Firstsource Solutions (FIRSOU)

CMP: ₹ 72 | Target: ₹ 84 (17%) | Target Period: 12 months | BUY

October 29, 2020

Healthy operating performance…

Firstsource Solution (FSL) reported a healthy set of Q2FY21 numbers. Dollar revenues increased 13.6% QoQ led by healthy growth in top client, 15% QoQ growth in BFS and 31.8% QoQ growth in communication, media and technology (CMT). In rupee terms, revenues increased 20.6% YoY, 11.8% QoQ. EBITDA margins increased 10 bps QoQ to 15.8%. Short-term debt declined from ₹ 834. 1 crore to ₹ 588.5 crore. FSL has guided 9-12% YoY growth (up from earlier guidance of 6-10%) in FY21E revenues in constant currency terms and operating margins in the range of 11.0-11.5%.

Healthy deal pipeline in mortgage to drive growth

The current quarter growth was driven by healthy growth in top client and banking, mainly led by the mortgage business. Going forward, the company expects top client contribution to reach pre-Covid levels by the next two quarters (from current 16.2% to at least 20.3% by Q4FY21E). In addition, FSL has seen healthy client wins (~15) in the quarter of which nine were in banking (especially mortgage). This, coupled with healthy wins in the previous quarter, improving UK BFS and ramp up of existing clients will drive mortgage business. A key driver of mortgage business (as per FSL) is refinancing & new home sales, which is expected to drive growth at least in the medium term. It also expects better growth if delinquencies increase. In addition, traction in the payer business, tele health and self-pay are expected to drive healthcare business. Further, FSL's strategy of increased penetration in technology segment, cross-selling of platforms business, increase in deal sizes and hiring of leaders to boost its digital business will be long term driver of revenues for the company. Hence, we expect FSL's dollar revenues to increase at a CAGR of 10.4% in FY20-23E.

Margins to be in range of 11-11.5% in medium term

FSL is investing in leadership to improve its revenue growth and its time to billing. This, coupled with increase in talent cost, is expected to act as a headwind to margins. However, improvement in revenues (especially in mortgage business) and cost efficiencies is expected to offset the margin headwinds. Hence, the company expects margins to remain in a narrow band of 11-11.5% in the medium term. Consequently, we bake in 77 bps improvement in EBIT margins to 11.6% in FY20-23E.

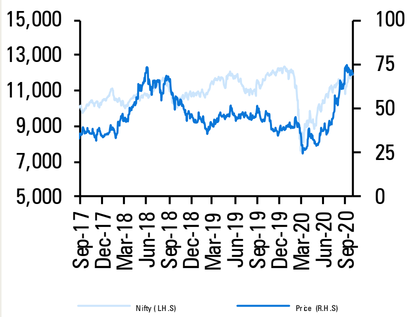
Valuation & Outlook

We believe increased contribution from top client, healthy deal pipeline & outlook in mortgage business and traction in payer business will drive the company's revenues. Also, the strategy of increased penetration in technology segment, cross-selling of platforms business and hiring of leaders to boost its digital business will be long term driver of revenues. Based on this, we revise our revenue, EPS estimates upwards, prompting us to maintain **BUY** on the stock with a revised target price of ₹ 84/share.

Particulars

Particular	Amount
Market Cap (₹ Crore)	4,944.1
Total Debt (₹ Crore)	836.9
Cash and Invests (₹ Crore)	190.7
EV (₹ Crore)	5,590.3
52 week H/L	78 / 21
Equity capital	693.8
Face value	10.0

Price Performance



Key Highlights

- Traction in banking, CMT verticals to drive revenue growth
- Revise our revenue, margin estimates upwards
- Maintain BUY with target price of ₹ 84 (10x FY23E EPS)

Research Analyst

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Key Financial Summary

Key Financials	FY19	FY20	FY21E	FY22E	FY23E	FY(20-23E)
Net Sales	3,826	4,099	4,805	5,280	5,881	12.8%
EBITDA	535	629	764	845	941	14.4%
Margins (%)	14.0	15.3	15.9	16.0	16.0	
Net Profit	378	340	426	493	564	18.4%
EPS (₹)	5.4	4.9	6.1	7.1	8.1	
P/E	13.2	14.7	11.7	10.1	8.9	
RoNW (%)	13.9	12.3	14.2	15.0	15.7	
RoCE (%)	14.0	11.1	13.4	14.5	15.6	

Source: Company, ICICI Direct Research

Company Update

ICICI Securities – Retail Equity Research

Financial summary

Exhibit 1: Profit and loss statement ₹ crore

	FY20	FY21E	FY22E	FY23E
Total Revenues	**4,099**	**4,805**	**5,280**	**5,881**
Growth (%)	7.1	17.2	9.9	11.4
Employee expenses	2,774	3,219	3,538	3,940
Other Expenses	696	822	898	1,000
EBITDA	**629**	**764**	**845**	**941**
Growth (%)	17.4	21.5	10.6	11.4
Depreciation & Amortization	185	223	232	259
Other Income	9	6	6	11
Interest	58	45	39	30
PBT before Exceptional Items	394	502	581	663
Growth (%)	(9.6)	27.2	15.7	14.3
Tax	55	75	87	99
PAT before Excp Items	340	426	493	564
Exceptional items				
PAT before MI	340	426	493	564
Minority Int & Pft. from asso	(0)	(0)	(0)	(0)
PAT	**340**	**426**	**493**	**564**
Growth (%)	(10.1)	25.5	15.7	14.3
EPS	4.9	6.1	7.1	8.1
EPS (Growth %)	(10.3)	24.9	15.7	14.3

Source: Company, ICICI Direct Research

Exhibit 2: Cash flow statement ₹ crore

	FY20	FY21E	FY22E	FY23E
Profit before Tax	**394**	**502**	**581**	**663**
Depreciation & Amortization	185	223	232	259
WC changes	(135)	(165)	(93)	(118)
Other non cash adju.	(34)	(36)	(55)	(81)
CF from operations	**410**	**523**	**665**	**724**
Capital expenditure	(95)	(58)	(121)	(134)
Δ in investments	128	-	-	-
Other investing cash flow	(18)	6	6	11
CF from investing Activities	**14**	**(52)**	**(115)**	**(123)**
Issue of equity	8	-	-	-
Δ in debt funds	150	(330)	(100)	(150)
Dividends paid	(376)	(188)	(217)	(248)
Other financing cash flow	(58)	(45)	(39)	(30)
CF from Financial Activities	**(277)**	**(563)**	**(449)**	**(521)**
Δ in cash and cash bank balanc	148	(91)	101	80
Effect of exchange rate changes	(5)			
Opening cash	47	191	100	201
Closing cash	**191**	**100**	**201**	**281**

Source: Company, ICICI Direct Research

Exhibit 3: Balance sheet ₹ crore

	FY20	FY21E	FY22E	FY23E
Equity	694	694	694	694
Reserves & Surplus	2,072	2,310	2,587	2,902
Networth	2,765	3,004	3,280	3,596
Minority Interest	1	1	1	1
LT liabilties & provisions	487	487	487	487
Total Debt	837	600	500	350
Source of funds	**4,090**	**4,092**	**4,268**	**4,434**
Net fixed assets	588	516	498	466
CWIP	-	-	-	-
Goodwill	2,232	2,232	2,232	2,232
Other non current assets	662	722	763	815
Loans and advances	-	-	-	-
Current Investments	-	-	-	-
Debtors	557	653	718	800
Cash & Cash equivalents	191	100	201	281
Other current assets	357	452	497	554
Trade payables	95	112	123	137
Current liabilities	355	419	460	513
Provisions	46	52	58	64
Application of funds	**4,090**	**4,092**	**4,268**	**4,434**

Source: Company, ICICI Direct Research

Exhibit 4: Key ratios ₹ crore

(Year-end March)	FY20	FY21E	FY22E	FY23E
Per share data (₹)				
EPS-diluted	4.9	6.1	7.1	8.1
DPS	2.5	2.7	3.1	3.6
BV	40.3	43.7	47.8	52.4
Operating Ratios (%)				
EBITDA Margin	15.3	15.9	16.0	16.0
PBT Margin	9.6	10.4	11.0	11.3
PAT Margin	8.3	8.9	9.3	9.6
Return Ratios (%)				
RoNW	12.3	14.2	15.0	15.7
RoCE	11.1	13.4	14.5	15.6
Valuation Ratios (x)				
P/E	14.7	11.7	10.1	8.9
EV / EBITDA	8.9	7.1	6.2	5.3
Price to Book Value	1.8	1.6	1.5	1.4
EV / Net Sales	1.4	1.1	1.0	0.9
Mcap / Net Sales	1.2	1.0	0.9	0.8
Turnover Ratios				
Debtor days	50	50	50	50
Creditors days	8	9	9	9
Solvency Ratios				
Total Debt / Equity	0.3	0.2	0.2	0.1
Current Ratio	1.8	1.9	1.9	1.9
Quick Ratio	1.8	1.9	1.9	1.9
Net Debt / EBITDA	1.0	0.7	0.4	0.1

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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