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Q1 FY2018 Earnings Call Transcript – August 08, 2017

CORPORATE PARTICIPANTS:

- Mr. Rajesh Subramaniam – Managing Director and Chief Executive Officer
- Mr. Dinesh Jain – CFO
- Mr. Ankur Maheshwari – Head Corporate Planning & Investor Relations

Moderator: Good day, ladies and gentlemen and a very warm welcome to the Firstsource Solutions Limited Q1 FY18 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing * then 0 on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Ankur Maheshwari – Head of Investor Relations and Corporate Planning. Thank you, and over to you, sir.

Ankur Maheshwari: Welcome everyone and thank you for joining us for the Q1 FY18 and the quarter ended June 30th, 2017 earnings call for Firstsource. Please note that the results, factsheet and the presentation have been mailed to you and you can also view this on our website www.firstsource.com.

To take us through the results and to answer your questions, we have with us today, Mr. Rajesh Subramaniam – our MD & CEO; and Mr. Dinesh Jain – our CFO. We will be starting this call with a brief presentation providing an overview of the company's performance followed by a Q&A session.

Before we begin this call, let me remind you that some of the matters we will discuss on this call, including our business outlook are forward-looking and as such, are subject to known and unknown risks. These uncertainties and risks are included, but not limited to what we have mentioned in our prospectus filed with SEBI and subsequent annual report that are available on our website.

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

Rajesh Subramaniam: Hello, everybody and welcome to our earnings call. I will go through the Q1 highlights and some of the nuances of our business highlighting some of the impact that currency and some of the business unit performance we have had. Some of you have already sent in your questions through an update and I will try and address them proactively.

In Q1 FY18, our operating revenues came in at Rs 877.7 crores as compared to Rs 892.3 crores in Q4 FY17 and Rs 893.5 crores in Q1FY17. Year-on-year de-growth of 1.8% in rupee terms and growth of 6% in constant currency terms. Quarter-on-quarter de-growth of 1.6% in rupee terms and growth of 0.8% in constant currency terms. Before I go deeper into the other operating metrics, I would like to state the context that in Q1FY17, our exchange rates were Rs 96 to the pound and Rs 66.92 to the US dollar. In Q1FY18, the numbers are Rs. 64.47 to the dollar and Rs. 82.44 to the pound. So, I would like to set the context as you evaluate the constant currency numbers and reflect on the health of the business.

Operating EBIT in Q1FY18 came in at Rs 85.3 crores compared to Rs 88.0 crores in Q4FY17 and Rs 102.9 crores in Q1FY17. Year-on-year de-growth of 17.1%, margin contraction by 180 basis points from 11.52% to 9.72%. Quarter-on-quarter de-growth of 3%, margin contraction by 14 basis points from 9.86% to 9.72%. Again, if the currency levels in Q1 were similar to the currency levels of Q1 of last year, our EBIT would have come in at closer to Rs 104 crores or 10.9% of revenues, year-on-year growth of 1% and margin reduction of 0.6%. The margin reduction of 0.6% largely on account of the mortgages business, delivered a profit of about almost $2.5 million in Q1 of last year and came in with a loss of $460,000 in Q1 of this year. So, that is the only reason why there is a margin reduction of 0.6%, which significantly reverses itself in Q2. Similarly, at a profit after tax level, Q1 FY18 PAT came in at Rs 65.4 crores same as compared to Q4 of last year and Rs 73.4 crores in Q1 of FY17. Year-on-year de-growth of 10.9%, margin contraction by 76 basis points, from 8.21% to 7.45%. Quarter- on- quarter flat, margin expansion of 12 basis points from 7.33% to 7.45%. Similarly, PAT in Q1 FY18 would have been Rs 78.1 crores on a constant currency basis or 8.2% of revenues. It would have been a year-on-year growth of 6.4% and margins would have been largely flat, slightly a few basis points higher, but we are calling it largely flat. Similarly, if Q1 would have been in line with Q4 FY17**,** Q4 FY17 our rates were Rs 67.06 to the dollar and Rs. 87.66 to the pound. The margin expansion at EBITDA would have been 90 basis points, representing a 11% growth, margin expansion at EBIT would have been 40 basis points, representing 7% growth. We had higher depreciation charge because we took over one of the large centers, which we took over in March. The full quarter was visible in FY18 and our PAT would have demonstrated a 7.5% growth, margin expansion of 30 basis points, this is constant currency, the health of the business being the same.

The other highlights - employee and attrition details. Headcount of 25,013 employees as on Q1FY18; 15,146 in India, 9,867 outside India. Net reduction of 858 employees in Q1FY18, a big portion of that is in the domestic state, another portion of that is in the healthcare state in the US where the volumes build-up for the enrollment season which starts in October, November and ends in end of Feb, early March and then picks up again in October this year. So, there has been some headcount reduction. Attrition details – offshore (India and Philippines) 40.5% as compared to 42.2% in Q4FY17, largely flat. Onshore, a slight spike because of some of the realignment and readjustments, 48.2% compared to 40.7% in Q4FY17. Domestic (India) 94.4% compared to 81.1% in Q4FY17 because of some of the ramp downs. Net debt position $76.2 million, we have continued to repay our debt of $11.25 million. Our cash balance is not reported here, but it is about Rs 135 odd crores compared to Rs

190 crores and again period in cash largely because there was a delay in collecting from our largest client, which has been normalized in the middle of July. Otherwise, the cash balance would have been largely similar. On the outstanding FX hedges $39 million for the US dollar and £56 million for the GBP. Next 12 months, until Q1 of FY19, 43% dollar coverage at Rs 72.3, 91% coverage for the pound at Rs 110, 38% for between the dollar and the Philippine peso at 50.7 and 46% for the pound and Philippine peso at 65.4. Subsequent 12 to 24 months, 15% of the USD at Rs 74.4 and 45% coverage for pound at Rs 97.4. Post 24 months, we have decided to take coverage for the deal that we won with our largest customer for the committed business that we have offshore. We thought it was prudent to take some covers to enable stability and predictability of the P&L. We have taken 16% coverage for the pound at Rs 104.9 levels.

Flipping ahead in Q1 FY18, the revenue snapshot; North America came in at 52.6%, a decline of about 300 basis points between Q4 FY17 and Q1 FY17. UK came in at 41.2% and India, Rest of the World declined by about 30 basis points. The North America decline largely has been on account of the collection seasonality follow-up, which is one. Plus, the second element is in the healthcare business, the enrollment business that we have, as people come on to the exchanges generates about $3 million to $4 million of revenue between later part of October, November, goes until end of February and early March, so that falls of between Q4 and Q1. Combination of two reflects why the North America footprint is lower sequentially. From a location perspective, onshore was 73%, offshore 20.7%, and domestic 6.2%. By segment, customer management 49.5%, the increase largely attributed to the full quarter reflection of the Tupe deal with the largest client. Healthcare reduction 35.1% to 33.9%, again, on the back of the payer enrollment business. Collections business reduction from 12.2% to 10.5%. And Domestic business between Q4 and Q1 has increased. From a vertical perspective, BFSI which was 32.4% in Q1 last year down to 27.1% in Q1 of this year, largely on account of the Mortgage business, revenue reduction between the two periods and the increase in Telecom and Media to 36.6% is the go-live of the 3 months, the full quarter numbers of the center in UK with 1,000 people that we took over. And the reduction in healthcare from 38.1% to 36.2% reflection of the fall-off of the enrollment and some realignment of volumes in the business, but the alpha reason is the enrollment engine. Revenue by client concentration, top client increased to 27.8%, no surprises there. Top 5 clients for 46.9% in the Q1FY18.

From a numerical representation of the numbers we have gone through most of the details, the only call out is a 40 basis point improvement in operating EBITDA sequentially from 11.1% to 11.5%, this is despite two reasons; one is, despite, Q4 collection seasonality falling off which normally tails off in Q1, the results are usually muted, but despite that there is an increase. Also, the stability in the ISGN business, Q4FY17 was a $2 million loss and the loss has come down to sub $500k in Q1FY18. So, a clear arresting that decline, the turnaround will be evident in Q2, which will help in a pretty much 80 basis point to 100 basis point improvement in margins in Q2, which is not just the Mortgage business turnaround, but also coupled with the fact that we have divested a big portion of our domestic business. The other call-outs here are largely around sequential increase in margin expansions both at operating EBIT of 20 basis point, PBT of 50 basis points and PAT of 20 basis points. And these are reported currencies, this is also not normalizing for the constant currency rates that includes overall Q1.

From a business outlook, the sale of portion of our domestic business is progressing as per plan. We expect to close it within the end of this month. Margin expansion will be evident from some part of Q2, because there are still some shutdown cost, some restructuring costs, which will be evident. But from Q3FY18 onwards, the margin expansion will be clearly present. Non-repeal of Obamacare is positive, especially for the payer business. The enrollment business continues and will continue giving us revenue. But even if there was a repealment, what it does is, it basically puts more uninsured and that will benefit our provider business. So, on balance, how this will play itself out would have been a scenario, which we would have evaluated if this had happened, but as of now, it is clearly a positive. The demand environment for transformation led growth especially on the robotic process automation in several back office processing deals that we are engaged with current clients and new logos is looking extremely good, looking very good in healthcare, looking very good in the mortgage businesses in the US and the BFSI businesses in the UK. The size of deals pursued have increased, but the decision-making cycles are longer because the entire gamut of transformation takes a little more longer to demonstrate itself out within the client universe, given the impact is still an unknown for the clients unlike what regular businesses and regular outsourcing that they we have done historically. As I mentioned, ISGN losses have been arrested, while Q1 was in the negative, I did mention, it was just under $500k. Profitable recovery will be evident from Q2. The profit swing will be almost $650,000 to $700,000 between Q1 and Q2. FY18 constant currency revenue growth to be in line with industry growth rates. If we don't pro forma the ABU businesses, if it is assumed that the Asia business unit (ABU) was there in existence for all of last year, and obviously it is not going to be in existence for 8 months in this year, then the growth rates would be lower by about 175 basis points, but on a like-to-like basis, assuming it is taken off from both the years, we would be in a comfortable place from the earlier guidance of where growth rates have been and they will continue. Debt repayment continues as per plan. And I guess the issues on debt repayment cash, they have become non-issues right now given where the business is, so not to ensure, we should crowd the real estate on this slide with any of those details. Q2 FY18, as I said is looking good. The deal momentum is looking good. Q2, our forecast clearly suggests clear margin expansion on a reported basis, both at EBITDA, EBIT and PAT levels contributed by ISGN turnaround, contributed by the growth that we have signed in businesses especially in the Customer Management business in the UK and some very encouraging signs of growth from some of our customers in the healthcare payer and provider segments. So, while the headline numbers look negative, all I can say is that underlying health of the business is robust; the demand environment is looking good. On a translation basis, there is not much we can control on where the numbers end up at, but from a constant currency basis, the guidance of growth both on revenue and profitability should play themselves out this year.

That is all I had from a presentation and articulation perspective, I am happy to hand it back to the moderator to open it up for questions. Thank you.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. We will take the first question from the line of Priya Rohira from Axis Capital. Please go ahead.

Priya Rohira: My first question relates to the structural changes we have seen in terms of business transformation and automation adoption in various businesses. You did mention about the pipeline being healthy. Can you outline some of the pipeline, which you have in automation and our preparedness in terms of leading the clients transformation in this journey? And second thing is, in terms of the deal pipeline, you mentioned last quarter it was $375 million, if you can give an update in the current quarter and maybe break it up and to see one, which is transformation led and one which is the regular business.

Rajesh Subramaniam: So, transformation led growth is not a standalone assignments. What happens is transformation is a core embedded part of the end-to-end business processes that we undertake. So, all I can tell you is that the deal values of some of the transformation led growth, what earlier used to be deals in the customer management business anywhere between $3 million to $5 million that used to start up, today, deal values are in excess of $15 million to $20 million ACV. Now typically what happens in these $15 million to $20 million deals is that, let's say it's a $20 million deal, by the end of one year, when the whole automation and the deflection argument start playing themselves out, the ACV start reducing, but the margin profile start improving. And then what happens is the way that the revenue growth comes back is as more and more business comes in, but the revenue growth will be lower than the profit growth and that is what automation does, because first it improves the productivity of the employee in terms of what are the base level process that get automated and then it eliminates the requirement of the employee and then through several machine learning techniques what happens is, it starts moving to a higher level of decision support, which obviously is not at the same scale as what the L1, L2 processes are, but that's how the margin accretion happens. So, from a pipeline perspective, it is difficult for me to tell you that $30 million is transformation, $200 million is regular services. All I can say is that all the new deals which are coming into the pipeline are of significant size and scale in the CM business, are of significant impact from embedding analytics and embedding RPA in the healthcare provider space. In the payer space, given it is claims and mail room operations that we run across the spectrum of customers, it is basic simple automation that can drive efficiency and will potentially lead to a requirement for consolidation that our customers could undertake depending on how some of the theses features play out. So, again, as I said, very excited in all the efforts we have done over the last two years including demonstrating the largest consolidation that we did with our customer, largest customer. What we have done with a large Bank on and some of those are clearly playing themselves out in terms of the centers of excellence helping us get a differential mind share on the deals that we are doing. So that is one. Second, again the deal pipeline is something which we picked up right now. The pipeline today is closer to about $300 million and then the reason why it looks reduced one, the pipeline in the UK earlier was being represented to be converted at a higher dollar number and because of where the pound is today in relation to the dollar, the conversion comes in at a lower level. So, the health of the pipeline remains, but the size has been constricted because of exchange. Also, about $40 million to $45 million of pipeline have been qualified out. There has been no movement in some of the deals and some have been, you know, deals where we have come very close to being one out of two, but certain changes at the stakeholder level and certain changes of priority have ensured those deals have gone into cold storage. So, in realization of both managing the translation impact of the pound pipeline into dollars and qualifying out some of the businesses which have been in CM and in the payer business, the pipeline today is closer to $300 million. Hope that answers your question at some level.

Priya Rohira: Sure, that's helpful. Okay, I just had a follow-up one to this automation led transformation which we are seeing globally and more so in the BPO getting more entrenched. Are we seeing any sort of pricing pressures odd cost take-outs in the sense, you might be doing the entire automation work for your client, but the client wants to take 100% of the benefit?

Rajesh Subramaniam: No. The game here is, it is moved out from being an input basis to an outcome basis. So here the impact of what automation does is we give a commitment that we will reduce your cost to serve by a certain level. I mean driving automation and driving transformation and being measured again on an input basis, it is almost like I lose revenues and I don't make money because I am being measured on an input basis. The whole transformation engagement is to be demonstrate the skin in the game and come with a proposal, which is a combination of input basis where certain elements of what cannot be automated and requires a different level of engagement where it is input based and on an outcome basis where we put a stake on the ground to remove ex-resources by a certain point in time which reduces their cost to serve and it enables me to drive a higher margin profile while reducing revenues.

Moderator: Thank you. We have the next question from Mohit Jain from Anand Rathi. Please go ahead.

Mohit Jain: Just wanted an update on the Sky deal. So, we have incrementally got $6 million in this quarter in terms of revenues. Has the run rate on an annual basis come down?

Rajesh Subramaniam: The run rate on an annual basis won't come down because we were supposed to get, March is when we took over the new center and Sky today if you take a look at it, my revenues have grown and Sky concentration has gone up to about close to 27% - 28%. So, I am not sure where you are seeing it.

Mohit Jain: What I am saying is 4Q had one month consolidation, 1Q had three month consolidation. So incrementally you got two month revenues in this particular quarter, which was around $6 million if I look at top client revenue incremental contribution Q-on-Q.

Rajesh Subramaniam: Correct and in relation to that, in Q4 Sky was 24% of our revenues, in Q1 it is 27.8% of our revenues.

Mohit Jain: Right, so I am not denying that. What I am saying is that $3 million per month is more like $35 odd million.

Rajesh Subramaniam: No, the other point is, it is also the currency impact between Q4 and Q1.

Mohit Jain: So, it is more or less stagnant and 3% is I guess the move in currency Q-on-Q.

Rajesh Subramaniam: It's Rs. 87 to Rs. 82.5. It’s 7%.

Mohit Jain: Okay. And second is, in terms of your payment which was due over the next 2 years, so that is also denominated in GBP right?

Rajesh Subramaniam: That is right. So, we have made one payment in July for 4 million pounds and the next one is due next year, 4 million pounds, the last payment.

Mohit Jain: So FY18, is there anything which is due?

Rajesh Subramaniam: 4 million pounds.

Mohit Jain: And FY19?

Rajesh Subramaniam: 4 million pounds

Mohit Jain: Another 4 million pounds?

Rajesh Subramaniam: Yes.

Mohit Jain: And this is already part of your 1Q net debt or this will be done during the…?

Rajesh Subramaniam: The 4 million pounds is already being done. The 4 million pounds next year will be next year.

Mohit Jain: Understood. So, what is your total net debt position now?

Rajesh Subramaniam: About 76 million pounds.

Mohit Jain: That is long-term including…

Rajesh Subramaniam: Working capital debt is backed by a huge margin on receivables. I can give you the numbers. We will come back to you.

Mohit Jain: Okay, second thing is on the tax rate. What is your tax rate for FY18?

Dinesh Jain: FY18, I think as last time guided should be in range between 17% to 19%, depends on the mix of the businesses or profitability.

Moderator: Thank you. We will take the next question from the line of Arun Malhotra from Santalum Capital. Please go ahead.

Arun Malhotra: Just wanted to ask, you have mentioned sale of India domestic business to Vertex, what is the valuation for that? And you had mentioned as per the strategic and long term plans, could you elaborate on those strategic and long term plans?

Rajesh Subramaniam: Yes, I think strategic long term plans is very simple. The return on time and return on capital is not aligned in this business at least for the business mix that we have. So we decided it was best to exit the business and focus on where we can get a better impact on capital allocation. So that is the reason why we exited. At this point in time, consideration until the deal closes, I cannot divulge it because it is not an entity sale, it is a slump sale, contract sale, asset sale and lot of it is dependent on successful novation of contracts to Vertex. So once that is done and we get a final picture, at that point in time, I would be able to disclose the consideration, disclose what we are getting for the sale of assets, what we are getting from a working capital perspective, because on the date of sale, all the working capital prior is ours. So, there will be a fair bit of solvency which will come back into Firstsource, but those numbers will be disclosed once all the change in control novations are successful.

Arun Malhotra: Sure, and which part of your business would have better growth profile and a margin profile, the healthcare or the telecom and media or the new automation business?

Rajesh Subramaniam: I think automation is ubiquitous to all the businesses. At this point in time, we are seeing a significant margin expansion continuing in our healthcare provider business, but the ticket sizes are small. Every deal there is $0.5 million, $1 million, $2 million in size. So, while the healthcare provider business is going to do exceedingly well this year, the margin profile is significant there because all the business is done onshore, it has got the best return on capital employed. It has got one of the highest revenue per employee and it has got one of the highest revenue margins. So, both from a conversion to cash perspective and margin perspective, that is extremely profitable business. The automation led businesses that we are seeing in customer management is again proving to be very attractive. We are generating very healthy margins, delivered and most of this transformation is done onshore. The offshore transformation is still nascent because the cost of licenses and driving the transition is more expensive. So right now, the approach is to go after many TUPE deals, many onshore deals, drive the transformation agenda, then take a look at the BAU and then figure out what the offshoring agenda will work out to drive the next level of cost savings that can happen post stabilization onshore. So, again that is, from a cash contribution perspective, that business is extremely attractive at this point in time. Several transformation and automation led opportunities are being pursued in healthcare payer, in the mortgages business. It is too early for me to comment how those will play itself out, but the momentum is there. I should be able to give a better update on these two businesses in Q3, not even Q2, in Q3.

Arun Malhotra: Sure. And lastly your largest client comprises of 26%-27% of your revenues. Does that worry you or is there any strategy to mitigate that?

Rajesh Subramaniam: No, it would have worried me if I had signed a two-year deal, if my contract was valid for two years and a 28% will absolutely worry me. I have a 10-year deal with this client. So, I have time to figure out how we create strategies to try and bring it back to reasonable levels of 15% to 16%, which is a threshold I would be more comfortable with, but I am not worried at this point in time because it is a 10 year deal that I have with my largest clients.

Moderator: Thank you. We will take the next question from the line of Ruchi Burde from Emkay Global. Please go ahead.

Ruchi Burde: If I look at your client bucket from top 2 to top 5, this quarter we saw stability after two quarters of decline. Could you give us an outlook going ahead, how this client bucket looks like, were there any contract renegotiation which happened over the last 3 quarters and how that would pan out going ahead?

Rajesh Subramaniam: Yeah, I think contract renegotiation, last 3 quarters as you realized, the largest client contract renegotiation, consolidation happened about 3 quarters back.

Ruchi Burde: Yes, I understand that happened for our largest client, I am asking between 2 to 5 clients.

Rajesh Subramaniam: 2 to 5, one of the clients would be a part of my domestic business, which will cease to exist once the sale is successful. So that is something which will fall away. Couple of my banking clients we have, one in the UK, significant opportunities that we clearly see from both onshore and offshore perspective. We see that playing itself out, but the gap between the top 5 and then between 5 and 10, there is a significant gap. So, all efforts are on to see how we grow the second tier of clients, which are sub $10 million and then of course some of the long tail customers that we have. Similarly, as I said, one of our healthcare clients will be in our top 5 and how the engagement with them plays out will be clearer end of Q3 post some of the action items that we will present to them within the next 30 - 45 days.

Ruchi Burde: This healthcare client, is this the payer or provider, if I may?

Rajesh Subramaniam: Provider we don't have, I mean no client would be in size and scale anywhere close to these kinds of numbers.

Ruchi Burde: Yeah. This is good to hear that one of the payer client is scaling up. Could you throw some more light what kind of services in the payer segment we are able to sell when there is kind of uncertainty in the US market with the ongoing Obamacare related issues?

Rajesh Subramaniam: Nothing, it is some of the investments which are coming back in the payer segment, the healthcare exchanges are going to continue. There are cost pressures. So now the agenda is on cost, the agenda is on transformation and transformation is a very wide word. Let me bring it down to automation, huge automation opportunities right from when a claim comes in, to the way the claims get adjudicated, significant opportunity, and I think that is going to keep a lot of us busy for the next couple of years.

Moderator: Thank you. We'll take the next question from the line of Dipesh Mehta from SBI Cap Securities. Please go ahead.

Dipesh Mehta: Yes, I have two questions. Can you help us about India business, what kind of business is moving out as a part of transaction and what impact would be there on margin on the standalone India business related transaction? Second thing is, can you provide us data on ISGN revenue? I think you provided margin related number, but what is the revenue run rate currently going on in ISGN and how you expect it to trend? The reason for asking is because you expect profit to improve whether it is some kind of, where we find where revenue, without revenue we can manage core structure better or it is linked with revenue uptick which we are looking?

Rajesh Subramaniam: Okay, great questions. So, first one is the agreement is to get rid of the entire domestic business and the clients that get novated will go, clients that don't get novated at some point when they do, will go. So, at this point in time, we pretty much see 90% of the business going and 10% will have slightly longer lead time, but it will happen. So that is one. This year given the timing of the deal and some of the shutdown costs we had to do in some centers in the North East, in East India and South India, some are customer related ramp downs which was evident in Q1 and Q2, which was not part of the sale, but it is something which we had to undertake. There will be a cost element and hence the benefits for the rest of the year would be an improvement in margins by about 20 basis points, but next year, at least on a Q4 run rate basis, the numbers will be closer to 40 to 50 basis point improvements in EBITDA margins flowing downwards at the company level. So that is the domestic business. Now as far as ISGN is concerned, in Q1, the revenue was at $7.3 million and a negative $460k EBIT. Q2, the revenues are expected to be at $8 million and a $200k EBIT. So minus $460k to plus $200k is a $660k swing, which will aid in the margin expansion of 90 basis point to 100 basis point I spoke about between Q1 and Q2.

Dipesh Mehta: Sir, just one follow-up on India business side. You earlier indicated we expect Q2 margin to be 80 basis point to 100 basis point higher. Now considering domestic BPO exit has some one-off cost, which you incur in Q2, it is factoring those costs or it is excluding that costs?

Rajesh Subramaniam: Factoring those costs. There is also growth which we have, which will start translating the operating level, I mean it is disingenuous for me to say the margin expansion is only on account of these two. There are several other factors where the growth in the business is going to help us drive revenues. The revenues also between Q2 and Q1 will be higher, sequentially will be higher, basis some of the new deals that are going to translate and convert into revenues.

Dipesh Mehta: Sure. And on ISGN whether because with revenue trajectory, I can understand about margin expansion, but considering the uncertainty about interest rate cycle and other thing, do you expect the profitability is on sustainable rise trend or you expect revenue is still uncertain kind of thing?

Rajesh Subramaniam: No, I think while interest rate that is on the origination side, we have seen significant diversification into the servicing side. A clear example is, if you recollect, we lost a contract with a very large US telco where we had to shut down two centers in the US, and one of the centers has been affecting my unallocated costs, because they are very difficult to sublease in Oregon and ISGN basis the thesis of a larger player helping the domain driven business diversifying into the servicing business. I know we are going live with one of our existing clients on a large footprint , in Eugene, Oregon on the servicing side. So, the revenue growth driver is going to be on the servicing side. The deals we are pursuing right now that we have and because we don't have legacy, the ability to drive automations and reduce cost to serve on the servicing side is, it is a no-brainer. Incumbents are fighting it by reducing prices, all the big companies we see, but reducing prices and trying to get some status quo. Reducing prices cannot give you the same advantage as automation, but it maintains status quo, but there is going to be disruption in the servicing side which we're betting big on and that is going to drive the growth, that is more predictable because that's on existing portfolios and the margins also will be attractive because it also offers a large offshore footprint.

Dipesh Mehta: Is it possible to, sir, mix between origination and servicing maybe over the last four quarters how it shaped?

Rajesh Subramaniam: No, no, it's largely been origination. See there is origination that is tightly valuation and servicing. So, until, in the first, since the acquisition in the first 2 quarters, first 3 quarters, the growth has been predominantly on origination and that is where $2.5 million profit in Q1 last year turned into a $2 million loss in Q4 last year when volumes went from $11 million to $7 million. straight decline and this is all origination driven. The servicing portfolio has been small, but the servicing portfolio will expand, brings a lot more predictability, brings a lot more ability of driving transformation. In the origination side, driving the automation agenda is a little more complex because origination by itself means the number of channels from where the origination happens and the ability to standardize into one set process flow is slightly more complex than doing it for servicing, it can be done, but it is slightly more long way, it is slightly more complex, but given the pipeline that we have seen on the servicing side, given some of the deals we have very attractively positioned, because it leverages the core skills of the arrowheads of Firstsource larger family and leverages the domain that we have with the ISGN acquisition and the excellent client relationships that have endured and tenured with them over the many years. We are pretty excited that the turnaround in this business will be significantly evident by the time we get to

Q4. Right now, its baby steps, big loss, small loss, profitable, better profitability and turnaround.

Moderator: Thank you. We will take the next question from the line of Ankit Pande from Quant Capital. Please go ahead.

Ankit Pande: Good to connect with you again, Rajesh. Couple of questions would be, one on, can you just elaborate a little bit more when you said about healthcare and your plans on the provider side, sorry, payer side, and how you would stand to benefit even if Obamacare is to be annulled. And a second would be a more technical clarification on the seat utilization dropping quite a bit and whether the headcount reduction has still to catch up with that in the coming quarters?

Rajesh Subramaniam: Yes, okay. So let me start with the last one. The headcount reduction, obviously, with the domestic business going, almost 4,500 people will leave the organization. So there will be a headcount reduction, which will be evident if the deal successfully, I expect it to close any time over the next few days. If we are lucky, the next few days, otherwise definitely by end of August. And so that will have a significant reduction in employees, but as I said margin expansion will start evidencing itself. Seat fill factor was something which we have been showing for many years ever since we went public and that is how we viewed our business. For me, seat fill factor and the leverage that offers from a margin or capacity is not relevant, almost like talking about cash position or debt, because all those will get run down. Very relevant 3 years back, four years back when we had huge debt and the cash flow was a problem, but today it's not an issue, that's why. That is the reason why we thought we will try and change some of the messaging and take these conversations little more elevated on the transformation side going forward and be more specific on what are the levers which are demonstrated and is showing up in the business, which is going to improve the business. So that is why and the seat fill factor will only get better. As I said, Eugene in Oregon gets filled up with ISGN's new servicing business. All those things will start trending up, we have given up our SEZ in Airoli which is again, I know it's not showing up in the margin, so the seat fill factor argument is a little irrelevant going factor because it doesn't have a huge leverage on the margins. Then coming back into your more strategic question on the healthcare side, as I said, the cost agenda is paramount. If there is a repealment of Obamacare, the enrollment business goes away. That has an impact of about three and a half million dollar whenever that happens. Now it has not happened, so this year we will see it again back. Now whether it happens in FY19, crystal ball gazing, nobody knows how leave bipartisan support, they do not even have the Republican support to get this thing done, but the cost agenda has become paramount for pretty much all the payers. We have seen a huge, where there was complete lethargy in driving any of this transformation agenda despite us telling them that is the art of the possible, I think it has now become front and center of some of the conversations we are having with the business heads and the COOs and I expect, I mean I'm not saying that we'll get results in the next 30-60 days, but once it is in the agenda, people have a recollection of what is the art of the possible basis on everything that we have demonstrated, the engagements with our existing customers is clearly evident. New customers in the payer space, adding new customers or big customers is not the norm. Whoever current customers are working with, they tend to have longer-term relationship. They don't do mystery shopping or putting RFPs out. It doesn't happen in the healthcare space unlike what we see in the customer management space in the UK. So overall, again, we have great names. We have 3 of the top 5, top 7 payers and managed service providers in North America are clients of ours and we are very excited what potentially the benefits can be. And as I said, some of the real conversations, not board room conversations and courtesy conversations, some of the real workshops that we are having right now, I expect will translate into something actionable, not in the next 30, 60 days, but definitely when I come to you by Q3, I should have clear updates.

Ankit Pande: So, if I were to just understand this, I mean, this is regardless of whether Obamacare, whatever happens with it, because the discussions are already moving in that direction.

Rajesh Subramaniam: Absolutely.

Ankit Pande: And I mean, these are conversations you say you're driving, but, I mean, what does it take? Does it take another system integrator or another partner, are these biggish engagements or is this something that you can handle yourself or would you need to partner with somebody for example?

Rajesh Subramaniam: No, as I said, for me, the domain we have in healthcare, the domain we have in mortgages across US and UK, that is the more important. Driving the solution to predicate the outcome is more important than the systems integration part. The systems integration part is important because it requires the customization time, it is not something which is going to happen in 30, 60 days if the customer decides to go. Every customization is unique, every customization has its own challenges. And here we don't own the platform, we don't believe that is a good use of our capital and our time because for us domain is driven more by predicating outcomes and predicting outcomes of the future, but we align with the Blue Prisms and the Automation Anywhere and the other solutions which are available on which we can drive the customization and build our solutions and go sell it to our customer. Again, if we sign a deal, it is not that the outcome will be evident immediately. The whole process takes at least 6 months is our experience in that last 2-3 deals we have done.

Moderator: Thank you. We will take the next question from the line of Priya Rohira from Axis Capital. Please go ahead.

Priya Rohira: You just mentioned about the margins, couple of levers which we have and which we would showcase from Q2 FY18, which is from a full-year perspective, we are on course to deliver a better EBITDA margin to the extent of 50 basis points?

Rajesh Subramaniam: Absolutely.

Priya Rohira: And this would be a function more of the healthcare vertical and the ISGN as well, right?

Rajesh Subramaniam: Healthcare, ISGN and ABU.

Priya Rohira: Okay, sure. And just a last book keeping question from my side. What is the net debt, sorry, I missed out in between when it was mentioned?

Rajesh Subramaniam: Right now it's about $76 million because a combination of a payout to our largest customer which we had to make and a delay in collections has ensured that we had to leverage a little bit, but by the time we get to the end of the year, it should come down to sub $30 million would be my guess.

Priya Rohira: And is it possible to get a break-up for the working capital amount which is for the long term?

Rajesh Subramaniam: Yes, absolutely.

Dinesh Jain: Working capital has not changed from the March. I think that remains the same. Only the cash balances have changed. If you've seen the fact sheet, which we have circulated, debtors [ph] collection have changed the cash balances which we have. And I think long term that had reduction of $11 million, which we paid the repayment in June.

Priya Rohira: So, in FY18, this long term will completely go to zero.

Dinesh Jain: No, current year will repay around $45 million, $11 million we paid, another $34 million, $35 million, we will pay. So, I think long term debt will remain at a gross level of around $35 million to $40 million.

Rajesh Subramaniam: $40 million. Net debt will be about $20 million, $25 million.

Priya Rohira: You are answering it for FY19 -- I'm sorry?

Rajesh Subramaniam: Yes, FY19 will be gone.

Ruchi Burde: Thank you for the follow-up. Rajesh, you talked about increasing decision making cycle. Could you give us more color as to which segment or which vertical we are seeing this more? And in your view what is driving this elongated decision cycle?

Rajesh Subramaniam: I think when Brexit happened, all our deals went into a tailspin because decision making went into a tailspin because the priority was to figure out the impact. Now the realization of what is going to happen because of Brexit is clear. It is clear as in there are scenarios which have been created basis which one common underlying theme is that there has to be cost realignment. So the delay in decision making, the delay in the clients understanding the full gamut of transformation unlike earlier engagements it was very simple because there was no need to disturb the status quo and what were the outcomes to be driven were clear, but right now, the whole transformation agenda has many more dependencies beyond just the businesses, it has a big technology dependency on the CTO and there are multiple dependencies, which delay the decision cycle, but the clear alignment of the fact that the outcome it can drive everybody is aligned to, but how to make that happen is taking time for it to convert into actual decisions, but it is coming. It will come and once that learning curve comes up the curve we expect next year onwards those to improve significantly.

Ruchi Burde: And any particular vertical you see?

Rajesh Subramaniam: Everywhere there is a big back office processing element, because back office are the ones which are predictable, which can be set up in a predictable way and can be done. Unlike contact center businesses, which are more difficult. We are clearly seeing an impact on, we can do it in mortgages, the healthcare, banking in the UK, P&C insurance in the UK. We clearly see a gamut of possibilities which involve transaction processing.

Ruchi Burde: And this elongated decision making cycle is more a phenomena in the European market or you have similar experience in the US as well?

Rajesh Subramaniam: As I said, UK is where our biggest pipeline is. UK is where the sample size is bigger . As I had mentioned in healthcare, it was more, the requirement didn't exist. Now people have woken up to it and are acting on it, how that will play itself out, we'll see, but I don't expect it to see that the learning curve of what we saw in the UK segment, because they had the compounded problem of Brexit. And in some of the clients we have in our mortgages business are very nimble, very open to quick decision making as long as they can clearly see a proof of concept. So those timelines I definitely see a lot more quicker than what we have seen in the UK.

Moderator: Thank you. We will take the last question from the line of Anirudh Gangahar from Nomura. Please go ahead.

Anirudh Gangahar: Just one clarification based on a lot of commentary from your side about the domestic business going out, margin improvement, ISGN turnaround? Just to putting it all together, last time we had expected a 50 to 60 basis points margin improvement in FY18 and a 6% to 8% growth in constant currency. Considering all the permutations and all the changes which are likely to happen, how is this overall statement change in terms of guidance, if you can help clarify?

Rajesh Subramaniam: I think from a revenue perspective, the top line business will be the same, constant currency basis, actually it could be better than 6% to 8% if you take the ABU businesses out, both this year and last year. If the ABU business from a reporting perspective is seen existing last year and going out for 8 months of this year, the growth rates are likely to be about 150 to 200 basis points lower because those revenues don't exist. So, it is one base effect. Margin profile between ISGN and between ABU and between fundamental growth we see on a constant currency basis, the margin expansion would be significant compared to last year. On a reported basis, to deliver a 50 basis point improvement is something we definitely see attainable over the next three quarters. Some of that will be clearly evident from our Q2 numbers itself.

Anirudh Gangahar: I see and just one other clarification. Q2, you mentioned ISGN you expected about $8 million in the top line and was it $600,000 is what the EBIT, is that?

Rajesh Subramaniam: No, EBIT would be $200,000, which is a swing of about $600,000 between the loss in Q1 to profitability in Q2.

Moderator: Thank you. That was the last question. I now hand the conference over to the management for their closing comments.

Rajesh Subramaniam: Yeah, thank you and thanks for your time and the insightful questions. The translation impact of currency has kind of changed some of the headline numbers. The underlying health of the business is robust. This year is shaping up really well from what we see in the demand environment. Some of the arrowheads transformation levers which we have been talking about is no more theory, it is clearly demonstrating itself into profitable growth and we are very positive about the future of ISGN. While we have had these temporary setbacks, I think the longterm vision and the potential of the business is robust and I am saying this because we have been on the road meeting customers and evaluating the potential of what that business is. The healthcare business is doing outstandingly well. Both the payer and provider businesses have come around very well, while Q4 to Q1 the numbers don't suggest that, but from what internally our budgets were and what the growth is, it is completely playing out the script and I am very happy of how that business is shaping up. The UK customer management business, we have won four, five new logos over the last four, five months will start scaling up and some of the deals on the table, if one of them translates over the next few quarters, it can change the profile of our numbers clearly. Thanks for your time and that is the commentary I had for all of you today and if there are any specific questions, any specific clarifications, Ankur, who is our new Head of IR and Diwakar will be more than happy to take them and happy to meet with any of you if you need more insights into some of the commentary I have made today. So, thanks for your time, appreciate it. Thank you.

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