OWW *Investment Quarterly* 4Q06

US Slowdown - what lies ahead for Asian BPO/IT outsourcing players?

US economic growth has slowed from a torrid pace of 5.6% in Q1 2006 to 2.0% in Q3 2006. Furthermore, the Economist poll of forecasters in December shows an average growth forecast of 2.2% for 2007, a downward revision from 2.4% surveyed in October. There are already speculations that the Federal Reserve may cut interest rates in 2007 to counter the slackening economic outlook. However, despite the evident slower economic expansion, the BPO/IT outsourcing industry in Asia is unlikely to be unduly affected.

Indian IT outsourcing majors are sanguine about the outlook as they continue to clock growth rates of 30-50%. Significantly, they expect billing rates to improve in the near term. Tata Consultancy Services intends to raise its billing rates by 3-5% for existing contracts and 5-10% for new contracts. Infosys sees a slight increase for existing clients and a hike of 3-4% for new contracts. Satyam too expects 3-5% rise for both existing and new contracts.

Outsourcing has become well accepted as an avenue to achieve cost savings. Even with a slowdown in the US, US companies are still likely to increase their outsourcing budget in order to stay cost competitive. Notwithstanding signs of wage inflation in India, salary levels in various outsourcing destinations in Asia including India, remain a fraction of that in the US (costs in India are between one-fourth to one-fifth of that in the US). Many Asian countries remain highly ranked as favourable outsourcing locations by many researcher houses, for example AT Kearney, neoIT and Frost & Sullivan.

Increasingly, service providers are stepping up their offerings and moving into higher-end services such as knowledge process outsourcing and design services. On the other hand, they are putting more effort into geographical diversification and are focusing on increasing contribution from the Europe and Asia Pacific regions. As such, the BPO/IT outsourcing players should be reasonably well placed to withstand a US slowdown.

Vietnam's budding outsourcing industry

A rush of good news has been going Vietnam's way recently. Vietnam, which successfully hosted the APEC leaders' meeting in Hanoi in November 2006, has ratified its WTO membership. The economy continues to show robustness and GDP for the first 9 months of 2006 grew 7.84% over the same period last year. In addition, Intel and its venture capital arm both announced significant investments in Vietnam recently.

Amid all these positive vibes, there is a promising sector showing strong potential. Vietnam is emerging as an attractive outsourcing location: the outsourcing industry has shown tremendous growth in recent years and has achieved a 52% CAGR between 2002 and 2005. The country possesses a cost advantage even over China and India. It can boast of a young population base of which 60% are below the age of 30 and a high literacy rate of 97%. There is improving infrastructure with the availability of several dedicated technology and software parks. Similar to China and India, there is also a growing number of returning "Viet Kieu" or overseas Vietnamese who were educated and trained overseas.

Vietnamese outsourcing players are especially attracting interests from Japanese clients who are concerned about China's rising costs and increased anti-Japanese sentiment. For example, a mid-sized software outsourcing service provider based in Ho Chi Minh City procures roughly 75% of its revenue from the Japanese market. Other players are also having success in drawing blue chip clients from North America, Europe and Japan.

Key challenges remain to be tackled, including weak business environment and a shallow talent pool where there is a lack of senior management expertise. Poor non-IT infrastructure (such as roads, power and airports) continues to hobble the industry. The government is not standing still and has adopted many polices and plans relating to ICT development for the period 2006-2010. With the global companies' desire for a backup outsourcing hub outside of India and China, Vietnam has a golden opportunity to capture a critical slice of the global outsourcing market.

Software outsourcing investment

OWW has injected US$2.1 million into Shanghai Newtouch Software Co., Ltd. (上海新致软件有限公司) (www.newtouch.com.cn), a Shanghai-based software outsourcing service provider. Dalian Software Park, a co-investor, has invested an equivalent amount in Newtouch. The investment comes amidst an environment of strong demand for software outsourcing services in China. CCID Consulting expects Chinese software outsourcing market to reach US$7 billion in 2010 with an annual compound growth rate of 50.2% (2005-2010).

Established in 1994, Newtouch embarked on providing software outsourcing services in the late 90s. It is one of the enterprises that have qualified for the China Torch Program administered by the National Science and Technology Ministry and received various forms of support under the programme. Newtouch attained level 4 SEI-CMM accreditation in 2004.

The company, which is a Sino-Foreign JV (中外合资经营企业), has a total headcount of close to 800 and counts NEC, Hitachi, IBM, Peugeot and Bank of Communications as key clients. Newtouch focuses on the financial services, telecommunications and government sectors. The funding will allow Newtouch to continue with its business expansion as well as to further enhance its operational scale and skill sets.

Investee profile – Creditel (S) Pte Ltd

Creditel is a provider of payment authentication and end-to-end delivery services for e-commerce purchases. It connects international online shoppers to more than 300,000 online merchants in the US through its *comGateway* (www.comgateway.com) service.

comGateway enables customers using non-US credit cards to make purchases from US online retailers. For customers without credit cards, it offers a concierge service to facilitate purchases. *comGateway* offers security to both merchants and customers by authenticating all transactions via mobile phone.

Through its network of logistics service providers in various countries, *comGateway* offers shipping and delivery at a fraction of the costs charged by online retailers in the US.

In partnership with MasterCard and DBS Bank, Creditel has successfully launched *comGateway* service in Singapore, and has recently inked an agreement with American Express to roll out the service in several countries in Asia.

About OWW

OWW Capital Partners Pte Ltd ("OWW") (www.oww.com.sg), formerly known as OCBC, Wearnes & Walden Management (Singapore) Pte Ltd, was established by OCBC Bank, WBL Corporation and Walden International in 1991. In October 2006, the management team of OWW acquired WBL Corporation's interests and the company assumed its current name.

OWW focuses on expansion stage companies in the enterprise and consumer services sectors within the South East Asia and North Asia regions.

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