

CMP: INR 114

Rating: Hold

Target Price: INR 125

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)	7904
52w H/L (INR)	125/ 93
Avg Yearly Vol (in 000')	210

Shareholding Pattern %

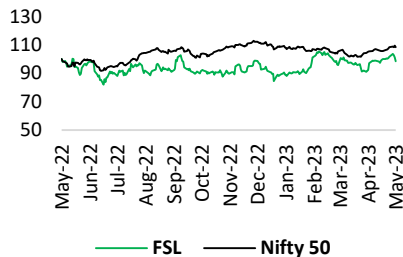
(As on Mar, 2023)

Promoters	53.66
Public & Others	44.11

Stock Performance (%)

	1m	3m	12m
FSL	6.88	-2.45	-1.22
Nifty 50	2.92	1.20	8.31

FSL Vs Nifty 50



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Firstsource Solutions Ltd (FSL) in Q4FY23, revenue above our estimates and FY24 guidance 2%-5% in cc term: The company reported revenue at INR 15,578 mn (US\$ 190 mn against an estimate of US \$ 192 mn), growth of 3.8% QoQ/-7.8% YoY above our estimate of INR 15,400 and de-growth of 2.8% YoY/-1.1% for the FY23 in Constant Currency. The revenue growth is led by Communication, Media, and Technology (grew by 5.6% QoQ/19.5% YoY) and Diverse Industries (grew by 85% QoQ/151% YoY). This year was clearly challenging as a unique business mix was negatively impacted by unprecedented macroeconomic cyclicality.

Expansion in Margin led by cost action: Margin at INR 1.799 mn against our estimate of INR 1,670 mn. Margin at 11.6% above our estimate of 10.8% led by cost management and a strong pipeline. The company indicated an operating margin range of 11% to 12%. Expect the margins to expand. Operating margins will benefit from the multiple initiatives in FY23 to take costs out and protect against margin erosion.

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. expand geographically to the UK Please stay focused on the digital collection platform roadmap and reduce new client's on-boarding timeline. And, drive revenue and margin growth in the legal collection segment. UK BFS continues to deliver strong growth. In the collections segment, the consumer credit metrics continue to soften, which is a positive for the business. Overall, US card-based delinquency rose to 2.25% versus 2.09% in Q3FY23.

Valuations

The company has provided guidance for a growth of 2-5% in revenues in CC terms, along with an OPM (operating profit 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 declaration is expected to increase the volumes of eligibility services, along with the continued momentum in CMT (US), BFS in UK, and other factors. Considering that the growth guidance is slightly below average due to certain headwinds but expect the recovery in the near term led by growth across the segment. **We value FSL at a PE of 13.6x to its FY25E EPS of INR 9.2, which yields a target price of INR 125 per share (earlier target price; of INR 101 per share). We upgrade our rating to Hold from Reduce earlier.**

Exhibit 1 Financial Performance

Particular	FY22	FY23	FY24E	FY25E
Sales	5,921	6,022	6,421	6,971
EBIT	710	563	685	841
Reported PAT	537	514	522	642
EBITM (%)	12.0%	9.4%	10.7%	12.1%
PE (x)	14.4	15.1	15.2	12.3
EPS	7.9	7.3	7.5	9.2

Source: Arihant Research, Company Filings

Exhibit 2: Q4FY23 - Quarterly Performance (Consolidated)

Consolidated (in INR Cr)	Q4FY23	Q3FY23	Q4FY22	Q-o-Q	Y-o-Y
Revenue (CC Terms) (Mn USD)	190	183	206	3.8%	-7.8%
Net Revenue	1,556.8	1,504.9	1,543.9	3.4%	0.8%
Employee cost	969	986	984	-1.7%	-1.6%
Other Expenses	344	309	315	11.2%	9.2%
EBITDA	244	210	245	16.4%	-0.3%
EBITDA margin %	15.7%	13.9%	15.9%	175bps	-18bps
Depreciation	64	69	70	-6.5%	-7.8%
EBIT	179.9	140.9	175	27.6%	2.7%
EBIT margin %	11.6%	9.4%	11.3%	219bps	21bps
Other Income	13	62	-0		
Finance costs	21	20	19	4.7%	10.2%
PBT	171.9	183.7	156	-6.4%	10.2%
Exceptional item	-	-	-		
PBT and share net profit	172	184	156	-6.4%	10.2%
Tax Expense	31	26	24	18.7%	29.4%
Effective tax rate %	17.8%	14.0%	15.1%	377bps	265bps
PAT	141.3	157.9	132	-10.5%	6.7%
Non-controlling interest	-0	-0	-0	100.0%	-66.7%
Consolidated PAT	141.304	157.923	132.38	-10.5%	6.7%
Reported PAT	141.30	157.92	132.38	-10.5%	6.7%
PAT margin %	9.1%	10.5%	8.6%	-142bps	50bps
EPS (INR)	2.1	2.3	2.0	22.1%	16.6%

Consolidated (in INR Cr)	Q4FY23	Q3FY23	Q4FY22	Q-o-Q	Y-o-Y
Banking and Financial Services	628	626	746.251	0.2%	-15.9%
Healthcare	517	514	461.427	0.7%	12.1%
Communication, Media and Technology	347	329	290.493	5.6%	19.5%
Diverse Industries	65	35	25.707	85.1%	151.4%

Source: Arianth Research, Company Filings

Q4FY23 Concall KTAs

•**Guidance:** The company indicated to achieve constant currency growth of 2% to 5% in FY24 led by y/y decline in mortgage 3% headwind) This factors in a sequential decline in Q1 followed by steady growth from Q2 onwards. This guidance assumes a 3% revenue headwind from modernized business given H1FY23 was higher than H2FY23. A 3% revenue headwind from onshore-offshore estate rebalancing.

•**Margin:** The company indicated an operating margin range of 11% to 12%. Expect the margins to expand. Operating margins will benefit from the multiple initiatives in FY23 to take costs out and protect margin erosion.

• **Tax rate:** Expect to be range of 18% to 20% also factor in UK tax rate is moving from 19% to 25%.

•**Strategy:** 1) Diversify within the DSMs and CMT verticals and expand into select new sub segments of healthcare and CMT with the overall goal of reducing exposure to macroeconomic cyclicality and driving the next phase of growth., 2) Drive growth in chosen verticals by building adjacent capabilities, by systematically adding new clients and by growing existing signature accounts., 3) leveraging digital tools and services to create more cost efficiency and build new digitally powered solutions.

•**In BFS:** The company made good progress in going to the collections and UK BFS segments. The company is pleased with the organic constant currency growth of 18.3% in BFS portfolio X model. Continue to build new capabilities and adjacent areas, for instance, Sync Crime Ops and BFS, and extending digitally empowered contact center solution for the EdTech world to drive a better learner CX. launched a consulting practice idea and data integrity practice. In the first year, converted four consulting engagements to annuity contracts.

•The utility segment within the diverse vertical grew nicely 43% y/y, albeit in a small base, on the back of DECX, or digitally empowered contact center, offering its maturity in digital connections. The company expanded delivery footprint to two new geographies, Mexico and South Africa, and further strengthened Philippines operations to help address increasing challenges sourcing the right talent and the client need for greater value extraction. The company is present in six countries.

•The growth rate has slowed down primarily from conclusion of project-based engagements, delays in deal closure, and continued softness in the provider segment.

•Expect strong growth vectors to emerge from this change in H2FY24. In the health plan segment, the company is witnessing somewhat of a slowdown in the growth, especially where the solution involves significant transformation or digital interventions. The deal pipeline remains strong.

•Good traction for actively working with clients in moving parts of value chain offshore.

•The collection business to witness a gradual recovery throughout the year. UK BFS continues to deliver strong.

•**Client Addition:** Added 73 new clients this year, and did well to expand most of key relationships across non-mortgage BFS, CMT, and HBHS approach for FY24 continues to refine these building blocks. The company has reduced cyclicality in business, even as the global economic environment and sentiment is increasingly uncertain.

•**Collection:** The company key priorities for the collection business are, one, continue to diversify collections as a multi-industry offering with penetration into FinTech, auto, and across Telecom and e-financing. expand geographically to the UK Please stay focused on the digital collection platform roadmap and reduce new clients on boarding timeline. And, drive revenue and margin growth in legal collection segment. UK BFS continues to deliver strong growth. In the collections segment, the consumer credit metrics continue to soften, which is a positive for the business. Overall, US card-based delinquency rose to 2.25% versus 2.09% in Q3FY23.

Operating Metrics	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23
Revenue by Vertical									
Banking & Financial Services	52.20%	51.70%	48.90%	48.30%	49.00%	46.30%	43.40%	41.80%	40.30%
Healthcare	24.80%	26.70%	29.60%	30.30%	30.30%	32.10%	34.50%	34.20%	33.20%
Communications Media & Tech	20.80%	19.60%	19.50%	19.60%	19.00%	20.20%	20.20%	21.60%	22.30%
Diverse Industries	2.20%	2.00%	2.00%	1.80%	1.70%	1.40%	1.90%	2.40%	4.20%
Revenue by Service Lines									
Digitally Empowered Contact Centre	47.20%	46.30%	46.80%	45.90%	44.40%	46.60%	47.70%	50.40%	52.60%
Intelligent Back Office	47.90%	47.60%	45.60%	44.00%	36.50%	32.70%	30.90%	29.20%	27.00%
Platforms, Automation & Analytics	4.90%	6.10%	7.60%	10.10%	19.10%	20.70%	21.40%	20.40%	20.40%
Revenue by Geography									
US	67.40%	67.60%	68.40%	69.80%	70.70%	68.40%	67.20%	64.90%	63.30%
UK	31.50%	31.10%	30.10%	28.50%	27.50%	30.10%	31.30%	34.10%	36.30%
ROW	1.10%	1.30%	1.50%	1.70%	1.80%	1.50%	1.50%	1.00%	0.40%
Revenue by Delivery									
Offshore	30.60%	29.30%	31.00%	30.80%	27.00%	27.40%	25.90%	25.10%	24.60%
Onshore	69.40%	70.70%	69.00%	69.20%	73.00%	72.60%	74.10%	74.90%	75.40%
Top Clients Revenue									
Top client %	17.50%	16.30%	15.80%	15.20%	14.80%	15.20%	14.90%	15.80%	15.40%
Top 5 client %	42.30%	42.00%	41.20%	37.60%	35.90%	36.40%	36.60%	38.50%	37.40%
Other Metrics									
Total employees (end of period)	28004	27916	27835	27398	26557	25234	23932	23627	23018
Employees in India	16289	16677	16976	16289	16289	16289	16289	16289	16289
Employees outside India	11715	11239	10859	11715	11715	11715	11715	11715	11715
Net Addition	1386	-88	-81	-437	-841	-1323	-1302	-305	-609
Offshore Attrition (180 days+)	28.60%	29.20%	36.20%	45.20%	45.90%	43.80%	45.70%	44.40%	44.90%
Onshore Attrition (180 days+)	40.00%	54.80%	68.80%	59.50%	50.20%	56.90%	52.00%	47.20%	42.30%

Source: Arianth Research, Company Filings

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

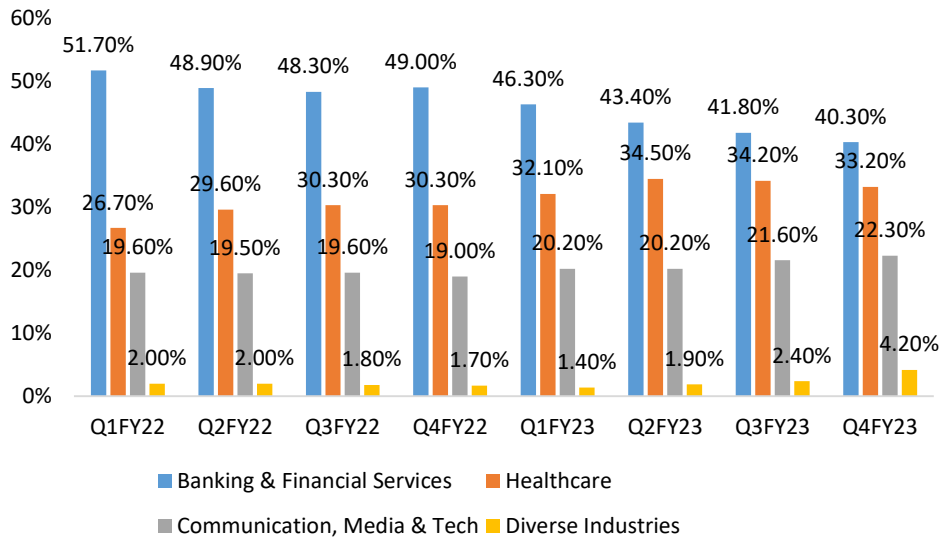


Exhibit 4: Revenue Split by Service line trend

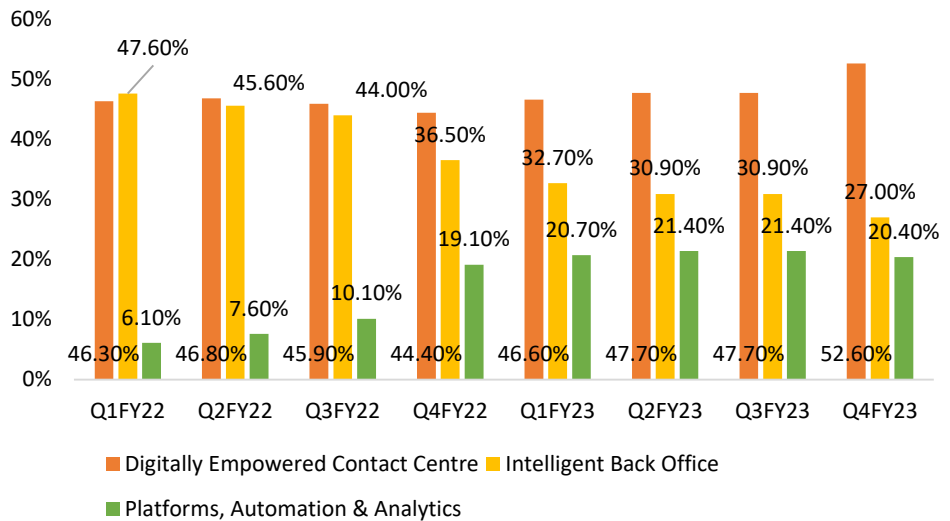
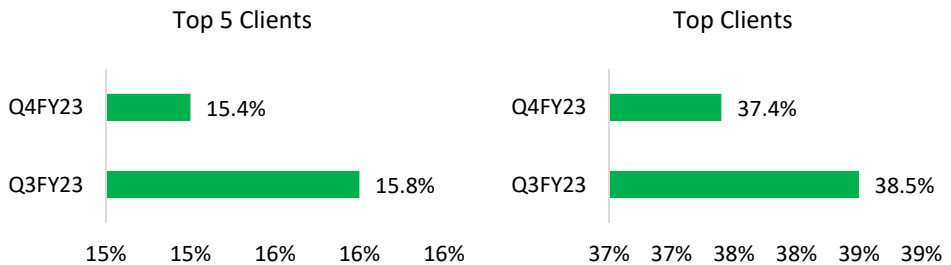


Exhibit 5: The company is adding new clients and by growing existing signature accounts



Source: Arianth Research, Company Filings

Key Financials

Income Statement (INR Cr)				
Year End-March	FY22	FY23	FY24E	FY25E
Revenue USD term	795	751	781.2	848.0
Change (%)	16.06%	-5.5%	4.0%	8.6%
Revenues	5,921	6,022	6,421	6,971
Change (%)	16.60%	1.7%	6.6%	8.6%
Employee costs	3,947	3,867	4,109	4,461
Other expenses	1,015	1,328	1,348	1,429
Total Expenses	4,961	5,196	5,458	5,890
EBITDA	960	827	963	1,080
EBIDTA Margin	16.21%	13.72%	15.00%	15.50%
Depreciation	249	263	278	239
EBIT	710	563	685	841
EBIT Margin	12.00%	9.35%	10.66%	12.07%
Interest	64	79	65	60
Other Income	1	131	17	2
PBT	647	615	637	783
Exceptional Items	-	-	-	-
PBT after exceptional				
Items	647	615	637	783
Tax	111	102	115	141
Rate (%)	17.1%	18.0%	18.0%	18.0%
PAT	537	514	522	642
Margin	9%	9%	8%	9%
Consolidated PAT	537	514	522	642
Change (%)	48.3%	-4.3%	1.7%	23.0%

Balance Sheet (INR Cr)				
Year End-March	FY22	FY23	FY24E	FY25E
Sources of Funds				
Share Capital	697	697	697	697
Reserves & Surplus	2,336	2,670	2,948	3,346
Non controlling interest	0	0	0	0
Total Equity	3,033	3,367	3,645	4,044
Loan Funds	1,010	827	721	671
Defered Tax Liability (Net)	96	120	120	120
Total Liability	5,709	5,664	5,803	6,190
Application of Funds				
Gross Block	1,092	1,156	1,221	1,286
Less: Depreciation	742	880	1,039	1,206
Net Block	350	276	182	80
CWIP	0	3	3	3
Financial Assets	1,195	1,341	1,721	2,169
Investments	119	60	60	60
Sundry debtors	961	1,038	968	1,050
Cash and bank	90	156	607	972
Other Current Assets	199	151	151	151
Total Current assets	1,421	1,408	1,789	2,236
Total Current liabilities	799	872	857	896
Total Non-Current assets	4,288	4,256	4,014	3,954
Capital Employed	5,709	5,664	5,803	6,190

Cash Flow Statement (INR Cr)				
Year End-March	FY22	FY23	FY24E	FY25E
PBT	647	615	637	783
Cash From Operating Activities	798	861	1,013	1,016
Tax	94	66	115	141
Net Cash From Operations	704	795	899	875
Capex	12	(54)	(65)	(66)
Cash From Investing	(594)	16	(165)	(166)
Borrowings	390	(235)	(50)	(50)
Finance cost paid	(58)	(79)	(65)	(60)
Cash From Financing	(158)	(743)	(279)	(346)
Net Increase/ Decrease in Cash	-49	68	455	364
Cash at the beginning of the year	132	83	152	607
Cash at the end of the year	83	152	607	972

Key Ratios				
Year End-March	FY22	FY23	FY24E	FY25E
Per share (INR)				
EPS	7.9	7.3	7.5	9.2
BVPS	44	48	52	58
Valuation (x)				
P/E	14.4	15.1	15.2	12.3
P/BV	2.6	2.4	2.2	2.0
EV/EBITDA	9.2	10.4	8.3	7.1
Return ratio (%)				
EBIDTA Margin	16.2%	13.7%	15.0%	15.5%
EBIT Margin	12.0%	9.4%	10.7%	12.1%
PAT Margin	9.1%	8.5%	8.1%	9.2%
ROE	17.7%	15.3%	14.3%	15.9%
ROCE	12.4%	9.9%	11.8%	13.6%
Leverage Ratio (%)				
Total D/E	0.3	0.2	0.2	0.2
Turnover Ratios				
Asset Turnover (x)	4.2	4.3	3.6	3.1
Receivable Days	47	58	55	55
Payable days	14	11	11	11

Source: Arihant 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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