Q1 FY2012 Earnings Call Transcript – Aug 3, 2011

CORPORATE PARTICIPANTS:

- Mr. Matthew Vallance – Managing Director and Chief Executive Officer
- Mr. Rajesh Subramaniam – Deputy Managing Director and CFO
- Mr. Carl Saldanha – CFO
- Mr. Tom Watters – President, Healthcare
- Mr. Santanu Nandi – Executive Vice President, Telecom & Media
- Mr. Sanjeev Sinha – Executive Vice President, BFSI
- Mr. Sanjay Venkataraman – Executive Vice President, Asia Business Unit
- Mr. Gaurav Bahadur, Executive Vice President – Human Resources
- Mr. Mahesh Pratap Singh – Head of Investor Relations

Firstsource Solutions Limited
Quarter One Earnings Conference Call, Financial Year 2012
Aug 3, 2011

Moderator Ladies and gentlemen good day and welcome to the Firstsource Solutions Limited Q1 FY2012 earnings conference call. As a reminder for the duration of this conference, all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call, please signal an operator by pressing "*" and then "0" on your touchtone telephone. Please note that this conference is being recorded. At this time I would like to hand the conference over to Mr. Mahesh Pratap Singh, Head of Investor Relations at Firstsource Solutions Limited. Thank you and over to you sir.

Mahesh Pratap Singh Thanks Melissa. Welcome everyone and thank you for joining us on our 1st Quarter ended June 30th 2011 earnings call. Results, press release, fact sheet and investor presentation has been mailed across to you and these are also available on our website www.firstsource.com. To take us through the results and to answer your questions we have with us Matthew Vallance, our Managing Director and CEO,

Matthew Vallance Hello everyone

Mahesh Pratap Singh Rajesh Subramaniam who has re-joined us effective 1st August as Deputy Managing Director and CFO.

Rajesh Subramaniam Good Morning Everybody

Mahesh Pratap Singh Carl Saldanha, our CFO who will be transitioning the function to Rajesh

Carl Saldanha Good morning.

Mahesh Pratap Singh Gaurav Bahadur, Executive Vice President, Human Resources.

Gaurav Bahadur Good Morning

Mahesh Pratap Singh Tom Watters, President of our Healthcare Business Unit.

Tom Watters Good Morning Everyone

Mahesh Pratap Singh Santanu Nandi, Executive Vice President of our Telecom and Media Business Unit.

Santanu Nandi Hello.

Mahesh Pratap Singh Sanjeev Sinha, Executive Vice President of our BFSI Business Unit

Sanjeev Sinha Good morning

Mahesh Pratap Singh Sanjay Venkataraman, Executive Vice President, Asia Business Unit.

Sanjay Venkataraman Hi everyone.

Mahesh Pratap Singh We will be starting this call with a brief presentation outlining the company's performance in the 1st Quarter followed by a Q&A session. I would like to remind you that anything we say on this call which reflects any outlook for the future must be viewed in conjunction with the risk company faces. A detailed statement and explanation of these risks is available in our prospectus filed with SEBI and in our subsequent Annual Report which can be found on our website. With that said, I would now turn the call over to Matthew Vallance to take you through the presentation. Over to you Matt.

Matthew Vallance Thank you Mahesh and welcome everyone on the call. I am going to spend some time talking through the highlights of the 1st Quarter of our fiscal year 2012 before handing it over to Carl to talk through the specific financial metrics.

In terms of the performance for Q1 – We ended the quarter with revenues of Rs. 523 crores and that represented a 6.6% growth in Rupee terms over the corresponding period of last year and in constant currency terms the growth is 7.3%. However, on the back of what was our strongest quarter in about eight quarters in Quarter 4, we saw a sequential decline in revenues of 4.3% in Rupee terms, 4.8% in constant currency terms. Now reason for the sequential decline in revenues has been partly due to the seasonality which we often see between Q4 and Q1 in our business, in particular the collection seasonality this year has been more pronounced than we have seen in previous years. I think that is really on account of the fact that our collections business is showing the usual seasonal fall off, it is also going through something of a cyclical downturn with less amounts of consumer debts in the market to collect on and we expect to see that come back as we go through the course of the year. Also some impact in terms of softness in volumes particularly in our telecom and media business on account of some client reductions that we talked about in previous quarters actually coming through and materializing in our numbers.

Again in telecom and media business we also do see a strong pipeline and we also reported some business closes in previous quarters which we expect to start to come through our numbers as we move to the end quarter of FY12. As far as our operating EBIT is concerned, our operating EBIT was down by 620 basis points over Q4, we reported an operating EBIT of 4% in Q1. The reason for the reduction from the 10% in Q4 were that we expected some amount of reductions in our operating EBIT in Q1 but the actual reductions were more pronounced than expected on the basis of some of the revenue reductions I talked about before and limited flexibility to mitigate our cost base in line with that. In terms with the revenue I mentioned that we see improving expect to flow through a revenue growth perspective as we move into Q2.

Our headcount in our Asia business unit grew by 25% during the course of this single quarter. So we added over 3000 people in the Asia business unit alone. And it’s that cost of growth which has caused some amount of pressure on our margins in Q1 but that growth will flow into profitable business as we move into Q2.

We have also been rationalizing some of our operational capacity and there has been some amount of parallel running infrastructure and our capacity consolidation exercise will benefit from a profitability perspective, cost reduction perspective, will bring benefits as we move into the second half of the year. In terms of our cash position we finished the quarter with a cash balance of $87 million. There was 10 million reduction of cash balance over the previous quarter on account of a post shipment credit facility that we decided to repay and the remaining differential is on account of rise in our DSOs and of course, reduced profitability affected our ability to accumulate cash during the quarter.

We are very pleased to say that we have successfully concluded a significant re-financing. We have raised $180 million in the form of a long term loan from the international loans syndication market. We have worked with the six financial institutions to combine an amount of $180 million. We believe it is a very significant move for the company in securing our financial position for the years ahead which will have a long-term financing to this extent and demonstrate the ability to raise money in the international markets and if there is strong demand for the syndicate that we worked with. So the funds that we raised have been used immediately for repaying existing loans. We had $64 million of existing loans and we have been able to repay those loans at a low interest rate with our new loan and also extend the term of maturity of the loan. So the balance cash we will continue to hold and as we accumulate cash reserves that we talked about in previous meetings, this one is important for us to accumulate cash reserves ahead of our FCCB redemption which is at the end of next year. So our cash balance as of today stands over $200 million and we would be accumulating more cash and since we have been successful in raising a significant amount in finance is a positive move for us.

In terms of clients we have continued to make progress in the pipelines specifically I am able to talk publicly about our relationship with Dialog Axiata, which is Sri Lanka's leading Telecommunications Company where we formed a joint venture and we have 74% of Firstsource Dialog Solutions to target the Sri Lankan market. That joint venture went live during the quarter and started to show up in our financials in the part of Q1 and will do so as we move over to Q2 and we are very excited about the prospects of that joint venture. We continue to enjoy a good relationship across the world with clients and growth as well.

In terms about our headcount, due to the significant number of net additions in the Asia business unit, our headcount has increased dramatically over Q4. We added a net 3,251 staff. Our employee strength as of end of June stood at just under 30,000. In terms of attrition on the people front, another thing to report is the reduction in staff attrition across the board. We have talked in previous meetings that we are very focused on reducing our staff turnover. We are making steps to bring that down and our offshore attrition has reduced down from 66% to 59%. So that is a big reduction in our offshore attrition in our India operations, and in our Philippines operations. So, a modest reduction in our onshore attrition which at such times is at acceptable levels. And in our domestic business we saw a 10% reduction in attrition. So that was a positive progress to report quarter on quarter.

In terms of our seating capacity we added 661 seats, taking our seat count to over 23,000. That is primarily in our Asia Business Unit in Sri Lanka with Dialog joint venture coming on stream as well as in other parts of our Asia Business Unit. So, the centre addition that we talk about, one additional centre which we go to 43 centers is Colombo, Sri Lanka. Our seat usages go up from 71% to 74%, and as I mentioned we are going through a rationalization of our capacity and we expect our capacity utilization to normalize by the end of FY12 at levels of utilization where we want to be and we believe that the rationalization that we were doing will help us to get to that point in the rest of the year.

On the Slide 7 – You see our hedging position for the financial year where we have 72% of our US Dollar revenues hedged and 100% of our Pound Sterling the revenues hedged. What I am talking here is about the revenues across the board where we have cost to one currency and revenues in another currency, we have an active policy of hedging to mitigate any pressure to our margins as a result of that. Of course most of our revenues come from onshore operations. So as a business itself, we are not very exposed to swings in currency movements in terms of our margins that some other companies are. But nevertheless where we have cross currencies in our model, we do hedge.

One another final thing I mention is the management team is very delighted to welcome Rajesh Subramaniam back to Firstsource, who re-joins us in the capacity of Deputy Managing Director and Chief Financial Officer and we also thank Carl, CFO who stepped out of that role, for his service to the business over the past years.

The final slide #8 really talks about our revenue mix and there was not much movement in terms of geography, vertical focus and where we deliver our services from and our client concentration has been relatively static in effect to Q4.

With that I will hand over to Carl to talk about the financial numbers and then we will hand over to Business Unit Heads, to give us a brief summary of what is going to happen in their verticals.

Carl Saldanha Thank you, Matt. We finished the quarter with a turnover of 523 crores, down 4.3% from 546 crores the last quarter and a gain of 6.6% from 490 crores the previous quarter last year. Other operating income over there reflects our income from foreign exchange hedge income, we just talked about, and some amount of grant income.

Personnel and operating expenses grew quarter-on-quarter from 467 crores to 480 crores and combined with the decline and revenue from last quarter and the increase in these expenses, our operating EBITDA came down from 79.2 crores to 42.9 crores, which is 14.5% to 8.2%.

Depreciation remains same at 23-22 crores. Our operating EBIT came down from 55.8 crores to 20.9 crores, 10.2% to 4%. Interest income continues to decline on a net basis because we get more income from our cash balances. Annualized cost on fair value FCCBs really the option value which we are charging of over times vis-à-vis every quarter. Net-net our profit before tax was 49 crores last quarter came down to 15.4 crores this quarter. Taxes came down in line with the income of course, that is also because some of the SEZ benefits have gone away. On a profit after tax basis declined from 38.3 crores to 10.3 crores. On an EPS basis 0.89 last quarter, 0.25 this quarter and with diluted EPS 0.8 to 0.25. With that I will hand you over to Tom to discuss the Healthcare.

Thomas Watters Thank you, Carl. Hello again, everyone. For the quarter the Healthcare vertical represented 35%, total company revenues delivered by just over 3,200 employees. We have a capacity of 3,221 seats, a seat fill factor of 73% and healthcare services are delivered from both India and the United States.

Key highlights for the quarter include strong quarter-over-quarter pipeline growth within our provider segment with consistent business acquisition across all of our service offerings. Our payer segment continues to gain sales traction with further penetration into both the existing clients as well as new logos, and we are introducing technology enhancements in connection with our Centers of Excellence initiatives that will further streamline our work load processes.

In terms of industry trends, Medicare/Medicaid continues to be a focal point for Congress with an emphasis on protection and continued funding of growth in both of these entitlement programs. Unemployment rose for the second straight month to 9.2% and estimates are that will drop only about 8% in 2012. Hospitals continue to look for opportunities to reduce costs and return to their historical profitability with a continued increase in consolidations to be expected throughout the next several years. Payers are ramping up efforts to reduce their administrative costs while at the same time they are building out health information exchange capabilities.

Moving on to the outlook for the business – as insurance ramp up their focus on medical loss ratios, as well as increasing their capacity to absorb enrollment increases, we are experiencing robust growth and opportunities with our payer segment and these opportunities include both on and offshore delivery. On provider side, hospitals continue to see increases in uninsured patient population and that is in line with the sustained unemployment that I spoke about previously and that is driving strong demand for our eligibility services offering. Also, as a result of the growing reimbursement pressure, the hospitals are seeing increasing opportunities for our receivables management services as well as hospitals turn their focus to reducing their back office costs.

In summary the outlook for Healthcare remains positive and we expect a stable growth with consistent financial performance. At this point I will turn it over to Sanjeev Sinha to walk you through the BFSI business.

Sanjeev Sinha Thank you, Tom. The Financial Services vertical at Firstsource offers solutions in Credit Cards, Retail Banking, Mortgages and General and Life Insurance. This quarter, we contributed 30% to the revenue of the company. We had over 5,000 employees and just under 4,400 seats. In the 1st Quarter, we saw the Manila centre continue to grow as work from an existing client migrated successfully to Manila. We also saw some strong headwinds in our collections business, where new volumes have dropped and so have the commission rates. There were some profitability pressures in India, as we continue to ramp a couple of existing processes. But at the same time, operational performance continued to be strong across our business; this has resulted in us winning additional business from a few other clients.

When we look at industry trends, the financial services community, especially in the UK and also in the US are coming under increasing pressure from regulatory reform and closer scrutiny. We also see mortgage volumes drop in our key market of the UK. And in the credit card space the delinquency rate and the charge off rates have all fallen significantly. These are trends that we believe will continue for a few months.

In terms of the business outlook, we expect our Collections business to continue to experience volume pressures for the next few months. We believe that due to regulatory pressures on banks, the new opportunities that are coming in and we are very well placed to cash in on those opportunities especially in the area of compliance and complaints. Our pipeline continues to be robust across the business so the long-term outlook we believe will continue to be positive.

Thank you and I will now hand you over to Santanu Nandi.

Santanu Nandi

Thank you, Sanjeev. As you are aware that we cater to key segments in the Telecom industry essentially across cable and satellite television, ISP, wireless and fixed line, and our revenue contribution to the organization was 23% this quarter, and we have employee strength of 6,120 and a seat capacity of about 5,100.

In terms of highlights for the quarter, as Matt identified earlier that we are experiencing softness in the volumes, and we have talked about ramp down from an existing client, and that has impacted our top-line. We have won a couple of additional businesses from our existing clients and we have been successful in deploying some of our existing employees, clients that we ramped down into new wins.

Matt also talked about capacity consolidation which has created parallel runs in various capacities and resulting into high cost in the interim. In the quarter we developed some strong pipeline across all the various markets, some of which will convert in Q2. We have also added to the sales team, both in UK and US, we have already added, and we have some in offer, some of those will materialize in Q2.

In terms of industry trends, we are seeing UK ISP market is experiencing a slower growth and this has been on for a while. We are also finding that decision-making cycles among the various clients in the industry are actually slower than expected. Apart from that we find that the new technology which is emerging in the industry in the fields like connected homes, in a field like touchless payment technology, etc., which will over a period of time expand the subscriber base.

We have seen some consolidation across the top telecom players in the industry. We are aware of the AT&T/T-Mobile merger. We have also seen in the Australian market at acquisition of Austar with FOXTEL in the cable space, satellite television space. In terms of newer channel, web chat is emerging as a major channel both across sales and service.

In terms of our business outlook, our volumes in the ISP segment will continue to remain soft and this will have an impact on the top-line. We have over the period, work towards sharpening our competitive advantage. We created a Center of Excellence for telecom within the organization to focus on this aspect to monitor developments on new technology, new market segments and help us create more differentiated offering, so that will help us in terms of our competitiveness in the market.

We have talked about the excess capacity and the new wins earlier and this will have some cost of growth and will have some impact on the bottom-line in the short run.

I talked about earlier; there is an emergence of new technology which will open up new opportunities for us, particularly in the premium tech support area. We talked about development of strong pipeline, particularly, in the web chat service line and we have significant capability there and we expect to gain from that. We talked about wins in Quarter 1 and we have some pipeline, which will convert in Q2, so we expect to see better yields in terms of revenue in the next half.

So overall, our business is stable despite some near-term challenges. We are very encouraged by the conversion of the pipeline and also some of the pipeline is imminent for closure. So overall, we feel very confident about the business.

With that I will hand you over to Sanjay Venkataraman.

Sanjay Venkataraman Hi everyone, Sanjay here. As you are all aware, the Asia Business unit is a geography unit, focused on two major verticals, the telecom and media vertical and the BFSI vertical. We operate in the geographies primarily of India and Sri Lanka right now. Sri Lanka as a delivery geography is a recent addition in

Quarter 1. We contribute 12% of FSL's revenues in Q1 and we did that with shade under 15,000 employees, a seat capacity of something like 10,275.

As far as Quarter 1 goes, the big highlight was obviously the fact that we entered a new geography. We formed a joint venture with Dialog Axiata Plc of Sri Lanka, which is Sri Lanka's largest telecom operator.

We also saw a significant increase in volumes which we were receiving from our existing customers. So this resulted in a huge number of additions to our manpower which we had to undertake to service those volumes. So we added a number of employees just a shade under 3,000 over last quarter, including Dialog, which had its impact on profitability.

Apart from increased volumes, we also expanded our footprint with our existing customers. With most of them we either added additional circles or we have added additional lines of business, which we serve for customers, and we conclude our focus towards improving our operational efficiencies in Quarter 1.

In terms of industry trends, I think all the things we are seeing emerging and picking pace rapidly is obviously the whole rural BPO initiatives and we are busy engaged in trying to figure out and work out our 'go-to-market' to address this opportunity. We also think the "Do Not Call Registry" which has been delayed a few times now will come to execution sometime this month, but again the situation is fluid with the DNC Registry. MNP, which was introduced six months back, has showed modest response. We believe that the market will continue to grow, the IT-BPO market for India is expected to grow by something like 17% from this year to the next. Our telecom customers are also telling us that the next wave of growth which they are seeing are all going to be fueled to a large extent by growth in volumes in 3G, data services and value-added services, and to some extent we saw that even in Q1, where most of the surge in volumes actually were around 3G and data services. And we are also seeing a flurry of activity in the government and PSU market in India. I think there are a number of opportunities out there, a number of bids out there, as a number of government departments start offering increased citizen services.

As far as the business outlook for next quarter goes, I think all the ramps and cost of growth which we undertook in Quarter 1 will translate into revenues and profitability in Q2. So we see significant revenue growth from Q1 to Q2 and significant profitability improvements from Q1 to Q2 for the Asia Business Unit. Q2 will also have the full impact of the JV we entered into with Dialog. So Firstsource Dialog Solutions will contribute a full quarter's revenue and profit in Q2. Our pipeline continues to be strong and there are some opportunities which we are pursuing in the Middle East, which are quite close to closure, and we will continue our focus on operational efficiencies in Quarter 2. Having said that I will hand it back to Matt for his closing comments.

Matthew Vallance Thank you, Sanjay. Just to summarize where we see things moving as we get into rest of the financial year 2012. we expect revenue momentum to pick up pace, as we particularly move into the second half of the year, and we expect our margins to improve from where they are in Q1 and continue to improve as we go through the year. Some of the reasons for the improvement in margins on account of the fact that, as Sanjay mentioned, that the big ramps will be in the Asia Business Unit have been completed and will flow through into profitable revenue, and we expect to continue to convert business in the pipeline, much of it comes in telecom and media business, and in fact as we have already concluded into our financials, as we move into the second half of the year. And we continued to focus very strongly to drive the operation efficiencies and rationalizing our cost base. However, as I point now, we do face some amount of headwinds in terms of decision-making cycles going protracted but in particular in terms of the decline in volumes that we have seen in our Collections segment compared to what we would expect when we began the year. Overall, I would say that we expect revenues to grow over the coming quarters and our margins will certainly improve from our Q1 levels.

So moving into Q2, we expect revenues to be somewhat along with some margin improvement. With that I hand over to the questions.

Moderator Thank you. The first question is from the line of Anand Bhaskaran from Spark Capital. Please go ahead.

Anand Bhaskaran What is the rationale for taking on $180 million; could you just walk us through your thought process in this?

Matthew Vallance We raised $180 million to do two things, one of which is to take out our existing debt which is on the shorter maturity cycle, so we really use the funds that we are seeing to take out $64 million of term debt and it would amount to both lower interest rates and a longer cycle and the balance cash we are using to essentially hold in reserve ahead of our convertible bond, which comes to maturity the end of next calendar year.

Anand Bhaskaran: Okay. At this point how confident are you of preemptively paying off the FCCB debt?

Matthew Vallance: We really need not to do anything preemptively or otherwise, is not what we are really focusing on, I think the bond becomes due at the end of next year, we firmly believe that by raising this financing now, it places us in a good position to continue to accumulate cash through our normal accruals, and I think the important thing to note is that we have gone out with our syndicators and raised a significant amount of cash to fix through well-made banking organizations, so I think it demonstrates our ability, should we have a need to raise cash flow down the line, it demonstrates our ability to do that. So I believe that we are on a very firm footing as far as the FCCB redemption is concerned.

Anand Bhaskaran Okay. And lastly, can you share with us the details of the interest rates on the debt?

Matthew Vallance We are not going to disclose the interest rates but what I can say is that the rates we secured on a LIBOR plus model and it is lower than the existing loans that we have.

Anand Bhaskaran Okay, thanks.

Moderator: Thank you. The next question is from the line of Shweta Malik from Marwadi Shares & Finance. Please go ahead.

Shweta Malik My first question is during one of the interviews done in television you have mentioned on the EBITDA margin decline because of the wage hike, so could you just walk us through what is the quantum of the wage hike and was it onsite/offshore?

Matthew Vallance: In terms of the wage hike, we do a wage increases in three cycles, entry level staff, which is the bulk of our staff get wage hikes at the beginning of Q1 and that really does have an impact on our operating margins, there will be other factors affecting our operating margins by the way and it is not truly wage hikes. But the wage hikes are more pronounced in India clearly, it is an economy which has a high level of wage inflation and the wage hikes we gave works up to 10%.

Shweta Malik My second question is to the margin front again. I just wanted to know what is your outlook for the FY12 EBITDA margins, and are you still confident of your last quarter, saying that you are able to maintain the operating margins at 14% kind of level?

Matthew Vallance Our operating margins will improve as we go through the year, and I guess you are right, historically we had EBITDA margins at the 14% plus level and we believe that with the steps we are taking and the movement we are seeing in the market with our clients, we expect to bring our EBITDA margins back up in the range we have seen, it is not going to happen immediately but as we progress through the year we will see a progression towards where we want to be.

Shweta Malik Sure. Also, I just wanted to take a look on the Healthcare side, because we have added a couple of deals I guess within the payer segment. So how is the deal size, the durations within the segment, how is the outlook, has that improved because even a seat addition within the healthcare segment has been pretty significant.

Matthew Vallance Tom, do you want to answer that question?

Tom Watters Yes, yes, absolutely. We are seeing a good pipeline growth on the payer side, the opportunities that are being generated as a result of healthcare reform, on the payer side are driving good opportunities for us, we are seeing increased penetration into the existing clients there, and we are also seeing some opportunities pursuing the service lines as payers look to increase their capacity and our capabilities for handling this huge amount of enrollment that is going to coming in the next few years. We are also seeing strong opportunities on the provider side as well. Hospitals are continuing to see increased reimbursement as a result of Healthcare reform, this is starting to look extremely closely at their costs, the uninsured rate continuing at the high levels and we expect to continue at high levels over the next several years is generating strong interest in our eligibility services, and we are also seeing an increase in M&A activity within the hospital market. As that happens, we see good interest and traction on payer system run out and conversion projects as hospitals consolidate and smaller facilities are incorporated into a larger health system.

Shweta Malik Sure, but can we have a look at how are the deal sizes coming out and duration of the same?

Tom Watters Deal sizes have increased across both the segments of Healthcare vertical and we are seeing duration of those deals being a good mix between our long-term engagements as well as short-term cleanup projects.

Shweta Malik Okay, sure. Lastly, how many seats have been added through the joint venture and even the employee addition?

Sanjay Venkataraman The Sri Lanka joint venture added about 500 seats to our total ABU seat count. The balance seats were actually seats which we have to build in our existing centers to cater for increased volumes we are witnessing.

Shweta Malik Sure, that was really helpful, thanks.

Moderator Thank you. The next question is from the line of Kunal Tayal from Bank of America. Please go ahead.

Kunal Dayal Could you please help with some comments on the size and profitability of deals that you have in the pipeline, in the Telecom and the Asia-Business Unit side?

Matthew Vallance We don't typically comment on specific matrix around deals in the pipeline, but Santanu, would you like to give some color in terms of the nature of the deals you are looking at, the nature of the pipeline you are seeing in the Telecom segment?

Santanu Nandi We have a couple of wins as I talked about, and one of them is quite large, and it will take time to the steady state, and it is expected to grow to roughly about 800-1,000 headcount over a period of time. The other one is relatively smaller one, growth of about 70-80 headcount over a period of time. In terms of some of the pipeline that we have, some of those are significantly sized, typically about more than 300 headcount. So, we have a few of those in the pipeline. I do not know if that answers your question. And most of these are basically from offshore delivery.

Kunal Tayal Got it and this large deal in telecom that you mentioned should we expect, at a very broad level margins, to be similar to company performance or they may be coming in a lower rates than the company average?

Santanu Nandi They should largely follow the company average, yeah.

Kunal Tayal Okay, sure. One more question on the Sri Lanka telecom deal, at a steady state, how would the profitability of this deal look like versus the company, this quarter there has been a drag because of this deal, because it is in a ramp up stage, but once it reaches a steady state does it compare to the company average levels or will it continue to be lower?

Sanjay Venkataraman Actually, the Firstsource-Dialog venture did not have too much cost of growth or ramp because we actually bought in and set up this joint venture with an existing center. So, if you look at profitability I think we have already started hitting steady state profitability on the Dialog venture and that will continue for the rest of the year.

Kunal Tayal So is there some one-time cost that you associated with this deal in the quarter?

Matthew Vallance Not for the Dialog deal, we talked about some ramp ups in other parts of Asia Business Unit which obviously has an associated cost of growth, but as Sanjay mentioned, this deal is one where we took over the assets and employees from day 1, and so there is essentially no ramp up to reach a certain volume.

Kunal Tayal: Okay, thank you.

Moderator Thank you. The question is from the line of Dinesh Kumar from Aditya Birla Money, please go ahead.

Dinesh Kumar Hi to all, just had a couple of queries; one is about this ABU, this quarter it is an EBITDA positive business or is there an element to a loss kind of a thing?

Sanjay Venkataraman It is an EBITDA positive business.

Dinesh Kumar So, this basically addition of around 3000 employees, it is in ABU, right?

Sanjay Venkataraman Right.

Dinesh Kumar So when do you see this ramp up happening, because by seeing the pipeline you added this in a substantial manner during this quarter, so when do you see if this pans out over a period of time?

Sanjay Venkataraman We see the full impact of this happening in Q2. In fact, we saw some impact starting off from the end of June and throughout the whole of Q2 these ramps will be paying off both in terms of revenue and profit.

Dinesh Kumar So this is basically for a telecom client, is it because of 3G or this new initiatives which is coming on now because of that?

Sanjay Venkataraman Sure. I think there are three contributing factors to the increase in headcount. About 500 of these are employees we added in Sri Lanka for the Firstsource-Dialog Joint Venture. Balance 2,500 was on two counts. One is that we saw a substantial increase in volumes which were being offered to us by our existing telecom vendors. So we ramped up the service base volumes. And the second is we also won new business from our existing customers, either to add on to service additional circles or to add on new service lines to things like 3G or dealer helpdesk etc. Now these are the three things which contributed to the ramp up of headcount in ABU and all of it will contribute to revenue and profit through Q2.

Dinesh Kumar Okay, that is fine. Regarding this EBITDA margins once again actually is it in line with company expected numbers, or it came below the estimates of the company? Whatever the top-line as well as margins and all those things is with in line with what company expected numbers or it is below that estimate level of the company?

Matthew Vallance Our margins for Q1 are below what we expected. As I mentioned we expected our margins to come down from Q4 levels, we expected a fair amount of reduction there. What we have seen is reductions in volumes as well as the ramp up in Asia Business Unit. So our margins are lower than the expected in Q1 and we expect to build them back up again in the subsequent quarters.

Dinesh Kumar Okay, fair enough, a touch up on this refinancing once again, actually we are going to repay the FCCB premature or still we hold the cash and we will refinance only in 2012 December?

Matthew Vallance We have a fixed time line at the end of December 2012. We look at options regarding FCCB beforehand we really are concentrating on the December 2012 date when the bond becomes due. And that is why we are building up cash reserves now to make sure that we are in a position, obviously, there are many FCCBs in India that become due for refinancing over the next couple of years, and we wanted to get out ahead of the curve to make sure we are well placed to deal with it and not to be in a position where we are rushing to refinance in the market that has less liquidity.

Dinesh Kumar Okay, fair enough. And what about this second quarter guidance which you gave that was flattish quarter on Q-o-Q basis, right?

Matthew Vallance On a revenue perspective, we expect the Q2 to be somewhat flat and we are expecting to see growth come through in the second half of the year.

Dinesh Kumar Okay, thanks a lot.

Moderator Thank you. The next question is from the line of Tariq Chotani from Ellerston Capital, please go ahead.

Tariq Chotani I have got a couple questions, one on the company wide basis, again coming to the EBITDA and the EBIT margin where is the improvement going to come from, is it going to be more in terms of productivity improvement because I am assuming that you'll continue to add people which will continue to have that fixed cost base in terms of personnel cost, so how is the improvement in the EBITDA going to come through over the next 2-3 quarters?

Matthew Vallance The improvements will come through the improvements in our operating efficiencies and there is a certain amount of improvements that will come through from efficiency in running the operation. Also the fact that many of the ramp ups we are doing to add 3,000 people during the last quarter, all those staff will be in billing mode so, both through operate the efficiencies and through delivering revenues from the previous ramp will help us to improve our margins, as we go beyond Q2 in Q3-Q4 we will see the top-line growth coming through and contributing to revenues as well.

Tariq Chotani Okay, sir, continuing with what you are talking about, we have seen employees add in the Asia business, 3,000 people you have also added 774 seats but you have seen seat factor improved from 73-79% now, would you have to add more seats to continue to enjoy the productivity gains or is the seat addition going to take a backseat and it is all going to give more productivity gains which means the seat fill factor would improve, that is what I am trying to get to.

Rajesh Subramaniam This is Rajesh here, I think the seat fill factor will definitely improve because I think with as programs mature, the utilization levels improve, which also has a direct bearing on the agent productivity. So if I move my agent productivity from say 6 to 6.5 hours it is straight bottom-line impact because my paid hours are the same and I am improving my work hours. So that gives me a benefit going straight in, and as the programs mature our ability to roster better given that we have a clear trend in terms of how the volumes and the customers are coming in drives productivity, and that is exactly how we have been managing to extract some of the operating leverages in the past as programs mature. So to answer your question I think we have enough capacity and seat fill will improve and you must have heard Matt in the earlier part of the presentation that we are also consolidating some of our capacity which will also start driving some of the seat fill and result in margin expansion.

Tariq Chotani And sir, just general question before I go to my second actual question is, where do you see marginal productivity actually reduced, at what seat fill factor does your operating leverage becomes negative? Is there a level because you have seen seat fill factors in BFSI and Telecom hit highs of 87% in the fourth quarter of 2010 but now it drifted lower, is there a level in general for the industry where it hits where it does not become efficient enough?

Rajesh Subramaniam No, I think but to answer that question you know unlike IT Services where it is ubiquitous to utilization on seats, our business is as you know it has got geographical diversification and within the geographies we have these various verticals. So the better way of looking at this is each customer value within the vertical and from the geography, and to give you a weighted average answer to say at this seat fill I would be making this margin and every improvement in seat fill involves this much of margin expansion would not be an appropriate way of guiding you.

Tariq Chotani Okay, fair enough. I had a question for Sanjeev Sinha from the BFSI, in the presentation as you said and even when you are saying, the commission rates are expected to continue to see a downtrend and delinquency rates are also at the lowest, could you just elaborate where this whole sector and this business model is going with all the issues that you are seeing in the UK for the next 3-4 quarters or at least a year, how do you see that spanning out, just wanted to get a feel of what you all are seeing on the ground there?

Sanjeev Sinha: Sure. This is largely for the US market for whom we do credit card collections today. What is happening is you might be aware is that over the last couple of years, many issuers have actually cut down on the number of new accounts that they are issuing. And when that happens then the number of accounts that go through the complete cycle become charged off, become delinquent and then become available for collection, that number starts dwindling. And so we are seeing some impact of that. Now the reason, why I have also said that this impact is going to be there for few quarters and then we will start seeing a turnaround, is because in the November-December timeframe last year, many of the card issuers have once again started issuing new accounts. So, normally in the 6-9 month frame after that you will see these accounts cycle through the charge off and delinquency cycles and add to the placement volumes. So yes, it is a negative headwind for the next couple of quarters, but it is not a long-term trend, it is something that should reverse, we hope by the end of this calendar year.

Tariq Chotani And the new consumer reform commission that is being initiated, how does that impact your business, because that has been impacting most banks right, at least they have been dumping it down, how does that impact your business model there in the US?

Sanjeev Sinha The single impact in terms of the collection industry is going to be from a compliance standpoint, because there will be a lot more requirements that need to be placed on the banks in terms of how debt is collected. Now, we have always been very, very strict about following compliance guidelines and that is actually one of the strengths because of which we work for some of the best known names in the industry. So we don't really see a significant impact in our operating practices, we do feel that the level of litigation in the industry will go and has been going up, so that would have some peripheral impact.

Tariq Chotani	Okay, one last question before I leave, the business that you do in the US in the credit card collection, is it more on a number basis or is it more on a SLA-driven outcome basis?
Sanjeev Sinha	No, it is largely a contingency model, so you keep a percentage of what you collect.
Rajesh Subramaniam	To answer your question it is outcome based.
Tariq Chotani	Its outcome based, okay, thank you guys, best of luck.
Moderator:	Thank you. The question is from the line of Ankit Pande from SBI Securities, please go ahead.
Ankit Pande	I just had some questions on the overall demand scenario that you are witnessing especially since there is bit of dichotomy in the Y-o-Y growth numbers there, that is one, and second is can you comment on, if the company is seeing any protectionism trends in the BPO business, in general? That is it.
Matthew Vallance	You talked about the demand trends and I think that varies according to the segments we are in, and as I mentioned, it would be characterized by our pipeline if you look at across the business, we see strong demand in Asia Business Unit, we are seeing a significant growth on the back of the rapid growing economy, we are seeing significant growth in strong pipeline in that segment, we are seeing strong pipeline in our telecoms, media verticals, where we actually have been closing deals over the last 2 or 3 quarters, which is bringing business closure, so we see that pipeline continuing to be strong there, and in certain areas about Healthcare business we see pipeline building up, particularly in our receivables management in our provider business and in payer segment and BFSI is somewhat slower and we are not seeing good pipeline in the Collections business, but I think it is hurting us a little bit in the placement volumes. We are winning these segments of business within collections, but overall the amounts in new paper getting placed with us has come off a lot and so when the market returns, there is one new segment, we are winning these segments, will help us to grow.
Ankit Pande:	Okay on the protectionism trends?
Matthew Vallance	In terms of protectionism we do not see it directly affecting us. I think one of the things is a big distinct to that Firstsource we have a significant proportion of our revenues coming from onshore, so I think that protectionism is manifested itself in the form of any laws of restrictions on off shoring, now we have a very much a large proportion of our business which is delivered onshore. I think our

model somewhat mitigate against the effect of protectionism, just because there may be either laws or sentiment, media sentiment, media pressures to essentially restrict off shoring, certainly prevents companies from doing outsourcing onshore from which they can get, also good savings by doing onshore outsourcing as well.

Ankit Pande Okay, can you give some idea of any government-based business in US and Europe?

Matthew Vallance No, not a sector that we have targeted in the past.

Ankit Pande Okay, and can you give us any guidance on your capital expenditure that was pretty much down this quarter?

Carl Saldanha Our budgeted capital expenditure is typically about $15 million every year and it is the same this year, but we only spent just about $2 million or less actually in this quarter, so it is much lower than what we expected. We finance our hardware and software, so we are actually spending very little.

Ankit Pande Alright. Any guidance when this will be spent or which quarter will be spent most?

Carl Saldanha No, as I said we don't expect to spend as much as we plan to spend, so it is not going to be very much.

Ankit Pande: Alright, thank you so much.

Moderator: Thank you. The next question is from the line of Rohit Gajare from UTI Portfolio Management, please go ahead.

Rohit Gajare Hi, just a few book-keeping questions. Now that we have raised $180 million debt and we plan to repay $60 million for some ECB, so on a net basis our gross debt would have increased by 120 million. So it was 650 million as in March and now it is 770 million, is that correct?

Deep Babur No, that is not correct. See, our debt prior to us taking this was about 265 million of the FCCB and about 65 million just rounding a number here of the debt from ICICI, both the ECB and the term loan in the US. So if you add those numbers up, you are seeing it about $330 million of debt. Effectively, on a gross debt basis, we have taken about a $115 million of additional debt. The 180 less 64 that we repaid ICICI, so gross debt position is about $445 million against which we now have about $200 million in cash. So net debt position is about 240.

Rohit Gajare So we have $445 gross debt and $200 odd in cash. And now if I look FY11, if I do a rough calculation of free cash flows we made around $45-50 million for FY11 approximately somewhere, right?

Deep Babur Yes, that is correct, just to taper that down slightly that included about $10 million that was raised from post shipment which actually has been repaid this quarter. So if you factored that out about 40 million is what we generated.

Rohit Gajare: So 40 million, okay, and do you think that thing should continue or become better for FY12 for us?

Deep Babur Well, yes absolutely it should remain at those levels, yes.

Rohit Gajare Okay so basically if I am looking at FCCB redemption in December 2012 and I am looking at say assuming no bond conversions or any such thing, may be around $290-300 million outflow in December 2012?

Deep Babur That is correct.

Rohit Gajare So basically we have 200 cash right now, and are there any other major debt repayments happening from today till December of 2012?

Deep Babur No, we have no other debt.

Rohit Gajare So basically the major debt principle repayment with the FCCB and there will be some interest repayment perhaps in the quarters to come.

Deep Babur That is right, there will be interest payments in the quarters to come, but that should be offset by the interest that we will gain on the cash that we hold.

Rohit Gajare Okay and what is the Capex guidance that you gave earlier?

Deep Babur The Capex guidance, Carl spoke moment earlier was about 15, but really the outflow will be much lesser although it won't be that number.

Rohit Gajare Okay sir, that is all I wanted to know, thank you very much.

Moderator Thank you. The question is from the line of Jamie Ang from 3 Degrees Asset Management, please go ahead.

Jamie Ang Hi this is not Jamie, this is her colleague, my question is the RBI has opened a window to buyback the FCCB between now and I think May next year. So now that you have the cash with you, is that something you guys are considering?

Deep Babur Well yes, absolutely, I think that is one thing which we consider to look at, but as you are aware there are certain restriction that the RBI has and there are some discount levels that we need to adhere to, provided the bonds are available at those discount levels is an opportunity we know, we will explore, but again as Matt also alluded to earlier that is not really our focus area, we are happy to redeem it when it is due because we don't really have a negative carry on the cash.

Jamie Ang Okay that is my only question. Thank you.

Moderator Thank you. The next question is from the line of Darshan Engineer from Alchemy Capital Management, please go ahead.

Darshan Engineer Based on your balance sheet provided for June 2011, there has been an increase in your debtor levels by around 50 crores. So any reasons for this significant increase in debtor levels?

Matthew Vallance There is no specific reasons, obviously, balance sheet is taken at particular point in time, our DSOs move and vary amongst through the course of quarter. So you saw a closing position at the end of March, closing position at the end of June, and there is nothing specific we should draw from the increase in debtor levels and it is just that we do see some fluctuations in our receivables from over the months.

Darshan Engineer Okay and also another question relating to your expense breakup, your employee cost increased in current quarter, which you have attributed to various ramp ups, so can you give me a breakup of your increase in cost, based on wage hikes and because of the various ramp ups that you have undertaken.

Matthew Vallance We haven't got a breakup for you, I am afraid.

Darshan Engineer Okay. Thanks a lot.

Moderator Thank you. Ladies and gentlemen that was the last question. I would now like to hand the floor back to the management for closing comments, please go ahead.

Matthew Vallance Thanks everyone for joining the call and I think we have spoken extensively about not just the quarter gone by, but also the prospects for the next quarter and for the rest of the year. It has been a quarter, where we have seen a dip in revenues, we have seen a dip in profitability, we articulated some of the reasons for that, and some of the reasons where we see improvements occurring and so we see obviously somewhat of a flat pitch of revenue for Q2, we expect to see an improvement in profitability and we expect to see further growth coming through to the business in the second half of the year and continue the expansion in our margins. Thank you very much for joining the call and we look forward to speaking to you next time.

Moderator Thank you gentlemen of the management. Ladies and gentlemen on behalf of Firstsource Solutions Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.