Q1 FY2022 Earnings Call Transcript - June 30, 2021

CORPORATE PARTICIPANTS

Mr. Vipul Khanna - Managing Director & Chief Executive Officer

Mr. Dinesh Jain - President and Chief Financial Officer

Mr. Ankur Maheshwari - Head Investor Relations

Moderator: Ladies and gentlemen, good day, and welcome to the Firstsource Solutions Limited Q1 FY 2022 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal 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. Thank you and over to you, sir.

Ankur Maheshwari: Thank you, Stanford. Welcome, everyone. And thank you for joining us for the quarter ended June 30th, 2021, earnings call for Firstsource.

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

Do note that the results, the factsheet and the presentation have been e-mailed to you, and you can also view this on the website, www.firstsource.com. Before we begin the call, please note that some of the matters we will discuss on this call, including our 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, I will now turn the call over to Vipul to begin the proceedings.

Vipul Khanna: Thanks, Ankur. Good morning, good evening, everyone. Thank you for joining us today. I hope everyone and your loved ones are keeping good health.

Let me begin by first acknowledging Firstsource leaders across the board in stepping up to provide 360-degree support to employees and their families impacted by the second COVID wave in India. And my heartfelt gratitude to all Firstsourcers in serving our clients and their customers with poise and commitment despite the dire circumstances. This wave appears to be receding, and we hope that the worst is behind us. Since May, we have been conducting frequent vaccination drives and encouraging our employees and their families to get vaccinated at the earliest, to strengthen our fight against COVID. Till date, more than 5,000 employees have been vaccinated in these drives.

Turning to our Q1 Results:

We had another quarter of solid performance in Q1 FY 2022. Revenue grew 38.5% year-on-year in constant currency and came in at INR 14,848 million or $201.3 million. Operating margins were at 12.1% and EPS grew 50.4% year-on-year. I am pleased with our Q1 results.

We are on track to achieve our full year targets, further validating our longer-term growth framework. Last quarter, we laid out in detail our growth framework to create a portfolio of businesses to drive sustainable growth and market leadership. In summary, the key components of this framework are:

1. To maintain a sharp focus on specific segments in our 3 core industries of Banking and Financial Services, Healthcare and Comms, Media & Tech.
2. To modernize our offerings, particularly investing in our Digital First Digital Now approach.
3. To build a purpose-led, scalable, and agile organization.

Let me now walk you through the Q1 performance and the key highlights in each of our industry segments:

Our Banking and Financial Services segment continues to perform well, delivering solid growth of 41.5% year-on-year and 41% in constant currency.

- The interest levels in the U.S. are still finding their new equilibrium after last year's record lows. The home purchase mortgage market continues to be strong. However, as we expected, the refinance volumes in the mortgage business started to taper and some of our clients began realigning their refinance capacities accordingly. That said, we are performing very well across the servicing and digital segments and continue to acquire new clients. We added 4 new clients this quarter for the mortgage business. We remain confident of achieving year-on-year growth in our mortgage business.
- In collection, recovery of the credit card segment has been slow due to macro factors. The charge-off and delinquency rates are at record lows from higher consumer savings and government stimulus programs. However, recent macro data points to increasing economic activity leading to a revival of consumer spending; and in turn, a likely gradual increase in delinquencies and charge-off. We therefore expect an improvement in our collections volume as the year progresses. We are executing strongly on our plans of diversifying this business beyond card receivables by using digital collection platform as the anchor. In this quarter, we added 5 new clients across fin-tech and utilities on this platform. We also continue our efforts to build a collections business in the U.K., and I am encouraged with the build-up of the pipeline there.
- Shifting to our U.K. BFS business, this business continues to grow solidly, driven by volume growth and expansion into new lines of businesses with our existing customers. The pipeline is quite robust, and we expect the momentum to continue through the year.

The Healthcare segment grew by 25.2% year-on-year and 28% in constant currency this quarter.

- The growth momentum is strong as we are beginning to see a wider acceptance of our platform-based solutions, and our increased participation in large transformational deals. In this quarter, we added 5 new clients in Healthcare. And our Health Plans and Healthcare business recorded its highest to date ACV in its history, from new and existing clients.
- This is an excellent example of our growth framework playing out as we envisaged.
  - As last year, we split the Healthcare segment into two – Providers and Health Plan and Health Services or HPHS, to drive sharper focus in these two different markets.
  - We invested in new leadership for HPHS, revamped the sales and account management engine, and bolstered the operations and solutions leadership for this business. Our new sales and account management team developed go-to-market plan and systematically worked at targeting new clients and expanding into existing relationships. Fast forward to today, we are now working with 6 of the top 10 health plans in the U.S.
  - We focused on our strengths and retooled our solutions to make them more agile, cloud-ready, incorporating product competence from industry-leading platform. Our digital intake platform is now among the best in the industry. And we are making solid progress in the emerging telehealth and remote patient monitoring market.
  - These efforts are beginning to bear fruit. I am very pleased to see the momentum that we are generating for this vertical.
  - We have now similarly expanded the leadership team for the Provider business. Last month, we welcomed Lauralea Tanner to lead the Market function for Provider business. She will be responsible for sales, solution and partnerships, and work alongside the existing team to build and execute on the Provider growth strategy.
  - The Provider business is also poised to grow well this year, although the timing of volume recovery is somewhat fickle, with the rise in Delta Variant cases in the U.S. Last week, the U.S. Government further extended the public health emergency till the end of October 2021. Notwithstanding, we are seeing distinct movement in the pipeline, with prospects restarting conversations put on hold from COVID and a good RFP from large health system and bodies well for our Provider business.

Our Communications, Media & Tech segment performed solidly. In Q1 2022, this segment grew by 70.1% year-on-year and 56.8% in constant currency, although coming off a low base in Q1 of FY 2021. While the second COVID wave in India had a transitionary impact, especially on this business, the impact has now subsided. Our key client relationships are in good health and we continue to execute well. Sales momentum is picking up, we added 2 new clients in this quarter and continue to strengthen our pipeline. For our go-to-market forays into newer segments of CMT, we are piloting new solutions, partnering with exciting product companies to help our clients' transition to digital. For instance, we are in the process of architecting the operating model for a digital new start-up that truly disrupts the news value chain. We believe this will be the template for more organizations to follow, both traditional and new age.

Shifting to another topic.

In the last quarter, we updated you on a 2018 Strategic Partnership Agreement with our largest customer group in mortgages. To refresh everyone's memory, under this agreement, based on the revenue realized by Firstsource, they could accrue options of up to 15% in our mortgage business entity.

- This relationship has served us very well, and after a strong FY 2021 the customer group had requested an early partial monetization of their options in the mortgage business.

We have now successfully completed negotiations with this customer group, and we are pleased with where we have landed. The customer group has agreed to extend the engagement beyond FY 2022 and continue our preferred partner status. We have bought back their options in our mortgage business for a guaranteed consideration of $23 million on a deferred payment basis, and a contingent consideration of $11.25 million linked to future revenues.

During FY 2022, the cash flow impact will be $12 million, which we paid now. The remaining amount will be paid as $3.5 million in FY 2023, up to $12 million in FY 2024, and up to $6.75 million in FY 2025. The buyback of this stake will be accounted in shareholders' equity in Q2 FY 2022, net off the option cost already considered. So, in effect, this will have no further impact on our P&L going forward. Again, we are pleased with this win-win agreement with a key client and a clearly defined outcome for our financials.

Finally, coming to the FY 2022 outlook. We are pleased with our Q1 results and confident in our full year outlook. As such, we are maintaining a revenue growth guidance of 15% to 18% in constant currency, and the operating margin range of 11.8% to 12.3%.

With this, I now pass it to Dinesh to cover the financial details.

Dinesh Jain: Thank you, Vipul. Here is a quick summary of Q1 FY 2022 Financial Performance:

Revenue for the quarter came in at Rs. 14,848 million or $201.3 million. This implies a year-on-year growth of 39.8% in rupee terms, and 38.5% growth in constant currency. On a margin front, operating margin or EBIT came in at Rs. 1,800 million or 12.1% of revenue for the quarter, which is 53.9% growth year-on-year and implies a margin expansion of 111 bps.

Profit after tax came in at Rs. 1,345 million or 9.1% of revenue for Q1 FY 2022. This is a 51.7% growth year-on-year with the margin expansion of healthy 71 bps.

In Q1 FY 2022, we generated Rs. 244 million cash from operations and our FCF was Rs. 141 million, after adjusting for CAPEX of Rs. 123 million. Our closing cash balance as of June 30th was approximately Rs. 2,159 million.

Our DSO came in at 56 days in Q1 FY2022 versus 52 days in Q4 FY2021. In this quarter, we saw an increase in our working capital requirement due to the annual bonus pay-outs, adjustment of the advance from customer and increase in some of the DSOs. We expect this to normalize in future.

Net debt as of June 30th, 2021 stands at Rs. 4,044 million or $54.8 million versus Rs. 5,531 million or $73.2 million as of June 30th, 2020.

We added 4 new centres globally, increasing our right-of-use asset and lease liability which is in the balance sheet due to the new centre got capitalized, resulting into also the higher depreciation and interest cost. The interest cost increase which you guys are looking is mainly on account of this, not on the working capital increases anywhere.

Tax rate for the Q1 was around 19%. For FY 2022 we expect it to be within the range of 17% to 19% for the year.

On our FOREX hedging, we have coverage of GBP 55.3 million for the next two years, with the rate ranging from Rs. 107 to Rs. 116 per pound. While the dollar coverage is at $103 million, with an average rate of around Rs. 76 to Rs. 80 per dollar.

With this, we can open the call for questions.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Sonaal Kohli from Bowhead. Please go ahead.

Sonaal Kohli: Firstly, I wanted to understand how was the moment of your mortgage business in Q1 as compared to Q4? Secondly, going forward, do you expect a trajectory to fall further considering if the interest rates remain here? When you came with your guidance, in the last quarter the interest rates were materially higher than what they are today, so do you expect, assuming the interest rates are constant, is it a fair assumption that there could be an upside to your estimates if interest rates remain here?

Vipul Khanna: Thank you for your question. So, look, Q4 last year of Q4 FY 2021 was a very strong and big quarter for the mortgage business, right. As we laid out our guidance and as we started the year, we had model that there will be a fair amount of moderation in the growth rate compared to what we saw last year in the mortgage business, especially for the refi volumes. So, the purchase volumes remain strong, that market is growing, the last estimate was that the purchase finance market is growing at about or expected to grow this calendar year by about 16%. The refi market, we had forecasted, and as forecasted they started to taper down. To your question, yes, the interest rate, end of last year the 10-year treasury were 0.9%. At some stage, we saw the forecast that they will go up to about 2% by the end of the year. But after peaking at about 1.75% early in the year, they have kind of come back down to 1.27%. So, it's kind of a little bit dynamic. Our clients are also watching how the volumes play out. At this stage, we expect that we have seen some amount of calibration in June, we will see the full year impact of that in Q2. But given sort of where we are, given the strength of the servicing business and sort of the broad relationships we have, we had guided to at least a low double-digit growth in the mortgage business. And we think we will kind of hit that. Beyond that, it's kind of a little bit variable, we will have more updates for you as sort of the month progresses, and we see sort of more settling down on the market.

Sonaal Kohli: But not from your guidance perspective, because obviously this is a dynamic situation, but assuming interest rates remain here, hypothetical question, give a hypothetical answer, is it fair to assume that there could be an upside in the volumes and there will be much more people willing to refinance then at 1.7%, wouldn't that be obvious?

Vipul Khanna: Directionally it's reasonable that if interest rates come back down again, I don't know if you notice, there is another variable we have seen, two weeks ago the Federal Housing Financial Agency, which oversees Freddie Mac and Fannie Mae, they had imposed a 0.5% adverse market fee at the start of the pandemic, almost like a risk premium for the market uncertainty. Now, beginning sort of July or somewhere in July, they ended that 0.5% fee, saying that the market conditions have stabilized. And that in effect means that there is a little bit of a reduction in the cost of refinance now. So, that and that plus sort of recent coming down on the interest rate markets directionally, it should mean that either we don't see as much a fall or we start to see some of the solidification of the market, as the quarters go by. So, directionally that there should be upside if these two factors play out favourably.

Sonaal Kohli: Secondly, my second question related to the Healthcare business. Would it be fair to assume that you will achieve your full normalization in the June or the September quarter? Or you had achieved that already in the March quarter as far as your Healthcare business was concerned? Or considering the lead-lag relationship between when the patients get admitted versus when you bill your clients, there would be some gap. Which is that quarter where you would assume that I am not talking about communal benefits, but from overall market perspective your revenues would stop having a positive impact of the Healthcare, so they will achieve your new level of normalcy, would you assume would that be December, September or which quarter would that be?

Vipul Khanna: Sonaal, your question is normalization from a standpoint of volumes for our hospital clients starting to come back to normal, to almost pre pandemic levels, that's the answer you are looking for?

Sonaal Kohli: Yes.

Vipul Khanna: Okay. So, look, I think the market are coming back, although sometimes it becomes fickle in certain geographies, depending on sort of how Delta Variant is playing out. But you are right, in the sense there is a cycle time to patients coming to hospitals, and the whole cycle of billing, finding coverage, etc, etc, we filing cases, getting approval and stuff like that. So, there is a lag cycle of that. I don't think I can say at this time that we will peak or we will normalize by September or something, because the volumes are still building up. And the extra variable of this public health emergency means that some of the states kind of delay the approval cases, because they are operating under the public health emergency sort of regime of sorts. So, there is an extra nuance of sort of how different states play out in terms of approval cycles.

But keep in mind, all this that you and I have been talking about is relating to our Provider business and for the eligibility part of that business. There is a whole receivables management part of the business within Provider, and then the whole Healthcare HPHS business, which has somewhat impact from claim volumes, depending on hospital visits and how many claims come to our clients. But all the effort that we put in last year is about new clients and new types of work, which are somewhat unrelated to sort of the macro conditions of the market. These are new wins fair share, and we expect that we will continue to grow up strongly as the year goes by.

Sonaal Kohli: Sir, what I was trying to ask you was, the normalization of revenues, is it fair to assume that the normalization of revenues would lead to much higher revenues in Healthcare than what we reported in the June quarter? That is what I was trying to assess, whenever that normalization happens.

Vipul Khanna: Sure. And again, I was trying to break it for you that I hope you appreciate the fact that it's broken into two parts, HPHS does not have a correlation to a normalization as much, so that's the first part, normalization of volumes or footfalls into the hospitals. As far as Provider is concerned, I think if the current trends of opening continue, and there isn't a significant impact from the Delta Variant, we expect better traction sort of starting to come through or we starting to hit to where we would like to, based on existing client portfolio by the December quarter.

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

Mohit Jain: So, two questions, first is on the Healthcare side, it is a follow-up to the previous one that you were explaining. In terms of growth outlook for FY 2022, now that you have some clarity emerging on public health emergency as well, what kind of growth rates are you expecting there in Payer and Provider? That is one. And the second follow-up to that is, as mortgage tapers off and Healthcare picks up sometime in FY 2022 second half, what impact would it have on margins? Like would Healthcare come at a relatively better margin or would it come at a lower margin in the mortgage business? Thank you.

Vipul Khanna: Mohit, great question. Healthcare growth rate, as I kind of detailed out the HPHS story, they had a great quarter in terms of annual ACV sales for Q1. And as we start to execute, we will see a good set of revenue bump up from those wins, as well as what we have in our run rate. And our pipeline is strong there as well, so expect strong growth rates from HPHS. Provider business is somewhat dependent on macro factors, but we still believe it will be a strong year. We are executing well on the patient matters integration, and we are starting to see the benefit of cross sell and the combined offerings coming together to play, either in terms of increased geography coverage or scope coverage for our clients. So, between the two combined, we expect Healthcare will be a strong growth rate from this point onwards. Margin is kind of an interesting question. And obviously, we are calibrating sort of different economic cycles which impact the businesses differently. And that's all advantage of having a portfolio business. The blended margins should be in line with the company average across those businesses. There is a cycle time to our HPHS business implementation, but at the same time, we have very healthy margins in our Provider business, so it kind of balances that out relative to what we could see some calibration in the mortgage business, and hence its margins.

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

Dipesh Mehta: I have a couple of questions. First about the top client, can you help us understand how you see top client is doing? I think this quarter we have some impact because of second wave of COVID. But going forward, for the year how you expect it to play out? Do you expect Q4 kind of run rate to continue or you expect some moderation?

Second question is about Healthcare, can you give some breakup about Payer, Provider, how they fared this quarter? Third thing is about our mortgage business and Sourcepoint related agreement which we have signed with the client? I missed out the cash outflow number which you shared; can you share that number? And Dinesh, if you can help us understand how P&L will be impacted, it is only interest costs related thing because of cash outgo, or any other changes you expect on P&L and balance sheet? Thanks.

Vipul Khanna: So, I will answer, and if I miss parts of it, please remind me. So, for the top client, Q4 was a very strong quarter. And as Q1, we have seen some supply side constraints, especially in India, given what we saw in April and May, so there was some compression from a supply capacity. But also, there was a little bit of softness in demand from the client, because they had a big run up, a lot of campaigns and stuff like that, which they ran in the March quarter, and kind of there was a little bit of a breather in the June quarter. As we go forward, I think purely from a relationship standpoint, very healthy, we continue to see small opportunities for growth, strength, and change, etc, in different campaigns. So, all that's going fine. My sense is that as the summer is kind of bearing out in Europe and people are outdoors, etc, etc, we will see a little bit of continued demand softness in Q2. But traditionally the December quarter is strong there because of the holiday season and stuff like that, and we expect to play a big part in their continued plans for that. So, to that extent, I think it will be a strong year on a full year basis. Barring some of these early challenges we saw in Q1, I expect this to be a strong year for rest of the year for the top client.

Let me take the mortgage question quickly. So, your question is what cash outflow is expected and you want me to repeat the numbers, yes?

Dipesh Mehta: That's right.

Vipul Khanna: Okay. So, FY 2022, the current financial year, the cash flow impact is $12 million, which we recently paid. In FY 2023, it will be $3.5 million; in FY 2024, it will be up to $12 million, because remember, it's linked to revenue, so it may be up to $12 million in FY 2024; and up to $6.75 million in FY 2025. The P&L impact, whatever had to be done is now done, we expect no more further P&L impact, because we bought back the options, and this will be now accounted in the shareholders equity in the balance sheet from this point onwards. Dinesh, anything to add on P&L impact.

Dinesh Jain: No, I think the question was the interest cost, I think he is right, because whatever the amount which we need to pay, that will come with some interest costs. So, again, I think we have a current working capital lines and interest cost is not going to be material because, again, the payments are in next three year and we will have sufficient cash to generate to pay off these liabilities. So, I don't think there will be big interest cost on it.

Dipesh Mehta: And Payer and Provider, if you can give break up.

Vipul Khanna: Okay. So, this quarter HPHS had a strong growth. And at this point in time, the breakup between our two Healthcare businesses for this quarter is closer to like 44:56, 44 HPHS and 56 Provider.

Moderator: Thank you. The next question is from the line of Manik Taneja from JM Financial. Please go ahead.

Manik Taneja: Vipul, I had a couple of questions. Number one thing is that, while the onsite-offshore mix is not such a big metric for you as much as it is for IT services, but is there increase in onsite mix this quarter linked to the Healthcare ramp up? That's question number one. And the second question once again relates to the Healthcare vertical, we have been seeing renewed focus from one of your tier 1 IT services players on their healthcare business. Do you see that as some sort of a challenge for you in the BPM case?

Vipul Khanna: Okay. So, on the first question, I think your interpretation is right, the slight movement we have seen for onshore this quarter is primarily driven by the growth of our Healthcare business. Last few quarters we have seen strong mortgage growth, which had a pretty solid offshore component, so that was kind of taken, now it's kind of come back a little bit this way. The second question you said is, you said tier one IT companies focused on Healthcare and is that a challenge for us?

Manik Taneja: Yes. Given their platform case and the renewed focus on the Healthcare business.

Vipul Khanna: Sure. So, first look a generic comment, the Healthcare, especially the Payer segment or HPHS is one of the older verticals or the deeply penetrated vertical for the Indian IT and BPO segment, all of the key players have forays and decent portfolios into this. The second comment is that as the Healthcare segment comes to sort of the challenges it is facing and its strategic direction for its operating models, digital and platform is becoming increasingly one of the substantive conversational topics between us and our clients and across the industry, right. The clients have appetite, there are models emerging, there are reasonable players with software, and there are reasonable players who are integrating it. So, it's good to have good competition, it kind of opens up the clients to possibilities and it kind of makes adoption easier. So, we welcome more and more competition on platform-based services in HPHS.

We are competing with sort of absolute Tier 1 players and we are holding our own. We have some platforms; in other cases, we will partner. And in some cases, we will partner with best of breed as well. But the good thing is that the market is realizing the possibilities of buying platform-based service, let's say, compared to two years ago. So, that's very encouraging. And then obviously, we will have to fight out fairly in the market and win on merit. But thus far, the results we have seen, given, as I mentioned, sort of the historically high win rate, or one of the highest quarters of wins that we have in Q1, I am confident that we will have our fair share of wins in the market.

Manik Taneja: If I can ask one more, just wanted to get your thoughts around the potential for increase offshoring with some of your U.K. BFS customers, given the labour conditions due to Brexit in U.K.?

Vipul Khanna: So, I am not necessarily hearing a more Brexit related labour issue. I think it's more the tactical operating models given the pandemic. And two, given either pandemic or this pandemic accelerating the digital to say, what's the right operating model with digital and then where else should the human supplement part of the service be. So, with that background, I think the conversations about using more offshore, whether it's Europe or Philippines or India, I think that has increased earlier from what we were seeing earlier. And clearly, as the banks find their new equilibrium post pandemic, and everybody has pressure from the fin-techs as well, we are seeing greater appetite for transformational solutions, more appetite for takeovers of captives and op centres, as well as moving to offshore. So, directionally, I think there is appetite. But as the market opens up, we are seeing good RFP flow and substantive conversations. I expect some of those will play out in the next two quarters. And kind of we feel where we land on that.

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

Sonaal Kohli: I have three queries. Firstly, on the margins side, based on your guidance, broadly the EBIT margin target for this year is 12%. What are your long-term margin aspirations and where do you see the numbers start going materially, is it like very back dated, let's say only five years from now you start seeing margin improvement? Or do you think the phase of investment would largely be over this year? And from next year, you could see 50, 75 basis points, or whatever the number is improvement, some idea on that side and how that trajectory would pan out over the next two, three to five years, would be very helpful, at least in terms of your aspirations?

And secondly, as far as this year is concerned, as far as absolute revenues are concerned, assuming there are more organic revenues, over the second half absolute revenues be bigger for you, or first half revenues be bigger for you, based on whatever you understand today? Lastly, what are your acquisition plans this year, are we expecting couple of acquisitions over next couple of quarters? I think Mr. Goenka was on TV and he mentioned about this. So, these are my questions, if something is not clear please let me know and I will reclarify the questions. Thank you.

Vipul Khanna: No, I think I got it. If I don't answer it, let me know. Sonaal, on the margin, we have guided for 11.8% to 12.3%, which in itself is about a 50-basis point improvement from what we got broadly last year. And as I said from a long-term aspiration standpoint, the way I see it, the way we have kind of building our business and the business model is that, we expect through operational excellence, through operating leverage to gain small, again, I am talking very broad aspirationally; 40, 50 basis points of movement year-on-year in the margins. We will get slightly more than that through our operational excellence and operating leverage. But at the same time, we will continue to invest, there's lots we can do in the market, we see a lot of runways across our business and as well as new offerings, digital etc. So, right now, we have a reasonable load of SGA investment across the business. You have kind of kept pace with sort of a lot of market and sales leadership we added early on. And now we are coming to sort of the second and third layer of investments.

What I mean by that is, now we are bulking up our delivery engines, bringing new exciting talent in different parts of our business. For this quarter for instance, we welcomed a very senior person as head of our training and skill development, we brought in a Global Head of Recruiting to kind of bring more sort of depth to our recruiting strategies and using technologies. At the same time, for instance, we have also welcomed two deep tenure experts, one in mortgage and one in media practice to be the practice heads, working with both sales and delivery teams to be deep domain guys with practice heads. So, that level of investment we continue to keep on doing. Obviously, my leadership level, we have kind of more or less done with sort of what we want at this stage, now it's about expanding that, to between gaining from operational excellence, and continuing to keep the SGA investment and every now and then a strategic deal investment, my long-term aspiration is to continue to grow our margins by about 40 to 50 basis points annually. And you can do the math, and we should be targeting to kind of get to closer to sort of the mid-teens level in the timeframe that you asked about.

The second question about absolute revenue for H2. So, look, I think the way we had modelled it for the 15% to 18% growth for this year, clearly, we had moderation in mortgage and to make up through higher growth in Healthcare to deliver the 15% to 18%. At our current run rate, if we just keep it without kind of a material movement, we end up at the lower end of our forecast. And if we kind of see uptick in the businesses that we are kind of currently pursuing, that should take us sort of to the upper end of the forecast. So, I think that's kind of how we see the model at this stage, between the 15% to 18% with the variables and in between determining where we land.

And the last question on inorganic, as I said, right, we have defined our growth areas clearly, we have built up a pretty reasonable Corporate Development capability, which Ankur leads. We have built up our network or strengthened our network, and we are starting to see a lot of inbound interest. Obviously, we want to be disciplined, we want to be selective. And we know the areas where we want to go for. So, that's the continual sort of journey now, as a channel to watch for. And as soon as things develop, I will obviously come back and update all of you.

Sonaal Kohli: Sir, one more question on your revenue growth trajectory from a longer-term perspective. So, while you have taken several initiatives, we also did benefit from tailwind in the mortgage business, though we had negative impact on our Healthcare business. And this year, we will see normalcy in Healthcare. But beyond 2022, I am talking from a two, three perspective beyond 2022, so let's say 2020 to 2025 or 2024 trajectory, what is the aspiration in terms of growth rate? And I understand the sales cycle in this business are long, so is it fair to assume that at least from a next year perspective some of the great work you guys are doing, and in terms of hiring people and making investments, we should see acceleration and benefits of that? Or am I wrong in my expectation? So, firstly, from a 2020 to 2024 or 2025 what is the revenue growth from all these investments.

And secondly, is my understanding correct, there is a lag between the efforts you put in as far as business is concerned, then that hasn't shown up. Some benefits have obviously accrued, but the larger benefits still have to accrue. So, some perspective on that would really help us understand your long-term growth plans with all these investments?

Vipul Khanna: So, I think, first of all, just the way I look at it, in the services business, with continuously changing client preferences and business models, a level of investment, I think, is healthy to keep up rather than a bumpy sort of way to look at it. But I think I just want to make sure you appreciated that, while I get your point about directionally the operating leverage from some of the heavier investments starting to come through. From the longer term, as I have said in the past, our aspiration is to deliver top quartile growth in the industry, which if you follow the current growth rates in the industry at this stage, that should be closer to sort of low to sort of mid double-digit growth. That's our aspiration to deliver that consistently. Mortgage tailwinds helped last year, but we took the opportunity to build a lot of foundational work and we are starting to see that pay off in Healthcare now, we are starting to see that pay off in even collections and the U.K. banking business. And you will see that even in mortgage, the investments in digital products and servicing, we will see sort of that continuing, regardless of where the interest cycles kind of go up and down. But we have a core foundation on which we can continue to expand our business.

And within this, I see a lot of headroom for growth in adjacent areas of growth. We are still, I think early in the cycle for these industries, especially Healthcare. There's a lot we can do in Healthcare. And then CMT, as I said in the past, we have a good portfolio in the U.K., we are in the early phase of building our go-to-market for CMT in North America, very early days, very small revenues, but that's something which I expect that in next two years it will start to kind of deliver results. And in the meantime, we will continue to invest in newer areas, so that we have this rolling phase of growth coming in, while existing portfolios and accounts go up. That's how I kind of look at the business to be able to deliver consistent top quartile growth.

Moderator: Thank you. We will take the next take the question from the line of Dipesh Mehta from Emkay Global. Please go ahead.

Dipesh Mehta: Two questions, just from broader medium-term perspective. Can you help us with your thoughts on some progress made on new age tech companies, I think that is the focus area, how we are seeing that progressing? And if you can help us, how the size of deals and overall engagements is evolving in that space? Second question is on U.K. BFS, if you can provide some perspective, how you expect U.K. BFS to play out? And any large deal opportunities in that market which you are foreseeing and likely to get materialized in next few quarters? Thanks.

Vipul Khanna: Sure. So, Dipesh, progress on new tech, clearly every industry has its share of new tech players or the new tech divisions of existing large players. From our progress standpoint, they made strong progress on the fin-tech segment. Obviously, digital collections is a lead horse for the people who are in the lending business. But we are at the same time seeing decent traction on servicing and back office for the non-lending fin-tech. If you look at the payment side, the buy now pay later segment, BNPL, which is emerging as a fast-growing segment for payments sort of innovation, with small deferrals, we made steady progress there and now we are working with three of the top five BNPL players in that. That's as far as fin-tech is concerned.

As far as health-tech is concerned, whether it's large plans kind of embracing remote patient monitoring and those newer models, or the providers kind of going there telehealth, we are playing in that, we are currently partnering with three platform providers and we are out there in the market piloting different solutions. And I expect that segment will grow, because we as consumers are shifting to remote health. And I think the business models as well as the operations models are emerging, and we are playing right with that. So, small deal but more consultative, more revolutionary deals that we are seeing on the health-tech side.

And then especially on media, as traditional media goes to digital media, whether it's publications or content, and we are starting to look at even things like education tech, because we are consuming education also sort of remotely. And of course, there is streaming, shifting from cable to streaming. On those segments, we have a strong play. Obviously, streaming has been a strength for us, given our large client relationship; building on that, as well as going into other traditional or new age media players kind of getting there. I shared the example of the new start-ups that we are talking about. So, again, as the playbook has been for most of the industry, starting with the players when they are young, because these guys grow fast, it's about evolving with them and growing with them. At this stage, the deals are small, but in fin-tech we are starting to see reasonably sized deals as they become sizable, not too far from some of the traditional deals that we have seen on the new tech.

U.K. BFS, steady, we have a strong portfolio of leading banks, we are part of their evolution. We have a reasonable sort of pipeline of large transformation deals. These are long cycle deals, we are playing strongly some with partnership with IT partners as well. And yes, as the two or three quarters go by, we will see how those you progress and come back and update you.

Dipesh Mehta: Just one follow-up on the first part, do we plan to have any scalable business in content moderation or digital catalogue and other things, Amazon and Swiggy of the world?

Vipul Khanna: So, content moderation, we are evaluating, we haven't done any meaningful sort of forays into that market yet. As far as e-commerce is concerned, that's the priority area for us. We have opened a large e-commerce relationship, small relationship, we have laid out a couple of pilot engagements, and we have kind of now scaled that up from a digital infrastructure for that. Rather than doing it through the traditional means we have added a lot of analytics and data to that offering and we are now showcasing that to the client and get sort of greater share of the wallet based on a new age solution to that. So, e-commerce in Europe or U.K., as well as North America is focus. And we are focused as much on the merchant servicing part of e-commerce, besides the traditional model of consumers, the demand side servicing or the consumer servicing part of it.

Moderator: Thank you. The next question is from the line of Sandeep Agarwal from Edelweiss. Please go ahead.

Sandeep Agarwal: So, Vipul, excellent set of number given the large base you have. I have two things to understand, there is a lot of confusion on the disruption and transformation which is happening on the digital front the traditional front. So, while you very nicely elaborated all the opportunities which we see in the mortgage market or other market, but do you believe or agree that once the rates stabilize that market can have some other business opportunities, rather than the ones which you are seeing right now? That is number one.

Number two, how you are looking at your manpower, because you have probably hired the best of the best talent available in the market for running your digital piece and other pieces. Do you still see you need to hire a couple of more people to fill few of the gaps which are there in some of the geographies? Or you think you are done for the time being? And if yes, then what is your plan?

What I am really trying to understand is that you had every time been looking for adding additional revenue growth drivers, so which are the areas where you are looking? I know it is a strategy question and you will not want to disclose, but if you have anything, which you can disclose publicly, it will be of great help. Thanks. And best of luck for the next quarter.

Vipul Khanna: Your first question, when you say disruption from traditional to digital, and when that is done, I am trying to follow the question, you are saying so where do you see the revenue models to emerge once that transition from traditional to digital is done?

Sandeep Khandelwal: Yes.

Vipul Khanna: Okay. Look, fair question, I think different manifestations of it; one, the humans will always be there, the human need for decision making, intuition, connecting the dots, all that judgment and decision making comes from human. Technology helps in taking away the repetitive work, and technology helps to go deep and bring data and bring insights which humans can then articulate at some stage. So, I think with that philosophy, and as you would have seen from others in the industry, the manifestation of that will be that it will be more rather than run-only engagements it will be design-run and continuously improve type of engagements. So, the mix of run resources versus change and design resources versus technologies, that interplay of factors of production into deal value, I think that will change. And the consult in the change value will not just be upfront, but it will be through the deal cycle or the life cycle of that engagement. So, that will be one manifestation where you are signing up for a directional transformation, you are starting with a point of saying, I will use ABC and tools and platforms. And who knows, by third year ML has improved at some level for that particular use case that you are able to use machine learning significantly, take down the human component, but there is a big chunk of ML deployment that could happen in that engagement. So, that's one manifestation with the interplay between change, design and run resources.

The second manifestation, obviously, what we talked at the early part of the call at Sonaal's question I think, is about the platform based. The platform-based services, I think, where the entire stack comes together, right; infrastructure, application operations, and analytics, all that comes together and you deliver an outcome to the client, I think that will become more prevalent. We are seeing that in Healthcare happening, we see that in parts of mortgage cycle happening, and we are seeing little parts of the narrowly defined segments of Healthcare Provider also wanting that. And I think, from BPO to BPAS, the platform-based services will be the other big manifestation of that.

And then third is what we have seen already play out with the FAANG players and sort of the technology players, is more where you are embedded as part of a new product or new feature launch. And hence, you are evolving, you are starting with the point of view. And as products take off, the service model also evolves. So, you are right, they are designing and then delivering to it. So, as new functions and features of our clients go up, we become sort of the intrinsic operators of those functions behind the scenes. So, those are the three manifestations that I see for the new revenue streams coming for our industry. And I am sure with your coverage, you have a good sense of that as well.

From a talent standpoint, good digital talent is always welcome, we take them with both arms. Our key leadership positions are filled, and obviously those key leaders continue to add people as we bring on new platforms and as we do new partnerships. So, we recently announced two COEs with two industry leading operational platforms. These are small COEs, but those are investments, and we will need to bring in leaders who understand and know depth of those platforms so that we can deploy those for us for our client solutions. So, some level of investment will continue, but our key leadership positions for digital, both in markets as well as in delivery, are now kind of filled up.

Sandeep Khandelwal: Thanks, Vipul, for that elaborate answer. One last question if Ankur allows me, so wanted to also check with you these FAANG companies, because people are able to travel within the U.S. and most of the places, so they are posting robust numbers. But a large part of those products and services are basically just moving from one party to another, actually from the seller to the user, but not necessarily the users are able to use it or implement it. So, how do you see, once this vaccination issues gets over and the world opens up, how do you see your business moving forward? Will you see a big jump up immediately?

And it doesn't mean that I am saying that right now your business is stuck because of that, but what I am trying to understand is that what my understanding of this huge revenue beat and profit beat, which is happening in the FAANG, because its panic buying by the CTOs who just generally are looking to somehow not take the blame of shifting of market share from offline player to online on them, and they are doing panic buying. And probably the implementation still has not started because the talent which is required to implement such a huge volume is not still available, and they are just managing things from how given the pandemic situation. So, how do you see when things open up, will there be a very huge pent-up demand? Or you think we will have some benefits; how do you interpret it?

Vipul Khanna: Sure. So, I think there are two parts to this question, if I understood it right. One is, we obviously are not an IT company, but clearly, as an industry sort of participant and an observer, I do see that IT talent, like other things, is in short supply, because the shift to cloud is driving up huge demand. To that extent, we see a lot of revenue to the big cloud providers happening, but there is constraint in terms of experienced people who can help in the transition to cloud. We see that small manifestations of itself as we move our products to cloud and as we bring clients to our platform-based services.

From a demand bumpiness linked specifically to the economies opening up, my sense is, some sectors like BFS, healthcare have been impacted less, I mean, somewhat you could say that the elective procedures were not done. So, some of the diagnostics, some of the preventative and some of the usual health procedures where there is a pent-up demand, and then it will have its sort of downstream impact through the healthcare value chain. Obviously, discretionary spend like travel, consumer goods, they are seeing the pent-up demand coming through now, right. Now, fortunately/unfortunately, we don't play in those discretionary spend verticals, so we are to that extent shielded. We saw some impact to the CMP vertical. But the other way to think about, as you have seen your behaviour, my behaviour as consumers, a lot of our relationships with entertainment, content, education, travel has changed to some extent permanently. And I think some of it is not going to go away, even when the novelty of the world is open up, let me go and travel, let me go and visit, let me meet, I think once that is over, some things are not going to change. So, to that extent, these are permanent.

So, I guess what I am saying net, net is, I think some of the transition for digital is in an early stage, I think it will play out for the next two, three years. And then with the new models, let's see how the demand environment, does it kind of adds as an exponential boost to the demand cycle from the new base and then we go on to the next cycle or we take a breather after that to the next cycle.

Moderator: Thank you. The next question is from the line of Shradha from Asian Market Securities. Please go ahead.

Shradha Agrawal: Vipul, given the supply side constraints, do you see a possibility of another round of wage hike after what we gave in 4Q?

Vipul Khanna: Shradha, not necessarily supply-side constraints. But in any case, we have budgeted for a wage cycle in this financial year, as we gave one at the start of the year in January, and we did budget for another one in this year. We will go through with that in the second half of the year and we have budgeted for that in our result.

Shradha Agrawal: And secondly, how should we think about the growth rate in our top clients, given that it was a soft quarter for the top client, and we expect a strong year for them despite having a strong start to the year? Should we see some material ramp up in the second half of the year?

Vipul Khanna: Shradha, look, we are their largest partner, the relationship is healthy. As they went through the down and then upcycle, and then expansion cycle, we played a key part in that. And we are playing a key part as they are going through this cycle. So, at this stage, as I answered to, I think, Dipesh earlier, Q4, our March quarter was very strong; Q1 we saw some element of catching up your breath from the demand side, and they were obviously supply-side constraints in India. We do expect the December quarter to be strong, it's traditionally a seasonally strong quarter for us. And we are looking to kind of broaden our engagements through digital now, that sort of COVID had kind of paused those conversations. Now with COVID sort of getting somewhat to the side, I think it's time to kind of bring those conversations tangibly. And that should add to more qualitative heft to the relationship to start with, and then we see what is the quantitative impact? But net, net, it should be a strong steady yes for the top client.

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

Madhu Babu: Congrats on a steady quarter. Sir, just on this milestone payment, because last quarter we provided a provision total of $ 15 million. Now if you add that variable component, almost it is touching to $ 33 million for this large account. So, I mean, how has been the payback from that account? Can we share like kind of what is the EBITDA and all it generated kind of stuff because it looks like a different size of a payment for that?

Vipul Khanna: Sure. Look, let me try to answer in two ways, and Dinesh, you can jump in if I miss something. So, first of all, this relationship has been foundational for us to build our mortgage business, this we started when our mortgage business was very small and obviously it's grown by leaps and bounds, the business, in no less parts to the contributions from this customer group directly as well as the halo effect in taking their credibility to other participants in the mortgage fold. They continue to be our top mortgage client, strong, healthy relationships. And with this, while the payout is obviously higher from what we had provisioned, but that's part of the negotiation. But the reason is also that they have extended the engagement and continue to give us the preferred partner status for the future as well. To that extent, it reflects that. From a profitability standpoint, it's healthy margins. And we expect that we continue to keep the health of the relationship and continue to leverage this relationship in building a stronger business. Our intent was to create a mutual win-win structure where while there is a fixed payout, there is also some incentive kind of philosophically in the continuation of the earnout structure which we had for them for the first cycle. And now kind of continues that philosophy in the next cycle as well. Dinesh, anything to add.

Dinesh Jain: No, I think it's covered.

Madhu Babu: Okay. And just, what is the CAPEX guidance for this year, just wanted to calculate the free cash flow and CAPEX?

Dinesh Jain: CAPEX I think last year was slightly higher, but I think current year also our estimation will be between $15 million to $20 million, which normally we have. So, I think we are targeting that number currently also.

Madhu Babu: Okay. So, almost $30 million, including the outgo, $32 million approximately including the outgo, right, this will be the cash outgo for the year?

Dinesh Jain: Yes. $12 million, you are including the other one, right?

Madhu Babu: Yes, this payment.

Dinesh Jain: That's true.

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

Vipul Khanna: Thanks, Stanford. Thank you all very much. We very much appreciate your interest in Firstsource. We are excited about what lies ahead as we go about growing and strengthening the key parts of our business. And we look forward to your continued engagement in helping us build a fast-growing purposeful business and look forward to coming back and talking to you next quarter. Thank you so much.

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