

STOCK DATA

Market Cap	Rs17bn
Book Value per share	Rs28
Eq Shares O/S (F.V. Rs.10)	427.3mn
Median Vol (12 mths)	799,417 (BSE+NSE)
52 Week High/Low	Rs93/30
Bloomberg Code	FSOL@IN
Reuters Code	FISO.BO

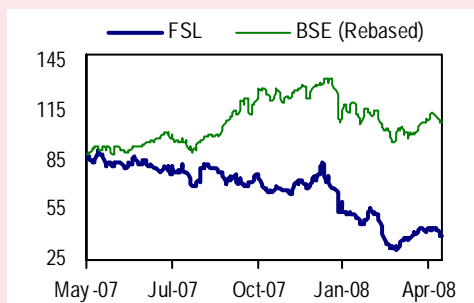
SHAREHOLDING PATTERN (%)

Qtr. Ended	Sep-07	Dec-07	Mar-08
Promoters	25.0	26.0	26.8
MFs/FIs	1.6	1.9	1.3
FIIIs	58.0	57.0	55.6
PCBs	6.5	6.8	6.9
Indian Public	8.9	8.0	9.3

STOCK PERFORMANCE (%)

	1M	3M	12M
Absolute	(4.6)	(17.3)	(54.7)
Relative	(8.0)	(12.3)	(61.0)

STOCK PRICE PERFORMANCE



KEY HIGHLIGHTS

Firstsource Solutions Ltd. (FSL) reported sales of Rs3.8bn in Q4FY08, a flat QoQ growth. However, operating profits posted a 7.4% QoQ rise to Rs622mn, as the previous quarter had one-off items. Net profit growth, though was subdued due to a provisioning for FCCB's (Rs195.6mn) which resulted in only a 1.9% QoQ growth to Rs210mn.

● **Improved QoQ Performance if we exclude notional loss**

Lack of one off items this quarter enabled FSL to report a 110bps sequential improvement in OPM to 16.6%. Net profits excluding the one time non cash notional loss witnessed a marked improvement to Rs406mn, propelled by lower taxes.

● **Margins could face pressure due to lower momentum**

The margin bounceback was below our expectations and it occurred primarily due to certain BFSI clients delaying ramp up or cancelling project starts. FSL expects this vertical, especially in the US to exhibit pressure points in H1FY09.

● **Revenue guidance though is stable**

FSL has pointed towards a revenue growth of 33-38% in USD terms, which is slightly lower than anticipated but not surprising considering the current environment.

VALUATIONS AND RECOMMENDATION

At the CMP of Rs40, FSL is trading at a P/E of 14.3x and EV/EBIDTA of 7.6x. Though FSL could face short term uncertainties in key segments we continue to believe that its offerings are expected to witness greater traction due to the under penetration of outsourced BPO services. Hence, as FSL possesses proven capabilities to capture these opportunities, it has the potential to report robust earnings growth and stable free cash flows which should enable its valuations to align with that of its global peers. Thus, we maintain our 'BUY' recommendation with a 12-month price target of Rs66.

KEY FINANCIALS (CONSOLIDATED)

Rs mn	Quarter Ended			Yr Ended (March)				
	Sep-07	Dec-07	Mar-08	2006	2007	2008	2009E	2010E
Net Sales	2,805	3,739	3,756	5,487	8,310	12,988	17,137	20,876
YoY Gr. (%)	54.2	74.3	35.4	70.5	51.4	56.3	31.9	21.8
Op Profits	547	579	622	799	1,656	2,309	2,923	3,859
Op. Marg. (%)	19.5	15.5	16.6	14.6	19.9	17.8	17.1	18.5
Net Profits	456	206	210	247	973	1316	1,719	2,472
Eq Capital	4,252	4,270	4,273	3,995	4,251	4,273	6,160	6,160

KEY RATIOS

	Yr Ended (March)				
	2006	2007	2008	2009E	2010E
Dil. EPS (Rs)	0.4	1.6	2.1	2.8	4.0
ROCE (%)	6.6	12.1	10.0	8.4	11.0
RONW (%)	10.9	14.8	11.6	9.2	9.3
P/E (x)	99.9	25.3	18.7	14.3	10.0
EV/ Sales (x)	4.7	2.7	2.7	1.3	0.9
EV/EBDIT (x)	32.3	13.7	15.4	7.6	5.1

FSL is seeing certain clients in the BFSI space delay ramp ups or defer new projects...

PERFORMANCE OVERVIEW

Net sales for the quarter were below expectations as FSL did witness certain BFSI clients delaying ramp ups or cancelling new projects. As a result, the rebound in margins was lower than anticipated. However, lower taxes enabled net profits (excluding the one off non cash notional loss of Rs195.6mn) to report a sharp jump QoQ.

Actual v/s Estimate			
Rs mn	PINC Estimate	Actual	Var (%)
Net Sales	3,928	3,756	(4.4)
Operating Profit	758	622	(17.9)
OPM (%)	19.3	16.6	(270bps)
Net Profit (excl one off)	414	406	(1.9)
Diluted EPS (Rs)	0.67	0.66	(1.9)

Source: PINC Research

The non cash notional loss relates to the USD275mn FCCB which FSL raised in Dec'07. As the rupee has depreciated over the past quarter, the closing Re/\$ rates of Q3FY08 and Q4FY08 have differed leading to this notional loss of Rs195.6mn. Such notional gains/losses can be expected going forward if the Re/\$ rate continues to be volatile.

Non cash notional charge on FCCB due to rupee depreciation QoQ...

For the full year, FSL reported net sales of Rs13bn, a growth of 56.3% YoY while OPM was at 17.8%, a drop of 210bps. Net profits for the year were at Rs1.3bn, a growth of 35.3%. If we exclude the one time notional loss reported this quarter, net profits were at Rs1.5bn, which translates into a net profit margin of 11.6%, in-line with our expectations.

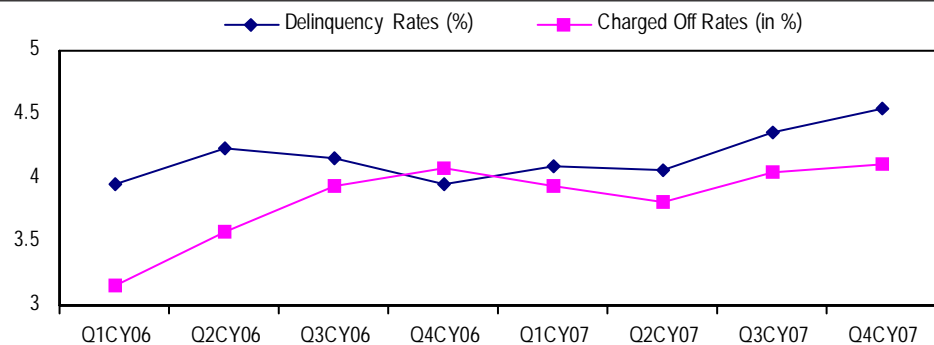
The collections business did report an uptick this quarter, which was expected considering that this is a seasonally good quarter due to individuals receiving tax rebates during this period leading to better collectibility.

The US BFSI (credit card) collections continue to be a concern for FSL as the deteriorating conditions in the US is impacting individual's ability to pay off credit card debt leading to surge in delinquencies and therefore impacting success ratios. Consequently, liquidity pressures are forcing them to sell off charged-off debt to debt buyers. Hence, FSL has realigned its strategy and has tied up with 4 debt buyers so far for whom it would conduct collections.

Though collection revenues have increased this quarter and BFSI revenues have also witnessed a surge, management comments point to further uncertainty panning out in this vertical in the next two quarters. Thus, the company does not expect to see significant traction from the BFSI vertical atleast until H2FY08.

U.S. credit card collections facing pressure as delinquencies rise...

Top 100 US Comm. Banks Credit Card delinquencies & charge off rates



Source: U.S. Fed Data

Telecom and Healthcare verticals remain stable and management is not seeing any significant pressures as yet from these verticals. The pipeline for FSL also remains stable with no significant downward movement but the near term worry continues to be lack/delay of decision making, which is leading to the pipeline not being converted into deal wins.

FSL Metrics have improved YoY and compare well with global peers...

In spite of pressures in certain segments, FSL's metrics continue to be stable as revenue/headcount, EBIDTA/headcount and PAT/headcount have reported a YoY increase and also compare well with global peers. Though this could be attributed to MedAssist which has better metrics, it reflects the ability of FSL to leverage output based pricing (60% of revenues) leading to greater non linearity and therefore improving metrics.

Metrics Comparison			
USD	FSL	Genpact	EXL
Revenue/Headcount*	17,857	25,158	17,989
EBIDTA/Headcount*	3,323	4,032	2,316
PAT/Headcount*	1,894	3,180	2,704

Source: PINC Research *FSL-FY08, Genpact, EXL - CY07

FSL Metrics have improved YoY		
USD	FY08	FY07
Revenue/Headcount	17,857	13,100
EBIDTA/Headcount	3,323	2,595
PAT/Headcount	1,894	1,536

Source: PINC Research

Outlook and Valuations

Downside probability to guidance is low as management has visibility over revenues...

FSL's guidance of USD revenue growth of 33-38% in FY09 was slightly below expectations as we were expecting a growth rate of ~42-46%. This revenue guidance does not come as a surprise considering the current environment it is facing in certain key segments but it is also comforting that FSL does have visibility over this revenue guidance. Thus the downside probability to this guidance is currently low.

Consequently, we have revised our estimates for FY09 and FY10. Our net sales estimates for FY09 and FY10 are at Rs17.1bn and Rs21.0bn respectively. Assumptions of rupee appreciations, higher onsite staff costs coupled with lower than expected revenue growth leads us to believe that margins would be under pressure in FY09. Hence we expect an OPM of 17.1% in FY09 but expect them to bounce back to 18.5% in FY10 as FSL can look to leverage its cost base. Our net profit estimate for FY09 and FY10 is at Rs1.7bn and Rs2.4bn respectively while our fully diluted EPS estimates are Rs2.8 and Rs4.0 respectively.

The under penetrated outsourced/offshore BPO services space offers growth opportunities to able players such as FSL...

The ability of FSL to report robust earnings CAGR (35% from FY07-10E) and stable free cash flows remains intact as it currently has visibility over its guided revenue growth. Therefore, though near term uncertainties and concerns may lead to short term volatility in valuations, the potential that an under penetrated outsourced BPO services market offers an able and proven player such as FSL is immense. Hence, we maintain our 'BUY' recommendation with a 12-month price target of Rs66.

Rs Mn	Revised Estimates					
	Previous		Revised		Change (%)	
	FY09	FY10	FY09	FY10	FY09	FY10
Net Sales	18,709	24,256	17,137	20,876	(8.4)	(13.9)
Operating Profit	3,571	4,987	2,923	3,859	(18.1)	(22.6)
OPM (%)	19.1	20.6	17.1	18.5	(200bps)	(210bps)
Net Profit	2,117	2,922	1,719	2,472	(18.8)	(15.4)
Diluted EPS (Rs)	3.4	4.7	2.8	4.0	(18.4)	(15.6)

Source: PINC Research

Robust earnings growth and stable free cash flows should enable valuations to align with those of global peers...

FSL Estimates					
USD (Mn)	FY07	FY08	FY09E	FY10E	CAGR
Net Sales	194.3	333.0	435.5	549.1	40.9%
EBIDTA	40.9	59.2	74.9	101.5	35.0%
EBIDTA Margins (%)	21.0	17.8	17.1	18.5	-
PAT	22.8	33.7	44.1	65.0	41.3%
Diluted EPS (\$)	0.04	0.05	0.07	0.11	42.4%
P/E	27.8	20.0	14.3	9.5	
CMP (\$)	1.0	1.0	1.0	1.0	

Source: PINC Research

Peer Comparisons															
USD (Mn)	Genpact					WNS					EXL				
	CY06	CY07	CY08E	CY09E	CAGR	FY07	FY08E	FY09E	FY10E	CAGR	CY06	CY07	CY08E	CY09E	CAGR
Net Sales	613.0	822.7	1035.5	1275.4	27.3%	219.7	293.8	365.7	520.3	32.9%	121.8	179.9	208.4	261.4	28.7%
EBIDTA	95.2	131.9	204.7	263.3	39.9%	32.3	39.1	60.6	74.5	31.7%	18.2	23.2	33.4	42.6	32.3%
EBIDTA (%)	15.5	16.0	19.8	20.6	-	14.7	13.3	16.6	14.3	-	15.0	12.9	16.0	16.3	-
PAT	85.2	104.0	121.7	156.8	22.3%	32.2	22.5	34.6	43.2	10.2%	14.1	27.0	25.4	28.5	26.1%
Diluted EPS (\$)	0.4	0.5	0.6	0.7	20.5%	0.7	0.5	0.8	1.0	12.0%	0.5	0.9	0.9	0.9	24.6%
P/E	33.2	27.2	23.3	18.9		26.0	37.2	23.8	18.4		41.8	23.5	21.5	21.5	
CMP (\$)	13.0	13.0	13.0	13.0		17.9	17.9	17.9	17.9		20.0	20.0	20.0	20.0	

Source: PINC Research, Bloomberg

Company description:

Firstsource Solutions Ltd. (FSL), promoted by ICICI, was incorporated as *ICICI Infotech Upstream Ltd.* in Dec'01 to provide BPO services. Over the years, FSL has grown through various acquisitions in order to break into new verticals and service offerings. In view of expanding its offerings and capabilities, FSL went public in Feb'07 prior to which, it was known as *ICICI One Source*.

Financial Results for the quarter & year ended 31 March 2008 (Consolidated)

Particulars (Rs Mn)	Quarter Ended			Year Ended		
	31/03/08	31/03/07	Gr %	31/03/08	31/03/07	Gr %
Net Sales	3,756	2,774	35.4	12,988	8,310	56.3
Expenditure	3,134	2,195	42.8	10,679	6,654	60.5
Personnel Cost	2,115	1,498	41.2	7,120	4,136	72.2
Operating Cost	1,019	697	46.2	3,558	2,518	41.3
Operating profit	622	579	7.6	2,309	1,656	39.4
Other Income	36	(15)	336.6	349	72	385.2
PBDIT	659	563	16.9	2,659	1,728	53.8
Interest	213	7	-	366	60	505.0
Depreciation	227	200	13.5	861	641	34.2
PBT	219	357	(38.6)	1,432	1,026	39.5
Provision for current tax	62	1	-	288	39	630.4
Provision for deferred tax	(60)	2	-	(184)	5	-
Fringe benefit tax	11	6	76.0	23	15	51.4
PAT	206	348	(40.8)	1,305	966	35.1
Minoroty Interest	4	1	300.0	10	6	61.8
Net Profit after Minority Interest	210	349	(39.8)	1,316	973	35.3
Equity Capital	4,273	4,251	0.5	4,273	4,251	0.5
Reserves (excl. rev. res.)	-	-	-	7,764	6,458	-
EPS for the period (Rs)	0.5	0.8	(41.1)	3.1	2.3	34.4
Book Value	-	-	-	28	25	-
OPM (%)	16.6	20.9		17.8	19.9	
NPM (%)	5.6	12.6		10.1	11.6	
Exp. (% of Net Sl.)						
Staff Cost	56.3	54.0		54.8	49.8	
Operating Cost	27.1	25.1		27.4	30.3	

Income Statement	2005	2006	2007	2008	2009E	2010E
Revenues	3,219	5,487	8,310	12,988	17,137	20,876
<i>Growth (%)</i>	79.6	70.5	51.4	56.3	31.9	21.8
Total Expenditure	2,702	4,689	6,654	10,678	14,214	17,017
Operating Profit	517	799	1,656	2,309	2,923	3,859
<i>Growth (%)</i>	168.3	54.5	107.4	39.4	26.5	32.0
Interest & dividend income	16	8	72	349	80	100
EBIDT	533	806	1,728	2,659	3,003	3,959
(-) Interest	30	85	60	366	30	21
(-) Depreciation & Ammortisation	330	451	641	861	950	1,030
PBT & extraordinary items	173	270	1,026	1,432	2,023	2,908
(-) Tax provision	(3)	27	60	127	304	436
Net Profits	176	243	966	1,306	1,719	2,472
(-) Extraordinary Items	5	4	6	10	-	-
PAT	181	247	973	1,316	1,719	2,472
<i>Growth (%)</i>	-	37.6	298.3	35.3	31.7	43.8
Fully diluted Eq. sh. O/s (mn no)	616.0	616.0	616.0	616.0	616.0	616.0
Book Value (Rs)	10	11	20	23	41	45
Diluted EPS before Extra Ord.(Rs)	0.3	0.4	1.6	2.1	2.8	4.0

Balance Sheet	2005	2006	2007	2008	2009E	2010E
<i>Equity Share Capital</i>	2,007	2,019	4,251	4,273	6,160	6,160
<i>Preference Share Capital</i>	1976	1976	-	-	-	-
<i>Reserves & Surplus</i>	134	379	6,458	7,764	19,169	21,640
Net worth	4,117	4,373	10,709	12,037	25,329	27,800
Total Debt	1,043	1,300	1,976	11,279	204	147
Deferred Tax liability	(4)	(4)	1	1	1	1
Capital Employed	5,155	5,670	12,686	23,317	25,534	27,948
Fixed Assets	1,005	1,154	1,802	2,323	1,873	1,343
Net current assets	538	443	4,311	2,226	4,893	7,837
Investments	-	-	1,154	-	-	-
Goodwill	3,612	4,073	5,419	18,768	18,768	18,768
Total Assets	5,155	5,670	12,686	23,317	25,534	27,948

Cash Flow Statement	2005	2006	2007	2008	2009E	2010E
PBT & Extraord. items	173	270	1,026	1,432	2,023	2,908
Depreciation	330	451	641	861	950	1,030
Interest & dividend inc.	(4)	(9)	(58)	(349)	(80)	(100)
Interest paid	29	85	122	366	30	21
Tax paid	(3)	(35)	(67)	(127)	(303)	(436)
(Inc)/Dec in working capital	(129)	(403)	(74)	(498)	(433)	(552)
Other Adjustments	4.3	12	(674)	-	-	-
Cash from operations	400	370	916	1,685	2,187	2,871
Net capital expenditure	(2,545)	(660)	(2,992)	(14,730)	(500)	(500)
Net investments	11	-	(1,100)	1,153	-	-
Interest recd	2	7	45	349	80	100
Cash from investing activities	(2,532)	(653)	(4,047)	(13,228)	(420)	(400)
Issue of eq. shares	6	16	5,400	22	710	-
Preference Shares Repaid	1,619	-	-	-	-	-
Change in debt	725	252	693	9,303	(212)	(58)
Interest Paid	(29)	(85)	(122)	(366)	(30)	(21)
Cash from financing activities	2321	183	5971	8959	468	(79)
Inc/Dec. in cash	189	(99)	2,840	(2,584)	2,235	2,392

Key Ratios	2005	2006	2007	2008	2009E	2010E
EBIDT (%)	16.1	14.6	19.9	17.8	17.1	18.5
ROACE (%)	5.5	6.6	12.1	10.0	8.4	11.0
ROANW (%)	14.3	10.9	14.8	11.6	9.2	9.3
Sales/Total Assets (x)	0.6	1.0	0.7	0.6	0.7	0.7
Debt:Equity (x)	0.3	0.3	0.2	0.0	0.0	0.0
Current Ratio (x)	1.8	1.4	4.1	2.0	2.6	3.1
Debtors (days)	70.0	67.0	60.0	60.0	60.0	60.0
Inventory (days)	0.0	0.0	0.0	0.0	0.0	0.0
Net working capital (days)	31.0	18.0	57.0	51.0	48.0	49.0
EV/Sales (x)	7.9	4.7	2.7	2.7	1.3	0.9
EV/EBIDT (x)	49.2	32.3	13.7	15.4	7.6	5.1
P/E (x)	136.1	99.9	25.3	18.7	14.3	10.0
P/BV (x)	3.9	3.8	2.0	1.8	1.0	0.9

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