Q3 FY2016 Earnings Call Transcript – January 28, 2016

CORPORATE PARTICIPANTS:

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

Moderator: Ladies and Gentlemen, Good Day, and Welcome to the Firstsource Solutions Limited Q3 FY16 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only modes. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Ganesh Iyer – Head, Strategy and Investor Relation. Thank you. And over to you, sir.

Ganesh Iyer: Thank you, Karuna. Welcome everyone and thank you for joining us for the Q3 FY16 Earnings Call for Firstsource. Please note that the results, the fact sheet and the presentation have been emailed to you and you can also view them on our website www.firstsource.com. To take us through the results and to answer your questions we have with us today Mr. Rajesh Subramaniam – MD and CEO and Mr. Dinesh Jain who is our CFO. We shall be starting this call with a brief presentation, providing an overview of the company's performance followed by a Q&A session.

I would like to remind you that everything that is said on this call that reflects any outlook for the future or can be considered as a forward-looking statement must be viewed in conjunction with uncertainties and the risk that we face. These uncertainties and risks are not included but not limited to what we have mentioned in prospectus filed with SEBI and the subsequent annual report that you can find on our website.

With that said, I would now turn on the call to Mr. Rajesh Subramaniam, our MD and CEO.

Rajesh Subramaniam: Thanks Ganesh. Good afternoon everybody, Good morning and Good evening if you are in different geographies. I will take you through our Q3 operating highlights, financial highlights and the outlook for the rest of the year.

Operating revenue in Q3 FY16 came in at Rs 817.8 crores compared to Rs 751 crores in Q3 FY15 and Rs 792.5 crores in Q2 FY16. This demonstrates a growth of 3.2% in rupee terms and 2.2% in constant currency terms quarter-on-quarter, a year-on-year growth of about 8.9% in rupee terms and growth of 3% in constant currency terms. These numbers would have been higher but for the impact because of the disruption in our Chennai operations, we employee about 3,000 people across our international healthcare and publishing work and our domestic business, if the impact was normalized our constant currency growth would have been higher by 2%, so we lost revenues of about $2 million which also translates into a 0.5% impact for the full year.

On the operating EBIT, Q3 FY16 operating EBIT at Rs 84.5 crores compared to Rs 74.6 crores in Q3 FY16 and Rs 80.1 crores in Q2 FY16, a quarter-on-quarter growth rate of 5.5%, margin expansion of 20 basis points from 10.1% to 10.3%, a year-on-year growth of 13.3% and a margin expansion by 40 basis points from 9.9% to 10.3%. On the profit side, the Chennai disruption costed us about almost $1 million in profitability, a combination of loss of profits from revenues and also the additional cost of BCP invoked in other cities to mitigate some elements of the disruption in business. The margin loss was approximately 50 basis points at the EBIT level, so our quarter-on-quarter growth would have been closer to 13.2% and year-on-year growth of about 21% if Chennai impact was neutralized.

At the profit after tax level, Q3 FY16 PAT came in at Rs 67 crores compared to Rs 57.5 crores in Q3 FY15 and Rs 61.9 crores in Q2 FY16, quarter-on-quarter growth rate of 8.4%, margin expansion of 40 basis points from 7.8% to 8.2%, a year-on-year growth of 16.6%, margin expansion by 50 basis points from 7.7% to 8.2%. Again, these numbers, the margins would have been closer to 8.8%, there would have been a 60 basis points impact on PAT and the growth rates would have been between 18% to 27% between quarter-on-quarter and year-on-year normalized for the rain impact in Chennai.

Cash and debt position, cash and cash equivalents of Rs 154 crores as of December 31, 2015, Rs 172.3 crores in the previous quarter, we continue to repay our principle installment of $11.25 million. We had some exceptional CAPEX spend of Rs 22.5 crores for supporting growth in the UK and in North America, which explains why there has been a marginal depletion in cash quarter-on-quarter. Net long-term debt of $97 million as of December 31, 2015, well on our way to be definitely sub - $85 million net debt by the time we end fiscal 2016.

On FX hedges, outstanding FX hedges at $38 million and £55 million for GBP, for next 12 months 82% coverage for the dollar at INR 68.9 levels and 81% coverage for the GBP at INR 113 levels and 25% coverage for pound to the Philippine Peso at 74 and 23% coverage for the USD to Philippine Peso at 47.6. Now for the ensuing 12 to 24 months forward, 44% coverage for USD at INR 72.4 levels and 55% coverage for the pound to the rupee at 111.5 0 coverage both for the pound and dollar in relation to the Philippine Peso.

From an employee strength, seat capacity and utilization perspective, 23,918 employees as of December 31, 2015, and our seat capacity pretty much the same as last quarter. 46 delivery centers, same as in last quarter, I mean the logical question is the Lyod Steel assets are still owned by the bank, it is not owned by Firstsource so that is why those seat capacity does not reflect in these numbers. 14,137 employees in India and 9,781 outside of India, net addition of 260 employees in Q3 FY16. Seat fill factor at 66.3%, largely flat between the two quarters. Attrition metrics largely remain the same, India and Philippines at 44.7% compared to 44.9% in Q2 FY16, onshore there has been an improvement, it was 43.2% compared to 48.9% in Q2 FY16 and the domestic business has also shown an improvement at 65.2% compared to 76% in Q2 FY16.

In terms of some of the other KPIs from revenue by client geography, North America continues to be the largest geography at 52.6%, we have seen a slight depletion because of growth in the UK which has gone from 37% to 39.6% and of course the impact of our operations in Chennai which was largely dealing with clients from North America. India, rest of the world has seen depletion from 8.2% to 7.8% in Q3 FY16, again a combination of some of the earlier volume rationalization and the domestic business that we undertake in our Chennai centers.

Revenue by verticals, healthcare we have seen a slight dip from being our largest vertical in Q2 with 39.2% to 37.8% in Q3 FY16, BFSI has shown an improvement because of the growth in the lift out deal that we did despite the adjustment in our collections where seasonally Q3 is the weakest quarter, given people are spending and paying less, so despite that adjustment we have still grown from 22.2% to 23.2% in Q3 FY16 and Telecom and Media largely remained stable.

From a delivery location, onshore has obviously grown for obvious reasons, offshore has been affected a little again for the major reasons and domestic has fallen by 30 basis points.

From a client concentration perspective, top five clients 47%, obviously a marked important from the previous quarter and our top client is about 23.2%.

From a tabular representation, no specific callouts, EBITDA largely flat, operating EBIT obviously has shown an improvement, PAT has shown an improvement and as I had mentioned earlier guidance was between 50 basis points to 70 basis points on EBITDA, thanks to the Chennai impact those numbers will fall closer to 20 basis points to 30 basis points for the year, but at a PAT level we have guided to about 70 basis points to 90 basis points improvement in EBIT and PAT, EBIT would largely be between 30 basis points to 50 basis points and PAT 70 basis points to 90 basis points improvement year-on-year is something that we feel we should be able to achieve given the strength that we see in quarter four.

Moving on to the slide on our outlook, we have signed a definitive agreement to acquire the BPO business of ISGN Corporation; it is a leading full service provider of mortgage technology and services. We have signed a definitive agreement to acquire the BPO and the services side of the business for the consideration of $13 million.

The acquisition helps us gain a footprint into the North American mortgage market, the two biggest market segment opportunities are healthcare and mortgages, we have a presence in healthcare, mortgages in the segment we have been looking at for quite some time and we fundamentally believe that the ISGN acquisition gives us access to a market opportunity which will see significant disruptions going forward where we believe we can clearly extend the runway and the flight path of what this asset has created in the past. The company has got an outstanding team, very strong domain capabilities, very deep relationships with marquee customers, obviously has had its own shares of ups and downs which are more scale related and nothing to do with capability. The culture fit with Firstsource is absolutely outstanding, professionally driven organization and with the balance sheet strength that we bring in and the capabilities that we bring in around elements of automation of digital strategies we see huge synergies playing out with customers. I have personally met most of their large customers and the feedback has been very outstanding on what they perceive of ISGN despite the challenges that they have seen in the past. Some of these challenges are regulatory driven, some of these challenges are capital driven but we have a fair idea on how we believe this asset can realize its full potential in our hands with the management team and the operating team that will join Firstsource. Over 700 employees of ISGN based in US and in India will become part of the Firstsource team on closure. Today we see there are regulatory approvals that are required, we expect the deal to close somewhere between February and March and given there are some licensing approvals that are required in the 50 states of North America, at this point in time our best guess is end February we should be able to get the deal closed.

On the other elements of our outlook, the transition of the UK bank lift out deal has been completed successfully and seamlessly with 375 people moving over to Firstsource. The operations of the US Telco which has been a little bit of a bug bear last year has been stable and the metrics are trending in the right direction. We spoke about the one-time impact of the Chennai rains.

I hope I have covered all the elements of the acquisition and the lift out deal. As I was going into the operations of the US Telco where these operations are stable and looking positive, Chennai rains we spoke about, on the collections business the US economic uptick is definitely having a favorable impact on our collections business. The collections business as I said Q3 is seasonally a weak quarter, it was lower by almost $1 million in revenues and proportionately a higher proportion of the marginal cost impact on profitability, but Q4 is looking very good given the buildup of inventory and I think the positive effects of seasonality will be slightly better than what we saw Q4 last year. Healthcare business spending continues to look good at least on the payer side, provider side there are some challenges but nothing that we cannot surmount. Customer management business is looking good, digital arrow heads and plays around automation to drive efficiency are the themes and the business uptick that we are seeing in the banking sector in the UK is looking very good. The growth momentum will continue in Q4 FY16. For Q4, our estimation is quarter-on-quarter the growth could be anywhere between 6.5% to 7% excluding the ISGN acquisition and then obviously profitability will be significantly higher because of the collection seasonality impact which potentially could get us into an EBITDA profile of anywhere close to 13% upwards.

On our investment earlier, we have made in Nanobi, we are strengthening that partnership, we are investing more money in the company to support its growth and we have got our Board approval to invest additional amounts which will help us strengthen the partnership given the significant go to market interventions that we are creating with this platform. We continue to repay our debt as per plan and overall ladies and gentlemen I think the word is a lot more positive as we are executing our Q4 and as we look at integrating ISGN and driving the synergies and business potential in the ensuing quarters and in FY17.

That is all I had with me for today and I am happy to take it back to the floor and open it 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 Mohit Jain from Anand Rathi. Please go ahead.

Mohit Jain: Couple of questions, one is on the telecom side. So what is happening in this particular vertical? While you have said that the business is now stable, the growth part is not coming there on a sequential basis, so if you could help us understand what should we expect from this vertical going forward?

Rajesh Subramaniam: So on the Telecom and Media side, the media client is obviously doing well and we are in the process of recontract which I will have clearer update in the next call where we would have come to a conclusion. On the telecom side, the customer we have in the US, the business is stable, the volumes are stable, the growth in volumes will be delayed, it is also a function of new marketing campaigns that the client launches which then translates into business both on the contact center side and on the digital webchat side. On the digital business that we won for India from one of the largest media companies in the US, it is proceeding as per plan, we will scale to a certain number by September and then accelerate once the business is stabilized. So at least at this point in time as I said the performance of our US business is stable, it is logical that as volumes come in the growth will ensue. At this point in time I am not in a position to tell you whether it will happen over the next three months or six months but all I can say is that all the problems of the past are settled and there is a valid reason why that business should grow once the customers, the market facing programs start gaining impetus.

Mohit Jain: Second is on the Chennai floods loss, you mentioned that there are around 3,000 employees there, doing some rough calculation and I assume your billing rate in Chennai would be much lower than the company level billing, so therefore $2 million loss looked a little on the higher side.

Rajesh Subramaniam: No, no the $2 million loss is two factors, one is, what I lose because of the days lost and the other thing what I lose because of the volume, because all the work that we do in Chennai on the international side is on transaction processing for healthcare, leave the domestic business out. In any transaction crossing what happens is that there is a chain of claims that need to get processed, so apart from the fact that the center was shut down during the rains there was an impact ensuing once we try to get the operations back to normalcy but there were volumes of business that were diverted to other partners across the world by our clients which ensured that some of the revenue which rightfully we would have got it did not happen to us for rest of December.

Mohit Jain: So by virtue of BCP this was not diverted to our center, it got diverted to some of the competitors, is it?

Rajesh Subramaniam: Who are not in Chennai, the good thing is at least two of the competitors who are on similar lines work just three buildings away from us, so a lot of it went into their captive centers too.

Mohit Jain: Third is on the acquired entity, are you disclosing their margins at this point of time?

Rajesh Subramaniam: At this time we are not disclosing their margins, at this point in time there is a lot of work that needs to get done in coming back with how this acquisition will play out from a margin perspective, we have a fair idea on the top-line and the growth perspective how this will work, on the profitability side there is still some amount of work which will happen and by the time we close the deal we should be able to come back and give you guys an update.

Mohit Jain: But are these like loss making or is there a range that we can put our estimates on?

Rajesh Subramaniam: At this point in time the business is EBITDA negative, but we clearly have an idea as to how we will turn this around, it will be an EPS accretive deal for us in near one.

Mohit Jain: And you have shown this revenue decline in the last two years, so what is the rationale behind taking it now that the business has already moved from like $65-odd million to $26 million?

Rajesh Subramaniam: So when at $65 million what has happened is the whole origination business obviously has come down, the portfolio has come down from $2 trillion to about $1 trillion, so there has been a lot of euphoria in the past and this business has had couple of customers that terminated it and there were new acquisitions which left them. The current set of customers that they have are long tenured customers, they will and I think this is pretty much as I said part of a diligence, I have spent time with each of these customers in the markets and have a pretty good sense of their commitment with ISGN. The company needs a little bit of capital, company needs a little bit of investments, company needs a little bit of working capital support, it needs a little bit of augmentation of the solutions team, we exactly know how to turnaround such situation, that is all I can comment to you at this point in time. And as I said we fundamentally believe this business will be accretive to us and the growth prospects with what we bring from a webchat, digital and contact center perspective and also what we bring from our capabilities in multi-geography both in onshore and in Philippines presents pretty big opportunities on how we can scale this business going forward.

Mohit Jain: What is the CY2015 revenue?

Rajesh Subramaniam: Flat.

Mohit Jain: Same as 2014?

Rajesh Subramaniam: Yes.

Mohit Jain: And last is on debt repayment which is sort of not happening if we look at your net debt position for the last one year or so, while we are repaying the overall debt position of the company remains more or less the same.

Dinesh Jain: No, comparing from last year we also have short-term borrowing which we have converted into long-term in the quarter one.

Mohit Jain: That $30 million is what you are referring to?

Dinesh Jain: Yes, I think that is the reason you are not seeing that change, otherwise the repayment is on track, cash generation on the same form, only along with the growth, cash utilizations are happening in the working capital as well. As you know that the refinancing and the market outside India is very attractive, so a lot of operating leases which were coming at a very attractive, my own funds which I can utilize is now much better, so I think we are trying to use somehow our cash to really also make the resume of the investment, you can see the CAPEX of around Rs 22 crores we did in this quarter.

Mohit Jain: That was my second question, actually now that CAPEX is growing up and our debt position is like $97 million, plus you are going to pay for the acquisition and lift out deals which you mentioned in the last quarter as well, one was expected to come in the fourth quarter. So with all those payments do you think your debt can actually come down?

Dinesh Jain: Yes, it will come down, the cash generation will also improve because the growth which we are seeing is happening in Q3 and Q4, so there a lot of debtors will get generated but those cash flows will come back because you have 45 to 60 days' debtors for the book which will come down.

Mohit Jain: Sir is there any target you have in your mind for end-FY17 debt levels?

Dinesh Jain: I think we are looking FY17 net debt levels should be around $25 million to $30 million, at least the 45 million is a normal repayment which will take place.

Rajesh Subramaniam: This is excluding the lift out deal consideration.

Mohit Jain: I am asking all inclusive because the position will remain where it is, the growth will come from the lift out deal but the cash will also go out.

Rajesh Subramaniam: I think the lift out deal what was supposed to it has been delayed, so right now we do not have an estimation on what that could be. So at this point in time after paying for the ISGN acquisition, after paying for the lift out deal that we already undertook in October a $25 million to $30 million net debt number is tenable as on March 2017. Any further lift out deal that we do will involve us increasing our debt exposure which will get taken care by the cash because any lift out deals that we do obviously are NPV accretive.

Mohit Jain: And should we expect your CAPEX to remain at this elevated level for sometime or do you think it…?

Rajesh Subramaniam: No, again we had to grow in whales, we had to set up a center for supporting growth with one of our customers who wanted to be in one center. There will be some incremental CAPEX on the capacities we have already created in North America and in Philippines and there will be some replacement CAPEX which will come up in India, but nothing to the extent that you see that we had to incur in Q3.

Moderator: Thank you. Our next question is from the line of Sanjiv Hota from Sharekhan. Please go ahead.

Sanjiv Hota: My first question is related with outlook for FY17, so if you could provide what it is going to be because Q4 FY16 is going to be a good quarter for us, so what is the outlook on the revenue and margins front if you could provide for FY17?

Rajesh Subramaniam: For FY17 at this point in time I think on a constant currency basis expecting a $550 million revenue profile without the ISGN acquisition, I think that is what we are working towards, that is the guidance that we have at this point in time. On the margins side, as I said ISGN there is a turnaround which will be at play, so while I fundamentally believe when we exit FY17 our margin profile will be far superior to our Q4 of FY16. But at this point in time I think I should be able to commit to 50 basis points to 75 basis points improvement in my net margins for FY17, but the details at the operating level are still being worked out and I should be able to present a clearer picture at the Q4 quarter.

Sanjiv Hota: Also, are you saying that in the near-term let's say for next two, three quarters we might see starting from Q1 2017 there could be some impact from the ISGN acquisition on the margins part?

Rajesh Subramaniam: Yes, there could be some impact in Q1 FY17 but also there are certain actions that we have taken which could mitigate the impact, one is, there is a lot of growth which is already being signed up to an ISGN on the back of the acquisition. So operating leverages will ensure certain mitigation of some of the EBITDA, attrition that the company has seen, plus from an integration perspective, from perspective of how the cost structure gets aligned to the business based on our experience at Firstsource some of those will start playing out post 90 days. So overall, the recovery in ISGN could be quicker but definitely I do not see material movement expected in Quarter, there will be some margin atrocity in Q1 on a like-to-like basis and of course Q4 is our traditionally best quarter, so it will be difficult for us to maintain that same momentum in Q1 once seasonality falls of. So yes, Q1 FY17 there will be some reduction but the pickup from there from Q2 FY17 onwards will be evident.

Sanjiv Hota: And we are just maintaining a net margin improvement of 50 to 70 basis points, so largely the function of higher hedging gain that we are counting in?

Rajesh Subramaniam: Actually the hedging from a like-to-like you would see would be largely flat between FY16 and FY17, if you take a look at next 12 to 24 months largely because of the investments we have made, it is also the growth that we see in our offshore business, some of the businesses as I explained to you. It is also the full year impact of the lift out deal that we see in Q3 which we have done in Q3 which will play for six more months next year. So there are a whole bunch of levers that we have, lower interest cost that also plays an impact. And the swing can happen based on the performance of the acquired platform which we are confident because where the alignment of the management team in ISGN to make it work.

Sanjiv Hota: And missed out on the revenue of ISGN for CY15, what is the revenue for CY15 for ISGN?

Rajesh Subramaniam: It is roughly about $25 million.

Sanjiv Hota: And if you could share the lift out revenue for this quarter, what were you expecting for Q4?

Rajesh Subramaniam: Q4, the lift out deal should have given us about $5 million kicker but that has been delayed, there are some regulatory nuances which the client has to fulfill, once that is done, negotiations and the process will commence. So this deal which gathered momentum in Q2 now the cash on the pedal has been lifted, but that could give us a positive clearance suffice next year if it plays out well.

Sanjiv Hota: So Q4 we are expecting $5 million from this lift out deal?

Rajesh Subramaniam: Yes, we were expecting about $5 million if we had got the benefit of at least 2 months of revenues, that was the size of the revenues. Right now, if the ISGN deal closes by end of February that would potentially give us anywhere between $1.5 million to $2 million, $2 million to $2.5 million of revenue uptick in March 2016.

Sanjiv Hota: So this guidance of 6.5% to 7% is excluding ISGN?

Rajesh Subramaniam: Yes, but 6.5% to 7% would not happen, if you recollect last time I had brought it down to 4% to 5%.

Sanjiv Hota: No, no I am talking about Q4 FY16, I am not talking about the year.

Rajesh Subramaniam: Yes, Q4 is excluding ISGN, that is right?

Sanjiv Hota: And including lift out deals?

Rajesh Subramaniam: Excluding lift out deal.

Sanjiv Hota: Okay, both excluded?

Rajesh Subramaniam: Yes, both excluded.

Sanjiv Hota: And last one bookkeeping question on the depreciation that is declining Q - o – Q, what kind of run rate we can take on the depreciation report?

Dinesh Jain: I think depreciation rate I think we will go back to what was in the Q2 because there is some investment in Q3 and some investment pending in Q4, so on a run rate basis we will go back on the Q2 levels.

Moderator: Thank you. Our next question is from the line of Deepesh Mehta from SBI Cap Securities. Please go ahead.

Deepesh Mehta: I have a couple of questions. First, can you tell us what is the deal intake during the quarter and how the deal pipeline looks like at the end of the quarter? Second question is, I am not very clear about the guidance and lift out deal, one deal we announced last quarter in banking, the two deal we suggested in the pipeline and now in the commentary you suggested about some deferment in one of the deal. So if you can provide some clarity about all those deals and what we bill into the guidance and what not?

Rajesh Subramaniam: So as I said at this point in time there is no more lift out deal guidance in our Q4 forecast and the other deal which we said we were in active when we had gone through the process of coming down to the final to shortlist has not been put on hold, so anyways any of the guidance that I have given you is excluding that lift out deal and any of the guidance we have given is excluding the acquisition.

Deepesh Mehta: Only one question, the UK bank which we announced, it is part of the guidance or it is also not?

Rajesh Subramaniam: No that is part, that is already done, so that is a part of the guidance, that will play itself out.

Deepesh Mehta: And how much that deal contributed into Q3?

Rajesh Subramaniam: We are not getting into that level of granularity.

Deepesh Mehta: And deal intake and deal pipeline if you can provide.

Rajesh Subramaniam: What do you mean by deal intake?

Deepesh Mehta: Previous quarter we used to suggest how much deal we have…

Rajesh Subramaniam: So at this point in time our deal pipeline is reduced to about $315 million from last quarter was about $500 million largely because four big deals have not moved, one is from a large bank, one is from a large credit card division of a bank and one is from a large Telco. So we have qualified out about $115 million of deals and we will bring it back when the activity starts. So at this point in time our deal pipeline is closer to about, my CFO corrects me, it is not $315 it is about $370 million.

Deepesh Mehta: And last quarter I think we won around $37 million worth of deals, any number this quarter we have closed kind of that?

Rajesh Subramaniam: This quarter our net addition has been about $7 million.

Deepesh Mehta: And the last question is about the ISGN acquisition, now you partly suggested about revenue decline and other thing, just want to understand how that business has revenue and profitability dynamics, if you can help us understand with a growth in revenue how the equation changes?

Rajesh Subramaniam: See, the business has got significant operating leverages and what happens in that business is it is a $25 million platform and obviously when they were $55 million, $60 million the level of profitability was much higher. They have had some setbacks with some customers in the past which obviously all that is history, the customer that we are today banking on driving growth are long tenured customers that have stayed with them. The US economic activity suggests that from being a purely refinanced market the refinance to pure origination those ratios are definitely looking a lot more positive. And this is a trillion-dollar market segment and right now we are just talking about the origination side, there is a big offshore scalable element in mortgage servicing which ISGN has a very small footprint today. They have repeatedly been disqualified on deals because of their size and scale, because the Chief Risk Officer of a bank would rather give it to a larger player given the scale of operations what servicing offers. I think that presents a very attractive opportunity for us with the existing customers and we know we will make a headway. Unlike the businesses that we manage, the level of redundancies that need to be maintained in floor management to deal with the swings in the types of mortgages interplayed with regulatory nuances of various states will require a little more investment in building a bench, so those investments ultimately have a bigger payoff because of the superior rate profile that they have with the customers. So a combination of multiple factors right from capacity utilization productivity to building a bigger bench to deal with more complex nuances and driving elements of automation in some of the processes where manual intervention can be taken out can clearly drive a path for both growth and profitable growth. So we have our plans cleared, I will come back with an action plan and probably one on one with all the analysts that cover us and explain to you how we expect this acquisition to play out going forward.

Deepesh Mehta: And just last one thing, when ISGN revenue run rate was over $60 million what kind of profitability they used to enjoy?

Rajesh Subramaniam: I think when they were over $60 million, if I recollect right the EBITDA margins would have been somewhere in the mid-teens.

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

Archit Singhal: Two questions, firstly on the guidance, last quarter we had mentioned that EBITDA uptick of 70 to 80 basis points for the full year FY16, so what are we seeing as of now?

Rajesh Subramaniam: So out of the 70 - 80 basis points I have had an almost 20 basis points impairment on Chennai, so right now I have visibility of 20 basis points improvement in EBITDA which would have been 40 basis points and my sense is, given some of the uptick that we see from our collections business, we would not get to 70 - 80 basis points on EBITDA, it is likely to be closer to 30 to 40 basis points on the EBITDA and between 80 to 100 basis points at the net level.

Archit Singhal: And in terms of the revenue we had mentioned a growth guidance of 7% in constant currency terms out of which we said that 4% to 4.5% we are certain about and rest depends on the deals.

Rajesh Subramaniam: Yes, out of 4% to 4.5% right now we are at closer to 2%, 2.5%, we have lost 0.5% from the Chennai impact, so it would have been closer to 3%, another 1.5% would be based on some of the ramps, I mean at this point in time I think for us to get to about 3%, 3.5% including the Chennai impact is something which is tenable, excluding the ISGN acquisition consolidation which potentially could happen in the month of March 2016.

Archit Singhal: So 3% to 3.5% and that would include the deal which we had in October, right?

Rajesh Subramaniam: That is right.

Archit Singhal: And for ISGN just wanted to check with the numbers again, so what was the revenue for CY15, I think you mentioned it previously.

Rajesh Subramaniam: It is about $25 million.

Archit Singhal: And how does it change quarter wise, I mean how does the seasonality play in that business?

Rajesh Subramaniam: I think January-February-March would be a very good quarter is our expectation, not because of seasonality but because of some of the latent demand which will correct itself. Q3 was a rough quarter because of big changes in regulation which impacted the workflow of mortgage alignment and assignment between US and India. So yes, January-February-March onwards clearly the uptick in the business will be clearly evident.

Archit Singhal: And last question, any positive things which can be coming, I mean any deals which can bring this 3% to 3.5% number upwards?

Rajesh Subramaniam: At this point in time, no.

Moderator: Thank you. Our next question is from the line of Priya Rohira from Axis Capital. Please go ahead.

Priya Rohira: Rajesh, just wanted to clarify, the deal pipeline which you mentioned right now is $315 million, right?

Rajesh Subramaniam: No, it is $370 million. So I was corrected, $315 million was the number I mentioned but my CFO mentioned it was $370 million.

Priya Rohira: And this is versus $500 million in the last quarter?

Rajesh Subramaniam: That is right, so we have qualified out about $115 million and we have won some of the other deals which have translated into wins which will translate into ensuing quarters.

Priya Rohira: And you had mentioned about a banking client which will contribute around $8 million to $9 million in the second half which had already commenced operations in Q2, that is going as per expectations?

Rajesh Subramaniam: That is right, that started in Q3 and that is playing out well, that is the 375 people we have transitioned over successfully which you have mentioned in the highlights.

Priya Rohira: So this was referring to banking account which you had mentioned will contribute $8 million to $9 million in H2 and which had commenced operations in Q2, are we on track on that particular account?

Rajesh Subramaniam: Yes, absolutely. So we won the deal in Q2 and the revenues were started translating in Q3 and that is done, so that is in my numbers.

Priya Rohira: And are you sharing the contribution in Q3?

Rajesh Subramaniam: No, we are not getting down to the deal specific levels Priya because it then becomes very difficult on every deal to start.

Priya Rohira: And this Telco account which you were saying coming back to the deal pipeline, if that happens then we will have an additional $115 million coming into our deal pipeline kitty?

Rajesh Subramaniam: That is right, so we have a very rigorous method where if we have clear guidance that things have not moved from milestone to milestone within a certain period of time it goes out. So in our basis if we believe that we are not going to get deletion in the next six months, based on the process from where it was left to what it takes to get to a successful conclusion whether it is a yes or a no, it takes certain period of time and if we cannot see momentum in six months we tend to take it out of our pipeline.

Priya Rohira: And last question from my side, Rajesh healthcare has always been a growth vertical for us, if I look at CY of 2016 how do you see, I mean conversations with clients, how do you see the healthcare from the growth outline given earlier of it growing at around 15% to 16%?

Rajesh Subramaniam: We will be able to support those growth rates Priya.

Priya Rohira: So there our traction is only enriching in that respect?

Rajesh Subramaniam: That is right, so healthcare is continuing, the thesis on our healthcare business is playing out more so in the payer side, provider side has some challenges.

Priya Rohira: And just as a follow-up on ISGN acquisition, do we see lot of cross selling opportunities what we have currently in terms of what we are offering on the BFSI side?

Rajesh Subramaniam: Absolutely, the opportunities around contact center work in the US, Philippines, encompassing everything from voice to web chat to omni-channel interactions and our ability, today we have significant presence in financial services and healthcare collections, student loan, we do not have a mortgage collection portfolio so that is another service we bring to the table, huge opportunities with their current customers.

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

Abhishek Shindadkar: Apologies, it could be a repeat question, but have you shared how you have done the acquisition, I mean what is the payment, is it in cash or debt plus cash?

Rajesh Subramaniam: It is a cash, debt is cash so it is a $13 million payout, the actual payout will be lesser given there would be some working capital solvency that will be retained within ISGN which will be a reduction from the purchase consideration and when the closing happens in three months it will be financed largely with a combination of some of the cash that we have and if we need to take some lines of credit for a few million dollars, we will have the existing limits with our lenders which we can utilize.

Abhishek Shindadkar: So for $25 million revenues what is the value that we are paying?

Rajesh Subramaniam: So $13 million.

Abhishek Shindadkar: And regarding the lines of credit you talked about, were there any covenants in terms of our debt repayment structure before we could go ahead and raise…?

Rajesh Subramaniam: All that is benign, nothing at all, everything there is nothing which impacts our ability to do either the transaction or what we are currently undertaking.

Abhishek Shindadkar: And last question regarding the 375 order book that you talked about, does that include ISGN or that excludes…?

Rajesh Subramaniam: Excludes, anything that we have given you on the number side excludes the acquisition.

Abhishek Shindadkar: Thank you. Our next question is from the line of Pratik Gandhi from Geecee Investments. Please go ahead.

Pratik Gandhi: I have a question with respect to the verticals, so your vertical concentration healthcare is roughly around $200 million, BFSI is roughly around $115 million on an annualized basis and rest is on the telecom, if one needs to take a call in terms of say three-year view, how should one look at this contribution going forward, so what will be the growth driver for us? And within that if you can just split how we want to penetrate more on the payer side, provider side and even in the BFSI side how you want to take it say collections or the customer management side would be helpful. Thanks.

Rajesh Subramaniam: So I think the question you have asked I have to draw a metrics of all the possibilities and things. So fundamentally, healthcare and banking are going to be the drivers of growth going forward, healthcare payer and UK banking specifically, from a three-year perspective I would expect healthcare to be my largest vertical, I would hope that banking would be my second largest vertical and Telecom & Media would by my third vertical.

Pratik Gandhi: So I guess if I look at your current year's numbers I believe we will be short of what we were earlier anticipating for again partly because of Chennai and some other issues. But going forward how you are looking at in terms of growth, is it fair to assume that we can restore double-digit growth?

Rajesh Subramaniam: Absolutely, if you just take a look at my exit number, so if I achieve the growth of 6% to 7% takes me into a Q4 of almost Rs 870 crores in revenues. At Rs 870 crores in revenues you take out seasonality element of typically about $1.5 million and then you annualize the numbers and then you bring in the elements of all the other pipeline growth conversions that I have had, if you do the math yourself you will see what I am saying.

Pratik Gandhi: So we will get around 4% kind of dollar revenue growth without doing anything else?

Rajesh Subramaniam: Actually it should be more I would guess.

Pratik Gandhi: Because assuming next quarter we will do $3.5 million our annualized revenue would be $510 million versus the current year number of $490 million, so that is around 4% dollar revenue growth.

Rajesh Subramaniam: Okay, my number is closer to 6% to 7% dollar revenue growth for my Q4 annualized normalized for seasonality to my FY16 numbers.

Pratik Gandhi: How good that will be because if I do the same math for the previous year logically we should be doing $484 million with no growth scenario and eventually we end up doing only $490 million, so it is hardly any growth in that case.

Rajesh Subramaniam: So last year the denominator of the dollar changes from INR 60 to 68 and then to INR 69, so that is why on a dollar term basis look, but from an actual if I take a look at the underlying earnings, at about Rs 870 crores compared to Rs 819 crores on the same basis Rs 870 crores you back out about Rs 10 crores from seasonality is Rs 860 crores, Rs 860 to Rs 919 crores and Rs 860 crore multiplied by 4 is do the math.

Pratik Gandhi: Rs 3,440 crores

Rajesh Subramaniam: This Rs 3,440 crores on our current base would be closer to about Rs 3,235 crores.

Pratik Gandhi: 6.3%.

Rajesh Subramaniam: That is next year answer to you.

Pratik Gandhi: And sir that is largely because of the exit benefit we will be getting this, over and above this we will also see some pipeline conversion, so I think we are seeing that 10%, 11% growth should not be a challenge for us.

Rajesh Subramaniam: Without including the ISGN acquisition.

Pratik Gandhi: Sorry, did I hear this is including ISGN acquisition?

Rajesh Subramaniam: Excluding.

Pratik Gandhi: So that will be around $25 million addition to that, right?

Rajesh Subramaniam: Right.

Pratik Gandhi: And you said ISGN margin is also double-digit when it was operating at…

Rajesh Subramaniam: ISGN right now is losing money at the EBITDA level, but as I said by the time we end the year it will be an EPS accretive deal.

Pratik Gandhi: And any integration in terms of the timeline where you see our margins heading from current levels?

Rajesh Subramaniam: I think as I said, I mentioned that there will be a further margin expansion next year based on the current business profile that we have and I will come back to all of you either in a one-on-one or in whatever forum. Once we have completed our work on entire ISGN integration and how those numbers will play themselves out to give you a final end of your margin story.

Pratik Gandhi: And lastly in terms of the debt on the books, are we on time to repay our debts, the one which we earlier integrated?

Rajesh Subramaniam: Are you saying are we likely to default on our debt? prepayments will continue.

Pratik Gandhi: No, no. So I guess earlier we had some plan that within next two, three years we want to be a debt free company?

Rajesh Subramaniam: Yes, that will happen.

Pratik Gandhi: And anything on the seat addition guidance for next year?

Rajesh Subramaniam: I think we have enough seats right now, all that we hope is clients do not expect us to create new capacities when they give us business but taking care of the capacity that we currently have, so I think we are pretty much at some of the lowest levels of film facts we have been. So I think that is again, maybe if that 66% gets about 75% that gives me nice margin levers to improve my margins. But as I said, all those will play themselves out the next three months when I close my budgets and I will have a clearer perspective to share with you either in a smaller forum or in my next earnings call.

Pratik Gandhi: And lastly if I can just squeeze in, in terms of this quarter my calculation indicates there is some realization improvement of around 2.5%, so was it because of some seasonality thing where the volume was slightly lower and hence I am getting higher realization or there is no like-to-like pricing improvement there in the current quarter?

Rajesh Subramaniam: I have no idea how you have calculated your realization, but we can take it offline, we can look at it and then we can go through it.

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

Anup Upadhyay: My questions have been answered. Thanks.

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

Manik Taneja: I suppose part of my question has been answered, but just trying to understand if you could give out the sense in terms of some of the large deals that we have won in telecom about 9 to 12 months back and there have been delays in ramps on those deals.

Rajesh Subramaniam: That deal Manik as I had mentioned last time, the realization of the deal was supposed to be closer to $40 million and it is about $22 million, at $22 million when it was trending towards $22 million we lost about $3.5 million last year, that has corrected itself, so that adds little bit of margin uptick for me going forward. But I will need that cushion for some of the contingencies that I need to build in terms of all the contract renewal that we are dealing with our largest customer. And that business right now can scale as I have mentioned based on some of the campaigns that the customer introduces and our improved performance, the volume increase is logical but the timing of that we still do not have guidance from the client, it would happen in three months or six months, but we have the capacity, we have the ability to ensure that we do not lose money on that going forward given some of the tools that we have implemented for ensuring smooth transition in operations. So at this point in time any of the guidance that I have given you on exit excludes the growth to the full potential, but if the growth catches itself up there is definitely upside for us in our numbers.

Manik Taneja: And if you could also call out the contribution for the lift out transaction that you completed towards the end of Q2?

Rajesh Subramaniam: I think I will restrict it to the revenue and not on the profitability, as I said it will add about $8 million to $9 million in our second half and it is playing itself out.

Manik Taneja: So it is pretty much on track on that regard?

Rajesh Subramaniam: Yes, it is business as usual.

Manik Taneja: And the other lift out deal that you were essentially negotiating, that is on the backburner?

Rajesh Subramaniam: That has been delayed due to regulatory reasons and the client will engage us back when they have taken care of the requirements that they need.

Moderator: Thank you. We take the last question from the line of Deepesh Mehta from SBI Cap Securities. Please go ahead.

Deepesh Mehta: Just a couple of data points, what we expect our effective tax rate to be and CAPEX likely for current year and next year? And then I just to understand ISGN business model, what will be the client concentration there and what will be the equation between permanent staff and temporary, if you can provide some color?

Dinesh Jain: So the tax rate will remain the same what we have this quarter, I think the last quarter is around same, so it will be around 10%. Next year I think last time also I said that it will move up by at least, it will go between 14% to 15%, so I think it will depend on the final assessment with the ISGN in mind and we have to do that but I think 13%, 14% is going to be there.

Rajesh Subramaniam: And on the ISGN question, I think the longer answer which we can take this offline, Ganesh Iyer will be happy to talk to you separately. And there is no concept of temporary stuff, these are full time equivalents that the company employees and we can spend more time on the business model on an offline basis but it is going to be a pretty long answer.

Deepesh Mehta: Sure. And last is, you suggested some challenges you are seeing on provider side, if you provide some color there.

Rajesh Subramaniam: Yes, the provider side, as I said last time we have had challenges on hospital consolidations which were happening which was resulting in some internalization of the businesses. So the situation we are in is that every time we win business that creates a little bit of acts as an offset to some of the businesses that we are losing, so the incremental impact on growth is obviously not evident but we are hoping next year we get to a better position then what we have had in FY16.

Deepesh Mehta: And CAPEX, I think the only remaining part.

Rajesh Subramaniam: CAPEX should be roughly about, my guess it should not be more than $10 million to $12 million next year and out of which roughly 50% to 60% is through operating mechanisms and 40% through cash on the balance sheet.

Moderator: Thank you. That was the last question from the participant, I would now like to hand over the floor to Mr. Rajesh Subramaniam for his closing comments. Over to you, sir.

Rajesh Subramaniam: Thank you everybody, thanks for your patience and time on the call today. Could have been a very good quarter but for some of the setbacks driven by first major Q4 is looking good as we are executing on it. Very excited about the ISGN acquisition, helps us play into all the biggest markets in North America, healthcare and mortgages, significant opportunities for us to grow that platform, I am very excited about the team and the domain that we inherit. And overall, I will be more than happy to explain how our thesis on the acquisition will play itself out in the near future which will give you more confidence on how the synergies are going to play for the benefit of Firstsource shareholders. So having said that, I thank you for your time and I look forward to speaking or meeting with each of you in the very near future. Thank you.

Moderator: Thank you very much sir. Ladies and Gentlemen, on behalf of Firstsource Solutions Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.