

Estimate change	↔
TP change	↑
Rating change	↔

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Bloomberg	QUESS IN
Equity Shares (m)	147
M.Cap.(INRb)/(USD\$b)	50.7 / 0.7
52-Week Range (INR)	639 / 165
1, 6, 12 Rel. Per (%)	-20/-37/-21
12M Avg Val (INR M)	116

Financials & Valuations (INR b)

Y/E Mar	2020	2021E	2022E
Sales	109.9	106.2	133.0
EBIT Margin (%)	3.7	3.4	4.0
Adj. PAT	2.6	1.6	3.5
EPS (INR)	18.3	11.4	24.8
EPS Gr. (%)	4.3	-37.5	117.1
BV/Sh. (INR)	200.8	215.1	246.4

Ratios

RoE (%)	10.4	6.9	13.5
RoCE (%)	15.4	8.9	13.7
Payout (%)	0.0	0.0	0.0

Valuations

P/E (x)	18.8	30.1	13.9
P/BV (x)	1.7	1.6	1.4
EV/EBITDA (x)	7.8	8.7	6.5
EV/Sales (x)	0.5	0.5	0.4

Shareholding pattern (%)

As On	Jun-20	Mar-20	Jun-19
Promoter	55.3	54.9	71.4
DII	15.7	16.6	6.2
FII	14.0	14.6	14.0
Others	15.0	13.9	8.4

FII Includes depository receipts

CMP: INR344

TP: INR480 (+40%)

Buy

Likely to benefit from near-term uncertainty in job market

Company-level improvements continue!

- Quess Corp (QUESS)'s 1QFY21 results were largely in line with estimates. Adjusted for businesses that remained completely closed (e.g., Excellus) and one-off COVID-19-related costs, underlying revenue, EBITDA, and recovery trends were reasonably resilient. Good cost rationalization, net debt reduction (by INR1b), healthy cash conversion (OCF/Ind-AS adjusted EBITDA = 152%), and the simplification of Terrier's holding structure are key micro-level positives.
- Recent unemployment data (e.g., CMIE) and hiring outlook surveys hint at quick and strong recovery in the job market. However, the back and forth on lockdowns across cities would mean some amount of uncertainty in the job market. Based on our learning in the immediate aftermath of GFC and the demonetization, this uncertainty would likely lead to the conversion of some otherwise permanent roles into temporary ones, consequently benefitting staffing firms.
- Operationally, our earnings estimate over FY21–22E remains largely unchanged. However, we increase our FY21E ETR to 23% (from 13%), with no bearing on cash tax outflow. Over the medium term, we expect QUESS to be the biggest beneficiary of the recently announced labor law reforms (refer to our earlier [note](#)). Reiterate **Buy**.

In-line results; debt reduction / healthy cash generation key positives

- Quess Corp reported revenue/EBIT/PAT growth of 1%/-23%/-62% YoY (v/s est. of 0%/-35%/-63% YoY).
- Sequentially, overall headcount declined ~13% and general staffing headcount ~15%, in line with our expectations.
- Revenue decline (~20% QoQ) was in line with estimates. Sequentially, revenue decline was led by General Staffing (22%), BPO (25%), and Facilities Management (21%).
- Notably, despite the sharp decline in General Staffing revenue, the company did not lose any major customer in this segment.
- Closure of IT offices during the quarter led to a strong impact on the Facility Management and Security Services businesses.
- Reported EBITDA was ~8% ahead of our estimates. Sequentially, a sharp drop in the revenue run-rate led to a proportionate impact on EBITDA (even as EBITDA margins remained largely stable).
- From Mar'20 levels, indirect costs were stated to have declined by ~20%.
- The EBITDA decline in General Staffing (~21% QoQ) was more or less in line with revenue decline.
- Businesses such as training and development (Excelus) and break-and-fix (Digi Care) remained an overhang on reported EBITDA for the quarter.
- Despite the bench costs incurred in some parts of the business, sequential EBITDA margin expansion in Tech Services and Operating Asset Management was a key surprise.

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Research analyst: Mohit Sharma (Mohit.Sharma@MotilalOswal.com) / **Heenal Gada** (Heenal.Gada@MotilalOswal.com)

Investors are advised to refer through important disclosures made at the last page of the Research Report.

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- Net debt reduction by INR1b to INR2.5b and gross debt reduction by INR1.7b to INR9.8b were a key positive.
- Cash conversion (OCF/Ind-AS adjusted EBITDA) was healthy at ~152%, supported by prompt collections, release of working capital, and refunds.
- Reported PAT included a one-off exceptional item of INR250m. This relates to fair value gains on the Terrier consolidation. Adjusted for this, PAT for the quarter (INR221m) was in line with our estimates.
- As Terrier Security becomes a subsidiary (hitherto associate), the total implied purchase consideration stands at INR1.5b. Provisionally, almost the entire amount was recognized as goodwill on consolidation.

Key highlights from management commentary

- Management indicated guidance for reaching 20% ROE by 2023 remains unchanged. In addition, the company expects 20% YoY growth in cash flows.
- It continues to focus on cross-selling its services. Customers using two or more services across the portfolio now contribute 68% to sales.
- Even as the situation remains uncertain, the company believes the worst related to COVID-19 was behind by 1QFY21. July has witnessed a 2x increase in the number of open positions (v/s June). Open positions in July are at 60% of pre-COVID-19 levels. Management expects recovery to be driven by the impending festive season.
- While margins are expected to remain under pressure in the near term, the company expects an improvement over the medium term.
- Headcount reduction in General Staffing was largely driven by headcount rightsizing in the Retail and BFSI verticals.
- Even as the headcount in IT Staffing declined (~7% QoQ), a new high-margin business (Digital Skills) partly offset this impact.
- Excellus witnessed sharp revenue and EBITDA impact due to the closure of training facilities. Even as the government assured the coverage of fixed costs, the company had already recognized costs. Management expects cost reversals as and when reimbursements come in from the government.
- Closure of educational campuses and IT offices impacted Facility Management and Terrier Security Services.
- The HRO segment within Allsec Technologies has been a rare bright spot. Slowdown in hiring activity led to a significant drop in search activity and the revenue of Monster during the quarter.
- Management does not expect any bad debt or receivables issue in the share of working capital-funded clients.

Valuation and view – Company-level improvement to drive re-rating

- The stock is still ~42% lower than pre-COVID-19 levels 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 markup- and outcome-based) did not witness any major dislocation over Mar–Jun'20. In fact, it was impressive to note very healthy cash conversion in 1QFY21 (OCF/Ind-AS adj. EBITDA = 152%).

- As the economy unlocks gradually and enterprises look to dodge supply disruption, we believe the company/sector has already passed the peak of uncertainty. Encouraging rebound in the unemployment situation (as reflected in CMIE data) and the hiring outlook (as reflected in the TeamLease survey) corroborate our view.
- Given some level of uncertainty in the economy (due to the back and forth on lockdowns), some of the otherwise permanent roles are also likely to be fulfilled through flexi-staffing as employers attempt to keep their costs variable. We noticed similar trends in the immediate aftermath of GFC and the demonetization, when staffing companies benefitted due to positive hiring trends in some verticals. Such a trend should likely play out in the near term, benefitting business services firms such as QUESS.
- Over the medium term, 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 10%/24% revenue/EPS CAGR over FY20–22E. Using the Residual Income approach, we arrive at TP of INR480. We adjust the FY20 book value for an appropriate share of outstanding goodwill/inter-company loans on the balance sheet. Welcome corrective steps undertaken by the new management to address some investor concerns and improve cash conversion/ROE should drive a re-rating. Our TP implies 19x FY22E EPS, still a steep 40% discount to TeamLease.

Consolidated - Quarterly

Y/E March	FY20				FY21E				FY20	FY21E	Est. 1Q	Var. (% / bp)
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE				
Net Sales	23,966	26,503	29,500	29,946	24,094	26,038	27,490	28,529	1,09,915	1,06,151	24,070	0.1
YoY Change (%)	21.8	26.7	35.8	30.5	0.5	-1.8	-6.8	-4.7	28.9	-3.4	0.4	10
Total Expenditure	22,474	24,889	27,706	28,260	22,797	24,580	25,895	26,874	1,03,329	1,00,147	22,873	-0.3
EBITDA	1,492	1,614	1,794	1,686	1,297	1,458	1,594	1,655	6,586	6,004	1,196	8.4
Margins (%)	6.2	6.1	6.1	5.6	5.4	5.6	5.8	5.8	6.0	5.7	5.0	41.3
Depreciation	579	652	658	596	594	599	605	628	2,486	2,425	606	-2.0
EBIT	913	962	1,136	1,089	703	859	990	1,027	4,100	3,579	590	19.1
Margins (%)	3.8	3.6	3.9	3.6	2.9	3.3	3.6	3.6	3.7	3.4	2.5	47
Interest	396	461	423	387	379	390	395	395	1,668	1,559	431	-12.1
Other Income	169	159	97	86	76	95	91	89	511	351	86	-12.0
PBT before EO expense	685	660	810	788	399	564	686	721	2,943	2,370	245	63.2
Recurring Tax	106	-29	51	69	178	130	158	166	196	631	29	
Rate (%)	15.4	-4.5	6.3	8.7	44.6	23.0	23.0	23.0	6.6	26.6	12.0	
Adjusted PAT	579	690	759	720	221	434	528	555	2,747	1,739	215	2.7
Extraordinary items	0	0	0	7,019	-250	0	0	0	7,019	-250	0	
Reported PAT	579	690	759	-6,299	365	434	528	555	-4,271	1,989	215	69.3
YoY Change (%)	6.5	11.9	16.7	-934.3	-37.1	-37.0	-30.4	-108.8	-266.5	-146.6	-62.8	2,576
Margins (%)	2.4	2.6	2.6	-21.0	1.5	1.7	1.9	1.9	-3.9	1.9	0.9	62

Key Perfor. Indicators

Y/E March	FY20				FY21				FY20	FY21
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Headcount (k)	357	377	385	384	334				384	
Segment Revenue (INR m)										
Workforce Management	14,880	16,690	19,590	20,390	16,180				71,550	
Operating Asset Management	4,270	4,320	4,480	4,280	3,680				17,350	
Tech Services	4,800	5,510	5,440	5,280	4,230				21,030	
EBITDA Margin (%)										
Workforce Management	6.0	5.5	5.3	5.1	3.7				5.4	
Operating Asset Management	7.5	6.7	7.4	6.6	7.1				7.1	
Tech Services	9.6	11.5	12.1	10.9	13.0				11.1	



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Exhibit 1: Revision to our estimates

Change in Estimates	Revised		Earlier		Change	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Revenue (m)	1,06,151	1,33,036	1,10,217	1,37,017	-3.7%	-2.9%
Rev. growth (%)	(3.4)	25.3	0.3	24.3	-368bp	101bp
EBITDA (m)	6,004	7,982	6,057	8,078	-0.9%	-1.2%
EBITDA Margin (%)	5.7	6.0	5.5	5.9	16bp	10bp
EBIT Margin (%)	3.4	4.0	3.3	3.9	8bp	12bp
EPS (INR)	11.4	24.8	15.5	25.1	-26.2%	-1.2%

Source: Company, MOFSL

Financial and valuation

Consolidated - Income Statement

								(INR M)	
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	1,06,151	1,33,036	
Change (%)	155.2	33.8	25.6	42.9	38.3	28.9	-3.4	25.3	
Cost of services	717	481	714	1,422	2,624	3,382	3,267	4,094	
Employees Cost	22,684	30,069	36,339	50,793	67,132	86,535	83,571	1,04,738	
Other Expenses	965	2,289	3,718	5,914	10,868	13,420	13,309	16,222	
Total Expenditure	24,366	32,839	40,771	58,129	80,624	1,03,337	1,00,147	1,25,054	
% of Sales	94.9	95.6	94.5	94.3	94.6	94.0	94.3	94.0	
EBITDA	1,305	1,511	2,378	3,544	4,646	6,578	6,004	7,982	
Margin (%)	5.1	4.4	5.5	5.7	5.4	6.0	5.7	6.0	
Depreciation	101	144	275	747	1,232	2,486	2,425	2,687	
EBIT	1,203	1,367	2,103	2,796	3,414	4,092	3,579	5,295	
Int. and Finance Charges	218	310	471	755	1,144	1,668	1,559	1,589	
Other Income	57	91	154	569	712	511	351	366	
PBT bef. EO Exp.	1,042	1,147	1,787	2,611	2,983	2,935	2,370	4,072	
EO Items	0	0	0	0	0	6,641	-250	0	
PBT after EO Exp.	1,042	1,147	1,787	2,611	2,983	-3,706	2,620	4,072	
Total Tax	370	335	534	-483	329	474	631	529	
Tax Rate (%)	35.5	29.2	29.9	-18.5	11.0	-12.8	24.1	13.0	
Minority Interest	0	0	-1	-4	88	138	107	0	
Reported PAT	672	812	1,254	3,098	2,565	-4,318	1,882	3,543	
Adjusted PAT	672	812	1,254	3,098	2,565	2,609	1,632	3,543	
Change (%)	276.3	20.8	54.5	147.0	-17.2	1.7	-37.5	117.1	
Margin (%)	2.6	2.4	2.9	5.0	3.0	2.4	1.5	2.7	

Consolidated - Balance Sheet

								(INR M)	
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	22,908	26,451	
Net Worth	2,525	3,566	13,048	24,608	27,256	22,759	24,383	27,926	
Minority Interest	0	0	9	16	31	769	876	876	
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	28,955	32,394	
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	8,269	10,956	
Net Fixed Assets	189	502	2,529	5,359	4,795	3,451	3,026	2,839	
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	36,183	43,485	
Inventory	4	18	71	85	221	284	284	284	
Account Receivables	2,755	6,926	8,966	13,936	16,164	18,795	19,485	24,056	
Cash and Bank Balance	818	1,094	3,039	5,661	5,855	7,587	6,543	7,106	
Loans and Advances	2,292	536	2,357	8,430	5,300	7,773	9,871	12,040	
Curr. Liability & Prov.	2,502	5,151	8,138	14,701	15,328	19,681	19,288	22,984	
Account Payables	414	674	778	1,481	1,729	1,633	1,582	2,398	
Other Current Liabilities	1,941	4,138	6,825	12,166	12,351	16,494	16,115	18,592	
Provisions	147	339	536	1,054	1,248	1,554	1,591	1,993	
Net Current Assets	3,367	3,423	6,294	13,411	12,212	14,759	16,895	20,501	
Appl. of Funds	4,660	6,005	18,864	30,638	29,742	27,339	29,062	32,501	

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	11.4	24.8
Cash EPS	6.8	8.3	12.3	27.1	25.9	35.7	28.4	43.6
BV/Share	22.3	31.5	115.1	217.1	240.5	200.8	215.1	246.4
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	58.1	48.9	34.0	15.8	19.6	18.8	30.1	13.9
Cash P/E	50.5	41.6	27.9	12.7	13.3	9.6	12.1	7.9
P/BV	15.4	10.9	3.0	1.6	1.4	1.7	1.6	1.4
EV/Sales	1.6	1.2	1.1	0.9	0.6	0.5	0.5	0.4
EV/EBITDA	31.0	28.1	19.8	14.9	11.2	7.8	8.7	6.5
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	1.2	13.2
Return Ratios (%)								
RoE	30.8	26.7	15.1	16.5	9.9	10.4	6.9	13.5
RoCE	22.6	17.1	11.4	14.6	10.6	15.4	8.9	13.7
RoIC	25.9	22.3	14.9	17.0	12.9	22.0	13.4	20.0
Working Capital Ratios								
Asset Turnover (x)	5.5	5.7	2.3	2.0	2.9	4.0	3.7	4.1
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 M)
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	2,370	4,072
Depreciation	101	144	333	747	3	2,486	2,425	2,687
Interest & Finance Charges	218	310	479	755	1,144	1,668	1,559	1,589
Direct Taxes Paid	-412	-482	-839	-744	-1,750	-1,450	-631	-529
(Inc)/Dec in WC	-942	-1,622	-941	-1,858	-1,248	-1,860	-3,181	-3,043
CF from Operations	15	-503	755	1,515	714	-3,476	2,543	4,775
Others	9	8	-71	-428	1,302	7,086	-351	-366
CF from Operating incl EO	24	-495	684	1,087	2,016	3,610	2,192	4,409
(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	172	1,889
(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	107	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	-1,559	-1,589
Dividend Paid	0	0	0	0	0	0	0	0
Others	0	0	13	0	-2,706	0	351	366
CF from Fin. Activity	798	867	7,079	9,605	-3,645	1,520	-1,217	-1,326
Inc/Dec of Cash	527	275	1,946	2,622	194	2,040	-1,045	563
Closing Balance	818	1,093	3,039	5,661	5,855	7,587	6,542	7,105

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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