11 May 2022

Firstsource Solutions

Rating: **Buy**

Target Price: Rs.145

Share Price: Rs.112

Mortgage weakens further; Healthcare/Telecoms catching up; Buy

FSOL was faced with challenges in mortgages (22% of revenue) with 30-40% declines expected ahead. Management expects stabilisation here by H2 FY23. In the other divisions (78% of revenue), the outlook is bright with BFS, telecoms and healthcare reporting growth. The company expects these divisions to deliver 18-22% growth in FY23, leading to overall 7-10% growth guidance. Q1 is guided to be soft; estimates are lowered ~5% and the target from Rs175 to Rs145 (15x FY24e EPS). We yet find the ruling price attractive and upgrade the stock to a Buy.

Mortgage declines to keep Q1/HH soft. Q4 revenue was $206m, down 1.5% q/q organically, 7.6% y/y. ARSI and TSG were consolidated for the whole quarter. Excl. BFS, FSOL grew 4% q/q, 10% y/y, with the Healthcare vertical carrying the company with 5% q/q growth, 26% y/y. CMT was up sequentially (2%) but y/y down 6%, largely due to the decline in the top client (-13% y/y). The positive takeaway was growth outside the top client and the fact that the top client's share of the revenue is now <15%.

Other verticals to absorb mortgage declines by H2 FY23. The UK BFS is expected to record steady growth in FY23 and the collections business is expected to pick up starting Q2 (higher interest rates are positively correlated with this business). Healthcare is expected to maintain 20%+ growth in FY23.

EBIT margins also bottoming out. The Q4 EBIT margin was 10.2% (reported 11.3%), down 76bps q/q, 139bps y/y, reflecting revenue declines and acquisitions. FY23 margins are expected at 10.5%-11% as performance is likely to bottom out in H1. We are building in better margins for FY24 as, by then, the rising healthcare contribution will offer some tailwinds and the mortgage-related revenue declines will also be behind.

Target raised to Rs145. The stock trades at 11x FY24e (7% average FCF yield FY23/FY24), which we find attractive from a risk-reward perspective. Our lowered target price and multiple takes into account the rise in capital allocation (and loans) toward acquisitions. **Risk:** Prolonged weakness in BFS.

Key financials (YE Mar)	FY20	FY21	FY22	FY23e	FY24e
Sales (Rs m)	40,502	50,327	58,657	64,131	73,406
Net profit (Rs m)	3,397	3,617	5,373	5,322	6,953
EPS (Rs)	4.9	5.2	7.7	7.6	10.0
P/E (x)	23.0	21.6	14.5	14.7	11.2
EV / EBITDA (x)	14.4	11.4	9.5	8.8	7.2
P/BV (x)	2.8	2.8	2.6	2.4	2.2
RoE (%)	12.4	13.0	18.4	16.9	20.5
RoCE (%)	9.5	11.1	11.9	11.2	14.0
Dividend yield (%)	2.2	2.7	3.1	3.6	4.5
Net debt / equity (x)	0.2	0.1	0.3	0.2	0.1

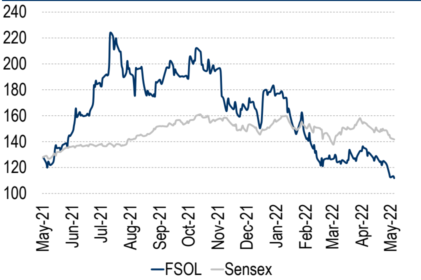
Source: Company, Anand Rathi Research

Key data	FSOL IN / FISO.BO
52-week high / low	Rs.243 / 107
Sensex / Nifty	54364 / 16238
3-m average volume	$8.6m
Market cap	Rs.78bn / $1007.7m
Shares outstanding	697m

Shareholding pattern (%)	Mar'22	Dec'21	Sep'21
Promoters	53.7	53.7	53.7
- of which, Pledged	-	-	-
Free float	46.3	46.3	46.3
- Foreign institutions	7.8	9.6	10.6
- Domestic institutions	14.8	14.8	13.8
- Public	23.8	22.0	21.9

Estimates revision (%)	FY23e	FY24e
Sales ($)	2.6	2.2
EBIT	(5.5)	(0.2)
PAT	(11.7)	(5.0)

Relative price performance



Source: Bloomberg

Mohit Jain
Research Analyst

Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
Revenues (US$m)	**572.2**	**684.4**	**795.2**	**849.4**	**972.3**
Growth (%)	**5.7**	**19.6**	**16.2**	**6.8**	**14.5**
Net revenues (Rs m)	40,502	50,327	58,657	64,131	73,406
Employee & Direct Costs	27,735	34,672	39,468	42,327	48,584
Gross Profit	12,767	15,655	19,190	21,804	24,822
Gross Margin %	31.5	31.1	32.7	34.0	33.8
SG&A	6,792	8,117	10,145	12,059	12,900
EBITDA	**5,975**	**7,537**	**9,044**	**9,745**	**11,922**
EBITDA margins (%)	14.8	15.0	15.4	15.2	16.2
- Depreciation	1,852	2,064	2,494	2,787	2,787
Other income	403	-633	560	438	441
Interest Exp	583	522	639	825	775
PBT	3,942	4,318	6,471	6,571	8,801
Effective tax rate (%)	14	16	17	19	21
+ Associates/(Minorities)	-0	-	8	0	0
Net Income	3,397	3,617	5,373	5,322	6,953
WANS	699	696	697	697	697
FDEPS (Rs/share)	4.9	5.2	7.7	7.6	10.0

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
Share capital	6,938	6,961	6,970	6,970	6,970
Net worth	27,654	27,993	30,329	32,600	35,162
Total debt (incl. Pref)	8,369	6,045	10,097	8,992	7,643
Minority interest	6	5	4	4	4
DTL/(Asset)	-1,776	-2,222	-1,859	-1,859	-1,859
Capital employed	**34,253**	**31,821**	**38,571**	**39,737**	**40,950**
Net tangible assets	5,885	7,487	9,043	8,542	8,086
Net Intangible assets	500	541	1,215	1,622	1,229
Goodwill	22,324	21,948	27,208	26,208	25,208
CWIP (tang. & intang.)	-	-	-	-	-
Long-term Assets (Liabilities)	-1,724	-2,803	-6,722	-5,277	-5,921
Investments (Financial)	122	823	1,300	1,300	1,300
Current Assets (ex Cash)	9,136	10,234	12,128	13,140	14,857
Cash	1,907	1,373	898	971	3,507
Current Liabilities	3,898	7,782	6,499	6,769	7,315
Working capital	5,238	2,452	5,629	6,371	7,541
Capital deployed	**34,253**	**31,821**	**38,571**	**39,737**	**40,950**
Contingent Liabilities	875	985	-	-	-

Fig 3 – Cash Flow statement (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
PBT	3,942	4,318	6,471	6,571	8,801
+ Non-cash items	2,051	3,240	3,394	3,159	3,121
Operating profit before WC	5,993	7,558	9,865	9,729	11,922
- Incr./(decr.) in WC	1,354	-2,895	1,884	742	1,170
Others incuding taxes	-535	-698	-945	-2,694	-1,204
Operating cash-flow	4,104	9,756	7,036	6,294	9,547
- Capex (tangible + Intangible)	948	1,731	850	893	937
Free cash-flow	3,156	8,025	6,185	5,401	8,610
Acquisitions	-	-950	-5,067	-1,065	-906
- Dividend (including buyback &	3,762	2,038	2,384	2,788	3,485
+ Equity raised	77	82	37	-	-
+ Debt raised	2,527	-2,672	3,905	-1,105	-1,349
- Fin Investments	-1,277	807	316	-	-
- Misc. Items (CFI + CFF)	1,857	2,231	2,835	372	334
Net cash-flow	1,418	-591	-475	72	2,536

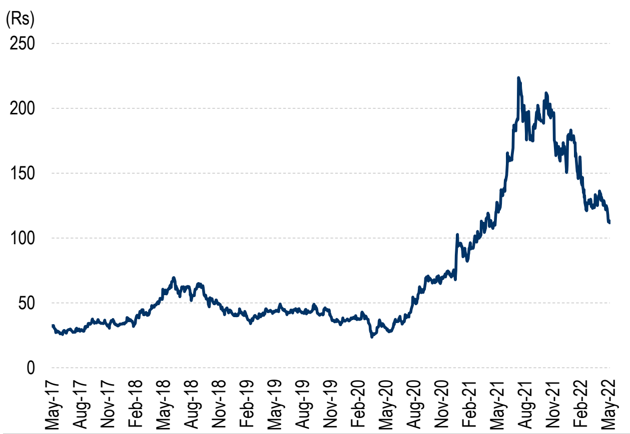
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year end Mar	FY20	FY21	FY22	FY23e	FY24e
P/E (x)	23.0	21.6	14.5	14.7	11.2
EV/EBITDA (x)	14.4	11.4	9.5	8.8	7.2
EV/sales (x)	2.1	1.7	1.5	1.3	1.2
P/B (x)	2.8	2.8	2.6	2.4	2.2
RoE (%)	12.4	13.0	18.4	16.9	20.5
RoCE (%) - After tax	9.5	11.1	11.9	11.2	14.0
RoIC (%) - After tax	9.9	11.7	12.5	11.7	15.1
DPS (Rs per share)	2.5	3.0	3.5	4.0	5.0
Dividend yield (%)	2.2	2.7	3.1	3.6	4.5
Dividend payout (%) - Inc. DDT	51	58	45	52	50
Net debt/equity (x)	0.2	0.1	0.3	0.2	0.1
Receivables (days)	68	61	60	60	60
Inventory (days)					
Payables (days)	10	24	13	12	11
CFO:PAT %	120.8	269.7	131.1	118.3	137.3
FCF:PAT % - includ M&A payou	92.9	195.6	20.8	81.5	110.8

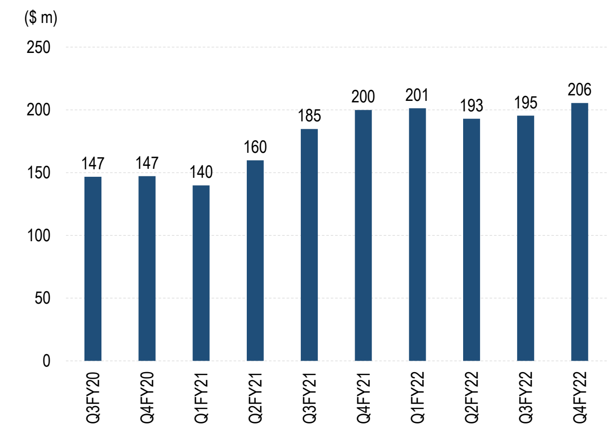
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Revenue trend



Source: Company, Anand Rathi Research

Result Highlights

Q4 FY22 Results at a Glance

Fig 7 – Segment-wise results (Rs m)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q/Q %	Y/Y %
Revenue ($ m)	199.9	201	193	195	206	5.2%	2.8%
Growth Y/Y % (organic est.)	33.1%	43.9%	20.8%	1.6%	-7.6%		
Industry Y/Y % (est.)	6%	21%	21%	21%	19%		
Revenue (Rs m)	14,496	14,780	14,182	14,456	15,239	5.4%	5.1%
Effec. exchange rate	72.5	73.4	73.5	74.0	74.2	0.2%	2.3%
Employees (EoP)	28,004	27,916	27,835	27,398	26,557	-3.1%	-5.2%
Rev. prod. ($ '000/employee)	7.3	7.2	6.9	7.1	7.6	7.7%	4.1%
CoR (excl. D&A)	(10,057)	(10,219)	(9,728)	(9,676)	(9,845)	1.7%	-2.1%
As % of revenue	-69.4%	-69.1%	-68.6%	-66.9%	-64.6%	233 bps	477 bps
SG&A	(2,229)	(2,246)	(2,171)	(2,583)	(3,146)	21.8%	41.1%
As % of revenue.	-15%	-15%	-15%	-18%	-21%	-278 bps	-527 bps
EBITDA	2,210	2,315	2,284	2,197	2,248	2.3%	1.7%
EBITDA margins %	15.2%	15.7%	16.1%	15.2%	14.8%	-45 bps	-50 bps
EBIT	1,677	1,732	1,687	1,581	1,551	-1.9%	-7.5%
EBIT margins %	11.6%	11.7%	11.9%	10.9%	10.2%	-76 bps	-139 bps
Industry margins % (est.)	17.6%	16.8%	17.2%	17.4%	16.8%	-61 bps	-76 bps
Other income (excl. forex)	132	68	104	182	201	10.3%	51.7%
Non-recurring / Forex	(1,118)	(0)	7	2	(4)	NM	-99.7%
Interest expenses	(137)	(146)	(155)	(151)	(188)	24.1%	36.7%
PBT	553	1,654	1,644	1,614	1,560	-3.3%	181.9%
PBT margins %	4%	11%	12%	11%	10%	-92 bps	642 bps
Taxes	(87)	(317)	(293)	(259)	(236)	-8.8%	172.4%
ETR %	-16%	-19%	-18%	-16%	-15%	91 bps	53 bps
Associates / Minority	-	8	0	0	0		
Net income	467	1,345	1,350	1,355	1,324	-2.3%	183.7%
Net margins %	3%	9%	10%	9%	9%	-68 bps	547 bps
Industry net margins %	12.6%	13.8%	13.9%	14.0%	14.3%	29 bps	168 bps
EPS (Rs)	0.66	1.93	1.94	1.94	1.90	-2.3%	187.8%

Source: Company Reports, Anand Rathi Research
Note: Non-recurring income for Q4 FY21 includes exceptional items related to the increase in the valuation of Sourcepoint

Fig 8 – Quarterly results (Rs m)

Year-end: Mar (Rs m)	Q4FY22	% chg. Q/Q	% chg. Y/Y	FY21	FY22	FY22 % chg. Y/Y	FY23e % chg. Y/Y
Sales ($ m)	206	5.2	2.8	684	795	16.2	6.8
Sales	15,239	5.4	5.1	50,327	58,657	16.6	9.3
EBITDA	2,248	2.3	1.7	7,537	9,044	20.0	7.7
EBITDA margin (%)	14.8	-45bps	-50bps	15.0	15.4	44bps	-22bps
EBIT	1,551	(1.9)	(7.5)	5,474	6,551	19.7	6.2
EBIT margin (%)	10.2	-76bps	-139bps	10.9	11.2	29bps	-32bps
PBT	1,560	(3.3)	181.9	4,318	6,471	49.8	1.5
Tax	(236)	(8.8)	172.4	(702)	(1,106)	57.6	12.9
Tax rate (%)	(15.1)	91bps	53bps	(16.2)	(17.1)	-84bps	-191bps
Net income	1,324	(2.3)	183.7	3,617	5,373	48.6	(0.9)

Source: Company, Anand Rathi Research

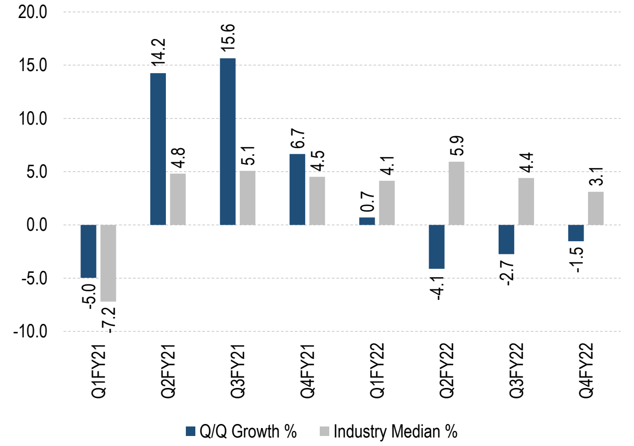
FSOL organic growth disappoints

FSOL declined 1.5% q/q (organic), falling again below the industry growth rate. For the previous four quarters its growth has been below the industry median due to its high exposure to mortgages (cyclical and dependent on the US interest rate and home-purchase cycles). This business is currently shrinking on account of a reversal in the interest-rate cycle in the US, leading to weakness in refinancing and mortgage-related activity.

From a y/y perspective, Q4 revenues declined 7.6% (organic, estimated), behind the industry median for the third straight quarter.

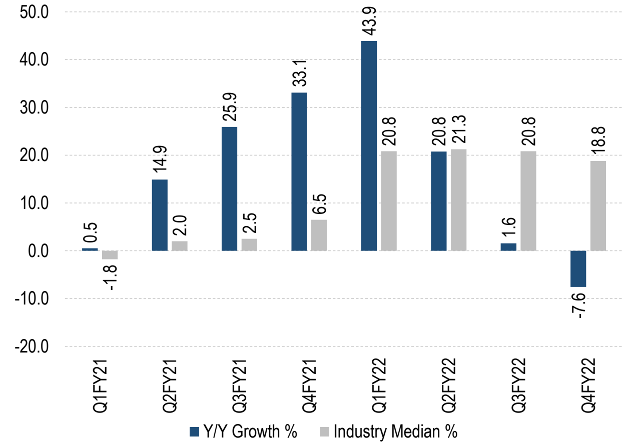
The company is also far behind in terms of growth when compared to its BPM peers.

Fig 9 – Growing slower than industry



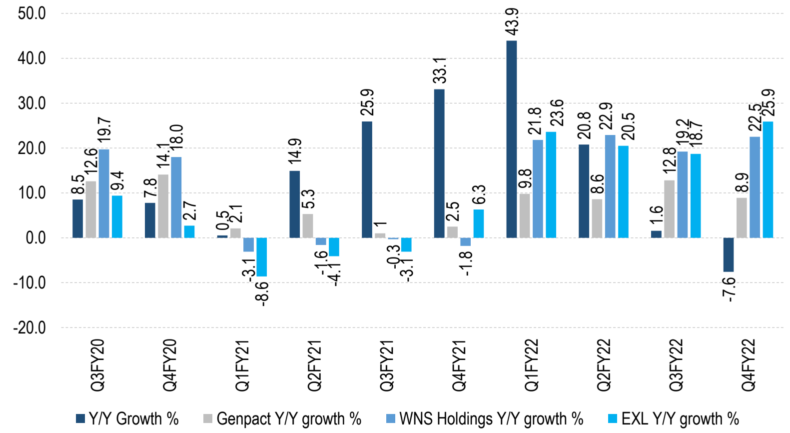
Source: Company, Anand Rathi Research

Fig 10 – Growth far behind industry



Source: Company, Anand Rathi Research

Fig 11 – FSOL growth v/s BPM peers (Genpact, WNS, EXL)



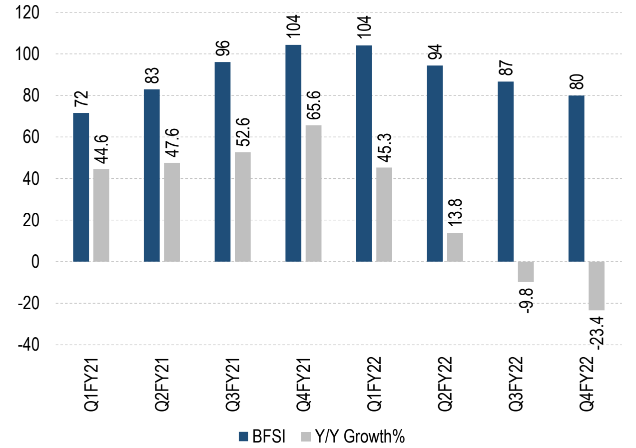
Source: Company, Anand Rathi Research Note: BPM peers data is based on Bloomberg.

Healthcare carrying the company, BFS declines, CMT steady

FSOL operations fall in three primary segments: BFS (49% of revenue), Healthcare (30%) and CMT (19%). The acquisitions of The Stone Hill group and American Recovery Services, Inc., were integrated for the entire quarter and brought ~$21m in Q4.

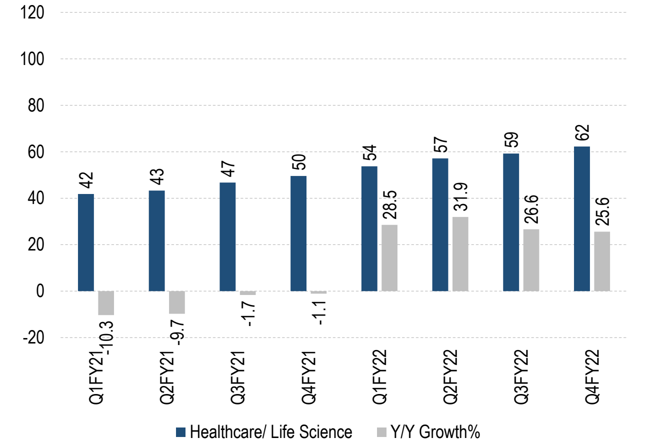
In Q4, BFS was down ~23% y/y (organic), soft on account of the mortgage business ($216m business in FY22, including acquisitions), which declined to ~$45m in Q4 from ~$50m in Q3. The company expects Q1 and Q2 FY23 to be soft for this business at $30m-$33m (incl. acquisitions). Management said the mortgage business is expected to decline sharply in FY23, though H2 is expected to be better. Further, the collections business underperformed; volumes were lower and some top clients asked to reduce capacity temporarily. This business improves (with a lag) as interest rates move up and people find it difficult to repay debt. The company is seeing good demand in collections starting Q2 FY23.

Fig 12 – BFS vertical facing headwinds



Source: Company, Anand Rathi Research Q3 and Q4 excludes contribution from acquisitions

Fig 13 – Healthcare revenue growth strong

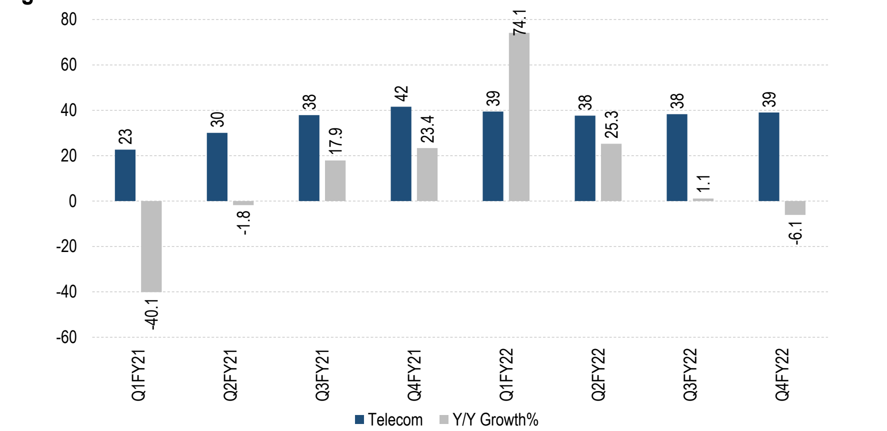


Source: Company, Anand Rathi Research

The healthcare vertical recorded 26% growth in Q4 and the outlook is strong as the company gains traction in this vertical. Management continues to see strong growth in the HPHS and provider business in FY23. This vertical is expected to be the growth driver in FY23.

CMT was down 6.1% y/y in Q4; the top client was down 13% y/y, impacting the vertical's growth rates. Some revenue moved from onsite to offshore, leading to lower revenues but higher margins. Management said it added three clients in tech across CX, automation and brand safety.

Fig 14 – CMT revenue stable

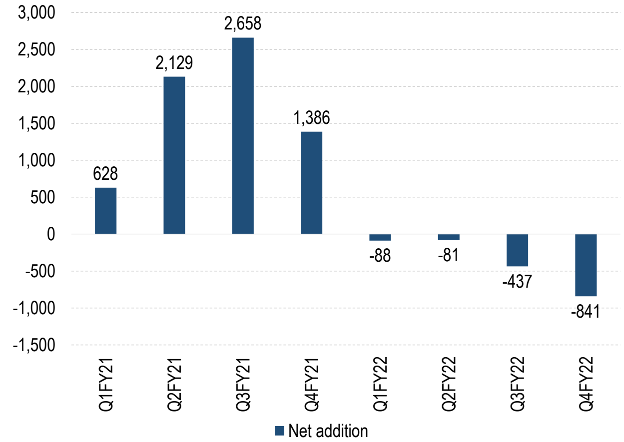


Source: Company, Anand Rathi Research

Headcount drops; productivity improves

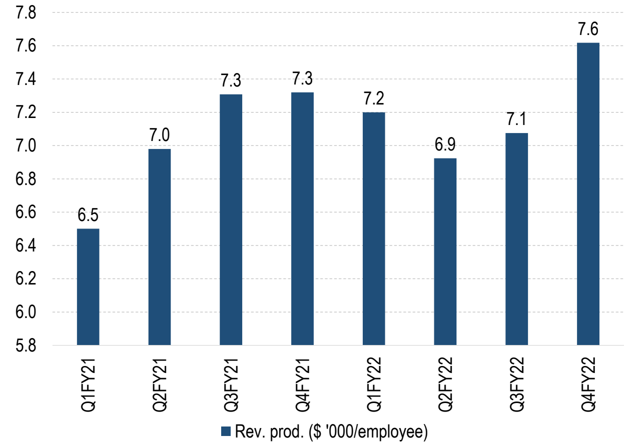
73% of FSOL's revenues arises from onsite delivery, where labour shortage was acute. In Q4, headcount dropped by 841, an organic decline of >1,800 employees in FY22. Onshore attrition was 50.2% (post-180-day attrition – quarterly, annualized) compared to Q3's 59.5%, which the company is trying to address. On the other hand, offshore attrition was 45.9% up from 45.2% in Q3. Margins declined in Q4 to 10.2% (11.3% GAAP), down 76bps q/q, 139bps y/y.

Fig 15 – Net addition negative



Source: Company, Anand Rathi Research

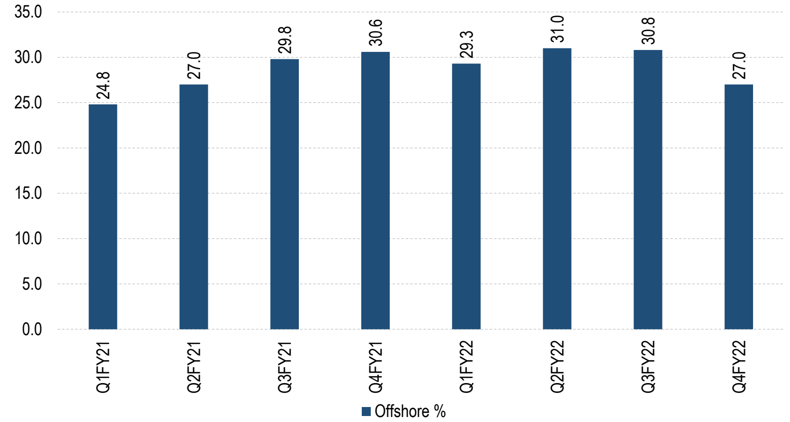
Fig 16 – Revenue productivity on a good trajectory



Source: Company, Anand Rathi Research

From a productivity perspective, FSOL is at the highest level of its recent past. This is due to the fewer headcount and more onsite revenues (73% in Q4, 69.2% in Q3 and 69.4% a year ago).

Fig 17 – Offshoring down, can be a lever for margins ahead



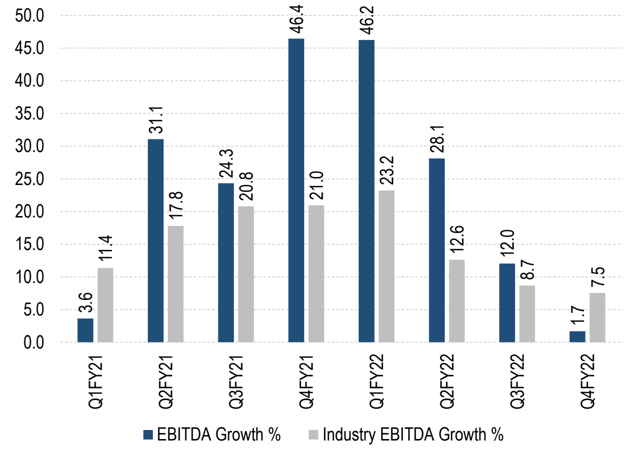
Source: Company, Anand Rathi Research

EBIDTA and NI (adj.) growth below industry

FSOL delivered 2% y/y EBITDA growth in Q4 FY22 and 20% for FY22, ahead of the industry only on an annual basis. The Q4 FY22 EBITDA margin contracted 50bps y/y to 14.8% due to decline in mortgages, supply-side challenges and acquisition-related costs.

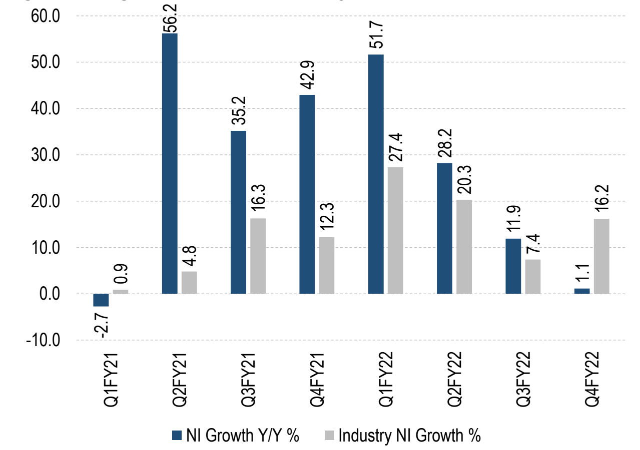
The company continued to operate at higher onshore levels as it believes that onshore delivery gives it a competitive edge in developing domain expertise and industry-specific solutions, critical ingredients in differentiation and industry-leading growth. NI grew 1.1% y/y in Q4 after adjusting for an exceptional item while NI margins (adj.) contracted 34bps y/y. NI y/y growth came in lower than the industry after six quarters of superior performance.

Fig 18 – EBITDA growth rate lower than industry



Source: Company, Anand Rathi Research

Fig 19 – NI growth below industry

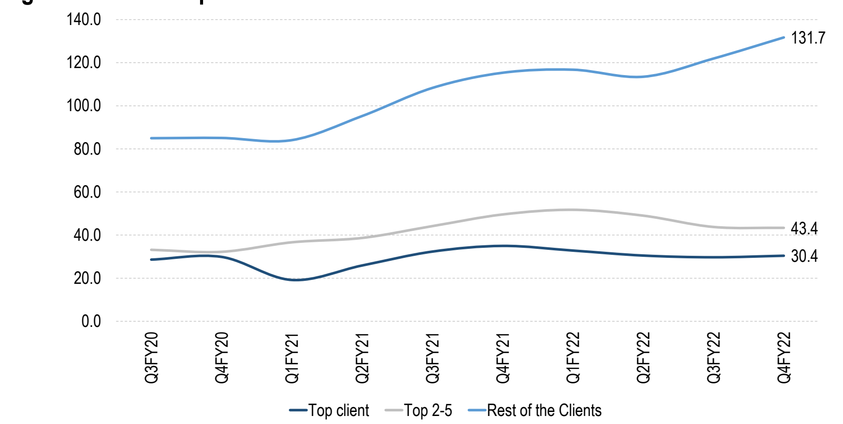


Source: Company, Anand Rathi Research

Top-5 clients' weak performance

FSOL's top client was up 2% sequentially, while Nos.2-5 were down 1% sequentially. Y/y, the top client and the top 2-5 were down 13%. The top client has reached a steady state, which is likely to persist. Some of the top 2-5 clients are from the mortgage unit where Firstsource is currently faced with headwinds. Hence, as the mortgage business shrinks, these clients also decline. The top-5 clients now bring 35.9% to revenue, compared to 37.6% in Q3. The non-top clients grew 8% sequentially, 14% y/y, and reflect growth in new client buckets and other verticals.

Fig 20 – Revenue split between client buckets



Source: Company, Anand Rathi Research

Conference-call takeaways

Q4 FY22

- Mortgage business to bottom out by Q2 FY23; to sharply decline in FY23. Mortgage to contribute $125m-135m in FY23 (two-thirds servicing, rest origination). Q4 run rate was ~$45m; Q1 and Q2 FY23 to be $30m-33m.
- UK BFS to record steady growth throughout the year; collections to record better growth from Q2. Collections business looking encouraging; the company expects strong growth in both core collection and legal portfolio in FY23.
- UK financial services slowly adopting chat; won two deals in offshore chat in FY22
- BPM outside of mortgage demand has strengthened. Seeing larger deals compared to the last 12-18 months.
- HPHS growth trajectory to continue for 2-3 years. Provider business to record healthy growth in FY23, better growth in H2. Healthcare overall to lead the way for growth in FY23.
- Healthcare, currently working on two extremely large RFPs from top-10 health plans.
- CMT. Moved some complex onsite work offshore; this will lead to lower revenue but better margins. Top client to grow in mid-single digits in FY23.
- FY23 revenue to grow 18-22% excluding mortgage and acquisitions. Management expects Q1 to be flattish, Q2 to record modest growth, Q3 and Q4 to register healthy growth.
- Operating margins to be 10.5-11%. Margins to be affected by mortgage business' sharp decline in H1; inflation and acquisition of ARSI. Expect margins to recover in the second half. End-FY23 EBIT to return to 11.5-12%.
- The company has planned a wage increase in the US and UK; a WFH model and other initiatives to manage attrition. It opened a satellite location in the UK to increase talent access
- In the last three months, it won a cross-sell with ARSI. ARSI margin to come closer to the company's margin by the year end.
- FY23 capex to be $8m-9m.
- Acquisition payout if it meets target would be $12m. Further, the company will have to pay $5m-10m to mortgage client, depending on performance.
- In FY23 and FY24 the company will make tuck-in acquisitions.

Business Outlook

- 7-10% growth in FY23.
- Operating margins to be 10.5-11%.
- Tax rate to be 18-20% in FY23

From the last quarters' conference calls

Q3 FY22

- Acquisitions contributed 4% y/y growth in Q3, Organic y/y growth stood at 1%. About 7-7.5m has come from acquisitions (Stone Hill integrated for almost 2 months and ARSI for 1 month)
- Provider business growth delayed as hospitals prioritize covid treatment, Mortgage declining quicker than anticipated due to timing and quantum of interest hikes.
- Mortgage revenue stood at $53m including acquisition, $50m without acquisitions for Q3. Q4 Mortgage revenue to be $45m including acquisitions, expect further softening due to refinance in H1FY23.
- Mortgage origination business affected by interest volatility, Fed's commentary on inflation and likely interest hikes led to sharper than anticipated drop in this vertical.
- Servicing segment remains solid, company has increased focus on developing digital solutions to address the cost efficiency needs of mortgage clients.
- Collections business- Collection business run rate stood at $15.5-16m in Q3, delinquencies at record lows while credit card spending is trending towards pre-covid levels. Collections business has already started easing off, expect delinquencies to rise in the next 3-6months. Finished acquisition of ARSI, this acquisition to bolster FSL's position in collections.
- Collections volume will aid margins in FY23 but mortgage will pull them down. Mortgage refinance segment is a headwind in FY23
- No major weakness in UK BFS, some weakness due to talent situation
- Healthcare - HPHS (~50% of total healthcare) was a major contributor to y/y growth, provider muted. HPHS pipeline is strong, Provider business delayed growth due to Covid surge. Pharma and Med device segment have a good pipeline. HPHS continue to be strong
- Actively evaluating near shore sites in US and UK. Opened delivery center in Mexico which will serve US as a near shore center.
- Added less than 400 people from both acquisitions, so drop in headcount is higher than the calculated number, since headcount numbers includes acquisition headcount.
- ARSI FY23 revenue to be less than $72million (revenue last year) in FY23 as lower delinquencies will hit them by then.
- FY22 growth to be 14-14.5% including acquisition, 4% to come from acquisitions in FY22
- FY22 EBIT margin to be in the range of 11.8-12% margins, affected by acquisitions and talent challenges
- ETR 16-19% for FY22
- Q4 will see impact growth over Q3 due to acquisition. Expect most businesses to starting growing other than Refinancing in Mortgage.

Q2 FY22

- Acquired The Stone Hill group to strengthen its mortgage business; transaction to be closed by the year end. This acquisition offers strong operations in quality control and due diligence in mortgages. It should contribute 50-70bps to growth in FY22. TSG's pricing is transaction-based; hence, despite its large onshore operations, it has healthier margins. The company will fund this acquisition from internal accruals.

- The mortgage business declined due to slowdown in refinance volumes in the origination segment. Despite this decline, the company gained market share. The servicing segment of the mortgage business continued to make gains and the digital portfolio is scaling up well. Mortgage revenue was roughly $55m, of which Origination was two-thirds, Servicing one-third.
- The collections business undershot management's expectation but still saw y/y growth.
- The UK BFS momentum was steady in Q2, adjusted for seasonality.
- The Healthcare-provider business was steady; it added two clients in the HPSS business.
- The company launched healthcare cloud, which offers nine services (Phase 1). CMT sales momentum is picking up; it added three clients in Q2.
- Expect Q3 revenues to be flat sequentially as the collections business is faced with macro challenges and the company's revenue is impacted from onshore talent challenges. Regardless, the company would deliver top quartile growth in the industry for FY22. Q4 is expected to be strong.
- The Mortgage business was expected to decline. The unexpected part was the decline in the collections business as volumes were lower and top clients asked to reduce capacity temporarily
- Wages have been hiked from 1st Oct, leading to expectations of soft margins in Q3, likely to then recover in Q4.
- Large deal won in Healthcare (BPS) of $210m, of which $110m is FSL's share of revenues. Expects $16m a year from this. This deal was won against large integrated players. Talent constraints will not affect this deal as it has a higher offshore component (India and Philippines). Deal to ramp up in Q4.
- Collections business will be marginally up from FY21 levels due to slower pickup in volumes. Revenue of $65m in FY21. Q3 to be flat for this business and Q4 to improve. For the top client, summer months are weak but Dec sees a pick up. The company is likely to see more volumes in 2H. Expects the top client to pick up in Q3 and sustain in Q4. Overall, FY22 will only be a marginal growth year versus expectations of much faster growth.
- The mortgage business to grow from high single digits to low double digits in FY22.
- Demand in the UK BFS strong; pipeline good. Expect strength to return in Q4
- Management guided to 14.5-15.5% cc growth for FY22 incl. the acquisition (50-70bps).
- The operating margin to be 11.8-12.3% for FY22

Q1 FY22

- Within BFS, home-purchase mortgage market continues strong, but mortgage refinance business has tapered. Confident of y/y growth in its mortgage business due to high servicing component. Collections pipeline in the US is encouraging. UK BFS continue to grow well; pipeline robust;

momentum to continue. Expects low double-digit growth in its mortgage business.

- Healthcare growth momentum strong. The business recorded the highest ACV from clients, old and new. Working with six of the top-10 health plans in the US. Digital-intake platform making progress in tele-health and remote-patient-monitoring market; seeing good momentum here. Expanded leadership in the Provider business;Lauralea Tanner to lead the market function for the Provider business.
- Revenue break-up of Healthcare:44% Payer, 56% Provider.Blended margin (provider and payer) to be in line with company average.
- Top client down due to supply-side issue and softness in demand after the campaigns run in Q4. Softness to continue in top client in Q2 on UK reopening. Q3 expected to be strong and, overall,FY22 is likely to be a strong year for the top client.
- Mortgage client extended engagement beyond FY22. FSOL has bought back itsstake in the mortgage business for $23m on a deferredpaymentbasis and contingent consideration of $11.25m. FY22 cash-flow impact $12m (already paid); FY23 $3.5m, FY24 upto $12m, FY25 upto $6.75m. No more P&L impact; the buyback will be accounted for in shareholder equity on the balance sheet.
- Increase in onshore due to growth in the Healthcare vertical. Also, reflects the impact of slowing mortgage as that segment primarily drives offshore delivery.
- Evaluating M&A opportunities on an ongoing basis.
- UK BFS seeing reasonably-sized transformational and long-cycle deals
- E-commerce a priority for FSOL,within which it is focusing on merchant servicing. Focusing on the UK, Europe and North America for e-commerce.
- Revenue growth of 15-18% in FY22. Expect Healthcare to be the growth driver in FY22.
- Operating margin to be 11.8-12.3%

Factsheet

Fig 21 – Revenue ($ m)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Revenue ($ m)	200	201	193	195	206

Source: Company, Anand Rathi Research

Fig 22 – Revenue, by area (%)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
North America	67	68	68	70	71
UK	32	31	30	29	28
RoW	1	1	2	2	2

Source: Company, Anand Rathi Research

Fig 23 – Revenue, by vertical (%)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
BFS	52	52	49	48	49
Telecoms	21	20	20	20	19
Healthcare	25	27	30	30	30
Others	2	2	2	2	2

Source: Company, Anand Rathi Research

Fig 24 – Revenue, by Service line (%)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Contact Centre	47.2	46.3	46.8	45.9	44.4
Back Office	47.9	47.6	45.6	44	36.5
Platforms and Automation	4.9	6.1	7.6	10.1	19.1

Source: Company, Anand Rathi Research

Fig 25 – Client concentration (%)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Top Client	18	16	16	15	15
Top 5 Clients	42	42	41	38	36

Source: Company, Anand Rathi Research

Fig 26 – Revenue, by delivery location (%)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
offshore	30.6	29.3	31.0	30.8	27.0
On-site	69.4	70.7	69.0	69.2	73.0

Source: Company, Anand Rathi Research

Fig 27 – Workforce spread (%)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
India	58%	60%	61%	61%	60%
Abroad	42%	40%	39%	39%	40%
Total	28,004	27,916	27,835	27,398	26,557

Source: Company, Anand Rathi Research

Fig 28 – Key segments' growth Y/Y (%)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Revenue, by region (%)					
North America	45%	41%	21%	10%	8%
UK	21%	51%	19%	-4%	-10%
RoW	0%	44%	39%	28%	68%
Revenue, by vertical (%)					
BFS	66%	45%	14%	-10%	-23%
Telecoms	23%	74%	25%	1%	-6%
Healthcare	-1%	29%	32%	27%	26%
Others	0%	7%	10%	-13%	-21%

Source: Company, Anand Rathi Research

Fig 29 – Service line growth Y/Y (%)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Contact Centre	25.2	38.8	15.1	-0.8	-3.3
Back Office	53.1	56.8	28.4	3.8	-21.7
Platforms and Automation	-40.6	-27.8	-13.7	69.5	300.7

Source: Company, Anand Rathi Research

Valuations

The stock trades at 11x FY24e EPS of Rs10. This, we reckon, is attractive, given our expectations of double-digit growth by FY24. Though H2 FY23 is expected to be better, FY23 growth is unlikely to be in double digits. The pipeline seems decent and, given the Q4 performance and outlook ahead, the FY22-24 revenue CAGR should be 11%, including acquisitions. Healthcare is expected to be the growth driver in FY23 and FY24.

The company delivered 11.2% EBIT margins in FY22. A 10.8% EBIT margin is likely in FY23, given the present revenue trajectory and sharp focus on growth to margins. However, in the medium term, we are positive on FSOL's ability to reduce the margin with peers to 12.4% by FY24. By then, we expect revenue issues to have been resolved at the portfolio level.

We are giving Firstsource (a BPM company) a 15x FY24e PE, reflecting single-digit growth in FY23, though on expectations of better margins and growth in FY24. This reflects a deviation from our outlook for the rest of the Indian IT/ BPO categories.

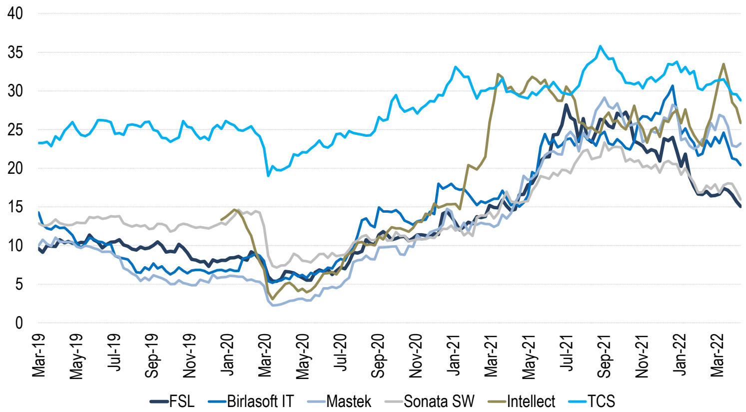
IT services companies, being higher up the value chain than BPO companies, command a higher billing rate and enjoy higher margins than the latter. On the other hand, BPM companies, being transaction-volume-driven, better reflect the prevailing economic situation as is the case now with FSOL. Considering these factors and the fact that IT-services companies are growing 18%+, at the current trading multiple, we find FSOL attractive. Our target price is based on a PE of 15x FY24e EPS, reflecting a target EV/EBITDA FY24e of 9.1x.

Fig 30 – Change in estimates

(Rs m)	FY23			FY24		
	New	Old	% Change	New	Old	% Change
Revenue ($ m)	849	828	2.6	972	951	2.2
Revenues	64,131	62,255	3.0	73,406	71,561	2.6
EBITDA	9,745	10,315	(5.5)	11,922	11,942	(0.2)
EBITDA margins %	15.2%	16.6%	-137 bps	16.2%	16.7%	-45 bps
EBIT	6,958	7,848	(11.3)	9,135	9,476	(3.6)
EBIT margins %	10.8%	12.6%	-176 bps	12.4%	13.2%	-80 bps
Net profit	5,322	6,030	(11.7)	6,953	7,321	(5.0)

Source: Anand Rathi Research

Fig 31 – PE band



Source: Bloomberg, Anand Rathi Research

Risk

- Prolonged weakness in BFS

Appendix

Analyst Certification

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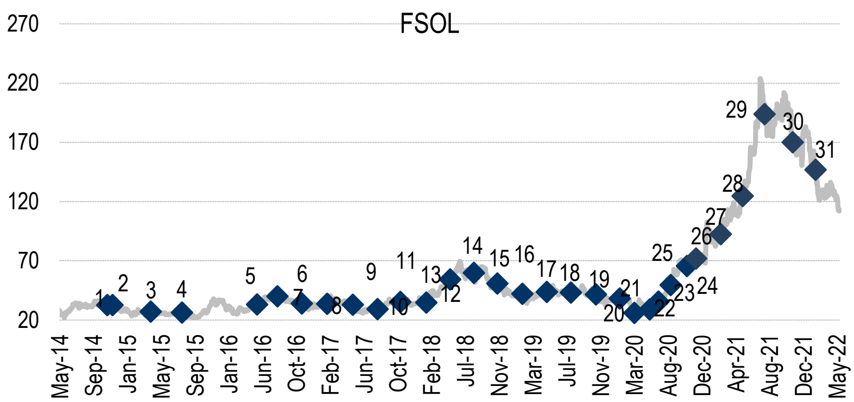

	Date	Rating	TP (Rs)	Share Price (Rs)
16	4-Feb-19	**Buy**	70	49
17	7-May-19	**Buy**	65	51
18	5-Aug-19	**Buy**	60	49
19	7-Nov-19	**Buy**	58	49
20	5-Feb-20	**Buy**	55	43
21	31-Mar-20	**Buy**	45	28
22	27-May-20	**Buy**	42	29
23	29-Jun-20	**Hold**	42	38
24	14-Aug-20	**Hold**	60	54
25	15-Oct-20	**Buy**	85	71
26	29-Oct-20	**Buy**	90	71
27	10-Feb-21	**Buy**	121	98
28	13-May-21	**Buy**	160	129
29	2-Aug-21	**Hold**	210	195
30	10-Nov-21	**Hold**	200	180
31	7-Feb-22	**Hold**	175	153

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