

Estimate change



TP change



Rating change



CMP: INR586

TP: INR710 (+21%)

Buy

Strong growth to continue in FY23

A gradual margin recovery to hurt near-term earnings

- QUESS delivered a strong performance in 1QFY23, with the 33% YoY growth in revenue driven by a strong 34% growth in Workforce Management. The strong headcount addition (~30k net) suggests huge growth visibility in FY23. EBITDA margin at 3.9% was in line, although down 100bp QoQ on elevated investments in Monster.com and salary hikes in 1QFY23.
- The management commentary on FY23 was very strong as demand continues to pick up. In GTS, IT demand remains strong, with the pipeline at 3x the capacity to onboard the workforce. The General Staffing business should benefit from a strong workforce addition in 1QFY23 and FY22.
- While we expect some growth moderation in GTS business after a strong FY22, overall growth in FY23 (~31% YoY) should exceed last fiscal's levels (up 26% YoY).
- The company should continue to improve its margin from current levels, despite increased investment in Monster (INR1.1b). We expect a FY23/FY24 EBITDA margin of 4.2%/4.8%. This will translate in a PAT CAGR of 46% over FY22-24E.
- The disallowance of 80JAA deduction by the Income Tax Department remains a key near-term risk on the stock. We expect QUESS to provision an additional amount over the next few quarters.
- The company should be a key beneficiary of formalization and labor reforms over the medium term. Moreover, it should see a strong growth in FY23 on strong growth trends. Our TP of INR710 implies 17x FY24E P/E. We reiterate our **Buy** rating.

Earnings broadly in line, but strong headcount addition a positive

- Workforce Management grew 33% YoY, Operating Asset Management rose 29%, GTS increased by 29%, and the Product-led business (new classification) grew 109% on a small base.
- EBITDA margin deteriorated further to 3.9%, down 100bp QoQ and 50bp YoY (in line). Weakness was driven by cash burn in the Monster business, SG&A investments, and a hit on IFM margin due to contract renegotiations.
- PAT grew 121% YoY to INR677m (in line) due to a lower margin, but was partly offset by a lower tax rate.
- Lower OCF generation in 1QFY23 (down 26% YoY to INR650m), resulted in the company reporting a net debt of INR590m.

Key highlights from the management commentary

- QUESS added 219 new customers in 1QFY23. It clocked 32 wins with cross-selling, totaling to an ACV of INR340m.
- Workforce Management witnessed a strong growth in General Staffing, driven by Retail, BFSI, and Telecom sectors. The core-to-associate ratio remained flat and General Staffing crossed the 300k headcount mark.



Bloomberg	QUESS IN
Equity Shares (m)	154
M.Cap.(INRb)/(USDb)	86.7 / 1.1
52-Week Range (INR)	990 / 528
1, 6, 12 Rel. Per (%)	-7/-11/-41
12M Avg Val (INR M)	182

Financials & Valuations (INR b)

Y/E Mar	2022	2023E	2024E
Sales	136.9	178.8	219.2
EBITA Margin (%)	4.8	4.2	4.8
Adj. PAT	2.7	3.9	6.5
EPS (INR)	17.6	25.3	41.7
EPS Gr. (%)	-18.7	43.3	64.9
BV/Sh. (INR)	215.1	234.6	268.5

Ratios

RoE (%)	11.5	15.4	22.7
RoCE (%)	11.4	14.8	21.1
Payout (%)	45.3	43.5	38.4

Valuations

P/E (x)	33.2	23.2	14.1
P/BV (x)	2.7	2.5	2.2
EV/EBITDA (x)	14.2	12.1	8.4
EV/Sales (x)	0.7	0.5	0.4

Shareholding pattern (%)

As On	Jun-22	Mar-22	Jun-21
Promoter	51.8	51.9	55.2
DII	10.7	11.7	14.4
FII	22.0	21.5	17.3
Others	15.5	15.0	13.0

FII Includes depository receipts

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- The drop in margin was associated with an additional cash burn in the Product-led segment in Monster and ESOP costs, higher SG&A (INR200m), wage hike (INR140m), strong headcount, and renegotiation with a large client in OAM (INR70m).

Company-level improvement to drive a re-rating

- Strong hiring trends have led to a robust recovery in demand. Such a trend is likely to play out in the near term, benefitting business services firms such as QUESS.
- Over the medium term, as both the Center and state governments look to liberalize and formalize the labor market, QUESS should be among the biggest direct beneficiaries.
- Strong growth and the improvement in cash conversion and RoE should drive a re-rating. Our TP implies 17x FY24E EPS.

Consolidated quarterly performance

(INR m)

Y/E March	FY22				FY23E				FY22	FY23E	FY23E 1QE	Var. (%/bp)
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Net Sales	29,869	32,278	36,850	37,920	39,793	42,404	48,205	48,442	1,36,918	1,78,844	39,777	0.0
YoY Change (%)	24.0	23.4	31.2	26.2	33.2	31.4	30.8	27.7	26.3	30.6	33.2	6
Total Expenditure	28,540	30,719	35,061	36,079	38,259	40,665	46,133	46,262	1,30,400	1,71,319	38,186	0.2
EBITDA	1,329	1,559	1,788	1,842	1,534	1,739	2,073	2,180	6,518	7,526	1,591	-3.6
Margin (%)	4.4	4.8	4.9	4.9	3.9	4.1	4.3	4.5	4.8	4.2	4.0	-14.4
Depreciation	497	486	494	643	610	581	581	581	2,120	2,354	572	6.6
EBIT	831	1,073	1,295	1,199	924	1,157	1,492	1,599	4,397	5,172	1,019	-9.3
Margin (%)	2.8	3.3	3.5	3.2	2.3	2.7	3.1	3.3	3.2	2.9	2.6	-24
Interest	218	195	184	195	204	192	192	192	792	780	192	6.3
Other Income	48	74	29	47	72	51	51	51	198	226	51	
PBT before EO expense	662	952	1,140	1,050	792	1,017	1,351	1,458	3,803	4,618	878	-9.8
Recurring Tax	356	186	254	270	115	152	203	219	1,066	689	184	-37.4
Rate (%)	53.7	19.5	22.3	25.7	14.6	15.0	15.0	15.0	28.0	14.9	21.0	
MI and P/L of Asso. Cos.	0	0	0	0	0	0	0	0	-1	0	0	
Adjusted PAT	306	766	885	780	677	864	1,148	1,239	2,738	3,929	694	-2.4
Extraordinary items	-140	354	0	14	0	0	0	0	228	0	0	
Reported PAT	446	412	885	766	677	864	1,148	1,239	2,510	3,929	694	-2.4
YoY Change (%)	22.4	-17.4	94.3	NA	51.7	109.5	29.7	61.7	240.3	56.5	55.4	-374
Margin (%)	1.5	1.3	2.4	2.0	1.7	2.0	2.4	2.6	1.8	2.2	1.7	-4

Source: Company, MOFSL

Key performance indicators

Y/E March	FY22				FY23				FY22
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	
Headcount (k)	369	401	422	437	470				437
Segment Revenue (INR m)									
Workforce Management	20,732	21,429	24,715	26,441	27,579				93,318
Operating Asset Management	4,545	4,899	5,779	5,772	5,967				20,995
Tech Services	3,893	5,950	6,356	4,711	5,074				20,910
EBITDA Margin (%)									
Workforce Management	3.5	1.8	3.1	3.6	3.4				3.0
Operating Asset Management	8.9	3.4	6.4	4.4	5.1				5.7
Tech Services	15.9	14.2	14.9	18.3	16.3				18.7

Source: Company

Key highlights from the management commentary

1QFY23 performance

- The business environment remains conducive. Service sector saw highest headcount addition.
- The outlook for the business is very positive with 470k FTE and ~30k net additions.
- Quess added 219 new customers during the quarter and 32 wins with cross-selling, totaling to INR 340m in ACV.
- WFM witnessed strong growth in general staffing driven by retail, BFSI and telecom. Core to associate ratio remained flat and general staffing cross 300k headcount mark.
- GTS saw secular growth in BPO and secular IT and a rapid 33% growth in life cycle management. Connect crossed 40k FTE during the quarter. Non-BPO segment had good collections (+35%)
- OAM had 23 new logos during the quarter. IT/ITES and education were soft during the quarter. Security business had 15 new logos and electronic security solutions gained traction during the quarter. There was a contract negotiation of major healthcare client after completion of three year lock-in (Revenue INR 2.7b vs 3.8b pre-negotiation). IT demand continues to be strong at 3x the capacity, the softness in revenue is attributable to restructuring efforts to move to higher margin business.
- In products business, Monster had good quarter with 53% jump in revenue. Quess has completed major investments in product development and marketing spends will continue. It maintained INR 1.1b cash burn rate for the year and suggested that there will be sharp increase in margins in next year.
- Net debt stood at INR590mn in 1QFY23 v/s a net cash of INR 150m in 4QFY22.

Margin

- Drop in margin was associated to additional cash burn in product led segment in monster and ESOP costs, higher SG&A (INR 200m), wage hike (INR 140m), strong headcount, renegotiation with large client in OAM (INR 70m).
- Margin in OAM was impacted by INR 70m due to renegotiation of contract with large healthcare client as margin was revised to market rate on completion of three year lock-in. Renegotiated margin also has a three year lock-in. OAM margin are expected to recover to 5.6%-5.7% by 4QFY23 based on the order book.
- In GTS, the dip in EBIDTA was due general slowdown in IT and BPO business coupled with wage hikes.
- It expects margins to improve gradually in WFM, OAM and GST as the year progresses.

Outlook

- The management is very optimistic about FY23 as the demand looks good.
- Its focus on normalization of corporate structure continues.
- Quess is still awaiting on the order from the department on disputed 80JJAA deduction and order is expected to come before 23rd March 2023.
- Quess will continue to claim 80JJAA deduction for current year.

- OCF/EBITDA dipped to 56% on account of delay in billings in BPO business. It maintained 70% guidance for FY23.
- The management expects a 15-18% tax rate from FY23 onwards

Valuation and view

- Strong hiring trends have led to a robust recovery in demand. Such a trend is likely to play out in the near term, benefitting business services firms such as QUESS.
- Over the medium term, as both the Center and state governments look to liberalize and formalize the labor market, QUESS should be among the biggest direct beneficiaries.
- Strong growth and the improvement in cash conversion and RoE should drive a re-rating. Our TP implies 17x FY24E EPS.

Exhibit 1: Revisions to our estimates

	Revised estimates		Earlier estimates		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Revenue (m)	1,78,844	2,19,251	1,76,087	2,15,765	1.6	1.6
Rev. growth (%)	30.6	22.6	28.6	22.5	201bp	6bp
EBITDA (m)	7,526	10,524	7,998	10,788	-5.9	-2.4
EBITDA Margin (%)	4.2	4.8	4.5	5.0	-33bp	-20bp
EBIT Margin (%)	2.9	3.7	3.2	3.9	-33bp	-20bp
EPS (INR)	25.3	41.7	27.7	42.8	-8.7	-2.6

Source: Company, MOFSL

Financials and valuation

Consolidated Income Statement								(INR m)
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Total Income from Operations	43,149	61,673	85,270	1,09,915	1,08,370	1,36,918	1,78,844	2,19,251
Change (%)	25.6	42.9	38.3	28.9	-1.4	26.3	30.6	22.6
Cost of services	714	1,422	2,624	3,382	3,335	4,213	5,504	6,747
Employees Cost	36,339	50,793	67,132	86,535	85,318	1,07,794	1,40,802	1,72,614
Other Expenses	3,718	5,914	10,868	13,420	13,940	18,393	25,013	29,366
Total Expenditure	40,771	58,129	80,624	1,03,337	1,02,593	1,30,400	1,71,319	2,08,727
As a percentage of Sales	94.5	94.3	94.6	94.0	94.7	95.2	95.8	95.2
EBITDAs	2,378	3,544	4,646	6,578	5,777	6,518	7,526	10,524
Margin (%)	5.5	5.7	5.4	6.0	5.3	4.8	4.2	4.8
Depreciation	275	747	1,232	2,486	2,285	2,120	2,325	2,412
EBIT	2,103	2,796	3,414	4,092	3,491	4,397	5,201	8,112
Int. and Finance Charges	471	755	1,144	1,668	1,113	792	793	790
Other Income	154	569	712	511	451	198	205	290
PBT bef. EO Exp.	1,787	2,611	2,983	2,935	2,829	3,803	4,612	7,612
EO Items	0	0	0	6,641	1,388	0	0	0
PBT after EO Exp.	1,787	2,611	2,983	-3,706	1,442	3,803	4,612	7,612
Total Tax	534	-483	329	474	590	1,066	689	1,142
Tax Rate (%)	29.9	-18.5	11.0	-12.8	40.9	28.0	14.9	15.0
Minority Interest	-1	-4	88	138	114	-1	0	0
Adjusted PAT	1,254	3,098	2,565	2,609	2,125	2,738	3,923	6,470
Change (%)	54.5	147.0	-17.2	1.7	-18.5	28.8	43.3	64.9
Margin (%)	2.9	5.0	3.0	2.4	2.0	2.0	2.2	3.0

Consolidated Balance Sheet								(INR m)
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Equity Share Capital	1,268	1,455	1,461	1,475	1,477	1,480	1,480	1,480
Total Reserves	11,780	23,153	25,795	21,284	21,954	22,898	25,114	28,952
Net Worth	13,048	24,608	27,256	22,759	23,431	24,378	26,594	30,432
Minority Interest	9	16	31	769	939	1,310	1,310	1,310
Total Loans	7,440	9,662	7,502	9,976	4,514	5,877	5,290	5,268
Deferred Tax Liabilities	-1,633	-3,647	-5,046	-6,166	-4,061	-3,983	-3,983	-3,983
Capital Employed	18,864	30,638	29,742	27,339	24,823	27,582	29,210	33,027
Gross Block	3,504	7,485	8,152	9,295	10,857	13,806	14,806	16,306
Less: Accum. Deprn.	976	2,126	3,357	5,843	8,129	10,249	12,574	14,986
Net Fixed Assets	2,529	5,359	4,795	3,451	2,728	3,557	2,232	1,320
Goodwill on Consolidation	9,187	10,959	11,769	8,358	9,890	10,096	10,096	10,096
Capital WIP	77	22	147	46	309	153	173	193
Total Investments	776	888	820	725	41	17	17	17
Curr. Assets, Loans, and Adv.	14,433	28,111	27,540	34,439	30,173	35,904	46,049	57,285
Inventory	71	85	221	284	290	275	275	275
Account Receivables	5,094	9,207	9,132	9,982	8,945	23,323	30,869	39,045
Cash and Bank Balance	3,039	5,661	5,855	7,587	5,646	4,105	5,277	7,924
Loans and Advances	6,229	13,159	12,333	16,586	15,292	8,201	9,628	10,042
Curr. Liability and Prov.	8,138	14,701	15,328	19,681	18,317	22,145	29,357	35,884
Account Payables	778	1,481	1,729	1,633	1,212	1,154	3,755	5,147
Other Current Liabilities	6,825	12,166	12,351	16,494	14,983	18,258	21,913	26,218
Provisions	536	1,054	1,248	1,554	2,122	2,733	3,688	4,520
Net Current Assets	6,294	13,411	12,212	14,759	11,856	13,759	16,693	21,401
Appl. of Funds	18,864	30,638	29,742	27,339	24,823	27,582	29,210	33,027

Financials and valuation

Ratios

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Basic (INR)								
EPS	10.1	21.8	17.5	18.3	14.9	17.6	25.3	41.7
Cash EPS	12.3	27.1	25.9	35.7	30.8	31.3	40.3	57.2
BV/Share	115.1	217.1	240.5	200.8	206.7	215.1	234.6	268.5
DPS	0.0	0.0	0.0	0.0	7.0	8.0	11.0	16.0
Payout (%)	0.0	0.0	0.0	0.0	135.7	45.3	43.5	38.4
Valuation (x)								
P/E	57.9	26.9	33.5	32.1	39.4	33.2	23.2	14.1
Cash P/E	47.5	21.6	22.6	16.4	19.0	18.7	14.6	10.2
P/BV	5.1	2.7	2.4	2.9	2.8	2.7	2.5	2.2
EV/Sales	1.8	1.4	1.0	0.8	0.8	0.7	0.5	0.4
EV/EBITDA	32.4	24.6	18.8	13.1	14.3	14.2	12.1	8.4
Dividend Yield (%)	0.0	0.0	0.0	0.0	1.2	1.4	1.9	2.7
FCF per share	2.4	1.1	7.2	21.3	45.7	30.3	26.1	36.4
Return Ratios (%)								
RoE	15.1	16.5	9.9	10.4	9.2	11.5	15.4	22.7
RoCE	11.4	14.6	10.6	15.4	7.7	11.4	14.8	21.1
RoIC	14.9	17.0	12.9	22.0	10.9	15.0	18.8	28.4
Working Capital Ratios								
Asset Turnover (x)	2.3	2.0	2.9	4.0	4.4	5.0	6.1	6.6
Debtor (Days)	43	54	39	33	30	62	63	65
Creditor (Days)	7	9	7	5	4	3	8	9
Leverage Ratio (x)								
Net Debt/Equity ratio	0.3	0.1	0.0	0.1	-0.1	0.1	0.0	-0.1

Consolidated Cash Flow Statement

(INR m)

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
OP/(Loss) before Tax	1,723	2,615	2,566	-4,319	737	2,510	4,612	7,612
Depreciation	333	747	3	2,486	2,285	2,120	2,325	2,412
Interest and Finance Charges	479	755	1,144	1,668	1,113	550	793	790
Direct Taxes Paid	-839	-744	-1,750	-1,449	1,648	-869	-689	-1,142
(Inc.)/Dec. in WC	-941	-1,858	-1,248	-1,933	-464	-307	-1,761	-2,062
CF from Operations	755	1,515	714	-3,547	5,319	4,004	5,281	7,610
Others	-71	-428	1,302	7,157	1,835	1,538	-205	-440
CF from Operations incl. EO	684	1,087	2,016	3,611	7,154	5,542	5,075	7,170
(Inc.)/Dec. in FA	-383	-928	-957	-570	-613	-833	-1,020	-1,520
Free Cash Flow	301	159	1,058	3,041	6,540	4,709	4,055	5,650
(Pur.)/Sale of Investments	0	-1,808	-117	732	-144	-390	0	0
Others	-5,434	-5,333	2,898	-1,865	-295	-653	0	0
CF from Investments	-5,817	-8,069	1,823	-1,703	-1,052	-1,876	-1,020	-1,520
Issue of Shares	3,693	8,485	5	478	2	628	0	0
Inc./(Dec.) in Debt	3,816	1,785	-74	2,197	-6,312	720	-588	-21
Interest Paid	-443	-665	-865	-1,158	-737	-553	-793	-790
Dividend Paid	0	0	0	-144	0	-1,868	-1,707	-2,483
Others	13	0	-2,706	-1,244	-997	-3,842	-602	-517
CF from Fin. Activity	7,079	9,605	-3,640	129	-8,045	-4,916	-3,690	-3,811
Inc./Dec. in Cash	1,946	2,622	199	2,037	-1,943	-1,250	366	1,839
Closing Balance	3,039	5,661	5,860	7,589	5,646	4,105	5,278	7,924

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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