Chief Executive Officer

A

And on your second question Nicholas, when I look at the figures and I look at the figures of the peers, we are at the same level of one, and yet a little bit behind on the other one, that for sure we are leading in profitability.

Now about your question, did we under-invested in the business, yes, for sure. This ambitious target supported strong focus on cost control. But as you know, this is appropriate in a business such as ours, with low margins and predictable cycle. It is a cyclical business and somehow it is a volatile business.

Now going forward, you should absolutely expect us to still focus on our productivity, that's very important, the efficiency, but also the flexibility of our cost base. And we remain committed to our EVA approach of price discipline, cost leadership and tight capital management.

Now, at the same time and looking forward, the revenue growth in the next 10 years will not come from riding the economic and legislative wave in the way that this industry did the last 10 years. So we will need to invest in our business to support sustainable growth, especially in the segment we want to, Professional Staffing, Perm placement, but I would say Adecco as the global leader in this industry is better placed than nobody to do so, and especially given our leading market position in General Staffing and in Professional Staffing, given our scale and our footprint.

Nicholas E. de la Grense
Bank of America Merrill Lynch

Q

Thanks. And just a very quick follow on to that. So it sounds like a bit more investment needs to go in. How does that sit with the kind of 50% incremental conversion rate guidance or benchmark or whatever we would have worked with, in the past? Is that no longer valid or is it valid that there might be additional costs next year that offsets the number?

Hans Ploos van Amstel
Chief Financial Officer

A

I think on next year, we gave – while we have that conversion or dropdown ratio, that there are two impacts in the margin. That's why next year is stable. Going forward, I think if you look at on longer-term basis, I am still new to the business and I look forward to meet you all then when we have the Investor Day. I have experienced in different industries, fast moving consumer goods, retail, and worked in private companies and private equity. We have continued opportunities to grow on the broad base. There are opportunities in any business in margin while we make the investments, the guidance we now give for next year because of what happens in IT, France and

Germany, that we do to 5.2%, but fundamentally we still will focus on growth and converting that growth into an EBITDA margin, like this business has done successfully in the past.

Nicholas E. de la Grense
Bank of America Merrill Lynch

Q

And sorry to push it, but is 50% the right ICR to be thinking about in that context or is it a lower number going forward?

Alain Dehaze
Chief Executive Officer

A

Yes. We have said in the Q2 announcement that's normal. What – and this 50% is an average value, but we said, always in the first year of recovery, you have a ratio of 60% dropdown ratio, but in the second year of recovery, you are more in the range of 40%.

Nicholas E. de la Grense
Bank of America Merrill Lynch

Q

Okay, so the previous ICR guidance or methodology is still valid?

Alain Dehaze
Chief Executive Officer

A

Yes, it is still valid.

Nicholas E. de la Grense
Bank of America Merrill Lynch

Q

Okay. Thank you very much.

Alain Dehaze
Chief Executive Officer

A

Next question, please?

Operator: The next question is from Mr. Konrad Zomer from ABN AMRO. Please go ahead.

Konrad Zomer
ABN AMRO Bank NV (Broker)

Q

Hi. Good morning, gentlemen. My first question is on your dividend policy. You stated, it doesn't change because of the impairment. But I was just wondering if you can reiterate previous statements from the management team, that even in a down year, you would still expect the absolute level of dividend to be at least flat? Because if 2016 was to turn into a down year for you, can you confirm that your intention today is to keep dividend at least at the 2015 level?

And my second question is on M&A. I think that Adecco has had a very good policy in terms of M&A in the last few years. But do you think that, that could possibly change now that the organic growth forecast for next year looks less optimistic than it might have been in some people's minds?

And my third and last question is to come back on what Nicholas also touched upon is that, I think if you look at the macroeconomic outlook for Western Europe and U.S., then it still looks reasonably good, and certainly not worse than what it looked at, let's say, the half-year stage.

So I just want to check again, the 4% growth that you guide us to for next year, is that really something you just want us to like – you just want to reset the level of expectations? But that means that it could possibly change again on January 18? I just struggled to see why you've put out an organic growth forecast for next year in a business with earnings visibility of maybe four weeks to six weeks?

Alain Dehaze
Chief Executive Officer

A

Okay. I'll take the first question, and Hans will take the third one. Regarding the dividend policy, we have confirmed already today that, this impairment charge will not have any impact on our dividend policy, and what is our dividend policy that we – I stated also in the Q2 result announcement is that, we were willing to pay at least at a minimum amount of the previous year, so in this case, CHF2.1.

Now, going forward that is what we want to do, and yes I confirm, we want to speak to this policy in good and less good time. Then on the second question, M&A, good policy. Somehow also I repeat what I said in the Q2 results announcement, no acquisition in the Staffing segment till 2016, at least. And if we see opportunities in relatively small bolt-on acquisition, for sure, we will look at it, and for sure, no transformation acquisition. And I can just reiterate, what I said three months ago.

Hans Ploos van Amstel
Chief Financial Officer

A

On your question on the guidance, one, it's not an organic growth forecast, it's the current expectation based on the current economic outlook. And we see the world as you see it; it is a continuation of about a stable economy, modestly growing economy, but not an acceleration.

We're guiding a view of the growth expectations we saw and the market expectations, because they had current levels which were above that, and we see a continuation based on the current expectation, which is based on the current economic outlook.

Konrad Zomer
ABN AMRO Bank NV (Broker)

Q

Okay. Thank you.

Alain Dehaze
Chief Executive Officer

A

Next question?

Operator: The next question is from Mr. Chris Gallagher from JPMorgan. Your line is open.

Chris C. Gallagher
JPMorgan Securities Plc

Q

Good morning. A couple of questions. One is on the margin in the coming quarter. I know you get a benefit in Germany, so can we talk about why the increase you're guiding to is relatively limited versus previous quarters?

And then the second question, it's just around restructuring, obviously, you've taken an impairment today. Is there likely to be any further restructuring of businesses that will actually have cash costs? Thank you.

Hans Ploos van Amstel
Chief Financial Officer

A

Okay. Let me start with the last question. We, at this stage, have no plan of a restructuring or we would announce that; we obviously go and look at an ongoing basis our business opportunities and we'll take this as they come. But we don't foresee anything as we speak today.

Q4 2014 had a strong base in U.S. and France, and if we look what happened in Q3 and our outlook for Q4, we see we have been consistently in Q3 delivering against that 4%, and our margin progressed to 40 basis points more than last year, we see consistently, and when we look at our outlook for Q4 and the year, we feel confident that, based on what we know today. But that will continue, but not more than that.

Chris C. Gallagher
JPMorgan Securities Plc

Q

Okay. And maybe one final one. Just when you talk about M&A, obviously, given the impairments today, how does that fill you with confidence that you cannot destroy value doing M&A? And second of all, what's the focus geographically or by discipline? Thank you.

Alain Dehaze
Chief Executive Officer

A

So the impairment charge we have been taking today regarding the acquisition are mainly about acquisitions done in Germany in the years 2006 and 2007, that's point one. Second, you see that we have been quite very successful in the last years with acquisition in the Solutions and the Outplacement business. So it will not prevent us to do no more acquisition in the future, because of this impairment.

Now regarding, let's say the focus areas, you will understand that for competitive reason, we cannot open everything, but once more, I repeat what I've just said, it will not be in the staffing activities 2016 at least and it should be, let's say, relatively small bolt-on acquisition in the Professional Staffing segment or Solution business, if any.

Chris C. Gallagher
JPMorgan Securities Plc

Q

Okay. Thank you.

Alain Dehaze
Chief Executive Officer

A

Next question, please?

Operator: The next question is from Mr. Andy Grobler from Credit Suisse. Please go ahead.

Andy C. Grobler
Credit Suisse Securities (Europe) Ltd.

Q

Hi, good morning. Just three from me, if I may. Firstly, you mentioned autos in Germany and expectations that, that would be weaker. Have you seen that change come through already, or is that just your expectation that, given what's going on, there must be a change at some stage?

Secondly, again on Germany, could you give a bit more detail about the proposed regulatory changes that you expect rather than just the ones that have been in place for the last couple of years?

And then thirdly, on the Professionals business, that's still not growing. What are the reasons behind that? At this stage in the cycle, wouldn't you expect a bit more growth coming out of that business? And do you think that after several years of very limited growth in Professionals, that that whole operation needs to be looked at in a bit more detail? Thank you very much.

Hans Ploos van Amstel
Chief Financial Officer A

Starting quickly with the automotive, and if you look at in Germany across the markets, we still have seen growth in automotive both in Germany and across our markets. But the sequential growth is coming down, and that is not only in Germany, that is something we see across the markets.

It's very hard to predict what's happening at the moment in automotive. But we have seen it, the sequential growth is coming down, and we're obviously all looking at what will happen, but it's not as clear yet, but it remains uncertain.

Alain Dehaze
Chief Executive Officer A

Then your second question was about regulation development in Germany. Let's say, first of all, there was a price increase – a tariff increase what it says, tariff increase – on June 1, 2016, but I would say, can be normal business. But it has margin pressure for us.

Now what we are currently discussing, and even today, they are negotiating about that, is different new regulation. First is about clarifying the proposed trend 18 months, 24 months limitation of employment duration. And what we have heard also is that, eventually they would put some new criteria for what they call the arbeitsuberlastung, meaning outsourcing. This would also potentially have a negative impact on our activity.

But we have to wait the results of the negotiation, this should not have material impact on the short-term also for 2016, but we have to observe how is it developing. For sure also, this equal pay – and I know that equal pay is not something new for Germany, but the equal pay is now taking full impact in 2015 with the last relief period that they had in this regulation.

Now, regarding Professional Staffing or activities in Professional Staffing are the biggest in the U.S. and in UK in North America, we see very good development in Finance, Medical & Science. You have seen also IT 3% improving, but we have a weak activity on Engineering and Technical, minus 9%. I would say Oil & Gas is also very – has also a very negative impact there.

The second country was very important sales for us and activity and Professional Staffing is UK. And there we are clearly underperforming, we have just changed the leadership, and we have now to give time, some time to the new leadership and his team to work on that.

We had also in the Perm business, some exit of excellent billers in the previous quarter, but for sure, one of our top priorities for Hans and myself is to drive successful Professional Staffing business.

Andy C. Grobler
Credit Suisse Securities (Europe) Ltd.

Q

Okay, thank you. Just a couple of follow-ups. On the automotive you noted that one – that's hard to predict. What are the assumptions, given you've done an impairment charge? You must have some assumptions going in to your expectations around autos in Germany, because it's such a large part of that market. What are you assuming? Do you think it gets worse from here, or not?

Hans Ploos van Amstel
Chief Financial Officer

A

We have looks at the German business. It's hard to get obviously that specific. What we have done on Germany is, in view of what we know today is re-balance the levels of go-to-margin. And again they work in the outer years predicting some higher levels of growth because of what that business used to deliver in 2006, 2007.

I think we expect modest growth in Germany by continuously proving our mix of clients and businesses and we expect that – because that's impairments we do on a longer front. I hope that the Germans continue to sell cars. They are going to probably next two years go through a rough ride.

What that impacts to us on the next two years and that Germany gets in a recession, we get – that I'm not taking into account. We looked at it, the trend line; because an impairment test you do on a longer horizon and I assume a longer horizon basis that's the German business. We'll go back to the performance. On the short-term what it does, that's for us a crystal ball.

Andy C. Grobler
Credit Suisse Securities (Europe) Ltd.

Q

Okay. And just on the Professionals, you mentions IT growth...

Alain Dehaze
Chief Executive Officer

A

Because of the constraints of the time, I would like to leave the floor also to some others, if possible. If there are still other people willing to ask question. I'm sorry.

Andy C. Grobler
Credit Suisse Securities (Europe) Ltd.

Q

Okay.

Alain Dehaze
Chief Executive Officer

A

Yes. Are there other people willing to ask questions? We've got two minutes left.

Operator: Okay. The last quarter is from Mr. Tom Sykes from Deutsche Bank. Please go ahead.

Tom R. Sykes
Deutsche Bank AG (Broker UK)

Q

Yeah. Good morning, everybody. Thank you very much. Just quickly running through questions, could you maybe outline the incremental level of IT investment both through the P&L, and to be capitalized, that you're seeing next year, please?

Could you also say, just in reference to your comment about outsourcing and the criteria in Germany, are you saying there are some structures you think may not be compliant in Germany under future proposed legislation? Or could you just clarify what you actually mean there, please?

And then please, could you just give an outlook for U.S. Industrial, and what the benefit of statutory non-wage costs has been, things like SUI and workers' comp please?

Hans Ploos van Amstel
Chief Financial Officer
A

Shall I start with quickly, IT? I think we gave the guidance that we expect to lose about 10 bps in additional IT cost for extra expenses, which will flow through the P&L. If we look what we have capitalized on the new IT, we're very early; you talk less than €100 million, that's still a very small part. And obviously, it's part of a strategic planning and we'll come back to in January 18 to give more color. But you will see that has an impact to the extent we have disclosed.

Tom R. Sykes
Deutsche Bank AG (Broker UK)
Q

Okay. Thank you.

Alain Dehaze
Chief Executive Officer
A

Now regarding Germany, as I was saying, the negotiation are really ongoing. I think today there is a day of negotiation. So it's very difficult to make a strong statement about the criteria and so on, but as an example one the criteria would be to apply the equal pay in the – also in the outsourcing business. So in this Arbeitnehmerüberlassungsgesetz. So this will have or could have potentially an impact on the competitiveness of such a solution. But again, everything is in negotiation. We will see how it will come, and at this stage it's too premature to give you more clarity.

Now your question on U.S. Industrial regulation, I would suggest that David come back to you, because due to the time it is now 12 o'clock. We have the next people waiting for us, but David will come back to you with more precision on that.

Tom R. Sykes
Deutsche Bank AG (Broker UK)
Q

Okay. Thank you.

Alain Dehaze
Chief Executive Officer

And with this I would like to close the call. Thank you for your presence. Thank you for your interest. Also Hans and myself hope to meet you in Zürich on January 18, and even perhaps before doing a road show the next two weeks. Thank you.

Operator: Ladies and gentlemen, the conference is now over. Thank you for choosing Chorus Call and thank you for participating in the conference. You may now disconnect your lines. Goodbye.