ArihantCapital
Generating Wealth

Q1FY23 - Result Update
4th August 2022

Firstsource Solutions Ltd

Growth momentum in H2FY23

CMP: INR 104

Rating: Hold

Target Price: 110

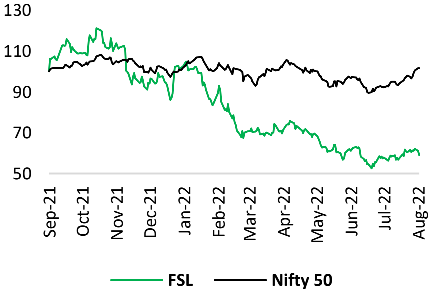
Stock Info	
BSE	532809
NSE	FSL
Bloomberg	FSOL:IN
Reuters	FISO.BO
Sector	IT Enabled Services
Face Value (INR)	10
Equity Capital (INR Cr)	697
Mkt Cap (INR Cr)	7,224
52w H/L (INR)	223/ 93
Avg Yearly Vol (in 000')	4464

Shareholding Pattern %
(As on June, 2022)

Promoters	53.66
FII	7.95
DII	14.57
Public & Others	23.82

Stock Performance (%)	1m	3m	12m
FSL	2.55	-11.2	-48.1
Nifty 50	10.08	4.52	7.21

FSL Vs Nifty 50



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Firstsource Solutions Ltd (FSL) in Q1FY23, revenue largely in-line with our estimates and lowered FY23 guidance to 2%-4% growth in constant currency: Reported revenue of $ 191 Mn (down 7.3% QoQ/5%YoY in USD terms) against our estimate of $197 Mn. In Constant Currency (CC) terms revenue was down 2.7%QoQ. Reported revenue of INR 1,472 Cr down 4.6% QoQ/ 0.8% YoY against our estimate of INR 1,470 Cr. The de-growth has been led by softness in BFS business was an outlier where revenues in mortgages declined in the rapidly rising interest rate environment. Excluding mortgages and the full-year impact of acquisitions of last year, the management expects to grow between 16% to 19% in constant currency. The macro environment remains dynamic and the past six or seven months have been unprecedented making it challenging for the company to forecast certain portions of business accurately.
Margin below our estimates and 10% to 10.5% expectation for FY23: EBIT margin was down 339bps QoQ/-417bpsYoY at 8% below our estimates of 11%. The management, expected margins to decline in H1 and then pick up in H2. The sharper fall in revenue and higher restructuring costs have accentuated the impact on margins for this quarter in the next one. The company is super-focused on rationalizing direct and indirect cost while, which anticipate will result in a positive impact to the operating margin by about 200bps this from Q3. The management is confident of hitting an operating margin of 11.5% to 12% by Q4FY23 taking into account all these factors, the company expect to achieve operating margins of 10% to10.5% for the year. This includes an 80 bps to 90 bps positive impact from the recent amendments in the accounting standard 37 upon this contract.

Valuations

The company has reassessed growth visibility and lowered guidance to 2-4% from 7-10% for the FY23 in CC term due to softness in BFS business was an outlier where revenues in mortgages declined in the rapidly rising interest rate environment. Excluding mortgages and the full-year impact of acquisitions of last year, the management expects to grow between 16% to 19% in constant currency. Margin guidance of 10.5-11% for the FY23. We believe, that this business will bottom out in Q3 and that factored in the down side with these lower numbers in the collection business, and as such, we continue to expect growth to pick up in H2FY23. Considering, that the macro indicators continue to point at a gradual increase in delinquency rate in H2FY23 however, the inventory is building up slower than the company anticipated. Hence, trimming growth expectations, the market business is expected to impact growth guidance by 3.5%-4% and collections by about 1% notwithstanding the challenges. We are confident that the long-term growth strategy is to diversify the business model. The demand environment across other segments is strong and is reflected in the strength in the rest of the businesses. **We value FSL at a PE of 14x to its FY24E EPS of INR 9.6, which yields a target price of INR 110 per share (earlier target price; INR 134 per share). We downgrade our rating to Hold from Accumulate earlier.**

Exhibit 1

Consolidated (in INR Cr)	FY21	FY22E	FY23E	FY24E
Sales	5,078	5,921	6,217	6,839
EBIT	5,293	6,334	7,487	8,721
Reported PAT	362	537	466	548
EBITM (%)	*11.8%*	*12.0%*	*10.3%*	*10.7%*
PE (x)	*19.5*	*13.1*	*15.5*	*13.2*
EPS	5.3	7.9	6.7	7.9

Source: Arihant Research, Company Filings, Ace Equity, Bloomberg

Exhibit 2: Q1FY23 - Quarterly Performance (Consolidated)

Consolidated (in INR Cr)	Q1FY23	Q4FY22	Q1FY22	Q-o-Q	Y-o-Y
Revenue (CC Terms) (Mn USD)	**191**	**206**	**201**	***-7.3%***	***-5.0%***
Net Revenue	1,472	1,544	1,485	*-4.6%*	*-0.8%*
Employee cost	960	984	1,022	*-2.5%*	*-6.1%*
Other Expenses	332	315	225	*5.4%*	*47.7%*
EBITDA	**181**	**245**	**238**	***-26.1%***	***-24.1%***
EBITDA margin %	*12.3%*	*15.9%*	*16.1%*	*-357bps*	*-19bps*
Depreciation	64	70	58	*-8.3%*	*9.5%*
EBIT	117	175	180	*-33.2%*	*-34.9%*
EBIT margin %	8.0%	11.3%	12.1%	*-339bps*	*-417bps*
Other Income	6	-0	-0		
Finance costs	19	19	15	*-0.5%*	*28.3%*
PBT	**105**	**156**	**165**	***-32.9%***	***-36.7%***
Exceptional item	-	-	-		
PBT and share net profit	**105**	**156**	**165**	***-32.9%***	***-36.7%***
Tax Expense	20	24	32	*-16.7%*	*-38.0%*
Effective tax rate %	18.8%	15.1%	19.2%	*364bps*	*-404bps*
PAT	**85**	**132**	**134**	***0.3%***	***-36.4%***
Non-controling intrest	-0	-0	-1	-	-
Consolidated PAT	**85.09**	**132.38**	**132.85**	***-0.36***	***-0.36***
Reported PAT	85.09	132.38	132.85	*-0.36*	*-0.36*
PAT margin %	*5.8%*	*8.6%*	*8.9%*	*-280bps*	*-37bps*
EPS (INR)	**1.3**	**2.0**	**2.0**	***-35.9%***	***-36.9%***

Source: Arihant Research, Company Filings, Ace Equity, Bloomberg

Q1FY23 Conference call highlights

- **Guidance:** The company has guided organic growth guidance 2%-4% growth in constant currency for the FY23. Excluding mortgages and the full-year impact of acquisitions of last year, the company expect to grow between 16% to 19% in constant currency. The key factors in the guidance revision. The outlook for the mortgage industry has considerably worsened since last quarter, this will translate to people, Q2 and Q3 decline in market volumes than the management previously anticipated. The management, believe that this business will bottom out in Q3 and that factored in the down side with these lower numbers in the collection business, and as such, the company continue to expect growth to pick up in the second the macro indicators continue to point to a gradual increase in delinquency rate half of this fiscal however, the inventory building up slower than the company anticipated.
- **Growth guidance:** Trimming growth expectation, the market business is expected to impact growth guidance 3.5% to 4% and collections by about 1% not withstanding these challenges. The company, confident that long-term strategy to diversify business and grow continue to yield results, the demand environment across.
- **Margin :** The company expect to achieve operating margins of 10% to10.5% for the year. This includes an 80 bps to 90 bps positive impact from the recent amendments to in the accounting standard 37 upon this contract.
- **Segment wise:** Banking and financial services segment de-grew by 11.9% yoy and 13.3% in constant currency. Mortgage business contributed about $32 mn of revenue in Q1. This implies a contraction of 28% QoQ and 48% yoy. Healthcare segment continues to grow consistently at 18% YoY and 13.3% in constant currency term. In the last 4 quarters HDS Segment had a number of significant then. The company is now sharply focused on executing and scaling on the recent rent.
- **Mortgage industry:** The recent outlook published by the Mortgage Bankers Association reflect the further reduction of 10% and 11% for CY22 and CY23 respectively from the Q1 forecast for the same period.
- **Client:** In Q1FY23, added four new clients for origination and servicing across additional target segment as well as a couple of exciting business property tax companies.
- **Collection business:** The macro data continues to show consistent improvement. According to the most recent data from the phase, delinquencies increase from 1.73% from 1.60% in the previous quarter. This is the third quarterly increase, although the metrics it's been lower than pre-pandemic level. The company continue to expect strong volume growth in H2 of this fiscal year, but it's strictly to be lower than our earlier estimates perspective, we continue to make solid progress in diversifying this business.
- **Deals:** The company, recently closed an exciting digital transformation deals with a leading FinTech in the UK. The demand environment, pipeline activity and digital adoption remain strong, despite the political uncertainty and tough economic conditions.
- **Attrition:** In Q1FY23, it stood it 43.8% against 45.9% in Q4FY22. The talent market continues to be challenging, the company is focused on execution, expanding delivery network and smaller nodal centers within UK and at the same time teasing out the shift towards off shore.

Exhibit 3: The softness in the economy, we are seeing demand in BFS we seeing demand in CMT and in the in small ways when we pay in the utility segment we think demand about in the UK market.

By the end of FY23, mortgages will be between 13% to 15% off a bit down from about 28% in FY '22. Ex-mortgage, we expect solid growth in Q2 and expect the trend to continue, delivering 16% to 19% growth for this fiscal.

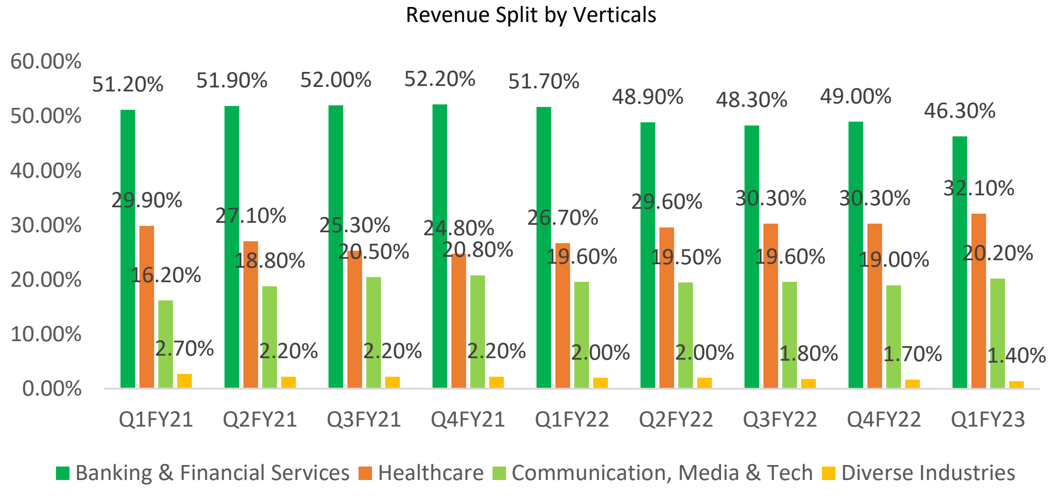


Exhibit 4: The company also opened the collection service line with a clients providing great validation of market effort from the last year. The ramp for these are underway and should deliver steady state revenue by Q3.

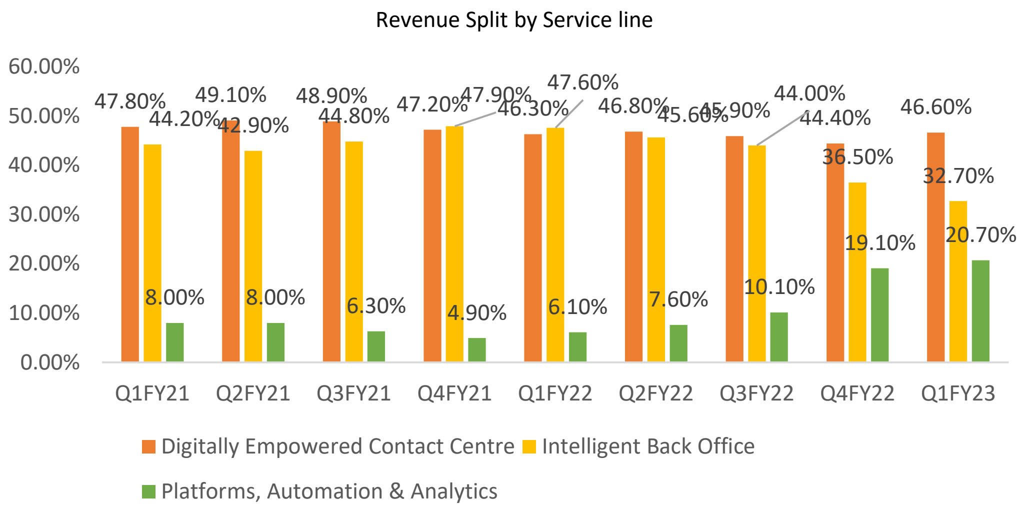
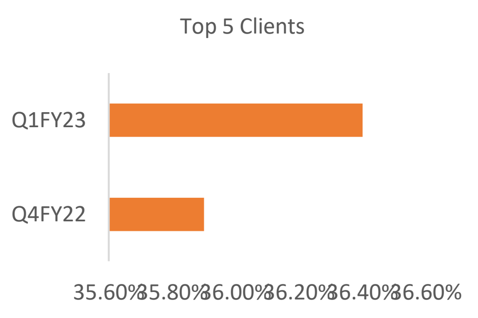
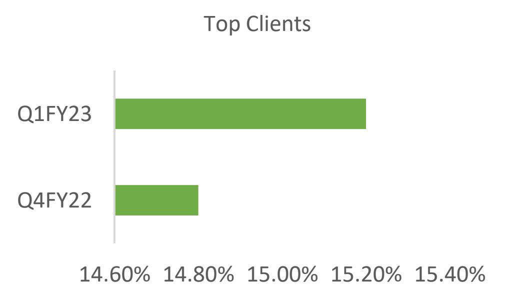


Exhibit 5: The company is steadfast in building a presence in FinTechs and added three new clients during this quarter and sales momentum is expected to remain strong through the year.





Source: Arihant Research, Company Filings, Ace Equity, Bloomberg

Key Financials

Income Statement (INR Cr)

Year End-March	FY21	FY22	FY23E	FY24E
Revenues	5,078	5,921	6,217	6,839
Change (%)	23.9%	16.60%	5.0%	10.0%
Employee costs	3,467	3,947	4,209	4,650
Other expenses	807	1,015	1,087	1,175
Total Expenses	**4,274**	**4,961**	**5,296**	**5,825**
EBITDA	**804**	**960**	**921**	**1,014**
EBIDTA Margin	**15.84%**	**16.21%**	**14.81%**	**14.82%**
Depreciation	206	249	283	278
EBIT	**598**	**710**	**638**	**735**
EBIT Margin	**11.77%**	**12.00%**	**10.25%**	**10.75%**
Interest	52	64	69	72
Other Income	1	1	1	1
PBT	**547**	**647**	**569**	**664**
Exceptional Items	115	0	0	0
PBT after exceptional Items	**432**	**647**	**569**	**664**
Tax	70	111	102	116
Rate (%)	*16.2%*	*17.1%*	*18.0%*	*17.5%*
PAT	**362**	**537**	**466**	**548**
y-o-y	**1%**	**-1**	**0%**	**0%**
Consolidated PAT	**362**	**537**	**466**	**548**
Change (%)	*6.5%*	*48.3%*	*-13.1%*	*17.4%*

Balance Sheet (INR Cr)

Year End-March	FY21	FY22	FY23E	FY24E
Sources of Funds				
Share Capital	696	697	697	697
Reserves & Surplus	2,103	2,336	2,558	2,862
Non controlling interest	1	0	0	0
Total Equity	**2,800**	**3,033**	**3,256**	**3,559**
Loan Funds	**604**	**1,010**	**771**	**721**
Defered Tax Liability (Net)	47	96	96	96
Total Liability	**4,830**	**5,709**	**5,647**	**5,947**
Application of Funds				
Gross Block	897	1,092	1,156	1,221
Less: Depreciation	662	742	880	1,039
Net Block	235	350	276	182
CWIP	0	0	0	0
Financial Assets	586	1,195	1,540	1,932
Investments	83	119	119	119
Sundry debtors	**577**	**961**	**801**	**881**
Cash and bank	137	90	595	906
Other Current Assets	153	199	199	199
Total Current assets	1,231	1,421	1,766	2,158
Total Current liabilities	1,217	1,232	1,269	1,316
Total Non-Current assets	**3,598**	**4,288**	**3,881**	**3,789**
Capital Employed	**4,830**	**5,709**	**5,647**	**5,947**

Cash Flow Statement (INR Cr)

Year End-March	FY21	FY22	FY23E	FY24E
PBT	**432**	**647**	**569**	**664**
Cash From Operating Activities	1,049	798	1,142	958
Tax	70	94	102	116
Net Cash From Operations	979	704	1,039	842
Capex	**(173)**	**12**	**(65)**	**(65)**
Cash From Investing	(350)	(595)	(164)	(164)
Borrowings	(267)	390	(50)	(50)
Finance cost paid	**(51)**	**(58)**	**(69)**	**(72)**
Cash From Financing	(689)	(158)	(363)	(366)
Net Increase/ Decrease in Cash	**-59**	**-49**	**512**	**311**
Cash at the beginning of the year	**191**	**132**	**83**	**595**
Cash at the end of the year	141	83	595	906

Key Ratios

Year End-March	FY21	FY22	FY23E	FY24E
Per share (INR)				
EPS	5.3	7.9	6.7	7.9
BVPS	40	44	47	51
Valuation (x)				
P/E	19.5	13.1	15.5	13.2
P/BV	2.6	2.4	2.2	2.0
EV/EBITDA	9.6	8.5	8.0	6.9
Return ratio (%)				
EBIDTA Margin	15.8%	16.2%	14.8%	14.8%
EBIT Margin	11.8%	12.0%	10.3%	10.7%
PAT Margin	7.1%	9.1%	7.5%	8.0%
ROE	12.9%	17.7%	14.3%	15.4%
ROCE	12.4%	12.4%	11.3%	12.4%
Leverage Ratio (%)				
Total D/E	0.2	0.3	0.2	0.2
Turnover Ratios				
Asset Turnover (x)	4.1	4.2	3.5	3.2
Receivable Days	41	47	47	47
Payable days	13	14	14	14

Source: Arihant Research, Company Filings, Ace Equity, Bloomberg

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Stock Rating Scale	**Absolute Return**
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

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