

Q1 FY2023 Earnings Call Transcript – June 30, 2022

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'23 Earnings Conference Call.

As a reminder, all participants 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 from Firstsource Solutions. Thank you and over to you, sir.

Ankur Maheshwari: Welcome, everyone and thank you for joining us for the quarter ended June 30th, 2022, Earnings Call for Firstsource. Do note that the results, fact sheet and the presentation have been e-mailed to you, and you can also view this on our website, www.firstsource.com

Before we begin the call, please note that some of the matters we will discuss on this call, including our business outlook, are forward-looking, and as such are subjects 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 Mr. Vipul Khanna to begin the proceedings.

Vipul Khanna: Good evening everyone and thank you for joining us today. Hope the summer and now monsoon are keeping you all well.

Quick Snapshot of the Quarter

Our revenues degrew 2.7% year-on-year in constant currency and came in at INR 14,724 million or \$191 million. Operating margins were 8% and EPS degrew by 36.6% year-on-year.

The macro-environment remains dynamic and the past 6 or 7 months have been unprecedented, making it challenging for us to forecast certain portions of our business accurately. Successive and substantial interest rates hikes, multi-decadal high inflation rates, and increased fears of recession are impacting parts of our BFS business.

The headwinds primarily to our U.S. BFS business are worse than we originally anticipated. As such, we have reassessed our growth visibility and lowered our FY'23 guidance to 2% to 4% growth in constant currency. Excluding Mortgages and the full year impact of acquisitions of last year, we expect to grow between 16% to 19% in constant currency.

The key factors in the guidance revision are:

The outlook for the Mortgage industry has considerably worsened since we last spoke. This will translate to a steeper Q2 and Q3 decline in Mortgage volumes than we previously anticipated. We believe that this business will bottom out in Q3, and that we have factored in the downside risk with these lower numbers.

In the Collections business, the macro indicators continue to point to a gradual increase in delinquency rates. And as such, we continue to expect growth to pick up in the second half of this fiscal. However, the inventory is building up slower than we anticipated. Hence, we are trimming our growth expectations.

The Mortgage business is expected to impact growth guidance for 3.5% to 4% and Collections by about 1%.

Notwithstanding these challenges, we are confident that our long-term strategies to diversify our business and grow continue to yield results. The demand environment across other segments is strong and is reflected in the strength, in rest of our businesses.

Given the significant revenue volatility, we expected our margins to decline in H1 and then pick up in H2. The sharper fall in revenue and higher restructuring cost have accentuated the impact on margins for this quarter and the next one.

We are super focused on rationalizing our direct and indirect costs, which we anticipate will result in a positive impact to the operating margins by about 200 bps from Q3. Overall, we are confident of hitting an operating margin of 11.5% to 12% by Quarter 4 taking into account all these factors, we expect to achieve operating margins of 10% to 10.5% for the year. This includes an 80 bps to 90 bps positive impact from the recent amendments to Ind Accounting Standard 37, on accounting of onerous contracts. Dinesh will share more details for this in a few minutes.

Segmental Performance

Banking & Financial Services

In Q1 FY'23, our Banking and Financial Services segment degrew by 11.9% year-on-year, and 13.3% in constant currency.

Mortgage Business

Our Mortgage business contributed about \$32 million of revenue in Q1. This implies a contraction of 28% quarter-on- quarter and 48% year-on-year.

Since we last spoke, the market activity has deaccelerated sharply. Weaknesses in refinances and purchases pushed the Market Composite Index, a measure of Mortgage loan application volume down to the lowest level since 2000. In fact, the refinance index was down 80% compared to a year ago. The recent outlook published by the Mortgage Bankers Association reflects a further reduction of 10% and 11% for CY2022 and CY2023 respectively, from their Q1 forecast for the same period.

From discussion with our clients, a key variable that has changed between the March and June quarter is the consumer outlook on home purchases. Despite pent-up demand, high inflation and economic uncertainty have dampened home purchases, at least temporarily.

A majority of our clients have continuously right sized their businesses in the last two quarters, to align with the rapidly changing market conditions, resulting in lower volume growth to us. We were expecting the Mortgage business to bottom out in Q2FY23 and then stabilize thereafter. Now, considering the current volume forecast our expectations has shifted out by one quarter, with further declines in Q2FY23, and business likely bottoming out in Q3.

In H1FY23, our margins will be impacted by the lagged alignment of direct cost, people restructuring cost and the higher fixed costs. Aligning our operating costs with lower volume trajectory has been a top priority for us.

We have and we continue to reduce the direct costs. The restructuring costs will taper down by Q2. And we are realigning our support functions and leadership as well as rationalizing our tech and facilities infrastructure. We anticipate to start realizing the savings from the infra and support cost rationalization from Q3.

Amidst the painful recalibration of the Mortgage industry to this economic cycle, we see a number of silver linings of our business. Clients need more structural and Deep Impact cost solution and our pipeline for such long-range conversation continues to build up. Offshore, Nearshore and Digital are few key value levers in this pipeline.

In this quarter, we added four new clients for origination and servicing, across our traditional target segment as well as a couple of exciting business proptech companies.

Collection Business

In our Collections business, the macro-data continues to show consistent improvement. According to the most recent data from the FED, delinquencies increased to 1.73% from 1.60% in the previous quarter. This is the third straight quarterly increase, although the matrix is still lower than pre-pandemic levels.

On the other hand, we also know that high inflation and higher interest rates, in general have a negative impact on repayment ability and credit demand. Coming out of the unique economic and societal conditions of the pandemic, card issuers are fine tuning their strategies between first- and third-party Collection, and between traditional and digital.

Our Collections business is tightly linked to the outcomes we deliver to our clients. In this period of exceptional volatility, it has been difficult to establish a strong trend for both our clients and for us. We continue to expect strong volume growth in H2 of this fiscal year, but it's likely to be lower than our earlier estimates.

Irrespective, we continue to make solid progress in diversifying this business. We recently secured a win with one of our key BFS clients in the UK, and I am encouraged by the Collection services demand in that geo. We are steadfast in building a presence in Fintechs and Utilities. We added three new clients during this quarter and the sales momentum is expected to remain strong through the year.

We continue to invest in building our Digital Collections platform incorporating ML recommended strategies, newer payment methods and increased API leverage. We are also seeing strong demand for our recently opened Mexico nearshore location.

UK BFS Business

The UK BFS segment is growing strongly. I had shared that reinvigorating the GTM focus for this UK business is a priority for me in this fiscal year, and I am pleased to report that it is working.

We had a strong quarter of new offering wins and growth with our UK BFS plan. We also opened the Collection Service line with a key client providing great validation of our market efforts in the last year. The ramps for these are underway and should deliver steady state revenue by Q3. We recently closed an exciting digital transformation deal with the leading FinTech in the UK.

The demand environment, pipeline activity and digital adoption remains strong, despite the political uncertainty and tough economic conditions. The talent market continues to be challenging. We are focused on execution, expanding our delivery network and smaller nodal centers within UK and at the same time teasing out the shift towards offshore.

We reaffirmed our top ranking within the UK CX Segment by bagging five different industry awards.

Healthcare Business

Our Healthcare segment continues to grow consistently at 18.1% YoY and 13.3% in constant currency terms. In the last four quarters HPHS segment had a number of significant win. We are now sharply focused on executing and scaling on these recent wins.

For our HPHS business, the growth thesis continues to be hinged on expanding into the Top 10 health plans, growing our digital intake business, and creating bespoke BPaaS solutions for mid-market health plans. Our targeted market making efforts continue to yield strong opportunities. The pipeline especially for large deals from top tier health plans is healthy. We also added two new clients this quarter.

In addition to the Everest Group and ISG recognizing us as a leader, Avasant has recognized us as a disruptor in the Healthcare Payer Operations market, citing our 'Digital First Approach', innovative solutions and strong execution.

I am also pleased at the demand pipeline for Mexico and Philippines, as Healthcare clients increasingly consider supplements to U.S. delivery, especially for the Medicaid business.

The Provider segment is gradually emerging from COVID and its residual impact. As anticipated, the public health emergency has been further extended until the end of this calendar year.

The talent supply challenges for this industry are acute and hospital margins continue to be under pressure. As a result, clients are receptive to engage in strategic broader scope solutions. For the provider business, our strategy is 1) To focus on competency of Eligibility Services and Receivables Management, to continue to gain market share.

2) Expand wallet share with a large portfolio of clients by developing adjacent capabilities, including offshore for mid-revenue cycle services.

We continue to invest in go-to-market capabilities and digitizing our offerings increase engagement with patient and their caregivers.

Provider revenue for the quarter was flattish. The strong sales momentum of Q4 '22 continued in this quarter, including the addition of three new clients. This segment has long implementation cycles, and we expect revenue yield to increase in H2 from the new payout of the last two quarters.

Communications, Media & Tech Business

Finally, our Communications, Media & Tech segment grew by 0.9% YoY and 5.9% in constant currency terms.

Our UK portfolio continues to perform strongly. We continue to scale with existing clients including adding new lines of business with our largest clients. During this quarter, we rolled out a large Process Automation program with a leading comms client. We are excited by the impact it creates on the clients operations, and by the opportunity to leverage the showcase engagement.

Our North America CMT portfolio is also scaling up nicely. And in this quarter, we added one new account in the tech segment.

Outlook Going Ahead

We have shared that FY'23 will be a year of transition of our revenue composition. These are clearly unusual and volatile time and it's challenging to forecast. Having said that, I am disappointed to speak with you once again about lowering our guidance. This is on me, and I am fully aware that we need to provide better clarity on the growth outlook of our businesses.

If we step back, I am very confident that our underlying business is strong. The strategic focus we established a couple of years ago, remains on track. We will continue to invest in our three core industries of Banking and Financial Services, Healthcare and CMT, consolidating the leadership position we have in the chosen sub-segments, and systematically adding growth adjacencies to them. We will push forward on digital solution and services to take disruptive offerings to market in each of the industry. And above all, build a purpose-led scalable and agile organization.

We continue to diversify our business profiles and form a strong base for sustained high quality growth. By the end of Fiscal '23 Mortgages will be between 13% to 15% of our business down from about 28% in FY'22. Ex-Mortgage we expect solid growth in Q2 and expect the trend to continue, delivering 16% to 19% growth for this fiscal.

On operating margin, we are confident of returning to our run rate of 11.5% to 12% by Q4, while maintaining our investments in the growth areas of Europe, Healthcare and CMT.

In addition to the significant cost actions on the Mortgage cost base, and the planned margin improvements in last year's acquisition, we have taken the opportunity to fine tune our operating model in certain areas, and recalibrate the timing of some of our investments.

I will now pass the call over to Dinesh, to cover the financial details.

Dinesh Jain:

Hi everyone. Let me take you through the some of the financial highlights.

Revenue for the Q1 came in at Rs. 14,724 million or \$191 million. This implies a degrowth of 0.8% in rupee term and 2.7% degrowth in constant currency.

On the margin front, operating margin came in at Rs. 1,171 million or 8% of the revenue for the quarter, which is 35% degrowth on year-on-year basis and implies margin decline of 417 basis points.

Profit after tax came in at Rs. 851 million or 5.8% of the revenue for the Q1 FY'23. This is 36.7% year-on-year degrowth with a margin decline of 328 basis point.

In Q1 FY'23, we generated Rs. 1,408 million of cash from operations, and our free cash flow was Rs. 1,238 million after adjusting for CAPEX of Rs. 170 million. Closing cash balance as of June 30th was approximately Rs. 1,935 million.

DSO came in at 59 days versus the 57 days last quarter. Net debt as of June 30th '22 stand at Rs. 7,333 million or \$92.9 million versus Rs. 8,013 million or \$105.7 million as of March 31st '22. Repayment of around \$12.8 million debt during the quarter has been done.

Tax rate for the Q1 was around 18.8%. For FY'23 we expect it to be within the range of 18% to 20% for the year.

On the Forex hedging, we have coverage of £2.9 million for the next 12 months with average rate of Rs. 114.4 per pound. On the other side the dollar coverage is \$52.5 million with the average rate of Rs. 79.1 per USD

Let me slightly brief on you on the change in the Accounting Standard 37, which got effective from April 1st, '22. This was the Ind AS 37 which have been amended, consequent to this amendment to Ind AS 37, "cost that directly relate to a contract" consists of now both the cost, first was the incremental cost of fulfilling the contract. And the second is allocation of all other costs that relate directly to the fulfilling contract. So, up to the previous standard only the direct cost was considered for the arriving at onerous contract. Now onwards the indirect or allocation of costs also has been considered. This is the change which have come in now.

Therefore, in evaluating whether or not a contract has become onerous, both direct and indirect cost of fulfilling a contract have to be considered. And as per the transitional provision of Ind AS 37, the effect of the commencement of the reporting period is to be reported an adjustment to the opening balance of retail earning.

The adoption of this amendment has resulted in a reduction of \$783.4 million net of deferred taxes in the opening retail earnings with a corresponding provision for onerous contract as prescribed in the Rule 2022. Accordingly, we estimate, this will result in a lower charge in the Profit & Loss by 55% to 60% of this value in FY'23 and balance will go to FY'24, and some portion maybe in the FY'25.

The liability for this onerous contract is mainly on account of unabsorbed, indirect allocated cost, comprising facilities costs, depreciation on fixed and intangible assets, technology cost utility, and some specific geographic support service costs. This is the change which has been done in this quarter and thus the accounting treatment we have done.

With this I open up for the Q&A.

Moderator: Thank you very much. We will now begin the question and answer session. The next question is from the line of Divyesh Mehta from Investec. Please go ahead.

Divyesh Mehta: My first question is, can you actually share again the guidance decline, where is how much basis point impact coming from Mortgage and Collection? And also, can you share accounting standard, what was the impact coming from this change?

Vipul Khanna: So, the guidance revision, about 3.5% to 4% is coming from Mortgage and about 1% is coming from Collections, which is primarily from trimming of the growth expectation in H2 of the year. On the impact of the accounting standard change, we expect this year that will positively impact our operating margin by 80 to 90 basis points.

Divyesh Mehta: So, my next question is that in the credit card repayment business, the delinquencies, as you said, are increasing. But if you look at the various banks commentary, all of them have been highlighting that customers now have a larger chunk of saving a bigger cushion. So, they are not expecting a big change in that number. So, what is driving your reasoning that repayment side can see a strong growth?

Vipul Khanna: So, both things are happening, right, as I mentioned, for the last three quarters, from the very lows at the peak of mortgage where people had a lot of surplus cash, delinquencies, quarter-on-quarter have been increasing. At the same time, people as the spend has increased, you will see more of that sort of coming through in the delinquency rates. We had anticipated volume growth. We have been continuously calibrating with our clients. That's partly the reason we have recalibrated down some of the growth expectation, but we still expect there will be additions and increased volumes coming through to us.

And the second factor is, since as I have been mentioning, we have been adding new clients in utilities, Fintechs, etc, as those implemented and as those volumes come through from us, right, as you have new client, they slowly start placing more volumes from you, that balance kind of builds up. And as that builds up, those two factors combined are what are driving our Collections forecast.

We have been careful in incorporating how much lift we take from existing clients. And that's the balance we have been trying to strike in our forecast. Looking at the volume flow today I have and we look at the guidance from our clients.

Divyesh Mehta: One last question. So, when you said that 13% to 15% of the business will be Mortgages that was by end of FY'23 or for the whole FY'23?

Vipul Khanna: So, for whole of FY'23.

Moderator: Thank you. Manik Taneja from JM Financial. Please go ahead.

Manik Taneja: So, my first question was with regards to the Healthcare business is seeing a sequential decline on the Healthcare side, the understanding was that we had won a few deals there and thereby one would see continued growth. So, from that standpoint, if you could help us understand what gave the sequential drop here, if there were any one time elements of revenues in 4Q if you could call that out?

And the second question was with regards to the underlying shift towards India, if you could talk about your comments there given the labor or the staffing challenges that one has seen in Philippines as well as in the Europe?

Vipul Khanna: So, Manik the second comment quickly first, clearly, both the UK and U.S. markets have talent shortage at the frontline level. And to that extent, I mentioned about Mexico Center getting opened in March; Philippines, we already had, but we are seeing good demand. We have won a couple of deals that we are scaling up there. And I think that recognition of considering for contact center or center processes Mexico, and definitely for chat and back-office for India, we see an uptick of demand in Healthcare, we see that in Mortgage, and we see that in BFS and CMT clients in UK, right. I can almost see that as a broad trend.

Obviously, the scale is small and unique kind of teases out, right, the scale buildup is small. But as the year goes by, we do expect that some of our existing business will convert to offshore as well as the new wins, it's an increasingly important part of the new solution that we are putting together between Philippines, Mexico and India, as far as our Healthcare, Mortgage and CMT business is concerned.

On your first question, Healthcare, it had a couple of very strong quarters of growth, coming into Q3 and Q4 of last year. This quarter has been sort of flattish, largely because HPHS took a little bit of a breath, as we kind of focused on executing some of the deals and putting our shoulder behind sort of all that it takes to implement between technology and people.

Provider business, it's kind of dealing with some of the reminisce of COVID, not necessarily in terms of consumer behavior, but the government interventions in the reimbursement cycle are kind of going away in an inconsistent manner across different states. So, there are some minor puts and takes from a timing standpoint or when approval come through from different states, on our Provider business, then it kind of flows through to our clients and hence to us because it's outcome driven.

So, nothing secular or structural out there. We expect strong growth to pick up from Q2 onwards in Healthcare. And overall, as we end of the year, we expect strong growth from HPHS and decent growth from the Provider segment.

Manik Taneja: One last question on the Healthcare HPHS business, over there should one expect a typical seasonality wherein 3Q and 4Q should do much better than first half the year given the vagaries of the enrollment for the open enrollment cycles with the American Healthcare System.

Vipul Khanna: So, there is definitely an uptick in Q3, and it bleeds over into Q4 because open enrollment period for a majority of the population is leading up to December, so that they are ready for next year. It's not significant, but it's definitely an uptick that we see in Q3, Q4, historically across our health plan.

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

Dipesh Mehta: Couple of questions, first about the guidance. In the guidance I think you alluded about weakness to persist in H1 and recovery in H2. So, can you help us understand let's say next three quarter how the trajectory look like, both from revenue perspective and margin perspective, whether we are making too much for Q3, Q4, and which again, carries some risk in terms of guidance or you believe Q2 onwards we will see sequential growth playing out, and margin also will start recovering?

Second related question is about let's say 2% to 4% constant currency, YoY when we say. what kind of CQGR we are building for next three quarters?

Second question is about the Healthcare business, to some extent you alluded, but if you can provide some sense about Provider business, it seems weakness for Provider business for some time. Some of your peers seeing healthy recovery over last couple of quarters, maybe mix change or some other differences, but our recovery seems to be very soft compared to some of our peers, so if you can provide some sense?

Vipul Khanna: So, guidance, overall, we expect that growth will pick up through the year. At an overall level, Q2 will be flattish compared to Q1, and then will kind of pick up. And that's largely because Mortgages will decline next year. And it will kind of mute away the growth in other sectors. So, ex-Mortgage, we expect decent set of growth in other businesses in Q2, and that trend will continue. When the Mortgage decline starts to arrest after Q2 that will kind of show up more in the growth at the overall level.

So, on your question of what is the compounded quarterly growth rate, at this stage, we expect that will be between something like 3.2% to about 4%, between Q2 to Q4. So, that's from the guidance.

As far as margins is concerned, couple of factors which are playing up on the margin. One as the margin decline, we have a direct cost base in the Mortgage business, especially that we need to tackle which we are tackling. There is an impact of restructuring costs that we have in this quarter. And kind of it will taper off by next quarter. So, that imbalance of direct costs, which is weighing heavy on Q1, and slightly less than Q2, that will kind of finish off by end of Q2, that's one positive factor to the margin.

Second, the actions we have taken on our indirect costs, whether its leadership support, as well as leadership and support or infrastructure, those actions have been implemented. Obviously, they have long notice periods and cycles from our facility and technology reduction. Those, we expect to kick in from Q3 and Q4. And as I mentioned, we expect that will lift our margins from Q3 by about 200 basis points.

So, between the reduction of load in direct cost, the restructuring costs tapering off, and the gains from indirect costs, we do expect that our operating margins should start to come back to around 11.5%, 12% by Q4 to end the year overall, between 10% to 10.5%. That's kind of the margin ramp that we see from Q1 to Q4.

On the Healthcare business, Provider, so I think I had mentioned we had a strong sales quarter in Q4, after about 10 quarter, we had a highest sales in Q4. We continued with pretty much the same trajectory of growth in Q1 as well. But this business has a longish implementation cycle. You get prospective placements from your clients, you don't work on whatever their previous vendor or in-house might be working on, you only get fresh placements. And there is a cycle for those placements, to work their way through the different service value chain, and by the time you recognize revenue, it kind of gets to be about sort of six to nine months in terms of meaningful revenue. So, those gains will kick off towards the second half of the year. That's one common.

Second, our business, as we have been saying, is kind of, we are the leaders in eligibility and building in RM business. That has its own nuances. It's completely an onshore business. Since the last couple of quarters, we have stepped back and broaden the scope of where we play. We have put in a new team. We are digitizing are offering. And we are also building up capabilities for mid revenue cycle, so that we can start to kind of cross-sell to our existing clients, on some of the mid revenue cycle opportunity where offshore plays an important part.

So, we also see growth in some of our competitors who have much broader offerings and also they have offshore presence in that. And that's one of the targets we are doing to increase our business. Our core business is obviously linked to how the macro conditions and the public health emergency plays. But given the fact that sales have increased, gives us confidence that as the year goes by, some of those remnants will kind of wash itself out through the RPM cycle of the U.S. industry.

- Dipesh Mehta:** Vipul, just on one follow up on margin. Let's say in Q1 we deliver 8% EBIT margin, you indicated revenue to be flattish in Q2 considering Mortgage business headwind likely to persist in the near term. So, you think this margin is also likely to remain closer to Q1 or you think now improvement will start from Q2 onwards.
- Vipul Khanna:** No improvement will start from Q2, Dipesh because some of the costs action we have taken and some of the restructuring will taper off. So, for instance, this quarter, and Dinesh can validate comment in, this quarter we had about 60 bps of impact from restructuring costs that will taper down to about 35% 40% in Q2, right. So, some of those direct cost benefit will come in, and we will see a lift in the margin from Q2 itself.
- Dinesh Jain:** No, that is right. I think the Q2 onward we will start seeing margin improvement. A lot of cost actions have been taken and some of the costs have already been taken out. So, Yes we will see the improvement.
- Moderator:** Thank you. Next question is from the line of Shradha from Asian Market Securities. Please go ahead.
- Shradha:** I have a couple of questions from my end. So, can you quantify the mix of servicing and origination in our Mortgage business this time around?
- Vipul Khanna:** Yes, so Shradha for the end of this year, we expect we will be between two-thirds servicing and one-third origination. At this point in time, we are at about 40-60, between origination and servicing.
- Shradha:** And Vipul, if we really look at what happened in this quarter, we had guided to Mortgage being at \$32 million to \$33 million run rate in 1Q. And that is where we actually landed. So, the interest in this quarter was more to do with other businesses than Mortgage actually, so is the understanding right?
- Vipul Khanna:** Partly, but look, we were expecting that we will taper off, we will kind of find the new equilibrium from Q2. But towards May and June, we have seen sliding down of revenues. And hence we are seeing a significant decline that you see in Mortgage quarter-on-quarter between Q1 to Q2, that has an impact on cost and margin significantly, right, because you have your revenue starts to tail off sort of mid-quarter from where we want it. So, yes, we are broadly slightly lower than where we wanted for Q1, but if the Q2 and the lower base for Q3 and Q4, which is a big driver for our guidance revision.
- Shradha:** And what kind of decline we are building in for 2Q, if we can give some sense on that? And do we expect a further decline in 3Q over 2Q or 3Q should be more steady state, vis-à-vis 2Q?

Vipul Khanna: So, at this stage, we are expecting Q2 on Mortgage to be closer to between, let's call it \$25 million to \$26 odd million. It will bottom out from there slightly in Q2, not a whole lot, that's how we see at this point in time, and then gradually pick up a little bit it will pick up from Q4.

Shradha: And just under leadership restructuring, what actually do we mean there, I mean, has there been some voluntary attrition of people that we have seen at the senior leadership level or what exactly do we mean there?

Vipul Khanna: So, I meant two parts, one that the whole support infrastructure, right, that is built up to support a business that had scaled up to a business which was running at about \$200 plus million right. Now, that's the business which will pretty much halved. So, to that extent, we are realigning the support infrastructure across the functions for that lower base.

And second, as the business for Mortgage has declined, obviously, across the pyramid, we have had to reduce some of the talent cost there. So, at the senior level, we have stability, but at the operating level at some of the solutioning and stuff level, we have had to kind of recalibrate the business to the new reality of the volumes.

Shradha: And just one last bit on the two acquisitions, how our cross selling synergy is playing out in both Stonehill and ARSI, we can talk more about that.

Vipul Khanna: So, the ARSI acquisition is playing out well, it's integrating well. We had mentioned that they had lower margin than us. And it will kind of take us this financial year to kind of bring them to parity by end of the year. I think that is on par, mostly.

On Stonehill, clearly they have also been impacted by the industry, significant decline in the industry on their revenue. And given it's a platform-based business, it has impacted their margins pretty significantly. And we have had to recalibrate that cost as well in Q1 to this new reality. The good thing is that because they had lesser exposure to origination, and they are mostly QC and due diligence, which are secondary market activity. We saw that they stabilized in June, and in July also we have seen strength in their business, or at least there is stability now. And they obviously will recover a little bit ahead of the core business, given once there is stability in the secondary market transaction. It shows through in volumes of QC in view of Stonehill.

So, revenue wise they are stabilizing, margin wise they were worse than where we anticipated, primarily because it's the platform business. And I think it will take us till end of the year to bring them back to a reasonable level of margins.

- Shradha:** And just one last thing, the guidance is on constant currency basis, which is of 2% to 4%, and assuming 250 bps cross currency headwind given a 30% exposure to Europe that we have. So, in dollar terms of we might actually see a decline in revenue this year versus 22, is this understanding right?
- Dinesh Jain:** I don't think we have done that working. But Yes, it can be because our rupee is at Rs. 79 or Rs. 80, so year-on-year basis that's a change, plus I think dollar, GDP also trending lower, it is now at 1.22 and 1.24, so it can, but we have not done the working, I think we will share with you once we have done that.
- Shradha:** And last time you that indicated that the guidance, yes --
- Ankur Maheshwari:** What I was saying Shradha is that we have about 30% of the business coming from UK. So, that obviously will be exposed to this moment. To that extent, we will have that impact on our dollar revenue.
- Shradha:** And the last time we had split out the guidance in terms of organic and inorganic, and we had expected almost a 600 bps contribution to come in from acquisitions. Is that number still the same or has there been a change of mix between inorganic and organic contribution now?
- Vipul Khanna:** I think so first of all, as I mentioned, excluding the impact of both Mortgage and full year impact of acquisition, we expect growth of 16% to 21% for the fiscal, which means that other businesses are performing strongly.
- On the inorganic impact I think we will see some trimming as I mentioned, ARSI is part of the Collection cycle. So, there will be some trimming, slight trimming there. And then Stonehill has also been impacted to some extent, I don't have a quantified, we can answer later. But I think it will be slightly lower than the 6% impact that we expected from the acquisitions.
- Moderator:** Thank you. My next question is from the line of Sachin Kasera from Svan Investments. Please go ahead.
- Sachin Kasera:** One thing is that, if you could give us some sense on your vision for more like a two, three year perspective, because of this heavy dependence on Mortgages, we had a very big impact on our numbers. So, how are we looking to build a company so that we are more diversified, both in terms of geography as well as in verticals, so that we again, do not have the same sort of mistakes. So, if you could just give your broad vision of post this month that we are seeing or headwind we are seeing, how do we see the company say in FY'25?

Vipul Khanna:

So, let me just quick comment on Mortgage before I get to the overall vision. So, look Mortgage is a volatile business, it's a more dynamic business, it's linked to economic cycles and we know that. Typically, these cycles are four to five years, right, these cycles work in the form of interest rates decline, refinance, become very viable, etc, etc. But given the unique circumstances of COVID, where interest rates went down to record low, demand picked up significantly, this cycle got compressed. And you saw some tremendous growth in our business in the last two years.

And at the other side of the cycle, that the economies come out of this and you have seen sort of successively increasing actions, and the pace of the actions which FED is now doing, has not been done in the last 40 years. So, with those sort of actions, the decline is also very precipitous, right. So, this cycle, instead of five years, has got compressed to two years on both way, on the way up, as well as the way down. And which has given less time to the industry, our clients and hence us to prepare for this kind of thing, but fundamentally solid business.

And as we go forward, we think from the start of the cycle to now, we have almost doubled the base of our clients, we have a diversified client base. We want to expand into other parts of the Mortgage chain, so that we are not totally at the -- so that originations become the smaller part. There are other pockets and products like Home Equity, Home Improvement, other parts of the value chain, where it can play, and also take this expertise and expand into consumer lending or other parts of BFS, right. So, take some Mortgage and go to other parts of consumer lending. So, take this core, and we can expand into multiple ways, that's one of the strategies coming out of this cycle that once we have this foundation of the Mortgage business, where do we take it.

At a broader level, as I mentioned, by end of FY23, Mortgage will be about 13% to 15% of our business, which means that rest of our business is less linked to that economic conditions. That's why we have been investing in Healthcare growth, like Healthcare, both payer and provider. We have been investing in CMT. And we have been investing in different parts of CMT, for instance, Digital Media, edtech etc. And we are also starting to think about, as I already talked about delivery dependency kind of coming on to other places.

So, I think from a vertical standpoint, within the broad verticals of Healthcare, BFS and CMT, we are finding segments where we think we have a legitimate claim to kind of win or right to win, and expanding into that.

Again, reiterating what I have said, if you take ex-Mortgage, if it's a 16% to 19% growth, going into next year, when Mortgage becomes a smaller base, and it has stabilized, I expect that at the reported level we will deliver good top quartile growth for the BPO **30** industry, we will be able to kind of give that consistently once we have this portfolio realigned after this year's aberration.

Sachin Kasera: Secondly, we have a significantly good exposure to the UK economy, we again have been reading that Europe itself is again seeing some sort of recessionary condition. And the Pound has also depreciated. So, what is your take on this? And can this also give us some negative surprises maybe if things deteriorate further from here, say, Q2 or Q3 and could again lead us to some sort of revision in guidance or outlook or negatively?

Vipul Khanna: Yes, the UK economy is also going through a pretty soft phase. There is political uncertainty, there is economic conditions, high inflation, high energy prices, which are impacting the economy and the populous there, no different as such from the U.S. economy. In general, when companies have pressures, outsourcing is a good answer. It is playing out in UK, it is playing out in U.S., ex-Mortgage. So, we are seeing good demand. Q1 was very strong quarter for UK. And looking at the ramp ups that we have in play as well as the pipeline we feel good about the growth in UK for this year, and going into next year.

The softness in the economy, we are seeing demand in BFS, we are seeing demand in CMT. And in small ways, when we play in the utility segment, we are seeing demand there as well, in the UK markets. The impact of Pound softening, that will play in our financials, Dinesh has kind of covered most of it from a Foreign Exchange exposure. So, for now, I don't expect any downside risks from the UK economy condition playing on our revenue and margins.

Dinesh Jain: No, I think Vipul, that's true, because I think the consolidation level, you may have revenue impact, but bottom line, not going to be significant, and all offshoring is as you know that we already covered one year at the average rate of 114, while your current GBP is around 95, 96, so it is very much covered.

Sachin Kasera: So, one question on the net debt, it had gone up significantly last two years because of acquisitions. So, what is the thought process there? Would we now look to reduce the net debt before we do any major acquisition?

Dinesh Jain: I think this quarter we reduced the debt because all the cash flow has been utilized only for that purpose. And I think I have said in the past also I think that debt level is like hardly to like 40% or 50% of the working capital which we have. And we have not taken really the long term debt for acquisition and more at cash flow which utilized. And I think its better to protect the interest rate, we have converted some of the working capital to a debt, which is two year and three year. But purely these are money utilized for working capital. So, I think I will say that these are all debt, which is for working capital and it's that way, I don't think there is anything else specific to it.

Sachin Kasera: So, the surplus cash that we will generate post the payout, we intend to, again look at some acquisition opportunities, or we will primary reduce debt, that was my question?

Vipul Khanna: So, we continue to look very systematically for adjacent growth areas, and as part of that, inorganic is always a strategy. Nothing imminent, nothing planned for now, but we continue to look into markets continuously evaluate opportunities as they come aligned to our growth trajectories. So, at this point in time, nothing specific to report on that aspect.

Sachin Kasera: And just last question on this margin in Healthcare QoQ I can see some significant compression, I don't know if you have covered that, but there seems to be a significant compression in the margins in the Healthcare vertical versus the March quarter. So, I don't know if you have commented on that --

Vipul Khanna: So, couple of reasons for Healthcare margin compression

i) The Q4 margin was higher, because there were one off items that that had taken the margin up for Q4. As that effect normalizes, that kind of shows up in Q1.

ii) Given some of the wins and the focus and execution, we have had the kind of starting to implement cost comes before revenue, that is another part of normalization, which we will see.

And then iii) As I have mentioned, in the past, digital intake is one of our go-to-market strategies for large health plans. It's a competitive business, it has a long lead implementation cycle, because it's dependent on technology and stuff. That business is kind of, at this stage going through its implementation phases, and it's impacting the margins. Once it scales up, once we have a better equilibrium on execution on that business, that will also contribute positively to the margin, but this quarter, it impacted the margins for HPHS business. So, these are the three reasons why we saw sequential decline on Healthcare margins.

Sachin Kasera: So, fair to say that Q4 was a little high because of one offs and this quarter, it's low, again, because of one offs. And hence, the compression looks much more magnified.

Vipul Khanna: Exactly.

Sachin Kasera: Would you be able to quantify this one offs, approximately, how much was the one off in Q4 on the positives and how much of the negatives, this quarter?

Dinesh Jain: I think we need to have exact in a percentage term. But I think there are three reasons which Vipul said, I will say that 25% reason for the last year, but the 75% reason for the current year, which is mainly the investments and I think due to the new businesses which we have taken where we have a cost of growth cost, which comes into play. So, I think that was the most bigger reason.

Moderator: Thank you. Next question is from the line of Chirag from Ashika Institutional Equities. Please go ahead.

Chirag: I have a few questions with respect to the margin levers, which we can use to maintain the performance of what you guided. Please throw some light, what are the levers we have? And also ex-Mortgage if our business model is under transition phase from next 3 to 4 year perspective then also will this lever will intact or will it be changed?

And also guidance from three to four years on top line?

Vipul Khanna: Yes. So, margin levers available to us as I had mentioned, one direct cost for Mortgage business needs to be realigned to the new revenue base, which we have been doing that's well underway. Second, our technical infrastructure as well as physical infrastructure obviously, needs to be recalibrated down, that's a longer reduction cycle. We have initiated those actions. We will see some benefits in H2, and we will see some more benefits come through in next year as those actions kick in.

And three obviously, when you transition this level of business the growth, the SGA as a percentage of the company, it becomes bigger. Once this effect wears down, the SGA itself will normalize as a percentage, and that will add the scale effect to the margins. So, between those three factors is where we see margin coming back to historical level by end of the year.

As we change, as the business becomes more diversified, does it change our margin profile? No, I think it continues in the same way. I have said in the past that we think we would like to get to a place where every year we can improve our margins by about 25 odd basis points to operational efficiency, etc. We had delivered that in leading up to FY22. This is a year of abrasion. And I think they will continue their journey once this kind of wears off from FY24 onwards. And the same for revenue. If you look at revenue, FY22 ex-Mortgage we grew 14%, this year ex-Mortgage we are saying we will grow 16% to 19%, not counting impact of acquisitions. And we do expect to continue in the same way to deliver double digit growth in line with top quartile BPM companies for the next four to five years. And I think the foundation of business, and if we look at last two year's trend, we are reasonably confident that we are on track to deliver that.

Chirag: Do we started the wage inflation price into the contracts on client side? I mean, increasing the project cost and all the other due to inflationary environment?

Vipul Khanna: Yes, we have been at it since last year, some of our contracts have automatic sort of kick in, especially for onshore delivery, as index changes, you know, price changes. For others we have been negotiating. There are obviously some lag. But in general, I'm pleased with sort of how clients have responded to the rising wage inflation.

Moderator: Thank you. Next question is from the line of Sonaal from Bowhead Investment Advisors. Please go ahead.

Sonaal: I have two questions. Firstly, on a quarter-on-quarter basis, our depreciation has declined. What is the reason for the same? And what would be let's say, a recurring depreciation or the depreciation for the next quarter?

My second query was you mentioned that you have been able to get some price increases and some of these price increases are part of your contract. So, in outcome-based contracts also, are there such clauses of price increases, like in your Collection business would you get a better pricing based on outcome, considering there has been inflation, or would the pricing be same, because it's outcome based?

Vipul Khanna: So, look, in general in outcome-based pricing, there isn't an auto inflation and it's hard to get price increases as your cost of input increases for outcomes. The lever there is operational excellence since we have the flexibility to continue to fine tune our operating model, continue to bring in innovation, that's a value lever to counter rising prices in general. It's mostly on the input based, FT based where we kind of have either automatic or negotiated price increases.

Dinesh Jain: On the depreciation part, I think some of the facilities which have completed the depreciation period. So, there is a slightly lower charge this quarter. And I think as you have seen the CAPEX, which we have invested, probably it will be range bound, I don't think it will increase to that number of Q4 level, but I think it will be range, Rs. 2 crores to Rs. 3 crores here and there. We did a Rs. 69 crores last quarter, we are at Rs. 64 crores I think it should be in that range of Rs. 65 to Rs. 68 crores, I don't think it will materially change.

Sonaal: Lastly, so I joined late, so maybe you have answered this, but in case of the Healthcare business won't be expecting growth in this quarter, if I remember correctly based on my past discussions and why didn't that materialize?

Vipul Khanna: So, as I said, Healthcare business will grow strongly this year, right. We have the deals, we are implementing, we know that. Partly, as I said this has been a quarter of execution on Healthcare on the health plan side, it didn't show up in revenue primarily because we have won, lot of deals, we are focused on executing; the pipeline is there excellent pipeline which will pick up Q2 onwards on the health plan side. And on the provider side, we had projected that the growth will come in later part of the year. The sales have happened; they will start to kind of kick in later part of the year. Next year in provider, you will see more expression of sort of the COVID impact going away. So, it's been a little bit of a flattish quarter on Healthcare, but nothing structural and we aren't worried about growth in this sector.

- Sonaal:** My question wasn't actually about structural part; I was trying to just understand so this Healthcare are you saying that was in line with your expectations when you had a Q4 call or has there been a change in Q1 compared to your expectations?
- Vipul Khanna:** Understood your question now. No, I think broadly in line with our expectations, this isn't something which we not expected.
- Moderator:** Thank you. The next question is from the line of Manik Taneja from JM Financial. Please go ahead.
- Manik Taneja:** Just wanted to understand the fact that you spoke about us aspiring to match peers on growth, or the high growth BPO company, should we probably expect given the fact that while Mortgage would have reduced to a much smaller size, but we have the top client which is not such a very high growth account. So, with almost 30% of your portfolio which has shown probably a subdued growth in that context, can you expect to get back for double digit growth in FY24?
- Vipul Khanna:** So, Manik I got the thrust of your question, your voice was a little bit in and out. So, you were saying that with the reduced Mortgage portfolio are we confident of getting double digit growth next year?
- Manik Taneja:** Yes, that's correct Vipul.
- Vipul Khanna:** Yes, so Manik as you just said, if you look at it, like last year, FY22 ex-Mortgage, we grew 14%. This year, ex-Mortgage and even excluding the Collections and Mortgage acquisition, we are projecting 16% to 19% growth. The foundation for Healthcare, CMT, and DFS business, including UK, and the Collection business, I think, are good businesses. They are showing what they have shown in the last two years, Yes. And I feel good that we will be able to deliver the medium-term growth that we have been talking about the low to mid-teens.
- Manik Taneja:** And just one last clarification question with regards 2% to 4% YoY CC growth outlook that we have provided for the full year, do you expect the second quarter to be a flat quarter at an overall composite level on a year-on-year basis? I couldn't understand the comment that you guys made around the 2nd Quarter performance should we expect it to be sequentially flat? Should we probably expect a YoY flat quarter, if you could clarify?
- Vipul Khanna:** So, it will be sequentially flat, YoY I think it will show up growth. It will be sequentially flat because Mortgage will see a decline while other businesses will increase. So, that's math of it.
- Manik Taneja:** Sure. Thank you, I'll take the discussion offline, because I guess asking rate for 3Q and 4Q will be very significant assuming 2Q is flat on a sequential basis but I will take it offline. Thank you.

Moderator: Thank you. Next question is from line Sonaal from Bowhead Investment Advisors. Please go ahead.

Sonaal: My question was pertaining to credit card recovery business and claims which you get, based on outcome basis. So, that business didn't do well in the last few quarters, what now, since people are talking about a slowdown, would that be a major part of your growth drive this year, and when do you expect that business to pick up, because there is some lag valuation I understand.

Vipul Khanna: Yes. So, you are right, that Collection is counter cyclical business right when the economies go soft Collections in general does well. Because people start to fall behind and stuff and you have more higher Collections than when the economy is good, and everybody's kind of making a lot of money and has a lot of cash. So, that's the classic economic cycle. This one because the coming of pandemic and people had a lot of cash surpluses, the buildup of that is something which is taking time, it's not falling predictable patterns. That's why we will careful instead of forecasting what we originally thought, but in general, we expect the volumes to increase, our clients are telling us to be prepared for volume increases, it's showing up in delinquency. And as I said, we have also been diversifying beyond credit cards, as new payment methods come in to BNPL, FinTech come into play, we have been targeting them, and we have had some very good wins in the last two or three quarters with those FinTechs because a chunk of the customer spend is now coming through those new payment methods, as opposed to the traditional credit cards. And we want to make sure that we start young with them. And as they grow, we grow with those payment companies. And that will become a reasonably chunky portion of our revenue as we go into this year, and next year.

Sonaal: My other question was a little bit mathematical from your Healthcare business side. So, let's take your Healthcare business rendered organic assuming no acquisition or assume the base for FY23 and FY22 is same. Now because of health emergency benefits if the base was 100 just with that going away what could be your revenue, would that be 110, would it 105, would it be 115? Just to understand the impact of this one off, versus, you know, the various initiatives we have taken that would give us a good perspective of how the business is shaping on the Healthcare side?

Vipul Khanna: Sonaal it's a little bit of a complex answer. Public Health Emergency is one of the contributors flowing into this mix, right. I am happy to take it sort of offline on how this plays out. But in general, if I was to give you an answer, we should see good single digit impact, once this whole remnant of COVID is kind of cleaned from the system. But there are multiple sort of complexities and when you add the fact that it's a state-by-state answer and political leanings, etc, play into that as well. So, it's a little bit of a complex equation that we deal with. But we can talk more offline, and I will give you more color on that.

Sonaal: And when do you expect this to be off or it's been already announced that there is an end date for this?

Vipul Khanna: So, what they have been doing is because it's a political decision, they have been kind of pushing it out right earlier, they said it'll be February than April, now, it kind of looks with midterm elections coming there. They said, it'll be more towards the end of the year. So, they keep taking a call to say extending it. But as I said, it's not as black and white, because some of the states have already started to prepare for that, depending on whether which is your political leaning, some of the states have already started to plan and put in place or stopping some of those reimbursements. So, it's kind of a mixed bag answer, not a big milestone event, which will kind of say this now goes up, it goes down.

Sonaal: In terms of, just to understand your forecasting of your revenues, what your assumptions are what kind of assumption around this method have you assumed in your forecast of ex-Mortgage, is this contributing significantly or not assume anything changing on this front, while giving you know the forecast because forecast is as good as the assumptions,

so regarding this particular measure of health emergency, because you said that it will have a single digit benefit. I am trying to understand when you are guiding for this are you assuming significant benefits from this in FY23? Or you are not assuming, because we don't know when this measure will go and you said it's been postponing. So, have you assumed anything? Have you assumed something between or you assumed full recovery in the forecast or you know from this health emergency benefits?

Vipul Khanna: We at this stage, we haven't assumed any uplift from the milestone coming through. We expect it will kind of slowly will kind of unwind its way through the year. So, we don't expect a big chunk or a big uptick, just because that demand, it'll be the other factors of building our business, where we think we will see growth.

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

Vipul Khanna: Thank you everyone. Look, I know this is a year, which is a year of abrasion, it is a difficult period. But I think the actions we have taken, the investments we have been doing, building our businesses, give us confidence that we will kind of work through this and deliver the growth that we are now talking. So, thank you for your engagement and I look forward to talking to you again.

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