Q2 FY2015 Earnings Call Transcript – November 14, 2014

ORPORATE PARTICIPANTS:

- Mr. Rajesh Subramaniam – Managing Director and Chief Executive Officer
- Mr. Dinesh Jain – CFO
- Ganesh Iyer – Head Strategy & Investor Relations

Moderator Ladies and Gentlemen, Good Day and Welcome to the Firstsource Solutions Limited Q2 FY'15 Earnings Conference Call. As a reminder, all participant' lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Ganesh Iyer – Head of Strategy and Investor Relations. Thank you. And over to you Mr. Iyer.

Ganesh S. Iyer Welcome Everyone and Thank You for joining us for the Q2-ended September 30 2014 Earnings Call for Firstsource. Please note that the 'Results', 'Fact Sheet', and the 'Presentation' have been mailed to you and you can also view this on our website www.firstsource.com. To take us through the results and to answer your questions we have with us today Mr. Rajesh Subramaniam – our Managing Director and CEO and Mr. Dinesh Jain – our CFO. We will be starting this call with a brief presentation providing an overview of the company's performance followed by a Q&A session.

I would like to remind you that everything said on this call that reflects any outlook for the future or which can be construed as forward-looking statement must be viewed in conjunction with the uncertainties and risks that we face. These uncertainties and risks are included but not limited to what we have mentioned in our prospectus filed with SEBI and subsequent annual report that we can find on our website. With that said, I now turn the call over to Mr. Rajesh Subramaniam – our M.D. and CEO.

Rajesh Subramaniam Thank you, Ganesh. Good Afternoon, everybody and Thanks for joining our call today. Our "Q2 FY'15 Performance Analysis" is the first section I will spend time on before we jump into the first half year. Operating revenues for Q2 FY'15 came in at Rs.774.0 crores compared to Rs.790.8 crores in the same period last year and Rs.755.6 crores in Q1 FY'15. This represents a Q-o-Q growth of 2.4% in rupee terms and flat in constant currency terms. Y-o-Y de-growth of 2.1% in rupee terms and de-growth of 4.2% in constant currency terms. On Y-o-Y basis, the reflection of de-growth is largely in relation to the terminated accounts and some of the actions that the company had undertaken. Despite the de-growth Y-o-Y, our margin expansion has been real. Q2 FY'15 operating EBIT came in at Rs.77.1 crores compared to Rs.69.1 crores in the same period last year and Rs.75.5 crores in Q1 of FY'15. On Q-o-Q basis, our operating EBIT grew by 2.2%, our margin percentages were flat largely on account of supporting cost of growth in some of our growth with large Telco at US. Operating EBIT Y-o-Y growth was of 11.7% and a margin expansion of 130 basis points from 8.7% to 10%. Profit after tax, Q2 FY'15 was Rs.61.2 crores compared to Rs.44.8 crores in Q2 FY'14 and Rs.53.2 crores in Q1 FY'15, Q-o-Q growth has been 15%, margin expansion by 90 basis points from 7% to 7.9%, Y-o-Y growth de-grew almost 37% and margin expansion of 220 basis points from 5.7% to 7.9%.

First Half Year Performance Analysis – Revenue came in at Rs.1,530 crores compared to Rs.1,510 crores same period last year, 1.3% in rupee terms and 4.3% de-growth in constant currency terms. Operating EBIT came in at Rs.152.6 crores compared to Rs.131.5 crores, Y-o-Y growth of 16% and a margin expansion of 130 basis points from 8.7% to 10%. H1 FY'15 PAT came in at Rs.114.5 crores compared to Rs.85.8 crores in the same period last year representing a Y-o-Y growth of 33.4% and a margin expansion by 180 basis points from 5.7% to 7.5%.

The other highlights during the quarter – cash and cash equivalents of about Rs.184.3 crores compared to Rs.210 crores, we had amortization repayment of our sixth principal installment of $11.25 million which we paid. We have spent on CAPEX in Q2 FY'15 of about Rs.4.4 crores. You will also realize we had the NanoBI investment, the analytics company we invested in was also made in Q2 FY'15. Our net long-term debt as on September 30, 2014 is $ 102 million and we are well on track to meet the target of debt-EBITDA of about 1 by March 2015.

Outstanding FX hedges at $41 million, £63 million, AUD 0.25 million. Next 12 months 89% of the USD is covered at Rs 66.3, 90% of the British Pound at Rs.105.4 and 20% of Australian Dollar at just little under Rs.62. And given that we also have operations in Philippines for UK customers, we have got 40% of our Philippine Peso coverage at 72.9. On a 12-24 month basis, we have covered 52% of our US Dollars at about Rs. 68.6 and 72% of our British Pound exposure at Rs. 113.7.

The next slide spends a little bit time around our "Employee Seat" and then "Attrition Statistics." We were 26,923 employees as on September 30, 2014 with a seat capacity of 23,593. 47 delivery centers as on September 30, 2014 compared to 46 as on June 30, 2014. 17,773 employees in India, 9,220 employees outside India, net reduction of 224 employees, seat-fill factor at 73.1% compared to 73.4% in September 30, 2014. Attrition better managed, it also results in some of the head count reduction is because the number of employees we need to keep on our bench to manage attrition absenteeism has obviously been a lot better. Offshore attrition came in at just under 50% compared to 56.6% in Q1 FY'15, 43.6% compared to 46.4% in our US and European operations and domestic has seen a marked improvement which I do not believe would be sustainable, but still we have managed to do well in Q2 FY'15 at 85.7% compared to 102.5% in Q1 FY'15.

The next few slides talks about our revenue diversity in terms of geography location, verticals, and client concentration, largely stable when compared to Q1 FY'15; revenue by geography in North America continues to be the largest geography. In terms of revenue by verticals, Telecom and Media has seen some acceleration on the back of the ramp up of large Telco client in North America. Revenue by location largely has been stable and client concentration has largely been in the same range.

The Slide #10 and Slide #11 will articulate our Q2 FY'15 performance and our H1FY'15 financial performance. The only callout I have is a 100 basis point improvement in our EBITDA margins Q2 FY'14 to Q2 FY'15, obviously we had 220 basis points improvement in our net margins from 5.7% to 7.9% and business pipeline is looking good, the margin improvements will continue going forward, and on that note if I take a look at my H1 FY'15 performance which I did speak about in my earlier summary, the only callout is again around the EBITDA margins which is about 100 basis points improvement from Rs.170 crores to Rs.188 crores between H1 FY'14 and H1 FY'15 and profit after tax representing 220 basis points improvement.

From a Business Outlook perspective, the demand environment is extremely robust, significant traction in our businesses, in customer management in Healthcare; Q1FY'15 we won about $36 million of ACV, Q2 FY'15 we won about $45 million of ACV taking at a net gross wins of $81 million. We have had a setback in terms of our client consolidation. The cost of the renewal would have ensured that we would have lost $5 million in EBIT every year for 5 years. So, that is a deal which we had to step out of and net of that we still have one $51 million of annual contract value between April and September, and the consolidation is not pertaining to Q2 FY'15, but I think it is relevant given on a YTD basis, it is something that we definitely know is the customer that will not be with us from sometime in November, and then some of all this still sets us up very well, I had maintained a 7% to 8% growth for next year at the end of our Q1 FY'15 without the consolidation. With the consolidation, I still maintain the same growth rate at this point in time with an upward bias in significant momentum with our clients in the Financial Services sector in the UK. The Telco client with whom we are in a significant ramp mode there is late in demand, but we are right now ensuring that execution catches up with what we need to deliver before we open the tap on growth in that business, the Healthcare business, the Payer business will grow as per my earlier guidance which will be consistent in the 17% to 18% range. The Provider business turnaround is evident, profitability matrices are significantly much better than where we are. The new product developments that we spoke about the products in the lab, we have had our first big signing with the big hospital chain in North America which we expect will hopefully give us more momentum into a capability as we sign up more customers in the product line that we have launched in the market. So, we are extremely bullish on the sales side given how we finally see the pipeline unclogging and we see deals coming to fruition. The Banking Customers that had delayed our growth from the UK, it is coming back on right now. So between Q3 FY'15 and Q4 FY'15, we will see significant growth from this customer and the growth from the Banking Customer and the Telco Customer be scaling will more than help absorb some of the losses from the consolidation that we spoke about. I had spoken at various forums between the calls where we are having today, which we had same time last quarter and also some of the fund managers and analysts I have met, the growth rate is ranging between 4% to 6% at this point in time given the timing of the consolidation and growth that is going to come back, we will lose about anywhere between $12 million to $14 million of revenues because of the consolidation which will ensure that the growth rate that we had guided to will come down. If it was 4% to 5%, it will now stand between 2% to 2.5% at this point in time, but Q4 FY'15 will be a quarter where the sequential growth will be in excess of 4% to 4.5% and with an EBITDA profile in excess of 13.50% to 13.75% which will demonstrate the fact that with getting into Q1 FY'16, we would be in a very good position dealing in industry-leading growth rates and profitability margins which would be much better than the guidance that we have for this year. I have spoken about the delays in decision-making and ramps, some of that which is now behind us will start claim themselves out.

From our Q3 FY'15 perspective, Q3 is seasonally a weakest quarter, a fewer number of working days, more holidays, Christmas, Thanks giving, there are more expense days than income days, but there could be some positive surprises on the revenue side given some of the Managed Services deals we are implementing in the UK. At this point in time, we have a flat to a slightly upward bias based on our Q2 numbers and our profitability numbers will be stable to slightly upward but not significantly upward because of the consolidation loss of the Telco client that is effective as of 1st November.

Margin expansion continued, we will achieve our 100 to 150 basis points improvement in our margins at the net levels will be obviously much higher, and as much as I spoke about Healthcare new quarter development, the produtization initiatives driven by our investment in NanoBI and the Analytics initiatives around our productized services when embedded with our existing productized services will be a significant driver, will drive a level of nonlinear growth in our profit in relation to our revenues next year. So, feeling extremely confident of Q4 and beyond. In the midst of all these good things, generating enough cash to ensure our quarterly repayments are adequately met without any hiccups. So, that is the summary I had for all of you today.

With that I will hand it back to the moderator to open the floor for questions. Thank you.

Moderator Thank you very much, sir. Ladies and Gentlemen, we will now begin the question-and-answer session. The first question is from the line of Srivatsan Ramachandran from Spark. Please go ahead.

S Ramachandran Hi Rajesh. In terms of the growth trajectory that we are seeing, leaving the consolidation out, you are far more confident of growth than what you were possibly 6 months back. Just wanted to understand if you could give slightly more detail color by vertical, is it what we are seeing in Healthcare or Telecom that is giving us this confidence on growth, some sub-segmental commentary would be helpful?

Rajesh Subramaniam Absolutely, Srivatsan. Two levels – one is lever of growth, if you remember, we had mentioned that one of my banking clients in Cebu was supposed to scale to (+400) by June but that was getting delayed, it was largely getting delayed because today the client sees us not as an offshore utility but as a Managed Service provider, and given what is happening due to actions of the FSA and the regulatory impositions by the Bank of England, several opportunities are coming up for us in the markets and the kind of numbers that have been shared with us is extremely robust. So, when I am talking about the growth rate confidence that I have right now is to assume moderated down to certain probabilities which there could be positive surprises. Similarly, in the Telecom and Media space, our Media client continues to do well. Obviously, they have made significant investments in Italy and Germany and we will see how the entire relation plays itself out next year and we are the alpha vendor as far as this customer is concerned. Specific opportunity of one of our top customers which was not in our top 10 but is likely to be in our top 3 next year is again huge execution on the ground right now. Opportunities for growth, the kind of visibility we have is phenomenal, but we need to succeed in our executions. So, we will execute over the next 3 months. The cost of growth which will impact us will be significant, but we will absorb that cost of growth. It is unfortunate, we would like to have had the cost of growth even across 4 quarters, but in our business, delays are a way of life, changes in client management is a way of life, but the underlying confidence in at least the 3 or 4 named accounts without counting in any of the other normal growth that we see based on our customers' business every year is something which gives us extreme confidence. In the Healthcare business, my story has been consistent. I think the opportunities that we see largely on the back of engaging with our client at a different level of what we can do for them other than for what we have been doing for them this far. So, one of our top 5 clients has signed up for a new initiative and the success of which will open the door with several other big hospital chains that we work for. Basically what is happening is the entire business transformation function that we set up and the kind of investments we have made over the last 12 to 18 months has completely changed the profile of our engagement relationship with our clients which is enabling me to demonstrate a different level of what I call "Showing Show Horses" in terms of how we can think for them which is ensuring that my current war horses are getting a differential benefit from revenue accretion. As we are ready, as and when the productized ideas are gaining stream, because it will take time for them to scale, they start as small consulting assignments, translating into POC as the services are shrieked up along the products, then it just sets me up very well going into next year. So overall, as I said, our pipeline which was close to about $395 million last quarter is about $375 million this quarter even after converting $46 million of ACV in

Q2. Q3 has started well, I will have more updates for you as the quarter unfolds before the holiday season and Q4 would be a stellar quarter for us.

S Ramachandran: On the productized services, it will be helpful if you can just dwell a bit deeper in terms of would it be more vertical-specific or in terms of what is the nature of these services, because we focused sharply on the Customer Care segment, so just want to understand how the productized services will go the Customer Care historically it has been talked of transaction-intensive area, but on the Customer Care piece, it will be very helpful?

Rajesh Subramaniam: In the Customer Care piece, to demystify the whole thing, there are three elements Srivats, what I am trying to do at the highest level is reduce the cost per contract for my customer, and that is through a very active deflection argument. To get to a deflection argument I should be able to predict the customer journeys. While predicting the customer journey, the impact I need to make to my customer is two-fold – one is improve my customer's advocacy with my customer, which what we call as "Net Promoter Score" which basically also has a direct bearing on churn rates. And the second thing is I need to sell more and generate a higher level of revenues so that channels at which my customer's customer engage with our customers. So I have given to you very simplistic, when I meet with you I will explain to you the exact product profile suite, the impact it makes and how we measure ourselves, and how we are able to price ourselves, because this is now a game which will now start to lend itself to an outcome-based pricing based on the impact we drive. So it is still early days, but it will gather traction, we are engaging with customers on consulting assignments which will scale to larger programs going forward. That is on the customer management side. On the Healthcare side, it is all about payment velocity, earlier it used to be just payment, now it is payment velocity, because two-prong, the inefficiencies of how the payments used to move between payer and provider used to be stuck because of the legacy ways of how things used to work, now with healthcare exchanges, with expected 35 to 40 million Americans that are going to come online between 2017 and 2018 adding 6 to 7 million every year, the number of policies being underwritten, the number of enrolments which are happening, contemporaneously you also have the ITD 9 to 10, which has got delayed but will have to get done by September next year, with all these happenings, huge amounts of opportunity for us in the Payer and the Provider side. So again early days, but we have the products and the products are now out of the lap and we have seen the early traction with customer. Also from a productized initiative the big imperative for us was to sell our customer services into a Payer segment, two of our top five customers have signed up and will scale pretty significantly and I fundamentally believe that selling customer care services within my Payer segment can be a big driver for growth and we have seen that happening.

Moderator: Thank you. The next question is from the line of Manik Taneja from Emkay. Please go ahead.

Manik Taneja: I just wanted to understand your outlook on business from Healthcare. Essentially we have seen one of the Tier-1 IT players make a platform acquisition. Does that by any chance, how does that change the competitive landscape for the BPO vendors in Healthcare? That is question #1. Second thing was with regards to our performance or revenues from our top five customers. While we have done very well in the top one client, top two to five client revenues have been under pressure for the last several quarters. If you could give us a sense on what is happening there?

Rajesh Subramaniam: Let me take your first question, Cognizant's acquisition of TriZetto, I have a lot of respect for Cognizant and TriZetto as a platform, specific to us we have actually had a benefit, Cognizant and we have a common client, and with the acquisition we see some of that business coming to us, because fundamentally the customer believes that platform provider and services provider being the same leads them into territories where their ability to manage and control becomes a lot lesser. So this is specific to one common customer that we have, that we have seen, but the future is about platform place. The only thing is unlike banking, unlike the SunGards, the Fiserv's and Fidelity's of the world, I think healthcare technology refreshes are a lot slower, the impact of legacy systems is far more significant. So I think in the long haul the acquisition will be beneficial but we will have to see how the near term 1 to 3 years play itself out. Impacts from our customers, as I told you, we have a couple of common customers and the feedback from one of them has been what I have articulated. In terms of pressure in our second, third, fourth, fifth, absolutely, among my top five is one of the customers which have got consolidated. The other one is a domestic customer, which we do not want to grow, you will see growth in another top five customers, to whose subsidiary we have sold contact center services, so that growth will happen, and my sense is that over the next six months you will see two new entrants into the top five customers; one which was not even in the top 10, which will make an entry, and this will not happen in the next quarter, but definitely when I look at my March run rate, you will see a completely different profile of top 5 customers.

Manik Taneja: If I could prod you a little further, basically there was some ramp down in a banking customer in Q1 FY'15 and this current quarter consolidation and the client is in a different vertical, is that correct?

Rajesh Subramaniam: That is right, Manik, thanks for bringing that up. Happy to say that the client which ramped us down, the decision which was made last year and impacted us this year has realized that they were better off with us and one-third of the business which was ramped down has already come back to us in the same location, and there could be some positive surprises there going forward.

Moderator: Thank you. The next question is from the line of Pooja Swami from Span Capital. Please go ahead.

Sudhakar: Yes, this is Sudhakar here. I had two questions. My first question is on NanoBI. If you could throw some more light on what exactly is NanoBI?

Rajesh Subramaniam: NanoBI is a products platform. Again to demystify it, as much as we talk about big data, these guys make sense of Big Data in creating smaller marts, called Nanomart, which then helps decision making in a much quicker turnaround time. So for example let us take a descriptive modeling, where there are gigabytes of data that every different stakeholder likes to see. So what they do is, they create binary codes of 1 and 0 for the relevant information that each stakeholder would like to see and more often than not 70% of the information turns out to be garbage and 30% is where decision takes are utilized from. So their neural network model that they have, enables in picking such elements of data to help in faster turnaround time. At a simplistic level what has happened is, when I use those systems internally within Firstsource my ability to conduct reviews have come down from 10th of the month to the 3rd of the month. So that is the number of days I save because I am able to assimilate data a lot quicker and take decisions a lot quicker. Similarly, you use that as a surrogate in crediting customer journeys in inventory management in our Healthcare Provider business where we are sitting on billions of dollars of inventory, in terms of how do you optimize workflow, workforce, and ticket size of the deals that you have to work with in a very systematic manner, that is where NanoBI comes in. Again, extremely excited, and our relationship with them is very simple. Firstsource Analytics is launched in the market. They are white labeling us, they are in the backdrop. And the two elements – one I launched, Firstsource Analytics, as a service to our customers, because we have a large platform of Fortune 100 customers – and the second thing is I take their platform and I embed it with my productized services where I have missing links in my offerings and go and sell a different profile of services, for both we have a revenue share arrangement with them and we are very excited about this partnership and hopefully this partnership will cave into something bigger over the next two to three years.

Sudhakar: Is it exclusive arrangement with Firstsource or is NanoBI free to tie up with other people also?

Rajesh Subramaniam: They will not tie up with other BPO companies.

Sudhakar: So for BPO purposes, it is an exclusive arrangement.

Rajesh Subramaniam: That is right.

Sudhakar: What is the amount you have invested in NanoBI, have you put in upfront payment or something?

Rajesh Subramaniam: We have put in an upfront payment. We have not disclosed that, it is at the request of the company.

Sudhakar: My second question is, what is your total gross debt on the books as of now, including short term and working capital?

Rajesh Subramaniam: Our net debt is about $102 million, our cash is about roughly $30 million, so that is the math.

Sudhakar: $102 million would also include short term debt?

Rajesh Subramaniam: No, short term debt is about $30 million, which is backed by a big margin by our net current assets, excluding cash.

Moderator: The next question is from the line of Mohit Jain from Anand Rathi. Please go ahead.

Mohit Jain: Two to three questions; one is on the ramp down, because commentary is positive, second your ACV announced is also going up this year, however you are revising the guidance downwards. One is, there is any negative surprise that happened specifically in the BFSI side during the quarter, if you could highlight that. Secondly, you also discussed about the Telecom in the beginning, the ramp down that you are anticipating, if you could help us understand, a little more about that?

Rajesh Subramaniam: BFSI, as a percentage has come down by 100 basis points because Telco has grown in the US. So there is no specific negative news in BFSI. The only negative news in BFSI is that the deals which were clocked over the last six months are now coming back, and the other positive is one of the customers which had given us a notice to ramp down last year has now started scaling up with us again in the same location where they ramped down. Just a testimony of the impact we made to them and the assumptions that they made, that is one. And the client which we have lost out to a competitor, as I said, the TCV of both the customers put together would have been close to about $250 million and our competitor went in with 40% to 45% lower number, and on that basis we would have lost about $5 million every year for five years, and it was best for us to rescue ourselves, but the good thing is most of that we have recovered, which will be evident in Q4, because the biggest impact of this customer ramp down would be in Q4, where we will lose about $10 million in revenues, we lose probably about $3 million to $3.5 million in Q2 so the unamortized portion would be about $15 million in FY16, but the good thing is the wins that we have had, the ACVs that we have signed up between Q4; Q4 of last year we signed up about $15 million ACV, Q1 we signed up $36 million, Q2 we have signed up $46 million. So whatever business I have lost I have more than made up to the deal wins I have had which will ensure that I am set up well for growth next year.

Mohit Jain: This 7% to 8% growth that you talked about in FY16, that includes the impact of consolidation?

Rajesh Subramaniam: That is right, last quarter it was excluding the impact, this quarter it is including the impact.

Mohit Jain: The last question is on the average cost of delivery. Do you think that number is moving up gradually or do you think you can maintain it at a very narrow range?

Rajesh Subramaniam: Average cost of delivery is a function of the geographical spread of how we deliver. So for me right now I am in significant ramp with the client in very complex contact center management spanning from customer service to tech help desk in the US. The early days of the ramp, the cost of delivery will be high, because we are trying to get it right by over-managing it, and it takes about six months for it to stabilize, and then it settles off into a different band. So once it comes into BAU, we can manage it in a very narrow band, but once it is in a significant ramp, and this is the kind of ramp, which I do not think ever in the history of the company we have seen something as significant in a year where a customer outside the top-10 is likely to become among my top-3 or top-4 customers. So that is why the cost of delivery will look a little high, but will normalize once it gets to BAU.

Mohit Jain: Margin guidance, essentially the benefits will come from SG&A optimization, is it?

Rajesh Subramaniam: Will come and sweating the assets, my capacity gets amortized over a larger base.

Moderator: The next question is from the line Sanjeev Hota from Sharekhan. Please go ahead.

Sanjeev Hota: There are some negative voices coming from Republican Party in the US. So, if you would like to comment on what will be the impact on the Affordable Healthcare going forward, are there any concerns going forward?

Rajesh Subramaniam: I think Congress and the Senate are now under the control of the Republicans, so there are all kinds of news and rumors and everything that they are talking about the Healthcare Reform, it is too macro level, it is too early right now. All we know that where there is going to be a clear conflict is in terms of the immigration laws which the President wants to undertake in relation to where the Republicans would be. So I think at least we have a very seasoned director on the board who is also part of the President's funding campaign. So what I am saying is based on what we hear at the board and the debates at the board. So I think at this point in time there is some noise, but I am not in a position to tell you whether it is going to impact us or not, because we have not seen anything change as far as enrollments in the Healthcare Exchanges are concerned and what we have seen in terms of performance of our business in North America, especially in Healthcare.

Sanjeev Hota: Let us say if there is a delay or visa cancellations, so would be the impact that we could see?

Rajesh Subramaniam: All I am saying is this year we are working towards the number for the Payer-Provider revenue and profitability, it will largely be there, there might be a little bit of a miss on the Provider side, but next year the growth rates will be significant. I do not think we are going to see delays as we saw in the first year, right now whatever is happening is playing itself out, unless there is some specific legislation which sets us back, there is no reason to believe that the growth trajectory that we will achieve next year would be undermined.

Sanjeev Hota: What is the tax rate going forward? This quarter we have seen a lower tax rate.

Dinesh Jain: The average tax rate for the year will be between 8% and 10%, which we are guiding in the previous quarters also. It depends on the mix between the businesses and the geographies which undergo change.

Sanjeev Hota: What is the other income component this quarter, Rs.4 crores profit this quarter?

Dinesh Jain: The other income has two components – one is the surplus cash which we carry on the books when we invest in the mutual funds and comes through the dividend route, so that is one of the components – the other is also when you have a UK - US so many entities, there is intercompany transactions take place, I think that is the one.

Sanjeev Hota: How much is the two part of MF treasury gain and auction gain?

Dinesh Jain: Auction gains are I think is not going to be there going forward, because most of the items have been hedged through, I think it is going to be one-off this time, first quarter where I have a loss of Rs.2 crores, while this quarter I have the same gains, it gets nullified, whatever left out for H1 is basically represents the dividend income which we have on the surplus cash.

Sanjeev Hota: So this Rs.2 - 3 crores of treasury income is going to continue?

Dinesh Jain: Yes, that is right.

Moderator: Thank you. The next question is from the line of Vimal Gohil from Union KBC. Please go ahead.

Vimal Gohil: In the starting of the year we had begun with a guidance of 8% to 10%, we scaled it back to 6% to 8%, and then we have reverted to 2% to 2.5%. We were reasonably confident at the start of the year, we are reasonably confident right now as well. So what risks do you see to your revenue guidance going forward?

Rajesh Subramaniam: I think given that we have less than 5 months for the end of the year I am not that worried about the guidance right now, but when we started the year our guidance was predicated on certain assumptions of customer scaling, and all I can tell you is that those customer wins which we believe would have scaled in time, they have remained whole, and they are coming back. I think you should measure us on our Q4 performance, which would clearly demonstrate the extent of growth which sets us up for next year. And the other reason why the guidance has come out, I could have kept my guidance whole at the cost of losing money which we clearly did want to, and the consolidation exercise is such that it was a deal, which was a lift-in deal where we manage the work force and the work flow within our clients level, and that gets cut off on a certain date and transfers to a different vendor. So there is no transition ramp down sign which is why the impact on revenues has set us back by almost 25% to 30% of our overall projections. So, if your question is, will I go from 2.5% to (-2.5%) the answer is 'no'. As I said, when we set out the customer deals that we have won have got delayed but they are playing oust.

Vimal Gohil: This is on the accounting front. Dinesh, what are we doing about the goodwill on the balance sheet, how do we account for it going forward, and are we planning to account it in Q4 or probably first half of FY16, because it is a significant portion of our balance sheet, almost 80% if I am not wrong?

Dinesh Jain: The accounting is the same, I think the goodwill is on account of consolidation process, that is going to remain the same, and we will do the quarterly impairment testing. So if there is any fallback on any of the businesses the impairment takes place, which is as of today nowhere. As far as the overall goodwill is high does not mean that value is not in the businesses, value remain in the businesses to that extent. But, at some point of time we are looking it saying that can we need to realign this goodwill along with the way the future is going to be look like and whether there is a chance to do some sort of impairment because this is mainly in the US business where we have generated a lot more huge reserves there. So at some point of time we will have a look and see whether against those reserves which is also not going to be used for any purposes, can we write down some of the goodwill. But as of today we have not come back to the conclusion of that, it is getting debated at my accounting folks and the tax levels and later on we need to take to the board. Probably we may do something in Q4 if everything gets laid out well.

Moderator: Thank you. The next question is from the line of Ankit Pande from Quant Capital. Please go ahead.

Ankit Pande: My question would be around the US Collections business. Rajesh, could you just give us a brief on the macro that is playing out there, and what your expectations are from that business going forward? My second question would be, as I see the figures for the Healthcare vertical, the Y-o-Y growth rate is roughly tracking at about just under double digits. So could you give us a flavor of the growth rates between Healthcare Provider and Payer. That would give us an insight into the enrollments and the growth that you are seeing there in specifics, please.

Rajesh Subramaniam: The first question, the Collections business is doing a lot better than what it was last year, largely on account of the fact that unemployment rates are a lot more benign this fiscal compared to last fiscal, and when unemployment rates are healthier it basically means the inventory of debt builds up because people are spending more and the liquidation rates, people's ability to pay becomes a lot better than what it was last year. So the Collections business, the recovery, obviously we have seen the green shoots in Q1 and we are seeing that the business is performing a lot better this year than last year. So there could be some positive surprises in Q4, which is the best quarter because of tax seasonality. So it is very difficult for me to predict what the liquidation rates on the inventory buildup would be in Q4, we have certain assumptions, but I am hoping that there will be some positive surprises there, it is too early to say that though at this point in time. So overall in a good place in the Collections business at this point in time. On the Healthcare business I have consistently stated, last year our business was roughly about $155 million to $160 million and I have stated that the Payer business which represents about 40% of the mix would grow at about 15% to 18%, the Provider business has had legacy issues and obviously has not done as well. So this is the year which we will demonstrate a growth of about 5% to 6%, and next year based on the run rate of all the wins and the new product development, the products that we have signed up and we expect to sign up in Q4, we expect that business to grow definitely within 10% to 12% next year. So next year would be a very good year for Healthcare Provider and will be a consistent year for Healthcare Payer.

Ankit Pande: Just one clarification on the Collections side. You had earlier said that we are not looking to grow that business. Have you changed your mind on that?

Rajesh Subramaniam: I am not growing that business from going and adding new logos, but when the inventory of debt with my existing customers increase, my revenue will increase.

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

Dipesh Mehta: I have two questions. First is about the deal, I just need a clarification about gross TCV won in H1 and the net. You suggested we lost deal which is contributing roughly $5 million annually and $25 million TCV kind of thing. But if I look gross and net ACV kind of thing, it is $30 million difference. So if you can help us reconcile those things?

Rajesh Subramaniam: The numbers which we spoke about were all ACVs. So today my net numbers of $51 million is my annual contract value, and to that the rough multiplier would be about 1.8 to 2 years, which will give us the TCV.

Dipesh Mehta: Because you multiple by 5 years, so I was confused about that.

Rajesh Subramaniam: No, the deal which I have lost would have been a 5-year deal, it was a 3-year deal the first deal, and then the renewal would have been for 5-years.

Dipesh Mehta: So ACV wise loss is roughly $30 million kind of thing on that deal?

Rajesh Subramaniam: Yes, it was a $30 million deal, correct.

Dipesh Mehta: From annual contract perspective?

Rajesh Subramaniam: That is right.

Dipesh Mehta: So that client was very significant if I look from current revenue run rate perspective?

Rajesh Subramaniam: Absolutely, it was among my top five clients, which is what I mentioned when a question was posed, as to the top client was doing well, but the rest four were not keeping up, so it forms a part of that category.

Dipesh Mehta: So if you can help us understand what factors would have played out about the decision-making that would help to understand stickiness if you can provide some color?

Rajesh Subramaniam: I think, first, this is a client which has had earlier come out of receivership, two and a half, three years back, it is the largest provider in the market it operates in, has had significant changes in control. So overall compared to my largest customers, this customer has a different financial and market situation. The biggest challenge in this business is when we do a lift in Managed Services, we inherit a certain set of people and we inherit the inefficiencies, and as part of the deals, the transfer of undertaking provisions, the liability transfer and depending on the solvency of the client deal get negotiated either to carry the employees or reengineer the employees. In our case, the inefficiencies of the operations that we inherited has resulted in so many stakeholder changes. It is unbelievable if I tell you the number of people that have got fired or left on their own in this relationship, including the decision-makers that have awarded this deal, the CEO of a company is gone, the CFO has become the acting CEO, the person that was the operations head is gone, the person who was a sales head is gone. So trust me, when I tell you that this was the client, it was a stressful situation, but we believe whoever has won it will have their hands full, historically, we have seen clients that have taken decisions to leave us, have come back to us, including the banking client I spoke about. So without saying anything, let us see how the next six months play out with this client.

Dipesh Mehta: Second question is about EBITDA margin. If I adjust for the hedge gain and loss which we book as a part of other operating income, our margin has declined 120 basis points QoQ. So if you can help us understand plus and minuses there?

Dinesh Jain: No, but that is the way the income is, because the forward covers are alongside the revenue. So if your revenue clocking at Rs.60 and your forward is at Rs.64, you are going to realize at higher, which will continue. So if you see my forward book, my next 12 months still at Rs.66. Those are part of the gross margins and the EBITDA which we play.

Dipesh Mehta: That is fine. What I want to understand is if I look from only pure business perspective without considering how the hedge gain and loss would behave, because when we have bidded I think we have not predicted how the movement would be.

Dinesh Jain: No, a lot of the times I think the businesses deal which we also do which we are also aware about what the pricings to be done, considering what the forwards I am carrying. We are not going to put the pricing on a table without knowing what you are going to rely.

Dipesh Mehta: If I remember correctly, we expected growth rate to pick up from Q3. Now because of consolidation, if you look at ACV win, whether Q3 would be a growth quarter or it would be what we have seen in last two quarters?

Rajesh Subramaniam: Q3 we will lose about $3-3.5 million from consolidation which we will absorb. So at this point in time the guidance is flat to with a slight upward bias. There could be some positive surprises over the next 30 days but if the consolidation had not happened it would have been a growth quarter, but Q4 will be the quarter where the sequential growth will be clearly evident.

Dipesh Mehta: Going into next year you expect we can see quarter-on-quarter growth or it would be similar level the deal would come into play kind of a thing?

Rajesh Subramaniam: No, when I start with FY16 April 1st run rate, as of last quarter, I had 7% - 8% visibility for FY16, now that was without the consolidation. With the consolidation, I am still holding to 7% - 8% which means by the time we end FY16, hopefully the numbers will look a lot brighter.

Moderator: Thank you. The next question is from the line of Riken Gopani from Infina Finance. Please go ahead.

Riken Gopani: Firstly, would like to understand the deal wins that you have had in terms of ACV for the quarter. Which would be the key areas that you would have won the deals and key geographies, if you could give me some color on that?

Rajesh Subramaniam: A big portion of that would be in the Customer Management business and the rest of it would be both in the Payer and in the Provider organization.

Riken Gopani: Geography wise, how would it be?

Rajesh Subramaniam: Customer Management Services North America, Telco, that is one construct, Payer North America, Provider North America.

Riken Gopani: So more on the North American markets that the deals have come through for the quarter?

Rajesh Subramaniam: That is right.

Riken Gopani: Just wanted to understand, you mentioned in the presentation that on a constant currency basis this quarter was flat in terms of revenue. So, was there any impact of this deal that we lost this quarter or what would have led to flattish revenues this quarter?

Rajesh Subramaniam: The expectations was a flattish quarter. If you take a look at my call last time I had mentioned that there will be some cost of growth from existing customers, a big cost of growth would be in Q3 because of muted cost of growth, which is the cost incurred to support growth, our quarter-on-quarter profitability improved by 15%. So next quarter is when we see the biggest impact of cost of growth but despite that we aim to keep our margin stable. So it is a seasonally weak quarter, big impact of cost of growth and the impact of consolidation. So despite all these three we expect to have a stable flat quarter with a slight upward bias.

Riken Gopani: You highlighted that one of the clients who has now come back to you again after sometime, are you seeing this kind of a trend in a particular geography where such competitive activity is happening on pricing, because I am just trying to understand that is it a market where outsourcing is a slightly newer concept that the clients also are behaving this way or they would have also some basic understanding of how somebody would be able to make money on this contract or continue with the same, so if you could highlight as to what is happening on the competitive activity itself?

Rajesh Subramaniam: It is a great question here. It was not to competition the client decided to go captive, they decided to take the business in-house.

Riken Gopani: Then they have come back to you?

Rajesh Subramaniam: Exactly.

Moderator: Thank you. The next question is from the line of Abhishek Shindadkar from ICICI Direct. Please go ahead.

Abhishek Shindadkar: Sir, the question is regarding the growth acceleration in Q4. Could you elaborate that growth quantitatively as well as qualitatively in terms of what we are seeing how would that growth come from the Collections business and the rest of the business given there is seasonality in the Q4 on the Collections part?

Rajesh Subramaniam: On the Collections business, what you should do is take three constructs – one is take a look at the basis that the revenues remain flat to slightly upward between Q3 and Q2, then what you do is take a look at the ratio of Q4 Collections to the rest of the period – you will get it from my statements – and use the same ratio to create an uptick for Collections, then the net of that I have given a number of 4% - 4.5% sequential growth between Q3 and Q4, so you top it up and then you do the sigma and then the subtractions based on the uptick of Collections ratio you will get to know the numbers yourself.

Abhishek Shindadkar: Where I was coming from is that at the start of the fiscal we had talked about that 20% of the business which is Domestic and Collections could be flat on a year-on-year basis and 80% of the business will grow. So, is that commentary still on or our commentary has changed substantially post? I am referring only to the Collections piece.

Rajesh Subramaniam: Excellent question, and again I remember the question which was asked earlier from a gentleman from Quant Capital, is the Collections business we are not adding, the endeavor is not to grow that business, the growth in the business is because the inventory of debt which has been placed with us from existing clients is growing, but it is not going to be an element, it is going to change the growth rates by a factor, it will add a few basis points here and there. So the endeavor that 20% of the business will not growth, of which the Domestic business has not grown, the only growth in the Domestic business is because of price increases, not because of volume increases, similarly, the only growth in the Collections business is because of inventory increases and liquidation rate improving where we then keep a percentage of it. And most of the focus growth where the sales team and the business transformation team are focused on is on the rest of the 80% manning Customer Management and Healthcare.

Abhishek Shindadkar: In terms of margins, we have been talking about improvement in the margins of 100-150 basis points, we know Q4 could be a strong quarter for margins, but given what we have done in H1, is there a risk to our guidance for the full year?

Rajesh Subramaniam: At this point I do not see that, because it is largely predictable, we know how the cost, only risk would be if some of the costs of grab go a little haywire for any reason and there is no reason to believe why that would happen. I am pretty fairly confident of where our margin profile will end.

Moderator: Thank you. The next question is from the line of Archit Singhal from Nomura. Please go ahead.

Archit Singhal: My question was relating to the employees. So employees outside India they have been reducing more so in first quarter as well as second quarter. So wanted to understand, this is coming from a geography and which segment?

Rajesh Subramaniam: I think this is largely the banking client which ramped down with us in North America, which as I mentioned is now coming back and scaling with us from Q3 onwards.

Archit Singhal: So is it fair to understand that for second half there will be an employee addition rather than reduction?

Rajesh Subramaniam: Yes.

Archit Singhal: Any guidance you are giving on the number of employees?

Rajesh Subramaniam: We normally do not guide on employees because ours is a solution-driven irrespective of the geography. So to generate 1 million revenues in US, I might need 120 people and I might need 300 people in India. So people related guidance is a little meaningless in our business. And also, the other impact is with lower attrition rate, the number of people I need also becomes lower, because I manage my bench a lot better. So people-linked driving revenues is not a very accurate way of looking at our business.

Archit Singhal: Second thing was on the domestic employees. Do we see a further reduction in second half?

Rajesh Subramaniam: As of now we have got price increases from customers. That is the business honestly we live every quarter-by-quarter, depending on what happens in the market and what happens with our customers. So at this point in time the business is tending towards its revenue and profitability profile; profitability is slightly lower because of some challenges that we have had in forecasting by our clients where we have to carry excess people at one point in time. But at this point in time it is very difficult for me to comment on that.

Moderator: Thank you. The next question is from the line of Nirav Dalal from SBICAP Securities. Please go ahead.

Nirav Dalal: I just had one question. Which are the top client deals that would come up for renewal going ahead in the next 6 to 12 months? Are there any?

Rajesh Subramaniam: Top 5 customers, as in the largest customer is going through a process – and I do not have the data ready off – but there is nothing which has come to my radar which worries me at this point in time.

Nirav Dalal: The Barclays deal would that be coming up for renewal anytime soon or?

Rajesh Subramaniam: That is next year sometime in October-November.

Moderator: Thank you. Ladies and Gentlemen, due to paucity of time, that was the last question. I now hand the conference over to the management for their closing comments.

Rajesh Subramaniam: Thank you, everybody. It has been a steady quarter. Though we have had our share of surprises, the key thing is the revenue momentum is back, the market environment looks very attractive, and we really appreciate your support and thanks for your time today. And if you have any more questions Ganesh Iyer, Head of IR and Diwakar Pingle from Christensen will be available to take them and keep set of follow up meetings in the ensuing week. Thank you for your support and your time today. I appreciate.

Moderator: Thank you very much, members 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.