Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy



# Quess Corp Limited

## Growth levers in place

| Miscellaneous | Sharekhan code: QUESS | Company Update |
|---|---|---|

| 3R MATRIX | + | = | - |
|---|---|---|---|
| Right Sector (RS) | ✓ | | |
| Right Quality (RQ) | ✓ | | |
| Right Valuation (RV) | ✓ | | |

\+ Positive = Neutral - Negative

**What has changed in 3R MATRIX**

| | Old | | New |
|---|---|---|---|
| RS | | ↔ | |
| RQ | | ↑ | |
| RV | | ↔ | |

| Reco/View | Change |
|---|---|
| Reco: **Buy** | ↔ |
| CMP: **Rs. 701** | |
| Price Target: **Rs. 850** | ↑ |

↑ Upgrade ↔ Maintain ↓ Downgrade

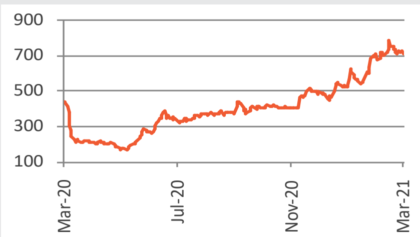
**Company details**

| | |
|---|---|
| Market cap: | Rs. 8,578 cr |
| 52-week high/low: | Rs. 807/165 |
| NSE volume: (No of shares) | 3.0 lakh |
| BSE code: | 539978 |
| NSE code: | QUESS |
| 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 | 2.2 | 45.3 | 60.0 | 68.7 |
| Relative to Sensex | 5.6 | 36.4 | 31.7 | 8.1 |

*Sharekhan Research, Bloomberg*


**Summary**

- We maintain a Buy on Quess Corp with a revised price target of Rs. 850. Strong growth potential of core staffing business, better cash flows and balance sheet, besides a focus on boosting return ratios will further re-rate valuations in the coming years.
- Quess' workforce management business is well-placed to clock double-digit growth in the coming years as flexi-staffing gains prominence and India's labour laws are simplified, providing growth levers.
- We expect the asset management business to post good growth in the coming years as the industrial cycle recovers. Revenues would clock a CAGR of 17% over FY2021-23.
- The management has maintained its target of achieving a 20% RoE through double-digit organic revenue growth, improvement in profitability through a better mix and efficiencies and growing PAT by reducing in interest cost (and sustained improvement in cash flows)


**Quess Corp's (Quess') revenues grew by 34% over FY2016-20 driven by organic and inorganic initiatives. Operating margins (OPM) improved to 6.0% in FY2020 from 4.4% in FY2016. The company strengthened its balance sheet by improving working capital (collection period improved to 62 days from 69 days earlier). In 9MFY2021, net cash position stood at Rs. 26 crore as against a net debt of Rs. 45 crore in 9MFY2020. Operating cash flow to EBIDTA conversion improved to 80% from 43% in FY2019. FY2021 will be muted in terms of revenues as most business verticals (including general staffing and facility management) were affected by the COVID-19 pandemic. Going ahead, low penetration of the flexi-staffing industry in India, a prudent cross pollination service strategy and recovery in the industrial cycle would help Quess achieve a organic revenue growth of 17% over FY2021-23 (the management eyes a 20% revenue growth). Penetration of the flexi-staffing industry is lowest at 0.5% with the industry clocking a CAGR of 16.3% over FY2015-18 to 3.3-million flexi workforce. Reforms such as implementation of GST, skilled India initiative, fixed term contract reforms and employee provident fund (EPF) reform would lead to a strong 20% growth in the flexi-staffing industry in the coming years. This along with simplified labour reforms would help Quess' general staffing business to grow in strong double digits in the coming years. Integrated facility management services (IFMS) industry is expected to record a CAGR of 20% in the medium to long term as the companies are expected to move to organised players with pan India presence. Quess will also benefit from cross pollination strategy, which will help to acquire more clients in the coming years. Industrial services business is expected to post recovery with recovery in the Industrial cycle. Quess is focusing on an asset-light model by developing partners, building domain expertise and an increase in solution selling to migrate from lower margin manpower projects to improve growth prospects of industrial services business. Better mix and efficiencies would lead to sustainable improvement in the operating margins (expected to grow by 100 bps over FY2021-23). Better profitability and cash flows would strongly drive up return ratios, with RoE and RoCE expected to stand at 14.7% and 14.6% in FY2023 from 6.9% and 7.9% in FY2020.**

**Our Call**

**View - Retain Buy with a revised PT of Rs. 850:** We have increased our earnings estimates for FY2022 and FY2023 by 9% and 4.5% to factor in better-than-earlier expected growth in the workforce management business (general staffing) and little higher OPM due to better mix. New client addition in the workforce management (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. Reduction in debt, prudent capital allocation and improving cash flows would help return ratios to consistently improved (management maintained target of achieving RoE by FY2023). The stock is currently trading at 16.7x/12.8x its FY2022 and FY2023 EV/EBIDTA. We maintain a Buy recommendation on the stock with a revised price target of Rs. 850.

**Key Risks**

Any slowdown in the key business vertical or improvement in the margins taking longer time than estimated would act as a key risk to our earnings estimates.

**Valuation (consolidated)** Rs cr

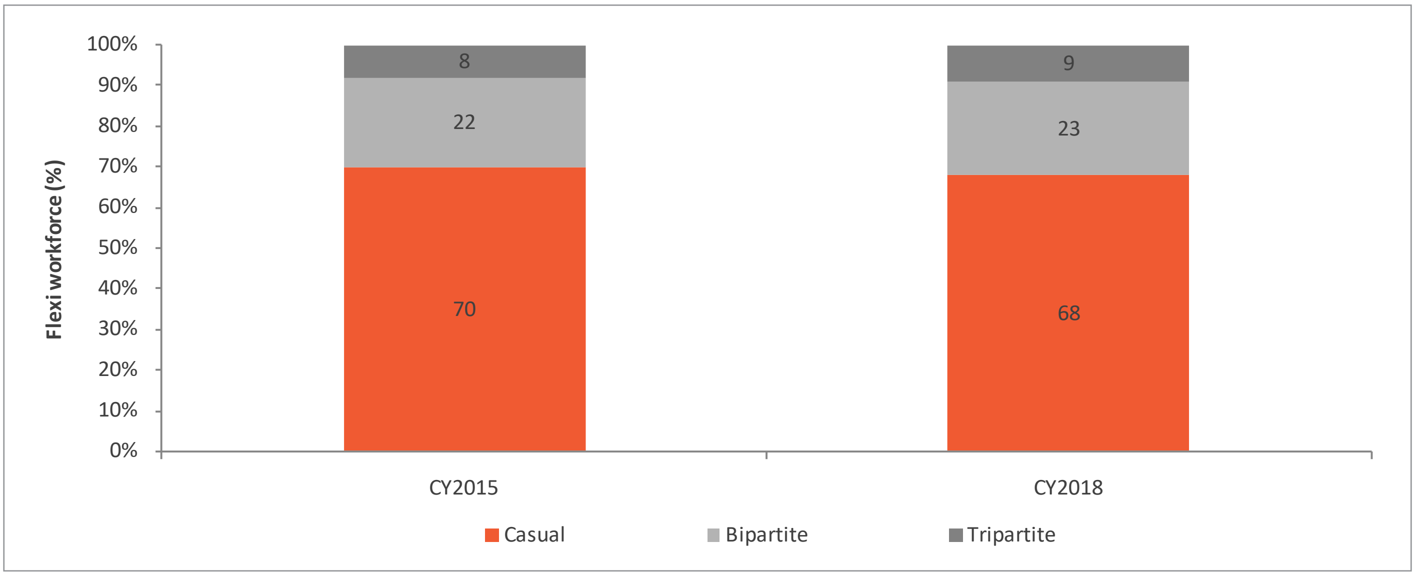
| Particulars | FY19 | FY20 | FY21E | FY22E | FY23E |
|---|---|---|---|---|---|
| Revenue | 8,527 | 10,991 | 10,749 | 12,512 | 14,595 |
| OPM (%) | 5.4 | 6.0 | 5.0 | 5.6 | 6.0 |
| Adjusted PAT | 265 | 299 | 162 | 285 | 427 |
| % YoY growth | -14.2 | 12.8 | -45.9 | 76.3 | 49.7 |
| Adjusted EPS (Rs.) | 18.2 | 20.3 | 11.0 | 19.3 | 28.9 |
| P/E (x) | 38.9 | 34.8 | 64.4 | 36.5 | 24.4 |
| P/B (x) | 3.8 | 4.6 | 4.3 | 3.9 | 3.3 |
| EV/EBIDTA (x) | 24.5 | 18.1 | 22.3 | 16.7 | 12.8 |
| RoNW (%) | 10.2 | 12.0 | 6.9 | 11.1 | 14.7 |
| RoCE (%) | 9.3 | 11.2 | 7.9 | 11.3 | 14.6 |

*Source: Company; Sharekhan estimates*

### Workforce management business to grow in strong double digits

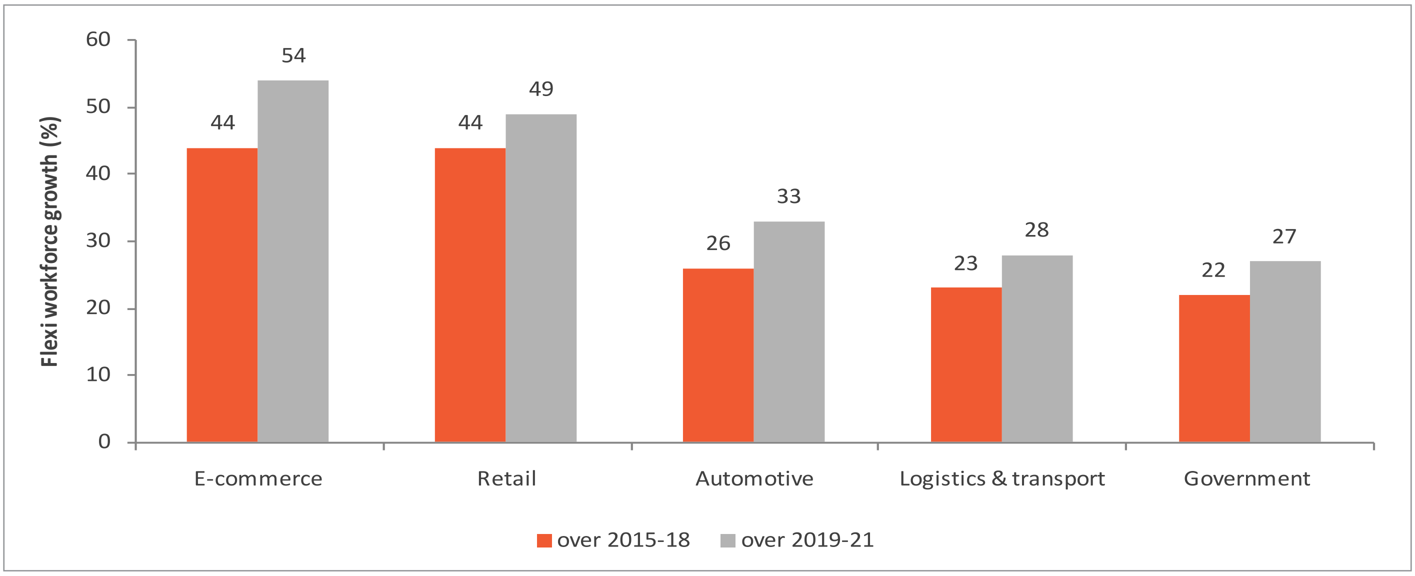
Penetration of the flexi-staffing industry in India is low at 0.7% as on 2018 with 3.3million employees under the flexi workforce management (grew by 16.3% over FY2015-18). Recent reforms such as implementation of GST, the Skill India initiative and fixed-term contract reforms will help the flexi-staffing industry to achieve strong of 20% in the coming years. E-commerce, retail, automotive and logistics and transport are expected to see a 28-54% growth in flexi workforce during 2019-21. IT/ITeS, E-commerce and BFSI 12.5%, 11.9% and 9.1% has more than 9% penetration in flexi-staffing adoption. The demand for IT talent is expected to gain momentum in 2021 and see a 10-12% growth backed by positive demand. The uptick is expected to lead by recovery in demand for contractual staff which had taken a massive hit apart from advanced technical skill-sets such as data sciences and data analytics the demand for which is expected to see an increase of 45-50%. Quess' workforce management (WFM) business is expected to grow at CAGR of 19% over FY2021-23.

**Tripartite (flexi) workforce has increased by 1.2mn from 2015-18**



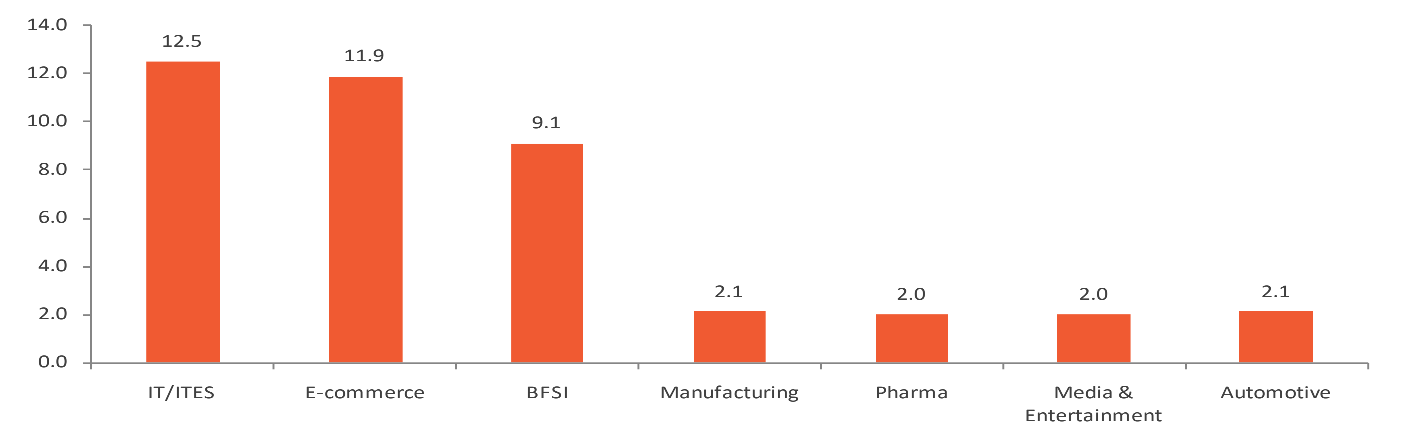

*Source: Indian staffing federation; Sharekhan Research*

**Five sectors to lead flexi workforce growth**



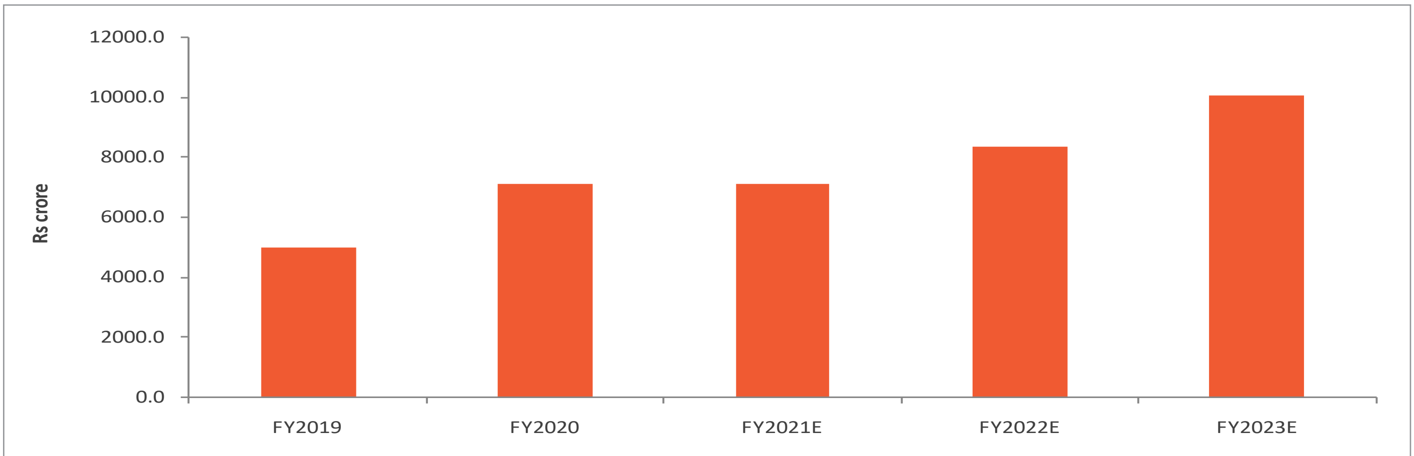

*Source: Indian staffing federation; Sharekhan Research*

**IT, e-commerce and BFSI leads flexi adoption**




*Source: Indian staffing federation; Sharekhan Research*

**Quess' WFM business to touch Rs. 10, 000-crore mark by FY2023**

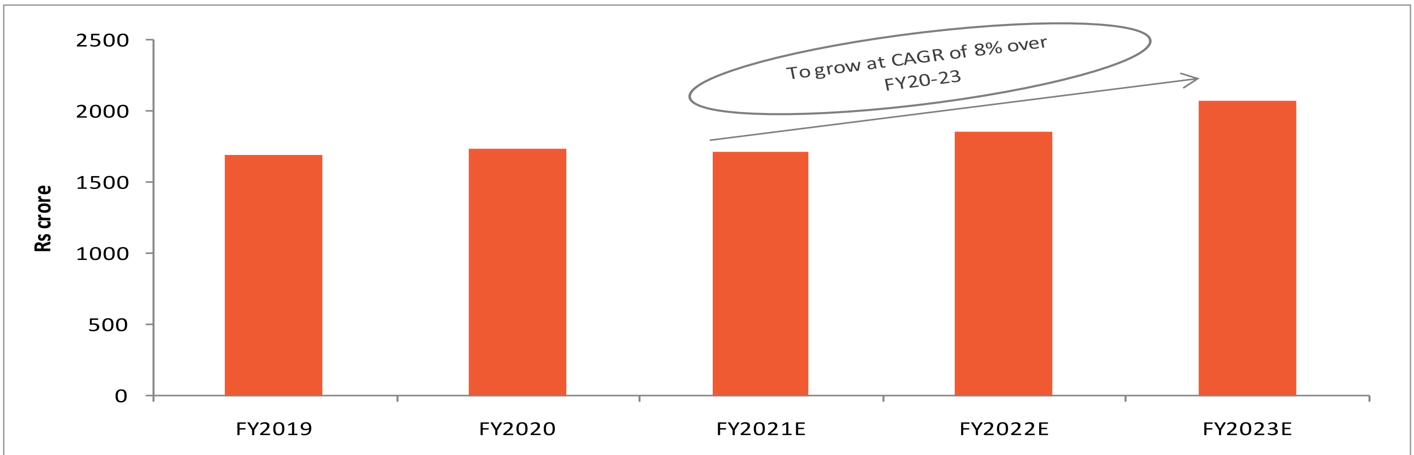



*Source: Company; Sharekhan Research*

## Operating asset management business to recover in the coming years

The operating asset management (OAM) business has seen flat growth for the past two years. Integrated facility management services (IFMS) vertical (contributes ~80% of overall OAM revenues) is expected to grow at CAGR of 20% in the medium to long term as companies are expected to move to organised players with pan-India presence. The company will also benefit from cross pollination strategy which will help to acquire more clients in the coming years. The industrial services business is expected to post better performance in the coming years with overall recovery in the industrial cycle. Quess is focusing on asset-light model by developing partners, building domain expertise and increase in solution selling to migrate from lower margin manpower projects to improve the growth prospects of industrial services business.

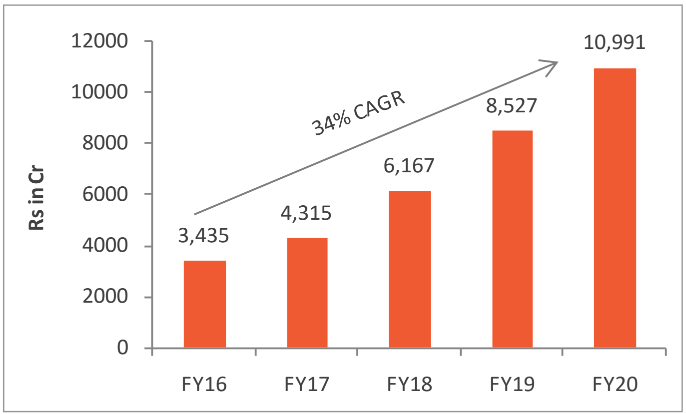
**OAM business to recover in the coming years**




*Source: Company; Sharekhan Research*

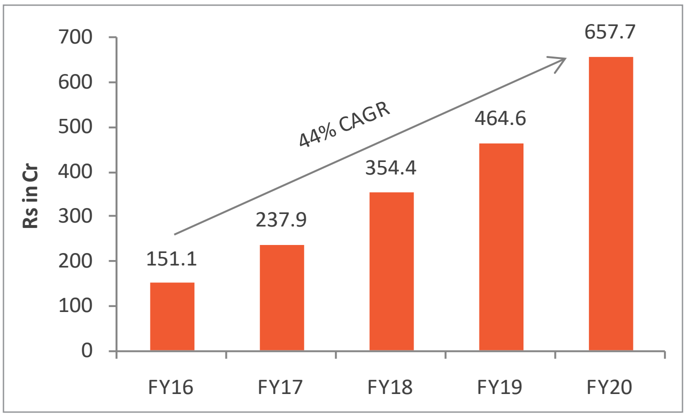
## Financials in charts

### Trend in revenues



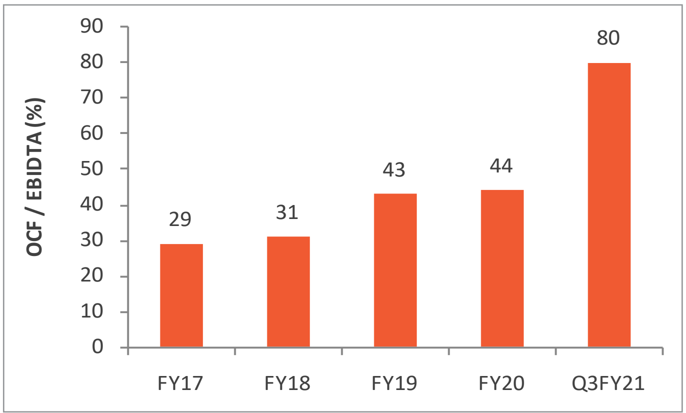

*Source: Company, Sharekhan Research*

### Trend in the operating profit




*Source: Company, Sharekhan Research*

### OCF/EBIDTA improved substantially

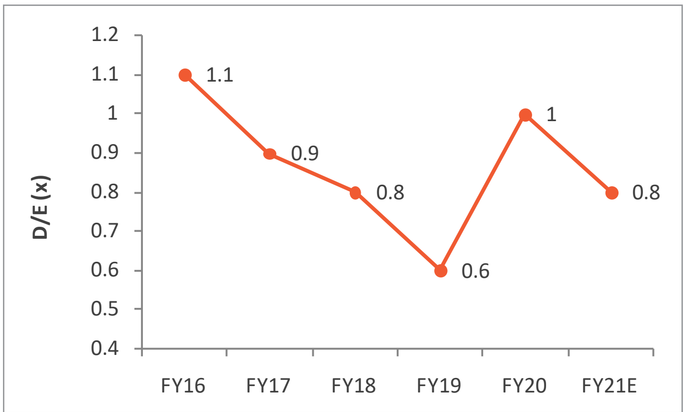



*Source: Company, Sharekhan Research*

### Collect & pay ratio (WFM) remained stable

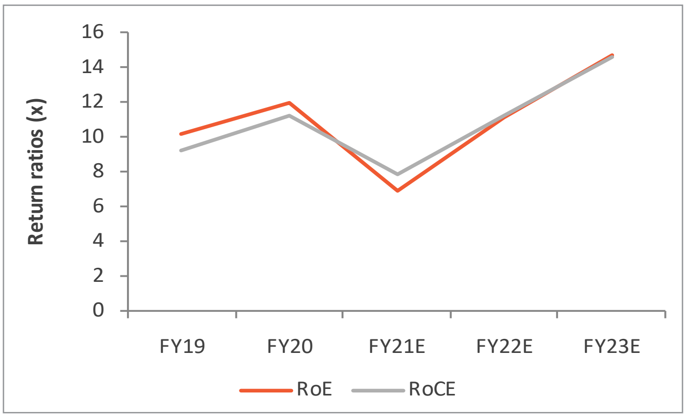

*Source: Company, Sharekhan Research*

### Debt/Equity ratio remained lower




*Source: Company, Sharekhan Research*

### Return ratios will improve the coming years




*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 labor 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.

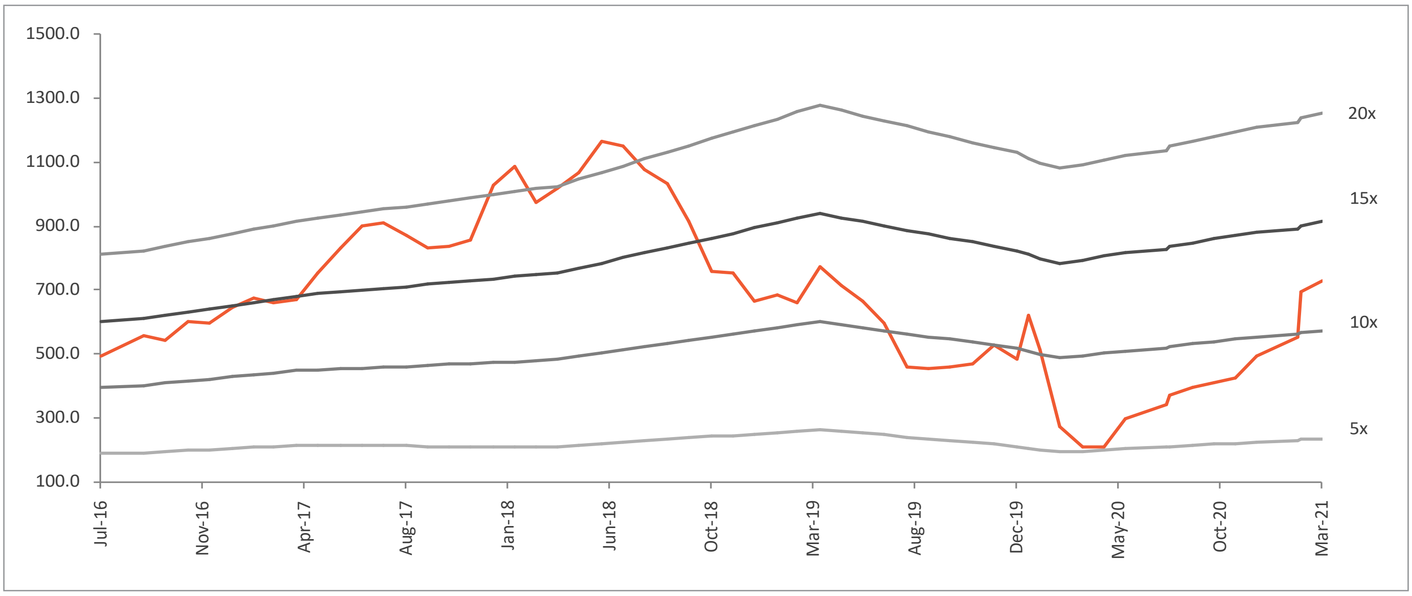
■ **Company outlook - FY2021 affected by pandemic; strong improvement expected from FY2022**

FY2021 has been marred by COVID-19, but with economy opening up the recruitment activities will improve which will drive Quess' FY022 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 Rs. 103 crore to Rs. 521 crore on QoQ basis in Q3FY2021 (debt:equity ratio stood at 0.21x). The company expects to reduce further through improving cash flows. We expect Quess' revenues and PAT to grow at CAGR of 17% and 59% over FY2021-23 driven by improved performance by segments, gradual improvement in 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 Rs850**

We have increased our earnings estimates for FY2022 and FY2023 by 9% and 4.5% to factor in better-than-earlier expected growth in the workforce management business (general staffing) and little higher OPM due to better mix. New client addition in the workforce management (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. Reduction in debt, prudent capital allocation and improving cash flows would help return ratios to consistently improved (management maintained target of achieving RoE by FY2023). The stock is currently trading at 16.7x/12.8x its FY2022 and FY2023 EV/EBIDTA. We maintain a Buy recommendation on the stock with a revised price target of Rs. 850.

**One-year forward P/E (x) band**




*Source: Sharekhan Research*

**Peer Comparison**

| Particulars | P/E (x) | | | EV/EBIDTA (x) | | | RoCE (%) | | |
|---|---|---|---|---|---|---|---|---|---|
| | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E |
| Teamlease Services | 70.2 | 50.5 | 39.9 | 57.4 | 43.0 | 34.8 | 13.8 | 15.9 | 17.2 |
| Quess Corp | 64.4 | 36.5 | 24.4 | 22.3 | 16.7 | 12.8 | 7.9 | 11.3 | 14.6 |

*Source: Company, Sharekhan estimates, Bloomberg*

## 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

- 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 |
| Suraj Moraje | Group CEO and Executive Director |
| Subramanian Ramakrishnan | Chief Financial Officer |
| Kundan K Lal | Company Secretary |

*Source: Company*

**Top shareholders**

| 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*

## 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 detoriating 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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