

CMP: INR 105

Rating: Reduce

Target Price: INR 93

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)	209/ 93
Avg Yearly Vol (in 000')	4004

Shareholding Pattern %

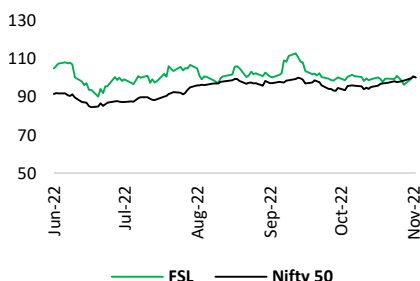
(As on June, 2022)

Promoters	53.66
FII	7.95
DII	14.57
Public & Others	23.82

Stock Performance (%)

	1m	3m	12m
FSL	1.02	-1.09	-47.7
Nifty 50	5.78	4.25	1.08

FSL Vs Nifty 50



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First Source Solutions Ltd (FSL) in Q2FY23, revenue below our estimates and lowered FY23 guidance from 2%-4% to -2%-0% growth in cc term:

FSL has reported consolidated revenue of INR 1,488 Cr, +4.2% YoY/1.1% QoQ in Q2FY23 against our estimate of INR 1,497 Cr. Driven by the Healthcare segment, Diverse Industries, and CMT. USD revenue of \$187Mn, -3.1% YoY/-2.1% QoQ in Q2FY23 against our estimate of INR \$189Mn.,YoY growth of 4.2% and 1.8% in CC.

Margin impacted due to uncertainty of macro environment:

Consolidated EBIT stood at INR 125 Cr, down by 30% YoY/7.1% QoQ against our estimate of INR 140 Cr. On the margins front, the EBIT margin contracted by 411bps YoY/ 48bps QoQ to 8.4% against our estimate of 9.4%.

PAT above estimates due to one off in other income:

Consolidated PAT stood at INR 129.4 Cr, up by 52.1% YoY/-4.2% YoY against our estimate of INR 109.5 Cr. Other Income includes INR 578.60 for the quarter ended September 30, 2022 relating to the fair value of the liability for contingent considerations. These liabilities are expected to be settled in Q3 / Q4 of FY23.

Decent client addition: The diversity of the business offerings and digital solutions has held FSL in good stead, enabling a strong suite of 25 client wins and a resilient quarter. Healthcare business added 2 client on the back of strong digital capabilities. BFS added 22 new clients. The Mortgage business witnessed continued success in services and automation practices onboarding 8 new clients.

Collections business opened offices in Mexico with key client wins enhancing BNPL portfolio and added 11 new clients in Q2FY23 leveraging Digital Collections. The Collections business is also witnessing green shoots in Europe. Europe business had an excellent quarter, onboarding 3 new clients, including a fast-growing specialist digital bank.

Valuations

The company has reassessed growth visibility and lowered guidance to -2%-0% from 2-4% for the FY23 in the CC term. The guidance adjustment is due to primarily pressure on the mortgage business and unique situation in the collection market and some deal delays in the healthcare market. Q3FY23E is expected to be flattish compared to Q2FY23 as a growth washout due to mortgage business and near terms concerns due to increasing macroeconomic risks. **We value FSL at a PE of 11x to its FY25E EPS of INR 8.4, which yields a target price of INR 93 per share (earlier target price; INR 110 per share). We downgrade our rating to Reduce from Hold earlier.**

Exhibit 1 Financial Performance

Particular	FY22E	FY23E	FY24E	FY25E
Sales	5,921	6,099	6,709	7,380
EBIT	710	571	691	778
Reported PAT	537	412	511	588
EBITM (%)	12.0%	9.4%	10.3%	10.5%
PE (x)	13.2	17.7	14.3	12.5
EPS	7.9	5.9	7.3	8.4

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

Exhibit 2: Q2FY23 - Quarterly Performance (Consolidated)

Consolidated (in INR Cr)	Q2FY23	Q1FY23	Q2FY22	Q-o-Q	Y-o-Y
Revenue (Mn USD)	187	191	193.0	-2.1%	-3.1%
Net Revenue	1,488	1,472	1,429	1.1%	4.2%
Employee cost	953	960	973	-0.7%	-2.1%
Other Expenses	344	332	217	3.7%	58.4%
EBITDA	192	181	239	5.9%	-19.7%
<i>EBITDA margin %</i>	12.9%	12.3%	16.7%	59bps	-1672bps
Depreciation	66	64	60	3.7%	11.1%
EBIT	125	117	179	7.1%	-30.0%
<i>EBIT margin %</i>	8.4%	8.0%	12.5%	48bps	-411bps
Other Income	49	6	1		
Finance costs	20	19	16	6.5%	28.2%
PBT	155	105	164	-32.9%	-5.7%
Exceptional item	-	-	-0		
PBT and share net profit	155	105	164	47.9%	-5.7%
Tax Expense	26	20	29	29.8%	-13.0%
Effective tax rate %	16.5%	18.8%	17.9%	-230bps	-138bps
PAT	129.401	85	135	52.1%	-4.2%
Non-controlling interest	-0	-0		-	-
Consolidated PAT	129.40	85.09	135	52.1%	-4.2%
Reported PAT	129.40	85.09	135	52.1%	-4.2%
<i>PAT margin %</i>	8.7%	5.8%	9.5%	292bps	-8.0%
EPS (INR)	1.8	1.3	2.0	47.2%	-9.4%

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

Q2FY23 Conference call highlights

- **Guidance:** The company lowered FY23 guidance to 2%-4% to -2%-0% growth in CC. Margin expectation to be in the range of 9-9.5% for FY23. The guidance adjustment is due to primarily pressure on the mortgage business and unique situation in the collection market and some deal delays in the healthcare market.
- Overall macro environment further deteriorated and the interest rates increased much faster which continues to impact the business. It will also impact the margin.
- The company was not expecting this outcome when the year started but parts of the portfolio are highly correlated with the macro environment because of that near term business highly impacted. The management believes this headwind is a trajectory.
- The company believes business is strong and continues to remain in the medium to long term this is validated by 12-15% growth this year excluding mortgage and last year's acquisition.
- The company expects to normalize its operating margin in Q4FY23E. The strategy remains investment in core and delivery of consistent growth and building a more balanced portfolio.
- **Industry:** BFS de-grew 7.7% y/y/10.2% in cc term, mortgage industry outlook is continuing to worsen due to aggressive fed rate hikes to counter inflation and the sharp downward movement of housing and the collapse of the re-financing market.
- Based on the client discussion mortgage business to bottom out by Q3FY23 but taking headwinds into count bottom will shift 1-2 quarters. Whereas housing demand is structurally strong, home sales demand medium term is likely to be 10% higher in FY24 as compared to FY21-22.
- Housing demand is still 10% higher demand in FY24, the home price is declining significant and continues strong growth driver.
- The company will continue to maintain market leadership as added 12 new clients and is strongly diversified by clients.
- The volume is low in this current market environment and the FSL is well positioned once the market activity stabilized.
- **Collection:** The company collections historically strong hedge against the down cycle of the mortgage industry. However, this time going through an economic phase. Delinquency at a slower pace despite rapidly rising of interest rates is primarily a very low employment rate and the strongest household balance sheet in USSC last for the year.
- **Deal:** Some delay in deal closure but still a healthy deal.
- **Attrition:** Onshore moderation and good 5-point reduction. The market continues to be strong offshore and the rest of the year similar trend and no material move up or down offshore and onshore respectively.
- Tech will become a good growth driver going forward.
- Q3FY23E is expected to be flattish compared to Q2FY23 as a growth washout due to mortgage business.
- Collection business run rate: Combine business \$31-32 mn (Q2FY23 in organic \$17 and in-organic \$16mn) vs \$ 14.5 Mn Organic in Q2FY22.

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

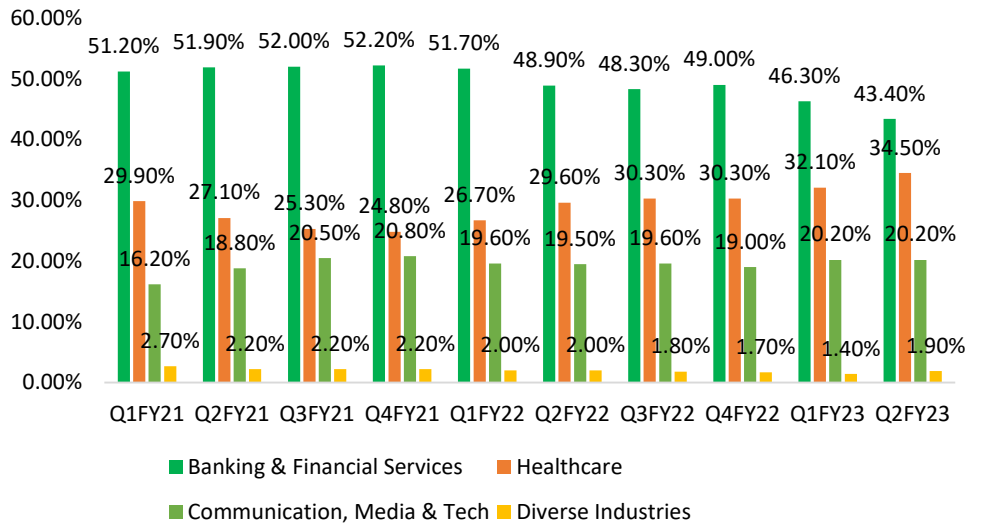


Exhibit 4: Revenue Split by Service line- The expectation of flattish Q3FY23E vs Q2FY23.

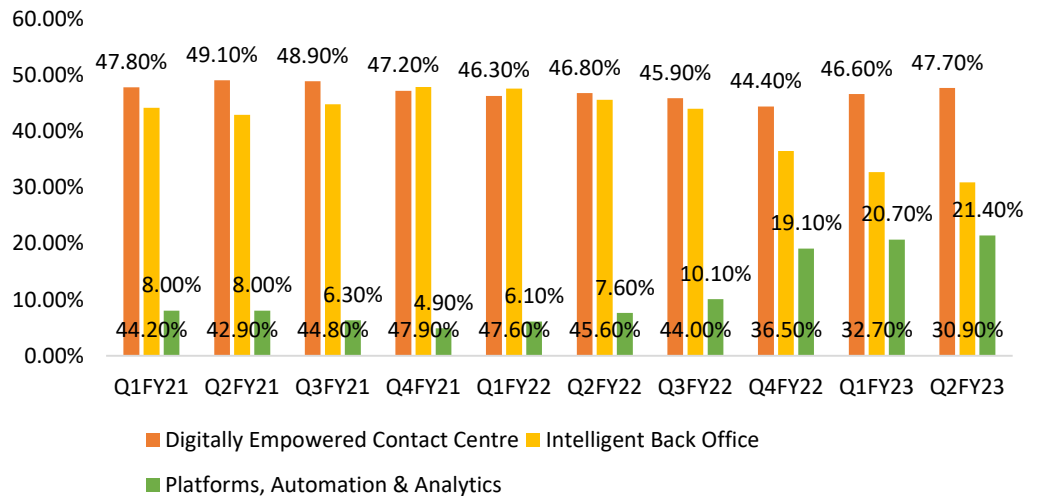
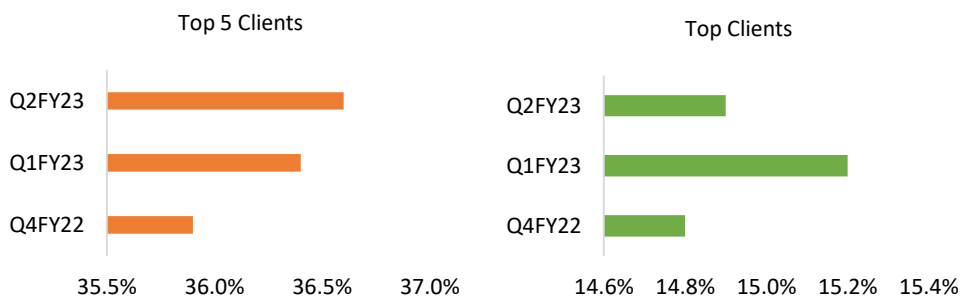


Exhibit 5: Tech will become a good growth driver going forward and added new clients during this quarter.



Source: Arihant Research, Company Filings

Key Financials

Income Statement (INR Cr)

Year End-March	FY22	FY23E	FY24E	FY25E
Revenues	5,921	6,099	6,709	7,380
Change (%)	16.60%	3.0%	10.0%	10.0%
Employee costs	3,947	4,178	4,562	5,018
Other expenses	1,015	1,067	1,153	1,255
Total Expenses	4,961	5,244	5,714	6,273
EBITDA	960	854	994	1,107
EBIDTA Margin	16.21%	14.01%	14.82%	15.00%
Depreciation	249	283	303	329
EBIT	710	571	691	778
EBIT Margin	12.00%	9.37%	10.31%	10.54%
Interest	64	69	72	67
Other Income	1	1	1	1
PBT	647	502	620	712
Exceptional Items	0	0	0	0
PBT after exceptional Items	647	502	620	712
Tax	111	90	108	125
Rate (%)	17.1%	18.0%	17.5%	17.5%
PAT	537	412	511	588
Margin	9%	7%	8%	8%
Consolidated PAT	537	412	511	588
Change (%)	48.3%	-23.2%	24.2%	14.9%

Cash Flow Statement (INR Cr)

Year End-March	FY22	FY23E	FY24E	FY25E
PBT	647	502	620	712
Cash From Operating Activities	798	1,086	940	1,048
Tax	94	90	108	125
Net Cash From Operations	704	996	831	923
Capex	12	-65	-65	-66
Cash From Investing	-595	-164	-164	-165
Borrowings	390	-50	-50	-50
Finance cost paid	-58	-69	-72	-67
Cash From Financing	-158	-363	-366	-352
Net Increase/ Decrease in Cash	-49	468	301	406
Cash at the beginning of the year	132	83	551	852
Cash at the end of the year	83	551	852	1,258

Balance Sheet (INR Cr)

Year End-March	FY22	FY23E	FY24E	FY25E
Sources of Funds				
Share Capital	697	697	697	697
Reserves & Surplus	2,336	2,504	2,772	3,115
Non controlling interest	0	0	0	0
Total Equity	3,033	3,201	3,469	3,813
Loan Funds	1,010	771	721	671
Deferred Tax Liability (Net)	96	96	96	96
Total Liability	5,709	5,588	5,851	6,193
Application of Funds				
Gross Block	1,092	1,156	1,221	1,286
Less: Depreciation	742	880	1,064	1,321
Net Block	350	276	157	-34
CWIP	0	0	0	0
Financial Assets	1,195	1,481	1,861	2,353
Investments	119	119	119	119
Sundry debtors	961	785	864	950
Cash and bank	90	551	852	1,258
Other Current Assets	199	199	199	199
Total Current assets	1,421	1,707	2,087	2,579
Total Current liabilities	799	881	926	975
Total Non-Current assets	4,288	3,881	3,765	3,614
Capital Employed	5,709	5,588	5,851	6,193

Key Ratios

Year End-March	FY22	FY23E	FY24E	FY25E
Per share (INR)				
EPS	7.9	5.9	7.3	8.4
BVPS	44	46	50	55
Valuation (x)				
P/E	13.2	17.7	14.3	12.5
P/BV	2.4	2.3	2.1	1.9
EV/EBITDA	8.6	8.8	7.2	6.1
Return ratio (%)				
EBIDTA Margin	16.2%	14.0%	14.8%	15.0%
EBIT Margin	12.0%	9.4%	10.3%	10.5%
PAT Margin	9.1%	6.8%	7.6%	8.0%
ROE	17.7%	12.9%	14.7%	15.4%
ROCE	12.4%	10.2%	11.8%	12.6%
Leverage Ratio (%)				
Total D/E	0.3	0.2	0.2	0.2
Turnover Ratios				
Asset Turnover (x)	4.2	3.6	3.2	2.9
Receivable Days	47	47	47	47
Payable days	14	14	14	14

Source: Arian 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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