

## QUESS CORP

MIDCAPS

31 MAY 2017

Quarterly Update

**HOLD**

Target Price: Rs 820

### Solid execution track record

Quess concluded FY17 with gross sales of Rs 41 bn, driven by strong organic growth of 21% YoY. EBITDA margin expanded ~100 bps YoY to 5.7%. PAT at Rs 1.13 bn, up 40% YoY. Positive FCF of Rs 330 mn or 30% of PAT should allay investor concerns. This is in line with our view that while in periods of supernormal growth fuelled by acquisitions, FCF conversion may suffer intermittently, the trajectory will turn positive as growth normalizes. Management is confident of 50%+ YoY growth for the foreseeable future: 20% organic and 30% from acquisitions. Directionally, EBITDA margin of 8% is the objective.

Retain est. and TP of Rs 820 (35x FY19 EPS); revise rating to **HOLD**. Over a 3 year horizon, we believe the stock still remains a compelling investment as numbers (FY19 onwards) do not factor in incremental upside from acquisitions which remain fundamental to business model.

CMP : Rs 833  
Potential Upside : -2%

#### MARKET DATA

No. of Shares : 127 mn  
Free Float : 11%  
Market Cap : Rs 106 bn  
52-week High/ Low : Rs 900 / Rs 452  
Avg. Daily vol. (6mth) : 112,085 shares  
Bloomberg Code : QUESS IB Equity  
Promoters Holding : 89%  
FII / DII : 4% / 2%

- ◆ The board has approved fundraising (up to 10% dilution) to reach minimum public shareholding. Additional funds can potentially fuel the next phase of inorganic growth and we expect the company will continue to demonstrate a strict capital allocation discipline with a 4-5 year payback period with margin/RoCE accretive deals
- ◆ In the last 3 years, Quess has posted a spectacular sales and PAT growth of 61% and 78%, of which 24% and 53% has been organic. Since we cannot forecast inorganic growth, we have built a case for organic Sales/PAT CAGR of ~20%/35% over the next 3 years. We believe this organic growth is sustainable as Quess has barely scratched the surface of an immense opportunity landscape in business services tied directly to macro, shift from unorganized to organized players, and continued consolidation of the vendor base
- ◆ We believe that given the secular organic growth in the business and track record of the management, a multiple of 35x will likely sustain. While immediate upside is limited, the stock can double in 3 years based on our organic growth assumptions alone. Any growth from additional funds provides an incremental option value

#### Financial summary (Consolidated)

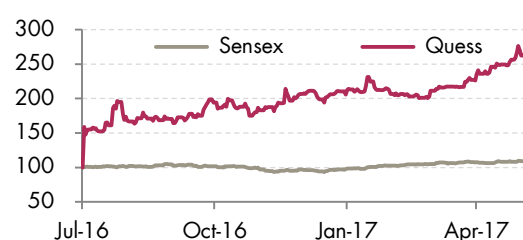
Y/E March	FY16	FY17	FY18E	FY19E
Gr Sales (Rs mn)	34,350	41,574	69,285	84,305
Adj PAT (Rs mn)	1,241	1,107	2,181	3,013
Con. EPS* (Rs)	-	-	-	-
EPS (Rs)	9.9	8.8	16.4	22.6
Change YOY (%)	80.1	(10.8)	86.3	38.1
P/E (x)	84	95	51	37
RoE (%)	42	19	18	18
RoCE (%)	31	18	19	20
EV/E (x)	53	45	28	21
DPS (Rs)	-	-	-	-

Source: Company, Axis Capital

#### Key drivers

(%)	FY17	FY18E	FY19E
Revenue growth	21	66	22
Core EBITDA margin	5.7	5.6	6.1

#### Price performance



**Exhibit 1: A 35x multiple on FY21E PAT implies that the stock can potentially double over the next 3 years**

Particulars	Quess Corp (Rs mn)								CAGR		
									FY14-17		FY18E-21E
	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E	FY21E	Overall	Organic	Organic
Gross sales	10,081	25,748	34,441	41,726	69,370	84,390	101,268	121,522	61%	24%	21%
EBITDA	419	1,368	1,601	2,381	3,905	5,108	6,582	8,507	78%	53%	30%
EBITDA margin	4.2%	5.3%	4.6%	5.7%	5.6%	6.1%	6.5%	7.0%	-	-	-
PAT	206	757	812	1,133	2,281	3,129	4,138	5,469	78%	53%	34%
PAT margin	2.0%	2.9%	2.4%	2.7%	3.3%	3.7%	4.1%	4.5%	-	-	-

Source: Company, Axis Capital

**FY17 highlights**

- Revenue growth of 21% YoY was driven by 28% YoY growth in Global Technology Services (GTS), 20% YoY growth in People and Services (P&S), 17% growth in Industrial Asset Management (IAM), and 9% YoY growth in Integrated Facility Management (IFM). EBIT margin expanded ~50 bps in GTS, ~90 bps in P&S, ~40 bps in IFM respectively. IAM saw a decline in EBIT margin of ~140 bps as the high-margin (30%+ at EBITDA level) Project & Consulting business in the Middle East saw some slowdown
- Addition of ~38K associates in FY17 to ~159,200, up 30% YoY. Core/associate ratio improved across verticals
- Gross debt at Rs 7.3 bn with gross debt/EBITDA improving to 2.4x in FY17 (3.3x in FY16)
- CFO at Rs 710 mn vs -440 mn in FY16. FCF at Rs 330mn
- Six acquisitions closed since IPO – all RoCE/EBITDA margin accretive, which are expected to contribute ~Rs 14 bn/1.2 bn to revenue/EBITDA in FY18

**Exhibit 2: Results update – consolidated**

(Rs mn)	Quarter ended					12 months ended		
	Mar-17	Mar-16	% Chg	Dec-16	% Chg	FY18E	FY17	% Chg
Gross Sales	11,221	9,965	12.6	10,266	9.3	69,285	41,574	66.7
EBIDTA	586	401	46.1	563	4.2	3,905	2,381	64.0
Other income	29	33	(14.2)	60	(52.6)	-	-	-
PBIDT	615	435	41.5	623	(1.3)	3,905	2,381	64.0
Depreciation	65	62	4.9	70	(6.4)	260	264	(1.7)
Interest	153	102	50.3	121	26.3	603	465	29.6
PBT	396	270	46.6	431	(8.2)	3,042	1,651	84.3
Tax	116	(6)	-	126	(7.8)	760	518	46.9
PAT	277	276	0.2	310	(10.6)	2,281	1,133	101.3
No. of shares (mn)	127	127	-	-	-	133	133	-
EBIDTA margin (%)	5.2	4.0	-	5.5	-	5.6	5.7	-
PBIDT margin (%)	5.5	4.4	-	6.1	-	5.6	5.7	-
EPS - annualized (Rs.)	8.7	8.7	0.2	-	-	17.1	8.5	101.3

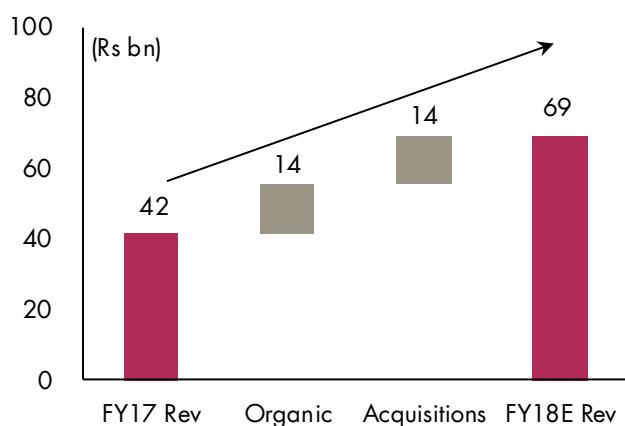
Source: Company, Axis Capital

**Exhibit 3: Recent deals start contributing FY18 onwards**

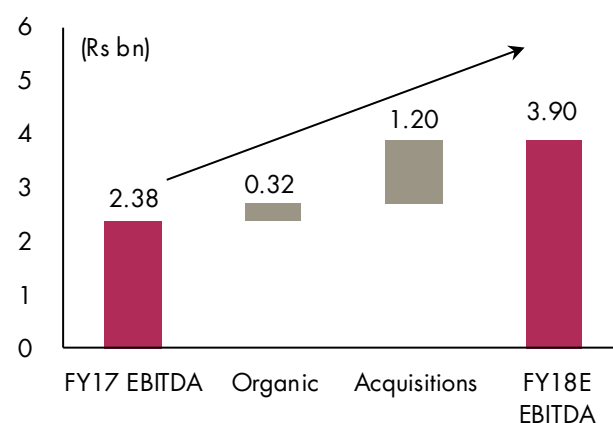
<p>Quess will continue to expand service portfolio and operations through strategic acquisitions that complement its existing operations</p>	<b>Manipal Integrated Services (MIS)</b> <ul style="list-style-type: none"> <li>Facility management, food services and hostels business of the Manipal Education and Medical Group</li> <li>Assured revenue of Rs 24 bn and gross margin of Rs 4 bn over next 5 yrs</li> </ul>	<b>Terrier Security Services</b> <ul style="list-style-type: none"> <li>Manned guarding and security solutions business</li> <li>&gt;400 clients like Infosys, TCS, ITC, HCL, ABB, Robert Bosch, TYCO, Hinduja Group</li> <li>Headcount &gt;18,000</li> </ul>	<b>Comtel Solutions</b> <ul style="list-style-type: none"> <li>Largest independent IT staffing company in Singapore and, adds to Quess' presence in Malaysia</li> <li>Headcount &gt;1,500</li> </ul>	<b>Simpliance</b> <p>Technology platform for labor compliance requirements</p>
				<b>Heptagon</b>
				<p>machine learning and automation technologies</p>
	<b>Consideration</b>	Rs 2.2 bn CCPS + 7.15 mn Quess shares	Rs 720 mn	SGD 43 mn
	<b>Stake bought</b>	100% of Chef on Wheels and Spiffy (part of MIS)	49% Planning to up the stake to 74% subject to FIPB approval	100%
<b>Revenue (FY17E)</b>	Rs 4.2 bn	Rs 3.5 bn	Rs 4.8 bn	Both in a start-up phase currently
<b>EBITDA margin</b>	10%	6%	7%	

These companies will generate revenue (annualized) of ~ Rs 14 bn with expected EBITDA of ~Rs 1.2 bn in FY18

Source: Company, Axis Capital estimates

**Exhibit 4: Pathway to FY18E Revenue**


Source: Company, Axis Capital

**Exhibit 5: ....and EBITDA**


Source: Company, Axis Capital

**Business and the huge opportunity ahead(refer coverage report)**

- Quess has created a formidable platform in the large business services space. Many businesses in India have been deciding that they can be more efficient, effective, and competitive if they buy certain services on the outside that they have hitherto taken care of internally. While manpower outsourcing is a mature business in the developed world, such companies are still in their early phase of growth in India. Globally, Serco (UK) is one such company operating in business services that has proven to be rewarding investments for investors. Between 1990-2000, Serco in its early growth phase compounded revenues at 23% and market cap at 44%.

- ◆ Despite 10-year 50%+ revenue/earnings CAGR, Quess has barely scratched the surface of the immense opportunity up ahead. A way to gauge the opportunity size of business services is to just look around your office surroundings – the janitor who cleans the desk and the chairs you sit on; the IT specialist who maintains the backend of the IT systems on your office laptop; the consultant who arranges interviews with potential candidates; the electrical and mechanical services specialists who fix the office lighting, wiring and alarm systems when they go bad; the caterers in your office canteen; the cleaners who make sure that your facilities are always clean; the security guard who checks your ID card before you enter the office, and the remote surveillance of your office premises. You probably never gave it enough thought but none of them are on your company rolls and in all likelihood are outsourced services from a single third party business services provider like Quess.
- ◆ And above is just your office (administrative part). The services also extend to warehousing, logistics, transportation, etc – non-core but critical business functions. Besides the B2B opportunity, the canvas gets even larger if we include public facilities like train stations, airports, hospitals, educational institutions, etc.

### Why Quess?

- ◆ Given the size and scale of the opportunity, and the fragmented nature of the market, we believe that a large part of Quess' growth will be driven by inorganic roll ups. Quess has demonstrated successful acquisition track record with 4-5 year payback periods, margin accretive with ~20% RoE, and retention of key management personnel. Such deal flow and successful scale ups would not be available to a minority investor and needs to be backed by a company like Quess that has proven its ability to successfully turn around and integrate acquisitions.
- ◆ When investing in a company like Quess, investors are betting on management and its vision. A strong management team headed by Ajit Isaac and backed by a seasoned investor like Fairfax are key ingredients

### Risks to our view

The company has completed a number of acquisitions in India and outside to grow business, expand business segments and service offerings, and diversify revenue streams.

While so far Quess' track record on capital allocation has been impeccable, business and operations of the company are subject to risks arising out of integration of future acquisitions

## Financial summary (Consolidated)

### Profit & loss (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Net sales	34,350	41,574	69,285	84,305
Other operating income	91	153	85	85
<b>Total operating income</b>	<b>34,441</b>	<b>41,726</b>	<b>69,370</b>	<b>84,390</b>
Cost of goods sold	(30,069)	(35,435)	(58,612)	(71,803)
Gross profit	4,371	6,291	10,758	12,587
<i>Gross margin (%)</i>	<i>12.7</i>	<i>15.1</i>	<i>15.5</i>	<i>14.9</i>
Total operating expenses	(2,340)	(3,910)	(6,853)	(7,479)
<b>EBITDA</b>	<b>2,031</b>	<b>2,381</b>	<b>3,905</b>	<b>5,108</b>
<i>EBITDA margin (%)</i>	<i>5.9</i>	<i>5.7</i>	<i>5.6</i>	<i>6.1</i>
Depreciation	(144)	(264)	(260)	(351)
<b>EBIT</b>	<b>1,887</b>	<b>2,116</b>	<b>3,645</b>	<b>4,757</b>
Net interest	(310)	(465)	(603)	(586)
Other income	-	-	-	-
<b>Profit before tax</b>	<b>1,577</b>	<b>1,651</b>	<b>3,042</b>	<b>4,171</b>
Total taxation	(335)	(518)	(760)	(1,043)
<i>Tax rate (%)</i>	<i>21.3</i>	<i>31.4</i>	<i>25.0</i>	<i>25.0</i>
Profit after tax	1,241	1,133	2,281	3,129
Minorities	-	(26)	(100)	(116)
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	1,241	1,107	2,181	3,013
<i>Adj. PAT margin (%)</i>	<i>3.6</i>	<i>2.7</i>	<i>3.1</i>	<i>3.6</i>
Net non-recurring items	-	-	-	-
Reported net profit	1,241	1,107	2,181	3,013

### Balance sheet (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Paid-up capital	1,133	1,268	1,332	1,332
Reserves & surplus	2,322	7,094	14,209	17,222
Net worth	3,456	8,362	15,540	18,553
Borrowing	3,750	7,307	6,897	6,898
Other non-current liabilities	232	225	225	225
<b>Total liabilities</b>	<b>7,437</b>	<b>15,903</b>	<b>22,771</b>	<b>25,901</b>
Gross fixed assets	975	1,215	1,761	2,378
Less: Depreciation	(446)	(710)	(970)	(1,321)
Net fixed assets	529	504	791	1,057
Add: Capital WIP	-	-	-	-
Total fixed assets	529	504	791	1,057
Total Investment	72	2,976	56	56
Inventory	18	57	57	57
Debtors	4,282	4,468	8,864	10,783
Cash & bank	1,094	4,596	2,229	3,548
Loans & advances	239	256	771	938
Current liabilities	4,713	3,726	8,898	10,776
Net current assets	3,960	8,260	9,189	12,052
Other non-current assets	2,876	4,163	12,736	12,737
<b>Total assets</b>	<b>7,437</b>	<b>15,903</b>	<b>22,772</b>	<b>25,901</b>

Source: Company, Axis Capital

### Cash flow (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Profit before tax	1,577	1,651	3,042	4,171
Depreciation & Amortisation	144	264	260	351
<i>Chg in working capital</i>	<i>(863)</i>	<i>(191)</i>	<i>(3,296)</i>	<i>(1,544)</i>
<b>Cash flow from operations</b>	<b>(440)</b>	<b>1,206</b>	<b>(754)</b>	<b>1,936</b>
<i>Capital expenditure</i>	<i>(484)</i>	<i>(240)</i>	<i>(547)</i>	<i>(616)</i>
<b>Cash flow from investing</b>	<b>(178)</b>	<b>(5,042)</b>	<b>(6,199)</b>	<b>(616)</b>
<i>Equity raised/ (repaid)</i>	<i>876</i>	<i>135</i>	<i>64</i>	-
<i>Debt raised/ (repaid)</i>	<i>1,534</i>	<i>3,556</i>	<i>(411)</i>	-
<i>Dividend paid</i>	-	-	-	-
<b>Cash flow from financing</b>	<b>791</b>	<b>7,355</b>	<b>4,586</b>	-
Net chg in cash	172	3,519	(2,367)	1,319

### Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
<b>OPERATIONAL</b>				
FDEPS (Rs)	9.9	8.8	16.4	22.6
CEPS (Rs)	11.0	10.9	18.3	25.3
DPS (Rs)	-	-	-	-
Dividend payout ratio (%)	-	-	-	-
<b>GROWTH</b>				
Net sales (%)	33.8	21.0	66.7	21.7
EBITDA (%)	48.5	17.2	64.0	30.8
Adj net profit (%)	80.1	(10.8)	97.0	38.1
FDEPS (%)	80.1	(10.8)	86.3	38.1
<b>PERFORMANCE</b>				
RoE (%)	41.6	18.7	18.3	17.7
RoCE (%)	30.9	18.1	18.8	19.5
<b>EFFICIENCY</b>				
Asset turnover (x)	6.9	4.8	4.4	4.0
Sales/ total assets (x)	3.6	2.6	2.7	2.5
Working capital/ sales (x)	0.1	0.1	0.1	0.1
Receivable days	45.5	39.2	46.7	46.7
Inventory days	0.2	0.5	0.3	0.3
Payable days	7.6	5.9	6.4	6.5
<b>FINANCIAL STABILITY</b>				
Total debt/ equity (x)	1.3	1.2	0.6	0.4
Net debt/ equity (x)	0.9	0.5	0.4	0.2
Current ratio (x)	1.8	3.2	2.0	2.1
Interest cover (x)	6.1	4.5	6.0	8.1
<b>VALUATION</b>				
PE (x)	84.5	94.7	50.8	36.8
EV/ EBITDA (x)	53.3	45.5	28.3	21.4
EV/ Net sales (x)	3.2	2.6	1.6	1.3
PB (x)	30.3	12.5	7.1	6.0
Dividend yield (%)	-	-	-	-
Free cash flow yield (%)	-	-	-	-

Source: Company, Axis Capital

## Disclosures:

The following Disclosures are being made in compliance with the SEBI Research Analyst Regulations 2014 (herein after referred to as the Regulations).

1. Axis Securities Ltd. (ASL) is a SEBI Registered Research Analyst having registration no. INH000000297. ASL, the Research Entity (RE) as defined in the Regulations, is engaged in the business of providing Stock broking services, Depository participant services & distribution of various financial products. ASL is a subsidiary company of Axis Bank Ltd. Axis Bank Ltd. is a listed public company and one of India's largest private sector bank and has its various subsidiaries engaged in businesses of Asset management, NBFC, Merchant Banking, Trusteeship, Venture Capital, Stock Broking, the details in respect of which are available on [www.axisbank.com](http://www.axisbank.com).
2. ASL is registered with the Securities & Exchange Board of India (SEBI) for its stock broking & Depository participant business activities and with the Association of Mutual Funds of India (AMFI) for distribution of financial products and also registered with IRDA as a corporate agent for insurance business activity.
3. ASL has no material adverse disciplinary history as on the date of publication of this report.
4. I/We, authors (Research team) and the name/s subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my/our views about the subject issuer(s) or securities. I/We also certify that no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. I/we or my/our relative or ASL does not have any financial interest in the subject company. Also I/we or my/our relative or ASL or its Associates may have beneficial ownership of 1% or more in the subject company at the end of the month immediately preceding the date of publication of the Research Report. Since associates of ASL are engaged in various financial service businesses, they might have financial interests or beneficial ownership in various companies including the subject company/companies mentioned in this report. I/we or my/our relative or ASL or its associates do not have any material conflict of interest. I/we have not served as director, officer or employee in the subject company.

## Research Team

Sr. No	Name	Designation	E-mail
1	Hiren Trivedi	Research Associate	<a href="mailto:hiren.trivedi@axissecurities.in">hiren.trivedi@axissecurities.in</a>
2	Kiran Gawle	Associate	<a href="mailto:kiran.gawle@axissecurities.in">kiran.gawle@axissecurities.in</a>

5. ASL or its associates has not received any compensation from the subject company in the past twelve months. ASL or its Research Analysts has not been engaged in market making activity for the subject company.

6. In the last 12-month period ending on the last day of the month immediately preceding the date of publication of this research report, ASL or any of its associates may have:

- Received compensation for investment banking, merchant banking or stock broking services or for any other services from the subject company of this research report and / or;
- Managed or co-managed public offering of the securities from the subject company of this research report and / or;
- Received compensation for products or services other than investment banking, merchant banking or stock broking services from the subject company of this research report;

ASL or any of its associates have not received compensation or other benefits from the subject company of this research report or any other third-party in connection with this report

## Term& Conditions:

This report has been prepared by ASL and is meant for sole use by the recipient and not for circulation. The report and information contained herein is strictly confidential and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ASL. The report is based on the facts, figures and information that are considered true, correct, reliable and accurate. The intent of this report is not recommendatory in nature. The information is obtained from publicly available media or other sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied, is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. The report is prepared solely for informational purpose and does not constitute an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments for the clients. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ASL will not treat recipients as customers by virtue of their receiving this report.

DEFINITION OF RATINGS	
Ratings	Expected absolute returns over 12-18 months
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%

**Disclaimer:**

Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to the recipient's specific circumstances. The securities and strategies discussed and opinions expressed, if any, in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient.

This report may not be taken in substitution for the exercise of independent judgment by any recipient. Each recipient of this report should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this report (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. Certain transactions, including those involving futures, options and other derivatives as well as non-investment grade securities involve substantial risk and are not suitable for all investors. ASL, its directors, analysts or employees do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of shares and bonds, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc. Past performance is not necessarily a guide to future performance. Investors are advised necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ASL and its affiliated companies, their directors and employees may; (a) from time to time, have long or short position(s) in, and buy or sell the securities of the company(ies) mentioned herein or (b) be engaged in any other transaction involving such securities or earn brokerage or other compensation or act as a market maker in the financial instruments of the company(ies) discussed herein or act as an advisor or investment banker, lender/borrower to such company(ies) or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions. Each of these entities functions as a separate, distinct and independent of each other. The recipient should take this into account before interpreting this document.

ASL and / or its affiliates do and seek to do business including investment banking with companies covered in its research reports. As a result, the recipients of this report should be aware that ASL may have a potential conflict of interest that may affect the objectivity of this report. Compensation of Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions. ASL may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Neither this report nor any copy of it may be taken or transmitted into the United State (to U.S. Persons), Canada, or Japan or distributed, directly or indirectly, in the United States or Canada or distributed or redistributed in Japan or to any resident thereof. If this report is inadvertently sent or has reached any individual in such country, especially, USA, the same may be ignored and brought to the attention of the sender. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ASL to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors.

The Disclosures of Interest Statement incorporated in this document is provided solely to enhance the transparency and should not be treated as endorsement of the views expressed in the report. The Company reserves the right to make modifications and alternations to this document as may be required from time to time without any prior notice. The views expressed are those of the analyst(s) and the Company may or may not subscribe to all the views expressed therein.

Copyright in this document vests with Axis Securities Limited.

Axis Securities Limited, Corporate office: Unit No. 2, Phoenix Market City, 15, LBS Road, Near Kamani Junction, Kurla (west), Mumbai-400070, Tel No. – 18002100808/022-61480808, Regd. off.- Axis House, 8th Floor, Wadia International Centre, PandurangBudhkarMarg, Worli, Mumbai – 400 025. Compliance Officer: AnandShaha, Email: [compliance.officer@axisdirect.in](mailto:compliance.officer@axisdirect.in), Tel No: 022-42671582.