

DARK HORSE

FIRSTSOURCE SOLUTIONS LTD



15th July 2020

Stock Data

CMP 42

Multibagger

Tenure 2-3 years

M.Cap (₹ in cr) 2914.09

Equity (₹ in cr) 693.83

52 wk H/L ₹ 55/20.65

Face Value ₹ 10.00

Div. Yield 5.95%

NSE Code FSL

BSE Code 532809

Valuation Data

P/E 8.60

P/BV 1.05

Financial Data

EV 3566.09

Net Worth 2768

BV 39.90

EPS 4.89

₹ In crores except EPS

Index Detail

Sensex 36051.81

Nifty 10618.20

Index S&P BSE500

LEAD RATIONALE

Expecting strong business momentum down the road

FSL delivered strong set of numbers during FY20. **3 new logo wins in Mortgage and 2 in Healthcare Provider** are mainly attributable to such growth.

Sympraxis, FirstCustomer Intelligence, MFocus, iLeverage and AnalyticsFirst are some of FSL'S prominent offerings across domains.

Amongst the recent launches, partnerships & deal wins, it has launched pioneering platform-based service for **'Post-Closing' operations for a top mortgage lender – an anchor client**. In addition has signed on one of the world's **leading card issuers** for Digital Collections offering. In the Retail and Commercial banking arena, FSL is strategically partnering with **top UK-based banks**, enabling them to rapidly adapt to changing consumer preferences. *More recently, have been playing a key role in helping them formulate a robust response to COVID-19 related challenges.*

The Company has operation centre in SEZ in Bangalore and Chennai, and will continue to identify qualifying locations in India that will be eligible for the SEZ benefits, going forward.

FSL is further strengthening Digital Services Practice on the back of its platform based services (e.g. Digital Collections) with an integrated IT, operations and infrastructure solution, to drive better outcomes for clients

The management believes that it has a well balanced mix of clients and industries, and going forward, shall continue to assess, evaluate and address the risk of any over dependency.

Last year, the Company has entered into energy sector in the UK with a new client and growth is expected to continue in this sector in the coming years.

The Company's continued focus in creating the Digital Business practices has enabled it to offer differentiated productized services across industry segments. *These services based on Digitisation, Robotics, Artificial Intelligence & Data Analytics enables the Company to retain and grow its wallet share with its clients and also win new logos. FSL has ramped up and stabilise the operations with a new client in Utility sector and continue to grow this segment to further diversify the revenue and industry concentration.*

| Revenue Share (%) | FY17 | FY18 | FY19 | FY20 | Trend |
|--|--------|--------|--------|--------|-------|
| Offshore | 21.30% | 21.20% | 19.80% | 24.10% | ↑ |
| Onshore (includes India Domestic Business) | 78.70% | 78.80% | 80.20% | 75.90% | ↓ |

The trade war conflicts emerging between major economy like the US and China is likely to impact global business sentiments adversely. Since beginning, the Company has recognized this and developed operational capabilities

across the globe.

In the process, the Company has successfully transformed itself from an offshore BPM Player to a multi shore BPM player, with significant local operational presence in the US and the UK, which has helped in winning more business in those geographies.

The Company derives majority of its revenues from onshore services. While, the share of Offshore revenue has slightly increased in FY20. However, on overall trend, its dependence on offshore revenues has continued to decrease over time. Today, the Company has 17 operation centres with 3,992 employees in the US and 6 operations centres with 5,005 employees in the UK. **Also, it is one of the largest employers in the UK BPM sector.**

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Key business Highlights- FY20

⇒ FSL continued to deliver strong growth across all its business segments. This was led by **3 new logo wins in Mortgage and 2 in Healthcare Provider.**

⇒ In the BFSI, Digitalization is transforming the overall segment. Company continues to evolve on Digital growth:

- Launched Platform based service for '**Post Closing market**' for Mortgage originations with an anchor client
- One of world's pre-eminent card issuers signed a deal for **Digital Collections** offering
- In Healthcare, significantly revamped the Digital Intake offering for Health Plans, FSL foresees this as a great opportunity for strong traction in the market.
- As a testimonial to as much Digital focus internally, the India Employee Engagement Summit 2020 recognized FSL with a top award for "Best Use of Technology in HR"

⇒ It has won two Golds and one Silver at the UK Complaints Handling Awards '20, jointly with a leading banking client in the UK, making this third win in a row. These are basically dedicated to managing consumer complaints efficiently.

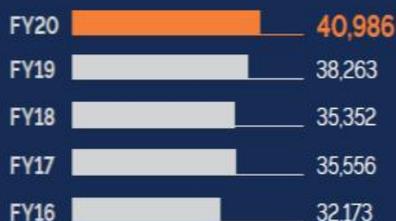
⇒ Strategically partnering with **top UK-based banks**, enabling them to rapidly adapt to changing consumer preferences. More recently, have been playing a key role in helping them formulate a robust response to COVID-19 related challenges.

⇒ Immediate focus on short haul opportunities in BFS and HC Payer arising from demand-supply capacity mismatch.

₹ in million

Financial Highlights- FY19-20

REVENUE

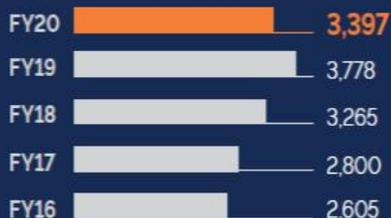


Strong growth across all business segments despite market challenges

➤ Revenue from operations grew 7.1% Y-o-Y to ₹ 4098.6cr and at a CAGR of 5% over FY16-20. *The Company attributes this increase in its income from services to new business from existing clients and addition of few new clients.*

In addition, the Digital revenues are scaling up, which would further drive higher levels of customer engagement and margin expansion.

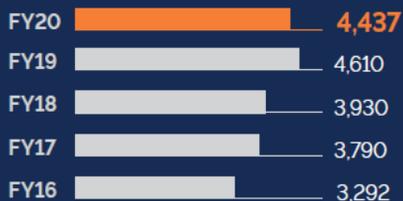
PAT



➤ Profit After Tax (PAT) fell 10.1% Y-o-Y to ₹ 339.7 cr. *This was primarily due to key investments undertaken in the second half to drive future growth and higher operational cost in the first half of the year.*

PAT grew at a CAGR of 5.5% over FY16-20.

Operating Margin



➤ Operating Margin de-grew 3.8% Y-o-Y to ₹ 443.7 cr. **It grew at CAGR of 6.2% over FY16-20. While,** Operating EBITDA grew 17.4% Y-o-Y to ₹ 628.9 cr. **It grew at a healthy CAGR of 10% over FY16-20.**

➤ During the year, the Company incurred capital expenditure of ₹ 90.3cr mainly towards refurbishment and maintenance of operation centers, technology upgrade and setting up of new operations centers.

Operating EBITDA



➤ Debtors' days as of March 20 were 50 days, as compared to 37 days in last FY. *The Company constantly focuses on reducing its receivables period by improving its collection efforts.*

➤ The cash and bank balance as of March 20 was ₹ 190.75 cr as compared to ₹ 47.38 cr in the previous FY. *This Increase in cash was due to cash generated from operating activities offset by cash used in payment of dividend and investing activities.*

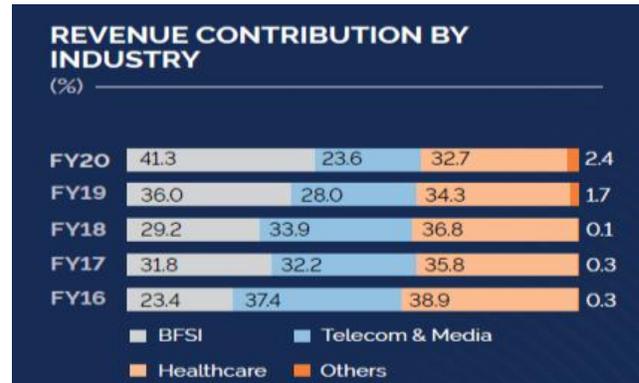
BUSINESS SEGMENTS

The Company serves clients for **Customer Management, Healthcare, Collections and mortgage business**. Clients from Customer Management accounted for 40% (FY2019: 47%), clients from Healthcare accounted for 33% (FY2019: 35%), clients from Collections accounted for 11% (FY2019: 9%), clients from Mortgage accounted for 16% (FY2019: 9%) of the income from services in FY2020.

Segment-wise breakdown of the income from services

₹ in cr

| Business Segments | FY20 | FY19 |
|---------------------|----------------|----------------|
| Customer Management | 1621.49 | 1791.10 |
| Healthcare | 1331.06 | 1309.48 |
| Collections | 440.97 | 353.63 |
| Mortgage | 656.68 | 332.50 |
| Total | 4050.20 | 3786.71 |



In FY20, the **BFSI vertical** recorded the **fastest growth** driven by strong momentum in the Mortgage and Collections businesses. The **Healthcare** reported mixed performance with growth in the Provider segment partially offset by weakness in the Payer segment. While, **Telecommunications and Media** was impacted by the re-balancing in a key client portfolio earlier during the year as well as some execution challenges. However, this vertical is showing signs of improvement.

1. Healthcare

In the **healthcare industry**, FSL is amongst the selected few BPM players to cater to clients in both **Provider and Payer segments**. It caters to the following segments here:

- **Hospital Providers (eligibility and enrolment services, receivables management)**
- **Health Plans (digital mailroom, claims processing and member services)**
- **Health and Pharmacy Benefit Managers Services (data integrity services)**

The growing need for reducing costs and improving Healthcare outcomes would continue to fuel the demand for FSL offerings that integrate digital capabilities with human expertise. Moreover, after being hit by the pandemic, **remote health monitoring and management** has become priority for every individual and this would tend to continue even for coming years as well. Thus, to offer seamless services to Healthcare clients, company is **sharpening focus and making dedicated investments in both Provider and Payer businesses**.

2. Banking and Financial Services

Digitalisation is transforming the **BFSI segment** in a big way. Today, banks globally are looking at evolving into a technology platform with a banking licence. *As per reports*, Credit card, auto loan and student loan collections witnessed healthy traction in the US in 2019. However, in the wake of pandemic large part of population could undergo financial stress resulting in delay for collections. Therefore, going digital is much needed for business or organization to save cost, time, improve collections and enhance customer experience. Thus, Financial services providers are fast adopting the technologies to deliver the same. They are either building in-house platforms or partnering with FinTech companies to harness such technologies.

On the Mortgage services side too, **Low mortgage rates** are likely to keep housing demand buoyant over the next few years in the US. Mortgage originators are more into adoption of digital technologies. The manual process of records seem to fade away as digital technologies will enable them to *reduce redundancies, is cost efficient, enhance productivity and deliver good returns.*

In addition, Credit card segment being the backbone in the collection business, FSL enjoys prominent position in the debt collection industry in the US. Thus, company is looking for tapping opportunities here. Also, it continue to strengthen its presence in the Pre-paid Payment Instruments (PPIs)-related requirements of large banks across key markets. Invoice financing, working capital factoring and SME lending are some of its other strengths.

In the banking & financial vertical,
FSL works with:

3 of top 6 *Retail banks in the UK*
4 of top 10 *Lenders in the US*
3 of top 5 *Credit card issuers in the US*
5 of top 10 *Mortgage servicers in the US*

Segments in which FSL operates in Banking & Financial vertical

Retail and SME banking (customer experience, transaction processing)

Mortgages (loan processing, servicing, title and valuations)

Collections and Recoveries (credit card, auto and student loan collections)

Complaints and remediation (complaints handling, fraud management)

Commercial finance (invoice factoring, risk management)

FinTech

3. Communications, Media and Technology

FSL provides a host of value-added services to its clients that include **Intelligent Automation (IA), NPS predictions, analysis of consumption patterns of customers, improved operational efficiencies, ensuring enhanced customer experience and maximisation of cross-selling opportunities.**

The outbreak of COVID-19 and the ensuing lockdown led to a surge in media consumption (video on-demand and gaming). Thus, broadcasting, pay TV and land/fixed line providers are witnessing a rapid wave of digitalisation. Demand for Augmented and Virtual Reality in several enterprise apps, ad-supported video is likely to sustain over the medium term, while that for data analytics, NPS predictions and analysis of customer consumption pattern is likely to remain strong.

In the Communications, Media and Technology vertical, FSL works with:

1 of top 2 *Broadcasting and media companies in the UK*
2 of top 6 *Telecom and broadcasting companies in the US*

Segments in which FSL operates in this vertical

Streaming services

Cable TV, Broadband and Telephony

Consumer Tech

E-Commerce

Shared economy

Consolidated Revenue- Geography

| Geography | ₹ in cr | |
|-----------------------------|----------------|----------------|
| | FY20 | FY19 |
| UK | 1502.51 | 1661.75 |
| US | 2490.76 | 2085.00 |
| India and rest of the World | 56.92 | 39.96 |
| Total | 4050.19 | 3786.71 |

The Company serves clients in North America, the UK and India. Clients from North America accounted for 62% (FY2019: 55%), clients from the UK accounted for 37% (FY2019: 44%), clients from India accounted for 1% (FY2019: 1%).

Client Concentration

| Particulars | ₹ in cr | | | |
|----------------------------------|----------------|-------------|----------------|-------------|
| | FY20 | | FY19 | |
| Client concentration to revenues | Amount | % | Amount | % |
| Top Client | 853.44 | 21% | 926.58 | 24% |
| Top 5 customers | 1666.02 | 41% | 1569.34 | 41% |
| All Clients | 4050.19 | 100% | 3786.71 | 100% |

In FY2020, the Company had top client accounting for **21%** of the income from services compared to top client accounting for 24% of its income from services in FY2019.

The Company derives a significant portion of its income from a limited number of large cli-

ents. In FY2020, the Company had **13 clients** contributing individually over ₹ 50 cr each in annual revenues as compared to 14 in FY2019. In FY2020 and FY2019, income from the Company's five largest clients amounted to ₹ 1666.02 cr and ₹ 1569.34 cr respectively, accounting for 41% and 41% of its income from services respectively.

Although FSL continues to increase and diversify its client base, it expects that a significant portion of its income will continue to be contributed by a limited number of large clients in the near future.

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Industry overview

In 2019, despite the challenges in global economy, the IT industry maintained its resilience and continued its growth momentum driven by higher growth within BPM services and strong demand for digital and IT services across leading industries and geographies. Infrastructure on Cloud, Cybersecurity, Big Data & Analytics, Artificial Intelligence (AI), Machine Learning (ML), Internet of Things (IoT), Block Chain and edge computing are the key emerging trends as opined by the global firms in the survey conducted by NASSCOM.

As per NASSCOM's Strategic Review 2020 report, the global ITBPM market stood at USD 1.5 trillion (excluding hardware) in 2019 reflecting a **growth of 5.6%** over 2018. The IT services was at USD 729 Billion, a **growth of 3.5%** driven by increasing demand for application development and management services. Global sourcing in IT services was in the range of USD 121 – 123 Billion as against USD 113 – 115 Billion in 2018 reflecting a **growth of 7.0%** characterised by a shift from traditional services to digital technologies, DevOps and Software as-a-service (SaaS) models. Intelligent Automation is emerging as a key growth driver for the BPM industry as clients automate recurring tasks and shift their focus on strategic work.

Organisations are shifting gears to more value-added and outcome driven solutions. In the BPM industry, BPM 4.0 model is witnessing significant increase in its acceptance, focusing more on digital intervention and reducing dependency on legacy processes.

The Indian IT-BPM industry, which accounts for 40%-45% share of the global services industry is expected to see some slivers of opportunities, though at a slower rate primarily due to the pandemic impact, tight credit policies and slow economic reforms.

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Risks & Threats

- ⇒ The Company has revenue concentration on few big clients, with primary business in the US and the UK geography. Hence, any sort of economic slowdown/downturn in these economies and industries may affect the Company's business.
- ⇒ The Company has a long selling cycle that ranges from months to multiple years for its BPM services and requires significant investment of capital, resources and time by both clients and the Company.
- ⇒ Highly competitive environment
- ⇒ Volatility in the US Interest Rates and Economic uncertainty
- ⇒ Currency volatility

Company Overview

Firstsource Solutions Limited is a leading player in the Business Process Management (BPM) industry. Part of the RP-Sanjiv Goenka Group, Firstsource provides bespoke services and solutions to its customers across **Banking and Financial Services, Healthcare, Communications, Media and Technology and other diverse industries**. It operates 36 delivery centres across four geographies – US, UK, Philippines and India – to serve 100+ leading enterprises globally, including 17 Fortune 500 and 9 FTSE 100 companies.

KEY FINANCIAL RATIOS

| Ratios | FY2020 | FY2019 |
|-------------------------|--------|--------|
| Debtors Turnover | 7.3 | 10.0 |
| Current Ratio | 0.8 | 0.9 |
| Debt Equity Ratio | 0.3 | 0.2 |
| Interest Coverage | 7.8 | 20.5 |
| Operating Profit Margin | 15.3% | 14.0% |
| Net Profit Margin | 8.3% | 9.9% |

Valuation Conclusion

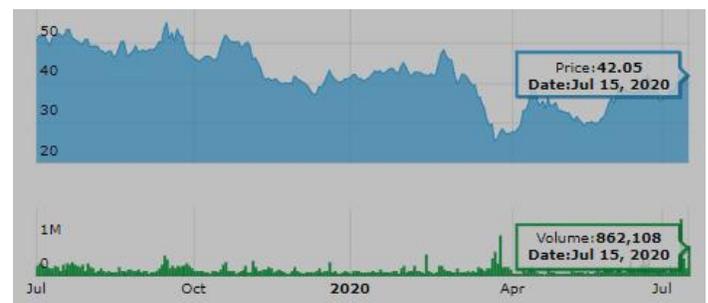
Though management has not provided any guidance, we believe FSL to continue to report decent revenue in the next 1-2years as recent launches, partnerships & new deal wins would help revenue growth further.

Moreover, as pandemic has hit economy hard the large part of population could undergo financial stress. Therefore, going digital is much needed for business or organization to save cost, time, improve collections and enhance customer experience. FSL is already on such growth path & would continue to evolve on Digital growth.

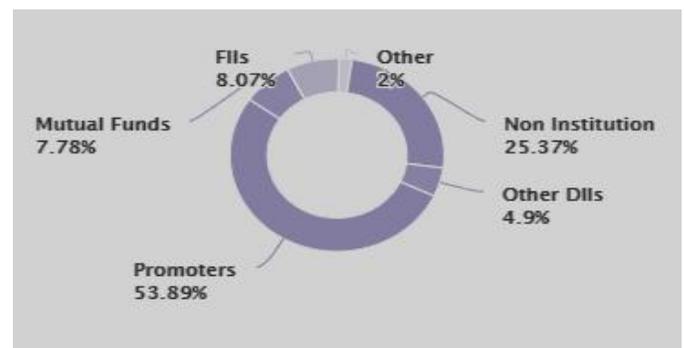
Also, the sound fundamentals & financials attract the share price. It a cash rich company with attraction ROE & ROCE at 12.21% and 13.70% respectively.

The stock is available at an attractive P/E of 8.60x, lower than the peers. Therefore, we suggest to accumulate the stock for 2-3 years tenure.

Share Price chart (past 1 year)



Shareholding pattern



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