Firstsource Solutions Limited
Q3 FY08 Results Earnings Call

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CORPORATE PARTICIPANTS:

Mr. Krishnan Akhileswaran – Head of Investor Relations
Mr. Ananda Mukerji – Managing Director and Chief Executive Officer
Mr. Raju Venkatraman – Joint Managing Director and Chief Operating Officer
Mr. Rajesh Subramaniam – Chief Financial Officer
Mr. Farid Kazani – Financial Controller

Moderator: Ladies and Gentlemen Good Evening. I am Rochelle the moderator for this conference call. Welcome to the Firstsource Solutions Limited Quarterly Earnings Conference Call. For the duration of this presentation all participant lines will be in the listen only mode and this conference is being recorded. There will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during this conference call please signal an operator by pressing "*" and then "0" on your touch-tone phone. I would now like to hand the conference over to Mr. Krishnan - Head of Investor Relations. Thank you and over to you Mr. Krishnan

Krishnan Akhileswaran: Thank you Rochell. A very good morning to participants from the US. Good afternoon to our UK participants and good evening to our participants from India. Welcome everyone and thank you for joining us on our earnings call for the third quarter and nine months ended December 31st, 2007. Please note that the results, fact sheet and press release are available on our website www.firstsource.com. The presentation and the transcript of this call will also be made available on our website. To take us through the results and to answer your questions, we have with us today Ananda Mukerji, our CEO and Managing Director.

Ananda Mukerji: Good evening everyone.

Krishnan Akhileswaran: Mr. Raju Venkatraman, our Joint Managing Director and COO.

Raju Venkatraman: Hi. This is Raju. Good evening.

Krishnan Akhileswaran: Mr. Rajesh Subramaniam, our CFO.

Rajesh Subramaniam: Hello everybody.

Krishnan Akhileswaran: And Mr. Farid Kazani, Finance Controller.

Farid Kazani: Good evening.

Krishnan Akhileswaran: We will be starting this call with a brief presentation providing an overview of the company's performance in this quarter, followed by Q&A session. Please note that anything said on this call that reflects any outlook for the future or which can be construed as a forward-looking statement, must be viewed in conjunction with the risk that the company faces. A full statement and explanation of these risks is available on our prospectus filed with SEBI, which can be found on www.sebi.gov.in. With that said, I would turn the call over to Mr. Ananda Mukerji, our CEO and Managing Director.

Ananda Mukerji: Good evening everyone once again and thank you for joining this call. What I will do is we have a small presentation on the earnings update and I will take you through that and then we will open it up for questions.

So to begin with the financial summary for Q3 of fiscal 08, our revenues are 3,825 million, which is up 71.6% year on year from the previous year Q3, and is up 29% quarter on quarter. The EBITDA is 665 million, which is down from 737 million in the previous quarter, but up from 505 million in the previous year, 31.6% year on year and down 10% quarter on quarter. And the profit is down from 456 million in the previous quarter to 206 million. And I will be talking about some of the reasons for that as we go forward. If we look at the detailed numbers, the other operating income has dropped from 218 to 150 and other income has dropped from 160 to 86. The other significant number in that chart, which is the interest expense, has gone up from 24 million in the previous quarter to 195 million in this quarter. These are really the significant numbers; our basic EPS is at Rs. 0.48 and the diluted EPS at Rs. 0.44 for the quarter.

If I look at the financial numbers for the nine-month period ended December 31st, the total income has gone up from 5,629 to 9,600 which is 70.5% increase year on year. The EBITDA has gone up from 1,170 to 2,075 which is 77% year on year. The EBITDA margin has gone up from 20.8% to 21.6%. And the profit after tax has gone up from 623 million to 1,105 million, which is a 77.3% year on year.

Turning to the next slide, in the broad highlight, EBITDA as a percentage of total income has gone up from 20.8% to 21.6% on a nine-month basis. The revenue has grown by 67.5%, that's revenue from operations. Total income has grown 70.6%. The PAT has grown from 623 to 1,105 with 77.4%. If we exclude the non-predictable Forex gains on consolidation and on the loan book from the operating income as it is an unusual item, the EBIT has gone up from 692 million to 1,194 million, a 72.5% increase. And as a percentage of income has gone up from 12.4% to 12.8%. So on a nine-month basis, the growth continues to be strong. The total income excluding MedAssist has grown 49.3% in Rupee terms and 67.7% in US dollar terms. And in spite of the lower exchange rates between these two periods and the challenges in Q3 which I will talk about, the margin has been decent. This total income growth as we said is of 49.3% in Rupee terms and 67.7% in USD terms excluding the MedAssist acquisition which we have done. So that is the pure organic growth in the company.

On the next slide on the performance of Q3 of the year, as I mentioned on the last earnings call, the 450 million level of profit which had come in Q1 and Q2, which is exceeding 15% net income margin, significantly higher than our stated and targeted net income margin of 11 to 13%. And there were reasons why the profits had come in higher for those two quarters. We have normalized some of that for you in this slide. We have said that the grant income will be lower in the second half of the year compared to the first half. So that has come in at 90 million lower. And the Forex gains on account of loan book is reduced from the previous quarter by 60 million. That normalizes the PAT to about 300 million. The actual Q3 PAT excluding Forex gains is 130 million. And that is lower by 170 million on account of three factors really. One is deteriorating credit environment in the US which I alluded to in the last earnings call and the potential impact we saw on our margins that has had an impact on our margins this quarter. And that has resulted in the profit being lower by about 70 million. Secondly, we had also a new center which we started in Salt Lake City. And that center has taken somewhat longer to stabilize and as a result is not handling the level of volumes which we expect it to handle. And that has caused a difference of 50 million. And lastly there have been certain one-time charges related to the convertible bond issue which we did and some other charges, which is about 50 million.

On the MedAssist acquisition, I should point out, the contribution of the MedAssist acquisition to the profit has been pretty much entirely negated in this quarter by the interest cost which we have charged. So that on a net net basis has had very little contribution in this particular quarter.

I will talk about the specific points which I mentioned.

The grant income reduction - this is the grant from the Northern Ireland to defray the initial setup, training stabilization cost for the Northern Ireland Center. It is paid on predetermined milestones. And our expectation was that about 550 million for FY2008, out of which 66% was realized in the first half and as we had mentioned in the last earnings call our projected number for the second two quarters would be lower to about Rs. 100 million per quarter. So this is one impact which I spoke about.

The other impact is on the collections business. Clearly the sub-prime crisis which is taking place in the US is resulting in increase in default initially on the mortgages. But, now we are seeing increased defaults on credit cards and other financial assets as well. And this is something the economy is seeing right across the spectrum and it is not just related to the sub-prime segment of the market. But even the prime segments are seeing increase in default rates. What it has done for us is that it has impacted the liquidation rates on our existing portfolios which we collect. As a result, we have lower collected dollars and hence lower revenues and profits. This is something we had mentioned in the last earnings call. This is something we are watching, the liquidation rate, the trends, we were seeing liquidation rates trending down and we are seeing the impact in terms of numbers for this quarter.

We are seeing a couple of things happening in the Industry. One is as the level of delinquent debt is increasing, as default in all asset classes, financial asset classes' increase, there is likely to be a sharp increase in business volumes over the next 2 to 3 quarters. That's as debt reaches the charge off position, the amount of charged off debt which is going to require collection services from companies like us is going to sharply increase. We are also seeing that card issuers are likely to sell more delinquent debts. And we have seen this in a number of card issuers selling more of their debts than they were doing earlier. Debt buyers are likely to become a bigger customer segment for us probably in the next year compared to what it was previously. And, we expect that the profitability of the business, which is under pressure at this point, will adjust over time. And the collection strategies will have to adjust for the lower liquidation rates and we are seeing in it. Essentially what is happening is that the portfolios which we are collecting on right now, the collectability of that portfolio has declined. As a result of which the strategy which we use for collection, needs to change. And that is something we are working on at this point and amending in terms of how we approach those portfolios to ensure that we maintain our profitability. And clearly the structures of commission and fee which we have with the client will change over time. We see this really as a fairly large opportunity really to expand our business, because overall the business size is going to increase. And we see that if we continue to maintain and improve our vendor ranking, we will get a larger market share as the business volumes increase. We are also diversifying our customer base from earlier what was we worked primarily with the card issuers; we today have a number of major debt purchasers in the US as our customers. Once again I would emphasize that we do not take any of the portfolio debt onto our books. We simply collect on behalf of the entity which owns the assets. Today we are working for two of the top 10 debt buyers in the US - we have 4 debt buyer customers out of which 2 are in the top 10. We are also going to grow the healthcare and telecom collection (non-financial services), which is currently about 50% of our total collection businesses, where the dynamics is somewhat different. And we expect that that is also going to be an area which we would focus on. So I think, there is going to be short term stress in this business for the next couple of quarters in terms of margins, but we believe in a down turn economy as we see the US going into, probably

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already in, the need for collection services and the business opportunity for us is actually going to increase.

Some of the other highlights for the quarter are: we completed the convertible bond issue. As I mentioned earlier, the entire MedAssist contribution has been completely negated by the interest cost on the high-cost loan which we used to fund the MedAssist acquisition and we have carried that loan for most of the last quarter. But this was taken out by the convertible issue which closed in December. And so, clearly the interest impact of that on our numbers will no longer be there.

Our total employee strength has gone up by 500 to 17,090. Most of this increase has come from the India based business and outside India has largely been stable. Attrition levels are something we again spoke about in the last quarter which spiked in the last quarter on account of the initial stabilization for some of the Vodafone centers which we had set up. And we had anticipated that that is going to come down. We have seen that come down fairly significantly in this quarter. We had reported post 90 days attrition until last quarter and that has come down from 58.4% annualized in Q2 to 48.8% now. In general, we have seen a lot of people are reporting our attrition numbers without the context of the period on which the attrition number is and the industry generally seems to be reporting post 180 days attrition, just for comparison purposes we have put that number in as well. That number for us is 34.4% annualized. Seat capacity has gone up by 340 since we have commissioned our center in Salt Lake City, which I mentioned, which is going through a stabilization period and a center in Indore as well.

Some of the other features in our business are: revenue from our top 5 clients has come down to 40% in year-to-date FY2008 from 51% in FY2007 and for the quarter this has come down to 33%. The revenue by geography, US has gone up from 47.3% in the previous year to 59.4%, UK 30%, and India has come down to 10.5% from 11.4% for the quarter and this is largely on account of the MedAssist revenues which have come into our number.

In terms of verticals on a year-to-date basis, healthcare accounts for 26%, telecom and media 39%, and BFSI was about 32%. For the quarter, healthcare is 40%, telecom and media 32%, and BFSI is 25%.

In terms of the outlook for Q4, some of the changes we expect to happen in Q4 are: firstly on the collections performance, while there are industry issues, as I spoke about, there is a seasonality in the business and Q4 is the tax season in the US and generally collections business tends to have higher revenue and profits during this quarter. So we expect to see that improvement take place this year as well. The Salt Lake Center, which we mentioned is going through a stabilization period, that stabilization will happen in this quarter. There have been also some volume swings in the last quarter which we expect most of it will correct itself. The one-time charges which we mentioned are clearly related to events which were there in the quarter and should not recur again. In terms of new business, we have signed two major deals with annual contract value of between $ 25 and $ 30 million during the quarter. Originally these revenues were forecast to come in during Q3. But now these revenues are expected to commence in Q4. In terms of outlook for FY2008, overall we see growth for the year to be 55 to 60% in Rupee terms and 65 to 70% in US dollar terms. In terms of margins, we had forecast at the beginning of the year 11 to 13% net income margins. The year-to-date net income margin is 11.6% and this is in spite of a significantly lower Q3 margin as I mentioned. Now clearly some of the up-side potential on the margins we believe is not going to be there because of the collection business challenges we have seen in this quarter and we expect will continue in relative terms in to the next quarter. But we do still expect that we will come in within the stated range, probably at the lower end compared to some of the up sides which we could have achieved but for the collection business.

So I think, in summary, the quarter numbers have been affected by three factors. One of which is the interest cost which has come in, which is now going to go away with the FCCB taking out the high cost debt. Two, the collections business underperformance which is a function of the credit environment deterioration we have seen in the US and that is something we believe will play itself out over the next few quarters. The industry is still in a fair amount of transition at this point and we will have to see how exactly it plays itself out. Three, there are some other, as I mentioned, one-time events which have taken place which we should be able to see reversing. And overall in terms of our forecast, we believe that in spite of the Q3 numbers, we will come in within the stated range as we spoke about.

With that, I will hand you back to the moderator and open it for questions.

Moderator: Thank you very much sir. Ladies and gentlemen we will now begin the question and answer session. At this time if you would like to ask a question please press "*" and then "1" on your touch tone phone. If you decide you would like to withdraw yourself from the question queue you may press "*" and "2" to remove yourself from the queue. Participants are requested to use only handsets while asking a question. The first question is from the line of Mr. Seth Freeman from EM Capital Management. Please go ahead Mr. Freeman.

Mr. Seth Freeman: Hi Sir, Greetings from San Francisco.

Ananda Mukerji: Greetings. Good morning.

Mr. Seth Freeman: Thank you. Are you involved in dealing with student loan collection?

Ananda Mukerji: No. We don't do student loan collections; we do credit card collections, auto loan collections, and some telecom collections, and healthcare collections.

Mr. Seth Freeman: Well you should be having a robust next 2 to 3 years.

Ananda Mukerji: I am sorry.

Mr. Seth Freeman: You should be having a really robust 2 or 3 years based on what we see here in the US.

Ananda Mukerji: Yeah. You make a good point and that's the point I was making. I think there is certainly going to be a lot of business for doing collection services. I think in the short term there are going to be challenges and pressures on margins. But I think there is going to be robust business.

Mr. Seth Freeman: Thank you.

Moderator: Thank you Mr. Freeman. The next question is from the line of Mr. Ruchit Mehta from HSBC Asset Management. Please go ahead Mr. Mehta.

Ruchit Mehta: Yeah. Good evening. Just missed out on the extraordinary charges during the quarter. What was the total amount and, I mean, under which heads have they been accounted?

Ananda Mukerji: The extraordinary charges are normally classified under the SG&A.

Ruchit Mehta: Okay.

Ananda Mukerji: And there are some which are categorized in the gross margin which are, you know, relating to the carrying cost of people and infrastructure that have not been stabilized.

Ruchit Mehta: Okay.

Ananda Mukerji: That falls off once these people and infrastructure gets into business as usual in the ensuing quarter.

Ruchit Mehta: So what's the quantum of one-time expenses that will not occur in the fourth quarter?

Rajesh Subramaniam: I think right now the way we see it, if you take a look at some of my unamortized expenses relating to FCCB and some one-time charges which we have of Rs 50 million, out of which, 80 to 85% is something which is one-time. And there is some related to compensation which will continue.

And then the Salt Lake City operations stabilization cost which constitute a large element of the other Rs 50 million is getting into business usual. So a large element of this Rs 50 million is going to fall off in the ensuing quarter. Only fluctuations, I mean, given the environment we play in, we have some financial services customers that are seeing some volume pressures which is reflecting in our business. But in some of our contracts, quite a few of them, we have some deal-minimums which protects us. So we are watching that environment, but a large element of the Rs. 50 million is attributed to the operations in Salt Lake City.

Ruchit Mehta: Okay. It's not a case of customers completely walking away from you; it's just a temporary, I mean.

Rajesh Subramaniam: Yeah. It's just temporary in nature while the adjustments happen in the system.

Ananda Mukerji: No customer has left our rooster because of what we are seeing in the environment.

Raju Venkatraman: We have always told you that, you know, quarter on quarter there will be fluctuations and we are seeing those.

Ruchit Mehta: Okay. Just finally on the equity side, the FCCBs are convertible at about Rs. 93 or something. What's the annual coupon that you will have to charge to the P&L if you?

Rajesh Subramaniam: It is zero coupon instrument.

Ruchit Mehta: Okay.

Rajesh Subramaniam: So that there's going to be no charge to the P&L.

Ruchit Mehta: And the YTM would be how much?

Rajesh Subramaniam: It's about 6.75%.

Ruchit Mehta: What will be fully diluted equity if the FCCBs do convert?

Rajesh Subramaniam: That will be about 117 million shares.

Ruchit Mehta: 117 million shares.

Rajesh Subramaniam: Yeah. One one seven.

Ruchit Mehta: Okay. Thank you.

Moderator: Thank you Mr. Mehta. The next question is from the line of Mr. Joseph Foresi from Janney Montgomery Scott. Please go ahead Mr. Foresi.

Joseph Foresi: Hi Gentleman, I wonder if you could just clarify something that you said in your remarks. I think you said that basically you get paid on the revenues when you do the collectable business and it's harder and harder to collect those debts which are affecting revenue. But on the flip side, volumes are going up because more people are of course, you know, having trouble paying their loans. Is that correct?

Ananda Mukerji: Yeah that is correct. If I look at the credit card part of our business, we do post charge of collection. So once an issuer charges it off in their book which typically happens after 180 days, sometimes earlier, but typically 180 days that debt portfolio gets placed with people like us to collect on. As they are facing larger delinquencies, the amount of such debts which is going to be there for placement is increasing. It is going to increase. It is not yet seen, but it will increase. And we will see that in fact coming in the next 2 to 3 quarters. In the short run what is happening is on the portfolios we already have, on which we are trying to collect on, the ability of the customer to pay that debt has gone down because he has for e.g. if he has defaulted on a mortgage payment, he is certainly not going to be in a position to clear his credit card payment at that point in time. So that is what we have seen in the short term. So in a sense what we believe will happen is that the size of the portfolios will increase, but the collection strategies and the way the portfolio is managed will have to change. Operationally we need to change that, the way we deal with it and that is the period which we are going through right now.

Joseph Foresi: Any plan of changing your payment method to volume versus the actual collectables?

Ananda Mukerji: The industry operates on a continuity model. That is one gets paid as a percentage of what one collects. It's not based on, you know, on input or effort and that is something which we prefer, because it gives us the flexibility to change strategies and decide how much collection effort needs to be put, into a particular portfolio. And that really works for us because we will be—we are able to manage profitability much better in that environment. Clearly, at this point in time, if one were to see it on a per input basis, it would have been better. But that is not the industry practice. And in the long run it is better to be on a basis which is linked to output.

Joseph Foresi: Good. And just one last question here. Obviously your standard economic argument is that if things were to slow in the US and are slowing, then you'd see an increase may be in some of the businesses as well as people move to offshore to save costs. I wonder if you go through it and just talk about that a little bit. How you're seeing that and are you seeing any other new opportunities? Thanks.

Ananda Mukerji: Yeah. See look at our business. We are fairly diversified across industry verticals. So we have business in the payor segment of the health care industry. We have a significant business within the provider segment of the health care industry. We have business in the telecom side. So those businesses all continue to grow very well in the US. Clearly health care does not get affected by any slow down. Telecom, we have not seen any slow down taking place. The business outside of the US, we have significant business in the UK and in India. Those are not affected obviously by any slow down in the US. In fact one of the things we have mentioned in the past is that one of the strategies we adopted is to diversify our revenues and go into markets other than the US. And one of the focuses was to grow our APAC market and that continues to be a significant driver for growth. I mentioned two major deals have been signed. One of them is a deal in the APAC region. So that is something which would be helpful to us. In the banking industry, specifically in the US, it's where we see a relative stress, and I think that is on account of the credit environment that they are facing right now, so clearly while there will be probably pressures on that industry to look for cost saving opportunities, at this point in time they are also fairly preoccupied with their own market issues which they are facing. So I think some of that dynamics is also playing at this point.

Joseph Foresi: Okay. Thank you.

Moderator: Thank you Mr. Foresi. The next question is from the line of Mr. Anthony Miller from Aretec Research. Please go ahead Mr. Miller.

Anthony Miller: Good evening. I have got a couple of questions please. One, just following on the discussion before. you said you are looking at different strategies for your collections business. Now I am kind of assuming that you run your collections, basically it's also the telephone based—outbound telephone based. What sort of different strategies might you be considering and, you know, and would these have any impact on your cost base?

Raju Venkatraman: Yeah. Currently we try to optimize the revenue collected in some way to the other by the strategy that we do. And we give our collectors certain loan portfolios. Now we are planning to give them a larger loan portfolio amount with them understanding that the collection liquidity will be lower, which also means we will use technology such as automated dialer management and others, which would now be the mechanism by which we start proactively calling people in a very, very structured manner rather than working one case at a time. We are also going to start working some portfolios which are less collectable on a workflow basis.

Anthony Miller: Oh I see. Is dialing equipment something new, I mean, is it just new equipment, new CapEx that you have to spend?

Raju Venkatraman: No. We already have them. But in the past we didn't have to get to that level, you know, because we didn't have to follow-up. Here now we will need to follow-up on promises lot more. Because we need to get the share of the wallet of that particular customer before he commits his dollar to someone else.

Anthony Miller: Right. You don't have any sort of feet on the street in the US market?

Raju Venkatraman: No. We don't do any physical collection.

Ananda Mukerji: The other aspect is in terms of what kind of settlement one negotiates, you know, in an environment that people are able to pay and have liquidity to pay, the focus is usually on trying to collect the maximum number of dollars up front as one can in a situation where they are facing personal pressures in liquidity. Then one looks at how one does settlement over a period of time. So there are many ways in which one does tactically, how one changes one's approach to the portfolio. Every portfolio we get from our customers, we analyze the portfolios, look at its collectability, we scroll the portfolio, segment it and see, which is the collectable segment, how much effort to put into it, how much to do through automation, how much to do through direct contact, how much to do through mails. It's a very dynamically managed environment with tactics change all the time. This is really fine-tuning it to deal with the fact that the quality of the portfolio is changing rapidly over time. That's the transition period that we are going through.

Anthony Miller: Sure. And can you just remind me how much of your business comes from collections?

Ananda Mukerji: Financial services collection is, about 9% of our revenues in the quarter came from that business.

Anthony Miller: So that's 9%.

Ananda Mukerji: That's right.

Anthony Miller: Okay. My second question is just on the mix of revenues off-shore and on on-shore. I see that obviously there has been a big increase in on-shore. Is this, sort of, purely due to MedAssist? Because they are all on-site personnel, aren't they?

Ananda Mukerji: Yeah, that is correct. It's largely due to the MedAssist acquisition and our philosophy on this is that we believe that we need a mix of on-shore and off-shore business. We need significant presence in the on-shore market where we leverage our off-shore capability and we use a lot of our off-shore domain expertise and the functional expertise and the process excellence and the technology capability we have created off-shore and leverage that in the on-shore market, which is closer. That is clearly the direction which we believe the industry will go to.

Anthony Miller: Sir, are you expecting that mix now to come down? Where roughly is this going to be?

Ananda Mukerji: No, I think we will see the mix change over time. We will see clearly off-shore generally will grow faster than on-shore. So we will see on-shore as a percentage come down over time. But we will have significant on-shore operations at all points in time.

Anthony Miller: Okay. Just one more question because I think it has the same answer, the mix between UK revenues and US revenues. Roughly that mix has changed radically. Is the US mix higher than the UK mix simply because of MedAssist?

Ananda Mukerji: Yeah. In this quarter the change has happened because of the MedAssist revenues which were not there in the previous quarter have come in.

Anthony Miller: Right. Thanks very much indeed.

Ananda Mukerji: Thank you.

Moderator: Thank you Mr. Miller. The next question is from the line of Ms. Mitali Ghosh from DSP Merrill Lynch. Please go ahead.

Mitali Ghosh: Thanks. Good evening.

Ananda Mukerji: Good evening.

Mitali Ghosh: Hi. On the outlook, you were mentioning that you have closed two major deals this quarter. Also if you could just comment a bit on, you know, one if you could just give us a sense of what is the area in which these two deals are. And secondly if you could just comment on how the pipeline additions were this quarter and may be how sales cycle etc. is progressing. You know, what you see over the next 2, 3 years kind of outlook.

Ananda Mukerji: Okay. Sure. We are seeing the outlook which we have given, the forecast for the rest of the year factors in some of the deals which have been closed. As I mentioned, two major deals have been closed. One is in telecom and the other is in banking. And these will - we were originally expecting them to - the revenues to start in Q3, but like all big deals, they take longer than what one would like them to take. So they are now going to start actually in Q4. These have been closed. Besides that, we are seeing very good momentum in the domestic India business and in the APAC market and a lot of client action taking place here. In the healthcare space, both on the provider side and on the payors side we are seeing very good momentum. I think we are seeing probably on the payors side more momentum now than we were seeing at any time in the year. In the UK also, we are seeing a pipeline building up after somewhat sluggish first two quarters, we are seeing pipeline building up. In the US market, I think on the banking side, on the collection side there is enough business momentum in the sense that there is as much or more business than what we want to handle at this point. The challenge is to make sure that we get our operation strategies right to be able to deal with it. The non-collections banking market is somewhat slower at this point, as I mentioned in answer to another question earlier. I think while banks are facing pressures to reduce their cost base, at this point, they are also fairly preoccupied with the charge-off they are taking on their exposure. So some of that dynamics is affecting their bandwidth and focus on doing things like outsourcing and off-shoring which tend to take management attention. So overall I would say that is the area where we see relatively slow growth but I think the other segments of the business continue to show good momentum.

Mitali Ghosh: Sure. And in the banking and financial services segment, what is the sort of broad break-up of services? How much would be collections, and how much would be the non-collections, banking kind of business?

Ananda Mukerji: Yeah. If you see the revenue mix from BFSI for the quarter was about 25%. Out of that 9% as I mentioned was collection. So 16% would be non-collections.

Mitali Ghosh: Okay. And in terms of, you know, where you mentioned, just to clarify, you talked about, you know good momentum and healthcare etc., you were talking of the US market, right?

Ananda Mukerji: Health care is entirely in the US market.

Mitali Ghosh: Okay. And in terms of pricing structures that you were seeing, is there anything different in terms of moving towards more of transaction processing or gain share or, you know, any different kind of structures and what are the trends?

Ananda Mukerji: See if I look at our mix of pricing structures and when we talk about the output based pricing as opposed to the input based pricing, last quarter we were at about 45% output based pricing and 55% input based pricing. Now the MedAssist business is largely output based. Today that mix is 60% of our revenues is output based, 40% is input based.

Mitali Ghosh: And which should presumably be better for margins?

Ananda Mukerji: Yeah it is better for managing margins and profitability in the long run. You know, at this point one may assume that if you are priced in input then you are not vulnerable to any fluctuations which take place in the business volumes and so on. But in the long run, in the sense of the collections business, if we were doing a fee based pricing instead of collecting based on our business deal in a percentage of what we collected, at this point we would have been indifferent or at least theoretically we would have been indifferent. In practice the customer would have come back and changed the rules of the game at that point. But in the long run, output based pricing obviously is better, because it gives—has all the levers of managing profitability in our hand and the customer is just concerned about output.

Mitali Ghosh: One final question for Rajesh. Rajesh, if you could just remind us on what is the Forex hedge position you have currently and also your policy, if I am right, is marking to market, right?

Rajesh Subramaniam: That's correct, Mitali. And right now our total Forex we have is about Rs 3.4 billion.

Mitali Ghosh: Okay. And in terms of your, I mean, how do you, typically how much do you cover? I mean, what is the policy there?

Rajesh Subramaniam: See Mitali, normally we cover 6 months forward. But now what we are doing is we'll be taking a little more aggressive view on the dollar, both on the pound leg and the pure dollar receivables leg. And it's likely that going forward we'll be a lot more aggressive and we could be looking at upto March 2009. And we'll take a more lenient view on the dollar GBP leg of our transactions.

Mitali Ghosh: Okay. Thank you very much.

Moderator: Thank you Ms. Ghosh. The next question is from the line of Mr. Ajay Mathrani from Deutsche Bank. Please go ahead.

Ajay Mathrani: Yeah. Thanks and good evening. First question was if you look at Q3 or Q2, what's the organic growth, you know, if you exclude MedAssist in Q2 and then exclude MedAssist in Q3?

Rajesh Subramaniam: Yeah. Ajay, if I exclude MedAssist, MedAssist in Q2 was marginal. If I exclude MedAssist in Q3, it's flat. But what will happen is there will be some growth because of the exchange rate and largely because of the pound moving lower than what it was last quarter. Dollar remaining stable, you know, the growth would have been 1.75 to 2% higher, if I had the same exchange regime as in Q2.

Ajay Mathrani: And large part of the growth impact was collections?

Ananda Mukerji: That's right.

Ajay Mathrani: Okay.

Ananda Mukerji: And also the stabilization of revenues in Salt Lake City. All of that has contributed to revenues being flat. Because we were not able to book revenues which we normally should have been able to.

Ajay Mathrani: Okay. And MedAssist, you know, revenue as well as margin profile has been on track.

Ananda Mukerji: That's correct.

Ajay Mathrani: Okay. If you look at the segmental EBIT, now you know, we've seen US and UK both come under pressure on a quarterly basis. And India jumped up substantially. So I guess, you know, I was just wondering if there is any trend to it and do we see it moving in the next couple of quarters?

Rajesh Subramaniam: Ajay, you would be looking at my standalone numbers, right? What typically happens is we have implemented a transfer pricing out of India, whereby there are certain common costs and certain arms length costs for resources we use from India, the costs of those are booked on the stand alone like for transition, for process excellence, for setting up a center and then of course the entire finance consolidation and all those costs. So what happened in YTD last year, none of that was in the numbers and most of the transfer pricing happened in Q4 last year based on the study we did with Deloitte. So this year you see the margins slightly higher in India because of how the transfer pricing is being implemented and that will explain what will happen between the two periods we are talking about.

Ajay Mathrani: Okay, alright. That's helpful. Lastly, on Metavante… Is there any upgrade there? Are we seeing a slow down in growth from that segment also? Slow down or, you know, delay in contract signing there?

Ananda Mukerji: Yeah. As I mentioned, I think, as with the banking market in the US, Metavante is seeing a slow down in terms of deals getting signed. They are finding, there are number of customers who are in discussions with and number of deals which were in discussions are getting deferred because the management in those banks don't have the bandwidth at this point to really focus on outsourcing, a kind of issue. They are more concerned with dealing with their immediate issues. But we will have to see how it evolves. There clearly is also, as I mentioned pressure to find ways to reduce cost. And we expect that some of those pressures will also start coming in and forcing banks to start looking at it. But at this point, we are seeing deals slowing down because of that.

Ajay Mathrani: Alright. Sorry, one last broad question. If you look at FY2009, you know, looking at next year and not looking for guidance, but just in terms of, do you think it's going to be a year of business as usual or are we looking at, you know, substantial acquisitions or changes in portfolio or, you know, or any other changes?

Ananda Mukerji: Well, I would say that if I look at what we have done in the course of this year and some of the moves we have made, those moves, I think, are going to continue for next year. For e.g. we got into the provider segment of the market and that's a big growth, hopefully we believe it will be a big growth in products next year. We got significantly into the domestic and the APAC market which we see will be a growth driver for next year. I think we have a fairly diversified set of businesses right now which have its own growth path and own dynamics. At this point, the collections business and the US banking opportunities are under some pressure. But the other drivers of business continue to be strong and we would expect it to continue to be strong into fiscal 09. And our aim is really to continue growing faster than the industry average and faster than most of the other companies. As you would see from our numbers for this year, the growth would be higher than what industry average is. And that's something we would want to see continue.

In terms of acquisitions, we have done acquisitions earlier and we do look at acquisition opportunities, but, you know, that depends on what we find. If we find something appropriate to our needs, that's when we would look at it.

Ajay Mathrani: Sir, a quick follow-up on that. Are you seeing prices coming off substantially when you are looking at acquisitions now, compared to what they were, say 3 or 6 months back?

Ananda Mukerji: We are—I think generally if we look at our space, clearly multiples have come down. So one would expect asset valuations to come down. But in reality, the private market tends to lag the public market in terms of multiples. So, I think it will catch up at some point in time.

Ajay Mathrani: Alright. Thanks and all the best. Thank you.

Moderator: Thank you Mr. Mathrani. The next question is from the line of Mr. Srivatsan Ramachandran from Spark Capital. Please go ahead sir.

Srivatsan Ramachandran: Good evening. This is Ganeshram here. We see your revenue by delivery location about 44 : 56 offshore onshore. Could you also breakup your cost by delivery location?

Farid Kazani: It is roughly a little over one third of the cost which is non-India based. And the rest is India based.

Srivatsan Ramachandran: Okay. And how was the change post the MedAssist acquisition? I would assume most of them are on-shore.

Farid Kazani: Yeah. Post MedAssist acquisition has changed as percentage on a YTD basis. On a quarter basis it will be much higher.

Srivatsan Ramachandran: Okay.

Farid Kazani: It will be close to around 40%.

Srivatsan Ramachandran: Okay. Another question I have is on the FCCB. If you could tell me till what date it was debt and from date it is FCCB?

Rajesh Subramaniam: Yeah, 10th of December is when the loan was repaid.

Srivatsan Ramachandran: Okay. Another question I have is on your hedge position. It's $3.4 billion till what date and at what price?

Rajesh Subramaniam: Rs 3.4 billion will cover me upto 75% for my April, May, June quarter.

Srivatsan Ramachandran: Okay.

Rajesh Subramaniam: 95% of this quarter.

Srivatsan Ramachandran: Okay.

Rajesh Subramaniam: And, you know, it betters down to my September quarter, which we will look to get the coverage up and to take it up to the next March quarter.

Srivatsan Ramachandran: Okay. And could you tell me what price?

Rajesh Subramaniam: The average price would be between 39.65 to 39.9.

Srivatsan Ramachandran: Okay. I guess that's about it for me. Thanks a lot.

Ananda Mukerji: Thank you.

Moderator: Thank you sir. The next question is from the line of Mr. Ram Prasad from Sundaram BNP Paribas. Please go ahead sir.

Ram Prasad: My question has been answered.

Moderator: Thank you Mr. Prasad. The next question is from the line of Mr. Sudhakar Prabhu from Span Capital. Please go ahead Mr. Prabhu.

Sudhakar Prabhu: Yeah. Thanks. Most of my questions have been answered. I just have one question for the management. I believe the top management has sold off a portion of their holding in the company. Is it just a routine asset diversification or does this signify lack of confidence in the business?

Ananda Mukerji: Yeah. First of all we haven't sold off significant part of our options. We have far more options than we have actually sold. If you look at the senior management team, most of them are holding options for the last 5 years. We were persuaded not to sell at the time of the IPO by the bankers. And we voluntarily had a lock-in for 3 months. Since that period we have been in a series of transactions as a result of which trading was shut. And this is the first opportunity we had to diversify the portfolio, as you put it. And more than diversify the portfolio, most of us had taken loans to buy the options because of the fringe benefits, that's coming in force. And some of us needed to sell some of our portfolio shares to be able to repay the loan. So there is absolutely no lack of confidence for the management in the business. We have significant stake and much higher stake in the business than we had earlier. And we are extremely committed to the business.

Sudhakar Prabhu: Yeah, thanks. That's helpful.

Moderator: Thank you Mr. Prabhu. The next question is from the line of Sanket Dalvi from IL&FS Investsmart. Please go ahead Mr. Dalvi.

Sanket Dalvi: Hi gentlemen. This is Sanket from IL&FS Investsmart. First question is this years guidance basically that you've given of 45% growth year-on-year for FY2008, is it for total revenue, that is including other operating income or only revenue from services?

Rajesh Subramaniam: This includes total income, which includes the other operating income.

Sanket Dalvi: Okay. So if I include that and do a quick math, assuming that you do around 45% year on year, and, say exclude your first three quarters do you see revenues coming down your fourth quarter or something like that?

Rajesh Subramaniam: You got to take a look at it from what has (a) happened to the exchange rate between the two quarters, which will normalize it more like 41- 42%. And then if you exclude the stress in the collections in Q3, it will be more like 35%- 36% in rupee terms. And this is excluding the MedAssist acquisition.

Sanket Dalvi: Yeah. Exactly.

Rajesh Subramaniam: If I include the MedAssist acquisition, the numbers are closer to 55 to 60% and given what some of our peers are reporting in dollar terms, it is about 65 to 70%.

Sanket Dalvi: Okay. And could you just repeat how much has MedAssist contributed this quarter?

Rajesh Subramaniam: MedAssist contributed approximately about 109 crores this quarter in revenue.

Sanket Dalvi: Okay. Thanks gentlemen. Thanks a lot.

Moderator: Thank you Mr. Dalvi. The next question is from the line of Mr. Ashakiran from Span Capital. Please go ahead.

Ashakiran: Sir! Can you give us your debtors days and cash flow, sir? Thank you.

Rajesh Subramaniam: DSO is about 61 days.

Ashakiran: And cash flow sir?

Rajesh Subramaniam: We have about 118.5 crores.

Ashakiran: Thank you.

Moderator: Thank you Mr. Kiran. Ladies and gentlemen if you have a question at this time, please press "*" and then "1" on your phone. The next question is from the line of Mr. Anthony Miller from Aretec Research. Please go ahead Mr. Miller

Anthony Miller: Just a follow-up question on Metavante. You mentioned that they were seeing a slow down in deal closures. Can you just briefly remind me what's the nature of your partnership with Metavante and how much business, you know, you are doing through them and how you would see that trending?

Ananda Mukerji: Yeah. With Metavante we have an agreement to approach the North America banking market together with them, the non-collections banking market together with them. And at this point in time there is fairly small amount of business which we are doing and we are looking at really signing new deals with them going forward from the pipeline which we have been creating.

Anthony Miller: And therefore what sort of processing would you expect to be doing for them as these deals come on board?

Ananda Mukerji: This would be, you know, a mix of—essentially Metavante if you are familiar is an application outsourcer. So they have whole suite of technology platforms which they offer to the financial services sector. The approach is to really combine their technology platforms with our processing capabilities and offer a complete solution to the banking market. So this could be check processing, item processing, loan origination, loan servicing.

Anthony Miller: In fact Metavante about I think a year ago or so also signed a partnership with the Swiss Bank - Taminos. Are you involved in that relationship or have you made any approaches to Taminos may be to work with them on a similar basis?

Ananda Mukerji: I don't know the full details of the relationship, but our understanding is what they are doing with Taminos is to develop new generation software platforms for application development. We are not—Taminos is really a software product company. We are not talking to them.

Anthony Miller: Okay. Thanks again.

Moderator: Thank you Mr. Miller. The next question is from the line of Mr. Zahara Shariff from Quantum Mutual Fund. Please go ahead.

Zahara Sharif: Thank you. I just wanted to know you talked earlier about the slowdown in the financial services collections part of the business. If we had to, sort of, compare on like to like basis, what could really, what would be the extent of the decline if you are looking at the operating parameter?

Ananda Mukerji: The impact of the collection business stress was Rs. 70 million in terms of profit terms, which is about 2% of our margins.

Zahara Shariff: I am sorry to interrupt you. I am not talking about impact in terms of on revenues or profit. I am saying when you would assess the liquidation of the portfolio, what would that erosion be like? X% last year or last quarter and you are doing, you know, Y% now. What is that difference, if you could share that?

Ananda Mukerji: About 15% is what we have seen reductions.

Zahara Shariff: Okay. In the collections?

Ananda Mukerji: Yeah. You asked about how much do we see liquidations on an absolutely like to like basis coming down?

Zahara Shariff: Right.

Ananda Mukerji: We have about 15%. And as I mentioned, given that quality of the portfolio is now something which liquidates 15% less, we need to modify and fine tune our tactics as to how we deal with that portfolio.

Zahara Shariff: Okay. And when you actually take on a business from a client, do those come with credit parameters attached, like you know the quality of, I don't know, credit scores or any of that sorts when you take on the portfolio?

Raju Venkatraman: We do. We have an analysis process by which we look at all of those parameters and calculate what we think is the collectability and the banks also disclose what they think based on their experience with those. But in a stressful situation like this, they get impacted and we got impacted last quarter. We didn't forecast the trend in the macro situation that was there.

Zahara Sharif: Which is why you are saying that now you are seeing more defaulting at the prime credit cards.

Ananda Mukerji: Right.

Zahra Sharif: Okay. Alright. Thank you so much. That's all.

Moderator: Thank you Ms. Sharif. The next question is from the line of Mr. Ruchir Desai from Pioneer Intermediaries. Please go ahead.

Ruchir Desai: Hi. Good evening. I just got a broad question. Lot of larger IT service companies have spoken about, you know, offering integrated services to their existing and new clients. What kind of competition have you come across in some of your negotiations that you are currently going through or some of the contracts you won in the past couple of quarters? Are you seeing increased competition from the BPO arms of IT service companies?

Ananda Mukerji: I think the bigger IT services companies, BPO business has always competed with us in the market basically in some of our business segment. The competition has really been on the strength of their BPO offering and we have at least not seen integrated offerings being asked for by the customer and losing business on account of that.

Ruchir Desai: Okay. In which segment do we mainly compete with the BPO arms of the IT services companies?

Ananda Mukerji: We compete with them in the BFSI based—they are not significant players in collections, but in the BFSI space, other than that we compete with them in telecom, not much in healthcare.

Ruchir Desai: Alright. Just the last question on the collection business. You mentioned now the clients are selling off debt more aggressively, when you say selling off debt that means they don't charge it off and just sell it to a certain party for collection?

Ananda Mukerji: Yeah. They go through the charge off process. Once they have charged it off, then instead of carrying that on their own and getting it collected by service providers like us and then booking the profit on that, they simply sell the debt at that point to some debt buyers who really focus on that as a business. Debt buyers assess the portfolio and in a sense pay them the net present value of what the future earnings would be. So many of the card issuers are using that as a means to smoothen their own earnings pressure.

Ruchir Desai: Alright. Okay. Thank you.

Ananda Mukerji: Thanks.

Moderator: Thank you Mr. Desai. The next question is from the line of Mr. Srivatsan Ramachandran from Spark Capital. Please go ahead.

Srivatsan Ramachandran: Hi. My question is on grant income. In YTD you made about 50 crores in grant income. For how long do you see the grant income continuing going forward?

Rajesh Subramaniam: Yeah. I think the grant income if you recollect that it was mentioned that it would be about 65 : 35 between the first half and second half of this year.

Srivatsan Ramachandran: Okay.

Rajesh Subramaniam: A small element of that will continue in the first quarter next year. Very small element. But the thing is the grant income is a subsidy to set off some start-up costs, as our operations are getting into some BAU which is happening at every stage of ramp-up for some of the customers we are executing.

Srivatsan Ramachandran: Okay.

Rajesh Subramaniam: The gross margin accretion takes care of this fall-off of the grant going forward. So next year while the grant is going to be minimalistic, the compensation from the gross margin accretion makes our margins grow.

Srivatsan Ramachandran: I just want to know what's the cash at hand?

Rajesh Subramaniam: 118.5 crores.

Moderator: Thank you. The next question is from the line of Sanket Dalvi from IL&FS Investsmart. Please go ahead.

Sanket Dalvi: Yeah. I just wanted to know; last year you had around 20% of your revenues from collections. This year how much do you see it going down or flat, how do you see it?

Ananda Mukerji: Collections business has come down in percentage terms as a result of the growth in the other businesses, particularly the MedAssist has contributed. The total collections business, as you mentioned, for the quarter is about 20%. Out of which about 9% is banking and 11% is for other sectors. And for the YTD basis, this will be about 12.8% from banking and 4.6% from healthcare.

Sanket Dalvi: Okay. Gentlemen, one more thing. Q4 of 2007 we have actually seen around 30% quarter on quarter jump in your revenues. And I suppose that is predominantly from your collections business, which is, you know, good for your collections business. So, you know, can I get a break-up, you know, in that quarter as well, you know, how much was your, you know, banking and health care division, bifurcation?

Ananda Mukerji: See, there are two aspects to the growth in Q4. It wasn't entirely collections; there was a collection seasonality increase which takes place every year. We also had some large client ramp-ups during the year; in fact you see our head count in that quarter had gone up significantly. We also did an acquisition in the end of Q3 of last year, which also contributed to some of the revenues coming in in Q4.

Sanket Dalvi: Okay. Thank you so much.

Moderator: Thank you Mr. Dalvi. The next question is from the line of Mr. Sashi Bhushan from Macquarie Securities. Please go ahead.

Sashi Bhushan: Thank you. My question has been answered. Thanks.

Moderator: Thank you Mr. Bhushan. The next question is from the line of Zahara Shariff from Quantum Mutual Fund. Please go ahead Ms. Shariff.

Zahra Sharif: Thank you. I just had a follow up question to one of the answers you gave earlier. When a particular portfolio goes from a credit card company or a bank and is purchased by a debt purchaser, and then eventually I am assuming they would also try to collect. And if it doesn't it could still get outsourced to you. Is that right?

Ananda Mukerji: Yeah. In some cases it is directly outsourced to us. For e.g. we had a situation where a particular portfolio we were collecting on behalf of the card issuer was sold to a debt purchaser and we continued collecting on the same portfolio now on behalf of the debt purchaser.

Zahra Sharif: And if something like that happens, do your realizations for the same given performance level differ or, you know, does the economics change?

Ananda Mukerji: No. The economics normally would not change.

Zahra Sharif: Okay. Alright. Thank you. That's all.

Moderator: Thank you Ms. Sharif. Ladies and gentlemen, that was the last question. At this time I would like to hand the proceedings over to Mr. Ananda Mukerji for closing comments.

Ananda Mukerji: Thank you everyone for joining the call and for a very good and extensive set of question and answers. If we are to re-emphasize, the numbers as we mentioned for this quarter has been affected to some extent by the collections business under-performance as a result of the US credit environment. But on the business momentum in terms of the other segments of our business, the same continues to be strong and we expect to continue to see good growth in our business. And in spite of relatively low margins in this quarter, we would expect to come in within the target margin range which we have indicated. Thank you very much. I will hand you over to Krishnan to wrap up.

Krishnan Akhileswaran: Thank you again everyone for participating in this call. If any of your queries have been unanswered, you could give us a call at Investor Relations. Thank you and wish you a good day.

Moderator: Thank you Mr. Krishnan, thank you Mr. Mukerji and Mr. Subramaniam. Ladies and gentlemen, on behalf of Firstsource that concludes this conference call. Thank you for joining us and for choosing Chorus Call. You may now disconnect your lines. Have a good evening.