

TeamLease Services

IPO Note – Valuations expensive

TeamLease Services Ltd (TSL) is one of India's leading providers of human resource services in the organized segment. Its staffing business accounts for 98.8% of the revenues while HR services accounts for the balance. It has a market share of ~6% in the Indian Flexi-staffing Industry. It delivers staffing services across industries like banking, manufacturing, retail, telecom, etc. The company has shown significant growth over FY2011-15, posting a revenue CAGR of 30.7% and after posting losses till FY2013, the company has since turned profitable and reported net profit of ~₹30cr in FY2015 vs. a net loss of ~₹16cr in FY2012.

Lower penetration levels suggest huge growth potential: The flexi-staffing industry in India as of FY2014 was valued at around ₹180-220bn and the penetration level of the industry in India at ~0.4% is lower than in developed regions where the penetration level is between 1.5-3.0%. Going forward, as per industry reports, Flexi-staffing industry is expected to report a CAGR of 25-30% and be around ₹610-640bn by FY2019 and the penetration level is expected to improve to 1.0% over the same period on back of increasing number of enterprises turning formal, skill development in the country, and regulatory amendments in favour of formal employment.

Focus on improving operating margins: The HR services business, which commands higher margin, accounts for a very small portion of company's overall top-line. HR services offers recruitment services, regulatory services, skills and development corporate training, and payroll services. The company is now focusing on such higher margin businesses apart from its regular staffing business. It is also looking for opportunities in the IT vertical and improving employee productivity.

Intense competition and lack of pricing power: The flexi-staffing industry is highly fragmented with intense competition. Almost 70-80% of the industry is unorganized consisting of smaller players and balance comprising of major players like Adecco, Randstad, Quesscorp, etc. TSL faces stiff competition from these companies as well as other small players, thus leading to lack of pricing power.

Outlook Valuation: TSL being leading staffing company in India and has the potential to further increase its market share. However, although the company has shown good growth momentum, it operates in an industry characterised by intense competition, lack of pricing power, low entry barriers and high degree of fragmentation which renders limited scope for margin improvement.

On the valuation front, at the upper end of the price band, the pre-issue P/E works out to 60.6x its 1HFY2016E annualised earnings. In comparison, its global peer Adecco is trading at 12.9x 9MCY2015 annualised earnings and has a better margin and ROE profile. Further, post the IPO, TSL's ROE is not expected to improve significantly in the near term. Considering the above mentioned business concerns and expensive valuation, **we recommend a Neutral on the issue.**

Key Financial

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	1HFY2016
Net Sales	926	1,251	1,530	2,007	1,210
% chg	34.8	35.1	22.3	31.2	-
Net Profit	(16)	(4)	18	30	11
% chg	-	-	-	66.3	-
OPM (%)	(2.2)	(0.9)	0.8	1.2	0.9
EPS (₹)	(10.8)	(2.4)	11.6	19.4	7.2
P/E (x)	-	-	73.0	43.9	-
P/BV (x)	12.4	12.9	11.0	8.8	8.2
RoE (%)	-	-	15.0	20.0	-
RoCE (%)	-	-	8.5	14.4	-
EV/Sales (x)	1.3	1.0	0.8	0.6	-
EV/EBITDA (x)	-	-	101.2	49.4	-

Source: Company, Angel Research; Note: Valuation ratios based on pre-issue outstanding shares and at upper end of the price band

NEUTRAL

Issue Open: February 2, 2016
 Issue Close: February 4, 2016

Issue Details

Face Value: ₹10

Present Eq. Paid up Capital: ₹15.3cr

Fresh Issue**: 0.18cr Shares

Offer for sale: 0.32cr Shares

Post Eq. Paid up Capital: ₹17.1cr

Market Lot: 15 Shares

Fresh Issue (amount): ₹150cr

Price Band: ₹785-850

Post-issue implied mkt. cap ₹1,354cr*-
 1,453cr**

*Note:*at Lower price band and **Upper price band*

Book Building

QIBs	75%
Non-Institutional	15%
Retail	10%

Post Issue Shareholding Pattern(%)

Promoters Group	45.6
MF/Banks/Indian FIIs/FIIs/Public & Others	54.4

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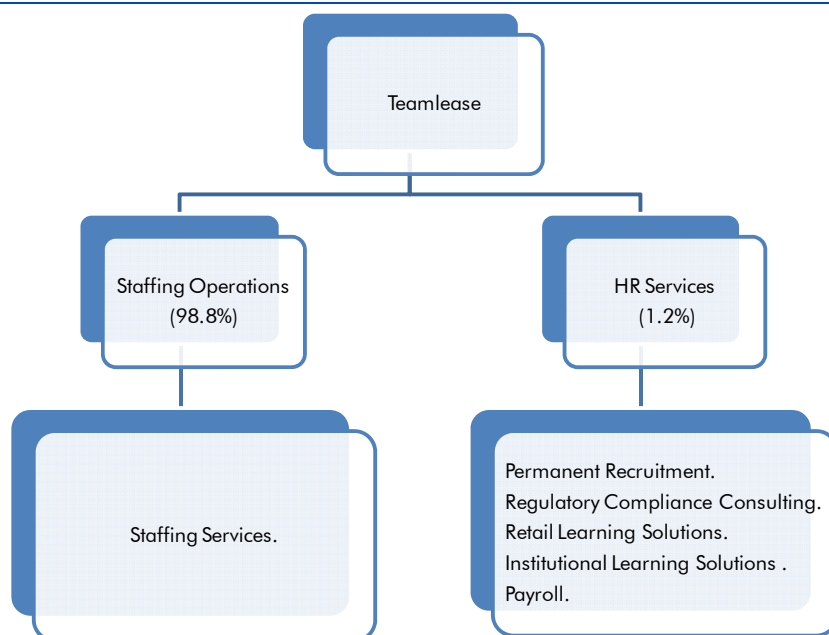
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Company background

TSL is one of India's leading providers of human resource services in the organized segment, providing staffing solutions across industry sectors and diverse functional roles. The company's operations are classified into Staffing and HR services. Staffing services account for 98.8% of its total revenues. As of March 31, 2015, the company has provided employment to ~1.12mn associates (since 2002).

Exhibit 1: Business model

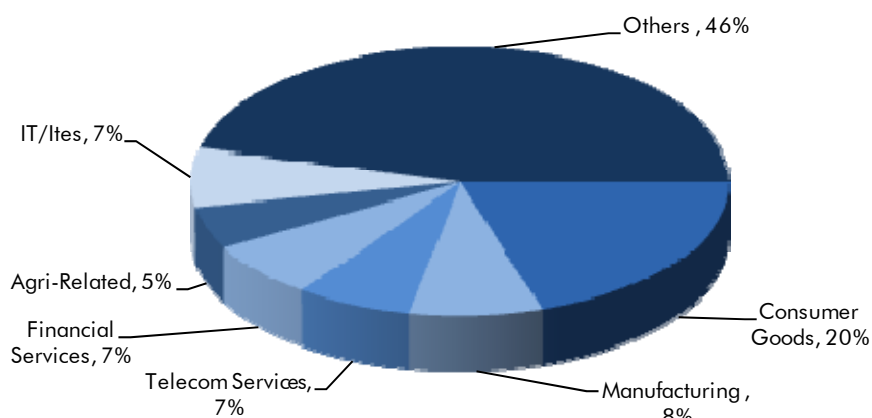


Source: Company, Angel Research

TSL operates on an asset-light model with low capital expenditure requirements. As of November 30, 2015, it had 104,946 associate employees, serving 1,021 clients and 1,218 full time employees based out of eight offices in India.

It delivers staffing services across various industries including the consumer durables, chemicals, manufacturing, media and telecom, retail, banking, financial services and insurance, e-commerce, pharmaceuticals and healthcare sectors. The majority of TSL's Associate Employees are engaged in sales, logistics and customer service functions.

Exhibit 2: Industry wise revenue contribution



Source: Company, Angel Research

Issue details

The company is raising ₹150cr through fresh issue of equity shares in the price band of ₹785-850. In addition, the issue also consists of offer for sale of 32.2 lakh shares of which 1.5 lakh shares will be offered by the promoter entities and 30.7 lakh shares by other investors. The fresh issue will constitute 10.3% of the post-issue paid-up equity share capital of the company assuming the issue is subscribed at the upper end of the price band.

Exhibit 3: Shareholding pattern

Particulars	Pre-Issue		Post-Issue	
	No. of shares	(%)	No. of shares	(%)
Promoter group	79,51,971	51.9	77,98,650	45.6
Others	73,80,093	48.1	92,98,120	54.4
Total	1,53,32,064	100.0	1,70,96,770	100.0

Source: Company, Angel Research

Objects of the offer

- Funding existing and incremental working capital requirements of the company amounting to ₹80cr.
- Funding for acquisitions and other strategic initiatives amounting to ₹25cr.
- For upgrading existing IT infrastructure amounting to ₹15cr.
- The balance will be utilized for general corporate purposes.

Investment rationale

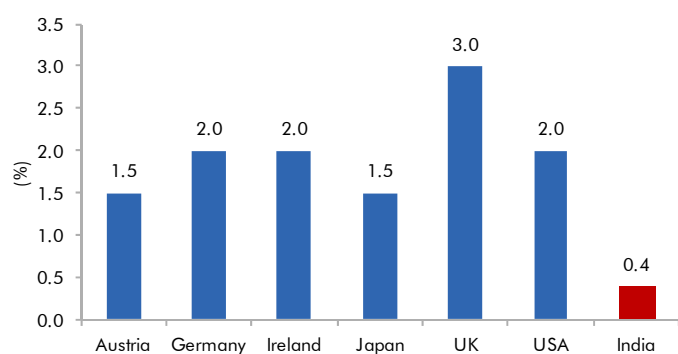
Lower penetration levels suggest huge growth potential

In India, the penetration level of flexi-staffing is at ~0.4% compared to 3% in UK, 2% in USA, and 1.5% in Japan as stated by the company

Penetration level of flexi-staffing industry is lower in India as compared to developed regions like UK, USA, Europe, Japan etc. In India, the penetration level of flexi-staffing is at ~0.4% compared to 3% in UK, 2% in USA, and 1.5% in Japan as stated by the company.

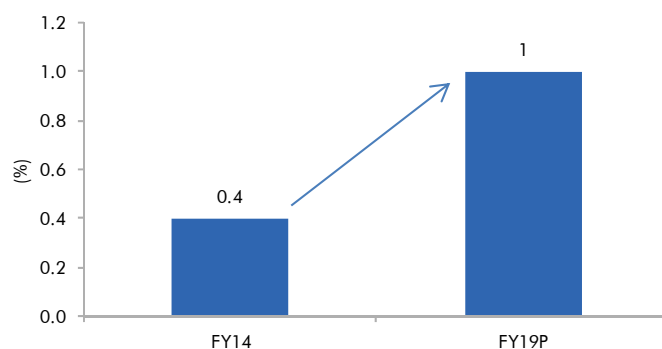
We believe that going forward, penetration of flexi-staffing would increase on back of increasing number of enterprises turning formal, skill development in the country, and regulatory amendments in favour of formal and flexi-staffing industry. The initiatives taken by the flexi-staffing industry, such as training services, are also likely to add to the industry growth over the long term. The expected growth in penetration levels to be witnessed in the domestic flexi-staffing industry over the next five years is largely in line with many global economies.

Exhibit 4: Flexi-staffing penetration levels



Source: RHP, Angel Research

Exhibit 5: Expected growth in flexi-staffing industry



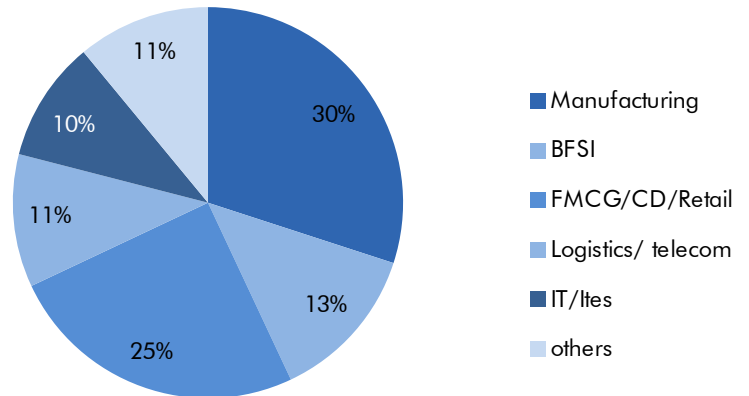
Source: RHP, Angel Research

Domestic flexi-staffing industry expected to post 25-30% CAGR over the next five years

Over the next five years, the flexi-staffing industry is expected to post a 25-30% CAGR to attain a value of around ₹610-640bn

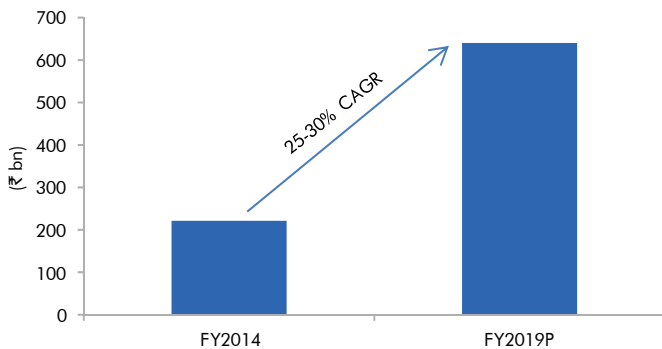
The flexi-staffing industry in India as of FY2014 was valued at around ₹180-220bn. The average wages for flexi-staffing workers is assumed to be around ₹8,000-10,000 per month (reflects weighted average of wages for organized and unorganized players). Over the next five years, the flexi-staffing industry is expected to post a 25-30% CAGR to attain a value of around ₹610-640bn. This growth is owing to various factors, including an increasing number of enterprises turning formal, skill development in the country, and regulatory amendments in favour of formal employment.

Exhibit 6: Industry-wise demand for flexi-staffing



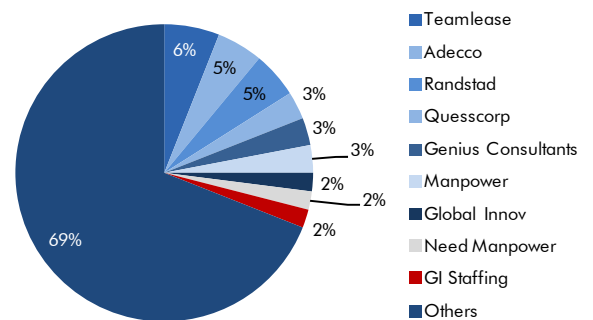
Source: CRISIL

Exhibit 7: Flexi-staffing industry size



Source: RHP, Angel Research

Exhibit 8: Market Share of TSL



Source: RHP, Angel Research

Currently, TSL is the largest player in the flexi-staffing industry with a market share of ~6%

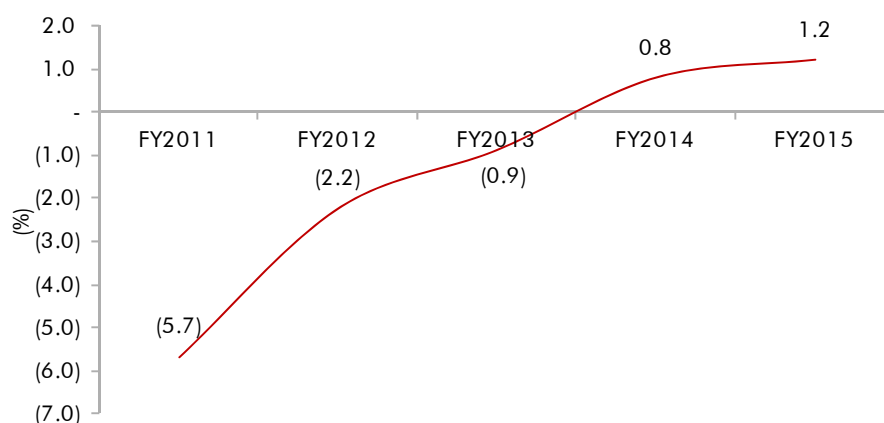
The unorganized sector constitutes 70-80% of the total industry. At present, TSL is one of the leading player in the flexi-staffing industry with a market share of ~6%, while Adecco and Randstad have a market share of 5% each, followed by Quesscorp and Genius Consultant Manpower with a combined market share of less than 5%. We expect TSL to benefit from increasing demand for manpower across industries on the back of its strong management, healthy track record, and with it being the market leader, which would help it to enhance its market share and increase revenue.

TSL is also focusing on recruitment services and regulatory services which are high-margin businesses

Focus on high-margin business

More than 98% of the company's revenue comes from its staffing business. The balance is accounted by recruitment services, regulatory services, skills and development corporate training, payroll, etc, which earn higher margins than the staffing business. The company is now focusing on such higher margin businesses apart from its regular staffing business. It is currently looking for opportunities in the IT vertical through an acquisition. It is also increasingly focusing on achieving internal cost efficiency. For instance, in the past, a full time employee of the company was handling 45 associate employees; now an employee handles more than 95 associate employees while the same is expected to touch 150, going forward.

Exhibit 9: Operating margin trend



Source: Company, Angel Research

Strong Management and thought leadership in public policy initiatives

TSL is a professionally managed company with a high-quality senior Management team, which thus provides the right balance of experience, expertise and strategic vision. This is contributing significantly to TSL's growth.

The company's Management team is backed by its individual Promoters, who have an extensive experience in the HR services industry in general and the staffing segment in particular. The company's Chairman, Manish Mahendra Sabharwal, is a well recognized person in the staffing industry and was selected to be a member of the Planning Commission Committee for labour reforms.

The company's Promoters are also well versed with labour reforms in the country and help in creating a market for the company's services in an otherwise unorganized sector and in building the TeamLease brand. We believe that the thought leadership demonstrated by the company's Promoters to reform India's labour laws together with focus on regulatory compliance and technology, would provide the company with significant competitive advantages in any resulting market size expansion.

Key investment concerns

Intense competition and lack of pricing power

The flexi-staffing industry is highly fragmented with intense competition and lacks a clear cut leader accounting for dominant share in the employment services market. Almost 70-80% of the industry is unorganized consisting of small players. Although TSL is a leading player in the industry, the gap between the top three to five players (Adecco, Manpower Inc., Randstad, etc) is very small if not miniscule. TSL faces stiff competition from these companies as well as other small players, thus leading to lack of pricing power.

Valuation expensive

The company has shown significant growth over FY2011-15, posting a revenue CAGR of 30.7%. After posting losses till FY2013, the company has since turned profitable and reported net profit of ~₹30cr in FY2015 vs. a net loss of ~₹16cr in FY2012. The company is a leading staffing company in India and has the potential to further increase its market share. However, although the company has shown good growth momentum in recent times, it operates in an industry characterised by intense competition, lack of pricing power, low entry barriers and high degree of fragmentation which renders limited scope for margin improvement.

On the valuation front, at the upper end of the price band, the pre-issue P/E works out to 60.6x its 1HFY2016E annualised earnings. In comparison, its global peer Adecco is trading at 12.9x 9MCY2015 annualised earnings and has a better margin and ROE profile. Further, post the IPO, TSL's ROE is not expected to improve significantly in the near term. Considering the above mentioned business concerns and expensive valuation, **we recommend a Neutral on the issue.**

Exhibit 10: Comparative Valuation

		P/E	P/BV	ROE	EV/Sales	EV/EBITDA
Pre issue valuation ^		(x)	(x)	(%)	(x)	(x)
TeamLease*	FY2016	60.6	7.6	12.6	0.5	52.3
Adecco#	FY2015	12.9	2.9	22.4	0.5	9.2

Source: RHP, Bloomberg; Note: *based on 1HFY16 annualised numbers; # based on 9MCY15 annualised numbers; ^ based on price at upper band

Risks

Slowdown in economy: Slowdown in economy can restrict TSL's growth as it provides temporary staffing solution to the various sectors like manufacturing, logistic, telecom, hospitality, IT/ITes etc. which are dependent on economic growth.

Upcoming Smart Cities could be a trigger for flexi staffing industry: Upcoming Smart cities projects are expected to create huge job opportunities in flexi-staffing industry which could be an upside risk to our recommendation.

Profit & Loss (consolidated)

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	1HFY16
Total operating income	926	1,251	1,530	2,007	1,210
% chg	34.8	35.1	22.3	31.2	-
Total Expenditure	947	1,262	1,518	1,983	1,198
Personnel Expenses	903	1,216	1,484	1,944	1,179
Others Expenses	43	45	34	39	19
EBITDA	(21)	(11)	12	24	11
% chg	-	-	-	99.7	-
(% of Net Sales)	(2.2)	(0.9)	0.8	1.2	0.9
Depreciation & Amortisation	4	4	2	3	1
EBIT	(24)	(15)	10	21	10
% chg	-	-	-	110.8	-
(% of Net Sales)	(2.6)	(1.2)	0.7	1.1	0.9
Interest & other Charges	0	1	0	0	0
Other Income	8	11	8	11	6
Share in profit of Associates	-	-	-	-	-
Recurring PBT	(17)	(4)	18	33	16
% chg	-	-	-	83.4	-
Prior Period & Extraord.Exp./ (Inc.)	-	-	-	-	-
PBT (reported)	(17)	(4)	18	33	16
Tax	-	-	-	2	6
(% of PBT)	-	-	-	5.5	34.7
PAT before Adjustments	(17)	(4)	18	31	11
Adjustments	(0)	(1)	(0)	1	(0)
Less: Minority interest (MI)	-	-	-	-	-
PAT after MI & Adj. (reported)	(16)	(4)	18	30	11
ADJ. PAT	(16)	(4)	18	30	11
% chg	-	-	-	66.3	-
(% of Net Sales)	(1.8)	(0.3)	1.2	1.5	0.9
Basic EPS (₹)	(10.8)	(2.4)	11.6	19.4	7.2
Fully Diluted EPS (₹)	(10.8)	(2.4)	11.6	19.4	7.2

Balance Sheet (consolidated)

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	1HFY16
SOURCES OF FUNDS					
Equity Share Capital	1	1	1	1	15
Reserves & Surplus	104	100	118	148	144
Shareholders' Funds	105	101	119	149	160
Minority Interest	-	-	-	-	-
Total Loans	8	12	1	-	-
Other long term liabilities	4.7	5.4	5.8	5.2	5.1
Long-term provisions	6.4	9.1	13.0	17.6	25.2
Deferred Tax Liability	-	-	-	-	-
Total Liabilities	124	128	138	171	190
APPLICATION OF FUNDS					
Gross Block	36	26	25	26	30
Less: Acc. Depreciation	19	17	17	19	20
Net Block	17	8	8	7	10
Goodwill	2	2	2	2	2
Investments	0	0	0	0	0
Current Assets	150	173	192	275	357
Inventories	1	1	0	0	0
Sundry Debtors	54	62	59	80	119
Cash	82	78	85	115	122
Loans & Advances	8	8	26	8	12
Other Assets	5	25	22	72	105
Current liabilities	73	97	105	179	269
Net Current Assets	77	76	88	96	88
Long term loans and adv.	21.0	30.9	25.5	43.6	54.2
Other Non Current Assets	6.6	9.4	14.6	16.7	27.8
Deferred Tax Asset	-	-	-	6	7
Mis. Exp. not written off	-	-	-	-	-
Total Assets	124	128	138	171	190

Cash flow statement (consolidated)

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	1HFY16
Profit before tax	(16)	(4)	18	32	17
Depreciation	4	4	2	3	1
Change in Working Capital	(16)	(2)	6	5	10
Interest / Dividend (Net)	(8)	(6)	(7)	(10)	(5)
Direct taxes paid	(10)	(9)	(8)	2	(13)
Others	7	8	6	4	2
Cash Flow from Operations	(40)	(9)	16	34	11
(Inc.)/ Dec. in Fixed Assets	(4)	(1)	(3)	(4)	(4)
(Inc.)/ Dec. in Investments	(26)	8	(32)	(21)	6
Cash Flow from Investing	(31)	7	(35)	(24)	3
Issue of Equity	99	-	-	-	-
Inc./ (Dec.) in loans	5	4	(11)	(1)	-
Dividend Paid (Incl. Tax)	-	-	-	-	-
Interest / Dividend (Net)	(0)	(1)	(0)	(0)	(0)
Cash Flow from Financing	104	4	(11)	(1)	(0)
Inc./ (Dec.) in Cash	33	1	(30)	9	14
Opening Cash balances	9	42	43	13	22
Closing Cash balances	42	43	13	22	35

Key Ratios

Y/E March	FY2012	FY2013	FY2014	FY2015
Valuation Ratio (x)				
P/E (on FDEPS)	-	-	73.0	43.9
P/CEPS	-	-	66.2	38.9
P/BV	12.4	12.9	11.0	8.8
Dividend yield (%)	0.0	0.0	0.0	0.0
EV/Sales	1.3	1.0	0.8	0.6
EV/EBITDA	-	-	101.2	49.4
EV / Total Assets	6.2	5.5	5.0	3.4
Per Share Data (₹)				
EPS (Basic)	(10.8)	(2.4)	11.6	19.4
EPS (fully diluted)	(10.8)	(2.4)	11.6	19.4
Cash EPS	(8.3)	(0.4)	12.8	21.8
DPS	0.0	0.0	0.0	0.0
Book Value	68.3	65.9	77.5	96.9
Returns (%)				
ROCE	-	-	8.5	14.4
ROE	-	-	15.0	20.0
Turnover ratios (x)				
Asset Turnover (Gross Block)	25.6	48.4	60.6	76.5
Inventory / Sales (days)	0	0	0	0
Receivables (days)	21	18	14	15
Payables (days)	1	0	2	1
WC cycle (ex-cash) (days)	21	18	13	13

Note: Valuation ratios based on pre-issue outstanding shares and at upper end of the price band

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