Q1 FY-17 Earnings Conference Call

July 14, 2016

Management

Mr. B.V.R. Mohan Reddy – Executive Chairman, Cyient Limited

Mr. Ajay Aggarwal – Chief Financial Officer, Cyient Limited

Mr. Krishna Bodanapu – Chief Executive Officer & Managing Director, Cyient Limited

Moderator

Mr. Sandip Agarwal – Edelweiss Securities Limited

Moderator: Good day ladies and gentlemen. Welcome to the Cyient Q1 FY17 Earnings Conference Call posted 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 the operator by pressing "*" and "0" on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Sandip Agarwal from Edelweiss Securities. Thank you and over to you, sir.

Sandip Agarwal: On behalf of Edelweiss let me welcome you to the Cyient Quarter 1 FY17 earnings call. We have with us the senior management of Cyient headed by Mr. B.V.R. Mohan Reddy, along with other senior member of the management team. Without further ado, I will hand over the call to Mr. Ajay Aggarwal to start the proceedings. Thanks, over to you, Ajay.

Ajay Aggarwal: Thank you Sandip, thanks a lot. Good day ladies and gentlemen welcome to the Cyient Limited earning call for the first quarter of financial year 2017 ended June 30, 2016. Really appreciate all your support and I am Ajay Aggarwal, the CFO for Cyient. Along with me is also our Executive Chairman – B.V.R. Mohan Reddy, the CEO and Managing Director – Mr. Krishna Bodanapu. Before we begin I would like to mention 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 Investor Updates which has been emailed to you and is also posted on our corporate website.

This call will be accompanied with an Earnings call presentation. Details of the same have been shared with you. I now invite our Chairman Mr. B.V.R. Mohan Reddy to provide a brief overview of the company's performance for the quarter ended 30 June 2016.

B.V.R. Mohan Reddy: Thank you Ajay. Good evening ladies and gentlemen. I welcome you all to this conference call. At the onset of financial year 2017 I would like to thank all of you for placing your trust on Cyient and its management team. Financial performance for Q1 financial FY 17 is in line with our expectations both on the top line and the bottom line. The services business grew by 5.4% in dollar term highest ever in the last six quarters.

Robust growth in most of the focal industries viz Aerospace grew by 5%, Transportation grew by 19%, Medical & Healthcare grew by 16% and Communication grew by 13%. All the business units witnessed a growth through the quarter except for Utilities and Geospatial in brief it is called U&G and our manufacturing business which is also called the Design Led Manufacturing.

In DLM we faced headwinds due to the cyclicality of the business, however with strong order backlog and pipeline we expect stronger revenue from DLM in the second half of the year and continue to be confident of the 50% growth in revenue that we have committed.

Operating profits stood at Rs. 1,090 million that is 13.1% marginally up from the previous quarter despite the wage hikes. As we said it again the operating profit stood at Rs. 1,090 million that is 13.1% marginally up from the previous quarter despite the wage hikes. The headwinds due to wage hikes were opted by improved quality of onsite revenue and operational efficiency. We closed the quarter with an improvement of 90 basis points on the operating margin for the services business and an increase of 10 basis points for the Group.

Net profit stood at Rs. 740 million, up by 12% quarter-on-quarter DSO was lowest ever at 77 days due to consistent foreign exchange policy we continue to see gain on forward covers in spite of the depreciation of the British Pound. This quarter we also initiated operations from newly established centers in Prague and have started realizing revenue from this center. In the coming quarters we expect a steady progress in revenue contributions from this center. We received ABB Performance Award for the best overall performance in Quality, OTD and Response for PA Measurement products ABB TF and USA. We received two awards at Asian Utility Week 2016 Best Customer Value AMI Infrastructure Rollout along with TNB Malaysia and Best Customer Engagement Project with Singapore Power.

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

Ajay Aggarwal: Thank you Mohan. I understand everybody is able to see the presentation now. We are on Slide # 5 just in case. Before I begin insight into the financial results I would like to mention that company has switched over to the Ind AS what is called as Indian Accounting Standard starting from 1 April 2016. We were preparing for it well throughout the last year and the switch over is complete, the quarter's results are as per Ind AS. As required by SEBI the quarter results for the Quarter 1 of previous year also have been recast but just to give you comfort the overall impact on revenue and bottom line is very small it is less than 1% both on top line and our bottom line and we have also in our Investor update very clearly quantified what is the change.

In terms of revenue as Chairman pointed out, this has been a very good quarter you have seen last quarter also the growth on the services business, on the engineering business had come back and we have seen the continuation of that we have a growth of 5.4% and if you look at our focal industries, that is Aerospace, Transportation, Medical and Health Care, Communication each one of them is growing at above 5%. In fact, in Transportation and Medical and Health we have 9% and 16% kind of growth, Communication on top of the activity which is happening in Asia Pacific and US in terms of the communication program is growing as high as 13% and in many of these industries we expect the traction to continue throughout the year.

In terms of the constant currency growth it is 2% in terms of DLM due to the cyclicity we had lower revenue in this quarter but we have looked at how that full year looked like and we are confident of that 50% plus growth including in the next quarter we should see the growth coming back a substantial growth in the next quarter will be back in DLM as well.

In terms of geographies only I would say AMEA we saw a negative growth in the quarter but nothing much to read into it because it is directly linked to the Middle East business which is coming in Rangsons which has got impacted in this quarter and some other U&G related work which again next quarter I think U&G should also do a very good growth and also for the full year. So our expectation is when Krishna will talk more about it that this growth traction will continue and each of the business units that we have is going to show very good growth and it will be well rounded growth this year in line with the commentary we had given.

In terms of income statement, we all know that the first quarter typically is the wage hike quarter so we have given to all the employees of the organization the wage hike except the managerial manpower which is a very small percentage despite that we have a operating margin improvement marginally by 10 basis points from 13% to 13.1% during the quarter. And this is a result of two major factors, one is the operational efficiencies the campaign that we are running which is for the whole year is showing up the results. Our utilization is better also on the onsite while the work is coming at on site for this quarter the onsite offshore ratio is constant, but at onsite work itself the margins have been much higher and that shift will also help us in margin management.

When we look at net profit as we have seen we have 12% growth quarter-on-quarter. In terms of other income there are two aspects. One aspect is on the realized gains so we do have I will show you in the next slide, good gains in this particular quarter we have a good healthy position of the forward cover book for the rest of the year. So on the realized gains as the quarter stands today we have a very healthy position.

As far as notional gains and losses are concerned, there is going to be a string of business fluctuations and most of it is driven in this quarter because we had a very high amount of about Rs. 10 crores of notional other income in last quarter on the FX the restatement is not there in this particular quarter.

Tax rate is higher in this particular quarter at 25.5%. This is mainly because of the share of America which has been higher in this particular quarter. But again as we see it internally we are slated to have the tax rates back to improvement of 100 basis points year-on-year. So I would say this is a one-off. Last year we had done about 24% as tax rate this year we will come back to 23% as the tax rate for the year as a whole.

On the cash generations, I can see on the slide there is some mix up, I apologize for that but I will give you the headlines. We have generated Rs. 815 million of cash flow in Cyient, we have consumed about Rs. 11 crores or about Rs. 118 million of cash in Rangsons. Net-net we have generated about 56%-57% of EBITDA even after taking into account the Rangsons the convergence of EBITDA to free cash flow continues to be high and it exceeds 50%. Our cash position is at $118 million or has exceeded Rs. 800 crores. It is about Rs. 801 crores first time we have crossed cash position of Rs. 800 crores. We have lowest ever DSO as we mentioned, so that campaign is continuing and we feel that we can continue the DSO to be 80 days plus minus few days.

Also we have made additional disclosure here. If you look at the bottom of the chart, we are explaining where we have used the cash so we have made some investments. Investments were Rs. 102 million have been made in Corporate Venturing, Rs. 102 million or about $1.5 million we have invested in two ventures and Krishna will also talk about it in his presentation. Both are in medical and healthcare and both of them are below 5% of the equity share that has taken about Rs. 149 million, Rs. 268 crores is the repayment of borrowings. And that is how our cash comes down to Rs. 802.5 crores. I repeat that, I stand correct it, it is not Rs. 801 crores, it is Rs. 802.5 crores is the closing cash. I again apologize for some mix up on the slides but I read out the numbers to you which are correct.

FOREX and other income update as I said, this quarter our other income has been lower compared to the previous quarter but both on Treasury income as well as realized gains on forward covers we have a very good position both have improved compared to the previous quarter. On the notional FX gains and losses which are mainly the balance sheet items, the restatement including some of the items in Euro, we have Rs. 49 million of notional loss. I think we should not look much into it, because actually our forward cover position for the full year is much better than the spot rate and the realized gains will continue to be there and the forward covers are adequate even to take care of the balance sheet exposure that is there including in Euro.

So in terms of the hedges position, total hedges are at $113 million, no change in our hedging policy we continue to be 70% of the net inflows. If you look at the current spot rate for US dollar in each of the currencies we will have a gain of $6 million from these forward covers, which can come up as a realized gain in the other income. So we are relatively in a good position as far as earnings growth is concerned because if the exchange rate goes up we make more money on operating margin and if exchange rate comes the other way around like it happened on British Pound then we make money from the forward contract.

With this I would like to hand over to Krishna who will give the updates on Strategy, M&A and Business.

Krishna Bodanapu: Okay thank you Ajay. So as always I will just first start with the M&A updates M&A and now we are calling it CV for Corporate Venturing and I will quickly take you through this slide. But basically we continue to be focused on the inorganic part of our business and also further accelerating some of the initiatives that we are taking through the inorganic route. In that context there are four deals that are currently in the pre-LOI stage there are three LOI stage and then there is one acquired which was a very small business in Australia to help us with some of the network planning and network design stuff that we are doing.

Again this was actually a very, very small deal it was more of an asset buyout for some specific capabilities. But again we will continue to focus on that and continue to locate various opportunities in that area and the four areas that we primarily focused on there are highlighted. In terms of Corporate Venturing, again what we had if you remember at the Investor Day we had taken you through the logic and the intent behind Corporate Venturing as looking at small businesses that can add to our competitiveness if because of the technology or because of the skills that they have or on the other side could be potential customers that are in an early start up stage and can help us or can become potential customers for us.

Within that context, we did invest like Ajay said in two companies, one was a medical Internet of Things company based in the US and the second was an Indian medical device company and for anybody who is interested I can take you through that either offline or online during the presentation if we have some time.

Just to give you a quick industry outlook around the eight industries that we currently operating. The first is Aerospace and Defense, here again things look quite good, it is actually a big week for the Aerospace and Defense industry because it is Farnborough Air show that is currently going on. In Farnborough there continue to be some good designs across the Aerospace industry be it Boeing, Airbus, Bombardier and Embraer on the aircrafts or on Pratt & Whitney, etc., on the systems.

But our business also continues to do quite well. We are seeing a lot of growth in supporting the manufacturing which is manufacturing engineering, we are seeing a lot of work in the aftermarkets and MROs which is the work that we do even in our Singapore acquisition. There is some good traction there and we will continue to see that. The Industrial energy and natural resources it is a bit of a mixed bag for us right now. The energy and natural resources market continues to be quite a challenge. There are cost pressures oil and gas and mining are seeing a lot of pressure and at best we see that this business will remain flat for us. But where we are seeing and that is why I said it is a little bit of a mixed bag, is on the EPC the engineering procurement and construction company, there we are seeing some very good traction.

You would have also seen we announced a deal with a company called SMEC they are a major Tier 1 EPC that is oil and gas plants and power plants and there is a couple of more in the pipeline that are coming to precaution and also one of our large customers Westinghouse Nuclear are seeing a lot of traction in this area and including the fact that you may have read in the newspapers that they will also build nuclear power plants in India. Next is the transportation industry. Transportation for us continues to do quite well.

We do have some good momentum there, we have some good wins. The one concern in transportation is the one that is most affected by this whole challenge that is going on in Britain at this point because a lot of our work in transportation is also UK centric work. We do not see any immediate challenge in a medium to long term we do see some potential risks again how that pans out we will have to see but there are some potential risks. Well having said that, I think in the short term transport continues to do quite well for us.

Medical technology and Health Care is a small business and therefore we are seeing some very good growth. This is an area we have put a lot of focus on we try to do a lot of work around defining our value proposition, making sure that we have a solid proposition for the market and I think we will continue to show some good growth. I think if you just recall our previous slide that the business quarter-on-quarter grew almost 20% and we will see continuous growth in that area.

Semiconductor for us it will be flat again interest in things going on in the market but I say for us it will be flat because the markets where we are consolidating our customer base a little bit we are trying to figure out the sort of the right type of customers to work with and where we should be working with and therefore it will be flat for the coming quarters but again we do not see any challenge there per se on the down side.

Utilities and Geospatial between Q4 and Q1 was flat, but that is because Q4 was actually an extraordinarily good quarter. We delivered some very good revenues there but we also delivered good revenues sort of working quite hard i.e. with a high degree of utilization. So we are really trying to make sure that we consolidate down because that is not a sustainable model. We have had a flat quarter therefore because while the revenue has been same we have had to add resources, etc., because again it was not sustainable to come and continue to run in that level.

But we do see that there is a lot of good pipeline there, the industry itself is doing reasonably well. Utilities it is something that a lot of investment is going on in the grid of utilities which is really where we play. Geospatial it is an area where we are very strong at and therefore we expect that this business will also do quite well for us.

Then comes the communications business which was sort of the star performer for us and it continues to be that going forward. There is a lot of opportunities because new initiatives like fiber to the home are being rolled out and there is other opportunity which is a North America initiative to connect the whole of the United States with broad band. Asia Pacific continues to do well overall this will continue to perform very, very well for us. On DLMs this was the design and manufacturing primarily centered around the Rangsons business but what I do want to say is Q1 there was a little bit of a challenge but I think that is something that we had already talked about.

And again it was in line with what we had expected, but it was a challenge from the previous quarters. But the heartening thing there is that there are some new orders in critical areas like Defense, Industrial, Aerospace, Medical these orders will turn into revenue starting probably some of it in Q2 but realistically Q3 but like I think the Chairman said in his speech we are quite confident that it will be this 50% year-on-year growth and I will talk about the outlook here in a minute overall for the company.

So overall, six out of these businesses delivered some strong profit, medical obviously was highest at 20%, comps was not much behind that. But other than that, other than DLM all the BUs had some growth at least. I think U&G was essentially flat that is Utilities and Geospatial, Medical and Healthcare was at plus 16% or 17&%. So overall it was a good quarter and that traction continues going forward. So therefore what I would like to summarize as the future outlook is what we had said both in the April call and also during the Investor Day for those of you who attended, the outlook remains unchanged.

We will deliver double-digit growth in the core business. The DLM business will grow at least to 50 basis points, sorry 50% I was reading a little bit ahead sorry about that. But I will just quickly take you through margin issues also because what happened in Q1 is we executed or implemented a salary increase for everybody in the organization up to a certain managerial level and a pretty high managerial level. So there is going to be one more impact which will again be a small impact in Q2 because the rest of the salaries will also be rationalized increased in Q2.

So therefore what we believe is that for the year right, the signs services business will have at least a 100 bps improvement in margin. The group OPM will be flat but marginally positive again there are some challenges in DLM that we still need to work through. But overall we are quite confident that margin will at least show a little bit of a positive movement and where that confidence also comes from is if you look at Q1 which is historically there is the biggest challenge because the majority of the wage increases are executed in Q1. In spite of that we were able to deliver a flat or a slightly better but I will even say a flat margin compared to Q4.

So from here we can build on it and therefore it gives me the confidence to make this statement that there will be a 100 bps improvement in services and marginal improvement in the overall business. And net-net what this will translate to is we will deliver at least a double-digit earnings growth and I will just leave it at double-digit because again there is a number of other things that is going to the line between operating profit and net profit, a lot of which can be out of our control like treasury income or other income and therefore just assuming nothing irrational happens either on the positive side or the negative side. We are very confident we will deliver the double-digit earnings growth this year.

With that, I think that was the end of the presentation and I will turn it over to the moderator.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question and answer session.

We take the first question from the line of Ravi Menon from Elara Securities. Please go ahead.

Ravi Menon: First of all, my congratulations to management on the excellent margin performance. And secondly, I just wanted to dig a little more into the reasons for that. Ajay, you said that the onsite margins were a little better is that because some of the lower margin projects finished and you had some new projects start off that especially in Aerospace or in other parts where it was much better margins?

Ajay Aggarwal: Yes, there are two aspects. If you see from the last year also we have been talking of the campaign of more and more rigor around how the margin management is taking place both in terms of improving the margin for the existing work as well as in terms of the deal margin for the new work that we are winning.

So I think it is a combination of both for example we do a lot of onsite work in communication, we do a lot of onsite work in Aerospace, where on the work itself we have been getting more margin now which was a conscious stride. And also in terms of improving the margin at the onsite also we have done some work. So it is a combination of both lot of this is happening in communication and aerospace.

Ravi Menon: And on Rangsons so you have been targeting a 50% improvement in the revenue overall for FY17 and if I look at just this quarter you have done year-on-year 50% plus. So should we expect that quarterly this trend would continue or should it be like the last second half of the year maybe a little more backend. I am just trying to get a sense of with the order book improvement this quarter is that going to translate in the uniform fashion and was that the case?

Krishna Bodanapu: Ravi, you will see second half will be a lot better it was the same last year also because if you look at it well there is a QoQ degrowth YoY in Rangsons we are at about 50% improvement in the last year. So if that will be the case we will see the growth in Rangsons being a little bit more back ended this year also.

Ajay Aggarwal: But just to if I may add Krishna, this is not to say that there is going to be definitely a growth in the next quarter we were seeing the uptrend of the order intake that will really show up in the growth in the next quarter. But there will be a exponential growth if I may so or a bumper growth which will happen in H2, but there is going to be double-digit growth in second quarter itself.

Moderator: Thank you. We will take the next question from the line of Mohit Jain, from Anand Rathi. Please go ahead.

Mohit Jain: First if you could help me understand the order backlog data that you have given that shows 33%-odd percent growth YoY. So how does that translate to revenue growth historically and how should we read that number? Second was is there is an SG&A onetime expense in Rangsons or in any other business which would have resulted into lower margins overall for the design led manufacturing business and what should we expect in terms of EBITDA margins there for this particular year?

Ajay Aggarwal: We had promised that some of the lead indicators we will start publishing so in line with that commitment we have started publishing order intake.. Coming back to your question, I will make some comments Krishna then please add. You would find that there is a very clear trend in case of DLM in terms of the growth of the order intake between year-on-year as well as on quarter-on-quarter. As far as Cyient is concerned, we have also explained by the way of footnote in many of our top 20 customers and other customers the order intake is not linear.

For example the largest customer in Aerospace lot of order intake comes in the Quarter 4 what is our Quarter 4. So because of that the order intake is not linear, so we analyze ourselves that to your question that what does this trend mean of 30% growth year-on-year, what it means is I think we are on track to deliver the growth that Krishna just talked about. And I would not read overly about it and let me be very honest, we do not have many years of clear accurate reliable trends to have reached that stage that we can translate it directly. And that is what we have been telling you transparently that our system integration and all is taking place. So we do have some challenges of not having experience of many years of having this correlation between order intake and revenue. Krishna, would you like to add?

Krishna Bodanapu: No, I think I just substantiate that and say I would not translate or I am still not certain that there will be a one-to-one correlation. I think we will and you will see there is a little bit of learning as we go along with this data. So as we learn we will make sure that we are transparent about what we learn. So I would not read 30% order intake improvement into 30% revenue because it is just that there is a few other things that go into. But what we are quite confident is (a) is in the numbers, that is a solid number and (b) in the fact that it is trending quite positively. So when I say double-digit growth then I can substantiate by saying there is orders to back that up.

Sorry I did not catch the second part of your question?

Mohit Jain: It is just a follow up on this. Does it include renewals in that sense also if you?

Krishna Bodanapu: Yes, it does, absolutely it does.

Mohit Jain: Second question was on SG&A is there a onetime expense that you have booked in this particular quarter and what is your outlook for margins from the DLM side?

Krishna Bodanapu: There was not anything that we have booked onetime on SG&A this quarter correct, there was not anything that we have booked this quarter. And last question was margins are?

Mohit Jain: Margins on the DLM side for the full year?

Krishna Bodanapu: Say through the year again they will improve this quarter obviously will be the most difficult quarter and that is how it usually is, we had a negative margin this quarter. But they will improve over the course of the year. Again I will say we are doing some work and making sure that it comes back to the sort of a mid-single digit number through the course of the year that is where I leave it at.

Mohit Jain: Mid-single digit is what we should assume at this stage?

Krishna Bodanapu: Yes, mid-single digit is because we are still making a significant number of investments over there and therefore it will grow towards the mid-single digits.

Mohit Jain: Despite this 50% increase in revenue?

Krishna Bodanapu: Yeah because actually this year I am quite committed to making that investments a lot of it is we are making the investments because we are seeing a 50% increase in revenue that gives me the confidence that the strategy there is playing out and the demand there is what we had anticipated to be. And therefore it will not be very linear because even if you see there are some opportunities to deliver some very, very good revenue there, but I am going to invest back whatever that we can make because of that good revenue because I strongly believe that for the long term sustainability of the organization this is a very good proposition that we have.

Ajay Aggarwal: And if I may add what we have said in our outlook for the full year what we are estimating we have already said that our margin from services to the Group will come down by 100 basis points. So that itself factors in that we are not really taking advantage of a drastic improvement. So the way we are saying is this will continue to be a year of investment on Rangsons and do not expect too much in terms of margin swing in Rangsons in the current year.

Mohit Jain: I understood Ajay. I was hoping that if revenue comes through then margins could surprise you positively.

Ajay Aggarwal: Yeah but because the investments are taking time and also the change in the revenue mix in terms of end-to-end orders is also coming up later in the period. So more and more orders are on prototyping more and more orders will be delivered towards the end of the year and in the next years. So I think that is another in terms of shift of the mix of revenue also takes more time and there are investments. That is why I am saying net-net you have to look at 100 basis points will again be consumed by Rangsons over the services business in this particular year.

Mohit Jain: Last is on this wage hike which you said were 1Q and 2Q how much impact should we build in for second quarter growth basically?

Ajay Aggarwal: So we are saying at the operating profit level we should take another 80, 90 bps for the next quarter.

Mohit Jain: So 80 bps this quarter and 80, 90 bps next quarter

Ajay Aggarwal: That is right.

Mohit Jain: And then we should be done with for the full year?

Ajay Aggarwal: That is right.

Mohit Jain: And attrition is currently at 20% so does that mean that you may look at more promotions or anything else to retain your employees for this year?

Krishna Bodanapu: No, I think we are doing various things on attrition I think there is also in our business there is various cases with various levels of attrition, some good some bad. So I will just say that we are working on various initiatives to control it but we would not do anything one time or special in that.

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

Madhu Babu: Sir, top 5 and Top 10 clients they have showed a very good growth, is it any one single client which have driven this or is it all around?

Krishna Bodanapu: No, it has been pretty much across the Board. Again I cannot remember exactly by client but it has been pretty much across the Board.

Madhu Babu: Almost 15% growth from top 10 clients?

Krishna Bodanapu: Yeah, it would be, correct.

Madhu Babu: That is but any license or something because the preferential bonds that helped a little?

Krishna Bodanapu: Nothing it is all pure services basis. There is nothing that one time like a license or a software sale or an advance, nothing it is just pure service.

Madhu Babu: Sir and DLM you showed the order book of $12 million but to get this 50% growth I mean substantial run rate is required over 2Q, 3Q and 4Q. So is it that we are anticipating the orders to come in or I mean how that is built in?

Krishna Bodanapu: No, see there is already a backlog that is also there, right, there is a quite a significant backlog, there is about a $40 million backlog that is there on top of this. So the backlog is really what is there.

Madhu Babu: The training which you have done this quarter the $12 million which you mentioned?

Management: This is the order that is booked in this quarter.

Madhu Babu: And the last one sir, what is the reason for the margin down grade because last quarter I think you said 150 basis points year-on-year improvement and so now we are saying almost flat margins for the full year. So I think substantial downgrade I mean is it because of the Rangsons the DLM investments or any other headwinds we have seen?

Ajay Aggarwal: See there are two parts. One is if you see we had also said that in the SMA business we were also counting for another 100 basis point swing. So as of now we are not factoring that upswing into the margin because last quarter as well as this quarter we have not done a great job on winning some software deals which are at high margins. So I think that has not been factored in this particular guidance. To that extent there should be upside that is one reason and second on the operational efficiencies also we are little muted because in utilization itself what we have targeted and what we have done in this quarter has been a little lower while we have improved drastically. And this is the two reasons why we are being a little conservative on the improvement of margins.

Madhu Babu: Sir and just one last question if you can give that based on that earlier breakup how much engineering grew and how much DNO has grown? Because I think this is the first quarter we changed this reporting, just for our comparison?

Ajay Aggarwal: We will provide you offline that particular data definitely engineering growth will be more than 4% and DNO would also be between 3% and 4% but we will provide you that data offline.

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

Avinash Sharma: Hi sir, my questions have been answered. Thank you.

Moderator: Thank you. We will take the next question from the line of Nandish Dalal from IIFL. Please go ahead.

Nandish Dalal: I just have one question on the order intake. Krishna, could you just clarify whether this order intake figure is it all the contracted orders or some of it are based on MSAs also?

Krishna Bodanapu: No, these are purchase orders, so these are contracted purchase orders. So they are not, if suppose there is a MSA then we would not take the value of the MSA. This is purely a tier that is available in the system.

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

Deepen Shah: Yeah most of the questions have been answered. Just one bookkeeping question. Could you just give us the revenues from Softential in the previous quarter and how it has done in this quarter?

Krishna Bodanapu: I think both the quarter are about $2.6 million.

Ajay Aggarwal: $2.8 million for this quarter and $2.2 million for the previous quarter.

Krishna Bodanapu: $2.2 million in Q4

Ajay Aggarwal: And $2.8 million for Q1

Deepen Shah: So given this and given our target of about $20 million are you still very confident we should be able to achieve that number or you know there could be some road blocks or headwinds to that?

Krishna Bodanapu: There could be some road blocks to that. But what I am confident is the overall number that we will make up I mean the communications business in general is doing extraordinarily well at this point. So we will make up I mean we will make up that number if we do not do it. We are obviously focused on doing it, there is a team dedicated to that, etc., but I will say even if we do not, we have other ways to make it up.

Deepen Shah: Okay I did not get it in the sense like are you pretty okay with the $20 million revenue for this year?

Ajay Aggarwal: Let me explain it. What we are saying is in terms of the accountability in the organization now, there is a vertical called our business unit called communication, which also has the responsibility of what we were calling as Softential business. And when we look internally we are looking at the complete plans for communication. So there we are saying that whether it comes from added activity which is coming from Asia Pacific and from the

North America overall on communications we are on track. That is what we are saying. There is some uncertainty on that $20 million, we are working towards it but it is uncertain.

Krishna Bodanapu: So what I wanted to say when I made the comment on the earlier outlook for revenue that is assuming that even Softential continue the current run rate and I am not saying it will continue at current run rate, to take even the worst case scenario we will still be able to meet our commitments.

Moderator: Thank you. The next question is from the line of Ashish Agarwal from Principal India. Please go ahead.

Ashish Agarwal: Just wanted to understand one thing, in your cost items cost name delivery management has come down substantially. What does this pertain to and what is the reason for this?

Krishna Bodanapu: So let me just look at the number but basically delivery management is all the overhead that goes into managing the deliverables. This is the people that are project managers, program managers and all those resources.

Ajay Aggarwal: Because it is more of advantage that Krishna is more of a somebody said book keeping question. So I think the way you should read it is take direct salary and delivery management together you are seeing there is lot of increase in the direct salary and related cost whereas there is a reduction in delivery management and there is some classification and grouping issues here so you have to really, there is no major reduction in delivery management headcount between the two quarters.

Krishna Bodanapu: So look at total cost of revenue rather than....

Ashish Agarwal: And secondly sir even on the margin guidance per say, is it fair to assume that the majority of our margin expansion will be back ended?

Krishna Bodanapu: So I think it will be through the year if you look at it this quarter for example we made up at least 100 some basis points because the salary increases and also if you look at some of the currency challenges towards the end of the quarter with Euro and specially Pound we made up a 100 some basis points. So it will be through the quarter it will not be just in one quarter or the other it will be through the quarter.

Ashish Agarwal: And sir last thing on the Softential side, what is the problem we are grapping because of Softential side that we are not sure whether we will be able to make up to that $20 million revenue mark?

Krishna Bodanapu: So I think basically there is a lot of technicality in the business with the software sales that have to happen. Typically, software sales will happen in Q2 and Q3 that is when the sale of new software has happened. And we believe that there is a good pipeline, we believe that there is a good opportunity there. But we still do not have the order book or the order intake order backlog to say with certainty that you know Softential will do $20 million.

That is why two things I will say. One is that is why we are just being prudent and still saying the commitment will be met it is just that it might be a little bit different from where it will be met. And the second thing is while we are not talking about the $20 million being met or not, we are saying that is the target that we are taking and we are working towards the $20 million target. It is still we are being prudent on where are the numbers going to come from rather than just throwing out a number.

Ashish Agarwal: Okay so assuming that Softential achieves your target then that is the upside on the margin side?

Krishna Bodanapu: That is up side both on the revenue and margin side beyond those.

Moderator: Thank you. The next question is from the line of Sumit Surana from Haitong Securities. Please go ahead.

Sumit Surana: My question is related to geographical breakdown that what we have given. So if you can give us any color on each of the geographies how is the demand outlook in especially maybe in EMEA if you can throw some more color on, that would be great. Thanks.

Krishna Bodanapu: Extraordinary in any other places I think the industry with a better reflection of how each industry is performing because I think the geography just have so many industries mixed up in them that it might not necessarily be a very accurate reflection. Now the one thing I will say is EMEA has some of the Rangsons orders in it because these are Israel orders for especially related to defense and those turn to be extraordinary receivables. And those tend to be unfortunately extraordinarily cyclical and therefore that is what is showing up in EMEA as the big negatives.

But again I would not be too worried about what happens quarter-on-quarter because again if you look at it last quarter it showed up as a big positive because some of the Israel orders came through with the Defense. Asia Pacific again is a relatively small geography and therefore the bearing is quite significant but there we see some very, very good opportunities the 20% quarter-on-quarter growth. It will not obviously I mean 20% is quite a high number it will not continue at that number but we will some really good growth.

So I will say there is nothing untoward in each geography and just if I may take one second and even comment on sort of this whole issue with Britain leaving the EU and the impact that it has on us, right now we do not foresee any impact. So I think it is the industry outlook would be a better reflection of what is going on rather than the geography outlook.

Moderator: Thank you. The next question is from the line of Amish Kannani from JM Financial. Please go ahead.

Amish Kannani: Sir, one of our key accounts was reportedly facing the issues in the newer products that they have supplied to one of the key vendors. So is there some issue that you can see on that account to us sir?

Management: Sorry say that again, I did not catch the first part.

Amish Kannani: One of the key accounts that we service has those engines related issues in turn to their vendors. And so is there any challenges that we might face in the medium term due to these issues? Or it would be an incremental work actually that would have come to us?

Krishna Bodanapu: No, there is both I mean right now we do not see that as an issue because in what happens in Aerospace this always happens in the initial dates. It is just the complexity of the system is such that these things happen. So I mean they have told us multiple times we have also heard from their end customers and I was actually with the CEO of their end customer yesterday or day before yesterday. These are the normal things there is nothing to be worried about.

And it is actually we have some interesting service offerings there around manufacturing, engineering, etc., which is leading to some good opportunities. So again I would not call that the trouble is good and because of the trouble we are getting opportunities but I do not think that to be a major issue at all at this point. But also that is one of the highest growing accounts in the last year as well as the same trend is continuing so whereas the aerospace growth is also coming from there. So we do not have more activity we have just opened in Vizag another center with them in terms of announcement of relationship and work that has happened but that is yesterday. Good things are happening on that account.

Amish Kannani: Okay so it is not at all a threat and if at all it could be an opportunity?

Krishna Bodanapu: Yeah, absolutely.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I would now like to hand the conference over to Mr. Sandip Agarwal for his closing remarks.

Sandip Agarwal: Yeah thank you everyone for participating in the call. I will hand over the call to Mr. Reddy for his final remarks. Over to you, Mr. Reddy.

B.V.R. Mohan Reddy: Thank you, Sandip. Thank you very much for participating in the call. I am sure you like the numbers that we have had. It is a great effort put by the leadership team of Krishna, Ajay and the rest of the people. We have continued to commit to our investors that we will create value for them and thanks again for your support. Thank you.

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