

CMP: ₹ 198

Target: ₹ 235 (19%)

Target Period: 12 months

BUY

May 7, 2024

Guides for healthy outlook ahead...

About the stock: Firstsource Solutions (FSL) provides business process services to BFSI, communication, media, tech and healthcare.

- The company generates ~65% revenues from the US and 35% from the UK
- FSL is a domain driven BPM services company which has 150+ global clients, including 18 Fortune 500 companies and 3 FTSE 100 companies. It has 27,940 employees across the US, UK, India and Philippines

Q4FY24 Performance: FSL revenue grew by 4.9% QoQ while in CC terms it grew by 4.2% QoQ at US\$ 201 mn. In rupee terms, revenue came at ₹1,669.28 crore, up 4.6% QoQ. EBIT margin was at 11%, up ~30bps QoQ. FSL won its highest ever ACV deal wins and added 9 new clients in Q4 taking the total new client addition in FY24 to 41 clients. For FY24, it reported revenue of US\$ 765 mn, up 2% while in CC terms the revenue grew by 1.1% YoY. The EBIT margin was at 11% in FY24, up 160 bps YoY. PAT for FY24 came at ₹ 514.7 crore, flattish YoY

Investment Rationale:

- **Healthy Growth outlook ahead:** FSL exuded confidence in sustaining momentum, driven by robust client relationships, market leadership, and strategic investments. FSL aims to achieve a US\$ 1 billion exit revenue run-rate by FY26 organically and it guided on expected revenue growth in CC terms is in the range of 10-13% for FY25. We have baked in 12.1% CAGR in revenues over FY24-26E to US\$ 961 mn.
- **Margins to expand in medium term:** The company guided for EBIT margin in the range of 11-12% for FY25. Further, margin expansion is expected over the medium term through various strategies including onsite-offshore shift, optimization of sourcing and staffing, technology adoption, and automation. We have baked EBIT margins of 11.6% and 12.1% in FY25 and FY26, respectively. Healthy revenue growth coupled in margins expansion to drive ~20% earnings CAGR over FY24-26E.
- **Acquisition to add to growth:** FSL announced acquisition of Quintessence Business Solutions & Services (QBSS) - 100% stake at a purchase consideration of US\$ 39.25mn. QBSS reported revenue of US\$ 14.6 mn in FY24, exhibiting a CAGR of 23% over two years. The acquisition is expected to enhance presence in revenue cycle management (market size of US\$ 25 bn growing at double digits) and to grow offshore capabilities

Rating and Target Price

- FSL is well placed to sustain its medium and long-term growth momentum driven by client acquisition, portfolio expansion, and margin enhancement initiatives.
- We assign **BUY**, with a target price of ₹235; at 22x P/E on FY26E EPS.

Key Financial Summary

₹ crore	FY22	FY23	FY24	5 year CAGR (FY19-24)	FY25E	FY26E	2 year CAGR (FY24-26E)
Net Sales	5,921	6,022	6,336	10.6%	7,211	8,079	12.9%
EBITDA	960	827	956	12.3%	1,127	1,303	16.7%
EBITDA Margins (%)	16.2	13.7	15.1		15.6	16.1	
Net Profit	537	514	515	6.4%	608	742	20.1%
EPS (₹)	7.6	7.3	7.3		8.7	10.6	
P/E	25.4	26.6	26.6		22.5	18.4	
RoNW (%)	17.7	15.3	13.9		15.1	16.8	
RoCE (%)	14.5	14.5	14.0		15.3	17.3	

Source: Company, ICICI Direct Research



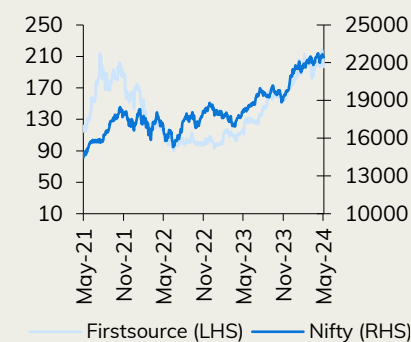
Particulars

Particular	Amount
Market Cap (₹ Crore)	13,669.3
Total Debt (₹ Crore)	812.3
Cash (₹ Crore)	218.5
EV (₹ Crore)	14,263.1
52 week H/L	229/ 112
Equity capital	697.0
Face value	10.0

Shareholding pattern

	Jun-23	Sep-23	Dec-23	Mar-24
Promoters	54	54	54	54
FII	10	10	10	10
DII	15	16	18	19
Other	21	20	18	17

Price Chart



Key risks

- Delay in interest rate cut in US, impacting the mortgage business
- Lower than expected margin growth

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Performance highlights and outlook

- **Strategic Acquisition:** FSL announced the acquisition of Quintessence Business Solutions & Services (QBSS) - 100% stake at a purchase consideration of US\$ 39.25mn - to enhance capabilities in revenue cycle management and to grow FSL's offshore capabilities. QBSS reported revenue of US\$ 14.6 mn in FY24, exhibiting a CAGR of ~23% over the last two years. The market for revenue cycle management (RCM) solutions is estimated at ~US\$ 25 bn and is growing at a fast pace of double digits per year on a CAGR basis. The company aims to gain share in this market from the traditional RCM players is taking a tech led offshore centric approach and its acquisition of QBSS is in line with that strategy. The acquisition, as per the company, will be both margin & EPS accretive for FSL and the acquisition is expected to close by 15.05.2024.
- **Revenue Performance:** FSL in CC terms reported a revenue growth of 4.2% QoQ & 4.5% YoY while in dollar terms it reported a revenue of US\$ 201 mn, up 4.9% QoQ & 6.2% YoY. In rupee terms FSL reported revenue of ₹1,669.28 crore, up 4.6% QoQ & 7.3% YoY. For FY24, FSL reported revenue of US\$ 765 mn, up 2% YoY and up 1.1% YoY in CC terms, while in rupee terms, revenue stood at ₹6,336 crore, up 5.2% YoY.
- **Geography performance:** The company witnessed well-distributed growth across all geographies. Geography wise UK region (34.9% of mix), US (65% of mix) and India (0.1% of mix) grew by 5.9%, 4% and 4.7% QoQ respectively.
- **Vertical wise Performance and outlook:** Vertical wise all verticals grew on a QoQ basis, wherein CMT (23.6% of mix), BFS (37.3% of mix), Healthcare (32.9% of mix) reported growth of 9.8%, 2%, 2.8% QoQ respectively while Others grew at 13.9% QoQ. Further, despite the offshore shift FSL's top client/top 5 clients reported a sequential growth of 13.9% & 7.3% respectively on the back of additional deal wins

The company outlined that anticipated growth would persist in healthcare, CMT and BFS sectors in the US.

– BFS vertical

- **Mortgage portfolio** - While growth was broad based across verticals in Q4, BFS saw slight weakness on a YoY basis due to the base effect in the company's mortgage portfolio while elevated interest rates remain an overhang in the sector. FSL has been investing in strengthening its sales and solutions team in this vertical to broad base its footprint in existing clients as well as expand its footprint into adjacent segments.
- **Credit card services** - The collection services with card holders saw a spurt in volumes with credit card spending reaching record highs and delinquencies also on the rise.

– Healthcare vertical –

The company won two large deals within the healthcare segment from its existing customers and added two new logos. While there was a minor impact in provider business due to a sudden drop in transactions in Q4, it was more than offset by increased volume on the payer side.

- **Margin performance:** FSL in Q4 reported an EBIT margin of 11%, up ~30 bps QoQ which was aided by normalisation in seasonal impact of annual compensation hike and promotion in Q3. FSL reported a PAT of ₹133.5 crore (up 3.7% QoQ) while PAT margin stood at 8% (down 10 bps QoQ). For FY24, FSL reported EBIT margin of 11% up ~160 bps. The growth in EBIT margins is aided by participation in cost optimisation, revenue generation and technology & process transformation agendas of FSL's clients.
- **Deal Wins:** FSL achieved highest-ever net new annual contract value (ACV) wins in a single year, securing significant deals across various sectors. The company successfully added 9 new clients in Q4,

accumulating 41 new clients in FY24. Noteworthy wins include a large cooperative financial institution in the UK and additional business from existing clients in retail banking and healthcare.

- **Attrition & Employee addition:** During Q4 FSL added 1,993 new employees bringing the total employee strength to 27,940 employees. FSL showed a downward trend in TTM attrition rates and emphasized focus on employee engagement and talent development initiatives.

Exhibit 1: Quarter Performance

₹ crore	Q4FY24	Q4FY23	YoY (%)	Q3FY24	QoQ (%)	Comments
Revenue	1,670.5	1,556.8	7.3	1,596.6	4.6	Revenue grew by 4.2% QoQ in CC terms & 4.9% in dollar terms
Employee expenses	1,055.8	969.0	9.9	989.3	7.4	
Gross Margin	614.7	587.8	4.6	607.3	1.2	
Gross margin (%)	36.8	37.8	-96 bps	38.0	-124 bps	
SG&A expenses	364.3	343.7	6.0	370.1	-1.6	
EBITDA	250.3	244.1	2.5	237.1	5.6	
EBITDA Margin (%)	15.0	15.7	-70 bps	14.9	13 bps	
Depreciation & amortisation	67.3	64.2	4.8	66.3	1.6	
EBIT	183.0	179.9	1.7	170.9	7.1	
EBIT Margin (%)	11.0	11.6	-60 bps	10.7	25 bps	Margins continue to improve due cost optimisation, revenue generation and technology & process transformation agendas of FSL's clients
Other income (less interest)	-23.7	-8.0	196.0	-10.1	135.6	
PBT	159.3	171.9	-7.3	160.8	-0.9	
Tax paid	25.8	30.6	-15.6	32.1	-19.6	
PAT	133.5	141.3	-5.5	128.7	3.7	

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 2: Profit and loss statement ₹ crore

	FY23	FY24	FY25E	FY26E
Total Revenues	6,022	6,336	7,211	8,079
Growth (%)	1.7	5.2	13.8	12.0
Employee expenses	3,867	3,909	4,471	5,009
Other Expenses	1,328	1,471	1,613	1,767
EBITDA	827	956	1,127	1,303
Growth (%)	(13.9)	15.7	17.8	15.6
Depreciation & Amortization	263	260	294	323
Other Income	131	37	18	20
Interest	79	103	100	84
PBT before Exceptional Items	615	630	751	916
Growth (%)	(4.9)	2.4	19.3	22.0
Tax	102	115	143	174
PAT before Excp Items	514	515	608	742
Exceptional items				
PAT before MI	514	515	608	742
Minority Int & Pft. from asso.	0	(0)	-	-
PAT	514	515	608	742
Growth (%)	(4.4)	0.2	18.2	22.0
EPS	7.3	7.3	8.7	10.6
EPS (Growth %)	(3.8)	0.2	18.2	22.0

Source: Company, ICICI Direct Research

Exhibit 3: Cash flow statement ₹ crore

	FY23	FY24	FY25E	FY26E
Profit before Tax	615	630	751	916
Dep & Amortization	263	260	294	323
WC changes	76	(240)	(118)	(117)
Other non cash adju.	(160)	(5)	(61)	(110)
CF from operations	795	645	866	1,012
Capital expenditure	(54)	(85)	(216)	(81)
Δ in investments	64	36	-	-
Other investing cash flow	1	1	18	20
CF from Inv Activities	16	(58)	(198)	(61)
Issue of equity	(42)	(52)	-	-
Δ in debt funds	(198)	128	-	(200)
Dividends paid	(238)	(241)	(292)	(334)
Other financing cash flow	(79)	(101)	(100)	(84)
CF from Fin Activities	(743)	(564)	(485)	(711)
Δ in cash and cash bank	68	23	183	240
Effect of exchange rate changes				
Opening cash	90	156	188	372
Closing cash	156	188	372	612

Source: Company, ICICI Direct Research

Exhibit 4: Balance Sheet ₹ crore

Particulars	FY23	FY24	FY25E	FY26E
Equity	697	697	697	697
Reserves & Surplus	2,670	3,003	3,320	3,728
Networth	3,367	3,700	4,017	4,425
Minority Interest	0	0	0	0
LT liabilities & provisions	598	737	737	737
Total Debt	827	812	812	612
Source of funds	4,792	5,250	5,567	5,775
Net fixed assets	670	800	815	665
CWIP	3	17	17	17
Goodwill	2,945	2,988	2,988	2,988
Other non current assets	638	740	792	842
Loans and advances	-	-	-	-
Current Investments	60	30	30	30
Debtors	1,038	1,161	1,320	1,479
Cash & Cash equivalents	156	188	372	612
Other current assets	155	158	180	201
Trade payables	231	306	348	389
Current liabilities	558	460	523	586
Provisions	83	67	76	86
Application of funds	4,792	5,250	5,567	5,775

Source: Company, ICICI Direct Research

Exhibit 5: Key ratios

(Year-end March)	FY23	FY24	FY25E	FY26E
Per share data (₹)				
EPS-diluted	7.3	7.3	8.7	10.6
DPS	3.5	3.5	4.2	4.8
BV	49.5	54.4	59.0	65.0
Operating Ratios (%)				
EBITDA Margin	13.7	15.1	15.6	16.1
PBT Margin	10.2	9.9	10.4	11.3
PAT Margin	8.5	8.1	8.4	9.2
Return Ratios (%)				
RoNW	15.3	13.9	15.1	16.8
RoCE	14.5	14.0	15.3	17.3
Valuation Ratios (x)				
P/E	26.6	26.6	22.5	18.4
EV / EBITDA	17.3	14.9	12.5	10.5
Price to Book Value	4.1	3.7	3.4	3.1
EV / Net Sales	2.4	2.3	2.0	1.7
Mcap / Net Sales	2.3	2.2	1.9	1.7
Turnover Ratios				
Debtor days	63	67	67	67
Creditors days	14	18	18	18
Solvency Ratios				
Total Debt / Equity	0.2	0.2	0.2	0.1
Current Ratio	1.4	1.6	1.6	1.6
Quick Ratio	1.4	1.6	1.6	1.6
Net Debt / EBITDA	0.7	0.6	0.4	(0.0)

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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