"Teamlease Services Limited
Q2 FY2022 Earnings Conference Call"

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Moderator: Ladies and gentlemen good day and welcome to the Teamlease Services Limited Q2 FY2022 Earnings Conference Call hosted by ICICI Securities. As a reminder, all participant lines will be in the listen-only mode. 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 "*" and then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sudheer Guntupalli from ICICI Securities. Thank you and over to you Sir!

Sudheer Guntupalli: Thank you Inba. Good evening ladies and gentlemen. Thanks for joining us today for the Q2 FY2022 Earnings Call of TeamLease. I would like to start off with thanking the management of TeamLease for giving us the opportunity to host this call. On the call, we are pleased to have Mr. Ashok Reddy, Managing Director and CEO; Ms. Rituparna Chakraborty, Executive Vice President, Staffing; Mr. Sunil Chemmankotil, Senior Vice President, Specialized Staffing and Ms. Ramani Dathi, Chief Financial Officer. We will start off with prepared remarks from the management, thereafter we will open the floor for questions. Thank you once again for joining us today. Over to you Ashok!

Ashok Reddy: Thank you Sudheer. Good evening and thank you all for joining. I think we have had a very strong organic growth in the current quarter. We have added over 25,000 headcount across various businesses. I think general staffing has added over 14,000 associates while there have been headwinds around markup and aspect of CAP and negotiations and stuff. I think the fact of what we have done in the past has enabled growth and hopefully we will continue to enable growth in volumes. Specialized staffing has grown with nearly 1000 headcount and has been gaining market share. We have also had a strong rebound in NETAP. The NETAP was impacted in Q1 on account of the second wave and they have had a good strong rebound and have added nearly 10,000 trainees in the last quarter. I think on the back of that coupled with HR services businesses also delivering to growth our operating EBITDA and PBT absolute numbers and margins have improved overall. We have also effectively focused on continuing the aspect of growth across these businesses while we maintain all the other parameters of operating cash flow and productivity and all of those. While Ramani will detail a little more from the provident fund perspsective, we have had settlement in DHFL and follow through on that we have taken a provision in the books for the investments made there, but we will cover that later. I think overall from an operating perspective it has been a very strong quarter and hopefully it is the reflection of the rebound in the market that we will continue to play to as we go forward. Ritu will give a commentary on staffing and then we will take it forward from Sunil.

Rituparna Chakraborty: Thanks Ashok. Good evening everyone. Hope Diwali was fun-filled and joyous. We did remarkably well with a net associate growth of 9% over the Q1 base. Each of the six business cohorts in staffing came together to deliver a noteworthy performance. Of course, based on the economic recovery indicators a few cohorts did better than the others. The key standout for us has been (a) Differentiated hiring across the six cohorts has led to a high volume of temp addition hired by us across diverse profile for the quarter, kind of bettering our best. Sustained aggression in new logos, fine arts and focus start up segments, and finally meaningful investments being made in talent and product keeping the long-term vision and roadmap in mind. I think the upside of the reorganization of the staffing business which we did at the beginning of the financial year is evident in the performance of the six business cohorts. We witnessed the most aggressive positive headcount growth in BFSI, consumer, e-commerce, and the tel-tech cohorts. We had 59 new logo signups as against 47 in the previous quarter. Hiring contribution to gross additions continued to improve and was about 31% in Q2 clearly signalling departure from our past wherein most of our addition used to come through client hired associates. Also contribution of hires through nonrecruiter-led channels stayed strong at about 60%. Our ST productivity ratio for staffing alone improved by about 7% in this quarter as against the dip we witnessed in Q1 largely on the back of our robust net associated additions for the quarter. We also managed to improve our product associate markup in absolute rupee terms marginally through the quarter. Barring one account all one-off discounts to clients on account of COVID have stopped. The impact of just one account would remain in Q3, however, stops completely thereon.

While there has been a robust increase in associate headcount our margins are under pressure. Given the impact of some COVID-driven price reduction that we had to absorb, one-time payouts like bonus which does not attract markup. Given all past loans for associates are done away with and that they are back on full wages, even associate increments and incentives are back again boosting our gross revenues, given the investments we are making in sales, hiring capabilities, and leadership. Given we had to incur higher recurring EDLI cost which we have chosen not to pass on to our customers, we are expecting of course continued positive momentum on associate additions for the next quarter given the pipeline and strong hiring performance; however, for the above-stated reasons our margins are likely to remain flattish for the next two to three quarters. However, as the annuity kicks on and productivity improves, we will definitely see our margins improving.

A little bit on the employment outlook - I think based on our recent employment outlook report which we do every quarter there has been an improvement in Q3 by about 3% in terms of intent to hire. Some of the key takeaways obviously shows that IT, educational services, healthcare, Pharma, BFSI, e-commerce, and FMCG are the top sectors with the highest intent to hire. Metros and tier-1 cities are bouncing back much faster than the rest. Bengaluru and Delhi is leading the pack. I think entry level hiring intent outpaces every other category as businesses look to optimizing cost. Sales and IT are some of the key hirers in function at this point. Side-by-side, attrition definitely has gone up whether it is IT or educational services. One good thing is the sectors those were worst affected by the pandemic like hospitality, aviation, lifestyle retail are making a comeback and showing marginal yet positive hiring intent.

On the regulatory environment, I think the subsection 3 of section 1 of the Haryana State Employment of Local Candidates Act of 2020 is an unpleasant move and contrary to the spirit of ease of doing business. While representations have been made by the various industry bodies to prevent this from coming into effect on January 15, 2022, we are not really sure of the outcome. Given elections are down the corner, it is safe to assume the motivation behind such a move. We will have some disruption in hiring of candidates with monthly wages below 30,000, but we are at the moment trying to kind of assess the extent of it. Meanwhile, government continues to maintain an uneasy silence over the implementation of the four labour courts. With the liberation and the alignment with the state being cited as the primary cause for the delay. While we have executed on our objectives of the reorganization at staffing level, differentiated hiring and improving productivity, however, the future directions for us in staffing now lies in developing stronger contextual mastery across the six business cohorts, create differentiated servicing and differentiated product stack as per the future needs of each customer in each cohort. Thank you.

Sunil Chemmankotil: Thanks Ritu. Good evening to everyone on the call. I hope you and your families continue to stay safe. We are delighted to share with you that we had yet another exceptional quarter with increased market share gain. The digitization supercycle post pandemic has led to huge deal wins for our customers and the same translated into healthy pipelines for us. Despite a huge talent work leading to skill shortage we focused on addressing the supply side challenges by offering hire, train, deploy solution in collaboration with our in-house TL Edtech company. Our state-of-the-art solution has helped our customers to meet their talent needs on time. Our strong hiring capabilities coupled with hire, train, deploy solutions across skill levels particularly in the new-age skills like digital skills have ensured our customers place more trust on us to fulfill the increased talent demand. These efforts have translated into 11.5% growth of our consultants headcount over the previous quarter. We closed with a headcount base of 8713. Our sales engine continued to fire on all cylinders resulting in 42 deal wins in Q2. In the last quarter we did 27 and we did 42 deal wins this quarter. New deals coupled with phenomenal growth in existing clients due to increased fulfillment of demand helped us to grow the revenue by 36% Y-o-Y and 17% Q-o-Q. We have been focusing on fulfilling high-value mandates and hire, train, deploy solutions which have helped us to improve our gross margin substantially. We increased by around 400 basis points Y-o-Y and 50 basis points Q-o-Q. In the current quarter, we have maintained a gross margin of 19.75%. PBT grew 41% Y-o-Y and 20% Q-o-Q. We improved our PBT margins by 17 basis points despite investment towards creating additional capacity, capability, team leadership and long-term incentive provisions for our employees. We are confident of maintaining the PBT margins in the same range. I would like to thank my team for a customer-centric approach which made us partner of choice across the segments. To summarize, I would say that the demand environment continues to be very strong and we are confident of continuing the current performance trends in the coming quarters backed by a well-set execution engine. Thank you.

Ramani Dathi: Good evening all, this is Ramani. Hope you are all doing well and safe. Let me first talk about the exceptional item that we have accounted this quarter. As you know, TeamLease PF Trust has made about 173 Crores of investment in DHFL and ILFS. Since they have maturities going up to financial year 2027 we planned to realize gains on other investments over the next six years to offset the loss. However, with the recent development on DHFL which got crystallized and we received 48% recovery as full and final settlement, we have taken a prudent call to make a provision of 75 Crores in TeamLease book towards the investment loss in PF Trust and this also factors for any potential interest shortfall in future at the trust level. There is no immediate need for TeamLease to transfer the 75 Crores to the trust because the trust is having sufficient reserves to maintain positive balance. On a need basis, we will be taking a call on how much of this 75 Crores provision has to be translated into a cash transfer. The second element on overall cash flow front we have maintained 100% conversion of EBITDA to the operating cash flow. Our funding exposure and DSO levels remain same as last quarter and on overall margin front while staffing margins have remained flattish on a Q-o-Q basis at a group level our margins have improved at both EBITDA level as well as PBT level. This trend would continue even for the coming quarters with majority contribution coming from specialized staffing and HR services. As we mentioned earlier, in previous quarter HR services have broken even in this quarter and it will start making meaningful contribution to the bottom line going forward. Thank you.

Ashok Reddy: Sudheer we are open for questions.

Moderator: Thank you very much Sir. Ladies and gentlemen, we will now begin the question and answer session. Anyone who wishes to ask a question may press "*" and "1" on their touchtone telephone. If you wish to remove yourself from the question queue you may press "*" and "2". Participants are requested to use handsets while asking a question. Anyone who has a question may press "*" and "1". Ladies and gentlemen, we will wait for a moment while the question queue assembles. Our first question is from the line of Sudheer Guntupalli from ICICI Securities. Please go ahead.

Sudheer Guntupalli: Ramani, probably we can start addressing the elephant in the room about the PF trust issue. Since this issue was first disclosed in September 2019 I think we maintain the same stance which is we have a net surplus and we have an unrealized mark-to-market gain, both of which will more than cover for any potential shortfall because of the let us say haircut in these two instruments. At one point in time, we have also gone to the extent of saying there is an unclaimed fund in the PF trust which can also be adjusted for liquidity needs. At multiple instances, I think we have maintained the same stance that an item of provisioning or the scenario of provisioning will only triggered if and only if there is a liquidity crunch in the funds. In that backdrop, I think even when the same issue came, the auditors have qualified this at one point in time, proxy advisory firms have suggested to vote against this. All those instances we have maintained the same stance that there will not be any liquidity crunch in the funds, accordingly there will not be a scenario of provisioning to be made. So, what has changed now, if I understand it right, let us say from the previous three months or last one month or two months to now, what has changed now? I understand that in BSFL there is a resolution, in fact it is a pleasant surprise for me because expected recovery earlier was lower than what you are able to recover now, so that should be a logically possible development, what made you change the stance and go for this provisioning at this juncture?

Ramani Dathi: Firstly, two elements to this. One is the DHFL crystallization that has happened in this quarter because as I mentioned earlier we have maturity of DHFL going up to year 2027 and our plan was between the reserve that we already have on the balance sheet of PF trust plus the future gains that we plan to realize on other investments over the next six years between these two, the plan is to offset the investment losses of DHFL and ILFS, that is one element and that got crystallized now and we have to upfront book for the investment loss in the books of PF trust, not in the books of TeamLease. The second element is as I mentioned this is more of a prudent decision taken by the management to make this provision of 75 Crores. This is mainly on account of any potential interest shortfall that might happen at the PF trust level in future because our liability to PF account holders is 8.5% while the average yield is currently standing at 7.5% again because of the shortfall happened with the DHFL and ILFS not making any yield for us. With this 1% interest shortfall on a prudent basis we want to create this provision, however, there is no need to make any actual cash transfer to the PF trust. On a Q-o-Q basis we see if there is any shortfall happening at the reserves of PF trust level only to the extent we take a call if the cash transfer has to be actually made.

Ashok Reddy: Just to add to that Sudheer, I think the aspect of what we said earlier about there being reserves and there being unclaimed accounts and there being no liquidity issue as the trust continues to play out. I think the settlement of DHFL which was maturing in 2027 is really what prompted the management to take a view that making a provision with the known aspect of the settlement and the aspect of how it has played out would be the prudent thing to do, does not have an immediate cash flow impact, that would only happen on a basis of requirement if need be.

Sudheer Guntupalli: Sure Ashok, I understand the fact that there may not be an immediate cash flow impact, but my only humble submission here is that for five to six quarters we have been maintaining the stance that there are X, Y, Z events, if and only if those X, Y, Z events happen the provisioning will get triggered, now none of those X, Y, Z happened and only another event which is DHFL settlement happened, actually if I look at it you are able to recover around 55 Crores and there is a realized loss of around 58 Crores. As per June 2021 financial results of TeamLease, I can see roughly there is 120 Crores unrealized surplus plus mark-to-market gain, which is your realized loss of 59 Crores is still lower than whatever your MTM unrealized gain plus net surplus of the pension plan, so just I am a little confused as to what triggered the provisioning event now.

Ramani Dathi: This is because of the early settlement of DHFL, as I mentioned earlier we thought the maturity is going up to 2027, we have another six years to realize gains and offset this, and also as you mentioned in your question that there have been queries from the quasi agents and few other investors on the audit qualification, it is more of a prudent call taken by the management to also get the qualifications removed and taken this one-time exceptional hit of 75 Crores.

Sudheer Guntupalli: Sure Ramani, sorry for stressing this again, but my earlier question holds on and it remains, actually when we were saying that we don't make provisioning for the last five or six quarters and we were saying based on the fact that there is a good amount of MTM gain plus unrealized surplus in the pension plan, we were not really betting on the fact that in the next six years we will make some excess income and that excess income will be able to offset the loss realized on these two instruments, right. We were only betting on the unrealized gain which we are seeing in the plan at that point in time. Whenever Ravi was there, whenever this issue came up in questioning in the calls also, we were maintaining the same stance that we have a particular MTM unrealized gain plus there is a net surplus in the pension plan and we were only betting on that. We were nowhere betting on the future expected gains on that plan to be able to offset the losses, so just because of the conclusion of this DHFL NCLAT proceedings, I am just a little unclear as to why that should trigger, logically the theoretical framework remains the same why that should trigger a provisioning event at this juncture?

Ramani Dathi: Sudheer there is a different between MTM gains and actual results. Because of settlement of DHFL we have to upfront recognize the investment loss on DHFL, so that gives the reserves, but we cannot completely realize the MTM gains that are there in the trust because majority of the MTM gains are on equity and after selling those equity whatever proceeds that we get 85% of them has to go into bonds and other securities, nonequity investments. So, that would further bring down the trust 7.5% yield to maybe 6% or 6.2%. We have to balance between the Y-o-Y yield rates as well as maintaining the reserves positive.

Sudheer Guntupalli: Fine Ramani, but again if this is the case obviously we were not expecting DHFL issue to go on till FY2027, settlement will happen sooner than later, so if not in September this year probably it would have happened in December or next March, then this should have happened earlier itself. The provisioning should have happened when auditors have flagged off this issue or when proxy advisory firms have flagged off this issue for the first time, that is point number one and based on your response I have a followup question on this.

Ashok Reddy: Historically, we have said that we wouldn’t be taking the element of provision and we did have reserves, but I think the qualification has been in our books, so has the call out from the proxy agencies been there. I think it is also a call with the settlement coming into play that it would just be a more prudent element to get the provision taken and offset it with the element of qualification being removed and take it on front.

Sudheer Guntupalli: Sure Ashok, one last question on this aspect before I move on to the next topic. Any further provisioning on the lines of the same that we may have to anticipate based on what exactly is the recovery rate on ILFS instrument?

Ashok Reddy: I don’t think we would have additional provision required. I think we have factored for the element of ILFS recovery also into the overall provisioning that has been taken. We don’t see any future addition to this provision.

Sudheer Guntupalli: Sure, and just if I understand it right, this is a trust and TeamLease is a trustee, so logically speaking there is no need to make the shortfall good unless and until there is a liquidity event. Again, do we have any liquidity event now or are we foreseeing any liquidity event in the next few quarters which is why we have now taken a call to kind of make this provision?

Ramani Dathi: Not at all. There is no liquidity crunch at the PF trust level and even the 75 Crore provision that we have created can be written back subsequently in case if the trust makes additional gains or if the ILFS recovery is slightly higher than what we have estimated, so this 75 Crores can be written back. That is why we said this is only a book entry, only a provision entry made in TeamLease book without no actual cash transfer to the trust.

Sudheer Guntupalli: Fair Ramani, and Ashok and Ritu probably you may answer this question. Worldwide we are seeing this phenomenon or the theme of great resignation playing out, and especially those developed economies like US and UK which religiously give out employment data we are actually seeing that the number of job openings to be higher than the number of unemployed people in many economies. Even in India, we are anecdotally hearing that we don't have solid data to kind of understand what exactly is happening in the job market. Any insights on how do you see this kind of either positively or negatively however it is impacting your business the theme which is playing out worldwide?

Rituparna Chakraborty: I think one of the most important aspects is that this term rate resignation is kind of floated around in countries where there is huge government bailout at an individual level to people during the pandemic. What one is noticing is that because of that a lot of resources now are refusing to come back to the job market and they prefer to lead the kind of life that they have gotten used to during the pandemic. I think that is definitely something which is very different from what is happening worldwide especially in some of these developed countries and India. This trend is widely seen right now in US and in UK, and a bit of Europe as well. Thankfully in India of course there were no such government pandemic-driven pensions or subsidies that have been given to at an individual level, that is one huge difference. The great resignation obviously is happening rather attrition is happening in the IT sector, but the reasons in that sector are obviously varied and maybe different from what is happening in other parts of the country. In India, again a lot of individuals especially in the tech sectors are preferring to either have the flexibility of choosing the kind of work that they want to do. They want the flexibility in choosing the location. They would like to continue to work on remote and if that becomes deciding factor on somebody's employment then they are choosing to opt out because they clearly know that there is a demand that exists in the market place. There is a lifestyle choice that is being made by candidates in that sector to kind of move to more freelancing rather than having a permanent kind of a job so that they can pursue activities, vocation, interest of their own in their free time. That is why you must have seen that there are some start-ups who are coming out with innovative ideas of four-day weeks, three-day weeks permanently for their employees. I think there is a difference in what is happening in some of the developed countries and in India, but in India the impact is widely being seen in the tech sector or the knowledge-driven sector, but in the other sectors no such trend, I mean as a matter of fact people are as hungry as they were now more than before in terms of wanting to get themselves a job and get back into the job market. I don't know whether that answers your question, but that is what is happening.

Sudheer Guntupalli: Sure Ritu. One last question before I leave the floor open for Q&A. Actually your commentary on margins seems to be a bit self-contradicting for the lack of a better word. On one hand you are saying that the pressure on markups is kind of behind us or maybe only in one particular account it may spillover to the next quarter, but in most of the reckons the pressure on markups is kind of behind us, but you are also saying that we may not see such a margin expansion for the next two to three quarters despite headcount going up dramatically in this quarter and in the future also we are expecting strong headcount addition, and despite markups remaining stable, so if you can dwell deeper a little bit that could be helpful?

Ashok Reddy: Let me just address that Sudheer, I think in absolute terms there is a marginal improvement in the PAPM realization despite the fact of discounts and renegotiation on pricing that has happened and so on. However, like Ritu mentioned earlier the topline billing from a wage perspective has gone up higher than the element of the growth on this front hence that kind of reduces the percentage realization from which the costs are further reduced to come at profit margin for the staffing business. I think one is the aspect that the wage cost and the pass-through cost have increased. Our PAPM in absolute terms have actually gone up marginally, and the other element is what she called out as a staff level at TeamLease end the element of the structural strategy that we adopted in terms of verticalization, the hiring focus, the elements that have enabled and driven our growth, and will play out for the future are investments that we would continue to make. Over and above that, obviously there have been some cost increases that have hit us on account of COVID one of which is the huge hike in insurance cost. Those effectively will put the pressure on the margin being flattish while growth will continue. In absolute term, the profits will go up.

Sudheer Guntupalli: Fair Ashok, that’s it from my side. I will let others join the queue.

Moderator: Thank you. Our next question is from the line of Manish Gupta from Solidarity Investments. Please go ahead.

Manish Gupta: I just wanted to understand how your PF trust structure works. Is there a return that you are guaranteeing to your employees under that scheme?

Ramani Dathi: 8.5% is the statutory requirement as a return to the PF account holders under the trust. It is guaranteed at 8.5%.

Ashok Reddy: The government announces annually the rate of credit to be given to the provident fund contributors and that is currently at 8.5%.

Manish Gupta: How do you intend to generate 8.5% because that would assume that you would need to take certain equity exposures, right?

Ashok Reddy: The corpus of the trust can be invested in percentage terms across central and state government bonds, across corporate bonds, and across equity linked investments. Effectively adhering to this the element of the return plays out. These are dictated by the government in terms of what categories and what percentages can happen and those are effectively looked at before making the investments.

Manish Gupta: Do you have internal guidelines at present or what is the equity exposure?

Ramani Dathi: Currently we have a capping of 10% on total equity exposure while the statutory limits allow us up to 15%. Again, on a prudent basis we have internally capped it to 10%. Also under equity, we are only investing in indexed funds, not direct equity.

Ashok Reddy: Currently, the exposure is around 6% in equity.

Manish Gupta: Sir my question is let us say long term in index fund returns 12% and you are saying you are capping that exposure today at 10% and you want to return 8.5% that means that on the rest of your debt portfolio you would have to, if I do the math, return something north of 7% or 7.25% on your debt portfolio while 10-year GSEC today is roughly 6.5%. I don't understand the math of how you will manage to return 8.5% by taking only 10% exposure to equities and hence is it that you would have to keep funding your provident fund trust from your core operating profits in order to bridge the deficit?

Ramani Dathi: Currently this 10% equity limit we are deliberating to take it up to the maximum levels in future, but as of now we would like to stick to the 10% limit that we set internally. Also there were a few indications that EPF guidelines also increased the exposure to equity limits from the current 15% to 20% to 25% because as you rightly said otherwise it is impossible for any PF trust including the EPFO also to manage this 8.5% yield.

Ashok Reddy: I think currently there are some investments that have been made historically that are giving higher yields. Obviously the current yield portfolio has reduced. At a balanced level is what we would be looking at. The 8.5% is not something that necessarily also has to hold forever into the future and in the past even at the rates that were indicated we had reserves built over the past few years. So, one is the element of the EPFO reviewing the 8.5% on the realizable yield, part of the weighted portfolio of the earlier investments also contributing and balancing the realization is where we would approach it.

Manish Gupta: If I just take the last 24 months my point is that incremental contributions that you have made over the past 12 or 24 months, if you assume that long term the equity return on those investments will be 11% to 12% because you are investing in an index fund and if 90% will be in debt instruments which will be in the range of 6.5% to 7% I just don't think the mathematics works to get you to 8.5%. That means would on the last 12 to 24 month investment are you on a long-term basis actually carrying a deficit?

Ramani Dathi: Currently there are a few basis points of deficit in the PF trust yield rate and also what we are petitioning to the government is to give a temporary interest holiday on the government accounts which they have done in the past. In the past for unclaimed balances they have given interest exemptions and out of the 1400 Crores of portfolio that we have under PF trust almost 500 Crores comes under the unclaimed government accounts. If there is an interest exemption to the extent of that 500 Crores that would completely offset the shortfall in yield rates.

Manish Gupta: I understand that madam, but you know this is luck siding in our favour. I am saying on a run rate basis, you know, we are carrying on a run rate basis assuming everybody claims what is due to them, we are actually carrying a deficit on a run rate basis.

Ashok Reddy: I agree with you Manish and we will call that out earlier, saying that it is at a few basis points less than the required rate to be given.

Ramani Dathi: And we will be revisiting the equity exposure policy on a Q-o-Q basis whether we have to increase it, managing the risk and yield rates.

Manish Gupta: Madam, there is no other option for you but to follow this 8.5% guaranteed return, I mean you cannot make it managed contribution plan which is invested based on certain risk profile that people choose?

Ramani Dathi: No Manish, it can't be done. The long-term plan is whether we can consider transferring this PF trust to the RBFC but that takes some time. It takes at least four to five years timeframe to get that aspect done, but that plan is there in the long term.

Moderator: Thank you. Our next question is from the line of Sachin Shah from Emkay Investment. Please go ahead.

Sachin Shah: Thank you for the opportunity. Sorry I am a little naïve on this PF thing. Continuing with the previous question, if that 8.5% guaranteed for whatever reason you are not able to earn from the investment that you made, you will have to make it up from your core business profits, is that a correct understanding?

Ramani Dathi: Yes, that is right.

Sachin Shah: Okay, can't we just put it in the government EPFs where we don’t have any liability or anything?

Ashok Reddy: That would be our long-term strategy if this were to continue to play out as yield what has to be credited, but from a servicing perspective of the employees having our own trust has always been better in the past and that is really where the element of setting up the trust and managing it had played out. We were also in surplus over past investments to returns to be given. This has been impacted by virtue of the two stressed assets and the current yield rate while the government has not revisited the 8.5%, but if over the coming years this element of differential between yield and what the government is asking to be credited continues to play out and as our reserves get depleted if on that count we would explore the aspect of moving to the RBFC.

Sachin Shah: Yes, and I am just saying that why should we distract ourselves from the core business?

Ashok Reddy: I think this is primarily done from a servicing of the employee's perspective. I think the historical element of service around the PF claims and transfers has been quite bad from the EPFO and as our employee base has grown our ability to give them comfort and confidence in servicing has been tremendously high by having our trust, but obviously we don't intend to do that if there is continued stress from financial asset, so we would relook at this as we go forward.

Sachin Shah: Yes, because in this kind of a world when everything is volatile, uncertain and complex it is going to be like this right, I mean whether this time it may be government, next time it would be some global X, Y, Z, something or the other, so why do we distract ourselves, I am just wondering, but anyways I am done.

Ashok Reddy: We totally take the point. For 15 years we have had no problem in administering the trust and ensuring better service to the associates. Obviously, the last two years have changed that and we would relook as we go forward. We are open to that.

Moderator: Thank you. Our next question is from the line of Mukul Garg from Motilal Oswal. Please go ahead.

Mukul Garg: I just wanted to checkup on the initial commentary around the Haryana government's plan to hire locally. Is that something which will be more from a nuisance perspective for you or do you think there can be a meaningful impact in our business because there is a requirement to hire locally and may be you will not be able to find enough people under that Rs.30,000 per month category.

Ashok Reddy: I mean it is more nuisance at this point Mukul rather than actually impacting the business. I think some of the governments have been approaching this reservation for locals for local jobs. In the past even Andhra Pradesh has done this and the throwback from industry has been where is the local talent to map to the jobs. So they have been a little flexible not following it through and so on. I think to some extent at this point in time it is more a nuisance value rather than impacting any of the growth aspect, but I will have Ritu also add into that.

Rituparna Chakraborty: I completely agree with what Ashok said. It is more an irritation and finally the reality on ground in Haryana is that local talent is not available for the said jobs. The thing is if you look at the wage level of Rs.30,000 and below this essentially covers even domestic call centers, international call centers. It also at one hand covers all the delivery agents, sales profiles. I think sooner or later I am sure prudence will shine upon us, especially the Government of Haryana. It is in election around the corner, so one can totally understand the need for making such a move. However, some latest reports that have come in industry bodies have chosen to contest it at the court level, so we will have to wait and watch how this essentially goes. None of the existing business obviously gets impacted. We believe that employers will come up with and so shall we probably of ways and means of ensuring that these candidates are routed to the appropriate states like Delhi or UP given that there is mobility available across India.

Mukul Garg: If we assume that this thing kind of get passed, how should we look at the different businesses in terms of exposure, both the general staffing as well as IT staffing, how much is the exposure from our end?

Ramani Dathi: I think it is more than our exposure. We have to think about the reaction from the industries per se, because there has been very aggressive pushback that has come through from NASSCOM, CII, the automotives association, the industrial association of Haryana. I think it is completely contrary to what they set out to do and why Haryana became attractive for them. So I guess from our perspective we feel that yes, it is a little bit of a hiccup in the short run, but I am sure more than us it has not gone well with the industries per se. If the industries choose to move actually and some of them are considering their base and thanks to the pandemic where remote work, hybrid work, the fact that you can easily relocate has been exposed to us, I think industry will avail all these options.

Ashok Reddy: I think just from our perspective, yes, if it was implemented strongly and enforced there would be the challenge of ensuring the only fine local candidates for the local jobs, so it will put additional pressure on the hiring on that front, but I think we will have to take this as we go forward because it also concerns industry per se about them being able to find the talent even if they had much more stringent standards or let loose the standards to find only local people for the jobs and more so in the knowledge industry.

Mukul Garg: Understood. The second question was on the associate addition. This quarter 25K was very, very strong number. I think your comment implies that you will continue to see strong additions in the next few quarters. Will they be on a similar scale or was there some seasonal factor which helped Q2, and again I think I will just kind of try to merge this with Sudheer's earlier comment, is there some sort of pressure on the non-IT general staffing side whether in terms of salaries or availability you are seeing on supply end?

Ramani Dathi: I think I will refrain from giving any guidance for the future in terms of exact ballpark that we are looking at, but yes we expect good, strong performance for the next few quarters based on the pipeline that we have. Now, availability of manpower whether there is pandemic or not is always a tricky thing for an organization like us, but we need to figure out ways and means to succeeding and solving for customer requirements in spite of it, and I think we have established a track record given the delivery mastery especially around hiring, the differentiated hiring capability we have developed across the six business cohorts which is playing through, we have been able to come out with the right kind of mix and we feel that will help us maximize our conversion ratio. Our conversion ratio actually to clients' requirement has been extremely good of late which is almost at the 60% level. There are challenges which we have narrated around the margin side, but on the associate growth and addition we feel that we will continue to maintain positive traction.

Ashok Reddy: I think we favour to break it down. In general staffing clearly we had called this out in Q1 also that the feedback from customers when wave two hit was that they were putting their plans on hold and deferring them rather than cancelling them. I think as unlocking has happened thereafter customers have come back strongly on their demand for headcount. It is twofold, one is that we have been adding headcount to existing customers and we have been adding logos across verticals coupled with the fact that our hiring delivery has improved substantially and a large number of the open positions that are coming in we are able to deliver to. I think when we look at the coming few quarters the element of the stake at demand from the customer side is still quite strong. I think on the back of that we are quite confident that growth in headcount should continue. Normally in Q2 and Q3 there is a seasonal element that comes into play, but we are talking about growth net or seasonal element. In specialized staffing, obviously the demands for the IT skill sets have been tremendously large. We have been making continuous investments in improving our delivery to the customers and beefing up the team given the growth in number of that they have, and I think from that perspective growth on that front also is something that we would continue to see. Similarly in NETAP which was the business that got hugely impacted on the negative in Q1 we have seen a strong rebound from customers and I think the element of the rebound existing customers wanting to fill up open positions and we being able to sign on a lot more new logos is what will sustain the growth for the future quarters.

Mukul Garg: Ashok sorry, just again a bit of a clarification here. This quarter is it possible at all to kind of separate out qualitatively or quantitatively the impact which came in because of a seasonality and the unlocks happening which obviously was last quarter, and the new logos which you are winning and new spend which is happening. Is there a way to kind of proportionate out these two?

Ashok Reddy: We could give the breakup between new logos and existing client growth, but it would be impossible to differentiate between seasonal element and continuing element because frankly attrition still continues. We have a differential between gross growth and net growth, and the stated numbers are net growth. So, element of seasonal up and down and natural attrition and forced attrition is factored into the element of the differential between the gross growth and net growth. So, it is difficult for us to quantify the seasonal element of it, but we can clearly call out the new to old client growth.

Rituparna Chakraborty: If I may add to that perpetuity has never been the pillar on which stem staffing has been built on which means that one of the reasons that an option like stem staffing has become attractive is ability to handle seasonality to handle projects, to handle ups and downs essentially. For us, this has always been the case that the Q2 and Q3 are essentially the quarters where there is always spike in demand and pretty much reflects the domestic consumption pattern and what happens overall in the GDP of the country. So, I guess like Ashok mentioned it is very difficult to unpack the impact of it. Some of the gains which we see in Q2 and Q3 actually have longer yields and some of the gains we kind of end up losing probably towards Q4, but that is how this business works.

Ashok Reddy: But overall I think Mukul as we have had a net growth in Q2, we expect the net growth in the coming quarters.

Moderator: Thank you. In the interest of time ladies and gentlemen, we will take our last question that is from the line of Susmit Patodia from Motilal Oswal AMC. Please go ahead.

Susmit Patodia: Good evening everyone and belated wishes for the festive season. My first question is despite the very healthy growth Q-o-Q in general staffing revenue the EBITDA actually declined in the segment result. I am sorry I joined in late, if you could throw some light on that?

Ashok Reddy: We had called that out earlier in the call where we said that in absolute terms the realization and the profits have improved, but the headline billing number has grown more rapidly than the realization, and that kind of contributes to the lower returns and also there has been some element of cost that has come in incrementally around insurance and otherwise that has given to the lower yield per se. We expect this to kind of hold out in that manner as we go forward.

Susmit Patodia: Okay, so the new margin that we see is what we should assume because of the increased insurance cost?

Ashok Reddy: Yes, but at our portfolio level we believe that we would be able to improve the margins because the other businesses would start contributing more as we go forward.

Susmit Patodia: Just one thing Ashok, just to clarify, while you are saying in absolute terms it has increased, Q-o-Q in absolute terms it has not increased the general staffing while the topline has gone up 10%.

Ramani Dathi: The PAPM has risen Q-o-Q in absolute rupee terms, about Rs.13.

Susmit Patodia: I am just referring to the presentation, you have said 23.8 Crores general staffing EBITDA, the same as Q1 and Q2 FY2022.

Ramani Dathi: Yes, on a Q-o-Q basis it has remained flattish.

Susmit Patodia: While the top line has gone up by 10% that is what I was referring to.

Ramani Dathi: That is with a combination of two things. One is the margin pressure continuing at PAPM level and some investments made at backend like in terms of our leadership pipeline, hiring capabilities, marketing and those areas, and the insurance cost which Ritu has explained.

Susmit Patodia: Is the operating leverage was taken at some point you think or this business has got cost as you grow as well?

Ramani Dathi: The operating leverage will kick in after a couple of quarters Susmit because as Ritu mentioned earlier, so we will continue to make investments in some of these areas which is reflecting in our strong headcount addition, sales, and growth, but for a coupe of quarters the margins would more or less remain at this rate.

Susmit Patodia: Right, just as a long-term share holder I have just one submission on this whole PF thing which is in the past you have called out that there will be no issue and then there is an issue, and this is quite significant. It is nearly four quarters of cash flow for us shareholders. I was just wanting to know when was this decision taken, how was this decision arrived, I hope you appreciate but there was also some change in some of the shareholding during the quarter, so if you could help us how was this decision taken?

Ramani Dathi: Firstly, the change in promoter shareholding has nothing to do with this decision. This is mainly triggered by crystallization of DHFL and also the board of directors have taken a call that w should go with a clean audit report without any qualification, so it is more like a prudent call to make a provision and get the qualifications removed.

Susmit Patodia: What is the real shortfall that we have and as somebody asked earlier as well, is this the treadmill that we are running where we are already behind the rates?

Ramani Dathi: At current loss of DFHL and ILFS the real shortfall is about 20 odd Crores, but there can be interest shortfall Y-o-Y because of the gap between the yield rate of 7.5% and our liability rate of 8.5%.

Moderator: Thank you. I would now like to hand the floor back to Mr. Sudheer Guntupalli for closing comments. Over to you Sir!

Sudheer Guntupalli: Thank you management team and all of you for joining us. Ashok I will leave the floor open to you if you want to make any closing remarks.

Ashok Reddy: Yes, I think in terms of the operating element we believe our investment, the team structure and the sales and hiring are paying off, and we believe that the growth that we have seen will continue to play out into the coming quarters, and element of HR services also having gotten into the positive will play to the aspect at a consolidated level, margin improvement that we can showcase as we go into the years. Obviously, as has been called out the provident fund provision is something that was the white elephant in the room and I think it is something that has been conscious debate with the board and with the auditors and view that going prudent and going with a provision and an unqualified report would be the right thing to do, and I do believe that we will not have any further surprises coming in from that side. I think with that behind us, the continued focus on operational growth and margin improvement with the physical discipline otherwise that we had is what we would be focused on. With that, thank you for participating in the call.

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