

CMP: ₹ 299

Target: ₹ 360 (20.4%)

Target Period: 12 months

BUY

August 1, 2024

Strong quarter, poised for a healthy growth ahead...

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

- The company generates ~68% revenues from the US and 32% from the UK
- FSL is a domain driven BPM services company which has 200+ global clients, including 19 Fortune 500 companies & 3 FTSE 100 companies. It has 29,231 employees across US, UK, India, Philippines, South Africa etc.

Q1FY25 Performance: FSL reported its highest ever quarterly revenue of ₹1,783.87 cr, up 6.9% QoQ/16.8% YoY. In US\$ terms revenue came at US\$ 215 mn, up 6.7% QoQ/15.4% YoY (6.5% QoQ/14.8% YoY in CC terms – including 2% contribution from QBSS acquisition). EBIT margin was at 11%, flat QoQ. FSL won 3 large deals and added 10 new logos.

Investment Rationale:

- Sustained revenue & margin growth momentum:** Based on the strong revenue growth in Q1, the company revised its revenue growth guidance to 11.5-13.5% in CC terms (vs.10-13% earlier). FSL maintained its EBIT margin guidance in the range of 11-12% for FY25 & expansion of 50-75 bps each year thereafter over the medium term. The upward revision seems a little conservative considering the healthy growth witnessed in Q1 & the strong deal pipeline. We expect it to beat this revenue & margin guidance. Further FSL reiterated its target to achieve US\$ 1 billion exit revenue run rate by FY26. **With improved revenue visibility over the medium term, we have introduced our FY27E estimates & accordingly baked in 14.9% CAGR in revenues over FY24-27E to US\$ 1,160 mn.**
- Key margins levers over the medium term:** The management has identified 24 margin levers such as offshoring/rightshoring, increasing span of control and consolidation of onsite delivery locations. These efforts would ultimately converge margins in the range of 14-15% over the next 3-4 years. Accordingly, **we have baked in EBIT margins of 11.5%, 12.3% and 13.1% for FY25/FY26/27E. Healthy revenue growth coupled with margins expansion to drive ~24.7% earnings CAGR over FY24-27E.**
- Broad-based deal & client wins:** FSL won 3 large deals and added 10 new logos in this quarter. FSL has reduced its macro-dependency on its BFS vertical and now looks forward to a more broad-based growth across Healthcare, CMT and Diverse verticals.

Rating and Target Price

- FSL is well placed to sustain its medium and long-term growth momentum driven by client acquisition, structural changes, GenAI and margin enhancement initiatives.
- We rollover our estimates and maintain BUY, with a target price of ₹360; at 28x P/E on average of FY26E & FY27E EPS.**

Key Financial Summary

₹ crore	FY22	FY23	FY24	5 year CAGR (FY19-24)	FY25E	FY26E	FY27E	3 year CAGR (FY24-27E)
Net Sales	5,921	6,022	6,336	10.6%	7,255	8,436	9,765	15.5%
EBITDA	960	827	956	12.3%	1,130	1,373	1,660	20.2%
EBITDA Margins (%)	16.2	13.7	15.1		15.6	16.3	17.0	
Net Profit	537	514	515	6.4%	601	790	997	24.7%
EPS (₹)	7.6	7.3	7.3		8.6	11.3	14.2	
P/E	37.8	39.6	39.5		33.9	25.8	20.4	
RoNW (%)	17.7	15.3	13.9		15.0	17.8	20.0	
RoCE (%)	14.5	14.5	14.0		15.3	18.3	21.3	

Source: Company, ICICI Direct Research



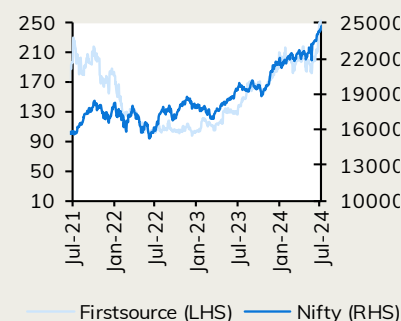
Particulars

Particular	Amount
Market Cap (₹ Crore)	20,344.0
Total Debt (₹ Crore)	812.3
Cash (₹ Crore)	218.5
EV (₹ Crore)	20,937.9
52 week H/L	309 / 140
Equity capital	697.0
Face value	10.0

Shareholding pattern

	Sep-23	Dec-23	Mar-24	Jun-24
Promoters	54	54	54	54
FII	10	10	10	9
DII	16	18	19	20
Other	20	18	17	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

- **Revenue Performance:** FSL reported a revenue of ₹1,783.87 cr, up 6.9% QoQ/16.8% YoY. In dollar terms it reported a revenue of US\$ 215 mn, up 6.7% QoQ/15.4% YoY (6.5% QoQ/14.8% YoY in CC terms – including 2% contribution from QBSS acquisition).
- **Geography performance:** Geography wise on a QoQ basis, growth was led by North America (68.2% of mix) which grew by 12.2% while Europe & MEA (31.8% of mix) and ROW (0% of mix) declined by 2.5% and 100% respectively.
- **Vertical wise Performance and outlook:** Vertical wise Healthcare (35.7% of mix), BFS (36.4% of mix) and CMT (22.3% of mix) reported growth of 16.1%, 4.4% & 1.1% QoQ respectively while Others (5.6% of mix) declined by 3.4% QoQ.
 - **BFS vertical:** The segment grew both sequentially and on a YoY basis in CC terms despite Q1 being a seasonally muted quarter. FSL reduced its macro dependency on the segment with increased focus on cost optimisation programs which have helped it in increasing its market share. Elevated interest rates continue to remain an overhang in the mortgage market. Additionally, the company's AI use case for this segment is also seeing strong interest from its clients. The management expects a sequentially improving growth trajectory in this segment for the rest of FY25 with 5 new logos being added in the segment for Q1.
 - **Healthcare vertical:** Q1 was a strong quarter for the healthcare vertical, aided by the ramp up in the deals won in the recent quarters, especially in the payer segment. It won 2 large deals in the segment during the quarter.
 - **CMT Segment:** The company is seeing a healthy momentum in the telecom and media business. Overall, 3 new logos were added in this segment. The offshoring of their top client might pose as a headwind in the short term. However, the segment is expected to see steady growth moving forward.
- **Margin performance and Outlook:** FSL in Q4 reported an EBIT margin of 11%, flat QoQ while PAT stood at ₹135.3 crore, up 1.3% QoQ/ 7.4% YoY and PAT margin came at 7.6% (down 40 bps QoQ). The management mentioned having **identified 24 margin levers such as offshoring/rightshoring, increasing span of control and consolidation of onsite delivery locations**. These efforts would ultimately converge margins in the range of 14-15% over the next 3-4 years. However, for FY25 it would continue to operate within a band of 11-12%. Additionally, accounts with suboptimal profitability are identified and corrective steps are being take for the same.
- **GenAI/AI:** The company is making significant investments in the GenAI space. During the quarter, it **launched "RelAI"** - suite of AI led solutions and platforms to drive transformation of clients in a responsible manner. FSL's other GenAI capabilities include Firstsense.AI, FirstCollab, and Partner ecosystem. Further, it has **completed 55+ POCs while 8+ co-pilots are in production**.
- **Deal Wins:** FSL **won 3 large deals and added 10 new logos** during the quarter. Noteworthy wins include one of the top 5 Banks in the UK and additional business from existing clients in retail banking and healthcare.
- **Attrition & Employee addition:** During Q1 FSL added 1,291 new employees bringing the total employee strength to 29,231 employees. The TTM attrition rate further declined to 32%.

Exhibit 1: Quarter Performance

₹ crore	Q1FY25	Q1FY24	YoY (%)	Q4FY24	QoQ (%)	Comments
Revenue	1,791.1	1,529.2	17.1	1,670.5	7.2	Revenue grew by 6.5% QoQ in CC terms & 6.7% in dollar terms
Employee expenses	1,126.8	923.7	24.2	1,055.8	7.4	
Gross Margin	664.3	605.5	9.7	614.7	8.1	
Gross margin (%)	37.1	39.6	-250 bps	36.8	29 bps	
SG&A expenses	394.4	365.3	8.0	364.3	8.3	
EBITDA	269.9	240.2	12.4	250.3	7.8	
EBITDA Margin (%)	15.1	15.7	-64 bps	15.0	8 bps	
Depreciation & amortisation	72.9	61.3	18.9	67.3	8.2	
EBIT	197.0	178.9	10.1	183.0	7.7	
EBIT Margin (%)	11.0	11.7	-70 bps	11.0	4 bps	Margins continue to improve due cost optimisation and operational efficiencies
Other income (less interest)	-29.8	-23.6	25.9	-23.7	25.5	
PBT	167.3	155.3	7.7	159.3	5.0	
Tax paid	32.0	29.3	9.2	25.8	24.1	
PAT	135.3	126.0	7.4	133.5	1.3	

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 2: Profit and loss statement ₹ crore

(Year-end March)	FY23	FY24	FY25E	FY26E	FY27E
Total Revenues	6,022	6,336	7,255	8,436	9,765
Growth (%)	1.7	5.2	14.5	16.3	15.8
Employee expenses	3,867	3,909	4,532	5,230	6,006
Other Expenses	1,328	1,471	1,593	1,832	2,099
EBITDA	827	956	1,130	1,373	1,660
Growth (%)	(13.9)	15.7	18.1	21.6	20.9
Depreciation & Amortization	263	260	297	337	381
Other Income	131	37	15	23	32
Interest	79	103	107	84	80
PBT before Exceptional Items	615	630	742	975	1,231
Growth (%)	(4.9)	2.4	17.8	31.5	26.3
Tax	102	115	141	185	234
PAT before Excp Items	514	515	601	790	997
Exceptional items					
PAT before MI	514	515	601	790	997
Minority Int & Pft. from asso.	0	(0)	(0)	-	-
PAT	514	515	601	790	997
Growth (%)	(4.4)	0.2	16.7	31.5	26.3
EPS	7.3	7.3	8.6	11.3	14.2
EPS (Growth %)	(3.8)	0.2	16.7	31.5	26.3

Source: Company, ICICI Direct Research

Exhibit 3: Cash flow statement ₹ crore

(Year-end March)	FY23	FY24	FY25E	FY26E	FY27E
Profit before Tax	615	630	742	975	1,231
Dep & Amortization	263	260	297	337	381
WC changes	76	(240)	(123)	(160)	(180)
Other non cash adju.	(160)	(5)	(50)	(124)	(186)
CF from operations	795	645	865	1,029	1,247
Capital expenditure	(54)	(85)	(217)	(84)	(97)
Δ in investments	64	36	-	-	-
Other investing cash flow	1	1	15	23	32
CF from Inv Activities	16	(58)	(202)	(61)	(65)
Issue of equity	(42)	(52)	-	-	-
Δ in debt funds	(198)	128	-	(200)	(200)
Dividends paid	(238)	(241)	(288)	(355)	(449)
Other financing cash flow	(79)	(101)	(107)	(84)	(80)
CF from Fin Activities	(743)	(564)	(488)	(732)	(822)
Δ in cash and cash bank	68	23	176	235	359
Effect of exchange rate changes					
Opening cash	90	156	188	364	599
Closing cash	156	188	364	599	958

Source: Company, ICICI Direct Research

Exhibit 4: Balance Sheet ₹ crore

(Year-end March)	FY23	FY24	FY25E	FY26E	FY27E
Equity	697	697	697	697	697
Reserves & Surplus	2,670	3,003	3,316	3,750	4,299
Networth	3,367	3,700	4,013	4,447	4,996
Minority Interest	0	0	0	0	0
LT liabilities & provisions	598	737	737	737	737
Total Debt	827	812	812	612	412
Source of funds	4,792	5,250	5,563	5,797	6,145
Net fixed assets	670	800	813	653	462
CWIP	3	17	17	17	17
Goodwill	2,945	2,988	2,988	2,988	2,988
Other non current assets	638	740	794	863	941
Loans and advances	-	-	-	-	-
Current Investments	60	30	30	30	30
Debtors	1,038	1,161	1,327	1,543	1,786
Cash & Cash equivalents	156	188	364	599	958
Other current assets	155	158	181	210	243
Trade payables	231	306	349	406	470
Current liabilities	558	460	526	612	708
Provisions	83	67	77	89	103
Application of funds	4,792	5,250	5,563	5,797	6,145

Source: Company, ICICI Direct Research

Exhibit 5: Key ratios

(Year-end March)	FY23	FY24	FY25E	FY26E	FY27E
Per share data (₹)					
EPS-diluted	7.3	7.3	8.6	11.3	14.2
DPS	3.5	3.5	4.1	5.0	-
BV	49.5	54.4	59.0	65.4	73.4
Operating Ratios (%)					
EBITDA Margin	13.7	15.1	15.6	16.3	17.0
PBT Margin	10.2	9.9	10.2	11.6	12.6
PAT Margin	8.5	8.1	8.3	9.4	10.2
Return Ratios (%)					
RoNW	15.3	13.9	15.0	17.8	20.0
RoCE	14.5	14.0	15.3	18.3	21.3
Valuation Ratios (x)					
P/E	39.6	39.5	33.9	25.8	20.4
EV / EBITDA	25.4	21.9	18.4	14.8	11.9
Price to Book Value	6.0	5.5	5.1	4.6	4.1
EV / Net Sales	3.5	3.3	2.9	2.4	2.0
Mcap / Net Sales	3.4	3.2	2.8	2.4	2.1
Turnover Ratios					
Debtor days	63	67	67	67	67
Creditors days	14	18	18	18	18
Solvency Ratios					
Total Debt / Equity	0.2	0.2	0.2	0.1	0.1
Current Ratio	1.4	1.6	1.6	1.6	1.6
Quick Ratio	1.4	1.6	1.6	1.6	1.6
Net Debt / EBITDA	0.7	0.6	0.4	(0.0)	(0.3)

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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