Q4 FY2011 Earnings Call Transcript – April 28, 2011

CORPORATE PARTICIPANTS:

- Mr. Matthew Vallance– Managing Director and Chief Executive Officer
- 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
- Mr. Gaurav Bahadur, Executive Vice President – Human Resources
- Mr. Mahesh Pratap Singh – Head of Investor Relations

Firstsource Solutions Limited
Quarter Four Earnings Conference Call, Financial Year 2011
April 28, 2011

Moderator Ladies and gentlemen good day and welcome to the Firstsource Solutions Limited 4th Quarter and fiscal year ended 31st March, 2011 earnings conference call. As a reminder for the duration of this conference, all participant lines will be in the listen-only mode. 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. 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 4th quarter and year ended March 31st, 2011. Please note that results fact sheet and press release have been mailed across to you and is also available on our website www.firstsource.com. To take us through the results and to answer your questions we have with us today, Matthew Vallance, our Managing Director and CEO.

Matthew Vallance Hello everyone

Mahesh Pratap Singh Carl Saldanha, our Global CFO.

Carl Saldanha Good afternoon.

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

Tom Watters Good afternoon.

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

Santanu Nandi Hi, everyone.

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

Sanjeev Sinha Good afternoon.

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

Sanjay Venkataraman Hello.

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

Gaurav Bahadur Hello.

Mahesh Pratap Singh We will be starting this call with a brief presentation outlining the company's performance followed by a Q&A session. Please note that everything we say on this call which reflects any outlook to the future or which can be construed as forward-looking statement must be viewed in conjunction with the risk company faces. A detailed statement and explanation of these risks is available in our IPO prospectus and annual reports, which can be found on our website www.firstsource.com. Additionally IPO prospectus is also available on SEBI website www.sebi.gov.in. With that said, I would now turn the call over to Mathew Vallance, our Managing Director and CEO.

Mathew Vallance Thank you Mahesh. Welcome everyone to the call. I will talk you through the presentation assuming that you have the deck in front of you and talk you through the highlights of fiscal 2011 which closed and also talk you through to the highlights of the 4th Quarter. Taking you to the slide number four you will see first that fiscal 2011, we recorded a growth in our operating revenues of 4.3% in rupee terms and on a constant currency basis we showed a growth of 6.9% to Rs. 2055 crores and you will see that between the first half and the second half we showed some relatively robust growth of 8.2% growth from the first half to the second half of the year in constant currency terms. From the operating EBIT perspective we maintained our margins at the same levels of FY2010, 9.8% and generated some good cash flows during the course of the year. We actually doubled our cash position from USD 50 million to USD103 million, I think for us crossing the USD 100 million mark in the cash reserves is a positive trend for us and the business continues to generate cash and we expect it to do so moving into next year as well.

From a client perspective, it's relatively a stable year with most of our clients we haven't seen huge growth in the client base that we have seen in the previous years. We have seen a lot of our growth coming through from new business. We are pleased to sign up earlier in the year two large clients in the financial services in the banking sector, Barclaycard and Axis Bank and both of those clients have contributed to our business growth during the course of fiscal 2011.

In terms of our scale of operations we close the year with 26,413 staff having added nearly 1600 during the course of the year and we continue to build our global delivery model what we refer to as our right shoring model where we deliver services both, close to where our clients are and through remote locations as well. We continue to build that model and of about 1600 staff that we added during the course of the year there were 848 staff additions in India net and net 705 additions outside of India. Outside of India, in particular we expanded our UK operations by 500 people and we expanded in the Philippines by 300. We certainly see traction in the Philippines geography and we expect that to continue moving forward. We are in the process of expanding our operational capacity in the Philippines geography amongst other places.

The next slide, in terms of our progress in other areas, the fiscal year has been a year of change in transition in some sense. I took over the position of CEO at the end of July. We had a new chairman at that point, and had a number of changes in the top management of the company. We have had a new head of HR, Gaurav Bahadur, who joined and Prashant took over as CTO more recently. We also had a new head of Corporate Communications Smita Gaikwad. So it's been a year of change and we are pleased with the progress we have made in that context. It has also given us the opportunity to review the business and develop a clear direction for the future and developing sustainable economic values in the geographies of our clients and we have initiatives in place to make that happen, initiatives which I will not go in great detail about right now. But a clear focus on driving operating cost improvements across the business to a greater position of cost leadership. We will be investing more into our sales and marketing efforts with building up of cash through efficiencies. We believe we have a good visibility to improve our growth rates over the coming years. And in the context of a very large BPO market, we operate in the fundamentally attractive space in terms of verticals that we operate in, in terms of the service lines we have. Also, at the same time we need to develop sharp differentiators in the areas that we compete in, that is something we intend to focus on very strongly in the coming quarters.

We talked in the past about our Asia business unit and that is an organization where we essentially created a pretty large-scale outsourcing business within the Indian market primarily serving the Indian client base. We have over 10,000 staff in that unit something that we build from scratch organically over a period of 3 to 4 years. That sort of organic growth build up has not come without its growing pains. We reported sometime back here that we are cash breakeven in that unit and that we would become EBIT operating profit positive during the course of the year, we actually did achieve that milestone though during the course of Q4. That has certainly helped our profitability as well in the Q4 period. As I mentioned before, a strong focus on cash generation has been very important for us. Some charts here are illustrating how we built up our cash-base in Rupees over recent quarters. It has been a pretty healthy buildup. And at the same time we have reduced our gearing ratios and are strengthening our financial position by reducing our debt equity ratios.

Moving on to slide #6 we continue to be recognized not only by our clients, by the industry for our best practices in the areas of operations and the way we run the business. We were ranked by the great place to work institute in India as one of the top 50 companies to work for in India for the 2010 period. It is a very prestigious award for us to have received. We received an award from Outsourcing Center, for the way we dealt with Barclaycard in the U.S. and we continue to win numerous awards for our quality processes our process excellence and we won six awards from the IQPC during the course of the year. So it shows how the process excellence, six sigma, kaizen, and other process improvement techniques are becoming embedded in the DNA of our organization.

In terms of challenges, of course some challenges we faced during the period. Delays in decision-making in some of our clients, we saw that particularly in our telecommunications segment where we were expecting deal closure and some of the deal closures have got pushed out beyond the time frames that we had expected and this has led to slowness in the telecom and media business and we believe that will start picking up over the coming months. Certainly we had pressures in the Asia business unit at the start of the year. We accelerated our growth in the Asia business unit particularly during the second half of the year which positions us well running into financial 2012. And we have experienced high attrition particularly at the back end of the year. We saw an improvement in our attrition in Q3 and deterioration again in Q4. That is something that we remain very focused on in this organization.

Now I will move to slide #8. I will talk through the main points about the quarter just closed. Q4 if I were to say is the strongest financial performance in the recent history of the company. We had the highest sequential revenue growth and the highest operating EBIT margins for any quarter in the past eight quarters of the company. And we have reached the 100 million barrier in our cash reserves which is a significant milestone for the company and that puts up our cash reserves at an all time high. And in terms of growth figures for the quarter, year-on-year over Q4 of the previous fiscal, 7.8% year on year growth in rupee terms and 8.6% in constant currency terms. Similarly quarter-on-quarter growth 6.2% up in rupee terms and 6% up in constant currency terms over what we achieved in Q3 which was already relatively strong quarter on the back of a number of things including in Q3 we benefited from the income from disposal of our stake in Pipal Research. If we normalize our Q3 revenues for Pipal revenue contribution, Pipal had close to 2 months of revenue in Q3, then our Q-o-Q growth in Q4 is more like 7.8% and that was driven by a couple of factors really. One is as we may know we do see typically a boost to our business in Q4 and that comes due to our collection business where we do a lot of work in cards collections and that benefit from the tax refund season in the U.S. and it enhances our ability to collect the outstanding. So we saw decent performance in the collections business especially considering that seasonality has been a lot more muted than we normally see in most years. But we also do see some Q4 benefits and we did have this year in the Healthcare segment. Also significantly we saw the full quarter revenues from the deal we did with Barclaycard earlier in the year.

In terms of operating EBIT margins expanded by 90 basis points over Q3 and again that is due to the seasonality I just mentioned as well as the turnaround in the financial performance of our Asia Business Unit, both of those things contributed to buildup in our profit margin in Q4 as against Q3, partially offset by some lower gains on hedges and as the rupee is strengthened over the last year against the dollar and pound, our hedging rates are not quite beneficial they have been in previous quarters.

Moving on to Slide 9, employee strength, employee stood at 26,413 as I mentioned we have just under 20,000 staff based in India and just under 6,800 staff based outside of India. And in the quarter itself we had a net reduction of 255 staff and net addition of nearly 1,800 in the previous quarter and a net reduction in Q4 in the corresponding quarter of last year which is due to some downsizing, particularly in our Asia Business Unit at that time.

Our attrition numbers that we are reporting in Q4 show deterioration in attrition from 55% annualized to 66%. Just wanted to make sure everyone is clear that these figures essentially are our Q4 attrition annualized for one year, so these are not quarterly figures, these are annual figures based on the performance during the quarter itself. Our offshore attrition which is the work we do in India and the Philippines for our UK and US clients in particular, Australian clients that attrition is up in the quarter. Our onshore attrition has come down slightly again. So, that continued to show positive trend. And our domestic attrition in the operations we run in India for our Indian clients have been improved quite substantially in the previous quarter, have actually declined again from 77% to 91%. And attrition is something that we see as an industry problem, it is not just our problem, it is certainly is our problem, it’s not just our problem. It’s an industry issue and we are working on a number of different fronts to bring our attrition levels down over the time. It is something that hurts us from a financial perspective in the sense that there is a lot of cost associated with rehiring, backfilling of staff and also we believe that if we have less attrition, our quality of output can be improved as well. So it is something that we are very conscious of improving.

If we move on to Slide 10, seat capacity at the end of the quarter stood at 22,681, that is a number of workstations we have worldwide. We added just under 1,600 during the quarter and this is really due to some amount of capacity additions in areas in parts of the world where we had run short of capacity. There is also a degree of restructuring of our operations in India where we are opening up two large sites which will serve our needs for the future in Mumbai and Bangalore in particular.

And we have 42 delivery centers as of the end of the quarter compared to 41 with adding one center in Chennai and due to the capacity that is why we have added, seat fill factor at end of March is 71% so that has shown a decline over the previous quarter which is at 75% and a decline where we started the year as well further decline. So we have an additional capacity that we have added and we believe that will allow us to expand as we move into the fiscal ’12.

And in terms of foreign exchange I mentioned just briefly on foreign exchange earlier, we hedge our exposures where we have cross currency, where we have particularly our costs in rupees and where our revenues are in pounds sterling or dollars that we tend to hedge the bulk of those exposures, so our margins are protected and for fiscal ‘12 we have 60% of our dollar revenues in the area covered at the levels of Rs. 48 to the dollar and 85% of the pound revenues covered at the levels of Rs. 75 to the pound.

The next slide is in terms of our mix of business. A few things to point out here is that in terms of our geographical mix, and this essentially means that the geographies where we derive our revenues from as opposed to geographies where our deliveries done from. So the geographies where we derive our revenues from, you have seen a sizeable increase from corresponding quarter last year, our UK mix of revenues has moved from 27% to 33%. And our US mix of business has moved from 61% to 55% and some client additions, client growth and acquisition of new clients including the Barclays contract contribute to the shift in the mix. Similarly, you will see a shift in the mix by verticals as well. So whereas BFSI was previously contributing towards 24% of our revenues is now 31%, telecoms and media have moved down from 38% to 34%. And pretty even mix of business between our three verticals now.

In terms of delivery locations, our onshore revenues have continued to grow. They have grown from 61% to 65% of our revenues. And our offshore revenues have reduced from 28% to 24% in terms of our overall revenues.

And the other thing you see, is the increase in client concentration of our top five clients now account for 38% of our revenues as against 31% of our revenues previously, which I think by industry standards is not excessively high concentration but fairly you would obviously want to reduce that level of concentration over the long-term. So that concludes the opening section of the presentation. I am going to hand over to our CFO, Carl Saldanha, who is going to talk you through the financial results from Slide 13.

Carl Saldanha Thank you, Matt. We closed the year 2011 at a turnover of 2055 crores, an increase from 1970 crores, an increase of 4.3% as I mentioned earlier. In this period the rupee actually strengthened. It went from 47.7 in terms of realization to 45.9 and therefore in terms of constant currency we actually grew by 6.9%, slightly better than the absolute amount of rupee.

Other operating income went up from 16.9 crores to 44.3 crores. Quite a big increase and that is why because of what we mentioned we hedged our positions a year out and we benefited from the strengthening of the rupee.

Personnel and operating expenses went up from 1690 crores to 1765 crores, a growth of 4.4%, slightly higher than the revenue growth and therefore EBITDA went down from 14.2% to 14.1%. In absolute amount it went up from 280 crores to almost 290 crores.

Operating EBIT went up from 193 crores for the year to 200 crores for the year. In terms of margins we remain constant at 9.8%.

Looking below the EBIT lines, some of the major items here are interest income. Interest income actually came down from 22.9 to 20.8 which represents the net interest income. Actual interest expense is basically constant because of our cash generation as we talked about, we are in good income on that and therefore our net interest income continues to go down, this will continue as we go forward.

The gain/loss on exchanges vary because we write-off on the option part of our FCCB and we do that regularly every quarter for that facility on regular account

Extraordinary expenses this year is 6.4 crores. This is basically because we closed one of our centers and we had to charge off certain expenses.

Net-net, profit before tax went up from 160 crores to 175 crores. Taxes went up from 24.2 crores to 36.8 crores. This is really because one of our centers in India came out of the STPI benefit, and also primarily because we earned more money in the US and some of our UK business. However, it is still only about 18% of our profit before tax. Profit after tax went up from 136 crores to 139 crores.

Moving on to the next page, which is the quarterly performance. As we mentioned earlier, we had a very good quarter. Our total turnover went up from 514 crores last quarter to 546 crores, an increase of 6.2% in terms of rupee terms. In these two quarters the rupee actually weakened. It went from 45.3 to 45.9, therefore the absolute constant currency was 6%.

In terms of operating EBITDA we went up from 13.8% to 14.5% and in terms of EBIT we went up from 47.9 crore to 55.9 crore. This is our best EBIT margin that we have got 10.2% is the best margin we have had for quite a long time. So really it is a pretty good performance.

Moving below the EBIT line, interest income as I mentioned, you can see the continuous decline, largely because of the continued gathering of deposits.

Profit before tax went up from 44 crores last quarter to 49 crores and profit after tax from 35 crores to 38.3 crores. Overall, as you might agree it has been a very good performance and as a result of which we have grown our cash balance by nearly 100 crores just in this last quarter.

The next section I will hand you to Tom to take you through the Healthcare.

Tom Watters Thank you, Carl. Hello, again, everyone. And for the quarter Healthcare delivered 34% of total company's revenues with just under 2,900 employees with a capacity of 3,290 seats and a seat fill factor of 70%. And we delivered healthcare services both in India as well as the United States.

In terms of industry trends, Medicaid programs are a major focus for states as they look for ways to reduce costs associated with unemployment and the corresponding increases in Medicaid enrolment. We believe that this will bode well for the payer segment of the vertical, as we continue to develop new solutions both internally, as well as through several existing partnerships.

Hospital consolidation has continued to gain momentum and we believe that these significant increases in M&A activity between hospitals and health systems will drive increased opportunities for our receivables management solutions for providers.

Bond ratings have begun to stabilize, as hospitals continue their move towards pre-recession ability levels and as a result of further moves towards consolidation in the marketplace.

Payers have been bolstered by strong margins. They are investing heavily in both short and long-term cost strategies as the healthcare reform mandates are implemented throughout the next few years.

Moving on over to the outlook for business – Unemployment levels remain high at just under 9% but they continue a slow downward trend from their peak last year. Private sector jobs are largely driving the decrease and we are particularly encouraged that the healthcare sector has added significantly more jobs last month than its average over the past 12 months. And we believe that this reinforces the early signs of financial recovery that is being exhibited by the hospital industry.

Payers continue to focus heavily on administrative cost reductions, which we have seen significant evidence of our closed contracts and pipeline growth over the past two quarters. Opportunities continue to remain strong within the provider marketplace as well as hospitals feel the impact of reimbursement pressures that have been associated with reform implementation and course on the heels of distraction around implementing electronic health records which must be in place by 2014.

Federal stimulus monies have bolstered State Medicaid programs that are due to expire in June of this year. This is going to cause states to look for new and creative ways to manage the utilization and costs and we believe that this will drive opportunities for both segments of the healthcare vertical.

In summary, the outlook for healthcare remains positive with modest growth and stable financial performance for the coming year. And at this point I will turn it over to Santanu for Telecom and Media.

Santanu Nandi

Thanks, Tom. Hello, everyone. As you know in telecom and media, we cater to four distinct segments of cable and satellite television, wireless mobile, the ISP market and the fixed line market. And we service the market geographies of US, UK and Australia, out of our delivery centers located in India, UK, and Philippines. We contributed about 24% to the overall revenue of the company and with the capacity of about 5,400 seats and utilization of about 67%.

In terms of the major trends that you see in the industry we find that there is an uplift in terms of business interest among the UK clients for delivery out of Philippines and this trend definitely augurs well for us because it gives growth opportunities for us with our existing operations in Philippines.

We also find that the connected home which is essentially an integration of entertainment, home control, security system, etc., and various other applications is picking up among the US telecom providers. And again this offers us good opportunity for complex technical support to our existing and new clients. It is again a good growth opportunity.

Driven by the competition that some of the new products like FiOS and U-Verse has introduced in the US market. The cable companies that are driving innovation and are working towards transforming customer experience and that is expected to improve the outlook for demand for customer support and technical support in the cable industry, so again, a good opportunity there.

In terms of the ISP market we are finding that there is a slower growth in that particular segment as a new customer addition is slower than what it was earlier. However, we will find there is a significant investment being committed by the various industry players in terms of the next generation networks. So this market we expect certain softness in the volumes in the near future. However, in the longer run, the opportunity remains very bright as you will see addition of new consumers from the next generation network.

Companies are obviously constantly evaluating various alternatives to the operational models and this obviously poses its set of challenges as well as the opportunities. In one such instance, one of our existing clients has decided to pursue a captive strategy and will be ramping down with us over the next two quarters. So obviously this will have an impact but we have managed to identify clients to redeploy these trained resources so thereby effectively mitigating it to a fair extent.

One of the other trends in the industry is that customer retention is becoming an imperative and companies are looking for partners who can help them achieve the objective of delivering better customer experience and thereby fostering retention. And we feel that we are very well-positioned on the basis of our track record of high quality service in terms of benefiting from this particular trend and we are engaged in several discussions with potential clients and we hope to benefit from this particular trend.

So overall, while there are a few near-term challenges, we do have very strong pipeline and we expect significant conversion in the near future. With that I will hand you over to Sanjeev Sinha.

Sanjeev Sinha Thanks, Santanu and hi, everyone. BFSI vertical at Firstsource as you know, services clients in credit cards, retail banking, general and life insurance and in mortgages. Our markets are in the US and UK and we deliver to our clients from India, Philippines, UK, and the US. This quarter we contributed 31% to the revenue of Firstsource, we are just over 5,000 employees working out of 4,200 seats with a seat fill factor of 72%.

When I look at the industry trends, we see that there is interest in outsourcing with international organizations in the US and UK and this is a growing trend. The need for low cost operations in both the processing and customer management space is making financial services companies explore new geographies for voice operations. So we see Manila being fairly high on the agenda for our existing and prospective clients as well.

Housing market is still muted. There is an interest rate rise which is expected as tighter regulation. In both of our markets, in the US as well as in UK, home values and new mortgages are poised to further fall this year. There is a trend of rising foreclosures and the expiration of homebuyer tax credits in the US. So this is the one segment in the financial services market where we still see a lot of softness.

Many organizations in the BFSI space are focusing on strategic alignments looking at customer satisfaction, focusing on building capability, so it is no longer just focusing on cost saving but a very integrated look at how to address customer needs.

The outlook for the BFSI sector across various segments that we serve in is fairly positive. We see activity picking up in the UK financial services sector especially in the retail banking. And given our strong UK retail banking footprint, Firstsource is getting a place at the table for the outsourcing discussions. Sales cycles are long and therefore we do expect deal closure to take time.

With the interest rates expected to rise in the UK, we expect that there would be demand for remortgaging as consumers try to move towards fixed rates. So that is the one area on the mortgage side of the business where some growth in business is possible.

Collections, is seeing a few countervailing trends. So business liquidation rates continue to move up even though volumes are contracting steeply. Charge-off rates as well are expected to hit historic lows by the end of this year.

Along with this we are also seeing increased pressure on commission rates in collections. However, we have been able to operate at a fairly high degree of efficiency over the course of the year and we believe that we will continue to gain market share on the back of strong operational performance. So the outlook for the vertical as a whole looks good.

With that, I will end the BFSI portion of the presentation. And I will hand you over to Sanjay Venkataraman.

Sanjay Venkataraman Thanks, Sanjeev, and good afternoon. As you are all aware the Asia Business Unit basically serves two major verticals in the domestic space; Telecom and

Media and BFSI. We contribute about 11% of Firstsource's overall revenues and we do that with a shade under 12,000 employees and about 9,500 seats.

In terms of industry's strength I think last quarter we did see growth come back into the Telecom sector fueled for the short-term by mobile number portability which was launched, and also to a large extent driven by 3G which is increasingly being adopted across the country, and we are beginning to see this reflect in some of the volumes which are being delivered to us. We are also seeing enhanced activity in the BFSI sector. We believe that, that sector is now embracing the efficiencies and advantages with outsourcing can bring to the table and we are seeing a number of opportunities emerging in the BFSI segment

In terms of growth within delivery locations we are also seeing that there is sustained growth in the Tier II and Tier III cities in India as organizations like us expand the catchment area of talent pools and to continue to drive operational efficiencies.

In terms of business outlook, the business unit did breakeven as we exited Q4 which was a significant milestone for the unit. The domestic market continues to show tremendous growth. I think the forecast for the market is to grow from a shade over 1 billion last year to a shade under 2.5 billion in 2014. So there is explosive growth happening in the domestic market and given our early mover advantage and the number of years we have spent learning the ropes in this market we believe that we are very well positioned to take advantage of opportunities presented to us.

Specifically in terms of the telecom industry which we serve, we see a lot of opportunities emerging around 3G and data services. We think this will be the way forward in the future and we are making appropriate investments to make sure that we are positioned to address this opportunity.

And in terms of growth we have also started exploring some amount of expansion into non-India geographies to make this truly an Asia business unit rather than the domestic unit which it is now. So overall we believe the outlook is very positive for the unit both in revenue and EBIT terms. Thank you and Mahesh, I will hand it back to you.

Mahesh Pratap Singh Thanks. I will hand it back to Matt to sum it up and then open it up to Q&A.

Matthew Vallance Sure, thanks, Mahesh. It has been a positive conclusion to the year Q4. If you turn to Slide #20, you can just see how FY12 is shaping up. We do expect the momentum that we built up in the BFSI segments to continue. Good traction there with some existing customers and we expect our momentum in the collection segment to continue where we believe we have a good value proposition and in the context of a market which is not necessarily expanding we are seeing that with our onshore/offshore model and our capabilities we are able to take market share and we expect to continue to do that with some key clients we have in our business.

We expect to see continued and accelerated growth in fact in the Asia Business Unit. As I mentioned we have seen a pickup in business in Q3, Q4 in that segment and we expect that to continue throughout FY12, so we are going to FY12 with some strong amount of momentum. The Indian Telecom market where we do the bulk of our work returned to great stability and that certainly is helping with our volumes in that segment and good traction in terms of building up that pipeline. And also, we expect margin improvements to continue in the Asia Business Unit. We did cross the operating EBIT breakeven mark in ABU; we expect to see more of that through fiscal 12. We expect to see further strengthen in the pipeline in the Telecoms and Media business and we expect to see some amount of deal closures start to happen there. On the negative side, we do have some currency headwinds. We have seen a strengthening of the rupee against the pound, particularly, against the dollar in recent weeks as well. I think generally we expect that trend to continue. And the hedging rates where we benefited as you know, we did quite well from beneficial hedging that we had done during FY11, the benefits we get from our hedging as we move into the current year will be less than what we have seen historically. And we have some near-term challenges in our Telecoms and Media business unit with low volumes that Santanu had talked about, as well as the ramp down that we are experiencing with one of our customers there. So we have some near term challenges but within that segment although as I said the pipeline is looking solid and we expect some deal conversion there over the coming months.

For FY12, at the company level, overall we expect higher revenue growth, we expect some amounts of improvements in operating margins. In Q1, in particular, we do expect a dip, we had a strong Q4 and some amount of seasonality in there and the seasonality falls off in both Collections and Healthcare business as well as the dip that we expect to see in the telecoms business due to the client ramp down. We do expect to sort of some amount of dip in Q1. Overall, for FY12 we expect the high growth and high profitability.

With that I will conclude. I will hand over to the moderator who can take questions if anyone wants to ask us any question.

Moderator Thank you. Ladies and gentlemen, we will now begin with the question-and-answer session. We have the first question from the line of Srivathsan Ramachandran from Spark Capital. Please go ahead.

Srivathsan I just wanted to get Matt's comments on two things. One, how is the pipeline within existing client shaping up in terms of the level of activity and extent of which conversations are happening? And second on new logos, are there any big new logos that are in pipeline that could potentially be very useful for us?

Matthew Vallance Okay. I think we are seeing a good pipeline across the business across all our different segments and that could change the mix of both existing clients and new logos. I think if you look at the year just gone, we benefited from large amounts of growth from new logos which was perhaps a little uncharacteristic specifically if we go back further years. I would expect in the coming years, growth to be coming from existing clients. We are seeing good existing client pipeline and of course we do have some new logos in the pipeline as well.

Srivathsan Okay. And in terms of the operating margin scenario you have seen, healthcare was expected to contribute to the margin expansion in FY11, how would you look at it on a FY11 basis and what kind of improvements you see in FY12 especially in Healthcare business?

Matthew Vallance You are talking about FY12 in terms of what improvements we are expecting, we expect us to see improvements in operating margins particularly in the Asia Business Unit on a year-on-year basis we see operating margin improvement there. We will see margin improvements to some degree as well in financial services and we will continue to get some incremental improvements in healthcare and telecoms and media as well.

Srivathsan How would you characterize pricing at this point of time? Because you have seen a lot of at least the IT or IT related players getting a decent pricing uptick on some of your services, how is it in the BPO space at this point of time? Do you see any of the existing clients even thinking of increasing their pricing maybe a percentage, two per cent? I just wanted to know what your commentary is on pricing from existing clients or at least pricing from the new deals.

Matthew Vallance The BPO market is certainly a competitive market space. In terms of the existing clients we did see a couple of years ago some amount of pricing pressure where our existing contracts were coming under pressure. I do not see any sustained pressure in that area. In some cases we do have the ability to increase our prices. Many of our larger contracts we have pricing indexation clauses, we have in some of our larger contracts where we have the ability to modify our pricing based on Forex rates as well. So we do have those kind of contractual protections in some of our contracts. In terms of the new contracts, as I said, it is a competitive marketplace but again, I do not think that we are seeing anything unusual in terms in order that amounts pressure on pricing.

Srivathsan Carl, it would be great if you can just run us through the whole plan for the one, the FCCB repayment and then what kind of outflows would we have from now on to the FCCB repayment in the form of ECBs that we have to repay. Just wanted to know what are the various cash outflows that we have, what could be the potential cash inflows over a period of maybe from now to next seven quarters?

Carl Saldanha The FCCB outstanding as you know is USD 212 million at this point in time. And with the accrued interest which should accrue up to December 12 when we have to repay the FCCB total amount due will be USD 296 million. At this point of time we have USD 103 million in cash to be precise at the end of March and as you know we are accruing USD 10 million a quarter so if you take the next six quarters which we have to go which should easily get up to the USD 160 million level. And we will also have growth in business, etc. So, this amount of cash we expect will continue to increase. There will be a gap, but we are pretty confident that we will be able to refinance that gap at the appropriate time.

Srivathsan Okay. I just wanted to know what kind of outflows would you be having on the term loans that we have at this point of time from now on to the repayment time? Just wanted to know what would be the total extent of outflow that we will have on the term loan repayment.

Carl Saldanha As you know the term loan which we got from ICICI had a large moratorium period, so we actually just about starting to pay. We will be paying maximum USD 5 million of that term loan.

Srivathsan From now to FCCB repayment?

Carl Saldanha Yes, yes.

Srivathsan Okay. And what would be the requirement for Capex and any guidance you want to give on tax rates?

Carl Saldanha In terms of Capex, last year we spent just about 50-odd crores. This year we are budgeting for slightly more than that. Because as we mentioned we are moving to some new centers now, and we are consolidating new centers, it will be slightly more than that. So basically this would be in the USD15 million range in terms of Capex.

Srivathsan And taxes?

Carl Saldanha Taxes right now we are paying about 18% and best it will go up to between 22 and 25%.

Srivathsan Sure, thanks a lot.

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

Kunal Tayal Hi, thanks. Just want to follow-up on an earlier question about the pipeline. Matthew, you mentioned that there are some good opportunities in the telecom vertical. So maybe if you could just talk a little bit about what is the deal sizes that you are talking of here and by when do we expect to close some of these deals?

Matthew Vallance You are talking specifically in the telecom sector I think.

Kunal Tayal Specifically to telecom and maybe if there is some good opportunity in the mid-to-late stage for any other vertical as well?

Matthew Vallance We have a number of opportunities in the Telecoms area that are in the late stage of the process. I think these deals are all relatively sizeable I would say and sort of USD 5 million plus deals and that gives you a little bit of flavor. A number of deals we are expecting closure on in the next three to four months.

Kunal Tayal Sure. And are all of these in Telecom or did you mentioned outside of Telecom as well?

Matthew Vallance No, we have them across the business but I am saying in Telecom we have a number of them that are at a fairly advanced stage of maturity and we obviously have a good pipeline in other parts as well of the business.

Kunal Tayal Right, sure. And again, a follow-up on FCCB. Is there a timeframe in mind by which the company expects to close the refinancing of the FCCB? Because as of now the plans are to refinance around 50% of the amount. So what timeline is the company looking at to finalize that?

Matthew Vallance The timeline is that we have to be done by December 2012. That is the timeline. And that is the timeline we are working to.

Kunal Tayal Sure, thanks.

Moderator Thank you. Our next question is from the line of Anup Upadhyay from SBI Mutual Fund. Please go ahead.

Anup Upadhyay If you could comment from a slightly medium to long-term point of view, in the last if you were to compare your own win rates, maybe three years back and now, have you seen any kind of change in those win rates because there has been an increase incidence of bundle contracts which would involve both IT services and BPO? And also in the context of Genpact acquiring an IT services company indicating that the pure play BPO model might need some kind of augmentation of IT services skills, do you think that is hurting our win rates and growth prospects?

Matthew Vallance In terms of winning rates, as I said, this is a competitive industry but I think we have as an industry also a number of levers that we can pull it in terms of getting more efficiency and more benefits from improved productivity, the way we have run our business. I think there are still many, many levers that we can pull. But it is a competitive industry. I do not think there is any dramatic change in billing rates in the industry. I think the markets have surprised, I think buyers of services expect the vendors to make a profit as well. In terms of your question around the pure play model I certainly believe there is a strong place for pure play BPOs and we talked about IT companies offering BPO, yes, there are IT companies that offer BPO and I think they probably benefit from some channel advantages that have been able to sell BPO services into existing clients. But I think the BPO services is a quite distinct from IT services in most areas. And we see also examples of where the large clients who used to buy BPO services from IT companies wanting actually to diversify and bring in pure play BPOs into that vendor mix. So I think that is another dynamic that we believe it should play well to our advantage every time. And we strongly believe that the pure play model is here. I think there is an element of hype around this context of IT-BPO combination. I think IT and BPO services at this point are really quite distinct services and will probably continue in that way to the foreseeable future.

Anup Upadhyay Okay sir. And secondly, if one were to compare the extent of recovery in IT services and BPO then definitely BPO seems to have lagged and one of the reasons that is being attributed by some of your peers is that typically a BPO contract involves sort of changes in the manpower structure or some kind of letting go of US based employees or Europe-based employees wherever the client is. And because of the increased sensitivity, in view of higher unemployment rate, BPO contracts, decisions have not been made on BPO contracts. So how soon do you see this changing? Do you think that in the past three months or six months the pace has improved?

Matthew Vallance Yeah, I did not really get the last part of the question. Can you just repeat the last part what you said?

Anup Upadhyay According to some of your peers decision making on BPO contract has been slow because companies are unwilling to outsource operations in an environment where the unemployment rates are running high and attract attention from government. So do you agree with this and if so how soon do you see this changing?

Matthew Vallance I think actually one of the dynamics that we have seen I believe has driven some good growth to the IT companies is the amount of change that this happened within the banks where there has been a lot of M&A, in some cases, forced M&A and this resulted in huge systems integration efforts, to bring different businesses on to single systems. I think that is something where banks have found themselves short of resource and they turn to outsourcing and that has given a significant boost to particularly the offshore outsourcing trends. So I think now that, that is over we are starting to see traction within the financial services area in particular, amongst organizations who are now looking to optimize their operations and I think that is where BPO has a role to play. So your point about jobs, I think what you are saying is very valid. The genuine concerns in our primary markets in the US and UK around job losses and I think that our model where we have more than 60% of our revenues, derive from operations that we run in the local geographies so it helps us obviously to win contracts that require services to be delivered locally as well. And that is exactly what we are doing. I think that there is still big cost savings that clients can make by outsourcing locally in that domestic geographies and we have seen growth there.

Anup Upadhyay Okay sir. NASSCOM, the Association of Indian Outsourcing Companies has come out with a growth forecast of 16-18% for the entire industry. In your assessment of your own order book and growth prospects, do you think you will be able to grow or match this growth rate?

Matthew Vallance I think that is a long term, we will be able to get to those rates and beyond but I do not see happening in the immediate future.

Anup Upadhyay Okay. And what is your expectations on operating margins and also if you could comment on the wage hikes that you are planning for the employees?

Matthew Vallance Operating margins, as I said, we did not expand operating margins for the year which is the same as the previous year. We have strengthened in Q4. We had 10.2% operating margins in Q4. We expect to expand our margins year-on-year. So we will get further margin expansion in FY12. You mentioned about wage hikes as well. Wage hikes if we look at across our entire business, we do obviously increase wages year-on-year in some cases that is our contracts allow for us to increase our pricing to allow for wage increases, but they are very different dynamics in different parts of our business, clearly in India there is more inflation and more wage inflation here in India which needs to be factored into our economics whereas in the US and in the UK, the wage increases are much more moderate and less impact on us on a year-on-year basis.

Anup Upadhyay Okay sir, thanks a lot.

Moderator Thank you. The next question is from the line of Atul Gharde from SGS Markets. Please go ahead.

Atul Gharde Yeah, hi, I just have a few couple of quick questions. First is on your Asia Business Unit. So you said that it broke even at the EBIT level this quarter so will you be able to quantify the EBIT or EBITDA contribution? And my next question is it is actually in the context of M&A that has been seen in India in the BPO space or IT/BPO space. So probably you kind of answered this, but I just wanted to get your view. Do you see yourself acquiring a company? Though I know you have already clarified this in the last conference call that you are not looking at any acquisition. Just wanted to get your confirmation on this, if you are looking to acquire any other company. And if I can squeeze in one more question. You guys have some cash reported of roughly USD 100 million. And I think you also include the investments that are in the balance sheet. I just wanted to know what is the nature of these investments and where have you parked this? Thank you.

Mathew Vallance Okay, yes, thanks. As far as the ABU is concerned we achieved breakeven during the last quarter. I am not going to go into any details on specifics but it is a modest profit but the only important thing it is it signals to us that the business has turned around to profitability and we look forward to building on that. The M&A, we do not see ourselves doing anything significant in M&A, there may be small opportunities that arise where we can acquire capabilities or businesses which are in our existing domains give us some further benefits in some ways in terms of capability or a new geography with the capability that we already have. So we will look for the opportunities but it is not the main thrust of our strategy, the main thrust of our strategy is really around driving our organic growth. In terms of cash, Carl will you clarify that question on investments.

Carl Saldanha The cash in investments is basically investments in short-term liquid mutual funds so they are very-very safe.

Atul Gharde Okay, thanks.

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

Shweta Malik Hi, thanks for taking my question. The first question is regarding one of the ramp down that would be going forward with the moment of an existing clients in Telecommunication and Media. Do we see a trend over there or is it just one-off in that particular client?

Matthew Vallance Yeah, I think it's a one-off, occasionally for different reasons clients do exit, it is obviously unfortunate when that happens but it is not something thankfully we see very frequently. We do not see as part of a wider trend.

Shweta Malik Okay, sure. Can we have the quantum of the annual revenue run rate that we were getting from that particular client?

Matthew Vallance I prefer not to quantify it but yeah, it has been an important client of ours and it is material in the context of the business unit itself, but as Santanu mentioned we believe we are going to be in a position to mitigate a good portion of the ramp down by reallocating the resource to another client of ours who is growing.

Shweta Malik Okay, sure. Matthew you talked about some initiatives in your commentary that would be looking forward in FY12 and going forward. Can we have some clarity on that perspective?

Matthew Vallance Yeah, I think I touched upon it briefly already, but yeah, as I mentioned, we see ourselves in the overall global BPO context which is a USD 300+ billion market, we are relatively small niche player, and our direction is to create niche capabilities and build niche capabilities. We believe that we operate in a very attractive market area. If you look at the three vertical markets where we operate they are all very attractive as far as outsourcing and BPO is concerned. Our horizontal capabilities which is fundamentally customer management, collections and document processing, again they are all very much at the forefront of BPO outsourcing, and we play in some attractive geographies so the US, UK, Asia and in particular India these are attractive geographies so we think we are playing in the right place, but I think what we need to do is couple of things, one of which is to sharpen our capabilities and develop more distinctive edges in the areas that we operate in and that is something that we are progressing to form an initiative for us. We believe there is an opportunity to develop cost leadership and by doing that it allows to invest more heavily in sales and marketing which would drive our organic growth, so I mean we are not going to huge amount of details of that but that's broadly the initiatives that I was referring to earlier.

Shweta Malik Okay, sure, my last question is would you like to quote anything on the number front in kind of growth that you are looking for in FY12?

Matthew Vallance I am not going to guide you on specific numbers but we do see improvements in our growth rate.

Shweta Malik Okay, sure, that was really helpful.

Moderator Thank you. The next question is from the line of Prashant Sawant from KNG Securities. Please go ahead

Prashant Sawant Thanks for taking my question. Congrats on your results. Just wanted to get your view on first is what is the total debt including FCCB you have and what is the outlay? You mentioned about 5 million you have to pay by next December but besides that is there any other outlay you have? And secondly despite the steady performance for the last two years the stock has not performed. Can I have your view on that? Thank you

Matthew Vallance Carl, do you want to comment on the debt position?

Carl Saldanha The outstanding debt right now in the FCCB including the accrued interest is USD 260 million. In addition to that as you know we have another loan from ICICI, which is about USD 65 million, so the total debt as of today is USD 335 million. Is that what you asked?

Prashant Sawant Yes, and you will be able to pay off ICICI by next December, is that right, is that what I understand USD 5 million?

Carl Saldanha Yes, we will be able to pay, as you can see our cash flows are strong enough to pay up the USD 5 million. The loan is actually due much later than that.

Prashant Sawant Okay, when is that due?

Deep Babur The loan is actually a longer tenure loan. I think USD 5 million that we talk about is really due until December 2012. The loan really it is due over installments right until 2016.

Prashant Sawant Okay, great, so once this FCCB gets matured in December next year, you will be having hardly any debt as such. Are there any plans to raise any more debt?

Deep Babur Well, you see for the focus and as I think there were a couple of questions earlier also on this for the purpose of redeeming the FCCB it is likely that we will need some debt which we will raise as Matt mentioned closer to the time when we actually need it.

Prashant Sawant Right, okay and that would be a domestic debt as such?

Deep Babur Well, it is a bit premature really to comment on that today.

Prashant Sawant Right, I understand, you are not worrying about the FCCB right now because still more than a year down the road?

Deep Babur That is right, about 20 months to go as we speak today.

Prashant Sawant Sure, okay, no problem. And about the share price I mean what is your thought on that?

Matthew Vallance Yeah, I mean the share prices is something that as management we believe will take care of itself over the course of time. What we are focused is on running the business, building profitability, growing the company and if we do that then the share price would take care of itself.

Prashant Sawant Absolutely. I understand. Could you just briefly point out we know the IT industry still grappling with the challenges. What are the major challenges you guys are facing in terms of going forward assuming you carry on with the same client base with the same business, do you have a target to grow at a particular rate for the next five years?

Matthew Vallance Yeah, we certainly expect to increase our growth rates, I mean somebody earlier quoted the NASSCOM figure of 15% to 18% growth rate. We think in the long term that we can get to and beyond that level and some of our segments of business today, we already are beyond that level. And I think the challenge for us is to make sure that all of our businesses is growing at that growth rates that really propels the overall business forward. I think we certainly have some work to do in accelerating our growth, and as I say we are trying to address that by getting more investments around sales and marketing, I think that we need to develop propositions a little bit distinctive, because that helps us to win deals, helps us to retain clients, and it also helps us to build more margin into the services.

Prashant Sawant If I understand your main growth area seems to be Asia, particularly UK, are you going to emphasize on those going forward or US seems to be a steady contributing region, is that what you are going to continue focus on what is happening on these regions?

Matthew Vallance There is Asia, UK, US these are the primary regions. We made a move into Australia as well. We did not really talk about that much and we have made some good progress in the early stages of doing that, but the USA is a focus area for us from sales and marketing perspective, we think we can do a lot more in the US, it is the biggest market for BPO, and we think we can make more traction there.

Prashant Sawant Okay, great, all the best, thank you so much for your information.

Moderator Thank you. Ladies and gentlemen the last question would be from the line of Anand Bhaskaran from Spark Capital. Please go ahead

Anand Bhaskaran Yeah, hi, just wanted to get some thoughts on other income yields for this quarter and also some comments on other income yield for FY12 as well? Thank you.

Mahesh Pratap Singh Are you referring to yield on cash?

Anand Bhaskaran Yeah, exactly.

Deep Babur Just to understand your question better you want a comment on other income…

Anand Bhaskaran Yeah. Cash yield for FY12 basically, some color on that.

Deep babur Yeah, I think, to be honest what happens with our cash is the other income largely, the accounting works is the gains that we make on investments as Carl earlier spoke about, which is where the investments are made in liquid mutual funds, those will be reflected under other income and interest income which is netted off against interest expense is really from the return we make on fixed deposits. As you are aware the rates of return today in the industry are in the region of 9%. That is pretty much the return that we also make. Obviously, there is an element of cash that is used for working capital purposes which is not yielding any return, rest of the money makes that return.

Anand Bhaskaran Okay, thanks. I think that answers my question.

Moderator As we have no further questions I would like to hand the floor back to Mr. Mahesh Pratap Singh for closing comments. Please go ahead sir

Mahesh Pratap Singh Thanks Melissa, thanks everyone for joining the call. We hope all your questions were answered. If there are any unanswered question please feel free to reach out to me or Ankit in the investor relations team, we will be more than happy to take those offline. Thank you so much.

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.