

Quess Corp

Estimate change ↔

TP change ↔

Rating change ↔

CMP: INR438

TP: INR450 (+3%)

Neutral

In-line 2QFY24 performance

Income tax issue to remain an overhang; reiterate neutral

- Quess Corp (QUESS) posted 11.1% YoY revenue growth in 2QFY24, in line with our estimate. The headcount addition was strong at ~22k net. The EBITDA margin of 3.4% (+10bp QoQ) was in line too. This was aided by a recovery in margins for OAM (+50bp QoQ) and PLB (+600bp) businesses.
- The management indicated a healthy demand, especially in BFSI and Manufacturing, while IT is likely to remain weak. While growth in WFM and OAM was slightly slower than expected, QUESS hired additional 22k individuals in 2QFY24, which provides good visibility for the near-term growth. We estimate a 16.6% revenue CAGR over FY23-25.
- EBITDA margin improved 10bp QoQ (in line) due to strong margin improvement in OAM and PLB, which was promising. The management reiterated its guidance for the PLB and American operations to achieve EBITDA breakeven by 4QFY24. We expect these investments to aid margins in FY25.
- While the margin pressure continues, we expect QUESS's EBITDA margin to improve gradually to 3.7%/4.4% for FY24E/FY25E, led by its focused efforts on improving efficiencies and declining burn from investments. Accordingly, we expect a PAT CAGR of 80% over FY23-25 on a low FY23 base (down 35% YoY on poor margin performance).
- QUESS received additional income tax disallowances for FY18-19 (Final) and FY19-20 (Draft) during the quarter. Though the company is contesting the disallowances, it has reported a massive jump in contingent liabilities of INR1.82b towards tax demands (earlier INR740m). The tax disallowance of the 80JAA deduction by the Income Tax Department is expected to remain an overhang on the stock.
- Though QUESS should benefit from the medium-term tailwinds of formalization and labor reforms, the growth has already been factored into the valuations. **We reiterate our Neutral** rating due to full valuations, taxation concerns, and weak macro. Our TP of INR450 implies 12x FY25E P/E.

Revenue in line, beat on margin; however, tax contingent liability up

- Revenue grew 3.2% QoQ/11.1% YoY, in line with our expectation. Workforce management rose 12.7% YoY, operating asset management grew 8.3% YoY, GTS rose 10.5% YoY and product-led business declined 4.6% YoY in 2QFY24.
- EBITDA margin was up 10bp at 3.4%, in line with our estimate. EBITDA margins for WFM and GTS stood flat QoQ, while OAM improved its profitability by 50bp QoQ to 5.0% after six quarters. PLB's EBITDA margin improved 600bp QoQ to -14%.

Bloomberg	QUESS IN
Equity Shares (m)	148
M.Cap.(INRb)/(USDb)	65 / 0.8
52-Week Range (INR)	579 / 337
1, 6, 12 Rel. Per (%)	5/13/-27
12M Avg Val (INR M)	151

Financials & Valuations (INR b)

Y/E Mar	2023	2024E	2025E
Sales	171.6	197.7	233.4
EBITA Margin (%)	3.4	3.7	4.4
Adj. PAT	1.7	3.3	5.6
Adj. EPS (INR)	15.2	22.3	37.2
EPS Gr. (%)	(35.3)	94.9	66.7
BV/Sh. (INR)	226.7	234.1	262.3

Ratios

RoE (%)	6.8	12.8	19.7
RoCE (%)	8.6	13.5	19.9
Payout (%)	53.2	71.7	43.0
Dividend Yield (%)	1.8	3.7	3.7

Valuations

P/E (x)	38.1	19.5	11.7
P/BV (x)	1.9	1.9	1.7
EV/EBITDA (x)	11.3	9.1	6.4
EV/Sales (x)	0.4	0.3	0.3

Shareholding pattern (%)

As On	Sep-23	Jun-23	Sep-22
Promoter	56.7	56.7	51.8
DII	10.2	7.3	9.4
FII	16.9	17.1	21.9
Others	16.2	18.9	16.9

FII Includes depository receipts

- PAT jumped 71% YoY to INR719m vs. our estimate of INR500m, largely due to lower D&A and ETR during the quarter.
- The company overall added a strong 22k to its headcount and 26k workforce to its workforce management business.
- QUESS received the final disallowance of its 80JJAA and depreciation on goodwill deductions from the income tax authorities for FY18-19, in addition to the previous year. It also received a draft assessment for FY19-20, disallowing the claims for the year. While QUESS is contesting the assessments, it has disclosed a contingent liability of INR1.82b towards tax demands (earlier INR740m). It has also claimed deductions of INR1.16b for 1HFY24.

Key highlights from the management commentary

- WFM segment added 25k headcount during the quarter. BFSI, Manufacturing, and Retail drove growth during the quarter. Expect strong growth to continue on the back of 38k open mandates.
- Income tax matter pertaining to FY17-18 is with ITAT. QUESS received a final assessment order for FY18-19 and a draft assessment order for FY19-20 with similar disallowances.
- The management remains confident of breakeven for North America business and Foundit by 4QFY24, which should drive incremental margin improvement.

Valuation and View: reiterate NEUTRAL

- Though QUESS should benefit from the medium-term tailwinds of formalization and labor reforms, the growth has already been factored into the valuations.
- We expect a gradual recovery in margins over FY24 and FY25, which should support earnings.
- We **reiterate our Neutral rating** on the stock due to full valuations, taxation concerns, and weak macro. Our TP of INR450 implies 12x FY25E P/E.

Consolidated quarterly performance

Y/E March	(INR m)											
	FY23				FY24				FY23	FY24E	FY24	Var.
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			2QE	(%/bp)
Net Sales	39,793	42,733	44,656	44,402	46,002	47,483	51,139	53,056	1,71,584	1,97,681	47,539	-0.1
YoY Change (%)	33.2	32.4	21.2	17.1	15.6	11.1	14.5	19.5	25.3	15.2	11.2	-13
Total Expenditure	38,259	41,386	43,200	42,882	44,463	45,848	49,196	50,881	1,65,726	1,90,388	45,923	-0.2
EBITDA	1,534	1,347	1,456	1,520	1,539	1,635	1,943	2,175	5,858	7,293	1,616	1.2
Margin (%)	3.9	3.2	3.3	3.4	3.3	3.4	3.8	4.1	3.4	3.7	3.4	4.4
Depreciation	610	676	695	765	686	697	693	693	2,746	2,768	743	-6.3
EBIT	924	671	761	756	853	939	1,251	1,483	3,112	4,525	873	7.5
Margin (%)	2.3	1.6	1.7	1.7	1.9	2.0	2.4	2.8	1.8	2.3	1.8	14
Interest	204	263	290	309	272	281	267	267	1,066	1,087	297	-5.4
Other Income	72	88	67	36	41	151	151	151	263	494	50	
PBT before EO expense	792	496	538	483	621	809	1,135	1,367	2,309	3,932	625	29.3
Recurring Tax	115	100	217	183	140	83	170	205	615	599	125	-33.4
Rate (%)	14.6	20.1	40.3	37.9	22.6	10.3	15.0	15.0	26.6	15.2	20.0	
MI and P/L of Asso. Cos.	64	-24	-24	-31	3	-10	0	0	-16	-7	0	
Adjusted PAT	613	421	345	331	478	735	965	1,162	1,710	3,340	500	46.9
Extraordinary items	0	0	-535	0	0	16	0	0	-535	16	0	
Reported PAT	613	421	880	331	478	719	965	1,162	2,245	3,324	500	43.8
YoY Change (%)	32.7	12.0	5.0	-55.0	-22.0	71.0	9.6	250.8	-6.9	48.1	18.9	NM
Margin (%)	1.5	1.0	2.0	0.7	1.0	1.5	1.9	2.2	1.3	1.7	1.1	46

Source: Company, MOFSL

Key performance indicators

Y/E March	FY23				FY24				FY23	FY24E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Headcount (k)	470	504	505	511	525	547			511	
Segment Revenue (INR m)										
Workforce Management	27,579	29,428	30,683	30,618	32,206	33,153			1,18,309	
Operating Asset Management	5,967	6,515	6,891	6,843	6,899	7,055			26,216	
Global Technology Solutions	5,074	5,287	5,607	5,710	5,633	5,843			21,678	
Product-led business	1,174	1,502	1,474	1,231	1,264	1,433			5,381	
EBITDA Margin (%)										
Workforce Management	3.4	2.7	2.8	2.8	2.6	2.6			2.9	
Operating Asset Management	5.1	4.3	4.5	4.4	4.5	5.0			4.6	
Global Technology Solutions	16.3	16.0	16.1	16.7	17.8	17.8			16.3	
Product Led business	(20.4)	(15.9)	(18.2)	(16.4)	(20.3)	(14.1)			(17.6)	

Source: Company



Key highlights from the management commentary

2QFY24 performance

- **WFM** added 25k headcount during the quarter. BFSI, Manufacturing and Retail drove growth during the quarter. Expect strong growth to continue on the back of 38k open mandates. PAMP for general staffing was stable during the quarter (INR 700). Professional (IT) staffing continues to face headwinds, with the open mandates remaining flat sequentially. The management is focusing on niche skills to drive margins in professional staffing. Though demand for IT Staffing remains weak, management is seeing green shoots in permanent hiring and GCCs.
- For **GTS**, all three platforms continued to do well during the quarter. Connect business had a strong order book of INR1b ACV (BFSI contributed 50% of new sales). CLM saw strong growth driven by North America. Non-voice BPO also witnessed robust growth during the quarter. The focus would be to sustain and accelerate the growth of non-voice BPO, to grow niche healthcare segment and improve margins.
- In **OAM**, IFMS (facility management) saw good demand from government services and industrials. Overall, the growth was driven by industrials, healthcare, and public infra. The focus will be to grow in logistics, public infra, and healthcare. Telecom business did well on the back of strong 5G adoption. Though headcount remained flat for the security business, management suggested 8-10% headcount addition in 3QFY24.
- In **PLB**, Foundit's performance aligns with the management's objectives to achieve breakeven in 4QFY24. It saw strong growth of 20% QoQ/35% YoY. QUESS will roll out its AI-driven Foundit 2.0 to customers from the end of 3QFY24, after a strong feedback from beta users. 2H is generally stronger for PLB; management expects this trend to continue in 2HFY24.
- Income tax matter pertaining to FY17-18 is with ITAT. QUESS received final assessment order for FY18-19 and draft assessment order for FY19-20 with similar disallowances.

Margin

- The improvement in gross margin for OAM was driven by operational efficiency measures taken by the company.
- The management remains confident of break-even for North America business and Foundit by 4QFY24, which should drive incremental margin improvement.
- Professional staffing business operates at a strong PAM of INR14k. Generally, PAM in North America is high (USD 1.5-4.5k; 4.5k for niche skills).

Valuation and View: reiterate NEUTRAL

- Though QUESS should benefit from the medium-term tailwinds of formalization and labor reforms, the growth has already been factored into the valuations.
- We expect a gradual recovery in margins over FY24 and FY25, which should support earnings.
- We **reiterate our Neutral rating** on the stock due to full valuations, taxation concerns, and weak macro. Our TP of INR450 implies 12x FY25E P/E.

Exhibit 1: Revisions to our estimates

	Revised estimates		Earlier estimates		Change (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Revenue (m)	1,97,681	2,33,445	1,98,188	2,35,125	-0.3%	-0.7%
Rev. growth (%)	15.2	18.1	15.5	18.6	-30bp	-55bp
EBITDA (m)	7,293	10,272	7,394	10,110	-1.4%	1.6%
EBITDA Margin (%)	3.7	4.4	3.7	4.3	-4bp	10bp
EBIT Margin (%)	2.3	3.1	2.2	2.9	6bp	20bp
EPS (INR)	22.7	38.4	23.3	37.9	-2.9%	1.4%

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	1,97,681	2,33,445
Change (%)	42.9	38.3	28.9	-1.4	26.3	25.3	15.2	18.1
Cost of services	1,422	2,624	2,671	2,007	2,787	4,794	5,524	6,523
Employees Cost	50,793	67,132	90,632	92,968	1,16,870	1,46,595	1,68,892	1,99,447
Other Expenses	5,914	10,868	10,027	7,617	10,743	14,336	15,973	17,203
Total Expenditure	58,129	80,624	1,03,329	1,02,593	1,30,400	1,65,726	1,90,388	2,23,173
As a percentage of Sales	94.3	94.6	94.0	94.7	95.2	96.6	96.3	95.6
EBITDAs	3,544	4,646	6,567	5,777	6,518	5,858	7,293	10,272
Margin (%)	5.7	5.4	6.0	5.3	4.8	3.4	3.7	4.4
Depreciation	747	1,232	2,486	2,285	2,120	2,746	2,768	3,035
EBIT	2,796	3,414	4,081	3,491	4,397	3,112	4,525	7,237
Int. and Finance Charges	755	1,144	1,668	1,113	792	1,066	1,087	1,284
Other Income	569	712	511	451	198	263	494	584
PBT bef. EO Exp.	2,611	2,983	2,924	2,829	3,803	2,309	3,932	6,536
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	3,932	6,536
Total Tax	-483	329	483	590	1,066	615	599	980
Tax Rate (%)	-18.5	11.0	-13.0	40.9	28.0	21.6	15.2	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	3,333	5,556
Change (%)	147.0	-17.2	1.7	-18.5	24.2	-35.2	94.9	66.7
Margin (%)	5.0	3.0	2.4	2.0	1.9	1.0	1.7	2.4

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	25,051	28,250
Net Worth	24,608	27,256	22,759	23,431	24,378	25,688	26,534	29,733
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	28,180	31,371
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	15,763	18,798
Net Fixed Assets	5,359	4,795	3,451	2,728	3,557	3,165	2,597	2,762
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	49,839	58,301
Inventory	85	221	284	290	275	282	282	282
Account Receivables	9,207	9,132	9,982	8,945	23,323	26,886	35,203	41,572
Cash and Bank Balance	5,661	5,855	7,587	5,646	4,105	4,376	3,668	5,002
Loans and Advances	13,159	12,333	16,586	15,292	8,201	9,886	10,685	11,445
Curr. Liability and Prov.	14,701	15,328	19,681	18,317	22,145	27,876	34,900	40,357
Account Payables	1,481	1,729	1,633	1,212	1,154	1,249	4,695	5,503
Other Current Liabilities	12,166	12,351	16,494	14,983	18,258	23,546	26,547	30,537
Provisions	1,054	1,248	1,554	2,122	2,733	3,080	3,658	4,317
Net Current Assets	13,411	12,212	14,759	11,856	13,759	13,554	14,939	17,944
Appl. of Funds	30,638	29,742	27,339	24,823	27,582	27,343	28,180	31,371

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	22.3	37.2
Cash EPS	27.1	25.9	35.7	30.8	31.9	29.9	40.9	57.6
BV/Share	217.1	240.5	200.8	206.7	215.1	226.7	234.1	262.3
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	71.7	43.0
Valuation (x)								
P/E	20.0	24.9	23.9	29.3	24.6	38.1	19.5	11.7
Cash P/E	16.1	16.8	12.2	14.1	13.7	14.6	10.7	7.6
P/BV	2.0	1.8	2.2	2.1	2.0	1.9	1.9	1.7
EV/Sales	1.1	0.8	0.6	0.6	0.5	0.4	0.3	0.3
EV/EBITDA	18.6	14.1	9.9	10.6	10.2	11.3	9.1	6.4
Dividend Yield (%)	0.0	0.0	0.0	1.6	1.8	1.8	3.7	3.7
FCF per share	1.1	7.2	21.3	45.7	31.6	24.6	15.0	28.5
Return Ratios (%)								
RoE	16.5	9.9	10.4	9.2	11.0	6.8	12.8	19.7
RoCE	14.6	10.6	15.4	7.7	11.4	8.6	13.5	19.9
RoIC	17.0	12.9	22.0	10.9	15.0	10.6	16.3	24.4
Working Capital Ratios								
Asset Turnover (x)	2.0	2.9	4.0	4.4	5.0	6.3	7.0	7.4
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	3,983	6,718
Depreciation	747	3	2,486	2,285	2,120	2,746	2,768	3,035
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	-599	-980
(Inc.)/Dec. in WC	-1,858	-1,248	-1,933	-464	-307	-231	-2,091	-1,672
CF from Operations	1,515	714	-3,547	5,319	4,004	3,816	4,909	7,894
Others	-428	1,302	7,157	1,835	1,538	846	-456	-425
CF from Operations incl. EO	1,087	2,016	3,611	7,154	5,542	4,663	4,452	7,469
(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	2,232	4,249
(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	-532
CF from Fin. Activity	9,605	-3,640	129	-8,045	-4,916	-5,239	-3,747	-3,723
Inc./Dec. in Cash	2,622	199	2,037	-1,943	-1,250	-536	-1,514	526
Closing Balance	5,661	5,860	7,589	5,646	4,105	4,376	3,669	5,002

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