Q3 FY2019 Earnings Call Transcript - February 04, 2019

CORPORATE PARTICIPANTS

Mr. Rajesh Subramaniam - Managing Director & Chief Executive Officer

Mr. Dinesh Jain - President and Chief Financial Officer

Mr. Ankur Maheshwari - Head Corporate Planning & Investor Relations

Moderator: Ladies and gentlemen, good day, and welcome to the Firstsource Solutions Limited Q3 FY19 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' followed by '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Ankur Maheshwari. Thank you and over to you, sir.

Ankur Maheshwari: Thanks, Aman. Welcome, everyone. And thank you for joining us for the quarter ended December 31st, 2018, earnings call for Firstsource. Please note that the results, the fact sheet and the presentation have been mailed to you. And you can also view this on our website www.firstsource.com.

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

Before we begin this call let me remind you that some of the matters we would discuss on this call, including our business outlook are forward-looking and as such are subject to known and unknown risks. These uncertainties, risks are included but not limited to what we have mentioned in our prospectus filed with SEBI, and the subsequent annual report that are available on our website.

With that said, I now hand over the call to Mr. Rajesh Subramaniam, our MD & CEO.

Rajesh Subramaniam: Thanks, Ankur. Hello, everybody. Thanks for your time today and attending our earnings call. I will take you through a quick summary on Q3 and our business outlook and then open it up for Q&A.

Revenues in Q3FY19 came in at Rs. 985.2 crores compared to Rs. 954.7 crores in the preceding quarter and Rs. 887.2 crores in the quarter of the last fiscal year of the same period. Quarter-on-quarter we have grown 3.2% in rupee terms and just under 1% in constant currency terms. Year-on-year we have grown by 11% in rupee terms and 3.5% in constant currency terms. Our EBITDA came in at Rs. 136.1 crores or 13.8% of revenues, sequentially higher by Rs. 3.3 crores or 2.5% growth, a slight margin reduction of 10 basis points. Year-on-year it has been higher by Rs. 20 crores or 17.2% growth and a margin expansion of 70 basis points. Operating EBIT came in Q3FY19 at Rs. 117 crores or 11.9% of revenues, sequentially higher by Rs. 2.6 crores or 2.3% growth and a margin reduction of 0.1%, very similar to our EBITDA profile. Given Q3 is seasonally weaker than Q2 and obviously the margin profile picks up in Q4, which is seasonally our strongest. Profit after tax came in at Rs. 98.1 crores or 10% of revenues, sequentially higher by Rs. 5.3 crores or 5.7% growth, margin expansion of 20 basis points. Year-on-year on reported net profit after tax it is Rs. 1.4 crores, 1.4% de-growth and a margin reduction of 1.3%. But on a normalized basis, just to jog your memory, Q3 last year we had a one-time tax credit of Rs. 24.1 crores which was on account of the change in taxes in the US, our peak tax went from 45% to 22% - 23%. So, on account of that we had a Rs. 24.1 crores tax credit, but if we normalize that tax credit out in the current quarter our profit growth year-on-year has been Rs. 22.7 crores or 13%, and a margin expansion of 1.5%. Cash at the end of December 31 was just under Rs. 100 crores or Rs. 99.8 crores as compared to Rs. 74.1 crores in the sequential quarter, in the quarter of September 30, 2018.

Nine months summary: Nine months revenues came in at Rs. 2859.1 crores compared to Rs. 2638 crores in the nine months of FY18. Year-on-year we have grown 8.4% in rupee terms and 1.5% in constant currency on reported basis. But if we pro-forma the domestic business which was contributing revenues last year between April and August, then the year-on-year revenue growth is 11.5% in rupee terms and 4.8% on constant currency terms. Similarly, nine months EBITDA of Rs. 397.1 crores or 30.9%, year-on-year higher by Rs. 70.7 crores or 21.6% and a margin expansion of 1.5%. Operating EBIT for nine months came in at Rs. 341.6 crores or 11.9% of the revenues, year-on-year higher by Rs. 63.9 crores or 23% growth and a margin expansion of 1.4%. Profit after tax, Rs. 279.5 crores or 9.8% of revenues, year-on-year higher by Rs. 45.8 crores or 20% growth, margin expansion of 0.9%. On a normalized basis year-on-year it is higher by close to Rs. 70 crores or 33.4% and a margin expansion of 1.8%.

So, overall, pretty satisfactory on our profit margin expansion story lead by a higher degree of transformation lead digital growth. Revenue metrics are slightly weaker than we expected, and I will touch upon some of the salient features as to what is happening in the business and how we are remediating some of our challenges.

The next slide is basically a tabular format of the financial performance of work Q3 FY19 and the nine months ended period of FY19. No call outs here, just focus you on the normalized profit after tax, Q3 FY18 was Rs 75.4 crores and we are at Rs. 98.1 crores. Similarly, nine months FY18 was Rs. 209.6 crores compared to Rs. 279.5 crores. Tax rate is 14% to 15%, which I can open it up for questions and Dinesh, our CFO, can give you any answers that you might have on taxation. But, overall, margin expansion story continues and we are pretty bullish on how this will play itself out in the future.

Some other highlights, headcount 18,595 employees as on December 31, 2018; 8,621 employees in India, 9,974 employees outside India. We have net addition of 226 employees in Q3. Attrition, here there are three statistics here and I will focus the relevance of each one once I finish the summary. Onshore US and Europe has reduced 45.8% compared to 54.9%, offshore also has reduced 44.8% to 39.3%. But the third statistics which I really wanted to highlight this quarter was that our early attrition has spiked to 83.4% compared to 43.9% in Q2, especially in the UK.

What is happening is early attrition is defined as a period between day 1 and day 180 when an employee has gone through the process of recruitment, training and has come into the workforce. And in that 1 day to 180 day period any attrition which happens in that period is usually seen to have a lesser of an impact on the business than attrition which happens greater than 180 day period. So, the current attrition which is being reported is greater than 180 days. But peculiarly in Q3 we have had significant high attrition in the early stages which has resulted in two things, one is we have left revenues on the table on account of inability to deliver headcount to fulfill existing business. And also, we have not been able to deliver on business commitments that our clients have given us because of this peculiar problem. So, we are trying to put a finger on why this has suddenly affected us. Obviously labor markets, at least in London there exists most of this impact, we have seen this in London Derry and Cardiff. We are the largest employers in London Derry, so the labor market suddenly seems to have tightened up and for reasons which could be because of the impending challenges around Brexit, people leaving the labor markets and going back, we do not know. But what we do know is we have also had new competition come in in Derry which have poached some of the people of ours in that 0 to 180 days where people have gone through, gone live and then figured out that they would rather go work somewhere else given the work profile that they undergo when they go live the program. So, whatever be the reasons, the reason I am calling this out is we have left revenues on the table, remediation is underway. It will have some impact in Q4 and I expect that we probably would leave about $4 million of revenues between Q3 and Q4 between opportunity lost and volumes that we have not delivered on our current estate which will impact us. Again, nothing to worry about and right now we are framing out other methods of how we can look at homeworking solutions, how do we work at bringing in some temporary staff in peaks where occupancy rates are highest, there are several operational measures that work to try and mitigate this. But the statistics of 43.9% at 83.4% and the impact it had on the business was real and I thought it was prudent and transparent on my behalf to bring it out and highlight this to you.

On the net debt position, obviously our long-term debt is done, we are $0.3 million net cash as of December 31. Any debt that we have is all short-term working capital related debt which is going to continue, which is going to be part of our business. So, everything that we had as far as long-term debt is now done with as far as the company is concerned.

On FX hedges, outstanding FX hedges at $71 million for the dollar and £107 million for the next 12 months anywhere coverage of the USD-INR at INR 70.1 levels, 90% coverage for GBP at INR at 99.4 levels and 51% coverage for the GBP at PHP 71.8 levels. For the ensuing 13 to 24 months, 60% coverage for USD at INR 73.8 levels, 84% coverage for GBP at INR 102 levels. Post 24 months, 88% coverage for the GBP at INR 110.4 levels. So, that is our position on hedging.

If I take a look at the revenue composition, by geography vertical, delivery, segment or top five clients, by geographies pretty stayed across Q2 and Q3. US continues to be the alpha at 55.2% and UK at 43.8%. India, one client we work for contributes 1%. From a vertical perspective, BFSI continues to be the largest segment at 35.3%, followed by healthcare at 34.1% and telecom and media at 28.5%. From a delivery location, offshore we have had some ramp downs in Manila which has shrunk our offshore estate plus we have had growth in on-shore, so a combination of both has ensured that there has been a 180-basis point reduction in our offshore estate between Q2 and Q3, which is reflected in a similar increase in our onshore revenues. From a revenue by segment perspective, the customer management is 56.6%, healthcare is 32% and collection is 11.6%. Our top client is about 25% of our revenues and our top five clients is 41.2% of our revenues.

Let me to go outlook:

I think from a business outlook perspective I will break it into three segments, one is what is happening at this point in time, as I said, the US business, despite labor markets being tight because both the US and UK are seeing record low unemployment rates, we still are in a good place because most of the businesses there are deeply domain driven, mortgages, healthcare, businesses and even collections where our pay-scales are definitely way above what some of the lower end thresholds are. So, there we do not see too much of a challenge. But in the UK market we definitely have seen a tightening of the labor markets and all I can do is we have been trying to diversify our footprint from highly concentrated locations like Cardiff, London Derry and Derby into higher unemployment towns. While in UK the unemployment rates are at 3.5%, 4% which has not been seen since 1970, I think there are certain towns which have 10% to 12% unemployment rates and that is there we are trying to go and convince customers to help us create capacities there where we can deliver for them. But that is longer term solving these supply chain challenges that we see currently. But I will give you an update on how some of the remediation work they are doing, how is it playing out, I will be more than happy to discuss as we make progress going forward. So, as I said, we expect a revenue loss of $2 million to $3 million because of the business that we are not able to deliver to the existing customers. We also have seen our revenue deferment of $2 million to $3 million of $20 million TCV contract that we won in Q2 of last year, which was supposed to go live in November in 2018 has now been delayed to March. That deal is one, it is a deferment because its first time the client is outsourcing anything and there are huge challenges around technology migration and integration of the middleware which is driving our digital agenda with the client has created certain issues in the go-live. So, the go-live has been delayed by a couple of months and we ran into Christmas and the holiday season where nothing works. So, what was supposed to go-live in November is now going live closer toward end of this month or early part of March, and that is going to cost us $2 million to $3 million. So, $2 million to $3 million volume reduction, $2 million to $3 million in deferment has essentially set us back by about 1.25% of our growth expectations that we had for the full year. Apart from that, significant momentum in our mortgages business. Our collections business and mortgages business will continue to have outstanding performance over the current calendar year which coincides into big part of next fiscal year. Healthcare provide a business on the back of uncompensated care integrated models, the digital models that we have introduced in hospitals on the front-end of patient access and patient care is doing outstandingly well. So, collections, mortgages and healthcare will provide and we will do very well. And the customer management business, we have the deals, we have the opportunities, we have customer contract signed, it is just that fulfilling those opportunities is where we are focused on and making sure we have no revenue leakage going into next year.

How would the Brexit play out? To be very honest, our clients have planned a certain level of contingency in case of a hard Brexit, but at this point in time it is crystal ball gazing, nobody exactly knows which form it will take. If it is a hard Brexit it has huge ramifications, if it is a Brexit with a deal then I think things will definitely settle down very quickly. And we should be back to where we were very quickly. So, again, it is a crystal ball gazing at this point in time. We will be depending on now events play out, we will let you know what the impact on our business is, both positive or negative.

The payer business has headwinds and it will continue to have headwinds going into next year, both on the back of follow-up of enrolment business which we saw from one principle client. The payer business is going through what the customer management business went through three, four years, where the mantra was shrink to grow. So, here we are shrinking our revenue to consolidate other partners that are in certain niches that we work in and we are taking that business and that will drive growth. But the shrinkage is going to be evident first and then the transformation lead revenue on how the consolidation plays itself out is more long-term. Our digital lead growth is clearly changing the margin profile of the company. Two years back our digital lead or transformation lead, which is the full spectrum of everything from automation, intelligent automation, AI and analytics was less than 5% of our revenues. We clearly are heading towards 10% this year and we have a path of getting that to 20% to 25% over the next couple of years. Several initiatives we have appointed McKenzie for looking at our entire digital strategy and entry into new business verticals which can have a disproportionate growth rate, leveraging the core capabilities and competencies that we currently have. And obviously we are looking at full augmentation of our sales force at this point in time to drive the growth rate that have been lagging us. Plus, our capital allocation is going to be prudent on our M&A strategy in some of the pivots that we are looking at.

So, overall, the margin expansion story will continue into next year. This year whatever commitments we have made we obviously have out-delivered on the margin front and we will likely under-deliver on our revenue growth for the reasons that I had explained. But next year we expect that both on the margin and revenue front should be good, basis the Q4 exit run-rate that we will see on the book businesses and some of the signed contracts which will start playing out beyond the Q4 run-rate into next year.

So, that is the summary and summation I had. And I am happy to open it up for questions at this point.

Moderator: Thank you very much. Ladies & gentlemen, we will now begin the question-and-answer session. Our first question is from the line of Ashish Aggarwal from Principle Mutual Fund. Please go ahead.

Ashish Aggarwal: Sir, two questions from my end. First of all, we alluded to some ramp downs in our Manila business, I wanted to understand the reason and whether that is permanent so to speak? And secondly, on the largest client, right after two, three quarters we saw some growth. I wanted to understand whether this type of a growth now is sustainable or do you think that client will still be flattish now going forward?

Rajesh Subramaniam: Yes. Firstly, on Manila, there were two long standing client accounts of ours which unfortunately haven't scaled beyond a threshold of $2 million to $3 million. Unfortunately, we have not managed it. We have grown onshore with one of those clients significantly, but not on offshore, and that business was also linked to certain compliance related work in the UK where part of it was offshored and that has run off. So, that was one client. The other client, which was a big US telco, we were doing provisioning work we ran out on automation. Provisioning work can easily be automated, there was a significant automation that we drove and the number of people on the program had come down significantly over the last two years. And then the client found it prudent to consolidate with a larger partner in Philippines than manage a vendor manager managing a small partner like Firstsource in the universe where we couldn't grow beyond what we were doing, the provisioning work that we were doing for them. So, that explains the Manila issue. On our largest client, we will see some volatility going forward. There is going to be a realignment of the estate over the next six to nine months. We will be partaking with some part of the business and we will be inheriting some other types of work as the client is going to rebalance portfolio. Plus, with the Comcast acquisition, we believe that the number of doors that open for more growth are obviously higher, but the timing of it, how it will play, we don't know. But now, at least for the next six months, we clearly believe that there is going to be some volatility which will happen. But secularly, it doesn't affect our position or our performance with the client.

Ashish Aggarwal: So, when you say next six months will be volatile, so is it fair to assume that once we exit this thing, right, we will be at a similar level what we are currently, or it could be lower?

Rajesh Subramaniam: Yes, we would be at a similar level, yes. When we get to the figuring state we will be at a similar level, yes, but timing could be different.

Ashish Aggarwal: And just wanted to understand a little bit on this issue in the UK. Now if I look at your UK revenues, that doesn't seem to have declined. So, I wanted to understand what impact did it have on your UK business, this whole attrition issue?

Rajesh Subramaniam: Yes. So, in the UK, our volumes in Q3 are usually higher than in Q2. So, some of those volumes we could deliver up to 104% - 106% on existing capacity through all times, all that went away because of the staffing issues. And the second one is incremental volume, new volumes that were coming our way is something we couldn't deliver, and this is again from our largest client.

Ashish Aggarwal: Right. Sir, but if I look at your guidance that, okay, this issue on the UK side, plus the deferment, so we will lose almost like $4 million to $5 million going into Q4 on the revenues. So, it looks like that our exit run rate in Q4 will also be flattish or we will do a flattish Q-on-Q type of number in Q4?

Rajesh Subramaniam: No, Q4 to Q3 there will be, because we have other businesses that have grown. So, we expect that between Q3 to Q4 there would be a 3% to 4% growth sequentially basis some of the signed contracts. But year-on-year, the 3% to 4% growth, you see Q4 is always seasonally the strongest quarter, so the incremental between Q4 of last year and Q4 of this year, with what we have done, 4.8% right now, will probably take us to somewhere close to 5.5% to 6%.

Moderator: Thank you. The next question is from the line of Nagraj Chandrasekar from Laburnum Capital. Please go ahead.

Nagraj Chandrasekar: Just wanted to ask on Brexit, what is the worst-case outcome here? And what is the contingency planning that you have done with clients for this outcome?

Rajesh Subramaniam: Yes. So, I think, Nagraj, there are two parts of Brexit: One is, what does Brexit do to our clients' business; and what does Brexit do to the currency. Now in the short term what we can try and do is increase our hedges on our GBP's exposure to the offshore book, which is what we are doing, given beginning rates of 110 and 120 within year three and year five. The expectation is that if it is going to be a very hard Brexit, there could be a parity of 1:1 between the USD and GBP. I mean, that is what some other pundits are saying. And if the Brexit outcome is extremely positive, the GBP could get to 1.5 to the USD. I mean, today, the GBP is at 1.33, it has climbed up from 1.28 to 1.33. So, the underlying message seems to be a little more of a bullish overtone than what the worst case could be, so we do not know. So, that is one angle of how we play the game of Brexit between the two spectrums of a hard Brexit or a Brexit which is amenable to all.

Second, on the business, let's take a look at the businesses that are going to get affected the most for us is going to be the banking business, because they are the ones which are completely integrated into cross-flows with Europe. I mean, the banks, we focus more on the retail side, but if banks' health overall gets affected and then decisions get taken on how do they spend their budgets if their numbers don't play out, basis a hard Brexit. At this point in time, to be very honest, we have not got any indication that tells us either to cut back or expand. I mean, logically speaking, a hard Brexit puts financial stress, which means the agenda becomes caught, which means people like us should benefit. But that will play itself out later. In the short-term, a hard Brexit could have a very different impact on customer behavior and customer experience, which means there could be volume shrinkage. It is something that customers are not telling us. So, at this point in time, to give you a very honest answer, the customers today have done some stress tests in terms of a hard Brexit, but nothing requires us to manage volumes at a lower level in our current core engagements. Now we also do some managed services work where we deploy people, we have a consultative engagement within our client infrastructure where we deploy our people, we drive our transformation agenda and where we drive the operations where in some of those engagements will the client want us to flex down if they have budget freezes, possibly yes. At this point in time, it is all crystal ball gazing, and I think there is an inclination that the Brexit, the honorable Prime Minister could get her deal finally with both parties, the bipartisan support coming through with some minor tweaks and the landing will be smooth. But again, it is going to be a poker game that is going to go down to the wire, and then we just have to see how it will play itself out.

Nagraj Chandrasekar: And secondly, on the labor tightness situation, this is something I think we spoke about the last con-call as well that it has actually fructified. Just over the last three months have you been able to take up, have you taken up compensation for your hires in Derry and Cardiff? And are you being able to pass this on to clients with the lag in discussions you may be having with them?

Rajesh Subramaniam: No, again, it's not just compensation. See, if it was compensation then my attrition rates of beyond six months tenure should have also shot up. If you take a look at it, my attrition rates of greater than 180 days have actually come down. So, this is a peculiar issue that we see where people coming in, in that quarter for the business either the occupancy rates, what they thought they were signing up to, what they actually went on the floor, what happened, could have been very different. Plus, earlier to hire 100 people we used to screen about 500 or 600 people and used to land one in 5 or 6. Now to create that pool of 500, 600 is proving to be a challenge. Which means, on the same ratio of 1:5, I am possibly screening 300 people and I am getting only the percentage conversion that the 20% conversion of 60% or 80%, and I am leaving 40% on the table, which is the tightening of the labor market. So, where is that labor supply going? I mean, were there people from mainland Europe? In Cardiff, we have seen it. In Cardiff also I have a similar challenge, not just Derry, in Cardiff also I have similar challenge for the largest utility we have signed up where, again, I have business for 130 FTEs and I am not able to deliver because I am not able to get the requisite number of people through the door. Again, Cardiff has got a huge student population, multicultural background, a lot of colleges taking students from Europe, and probably that workforce has decided not to join, I mean, that population has decided not to join the workforce in UK. I don't know. I mean, we are trying to work with local council office with recruiters to figure out what, including our peers, including our competition. Unfortunately, in Derry, we are the largest employer. I mean, the next competition would probably be a Danske Bank or somebody else, and not on the services side. So, at this point in time, I do not have a ready answers on how we are going to deal with this. Compensation is one part of it where we can increase deferred incentive plans, and the way we work the game is any DIPs we put in place, we try and earn it back through incentives because it is supposed to have an impact on productivity. But DIPs work very well with tenured staff, not with staff in the 0 to 180 day bucket, because lack of tenure means a lack of productivity. So, putting in an incentive plan when you don't have the optimal productivity doesn't make sense. So, at this point in time it is a question of numbers and it is all hands on deck in figuring out how we meet the numbers for a client's demand which is there. I mean, at this point in time, it is hard enough to go and create sales opportunities in a competitive market. But once we have the sales opportunity, the inability to deliver those numbers which you have seen in Q3, has set us back. But I think there are more minds at work to try and address that. Hopefully, I will have a better update and I am happy to give you an update in 30 days to 45 days as we come closer to the end of the quarter and we know where some of the numbers will settle.

Nagraj Chandrasekar: And would you, at this point, give us the guidance for constant currency growth rate you see in FY20 based on your back book?

Rajesh Subramaniam: No, not at this point. Again, in 30 days to 45 days, I will have my entire budgeting process done, including some of the initiatives we are driving with McKinsey and the outcomes we expect to come out from there. I should have a clearer picture by 15th of March.

Moderator: Thank you. The next question is from the line of Dipesh Mehta from SBICAP Securities. Please go ahead.

Dipesh Mehta: A couple of questions. First is about the impact of attrition, early attrition spike which we have seen. I think you alluded to two factors, first is about missed volume; and second is about lost business opportunity. Can you help us understand whether we are losing business to some other vendor in the same account kind of thing? So, whether wallet share shift we have started to observe?

Rajesh Subramaniam: No, it is the largest client where that miss volumes will go into their captive. And when it goes into their captive it goes at a higher cost, that is the reason. The business which would have come to us has gone into their own captive centers, and it increases their budget, it makes them a little unhappy, but nothing beyond that. The other one is an accelerated ramp with a large utility that we won, that business which was being implemented in Cardiff, if we had the supply chain we could have converted those into revenues into Q3 and full-blown revenues for all quarters in Q4. Now that delay is again revenue loss, it is not going to anybody, it just delayed the ramp process with the client.

Dipesh Mehta: The first part which you said with the top client, now if I look, even after that top client has done fairly well this quarter, so whether we expect that the top client to do that well?

Rajesh Subramaniam: No. As I said, the Q3 is a good quarter with the top client where we hit numbers of 104% to 106% of the stated volumes given the number of subscriptions and what we see with the top client. So, in Q3, which seasonally is our weakest quarter for all of our business, in this business it is a better quarter. So, we could have done better, if we had clawed back $2 million of revenues, we would have obviously done much better and our matrices would have looked much better with our top client.

Dipesh Mehta: Understand, So, broadly now once we have that seasonality moves out, you expect again Q4 to have some weakness in top client, right? Because...

Rajesh Subramaniam: Broadly speaking, yes, but we expect that some of the new businesses that we are going to get could keep it at the same level. But yes, assuming everything remains the same, Q4 will seasonally be slightly lower than Q3.

Dipesh Mehta: Understand. And if I look your top two to five customers, it seems to me there are some weaknesses kind of thing. Can you help us understand what is happening there? Because outside of top client, I think we have seen decline in top two to five.

Rajesh Subramaniam: Yes. So, top two to five one of the clients has been in healthcare. I think we have clearly seen, as I said, we are having headwinds in our healthcare payer business where we have to shrink to grow, and that is playing itself out. And so that is one element which will impact sequentially. Apart from that there will be some volume changes which keep happening plus or minus. probably in this quarter three of the top five clients would have seen some volume changes which is nothing material, nothing to worry about.

Dipesh Mehta: So, if I look your quarter two release, at the end of quarter we have shown headcount is 19,615, September-end. Now if I look this quarter September-end, your headcount is 18,369. So, there are different number for the same period-end headcount.

Ankur Maheshwari: So, Dipesh, it is Ankur. There was an error in the Q2 release, which has been corrected this time around. We caught the error while working through the quarter through and have corrected that now.

Dipesh Mehta: Because it seems the Q1 number also seems to be different because the way you provided Q2 number and year end numbers.

Ankur Maheshwari: Q1 should be the same. I mean, I can work with you after the call and take you through, but I don't think there is any change in Q1 numbers. Q2, there was a number we have changed here because there was an error in terms of how we calculated the number there.

Dipesh Mehta: Sure. Now coming to the outlook part. Now considering the challenges which we are facing in terms of staffing, particularly into UK market, any change you want to highlight into any of the verticals? Do you have any of those kind of things such as BFSI, telecom, healthcare or other way to look at this customer management, collection. So, any changes to the outlook you look for next 12 months.

Rajesh Subramaniam: So, as I said, the mortgages business and the collection business are going to have stellar years, next 12 months are going to be very good. Obviously, mortgages, again, January, February, March is seasonally weaker compared to October, November, December. As for the collections, January, February, March is far superior to October, November, December. So, overall that is as far as FY19 is concerned. But going into FY20, mortgages and collections will have outstanding growth, superlative growth basis some of the contracts that we have signed and the momentum we have seen. And both of them predominantly sit in the BFSI bucket. So, BFSI, we expect will be the largest vertical going into next year. Similarly, in customer management, our large client will largely remain stable. I do not see any changes there. So, the Media vertically is largely our largest client, there is nothing more beyond that and then one client in the US that we have which is all offshore, which is growing. But numbers are relatively smaller compared from a revenue perspective compared to onshore. So, media will be the smallest vertical. Healthcare provider will continue to do well, we are seeing very nice momentum and conversion of ACVs into booked revenues in businesses. The payer business will see headwinds and we will see some shrinkage. So, at the portfolio level, BFSI, healthcare and T&M would be the order of how the businesses will play out. And in customer management, the growth is going to be driven again by BFSI, spanning mortgages and contact center work we do in UK for UK banking clients.

Dipesh Mehta: Sure. And just last thing is about slightly medium term. If I look Firstsource, we are indicating a high single-digit growth is very sustainable kind of thing. But if I look last two years, particularly, it seems to be one or other channel we faced in last two years or maybe three years kind of thing. So, how confident you are for achieving medium-term high single-digit revenue growth trajectory?

Rajesh Subramaniam: So, I think when we start the year we always believe that we will achieve the 9% to 10% growth. It is just that, as I said, in our business the uncertainties we have seen in the economic environment over the last two years between what's happening in North America and UK, which are the two principle markets has set our sales engine back by a combination of missed opportunities and underperformance of the sales team, no going away from that. But we have got some ideas now and how we are going to fix it, and we also have the expertise of McKinsey now working with us in relooking at our entire front-end sales strategy and identifying new growth areas within our existing clients and new growth areas and new businesses that can help drive a different pivot. So, yes, again, nothing that is going to translate into results over the next three months, but we expect that over the next 12 months we should be on a more sturdy footing in the way on what we guide and how we achieve that guidance.

Moderator: Thank you. The next question is from the line of Rahul Jain from Emkay Global. Please go ahead.

Rahul Jain: Rajesh, so based on the current visibility can we say that going into CY19 we are relatively having more negatives compared to the 12 months back, I mean, be it in terms of attrition delay, healthcare payer side, top client run rate, Brexit and stuff? And similarly, what are the incrementally positive in CY19 compared for CY18? Like you said in case of mortgage BFSI staff, but anything apart from that we should count positive compared to what it was a year back?

Rajesh Subramaniam: Yes. I think CY19 has got four quarters and generalizing the labor supply market negativity which we expect from Q3 to some part of Q4 and expect to continue through CY19 is a generalization I won't make. So, Rahul, let's get them realism in that. And top client volatility in CY19 plus or minus, it keeps happening. You have seen that the top client numbers vary between three quarters, that's an engagement. And when you are a single supplier, that is what happens. But you will also appreciate that after being acquired by Comcast, there are more opportunities than less if you would like to believe that, that will play our way. So, that is number two. Number three, our collections business and our mortgages business will continue to grow upwards of 15% to 20% going into next year. And this is, again, you will see it in the numbers playing out basis on the contracts we have signed. And as I said, we don't have some of the peculiar challenges we face in the UK in the US. Similarly, the deals we have sold in the provider business, we have sold almost $18 million to $20 million of business in the provider business, which unfortunately have converted to only about $4.5 million of revenues this year. It is because most of the sales have been in eligibility services where the conversion to revenue takes over six to nine months basis and how our program ramps up. Now, the sales that we made in FY19 is going to translate into significant growth uplift as we start FY20. There will be some shrinkages, there will be some volume compression, that is the way of life, but net-net, the growth rates are going to be very good. So, between collections, mortgages and healthcare provider gives us enough momentum to set us up well for our fiscal 2020. Now, what those exact numbers are, we are still in the process of formulating them and come with a clear basis, and we will be able to do that by the middle of March.

Rahul Jain: Right. And anything more in terms of the top client? Because I mean, any movement in any direction would be significant to monitor given that run rate is much lower than the peak run rate?

Rajesh Subramaniam: Yes. So, as I said, I mean, I cannot tell you that the top client will move from 23.3% to 23.8% and then can come to 21.4%. In our business it really doesn't work like that. Unfortunately, it is not an excel spreadsheet, it is a business that we manage basis the economic environment and the business that our client's clients engage with them. So, as I said, the top client business will see volatility, there will be pluses and minuses which will happen, but secularly we are in a very good place with them and we have a long-term contract. That is the only comfort I can give you.

Rahul Jain: Right. And the mortgage and collection side of the business, what has been the biggest differentiating point in terms of driving this positive win that we have already achieved because I mean the peers have a very mixed set of a performance in this space?

Rajesh Subramaniam: Yes. So, as far as in mortgages, it is clearly the pivot to mortgage servicing which continues to bear results. So, as we have de-risked from the origination business, which was at the vagaries of the 10 year interest curves, I think we have the pivot to servicing whether the servicing side of the business which used to be less than 20% two years back this year will be more than 50% and expected to grow going forward is obviously giving us that much more stability. And the way we are winning business essentially using automation technologies to go and reduce the costs are far significant than what simple labor arbitrage would present itself. And then that also supports in margin expansion, so that's on mortgages. In collections, we have created an internal digital collections tool, which is enabling us in covering portfolios far higher multiple than what a human intervention could possibly do. You will appreciate if you understand our business we are completely on an outcome basis on our pricing. So, when we get a portfolio of leads, we have to figure out which person whose debt has been charged off is likely to pay and how do you create settlement strategies with them so that we get paid. But now with this digital tool, the coverage that we get is of a 10x multiple on the number of people we can try and work this through. And some of these low balances which I will not use employees, because the liquidation of a low balance scenario is not worth the time that an employee spends trying to collect, will start getting covered by the digital tools we have created. And we clearly are seeing a huge impact in the revenue uptake coming in from it. So, the clients that have signed up for this, this is not in the lab, this is deployed. The clients that have signed up, they are very excited of what is going to come out of this avenue. And we fundamentally believe that on a percentage growth rate basis, the collections business will have the highest percentage growth. It is roughly a $50 million business, but will have significant growth for FY20. As we finalize the numbers, we will give you more clarity.

Rahul Jain: Right. You said this is 50%?

Rajesh Subramaniam: It is a $50 million business right now.

Rahul Jain: And in this part, so is it more coming from first-time outsourcing kind of a client.

Rajesh Subramaniam: Existing clients.

Rahul Jain: Yes. So, it is like the volume which we are adding is coming at the expense of the internal resources or vendors?

Rajesh Subramaniam: Rahul, as I said, if you have an understanding of a business, I get a portfolio of clients on whom debt has been charged off. So, Rajesh Subramaniam could have a debt of $100 that has been charged off and Ankur Maheshwari could have a debt of $5 which is charged off. Now, it makes sense to put an agent to work the Rajesh's debt off so that Rajesh can have a settlement which will then ensure that Firstsource gets paid. But going after $5 that Ankur owes is not a worthwhile time for the agent. That is where I deploy my digital collections tool which then has a basis of entering into a settlement where Firstsource would not have worked on those accounts. You get it?

Rahul Jain: Yes, this is more on the outcome side of it?

Rajesh Subramaniam: That is why it is not cannibalization.

Rahul Jain: Right. So, this is in the same account perspective. What I am saying is, if this business needs to continue to grow, will the existing pool of customers is what we are targeting or there could be more opportunities?

Rajesh Subramaniam: No, existing pool. I mean, I work with six of the top 10 credit card issuers. I have 60% of the market share that I have access to. And so that is my first starting point. Second starting point, huge applicability of this tool in healthcare collections, huge applicability in healthcare receivables management, huge applicability in mortgage collection. So, what is happening is the efficacy of this tool is now being rolled out into other parts of the businesses where we are trying to figure out how we drive higher touch points using the analytical digital tool that we have, which enables the tool to create a conversion into cash strategy which doesn't require human intervention.

Rahul Jain: Right. Sir, but also, is it safe to assume that any more growth on this is very likely to lead to much better profitability because then that leverage will play out significantly?

Rajesh Subramaniam: Absolutely. That is a great catch because this will drive, that is why whenever I say that the outlook, my margin expansion story will continue on the back of digital transformation net growth. When I gave you that feedback of 5% to 10% and the migration to 20% over the next couple of years, that means that my margin expansion will rise in conjunction with the quality of the business I am doing with my clients in these businesses.

Moderator: Thank you. The next question is from the line of Ruchi Burde from Bank of Baroda. Please go ahead.

Ruchi Burde: Rajesh, I wanted to ask you regarding the UK labor market situation and the attrition that you mentioned. Would it have some margin ramification for you?

Rajesh Subramaniam: Absolutely. So, the fact that I am leaving existing business on the table will have some margin ramifications because it's already on the basis of an existing business But there are other parts of the business where my transformation-led growth is giving me a higher-margin uplift, which is compensating for the margin fall-off that I am seeing where I am leaving revenues on the table of my existing portfolio. Opportunity loss could have given me a margin uplift because some costs already paid for would have delivered on the incremental volumes, which is out there. So, there is an opportunity lost on a margin perspective and there is actual margin loss in the existing estate because of the conundrum I spoke about.

Ruchi Burde: Understood. Secondly, it has been a while that Firstsource have had significant large deals of something like the Sky consolidation that you won or previous to that, something like a Lloyd deal. How is the market for this large deal currently? Do we have something in pipeline or such large deals are no more there in markets?

Rajesh Subramaniam: No. We signed a $70 million TCV with a large utility last year, which I explained to you. Then we have signed in the US, we have signed a $20 million TCV deal. So, the deals exist. I mean, Sky was $150 million. That scale of consolidation was completely different. That honestly at this point in time, I don't have anything in my pipeline that suggests that I have an opportunity of that size and scale and magnitude. But the $20 million to $50 million TCV deal, so a contract period ranging from two to five years, absolutely. We have several which are under progress at this point.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to Mr. Rajesh Subramaniam for closing comments. Thank you, and over to you, sir.

Rajesh Subramaniam: Yes. Thanks, everybody, for your time. It's been a mixed bag quarter, but overall, the bias is positive. Feeling very good about Q4 because it is really a better quarter than Q3. And going into next year, we'll come back to you with more details and color on what the actual guidance on numbers will look like. But as I said, we feel positive. Apart from our Healthcare Payer business, we feel very positive about the outlook of the rest of the businesses that we manage. So, again, thank you for your time. And Ankur, Dinesh and I will be more than happy to take any questions that you may have, that you would like to cover on a one-on-one or a small group basis, happy to take them. Thank you very much. Appreciate your time. Bye.

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