

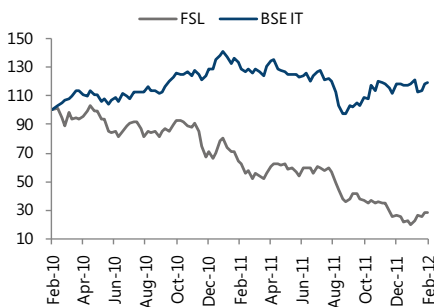
Result Update - Q3FY12

Buy

Reco	Upgraded
CMP	₹ 8.7
Target Price	₹ 11.9
Upside Potential	37%

Price Performance

52 wk Hi/Lo	22/5.5
All time Hi/Lo	93/5.5
6 mnth Average Vol	2003941
Stock Beta	1.59



Valuation

	FY11	FY12P	FY13P
P/E (x)	2.6	6.9	3.5
P/BV (x)	0.3	0.3	0.3
RONW (%)	10.2	3.9	7.3
ROCE (%)	7.1	2.6	6.1

Peer Valuation (FY13E Bloomberg)

	WNS	Genpact
PE	8.8	12.4
P/BV (x)	1.6	1.5

Equity Data

Market Cap. (₹ bln)	3.7
Face value (₹)	10
No of shares o/s (mln)	431

	Dec'10	Dec'11	Δ %
Promoters	20.24	19.86	-1.88
DFI's	3.60	2.73	-24.17
FII's	9.96	0.98	-90.16
Public	66.20	76.43	15.45

Shweta Malik

shweta.malik@msflibg.in

(+ 91 22 3094 7128)

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Firstsource Solutions Ltd.

Revenue visibility improves on new deal wins...

FSL reported better than expected sequential revenue growth of 8.3% at ₹ 5771mln led by favorable rupee. Revenue growth in CC terms was at 1% q-o-q. EBITDA however remain muted and declined by 6.9% q-o-q to ₹ 430mln on account of higher ramp up cost involved for new projects. EBITDA margin declined by 121bps q-o-q to 7.46%. Net profit declined sharply by 68% sequentially to 68mln on account of loss of 71.4mln from FCCB buyback. The cost pressures were expected to persist in medium term primarily from project ramp ups. However, going ahead revenue flow from ramp up projects will help improve operational performance of the company. Moreover, the good point was that FSL had new business wins with TCV of USD 160mln during the quarter that improves future revenue visibility which has been lacking for some quarters from now. The deals have been more vertical specific though with wins coming from telecom vertical as other verticals are slow to flat performers. Valuation for FSL looks compelling at CMP of ₹ 8.5, trading at 3.5x FY13P. We recommend buy with TP of ₹ 11.9.

Telecom, Healthcare drives the growth: Revenue growth in the quarter was led by traction in telecom and healthcare verticals. T&M vertical registered sequential growth of 15% followed by healthcare at 10.2%. BFSI remained muted and de-grew by 1.1% q-o-q. Geographically, US and UK showed good growth at 7.4% and 6.6% respectively. India led business declined by 8.6% q-o-q while revenue from ROW more than doubled compared to last quarter. Top client grew by 7.5% sequentially and top 5 at 6.2%.

Ramp up cost drives down the margin: Despite favorable currency, EBITDA margin declined by 121bps q-o-q on back of higher employee and operational expenses. This was on back of higher incremental cost from project ramp ups. Net employee addition was at 830 during the quarter with significant addition outside India at 788 resulting in increase in per employee cost. Seat fill factor came down to 75% from 78% in last quarter as a result of new additions. EBITDA margin is expected to improve as revenue flow from new projects starts to flow in as also seasonally better March quarter.

Net profit decline: Net profit in the quarter declined by 68% q-o-q to ₹ 68mln because of loss of ₹ 71.4mln from FCCB buyback. Adjusted Profit declined by 34.8%.

Outlook and Valuation: The new deal wins with TCV of USD 160mln does improves revenue visibility for FSL and is expected to improve margins provided there is not any sharp decline in other verticals primarily BFSI. At CMP of ₹ 8.7, the stock is trading at 6.9x FY12P and 3.5x FY13P earnings of ₹ 1.26 and ₹ 2.48 respectively. Due to Sharp fall in stock price and improvement in revenue visibility, we upgrade to 'Buy' with TP of ₹ 11.9 valuing at 4.8x FY13P.

Summary Financials

₹ in Mln	FY10	FY11	FY12P	FY13P
Net Sales	19708	20553	22333	24983
OPBDIT	2798	2889	1781	2605
Net Profit	1361	1439	542	1060
EPS	3.18	3.34	1.26	2.48
Networth	14244	14227	13896	14556
Debt	13578	14933	21601	13558
Fixed Assets	1838	2285	2109	1523
Net Current Assets	4248	5150	8791	2702

Exhibit 1: Q3FY12 Performance Highlights

Firstsource Solutions Ltd.

(₹ in mln)	Q3FY12	Q3FY11	% chg Y-o-Y	Q2FY12	% chg Q-o-Q
Net Sales	5771	5146	12.1	5330	8.3
Expenditure	5340	4435	20.4	4868	9.7
EBITDA	430	711	-39.5	462	-6.9
EBITDA Margin (%)	7.5	13.8	(630)bps	8.7	(120)bps
Depreciation	230	232	-0.9	225	2.0
Interest (net)	42	86	-51.3	57	-26.7
Other income	(65)	112	-157.9	51	-227.0
PBT	94	441	-78.8	261	-64.1
Tax	23	84	-72.0	47	-49.9
PAT	70	358	-80.3	214	-67.2
Net Profit	68	350	-80.4	215	-68.1
EPS	0.16	0.81	-80.5	0.50	-68.1

Q3FY12 Result Highlights

Telecom & Media to drive revenue growth

FSL reported 8.3% q-o-q growth in INR revenue led by favorable currency and traction in telecom vertical. Revenue in CC increased by 1% on sequential basis. Telecom & Media (T&M) vertical registered 15% sequential growth in revenue and Healthcare grew at 10% in INR terms. This was partially offset by BFSI which remained muted in the quarter with 1.1% decline in INR revenue. The good point in the quarter was new deal closure of TCV of USD 160mln in telecom vertical. One of the deals at USD 85mln was won from an existing customer spanning over 3 years and the other large deal provided entry into the European geography with CV of USD 65mln. The third deal was from an Australian customer with deal size of USD 12mln.

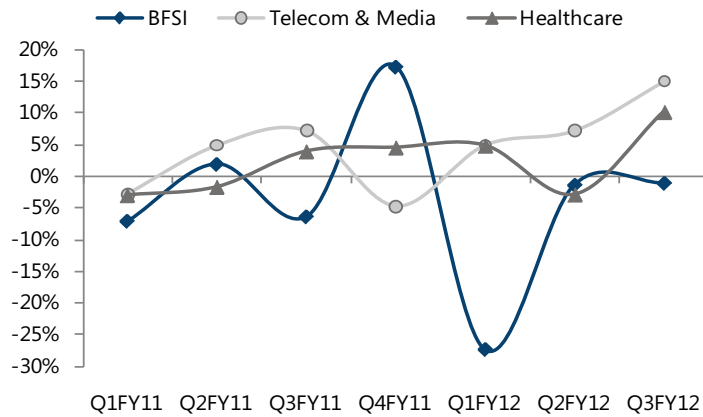
Exhibit 2: New Deal wins details

Customer	Geography	Deal size	Deal time	Delivery Location	Revenue flow
New	Europe	\$ 65mln	3 years	Onsite	Dec 2011
Existing customer	UK	\$ 85mln	3 years	Mix	Q4FY12
New	Australia	\$ 12mln	2 years	Offshore	Q3FY12

Source: Company, MSFL Research

BFSI is expected to perform good in next quarter on account of seasonality in collections business. However seasonal uptick would be lower due to low charge off rates on lower card debt resulting in volume decline on y-o-y basis. Healthcare provider segment will also witness seasonal uptick in March quarter.

Exhibit 3: Sequential growth across verticals



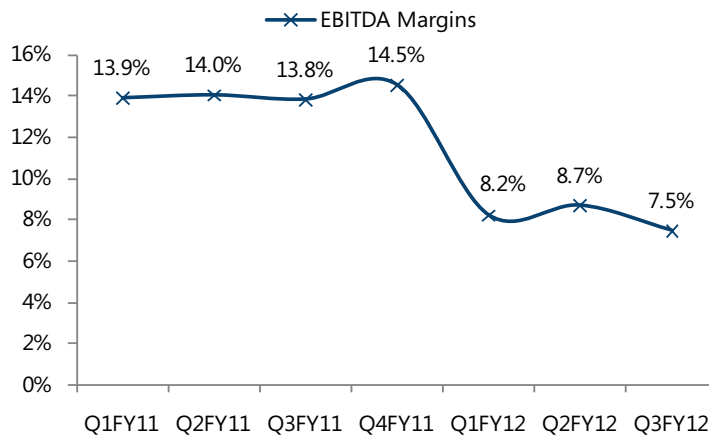
Source: Company, MSFL Research

Margin pressure from cost of growth... to start improving from Q4FY12

EBITDA margin for FSL has dropped sharply from FY11 levels because of incremental cost from ramp ups and client ramp down over H1FY12. EBITDA margin in Q3FY12 declined by another 120bps because of investments and cost of growth involved in some recent large deal wins. Company added 830 employees in the current quarter with 788 of them being added outside India. Total employee headcount stands at 30121 as on Dec 31, 2011. Since one of the new deal win is an onsite lift out deal, per employee cost escalated in the quarter.

Ramp up for USD 85mln deal from existing customer is expected to take place during Q4FY12 which will further increase the cost. However since other two deals has already gone live during Q3FY12; full quarter revenue impact of the same will be visible from Q4FY12 onwards. This in turn will help offset margin pressure from ramp ups. Also company is undertaking some cost rationalization measures which are expected to pay off beginning Q4FY12.

Exhibit 4: EBITDA Margin profile



Source: Company, MSFL Research

Total seat capacity in the quarter stood at 23587, indicating addition of 1068 seats during the quarter. Company also added 3 new delivery centers in the quarter with two in India and one in Philippines. Total number of delivery centers now stands at 48. Average seat fill factor stood at 75% decline from 78% in last quarter.

Profitability hit by FCCB buyback losses

Net profit for the company declined to ₹ 68mln from ₹ 215mln in last quarter, 68% q-o-q decline. This was on account of loss of ₹ 71.4mln on account of FCCB buyback. Company bought back USD 21.6mln FCCB during the quarter and outstanding FCCB is now down to USD 169.8mln. FCCB buyback resulted in cash outflow of ₹ 2000mln. Partial impact of FCCB buyback in Q2FY12 also flowed in Q3FY12.

Total cash balance as on Dec 31, 2011 stood at USD 130mln. Increase in unbilled revenue and lower in revenue receipts due to holiday season also impacted the operational cash flow generation.

Hedging position

Outstanding forex hedges are at USD 21.3mln, £ 39.2mln and AUD 15.4mln for USD, GBP and AUD respectively. Over 80% of cash flow of next 12 months is covered for USD at ₹ 49 level, GBP at ₹ 78 levels and AUD at ₹ 49.5 level. 30% of cash flow for next 12-24 months is covered for USD at ₹ 51 levels, GBP at ₹ 83.7 levels and AUD at ₹ 51.4 levels.

Outlook & Valuation

Revenue visibility has improved for FSL post new deal wins of TCV at USD 160mln. This is expected to recover margins going ahead which has declined sequentially and sharply starting Q1FY12. While next quarter is expected to be good because of higher revenues on account of collection seasonality as well as in Healthcare; quarters ahead needs to deliver steady revenue momentum in order to improve margins. Decline in volumes in BFSI is a concern which could result in offsetting incremental revenue gains from new projects over FY13.

At CMP of ₹ 8.7, the stock is trading at 6.9x FY12P and 3.5x FY13P earnings of ₹ 1.26 and ₹ 2.48 respectively. Since the stock price has fallen sharply, we recommend 'Buy' with TP of ₹ 11.8 valuing at 4.8x FY13P.

Financial Summary

Profit & Loss

Particulars (₹ in mln)	FY09	FY10	FY11	FY12P	FY13P
Net Sales	17494	19708	20553	22333	24983
Total Expenditure	15295	16910	17664	20552	22378
EBITDA	2198	2798	2889	1781	2605
EBITDA Margin (%)	12.6	14.2	14.1	8.0	10.4
Depreciation	961	873	891	893	904
EBIT	1237	1926	1998	888	1701
Interest	250	364	330	232	308
OPBT	987	1562	1668	656	1393
Non-Op Income	-480	136	149	8	33
Extraordinary Items	0	-95	-64	30	0
PBT	507	1603	1753	694	1426
Tax	199	238	295	147	357
PAT	308	1366	1457	547	1070
PAT Margin %	1.8	6.9	7.1	2.5	4.3
EPS	0.72	3.18	3.34	1.26	2.48
Sales Growth %	35	13	4	9	12
EBITDA Growth %	-5	27	3	-38	46
PAT Growth %	-77	344	6	-62	95

Balance Sheet

Particulars (₹ in mln)	FY09	FY10	FY11	FY12P	FY13P
Sources of Funds					
Share Capital	4282	4292	4306	4308	4308
Reserves & Surplus	9513	9948	9921	9588	10248
Networth	13794	14244	14227	13896	14556
Secured Loans	1856	2787	3347	9635	12635
Unsecured Loans	12090	10792	11586	11966	923
Total Loans	13946	13578	14933	21601	13558
Deferred Tax Liability	0	0	58	131	131
Minority Interest	55	50	1	19	29
TOTAL	27795	27872	29219	35647	28274
Application of Funds					
Net Fixed Assets	2261	1838	2285	2109	1523
Investment	18	1005	1329	699	0
Current Assets	5139	6513	8357	12782	7000
Current Liabilities	2639	2265	3207	3991	4298
Net Current Assets	2499	4248	5150	8791	2702
Goodwill	22876	20726	20454	24049	24049
Deferred Tax Asset	141	55	0	0	0
TOTAL	27795	27872	29219	35647	28274

Cash Flows

Particulars (₹ in mln)	FY09	FY10	FY11	FY12P	FY13P
Internal accruals	1269	2238	2348	1440	1973
(Inc)/Dec in Net Current Assets	(470)	553	(1,132)	540	175
Cash flow from Operations	1739	1685	3480	900	1798
Inc/(Dec) in Debt	1394	-367	543	6668	-8043
Inc/(Dec) in Equity	-2310	14	-632	-639	-641
Cash flow from Financing	-916	-353	-89	6029	-8683
Fixed Asset formation	1084	94	1193	278	318
Inc/(Dec) in Investment	-203	987	324	-631	-699
Cash flow from Investment	881	1081	1517	-352	-380
Net Change in Cash	-58	251	1874	7281	-6505

Ratio

Valuation Ratio	FY09	FY10	FY11	FY12P	FY13P
P/E	3.4	2.6	2.6	6.9	3.5
P/BV	0.5	0.3	0.3	0.3	0.3
EV/EBIDTA	8.1	5.8	6.0	10.4	6.7
EV/Sales	1.0	0.8	0.8	0.8	0.7
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0
EPS adjusted	2.5	3.4	3.3	1.26	2.48
DPS	0.0	0.0	0.0	0.0	0.0
Book Value	32.2	33.2	33.0	32.3	33.8
Adj. ROE (%)	2.2	9.6	10.2	3.9	7.3
Adj. ROCE (%)	2.7	7.1	7.1	2.6	6.1

Solvency Ratio (x)

Debt/Equity	1.0	1.0	1.0	1.6	0.9
Debt/EBIDTA	6.3	4.9	5.2	12.1	5.2

Turnover Ratio (x)

Asset Turnover	0.7	0.7	0.7	0.7	0.8
Fixed Asset Turnover	7.8	9.6	10.0	10.2	13.8
Current Ratio	1.9	2.9	2.6	3.2	1.6
Inventory (days)	-	-	-	-	-
Debtors (days)	49.6	48.3	42.4	51.7	47.7

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Key ratings:

Rating	Expected Return
Buy	> 15%
Accumulate	5 to 15%
Hold	-5 to 5%
Sell	< -5%
Not Rated	-

Marwadi Shares & Finance Limited

Institutional Business Group, MSFL

@p-sec, 306, Gresham Assurance House
 132, Mint Road, Fort, Mumbai – 400 001
 Tel : + 91 22 30947100 / 102 Fax : +91 22 2269 0478

Registered Office

Marwadi Financial Plaza, Nava Mava Main Road,
 Off 150 FT. Ring Road, Rajkot - 360 005
 Tel : + 91 281 2481313 / 3011000