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Q1 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, good morning. Welcome to the Q1 Results 2018 Analyst Conference Call. I'm Mirona, 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. Nicholas de la Grense, 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.

Nicholas de la Grense
Head of Investor Relations, Adecco Group AG

Good morning, and welcome to Adecco Group's Q1 2018 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 take a look at the disclaimer regarding forward-looking statements in this presentation.

Let me give you a quick summary of today's agenda. Alain will first briefly present the highlights of the quarter. Hans will take over to review the financial performance and comment on the outlook. Alain will then discuss our strategic and operational progress and initiatives. We'll then open the lines for your questions. And with that, Alain, I hand over to you.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

Thank you, Nick, And good morning, ladies and gentlemen. Welcome to our first quarter 2018 results investor call.

I will immediately start with the slide on the key highlights. In the first quarter, our positive revenue momentum has continued with growth of 6% organically and trading days adjusted. To be noted is that in France, the growth improved to 10% and we closed the gap to the market as we committed to last year, also another very solid performance in permanent recruitment with 18% growth. Gross margin was 18.1%, down 60 basis points organically impacted by several non-underlying items such as the timing of bank holidays, the higher sickness rates and strikes in Germany, and the lower CICE subsidies in France.

EBITA margin excluding one-offs was 3.8%, down 100 basis points due to the lower gross margin as I just mentioned, but also investments in [ph] staff (00:02:39) recruiters and strategic investments in digital and IT which had a 25 basis point impact. It is important to note that the margin trends will improve from the second quarter, as bank holiday timing is favorable, the year-on-year impact of investments reduces, and/or productivity improves.

We are on the right track with our investments in the innovation and the transformation agenda. We made good progress with GrowTogether which is transforming the way we interact with our customers to create more value at a lower cost-to-serve, and GrowTogether will deliver the first €50 million productivity savings in 2018. And we strengthened our Solutions portfolio with the acquisitions of General Assembly two weeks ago and Vettery in February.

And with this, I hand over to Hans for more insight on the financial performance.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

Thanks, Alain. We will now discuss the financial performance in more detail. Starting with our revenue growth. The underlying growth continued at 6%. We're pleased with the strong growth in France. We closed the gap to the market and improved the mix. And in Italy and Spain, we saw good growth momentum.

In North America General Staffing, we're seeing the first improvements coming from the new segmentation approach. On the other hand, we had slower growth in the U.K. following the strong double-digit growth in Q1 of last year. Professional Staffing in North America was stable and the U.K. results were down. The Brexit uncertainty remains.

In Germany, our General Staffing results are impacted by the merger of our Adecco and Tuja branch. The integration will strengthen our business to become a strong number two. It is impacting the performance in the short term. Our German Professional Staffing and permanent recruiting continued to perform well. And in Switzerland, we also delivered solid gold into the quarter. And let's say its market share growth continues to be strong, revenue is down reflecting the counter-cyclical nature of the career transition business.

Turning to the EBITA margin, down 100 basis points in total which included many elements. So it's important we go through all the details. First, we had a negative 35 basis points impact from the timing of bank holidays and the unusual level of sickness and strikes in the first quarter.

The CICE reduction had a 15 basis point impact. Pricing and mix had a negative 10 basis point impact. This leaves the 40 basis points reduction in the EBITA margin coming from higher cost. This is explained by, first, we continued to make the right investments and grow together IT technology and the digital ventures, which had a 25 basis point impact in Q1. This is in line with our guidance. The strategic investments will start to improve the profitability in the second half of this year. We will deliver the first GrowTogether benefits in the second half. The remainder 15-basis-point margin reduction comes from lower productivity in the first quarter.

Looking at the productivity in the first quarter, we had a challenging comparison base. Recall, in Q1 of 2017, we delivered 6% growth with only a 1% increase in head count. Needless to say, we expect to improve the productivity. Driving strong underlying operating leverage is a key pillar of our Perform agenda. Therefore, we remain very focused on driving the productivity to get the right balance between the performance (sic) [Perform] (00:06:54) and the Transform agenda.

Remember that the investments we're making today will drive productivity starting in the second half of this year. On the short term, implementing new systems and digital solutions has impacted our productivity in Q1. The investment will deliver higher profitability in the second half of 2018.

Looking at the profitability at the country level, we're pleased with the underlying performance in France. The head count investments delivered strong growth with a good gross margin. The EBITA margin was impacted by the CICE and the investments in IT and new digital solutions. In North America, UK General Staffing, we're building the foundation for profitable growth. This requires investments in capabilities at new-frontend, client-facing tools to support the segmentation strategy. This impacted the margin into the quarter.

The Germany integration started. Half the margin decline comes from the less favorable bank holidays into the first quarter. The balance comes from the impact of higher sickness rates and strikes, lower growth and double running cost during the integration. As you have seen, we took a €19 million restructuring charge mostly related to the Germany integration. This reflects the consolidation of the branch network and moving activities into the shared service center. Both will improve our profitability going forward.

Benelux and Nordics was impacted by the bank holidays and client mix. The mix will improve in the quarters to come. We delivered strong profitable growth in Italy and Spain. Japan had a good quarter of profitable growth while we're investing in new IT technology.

Let's now look at gross margin. Reported gross margin is down 70 basis points. Acquisitions and divestitures had a positive impact of 10 basis points. Currency had a negative 20 basis point impact. This leaves a 60 basis point organic decline. Permanent recruiting had a 20 basis point positive impact. This is offset by the lower LHH mix of 20 basis points. This means a 60 basis point reduction in temporary staffing gross margin.

25 basis points is due to less favorable timings of bank holidays, which had a significant impact in Germany and other regions where we operate the [ph] bank's mobile (00:10:01). 10 basis points is due to higher sickness rates in the Benelux and Germany, and the strikes in Germany. While this was in line with market, the impact was unusually high in Q1. CICE had a negative 15 basis points impact. So, all together, this leaves a net 10 basis points on pricing and mix. In summary, the underlying gross margin trend actually improved slightly.

On SG&A, it's good to recap the key message. SG&A increase 8% organically year-on-year. Half the increase comes from the 4% head count increase to support the growth. 2% of the 8% increase is explained by the strategic investments we're making in IT technology, GrowTogether, and the digital agenda. The balance comes from wage rates inflation, higher bonus payments related to our prominent recruiting results, and costs associated to the GDPR initiative.

Cash flow, first quarter cash flow conversion was 75%. DSO were 53 days versus 51 days last year. The Easter timing and the growth mix impacted the average receivables. Timings of tax payments also impacted the first quarter cash flow.

Turning to the outlook. The exit rate is 5% to 6%. Timing of bank holidays will have a positive impact of around 15 basis points in Q2 versus last year, and we're on track to deliver the €50 million GrowTogether benefits in the second half of this year.

Back to Alain to talk about our strategic and operational progress.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

Thank you, Hans. Indeed, let's now look at our strategic and operational progress during Q1. First, an update on GrowTogether, which is at the heart of our transformation agenda. We made good progress in the quarter with the rollout of our new Integrated Front-Office tools. During the first quarter, we continue to deploy the InFO or the Integrated Front-Office platform, which integrates seamlessly with new customer-facing portals.

In France, all candidate mobile application is now used by one-third of our associates, and we expect half to be using it by year-end. So, more online interactions and more efficient sales and recruiting processes will help drive consultant productivity and also improve the customer experience, which we measure with the Net Promoter Score.

Another example is middle and back-office process optimization. The time capture to cash collection process is being fully digitized. In the Netherlands, for example, this process will be completed by the end of 2018. This increases efficiency and reduces errors which should also help DSO. During the quarter, we also continued building our portfolio of digital solutions with two acquisitions: Vettery, about which we talked at our Q4 results; and General Assembly, which I would like to present to you now.

The world in which we live today is shaped by an acceleration of technological rate change impacted by megatrends such as automation, artificial intelligence, and digitalization. It is already impacting our clients, who tell us that there is not enough supply of talent with the right digital skills. And disruption will also mean that at the global level, as many as 375 million workers will need to reskill and transition to new roles by 2030.

General Assembly was founded in 2011 to solve the skills gap, providing training in high demands; digital skills like coding, data science, design and marketing. General Assembly or GA is no ordinary education provider. It is specifically focused on bridging the gap between education and employment. GA works with thousands of hiring partners to develop courses that deliver the skill they need most. The result is excellent; excellent outcomes for both students and for very satisfied enterprise clients, with a high NPS. And GA has been highly successful. In 2017, the company achieved revenues of $100 million, with 30% compound growth over three years, and another strong year of growth is anticipated in 2018. GA Solutions span both B2C and B2B segments, delivering training at its 20 global campuses at enterprise client sites, online and also via blended model. Its origins are in B2C but the strongest growth potential is in B2B where GA has developed highly innovative solution for enterprises, for example, helping them to source and train new talent with its Talent Pipeline as a Service model and also to assess and upskill existing employees.

GA's focus on education to employment makes it a strong strategic fit with the Adecco Group. There is strong demand from our clients for upskilling and reskilling solutions, something we discussed at the market – the Capital Markets Day last year. And our clients are actively looking for partners to help overcome talent scarcity. In terms of specific revenue synergies, GE or GA will clearly enhance the value proposition of Lee Hecht Harrison. Career transition is evolving into workforce transformation. Working with General Assembly, LHH will have a unique value proposition.

In Professional Staffing and Solutions, all brands will have access to high demand talent with potential to leverage General Assembly's Talent Pipeline as a Service model, to create pools of highly skilled candidates to be deployed with clients. The General Assembly team also recognized the value to be part of the Adecco Group. GA will leverage our more than 100,000 enterprise client relationships and we have already identified many opportunities. Access to our global infrastructure, data and comprehensive labor market knowledge will also further accelerate GA's developments.

Finally, the acquisition of General Assembly fits well with our criteria for merger and acquisition. General Assembly operates in a fast-growing market with attractive profitability and is adjacent to the services we currently offer. It is a natural fit with our existing solutions and allow us to leverage multiple workforce megatrends. It allows for the realization of significant revenue synergies. And with a very strong growth and margin potential, we expect the acquisition to be EVA positive by 2021 with very significant further value in the subsequent years.

Coming now to the concluding messages, in Q1, we saw a continuation of the positive revenue trends of 2017, which also continues into Q2 with growth of 5%, 6% in March and April organically and adjusted for trading days. We closed the gap to the market in our largest country, France, and we have a clear strategy to improve the performance in General Staffing in the U.S. and Germany where we are making steady progress. We continue to invest in the transformation and digitalization of the group. In our Transform agenda, GrowTogether is gaining momentum on its way to deliver €50 million productivity savings this year and €250 million in 2020. And our Innovate agenda was strengthened with the acquisition of General Assembly, which will be a key differentiator for the Adecco Group.

In the last 12 months, we have established businesses in a number of high-growth. high-value adjacent markets including online staffing with Adia and this co-created with Infosys. In the freelance business with YOSS, co-created with Microsoft but also in the digital permanent recruitment with Vettery and now in the upskilling and reskilling with General Assembly. With these ventures, we are aiming to build high margin businesses of skill within the group to complement our core operations. On the Perform side, we expect the margin trend to improve in Q2 and the second half as one-offs reduce and we start to get the productivity payback from all strategic investments.

To finish, I would like to thank our more than 34,000 worldwide colleagues for their commitment and engagement and I thank you for your presence, your attention. And now, I would like to open the line for the questions.

QUESTION AND ANSWER SECTION

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

Paul Sullivan
Analyst, Barclays Capital Securities Ltd.

Q

Yeah. Good morning everybody. Just a couple of related questions on margins trends. It looks like – I mean SG&A was clearly higher than expected in the first quarter. So, what's the conclusion from that? Are you running a little bit behind schedule in terms of the cost and benefits from the various different programs and how much visibility do you have on second half improvement? And maybe trying to look at that slightly differently, in terms of that organic growth rate in SG&A going forward, how should we expect that 8% in Q1 to involve into Q2 and the second half? And then just finally to wrap that all up and to cut to the chase, the markets are expecting broadly flat adjusted operating profit margins for the full year on the base of mid-single digit organic revenue growth. Do you still feel that is viable? Thank you.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

Thanks. I'll – as I'll open to the questions, so let me give it in different slices. First, give you some more color on Q1, then give you where we see it going into the second half and how we will position Q2. I think first, we're in the midst of a transformation and what we are continuing to do is make the right investments to strengthen the future of the business. We're making good investments in IT GrowTogether and the digital financials and we're really excited about that.

What we have been doing well in 2017 is offsetting the investments with operating leverage and that continues to be our goal. It is true that we did not do that in Q1. And I think there are a couple of reasons. One, the comparison base is strong. We delivered very high level of productivity in Q1 of last year, 6% revenue growth with 1% FTE growth. We're implementing new systems and new solutions for our people in the branches that has impacted the productivity as well. And we saw also Germany were in the midst of the integration. So, there are a couple of things into the quarters. As I said in my introduction, we expect to do better. Our goal is to improve the productivity and the margins. So, there are two things which are important in that. One, if you look at the second half, the good news is that the investments we're making will deliver the returns in the second half. The first GrowTogether benefits will be delivered in the second half. And what that means, there will be €50 million of true productivity coming through the bottom line into the second half of next year, and that will come on top of the normal productivity and operating levels. So, we will expect the margin to improve into the second half.

So, in Q2, we want to do better because we think Q1 had also [ph] lot of problems (00:24:21). Now, we're still in the investment phase in Q2. We will expect SG&A to be up a little less than that, plus 8%. But I think the key message is the comparison base. This is the first quarter [ph] in 2018 (00:24:37) but the operating level was not to the level of 2017 that we come back but I think the real message in the second half, GrowTogether will deliver benefits and we will come back to a normal level of productivity.

Paul Sullivan
Analyst, Barclays Capital Securities Ltd.

Q

And so you sort of alluded to second half margins up year-on-year. So do we infer from that the sort of [ph] full year (00:25:02) expectation of flat on the basis of current revenue trends is still feasible?

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

I cannot give you the margin outlook given the nature of our business because there's a lot going on. I think what I can give you as hard line is that we will deliver €50 million, which equates in the second half to 40 basis points of true productivity on top of the normal operating leverage. All the elements into the mix as well.

The CICE, the pricing environment is a little better in Q1, but that's where I would let you make the outlook. But I think the solid line is that what we did not do in Q1, we will do into the second half plus the GrowTogether benefits.

Paul Sullivan
Analyst, Barclays Capital Securities Ltd.

Q

Okay. Great. Thanks, Hans. Cheers.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Thank you, Paul.

Operator: The next question comes from Tom Sykes from Deutsche Bank. Please go ahead, sir.

Tom Sykes
Analyst, Deutsche Bank AG

Q

Yeah. Good morning, everybody, and excuse my bad cold. But just you mentioned the other elements of the SG&A increase in Q1 building up to the 8%. And I just wondered whether you could go through some of those, please, because obviously as you mentioned, your FTEs are up by 4%, but the SG&A up by 8%. You mentioned GDPR. Could you maybe just breakdown what was – what staff costs were doing versus non-staff costs, please?

And then I've got some questions on the onsite business. You should be annualizing I think a lot of the onsite growth. So, that was clearly very fast in Q1 last year. But what I don't quite understand is that your branch network was said to be up 1% in Q1 and then up 4% in Q – sorry, 1% in Q4 and then up 4% in Q1. So, was there any delayed increase in SG&A in taking on some of those onsite clients at all, which would affect your conversion? And when I look at that onsite business in totality, is it above or below group level profitability at the moment, please?

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

I'll maybe start with the first question. So, SG&A was up 8%. As we said, half of that 4% was the head count increase, 2% out of the 8% were the strategic investments which was in line with the guidance which splits between GrowTogether IT and the digital ventures. The remaining 2% was wage rates inflation. The bonus payments for foreign business, which was up 18% and some initiatives like the GDPR. I think the wage rates inflation was around half, a good 1%. So, the personnel costs without all that – they would be up [ph] 5% behind the 4% (00:28:16).

Tom Sykes
Analyst, Deutsche Bank AG

Q

Okay. Thank you.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Now, on your question regarding the onsite business because there were several questions. So, first of all, we had a strong performance of the onsite, 31% growth in the first quarter. And this gross level is coming from, let's say, three growth drivers. First, migration; second, increase of share of wallet; and, third, winning new clients. What you see in our figure regarding the branch network is that we consider a new onsite as also a new, let's say, a new location. So, that's what you see in these figures. And that's why it is difficult to read exactly what is coming from outside, what is coming from the branch network reduction, and so on.

Now, regarding the second part of your question regarding the profitability, the onsite margin is above the average gross margin we have in the [ph] large (00:29:24). So, that's why it is so interesting for us to migrate. But it is below the group average.

Tom Sykes
Analyst, Deutsche Bank AG

Q

Okay. And if you look at your conversion and whether there are any setup costs and how the profitability is in the first, because there's obviously been quite a substantial amount of growth, I mean, I think you're up 20% in Q1 last year, so you must be up roughly 50% in the onsite business over the last two years in Q1, and that doesn't seem to have had a positive impact on your profitability, or at least it's difficult for us to disaggregate that from everything else that's going on. And it's the major driver for your sales growth and, say, of one-offs. And so, therefore, is that generating the profitability that is expected or rather maybe one-off costs in setting up the onsite and that onsite growth that are themselves going to fall away in the second half of this year, please?

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

It's good, because I think your question is driven by because of where we are on our cost. That's not coming from the onsite business. The onsite business continues to drive up in line with expectation. I think while the productivity was a little less than what we normally would expect. [ph] With the three things (00:30:49) we said we'd a very tough comparison based in Q1. We are implementing new front-end solutions in our branches as we speak as part of the Transform agenda but impacted our productivity. Germany, the integration of Adecco Tuja. In the U.S., we're building capabilities on the segmentation. So, those are more where between the normal conversion operating leverage [ph] we had (00:31:18) we are below where we want to expect. That's we're coming back to in Q2. So, for the second half, we will come back to the normal level of conversion productivity, plus the GrowTogether €50 million.

Tom Sykes
Analyst, Deutsche Bank AG

Q

Okay.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

That was the noise into the quarter. It was not related to the [ph] outside (00:31:34), yeah.

Tom Sykes
Analyst, Deutsche Bank AG

Q

Okay. Perfect. Thank you. And just one final question on Vettery, what are the revenue and profit expectations for full-year 2018, please?

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

At this stage, we don't have – we don't give a precise guidance. As you know, we have [ph] now started to expand (00:31:56) Vettery first in the U.S. They were first in nine cities in the U.S. We are expanding them. We will also start in UK. So, we are still at an early phase to provide guidance on this.

Tom Sykes
Analyst, Deutsche Bank AG

Q

So, would you be able to say what annualized run-rate of revenue it actually [ph] generate them is (00:32:21) €80 million that you spent on it? So, just wondering what kind of revenues that actually generates.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

I think we will – going forward, over time, provide more disclosure to all our [ph] digital (00:32:36) events. I think while you can be reassured of that we – as we had to cover them. We're on track to the targets we need to deliver to deliver the returns here, out of that investment. So, Vettery is the first thing we already did on the profitability, which they were very happy with. We integrated finance and the legal, which giving them immediate savings. So, on the integration, we leave them alone on the front end. But on the back end, we're making already the integration that is giving us savings already, and [ph] in the core you see the (00:33:09) management team thank us for doing it. So, that's good – they're pleased with where we're integrating and where they can go on and on. If I look at that [ph] broad (00:33:17) booklet is in line with the economics set when we bought the business to deliver the targets we committed.

Tom Sykes
Analyst, Deutsche Bank AG

Q

Okay, great. Thank you very much, indeed.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Thank you, Tom.

Operator: The next question comes from Alain Oberhuber from MainFirst. Please go ahead.

Alain-Sebastian Oberhuber
Analyst, MainFirst Schweiz AG

Q

Good morning, Alain and Hans.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Good morning.

Alain-Sebastian Oberhuber
Analyst, MainFirst Schweiz AG

Q

Just two questions from my side. First is regarding the investments. I mean you mentioned, all these investments. Is it also because the market is getting tougher, i.e., do you sense some price pressure in some of the markets? And the second question is more a housekeeping is regarding the tax rate, what we could expect for this year, and maybe also what we could expect from the DSO for the – given that it increased to 53 in Q1?

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Okay. Now, regarding the price pressure, I would say that in Q1, we saw the same pricing trends with large clients as in the previous quarters. As you know, this market remains a competitive market. But, yes, there was a slightly improved pricing environment in the small and medium segment. You have heard the figures Hans quoted. They are indeed, let's say, there is a slight improvement versus the previous quarter. But I would say that it is too early to call this a trend. And we see this price pressure release especially in a number of countries where you have already a talent scarcity.

Alain-Sebastian Oberhuber
Analyst, MainFirst Schweiz AG

Q

Okay.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

And what we also see from the investments, which is good that's why we're very confident on the benefits we will live in the second half, we get good traction on the tools we're holding out. An example of what we're doing in the digital space with the candidates in France at the moment is not only getting us higher productivity but also from the candidate engagements, the matching we can and I always say fill the order faster and better with these tools, which should give us good growth and is also good for long-term pricing. So, that's good.

On your point on the tax rate, in the quarter it came down, there were some discrete events to get the benefits from the U.S. tax rate. For the fiscal year, we expect the tax rate of around 27%. DSO was slightly up into the quarter. Timings played a little, but what's important for us is three things. I think there's always pressure from large customers, and with our continued focus on EVA in the branches, we'll make sure we're very disciplined on it because large customers, but what's very important is the quality of the receivables. So, sometimes, it's one day up if you have large customers because the quality of the receivable is the most important thing. We have no overdues. We really checked that out. So, it was a little higher, but I want you to be reassured that the oversight of the quality of the receivable remains. Q1 of last year was also a little bit low because it ranges between 51, 52, 53 days, so it's hard to give a precise answer, but Q1 was a little bit impact by Easter, so we hope to drive that down.

Alain-Sebastian Oberhuber
Analyst, MainFirst Schweiz AG

Q

Thank you very much.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

You're welcome, Alain.

Operator: The next question comes from Hans Pluijgers from Kepler Cheuvreux. Please go ahead.

Hans Pluijgers
Head of Research, Kepler Cheuvreux SA (Netherlands)

Q

Yes. Good morning, gentlemen. One question from my side left. Looking at the cost savings, the first measure you have been taken in Q1, you already indicated a big part related to Germany, but [ph] can you just give (00:37:22) somewhat more detail where, let's say, those savings or let's say those investments and the restocking charge have been spent on. So, what kind of savings are you also then looking for going forward? Is it mainly coming from – purely from back office EBIT or marketing? Could you give some indication. First of all, where do you spend it on and where do you, let's say, expect it will come from the savings side?

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

Yes. So, in Germany, we're doing two things. We are integrating the branch network. We have Adecco and Tuja. So, we're eliminating some of the overlap. And with that, we can also put the segmentation strategy better to work. So, that should give us growth going forward. The second thing we're doing is with the integration of Tuja. We're also moving activities into our shared service center of Adecco. Tuja was run relatively standalone, and now it's getting integrated at the front and the back. Therefore, they've a relatively large [indiscernible] (00:38:32) restructuring cost that will have a payout of around 24 months.

Germany is a little bit more expensive whether we get the savings first from the integration of the branch offices, the more effective and efficient branch network, and we'll get savings from the shared service center. But at the moment, we have a little bit double cost because while we're building up the capabilities in the shared service centers we have people that will fall off in Q3. So, we're in the midst of this integration. So, we're building up the capabilities. We will let that go. So, Q3 the margin in Germany will improve and I don't know whether Alain you want to give some color...

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

No.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

...because [indiscernible] (00:39:23) that how we integrate like Tuja, it strengthened the business because we now go to market with one connected commercial strategy under the Adecco Tuja [indiscernible] (00:39:34).

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Absolutely.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

Those were two businesses, and now it's one business also at the [indiscernible] (00:39:39).

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Since the May 1, we are operationally merged. So, there is always a legal process in Germany where you have to agree with the workers council and the unions about this merger process. This has been done and now technically operational since the 1st May we are working and acting as one company, Adecco, in Germany. And with all what we are doing putting the segmentation in place and merging the number six and the number seven, we are building the number two on the German market.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG
A

Yeah, and maybe...

Hans Pluijgers
Head of Research, Kepler Cheuvreux SA (Netherlands)
Q

Are those costs mainly now related to people or also, let's say, to lease – write-down on lease cost and on the brand name, or how should I see that?

Alain Dehaze
Chief Executive Officer, Adecco Group AG
A

No...

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG
A

No impact on the brand name. Its majority is people-related costs.

Alain Dehaze
Chief Executive Officer, Adecco Group AG
A

Yes.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG
A

Recall, when you do this, it's not always, you want to hear this, but when you make such transformation, you will really strengthen the business. But we need to also build new capabilities. So, the change is a little bit more than a net change because you are strengthening the commercial ability, you move things into the shared service center, but we will deliver better margin in Germany in Q3 because the first hard benefits from the cost savings will come. It's predominantly people-related costs. I think it's good while we're on Germany to emphasize that our professional business is doing well, and also in permanent recruiting, we're doing well. So, this is really zoom to Adecco Tuja, the balance of our business in Germany is delivering solid results.

Hans Pluijgers
Head of Research, Kepler Cheuvreux SA (Netherlands)
Q

And then also going forward it should mainly, let's assume that the savings will be people-related.

Alain Dehaze
Chief Executive Officer, Adecco Group AG
A

Yeah.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

Yes.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Yes.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

Yeah, better productivity and conversion rates were coming from Germany.

Hans Pluijgers
Head of Research, Kepler Cheuvreux SA (Netherlands)

Q

Okay.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

And you see that in the margin, we need to get the margin back.

Hans Pluijgers
Head of Research, Kepler Cheuvreux SA (Netherlands)

Q

Clear.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Good.

Operator: The next question comes from Konrad Zomer for ABN AMRO. Please go ahead, sir.

Konrad Zomer
Analyst, ABN AMRO Bank NV

Q

Hi, good morning. Two questions, please. The first one on the targeted €50 million of efficiency savings for the second half of this year, can you share with us how we are going to see those efficiencies coming through? I mean, how specific will you be in telling us where you achieved these savings?

And my second question is on the U.S., you mentioned in the press release that the growth in IT recruitment in the U.S. was negatively impacted by market developments. Can you share with us if that's particularly related to the West Coast or is that a nationwide decline?

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

I can start with the U.S. But yeah, what you see in the U.S. and in IT is that, yeah, you have the shift of technology, and shift of technology and sometimes and both shift of technology and shift of geography. One of the typical example is when you move from datacenter on-premise to cloud, you need other type of capability, so our customers are reducing their capabilities in typical datacenter experts and they are going to cloud. The question is, where do they go to cloud, not per se in the U.S. This is a typical example of technological inroad, and that's what we see in the U.S. It's not really a question of West Coast or East Coast. It is really a change in technology and in the needs of profile of talents.

Konrad Zomer
Analyst, ABN AMRO Bank NV
Q

Okay.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG
A

On delivering – Hans here – the targeted €50 million, I think the key line to watch is that the SG&A as percent of sales is coming down and that the conversion ratio goes up beyond the normal operating leverage so that you deliver €50 million [ph] revenue (00:44:13) savings on top of normal operating levels. That, I think, is the real line we will make very clear so that you see the results from the €50 million coming through the bottom line.

Now what do we do internally to make sure we realize that? Needless to say, we have a very targeted head count tracking by function, by country with GrowTogether, with a more customer-focused and candidate-focused metrics we're driving the productivity through the new tools we're bringing to the business. And with digitalization, we're bringing new front office solutions, we're setting clear productivity targets and are putting that into people's budget. So when we get new tools for digital timesheets, we know how much productivity, and we adjust the head count.

So we internally track it at that level of specificity, by function, by country. And then also becoming more customer-centric where we're driving down the indirect spend, yeah, any function which is not customer-facing that that gets optimized, but for you the outcome should be that you see €50 million real savings on top of normal operating levels. And we'll make sure that we report that, that you can really see we deliver better portability with it.

Konrad Zomer
Analyst, ABN AMRO Bank NV
Q

Okay. Thank you very much.

Alain Dehaze
Chief Executive Officer, Adecco Group AG
A

Thank you, Konrad.

Operator: The next question comes from George Gregory from Exane. Please go ahead, sir.

George Gregory
Analyst, Exane Ltd.
Q

Good morning. Could we possibly go back to the slide 8 where you showed the EBITA margin evolution for the quarter and you helpfully identified the various buckets? Could we just use that as a process of discussion for the duration of this year? Obviously, the non-underlying effects, you've explained on the sickness and bank holidays and we have guidance for the remainder of the year. The 25 basis points of underlying which is made up of CICE and base effects, how would you expect that to evolve for the duration of the year? And similarly on the final bucket, the minus 15 bps which you attributed to reduced productivity. How should we think about that for the duration of the year please? So, really it's the minus 25 bps organic underlying and the minus 15 bps, please.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

Yeah. Maybe I'll give some more color already for the second quarter. The bank holidays will be favorable in the second quarter by 15 basis points. So, that will be a positive. CICE, we expect to continue at that same level of around 15 basis points. What's not in here is but [indiscernible] (00:47:19). Currency we expect to continue also at the similar level of Q1 and M&A.

So, in pricing and mix, our goal is to hope that we can keep that momentum we're getting into Q1 and that would take the gross margin for Q2 down by around 20 basis points all inclusive.

If we look at SG&A, two things, in Q3/Q4 as we said we get back to normal productivity. The GrowTogether savings will come on top in Q2. We still have the effect of a very lean base and had very strong productivity also in Q2 of 2017. We're still in that investment base on the strategic initiatives. So, it's fair to assume SG&A will be slightly below the Q1 level organically, but we're still in Q2, a little bit in the investment base and then in Q3/Q4 we will really come back to the productivity. So that that minus 15 basis points should be a plus of GrowTogether and normal operating leverage. And we will show that with that transparency.

George Gregory
Analyst, Exane Ltd.

Q

Sorry. Just going back to the gross margin dynamics, the plus 10 bps net on M&A and FX, the M&A, is that Beeline or what's the plus 10 bps on M&A?

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

That is Vettery...

George Gregory
Analyst, Exane Ltd.

Q

Oh, it's Vettery.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

Sorry, Mullin – no, Mullin, sorry, I apologize, Vettery – it's Mullin.

George Gregory
Analyst, Exane Ltd.

Q

Okay.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

We bought Mullin last year which is in the LHH business. Sorry.

George Gregory
Analyst, Exane Ltd.

Q

Okay. And sorry, I understand the minus 25 bps on strategic initiatives, but the minus 15 bps, the other, would you expect that – it sounds like you expect a similar – a headwind perhaps not quite as big in Q2. What happens to that minus 15 bps as we go into the second half? The other...

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

When we go into the second half, that's become a positive again. So what you will see in the second half is that the operating leverage from the growth will be positive, plus €50 million of GrowTogether savings.

George Gregory
Analyst, Exane Ltd.

Q

Sorry, and on the very – the final, the third bucket, where you've suffered 15 basis points in the first quarter, the SG&A revenues, other...

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

Yeah.

George Gregory
Analyst, Exane Ltd.

Q

...that will be a positive in the second half?

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

Yes, because that was a little bit the outlier into the quarter, is that what we have been doing in the past and in the full year of 2017 is the minus 25 bps of investments we always offset with operating leverage, that we didn't do for the reasons we discussed in Q1. Our expectation in the second half is that we will do that, plus deliver the GrowTogether benefits.

George Gregory
Analyst, Exane Ltd.

Q

Very clear. Thank you.

Operator: The next question comes from Rajesh Kumar from HSBC. Please go ahead, sir.

Rajesh Kumar
Analyst, HSBC Bank Plc

Q

Hi. Good morning. Just on the productivity piece, could you give us some color on the difference between volume productivity and value productivity? I mean, I appreciate you're talking about revenue per head but if you are looking at it from the lens of placements per head or number of temp man hours manage per head. How is that shaping up? And do you see any difference in the rate of wage inflation your temps are getting versus your staff are getting?

And the second one is when you talk about 6% organic growth, that's a net figure of churn, but was there any difference in the growth churn levels or the duration of contracts temps have in the quarter compared to previous years?

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

So, on your question regarding the productivity, for sure we are measuring those and we are looking at both, because as we are in different businesses, we have different kind of metrics to measure this productivity. If you take the biggest business is the temporary staffing, for sure, we look at the gross profit per FTE, but for sure we look also at the number of temps per FTE to make sure we don't take into account especially in some countries where you have some inflation that we don't fool ourselves in the target due to the inflation. So, we look really at the temps per FTE. In the perm business, it will be different. In the perm business, it will be more on the gross profit per FTE. So, I think it gives you a color how we are doing it and how we exclude inflation from all metrics.

Now, to your second question, Hans will take this one.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

There is no real difference there. So, if you look at the underlying growth which continued at around 6%, it was very consistent with the investments from France delivering us good growth, good growth momentum [indiscernible] (00:53:15) in Southern Europe. Germany, we're going a little bit through the period because of the integration. We didn't see anything changing in that perspective.

As Alain said on the productivity, we have very targeted targets, which correct for inflation, but also take into account the investments we will make between small – the earlier question [indiscernible] (00:53:40) that goes to that level of granularity to make sure to really set a targeted productivity at the level you can manage the business.

Rajesh Kumar
Analyst, HSBC Bank Plc

Q

Thank you. Appreciate that. On the first answer, I understand the process that you do look at temp had and gross profit had for perm side. The question was, do you see any meaningful differences in that productivity measure compared to the nominal measures you discussed in the slides earlier?

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

No, if you look at our productivity in Q1, that's the question we saw a very tough comparison base, we are implementing some systems which impacted our productivity in Germany. That's not something – our productivity in the perm business continues to be good. So, it's for the reason we discussed.

Rajesh Kumar
Analyst, HSBC Bank Plc

Q

Thank you.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

And then the second half will improve as we said.

Nicholas de la Grense
Head of Investor Relations, Adecco Group AG

A

Good. Next question.

Operator: The next question is a follow-up question from Hans Pluijgers from Kepler Cheuvreux. Please go ahead, sir.

Hans Pluijgers
Head of Research, Kepler Cheuvreux SA (Netherlands)

Q

Yes. Good morning. Hans Pluijgers again. You mentioned that in H2, you will see the €50 million on top of the normalized operational leverage. Could you give us some feeling what you see as normalized operational leverage, let's say, with the current growth of between 5% to 6%? And you're talking about 2% to 3% OpEx [ph] growth (00:55:17) or can you give some feeling on that?

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

Yeah. I think I will take it back to our Investor Day, what we committed to. We in 2017 said we would offset the investments which are constant at 25 basis points with operating leverage. That we haven't done in Q1. Our goal is to do that in the second half so that the investments are not impacting the margin negatively, and then on top to improve the margin, the GrowTogether benefits will improve the margin structure by that 50 basis points. That's all things equal because the CICE [indiscernible] (00:56:00) all elements, but you will see it through improvement in the SG&A line.

Hans Pluijgers
Head of Research, Kepler Cheuvreux SA (Netherlands)

Q

Yeah. Okay. But, of course, that depends, of course, on which level of growth you're talking about. So, [indiscernible] (00:56:17), let's say, detailed feeling? Are you talking about, let's say, underlying growth in cost should be, let's say, half or less than half or more than half or, let's say, the current growth in top line, so the 5% to 6% or could you give some feeling on that because it all depends, of course, a little bit on the level of growth?

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Yes. So, we would see a 5% growth in operating leverage of around 20 – Hans?

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

20 basis points.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

20 basis points.

Hans Pluijgers
Head of Research, Kepler Cheuvreux SA (Netherlands)

Q

Okay. Thanks.

Nicholas de la Grense
Head of Investor Relations, Adecco Group AG

A

Good.

Operator: The next question comes from Andy Grobler from Credit Suisse. Please go ahead, sir.

Andy Grobler
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Hi. Good morning. Just one for me, if I may. One-off costs in the quarter were around €20 million. I guess we've had one-off costs most quarters for the past several years. I mean, what are your expectations for that line through the rest of this year and into next year, please?

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

Yes. Again, those you can only discuss because of regulation when you announce, like Germany, you have to go through the workers council. If we look what we announced in the Investor Day, we said to get to the total transformation program, we need around €200 million till over the next couple of years. I think that depends a little bit how positive the economy is because if we can reorganize on growth, we could do a little better. If you get to a period where the growth is tighter, you would probably need more restructuring, but we will stay within that €200 million. That includes that €19 million or €20 million we made into the quarter for the year I expect around €60 million, which includes already that €19 million for Q1.

Andy Grobler
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

So, €60 million for this year, and then, the remainder of €100-plus-million next year. Is that the right way to think about it?

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

Yes. Sorry, I wasn't maybe – €60 million for this year.

Andy Grobler
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Yeah.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

And then, the total of what we said in the Investor Day, we stayed within that amount.

Andy Grobler
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Okay. Thank you very much.

Nicholas de la Grense

Head of Investor Relations, Adecco Group AG

Good. With that, we'll draw the call to a close. Thank you very much, everyone, for joining in for your questions and we look forward to seeing some of you at the roadshow. And otherwise, we look forward to speaking with the rest of you on our Q2 [indiscernible] (00:58:51). Thanks very much.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

Thank you very much, guys.

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.