Quess Corp

IPO Note – Attractive Quest on Valuations: Subscribe

Quess Corp Ltd (QCL), promoted by Thomas Cook (~63% holding post dilution), provides comprehensive solutions including recruitment, temporary staffing, technology staffing and IT product and solution, skill development, payroll, compliance management, integrated facility management and industrial asset management services. The company derives 86% of its revenues from India while the balance comes from its international business. Over the past three years, the company has made several acquisitions which has fueled its growth and has shown good track record of improving the performance of its acquisitions.

Huge growth opportunities across business verticals: QCL has presence in high-growth business verticals like temporary general staffing, payroll & compliance outsourcing, professional IT staffing, facilities management, etc. under different brands. As per a report by Frost & Sullivan, the market for these segments in India is expected to grow at a CAGR of 19-24% over 2014-19. Further, the penetration level of temporary staffing is low in India (0.1%, which is among the lowest in the world), and is likely to improve from hereon on account of increasing need for cost efficient structures. Thus, we expect QCL to benefit from increasing demand for manpower across industries on the back of its strong Management, healthy track record and presence in diversified business verticals which would help it to enhance its market share and increase revenue.

Focus on improving operating margins: Going forward, we expect the company's overall operating margin to improve on back of (a) change in revenue mix in favor of higher margin businesses (currently the People and Services business contributes ~55% of the company's overall top-line which is a low margin segment) (b) two of its acquisitions Brainhunter and MFX showing improvement in performance with the latter having turned profitable recently, which should result in increase in margins (c) improvement in 'core to associate employees handled' ratio from ~200 to 250.

Outlook & Valuation: Over the last four years, the company has reported strong revenue CAGR of ~52% and PAT CAGR of ~94% which was largely fuelled by its strategic business acquisitions and by strong growth across business verticals. Going forward we expect the company to report healthy growth on back of increase in industry penetration. Further, the company's profitability is also expected to increase due to its focus on increasing the share of higher-margin businesses in the revenue mix.

On the valuation front, at the upper end of the price band, the pre-issue P/E works out to 40.6x its FY2016 earnings which is lower compared to its peers (Team Lease is trading at 63.1x FY2016 earnings) and also has a better margin and ROE profile. Further, post the IPO, QCL is expected to improve its operating margin significantly. **Considering the above mentioned positives and the company's relatively lower valuation, we recommend a SUBSCRIBE on the issue.**

Key Financial

Y/E March (₹ cr)	FY2012	FY2013	9MFY14	15MFY15	FY2016
Net Sales	637	1,001	1,006	2,567	3,435
% chg	-	57.2	-	-	-
Net Profit	6	12	18	67	89
% chg	-	94.1	-	-	-
OPM (%)	4.2	4.3	4.0	5.1	4.8
EPS (₹)	0.5	1.1	1.6	5.9	7.8
P/E (x)	577.5	297.6	201.1	53.5	40.6
P/BV (x)	67.7	52.6	19.5	14.3	10.4
RoE (%)	11.7	17.7	9.7	26.7	25.6
RoCE (%)	21.4	24.8	14.3	25.5	20.6
EV/Sales (x)	5.7	3.7	3.6	1.5	1.1
EV/EBITDA (x)	134.3	84.9	91.0	28.6	23.5

Source: Company, Angel Research; Note: Valuation ratios based on pre-issue outstanding shares and at upper end of the price band

SUBSCRIBE

Issue Open: June 29, 2016
Issue Close: July 1, 2016

Issue Details
Face Value: ₹10
Present Eq. Paid up Capital: ₹113.3cr
Fresh Issue**: 1.26cr Shares
Offer for sale:-NA
Post Eq. Paid up Capital: ₹126.0cr
Market Lot: 45 Shares
Issue (amount): ₹400cr
Price Band: ₹310-317
Post-issue implied mkt. cap ₹3,913cr*-3,993cr**

*Note:*at Lower price band and **Upper price band*

Book Building	
QIBs	75%
Non-Institutional	15%
Retail	10%

Post Issue Shareholding Pattern(%)	
Promoters Group	89.5
MF/Banks/Indian FIs/FIIs/Public & Others	10.5

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Company background

QCL is among India's leading integrated business service providers, focused on emerging as the preferred partner for handling end-to-end business functions of its clients. It has a pan-India presence with 47 offices across 26 cities, as well as operations in North America, the Middle East and South East Asia. As of February 29, 2016, the company has employed more than 120,000 employees, including over 3,400 Core Employees and over 117,000 Associate Employees, i.e. employees placed with its clients. As of March 31, 2016, the company had more than 1,300 clients, based on ongoing contracts. The company's top 10 clients accounted for 30.4% of its revenue in FY2016 and the largest client's share was 7.4% in the same period.

The company's operations can be classified into four key business services - Global Technology Solutions (GTS), People and Services (P&S), Integrated Facility Management (IFM) and Industrial Asset Management (IAM).

Exhibit 1: Operational snapshot

	Quess Corp			
	Global Technology Solutions (GTS)	People and Services (P&S)	Integrated Facility Management (IFM)	Industrial Asset Management (IAM)
Services	IT staffing, and IT product solutions & services	General Staffing, Recruitment & executive search, Recruitment process outsourcing, and Payroll, compliance & background verification services, and Training and skill development services	Soft services (cleaning, security, pest control, etc), Hard services (electro mechanical, HVAC, refurbishment, etc), and Food & hospitality services	Industrial operations & maintenance, Technology & consultation, and Managed services
Brands	MFX, Brain Hunter, Magna Infotech, and Mindwire	IKYA, CoAchieve, and Excelus	Avon, and Aravon	Hofincons, and Maxeed
Key Clients	Amazon, Bata, FMC, Hinduja Group, PNB Housing Finance, and VF Brands	Four Fortune 50 companies, Large international banks and Indian IT consulting companies	Robert Bosch, Large financial institutions in India, Fortune 500 real estate services companies, and Private airport management companies	L&T Special Steels and Heavy Forgings, and India's leading steel, cement & energy companies
Competitors	Manpower, Collabera, Artech, SourceOne, and Datamatics	TeamLease Services Limited, Adecco Personnel Pte. Ltd., Randstad Holding, Genius Consultants, Manpower Group, Global Innovsource Solutions, etc.	Sodexo India, ISS Integrated Services Private Ltd, Compass Group India Support Services Private Ltd, BVG India Ltd, and Updater Services India Ltd	Power Mech Projects Ltd, Energo Construction Ltd, and McNally Bharat Engineering Company Ltd in India
Associate Employees	8,077	82,170	20,012	-
Core Employees	723	405	343	-
Core/Associates	11	203	58	-

Source: Company, Angel Research

Over the years, the company has grown inorganically, with it having acquired 9 companies since 2008. It has also entered into an agreement to acquire Transfield Services (Qatar) WLL (subject to receipt of relevant approvals).

Exhibit 2: Key Acquisitions

Company	Date of Acquisition/ Consolidation	Shareholding Acquired	Total Shareholding
Avon	July 14, 2008	74.0%	74.0%
Magna Infotech	December 23, 2010	51.0%	51.0%
Avon	May 14, 2013	26.0%	100.0%
Magna Infotech	May 13, 2013	49.0%	100.0%
Hofincons	June 27, 2014	100.0%	100.0%
Brainhunter	October 23, 2014	100.0%	100.0%
MFX	November 3, 2014	49.0%	49.0%
Aravon Services	April 1, 2015	100.0%	100.0%
MFX	January 1, 2016	51.0%	100.0%
Randstad Lanka	April 26, 2016	100.0%	100.0%

Source: Company, Angel Research

Issue details

The company is raising ₹400cr through fresh issue of equity shares in the price band of ₹310-317. The fresh issue will constitute 10% of the post-issue paid-up equity share capital of the company assuming the issue is subscribed at the upper end of the price band.

Exhibit 3: Shareholding pattern

Particulars	Pre-Issue		Post-Issue	
	No. of shares	(%)	No. of shares	(%)
Promoter group	11,27,75,280	99.5	11,27,75,280	89.5
Others	5,59,776	0.5	1,31,78,073	10.5
Total	**11,33,35,056**	**100.0**	**12,59,53,353**	**100.0**

Source: Company, Angel Research

Objects of the offer

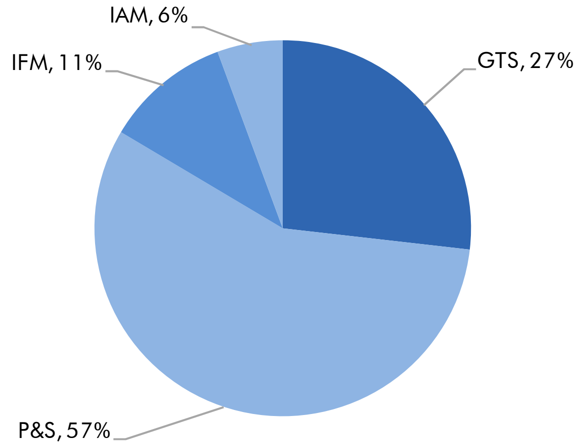
- ₹50cr will be utilized for repayment of debt availed by the company.
- ~₹72cr will be used for funding capital expenditure requirements of the company and its subsidiary, MFX US.
- ~₹158cr will be used for funding incremental working capital requirement of the company.
- ₹80cr will be utilized for acquisitions and other strategic initiatives.
- The balance will be used for general corporate purposes.

Investment rationale

Huge growth opportunities across business verticals

QCL is present in high growth business verticals like temporary general staffing, payroll and compliance outsourcing, professional IT staffing, and facilities management etc. through its different brands.

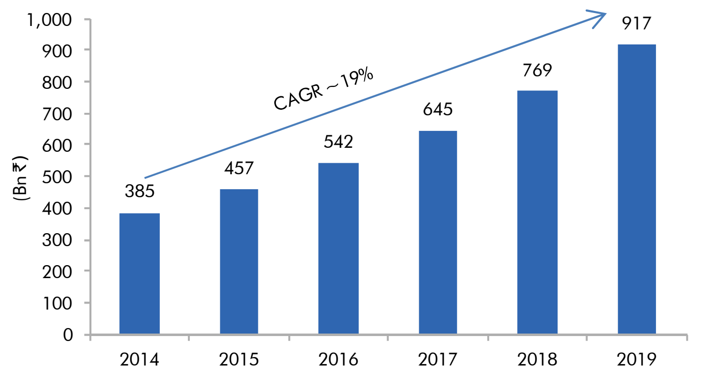
Exhibit 4: Revenue break-up business verticals wise (in FY2016)



Source: Company, Angel Research

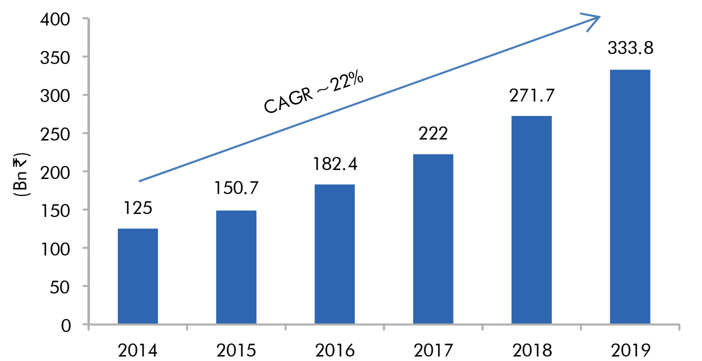
The market for these verticals in India is expected to grow at a CAGR of 19-24% over 2014-19 according to a report by Frost & Sullivan (published in January 2016). Further, penetration levels of these business services is low in India (0.1% for temporary staffing; among the lowest in the world), whereas the same is expected to rise as there is a growing need for flexible and efficient cost structures.

Exhibit 5: Temporary General Staffing Market-Revenue Forecasts, India, 2014-19



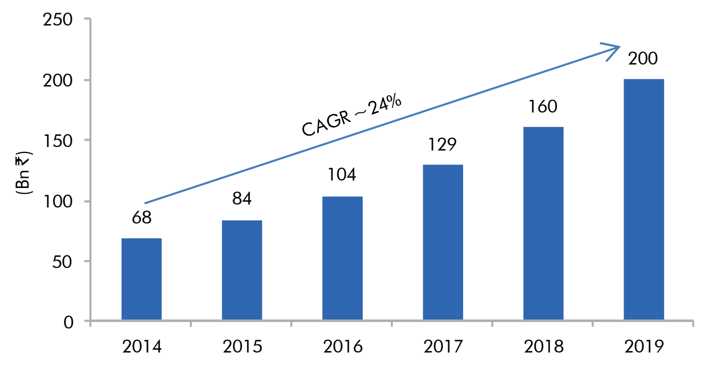
Source: Company, Angel Research

Exhibit 6: Professional IT Staffing Market-Revenue Forecasts, India, 2014-2019



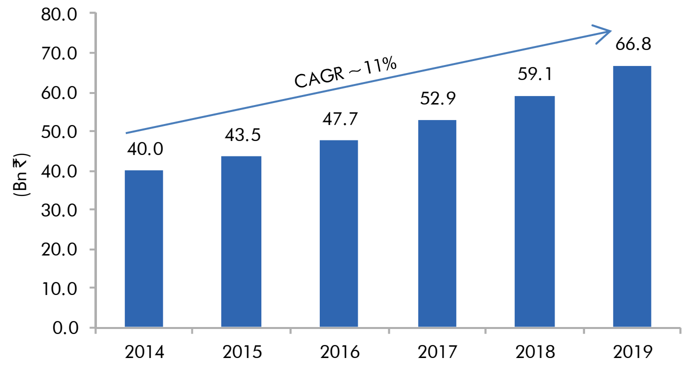
Source: Company, Angel Research

Exhibit 7: Integrated Facilities Management Market-Revenue Forecast, India, 2014-19



Source: Company, Angel Research

Exhibit 8: Forecast of the Industrial Asset Management Market, India, 2014-19



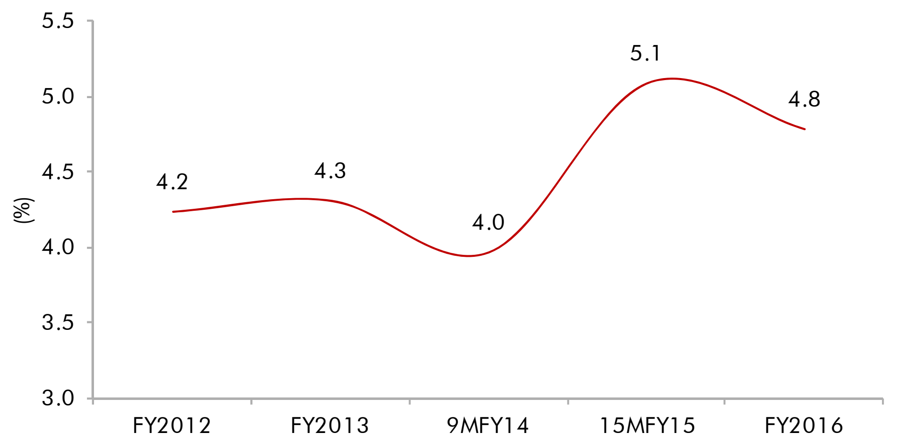
Source: Company, Angel Research

We expect QCL to benefit from increasing demand for manpower across industries on the back of its strong Management, healthy track record and presence in diversified business verticals which would help it to enhance its market share and increase revenue.

Focus on high-margin business

Going forward, we expect the company's overall operating margin to improve on back of (a) change in revenue mix in favor of higher margin businesses (currently the People and Services business contributes ~55% of the company's overall top-line which is a low margin segment) (b) two of its acquisitions Brainhunter and MFX showing improvement in performance with the latter having turned profitable recently, which should result in increase in margins (c) improvement in 'core to associate employees handled' ratio from ~200 to 250.

Exhibit 9: Operating margin trend



Source: Company, Angel Research

Successful track record in strategic acquisitions which has boosted the company's overall financials

Over the years, QCL has acquired 9 companies. The company has established a track record of successful inorganic growth through strategic acquisitions to supplement the business verticals, diversify revenue streams, and integrate such acquired businesses to further strengthen the service portfolio.

The company has historically introduced operating efficiencies, revenue growth and increased profitability in acquired businesses, resulting in increased operating margins. In the past, the company has significantly grown the business and improved the financial performances of Magna and Avon following their acquisitions.

Exhibit 10: Financial performance of Magna and Avon following their acquisition

Avon	Year of acquisition	FY2011	FY2012	FY2013	9MFY14	15MFY15	1HFY2016
Revenue (₹ cr)	11.7	46.3	71.7	114.2	127.2	302.1	152.2
EBITDA	0.2	2.2	5.2	8.0	8.1	20.7	9.8
(%)	1.9%	4.7%	7.2%	7.0%	6.4%	6.9%	6.5%
Magna Infotech							
Revenue	182.0	181.96	205.3	269.3	262.8	544.8	233.7
EBITDA	10.0	10.0	13.6	18.4	21.6	63.7	26.6
(%)	5.5%	5.5%	6.6%	6.9%	8.2%	11.7%	11.4%

Source: Company, Angel Research

Outlook and Valuation

Over the last four years, the company has reported strong revenue CAGR of ~52% and PAT CAGR of ~94% which was largely fuelled by its strategic business acquisitions and by strong growth across business verticals. Going forward we expect the company to report healthy growth on back of increase in industry penetration. Further, the company's profitability is also expected to increase due to its focus on increasing the share of higher-margin businesses in the revenue mix.

On the valuation front, at the upper end of the price band, the pre-issue P/E works out to 40.6x its FY2016 earnings which is lower compared to its peers (Team Lease is trading at 63.1x FY2016 earnings) and also has a better margin and ROE profile. Further, post the IPO, QCL is expected to improve its operating margin significantly. Considering the above mentioned positives and the company's relatively lower valuation, **we recommend a SUBSCRIBE on the issue.**

Exhibit 11: Comparative Valuation

Pre issue valuation ^		P/E (x)	P/BV (x)	ROE (%)	EV/Sales (x)	EV/EBITDA (x)
QCL	FY2016	40.6	10.4	25.6	1.0	23.5
TeamLease	FY2016	63.1	5.0	8.0	0.5	51.4

Source: RHP, Bloomberg; Note: ^ based on price at upper band

Risks

Intense competition and lack of pricing power: The staffing industry is highly fragmented with intense competition and lacks a clear cut leader accounting for dominant share in the employment services market. Almost 70-80% of the industry is unorganized consisting of small players. Although QCL is the third largest player in the industry, its lead over its followers is narrow. QCL faces stiff competition from these companies as well as other small players, thus leading to lack of pricing power.

Slowdown in economy: Slowdown in economy can restrict QCL's growth as it provides temporary staffing solution to various sectors like manufacturing, logistic, telecom, hospitality, IT/ITes etc. which are dependent on economic growth.

Profit & Loss (consolidated)

Y/E March (₹ cr)	FY2012	FY2013	9MFY14	15MFY15	FY2016
Total operating income	637	1,001	1,006	2,567	3,435
% chg	-	57.2	-	-	-
Total Expenditure	610	958	966	2,437	3,271
Cost of Services	5	15	22	72	63
Personnel Expenses	574	907	910	2,268	3,036
Others Expenses	31	36	34	96	172
EBITDA	27	43	40	130	164
% chg	-	59.9	-	-	-
(% of Net Sales)	4.2	4.3	4.0	5.1	4.8
Depreciation& Amort.	4	4	4	10	16
EBIT	23	39	36	120	148
% chg	-	66.3	-	-	-
(% of Net Sales)	3.7	3.9	3.5	4.7	4.3
Interest & other Charges	13	18	9	22	31
Other Income	2	3	2	6	7
(% of PBT)	18.6	13.2	7.4	5.5	5.9
Recurring PBT	13	24	29	104	125
% chg	-	85.6	-	-	-
Extraordinary Expense/(Inc.)	-	-	-	-	-
PBT (reported)	13	24	29	104	125
Tax	5	7	10	37	36
(% of PBT)	36.5	29.6	33.7	35.5	29.0
PAT before MI	8	17	19	67	89
Minority Interest (after tax)	2	5	1	-	-
PAT after MI(reported)	6	12	18	67	89
Exceptional Items	-	-	-	-	-
ADJ. PAT	6	12	18	67	89
% chg	-	94.1	-	-	-
(% of Net Sales)	1.0	1.2	1.8	2.6	2.6
Basic EPS (₹)	0.5	1.1	1.6	5.9	7.8
Fully Diluted EPS (₹)	0.5	1.1	1.6	5.9	7.8
% chg	-	94.1	-	-	-

Balance Sheet (consolidated)

Y/E March (₹ cr)	FY2012	FY2013	9MFY14	15MFY15	FY2016
SOURCES OF FUNDS					
Equity Share Capital	30	30	96	26	113
Reserves& Surplus	23	38	88	226	232
Shareholders Funds	**53**	**68**	**185**	**252**	**346**
Minority Interest	11	16	-	-	-
Total Loans	56	88	64	220	374
Other long term liabilities	-	0	2	1	-
Long-term provisions	1	1	1	9	46
Deferred Tax Liability	-	-	-	-	-
Total Liabilities	**121**	**174**	**252**	**482**	**767**
APPLICATION OF FUNDS					
Gross Block	19	24	32	60	147
Less: Acc. Depreciation	12	16	20	41	97
Net Block	**7**	**8**	**12**	**19**	**51**
Capital Work in Progress	-	-	0	-	2
Goodwill	25	25	73	110	205
Investments	-	-	-	-	4
Current Assets	**189**	**261**	**245**	**531**	**867**
Inventories	0	0	0	0	2
Sundry Debtors	118	158	124	275	428
Cash	29	23	29	82	109
Loans & Advances	14	26	9	44	40
Other Assets	29	54	82	131	288
Current liabilities	**133**	**157**	**146**	**238**	**471**
Net Current Assets	**56**	**104**	**99**	**294**	**396**
Long term loans and adv.	25	29	63	55	84
Other Non Current Assets	0	1	0	0	2
Deferred Tax Asset	8	7	5	4	23
Mis. Exp. not written off	-	-	-	-	-
Total Assets	**121**	**174**	**252**	**482**	**767**

Cash flow statement (consolidated)

Y/E March (₹ cr)	FY2012	FY2013	9MFY14	15MFY15	FY2016
Profit before tax	13	24	29	104	125
Depreciation	4	4	4	10	16
Change in Working Capital	(16)	(45)	(5)	(94)	(164)
Interest / Dividend (Net)	11	16	9	21	30
Direct taxes paid	(9)	(20)	(25)	(41)	(53)
Others	2	4	4	3	2
Cash Flow from Operations	**5**	**(16)**	**15**	**2**	**(44)**
(Inc.)/ Dec. in Fixed Assets	(5)	(4)	(9)	(14)	(23)
(Inc.)/ Dec. in Investments	1	0	(57)	(55)	0
Cash Flow from Investing	**(4)**	**(4)**	**(66)**	**(69)**	**(23)**
Issue of Equity	-	-	97	-	3
Inc./(Dec.) in loans	19	32	(24)	101	114
Dividend Paid (Incl. Tax)	-	-	-	-	-
Interest / Dividend (Net)	(13)	(17)	(9)	(22)	(30)
Cash Flow from Financing	**7**	**15**	**64**	**80**	**86**
Inc./(Dec.) in Cash	7	(5)	13	13	19
Opening Cash balances	**10**	**18**	**12**	**25**	**74**
Acquired on acquisition	-	-	-	37	13
Forex translation	-	-	(0)	(1)	(0)
Closing Cash balances	**18**	**12**	**25**	**74**	**107**

Key Ratios

Y/E March	FY2012	FY2013	9MFY14	15MFY15	FY2016
Valuation Ratio (x)					
P/E (on FDEPS)	577.5	297.6	201.1	53.5	40.6
P/CEPS	362.6	218.2	162.6	46.4	34.4
P/BV	67.7	52.6	19.5	14.3	10.4
EV/Sales	5.7	3.7	3.6	1.5	1.1
EV/EBITDA	134.3	84.9	91.0	28.6	23.5
EV / Total Assets	14.2	11.1	9.1	5.2	3.1
Per Share Data (₹)					
EPS (Basic)	0.5	1.1	1.6	5.9	7.8
EPS (fully diluted)	0.5	1.1	1.6	5.9	7.8
Cash EPS	0.9	1.5	1.9	6.8	9.2
Book Value	4.7	6.0	16.3	22.2	30.5
Returns (%)					
ROCE	21.4	24.8	14.3	25.5	20.6
Angel ROIC (Pre-tax)	42.5	35.9	24.4	43.0	37.0
ROE	11.7	17.7	9.7	26.7	25.6
Turnover ratios (x)					
Asset Turnover (Gross Block)	33.4	41.1	31.6	42.5	23.3
Inventory / Sales (days)	0	0	0	0	0
Receivables (days)	67	58	34	49	45
Payables (days)	2	2	1	7	7
WC cycle (ex-cash) (days)	65	56	33	42	39

Note: Valuation ratios based on pre-issue outstanding shares and at upper end of the price band

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