

19th November 2022

Team Lease – Exit Note

Our context

- Allocators of capital in the best 20 opportunities we see over the next 5 -10 years
- Practice “good churn”: when we are wrong, when valuations are euphoric, when we can re-allocate for better returns elsewhere

Team Lease – entered portfolio as Clear Leader.

- Contract staffing – a mega trend
- Great business as results in “win win” outcomes for customers, Govt and companies as it encourages formalization
- Industry consolidation should happen as is happening in other industries in India and will lead to margin expansion
- Team Lease, the best run company in the sector with excellent governance/promoters
- Low margin business, but capital light due to low Working Capital, so can be 25% ROE
- Possible to get 15%+ top line growth plus some margin expansion over time. Margin expansion over low base will be a meaningful driver of bottom-line growth.
- 15-18%+ decadal compounding possible

Key assumptions that have changed

- Industry consolidation not playing out. The industry is stuck at pre Covid Gross Margin/person. Companies are willing to drop margins to gain business.
- IT Staffing, a higher margin business facing head winds.
- Our margin expansion assumption is wrong which means bottom line growth will mirror top line growth or could be a bit lower due to drag from IT Staffing.
- Without margin expansion, the thesis breaks as Team Lease is a very low margin business which will be unwieldy with scale.
- In hindsight, we have over-paid as we were far more optimistic on pace of consolidation and Earnings growth prospects than warranted.

Choices before us

- We can stay invested as TL is a well-run company and growth will cover valuation errors over time.
- We can re-allocate capital elsewhere. It is not amongst the best 20 opportunities we have at present.

Our learnings

- Ride winners. Average down on companies executing well where stock price may not be recognizing Operational improvements

- Exit if the original thesis is no longer valid before the market comes to the same conclusion. Companies can end up stagnating for long periods of time.
- Taking a loss is painful, but the right thing to do if capital can be re-allocated. We need to act basis facts today, and not basis what was our cost price on a position.

Hence, we have exited and the money is being re-allocated to other opportunities where we have more conviction