"Cyient Limited Q2 FY2019 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to the Cyient Q2 FY2019 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 "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sandip Agarwal from Edelweiss Securities. Thank you, and over to you, Sir!

Sandip Agarwal: Thanks, Rio. Good evening to everyone. On behalf of Edelweiss, let me welcome you to the Cyient Q2 FY2019 earnings call. We have with us the senior management of Cyient, headed by Mr. B. V. R. Mohan Reddy, along with senior members of the management team.

Without further ado, I will hand over the call to Mr. Ajay Aggarwal to start the proceedings. Thanks.

Ajay Aggarwal: Thank you. Good evening, ladies and gentlemen. Welcome to Cyient's earnings call for Second Quarter of Financial Year 2019 ended September 30, 2018. I am Ajay Aggarwal, President and CFO. Present with me are also the Executive Chairman, Mr. Mohan Reddy and Mr. Krishna Bodanapu, the Managing Director and CEO.

Before we begin, let me make the customary statement that some of the statements made in today's discussions may be forward-looking in nature and may involve risks and uncertainties. A detailed statement in this regard is available in our website, which has been e-mailed to you as well as posted in our website. This call will be accompanied with our usual presentation and same has already been shared with you.

I now invite Mr. Mohan Reddy to provide a brief overview of the company's performance for the quarter.

B.V.R. Mohan Reddy: Thank you, Ajay, and a very good evening to all of you, ladies and gentlemen. I, once again, like to extend a very warm welcome to all of you to this conference call.

The Q2, that is the Q2 of Financial Year 2019, was a very robust quarter for Cyient with all-round growth, wherein we have passed many milestones happening in the quarter.

To start with, we saw the highest-ever quarterly revenue at USD $168.9 million with a strong growth of 5.1% and 12.5% quarter-on-quarter in U.S. dollar terms. In constant currency, we grew by 6.5% quarter-on-quarter and 14.5% year-on-year. The services revenue grew by 3.5% quarter-on-quarter on a constant-currency basis.

In INR terms, we saw revenue growth of 9.9% quarter-on-quarter and 23% year-on-year. Again I repeat, 9.9% quarter-on-quarter, 23% on year-on-year on INR terms. The services operating margin expanded by 212 basis points quarter-on-quarter at 15.3%, which was primarily led by utilization improvement of 294 basis points. The group operating margins is at 13.7%, an expansion of 151 basis points quarter-on-quarter.

The operating profit is at Rs.162.6 Crores or INR 1,626 Mn, which is a quarter-on-quarter growth of 23.5%. Net profit for the year stood at Rs.127.1 Crores or INR 1,271 Mn, which is a growth of 54% quarter-on-quarter.

We continue to have a healthy cash balance. Currently, the cash balance stands at Rs.1,211 Crores. The cash flow to EBITDA conversion for the quarter stood at 72%. The company declared an interim dividend at Rs.6 per share at the board meeting earlier this morning.

On the infrastructure front, Cyient received an AS9100 Rev D and an ISO 9001:2015 quality certification for our Melbourne facility in Florida, U.S.A. We successfully completed the TL 9000 second surveillance audits for our Hyderabad and Paragould locations.

Cyient's BlueBird joint venture won the first order from Indian Army for the SpyLite Mini UAV, which is a significant step in the right direction. We also extended our Pune facility to accommodate growth for one key customer.

As a part of our ongoing CSR initiatives, we continue to support 25 government schools in educating the underprivileged children. As a part of the green drive initiative, Cyient Foundation participated in the Haritha Haram, a mega plantation drive in the state of Telangana. We added 7 more Cyient Digital Centres that provide digital education resources, taking the total to 67, providing digital literacy to 27,000+ children.

On awards and recognition front, Cyient was recognized as the Top IT/ITES exporter from the City of Hyderabad in the category of Rs.1000 Crores-plus export in the category of Rs.1000+ Crores. Cyient got Major Contender in the Everest Group Verification & Validation Engineering Services PEAK Matrix 2018. I am also happy to report that Cyient featured in the Top 20 Most Promising Aerospace Technical Solutions Providers list in the CIO Review.

With this, I would like to hand over the call to Ajay, who will take you through the detailed financial performance. And then Krishna, will speak to you on the business performance. Thank you.

Ajay Aggarwal: Thank you, Mohan. In terms for the quarter, as Chairman said, we have slogged $168.9 million or Rs.11,870 million, so this is our highest revenue. And the growth rate, if you look at it in constant currency, is 6.5%.

Let me just take you through the colour of the verticals. If you look at the group, which is both our services and manufacturing, you will find that in most of the business groups or the verticals, we have seen good traction there. Even the solutions business or our engineering manufacturing is also moving in nice direction.

A&D is moving at about 7.4% quarter-on-quarter.

When you look at Communications, while we are seeing a number of 1%, actually that is because of in DLM we have let go of some business, which was low margin. And if we look at Communication per se, we are at about 2.6% in constant currency. That is about 4% growth in Communication in this particular quarter.

Just to complete that comment about what business we have let go of in case of Communications in DLM. Without that also you will see that our DLM business is doing very handsomely. And as we come to the end of the presentation, you will see, we are meeting or exceeding the guidance on DLM, and this is business that is margin accretive.

In terms of U&G, you can see there is no DLM business here. And in constant currency we have 4% growth. Transport, we have 0.3% growth in constant currency; INR, almost 5%; semiconductor, 8.8% in constant currency. Of course, this has the benefit of about $3 million of revenue from our acquisition, where we had taken two months of revenue last quarter. And this quarter, we have accounted three months of revenue. That is addition of about $1.4 million during the quarter. Medical, as you see, you will see a number for combined of 24% quarter-on-quarter. Even for services alone, the number is quite good.

So the point I am making is that as you see, in terms of most of our industries, and if you look at the next chart, 14.5% growth. Most of the industries, if you take Communication at that 12%, then all the industries, except U&G, which was flattish year-on-year or minus 2%, all of them are growing in double digits. So I again repeat, 6 out of 7 industries are growing in double-digit year-on-year during the quarter, and this is quite a reflection of how we are seeing the whole year.

In terms of the profitability, let me take you through what has happened in terms of operating profit. I think we are very delighted to see that we are on track, what target we had set for ourselves. In terms of services business, we have expanded about 200 basis plus margin. And it is in a quarter where we also gave the wage hike that has impact of about 100 BPS. No doubt, we got some benefit from exchange rate. Even if you cancel each other out, still we have 200-plus basis points improvement, which is purely on account of the efficiencies and the volumes.

I think this will continue as we move during the year. I am sure Krishna will talk more about it, but I think operating margin is on track. Operational efficiencies are picking up. And this is again despite the fact that we continue to make investments on NBA, which as we have spent as per the plan, we are likely to track to the plan for the year, which is further adding to the benefits in the coming years. Roughly, we saw that for 1% spend on NBA, we are talking about something like 8% to 10% of earnings growth in this year, and this is reviewed today. We are adding that 8% to 10% in year three to year five to our earnings growth. So if our normal earnings growth, let us say, is historically about 15% CAGR, because of New Business Accelerator, it will be likely to be more like 18%-plus just because of this initiative. So that is what I wanted to clarify that we have achieved 200 basis points of improvement purely from operations and also making investment into the New Business Accelerator as per the plan.

At the group level, I think DLM continues to do nicely. Internally, they have met all whatever expectations we had from them during the quarter. And the margin is positive. And overall for the group, the margin is up by 1.5%.

Let me take you through when we look at the 54% expansion of profit after tax. You will definitely have some questions on that so let me spend a minute or two on this.

When you look at profit after tax, you will see that we do have two special things that I would like to mention. One is, we have the other income on account of some incentives that we are getting on export of merchandise and engineering services, both for our services business and DLM. For the quarter, we have got about Rs.234 million and for the full year, we expect this amount to be something like Rs.450 million. And it is something, which will be recurring, which whatever benefit we are getting it is not one-off. It will continue in the next year on a similar level of about Rs.450 million.

Second, you will see that there is a forex restatement of Rs.207 million. This is on basis of an exchange rate change from the beginning of the year from around Rs.65 to about Rs.72. And if you look at the overall situation, continuing at this level, our expectation is on the restatement itself, we should have Rs.35 Crores to Rs.45 Crores of benefit if the rupee was to close at Rs.72 to Rs.74 levels, depending on what assumption we make. So these are two items, which are there in this quarter, but we do not see them as one-off.

In terms of the tax rate, you will find a number of 29.8%. Let me explain to you how to read it. Last year, our reported tax rate was 26%. We had committed to 200 basis points of improvement year-on-year. We are absolutely on track on that. I think half of it was based on the government change in terms of U.S. tax. That is flowing through very nicely. Also, we had looked at the growth coming from the businesses in the further development that we are doing in special economic zones. So both put together are giving us a saving of about 200 basis points.

But some of this other income, for example, from this incentive, is taxed at 34%. Because of that, you will see the reported tax will be more like 25%. So ideally, you should have seen, again, 26% to 24% tax rate, but in the final P&L, we should see a rate of 25%. But it is for a good reason. Whatever is the increase in tax, the increase in the PBT is much higher than that, for obvious reasons. And we are on track to have a tax rate on a steady state of 22% to 23%. That is what another thing I would like to clarify.

I think there was a lot of confusion in terms of some of the drivers of operating margin. So we have enhanced our disclosures, and you can look at this sheet. This is what I broadly explained to you. And we will also explain to you how do we anticipate the situation at this stage.

I think when we met last time our clarity in terms of what is likely to happen, also our preparedness for growth. But this time, we are very clear what has happened, and we will also articulate to you what is likely to happen on this for the full year.

Most of the other income, I already explained. I would say that in terms of the forward contracts, we have Rs.62 million of loss during the quarter. Last quarter, we had about Rs.4 Crores of loss, and this is in line with what we expected.

In terms of unrealized FX gains, I already said that we have gotten the last few quarters about Rs.26 Crores. Our estimate is at current rate, it should be Rs.35 Crores to Rs.45 Crores. Of course we do not bill it in running the business what is purely from the perspective of how the profit growth is likely to happen. Roughly, we have about $35 million of net monetary assets between foreign exchange assets and liabilities, so for every Re.1 change, I think we have an impact of about Rs.5 Crores on this restatement. That is how I talked about that number of Rs.35 Crores.

I will go to the next item, in terms of our hedge book. As we have seen, we have been very consistent in our policy despite the fluctuation, no change in the policy. We are covered for 70%, 12 months forward. Total coverage is $127 million. And for the current situation, if spot rate was to continue at current rate that is about 72.6, then loss for the next 12 months will be $2.5 million. Most of that will be in the next six months. And the rest of the year, our position is around 73 for the 6 months of the next year, so there will be no profit or loss there. That is what we expect.

Last time, we had some one-offs where in terms of DSO there were some concerns. I am very happy to inform that we have got a reduction of 7 days, as Chairman said, quarter-on-quarter. This is despite the fact that currency was a headwind. So we are not taking that into account. If you take that like-to-like, this number will look like more like 9 days of production quarter-on-quarter.

And free cash flow, we have generated of about Rs.1585 million and 72%. On Design Led Manufacturing also, you will see we have generated a positive free cash flow. We are very happy on Design Led Manufacturing, as I said earlier. Revenue, profit, cash, I think all are tracking internally to the plans that we have in the outlook that we had given, so again, having a positive cash flow, which is likely to be sustained for the full year is a good news for us.

With this, I will hand over to Krishna. Only my comment is that whatever you have seen in terms of some of these things that have happened in Q2, we are very confident that on each of those items, we will have an extremely good year.

And with that, I am handing over to Krishna for his business update, please.

Krishna Bodanapu: Thank you, Ajay. So in terms of the business update, the first thing that I will talk about is Cyient Systems and Solutions, which is the UAV venture that we have along with BlueBird Aero Systems of Israel.

As Chairman said, and I think there was a press release also on this earlier in the quarter, we won our first deal. We believe that we have a very comprehensive solution for this market. You will see that we have identified about $190 million pipeline, and this is probability-adjusted pipeline. So these sort of raw numbers would actually be much higher than this. So there is a good robust pipeline. We believe this found a good niche for us to deliver a complete solution. And we will continue to work on this, and we will continue to address this market.

Also, the other thing is the New Business Accelerator. This is the accelerator where, if you recall, we said we invest a percent of our revenue, 1% of our revenue, in undertaking technology, new business models, etc., to prove them out and take them to market. And I will say, while we have not generated revenue from there yet, but there are 7 projects that got added into the pipeline, so there is total of 19 different projects that we are working on. And we are seeing some significant traction in the product and solutions that are being generated under this NBA gamut, especially in the IoT space and also some on the other emerging or new technology space.

What we believe is these initiatives will accelerate Cyient's EPS growth from year three onwards, which is FY 2020, so we are taking this investment. If you remember last quarter, that was one of the reasons why margins had dipped also, was because we were making the 1% investment into NBA. We will continue to do that. And we believe that in a 18-months time, which is FY21, actually we will see the benefit in EPS acceleration.

In terms of the investment pipeline and focus areas, I will just say, no significant movement there. There are a few things that we have done over the course of the first half of the year. AnSem was acquired. We bought 100% of Cyient Insights, which is now a part of Cyient, which is the analytics company. We also finished the JV with BlueBird. But we will continue down this path of more inorganic investments. While a big acquisition is something that we would like to do, the reality is they are few and far in-between. And therefore, we are also looking at other ways in which we can enhance our competitiveness.

There is also a commentary on what sort of companies we are looking for, and I will leave that because that has not changed much over the last few quarters at least.

In terms of the business outlooks and update. Aerospace & Defense is witnessing a strong growth. We do have a little bit of challenge in Q3 in A&D just because of the cyclicality, but in spite of that, we believe we are in a very good position for the year. The revenue in services will grow high single digit, but more importantly, the integrated revenue, that is services plus manufacturing, will grow in the double-digit. And we are seeing some very, very good opportunities, and the pipeline continues to build. So this is a very large part of our business, in fact the largest part of our business. And we see some very, very good traction going forward.

In terms of the Communications industry, I will say, we did reasonably well in APAC and NAM. We do have some challenges in Europe that we are working through. While if you look at the numbers, when Ajay talked about them, in terms of quarter-on-quarter, there was a growth. In terms of year-on-year, also we have more than a double-digit growth. In constant currency year-on-year, we are at 14% growth. So we think that the Comms business still has a lot of momentum behind it, and we do have a short-term dip in the sense that between Q4 and Q1, we had a small drop in revenue, but we are working on it to make sure that for the year we will still come up around this 14% number on growth.

Utilities & Geospatial is also in an interesting spot, I would say. Essentially we are calling the flat number there. That is the one bearing growth. And we think we have mitigated against rupee growth scenario also, but essentially we will be flat.

There are a lot of things that are going on in the industry. I think we have finally managed to build some good offerings and some good proposition to the market. We are really in the early stages of selling it, so we are not necessarily seeing the potential traction from those opportunities. But again, I believe that this is just a matter of time because a lot of investment has gone into building the right capability in Utilities & Geospatial.

Transportation is another very strong growth driver for us. Year-on-year, the Transportation business grew 14.8%, almost 15%. So we see that there is a lot of traction. There is also a fair amount of disruption and change that is coming in the transportation industry, which gives us a good opportunity to be successful in that industry.

The next one is Industrial, Energy and Natural Resources. I would say this is a good outlier this time, especially on the positive sense. With all the investments that are going on in oil and gas and also in mining, especially driven by the fact that prices have recovered quite a bit, we do see significant investments in these areas. And we believe that, that will help us. If we are positioned correctly, it will help us quite a bit with growth.

We believe we have the right set of services for this industry, which primarily revolve, not just around traditional engineering, but more importantly, around things like IoT, connected devices and so on, so forth. And we are seeing some very, very good traction. I think this is one industry or one set of industry is where we did not have a very good run for the last couple of years. But I think this time around, we are definitely back to a situation where we will show some very good numbers and some very good growth.

The semiconductor industry is the industry itself is doing very well. It is growing 4.4% year-on-year. And that too in a business that is at least $600 billion, so that is a large set of growth. I think we are also participating quite well. Our proposition of having an integrated data capture, data interpretation, which is basically the analytics business, the whole continuum is going very well. And we continue to be quite bullish there.

Medical technology market itself is growing. I believe we have found a good niche in the market or a good proposition in the market with MOM, which is machine-to-machine communication, also with things like IoT, additive manufacturing, etc. So we will continue to grow in that business. And if you look at the numbers, while the numbers are, agreed, a little bit small, but it was a 9.1% quarter-on-quarter growth if you take the integrated business. And also, it was, I think, a 25% year-on-year growth.

So what I would suggest there especially is we have to look at the integrated services plus design. Because those two parts of the value chain are very integrated in that industry.

So net-net, I would say most of the businesses are performing quite well. It gives us confidence of having a good year ahead.

So what I will do quickly is just take you through the outlook for the year and also compare it to how this looks like when we talked about the Q1 outlook. I just want to quickly say that Q1 outlook was not the most robust. Honestly, we were caught a little bit off guard because a lot of the currency changes only happened just before we announced. So we were still assessing the impact of what the currency changes mean for us. And therefore, I think we definitely were not as communicative as we could have been. But I think now we have a clear understanding and, therefore, we have much better understanding where our business will end up.

In terms of revenue, we said double-digit revenue growth in services. We still hold that view. DLM will grow at least by 20%. This is the legacy DLM, which is the company called Rangsons Electronics that we purchased. Overall, DLM will grow even better. Obviously, there could be an acquisition that is also there. Operating profit growth will be in double-digits. It will be more than double of last year. And last year we grew 13%, so you can extrapolate that. But from a percentage perspective, it will be at least double of last year.

And what we also believe is that the operating margin will be about 50 basis points higher than what it was. And if you look at the table, it gives you a sense of what are the drivers that we are looking for, be it utilization.

Obviously, the FX gain is something that we have not budgeted at the beginning of the year. But FX gain gives us a fair amount of benefit, which helps us mitigates against things like wage hike. Obviously, there is the additional investment in NBA that is also there. So all this taken into account, put together, we believe we will still get to about 50 basis points improvement in margin.

DLM margin will also improve. It will be in single-digits. We believe that at a PAT level, we will break even this time, which is the first time under our management that has happened.

Also, the other income has been higher. That helps a little bit with at least the profit after tax. Tax rate is in line with what we thought and, therefore, what I am very happy and contented to report is if you look at all the parameters, we are in green there is only one utilization where we are in yellow, but we can look at that because the rest of the parameters more or less make up for what we can do in FY19.

So net-net, I will say the outlook remains robust. We believe that we have had a very good quarter, and the momentum will continue into the second half of the year. And therefore, it will be another good FY19.

So with that, I will turn it over for any questions or comments.

Moderator: Thank you very much. We will now begin with the question and answer session. We have the first question from the line of Urmil Shah from IDBI Capital. Please go ahead.

Urmil Shah: Congrats on a good quarter. My first question is on the revenue growth for the services business. Was it slightly less than what we were expecting at the start of the quarter? And secondly, for a double-digit growth for the full year, it appears like our verticals like Communication, Transportation, IENR might have to do the heavy lifting in the second half, your comments on the same?

Krishna Bodanapu: Absolutely Urmil. I think the one is yes, we came in at in terms of constant currency quarter-on-quarter we came in at 3.5% in services. And that is in the range of what we were expecting. 3% to 4% is what we were expecting at the beginning of the quarter, so we came in pretty much exactly where we thought we would come in. So we are quite happy with it.

In terms of the rest of the year, yes, I mean Communications we are seeing a good pipeline. We will have a good growth there. IENR, Transport will do well. Aerospace will also have a good uptick, especially in Q4. Because the challenge with Aerospace in Q3, we have a significant capacity problem given that a lot of that business is also U.S.-centric, so we lose a lot of capacity. So having said that, I will say in U&G, we are struggling a little bit still, and we believe flat is a realistic case scenario there. But we believe that there is enough momentum in the rest of the businesses to carry us through to the double digit that we are targeting.

Urmil Shah: Sure. Next question to Ajay. As regards the 100 BPS downward revision, as regards benefit from utilization, offshoring and other efficiency drivers, your commentary on that. And also as regards to the JV with BlueBird and the NBA EPS accretion coming from FY2021, so what is the kind of investment we should build in for FY2020 and 2021 for both these factors?

Ajay Aggarwal: Let me tell you about the utilization, offshoring and other efficiencies. I think as far as utilization is concerned, more or less, this is tracking to what we envisaged. And I think we are doing well on that.

As far as offshoring is concerned, I think right now, what we are seeing is, while you will see quarter-on-quarter there is an improvement in offshoring, but for the full year, we are viewing that we will not get what we had originally expected. These are the two major drivers, and we just want to be transparent on how much we will be able to get to this. And the fact is, currency is also helping us. So it is not that we are very desperate to make sure that we tighten every single belt and get to that margin anyhow. So that element is also playing in.

Second question, in terms of the JV, I think we are anticipating an investment of about $5 million for that particular JV-related activities. And I would say whatever is the business in Cyient Systems and Solutions between that BlueBird JV as well as the other programs that we have on specialized communication equipment. And from year 2021, I think we are looking at almost a similar return on that investment with a gestation period of two years.

As far as NBA is concerned, that is already factored in. There is a very small amount of capex. So if we are talking about, let us say, $6 million or $7 million, I would say the capex is less than $1 million in that. That would not have so much of impact. All of that is already written off. Only the investment, which will be, which is right now $5 million, we will keep giving you an update on that. That will start kicking in from financial year 2020. Broadly, my estimate is that we should have earnings growth of 5% to 7% from year three because of these investments plus NBA.

Urmil Shah: Ajay, just a clarification. The $5 million in the BlueBird JV would have EBITDA impact or if it includes also capex investments?

Ajay Aggarwal: No. This has mostly capex investment, so I would say that you can assume that all the investment is capitalized. And whatever are the benefits, as Krishna said it will start flowing in from financial year 2021.

Urmil Shah: What could be the impact on EBITDA from this?

Ajay Aggarwal: I would say that we just got this initial order from the defense. We are still to get the commercial orders on the communications systems. Give us some more time. We are being very transparent on this. As we keep progressing, we will keep on giving you the investment as well as the return. Right now, I think just to get this guidance on these investments, we are very confident from year three, that is 2021 onwards, or 18 months from now, I think we should start getting some 5% to 7% earnings growth accelerator, both because of NBA and other initiatives.

Urmil Shah: Thank you so much and appreciate the increase in the disclosures. Thank you.

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

Sandeep Shah: The question is on the services business. So just a clarification, when you say you are double-digit growth in services business for FY2019, are we saying in U.S. dollar terms?

Krishna Bodanapu: We are saying in both. Yes we will get to that number in both USD and constant currency or obviously, USD exchange and constant currency.

Sandeep Shah: Okay. So if I look at the 1Q and 2Q number, the ask rate for 3Q and 4Q would be 4.5%. Well, we are entering into a seasonally soft quarter, which is Q3, which has historically impacted you. So what is the confidence of saying this double-digit? Is it based on a signed business? Or is it based on expected deal ramp-ups and the deal signings?

Krishna Bodanapu: No, how we measure pipeline is there is a certain element of that, which is in the backlog. That is the deal signings. So there is also an element, which is business that is going to come in, and we are in various stages of closure with that business. So it is a combination of both these.

I would say there is still a risk here. It is not that double digit is minimum, and then we will add on top of it. But having looked at the pipeline and the backlog, we are saying is it will be double digit.

Sandeep Shah: Okay, okay. So is it a fair way to look at that Q4 could be very high growth quarter, with Q3 may be seasonally soft?

Krishna Bodanapu: Yes, that is fair. So what will happen in Q3 is there will be seasonal softness, but there is also growth. So we will still have a decent Q3, we believe and then you take the seasonality out, automatically, Q4 will be quite strong.

Sandeep Shah: Okay. And just wanted a clarification again. What are we guiding for the tax rate for the full year? You said, Ajay, but just one more, if you can, once again, clarify on the same, how to look at it. Yes, and the second, I think, the incentive you said that Rs.450 million will even continue in FY 2020. Is it right?

Ajay Aggarwal: Yes.

Sandeep Shah: Okay. So just on the tax rate?

Ajay Aggarwal: Yes. So with tax rate, I think the reported tax will be 25%, including one-offs.

Sandeep Shah: Okay. But next year, including incentives, you are saying it will come down to 22- 23%?

Ajay Aggarwal: That is right because we do have one item. There is a dividend that has been received from one of the subsidiaries. The way it works it is showing up in EPS. Some of it is mapped whereas its get adjusted when we distribute the dividend to the shareholders. So to that extent, our tax is high, which will not be there in the next year.

Sandeep Shah: Thanks. If I have more questions will come in the follow-up.

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

Gaurav Rateria: Thanks for taking my questions. Good execution on margins. Firstly, Krishna, just want to check on the DLM transition from the legacy to the synergy deals. We were chasing some large deals. But in terms of order intake number, that is not reflected yet. So if you could update on what the pipeline looks like. And are we expecting some large deals to close in the synergy deal side in the next two quarters?

Ajay Aggarwal: Ajay here, if I can take that, Krishna. From the perspective of the transition in DLM, if you see the mix of the business is really getting more and more business. If you look at our verticals, where we saw strong growth, the A&D is almost 27%, IENR is 12% and MT&H is 29%. All that is reflected because we are getting a lot of business from our kind of synergy customers that is coming in. But from the perspective of the margin also, this is helping because most of this business is 15% plus.

In terms of the order intake, I would say that we still have the pipeline, which is there for us. But in terms of the growth that we have guided of about 35% plus for our manufacturing business, we are very confident about that. And that is including the backlog and the pipeline that we have.

Krishna Bodanapu: Ajay, I will just add to that, Gaurav, and say that the reality also is that the way that the synergy business happens is there is going to be small orders to start with. Because there will be design, there will be prototype and certification and so on and so forth. So if you look at it, there is a fair amount of backlog that is already there. And then the synergy business is really starting small, just because there has to be designed, there has to be prototype certification.

So taking all that into account is where our confidence comes from and like Ajay said the legacy business will grow at least 20% this year. And if we add the acquisition of B&F, which is another specialized tool manufacturer then we will get to 35% range for the year. So it is a combination of those things that gets us to where we are.

Gaurav Rateria: Second question for Ajay. You broadly described the various factors, which will help you to get to margins for the full year. If you can help us understand of all these things, what has already played out? And what are likely to play in 2H? That will be very, very helpful.

Ajay Aggarwal: I think if you look at, the easiest one is currency. What we are assuming is that the currency, whatever is the current level, that is about 72, if that 72 continues then for the full year, you have the benefit of about 160 BPS. For the quarter, we have already articulated about 60 BPS of gain. So currency has already played out.

Indirect cost absorption, if you look at plus 70 BPS or 50 BPS. If you look at current quarter, we had the absorption benefit of about 1%, so it is already there in H1 and Q2. And with the volumes playing out this is also certain.

Utilization, I already commented. We are already up by about 2.5- 3%, so that has already played out. Offshoring as I already said, we are not baking much into it. And in terms of additional investment in NBA, we already have 19 projects underway and more or less because we customize. So I would say most of the drivers, except the assumption on the FX gain, are there and they seem to be quite predictable.

Gaurav Rateria: Sir, I just want to understand that from a Q-on-Q perspective over the next two quarters, barring the FX gains, what all other factors can help you on the margins? Because I do understand that there is going to be seasonality element in 3Q, where the payday and billing day will be different. And there will be some impact on the margins from that? Thank you.

Ajay Aggarwal: Gaurav, I would say that there could be some risk. There could be some opportunity. So I would say that you can always say that even if it were something like 50 BPS, depending on each of these drivers, the worst case could be 30 BPS. Best case could be something like 70 BPS. So I would not read too much into that. I think whether it is absorption, whether it is utilization at this stage. But I would say the band of 30 BPS to 70 BPS is what I would say.

Gaurav Rateria: Thank you.

Moderator: Thank you. Next question is from Madhu Babu from Prabhudas Lilladher. Please go ahead

Madhu Babu: Top accounts have been a bit soft this quarter any particular call out there?

Krishna Bodanapu: No, nothing. I think it is just a point in time thing. There were no issues in the top accounts. It is just a point in time thing.

The other thing is in some of the businesses, especially on the Utilities & Geospatial business, some of the new accounts are actually doing quite well, and that has been one of the key concerns of long-term sustainability is just getting the right kind of accounts and getting them to ramp up. So I would say it is more some new accounts are kicking in, especially in Utilities & Geospatial and also in IENR, so that is driving this quite a bit. So it is nothing to be concerned about.

Madhu Babu: Sir, second thing on the semiconductors, which are currently around the 32 million to 33 million kind of annual practice for us whereas I think if you see that industry, as such, has seen strong momentum in the engineering side at least. So would you look for further acquisitions to scale this sector, because even after the AnSem acquisition, it is very subscale in terms of the overall SBU?

Krishna Bodanapu: Absolutely. We are quite pragmatically and proactively looking at various options there. I would like to say, even after AnSem, it is still a little bit subscale. But I think we have a very, very clear strategy that is articulated there. I think we know what we want to do there and how we are going to do it. We also have a good process for identifying targets in that BU. We have some very good leadership in that BU that understands the business. So that is definitely a part of the plan, and we are looking at more opportunities.

Only thing I will say is that the challenge is a number of the companies in that sector ends up being more staff providers, which is not what we want. We really want companies, which have the right capability that support our vision to be able to design and then work with partners to get a chip fabricated, and take ownership. And if you look at it, AnSem has that capability and actually, a lot of their revenue comes from unit chip ships, which is where we want to be in that business. So while there is a lot of companies, and you will see some activity in that industry, we are being quite picky because we really want that competence to design rather than provide manpower.

Madhu Babu: And Aerospace, Sir, how are we seeing the top account growth in that SBU? And the new accounts, which we have mentioned, of that, so is there any account which you can see strong scalability? I am expecting that that is the other engine maker, which you are trying to pursue for quite some time?

Krishna Bodanapu: No, there would not be any from the other engine makers. I think our top customer is doing fine. I mean the growth rate would still be slower than the company average. But we are where we are with them. I mean it is a very large opportunity set. This is how it is worked for the last 20 years there: we grow, we plateau, we grow, we plateau. I think we are coming off the current plateau period because there is a few opportunities that have been identified that are going get us to the next step of growth.

Also, there were projects like won and cost, where it was a risk reward project based on actual outcomes. That project is starting to pay the revenues, so we are going to see some good profitability because the cost has already been incurred, and now we are getting some good revenues.

So top account, I am not too worried. There are a few others. There is no aero engine manufacturer, but there is some very large or there is OEMs and Tier 1s, both of which are doing quite well in that business. And while the top account has grown some, the non-UTC business in aerospace has really grown about 50% year-on-year. And we continue to believe that momentum will continue.

Ajay Aggarwal: Let me just add, Krishna, just to add to that. I think in terms of the services, yes, the growth of Aerospace may be marginally lower than the company average for the current year. But if you really look at Aerospace also, there is a lot of focus on solution. And if you look at what traction is coming from our largest customer, and legacy, if we look at our growth, including those additions on manufacturing, this number will be much higher than the company average. So you are looking at 20%, 25%. 20%, 25% kind of a growth in Aerospace if you combine that together.

Madhu Babu: Yes, because Quest works at both Rolls Royce and Pratt. So I am just wondering why Rolls Royce, we cannot I mean, because the UTC has already exited this stake, right, so whether Rolls Royce would chip in as a customer?

Krishna Bodanapu: Look, it is not that simple. I think it is a more complicated and nuanced approach. I will just say that we are where we are. And overall, we believe that where we are with Pratt is also in a very different spot in terms of scale and complexity, and so on and so forth. But what we will see is going forward, the performance of the top account will also change because there is some very significant opportunities, and it puts us in a very different league with them on what they are going to do.

Madhu Babu: Thanks.

Moderator: Thank you. Next question is from the line of Srivasthan Ramachandran from Spark Capital. Please go ahead.

Srivasthan R: Just wanted to get comments on two questions. One was, what is the exact nature of these incentives in terms of, is it paid by whom? And what kind of cash flow will follow? The second one is on currency. For about 4.5% to 5% depreciation of rupee, 80 basis points margin expansion seems too low. Is there any change in terms of the broad thumb rule we should work with here, say with 30 basis points for 1% depreciation? Any changes there?

Ajay Aggarwal: Sure, first on the currency side, I think that you see our revenue growth is 5.1% in dollar terms and that is 6.5% in cc. What it tells us, there is a headwind of 1.4% in cross currencies, right, and we do have a good share of currencies in Australian dollars, in GBP in Europe. So that headwind, when you look at, so you I think there is no change in the sensitivity of whatever we said, 20 basis points for every 1% change. But sometimes, during the quarter, how these other currencies behave, that impacts us. That is one part.

Secondly, in terms of the incentives, I think that there is a combination of the incentives for our Design Led Manufacturing facility against government incentives. It also includes for services, where we have specialized services and engineering services or geospatial services, which are entitled for these incentives. And we have some other incentives. So all this put together is the bucket. And I think whatever is the impact on the steady state on the accrual basis will be the impact on the cash flow business. That is what you can simply take that. And as I said, we have already received that money, whatever we have taken, most of it we have received. So that is what it is.

Srivasthan R: Just to clarify on the incentives. This is all from government of India. It is not some client incentive or anything.

Ajay Aggarwal: If you look at the bucket called other income, I will say it will take care of all incentives and grants across the group. But most of it will be India.

Krishna Bodanapu: Yes, so I think there is two parts: There is India. And also, because of the expansion that we are doing in various states in the U.S., we have also got some benefits from the U.S.

Srivasthan R: Thank you.

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

Abhishek S: Thanks for the opportunity. My first question is regarding demand. Krishna, are there any early indications of customers becoming watchful in terms of their spending patterns?

Krishna Bodanapu: Not really, Abhishek. I do not see any significant structural signs. I mean, there is always going to be one-off. Because of certain customer situations, we will always have one-off caution. But structurally, I do not see any challenges to demand at this point. And even if I take into account some of the cyclicality in the industries that we work in like oil and gas, there is a lot of cyclicality. Semiconductor has its own cyclicality. Even if I take into cognizance the cyclicality of the industry, at this point, I do not see any challenges to demand at least, structural challenges to demand.

Abhishek S: That is helpful. And my second question is, if I can rephrase the 100 basis points downward revision, the utilization and other drivers in the margin assumption. Do we believe that any of this metric would deteriorate in the H2, meaning utilization or offshoring? Because if I look at it from a 4Q 2018 and a 2Q 2019 perspective, utilization is at a similar level. So what are we building in the next half of the fiscal?

Krishna Bodanapu: The Q3 will always have structural challenges because there is some parts of our business, which are quite U.S.-centric or Europe-centric where we will lose some capacity, or even Australia-centric. So we will lose some capacity, but what we believe is there is enough demand to add new capacity that will make up for the lack of any drop in utilization. There will be a little bit of dip, but it would not be anything that is concerning or meaningful in terms of Q3.

Abhishek S: Thank you for taking my question.

Moderator: Thank you very much. The next question is from the line of Shyamal Dhruve from Phillip Capital. Please go ahead.

Shyamal Dhruve: Thanks for taking my question and congrats on good set of numbers. My first question is on the DLM front. So in initial comments, you had mentioned that we exited from some of the telecom segment, which were low margin in the DLM side. So can you just explain like what type of projects were there? And are there any more projects where we are planning to exit in next few quarters?

Krishna Bodanapu: This was for a telecom equipment manufacturer. It was low margin. But more importantly, it did not fit into that strategy of what we were trying to achieve. So we gave them a notice, and I think we ramped down in Q2, and we will completely exit in Q3.

There would not be anything that is significant that will stand out for at least the rest of the year in terms of an exit. As demand is picking up, and the fact that we do not want to add unnecessary capacity, we are trying to rebalance it in such a way that the new synergistic revenue that is coming in, high margin, the type of revenue that we want that is coming in, to service that, we will add capacity or we will free capacity by giving up some of the low-margin, non-synergistic work. And that is basically what will continue for at least the rest of the year. Next year, obviously, we will review it as the year progresses. But at this point, we would not drop any large chunks of business. We will take care at this point.

Moderator: Thank you. Next question is from Pradyumna Singhania from Ampersand Capital. Please go ahead.

Pradyumna Singhania: So my first question is, the guidance that you have given us for the outlook for FY19 in your presentation, is that in constant currency terms? Or is that in INR?

Ajay Aggarwal: Can I take this? As far as whatever is the currency that we monitor, the way we look at this is, as far as growth of revenue is concerned, it is taken in dollar terms and constant currency. As far as operating profit and net profit are concerned, they are taken in rupees terms.

Pradyumna Singhania: Okay, so a follow up on that question because you have given double-digit growth guidance in operating profits and in revenue growths, why have you just given the guidance of a higher single-digit growth for that for the FY19?

Krishna Bodanapu: This is just a commentary on the business. We do not give guidance as a rule, so this is just a commentary on the business. You can do the math, and that will get you the number ultimately. But essentially, what I would suggest we look at is, what is the revenue growth? What is the change in operating margin? And also the commentary on below the operating margin, such as tax, which is the best way to extrapolate what the operating profit growth is and potentially, net profit growth is.

Pradyumna Singhania: Thank you. That is it from my side.

Moderator: Thank you very much. Due to time constraints, we will take that as the last question. I would now like to hand the conference back to the management for closing comments.

B.V.R. Mohan Reddy: On behalf of Cyient's leadership team, I would like to thank everyone who has participated in our Q2 financial results earnings call. As both Krishna and Ajay has assured you, we do not only have good results, but we also have good momentum in our business. We will make sure that we will have double-digit growth on revenue and margins, and margin expansion will be 50 basis points moving forward. With that, I will conclude today's call by thanking you all one more time. Thank you.

Krishna Bodanapu: Thank you.

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