

Quess Corp Limited

ADD

Superior sourcing drives a competitive edge

Rs555

Reason for report: Initiating coverage

We initiate coverage on Quess Corp (Quess) with an ADD rating and a DCF-based target price of Rs590. Quess has grown its revenues and EBITDA at a CAGR of 50.8% and 56.2% respectively over FY13-FY16. However, superior execution is reflected in a premium valuation of 33x Sep'18E EPS. We believe that improvement in working capital and cash conversion (Quess has generated positive FCF in just one of the past four years) will be critical for the valuation multiple to sustain or grow hereon. We expect three of the company's four business segments – general staffing, facilities management (FM) and industrial asset management (IAM) – to benefit from the structural trends of macro improvement, under-penetration and the shift from unorganised to the organised sector. We are relatively less sanguine on the IT staffing segment from a structural standpoint given the likely impact of automation on volume growth, though we expect the segment to grow very strongly for Quess at 25-30% in FY17. Quess has had an impeccable track record in integrating and assimilating acquisitions having grown the margins on acquisitions like Avon (FM) and Magna (India IT staffing) from 1.9% and 5.5% respectively at the time of acquisition (FY09 and FY11 respectively) to 6% and 12.7% in FY16. We expect acquisitions to remain an integral part of the strategy and expect acquisitions in the manned guarding and security services space, facilities management, and IT staffing in the US to be the key priorities.

- **Strong execution on growth and margins.** Quess has grown its revenues, EBITDA and EPS at CAGRs of 50.8%, 56.2% and 89.4% respectively over FY13-FY16. Growth has been strong even on an organic basis. For example, though reported revenue growth in FY16 was 67.3%, growth was very strong at >45% even on an organic basis excluding Brainhunter, MFX, Aravon and Hofincons. We expect strong execution to be sustained in the medium term with revenues, EBITDA and EPS estimated to grow at CAGRs of 26.4%, 36.4% and 38.7% respectively over FY16-FY18. Predictability of growth is higher for Quess given that it operates across segments like general staffing, IT staffing, facilities management (FM) and industrial asset management (IAM), which makes the company less reliant on growth from any one segment of the economy.

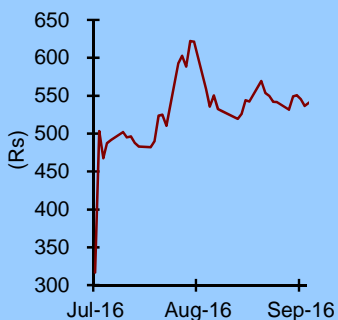
Technology

Target price Rs590

Shareholding pattern

	Jul '16
Promoters	89.5
Institutional investors	7.5
MFs and UTI	2.1
FIs / Banks	0.7
Insurance	0.2
Other Institutions	2.8
Others	3.0

Price chart



Note: Company listed on July 11, 2016

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Market Cap	Rs70bn/US\$1.1bn	Year to March	FY15	FY16	FY17E	FY18E
Reuters/Bloomberg	QUESS.BO/QUESS IN	Revenue (Rsmn)	20,536	34,350	44,795	54,886
Shares Outstanding (mn)	126	Net Income (Rsmn)	538	885	1,450	1,898
52-week Range (Rs)	622/317	Adj. EPS (Rs)	4.7	7.7	11.4	14.9
Free Float (%)	10.5	% Chg YoY	71.8	64.6	63.8	30.9
FII (%)	1.6	P/E (x)	117.2	72.4	48.6	37.1
Daily Volume (US\$'000)	NA	CEPS (Rs)	5.4	9.1	13.2	17.1
Absolute Return 3m (%)	NA	EV/E (x)	70.1	44.6	30.2	23.9
Absolute Return 12m (%)	NA	Dividend Yield	0.0	0.0	0.0	0.0
Sensex Return 3m (%)	7.4	RoCE ex cash (%)	19.9	19.9	20.8	23.5
Sensex Return 12m (%)	10.8	RoE (%)	24.6	29.6	23.2	19.0

Please refer to important disclosures at the end of this report

- **Predictability of growth and headroom on margins drive premium valuations.** We expect EBITDA margin ex other income to grow to 5.6% in FY18 from 4.8% in FY16 on account of the following: 1) profitability turnaround in Brainhunter and MFX, which should help the companywide EBITDA margin by 50-60bps from FY16 to FY18, 2) profitability improvement in the P&S segment as the higher-margin Training & Development (T&D) business grows faster than the segment average and as core employee headcount in general staffing is unlikely to increase meaningfully from the current 450 in the medium term.

Though the company's aspiration is to eventually get to an EBITDA margin of 8%, we don't see that happening with the current portfolio of services it offers. Target EBITDA margin is likely to be achieved primarily through acquisition of higher-margin assets.

- **Working capital improvement key for the premium multiple to sustain.** Quess has generated positive free cashflow in just one of the past four fiscals reporting OCF and FCF of a negative Rs442mn and Rs672mn respectively in FY16. Aggregate debtor days, though lower than the 49 reported in FY15, were still high at 45 in FY16 with debtor days being well higher at 60-65 days in segments like IT staffing, FM and IAM. It is also important to point out that Quess extends funding for 40% of its general staffing revenues (rest being 'collect and pay') with the same metric being 20% for Teamlease. However, we don't see funding increase further from the current levels for Quess. The company expects to lower debtors by four days in FY17. Though management focus thus far has been largely on the P&L in terms of integrating acquisitions and growing revenues and margins on them, it is imperative for the focus to move to the balance sheet and cashflow now for incremental value accretion.
- **Acquisitions to be an integral part of strategy; stellar integration execution thus far.** Apart from its general staffing business Ikya, which the company has built on an organic ground-up basis, Quess has done acquisitions across all other segments to either gain entry or build scale. Avon in facilities management, Magna and Brainhunter in IT staffing and Hofincons in industrial asset management have been some of the key acquisitions. Management has done an impeccable job integrating and growing the acquired assets. As an example, Avon's revenues have grown at a CAGR of 47% post acquisition from FY11 to FY16 with its EBITDA margin improving from 1.9% at the time of the acquisition (in FY09) to 6% in FY16. Likewise, Magna has grown at FY11-FY16 CAGR of ~20% with its EBITDA margin improving from 5.5% to 12.7% during the same period.

We would expect Quess to continue to make acquisitions with manned guarding and security services, facilities management and US IT staffing likely to be the key areas for inorganic investment.

- **Strong recruitment expertise and extensive branch network helps better client mining.** One key strength of Quess is its superior recruitment capability with the company having a team of >850 recruitment consultants across segments. Quess recruits between 70-80% of its gross additions in general staffing as against 20-50% by peers. In addition, Quess has a total of 47 branches across 26 cities which makes both sourcing of talent and handling of customer issues relatively easier. This is one of the reasons why Quess has been able to create better value add for its clients and mine them better. As an example, Quess has just around 200 clients within staffing and yet had >82,000 associates as at the

end of FY16. In contrast, Teamlease had 1,08,860 associates as at the end of FY16 (~30% more than Quess) though they have 1200 clients within staffing.

- **Established long-term relationships with clients and higher value add enhance revenue predictability.** Twenty-three out of the top 25 clients for Quess have been with it for over three years, with 15 having been a client for more than five years. Apart from strong sourcing capabilities and a wider branch network, what has helped Quess maintain sticky relationships and grow wallet share with its largest clients is its ability to go beyond the contract and look at incremental ways of creating value for clients. A case in point is the last mile logistics engagement (Dependo) that Quess has with Amazon, which now has been extended to Flipkart and Bigbasket as well. Given superior mining of large clients, client concentration is somewhat high but within reasonable limits for Quess with its top 10 clients contributing 30.4% (17% for Teamlease) of total revenues and the largest client (Samsung) contributing 7.4% of total revenues in FY16.

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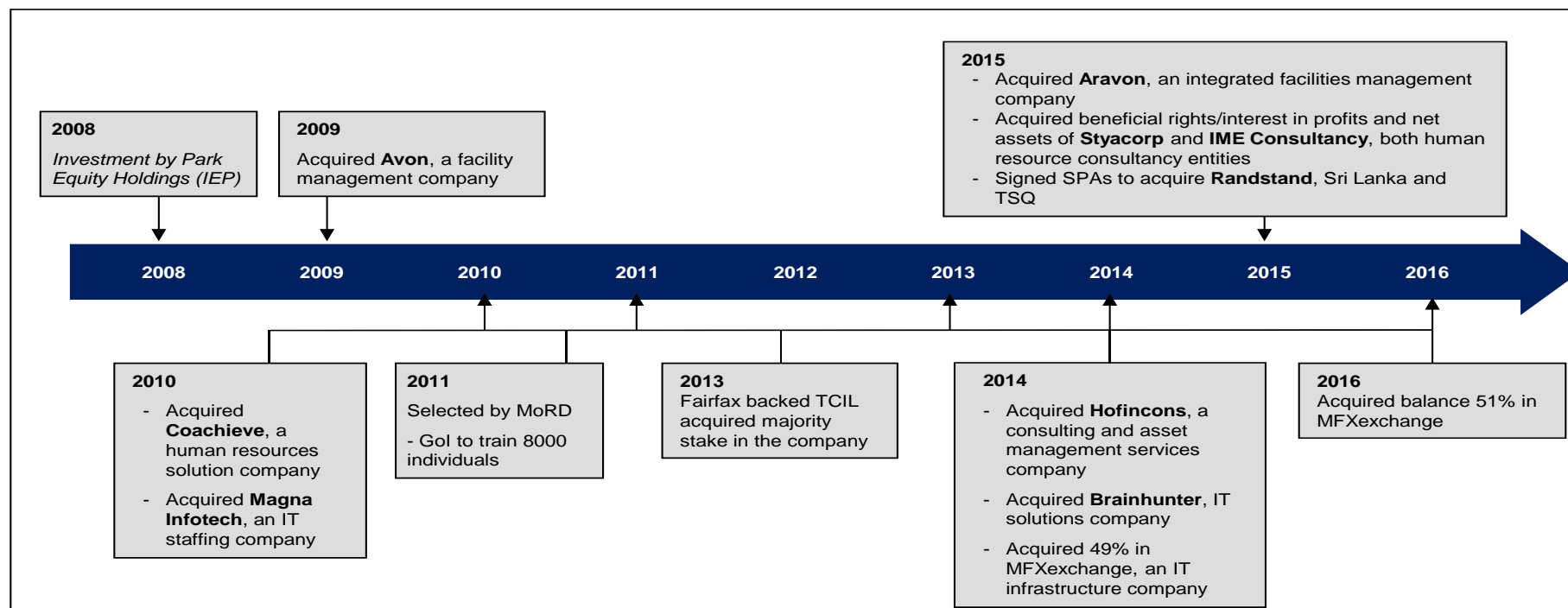
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Company overview in charts and tables

Chart 1: Corporate timeline



Source: Company data, I-Sec research

Table 1: Key acquisitions

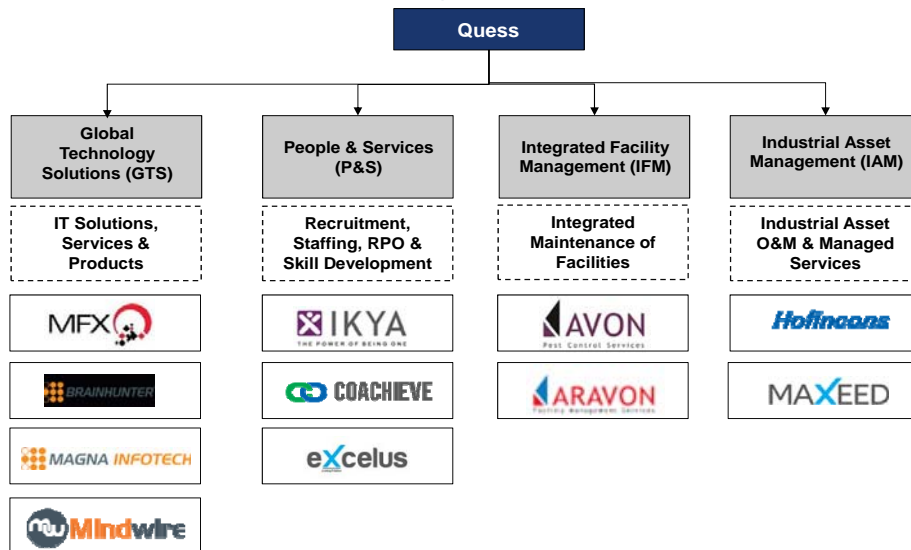
No	Company	Date of acquisition/consolidation	Shareholding acquired (%)	Total shareholding (%)
1	Magna Infotech	December 23, 2010	51	51
2	Avon ¹	May 14, 2013	26	100
3	Magna Infotech	May 13, 2013	49	100
4	Hofincons	June 27, 2014	100	100
5	Brainhunter	October 23, 2014	100	100
6	MFX	November 3, 2014	49	49
7	Aravon Services	April 1, 2015	100	100
8	MFX	January 1, 2016	51	100
9	Randstad Lanka	April 26, 2016	100	100
10	TSQ ²	SPA dated June 1, 2015	49	49

Source: Company data, I-Sec research

*1. 73.96% shareholding in Avon was acquired in July 2008.

2. Company entered into an agreement to acquire 49% of the equity shares of TSQ and beneficial interest in the remaining 51% of equity shares from Middle East Business Development Company WLL.

Chart 2: Diversified business segments and revenue streams



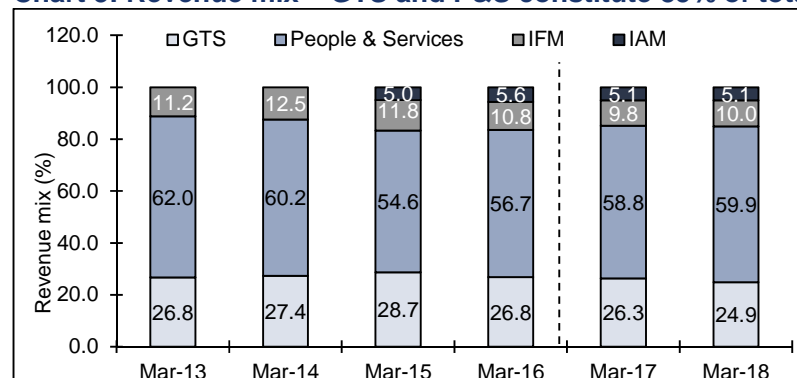
Source: F&S Report 2016; I-Sec research

Chart 6: Quess participates across segments with few end-to-end competitors

Segment	P&L Cost items	Quess	Competition	Global peers offering integrat business service
Global Technology Solutions	IT services and Maintenance	✓	Manpower Source One	
People and Services	Director labour	✓	Randstad Adecco Teamlease	
	Marketing services	✓	Adecco Teamlease	
	Training & skill Development	✓	ILFS Skills Datapro Computers	Interserve
	Compensation and benefits	✓	ADP Sodexo ISS	ISS World Sodexo
	Compliance management	✓	Aparajitha	Compass Gro
	Logistics	✓	Go Javas Delhivery	Serco
Integrated Facility Management	Building & Facilities Maintenance	✓	Dusters Total Solutions Services (DTSS) BVG India Ltd	
Industrial Asset Management	Plant and Machinery Maintenance	✓	Energro McNally Bharat Power Mech Projects	

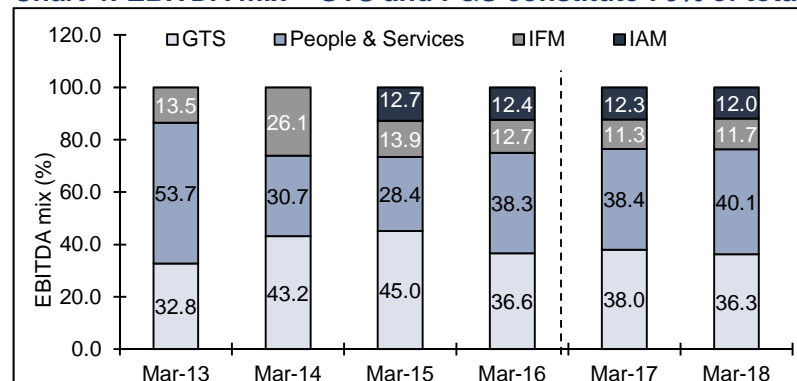
Source: F&S Report 2016; I-Sec research

Chart 3: Revenue mix – GTS and P&S constitute 85% of total



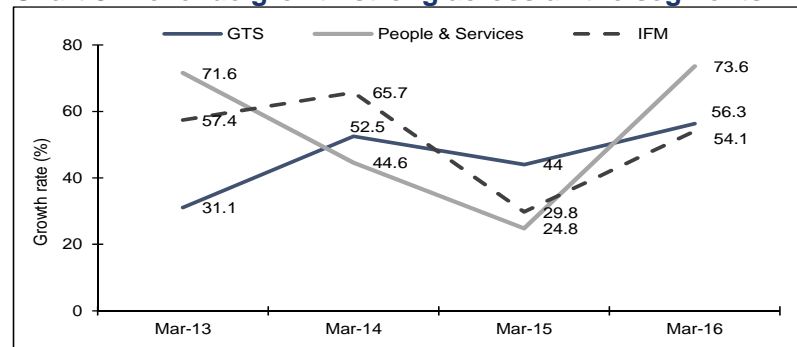
Source: F&S Report 2016; I-Sec research

Chart 4: EBITDA mix – GTS and P&S constitute 76% of total



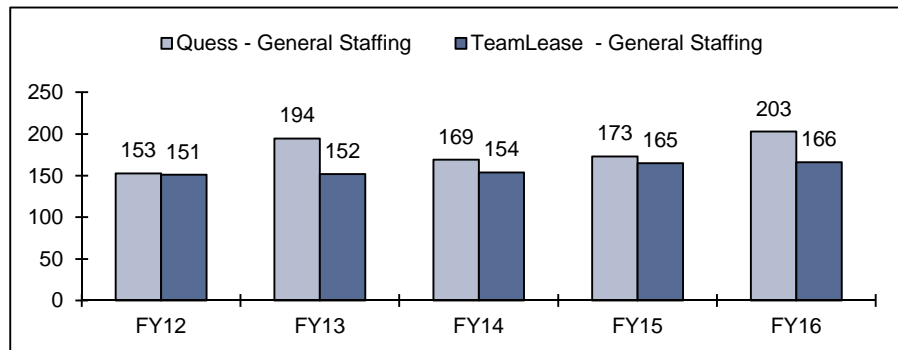
Source: F&S Report 2016; I-Sec research

Chart 5: Revenue growth strong across all the segments



Source: F&S Report 2016; I-Sec research

Chart 7: Associate to Core employee ratio – General Staffing



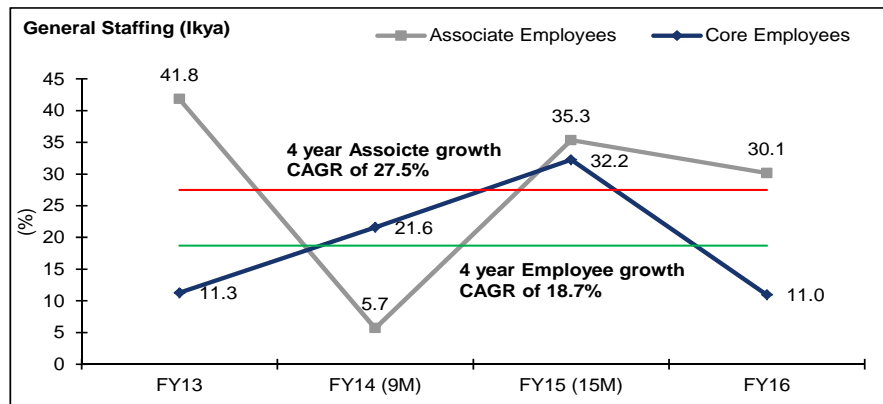
Source: Company data; I-Sec research

Table 2: Headcount – Core and Associate Employees

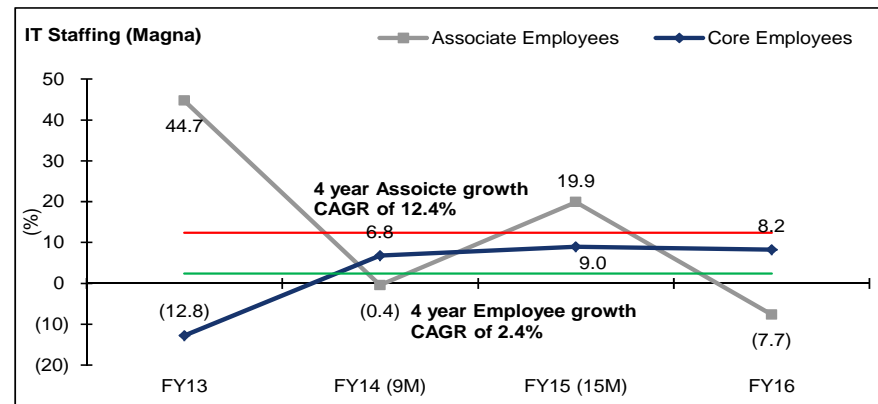
Segment	Core Employees	Associate Employees	Total
GTS	1167	8918	10085
P&S	1811	83038	84849
IFM	343	20012	20355
IAM	179	5427	5606
Total	3500	117395	120895

Source: Company data; I-Sec research
* as at the end of Feb 29, 2016

Chart 8: Volume growth > non billable headcount in General staffing (Ikya) as well in India IT staffing (Magna)

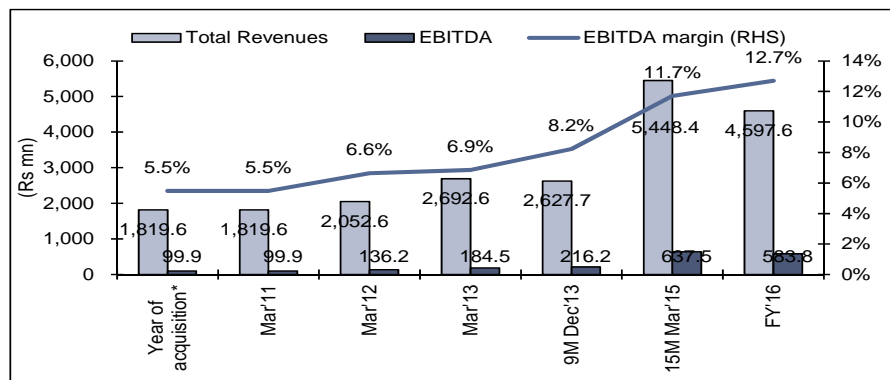


Source: Company data; I-Sec research

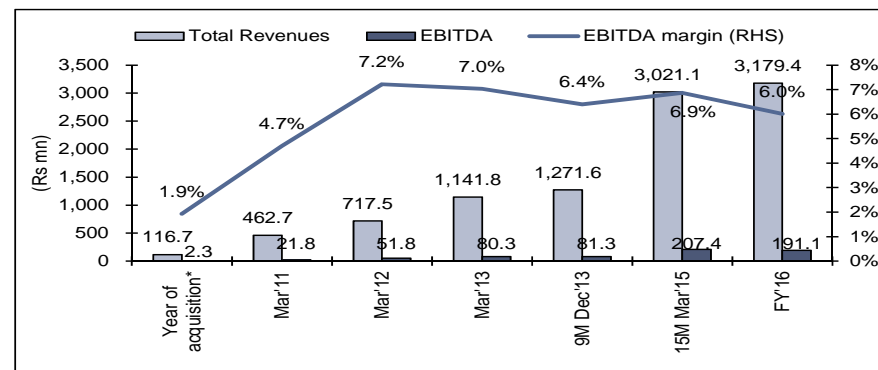


Source: Company data; I-Sec research

Chart 9: Stellar execution on acquisition integration – Magna and Avon



*Magna; Source: Company data; I-Sec research



*Avon; Source: Company data; I-Sec research

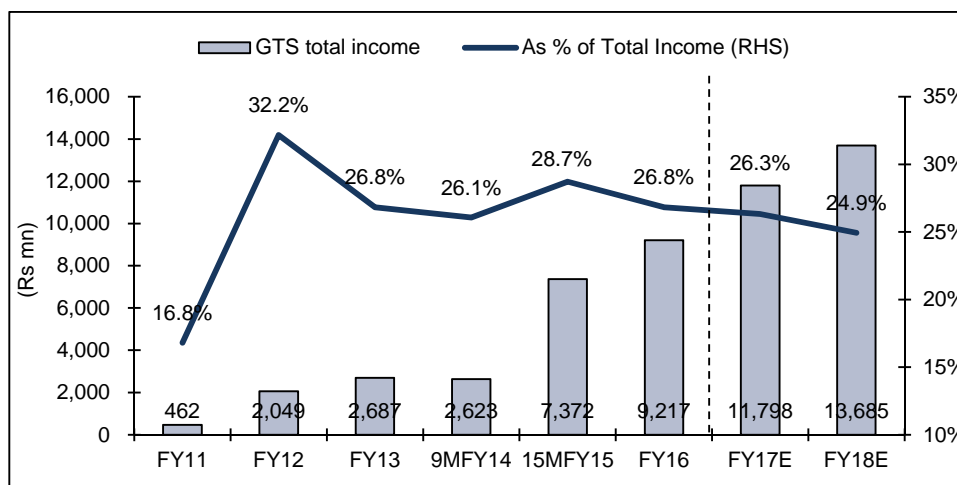
Business Overview

Quess is a leading integrated business services company with presence across general staffing, IT staffing, integrated facilities management (IFM) and industrial asset management (IAM). Quess was founded in September 2007 and has scaled quickly to a revenue base of Rs34350mn in FY16. Quess has grown revenues at a CAGR of 65.7% from FY11 to FY16 driven by a healthy mix of organic growth and strategic acquisitions. Quess is the largest IT staffing company in India by volumes and within the Top 5 companies as far as general staffing is concerned. The company worked with a total of 1300 clients as at the end of March, 2016 though the core general staffing business had just over 200 clients. Quess works with some of the largest brands and companies like Amazon, Samsung, Bata within general staffing, Bosch within IFM and L&T speciality steels within IAM. The company worked with a total of 20 Fortune Global 500 clients (2015) as at the end of March, 2016. Quess had a total of 1,27,250 employees (associate + core) as at the end of June 30, 2016 and had a pan India presence with 47 offices across 26 cities. International geographies constituted 14.3% of revenues in FY16 with Quess having presence across North America, the Middle East (UAE, Qatar) and South East Asia (Philippines, Malaysia) with more than 2000 employees (associate + core) working across such locations.

Global Technology Solutions (26.8% of revenues; 36.6% of EBITDA)

Global Technology Solutions (GTS) segment constituted 26.8% of overall revenues and 36.6% of overall EBITDA (excluding allocation of corporate costs) in FY16. The segment primarily comprises of three sub-segments: 1) India IT staffing (Magna), 2) Canadian IT staffing (Brainhunter), and 3) IT services products and solutions (MFX). Apart from Magna, Brainhunter and MFX, Quess also offers IT staff augmentation services in South East Asia, particularly in the Philippines and Malaysia but that business is still sub-scale. As of 29-Feb'16, the IT staffing business in South East Asia involved around 160 associate employees.

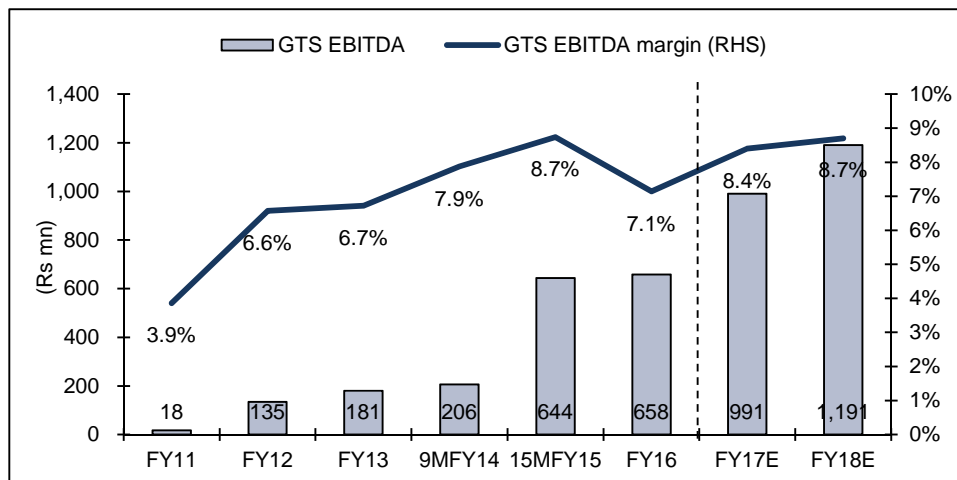
Chart 10: GTS contribution to overall revenues has been steady at 26-29% over the past four years



Source: Company data; I-Sec research

The segment has posted a 3 year revenue and EBITDA CAGR of 50.8% and 53.9% over FY13-FY16. EBITDA margins improved from 6.7% in FY13 to 7.1% in FY16 despite the integration of margin dilutive acquisitions in Brainhunter and MFX. India IT staffing margins actually have improved significantly from 6.7% in FY13 to 12.7% in FY16.

Chart 11: GTS EBITDA margin declined in FY16 on account of integration of Brainhunter and MFX



Source: Company data; I-Sec research

All three sub-segments have been built by way of acquisitions though Quess has done an exceptional job in integrating and assimilating the acquisitions very well. For example, Quess acquired Magna Infotech in FY11 for a total consideration of Rs881.4mn when the revenue and EBITDA margin of the business was Rs1819.6mn and 5.5% respectively. The business has grown at a CAGR of 20.4% from FY11 to FY16 with the margins having more than doubled to 12.7% since.

Quess had 1,167 own employees within GTS with 723 of them being related to the India IT staffing segment. There were a total of 450+ recruiters for the India IT staffing business as at 31- Mar'16.

With regards to acquisitions in the segment, Quess may look to either acquire an IT staffing company in the US or some assets in the IT P&C insurance space.

India IT staffing (Magna) – largest player by volumes

Magna is the largest player for staff augmentation and IT staffing in India as per Frost & Sullivan. The key clients for Magna are captives within the IT and BFSI verticals with the company having reasonable exposure to other verticals like telecom and manufacturing as well. Clients within GTS include four Fortune 50 companies ranked in the 2015 Fortune 500 list. Key competition for Magna in IT staffing comes from companies like Manpower Group, Collabera, SourceOne, Artech Infosystems and Datamatics Staffing Services Limited.

Revenue per associate employee (average) per month for Magna has grown at a CAGR of 8% over FY13-FY16 with number of associates (average basis) having grown at a CAGR of 10.7%. Revenue per associate has been a function of both wage inflation and the improving mix of employees.

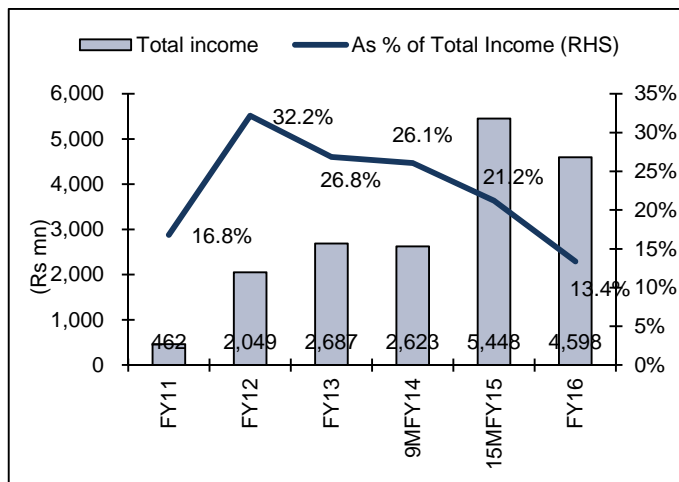
However, total associates as at the end of FY16 for the India IT staffing segment were 8077, well lower than the 8748 associates as at the end of Mar'15. The decline was largely on account of completion of assignment at one client where both the realisation and margins were very low. Despite the decline in volumes on a year-end basis, revenues at Magna increased by 5.5% YoY to Rs4597.6mn in FY16 given the growth in associates on an average basis with the revenue per associate (average) being broadly flattish YoY at Rs45,543.

Table 3: Key volume and realisation metrics - Magna

	FY11	FY12	FY13	FY14 (9M)	FY15 (15M)	FY16
Associate Employees	3,926	5,063	7,328	7,296	8,748	8,077
Average - associate employees		4,495	6,196	7,312	8,022	8,413
Core Employees	543	658	574	613	668	723
Associate to Core Employee Ratio	7.2	7.7	12.8	11.9	13.1	11.2
Revenue/associate employee (avg) per month (in Rs)	nm	37,999	36,144	39,853	45,279	45,543

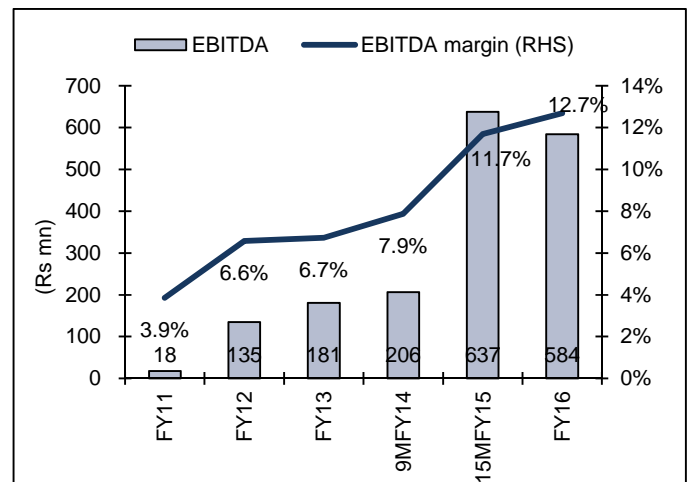
Source: Company data; I-Sec research

Chart 12: Magna contribution is now just 13.4% of revenues – down from a peak of 32.2% in FY12



Source: Company data; I-Sec research

Chart 13: Magna margins have seen a consistent improvement over the years



Source: Company data; I-Sec research

Quess has seen encouraging traction in the segment in FY17 thus far with total associate headcount already near 8800 as against 8077 as at the end of FY16 and we are projecting the headcount to move to 9500 by FY17-end. As a result, we expect growth in the segment to be 25-30% in FY17. However, we would expect growth to slow to a CAGR of 15-18% post that for the next three years on account of slowing growth within the IT services industry given the law of large numbers as well as the impact of automation on IT industry volumes.

Magna has a debtor profile of more than 65 days currently though we expect the same to be in the 60-65 days range on a structural basis.

Automation a headwind but Magna relatively well placed

We believe that automation would eventually lead to higher non-linearity and thus a lower volume requirement within the IT services industry which will have an implication for IT staffing growth as well. However, Magna is relatively better placed within the segment on account of the following: 1) it has modest exposure to the BPO segment where the risks to volume from automation are higher, 2) Quess has a higher exposure to the captives than India heritage vendors, with automation likely to play a smaller role in the case of the former in the medium term, and 3) Quess targets 4-7 year pyramid and does not engage with freshers who are more likely to get impacted from automation in the near-to-medium term.

Brainhunter and MFX: Sources of cost optimisation and margin expansion

Quess acquired Brainhunter in Oct'14 from the Zylog group for a total consideration of US\$10mn (with Rs5.5mn being equity and the rest being assumption of working capital debt). Brainhunter is an IT staffing company in Canada and had revenues of CA\$85mn in the year of the acquisition. Brainhunter turned EBITDA positive in Q4FY16 and we expect the segment to have a steady state EBITDA margin of 1.5-2% over FY17-18. In addition, the wholly owned subsidiary of Brainhunter, Mindwire based in Ottawa, Canada, focuses on providing Canadian government departments and agencies with IT services and solutions.

Though Quess had purchased a 49% stake in MFX in November 2014, it acquired the remaining 51% stake in Jan, 2016 and started consolidating MFX from Q4FY16. MFX provides IT Solutions and Product offerings through MFXchange Holdings Inc. MFX has a track record of around 15 years in developing IT solutions focused particularly on the P&C insurance industry and is also SOC 1 Report certified IT solutions provider which provides customized data-centre and infrastructure services, including private cloud services, to various industries.

MFX data centres are located in Virginia and New Jersey in the US and Quess supports these data centres through its wholly-owned offshore delivery centres in Chennai and Bengaluru in India.

Quess has paid just US\$100 for MFX upfront but will be paying 40% of net profits till CY19 to Fairfax. MFX has already turned profitable in Q4FY16 and can have steady state EBITDA margins within a range of 8-10%. Quess has already provided Rs322mn within the balance sheet as an estimate of the purchase consideration for MFX and therefore does not need to expense that separately in the P&L. We are embedding revenue growth of 15% for MFX in FY17 with the company recently having won a large deal with an APAC client where MFX is partnering with NTT Data to provide system integration and associated services. Asset requirement for MFX should be modest in the medium term as the current data centers are underutilised with the company willing to lease infrastructure and/or use cloud capabilities as well.

Brainhunter and MFX should help the segment margins by ~200bps and overall company margins by 50-60bps from FY16 to FY18, by our estimates.

Professional staffing industry background

The Indian IT staffing industry is expected to grow at a CAGR of 21.7% from Rs125bn in CY14 to Rs333.bn in CY19, according to Frost and Sullivan, with growth to be a combination of volume requirements of the IT industry, wage inflation and better mix as need for niche skills sets (e.g., for big data, cloud, analytics, IoT etc) and domain expertise goes up.

The IT industry in India added 230,000 jobs in FY15 with significant hiring of IT resources seen in other industries like BFSI as well. The percentage of temporary employees in the total manpower ranges between 5 to 15%, with the percentage being higher in Captives and MNC IT companies and small in the case of India heritage vendors.

Table 4: Professional IT staffing market – Spending on temporary staff by IT companies, India, 2014

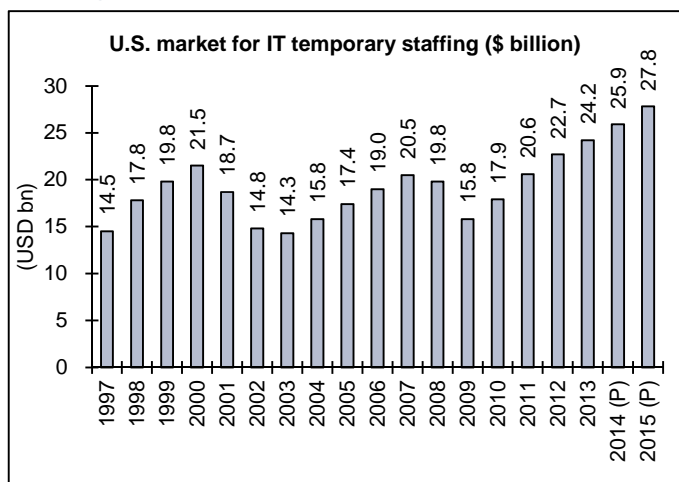
S. No.	Company name	Annual Spending, 2014
1	IBM	USD 120 - 150 million
2	Accenture, Microsoft, Cisco	USD 60 - 80 million
3	Cognizant, HCL Technologies, Oracle	USD 50 – 80 million
4	MacAfee, Tech Mahindra, Wipro, Goldman Sachs, Intel, Motorola, Google, Tata Consultancy Services	USD 30 – 50 million
5	Infosys, Cap G, JP Morgan, iGate	USD 10 - 30 million

*USD = INR 61.00, Average 2014; Source: F&S Research & Analysis

Professional IT staffing market in North America

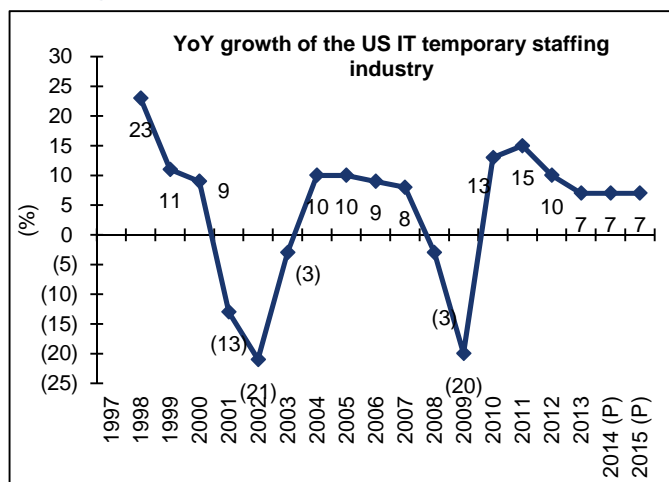
The size of temporary IT staffing market in the US was US\$24.2bn in 2014 with the Canadian market size being CA\$ 2.1bn. The US staffing market is expected to grow around 6-7% p.a. with the market likely to be exposed to macro driven cyclicality unlike the Indian market where IT staffing opportunity is more structural in nature.

Chart 14: Market size of the US IT temporary staffing industry



Source: SIA - US IT Staffing Growth Assessment

Chart 15: YoY growth rate in U.S. IT temporary staffing industry



Source: Staffing Industry Analyst's U.S. Staffing Industry Forecast – September 2014 Update

Table 5: Largest IT staffing firms in the United States

Rank	Company	2014 U.S. IT temporary staffing revenue (US\$ million)	Market share
1	TEKsystems (Allegis Group).	3,078	12%
2	Software Developers, systems software.	1,388	5%
3	Software Developers, applications.	1,221	5%
4	Computer systems analysts.	1,104	4%
5	Database administrators.	925	4%

Source: SIA – 2015 Largest IT Staffing Firms in the United States

IT staffing in North America is characterized by significant shortage of skilled workers as reflected in the low fill rates (24% compared to 70% for the overall staffing industry in the US) and high time-to-fill metrics for the industry (10 days compared to 5 days for the overall staffing industry in the US). This skill shortage translates into high gross margins for the IT staffing business of around 25%. (Source: SIA - US IT Staffing Growth Assessment).

Over the past 14 years, IT employment in the US has increased more than 41%, compared to just 5.5% growth in overall employment. The segment is expected to continue to outperform through to 2022, growing 18% vs 10.8% for total employment (Source: SIA - US IT Staffing Growth Assessment).

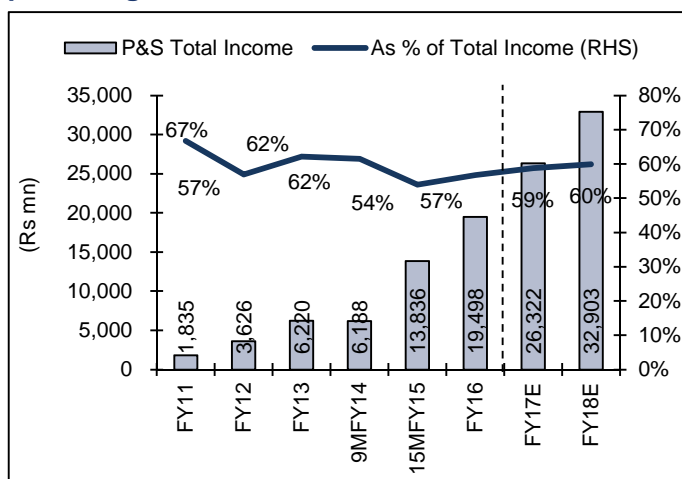
Geographically, the IT staffing market in the US is largely concentrated in California, Texas, New York (together forming 30% of the total US IT staffing market), while 96% of the Canadian employment services market is concentrated in Ontario, Alberta, Quebec, and British Columbia (Source: SIA - US IT Staffing Growth Assessment and SIA - Canadian Staffing Industry Outlook). As a result, Quess would be focusing largely on the same micro markets to grow their staffing business in North America.

People & Services (56.7% of revenues; 38.3% of EBITDA)

Quess's People and Services segment comprises of three key sub-segments: 1) General Staffing (Ikya), 2) Payrolling/Compliance/RPO (Coachieve), and 3) Training & Development (Excelus). Within general staffing, bulk of the revenue is contributed from India though the company has presence in UAE and Srilanka as well through the acquisition of Styracorp and Randstad, Srilanka respectively.

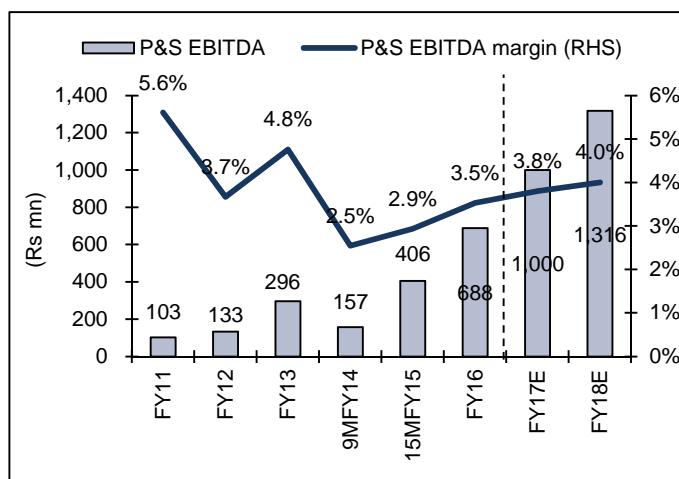
P&S segment comprised 56.7% of overall revenues and 38.3% of overall EBITDA in FY16. P&S revenues have grown at a CAGR of 46.4% from FY13 to FY16 with growth being even higher at 73.6% in FY16. Volume (associate employees) has grown at a CAGR of 24.5% over FY13-16.

Chart 16: P&S segment revenues and as percentage of total revenues



Source: SIA - US IT Staffing Growth Assessment

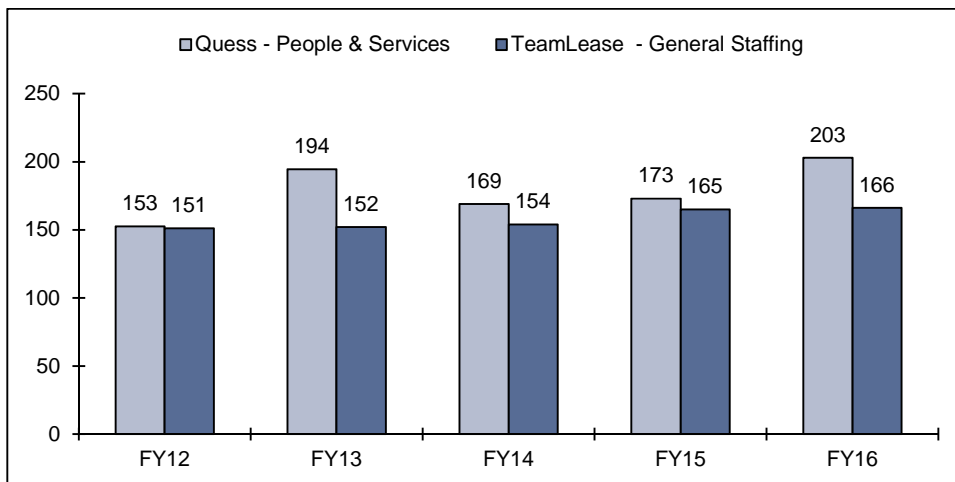
Chart 17: P&S EBITDA and EBITDA margin



Source: Staffing Industry Analyst's U.S. Staffing Industry Forecast – September 2014 Update

The P&S segment has seen its EBITDA margins increase from 2.7% in FY14 to 3.5% in FY16 driven by an improvement in business mix (higher T&D revenues) and improving productivity. Associate to core employee ratio within general staffing has improved from 169 in FY14 to 203 in FY16.

Chart 18: Associate to Core employee ratio



Source: Company data; I-Sec research

Total associate employees within the India business as at the end of FY16 were 82,170 as against just 63,141 at the end of March, 2015. Realisation per associate (average) per month increased by ~31% in FY16 on account of 1) normal wage inflation, 2) minimum wage revisions in some states, and, 3) improvement in employee mix.

Table 6: Key operating metrics for the general staffing business

	FY11	FY12	FY13	FY14 (9M)	FY15 (15M)	FY16
Associate Employees	15,313	31,128	44,146	46,652	63,141	82,170
Average - associate employees		23,221	37,637	45,399	54,897	72,656
Core Employees	NA	204	227	276	365	405
Associate to Core Employee Ratio	NA	153	194	169	173	203
Revenue/ associate employees (avg) per month (in Rs)	9,983	13,011	13,773	15,145	17,045	22,364

Source: Company data; I-Sec research

Better sourcing capabilities, verticalised go-to-market and focus on value added activities the key differentiators for Quess in general staffing

Quess has strong sourcing capabilities with the company typically sourcing 70-80% of their client’s associate requirements in a given year. This is in contrast to TeamLease, which does sourcing for just 20% of their associate gross additions in a given year. The company ties up with government agencies, NGOs and works on the ground with Village Panchayats etc for better sourcing of the candidates. Also, Ikya gets a significant majority of its revenues from the retail and e-commerce verticals and has verticalised its go-to-market to expand aggressively into other verticals like BFSI and Manufacturing. Total clients within general staffing are somewhat over 200 for Quess as against Teamlease having a total of 1200 clients within their staffing business. Ikya provides funding to a larger proportion of its clients than Teamlease with funding constituting 40% of its revenues v/s just 20% for Teamlease. We would expect this proportion to remain stable going forward.

One defining characteristic of Quess has been its ability to provide value added services to its clients like providing last mile logistics for some of its e-commerce clients. Quess has a logistics subsidiary Dependo which primarily handles delivery for e-commerce companies like Amazon amongst others, with special expertise in last mile solutions. Given the staffing genesis of Quess, the company is able to manage the attrition of the delivery resources very well, which typically tends to be very high at 40-50% per annum.

Dependo has a workforce of 1000+ employees, has offices across 36 locations in India and is already delivering more than 10,000 packages per day. The company has set up warehouses with micro delivery centres across cities in India with all shipments from clients coming to the delivery centre first with the consignments getting picked for delivery by the associates the next day. The company runs a hub and spoke model with the sub-hubs catering to an area of 8-10kms.

The company did 2,80,000 shipments in the month of July with the volume expected to triple by the end of FY17 itself. The segment should be EBITDA positive in FY17.

Better sourcing capabilities, sharper focus on hunting in addition to efficient farming, willingness to provide higher funding in a prudent manner, and ability to provide value added services on top should ensure that volume growth within general staffing remains at high levels over the next few years.

We would expect volume growth in the business of 25%+ with growth in gross revenues of ~35% in FY17. Ikyo has already crossed 90,000 associates as at the end of July and added nearly 2400 associates just in the month of July itself. Core employee headcount within Ikyo is unlikely to grow significantly from the current 450 in the medium term which should enable continued improvement in the operating margins in the segment.

Training and RPO have small scale but meaningfully better profitability

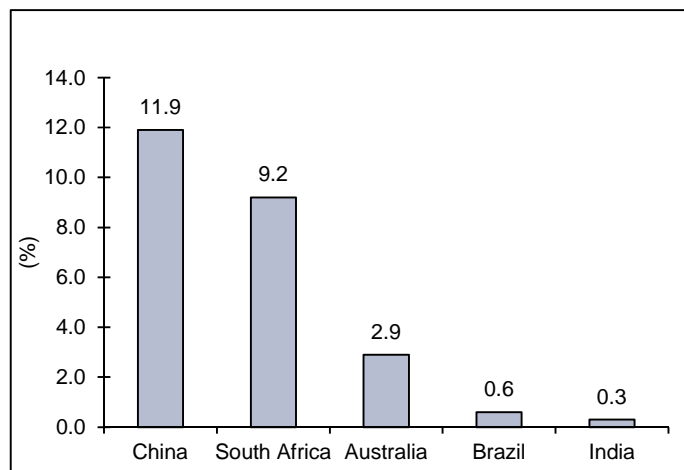
Within Training and Development, Quess is focused on government funded as against candidate funded programs. The company is participating in schemes like PMKVY and DDUKVY where the working capital characteristics are reasonable with government paying 25% of the project cost upfront in the case of some schemes. The company pays a small rental for the infrastructure which is again typically acquired from the government like Colleges, Polytechnics etc. The company has 66 centres across India and has trained 14,500 candidates in FY16. We would expect revenue growth in the segment to be 50%+ in FY17 given the recent deal wins in the space which the company is executing on.

Quess also provides services like payrolling, background verification and compliance management under its Coachieve brand alongwith recruitment process outsourcing. Though these services in aggregate have a smaller scale with FY16 revenues of nearly Rs350mn, the segment makes EBITDA margins of 20%+. We would expect this segment to grow within a range of 25-35% p.a over the next few years.

Temporary and General Staffing - Industry Background:

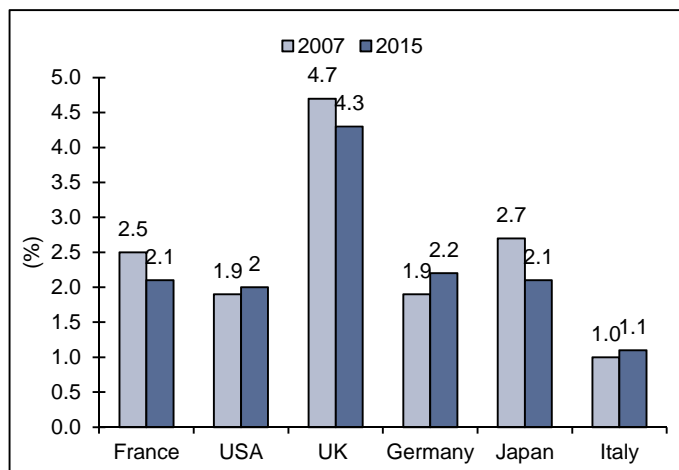
Global average for flexi staffing penetration is 2% with the penetration being significantly higher in countries like China and South Africa where the penetration of flexi staffing was 11.9% and 9.2% in 2014.

Chart 19: Temporary staffing market penetration rate in emerging markets



Source: CIETT Economic Report 2014, CRISIL Research, World Bank database

Chart 20: Temporary staffing market penetration rate in mature markets

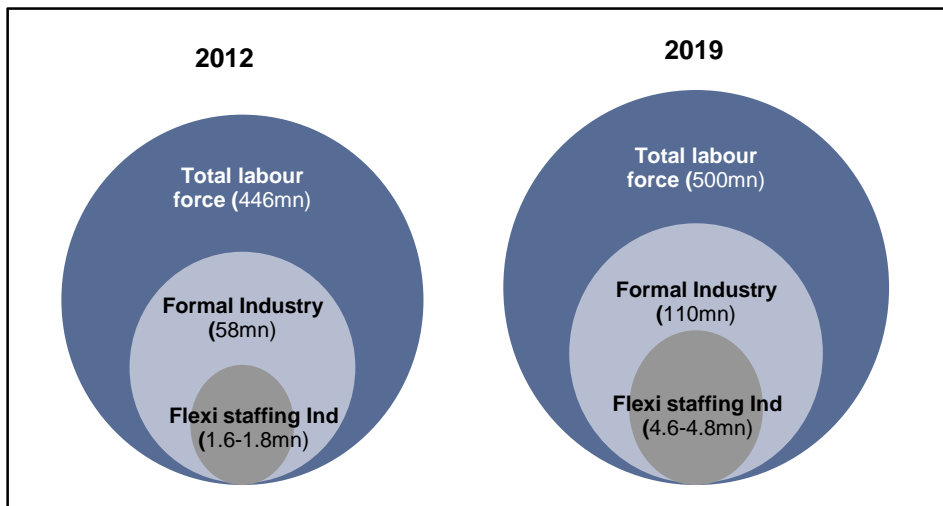


Source: Adecco annual report (2015)

Staffing penetration in India is just 0.3%, well lower than the global average of 2%. Total working population in India was 446mn in 2012. However, only 13% of the labour force or 58mn employees came from the formal sector out of which 1.6-1.8mn were on the payrolls of third party staffing service providers. In essence, the penetration of flexi staffing as a percentage of the formal sector employment in India is in fact higher at around 2.9%, which though higher than the global average is still lower than other emerging economies like China and South Africa where the staffing penetration of overall employment is 11.9% and 9.2% respectively.

As a result, we expect staffing penetration in India to be more a function of the increased formalization of the workforce. Though overall labour force is expected to grow at a CAGR of just 2% from 2012 to 2019, the formal sector is expected to gain share and grow at 9-10% CAGR with the penetration of flexi staffing expected to reach 1% by then. Stricter compliance towards minimum wages and benefits is also driving a swifter shift towards the formal sector and flexi staffing in India. Associates on the payrolls of flexi staffing companies are expected to grow at a CAGR of 20-25% from the range of 1.6-1.8mn in 2012 to a range of 4.6-4.8mn by 2019.

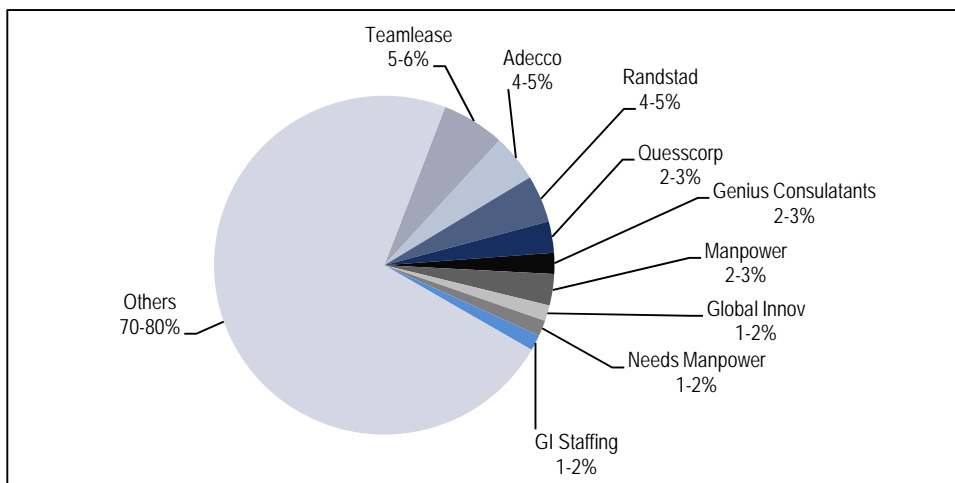
Chart 21: Flexi Staffing volume to grow at a CAGR of 20-25% from 2012 to 2019



Source: Crisil Research, Survey by ASSOCHAM and National Institute of Labour Economics Research & Development

Regulation and legislation should hasten the market share consolidation within the sector. Nearly 70 to 80% of the staffing market share in India resides with the no-name, local and unorganised players with the Top 5 players in TeamLease, Quess, Adecco, Manpower and Randstad constituting just 22% of the overall market. The key value proposition of the unorganised players at times is to take advantage of regulatory arbitrage ensuring higher take home pay for the associates but compromising on regulatory deductions. We expect GST to be a key catalyst for driving market share away from the fragmented long tail of service providers to brand name players like Quess, TeamLease, Adecco and manpower amongst others.

Chart 22: Market share of players by number of associates



Source: CRISIL Research; I-Sec research

We would expect GST to be the first key piece of legislation which will help drive the market share away from unorganised players. Under GST, companies will get the input credit only when they have remitted GST payments to the relevant tax authorities – which they are able to get today despite the fact that their staffing vendors may not have made the requisite service tax payments.

Growth in general staffing is likely to be driven primarily by verticals like e-commerce, Telecom, BFSI, Healthcare and Retail. Telecom sector is likely to generate direct and indirect jobs of 4mn over the next 5 years in domain areas like sales, marketing, technicians and engineers. E-commerce industry in India is expected to grow at a CAGR of 15-20% over the next 5 years. The industry size was nearly US\$16bn in CY15 as per Internet & Mobile Association of India (IAMAI). E-commerce sector relies extensively on temporary staffing across the roles of delivery, customer service, warehousing and online marketing. e-commerce constituted 15,000 associates for Quess as at the end of FY16 out of its total associates of 82,170. According to National Skill Development Corporation (NSDC), the banking industry is likely to employ about 1.4million people by 2022. Likewise, Healthcare is one of the largest sectors in India both in terms of revenue and employment with the sector employing around 4million people in 2014.

Permanent recruitment market

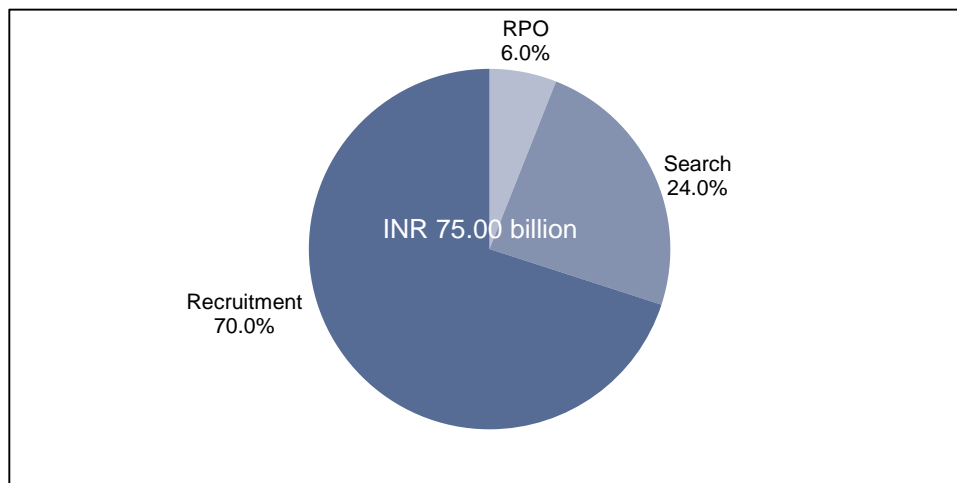
Search and Recruitment:

Permanent recruitment comprises of two main segments, 'search' and 'recruitment'. Recruitment forms a substantial part of the permanent recruitment segment catering to the junior and mid-level positions. The market for permanent recruitment was estimated at Rs 75.0 billion in 2014. The search market is a niche market focusing on CXO, board and top-level hiring. The demand for executive search has largely come from global MNCs based in India.

Recruitment Process Outsourcing (RPO):

RPO services are mainly needed for junior and mid-level employees due to the high volume of recruitments that happen at this level. RPO is a key growth segment in India. Industry estimates suggest that the RPO industry is expected to grow at a rate of 25-35% p.a over the next few years. IT/ITeS, BFSI and e-commerce are the key industries which are expected to accelerate the adoption of RPO services.

Chart 23: Permanent Recruitment Market – Breakdown by type of recruitment, India, 2014



Source: F&S Research & Analysis; I-Sec research

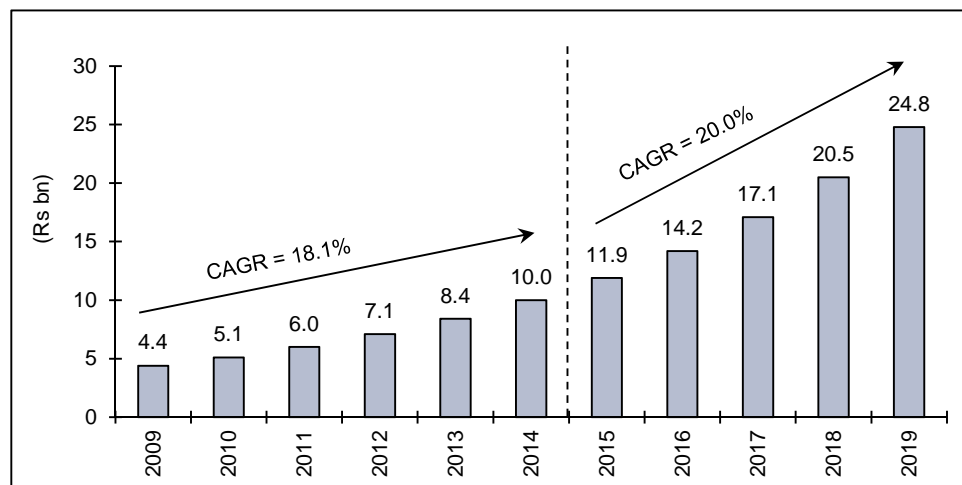
The revenue model for permanent recruitment and search is largely commission-based. Clients pay a fixed percentage of salary (as commission) based on the employee’s cost-to-company once the candidate joins the organisation. For mid-level recruitment, industry averages suggest clients pay 12-16% (of the employee’s annual cost-to-company) once the candidate joins the organisation. For junior level recruitment, given the volume nature of the segment, fees for consultants may be lower in the range of 7-12% (of the annual cost-to-company) per recruitment.

Payroll and Compliance

Payroll processing involves processing of the compensation of employees including salaries, advances, reimbursements, computation of taxable deductions and withholding of tax and other statutory dues. Larger business see payrolling as a non-core activity and use it as a cost saving technique whereas small businesses typically do not have the proficiency or time to administer payroll. The increased outsourcing payroll and compliance has enabled third-party service providers to develop scale and offer services linked to SLA and key performance indicators. Companies like Quess provide payrolling services only for their own associate employees and do not offer it as a service to permanent employees either of client organisations or otherwise.

Regulatory compliance involves providing consulting services with respect to staffing and labor compliance issues as well as on corporate and legal compliance issues. Regulatory compliance services include providing a consolidated monthly management information system of compliance issues as well as fact-sheets that provide an executive level summary of a client’s regulatory compliance status across India. Payroll and Compliance is estimated to have been a Rs 10 billion market in 2014 having registered a CAGR of 18.1% between 2009 and 2014. The market is expected to grow at a 5-year CAGR of 20% from 2014 to Rs 24.8 billion in 2019. The increased adoption of outsourced payroll & compliance solutions by small and mid-sized enterprises will be the key growth driver as there are a total of 48.8mn MSME units as of 2014 which account for 17% of Indian GDP.

Chart 24: Payroll and Compliance Market – Historic revenue trend, India, 2009-14



Source: F&S Research & Analysis

The top companies in payroll and compliance market include ADP India Pvt. Ltd, Excelity Global (formerly payroll business of Aon Hewitt), Allsec Technologies Ltd, and Aparajitha Corporate Services (P) Ltd.

Integrated Facilities Management (10.8% of revenues; 12.7% of EBITDA)

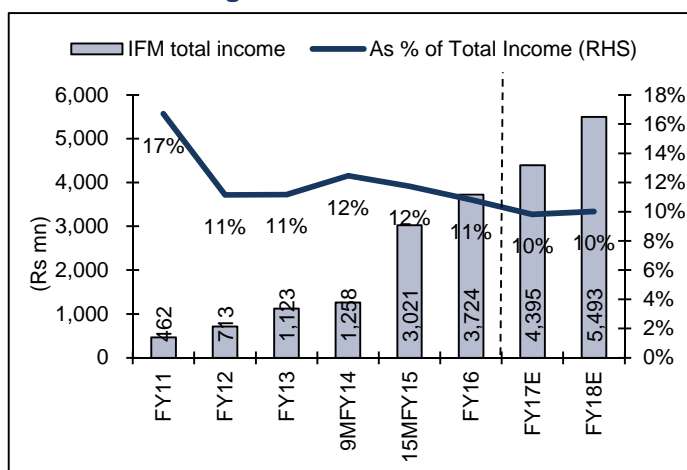
Facilities management constituted 10.8% of overall revenues and 12.7% of overall EBITDA in FY16. Quess provides integrated facilities management services across Soft services, Hard Services as well as Food & Hospitality with Soft services constituting 85% of segment revenues and Hard services constituting just 15%. Hard services capabilities were acquired through the Hofincons acquisition, which though an Industrial Asset management company had a small hard services segment as well, which Quess is now reflecting within Facilities management. Soft services are provided under the Avon brand whereas hard services and Food & Hospitality services are offered under the Aravon brand (F&H business was acquired from Aramark).

Within Soft Services, Quess provides a range of services including janitorial services, housekeeping, mailroom management, landscaping and pest control etc. whereas hard services comprise of HVAC, electrical, plumbing etc.

Soft services capabilities were acquired through the acquisition of Avon in FY09 with the company having successfully integrated and grown that asset. Avon has a track record of more than 21 years in the space.

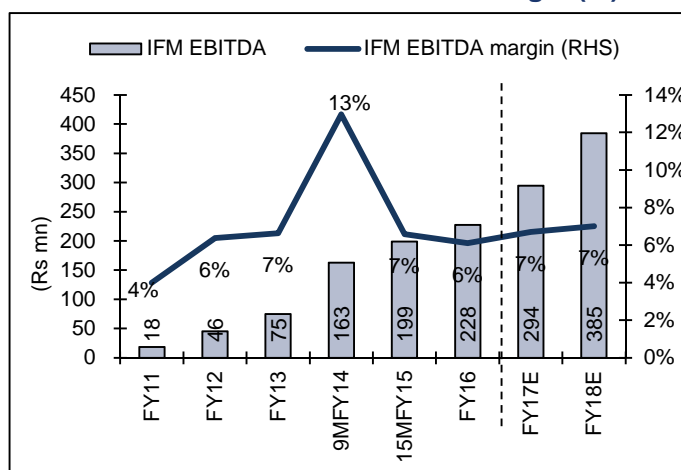
Avon has grown at a CAGR of 47% from FY11 to FY16 with growth remaining very strong at 31.5% even in FY16. EBITDA margins on the company at the time of the acquisition were just 1.9% which Quess improved to 7.2% in just 2 years with EBITDA margins for the business being a very healthy 6% even in FY16. Avon has a high exposure to the IT and BFSI segments though it does cater to other segments like hospitals and manufacturing as well. The company is also focussing on expanding into other industry verticals like airports and educational institutions which should drive predictability of growth. As per Frost & Sullivan, the company managed around 150mn sq. ft. of space in 2014 spread across India, and as of March 31, 2016, the company was spread across more than 550 locations in India across a range of industries including healthcare, BFSI, retail, and telecom. As of March 31, 2016, the company had 170 clients for soft services facility management business.

Chart 25: IFM segment revenue and as a % of total



Source: Company data; I-Sec research

Chart 26: IFM EBITDA and EBITDA margin (%)



Source: Company data; I-Sec research

Quess also acquired Aravon Services Private Limited (previously known as Aramark Services Private Ltd) in April 2015, which provides specialized services such as maintenance of healthcare, guesthouses, and hospitality facilities under Aravon brand.

With regards to Hard services, Quess provides a range of services including electro-mechanical services, including electrical maintenance, diesel generator set operations, plumbing, water supply management, carpentry, painting, HVAC and handyman services. As of March 31, 2016, the hard services facility management business had over 90 clients.

The company's food and hospitality service is ISO 22000:2005 certified (International standard for food safety management system) and is operated under the Aravon brand. The company operates central kitchens in Bengaluru and Mumbai with an aggregate capacity to serve over 850,000 meals per month. It had 15 clients as of March 31, 2016.

Quess has also entered the B2C segment through an exclusive arrangement with Helpr, an online home services marketplace in September 2015. Under such arrangement, the company will provide trained and certified personnel to service IFM orders aggregated by Helpr including pest control, cleaning, electrical repair, plumbing, appliance repair, and carpentry.

Facilities management works on a cost plus model with a typical mark-up being 10-12% with the segment having a DSO profile of 60 days.

Key competitors in the space are real estate consultancies like Knight frank, Jones Lange Lasalle, CB Richard Eliis as well as other companies like Bharat Vikas Group (BVG), Updaters and Dusters on the commercial side. We would expect consolidation to be a recurring theme in this segment.

The company's IFM business includes over 340 core employees and 20000 associate employees, and has served more than 850 clients as of February 29, 2016. The IFM business has also received global process quality certifications (ISO 9001:2008 and ISO 22000:2005), and it is also a member of ISSA, the global cleaning industry association.

Table 7: Associate to core employee ratio for IFM

	FY11	FY12	FY13	FY14 (9M)	FY15 (15M)	FY16
Associate Employees	5,237	6,871	9,040	12,312	17,619	20,012
Average Employees	5,237	6,054	7,956	10,676	14,966	18,816
Core Employees	104	132	198	233	241	343
Associate to Core Employee Ratio	50.36	52.05	45.66	52.84	73.11	58.34
Revenue/associate (avg) employees per month (Rs)	7,345	9,821	11,767	13,088	13,458	16,494

Source: Company data; I-Sec research

Key clients for this segment include engineering companies such as Robert Bosch, several large financial institutions in India, Fortune 500 real estate services companies, and private airport management companies.

Increased acceptance for outsourcing of non-core activities, shift from single service contract model with multiple vendors to an integrated model with a single vendor and new opportunities within the B2C and B2G space are the key drivers of demand within

this segment apart from the burgeoning growth in real estate across the commercial, industrial and residential segments.

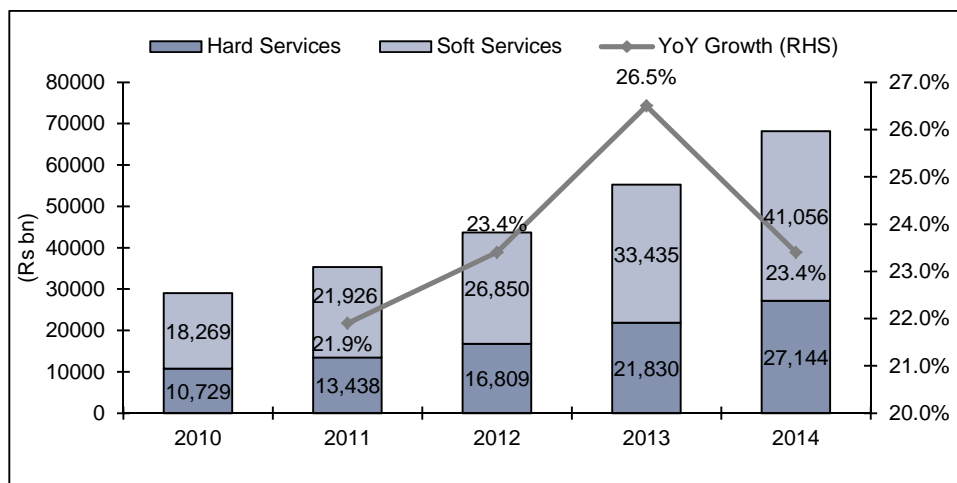
Facilities Management – Industry Background:

Integrated Facilities Management (IFM) refers to services which are non-core activities of a business and encompasses end-to-end maintenance of buildings and properties across residential, commercial and industrial sectors. FM services are broadly classified as hard services, which includes HVAC (Heating Ventilation and Air Conditioning) maintenance, fire safety systems, and plumbing maintenance and soft services which includes cleaning, housekeeping, catering, landscaping, pest control, and other services such as security services, guest house / service apartment management.

The segment is highly fragmented with the unorganised players constituting 60% of the market. There are more than 500 companies participating in the market opportunity with a significant number of the companies being subscale and operating only at a city level. Though receivables are high at around 60 days within the segment, it also means that only companies with a very strong financial position would be eventually able to scale. Within the organised segment, there are 10 to 12 large players which control about 50% market share. Some of the key market players offering integrated business services include Sodexo India On-site Service Solutions Pvt.Ltd, ISS Integrated Services Pvt.Ltd, Compass Group India Support Services Pvt. Ltd, Avon FM Services Pvt Ltd, BVG India Limited, Dusters Total Solutions Services and Updater Services India Limited.

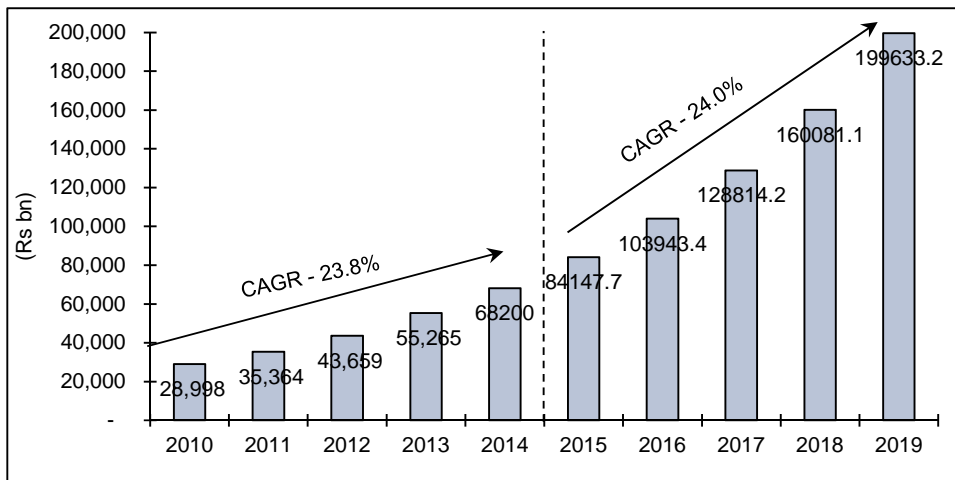
The FM market is shifting from single service contract model to integrated model as increase in consumables, manpower and management cost have impacted the cost of FM services, forcing customers to replace long-term contracts and providing momentum for Integrated Facilities Management (IFM) contracts. The Indian FM Market has grown at a 4-year CAGR of 23.8% from Rs28,998million in 2010 to Rs68,200million in 2014.

Chart 27: IFM market size and dispersion between Hard and Soft services



Source: F&S Research & Analysis; I-Sec research

Chart 28: Historical assessment and forecast of the FM Market, India, 2010-2019

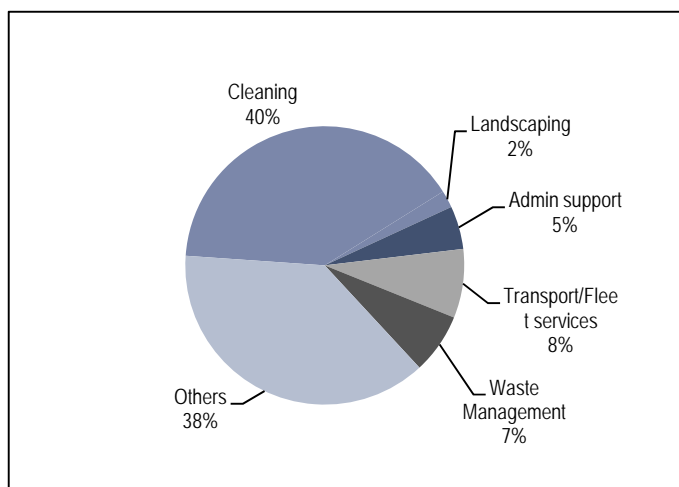


Source: F&S Research & Analysis, I-Sec research

The FM market in India is estimated to grow at a 5-year CAGR of 24% from Rs 68,200.00 million in 2014 to Rs199,633.20 million in 2019. Majority of the growth is expected to be driven by consistent growth in demand from the commercial sector. In addition, the increasing preference for professional FM in the residential sector coupled with increased incidence of high-rise residences that require unique FM solutions is expected to further drive growth.

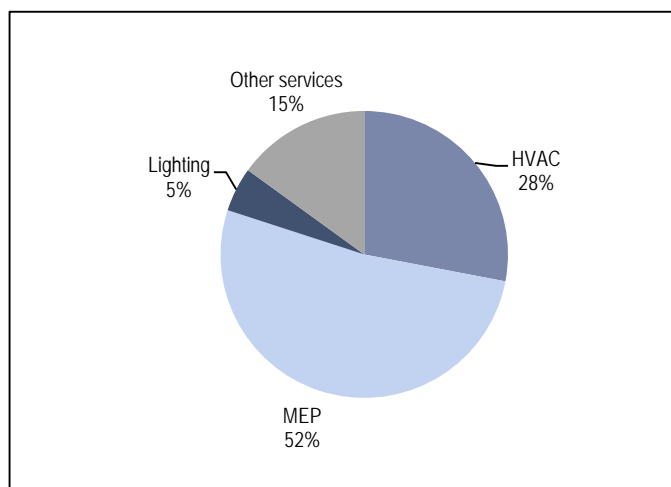
Hard services constituted 40% of the overall market with more than half of the revenues contributed by the Mechanical Electrical and Plumbing (MEP) services followed by HVAC. Within Soft services, cleaning constituted 40% of revenues followed by transport services and waste management.

Chart 29: Sub-service break-up of Soft services



Source: F&S Research & Analysis, I-Sec research

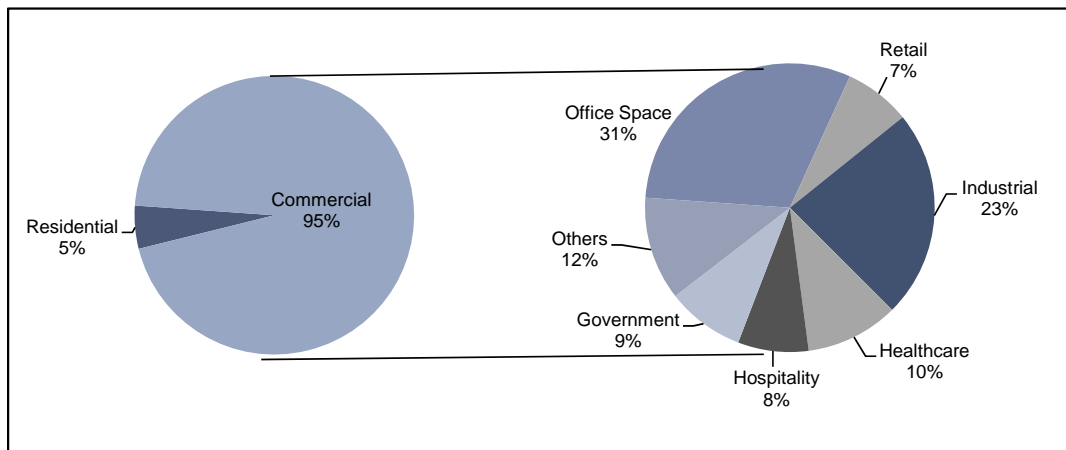
Chart 30: Sub-service break-up of Hard services



Source: F&S Research & Analysis, I-Sec research

Residential segment constitutes just 5% of the overall FM market in India. Within the commercial segment office sub-segment constitutes roughly 30% of the total. Industrial segment, Retail, Healthcare, Hospitality and the Government vertical are some of the other large segments for the industry

Chart 31: Office segment the largest FM market followed by Industrial



Source: F&S Research & Analysis, I-Sec research

Industrial Asset Management (5.6% of revenues; 12.4% of EBITDA)

Industrial Asset Management constituted 5.6% of revenues and 12.4% of EBITDA in FY16. Quess was running IAM through its own brand Maxeed (since 2007) in a managed services construct though the company enhanced capabilities within the segment through the acquisition of Hofincons in 2014. Hofincons now constitutes ~60% of segment revenues with managed services constituting the remaining 40%.

Within managed services, the company primarily engages with the Telecom and Utility verticals on engagements like installations of RF antennas, tower maintenance, network deployment services for the Telecom segment and for Smart meter installations, meter reading and bill raising for Utilities. Hofincons provides industrial Operations & Maintenance (O&M) services and related asset record maintenance services and typically engages with companies within the metal (ferrous and non-ferrous) and oil & gas industries. The company provides solution-driven maintenance services such as preventive maintenance, condition maintenance, shut down services, break down repair, and asset life extension services, which are aimed at reducing operational and maintenance costs, increasing operational efficiencies, and optimizing plant availability by reducing downtime. The company intends to expand operations in South East Asia, and thereby has entered into arrangements with CPI Engineering Services to commence operations in Malaysia.

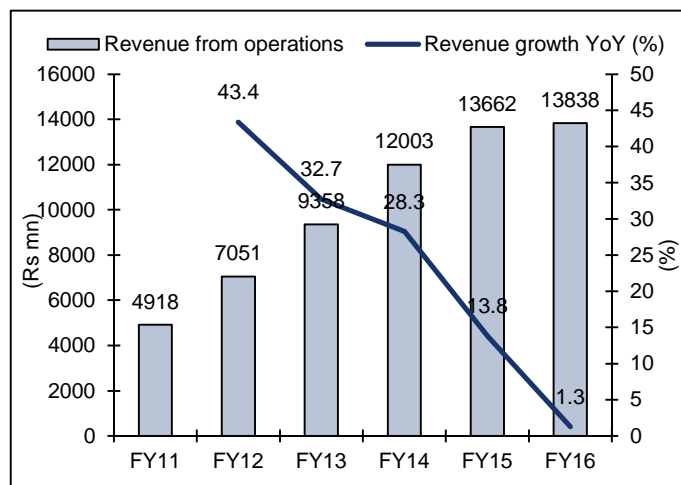
The company's intent is to move from providing point solutions (the company is largely an O&M player currently) to contracts that serve the entire industrial asset life cycle of erection, commissioning, maintenance and overhaul (Power Mech is a strong player within the power segment). The company also wants to move up the value chain and provide higher value added services like shutdown maintenance and providing technical training to employees over time as well. The company also wants to grow its Technology and Consulting services segment (primarily focused on Oil & Gas sub segment) faster than the company average given the 30-40% EBITDA margin profile of the sub-segment. The company specialises in managing master data for all industrial assets and providing improved information management services regarding those assets. T&C also encompasses ERP data solutions for large industrial clients. Key clients in this segment include L&T Special Steels and Heavy Forgings as well as

some of India's leading steel, cement, and energy companies as well as some of the largest conglomerates.

EBITDA margin in the IAM segment was 11.5% in FY16 though we would expect the margins to inch up to a range of 12-15% over the next few years. We would expect revenue growth to be modest in the segment in the range of 15-20% in FY17 given the company's exposure to distressed verticals like Power and Steel and would expect working capital to remain challenging in the near term for the same reason as well. Key competitors in this space are PowerMech Projects, Energo, Voltech, Voith, Thermax Services etc.

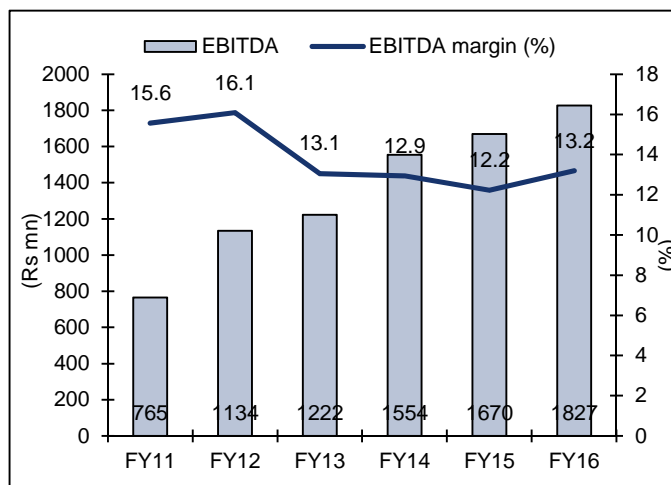
PowerMech is one of the few listed power infrastructure services companies in India with presence across ETC (Erection, Transmission and Commissioning), O&M services and Civil works. PowerMech is trading at just 0.45x trailing revenues which is reflective of the modest operating metrics of the business. Though PowerMech has been able to sustain margins in a narrow and reasonable range of 12-13% over the past 4 years, slowing growth (1.3% in FY16), high working capital requirements (DSO of 72 days and inventory of ~10 days), modest return on capital employed (16.5% post tax in FY16) and negative free cash generation in the past 5 years (FY11 to FY15) are some of the key reasons for its underwhelming revenue and earnings (8x trailing) multiple.

Chart 32: Operating revenue and revenue growth for PowerMech



Source: Company data; I-Sec research

Chart 33: EBITDA and EBITDA margin for PowerMech



Source: Company data; I-Sec research

Chart 34: Market Cap of PowerMech since its listing



Source: Company data; I-Sec research

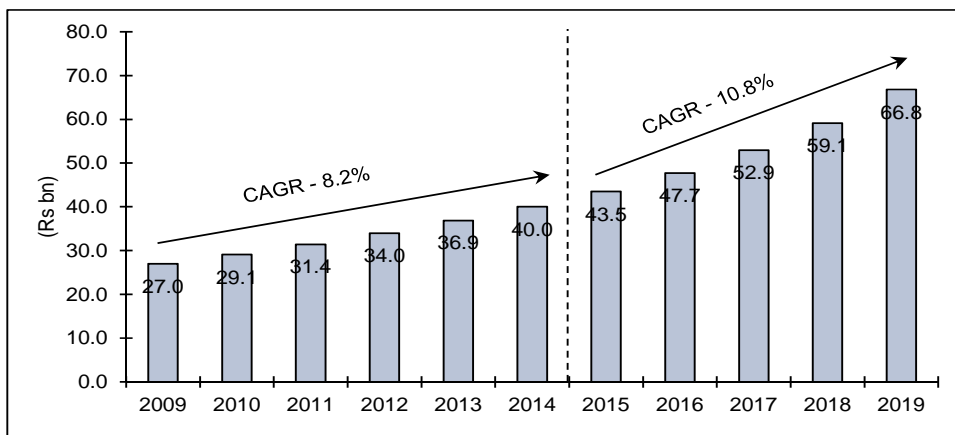
Industrial Asset Management - Segment Background

The Operations and Maintenance (O&M) market size was Rs40bn in FY14 according to Frost & Sullivan with revenue CAGR being 8.2% from FY09 to FY14. Growth is likely to pick-up to a CAGR of 10.8% from FY14 to FY19 in-line with a pick-up in macro and industrial activity. A large part of the growth is expected to be driven by the inflation in labour costs as well as the prices of consumables.

O&M services are provided by both OEMs and 3rd party service providers with OEMs having an advantage since they supply equipment as well and have a superior technical knowledge of the assets. However, OEMs over time have shifted their focus more on supervisory roles and for providing technical guidance while outsourcing services like dismantling, refurbishing and reassembling to 3rd party service providers.

Third party service providers now constitute roughly 55% of the market with key players in the segment apart from Hofincons being Power Mech Projects, Energo Construction Limited, Voith Industrial Services, STEAG Energy Services, Encotec, Enmas, Predominant and Rotodyne amongst others. BHEL, Siemens, Alstom, ABB and Thermax are some of the large OEMs with extensive service arms of their own. IAM is more formalised than other segments like Facilities management or general staffing though the unorganised sector still constituted 40% of overall revenues in FY14.

Chart 35: Historical assessment and forecast of the IAM Market, India, 2009-2019



Source: Frost & Sullivan; I-Sec research

Top four industry segments i.e., Power, Oil & gas, Steel and Engineering constitute roughly 90% of the market. Oil & Gas O&M market is expected to witness the fastest growth of 14% from FY14 to FY19 with the Cement segment expected to witness the slowest growth CAGR of 8% over the same time period.

Chart 36: O&M Market Forecast - Power

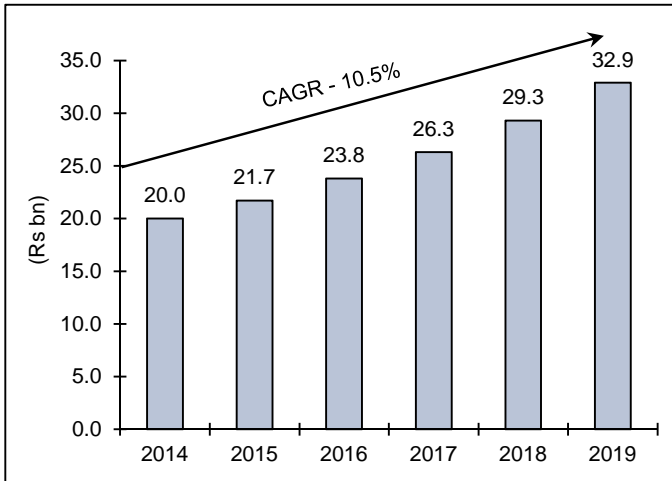


Chart 37: O&M Market Forecast – Oil & Gas

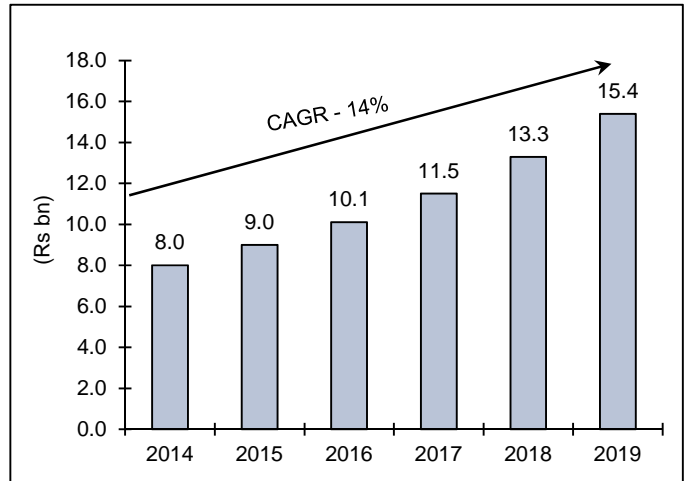


Chart 38: O&M Market Forecast - Steel

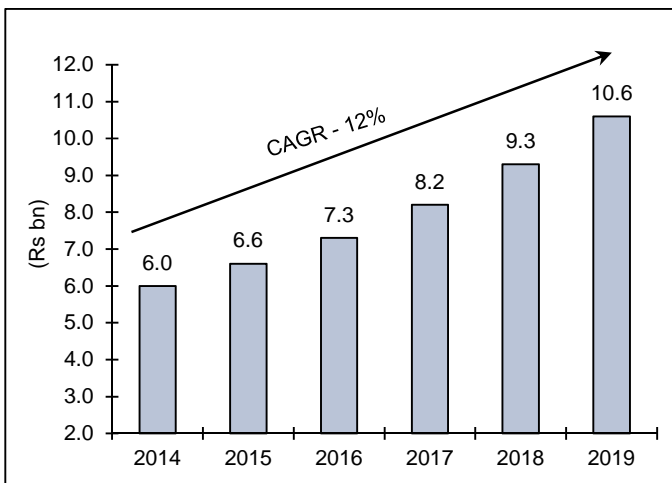
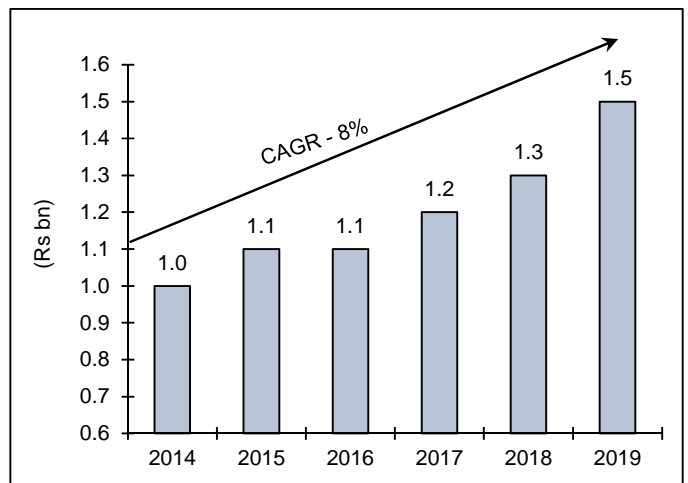


Chart 39: O&M Market Forecast - Cement



Source: F&S Research & Analysis, I-Sec research

Acquisitions integral part of strategy; focus on tuck-ins rather than scale acquisitions

Quess has made multiple acquisitions in the past and across segments. Avon in facilities management, Hofincons and Aravon in industrial asset management, Magna In India IT staffing, Brainhunter and MFX in NA IT staffing and services and Randstad Srilanka and Styracorp within general staffing have been some of the key acquisitions made by the company. However two key defining characteristics of most acquisitions for Quess have been – 1) Prudence in upfront valuation paid for the assets (though they have taken balance sheet liabilities in some acquisitions like Brainhunter and MFX), and 2) stellar track record of driving economies of scale and margin improvement across acquisitions including on overseas acquisitions like Brainhunter and MFX.

Quess has a five pronged philosophy on acquisitions: 1) Targets have to be RoCE accretive to the company average, 2) EBITDA payback should be 4-5 years, with focus on cash generation, 3) risk containment with focus on smaller rather than scale acquisitions, 4) targets should have the potential to grow at a multiplier to GDP growth, and 5) staying away from hostile bids as the intent is to retain employees of the acquired companies.

Table 8: Key acquisitions across business segments

Sr No	Company	Date of acquisition/ consolidation	Shareholding acquired	Total shareholding
1	Magna Infotech	December 23, 2010	51.00%	51.00%
2	Avon ¹	May 14, 2013	26.04%	100.00%
3	Magna Infotech	May 13, 2013	49.00%	100.00%
4	Hofincons	June 27, 2014	100.00%	100.00%
5	Brainhunter	October 23, 2014	100.00%	100.00%
6	MFX	November 3, 2014	49.00%	49.00%
7	Aravon Services	April 1, 2015	100.00%	100.00%
8	MFX	January 1, 2016	51.00%	100.00%
9	Randstad Lanka [*]	April 26, 2016	100.00%	100.00%
10	TSQ ²	SPA dated June 1, 2015	49.00%	49.00%

*1. 73.96% shareholding in Avon was acquired in July 2008.

2. Company entered into an agreement to acquire 49% of the equity shares of TSQ and beneficial interest in the remaining 51% of equity shares from Middle East Business Development Company WLL.

Source: RHP, Company data, I-Sec research

Table 9: Purchase consideration for acquisitions

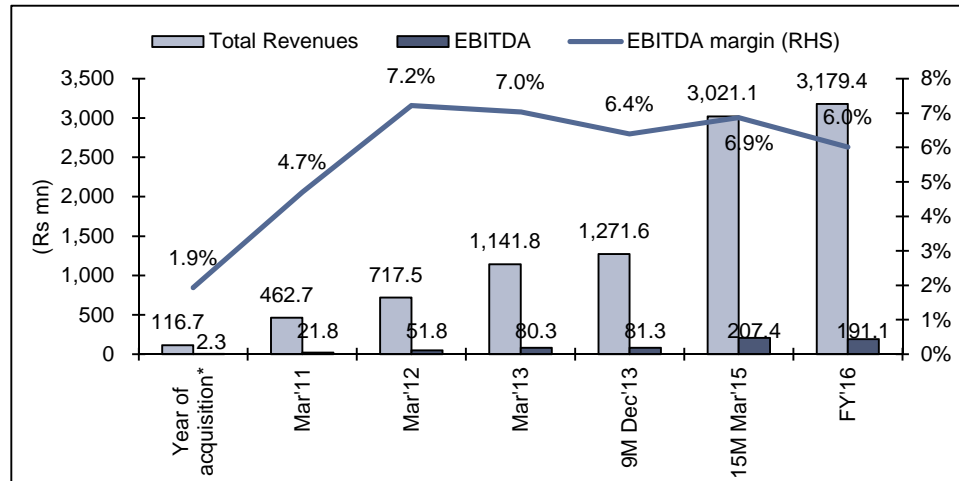
(Rs mn)

	Net assets acquired	Purchase Considerations	Goodwill
Avon Facility Management		162.6	
Coachieve Solutions Private		12.0	
Magna Infotech Limited		881.4	
Quess Corp (USA) (Magna Infotech Inc.)		6.3	
Brainhunter	-295.21	5.5	CAD0.1mn 300.71
Hofincons	401.94	503.0	101.06
MFXCHANGE Holdings	-608.96	322.1	US\$4.87mn 931.08
Company	Net assets acquired	Purchase Considerations	Capital reserve
Aravon Services Private Limited	29.06	0	29.06

Source: Company data, I-Sec research

Quess has been able to turn around every acquisition that they have made so far though improvement at Brainhunter may have lagged their initial expectations. As an example, Avon’s revenues have grown at a CAGR of 47% post acquisition from FY11 to FY16 with its EBITDA margin improving from 1.9% to 6%. Likewise, Magna has grown at FY11-FY16 CAGR of 20% with its EBITDA margin improving from 5.5% to 12.7% during the same time period.

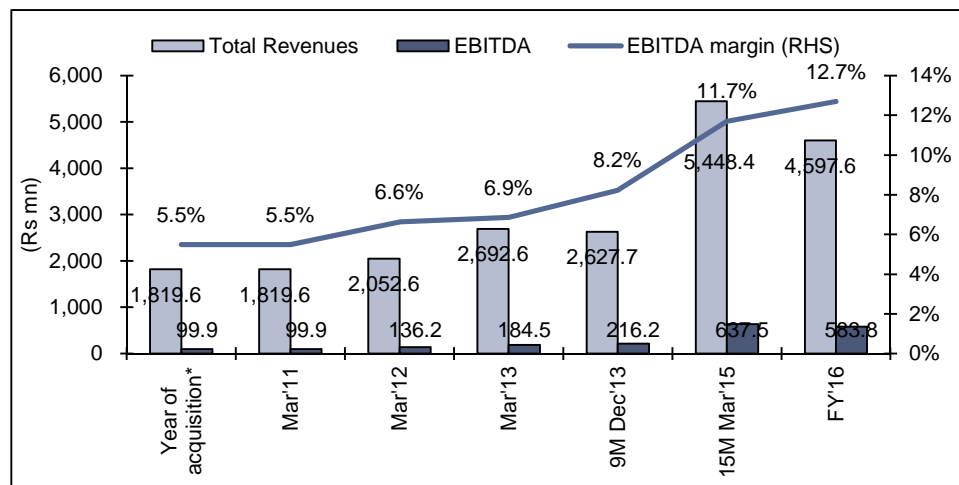
Chart 42: Revenue, EBITDA, and EBITDA margin for Avon



*Year of acquisition denotes the year of completion of first tranche of acquisition. Fiscal 2009 was the year of acquisition (first tranche) of Avon. Avon was merged with effect from January 1, 2014. The results of operations reflect audited financial results prior to such merger and reflect standalone IFM segment financial results subsequent to such merger.

Source: Company data; I-Sec research

Chart 43: Revenue, EBITDA, and EBITDA margin for Magna



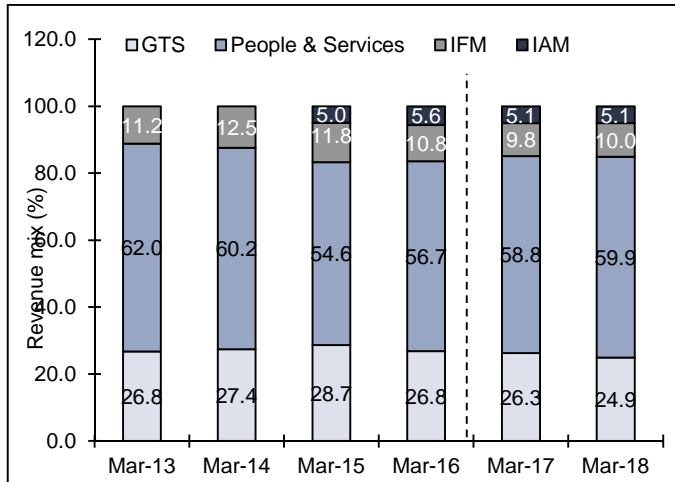
*Year of acquisition denotes the year of completion of first tranche of acquisition. Fiscal 2011 was the year of acquisition (first tranche) of Magna. Magna Infotech was merged with the Company with effect from January 1, 2014. The results of operations of Magna Infotech reflect audited financial results prior to such merger and reflect standalone India IT staffing segment financial results subsequent to such merger.

Source: Company data; I-Sec research

Quess has been able to improve the profitability profile even on overseas acquisitions like MFX and Brainhunter, each of which were loss making even at the EBITDA level at the time of acquisition but are expected to have EBITDA margin of 1.5% and 8-10% respectively in FY17.

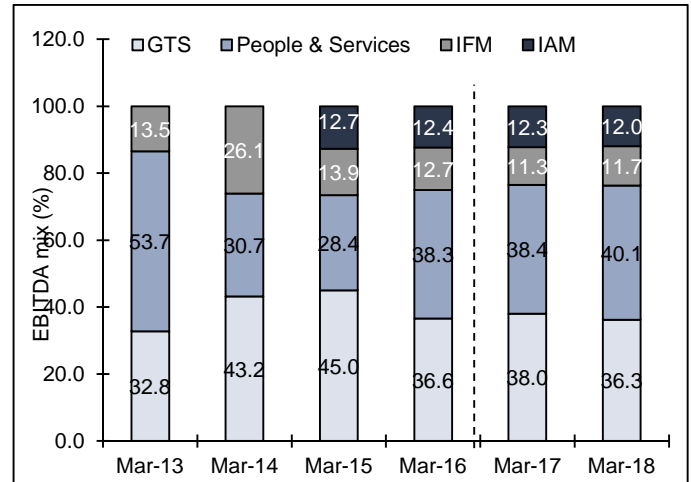
Financials

Chart 40: Revenue mix from various segments



Source: Company data; I-Sec research

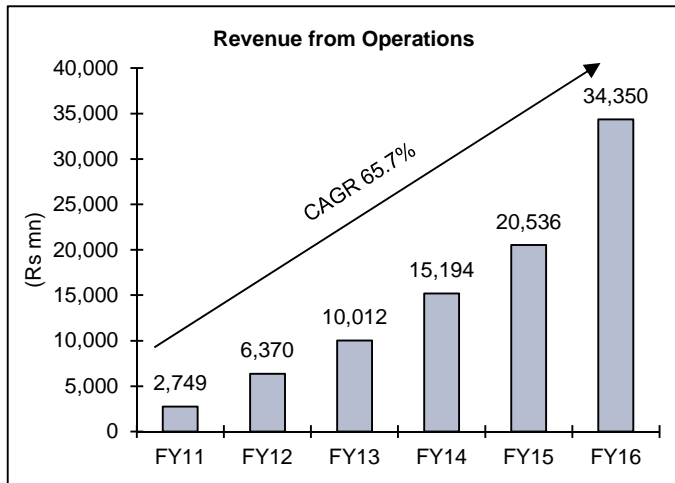
Chart 41: EBITDA mix from various segments



Source: Company data; I-Sec research

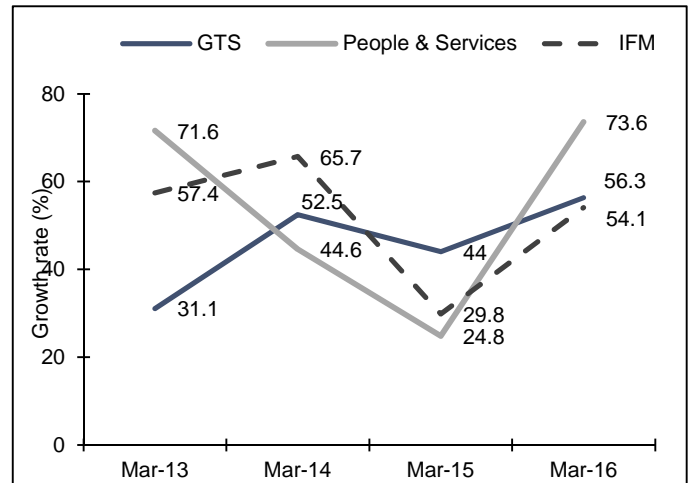
Revenue from operations has increased at a three year (FY13-16) and a five year (FY11-FY16) CAGR of 50.8% and 65.7% respectively. Revenue increased by 67.3% YoY to Rs. 34350mn in FY16 from Rs. 20536mn in FY15. Even on an organic basis, revenue growth was very strong at >45% in FY16 if one was to exclude acquisitions like Brainhunter, MFX, Aravon and Hofincons. We expect revenues to grow at a two year CAGR of 26.4% from FY16-FY18.

Chart 42: Operating revenue and revenue growth (annualized)



Source: Company data; I-Sec research

Chart 43: Revenue growth YoY from various segments

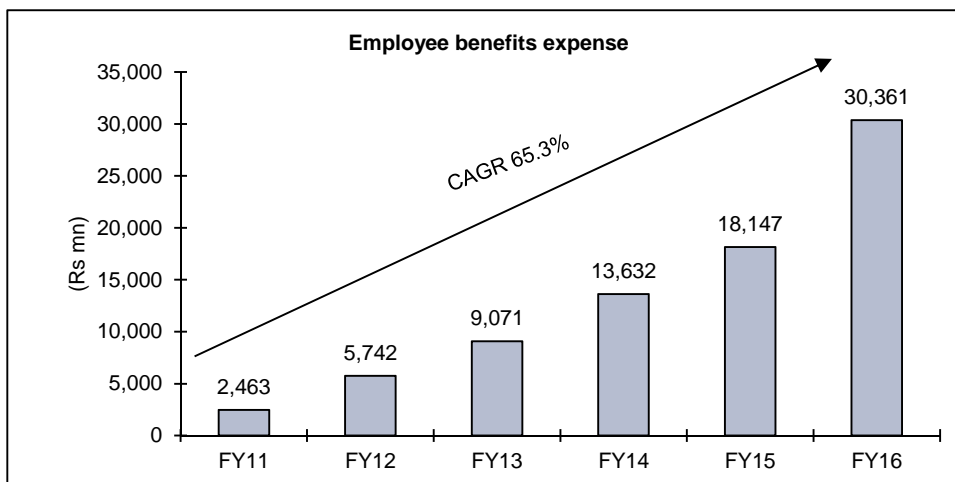


Source: Company data; I-Sec research

Segmental Details (EBITDA margin as discussed below is before the allocation of corporate costs):

- GTS revenues grew by 56.3% in FY16 though the growth was driven largely on account of acquisitions. India IT staffing revenues grew by just 5.5% YoY with rest of the growth driven by 1) full year integration of Brainhunter acquisition as against integration for approximately five months in FY15, 2) consolidation of MFX for one quarter in Q4FY16, and 3) initial revenue contribution from Magna Philippines. Associate employees (average) for the India IT staffing business have grown at a CAGR of 10.7% from FY13 to FY16 with revenue per associate having increased at a CAGR of 8%. India IT staffing EBITDA has increased from 6.7% in FY13 to 12.7% in FY16. Overall GTS EBITDA margin has grown only modestly from 6.7% in FY13 to 7.14% in FY16 given the dilutive impact of acquisitions. We expect steady state EBITDA margin for Brainhunter to be around 1.5-2% and for MFX to be in the range of 8-10%.
- P&S revenues grew by 73.6% in FY16, with growth being all organic and all three sub-segments of general staffing, Training & Development and Recruitment/RPO growing very strongly, with T&D revenues more than quadrupling YoY. Within general staffing, average headcount increased by 32% YoY with revenue per associate per month increasing by ~30% to Rs22,364. Revenue per associate increased on account of 1) Minimum wage revisions in various states, 2) general wage inflation of associate employees, and 3) improvement in associate mix. EBITDA margins for the segment increased from 2.9% in FY15 to 3.5% in FY16 as 1) growth in core employees in general staffing meaningfully lagged the growth in associates (405 as at the end of FY16 vs 365 in FY15), and 2) faster growth in the highest margin Training & Development sub-segment. Growth in FY17 would be modestly aided on account of the integration of Randstad Srilanka revenues.
- IFM revenues increased by 54% YoY in FY16 with growth in associates (average) of ~26%. Revenue growth in FY16 was aided on account of 1) integration of Aravon revenues, and 2) full year consolidation of Hofincons Hard services revenues in FY16 as against a 9 month integration in FY15. Organic growth in the segment would have been ~25-30% by our estimates. EBITDA margin in the segment declined from 6.6% in FY15 to 6.1% in FY16 given an inferior mix.
- IAM revenues increased by 89.6% in FY16 to Rs1932mn. Growth was especially strong in the managed services segment given ramp-up of a large engagement with a telecom client. Growth in Hofincons on an adjusted basis (Hofincons was integrated for nine months only in FY15) was relatively modest at 15-20% by our estimates. EBITDA margin in the segment declined from 14.3% in FY15 to 11.5% in FY16 though should be within a range of 12-15% over the next few years.

Chart 44: Employee benefit expenses and growth rate (annualized)

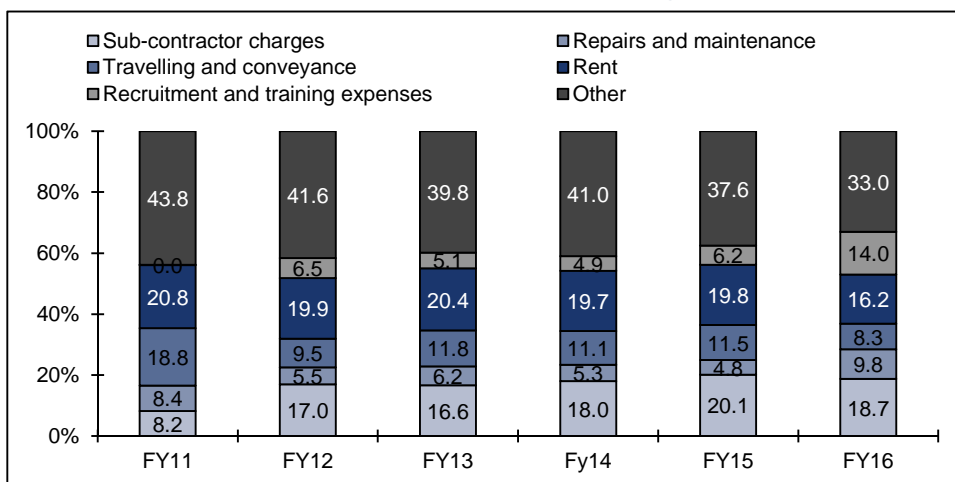


Source: Company data; I-Sec research

The main cost to the company is the employment benefit expenses which consist of salaries, wages and bonus payments to Associate Employee as well as to the own permanent employees, contribution to provident and other funds, leave encashment, insurance, staff welfare and training expense. Employee benefit expense constituted 88.4% of the total operating revenue in FY16.

Some of the other key cost items for the company are sub-contractor expenses (0.9% of revenues), rent (0.8% of revenues), recruitment & training (0.7% of revenues), travel & conveyance (0.4% of revenues), repairs & maintenance (0.5% of revenues), and communication costs (0.3% of revenues). Other expenses comprised 5% of operating revenues in FY16 as against constituting just 3.8% of revenues in FY15 on account of higher recruitment and repair and maintenance costs.

Chart 45: Key other expense items (as a percentage of total expenses)



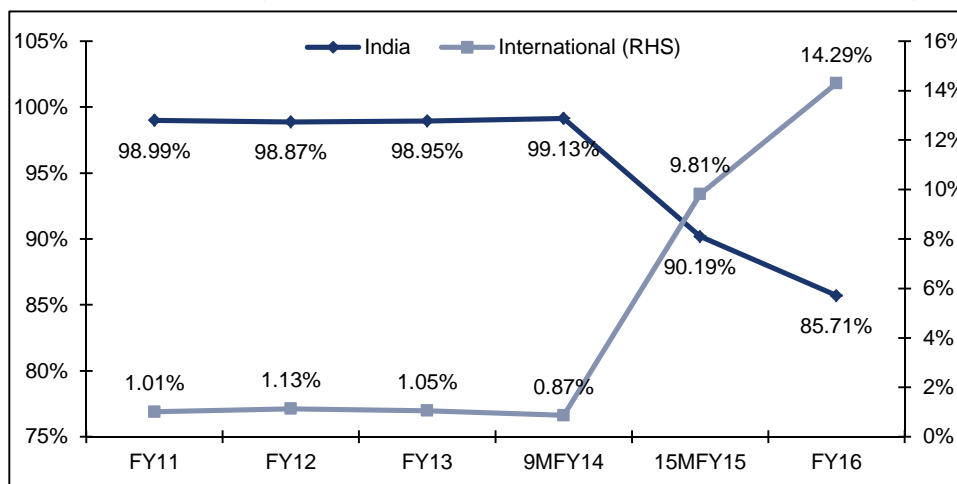
Source: Company data; I-Sec research

Company-wide EBITDA margin declined by 30bps to 4.8% in FY16 with the decline driven primarily from the full year integration of Brainhunter (which was loss making in FY16) and one off increase in certain other expenses as detailed above.

Increase in mix of International revenues

International geographies comprised 14.3% of overall revenues in FY16 with the percentage likely to go up in FY17 given the full year consolidation of MFX and the integration of Randstad Srilanka. Brainhunter, MFX, Magna Philippines and Randstad Srilanka are the key overseas businesses for Quess (Styracorp is still shown as an investment and will likely be consolidated in the latter half of FY17) with the company likely to grow international revenues further through likely acquisitions in the IT staffing and the IT services space in North America.

Chart 45: Percentage of total revenues from India and International geographies



Source: Company data; I-Sec research

Headcount Break-up

Quess had a total of 3500 core employees as at the end of Feb, 2016 with 52% of the headcount pertaining to the P&S segment (large part is for Training & Development), 33% pertaining to GTS and 10% and 5% belonging to IFM and IAM respectively.

Core employees in Magna and Ilya were just 723 and 405 as at the end of FY16. Quess has a very strong recruiting team of >850 consultants across segments with the remaining employees largely focused on support activities, business development and technology.

Table 10: Headcount details – Core and Associate employees

Segment	Core Employees	Associate Employees	Total
GTS	1167	8918	10085
P&S	1811	83038	84849
IFM	343	20012	20355
IAM	179	5427	5606
Total	3500	117395	120895

Source: Company data; I-Sec Research

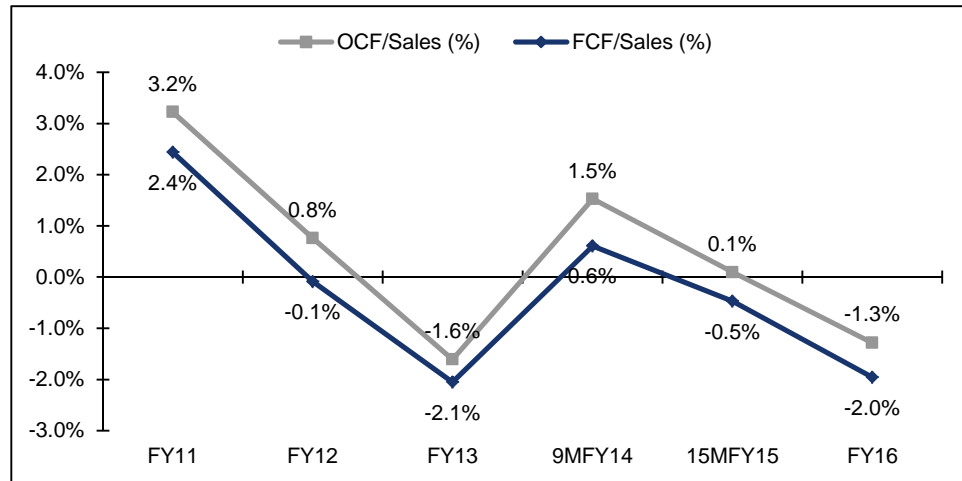
* as at the end of Feb 29, 2016

Working capital and Cash generation

Quess has generated negative operating cash flow of Rs377mn and negative free cash flow of Rs942mn in aggregate over the past 5 years. OCF and FCF was a negative Rs442mn and negative Rs672mn in FY16. DSO days were 45 days as at the end of FY16 with the DSO days being ~20 in General staffing and between 60-65 days in IT staffing, IAM and FM. Working capital may improve modestly as we expect the

general staffing business, which has the lowest receivables profile, to outgrow other segments over the next two years. Meaningful like to like improvement in debtors may be difficult in FY17 especially in segments like IAM where majority of the clients belong either to distressed industry segments like metals and power and/or are large conglomerates which would ensure favorable payment terms to themselves.

Chart 46: OCF and FCF as percentage of sales



Source: Company data, I-Sec research

Key Risk Factors

We see acquisition integration and working capital management as the key factors to watch for the company.

Shareholding Details

Table 11: Shareholding pattern

Category Code	Category of Shareholder	Number of Shareholders	No. of fully paid up equity shares held	Total Number of Shares	Total Shareholding as a percentage of total number of shares
(A)	Promoter and Promoter Group				
1)	Indian				
a)	Individual / HUF	1	1,85,85,960	1,85,85,960	14.76
b)	Others	2	9,41,89,320	9,41,89,320	74.78
	Sub Total : (A) (1)	3	11,27,75,280	11,27,75,280	89.54
2)	Foreign				
a)	Others	0	0	0	0
	Sub Total : (A) (2)	0	0	0	0
	Sub Total (A) = (A)1+(A)2	3	11,27,75,280	11,27,75,280	89.54
(B)	Public shareholding				
1)	Institutions				
a)	Mutual Funds	51	2,668,741	2,668,741	2.12
b)	Venture Capital Funds	5	108,264	108,264	0.09
c)	Alternate Investment Funds	5	70,063	70,063	0.06
d)	Foreign Portfolio Investors	19	2,101,253	2,101,253	1.67
e)	Financial Institutions / Banks	14	815,309	815,309	0.65
f)	Insurance Companies	13	280,420	280,420	0.22
g)	Others	16	3,419,674	3,419,674	2.72
	Sub Total : (B) (1)	123	9,463,724	9,463,724	7.51
2)	Non-Institutions				
a)	Individual Shareholders Holding Nominal Share Capital up to of ₹ 2 lakh	28312	21,88,368	21,88,368	1.74
b)	Individual Shareholders Holding Nominal Share Capital in excess of ₹ 2 lakh	6	559,776	559,776	0.44
c)	Others	164	966,205	966,205	0.77
	Sub Total : (B) (2)	28,482	4,441,050	4,441,050	2.95
	Sub Total (B) = (B)1+(B)2	28,605	1,31,78,073	1,31,78,073	10.46
(c)	Non Promoter and Non Public	0	0	0	0
	Total = Sub Total (A) + Sub Total (B) + C	28,608	12,59,53,353	2,59,53,353	100.00

Source: Company data, I-Sec research

Board of Directors

Name	Designation	Total experience	Comments
Ajit Isaac	Chairman and Managing Director and CEO	25 years of experience in the field of corporate management	<ul style="list-style-type: none"> • Holds a master's degree in Arts in Social Work from the University of Madras and has completed the Managers for Leadership Course from the University of Leeds, United Kingdom. • Responsible for the daily operations and strategic decisions of the company • Nominated for the India Forbes Leadership Awards, 2011 under the category of "Outstanding Startup" and for the CII Regional Emerging Entrepreneur Awards, 2011. • Prior to joining Quess, he was the country manager for India and the Middle East of Adecco Peopleone India Limited • Has been a director of the company since April 2009 and the Chairman and the Managing Director since May 2013
Chandran Ratnaswami	Non executive Director	23 years of experience in the field of investment management	<ul style="list-style-type: none"> • Holds a bachelor's degree in Civil Engineering from the Indian Institute of Technology, Madras, and a master's degree in Business Administration from Rotman School of Management, University of Toronto, Canada. • Has been a director of Quess since January 2016 and also the nominee Director of TCIL.
Madhavan Karunakaran Menon	Non executive Director	Over 30 years of experience in the fields of banking, finance and foreign exchange management	<ul style="list-style-type: none"> • Holds a bachelor's and a master's degree in business administration from George Washington University, USA. • Has been a director of Quess since May 2013 and also the chairman and managing director of TCIL
Pratip Chaudhuri	Non executive and independent Director	Over 40 years of experience in the field of banking	<ul style="list-style-type: none"> • Holds a bachelor's degree in Science from the University of Delhi and a master's degree in Business Administration from the Punjab University, and is a member of the Indian Institute of Bankers. • Served as the Managing Director of the State Bank of Saurashtra and as the chairman of SBI Global Factors Limited, State Bank of Mysore, State Bank of Bikaner & Jaipur, State Bank of Patiala, State Bank of Travancore, and State Bank of Hyderabad. • Has been a director of Quess since July 2015
Pravir Kumar Vohra	Non executive and independent Director	Over 38 years of experience in the field of banking and information technology	<ul style="list-style-type: none"> • Holds a master's degree in Arts (Economics) from University of Delhi, and is a certified associate of the Indian Institute of Bankers. • Previously, he was the group chief technical officer at ICICI Bank Limited, and also held various positions with State Bank of India, both in India and abroad. • Has been a director of the company since July 2015.
Revathy Ashok	Non executive and independent Director	Over 30 years of experience in the field of finance	<ul style="list-style-type: none"> • Holds a bachelor's degree in Science from Bangalore University and a post graduate diploma in Management from the Indian Institute of Management, Bangalore. He has also been awarded the faculty medal from the Indian Institute of Management, Bangalore. • Previously, the Director (finance and administration) of TSI Ventures and the Chief Financial Officer at Syntel Limited. • Nominated as one of the women achievers by the CII for southern India in 2011 • Has been a director of the company since July 2015
Sanjay Anandaram	Non executive and independent Director	Approximately 30 years of experience as an investor and corporate executive	<ul style="list-style-type: none"> • Holds a bachelor's degree in Electrical Engineering from Jadavpur University, Kolkata, and a post graduate diploma in Management from the Indian Institute of Management, Bangalore. • Has been a director of the Company since December 2015.
Subrata Kumar Nag	Executive and wholetime Director and Chief Financial Officer	27 years of experience in the field of finance	<ul style="list-style-type: none"> • Holds a master's degree in Business Management from the University of Calcutta. He is also a member of the ICWAI, ICSI and the AICPA. • Responsible for the overall finance and accounts functions of the company. • Prior to joining Quess, he was the Vice President (finance) and Company Secretary at Ilantus Technologies Private Limited. • Has been a director of the company since July 2013

Source: RHP, Company data

Key management personnel

Name	Designation	Total Experience	Comments
Guruprasad Srinivasan	President – People and Services	Over 18 years of experience in healthcare and services industry	<ul style="list-style-type: none"> • Holds a bachelor's degree in Commerce from Bangalore University and a master's degree in Business Administration from the Karnataka State Open University. He has also completed Stanford Ignite certificate program from Stanford University Graduate School of Business. • Prior to joining Qess, he has worked with Adecco India as GM - Payroll & Services • He has been associated with Qess since October 27, 2007, and heads the company's People and Services business
Vikram Gulati	President – Global Technology Solutions	Over 25 years of experience in the IT services industry	<ul style="list-style-type: none"> • Holds a bachelor's degree in Electrical Engineering and a master's degree in Business Administration from University of Bombay. • Prior to joining Qess, he was the Chief Executive Officer and Co-Founder of Happiest Minds; prior to that, he was the Chief Executive Officer for Intelligroup and has had multiple roles at Wipro. • Has been associated with Qess since November 1, 2014, and heads the company's global technology solutions business.
A Rajeshwara Rao	President – Industrial Asset Management	Over 40 years of experience in the field of commercial, manufacturing and business operation segments and heads our industrial asset management group	<ul style="list-style-type: none"> • Holds a bachelor's degree in Science (Physics) from the University of Madras and a master's degree in Arts in Personnel Management and Labour Welfare from the Tata Institute of Social Sciences. • Prior to joining Qess, he held positions at TVS Srichakra Limited, Sundaram Industries Limited, Tube Investments of India Limited, and Parry & Company Limited. • Has been associated with Qess since June 30, 2014, and heads the company's industrial asset management group.
TS Krishna Kumar	President – Professional Staffing	Over 23 years of experience in the field of IT and heads our India IT staffing business	<ul style="list-style-type: none"> • Holds a bachelor's degree in Industrial and Production Engineering from Bangalore University and a master's degree in Technology in Foundry - Forge Technology from National Institute of Foundry and Forge Technology. He has also completed Stanford Advanced Project Management Program from Stanford University. • Prior to joining Qess, he worked with Wipro Infotech and Wipro Power Fluid (both divisions of Wipro Limited) and Wipro Limited. • Has been associated with Qess since February 24, 2014, and heads the company's India IT staffing business.
Vivek Arora	Business Head – Integrated Facility Management Services	Over 16 years of experience in the service industry ranging from IT, human resources and facility management services	<ul style="list-style-type: none"> • Holds a bachelor's degree in Technology (Computer Science) from the University of Allahabad. • Prior to joining the company, he worked in a management role with Strategic Manpower Solutions Limited. • Has been associated with Qess since January 27, 2009, and heads the company's integrated facility management business.
NVS Pavan Kumar	Company Secretary	Over 11 years of experience in the field of corporate compliance	<ul style="list-style-type: none"> • Holds a bachelor's degree in Commerce and Law from Nagarjuna University, Vijayawada, and a master's degree in Business Administration from Dr. B.R. Ambedkar Open University. Also an associate member of the ICSI. • Prior to joining the company, he worked with Tejasarnika Hydro Energies Private Limited as Company Secretary. Also has prior experience with NCC Limited, Dr. Reddy's Laboratories Limited and Delhi International Airport Pvt Ltd. • Has been associated with Qess since March 26, 2015.

Source: RHP, Company data

Annexure 1: Financials

Table 12: Profit and loss statement

(Rs mn, year ending March)

	FY12	FY13	FY14 (9M)	FY15 (15M)	FY16	FY17E	FY18E
Operating Revenues (Sales)	6,370	10,012	10,060	25,671	34,350	44,795	54,886
Operating Expenses	6,101	9,581	9,662	24,366	32,709	42,370	51,833
EBITDA	269	431	398	1,305	1,641	2,425	3,054
<i>% margins</i>	4.2	4.3	4.0	5.1	4.8	5.4	5.6
Depreciation & Amortisation	37	44	42	101	160	224	274
Other Income	24	32	21	57	74	210	250
Interest & Finance Chgs	126	176	88	218	308	246	197
Profit / (Loss) before Exceptional items and Taxation	131	243	289	1,042	1,247	2,165	2,832
Add: Extraordinary exps / (Inc)	0	0	0	0	0	0	0
Less: Taxes	(48)	(72)	(97)	(370)	(362)	(714)	(935)
- Current tax	(59)	(64)	(94)	(300)	(558)	0	0
- Deferred tax / MAT Credit	12	(7)	(3)	(70)	195	0	0
- Fringe benefit taxes	(0)	0	0	0	0	0	0
Net Profit/(Loss) as Restated before minority interest	83	171	192	672	885	1,450	1,898
Profit attributable to minority shareholders	21	50	13	0	0	0	0
Restated net profit after tax for the periods / years	62	121	179	672	885	1,450	1,898

Source: Company data, I-Sec research

Table 13: Balance sheet

(Rs mn, year ending March)

	FY12	FY13	FY14 (9M)	FY15 (15M)	FY16	FY17E	FY18E
Assets							
Total Current Assets	1,892	2,608	2,454	5,319	8,673	14,180	16,629
<i>of which cash and deposits</i>	291	234	291	818	1,094	4,834	5,633
Total Current Liabilities & Provisions	1,891	2,446	2,069	4,580	8,103	8,781	9,608
<i>of which borrowings</i>	556	879	609	2,204	3,390	2,890	2,390
Net Current Assets	1	162	385	739	570	5,399	7,021
Net Fixed Assets	74	85	122	189	529	619	729
<i>Tangible assets</i>	71	65	76	146	444	534	644
<i>Intangible assets</i>	3	19	42	43	61	61	61
<i>Capital work in progress</i>	0	0	4	0	24	24	24
<i>Deferred tax assets (net)</i>	76	66	50	35	233	233	233
Long-term loans and advances	250	293	626	545	839	1,227	1,504
Other Long Term Assets	1	8	0	4	58	5	5
Goodwill on consolidation	250	250	729	1,104	2,046	2,046	2,046
Total Assets	651	863	1,914	2,617	4,275	9,529	11,537
Liabilities							
Long Term Borrowings	0	0	32	0	355	0	0
Long term provisions	6	13	12	85	465	491	601
Other Long Term Liabilities	0	4	23	7	0	5	5
Minority Interest	114	164	0	0	0	0	0
Equity Share Capital	300	300	962	258	1,133	1,260	1,260
<i>Face Value per share (Rs)</i>	10	10	10	10	10	10	10
Reserves & Surplus	231	383	884	2,267	2,322	7,773	9,670
Net Worth	531	682	1,846	2,525	3,456	9,033	10,930
Total Liabilities	651	863	1,914	2,617	4,275	9,529	11,537

Source: Company data, I-Sec research

Table 14: Cash flow statement

(Rs mn, year ending March)

	FY12	FY13	FY14 (9M)	FY15 (15M)	FY16	FY17E	FY18E
Operating Cash flow before W Cap changes	212	293	205	966	1,201	1,711	2,119
Working Capital Inflow / (Outflow)	(163)	(454)	(52)	(942)	(1,643)	(928)	(489)
Capex	(54)	(44)	(92)	(145)	(230)	(314)	(384)
Free Cash flow	(6)	(205)	61	(120)	(672)	469	1,246
Cash Flow from other Invst Act (Ex Capex)	11	3	(568)	(547)	3	210	250
Proceeds from Issue of Share Capital	0	0	965	0	26	4,000	0
Inc/(Dec) in Borrowings / Deferred Liabilities	193	323	(237)	1,015	1,137	(855)	(500)
Interest paid	(126)	(174)	(90)	(217)	(304)	(246)	(197)
Increase/(Decrease) in Cash	73	(54)	132	130	189	3,578	799

Source: Company data, I-Sec research

Table 15: Key ratios

(Year ending March)

	FY12	FY13	FY14	FY15	FY16	FY17E	FY18E
Per Share Data (Rs)							
Recurring EPS - Diluted	0.6	1.1	2.8	4.7	7.7	11.4	14.94
Cash earnings per share	0.9	1.6	3.3	5.4	9.1	13.2	17.1
Dividend per share	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Book Value per share	5.1	6.5	16.4	22.2	29.9	71.1	86.1
Growth Ratios (%)							
Operating Income (Sales)	131.7	57.2	51.8	35.2	67.3	30.4	22.5
EBITDA	226.3	59.9	53.0	58.3	57.3	47.7	25.9
Net Income	258.4	94.1	159.3	71.8	64.6	63.8	30.9
EPS	244.3	94.1	151.5	60.9	57.2	47.2	30.9
Cash earnings per share	241.7	93.2	143.2	70.3	62.0	48.9	30.9
Valuation Ratios (x)							
P/E	nm	nm	199.6	117.2	72.4	48.6	37.1
P/CEPS	nm	nm	166.3	101.8	61.3	42.1	32.4
P/BV	nm	nm	33.8	25.0	18.5	7.8	6.4
EV / EBITDA	nm	nm	110.9	70.1	44.6	30.2	23.9
EV / Sales	11.5	7.3	4.8	3.6	2.1	1.6	1.3
EV / FCF	nm	nm	nm	nm	nm	156.1	58.7
Operating Ratio							
Operating Exp./Sales (%)	90.1	90.6	89.7	88.4	88.4	0.0	0.0
Other Income / PBT (%)	18.6	13.2	6.6	5.5	5.9	9.7	8.8
Effective Tax Rate (%)	36.5	29.6	34.4	35.5	29.0	33.0	33.0
NWC / Total Assets (%)	0.0	4.9	9.7	10.3	4.6	29.5	33.2
Fixed Asset Turnover (x) on average	86.0	118.3	124.1	108.8	64.9	72.4	75.3
Receivables (days)	67.5	57.6	29.9	49.0	45.5	43.0	40.0
D/E Ratio (x)	1.0	1.3	0.3	0.9	1.1	0.3	0.2
Return/Profitability Ratio (%)							
Recurring Net Income Margins	1.0	1.2	2.1	2.6	2.6	3.2	3.5
RoCE (Based on Avg)	13.9	18.5	18.3	16.9	16.8	14.7	14.1
RoCE ex cash (Based on Avg)	18.2	22.5	20.9	19.9	19.9	20.8	23.5
RoNW (Based on Avg)	12.5	19.9	24.8	24.6	29.6	23.2	19.0
Dividend Payout Ratio	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dividend Yield	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EBITDA Margin	4.2	4.3	4.3	5.1	4.8	5.4	5.6

Source: Company data, I-Sec research

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