



HDFC securities

Equity
Research

Pick_{of the}
week

Industry	CMP	Recommendation	Add on dips to	Target	Time Horizon
BPO/KPO	Rs. 38	Buy on Dips	Rs. 36 - 33	Rs. 47-55	6 Quarters

FirstSource Solution Ltd (FSL) is a leading global provider of BPO services through end to end customer life cycle management across different industry verticals i.e. Telecom & Media, BFSI and Healthcare. The verticals contributed 32.2%, 31.8% and 35.8% respectively to the company's revenue during FY17. The company, on a consolidated basis has 48 global delivery centres as on FY17, located in India, US, Europe, Philippines and Sri Lanka. 17 out of 'The Fortune 500' Companies are included in company's client list.

On consolidated basis, company has 48 global operation centres as on 31 March 2017. 20 of the Company's operation centres are located across 13 cities in India and it has 18 centres in US, 8 in UK and 2 in Philippines.

We Recommend FirstSource Solution Ltd (FSL) as a BUY on decline of Rs. 36 to 33 for the targets Rs. 47 (8.2x FY20E) and Rs. 55 (9.6x FY20E) in six Quarters time frame.

Investment Rationale:

Strong Parental Base

FSL was promoted as ICICI Infotech Upstream Ltd in December, 2001 by ICICI Bank Ltd. In 2012-13, the RP Sanjiv Goenka Group acquired 56.8% (34.5% by subscribing to preferential issue of shares and the balance by secondary purchase and open offer for sale by existing investors) shares of FSL through, wholly-owned subsidiary of CESC Ltd, SpenLiq Pvt Ltd. ICICI bank still holds around 4.9% stake in the company. The RP-Sanjiv Goenka group has interests across diverse business sectors such as power & natural resources, infrastructure, carbon black, retail, education and media & entertainment. Strong parental base help company in gaining trust while acquiring new clients.

Company well on track to go debt free

Company has maintained healthy free cash flow over last few years and this has helped it in repayment of debt considerably. FSL has continued its debt repayment this quarter also and successfully made its quarterly principal repayment of US \$11.25mn. Net long term debt is at \$ 64.3mn as on September 30, 2017. At the current repayment rate of \$11.25 mn quarterly run-rate, FSL is expected to go debt free by FY19.

HDFC Scrip Code	FIRSOL
BSE Code	532809
NSE Code	FSL
Bloomberg	FSOL
CMP as on 2 Feb 18	38
Equity Capital (Rs Cr)	685.3
Face Value (Rs)	10
Equity O/S (Cr)	68.53
Market Cap (Rs Cr)	2,601.8
Book Value (Rs)	30
Avg. 52 Week Vol	4536681
52 Week High	49.3
52 Week Low	30.4

Shareholding Pattern (%)	
Promoters	54.8
Institutions	12.8
Non Institutions	32.4

PCG Risk Rating*	Yellow
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* Refer Rating explanation

FUNDAMENTAL ANALYST

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KEY HIGHLIGHTS

- ***FSL is a leading global provider of BPO services through end to end customer life cycle management across different industry verticals i.e. Telecom & Media, BFSI and Healthcare.***
- ***Strong parental base help company in gaining trust while acquiring new clients.***
- ***At the current repayment rate of \$11.25 mn quarterly run-rate, FSL is expected to go debt free by FY19.***
- ***In the last January company has renewed its contract with Sky for next 10 years. This deal will add revenue worth ~Rs. 12000 Cr over the next 10 years.***
- ***We Recommend FirstSource Solutions Ltd (FSL) a BUY on decline of Rs. 36 to 33 for the targets Rs. 47 (8.2x FY20E) and Rs. 55 (9.6x FY20E) in 6 Quarters time frame.***

Healthcare: The backbone

Firstsource addresses two market segments within the Healthcare vertical, the Payer market represented by the Insurance companies and the Provider market represented by hospitals in the US. Healthcare & Insurance is the largest vertical for FSL, and contributes 36% to the revenue mix.

Cliental base for the company includes 5 of the top 10 health insurance/managed care companies and around 650 hospitals in US. Its presence across both the segments (Player and Provider) of this market gives the Company a strong differentiating edge.

The Global Healthcare BPO market is expected to register ~6% CAGR by 2020. Revenue of the Global healthcare IT-BPM market is expected to grow from US \$170.7 bn in 2016 to US \$276.8 bn in 2021. The market drivers for the Healthcare IT-BPO industry are consolidation among and between payers and providers. In addition, the technological advances like robotics process automation, digital transformation, new operations and billing models, will contribute to the forecasted growth.

Telecom and Media

2016 was a transformational year for the telecom and networking industry. Since then the demand for data is surging day by day. This has changed the whole industry landscape. The growth of phones is far outpacing the fixed line connectivity. With more and more people using mobile, the consumption of voice and data is only going to increase. With a plethora of schemes for pre-paid and post-paid being introduced at regular intervals by the mobile operators, subscribers are going to increasingly use the services of BPO/BPM providers for the clarification on pricing and usage. Company derives 32.2% revenues from Telecom & Media segment as on FY17.

Last January, the company has renewed its contract with Sky for the next 10 years, which has been customer since 2002. Sky is the largest entertainment company in Europe and a provider of DTH, mobile and broadband services in the UK. This deal will fetch revenue worth ~Rs. 12000 Cr over the next 10 years.

Banking, Financial services and Insurance (BFSI)

BFSI has been one of the largest adopters of global outsourcing services in the last few years. The global outsourcing market in BFSI sector is likely to grow at a CAGR of around 6% during FY16-20. The need to conform to regulatory compliance is a key factor driving the growth of this market. The BFSI sector is witnessing massive regulatory changes and oversight which has resulted in increased demand for regulatory compliance and transparency in this sector. The reduction in cycle time obtained by outsourcing is another factor driving the market growth. Outsourcing of business processes in the BFS sector has enabled multinational financial institutions to reduce their turnaround time.

Mortgage BPM stands out as one of the largest segment within the banking BPM space. According to Everest research group the mortgage BPM industry is estimated to be \$1.5 bn, currently which is growing at CAGR of 11-12% in the last couple of years and a similar growth rates is expected in the future. Company derives 31.8% revenues from BFSI segment as on FY17.

View & Valuation:

Company trades at a compelling valuation of 9x of FY18E earnings and 6.7x of FY20E. We have predicted around 5% CAGR in Rupee revenue and 11% CAGR in PAT over FY17-20E. According to the management's guidance, company will be debt free by FY19.

Post CESC spin off, the resultant holding company might want dividend as income from the investment it holds and FSL being one such investment might have to start giving dividend. Although we have not considered any such entry in our predictions.

Sky and ISGN solution deals renewal is another big positive for the company.

Ace investors like Rakesh Jhunjhunwala also holds 2.92% equity in his portfolio.

We Recommend FirstSource Solution Ltd (FSL) as a BUY BUY on decline of Rs. 36 to 33 for the targets Rs. 47 (8.2x FY20E) and Rs. 55 (9.6x FY20E) in 6 Quarters time frame.

Risk & Concerns:

- Intense competition in BPO industry.
- Currency Volatility.
- Macro-Economic uncertainties.

Top Client Profiles:

Healthcare	Telecom and Media	BFSI	
5 of the top 10 health insurance / managed care companies in US	U.K.'s largest news and broadcasting company	6 of the top 10 U.S. credit card issuers	1 of the largest independent loan servicers in the U.S.
650+ hospitals in US	One of the world's largest media and entertainment conglomerates	Largest credit card issuer in UK	6th largest bank in North America
	1 of the top 10 U.S. telecom companies	Largest retail bank and mortgage lender in UK	Nation's leading online marketplace for buying and selling real estate
	Largest pay TV operator in the UK	1 of the top 3 motor insurance companies in UK	A full-service direct lender founded in 1990
	A leading MVNO in the UK	1 of the leading auto insurers in US	Private mortgage insurance company
	Global provider of telecom equipment & networks	A leading Irish bank	
	1 of the top 5 mobile companies in India	India's leading private life insurer	

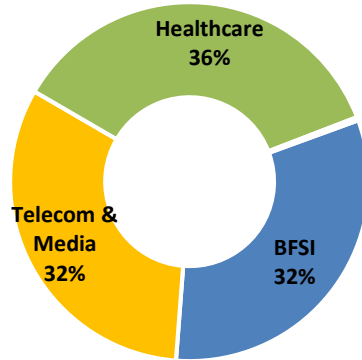
Source: Company, HDFC sec Research

Peer Comparison:

FY17 (Rs. Cr)	CMP	Mcap	Revenues	EBITDA Margin (%)	PAT	EV/EBITDA (x)	EPS (Rs)	PE (x)
FSL	38	2,601.8	3555	12.4	279.2	10.8	4.1	9.3
HGSL	957.6	1,991.6	3710	11.9	180	3.4	86.6	11.1
Allsec Tech	398	606.5	323	21.5	61.5	7.7	40.3	9.9

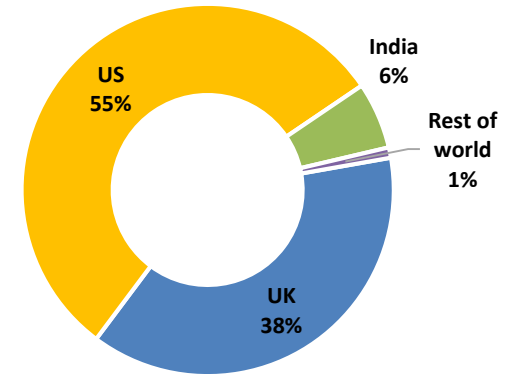
Source: Company, HDFC sec Research

Revenue Contribution by Industry (FY17)



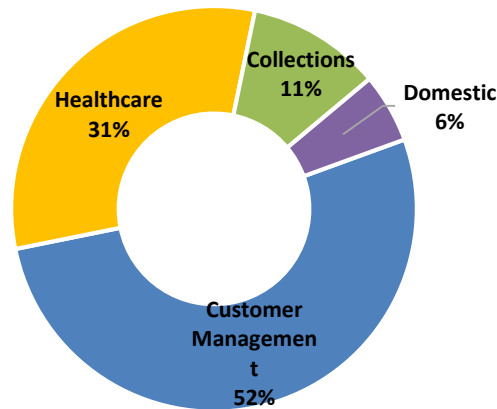
Source: Company, HDFC sec Research

Revenue Contribution by Geography (FY17)



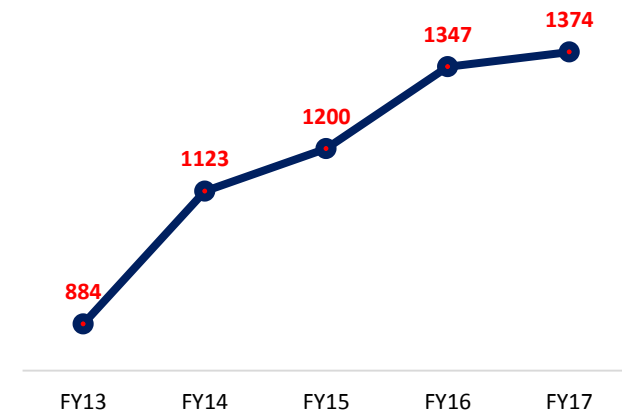
Source: Company, HDFC sec Research

Revenue Contribution by Segment (FY17)



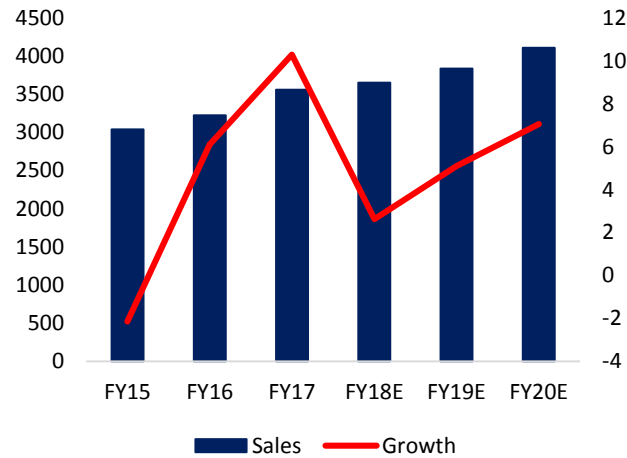
Source: Company, HDFC sec Research

Revenue / Employee (In '000)



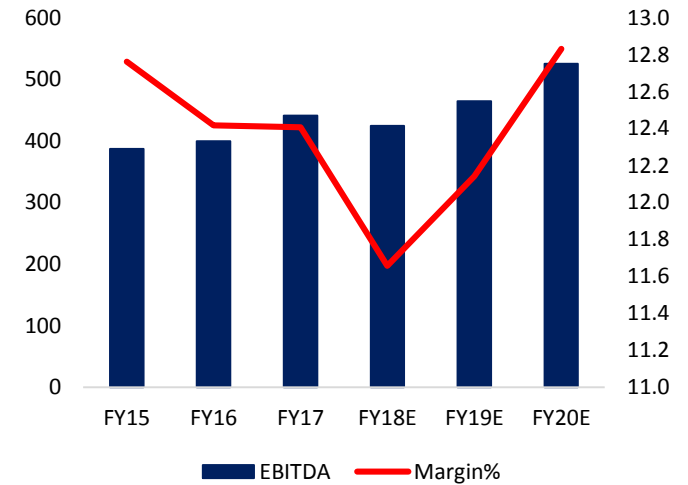
Source: Company, HDFC sec Research

Revenue may see ~ 5% CAGR over FY17-20E



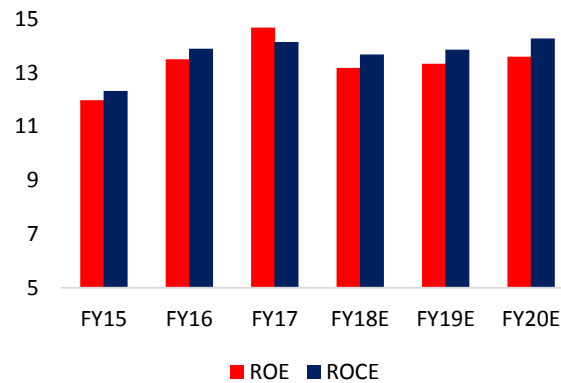
Source: Company, HDFC sec Research

EBITDA and EBITDA Margin



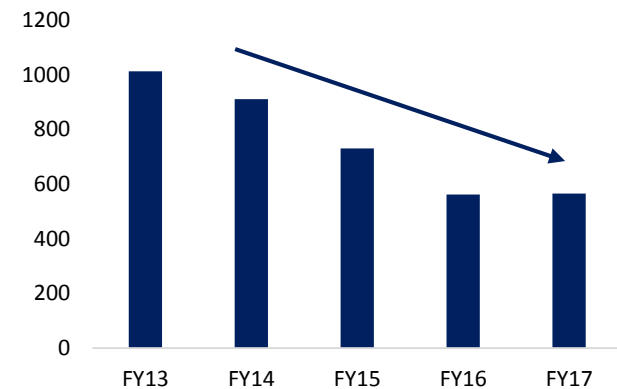
Source: Company, HDFC sec Research

Return Ratios



Source: Company, HDFC sec Research

Well on track to go debt free



Source: Company, HDFC sec Research

Income Statement (Rs.Cr)

(Rs Cr)	FY16	FY17	FY18E	FY19E	FY20E
Net Revenue	3217	3556	3645	3827	4095
Other Income	9.4	3.2	8.0	12.0	15.0
Total Income	3227	3559	3653	3839	4110
Growth (%)	6.1	10.3	2.6	5.1	7.1
Operating Expenses	2827.2	3117.6	3227.6	3374.0	3584.2
EBITDA	399.5	441.2	424.9	464.7	525.4
Growth (%)	3.2	10.4	-3.7	9.4	13.1
EBITDA Margin (%)	12.4	12.4	11.7	12.1	12.8
Depreciation	60.9	59.0	55.4	58.7	60.3
EBIT	339	382	369	406	465
Interest	52.4	45.3	33.0	17.0	11.4
PBT	286	337	336	389	454
Tax	25.3	57.7	50.5	58.3	68.0
RPAT	261	279	286	331	386
Growth (%)	4.3	7.0	2.4	15.6	16.6
EPS	3.9	4.1	4.2	4.9	5.7

Source: Company, HDFC sec Research

Balance Sheet (Rs.Cr)

As at March	FY16	FY17	FY18E	FY19E	FY20E
SOURCE OF FUNDS					
Share Capital	673.3	681.3	681.3	681.3	681.3
Reserves	1104	1347	1633	1963	2349
Shareholders' Funds	1777.0	2028.0	2314.0	2644.7	3030.2
Long Term Debt	409.8	358.0	71.6	7.2	0.7
Net Deferred Taxes	222.4	287.4	287.4	250.0	200.0
Long Term Provisions & Others	26.6	28.8	28.8	28.8	28.8
Minority Interest	2.0	1.2	0.0	0.0	0.0
Total Source of Funds	2438	2703	2702	2931	3260
APPLICATION OF FUNDS					
Net Block	124	150	114	81	60
Deferred Tax Assets (net)	370.2	406.5	500.0	550.0	600.0
Long Term Loans & Advances	2034.3	2180.6	2028.9	2127.7	2274.3
Total Non Current Assets	2529	2737	2643	2758	2935
Current Investments	76.8	152.3	152.3	220.0	220.0
Inventories	0.0	0.0	0.0	0.0	0.0
Trade Receivables	304.1	304.1	309.5	325.0	336.5
Short term Loans & Advances	20.3	9.7	10.7	12.8	15.4
Cash & Equivalents	68.6	38.7	93.3	67.9	128.7
Other Current Assets	177.8	277.7	305.4	342.1	393.4
Total Current Assets	647	783	871	968	1094
Short-Term Borrowings	152.5	207.7	186.9	158.9	119.2
Trade Payables	86.9	99.4	106.1	110.9	117.8
Other Current Liab & Provisions	491.0	500.6	510.7	515.8	520.9
Short-Term Provisions	8.2	8.3	9.1	10.0	11.0
Total Current Liabilities	738.6	816.0	812.8	795.6	768.9
Net Current Assets	-91.1	-33.5	58.5	172.2	325.1
Total Application of Funds	2438	2703	2702	2931	3260

Source: Company, HDFC sec Research

Cash Flow Statement (Rs.Cr)

(Rs Cr)	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	286.2	336.9	336.5	389.0	453.6
Non-operating & EO items	-702.3	9.6	-8.0	-12.0	-15.0
Interest Expenses	52.4	45.3	33.0	17.0	11.4
Depreciation	60.9	59.0	55.4	58.7	60.3
Working Capital Change	-46.7	-87.5	-37.3	-139.2	-92.1
Tax Paid	-25.3	-57.7	-50.5	-58.3	-68.0
OPERATING CASH FLOW (a)	-374.7	305.6	329.0	255.1	350.3
Capex	46.8	-133.4	-20.0	-25.0	-40.0
Free Cash Flow	-327.9	172.2	309.0	230.1	310.3
Investments	159.7	-182.5	58.1	-148.8	-196.6
Non-operating income	9.4	3.2	8.0	12.0	15.0
INVESTING CASH FLOW (b)	215.9	-312.7	46.1	-161.8	-221.6
Debt Issuance / (Repaid)	192.3	15.4	-286.4	-101.8	-56.4
Interest Expenses	-52.4	-45.3	-33.0	-17.0	-11.4
FCFE	-188.1	142.3	-10.3	111.3	242.4
Share Capital Issuance	7.4	7.2	-1.2	0.0	0.0
Dividend	0.0	0.0	0.0	0.0	0.0
FINANCING CASH FLOW (c)	147.2	-22.8	-320.5	-118.8	-67.9
NET CASH FLOW (a+b+c)	-11.6	-29.9	54.6	-25.5	60.8
Closing Cash	68.6	38.7	93.3	67.9	128.7

Source: Company, HDFC sec Research

Key Ratios

	FY16	FY17	FY18E	FY19E	FY20E
EBITDA Margin	12.4	12.4	11.7	12.1	12.8
EBIT Margin	10.5	10.8	10.1	10.6	11.4
APAT Margin	8.1	7.9	7.8	8.6	9.4
RoE	13.5	14.7	13.2	13.3	13.6
RoCE	13.9	14.1	13.7	13.9	14.3
Solvency Ratio					
Net Debt/EBITDA (x)	1.0	0.8	0.0	-0.3	-0.4
D/E	0.3	0.3	0.1	0.1	0.0
Net D/E	0.2	0.2	0.0	0.0	-0.1
Interest Coverage	6.5	8.4	11.2	23.9	40.7
PER SHARE DATA					
EPS	3.9	4.1	4.2	4.9	5.7
CEPS	4.8	5.0	5.0	5.7	6.5
BV	26.4	29.8	34.0	38.8	44.5
Dividend	0.0	0.0	0.0	0.0	0.0
Turnover Ratios (days)					
Debtor days	34.5	31.2	31.0	31.0	30.0
Inventory days	0.0	0.0	0.0	0.0	0.0
Creditors days	11.2	11.6	12.0	12.0	12.0
VALUATION					
P/E	9.7	9.3	9	7.8	6.7
P/BV	1.4	1.3	1.1	1.0	0.9
EV/EBITDA	8.6	7.8	8.1	7.4	6.5
EV / Revenues	1.1	1.0	0.9	0.9	0.8

Source: Company, HDFC sec Research

Rating Chart

R E T U R N	HIGH			
	MEDIUM			
	LOW			
		LOW	MEDIUM	HIGH
		RISK		

Ratings Explanation:

RATING	Risk - Return	BEAR CASE	BASE CASE	BULL CASE
BLUE	LOW RISK - LOW RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 20% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 15% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 15%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 20% OR MORE
YELLOW	MEDIUM RISK - HIGH RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 35% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 20% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 30%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 35% OR MORE
RED	HIGH RISK - HIGH RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 50% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 30% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 30%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 50% OR MORE


Rating Definition:

Buy: Stock is expected to gain by 10% or more in the next 1 Year.

Sell: Stock is expected to decline by 10% or more in the next 1 Year.

Disclosure:

I, Nisha Sankhala, MBA, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. HSL has no material adverse disciplinary history as on the date of publication of this report. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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Any holding in stock –NO

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