Q4 FY2020 Earnings Call Transcript - May 27, 2020

CORPORATE PARTICIPANTS

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Moderator: Ladies and gentlemen, good day and welcome to the Q4 & Full Year FY'20 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 '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Ankur Maheshwari, Head Investor Relation from Firstsource Solutions Limited. Thank you, and over to you, sir.

Ankur Maheshwari: Thanks, Margaret. Welcome, everyone, and thank you for joining us for the Quarter and Full Year ended March 31st, 2020 Earnings Call for Firstsource. Hoping that you and everyone around you are keeping well in these times.

To take us through the results and to answer your questions, we have with us, our Mr. Vipul Khanna our M.D. 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 a Q&A Session. Please note that the results, the fact sheet and the presentation have been e-mailed to you and you can view this on our website, www.firstsource.com.

Before we begin the call, do 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 now turn the call over to Vipul Khanna to begin the proceedings.

Vipul Khanna: Thanks, Ankur. Good morning, everyone. I wish everybody is keeping good health, good spirits and hopefully minimal cabin fever coming into wherever in the world you are, week-8, week-10 or week-12 of the lockdown.

So today, let me start by taking you through the impact of COVID-19 on our business and what measures we have taken to combat the situation, give you a sense of how Q4 was and highlights for the full year 2020 and then give you a quick sense of the outlook before we open up for the Q&A. Now given the situation, I have slightly longer remarks today so please bear with me.

So clearly, right, everybody is kind of, I am sure fatigued with the sort of COVID situation. We know what has happened. We as a business swung into action sort of 2-3 week of March as situation unfolded. We set up a war room to quickly organize and respond to the situation around the world. Very proud to see how our leadership team, facilities, HR, IT, procurement and a number of other functions work tirelessly 24/7 to make sure we had client approvals, mobilization of equipment, connectivity, etc., so that we could enable work from home in as many locations as we could. And clearly, very proud of the 21,000 Firstsourcers' who navigated the change and kind of seamlessly went into delivering what they needed to do for their clients. So obviously, our first focus was getting the work at home of go live wherever we needed to. Clearly, some of our centers in UK and US continue to operate at reduced capacity and then a lot of capacity has shifted to work from home.

Initially, we had some supply-side challenges, but we are able to meet the demand in a fairly short period of time. And I am pleased to note that we are addressing today almost 95% of the recalibrated demand from our clients. Once that was done, we set up 8 work streams to fine tune our work at home operations and re-architect the distributed operating model. Each one of my leadership team executives is leading one of these 8 tracks, and we have nearly 100 of our top leaders participating in this.

Quick sense about these tracks are: First track is obviously staying exceptionally close to clients and their industries for their short-term needs and emerging trends, getting a sense of what they are feeling, what the clients are seeing, what are they sensing, what their needs are so that we are responsive and as much as possible ahead of the game relative to the industry trends.

The second track was effectively managing remote operations. Clearly, we do it at some scale or pre-COVID we did it at a small level, but not at this scale. And it has taken some doing. But we are in a good shape now where productivity, quality, information, security is sort of as much calibrated to as it was in a normal operating environment.

The third track was about employee engagement and well-being especially in this environment. They are grappling with multiple variables as well and yet continuing. So, it takes a different level of engagement and taking care of oneself and the team to make sure things work.

Fourth track was scaling up our capabilities for remote hiring and remote training. Again, we have been doing that in the past, but this is about scaling at that level, using technology effectively and making sure our methodologies are robust enough to make sure even without meeting anyone, we are able to bring in people, train them and put them onto production on client-critical processes.

Fifth track was up-skilling for digital given how rapidly the environment has changed.

Sixth track was about given the macro conditions in most of the geographies we operate, we are very focused on how do we step up on our impact sourcing of talent.

Seventh track is about how do we sell effectively in a remote environment, right? Our sales folks, our product guys, our solution folks, how do they become as effective if not more in being able to do it through video when they do not have some of the traditional avenues available.

And obviously, the last track is about cost actions to keep our business healthy, calibrated to sort of revenue trends, while also protecting our core growth investments. So, these tracks are how we are kind of managing through beside our BAU business and I am pleased that the progress we made and the energy it has created in the organization to operate in this environment.

With that, let me give you a sense of the Impact of COVID-19 on Q4 Results. Our Q4 FY'20 performance was impacted by approximately $6 million in revenue. There was a reasonable part of this, which was supply-side impact, as well as some client demand where in some of the geographies client had to initiate action, as their economic environment changed, as their physical environment changed, they cut down on some of the activities, and we saw some of the demand side impact. Primarily, 2 business's impacted customer management. A couple of our clients prioritized service only to specific customer segments and took a risk call not to pursue work at home. So that impacted CM revenue. And then healthcare, we saw a downtick from sort of February onwards in the state payments to hospitals. And keep in mind, we work on an outcome basis. When the hospitals get paid is when we get paid for the work we done for eligibility services, etc., So that was February onwards and then second half of March onwards, as COVID treatment became priority, the normal procedure, the elective procedure that you will see in hospitals, that volume plummeted, right? And again, that kind of ripple impact came to some of us to a couple of our services. So those are the 2 businesses impacted amounting to about $6 million of revenue impact.

As we go into Q1, we do not anticipate any supply-side restrictions in our business now, I think we are pretty much covered on that. However, we do see demand-side impact as a lot of our B2C clients as their economic environment has been impacted. As they slowly start to kind of open up and we scale, we will see some resurrection of the volume kind of come to us. But I will give you a little bit more details on Q1 towards the end of it. Healthcare and Collections also seeing some impact in Q1. But we expect that demand to kind of bounce back pretty quickly. The one thing to point out is that the inherent advantages of our portfolio mix has helped. right? We have no exposure to the first order industries which are impacted today -- travel, hospitality, retail, etc., Also, our delivery footprint with heavy onshore presence gives us greater optionality relative to how hard the lockdown in India and Philippines have been. That is kind of the state of affairs from the operating standpoint.

We also see some pockets of opportunities emerging with the interest rate environment even lower than what it was sort of in quarter-ended December. There are macro tailwinds in our mortgage business, and we have had to scramble additional capacity. In one instance, we repurposed nearly 300 people in India almost overnight to meet additional demand and obviously we had to look for redeployment of resource as well given the shortfall in demand in CM as I mentioned earlier.

The second opportunity we are seeing is that as our clients face some of the supply-side constraints in their own operations or rather face maybe with other partners, we are seeing some short-term demand come through given the supply/demand imbalance in their capacity, especially in Customer management and Payer. We hired 180 work from home associates for one payer client in 4 weeks given how they needed additional capacity for one of their businesses.

And thirdly, Digital work demand is accelerating and we have had very good conversations progressing for M FOCUS, which is our Healthcare product, digital collection, the digital intake product for Payer and then intelligent automation and I will give you a little bit more sense as we go along.

So with that context, let me brief you on our performance for this quarter and the year-ended March 2020. If you are following along with the slides, the first slide. Our revenue for fourth quarter was Rs. 10,804 million; this was quarter-on-quarter growth of 2.6% and 0.6% on constant currency basis. This also translated to year-on-year reported growth of 11.7% and constant currency growth of 8.2%. Our operating margin came in at about Rs. 1,168 million which is about 10.8%. This was a contraction of 40 bps from the last quarter. And then our profit after tax came in at Rs.916 million which translates to 8.5% PAT Margin. QoQ PAT was flat. And EPS came in at Rs.1.31 versus Rs.1.29 per share in Q3 FY20. Now, the revenue and margins are slightly lower than what we had planned for. We had given you a carefully calibrated forecast in February when we had talked about the Q3 results. Since I have joined in August, I have been very conscious of the forecast we gave. And I think we were progressing really well when the quarter started. However, the last half of March put paid to those efforts and we saw that impact in our revenue and our operating margins.

If I give you a quick sense of the FY20, our revenue came in at Rs. 40,986 million which is year-on-year growth of 7.1% and a constant currency growth of 6.6%. Operating margins came in at 10.8% and PAT came in at 8.3% at Rs. 3,397 million. Full year earnings per share came in at Rs.4.89. Now, just to draw your attention, we had guided to a full year growth of 7.5% to 8% in the third quarter and we had said our operating margins will be in the 11% to 11.2% range for the full year. Again, this contraction is due to sort of revenue and the resultant cost impact from COVID. And if I could take a minute to draw a perspective for the full year, as I have been saying in the past couple of quarters, when we started the year, we had a reasonably large portfolio, rebalancing of our Sky estate, given they had taken some call of rationalizing their portfolio and taking some of the operations back. We had initially in the first quarter and a half attrition and hiring challenges and then we had delays due to the Brexit related demand. So, in that backdrop and how we started, I am pleased that sort of where we landed up at a 6.6% constant currency growth and stability in our margins, notwithstanding sort of the COVID impact towards the end of the year.

If I take you to the next slide, which is titled 'Other highlights', our headcount came in at 21,203, of which 11,450 are in India, the remaining 9,753 are outside, that translates to a net addition of 721 in the Q4. Retention continued to improve; it came in at 42% compared to 46% annualized in Q3 onshore and for offshore, it dropped by 2% points to 34%. And this is sort of when we had a full quarter. Obviously, Q1 with the situation, it will only strengthen from this point onwards. A Quick Comment on the foreign exchange hedges. We had outstanding foreign exchange hedges of $40.6 million for USD and £75 million for GBP. And if we give you a quick sense of the next 12-months, we have about 48% coverage for USD at Rs.76.25 and 100% coverage for GBP at Rs.102 level and 32% coverage for GBP at PHP 67.73 levels.

If I could give you a quick comment on our liquidity position, as of March 31, we had cash in hand of Rs.191 crores and net working capital debt of Rs.643 crores. We are very comfortable with our liquidity position and we do not expect any challenges going ahead and we have sufficient working capital lines to draw upon should the need arise. And just as a quick reminder, you are aware, we paid an interim dividend of Rs.2.50 per share in March on top of the August'19 dividend for the previous year. So that pay-out was about Rs.210 crores at the start of March.

Let me now dive to revenue snapshot by segment. We had a strong start to the quarter with seasonal surge in volume for collections and a new line of business time for our largest customer, Sky. And our overall trajectory was on track to meet the quarter results; however, there was a follow-up due to the pandemic. So, if you look at the Q4 numbers, CM is at 38.5%. This benefited from the growth in Sky pre-COVID and a couple of other smaller ramps in our CM customer base.

Collections grew quarter-on-quarter; however, the growth could have been better, but because the tax season and refunds, etc., were delayed in the US from April to July, some of that growth petered out. And the seasonality that we normally expect, it was a little bit subdued.

Healthcare, as I mentioned, saw some decline due to state response to our hospital clients starting February. And then remember it is a completely outcome-based client contract there. And we also started to see the drop in elective procedures as hospitals thrust for COVID patients. So, we had some volume downtrend in provider and then lagged impact on payer as well as in less hospital procedures, less claim for our payer clients and then in some cases less volume for us. But despite that, we had 2 good new logo wins in our provider business for our healthcare business.

Mortgage continue to perform strongly. There is some seasonality in calendar year Q1 because origination business works at a little bit of a lag. So, the holiday season flatness reflects in start of Q1 in the US. So, we had some of that. But overall, we continued strong forays into the market, strong execution, revenues came in flat, but given the seasonality on a run rate basis, they are slightly higher, and we had 3 good logo wins in mortgage as well.

Overall, if I look at the segments, all our segments in this quarter grew over Q3 except for healthcare.

Now let me give you a little bit progress on our digital strategy. We had some marquee milestones there and we will see impact for those in the forthcoming quarters. We launched our platform-based service for post-closing market for mortgage originations with a leading lender. Post-closing is a sharply defined segment in the origination value chain and in our assessment, the market is looking for an integrated solution.

Our collections client which is one of the world’s eminent card issuers signed on an additional contract with us for our digital collections offering, and we are very excited about this win.

In healthcare, we significantly revamped our digital intake offering for health plans and we are seeing very good early traction in our pipeline in that marketplace. And for intelligent automation services, we are starting to see our pipeline build up since Sundara joined in February as Chief Digital Officer, we are starting to see some pipeline building in our BFS and healthcare space.

And lastly, as a testimonial to our digital focus internally, at the India Employee Engagement Summit 2020, we were recognized with the top award for Best Use of Technology in HR.

That is kind of a little bit of commentary on revenue by segment.

If I was to give a quick comment on revenue by industry verticals, Healthcare was down 1% quarter-on-quarter as we discussed some of the reasons; however, we believe that this growth will start to revert strongly in Q2. The other comment I wanted to make is healthcare is a strength for us, it is a changing market, a lot of focus there. So, in line with sort of our belief in that marketplace, Venkat, who was running both payer and provider business, will now focus exclusively on providers. And Venkatgiri Vandali has joined us recently to focus on the healthcare or plan Business. So, we want to make sure we have dedicated leadership for those 2 businesses. BFSI contribution was flat quarter-on-quarter. So, while the segment has grown, its contribution was lower in the overall volume. And Media and Telecom was slightly higher because of the pre-COVID ramp that we talked about.

Let me quickly jump to revenue by geography. If you look at our revenue by geography, mostly flat; US at 63.2%, Europe or UK at 35.3% and by delivery, we kind of continued with sort of our strong gains we had made in the first 3 quarters as well. So, 75% onshore, 25% offshore compared to 82% onshore and 19% offshore in Q4 of 2019.

Client concentration, we had stability as I mentioned with Sky early on with new ramps in place; however, in the coming quarter, we do see a significant decline in the volume from our largest client given the reduced economic activity and how they have given us the forecast. Again, it is a dynamic situation. As UK begins to open up, we will see how the scale-up and the rescale plans kind of come through. But as a testimony to a long and tenured partnership with them, we have very good sort of conversations with them for some of the cost sharing for the stranded costs and we are making pretty good progress on that. Our overall top 5 contribution was flat quarter-on-quarter.

If I was to give you a quick summary of the year, it kind of reflects the same what I said for Q4. We had solid growth in our mortgage and collections businesses making BFSI as one of our fastest growing vertical contributing to about 40% of the revenue. Healthcare providers grew decently; however, our reboot on payer has just about started and we hope to make sort of reasonable gains this year and continue to build momentum going into the next year for the payer business.

CM, our biggest BU was challenged due to Sky portfolio rebalancing early in the year and some of the execution challenges. However, as I said, it is heartening to see that we have now seen broad growth to end at 6.6% growth overall. Pretty much what I mentioned in terms of the delivery mix and the geo mix, those comments for Q4 are reflective of our full year numbers as far as those aspects are concerned as well.

Next, conscious of time, maybe I can take you through the slide which is titled as 'Business Outlook'. Now, even we have entered FY'21 with the uncertainty that we have, and a number of scenarios are possible both on demand side and maybe some supply side impact if the condition worsens. Given the uncertainty, we have decided to suspend forecast for the future and suspend our annual guidance. I will give you a quick sense of how this quarter looks like. And as the year progresses, we will keep coming back to you once we have a better sense of how the full year could look like. So for Q1 FY'21, at this point in time, sitting where we are, we expect revenues could be lower by about 7% to 10% in constant currency terms quarter-on-quarter and we could see operating margin contraction between 150bps to 200bps. Having said that, given the inherent advantage of our industry portfolio mix, I expect the business momentum to remain strong, while we will have short-term volatility, but I am confident of the demand bouncing back in most of our businesses as well as the investments we are making for the new verticals.

Collections, we are seeing some near-term volatility. Some of our clients have suspended activities in some of the states for this quarter and next quarter. So, there is some softness there. However, it is a countercyclical business. You have seen the significant uptick in credit loss provisions which most of the US financial services sector has made. We are having good conversations with our existing clients to ramp up capacity as they start to work through as the economy opens, as they start to work through with their end customers in getting their financing in order. So, I am hopeful of how collections demand will pick up.

Our digital collections offering is seeing very strong traction especially in this environment as clients raise to add capacity and be true to sort of the environment. So, collections, we see short-term volatility, but it should sort of rebound back pretty strongly, starting almost end of this quarter.

Healthcare, we see demand recovery. Some of the volumes which were deferred by either hospitals or patients not going there, we expect that most of that demand will not be lost, it will come back, it has only kind of postponed. We are seeing some short-term pricing pressure as a lot of our hospitals face massive revenue drop in the short-term. So, in the spirit of partnership for some of our key clients, we have participated in giving them short-term relief. In return, we are having good strategic conversation to upgrade into our M FOCUS, which is a digital product as well as having more strategic conversations.

We are seeing opportunities to push upstream in new services like digital streaming at patient registration while we continue to run hard in our traditional eligibility services and hospital self-pay collections. And we see a fair amount of consolidation opportunities for smaller players in that segment as well.

On Payer, as I mentioned, we brought in a new team. Right now, Giri has joined. He is added as a Head of Solutioning. Right now, in the short-term, we are focused on revamping our traditional strength areas which is digital intake and contact center and sort of getting traction with top clients, top-10 health plans in the US market. And we see a good pipeline build up there while simultaneously we are working for our strategy on the health plan middle office market.

Mortgage will continue to benefit from the refinancing boom which is driven by sort of record low interest rates. We believe this will continue for at least the next 2 quarters and then who knows after that. But, given the credit quality concerns, we have seen several new opportunities with existing and new clients open up for forbearance and default support. I talked about the platform based offering for post-closing in origination that we have sold to our first anchor client. And as a mark of traction in this marketplace, we have added 3 new sales executives in the last few months.

Customer management, as I mentioned, we will see big impact in Q1 largely driven by the demand environment and also digital deflection in the customer management business. On the flip side, we are seeing some short-term opportunities in financial services and we do expect some opportunities to come for vendor consolidation and carve-outs as the cost pressure on the clients increase. Sales pipeline is pretty solid. Large deals are seeing some delays in decision-making and go live. But we are happy with sort of the wins we had in Q4 and how April has also shaped up.

If I look at sort of this year, kind of there is a duality of our objectives. We are geared up for running a lean marathon for FY'21 which is to make sure that our costs and our capacity is flexed with the demand. We have taken some resolute cost actions. We have minimized discretionary spend, no travel, etc., We have frozen on increments and promotions for the next few quarters at least and we will take a call as we go along. And there are a number of other cost actions to make sure that our costs stay in line with sort of the demand volatility.

Majority of our operations I believe can now easily switch between office and work from home. I talked about those 8 tracks. We see continued digitization of the entire value chain from selling, executing and delivering, transforming to our clients. In the entire value chain, we are getting better and better at operating in a distributed model across that value chain. So that is kind of making sure we are lean and agile to respond to the circumstances. On the other hand, we continue to bulk up and add muscle for the growth spurts in the right areas where we need to. So digital services are beginning to shape well.

Our next-generation customer experience service is getting ready. Ashish Bisaria joined us I think in March, to lead the customer experience practice and he is hard at work to make sure that we continue to modernize the tool kit and make it relevant for today's digital environment.

I talked about Giri joining for Payer. And the other key executive who joined us is Anshul Verma. He joined us on 1st of May to lead us foray into the comms, media and tech vertical, specifically the focus on the bond digital players.

In all, in CY '20, during the last 4.5-months, we have added 18 new sales/account management sort of execs including a few replacements given the continued push we want to make into our existing areas as well as the new growth areas.

So looking at sort of our portfolio, looking at how we have responded, given kind of the stability we have in today's environment and we are managing the demand volatility as well as continuing to play often in the new areas, I believe we will come in pretty strong at the other end with the pandemic. So with that, let me conclude my long monologue and then open it up to your questions and comments.

Moderator: Thank you. We will now begin the question-and-answer session. The first question is from the line of Manik Taneja from Emkay Global. Please go ahead.

Manik Taneja: Vipul, I just wanted to understand from you, over the last 1 year, we have seen significant increase in terms of our offshore delivery of business and that has largely helped by some of the work around customer management and mortgage servicing and origination business. Do you see that trend continuing through the foreseeable future and leading our margin profile more through medium-term perspective?

Vipul Khanna: Hi, Manik. Yes, mortgage continues its growth and it is showing good open on mix, CM as well. Although I would say that given the new environment and given some of the short-term opportunities let us say forbearance for now in mortgage, there is more demand for onshore service given the sensitivity of those operations. Similarly, for some of the short-term BFS demand that we are seeing in UK, where clients are looking for surge capacity, our existing clients to make up for shortfalls in other areas, at this time, they are looking more for onshore demand. So secular trend is more offshore although for the next couple of quarters some of the wins we will see will be maybe more onshore-heavier. How it plays out at the end of FY'21, we are keeping a close watch, but secular trend should continue towards the more offshore-heavier.

Manik Taneja: If I could ask a couple of book-keeping questions as well, what would be the share of the payer and provider business within our healthcare business now? And similarly, on the mortgage side also, I guess we had a higher share of origination business. If you can give us a split between origination and servicing there?

Vipul Khanna: So between our provider and payer, at this point in time, it will be closer to 60:40 or in the ballpark give or take a couple of percentages in the provider and payer, so provider is bigger. And on the mortgage side, we obviously saw strong growth in our origination portfolio this year, but we were very conscious of building up the servicing side as well. And that will get a further boost now with the more demand coming for forbearance and default support. So, it will improve. My sense is that as of March, that ratio was again more in the 60:40 ratios.

Manik Taneja: If I can prod you a little bit further, so you have done some investments in terms of beefing up your leadership organization, so are we completely done with that exercise now?

Vipul Khanna: So, at the leadership level from a market capability, we are done, we have some more a couple of positions, which we have closed, we are waiting for executives to join to beef up further strengthen our global delivery. And obviously as leaders have joined they will now add in a few like Anshul has just joined, he is kind of just about building his team to make our go-to-market strategy for the tech sector. So, we will have some level of sales and account management additions to continue.

Manik Taneja: You talked about this opportunity around vendor consolidation and potential carve outs. If you could help us understand, are there some vertical-specific or geographic-specific clients here?

Vipul Khanna: Thematically, if you saw post the financial crisis as well, when our clients across industries had revenue shocks and they had to move on costs, one of the levers for them was vendor consolidation more rationalized but more strategic outsourcing and also kind of looking a hard look at what they did in-house versus outsource. I think the economic environment is the same, the drivers are the same, it is not even more exacerbated. And our sense is that a number of our prospectus clients are starting to think along those lines. Again, early days. As the quarters go by, we will give an update. But I think that is a very kind of proven playbook for clients across industries to meet continued sort of cost pressures.

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

Mohit Jain: Vipul, one thing, why our visibility on BPO revenue is so low in Q1? It is more looking like an IT expenditure kind of a revenue versus a BPO which was thought to be more stable because you guys are part of OPEX and your sectors are not, those sectors which are highly troubled in the current environment?

Vipul Khanna: Hi, Mohit. Look, I think as I mentioned, in our healthcare business, we work on outcome basis and the hospital segment in the US has seen a big revenue shock in the first half of this quarter. And so, it kind of permeates on to us. Similarly, if you look at our Customer Management business, especially for our B2C volume, it is very driven by what is the level of market activity which our clients are doing either in terms of marketing, selling, new products shipped out and stuff like that which creates the volumes that we service. With that activity kind of slowing down, obviously, it impacts the volume that they need us to service as well. So those are some of the impacts on volumes that we have seen. Hopefully, they are temporary. As economic activity picks up, definitely, for collections, we are confident as volume activity picks up or states allow some of the activities to pursue in the US, we will see some of the demand volumes come back. But I think given BPO deals with live volume lot of it is protected, but sort of that volume volatility that we have seen, that 80:20 rule or whatever you kind of apply to it, we have seen that impact come through in this massively subdued economic environment for some of our clients.

Mohit Jain: This includes top client decline that you are anticipating for the year, the dip will happen in 1Q and then stabilize or that dip will come later on during the year?

Vipul Khanna: The dip that I mentioned, 7% to 10% is for the first quarter only. At this point, we are not giving any guidance for rest of the quarters. But I do believe that this will be sort of the worst quarter. It should start to improve from this point onwards.

Mohit Jain: Lastly, on receivables. Receivables were quite high for the end of the year. So, our discounts or whatever was included in your opening remarks in terms of trade discounts, etc., they were part of it, or should we expect receivable to further deteriorate in the first half or during the year? So, what I mentioned in the previous question was Sky decline is built into your outlook or that will happen during the year gradually?

Vipul Khanna: No, it is built into that outlook.

Dinesh Jain: Mohit, I think on the debtor side due to the last seven, eight days where most of the clientele level the offices were closed, so we have a less collectability, but most of these overdues has been collected within the first two weeks of April. We are at normal DSOs now back. So, there is no risk. As far as the discount and all which you are talking about, most of the discounts will come in the current quarter. Those are very small amounts. I do not think any significant value which can really go to the debtors and the issues on that.

Moderator: Thank you. The next question is from the line of Madhu Babu from Centrum Broking. Please go ahead.

Madhu Babu: Second half can we expect a recovery or whether the pricing pressure will lead to that follow on effect even for the second half? I think we have done around Rs.100 crores of CAPEX this year and last year also around Rs.100 crores. So, what is the steady state run rate in CAPEX because whether it will come down substantially or where the incremental investments are there?

Dinesh Jain: CAPEX, I think you always know the tax refresh is important and as and when I think customers growing into the respective geography need to set up a center. And that is always being a range, you have seen from last three, four years. So, I expect that the same range will remain between $10 million to $15 million with the CAPEX we do. I do not think any significant up or down will take place, but I see that still remain that level. Maybe a few millions here and there, but otherwise, it would be normal $10 million to $15 million.

Vipul Khanna: Madhu, on your pricing pressure question, what I mentioned is that we are seeing pricing pressure in just one part of our business, which is the healthcare provider business, very limited to that extent only. In collections, in mortgage, in CM, we are not seeing any pricing pressure and I do not expect any of that to continue in H2. Whatever we had to do, we have baked into the forecast that we have set for Q1 that I mentioned earlier on. It is very localized to one business and we do not expect that to continue in second quarter onwards.

Madhu Babu: Sir, just to follow on, on the CAPEX. Because when the growth is going to come down next year, so whether that will be a substantial reduction? And there is intangible software in last year, so Rs.35 crores. Is there any licenses we are purchasing for that BPO business in the CAPEX?

Dinesh Jain: Intangible licenses will always be there, and Microsoft licenses will be there part of which is normally you have to buy. And as far as the de-growth which we are talking is only the short-term play for the first quarter which really does not change the overall for a year. So, I do not think that need to be factored that you have a de-growth coming, so you probably do not need a CAPEX. I do not think that is the situation. It is only for a quarter we are talking.

Moderator: Thank you. The next question is from the line of Sarvesh Gupta from Maximal Capital. Please go ahead.

Sarvesh Gupta: Sir, first thing is on your dividend pay-out policy. So last year we had two rounds of dividend, maybe one was because of the taxation changes which came in from this year. So, what is going to be our dividend pay-out policy going forward?

Vipul Khanna: The interim dividend that we paid out was driven by some macro opportunities. Obviously, we have just started the year. It is a very uncertain year. At this point in time very early to say what that would mean. Right now, the focus is to make sure we keep our costs aligned and continue our focus on growth investments. We are seeing opportunities out there across our businesses. We have a good healthy mix - mortgage, collections, healthcare, CM and the new thing we started with Digital and CMT. We do want to prioritize enough investment for that and build that. So, there is no specific policy. We will see how the year plays out and then as we come to the next quarter, we can talk a little bit more color on what that outlook on dividend will be.

Sarvesh Gupta: You mentioned two impacts -- one was $30 million impact in Q4 on revenues and then 7% to 10% constant currency decline expected in Q1. Can you also give us some color on the impact that will come on the operating margin level because against this $30 million what was the impact on the margin which were looking lower than the guidance number? And on the 7% to 10% constant currency decline, we may have a lot of maybe 2% to 3% of travel cost, I do not know. So, there are many cost reductions also that you are also talking about. So net-net, if 7% to 10% decline happens in Q1, then what is the absolute impact on the EBIT number for Q1 because there is a scope to save cost in terms of variety of measures?

Vipul Khanna: I want to clarify that the Q4 revenue impact due to the COVID-19 pandemic was $6 million only, not $30 million and then it had a marginal impact on our margin. We were hoping to come in closer to 11% to 11.1%, it kind of came in at about 10.8%, so about 30bps to 40bps full year impact in FY'20 because of the COVID. As we go forward, I talked about the fact that for this quarter, Q1 of FY'21, we expect revenue will be lower between 7% to 10% and baking in some of the short term cost measures we have taken already in place including very heavy focus on redeploying capacity where we have excess capacity, making sure I talked about that we will be deploying capacity from CM to mortgage. With that baked in for this quarter, we see a fall in impact of anywhere from 150bps to 100 bps. Absolute should be sort of $2 million to $3 million from a margin standpoint in this quarter.

Sarvesh Gupta: Finally, alluding to a previous question also, we are doing around Rs.100 crores CAPEX on tangible assets every year. So are we seeing any shift in that because a) Every company is now talking about work from home being one of the major drivers, so we may not need so many seats; and b) Maybe you will get better deals in terms of commercial real estate, rentals also. So, are we seeing any good opportunities in terms of saving that because that is almost one-fourth of our cash flows from operations which we generate in a year?

Vipul Khanna: Let me start and then Dinesh can add in a little bit more. So, yes, absolutely, today, big chunk of our capacity is operating remotely or work from home. We slowly started to open our Bangalore and Mumbai offices. All our new bids are now going with the work from home option including all the investments and methodology and technology for running remote or distributed operations. So, as a way forward, it is an embedded part. Clearly, how clients see that on a long-term basis is something to play out. Give you an example of the new health plan deal that we signed in March. For now, they said, hire these people for me on a work at home basis, but I do want the optionality that towards the end of the year or next year, I may want to bring them to office. So, at this point in time, it is early days to see how it will play long-term, but I think we are all geared up for very seamless operation between work from home and office. How that plays out in CAPEX at this point in time? We are keeping our demand forecast fluid. And based on that the CAPEX will follow. I do not know, Dinesh, if you had any more color to add in terms of this year's CAPEX versus last year?

Dinesh Jain: No, I think the work from home also we need to be sure that the tech investment will continue, you still need to provide that thin client PCs to the people. Only the infrastructure base can be lower. But again, there are clients which are clearly coming with that aspect of being this is a work from home for as of today, but later I need a facility to run with. So as of today, we are not seeing that the customers are fully coming and saying, this is the business purely for work from home. They still want the option to be at the end of the period. Now what that period? Whether it is six months down line, nine months down the line? These all will happen when we see the reality of it. So, this is the estimation as of today. We believe that this continue to be. We do not see that it is going to be materially changed. And again, on a price point, yes, there may be some places the deal may be slightly different, but again, it is as of today the more guess work. I do not think as of today, anybody is coming and saying, "I have a facility, you take it at half the price." Answer is no. I do not think anything which is happening in the market as of today. It may happen in future. And if we have a demand too, probably we will utilize those one. But, as of today, I do not see that… and as I said, it all depends on when the CAPEX will start. We always thought this period we will have no CAPEX, but there is a CAPEX which is taking place for people to work from home. We have a demand and which we need to fulfil.

Sarvesh Gupta: You said Q1 directionally is looking to be like probably the worst quarter in the coming year and then things should improve. So, do you imply that this Q1 de-growth of 7% to 10% QoQ would be the worst and then Q2 onwards de-growth will continue, but will be at a reduced number or do you imply that Q2 onwards, you will see growth coming in, so we will be back on the growth trajectory from Q2 QoQ?

Vipul Khanna: I mean, we obviously have refrained from giving full year guidance given the number of sort of variables open at this point in time. It is hard to kind of go more than that. But, as I mentioned, if you look at chunk of our portfolio, mortgage, collections, healthcare, mortgage is obviously in a growth trajectory right through. Collections, growth did not come through as we expected due to seasonality. Some softness in Q1 because of pended actions by some of our clients. They do not resume collections at this point in time. But, we expect that volume to start to come back given the credit quality deterioration. And similarly, healthcare, it should start to pick up. So I would not venture at this stage to say is it is less de-growth or growth, but I am just laying out sort of the scenarios as we have seen, but I feel generally good about Q2 as opposed to sort of the known impact in Q1 in our CM and healthcare business.

Moderator: Thank you. The next question is from the line of Sonaal Kohli from Bowhead Investment. Please go ahead.

Sonaal Kohli: A couple of questions: Firstly, how is the pricing done in your credit card business? And if it is on an outcome basis, if the volumes also go up, is it not fair to assume that the revenues may not still materialize in case the March case defaults on the credit card business? Secondly, what is the driver of your mortgage origination business? How is the pricing done? And based on economic environment, does it get impacted or that does not have a major impact?

Vipul Khanna: Look, collections, majority is on in outcome basis. The more successfully we do, the more money we make. And our digital collection product is sort of obviously relatively more profitable because technology makes it that way. If you look at sort of the overdues as well as the loss ratio starting to creep up, the volume of work which our clients will have for the collections industry and for us, will increase. This quarter we have seen for instance the stimulus packages and the cheques that have reached, we have seen some of that kind of starting to flow through in our collections. And as people kind of get back to work and whatever arrangements they make with increased volume that should mean more revenue for us on collections. On origination, it is a mix of both. We have cases where we work on transaction basis. So, case wise, as we complete cases, we get paid and there are contracts where we get paid on FTE or time and material basis with sort of incentives for productivity and quality of that. So, it is kind of more traditional pricing. Is that what you were looking for in origination?

Sonaal Kohli: In origination, what I meant to ask you was that what is the driver overall for your clients and then obviously for you is it economic activity, so does this business grows with the economic activity and declines with economic activity, what is the broader driver of that business, because finally you will also be impacted based on the driver of that business?

Vipul Khanna: Great question. So, one, origination, the driver is interest rates. When you are doing the refinance activities, it is the same homeowner with a property loan who is refinancing and saving money. So, the driver is it is actually if you think about it countercyclical, right. When economic conditions get tough, people would like to save money and banks are borrowing cheap and they are kind of lending cheap. So, it is kind of a win-win all around to that extent. And we have seen continued demand uptick as interest rates have fallen more and more. Smaller portion of the market is linked to new home purchases or people upgrading new homes. That activity might see a slowdown. But that is also function of demand/supply inventory in terms of housing as well. So that is a smaller portion of the market at this point in time. Bigger portion is refinance of existing loans where we are seeing very robust activities for our clients and that is going through to us.

Sonaal Kohli: Okay. Let me rephrase my question differently so that I am able to explain it in a better way. What I meant was that considering there will be a recession and that is a given at least for the next couple of quarters, if not for next few years, do you think that your credit card business would be structurally impacted because the sticks are coming in now, they cannot continue forever. So, at some point of time, normal recession would start. And at that point of time, would your credit card business get impacted? So, it may not see an impact immediately in Q2, but in Q4 or Q3, as the economy opens up and there are no dole outs for every unemployed, would you see an impact because finally though your volumes go up, it is a success-based outcome and the success ratio should fall in this business and 10-years, US economy was having a massive expansion So you may not have seen this period for a very long time. Secondly, also on the mortgage business, in a period where people are jobless, would banks be willing to refinance new customers at least the guys who may not have jobs?

Vipul Khanna: Look, the unfortunate reality on the mortgage part is that today, bulk of the impact that we have seen is mostly on the renter's market. People at the lower end of the economic spectrum and a big chunk of them would be renters as opposed to homeowners. And refinance is happening for the same asset for the same borrower if you go to the homeowner activity. As long as interest rates create an incentive for the homeowner, we have seen continued demand. We had demand even before COVID and interest rates have gone further down. Once interest rates start to climb up is when we will see an impact on the refinance activity. By that time hopefully some of the new and the upgrade demand will pick up. On collections, keep in mind that we came through about eight or nine years a very benign economic environment with sort of a lot of expansion and fairly low credit loss ratio. If you were following, just in the March FY'20 quarter I was just doing a rough math, the top four banks in the US have made additional $20 billion of provision for credit loss. Now this is a high level modelling. All that will mean more volumes for the collection industry, far more than what we have seen in the last nine years. There will be increased write-off rates as well, but we work on both first party and third party and we will see a significant surge in volume at least for the next as you outlined, whether the recession for like two quarters or two years, who knows. But I think the volumes will be significantly higher through that.

Sonaal Kohli: Do you plan to reduce your headcount next quarter or somewhat or as of now there is no plan?

Vipul Khanna: At this point in time, we are very sharply looking at it. We are redeploying, we are retraining. At this point in time, we do not see the need for any headcount reduction. What we have is sized up for what we see the need for May and June. As conditions develop after that, we will continue to manage our headcount levels and our utilization to that. Right now, we are optimized.

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

Dipesh Mehta: A couple of questions. First, on the Q1 guidance, if you can help us understand how is the growth trajectory or your revenue trajectory across months -- so whether we are seeing improvement happening let us say over the last few weeks versus the beginning of the quarter and what you are building into June? Why I am asking is just to get a sense about how future quarter likely to play out, if you can provide some trajectory at least for Q1 the way you guided?

Vipul Khanna: Hi, Dipesh. Let me start and then maybe Dinesh or Ankur could add a little bit more color for us. So, April obviously was a complete lockout in India and Bangalore. Wherever we had client approvals, we were operating from work from home, so that revenue was coming in. Couple of key clients for either demand reasons or risk reasons had not allowed, that has not functioned. As May has come in, from second or third week onwards, we prioritized those accounts to start to function from Bangalore and then in other cities, we are starting to see volumes come back. On our healthcare business and collections business, obviously, April was lower on a full month basis compared to March. In the second half of May, we are starting to see some uptick relative to April on the healthcare inventory. So, I think we will continue to build because most of the states have opened up. Hospitals are now allowing regular procedures and sort of pent up procedures to come in, so, I think that demand is starting to come to uptick. And then given we play in the eligibility services side of the healthcare value chain, given the recession or given the economic hardship, we will see more surge in that area because that is a demographically help get into the coverage zone for our hospitals. So, I think at least the hospital should see a surge of people who need help their starting to come through. May has been better I think across compared to April. Part of I think the variable left for us is that for June, as US and UK economies open up, especially UK economy given our B2C sort of exposure there, how much economic activity picks up for clients and that means for increased transactions for us. Right now, we have good visibility for June. What it means? After that is something that we are talking weekly to some of our key clients.

Dipesh Mehta: Broadly, across months you are expecting improvement -- May is better than April and June is likely to be better than May?

Vipul Khanna: At this point in time, yes.

Dipesh Mehta: The second question I have about the leadership. We are investing into leader and building good leadership. So just want to get some sense about let us say the new hire which we have over the last couple of quarters, what would be their KRA and how it would be different than let us say earlier our overall value proposition for respective segment, if you can provide your thoughts on this, it would help us to get some medium-term perspective?

Vipul Khanna: Dipesh, quick one, we talked about Sundara joining as Digital Officer. His key mandate and KRA is to build digital services revenue line product working with the clients on intelligent automation, on digital transformation. And he is also working with our core industry segments in healthcare, collections, and mortgage to build platform-based services. These are more targeted offerings. They solve more acute problems and are more profitable for us. So, his mandate will be to increase digital services revenue, whether it is intelligent automation or building digital products for core business line. Our intention is that Venkatraman puts extra focus on provider. We are very strong there. It is a market in turmoil. We think there are opportunities there. And Giri will focus on making sure that we reboot and bring growth back into our payer business. So that will be his KRA. And then lastly, if I could comment, Anshul, who has joined to lead the comms, media and tech vertical, his primary mandate is to make sure that we have a strong value proposition and a strong go-to-market approach for bond digital company. He is based in Seattle. His focus will be to start with bond digital companies and then over time kind of expand into the media and the streaming space as we go along. So those are high level KRAs for the three key leaders who have joined in the last few months.

Dipesh Mehta: One of the things about let us say, CMT, Anshul, now it is largely a highly customer concentrated at this point of time. We have one customer, which is big chunk of overall revenue. So, considering that how it will overall play out -- whether it would be more client, or it would be totally new set of clients with some M&A else, what would be your overall thinking there? And second is what will be digital as a percentage now for us?

Vipul Khanna: So clearly, the focus is that a big chunk of the economic value we have seen through the pandemic has gone to technology companies, whether it is e-commerce, whether it is enterprise software, whether it is consumer technology. They continue to expand their market share, their revenue. And that is where we see a chunk of the BPM revenue spend going. So, our intention is to target a portion of that spend, bringing in either our traditional customer service or collections offering or build new back office offerings for them. So, to that extent, the idea is to kind of grow the other aspects of our business while we continue to have the strategic partnership with our big client. And hopefully it kind of reduces the concentration with COVID time. On the other question, of digital revenue, I want to say at this time is about 12% odd of our overall revenue. But given some of the key wins we had in March, we will see a much richer impact in the next couple of quarters from those wins.

Dipesh Mehta: In Sky, we expect some weakness. Is there any protection for us which can help us to maintain our margin, because that is a very significant chunk and maybe to some extent broader with some of our key clients because we are expecting sizable volume decline in Q1?

Vipul Khanna: Look, it is a strategic relationship for them and obviously it is a very strategic relationship for us. I have been in constant touch. We are seeing some good partnership for them on cost sharing for fixed costs which are unrecovered at this point in time as well as cost for keeping some of the capacity which is unutilized for them. That is the extent of sort of very positive partnership from them. Contractually, it was not built for this sort of more force majeure contract, but I think our strength of our relationship and the very substantive actions that we are seeing from them is far more sort of eight years than sort of what is in the contractual protection.

Dipesh Mehta: And that holds true for other key clients?

Vipul Khanna: Yes.

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

Rahul Jain: Firstly, in terms of the approvals, when you said around 95% of the recalibrated demand is now fulfilled, so where are the gaps right now and how these approvals have improved and where it is still pending?

Vipul Khanna: I think the approvals as much as we needed to have, more or less we have it in place. A couple of key clients, as I mentioned, either due to their own demand environment or to their sort of risk call at this point in time they have decided not to go for work from home. There is optionality, there is some discussion, if this persists for a much longer-term, then maybe we could see that. But it is only a few clients at this point in time and it is very case-specific. When I mentioned 95%, part of it is demand fluctuations, day-to-day part of it is sort of some of the productivity impact that you see because of either infrastructure or power outages and this and that. So, it is the cumulative impact of little thing here and there which gives us something like 95%. But bulk of our client place, we are in a decent place now of either work from home or in UK, US delivery with reduced capacity in the offices because of social distancing.

Rahul Jain: So, when we hear most of the peers especially the global ones, they talk about close to 80% odd utilization or work from home status on the BPO side of the business. So, can we say that given that we are at far higher level right now, we are getting incremental market share opportunities which we can tap on to?

Vipul Khanna: I think it is hard for me to because I think everybody has different variables that they are playing with. Given some of our clients have not allowed at this point in time work from home, I am talking about the addressable capacity which is at 95%. If I take it at an overall level, it might be a different number for other players. It is hard for me to say what we are. But if I step back, pipeline is strong, we had good wins in Q4, and we started off very strongly in April as well as far as new wins are concerned, both strategic as well as short-term. So, to that extent, we feel good about the investments and our relationships on how our continued market opportunity both with existing and new clients is progressing especially in the sectors that we play in.

Rahul Jain: On the capital employed, why this number is so high for the healthcare vertical if you could explain that?

Dinesh Jain: I think the capital employed in the healthcare is mainly on account of acquisition, which we did in 2007. So, that is the reason the investment value is higher there.

Rahul Jain: Dinesh, but even if we see on the incremental value for the year and the incremental revenue addition, it still looks like the investment are going up even on FY'20 basis?

Dinesh Jain: Currency dollar moved from Rs.70 closing to Rs.75, so Rs.5 is the upside on the INR terms. So, all balance sheet values will be higher. I think that is the main component for the current year increase. There is no planned investment we are doing. But I think due to the currency is moving up by Rs.5.

Moderator: Thank you. The next question is from the line of Devang Bhatt from ICICI Direct. Please go ahead.

Devang Bhatt: Just wanted to ask a question like our short-term borrowings have increased significantly whereas our revenue has increased by just 11%. What was the reason for that? And what is your plan for reduction in debt?

Dinesh Jain: I think the debt level which we are as of today is purely the working capital debt. There is no other debt which we are carrying alongside the receivable position as the March was slightly higher, it will get normalized. So, all the cash flow is going to use only for the purpose of next two, three quarters or four quarters is purely going to be for the purpose of a taxes or CAPEX, balance all will get to the normalizing the debt. So as and when the collectability happens and the profitability happens, everything will go back to the debt reduction. It is a pure working capital. There is no long-term debt which we have in the books.

Devang Bhatt: I am just asking because your short-term debt has increased by 55% whereas your revenue has increased by 11%. And secondly, going forward, how much you will be able to repay the debt?

Dinesh Jain: I think the DSO is a reflection of the working capital line. So, DSO are normally between 50 to 60 days in overall scheme of thing. Currently, March was higher. So, if you go back, then you probably save seven, eight days. And again, I think one of the factors is also currency in the current year because outstanding is shown at Rs.75-Rs.70 to a dollar instead of being Rs.70. But otherwise, normalized the DSO should be around that range of 55 days, and automatically your debt level which should be around between I will say net debt level should be Rs.400 crores if you ask me. Again, you have to remember that current year, we have also paid a dividend in advance; we have Rs.200 crores extra gone there as a cash flow utilization which should have done in the July-August period. So that is the reason at the March level you are seeing a higher. Otherwise, we should have the last year level; last year was I think we are at Rs.370 crores or Rs.380 crores net debt level,

Moderator: Thank you. As there are no further questions from the participants, I now hand the conference over to Mr. Vipul Khanna for closing comments.

Vipul Khanna: Well, first of all, thank you, everyone for joining in and thank you for your patience for extending and going over time. I said we had more prepared remarks. So, I know you had to stay back for another 20-minutes. So, thank you for your great questions, thank you for your patience and continued engagement. And we will come back next quarter as we learn with more specific guidance.

Moderator: Thank you. On behalf of Firstsource Solutions Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.