# "Cyient Q2 FY2017 Earnings Conference Call"

**October 13, 2016**

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| **MANAGEMENT:** | **MR. B. V. R. MOHAN REDDY – EXECUTIVE CHAIRMAN, CYIENT LIMITED**<br>**MR. AJAY AGGARWAL – CHIEF FINANCIAL OFFICER, CYIENT LIMITED**<br>**MR. KRISHNA BODANAPU – MANAGING DIRECTOR AND CHIEF EXECUTIVE OFFICER, CYIENT LIMITED** |
| **MODERATOR:** | **MR. SANDIP AGARWAL – EDELWEISS SECURITIES LIMITED** |

**Moderator:** Ladies and Gentlemen, Good Day and Welcome to the Cyient Q2 FY17 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 this 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. Good evening to everyone. On behalf of Edelweiss, let me welcome you to the Cyient Quarter Two FY17 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 Team. Without further ado, I will hand over the call to Mr. Ajay Aggarwal to start the proceedings. Thanks and over to you, Ajay.

**Ajay Aggarwal:** Thank you very much, Sandip. Good evening and Good Day Ladies and Gentlemen. Welcome to the Cyient Limited's earnings call for the second quarter of financial year 2016, ended September 30th, 2016. I am Ajay Aggarwal – Chief Financial Officer. Present with me on the call is our Executive Chairman Mr. Mohan Reddy; Managing Director and CEO, Mr. Krishna Bodanapu.

Before I begin let me make the customary statement. Today's discussion maybe forward-looking in nature and may involve risk and uncertainties. A detailed statement in this regard is available in our investor update which has been emailed to you and is also posted on our corporate website. This call will be accompanied with earnings call presentation, details of the same have already been shared with you.

I now invite Mr. Mohan Reddy to provide a brief overview of the Company's performance for the quarter ended 30th September 2016.

**B. V. R. Mohan Reddy:** Thank you, Ajay. And a very good evening to all of you, Ladies and Gentlemen. Once again, a warm welcome to all of you for our Q2 earnings call. This is a very special quarter for us. We celebrated our 25th anniversary for the Company during this quarter. I would like to take this opportunity, once again, to thank you all for your continued support and trust in our Company, Cyient.

Q2 FY17 results are in line with our expectations on both revenue and also margin. The growth in the quarter was entirely organic and does not have any inorganic revenues or any one-time revenues. We grew 9.5% in dollar terms and 10.3% in constant currency over the previous quarter. Most of the impact due to the currency, the Pound depreciation impacted our Transportation and Utilities & Geospatial business unit due to a significant portion of the revenue coming from United Kingdom. Growth in the BUs was led by communication which grew by 24% over the previous quarter, Utilities & Geospatial grew by 14% over the previous quarter. In addition to this, our Design Lead Manufacturing or DLM business grew by 34% over the previous quarter.

Our top 20 customers' revenue grew by 9% quarter-on-quarter. Our operating margins at the Group level also improved by 100 basis points, despite a wage hike impact and also a one-time expenditure on 25 years' celebrations. The implement in operating margins was largely driven by an improvement in utilization and also bringing in better operational efficiency across all our businesses. The Prague Engineering Center which opened last quarter has started contributing tangible results. We expect the contribution from this center to increase through the second half of the year. The quarter also saw opening of several more Centers of Excellence aided to extend the current operations of key customers to start operations for new strategic customers.

Our outlook for the year remains unchanged. We expect our services business to grow in double-digits and our DLM business to grow by about 50% compared to last year. We expect our operating margins to remain flat or marginally higher for the year leading to double-digits earnings growth. The operating profit for the current quarter was Rs. 128.3 crores, which translates to an operating margin of 14%; which is, as I said earlier, an improvement of 100 basis points compared to the last quarter despite the headwinds of salary hike, foreign exchange challenges and one-time 25-year celebration expenses. The net profit was at Rs. 97.3 crores, up by 31.5% quarter-on-quarter. Our base sales outstanding stand at 77 days which is a reduction of 12 days' year-on-year.

We celebrated our silver jubilee anniversary at various locations in the second quarter that culminated in a celebration of a grand scale in Hyderabad. Our Company's belief has always been there are four stakeholders who made us successful - our Customers, our Investors, our Employees or Associates and the Society. So, we celebrated this event with all the four stakeholders with the same earnestness because we honestly believe that all of them made us successful and we showed our equity to each one of these stakeholders too. We announced a special dividend of Rs. 2.5 per share on the eve of the 25th anniversary, which meant it would cost us about Rs. 34 crores which has been disbursed already including the dividend tax. But to keep up with the same spirit, we also are rewarding our employees on the occasional silver jubilee by introducing a Restricted Stock Unit Scheme and this will be granted in the quarter which is going to be January 2017. Most gratifying of course that we rewarded the society by opening up 54 digital learning centers by donating a thousand new computers to the schooling system. The impact of this particular initiative of Cyient Foundation will be on 20,000 school children and 50,000 common citizens.

Back to business, we signed Global Partnership Agreement with Pink Elephant to expand the IT services management, delivery and consulting capabilities. We were awarded the CMMI Lab certification for design and manufacturing of aerospace products for Indian military.

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 am on slide number 6 for revenue update. On the revenue update, we have done $136.5 million of revenue or INR 9,136 million. In terms of the quarter-on-quarter growth, dollar term growth is 9.5% and INR growth is 9.4%. There has been headwind from the currency, especially from British Pound that has taken away about 0.8% of growth. In constant currency, we have grown by 10.3% quarter-on-quarter. If you see year-on-year growth, we have grown in dollar terms by 15% and in terms of INR we have grown 18.3%.

In terms of this growth despite broad based it has been all the business unit, all the eight business units have grown. This has been led by double-digit growth from DLM 33%, Communication 24%, Utilities and Geo 14% and then single-digit growth lead by Aerospace and Defense and all other verticals. Transport, you are seeing a (-2.7%) growth in dollar terms, but in constant currency it is 0.6% because Transport and Utilities and GIS are the two verticals for us where we have the maximum impact of the currency. Also, you would note at the bottom that the growth across the geography is also very strong, the growth of 9.5% comes 7% from North America, IMEA is 11% and 13% in constant currency, Asia-Pacific is 17% and 19% in constant currency. So, a very well rounded growth lead by DLM and obviously that growth is likely to continue.

I will go to the next slide, slide number 7. This time the SEBI has issued the guidelines that all the revenue must be reported, including excise duty. So, you would see in this chart we have given a fair comparison of what the revenue would look like had we not included the excise duty. So, $136.5 million would have looked like $135.6 million and the dollar term growth would have been 9.3% in place of 9.5%. Same way, the constant currency growth would have been 10.1% instead of 10.3% that is reported, would have been 10.1%. So, as such the growth of 9.5% to 10% depending on which currency you are looking at, irrespective of the excise duty that is prevailing because we have restated the numbers for all the quarter.

In terms of the income statement, I would like to highlight that while the revenue has grown in INR terms by about 9.5% - 10%, the operating profit has grown by about 18%, INR 1,283 million in this quarter compared to INR 1,090 million of the last quarter, that is a growth of 18% for the revenue growth of 9%. This has happened because apart from the volumes we have also worked on improving the operating margins and in this quarter we have improved the operating margins by 100 basis points. You would see that we had headwinds of almost 170 basis points in this particular quarter, 70 bases each from the second tranche of salary increase that we had. As you all know, the salary increases were planned for the full year in two tranches, quarter one and quarter two; and as we speak all the salary increases have taken place now, there will be no further impact of the salary increases in H2, that has taken away 70 bps. 70 bps, about Rs. 6 crores is what we spent on the 25-year celebration and 30 bps is the impact of the foreign exchange. Due to this headwind of 170 basis, despite that the margin has gone up by 100 basis points the utilization has improved by 4.5% that has given us an advantage of 200 bps and also the absorption has helped. So, it is very nice to see this operating margin going up and we expect this traction to continue. On top of the operating margin growth of 18%, we have seen 31.5% increase in net profit, obviously, most of it is coming from the increases operating profit, other than that the other income has also been favorable, and I talk about it in the next slide, the forward contract that we are booking are giving us good realizations and quarter-on-quarter we have got more realized gains on the forward contract. Third, the ETR, ETR you would have seen last quarter had gone to about 25%, it is back to 22.5% levels and for the full year I think we are very confident of bringing it down by 50 basis points to 100 basis points.

I am on slide number 9, on the cash generation. The first thing you would notice is, for H1 we have generated about Rs. 105.5 crores or INR 1055 million of free cash flow, INR 558 million of free cash flow in this quarter. H1 free cash flow to EBITDA ratio is 14%, you would have seen we have been doing close to 45% - 50%. As you can see, the growth has consumed some of the money in the working capital and that will get released in H2, so we are very confident that this free cash flow will go north of 45% for the year financial year 2017. If you just look at the right hand chart, day sales outstanding, it is 77 days. It is as per the plan, down by about 12 days' year-on-year, flat compared to the quarter-on-quarter and I think the whole balance sheet looks very clean and healthy. Last comment on the bottom chart on cash position, at the beginning of the quarter we had Rs. 802.5 crores or INR 8,025 million of cash, we generated INR 474 million in services business, also we generated INR 84 million of free cash flow in Rangsons. Rangsons also has got lot of discipline around free cash flow now and you will see this positive free cash flow continuing in DLM or Rangsons, that gives us a total free cash flow of INR558 million for the quarter. Dividend was paid out for INR 337 million, repayment of borrowings INR 197 million, closing cash position INR 8,064 million, so we have sufficient cash for further investment in the growth.

Last item before I hand over to Krishna in terms of the foreign exchange, it is very gratifying to see that our foreign exchange policy is really playing. Let me start with the right hand side of the chart, you will see our other income is up from INR 115 million to INR 184 million in this particular quarter. Most of the increase is from the increase in the realized gains from INR 53 million in last quarter to INR 95 million. And if you go back to the chart on the left side, you will see that our forward cover position compared to the current spot positions are about Rs. 4 to Rs. 5 higher on dollar and on euro, in terms of British Pound they are higher by about Rs. 15 and Australian dollar it is flat. That is what is giving us this forward contract income. And as we speak, the total forward contracts are about $114 million, we are in line with our stated policy of 70% of inflows. And if the spot rate was to be at today's spot rate, we would make $8 million of other income on realized forward contract gain in the next four quarters. I repeat, if we were to look at this other income at today's spot rates, what this our forward contract position for next 12 months, we should be making around $8 million of other income. So, I think this other income has been playing out well and the currency wide exposure are given on the top most chart.

With this, I would like to hand over to Krishna. Before that, I would say that Chairman talked about the celebration of 25th year and we are very happy that this quarter's performance has come in this particular quarter of 25th year and we are very confident this momentum is going to continue and I am sure Krishna will talk more about it.

**Krishna Bodanapu:** Thank you, Ajay. So, just to pick up on the quick M&A update which we have been consistently providing. On where we stand with M&A, there is two targets that are in the LOI phase, we are working diligently on those. But other than that it is just a quick summary of where our intent to invest is and the areas that we are focused on in getting out our investments.

Going to the next slide on the industry outlook, and I will try to give you an overview of where things stand, as in color of where things stand in the various industries. On aerospace and defense, I think there is a strong traction in certain areas, for example, avionics which is aerospace electronics. We have actually proactively made some investments and that is turning into some really good opportunities, we have signed on some very large deals and given that it is electronics it also ties well with our manufacturing capability. So, a number of these deals have both the design element and a long-term manufacturing element. Also, what is happening is a lot of the focus is moving away from just design to productions, so a lot of money has been spent on designing a number of aircrafts and related systems, but now a lot of that is going into production. So, if you look at a significant portion of our growth or I would say almost all our growth is coming and supporting the engineering that is required for production ramp up and for production. So, we are doing a number of things on supply chain, on manufacturing engineering, on supplier efficiency and so on and so forth. So, while the new design status is relatively unique our opportunities are quite significant and we see continued growth both in avionics and electronics and also in manufacturing, engineering, supply chain management, etc.

The next is Industrial Energy and Natural Resources or what we call IENR. There basically a couple of businesses that are there which are all the industrial type of businesses. Oil and gas obviously is quite muted. With where the oil prices are right now we are not seeing a whole lot of investments but what we are trying to do there is two things, one is in the current scenario we do have some good offerings for the market, but also the experts believe that by late 2017 our production will again increase. So, we have put together a number of offerings that we can take to the market that help them with ramping up their production which include restarting equipment which include reconfiguring equipment for new opportunities, etc. So, while right now we see that business to be flat, at least for the foreseeable future, when things turnaround I think we have a good opportunity. Having said that though, on the plant engineering business which is where we help companies on infrastructure and helping them design plants etc, we are seeing good traction both in traditional industries, nuclear for example will see a significant amount of traction because there are a number of plants coming up, but also in newer industries like solar and wind. Also, there we have signed up two new customers one of which we announced which was SMEC a couple of months ago or I think a couple of weeks ago, there is one more that is happening as we speak, both these customers are in ramp up phase and therefore we will have some good traction. Transport, transport is most affected by the whole issue with the British Pound currency. So, while we have seen growth and actually Q1 was a very strong quarter, it was a 10% plus growth, Q2 was about a 3% growth but the reported number is (-0.6%) because a lot of that goes away to currency, but from a volume perspective we continue to see some good growth. We have won some projects that we have budgeted for, we are also seen some new customers, we are also seeing opportunities in newer areas, for example historically we have worked only with the OEMS, i.e. the equipment manufacturers. But, last quarter for the first time we also won a pretty nice deal with an operator, because this operator has a lot of assets that have to be maintained and engineered and that is where we come in. So, overall the challenge there will continue to be the dependence on the Pound and Euro, but we continue to see that the volume will grow.

The next industry is Medical Tech and Healthcare. Again, a small industry for us but we are seeing some very good opportunities. It is also an industry where our value proposition is resonating quite well, the design to build as we call it which includes sort of the historic signs, business of design and the historic Rangsons business of building stuff. So both put together, the service offering resonates quite well with our customers.

Semi-Conductors, there is a little bit of pressure with capital investment that turns into fewer number of design stuff. But having said that, at the same time the demand for things like IoT and smart devices etc means that there are some good opportunities. Again, we are in a little bit of a reset phase in that industry, we are trying to get into a situation where we clearly define our offering and what it means to the market. But at least in the immediate term we see that it will be flat, it would not see any headwinds in the coming quarters and towards the end of the year it will again start growing quite well. But again, I think it is a relatively small part of our business.

Utilities & Geospatial, we will continue to do very well. It had a double-digit kind of a growth this quarter but that will continue, or that momentum will continue. Obviously, we will talk about Q3 in a minute here but overall for the year that momentum will continue, I do not see any issues whatsoever over there and we have a good offering. The utilities market is growing, at least for our offering and in commercial geospatial also we continue to do quite well. So, I do not see any significant issues.

The best performer this time around obviously was communication, it grew 23% quarter-on-quarter and I think almost 40% year-on-year. And I think I will sort of take some credit and say some of the things that we have done to make sure that we have a solid value proposition for that market. There is a good growth because of things like NBN in Australia where they are trying to create a national broadband network or CAS-II in the US which gets broadband to rural communities. And we have positioned ourselves very well with a solid service portfolio and with a solid offering.

Also, if you look at the S3 strategy as it is relevant to that market, this is plan, build and maintain, we have put together a good offering across the spectrum. So, historically we have only been on plan which is sort of the detailed engineering, but we have built the design which is the detailed engineering but we have also built domain expertise on plan which includes things like going out into the field and doing service. Again, a lot of the mundane work is done by subcontractors but we have a lot of the domain expertise. Also, we maintain around, again, making sure that we are provisioning networks correctly or even doing field work in terms of making sure that the networks are well maintained. So, our offering, really is the complete offering from the conceptualization of a network all the way through the maintenance of a network. So again, I think I do want to reiterate there because it was a good growth that is the base going forward. All the growth, like Chairman said, there is nothing that is inorganic one-time etc, so it is a good solid growth and we will really build off of this base.

DLM also continues to do well, this is the Rangsons business plus all the capabilities of design and product introductions and so on so forth. Distraction in aerospace and transport overall receives a very-very large deals. My commentary and commitment around doing a 50% year-on-year growth stands. If anything, I would rigorously reiterate what is going on over there in terms of the pipeline that is building up, the opportunities that we are seeing. So, again plan was that H1 was what it was which we delivered which was $23 million and there is a $30 million plus H2 and we are quite confident that we will hit that number for that 50% growth.

So, net-net I will reiterate the outlook that I have talked about earlier, if anything, I will vigorously reiterate the outlook that I have talked about earlier for the year. There will be double-digit growth in the BUs or the core services business which is the historic services business. There will be at least a 50% or there will be a 50% growth in the DLM which is the Rangsons plus, there are some positives and there are some negatives in the margin right now but net-net I will again reiterate that the group operating margin will at least remain flat but most likely be marginally positive which all of which will lead to at least double-digit earnings growth in FY17. The only caveat I will put to that is the RSUs that Chairman talked about, we will have to take a hit against those RSUs as an exceptional item, but we will be very clear and transparent when that happens and how much and why. So, you will have to park that aside for a minute, but without that I do want to reiterate again that it will be at least a double-digit earnings growth this year and we are very confident on what is happening with the business.

It was a good quarter, I again will reiterate that everything that happened in the quarter is organic growth in the business, there is no one-off, there is nothing that is one-time kind of a thing, this is the base. Obviously, Q3 has its challenge with the number of working days and the capacity going down and we start off with a negative 4% because of the capacity related challenges, but that is the reality of our business and we will deal with it. But having said that, taking all that into account I will like to reiterate the forecast that we have been talking about.

I think that is it in terms of the presentation. We will hand it over to moderator for question

**Moderator:** Thank you very much. We will now begin with the question-and-answer session. Our first question is from the line of Ravi Menon of Elara Securities. Please go ahead.

**Ravi Menon:** Just wanted some clarity on the subcontracting expenses and why is that sort of moving up again, should we correlate that with the growth in the communications business?

**B. V. R. Mohan Reddy:** See, I think the way we track our businesses, we look at the gross margin and the operating margin depending on the means of the business it does change. One of the driver of it is the North America utility work which has picked up in this particular quarter, and then there could be other subcontracting works. I think we should really not worry about whether it is direct cost or subcontracting, we have to look at the margin and that margin is moving in the right direction.

**Ravi Menon:** Overall, we are looking at subcontracting as a percentage of revenue at about 7% or so, we were at I think just over 6% a quarter back, so just worried about that trending back up, that is all.

**B. V. R. Mohan Reddy:** That is just a mixed issue because it does not reflect that the margin is going down, what it tells is there is more job which is being done which involves the contracting. Which is for example, if you look at the North America utility, there is a huge growth which has come and which will continue in the coming quarter that drives some of this change.

**Ravi Menon:** And then secondly on the material cost for Rangsons, so this fluctuates quite a bit and the thing that since the margins are quite thin in that business I would say that this is what would determine sustainable margin level. So, trying to understand if we get a better mix, say more aerospace and defense, should we expect those to change?

**Krishna Bodanapu:** It will over a period of time, Ravi. But right now those are the numbers that are there, I mean, depending on the mix it does change on a quarterly basis. But those are the numbers that are there.

**Moderator:** Thank you. We have the next question from the line of Mr. Mohit Jain of Anand Rathi. Please go ahead.

**Mohit Jain:** On your guidance, while you had a fantastic Q2 you seem to reserve the guidance for the same number that we had at the end of 1Q. So, is there any softness that we should expect in the second half?

**Krishna Bodanapu:** I do not think there is any softness, it is just we are going to start off with Q3 with a disadvantage or a little bit of a handicap, in the sense that with the number of working days that are there you end up losing a lot of revenue. So, to my point Q3 we start off with a (-3%) or a (-4%) because some of our revenues also onsite that has a big impact in North America and Australia. India also actually surprisingly Q3 has a big impact because Diwali and Dussera in October, New Year's is always a low time. So, the point I am trying to make is it is just that Q3 is always a tough quarter. So, taking all that into account and looking at our pipeline and forecast, I think it has proven just to reiterate the guidance. Only thing I will say is I am a lot more confident in reiterating the guidance now than at the beginning of the year.

**Mohit Jain:** Second was on your utilization rate which moved up sharply this particular quarter, so is there a change in the way you circulate or is this a new normal of utilization, how should we read that number?

**Krishna Bodanapu:** So, there has not been any change, I mean, all the metrics are like-to-like. Whenever there has been a change in anything we have actually been very proactive and communicating, actually even if you look at revenue, Ajay communicated the excise impact for example. So we have always been proactive if there is a change. It is just, we have had a lot of focus on utilization because that has a big bearing on margin, it just has gotten better. Is it the new normal? No, because in terms of Q3, again it will go down because you do not have available capacity and so on so forth. But it has gone up, structurally we are seeing better utilization and what I will say is we are working off of this base right now, I mean there is nothing that happened this quarter that is one-off. So, it will come down naturally next quarter but it will again go up in Q4.

**Mohit Jain:** Lastly on the tax rate, there was a slide on the presentation where you mentioned there was a one-off in taxes this particular quarter, so what was that and what should we expect in terms of full year tax rate?

**Ajay Aggarwal:** So, I would say in terms of the full year tax rate we should assume a tax rate which is 50 to 100 basis points lower than the last year. So, last year we had 23.6%, this year we should end up somewhere between 22.5% and 23%. What is the one-off in this quarter, we had some gains which came in Europe, we had applied for some tax credits for certain jurisdictions, that came? So, I think these fluctuations in tax rate are natural, based on deferred tax and based on the revenue**.** I would say we should really look at our guidance on the tax rate, that is the right way of looking at it.

**Moderator:** Thank you. Our next question is from the line of Mr. Sagar Lele of Motilal Oswal Securities. Please go ahead.

**Sagar Lele:** Just wanted to understand where the confidence of 50% growth in Rangsons is coming from, given the fact that you would have to end up at somewhere around $59 million for the entire year, that would mean about 36 million for the second half. So, is this coming from the deal pipeline or the order book or how much do you have in hand or are you hoping for some of the deals to convert into orders and then eventually into revenue growth?

**Krishna Bodanapu:** So, it is a combination of both, I think for Q3 the reality is whatever the Q3 number is most of it has to already be in the bag as an order because what happens is while the dynamic is a little bit different in terms of lead time, in our services business the lead time is manpower, here the lead time is material. And because again, some of the material that we use is quite sophisticated, there is a long lead time. So, Q3 pretty much what we have internally been looking at as Q3 growth is in the order book and Q4 is also in the order book and there is a bit of a pipeline. So, it is just a combination of these two things, like you said 23 million has to go to 36 million or so but also this quarter we did 13.5 million. So, it is not a steep increase because again, and again I do not want to sort of speculate on what are the combinations to add up to 36 million but basically both between order book and pipeline that gives me the confidence that we will hit the number.

**Sagar Lele:** And also, has there been any progress on cross selling Rangsons offerings to the existing customers of Cyient, at least the top 10 that you were probably earlier targeting?

**Krishna Bodanapu:** Yes, absolutely, I think both existing customers of Cyient, again I would say if there is one sort of oversight, it was an over expectation of how quickly that would happen but it is absolutely happening, I mean, we are seeing some significant bits that we are putting into our top customers. We have also generated some revenue from them for the Rangsons kind of services and also some of the new deals that we are talking about are very-very significant. So, the premise absolutely holds, it is just hat disappointments at least for me is it has just taken a much longer time than what I had originally anticipated, but the premise absolutely holds.

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

**Madhu Babu:** So, are there any onsite projects which have driven growth over the last two quarters and which can roll off in Q3 and Q4?

**Krishna Bodanapu:** I mean, the growth onsite has just been a little bit more than offshore, that is what has been happening. But again, nothing that is one-off or specific, I mean, all the projects are sustainable projects, there is nothing that is particular one-off onsite project that has given us any additional revenues. And even most of these onsite projects also have offshore component, so that is how business is evolving right now, there is a mix bag between the onsite component around domain expertise and so on so forth and offshore and on efficiency. So, nothing one-off, I mean, everything is part of the course.

**Madhu Babu:** And sir, how should we build 3Q in the core services business, can we take a 2% - 3% growth when you say softness, because last two quarters have been very good?

**B. V. R. Mohan Reddy:** Madhu, we had agreed that we are going to give the guidance for the full year and we are getting away from the quarterly guidance, so we are very-very confident about the guidance for the year and we would not like to comment about specific quarter. The point Krishna made is that in terms of whatever revenue which has come, that base is solidly there, that $136 million of this thing, the capacity will go down from there by about 3% to 4% in some of our businesses because of lower number of working days and then obviously there will be plusses and minuses, beyond that we would not like to comment on any particular quarter.

**Madhu Babu:** And sir, congrats on the DLM margin moving positive, I think that is a 2.5%. So, when you say DLM is going to see good traction for H2 so how should that imply on the consolidated margins and what would be the steady state margins for the DLM business?

**Ajay Aggarwal:** In short-term we are still looking at something like low single-digit margins for the year and we are trying to work on breakeven for profit and cash for this particular year. This quarter for example, we had Rs. 8 crores of cash generation, last quarter we had (-11 crores) of cash generation, now we are targeting that we have a breakeven cash and breakeven profit. And on steady state definitely we would, our aspiration still will be in the years to come when that pipeline of our cross selling comes in, we have to get to the double-digit margin there.

**Madhu Babu:** And sir lastly, how should we read this order book, I mean, the services order book total outstanding is around 50% both year-on-year as represented in 2Q, $133 million compared to last year it was $88 million. So, would that indicate substantial acceleration in momentum in core services business because these metrics you are giving only for last two quarters?

**Krishna Bodanapu:** I would say, it definitely indicates acceleration momentum, the question is how substantial I would read. And again, I would say the reason why we have only been giving it for the last two quarters is we have had it only in a format where we can completely sort of have confidence in the numbers. There definitely acceleration in the business and we will be as transparent as possible with that, but I would not say it is a like-to-like correlation, I mean, a growth of 50% does not necessarily translate to a revenue growth obviously in that range.

**Moderator:** Thank you. We have the next question from the line of Vivek T from Best Pals LLC. Please go ahead.

**Vivek T:** I have two questions about DLM, I want to understand where are the opportunities coming for us in the electronic manufacturing services space, is it just the aerospace and defense or is it industrial or is it telecom, where are we going to find opportunities going in the next two, three, four years when you scale up this DLM given that we are now including…? And the second question is, how did we plan to take more of B2S jobs, from built-to-print to build-to-design? Thank you.

**Krishna Bodanapu:** So, I would say a couple of things on that. One is, the jobs are coming across the board, we are focused on a couple of industries and there is really a good momentum across the industries, be it aerospace and defense, rail, medical, etc. So, it has been quite a good mixed bag of where the deals are coming from. And for B2S, it has been a little bit of a struggle to build a proper organization because it is not just the factory, factory just becomes a B2B, we have built supply chain, we have built new product introduction, we have built design, etc. So, we have built a lot of capability around that and if you have time and visit there, you can meet some of the management who have done this kind of work. Also, I will just caveat this by saying that DLM is 10% of our business or less than 10% of our business, it is a good growth driver for the future but also look at the core services business between that is also growing very-very well at this point. Just on the core services business we had a 6% to 7% growth quarter-on-quarter which I do not think there are many services businesses that are also growing at that rate at this point. But leaving that aside, DLM is important obviously for the future, we are doing a lot of work, we believe that therefore the B2S projects will start, we have build the team, we have build the capability but also look at it in the context of 10% of our revenue.

**Moderator:** Thank you. We have the next question from the line of Gaurav Rateria of Morgan Stanley. Please go ahead.

**Gaurav Rateria:** Just an update on Softential, how is it progressing and when do you think it will be back to its normal growth trajectory and margins?

**Krishna Bodanapu:** So, I think we have already seen in H1 a lot of traction compared to H2 where we had sort of reached the bottom. So, in terms of new management structure, new leadership, I think all that is showing up, the new sales have taken over. So, we have already seen about 10% - 15% growth in H2 compared to H1, in H1 compared to H2 of last year. There are software deals which are coming in, we expect a lot of further growth in H2 and that could again give us another 50 - 70 bps improvement over H1 and H2. So, worst case we are looking at some $15 million to $16 million of revenue from there, best case could be $18 million to $20 million of revenues from there.

**Gaurav Rateria:** And also if you could help us identify some of the tailwinds and headwinds for margins in second half, probably the one-off expenses will not be there, Softential will come with better margins. So, how should we think about overall second half, what are the headwinds which you are thinking?

**Krishna Bodanapu:** See, in terms of the headwinds, the quarter three always poses a challenges that we have to pay for the working days for which we cannot use the capacity, so normally that impacts the margin in quarter three. But again, quarter four we have built from where we left on the utilization, get back to the growth and that gives you. So, I think utilization and operational efficiency definitely will continue to be tailwind. There are no major headwinds that we are aware of, further growth will also give us SG&A benefits, both DLM and SMA business or Softential business also will contribute in H2 with the higher traction and higher volumes. So, these are some of the levers that we look at in H2. But I would say in each one of them, with all these one-off there is only one way we can only go not now on the operating margins, especially leave the issue of capacity in quarter three.

**Gaurav Rateria:** Last question, just on 3Q you talked about capacity reduction, this would be probably as usual like historical years or do you think anything unusual is there and is it only a conservatism which is letting you to kind of maintain the guidance despite 2Q better than expected?

**Krishna Bodanapu:** See, I will say that is your call, I will leave it up to your judgment, I think we are just being as prudent as we can be. But your first point is nothing, it is a normal stuff, I mean, there is absolutely nothing that we see in Q3 that would be extra ordinary, 3% to 4% will be the loss in capacity. We see ways that we can make most of that up and we are quite confident of that, but again it does have an impact on margins because you are paying for a lot more capacity than you actually have because the salary cannot change for example of individuals. So, I would say we are being prudent but there is nothing extraordinary in Q3.

**Ajay Aggarwal:** One more comment if I may make, in terms of the growth coming from the top customers, if you really see that the 9% is the growth which has come from the top 20 customers in the services business and that traction is really showing up and that is likely to continue, so that gives us confidence that other than capacity there are no issues on top customers that we are aware of which will be there in H2.

**Moderator:** Thank you. We have the last question from the line of Neerav Dalal of Maybank. Please go ahead.

**Neerav Dalal:** Most of my questions have been answered, I just wanted to know the absolute revenues of Softential in this quarter.

**Ajay Aggarwal:** Absolute revenue of Softential, we will check and get back to you, I think it is $3.6 million - $3.7 million.

**Neerav Dalal:** And in terms of the growth that you are seeing in telecom…

**Krishna Bodanapu:** It is not Softential growth in telecom, it is actually pure services.

**Neerav Dalal:** Yes, yes, so the pure services growth does you see it maintain this growth momentum or do you see it slowing down going ahead?

**Krishna Bodanapu:** So, it would not be the same volume in terms of we would not grow 23% quarter-on-quarter because obviously that is a very large number, but the pace is there. For example, whatever we have debt there is nothing one-off so it will grow on top of this. Also, what has happened is and hopefully you will see some information or we will talk about it during the course of the quarter, we have signed one or two very large deals also which will continue to keep that momentum up. Now, I will say 23%, honestly I would be very surprised if in say Q4 we again, and I say Q4 because Q3 will obviously have its challenges but in Q4 again if we grew 23%, but it will be a good solid growth for the foreseeable future because the existing customers are growing well and we are signing up new deals.

**Ajay Aggarwal:** Just to confirm, SMA revenue is $3.5 million in quarter two.

**Neerav Dalal:** Yes, because what I wanted to know is, in the sense would you be worried that telecom is growing fast rate and couple of customers growing a lot faster than the company average, so it is getting more concentrated growth?

**Krishna Bodanapu:** No, not necessarily because as much as there are those telecom customers, if you look at say our top 20 customers there is only two telecom customers in that, maybe two or three telecom customers. And that would not significantly change because while say Telstra which is probably one of our top three customers right now is growing, the other two also in the top three are growing reasonably well, I mean, maybe not at the same sort of blistering pace but they are growing reasonably well. So, I think the reality of our business at our scale is that customer concentration will always be there. So, as long as we are doing a good job about building relationships so we do not get blindsided, mitigating against any risks and not sort of overtly dependent on making investments etc, we should be fine. So, I am not too worried about that, it is just… even if you look at some of our largest customers, they are still in the tens of millions of dollars, they really need to pay in the hundreds of millions of dollars.

**Neerav Dalal:** Yes, it's just that your top five has moved up from 35% to 43%, so that is what is worrying.

**Krishna Bodanapu:** See, that will be there because you look at the top five, they are five of the largest companies in the world, they are spending a lot of money in areas where we are relevant, we are doing a lot, we are becoming a lot more strategic for them. So, again that is the nature of our business, I would not be too worried about it.

**Ajay Aggarwal:** Just if I may add, I think you should look at our top 20, top 10 customer or top 5 customers, I think a lot of them are having almost, if I may say, 1.5x or 2x the average growth of the company, so it is not only one customer there are customers in BIS, there are customers on transportation, in aerospace, in utility, in energy, communication, all these customers are growing at outlier rate of growth, so it is not only one.

**Moderator:** Thank you. We have one last question from the line of Mr. Sandip Agarwal of Edelweiss. Please go ahead.

**Sandip Agarwal:** Sir, I have one question which is more of macro in nature. Just wanted to know are you seeing some signs of cautiousness or something in the European and the UK region because of Brexit? That is point number one. Point number two, what is your sense that the way the GBP is depreciating, is there a scope to renegotiate the contract to some extent or is there any way you can get rewarded there for the loss? And finally, I know your business does not have that much impact of cloud but are you seeing anything, any kind of trend there?

**Krishna Bodanapu:** So, the middle one I will answer, there is no chance that we will be able to renegotiate contracts because I think at this point UK actually if anything I would argue, the slip of the problem exists that UK itself is becoming more and more attractive to some of the work. So, I think renegotiating the contract, I would be very-very surprised if anybody can do that. But having said that, I will say the impact on our business is relatively lower because a lot of work that we do in the UK is for the UK market and basis some very large infrastructure projects that have been already funded, for example, I think it is called H2S which is one of the largest high speed train project or if you look at the signally upgrade for London underground, these are some very large public works where there is funding and government is committed to doing the funding. So, most of our work in the UK is because of these kind of projects. Also, there is one or two customers where there is a risk because there is some European angle to it or a EU angle to it, but again Brexit has not happened yet, it is a two year process and we will figure out what is the best way forward within it. Extending that to Europe, also if you look at most of our business in Europe is for large infrastructure projects around the world or for large capital projects around the world, what I mean is Bombardier is building a train for say Mecca or Bombardier is building a train for Melbourne and therefore we are doing work for them. So, they are more global dependent rather than very Europe dependent. So, in that context I am not, I mean, obviously we have to be cautious but I am not too worried that the European situation be it Brexit or just the general tepid market in Europe impacts us.

Also on to your last point on cloud, we do not see a huge amount of impact because of that. Yes, there are always some opportunities because if you look at what is happening because of cloud, the extension of that is IoT because a lot of the IoT kind of data gets stored in the cloud and the extension of the IoT is you have a lot of sensors and computing powers, silicon on devices across the world which means that there is a lot of design and manufacturing. So, I would say we are seeing some good opportunities because of that, for example, there is a large project around a train control system that we are working on which is because data can be efficiently captured and then stored in a cloud and analyzed. So, I would say if anything I think there is some positive impact, I mean it is not like we do application maintenance and that is going away, it is because of cloud people have to redesign intelligent products and build intelligent products and that is what we do best.

**Moderator:** Thank you. Due to time constraints that was the last question. I would now like to hand the conference back to Mr. Sandip Agarwal for any closing comments.

**Sandip Agarwal:** Thank you, everyone, for participating in the call. I will hand over the call to Mr. Reddy for his final remarks. Thank you and over to you, sir.

**B. V. R. Mohan Reddy:** Thank you, Sandeep. Again, I would like to thank everyone of you who has participated in this call today. As I said, it has been a very special quarter for us for we celebrated our 25th anniversary, we like to once again thank you for all the support you gave us and the trust you showed to us, it is almost 20 years since this company has gone public. Again, we want to reassure you that this company is built on values and we certainly will be as transparent as we can to make sure that you get the right information from us. Thank you, again. Thank you.

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