"Cyient Q1 FY'19 Earnings Conference Call"

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MODERATOR: **MR. SANDIP AGARWAL – EDELWEISS SECURITIES LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to the Cyient Q1 FY'19 Earnings Conference Call hosted by Edelweiss Securities Limited. 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 an operator by pressing '*' then 'o' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sandip Agarwal of Edelweiss securities. Thank you and over to you, sir.

Sandip Agarwal: Thanks, Raymand. Good evening to everyone. On behalf of Edelweiss, let me welcome you to the Cyient Q1 FY'19 earnings call. We have with us the senior management of Cyient headed by Mr. BVR Mohan Reddy along with other senior members of the team. Without further ado, I will hand over the call to Mr. Ajay Aggarwal to start the proceedings. Thanks, and over to you, Ajay.

Ajay Aggarwal: Thank you so much, Sandip, and good evening ladies and gentlemen especially on behalf of Cyient and greetings for people from other time zone, I welcome you to the earnings call for first quarter of financial year 2019 ended June 30th 2018, I am Ajay Aggarwal – President and CFO. Present with me on this call are also our Executive Chairman – Mr. Mohan Reddy and Managing Director – Krishna Bodanapu.

Before I begin, I would like to also say that there has been some delay in release of our results. What happened today, we had the board meeting, then we had a shareholder meeting and then we had continued board meeting which just concluded a few minutes back. So my apologies that we have not been able to give you the sufficient time, actually we are trying to make sure that the directors are there, we use their time for all these matters, so because of that I think we got it packed up, but we will make sure going forward we will give you sufficient time.

Just a normal disclaimer:

I would like to say that some of the statements in today's discussion maybe forward-looking in nature and may involve risks and uncertainties. This call will be accompanied with 'Investor Presentation.' We also made some further improvements in the investor presentation, this being a new year; please do give us a feedback.

With this, I invite Mr. Mohan Reddy to provide a brief overview of the company's performance for the quarter ended June 30th 2018.

BVR Mohan Reddy: Thank you, Ajay and good evening to all of you, ladies and gentlemen. I once again welcome you all to this conference call. Q1 Financial Year '19 was in line with our expectation on revenue, margin and cash generation. We saw the quarterly revenue of $160.8 million with the strong YoY growth of 14.3% in US dollar terms and 13.3% growth in constant currency. The Services revenue grew by 1.1% QoQ on constant currency. In rupee terms, our performance for Q1 was INR1,080 crores, which is 19.1% growth YoY, or 1.7% growth QoQ. The operating profit for the quarter stood at Rs.1,316 million, operating margin of 12.2% for this quarter. We continue to have a healthy cash balance. Currently, the cash balance is at Rs.1,100 crores. The growth during this quarter was led by Aerospace & Defense, Transportation, Semiconductor, IoT and Analytics at 26%, 28% and 35% respectively on YoY basis.

Some of the business highlights for the quarter are: We acquired a Belgium-based semiconductor company, AnSem, a leading fabless, custom analog and mixed-signaling company thus foraying into new technologies. Actually, I feel very proud about this acquisition. We have about 54 professionals in this company, but almost half of them are Ph.Ds in Micro Electronics. That is the type of domain expertise we have got with this acquisition.

We commenced operations of JV with the Israeli partner for the unmanned aerial vehicles. We have a license for it and we have obtained industrial license also from DIPP which is from Government of India.

We also acquired 49% stake in Cyient Insights, now 100% owned by Cyient and this should help in improving our focus in the analytics portfolio.

We created a Silicon Solution Lab for automated testing of chips which will help in accelerating delivery to our clients.

We received AS9100 Rev D and ISO 9001:2015 Quality Certifications for our facility in Melbourne, Florida.

We successfully completed the AS9115A software audit for a major aero customer for our DLM facility in Mysore.

We also got recognized for good practices at the 6th FICCI Quality Excellence Awards. We also won the "Commendable Performance Award 2018" from John Deere.

Our CFO, Ajay Aggarwal was recognized among the top three CFOs in Asia under the sell-side category for investor relations in the IT Services and Software category by an independent survey conducted by the Institutional Investors.

As a part of our ongoing CSR initiatives, we continue to support 25 Government Schools supporting education of underprivileged children. Early part of this week on Monday, we laid the foundation stone for a multi-skilling center in a small suburb of Hyderabad where we have a number of schools. We want to make sure these schools within further get skilled.

As a part of our initiative to increase the IT literacy, we have added three more Cyient Digital Centers taking the total to 60 and we are now providing digital literacy to 25,000 plus children.

With this, I would like to hand over the call back to Ajay who will take you through the detailed financial performance for the year and the quarter.

Ajay Aggarwal: Thank you, Mohan. In terms of the performance for the quarter, you will see that we have done about $160.8 million of revenue, $143 in Services which is a constant currency growth of 1.1% and there is a decline in DLM on the anticipated lines and the revenue was $18 million. We have seen growth coming in from Transportation, Semiconductor and we do have little decline in some of the industries in the particular quarter, but what I would like to say is as far as our overall performance is concerned, it is in line with our annual plan, we did expect the first quarter to be little lean, so as far as our internal annual plan is concerned, internally we are seeing this as completely in line; North America has grown very nicely at about 14% YoY and 5% QoQ and other regions also if you see EMEA is 16% and APAC is 12%. If you look at our YoY number, we really have got good 14.3% growth in dollar terms which is almost (+15%) on constant currency and in rupee terms we are at about 19%, which is a good indication for us for our double-digit growth.

In terms of income statement, first thing I would say is that we see internally, we are absolutely in track with whatever annual plan we had and how we were looking at this skew for the quarter in terms of performance and also the seasonality in DLM. So overall, we have delivered operating profit of INR1,316 million and the margin has been 12.2%. So if you look at our Services margin, we have clocked 13.2%. What has happened in the quarter, I think we did have the wage hike which impacted about 70 bps which is in line with what we planned. We did have some one-offs in terms of this particular quarter about 200 basis points. One, I would say is that we had lower volumes in this particular quarter. So QoQ, we had impact of about 120 basis points in terms of operational efficiency. We did get some efficiencies or betterment from the forex side which gave us 60 bps and we had some one-off both in terms of absorption as well as some of the one-off expenses in investments which is another 70 bps between them. The point I am trying to make is if we look at excluding the one-off, we did have 15.2% kind of services margin and that is what if we look at the coming quarter with the growth guidance that we have given, we are looking at getting back to our Q4 FY18 kind of margins going forward as we move into the particular year.

In terms of the profit after tax, you would see whatever is the difference, operating profit I already explained what has happened, we did have strong Q4 in terms of the forward cover gains as well as some one-off on the other income. I go into details of the other income. So this is what is causing the profit after tax particular movement, but from the operational side, there is nothing that we should be concerned about. If you look at the ETR, we have also disclosed the ETR excluding the one-off, that is about 25%, same as last quarter. As I have shown lot of growth has come from North America in this particular quarter. So because of that mix, I think our tax rate is 25%, but we are confident of extreme good traction on special economic zone and full year benefit of the US tax rate and we are tracking to the 200 basis points reduction minimum YoY on that.

If I go to the next one is in terms of other income, I would like to point out that treasury income is in line, I think we have done better than the last quarter despite the fact that we had invested into some investments that Chairman also talked about, so I think treasury income has been growing, cash is at healthy levels of INR 11 billion. If you see the movement on the forward cover for (+46) million and the (-46) million for the quarter, because of a forward contract position, if you look at the chart below is that is around 67 as against 68 for the last quarter. We gained almost Rs. 4 in last quarter compared to the spot rate, in this quarter we are only at 50 paisa compared to the forward rate. Other currencies have been little headwind for us in terms of the forward contract, but overall, I would say that in terms of other income the way we see, that overall even if at the current rate, other income is not going to be negative, but yes, there is a change QoQ because Q4 was very strong and this change should not see going forward. So overall I think treasury income will continue to be strong in terms of forward contract, I will go into details in the next slide which will give you overview of where we are.

No change in the policy of the company. We continue to be at 70% for the next 12-months which means we have forward contracts of about $125 million, our forward cover rates are given in this particular table where you will see 68 is the rate that we have for US dollar and for respective currency. If you see the spot rate continue, not the current spot rate, we have taken it for 30th June which was 68.8, the forward contract gains that we have are at about $2 million, but we also analyze whatever we have to gain on the operating profit side because of the exchange rate is higher than what we are losing on other income, so there is no concern as such either on the policy or of the forward contract or in terms of what is happening overall on the earnings growth.

In terms of cash generation for the quarter, I would say that there is no change in the focus on free cash flow, there is nothing extraordinary. When you look at our DSO, our DSO is at 88-days compared to 80-days for the last quarter. Six days I would say is one-off, one is about 3.5-days is the impact of the foreign exchange fluctuation and we did have a spillover of collections of about $5-6 million which is three days into July and we are getting that money in July. So our sense is that this $5 million will be extra collection in Q2. So in terms of the free cash flow which is 30% at Rs.445-450 million, we expect this DSO to get back to the normal levels in Q2 and rest of the year and we will generate absolutely the right free cash flow in line with our plans which is at least 40% conversion that will take place. So, again, I would say both on DSO, there is no stick debt, there is no specific account where there is a problem, I think there were seven or eight accounts for which we got about $5 million of collection which spilled over to July which is the point of time thing. So I just again want to reiterate both our DSO and free cash flow, we feel for the year we are absolutely rightly placed.

With this may I hand over to Krishna to take us to other business highlights.

Krishna Bodanapu: Thank you, Ajay. To give you a quick overview of the other significant developments of the quarter, as Chairman said, we finished the acquisition of AnSem N.V., fabless semiconductor company. The strategic importance of this deal is that it competes our service offering or service portfolio for the design build of the semiconductor industry. As you can imagine, that is a core and integral part of digital technologies in many other industries. AnSem has been working on chips that facilitate digital and they are one of the leading players especially at the cutting edge 7 nanometer technology. So that really complements our skills very well.

There is 51:49 JV with Bluebird Aero Systems of Israel to do some UAV kind of work.

We also acquired the portion of Cyient Insights which was 49%, so it is a 100% subsidiary now, but it will also get merged into Cyient because again I think our key differentiator in that whole business is we are able to design and outsource chips that collect the data, actually transmit the data and ultimately analyze the data. So it became quite important that we have a fully integrated offering and not bits and pieces in various places.

We also receive shareholder and RBI approval to cap foreign shareholding to 49%. That was important because we also have some India focus projects which are premised on the fact that the business will be categorized as India-design, develop and manufactured. We believe we are in a very good situation there. Since it is required that the shareholding for such projects to be less than 49%, we requested the shareholders and we got the approval, I am sure some of you on the call also were voted for it, so thank you.

Under the New Business Accelerator, NBA Program, nine projects are there, each will have a development cycle of 12-24-months and roughly 10% of what we have forecasted for the year has been spent on the quarter, but going forward we will also be a little bit more aggressive on that because we are also seeing some potential revenue come out quickly from these nine initiatives.

In terms of investment pipeline, Q1 has been relatively good, AnSem was a key acquisition, there was another small acquisition in the US which is a precision manufacturing company which helps us design, prototype, certification, those kinds of activities. We continue to focus on this, we continue to proactively look at the opportunities in the eight areas that are articulated around A&D, Comms, Medical, Rail, I&ENR, SIA. Also, the DLM business, there are certain things that can enhance that business and obviously corporate ventures and corporate investment, where if you recall the idea between the corporate venturing was to invest in relatively small sort of new start-ups which either are potential customers at a leading edge of the technology or a potential collaborators /suppliers where we can take their technology integrated into our portfolio and sell it to the customers. Net-net I would say we are doing quite well with building up of that pipeline and this was a good quarter relatively speaking.

To quickly take you through the industry outlook, first and foremost, the aerospace and defense industry is actually looking quite good. As many of you know that is a big part of our business. We have also had a couple of tepid years in that business, but if you look at it this quarter, we grew 26% YoY which is quite a significant number. Also, while there was one acquisition which was B&F just earlier in the year, that would not have really skewed the number, I mean, that would have been about 2% of that total number. So, organically itself, the Aerospace business would have grown (+20%) YoY and we see that momentum will continue till the rest of the year.

The Comms business, as you know, that was the star performer for a long time. Q1 was a little bit tepid there, but again I will say overall the industry is witnessing some really-really good opportunities, we are well positioned. Just a point of time thing that in Q1 we had a little bit of challenge, but we are quite confident that going forward we will continue to come back to good growth, we will continue to see strong double-digit growth over there and I do not see that there is any risk to that as we speak.

The Utilities and Geospatial business, I will say, there is a significant change going on in that business. A lot of the traditional services are now no longer being undertaken and where the opportunities are really in the areas of digitization, in the areas of smart technologies, be in smart grids, smart city etc. I think we are still catching up with our portfolio. We had a little bit of a challenge there in Q1, there was a degrowth even compared to last year same quarter and a relatively large degrowth compared to the last quarter. Again, I think we do not think that there is any further downside, we will see growth for the rest of the year and overall for the year also will show growth., but it is one part of our business that we are just making sure that we do not run into any further challenges, but we do have a challenge, but it is a manageable challenge.

The transportation industry again has been doing quite well overall and for us also therefore has been doing quite well. If you look at it year-on-year we grew I think 30% in the Transportation business give or take, quarter-on-quarter we grew ~5%. Having said that, I think in general we are doing quite well in the Transport business and that momentum will continue.

The next business is the Industrial Energy and Natural Resources. I will say, we have had a rough couple of years here, but I think we turned the corner; this quarter was quite good especially year-on-year also we grew almost 7% there and we actually are going to see a good acceleration of that growth going forward. That is a very good thing considering that we have had some challenges in that business, but those challenges are definitely behind us and we can see strong growth going forward. I am quite excited about that business.

The Semiconductor business: Like we were saying earlier, I think we have quite a clever strategy if I can say that about ourselves, of how we are going to manage the business, run the business and how we are going to build a differentiator, not by just being a chip designer or a chip manufacturer, but really providing use cases around the capture of the data, transmission of the data and analysis that can make the product itself better. So, I think that is also if you look at it, the global semiconductor industry itself is growing at a very-very rapid pace, an industry which is in the hundreds of billions of dollars growing at double digit is not something you hear very often, but that industry is doing well. I think we have a very unique place because of all the competencies that we build starting and now with AnSem also and through to the analytics. So while the business has done quite well both organically and inorganically, I think the numbers that you would have seen earlier is including AnSem. So that is why that is a relatively large number, quarter-on-quarter itself is 38.9%., but even if you take out AnSem we still have some reasonable growth over there. I think I am quite confident that growth will continue.

MT&H:

Again, that is the fastest growing part of our business, but is smallest part of our business, but I think we are doing some very interesting things there, we demonstrated some during the investor day also in May, I think we are quite confident about that business.

So to summarize it, I will say the good news is the Aerospace & Defense growth is back and is back very-very strongly. Comms had intermediate challenge, but I do think that challenge does not continue Q2 onwards, we are quite clear on where the growth is going to come from and we are going to have another good year there. Just nothing else if you look at the two largest industries that we have - Aerospace and Comms – those two are going to grow at a very good rate.

We do have a little bit of a challenge specifically on the Utilities part, but again that is a small part of our business. We are also doing the right things. It is just a matter of when the revenue will start kicking in which in my opinion will be Q2, Q3 onwards, it is not a crisis.

So net-net, I feel quite confident of where we are. I feel that obviously we had a very good quarter, year-on-year which I think is a good metric, the growth has been 14.3% I think in dollar terms a little bit, more in rupee terms, the operating profit has also grown almost about 14% compared to the last year same time. So if you look at both these parameters, the operations are very strong, a good strong start to the year and this will continue because we see the growth momentum.

So if I take all that and summarize the outlook for the year, revenue I will reiterate what I said, double digit growth in the Services business, good reference point is Q1 because compared to last year, Q1 grew double digits, the legacy DLM will grow about 20%, overall DLM which includes B&F now will grow 35%, but again that is mathematics, but net-net it will be good. Operating profit will grow in double digits again in FY'19. I just take a second to articulate that I think OPM we are saying will be flat, just because I think there are some operational improvements, there are obviously some upsides from exchange rate, but we are still not sure about the exact impact and that is why on this part, we will come back to you during the course of the quarter or no later than the end of the quarter that exactly what the impact is because unfortunately what we are seeing is the impact of exchange rate is not direct or linear in the sense that there is also mix issue, there is onsite/offshore, where the cost is being incurred, etc., therefore while we expect some upsides in exchange rates, it will take a little bit of time to assuage what exactly it is. Of course, it will be offset by investments. We talked about NBA. If you recall, we said we are targeting little bit lower than 1%, but we are trying to get to 1% because what gives us confidence is we have some great ideas, we have some great talent, we are coming up with some really cool solutions, we are starting to see the first aspect of that, so we do want to invest in that. Net-net, DLM will also improve. Lastly, tax rate will be lower by 200 bps as Ajay explained.

So what I want to say, net-net is the outlook remains what it was at the beginning of the year. We are quite confident about the business. Only thing is we need a little bit more time on the OPM because we think it is going to be flat, of course, we are truing up all the other potential upsides/downsides challenges, etc., but net-net this is where we will stand, and which is essentially very similar to what it was at the beginning of the year.

So, with that we will turn it over for the Q&A.

Moderator: Thank you very much. We will now begin with the question-and-answer session. We will take the first question from the line of Pankaj Kapoor from JM Financial. Please go ahead.

Pankaj Kapoor: Krishna, can you just please elaborate on the challenges that you mentioned in the Utilities and Geospatial – is it in the Utility side or in the Geospatial side or the client-specific thing that you are referring to and what is giving you the confidence that this will normalize from the next quarter onwards?

Krishna Bodanapu: Pankaj, the issue is really the Utility side, I think Geospatial side the business continues to do quite well. There have been specific challenges on Utilities because if you look at that business, it is quite project-driven. So we get a project, we complete it, the next project has to start. We are still having challenges with phasing of the projects, that in some of the expected ramp downs have happened or happening with some of the ramp ups have not exactly backing up to those ramp downs, so there is a little bit of phasing challenge, but what gives me confidence is just the pipeline and looking at where the potential opportunities are going to come from, I think the pipeline is quite strong, we are seeing some really good opportunities there, that gives me the confidence. Also, what else is if you take out the geospatial part, utilities part is relatively small part of our business, it will be roughly about ~5% of our business. So the challenge is quite mitigable because one is it is a small part of our business, and the second is I will say the larger part of our business are doing quite well at this point even if there is a challenge, I will say that is not the intent to say that there is a challenge, but there is also mitigation in place.

Pankaj Kapoor: So it is not a client-specific thing, it is multiple project related issue which is I am presuming is across multiple clients not with a single client?

Krishna Bodanapu: Yes.

Pankaj Kapoor: Although it is a little early, but any view in terms of the ongoing tariff related conflicts which are coming up, do you see any impact of that on your client ER&D related spend if there is any kind of push out of the product development pipelines and all, so I am not sure if you had any conversation with the client yet on those issues, but anything if you have heard which you can share?

Krishna Bodanapu: I think it is too early. Having said that, a lot of our design business is also in the US, if you look at the work that we do for US Defense, it is primarily in the US, if you look at the work that we do for Pratt or Boeing, a lot of it is in the US. So again, I think it is too early. Even if it becomes an issue and we have to do more design in the US, I think we are prepared for this. I am not too worried about that at the moment.

Pankaj Kapoor: Ajay, can you just elaborate on these one-offs on the margin side? I could not get it very clearly when you were in the initial part of the presentation.

Ajay Aggarwal: Let me explain again, if you look at what kind of challenges we had in this quarter, one is I think the volume, which has impacted in two areas; one is utilization, if you see our utilization is down by about 4% QoQ, also if you look at our SG&A absorption that has been impacted. So if you take both of them on the operational efficiencies and SG&A, purely on account of the volume, we do have a headwind of about 1.5%, which is when the volumes pick up, I think a lot of it can be recovered. Second, I said, both in terms of some of the M&A expenses which were towards the acquisition that happened and some other SG&A, they have also been one-off, so that is another 25-50 bps. That is why I said we have about 200 bps. If the volumes come up, those are the one-offs which can turn around in the coming two quarters.

Pankaj Kapoor: So essentially I am linking it with the earlier commentary from Krishna, so the impact on the volume side could have been in the Utilities space where the ramp-downs happen and the ramp-ups did not happen as expected.

Ajay Aggarwal: Yes.

Pankaj Kapoor: These ramp-downs were anticipated at the start of the quarter, what probably would have been a surprise for you was the ramp-ups getting delayed, is that a fair understanding?

Krishna Bodanapu: No, we knew this was going to happen. It is not a surprise, I am just saying what happened. We knew this was going to happen for a while because the projects we have been planning for a while. That is why when we gave you the overall commentary on the year and therefore how it was going to pan out. We also said therefore Q1 will be a little bit softer. So I think this is all anticipated, it is not that we got a surprise, because that was there this is what is happening.

Moderator: Thank you. The next question is from the line of Gaurav Rateria from Morgan Stanley. Please go ahead.

Gaurav Riteria: Krishna, question on Communications vertical. You talked about good confidence from 2Q onwards. If you could elaborate a little bit on what is driving that confidence and growth? Secondly, what is happening on the A&D vertical with respect to Services business?

Krishna Bodanapu: There are two things; first the Comms business, these were all anticipated things, the projects that are moving around a little bit, there is some work that we had planned to start offshoring, that transition is happening, but there is also some new work will cover up, etc., etc., So, that gives me the confidence. Basically if you look at where the confidence comes from is the backlog and the pipeline, because ultimately unless it is not there in the backlog, you cannot produce this work, in the sense that suddenly work does not come, it wells through the backlog. Some of the issues are anticipated and some of these issues are what was planned, for example, in one of our customers in Australia, the work which was traditionally onsite is going to be moving offshore, some of that has started to happen and that is also impacting the revenue because obviously the absolute number will be a little bit lower. That is also extracting cost a little bit in terms of margin because we still have the team in Australia because we are redeploying them in elsewhere and again that is basis of the work and the POs that we have. We built up a big team in India, the work is just ramping up, etc., So that is the confidence that I get. A&D services business is growing quite nicely. While the overall growth is 26% YoY, the Services business you take off about 3% for B&F because that would have added. So the Services business is also growing at about 15-18% something like that, because there was some growth in DLM also. So, if you look at that net-net is one is our largest client where we have some issues, etc., last year, it has come back to growth, that client grew 6% year-on-year, it is just the growth rate trajectory continues, we will have a good year there, we have an aggressive budget which we are quite confident of meeting. Service business on Aerospace business at 15.4% year-on-year growth. So, if you look at the 26% that was 2% or 3% because of B&F that was about 6% or 7% because of the traditional DLM business, but pure services grew 15.4% in Aerospace & Defense. The top client grew were ramping up to very-very large clients. So, I will say we have had some rough years, but we are back in the growth.

Gaurav Rateria: Two more questions, Krishna; one, any status on the large orders which we are pursuing on the DLM side which are like more synergy deal from our existing clients? Secondly, question to Ajay on margins. Last time when we provided the margin outlook, it was based on rupee rate of let us say 64-65, now the rupee has moved quite a bit and despite that margin guidance has not changed. So, are we using this rupee benefit for increasing investments in the business, how should we read this?

Krishna Bodanapu: Gaurav, first on the pursuits, I think there are some good pursuits that are building up, some of these are in advanced negotiations. So, we will keep you posted, but I think we have not lost anything that is of concern, pipeline continues to add, so in the next quarter or two we will start to update a little bit more granular detail.

Ajay Aggarwal: In terms of margin, Gaurav, very fair comment, I think apart from God there are very few people who know where this exchange rate will go in the next few quarters, but how you are seeing internally, as Krishna explained in the outlook for financial year '19, we are looking at three levers, I think volumes we are very confident that we will have double digit growth, which itself is a lever for operational improvement. Now when we look at the first quarter, you will also see that our offshoring is lower than the last quarter by about 2% and internally also when we look at our target, I think there have been some headwind from the offshoring. So on the volume side taking into the utilization improvement we should be fine. Offshoring right now we do not have a clear visibility of how much of that levers will play in the coming quarter, but we still have a lot of run rate in terms of the next nine months. As far as the exchange rate is concerned, we are really not baking in, the way we look at is that we have these variables of operational improvement, investment and what comes out of the exchange rate. As Krishna explained, we are also seeing that the benefit of exchange rate is also little muted, not exactly the way it should span out, but I think some of it also flew in the quarter towards the end of the quarter, so we are not seeing the full impact. So I would say theoretically yes, it will change from 64 to 65 versus whatever number you want, let us say 67 or 68 that should be 100 basis points improvement in our guidance but we are just saying if there is a scope for further enhanced investment, if there are headwind which may phase in terms of that 100 basis points of improvement and also who knows where this exchange rate will settle, that is why we are just saying 100 basis points, another nine months to go, that is the honest answer for that, Gaurav.

Moderator: Thank you. The next question is from the line of Madhu Babu from Prabhudas Liladhar. Please go ahead.

Madhu Babu: Sir, on the new client additions in the Aerospace, so are there any new engine makers which we added like Rolls or GE?

Krishna Bodanapu: No, it still the OEMs or systems manufacturers, we do not work with any other engine companies or we work with one of them in a small way, but it is also a longstanding relationship, it is not a net new kind of a thing.

Madhu Babu: Another one on Boeing has started engine makers for a bid for this 797 plane. So would that lead to pent up demand from Pratt & Whitney, too early for that, but any view on that?

Krishna Bodanapu: Like you said it is a little bit early for that, but that is the expectation.

Madhu Babu: On the Communications side, when that has been growing very fast over the last three, four years, but how is the onsite effort there and what is the margin profile of the SBU?

Ajay Aggarwal: If we look at overall basis Communications is average margin business, if you look at company average gross margin and the margin for Communications, I think that we are tracking quite at par. In terms of onsite, I think some of the new contracts that we got in Asia Pacific and all, it is quite high, you know our onsite margins are traditionally much lower, but in this particular case I think they are quite high in terms of the onsite margin, maybe about 5% to 7% lower than the company average. So that is what I would say about the Communications margin.

Madhu Babu: The New Business Accelerator, can you explain us one solution, how we are selling it to the client, just a traction over there?

Krishna Bodanapu: Basically these are things where we are generating the end product, end product meaning not just a physical product, but an end solution, and the intellectual property of that end solution results with us. So, we are able to monetize this very differently when compared to simple services kind of a business. So, we are making sure that we do not sell the effort, which is currently what happens in the Services business, but rather we sell the outcome which is what the NBA solutions are, but having said that, I do want to say that while we are seeing some traction there, we have shipped some products, we have executed some solutions, the volumes would not pick up at least for another year or two because it will take time, these are things that are long cycle, the development time is 12-to-24 months. So what I want to say is it just gives us the confidence that the market is receptive to these. That is why we are continuing to invest. Very honestly, substantial revenue generation will at least be 24-months away.

Moderator: Thank you. Next question is from Ravi Menon from Elara Securities. Please go ahead.

Ravi Menon: I am not sure we should look at this SG&A absorption as a one-off in the project based business. We will have quarters in which utilization would be lower. So, how should we look at this? Will this continue to effect margin or do you think we now move to slightly longer duration contract, how will that happen over time, how we should view that?

Ajay Aggarwal: Let me explain to you what has happened and what we meant by this. Definitely, if you look at one example of Communications right, we have seen that we have extremely good traction on that particular vertical and volumes are going to be back, we will witness in the next quarter itself. If you look at our reduction in the utilization quarter-on-quarter, about 8% has come from Communications. Now the movement that volume comes, because obviously we know the business is there and people are there and it is not for one-off project which are cyclical, we have that business which is known to us, which is there in our back log. So I think definitely you will see a swing of about 5% to 6% QoQ in these kinds of situations. So, I would say that we have lower volumes especially which come from the known business, we do have position of improving the utilization very quickly.

Ravi Menon: Secondly, if we were to assume theoretically that the rupee remains where it is currently, even the 30th June end rate for the rest of the year, do you think that we should actually see 50-100 basis points margin improvement or do you think that is unlikely that we will still be flat for the year?

Ajay Aggarwal: As I clarified that the equation of how much we will get from operational investments, because of the challenge on the onsite/offshore in the Q1 how do we play out, operational improvements, whether there will be 100 basis points or 50 to 100 basis points, we have to watch out. Is there a scope for us to invest more in terms of the investment? We have to watch out for the next nine months. On the currency, what is the actual benefit given our situation of cost structure, we have to watch out, is it 100 basis points or 50 basis points. Definitely, 50-100 basis points improvement is definitely there because of the currency, but how much is the headwind on other count and how much is the opportunity improve on the investment, we will give us time till H1 and we will be able to make a commentary next quarter.

Ravi Menon: On DLM, do you think that given where we are, are you still seeing a mix change over there and do you have a pipeline of some sort of synergy deals coming from traditional services client?

Krishna Bodanapu: The mix is definitely changing and I think we are also consciously changing that is we are not taking as much business as that is available on some of the traditional models, we are being very careful on what we take and what we do not take. We are seeing some good opportunities coming in from the synergy customers, there is a couple who are looking at based on purchase order and back log in the $5 to $10 million range this year itself, that is in FY'19. We are just managing that very carefully, there is also reputational risk, that is we do not want to drop customers very easily, but we are managing it in such a way that as the ramp up in the clients that we want happens, we slow down on the clients that we do not want.

Moderator: Thank you. Next question is from Urmil Shah from IDBI Capital. Please go ahead.

Urmil Shah: Krishna, just for better understanding, Services business adjusted for the AnSem acquisition has declined even on CC term. So, if we adjust for the decline in the Utilities business, is there still a decline or the entire decline has been driven by the Utilities part?

Krishna Bodanapu: In terms of the decline, large part of the decline would have been Utilities, but there are also some areas where we have seen growth, like Transportation has seen some decent growth, Semiconductor without AnSem also has actually seen some decent growth. So net-net if you take that out, it would be flat.

Urmil Shah: You said that some of this ramp-downs were anticipated both in Utilities and the shift to offshore, Communications was anticipated. So was that a negative surprise in any other verticals resulting in Services declining on QoQ basis?

Krishna Bodanapu: Actually if I look at the budget that we had put together at the beginning of the year we are pretty much spot on the budget. We have control over what is going on. The reality is there is going to be cyclicality in our business and I think we know how to manage that cyclicality. We are pretty much on the spot with budget which gives me a great deal of confidence of where things are headed.

Urmil Shah: Lastly, on the impact of NBA on the OPM this quarter, would it be fair to assume that it was between like 30 to 40 bps or it was still lower than that?

Ajay Aggarwal: So if you see the impact quarter-on-quarter, you are right about 30 to 40 bps, because already we had also spent something in Q4.

Urmil Shah: Again this during the year should increase and for the full year it should be about 100 bps so that in some of this quarter the impact could be more than 100 bps?

Ajay Aggarwal: I think overall for the year as we have said that we are targeting towards 100 bps, as Krishna explained right now we are tracking lower than that, but I would leave it just there, obviously, there is going to be cyclicality within the quarter, but I would be very surprised if in any quarter it is more than 1%.

Moderator: Thank you. The next question is from the line of Sandeep Shah from CIMB Securities. Please go ahead.

Sandeep Shah: Just the first question in terms of the margins, if I look at, I think the commentary in terms of the revenue has not changed. So, we are saying that what we have anticipated at the end of last quarter, it has been coming in after the first quarter., but the commentary seems changing in terms of the margin because as earlier been asked, we were not factoring rupee depreciation, now we are factoring rupee depreciation and calling out of flattish kind of a margin. So if nothing has changed on the revenue side, what has changed in terms of the cost management which is not giving us a color to say that the rupee depreciation can be an additional tailwind and the margin could be flattish on a CC basis, that is a question #1.

Ajay Aggarwal: I think I have already explained that your guess is as good as mine whether we will be flat or we will be marginally better because of the exchange rate. I think the concerns from all of you is very valid. I would say it is just that we want to really wait and watch on three factors, again I am repeating, how much of operational improvements come out, the only risk that we are aware of right now is the offshoring since revenue is on track, as you said, utilization we definitely see why we had 4% decline this quarter, we can catch up and that should be intact, that is one risk we are seeing. On the exchange rate I think while we have been traditionally believing that for every Re.1 we get about 30 bps. I think given the current structure which is more towards onsite, we are also be revisiting that because the impact of this as I said in Q1, we could only observe, then I run our constant currently P&L, I could only see it only for a quarter which was not fully impacted by the currency. So, that is another thing we are saying, whether it is going to be 20 bps or is it going to be 30 bps, then some of it will keep changing quarter-on-quarter. Third, we are saying, we are also seeing this as an opportunity depending on we really see extremely good set of sufficient projects that are coming from businesses as Krishna explained and if currency is really a tailwind for us, we may spend more on investments or maybe the investments for SG&A and other things, that is really open. That is why we are saying that we have just been little cautious here in terms of the variables and who knows about the currency itself, it is not right for me to say that the currency we can factor, as somebody said spot rate of 68.8, that will not be fair. So I think give us time till H1 and we will be more clear by then on these variables.

Sandeep Shah: In the first quarter you mentioned that the forex upside has led to 60 basis points. So can you explain because it looks like almost 4.5-5% rupee depreciation, I do agree there would be a cross-currency headwind, but it still looks lower in terms of 60 basis points kind of impact only.

Ajay Aggarwal: So, roughly we calculate it, I think currencies have been moving in different direction and as we have been saying in this call, looking at our cost structure onsite/offshore, mix and all that, broadly, I would say we saw about 20 basis points for every Re. 1 as far as Q1 is concerned, but I am not saying that is going to be the norm, because the restatement of some of the WIP, some other things will be happened one time, they will not happen every quarter. Give us some time to understand. As of now, I think what our limited understanding is about 20 basis points is sustained by about Rs.3 and that is how it is 60 basis points.

Sandeep Shah: Ajay, if you are starting with 12% and for the full year to maintain flat at close to14%, it is like a good ask rate in the next three quarters. So, you believe the volume growth itself has a revival would bring that swing on QoQ basis?

Krishna Bodanapu: Absolutely, there is volume growth, there is also some operational efficiency issues that are continuing.

Sandeep Shah: The last question in terms of DLM margin, so I think with an improvement in the revenue growth trajectory. How is that margin tracking both in terms of even the revenue growth outlook and the margin outlook for the DLM?

Krishna Bodanapu: It will be low single digit for the year. That is what we believe it will be. I think first quarter it was 4.5%. It will probably come down a little bit because there is some lower margin business also that is there in the backlog., but it will be low single digit for the year.

Sandeep Shah: Krishna, in terms of Aerospace & Defense, you also said the order backlog is helping you. So just want to understand in the cycle when the aircraft goes into production, is it more business which comes in terms of the order backlog to the order getting ready where you play a role more in terms of the avionics, how you participate in the cycle from order backlog to the product be in ready?

Krishna Bodanapu: I think that is a little bit of a complex answer to that, because it depends on what we are doing and which part of the cycle we are in because large part of our business is still design related. So the design related business has no correlation with the order backlog because the design cycle itself precedes. So it really depends on which part of the cycle we are working on, the design is one, we do some manufacturing where what you said is very right, that is that the backlog needs to be delivered, we build a sub-system, etc., So, it really depends on which part of the value chain that we are working on but each one is very different and it will not be right to generalize it.

Sandeep Shah: No, my question was if you are not in design and the aircraft has come in terms of order backlog, if we keep aside the DLM part, you still have a role to play from the order backlog of the OEMs till the aircraft is ready in terms of a delivery?

Krishna Bodanapu: Yes, of course, in manufacturing engineering, there is MRO, there are various elements, so that is also part of the whole equation.

Moderator: Thank you. Next question is from the line of Abhishek S from Equirus Securities. Please go ahead.

Abhishek S: Krishna, you mentioned about the recovery in Aero business. Could you just elaborate that what is driving the business in terms of the service lines, what are we going to do over the next couple of months, that will be helpful?

Krishna Bodanapu: I think the recovery is quite broad-based, it is a set of existing customers that are growing, also some new additions. Avionics is doing very well, which is the aerospace electronics we are doing quite well on the mechanical side. MRO is doing well which is the services that we provide for the aftermarket portion of the airline industry. So, the numbers are fairly significant because run rate there, it is $200 million business that grew 15% YoY. Just coming to Services, which means that the growth itself has been quite broad-based.

Abhishek S: Just a follow up on that, so how are B&F, Certon helping us there if you can just help us understand that quickly?

Krishna Bodanapu: If you look at aerospace electronics there is a lot of certification, verification, validation, testing, Cetron is able to automate that piece of the equation. So if we look at the value chain, Cetron is early part of the value chain, that is in design, or automate or help us automate a large part of the repetitive work. If you look at B&F, it is on the other part of the value chain, that is when we design something especially at a very low volume, these are very-very complex parts or tools which need to be manufactured because there is a high volume of design content there. So we are able to manufacture what we have designed. So, B&F comes at that part of the value chain. The fact that we are able to cover the entire value chain and have some very strong competency is helping us quite a bit.

Moderator: Thank you. Next question from Harit Shah from Reliance Securities. Please go ahead.

Harit Shah: I just get a proper structure of what happen specifically in Europe in this particular quarter – was it again mainly because of the Utilities vertical or was there any specific events that you would like to call out over there because US growth was quite healthy, but Europe obviously was a bit of disappointment and specially given that a lot of other IT firms, obviously not necessarily comparable directly with an IT firm, but generally IT firms are seeing pretty good traction in that particular region. So if you could give some perspective on that, that will be helpful?

Krishna Bodanapu: Honestly, it is just a point in time thing. At least we anticipate the Utilities business was Europe-centric. Also, there were some good projects that we did towards the end of last quarter in Europe which would have come down. If you look at all of last year, Europe did very well, it is just one quarter, also rest of the year we do not see any challenges in Europe, so, I would not read too much in what happened in one quarter.

Moderator: Thank you. Due to time constraints, we take that as the last question. I would like to hand over the conference to Cyient senior management for closing comments.

BVR Mohan Reddy: I guess the quarter was challenging in terms of margins, but I like to assure our investors that moving forward in the next three quarters we will make it up as Ajay and Krishna talked about it. Currently, we have seen that it will be flattish in terms of the operating margins, that is what we are very confident about, but based on several things that could happen, we could basically see more improvement than where we are today. We appreciate your confidence in us. We continue to communicate with you on all the developments. Thank you very much for participating in the call today.

Krishna Bodanapu: Thank you.

Ajay Aggarwal: Thank you.

Moderator: Thank you very much. On behalf of Edelweiss Securities, that concludes this conference. Thank you for joining us, ladies and gentlemen. You may now disconnect your lines.