Q2 FY2011 Earnings Call Transcript – October 28, 2010

CORPORATE PARTICIPANTS:

- Mr. Matthew Vallance– Managing Director and Chief Executive Officer
- Mr. Aashu Calapa – President, HR and Country Manager, India
- Mr. Carl Saldanha – Global 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
- Ms. Chandra Iyer – Head, Asia Business Unit
- Mr. Mahesh Pratap Singh – Head of Investor Relations

Firstsource Solutions Limited
Quarter Two Earnings Conference Call, Financial Year 2011
October 28, 2010

Moderator Ladies and gentlemen, good day and welcome to the Firstsource Solutions Limited Q2 FY2011 earnings conference call. As a reminder for the duration of this conference, all participants 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 our 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. Thank you and over to you sir.

Mahesh Pratap Singh Thank you Melissa, good afternoon to participants from Asia, and good morning to participants from Europe and the US, welcome everyone and thank you for joining us on our earnings call for the second quarter ended September 2010. Please note that the press release fact sheet and results are available on our website www.firstsource.com and have also been mailed across to you. To take us through the results and to answer your questions we have with us today Matthew Vallance our Managing Director and CEO, Aashu Calapa, President HR and Country Manager India, Carl Saldanha, our Global CFO**,** Tom Watters President of Healthcare Business Unit**,** Santanu Nandi Executive Vice President Telecom & Media Business Unit, Sanjeev Sinha, Executive Vice President BFSI Business Unit, Chandra Iyer, Executive Vice President Asia Business Unit, Sanjay Venkataraman, Executive Vice President, Asia Business Unit

We will be starting this call with a brief presentation providing an overview about the company's performance followed by a Q&A session. Please note that everything we say on this call which reflects any outlook for the future or which can be construed as forward looking statement must be viewed in conjunction with the risk the company faces. The full statement and detailed description of these risks is available in our prospectus filed with SEBI which can be found on www.sebi.gov.in. With that said I would now turn the call over to Matthew Vallance, our Managing Director and CEO

Matthew Vallance Thanks, Mahesh and hello everybody and welcome to the call that we convene to talking through our Q2 results which have been announced today and I am assuming that you have the presentation open in front of you which we will control from this end. If you move forward to slide 3, first of all we will talk to you about the Q2 performance and then we will end the presentation by talking about the outlook.

If you turn to Slide 4, which talks about our financial performance for Q2 you will see that our revenue from operations increased quarter-on-quarter by 2.6% from 490 crores to 503 crores. In terms of our operating EBIT quarter-on-quarter improved and the operating EBIT is equating to 5.2% moving up from just under 47 crores so just over 49 crores and that represents 30 basis points improvement in the margin to now 9.8%.

As far as our PAT is concerned obviously we see unusual items in some cases, below the operating EBIT line affecting our PAT. In this case our PAT has moved up 3.6% quarter-on-quarter and it has moved to 33 crores for the period.

If we turn to slide 5, where we are presenting the H1 performance you will see that on a like-to-like basis on page 2, second half of our last fiscal to the first half of this fiscal basis, our revenue is down very slightly by 0.3% to 994 crores, our operating EBIT is down 1.1% to 96 crores, the operating expenses remain flat between these areas and at a PAT level there has been a decrease of about 3.5 crores to 65.3.

I move on now to slide 6 in the presentation. As far as the operating EBIT is concerned I mentioned that our margins have expanded by 30 basis points and the reason for that is two-fold, this is in terms of our margin expansion over previous quarters so it is a sequential change there. Number one, we have improved the operating margins in the Asia Business Unit and you may recall that we talked about building more efficiency and optimization in our Asia Business Unit, we started to see some results with that flowing through. We had already previously reported that business unit is cash positive, it's made further progress in the Q2 and by the end of the fiscal as we said before we expect the business would be EBIT positive as well.

And also there has been some improvement on account of lower depreciation charges. So as a fundamental point of view, we need to generate cash as a company although cash and cash equivalents look at Q2 closing cash, it appears to be lower than in the previous quarter, there is some unusual movements in our working capital, in particular, we have had some delays in invoicing in some elongated receivables timeframes, a small number of our clients perhaps at those points had stress and have been resolved now and if you were to look at removing those unusual items, there is unusual movements which have now been restored then the cash generation for the quarter would have been about $8 million which is beyond our expectation.

Moving now to slide number seven, other highlights in the performance of Q2, we are particularly pleased to secure two significant client contracts during the course of the quarter and you may have already seen these announcements first of which is the Barclay Card UK contracts, Barclay which is the existing clients of ours as well, where we work with the company in the United States and we have secured contracts for Barclay Card in the UK, we have been selected as a strategic partner of Barclays to manage their credit cards and payments since we manage the processing of developments of that credit card and payment as we did in the UK. It is a five year deal which we signed and it comes into effect from the beginning of November 1st and as part of the deal take over the management of majority of the stocks on seats sites for Barclays and also part of the operation in another site and it equates to over 700 staff that would be joining Firstsource from Barclays in November. So we are particularly pleased to deepen our relationship with Barclays and also make further strides in the cards area, which has been an area of focus for us. Also Axis Bank, you may have seen that we secured contract from Axis bank, again another five year outsourcing contract for a range of contact services across multiple channels voice, email, web chat, servicing accesses retail customer base. We are delighted to have strengthened our position in both the BFSI segment and in the Asia Business Unit through these two contracts and it also underlines the fact that we are seeing traction within the banking and financial services segment in general.

Employee strength we were just a shade under 25,000 employees as of the close of the quarter, of which 19,000 are based in India, just under 6,000 are based outside of India and this forms part of our right shoring business model that we have talked about in the past and this holds us in good stead with our clients and prospects as we secure further business by having a range of geographical options for our clients focusing on India into the home markets of our clients in the UK, and US as well as other key outsourcing destinations including the Philippines.

We added 212 employees during the quarter as compared to a slight reduction of a 163 in Q4 FY10. And moving on to attrition, attrition continues to be an area of focus for us. We believe we have not made as much progress as we want to in this area and we do continue to take it very seriously and have a number of initiatives underway to bring the attrition down. Some positive signs of improvement in the offshore side of our business, our attrition rate has come down by 5 percentage points to 50.1, however, our onshore prices is driven by particularly, one major international sites particularly where we have seen significant growth of business, our onshore attrition has increased to 48.4% but the domestic attrition is flat in that effect, we are taking steps to bring these numbers down across the board.

Moving onto slide number 8, you will see our capacity and our utilizations statistics noted down. We have seat fill factor, this is a number of seats that are currently occupied by staff at 75% and that is same as it was in the previous quarter and we do believe the scope to improve this, our seat capacity is not entirely flexible in terms of moving programs and processes from one site to another, one geography to another, as there will always be some headwind in our capacity, but we do believe that we can improve on this 75% figures which will also have positive impacts on our operating margins. We have still 42 delivery centers which is the same as we had when we last reported and just under 21,000 seats worldwide. We added 330 seats during the quarter in question.

In terms of our foreign exchange, we have a policy of hedging our foreign exchange, as it relates to our cross border business so we work for example we conducted India for our US clients and UK clients where we have potential for margin fluctuation on account of exchange movements between the two currencies. So we have a policy for those types of revenues which is approximately 20% of our business for policies of hedging on a rolling 12 month basis and you will see in the presentation that we have hedged 31 million of our US dollar revenues and 35 million of our GBP, pound revenues and you will see various different hedging rights we have. Most of these revenues covered for the remainder of this year except for our H2, most have been covered, 100% of our dollar revenue as well our pound revenues at the level of 47 to the dollar at 78 pounds respectively. And moving into H1, we have also taken out number of hedging contracts at 40 and above rupees to the dollar and 75 and above rupees to the pound. So that is the hedging position something that has worked or policy which has worked well in the past and we expect it will do in the future as well.

We also reported divestments of Pipal Research which was a majority owned subsidiary of ours, research company and we have reached agreement where 51% of our ownership of this business to a company called CRISIL which is a business owned by Standard & Poor's. And so that deal has been signed in the subject to completion which we may expect to complete in Q3 of the current year and the total deal size with 100% in equities is $12.75 million.

I will move on briefly to slide 9, it talks about the mix of our business between geography by verticals, by client concentration and by delivery location, really not a great deal to report here over the previous quarter. So in terms of these split of the revenues it remains more or less unchanged over the period, one slight change in terms of the US mix of business versus the UK mix, much largely accountable by exchange of movements rather pound has strengthened more from dollar against the rupee.

We are now going to break into the individual business unit segments and we will kick off with healthcare. Tom Watters will talk through the healthcare segment, Santanu will then followed by talking through the telecoms and media segment, followed by Sanjeev Sinha who is Head of our BFSI business and concluded by Chandra who will discuss our Asia Business Unit. That concludes the opening segment now. I now handover now to Tom Watters

Tom Watters Thanks, Matt. Hello again everyone. For the quarter healthcare represented 37% of total company revenues through just over 2,800 employees with a capacity of about 3,100 seats and a seat fill factor of 74%. We deliver healthcare services in both India and the United States. In terms of the industry trends, we are now six months into healthcare reform there had been a few key provisions that have been acted up to this point. A primary focus of the Obama administration has been on aligning incentives towards wellness and prevention and away from reimbursement that's focused primarily on acute and chronic conditions as a result preventative services such as immunizations, cancer screenings no longer require out of pocket payments for members therefore the administration believes that will give them an incentive to participate in higher levels in these type of programs. Another key element implemented during this past quarter is the coverage can no longer be rescinded by insurers due to technical errors made by the member in completion of an application or because a member has reached their lifetime coverage limit. So going forward insurers may only rescind a member's coverage in the case of fraud. Unemployment rates sustaining at about 9.6% that continues to board well for eligibility services offering and also draws additional onshore opportunities within the payer segment. On the provider side, they continue to struggle to restore their financial viability to pre recession levels they are attempting stabilize investment portfolios, they are regaining any lost ground on bond ratings and they are also working for new channels for access to capital. Payer reserves have come under increased scrutiny given the national dialogue around healthcare reform, these reforms most likely will resolve in margin pressures to payers who will increasingly look to their internal cost structure and we are seeing significant evidence of that in the marketplace. Moving onto the outlook for our business, we are continuing to see some protectionist sentiment it has been a continuing theme in the upcoming midterm elections in the US, it's also resolving in new and increasing opportunities for our onshore delivery. Health insurers have come under increased federal scrutiny with many of their proposed rate increases being denied, the administration has actually gone as far as suggesting that insurers who continue to propose what they believe are excessive rate increases maybe barred from participation in the health information exchanges and of course that the primary enrolment process for the newer insured going forward. Lawmakers approved an additional $16 billion in funding for state medicate programs to help states manage shortfalls for the remainder of their fiscal 11 and of course that's a result of the persistently high unemployment rates. To counter ongoing customary reimbursement providers are increasingly looking to improve their efficiencies their outsourcing larger segments of their accounts receivables all that obviously in an effort to maximize cash flow and ease their margin pressures. In summary, the outlook for healthcare remains positive where we expect moderate growth and sustained financial performance.

Matthew Vallance Thank you Tom. Just would like to handover now to Santanu Nandi who will take you through the telecom section.

Santanu Nandi Thank you Matt and Hi everyone, in the telecom and media vertical we delivered a revenue contribution of about 27% out of three delivery geographies in India, UK and Manila and it is an overall employee strength of close to about 7,400 and seat capacity of about 4,900 odd with seat fill factor of about 78%. As you are aware, we cater to all the key segments in the telecom and media market essentially cable and satellite television, wireless and mobile, fixed line and broadband and narrowband segments for geographic markets of the US, UK and Australia. I will now walk you through some of the industry trends and the business outlook, the much anticipated vendor consolidation which we have talked about earlier and were indicated by the market earlier is much slower than expected and this has resulted in the slowdown of our business with some of our key clients however I would like to point out here that the pipeline continues to grow, based on our domain expertise and value proposition however, the ramps are getting delayed as a result of this delay in vendor consolidation. We are noticing a new wave of outsourcing from the UK telecom operators and we have participated in some very large bids in the segment both in UK as well as Republic of Ireland. We are noticing some increase in competition in the UK pay-monthly market particularly at the lower end of the market and this augurs well for us because this will create a greater need for driving down cost and which dovetails well with our right shore offering that we provide to our clients.

There has been an OfCom ruling based on which BT has to open up the high speed fiber optic broadband network that they are setup are setting up across the whole of UK and have to make it available to other ISP players. So which will bring in opportunity for us because we are a strong player essentially in the broadband and the TV market which is what this entire fiber optic broadband network will give flip to.

HD or High Definition TV which we have been talking about for a while is slowly becoming mainstream and the 3D television is emerging as the new market segment and we believe that as the TV product gets more and more complex there will be greater need for services which we offer essentially in the text port and customer service space.

We also found, iPhone which has thus far been tied up with AT&T is expanding the tie up to other operators as well and this along with other segments will actually help us, we are continuing to see pipeline growth in North America and UK across both existing and prospective client base. So overall while there is softness in the volume in our business due to the timing related issue as I said some of the ramps are getting delayed as a result of delay in vendor consolidation. So there is a significant growth in the pipeline and the business continues to look promising, thank you with that I will hand to Sanjeev to take you through the BFSI outlook.

Sanjeev Sinha Good afternoon, let me begin by just giving you a broad overview of the BFSI market for us our clients are in the US and in the UK and the delivery geographies are the US, Philippines and India. Our offerings and client base encompass all the key segments, credit cards, retail banking, mortgage, as well as general life insurance. We contributed 23% revenues of Firstsource this quarter, our employee base grew marginally and so did the number of seats that we utilized are leading to a seat fill factor of 80%. In terms of industry trends we continue to see increased interest in outsourcing and this is evidenced by the nature of conversations that we have with our existing clients and the prospective ones that we are trying to close business with, so those conversations are starting to become much more substantive. We are also seeing some interest now in Australia. In the UK we have seen change of guard at three of the top five UK banks and we believe that this could lead to a change in the way they have viewed outsourcing as well as off shoring so we are hopeful that this could in the future lead to some other opportunities. The credit card industry as most of you would be aware has been contracting over the last 12 to 15 months and this has largely been the result of various legislative and regulatory initiatives being carried out in the market that we serve and that is something that we have noticed and that trend has become quite evident but at the same time the prepaid card market is rapidly expanding. We are extremely happy about that because that's another market that we been playing and we have a client in the US in that particular space and with that segment expanding we are hopeful that this would lead to business opportunities. The mortgage sector unfortunately continues to suffer, our stable recovery in that sector doesn't seem to be in sight either in the US or in the UK. Our 2009 was weak for the US retail banking sector but we believe that it will continue to be impacted by several business issues in this current financial year as well and some of these issues are government regulations, the sluggish growth in their respective GDPs and the continued impact of the various stimulus packages that had been enacted by the US government. So all of these leads us to believe that the US retail banking sector would continue to be weak during this current financial year. Moving onto the business outlook as our CEO mentioned we have signed a five year outsource contract with Barclay Card UK which is a significant deal for us looking at their customer service, their consumer, their commercial as well as their shared services business and we believe it talks to the capabilities that we have built on the credit card side of our offerings. Banks are actively considering outsourcing as an option for increasing efficiency as the cost ratios mount this is certainly something that they are more than willing to explore as a strategic alternative, we also find lift out opportunities in the market today and we will be happy to engage with those kind of opportunities as well. We are rolling out prepaid service offering to the broader market beyond the existing clients and the initial interest seems to be extremely encouraging and as I mentioned this is a segment of the market which is expanding very rapidly and we are hopeful for further growth here. In collections, we see liquidation rates moving up almost 10% year on year, even though the volumes are contracting and overall debt, the net cash in those accounts is forecasted to decrease and these are all impacts of a couple of things, firstly the changes in regulations over the last 15 months and the impact of the economic crisis. We see increased pressure on commission rates and sometimes it goes hand in hand with the increased liquidation, we also see India delivery becoming more popular among our US clients. So we see expansion in terms of delivery capabilities from India to our clients in the US. Thanks. Now, let me pass you on to Chandra Iyer who heads our Asia Business Unit.

Chandra Iyer

Good afternoon. Most of you must have read our press release today that I am stepping down this quarter. I like to introduce you to Sanjay Venkatraman who joined us in this past quarter and while have been working over this period to ensure seamless transition. I have spent close to seven years with Firstsource and I have been an integral part of leadership looking at growth from its nascent stage. The past couple of years particularly where we spend time building Asia business unit has been extremely gratifying now have business with a very very strong foundation and leadership team. We have got reach, we have got scale, we have got customers. This is I think in a right time for me to hand over the mantle and, I am extremely happy to hand it over to Sanjay. Sanjay is taking over from this quarter and he joins us from Mahindra Satyam where he was Head of the South Asia. Sanjay, I believe is a great choice and I am sure that he will be able to take this business to greater heights with his entrepreneurial skills. With that said I will hand it over to Sanjay to walk you through the Asia Business Unit.

Sanjay Venkatraman

Thank you, Chandra and Hi, everybody. Let me start by giving a very quick brief through of Asia business unit per se. Currently our business is primarily domestic, most of our clients are located in India and we do a bit of work for customers in Sri Lanka. Today, this is a primarily a domestic unit, most of our clients tend to be within the Indian subcontinent and the primary delivery location also continues to be India. We account for something like 11% of the overall organization's revenues. A shade under 11,000 associates. We probably are the largest unit in terms of seat capacity, we have something like 8,500 seats as part of the Asia business unit. Of which we filled about 73% last quarter, so that is just a quick view of the unit per se.

Moving on to the industry trends, we are actually seeing a few themes being played out in our part of the world. One is we are beginning to see a lot of activity and interest in the Middle East and African regions. Number of clients are now embracing the idea of outsourcing. We are also seeing a number of major BPO players now beginning to invest significant time, money and resources into this part of the world. So that is the theme we see continuing. We see Africa and Middle East beginning to emerge and contribute tremendously to the outsourcing boom in the coming few months.

Secondly, within India we are also beginning to see a big theme being played out in rural BPOs. While admittedly, it is a very, very small segment of the delivery market today, I think it is just about 4,000-5,000 people who form part of this industry. We are beginning to see that this is again something that is poised for explosion and over the next five years we think rural BPO, especially in quality of work like back office work and data entry, will start to explore. So that is the second big thing which we are beginning to see.

The third obviously is that the Indian domestic market continues to offer tremendous opportunity across segments, whether it is telecom or BFSI, I think we are seeing tremendous opportunity and traction within the Indian geography and we believe we are well placed there given that we have experience of delivering in this part of the world now for a few years. We are also seeing some stability returning to the telecom sector. From our point of view, volumes are beginning to stabilize from telecom. We think this sector again will continue to stabilize over this quarter and the course of the next and will actually fuel growth once again when new value-added services, mobile number portability and the launch of 3G actually take place. So that's as far as industry trends go.

Moving on to the business outlook, BFSI is a theme which you will hear from us a lot going forward. It is a conscious decision to invest a lot of effort in to this part of the market and we believe that the deal we have won from Axis Bank gives us a fantastic beach head to address this market opportunity. So, BFSI again is a huge market within the country and in the region and we believe that Axis offers us a perfect opportunity to participate in that market.

With the existing customers in the telecom space, we have seen a number of new opportunities, number of new services, which our existing clients wants us to deliver and that is another opportunity we see continuing in the coming quarter. And as I mentioned before we do believe that all the new developments within the telecom industry in terms of MNP and 3G will offer opportunities for players like Firstsource to participate in offering services to our clients.

Just to wind it up, we just want to reiterate that driven by the very, very strong operational efficiencies and programs which were kicked off by Chandra, the business is cash positive today and we fully expect to be completely operating EBIT positive in Q4. Thank you.

Matthew Vallance Thank you, Chandra and Sanjay. If I just turn to Slide 15, I will quickly cover off what we see has been the business outlook to the second half of the year. Overall, as we look at the second half, we will see growth in revenues, we will see improved margins when compared to the first half of the year, but as I said the magnitude of the growth is somewhat impacted due to the factors that Santanu, who talked around in terms of the delays and deferrals in the ramp ups in the telecommunication sector. Some offset by faster than expected growth in BFSI. In Q3 we expect to see modest growth in terms of revenue and the growth will come around largely on account of the Barclaycard contract which will start during the quarter and ramp-ups in the healthcare provider business, we expect some pressures on our operating margins as traditionally it is a seasonally weak quarter for us Q3, and have some seasonal effects as well as some cost of the ramp ups of the new contract. Q4 we expect to see strong performance both in terms of the revenues and the profitability. We do normally see a strong Q4 in our collections business, we expect that to also play out in the current year, we have ramps in the pipeline in the healthcare provider business in other parts of our BFSI business. And also on the profitability line the assisted by the return of the operating EBIT breakeven at the Asia business unit. That concludes the presentation. I will turn it back to Mahesh to moderate the Q&A session.

Mahesh Thanks, Matt. Melissa, we can open the call for Q&A.

Moderator Thank you. Ladies and gentlemen we will now begin the question and answer session. The first question is from the line of Mitali Ghosh from Bank of America. Please go ahead.

Kunal Tayal Just in terms of the delays in the pipeline, could you talk a little more about the reasons of the delay and any feelers as to when we should normalize again? And secondly, if you could also talk a little bit about what is your late stage pipeline look like currently? Thanks.

Matthew Vallance Sure. Of course. In terms of the overall pipeline at a company level, it is looking robust and despite the fact that some business streams have come out of the pipe line because we have actually converted them into wins. The pipeline remains at the level of the previous quarter so the pipeline is fairly up as per the current quarter and continues to grow at a company level. And you refer to the delays in ramps, that relates to our telecoms business and we had expected to see more growth come through from some existing clients primarily and that was on account of vendor consolidation programs they had in progress. It looks like those decisions have got deferred. We see as a deferment is more of a timing issue. We expect that growth to come through in the later stage. As far as the telecom pipeline is concerned, as Santanu mentioned, we see the telecoms pipeline is one which is expanded over the last quarter so we see a robust pipeline with some solid opportunities in that which then we hope will conclude join the rest of this fiscal and give us growth in the next fiscal.

Kunal Tayal Sure. Just any incremental sense as to when these decisions or when the cycle should normalize again?

Matthew Vallance It is little hard to say but we see the deferment by maybe a couple of quarters, we do not see anything has been more significant than that.

Kunal Tayal Sure, thanks.

Moderator Thank you. The next question is from the line of Bikram Mahajan from Bay Capital. Please go ahead.

Bikram Mahajan Thank you. My first question is addressed to Tom. What impact would the upcoming inclusion of the class program, will this have an impact on revenues from the player or provider side, especially when class will be the primary payer for individuals who are also eligible for Medicaid?

Tom Watters Is this the question about mid-term elections and any impact that we see on market opportunity?

Bikram Mahajan That is right.

Tom Watters Okay. There has been obviously from a poll perspective some decrease in sentiment by the US population as a result as it relates to our healthcare reform and of course republicans are expecting to gain some ground in the elections as a result of that and of course, the continued higher unemployment rate. We do not believe that traction will result in gaining a majority in both Houses. Of course, the President will retain his veto authority. So, with healthcare reform being the primary initiative of his administration, we do not see any significant changes in market opportunities as a result of the upcoming mid-term elections in November.

Bikram Mahajan In the wake of these reforms are we witnessing consolidation within the payers and providers and how well are we positioned to benefit from such a trend?

Tom Watters We are seeing a consolidation on both the provider side and the payer side and of course that bodes well for both segments of our business. As payers consolidate of course there will be the need to integrate systems which is a strong capability of our payer segments as providers do the same thing. There will be increased opportunities for cleaning up what we call run out accounts receivable that were on the old systems. So in both of those consolidation initiatives we see that as very good for our business moving forward.

Bikram Mahajan My next question is to Sanjay. You spoke about tremendous potential for growth in various geographies and you have recently bagged Axis Bank deal, so have you revised the internal expected timeline when ABU will be breaking even.

Sanjay Venkataraman While, it is true that there is a lot of traction in the BFSI segment. I think our breakeven point for ABU continues to be next quarter which is Q4.

Bikram Mahajan All right. Thanks and my next question is on Pipal research. What was the strategic rationale for this exit? When the KPO industry is flourishing both in terms of growth prospects as well as higher margins or is it part of the broader strategy where you have identified certain non-core businesses which you wish to divest? And will we witness most of the divestments or anything else you have identified as non-core?

Matthew Vallance Pipal divestments, of course as we were not a wholly-owned business, so it is in some sense standalone entity, we had a majority holding in. And as it is quite a different business model to the rest of the organization and very little synergy in terms of operating synergy, in terms of distribution, in terms of sales, the sales model and the sales force, very little synergy that is possible on that front. And we thought it was more important for us to focus on our core outsourcing of that activities rather than to be distracted in the KPO space, in particular, in the area where the expertise which is market research. The decision makers are very different. Sales teams are very different. The types of contracts are very different and being that there is no synergy on the operating front as well result and the fact that majority of our holder in the sense we thought it was appropriate and what we thought was an attractive valuation to exit the investment. And we have a situation where we have, relative to high amount of leverage as an organization and we have to take the cash into the business, to increase the cash reserves.

Bikram Mahajan Okay. And my last question is on attrition. There has been a shift in the utilization levels from 80% in FY10 to 75% in the first half of FY11, is that a conscious decision in the wake of attrition continuing to remain high?

Matthew Vallance I think you have been referring to seat utilization when you talk about 75% and that is the number of the percentage of our active seats that we are currently using for productive work, which does not lead to anyway to attrition.

Bikram Mahajan All right. So, in attrition what has been the broad trend across levels, is it a secular trend across several executive as well as associate levels or ….?

Matthew Vallance The attrition is primarily at the associate level. At a managerial level, attrition is relatively low. The attrition is primarily at the associate level.

Bikram Mahajan What recent initiatives have you taken to arrest these levels?

Matthew Vallance We have many initiatives and as mentioned earlier it is something that we take extremely seriously and our Head of HR, Aashu Calapa, summarize, will respond to your question.

Aashu Calapa Yeah, I took this question last time also and I did mention in the last analyst meeting that this is something that we are very focused on and this is something that we take very seriously and having said that I said this is something that will not get solved in the short-term, this is something which will take some time to fix, but we are very focused on sort of solving this problem. I had also mentioned last time that in addition to all the internal efforts that we are making to solve this problem, we will also seek external help and we have gone ahead and appointed a consultant to look at some of our retention practices and see whether there needs to be some change or improvement in them. I think there is a whole lot of initiatives which have been started to bring down the attrition levels, we are doing some best practice sharing programs that have low attrition, we have tweaked the compensation structure to be more competitive in the marketplace, we have created a privilege program for better performing associates, there are a lot of Six Sigma projects around reducing the pain points for employees, especially in the first 90 days and the first 180 days, we are doing a lot of focus on training programs for first time supervisors. So there is a whole lot of stuff that we are doing and I think this is the problem that we will take but it is going to take us some time to sort of bring attrition down to levels that we think are manageable.

Bikram Mahajan Sure, thank you so much.

Moderator Thank you. The next question is from the line of Srivathsan Ramachandran from Spark Capital. Please go ahead.

Srivathsan Hi, Matt, just wanted to get an update on the guidance that you gave initially at the beginning of the year we had talked about Y-o-Y constant currency growth being better than FY10. With the Barclays deal in would you think of kind of looking at a higher rate?

Matthew Vallance Well, as I mentioned, the current outlook is that the growth is somewhat slower than we had expected at the beginning of the year. However, H2 will show a solid growth over H1. But that will be somewhat slower than we initially anticipated at the start of the year.

Srivathsan Okay. Just wanted to understand on the healthcare almost for six to seven quarters in a row, we have been flat on absolute basis for about seven quarters. What is really driving this kind of almost zero revenue growth? Is it more lack of deal signing/ramp-ups that is happening or clients not making decisions, just wanted to understand what is driving this almost muted growth for almost six to seven quarters now?

Matthew Vallance We have seen over the last few quarters if you look back a few quarters, we had seen a period where our payer business was suffering and on account of the economic downturn in the US, we have also restructured that payer business. We also brought in new sales organization and brought in a new operational team as well. So, we made some restructuring changes that payer business we saw our revenues falling in that segment if you look back a few quarters. However, we are now seeing that business picking up again and it is now expanding on the back of both new client wins and secured client growth and it is also the operational metrics in terms of the quality of the delivery has improved dramatically. So, we see that business coming back, but over the last few quarters overall healthcare growth rate slowed down, the provider business has been growing at a steady pace. Tom would like to elaborate any of that?

Tom Watters Yeah, Matt, I think when we entered fiscal 2011, we were suffering from some cost compression in the previous years that we knew would flow through current fiscal obviously we have had some churn in the payer business that is largely gone and we are growing that business. So, we knew about some of these factors going into FY11 and I think what you are seeing is a result of those economic conditions that were impacting primarily the US with the unemployment rates impacting some of the payer volumes, but we do see that being normalized going forward in FY12.

Matthew Vallance The other thing you might see also in the most recent quarter, the effective currency movement, when we are looking at the rupee number, we see that relatively at least the pound is strengthening against rupee more than the dollar has.

Srivathsan Okay. And third question just wanted to understand one of our top clients in India has gone out and handed out substantial BPO contract for African market and we have not among the winners. So just wanted to know if you are in the race, just wanted to understand what led us not to be on the winning side, is it because we did not have any existing factors, just wanted to understand that?

Matthew Vallance We are not in a position where we want to comment on individual clients or prospects specially when they are not in the public domain. So it is not reasonable for us to comment.

Srivathsan Sure, thanks a lot.

Moderator Thank you. The next question is from the line of Shradha Agarwal from B&K Securities. Please go ahead.

Shradha Agarwal question is more on your expectation as to what the company could clock as growth rate in FY12. Considering that we would have ramp-ups in Barclays and Axis account and there would also be some action happening on healthcare reform front. So directionally, if you could give us some sense as to what kind of a growth number do you think the company would be in a position to clock?

Matthew Vallance We are certainly not in a position to give guidance on FY12 at this point in time. But we certainly expect to see the growth in FY12 to be better than the current fiscal year.

Shradha Agarwal Right. Current fiscal year it was kind of flattish if I look compared to FY10, so I mean we are talking about really robust growth coming in for larger IT services, peers in both FY11 and 12. So any sense as to whether the growth will be below 15%, I mean any sense as to which sub-segment among the three key sub-segments would drive growth and which sub-segment are you the most bullish on?

Matthew Vallance The business is not flat and the year-on-year growth in the first half is about 6% and as I said we are expecting second half of the year to show strong growth in comparison to the first half of the year. FY12, I would expect to show growth in excess of the current fiscal year growth rate.

Shradha Agarwal Right. And any outlook on margins given that ABU will breakeven in fourth quarter? And with seat utilization at 75%, there is a scope of betterment on seat utilization. So what would you be giving a direction on margins?

Matthew Vallance Without specifying the details, we do see over time our margins continuing to expand.

Shradha Agarwal Right. And lastly on tax rate, what should we be the assuming for taxes in FY12?

Dinesh Jain I think the current year we are talking around 18 to 20%. I am sure, the way the growth are going to look and ABU coming into picture I think the tax rate will be slightly higher than what they are presently.

Shradha Agarwal Right. Thank you. That is it from me.

Moderator Thank you. The next question is from the line of Deepa Salvi from Anvil Shares & Stock Broking. Please go ahead.

Deepa Salvi I have just one question on telecom vertical. You mentioned about Dell coming in on the back of 3G and MNP implementation. I would just like to know the nature of the deals and the size if you can?

Matthew Vallance This is in relation to our Asia business unit perhaps. We are seeing growth through the sale of 3G spectrum in India, perhaps is that the question, and mobile number portability as well.

Sanjay Venkataraman I think what we are indicating there is that a number of these new developments within the telecom industry we believe will open up opportunities for us. We are in discussions but no specific details in terms of specific opportunities or clients.

Deepa Salvi Okay. Nothing else like now open about what kind of deals or size could be?

Matthew Vallance The point is that while there has clearly been volume reductions in the Indian domestic telecom area that these new technologies in particular 3G spectrum will lead to more activity on the class of our clients which is rolling out new products and services and that would drive volumes, we believe we will be able to benefit from that, especially our clients, the companies that we work for will be big players in the Indian 3G market.

Deepa Salvi I just wanted to know what would be the nature of the services like if at all this roll out happens then in which manner Firstsource will take part in the services, what would be the nature?

Matthew Vallance Primarily, we are talking about customer life cycle management services across the full spectrum, life cycle management from service, sales, provisioning, technical support, collections across the multiple channels. So it is full spectrum interaction management services is what we expect to be selling in the environment.

Deepa Salvi Okay. Thanks. That is it from me.

Moderator Thank you. The next question is from the line of Biplab Chakraborty from B&K Securities. Please go ahead.

Biplab Chakraborty Sir, this is related to, any possible salary hikes that we plan to give in the future, given that the attrition still remains higher?

Matthew Vallance We review our pay scale and pay increases on an annual basis and we look at a number of factors in determining what increase we give in terms of the local economy, inflation and the benchmark wage rates and number of other factors, And clearly, we have in mind our attrition objectives as we do that we do not think that the correlation between pay and attrition is necessarily the strongest factor and as I mentioned, we do pay increase on an annual basis, for associate population those increments happen in Q1 of the fiscal year. So there will be nothing happening in the current fiscal year. Our managerial increases take place in Q3 in the next quarter.

Biplab Chakraborty Sure, that is helpful, Sir. In terms of hiring plans, we saw an uptick this quarter, do you think that will be sustained over the remainder of the fiscal?

Matthew Vallance In terms of the numbers of hiring?

Biplab Chakraborty Yeah.

Matthew Vallance We will continue to add headcount and I suspect it will be higher in the subsequent quarters.

Biplab Chakraborty Thanks and my last question was in terms of your other operating income. If you could throw some light on that?

Matthew Vallance I will let Carl Saldanha, our Global CFO comment on that.

Carl Saldanha The other operating income really refers to the hedges that we have on our offshore income. Basically, if you look at our other operating income for the quarter it shows 13.5 Crores for the last quarter which is basically the difference between the rate at which we hedge the currency and the actual spot rate at that point in time. So, this particular quarter, we have hedged our Sterling at round about 78 to 79, the actual spot rate was a gain at about Rs. 8 on every Pound, that is what it is.

Biplab Chakraborty Sure. Thanks for the answers and good luck for the remainder of the fiscal. Thank you.

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

Dinesh Kumar Actually I have a couple of queries. First one is in this quarter the telecom contributed a bit more compared to BFSI and healthcare. Can you throw some light on whether this income is come from Indian operations or UK?

Matthew Vallance The number you see in that we are going to check this in terms of number you are looking at, but I believe that is including all of our telecoms – sorry, this is purely telecoms and media segment, is the international business what we do for our overseas clients in telecoms and media.

Dinesh Kumar So it is purely from UK, right?

Matthew Vallance And also from USA as well. We have a telecom business in the US as well. Also Australia as well.

Dinesh Kumar Okay. Going forward, which sector do you think that will drive the growth, in the second half apart from this Barclays and Axis Bank deal?

Matthew Vallance In terms of which sector?

Dinesh Kumar Yeah.

Matthew Vallance Actually, BFSI segment has been the segment that is providing the strongest growth at this point in time.

Dinesh Kumar How much run rate do you see because of this Barclays and Axis Bank which will add more compared to your current year. Any internal estimates which is much of additions will come from….

Matthew Vallance Okay. Your question is how much will the Barclays and Axis Bank deals provide in terms of the additional top line. We are not able to talk about the specifics I am afraid.

Dinesh Kumar Okay. Another thing is your employee cost is still on the higher side for the first half of this year, around 62%-63%. Are there any opportunities to drag it down to the previous levels of around 60 levels? Or else it is purely because of this once the ABU unit which comes to operating profit, will it have a positive impact on it?

Matthew Vallance Okay. So your question is around why our employee cost increased. It is primarily on account of the onshore salaries, the staff that we employ outside of India and the fact that there will be Forex movements, which is really the account for increase in salaries. I think that is the movement you are seeing there.

Dinesh Kumar Okay. Going forward, will it have the same kind of impact for this year as well as for the next year?

Matthew Vallance The constant movement in that direction, yes.

Dinesh Kumar Okay. That is it from my side. Thanks.

Moderator Thank you. As we have no further questions I would like to hand the floor back to Mr. Matthew Vallance for closing comments. Please go ahead sir.

Matthew Vallance Sure. Thank you for that. And I would just like to briefly conclude by reinforcing some of the points I made earlier which is that the course of Q2 has been a quarter of steady performance and we are seeing Q-o-Q growth in our top-line 503 Crores, we have seen growth of the operating EBIT line 5.2%, 49 Crores, we have seen quarter on quarter growth in our PAT line by 3.6% to 33 Crores. So, operating margins have improved by 30 basis points from quarter-to-quarter. And the significant thing which draws attention to, is the large strategic deals that we signed with blue chip brand names including Barclays Card and Axis Bank, both in the financial services segment and we are seeing a good build-up in the pipeline, so we are also seeing lengthening of sales cycles particularly in the telecoms area. So from a direction point of view we expect H2 second half of the year to show solid growth over the first half but we see has been somewhat slower than we had previously expected. So that is it from me. And I will hand back over to Mahesh to wrap it up.

Mahesh Pratap Singh Thanks, everyone. Thank you for joining us on the earnings call. If you have any further follow-on question you can give us a call on investor relations and we will be happy to discuss those in detail. Thank you so much and I will hand it back to moderator.

Moderator Thank you. 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.