



3R MATRIX

	+	=	-
Right Sector (RS)	✓	■	■
Right Quality (RQ)	■	✓	■
Right Valuation (RV)	✓	■	■

+ Positive = Neutral - Negative

Reco/View

Reco: Buy

CMP: Rs. 581

Price Target: Rs. 715

Company details

Market cap:	Rs. 8,578 cr
52-week high/low:	Rs. 639/165
NSE volume: (No of shares)	2.6 lakh
BSE code:	539978
NSE code:	QUSS
Free float: (No of shares)	6.6 cr

Shareholding (%)

Promoters	55.3
FII	16.3
DII	15.9
Others	12.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.4	44.0	69.1	-6.7
Relative to Sensex	11.2	27.5	47.5	-19.0

Sharekhan Research, Bloomberg

Summary

- Quess Corp (Quess) registered sequential improvement in the performance with revenues and operating profit growing by 7% and 8% on a q-o-q basis; General staffing headcounts grew by 5% on q-o-q basis to 3.33 lakh.
- OCF-to-EBIDTA stood at 80% in Q3FY21 vs. 51% in Q3FY20. Gross Debt reduced by Rs103crore on QoQ (Interest cost is down by 42% yoy and 24%QoQ).
- The management has maintained its target of achieving 20% RoE through double digit organic revenue growth, improvement in profitability through better mix and efficiencies and growing PAT by reducing in interest cost (coupled with sustained improvement in cash flows)
- FY2021 marred by Covid-19, but with economy opening up the recruitment activities will improve which will drive Quess' FY22 performance. We recommend Buy with a price target of Rs715.

Quess Corp (Quess) revenues stood at Rs2, 807.9 crore in Q3FY2021 improved by 7% on a q-o-q basis. The growth of 7% in revenues was driven by 9% growth in General Staffing and 12% growth in Conneqt. Allsec revenues grew by 6% q-o-q. EBIDTA margins stood flat at 5.4% q-o-q while down by 71 BPS on a y-o-y a basis. Margins were down y-o-y due to lockdown impact (Rs29cr) in IFM food and Excelus. EBIDTA grew by 8% on a q-o-q basis to Rs151 crore (decreased by 15% on yoy basis). Reduction in the interest cost led to a 42% gain in PBT that now stands at Rs80.0 crore (grew by 8% QOQ). However, the highlight of the quarter was a strong improvement in the operating cash flows (OCF) to Rs90 crore (OCF/EBIDTA stood at 80% in Q2 vs. 51% in Q1). IFM (Indian facility management) performance flat q-o-q, with early signs of improvements in education & ITS verticals, and food business. 21 logos won in Q3, with a strong sales pipeline going forward. Addition of new clients, cross sales of services and improving growth prospects of acquired businesses remains key growth levers in the near term. Collect & pay ratio was maintained at 73%; receivable days were reduced by 3 days to 62 days. Gross debt on books reduced by Rs103 crore to Rs521 crore on QoQ basis in Q3FY2021 (Debt:equity ratio stood at 0.21x). The company became net cash positive at Rs26crore from net debt of Rs45 crore in Q2FY2021. The company has maintained its target of growing OCF by 20% and achieve RoE of 20% by FY2023E. Quess entered digital gig economy through investment of Rs10crore in task-based services business Taskmo.

Key positives

- General Staffing revenue up 9.1% q-o-q with 20 new clients; Headcount 5% q-o-q
- Global tech services (GTS) revenues stood flat while OPM improved by 167 BPS on a y-o-y basis.
- Interest cost was down by 42% on y-o-y basis due to reduction in debt; Gross debt decreased by Rs 627 crore compared to March 20.

Key negatives

- OPM decreased by 71 BPS on y-o-y basis to 5.4%.

Our Call

View: Recommend Buy with Target Price Rs715 - Quess has maintained its target of achieving 20% revenue and EBIDTA growth and RoE of 20% by FY2023. New client addition in the WFM business, cross selling of other services in the existing clients and better performance by operating asset management business would help to achieve double digit organic growth. Better revenue mix and operating leverage would help margins to improve in the coming years. Sustained reduction in debt, prudent capital allocation and improving cash flows would help RoE to consistently improve. The stock is currently trading at 14.8x/11.0x its FY2022/23E EV/EBIDTA. Continuous strengthening of balance sheet and improvement in the cooperate governance remains key re-rating trigger for the stock. We recommend Buy on the stock with the price target of Rs715.

Key risk

Any sustained reduction in the headcounts in the coming quarters or slowdown in the key business verticals would act as a key risk to our earnings estimates.

Valuation (Consolidated)

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	8,527	10,991	10,749	12,011	14,046
OPM (%)	5.4	6.0	5.0	5.5	6.2
Adjusted PAT	265	299	162	261	409
% YoY growth	-14.2	12.8	-45.9	61.4	56.6
Adjusted EPS (Rs.)	18.2	20.3	11.0	17.7	27.7
P/E (x)	32.2	28.8	53.3	33.0	21.1
P/B (x)	3.1	3.8	3.6	3.2	2.8
EV/EBIDTA (x)	20.7	15.3	19.0	14.8	11.0
RoNW (%)	10.2	12.0	6.9	10.2	14.2
RoCE (%)	9.3	11.2	7.9	10.6	14.2

Source: Company; Sharekhan estimates

*We now convert Quess Corp Limited into a Stock Update; It was earlier a 'Viewpoint' under our coverage

Revenue and EBIDTA grew by 7% and 8% QoQ: Revenue stood at Rs. 2,807.9 crore in Q3FY2021 on y-o-y basis (grew by 7.4% on Q-o-Q basis to Rs2,615.1 crore). Headcount saw V-shape recovery and now stands at 3.33 lakh improved from 3.25 lakh in Q2 (stood at 3.71 lakh in Q3FY20). Work force management (WFM) and Tech services business grew by 9% and 7% on q-o-q. EBIDTA margin was down by 71 BPS to 5.4%. Margins were down y-o-y due to the impact of the lockdown (Rs29cr) in IFM food and Excelus. EBIDTA grew by 8% on QoQ basis to Rs151 crore (decreased by 15% on yoy basis). Reduction in the interest cost led to by 42% led to PBT stand at Rs80.0 crore (grew by 8%QOQ). PAT down by 40% on y-o-y basis to Rs45.5 crore mainly account of higher tax rate.

WFM and Tech Services sequentially improved; OAM stood flat

- ◆ **Revenue of the workforce management (WFM) business grew by 9% QoQ:** General Staffing revenue up 9.1%q-o-qwith 20 new clients on boarded. Headcounts grew in September compared to August and stood at 2,26,000 in Q3FY2021 (Q-O-Q improvement of just 5.5%). Over the WFM business added new clients during the quarter. IT Staffing Domestic business EBITDA up y-o-y with significant margin expansion. 1/3rd IT Staffing HC employed at higher margins. Core to Associate ratiowas lower due to higher investments in sourcing. Training & Skill Development EBITDA down by Rs19 crore YoY driven by lockdown of training facilities and re-starting costs. 104 of 112 centers currently running, with no COVID incidents to date.
- ◆ **Revenue of the operating asset management (OAM) business stood flat at Rs428 crore QoQ** Performance of Indian facility management (IFM) stood flat q-o-q, with early signs of improvements in education & ITS verticals, and food business. 21 logos won in Q3, with strong sales pipeline going forward. Terrier security business was up marginally on a sequential basis. Industrial segment revenues improving sequentially. Overall EBIDTA margins of the business stood flat on QoQ basis at 6.8% during the quarter.
- ◆ **Revenue of the tech services business grew** by ~7% on QoQ basis to Rs536 crore with Conneqt and Allsec revenues grew by 12% and 6% sequentially. Collections business showed strong recovery with easing of moratorium in banking industry. HRO business EBITDA margins grew 190 basis points from 25.5% in the last quarter to 27.4% in the current quarter, on the back of new customer introductions and operational efficiency gains.
- ◆ **Emerging business:** Monster job posting doubled to 124,000 in Q3 from 64000 in Q1; Job view per month has gone up by 122% on Sequential basis. Digicare business volumes are improving on Q-o-Q basis.

Key Conference call takeaways

- ◆ Quess is the market leader in general staffing business in India continues to see massive tailwinds in the business. The new labour laws will improve ease of doing business, provide more impetus to flexible staffing and drive formalization. Further flexi staffing business penetration is lower at 50% compared to other countries which provide huge opportunity for player like Quess to grow in the coming years.
- ◆ Staff-based work is gaining good response over temporary labour in the workforce. Quess is running several staff-based staffing pilot projects with several customers, which are showing encouraging results, both from a quality of delivery and flexibility for customer perspective and from a gross margin perspective
- ◆ The domestic IT staffing business has seen absolute EBITDA and EBITDA margins grow handsomely, with about 1/3 of our headcount now engaged in higher margin areas. With growing demand for technology skills, especially around 5G, technology and others, both from domestic companies and global companies there'll becontinued tailwind in this business.
- ◆ Under training and skills about 95% of the segment revenues were coming from B2G government activities, which led to poor cash flows. The company has decided not to pursue new government business rather focus on B2B business as skill development is huge opportunity in India. This transition will take another 18-24 months.
- ◆ Conneqt is a market leader in the domestic BPO space. About 70% of revenues come from CLM, 20% from collections and 10% from SME and back office processes. The business has made great progress since the

acquisition, delivering 16% revenue CAGR, expanding EBITDA margins. The client concentration has come down from 75 to 54. Business saw strong recovery in EBIDTA which grew by 13% in Q3.

- ◆ Quess holds 74% stake in Allsec (BPO business). Over half of Allsec's EBITDA comes from HRO business, which processes payroll for large enterprise customers in India and beyond. Allsec is a leader in this space in India. The business has experienced an 8% year-on-year growth in Q3 with 21 new customers added in the current financial year on top of its existing set of about 500 customers. The company is investing heavily in HRO platform to accelerate growth of the business in the medium term.
- ◆ On Facility management front (part of OAM business) the company is investing heavily in new sales capacity and upgrading its delivery practices to ensure growth in the business. It has added about 77 new logos in the first nine months of this year. Business is depressed because of the depression in education and IT verticals as well as the food business where it expects customers come back online.
- ◆ The company is seeing lot of opportunity in the security services business (under the Terrier brand). Out of 21 new facility management deals in Q3, 7 deals are bundled with security services.
- ◆ Quess is strengthening the individual business effort through continued cross-sell initiatives. It has cross-sold services to 40 existing clients with a potential annual contract value of about Rs200 crore.

Results (consolidated)

Particulars	Rs cr				
	Q3FY21	Q3FY20	Y-o-Y (%)	Q2FY21	Q-o-Q (%)
Total revenues	2807.9	2950.0	-4.8	2615.1	7.4
Total expenditure	2657.1	2770.6	-4.1	2475.3	7.3
Operating profit	150.8	179.4	-15.9	139.7	7.9
Other income	9.9	9.7	2.0	24.3	-59.4
Interest expenses	24.5	42.3	-42.2	32.3	-24.2
Depreciation	56.2	65.8	-14.5	57.8	-2.7
Profit Before Tax	80.0	81.0	-1.2	74.0	8.1
Tax	34.5	5.1	577.1	9.9	249.5
PAT before minority interest	45.5	75.9	-40.0	43.8	3.9
Minority interest	0.7	-1.0	-	0.0	-
Extra-ordinary item	6.1	0.0		18.3	
Reported PAT	46.2	74.9	-38.3	49.9	-7.5
EPS (Rs)	3.1	5.1	-38.3	3.4	-7.5
			BPS		BPS
OPM(%)	5.4	6.1	(71)BPS	5.3	3

Source: Company; Sharekhan Research

Business wise performance

Particulars	Rs cr				
	Q3FY21	Q3FY0	Y-o-Y (%)	Q2FY21	Q-o-Q (%)
Revenue					
Workforce Management	1843.0	1959.0	-5.9	1686.0	9.3
Operating Asset Management	428.0	448.0	-4.5	427.0	0.2
Tech Services	536.0	544.0	-1.5	502.0	6.8
EBITDA Margin (%)			BPS		BPS
Workforce Management	3.7	5.3	-157	3.7	-5
Operating Asset Management	6.8	7.4	-59	7.0	-25
Tech Services	13.8	12.1	167	13.3	46

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Staffing business to gain from improving IT sector outlook and new labour laws

The global staffing market was worth ~USD 498bn in 2019 of which 45% was generated by top 100 firms. Indian IT services sector's growth to accelerate in the next few years led by - (1) emergence of new operating models, (2) building operational resiliency, (3) reimagining customer experience, (4) faster adoption of cloud and digital transformation at workplace, (5) acceleration in core modernisation, and (6) captive takeout/carve-outs initiatives. This will drive the growth in the IT staffing segment in the coming years. The new Indian labour laws will improve ease of doing business, provide more impetus to flexible staffing and drive formalization. Further flexi staffing business penetration is lower at 50% compared to other countries which provide huge opportunity for player like Qess to grow in the coming years.

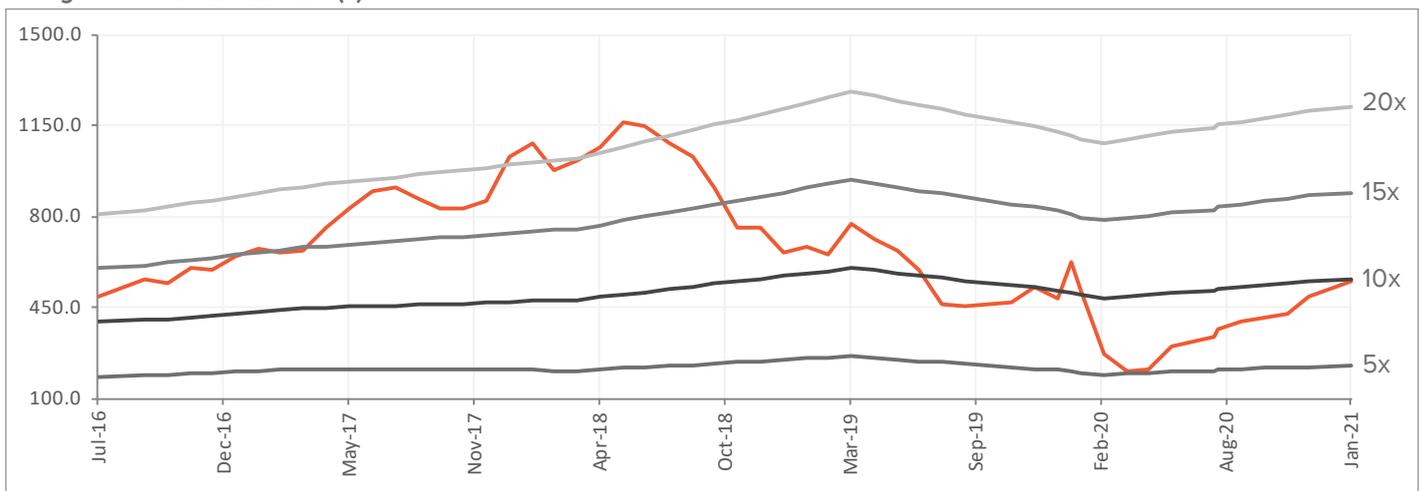
■ Company Outlook – FY2021 affected by pandemic; Strong improvement from FY2022

FY2021 marred by Covid-19, but with economy opening up the recruitment activities will improve which will drive Qess' FY22 performance. Sequential improvement in Headcounts is witnessed. Addition of new clients, cross sales of services and improving growth prospects of acquired businesses remains key growth levers in the near term. Collect & pay ratio was maintained at 73%; receivable days were reduced by 3 days to 62 days. Gross debt on books reduced by Rs103 crore to Rs521 crore on q-o-q q basis in Q3FY2021 (Debt:equity ratio stood at 0.21x). The company expects to reduce further through improving cash flows. We expect Qess' revenues and PAT to grow at CAGR of 14% and 59% over FY2021-23 driven by improved performance by segments, gradual improvement in the EBITDA margins and sustained reduction in the interest cost due to reduction in debt. Thus strengthening of balance sheet and simplification of corporate structure will be key positive trigger for the company.

■ Valuation – Recommend Buy with Target Price Rs715

Qess has maintained its target of achieving 20% revenue and EBITDA growth and RoE of 20% by FY2023. New client addition in the WFM business, cross selling of other services in the existing clients and better performance by operating asset management business would help to achieve double digit organic growth. Better revenue mix and operating leverage would help margins to improve in the coming years. Sustained reduction in debt, prudent capital allocation and improving cash flows would help RoE to consistently improve. The stock is currently trading at 14.8x/11.0x its FY2022/23E EV/EBITDA. Continuous strengthening of balance sheet and improvement in the cooperate governance remains key re-rating trigger for the stock. We recommend Buy on the stock with the price target of Rs715.

One-year forward EV/EBITDA (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Teamlease Services	55.7	40.1	31.7	45.6	34.2	27.6	13.8	15.9	17.2
Qess Corp	53.0	32.8	21.0	18.8	14.8	10.9	7.9	10.6	14.2

Source: Company, Sharekhan estimates

About company

Quess is one of India's leading integrated business services providers that focuses on emerging as the preferred partner for handling end-to-end business functions of its clients. The company offers comprehensive solutions, including recruitment, temporary staffing, technology staffing, IT products and solutions, skill development, payroll, compliance management, integrated facility management and industrial asset management services. The company has a team of over ~3,34,000 employees across India, North America, South America, South East Asia, and the Middle East across various business verticals. Quess has more than 2,450 clients across 10 countries and has 65 offices in India.

Investment theme

With a strong focus on cross-selling under various businesses, adding new clients and increasing headcount, Quess is well poised to achieve strong double-digit revenue growth in the near to medium term (except for FY2021). Further, focus on strategic acquisition improves growth prospects in the long run. Any substantial improvement in EBIDTA margin would be a key lever for the stock in the near term. Management has maintained its thrust on improving cash flows and strengthening the balance sheet in the near to medium term.

Key Risks

- ◆ Non-recovery of loans to subsidiaries/associates would be a key risk to the balance sheet going ahead.
- ◆ Slowdown in performance of key business verticals will affect earnings growth in the near term.
- ◆ Any delay in payment from key clients would affect working capital management and cash flows going ahead.

Additional Data

Key management personnel

Ajit Isaac	Chairman and Managing Director
SurajMoraje	Group CEO and Executive Director
Subramanian Ramakrishnan	Chief Financial Officer
Kundan K Lal	Company Secretary

Source: Company Website

Top shareholders (As on 29th July, 2020)

Sr. No.	Holder Name	Holding (%)
1	Aditya Birla Sun Life Asset Management	6.5
2	Sundaram Asset Management Co Ltd	3.5
3	Steadview Capital Mauritius Ltd	2.6
4	India Capital Fund Ltd	2.2
5	Royal Bank of Canada	2
6	Aditya Birla Sun Life Trustee Co Pvt Ltd	1.4
7	ICICI Prudential Asset Management Co Ltd	1.2
8	Vanguard Group Inc	1.2

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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