Q3 FY2021 Earnings Call Transcript - February 10, 2021

CORPORATE PARTICIPANTS

Mr. Vipul Khanna - Managing Director & Chief Executive Officer

Mr. Dinesh Jain - President and Chief Financial Officer

Mr. Ankur Maheshwari - Head Investor Relations

Moderator: Ladies and gentlemen, good day and welcome to the Firstsource Solutions Limited Q3 FY21 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal for an operator by pressing "*" and then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Ankur Maheshwari from Firstsource Solutions Limited. Thank you and over to you, sir.

Ankur Maheshwari: Thanks, Zaid. Welcome, everyone. And thank you for joining us for the quarter ended December 31st, 2020, earnings call for Firstsource.

To take us through the results and to answer your queries, we have with us today, Mr. Vipul Khanna – our MD and CEO; and Mr. Dinesh Jain – our CFO. We will be starting this call with a brief presentation providing an overview of the company's performance followed by Q&A session.

Do note that the results, the fact sheet, and the presentation have been e-mailed to you, and you can also view them on our website www.firstsource.com. Before we begin the call, please note that some of the matters we will discuss on this call, including our business outlook, are forward-looking, and as such are subject to known and unknown risks. These uncertainties and risks are included, but not limited to, what we have mentioned in our prospectus filed with SEBI, and subsequent annual reports that are available on our website.

With that said, I will now turn the call over to Mr. Vipul Khanna to begin the proceedings.

Vipul Khanna: Thank you Ankur. Good morning, everyone from a cold San Francisco evening. Thank you for joining us today. I hope everyone continues to keep good health as we enter hopefully the home stretch of this long COVID fight.

Let me start by giving a quick overview of our Q3 performance. We had another strong quarter with revenue growth better than expectations. Revenue grew 23.8% year-on-year in constant currency, 29.6% in rupees, and came in at Rs. 13,652 million or $184.8 million. Adjusting for the acquisition of PatientMatters, organic growth in constant currency was 22.9% year-on-year. I will discuss the importance of this acquisition in a few minutes. The EPS for third quarter came in at Rs. 1.72 per share compared to Rs. 1.29 per share last year for the same period.

The demand environment has been good, and our teams have stepped up to execute strongly to take advantage of it. Revenue growth in CMT segment was driven by strong demand from existing clients and ramp-up of recent wins. Incidentally, this segment grew the most sequentially.

BFS witnessed continued demand, particularly in our mortgage unit, and our U.K. retail banking business also saw a sequential recovery. In healthcare, especially in Health Plan and healthcare services segment, recent wins fuelled the sequential growth in revenues.

Sales momentum continued. We added 18 new clients this quarter, taking the tally to 43 new clients year-to-date. This does not include the clients added through the acquisition of PatientMatters.

Our intelligent automation practice is making meaningful strides across verticals, including a significant win in the born digital segment. Overall, I am pleased with the way our overall strategy is playing out and the execution rhythm of our organization. Despite the logistical challenge of a distributed operation, the team is doing a phenomenal job in ensuring both clients and employee satisfaction while delivering strong growth.

In the past, I have spoken of the 3 tenets of our ambition to build sustainable, high-quality growth platform. These 3 tenets are:

1. For the 3 core industries we serve, sharp focus on specific segments where we have or can attain market leadership.
2. Modernizing our offering, underpinning them with our Digital First Digital Now approach.
3. A scalable and an agile organization with the right leadership and skills to drive our growth and vision.

We are making good progress against each of these three dimensions. Let me give you a few additional data points on that. In the last 12 to 18 months, I have spoken about our aspiration of expanding into the new age sector and amongst the born digital companies. In the last 9 months, we have added 9 new clients, which are in the fintech or the tech industry. At the same time, we are solidifying our domain expertise in our chosen segments. The addition of PatientMatters in our portfolio not only enhances our scale in the health care industry but also provides niche platform-based capabilities.

Second, our digital office, as we call it, has turned one last week. In these last 12 months, we have retooled most of our existing capabilities, making them more agile and market ready. The solution for almost all deals that we compete for now, leverage our new tools and platforms. And I will talk a little bit more when we discuss the segment results.

The third key element is to scale our organization. In the last three quarters, we added nearly 5,300 people organically. This already exceeds the net addition of any fiscal year in the history of the company. And what's exciting is that we were able to pull this off remotely. I am very impressed by the energy, focus and collaboration across our teams globally to make this possible.

Let me talk a little bit about the PatientMatters acquisition. As we have said in the previous quarters, we are pursuing a systematic inorganic growth strategy for growth adjacencies to our existing offerings. During this quarter, we completed the acquisition of PatientMatters. PatientMatters is a national revenue cycle service Provider that provides 2 services; patient advocacy services and a front-end Revenue Cycle Management SaaS platform to address patient responsibility and self-pay segments. This acquisition complements Firstsource's Provider business on 2 dimensions. One, it strengthens our geographic presence in large markets like Texas and New York. And two, it adds new capabilities of pre-authorization and patient bill estimation at the front-end of the RCM cycle, strengthening our core offerings of self-payments and uncompensated care. This acquisition cost us $13 million, 100% funded in cash and the integration process is underway. We are focused on growth synergies as we prepare for the hospitals and the physician segment to return to normalcy. We have consolidated our healthcare Provider brands, MedAssist and PatientMatters under the Firstsource Provider business to reflect the close alignment with our core brand and leveraging our position as a global BPM leader.

Let me now move into our key industry performances -

Our Banking and Financial Services segment grew 56.5% year-on-year, 49.9% in constant currency terms. Growth was driven by volume recovery in U.K. Retail Banking and continued volume and business growth in Mortgage. Collections had a somewhat softer quarter due to seasonality. In this quarter, we added 10 new clients, including one fintech. The deal momentum continues to remain quite strong amongst both new and existing clients. Digital collections product continues to gain market share.

The Mortgage industry continues to benefit from a low interest rate environment. And even today, a large portion of existing mortgages would benefit from refinancing. New home sales are at record high, driven by people moving, low interest rates and higher disposable surplus with consumers. If interest rates remain low, as widely expected, mortgage volume should stay strong. We continue to focus on building the mortgaging services portfolio and are witnessing good momentum of new wins here. This helps diversify the overall mortgage portfolio. Volumes are recovering in the U.K. retail banking sector. We are seeing good traction with our existing customers and a healthy pipeline as U.K. banks gear up for post-Brexit and a post-pandemic economic environment. Overall, trends for this segment look positive.

Healthcare increased 0.8% year-on-year while declining 3% in constant currency. Organically, the segment declined 2% year-on-year and 5.7% in constant currency. Volumes for this industry remain flat or lower than last year as U.S. deals with the second wave of COVID-19, and more states are grappling with a higher Medicaid cost load. Despite these trends, we are encouraged by the progress in our portfolio. We have been systematically enhancing and productizing our go-to-market offerings over this past year, and this is being received positively in the market.

Health Plan and Healthcare Services has shown good momentum with a strong pipeline and a number of strategic deal wins. In the third quarter, we won a 5-year deal to manage digital intake of claims, etc., for a top 5 Health Plan in the U.S. We continue to make steady inroads in the telehealth market, adding one new client this quarter.

In the Provider business, we expect a return to growth in the coming quarters. As you know, the last couple of quarters have been soft for the industry. The addition of PatientMatters' capability will help us strengthen our patient responsibility value chain and help us differentiate in the marketplace. In this quarter, we added 3 new clients for the Provider business, and all of them on our platform-based offering. I am confident that the healthcare sector will see a rebound in growth during the next fiscal year.

Let's talk a little bit about Comms, Media & Tech, the CMT segment. This segment grew 21.3% year-on-year and 15.1% in constant currency. We are seeing good growth with our top customer. Their business has recovered nicely and growing, especially the OTT or the streaming business. This has driven volume recovery and new work stream for us. We have achieved nearly 50% work-from-home capacity for the U.K. operations supporting this largest customer, minimizing the impact of the second wave, which U.K. is grappling with now. India operations remain very stable over the last few quarters now.

Other media clients are also trending better than their pre-COVID level, led by strong volumes. We added an international weekly publication for high mix of clientele to our clients this quarter. We will manage this client's digital customer engagement journey based on our new age contact center offering for their U.K. and U.S. user base. The media and tech portion of CMT is a key and a new area of investment, especially in the U.S., and is beginning to take shape. We added 2 new clients this quarter, including an e-commerce giant and one of the largest born digital process automation platform. While revenue contribution is still small, I am pleased with the progress we are making in this new market segment.

And lastly, the diverse industries grew 5.1% year-on-year and were flat in constant currency.

Finally, a look at our outlook for FY 2021. Considering the momentum that we are witnessing across our businesses; we are further revising our guidance upwards. Our fiscal 2021 revenue now is expected to grow between 16% to 17%, in constant currency. This includes 0.9% from the PatientMatters acquisition. On the operating margin, we expect a range of 11.25% to 11.5% for the current fiscal. This factors in promotion and increments effective 1st January.

With this, let me turn the call over to Dinesh to cover the financial details of the quarter.

Dinesh Jain: Thank you, Vipul. And good morning, everyone. Let me take you through the financial performance highlights for Q3 FY 2021.

Revenue came in at Rs. 1,365.2 crores or $184.8 million. This implies a year-on-year growth of 23.8% in constant currency and 29.6% in rupee terms. On the margin front, operating margin came in at Rs. 159 crores or 11.6% of the revenue. Profit after tax came in at Rs. 121 crores or 8.9% of the revenue.

I am pleased to inform that Board has also approved an interim dividend of Rs. 3 per share. This will result into a pay-out of Rs. 208.7 crores. We have generated Rs. 645.3 crores cash from operation, and our FCFs came in at Rs. 535.5 crores. This is after adjusting for CAPEX of Rs. 109.8 crores, and in the Q3, it was almost Rs. 63 crores, which is the highest in some of the quarters.

We are also lucky in some form where one of the largest customers wanted to give advance for future receivables, and we have happily taken those one, which was about Rs. 180 crores. And this also results into a good interest arbitrage to us, because we also still have a debt in the balance sheet.

CAPEX for the quarter was slightly higher, as I spoke. This was for the 2 new centers, which we have set up, one in Mumbai and another in the U.S. Our DSO declined sequentially from 54 to 53 days, including the unbilled. This is driven by timely collection of receivables and also billing on time.

Our closing cash balance as of December 31 was approximately Rs. 301.3 crores after repaying Rs. 101 crores of our working capital borrowing, and also utilizing the Rs. 95 crores for acquiring PatientMatters. Of the $13 million which we have paid for PatientMatters, we have allocated $1.5 million or Rs. 10.9 crores to the fair value of the identified net assets, and balance of $11.5 million or Rs. 84 crores has been allocated to goodwill on a provisional basis.

The net debt stands at Rs. 204 crores versus the Rs. 391 crores in the Q2. And in the dollar term, we have a net debt of $27.9 million against $53 million in Q2. During the quarter, also looking at low interest rate environment, we have converted £15 million working capital to a long-term debt, which will have a 2-year period. Last three quarters, we have brought down our net debt by Rs. 448.5 crores or approximately $58 million.

Tax rate for Q3 was 18%, but we expect that it should be in the range between 16% to 18% for the year. On the FOREX hedging, we have coverage of £63 million for the next 3 years with the rates ranging between Rs. 103 to Rs. 119 to the pound. And the dollar coverage is $90.5 million with average rate of Rs. 76.57.

I am pleased with our business performance and various constituents of the business are coming together to drive holistic growth. With this, we can open the call for questions.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the questions-and-answer session. The first question is from the line of Manik Taneja from JM Financial. Please go ahead.

Manik Taneja: Congratulations to the team for very solid execution. I have a couple of questions before I get back into the queue. Number one question is on your guidance. Given the fact that typically 4Q is broadly in line with 3Q, how should we be thinking about the sharp Q-o-Q fall in growth rate that the guidance seems to suggest? While I understand that it is coming on the back of a very solid 2Q and 3Q performance. And the second question was to get some quantitative sense on the contribution of the mortgage business in the BFSI revenue performance this quarter.

Vipul Khanna: Thanks, Manik. So, look, we had obviously a very strong sequential growth in Q3, primarily driven by a couple of factors. CMT had good volume recovery in Q3. Mortgage, obviously, continued to grow strongly, but we do expect the growth rate will start to kind of moderate a little bit, right, while the business will still grow maybe not just at the same pace. So, we have kind of tried to model that in as we start this new year in the U.S. Hospital segment, it's still evolving. We were looking at good traction sort of as the Q3 started. But with the second surge and Thanksgiving surge, it's kind of gone again into a little bit of de-growth zone. So, you will see sort of how Q4 plays out on the hospital side of it. So overall, when we model all this in, we felt that 16% to 17% for the full year reflects the good estimate of where we think the year will end at this point in time, building on Q3 and seeing some of the factors that I mentioned for the Q4 development. Your second question was share of mortgage?

Manik Taneja: Yes. That's correct, Vipul.

Vipul Khanna: So, look, Mortgage continued to be a strong performer. The revenues this quarter for Mortgage jumped to I think about $55 million to $56 million. We continue to gain good market share in terms of new wins as well as volume growth. But at the same time, U.K. retail banking, which is the other large component of our BFS business, that has started to show very good traction. We have had a decent amount of win and a strong pipeline as we execute this quarter, which we are excited about.

And Collections, if I could take a moment to comment on collections, when COVID started, there was expectation that the credit default will increase in the U.S. But as the government has stepped in, as the stimulus has stepped in, as moratorium stepped in, that default scenario has got pushed out further and further and further, right? So, to that extent, collections is somewhat off from what we started the year, somewhat lesser growth, more muted growth than we expected. But overall, I think Q4 typically tends to be a stronger quarter, we will see better results from them. And then we will see how the macro will pay out in the next year for collection.

Moderator: Thank you. The next question is from the line of Mohit Jain from Anand Rathi. Please go ahead.

Mohit Jain: Hi Vipul, first for you, like in Healthcare vertical, firstly on the large deals that you have signed. So, if you could quantify some numbers there and how healthcare verticals recovery is expected next year, given that you're talking about some moderation in the mortgage business. That's one. And second, on the offshore side of it, we have seen some improvement, but as you reduce contact center and move more towards healthcare, should we expect offshore overall and just for margins to have a positive bias going ahead?

Vipul Khanna: Sure. So, look, for the healthcare segment, there are 2 segments, there is the Health Plan and Healthcare Services, and there is the Provider. In the Health Plan and Healthcare Services, HPHS, we have been working hard for the last almost 12 months now. We built a team focused on sort of our strength. And our digital intake platform is being received very good in the market. And the new win that I mentioned is for the digital intake, for one of the top 5 health plans, and this is a new relationship that we opened up. And it's a giant health plan, we hope that we can continue to kind of build on this relationship. It's a 5-year contract, and this, for now, we have quantified about a $22 million TCV on a 5-year basis.

We have other wins as well in HPHS and a strong pipeline. So, I am expecting that Q4 onwards as well as going into next year, HPHS will perform strongly, and we will start to see meaningful revenue growth starting to come from there. Although I would just add one little qualifier that typically Q3 or the December quarter for HPHS tends to be higher because of the open enrolment season in the U.S., and then we see some seasonal downtick in Q4. That's just a peak up of Q3, which does not sustain in Q4. But structurally, our pipeline and products are developing well. And from the historical numbers, you will see meaningful growth going forward on HPHS.

On offshore, yes, given a lot of our growth this quarter has been driven by mortgage, so we have seen continued uptick of offshore. As I mentioned earlier, given the value proposition that we offer of a global delivery, right, we don't necessarily go to the clients with one or the other, it's the proposition of a layer onshore and where required a layer offshore. So, it's not a conscious strategy by design to go and say, we want more offshore-heavy business here. It all depends on what the opportunities and what the client's context is. So as a margin lever, it's not something we are consciously driving. But overall, on the margins, you have seen this kind of delivered on what we had forecast. And even this quarter, we had about, year-on-year 40 basis point improvement in our operating margin. So, we are kind of within the range of margin that we had forecast on top of the strong growth.

Mohit Jain: Right. What I was asking was, last year when you took charge, that time there was this talk of investment into the growth. And therefore, we had this 150 or 200 basis point additional investment requirement, which was brought in. And I was hoping that in 2022, that may sort of start eroding, given that your growth is sort of back, and the investment side would have been complete. So, your margin should have some tailwind ahead. Is that a fair assessment?

Vipul Khanna: Let me answer it this way, right, that there was a bump of our investment we made in our SGA. Now as we go deeper into the segment, we continue to make investments, maybe now at an account level or trying to open new offerings. Like in mortgage, we are evaluating one or two adjacencies into the closure and the due diligence segments, right? So, investments are building, not at the bumpy level that you saw in 2020, we will see continued investments to kind of fuel the growth. From a margin standpoint, directionally, you are right, we are aspiring that through operational excellence and as our service mix changes a little bit, a little bit more higher margin, digital options come into play. We should see a tick up in our margins over the next couple of years. But keep in mind, sort of primary sort of strategy at this point is to drive top-quartile growth with continued investment focused for them.

Mohit Jain: Right. And then second for Dinesh, sir. So, your debt was going down, which is good to see. But current liabilities saw some jump ex-customer advances. Is there any other liability which has gone up in this particular quarter? And last is on tax rate for FY 2022, like when do you expect tax rates to be more in sync with the rest of the industry?

Dinesh Jain: Yes. So, the current liability, normally, other than the one advance which is now taken out, so it's only on account of the employees' payments. What happened is the payment cycle in U.S. and U.K., so you have sometimes the lesser number of days get picked, you have to accrue those liability. So that is one component. As well as U.K. has given that VAT liability can be postponed for 12 months, so we have opted for that. So, your VAT liability, in future, will get paid in a proportionate basis. These are two components which have added to the current liability.

As far as the tax rate is concerned, I think, going forward, it has to be slightly increased. But as you know, onshore still the U.S. and U.K. rates are around 19%. And till the time U.S. government does not come back and change the tax rate, I think it should range around, I will say, between 18% to 20% for at least next one, two years. It should not drastically change. India side also, again, I think the new SEZ will not come. So probably next two, three years, still we have a good window to have a benefit of SEZ, which will taper down in the future. But I see at least the next two, three years we should be around 18% to 20%.

Moderator: Thank you. Next question is from the line of Rahul Jain from Dolat Capital. Please go ahead.

Rahul Jain: Congratulation on strong execution. Firstly, on this acquisition, I would just like to understand how we plan to improve for the hospital kind of revenue for this business. And what is the cross-sell opportunity that we see in general, which could be done in the immediate future?

Vipul Khanna: Hi, Rahul. Thanks for your wishes. So, this acquisition, as I said, is complementary to us in two. We see cost-sell opportunities both ways. Their patient advocacy business is similar to what we call eligibility services, except they operate in states like Texas and New York and Arkansas where we are not very big as it opens up new client segment for us. And we can take our payments offering and our other automation services offering to their clients, right? So that's cross-sell into their client base.

Second, they have a front-end SaaS, which does upfront patient estimation and pre-procedure payments. Historically, we have done post-procedure payments and collections, that's been our play on the payment side. These guys are coming at the front-end on the prepay side of it. I think with this, it allows us to expand our platform and start to kind of go with the vision of end-to-end payment of the self-pay portion of the patient expenses. So, there is the insurance portion, right, which is collected either from commercial or Medicaid. But the self-pay portion, which is mined as a patient share, collecting that, and that's about a big chunk of the debt for the hospital. Collecting that, that proposition is the one which expands for us. And I think we can take it to our existing clients, and we will take to their clients in an expanded form. So those are the two cross-sells or the revenue synergies we see with them.

Rahul Jain: Yes. So, in any sense of quantification of changing addressable opportunity size? Because I think our base of hospital is much larger, so taking their capability into our set of customer and other way around. Do you think this total addressable opportunity within the current client pool itself goes up significantly higher?

Vipul Khanna: It does. Absolutely, it does. I don't have the numbers handy in terms of the addressable market on what it does, we will get back to you. But in general, if you ask me, for PatientMatters, the acquisition is about a $15 million, $16 million annual run rate. And we have a base case or a business case to drive up in the next two to three years revenue synergies from them at a reasonably sort of aggressive cliff, right? That's the synergy that it's selling to their client base or ours. But we expect this revenue to go pretty aggressively in the next two or three years as we integrate and go to their client base, and vice versa.

Rahul Jain: Okay, thank you. Just one more, if I may. Despite the significant growth leverage which we have right now, we have not seen this translating into profitability. And of course, we are investing in the areas which we have been articulating for some time. My worry is more from the point of view because how we would ensure that these levels of profitability can be protected if the growth slows down eventually?

Vipul Khanna: Okay. So, your question is, how will we protect the margins?

Rahul Jain: Yes. So, for example, as you guys are portraying that this is the level of profitability, beyond which you are mostly investing back for the channels you want to. And so as long as we have such a high growth, I mean, flattish profitability is also a very strong trend because you end up growing based on EBITDA as well. But when the reverse of the cycle happens, when your growth comes off, but costs have their own inflation involved from the supply side factor also, how you protect this margin at this level also?

Vipul Khanna: Sure. Let me give you two colours, first of all, for sort of how this year's margins are playing out, right? First of all, you see the mortgage business has grown very aggressively, and we want to invest to harvest the growth. So things like hiring ahead of time, investing in longer training cycles to kind of make sure that semi-finished talent we can bring up to speed before we put them up to client processes and to billability because we want to make sure when clients come to us and when they have high needs, we are there to meet that, right? So, we continue to be the first port of call for them. That's been our sort of strategy. So, to that extent, we have invested at the account level, at the talent level to kind of make sure we harvest this growth. And I am convinced that this adds up to deeper and healthier relationships in the long term.

The second aspect is that our Provider business is largely outcome driven. And with muted volume, it impacts margins from fixed and semi-fixed costs. As volumes return, in the next fiscal and we add more plans to this platform, we will see the margins for this business kind of rebound back strongly. So, these have been sort of a couple of factors which have played on the margin for this year, some to feed the growth and some kind of deal with sort of the volume volatility in the Provider business. At the overall level, the businesses that we have added, the wins that we have added, whether it's in mortgage or HPHS or the new wins in CMT, these are high-quality, above-threshold margin deals that we have done. So I am confident that while we will continue to drive top-quartile industry growth, we can see year-on-year sort of modest increases to our operating margins from the current level to OPEX and higher-margin mix of our sales.

Rahul Jain: Okay. So, you expect this as a bit gradual uptick over a period of time?

Vipul Khanna: Yes.

Rahul Jain: Okay. And in a way, we can also view if the mortgage growth opportunity slows down, whenever it happens, and Provider also picks up, this itself should have a good outcome on reported profitability?

Vipul Khanna: For sure on Providers because that's the nature of the business. Its big chunk is outcome driven. And mortgage, as I said, obviously, origination has been a strong part, but we have been building our servicing portfolio as much. And a good chunk of our recent wins had been in the servicing business, which is steady business with decent margins, and that will continue to free up. So yes, the gist of your question is correct or your assumption. The gist of your assumption is correct.

Moderator: Thank you very much. Next question is from the line of Dipesh Mehta from Emkay Global. Please go ahead.

Dipesh Mehta: Congrats on a very strong execution. First question is just trying to understand if you can provide some outlook on CMT business outside of the top client, how you expect it to play out? You gave some new client addition and acquisition in fintech and other new age technology, but if you can provide some perspective about how you expect it to play out over the next couple of years?

Second is about U.K. BFS. Seeing some recovery this quarter, but how you expect that recovery to certain and accelerate or you think it reached to plateauing once we exit this year?

Third question is about the top client. Now we have seen strong recovery this quarter. How do you expect that recovery to play out? Do you expect this momentum to sustain or it is likely to see some softness?

And related question is about the advance received. I just want to understand nature of this advance received in terms of whether it is a normal course of business or it is some specific event and that's why we see it is advancing?

Vipul Khanna: Okay. Great. First question, CMT business outside of Sky. So outside of Sky, we have a good niche developing for digital media. I talked about the win with a global leading publication to manage their customer experience across channels. And on the strength of that win and the capability that we have, we are expecting good sort of outcomes in our pipeline in this quarter as well. So digital media is one area of growth.

The second area of growth is the technology segment, right, the born digital segment that I have been talking about. So there, we have been working hard. Obviously, we are starting afresh on that. So, it will take time to build revenue. But we have had good wins, we are zeroing in on sort of what the value proposition there will be. And I expect that in FY’22 we continue to make good new account wins in the born digital or the tech segment, whether it's fintech or consumer tech or enterprise tech. Some of it will have to play out. Meaningful revenue, I expect, will start to come towards the flag end of FY‘22 or into FY '23, unless we kind of have some early and substantial wins. And this incidentally is also an area of inorganic focus for us to kind of get more momentum into our efforts for the born digital segment.

Besides that, I think the U.S. portion, the C portion of our CMT, the comms portion, that also saw good growth in Q3, which we expect will sustain through from here onwards. So that's kind of colour on CMT outside of our largest customer.

U.K. BFS, we are amongst the leaders. We fought hard, and I think we are starting to see some good wins come out on our existing clients there. Our overall sense is that the U.K. banking sector is preparing for continued low interest rate regime, right, and post pandemic, whatever the fall out on the economy would be. So, there is a good momentum of conversations among the U.K. banks for looking at their cost base. And we are starting to see those opportunities line up or come up to fore, which were not there in the last two years. And we are kind of working hard to make sure we win a fair share of their efforts to find cost benefits as well as transformation to their portfolio of businesses as they don't want to lose the tactical gains on digital. They want to make it more permanent gains in digital. There are opportunities for transformation of individual business lines. So, the bottom line there is, I think the momentum there will be sustained in the U.K. BFS segment.

Sky, last question, whether this momentum will sustain. Clearly, we have worked very hard and be very agile and flexible to their needs, this is well recognized by the client. We continue to be their pre-eminent supplier, and I think we have gained market share compared to some of their other smaller partners. What we are now back is sort of the pre-COVID levels. Their businesses are at pre-COVID levels, and we are slightly ahead of that from a pre-COVID level of our share of the spend that they have with us. I expect that this will sustain. And as we get into the summer and as the world finds its new ways of sort of evolving, as they kind of figure the way out, we are kind of working lock, stock, and barrel with them under their new leadership. As they lay out their growth strategy, we want to play an integral part of that. So, we definitely expect this to be sustained and hopefully grow modestly from this level, given we are specific part of their momentum, a big part of their portfolio.

Lastly, the advance received. It's a fairly widely used technique of when interest rate regimes are low, that customers want to do advanced payments of invoices to gain some interest rates. And as Dinesh said, it is still beneficial to us. So, we kind of wanted to do this as a win-win for our largest client as well as for us. But I have seen this used fairly regularly during interest rates regimes where treasuries of our clients want to get some financial advantage by paying ahead of time. Dinesh, you want to add to that last comment.

Dinesh Jain: No. I think that's perfect. I think that was the reason they have reached out to us and say whether we are happy to take their advance. And this will be adjusted against the invoices between March to June. So yes, it is very clear understanding of future receivables. And absolutely, for their treasury purposes, this has been done.

Dipesh Mehta: Understood. And last question is about the development center, which we had almost fixed in the last two, three quarters. Now considering work from home, I understand because of mortgage business, you might require increase, but your OPEX seems to flat, if I look, let's say, Q2 to Q3. I just want to understand thinking on this part. When you have work-from-home option available, then why to add center? And if you are adding, why it is not getting reflected into OPEX?

Vipul Khanna: Sure. Dinesh, do you want to start on that?

Dinesh Jain: Yes. So OPEX cost, if you see my most of the centers are open. It's not that due to work-from-home, those are not there, because for some of the customers we are still working from offices. And due to the social distancing, the number of seats used is lesser. As far as the new centers are concerned, those have started into this quarter. So there, slight increase of cost must have happened. But in a percentage terms to revenue, there is no meaningful increase. The reason being that all of the centers are operating at the same operating cost, including rentals, are all getting incurred. Future going, when people will start coming back to the offices, again, we don't see that we have to add a meaningful capacity. We may have to add few capacities around. But again, there are some of the costs, which is, as of today's excess for us, for example, on a technology or, for example, on the transport to bring the people to the offices, which will also come down when everybody in the office and all public transport will open. I think going forward, when everybody who are working from home will be back to offices, we don't see it's going to be a meaningful change into the operating expenses per se. Hope that answered your question.

Dipesh Mehta: No. Understood. So, my immediate question was, is the work from home any benefit we are getting? Because now even top clients gave some permission for us to work from home.

Dinesh Jain: Which is the additional one. I think you have seen the U.K. COVID situation, the people who are not able to come to the office, they have been given work from home and the extra work. We have sufficient capacity. So, once they will come back, probably, we will run at 95%, 98% capacity, which is as of today, 50%, the reason being social distancing. And these businesses which we are getting is basically to the growth, which we already have a seat capacity available. We may add a few more centers, there is no doubt on that. But it's not going to be that the huge additions we need to do.

Vipul Khanna: We are right now, overall, at a global level, about 40%, slightly south of 40% working from office, right, as some of the folks are starting to come in. But obviously, as we have added far more business, we obviously have to start preparing for that capacity for eventual, even if it's not 100%, but partial return to work. So, we are starting to prepare for some of that request, right, when the transition happens back to office in sort of like earnest.

Moderator: Thank you. The next question is from the line of Kshitij Kaji from Carnelian Capital. Please go ahead.

Kshitij Kaji: Congratulations on very strong growth in this quarter. Most of my questions have been answered, just had one broad question. In the revenue by service line that we have defined in our fact sheet, the platform service line has basically seen a de-growth over the last quarter, while it was seeing an uptrend over the previous two quarters. So just wanted to understand what is the reason for that?

Vipul Khanna: Sure. Thanks for picking it up. Look, this is a focus area, we continue to work on building platforms and even because it's a better way of doing things, we even go to our existing clients and convert them from the traditional way of doing to the new platform, right? And that's the transition that we were working on. Specifically, this quarter, the decline in this service line was primarily from a short-term project that we had finished and that had impact on revenue. But directionally, in terms of our wins that we saw in this quarter in Q3 as well as the pipeline, the share of digital continues to rise from what it was a year ago, but this is more a quarterly aberration from a seasonal project or a short-term project.

Kshitij Kaji: Okay. Perfect. So, from next quarter, now you see this again picking up and growing as we go forward?

Vipul Khanna: Correct.

Moderator: Thank you. Next question is from the line of Shradha Agrawal from AMSEC. Please go ahead.

Shradha Agrawal: Congratulations on a great set of numbers. Two questions, Vipul. Firstly, we have seen a meaningful increase in our offshore revenue mix. And despite that, EBITDA margins have declined. I am not talking about EBIT margins, but EBITDA margins have declined. So, your comments there would be helpful.

Vipul Khanna: Sure. On the margin, the earlier comment I had made that we are not consciously going to apply it with one or the other. We have a global delivery proposition that we are taking. From a margin impact standpoint, as I mentioned earlier, the growth that we have seen in mortgage, the aggressive growth or servicing that faster growth, it has taken some additional investment from us, right? We have had to hire people ahead of time. Obviously, salaries for certain high-skill segments are high, and training cycles are longer, right, even from the fact that because we are in a distributed operation, managing the logistics of getting equipment to everybody's home, getting them set, etc., that impacts somewhat the time to bill.

So those are some sort of executional reasons on why we have focused on pursuing the growth, not leaving growth opportunities, even though it has meant additional sort of effort and additional costs from our side to harness that growth. And then the second reason was that the Provider’s muted growth impacts margins disproportionately because they are an outcome-based service. It's a completely onshore-based business, 100% onshore-based business, outcome based. When the volumes return, cost base kind of remaining the same, we will see a better impact on the margin. But it’s kind of hurts us on the reverse when the volumes decline. Those are the two primary reasons why we have seen margins flattish despite some of the positive levers of growth in offshore coming there.

Shradha Agrawal: Okay. And just a follow-up to this, Healthcare, the segmental margins, which we disclosed, healthcare margins have also come off 350 bps on a sequential basis. So, is it more to do with consolidation of PatientMatters? Or is it because of the outcome-based revenue model that we follow?

Vipul Khanna: I am drawing a blank on that. Ankur, can you answer that?

Ankur Maheshwari: Sure. So, Shraddha, there will be some element of the PatientMatters acquisition as well on a sequential basis. But having said that, the margin softness is largely attributed to the revenues of the Provider segment. As that normalizes, you should see the margin come back as well.

Shradha Agrawal: Okay. That's helpful. And just one last bit for me, Vipul. You did mention that you added a large e-commerce giant as one of your tech clients in this quarter. What is the kind of work which we will be providing to the same account?

Vipul Khanna: Yes. It's a small win, our intention is more to kind of open up the relationship, open up the MSA, right, and start to work through. So, this is on merchant acquisition that we started to work with them. Again, small core project, more to open the innings with them and then work our way through their organization. But it's merchant acquisition.

Shradha Agrawal: Sure. So, the ticket size would be relatively quite low to start with?

Vipul Khanna: Yes. Fairly insignificant.

Moderator: Thank you. The next question is from the line of Manoj Bahety from Carnelian Capital. Please go ahead.

Manoj Bahety: So, if you can elaborate a bit on your Digital Now strategy. In fact, I will break this question into three parts. First one is that what kind of digital budget you are putting for next two, three years? Secondly, I just wanted to understand, like when you are moving to digital, whether it will be like in-house capability or it will be a collaboration with other IT majors?

And lastly, just wanted to understand that what kind of disruption you see to your legacy business on account of this digital migration, though like digital brings its own set of opportunities, but it can also bring kind of disruption risk to your legacy business. So, on these three parameters, if you can give your views.

Vipul Khanna: Sure. So, look, our strategy on in-house versus partnerships, it's absolutely blended. For product companies, either the giants like AWS Connect or the automation platforms like UiPath and a host of new emerging, either specific use case players on AI or chat-bots, etc., we will partner. Because they bring the product, and we will take that product and embed that into our solution, and our value is to take that product, deploy it in the client context so that we can drive the benefit specific to the clients' needs for that process, for that business unit, for the client segment, etc.

Second, there are a number of tools or platforms that we are developing in-house as well because they are core to our process. We understand those processes, and it's about codifying that into our platform. It's a blended strategy for external products and in-house products. As far as implementing and considering those products is concerned, largely it's in-house. Prashant Achanta joined us as CTO several months ago, he's been building up the capability. I think that's the source of value where we can go for clients and configure a particular application or a particular platform to their needs ourselves, because we understand it well. So, I think that part we want to keep in-house as much as is required in that specific to the use case.

On digital migration, I think it's a fair observation that if there are better ways of doing it, and we take it to existing clients, there will be some disruption. Typically, the thematic impact we see, take digital collection as an example. Our digital collection products, it does far better collections than traditional way of doing collecting, and it costs lesser. So, it invariably means that our revenue is lower with this digital collection deal. And if you are converting, yes, we will lose some revenue. That does not happen as often. But if there was a direct conversion, we will lose revenue. But we will gain, far more profitable revenue, right? That's the whole idea of an IP-based solution that is more profitable. And I think it's a valid trade-off to be done because the market is kind of heading there. Market wants those new generation solutions, and I am very open to pursuing those solutions to give a better or a next generation way of doing things to our clients, even if it means there is some element of short-term or temporary revenue compression because of that. So overall, at this point in time, we haven't seen decline because of that. I think the idea is because these markets are vast, if you take this thing, I see them as an opportunity to gain market share of profitable revenue and not necessarily impacted on revenue thus far. Those are two responses. Did I answer all three questions? There was another one.

Manoj Bahety: Yes. Just the first one, like what kind of uptick you have budgeted for your digital outlay? And will there be a short-term impact on the margins as you transform your more and more business to a digital side?

Vipul Khanna: So, we haven't quantified systematically. We have been investing in platform teams for every idea within every BU to say, if this is a specific platform idea we want to chase, build a team around it. Those investments are baked into, what we saw in YTD thus far, and it's baked into the forecast for the future. I don't expect this to be a meaningful call-out to kind of impact the margin, but it will be a continued investment but not necessarily that it causes a down-draft into the margin.

Moderator: Thank you. Next question is from the line of Madhu Babu from Canara HSBC. Please go ahead.

Madhu Babu: Congrats on a good quarter. Sir, any discussions on a new blend model where you will have a mix of work-from-home and office? And how is that going to impact the pricing in the sector? Especially in BPO, obviously, not everything can be done from home and all that. So just your views on any potential changes in the delivery model over the next one and a half year.

Vipul Khanna: Yes. So yes, this is the topic amongst the few clients. And some of our big clients are testing out different models of, if I was to do a blended work-from-home, is it one person goes to work one week, another person comes in next week or two days a week and then two days someone else? Or is it a percentage of people who are permanently hired to work from office and a percentage of people permanently hired to work from home? A couple of our clients are testing these two models at some level of pilots to see what the impact on performance and employee engagement is? So, I think we will see how this evolves. It hasn't reached a stage where people are saying, "Hey, I need a discount or the other," because we know that there will be some trade-off one way or the other.

For instance, we have seen that wherever we do more work-from-home. While there might be some savings on the facilities cost, there is a higher leadership and engagement costs because when somebody is remote, you have to spend that much more effort to engage with them, to train them, right, and sort of do all the stuff that you need to do to make sure the culture remains intact. So, there is a put and take on the cost side of it. But we haven't reached a stage with clients to start to quantify in terms of discounts opinions. My sense is that over the next two years, it will reach a stage where it will change from what we have done historically. Whether that changes to 33% of the population or 40% or 50%, we will see. And it might vary from industry to industry as well in terms of banking behaviour versus born digital behaviour, right? So, a lot of it will depend on sort of how regulated this industry. But thematically, I do expect this to change for BPO, at least to the range of sort of 20% to 30% capacity starting to work from home once life returns to full normal.

Madhu Babu: Sir, on the CAPEX, the Rs. 109 crores of CAPEX for the nine months, how much of it is for the licenses? Because we have some license purchases every year in the CAPEX.

Ankur Maheshwari: So, on the CAPEX, again, whatever you are seeing right now is predominantly to drive for growth, get the equipment, some of the offices fit out and mostly on the IT equipment part of it. There will be some element of licenses, but again, from the way our business is structured, that is a not really the biggest element of CAPEX that goes out.

Madhu Babu: Yes. Because I remember last year or year before license was a significant part. And just last one on the top account, obviously, sir, how do we see the disruption, how it is going in next year, can that be again a risk in terms of overall growth or a decline in that account? Can you give your views because OTT is a big disruption happening in the sector?

Vipul Khanna: Sorry. So, are you saying that do the clients business mix, we see their business mix changing?

Madhu Babu: Yes. Any impact on the client and obviously from that to your business?

Vipul Khanna: Yes. Look, they have a very strong OTT offering in the markets that they operate in. We serve them primarily for the U.K. market. And we have as much a market share of servicing their OTT as much as their core triple-play product that they have. So, they are moving with sort of the change in the mix. But the U.K. market hasn't shown any major movement from what it was earlier, except people are consuming more. But OTT is a very big focus area for us. We are very focused to make sure that whatever the key drivers of that market are, which are primarily customer retention and moving customers wherever the product is, like you look at Peacock in the U.S., Peacock is a free product and a $5 a month product and $10 a month product, that people move up from the free to the $5 and the $5 to the $10. So, we are working hard to develop our capabilities and offerings such that we can address this primary need for the OTT segment. But I see this market has a lot of growth potential from the traditional way of doing things, and we hope that we can play a meaningful part in this market, the OTT evolution that's going on around the world.

Moderator: Thank you. The next question is from the line of Sachin Kasera from Svan Investment. Please go ahead.

Sachin Kasera: Yes. Congratulations, Vipul. Nice to see that growth has started to come back after a longer time. So that's very happy thing, congrats for that. I had just two quick questions. One was regarding the capital allocation policy. Now that on the prime area of focus for growth? And secondly, now that the debt is down, how are you going to look in terms of allocating the cash flow going ahead in terms of pay-out to shareholders as well as using it for growth CAPEX?

Vipul Khanna: Yes. Look, so capital allocation, from the free cash flow that we generate, three avenues are organic investments, inorganic investments and return to shareholders through dividends. These are the three primary things that organic CAPEX means, center, equipment, etc. I think the strategy that I have been articulating and is starting to take root is that if we want to pursue industry-leading growth, top-quartile growth, we need to continue to invest in adjacent areas of growth and continue to gain market share in the segments that we operate. So, there will be some element of continued organic investment in things like capability building, sales capacity, solution capacity, etc., even delivery leadership, etc. And that will sort of continue at some level. Inorganic, we want to be disciplined, we want to be systematic on saying what are our priority growth areas, right? So, Provider is one area of growth where we think a lot of disruption in the market, a lot of potential, and we need to continue to buy pockets of expertise to expand our footprint in that market. Likewise, for Collections, we see opportunities to grow in the U.S. as well as in adjacent markets. So, there are some priority areas where inorganic that we are focusing on. Again, nothing specific to report. And now, Ankur, remind me, this was a third or the fourth dividend pay-out now.

Ankur Maheshwari: This is the fourth.

Vipul Khanna: Fourth. So, Sachin, we are falling into sort of a reasonable pattern of return to shareholders. And this was the fourth pay-out since the company returned into good financial health. And I expect this sort of allocation between organic, inorganic, and return to shareholders will continue as a part of the framework of our capital allocation policy. That's all, I can get at this stage.

Sachin Kasera: Sure. Great. Second question was it's been now a while you have spent time at FSL. Can you give us, not a guidance, but sort of a vision here how do you want to take the FSL from here, and now where do you want FSL to reach?

Vipul Khanna: That's a long answer. Just summarizing the point. Choose our battleground carefully. For now, a lot of segments in BFS that we think we can expand into. Healthcare, we play in both the Provider and the payer space as well as the Health Services, we see growth segment and then CMT, especially with focus on media and tech. In all 3, the vision is that choose the battleground carefully and either have the leadership position or aim for leadership position. All this totalling up, as I have been saying, should mean top-quartile growth for the BPO segment. And this cannot come unless it's powered by digital. whether it's digital services, automation, and business IT or BPaaS, business process as a service. So digital will form an increasing part of either our custom solutions or BPaaS. And yes, the vision would be to be a company which attracts top talent because we grow, and we do contemporary solutions. And because the culture is such, which allows empowerment and engagement to people and allows them to grow. I think that will be the biggest testimony, that if we continue to attract top talent, that in itself will exceed our growth, and we'd like to be confident in chosen segments. It's pretty mundane description of the vision.

Sachin Kasera: Sure. That's very helpful. Just one bookkeeping question. Is net debt of Rs. 200 crores, this is after adjusting for the customer advances. So, it's not for that, the net debt would have a little higher.

Vipul Khanna: That's right.

Moderator: Thank you very much. Our next question is from the line of Anirudh Thakkrey, an individual investor.

Anirudhdha Thakkrey: Congratulations for good results. I just want to know like what is the next sector which you feel that will grow in coming quarters? And how much it will grow and why it will grow? And the second question is like do you see any big opportunity in India after this new budget?

Vipul Khanna: Sure. I am presuming, when you talked about sectors, you're talking in the context of Firstsource, right, and where we are and where we want to play?

Anirudhdha Thakkrey: Yes. Right.

Vipul Khanna: Yes. Okay. So, as I have said before, BFS is performing strongly, and I think it will continue to perform strongly. Healthcare is the one where we see increased growth rates than what we have seen as we go into the next year. CMT also saw strong growth, but we play mostly in the C segment, right, the communications segment. But media and tech are the growth segments where we expect to start to see some wins next year and meaningful revenue start to come in maybe end of the year, next fiscal. That's how I think the growth rate will pan out, overlapping growth rates of BFS, Healthcare and CMT, right, to kind of provide the sustained growth that we want.

For India, we do few multi-clients, which are strong historical relationships that we have done. We are starting to look at India, because of the rise of telehealth, we see opportunities for telehealth and remote patient monitoring. So that is something that we are exploring with a couple of leading sorts of hospital service Providers for the India market. And again, the intention is not to do big things but kind of do targeted things, which allow for newer operating models to develop for the India market, and then we can leverage that for the broader core U.S. and U.K. market. That will be the strategy behind choosing targeted Indian client base to build some new operating models and then take it out.

Anirudhdha Thakkrey: Right. Just to add on to my earlier question. Like as far as this COVID situation, we can see some recovery in U.S. and U.K. business. But pertaining to Health Services, now probably you may have like better opportunities upcoming in coming time because of this improvement in the situation compared to other segments?

Vipul Khanna: Of course. As we have been saying that lot of electric procedures have been deferred by patients in the U.S., because they don't want to go to the hospital unless it's a true emergency, right? And people have been advised not to as well to save and conserve hospital capacity where the counties and states have been more severely impacted. So as life begins to come back to normal, elective procedures, diagnostic procedures, which have taken a back seat, they will come back to the fore, and you will see increased volumes into our hospitals, which then has a ripple effect on our different models, whether it's the claim volume for a health payer business or it's for the eligibility services and payment business of our Providers. As life begins to normal, I think Healthcare will see volumes return, plus the gains from new operating -- new emerging opportunities like the telehealth, which has taken off really well, I guess, across the world, not just in U.S. or U.K.

Anirudhdha Thakkrey: Yes. See, I just want to understand, like you know the situation very well. So, in which quarter do you feel that this will come up on normalcy rate or something like that? Can you give me any insight on that? Like is it possible?

Vipul Khanna: I am sorry. I didn't follow.

Anirudhdha Thakkrey: See, now this corona vaccine jabs are available in the market, so in the U.K. and U.S., most of them are getting it on a priority basis. So, I just want to know like the situation over there, wherein you can understand that okay, for next few quarters or second quarter in the upcoming financial year, you can have this particular normalcy for this healthcare sector. Can you get the point?

Vipul Khanna: No. I am trying to follow.

Anirudhdha Thakkrey : My query is like, till which quarter, you feel that you can get a good amount of business from this health care sector, like when we can expect a good result, knowing these jabs and all the injections in the market available.

Vipul Khanna: Yes. We will see sort of how quickly the vaccination picks up. In the U.S. right now, we have been doing about 1.3 million to 1.4 million people a day. Our new President has said by summer, so by June or July, we should have majority people inoculated. From a hospital standpoint, I think we obviously had a surge from November, December, which kind of went back a little bit, as the volumes went back a little bit. Otherwise, we were starting to see September, October level of normalcy. My sense is that if you can continue the current down trajectory, right, unless this U.K. or the South African variant kind of takes off, hopefully not, but if this down trajectory of caseload comes down, you will start to see normalcy, revenues start to climb up for our hospital clients in March, April and then continue to build forth in Q1, Q2, which is the Indian fiscal Q1, Q2. But it's still a very dynamic situation. Hard to kind of predict these things change on a two-weekly basis.

Moderator: Thank you very much. As there are no further questions, I now hand the conference over to the management team for closing remarks. Over to you.

Vipul Khanna: Great. Well, first of all, thank you, everyone, for giving us an hour and 15 minutes of your time and your interest. Truly enjoyed your questions and your continued engagement with the health and sort of opportunities for our business. We hope to continue to engage with you and look forward to seeing you and talking to you next quarter.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of Firstsource Solutions, that concludes today's conference call. Thank you all for joining us. And you may now disconnect your lines.