Result Update

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Operating performance beat; Recovery on track

CMP	Target Price
Rs 116	Rs 130 (▲)
as of (February 3, 2023)	12 months
Rating	Upside
BUY (■)	11.8 %

FSOL's Q3FY23 operating performance was above expectations. Constant currency revenue growth was a tad below estimates, while EBITM beat our estimates. Mortgage revenue fell ~20% QoQ to ~USD19mn in Q3. Management expects weak volume in the mortgage business in Q4 and indicated that Q4 mortgage revenue will be lower than that in Q3. UK BFS continues to deliver strong growth with a recent deal win with a top-10 retail bank in the UK; the demand environment, deal pipeline, and digital adoption remain strong despite uncertain macro conditions. FSOL has narrowed its FY23 CC revenue growth guidance to -2 to -1% and 12.5-14.5% excluding mortgage and acquisitions (earlier -2 to 0% and 12-15%, respectively), implying 1-5% QoQ growth in Q4 accounting for seasonality in the collections business and continued weakness in the mortgage segment. FSOL has also narrowed its EBITM guidance to 9.25-9.5% for FY23 (earlier 9-9.5%) and expects to achieve normalized margin of 11.5-12% in Q4, which will then act as a base for FY24 margins. We have largely retained FY24-25E EPS estimates, while we have increased our FY23E EPS estimates by 15%, factoring in Q3 performance. We expect the stock to gradually recover as investors gain confidence in a sustainable recovery in sequential revenue growth and margin. We maintain our BUY recommendation with a TP of Rs130 (earlier Rs125) at 13x Dec-24E EPS.

Result summary: Revenue declined by 2.1% QoQ to USD183mn (-0.9% CC), a tad below our estimates of -0.4% CC. Organic revenue excluding the mortgage business grew by 18.6% CC YoY. EBITM expanded by ~90bps QoQ to 9.4%, 80bps above our estimates. Net profit stood at Rs1.58bn, beating our estimates due to margin beat and higher other income (includes ~Rs0.6bn on account of changes in the fair value of the liabilities for purchase of non-controlling interest and contingent considerations). Mortgage revenue declined by ~20% QoQ to ~USD19mn in Q3, with contribution from origination:servicing at a 35:65 ratio. The collections business continues to remain soft but is expected to pick up, with a well-diversified deal pipeline, which is at its highest-ever level. While the delinquency rate remains lower than its historical average, it inched up to 2.08% in Q3FY23 vs. 1.85% in Q2FY3. **What we liked:** Stability in performance and EBITM beat. **What we did not like:** Weak cash conversion (OCF/EBITDA at 38.2%), slow recovery in provider, and continued weakness in mortgage.

Earnings call KTAs: 1) Management highlighted its three-part strategy is to a) build and grow in chosen verticals, b) diversify within BFS and sub-segments of CMT and healthcare to reduce the cyclicality of its portfolio, and c) adopt a digital-first digital now approach to create more cost efficiencies. 2) FSOL added 12 new clients (Provider – 1, Collection – 7, Edtech – 2, and Technology – 2) in Q3 and saw healthy expansion in the deal pipeline. 3) TSG and ARSI acquisitions did not meet their revenue target, leading to reversal of earnouts payable of Rs279mn in other income. Management indicated there is no further contingent consideration payable on these acquisitions. Change in fair valuation of liabilities for the purchase of non-controlling interest (option purchase agreement with mortgage client) further added Rs319mn to other income. 4) Healthcare growth moderated on account of delayed ramp-up and elongated sales cycle. Payer business witnessed large deals from market consolidation. 5) CMT grew ~17.5% CC YoY and is expected to maintain its healthy growth momentum. The top client in CMT continues to demonstrate healthy growth. 6) DSO stood at 61 days in Q3 vs. 56 days QoQ. Higher DSO led to lower OCF (Rs800mn; OCF/EBITDA 38%) in Q3. Management expects this to normalize in Q4. 7) ETR stood at 14% in Q3 and is expected to be 16-17% for FY23. 8) The board declared an interim dividend of Rs3.5/share.

Financial Snapshot (Consolidated)

(Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Revenue	50,780	59,212	59,885	65,888	75,108
EBITDA	8,042	9,599	8,208	10,744	12,152
EBITDA Margin (%)	15.8	16.2	13.7	16.3	16.2
APAT	4,767	5,374	4,992	5,974	6,938
EPS (Rs)	6.8	7.7	7.2	8.6	10.0
EPS (% chg.)	39.9	12.6	(7.1)	19.7	16.2
ROE (%)	17.1	18.4	15.8	17.3	18.3
P/E (x)	17.0	15.1	16.2	13.6	11.7
EV/EBITDA (x)	10.4	9.2	10.6	7.9	6.7
P/BV (x)	2.9	2.7	2.5	2.2	2.0

Source: Company, Emkay Research

Change in Estimates	
EPS Chg FY23E/FY24E (%)	15.3/0.1
Target Price change (%)	4.0
Target Period (Months)	12
Previous Reco	BUY

Emkay vs Consensus

EPS Estimates	FY23E	FY24E
Emkay	7.2	8.6
Consensus	6.1	7.6
Mean Consensus TP (12M)		Rs 116

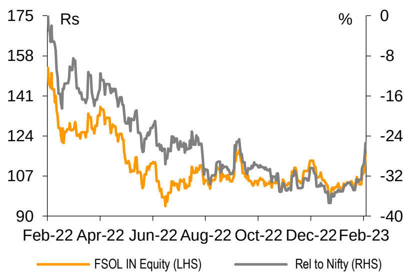
Stock Details	
Bloomberg Code	FSOL IN
Face Value (Rs)	10
Shares outstanding (mn)	697
52 Week H/L	167 / 93
M Cap (Rs bn/USD bn)	81 / 0.99
Daily Avg Volume (nos.)	2,364,257
Daily Avg Turnover (US$ mn)	3.1

Shareholding Pattern Dec '22	
Promoters	53.7%
FIIs	8.4%
DIIs	14.2%
Public and Others	23.8%

Price Performance

(%)	1M	3M	6M	12M
Absolute	12	12	12	(29)
Rel. to Nifty	14	13	9	(30)

Relative price chart



Source: Bloomberg

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Exhibit 1: Quarterly snapshot (Q3FY23)

Rs mn	Q3FY23	Q2FY23	QoQ (%)	Q3FY22	YoY (%)
Revenue (US$ mn)	183.0	187.0	-2.1	195.4	-6.3
Net sales	15,049	14,882	1.1	14,638	2.8
Total Income	15049	14882		14638	
Operating expenses	12,952	12,965	-0.1	12,259	5.7
EBITDA	2097	1917	9.4	2379	-11.9
Margin (%)	13.9	12.9	110	16.3	(230)
Depreciation	687	663		617	
EBIT	1409	1254	12.4	1762	-20.0
Margin (%)	9.4	8.4	90	12.0	(270)
Interest Paid	197	199		151	
Other income	625	494		2	
Non-recurring items	0	0		0	
Pre-tax profit	1837	1549	18.6	1614	13.8
Tax provided	257	255		259	
Profit after tax	1579	1294		1355	
Minority	0	0		0	
Emkay Net profit	1,579	1,294	22.0	1,355	16.6
EPS, Rs	2.3	1.9	22.0	1.9	16.6

Source: Company, Emkay Research

Exhibit 2: Actuals vs. estimates (Q3FY23)

(Rs mn)	Actual	Estimate (Emkay)	Consensus estimate	% variation		Comments
				Emkay	Consensus	
Revenue (US$ mn)	183	186	187	-1.6%	-2.0%	Revenue came a tad below estimates in CC terms (-0.9% CC QoQ vs. expectations of -0.4%).
Sales	15,049	15,300	15,366	-1.6%	-2.1%	
EBIT	1,409	1,317	1,314	7.0%	7.3%	
EBIT, margin %	*9.4%*	*8.6%*	*8.6%*	*80 bps*	*80 bps*	Margins came ahead of expectations.
PAT	1,579	927	982	70.3%	60.8%	Profit beats estimates due to better operating performance and higher other income boosted by one-offs.

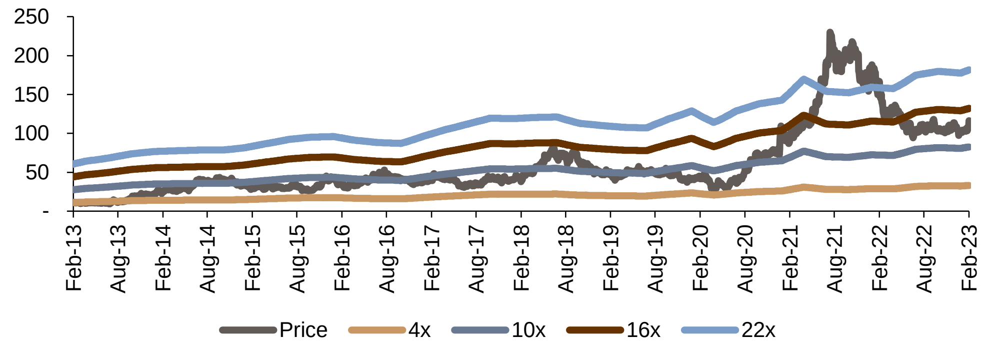
Source: Company, Emkay Research

Exhibit 3: Changes in estimates

INR mn	FY23E			FY24E			FY25E		
	Old	New	*Change*	Old	New	*Change*	Old	New	*Change*
Revenue (USD mn)	753	749	*-0.5%*	817	813	*-0.4%*	918	916	*-0.2%*
US$ revenue, YoY growth %	*-5.3%*	*-5.8%*		*8.4%*	*8.6%*		*12.4%*	*12.6%*	
Revenue	60,218	59,885	*-0.6%*	66,137	65,888	*-0.4%*	75,279	75,108	*-0.2%*
Revenues, YoY growth %	*1.7%*	*1.1%*		*9.8%*	*10.0%*		*13.8%*	*14.0%*	
EBIT	5,448	5,550	*1.9%*	7,958	7,932	*-0.3%*	9,057	9,037	*-0.2%*
EBIT margin %	*9.0%*	*9.3%*		*12.0%*	*12.0%*		*12.0%*	*12.0%*	
PAT	4,330	4,992	*15.3%*	5,967	5,974	*0.1%*	6,923	6,938	*0.2%*
EPS (Rs/share)	6.2	7.2	*15.3%*	8.6	8.6	*0.1%*	9.9	10.0	*0.2%*

Source: Company, Emkay Research

Exhibit 4: FSOL's one-year forward P/E



Source: Company, Emkay Research

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Key Financials (Consolidated)

Income Statement

Y/E March (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Revenue	**50,780**	**59,212**	**59,885**	**65,888**	**75,108**
Expenditure	**42,738**	**49,613**	**51,677**	**55,144**	**62,956**
EBITDA	**8,042**	**9,599**	**8,208**	**10,744**	**12,152**
Depreciation	2,064	2,494	2,658	2,812	3,116
EBIT	**5,979**	**7,105**	**5,550**	**7,932**	**9,037**
Other Income	13	6	1,199	84	88
Interest expenses	522	639	770	731	663
PBT	**5,469**	**6,471**	**5,979**	**7,285**	**8,461**
Tax	702	1,106	988	1,311	1,523
Extraordinary Items	(1,151)	0	0	0	0
Minority Int./Income from Assoc.	0	(8)	0	0	0
Reported Net Income	**3,617**	**5,374**	**4,992**	**5,974**	**6,938**
Adjusted PAT	**4,767**	**5,374**	**4,992**	**5,974**	**6,938**

Balance Sheet

Y/E March (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Equity share capital	6,961	6,970	6,970	6,970	6,970
Reserves & surplus	21,032	23,360	25,912	29,097	32,899
Net worth	**27,993**	**30,329**	**32,882**	**36,067**	**39,869**
Minority Interest	**5**	**4**	**4**	**4**	**4**
Loan Funds	**5,213**	**9,683**	**9,620**	**7,010**	**4,500**
Net deferred tax liability	470	959	959	959	959
Total Liabilities	**33,681**	**40,975**	**43,464**	**44,040**	**45,332**
Net block	**29,976**	**37,436**	**36,989**	**36,737**	**36,831**
Investment	**943**	**1,300**	**1,915**	**2,015**	**2,115**
Current Assets	**17,378**	**18,321**	**19,074**	**20,081**	**21,835**
Cash & bank balance	1,373	898	1,526	1,676	1,785
Other Current Assets	9,308	9,247	9,452	9,520	9,853
Current liabilities & Provision	**14,616**	**16,112**	**14,513**	**14,793**	**15,449**
Net current assets	**2,762**	**2,209**	**4,561**	**5,288**	**6,386**
Misc. exp	0	0	0	0	0
Total Assets	**33,681**	**40,975**	**43,464**	**44,040**	**45,332**

Cash Flow

Y/E March (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
PBT (Ex-Other income) (NI+Dep)	**5,469**	**6,471**	**5,979**	**7,285**	**8,461**
Other Non-Cash items	445	(59)	(1,199)	(84)	(88)
Chg in working cap	2,895	(1,884)	(72)	(577)	(989)
Operating Cashflow	**9,756**	**7,036**	**6,378**	**8,124**	**8,977**
Capital expenditure	(2,646)	(5,796)	(1,683)	(960)	(1,210)
Free Cash Flow	**7,110**	**1,239**	**4,695**	**7,164**	**7,767**
Investments	(807)	(156)	(615)	(100)	(100)
Other Investing Cash Flow	6	2	0	0	0
Investing Cashflow	**(3,439)**	**(5,946)**	**(1,098)**	**(976)**	**(1,222)**
Equity Capital Raised	82	37	0	0	0
Loans Taken / (Repaid)	(2,672)	3,905	(556)	(2,610)	(2,510)
Dividend paid (incl tax)	(2,038)	(2,384)	(2,439)	(2,788)	(3,136)
Other Financing Cash Flow	(1,092)	(2,057)	(1,657)	(1,600)	(2,000)
Financing Cashflow	**(6,234)**	**(1,080)**	**(4,652)**	**(6,998)**	**(7,646)**
Net chg. in cash	**83**	**10**	**628**	**150**	**109**
Opening cash position	1,907	1,373	898	1,526	1,676
Closing cash position	**2,026**	**1,385**	**1,526**	**1,676**	**1,785**

Source: Company, Emkay Research

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Key Ratios

Profitability (%)	FY21	FY22	FY23E	FY24E	FY25E
EBITDA Margin	15.8	16.2	13.7	16.3	16.2
EBIT Margin	11.8	12.0	9.3	12.0	12.0
Effective Tax Rate	12.8	17.1	16.5	18.0	18.0
Net Margin	9.4	9.1	8.3	9.1	9.2
ROCE	17.0	19.0	16.0	18.3	20.4
ROE	17.1	18.4	15.8	17.3	18.3
RoIC	15.8	16.8	11.8	16.2	18.1

Per Share Data (Rs)	FY21	FY22	FY23E	FY24E	FY25E
EPS	6.8	7.7	7.2	8.6	10.0
CEPS	9.8	11.3	11.0	12.6	14.4
BVPS	40.2	43.5	47.2	51.7	57.2
DPS	3.0	3.5	3.5	4.0	4.5

Valuations (x)	FY21	FY22	FY23E	FY24E	FY25E
PER	17.0	15.1	16.2	13.6	11.7
P/CEPS	11.8	10.3	10.6	9.2	8.1
P/BV	2.9	2.7	2.5	2.2	2.0
EV / Sales	1.7	1.5	1.5	1.3	1.1
EV / EBITDA	10.4	9.2	10.6	7.9	6.7
Dividend Yield (%)	2.6	3.0	3.0	3.4	3.9

Gearing Ratio (x)	FY21	FY22	FY23E	FY24E	FY25E
Net Debt/ Equity	0.1	0.2	0.2	0.1	0.0
Net Debt/EBIDTA	0.4	0.8	0.8	0.3	0.0
Working Cap Cycle (days)	10.0	8.1	18.5	20.0	22.4

Growth (%)	FY21	FY22	FY23E	FY24E	FY25E
Revenue	23.9	16.6	1.1	10.0	14.0
EBITDA	27.9	19.4	(14.5)	30.9	13.1
EBIT	34.7	18.8	(21.9)	42.9	13.9
PAT	6.5	48.6	(7.1)	19.7	16.2

Quarterly (Rs mn)	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Revenue	14,638	15,439	14,724	14,882	15,049
EBITDA	2,379	2,448	1,810	1,917	2,097
EBITDA Margin (%)	**16.3**	**15.9**	**12.3**	**12.9**	**13.9**
PAT	1,355	1,324	851	1,294	1,579
EPS (Rs)	**1.9**	**1.9**	**1.2**	**1.9**	**2.3**

Source: Company, Emkay Research

Shareholding Pattern (%)	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
Promoters	53.7	53.7	53.7	53.7	53.7
FIIs	9.6	7.8	8.0	8.4	8.4
DIIs	14.8	14.8	14.6	13.3	14.2
Public and Others	22.0	23.8	23.8	24.7	23.8

Source: Capitaline

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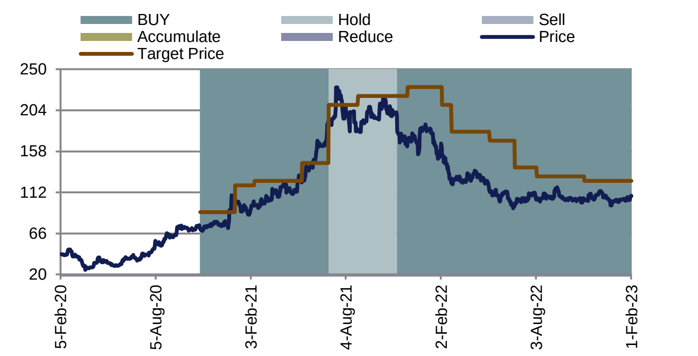
RECOMMENDATION HISTORY TABLE

Date	Closing Price	TP	Period (months)	Rating	Analyst
2-Jan-23	103	125	12m	Buy	Dipeshkumar Mehta
3-Nov-22	104	125	12m	Buy	Dipeshkumar Mehta
4-Oct-22	105	130	12m	Buy	Dipeshkumar Mehta
4-Aug-22	105	130	12m	Buy	Dipeshkumar Mehta
23-Jun-22	100	140	12m	Buy	Dipeshkumar Mehta
6-May-22	112	170	12m	Buy	Dipeshkumar Mehta
1-Apr-22	128	180	12m	Buy	Dipeshkumar Mehta
22-Feb-22	122	180	12m	Buy	Dipeshkumar Mehta
4-Feb-22	153	210	12m	Buy	Dipeshkumar Mehta
1-Jan-22	183	230	12m	Buy	Dipeshkumar Mehta
30-Dec-21	183	230	12m	Buy	Dipeshkumar Mehta
30-Nov-21	170	230	12m	Buy	Dipeshkumar Mehta
23-Nov-21	170	220	12m	Buy	Dipeshkumar Mehta
10-Nov-21	180	220	12m	Buy	Dipeshkumar Mehta
2-Oct-21	195	220	12m	Hold	Dipeshkumar Mehta
27-Aug-21	182	220	12m	Hold	Dipeshkumar Mehta
30-Jul-21	195	210	12m	Hold	Dipeshkumar Mehta
2-Jul-21	189	210	12m	Hold	Dipeshkumar Mehta
12-May-21	128	145	12m	Buy	Dipeshkumar Mehta
5-Apr-21	119	125	12m	Buy	Dipeshkumar Mehta
18-Mar-21	111	125	12m	Buy	Dipeshkumar Mehta
2-Mar-21	101	125	12m	Buy	Dipeshkumar Mehta
10-Feb-21	98	125	12m	Buy	Dipeshkumar Mehta
4-Jan-21	101	120	12m	Buy	Dipeshkumar Mehta
18-Dec-20	77	90	12m	Buy	Dipeshkumar Mehta
29-Oct-20	71	90	12m	Buy	Dipeshkumar Mehta

Source: Company, Emkay Research

RECOMMENDATION HISTORY CHART



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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: 03 Feb 2023 23:12:39 (SGT)
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