

CYIENT

“Cyient Q2 FY20 Earnings Conference Call”

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CYIENT



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LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to the Cyient Q2 FY20 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal 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. Ajay Aggarwal. Thank you and over to you, sir.

Ajay Aggarwal: Thank you. Good evening, ladies and gentlemen. I welcome you to the Cyient Limited earning call for second quarter of financial year 2020 ended September 30th 2019. I am Ajay Aggarwal – President and CFO. Present with me on this call are our Executive Chairman – Mr. Mohan Reddy and Managing Director and CEO, Mr. Krishna Bodanapu.

Before we begin, I would like to make the customary statement. Some of the statements made in today's discussion may be forward-looking in nature and may involve risks and uncertainties. A detailed statement in this regard is available in the investor update and has been e-mailed to you and is posted on our corporate website as well. This call is accompanied with the usual earnings presentation, the details of the same have already been shared with you.

I now invite our Chairman to provide a brief overview of the company's performance for the quarter ended September 30, 2019.

BVR Mohan Reddy: Thank you, Ajay. Good evening to all of you, ladies and gentlemen, I welcome you all to this conference call. Let me take you through the highlights for the current quarter.

We posted a quarterly revenue of 1,158.9 crores. This signifies a growth of 6.4% quarter-on-quarter basis and a degrowth of 2.4% year-on-year. In US dollar terms, we posted revenue of 164.2 million, which translates into a growth of 4.9% on a quarter-on-quarter basis and a degrowth of 2.8% year-on-year. Services revenue is at \$140.4 million, which signifies a growth of 1.8% quarter-on-quarter and 2.6% in constant currency and a degrowth of 3.8% year-on-year.

The EBIT for the quarter stood at Rs. 1,110 million or 111 crores. The group EBIT margins stood at 9.6% for the quarter, which translate to a margin expansion of 35 basis points on a quarter-on-quarter basis and 169 basis points margin contraction on a year-on-year basis. Excluding one-off and adjustments, our normalized margins stood at 12.3% for the group. Net profit for the quarter stood at Rs. 98.5 crores, which translates to quarter-on-quarter growth of 8.8% and a year-on-year degrowth of 22.5%.

Now let me come to a few business highlights for the quarter. Cyient signed a memorandum of understanding with U.K.-based defense technology firm, QinetiQ Target Systems, QTS as it's called, to offer avionics products for its unmanned target systems. Cyient will provide advanced manufacturing and electronics engineering solutions to QTS' range of unmanned air, land and sea target systems from its facilities in India. We also extended the CoE setup for John Deere in Hyderabad and Pune. We received Singapore Health Award 2019 for Cyient's efforts in promoting health and well-being of employees at the workplace.

Very briefly on the CSR front. We continue to support the 25 government schools. We provide education to over 18,500 underprivileged students. We continue to support 67 Cyient Digital Centres, CDCs, in and around Hyderabad, which cater to more than 25,000 children and 15,000 community members every year. We completed training to a pilot batch of 600 community unemployed women in tailoring, bakery, beauty courses through Cyient urban micro skilling center for urban poor. We also distributed and planted more than 7,000 saplings around Cyient adopted schools and community as a part of the Haritha Haram, a mega plantation drive in the state of Telangana.

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

Ajay Aggarwal:

Thank you, Mohan. Let me start with giving a color to the revenue. As you would have seen in the results, we got a nice jump in the revenue between quarter 1 and quarter 2. We have clocked \$164.2 million of revenue. And also if you see from the cross currencies perspective, we had a headwind in British pound, euro and Australian dollars that have taken away about 80 bps of growth. So if you see in constant currency comparable number to 156.6 is about \$165 million. That's the average for the last 4 quarters. So I think one of the concerns that are we getting back to growth gets addressed in terms of at least getting to the average. And now our endeavor is, in the coming quarters to not only sustain the average, but also get back to higher growth compared to where we were in the last year. So overall, in terms of constant currency, our growth is 5.7%, 4.9% in dollars. And in terms of the quarter, for services, it's 1.8% in dollar terms and 2.6% in constant currency.

As you can see, we had good growth in Communication. It is about 3.3% in constant currency. E&U business, energy and utility business is showing good traction. We had in constant currency more than 10% growth there. In transport, in constant currency, we had more than 5% growth. Aerospace, we had a degrowth of 1.7% quarter-on-quarter, we did 47.6 million. DLM has clocked \$23.8 million, which is about 27.4% growth quarter-on-quarter. So overall, as I said, we have delivered a growth of 6.4% here. Of course, we continue to be lower than where we were year before. In constant currency, we are lagging by about 1.2% compared to the same quarter last year.

Before I move to the other statements, let me update you, we have been talking about this cost optimization exercise that we are doing with large consulting firm. And I am happy to report that we have got good traction on this. This revolves around improvement in margins on a sustainable basis by improving the cost of delivery and also improvement on SG&A cost. We have set ourselves an internal goal and we have looked at our position for the full year, and we seem to be on track to achieve the full year target. And we are further working on some additional levers. We have also setup a sustainable workforce management group and a process to make sure that we continue to do the efficient resource deployment, which is one of the important levers in this whole exercise. We will be creating a sustenance center in the company, creating the KPIs and make sure that we have the necessary support system created both for the business units as well as in the corporate to sustain this in financial year '21.

In terms of the hedge book for quarter 2, I would like to highlight, there is no change in the policy. We continue to be 70% in 12 months. Our exposure is about \$135 million. About a year back, this was \$127 million. And if you see on the chart on the right-hand side, we have gains of about Rs. 8 to Rs. 9 compared to the spot rates today in British pound as well as on euro. We have about a gain of Rs. 4 in Australian dollars, about Rs. 3 compared to U.S. dollar and about Rs. 2.5 for Canadian dollars. That translates for the next 12 months about \$8.5 million of Forex gains at current spot rate.

So with this background, in terms of the other income, I would say overall, we have a change marginally of 18 million or about 2 crores. The treasury income is marginally lower. In terms of the forex gains, you will see that our position. If you look at the table below, for quarter 1, our gap on dollar, for example, was less than 1 rupee, and for the current quarter, our gap is about Rs. 3. So I think the forward positions have improved. And going forward, at current spot rate, as I said, the gap is nice for us, so we should be able to continue realized gains at current spot rate.

Export benefits, I would say we have been talking about them. We are accounting them on cash basis, and we were always anticipating them more towards H2 whereas in case of the last year's quarter 2, we had some gains, which were recorded in H1 and quarter 2. So I think there is nothing to worry about it. For the full year, we are sure about having the other income equal to or marginally higher compared to last year.

In terms of the income statement, you have seen that we have a growth of about 10% in EBIT quarter-on-quarter, and our reported EBIT is INR 1,110 million, that's 111 crores. Our net profit is up by 8.8%. And of course, year-on-year, we're down by 22.5%. As I said, some of it is also impacted due to the timing of the other income, and there is no concern as far as full year is concerned.

Let me just explain to you on the right hand side what has happened on the margin. Our cost optimization is working well. So between the cost optimization and the gain in the volumes, we gained more than 200 basis points, another 50 basis point from the normal operational efficiencies. We gave our second tranche of wage hike, which was planned similar to the last year, which has taken about 107 bps. And we also, as we explained earlier, we have also incurred onetime restructuring cost, which is a combination of the consultation fee and the amount that you spend in terms of execution of the restructuring. That is about 85 bps for the current quarter. So if you just see, we are trying to explain on the right hand side, while our reported EBIT is 9.6%, if we exclude the one-offs in terms of the onetime cost optimization exercise cost because we expect these benefits to continue into the coming year and the years thereafter and also if you look at despite some challenges in the current period, we continue to make our investments into NBA, which is charged off to the P&L, so if I add these 2 back, our like-to-like margin compared to the previous years will be more like 12.3% because a good growth of 105 bps quarter-on-quarter. And for services if you see, this number is much better because services margin is roughly 150 basis points higher than the group margin. And the same thing if you see quarter-on-quarter, excluding the one-offs for services, it is up by 158 bps.

So from that perspective, I think the growth focus as well as cost optimization focus is helping us. And on the ETR, we are in line to have 22% to 23% tax for the full year as per our original expectation. And we have also provided a detailed bridge for your reference on what has happened in terms of the EBIT this thing. We had the headwinds in terms of the wage hike and onetime restructuring cost. We had the benefits of cost optimization, volume gains and operational efficiencies. Thereby, we have got almost 164 bps or about 1.6% improvement in the margin for the services level, which is a very good indication.

On the cash side, I think, we are back to our good cash generation. The total cash available is 8,641 million. And if you look at our cash flow, we have given the number with and without one-off. 42.9% is the conversion if we do not take out the one-offs. But if you see, whichever are the items which are special investments, they, according to us, do not represent the correct free cash flow from the operations and there the deployment of the free cash flow, that is in terms of the investments into the long term as well as the onetime restructuring cost, our conversion is 51%.

And if you see our DSO, especially from accounts receivable, has come down by about 10 days and overall DSO has come down by 9 days. And we still see in H2, we will continue a good traction on cash flow and DSO.

With this, I will hand over to Krishna for providing us the business update.

Krishna Bodanapu:

Thank you very much, Ajay, and good evening, everyone. And thank you for your time.

In terms of the business update, quickly on the M&A pipeline. It continues to be a focus area and I will just say that nothing has changed in terms of what we are focused on. There are 3 deals in the pre-LOI stage, which we will continue to work on. In terms of corporate venturing investments, we did close 1 deal which is an investment into a cybersecurity company, which focuses on cybersecurity technologies for rail transport applications specifically. So the intent is that we're able to take the technology and the platform, the algorithms that this company Cylus has and we're able to integrate them into our offerings and sell them to our customers, and we see some very good traction on that already.

In terms of the BU outlook, in aerospace & defense, the good news is there's still a lot of commercial aircraft backlog which is there with all the large OEMs and also defense is picking up because of the global geopolitical risks. So as I have previously said, our focus on this market is really the aftermarket MRO type of engineering and services because while the demand is good, there are no new programs which contributes to design, so there is no new programs in the pipeline at this point, which means that the design piece is coming down and we're seeing that for us and we're seeing that in the market in general. But having said that, I think we have done a reasonable job in terms of building up capability on the other areas that we are able to leverage. And while we had a small degrowth this quarter, we believe that at least we are able to contain a lot of that, and we will see growth coming into the future there.

In the Communication industry, there are a lot of new technologies that are coming including 5G. But while 5G is coming in, we see that the deployment of 5G is going to be a little bit slow because the costs that are involved with the 5G deployments are very significant. And what our clients are telling us is that we will do it in a little bit more of a phased manner than, say, they did 4G because they want to really look at the cost benefit of rolling out 5G as the 5G speeds are really beneficial only for certain applications, not necessary for all applications. So while they have a good offering and will continue to focus on it, we think the rollout will be a little tepid there is what we're hearing from our clients.

In energy and utilities, we believe that the industry is doing quite well. The commodity prices are doing well. Utilities industry is also doing well because there is a lot of investments in things like distributed grids, renewable energy etc. Our outlook remains quite strong and that is one of the big growth drivers for us this quarter was the services business in energy and utilities, and we believe that momentum will continue into the future.

Transport industry also is growing as an industry. Again, it's a very large industry, so the growth will be a little bit smaller just by definition. Transport has been a little bit of a static industry from a technology perspective, but we are seeing a lot of new stuff that is coming in and the investment in Cylus is really along these lines because we believe rail cybersecurity, for example, all of a sudden becomes very important. And therefore, with the new technologies being adopted, we have a pretty interesting play in that market.

The portfolio BU remains quite tepid both as a market and also for us, while there is a lot of growth in geospatial applications where we play in that market has been a little bit of a challenge, and you will see that year-on-year, we've had a degrowth in that business. So we are trying to manage it as best as we can, but we believe that, that business particularly will remain a challenge for the rest of the year.

The semiconductor industry also from where we started off the year, the forecast then was the industry would degrow about 5%. Now the forecast is that the semiconductor industry will degrow 15%. We do see some impact of that on us, while we have been able to mitigate a lot of it because of the capabilities that we have built on currently analog design, which is essentially the company that we bought in Belgium, and we have been able to integrate it into Cyient. Overall, in the larger digital semiconductor space, we see some significant issues. We believe we will grow in that business this year, the pipeline and the order backlog is there, but it will be a tepid growth in that business because overall, the business obviously is under significant pressure with a minus 15% growth.

Lastly, medical tech and health care. That business is growing very well. There is a lot of new technology, again, just like rail that we have talked about that's been adopted into that business. And I believe actually, we had a growth story. If you look at this quarter, there is a double digit growth both quarter-on-quarter and year-on-year. And we believe given that it is a smaller business that will also continue to grow.

So net-net and if I may also sort of summarize what Ajay said, the growth is back in the business, we are quite confident about the growth coming back into the business. Unfortunately, we did have, I would say, 2 down quarters, but we believe that having had those down quarters or at least Q1 was a tough quarter, we have had just flat 2 quarters, which is 3 and 4 and Q1 was a down quarter but I believe that the growth has come back. We will continue to see this good growth momentum into Q3 and beyond. Q3, we will see good growth in the services business in spite of the working day challenges. But in spite of that, we are actually seeing growth in the services business in Q3. It will be a small growth, but there will be growth quarter-on-quarter even in the services business, which I believe bodes very well for Q4 because once the capacity comes back in Q4, you will see that year-on-year Q4 will be a very solid year from a growth perspective. And what it will also translate to is from a margin perspective, we do see some good momentum because a lot of the restructuring cost come Q3 and Q4, especially that we will still have some restructuring cost in Q3, but in Q4, the restructuring cost will also come back.

So what I'd say is we've had 3, not our shining moments for 3 quarters. Momentum is now back in Q2. It will continue into Q3, but Q4 onwards, you will see some good change in momentum and direction for the organization.

So with that, I will stop here and I guess, we'll turn it over for any questions.

Moderator: Thank you very much sir. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Harit Shah from Reliance Securities. Please go ahead.

Harit Shah: I just wanted to get a sense of in terms of the weak order bookings for this particular quarter. So year-on-year you have seen significant declines. So if you could just give some sort of incremental color on that it will be quite helpful.

Krishna Bodanapu: Sure. So year-on-year, there is a decline, but what also happened is Q2 of last year was a very good quarter in terms of the order intake. Now what we also need to look at is if you look at it there is a number of orders, almost \$20 plus million of orders in Q2 of last year that were multiyear orders. So that order intake actually covered us for multiple years, which doesn't repeat, again. So while we have had a challenge in the order intake in Q1, if you look at the quarter-on-quarter growth, there is a decent growth and that was reflective of the momentum that will carry in because that order intake really converts into revenue going forward. So net-net, I'll say is that Q2 of last year was a very good year and also because of the multiyear purchase orders that were there. Therefore, not necessarily, the best reflection of what the order intake should be, but if you compare it to Q1, we are quite confident that the momentum is there for going forward.

Harit Shah: Okay. Secondly, I just wanted to get a sense of the outlook in terms of margins maybe in the third and fourth quarters. Third quarter, you did say that there will be some further restructuring cost, although I think you could have the tailwind of no wage hike impact. So how is this overall likely to play out as far as the margins are concerned?

Ajay Aggarwal: In terms of the restructuring cost, the program is continuing from quarter 1 to quarter 4. So you will see the restructuring cost being incurred in each of the quarter. However, by the nature of this restructuring cost, you always would see that the cost will precede the benefits. So in terms of what you should expect is, I think you should have a good margin in terms of quarter 4 to reflect the complete benefits that will start accruing in the next year. And to put it at a very high level, I would say if you remove the onetime restructuring costs and the investments that we are making, like-to-like margin from quarter 4 of last year to quarter 4 of this year, we expect 200 to 300 bps higher.

Harit Shah: Okay. So that is adjusting for any onetime cost, right?

Ajay Aggarwal: That is right.

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

Sandeep Shah: Just wanted to understand, we had a lot of client specific issue in the Communication segment. With the growth being at 3.3% in constant currency, is it in line with your earlier expectation and you believe that the growth could be further higher in the coming quarters as a whole? So what is the status update in terms of client-specific issue and the growth momentum going forward?

Krishna Bodanapu: So I think, what I will say is the client-specific issues, I think have been resolved. I think obviously, we are not back to the old sort of levels of revenue with those clients, specifically the client that we had an issue. But I think all of our large clients are now in a stable situation and have shown quarter-on-quarter growth. So we believe that we are not going to significantly accelerate the growth, but what I am confident about in the comms business is now we will grow at this stage maybe a little bit faster for the rest of the year and into the next financial year. So I think at least the good thing and this is what I said last time was the worst we had hit in Q1 and that seems to be the case because obviously, there are always going to be some one-offs with clients where there will be a further decline or increase etc., but leave those aside. But at least in all our large clients, I think we've had some good stability and growth and we see that continuing into the coming quarters.

Sandeep Shah: Is there any other client-specific issue in any of the other segments, including aerospace, which we had 1 client specific issue?

Krishna Bodanapu: No. I'd say there is a fair degree of stability in pretty much all our large clients. I think unfortunately Q1 came together with a number of specific issues with various clients and that led to the kind of quarter that we had, but we believe that we are out of all of them. Again, not all of them are back into a significant growth mode, but even where we have had an issue previously, we're at least stabilized and we're seeing like in our aerospace business, we are seeing that we have hit the bottom in Q2, and we are seeing growth coming into Q3. And that's why

I'm able to say that in spite of the challenges that we typically have with capacity in Q3 on the services business, still we will see growth because there is momentum behind these accounts.

Sandeep Shah: Just a clarity in terms of restructuring cost. So I think, if I'm not wrong, the restructuring cost for the cost optimization is on a risk-reward basis. So why we are calling this out as a one-off? So there should be some gain also, right, when we have made the payments as a whole. So just some clarity on the same.

Ajay Aggarwal: So if I can take that. I think you are absolutely right. There are 2 parts. I think one is that when you look at especially the severance cost and other elements of it, they are quite heavy and upfront, whereas the benefits are realized later. Second, the whole program that we have run, as you rightly said, apart from having risk-reward model is also on sustainability of it. So we come out with a saving based on an annualized run rate and say for the cost on it. What we realize is over the quarters, and that is why I am saying if you look at what margin will be available to us for the next year, it will be without any restructuring cost and the complete benefits of the exercise will accrue in quarter 1, for example. And they will also reflect in quarter 4. So quarter 4 will still have the restructuring cost whereas quarter 1 will not have the restructuring cost. So I think, you're right. You should look at the overall margin. However for you to look at what is our sustainable margin or what is our comparable margin to our other players, we thought we will give you both the perspectives.

Sandeep Shah: So Ajay, is it fair to say in 3Q and 4Q you will have restructuring cost, but there would be some benefits also and net-net impact of that on the margins will not be a negative, but could be positive? Because your presentation slide is saying that the benefits will start accruing from H2 of FY20?

Ajay Aggarwal: So you are right. I think we will have the net savings, which is the positive.

Sandeep Shah: In 3Q, 4Q itself, right?

Ajay Aggarwal: That is right.

Sandeep Shah: And just based on the commentary on 3Q, when we say there would be a slight growth, are we saying on a Q-on-Q or on a Y-o-Y basis in the services business?

Ajay Aggarwal: No. We're saying on a Q-on-Q basis.

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

Mohit Jain: First is on the free cash flow statement you have given on this slide. So you are saying free cash flow conversion for us now is 43% prior to one-offs. So this is now the recurring number that we should assume for '21 or how does this number work in terms of your targets?

Ajay Aggarwal: So if you look at the number, which is excluding the one-offs, which are not going to be there next year or the benefits of those investments will also accrue in the next year. So I would say 51% is the number you should look at for '21 and not 43% or whatever is that number.

Mohit Jain: 51 is for services, right? So then you will have group conversion, which could be potentially at a lower number?

Ajay Aggarwal: I think I cannot predict for '21.

Mohit Jain: On a normalized basis, sir, Q4 will also help, but on a normalized basis what is this number going to look like?

Ajay Aggarwal: So I'm saying for the overall group, we are targeting 50%. As far as services is concerned, that also depends on growth as we have discussed in the past also, I think if we have muted growth, we are targeting 50% to 60% conversion. If we have high growth, we are targeting 45% to 50% conversion.

Mohit Jain: And this normalized EBIT 12.5, I heard that you said 300 basis point margin expansion will happen once the exercise is completed. Is that correct?

Ajay Aggarwal: I said yes that since our baseline for this exercise was quarter 4 of last year. From quarter 4 of last year to quarter 4 of the financial year '20, we will have an improvement of 200 to 300 basis points on account of this exercise, and there will be restructuring cost, which will also be there. So net savings will be lower than 200 to 300 basis point, but sustainable savings will be 200 to 300 basis points.

Mohit Jain: Q4 normalize margin you're looking at 15% to 16% EBIT, right?

Ajay Aggarwal: So I would not give the number on the margin because margin also has number of variables in terms of the volume growth what is happening, our investment and what is happening on exchange rate. So I would say that let us not talk of an absolute number. The range of 100 is to take care of other variables.

Mohit Jain: Okay. And that should be the starting range for '21 broadly because restructuring cost will go away, therefore, your margin will be same as normalized margin, is that fair?

Ajay Aggarwal: Correct. That is right.

Mohit Jain: Sir, last thing is on NBA. How much investment are we looking for it in '21, any estimate?

Ajay Aggarwal: So this year, we are spending about 1.5%, which is significantly higher than the last year. We are reviewing the projects and taking a call based on what benefits will come, so it is little early for us. So many of the projects, you're right, go into '21 as well. We are keeping a very close watch in terms of the progress. So it will be a little early for us to say how much is the investment

next year, but there should be a good amount of benefit, which will also start accruing in financial year '21 so the net-net headwind from that should be lower.

Krishna Bodanapu: So just to add to that, I'd say this quarter actually if you look at the order intake from solutions as we define them which are really the sort of the newer types of businesses that we're going after, we actually hit our target. We had an internal target for it and we hit the internal target for the first time. And I will say more importantly, there were 5 new projects that we sold for the first time. And just to give you a flavor, we sold an IoT project to a major mining company, which is essentially to retool or rechip their existing platforms with an IoT solution and that will also turn into analytic solution for us in the due course. So that was a good example of taking an NBA project, an IoT device that was incubated in the NBA and monetizing it. Or the second thing is we also won a deal and will start supplying those components this quarter on additive manufacturing. Again, the first deal is small because it's plastic components, but we're also setting up an additive manufacturing facility in Florida this quarter, which will again translate to recurring revenue. So additive manufacturing was something that was also incubated in the NBA. We also have 2 other large deals that we won, which weren't incubated in the NBA, but directly in the businesses: one on intelligent distribution management systems for utilities where a lot of the data can be captured automatically; and the second is around quality tools that we built for aerospace application, where a lot of things can be done automatically and workflow management etc. So to Ajay's point, I'd say for the first time we are actually seeing some significant order intake from our solutions while we have invested a lot of money on those. We believe that the outcome is now happening, which is very gratifying.

Mohit Jain: So 1.5% is the investment in FY '20, right?

Krishna Bodanapu: '20, yes.

Mohit Jain: And anything on the capex, like setting up this facility and all will it be like capex heavy or, capex light? Earlier, we discussed, I think, few quarters back that it may involve some capex.

Krishna Bodanapu: We will have some capex, but the good thing with additive manufacturing is it's not intensive capex. I mean, it'll be within our normal capex, Anyway the facility is already there in Florida, the building and all the associated stuff is there because we have the ability to make prototypes and quick turnaround engineering in Florida, anyway. So that facility is there, it's really the equipment. So it won't be a significant amount from that sense.

Ajay Aggarwal: So just to clarify on the capex. We have typically in talking of 3% capex, so I can tell that capex, including any capex that is involved in NBA because most of it or almost all of it is opex being put on the P&L, still our capex for the year will be between 2.5% to 3.5%.

Mohit Jain: Sir, last thing on DLM. Like, what is the kind of Y-o-Y growth we are targeting now? There is some change there.

Krishna Bodanapu: I think we were looking at it on quarterly basis right now, but we believe that we'll see some growth. We might not see the double-digit growth that we are originally anticipating, but we will see some growth in DLM. I think there are still some things that are evolving, so we are still trying to figure out where we will end up. But yes, the momentum is there. What we are also trying to do is manage through the kind of accounts that we want and we do not. So we're actually using this opportunity to give up some of the revenue that is not strategic or doesn't come at a high margin, so that's where we stand with DLM.

Mohit Jain: And utilization here would be close to 70%, 80% in relation with the manufacturing unit?

Krishna Bodanapu: It will be about 60-70%. Because I think the problem there is it depends on what we are manufacturing also, so there is a little bit of thing there, but we are at about 60% to 70%.

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

Madhu Babu: Sir, so if we see a modest growth in services business in 3Q. So most likely for full year, services will see a decline Y-o-Y this year?

Krishna Bodanapu: I think we are still working on the Q4 numbers, but we think that if we see modest growth also in Q3, that will give us some very good momentum into Q4. So we are still working towards a flat year. We have a line of sight to that. We want to make sure that we don't decline, that's the first sort of objective. We will need to have a strong Q4 for that, but we do see a line of sight for that.

Madhu Babu: Second, sir, on Communication, what was the traction in the Australian client this quarter or how is the Australian client faring?

Krishna Bodanapu: We showed quarter-on-quarter growth there, which means that at least I think we are out of the sort of the low point over there. But I don't want to say there's significant traction back because of what has happened there, we will take it 1 quarter at a time. Q2 was okay there. Q3 also looks okay. So we'll take it 1 quarter at a time, but at least, I think the worst is over.

Madhu Babu: Because NBN there is a lot of negative comment, so would there be any leakage further there or are you just saying it won't be, and will be more like a stable performance?

Krishna Bodanapu: No. Because the one thing that we're doing for our client is not NBN work anymore, it's for their own network.

Madhu Babu: On the New Business Accelerator - would this be helping us to land in some clients because this is more of IT kind of thing? So would we be able to win couple of new accounts because of this strategic initiative? I mean would that be enabling a perception premium and get a couple of new accounts in the railways or aerospace? Would that be a possibility?

Krishna Bodanapu: One thing I'll clarify is it's not necessarily, IT right? I mean there is an IT layer to it, but it is still premised on our ability to do product design, manage products and maintain products. So it's still engineering in that sense. I mean there is an IT layer, but also obviously, what we are seeing more and more is there is a convergence. So there is some degree of convergence between pure engineering and IT, so that's something that we are cognizant of and working on. Now the IoT example that I gave you of a mining customer is a good example because this client is brand-new for us. And the reason why we have been able to make the approach there is because we came with a pretty unique offering. So we believe, yes, absolutely, I mean, we will continue to focus on new clients there, not just the existing clients.

Madhu Babu: Yes, that's what. I meant that because these are some of the innovative solutions on the engineering side. Would that help us get a perception premium and able to get a couple of new accounts and after that would be able to cross sell and gain a more stable business, is that a possibility?

Krishna Bodanapu: Yes, absolutely. I think that is the reason why again, you look at the IoT I talked about, IoT is just the first, but IoT is also one-off. But where we believe that the stability will come is because IoT then parlays into analytics, and analytics is really around the maintenance and the management of the mining equipment, which is really where we believe it's a long-term stable engagement. So you are absolutely right. I think the technologies might give us the inroad, but then we will also figure out how to stay stable for a while there.

Madhu Babu: Okay, sir. And the last one on the capital allocation. Last year, we completed the buyback in February, if I'm right. So I think currently, the stock is at a very depressed valuation. So would you look at that as an option again in March and April? I mean any possibility on that?

Krishna Bodanapu: Yes. I think it's too early to look at because I think very honestly, we feel quite bullish about our business. I mean the stock is what it is, but we believe that there was a strategic intent of doing the buyback at that point. We did think that we had some excess cash that we wanted to return to the investors. That was the reason why we did the buyback. But at this point, we believe that there is a lot of momentum back in our business. We believe that both for existing customers there's lot of things that we can do, we need to add a lot more capacity in certain areas. M&A is another focus area, and we are back to making sure that there's good focus there. All those things coming together, I believe, we will need the capital that we have. So what you would have also seen is we have announced the interim dividend of Rs. 6 a share. At this point, I wouldn't go to the buyback route is because there are good opportunities to deploy capital and there is need for capital, and we have that momentum back in the businesses if we want to go do those things.

Moderator: Thank you. The next question is from the line of Prashant Kothari from Pictet. Please go ahead.

Prashant Kothari: The first question is around the restructuring part. Can you share some details around what you have exactly done in there? What kind of employees have been let go? And is there any numbers you could share around that?

Krishna Bodanapu: So if you look at the employee head count quarter-on-quarter, it is down by about 185 people roughly. We have had growth quarter-on-quarter and the fact that we have been able to do it with fewer employees and that will continue into the next quarter because even with the growth in the services business in the next quarter, we were not planning on large-scale additions because we will optimize the employees. Who they are, again, it is across the board, we have looked at performance strictly. I think the HR team with the businesses, of course, has done a very comprehensive job of looking at where the value creation is happening, and therefore, we have looked at where there isn't value creation and not just from a delivery perspective, even from a sales and marketing perspective. We have had a very hard look at various things on what function, what value, what are the other ways of coming up with this value, so one is the people aspect. The second thing is there's also a lot of other indirect cost. For example, we have been able to restructure our office in Melbourne in Australia. It was a large office for whatever reasons when the opportunity was there etc. Now we've had a onetime cost, for example, of about US \$300,000 there, but the savings is really going to be about \$1.5 million or \$1.75 million over the next couple of years. So then there is that second category, which is the indirect spend that we're focused on which is offices, leasing. We've done a lot around travel, auxiliary services like cabs and transport and all those things. So these are the 2 categories that we have actually done and the restructuring cost has come in. Of course there are other things, like we've started to disengage with non-profitable customers or where the profitability doesn't meet our expectations. I mean there is another set that those don't necessarily have a restructuring cost. These are the 2 things, the people and the indirect cost where we had to bear the cost of restructuring.

Prashant Kothari: And I guess the restructuring cost will continue in Q3 and Q4 also. So is there any kind of target there in terms of how big those costs could be?

Krishna Bodanapu: Yes. I think Q3 will probably be in the same level as this quarter because we continue with some of the things. And we believe that Q4, it will start to come down. I think the benefit, I'd say, will be felt only in Q1. So Q3 will be at the same level, Q4 it'll come down a little.

Ajay Aggarwal: Just to add to that, it has 2 components. One component is consultants' fee, which is all across the quarter and stops after quarter 4. Second element is restructuring cost in terms of the cost associated with the cost reduction.

Prashant Kothari: Got it. And the DSO has come down this quarter. Anything specific you have done to get there?

Ajay Aggarwal: See, if you look at last quarter, we said that we do have 100 crores plus of cash that we can release from our receivables, and our account receivables have come down. So if you see this reduction, most of it is from the receivables. We did have some spillovers in the last quarter. We also talked about some system issues. So I think that is what has been done, nothing extraordinary. So you should look at it, I think, H1 together then you will get a good sense of both the DSO and the free cash flow, and I can promise to you H2 will be better than H1.

Prashant Kothari: So this is not the normalized level of DSO yet?

Ajay Aggarwal: So I would say that there is still scope to further take it to 90 in the next 2 quarters. So we'll be working on that goal.

Moderator: Thank you. The next question is from the line of Neerav Dalal from Maybank. Please go ahead.

Neerav Dalal: Couple of questions. So one is on the ETR. Obviously, if I look at it, this quarter again, we were about to 22.5%, so what should be that number for this year and the next year?

Ajay Aggarwal: So if you look at the ETR, first, as far as current year is concerned, we had said it will be 22% to 23%. So we are going to be in this range and you know given some of the technicalities of computation, you should not overly worry about things between quarter-on-quarter, but it should be in this range. As far as next year is concerned, we are evaluating the new tax that has come. But obviously on face of it, it looks like especially for the services business that the feature where we continue with the current incentives for the next few years is better for us, which means that we will continue to be at the current rate, which are lower than that 25%, which is the other option company can adopt.

Neerav Dalal: And in terms of subcontracting cost, how should one look at it?

Ajay Aggarwal: I think we have been talking about subcontracting cost number of times that it's all about the mix of the business. I would say that in some of our businesses like Communication, we are trying to reduce the revenue mix more towards non-subcontracting, in the U.S it continues. So I would say maybe marginally lower, but nothing significantly will change in subcontracting cost.

Moderator: Thank you. The next question is from the line of Rajin Rajan from Geojit Financial Services. Please go ahead.

Rajin Rajan: My question is related to that employee count. Is it largely based on restructuring only or is there any specific other reasons for that?

Krishna Bodanapu: No. It's mostly restructuring and just we are looking at the capacities that we have and the capacity that we need and we figured that because of the whole exercise that we are undertaking in terms of efficiency, we were able to look at exiting a few resources. Of course, there is also attrition and we manage both of them together that when there is attrition, we might not backfill. But the whole intent is because of the restructuring.

Rajin Rajan: I mean the historical trend was 18% in 2014. So that kind of margin growth, when can we expect?

Krishna Bodanapu: I think that we'll have to look at things, we've had probably like I said, coming of where we are, we are looking at things really from a 1 or 2 quarter basis at least from an operating level, obviously from NBA and other things, we are focused on longer term. I'd say maybe it's a good conversation to have in a few quarters once things stabilize a little bit.

Moderator: Thank you. The next question is from the line of Mayank Babla from Dalal & Broacha. Please go ahead.

Mayank Babla: Sir, I just wanted your view on what is going on with the Boeing since the last 2-3 months? And how is that impacting Pratt & Whitney and in turn impacting our operations?

Krishna Bodanapu: What's going on with Boeing is obviously in public knowledge. So it is not right for us to comment as they have been saying that. We had nothing to do with the particular program that's been the question at this point or at least nothing to do with the technology or the software that caused some problems in the program that's been talked about. We have talked about the impact that we had because of just the refocus of Boeing on some of the immediate issues versus new designs, and I think the impact has been baked in. We are hoping some of these things will get sorted out. Publicly they've said 737 will fly in probably Q1 of next year. We're just waiting for things to stabilize as we believe that certain projects that have been put on hold will come back at that time.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to Mr. BVR Mohan Reddy for closing comments.

BVR Mohan Reddy: Thank you very much for participating in our earnings call. We appreciate all of you taking time listening to us and asking questions. As Krishna and Ajay explained, I think looking at the future, it looks very bright. We think we'll probably have lot more traction to our business in coming quarters. Thank you very much, again.

Moderator: Thank you very much, sir. Ladies and gentlemen, on behalf of Cyient that concludes this conference. Thank you for joining us, and you may now disconnect your lines.