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Initiating Coverage

Quess Corp Ltd.

30-December-2020

RETAIL RESEARCH

Quess Corp Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Business Services	Rs 535.7	Buy at LTP and add on dips to Rs 483-489 band	Rs 587	Rs 637	2 quarters

HDFC Scrip Code	QUECOREQNR
BSE Code	539978
NSE Code	QUESS
Bloomberg Code	QUESS: IN
CMP Dec 29, 2020	535.7
Equity Capital (Rs cr)	148
Face Value (Rs)	10
Equity Share O/S (cr)	14.8
Market Cap (Rs cr)	7912
Book Value (Rs)	154.3
Avg. 52 Wk Volumes	795237
52 Week High	639
52 Week Low	165.4

Share holding Pattern %	(Sep, 2020)
Promoters	55.25
Institutions	31.25
Non Institutions	13.5
Total	100.0

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Our Take

Quess Corp is the no.1 player in temporary staffing space and 4th largest staffing company globally. It also offers facility management and industrial asset management services to diverse end users. Quess had a team of ~384,000 employees across India, North America, South America and South-East Asia across all segments and serves over 2600+ clients worldwide as on Mar-2020. As on Sep-2020, the total headcount registered steep decline and stood at 3,25,000 due to Covid-19.

We like Quess Corp due to 1) strong growth potential from all of its verticals 2) series of acquisitions in the last 2-3 years across all verticals 3) Focus on margin accretive growth and also on free cash generation. Management has reiterated at a target of ~20% RoE and ~20% YoY OCF (Operating Cashflow) growth over the next 3 years. They have also indicated that goodwill impairment may not be required any further. Management indicated that impact on operations in Apr-May'20 was not as bad as initially feared. Having large enterprises as customers and limited exposure to SMEs has helped the company in navigating through this crisis.

In general staffing, Quess remains focused on volume growth through new client additions. Renewed sales engine, focus on new acquisitions (enterprise, tech, SE Asia), rebuilding/modernizing talent, reinforcing performance culture and digital marketing are the key priorities in Monster. Faster collections, project closures and reducing capex intensity will be the key objectives in training and development. New management team is making encouraging efforts to address investor concerns around areas like governance, capital allocation, etc. We see the balance sheet rationalization, progress on exit from unrelated businesses (e.g. East Bengal Club) and the resultant improvement in return ratios as key positives. We think that past concerns like related party loans, Trimax project receivables, higher working capital cycle, Monster acquisition (EBITDA loss) and recent Covid-19 impact are almost priced in the stock. Company's core business continues to grow well along with its acquired companies except Monster. Given the superior quality of Quess' general staffing business, IT staffing, Facility management and GTS business segments, we feel that the stock deserves better valuations.

View & Valuation

Quess has registered ~36% revenue CAGR over FY17-20 while EBITDA has grown at 40% CAGR over the same period. Company continues to grow with organic and Inorganic routes with about 25 acquisitions since inception. Net profit has posted 28% CAGR due to higher finance cost. Quess has acquired companies at reasonable valuations and then turned around well. Constant inorganic expansion has resulted in 50% CAGR in revenues over FY11-20. Quess has huge advantage of scale in general staffing with largest market share in India.

Quess Corp Ltd.

It’s a pure bet of an asset-light business model with presence across varied business where the opportunity size is mammoth. In longer term, we believe, it is a unique integrated business model with a strong multi-decade compounding growth visibility.
We believe that FY21 would be a tough year for the company given Covid related disturbances. We think that margin for the year could see moderation and so on profitability. We project 7%/14% revenue/EPS CAGR over FY20-23E. We think that the company would return to normal business environment from FY22 onwards. Regulatory easing in the labor markets could result in structural decline in hiring / compliance / workforce management costs in the formal sector. Over the medium to long term, this should translate into higher formality in the labor market. Sectors such as IT/ITES, BFSI and Retail would in turn drive a higher need for flexi/temp staffing. Accordingly, we believe organized players like Quess, TeamLease etc. would be the key beneficiaries of these reforms. Continuous strengthening of balance sheet and improvement in corporate governance remain key re-rating triggers.

Substantial improvement in EBIDTA margin and thus profitability would be a key lever for the stock in the medium term. Management has maintained its thrust on improving cash flows and strengthening the balance sheet in the medium term. In Q4FY20, the company paid higher tax as it has now decided to move to the new tax regime offered under section 115BAA. As both the central and state governments look forward to liberalizing and formalizing the labor markets, Quess should be among the biggest direct beneficiaries. Factors such as (1) Formalisation of jobs, (2) Vendor consolidation, (3) Focus on collect & pay (4) Cost-cutting by Enterprises, and (4) Client diversification will benefit market leaders like Quess Corp. Efforts by the management to resolve capital allocation issues will be appreciated by investors. Financial deleveraging should aid fast growth in earnings. At CMP, Quess trades at ~26x FY22E earnings and 20x FY23E earnings (around 30% discount to Teamlease - negatives related to capital allocation are priced in). Quess’ valuations could re-rate as it simplifies its structure and balance sheet. We feel investors can buy Quess at LTP (26.5x FY22E EPS) and add on dips to Rs 483-489 band (24.0x FY22E EPS)) for base case fair value of Rs 587 (29.0x FY22E EPS) and bull case fair value of Rs 637 (31.5x FY22E EPS) over the next two quarters.

Quess Corp Ltd.

Financial Summary

Particulars (Rs cr)	Q2 FY21	Q2 FY20	YoY (%)	Q1 FY21	QoQ (%)	FY19	FY20	FY21E	FY22E	FY23E
Total Revenues	2615	2650	-1.3	2409	8.6	8,527	10,991	10,589	12,001	13,379
EBITDA	140	161	-13.4	130	7.7	465	658	570	702	822
Depreciation	58	65	-11.3	59	-2.7	123	249	245	261	282
Other Income	24	16	52.8	8	219.7	71	51	57	62	68
Interest Cost	32	46	-29.8	38	-14.8	114	167	131	104	79
Tax	32	0	-	18	78.7	33	47	56	78	111
APAT	50	65	-23.1	37	37.0	257	267	209	298	394
EPS (Rs)						17.6	18.0	14.2	20.2	26.7
RoE (%)						9.9	10.7	8.8	11.4	13.3
P/E (x)						30.3	29.4	37.6	26.4	19.9
EV/EBITDA						15.6	11.1	12.8	10.4	8.8

(Source: Company, HDFC sec)

Revenues (Rs cr)	Q2 FY21	Q2 FY20	YoY (%)	Q1 FY21	QoQ (%)	H1 FY21	H1 FY20	YoY (%)
Workforce Management	1686	1667	1.1	1618	4.2	3304	3157	4.7
Operating Asset Management	427	432	-1.2	368	16	795	859	-7.5
Tech Services	502	551	-9	423	18.6	925	1031	-10.3
EBITDA Margin (%)			**bps**					**bps**
Workforce Management	3.7	5.5	-90	3.7	-	3.7	5.7	-200
Operating Asset Management	7	6.7	30	7.1	-15	7.0	7.1	-10
Tech Services	13.4	11.5	190	13	40	13.2	10.6	160

Q2FY21 result update

Quess' revenues stood flat yoy at Rs 2,615 crore in the second quarter, but improved by 9% on qoq basis. The qoq rise was driven by General Staffing, Conneqt, Qdigi and inorganic revenue growth from Terrier. Operating margin fell by 75 bps to 5.3%. Higher other income and fall in interest expense drove up pre-tax profit by 12% to Rs 74crore. Company reported 25% yoy dip in PAT at Rs 50cr due to higher tax expenses on yoy basis.

Quess Corp's revenues remained almost flat in H1FY21 with some of the business verticals posting decline in revenues due to reduction in the workforce (especially in the retail and BFSI segments). Operating profit declined 13% yoy on higher employee benefit expenses even though other expenses were down by 35% during H1FY21. Company registered 4% rise in pre-tax profit while PAT declined 30% yoy on higher tax expenses. With easing of lockdown norms, the company has seen good recovery in e-commerce, BFSI and logistics segments in terms of General staffing business. Technology services and operating asset management (OAM) businesses have seen sequential improvement. The company is focusing on maintaining stable cash flows and reducing cost in the current environment (reduced indirect cost by 24% as compared to Q4FY20). Thus, FY21 is expected to see an impact of subdued business environment but we expect strong recovery in FY22 with strong increase in headcounts and client additions.

General Staffing business' revenue rose by 5.3% qoq, with 23 clients getting on-boarded. Headcount grew in September as compared to August and stood at 2,16,000 as on Q2FY21 (qoq reduction of 3% compared to 13% in Q1). Domestic IT staffing business EBITDA improved compared with Q4FY20 despite 10% headcount reduction, with significant margin expansion. Singapore and Middle East operations continue to perform strongly. Training & Skill Development revenues were down by 84% and EBIDTA was down 17% due to closure training facilities during the lockdown. The segment has started operations in most states with easing of lockdown norms. Improvement in the performance training & development segment will also help margins of the workforce management (WFM) business improve in the coming quarters.

Key Triggers:

Leading player in the staffing space with presence across verticals

Quess Corp has transformed itself very well over the past 4-5 years. The company had started out as just an HR-outsourcing company, and now it caters to multiple non-core business requirements of corporates. It continues to grow in its existing group of companies, while adding new companies wherever it sees opportunities. In the organised sector, Quess is the industry leader in most of the segments in which it operates. The organised sector makes up only 20-30% of the overall industry. However, with the introduction of GST, unorganised players are expected to face issues that will eventually increase the share of the organised players. This, coupled with the fact that the Government is inclined to introduce changes with regard to skill development and labour law reforms, are all expected to work in the company's favour.

Quess has a track record of successful series of acquisitions, which have been key enablers for the company to diversify into new service lines and geographies, as well as drive revenue growth and profitability. It has also been constantly de-risking its business model with no concentration in terms of segmental and sectoral exposure. Quess has made successful acquisitions and grown inorganically by extracting value from the acquired companies. But at the same time, it has also grown organically. We believe Quess has good potential to further grow in all the segments.

Shift of focus toward RoE improvement

The company indicated that key focus going forward will be on RoE improvement at contract/individual business unit level. The focus will be on these rather than the EBITDA margin targets. Over time, the company intends to divest businesses that do not meet the RoE threshold, which is at ~20%. It is in the process of taking further corrective actions by divesting non-core businesses which mainly include the football club and exiting venture Dependo Logistics that are yielding sub-optimal returns. Quess also hinted at further headroom for an improvement on asset turns. At the company level, RoE of ~20% is aspired to be achieved by FY23. Strengthening governance, improving capital allocation and balance sheet lightening are the other key priorities of the new CEO.

Clients' retention

Quess has over the years established long-term relationships with its clients, leading to recurring business. The high client retention levels reflect the value provided by Quess' services as well as the company's ability to deliver in accordance with client requirements. Such long term, established relationships have helped the company grow with client needs, increase its market share, and reduce the revenue uncertainty associated with the short-term nature of most of its client contracts.

Changing industry trends

With newer technologies coming up and the rising costs associated with training and development, skills upgradation, etc. companies are choosing to outsource non-core organisational work to professionals. Thus, reducing the costs related to training of employees, HR related activities, etc. This is where companies like Quess step in. While Quess has already invested in the required technology and digital platforms, they can service multiple clients through these existing channels. This way with existing fixed costs, they can achieve economies of scale.

Company has divided its operations in the three segments: a) Workforce Management b) Operating Asset Management (OAM) and c) Global Technology Solutions

Workforce Management (WFM)

The segment provides comprehensive staffing services and solutions which includes general staffing, recruitment and executive search, recruitment process outsourcing, as well as payroll, compliance and background verification services under the IKYA and Coachieve brands. Quess also provides training and skill development services through 100+ centres spread across 10+ states in India under Quess' Excelus brand, in partnership with the Government of India. Quess' WFM segment also includes a couple of high-margin businesses, such as Training & Skill Development and Recruitment Services and that's why the margins are closer to 5.5%, whereas TeamLease' at around 2%.

In FY20, the segment revenue increased 42% yoy at Rs 7154cr led by strong headcount growth. It was mainly driven by strong headcount growth in General Staffing which is the oldest and organic service line. In the segment, the total headcount crossed 2.55 lakhs as on Mar-2020. EBITDA margin dipped 70bps yoy at 5.4%. Company derived 89% revenues from India while 11% from South East Asia. WFM is the biggest contributor to overall revenue, contributing around 65% of total revenues in FY20. Company improved the collect & pay to credit contracts to 72:28 in FY20 from 65:35 in FY19.

In H1 FY21, WFM revenues grew 4.7% yoy at Rs 3304cr. Margin for the segment contracted by 200bps to 3.7% due to competitiveness and change in revenue mix. As on Sep-2020, associate headcount stood at 2,16,000. Company added 23 new clients in general staffing segment.

Quess' WFM segment offers expertise in General Staffing, IT staffing, Skilling and learning solutions, Digital compliance solutions and Logistics services. In terms of scale and reach, it has successfully established a pan-India presence with 65 branches. Further, with a total team size of 3,578 members, Quess Corp is one of the few players in India to handle large-sized payrolls, i.e. clients with more than 10,000 employees. IT staffing business, earlier known as Magna Infotech, is India's largest IT staffing company with over two decades of experience in recruiting IT professionals for more than 400 companies, across multiple levels and profiles. The IT staffing business added nearly 207 new customers in India and ~100 unique customers globally. Company plans to expand IT staffing beyond the BFSI industry in Singapore and introduce new general staffing services with a dedicated team through time-tested Hire-to-Deploy Model.

Simpliance is India's largest digital compliance platform for labour law consolidating the numerous acts, rules, Govt. notifications and minimum wage codes. Company provide technology-based governance, risk and compliance (GRC) solutions to organizations ranging from large corporates to start-ups. Simpliance GRC Solutions registered more than 1.04 lakhs users across manufacturing, consulting, logistics, IT & ITES, telecom, media and retail sectors.

Key growth drivers for WFM

This business has strong growth prospects, given the low penetration rates of temporary staffing in India as well as ample supply of manpower being added to the labour force every year. Quess has also benefitted from a shift in mix towards relatively higher-earnings associates (e.g. driven by the e-commerce boom), which too has led to increase in revenue per associate. General staffing is by far the lowest-margin business still the company managed to earn EBITDA margin of 5.4% in FY20. Quess has consistently tried to move profit margins upward in this business, by offering relatively higher-value services such as recruitment and attendance, in addition to plain-vanilla payroll services. In addition, company also does greater proportion of its business under the pay-and-collect model, which is relatively working capital intensive. Quess' margins in its general staffing business are higher than those of Team Lease, its listed peer, whereas Quess' working capital needs are also higher.

Global Technology Solutions (GTS)

Global Technology Solutions segment provides a host of IT/ITeS support services viz. customer lifecycle management, business process management, IT staff augmentation, IT infrastructure managed services, IT products, digital solutions and after-sales support services. Quess offers these services across India, South-East Asia and North America. GTS business comprises ~18% of the total revenues share and 41% of its overall EBITDA in H1FY21. Quess is the largest IT staff augmentation provider in India, and also operates the largest independent IT staffing firm in Singapore through its subsidiary - Comtel Solutions. The associate headcount in the company's professional IT staffing operations stood at approximately over 21,000 as on Mar-2020. Revenues for the GTS segment grew ~15% at Rs 3241cr. EBITDA margin improved 190bps at 9.8%. Company derived ~72% of the segment revenues from India and the balance from North America with BPM contributing to 67% of business and Digital IT Services 33%. Top-10 clients contributed to 46% of the GTS revenues in FY20. BFSI and IT/ITES both segments contribute to ~58% of GTS revenues.

In GTS division, the company provides service in Business Process Management (BPM) and Digital IT services. Continuous focus on client acquisition and operational transformation led to significant value accretion in both North America and India. Quess GTS has left an indelible mark in North American Insurance industry through longstanding partnerships with Global P&C insurance majors. The proprietary InsureTech platform in MFX, spanning insurance business value chain across submission, policy, underwriting, claims and corporate records transact more than US$ 3bn of premiums through the platform annually. Qtek Systems complements Digital IT Services offerings in the domestic market, through a focused play in cloud, Infrastructure Management and Cyber Security Services space. Over the 2 years since its inception, it has been one of the fastest growing players in the Indian market.

Digicare is a leading player in India’s after-sales service and support market for consumer products like mobile phones, electronics and durables with facilities for repairing 1.5+ million mobile phones and electronic appliances. It has a mix of in-centre & home service revenue streams through partnerships with marquee OEMs and e-tailers, to serve consumers across 500+ cities in India. Quess and Digicare executed an investment agreement with Amazon for Rs 51cr. Amazon’s investment in the company would be utilized for the rapid expansion of its service network and adding new service lines & product categories to strengthen the technology platform.

Conneqt is amongst top two BPM providers in India and has strong customer relationships with leading business houses in India. The acquisition of Allsec Technologies helped company to deepen presence in CLM segment and acquiring a market leading foothold in HRO Segment. Allsec has created significant salience in HRO market through SaaS based outsource payroll solution. Allsec employs 400+ full time employees and provide services to 400+ companies across 30 countries in Middle East, South Asia, Africa and Asia.

With a database of more than 65 million registered users, around 2.7 million job views per month and about 11.1 million site visits per month, Monster.com is one of the premium job portals catering to India, South East Asia and the Middle East, offering a host of services for recruiters and job seekers.

Operating Asset Management (OAM)
Quess offers a wide range of services including Integrated Facilities Management (IFM), Security, Industrial O&M, Utilities and Telecom services in the segment. Quess provides service in the industries such as IT & Education (37% of OAM revenues), Industrial (22%), BFSI (13%) and the balance from others. Company manages nearly 258 mn sq. ft. of workspace for 700+ customers across 2,200 client sites. With more than 33 offices across 22 cities in India and an employee base of around 68,000, the company provides facility management services to some of the renowned corporates in India.

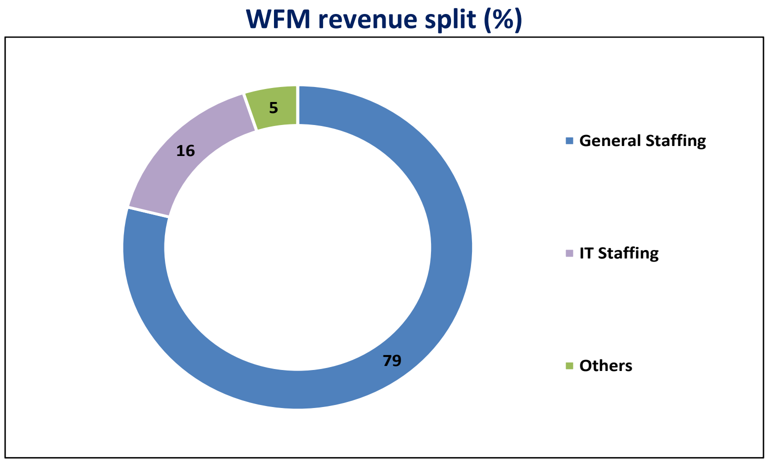
Quess Corp Ltd.

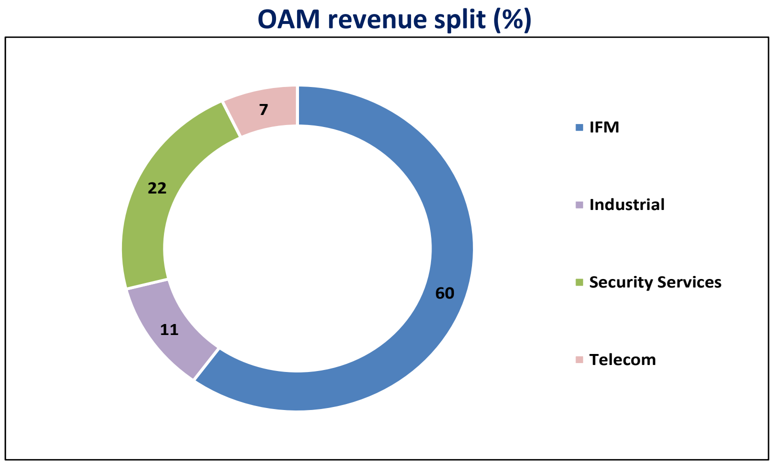
Quess is the leading integrated facility management provider in India. Within OAM segment, facility management business is the largest revenue contributor with around 60% of OAM segment. Quess offers a host of services including soft services (housekeeping), hard services (technical services or utilities), food & hospitality (industrial catering), pest control, manned guarding and landscaping. Quess Corp is amongst the Top-3 players in India. Quess provides facility management & security services to companies operating across sectors like banking & financial services, healthcare, education, airports, real estate & property management, manufacturing, information technology, FMCG and travel & tourism.

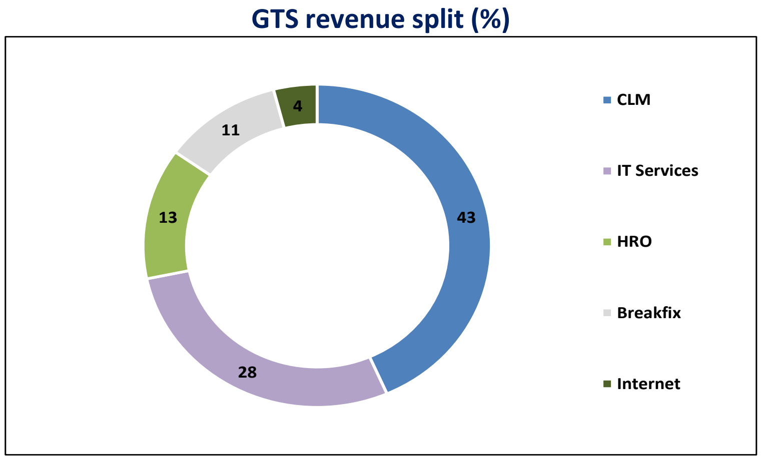
Revenues for the segment grew 2% yoy at Rs 1734cr in FY20. Increased acceptance of outsourcing non-core activities and sustained commercial and office space absorption have been significant for the growth of this segment in India. The Facility management market is now shifting from a single-service contract model to an integrated model. An increase in consumables, manpower and management costs have impacted the cost of FM services, forcing customers to replace long-term contracts and providing momentum for integrated facility management contracts in India. With operations spread across 35 sites in 11 states of India and international presence in the Middle East, Africa and Malaysia, the company provides O&M services to more than 45 steel and power companies with cumulative capacity of 40 metric tons and 470 MW respectively.

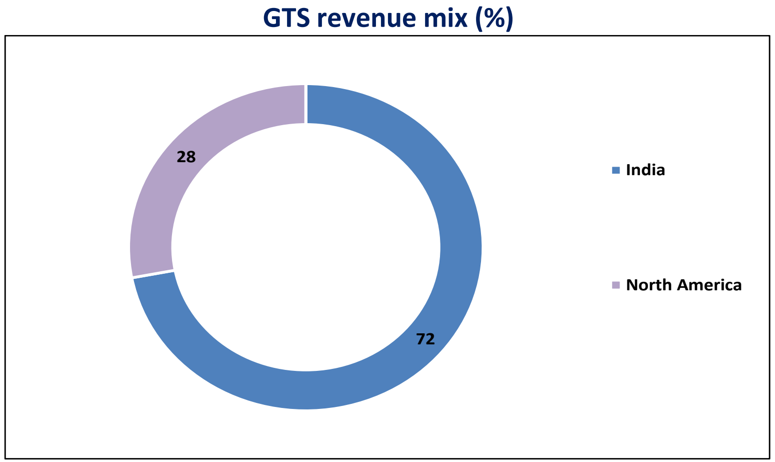
On the industrial side, Quess is among the leading players in the Plant Asset Management whereby it provides comprehensive solutions in industrial operations and maintenance along with managed services. Provides technology and consulting business (high margin in nature) to oil and gas companies. Terrier, Quess' security services arm, is one of leading integrated security solutions providers. It provides security solutions that include technology-enabled manned guarding, e-surveillance, command center-led business solutions, perimeter intrusion detection, intelligent protection and total loss prevention. With about 20000 security guards and PSARA license in 19 states, the company provide services to schools, colleges, banks, corporate offices and large public events.

Quess Corp Ltd.









Source: Company, HDFC sec Research

Quess Corp acquired 61% stake for Rs 271cr in Allsec Technologies

Allsec Technologies is the second largest Payroll Service Provider in India. The acquisition got concluded in Q2FY20. Now, Quess through Conneqt Business Solutions holds ~73% stake in the company. This acquisition underlines Quess' ability to quickly build scaled global business platforms. Through this transaction, Quess has the opportunity to leverage Allsec's global presence as well as their deep domain expertise in the HRO business to further deepen client relationships to drive growth and profitability for both Tata Business Solutions (Conneqt) and Allsec. Apart from the business synergies, the transaction was accretive to both Conneqt and Quess from margins, cash flow conversion as well as RoCE perspective thereby creating long term value for shareholders. It has been the goal for the company to increase the revenue share of the customer life cycle management platform because it's a higher margin business. After the completion of the deal, Quess added two service lines in the customer life cycle management and the human resource operations segment. Almost two years ago, Quess had entered into an agreement to acquire 51% stake in Conneqt (Tata business solutions). Quess had paid Rs 153cr cash consideration for the acquisition.

Allsec is into mainly two segments 1) Customer lifecycle management (CLM) and Human Resource Outsourcing (HRO). CLM contributed to ~70% of revenues and the balance from HRO. Revenues for H1FY21 declined 13% yoy at Rs 132cr. HRO business reported revenues of Rs 48cr and Digital business stood at Rs 84cr. EBITDA margin witnessed 620bps yoy compression at 20% due to lower revenues and Covid expenses & forex loss. Company had headcount of 3901 as on Sep-2020. Cash and investments increased by Rs 13.6cr to Rs 171.2cr as on Sep-2020 from Rs 157.6cr in March-2020. Total receivables reduced from Rs 45cr in March 2020 to Rs 37.5cr in Sep-2020. Receivable days reduced to 50 days from 56 days in March 2020.

Amazon had invested Rs 51cr in the company in Jul-2019

In Jul-2019, Amazon announced an equity investment of Rs 51cr in QDigi, which is a subsidiary of Quess Corp. Quess Corp had approved issuance of 7.55 lakh equity shares (0.51% stake) at Rs 676 per share on preferential basis. QDigi, earlier a subsidiary of HCL Infosystems, is an after-sales service provider for product categories such as mobile phones, consumer electronics and consumer durables in the customer lifecycle management space. Also, as a part of the deal, Amazon has also taken certain rights in Qdigi. This includes a right of first refusal that gives it the option to be the first to purchase or buy in Qdigi before Quess tries to sell it to a third party, non-compete and a right to acquire it in the future. It has an extensive service network across the country and provides end to end support services with over 200 authorized service centers and has a network of 80 walk-in centres. It has strong relationships with leading smart phone makers and consumer durable companies with over 2 millon repairs annually.

Quess did impairment of goodwill/intangibles in Q4FY20

In Q4FY20, organic/overall revenue increased 27%/30% YoY, largely led by general staffing segment (67% YoY) while performance in other key segments remained modest. EBIT margin contracted ~30bps QoQ to 3.6%, largely due to COVID-19 impact on BPO utilizations and the food catering businesses. Besides an improvement in key operational metrics and revenue run-rate, Monster also came close to EBITDA break-even during Q4FY20. The company made one-off non-cash write-downs in (a) goodwill consolidation (Rs 510cr), (b) intangible assets (Rs 130cr), and (c) East Bengal Club investments (Rs 35cr).

Company has done 25 acquisitions in its 13 years of existence, the company accumulated goodwill assets worth Rs 1,335 crore and other intangible assets worth ~Rs 278 crore on its books, as of March, 2020, together accounting for more than half the company's total long-term assets. The management's rationale behind the series of acquisition deals was to diversify into different verticals and geographies by turning around acquired companies.

While goodwill impairment was taken across businesses like MIS, Allsec, Vedang, Trimax, MFXchange and intangibles impairment was taken in MIS, Allsec and Vedang. Presence of the unjustifiable goodwill/intangibles on the balance sheet resulted in a drag on return ratios and was one of the key concerns. RoE has declined to ~11% in FY20 from 37% in FY15. This corrective should rationalize the balance sheet and improve return ratios. As the company is migrating to the new tax regime, it had written down MAT credit (Rs 120cr). Adjusted for these one-off non-cash write-downs and tax impact, PAT came in at ~Rs 70cr in the quarter. Quess has roped in Mr. Suraj Moraje as Group CEO and ED. He had spent two decades with McKinsey & Company before joining Quess Corp in Nov-2019. Company roped in another two persons Mr. Sekhar Garisa as Chief of Emerging business and corporate development and Mr. Joy Kurien as Group Chief Technology Officer. Quess said that it has terminated of JV between QEBC and East Bengal football club from May-2020.

Trimax receivables to be collected in the medium term

Overall exposure to Ahmedabad smart city project (Trimax) is at ~Rs 230cr, while Quess has recovered ~Rs 98cr as on Mar-2020. Trimax executed an agreement with Smart City Ahmedabad Development Limited (SCADL), a government undertaking for supply, installation, commissioning and operation & maintenance for a pan-CIT infrastructure and intelligence command and a control centre for the Ahmedabad Smart City Project.

Near Term Triggers

Company believes Indian corporates are now increasingly opening up to the idea of temporary hires (concept is prevalent in western economies). In fact, some of its clients are replacing their trimmed permanent staff with temporary hires. The staffing industry is likely to consolidate towards larger vendors who not only can survive events like Covid-19 but also provide value-added services. Quess is well-placed to benefit from these trends due to its strong positioning (largest player in India).

With about 83% of the total workforce in India working in the informal sector, labour reforms are expected to have a profound impact on the flexi-staffing industry. India has one of the largest staffing markets globally and due to policy reforms, around 11 million jobs shall be formalised by 2021. Along with that, introduction of GST and demonetisation have also significantly contributed to the overall flexi-staff size.

Growth of E-commerce

In terms of flexi adoption, E-commerce is one of the highest growing segments creating high demand for workers in customer service centers, and delivery stations, particularly during festivals and sale period. One of the key factors driving the growth of the industry is the seasonality of e commerce business. Andhra Pradesh, Gujarat, Rajasthan and Madhya Pradesh are some emerging states experiencing the growth in e-commerce businesses.

GST – shift from unorganised to organised helps players like Quess

The rollout of the Goods and Services Tax (GST) has led to a structural shift towards organised players and create a level playing field between unorganised and organised players. Prior to GST implementation, clients were getting tax credits for payment made to unorganised flexi staffing players irrespective of whether the unorganised players were actually making statutory employee payments or not. Hence, unorganised players were offering flexi staffing services at cheaper rates compared to organised players Post GST, the client would be able to claim input tax credit only when taxes and statutory payments are made by flexi staffing players due to the bill matching mechanism in GST era. Hence, we believe unorganised players would have to comply with statutory requirements to survive in the industry. These changes would narrow the pricing difference between unorganised and organised companies, thereby benefiting organised listed players Quess Corp, Teamlease and SIS.

Long Term Triggers

Flexi-staffing offers an interesting proposition for both employees as well as employers. While employees have the option to work as and when they feel like, companies have an option to recruit 'on a need' basis, rather than on a permanent basis. Also, companies can hire extra employees according to their requirement and employees also gain much needed experience and training within short periods. Recruitment and replacement also becomes easier with temporary staffing solutions.

The demand for emerging technology such as Artificial Intelligence, Machine Learning and Big Data is quite high in the IT industry. Based on project requirements, companies can hire flexi-staffing staff to meet varied requirements. A flexi-workforce also allows a company to retain its competitive edge. E-commerce companies also prefer flexi-staff to meet their seasonal requirements. Labour reforms are likely to aid the staffing sector and bolster growth. Labour reforms like the New Wage Code and the National Floor Minimum Wages are expected to be introduced in the short term and it is expected to favour people bound by contractual employment terms [like abolishing The Contract Labour (Regulation & Abolition) Act, 1970]. It will also increase the adoption of flexi-staffing. Although, many companies are now apprehensive about the flexi-staffing culture, new laws and labour reforms are likely to make the process transparent and simple.

IT Flexi Staffing Industry

With more companies reducing their bench strength, removing people who are not working on ongoing projects, the Indian IT industry is renewing its push towards flexi staffing. The sector's flexi workforce is expected to grow to 720,000 by 2021 from half a million in 2018, registering an increase of 44%. This is largely driven by increasing demand for digital technology skills, a waning bench and cost-efficiency mandates. Growth in flexi workforce is helping to deliver projects faster and is also shifting the trend beyond legacy businesses, thereby prompting automation across ranks and employee operation levels.

People with skills in artificial intelligence, machine learning and other emerging skills want to be a part of the gig economy and companies are also seeking faster deployment for certain niche skills. Enterprises today have realised that the future of work will be much more technology driven. Flexi staffing is becoming a way of life for many as more organisations, both in technology and non-technology sectors,. Demand for niche skills is rising as the challenge to find the right talent becomes quite difficult. Given the changing industry dynamics, businesses that adopt subcontract and flexi hiring models will be at an advantage.

Industry Trends

General Staffing: India is the 5th largest staffing market globally (by volume) and is poised to grow at a CAGR of 22.7% from 2018-2021, to reach 6.1 million flexi staffing workforce by 2021. Demonetization and implementation of GST had given significant push to the formal sector. With a rising percentage of formal employment, more jobs are being created, which in turn is driving growth for the sector.

Integrated Facilities Management: Indian facilities management sector involves the maintenance of property, buildings, equipment and optimization of inventory and other operational elements. The country’s facilities management sector is fragmented, as most of facilities in India rely on in-house operations for their maintenance and building management processes. Of the total market, organized facilities management accounts for about 54% and is expected to grow at CAGR of ~20% from CY19-30, to reach US$ 15bn. Other factors such as increased formalisation of jobs, growing adoption of IoT devices & smart connected devices for building automation, rising investment in infrastructure, increase in co-working space, and growth in retail & hospitality sectors will contribute to the growth of the sector.

Security Services: Private Security industry is the 2nd largest employment generating sector after agriculture. The sector is primarily dominated by unorganized players, although organized players occupy around 40% of the sector.

The main factors contributing to growth of this sector consist of an increasing need for property security, urbanization, low police to person ratio and growing population in major cities, among others. With increasing shopping malls, special economic zones, self-contained townships, IT parks and other exclusive facilities, demand for private security services in India is expected to see strong growth in the coming years.

Penetration of flexi staffing in India is materially low at 0.6% of workforce compared to the global average of 1.6%.

Key Risks

- Demand for staffing and other business services is subject to the state of the overall economy. Pronounced softness in the economy in India or in Quess’ other markets could therefore dampen demand for the company’s services. The staffing industry is a play on employment, which has a correlation with the economic conditions of any country. Any economic downturn in the country could impact the demand for staffing services as many companies reduce their use of temporary employees.
- In case the acquired companies do not show continuous improvement in their performance, Quess will have to impair Goodwill and also write off intangibles putting pressure on profits and networth.

- Despite a large workforce, employability of this labour is low. 54% of graduates are unemployable and require investments on skilling before they can enter the workforce. The Indian Government, in 2015, started the Skill India Mission with a vision to provide market-relevant skills to more than 400mn people by 2022. The impact of these programs will have to be monitored to ensure better employability of labour.
- Non-recovery of loans to subsidiaries/associates would be a key risk to its balance sheet.
- Delay in payment from key clients would affect working capital management and cash flows going ahead.
- Any attrition in senior management could further aggravate investor concerns and delay the deleveraging journey.
- Higher than expected competitive pressure leading to lower headcount growth or loss of market share is a downside risk.
- The Covid-19 crisis continues to affect staffing associate demand as well as pricing in the industry. With a highly fragmented industry, price competition becomes intense, making it difficult for organised players to see an up-tick in pricing.
- Inability of the company to consistently improve margin would hinder growth in profitability. Over long term, with higher scale and size, if the company is unable to expand its margins, it can have a downside risk to overall earnings growth trajectory.
- Any unreasonable acquisition or a failure to efficiently manage any acquired business remain risks.
- New and complicated laws may expose company to higher risk of non-compliance, resulting in possible claims, fines, business suspension, and reputational damage.
- Future competition from higher use of artificial intelligence in services and robotics in manufacturing sector can pose a threat to incremental demand for staffing solutions.
- Change in government regulations with regards to tax free status for staffing industry can impact the future earnings growth trajectory of Quess Corp.
- Optimal utilization across verticals needs to be the top priority to sustain strong growth. Aggressive diversification without improved utilizations and capital allocation can have an adverse impact on company’s future growth.
- Increase in proportion of pay and collect contracts could impact cash flow and debt position.

Quess Corp Ltd.

Company Background

Quess was founded in 2007 by Ajit Abraham Isaac in Bengaluru. It was Isaac's second entrepreneurial project after he sold his first venture, HR staffing firm PeopleOne, to Adecco in 2004. In 2013, Canadian billionaire Prem Watsa acquired 74 per cent in the company and now owns 32.3 per cent post-initial public offering (IPO) stake; Isaac owns 23 per cent as of Sep 2020. Company had raised ~Rs 400 crore from its IPO and more than twice the sum i.e. Rs ~874 crore at Rs 800 per share through an institutional placement programme (IPP) in Aug-2017. Company has divided its operations in the three segments: a) Workforce Management (WFM) b) Operating Asset Management (OAM) and c) Global Technology Solutions. Company derived 66% of its revenues and 41% of EBITDA from WFM segment while 16% of revenues and 19% of EBITDA from OAM while GTS division contributed to 18% of revenues and 40% of EBITDA in H1 FY21.

Quess has team of ~384,000 employees across India, North America, South America and South-East Asia across all segments. Quess serves over 2600+ clients worldwide. In the past few years, company has made around 25 acquisitions and investments and turned them around well. The acquisition has been done largely at attractive valuations, and then turned them around successfully. Quess has India's largest Staffing team with ~1,60,000 associates. Quess is 4th largest staffing company in the world and amongst top 3 domestic BPO players in India. Quess is No.1 in Indian general staffing market and IT Staffing segment, No.1 in Singapore IT staffing space, and Top 3 facility management services provider in India.

Peer Comparison

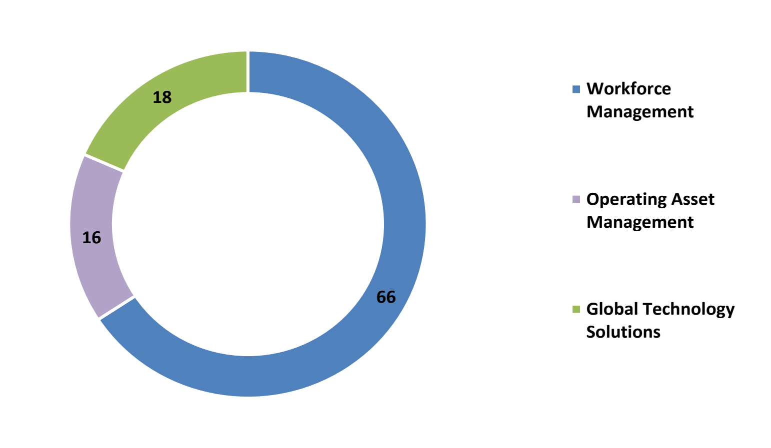
Company	Mcap (Rs cr)	Revenue				EBITDA Margin				PAT				RoE			
		FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
TeamLease	4380	5201	4743	5811	7126	1.8	2.2	2.5	2.7	85	84	123	165	15.2	14	17	19
Quess Corp	7912	10991	10589	12001	13379	6.0	5.4	5.8	6.1	267	209	298	394	10.7	8.8	11.4	13.3
SIS*	6534	8485	8926	9895	11183	6.1	5.8	6.1	6.2	225	279	303	402	16.8	17.7	17.3	18.7

Company	P/B (x)				P/E (x)			
	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
TeamLease	7.7	6.7	5.6	4.8	51.8	52.3	35.6	27.0
Quess Corp	3.5	3.2	2.8	2.5	29.4	37.6	26.4	19.9
SIS*	4.1	3.3	2.9	2.3	29.0	23.4	21.6	16.3

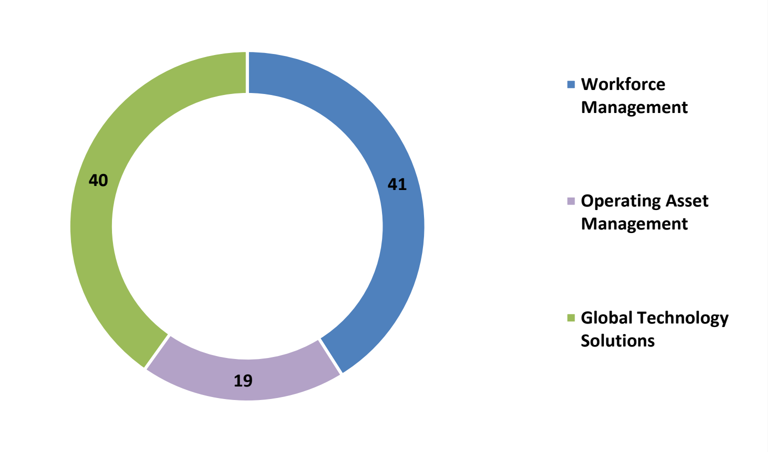
Source: company, HDFC sec Research, *Bloomberg Consensus

Quess Corp Ltd.

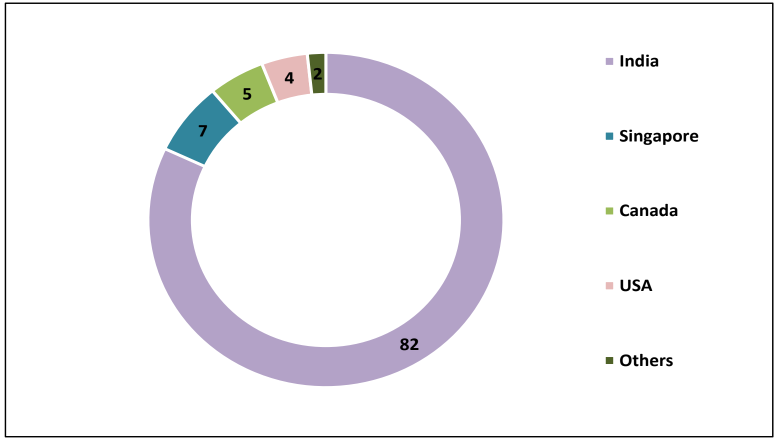
H1 FY21 revenues split (%)



H1 FY21 EBITDA Mix (%)



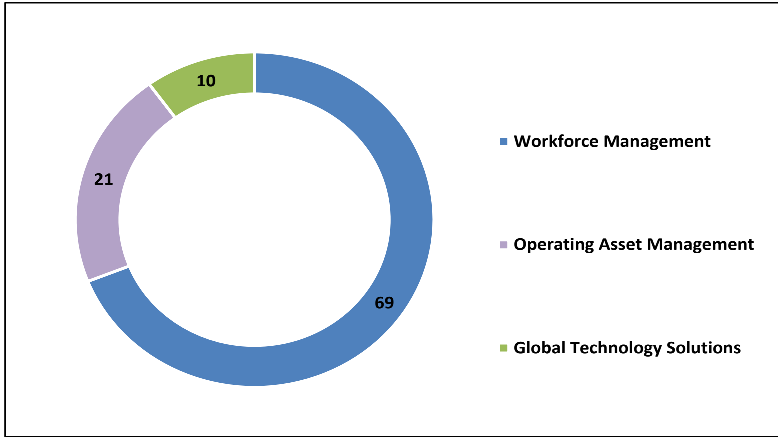
Geographywise revenue split (%)



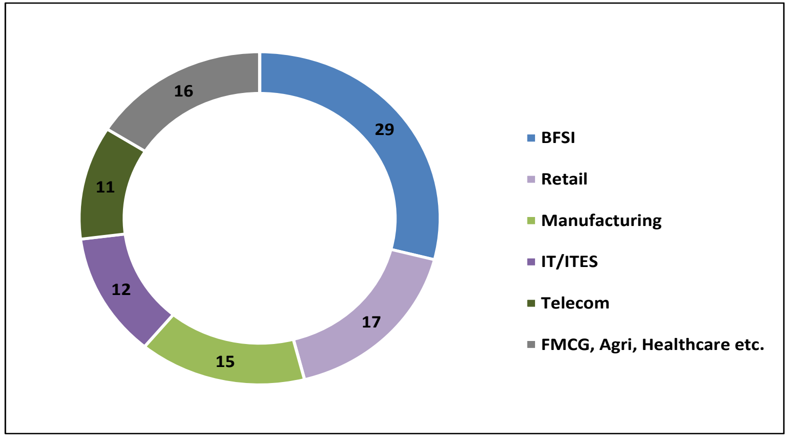
Source: Company, HDFC sec Research

Quess Corp Ltd.

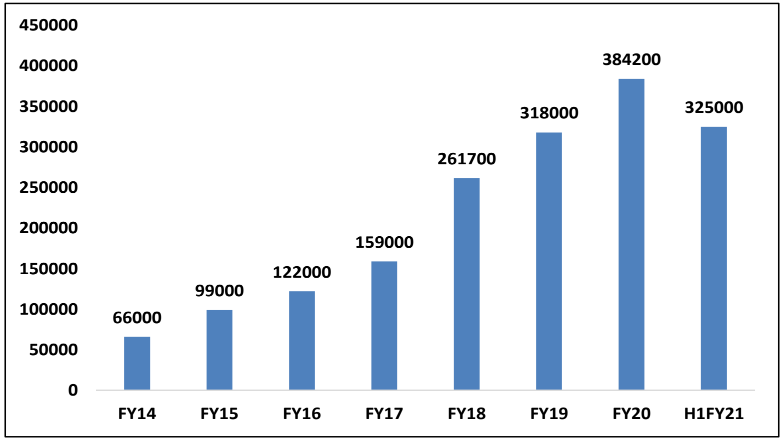
Headcount Split (%)



Revenue mix by end industry (%)



Headcount Trend (#)



Source: Company, HDFC sec Research

Quess Corp Ltd.

Income Statement

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
Total Revenues	**8527**	**10991**	**10589**	**12001**	**13379**
Growth (%)	38.3	28.9	-3.7	13.3	11.5
Operating Expenses	8062	10333	10019	11299	12557
EBITDA	**465**	**658**	**570**	**702**	**822**
Growth (%)	30.9	41.6	-13.3	23.1	17.1
EBITDA Margin (%)	**5.4**	**6**	**5.4**	**5.8**	**6.1**
Depreciation	123	249	245	261	282
EBIT	342	409	325	440	540
Other Income	71	51	57	62	68
Exceptional Items	0	-664	0	0	0
Interest	114	167	131	104	79
PBT	298	-371	276	393	527
Tax	33	47	56	78	111
Minority Int	-9	-14	-11	-17	-22
RPAT	**257**	**-432**	**209**	**298**	**394**
Growth (%)	-17	-268.2	-148	43	32
APAT	**257**	**267**	**209**	**298**	**394**
Growth (%)	-8	4.1	-21.7	42.7	32.2
Adj EPS	**17.6**	**18.1**	**14.2**	**20.2**	**26.7**

Balance Sheet

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
SOURCE OF FUNDS					
Share Capital	146.1	147.5	147.5	147.5	147.5
Reserves	**2580**	**2128**	**2337**	**2619**	**2994**
Shareholders' Funds	2726	2276	2485	2767	3142
Minority Interest	3	77	85	85	85
Long term debt	209	115	85	63	33
Long Term Provisions & Others	321	566	580	565	546
Total Source of Funds	**3259**	**3034**	**3235**	**3480**	**3806**
APPLICATION OF FUNDS					
Net Block	236	513	397	294	244
Intangible Assets	1421	978	1056	1008	964
Non-current Investment	90	73	80	91	103
Income Tax Assets	505	616	616	616	616
Long Term Loans & Advances	341	247	258	254	248
Total Non-Current Assets	**2593**	**2427**	**2407**	**2263**	**2174**
Inventories	22	28	38	39	48
Trade Receivables	913	998	981	1101	1217
Cash & Equivalents	586	759	733	884	1008
Other Current Assets	885	1105	1147	1198	1261
Total Current Assets	**2410**	**2892**	**2861**	**3192**	**3487**
Short Term Borrowings	541	883	548	448	298
Trade Payables	173	163	186	201	213
Other Current Liab & Provisions	1030	1239	1299	1326	1344
Total Current Liabilities	**1744**	**2285**	**2033**	**1975**	**1855**
Net Current Assets	666	607	828	1217	1632
Total Application of Funds	**3259**	**3034**	**3235**	**3480**	**3806**

Quess Corp Ltd.

Cash Flow Statement

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
Reported PBT	298	-371	276	393	527
Non-operating & EO items	-71	-51	-57	-62	-68
Interest Expenses	114	167	131	104	79
Depreciation	123	249	245	261	282
Working Capital Change	-94	229	-286	-231	-306
Tax Paid	-33	-47	-56	-78	-111
OPERATING CASH FLOW (a)	**338**	**175**	**253**	**388**	**402**
Capex	-125	-141	-100	-200	-250
Free Cash Flow	213	34	153	188	152
Investments	-338	462	-114	41	39
Non-operating income	71	51	57	62	68
INVESTING CASH FLOW (b)	**-392**	**372**	**-157**	**-97**	**-143**
Debt Issuance / (Repaid)	-27	-77	9	-20	-31
Interest Expenses	-114	-167	-131	-104	-79
FCFE	72	-209	31	64	42
Share Capital Issuance	1	1	0	0	0
Dividend	0	0	0	-16	-24
FINANCING CASH FLOW (c)	**-141**	**-242**	**-122**	**-140**	**-134**
NET CASH FLOW (a+b+c)	-194	305	-26	151	125

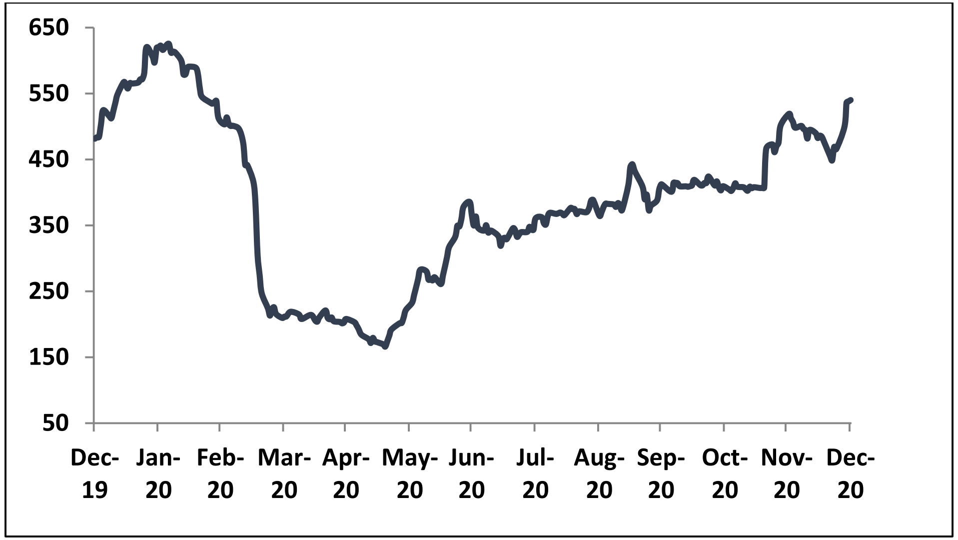
Key Ratios

	FY19	FY20	FY21E	FY22E	FY23E
EBITDA Margin	5.4	6	5.4	5.8	6.1
EBIT Margin	4	3.7	3.1	3.7	4
APAT Margin	3	-3.9	2	2.5	2.9
RoE	9.9	10.7	8.8	11.4	13.3
RoCE	9.7	15.2	8.8	11.1	12.3
Solvency Ratio					
Net Debt/EBITDA (x)	0.3	0.3	-0.3	-0.6	-0.9
Net D/E	0	0.1	-0.1	-0.2	-0.2
Interest Coverage	3	2.5	2.5	4.2	6.9
PER SHARE DATA					
EPS	17.6	18.1	14.2	20.2	26.7
CEPS	26	35	30.8	37.9	45.8
BV	186.6	154.3	168.4	187.6	213
Dividend	0	0	0	1	1.5
VALUATION					
P/E	30.3	29.4	37.6	26.4	19.9
P/BV	2.9	3.5	3.2	2.8	2.5
EV/EBITDA	15.6	11.1	12.8	10.4	8.8
EV / Revenues	0.7	0.6	0.6	0.5	0.4

Source: Company, HDFC sec Research

Quess Corp Ltd.

One Year Price Chart



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