

**CMP: INR 145**

**Rating: Accumulate**

**Target Price: INR 167**

**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)	10,026
52w H/L (INR)	147.5/96
Avg Yearly Vol (in 000')	217

**Shareholding Pattern %**

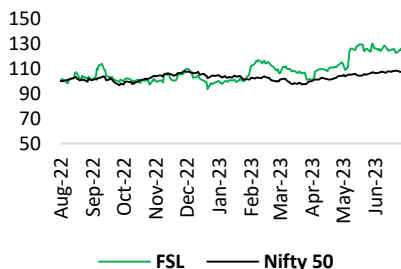
(As on June, 2023)

Promoters	53.66
Public & Others	44.11

**Stock Performance (%)**

	1m	3m	12m
FSL	10.7	21.9	38.7
Nifty	0.31	7.1	11.4

**FSL Vs Nifty**



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Firstsource Solutions Ltd (FSL) in Q1FY24, Top and bottom line below our estimate; Improvement on the margin front guidance remain intact FY24 guidance 2%-5% in cc term: The company reported revenue at INR 1529 Cr (US\$ 186 mn against an estimate of US \$ 195 mn ), YoY de-growth of 2.6%/-2.1% against our estimate of INR 1605 Cr and de-growth of 1.8% QoQ/+3.9% YoY. The de-growth led by Banking and Financial Services was down by (7.3% YoY/-0.7%QoQ). While growth seen in diverse Industries was up (256.6%YoY/13.4% QoQ) followed by Communication, Media, and Technology (up13.6%YoY/-4.2% QoQ), Healthcare (6.7% YoY/-3.8%QoQ).

**Margin guidance 11-12% as anticipating acceleration in growth for H2FY24:** EBIT at INR 178.9 Cr and Margin at 11.7% our estimate of 10.8% led by cost management and strong pipeline. The focus is on growing that part of the portfolio, with the current margin outlook in the range of 11%-12%, and a plan to gradually improve by ~25 to 30 bps going forward. Expecting sequential growth, with Q2 showing relatively modest growth due to higher impact of onshore to offshore, but anticipating acceleration in growth for Q3 and Q4.

**Traction in Collection Segment:** The company's key priorities for the collection business are, one, to continue to diversify collections as a multi-industry offering with penetration into FinTech, auto, and across Telecom and e-financing. In this segment shows signs of increased business activity with rising US credit card delinquencies at 2.43% (2.25% in Q4FY23), 6th consecutive quarterly increase post COVID, supported by trends seen in large US banks' latest earnings.

**Company focuses on the diversification:** Origination volumes slightly increased; refining activity expected after Fed interest rate reversal; steady home purchase volume, driving new home project starts; strong demand for existing properties in hydro places; solid progress on portfolio diversification, expanding relationships with key clients; overall mortgage outlook for the year unchanged.

**Valuations**

The company has provided guidance for a growth of 2-5% in revenues in CC terms, along with margin of 11%-12%. This growth is expected to be driven by an improvement in the collections business and a potential revival in the Provider business, as the US has announced the end of Public Health Emergency (PHE) from May 11th. This decision is likely to boost eligibility services volumes, alongside sustained momentum in CMT (US) and BFS in the UK, among other contributing factors. The company also considers exploring inorganic opportunities in adjacent capabilities to address growth concerns. **We value FSL at a PE of 16x to its FY25E EPS of INR 10.4, which yields a target price of INR 167 per share (earlier target price; of INR 125 per share). We upgrade our rating to Accumulate from Hold earlier.**

**Exhibit 1 Financial Performance**

Consolidated (INR Cr)	FY23	FY24E	FY25E	FY26E
Revenue USD term	751	781	848	929
Net Sales	6022	6421	6971	7640
EBIT	563.3	694.4	842.8	944.3
EBIT Margin	9.35%	10.81%	12.09%	12.36%
Net profit	513.7	530.1	643.4	725.5
EPS ( INR)	7.3	7.6	9.2	10.4
PE (x)	19.8	19.0	15.7	13.9
ROE	15.3%	14.5%	15.9%	16.0%
ROCE	9.9%	11.9%	13.6%	14.2%

Source: Arihant Research, Company Filings

## Exhibit 2: Q1FY24 - Quarterly Performance (Consolidated)

Consolidated (in INR Cr)	Q1FY24	Q4FY23	Q1FY23	Q-o-Q	Y-o-Y
<b>Revenue (CC Terms) (Mn USD)</b>	<b>186</b>	<b>190</b>	<b>191</b>	<b>-2.1%</b>	<b>-2.6%</b>
<b>Net Revenue</b>	<b>1,529</b>	<b>1,557</b>	<b>1,472</b>	<b>-1.8%</b>	<b>3.9%</b>
Employee cost	924	969	960	-4.7%	-3.7%
Other Expenses	365	344	332	6.3%	10.1%
<b>EBITDA</b>	<b>240</b>	<b>244</b>	<b>181</b>	<b>-1.6%</b>	<b>32.7%</b>
<b>EBITDA margin %</b>	<b>15.7%</b>	<b>15.7%</b>	12.3%	3bps	341bps
Depreciation	61	64	64	-4.7%	-4.2%
EBIT	<b>178.9</b>	<b>179.9</b>	<b>117</b>	<b>-0.5%</b>	<b>52.8%</b>
<b>EBIT margin %</b>	<b>11.7%</b>	<b>11.6%</b>	8.0%	<b>15bps</b>	<b>375bps</b>
Other Income	2	13	6		
Finance costs	25	21	19	<b>22.7%</b>	<b>35.9%</b>
<b>PBT</b>	<b>155.3</b>	<b>171.9</b>	<b>105</b>	<b>-9.6%</b>	<b>48.2%</b>
Exceptional item	-	-	-		
<b>PBT and share net profit</b>	<b>155</b>	<b>172</b>	<b>105</b>	<b>-9.6%</b>	<b>48.2%</b>
Tax Expense	29	31	20	-4.1%	49.0%
Effective tax rate %	18.9%	17.8%	18.8%	109bps	10bps
<b>PAT</b>	<b>126.0</b>	<b>141.3</b>	<b>85</b>	<b>-10.8%</b>	<b>48.1%</b>
Non-controlling interest	-0	-0	-0	50.0%	0.0%
<b>Consolidated PAT</b>	125.997	141.304	85.09	-10.8%	48.1%
<b>Reported PAT</b>	126.00	141.30	85.09	-10.8%	48.1%
<b>PAT margin %</b>	<b>8.2%</b>	<b>9.1%</b>	5.8%	-84bps	246bps
<b>EPS (INR)</b>	<b>1.9</b>	<b>2.1</b>	<b>1.3</b>	<b>22.1%</b>	<b>16.6%</b>

Consolidated (in INR Cr)	Q1FY24	Q4FY23	Q1FY23	Q-o-Q	Y-o-Y
Banking and Financial Services	623	628	673	-0.7%	-7.3%
Healthcare	498	517	467	-3.8%	6.7%
Communication, Media and Technology	332	347	293	-4.2%	13.6%
Diverse Industries	73	65	21	13.4%	256.6%

Source: Arian Research, Company Filings

Q1FY24 Concall KTAs

The company remain confident in revenue growth guidance of 2% to 5% for FY24. The revenue guidance incorporates a 3% headwind from last year's base effect and a 3.5% to 4% headwind from onshore-offshore portfolio rebalancing.

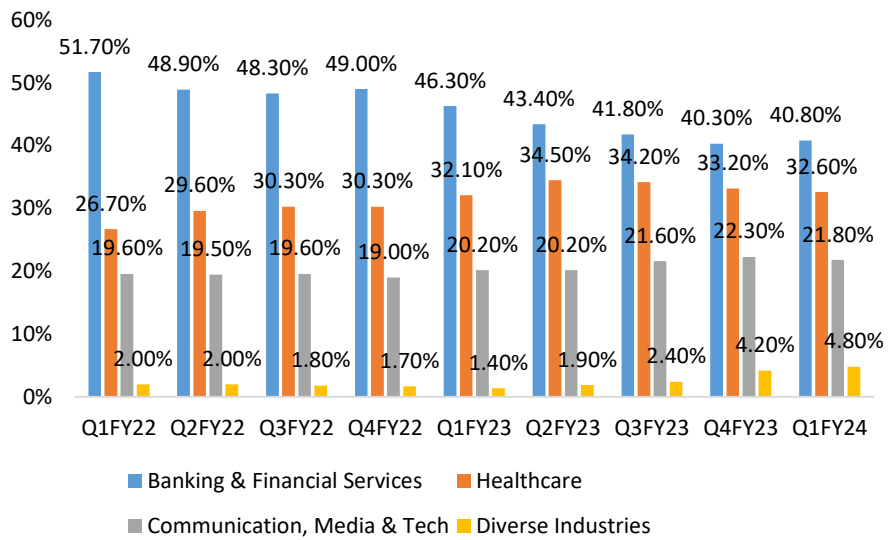
The focus is on growing that part of the portfolio, with the current margin outlook in the range of 11%-12%, and a plan to gradually improve by ~25 to 30 bps going forward. Expecting sequential growth, with Q2 showing relatively modest growth due to higher impact of onshore to offshore, but anticipating acceleration in growth for Q3 and Q4.

- The growth strategy centers on reducing exposure to macro simplicity, broadening BFS, scaling new segments in healthcare and utility, driving growth in chosen verticals, leveraging digital tools for cost efficiency, and harnessing AI advancements.
- The US CMT and US Utility client base has grown, with notable wins in FY23 in both segments. These expansions are aiding the company in increasing the share of utilities in its overall business mix, while still exercising caution.
- Mortgage:** Revenue was 9%, down 17% YoY; Q1FY24 saw 10 new foreign BFS clients, 5 in healthcare, and 1 in CMT, with gradual scaling expected over 12-15 months depending on complexity costs.
- Pipeline in digital and platforms,** Automation and Analytics service clients across industries continues to expand, especially in the areas of repeated intake, repeated collections and process automation faster.
- Implemented ML-based** machine translation solution over chat and email for a large media client to quickly scale and support sales across multiple languages from India.
- Over 98% accurate translations,** faster and cost-effective native-like experience; reduced inquiry turnaround time to one day; extended contract with top client for 10 more years.
- Transitioning considerable** portion of UK operations to India for the account to counter 3% revenue headwind; estimating onshore to offshore impact at 3-4%, including healthcare and BFS movements; potential for growth as serve complex processes from India.
- UK slowdown** affecting core portfolio volumes, US clients cautious on large transformations, but strong engagement in cost optimization programs across industries; detailed discussion on key trends in industrial segment to explore growth drivers.
- BFS segment** declined 13.6% YoY due to mortgage base effect, with a 1.5% sequential decline; mortgage business stabilized, volatility behind, volumes bottomed out, engaged in strategic cost-saving program, and achieved a solid sales quarter.
- Diversification:** Origination volumes slightly increased; refining activity expected after Fed interest rate reversal; steady home purchase volume, driving new home project starts; strong demand for existing properties in hydro places; solid progress on portfolio diversification, expanding relationships with key clients; overall mortgage outlook for the year unchanged.
- Collection:** In this segment shows signs of increased business activity with rising US credit card delinquencies at 2.43%, 6th consecutive quarterly increase post COVID, supported by trends seen in large US banks' latest earnings.
- Making progress** in acquiring new clients and cross-selling, added four new clients; success in expanding into auto finance segment; strong UK BFS performance but slower growth due to economic challenges and offshore movement; focusing on digital call center capability for US bank segment.
- Steady segment growth, impacted by the public health emergency during COVID, lifted in May '23; expecting deal activity to pick up in H2 as states
- Healthcare:** Health systems adjust to new reimbursement environment; expanding offshore capabilities, added one new client and migrated onshore clients to offshore, expecting gradual scaling.
- The revenue decline in provider and growing share of wallet across top 10 health plans in HPHS while strongly executing on the opportunity, the digital intake opportunities.
- Finalizing contract,** hiring for strategic client's sophisticated operations, expecting \$15-18M annual revenue, go-live in Q3, ramp up by Q4FY24 or latest by Q1FY25, FY24 revenue growth guidance: 2-5%, 11-12% operating margin, includes 3% headwind from last year and 3.5-4% headwind from onshore-offshore portfolio rebalancing.
- DSO** came in at 62-63 days against 60 days.

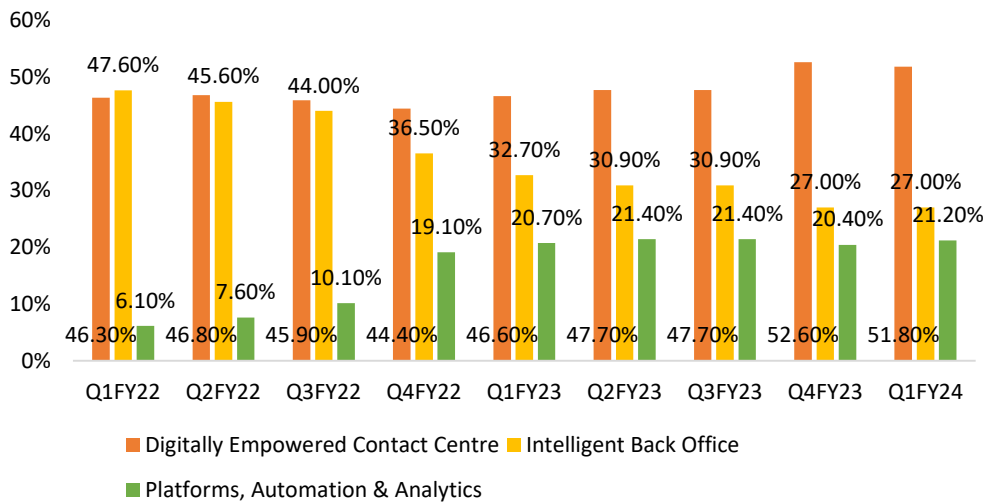
Operating Metrics	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24
<b>Revenue by Vertical</b>									
Banking & Financial Services	51.70%	48.90%	48.30%	49.00%	46.30%	43.40%	41.80%	40.30%	40.80%
Healthcare	26.70%	29.60%	30.30%	30.30%	32.10%	34.50%	34.20%	33.20%	32.60%
Communications Media & Tech	19.60%	19.50%	19.60%	19.00%	20.20%	20.20%	21.60%	22.30%	21.80%
Diverse Industries	2.00%	2.00%	1.80%	1.70%	1.40%	1.90%	2.40%	4.20%	4.80%
<b>Revenue by Service Lines</b>									
Digitally Empowered Contact Centre	46.30%	46.80%	45.90%	44.40%	46.60%	47.70%	50.40%	52.60%	51.80%
Intelligent Back Office	47.60%	45.60%	44.00%	36.50%	32.70%	30.90%	29.20%	27.00%	27.00%
Platforms, Automation & Analytics	6.10%	7.60%	10.10%	19.10%	20.70%	21.40%	20.40%	20.40%	21.20%
<b>Revenue by Geography</b>									
US	67.60%	68.40%	69.80%	70.70%	68.40%	67.20%	64.90%	63.30%	63.50%
UK	31.10%	30.10%	28.50%	27.50%	30.10%	31.30%	34.10%	36.30%	36.40%
ROW	1.30%	1.50%	1.70%	1.80%	1.50%	1.50%	1.00%	0.40%	0.10%
<b>Revenue by Delivery</b>									
Offshore	29.30%	31.00%	30.80%	27.00%	27.40%	25.90%	25.10%	24.60%	25.60%
Onshore	70.70%	69.00%	69.20%	73.00%	72.60%	74.10%	74.90%	75.40%	74.40%
<b>Top Clients Revenue</b>									
Top client %	16.30%	15.80%	15.20%	14.80%	15.20%	14.90%	15.80%	15.40%	14.60%
Top 5 client %	42.00%	41.20%	37.60%	35.90%	36.40%	36.60%	38.50%	37.40%	37.20%
<b>Other Metrics</b>									
Total employees (end of period)	27916	27835	27398	26557	25234	23932	23627	23018	22384
Employees in India	16677	16976	16826	16045	14769	13431	12489	12395	12457
Employees outside India	11239	10859	10572	10512	10465	10501	11138	10623	9927
Net Addition	-88	-81	-437	-841	-1323	-1302	-305	-609	-634
Offshore Attrition (180 days+)	29.20%	36.20%	45.20%	45.90%	43.80%	45.70%	44.40%	44.90%	39.10%
Onshore Attrition (180 days+)	54.80%	68.80%	59.50%	50.20%	56.90%	52.00%	47.20%	42.30%	45.30%

Source: Arianth Research, Company Filings

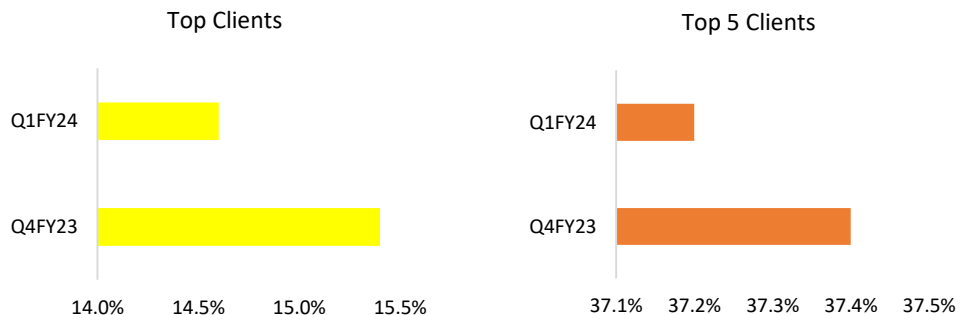
**Exhibit 3: Revenue Split by Verticals-Increase mix in Diverse industries**



**Exhibit 4: Revenue Split by Service line trend**



**Exhibit 5: The company is adding new clients and by growing existing signature accounts**



Source: Arianth Research, Company Filings

## Key Financials

Income Statement (INR Cr)					Balance Sheet (INR Cr)				
Year End-March	FY23	FY24E	FY25E	FY26E	Year End-March	FY23	FY24E	FY25E	FY26E
<b>Revenue USD term</b>	<b>751</b>	<b>781.2</b>	<b>848.0</b>	<b>929.5</b>	<b>Sources of Funds</b>				
<i>Change (%)</i>	-4.3%	4.0%	8.6%	9.6%	Share Capital	697	697	697	697
<b>Revenues</b>	<b>6,022</b>	<b>6,421</b>	<b>6,971</b>	<b>7,640</b>	Reserves & Surplus	2,670	2,961	3,361	3,842
<i>Change (%)</i>	1.7%	6.6%	8.6%	9.6%	Non controlling interest	-	-	-	-
Employee costs	3,867	4,109	4,461	4,878	<b>Total Equity</b>	<b>3,367</b>	<b>3,659</b>	<b>4,058</b>	<b>4,540</b>
Other expenses	1,328	1,332	1,428	1,566	<b>Loan Funds</b>	<b>827</b>	<b>721</b>	<b>671</b>	<b>620</b>
<b>Total Expenses</b>	<b>5,196</b>	<b>5,442</b>	<b>5,889</b>	<b>6,445</b>	Defered Tax Liability (Net)	120	120	120	120
<b>EBITDA</b>	<b>827</b>	<b>979</b>	<b>1,082</b>	<b>1,196</b>	<b>Total Liability</b>	<b>5,664</b>	<b>5,816</b>	<b>6,205</b>	<b>6,678</b>
<b>EBITDA Margin</b>	<b>13.72%</b>	<b>15.25%</b>	<b>15.52%</b>	<b>15.65%</b>	<b>Application of Funds</b>				
Depreciation	263	278	239	251	Gross Block	1,156	1,221	1,286	1,353
<b>EBIT</b>	<b>563</b>	<b>701</b>	<b>843</b>	<b>944</b>	Less: Depreciation	880	1,039	1,206	1,409
<b>EBIT Margin</b>	<b>9.35%</b>	<b>10.91%</b>	<b>12.09%</b>	<b>12.36%</b>	Net Block	276	182	80	(56)
Interest	79	65	60	62	CWIP	3	3	3	3
Other Income	131	17	2	2	Financial Assets	1,341	1,734	2,183	2,727
<b>PBT</b>	<b>615</b>	<b>653</b>	<b>785</b>	<b>885</b>	Investments	60	60	60	60
Exceptional Items	-	-	-	-	<b>Sundry debtors</b>	<b>1,038</b>	<b>968</b>	<b>1,050</b>	<b>1,151</b>
<b>PBT after exceptional Items</b>	<b>615</b>	<b>653</b>	<b>785</b>	<b>885</b>	Cash and bank	156	620	986	1,429
Tax	102	118	141	159	Other Current Assets	151	151	151	151
<i>Rate (%)</i>	18.0%	18.0%	18.0%	18.0%	Total Current assets	1,408	1,802	2,250	2,794
<b>PAT</b>	<b>514</b>	<b>535</b>	<b>643</b>	<b>726</b>	Total Current liabilities	872	857	896	938
<b>Margin</b>	<b>9%</b>	<b>8%</b>	<b>9%</b>	<b>9%</b>	Total Non-Current assets	<b>4,256</b>	<b>4,014</b>	<b>3,954</b>	<b>3,884</b>
<b>Consolidated PAT</b>	<b>514</b>	<b>535</b>	<b>643</b>	<b>726</b>	<b>Capital Employed</b>	<b>5,664</b>	<b>5,816</b>	<b>6,205</b>	<b>6,678</b>
<i>Change (%)</i>	-4.3%	4.2%	20.2%	12.8%					

Cash Flow Statement (INR Cr)				
Year End-March	FY23	FY24E	FY25E	FY26E
<b>PBT</b>	<b>615</b>	<b>653</b>	<b>785</b>	<b>885</b>
Cash From Operating Activities	861	1,029	1,018	1,117
Tax	66	118	141	159
Net Cash From Operations	795	912	877	958
<b>Capex</b>	<b>(54)</b>	<b>(65)</b>	<b>(66)</b>	<b>(67)</b>
Cash From Investing	16	(165)	(166)	(168)
Borrowings	(235)	(50)	(50)	(51)
<b>Finance cost paid</b>	<b>(79)</b>	<b>(65)</b>	<b>(60)</b>	<b>(62)</b>
Cash From Financing	(743)	(279)	(346)	(349)
<b>Net Increase/ Decrease in Cash</b>	<b>68</b>	<b>468</b>	<b>365</b>	<b>442</b>
<b>Cash at the beginning of the year</b>	<b>83</b>	<b>152</b>	<b>620</b>	<b>986</b>
Cash at the end of the year	152	620	986	1,429

Key Ratios				
Year End-March	FY23	FY24E	FY25E	FY26E
<b>Per share (INR)</b>				
EPS	7.3	7.7	9.2	10.4
BVPS	48	52	58	65
<b>Valuation (x)</b>				
P/E	19.8	18.8	15.7	13.9
P/BV	3.0	2.8	2.5	2.2
EV/EBITDA	13.0	10.4	9.0	7.8
<b>Return ratio (%)</b>				
EBITDA Margin	13.7%	15.3%	15.5%	15.7%
EBIT Margin	9.4%	10.9%	12.1%	12.4%
PAT Margin	8.5%	8.3%	9.2%	9.5%
ROE	15.3%	14.6%	15.9%	16.0%
ROCE	9.9%	12.0%	13.6%	14.1%
<b>Leverage Ratio (%)</b>				
Total D/E	0.2	0.2	0.2	0.1
<b>Turnover Ratios</b>				
Asset Turnover (x)	4.3	3.6	3.1	2.7
Receivable Days	58	55	55	55
Payable days	11	11	11	11

Source: Arianth Research, Company Filings

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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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