Q4 FY2010 Earnings Call Transcript – April 30, 2010

CORPORATE PARTICIPANTS:

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

Firstsource Solutions Limited
Quarter Four Earnings Conference Call, Financial Year 2010
April 30, 2010

Moderator

Ladies and gentlemen good morning, good afternoon and welcome to the Firstsource Solutions Q4 Earnings Conference Call. This is Rochelle, the moderator, for your conference. As a reminder, all participant lines will be in the listen only mode and this conference is being recorded. There will be an opportunity for you to ask questions at the end of today's opening remarks. Should you need assistance during this conference call, please signal an operator by pressing * and then 0 on your touchtone telephone. I would now like to hand the conference over to Mr. Mahesh Pratap Singh, Head of Investor Relations at Firstsource; thank you and over to you sir.

Mahesh Pratap Singh

Thank you Rochelle. Good afternoon to participants from Asia and good morning to participants from Europe and the US. Welcome everyone and thank you for joining us on our Earnings call for the fourth quarter and year ended March 31st, 2010. 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. To take you through the results and to answer your questions, we have with us today Ananda Mukerji, our Managing Director and CEO.

Ananda Mukerji

Good afternoon everyone!

Mahesh Pratap Singh

Matthew Vallance, our Joint Managing Director.

Matthew Vallance

Good afternoon!

Mahesh Pratap Singh Carl Saldanha, our Global CFO.

Carl Saldanha Good afternoon!

Mahesh Pratap Singh Tom Watters, President Healthcare.

Tom Watters Good afternoon!

Mahesh Pratap Singh Santanu Nandi, Executive Vice President, Telecoms and Media,

Mahesh Pratap Singh Sanjeev Sinha, Executive Vice President BFSI.

Sanjeev Sinha Good afternoon!

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

Chandra Iyer Good afternoon!

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

Ananda Mukerji Good afternoon again and good morning to participants from Europe and US; I will take you through short presentation giving our performance both for the fiscal

2010 as a whole and for Q4 of fiscal 2010. And then after the overall company performance, we will have individual business unit analysis from the business unit heads and then we shall briefly talk about the outlook for the coming year.

So overall fiscal 2010 has been a year of strong performance both from financial side top line growth and EBIT margins as also in terms of progress in strategically positioning the company in the marketplace and I will take you through the details now.

In terms of financial performance, our operating revenue has grown by 12.7% year-on-year in rupee terms and 11.2% in constant currency terms. The operating EBIT has grown by just under 40% year-on-year at 1,933 million compared to 1,383 million in fiscal 2009. The margins have expanded by 190 basis points from 7.9% in the previous year to 9.8%.

We made significant progress in the way the company is organized and positioned. You may recall a year back, we had undergone a major restructuring and had converted the business into four independent business units, three of them focused on our key industry verticals in the US and UK, that is the Telecoms & Media, BFSI, and Healthcare verticals and the fourth one being the Asia Business Unit which at this point primarily focuses on India domestic market. This restructuring has now been completed and the strong vertical domain focus that we demonstrate to the market is now an important differentiator for our customers.

One of the aspects we have spoken about at the beginning of last year in terms of where improvement in performance of the company is expected is in terms of utilizing the capacity we have. At the beginning of last year, out of the total seats we had, we were using only 70% of the seats as of that point in time and this was an important focus and we have seen continuous improvement in that through the year and as of March 2010, what we call the seat fill factor has improved to 80%.

We continue to scale our operations. Our employee count as of March 31, 2010, is 24,860 employees, so we have added about 3,200 employees during the year. Out of that 1,925 employees were added in India and 1,365 employees added outside of India. Today the reality is that the unemployment rate is continuing to be very high both in the US and UK. There are elements of protectionism and concerns about job loss and so therefore the well-established onshore presence that we have has helped us to win more business both in the US and UK and we have added 700 employees in the UK and 400 employees in the US. We are seeing a lot of deals which require delivery expertise and delivery capability onshore as well as offshore and I think the fact that we have created this model of delivery over the years has stood us in a good stead at this point in time and we expect that it is going to continue to be an important factor in the coming year.

We have also significantly expanded our Philippines delivery which had just started about a year back and we have over 650 employees in Philippines and from one customer at that point in time we now have two customers those we are delivering out of that geography.

One of our major strengths in the company is the strong customer base we have. We have excellent customers in all the verticals, in telecoms, in BFSI, and healthcare and it is continuing source of growth for us. In any one year, the growth which comes for the company largely comes out of our existing customer base and we are very happy that that trend continues and we have expanded relationship with our existing clients. In fact 8 of our top 10 clients have grown with us during the year. In our business, we do not generally add a whole lot of new logos, sale cycles tend to be long and once the customer is added to our base then it becomes the source of growth for many years to come. So we have added some important marquee clients during the year which will be a source of growth in the future. These include a leading UK telecom service provider, two of the top 15 credit card issuers in the US. We already have a number of the top card issuers as our customers and we have added to that by two more. We also added a leading issuer of prepaid debit cards in the US as a customer. On the healthcare provider side, which is the much more distributed model where we have close to over 800 hospitals as customers. We do add a lot of customers during every year and here again the investments we have made over the last two years in sales and marketing effort has also been sharpening our focus in rationalizing our service offering has starting to pay off and we have seen new business wins in the healthcare provider segment up 60% compared to what it was in fiscal 2009.

We have had significant international awards and recognition as a company. The UK Trade and Investment awarded us as the Indian Investor of the Year Award, recognizing us to contribution we have made to the UK economy. We were recognized as one of the top 100 companies in the world by the CIO Magazine for the innovative use of IT. Technology is a very important part of our delivery proposition and it is embedded in what we offer to our customers and this is something we are particularly proud of. We were ranked No.2 globally among the extended business service providers for the healthcare business. Healthcare is our largest vertical in size and we are very well-positioned there and the ranking clearly shows our position in that marketplace. We are recognized among the Top 25 companies in India for excellence in corporate governance for 2009 by the Institute of Company Secretaries of India. We continue to win awards internationally for our process excellence and our operations excellence and we won two awards at the International Quality and Productivity Council, USA during the year.

Some of the other highlights, we received our third annual HFMA Peer Review Designation for eligibility services, receivables management and collection services and the Medical Advantage Plan Program. So this is a peer rating in terms of our performance and serves as a basis on which a lot of customers source business from us and that is the part of the reason why we are able to add and increase our growth in that segment.

We also took the initiative to get registered with the US Government under their Multiple Awards Schedule, MAS, and we have become General Services Administration Contractor by which we are now eligible to bid for and win business from the Federal and State Governments in the US. Up till now, our focus has been on private players and private hospitals and this opens up opportunity for us, which we expect will come as a result of the healthcare bill coming into effect now.

To take you through the numbers then for fiscal 2010, if I look at the overall numbers, I mentioned our top line has grown by 12.7% in rupee terms, our operating EBITDA has grown by 21% year-on-year and the margin has gone up from 13.3% to 14.2%. And then the operating EBIT level, we have increased by 39.8% and the margin has gone up from 7.9% to 9.8%. Overall, I think it's been a strong year in terms of financial performance both in terms of top line growth and in terms of margin improvement.

As you would see, during the last year below the operating EBIT line, there were some unusual items which were really related more towards the FCCB buyback we did towards the end of the year. And so the profit after tax while it shows a huge increase from 307 million to 1,361 million for the year is not really comparable like-to-like comparison because we had unusual items in fiscal 2009. So the real comparison to look at is the operating profit levels where the increase is 40%.

Let us talk about the Q4 FY10 performance, the quarter has also been a strong quarter. We have increased top line by 7.3% year-on-year and 3.2% quarter-on-quarter. Our margins at the operating EBIT level have gone up from 9.5% to 9.9%. On the quarter-on-quarter basis, the EBITDA has remained flat at 13.9% and that's because of some one-time charges we took during the quarter on account of some restructuring which we have done. There are not a whole lot of changes below the operating EBIT line, so overall a strong performance quarter-on-quarter both in terms of revenue and operating EBIT.

Some of the numbers which I mentioned once again, Q-on-Q growth 3.2% in rupees terms and 4.5% in constant currency terms, year-on-year growth is 7.3% in rupees terms and 11.7% in constant currency terms. During the quarter, the impact of the sharp depreciation of the pound against the rupees affected our rupees numbers and as we have seen constant currency terms our numbers are pretty strong. Operating EBIT has gone up by 40 basis points compared to the previous quarter that is largely because of the strong seasonality in collections due to tax refunds in the US, this is a seasonal factor that we have every fourth quarter. At the beginning of the quarter, in the last quarter call I had said that we are not entirely sure what is the kind of seasonality we would see this year given the unusual economic condition in the US at this point, but in reality we did see a strong seasonality coming and that contributed to the improvement in the margins.

We also have had ramp up in the existing telecoms customers, we have in Northern Ireland and that contributed to margin improvement. This has been partially offset by some reduction in volumes in the Asia Business Unit. For the Asia Business Unit, a significant part of the revenue comes from the telecom industry in India and that industry has been going through significant competitive pressures and that has resulted in volume of work slowing downstream to service providers coming down and as a result of that, we have had to make some adjustments in the workforce and that has also affected our margin performance in the quarter.

I talked about the adverse Forex impact net of gains on realized hedges. We have also had a one-time increase in SG&A due to US entities reorganization related fees. What we had as the result of some of the past acquisitions we had done, we had a number of legal entities in the US and that was extremely inefficient from both an operations and a tax point of view. And we have undergone a major restructuring of that and streamlined it into just a few legal entities and that should help us in terms of efficiency going forward.

In terms of foreign exchange hedges, our outstanding foreign exchange hedges are at $26 million and £35 million pounds. It comprises about 85% coverage for the US dollar at the Rs. 46 level and 80% GBP coverage at Rs. 79 level.

Our total employee strength at the end of the year was 24,860 out of that 18,784 are based in India and 6,076 are based outside India. There is a net reduction of just under 2,500 employees in Q4 compared to the net addition of 876 employees in Q3 and net reduction of 950 in Q4 of last year. This is, as I mentioned last quarter on account of downsizing, on account of lower volumes coming in the domestic business, and that is about 2,773 employees. Netting that off about 180 employees were added in India for the offshore delivery and 145 employees were added outside India primarily in the UK.

Attrition has been largely stable both offshore and onshore, pretty much stable compared to the previous quarter. In the domestic business, attrition is really not meaningful in this current quarter because of the significant downsizing which we were doing. Our seat capacity is at 19,556 seats worldwide. We reduced one center in the course of the year. Buenos Aires, Argentina delivery center has been shut down post the successful completion of the migration to Manila. The seat fill factor as I mentioned has increased to 80% and the average seat fill factor for the quarter was also at 80%.

In terms of the mix of businesses, the little bit of shift you see is really on account of two factors, one is the seasonality in collections which increases the BFSI proportion of our business as also the onshore proportion of our business. And the reduction in volumes in the Asia Business reduces the domestic delivery of our business, but otherwise there is not a whole lot of change between the previous quarter and this quarter.

Our client concentrations have remained largely steady both in terms of top clients and top five clients.

So that's really overview of the company's financial performance and overall performance for fiscal 2010 and for the quarter ended March 31, 2010. With that I will hand it over to the individual business heads to take you through their specific areas and I will start with Tom Watters. Tom Watters has been appointed as the President, Healthcare in North America and CEO, North America. He takes over from Mark Shea who after a long innings in this business has retired and Tom was earlier the Chief Operating Officer of the business, has taken over as CEO. Tom, can you take them through the healthcare?

Tom Watters

Thank you Ananda. As I am sure that many of you are aware, we have just seen the passage of landmark legislation that will bring sweeping changes to the healthcare delivery model within the United States as well as have implications for both payers and providers alike in the marketplace. These healthcare reform provisions will roll out over the next 10 years, but the most significant of those will be implemented in 2014. As a result, we see opportunities in both segments of the industry. We initially see those on the payer side as several changes impact insurance companies and their cost structures. We have seen a flurry of initial activity in the marketplace around member enrollment, member customer service as well as claims adjudication and we expect to see those increased opportunities in the coming years as payers absorbs significant increase in membership.

High unemployment rates do persist, but they appear to have leveled off and the expectation is that we will have somewhat slow, but steady improvement in those rates within the coming year. Another encouraging indicator is that while the US has lost approximately 8.2 million jobs since the beginning of the economic downturn, the healthcare industry has actually gained 600,000 jobs during that same time period, which points to the ongoing growth and strength of that sector.

Moving on to the business outlook, high unemployment is driving some consideration in the payer market, upbringing profit is back onshore as well as utilizing onshore delivery for new capabilities needed as a result of the healthcare reforms and we believe that we are ideally positioned as these opportunities progress. In addition to losing the ability to exclude preexisting conditions and the practice of imposing life time caps on coverage, insurers will also now be required to report their medical loss ratios. This ratio is the percentage of premium payments that go to actual provision of healthcare and essentially going forward that will be 85% or greater for the provision of healthcare which means that administrative cost for insurance companies must be 15 cents or less of every premium dollar. This is driving interest by payers, as they look for significant ways to decrease costs and we believe that this will continue to bode well for the payer segment of our business.

On the provider side, although states may lift their Medicaid thresholds to 133% of Federal Poverty Guidelines; this is not actually mandated until 2014 and will be heavily subsidized by the Federal Government at that time. So given that many states currently have significant budget shortfalls, we don't see this as a significant opportunity until 2014, but we do expect our eligibility services lines to continue to grow in interim as unemployment remains high.

As for the receivables management line, we see continued growth in reimbursement and opportunities there as well. These will be driven initially by some reduction in reimbursements for the provider base, causing them to seek more cost effective solutions within our operations as well as more medium term opportunities associated with payment reform in the coming years.

Overall, we believe the outlook for this sector continues to be positive and we expect moderately higher growth in FY11 with sustained margins.

Ananda Mukerji Thank you Tom. I will now hand over to Matt to take you through the telecoms media and the BFSI verticals.

Matthew Vallance Good afternoon; I will take you through the telecoms media segment first of all and for the quarter that ended 31st of March, this vertical business contributed 27% of the company revenues. We closed the quarter with 7,145 employees, using 4,342 seats and we had a positive seat fill factor of 87%.

I will just talk for a minute about the trends we are seeing in the industry. We are seeing a theme of consolidation within the telecoms and media market along the number of different dimensions, one of which is some merger acquisition continues in the UK market, we have seen the completion of the Orange & T-mobile merger in the UK and that has created a new number one player in that particular market. In the US, we have seen continued merger activity there as well with recent link up of Centurylink and Quest. And we see a theme of vendor consolidation as companies merge, as the telecom business is mature, there is a theme towards reducing the number of vendors on which they draw their service from. In the UK market, particularly among most of mobile operators, we are seeing, an outsourcing of networks beyond their wireless networks as for companies such as Orange and Vodafone who operate beyond mobile in areas such as broadband and fixed line. We see companies like this outsource those operations to companies in particular, British Telecom who are making use of that third generation, the next generation network to provide services to the mobile operators in both the fixed line and broadband area.

We are seeing high definition TV started to become mainstream in the UK and 1 in 4 our TV customers is now using high definition and emerging area of 3D TV which is starting to come through. And we are seeing one of our major clients move into the Quad-Play environment again an early indication of organizations are rolling out multiple products to their customer base. In the US where we do fair amounts of work in the enterprise segments we are seeing that the slowness of the US economy is still affecting that market in terms of volumes although the pace of contraction has reduced.

In terms of the outlook, we have seen very robust growth in the telecom and media segment over the last year. We expect that growth to continue; we see a good outlook for growth as we see our clients expanding to new product lines and across supports for new products they are launching. It is that products have become more complex as they roll out Smart Phones and IPTV. Some mobile operators now are selling over a quarter their new handsets in now Smartphones and that will require increased technical support requirements.

We are also seeing demands for new interaction channels for supporting sales and service for customers. In particular the web chat channel is really starting to take off as a means for organizations to communicate with their customers and that's driving some interesting business opportunities in our direction. And we are also going into the area in the telecom business that is forum management where we are managing consumer forums to resolve technical issues and customer service issues for our client's customers.

We are seeing a growth opportunity for ourselves through the vendor consolidation because of the depth of the relationships we have with our clients and also the breadth of the services that we can offer them, so we are seeing ourselves as being a beneficiary of the consolidation process as we have said in the past.

We are seeing increased demands as Ananda mentioned early in terms of some of the protectionism around jobs in local markets. We are seeing some strong demand for our multi-geography deliver capability and we are certainly seeing in the enterprise segments the needs for cost cutting driving businesses, we certainly expect continue to see that driving our business in that direction both in the UK and the US markets.

If I move on to the financial services and banking segments – In terms of the segment as a whole, we derive 24% of our revenues from BFSI during the course of this quarter. Our employee headcount level was 3,409 using 3,090 seats and again healthy seat fill factor of 87%. In terms of industry trends, as we provide a large amount of collection services in the BFSI segments, we are seeing along with the economic recovery, we are seeing increasing yield on those portfolios in the collections business. And in the banking segment as companies have been through a cycle of mergers and balance sheet strengthening, we are now seeing banking organizations looks towards improvements of their cost-to-income ratio and of course there are some levers to do this around consolidation, automation of business processes but of course outsourcing as well, so we see outsourcing has been an opportunity that would drive that.

We are seeing some are larger multinational clients look towards outsourcing on a multi-geography basis, like for example, they may be operating in the UK and US and looking for common vendors across those geographies. In the UK retail banking space, there has been continued restructuring, we continue to see restructuring in the marketplace. We are seeing new entrants coming into marketplace. We are seeing banks such as RBS and Llyods Banking group sell off parts of their operations. So new entrants will come in into market through those types of activities; new entrants will come in to market through applications with new banking licenses and there are numbers of applications with the financial services authority in the UK for starting new banking businesses in the near future. In card industry across the board we are seeing card issuers adopting cautious and conservative approach towards lending and in the UK market in the mortgage area, we are certainly seeing lower levels of mortgage lending by 24% compared to the previous quarter.

In terms of business outlook, we expect to see more opportunities amongst our collections clients in other areas including customer service and back-office operations, we have already talked about the fact that we see opportunities from our clients who are operating across geographies. We expect in the collections business to increase our market share amongst our clients on the back of very strong operational performance and a very strong operating base, so we expect to win market share. On that basis and also we have added some significant logos during the course of last year and we expect to see growth from those clients through the course of the current year and beyond. And in terms of UK banking markets, we see opportunities from the restructuring in the industry where we have mergers and consolidation in the industry, we see opportunities there. We are already seeing opportunities in the area of data migration and the support to restructuring operations which will throw up outsourcing opportunities. In the mortgage market, the economic recovery continues to hold, we expect to see increase volumes in our mortgage business.

Ananda Mukerji Thanks Matt; with that I will hand it over to Chandra to take us through the ABU business outlook.

Chandra Iyer Good afternoon again; The Asia Business Unit contributes about 11% of the company revenues. The employees in this as of March 2010 have gone down from the previous quarter and this as Ananda had mentioned earlier is fair bit on account right sizing to match the volume shrinkage that we saw particularly from the domestic telecom industry.

In terms of seat utilizations, we are marginally lower than last time again as same right sizing and our seat fill factor is more or less same with the marginal percentage reduction in line with right sizing.

We have added a delivery to one geography, which is Sri Lanka through our India delivery operations.

From the industry point of view, as has been said before, the domestic unit has large customers basically from the telecom sector. And the flux in the telecom industry is continuing, there has been high degree of competitiveness created with new entrants, there have been tariff wars and that continues to impact the Telco's and their margins.

The call center charging which was a new phenomenon which was introduced some time back has once again been kind of suspended by the regulatory authority which is TRAI and there has been a fair bit of lobbying amongst the carriers to have this reinstated. In any case the way this would operate is that the cost of any inquiries or any such service requirement by a user of a telecom provider would have a small cost. It won't really change much in terms of the overall volumes.

The number portability has been on the anvil for a while and this has been going through some security concerns for clearance. It once again has a deadline of a date which is now visible, has gone through multiple changes and this has been something that we are not sure when it will really come into play. But we have actually done some of this work internationally and whenever this comes we should be ready to support that activity.

In the banking and financial world, the RBI has indicated to grant new licenses for private sector banks to come in and we should see plenty of activities on that front. The PSU and certain other banks are exploring service with hybrid models where they are looking at having service providers come in and support those services at their own premises and such are the models of engagement. We are seeing a fair bit of new entrants in insurance sector again with FDI regulations under continuous relook, we hope that that would change the industry and that is going to call some activity in the insurance industry as well.

In terms of business outlook, we have aligned our business and right sized it to the volumes that we have now seen. We do see our existing customers look at newer areas of services in which they need support and we are working with them on that. We see growth opportunities coming from the increased tele density which people are looking at penetration in India and there would also be expanded service lines that people are looking at and these would provide good opportunities for us. We have seen a lot of traction in the banking world and we are in fairly advance stage of discussion in this industry with participants in this industry. Insurance sector opening up is also allowing for a fair amount of traction and that would be business opportunities here as well.

All in all, although our base business continues to look at kind of a subdued or stable level of contraction at base level operation, we do continue to expect the unit to grow through the overall increase in services offerings and through new customers.

Ananda Mukerji Thank you Chandra. So to move on to the outlook for the coming year. We put down what we think are positive drivers and what are the negative impacts we are expecting to have in the coming year.

On the positive side – We do see the strong growth in telecoms and media business unit. We have good traction with existing customers, both onshore and offshore. It has been our strongest growing vertical in fiscal 2010 and we expect it to continue its strong growth in fiscal 2011. Our BFSI collections business has shown significant improvement in performance in fiscal 2010 and as Matt mentioned we have signed on new customers, our performance with our existing customers is strong and we do expect that growth momentum to continue.

We have had good wins in the healthcare provider segment and the first few months of this calendar year seems to indicate that even after a very strong growth over the fiscal 2009 and fiscal 2010, we are expecting to see even higher growth in fiscal 2011.

We do expect to see margin improvement in the Asia Business Unit on the back of process stabilization and operational efficiencies. At this business unit, right from the time it has been set up has in some sense being in a state of continuous large ramps and when processes are in large ramps, it tends to be inefficient in terms of its operations. It is now that finally the operation started to stabilize and we do not see any major ramps coming up, so we expect stabilization of the processes and focus on operational efficiency to drive margin improvements for the business unit and therefore for the company as a whole.

We expect to see the improvement in capacity utilization continuing. We are at 80% level at the company as a whole, but as you would have seen in the business unit wise presentations, a number of the businesses that are operating at well over 84%-85% and that is our aim is to get that overall company utilization to somewhere in the mid 80, so that should improve our performance in the coming year.

On a negative side, clearly currency headwinds is a concern for the whole industry and while we are largely hedged in the current year as we mentioned, clearly from the longer term basis, this has some impact going forward and will impact us even in the current year in terms of the open positions we have and the business which we do onshore.

As Chandra mentioned we have seen contraction in our base business with telecoms customer in the Asia Business Unit and that lower volumes are persisting and we think will continue for the next few quarters. So while we continue to win business in other segments of our customer base, the base contraction impact has to be first counteracted before we can see growth.

In the healthcare provider segment we have seen price reductions in the course of last year, during the whole year and we believe most of it has probably already happened, although the market environment does continue to be tough and there will be some more probably, but the bulk of it has probably happened, but we will see the full year impact of that in this year. And the volume impact in the healthcare payer segment last year as a result of business volumes coming down in the industry as a result of the unemployment will continue to see the full year impact this year.

So all in all between the positives and negatives, we overall expect to see a fairly strong fiscal 2011. We expect similar growth to what we did in fiscal 2010 probably a little bit higher in constant currency terms and we do expect to see the operating margin improvements which we have achieved 190 basis points last year. We do expect to see operating margin improvement continuing in this current year.

For the next quarter, because the seasonality impact of collections and this is something which hits us every year, we expect to see some dip in revenue and profitability for the specific quarter primarily due to the collections business.

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

Moderator Thank you very much sir. Ladies and gentlemen, we will now begin the question and answer session. Our first question is from the line of Anand Bhaskaran of Spark Capital. Please go ahead.

Srivathsan Hi Srivathsan here. Ananda the first question is on the FY11 guidance that you are looking at, given that FY10 was quite a tough year, is the current guidance of slightly above FY10 growth in the constant currency terms is a bit conservative or is there some big looming risk you are seeing that we are not seeing at this point of time?

Ananda Mukerji No, I think we are positive about the business going forward and certainly if I look back in April 2009 when we were doing this call last year, the outlook is certainly a lot better than what it was at that point. If I look at it for us, while the US economy is recovering and I think fears of double dip recession are now receding and we do expect to see the economy recovering there, for it to translate into business volume increase on the ground, we are a little cautious in terms of when that is actually going to take place. In segments of business where we have seen strong growth, we expect that strong growth to continue. But specifically in segments like the healthcare payer part of our business and on the BFSI outside of collections, we do think that the actual volume on the ground impact will probably take some time. So that is why I think it is probably what we are expecting to see is, let's say, somewhat better than last year, but I think we are not really coming back to historical growth rate yet in this year.

Srivathsan Okay sir, my next question is more on vertical specific, I just wanted to touch base on this healthcare, you say that the medical loss is being cut down to 15%, what is it currently and by when the company is expected to reach this kind of level?

Ananda Mukerji I will ask Tom to take that question. The question Tom was that medical loss ratio which is now 15% is the limited in administration cost, what is it currently and how soon does it have to come to that 15% level?

Tom Watters Well, it ranges by insurance company currently, I mean it can be anywhere from 15% up to 20%-25% and in some cases 30%. In terms of the timeframe when that 15%, the legislation that we have looked at up to this point is that by the end of this year, they are wanting to be compliant with those cost changes in calendar year 2010.

Srivathsan Is that calendar year 2010?

Ananda Mukerji Yeah end of calendar year 2010.

Tom Watters That's right okay.

Srivathsan Okay. My next question is what kind of cost savings do typically the payer side gets or especially the payer side when we talk about outsourcing not per se offshoring, suppose we are doing out of our onsite centers in US, what kind of cost savings does it give you over the short term and over the medium term that they can kind of hope to achieve?

Ananda Mukerji Okay. I will ask Tom to take it, Tom the question is how much cost savings does a payer typically expect to get by outsourcing or offshoring, when they outsource their operation, what kind of cost savings do they really target?

Tom Watters Well that would depend upon the scope of services that they are looking to outsource, but generally those range anywhere from 10%-35% in cost savings.

Srivathsan Okay sure. On the collection in BFSI, I just wanted to get some better understanding of the trend, because some of the data I was looking at. Is it a kind of safe assumption that now if unemployment improves over a period of time from now on, do you see liquidation rates reducing further and resulting in better collections?

Ananda Mukerji The question is that as the economy improves, do you see liquidation rates start to improve. And I think Matt did answer it.

Matthew Vallance We will see the improvements in liquidation rates with the improvement in the economy. We will also see through the CARD legislation that is coming to effect in the United States which will inherently improve the quality of the lending that is out there in the marketplace.

The liquidation rates will increase for both of those reasons.

Ananda Mukerji In fact, if I look at the current performance, we have seen some improvement in the liquidation rates already. While the unemployment rates have not moved too much in the US, I think the general sentiment is more positive and so therefore consumers' willingness and preparedness and capability to actually pay out their debt is improving. And as Matt mentioned, clearly the quality of the underwriting which is being done by card issuers is much more stringent now than it was earlier. So yes we do expect the improvement in the yield on portfolios. Having said that, clearly there is also going to be an overall contraction in the volume of overall outstanding debt, so there are two different impacts to the result of that, however, again as Matt mentioned, we expect to see our business to increase because of market share increase, because we have strong customers, we have done very well with them, added new customers which will grow, and therefore we are pretty positive about the prospects of the collection business in the coming year.

Srivathsan Sure. My next question is on margins you have done pretty well this year both on the EBITDA and EBIT margins improving. The expansion in margins in EBITDA is about 90 basis points whereas EBIT throughout year is slightly more. I just wanted to know how do you see in respect do you continue to see depreciations kind of expansion in EBITDA far out shipping EBITDA expansion.

Ananda Mukerji Well I think the EBITDA expansion is a little muted because of some of the one-time charges we have taken. Otherwise EBITDA is also expanding and overall in the year it has expanded. Now clearly, depreciation does play a factor. We have set up a lot of capacity in the initial years of the company being setup and probably peaked about a couple of years back and now centers are getting fully depreciated and we are not setting up as much capacity because we do not need to. Yes depreciation as the percentage of revenue is coming down and that obviously adds at the operating EBIT level.

Srivathsan Okay. On the margin expansion you will be targeting something similar to what we did in FY10 margin level?

Ananda Mukerji We are not making any prediction or not giving any guidance on that, but I think what we are saying directionally is that we will see margins improve.

Srivathsan Just couple of book keeping questions, what are the tax rates that we can look out for FY11 and any plans to hedge FY12 at this point?

Ananda Mukerji Dinesh, do you want to answer this tax rates we expect?

Dinesh Jain Tax rate, I think will be between 15%-20% and I think still direct tax code has not yet come and I think STPI regime is not really going to go out in 2011, there are still some hopes there. We expect it should be between 15%-20%.

Srivathsan Okay and just last bit the unsecured loan that is sitting in the balance sheet is completely FCCB, right?

Dinesh Jain That's right.

Srivathsan What is the dollar amount of it, just at what rate it has been translated?

Ananda Mukerji At 44.9.

Srivathsan 44.9 okay, thank you. I will come back later.

Moderator Thank you Mr. Srivathsan. Our next question is from the line of Ankit Shah of B&K Securities, please go ahead.

Ankit Shah Good afternoon. In this quarter we have seen a sharper rationalisation in the terms of employees count; still we have seen some marginal increase in the employee cost. Was some salary hikes been taken in this quarter?

Ananda Mukerji We will just come back to you, just look the numbers and come back to you. There have been no salary hikes, so it's not an account of salary hike. Just want to see what will be the reason of this, is it exchange rate and what is the impact on that, we will just come back to you.

Ankit Shah Not a problem sir. Regarding my second question in terms of healthcare verticals, sir in the past three quarter we have seen your employee count has been reducing at a slower pace, but we see an increase in the seat capacity, any specific reason, we are not increasing the employees out there in the healthcare verticals, but I still see an increase in the seat capacity?

Ananda Mukerji Again let us just check and come back. I don't believe we have added. Tom have we added any seat capacities in the healthcare business in the last quarter?

Tom Watters We have not.

Ananda Mukerji I don't think we have added any seat capacities, so I am not sure…

Ankit Shah Because in December 2009 the seat capacity was 3,414, this quarter it has marginally improved to 3,481. In September, it was 3,207. So we have been increasing the seat capacity maybe at very slow pace, but at the same time the employees have been reducing.

Ananda Mukerji Yeah, ok, I see, I can address that bit. We have moved centers, in India we moved from one location, we shut down one older center and moved to a newer center, so I think it's just a matter of how many more seats there was in the newer center. As you have said it is pretty marginal changes in the terms of number seat capacity, so we have not added any centers as a result of that.

Ankit Shah Okay. And sir in terms of the outlook, what you have mentioned is that full impact of price reduction in healthcare provider segment will be there for FY11. Sir, can you just throw some more light on this, what kind of price reductions were across the board for specific clients?

Ananda Mukerji I will pass it to Tom. Tom, the question is what kind of price compression we have seen last year; we have said that price compression, we are going to see in full year impact of that. Overall, was it across the board and what is the percentage of it we see?

Tom Watters Yes the price compression that we have seen has been on essentially a handful client at this point. In terms of the percentages or total revenues that we are looking at in terms of the price compression, it is somewhere in the neighborhood of 5% to 10%.

Ankit Shah

And are we expecting any further price reductions for this year?

Tom Watters

We don't expect it to the extent that we have seen it in FY 2010, but we are still seeing some price compression we expect that to continue throughout FY 2011.

Ankit Shah

Okay. Sir, regarding your collections business, what I understand is being a seasonal business, I think third quarter was where the collection business would be impacted the most, but I have just heard is that even the first quarter would be seasonally weak quarter because of collections. I fail to understand, are these two quarters seasonally weak for collections or only the third quarter is seasonally weak?

Ananda Mukerji

No. If you look at the fourth quarter, it is seasonally strong, so there is, it is slight up in Q4 so that's what in relation and Q3 seasonality is actually not specific to collection. Q3 seasonality is basically because of the number of working days and that is across the board and because of the holiday season in the market, so whether it's telecoms, BFSI or healthcare number of working days are less, so that's the impact in Q3. The seasonality is the positive seasonality in Q4 and then it comes back to normal in Q1.

Ankit Shah

Okay. And in terms of your ABU unit, when are we seeing a breakeven because we see that the volumes are still going down and we were expecting I think breakeven by the second half of this year or first half of

FY11. So are we still on track for that or we see delay in the breakeven happening for ABU?

Chandra Iyer Actually you are right; this business since conception has gone through large ramps in the past. We have had to invest towards that. This year it would have been profitable, we had some contraction in our business volumes which we saw, but in the coming year we definitely see it turning profitable and not just breaking even.

Ankit Shah Okay. So this would probably be by second half of FY11. We can expect that business turn profitable?

Ananda Mukerji That is right.

Ankit Shah Okay. And sir lastly, recently we heard that Patni had won a huge deal in the BPO space especially in the healthcare in USA, so what kind of opportunities, do we similar kind of large deals being available in the US market and are we bidding for the same?

Ananda Mukerji Yeah I mean, clearly the kind of opportunities are there for IT companies are different in the kind of opportunities there are for BPO companies, but yes we do see opportunities out there and most of the large players are looking at their business model. And as Tom mentioned there is pressure on them to comply with reform mandates, so there is going to be activity on the payer side in the coming year.

Ankit Shah Finally a last question regarding the attrition rate, sir we were talking of reducing the attrition rates over the past few quarters, but I think it has remained the same, so what are we doing on that front so as to reduce the attrition rate and because it is still high as compared to the industry average?

Ananda Mukerji We agree it is higher than what we would like it to be and there is focus attention on trying to get it improved. I think the labor market has become a little bit hotter than it was some time back, so that does contribute. But yes we do recognize the fact that this is an area where we have to improve and there is focus in trying to do that.

Ankit Shah What kind of wage hikes are we expecting going forward for onshore and onsite employees?

Ananda Mukerji Aashu, wage hike we are expecting this year?

Aashu Calapa In India we think the salary increase that we are planning would be somewhere around 8%-10% and in the US and UK it would be around 3%-4%

Ankit Shah And this should be effective from the next quarter or from April?

Aashu Calapa No, this would be spread across the year. In the US, we have a system of giving increases on the anniversary that is when people complete 12 months and in India, it is going to be spread across three quarters.

Ankit Shah Okay. Thanks a lot.

Moderator Thank you Mr. Shah. Our next question is from the line of Rachel Stormonth of Nelson Hall. Please go ahead

Rachel Stormonth Hello Good afternoon gentlemen and congratulations on a good year. Few questions, attrition rate is creeping up again on onshore operations, I mean in spite of the term wage hike, any comments on what we are looking to keep this on hold, this is my first question?

Ananda Mukerji Yeah in the last question, I talked about it, we do recognize the fact that attrition is higher than what our level of comfort is and we are focusing on many ways of bringing back that down, but it hasn't really gone up in the recent past, it remains largely stable, but at a high level than what we would like. I think in the US, our onshore business where the attrition levels are probably normal in the businesses we are in and we see high attrition in customer service, collections environment, everywhere whether it is in the US or UK. We have relatively low attrition in our healthcare business, but that I think are normal levels of attrition which the industry faces. Our offshore business which we do out of India, the attrition is a little bit higher than what we would like it to be, probably reason is also because the ramps we have done and increases we have had in the business, but yes definitely it is one of our focus areas to try to bring that attrition down in the course of the year.

Rachel Stormonth And can you share with us any new initiatives you are doing to try to contain it?

Ananda Mukerji Aashu, the question is what are the things you are looking at doing in terms of bringing attrition down?

Aashu Calapa I think that will take me the next one hour, but essentially better employee engagement, more focus on first time supervisory training, better targeted compensation measures, probably more focus towards retention rather than monthly increases. Whole lot of other measures but there is a lot of stuff that we are doing. There is a lot of focus this year on bringing down attrition, so hopefully we should see some decrease in attrition during the course of this year.

Rachel Stormonth Okay fine. My second question is the revenue contributions from your top 5 clients went down sequentially, can you explain what that decrease of activities was?

Ananda Mukerji Yeah that's largely because of the weakening of the pound. A lot of our big customers are in the UK and so that is part of the reason and also reduction say in one of our top 5 customers is in India that has been affected by the volume reduction. So I think the international customer in constant currency terms actually have not gone down. It is pound impact which is affecting that.

Rachel Stormonth So what proportion of that is kind of volume impact.

Ananda Mukerji On the domestic customer?

Rachel Stormonth Yeah.

Ananda Mukerji Domestic customer I think the volumes have come down anywhere from I think depending on segments of work about 10% to 20% reduction in volume.

Rachel Stormonth Okay. Thank you. And my last question is in the support that you are providing on Smartphones in the UK with the iphone now coming on board how do you see in the growth so far in tech support for some more complex products that you are expecting?

Matthew Vallance Yes we have seen increases in volumes as a result of Smartphone usage.

Rachel Stormonth Okay what is the kind of level of growth that you are anticipating?

Matthew Vallance I do not think we expected the Smartphone to take off in the speed in which they have done, but we did expect the increase complexity to drive volumes and having driven volumes from that point of view.

Rachel Stormonth And my last question is in what proportion of services of the customer support is coming for the web chat.

Matthew Vallance Relatively small percentage of our overall customer service volume is web chat. It will be less than 10%, probably more closer to the 5% at this point. We are seeing it emerging as a channel that is relevant. We have been hearing about web chat for the last 10 years as a service channel and as a sales channel but it is only now just starting to reach an inflection point and the web chat is really being use for sales conversions customers who are lingering on websites in shopping areas of websites. So it has been very good for the sales conversion tool but we are now starting to see it is being as a service tool as well.

Ananda Mukerji I think it is important to say that the way customers are being serviced in this industry is dramatically changing from the time when all of it was being done by contact call centers and in a single channel the way the servicing out there, now almost all our customer use multiple channels, they use e-mail extensively, they continue to using call centers, they use IVR, they are now getting into web chat, and an innovative means to forum management. So to be able to do customer service now you do need to have a very wide range of capabilities in terms of the channels you are experienced in.

Rachel Stormonth So**.** I do have a last question the Asia Business Unit I missed out the opportunities that you are exploring in the banking sector can you tell us what those are?

Ananda Mukerji Yeah in relative term the banking sector is outsourced much less than telecom sector at this point in time and most of the work which is being done is in-house. So I think the opportunity it is only just a handful of banks who have outsourced any function at all and we are now starting to see in both the public sector banks and the private sector banks starting to look more aggressively at models where they use a combination of in-source work and outsource work. So we are having conversation with customers on wide range of services from customer service to application processing, back office, and a lot of range of work with them.

Rachel Stormonth Okay. I agree with the point so the opportunities that you are pursuing are various banks?

Ananda Mukerji That is right.

Rachel Stormonth Thank you very much.

Moderator Thank you Ms. Stormonth. Our next question is from the line of Abhishek Sasmal of VCK Shares, please go ahead.

Abhishek Sasmal Good afternoon sir. I just want to know what is the pricing impact on revenue for this quarter.

Ananda Mukerji Pricing has remained largely stable. We have not seen any major change in this quarter compared to the earlier quarters. Not really too much change.

Abhishek Sasmal Okay what kind of pricing pressure you are seeing in India domestic business?

Ananda Mukerji We are seeing pricing like actually all the sectors of our business in the last year we have seen price reduction request from customers but particularly in the domestic business it is really more of a conversation in terms of how do we reduce the overall cost to serve our customers and while we have given price reductions to our customers in say anywhere between 5% to 10% it has been accompanied by a relaxation in service levels and flexibility in the way we can deliver. So customers are working with their business partners to figure out what is the best way to deliver the services to their customers.

Abhishek Sasmal Okay and how many seats are you planning to add during FY11?

Ananda Mukerji We do not give projections in seats but our budget for next year in terms of Capex is about $15 million.

Abhishek Sasmal And sir I just want to know one thing, in larger IT players recently they are actually streamlining their BPO services with their main pure play IT services and may be in future they will encroach into your type of work which actually a pure play BPO provider is providing, by doing a price reduction or billing rate reduction, so how are you seeing that as a threat to your business.

Ananda Mukerji Well I do not think it's anything new I am seeing many major IT companies have been players in the BPO industry right from the beginning so it is not the recent phenomenon and they have had various business models including having them in a separate company and having them as part of their company as a separate division or some of them are integrated BPO and IT and look at their business as vertical so different companies have different approach. I think there is competition from those IT companies but I think that has been there all through so I do not really see any new threat coming from them. We have focused on the industry verticals and in those areas I think pure plays are probably more relevant than in some of the horizontal space where IT BPO combined offerings are probably more present. We really do not see that as something that has changed the intensity.

Abhishek Sasmal And in the margins front you are actually saying previously that you are looking to expand your margins during FY11 I just want to understand with the supply side constraints, available higher wages and currency fluctuations apart from utilization what sort of levers you have for expanding your margins?

Ananda Mukerji Well actually number of levers, I think we continue to see improvement in productivity and efficiency in our operations. We are seeing that as process has stabilized across the board not just in any specific segment. As processes stabilized we do see improvement in productivity that guides improvement in margins. There is clearly a lot of capacity not just in terms of seats but in terms of the SG&A capacity, we have created in terms of managing the operation which we have and growth of business clearly provides operating leverage for us that contributes the margin expansion. I think there are segments of our business which are currently underperforming, Chandra spoke about the Asia Business Unit turning around and going positive so that will improve the overall profitability of the company as a whole. So there are number of levers we have for the margin improvement and all the factors that you mentioned were there this year as well and we did improve margins during the course of the year. So we are fairly confident that we will in the course of the year we will continue to see margin expansion.

Abhishek Sasmal Thank you sir and good luck for the next year.

Moderator Thank you Mr. Sasmal. Ladies and gentlemen that was the last question. I now hand the conference over to Mr. Ananda Mukerji to add closing comments. Please go ahead sir.

Ananda Mukerji So thank you for the joining the call and for your questions. I hope we have been able to answer all the questions you had. Just wanted to reiterate I think we had a strong fiscal 2010 and we feel positive about prospects for fiscal 2011 and we should see continued growth both in top line in a rate very similar to what we have achieved last year and improvement in margins so we expect to see a strong fiscal 2011. Thank You.

Moderator Thank you Mr. Mukerji, thank you members on the management team. Ladies and gentlemen on behalf of Firstsource Solutions that concludes this conference call. Thank you for joining us on the Chorus Call conferencing service and you may now disconnect your lines. Thank you.