

Estimate change

TP change

Rating change


Bloomberg	QUESS IN
Equity Shares (m)	147
M.Cap.(INRb)/(USDb)	96.4 / 1.4
52-Week Range (INR)	1300 / 581
1, 6, 12 Rel. Per (%)	-4/-23/-54
12M Avg Val (INR M)	104

Financials & Valuations (INR b)

Y/E Mar	2020	2021E	2022E
Sales	109.9	115.1	140.8
EBIT Margin (%)	3.7	3.5	3.9
PAT	2.6	2.5	3.8
EPS (INR)	18.3	17.7	26.5
EPS Gr. (%)	4.3	-3.1	49.8
BV/Sh. (INR)	200.8	223.1	256.5

Ratios

RoE (%)	10.4	10.5	13.9
RoCE (%)	15.4	11.8	14.8
Payout (%)	0.0	0.0	0.0

Valuations

P/E (x)	11.6	12.0	8.0
P/BV (x)	1.1	1.0	0.8
EV/EBITDA (x)	5.0	5.3	3.9
EV/Sales (x)	0.3	0.3	0.2

Shareholding pattern (%)

As On	Mar-20	Dec-19	Mar-19
Promoter	54.9	54.7	71.4
DII	16.6	13.2	7.1
FII	14.6	16.6	13.1
Others	13.9	15.5	8.4

FII Includes depository receipts

CMP: INR211
TP: INR360 (+71%)
Buy

Welcome corrective steps!

Stable business and liquidity position

- Quess Corp's (QUESS) quantum of goodwill/intangible write-downs (38%-49% of the outstanding) taken during 4QFY20 is a positive surprise. This reinforces our assessment (refer our earlier [note](#)) that the new management is making encouraging efforts to address investor concerns around areas like governance, capital allocation, etc. We see the balance sheet rationalization, progress on exit from unrelated businesses (e.g. East Bengal Club) and the resultant RoE improvement also as key positives.
- Despite the lockdowns and sharp spike in unemployment, key portfolio businesses have remained more or less stable and are doing better than initially feared. A material displacement is unlikely as the economy goes into phased re-opening and firms try to dodge supply-side disruption.
- We upgrade our FY21-22E EPS by 12-13% as we adjust (a) amortization run-rate, and (b) EBITDA margin trajectory of Monster. Our TP increases by ~29% as we tweak the book value and equity charge assumptions (15% v/s 16% earlier) in our Residual Income valuation model. Over the medium term, we expect QUESS to be the biggest beneficiary of the recently announced labor law reforms (refer our [note](#)). Reiterate **Buy**.

Encouraging performance in 4QFY20 despite COVID-19 impact

- In 4QFY20, revenue/EBIT/PBT was 3%/13%/9% ahead of our estimates.
- Organic/overall revenue increased 27%/30% YoY, largely led by general staffing segment (67% YoY) while performance in other key segments remained modest (IFM: +5% YoY, Conneqt: +5% YoY).
- EBIT margin contracted ~30bp QoQ to 3.6%, largely driven by the COVID-19 impact on BPO utilizations and the food catering businesses.
- Besides an improvement in key operational metrics and revenue run-rate, Monster also came close to EBITDA break-even during 4QFY20.
- The company made one-off non-cash write-downs in (a) goodwill consolidation (INR5.1b), (b) intangible assets (INR1.3b), and (c) QUESS' East Bengal Club investments (INR350m). While goodwill impairment was taken across businesses like MIS, AllSec, Vedang, Trimax, MFXchange, intangible impairment was taken in MIS, AllSec and Vedang.
- Presence of the unjustifiable goodwill/intangibles on the balance sheet resulted in a drag on return ratios and was a key concern for us earlier. Accordingly, we see this one-off impairment to be a welcome corrective step toward rationalization of the balance sheet and improvement in RoEs.
- As the company is migrating to the new tax regime, it had written down MAT credit (INR1.2b) and made an adjustment in the carrying value of Deferred Tax Asset (resulting in write-down of INR160m). In conjunction with the reversal of Deferred Tax Liability (~INR1b, consequent to goodwill/intangible impairment), tax provision for 4QFY20 (~INR360m) came out to be higher than normal.

- Adjusted for these one-off non-cash write-downs and quarterly tax aberrations, PAT of ~INR720m came in above our est. of INR642m.
- Cash generation (OCF/EBITDA at 33% v/s 51% in 3QFY20) was impacted due to COVID-19. However, QUESS has indicated that focus on aged and government receivables remains high and it is hopeful of no defaults.
- Overall exposure to the Ahmedabad Smart City project stands at INR2.3b; of this, QUESS has recovered INR975m by end-4QFY20.

Highlights from management commentary

- Management has indicated that impact on operations in Apr-May'20 was not as bad as initially feared. Having large enterprises as customers and limited exposure to SMEs has helped QUESS in navigating through the crisis.
- General Staffing witnessed headcount reduction of ~5% in Apr'20 over Feb'20 level. Further, management expects ~5% MoM reduction in May-Jun'20. As enterprises try to dodge supply-side risks in the context of labor migration, we anticipate a positive surprise on this front too.
- The company has reduced indirect costs by ~20% during Feb-Apr'20. It is further looking for avenues to variabilize the cost structure in order to maintain margin in case the COVID-19 situation deteriorates further.
- Management has hinted at a target of 20% RoE and 20% YoY OCF growth over the medium term. They have also indicated that goodwill impairment may not be required any further.
- According to QUESS, Excellus, Digicare and BPO are the worst hit. While Facilities Management may witness some headwinds due to Work from Home (WFM), formalization in the industry should help offset it. Management expects Monster to witness growth and margin challenges in the near term as renewals (typically happen in last week of March) are hit. However, as recruitment picks up, this segment should also recover.

Valuation and view – Corrective measures to drive re-rating

- The stock had corrected ~66% from pre-COVID-19 level on concerns of severe impact on (a) general staffing and collections/receivables, (b) liquidity position, and (c) potential legal liabilities in outcome-based businesses in the event of massive employee lay-offs.
- However, we understand these concerns were exaggerated as the business/cash collections (both mark-up and outcome-based) did not witness any major dislocation over Mar-Apr'20. As the economy prepares for a gradual re-opening and enterprises look to dodge supply disruption, we believe the company/sector has already passed the peak of uncertainty. As both the central and state governments look forward to liberalizing and formalizing the labor markets, QUESS should be among the biggest direct beneficiaries.
- We expect 13%/21% revenue/EPS CAGR over FY20–22E. Using residual income approach, we arrive at a TP of INR360. We adjust FY20 book value for appropriate share of outstanding goodwill/inter-company loans on the balance sheet. Welcome corrective steps being taken by the new management toward addressing some of the investor concerns around governance prompt us to reduce the equity charge to 15% in our residual income model (v/s 16% earlier). Our TP implies 14x FY22E EPS, still a steep 60% discount to TeamLease.

Consolidated - Quarterly

(INR m)

Y/E March	FY19				FY20				FY19	FY20	Est. 4Q	Var. (% / bp)
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Net Sales	19,684	20,917	21,722	22,948	23,966	26,503	29,500	29,946	85,270	1,09,915	29,002	3.3
YoY Change (%)	51.7	49.9	37.1	21.4	21.8	26.7	35.8	30.5	38.3	28.9	26.4	411
Total Expenditure	18,659	19,797	20,538	21,630	22,474	24,889	27,706	28,260	80,624	1,03,329	27,383	3.2
EBITDA	1,025	1,120	1,183	1,318	1,492	1,614	1,794	1,686	4,646	6,586	1,619	4.1
Margins (%)	5.21	5.36	5.4	5.7	6.2	6.1	6.1	5.6	5.4	6.0	5.6	4.8
Depreciation	299	291	317	325	579	652	658	596	1,232	2,486	655	-8.9
EBIT	726	829	867	992	913	962	1,136	1,089	3,414	4,100	964	13.0
Margins (%)	3.7	4.0	4.0	4.3	3.8	3.6	3.9	3.6	4.0	3.7	3.3	31
Interest	261	282	280	321	396	461	423	387	1,144	1,668	400	-3.1
Other Income	156	143	123	290	169	159	97	86	712	511	164	-47.4
PBT before EO expense	621	690	710	962	685	660	810	788	2,983	2,943	725	8.8
Recurring Tax	93	105	11	121	106	-29	51	60	329	196	72	
Rate (%)	14.9	15.1	1.5	12.6	15.4	-4.5	6.3	8.7	11.0	6.6	10.0	
MI & P/L of Asso. Cos.	-16	-31	49	86	-2	39	10	91	88	138	10	
Adjusted PAT	544	616	650	755	582	650	749	720	2,565	2,609	642	12.2
Extraordinary items	0	0	0	0	0	0	0	6,937	0	6,928	0	
Reported PAT	544	616	650	755	582	650	749	-6,299	2,565	-4,319	642	-1,080.8
YoY Change (%)	19.2	-51.6	6.5	-0.3	6.9	5.5	15.2	-934.3	-17.2	-268.3	-14.9	-91,939
Margins (%)	2.8	2.9	3.0	3.3	2.4	2.5	2.5	-21.0	3.0	-3.9	2.2	-2,325

Key Perfor. Indicators

Y/E March	FY19				FY20				FY19	FY20
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Headcount (k)	272	280	293	318	357	377	385	384	318	384
Segment Revenue (INR m)										
Workforce Management	11,480	12,080	12,850	13,940	14,880	16,690	19,590	20,390	50,350	71,550
Operating Asset Management	3,980	4,340	4,310	4,380	4,270	4,320	4,480	4,280	17,010	17,350
Tech Services	4,220	4,490	4,560	4,620	4,800	5,510	5,440	5,280	17,890	21,030
EBITDA Margin (%)										
Workforce Management	5.9	5.7	6.0	6.8	6.0	5.5	5.3	5.1	6.1	5.4
Operating Asset Management	7.5	7.9	7.8	8.2	7.5	6.7	7.4	6.6	7.9	7.1
Tech Services	5.2	6.1	6.2	4.3	9.6	11.5	12.1	10.9	5.5	11.1



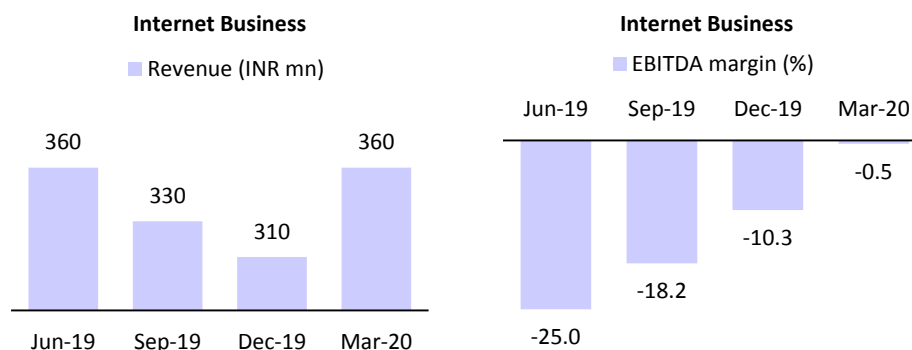
Management commentary highlights

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Encouraging performance in 4QFY20 despite COVID-19 impact

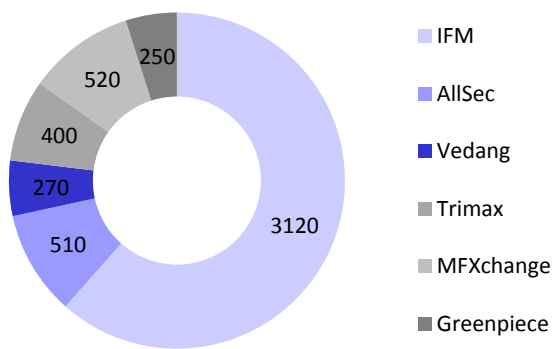
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Exhibit 1: In Monster revenue run-rate improved, loss run-rate moderated



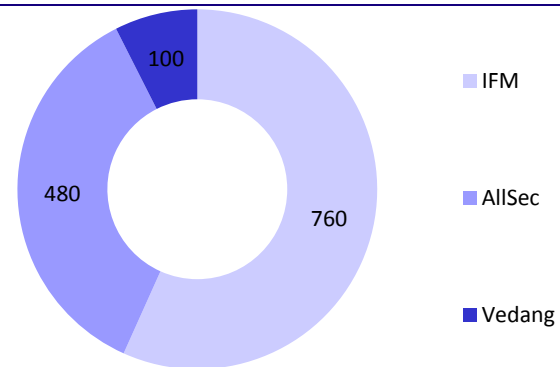
Source: Company, MOFSL

Exhibit 2: Goodwill impairment (INR m) across businesses



Source: Company, MOFSL

Exhibit 3: Intangible impairment (INRm) across businesses



Source: Company, MOFSL

Valuation and view – Corrective measures should drive re-rating

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Exhibit 4: Revision to our estimates

Change in Estimates	Revised		Earlier		Change	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Revenue (m)	1,15,081	1,40,825	1,16,043	1,39,661	-0.8%	0.8%
Rev. growth (%)	4.7	22.4	6.5	20.4	-181bp	202bp
EBITDA (m)	6,368	8,419	6,431	8,127	-1.0%	3.6%
EBITDA Margin (%)	5.5	6.0	5.5	5.8	-1bp	16bp
EBIT Margin (%)	3.5	3.9	3.3	3.6	18bp	32bp
EPS (INR)	17.7	26.5	15.7	23.6	12.6%	12.3%
EPS Growth (%)	-3.1	49.8	(11.6)	50.1	2077bp	-29bp

Source: Company, MOFSL

Exhibit 5: Residual Income model**Residual income model for Qess**

Qess Share price (INR)	211
Average ROE (FY20-22)	16%
Average ROE (FY20-30)	20%
Average ROE (FY25-30)	21%
Book Value - FY20 (INR Mn)	22,759
Our adjustments to Book Value in FY21 (INR m)	
· Goodwill	5,850
· Inter Company loans	4,000
Total adjustment	9,850
Adjusted Book Value FY21E (INR m)	15,437
Equity charge	15%
Valuation per share (INR)	360
Upside	71%

Source: Company, MOFSL

Financial and valuation

Consolidated - Income Statement						(INR Million)		
Y/E March	2015	2016	2017	2018	2019	2020	2021E	2022E
Total Income from Operations	25,671	34,350	43,149	61,673	85,270	1,09,915	1,15,081	1,40,825
Change (%)	155.2	33.8	25.6	42.9	38.3	28.9	4.7	22.4
Cost of services	717	481	714	1,422	2,624	3,382	3,541	4,334
Employees Cost	22,684	30,069	36,339	50,793	67,132	86,535	90,602	1,10,870
Other Expenses	965	2,289	3,718	5,914	10,868	13,420	14,570	17,202
Total Expenditure	24,366	32,839	40,771	58,129	80,624	1,03,337	1,08,713	1,32,405
% of Sales	94.9	95.6	94.5	94.3	94.6	94.0	94.5	94.0
EBITDA	1,305	1,511	2,378	3,544	4,646	6,578	6,368	8,419
Margin (%)	5.1	4.4	5.5	5.7	5.4	6.0	5.5	6.0
Depreciation	101	144	275	747	1,232	2,486	2,312	2,878
EBIT	1,203	1,367	2,103	2,796	3,414	4,092	4,056	5,541
Int. and Finance Charges	218	310	471	755	1,144	1,668	1,676	1,929
Other Income	57	91	154	569	712	511	493	691
PBT bef. EO Exp.	1,042	1,147	1,787	2,611	2,983	2,935	2,873	4,303
EO Items	0	0	0	0	0	6,641	0	0
PBT after EO Exp.	1,042	1,147	1,787	2,611	2,983	-3,706	2,873	4,303
Total Tax	370	335	534	-483	329	474	345	516
Tax Rate (%)	35.5	29.2	29.9	-18.5	11.0	-12.8	12.0	12.0
Minority Interest	0	0	-1	-4	88	138	0	0
Reported PAT	672	812	1,254	3,098	2,565	-4,318	2,528	3,787
Adjusted PAT	672	812	1,254	3,098	2,565	2,609	2,528	3,787
Change (%)	276.3	20.8	54.5	147.0	-17.2	1.7	-3.1	49.8
Margin (%)	2.6	2.4	2.9	5.0	3.0	2.4	2.2	2.7

Consolidated - Balance Sheet						(INR Million)		
Y/E March	2015	2016	2017	2018	2019	2020	2021E	2022E
Equity Share Capital	258	1,133	1,268	1,455	1,461	1,475	1,475	1,475
Total Reserves	2,267	2,433	11,780	23,153	25,795	21,284	23,804	27,591
Net Worth	2,525	3,566	13,048	24,608	27,256	22,759	25,279	29,066
Minority Interest	0	0	9	16	31	769	769	769
Total Loans	2,170	3,783	7,440	9,662	7,502	9,976	9,861	9,758
Deferred Tax Liabilities	-35	-1,345	-1,633	-3,647	-5,046	-6,166	-6,166	-6,166
Capital Employed	4,660	6,005	18,864	30,638	29,742	27,339	29,744	33,428
Gross Block	604	1,043	3,504	7,485	8,152	9,295	11,295	13,795
Less: Accum. Deprn.	415	541	976	2,126	3,357	5,843	8,155	11,033
Net Fixed Assets	189	502	2,529	5,359	4,795	3,451	3,140	2,761
Goodwill on Consolidation	1,104	2,020	9,187	10,959	11,769	8,358	8,358	8,358
Capital WIP	0	24	77	22	147	46	59	79
Total Investments	0	37	776	888	820	725	725	725
Curr. Assets, Loans&Adv.	5,869	8,573	14,433	28,111	27,540	34,439	38,039	45,593
Inventory	4	18	71	85	221	284	284	284
Account Receivables	2,755	6,926	8,966	13,936	16,164	18,795	21,124	25,464
Cash and Bank Balance	818	1,094	3,039	5,661	5,855	7,587	6,282	7,345
Loans and Advances	2,292	536	2,357	8,430	5,300	7,773	10,349	12,500
Curr. Liability & Prov.	2,502	5,151	8,138	14,701	15,328	19,681	20,576	24,087
Account Payables	414	674	778	1,481	1,729	1,633	1,718	2,539
Other Current Liabilities	1,941	4,138	6,825	12,166	12,351	16,494	17,133	19,438
Provisions	147	339	536	1,054	1,248	1,554	1,725	2,110
Net Current Assets	3,367	3,423	6,294	13,411	12,212	14,759	17,464	21,505
Appl. of Funds	4,660	6,005	18,864	30,638	29,742	27,339	29,744	33,428

Financial and valuation

Ratios

Y/E March	2015	2016	2017	2018	2019	2020	2021E	2022E
Basic (INR)								
EPS	5.9	7.0	10.1	21.8	17.5	18.3	17.7	26.5
Cash EPS	6.8	8.3	12.3	27.1	25.9	35.7	33.9	46.6
BV/Share	22.3	31.5	115.1	217.1	240.5	200.8	223.1	256.5
DPS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payout (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Valuation (x)								
P/E	35.8	30.2	21.0	9.7	12.1	11.6	12.0	8.0
Cash P/E	31.1	25.6	17.2	7.8	8.2	5.9	6.3	4.5
P/BV	9.5	6.7	1.8	1.0	0.9	1.1	1.0	0.8
EV/Sales	1.0	0.8	0.7	0.6	0.4	0.3	0.3	0.2
EV/EBITDA	19.5	18.0	12.9	9.6	7.0	5.0	5.3	3.9
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF per share	-1.1	-6.2	2.4	1.1	7.2	21.3	0.0	16.8
Return Ratios (%)								
RoE	30.8	26.7	15.1	16.5	9.9	10.4	10.5	13.9
RoCE	22.6	17.1	11.4	14.6	10.6	15.4	11.8	14.8
RoIC	25.9	22.3	14.9	17.0	12.9	22.0	17.1	20.3
Working Capital Ratios								
Asset Turnover (x)	5.5	5.7	2.3	2.0	2.9	4.0	3.9	4.2
Debtor (Days)	39	74	76	82	69	62	67	66
Creditor (Days)	6	7	7	9	7	5	5	7
Leverage Ratio (x)								
Net Debt/Equity	0.5	0.7	0.3	0.1	0.0	0.1	0.1	0.1

Consolidated - Cash Flow Statement

(INR Million)

Y/E March	2015	2016	2017	2018	2019	2020	2021E	2022E
OP/(Loss) before Tax	1,049	1,147	1,723	2,615	2,566	-4,320	2,873	4,303
Depreciation	101	144	333	747	3	2,486	2,312	2,878
Interest & Finance Charges	218	310	479	755	1,144	1,668	1,676	1,929
Direct Taxes Paid	-412	-482	-839	-744	-1,750	-1,450	-345	-516
(Inc)/Dec in WC	-942	-1,622	-941	-1,858	-1,248	-1,860	-4,010	-2,979
CF from Operations	15	-503	755	1,515	714	-3,476	2,506	5,615
Others	9	8	-71	-428	1,302	7,086	-493	-691
CF from Operating incl EO	24	-495	684	1,087	2,016	3,610	2,013	4,924
(Inc)/Dec in FA	-145	-226	-383	-928	-957	-570	-2,020	-2,520
Free Cash Flow	-120	-721	301	159	1,058	3,040	-7	2,404
(Pur)/Sale of Investments	-525	0	0	-1,808	-117	570	0	0
Others	375	129	-5,434	-5,333	2,898	-3,090	0	0
CF from Investments	-295	-97	-5,817	-8,069	1,823	-3,090	-2,020	-2,520
Issue of Shares	0	34	3,693	8,485	0	480	0	0
Inc/(Dec) in Debt	1,015	1,137	3,816	1,785	-74	2,200	-115	-103
Interest Paid	-217	-304	-443	-665	-865	-1,160	-1,676	-1,929
Dividend Paid	0	0	0	0	0	0	0	0
Others	0	0	13	0	-2,706	0	493	691
CF from Fin. Activity	798	867	7,079	9,605	-3,645	1,520	-1,298	-1,341
Inc/Dec of Cash	527	275	1,946	2,622	194	2,040	-1,305	1,063
Closing Balance	818	1,093	3,039	5,661	5,855	7,587	6,282	7,345

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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