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Adecco Group AG (ADEN.CH)

Q2 2018 Earnings Call

CORPORATE PARTICIPANTS

Alain Dehaze

Chief Executive Officer, Adecco Group AG

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

Nicholas de la Grense

Head of Investor Relations, Adecco Group AG

OTHER PARTICIPANTS

Alain-Sebastian Oberhuber

Analyst, MainFirst Schweiz AG

Chirag Vadhia

Analyst, HSBC Bank Plc (Broker)

Hans Pluijgers

Head of Research, Kepler Cheuvreux SA (Netherlands)

Suhasini Varanasi

Analyst, Goldman Sachs (India) Securities Pvt Ltd.

Tom Sykes

Analyst, Deutsche Bank AG

Michael Foeth

Analyst, Bank Vontobel AG (Research Firm)

George Gregory

Analyst, Exane Ltd.

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, good morning or good afternoon. Welcome to the Q2 Results 2018 Analyst Conference Call. I am Alice, the Chorus Call operator. I would like to remind you that all participants will be in listen-only mode and the conference is being recorded. After the presentation, there will be a Q&A session. [Operator Instructions] The conference must not be recorded for publication broadcast.

At this time, it's my pleasure to hand over to Mr. Nicholas de la Grense, Head of Investor Relations, accompanied by Mr. Alain Dehaze, CEO, and Mr. Hans Ploos van Amstel, CFO of Adecco Group. Please go ahead, gentlemen.

[0C9PYC-E Nicholas de la Grense]

Good morning and welcome, everyone, to the Adecco Group Q2 2018 results conference call. Presenting today, I have 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.

Okay. Moving on. So, on slide 3, you'll see today's agenda. We'll follow the usual format starting with the highlights of the quarter from Alain followed by a review of the financial performance and comment on the outlook from Hans, and back to Alain to discuss recent progress in our Perform, Transform, Innovate agenda. And, finally, we'll open the lines for your Q&A.

With that, Alain, I hand over to you.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

Thank you, Nick, and good morning, ladies and gentlemen, and welcome to our second quarter 2018 results investor call. I will start with the slide on the key highlights. In the second quarter, underlying revenue growth decelerate modestly but remain solid at 4%, and the mix of growth became more balanced. To be noted, in France, our largest business, we significantly outperformed the market.

In North America, General Staffing returned to growth, achieving its strongest performance since the second quarter of 2015. Also, our strong performance in permanent recruitment continues with 18% organic growth.

Gross margin was 18.3%, stable year-on-year organically and on a reported basis. The quarter was less impacted by one-off factors which weighted on Q4 and Q1 gross margin. Temporary staffing price and mix effects had a 10 basis point negative impact. This was the same as in the first quarter showing a continuation of the slightly improved pricing environment.

EBITDA margin, excluding one-offs, was 4.5%, down 30 basis points. This is explained by our ongoing strategic investments in digital and IT, which had a 30-basis-point negative impact. Lower productivity in Germany also had a negative impact of around 10 basis points, which was offset by improved productivity in all the regions. Recall that we are making investments in Germany to strengthen our recently merged General Staffing brands, Adecco and Tuja.

In June and July, revenue trends remained in line with the second quarter with growth of 4%. We are on track with our investments in the innovation and the transformation agenda. In July, we announced the sale of our stake in Beeline illustrating our disciplined approach to managing our business portfolio and realizing significant value for our shareholders.

Indeed, after-tax proceeds are expected to be more than €170 million, which will be used to support the group's ongoing digital investments. Also in Q2, we completed the acquisition of General Assembly, a leader in digital skills education, which significantly strengthens our workforce transformation offering. And we are very pleased by the positive reaction of our clients to this partnership.

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

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

Thanks, Alain. We will now discuss the financial performance in more detail starting with our revenue growth. Revenue growth slowed modestly in the second quarter, but remains solid at 4% on a trading day-adjusted basis. You saw a slowdown in certain European countries notably France and Southern Europe. The return to growth in North America General Staffing helped to offset this. The result is our growth is now more balanced across the regions.

Looking at the individual regions, you can see that the growth was ahead or in line with the markets with most regions with the exception of Germany and Benelux. In our largest market, France, the underlying growth was 8%. This was solidly ahead of the market reflecting the investments that we made and a continued strong commercial focus.

In North America, UK, Ireland General Staffing, revenue growth turned positive, thanks to the improvement in North America which recorded its strongest growth since the second quarter of 2015. We're pleased to see that the changes we're making in the U.S. are delivering strong results and we look forward to further progress as our segmentation strategy becomes more embedded across the total business.

Professional Staffing in North America was stable year-on-year while the UK was down. We see good growth in most U.S. professional brands, but overall growth was held back by our IT business which was impacted by a reduction in volumes at a few large clients. The Brexit uncertainty continues to impact the UK market.

In Germany, our growth was behind the market, while Professional Staffing was up high single digits, our General Staffing business, which is the largest part, declined. Germany General Staffing results are impacted by the reorganization of the business because of the merger of our Adecco and Tuja brands. While this impacts the results in the short term, the integration will strengthen our business going forward.

In the Benelux, we're seeing the impact of analyzing some large customers wins from 2017. In Italy and Iberia, growth remained strong, although at a lower level than in Q1 after many quarters of strong growth. Both businesses continued to deliver solid performance vis-à-vis the market. Lee Hecht Harrison continues to outperform peers through expanded market share. The revenue decline was consistent with the counter-cyclical nature of that business.

Turning to the EBITDA margin, down 30 basis points in total, improving on the performance of Q1. Looking at the margin in more detail. Gross margin, which we'll discuss in the next slide, was stable organically. This leaves a 30 basis points reduction in the EBITDA margin coming from higher cost. This is explained by two factors. First, we continue to make the right investments in GrowTogether, strategic IT upgrades and our Digital Ventures which had a 30 basis points impact in Q2. This impact is partly reflected in the organic SG&A increase and partly in M&A because of the investments in the two new ventures, General Assembly and Vetterly.

Second, the German reorganization impacted the quarter. This explains the 10 basis points decline in the total margin. We're combining our two General Staffing brands and are making fundamental changes in the way we approach the market. We're in the process of rolling out the segmentation, and it takes time to get the results of implementing this commercial strategy. The German General Staffing reorganization will impact the results in the short term. But it's the right thing to do, because it will strengthen the German business for the medium and long term. The positive news is that the improved productivity across the rest of the group offset the impact from Germany.

Let's look at the profitability at the country level. Continued strong profitability in France. The margin was mostly explained by a reduction in the CICE wage subsidies of 60 basis points, and we're pleased with the underlying performance with operating leverage and good cost control offsetting the ongoing investments in the strategic GrowTogether initiatives.

In North America, UK, Ireland General Staffing, we continue to build the foundation for profitable growth. This requires investments in capabilities and new frontend client-facing tools to support the segmentation strategy and the GrowTogether initiative. This impacted the margin in the second quarter but will drive productivity improvements in the second half of the year.

In North America, UK, Ireland Professional Staffing, consolidation of Vetterly and the IT investments reduced the margin. The underlying margin performance remained strong supported by a positive pricing environment due to the talent scarcity in the tight labor market.

Margin was flat in Germany, Austria, Switzerland. Lower productivity in Germany was offset by a positive impact from the trading days. Benelux and Nordics was impacted by the client mix and lower subsidies in Belgium. We delivered strong profitable growth in Italy and Iberia supported by strong operating leverage. Japan had a good quarter while we're making the relevant investments in new IT technology.

In the rest of world, our strategy of focusing on client mix and quality of growth is delivering strong results with the EBITDA margin improving by 50 basis points. Career transition and talent development was impacted by the consolidation of General Assembly, which is still in an investment stage.

Let's now look at gross margin and SG&A, starting with the gross margin. Reported gross margin is flat. M&A had a positive effect of 15 basis points mainly due to Vettery and General Assembly which are high gross margin businesses. Currency had a negative 15 basis point impact mainly driven by a weaker U.S. dollar and Japanese yen.

The organic gross margin was stable. Permanent recruiting had a 20 basis points positive impact. Career transition had a negative 15 basis point impact with [ph] over (00:12:19) including outsourcing positive at plus 10 basis points. This leaves a 15 basis point reduction in the temp gross margin. We had a 10 basis point positive impact from the favorable timing of bank holidays in Germany and the other regions where we operate advanced business model.

This leaves the underling temp gross margin down 25 basis points. CICE had a negative 15 basis point impact. The remaining 10 basis points is driven by pricing and mix. The pricing and mix trend was the same as in the first quarter and continues to run at an improved trend compared to 2017.

On SG&A, SG&A was flat sequentially and increased 7% organically year-on-year. As in the first quarter, the base effect was challenging with organic SG&A cost only 2% in Q2 of last year. Our FTE productivity improved this quarter with 5% organic gross profit growth supported by a 3% head count increase. Investments in strategic initiatives including the rollout of new IT infrastructures and the investments in the group Digital Ventures portfolio has a 3% impact on SG&A.

Turning to cash flow. Average cash conversion was 78% over the last four quarters. DSO was 53 days, similar to Q1 2018 versus 51 days last year. Net debt was €1.6 billion at the end of June 2018 compared to €1.1 billion at the end of March 2018.

Net debt-to-EBITDA excluding one-offs was 1.4 times at the end of June compared to 1 times at the end of March 2018 and 0.8 at June 30 last year. The year-on-year increase was driven by acquisitions, higher dividend payments, and the completion of the 2017 share buyback.

Seasonally, stronger free cash flow and the proceeds from the sale of our stake in Beeline will reduce net debt in the second half. We're in a position to accelerate the €150 million share buyback program versus what we had communicated at the end of the first quarter.

Turning to the outlook. Revenues in June and July were up 4% organically and trading day-adjusted. In Q3 2018, we do not foresee any significant one-off effects on the group gross margin. We're on track to deliver the €50 million GrowTogether productivity savings in the second half.

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

Alain Dehaze

Chief Executive Officer, Adecco Group AG

Thank you, Hans. And indeed, let's have a look now at our strategic and operational progress during the second quarter.

At the end of July, we announced the sale of our remaining equity interest in the VMS platform, IQN, Beeline. The transaction is expected to close during the third quarter and it will result in after tax cash proceeds of approximately €172 million with a gain on sale of around €110 million.

Recall that in December 2016, we merged Beeline with private equity-owned IQN to create the leading independent vendor management system provider. We received \$130 million in cash and loan notes, and retained a 43% stake in the combined business.

At that time, we recognized that synergy for Beeline within the Adecco Group had become limited and we decided that more value could be created for our shareholders by merging Beeline with IQN. It is now clear that this was the right decision. Pre-tax proceeds from the disposal of Beeline will total more than €300 million, and the total gain on sale will be more than €200 million. That represent a very good results for shareholders for an asset that made only a modest contribution to group earnings in 2016 before the consolidation, and on which we recognized no earnings in 2017. It also illustrates our commitment to discipline capital allocation and portfolio management.

And while we are talking about portfolio management, let's speak now about our recent acquisition of General Assembly. General Assembly is a leader in digital skills transformation, and officially joined the group on the 31st of May 2018. We are very pleased with the positive response from our clients with many wanting to explore the enhanced workforce transformation possibility that our combined business can now offer.

A number of joint meetings with clients have already taken place, and we see confirmation that substantial synergies exist, particularly with Lee Hecht Harrison and with Modis, our IT and engineering professional staffing and solutions brand.

General Assembly expertise also further reinforce our thought leadership and/or ability to offer client innovative solutions for the changing world of work.

Coming now to the concluding messages. In the second quarter, we saw a modest slowdown in revenue growth but also more balanced broad-based growth. In our largest country, France, we strongly outperformed the market. In the U.S., our General Staffing business is back to growth with its best performance since the second quarter 2015, reflecting the investments that we have made in 2017. Our permanent recruitment growth continued at 18%, and this trend continues in June and July with revenues growing 4% organically and trading days adjusted.

While our margin was negatively impacted by investments in our strategic initiatives and challenges in our Germany staffing business, we saw improved productivity in most regions, and we continue to invest in the transformation and digitalization of the group while also focusing on operational performance.

On the Perform side, we focus on driving profitable growth while making the right investments. In our Transform agenda, GrowTogether is building momentum and is on track to deliver €50 million productivity saving this year and €250 million in 2020. GrowTogether initiatives are already helping to improve recruiting efficiency, sales effectiveness, and also our back office processes. As example, we have the deployment of chatbot, client and candidate portals, and a new integrated front office system and the digitization of the time sheet processing.

Our Innovate agenda was strengthened with the acquisition of General Assembly, which is a key differentiator for the Adecco Group. The reaction from clients confirms that our approach is the right one to address talent scarcity and also the need for workforce transformation that the changing world of work brings.

To finish, I would like to thank all of our world-wide colleagues for their commitment and engagement. And I thank you for your attention. And before we open the line for your questions, I would like to remind you that we will host an investor seminar in London on the 19th of September. And for sure, we would be delighted if you would join us.

And now, we open the line for the questions.

Operator: We will now begin the question-and-answer session. [Operator Instructions] The first question comes from the line of Alain Oberhuber from MainFirst. Please go ahead.

Alain-Sebastian Oberhuber
Analyst, MainFirst Schweiz AG

Q

Good morning, gentlemen.

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

Good morning, Alain.

Alain-Sebastian Oberhuber
Analyst, MainFirst Schweiz AG

Q

Just two questions from my side. Regarding the guidance, obviously going into the next quarters, the base effect is obviously an issue, and secondly, do we also see some negative momentum? And if so, in which markets have we seen this negative momentum sequentially?

And the second question is regarding the gross profit margin development. Could we expect also higher gross margins coming through particularly because of the German development and we seeing that? How much do you expect this will impact fully this year? And in that as well, what do you expect for next year regarding CICE or a similar new model in France which could be present by the end of the year?

Alain Dehaze
Chief Executive Officer, Adecco Group AG

A

There are many questions, and I suggest I start with the guidance, then Hans can go to the gross profit margin, and then I can elaborate on the CICE. So regarding your point of growth, and first of all, when you look in details at the 6% of the first quarter versus the 4% of the second quarter, these are rounded figures. If you look in details, we had about 5.5% in the first quarter and 4.4% in the second quarter. So we speak about a kind of deceleration of 110 basis points. That's point one.

Second, when we looked at the economic outlook, you look at the macro, they are all remaining good, including when we look at the buying pattern behavior of our customers these days are robust.

Now, going in all figures, yes, there was a kind of moderate slowdown in certain European markets in Q2. First, you see Italy and Iberia. Still, I would say normalized growth because Italy [indiscernible] (00:24:23) quarter of

double-digit growth, and we are entering there in a kind of flow of normalized growth; the same for Iberia. For sure in France, we had a weak month of May because of a combination of the holidays and also the strikes, but I would say the good thing there is that on the other side of the ocean, we had the U.S. and there we have been able to turn positive the Adecco General Staffing business to 3% growth, which is a good news because it's the strongest or the best performance since the second quarter 2015, which also proves that the recipe we have; segmentation, commercial system, a new front office that we have deployed in the U.S., like we have done in previous countries before, is delivering its fruits. So, that's why we said it is a broad-based growth.

Now, going into the future the exit growth rates June-July combined is 4%. We expect this growth to continue at that sort of level. Let's not forget, we are still mid-cycle in Europe and we have no U.S. economy, which is very supported by tax cuts and strong employment growth, not avoiding or forgetting to mention that the longer-term perspective. All these mega trends are driving increased penetration rate. Our customers are looking for more flexibility. And so, we are convinced that we have this and we will generate structural growth through the cycle.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

If we turn to the gross margin, I think we saw into Q2 on CICE this year, this reduction from 7% to 6% which impacts our gross margin to be negatively impacted by 15 basis points that we expect [indiscernible] (00:26:42) in Q3. On the margin guidance on CICE for 2019, there is nothing new to report because next year there will be this change from CICE to the [ph] social curve (00:26:56) but that's in line with what we discussed in the previous calls.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

Now...

Alain-Sebastian Oberhuber

Analyst, MainFirst Schweiz AG

Q

Thank you.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

...regarding your sub-questions CICE. Since the last quarter, we had no update or further update. And we expect like we mentioned in the previous quarter that this will be transformed into a kind of equivalent reduction in social charges from 2019. We are waiting for the details how this social charges reduction will be distributed among the level of the salaries, which is very important for us and which could also have a positive impact for us. So, unfortunately there are still today lots of moving parts, and we have to wait for the so-called budget draft law, which will come out in September in France to get more details on that.

That's it. So, I think I cannot say anymore.

Alain-Sebastian Oberhuber

Analyst, MainFirst Schweiz AG

Q

Thank you very much, Alain and Hans.

Operator: The next question comes from the line of Chirag Vadhia, HSBC. Please go ahead.

Chirag Vadhia

Analyst, HSBC Bank Plc (Broker)

Q

Hi there. I've just got two questions. I would like to understand the underlying operational leverage of the business a little better. So, SG&A was up 4%, of which you mentioned 3% is strategic. And I think FTEs are up 3%, and the branch is up 4%. So, without these investment costs to facilitate future growth, what could the margins have been?

And the second question, sorry, do you monitor what the percentage of vacancies you're failing to fill? Do you have a feeling for whether it's getting harder for Adecco to match the skills demanded with the candidates you have? Thanks.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

Yeah. Let me start giving some more color on the operating leverage. As we said that and as in the cost base, we are making the right investments for the future and that is impacting the cost base into the second quarter. And our Digital Ventures now are also into full swing, because we added Vetterly and General Assembly. But we also saw that there is the investment in this quarter is at full swing. The good news is on the investments that in the second half, we will bring the first €50 million of GrowTogether savings, which will drive our operating leverage and performance.

If you look into the quarter at the underlying operating leverage, we drove 5% improvement in gross profit from a 3% improvement in head count. So, we have seen operating leverage into the quarter. You have to remember that's on the back of a very strong productivity in Q2 last year because recall in Q1, Q2 last year, we grow very strong operating leverage.

So, we drove on top of that with a 3% head count, at least a 5% gross profit. We did that while we're making the investments in the U.S. of our segmentation strategy which is driving growth and will drive the results, while we're investing in France with a very strong margin to deliver strong growth, and we have the drag from Germany. And that's all in that operating leverage.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

Now, regarding your questions about the percentage vacancies, it is clear like in country like the U.S., it gets harder to find candidates. But we are helped or it helps on two things. First of all is that we are getting more pricing power and negotiation power because we translate these efforts. We are spending in price increase. That's point one.

And second, we are also, and especially in the U.S., we are putting technology at work. That's for example why we have to put Mya at work in the U.S. at around 70 customers now, so that this prescreening outreach of the candidate is fully automated 24 hours per day, 7 days per week allowing to work on our efficiency and productivity. So these are the two points on the vacancy.

Chirag Vadhia

Analyst, HSBC Bank Plc (Broker)

Q

Thank you. Thanks.

Operator: The next question comes from the line of 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 from my side. First of all on the U.S., could you give some indication of split on what the increase in General Staffing from volumes and, let's say, price wage? And secondly on Italy, of course you have with the new coalition, some implications maybe for the labor market. Do you have already some more detail on the new legislation and what the impact could be for your operations in that country?

And then going towards the strategic investments, 30 basis points impact slightly higher than initial guidance. Could you give some more flavor on what's the reason behind that? And secondly, what do you expect, let's say, going forward? Should we expect more investments in that in also next year and H2? And lastly on amortization and depreciation it was up sequentially somewhat also year-on-year. Where there some one-offs in there related to write-downs related to restructuring cost? Could you give some feeling on that?

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

Yeah. Many questions. You start, Hans, with the U.S.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

Let me start with the U.S. The good thing I think in General Staffing, as I said, we had a good quarter and I think that the investments we're making are paying off. It's helped with a little bit wage inflation, around 2%, 3% depending on the area. So, that shows that that's helped, but it's still low in General Staffing. On Professional Staffing, this helps the margin. It was a little higher. It was around 3%, 4%.

And on the strategic investments, you're right. In Q1, we were a little bit off our guidance. In Q2, we're back to the guidance. We better understand now that we are in full investments. It's a little higher than we guided in the Investor Day, and the reason why that is, is that the transitioning into these old legacy-based systems and then also to this digital world, the integration costs, some of the transition costs into that was a little bit more than we anticipated.

We have now strengthened our process of that. That is now in line with the guidance, but that is a little more. The good news is that it's just transition costs. And the good news is that when we put the new technology in, we will deliver the productivity as we had expected. In Q3, that will impact the margin a little bit as well because we have a little bit more digital into the mix in Q3, while we have a little bit more on that transition cost on the core business also hitting the third quarter.

So, I think versus the 25 bps we gave in the Investor Day, we're probably around 5 basis points higher. So, it's a little more. It's not good, but we know what it is, and it was due to the transition into the new world. And on your amortization question, those are related to the recent acquisitions of Mullin, Vetterly, and BioBridges.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

Now, coming to the Dignity Decree because that's the name of what the new government in Italy has approved 48 hours ago. And in this Dignity Decree, you have different new rules. One of them is now a shortening of the maximum duration of fixed term and temporary contract from 36 to 24 months. There is also an additional

surcharge of 0.5% if you use that kind of contract. There is also a maximum [ph] prorogation of 4 (00:35:55). So, these are the major let's say point in this new decree which has been improved and that will be enforced by the 1st of November of this year. Yeah.

Now, regarding the second part of your question, impact. With the visibility of today, it is quite difficult to have already a clear visibility, but it could also be positive for us. First of all, 24 months period, we have not that many mission with more than 24 months in the temporary staffing. This is point one. So, there I see a limited impact. But I see clients who could decide to replace some workers with a longer term fixed contract with temporary agency workers.

And let's not forget that this fixed term market in Italy is 4 to 5 times bigger than the temp market. So this could be also an opportunity. Flexibility in Italy but also in the word will remain very important given the economic and political uncertainty. And so, we expect our customers to tap into the temporary solution further as the temporary staffing is the form of flexibility that provide the most protection for workers, for example, with equal pay and the other employment rights.

Hans Pluijgers

Head of Research, Kepler Cheuvreux SA (Netherlands)

Q

Maybe one quick follow-up on that. So, are you, let's say, also thinking about taking more temps on your fixed payroll to fill in, let's say, somewhat longer-term demand by some clients?

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

This is for sure one of the avenue.

Hans Pluijgers

Head of Research, Kepler Cheuvreux SA (Netherlands)

Q

Okay. Thanks.

Operator: The next question comes from the line of Suhasini Varanasi, Goldman Sachs. Please go ahead.

Suhasini Varanasi

Analyst, Goldman Sachs (India) Securities Pvt Ltd.

Q

Hi. Good morning, everyone. Just a couple of questions from me, please? In France, it's very good to see the strong organic growth, 8% ahead of the market. Just curious to hear what your thoughts are on what's driving it and whether it's sustainable into the second half.

And second one is on the exit rate. Obviously, you're running at around 4%. What are the implications on operating leverage going into second half of the year? You've talked about productivity savings, but if this top line growth continues at the 4% levels, are you still comfortable with margin expansion in second half coming from productivity savings? Thank you.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

Okay. On France. On France, 8% growth. So, indeed, we are very pleased because it is also – it is outperforming the market. And remember, we told you last year that we would come back in the first quarter at market. We did it.

And in the second quarter, we are outperforming the market with about 400 basis points. And we are doing it, this is also very important, in a profitable way. We remain the most profitable company among the peer group in France. The profitability went down with 70 basis point, but 60 basis point is coming from the CICE reduction from 7% to 6%. And also, we are investing in France and we can mitigate that through our cost control and pricing management.

Now, what were the drivers of this growth? The drivers were, I would say the classical one, manufacturing, automotive, logistic, distribution. They were all at double-digit growth. What was, let's say, slow growth – flat to slow growth was two segments: construction and retail.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

The question on the second half, 4% organic growth is not 6% we started the year with. That will have an implication on how much operating leverage you have, but that doesn't mean you don't get [indiscernible] (00:40:16). We continue to expect to improve our profitability in the second half after the decline we had in the first half. But a couple of points I think which are very important to you. One, on road to get a productivity savings, we're on track and we'll deliver €50 million or 40 basis points into the second half and we're pleased with the things. And we'll lay out in the second half where and how we delivered those on the progress we're making.

Offsetting that, we continue to make investments in our strategic initiatives and the digitalization of the group. As we said in Q2, we invested a little bit more in our IT and [indiscernible] (00:41:02) for the reasons I mentioned before. And we'll see the total strategic initiative impact this quarter at around 30 basis points. I would expect that Q3 will still be a little higher at around 40 basis points. So, Q3 will be impacted by the investments. And that's, as I said, a little above where we want to be for this additional transition cost from the legacy world to the digital world. But the good news is, all together will come through. So, I think that's also important.

And last but not least, what will be in the transformation of our German business will be remaining a little bit a drag on our growth and profitability in the second half because we were making all the right changes. In Germany, we are confident that we're doing the right things. But given the size of the change, that takes us a little longer. And that will be a drag. And as we said, in Q2, we drove good operating leverage while we made these investments and had the German drag.

Suhasini Varanasi

Analyst, Goldman Sachs (India) Securities Pvt Ltd.

Q

Understand. Just a quick follow up then, because consensus is probably looking for 4.7% margins for this year, which implies some margin expansion in second half of the year – maybe flat on Q3, a little bit up on Q4. So, it sounds like what you're saying is that Q3 is probably still going to see a decent impact from the strategic investments which will offset those productivity savings and maybe it's Q4 weighted. Is that right?

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

I could give a couple of – I can't comment [indiscernible] (00:42:43) of short visibility. That's the nature of our business, I think a couple of points, I think. Maybe I'll give on Q3 a little bit more what's happening.

Suhasini Varanasi

Analyst, Goldman Sachs (India) Securities Pvt Ltd.

Q

Sure.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

If you look at the gross margin in Q3, M&A will continue to be positive at around 30 basis points because we get them full, which is great because it shows that we have new businesses which adding higher value to their customers and are in an investment phase with our good gross margin businesses. Between permanent recruiting and our placement, you see the offset, the plus and the minus. And we'll see CICE in gross margin having a minus 15 basis point impact. And I think if you then add what we have seen into pricing and mix in the first half that gives you some more color how you can link at gross margin. I would say on Q3 the sequential growth of the SG&A I would say would be plus 1% because we still have in Q3 the investments we discussed. That gives you a little bit more color on the third quarter.

Suhasini Varanasi

Analyst, Goldman Sachs (India) Securities Pvt Ltd.

Q

That's very clear. Thank you.

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

Tom Sykes

Analyst, Deutsche Bank AG

Q

Yeah. Good morning, everybody. Just following up on that last point. Is it possible to say ballpark how much of the GrowTogether savings are actually taking out cost? And how much are just not putting cost in if you're growing and would be considered productivity gains?

On the issue of temp-to-perm fees, is it possible – I assume you put this to your temp gross margin, but is it possible to say what the growth of temp-to-perm fees and how significant they are at the moment, please?

And then on the cash flow, the CapEx has obviously been very high in H1 I think at around about 90%. I just wondered if it's possible to split out how much of that might be software systems related and how much is sort of other fixed assets and whether there's any internally developed software costs that are going on to the balance sheet there, please?

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

Well, I'll maybe start with GrowTogether. We will deliver operating leverage and we will structurally, as we always said with GrowTogether, improve the productivity of the business, and that will be in three areas, which are our main activities.

Three main activities is from client capture to invoice, our recruiting processes, and our sales processes. And the €50 million we will deliver will be from – in those three areas, and when we announce Q3 and Q4, we'll be specifically showing you how that will impact our business. But in the U.S., we have rolled out new home office solutions, which are impacting the margin now, and we will see productivity from those new systems in the second half.

In France, with the new candidate portals and also with our new – the investments we have been making, we'll see a higher level of productivity and then we're digitalizing [indiscernible] (00:46:16). So, you see that we will see an acceleration of operating leverage, which is fueled by the GrowTogether program.

So, before Alain might want to give some color on the temp-to-perm business, the cash CapEx is higher. We expect, for the year, around almost €20 million. Yes, there's always some software development cost in CapEx. We are working with large partnerships. So, we're not developing our own software, but that doesn't mean with Salesforce or Microsoft, we need to develop the solution using their technology. So, the technology is from well-established global players like Infosys and also developing the Adia tools. But the development of that is our software. That's good because it's then our technology leveraging global supplies.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

Now, regarding your question to – about temp-to-perm income, where we see a really substantial increase of temp-to-perm activities is in the U.S., especially in the General Staffing activities because there is a tendency of trend also to hire faster the people. It has been in the media.

Nevertheless, when you look at our performance – strong performance on the perm and 18%, first of all, this performance is really global-based. We see a strong performance in every part of the world, being in Japan more than 25%, being in Europe and being in the U.S. And also this perm is coming, yes, from one part from the General Staffing but especially from the brands – the specialized brands we have launched years ago in the professional recruitment, Spring and Badenoch & Clark, and we have really a very good success with these brands globally in all the countries where we are active with these brands.

Tom Sykes

Analyst, Deutsche Bank AG

Q

Okay. Thank you very much for that. Just to be clear though, so if somebody sort of six months in working and then on a temp basis, and then they get converted and you get a fee for that. You are actually booking that into your perm revenues as opposed to putting those in your temp revenues? And so, that will not affect your gross margin? I thought it was actually booked in temp revenue, so reflecting at the temp gross margin. That's basically the essence of the point is how much might those conversions be affecting the temp margin?

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

Yeah, yeah, I understand. No, no, two input on this. If we would indeed have temp on temporary staffing, so the margin would be booked in temporary staffing. And if we would get a fee for a perm transaction following the temporary staffing, it would be booked in the perm business. Now, you know also one of the – especially with large customers, one of the – a lot of agreement we have is that we pay ourselves through the temporary staffing. And so it's not that always we get, at the end of temporary staffing, end of fee though. The temporary staffing is also paying the perm fee.

Tom Sykes

Analyst, Deutsche Bank AG

Q

Okay. Thank you. Sorry to be a bit of a dog with a bone, but is it just possible to say broadly approximately what percentage of sales or gross profit and the level of change that we're seeing now, because obviously, some peers particularly understate the same quite. Okay.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

It's not really material. We don't see a material – if your question is do we see a material shift from temp to perm, we don't.

Tom Sykes

Analyst, Deutsche Bank AG

Q

Okay. All right. I'll leave it there. Thanks very much.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

Thank you, Tom.

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

Michael Foeth

Analyst, Bank Vontobel AG (Research Firm)

Q

Yes. Hi gentlemen. Three questions. One regarding France, you already elaborated which segments that your growth came from mainly, but I was wondering is there are any particular larger client wins that explain the outperformance versus peers, and which would then also make that outperformance sustainable into the coming quarters. That would be the first question.

The second question is if you could just explain the strong growth in Switzerland? Is that in line with the market or anything particular that happened there on your side?

And the third question is North America General Staffing, the re-acceleration, if you could give some color also here which segments in particular that came from? Thank you.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

Yeah. Okay. Regarding France, no, there is no particular customer wins which would influence significantly our performance and our growth. No, I'd say. It's really a very broad based according to the growth I've given by segment. So, no, nothing special to mention there.

Switzerland, I think Switzerland, I would like to reflect a little bit, because remember more than two years ago, Switzerland was a very difficult market for us. And we did four things. We started by changing the leadership. Then we put in place the segmentation, meaning treating differently a large customer from small and medium, the on-site offer. Then we put in place our commercial system, the so-called [ph] CCPN (00:52:38). This has been rolled out. And we also changed the commercial front system.

And we are very happy to see that, yeah, after having put our classical recipe in Switzerland, we are reaping the benefits of what we have applied in other countries. We have applied that in France. We have applied that in Italy, in Spain. We are now applying it in the U.S., and we are also in the process to apply it in Germany. So, that's why we did what we did.

Now, coming to North America General Staffing, please remind me your question.

Michael Foeth

Analyst, Bank Vontobel AG (Research Firm)

Q

Yeah. Just which industries are primarily driving that?

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

We see in the half year particularly the improvement we're seeing in the U.S. is driven by also the segmentation strategy. So, we see that we're gaining of course more sectors growth, so that is a more sustained level of growth from the investments we have been making with the segmentation strategy. And then – yeah.

Michael Foeth

Analyst, Bank Vontobel AG (Research Firm)

Q

Yeah. Any particular industry verticals, like logistics or...

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

Yeah. We see technology doing good. We see consumer goods, automotive, manufacturing. We are at low level. You have seen 3%. But this one are, let's say, stable to up single digit where we have more down double digit, it's medical and health care, but that's the overview.

Michael Foeth

Analyst, Bank Vontobel AG (Research Firm)

Q

Thank you.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

Thank you very much.

Operator: The next question comes from the line of George Gregory from Exane. Please go ahead.

George Gregory

Analyst, Exane Ltd.

Q

Good morning. Thanks for taking my question.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

George.

George Gregory

Analyst, Exane Ltd.

Q

So, a couple, please. Hi. If we start with just the – going back to the Q2 EBITDA margin bridge, just digging into that in a little bit more detail to clarify the moving parts. So, it looks like price mix and CICE were a negative 25 basis points. You've articulated strategic was negative 30 basis points. It looks like working days was a positive 10 basis points. Correct me if I'm wrong, but that sums to a negative 45 basis points. Just to be clear, if you could

split out the remaining positive 15 basis points between productivity and anything else, please? That's my first question.

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

Yeah. We got two. One, we got operating leverage in the balance of the business [indiscernible] (00:55:37) because within that, we have Germany as well. And we have – the gross margin was stable because we had positive impacts from outsourcing and the net balance between the perm business and [indiscernible] (00:55:54), so, it's most likely positive this quarter. So, we got some offsets in the gross margin, and we got the operating leverage offsetting it.

George Gregory

Analyst, Exane Ltd.

Q

So, to the plus 15 basis points, you would consider to be, what, net positive leverage?

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

A

Yeah, because as such, we have around – if you include in Germany, which is a drag, we have 2% improvement in the sales and gross profit per FTE. And again, that comes on top of a very strong Q2 of last year.

George Gregory

Analyst, Exane Ltd.

Q

Okay, because it looks there were a few other – when we look at the gross margin bridge, I mean, M&A was a positive, perm was a positive. But you see, you think there was an underlying 15 basis points productivity improvement in Q2. Okay. Just secondly, just on CICE, I think there's already been some guidance on the distribution of the payroll tax cuts across salary bands. And as far as we understand it at least, the payroll tax cuts are unlikely to fully compensate for the loss of tax deductibility next year. Just be useful to get your best current take on that given that I think most people consensus are assuming that it's going to be neutral next year. So what's your sort of best take? I appreciate it's not been fully formalized yet.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

A

No, it has not fully formalized. So what has been said by the government, the French government is that it should be – we should – nobody should lose out of the compensation and the transformation of the CICE in social charges reduction. But what is not clear today is how the social charges reduction will be distributed by level of salary because there will be different level of reduction according to the level of salary. This is point one.

And to compensate potentially higher tax, they would also put – they will also increase the social charges. But all these details have not been confirmed, and that's why we need this draft law in September, the draft law for 2019 to have more details on that. But I can – I think that we have – as the biggest private employer in France, we are rather good informed. But this is the stage of the information we have.

George Gregory

Analyst, Exane Ltd.

Q

Okay. So too early to be able to say whether it would be...

Alain Dehaze

Chief Executive Officer, Adecco Group AG

Yes.

A

George Gregory

Analyst, Exane Ltd.

...neutral or negative. Okay. And sorry, Hans, just going back to the margin bridge there and thinking about Q3/Q4. You talked about margin improvement in the second half. Just to clarify, should we expect Q3 to be more of a stable profile given the ongoing strategic investments or within that could Q3 still be slightly down?

Q

Hans Ploos van Amstel

Chief Financial Officer, Adecco Group AG

We will see an improvement in the margin trend versus what we see today. When we look at Q3, we need to take still a couple of points into account which we pointed out. And that is that we have that higher level of investment which we discussed during the call flowing through into the cost of Q3 and we expect sequentially versus this quarter SG&A in total to be up about around that 1%.

A

George Gregory

Analyst, Exane Ltd.

Okay. Thank you very much.

Q

Alain Dehaze

Chief Executive Officer, Adecco Group AG

Thank you.

A

Operator: Gentlemen, there are no more questions at this time.

Nicholas de la Grense

Head of Investor Relations, Adecco Group AG

Well, thank you very much, everyone for joining us in this busy results season again so thank you for joining the call. And just one final reminder, we'll be hosting an investor seminar in London on September 19th and we would love to see as many of you as possible there. Thank you very much.

Alain Dehaze

Chief Executive Officer, Adecco Group AG

Bye-bye.

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

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