Q3 2018 Earnings Call

MANAGEMENT DISCUSSION SECTION

Jacques W. van den Broek

Yes. Thank you very much. Good morning, everybody. Jacques van den Broek here, together with Henry Schirmer and David Tailleur to take you through our Q3 results, and of course to handle questions you might have afterwards.

So, I immediately start at slide 6, which has a few of the headlines as far as we're concerned. So, mixed growth, some slowdown in Europe, but improvement in the U.S., still very strong in what we call rest of the world, leading to an organic growth of close to 3%. And we're very happy with the fact that based on stable margin and good cost management, we've been able to improve our EBITA both as a percentage, but also in absolute terms with an ICR slightly above 50%.

So, where is the growth still coming from? Our Professionals business doing very well in many markets. Perm, still like Q2, 13% up. Our North American business, very happy there. We do see good growth in our Staffing business being above market with 5%. Our Professionals business all growing. You know and I say the hard work we've done in our Professionals businesses and very happy with where they are. And also, our Canadian business, 10% of North America back to growth again. Then rest of the world, I flagged that already in the second quarter, is now annualized some €2 billion, so the size of our German business, half of our U.S. business, but growing above average at very decent returns. So, definitely a new area of strength for us as a company.

The digital strategy, as many of you know, tomorrow, we'll have a breakfast where we'll go more in-depth, but we just want to share a few highlights, because next to managing the business as is on a daily basis, we're very much of course working on our growth for the coming three to five years.

Some highlights here on workforce scheduling. This is where we give a planning tool free of charge to our clients. We connect them, thanks to app technology to basically plan themselves. We do this in our current Inhouse businesses, but also towards clients which don't have an in-house, because they don't want to buy it as service or they're slightly smaller. It's now implemented in nine countries.

The country where it started was France. They've now implemented it at close to 300 clients, basically their existing clients and they are now moving to prospects. So, very much moving towards prospects we feel will fuel our growth into 2019 and beyond.

Data driven sales, the support for our consultants where they know where demand is, where they can combine one visit with a client with another prospect that on their mobile shows that there's opportunity. We started this service or this development in our main markets, U.S., France, and the Netherlands, but made in their home system, in their back office. Now, we have a system in Belgium that is going to travel around the world and then we will implement in six countries going forward, helping our consultants to be more effective in sales.

Candidate engagement. As you know, we work under the assumption that clients will less and less be actively looking for a job, so we really need to engage them very proactively. We call that dialogues. So, in 12 countries, we now have various initiatives with chat bots, some off-the-shelf third-party, some we made ourselves. Chat-bot is very young technology, so we're still experimenting here, but there's a lot of traction going on, a lot of learning going on for us and our consultants.

And then, finally, again, aimed at candidates, video and digital assessments. This enables our candidates to connect with us wherever and however they want either at home or through mobile; now active in 21 countries, again, making us more accessible for candidates around the world which we think is crucial going forward.

Going to slide 7, looking more in-depth at markets. I already said how happy we are with the return to positive growth of all our Professionals businesses in the U.S. Great complements goes out for me to our colleagues. Our Randstad Professionals business is aimed at financial profiles, had a struggle, but we have seen consistent improvement throughout the year, now leading to positive growth in this quarter. Our Staffing and Inhouse business, 5% growth, above market. Inhouse is still doing very well there.

And our Canadian market, the Canadian market was hit by legislation, basically a variance of user pay in the Toronto area, but still we bounced back into growth this quarter and that leads to a stable above average group return of 6.2%.

The Dutch market, very disciplined on pricing. As you know, nothing new there, but we're still closing to get to market here. Our Staffing and Inhouse business is quite stable at a 2% growth. Our Professionals business at 15% growth and above market absolutely. And perm for the group at 13%, but also in our Dutch business, a growth of 9%, so an improvement there.

We turn to slide 8, our French business. What we see here is that the growth slowdown is in our large accounts, partly our own doing. As you know, we have large clients in automotive. We do see weakness in this sector, that's most of the weakness we're seeing also in France.

Our SME space is still growing; roughly 50% of our branches still see positive growth. So, it's a mixed picture, but overall, a slight deceleration. But again, here, like our Dutch business, for example, our Professionals business still up quite good, mainly driven by our medical business, L'appel Medical. Our EBITA margin goes down as a percentage, but that's wholly or almost wholly due to the lower CICE subsidies we got here, and also the lower growth. And still in Q1, we still saw high growth. So, we could, in a way, compensate it in absolute terms. That's tougher now.

Our German business, also automotive. Automotive as a sector in Germany is even more important than it is in France. So, you see the sequential drop from 6% growth into 2% minus into – from Q2 to Q3. 75% is due to this automotive weakness, you see in many of our clients going out with warnings on trade tensions and also the fact that there are some unclarity about diesel legislation, which meant for them that they had to tone down the volume production and of course, they use flexible labor also to battle their own costs here. So, you see it in our Staffing and Inhouse business predominantly. Again, Professionals, very stable in our German business. EBITA margin going down as a result of this and we will take out cost in this quarter in Germany to adjust to the lower growth.

Belgium, again, a very stable performer in our markets growth going down, but still above market. Also, here again, very good perm. As you know, in many of our large Staffing businesses a few years ago, we started also selling perm through our staffing consultants. Works very well for us as it does in Belgium in many countries and a quite stable and above group average and high margin.

Italy; very tough comps for last year this time around, probably around 25% growth, but still 7% growth this quarter. Again, strong perm growth, same story as Belgium and good returns. There has been some design new legislation in Italy. It's actually too soon to call the actual effects. We don't see it yet in our markets, but we will definitely keep you updated once we know more. By the way, the same goes for France on the changes of CICE into another scheme. Too early to talk about the details here.

We move to slide 10 on Iberia. Our Spanish business, again tough comps; last year, high teens, good growth 3%. Great cost management there where the EBITA percentage went up. Our Portuguese business, however, is down. Other European countries, again, tough comps almost everywhere, but still an improvement in EBITA margin, so quite happy with the way our colleagues in all these markets are handling the current market circumstances.

We move to slide 11 of rest of the world. As I said, it's been a region for us. We're there now for a little bit more than 10 years, but certainly now, we do see this becoming a very, very important market sector or call it region for us. Our Japanese business shows good growth. But also, this – Japan is a market with low unemployment, and our management has become very diligent on pricing. So, margin is increasing there, and also our results then go up also based on good growth in perm.

Our Australia business, way above market as far as we can judge with 14%, so well done there. Our Chinese business up 6%, Latin America, which for us is predominantly Argentina and Brazil, growing at 30%, 35% in Q2, so stable there. Also in this business, we see Sourceright, so RPO in the Brazilian business becoming a part of our sector. Most of this region is very much perm-led, and therefore, for the whole region, perm is up 16% driving our results.

Then we go to our global businesses starting with Monster. As we mentioned in Q2, this business is financially under control for us. We are increasingly using the Monster database and the Monster capabilities for our Randstad consultants. You know it is very much part of our strategy to create a bigger data lake accessible for our consultants, and over time, also using the data out of this data lake to talk to our clients on trends we see in the labor market availability of talents. But at the same time, that's investment. So, the balancing act for Monster is very much the old business, the job postings, being under pressure, and the new businesses are gaining traction in the Monster top line.

New products such as Monster Studios which we launched at HR Tech in Las Vegas last month, where clients can basically present themselves through their own videos, their own clips to a tied labor market. And that was met with quite some enthusiasm. Also, the resume builder something we got from RiseSmart where we allow our candidates to create a very effective social media profile and they're paying for that. So, that's great, very promising stuff, but still a lot of work to be – to really revamp this business as such.

Let me go to Sourceright. On the first instance, you might say, okay, so 14% growth in Q2 and now, we do feel that in Q4, given the pipeline of clients and new clients we're currently landing here, they're very optimistic that the growth here will increase in Q4. So, that's very much what we see currently around the globe.

And with that, I take you to Henry to update you on the financials.

Henry R. Schirmer

Okay. Thanks, Jaques. So, it's my pleasure now to take you through the financial results and then move to Q&A after that. Let me go straight to the P&L here on page 13. So, we look down – revenue down to EBITA quarter three year-over-year.

And as discussed by Jaques, we reported a competitive revenue growth of 3% in light of slowing macro and toughing markets in Europe. It was good to see again the strength of our portfolio coming through. Perm and rest of the world grew double digits with excellent conversions and North America accelerated growth. Gross margin came in at 19.8%, down 30 basis points, underlying stable and slightly ahead of guidance. Operating expenses are up 1% year-over-year, well monitored and under control and we've been able to adjust the cost base quickly to changing market conditions and are still geared up to capture further growth opportunities.

And last but not least, EBITA came in at €299 million with a 5% EBITA margin, 10 basis points up year-over-year. Quarter three was a pretty clean quarter with just 0.3 extra working days, hence not an awful lot of tailwind from that side. Let me also point out that the incremental conversion rate for the last four quarters was about 50% and even higher in quarter three.

So, now on page 14, we show the gross margin in a bit more detail. For the gross margin, it's a solid story. On the left, you see the quarter three 2017 gross margin of 20.1% and the very right part shows the quarter three 2018 gross margin of 19.8%. As mentioned, the gross margin came through underlying stable ahead guidance and 30 basis points below last year. The fact that year-over-year the gross margin is showing a blow, is again mostly related to mix.

The bar on the left shows the impact of our temp gross margin which is 20 basis points gross margin dilutive. And 10 basis points of the 20 basis points are due to lower CICE payments in France and the remainder of the 10 basis points relates to price mix, fully in line with the last quarter. The bar in the middle shows the positive impact of our fast growing perm business, 13% growth, driving 20 basis points positive mix. It's all fee income and therefore gross margin accretive.

And lastly, the red part on the right represents HR services including Monster. And as stated before, Monster is 100% fee business, still in decline. And hence, it shows up negative mix in the bridge, also here a pure technical effect.

Also going forward, there will be quite some mix effect at play here. We always have an eye on gross profit in relation to OpEx to ensure enough benefit is showing up in the EBITA. It is reassuring that the underlying price environment is stable and even improving in some areas like France and Japan.

On the next page, page 15, operational expenses. As you know, operational expenses are always getting our full attention, but especially in times of economic uncertainty. And sequentially, we reported OpEx coming down from €908 million in quarter two to €892 million in quarter three with adverse forex impact of €4 million and €19 million organic net OpEx decrease. Costs are down 2% sequentially and just 1% up year-over-year, reflecting the flexibility we have in our cost base. Also, productivity was stable year-over-year.

Finding the right balance between tough cost management, investing for growth worked out well in quarter three and we do our best to do the same for the remainder of the year. It's one of the keys throughout the business for leverage going forward. Let me also close the chart with a confirmation that we are fully on track to deliver our cost savings target of €90 million to €100 million annually by 2019, as presented to most of you at the Capital Markets Day in November 2017.

So, on page 16, let me now shed some light what it all means for cash flow and balance sheet. So, reported free cash flow for the quarter of €220 million, an improvement by €43 million in absolute terms and 24% up year-over-year. But the main driver for the good cash flow was an improved EBITA, helped by reduced working capital requirements, which illustrates perfectly the countercyclical nature of working capital in our business. And hence, the resilience of our cash flow through economic cycle.

The last bullet on the left shows day sales outstanding which increased by 1.5 days on its first month on the 12-moving average, mainly due to mix effects. Note however this was sequentially stable. And on the right hand of the chart, let me go straight to our strong balance sheet. Despite our special dividend payment of €126 million in quarter three, the net debt came in only €30 million higher than last year. We reported an improved leverage ratio of 1.2 versus 1.4.

Most of you will know that quarter four is traditionally one of the strongest free cash flow quarters in the year. This time, it's all supported by CICE cash-in of about €100 million. Our guidance on taxes remains unchanged at 23% to 25% for effective tax rate and slightly north of 20% for the cash tax rate and we iterate our guidance for our higher free cash flow year-over-year.

Now on page 17. Let me just summarize the key messages and provide you with an outlook for the full year 2018. Firstly, the quarter brought competitive top-line growth, further EBITA progressions and strong free cash flow conversion. Secondly, our digital strategy is well underway and embedded in our business and it's not only helping to drive productivity, it also redefines our way we engage with customers and candidates. And thirdly, we are well positioned to deliver a full-year EBITA margin ahead of last year's 4.6%.

On the right side of the chart, I'd like to mention the fact that September and October so far grew at a similar pace at quarter three. And as far as Germany and France are concerned, we do not expect to return to growth yet. Let me point out that the gross margin for quarter four is expected to be modestly lower sequentially. We don't receive CICE for the month of December, as the replacement subsidy will start in January 2019. We also expect OpEx to be broadly stable sequentially. In quarter four, there will be an additional 1.1 day impact on number of working days.

Well, that concludes our prepared remarks. I hope it helps shed some light on our Q3 performance. We're now delighted to take the questions. Operator?

Q&A

Operator

Thank you. [Operator Instructions] Okay, we have a few questions coming through. And the first one comes from the line of Bilal Aziz from UBS. Please go ahead.

<Q - Bilal Aziz>: Good morning, everyone. And just three quick questions for me please. And firstly and just on Germany, and clearly quite a lot of noise in the German labor market right now. Do you see just most of the weakness you saw was tied to the disruption in auto? So, just trying to get a sense of the near-term outlook, given you still expect to be negative in the fourth quarter and whether you expect a small pick up if auto production bounces back? Or do you feel with the general market is now also slowing?

Secondly, in Italy, there've been some regulatory changes over the summer, and have you seen that negatively impact the demand for temps within that region? And finally on gross margins and your underlying temp margin have seen a gradual improvement as we moved through the year. How much of that is pricing slightly getting better with wage inflation versus just mix moving around? Thank you.

<A - Jacques W. van den Broek>: Okay. Yeah, on Germany, we don't expect an improvement, Aziz. So, automotive is a sector that works with – it's quite a planned sector and they don't expect an improvement, as far as we can see always for this year. That's also why in Germany, we take out costs accordingly. The rest of the market is quite stable, but the 18 months rule has a bit of an effect on the temps being hired quicker. So, not a lot of deceleration, but definitely not an improvement for the rest of the year. So, that's Germany for you.

Italy, yeah, there's no effect yet on the demand purely because of legislation. There must be, of course, more of an uncertainty in Italy, but that's always very tough to call. We still see 7% growth on the 25% we saw last year. So, all in all, still a pretty good picture for us in Italy.

<A - Henry R. Schirmer>: I'll just chip in on the margins in Italy. Actually, pretty stable gross margins, but I give kudos to the Italian team that's been very disciplined on price management, but then also turning that into EBITA with good OpEx control.
<A - Jacques W. van den Broek>: Yeah. So, on gross margin in general, it's partly ourselves. As we said, we do see – we do say goodbye to some clients. Sort of the fact that Henry said that gross margin in France is stable, is also us proactively changing the mix which comes, yeah, at [ph] cost of terms (00:22:51) of top line growth, but we do feel it's our role as the leader in this world, not in France, we're the number three, but still leading the way here on sensible pricing. We think that's important for the long-term sanity of the sector.

In general, certainly in the U.S., but also in countries like the Netherlands and Japan, there is some pricing power if you might call it like that because of the scarcity. And again, we're very disciplined on pricing. In the Netherlands, we support this with data. So, there is a pricing tool that our consultants discuss with clients where based on the profile and based on the relative scarcity in the market, a price comes out and that shows some good results for us in our Dutch business.

<Q - Bilal Aziz>: Thank you very much.

Operator

The next question comes from the line of Paul Sullivan from Barclays. Please go ahead.

<Q - Paul Sullivan>: Yeah. Good morning. Just on gross margin and the sequential decline you're flagging for the fourth quarter. Presumably that's all to do with the CICE transition and is there a risk that that could continue or be a drag into next year and manpower pretty specific in the CICE impact, as I saw it – as I see it now running through next year, you're still sort of not commenting. I don't know whether you can comment on that.

And then, secondly, in terms of the OpEx control we saw in the third quarter, how much of that is due to your sort of structural and more strategic cost reductions and how much sort of was due to, sort of, nearer term, sort of short-term measures? And can that be repeated if growth slows more materially from here? Thank you.

<A - Henry R. Schirmer>: Thanks, Paul, for your questions. Good morning. So clearly, on as far as the gross margin is concerned, we at this point in time, we've got the visibility that CICE in December will not come and we are – we don't guide on CICE going forward. We need to wait the news in quarter four and as soon as we have something to talk about, we will.

So, as far as the OpEx concerns, there's clearly measures we're taking now in the short term. You've seen that in quarter three. We'll do the same in quarter four, but then also going forward, we will have very, very close eye on operational expenses. So, we are clearly factoring in a slightly lower growth in – for the next quarter and that will show up in OpEx as well.

<A - Jacques W. van den Broek>: Yeah. And Paul, there's nothing new here. We've done it before in totally different scenarios. So, our cost is very variable. We have variable pay. We have 25% turnover rates and all that. So, we always look. As Henry already said in his presentation, we always look closely at our costs every week. So, we're confident that if necessary, we'll take the appropriate measures. But we don't want to kill. We don't want to kill costs. We don't want to kill growth, because there's still a lot of growth in our business.

<Q - Paul Sullivan>: Great. Thank you.

Operator

The next question comes from the line of Matthew Lloyd from HSBC. Please go ahead.

<Q - Matthew Lloyd>: Good morning, gentlemen. A couple of questions for me. One, sort of France and the CICE. We've picked up a couple of stories that some of the smaller guys are being a little bit less aggressive on pricing certainly in the SME market. Now, they don't have the CICE to fill up their profitability. Have you heard anything like that? Is that helping your SME business, the old Randstad business? And then, a sort of another question about this sort of more dynamic pricing in the Netherlands. How quickly can that be rolled out to the rest of the business?

<A - Jacques W. van den Broek>: Okay. Yeah. The latter one is a great question. It's depending a bit on the whole back office, and also availability of labor market information in the market. I definitely – we definitely have the plan to have a tool like this in our major markets, which in probably a year from now. It is something that is picked up by our digital factory as what we called a proven model. So, we'll definitely take it as quickly as we can to other markets, because we do feel it's very beneficial in the conversation that the consultant has with the client.

CICE, SME, I've not picked up on those rumors. And by the way, it doesn't help us either. We've been focusing on SME for a long time in France. We want to proactively change the weight of large clients towards SME in our French business. We've consistently done that. And also, the technological support, so the data-driven sales that I explained earlier helps in the SME sales. So, we're happy with our performance, still see growth there. We don't think it has anything to do with what you mentioned.

<Q - Matthew Lloyd>: Okay. Good anyway. And just a final question. We've seen a number of reasonably high profile RPO and MSP contracts either dramatically reduced in scale with slightly wider gross profit bands or indeed just completely ditched in the UK and in the States. Have you had any situations where clients have just said, look, still the rates aren't good enough, we want to do something different.

<A - Jacques W. van den Broek>: No. Of course, we never have that, Matthew. Of course, although these contracts similar to our Inhouse are quite sticky, so we don't lose a lot of them and we win way more than we lose, let me put it that way and that's really a more than 80/20 situation. So, our growth is very much on keeping what we have and learning new customers.

Having said that, the UK is a business, but of course, Europe for us, Mainland Europe is historically much more important. And also, in the U.S., and in Asia-Pac, we're doing quite well with our Sourceright business. But it's absolutely hard work, also with our clients to educate them on what the labor market is all about. And again, the data we're having does help to educate our clients and also give them when they're international a global picture where labor markets are going. So, yeah. It is labor intensive, but we're very happy with our Sourceright performance overall.

<Q - Matthew Lloyd>: And the fill rates are holding up okay or are they sort of giving way a bit given the scarcity?

<A - Jacques W. van den Broek>: No. Not really. What you do see is that in markets like the U.S. and in certain profiles in Europe is that people are hired quicker. So therefore, it's tough to keep your volume up so to say. But fill rates by and large are holding up well, provided that the clients also wants to play bull on talking about training, talking about different profiles, and that sort of thing.

<Q - Matthew Lloyd>: Okay. Thanks a lot for your help.

<A - Jacques W. van den Broek>: You're welcome.

Operator

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

<Q - Tom Sykes>: Yeah. Morning, everybody. Just on the perm revenue gross, the gap between perm and the rest of the business is obviously quite wide at the moment. And in looking at each major region, it's where the head of the temp growth and yet your EBIT margins are flat to down in most major regions. So, could you maybe just talk about the profit impact of your perm growth and what level of cost you're putting in there and whether you expect that perm growth to persist?

And then, just on Monster, the revenue growth is obviously around about the same, but slightly less down year-on-year.

I wonder, in that Monster line, you do book where other parts of the Randstad Group will buy services from Monster.
So, I just wondered, can you make a comment? Are the external sales seeing a slightly slower rate of decline or are they declining at the same rate, please?

<A - Jacques W. van den Broek>: Yeah. The spend of Randstad within Monster is fairly limited. So, that doesn't play a role – significant role in the Monster top-line, so to say. As I mentioned in my presentation, the traditional part of Monster, so let's say the job postings, that's hard work to keep that up. And again, you will see renewals all the time. So, very tough to really predict this one. And as we of course don't provide visibility for our businesses, we don't for Monster. It's absolutely the same in terms of visibility.

Perm, yeah, Tom, so it adds 20 basis points to our gross margin. So, we're very happy there. What we see, and I wouldn't say that's regardless of the economic situation, but our big incumbent businesses, our staffing businesses such as our French business, our Belgium business, our Italian business, our German business are gaining a lot of momentum with what we call perm in Staffing, and we've not seen the end of that. So, this will help our result going forward.

<Q - Tom Sykes>: Okay. And so, well, one follow-up on Germany. It looks like your corporate staff are up about 15% year-on-year. So, what are the – what's the scale of the actions that you're intending to take in Germany? Can you allude to the level of OpEx that you think you need to save there? Thanks.

<A - Jacques W. van den Broek>: We are taking out the cost as we speak. We're still in discussion internally with our workers council. So, we're not giving any concrete guidance here. But of course, it's enough to safeguard our EBITA as a percentage. We are investing mostly in our Professionals businesses, beefing up perm there, and also in a model which we call Gulp Direct. As you know, our Professionals business is called Group based on the company we acquired with Vedior a long time ago. And what we're doing here is we allow our clients to search our 90,000 freelance IT database directly. That comes with a marketing investment. It's sort of a mini Monster, but then homemade and it comes – but we do see improvement now as in some 40 placements per month now. So, that's an investment – a deliberate investment in the future. But again, taking out costs in Germany, we'll update you fully after the Q1 presentation.

<Q - Tom Sykes>: Okay. Many thanks indeed.

Operator

The next question comes from the line of Marc Zwartsenburg from ING. Please go ahead.

<Q - Marc Zwartsenburg>: Yeah. Thank you for taking my questions. So, the first question is on the OpEx line. You're guiding for the broadly stable development quarter on quarter, but given that you were putting the brakes in Germany, the fact that maybe accruals might be lower or a bit of release of accruals, shouldn't we expect actually the cost base quarter-on-quarter to come down actually?

<A - Henry R. Schirmer>: Yeah. So, when we give guidance sequentially stable, when we guide for something we're very, very confident on, and we're working hard to maybe beating that. But at this point in time, we definitely see that's going to be stable.

<A - Jacques W. van den Broek>: On the German effect there, Marc, you'll see most of that into Q1. So, we will see people leaving somewhere in November. So, the actual cost effects in Germany will be fairly limited for the quarter. I think our German management was very short on the bull and we always have scenarios as we might have talked to you about what ifs. So, we'll be very quick on it, but we wanted to see what happened after the summer to act. We concluded that we needed to act more on a different scenario which was probably three, four weeks ago, then you need to be in discussion with your workers' council, because we're talking about people here of course, we take out these people and the full effect will be visible in Q1. So, we'll have a good start in terms of costs in our German business, we think reflective of what we're currently seeing as the revenue develop.

<Q - Marc Zwartsenburg>: And maybe looking through your personnel development, the minus 3% in Q3, that's quite a significant number already. What is driving that? Is that for a big part still restructurings and integration savings or is this specifically in certain countries and is that already a full trend number or is it just something from the last couple of weeks? Can you can maybe give a bit of a feel there? And the productivity remained stable, so maybe also comment there how you see the development going forward?

<A - Jacques W. van den Broek>: Yeah, well, a significant part of course is still in what we guided for that and we do need – we now see – we still see markets which are growing, but in many markets, we also still feel that we can truly in Asia for example, still grow without adding people.

So, yeah. There is always some upside in productivity of course, but yeah, at low growth. That's quite tough to achieve at the same time. But overall, the cost goes up less than the GP, so that's good at stable margins. So, more than 50% ICR for the quarter as Henry already stated. So, yeah, working hard to keep that up.

<Q - Marc Zwartsenburg>: And then maybe on the cash flow and your leverage ratio, Henry, can you take us through the moving parts? You already highlighted €100 million for CICE, they're currently 20% up. I think you mentioned in the call on the cash flow with the markets coming down a bit and maybe some working capital releases. Should we see, perhaps, an almost €500 million cash inflow in Q4, or is it too wild to getting it just below €400 million last year?

<A - Henry R. Schirmer>: No, that's probably a little too much on the wild side. But, it's not too far off, yeah. I mean, it's pretty easy to make a calculation on the EBITA. Indeed, we see a release in working capital. CICE is coming in with about €99 million in there. So, it will be a very, very, very strong cash flow quarter in quarter four. But, I am not in a position to give you kind of an exact number on that.

<Q - Marc Zwartsenburg>: And on cash EBITA, that brings the leverage ratio back to 1 that will be paid out as a special dividend?

<A - Henry R. Schirmer>: Yeah, absolutely. We're confirming our new capital allocation policy. We expect actually the leverage ratio coming below 1, and then indeed, we will return cash to shareholders. And how we return it, we will have a close look when we have that, whether that will be a special dividend or share buyback.

<Q - Marc Zwartsenburg>: Okay. Clear. Thank you very much.

Operator

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

<Q - Anvesh Agrawal>: Hi, good morning. I got a couple of questions. First, in your opinion, over longer term, do you think the form of CICE change could actually lead to contract renegotiations with clients? Because I think you charged a multiplier of wages to client and once the form changes, it will lead to a lower employment – of lower cost of employment? So, will the clients kind of continue to pay the same multiplier?

And then, the second, in the presentation, you mentioned that the workforce scheduling tool you kind of gave free of charge to your clients. Then, can you shed some light how do you actually generate return from these investments? Thank you.

<A - Jacques W. van den Broek>: Yeah, absolutely. So, CICE is part of life. So, subsidies are part of life. So, CICE is one of four subsidies which are in the total cost price. So, the discussion with large clients is not so much literally on the multiplier, but absolutely on what are the constituting elements in the cost price. So, yeah, absolutely, when there's a new system, it will lead to negotiations. But our management is very experienced there. We are very disciplined. So, we're quite optimistic that any change will not lead to a significantly lower result, but yeah, we need to go back and explain to clients the change that that's true.

And workforce scheduling, good question. So, we gave the tool free of charge. If it's in our Inhouse business, that means that our consultants become more productive, because the temps are planning themselves. That gives our consultants more time to do stuff which really matters. So, walking around the floor, talking to clients, talking about the size of the pool, but maybe also picking up other businesses, other profiles, perm orders, that sort of thing.

If it's a bigger client where we have four or five consultants, we can probably do with less and therefore improve our productivity. So, in our U.S. business where we now have 77 Inhouse clients implemented with this tool, we do see on all elements of pool management that we see improvement. So, we see better fill rates, lower churn in the pool, and that's all good news for clients.

So, and normally then on the financing, we take market share and we improve our productivity. In the situation where we give the service to new prospects, of course, it's quite clear. We get revenue and we get market share we're already small there, so that's real – a new growth which comes in at a decent return and the investments for us are not great. So, we make these apps in Portugal for Europe and in Malaysia for Asia.

And so, that's relatively low cost for us. And the tool that we give free of charge is actually companies that we've invested in our Innovation Fund. As we said already quite a few times, digital is not the absolute cost, it's very much the sales and the different way of working that gives you more growth or higher leverage from the business you're having. So, that's our strategy here.

<Q - Anvesh Agrawal>: Yeah. That's clear. Can I just ask one more, sorry. You said you expect €90 million to €100 million of cost saving next year. How much has been achieved till date?

<A - Henry R. Schirmer>: Yeah. We have – absolutely, we're confirming that. A big part of that sits in Monster and we're well underway to achieving that. We cannot give kind of very, very detailed view of where we are year-to-date.

<A - Jacques W. van den Broek>: And the second part is what we call Global IT solutions, where we bring our 450 databases to the cloud which apart from cost gives us a lot of benefits in terms of database security and all that, and also makes the cost here variable for us which is also good, but most of those savings will come through next year and that's the second part of this €90 million to €100 million.

<Q - Anvesh Agrawal>: Thank you so much. That's clear.

<A - Jacques W. van den Broek>: Okay.

Operator

The next question comes from the line of Hans Pluijgers from Kepler Cheuvreux. Please go ahead.

<Q - Hans Pluijgers>: Yes. Morning, gentleman. Yeah. Some of my questions already been asked, but I'm looking at the U.S. There, could you give us some indication what you see with respect to volume and wage inflation impact on your sales trends? And do you see, let's say, any further increase in wage inflation driving your growth?

Then, going to France. In the previous quarter, you indicated you would – let's say adjust your cost base so much. Could you only give some feeling what already, let's say, has happened, and has there already been any impact in Q3? I assume not. But when do you expect those savings to filter through?

And lastly on Monster. Yeah. Could you give us some feeling, is it now at breakeven or slightly profit contribution? And looking at the current trends – yeah, if the current trend continues, when do you expect, let's say, again to have the additional measures to reduce cost?

<A - Jacques W. van den Broek>: Yeah. U.S. wage inflation, it is happening in blue collar around 2%, 3%. So, we don't make exact calculations here. But let's say of the 5% growth in Staffing, might be 1% wage inflation slightly less. So, it is there. It's not massive.

On France, yeah, well, this is a country where it's tough to take out costs massively. So, France will be very organically. We're not going to any drastic measures such as a social plan and all that. So, as opposed to Germany, the takeout of costs in France will be slower than in any other market, but that's a deliberate choice we're making not to destabilize the business, because as I mentioned, half of our branches are still growing. So, it's a very mixed picture with very targeted negative growth in certain pockets of our business.

On Monster, so, Q3 is around breakeven. But, what I said last time, it's not an absolute goal for us on the short-term to breakeven, or have a small profit. The goal is very much to replace Monster or revamp Monster from a traditional [ph] jump board (00:45:12) to a very dynamic platform where clients can find their candidates and we help them do so and they also can improve their employer brand. If you stop – it's very much a marketing play. If you stop investing in marketing, then your traffic goes down. So, we're not going to do that. And that's why, we say it's under control, which is very much for us, the – how do you call it – the balancing act of investing in the future and taking out cost which is not necessary.

<Q - Hans Pluijgers>: Could you give maybe some feeling on Monster, what you see is still as part of sales to traditional business and what you see let's say as the new business?

<A - Jacques W. van den Broek>: No, not really, because – then I'm putting the whole business out in the open and there's also competition in many markets. So...

<Q - Hans Pluijgers>: Okay. Clear. Thanks.

Operator

The next question comes from the line of Konrad Zomer from ABN AMRO. Please go ahead.

<Q - Konrad Zomer>: Hi. Good morning, everybody. I have just one question on the operational leverage of the business. You stated in your presentation that you confirm the margin guidance for the full year. But just in general, if you are going to achieve any improvement of the underlying EBITA margin up from the 4.6% last year, you stated before you needed some 4% to 5% organic revenue growth. Is the fact that you confirm your margin outlook, does that state implicitly that you still look for 4% to 5% organic revenue growth for the full-year 2018?

<A - Henry R. Schirmer>: Yeah. Thanks, Konrad, for your question. So, indeed, we set bases of 4% to 5% growth. So, a step from 4.6% to 5% to 6%. Even if it's a notch lower, we are confirming that we will be able to deliver that. So, when you just make the calculation and [ph] with that the first two weeks in quarter four, you see about the same growth as in quarter three will probably be a notch below that. So, but still our guidance is pretty much in place.

<Q - Konrad Zomer>: Right. So, just to confirm, even if you – if your organic growth rate for the full year comes in at say somewhere between 3.5% and 4%, you still think that your adjusted EBITA margin will be higher than the 4.6% you reported last year?

<A - Henry R. Schirmer>: That's correct. That's what we're working on, yeah. Right.

<Q - Konrad Zomer>: Thank you very much.

Operator

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

<Q - George Gregory>: Morning, chaps. Three please. Starting off with the Q4 guidance, it looks like you expect, when I look at your gross margin and SG&A guidance, it looks like you expect your EBITA margin to be broadly flat year-over-year, yet you suggest CICE dropping out will have about a 20 basis – in some having a 20 basis point headwind in the fourth quarter. I'd just be interested to know what's driving that sort of 20 basis point operating leverage. Is it Monster or is it perm? Is it temp? Just if you could elaborate on that, please.

Secondly, similar subject, CICE 2019. As I'm aware, the budget is more or less confirm now. We know CICE is converting to a payroll subsidy from January. We know the additional fee on subsidies don't kick in until October. So, what is it exactly you're waiting on before giving us guidance, please? I would have thought you have enough info now.

And finally, sort of aligned with the previous question, I think it was around this time last year when you gave guidance for some progression in the EBITA margin in 2018. Just wondered how you're thinking about 2019 and what sort of growth rate you would require to generate some progression, a broad range is fine. Thanks.

<A - Henry R. Schirmer>: So, let me take the first one and the last one. So, on Q4, we've – we just spoke about that, so we've a very, very close eye on operational expenditure in quarter four. You're right. CICE in December, we spoke about for the rest of it, we see actually underlying gross margin being pretty stable.

And if you take the two together, we see overall for the full year provided that the top line is relatively stable leverage for the year. For 2019, I'm afraid we are not in a position to give you any guidance at this point in time. That leaves to Jacques for CICE.

<A - Jacques W. van den Broek>: Yeah. And maybe a bit on Q4, of course, we can talk about France there as a sort of benchmark for Q4, but we have many businesses that showed good growth, and they of course deliver improvements in results and that carries our group results. Our U.S. business, Asia-Pac business, there's a lot of businesses that are doing still fairly well; our Italian business. So, it's a mixed picture and that also drives our results fortunately.

Yeah. On CICE, so, apparently, you know a lot, which is good. We don't. So, the moment we have a formal write-up of the system, the French Government tends to not have very straightforward systems. So, the devil is in the details here. And the moment we know, but then knowing is really in writing, in the details, the start date, how does it work, then we'll share it with you, but we don't have it. So, if you have it, please send us a copy. We're well prepared.

<Q - George Gregory>: Okay. But what if – so, you're – but without knowing the detail? You can't sort of guide based on the conversion of CICE on the 1st of January, and the deferral of – or even the exclusion of any additional payroll tax cuts as you'd previously guided from October. That alone is not enough to give a range.

<A - Jacques W. van den Broek>: No. Because if you would now ask my colleague, François, he would not be able to give me an answer. So, that's a very honest answer. We really don't know at this moment. So, probably, it will come in a few weeks. But what I've seen, what the systems are looking at this market for a long time, you first need to actually a lot of, well, time yourself to really look into the details.

<Q - George Gregory>: Okay.

<A - Jacques W. van den Broek>: And the only thing I can say is how do we do it, these things. You know the drill.

We're probably the ones that give the least away. So, time will tell.

Operator

The next question comes from the line of Rajesh Kumar from HSBC. Please go ahead. Hello, Rajesh, your line is now open. Please go ahead with your question.

<Q - Rajesh Kumar>: Hi. Morning, gents. Sorry, mute was on. Just a couple from me. On the CICE a bit, it looks like everyone on the sell-side have a calculation, with they're able to do and come up with a number. And you and some of your competitors are not very keen to give out a number. What is it that we might be getting wrong? I mean, there's clearly something you think is very uncertain and the sell-side teams that also is very certain. So, there's a gap between our understanding and yours. Can you help us understand what that gap might be?

The second one is, your effort to U.S. wage inflation in blue collar is at 2% to 3%, that's quite helpful. Looking at the temp wage inflation data, that's 3.5% to 4.5%, private employment payroll is up 3% to 4% or 2%, 3%, to 5% in August and September. Is it the difference of your exposure which is causing lower wage inflation or is it a guesstimate number, hence we should basically – because you don't compute it, we should rely on BLS and other sources for that?

<A - Henry R. Schirmer>: Yeah, let me take the first one on CICE. Obviously, we do understand your keenness to get more clarity on CICE and we are completely with you on that one. But we don't think it's good if we start speculating on it. So, let me really – let us wait until we see really all the detail and then we will translate it into what we think about it, but before that, it would not be good to speculate.

Please understand that.

<Q - Rajesh Kumar>: Yeah.

<A - Henry R. Schirmer>: The second one on inflation.

<A - Jacques W. van den Broek>: Yeah, Rajesh, on the wage inflation. So, in general, it's always overestimated as the effect it has for us, which is mostly about the fact that with us, it's always a bit watered down. So, wage inflation is the same amount of people staying in a job and then increasing their wage. But of course, we always put new people in there and sometimes or many times, they sort of come in at the lower wage scale or at the new wage scale. So, it's always watered down. So, if it's on average 4%, then with us it will be 1% to 2% or something.

<Q - Rajesh Kumar>: On that wage inflation data, what I can tell you is that the people who are changing jobs, they have a higher wage inflation number, so that does not basically add up in my head.

<A - Jacques W. van den Broek>: Yeah. That's a pity, but we – that is the individual people getting individual jobs. What we see a lot in our Staffing business, there are predefined schemes which don't necessarily mean that people go off automatically. It's all dependent where they're coming from, sometimes they come from no job, sometimes they come from a sector that pays lower. So, for us, it's not as clear cut as just running the numbers.

<Q - Rajesh Kumar>: Okay. So, basically, what you're saying is, in the mix you are operating in, with basically the bulk contracts you have in place, you are unable to benefit from that broader wage inflation data which is coming across from people who are changing jobs?

<A - Jacques W. van den Broek>: Well, that is sort of what I'm saying, but not really. So, first of all, it's more about bulk contracts. So, we have a very fragmented labor force. If for example, logistics in our sector grows faster than life sciences or car manufacturing, then we have a different mix. So, it's not like we have the same amount of people in the same job. So, in a year, in a sector like ours, there's a lot of changes. So, what I'm saying is it's not as straightforward as that you should translate wage inflation into growth for our business. That's the only thing I'm saying. It's just too complicated for that.

<Q - Rajesh Kumar>: Okay. So, you've done some backed-out calculations, which tells you your rate inflation is lower based on your mix?

<A - Jacques W. van den Broek>: Yeah. Well, you're sort of – how do you call that? Rephrasing my answers in a way that I don't recognize. So, let me do it finally. Wage inflation should not be translated directly into growth numbers in our industry, because it doesn't work that way, because we don't have a stable workforce as such.

<Q - Rajesh Kumar>: Okay. But do you have a hard number backing it?

<A - Jacques W. van den Broek>: No, I don't have a hard number. I've got a guestimate which is probably in our Staffing business around 1% of the 5% growth, and the rest is more people at work predominantly in our Inhouse business which is doing very well.

<Q - Rajesh Kumar>: Understood. That's very clear. Thank you.

<A - Jacques W. van den Broek>: Okay.