

EBIT margin drop disappoints...

Firstsource Solution (FSL) reported a mixed set of Q4FY20 numbers. While revenues increased 2.6% QoQ and 11.7% YoY, EBIT margins fell 40 bps QoQ, 154 bps YoY to 10.8%. The increase in revenue was led by 6.8% QoQ growth in telecom & media vertical and 1.7% QoQ increase in BFSI. Overall debt has increased by ₹ 290 crore to ₹ 836 crore in FY20.

Collections, digital to drive long term revenues

Revenues in the quarter were impacted by the Covid-19 pandemic. The company has indicated at supply side issues and client specific challenges impacting Q4FY20 revenues. In the near term, FSL expects pressure in healthcare business (due to lower elective surgeries & pricing pressure), challenges in top client (due to slowdown in UK economy) and seasonality in collections. Hence, we expect revenues to decline 10% QoQ in Q1FY21E with margins falling 200 bps. Going forward, we expect a gradual recovery in the collection business (led by higher origination business and higher refinancing), BFSI and healthcare (led by revival in provider business). Further, the company has hired a few leaders to boost its digital business (currently 12% of revenues), drive healthcare business and diversify communication & media business. This will drive long term revenues. We expect FY21E revenues to decline 2.6% YoY mainly led by sharp drop in Q1FY21E. However, we expect FY22E revenues to increase 7.0% YoY led by a recovery across segments.

Margins to remain subdued in near term

The company is taking various measures to rationalise cost like lower discretionary spend, lower salary hikes, lower travel cost and other cost efficiency. However, a sharp drop in revenues in Q1FY21E is expected to dent its Q1FY21E margins. This, in turn, is expected to lead to a 50 bps dip in FY21E EBIT margins to 10.3%. We expect FY22E margins to improve led by a recovery in demand and cost rationalisation. As a result, we expect EBIT margins to improve 70 bps to 11.0% in FY22E.

Valuation & Outlook

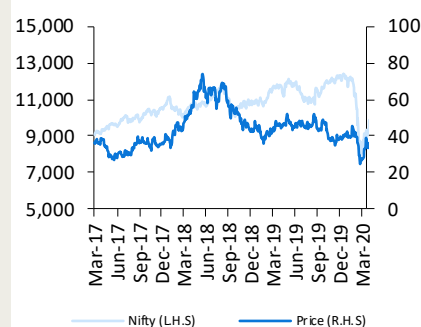
We expect near term revenues to be impacted by pricing pressure in healthcare and challenges in top client. This is expected to dent Q1FY21E revenues by 10% QoQ. This sharp drop in Q1FY21E is expected to impact FY21E revenues and margins. As a result, we revise our FY21E revenues and EPS estimates downwards. In addition, we believe the debt will remain elevated due to higher DSO days. Hence, we downgrade the stock from BUY to **HOLD** with a revised target price of ₹ 31.



Particulars

Particular	Amount
Market Capitalization (₹ Crore)	2,042.9
Total Debt (₹ Crore)	836.9
Cash and Investments (₹ Crore)	190.7
EV (₹ Crore)	2,689.1
52 week H/L	58 / 21
Equity capital	693.8
Face value	10.0

Price Performance



Key Highlights

- Pricing pressure in healthcare and challenges in top client to impact near term revenues
- We expect margins to improve in FY22E
- Downgrade from BUY to HOLD rating with target price of ₹ 31

Research Analyst

Devang Bhatt
devang.bhatt@icicisecurities.com

Key Financial Summary

Key Financials	FY18	FY19	FY20	FY21E	FY22E	FY(20-22E)
Net Sales	3,535	3,826	4,099	3,997	4,278	2.2%
EBITDA	459	535	629	596	659	2.3%
Margins (%)	13.0	14.0	15.3	14.9	15.4	
Net Profit	327	378	340	311	369	4.3%
EPS (₹)	4.8	5.4	4.9	4.5	5.3	
P/E	6.3	5.5	6.1	6.6	5.6	
RoNW (%)	13.9	13.9	12.3	10.5	11.6	
RoCE (%)	13.0	14.0	11.1	9.8	11.2	

Source: Company, ICICI Direct Research

Financial summary

Exhibit 1: Profit and loss statement ₹ crore				
	FY19	FY20	FY21E	FY22E
Total Revenues	3,826	4,099	3,997	4,278
Growth (%)	8.2	7.1	(2.5)	7.0
Employee expenses	2,557	2,774	2,718	2,892
Other Expenses	734	696	684	727
EBITDA	535	629	596	659
Growth (%)	16.7	17.4	(5.3)	10.6
Depreciation & Amortization	74	185	186	188
Other Income	4	9	10	11
Interest	29	58	58	52
PBT before Exceptional Items	436	394	361	429
Growth (%)	21.7	(9.6)	(8.4)	18.9
Tax	58	55	51	60
PAT before Exceptional Items	378	340	311	369
Exceptional items				
PAT before MI	378	340	311	369
Minority Int & Pft. from associat	(0)	(0)	(0)	(0)
PAT	378	340	311	369
Growth (%)	15.7	(10.1)	(8.6)	18.9
EPS	5.4	4.9	4.5	5.3
EPS (Growth %)	14.5	(10.3)	(8.6)	18.9

Source: Company, ICICI Direct Research

Exhibit 2: Cash flow statement ₹ crore				
	FY19	FY20	FY21E	FY22E
Profit before Tax	436	394	361	429
Depreciation & Amortization	74	185	186	188
WC changes	(65)	(135)	(157)	15
Other non cash adju.	2	20	49	41
CF from operations	385	410	388	614
Capital expenditure	(109)	(95)	(200)	(214)
Δ in investments	(96)	128	-	-
Other investing cash flow	1	(18)	(10)	(9)
CF from investing Activities	(204)	14	(190)	(203)
Issue of equity	14	8	-	-
Δ in debt funds	(119)	150	(3)	(187)
Dividends paid	(125)	(376)	(124)	(148)
Other financing cash flow	(28)	(58)	(58)	(52)
CF from Financial Activities	(258)	(277)	(185)	(384)
Δ in cash and cash bank balance	(77)	148	13	27
Effect of exchange rate changes	1	2	3	4
Opening cash	123	47	191	204
Closing cash	47	191	204	230

Source: Company, ICICI Direct Research

Exhibit 3: Balance sheet ₹ crore				
	FY19	FY20	FY21E	FY22E
Equity	691	694	694	694
Reserves & Surplus	2,030	2,072	2,258	2,480
Networth	2,721	2,765	2,952	3,173
Minority Interest	1	1	1	1
LT liabilities & provisions	53	487	487	487
Total Debt	546	837	834	650
Source of funds	3,320	4,090	4,274	4,311
Net fixed assets	114	588	602	628
CWIP	2	-	-	-
Goodwill	2,045	2,232	2,232	2,232
Other non current assets	674	662	653	677
Loans and advances	-	-	-	-
Current Investments	122	-	-	-
Debtors	387	557	541	457
Cash & Cash equivalents	47	191	204	230
Other current assets	284	357	375	402
Trade payables	90	95	93	99
Current liabilities	205	355	197	169
Provisions	61	46	43	47
Application of funds	3,320	4,090	4,274	4,311

Source: Company, ICICI Direct Research

Exhibit 4: Key ratios ₹ crore				
(Year-end March)	FY19	FY20	FY21E	FY22E
Per share data (₹)				
EPS-diluted	5.4	4.9	4.5	5.3
Cash per share	0.7	2.8	3.0	3.4
BV	39.6	40.3	43.0	46.2
Operating Ratios (%)				
EBITDA Margin	14.0	15.3	14.9	15.4
PBT Margin	11.4	9.6	9.0	10.0
PAT Margin	9.9	8.3	7.8	8.6
Return Ratios (%)				
RoNW	13.9	12.3	10.5	11.6
RoCE	14.0	11.1	9.8	11.2
Valuation Ratios (x)				
P/E	5.5	6.1	6.6	5.6
EV / EBITDA	4.5	4.3	4.5	3.7
Price to Book Value	0.8	0.7	0.7	0.6
EV / Net Sales	0.6	0.7	0.7	0.6
Mcap / Net Sales	0.5	0.5	0.5	0.5
Turnover Ratios				
Debtor days	37	50	49	39
Creditors days	9	8	8	8
Solvency Ratios				
Total Debt / Equity	0.2	0.3	0.3	0.2
Current Ratio	1.9	1.8	2.7	2.7
Quick Ratio	1.9	1.8	2.7	2.7
Net Debt / EBITDA	0.7	1.0	1.1	0.6

Source: Company, ICICI Direct Research

RATING RATIONALE

ICICI Direct endeavors to provide objective opinions and recommendations. ICICI Direct assigns ratings to its stocks according to their notional target price vs. current market price and then categorizes them as Buy, Hold, Reduce and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock

Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruiti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

ANALYST CERTIFICATION

I/We, Devang Bhatt, PGDBM, Research Analysts, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. It is also confirmed that above mentioned Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months and do not serve as an officer, director or employee of the companies mentioned in the report.

Terms & conditions and other disclosures:

ICICI Securities Limited (ICICI Securities) is a full-service, integrated investment banking and is, inter alia, engaged in the business of stock brokering and distribution of financial products. ICICI Securities Limited is a SEBI registered Research Analyst with SEBI Registration Number – INH000000990. ICICI Securities Limited SEBI Registration is INZ000183631 for stock broker. ICICI Securities is a subsidiary of ICICI Bank which is India's largest private sector bank and has its various subsidiaries engaged in businesses of housing finance, asset management, life insurance, general insurance, venture capital fund management, etc. ("associates"), the details in respect of which are available on www.icicibank.com

ICICI Securities is one of the leading merchant bankers/ underwriters of securities and participate in virtually all securities trading markets in India. We and our associates might have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. ICICI Securities generally prohibits its analysts, persons reporting to analysts and their relatives from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

Recommendation in reports based on technical and derivative analysis centre on studying charts of a stock's price movement, outstanding positions, trading volume etc as opposed to focusing on a company's fundamentals and, as such, may not match with the recommendation in fundamental reports. Investors may visit icicidirect.com to view the Fundamental and Technical Research Reports.

Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.

ICICI Securities Limited has two independent equity research groups: Institutional Research and Retail Research. This report has been prepared by the Retail Research. The views and opinions expressed in this document may or may not match or may be contrary with the views, estimates, rating, target price of the Institutional Research.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on a reasonable basis, ICICI Securities is under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities might be acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and shall not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgment by any recipient. The recipient should independently evaluate the investment risks. The value and return on investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities accepts no liabilities whatsoever for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities or its associates might have managed or co-managed public offering of securities for the subject company or might have been mandated by the subject company for any other assignment in the past twelve months.

ICICI Securities or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory service in a merger or specific transaction.

ICICI Securities encourages independence in research report preparation and strives to minimize conflict in preparation of research report. ICICI Securities or its associates or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither ICICI Securities nor Research Analysts and their relatives have any material conflict of interest at the time of publication of this report.

Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions.

ICICI Securities or its subsidiaries collectively or Research Analysts or their relatives do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

Since associates of ICICI Securities are engaged in various financial service businesses, they might have financial interests or beneficial ownership in various companies including the subject company/companies mentioned in this report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Neither the Research Analysts nor ICICI Securities have been engaged in market making activity for the companies mentioned in the report.

We submit that no material disciplinary action has been taken on ICICI Securities by any Regulatory Authority impacting Equity Research Analysis activities.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.