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Adecco Group AG (ADEN.CH)

Q4 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

Good morning, and welcome to Adecco Group's Fourth Quarter and Full Year 2018 Results Conference Call. I'm joined today by Alain Dehaze, Group CEO, and Hans Ploos van Amstel, Group CFO. As usual, before we begin, please review the disclaimer on page 2 regarding any forward-looking statements in this presentation.

Let me give you a quick overview 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, and we'll then open the lines for questions and answers.

So, with that Alain, I'll hand over to you.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

Thank you, Nick, and good morning, ladies and gentlemen. Welcome to fourth quarter and full year 2018 results investors call. I will start on the slide 5 with the key highlights. Looking first at the fourth quarter 2018, we see that operationally, we had a good quarter building on the momentum of the third quarter, especially [indiscernible] (00:01:03) continue to grow strongly, up 18% on top of the 18% growth achieved in the previous year. And underlying profitability further improved, or EBITA margin was at 20 basis points year-on-year with the positive impact of around 45 basis points coming from GrowTogether, positive pricing trend and the mix.

Nevertheless, the external environment became more challenging. Revenue growth slowed further in Q4 turning slightly negative at minus 1% on the trading days adjusted basis. Like in the third quarter, the slowdown was driven by Europe and in particular France, Germany and in Italy, all in line with the macroeconomic and market trends. Outside of Europe, we saw more positive trends particularly in U.S. General Staffing and Japan. But we [indiscernible] (00:02:04) of our business in Europe, the market slowdown there has a significant impact.

You will also see that we took a goodwill impairment in Germany in the fourth quarter. As you know, we are in the middle of the transformation of our German General Staffing business. The impact of new regulations and the market slowdown has made this process more challenging, and based on this, it was necessary to make the impairment. We have also announced changes to the leadership of the Northern Europe region. Mark De Smedt will leave the company, and I would like to thanking for his 15 years contributions. Christophe Catoir, Regional Head of France, will expand his responsibilities to Northern Europe.

For 2018, the Board of Directors will propose a stable dividend of CHF 2.50, which corresponds to a payout ratio of 48%. Recall we're committed to paying at least a stable dividend every year supported by the group's strong [indiscernible] (00:03:14) cycle cash flow generation.

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

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

Thanks, Alain. Let's now look at the financial performance in more detail, starting with the revenue. In the fourth quarter, revenues declined 1% organically and trading days adjusted, driven by a further slowdown in the European economy. We saw that trends continued in January, with revenues down 2%. The volume trend in February indicates a further but small deceleration.

Looking at the individual regions, the slowdown was very much market driven. Our growth was ahead or in line with the PS in most regions with the exceptions being Germany and the Benelux. In France, we remained ahead of the market confirming the strength of our strategy. In North America, UK, Ireland General Staffing, our revenues accelerated to 4% North America was up 6% driven by new client wins and strong seasonal demand. UK declined 1% reflecting generally soft market conditions. Remember also that last year, we benefited from new client wins delivering strong growth.

Professional Staffing in North America, UK, and Ireland declined 2%. Important to note here is that our U.S. retail business continues to perform well. The total results were held back by our IT enterprise business. The UK business was up 2%. In Germany, Austria and Switzerland, our revenues declined 9% which was driven by the decline in Germany. Austria and Switzerland delivered solid growth. There are number of changes impacting Germany. So we would like to explain this a bit further and why we took the goodwill impairment in Q4.

The new regulations that limits the temporary staffing maximum assignment duration at 18 month became effective in October of 2018. It meant that associates with a tenure longer than 18 months either need to be hired by the client directly or redeployed to other clients. As a result, we're seeing a high level of conversion to permanent employees and our customers. This is more than we had anticipated. We also see that redeployment is lower because of a mismatch in both skills and salary levels.

Lastly, we see [indiscernible] (00:05:57) rates increasing as the 18 months [indiscernible] (00:06:00), which impacts the bench costs. This means that the new regulation has relevant implications. We expect this to continue

for the remainder of 2019. On top of the regulatory changes, there is a structural slowdown in the automotive sector, which represents around 30% of our business. And the German economy continues to grow below the European average. Finally, we're in the middle of consolidating our General Staffing brands, Adecco and Tuja. So all in all, it's a challenging picture in Germany in the short term.

Looking at the other regions, we see that in the Benelux, growth slowed due to softer market conditions and reduced demand at a few large customers. Italy decelerated following a period of strong growth and our relative performance versus the market remained good. Japan continued to achieve great performance in both top and bottom line. Iberia slowed with the market trend. Lee Hecht Harrison, which is a countercyclical business, was down 1% in the quarter and continues to outperform peers and gain market share. And between other [indiscernible] (00:07:19) and General Assembly, multiple cost brands initiatives are on the way.

Turning to the EBITA margin, the margin was up 20 basis points in total. The benefits of our GrowTogether program combined with the favorable price [indiscernible] (00:07:37) underpins the underlying margin improvement. Looking at the margin in more detail, it shows that the investments in the new ventures had a 25 basis points impact. The German transformation also impacted the results by 20 basis points.

We had some non-recurring items in the fourth quarter which had a positive impact of 20 basis points including favorable year-end accruals and timing of bank holidays partly offset by the lower CICE in France. This leaves the true 45 basis point positive EBITA margin improvement in the balance of the business, as mentioned, driven by the GrowTogether productivity savings and the positive mix and pricing development.

Looking at the profitability at the country level. We saw continued strong profitability in France where the margin was up 110 basis points year-on-year. France is where we had most of the non-recurring items in Q4. This helped the margin by 70 basis points. This is more than offsetting the negative impact of CICE. It's a big impact because these reflect true-ups for the full year realized in the fourth quarter.

The largest piece related to a change in training fund contributions in Q4 which is not specific to Adecco that benefited the whole industry. This was worth 120 basis points in France and 30 basis points for the group. Adjusting for the positive non-recurring items, the underlying margin improved by 40 basis points in France even if we continue to invest. GrowTogether is driving excellent productivity growth, pricing contributed positively as well as business mix.

North America, UK, and Ireland General Staffing also delivered a very strong improvement in the profitability. The new front office platform and automated candidate outreach tools which are part of the GrowTogether program drove a significant increase in consultant productivity. Pricing and mix also contributed to the margin improvement. North America, UK, and Ireland professional staffing improved the margin by 2 basis points or 3 basis points benefiting from pricing and mix and the GrowTogether productivity improvements which are more than offsetting the investments in Vetterly. In Germany also and Switzerland, we had almost 50 basis points margin decline driven by Germany with a lower productivity, higher bench cost and the negatives from the new regulation are impacting the profitability. In Italy an improvement in the temporary staffing gross margin and strong growth in permanent recruiting resulted in almost 10 basis points margin increase. Lastly, the Career Transition & Talent Development margin was impacted by the consolidation of General Assembly, which is still in an investment phase. LHH maintained its strong margin leadership in career transition.

Let's now look at gross margin and SG&A, starting with the gross margin. The reported gross margin is up almost 20 basis points, M&A had a positive effect of 30 basis points driven by Vetterly and General Assembly, both are high value high gross margin businesses. Currency had a positive effect of 10 basis points as a result the organic

gross margin was up 80 basis points. Permanent recruiting had a 30 basis points positive impact, career transition and other changes had a combined negative 20 basis points impact. The temp gross margin increased 70 basis points. CCA had a negative 30 basis points impact. This was offset by the favorable [indiscernible] (00:11:58) of 60 basis points. Bank holiday timings had a positive 10 basis points impact. This leaves a 30 basis points positive impact from pricing and mix, conforming we continue to strengthen the temporary gross margin.

On the SG&A, organic cost growth was up 4%. Headcount was down 1% informing our strong productivity focus, the SG&A increase was driven by higher permanent recruiting commissions, the investments and impacts of less favorable accruals.

The organic conversion ratio continues to be very strong at 26.5% and is up 100 basis points year-on-year, even with the German situation. Turning to cash flow, the cash conversion was 84% improving from 78% last quarter.

Accounts receivables or days sales outstanding was 53 days, up one day year-on-year, but down a day versus last quarter. Net debt to EBITDA excluding one-offs was one times at the end of December compared to 1.1 times at the end of Q3. In line with our capital allocation policy with net debt to EBITDA at one times at year-end, there will be no additional cash return of both the ordinary dividend of CHF 2.5.

Turning to the outlook, revenues in January were down 2% organically and adjusted for trading days. Our volume growth in February suggests the further slight deterioration. As we said before we need to remember that we saw a very strong recovery in France and Southern Europe over the same period last year. We will continue to invest to strengthen our business to deliver sustained higher performance through the cycle.

Clearly it becomes more challenging to improve the margins in a more negative growth environment. So delivering growth to get a productivity saving savings becomes even more relevant. We delivered the first benefits in Q3 and Q4 already, improving both the customer value, improved net promoter score and reducing our cost to serve. Note that the New Ventures investments have a neutral year-on-year impact of the full year 2019 margin but will be dilutive in the first half as we did not have General Assembly and Vetterly into the numbers last year. With that I hand back to Alain to talk about our strategic and operational progress and give some concluding comments.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

Thank you Hans and before we move to Q&A I would like to provide two quick examples of how the Perform, Transform, and Innovate strategy is now supporting the results in practice.

The first example is North America General Staffing. Remember almost two years ago we said that the business was capable of delivering more growth, in a more sustainable way. We changed the management in Q2 2017 and begun to roll out the commercial strategy. Segmentation, customer and Candidate Portfolio Management, focus on perm and pricing. On the technology side we also during 2018 implemented a new advanced front office platform and rolled out an artificial intelligence chat bot at more than 100 large clients. By following a proven commercial proposes – processes and giving our people the right tools, it has add a clear positive impact positive impact on the performance in full year 2018. A return to revenue growth for the first time since 2015 productivity was up 6% organically, EBITDA margin improved 20 basis points even including the cost of investments and very importantly, we improved our clients NPS by 14 points, which is key for driving sustainable growth.

The second example is France; already we had a business with leading profitability and efficiency driven by strong execution of our commercial strategy. And to take it to the next level requires transformation and

innovation. The French team has focused on two key pillars, the one being growth and value and the second one being technology. The growth and value strategy means expanding outside of the core temporary staffing business expanding [indiscernible] (00:17:02) business or apprenticeship solution and [indiscernible] (00:17:07) all high volume and higher gross margin activities.

At the same time France is embracing technology to improve efficiency in the core business. The Adecco & Moi candidate app is now being used by more than 150,000 associates every month, a new client portal to allow customers to place orders is now functioning 24/7. Digitization of documents to reduce paper documents, I think have already saved €7 million cumulatively during 2017 and 2018. And the results are proving the success, revenue growth ahead of the market in 2018, perm growth at 20%, EBITDA margin was down 10 basis points for the full year 2018, almost fully offsetting the headwind from [ph] CICE (00:18:09) changes and strategic investments. As you can see, our strategy is starting to drive the financial performance and will support [ph] rapid (00:18:19) growth and margin improvement going forward, which is even more important in a challenging external environment.

Now, coming to the concluding messages. Looking back on 2018, there is a lot for our colleagues around the world to be proud of. Significant progress was made on the Perform, Transform, and Innovate strategic agenda. GrowTogether is moving out of the investment phase and has already delivered its first benefit in the second half and it will continue to support the results in 2019. On the innovate agenda, we are very excited with our complete portfolio, adding new value-added services for our customers. And in this context, I'm proud that General Assembly was recently announced as one of the top 10 most innovative companies in education for 2019 by Fast Company magazine.

On the Perform agenda, we continue to perform strongly and strengthened for business in France and the U.S., Germany is impacting the results in the short-term, but is an opportunity to improve the performance going forward. It is important for me to highlight that this progress is only possible because of the hard work and strong commitment of our colleagues around the world. So, I would like to thank them for making us both the global leader and also a great place to work.

And with this, I would kindly ask the operator to open the line for the questions.

QUESTION AND ANSWER SECTION

Operator: The first question from the phone comes from Paul Sullivan with Barclays. Please go ahead.

Paul Sullivan

Analyst, Barclays Capital Securities Ltd.

Yeah. Good morning, everybody.

Q

Alain Dehaze

Chief Executive Officer, Adecco Group AG

Good morning, Paul.

A

Paul Sullivan

Analyst, Barclays Capital Securities Ltd.

Just firstly – good morning. Are you prepared to put any numbers behind YOSS and Adia at the moment in terms of revenue contribution and losses? And in terms of General Assembly, it looks like that loss is running at about CHF 15 million a quarter. How should we see that moving through 2019? That's the first question on, sort of, the New Ventures.

Q

And then secondly, usual question about moving parts in terms of gross margin and any guidance on SG&A for at least Q1 or for the rest of the year? Thank you.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

Yes. Maybe I'll start. What we – we have the New Ventures and they are early in their development, but doing well. What we are committed to is that we stay within the 25 basis point investment into the New Ventures, and we will manage all the ventures along those lines. And a large part of that [ph] help (00:21:08) is in between General Assembly and Vetterly. I think what's more important – so, yes, we are making good progress on the General Assembly with [indiscernible] (00:21:19) the cross-selling is moving, the growth trajectory continues, but for us it's important, while we have these New Ventures that we stay within the commitment we set as the 25 basis points, and around 20 basis points of that is General Assembly and Vetterly. So those are a big part as you mentioned.

A

I think on your other question is the outlook; needless to say, we have some visibility, but I think to help you for Q1, we can give you some things and I want to give a little bit color to the year as well. Gross margin M&A will continue at the plus-30 basis points. Exchange rate, we expect at the same level as the fourth quarter, around 10 basis points. Bank holidays will be favorable by around 10 basis points as well in Q1. Then you have to make your usual assumptions for [indiscernible] (00:22:14) the perm business and our temporary gross margin, which was positive in Q4.

I think we are entering a positive period, I wouldn't take the Q4 and just extrapolate it. Without helping you too much, I can give you one tip, if you add this all up, sequentially you come to a little bit below Q4, so that's a good check, and you fill all the details that gross margin would be.

SG&A, sequentially we expect stable or slightly down. Remember, the M&A impacts are about plus 4% on SG&A, the exchange rates, which is a benefit, and gross margin goes the other way in the exchange rate, so that's around 1 percentage point from SG&A. I think that gives you some color on Q1 and as we said, the Vetterly and the [indiscernible] (00:23:07) New Ventures will be dilutive in the first half.

Our objective remains, needless to say, to improve our profitability for the year. We don't have a crystal ball on the sales, but we are delivering the first benefits of GrowTogether and are on track to deliver the commitments we laid out in the Investor Day, so that's the good news.

The digital ventures, as I said, the investments are staying within the commitment, and they are driving us good growth and then Germany right in the first half, we need to be cautious about while we make some improvement.

Paul Sullivan

Analyst, Barclays Capital Securities Ltd.

Q

Okay. Thanks. Just to be clear, and given the run rate of revenue decline going through the first quarter and down 1% to 2% to 3% is not inconsistent with margin improvement for the full-year given the savings.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

That is correct, but the disclaimer is obviously, Paul, I don't have a crystal ball.

Paul Sullivan

Analyst, Barclays Capital Securities Ltd.

Q

Yeah.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

But the first half, you could see more dilutive because of one, you see some contraction in Q1, you see Germany still being difficult because Germany became more difficult in the second half and that the digital ventures are now in full swing, which they weren't in Q1 or Q2 last year. And the positive one is GrowTogether, but you see that balance between first half, second half, but the prediction on the economy, needless to say, I can't give.

Paul Sullivan

Analyst, Barclays Capital Securities Ltd.

Q

And any revenues behind Adia and YOSS at the moment?

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

No, I think what we can say, and I apologize – I think for us it's important that we control our commitments in the margin structure, which we are, but we're pleased with the events if we look at Adia, and I don't know, Alain, whether you want to give some color. It's still small but good growth and some of the learnings we're reapplying in GrowTogether. So I don't think Adia is just a standalone thing. Some of the candidates' learnings we have reapplied in GrowTogether and I said GA and Vetterly continue to drive very strong growth momentum and also reactions and the like Vetterly, do you call it [ph] here (00:25:22) subscription model?

Alain Dehaze

Chief Executive Officer, Adecco Group AG

Yeah.

A

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

So, customer stickiness is very strong.

A

Paul Sullivan

Analyst, Barclays Capital Securities Ltd.

Great. Thank you very much.

Q

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

Thank you, Paul.

A

Operator: The next question from the phone comes from the line of Anvesh Agrawal with Morgan Stanley. Please go ahead.

Anvesh Agrawal

Analyst, Morgan Stanley & Co. International Plc

Hi, good morning. I just got two questions; first obviously, we have seen a change in trend in the price and mix of 30 basis point. I just wanted to check whether it has come at the cost of some growth or you have seen some broad based improvement into the market. And second on Germany, I mean, when I look at the impairment you have taken of €270 million, that is almost like 40% of the carrying amount of goodwill, which is quite significant. So just – just assuming the market conditions stay where they are, when can we expect some sort of improvement in the growth rate and how should we think about that?

Q

Alain Dehaze

Chief Executive Officer, Adecco Group AG

First, I can start with the Germany and explaining the three reasons behind the background of the impairment. The first one is the regulation and you have seen that since the 1st October, the maximum duration of [ph] stamping (00:26:27) has been limited to 18 months. We have explained that also in our call in our presentation. This had impact not only with us, but with the whole industry. So this is one structural, let's say, going forward, difference for the German market, which remains the biggest market in the world, very attractive, but it is clear that is the first change.

A

The second change, structural is also automotive, and every day you see that the new technology, and especially the electrification of this industry, is changing a lot. The manufacturing of electrified cars are requesting less labor force and this has long-term, an impact, on the country Germany, but also on our business as we have 30% of our business in the automotive sector.

And then the third reason is that near-term slowdown of the economy, the German economy, where we have seen that during the last seven quarters out of the last eight, the German economy has performed at a lower level than the average European. So, this is – this is explaining the German – German impairment beside the fact that

yes, we are integrating Tuja within Adecco. We would have loved to be further in this integration, but we are also facing some headwinds as I described the context in which we are in.

Anvesh Agrawal

Analyst, Morgan Stanley & Co. International Plc

Q

Before you move on to the next question, sorry, the thing is like, assuming there is no further acceleration of the macroeconomic environment and the automotive industry remains where it is, can we expect some sort of improvement in growth rate into the second half or not, versus what you're doing currently?

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

Yes. We said we will have – we will continue to have the drag on the first half, but it should start to improve in the second half.

Anvesh Agrawal

Analyst, Morgan Stanley & Co. International Plc

Q

Okay. Price and mix please, sir.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

Yeah. On the pricing, yes, we have been very happy to see the structural improvement coming from all the work we have done and we are doing – still doing with the pricing. For sure, the degree of sophistication in pricing management depends [ph] of (00:29:06) the country and maturity of organization. But it all started with the segmentation because when you do the segmentation then you can start to differentiate it, to differentiate your pricing according to the segment you are active, being small, medium, large or on-site. But then on top of that, we have developed tools that we have rolled out in the branches.. We have started also to leverage an big data in combination with analytics, allowing us to really have a dynamic pricing in some markets, where we have enough data to put that in place, meaning that the pricing is adapted to the current – let's say offer/demand situation, the timing of the demand because seasons plays an important role in our business and [ph] comment on (00:30:04).

Anvesh Agrawal

Analyst, Morgan Stanley & Co. International Plc

Q

Okay.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

Yeah, I think. So we saw that positive pricing and I think, if I look at the growth trajectory we delivered in Q4, we had a good growth trajectory in the slowing market. Again Germany was a little bit to stand out, as we said. So which is in a reformation that [indiscernible] (00:30:25) has its better pricing tools and I think a little bit of the candidates, market is helping here. So [ph] heavy (00:30:32) environment is obviously a little better, so that's good. And I think on the German impairments that Alain laid out, where we're at. We are going to improve it, but this year the margin in Germany is lower and is impacting the company margin. So we need to be recover and that relates to [indiscernible] (00:30:51).

Anvesh Agrawal

Analyst, Morgan Stanley & Co. International Plc

Q

Okay. Thank you, that's very clear.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

You're welcome.

A

Operator: The next question comes from Matthew Lloyd, HSBC. Please go ahead, sir.

Matthew Lloyd

Analyst, HSBC Bank Plc

Good morning, gentlemen. Well done on the gross margin, that's a nice thing to see. Couple of questions, just to get my head round it, how much of that is mix in terms of – I know you won't know a hard answer, but is some of that the industrial is worse than white collar and therefore there's a bit of lift in the temp gross margin from that. And then just a follow-up question, just with this sort of the new tools with the dynamic pricing, do you think that you've got a better grasp on pricing for scarce labor than you've had in recent years.

Q

Alain Dehaze

Chief Executive Officer, Adecco Group AG

Regarding the new tools, I would say definitely we are definitely more mature in pricing management. I would say that it has started with the segmentation because when you – you add your segmentation in place then you can also work out a better pricing policy according to the segment because you don't price in the same way in the small segment or as in the medium and large. And if you have not segmented your portfolio your cost to serve in advance, it's much more difficult to really fine-tune your pricing strategy. So, we did the segmentation in place we – we – and then we started to develop the tooling which for sure would continue to have positive impact on this. On the mix I will pass to Hans.

A

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

Yeah, no. The good news is that most of it is really driven by the pricing action plans. So there's some mixed in that which you always see because you also grow smaller medium but the majority is driven by what Alain said. I think we're much more precise on the pricing now. And I think that the market is helping, so I don't think – but within that market environment having these new tools is driving that positive development.

A

Matthew Lloyd

Analyst, HSBC Bank Plc

Ask one more question like all analysts would do. Have you addressed or thought about or changed any of the remuneration structures or KPIs along the lines with the segmentation. Is there a scope for sort of paying people to chase the money rather than the volume?

Q

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

One thing we have changed and strengthened is that we have a very good – in the old days it was – this is before we came here [indiscernible] (00:33:34) then people could compromise one over the other, because you let them make the table. So we have changed two things. One, we care about relative growth. We care about the margin structure and under these old, but let's never forget that the quality of [indiscernible] (00:33:52) was important. But we review all three, so we make sure people don't make the home tradeoff. What we also have improved which

A

we have introduced is we have ranks, scorecards, which we really deeply [ph] engaged in (00:34:07) which measures small, medium, large home sites so we can go to a level of granularity that we can know both on the pricing the growth that we are really making and that our people are making the right tradeoffs. And I think the key work here is always granularity and that everybody has and we review that quite rigorously. I think that tone is important so that people know to your point that that tradeoff isn't making the sustained right way to drive profitable growth.

Matthew Lloyd

Analyst, HSBC Bank Plc

Q

Thank you very much. And let's hope the European economy picks up.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

Thank you, Matthew.

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

Tom Sykes

Analyst, Deutsche Bank AG (UK)

Q

Yeah. Good morning, everybody. Just on the permanent revenue growth and then how that's related to the SG&A growth. You pick out the 1.5% extra from SG&A growth due to the high payout ratio in Perm. Can we just explain something that ratchets up sort of over the course of the year and as you hit targets in the discrete year or should we expect that the payout ratio is lower as a run rate on Perm now or if you did hit the same level of Perm revenues for argument's sake in Q1, would we expect to higher payout from Perm in Q1? And then just on the SG&A, what level of wage inflation do you expect to see for your own staff this year? And what's the view on head count growth please?

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

Okay. I would say on our own staff that the inflation is quite limited. You see what kind of inflation or associates – you have inflation just in some parts of the world, but I would say on four side wage inflation is also very limited. You have seen that in the fourth quarter, we had minus 1% on the SPE number and I would say the inflation is in the range of 1% to 2%.

Now to your second question is Perm, yeah, we had, first of all, we had strong performance, because you have to put the 18% growth of the Q4 2018 in relation with also 18% growth in the fourth quarter 2017. So, a very strong growth and this growth is also growth based, we had it in the U.S. really above, largely above 20% in Professional Staffing firm in the U.S. from 22%. So, it was really broad based and at such a level of performance, it is clear that you have to a payout – a payout on commission and bonus, which is – which is significant.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

Which makes [indiscernible] (00:37:27) to your question Q4 relatively higher, because it's a little bit because some people hire, if you have an annual bonus and you have a very strong Q4 to get a little bit of true up for the year.

Tom Sykes

Analyst, Deutsche Bank AG (UK)

Q

Okay. So are we expecting therefore, we should be – we should get a higher level of conversion as a perm at the beginning of the year? But also you know how sustainable is the 18% given that...

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

Yes.

Tom Sykes

Analyst, Deutsche Bank AG (UK)

Q

...you know we're obviously seeing some weakness elsewhere in France at plus 20% that it seems pretty high compared to negative temp growth.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

That's why, we are having certain visibility, I think that there are two different questions. One, is that because of the strength of the perm business in Q4, ahead of expectations we had true up in the SG&A, which is impacted Q4, which is Q4 only it won't have an impact there in Q1. Two, because every year you reset the clock, when it's specifically talked the Perm business,, but I think what we singled is that in Gen Staff, we saw some slowing, but I think we also need to realize that that is on the back with very strong recovery in Southern Europe and France over the same period last year.

Tom Sykes

Analyst, Deutsche Bank AG (UK)

Q

Okay. Thank you very much indeed.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

Thank you, Tom.

Operator: The next question comes from Michael Foeth from Vontobel. Please go ahead, sir.

Michael Foeth

Analyst, Vontobel

A

Yes. Hi gentlemen. Two questions from my side, first of all, these are the – those pricing tools, which help you in the mix and pricing, on the gross margin, in which areas or which regions do you – do you apply that and what's the scope of extending the advantage that you – that you've got from that further geographically. And the second question is the accruals which helped the gross margin by 60 basis points and how far is that a one-off or will any of that or such accruals recur in 2019?

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

No, I think the 60 basis points we call out as non-recurring are special for Q4. So, they won't have an impact next year. They relate to a number of things. The normal year end things for the year got true up in Q4. We had the

impact of the French training fund, which was a one-time impact, which is about half of this 60 basis points. But they are called out for the reasons that they are [indiscernible] (00:40:11) so that they are having a positive impact.

And as we said the reason why we do it so you understand how that impacts the margin, but is not [indiscernible] (00:40:21) underlying performance was stronger with that 45 basis points, but this is just one-time element.

On the pricing tools, we have rolled those out with our initiatives in the larger markets, markets like [indiscernible] (00:40:36), markets like U.S. were more into that because these analytics were the best in the bigger markets first and we have [ph] pilots (00:40:46) in there. And then the [ph] scarcity (00:40:49) let's not forget the market is helping as well. The tools are coming in combination with the markets. And I think that's important to mention.

Michael Foeth

Analyst, Vontobel

Okay. Thank you.

Q

Alain Dehaze

Chief Executive Officer, Adecco Group AG

Thank you, Michael.

A

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

Konrad Zomer

Analyst, ABN AMRO Bank NV

Hi. Good morning. I have two questions on Germany, please. The first one is that you reported an operating loss in the fourth quarter and I was wondering is that because the slowdown maybe particularly in automotives developed a bit quicker than you anticipated or are you keeping a lot of your FTE on board to benefit from an expected recovery this year.

Q

And my second question is the integration of Adecco and Tuja has been going on for the best part of two years now. And I understand that you have lots of different things happening at the same time in Germany, but I would have thought that to integrate those two businesses could actually benefit from a market slowdown and not lead to a further delay. So I'm slightly puzzled why you would not be able to integrate those businesses a bit quicker probably at the expense of more FTE?

Alain Dehaze

Chief Executive Officer, Adecco Group AG

Regarding the integration of Adecco and Tuja, the official dates and the legal date on which we have operationally started the integration was on May – 1st of May 2018, so it's two years but it's about little bit than seven, eight month in the meantime. I think this is important to acknowledge.

A

Looking at this integration, I would say yes we would have loved and we would love to go faster and be in accelerated way that unfortunately – and this explain also the second part of your question, we are also in an external context which is not the easiest. You have [indiscernible] (00:43:08) you had the slowdown of the German economy. Second, you have the auto which is transforming itself. But besides the transformation, we recall all this emission-control mechanism reinforced which has blocked the manufacturing. You have also the trade war impact and so on. And for us it's 30% of our business, so it's a major important one.

And the third one, which explain this decrease of activity not only at [indiscernible] (00:43:52) is that the impact of the new legislation. Yes, I would say a large part of [indiscernible] (00:44:05) were taken over by all customers. Some of them we were able to redeploy. But that we have two issues. We had the sickness rates of people coming to the 18 months rising and it means for us more cost. And second, we had also profile of people with capabilities with skills and salary level that we were not able to replay. So that's why we had this impact. And for sure, I can assure you the turnaround is a clear priority for us and not only for us, but also for me and I will take direct oversight on Germany.

Konrad Zomer

Analyst, ABN AMRO Bank NV

Q

Right. But maybe I didn't ask the question in the right way, because if the German market would have been great, you would have had a much bigger discussion with maybe the unions to integrate two successful companies into one, because it will undoubtedly lead to lower FTE. Now that the market is quite difficult, I would have thought that to integrate those two businesses would be slightly easier.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

Yeah, I think that's a good question. I think that two points which made it a little bit more complex. One, I think we have to accept that [indiscernible] (00:45:37) acquisition which it's been with Adecco for a longer period. And I think the cultural differences between the original management, I would say, and the company and Adecco [indiscernible] (00:45:50) so we lost a little bit more [indiscernible] (00:45:54) because of the connectivity. I think that's now behind us. With that, we lost some business.

I think the second thing which is making it a little bit more painful is that we have the new regulation coming on top, which is quite complex to implement that Alain gave some reasons for that. So while you change all these changes and then the new regulation came, a little bit difficult. And I think it's a good and the bad news story. The bad news story is that it is impacting our margins negatively by 20 basis points in the year-on-year comparison which confirms that the balance of the business is performing strongly. And now as Alain said [indiscernible] (00:46:38) the regulation is now clear, we have integrated Adecco [indiscernible] (00:46:45) which makes us [indiscernible] (00:46:47) from a market position is point number two.

And now we need to diversify away from automotive, put the commercial strategies in place which are working across all the other businesses because that wasn't done at Tuja in the past that's why we [indiscernible] (00:47:02) on automotive. So you could draw a conclusion, it's all a little later than you hope. Yeah, that's I think...

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

Clear.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

...clear, and we all can agree to, but [indiscernible] (00:47:13) direct oversight applying the new recipes which we do in the other markets. We will make the progress in you all would like to see.

Konrad Zomer

Analyst, ABN AMRO Bank NV

Q

Okay. Thank you very much indeed.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

You're welcome.

Operator: The next question comes from Kean Marden with Jefferies. Your line is now open. Please go ahead.

Kean Marden
Analyst, Jefferies International Ltd.

Q

Morning all. Can I come back to I think the comment that you made earlier that you'd seen slowdown in perm growth in January and early February, so is that correct, Alain? And if so, if you could share, what the degree of the moderation has been. And the second question, just if you can provide us with a bit of background, please, on the €16 million software impairment. So I recall a couple of years ago that, obviously, there was a substantial write-down of some legacy IT platforms. Just wondering, what that relates to. Thank you.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

Yes. Let me take those two questions. Starting with the latter. Yes, we have made it relatively modest, but it's still a relevant demand, some software impairments of legacy software, while we are accelerating on the growth together new initiatives. When we came, we did some impairments of software and we had hoped certain tools, we could maybe still use but we identified now with our new suppliers much better – much productive tools and it's a small price to pay to get to the new role. So that's one.

Then I made the comment about the slowdown on January, Feb, I might have confused you, I did not talk about the perm business. I told that in the total business, we saw a slowdown. We saw a little bit of a slowdown in the perm as well, but I think the key message we wanted to flag that while we enter into the quarter that we saw overall [indiscernible] (00:49:06) because we're customers still into the month of February that the business has slowed a little but given what we saw last year, we can almost stand that.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

And everything is taking place in the context where we had a very strong first half, and let's not forget also on the perm side.

Kean Marden
Analyst, Jefferies International Ltd.

Q

Okay. Thank you very much.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

You're welcome.

Operator: The next question from the phone comes from Simona Sarli with Bank of America. Please go ahead.

Simona Sarli

Analyst, Bank of America Merrill Lynch

Q

Yes. Good morning, gentlemen. Just a very quick follow-up in terms of pricing dynamics, apart from the benefit that you saw from the implementation of your pricing tools, can you maybe comment on what you're seeing on a country-by-country basis and how much of this pricing improvement is being driven by wage inflation? Thanks.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

So starting with the wage inflation, we see wage inflation first of all where there is real scarcity of candidates and those low unemployment figures. So if we speak about countries like the U.S., Germany, and Japan, [indiscernible] (00:50:26) in the range of 2% to 4% and then in the other countries, we have a kind of low single digit inflation rates over the border, I'd say, across all the markets.

Now regarding the pricing, I think it's not only a question of tools, it's also a question as I said segmentation and the governance. We have also hired in some market pricing manager to make sure that not only the tools were deployed but also that there was governance, discipline, reporting on this with the result you have seen. We don't provide specific guidance by country but out of the segment reporting, you can see how it develops.

Simona Sarli

Analyst, Bank of America Merrill Lynch

Q

Okay. Thanks.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

You're welcome, Simona.

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

George Gregory

Analyst, Exane BNP Paribas

Q

Good morning, everyone. Apologies I got briefly [indiscernible] (00:51:36) this one's already been dealt with. But just going back to Germany, I was hoping to get a bit more color on the impact of the regulations specifically what proportion of your temp base have a tenure of longer than 18 months in Germany and roughly what proportion of those are currently converting to perm, please? Thanks.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

Yes. So around 10% is impacted by the regulation of the business on that longer assignment temp, and some business, we lost about half of that is also linked to this temp to perm. So you have like if you take Germany, we lost 14% business, about half we say is linked to the regulation, 10% of our people is in that temp, and of that half, half is temp to perm. So there companies took our temps and made them permanent [indiscernible] (00:52:42).

George Gregory

Analyst, Exane BNP Paribas

Q

Okay. Thank you.

Nicholas de la Grense

Head of Investor Relations, Adecco Group AG

Okay. As there are no further questions, thank you everyone for dialing in today and asking your questions. We look forward to meeting many of you during the road show over the next few days, and after that with the Q1 results in May. Thank you very much. Bye.

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