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Adecco Group AG (ADEN.CH)

Q3 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, welcome to the Q3 Results 2019 analyst call and live webcast. I am Sandra, 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. The presentation will be followed by 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 Nicholas de la Grense, Head of Investor Relations. Please go ahead, sir.

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

Good morning and welcome to the Adecco Group's Q3 2019 Results Conference Call. As usual, today I'm joined by Alain Dehaze, Group CEO; and Hans Ploos van Amstel, Group CFO. Before we begin, please review the disclaimer regarding forward-looking statements on page 2.

Coming to todays' agenda. First, Alain will briefly discuss the highlights of the quarter. Hans will then review our financial performance, after which Alain will describe some of the progress being made on our transformation and innovation agenda. We'll then open the lines for Q&A.

And with that, I hand over to Alain.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

Thank you, Nick, and good morning, ladies and gentlemen. Welcome to our third quarter results investor call. Before I begin with the key highlights from the quarter, let me first give a few comments on the divestment of Soliant Health which we announced this morning. As you know, we actively manage our portfolio to ensure optimal capital allocation, regularly evaluating whether we are the best owner of each business in the Adecco Group. In the last two years, we divested Beeline and also increased capital deployed to new ventures. This morning we announced that we have entered into an agreement to sell our US healthcare staffing business, Soliant for around €550 million, which is approximately 11.5 time the last months – the last 12 months EBITDA. We believe this represents good value for our shareholders. It is also consistent with our portfolio strategy to focus on our brand that can be deployed globally and where we can create separate value for clients and candidates by leveraging our ecosystem.

We expect the Soliant transaction to close by the first quarter 2020 and we will provide an update on the use of proceeds with the full year results at the end of February in line with our capital allocation policy which remains unchanged. Now coming back to the third quarter with the key highlights. The third quarter demonstrated a solid performance in an uncertain environment. While revenue growth moderated slightly to minus 4% trading days adjusted, we continue to drive gross margin improvement with gross profits stable organically year-on-year.

Our focus on value-based pricing and delivering more value to our customers through digital tools and solutions is having a positive impact, also helped by talent scarcity. EBITDA margin excluding one-off was down 10 basis points year-on-year, showing that we managed to offset almost all of the impact of the lower revenue growth and the continued transformation investments.

On Transform, we made excellent progress with the GrowTogether program which helps deliver another good productivity performance in the third quarter. We have confidence that we will deliver the €250 million productivity target in 2020, driving structural improvement in the margin and the customer value proposition. And we also confirmed that the service excellence [indiscernible] (00:04:25) of GrowTogether is having a positive impact with improvement in both for client and associate Net Promoter Score.

On our Innovate agenda, we are pleased with positive results we have seen at General Assembly this quarter with organic growth of 31% year-on-year, and the collaboration between Lee Hecht Harrison and General Assembly stepped up with further client wins and many more opportunities in the pipeline confirming the strengths of the combined value proposition. So, you can really see the Perform, Transform, Innovate strategy is delivering a solid performance in Q3.

Now, I will hand over to Hans to take you through the financial performance in more detail.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

Thanks, Alain. Let's start with the revenue. Revenue was down 4% on the trading days adjusted basis. This is slightly below the 3% decline we saw in the second quarter and reflects slow economic growth in most regions, despite the easier comparison base and improvement in Europe did not materialize. Europe was minus 6%, down 1 percentage points from previous quarter, which was driven by France and UK. The other European countries are starting to stabilize, but the overall trend remains soft, especially in the automotive and manufacturing sectors. In North America, we saw a slowdown to minus 6%, driven by a slowdown in the general staffing market. Japan remains strong and in the rest of world, we had lower growth in Australia.

Looking at the country revenue results in more detail on slide 9, France's growth slowed versus the second quarter as the market slowed. We're slightly behind the market, but remember that in Q3 of last year, we were strongly outperforming. While revenues were down in France, we grew our gross profit confirming that we're improving the quality of the mix as we continue to focus on higher value services.

In North America and UK General Staffing, revenues were down 5%. UK is very much Brexit-related. In North America, the decline is driven by the market slowdown, and in particular, by a high exposure towards the manufacturing sector. In North America and UK Professional Staffing, the trend was in line with the previous quarter.

Our IT and legal businesses remain under pressure. We have talked about what we're doing. They have to improve the performance in [indiscernible] (00:07:16). We're making progress with the turnarounds and should expect to see a gradual improvement in the quarters to come. On the other hand, we had continued good growth in finance and office, engineering, and healthcare. In the UK, we saw slight decline modestly outperforming the market, again the Brexit uncertainty is not helping the UK.

In Germany, Austria, and Switzerland, the decline was in line with the market. Germany continues to be a very tough market impacted by a slowdown in automotive and by the regulatory changes that were introduced in Q4 of last year. We're seeing an improvement in the trends in Benelux and Nordics. Italy was down 6% in the slowing market, remember that we were growing at 6% in Q3 of last year. The normal quarter of good performance in Japan, growing market share supported by a strong margin, Professional Staffing including the Modis VSN business growing double-digits.

Iberia at plus 6% also had a strong quarter outperforming the market. In the Rest of World, the slowdown is mostly driven by Australia, where we made the decision to exit some low margin business. Career Transition & Talent Development saw a strong acceleration in growth. First, Lee Hecht Harrison is back to growth at 5%. Second, General Assembly is now included in the organic growth rate and delivered 31% growth in the quarter.

Turning to the gross margin. The reported gross margin increased by 70 basis points. Currency had a positive 10 basis point impact, the organic gross margin was up 60 basis points. Temporary staffing contributed 40 basis points, driven by a value-based pricing and proactively shifting the mix. Permanent recruiting had a positive 10 basis point impact, the growth in Career Transition added another 10 basis points in gross margin.

Let's now look at the EBITA margin. The margin, excluding one-offs, was down 10 basis points. Our productivity benefits were offset by the sales decline and the investments in IT technology. The revenue slowdown impacted the productivity. We're taking the appropriate measures to correct this. In Q3, we had less benefits from GrowTogether with the benefits being more skewed to the first half of 2019, as we have mentioned in previous calls. We're also investing in Q3 with the implementation of a new integrated home office solutions and rolling out the candidate apps to North America and Germany.

Looking at the profitability by country on slide 12, we will now provide some further perspective for the key markets. France margin strengthened further by 30 basis points to 6.8%. The improvement was driven by a combination of our value strategy, diversifying the business mix, and the benefits from GrowTogether. The North America and UK General Staffing margin declined by 70 basis points year-on-year in reported terms. The revenue slowdown impacted the productivity. We expect to recover some of that margin in Q4 with the actions taken.

In North America and UK Professional Staffing, the margin was down 20 basis points, mainly due to lower revenue. The EBITDA margin in Germany, Austria and Switzerland improved by 20 basis points confirming that our actions are paying off. The measures that we took to streamline the organization helps protect the profitability despite the negative revenue.

In the Benelux & Nordics, our margin improvement comes from the focus on higher value customer portfolio. In Italy, we are investing in IT and head count to further strengthen our market position. Finally, in Career Transition & Talent Development, the improvement is coming from reduced losses at General Assembly, confirming that the growth is improving the profitability.

Let's look at SG&A in more detail on slide 13. We broadly reduced the head count with revenue decline but need to recognize that the revenue shortfall impacted the productivity. We did increase the gross profit per FTE by 2% in the quarter as we continue to focus on improving the gross margin. SG&A growth was higher than the first half at 3% organically. This is driven primarily by higher IT investments, wage rates inflation, and some discrete items. We expect the SG&A growth to come back down in Q4.

Turning to the cash flow and balance sheet on slide 14, cash flow was strong in the quarter. Days of sales outstanding are down 1 day at 53 days. Net debt to EBITDA is 1.1 times confirming the strength of the balance sheet.

Coming to the outlook, revenues in September and October combined were down 4% trading days adjusted, showing a similar trend to Q3. GrowTogether is delivering the incremental €70 million benefits for 2019. We are on track to deliver the total €250 million GrowTogether target for 2020, meaning that we are delivering on our commitments.

And with this, I hand back to Alain for the update on the transformation and innovation.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

Thank you, Hans, and let's start indeed with transformation and more specifically our GrowTogether program. GrowTogether is about strengthening the value proposition to drive sustained profitable growth. It's about increasing productivity while also improving the quality of service we provide to our candidates and clients.

Let's have a look at what we have delivered across the three pillars of GrowTogether during the quarter. First pillar, the service excellence one, you will remember that we have put in place a systematic tracking for Net Promoter Score for all clients and candidates, and also activations plans to continuously improve our services based on the feedback we receive. We've just got the 2019 annual results, which confirmed an 8-point NPS increase for our clients and 4 points for the people we place into the jobs. NPS is not the outcome itself, but it offers an important insight into how we are doing with our customers, which is the key driver for our long-term success.

The second pillar is reengineering our work processes, and we continue to expand with our PERFORM method across the group with around now 10,000 colleagues being trained. We continue to get proof points that it reduces inefficiency and provides a strong foundation on which to deploy new technology.

Lastly, we made significant progress with our technology road map in the third quarter. We launched an enhanced version of integrated front-office solution in France and Spain, and this is the backbone of accelerated transformation in all branches in 2020 and beyond.

We also expanded the global candidate mobile app to the US and Germany, leveraging the experience from our market-leading tool in France. So, we are on track to deliver on our commitments with a strong foundation to accelerate transformation in the years to come.

Now, a quick update on progress on the final part of our strategic agenda, Innovate. We acquired General Assembly last year because we saw upskilling and reskilling as an important growth area and differentiator in the human resource solutions space.

We identified two clear opportunities to generate synergies with Modis and Lee Hecht Harrison. And we mentioned it on the last call that we had some first successes. I am pleased to say that the new business activity continued in Q3 with further wins resulting from the combined GA and LHH value proposition. We also expanded the Modis Academy concept with another class of recruits, reapplying our proven model from Modis VSN in Japan.

In General Assembly, organic expansion has also continued, 31% organic revenue growth in Q3, nine new markets opened in the last six months, very strong demand for its differentiated online immersive offerings and enterprise bookings up 50% in Q3. So, we are really pleased with the performance at GA and in particular with the collaboration with other group brands, leveraging the ecosystem to deliver for our clients and candidates.

Coming now to the concluding messages, the third quarter was a quarter of good execution and solid performance in a challenging market environment. We continue to invest in our digital transformation to fundamentally strengthen the business with GrowTogether, IT and our New Ventures. And our innovative and differentiated new business models continue to gain traction with clients.

As we look to the fourth quarter, we are continuing to build the next layer of the GrowTogether program with a focus on consultant tools and commercial solutions to deliver greater value to our clients and candidates. And we're on track to deliver the €250 million GrowTogether target for 2020.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] The first question comes from Paul Sullivan from Barclays. Please go ahead.

Paul Sullivan
Analyst, Barclays Capital Securities Ltd.

Q

Yeah. Morning, everybody. Just a few from me. Firstly on the disposal, do we – is it a clean – is the price you've given us today, is that a clean price? Should we get any leakage from tax or anything else like that? And is there any reason why we shouldn't expect the dilution to be offset by share buybacks? I know the board makes the decision but in your view is your recommendation – what's your view in terms of returning the excess cash to shareholders? That's the first question.

Secondly, on the digital ventures, the sort of €65 million, any update there in terms of how that's progressing? Any update in terms of organic from the other parts of the New Ventures ex GA? That would be helpful.

And then finally, could you just give us or give us a bit more color on your gross margin and SG&A expectations for the fourth quarter? Thank you very much.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

Maybe shall I start with the divestiture. So, we're pleased with the price because I think we got a good price for Soliant. We will be making profit on that and that will be taxed in the US. So, you will see in your words some dilution to that. We're still working on how to structure and optimize that, so we propose to give the full disclosure on that amount at the end of Q4 because we still need to execute that.

We have a very clear capital discipline and allocation which we report at the end of the year, where we have a clear process for returning our excess cash and that we will announce at the end of Q4. Before coming to debentures, maybe some color on Q4 to help you a little bit further. On the gross margin, we expect exchange rates to be positive by 10 basis points. France, we will get a benefit of 40 basis points. Then that splits between the new regulation around 10 basis points and 30 basis points because last year [indiscernible] (00:21:45), but you also have to remember that we had a reversal of a course last year of around 50 basis points. So, that is a lot of things but in the end come to a net zero.

You can add for the perm LHH and the temp around 30 bps I would say in total. I would say 3 times 10. Remember the temp gross margin started to improve already in Q4 of last year. So, I would probably taking what we had this quarter, but 3 times 10. SG&A will be slightly up because of currency impact, because if we get that in the gross margin, the currency will also in the SG&A around 2% but organically we will be down around 1%. I think that give you some indication to model your fourth quarter.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

On the ventures, not only the digital ventures, but all the ventures, overall we are pleased. We are really pleased with the progress we are doing. You have heard our performance with General Assembly, which is growing strongly and we are working together with LHH and Modis to develop that kind of ecosystem and unique offering. I've mentioned some significant business wins with LHH, but also the combination of the capability of GA with

Modis as – is at the basis of the Modis Academy we have now launched in the US. And for sure, this will take a little bit longer, but it is a truly innovative solution that we know from Modis VSN in Japan.

For the digital ventures, Vettery, Adia, YOSS, all of them are continuing to make progress. At this stage we continue to invest around 5% of our profitability in these ventures, which it is absolutely the right thing to do. And I think it is important that as a company, we are performing on today's business while we also invest for the future especially in these ventures.

Paul Sullivan
Analyst, Barclays Capital Securities Ltd.

Q

And thank you. And just to follow up on that 5% of profitability. You've sort of laid out your expectations on how you thought that was going to evolve over the next sort of couple of years, how – has your thinking changed today?

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

I think if – maybe I'll give you two answers to that. I think if I look first at our current quarter where we continue to invest in the IT agenda to set ourselves up for GrowTogether and we'll also continue to invest in growing our ventures. And while we do that, we have delivered a very strong conversion ratio of 25 basis points and confirming our margin strength with the opportunity to improve it by delivering the returns on the investments we're making. And the first one we confirmed is we're putting the actions in place this quarter and next quarter to deliver the €250 million GrowTogether benefits.

So, I end and then I conclude 2020 that we have a very strong margin, but I also call it an opportunity-rich margin. And why do I say that? We are delivering a very strong margin into the quarter with all these investments in. Our objective for 2020 is clearly is to structurally improve the profitability [ph] and GrowTogether (00:25:33). We are very confident with what we're doing. We're also having a better mix of business. You see our gross margin and our value creation of that.

On the ventures, we will need to make the decision, right, how much we invest for the growth. The good news is the growth you saw that on General Assembly is reducing the losses. We're opening in all the market. So that trade off we will make will probably give you a little bit more color on that when we end the year but always with the objective to structurally improve the profitability like we're doing this year, because this year if you look at the first three quarters, we're structurally improving the profitability in the more challenging trading environment and our goal is to structurally improve the profitability next year.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Thank you, Paul.

Paul Sullivan
Analyst, Barclays Capital Securities Ltd.

Q

Thank you very much.

Operator: The next question comes from Anvesh Agrawal from Morgan Stanley. Please go ahead.

Anvesh Agrawal
Analyst, Morgan Stanley & Co. International Plc
Q

Hi. Good morning. I had a few questions. The first just on the working capital, given where the growth is, you would have us hope for a net positive inflow on the working capital, but it was dragged down the payable. So maybe if you can just clarify is it just a timing issue and should we expect some reversal come Q4 assuming the growth remain in minus 4% kind of a range?

And the second one is recently we had two kind of major auto players announcing a merger, I'm wondering if you can probably give some comment on your exposure there especially in the UK and any sort of kind of early discussion that would mean some sort of negative impact going forward? Thank you.

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

So I'll start with the working capital. And so, I think we had a strong cash. If you look at the DSO, the DSO was down but you would indeed [indiscernible] (00:27:17) we have seen, normally see a little bit higher cash conversion. There are two things which were in the quarter. One the way this [indiscernible] (00:27:26) changed in France is having still year-to-date negative impact and some of that will come in Q4.

So that – if you correct for that, we're running at 90. So, the 83 becomes 90. And then like you have spotted very well is that the tables, the timing of some of the social securities [indiscernible] (00:27:47) into the quarter, but over the year washes through. So, we're running well above that 90 if you adjust for [indiscernible] (00:27:56) and some timings of payments, which confirms strong DSO and cash management.

Alain Dehaze
Chief Executive Officer, Adecco Group AG
A

Then on the automotive, it is clear that when we look at this quarter, automotive is weak almost everywhere. But according to what we see beginning to stabilize again is your comparables. If you look at our top line this quarter, overall auto explained around 1 percentage point of the revenue decline. We don't anticipate near-term improvement in auto, especially because of the structural trends [ph] hitting the sector (00:28:38), electrification, [indiscernible] (00:28:42) and some, as well as the trade war and the [ph] trade (00:28:47) of the US tariffs.

This is on auto. But also in manufacturing, in general, we have seen a soft environment which slows further in the third quarter. So far when we look at the Q3, we see that the service side of the economy has held up better, but it's also negative year-on-year. So, as a conclusion, the slowdown is quite broad based. I'm sure auto and manufacturing were the most impacted.

Anvesh Agrawal
Analyst, Morgan Stanley & Co. International Plc
Q

Yeah. And maybe just a follow up, can you just give us what your overall manufacturing exposure in Europe is? And just on the earlier question on SG&A when you said organically down 1%, is that sequential or year-on-year? Thank you.

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

So, our total exposure to manufacturing is around 20%, 25% in the group and that includes the automotive sector.

Anvesh Agrawal
Analyst, Morgan Stanley & Co. International Plc
Q

Okay.

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

And then I said it's year-over-year.

Anvesh Agrawal
Analyst, Morgan Stanley & Co. International Plc
Q

Okay. That's clear. Thank you.

Alain Dehaze
Chief Executive Officer, Adecco Group AG
A

You're welcome.

Operator: The next question comes from Bilal Aziz from UBS. Please go ahead.

Bilal Aziz
Analyst, UBS AG (UK)
Q

Good morning, everyone. And just a few from my side please. And can you please identify if there was a working day benefit in the temp gross margin? And if so, how much it was? And separately, I guess more on the underlying trends in the temp margin, you've had four consecutive quarters of an improvement on that side. And I guess as the weakening top line trends continue, are you seeing any signs of price aggression from some of your competitors?

And finally, on General Assembly, I think this year guidance was in a slightly loss making. When we look ahead to 2020, just trying to get the message clear, do you expect more level of investment going into that business or do you expect to be profitable? Thank you.

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

Let me start with the gross margin. We had no – because it only has a benefit [indiscernible] (00:30:54) changing bank holidays, not in working days. So, there's no meaningful impact on the gross margin from the working days into the quarter.

Alain Dehaze
Chief Executive Officer, Adecco Group AG
A

Then regarding your question of the potential gross margin benefit in the quarter because of additional working days, in this quarter we had no meaningful impact on the gross margin from the working days. And I would say that's also no real impact from holidays in the third quarter. So, that's in a nutshell.

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

Could you – I lost your other question because we answered the first one. I apologize.

Bilal Aziz
Analyst, UBS AG (UK)
Q

No, no. It was just on pricing and how you think that is sustaining in the current demand environment?

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

Yes. So, I think we're pleased to report that on the pricing that we're becoming, I would say, more sophisticated on the price discipline. We're also adding better value services to the customer. And I think our GrowTogether initiative and our Net Promoter activation is playing into that, so that we – if we bring a better candidate faster to our clients [indiscernible] (00:32:14) that that improves the pricing. But also on the value solutions we are providing is that we are working on the pricing. And in some markets like Germany, we're happy that the new regulation which is adding some cost is also being passed on into pricing. So, we're pleased with that.

Now, where we need to be careful in Q4 is that and that's why I gave a little bit a lower outlook for the fourth quarter is that we already saw that improvement, so we need to be careful. But I think what is really great for the industry we came out of a negative area. We came into the stable area. We're now into this more positive area. So, we should see that as a positive development from the value we create. So, we're pleased with that.

Alain Dehaze
Chief Executive Officer, Adecco Group AG
A

Okay. Thank you, Bilal.

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

Matthew Lloyd
Analyst, HSBC Bank Plc
Q

Good morning, gentlemen. A couple of questions from me really. Just in terms of the cost savings and the sort of the productivity gains that you're making. Perhaps I'd just be interested and I don't want a spreadsheet answer, just where you think you might be able to go more broadly, but what does that mean if you start to get volume come back? Does that mean you don't have to put in as much additional cost to sustain any growth if we're not sliding into a recession, if this is a slowdown and we're stabilizing, or does it mean something that you can hold the sorts of margins that you're at in a more growthy period? That's the first question. So, I suppose I'm thinking about sort of SG&A per person or per consultant, I suppose.

And then the second thing is how big a market is it for using General Assembly to equip people with skills that are scarce and then placing them? There are a lot of very small players trying to do that, and you've done it in Japan as FDM in the UK. But I just wondered if you got the size of that market or its potential.

Alain Dehaze
Chief Executive Officer, Adecco Group AG
A

Perhaps I can start with the last one, Matthew. There are some figures I can – for example, I can quote McKinsey. McKinsey has said that there is a need to reskill and upskill 370 million, so 3-7-0, 370 million workers by 2030, which is approximately 14% of the global workforce. This is one type of, let's say, – I would say one type of activity is the reskilling of existing staff in companies. Beside this, you have the example we have taken of the Modis Academy, where we take people without the capabilities companies are looking for and we skill them. It can be in system engineering. It can be in Python, in Java and so on and so on. The model we are doing in – at

VSN. We know that there is a huge scarcity of such a profile and – but I don't have a precise idea of figures. I know, for example, that Europe is missing around 600,000 IT people because not trained and we are participating now to that kind of new markets.

Matthew Lloyd
Analyst, HSBC Bank Plc

Q

Great. Thank you.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

On your GrowTogether question, so it helps on the downside because you have a better productivity. But like you say, as usual, it works even better when the business is growing because these tools we're giving to our people will make them more productive. This means that with adding less people you can drive more growth.

The candidate apps we have in France really are driving productivity and better candidate engagements. The new integrated sales solutions we're rolling out in Spain and France will drive higher sales productivity because they help our sales people to go much targeted to the right clients and then the whole digitalization of the administrative process means that if you go to business, right, that gets more automated, so you don't need to [indiscernible] (00:36:49) a linear business model. With that, we become more scalable business [ph] model on the (00:36:55) growth and the PERFORM method will help to do that. So, growing the business, you will do more productive going forward. So, that's a structural change.

Matthew Lloyd
Analyst, HSBC Bank Plc

Q

It's a dangerous question but – so, I fully expect you to avoid it. But do you have any numbers in terms of you think it makes a consultant somewhere between 10% and 15% more efficient in a growing market, or are you going to avoid that question?

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

No. I won't because we measure that, because otherwise we wouldn't control that GrowTogether. First, PERFORM alone will – when it's fully rolled out and people are really mastering that gives already 10% productivity. We know also form the candidate apps. We have a process what we call value realization to make sure we really control that €250 million and we know initiative by initiative, market by market, we do time studies like manufacturing. So, we really make a structural shift in the productivity.

Again, we are in the midst still of rolling this out. We have a lot of people, so these things don't go overnight but this will be a structural improvement in the productivity and we measure that project by project, initiative by initiative and that's very important because we're scaling our certain parts of GrowTogether from one market to the other, so we can also then tell the market what benefits we expect to be delivered when we bring the technology.

Matthew Lloyd
Analyst, HSBC Bank Plc

Q

Great. Thank you very much.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

You're welcome, Matthew.

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. A few questions over my side. First of all on France, yeah, slowdown in your top line, could you little bit maybe give some indication what's happening, let's say, by segment in France? Are there any specific segments in France that will you see slowdown much faster than the others?

And then on – coming back on SG&A, it was slightly higher than you initially guided for. What were the drivers of that somewhat higher growth in SG&A had initially thought despite the fact that maybe sales decline is slightly more than – maybe – a little bit maybe expect at the beginning of the quarter. And then on Soliant, a more or less, say, conceptual for the longer term, first of all how much was this business growing under your – under the Adecco operations? And secondly, is it something that you would expect more going forward, that businesses which are more or less, let's say, focused on certain countries and which are not that global, you would maybe look for divestment. Is this something, let's say, more – you could more expect on?

And lastly on the whole GrowTogether productivity savings you're just mentioning, yes, quite significant improvement in productivity you're seeing but is it not also a part, let's say, to offset, let's say, the longer term pricing pressure you see in the general staffing market? Or do you really expect that the productivity could benefit your bottom line in the long term when growth picks up again.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Okay. I will start with France. When we look at the top line of France, we see that there are two key drivers of the relative growth gap. The first one is that the comparable base and last year we had quite a strong third quarter, we were growing 6% faster than the competition. So when you look at the two quarters today I say it explain also what we had – why we had a kind of slowdown.

Second, the business mix and if – we do around 90% of our revenues in temporary staffing in France and so we have a smaller weighting in Professional Staffing which, by the way, is growing faster. If you look at our France Professional business If you look at our France Professional business, we had growth of 11% in the third quarter. This explain also when you look at the mix we have quite a sizable exposure to large manufacturing customers including auto. And you see that's where [indiscernible] (00:41:37) has been the weakest.

Now, on the other side, we are very pleased with the overall performance in France, very solid. You see that the gross profit is flat year-on-year despite the revenue decline which is a good proof point that we have a strong pricing discipline, that we are driving value strategy. We are deploying really value adding services such as the contract of indefinite duration for temporary staffing, apprenticeship, and so on and so on. Also, GrowTogether. GrowTogether is there [ph] in at least (00:42:15) one of the country at the forefront of the program.

We had a very good results supported by the PERFORM methodology or productivity improved by 6% and gross profit per FTE. And we continue to lead the profitability field, while we are doing at the same time significant investment in the digital transformation. So, and we expect this gap to market to narrow as the comparison base would become easier.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

Yes. Let me start with Soliant and then come through the SG&A because there's a link with GrowTogether. Soliant was growing mid- to high-single digits. But given the absolute size, it doesn't really have on the company level a material impact on our organic growth pace.

On SG&A which was up and indeed a little bit higher than we guided for. I think a couple of points. First, we adjusted the head count but we have to recognize that the revenue shortfall we saw had an impact on the productivity into the quarter. What is important to mention is we continue to invest, we did not compromise on the investments, we continue to invest in the digital ventures. And in bringing the IT tools in the business to make sure we [indiscernible] (00:43:42) our commitment on GrowTogether next year. So, this puts us on-track to do that.

We have to recognize that that's also versus the guidance, we had a little bit of higher gross margin and some of the mix in the gross margin is margin accretive. But it's not one on one dropping to the bottom line and, LHH and [ph] foreign (00:44:04) business are examples of that. So, if you have higher gross margin, there's also a little bit SG&A, but again margin accretive.

If you add it all up with the conversion ratio in the quarter of 25%, which is very strong, while we – with a little – put back on some of the productivity with the slowdown in sales and continued investments with less sales, we think we have a strong productivity while this happens. And as I said, and that brings me to [ph] next here (00:44:35), on GrowTogether, this is why I call it an opportunity rich, strong margin. We are making the investments and we will, on GrowTogether, come through on our productivity targets in 2020.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Now, and to finish your question, Hans, regarding portfolio and the decision we are taking on sometimes to divest activities. I would like to answer it in a broader context. So, we actively, and you have seen that during the last two years, we actively manage our portfolio to ensure optimal capital allocation. And we are looking for investing in brands in order to globalize them, on one hand. Second, we are looking to invest in brands where we have synergies between the brands, so that we can develop and propose to a customer and candidates unique service offering. The example of GA and Modis for Modis Academy is one. The other example is GA with LHH is another one. And that's why for Soliant, there was very limited synergies with the other brands and also no real, let's say, rational behind expanding this brand internationally, no real global international customer, very locally regulated industry. So, that's why we took the decision.

We see that we have and you see that we have already some of our global brands: Adecco, Modis, Lee Hecht Harrison, General Assembly, and so on, but we have also some very, what we call, local [ph] Euro (00:46:20) brands which have very good business. And we continue to invest in their growth, and we see also that some of the local [ph] Euro (00:46:31) brands have the potential to be geographically expanded in keeping with our strategy. So, again, portfolio management is a continuous process, and objective is to create more value for our shareholders by in this case for Soliant by selling to a better owner.

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

Q

Okay. Thanks.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Thank you, Hans.

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

Alain-Sebastian Oberhuber
Analyst, MainFirst Schweiz AG

Q

Good morning, Alain, Hans, and Nick. Alain Oberhuber, MainFirst. I have also three questions. First, could you elaborate a little bit more on Germany? Obviously, the introduction of the new regulatory of the new regulatory in last year is now going through. But what could we expect? You are cautious for Q4. But could we expect the H1 next year an improvement in Germany?

The second question is regarding North America and this is specifically in the Professional Staffing business. Obviously, it looks like that IT is still negative for you. You lost some market share. But also now in finance and legal, it's down. When do you think you have reached a bottom that we could see an improvement in particular again in IT?

And the last question I have regarding the restructuring costs of this year. Would you guide us how much we could expect for the last quarter and then, obviously, the rest will be in 2020? Thank you.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Okay. I will start with Germany. And, yes, you are right, Alain. The new regulation regarding this [indiscernible] (00:48:16) is now – has now its first year anniversary. What we see is that, in the way we operate, the situation has normalized. At the very beginning, we had a lot of negative impact because we had a lot of people beyond the maximum term. So, we had to handle this and so on. But now, I would say it's almost business as usual regarding managing the duration of the contract of the temporary staffing. What you have seen also in Q3 is we should not celebrate the results [indiscernible] (00:49:01). But you see that we have improved the profitability, that the top line is in line with the peer group, and we continue to, let's say, to put operation excellence at work with the first results. When you look also at auto, there was, yesterday, the launching of the new fully electrified car from Volkswagen. We expect also there a kind of slow stabilization because new models will start to roll out of the manufacturing chain. The bottleneck in the car emission control institute is also starting slowly to be regulated and to be normalized. So, that's how we look at Germany.

Hans Ploos van Amstel
Chief Financial Officer, Adecco Group AG

A

On North America, I think the key driver in – is the IT business because we were down on legal because we were [indiscernible] (00:50:09) on some big contracts last year. So, we had some big wins and finance is positive. So, I think between the two, it's not really the driver, the IT is the driver. As we discussed in previous calls, what we're doing on the Modis US business, I think, is quite transformative because of the changes we're making. And we're making good traction on the changes so that we see gradual improvements to come.

We now built the offshore capabilities in India. So, that's open and is starting to fill the positions. We started the Modis Academy and the retail business under the new leadership, [ph] while it's still small (00:50:53), is starting to grow. On restructuring, we said that we would spend €200 million in total over the period 2018, 2019, 2020.

We spent a small €100 million of that already. And Germany has been a [indiscernible] (00:51:15) of that, that means we still have €100 million left of that €200 million, and we will announce quarter-by-quarter because these things are sensitive because of legislation and it's planning for it and also with – because it impacts employees, but we are staying within the total amount we always communicate.

Thank you very much.

Alain-Sebastian Oberhuber
Analyst, MainFirst Schweiz AG

Q

Thank you very much.

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

Tom Sykes
Analyst, Deutsche Bank AG

Q

Hey. Good morning, everybody. Just...

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Good morning, Tom.

Tom Sykes
Analyst, Deutsche Bank AG

Q

First question please is on your gross profit split. Given the changes in subsidies the kind you put [indiscernible] (00:51:59) gross margin, et cetera. How much of the gross profit is coming from industrial now? I think in this quarter, it's 52% of revenue you split. Presumably, that's lower gross margin. So, just ballpark whether you could say what proportion is coming from, and of course, profit is coming from industrial. Presumably, that's lower gross margin.

Then also just on your variable pricing, are you able to push up prices in industrial when the volumes are down? And if not, then where are the prices being pushed up? And obviously you referenced Germany there on the legislation but that may be a special case, but if you could sort of say where the value-based pricing is actually having a positive effect, and are you able to do anything in industrial?

And finally, just on the front-office systems and the new IT systems that you're rolling out, could you maybe just clarify again how much of that is proprietary system that is yours? Excuse me. And how much of the shelf systems that you tailored to your own specifications, please?

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Okay. I will start with the last two, the front office and the variable pricing. On the front, the new so-called integrated front office, we stick to our IT strategy we announced, I think, in 2016. It means that we focus on cloud-based off-the-shelf standard system, but that we in a certain sense packaged or developed to our own needs.

If I take the example of the so-called integrated front office, why do we speak about an integrated front office because it is integrating two software, one which is a customer relationship management and the other one which is the candidate relationship management. And we have, let's say, coupled the two system in an integrated front office, but both of them are stand out of the shelves cloud based. On the variable pricing, I think there are different elements because it depends according to the segment you are in.

Not only is it industrial service, I don't know, hospitality, food, and so on, and so on. But are you active in a small customer, medium customer, large customer, international customer, and so on. I must say the variable pricing is – and dynamic pricing is mainly – has mainly its impact on the small and medium impact because that's where you can really manage and leverage the data and the knowledge of the data. And that's where including by the way in Germany we have made a good progress. And then for your large and international customers it's all about negotiation and also internal discipline because all these large and international contracts are driven by tender, negotiation, and so on and not really by, let's say, by spot – on the spot pricing. But there also we are and we continue to be very disciplined. We are not afraid to turn down some tender if the pricing we request is not accepted. So we have – we are quite focused on this.

Tom Sykes Q
Analyst, Deutsche Bank AG

Okay. Thank you. Would it be fair to say that your SME profitability is – cost decrease is running at peak levels now, I mean after the pricing improvements? I mean it's obviously difficult to tell vis-a-vis kind of couple years ago but is your SME – is that skewed between SME and, say, large account is a bit bigger than it has been before now because of growth in SME and pricing, is that fair to say?

Alain Dehaze A
Chief Executive Officer, Adecco Group AG

I think there is still opportunity there. Because there I think we are still early in our GrowTogether program and we're bringing also important technology there and that is still a very fragmented market and through technology also in that segment you can fill the order faster with the better candidate. So, the technology there will help us going forward. On the gross margin, I try to answer your first question, but it's not as easy as it looks on the surface. If you – blue collar is an Onsite for sure, the gross margin is lower, but also the cost to serve. But it's not that across the markets that call it industrial type of labor versus call it office labor has a different margin structure. Because in many countries for unqualified labor, the Social Security and some of the subsidies are also a little better. So, it's not by definition that blue collar has a lower gross margin than office. That's something you – the Onsite solution, yes, but outside the Onsite solution because of – and this is different market-by-market.

On your pricing, I think the pricing is linked to the value we deliver. So, making sure we deliver for the customers and the value we create. For sure, we're in a very competitive business model, but you should never forget the total cost for our customers is our net sales. And we make around five margin on that because they would also have to do the recruiting. If you pay €105 or €106, you get the best candidate and the Onsite solutions are working, that plays. You should not forget this is a people business. So, the value we add and linking that to the pricing we command to get not just the pricing discussion is a key part of that value-based pricing and is very important, not only in the market of today but more in the market of tomorrow.

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

I'm looking at the time, and we'll pick the last question. And...

Tom Sykes
Analyst, Deutsche Bank AG
Q

Thank you very much.

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

You are welcome, Tom.

Operator: The next question comes from Kean Marden from Jefferies. Please go ahead.

Kean Marden
Analyst, Jefferies International Ltd.
Q

Thanks, guys for [indiscernible] (00:59:07). My line dropped at out about 10 minutes ago so I appreciate it. A few quick questions on the Career Transition business growth. Is that growing in the US, France or both? Secondly, coming back to Soliant's capital gains, it might be helpful if you could possible share with us the book value of the assets in your accounts as of December 18 and we can make our own assumptions around that.

And then finally just a quick modeling question. There's a 9 percentage point gap between the organic and the reported growth rates in Japan for Q3. [ph] Forgive me (00:59:47) I didn't think the effects was quite that substantial so is there a small bolt-on acquisition in that? Thanks.

Alain Dehaze
Chief Executive Officer, Adecco Group AG
A

Okay. I will start with LHH. The growth of LHH is for sure coming from the US. We are growing everywhere but in the US not really France at this stage.

Kean Marden
Analyst, Jefferies International Ltd.
Q

Okay, thank you.

Alain Dehaze
Chief Executive Officer, Adecco Group AG
A

And what we see that's also interesting to note is that growth is very linked to transformation program of customers. By the way you see that in the media. Many industries, many companies are in transformation and we are participating to the transformation with LHH.

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

Yeah. On Soliant, we will give you the full numbers in Q4 because I prefer that we give you the precise numbers because we're also looking at how we compromised that transaction which is linked, how you allocate some of the assets, so could give you a number but it still wouldn't give you the answer. On Japan, it is regulated to the trading days impact and the FX. And I can come back with Nick to give you some more specifics after the call. [indiscernible] (01:01:09) days? That is [indiscernible] (01:01:13) acquisition.

Kean Marden
Analyst, Jefferies International Ltd.

Q

Okay. Thank you.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

You are welcome.

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

So, thank you, everyone, for joining the call today and for your questions. Looking forward to meeting some of you on the road show and otherwise, we look forward to speaking to you again with the Q4 results on the 26th of February next year. Thank you.

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