

Estimate change	↔
TP change	↑
Rating change	↔

CMP: INR425 TP: INR440 (+4%) Neutral

Margin recovery remains critical for any rerating

Breakeven in Product business by 4QFY24 tough, due to weak demand

- QUESS delivered a 15.6% YoY growth in revenue, slightly below our estimate of 16.5%. The headcount addition was strong at ~14k net. The EBITDA margin at 3.3% was below our expectations of 3.5%. The margin was negatively impacted due to ongoing investments and headwinds in workforce management (WFM).
- The management indicated good demand in BFSI, manufacturing, and telecom, while the demand for FMCG and IT is expected to remain weak. QUESS hired an additional 14k individuals in 1QFY24. The company indicated that it made this hiring in anticipation of a strong festive demand in the next two quarters. This move provides good visibility for near-term growth and we estimate a revenue CAGR of 17.6% over FY23-25.
- EBITDA margin declined 10bp QoQ on account of wage hikes, impact from headwinds in WFM, and higher drag from Product-led business (PLB). As wage hikes are behind, management expects margin improvement on hopes of recovery in IT staffing and a decline in burn for PLB and North American operations. The management reiterated its guidance for the PLB to achieve EBITDA breakeven by 4QFY24. It anticipates margin recovery in the following quarters, given the expected strong growth and the stabilization of the cost structure. We however remain concerned on a delay in breakeven, given the adverse demand environment, which will weigh on near-term growth and risk a miss on the guidance.
- While the margin pressure continues, with QUESS's focused efforts on improving efficiencies, we expect EBITDA margin to gradually improve to 3.8%/4.3% for FY24/FY25. Accordingly, we expect a PAT CAGR of 79% over FY23-25, on a low FY23 base (down 35% YoY on poor margin performance).
- The tax disallowance of 80JAA deduction by the Income Tax Department is expected to remain as an overhang on the stock.
- Though QUESS should benefit from medium-term tailwinds of formalization and labor reforms, the growth has already been factored into the valuations. **We reiterate our NEUTRAL stance due to full valuations, taxation concerns, and weak macro. Our TP of INR440 implies 12x FY25E P/E.**

In-line revenue; PAT miss on lower margin and higher ETR

- Revenue was up 3.6% QoQ/15.6% YoY, slightly below our expectation of 4.4% QoQ/16.5% YoY.
- WFM grew 17% YoY; OAM grew 16% YoY; GTS grew 11.0% YoY; and PLB grew 8% YoY.
- Quess experienced a substantial increase in its overall headcount with the addition of 14k employees. Moreover, the company hired an additional 17k individuals to its workforce management business.



Bloomberg	QUESS IN
Equity Shares (m)	148
M.Cap.(INRb)/(USDb)	63.1 / 0.8
52-Week Range (INR)	673 / 337
1, 6, 12 Rel. Per (%)	-5/7/-38
12M Avg Val (INR M)	157

Financials & Valuations (INR b)

Y/E Mar	2023	2024E	2025E
Sales	171.6	200.1	237.4
EBITA Margin (%)	3.4	3.8	4.3
Adj. PAT	1.7	3.5	5.4
Adj. EPS (INR)	15.2	23.4	36.5
EPS Gr. (%)	(35.3)	103.9	56.3
BV/Sh. (INR)	226.7	235.5	263.0

Ratios

RoE (%)	6.8	13.3	19.3
RoCE (%)	8.6	13.7	19.2
Payout (%)	53.2	68.5	43.8
Dividend Yield (%)	1.9	3.8	3.8

Valuations

P/E (x)	37.1	18.2	11.6
P/BV (x)	1.9	1.8	1.6
EV/EBITDA (x)	11.0	8.6	6.2
EV/Sales (x)	0.4	0.3	0.3

Shareholding pattern (%)

As On	Jun-23	Mar-23	Jun-22
Promoter	56.7	56.8	51.8
DII	7.3	6.6	10.7
FII	17.1	17.9	22.0
Others	18.9	18.8	15.5

FII Includes depository receipts

- EBITDA margin was down 10bp to 3.3%, 20bp below our estimate of 3.5%. WFM EBITDA margin was down 20bp, due to a slowdown in permanent hiring, while GTS saw a good 110bp margin expansion.
- Adj. PAT decreased 22% YoY to INR 478m vs. our estimate of INR 669m, largely due to a margin miss and higher ETR (22.6% vs. 15% estimated).
- Net Cash stood at INR490m (down 60% QoQ; up 183% YoY).

Key highlights from the management commentary

- The business environment remains weak for IT and FMCG while BFSI, manufacturing, and telecom are expected to do well.
- The management indicated that implementing price hikes in the industry is not currently feasible. It mentioned that unless there is more consolidation and increased compliance among other players, raising prices would continue to be challenging.
- The profitability in the products business is in line with expectations. The cash burn in Foundit is expected to decrease in the upcoming quarters to breakeven by 4QFY24.

Valuation and View: reiterate NEUTRAL

- Though QUESS should benefit from medium-term tailwinds of formalization and labor reforms, the growth has already been factored into the valuations.
- We expect gradual recovery in margins over FY24 and FY25, which should support earnings.
- We reiterate our NEUTRAL stance on the stock due to full valuations, taxation concerns, and weak macro. Our TP of INR440 implies 12x FY25E P/E.

Consolidated quarterly performance

Y/E March	FY23				FY24				FY23		FY24E		
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE	FY23	FY24E	FY24	Var.	(INR m)
											1QE	(%/bp)	
Net Sales	39,793	42,733	44,656	44,402	46,002	49,347	52,018	52,738	1,71,584	2,00,106	46,360	-0.8	
YoY Change (%)	33.2	32.4	21.2	17.1	15.6	15.5	16.5	18.8	25.3	16.6	16.5	-90	
Total Expenditure	38,259	41,386	43,200	42,882	44,463	47,571	49,989	50,523	1,65,726	1,92,547	44,728	-0.6	
EBITDA	1,534	1,347	1,456	1,520	1,539	1,777	2,029	2,215	5,858	7,559	1,632	-5.7	
Margin (%)	3.9	3.2	3.3	3.4	3.3	3.6	3.9	4.2	3.4	3.8	3.5	-17.5	
Depreciation	610	676	695	765	686	700	700	715	2,746	2,801	696	-1.5	
EBIT	924	671	761	756	853	1,076	1,328	1,500	3,112	4,758	936	-8.8	
Margin (%)	2.3	1.6	1.7	1.7	1.9	2.2	2.6	2.8	1.8	2.4	2.0	-16	
Interest	204	263	290	309	272	250	250	228	1,066	1,001	249	9.6	
Other Income	72	88	67	36	41	100	100	159	263	400	99		
PBT before EO expense	792	496	538	483	621	926	1,178	1,432	2,309	4,157	786	-21.0	
Recurring Tax	115	100	217	183	140	139	177	215	615	671	118	19.0	
Rate (%)	14.6	20.1	40.3	37.9	22.6	15.0	15.0	15.0	26.6	16.1	15.0		
MI and P/L of Asso. Cos.	64	-24	-24	-31	3	0	0	0	-16	3	0		
Adjusted PAT	613	421	345	331	478	787	1,002	1,217	1,710	3,484	669	-28.5	
Extraordinary items	0	0	-535	0	0	0	0	0	-535	0	0		
Reported PAT	613	421	880	331	478	787	1,002	1,217	2,245	3,484	669	-28.5	
YoY Change (%)	32.7	12.0	5.0	-55.0	-22.0	87.1	13.8	267.4	-6.9	55.2	9.1	NM	
Margin (%)	1.5	1.0	2.0	0.7	1.0	1.6	1.9	2.3	1.3	1.7	1.4	-40	

Source: Company, MOFSL

Key performance indicators

Y/E March	FY23				FY24				FY23	FY24E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Headcount (k)	470	504	505	511	525				511	
Segment Revenue (INR m)										
Workforce Management	27,579	29,428	30,683	30,618	32,206				1,18,309	
Operating Asset Management	5,967	6,515	6,891	6,843	6,899				26,216	
Global Technology Solutions	5,074	5,287	5,607	5,710	5,633				21,678	
Product-led business	1,174	1,502	1,474	1,231	1,264				5,381	
EBITDA Margin (%)										
Workforce Management	3.4	2.7	2.8	2.8	2.6				2.9	
Operating Asset Management	5.1	4.3	4.5	4.4	4.5				4.6	
Global Technology Solutions	16.3	16.0	16.1	16.7	17.8				16.3	
Product Led business	(20.4)	(15.9)	(18.2)	(16.4)	(20.3)				(17.6)	

Source: Company



Key highlights from the management commentary

1QFY24 performance

- The business environment remains weak for IT and FMCG, while BFSI, manufacturing, and telecom are expected to do well.
- **WFM** was negatively impacted by a slowdown in permanent hiring (down 30% QoQ). Manufacturing contributed 50% of the new client wins and expects good demand in Manufacturing. PAPM was stable during the quarter (670-700). It is hiring in anticipation of a strong festive demand 2Q and 3Q. Though demand for IT services remains weak, it is seeing good demand from GCCs.
- **GTS** saw strong growth on the back of strong order book. F&A saw strong 59% YoY growth. CLM and the non-voice BPO also witnessed robust growth with revenues up 29% and 31%, respectively. The focus for the North America platform business will be to improve margins and expand its healthcare segment. It is planning to launch new HRO products over the coming quarters.
- In **OAM**, IFMS (facility management) saw good demand from manufacturing, BFSI, and public infra. The focus will be to grow in logistics, public infra, and healthcare. The headcount in securities business declined as it rationalized low margin clients. Expect strong demand from 5G roll-out to continue.
- In **PLB**, Foundit's performance aligns with the management's objectives to achieve breakeven in 4QFY24. With the cost structure now stabilized, the catch-up on revenues is expected to drive the break-even milestone (1Q is seasonally weak).
- Income tax matter pertaining to FY17-18 is with ITAT (hearing in current month), while the assessment for FY18-19 is at the DRP stage (order expected before Sept'23)

Margin

- For WFM, 1QFY24 margin was adversely impacted by merit increases, muted permanent hiring, and a slowdown in the North America business. The margin is expected to recover as IT has bottomed out, merit increases are behind, and high burn in North America is expected to moderate (highest in 1QFY24). This should help QUESS to recover margin to 2.8%, before reaching the 3% mark. Recovery in IT services and contribution from North America should help inch up margins to 3.2%. Though it is experiencing project delays in the North American business, the guidance to breakeven in 1HFY24 remains intact.
- For OAM, strong growth and cost reduction should aid margin. The margin can go up to 5.5%.
- The management indicated that implementing price hikes in the industry is not currently feasible. It mentioned that unless there is more consolidation and increased compliance among other players, raising prices would continue to be challenging.
- The profitability in the products business is in line with expectations. The cash burn in Foundit is expected to decrease in the upcoming quarters to break even by 4QFY24.

Valuation and View: reiterate NEUTRAL

- Though QUESS should benefit from medium-term tailwinds of formalization and labor reforms, the growth has already been factored into the valuations.
- We expect gradual recovery in margins over FY24 and FY25, which should support earnings.
- We reiterate our NEUTRAL stance on the stock due to full valuations, taxation concerns, and weak macro. Our TP of INR440 implies 12x FY25E P/E.

Exhibit 1: Revisions to our estimates

	Revised estimates		Earlier estimates		Change (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Revenue (m)	2,00,106	2,37,400	1,98,911	2,36,828	0.6%	0.2%
Rev. growth (%)	16.6	18.6	15.9	19.1	70bp	-42bp
EBITDA (m)	7,559	10,208	7,540	10,302	0.3%	-0.9%
EBITDA Margin (%)	3.8	4.3	3.8	4.4	-1bp	-5bp
EBIT Margin (%)	2.4	3.0	2.4	3.1	-1bp	-5bp
EPS (INR)	23.7	37.8	24.0	38.4	-1.2%	-1.6%

Source: Company, MOFSL

Financials and valuation

Consolidated Income Statement

(INR m)

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Total Income from Operations	61,673	85,270	1,09,896	1,08,370	1,36,918	1,71,584	2,00,106	2,37,400
Change (%)	42.9	38.3	28.9	-1.4	26.3	25.3	16.6	18.6
Cost of services	1,422	2,624	2,671	2,007	2,787	4,794	5,591	6,633
Employees Cost	50,793	67,132	90,632	92,968	1,16,870	1,46,595	1,70,964	2,02,827
Other Expenses	5,914	10,868	10,027	7,617	10,743	14,336	15,992	17,732
Total Expenditure	58,129	80,624	1,03,329	1,02,593	1,30,400	1,65,726	1,92,547	2,27,192
As a percentage of Sales	94.3	94.6	94.0	94.7	95.2	96.6	96.2	95.7
EBITDAs	3,544	4,646	6,567	5,777	6,518	5,858	7,559	10,208
Margin (%)	5.7	5.4	6.0	5.3	4.8	3.4	3.8	4.3
Depreciation	747	1,232	2,486	2,285	2,120	2,746	2,801	3,086
EBIT	2,796	3,414	4,081	3,491	4,397	3,112	4,758	7,122
Int. and Finance Charges	755	1,144	1,668	1,113	792	1,066	1,001	1,187
Other Income	569	712	511	451	198	263	400	475
PBT bef. EO Exp.	2,611	2,983	2,924	2,829	3,803	2,309	4,157	6,410
EO Items	0	0	6,641	1,388	0	-535	0	0
PBT after EO Exp.	2,611	2,983	-3,717	1,442	3,803	2,844	4,157	6,410
Total Tax	-483	329	483	590	1,066	615	671	961
Tax Rate (%)	-18.5	11.0	-13.0	40.9	28.0	21.6	16.1	15.0
Minority Interest	-4	88	138	114	98	-16	0	0
Adjusted PAT	3,098	2,565	2,609	2,125	2,640	1,710	3,487	5,448
Change (%)	147.0	-17.2	1.7	-18.5	24.2	-35.2	103.9	56.3
Margin (%)	5.0	3.0	2.4	2.0	1.9	1.0	1.7	2.3

Consolidated Balance Sheet

(INR m)

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Equity Share Capital	1,455	1,461	1,475	1,477	1,480	1,482	1,482	1,482
Total Reserves	23,153	25,795	21,284	21,954	22,898	24,205	25,212	28,321
Net Worth	24,608	27,256	22,759	23,431	24,378	25,688	26,694	29,803
Minority Interest	16	31	769	939	1,310	1,621	1,621	1,621
Total Loans	9,662	7,502	9,976	4,514	5,877	5,311	5,301	5,293
Deferred Tax Liabilities	-3,647	-5,046	-6,166	-4,061	-3,983	-5,275	-5,275	-5,275
Capital Employed	30,638	29,742	27,339	24,823	27,582	27,343	28,341	31,441
Gross Block	7,485	8,152	9,295	10,857	13,806	16,160	18,360	21,560
Less: Accum. Deprn.	2,126	3,357	5,843	8,129	10,249	12,995	15,797	18,883
Net Fixed Assets	5,359	4,795	3,451	2,728	3,557	3,165	2,563	2,677
Goodwill on Consolidation	10,959	11,769	8,358	9,890	10,096	10,427	10,427	10,427
Capital WIP	22	147	46	309	153	181	200	220
Total Investments	888	820	725	41	17	17	17	17
Curr. Assets, Loans, and Adv.	28,111	27,540	34,439	30,173	35,904	41,429	50,394	59,118
Inventory	85	221	284	290	275	282	282	282
Account Receivables	9,207	9,132	9,982	8,945	23,323	26,886	35,635	42,277
Cash and Bank Balance	5,661	5,855	7,587	5,646	4,105	4,376	3,740	5,031
Loans and Advances	13,159	12,333	16,586	15,292	8,201	9,886	10,737	11,529
Curr. Liability and Prov.	14,701	15,328	19,681	18,317	22,145	27,876	35,260	41,018
Account Payables	1,481	1,729	1,633	1,212	1,154	1,249	4,748	5,602
Other Current Liabilities	12,166	12,351	16,494	14,983	18,258	23,546	26,810	31,026
Provisions	1,054	1,248	1,554	2,122	2,733	3,080	3,703	4,391
Net Current Assets	13,411	12,212	14,759	11,856	13,759	13,554	15,133	18,100
Appl. of Funds	30,638	29,742	27,339	24,823	27,582	27,343	28,341	31,441

Financials and valuation

Ratios

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Basic (INR)								
EPS	21.8	17.5	18.3	14.9	17.7	11.5	23.4	36.5
Cash EPS	27.1	25.9	35.7	30.8	31.9	29.9	42.1	57.2
BV/Share	217.1	240.5	200.8	206.7	215.1	226.7	235.5	263.0
DPS	0.0	0.0	0.0	7.0	8.0	8.0	16.0	16.0
Payout (%)	0.0	0.0	0.0	135.7	45.2	53.2	68.5	43.8
Valuation (x)								
P/E	19.5	24.3	23.3	28.6	24.0	37.1	18.2	11.6
Cash P/E	15.7	16.4	11.9	13.8	13.3	14.2	10.1	7.4
P/BV	2.0	1.8	2.1	2.1	2.0	1.9	1.8	1.6
EV/Sales	1.0	0.7	0.6	0.6	0.5	0.4	0.3	0.3
EV/EBITDA	18.2	13.8	9.6	10.3	10.0	11.0	8.6	6.2
Dividend Yield (%)	0.0	0.0	0.0	1.6	1.9	1.9	3.8	3.8
FCF per share	1.1	7.2	21.3	45.7	31.6	24.6	15.4	28.1
Return Ratios (%)								
RoE	16.5	9.9	10.4	9.2	11.0	6.8	13.3	19.3
RoCE	14.6	10.6	15.4	7.7	11.4	8.6	13.7	19.2
RoIC	17.0	12.9	22.0	10.9	15.0	10.6	16.9	23.9
Working Capital Ratios								
Asset Turnover (x)	2.0	2.9	4.0	4.4	5.0	6.3	7.1	7.6
Debtor (Days)	54	39	33	30	62	57	65	65
Creditor (Days)	9	7	5	4	3	3	9	9
Leverage Ratio (x)								
Net Debt/Equity ratio	0.1	0.0	0.1	-0.1	0.1	0.0	0.1	0.0

Consolidated Cash Flow Statement

(INR m)

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
OP/(Loss) before Tax	2,615	2,566	-4,319	737	2,510	2,229	4,216	6,609
Depreciation	747	3	2,486	2,285	2,120	2,746	2,801	3,086
Interest and Finance Charges	755	1,144	1,668	1,113	550	1,066	848	794
Direct Taxes Paid	-744	-1,750	-1,449	1,648	-869	-1,994	-671	-961
(Inc.)/Dec. in WC	-1,858	-1,248	-1,933	-464	-307	-231	-2,214	-1,676
CF from Operations	1,515	714	-3,547	5,319	4,004	3,816	4,980	7,851
Others	-428	1,302	7,157	1,835	1,538	846	-456	-431
CF from Operations incl. EO	1,087	2,016	3,611	7,154	5,542	4,663	4,524	7,421
(Inc.)/Dec. in FA	-928	-957	-570	-613	-833	-987	-2,220	-3,220
Free Cash Flow	159	1,058	3,041	6,540	4,709	3,676	2,304	4,201
(Pur.)/Sale of Investments	-1,808	-117	732	-144	-390	485	0	0
Others	-5,333	2,898	-1,865	-295	-653	543	0	0
CF from Investments	-8,069	1,823	-1,703	-1,052	-1,876	41	-2,220	-3,220
Issue of Shares	8,485	5	478	2	628	352	0	0
Inc./(Dec.) in Debt	1,785	-74	2,197	-6,312	720	-567	-9	-9
Interest Paid	-665	-865	-1,158	-737	-553	-640	-848	-794
Dividend Paid	0	0	-144	0	-1,868	-1,855	-2,388	-2,388
Others	0	-2,706	-1,244	-997	-3,842	-2,530	-501	-526
CF from Fin. Activity	9,605	-3,640	129	-8,045	-4,916	-5,239	-3,747	-3,717
Inc./Dec. in Cash	2,622	199	2,037	-1,943	-1,250	-536	-1,443	484
Closing Balance	5,661	5,860	7,589	5,646	4,105	4,376	3,741	5,031

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NOTES

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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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