“TeamLease Services Limited Q2 FY20 Earnings Conference Call”

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MANAGEMENT: **MR. ASHOK REDDY – MD & CO-FOUNDER**
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MODERATOR: **MR. ROHIT DOKANIA – IDFC SECURITIES LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to the TeamLease Services Limited Q2 FY20 earnings conference call hosted by IDFC Securities Limited.

As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touch-tone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Rohit Dokania from IDFC Securities. Thank you, and over to you.

Rohit Dokania: Good evening everyone and welcome to the Q2 FY20 results conference call of TeamLease Services Limited. I would like to thank the management for giving IDFC Securities the opportunity to host this call.

The management team is represented by Mr. Ashok Reddy – MD & Co-Founder, Mr. Ravi Vishwanath – CFO, and Ms. Ramani Dathi – Financial Controller with other senior management personnel.

We will start the call with the commentary from the management and then move into the Q&A. Thank you everyone and over to you, sirs.

Ashok Reddy: Just as an update on the quarter, while we have been showing a steady growth on the associate front by about 4500 to 5000, we have also negated all the losses that we have on account of the provident fund notification go live. 100% of the associates are live on that front. We have had a loss in the NETAP numbers, though, of about 6500. And I think some element of an industry slowdown specific to manufacturing and auto having an impact on that front.

I think the HR services businesses have been what we had indicated last time of saying that we will reduce the element of exposure to the government revenue and focus on the collections have played out and I think the continued focus towards both those variables on the training business will continue, and I think other HR services businesses have started to show improvement quarter-on-quarter, which we see will reflect into Q3 also.

Just in the general staffing business, while the volume of associates has increased, I think we do have some additional costs that have come into the P&L this quarter – 1 crore on account of ESOP, about 70 lakhs hit on revenues because of the NETAP trainee count reduction, an element of an additional focus and cost increase on the hiring front where we have been upping the numbers that we can do by about 70 lakhs, and some other one-time expenses.

But I think largely the platform for growth on the general staffing front stays good, and we believe the open positions will support the growth going forward. The NETAP, we have lost those numbers as a function of the industry. We are seeing a slowdown in that reduction and hopefully in Q3, there will be a turnaround on that front. And the HR services largely are on track in terms of their revenue, the collections having been a problem are starting to come in and we have had a reversal on that front. So, I think overall a muted quarter, but I think the aspect of continued growth on associates will be playing out.

We do also have some element of PAPM improvement to 739 from 730, but the overall aspect of reduction in the total headcount on account of NETAP has reduced the productivity ratio for the quarter. But I think as we add numbers, we should be able to correct that as we go forward.

Also, the IT staffing, Hyderabad eCentric that we acquired is on track in terms of its numbers and growth. The earlier one on the services clients still does seem to have a pressure, but the captive and the product company numbers continue to grow on that side.

That's from my side, and we are happy to take questions to answer.

Moderator: We will now begin the question & answer session. The first question is from the line of Vimal Gohil from Union Mutual Fund. Please go ahead.

Vimal Gohil: Firstly, sir, I wanted to understand the reduction in NETAP employees. Why has that led to an increased cost pressure of 70 lakhs?

Ashok Reddy: The NETAP trainees are brought through the university and we have a stipend and a markup that we charge on that. Rs. 400 of the markup comes to TeamLease staffing as a revenue for the comprehensive administration of the life cycle of the trainees. That revenue dropped off because of the reduction in the trainee count.

Vimal Gohil: That has been included in the cost item?

Ashok Reddy: The revenue item.

Vimal Gohil: So, 70 lakhs is from the one-time revenue loss?

Ashok Reddy: Not a one time. It's a recurring revenue. For the quarter, it was 70.

Ravi Vishwanath: What Ashok actually alluded to earlier was things that impacted profitability was this NETAP reduction along with other cost items, actually.

Vimal Gohil: On an EBITDA front, will NETAP be contributing to higher margins? Or can we say that the NETAP has better EBITDA margin and thus even that really contributed to the pressure on margins this quarter?

Ashok Reddy: Yes, NETAP does have higher margins and obviously the reduction in numbers on that front.

Vimal Gohil: Sir, regarding the HR services, last quarter, we had made some provision of 6 crores. Has that come back? Because we were expecting that to come back this quarter.

Ashok Reddy: A part of that has come back. The overall training business is in about 1.2 crores profit this quarter, and I think some more of the collections are in the pipeline. Actually, effective today, we got one bank credit, and some more are in the pipeline.

Vimal Gohil: Out of 6 crores, how much has come back?

Ashok Reddy: 2.5 crores.

Vimal Gohil: When do we expect this balance to come through?

Ashok Reddy: It could be happening in this quarter.

Vimal Gohil: So, we should see significant improvement in the HR services margins in the next quarter? Would that understanding be right?

Ashok Reddy: Yes.

Vimal Gohil: Sir, my next question is on the balance sheet. We have seen a significant expansion in your receivables this quarter. If I am not wrong, about 27% from 264 to 335 crores. Can we have an explanation there? And also, if you could just give some explanation on the Other Current Assets which have gone up from 132 to 185 crores? How has this happened?

Ramani Dathi: The trade receivables have mainly gone up because of the eCentric receivables, which got added from Q1 onwards. If you compare with March, in IT staffing business, the DSO is much longer compared to the general staffing. Especially for eCentric, we mentioned that they are at a much higher DSO which is about 90 days. We are working on it to bring it down over time. That is the main contributor for increase in trade receivables.

Your other question is on Other Current Assets. That's again on account of unbilled. Because unbilled is high in IT staffing and telecom staffing business, that has slightly gone up in the last 6 months.

Vimal Gohil: Ma'am, do you expect these kind of receivables to stay on? For how long will this higher working capital remain? Because essentially, if I were to see, your working capital has almost trebled or more in the last 2 years, from 18 to 20. Do you see this trend reversing soon or….?

Ramani Dathi: Yes, as Ashok mentioned, some 4.5 crores will come down in HR services, and in eCentric, again, we are working on the DSO to bring down from 90 to 60 days in the next 2 quarters' time. So, you will see a reduction in working capital cycle in the next quarter.

Ashok Reddy: Just as an add-on, the working capital increase overall over the last 2-3 years is also the fact that we have gotten into the specialized staffing, which is all a funding model and effectively has a DSO post paying the salaries between 45 days to 90 days. But if you look at it in the general staffing business, the funding exposure has been reducing year on year and it is now down to about 13.8%.

Vimal Gohil: For us, that's not getting reflected in the overall picture because given the fact that the working capital for the core staffing business is fairly low and that's the larger part of the business, shouldn't that really reflect in the lower working capital because your specialized staffing is still a smaller business at this point in time?

Ramani Dathi: No. In terms of revenue, they are still small, you are right, they are only 4% contributor, but while general staffing DSO is 7 days, specialized staffing is 90 days. There is a huge difference in the working capital cycle.

Vimal Gohil: And final question, ma'am, on working capital only. Where do you see this working capital to be sustainable? At what levels? If you could just give me a number?

Ramani Dathi: At consolidated level, it should sustain at about 15 days.

Vimal Gohil: Okay.

Moderator: The next question is from the line of Abhijit Akella from IIFL. Please go ahead.

Abhijit Akella: The first question is, if you could give us a little bit more clarification on this PF matter that has been alluded to in the footnotes to the account, the investment in the NBFCs. Any details you could share in terms of which 2 NBFCs these amounts have been invested in? And how much do you expect the amount at risk might be? And then the unrealized gains and surplus, how much that might be? And what's the amount at risk essentially?

Ravi Vishwanath: The amounts are about 173 crores, which is what the footnotes contain. These are typically with IL&FS and DHFL. These are the 2 NBFCs where the investments have been made with maturities of these instruments ranging from '20, '21 and going all the way up to '26, '27. So, over the next 5 to 6 years is when the maturity period of these investments are. Close to about 90 crores of surplus is what the trust has currently in the form of reserves and unrealized gains, which is why we believe that it's a little too premature at this stage to look at any kind of provisioning or to even assess what kind of loss that needs to be provided for because there is an adequate amount of headroom available at this stage, like about 90 crores of reserves and unrealized gains is what we have in the trust currently.

Abhijit Akella: So, 173 crores is the amount at risk and 90 crores is the surplus.

Ravi Vishwanath: Correct.

Abhijit Akella: In case the entire amount is unrecoverable, then there will be a provision required of some 80-odd crores?

Ravi Vishwanath: Over a period of time, as and when these investments mature, that is when the provisions would be required to be made, yes.

Abhijit Akella: Secondly, on the employee headcount. There has been quite a sharp increase in the core employees in the staffing business it seems this quarter. What might have driven that?

Ashok Reddy: Largely, some element of project-driven hirings that have happened for the festive hiring specific to certain projects that we have. These will be for 2 quarters that we will have these project-based teams on board and some element of beefing up on the client's team at the back end that has also happened. Part of it is temporary, part of it will stay for a while.

Abhijit Akella: On the productivity matrix which has dipped this quarter both because of the fall in NETAP associates as well as the increase in core employees, is there sort of a target that we can work with for year-end?

Ashok Reddy: On an average, we have been moving it up by about 50 to 60 numbers yearly, and I think largely we should be able to stay on track for that.

Abhijit Akella: 50 to 60 is the core employee headcount, is it?

Ashok Reddy: No, 50 to 60 productivity enhancements. We were at about 270. We are targeting between a 300 to a 310 by the end of the year.

Abhijit Akella: Specialized staffing also, there has been a dip sequentially in headcount. If you could help us understand that and also give a breakdown between IT and telco?

Ashok Reddy: In the IT staffing, like I just mentioned earlier, the product company growth has been good. That has actually grown from 880 to 982 but the service company growth has actually reduced. From about 2200 in the previous quarter, it has come down to 2073. The reduction has largely happened on that side.

On the telecom front, from a 3700, it has come down to a 3500, but that is an anticipated reduction that we were talking about of reducing exposure to certain projects in a phased manner. And to some extent, there is also no new growth happening there given the overall telecom industry slowness.

Abhijit Akella: The unallocated expenses are a bit on the higher side this quarter. Some clarification there? And the other HR services also is still at a little bit of a slight loss.

Ashok Reddy: On a cumulative basis it is. The learning services has gotten into the positive. The other businesses, like I mentioned, have improved from Q1 to Q2, and we will see a further improvement in Q3. Some of the other cost items that have added in, one is we have got new leadership which is a cost of about 40 to 50 lakhs that has come in to take charge on some M&A pipeline that we have. So, we wanted to have the leadership in advance to take ownership for any deal that happened. The CSR provision of 60 lakhs has happened this time. This will be the first year where we have the compulsory CSR and we have started making provisions for the same.

Schoolguru, some collections have been delayed. That's about 1 crore additional cost that has come in on that front and about 40 lakhs of other expenses.

I think the new leader one will get distributed in a phased manner. The CSR is additional one. Schoolguru collections will again, on collection, get reversed and stuff.

Abhijit Akella: All these items were in the unallocated line, is it?

Ashok Reddy: Yes.

Moderator: The next question is from the line of Pritesh Chheda from Lucky Investment Managers. Please go ahead.

Pritesh Chheda: Sir, I have 2 questions. One on the HR services and the expenses that are leading to this EBITDA loss, if you could highlight them? And I think at the end of quarter 1, we were of the opinion that we have taken some write-offs and a lot of it would reverse. That's my first question.

My second question is, on the headcount side, this NETAP trainee reduction, is it a quarter-end phenomenon which came in? Because until quarter 1, we were of the opinion that the overall staffing growth rate would be about 20%. If you could explain that? And does that 20% now hold true or it stands to get revised?

Ashok Reddy: I think our outlook on the staffing size still stays positive, and I think we will continue the element of growth. The apprenticeship program, the NETAP, by virtue of its nature, has a larger exposure to manufacturing and auto industry. These 2 were large contributors to the volumes on that front. And I think the general slowdown that has impacted these 2 sectors has had an element of adjustment on numbers on that side. I think a large element of what should or could get reduced has happened. We don't expect similar reductions going forward, but I think we will have to wait to see how the industries play out per se.

On the HR services front, I think we had a large provision that had happened in the training business. We had expected a reversal and the bottom line turning around on account of the reversals. A part of those collections has come in. The training P&L has turned positive. We are expecting more collections and reversals to happen in Q3.

Having said that, some of the other businesses in the HR services – the hiring and the compliance businesses – were loss-making, continue to be loss-making, but have reduced their losses considerably compared to the previous quarter. We believe the trajectory for growth on revenues and their costs being kind of flattish kind of sets them for a better play in Q3.

Pritesh Chheda: What is the quantum of provision in the 1st half? And what is the nature of these provisions?

Ashok Reddy: Delayed collection is the only nature of provision.

Ramani Dathi: We made a total of 6 crores provision in Q1. Out of that, 1.5 crores has already been collected and reversed in Q2. We are expecting another 3 to 4 crores reversal in Q3.

Pritesh Chheda: Despite that, the EBITDA is negative. That gets explained by the dip in revenue?

Ramani Dathi: Yes. Because we are slowly tapering off our exposure in the government training business, you can see that the revenue has declined by over 30% year on year, especially in the government training business. In addition to that, in HR services, we have other businesses like our compliance outsourcing and permanent recruitment. Both of them are closer to a breakeven but still kind of contributing to the losses.

Pritesh Chheda: Which means that revenue growth is imperative for this division to turn profitable?

Ramani Dathi: Yes, for HR services.

Ashok Reddy: For CPO and for perm business, yes.

Pritesh Chheda: So, what is the outlook there?

Ashok Reddy: I think we have a strong pipeline of revenue on that front. In the perm business itself, they have actually increased revenue substantially in Q2 and there is a clear visibility for stronger Q3 revenues also. Similarly for the CPO business.

Pritesh Chheda: Lastly, my question is on the cash flow side. What should be the EBITDA conversion into cash flow for you? Because if it is 25 days of debtors, then that EBITDA to cash flow conversion actually reduces a lot plus we have this TDS element which gets cut. So, I just wanted to know how much of EBITDA gets converted into cash flow for us.

Ramani Dathi: Typically, 50% to 60% of EBITDA converts into our operating cash flow. But because of the huge TDS impact, it's kind of not reflecting it. Going forward, since we are getting an early lower deduction certificate, even with the TDS factored in, we should be at a 50% conversion for the 1st half year. By the end of the year, it will improve to 65% to 70% because 1st half year is when we will have more TDS deductions.

Pritesh Chheda: I see in the last 5-6 years of operations, there were a couple of years where this operating cash flow was negative because of TDS certificate. Those episodes are far and few or the nature of these episodes can be repetitive?

Ashok Reddy: We normally have to get the lower withholding order every year. Some delay is short term, but I think the longest delay has been when we were shifting the registered office from Mumbai to Bengaluru.

Pritesh Chheda: So, I can see that in FY19, there was a negative cash flow?

Ashok Reddy: Yes, that is the year we shifted the registered office. So, during that period, the lower withholding order was not passed until the transfer and transition to Bengaluru had happened.

Pritesh Chheda: Lastly, sir, that footnote of yours with respect to 170 crores of investment, I couldn't understand. Is it our cash of the balance sheet which is invested in DHFL and IL&FS or how is it?

Ashok Reddy: We have a provident fund trust which has about 1000 crores in balance sheet in investment as per the government stipulated guidelines. This is the money from there that had to be invested in different securities, and these were the 2 corporate exposures that are there from the provident fund trust.

Pritesh Chheda: Okay, it is an employee trust. Instead of having EPFO, you have your private employee trust under which the PF money is managed?

Ashok Reddy: That's right, yes.

Pritesh Chheda: When you mentioned currently positive by 90 crores, what does that mean?

Ashok Reddy: Because of historical additional interest earnings and appreciation on certain investments, we have a 90-crore surplus in the trust. Again, the liability is towards the provident fund of the employees.

Pritesh Chheda: And you actually didn't mention whether you will grow 20% on the headcount side for the FY20 or there will be a miss on that growth number?

Ashok Reddy: Normally, revenue has always been 20-plus percent, and I think we will be sustaining that.

Pritesh Chheda: No, the headcount number?

Ashok Reddy: Headcount has normally been about 15% to 17%.

Pritesh Chheda: You will sustain that despite missing it in last quarter?

Ashok Reddy: We should be able to sustain that.

Moderator: The next question is from the line of Dipan Mehta from Elixir Equities. Please go ahead.

Dipan Mehta: Sir, looking at the guidance, you gave about 20% of growth rate. My question is that, with the kind of stress that is there in the economy, which are the sectors that you are looking at where you feel that your services are required and to an extent, those are the growth opportunities available to you? Because there is a lot of stress in your traditional sectors like, say telecom and to an extent even IT. Are there any new segments which you are looking at expanding?

Ashok Reddy: In the general staffing business, our exposure to telecom and to IT is relatively low and similarly towards manufacturing while we had a higher exposure from the NETAP side to manufacturing and auto. But overall if you look at – while we agree with you on the stress per se – I think we are seeing demand still coming in from the BFSI sector, some element of FMCG, and some element of the e-commerce players. And I think besides the element of potentially new hires that they could be looking at, we are also seeing some element of rebadging that is kind of happening. So, the opportunity to grow for us comes from a perspective of sectors that could add new employees and hence outsource it to us or could be coming from a rebadging that is happening and playing out to us.

Dipan Mehta: My second question is relating to other HR services. Is it a strategic decision to reduce focus on government business and therefore this may remain for 3-4 more quarters until the government business is completely off the base effect and then you grow the business in the private side? Is that a correct understanding?

Ashok Reddy: Yes. We historically had a primary focus on the government business and over the last 2 years have been driving up the corporate training business alongside. To answer the first part of the question, we clearly want to have a sunset on the government business. It's not going to happen over the next 2-3 quarters. It is going to happen over the next 2-3 years given the mandates that we have but we are not taking any new mandates. But we clearly want to ramp up the corporate revenue to replace the loss in government revenue. Right now, we have about 30% of the training revenues coming in from the corporate side. We would like that to slowly phase itself up to 70% and become 100% in the long run.

Dipan Mehta: And when that happens, you will have a similar type of margin profile what we are seeing or the private sector has got a lower?

Ashok Reddy: Yes, and we won't have the challenges of collection because at least in the experience that we have had in the corporate training business, we don't have that much of an issue on invoicing and collection.

Dipan Mehta: One last question, sir. It is again regarding the provident fund. What you are saying is that the 90 crores is really the surplus, which was there, which you can use towards the 173-crore loss and still the 90 crores which is there would still not impact the kind of liability that the trust has towards its employees. It is just like a secret reserve or a safe reserve which was built in the PF trust. Is that a correct understanding?

Ashok Reddy: Yes. And on the 174 crores, the maturity profile is up to 2026 and we would keep a watch on the recovery of the amounts over that period and effectively take a call as the maturity period arose for each of those papers.

Dipan Mehta: Yes, but at present you are not receiving any interest on those investments, right?

Ashok Reddy: Yes.

Moderator: The next question is from the line of Vimal Gohil from Union Mutual Fund. Please go ahead.

Vimal Gohil: Again, sorry to harp on this PF trust issue. Sir, factoring in the worst-case scenario, what would be the write-off that we will have to take on our P&L?

Ashok Reddy: The 174 is the investment value. So, the worst case would be that. And we have a 90-crore surplus. As a running trust, we will not have any liquidity issues for the trust because, like I mentioned, we have got about 1000 crores corpus and we have got about 460 crores in aged, inactive accounts and the average claim ratio there is about 15% to 20%. So, from a recurring liquidity settlement aspect of continuance of the trust, we will not have any problems on that side.

Vimal Gohil: So, on the worst-case scenario, this 173 crores is the kind of write-off we will have to take in the worst-case scenario on the P&L?

Ashok Reddy: Up to 2026.

Vimal Gohil: So, would you want to take it in one shot or would you want to distribute it if at all the worst-case scenario plays out?

Ashok Reddy: We have evaluated the other trusts in the space with other companies. Everyone would like to just wait and watch how the repayment of the monies from this side is going to play out. There is a clear indication and a dialogue for trying to effectively give priority to retiral trust when the repayment aspect starts. We will wait to see how it plays out and then take a call on that.

Ravi Vishwanath: Specifically, the NCLT in the case of IL&FS has held that provident fund trusts and other retiral trusts should have precedence in settlements over others, and that is something that we would like to see how that plays out in the final tally, and probably something similar might be held for DHFL as well, which is why we said we will probably look at provisioning it as we go along the way and not look at one big-bang provision upfront.

Vimal Gohil: Sir, could you have made this disclosure earlier rather than making it in Q2? Maybe after the end of Q1 or so?

Ashok Reddy: We were waiting to see how the element of the payout plays out. And this has been in discussion, like I said, with other trusts and how everyone is going about it and we just felt it right to put the disclosure. Though we don't know the value of the liability to be taken into the future, we said just it would be good to disclose it now.

Vimal Gohil: Fair enough, sir. I have just one question now on the working capital, it's a followup. If I am not wrong, your current working capital days are about 18 days. You are expecting that to go up by 25 days on a sustainable basis because of the improvement in the specialized staffing business, right?

Ramani Dathi: Because of the growth in specialized staffing business. But general staffing will continue at the 7-day working capital, 7-day DSO.

Vimal Gohil: Wouldn't that be ROE dilutive getting into businesses which have a slightly higher working capital? What is the rationale of getting into these working capital-heavy businesses?

Ravi Vishwanath: As part of our margin expansion strategy, one of the things that we had said was we will get into specialized staffing and not restrict it to just IT alone. And we had identified IT, telecom, engineering services, infra services, hospitality, and healthcare as potential areas for us to get into because, (1) The business models are different, and (2) The margin profiles are also very different.

While we do have the flexibility of a lower working capital or almost kind of a negative working capital in the general staffing business, we said we will manage these other businesses in such a way that we do continue to maintain a fairly balanced return on equity as we go along despite these acquisitions that we make in these specialized staffing services.

Vimal Gohil: Sir, last question. That FY19 issue of TDS, what was that amount which is yet to come back?

Ramani Dathi: It is about 90 crores, last year FY19, the TDS amount.

Vimal Gohil: And if that really comes back, that will improve our working capital situation?

Ramani Dathi: Yes. That's right.

Vimal Gohil: When do we expect that to come back?

Ravi Vishwanath: That will take 2 years at least.

Ramani Dathi: We have, overall, about 250 crores from TDS receivables over the last few years. This will be received over the next few years.

Ashok Reddy: Normally, with a 3-year lag, the amount deducted 3 years back gets paid with 6% interest by the government.

Ravi Vishwanath: The 2017 assessment is probably getting done now and the return for 2019 March just got filed recently. So, it will take some time before those get taken up and assessed, actually.

Vimal Gohil: So, if at all we have any working capital cushion, it will only be after 3 years, not now?

Ashok Reddy: We will get 20 crores which was deducted 3 years back, hopefully this year.

Moderator: The next question is from the line of Akash Gupta from Zen Securities.

Akash Gupta: Sir, just to come back on the point that you mentioned that you are strengthening your M&A pipeline. I just wanted to understand 2 things. Of the past acquisitions that you have done, are there any future commitments and what could be the outflow with that?

And second, what kind of acquisitions are you looking at in the specialized staffing or learning management solution, as you have done in the past? What could be the size of those acquisitions? And given the cash requirement, would we see any debt in your books because of those acquisitions?

Ashok Reddy: I think, largely, the acquisitions in the IT staffing and telecom are 100% done and Freshersworld. There is no additional cash requirement on that front. We have taken a partial stake in Schoolguru and Avantis, which is online education and the regulatory compliance company. In those two, we would be increasing the stake in a phased manner, but these are milestone related. As they scale to certain numbers and stuff, we would look at increasing the stake over a period of time.

On the additional acquisitions where we are looking at is largely smaller deals but things that can either complement the existing P&Ls that we have or bring in a new specialized staffing vertical into the fold. Like the eCentric deal that we did recently was a fold-up to the IT staffing business and it came as a good opportunity to complement the existing business that we had and we brought it on board. Similarly, we continue to look for other options that will complement existing P&Ls, and we do have some dialogues for some specialized verticals that are not in play at this point.

And the reason for bringing Sunil in as a leader is to have a leader who participates in the M&A discussions so that there is more intimacy and ownership to running with those P&Ls as we close on the acquisitions.

Moderator: The next question is from the line of Hiren D from Goldman Sachs. Please go ahead.

Hiren Dasani: On the specialized staffing business, what kind of EBIT margins you are running at today?

Ashok Reddy: The IT staffing is at about 9% to 10%. The telecom is at about 3% to 4%. These are the two that we have and there are certain other ones that we are exploring but nothing on the table right now.

Hiren Dasani: And the receivable days are 90 days for both telecom as well as IT?

Ramani Dathi: IT on services front, it is about 60 days – 55 days to be precise. And for product companies, it is about 90 days. Even those 90 days, we are trying to bring down to 60 by working with the clients in the revised agreements and POs. Telecom is at about 90 days.

Hiren Dasani: So, effectively, from an ROC perspective, telecom and specialized staffing is not something which you should do, right? Because at 4% EBIT margin, 90 days receivables, it is a very poor ROC compared to your overall ROC. The IT staffing still looks respectable because you are making 9% to 10% EBIT margin and it is 60 days receivables, assuming that there is no other CAPEX and there is no other inventory and other capital employed. But why would you want to do telecom, if there is no scope of improvement there?

Ashok Reddy: Telecom was at an EBIT of 8% to 9% but, like we had mentioned, because of certain projects that were taken on and currently the stress in the industry is what has brought down the EBIT and which is why we have been reducing some element of the exposure in some projects and stuff. But our belief is that over a period of time, we should be able to take that EBIT back up.

Ramani Dathi: And also within telecom, if we look at the DSO of the core telecom clients, it is still 50 days, the DSO, whereas on the TIRF front, it is almost 120 days. Because of that, the blended one is currently sitting at 90 days. Once we tone down the TIRF revenues, the overall DSO in telecom will also improve.

Hiren Dasani: What should be the timeline which we should look at in terms of the specialized staffing overall with all the corrective actions which you are taking? What is the timeline for you to improve the overall ROC profile of that?

Ashok Reddy: I think it should take another 2 quarters to get that in play.

Hiren Dasani: Sorry to hop back on this PF thing again. Basically, if I understand this correctly, there is a potential contingent liability of 173 crores or can you offset it against the unrealized gains in the trust? Because the trust is currently in the surplus, right? You may have to fund the trust only to the extent of the deficit, right?

Ravi Vishwanath: That's right, yes.

Hiren Dasani: Even in the hypothetical scenario, you recover zero money on this entire 174 crores, the actual P&L hit on the company should be 174 minus whatever is the surplus at the trust level, right?

Ravi Vishwanath: That's right. And also spread over multiple financial years going all the way until 2026.

Hiren Dasani: Yes, that is correct. But in terms of the P&L impact, although many people will treat that as a one-off, still it is a P&L impact or contingent liability. But just wanted to clarify, it is net of the unrealized gains or does the accounting not allow you to set off against unrealized gains in the trust?

Ravi Vishwanath: The accounting allows us to set off the reserves in unrealized gains against potential losses.

Moderator: The next question is from the line of Soumitra C from Spark Capital. Please go ahead.

Soumitra Chatterjee: Ashok, if I recollect in the last quarter, when the concerns about the economy and its impact on temp staffing company, you were relatively upbeat and you had mentioned some 16,000 open applications still there. While you continue to be upbeat, the tone seems to have changed with respect to some of the factors that it is undergoing. If the trend were to continue, can it happen that things can worsen further and your growth expectation what is currently being set at, 14% to 15% at volume level, it can reverse back to FY18 levels of 5% to 6%. Can that happen?

Ashok Reddy: I don't think so. I was upbeat and I continue to be upbeat on the general staffing business. And I think our open positions and pipeline is healthy on that side, and we have grown with about 4500 associates on that count. I think the impact of the slowdown and the general weakness largely came in from manufacturing and auto which the NETAP had exposure to. Again, as an immediate knee-jerk reaction aspect, I think the numbers that had to be let go of or laid off are done. And again, as feedback, while I am not expecting some huge growth on the NETAP front, I don't think we should see a similar large reduction under some external macro variable changes. So, as of now, the staffing outlook from our perspective still stays positive.

Soumitra Chatterjee: On the NETAP front, the last quarter, you had an impact from the requirement of provident fund on these trainees, which the central government came out with a circular. As a result of which, a lot of companies had an issue on that while this quarter, it is more or less with manufacturing and auto – you said that you are not expecting any growth – but for the people who are currently there, is the requirement of PF still there, which can actually impact the NETAP trainees further in 2nd half of fiscal '20 and more so in '21?

Ashok Reddy: There have been some guideline changes in NEEM per se, the NEEM guidelines which drive the NETAP numbers. By virtue of some smaller players, effectively rebadging existing employees as NEEM trainees and shifting people from provident fund coverage into a stipend structure, there was a throwback from the Provident Fund Department, and they did go back to AICTE and MHRD and they have tweaked the element of the applicability and conditions for NEEM employees.

I think as on date, while we have covered all the employees and the employers to the required stipulations, we will also follow through with it for the future. So, I think some element of the weeding out of the smaller players who were not abiding by the required structures should clean that element of demand from the Provident Fund Department.

Soumitra Chatterjee: So, the guideline of provident fund on NETAP trainees still continues, right?

Ashok Reddy: There is no guideline of provident fund applicability on NETAP employee.

Soumitra Chatterjee: My 3rd question is, can we get the number of contribution from NETAP to TeamLease's EBITDA for FY19 and 1st half of FY20?

Ramani Dathi: I will get back to you with that number separately, Soumitra.

Soumitra Chatterjee: Sure, no problem.

And my apologies for asking this question on the PF thing again. The provident fund trust is investing in IL&FS and DHFL, the issues are going on for some time now, more than a year. When the issues first came in, few companies started to disclose in other sectors as well, in the IT services per se. Aren't we a bit late on this thing that we should have ideally disclosed it earlier? One of the previous participants also asked this.

And second part is, provident fund capital getting into some of these riskier instruments, obviously with the benefit of hindsight, are we going to see in future whether proper risk assessment procedures were in place or not?

Ashok Reddy: I think investment policies were strictly dictated by the government for investments into central government securities, state government securities, private corporate bonds and mutual funds. And the structure of that was what we followed from the trust perspective. So, there is no deviation in investment policy and philosophy on that front. Obviously, in hindsight, these two have been bad companies from the perspective of the current exposure. From a regular structural investment perspective, no deviation. Most provident fund trusts do have an exposure on that front.

From a timing perspective, I think we were waiting to get more element of clarity in terms of the payouts and stuff. Our first maturity towards these bonds happen from next year. We have been in discussion with the auditors. We just felt that maybe this is the right time to put it out there. Again, in retrospect, we can say it could have been done earlier, but I think we just have been analyzing that situation, evaluating it and we just decided that it is better to.…

Soumitra Chatterjee: One last question. We have recovered 1.5 crores, if I am not wrong, of the 6 crores, right? From the government contract?

Ramani Dathi: That's right.

Soumitra Chatterjee: And balance 4 crores we hope to recover in this quarter?

Ramani Dathi: Yes, at least 3 to 4 crores, we are hopeful to recover in Q3.

Moderator: The next question is from the line of Sandesh Shetty from PhillipCapital.

Sandesh Shetty: Most of my questions are answered, but I just wanted to ask one question with regard to sustainable margins. Do we see any uptick in the margins going forward for the 2 quarters that we have in the current fiscal year?

Ashok Reddy: I think there are elements that effectively drive the margin, the PAPM realization, and the headcounts. I think both of them you have visibility for driving up coupled with keeping the cost structures kind of flat. I think, given all of these 3 variables, we should see a margin improvement as we go forward, as headcount growth happens.

Sandesh Shetty: Just a followup on that. With regard to interaction with your clients, do you see any uptick in NETAP trainees going forward for the 2 quarters?

Ashok Reddy: For the immediate quarter, I would say, no. Difficult to say for the 2 quarters given the clients in the slowdown are taking it month by month.

Moderator: The next question is from the line of Prince Poddar from JM Financial. Please go ahead.

Prince Poddar: My question is that on the Other Expenses on a consolidated basis, which have increased from 34.5 odd crores to 43.7 odd crores in the current quarter on a Q-on-Q basis. Could you please help me in breaking down the 9-crore increase in Q-on-Q Other Expenses? What are the various elements which are increasing in the Other Expenses?

Ramani Dathi: Other Expenses on a QOQ basis have gone up largely on account of the new Ind-AS leaseholding. So, whatever incremental offices that we have been taking, they are all falling under the new lease accounting because of which there has been a straight 2-crore increase in Other Expenses between Q1 to Q2.

Also we have other expenses like CSR provision which we have started from this year. And we have other regulatory opinions and consultations which is to the tune of about 1 crore because of the recent tax changes and NETAP-related changes. And overall, some increase in training expenses under the ILS business, which is in line with the revenue.

Prince Poddar: If I am not wrong, Q1 also had that impact of Ind-AS 116. So, why this difference in rent accounting?

Ramani Dathi: This is the incremental business. These are the new offices which we have taken from our clients. We are also working on a few projects where we give associates along with the offices. We have signed up for some new offices in Q2, which has contributed to about 2-crore increase in lease rentals.

Prince Poddar: Just a bookkeeping question, Ramani. Margin in telecom and IT at 3% to 4% and 9% to 10% respectively is for this quarter, right? These are the levels as of this quarter?

Ramani Dathi: For this quarter, IT staffing is at about 9% margin and telecom is at 3.5% margin.

Prince Poddar: Last bookkeeping question. Can you break up the specialized staffing of 6500 associate employees into telecom and IT?

Ramani Dathi: IT staffing, we had a revenue of 56 crores this quarter with an EBITDA of….

Prince Poddar: Number of associates.

Ashok Reddy: It's about 3500 in the IT staffing and about 3500 in the telecom.

Moderator: The next question is from the line of Devang Bhat from ICICI Direct. Please go ahead.

Devang Bhat: I just wanted to know how long will your 80JJAA benefit continue? And if you are moving to the new tax regime, will this 80JJAA benefit continue with the new tax regime?

Ravi Vishwanath: Yes, the 80JJAA will continue in the new tax regime. In fact, that's the only deduction that the company will be entitled to that is lower tax dispensation. Having said that, we have evaluated the option of moving to the lower tax regime, though we haven't taken a final call given that there are still clarifications and consultations that are going on by the tax authorities in terms of how MAT credit entitlement, etc., are still being debated, which is why we discussed it and said that we do have time until the end of the year before which we could probably take a call on opting for the lower tax regime; in which case, the 80JJAA will get protected for us into the future.

Ashok Reddy: We have until the year-end, at least immediately, to take a call on which of the options that we opt for. The 80JJAA right now does not have a sunset clause, at least as of now, will continue to play out. However, while clarity is still pending and there are still discussions going on, we do have MAT credit that has accumulated. Whether moving to the new tax regime requires us to write off that MAT credit or not is the opinion that is still pending. At the required time, we would take that call.

Devang Bhat: And just one bookkeeping question. Your 1st half profit is 38 crores and your cash flow shows tax paid of 36 crores. Can you help me with that?

Ravi Vishwanath: That's the withholding taxes that happen in our business. Like Ramani explained earlier.....

Devang Bhat: Understood, yes.

Ravi Vishwanath: In the 2nd half, it does come down significantly for us for the whole year, actually.

Ashok Reddy: I am sorry to interject. On the earlier question, the IT staffing numbers are 3050, not 3500. And 3500 for telecom.

Moderator: The next question is from the line of Dipan Mehta from Elixir Equities.

Dipan Mehta: Just a quick one, sir. Still, so far, any assessment has been completed with 80JJAA being accepted by the department?

Ravi Vishwanath: This is the first year that we are doing it, and we expect to get some orders very soon on this.

Ashok Reddy: So, we will know for sure, in that sense, with the tax refunds that will happen this year.

Ravi Vishwanath: The hearings have been concluded and orders are expected.

Dipan Mehta: Just a suggestion, sir. Whenever it happens, if you can just make a public disclosure because it's a very major risk factor for the company being a new section which has come in. Sometimes, there could be a slip between the cup and the lip between what you have provided for and accounted from what the tax department thinks is the right way to calculate.

Ravi Vishwanath: We will do that, yes.

Moderator: The next question is from the line of Prashant Tiwari from SBICAP Securities. Please go ahead.

Prashant Tiwari: Can you please tell me the markup for trainees in this quarter?

Ashok Reddy: It is average of 572. It was 565 the previous quarter.

Prashant Tiwari: In Q1, it was 565, right?

Ashok Reddy: Yes.

Prashant Tiwari: And what is the average salary for a core employee right now?

Ashok Reddy: Core or temp?

Prashant Tiwari: I am asking for the core employee.

Ramani Dathi: For core employee, average salary is about 28,000 because we have a large chunk of employees at entry level for the data processing and payrolling.

Prashant Tiwari: Finally, on the acquisitions; when you said that you are looking for something in maybe hospitality, healthcare, or engineering services, will these be purely staffing-based companies or you could look for some project kind of revenue also?

Ravi Vishwanath: These would be largely staffing-based companies with very minimal to know….

Ashok Reddy: They will be flux on staffing but they're not outcome based.

Prashant Tiwari: So, these will not be outcome based.

Ashok Reddy: Yes.

Prashant Tiwari: In terms of working capital days, will these be at around (+60) days?

Ashok Reddy: Yes.

Moderator: As there are no further questions, I now hand the conference over to the management for closing comments.

Ashok Reddy: We, on the headcount front, had a muted quarter and effectively do believe that the pipeline that we have as open positions and client requirements will sustain growth in numbers as we go forward and that should again play back to the aspect of productivity and the margin recovery as we go forward. We, from the investments on the provident fund trust, continue to keep a close watch on proceedings that are happening with the 2 companies and we will update as and when we hear more. The aspect of the M&A opportunities, we will continue to evaluate, that will either complement us on verticals or will integrate with an existing P&L. On the telecom staffing front, like we said, over the next 2 quarters, we will pare-down some of the low-margin projects and effectively work to improve the margins on that front. I think that's the way.

Moderator: Ladies and gentlemen, on behalf of IDFC Securities Limited, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.