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Team Lease (Emerging Leader)

Team Lease (TL) Is India's second largest flexi staffing company.

What is Flexi Staffing?

In flexi staffing, a staffing agency enters into service level agreement with the client/customer (e.g. Samsung, TCS, Amazon, etc) to provide employees (referred to as associates) on a temporary basis for a specific duration or a project and gets paid on a variable basis for the duration of the engagement. The associates will be deployed at client's locations and work under the supervision of the client, whereas the staffing agency will be responsible for paying salaries and other mandatory obligations like Provident Fund etc.

Customers use flexi staffing agencies as it enables them to scale up/down their workforce with more ease/speed and helps them manage complex regulatory compliances in a cost-efficient manner. Flexi staffing includes both General Staffing, in which specific skill sets are not required (e.g. Retail staffing) and Specialised Staffing which requires functional expertise (e.g. IT industry).

TL is a long term, structural growth story.

The key drivers of growth are:

- Reforms undertaken by the Government and increasing per capita GDP (inverse correlation of informal employment with per capita GDP) will lead to strong growth in formal jobs and their share in total workforce is expected to double over the next decade from ~21% currently.
- Increasing preference for having workforce flexibility and have variable cost structures (i.e., ability to hire for short term requirements vs. permanently) will result in the flexi staffing industry gaining share within the formal workforce.
- Organized players in the flexi staffing industry will gain share from mom-and-pop shops. Overall, the share of organized flexi staffing industry within the total workforce is expected to increase by ~3x over the next decade from (0.8% share currently to 2.7% share in 2030).

TL's earnings will grow faster than revenues due to margin expansion driven by:

- Improving Gross margin as the industry consolidates. Pricing in the industry will improve as unorganized players come into regulatory scrutiny and therefore cannot price unfairly. In the West, where this industry is more consolidated, gross margins are 3-5x those of the organised players in India.
- Additional boost to Gross Margin as the share. of high margin specialised staffing increases in overall revenue.
- Increased EBITDA margin as technology usage improves productivity and operating leverage.

The business enjoys a strong and growing competitive edge.

This is a very low margin business (EBITDA ~2%). Drivers of competitive edge are:

- Scale is critical to success as costs of core employees, technology and SG&A is largely fixed. Hence, the staffing company which achieves maximum scale and productivity will be able to

offer the best pricing in the industry. TL has consistently delivered SG&A productivity through use of technology.
- Competence to adhere to multiple, complex regulatory compliances without customers having to worry about any slip up which could lead to reputation loss.
- Ability to provide pan-India services with quick turnaround time to customer requests.

The above aspects create a virtuous cycle:

- Increasing scale leads to market share gain
- Ability to lower pricing for customers with improved scale without compromising account profitability.
- Ability to further invest in technology to improve productivity, increase presence across India & improve service quality resulting in further market share gains.

We believe, TL can deliver ~15-20% revenue CAGR and ~20-25% PBT CAGR over next 5-10 years as margins should expand. We believe it can deliver these growth rates at a post-tax ROIC of ~25-35% as it is not a capital-intensive business and runs on < 20 Days of Working Capital. Hence, currently rich valuation multiples can be justified if the above numbers are delivered.

The leadership team has demonstrated disciplined execution.

Management has focused on margins, ROIC and ensuring that they have a resilient balance sheet. They have not shied away from acquiring complementary capabilities. TL's net cash balance sheet since inception highlights the conservative nature of the leadership.

Risks

The Govt at present provides the sector Income tax benefits under section 80JJA of Income Tax Act. According to this section, if the company employs more associates than in the previous year, it gets to claim a deduction of 30% of total employee salaries from its PBT in that year as well as next 2 years. Given that employee expenses are >90% of revenues, 30% of this implies deduction is greater than PBT and hence company pays zero tax. If this is withdrawn, TL's earnings growth in the short run will be hit as we don't believe it will be able to increase prices to offset this impact. However, we believe this is a low probability scenario as the Government aims to increase formal workforce in the overall pool. TL made statutory remittances of ~Rs 1400 crores in FY21 and they have a miniscule share of the flexi staffing industry. Governments stand to gain if the share of organised players goes up over time and hence should continue to encourage formalisation of the sector.