29 January 2019

3QFY19Results Update | Sector: Others

TeamLease Services

BSE SENSEX	S&P CNX
35,593	10,652

Bloomberg	TEAM IN
Equity Shares (m)	17
M.Cap.(INRb)/(USDb)	43.6 / 0.6
52-Week Range (INR)	3339 / 1951
1, 6, 12 Rel. Per (%)	-9/-1/15
12M Avg Val (INR M)	96
Free float (%)	59.2

Financials & Valuations(INR b)

Y/E Mar	2019E	2020E	2021E
Net Sales	45.1	55.6	68.2
EBITDA	1.0	1.4	1.9
PAT	1.0	1.5	2.1
EPS (INR)	61.0	87.7	122.9
Gr. (%)	41.8	43.8	40.1
BV/Sh (INR)	327.0	414.7	537.6
RoE (%)	20.6	23.7	25.8
RoCE (%)	20.9	23.7	25.9
P/E (x)	41.8	29.1	20.8
P/BV (x)	7.8	6.2	4.7

Estimate change	↓
TP change	↔
Rating change	↔

CMP: INR2,548 TP: INR3,300 (+30%) Buy

Volume growth, through large clients; at a small cost

Strong revenue beat; but margins lower in non-general staffing

- TEAM's 3QFY19 Revenue at INR11.7b grew by 28% YoY (exp. of +22% YoY); EBITDA at INR245m grew by 37% YoY (exp. of +44% YoY); PAT at INR255m grew by 39% YoY (exp. of +46% YoY)
- General staffing associates grew by 7,548 QoQ, +5.2% QoQ and 16.6% YoY to 152,693, above our estimate of 5,000 additions QoQ. Specialized staffing saw in uptick of 52 associates QoQ to 6,117 (+3.5% YoY), and in line with our estimate of 6,100.
- **EBITDA margin** at 2.1% declined 10bp sequentially, below our estimate of 2.3%. However, EBITDA margin in General staffing came in line with our estimate of 2.1%, whereas the disappointment was led by specialized staffing, where EBITDA margin was 5.6% (-170bp QoQ) v/s estimate of 7.9% and Other HR services, where EBITDA margin plummeted from 10.6% to 1% (estimate of 4.5%)
- **PAT** at INR255m (+1.3% QoQ, +38.6% YoY) was 5.4% below expectations, led by operational miss.

Game for large deals, at lower PAPM

- TEAM's Per-associate-per-month (PAPM) realization is down to INR710 during the quarter from ~INR750 in the previous year. This has been a function of large deal bids on a fixed mark-up basis (INR560). The approach is vindicated by the profit performance within the segment – which was in line despite the aggression, as the company's Associate-to-core employee ratio inched up from 241 to 260. TEAM will be open to lower PAPM only for large volume opportunities.
- Margins in other HR services plummeted due to: [1] high provisions created due to delay in payments towards training in a couple of states, and [2] Weak 3Q seasonality that drives lower revenues QoQ. This should recover in 3Q. Within the specialized staffing, Telecom staffing is still at 2.8%, thanks to investments in Telecom infra staffing segment.

- **Valuation view:** We value TEAM using DCF to arrive a target price of INR3,300 (implied target P/E of 37x/27x on FY20E/FY21E EPS). We have revised our FY20 margin assumption downward by 20bp to accommodate for near-term investments select verticals in general staffing (and EPS by 6.5%). At 29x/20x FY20/21E earnings, valuations are rich, but justified given revenue/EBITDA/EPS CAGR of 23/41/42% over FY18-21. Sustained superiority of the financial performance because of industry trends, business model and operational excellence continue strengthening our long-term view. **Buy**.

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Consolidated - Quarterly Earning Model (INR m)

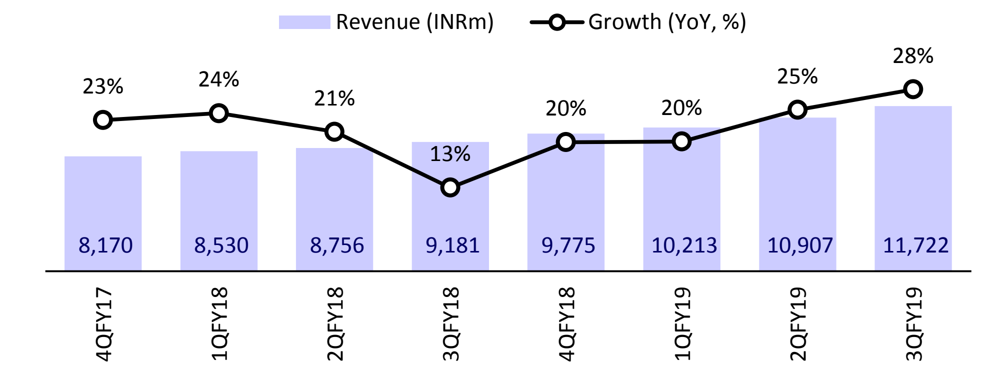
Y/E March	FY18				FY19				FY18	FY19	Est.	Var. (% / bp)
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			3QFY19	
Net Sales	**8,530**	**8,756**	**9,181**	**9,775**	**10,213**	**10,907**	**11,722**	**12,275**	**36,241**	**45,117**	**11,210**	**4.6**
YoY Change (%)	24.1	21.2	12.7	19.6	19.7	24.6	27.7	25.6	19.2	24.5	22.1	
Total Expenditure	8,399	8,605	9,002	9,547	10,012	10,666	11,477	11,982	35,553	44,137	10,953	4.8
EBITDA	**130**	**151**	**179**	**227**	**202**	**240**	**245**	**293**	**688**	**980**	**257**	**-4.5**
Margins (%)	1.5	1.7	1.9	2.3	2.0	2.2	2.1	2.4	1.9	2.2	2.3	
Depreciation	20	20	24	28	27	29	25	25	92	105	25	0.8
Interest	2	3	8	11	11	14	13	10	25	48	10	34.2
Other Income	58	44	42	12	52	40	36	45	157	173	45	-18.7
PBT	**166**	**173**	**189**	**200**	**217**	**236**	**240**	**299**	**729**	**1,001**	**264**	**-8.9**
Tax	2	-3	5	-15	-3	-12	-9	0	-10	-24	0	na
Rate (%)	1.3	-1.5	2.5	-7.4	-1.2	-5.3	-3.7	0.0	-1.4	-2.4	0.0	
MI & P/L of Asso. Cos.	0	0	0	0	0	2	3	4	0	9	3	
Adj PAT	**164**	**176**	**184**	**215**	**219**	**252**	**255**	**307**	**739**	**1,034**	**270**	**-5.4**
YoY Change (%)	158.5	99.5	99.9	-35.1	33.8	43.6	38.6	42.6	28.4	39.8	46.4	
Margins (%)	1.9	2.0	2.0	2.2	2.1	2.3	2.2	2.5	2.0	2.3	2.4	
Headcount	**1,59,261**	**1,62,090**	**1,77,283**	**1,81,323**	**1,91,635**	**1,99,935**	**2,11,335**	**2,20,515**	**1,81,323**	**2,20,515**	**2,09,199**	**1.0**
Revenue composition (%)												
General staffing	96%	95%	92%	90%	91%	90%	89%	89%	93%	90%	90%	
Specialized staffing	3%	3%	6%	7%	7%	7%	7%	7%	5%	7%	7%	
Other HR services	1%	2%	2%	2%	3%	3%	3%	3%	2%	3%	3%	

E: MOSL Estimates

Revenue beat led by traction in general staffing

- Revenue growth for TEAM at 7% QoQ was ahead of expectations 2.8% QoQ.
- Growth was in general staffing (+9% QoQ), this was dragged by relatively muted growth in Specialized Staffing (+5% QoQ) and decline (-17% QoQ) in other HR services.

Exhibit 1: 28% YoY growth seen in revenue in 3QFY19



Source: Company, MOSL

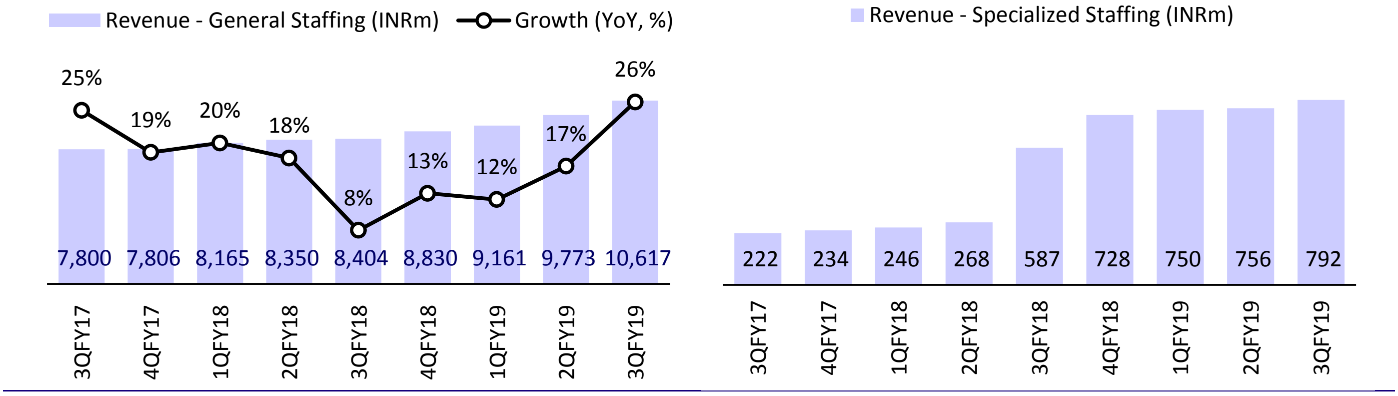
- The General Staffing business grew by 26.3% YoY, healthy uptick compared to the previous quarter, whereas the Specialized Staffing business grew by 34.8% YoY (aided by Evolve acquisition).
- Other HR Services declined sequentially while growing 65.4% YoY.

Exhibit 2: Segment revenue (INR m)

	3QFY19	2QFY19	QoQ (%)	3QFY18	YoY (%)
Staffing and allied services	10,617	9,773	8.6%	8,404	26.3%
IT staffing services	792	756	4.7%	587	34.8%
Other HR services	314	377	-16.8%	190	65.4%

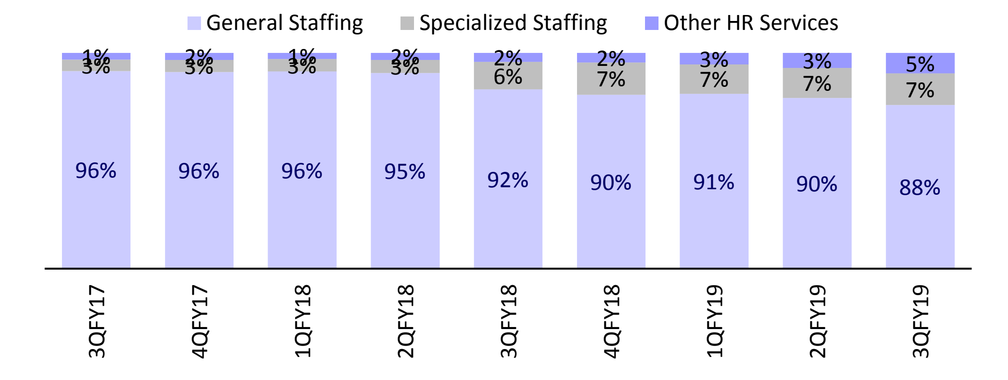
Source: Company, MOSL

Exhibit 3: Revenue from General Staffing and Specialized Staffing



Source: MOSL, Company

Exhibit 4: Revenue composition diversifying

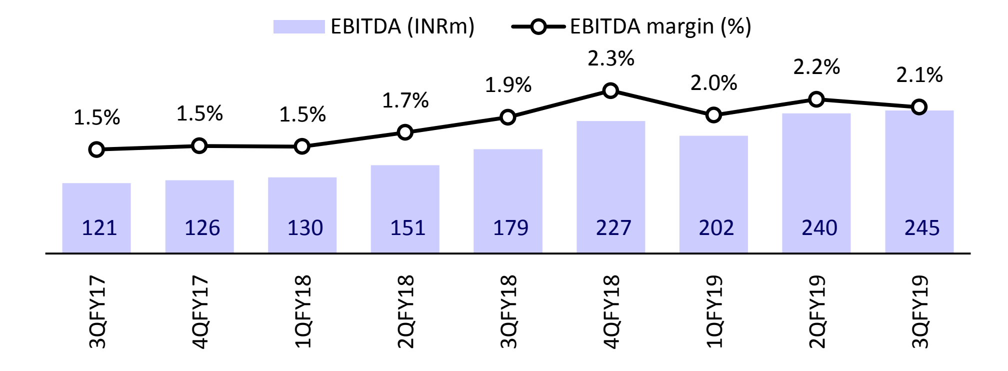


Source: Company, MOSL

Dip in margins led by Specialized Staffing and Other HR Services

- EBITDA margin at 2.1% declined 10bp sequentially, below our estimate of 2.3%.
- This was due to dip in margins in Specialized Staffing (-150bp QoQ to 6.2%, Telecom margin at 2.8% and IT Staffing at 11.9%) and Other HR services margins were near break-even (v/s 10% margin in the previous quarter)
- Strong headcount additions in General staffing drove profitability in the segment – up 20bp QoQ
- **PAT** at INR255m (+1.3% QoQ, +38.6% YoY) was 5.4% below expectations, led by operational miss.

Exhibit 5: Margins dip by 10 bp



Source: Company, MOSL

Exhibit 6: Lower margin in Specialized Staffing – a function of costs in Evolve

	EBITDA (INR m)	EBITDA margin (%)	Change (QoQ, bp)	Change (YoY, bp)
Staffing and allied services	217	2.0%	30	(10)
IT staffing services	45	5.7%	(160)	(440)
Other HR services	3	1.0%	(920)	(270)

Source: Company, MOSL

Takeaways from Management commentary

- **PAPM reduction may not jeopardize margins**: TEAM's Per-associate-per-month (PAPM) realization is down to INR710 during the quarter from ~INR719 in the previous quarter and ~INR750 in the previous year. This has been a function of the company's willingness to bid for large deals on a fixed mark-up basis (INR560). This has helped the company bag three large customers which have entered into its top-10. The approach is vindicated by the profit performance within the segment – which did not disappoint, as the company's Associate-to-core employee ratio inched up from 241 to 260. Secondly, this has seen its funding exposure come down to 15% from 22% one year ago.
- **Other HR services business suffered from debt provisions**: Margins in other HR services plummeted due to: [1] high provisions created due to delay in payments towards training in a couple of states, and [2] Weak 3Q seasonality that drives lower revenues QoQ. This should revive in 4Q
- **Telecom margins to recover in a couple of quarters**: Within the specialized staffing, while IT staffing margins held their range of 11-12%, Telecom staffing is still at 2.8%, thanks to investments in Telecom infra staffing segment.
- **Broader focus in tact; but for bulk volume opportunities**: TEAM has not derailed from its focus of inching towards higher PAPM, and gradual improvement in margins, but will be open to looking at large deals, which despite lower PAPM, will drive maximization of operating profits with efficiencies of scale.
- **Open positions indicate continued growth**: TEAM has ~ 8000+ open positions spread across industries, lending visibility for continued growth momentum. This is spread across verticals such as BFSI, Retail, Agri, Telecom, FMCG. No one sector has historically driven open positions.

Valuation view

- TeamLease is a market leader in the highly fragmented temporary staffing industry, with a 6% market share. Its extensive geographic reach, presence in multiple industries and functions, scale, ability to fill positions, and sourcing capabilities reflect in its operational prowess, which is a key determinant of success in this industry.
- Temporary staffing across the globe has gained prominence in the last few years, as companies seek flexibility and better cost management. This segment constitutes 2-4% of the total workforce for developed countries, and averages at 1.6% for the world, v/s 0.5% in India. A convergence to the global average itself can triple the industry.
- A further impetus would be provided by formalization; which would be catalyzed by GST implementation, erasing the 15% pricing benefit that unorganized players could give customers by evading the tax net. However, for a full-fledged movement towards organized, reforms in labor laws would be necessary; so the loopholes in statutory payment to employees are also plugged.
- Together, growth in the industry and formalization can together ensure a sustained >20% growth in the sector (and for TeamLease) over the next decade.

For TeamLease, performance would be further driven by profitability improvement, led by [1] operational leverage because of an improvement in the Associate/Core Employee ratio, and [2] higher proportion of revenue from IT staffing, training and other HR solutions, which command better margins. We expect a cumulative 60bp margin expansion for TeamLease over FY19-21E.

- Add to this the benefits of Section 80JJAA of the Income Tax Act, and a consequent near-zero tax rate; and a revenue CAGR of 24% and EBITDA CAGR of 40% translates into 42% PAT CAGR.
- TeamLease will be a key beneficiary to industry trends, and expect it to demonstrate a high-growth trajectory over the next three years. Consequently, prospective improvement in return ratios and cash generation, led by the business model, would be a key driver of value creation for TeamLease.
- We value TEAM using DCF to arrive a target price of INR3,300 (implied target P/E of 37x/27x on FY20E/FY21E EPS). We have revised our FY20 margin assumption downward by 20bp to accommodate for near-term investments select verticals in general staffing (and EPS by 6.5%). At 29x/20x FY20/21E earnings, valuations are rich, but justified given revenue/EBITDA/EPS CAGR of 23/41/42% over FY18-21. Sustained superiority of the financial performance because of industry trends, business model and operational excellence continue strengthening our long-term view. **Buy**.

Key triggers

- GST-related pick-up driving higher growth in the general staffing business
- Significant scaling up of the IT staffing business
- Continued profitability expansion

Key risks

- Economic downturn leading to a proportionate and direct impact on business
- Loss of business or issues with a top client (top-5 contribute 12% of revenue; top-10 contribute 19% of revenue)
- Inability to have a higher proportion of revenue from other HR services and professional staffing, leading to lower realizations and profitability

Exhibit 7: Fair value of INR3,300/share based on DCF

Discount rate	12.00%
Terminal growth rate	5.00%
PV FCF	14,890
PV of terminal value	37,694
NPV	52,584
Less: Debt	111
Add: Cash and cash equivalents	2,953
Total equity value	**55,426**
Per share	
PV FCF	871
PV of terminal value	2,204
NPV	3,075
Less: Debt	6
Add: Cash and cash equivalents	173
Total equity value	**3,241**
NOSH m	17
CMP	**2,548**
Target price	3,300
Upside (%)	**30%**

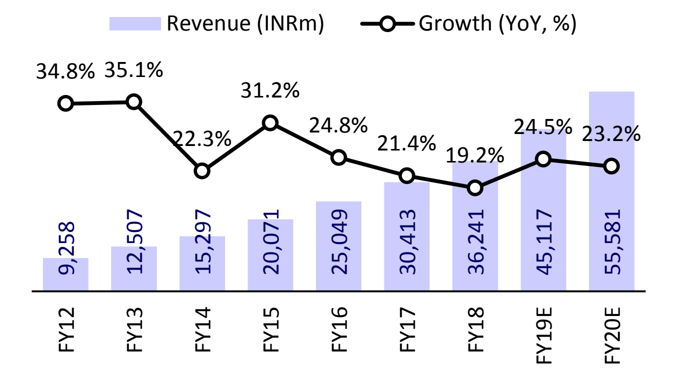
Source: MOSL

Exhibit 8: We assume 12% WACC and 5% terminal growth rate

WACC/g	Sensitivity analysis				
	3.0%	4.0%	5.0%	6.0%	7.0%
10%	3,600	4,100	4,700	5,700	7,200
11%	3,100	3,400	3,900	4,400	5,300
12%	2,700	2,900	3,200	3,600	4,200
13%	2,400	2,600	2,800	3,100	3,400
14%	2,100	2,300	2,400	2,600	2,900

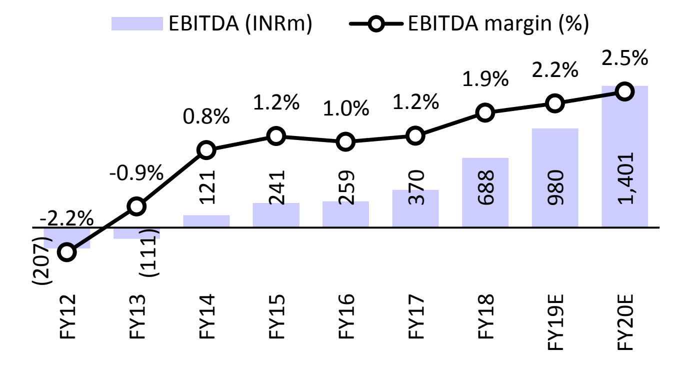
Story in charts

Exhibit 9: Revenue growth momentum to remain intact



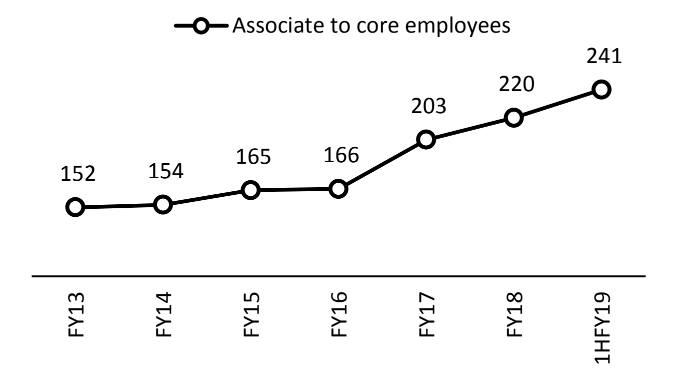
Source: Company, MOSL

Exhibit 10: Margin expansion to be aided by scale and business mix change



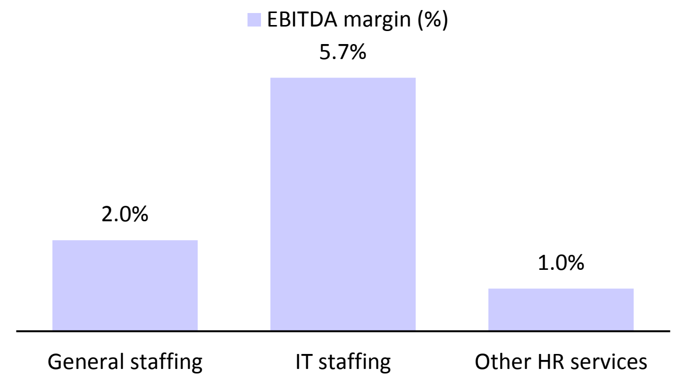
Source: Company, MOSL

Exhibit 11: Scale has resulted in higher efficiency



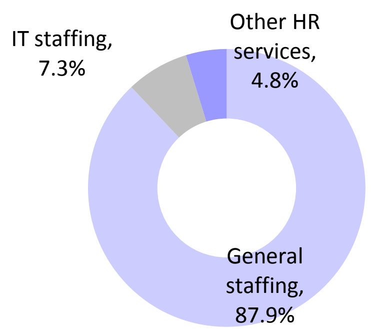
Source: Company, MOSL

Exhibit 12: Steep margin dip seen in Other HR services



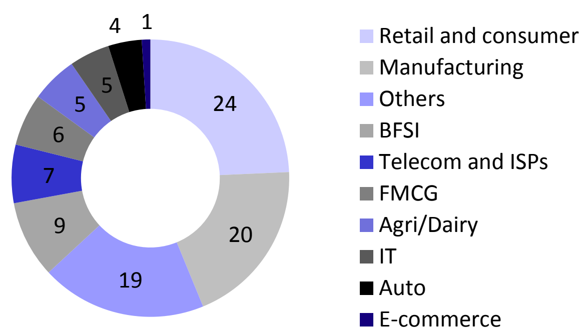
Source: Company, MOSL

Exhibit 13: Portfolio currently dominated by general staffing



Source: Company, MOSL

Exhibit 14: Well-diversified staffing portfolio (FY17)



Source: Company, MOSL

Financials and Valuations

Consolidated - Income Statement								(INR Million)
Y/E March	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19E**	**FY20E**	**FY21E**
Total Income from Operations	**15,297**	**20,071**	**25,049**	**30,413**	**36,241**	**45,117**	**55,581**	**68,158**
Change (%)	22.3	31.2	24.8	21.4	19.2	24.5	23.2	22.6
Total Expenditure	**15,175**	**19,829**	**24,790**	**30,043**	**35,553**	**44,137**	**54,180**	**66,227**
% of Sales	99.2	98.8	99.0	98.8	98.1	97.8	97.5	97.2
EBITDA	**121**	**241**	**259**	**370**	**688**	**980**	**1,401**	**1,931**
Margin (%)	0.8	1.2	1.0	1.2	1.9	2.2	2.5	2.8
Depreciation	19	27	30	61	92	98	116	135
EBIT	**102**	**214**	**229**	**309**	**596**	**882**	**1,284**	**1,797**
Int. and Finance Charges	2	2	5	11	25	40	20	20
Other Income	79	114	154	216	157	178	236	326
PBT	**178**	**326**	**378**	**514**	**729**	**1,021**	**1,500**	**2,102**
Total Tax	0	18	130	-61	-10	-24	0	0
Tax Rate (%)	0.0	5.5	34.4	-11.8	-1.4	-2.4	0.0	0.0
Minority Interest	0	0	0	0	-3	-1	0	0
Reported PAT	**178**	**308**	**248**	**575**	**736**	**1,043**	**1,500**	**2,102**
Adjusted PAT	**178**	**308**	**248**	**575**	**736**	**1,043**	**1,500**	**2,102**
Change (%)	-581.9	72.6	-19.4	131.8	28.0	41.8	43.8	40.1
Margin (%)	1.2	1.5	1.0	1.9	2.0	2.3	2.7	3.1

Consolidated - Balance Sheet								(INR Million)
Y/E March	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19E**	**FY20E**	**FY21E**
Equity Share Capital	5	5	171	171	171	171	171	171
Total Reserves	1,183	1,483	2,945	3,640	4,376	5,420	6,920	9,023
Net Worth	**1,188**	**1,488**	**3,116**	**3,811**	**4,547**	**5,591**	**7,091**	**9,194**
Total Loans	9	0	194	11	161	111	61	11
Deferred Tax Liabilities	0	-57	-45	-149	-149	-149	-149	-149
Capital Employed	**1,197**	**1,431**	**3,264**	**3,673**	**4,559**	**5,552**	**7,003**	**9,055**
Gross Block	276	221	309	349	499	534	634	734
Less: Accum. Deprn.	199	222	252	302	393	491	607	742
Net Fixed Assets	**77**	**-1**	**57**	**47**	**106**	**43**	**26**	**-9**
Goodwill on Consolidation	30	54	54	982	982	982	982	982
Capital WIP	0	42	0	0	0	0	0	0
Total Investments	**0**	**0**	**0**	**103**	**103**	**103**	**103**	**103**
Curr. Assets, Loans&Adv.	**2,326**	**2,974**	**5,629**	**5,641**	**7,095**	**8,973**	**11,521**	**14,896**
Inventory	3	2	2	2	2	2	2	2
Account Receivables	595	813	1,205	1,872	2,250	3,009	3,724	4,577
Cash and Bank Balance	847	1,147	2,590	1,593	2,230	2,953	4,071	5,741
Loans and Advances	881	1,012	1,832	2,174	2,613	3,009	3,724	4,577
Curr. Liability & Prov.	**1,236**	**1,638**	**2,476**	**3,101**	**3,727**	**4,549**	**5,630**	**6,918**
Account Payables	72	69	88	105	126	154	190	234
Other Current Liabilities	976	1,303	2,013	2,469	2,967	3,621	4,482	5,507
Provisions	188	266	375	528	634	774	958	1,177
Net Current Assets	**1,090**	**1,336**	**3,153**	**2,540**	**3,368**	**4,424**	**5,891**	**7,978**
Appl. of Funds	**1,197**	**1,431**	**3,264**	**3,673**	**4,559**	**5,553**	**7,003**	**9,055**

E: MOSL Estimates

Financials and Valuations

Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Basic (INR)								
EPS	**10.4**	**18.0**	**14.5**	**33.6**	**43.0**	**61.0**	**87.7**	**122.9**
Cash EPS	11.5	19.6	16.3	37.2	48.4	66.7	94.6	130.8
BV/Share	69.5	87.0	182.2	222.9	265.9	327.0	414.7	537.6
Valuation (x)								
P/E		143.5	178.1	76.8	60.0	42.3	29.4	21.0
Cash P/E		131.9	158.8	69.5	53.4	38.7	27.3	19.7
P/BV		29.7	14.2	11.6	9.7	7.9	6.2	4.8
EV/Sales		2.1	1.7	1.4	1.2	0.9	0.7	0.6
EV/EBITDA		178.2	161.1	115.0	61.2	42.2	28.7	19.9
FCF per share	8.0	17.9	-8.9	18.4	20.7	37.1	55.6	82.8
Return Ratios (%)								
RoE	16.2	23.0	10.8	16.6	17.6	20.6	23.7	25.8
RoCE	15.5	23.1	10.5	16.5	17.9	20.9	23.7	25.9
RoIC	29.1	68.5	32.8	26.1	28.8	38.2	48.2	59.5
Working Capital Ratios								
Asset Turnover (x)	12.8	14.0	7.7	8.3	7.9	8.1	7.9	7.5
Debtor (Days)	14	15	18	22	23	24	24	25
Creditor (Days)	2	1	1	1	1	1	1	1
Leverage Ratio (x)								
Net Debt/Equity	-0.7	-0.8	-0.8	-0.4	-0.5	-0.5	-0.6	-0.6

Consolidated - Cash Flow Statement **(INR Million)**

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
OP/(Loss) before Tax	179	326	378	613	726	1,019	1,500	2,102
Depreciation	19	27	30	43	92	98	116	135
Interest & Finance Charges	-69	-97	-95	-157	25	40	20	20
Direct Taxes Paid	-78	17	-265	-191	10	24	0	0
(Inc)/Dec in WC	58	38	-150	-19	-191	-333	-349	-416
CF from Operations	**108**	**311**	**-102**	**289**	**661**	**849**	**1,287**	**1,841**
Others	55	32	-3	43	-157	-178	-236	-326
CF from Operating incl EO	**164**	**343**	**-105**	**332**	**505**	**670**	**1,051**	**1,515**
(Inc)/Dec in FA	-26	-37	-47	-18	-150	-35	-100	-100
Free Cash Flow	**137**	**306**	**-152**	**314**	**355**	**635**	**951**	**1,415**
(Pur)/Sale of Investments	2	3	2	-85	0	0	0	0
Others	43	0	23	-814	157	178	236	326
CF from Investments	**19**	**-34**	**-22**	**-917**	**7**	**143**	**136**	**226**
Issue of Shares	0	0	1,500	0	0	0	0	0
Inc/(Dec) in Debt	-113	-8	0	0	150	-50	-50	-50
Interest Paid	-2	-1	-4	-11	-25	-40	-20	-20
Dividend Paid	0	0	0	0	0	0	0	0
Others	0	0	73	-401	0	0	0	0
CF from Fin. Activity	**-115**	**-10**	**1,569**	**-412**	**125**	**-90**	**-70**	**-70**
Inc/Dec of Cash	**67**	**300**	**1,443**	**-997**	**637**	**724**	**1,117**	**1,671**
Opening Balance	780	847	1,147	2,590	1,593	2,230	2,953	4,071
Closing Balance	**847**	**1,147**	**2,590**	**1,593**	**2,230**	**2,953**	**4,071**	**5,741**

NOTES

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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