

## RESULT UPDATE

### MID CAP

#### Share Data

Reuters code	FISO.BO
Bloomberg code	FSOL IN
Market cap. (US\$ mn)	299
6M avg. daily turnover (US\$ mn)	5.4
Issued shares (mn)	429
Target price (Rs)	35

#### Performance (%) 1M 3M 12M

Absolute	7	(1)	97
Relative	7	(8)	28

#### Valuation ratios

Yr to 31 Mar	FY11E	FY12E
EPS (Rs)	3.4	3.7
+/- (%)	28.0	11.1
PER (x)	9.2	8.3
PBV (x)	1.0	0.9
EV/Sales (x)	1.2	1.1
EV/EBITDA (x)	8.6	7.3

#### Major shareholders (%)

Promoters	21
FII's	7
MFs	5
Public & Others	66

#### Financial highlights

(Rs mn)	3QFY10	4QFY10	QoQ (%)	4QFY09	YoY (%)	FY10P	FY11E	YoY (%)	FY12E	YoY (%)
Revenue	4,909	5,067	3.2	4,723	7.3	19,708	21,208	7.6	24,318	14.7
EBITDA	682	705	3.4	493	43.0	2,805	2,995	6.8	3,514	17.3
EBITDA margin (%)	13.9	13.9	-	10.4	-	14.2	14.1	-	14.5	-
Other income	22	8	(62.9)	338	(97.5)	136	232	70.5	0	(100.0)
Interest	92	102	10.2	132	(22.9)	466	250	(46.4)	177	(28.9)
Depreciation	215	205	(4.8)	272	(24.7)	873	879	0.8	917	4.2
PBT	397	407	2.5	427	(4.7)	1,603	2,099	30.9	2,420	15.3
Tax	51	51	(1.1)	78	(35.1)	238	357	50.1	484	35.7
Minority interest	-	1	-	-	-	5	-	-	-	-
Adjusted PAT (after extraordinary)	333	356	7.0	408	(12.7)	1,361	1,742	28.0	1,936	11.1
Adjusted PAT margin (%)	6.8	9.3	-	8.6	-	6.9	8.2	-	8.0	-

## Firstsource Solutions

Maintain Outperformer

Price: Rs 31

BSE Index: 17,559

30 April 2010

### 4QFY10 Result – Stable operational performance...

Firstsource revenues at Rs 5,067 mn and profits at Rs 356 mn (B&K: Rs 344 mn) were broadly in line with our expectations. With expected ramp down in the ABU business and sharp GBP depreciation against dollar, the company still managed to post strong revenue growth of 3.2% QoQ, mainly volume led. Improved collections business volume (seasonality), ramps from Northern Ireland telecom clients and growth from healthcare provider segment compensated for the sharp revenue decline in ABU business. EBITDA margins remained stable at 13.9% despite currency headwinds and one-time SG&A cost due to US entity reorganisation related fees. Strong volume growth and seat fill factor at 80% (same as last quarter) helped in maintaining margins. PAT improved by 7% QoQ due to stable operational performance, lower depreciation (rationalisation of delivery centre) and lower tax rate of 12.4% versus 16.2% in 3Q.

Employee rationalisation by ~2,500 (mostly for domestic business) was done to streamline the domestic resource pool to reconcile with lower expected volume from ABU business. With the US healthcare reforms bill signed successfully, we see benefits accruing to Firstsource in the long run as most reforms would be implemented post 2014; we have built in industry average revenue growth in US dollar for FY11. We believe the impact of wage hike (offshore 10% and onsite 4%), currency headwinds and lower volume growth from domestic business to be partially compensated by the available SG&A cost lever (from centre rationalisation), traction in collections, telecom and healthcare provider verticals and potential to increase the seat fill factor by another ~200-300 bps. We treat FCCB as debt and our adjusted EPS estimate for FY11 is Rs 2.9. We maintain our Outperformer rating on the stock.

## Business unit performance

**Healthcare vertical:** New opportunities visible in payer segment with the new Government mandate to restrict the medical loss ratio to less than 15% (from current 20-30%) by the end of 2010. Expansion of medicaid coverage to another ~32 mn of uninsured population will translate into higher provider segment revenues. However, high US unemployment rates and full impact of pricing decline needs to be watched for.

**Telecom & Media:** Continue to benefit from vendor consolidation in the US and UK mobile markets. Increased opportunities visible from increased technical support for smartphones and new customer service channels like web chat and forum management.

**BFSI:** Collections business will continue to show good traction with new opportunities visible from non-collections business like customer care and back office operations.

**Asia business Unit:** Lower volume expected from existing telecom clients. Right sizing the current delivery capacity to rationalise cost and increasing looking to tap the BFSI vertical. The business is expected to breakeven by 2HFY11.

## Other highlights

- Cash & cash equivalents at the end of quarter stood at Rs 2,223 mn, an increase of Rs 376 mn QoQ.
- Goodwill, which accounts for ~74% of total assets on book, stood at Rs 20,726 mn versus Rs 21,328 mn in 3Q.
- In geography terms, US contributed 61% (growth of 9.0% QoQ), UK contributed 27% (decline of 1.4% QoQ), India contributed 11.0% (decline of 10.6% QoQ) and RoW at 0.8% (increase of 12% QoQ).
- Seat fill factor remained steady at 80%, same as 3Q despite reduced volumes from the domestic business.
- FCCB outstanding position is US\$ 212.4 mn, same as last quarter.
- Outstanding hedges at US\$ 26 mn and GBP 35 mn
  - o FY11 - 85% USD coverage at Rs 46 and 78% GBP coverage at Rs 79 levels
- The company rationalised further ~2,500 employees (net) taking the total headcount to 24,860 employees at end of 4Q, with major reduction in ABU which is under from declining volumes. Number of seats stood at 19,556 versus 19,407 in 3Q, due to addition of delivery centre in Bhopal.

## Valuation

Our adjusted EPS estimates of Rs 2.0/2.9 for FY10/11 treat the FCCB as debt and assign interest cost to the outstanding FCCB's. The interest cost is the premium applicable (on redemption) on the outstanding bonds. We have not factored in any dilution of equity, as FCCB conversion price of Rs. 92.29 is significant lower than its current market price of Rs 31.

**Adjusted EPS estimates - Considering interest as debt**

<b>FCCB accounting (Rs mn)</b>	<b>FY11E</b>	<b>FY12E</b>
PBT + Amortised option value	2,214.3	2,535.9
Amortised interest cost on FCCB (YTM)	701.2	749.3
Adjusted PBT	1,513.1	1,786.6
Tax rate	17.0	20.0
<b>Adjusted PAT</b>	<b>1,255.9</b>	<b>1,429.3</b>
PAT margins (%)	5.9	5.9
Shares outstanding (mn)	429.1	429.1
<b>Adjusted EPS (Rs)</b>	<b>2.9</b>	<b>3.3</b>

**Operational parameters consolidated (reported Rs mn)****Verticals**

<b>%</b>	<b>% of revenue</b>	<b>QoQ</b>	<b>YoY</b>
BFSI	24.1	13.4	4.6
Telecom & Media	38.1	(0.4)	19.3
Healthcare	36.0	2.1	(4.6)
Others	1.7	(7.4)	(18.5)

**Client concentration**

<b>%</b>	<b>% of revenue</b>	<b>QoQ</b>	<b>YoY</b>
Top Client	12.0	(6.6)	18.3
Top 5 clients	31.5	(6.3)	4.9

**Income Statement**

Yr end 31 Mar (Rs mn)	FY09	FY10P	FY11E	FY12E
<b>Net sales</b>	<b>17,494</b>	<b>19,708</b>	<b>21,208</b>	<b>24,318</b>
<i>Growth (%)</i>	<i>34.7</i>	<i>12.7</i>	<i>7.6</i>	<i>14.7</i>
Operating expenses	(15,295)	(16,903)	(18,213)	(20,803)
Operating profit	2,198	2,805	2,995	3,514
<b>EBITDA</b>	<b>2,198</b>	<b>2,805</b>	<b>2,995</b>	<b>3,514</b>
<i>Growth (%)</i>	<i>(4.8)</i>	<i>27.6</i>	<i>6.8</i>	<i>17.3</i>
Depreciation	(961)	(873)	(879)	(917)
Other income	298	136	232	-
<b>EBIT</b>	<b>1,535</b>	<b>2,069</b>	<b>2,348</b>	<b>2,597</b>
Interest paid	(1,028)	(466)	(250)	(177)
Pre-tax profit (before non-recurring)	507	1,603	2,099	2,420
Pre-tax profit (after non-recurring)	507	1,603	2,099	2,420
Tax (current + deferred)	(199)	(238)	(357)	(484)
Net profit (before Minority Interest, Pref. Dividend, etc.)	308	1,365	1,742	1,936
Minority interests	(1)	(5)	-	-
Reported PAT	307	1,361	1,742	1,936
<b>Adjusted net profit</b>	<b>307</b>	<b>1,361</b>	<b>1,742</b>	<b>1,936</b>
<i>Growth (%)</i>	<i>(76.7)</i>	<i>343.7</i>	<i>28.0</i>	<i>11.1</i>

**Balance Sheet**

Yr end 31 Mar (Rs mn)	FY09	FY10P	FY11E	FY12E
Cash & Marketable sec.	967	1,218	3,956	5,698
Other current assets	4,172	5,295	5,887	6,786
Investments	18	1,005	1,005	1,005
Net fixed assets	25,137	22,564	22,385	22,278
Other non-current assets	141	55	55	55
<b>Total assets</b>	<b>30,434</b>	<b>30,137</b>	<b>33,288</b>	<b>35,822</b>
Current liabilities	2,639	2,265	2,926	3,269
Total debt	13,946	13,579	14,327	14,582
<b>Total liabilities</b>	<b>16,585</b>	<b>15,843</b>	<b>17,253</b>	<b>17,851</b>
Share capital	4,282	4,292	4,292	4,292
Reserves & surplus	9,512	9,952	11,693	13,629
<b>Shareholders' funds</b>	<b>13,794</b>	<b>14,244</b>	<b>15,986</b>	<b>17,922</b>
Minorities interests	55	50	50	50
<b>Total equity &amp; liab.</b>	<b>30,434</b>	<b>30,137</b>	<b>33,288</b>	<b>35,822</b>
<b>Capital employed</b>	<b>27,795</b>	<b>27,872</b>	<b>30,363</b>	<b>32,553</b>

\* Adjusted EPS before considering the impact of FCCB as debt

**Cash Flow Statement**

Yr end 31 Mar (Rs mn)	FY09	FY10P	FY11E	FY12E
Pre-tax profit	507	1,603	2,099	2,420
Depreciation	961	873	879	917
Change in working capital	(4,080)	(1,498)	68	(555)
Total tax paid	(155)	(152)	(357)	(484)
Other operating activities	4,513	-	-	-
<b>Cash flow from oper. (a)</b>	<b>1,746</b>	<b>826</b>	<b>2,689</b>	<b>2,298</b>
Capital expenditure	(4,984)	2,056	(700)	(810)
Change in investments	203	(987)	-	-
Others	(7)	(355)	(0)	(0)
<b>Cash flow from inv. (b)</b>	<b>(888)</b>	<b>(194)</b>	<b>(700)</b>	<b>(810)</b>
<b>Free cash flow (a+b)</b>	<b>858</b>	<b>632</b>	<b>1,989</b>	<b>1,488</b>
Equity raised/(repaid)	9	(4)	-	-
Debt raised/(repaid)	1,394	(367)	749	254
Others	(2,319)	(9)	-	-
<b>Cash flow from fin. (c)</b>	<b>(916)</b>	<b>(381)</b>	<b>749</b>	<b>254</b>
<b>Net chg in cash (a+b+c)</b>	<b>(58)</b>	<b>251</b>	<b>2,738</b>	<b>1,742</b>

**Key Ratios**

Yr end 31 Mar (%)	FY09	FY10P	FY11E	FY12E
Adjusted EPS (Rs)*	0.7	2.6	3.4	3.7
Growth	(74.7)	265.6	28.0	11.1
Book NAV/share (Rs)	27.8	27.5	30.9	34.6
Tax	39.3	14.8	17.0	20.0
EBITDA margin	12.6	14.2	14.1	14.5
EBIT margin	8.8	10.5	11.1	10.7
RoCE	6.4	7.4	8.1	8.3
Net debt/Equity	93.7	86.5	64.7	49.4

**Valuations**

Yr end 31 Mar (x)	FY09	FY10P	FY11E	FY12E
PER	43.1	11.8	9.2	8.3
PCE	10.4	7.2	6.1	5.6
Price/Book	1.1	1.1	1.0	0.9
EV/Net sales	1.5	1.3	1.2	1.1
EV/EBITDA	11.7	9.1	8.6	7.3

**Du Pont Analysis – ROE**

Yr end 31 Mar (x)	FY09	FY10P	FY11E	FY12E
Net margin (%)	1.8	6.9	8.2	8.0
Asset turnover	0.6	0.7	0.7	0.7
Leverage factor	2.7	2.2	2.1	2.0
Return on equity (%)	2.9	9.7	11.5	11.4

**Ankit Shah**  
**ankit.shah@bksec.com**  
**+91-22-4031 7167**

**Shradha Agrawal**  
**shradha.agarwal@bksec.com**  
**+91-22-4031 7260**

**Analyst Declaration:** We, Ankit Shah & Shradha Agrawal, hereby certify that the views expressed in this report accurately reflect our personal views about the subject securities and issuers. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendation or view expressed in this report.

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**B & K SECURITIES INDIA PRIVATE LTD.**

**Equity Research Division:** City Ice Bldg., 298, Ground/1st Floor, Perin Nariman Street, Behind RBI, Fort, Mumbai - 400 001, India. Tel.: 91-22-4031 7000, Fax: 91-22-2263 5020/30.  
**Registered Office:** Room No. 3/4, 7 Lyons Range, Kolkata - 700 001. Tel.: 91-33-2243 7902.

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