

**CMP: INR 208**

**Rating: Buy**

**Target Price: INR 254**

**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)	14,427
52w H/L (INR)	217/103.5
Avg Yearly Vol (in 000')	2,613

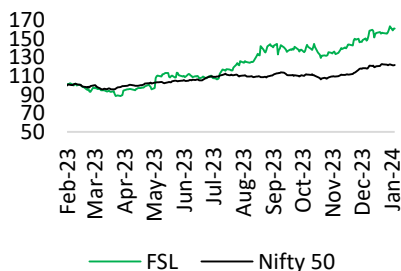
**Shareholding Pattern %**

(As on Dec, 2023)

Promoters	53.66
Public & Others	44.11

Stock Performance (%)	1m	3m	12m
FSL	7.1	30.4	75.0
Nifty	1.0	13.0	23.7

**FSL Vs Nifty**



Firstsource Solutions Ltd (FSL) in Q2FY24, In-line with estimates. The company reported revenue at INR 1597 Cr (US\$ 192 mn against an estimate of US \$ 191 mn ), YoY growth of 3.2% QoQ/4.9% YoY% (In-line with the estimate of 3.2%) Segments: Banking and Financial Services was down by (2.5% YoY/-3.0%QoQ). While growth seen in diverse Industries was up (160%YoY/12.6% QoQ) followed by Communication, Media, and Technology (up 9.0%YoY/9.5% QoQ), Healthcare (4.2% YoY/6.1%QoQ). EBIT at INR 170.9 Cr and Margin at 10.7% our estimate of 10.6% led by cost management and strong pipeline. PAT at INR 128.7 Cr against our estimate of INR 128 Cr. EPS of INR 1.88 vs of INR 1.85 in Q2FY24. Net employee increased by 1,994 employees during the quarter to close at 25,947 employees. Attrition: Offshore attrition declined by 230 bps QoQ to 33.80% & Onshore attrition declined by 150 bps QoQ to 43.3%.

**Despite subdued collections Business, company focus on expanding geography:** The collections business witnessed a Q3 downturn due to a strategic shift towards offshore operations. Despite this, there's a focus on expanding geographically and diversifying into various industry verticals. Progress includes service footprint expansions, securing new clients, and increased execution capacity. Anticipated Q4 recovery is expected, supported by sustained growth factors like client additions and enhanced customer experience services.

**Strong Growth traction in Healthcare:** Healthcare vertical was up 3% YoY and 5% QoQ in constant currency terms. This was driven by the payer segment, where revenue grew mid to single digit on a YoY basis and double digit sequentially, led by rampups across clients. While the macroeconomic environment has been relatively stable for health plans, they continue to explore more opportunities for cost optimization and acquisition to drive member expansion.

**Strategic Unveiling: A Seven-Pronged Approach with a Focus on Near-Term Challenges:** The recently revealed strategy, encompassing organizational simplification, cross-selling and up-selling, capability expansion, brand enhancement, and more, aims to propel the company toward top-quartile growth and improved profitability in the medium term.

**Valuations**

For FY24, the company has narrowed constant currency growth guidance to 0.5% to 1.5%, projecting a normalized EBIT margin at the lower end of the 11% to 11.5% range. In Q4, anticipating modest growth, the banking and financial services portfolio emphasizes risk, compliance, financial crimes, fraud, and order finance. Anticipating good growth momentum in healthcare, the company expects demand driven by diversification in retail and commercial banking portfolios amid market improvements. We expect FSL revenue, EBITDA, and PAT to grow at a CAGR of ~6%, ~11%, and 9%, respectively, over FY23-26E. **We value FSL at a PE of 22x to its FY26E EPS of INR 11.5, which yields a target price of INR 254 per share (earlier target price; of INR 188 per share). We upgrade our rating to Buy from Accumulate on the stock.**

**Exhibit 1 Financial Performance**

Particular	FY23	FY24E	FY25E	FY26E
Sales	6,022	6,270	7,014	7,815
EBITDA	827	946	1,045	1,196
EBITDA Margin	13.7%	15.1%	14.9%	15.3%
Reported PAT	514	565	704	804
PE (x)	28.3	25.5	20.5	17.9
EPS	7.3	8.1	10.1	11.5

Source: Arihant Research, Company Filings

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## Exhibit 2: Quarterly Performance (Consolidated)

Consolidated (in INR Cr)	Q3FY24	Q2FY24	Q3FY23	Q-o-Q	Y-o-Y
Revenue (Mn USD)	192	186	183	3.2%	4.9%
Net Revenue	1,597	1,540	1,504.9	3.7%	6.1%
Employee cost	989	940	986	5.2%	0.3%
Other Expenses	370	371	309	-0.3%	19.7%
EBITDA	237	229	210	3.6%	13.1%
EBITDA margin %	14.9%	14.9%	13.9%	-1bps	92bps
Depreciation	66	65	69	1.4%	-3.6%
EBIT	170.9	163.4	140.9	4.5%	21.2%
EBIT margin %	10.7%	10.6%	9.4%	9bps	134bps
Other Income	15	17	62	-9.4%	-75.4%
Finance costs	25	26	20	-2.5%	28.7%
PBT	160.8	154.3	183.7	4.2%	-12.5%
Exceptional item	-	-	-		
PBT and share net profit	160.790	154.303	184	4.2%	-12.5%
Tax Expense	32	28	26	15.4%	24.5%
Effective tax rate %	19.9%	18.0%	14.0%	193bps	592bps
PAT	128.7	126.5	157.9	1.8%	-18.5%
Non-controlling interest	-0	-	-0		
Consolidated PAT	128.629	126.509	157.923	1.7%	-18.5%
Reported PAT	128.63	126.51	157.92	1.7%	-18.5%
PAT margin %	8.1%	8.2%	10.5%	-16bps	-244bps
EPS (INR)	1.88	1.85	2.3	1.6%	-19.0%

Consolidated (in INR Cr)	Q3FY24	Q2FY24	Q3FY23	Q-o-Q	Y-o-Y
Banking and Financial Services	610	629	626	-3.0%	-2.5%
Healthcare	535	505	514	6.1%	4.2%
Communication, Media and Technology	358	327	329	9.5%	9.0%
Diverse Industries	91	81	35	12.6%	160.2%

Source: Arianth Research, Company Filings

**Concall Highlights**

Firstsource aims for top quartile revenue growth with medium-term margin enhancement; despite potential short-term margin impact, the company is optimistic about a sustained structural improvement, anticipating robust growth in the healthcare vertical for Q4FY24, narrowing the FY24 constant currency growth guidance to 0.5% to 1.5%, and projecting a normalized EBIT margin at the lower end of the 11% to 11.5% range.

**Segment**

The company expects good growth momentum in the healthcare verticals in the coming quarter.

**Investment**

The company is continuing to fund investments mainly through internal cost optimization and efficiency gains. The company is bringing forward some of its planned investments to boost medium-term growth outlook.

**Margin**

The company remains confident of a structural improvement in its margins over the medium term.

**Dividend**

The company announced dividend of INR 3.5 per share.

The company added new sitting capacities in Bangalore, Mumbai, and Philippines Q3FY24. Firstsource is focusing on automation and deploying technology to improve the hiring process. Firstsource is working on a skilled refresh across levels and functions.

The company has two acquisitions with contingent consideration that was not paid and was recorded as other income in Q3FY23.

The company is experiencing higher interest rates on working capital and expensive debt servicing, which is pushing companies with global capital footprints to consolidate and divest to free capital itself.

**Interest rate**

The company is preparing for the next cycle of interest rates coming down, which will create a market move towards maintaining a certain threshold of people to support that volume itself.

**Mortgage**

Firstsource's mortgage business was down sequentially and YoY due to the market cycle, while the broader demand remains sensitive to changes in mortgage rates both in refinance and purchase business.

**Gen AI**

Firstsource's efforts to bring in technology interventions into its sales propositions in the form of advanced automation and Gen AI is also attracting encouraging interest from customers. The company is seeing encouraging traction of Gen AI where discussions are moving from POCs to live projects.

**Weakness in collection**

Demand is expected to be muted due to reduced share of third-party collections.

**Demand**

The company is seeing significant demand come from emerging services such as trust and safety and data and analytics. Demand is expected to be driven by diversification of overall retail banking and commercial banking portfolio with market improvements. Demand is expected to be driven by partnerships with banks to provide disruptive propositions to help them be more competitive and relevant to their member base across the entire value chain.

Demand is expected to be driven by the onshore to offshore transition underway in the top client. Demand is expected to be driven by the healthy momentum in the telco business. Demand is expected to be driven by the fresh inroads in the client base in the energy market. Consumer demand is still seen as a macroeconomic duality.

**Deal Wins**

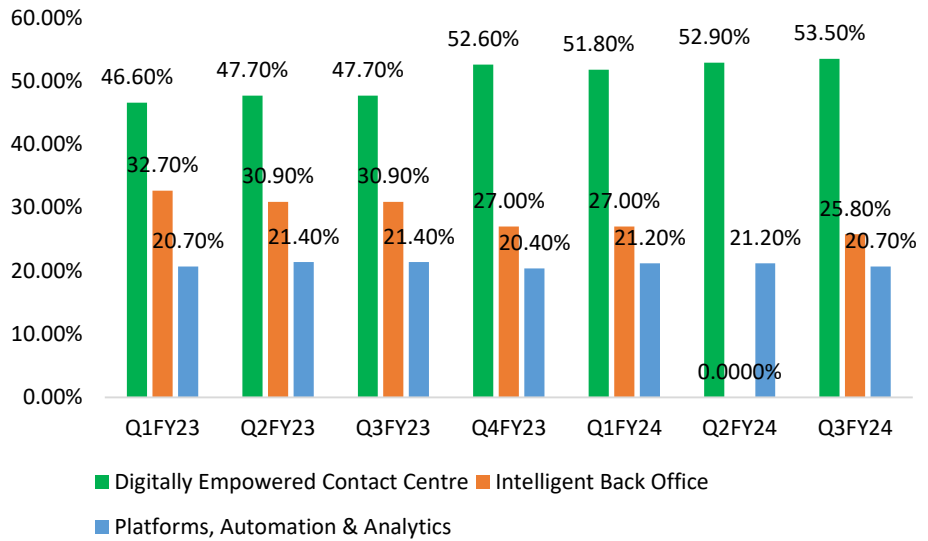
The company has seen higher costs related to ramp-ups in recent deal wins. The company's cost of increments are higher, at around 120-130 bps.

The company rolled out the new ORC structure effective from January 1.

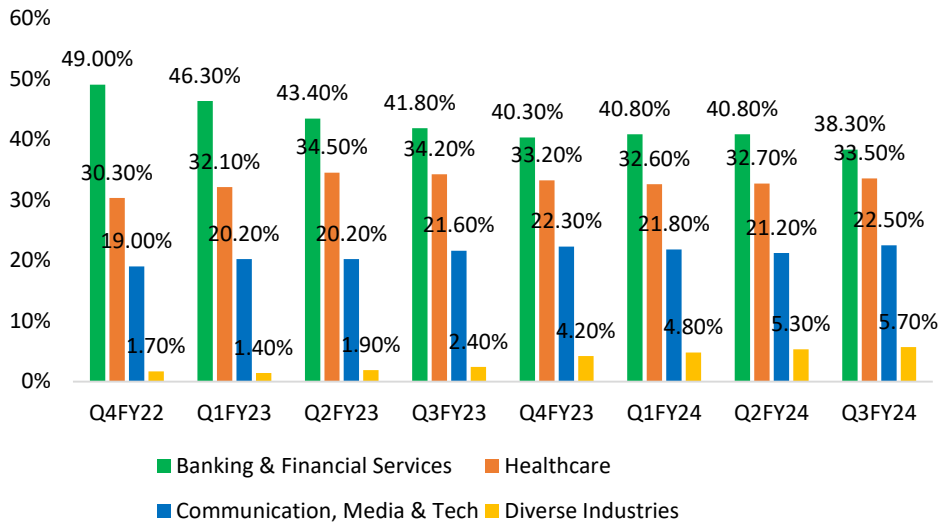
Operating Metrics	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24
<b>Revenue by Vertical</b>											
Banking & Financial Services	51.70%	48.90%	48.30%	49.00%	46.30%	43.40%	41.80%	40.30%	40.80%	40.80%	38.30%
Healthcare	26.70%	29.60%	30.30%	30.30%	32.10%	34.50%	34.20%	33.20%	32.60%	32.70%	33.50%
Communications Media & Tech	19.60%	19.50%	19.60%	19.00%	20.20%	20.20%	21.60%	22.30%	21.80%	21.20%	22.50%
Diverse Industries	2.00%	2.00%	1.80%	1.70%	1.40%	1.90%	2.40%	4.20%	4.80%	5.30%	5.70%
<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%	52.90%	53.50%
Intelligent Back Office	47.60%	45.60%	44.00%	36.50%	32.70%	30.90%	29.20%	27.00%	27.00%	21.9%	25.80%
Platforms, Automation & Analytics	6.10%	7.60%	10.10%	19.10%	20.70%	21.40%	20.40%	20.40%	21.20%	21.20%	20.70%
<b>Revenue by Geography</b>											
US	67.60%	68.40%	69.80%	70.70%	68.40%	67.20%	64.90%	63.30%	63.50%	65.10%	65.40%
UK	31.10%	30.10%	28.50%	27.50%	30.10%	31.30%	34.10%	36.30%	36.40%	34.80%	34.50%
ROW	1.30%	1.50%	1.70%	1.80%	1.50%	1.50%	1.00%	0.40%	0.10%	0.10%	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%	26.70%	30.30%
Onshore	70.70%	69.00%	69.20%	73.00%	72.60%	74.10%	74.90%	75.40%	74.40%	73.30%	69.70%
<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%	12.70%	13.70%
Top 5 client %	42.00%	41.20%	37.60%	35.90%	36.40%	36.60%	38.50%	37.40%	37.20%	35.00%	35.80%
<b>Other Metrics</b>											
Total employees (end of period)	27916	27835	27398	26557	25234	23932	23627	23018	22384	23953	25947
Employees in India	16677	16976	16826	16045	14769	13431	12489	12395	12457	14437	16269
Employees outside India	11239	10859	10572	10512	10465	10501	11138	10623	9927	9516	9678
Net Addition	-88	-81	-437	-841	-1323	-1302	-305	-609	-634	1569	1994
Offshore Attrition (180 days+)	29.20%	36.20%	45.20%	45.90%	43.80%	45.70%	44.40%	44.90%	39.10%	36.10%	33.80%
Onshore Attrition (180 days+)	54.80%	68.80%	59.50%	50.20%	56.90%	52.00%	47.20%	42.30%	45.30%	44.80%	43.30%

Source: Arian Research, Company Filings

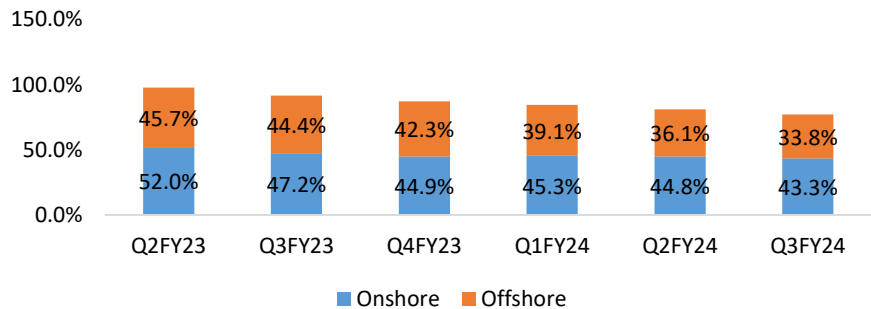
**Exhibit 3: Revenue Split by Verticals-Increase mix in Diverse industries**



**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)

Year End-March	FY23	FY24E	FY25E	FY26E
<b>Revenue USD term</b>	<b>751</b>	<b>762.8</b>	<b>853.3</b>	<b>950.7</b>
<i>Change (%)</i>	281.2%	1.6%	11.9%	11.4%
<b>Revenues</b>	<b>6,022</b>	<b>6,270</b>	<b>7,014</b>	<b>7,815</b>
<i>Change (%)</i>	1.7%	4.1%	11.9%	11.4%
Employee costs	3,867	4,013	4,531	5,025
Other expenses	1,328	1,312	1,438	1,593
<b>Total Expenses</b>	<b>5,196</b>	<b>5,325</b>	<b>5,969</b>	<b>6,619</b>
<b>EBITDA</b>	<b>827</b>	<b>946</b>	<b>1,045</b>	<b>1,196</b>
<b>EBIDTA Margin</b>	<b>13.72%</b>	<b>15.08%</b>	<b>14.90%</b>	<b>15.31%</b>
Depreciation	263	254	226	251
<b>EBIT</b>	<b>563</b>	<b>692</b>	<b>819</b>	<b>945</b>
<b>EBIT Margin</b>	<b>9.35%</b>	<b>11.03%</b>	<b>11.68%</b>	<b>12.09%</b>
Interest	79	130	134	155
Other Income	131	133	174	191
<b>PBT</b>	<b>615</b>	<b>695</b>	<b>858</b>	<b>981</b>
Exceptional Items	-	-	-	-
<b>PBT after exceptional Items</b>	<b>615</b>	<b>695</b>	<b>858</b>	<b>981</b>
Tax	102	130	154	177
<i>Rate (%)</i>	18.0%	18.7%	18.0%	18.0%
<b>PAT</b>	<b>514</b>	<b>565</b>	<b>704</b>	<b>804</b>
<b>Margin</b>	<b>9%</b>	<b>9%</b>	<b>10%</b>	<b>10%</b>
<b>Consolidated PAT</b>	<b>514</b>	<b>565</b>	<b>704</b>	<b>804</b>
<i>Change (%)</i>	-4.3%	10.0%	24.5%	14.3%

## Cash Flow Statement (INR Cr)

Year End-March	FY23	FY24E	FY25E	FY26E
<b>PBT</b>	<b>615</b>	<b>695</b>	<b>858</b>	<b>981</b>
Cash From Operating Activities	861	1,130	1,129	1,291
Tax	66	130	154	177
Net Cash From Operations	795	1,000	974	1,114
<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>(130)</b>	<b>(134)</b>	<b>(155)</b>
Cash From Financing	(743)	(344)	(420)	(442)
<b>Net Increase/ Decrease in Cash</b>	<b>68</b>	<b>492</b>	<b>389</b>	<b>505</b>
<b>Cash at the beginning of the year</b>	<b>83</b>	<b>152</b>	<b>644</b>	<b>1,034</b>
Cash at the end of the year	152	644	1,034	1,539

## Balance Sheet (INR Cr)

Year End-March	FY23	FY24E	FY25E	FY26E
<b>Sources of Funds</b>				
Share Capital	697	697	697	697
Reserves & Surplus	2,670	2,991	3,451	4,011
Non controlling interest	0	0	0	0
<b>Total Equity</b>	<b>3,367</b>	<b>3,689</b>	<b>4,148</b>	<b>4,709</b>
<b>Loan Funds</b>	<b>827</b>	<b>721</b>	<b>671</b>	<b>620</b>
Deferred Tax Liability (Net)	120	120	120	120
<b>Total Liability</b>	<b>5,664</b>	<b>5,842</b>	<b>6,296</b>	<b>6,852</b>
<b>Application of Funds</b>				
Gross Block	1,156	1,221	1,286	1,353
Less: Depreciation	880	1,015	1,169	1,372
Net Block	276	206	117	(19)
CWIP	3	3	3	3
Financial Assets	1,341	1,735	2,237	2,864
Investments	60	60	60	60
<b>Sundry debtors</b>	<b>1,038</b>	<b>945</b>	<b>1,057</b>	<b>1,178</b>
Cash and bank	156	644	1,034	1,539
Other Current Assets	151	151	151	151
Total Current assets	1,408	1,803	2,305	2,931
Total Current liabilities	872	852	897	943
Total Non-Current assets	<b>4,256</b>	<b>4,039</b>	<b>3,991</b>	<b>3,921</b>
<b>Capital Employed</b>	<b>5,664</b>	<b>5,842</b>	<b>6,296</b>	<b>6,852</b>

## Key Ratios

Year End-March	FY23	FY24E	FY25E	FY26E
<b>Per share (INR)</b>				
EPS	7.3	8.1	10.1	11.5
BVPS	48	53	60	68
<b>Valuation (x)</b>				
P/E	28.3	25.5	20.5	17.9
P/BV	4.3	3.9	3.5	3.1
EV/EBITDA	18.2	15.3	13.4	11.3
<b>Return ratio (%)</b>				
EBIDTA Margin	13.7%	15.1%	14.9%	15.3%
EBIT Margin	9.4%	11.0%	11.7%	12.1%
PAT Margin	8.5%	9.0%	10.0%	10.3%
ROE	15.3%	15.3%	17.0%	17.1%
ROCE	9.9%	11.8%	13.0%	13.8%
<b>Leverage Ratio (%)</b>				
Total D/E	0.2	0.2	0.2	0.1
<b>Turnover Ratios</b>				
Asset Turnover (x)	4.3	3.5	3.0	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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