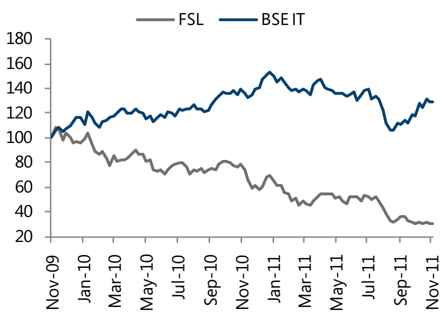
Result Update - Q2FY12

Hold

Reco	Maintained
CMP	₹ 11.2
Target Price	₹ 11.7
Upside Potential	4%

Price Performance

52 wk Hi/Lo	29/10
All time Hi/Lo	93/9
6 mnth Average Vol	2005650
Stock Beta	1.59



Valuation

	FY11	FY12P	FY13P
P/E (x)	3.4	5.0	4.3
P/BV (x)	0.3	0.3	0.3
RONW (%)	10.2	6.7	7.5
ROCE (%)	7.1	5.0	7.9

Peer Valuation (FY13E Bloomberg)

	WNS	Genpact
PE	11.3	10.5
P/BV (x)	2.0	1.0

Equity Data

Market Cap. (₹ bln)	4.8
Face value (₹)	10
No of shares o/s (mln)	431

	Sep'10	Sep'11	Δ %
Promoters	21.21	19.83	-6.51
DFI's	4.52	3.34	-26.11
FII's	8.42	8.47	0.59
Public	65.85	68.33	3.77

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Firstsource Solutions Ltd.

Revenue and cost pressure persist in medium term

FSL reported slightly better than expected result at 1.9% sequential growth against our estimates of 0.8% growth in top-line on account of momentum in ABU unit and favorable currency. Revenue grew by 0.4% in constant currency terms. EBITDA margin improvement was however lower than expected at 47 bps q-o-q to 8.7% because of softness in BFSI collection business volumes. Net profit was benefitted from forex gain of ₹ 26mln and gain of ₹ 3.8mln on FCCB buy back. Lower interest expense and higher other income also aided in better net profit at ₹ 214mln.Company bought back USD 21mln of FCB during the quarter with outstanding FCCB now at USD 191.4mln. Owing to low single digit revenue growth and business pressure from seasonality and vertical concentration, company has realigned its business structure creating distinct horizontals to increase cross selling opportunities within BFSI and T&M while Healthcare will continue to operate as a vertical unit only. Any positive impact from this alignment will only flow from H2FY13. While deal pipeline in T&M will drive revenue, pressure on BFSI and Healthcare will partially offset the same keeping revenue growth tepid.

Telecom & Media, India provided growth: T&M witnessed the strongest growth among verticals at 4.9% q-o-q followed by BFSI at 1.9%. Revenues in healthcare vertical continue to remain sluggish with 1.6% sequential decline. Among geographies India and ROW added the incremental revenues with 23% and 43% sequential growth respectively. Higher India related growth is a result of revenue flow from ramp up of telecom clients that started during Q1FY12. Revenue from top client grew by 7.3% and from top 5 clients by 7.6% q-o-q. H2FY12 is expected to be more favorable with growth from telecom client ramp ups. However, tepid business momentum in BFSI and Healthcare will offset the same partially. BFSI collection is also expected to witness lower growth in Q4FY12 compared to Q4FY11.

Margin improvement slow: Margin improved marginally by 47bps to 8.7% lower than expectation. FSL had net employee reduction of 373 (net reduction of 385 in India and addition of 12 outside India). Seat fill factor improved to 78% from 74% in Q1FY12. Margin growth from here onwards will only be gradual. Though deal addition is strong in telecom, initial phase of these deals will have lower margins along with volume pressure in BFSI and Healthcare units.

Valuation: Our FY13 EPS has increased to ₹ 2.62 from ₹ 2.48 earlier (5.6% increase) on back of change in exchange rate assumption. Increase in low cost debt raised for FCCB repayment has resulted in decrease in interest cost, the same has resulted in drop in NPV of FCF. We maintain 'Hold' with TP of ₹ 11.7 (average of 4.8xFY13P and FCF target of ₹ 10.8).

Summary Financials

₹ in Mln	FY10	FY11	FY12P	FY13P
Net Sales	19708	20553	21707	22570
OPBDIT	2798	2889	2214	2538
Net Profit	1361	1439	968	1121
EPS	3.18	3.34	2.25	2.62
Networth	14244	14227	14552	15030
Debt	13578	14933	21109	9883
Fixed Assets	1838	2285	1985	1564
Net Current Assets	4248	5150	11958	2769

Exhibit 1: Q2FY12 Performance Highlights

Firstsource Solutions Ltd.

(₹ in mln)	Q2FY12	Q2FY11	% chg Y-o-Y	Q1FY12	% chg Q-o-Q
Net Sales	**5330**	**5036**	**5.9**	**5231**	**1.9**
Expenditure	4868	4330	12.4	4802	1.4
EBITDA	**462**	**705**	**-34.5**	**429**	**7.8**
EBITDA Margin (%)	8.7	14.0	(530)bps	8.2	47bps
Depreciation	225	213	5.7	220	2.5
Interest (net)	57	86	-33.1	70	-18.4
Other income	81	9	825.2	15	454.1
PBT	**261**	**415**	**-37.2**	**154**	**69.8**
Tax	47	79	-40.9	46	1.9
PAT	**214**	**336**	**-36.3**	**108**	**98.8**
Net Profit	215	332	-35.4	106	101.6
EPS	0.50	0.77	-35.5	0.25	101.5

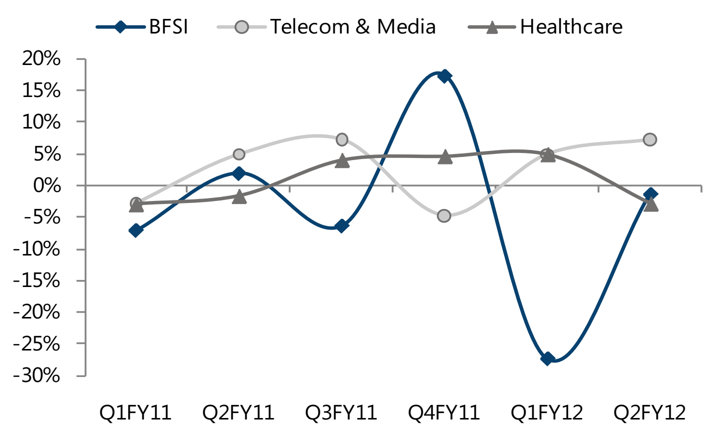
Q2FY12 Result Highlights

Telecom & Media and India aided in growth

FSL current quarter growth was mainly driven from telecom vertical. Revenue in this vertical increased by 4.9% q-o-q. This was possibly led by 7.3% q-o-q increase in revenue from its top client. Revenue from top 5 clients also increased by 7.6% q-o-q and compensating for revenue loss from ramp down of telecom client. FSL has started ramping up for telecom clients in ABU in Q1FY12 with two deal won in last quarter as it added close to 2300 employees in India (excluding Dialog) in Q1FY12. Revenue from such deals will materially start to flow from next quarter. Pipeline in telecom vertically is equally strong with two new 3 yr deals with TCV of USD 85mln expected to close in next 3 months. It has also finalized expansion with an existing customer, the incremental TCV for which stands at USD 75mln (3 yr deal) and is expected to be closed in next 3 months. However revenue impact from the same will only be visible in late H2FY13.

While telecom has started to see ramp ups, BFSI and Healthcare continues to remain tepid. BFSI with major proportion in collections will be under pressure. Healthcare also remains weak and both will hence partially offset the incremental revenue from telecom vertical.

Exhibit 2: Sequential growth across verticals



Source: Company, MSFL Research

Margin to improve gradually…

Significant ramp up during last quarter and revenue pressure has significantly diluted margins to 8.4% for H1FY12 compared to 14% for FY11. As expected margins in the current quarter improved marginally by 47 bps q-o-q and is expected to increase gradually in H2FY12 on back of better revenue traction than H1FY12 and operational levers like capacity consolidation, seat fill factor and cost rationalization. Seat fill factor improved to 78% from 74% in last quarter.

However since the new deals will be in their initial phases and will involve cost of growth, margins are expected to remain below average levels. Moreover company has decided to realign its business according to horizontals across BFSI and T&M to increase cross-sell opportunities in customer management and collections which will also incur some cost. All these will result in gradual increase in margins from here on.

Better profitability from forex gain, FCCB buyback and low interest

Net profit for the company doubled to ₹ 215mln from ₹ 106mln in last quarter, 101% q-o-q increase. Syndicated loan raised during the quarter for repayment of FCCB has resulted in better cash & investment position earning higher interest income and other income and hence lower net interest (lower interest on loan raised). This will benefit going forward as well till FCCB redemption takes place during Dec 2012.

Total cash balance as on June 30, 2011 stood at USD 184mln compared to USD 87mln in last quarter. Company bought back USD 21mln of FCCB during the quarter and outstanding FCCB now stands at 191.4mln.

Outlook & Valuation

Slow revenue growth and higher seasonality impact along with significant increase in ramp up cost in last quarter has resulted in lower profitability over H1FY12. However H2FY12 will be better in terms of revenue growth on account of revenue flow from ramp up deals. Margins improvement will however remain slow because of initial phase of these deals, realignment cost and volume pressure in BFSI and Healthcare.

Our FY13 EPS is increased to ₹ 2.62 from ₹ 2.48 earlier (5.6% increase) on back of change in exchange rate assumption and lower interest cost. Increase in low cost debt raised for FCCB repayment has resulted in decrease in interest cost, the same has resulted in drop in NPV of FCF. We maintain 'Hold' with TP of ₹ 11.7 (average of 4.8xFY13P and FCF target of ₹ 10.8).

Financial Summary

Profit & Loss

Particulars (₹ in mln)	FY09	FY10	FY11	FY12P	FY13P
Net Sales	**17494**	**19708**	**20553**	**21707**	**22570**
Total Expenditure	15295	16910	17664	19493	20032
EBITDA	**2198**	**2798**	**2889**	**2214**	**2538**
EBITDA Margin (%)	12.6	14.2	14.1	10.2	11.2
Depreciation	961	873	891	884	901
EBIT	1237	1926	1998	1331	1636
Interest	250	364	330	267	287
OPBT	987	1562	1668	1064	1349
Non-Op Income	-480	136	149	151	158
Extraordinary Items	0	-95	-64	30	0
PBT	**507**	**1603**	**1753**	**1245**	**1507**
Tax	199	238	295	272	377
PAT	**308**	**1366**	**1457**	**973**	**1130**
PAT Margin %	1.8	6.9	7.1	4.5	5.0
EPS	0.72	3.18	3.34	2.25	2.62
Sales Growth %	43	11	4	10	3
EBITDA Growth %	-5	27	3	-23	15
PAT Growth %	-76	343	7	-33	16

Balance Sheet

Particulars (₹ in mln)	FY09	FY10	FY11	FY12P	FY13P
Sources of Funds					
Share Capital	4282	4292	4306	4306	4306
Reserves & Surplus	9513	9948	9921	10246	10724
Networth	**13794**	**14244**	**14227**	**14552**	**15030**
Secured Loans	1856	2787	3347	8867	9367
Unsecured Loans	12090	10792	11586	12243	516
Total Loans	**13946**	**13578**	**14933**	**21109**	**9883**
Deferred Tax Liability	0	0	58	58	58
Minority Interest	55	50	1	7	16
TOTAL	**27795**	**27872**	**29219**	**35726**	**24987**
Application of Funds					
Net Fixed Assets	**2261**	**1838**	**2285**	**1985**	**1564**
Investment	18	1005	1329	1329	200
Current Assets	5139	6513	8357	15149	6087
Current Liabilities	2639	2265	3207	3191	3318
Net Current Assets	**2499**	**4248**	**5150**	**11958**	**2769**
Goodwill	22876	20726	20454	20454	20454
Deferred Tax Asset	141	55	0	0	0
TOTAL	**27795**	**27872**	**29219**	**35726**	**24987**

Cash Flows

Particulars (₹ in mln)	FY09	FY10	FY11	FY12P	FY13P
Internal accruals	1269	2238	2348	1857	2032
(Inc)/Dec in Net Current Assets	(470)	553	(1,132)	186	83
Cash flow from Operations	**1739**	**1685**	**3480**	**1671**	**1949**
Inc/(Dec) in Debt	1394	-367	543	6177	-11227
Inc/(Dec) in Equity	-2310	14	-632	-643	-643
Cash flow from Financing	**-916**	**-353**	**-89**	**5534**	**-11870**
Fixed Asset formation	1084	94	1193	583	480
Inc/(Dec) in Investment	-203	987	324	0	-1129
Cash flow from Investment	**881**	**1081**	**1517**	**583**	**-649**
Net Change in Cash	**-58**	**251**	**1874**	**6622**	**-9272**

Ratio

Valuation Ratio	FY09	FY10	FY11	FY12P	FY13P
P/E	4.4	3.3	3.4	5.0	4.3
P/BV	0.6	0.3	0.3	0.3	0.3
EV/EBIDTA	8.5	6.2	6.4	6.7	5.5
EV/Sales	1.1	0.9	0.9	0.7	0.6
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0
EPS adjusted	2.5	3.4	3.3	2.25	2.62
DPS	0.0	0.0	0.0	0.0	0.0
Book Value	32.2	33.2	33.0	33.8	34.9
Adj. ROE (%)	2.2	9.6	10.2	6.7	7.5
Adj. ROCE (%)	2.7	7.1	7.1	4.2	7.2
Solvency Ratio (x)					
Debt/Equity	1.0	1.0	1.0	1.5	0.7
Debt/EBIDTA	6.3	4.9	5.2	9.5	3.9
Turnover Ratio (x)					
Asset Turnover	0.7	0.7	0.7	0.7	0.7
Fixed Asset Turnover	7.8	9.6	10.0	10.2	12.7
Current Ratio	1.9	2.9	2.6	4.7	1.8
Inventory (days)	-	-	-	-	-
Debtors (days)	49.6	48.3	42.4	45.0	45.0

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Key ratings:

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

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