Q2 FY2010 Earnings Call Transcript – October 28, 2009

CORPORATE PARTICIPANTS:

- Mr. Ananda Mukerji – Managing Director and Chief Executive Officer
- Mr. Carl Saldanha – Global CFO
- Mr. Mike Shea – President, Healthcare
- Mr. Matthew Vallance – President BFSI and Telecom & Media
- Mr. Santanu Nandi – Executive Vice President, Telecom & Media
- Mr. Sanjeev Sinha – Executive Vice President, BFSI
- Ms. Chandra Iyer – Executive Vice President, Asia Business Unit
- Mr. Mahesh Pratap Singh – Head of Investor Relations

Moderator: Good afternoon ladies and gentlemen. I am Manjula, the moderator for this conference. Welcome to the Firstsource Solutions Q2 FY 2010 Earnings Call. For the duration of the presentation, all participants' lines will be in the listen-only mode. I will be standing by for the question and answer session. Now, I would like to hand over to Mr. Mahesh Pratap Singh, Head of Investor Relations. Thank you and over to you sir.

Mr. Mahesh Pratap Singh: Thank you Manjula. Good afternoon to participants from Asia and good morning to participants from Europe. Welcome everyone and thank you for joining us on our earnings call for second quarter ended September 30, 2009. Please note that the results, fact sheet, and press release are available on our website www.firstsource.com and have also been mailed across to you. The transcript of this call will also be made available on our website. To take us through the results and to answer your questions, we have with us today Ananda Mukerji, our Managing Director and CEO.

Mr. Ananda Mukerji: Good afternoon.

Mr. Mahesh Pratap Singh: Carl Saldanha, our global CFO.

Mr. Carl Saldanha: Good afternoon.

Mr. Mahesh Pratap Singh: Mike Shea, President, Healthcare.

Mr. Mahesh Pratap Singh: Matthew Vallance, President, Telecoms and Media and BFSI.

Mr. Matthew Vallance: Good afternoon.

Mr. Mahesh Pratap Singh: Santanu Nandi, Executive Vice President, Telecom and Media.

Mr. Santanu Nandi: Good afternoon.

Mr. Mahesh Pratap Singh: Sanjeev Sinha, Executive Vice President, BFSI.

Mr. Sanjeev Sinha: Good afternoon.

Mr. Mahesh Pratap Singh: And Chandra Iyer, Executive Vice President, Asia Business Unit.

Mr. Chandra Iyer: Good afternoon.

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

Mr. Ananda Mukerji: Yeah, welcome everybody once again to our Q2 earnings call. So, I will take you through the initial part of the presentation, give you an overview of the financial performance and where we are, how the outlook is right now, and then we will do individual business unit wise brief update from all the vertical heads and then we will open it for questions.

Okay, so if I take you to the first slide on the presentation, slide 4, the performance for Q2 for fiscal 10, we have had a reasonably strong quarter both from a revenue perspective as also from a profitability perspective. Revenue has grown by 15% year on year for the quarter. Operating EBITDA has grown 10.9% year on year and operating EBIT has grown 12.8% year on year. Revenue sequentially has grown by 0.9%, but that is actually on the back of last four quarters of fairly strong sequential growth, so there has been some catch up of that, but we expect sequential growth to continue to be positive in the coming quarters as well. If I look at the margin performance, as you might remember, our operating margins improved from about 790 basis points to 970 basis points, so 180 basis point improvement from Q4 to Q1. We have seen continued improvement in the margins. In this quarter, we have improved margins by 30 basis points to 10% operating EBIT. Below the operating EBIT lines, of course, in the last quarter, we had again some gains from FCCB buyback and some gains on account of cancellation of excess Forex covers which were set off by some extraordinary expenses. So, there were some one-time cost items below the operating EBIT line, which is why the profit after tax between the two quarters is not really comparable.

If I turn to the next slide, slide 5, the first half performance compared to the first half of the previous year, we have seen 16.8% year-on-year growth in revenue, 12.9% year-on-year growth in EBITDA, and 17.5% year-on-year growth in operating EBIT. Between the last half, that is second half of last year and the first half of this year, we have seen a 6.2% revenue growth, 33% operating EBITDA growth, and 70% operating EBIT growth and this is, of course, due to the fact that in the last two quarters of the last fiscal year we had a substantially depressed profitability and our operating EBIT was just about 6.1%. So, that is where the numbers between the last half and this half is showing as significant increase.

In terms of overall performance analysis, as I mentioned quarter-on-quarter growth of 0.9% both in rupee terms and constant currency terms, a year-on-year growth of 15% in rupee terms and 9.3% in constant currency terms. This has come largely from increased revenue from telecoms and media and the Asia business unit, coming largely from ramps from existing customers and partially this has been reduced by the drop in the healthcare provider business. There was delayed payment catch-up in Q1 because of which the revenues in Q1 were higher than normal and that was caught up in the next quarter. The operating EBIT margin improvement is largely on account of the Asia business unit margins where, you know, we have been on a fairly continuous growth phase in this business for the last few quarters starting with Q3 of last year. So, Q3 and Q4 both saw ramps in this business. Some of those ramps have now started to get into more stable mode and so that has resulted in improvement of margins and lower SG&A costs. There were some costs which were there in the earlier quarters which have not recurred in this quarter and partially this has been compensated by fall off of higher volumes and cost of ramps we have seen in the collections business. The collections business as you may remember from past calls, we normally see it falling off between the seasonal high in Q4 to Q1. However, this year, Q1 maintained its performance, but Q2 has come down a little bit as the normal reduction but overall is still much higher than where it was in the previous year. Healthcare also, there are significant ramps going on as we are hearing a fair amount of business traction there, particularly on the provider side and we have a large number of ramp-ups happening there and that is causing some erosion of the margins as a result of that and Mike will talk about that when he talks about healthcare.

On the client side, we have seen stable relationship with the customers. 6 of our top 10 clients have grown during this quarter which has been a healthy trend and this is something which is characteristic of our industry and something we are, you know, happy to see our top customers grow.

Foreign exchange hedges, we are, 100% covered for fiscal 10 at the US dollar level at 45 rupee level and 85% of the pound at the 80 level. Fiscal 11 again, we have 100% covered for the dollar coverage at 46 rupee level and 60% of pound at the 80 rupee level.

We have seen employees grow by net addition of about 3000 employees in this quarter, compared to the net addition of 1785 employees in the first quarter and net addition of 1223 employees in the previous quarter of the previous year. These are all as always ramps which happen because of specific customer requirements. We continue to have ramps in India as also ramps outside India in our collections business, in our healthcare business, as also in Northern Ireland operations. So, across the board, there have been increases in employees and employee increase in this case, particularly the India part of it is because of the ramps and as has happened in the past, we typically would add more headcount than we need in a steady state during a ramp and so we will see some of this headcount probably correcting a little bit in the subsequent quarter.

Attrition, we have seen some increase in attrition, both offshore, that is India, Argentina, and the Philippines operations as also onshore in this quarter compared to the previous quarter and most of this is really seasonal, you know, this is the time when a lot of college admissions take place in the US as also in India, so there tends to be higher number of people moving on that. We have also been significantly tightening up our operational metrics and our focus on performance and that is also leading to greater pressure in terms of performance by which we are weeding out lower performing employees. Domestic business has seen a reduction in the attrition numbers, but the attrition numbers are still higher than where we would like to see them come in at and we expect to see progressively these numbers coming down over time.

If I go to the next slide, seat capacity, number of seats is more or less stable compared to the previous quarter. We have added one center during this quarter, but that is primarily to migrate business from an existing center in Chennai to a new center. So, the existing older facility will be shut down post the migration, so post that we will have the same number of centers as before. Seat fill factor has started to improve, so as compared to 73% in the first quarter of FY10, it has gone up a little bit to 76% in this quarter.

In terms of awards and recognitions, we are proud of the fact that we have been recognized as a largest foreign investor in the UK out of India in the contact center and the shared services sector, the largest creator of jobs in the UK during the last three years of all the Indian companies that have invested in the UK. This is part of our value proposition by which we deliver both onshore and offshore and, you know, certainly it positions us well in the market there as a service provider who is investing in that market and is growing business in that market. We have also won, you know, a recent award in Lean and Six Sigma Awards and we continue to win awards in our process excellence area quite consistently.

In terms of mix of businesses, you know, really little bit of shifts of business. In terms of geography, UK and India has grown in relation to the US. This is largely a function more of the verticals than really a geography-specific factor. Our telecoms business is showing significant growth as you would see on the next chart which shows a percentage in the industry wise and that growth has largely come in the UK, so therefore the UK in relative terms has grown a little bit further than the US in this quarter. The delivery locations, you know, not too much change from before. Client concentration, we have had some increase in our top 10 and our top clients in our top 5 client percentage, so this is because I think 4 of our top 5 customers have grown business this quarter. We are seeing ramps in our largest customer as also in our top 5 customers more than where the rest of the business is, so that is causing these numbers to increase a little bit.

With that, I will go on to the next section which is on specific industry verticals outlook and I will request Mike Shea to come in and talk about the healthcare industry.

Mr. Mike Shea: Thank you Ananda. Good afternoon to everyone. As you can see, the healthcare market revenues contributing 38% of the income services in Q2 and we have grown to 3053 employees. Our capacity seat fill factor is 78%, so we have still significant room for growth. If you look at our industry trends, first and foremost on everyone's mind is healthcare reform in United States and the US congressional law makers have completed their draft bills and are working to combine these efforts and to finalize healthcare plan. As you may know, at this point, they are trying to insert a public option in just as recently as the day before yesterday. They are running into some issues with that and that a number of the democrats are peeling off of their support as well as the lone Republican. So, the reform measures at this point are still unclear. However, we believe that the reform measures will pass and will likely result in the expansion of existing key program such as Medicaid which we believe will be good for us. For payers, the insurance reform, an act that we believe will resolve and shift the regulatory balance from the state to the federal oversight which we also believe may have very positive implications for us. On the economy side, the experts are continuing to predict slow US economic recovery or as they are calling it a jobless recovery and the average unemployment has risen to 9.8% and some people are expecting it to go over 10% and sustaining throughout most of 2010. As such the provider margin pressures we also believe are going to continue and in the payer segments focus on operational efficiencies in light of declining enrollment we feel will continue as well. Business outlook though is quite positive. The rise in the unemployment and the uninsured continues to drive increased need for the eligibility services in the provider segment, although the employer sponsored coverage continues to be soft resulting in unfavorable impact to the payer segment at the moment. We believe this is going to be a short term thing, however. On the provider operating and margin pressures, we believe these will persist for most of the remainder of 2009, but have a favorable impact to demand for receivables management and collection services. So, healthcare reform legislation I mentioned a few moments ago, as we mentioned, will likely result in expansion of Medicaid and increased long-term need for enrollment services which is certainly one of our strong core competencies. These early reform measures suggest opportunities are going to abound for enhanced value proposition through utilization of outsourcing to reduce costs and increased efficiency. Finally, sustained and favorable growth and operating performance is what we expect in the near term. Thank you.

Mr. Ananda Mukerji: Okay. With that, we will move over to the telecom and media vertical and I will request Mat to give an update on the same.

Mr. Matthew Vallance: Thanks Ananda. Hello everybody. So, the telecoms and media sector during the quarter, there was a slight increase in the revenue contribution from this sector in comparison to the whole. We added about 2 percentage points in terms of our contribution from telecoms and media, 26% of overall company revenues. We added a net 400 employees in the previous quarter and our capacity utilization has increased from 71% to 74%. In terms of industry trends, we look at really four core segments within the telecoms and media market and within mobile and wireless segments and in terms of the industry trends one of the significant things that we have seen in the market in the UK is a merger between Orange and T-Mobile, the number 3 and 4 operators in the UK market who are combining to become the largest operator in that market with a 37% market share. Other significant developments would be the distribution of the iPhone in that market will be expanded beyond the O2 network and will now be offered by Orange and Vodafone. We believe this will drive more wide scale adoption of smart phone and database usage of telephony in the UK market and see ourselves…in terms of the business outlook within the market and this applies beyond the mobile to most of the segments, we see a trend towards vendor consolidation, particularly amongst the large clients. We see them reducing their number of vendors and within all these segments, we see this playing to our strengths as an organization as we have a wide range of service capability, a good geographic footprint and strong operational delivery capability. Within the UK mobile and wireless market, we see ourselves as being well positioned as we would for a number of the leading mobile operators in the market. So, we see ourselves as being able to take additional shares as we move forward.

In the broadband or high speed internet segments, in terms of industry trends, we are seeing relatively subdued levels of customer churn and relatively low levels of churn driven by the slow residential housing market. Often churn associates with house moving, so we are seeing low levels of churn, although they have seen some up-tick in the customer additions for our clients. Again, we see this as positive, particularly in the UK market where we work for three of the leading broadband companies in the market and with at least two of those companies continuing to grow market share in the market. In the fixed wire line business where we have significant presence with our US business, we see that the US economy, the slowdown in the US economy continues to affect our enterprise clients and we see within residential fixed line telephony those markets are also under pressure and particularly the small operators in residential telephony. We see that there is certainly potential for us to support clients with their cost cutting initiatives within both the enterprise and the consumer segments. We see within some of the existing streams of business, there is short-term drop in volumes, but we see that being counterbalanced in the future by our ability to take greater share of wallet from our clients and relative consolidation.

Within the cable television, satellite TV, the pay TV business, we see further penetration of bundled products, Triple Play, we are starting to see strong uptake in new service lines like high-definition TV and again Firstsource is well positioned in that market.

Continuing with the BFSI segments, BFSI our revenue contribution as a proportion has reduced slightly from quarter on quarter from 23% of overall revenue to 22%. Our employee base has been more or less flat; however, our capacity utilization through some rationalization of facilities has allowed us to increase our seat fill factor from 78% to 85%, so 7 percentage point improvement there. In terms of the industry trends in the credit cards markets where we have a significant proportion of our business, clearly the US economy as well as the UK economy is still facing significant challenges. Consumer bankruptcies are continuing to increase and unemployment continues to rise. The overall debt, consumer outstanding debt will contract during the course of the year by about 2 percentage for the first time since 1980 when this has happened, but, however, we see within our collections business, we are seeing increased volumes due to higher rates of delinquency, although overall levels of debts are reducing, we are seeing higher volumes due to higher rates of delinquency and we are seeing liquidation rates relatively stable and with improved operating performance we are seeing improvements in the business quarter on quarter. We have also added through the penetration in this sector with the new client has given a footprint in the prepaid card market. In addition to that, the new credit card legislation in the United States will we believe over the next 12 months create more likelihood of clients looking to outsource to help them to reduce their operating cost.

Within the retail banking sector, banks have been extremely busy with strategic balance sheet items like restructuring that business, rights issues, capital raising, restructuring into good bank-bad bank type structures and, of course, are very focused on their reputation management. As a result of that, we are seeing in the retail banking sector relatively muted opportunities for large scale offshoring and we are seeing banks continuing to focus on core issues relating to capital raising.

In the mortgage sector where we have a strong presence in the UK market, the mortgage market has improved somewhat quarter on quarter. Mortgage lending in the United Kingdom has increased 18% from Q2 calendar year and the base rates remaining low, keeping value mortgaging and churn at low levels as well as the slow housing market. So, within our mortgage origination servicing business, we continue to see relatively slow volumes.

In general insurance market, direct insurance is continuing to take market share in the market due to significant price competition in the market and challenging economic environments and we see ourselves as well positioned with our proposition for direct insurance. So, we expect the revenues will remain flat for that.

Mr. Ananda Mukerji: Okay. May I request Chandra to give an update on the Asia business unit.

Ms. Chandra Iyer: Hi. On the Asia business unit, the revenue contribution for this quarter has been a percentage higher than the last quarter in terms of the share in the company's overall revenues. Our employees have gone up by about 2000 odd employees and that is largely to take care of the ramps that we saw in this quarter. Our capacity utilization and our seat fill factor has really improved by about 6% and that is also on account of the ramps and growth that we have seen in the quarter. In terms of our industry trends, largely we see a lot of activity in the telecom and media sector in the country. The established players, they are increasing their presence into newer circles as the, you know, deepening of the market is happening. A large part of the future growth of the existing telecom players seem to be coming from newer markets which are more deeper in the country and more like rural markets. There are many new players who are, you know, on the anvil and are potential entering, some have entered and some are on the anvil to enter into the segment offering their services and that entry is coming with some, you know, significant aggressive tariff plans of changing the scenario in that front. There is a potential of a number portability which will enable people to use common numbers across and that is something that was originally going to be some time in this quarter and now has been announced to come in a little later this year, but those are the kind of things that the industry is seeing in this sector. We are seeing a lot of traction happening on the insurance sector, particularly in the BFSI segment and government, there are discussions around a lot of potential servicing in the government sector, although so far the large deals we have seen are all more ITO type of deals rather than BPO type of deals.

In terms of our own outlook, we believe that this growth that the telecom and media sector which has already been a large part of our business continues to fuel that growth. Our existing customers, as they are deepening their market, that offers huge opportunities for us. The ability to reach out to the newer segment that these players are trying to reach will need us to be matching with their trends, you know, more matched delivery models for which we are ready. We understand there could be large opportunities through the new entrants into the segment and we have certain capabilities which are very deep entrenched in the vertical and our ability to reach out and provide those services which also offers opportunities to us. We are currently, you know, doing some high-end complex work which we can take to the newer segments. We also believe that our international work in terms of number portability understanding also is something that we can bring to this market as we are entering into that new field. We overall see that the positive growth that the Asia business unit has seen in the last quarter will continue.

Mr. Ananda Mukerji: So, in terms of business outlook for the next couple of quarters, I think Q3 is seasonally a weaker quarter. We have lesser number of working days on account of, you know, Christmas and Thanksgiving, as a result of which effectively we have about 10% or more lesser number of effective working days in this quarter compared to Q2 or Q4. Historically, it has lower liquidation rate in the BFSI collection side. We do expect to see sequential constant currency revenue growth happening between Q2 and Q3 on the back of some of the ramps we have had in the current quarter and margins will be slightly lower on account of both the seasonal factor which I mentioned just now, as also the fact that pretty much all our business segments are actually ramping up in this quarter, whether it is telecoms in India, telecoms in the UK and collections in the US and in India, healthcare in the US, so there is all ramps happening in all these segments which will lead to some cost of growth. Q4, we expect to see positive movements both on revenues and profitability on the back of the planned ramps in Q3, some of them fructifying into revenues in Q4 and plus a positive seasonal factors in BFSI on the collection side. So, I think sequential growth in revenue in both Q3 and Q4 and a slight dip in margins next quarter should get recovery in Q4. So, that is the overall presentation, overall outlook. We have had, as I mentioned, a fairly strong quarter. We have maintained a strong growth rate which I think at the beginning of the year if we were to see what kind of growth you were expecting, the outlook was pretty uncertain. Today, we have lot more visibility in the outlook. I think there are a lot more deals, you know, which are now getting closed in this quarter compared to the previous quarters and while, you know, as you would have seen from the individual vertical presentation, there are challenges on the ground and really on the ground, growth is still probably some distance away. We are seeing improvement in the outlook from most of our business segments.

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

Moderator: Thank you very much sir. We will now begin the Q&A interactive session. Participants who wish to ask questions at India Bridge, please press *1 and participants connected to international bridge, please press 01 on your telephone keypad. Participants will get a chance to present their questions on a first-in-line basis. Participants are requested to use only handsets while asking their questions. To ask a question, kindly press *1 and 01 now. First in line, we have Mr. Srivatsan from Spark Capital. Please go ahead.

Mr. Srivatsan: Yeah, hi. Just wanted to get your sense in terms of how have the deal closures actually happened during the quarter, if you have to compare it with the last quarter or two quarters back and almost one month now in October, how were the actual deal closures, have there been any good traction we have seen on deal closures?

Mr. Ananda Mukerji: I think we are seeing positive movement on deals close, you know, this quarter we have seen annual value of deals closed in this quarter is double what the annual value of deals which were closed in the previous quarter. Some of this is, of course, I think partly because there has been a backlog of deals which have taken…which have probably got held up for the last few quarters catching up, but overall also we are seeing positive momentum on the deal closure side. Healthcare, for example, on the provider side, the first nine months of this year, calendar year, we have closed more than double the number of deals we have closed in terms of the annual contract value than the first nine months of last year. So, yes, in certain segments, we are seeing positive momentum. Some segments continue to be depressed. For example, the healthcare payer side continues to be slow and the BFSI side continues to be slow.

Mr. Srivatsan: And just wanted to come back on the BFSI side, how is business outside collections, collections could be weak, but how is the business traction in outside collections?

Mr. Ananda Mukerji: Matt, would you like to answer this?

Mr. Matthew Vallance: Outside of collections, we are seeing some improvements in the credit card space, improvement of deals closed in the credit card space. Within the mortgage sector, we are seeing volumes have been relatively subdued due to the low level of mortgage lending and the reduced level of house moving.

Mr. Srivatsan: Okay, yeah.

Moderator: Thank you very much sir. Participants who wish to ask questions may kindly press * followed by 1 or 01 on your telephone keypad. Next in line, we have Mr. Nimesh Mistry from Man Financial. Please go ahead with the questions.

Mr. Nimesh Mistry: Yeah, hi sir. I had a query on margins actually. Last quarter, if I am not wrong, is there a restatement of some expense because of which your last quarter margins are at 14.4% because I see EBITDA margins at 12.6%, for the last quarter.

Mr. Ananda Mukerji: Yeah, I think last quarter there was an extraordinary expense, one time expense of 84 million…

Mr. Nimesh Mistry: Okay.

Mr. Ananda Mukerji: …that is coming below the operating EBIT line.

Mr. Nimesh Mistry: Okay. That was regarding?

Mr. Ananda Mukerji: That was, you know, we are shutting down an operation in Argentina and moving that to the Philippines, so this was a one time provision we have made for expenses for that purpose.

Mr. Nimesh Mistry: Okay, okay. And this quarter as well, you have stated, you know, shutting down of one facility and then moving out, so will there be a one-time here as well or it is already there in the last quarter?

Mr. Ananda Mukerji: No, the one-time cost in the Argentina move was largely related to redundancy cost because we are moving it from one country to the other…

Mr. Nimesh Mistry: Okay.

Mr. Ananda Mukerji: …and that was the cost. Here we are moving from one location in Chennai to another location, so this is just a physical move where from an older, more expense rent and utilities kind of a center we are moving to a more efficient center. So, there is no cost in account of that.

Mr. Nimesh Mistry: Okay. And in your remarks, you have said that your collections business have seen some improvement and at the same time you have said that generally there is a seasonality effect in Q4 where the collection revenues are higher and Q1, you know, generally it is lower because of the base, but, you know, that collection revenues were still better in Q1 and you see that coming down in Q2, I mean that has largely led to slightly lower volumes there. Can you cite a reason for this, why it would have happened?

Mr. Ananda Mukerji: Yeah. See, as I was saying that normally the secular trend in the collections business is that Q4 has a seasonal high because of the US tax collection season when tax refunds come to the consumers, they tend to use that to pay off their credit card debts and so we collect a lot more, so therefore we make more revenues and profits in that quarter and that tends to then fall off in Q1 and stay at that lower levels for Q1, Q2, and Q3 and then pick up again in Q4. What happened is at the same time we are generating a fair amount of operational efficiency and operational improvement in performance, so the drop between Q4 to Q1 which normally happens, we didn't see quite that amount of drop this time because it was counterbalanced by improvement in operation performance. So, now the operation performance has remained, but some of the volumes of work in Q2 have come down a little bit. In addition, we have had cost of ramp in collections. We are adding significant number of collectors in the business right now and that has some cost. So, that is the reason why collections probably may have come down in Q2.

Mr. Nimesh Mistry: Okay. So, because you have ramps in collections in Q2, would you expect in Q3, you know, some result yielding on the back of these ramps and volumes would improve and that is the reason margins will improve in that segment?

Mr. Ananda Mukerji: I think we are expecting the margins to really pick up in Q4 because traditionally it is a stronger season. In Q3, as I mentioned in my remarks, there are 10% lesser number of days compared to Q2.

Mr. Nimesh Mistry: Okay.

Mr. Ananda Mukerji: Because that is a holiday season. So, that impacts, you know, effectively number of days in which we can work, that impacts, you know, margins in this quarter a little bit.

Mr. Nimesh Mistry: Right. And do you see your, you know, margins improving, you know, on a monthly basis in the collection business, I mean to say your collection rate margins improving?

Mr. Ananda Mukerji: Well, I think the collections business has shown a fairly steady improvement in its performance over the last one year. In spite of the fact the liquidation rates are down, collections business has shown strong performance. I think it will continue to improve over the coming quarters we expect, but it is hard to say, you know, whether it is going to be absolutely steady month on month kind of a performance improvement, but we are seeing good steady operational performance with general bias towards improvement.

Mr. Nimesh Mistry: Okay. Second question would be on the telecom side, you know, just trying to understand on the broadband, you know, part of the wireless channel. There, what is it that is, you know, that is keeping you optimistic, is it the migrations or is it that, you know, there is more focus from the government on, you know, the availability of the bandwidth or it is something else, I mean just that, you know, there has been improvement in the number of connections, what is it that is…

Mr. Ananda Mukerji: Yeah, I will let Matt answer that, but just to clarify and I hope there is no misunderstanding here, when we talk about the telecom vertical, we are not talking about the telecom vertical in India. This is all…

Mr. Nimesh Mistry: Yeah, yeah, absolutely, this is UK I am asking.

Mr. Ananda Mukerji: Yeah, Matt…

Mr. Matthew Vallance: In the sense why we are optimistic on the broadband market, I think that is really because, you see, we have a strong client base already in that segment and we are seeing a process of vendor consolidation, so we are seeing our clients reduce the number of vendors they work with and we see ourselves as being well positioned in regard to that process because we have a strong and wide service portfolio, we have a range of different geographies that we deliver from, so we can offer significant financial savings and we have a track record of strong operational performance. So, for those reasons, we see the broadband segment as being one in which we expect to continue to grow.

Mr. Nimesh Mistry: Right, right. Mr. Ananda, a final question, you know, with regard to, you know, migration. You know, this is the second time there is some migration happening and this is in the local geography I am talking about which has happened this quarter. I just want to know what would be the rationale for this migration, would you enjoy any tax benefit here or would you enjoy any other benefits?

Mr. Ananda Mukerji: Yeah, this is the second time we are seeing a migration there for very different reasons. The first migration was the move of that process from Argentina to Philippines and that was based on basically moving to a more viable long-term location for the kind of work we are doing there and that is what the customer wanted and that is what dictated the move. It was also a more profitable location from our perspective than Argentina. The kind of move which we have done in this quarter is really a matter of, you know, where centers have got fully depreciated and rentals are continuing to be high, we are moving to a location where the rentals are lower and where we can set up a newer and more attractive center for both our employees and our customer. It is really tactical reasons like that. We have done in the past as well. We have moved from, you know, shut down older centers and moved to newer centers, so that is a normal part of our business actually.

Mr. Nimesh Mistry: Okay. And would you enjoy any tax benefit here?

Mr. Ananda Mukerji: I think the same tax benefits apply between the existing one and the new one.

Mr. Nimesh Mistry: Okay. Alright, thanks a lot.

Mr. Ananda Mukerji: Okay.

Moderator: Thank you very much sir. Next in line, we have Ms. Mitali Ghosh from DSP Merrill Lynch. Please go ahead with the questions.

Ms. Mitali Ghosh: Yeah, good afternoon.

Mr. Ananda Mukerji: Good afternoon.

Ms. Mitali Ghosh: Hi. Just on the telecom I wanted to check, you know, the growth that you have been seeing, if you could give a bit more detail in terms of what is the kind of…nature of demand that is coming back and, you know, what is the kind of competition you are seeing there?

Mr. Ananda Mukerji: Yeah, Matt…

Mr. Matthew Vallance: In the telecom sector, we have, to give you some kind of flavor on the quantum of growth for the sector as a whole during the quarter, quarter two, we had about 400 staff and we are seeing that growth continue through into Q3 and we expect to add a significant, in excess of another 600 staff. So, we are seeing, if that gives you some color around the scale of the growth that we are seeing, that is going to push through into the Q3 and the rest of the year.

Ms. Mitali Ghosh: Sure. And in terms of nature of work that you are seeing, you know, is it possible to give a little bit more color on that, is it because of, you know, work being sort of shifted maybe offshore or it has been spending coming back, you know, what is the kind of demand that you are seeing?

Mr. Matthew Vallance: What we are seeing is that we are expanding into new areas with our clients. What we are seeing is additional work types, particularly back office processing work which we are delivering from our offshore centers. We are seeing significant increases in those work types, some more highly skilled technical support work, we are seeing increasing levels of that coming through from our telecoms clients. So, a lot of the growth is coming from existing clients where we are broadening our share within the clients and adding new work types, particularly back office processing.

Ms. Mitali Ghosh: Right, that is very helpful. In terms of, you know, the customers volumes itself going up, have you seen some of that happening as well?

Mr. Matthew Vallance: In terms of our clients' volumes increasing?

Ms. Mitali Ghosh: There was a time when that was actually decreasing and that was hitting the vendors as well.

Mr. Matthew Vallance: What we are seeing is within the consumer markets that we operate in through our consumer base clients, we are seeing the volumes in that businesses increase a fair bit over recent months. So, during the course of this year, we are seeing in spite of the economic downturn that their volumes as organizations have been very robust and, if anything, have increased quite a bit. Where we are seeing dips in volumes has really been in the enterprise market where the economic downturn has led corporates to cancel orders or reduce their telecom spending, but we are not really seeing that in the consumer market, here we are seeing quite the converse.

Ms. Mitali Ghosh: Right thanks. Secondly just on the attrition, employee attrition trending up, you know, if you could give us a sense of maybe how much of it is involuntary attrition that is driving that number up and, you know, what we should expect going forward and, you know, also connected to that, what are your thoughts on wage hike and when should one expect that?

Mr. Ananda Mukerji: Yeah, you know, we did give wage hikes this year both in India and in the UK, particularly at the associate level and at the junior management levels. In India, the hikes were more modest obviously compared to the previous year. I think in India we gave an average 6% hike and in the UK, you know, 1.3% hike. So, we did give some hikes and in the US we did not give any hikes. I think the attrition increase is a temporary phenomenon. We do get fluctuations in attrition from quarter to quarter at points in time with program to program. The factors I mentioned in my remarks were related to the timing, the seasonality, and the fact that this is a time when lot of people go to join college, so people leave work for some time and then leave and join college. Now, involuntary attrition has remained more or less steady from the pervious quarter, but what has happened is, you know, when pressure on performance increases, that tends to drive up a little bit of voluntary attrition as well and people in anticipation of not being able to make it also start to leave. So, there is a little bit of that, but I think it is more of a, you know, quarterly movement kind of a phenomena, I don't think there is any secular trend here.

Ms. Mitali Ghosh: And finally, just in terms of the margin outlook for, you know, next year, what are the sort of factors that one should keep in mind?

Mr. Ananda Mukerji: Well, I think we have said in the beginning of the year we are going to see margin improvements in this year.

We have seen that in the first two quarters and, you know, with some slight dip in the third quarter, we expect that margin improvement trajectory to continue. It is a little early for us to project what we will see in the next year, but I overall see margins, you know, in spite of all the pressures on pricing and all the things which we talk about and hear, we have been able to get margins up and we feel that that trend would probably continue for the next few quarters.

Ms. Mitali Ghosh: Okay, thanks.

Moderator: Thank you very much ma'am. Participants who wish to ask questions may kindly press *1 and 01 on your telephone keypad. Next in line, we have Mr. Tarun Sisodia from Anand Rathi Securities. Please go ahead.

Mr. Tarun Sisodia: Yeah, hi. I just wanted a clarification on the industry analysis being done on BFSI. Is it true from whatever I gathered from the statement that your expectation is that US is slightly worse off than the European zone or UK?

Mr. Ananda Mukerji: Matt, the question is, is the US worse off than the Euro zone in the BFSI segment, is that what we are seeing is the question.

Mr. Matthew Vallance: I think our primary market within Europe is the UK and we are seeing a comparable market situation between UK and US banking where organizations have been spending a lot of time sorting out balancing issues recently and many of them have actually gone to the government for support. In the light of that backdrop, the large, many of the large banks are hesitant about engaging in significant offshoring exercise in particular our outsourcing exercises if that may affect them from a publicity point of view. So, we are seeing a fair bit of commonality across the two geographies from that point of view.

Mr. Tarun Sisodia: I have one more question, if you generally look at the kind of revenues which is being generated between healthcare and say Asia versus rest of the other units which is BFSI and telecom, the realizations are far different. How would you really reflect it in terms of margins, margins are also equally different between the three segments?

Mr. Ananda Mukerji: I think the margins are different across different industry segments and within the verticals also there are different segments of business we do which have different margins. So, there is no, you know, one common margin across all the business segments, so each vertical has a different profitability profile and within those, clearly, you know, onshore and offshore have got different profiles. It also depends on what investment stage we are in in those verticals. For example, the Asia business unit is still in a large investment mode and is yet to reach steady state at this point. So, there are different margin points in different verticals.

Mr. Tarun Sisodia: From the business model perspective, if you compare yourself versus lot of other integrated players who are offering BPO along with a lot of other services, do you see significant difference given the fact that there is a significant move towards consolidation?

Mr. Ananda Mukerji: Well, I think, you know, move towards consolidation is something we also feel is certainly happening and, you know, we believe we are gaining at this point from that because we have very good customer relationships in each of the verticals we are in. You know, we have a strong proposition, we have a lot of experience with working in those industries and with those customers and we have a track record of delivery and we have proven. So, within the specific industry verticals we play in, we actually have a very strong proposition in each of them. So, I think we are gaining from consolidation as opposed to, you know, losing.

Mr. Tarun Sisodia: So, you don't foresee a fully integrated service provider as being a big threat, is that what you are saying?

Mr. Ananda Mukerji: I think the larger IT companies with BPO offerings are also players in our market place, but I think they are more of a threat according to me in the horizontal plays as opposed to the vertical plays which we are in.

Mr. Tarun Sisodia: Right.

Mr. Ananda Mukerji: Where we are in, for example, in the healthcare vertical which is a big part of our service offering, we really don't see any of the big IT companies having a significant presence really.

Mr. Tarun Sisodia: But in say telecom and BFSI where these guys are also present, there...

Mr. Ananda Mukerji: Yeah.

Mr. Tarun Sisodia: …how do you see it happening?

Mr. Ananda Mukerji: Yeah, in telecoms again, I think if I look at it, there are a few, you know, Indian IT companies who have got a presence there. You know, there are some global pure play BPO companies with telecoms expertise who have a presence there. There are a people like us who have a presence there. I think we have a strong proposition with our, you know, offshore/onshore footprint, the wide customer base we have. We work for some of the top telcos in the world and have been working with them for a long time expanding service propositions with them. I think we have a very strong proposition in telco as well.

Mr. Tarun Sisodia: Right, thank you. All the best for your future.

Mr. Ananda Mukerji: Thank you.

Moderator: Thank you very much sir. Next in line, we have Mr. Ankit Shah from B&K Securities. Please go ahead with the questions.

Mr. Ankit Shah: Yeah, good afternoon sir. Sir, just a couple of questions. Regarding the tax rate, sir this quarter it was marginally higher around 17%, so what is that we can build in for the next year or the current year?

Mr. Ananda Mukerji: We expect it to be more or less at the same levels.

Mr. Ankit Shah: At the current quarter levels right?

Mr. Ananda Mukerji: Yes.

Mr. Ankit Shah: At 17%.

Mr. Ananda Mukerji: Yeah.

Mr. Ankit Shah: Okay. Sir, can you give the breakup of other income in terms of what were the hedging losses for this quarter?

Mr. Ananda Mukerji: The hedging losses for this quarter was only consolidation losses that we had.

Mr. Ankit Shah: Okay.

Mr. Ananda Mukerji: That was around 1.2 crores as part of the other income.

Mr. Ankit Shah: Okay, okay.

Mr. Ananda Mukerji: And whereas in the other income of last quarter, we had approximately 11 crores gain which was on account of cancelled hedges

Mr. Ankit Shah: Okay, okay. And sir, there has been an overall improvement in the seat factor as compared to the last quarter and also with respect to each of the BUs, there has been significant improvement. So, is this seat factor going forward sustainable or what are the steady state seat factors that we can assume?

Mr. Ananda Mukerji: Well, we have said this…in every call that our seat fill factor is much lower than where we would like it to be and one of our goals for this year was to see this improve and I am happy to see that we have been able to get improvement in the seat fill factor. Our aim is to get into the, you know, into the 80% level at least and that is what we are driving towards.

Mr. Ankit Shah: Okay, okay. And sir lastly in terms of the pricing pressure, sir how do you see the pricing pressure going forward, are all the pricing pressures done with or we are still expecting some worse to be factored into?

Mr. Ananda Mukerji: Well, I think we have been seeing pricing pressures in this market environment over the last, you know, several quarters, but I think it is also fair to say that pricing pressures are also accompanied by, you know, increase in businesses and flexibility, how we deliver it, so it is not a straight forward one dimensional issue alone. Having said that, I would say that probably the majority of pricing pressures have already happened. Some more may happen in the coming quarter, but I would say the bulk of it has probably already happened.

Mr. Ankit Shah: Okay, okay. And sir, lastly in terms of your healthcare verticals, sir there has been a sequential fall in revenues. Sir, regarding your outlook in the provider segment, margins are under pressure and your payer segment is affected by the increase in unemployment, so then do we expect a decrease in the contribution from the healthcare vertical going forward?

Mr. Ananda Mukerji: No, I think we have seen a slight decline in this quarter on account of the reasons which we spoke about, but we expect, you know, we expect positive movement in the healthcare revenues over the coming quarters. As I mentioned in my remarks that we are seeing, you know, the new contracts being booked in healthcare are increasing, so we do see that improving. Mike, would you like to add to that?

Mr. Mike Shea: Yeah, I think that, you know, certainly we are expecting to see moderate growth over the next few quarters. Our sales pipeline has come close to doubling and the deal closure has more than doubled year on year. So, we have laid some really nice foundations for growth and we are going to expect to see those in the coming quarters.

Mr. Ankit Shah: Thanks.

Moderator: Thank you very much sir. I request the participants to ask two questions at the initial round and then come back for the followup question. Next in line, we have Ms. Archana from Morgan Stanley. Please go ahead.

Ms. Archana: Hello sir, good afternoon. My question is pertaining to the win rate. So, considering that, you know, competition has increased, considering that, you know, the BPO players who are chasing deals now, so what has your win rate been for first half of this year versus, you know, the first half of last year?

Mr. Ananda Mukerji: We didn't hear you very clearly. Are you talking about win rates?

Ms. Archana: Yeah, I am talking about win rate.

Mr. Ananda Mukerji: Okay. See, as I mentioned if I look at it, in this quarter, the value of deals we have closed in this quarter is more than double the value we have closed in the first quarter. So, we are seeing increase in deals getting closed and we are winning more deals. Now, it is hard to, you know, hard to say, what is it in terms of win rates with others, but a lot of the wins are in terms of the existing customer businesses and there, of course, our win rates are fairly high, you know, we are very, very likely to win an opportunity from an existing customer and so I would say that overall there is a good positive momentum on deals being closed at this point.

Ms. Archana: Okay, thank you.

Moderator: Thank you very much ma'am. Next, we have a followup question from Mr. Srivatsan from Spark. Please go ahead.

Mr. Srivatsan: Hello…yeah, hi. Just wanted to get a couple of points. The unsecured loans is just FCCB or is there anything else included in the unsecured loans?

Mr. Ananda Mukerji: Just the FCCB, that's right.

Mr. Srivatsan: Just FCCB, okay. And in terms of what is the current net cash position because I see a jump in investments, is that more liquid investments?

Mr. Ananda Mukerji: That's right, that's right.

Mr. Srivatsan: And what will be the breakup between what component of it would be liquid investments?

Mr. Ananda Mukerji: All of it is liquid investment, so I think the overall cash position with the liquid investment is about 180 crores.

Mr. Srivatsan: 180 crores, okay. And what will be the Capex plan for the next two quarters and maybe for FY11?

Mr. Ananda Mukerji: Yeah, so if I look at the Capex, for the first six months we did about 25 crores of Capex. We expect the second half to be probably similar to that and last year our total Capex was about 98 crores, so our Capex should probably be about half of what the last year's Capex was and that is because last year we added a lot of capacity. If you remember, we added 7 centers and about 4000 seats of capacity last year, so we really are in a catch-up and utilization phase this year and so really don't need to do so much Capex.

Mr. Srivatsan: Okay, sure. Thanks a lot.

Moderator: Thank you very much sir. At this moment, there are no further questions from participants. I would like to hand over the floor back to Mr. Ananda Mukerji for final remarks.

Mr. Ananda Mukerji: Okay. So, thank you everybody for joining the call. As I just sort of summarize here, I think we have had a fairly strong quarter in top line growth and in profit growth. We have crossed the 100 million dollars a quarter revenue threshold in this quarter. I think we are seeing positive, you know, momentum in different parts of our business, on the telecom side, on the healthcare, on the provider side, on the Asia business side, so we continue to see growth. However, the environment from our customers' side continues to be down, so I don't think our customers, particularly on the banking side or on the healthcare payer side are seeing immediately a growth opportunity. So, there is going to be, you know, an impact on the ground in terms of growth rates, you know, coming back to historical levels will probably be some quarters away, but overall I think the environment is a lot more positive today than what it was six months back and we are being able to deliver some of the operational efficiencies and the benefit of some of the investments we have made in the past are now starting to come in and that has given rise to some of the profitability improvements we have seen. So, we hope to be able to, you know, maintain this over the coming quarters with some of the seasonal variation which we will see in the next couple of quarters. Thank you for joining the call.

Moderator: Thank you very much sir. Ladies and gentlemen, thank you for choosing WebEx's conferencing service. That concludes this conference call. Thank you for your participation. You may now disconnect your lines. Thank you.