Q1 FY2017 Earnings Call Transcript – July 26, 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 Q1 FY17 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode 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 for an operator by pressing '*' followed by '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Ganesh Iyer -- Head of Strategy & Investor Relations. Thank you and over to you sir.

Ganesh Iyer: Thank you, Zaid. Welcome everyone and thank you for joining us for the Q1 FY17 Earnings Call. Please note that the 'Results', 'Fact Sheet' and 'Presentation' have been mailed to you and you can also view this in our website, www.firstsource.com.

To take us through the results and to answer questions, we have with us today Mr. Rajesh Subramaniam -- our Managing Director and CEO and Mr. Dinesh Jain -- our CFO. We will be starting this call with a brief presentation providing an overview of the Company's performance followed by 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 which can constitute as a forward-looking statement must be viewed in conjunction with the uncertainties and the risks that we face. These are included but not limited to what we have mentioned in our prospectus filed with SEBI and the subsequent annual report that we have on our website.

With that said I now turn the call over to Mr. Rajesh Subramaniam -- our Managing Director and CEO.

Rajesh Subramaniam: Hello everybody and thanks for your time today on the call. I will take you through the Operating Highlights and we will then open it up for Questions. In Q1 FY17 our operating revenue came in at Rs.893.5 crore compared to Rs.869.4 crore in Q4 FY16 and Rs.741.4 crore in Q1 FY16. The quarter-on-quarter growth has been 2.8% in rupee terms and 3.3% in constant currency terms. The delta being explained by the consolidation value of the pound in Q4 which was closer to about 98.5 compared to 96 in Q1. On a year-on-year basis we have grown 20.5% in rupee terms and 16.2% in constant currency terms. Operating EBIT in Q1 FY17 came in at Rs.102.9 crore compared to Rs.96.7 crore in Q4 FY16 and Rs.66.9 crore in Q1 FY16. Profitability growth on quarter-on-quarter has been 6.4%, demonstrating a margin expansion of 39 basis points from 11.13% to 11.52%, margin expansion despite collection seasonality falling off and year-on-year growth of 53.8%, margin expansion of almost 250 basis points from 9.03% to 11.52%. At the profit after tax level, Q1 FY17 PAT came in at Rs.73.4 crore compared to Rs.76.2 crore in Q4 FY16 and Rs.52.9 crore in Q1 FY16. Quarter-on-quarter there has been de-growth of 3.7%, largely on account of higher tax regime, which we will talk about in the ensuing chapters. Margin contraction of 57 basis points from 8.78% to 8.21%, but on year-on-year basis the profit growth has been 38.8%, margin expansion of 106 basis points from 7.15% to 8.21%.

Other metrics around people, seat capacity, utilization and hedges - 24,148 employees as on June 30,2016, seat capacity of 23,920; 14,606 employees in India and 9,542 based outside

India, net addition of 262 employees in Q1 FY17 representing the add-in of ISGN and the take out of the Verizon ramp down which was effective in the 3rd week of May. 47 delivery centers as on June 30, 2016 compared to 45 delivery centers in Q4FY16. Seat-fill factor improvement from 68% on March 31, 2016 to 71.8% as on June 30, 2016. The offshore attrition rates have improved - 50.1% in India and Philippines compared to 56.7% in Q4 FY16. Onshore (US and Europe), slight spike 49.3% compared to 43.5% in Q4 FY16, also explained by the separation with a whole bunch of employees with Verizon in Eugene and Louisville. India attrition obviously has done better - 84.1% in Q4 FY16 and step down to 76.8% in Q1 FY17.

Cash and cash equivalents of Rs.114.7 crore as of June 30, 2016 compared to Rs.145.4 crore in the previous quarter. There has been the scheduled repayment of $11.25 million on June 30, 2016 and there has been CAPEX spend of Rs.27.2 crore. The acquisition of ISGN was completed in Q1 FY17 for a total consideration of $13 million. The net long-term debt is $97 million as of June 30, 2016.

Outstanding FX hedges at$30 million for the US dollar and £66 million for GBP, so next 12-months 76% of the US dollar is covered at about Rs 70.2 levels and 82% of the GBP at Rs 110.5 levels and 38% has been covered for GBP at Philippine Peso 68.8 levels. For the forward 12-to-24-months, 36% coverage for the USD at Rs 74.2 levels and 80% for the pound at Rs 110 levels and given some of the impact that we have seen with Brexit, we thought it was prudent to take some coverage for next 24-to-36-months we have covered 17% of our GBP at Rs 105.3, and we will watch future developments and we will take calls on what we need to increase in this or maintain the exposure, basis on some of the long-term contracts that we have signed up.

So if I go to the next section which talks about our revenue segmentation by geography, North America continues to be the largest geography at 54.4%, largely flat which basically demonstrates the absorption of the ramp-down of Verizon Wireless. UK again largely flat at 38.3% and India, rest of the world largely flat at 7.3%.

By vertical, as I had always articulated, the BFSI vertical has obviously stepped up from 25.3% to 32.4%, a combination of the ISGN acquisition and growth in some of our Banking clients. Telecoms and Media have fallen from 36% to 32.5% and Healthcare has fallen from 38.4% to 34.8%.

From revenue by delivery perspective, almost 73% of the revenues delivered onshore, 21.4% offshore and 5.7% from our domestic business.

From revenue by segment basis, as per the new Ind-AS categorization, the segments we have now represented are Customer Management, Healthcare, Collections and the Domestic business. The Customer Management business in Q1 FY17 was 51.4%, the ISGN business consolidates within the Customer Management business given the synergies that we see in cross-selling businesses across both spectrums of the service offerings that we have. The Healthcare business 32.2%, Collections at 10.6% and the Domestic business at 5.7%.

From a client concentration mix, top-5 clients at 41.6% down from 45.7%, top client at 20.7% largely flat between Q4 FY16 and Q1 FY17.

If I take you to the next slide, it basically is the tabular representation of our financial performance. No specific call outs apart from the fact that our operating EBITDA has improved by 200 basis points and PBT has improved by 2.6% to 60 basis points and obviously, there has been a step up in tax by almost 300% between Q1 FY16 and Q1 FY17. So, no specific call outs here, numbers are self-explanatory.

I want to spend some time on the Business Outlook: As you are aware we have announced the 10-year strategic partnership with Sky following a comprehensive partner review and we have been selected as the exclusive preferred partner for their core TV and Broadband Services, not to mention that for the NOW TV segment which is targeted against the Netflix of the world, which does not have a subscriber base which is pay as you use, we are the alpha partner and likely to be getting into a separate MSA which is longer-term. At a company level pretty proud of this achievement, because it just demonstrates the value adds that we have been exhibiting in our partnership, it has been a 14-year partnership with Sky. We were one of 9 vendors. From 9 we came down to 2 vendors and when we went from 9 to 2, our business doubled, and from 2 we are now the single partner for their core businesses in the United Kingdom. It is pretty exciting because it is a two-pay deal, we take over our competitor's business and all future growth we would be the exclusive partner for Sky going forward. This changes our perception and our footprint in the UK market. I fundamentally believe it accelerates some of the decision-making with other clients where we have similar propositions out. Sky is the utility; it is like electricity, water, that is the predominance of Sky, and for them to choose Firstsource as their exclusive partner is basically representative of where we believe that the last 14-years and the next 10-years are going to take us to a different level. It increases the customer concentration level, but it is a 10-year deal. So it just gives us that much room and flexibility as we look out in the future.

The second element, the ISGN BPO acquisition was closed effective April 1st, 2016 and the business recovery and growth has been superlative. When we signed the deal I was cautious in the last quarter when we talked about we had an early inkling that the performance is going to be ahead of plans. At this point in time we are very happy that the acquisition pieces that we set out is playing itself out in a stellar manner, larger balance sheet and demonstrating stability has only augmented the deep domain that the platform has had the capability, the integration has been very good, very smooth, one of the longer tenured employees of the business has been elevated as the CEO, the business has basically had a complete different shift in its outlook at least what we see over the next few quarters given the customer behavior that we have seen, it is almost like how first it is like a déjà vu moment, it was almost like where Firstsource was 4.5-years back and obviously ISGN is a smaller platform, but driving the same behaviors, the same leadership principles and governance we have just seen an amazing turn around and the potential is being unlocked as we see the next few quarters playing out. I had cautioned the impact of Brexit is to be monitored closely. At that point in time it was assumed that the UK would stay in the EU based on all the opinion polls. So it was not seen as a big challenge, but obviously the results state otherwise. Fundamentally, I believe that there will be short-term blips as we talk to our customers, as we talk to our influencers, as we talk to our advisory council in the UK. Lot of companies unfortunately has not been prepared for the outcome, which ultimately played itself out. So as we are talking to our stakeholders, the likelihood of the UK entering into a recession has greater than 50% probability is the guidance we are getting. While there is an impact on the currency that we are seeing obviously the GBP-USD and resultant GBP-Rupee numbers have depreciated. But in longer term this will have a positive impact at least, in the next couple of years as companies look to shore off their profitability through more aggressive cost take out exercises. There are two factors - our growth based on growth of our customers and obviously our growth based on what happens when profitability has an impact due to recessionary pressures. So I fundamentally believe that over the next couple of years the impact is going to be positive and obviously with the pound depreciating the investment cycle in the UK with lower interest rates I think will look attractive which hopefully will bring UK back on the growth track. Again, crystal ball gazing. The commentary I am giving you is based on what I hear from our customers and from people that have basically had a big presence in the UK and on the board at Firstsource.

As far as going forward, fundamental question all of you are going to ask is if you demonstrated 16% constant currency growth, 10% to 12% seems low. There is a clear upward bias to our numbers. Basis on how the ISGN growth plays itself out I will give firmer numbers going forward, but the numbers are looking good. Margin guidance for the year we had given a number of 70 to 90 basis points, again there is a clear upward bias that we see will play itself out on a constant currency basis on what we end Q1 with. Nothing significant, debt repayment on plan, obviously, our leverage has increased to pay for the acquisition and there will be investments that we will have to make to support the Sky contract over the next 3-years.

That's it from me. I have nothing else on the presentation and I am happy to open the floor for questions and I will try and answer them to the best of my ability.

Moderator: Thank you very much. Ladies and Gentlemen, we will now begin with the Question-and-Answer Session. The first question is from the line of Priya Rohira from Axis Capital. Please go ahead.

Priya Rohira: Rajesh, if you can give us more color into the Sky contract in terms of the volume upsides you have seen and any renegotiations on pricing? Also, you mentioned towards the end that debt increase is likely because of investments in Sky contract - is it material?

Rajesh Subramaniam: On Sky, just to give you a little bit of perspective, let me tell you that the final contracts are not signed yet, the final contracts will get signed by the end of August. So whatever I am going to tell you will be more on a guidance basis where you will be able to inference this out. So today Sky onshore we have roughly about 2,500 people generating close to about $22 million a quarter. What we are taking over, we have got one set of employees that pay over to us on the 1st of September which will be roughly 1/5th of the total universe and the balance on March 1st of 2017. So the total number of employees that will be to paying over to us would be somewhere in the range of about 1,000 to 1,100 people that will be coming on to us. The summation of what we currently deliver and what we take over is the baseline for the 10-year deal. Going forward over the 3 to 4years we are driving a whole digital transformation working with Sky, leveraging elements of Arrowheads and Speech Analytics to try and see what is the level of deflection we can undertake that will reduce contacts over the next 3 to 5 years. That is why today I am not giving you specific numbers because some of these minimum guarantees and the ranges are being worked out as we sign the contract, but whichever way I see it, it is a big contract and this is on today's baseline and we are exclusive, all future growth in TV, broadband is going to come to us will be between Sky's own captive and us, which as I had mentioned when we went from 9 to 2, we doubled our business, now we are going from 2 to 1 and Sky is a very aggressive growth-based organization in the UK. So very excited about this. From an investment perspective over the next 3-years, the investments that we will be making will be in the order of magnitude of close to £20 million over 3-years, in a sense it is a big investment but the payback on these investments we expect will be pretty significant going forward and some of the growth that we see coming out in the future despite the entire deflection strategy that we are going to be working with Sky which then becomes a reference point for us as we accelerate our sales momentum to UK market. So that is the outline on Sky at this point in time. Once the contract is signed I will be more than happy to share more specific details going forward.

Priya Rohira: Rajesh, if I were to just read on to it, what is implying is at least 40% to 45% volume growth from the base line which is currently, presuming that 1,100 on 2,500 is roughly 40-45%. Would that be a right way to look at it or…?

Rajesh Subramaniam: Yes, that is the right way to look at it.

Priya Rohira: Just on the deal pipeline, if you can give some color, last quarter we had around $370 million. You sound more confident than what you were at end of fourth quarter which is just mid-way of May. So just wanted to check how has the deal pipeline moved and you did mention about upward bias on margins. So this would mean that basically what you have guided of 70 to 90 basis points, this I would presume that from a full year perspective this would inch up quite materially given the Q1 numbers basically?

Rajesh Subramaniam: It will, Priya, and given the fact that the Sky impact will be visible only next year, most of the growth that we are going to be seeing this year is going to be a combination of the Healthcare business where the provider business margins have seen a nice turn around base on the New Product Development (NPD) sales that we have effected plus from Q3 onwards the momentum on the open enrollment on the payer side will give us the benefit of operating leverages. Of course, ISGN margins as I said the turnaround has been spectacular, in my earlier guidance I had mentioned that ISGN for the full year for FY17 would be EPS-accretive I was cautious, it is going to be significantly EPS-accretive and margin-accretive, it is likely that the ISGN business at a company profile EBITDA it should deliver at least 100 to 125 basis points more than the company average as a business unit in FY17.

Priya Rohira: You mention on ISGN in terms of the run rate. Was this there for the entire quarter or it was only for a one month and they are on track or higher than the $25 to $27 million annual run rate to…?

Rajesh Subramaniam: Higher than $25 to $27 million, Priya, so this ISGN is likely to be at least 30% to 35% higher than the earlier guidance I had given you basis on what we see today.

Priya Rohira: My next question is on the tax rate, this +19% tax rate, would this be a new norm to look at?

Rajesh Subramaniam: Our earlier guidance was about 14% to 15% and a step up to 19% at some level has caught us by surprise also because the profit contribution from ISGN has been robust, more than we anticipated and they are at 40% tax rate onshore and the peak tax rate in India, they operate out of STPI regime. So we are looking at aggressive measures of how we fill up some of our Bangalore SEZ that we have. So I would expect latter part of Q3 and Q4 we should be in a better place to manage our taxation going forward.

Priya Rohira: Any guidance you may want to give on the new net debt-to-equity because given the ISGN acquisition which was a pretty creditable one, there has been a little inch up. So I think the cash flow generation from the business itself would be…

Rajesh Subramaniam: It is $97 million net debt, take the next three quarters of $33-35 million out, it comes back to about $65 million, there is a cash accretion, it will come down lower, and then there will be some payout that we will have to effect the Sky, the quantum and the timing is being decided. So my sense is we definitely compared to what we believe we would have been sub-$30-35 million at the start of the year before the ISGN and Sky we definitely will be higher but it does not matter, what it does for the growth of the business and where we see the future cash flow generation and all the benefits of what ISGN has brought to the table, some of the paybacks are going to be far-far quicker than what we had anticipated.

Priya Rohira: ISGN was there only for one month this quarter, right?

Rajesh Subramaniam: No, three months, the effectible close was done on April 1st and it has been consolidated for the full quarter.

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

Mohit Jain: First is on the Sky. I did not understand it well while you explained it in the last question. So for the $100-odd million that we derive from this client, you will be getting incrementally $40 million and for which we are investing $26 million. Is that what you are telling us?

Rajesh Subramaniam: Incremental, the number that you had stated plus exclusivity plus we also have a longer-term contract which is obviously not in these numbers on their NOW TV which is again which adds up to this, and for a summation of all this for 10-years, the payout is roughly about £20 million.

Mohit Jain: This will go out of your balance sheet as CAPEX or where do we see it or is it part of the employee cost that you are revaluing?

Rajesh Subramaniam: So we would be buying over the assets of our competitor, we are taking over the facility, leaves employee liability, so it will be a combination of all these and it will build up on goodwill.

Mohit Jain: $26 million is not annual, it is one-time, right?

Rajesh Subramaniam: No, it will be over 3-years, not equally but the numbers could be a little more in year-one and then year-2 and year-3.

Mohit Jain: Second was on the ISGN. What is the quantum of revenue that is included in the first quarter numbers?

Rajesh Subramaniam: The first quarter numbers are closer to about $9-$9.5 million has been included in Q1 FY17.

Mohit Jain: Is there a seasonality to this or should we assume this run rate?

Rajesh Subramaniam: At this point in time, there is no seasonality, the seasonality element of ISGN business; they play in the origination, valuation and on the title checks. The health of the business is largely predicated on where the 10-year treasury yield rates are. Thanks to Brexit, the US treasury bills have become the safe haven and that is driving a higher level of origination through for refinancing, which is obviously giving us the impetus. Now let us see how the future plays out on these yields which will give us the sense on how the volumes fluctuate. But apart from that, like our Collections business, Q3 seasonally there will be some run off, but what we are seeing in Q2 is obviously a lot more encouraging than what we saw in Q1, and if the momentum continues the guidance I gave you of how much more it would be basis on the earlier $25 to $27 million guidance I had given you will be real.

Mohit Jain: This Rs.27 crore CAPEX that you have incrementally done, is this purely for the organic business or does it include any payments, etc.,?

Dinesh Jain: These are for organic business.

Mohit Jain: Should we assume this run rate?

Dinesh Jain: No, this is not the run rate because this is the cash flow which we are talking which is also the creditors which are lying in the books for a month, the incremental fresh investment was around Rs.12 to 15 crore per quarter and Rs.60 to 70 crore for the year as a new one.

Mohit Jain: You mentioned about some impact in this quarter. What is the outlook for Q2 full three months, impact will come in Q2 FY17?

Rajesh Subramaniam: Yes, so Verizon, as I had mentioned, the full year impact is going to be about $17 to $18 million for FY17, so the business ramp down in the third week of May. So roughly the next three quarters the impact will be about $4 to $5 million.

Mohit Jain: One-month impact is built into Q1 and two-month impact will come in the second quarter, is it?

Rajesh Subramaniam: That is right on incremental basis.

Mohit Jain: On the Sky thing again, is there a margin impact also because of revising, etc., which will…?

Rajesh Subramaniam: This year, we do not see any impact because of the timing as I had explained, next year FY18 basis the scale that we have after amortizing element of the payout we potentially see about 35 to 40 basis points impact on the margin which we will easily absorb with some of the operating leverages.

Mohit Jain: That is when the revenue benefit will also start coming?

Rajesh Subramaniam: That is right.

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

Dipesh Mehta: Just want to understand the Sky transaction. We suggested by September 1st we expect one-third of the people transfer to happen. So can we expect from Q3 the revenue would start accruing from that transaction and the next chunk will start from end of Q4 kind of thing?

Rajesh Subramaniam: That is right, so September 1st there would be about 200 to 220 people, March 1st about 800 people.

Dipesh Mehta: Just to understand from cost structure perspective, whether the cost would be materially different than where our 2,500 people might be having or it would be more or less same kind of structure?

Rajesh Subramaniam: Same kind of structure, because what we are doing today is certain lines of work within TV and Broadband, what we are taking over are different lines of work which makes us truly end-to-end across the entire spectrum of services right from customer acquisition to retention and lessening churn, what we call 'sales'. So retention and sales are the footprint of our competitor, customer service and sales is what we have been doing and now we have become end-to-end.

Dipesh Mehta: Just to understand this; you give some bifurcation where the other vendor used to operate retention and we were into customer service and sales. Can you help us understand growth trajectory of these two different businesses?

Rajesh Subramaniam: You acquire a customer, you have to retain the customer and save the customer. So now our ability to drive Analytics in creating what we have as our Arrowheads NPA's predictor, first customer insight which then enables in driving a lower level of churn by driving higher NPAs is extremely applicable on the estate that we have taken over. So, again, all the investments we have made on the business transformation side has obviously helped us and it now enables Sky to drive a different level of efficiency because they are just dealing with us and they are captive and it harmonizes lot of efficiency that comes and basically getting a single window of how the business is operated. So specifically saying both the estates have been growing because fundamentally Sky, if you take a look at their growth, if you take a look at their ARPU, take a look at some of their IRR desk, it will give you a very good sense of the number of subscribers they have added, the improvement in their ARPUs which is representative in their own ARPU and profit trajectory over the last three years and there is no reason to believe any of that will change going forward.

Dipesh Mehta: Just to get on NOW TV side, you said we are the alpha partner and likely to sign another MSA with the company. Can you provide some color around it, what…?

Rajesh Subramaniam: It is a smaller deal, but it is a part of the Sky umbrella and we currently have three-year contract signed with them, again, the business plan numbers that we have seen, they hit the numbers, it looks very attractive over the next three years and again the news is extremely positive from that part of the universe.

Dipesh Mehta: Three-year when you say we are adjusting doing that work for last three-years or it is new for next three-years?

Rajesh Subramaniam: No, it is a new MSA, we have been doing some work basis which they have now the scaling with us, with increased volumes over the next three-years and that contract would become a longer-term contract as negotiations are undergoing right away.

Dipesh Mehta: Just to understand the investment what you hinted about 20-odd million GBP. Can you help us, whether it includes some kind of upfront payment to the client or it is largely investment to create capacity and to invest into people to drive?

Rajesh Subramaniam: Combination of both and right now we expect to sign the contract by end of August but for the sake of purpose you can take £20 million as the total sum.

Dipesh Mehta: Just to understand because ISGN also we made some payment and in this also. So how depreciation and amortization one should look at going forward?

Dinesh Jain: I think depreciation and amortization, ISGN have been already part of the number which you are seeing. As far as the Sky contract is concerned, as Rajesh explained, there are a different parameter on which the payment is going to take place. So some of the cases maybe three-to-five years, some of the cases can go up to two-years, some can be eight-to-ten years. So, I think as of today you can take the number which is the same except Rs.70 crore investments which we are going to make on the depreciation side that will increase the depreciation charge. So ISGN been already factored. Sky after the Q2 when we will have a definitive thing, I think we will come back and give you the more guidance about Q3, Q4 depreciation charge, amortization charge that is going to change.

Dipesh Mehta: Last is about the tax rate, you partly addressed. So just to understand you intend to increase our SEZ kind of revenue mix to help ISGN reduce overall tax burden. But in the meantime our tax rate is likely to remain this kind of level, right?

Dinesh Jain: Absolutely, I think this is basis only the difference of say 1-1.5% here and there, but I think range will be 17-19%.

Moderator: Thank you. The next question is from the line of Rumit Dugar from Religare Capital Markets. Please go ahead.

RumitDugar: Hi! Rajesh. I had a question on the revenue growth of ISGN. Basically based on the data that you have given it appears that the revenue run rate has jumped almost 50%. So what is really the revenue potential or the growth potential in this business do you think this is one-off or this 20-30% kind of growth is potentially doable?

Rajesh Subramaniam: I just want to caveat that, 'one swallow does not make a summer' but nonetheless basis on what we are seeing right now is the fact that the relationships that ISGN team has with the customers is superlative, this is right at the CXO level and all the constraints of the past, those shackles have been opened up, so we are seeing a lot of pent up demand which is coming out. Coupled with all the performance issues that were there prior to the acquisition, which was largely because of the lack of investing in the key constituents of people, I had spoken to you about your need to maintain little more of a bench in this business, the domain requires a different level of training before people get to the level of productivity they can. All those things have played themselves out where one customer where they used to be closing about 700 loans a month, within 6-months those numbers have stepped out to about 2,000-2,500 and with the potential to increase but those numbers can also come down if the yields on the 10-year treasury start increasing, but we do not see that in the near future at least until the US elections and post that we will see how things play themselves out. So that is one. The ability to add new logos has also increased because the transformation of the ability of the sales team to go, make commitments and go drive sales also. So we are seeing new logo additions coming through. This is in the core business. The second element is our ability to sell our arrowheads into their customers. It has been embraced thoroughly. So today within the time, obviously, the asset has been run under certain covenants even post signing, but we have got our first web chat customers that is going to go live from the ISGN universe and there is already a team which is planning to visit Philippines to take a look at how some of the CM business can scale within that. So, against the measure of how well the integration is going. Now, for the blue sky element, the asset has consistently been excluded from mortgage servicing deals. Mortgage origination title valuation these are complex, multiple hand of multiple systems and it is complex to an extent that there are many interfaces that need to be fulfilled to get to closing alone, but then after that the loan has to be serviced which is the entire life cycle, right from payment posting to collections and everything in between and all the customer service in between. So, here these deals can scale rapidly and ISGN historically has been excluded because the Chief Risk Officer of an NBFC or a bank would say these guys are too small, it is too risky to scale 300, 500 FTEs because if something goes wrong, we would not have a basis to move it. Now, those problems have gone away with the Firstsource backing. Now, to that you add the level of automation that we can drive. What we have done with UK's largest bank which is in their corporate banking segment, driving transformation, using a combination of work flow which is our proprietary platform and aligning with technology platforms, external and customizing the entire robotic process automation, this can drive a significant level of automation in the servicing business which is where I fundamentally believe over the next 3 to 4 quarters you are going to see action. Big players are setting on thousands of FTEs on the servicing side, and there is a lot of money to be made, but fundamentally I think that is a space where we will enter with the completely different proposition through our existing clients where we already have a deep relationship on the origination side. So the only thing which is an unknown here is today the growth has been aided by refinancing. Now, if the yield curve turns, then there will be an abatement. Now, when will that happen? If that happens, we will see over the next few quarters definitely after the US Presidential election.

RumitDugar: Now a follow up question on that, Rajesh, is what does it mean for the margins? Can you help us understand what is the operating leverage in that business – is this the business which can deliver 18% -20% kind of margin?

Rajesh Subramaniam: At this point, 18% - 20% EBITDA margins, "No", as I said, it can definitely deliver up to 20% - 25% of our last year EBITDA margin, put it in numbers, "Can I by March '17 deliver 14% to 15% EBITDA margin? The answer is "Yes". From 15% to 18%, it is too early for me. Give me another 3 to 6-months I will be able to give you more clarity.

Rumit Dugar: Were there any deal wins this quarter outside Sky or …?

Rajesh Subramaniam: We have added $20 million between the Provider business, we had a very good June which will reflect going forward. In the CM business we have added a couple of big logos in the UK. I cannot divulge the names, but big potential going forward.

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

Archit Singhal: Sir, a few questions: Firstly, on the employee side. We have already added the employees of ISGN. But I can see a reduction in employees outside India. So, is it coming entirely because of Verizon ramp-down?

Rajesh Subramaniam: That is right.

ArchitSinghal: Can you quantify the number of employee's addition due to ISGN?

Rajesh Subramaniam: About 250-odd people onshore and about 700-people offshore.

ArchitSinghal: So fair to assume everything is coming from Verizon?

Rajesh Subramaniam: That is right. There will be some volume fluctuations which will happen. So that is BAU but the big significant element is the Eugene and Louisville ramp down for Verizon.

Archit Singhal: On the Sky deal, you said that from September'16 we will be seeing some 200 to 250 people moving in. So is it fair to assume that there will be some revenue uptick also for FY17 because of this?

Rajesh Subramaniam: Yes, absolutely. As I said, this year we potentially expect Sky the uptick would be between $10 to $12 million but the big incremental numbers will be in FY18.

ArchitSinghal: Ok, Thirdly, you have mentioned about the EBITDA for ISGN which is higher than what FSL EBITDA were last year. Any color on the profitability what it was in the first quarter?

Rajesh Subramaniam: Roughly, you can take between about 9 to 10% operating profit.

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

Priya Rohira: Just a follow-up question on people. You mentioned 200 to 250 will be added in 1st September '16 and additional 800 to 850 on 1st March, so total around 1,000-1,100 by end of March basically?

Rajesh Subramaniam: That is right.

Priya Rohira: On the ISGN the EBIT margin of 9-10% in Q1, that for a full year will turn out to be better than the company average which could be anywhere between 11.5-12%-odd?

Rajesh Subramaniam: No Priya, 10-11% is EBIT also higher in the zone of what we did last year. So at 9-10% EBIT, the EBITDA is about 11-12% and the EBITDA will step up to above company average as we end FY17.

Priya Rohira: Is there some seasonality in any of the quarters for ISGN?

Rajesh Subramaniam: As I said, Q3 traditionally will be the weakest quarter, but more than seasonality as I said, all eyes on the yield curve.

Priya Rohira: This year you would see an incremental $10-11 million just to clarify on this Sky deal and the major bump up comes in from FY18 which could be anywhere between $35 to 45 million?

Rajesh Subramaniam: That is right.

Priya Rohira: Why do we see this margin impact of 35-40 basis points because the volumes will more than offset?

Rajesh Subramaniam: There is a pricing impact and the investments and amortizing some of the investments we are making.

Moderator: Thank you. The next question is from the line of Ruchi Burde from Emkay Global. Please go ahead.

Ruchi Burde: In balance sheet I could see decline in the goodwill and similar trend in the reserves and surplus line as well. Could you help me understand why is that?

Dinesh Jain: As the company adopted Ind-AS as requirement, the business combination, all the transaction needs to be restated from the date of when we acquired. During that process, you need to identify other than the goodwill. The goodwill breaks into the intangible and those intangibles get charged to the period. So you have got around Rs.560 crore which is the charge which have been gone to the opening reserves and there are some small other adjustments. So, all put together have reduced the retained earnings.

Ruchi Burde: So basically because of the Ind-AS adoption?

Dinesh Jain: Absolutely.

Moderator: Thank you. The next question is from the line of Amit Goela from Rare Enterprises. Please go ahead.

Amit Goela: Rajesh, a little bit confused on the margins. So could you tell me in absolute terms what you are guiding for like you said 80-90 bps uptick, what is the exact margin or range of margin you are looking at?

Rajesh Subramaniam: I think EBITDA of 13.5% - 14% would be a good outcome, Amit.

Amit Goela: If you are looking at some tax adjustments in the third or fourth quarter or you are looking at some tax efficiency in the third and fourth quarter, can we assume that your full year tax rate will be about 14% or will it be 19%?

Rajesh Subramaniam: No, it would not be 19%, it would not be 14%, and my sense is it will be closer to 16.5% to 17%.

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

Dipesh Mehta: Just want to understand margin trajectory of ISGN. When it was operating at $25 to $27 million kind of run rate, what was the margin it used to operate at?

Rajesh Subramaniam: When we did the diligence at $25 million it was losing about $3 million in EBITDA.

Dipesh Mehta: So roughly around $8-10 million incrementally largely flow through margin kind of thing?

Rajesh Subramaniam: Yes, in simplistic terms, but a lot of hard work has gone in ensuring that the resource optimization happens. In a nutshell, yes, but it is not that every dollar of revenue flow to the bottom line.

Dipesh Mehta: Why I was asking for it because if presuming yield start increasing and maybe we have some implication in revenue lines, so margin is likely to reflect similar kind of behavior if revenue holds?

Rajesh Subramaniam: It would not. That is what I am saying. The nature of business is not that when every dollar of revenue gives me a dollar of profitability, because there are interventions right from looking at analytics in understanding which categories of loan are likely to get funded, because we get paid only the loan gets funded. So right from looking at using our Nanobi platform and integrating that in the segmentation of the loan and then looking at the right skilling of the people on handling with the more complex loan. So a lot of interventions have happened which basically ensures that if a dollar of revenue falls, a dollar of profitability would not fall. What will it be at the margin when we get to the situation we will be able to tell you clearly.

Dipesh Mehta: How many clients we have in ISGN business?

Rajesh Subramaniam: Predominantly four or five big clients and then a long tail of probably another five to seven clients.

Dipesh Mehta: This four to five clients would be around 85-90% of ISGN's revenue?

Rajesh Subramaniam: Yes.

Moderator: Thank you. As there are no further questions, I would now like to hand the conference over to Mr. Rajesh Subramaniam for closing comments. Over to you sir.

Rajesh Subramaniam: Thank you. It has been a good quarter. I think we are very positive about rest of this year. I think what is heartening is the quality of our earnings looking very good with domain-driven businesses and transformation-led deals in what earlier has largely been perceived as the commodity business. So, I think our journey over the next two years definitely looks exciting with the engines of growth that we have invested in and we believe can lead to Firstsource demonstrating industry leading growth rates both at revenue and profitability level. So, Ladies and Gentlemen, thank you for your time today. We will be more than happy to take any follow-up questions, as all of you know, Ganesh Iyer -- Head of Strategy and Investor Relations and Diwakar Pingle. So we will be more than happy to schedule follow up calls. Thanks for your time. Cheers. Bye.

Moderator: Thank you very much to the members of the Management. Ladies and gentlemen on behalf of Firstsource Solutions Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.