

Firstsource Solutions

Refer to important disclosures at the end of this report

Mortgage biz drives revenue growth; raises revenue guidance

CMP: Rs 71

as of (October 29, 2020)

TP: Rs 90 (■)

12 months

Rating: BUY (■)

Upside: 26.6 %

- Revenue grew 11.8% QoQ to Rs11.9bn (up 12.2% QoQ/13.1% YoY in CC), led by strong momentum in mortgage and recovery in the top account. EBITM expanded 40bps QoQ to 11.4% on the back of acceleration in revenue, offshore shift and operating efficiencies.
- BFS grew 13.4% QoQ on continued traction in the mortgage business (up ~2.1x YoY). Healthcare was muted (1.4% QoQ) as it experienced volume compression with delayed elective treatments and declining hospital visits and claims volume. CMT recovered sharply in Q2 due to a solid volume recovery at the top client.
- FSOL upped its FY21 revenue growth guidance to 9-12% YoY CC (earlier 6- 10%) and retained EBITM guidance of 11-11.5%. Revenue guidance implies a 1.7-5.2% CQGR in H2. Management attributed the wide guidance range to uncertainties over the health crisis.
- Anticipated increase in revenue growth, delivery on guidance and strong cash generation would support high valuations. We assume coverage on FSOL with Buy and a TP of Rs90 at 12x Sept'22E earnings.

What we liked? Strong traction in BFS led by Mortgage business; Sharp recovery in Top client; Robust cash generation (Rs3.9bn FCF in H1).

What we did not like? Softness in Healthcare.

Strong revenue performance; revenue growth guidance raised to 9-12%: FSOL upped revenue growth guidance to 9-12% YoY CC for FY21, implying a 1.7-5.2% CQGR in H2. The management remained confident on sustaining revenue growth momentum on the back of a) strong traction in BFS led by the mortgage business (up ~2.1x YoY in Q2 and the run rate is likely to grow further), b) anticipated recovery in Healthcare by Q4-end, and c) robust deal intake/pipeline. BFS is expected to maintain growth trajectory, aided by strong momentum across segments (mortgage, collection and UK retail and commercial banks), macro tailwinds and healthy deal wins. Healthcare is expected to revive in the next few quarters (payer showing good traction, while a recovery expected in provider by Q4). It added 15 clients in Q3 (11 in BFS, including 9 in mortgage; 4 in Healthcare, including 2 in provider). Top client rebounded sharply (32.2% QoQ) and FSOL expects YoY growth to return by Q4-end.

Assume coverage on Firstsource Solutions with Buy and TP of Rs90: Low interest rates in the US should drive refinance volumes and new home sales in the foreseeable future, which should augur well for FSOL given its comprehensive offerings in BFSI. We believe that anticipated acceleration in revenue growth momentum, stability in margins, strong consistent execution, delivery on guidance and strong cash generation would support high valuations. We assume coverage on FSOL with Buy and a TP of Rs90 at 12x Sept'22E earnings.

Please see our sector model portfolio (Emkay Alpha Portfolio): [Information Technology \(Page 9\)](#)

Financial Snapshot (Consolidated)

(Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Revenue	38,263	40,986	47,224	53,320	58,812
EBITDA	5,355	6,289	7,372	8,285	9,240
EBITDA Margin (%)	14.0	15.3	15.6	15.5	15.7
APAT	3,778	3,397	4,114	4,897	5,391
EPS (Rs)	5.5	4.9	5.9	7.0	7.8
EPS (% chg)	14.9	(10.4)	20.9	19.0	10.1
ROE (%)	14.9	12.4	14.3	15.5	15.5
P/E (x)	13.0	14.5	12.0	10.1	9.2
EV/EBITDA (x)	9.9	8.9	7.3	6.1	5.2
P/BV (x)	1.8	1.8	1.6	1.5	1.4

Source: Company, Emkay Research



Change in Estimates

EPS Chg FY21E/FY22E (%)	-/-
Target Price change (%)	NA
Target Period (Months)	12
Previous Reco	NA

Emkay vs Consensus

EPS Estimates		
	FY21E	FY22E
Emkay	5.9	7.0
Consensus	5.7	6.5
Mean Consensus TP (12M)	Rs 93	

Stock Details

Bloomberg Code	FSOL IN
Face Value (Rs)	10
Shares outstanding (mn)	695
52 Week H/L	78 / 20
M Cap (Rs bn/USD bn)	49 / 0.67
Daily Avg Volume (nos.)	45,26,674
Daily Avg Turnover (US\$ mn)	3.9

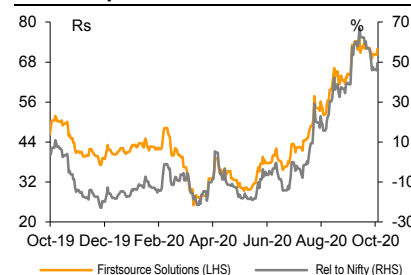
Shareholding Pattern Sep '20

Promoters	53.8%
FIIIs	6.6%
DIIIs	14.0%
Public and Others	25.7%

Price Performance

(%)	1M	3M	6M	12M
Absolute	(1)	52	106	41
Rel. to Nifty	(5)	46	69	42

Relative price chart



Source: Bloomberg

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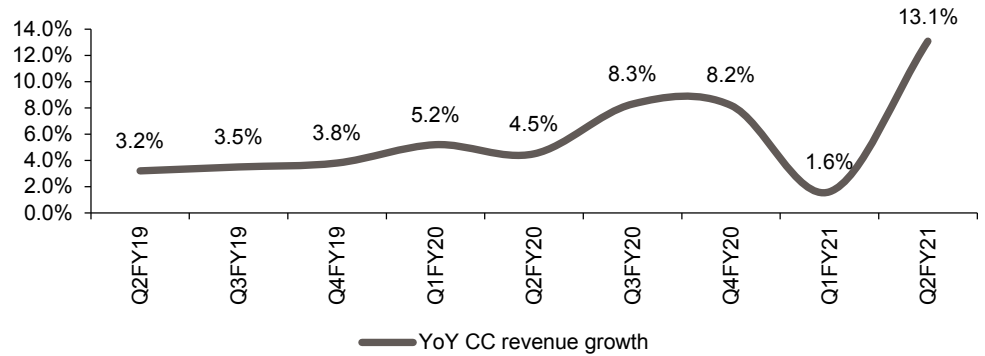
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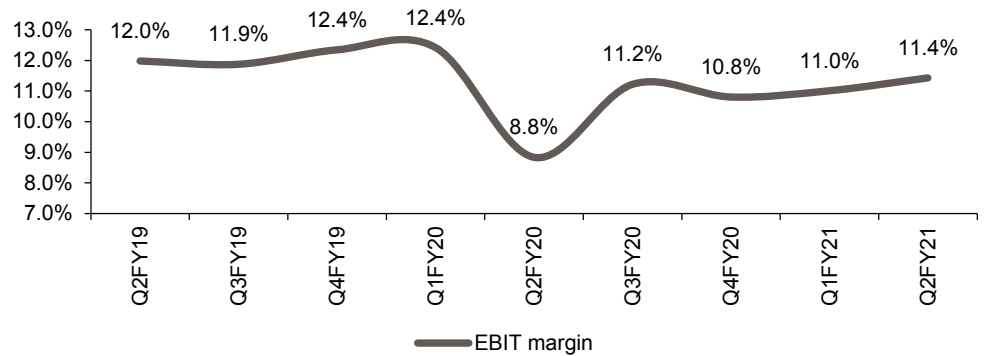
Story in charts

Exhibit 1: YoY CC revenue growth rebounded to 13.1% in Q2FY21



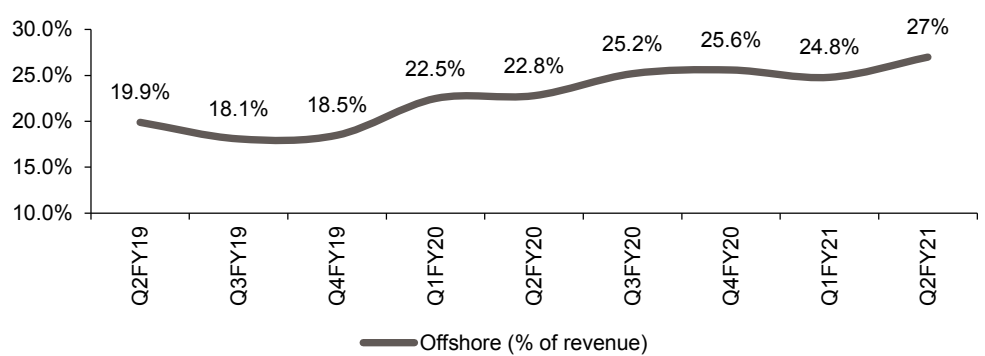
Source: Company, Emkay Research

Exhibit 2: EBIT margin expanded by 40bps sequentially



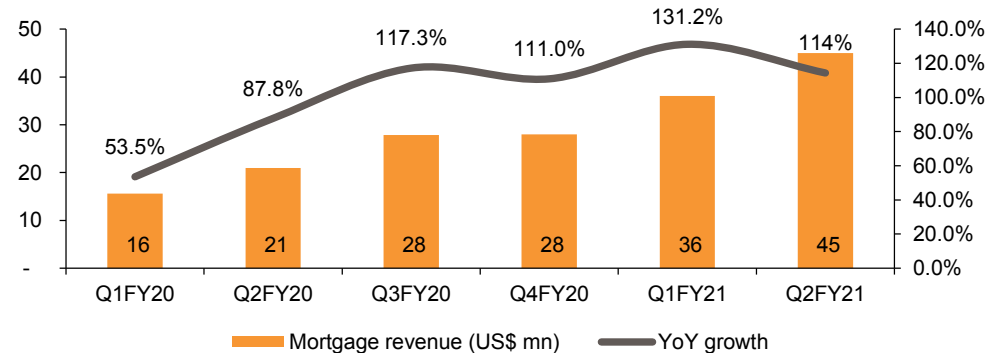
Source: Company, Emkay Research

Exhibit 3: Offshore mix has improved steadily over the quarters



Source: Company, Emkay Research

Exhibit 4: Strong revenue growth momentum in Mortgage business continues



Source: Company, Emkay Research

Exhibit 5: Quarterly snapshot

Rs mn	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	QoQ	YoY	FY21TD	FY20 TD	YoY
Revenues (US\$ mn)	140	148	149	141	160	13.6	14.2	301	281	7.0
Revenue	9,849	10,535	10,804	10,622	11,877	11.8	20.6	22,499	19,647	14.5
Operating Expenditure	8,525	8,868	9,163	8,954	10,001	11.7	17.3	18,955	16,666	13.7
Employee Expenses	6,722	7,053	7,350	7,128	7,985	12.0	18.8	15,113	13,333	13.4
as % of sales	68.2	66.9	68.0	67.1	67.2			67.2	67.9	
Other Expenses	1,803	1,816	1,813	1,826	2,016	10.4	11.8	3,841	3,333	15.3
as % of sales	18.3	17.2	16.8	17.2	17.0			17.1	17.0	
EBITDA	1,325	1,666	1,641	1,668	1,876			3,544	2,981	18.9
Depreciation	455	484	474	498	519			1,017	894	
EBIT	870	1,182	1,168	1,170	1,358	16.1	56.1	2,527	2,087	21.1
Net interest	-148	-159	-142	-134	-124			(258)	(282)	
Other Income	85	12	6	-1	21			20	70	
PBT	806	1,036	1,031	1,035	1,254	21.2	55.6	2,289	1,875	22.1
Total Tax	132	140	115	148	202			350	290	
Adjusted PAT	674	895	916	887	1,053	18.7	56.2	1,939	1,586	22.3
APAT after MI	674	895	916	887	1,053	18.7	56.2	1,939	1,586	22.3
Reported PAT	674	895	916	887	1,053	18.7	56.2	1,939	1,586	22.3
Reported EPS	1.0	1.3	1.3	1.3	1.5	18.6	55.8	3	2	22.1

Margins (%)						(bps)	(bps)			(bps)
EBIDTA	13.4	15.8	15.2	15.7	15.8	9	235	15.8	15.2	58
EBIT	8.8	11.2	10.8	11.0	11.4	42	260	11.2	10.6	61
PBT	8.2	9.8	9.5	9.7	10.6	82	237	10.2	9.5	63
PAT	6.8	8.5	8.5	8.3	8.9	52	202	8.6	8.1	55
Effective Tax rate	16.4	13.6	11.2	14.3	16.1	177	(35)	15.3	15.4	(17)

Source: Company, Emkay Research

Exhibit 6: Revenue by industry

As a % of revenue	Q2FY21	Q1FY21	Q2FY20	QoQ (%)	YoY (%)
BFS	51.9%	51.2%	40.4%	15.1%	46.6%
Communications, Media & Tech	18.8%	16.2%	22.0%	31.8%	-2.5%
Healthcare	27.1%	29.9%	34.5%	2.9%	-10.3%
Diverse Industries	2.2%	2.7%	3.1%	-7.5%	-19.0%
Total	100%	100%	100%	13.6%	14.2%

Source: Company, Emkay Research

Exhibit 7: Revenue by geography

As a % of revenue	Q2FY21	Q1FY21	Q2FY20	QoQ (%)	YoY (%)
US (including Canada)	68.1%	69.1%	61.6%	11.9%	26.2%
UK	30.6%	29.7%	36.9%	17.0%	-5.3%
Rest of World	1.3%	1.2%	1.5%	23.0%	-1.1%
Total	100%	100%	100%	13.6%	14.2%

Source: Company, Emkay Research

Exhibit 8: Revenue by delivery location

As a % of revenue	Q2FY21	Q1FY21	Q2FY20	QoQ (%)	YoY (%)
Offshore	27.0%	24.8%	22.8%	23.7%	35.2%
Onshore	73.0%	75.2%	77.2%	10.3%	7.9%
Total	100%	100%	100%	13.6%	14.2%

Source: Company, Emkay Research

Exhibit 9: Client concentration

As a % of revenue	Q2FY21	Q1FY21	Q2FY20	QoQ (%)	YoY (%)
Top-1	16.2%	13.7%	19.8%	34.3%	-6.6%
Top-5	40.4%	39.9%	39.5%	15.0%	16.8%

Source: Company, Emkay Research

Exhibit 10: Revenue by service line

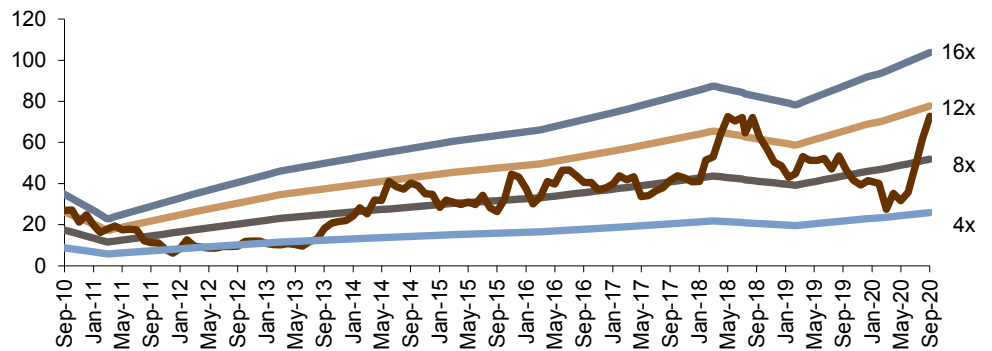
As a % of revenue	Q2FY21	Q1FY21	Q2FY20	QoQ (%)	YoY (%)
Digitally Empowered Contact Center	49.1%	47.8%	51.6%	16.7%	8.6%
Intelligent Back Office	42.9%	44.2%	42.8%	10.2%	14.4%
Platforms, Automation & Analytics	8.0%	8.0%	5.6%	13.6%	63.1%
Total	100%	100%	100%	13.6%	14.2%

Source: Company, Emkay Research

Exhibit 11: Key assumptions

Key Assumptions	FY20A	FY21E	FY22E	FY23E
USD revenue growth (%)	5.4	11.0	13.0	9.0
USD/INR	70.9	73.9	74.0	75.0
INR revenue growth (%)	7.1	15.2	12.9	10.3
EBIT margin (%)	10.8	11.3	11.6	11.8
EPS growth (%)	-10.4	20.9	19.0	10.1

Source: Company, Emkay Research

Exhibit 12: FSOL's 1 year forward P/E band

Source: Company, Emkay Research

Key takeaways

Q2FY21 performance: Revenue grew 13.6% QoQ and 14.2% YoY to US\$159.8mn. In CC terms, revenue grew 12.2% QoQ and 13.1% YoY. Revenue growth was led by strong momentum in the mortgage business and recovery in the top account. EBIT margin expanded 40bps QoQ and 260bps YoY on account of revenue acceleration, offshore shift and operating efficiencies.

Verticals: Growth was led by CMT (29.8% QoQ after a ~30% fall in Q1) and BFSI (13.4% QoQ) led by the surge in demand in the mortgage business. Revenue from the mortgage business stood at US\$45mn for the quarter (~25% QoQ). Within the mortgage business, FSOL is seeing good growth in refinance mortgages and new purchase mortgages, and believes that the growth momentum in the new purchase mortgages would partly offset any softness in the refinance mortgages in the future if the interest rates rise. Growth in the Healthcare business was below expectations at 1.4% QoQ due to the continued impact of the pandemic. The company had anticipated demand recovery in Q2FY21 in this vertical but now expects demand to recover at the end of the fiscal year and has indicated that the deal pipeline is strong. The CMT business saw solid volume recovery as the top client normalized. Management indicated that the deal pipeline remains strong and expects the CMT vertical to reach pre-Covid levels by Q4FY21. Within the Healthcare business, management is bullish on the payer business.

FY21 Outlook: FSOL increased its FY21 revenue growth guidance to 9-12% YoY CC (earlier 6-10%) while retaining EBITM guidance of 11.0-11.5% based on the robust deal pipeline and strong demand in the mortgage business. BFS margins remained under pressure in Q2 due to strong growth in mortgage and management attributed one-fourth of the margin impact to an increase in talent cost and the rest to capacity creation & time to bill delay. CMT vertical's margin expanded on account of tighter cost control and acceleration in revenue, however, management indicated that the sustainable margin range for this vertical is 10-13%. The deal pipeline remains robust with the deal size in BFSI and Healthcare payer business growing compared to earlier.

Other takeaways:

- DSO days, including unbilled, fell considerably from 63 to 54 due to better collection.
- FSOL added 11 new clients in BFS (9 mortgage clients) and 4 in healthcare.
- The company is focusing on the healthcare provider and collections segment to expand its capabilities through M&A.

Key Financials (Consolidated)**Income Statement**

Y/E Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Revenue	38,263	40,986	47,224	53,320	58,812
Expenditure	32,908	34,697	39,852	45,035	49,572
EBITDA	5,355	6,289	7,372	8,285	9,240
Depreciation	744	1,852	2,021	2,111	2,286
EBIT	4,610	4,437	5,351	6,174	6,954
Other Income	39	88	27	34	18
Interest expenses	290	583	531	447	385
PBT	4,359	3,942	4,848	5,761	6,586
Tax	581	545	733	864	1,195
Extraordinary Items	0	0	0	0	0
Minority Int./Income from Assoc.	0	0	0	0	0
Reported Net Income	3,778	3,397	4,114	4,897	5,391
Adjusted PAT	3,778	3,397	4,114	4,897	5,391

Balance Sheet

Y/E Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Equity share capital	6,911	6,938	6,948	6,948	6,948
Reserves & surplus	20,297	20,716	23,093	26,252	29,559
Net worth	27,207	27,654	30,041	33,201	36,508
Minority Interest	6	6	6	6	6
Loan Funds	5,459	8,369	5,100	4,000	2,000
Net deferred tax liability	461	735	735	735	735
Total Liabilities	33,133	36,764	35,882	37,941	39,248
Net block	22,227	28,709	28,548	28,426	28,351
Investment	1,339	122	122	1,322	1,922
Current Assets	13,171	17,040	16,469	17,946	19,159
Cash & bank balance	474	1,907	744	1,140	1,374
Other Current Assets	8,153	8,778	9,089	9,393	9,673
Current liabilities & Provision	3,624	9,107	9,257	9,753	10,184
Net current assets	9,547	7,933	7,212	8,193	8,975
Misc. exp	0	0	0	0	0
Total Assets	33,133	36,764	35,882	37,941	39,248

Cash Flow

Y/E Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
PBT (Ex-Other income) (NI+Dep)	4,359	3,942	4,766	5,624	6,242
Other Non-Cash items	(316)	(413)	(27)	(34)	(18)
Chg in working cap	(647)	(1,354)	(366)	(585)	(549)
Operating Cashflow	3,851	4,104	5,742	6,389	7,111
Capital expenditure	(1,081)	(946)	(1,060)	(1,090)	(1,210)
Free Cash Flow	2,770	3,158	4,682	5,299	5,901
Investments	(960)	1,277	0	(1,200)	(600)
Other Investing Cash Flow	0	(184)	0	0	0
Investing Cashflow	(2,035)	158	(1,032)	(2,256)	(1,793)
Equity Capital Raised	136	77	10	0	0
Loans Taken / (Repaid)	(1,190)	2,527	(3,345)	(1,100)	(2,000)
Dividend paid (incl tax)	(1,242)	(3,762)	(1,737)	(1,737)	(2,084)
Other Financing Cash Flow	0	(1,025)	(800)	(900)	(1,000)
Financing Cashflow	(2,576)	(2,768)	(5,873)	(3,737)	(5,084)
Net chg in cash	(761)	1,495	(1,163)	396	234
Opening cash position	1,230	474	1,907	744	1,140
Closing cash position	474	1,907	744	1,140	1,374

Source: Company, Emkay Research

Key Ratios

Profitability (%)	FY19	FY20	FY21E	FY22E	FY23E
EBITDA Margin	14.0	15.3	15.6	15.5	15.7
EBIT Margin	12.0	10.8	11.3	11.6	11.8
Effective Tax Rate	13.3	13.8	15.1	15.0	18.1
Net Margin	9.9	8.3	8.7	9.2	9.2
ROCE	15.4	12.9	14.8	16.8	18.1
ROE	14.9	12.4	14.3	15.5	15.5
RoIC	16.1	13.4	15.3	17.5	19.5

Per Share Data (Rs)	FY19	FY20	FY21E	FY22E	FY23E
EPS	5.5	4.9	5.9	7.0	7.8
CEPS	6.5	7.6	8.8	10.1	11.0
BVPS	39.4	39.9	43.2	47.8	52.5
DPS	2.0	2.5	2.5	2.5	3.0

Valuations (x)	FY19	FY20	FY21E	FY22E	FY23E
PER	13.0	14.5	12.0	10.1	9.2
P/CEPS	11.3	9.7	8.4	7.3	6.7
P/BV	1.8	1.8	1.6	1.5	1.4
EV / Sales	1.4	1.4	1.1	1.0	0.8
EV / EBITDA	9.9	8.9	7.3	6.1	5.2
Dividend Yield (%)	2.8	3.5	3.5	3.5	4.2

Gearing Ratio (x)	FY19	FY20	FY21E	FY22E	FY23E
Net Debt/ Equity	0.1	0.2	0.1	0.0	0.0
Net Debt/EBITDA	0.7	1.0	0.6	0.2	(0.1)
Working Cap Cycle (days)	86.6	53.7	50.0	48.3	47.2

Growth (%)	FY19	FY20	FY21E	FY22E	FY23E
Revenue	8.2	7.1	15.2	12.9	10.3
EBITDA	16.7	17.4	17.2	12.4	11.5
EBIT	17.3	(3.8)	20.6	15.4	12.6
PAT	15.7	(10.1)	21.1	19.0	10.1

Quarterly (Rs mn)	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21
Revenue	9,849	10,535	10,804	10,622	11,877
EBITDA	1,325	1,666	1,641	1,668	1,876
EBITDA Margin (%)	13.4	15.8	15.2	15.7	15.8
PAT	674	895	916	887	1,053
EPS (Rs)	1.0	1.3	1.3	1.3	1.5

Source: Company, Emkay Research

Shareholding Pattern (%)	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20
Promoters	54.0	53.9	53.9	53.9	53.8
FII	9.8	9.0	9.0	7.6	6.6
DII	10.9	11.6	12.4	12.7	14.0
Public and Others	25.4	25.5	24.7	25.8	25.7

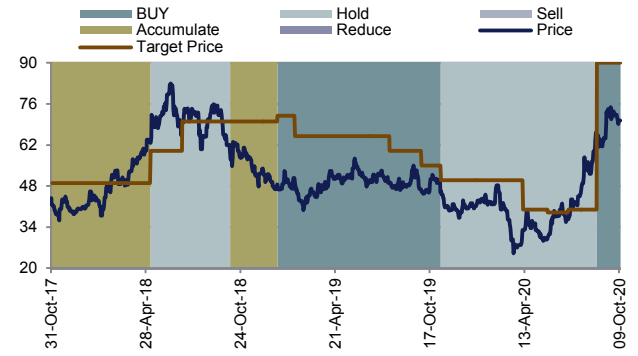
Source: Capitaline

RECOMMENDATION HISTORY TABLE

Date	Closing Price	TP	Period (months)	Rating	Analyst
28-Aug-20	65	90	12m	Buy	Manik Taneja
05-Jul-20	37	40	12m	Hold	Manik Taneja
25-Jun-20	39	39	12m	Hold	Manik Taneja
27-May-20	31	39	12m	Hold	Manik Taneja
10-Apr-20	33	40	12m	Hold	Manik Taneja
04-Feb-20	43	50	12m	Hold	Manik Taneja
01-Jan-20	41	50	12m	Hold	Manik Taneja
21-Nov-19	40	50	12m	Hold	Manik Taneja
07-Nov-19	46	50	12m	Hold	Manik Taneja
01-Oct-19	46	55	12m	Buy	Manik Taneja
02-Aug-19	49	60	12m	Buy	Manik Taneja
03-Jul-19	52	65	12m	Buy	Manik Taneja
06-May-19	51	65	12m	Buy	Rahul Jain
04-Apr-19	47	65	12m	Buy	Rahul Jain
04-Feb-19	49	65	12m	Buy	Rahul Jain
02-Jan-19	48	72	12m	Buy	Rahul Jain
01-Nov-18	60	70	12m	Accumulate	Rahul Jain
05-Oct-18	57	70	12m	Accumulate	Rahul Jain
06-Aug-18	69	70	12m	Hold	Rahul Jain
06-Jul-18	70	70	12m	Hold	Rahul Jain
07-May-18	63	60	12m	Hold	Rahul Jain
07-Feb-18	40	49	12m	Accumulate	Ruchi Burde
02-Nov-17	42	49	12m	Accumulate	Ruchi Burde

Source: Company, Emkay Research

RECOMMENDATION HISTORY CHART



Source: Bloomberg, Company, Emkay Research

Emkay Alpha Portfolio – Information Technology



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Sector

IT Services, ITes and Software

Analyst bio

Dipesh is a seasoned Equities professional who has covered Technology sector for over 15 years. Dipesh has completed his B.E. in Information Technology from Sardar Patel University and MMS in Finance from Mumbai University.

EAP sector portfolio

Company Name	BSE200 Weight	EAP Weight	OW/UW (%)	OW/UW (bps)	EAP Weight (Normalised)
Information Technology	13.89	13.42	-3%	-47	100.00
BirlaSoft	0.00	0.13	NA	13	0.90
Coforge*	0.00	0.00	NA	0	0.00
eClerx Services	0.00	0.00	NA	0	0.00
Firstsource Solutions	0.00	0.00	NA	0	0.00
HCL Tech	1.39	1.50	8%	11	10.80
Hexaware Technologies	0.00	0.00	NA	0	0.00
Infosys	6.15	6.41	4%	26	46.16
Intellect Design*	0.00	0.00	NA	0	0.00
L&T Infotech	0.19	0.00	-100%	-19	0.00
Majesco*	0.00	0.00	NA	0	0.00
Mindtree	0.09	0.00	-100%	-9	0.00
Mphasis	0.17	0.19	14%	2	1.39
MPS	0.00	0.00	NA	0	0.00
NIIT	0.00	0.00	NA	0	0.00
Nucleus Software*	0.00	0.00	NA	0	0.00
Oracle Financial Services*	0.11	0.00	-100%	-11	0.00
Persistent Systems	0.00	0.58	NA	58	4.16
Ramco Systems*	0.00	0.00	NA	0	0.00
TCS	4.26	3.09	-28%	-117	22.23
Tech Mahindra	0.77	0.79	3%	2	5.67
Wipro	0.77	0.74	-5%	-3	5.30
Cash	0.00	0.47	NA	47	3.39

Source: Emkay Research

* Not under coverage: Equal Weight

■ High Conviction/Strong Over Weight ■ High Conviction/Strong Under Weight

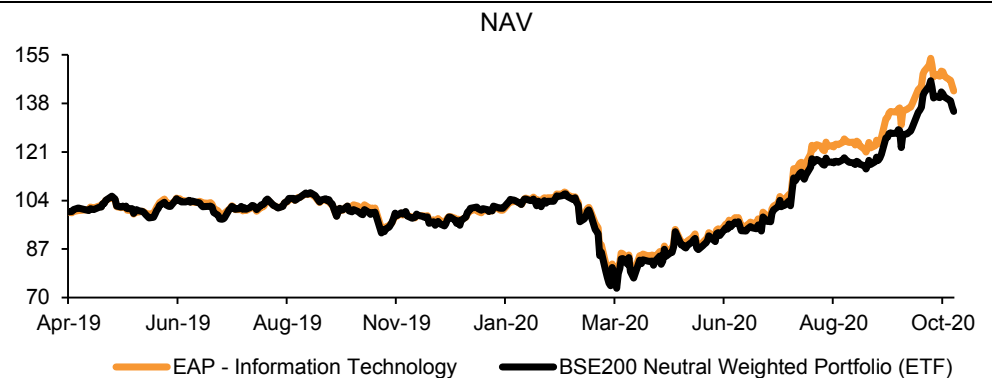
Sector portfolio NAV

	Base					Latest
	1-Apr-19	29-Jan-20	29-Apr-20	29-Jul-20	28-Sep-20	28-Oct-20
EAP - Information Technology	100.0	105.2	89.0	122.0	136.0	142.4
BSE200 Neutral Weighted Portfolio (ETF)	100.0	104.6	87.9	117.3	127.4	135.2

*Performance measurement base date 1st April 2019

Source: Emkay Research

NAV chart



Source: Emkay Research

Please see our model portfolio (Emkay Alpha Portfolio): [Nifty](#)

Please see our model portfolio (Emkay Alpha Portfolio): [SMID](#)

“Emkay Alpha Portfolio – SMID and Nifty are a supporting document to the Emkay Alpha Portfolios Report and is updated on regular intervals”

Emkay Rating Distribution

Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

Completed Date: 29 Oct 2020 19:33:38 (SGT)

Dissemination Date: 29 Oct 2020 19:34:38 (SGT)

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