

June 12, 2023

Innovsource Services Private Limited: Long-term rating upgraded; short term rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term/ short-term – Fund based working capital	95.00	95.00	[ICRA]A+ (Stable) upgraded from [ICRA]A (Stable); [ICRA]A1 reaffirmed
Total	95.00	95.00	

*Instrument details are provided in Annexure-I

Rationale

While arriving at the ratings of Innovsource Services Private Limited (ISPL), ICRA has taken the consolidated financial of First Meridian Business Limited (First Meridian or the Group; the group holding company of ISPL), which includes its subsidiaries, given their common management, significant operational and financial linkages.

The long-term rating upgrade factors in the strengthening of ISPL's credit profile, marked by steady revenue growth, improvement in operating margins, comfortable capital structure, and strong liquidity position (unencumbered cash/ deposits/ liquid investments of ~Rs. 253.2 crore as on March 31, 2023). In FY2023, the Group recorded revenue growth of ~26%, supported by growth across the general staffing business and global technology solution (GTS). This, coupled with investments made by the Group in the last two fiscals to acquire entities in the IT staffing business, has led to an increase in revenue share from the GTS segment (11.3% in FY2023 from 8.3% in FY2022), resulting in improvement in operating margins (3.1% in FY2023 versus 1.7% in FY2021). The margins in IT staffing (~14-16%) are significantly higher than the general staffing business (~1.7 to 2.0%). Moreover, the Group's net debt-free status, coupled with healthy internal accrual generation, has continued to result in strong debt protection metrics. ICRA notes that the Group has filed DRHP¹ for its planned IPO², as it plans to raise Rs. 50 crore through fresh issue, and its existing promoters have also planned an offer for sale of Rs. 690 crore.

ICRA expects the Group to sustain its revenue growth and margins in the near to medium term, while maintaining the strong credit metrics, supported by overall growth in the Indian economy leading to an increase in employment levels, especially in the organised markets, coupled with the company's inorganic growth plans. The ratings also continue to factor in the Group's established brand equity, strong market share as the third-largest domestic player in the fragmented staffing industry, and its established & diversified client base of reputed companies across industries. The end-user industries include telecom, BFSI, infrastructure, e-commerce, etc.

However, its ratings remain constrained by the inherently low profit margins and high attrition in the general staffing segment, which contributes ~89% to the Group's total revenues at present. The ratings remain constrained by the intense competition in the fragmented manpower outsourcing industry as a major portion is provided by the unorganised sector, leading to weaker pricing flexibility. However, the increasing compliances toward regulatory requirement has led companies to move towards the organised sector, which provides better revenue visibility. ICRA has also taken note of the risks arising out of the expected planned acquisition by the Group and the expected cash outflow to fund those acquisitions. ICRA notes that some other leading industry participants have received notices from the income tax (IT) department towards disallowance of benefits under section 80JJAA of the IT Act, 1961. While the Group or any of its subsidiaries have not received any notices from the IT

¹ Draft Red Herring Prospectus

² Initial public offering

department pertaining to the same, any future action from the department towards disallowance of benefits under this section for the Group or across industry, will remain a key monitorable.

The Stable outlook on the rating reflects ICRA's opinion that the company and Group will maintain its strong credit profile and liquidity position, supported by healthy internal accrual generation and continued net debt-free status.

Key rating drivers and their description

Credit strengths

Established presence and strong market share in staffing business – The First Meridian Group is the third-largest player with market share of 1.7%³ in the fragmented domestic staffing industry, supported by a strong brand equity and increasing formalisation of the industry. Through various acquisitions, the Group has built a strong presence in general staffing and IT staffing, with a total associate strength of 1,20,772 as on March 31, 2022. The Group has a pan-India presence with over 50 branch offices for sourcing and recruitment in 75 cities. Going forward, a steady growth in the employee base, increased focus toward the more margin-accretive IT and professional/industrial staffing and steady demand outlook are expected to support the Group's revenue growth and margin expansion.

Diversified and established client base – The Group has a diversified geographical footprint with its client base consisting of top multinational firms from diversified industries such as telecom, BFSI, infrastructure and e-commerce, etc. As on September 30, 2022, it serves over 1,261 clients across industries in the domestic market. Under the general staffing segment, the Group adopts the collect-and-pay model (for ~60% of its billing) for most of its customers, wherein the salaries of the associate employees deployed to its customers are collected in advance and then paid to the associate employees. In the event where credit period is allowed to customers, the Group has an understanding with most of its customers that it will not do funding for the second month. This reduces the risk of bad debts and lowers the Group's working capital requirements.

Healthy financial profile of the Group – The Group reported healthy revenue growth of 26% YoY in FY2023, supported by growth across both the general staffing (22% YoY) and GTS segments (68% YoY). The GTS segment growth is supported by a lower revenue base, the management's focus to increase high-margin IT staffing business and consolidation of Rlabs for full fiscal (acquired in February 2022). ICRA expects healthy revenue growth in the medium term, supported by steady requirement for staffing across various sectors and other inorganic acquisitions. ICRA notes the growth in the ITS staffing to remain muted in the near term owing to lower hiring in the IT segments. The Group's capital structure and coverage metrics remain healthy, supported by no external long-term debt and strong net worth of ~Rs. 491 crore as on March 31, 2023. ICRA expects the overall financial profile to remain comfortable with healthy revenue growth, stable cash flow generation and no material increase in its leverage levels.

Credit challenges

Inherently thin operating margin in general staffing business – The Group's operating margins are inherently thin (3.1% in FY2022) due to the high share of revenues from the general staffing segment (87.3% of revenue), wherein the Group mainly adopts cost-plus mark-up model for pricing its customers. The mark-up is usually around 4-5% on the employee cost or on a per-employee basis. Due to low mark-up in the general staffing industry, players generally have a low gross margin of about 4-5% and operating margin of 1.5-2%. Further, competitive intensity limits pricing flexibility in the general staffing business. However, the margins are considerably higher in the specialised staffing segments like IT staffing, which generates about 11% of the Group's revenue.

³ Source: DRHP of First Meridian

Intense competition in the fragmented manpower outsourcing industry and high attrition risks – The staffing industry is a fragmented market, where the top-five players combinedly have a market share of 12% and includes a lot of unorganised players, who offer services at low prices. Consequently, competitive pressures continue to limit the Group’s pricing power and scope for margin expansion in these segments. However, with increasing focus on compliance and the expected streamlining of labour codes, the organised sector is likely to improve its market share, going forward. This should further support the growth of the Group, which is the third-largest organised player in the staffing industry. Inherent to the industry, the Group witness’s high employee attrition owing to low skill/entry level and the temporary nature of the jobs.

Liquidity position: Strong

The Group is expected to generate cash flow from operations (FFOs) of Rs. 90-100 crore in FY2024, supported by healthy cash accruals. The Group’s liquidity position is strong, supported by healthy cash and cash equivalent of Rs. 253.4 crore as on March 31, 2023, and no long-term debt repayment liability. ISPL’s working capital utilisation levels were low, at an average of ~9% during the 12 months ended March 31, 2023; however, the utilisation typically increases by mid-month for paying associate salaries under cost-and-pay model, which moderate the liquidity buffers to an extent, though continues to be strong.

Rating sensitivities

Positive factors – The ratings could be upgraded, if the company demonstrates healthy revenue growth led by diversification in its business profile with improvement in margins on a sustained basis, while maintaining healthy credit metrics and liquidity position.

Negative factors – Pressure on the ratings could arise, if there is any significant contraction in revenues and margins or any debt-funded acquisition that could lead to deterioration in its liquidity and debt protection metrics, on a sustained basis. Specific credit metrics that could lead to a rating downgrade include Net Debt/OPBITDA of more than 1.5 times, on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Approach- Consolidation
Parent/Group support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of First Meridian Business Private Limited. As on March 31, 2022, the Group had five subsidiaries and one stepdown subsidiary, which are listed in Annexure II

About the company

First Meridian Business Services Limited was formed on February 20, 2018, backed by the three PE investors, Samara Capital, Janchor Partners Pan-Asian Master Fund (Hong Kong), and Emerald Strategic Holdings PTE. The Group is the holding company of the five subsidiaries and one step-down subsidiary.

The Group provides wide range of services comprising:

- **General staffing and allied services:** contract staffing solutions, workforce automation solutions and trade marketing solutions
- **Global technology solutions (IT staffing):** short and long-term technology contract staffing solutions

- **Other HR services:** permanent recruitment, recruitment process outsourcing, pharmaceutical and healthcare staffing and facility management

ISPL was incorporated in March 2016 and acquired by First Meridian in June 2018. The company is mainly engaged in providing general staffing services. General staffing is primarily manpower outsourcing on a skill requirement basis or project completion basis for a limited period.

Key financial indicators (audited)

First Meridian Business- Consolidated	FY2021	FY2022	FY2023*
Operating income	2,110	2,862	3,612.3
PAT	-33.7	34.1	81.4
OPBDIT/OI	1.7%	2.1%	3.1%
PAT/OI	-1.6%	1.2%	2.3%
Total outside liabilities/Tangible net worth (times)	1.7	1.5	1.2
Total debt/OPBDIT (times)	0.9	1.5	0.7
Interest coverage (times)	12.3	14.5	15.9

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amounts in Rs. crore * provisional

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current rating (FY2024)		Chronology of rating history for the past 3 years				
		Amount rated (Rs. crore)	Amount outstanding as of Mar 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	
				Jun 12, 2023	Jun 23, 2022	Apr 08, 2021	-	
1	Fund based working capital facilities*	Long-term and short-term	80.0	-	[ICRA]A+ (Stable)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1	-
2	Fund based working capital facilities	Long-term and short-term	15.0	--	[ICRA]A+ (Stable)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1	-

*Co-borrower includes Affluent Global Services Private Limited, V5 Global Services Private Limited and CBSI India Private Limited

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term/ Short -term – Fund-based working capital facilities	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: [Click Here](#)

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Working Capital	NA	NA	NA	95.0	[ICRA]A+ (Stable)/[ICRA]A1

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure II: List of entities considered for consolidated analysis

Company Name	First Meridian Ownership	Consolidation Approach
Innovsource Services Private Limited	100.0% (Rated entity)	Full Consolidation
Innovsource Facilities Private Limited	100.0%	Full Consolidation
V5 Global Services Private Limited	100.0%	Full Consolidation
Affluent Global Services Private Limited	100.0%	Full Consolidation
CBSI India Limited	100.0%	Full Consolidation
Rlabs Business systems Private Limited	100.0%	Full Consolidation

Source: Company data

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About ICRA Limited:

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Branches



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