

DATE: 29/07/2016

SECTOR: COMPUTERS –
SOFTWARE MEDIUM & SMALL

Financial Snapshot:

The company has reported decent Q1FY17 earnings wherein the operating performance was much better than what is actually expected, although the bottom-line was lower due to higher tax rate. Revenues from operations had a growth of 2.3% QoQ which stood at 893.5 crore. Constant currency revenues grew 3.3% QoQ. EBITDA margins of the company have stood at 13.3%. The reported PAT stood at 73.4 crore which is mainly on account of higher tax expense.

The company's revenues grew by 2.3% QoQ, which is led by consolidation of ISGN BPO acquisition. With this acquisition, FSL's revenues are broadly equally distributed among BFSI (32% vs. 25% in Q4FY16), Telecom & Media (33% vs. 36% in Q4FY16) and Healthcare (35% vs. 38% in Q4FY16). In terms of guidance, the company reiterated its revenues of 10-12% and margin improvement guidance of 50-90 bps with an upward bias. Keeping in mind the performance we anticipate that FSL's revenues will grow at CAGR of 14.8% which will stand 4254.4 crore with average EBITDA margin of 13.4% in FY16-18E.

ISGN Acquisition Completed, Revenues may be better than Expectations:

ISGN BPO business has been acquired completely for a total consideration of USD 13mn. The revenue contribution from this acquisition stood at USD 9.7mn for QTR IFY17. The management is expecting EBITDA margin from the acquisition for the company to be largely in line with the company's EBITDA margin. The management have built in revenues of 235 crore in FY17E and 258 crore in FY18E from the ISGN acquisition.

SKY UK: Ten Years Strategic Partnership Intend:

In July, 2016, the company has announced that FSL UK, a wholly owned subsidiary of FSL, has signed a letter of intent with Sky UK for a new 10 year strategic partnership. SKY UK has decided to make FS UK their single preferred partner for their core TV and broadband services across their estate. The contract signing is expected in August, 2016. The transition of employees is expected in two phases. In the first phase, 200 employees will be transitioned from September, 2016 while the remaining 800-900 employees will be transitioned in phase II in March, 2017. The deal is expected to contribute USD 10-12mn in FY17E and USD 40mn in FY18E. The EBITDA margin is expected to be largely in line with the company's EBITDA margin of 13-13.5%.

Stock Summary:

Particular	
CMP	46.55
Target Price	54
Potential Upside	16%
O/S No of Shares	67.48
Market Cap.	3192.25
Equity Cap.	673.32
52 Week High	54.65
52 Week Low	24.20
Face Value	10
NSE Code	FSL
BSE Code	532809

Share Holding Pattern:

Particular	Mar-16
Promoters	55.54%
Public (FIIs+DIIs)	44.46%
Others	0%
Total	100%

Stock Performance:



Valuation & Outlook:

We estimate FSL will report revenue, PAT CAGR of 14.8%, 18.9% in FY16-18E (average 13.2% EBITDA margins in FY17-18E), vs. 9.5%-14% reported in FY11-16 (average 11.3%) as ISGN acquisition. The SKY deal would contribute significantly in revenues and bottom-line growth. Looking to the performance & financial results we are providing a target price of INR 54. We value the stock on FY18E applying EV/EBITDA multiple of 6x largely in line with its FY11-16 average multiple of 5.7x. Our target price implies 10x FY18E EPS.

Key Financials:

Particular (INR Cr.)	FY15	FY16	FY17E	FY18E
Net Sales	3,035	3,230	3,753	4,254
EBITDA	381	405	499	574
Net Profit	234	265	334	374
EPS	3.5	4.0	5.0	5.6

Valuation Summary:

Particular	FY15	FY16	FY17E	FY18E
P/E	13.7	12.2	9.7	8.6
Target P/E	15.3	13.6	10.8	9.7
EV / EBITDA	10.3	9.4	7.1	5.6
P/BV	1.5	1.5	1.4	1.2
RoNW (%)	11.2	12.7	14.2	13.9
RoCE (%)	8.3	10.3	12.5	14.6

Quarterly Performance:

Particular	Q1FY17	Q1FY16	YoY (%)	Q4FY16	QoQ (%)
Revenue	875	738	18.5	856	2.2
EBITDA	101	81	24.4	99	1.7
EBITDA (%)	11.5	11.0	54 bps	11.6	-8 bps
PAT	73	56	30.1	80	(7.8)

Valuation Snapshot:

Particular	Sales	Growth	EPS	Growth	PE	EV/EBITDA	RoNW	RoCE
	(cr)	(%)	(x)	(%)	(x)	(x)	(%)	(%)
FY15	3,127	10.0	2.9	0.2	16.5	11.4	11.3	0.0
FY16	3,035	(3.0)	3.5	20.5	13.7	10.3	11.2	8.3
FY17E	3,230	6.4	4.0	11.9	12.2	9.4	12.7	10.3
FY18E	3,753	16.2	5.0	25.9	9.7	7.1	14.2	12.5

Performance Analysis:

Expected Growth in Revenue CAGR 14.8% during FY16-18E:

FSL completed the acquisition of ISGN in Q1FY17 and has a profit contribution which is more than the expectations of the company. Consequently, there will be increase in revenue contribution leading to an upward shift in FY17E estimate. Over 700 employees from ISGN's BPO division is in the US. India will become a part of First source through this acquisition. With this acquisition:

- 1) FSL will have a penetration into the growing US mortgage BPO market,
- 2) FSL will strengthens its banking, financial services and insurance (BFSI) portfolio, and
- 3) Will offers significant potential cross-selling opportunities to ISGN's marquee customers.

FSL's revenues during the quarter grew 2.3% QoQ which is led by consolidation of ISGN BPO acquisition followed by continued growth in BFSI (30.9% vs. 16.6% QoQ). FSL's management highlighted that profit contribution from ISGN has been robust. It is more than what the management had anticipated. As per the management, deals worth USD 20mn were added in the pipeline, which will be reflected, going forward. Also, in the CM business, the company added a couple of big logos in UK. Looking on these points and performance we anticipate FY17E revenue estimate to 3753 crore (16.2% YoY growth against 3,230 crore and 6.4% growth earlier) led by ISGN acquisition and SKY deal.

SKY Deal to have an Add on Benefit:

In July, 2016, FSL announced that its wholly owned subsidy FSL UK, has signed a letter of intent with Sky UK for a new 10 year strategic partnership. Sky UK has decided to make FS UK their single preferred partner for their core TV and broadband services across their estate. The transition of employees is expected in two phases where 200 employees will be transitioned from September, 2016 and remaining 800-900 employees will be transitioned in phase II in March, 2017. The deal is expected to contribute incremental revenue of USD 10-12mn in FY17E and USD 40mn in FY18E. The EBITDA margin is expected to be largely in line with the company's EBITDA margin of 13-13.5%. as per management the impact of Sky contracts will be observed in the next year.

Repayment of Debt is on the Track:

As on Q1FY17 end, FSL had net long term debt of around USD 97mn. At the current repayment rate, FSL would repay around USD 33mn of its debt in FY17E and could result in a net debt of around USD 65mn assuming current cash levels and no accelerated payments.

Revenue De-growth of top 2-5 players:

Top customer increased 1.7% QoQ as against -4.2%in Q4FY16, 4.1% in Q3FY16, 16.2% in Q2FY16, -5.8%in Q1FY16, -7.9%in Q4FY15 and -8.1%in Q3 FY15 respectively. Noticeably, revenues grew 18% YoY, in previous four quarters (9.2% in Q4FY16, 5.0% in Q3FY16, -7.3%in Q2FY16, -16% in Q1FY16) and aided company average. Top 2-5 customer revenues de-grew 17.4% YoY (vs. 42.3% YoY) and declined 14.2% QoQ (vs. 11.4% in Q4FY16, 15.3% in Q3FY16, 6.5% in Q2FY16 and 4.0% in Q1FY16 respectively) and are higher compared to 9.4% YoY CAGR achieved during FY10-15. Though the recovery in top clients vs. uneven earlier (led by client specific ramp-downs) bodes well for company average growth, refilling lost revenues from a large US based telecom. That said, ISGN acquisition and SKY deal could help replenish the same.

Financial Statement:
Income Statement:

Particular (INR Cr.)	FY15	FY16	FY17E	FY18E
Total Revenues	3,035	3,230	3,753	4,254
Growth (%)	(2.3)	6.4	16.2	13.3
Employee expenses	2,018	2,172	2,504	2,829
Other Expenses	636	653	751	851
EBITDA	381	405	499	574
Growth (%)	5.1	6.3	23.2	15.1
Depreciation & Amortization	72	66	83	106
Other Income	2	-	9	9
Interest	67	43	25	25
PBT before Exceptional Items	244	296	400	452
Growth (%)	20.0	21.2	35.3	12.9
Tax	10	30	66	77
PAT before Exceptional Items	234	265	334	375
Exceptional items	-	-	-	-
PAT before MI	234	265	334	375
Minority Int & Pft. from associates	0	0	0	0
PAT	234	265	334	374
Growth (%)	21.4	13.1	25.9	12.3
EPS	3.5	4.0	5.0	5.6
EPS (Growth %)	21.4	13.1	25.9	12.3

Balance Sheet:

Particular (INR Cr.)	FY15	FY16	FY17E	FY18E
Equity	666	666	666	666
Reserves & Surplus	1,422	1,687	2,021	2,395
Networth	2,089	2,354	2,687	3,062
Minority Interest	2	2	2	2
LT liabilities & provisions	467	479	279	79
Source of funds	2,557	2,834	2,967	3,142
Net fixed assets	119	168	160	134
Goodwill	2,334	2,334	2,334	2,334
Other noncurrent assets	336	360	360	360
Loans and advances	29	-	2	2
Current Investments	68	68	68	68
Debtors	289	295	319	344
Cash & Cash equivalents	80	176	243	352
Other current assets	278	283	302	326
Short term borrowings	316	153	83	13
Trade payables	93	98	106	115
Current liabilities	447	476	507	526
Provisions	14	16	17	19
Application of funds	2,557	2,834	2,967	3,142

Cashflow Statement:

Particular (INR Cr.)	FY15	FY16	FY17E	FY18E
Profit before Tax	244	296	400	452
Depreciation & Amortization	72	66	83	106
WC changes	(105)	31	(5)	(22)
Other non cash adju.	86	43	16	16
CF from operations	246	405	428	475
Capital expenditure	(46)	(115)	(75)	(80)
in investments	(62)	-	-	
Other investing cash flow	4	-	9	9
CF from investing Activities	(104)	(115)	(66)	(71)
Issue of equity	11	-	-	
in debt funds	(213)	(151)	(270)	(270)
Dividends paid	-	-	-	
Other financing cash flow	(44)	(43)	(25)	(25)
CF from Financial Activities	(246)	(194)	(295)	(295)
in cash and cash bank balance	(105)	96	67	109
Effect of exchange rate changes	-	-	-	
Opening cash	185	80	176	243
Closing cash	80	176	243	352

Key Ratios:

Particular	FY15	FY16	FY17E	FY18E
Per share data				
EPS-diluted	3.5	4.0	5.0	5.6
Cash per share	2.8	1.2	2.6	3.6
BV	31.5	31.1	35.1	40.1
Operating Ratios (%)				
EBITDA Margin	12.5	12.5	13.3	13.5
PBT Margin	8.0	9.2	10.7	10.6
PAT Margin	7.7	8.2	8.9	8.8
Return Ratios (%)				
RoNW	11.2	12.7	14.2	13.9
RoCE	8.3	10.3	12.5	14.6
Valuation Ratios (x)				
P/E	13.7	12.2	9.7	8.6
EV / EBITDA	10.3	9.4	7.1	5.6
Price to Book Value	1.5	1.5	1.4	1.2
EV / Net Sales	1.3	1.2	0.9	0.8
Mcap / Net Sales	1.1	1.0	0.9	0.8
Turnover Ratios				
Debtor days	36	33	29	27
Creditors days	14	11	10	9
Solvency Ratios				
Total Debt / Equity	0.4	0.3	0.2	0.1
Current Ratio	0.9	1.1	1.0	1.0
Quick Ratio	0.9	1.1	1.0	1.0
Debt / EBITDA	2.4	1.8	1.2	0.5

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