

CYIENT

“Cyient Q1 FY2018 Earnings Conference Call”

July 13, 2017

CYIENT



ANALYST: MR. SANDIP AGARWAL – EDELWEISS SECURITIES LIMITED

**MANAGEMENT: MR. BVR MOHAN REDDY – EXECUTIVE CHAIRMAN –
CYIENT LIMITED**

**MR. AJAY AGARWAL – CHIEF FINANCIAL OFFICER –
CYIENT LIMITED**

**MR. KRISHNA BODANAPU – MANAGING DIRECTOR &
CHIEF EXECUTIVE OFFICER – CYIENT LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to the Cyient Q1 FY 2018 earning conference call hosted by Edelweiss Securities Limited. As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone telephone. 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: Thanks Janis. Good evening to everyone. On behalf of Edelweiss, let me welcome you to the Cyient Q1 FY 2018 earnings call. We have with us the Senior Management of Cyient, headed by Mr. BVR Mohan Reddy along with senior members of the management team. Without further ado, I will hand over the call to Mr. Ajay Agarwal to start the proceedings. Thanks and over to you Ajay!

Ajay Agarwal: Thank you Sandip. Let me just welcome all of you to this Cyient's earning call for the Q1 Financial year 2017-2018 ended June 30, 2017. I am Ajay Agarwal, the Chief Financial Officer for the Company. Present with me on this call is also our Executive Chairman, Mr. BVR Mohan Reddy and also Mr. Krishna Bodanapu who is our Managing Director and Chief Executive Officer.

Let me make the customary statement that 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 on our investor update, which has been emailed to you and also posted on our corporate website.

As usual this will be accompanied with the presentation like we have been doing every quarter. Now I would request Mr. Mohan Reddy to provide a brief overview of the Company's performance for the quarter ended June 30, 2017.

BVR Mohan Reddy: Thank you Ajay. Very good evening to all of you, ladies and gentlemen. I welcome you all to this start conference call. Q1 FY2018 was in line with our expectation both in terms of revenue as also margins. We saw strong year-on-year revenue growth of 12.8% in US dollar terms at US \$141 million.

For services business we saw a year-on-year revenue growth of 12.4% and a quarter-on-quarter growth of 3.2%. The services business at US \$129 million is the highest ever revenue we grossed for this Company. The growth in our services business was driven by communications, transportation, and semiconductor business units. The Design Led Manufacturing, DLM business continues to improve performance and deliver a double-digit growth year-on-year.

There were robust year-on-year operating growth at 6.5% in INR terms at Rs.1160 million despite wage hike and rupee appreciation. For the quarter, we saw a net profit year-on-year growth of 18.7% at Rs.878 million or 87.8 Crores. Cash and cash equivalent crossed the Rs.10

billion number for the first time ever. That is 1000 Crores of cash. Precisely we have 1032 Crores which is highest ever in this Company's history.

The free cash flow/FCF generated stands at Rs.468 million or 64.8 Crores which is 43% of our EBITDA. Attrition has come down both voluntary as well as involuntary attrition together are at about 18.5%, which is the lowest ever in the last 11 quarters.

Recognizing our focus on strategy, we were awarded the Times Network Award for Strategy from the Institute of Competitiveness. This award serves as a strong and credible endorsement of our S3 strategy and acknowledges that our design built, maintain value proposition is not only shaping our industry positioning but also redefining the basis of competition and helping us accelerate our growth.

As a part of our ongoing CSR initiative for the quarter, we adopted nine more government schools under this programme called Adoptive School Programme supporting underprivileged children taking the total to 25 schools in all that we support currently just on the Adopt the School Programme. The girl child population in our schools stood in excess of 54% and that is very gratifying.

As a part of our initiative to increase the IT literacy, we have also added eight more Cyient Digital Centres taking the total to 54.

On the infrastructure side, we have opened a near shore centre in Bengaluru for one of our customers. We have also started working for another aerospace customer in our Prague centre. I am happy to report that Cyient has signed a MoU to establish the presence in Telangana with the Medical Technology Park.

On operational update, Cyient DLM business got approved as a product supplier to UTC Aerospace Systems with whom we have had a relationship spanning over 15 years.

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

Ajay Agarwal:

Thank you Mohan. I am on slide, Revenue at a Glance, Slide No.6. In case if you have any difficulties with the technology, I will read out the slide numbers and the titles. If you look at this particular quarter, we have 3.2% in Services and in DLM we had anticipated internally the kind of seasonality impact and it is in line with our internal expectations. We have also reviewed how it looks for the full year hence very much on track.

If you look at the full year, the year-on-year numbers, we had a growth of 12.8% and if you look at the left hand side, you will find that six out of eight verticals have double-digit growth except for I&ENR where we have some challenges. I think all the verticals are growing year-on-year and Aerospace and Defense is also picking up as of now it is a little muted and if you look at the bottom chart, the growth is quite widespread across geographies we are seeing the traction.

In terms of the income statement, I am on Slide No.7, you would see that we have made a net profit of 878 million while if I compare like-to-like in terms of the overall profits for the last quarter, we do have a dip in this quarter, but as all of you know, Q1 for our business is the wage hike quarter. We also had some headwinds, which happened because of the rupee appreciation against dollar, which was about 3%.

Let me just give a little more commentary about the wage hike like the last year we had done the wage hike in two phases. The total impact planned is about 180 to 190-basis points. Half of it has come in Q1. The rest of it will come in Q2 and net-net if you see after the wage hike and this 3% foreign exchange impact we have a gross margin, which has improved quarter-on-quarter. Net-net operating profit is down by 50-basis points. So that really gives us for those of you who have been seeing our quarterly performance, a good footing for rest of the year and in terms of profit after tax the only thing I would like to highlight is that if you look at this quarter the other income continues to be good, which is in line with what we had anticipated looking at the position of our forward covers.

Also I think there has been a headwind in this quarter. You are looking at a tax rate of 31%. I would say if you take out the one offs the correct number to look at is 27%. What has happened starting April 1, 2017 majority of our special economic zones has moved into the 50% tax bracket as against 100%, which we enjoyed in the previous five years.

The impact of this is compared to the last year where we had done 24%; we are expected to clock a tax rate of 26% to 28% this year. This range partly is dependent on how exactly we do in terms of the SEZ headcount increase, deployment which we feel there is a good potential in this year given the growth. Also it will depend on some other initiatives.

Overall based on this we had 18.7% growth in net profit which is again, I will say quite nicely done in terms of growth of operating profit year-on-year as well as other income partly taken away by the tax.

Coming to the cash generation, as Chairman mentioned we exceeded 10 billion INR. We are at 10,320 million INR in terms of the cash position, which is about \$159 million. In this quarter we have generated a free cash flow of 767 million INR at a good conversion of about 42.9%. On services this number is 49% conversion, so we continue to be at about 50% conversion in services. In case of DLM we did have cash consumption but we are very confident that this is the last quarter where we are seeing the cash consumption by DLM. Going forward when we look at the next three quarters we are very confident that this number is going to be positive and as such for H1 the sigma of Q1 and Q2 itself is likely to be positive and the cash usage has been in terms of some of the investments which we have been apprising you from time-to-time including some of the initiatives on IT development related collaboration.

In terms of the hedge book if you look at the right hand side, you will see a good growth in other income from 265 million of last quarter to 351 million. Most of it continues to come either from

the treasury income, which is 115 million, and the realised forward contracts, which is 216 million. Again I repeat these are actual realized gains on the forward covers.

Looking forward I this trajectory at least for the next three quarters should continue because company continues to have the same policy of 70% of net inflows to be covered under the forward covers. The total build up of that if you look at the chart in various currencies is \$118 million and at current spot rates we anticipate a gain of about \$7.2 million and about \$6.2 million is in current year and rest of it is for the next financial year. With this I would request Krishna to give us an update on investment pipeline and business outlook.

Krishna Bodanapu:

Thank you Ajay. As we have done in the past I will give you an update on the M&A and then the outlook on the business and the overall financial outlook for the year. But in terms of the M&A pipeline they continues to look strong which are in several discussions in the pre-LOI stage and one in an LOI stage which if all goes well we will announce during the course of the quarter. There have also been a few corporate investments that have been made from a corporate venturing perspective. There is no change in what we have articulated as our active investment pursuits, which we continue to look at, and we have actually seen some good traction in some of those areas and opportunities.

Going to the industry outlook on the global aerospace and defense market, I want to say the quarter was a little bit of a two stories in one in the sense that we are seeing some very good traction both from our existing business which is the business that we have been doing for a while now obviously and also in the new business which are things like Certon and also the DLM for aerospace. Overall the sector is actually doing quite well because there is just a lot of deliveries of aircrafts that are happening globally.

As I have said in the past what that means is there is a lot of opportunities and supporting things like manufacturing, engineering things like aftermarket etc., and not necessarily in new programmes. We see that transition and we have spoken about that multiple times and therefore we believe we are quite well placed at least to maintain the current levels of business that we see.

The communications industry continues to be quite growth industry at this point at least the path of the value change that we are addressing. There is just a lot of investments that are going on for a high speed infrastructure around cable fibre deployment etc., also there is a lot of investments that are going on in areas like small cells which is basically a way to enhance 4G networks before 5G networks come in and we have some very, very strong competitiveness in these areas both in Asia-Pacific specifically Australia, the US and also Europe in all three locations we are seeing some very strong traction in communications and we believe that that will continue at least for the foreseeable future.

The U&G industry, which is the next industry, I will talk about again. The industry itself is going through a bit of transformation because as most of you know this industry is something where infrastructures have been placed or has been of interest for a while, companies are really leveraging the infrastructure and investments only happen every so often, but what we are seeing

is the proliferation of the so-called digital technologies be it advanced metering, smart metering, smart grids, all those self correcting networks all those kinds of things are coming in which means that there is a fair amount of opportunity to invest in these areas. Our outlook therefore remains quite positive both the existing business and also the data capture business which if you recall of the Blom acquisition we did late last year, both of them continue to do well and we are quite confident on what is happening there and how business growth is coming and the momentum that will carry on for the rest of the year.

The rail transportation industries also witnessing some large scale investments in infrastructure globally. There is a 3% expectation of growth this year, we are obviously very, very well positioned, we are pretty much every major rail OEM. If you look at it this business unit did exceptionally well this quarter where double-digit year-on-year growth and we had close to actually double-digit quarter-on-quarter growth. The momentum continues there, we do not see any challenges at least through the rest of the year and therefore I am quite confident we will be able to leverage the overall growth in the rail transportation industry.

I&ENR, which is Industrial Energy and Natural Resources, we continue to have a challenge here. The market is soft and our historic service offerings here around mechanical design, some amount of electronics etc., do not really resonate very well in the soft market. While we continue to work well with some of the largest companies in the sector, we believe that we do need to transform our services a little bit and that is why there is a lot of focus on things like Telematics, electronics, Internet of Things, analytics, etc., but this is the one area that will be a concern through the rest of the year.

Again I will say the good news it is about 7% or 8% of our revenues so the bearing is quite limited, but this is definitely a soft sector at least as I see for the rest of the year.

The semiconductor industry is also doing very well actually if we look at the growth in the industry expected to be 7.2% for an industry of that size is actually very, very significant. That is also translating to good business for us if you look at the growth quarter-on-quarter it has been very strong. We will see a little bit of softness from revenue perspective there just because we are also trying to transition a lot of the overseas work into India, but that will also be quite helpful from a margin perspective. But net-net I will say the momentum is there, that business is done very well in Q1. It will continue to do quite well through the rest of the year and also as you may recall from the last few times, we have new leadership and I think finally we have some very good stability in that business that will help us to deliver some pretty numbers for the year there.

The next set of industries are the Medical Technologies and Medical Devices, again another industry that is growing quite well, CAGR of 4.5% on a \$340 billion industry obviously is quite impressive and there is a lot of emerging trends that are occurring there be it the proliferation of digital technologies, the proliferation of lower cost devices, smaller devices etc., and again we believe that our value proposition there is starting to resonate very well. This is one industry where we are truly doing design led manufacturing projects which where we take the design, re-design and then ultimately at least stated up to a prototype stage for a customer to then take it

through their regulatory approval etc. We have added three new customers there during the course of the quarter, three of the largest medical device companies in the world and when I say added we have actually done it not just 1%, 2% type deals but quite significant and we will see this play out over the next six months.

Lastly the DLM business unit, which cuts across, all these BUs. I think to Ajay's point I want to substantiate saying Q1 was soft which was anticipated which is expected also if you look at it last year and the year before we have owned this business, this is the third Q1, every Q1 has been soft in the business. There is absolutely nothing to be concerned about there it is the cyclical nature there and when I talk about the outlook for the year I have already explained it. But basis the pipeline and more importantly basis the backlog and the POs in the system we are quite confident that we will have a good year over there and going forward. I just want to reassure that Q1 has no special meaning. It is just Q1s are soft. That is the nature of the business and that is what it was this year.

So if I summarize this I will say the future outlook for FY2018 remains what it was when we spoke at the beginning of this year. We will see double-digit growth in the services business. If you see there was a 3.2% quarter-on-quarter growth in the services business. There was also a double-digit year-on-year growth and we continue to see the momentum, so I am very confident that we will see double-digit growth there.

The DLM growth will be 20% plus again I am saying this basis the backlog in the pipeline that we have or actually the basis the backlog that we have and not even the pipeline. So I am quite confident that DLM will grow 20% plus. Margin expansion will be 50-basis points or so through operational efficiency. We broke it down a little bit. We are seeing the benefits especially things like pyramid correction which we put a lot of work into over the last couple of quarters. So we are still quite confident. If we look at the in spite of the currency headwinds and in spite of the wage hike, the drop in operating profit was above 50-basis points which is absolutely something that we anticipated and we built that into our budget and with that we are confident that we will come back to a plus 50-basis points for the year and you will see some good improvement in Q2 which will substantiate it.

Net-net while to Ajay's point, tax has been a concern in Q1, we believe that there are a number of initiatives in place that will also mitigate some of that effected I do not want to say negate because that was also anticipated given that we have reap the fruits of the SEZ tax benefits for five years. This was anticipated, so I do not want to say we will mitigate it, but we will negate it but will definitely mitigate some of it and net-net we will have double-digit earning growth. Fundamentally if you look at the numbers we actually had a very, very strong Q1 even taking into account the effects in the salary increases it is just that the tax also hit us a little bit that is where earnings growth which obviously was good but it could have been much better if that was in there.

So net-net I want to reassure you that the commentary that we gave at the beginning of the year absolutely holds for the rest of the year and we are very confident that we are headed towards those numbers. With that I think we will open it for questions.

Moderator: Thank you. We will now begin with the question and answer session. We will take the first question from the line of Vishal Desai from Axis Capital. Please go ahead.

Vishal Desai: Thanks for the opportunity. Good performance on the services side. Quickly in terms of the overall outlook that you all are expecting, could you break it up in terms of what is the outlook on your aerospace division and further into the aerospace what is the kind of traction that we are seeing on the DLM side of the business?

Krishna Bodanapu: If you look at the aerospace, the services business of aerospace over the last five years we have grown at about a CAGR of close to 10%, I think it is a shade under 10% but about 10%. The services business, this year and I am just talking about aerospace here, the services business in aerospace this year will probably grow a little bit lower than that we are expecting. There are some headwinds that we are facing. There are also some good opportunities. So net-net we will grow somewhere in the ballparks, slightly lower than that, but where we are seeing significant opportunities in the aerospace business is with the DLM opportunities. We have a couple of contracts that have been signed, POs that have been issued where we are beginning what is called the NPI, the New Product Introduction that is really doing the first couple of products, doing the engineering, which also is a significant portion of that, so once those start kicking in from Q3 onwards we see some very significant opportunities kick in, in the aerospace DLM, so taking that into account, we will definitely see a double-digit growth in the aerospace business all put together, just pure services will be under 10%, but once you had the DLM, it will be above 10%.

Vishal Desai: If I could just break it down further in terms of the MRO opportunities. Just in terms of the MRO opportunity that we are currently witnessing could you give some colour in terms of the kind of wins that we are seeing or any kind of trends that we are seeing, given a GSE Asia acquisition?

Krishna Bodanapu: So the most of the growth or a lot of growth is coming from MRO aftermarket manufacturing engineering, so we have seen a number of wins. I do not want to talk about the specifics because there is a sensitivity there, but we are seeing a number of wins – we have seen a couple of Asian customers and also a couple of western customers, so across the board we are seeing some good wins from the MRO type of business. I will call it basically the aftermarket and support business.

Vishal Desai: Ajay, quickly if you could just help me understand what are the levers that we have for a 50 bps expansion in margin particularly in terms of utilization and any kind of pyramid data that you could provide us to understand what kind of correction are you further envisaging?

Ajay Agarwal: I think what we are seeing this that utilization for example if you look at where we ended last year and what has been the performance this year, has huge potential of improvement and that is what we said at the beginning of the year that is a very important lever for us. At least we feel we can improve by 2% to 3% during the year across verticals and that impact is really not there in current quarter results, where we have already seen some improvements. If you see in terms of the pyramid corrections and SG&A we have said about 150 bps to 170 bps we can get from that. This quarter we had seen good traction already coming in from improvement in onsite margins as well as the deal margins on the new business on onsite is also improving. Offshore in certain

cases on matured businesses has also been improving, so I would say this is where the benefits are coming depending on how we perform in each of the seven verticals somewhere it will come from utilization, somewhere from pyramid, somewhere from offshoring, overall as a group we are confident that we will be able to offset the wage hike and a little bit of pricing pressure through these operational improvements.

Vishal Desai: Just one last thing from me, currently margins are at around 12.8% at EBITDA levels, are we expecting any kind of uptick in Q2 or do we expect it to be impacted given that we are expecting half of the wage hike cost to kick in as well?

Ajay Agarwal: So as we spoke, the 92% of the revenue has come from services business and our margin in services business is 14.6% for this quarter. That is after the currency headwind, after the wages headwind. We are very, very confident as Krishna said there is going to be a good growth, there is going to be good improvement on operational efficiencies and you will see good evidence of this margin improvement in next quarter and also if I may comment about DLM as you know we are looking at a scenario last year where we are breaking even at operating profit level, so we are very sure that by while we did about given the very low volumes and some other headwinds we did about -7% operating margin. We are very confident the worst case is where we were last year. So at least we do not have any headwind at all from DLM and services as I said is absolutely on track right from the Q1.

Vishal Desai: Thanks. All the best.

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

S. Ramachandran: Krishna, wanted to get your thoughts on the strong growth we have seen in Europe or Continental Europe, as the case maybe is it something you had anticipated or there are some positive surprise also to see a kind of growth we have seen?

Krishna Bodanapu: I think this is something that we anticipate Srivatsan. I think one of the good things that is happening is on aerospace last two, three years we have had a little bit of a soft run in Europe primarily, so I think that is coming back, which is good. Also there is a good ramp up in Comms with Liberty Global is kicking off that has been helpful and the third thing is Bombardier has been doing very, very strongly and that is something that we have been anticipating for a while, so there is nothing here that we did not necessarily see coming through and I will say that other thing is the rest of the customers all of them did what we expected to do so there was no negatives also, so that being the case, I would not say anything that we did not expect happened.

S Ramachandran: On the overall scenario is there any sense of especially in UK given the way pound has kind of played sustainably is there a chance of any price hikes in your existing customers that is possible given profitability in those aspects would have been taken it, given the way the pound has especially moved in the last 12, 18 months. It is sustained at these levels, any thoughts, and any conversations on what is being client feedback?

Krishna Bodanapu: I think price increase at this point is or at least basis the currency price increase has not necessarily a sustainable conversation or a conversation we can have. I think if you look at it a lot of these longer term contracts also we had signed for example when the pound was 80, 85 five years ago, six years ago, so I think immediate pushback again there are some specifics where things are different, like if we have a low margin account with pound and therefore we can go back and have an argument to have with the customers, but in general I would say the immediate pushback from most customers is when pound appreciated, we did not get a discount, so when pound depreciates why would we give you a price increase.

S Ramachandran: Thanks. I will come back later.

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

Gaurav Rateria: Krishna, could you please help us to understand what really happened the utilities vertical you talked about ramp down in few customers?

Krishna Bodanapu: It was just anticipated, Southern California Edison, which is a big part of that business continues to grow well. It is just that there are quarters where we do more work and less work because there is also – the input to that is field work, so we actually need to have sort of people on the ground who can go into the field and look at some of the data etc., so Southern California Edison is one where it is just cyclical and this quarter we anticipated lower work. Also there are one or two projects that have ended, we do have backfills for them. For example, a large utility project in the US that will kick off or that has kicked off, it is just that we anticipated it to kick off a little bit earlier, so this was actually, if you look at that business from a budget perspective they are pretty much on budget they are about \$100,000 above budget which for \$25 million business is quite good. It is just that the cyclical nature of the business.

Gaurav Rateria: Is there any moderation or change to your outlook within the services business because last time you were mentioning that services would grow in double-digits in fiscal 2018 in similar to fiscal 2017 now that comment is not there?

Krishna Bodanapu: No. I think it is still be in line with fiscal 2017. I think that is expected, so I still hold the inline with fiscal 2017. I think it is just an oversight that we did not put that.

Gaurav Rateria: On the DLM part have you seen any meaningful conversation with respect to that part of the business, really starting getting traction this part of the year or do you think this will be largely FY2019 phenomenon and you also talked about turning cash positive does it mean that on the margin side the DLM business will start showing a turnaround from Q2 itself?

Krishna Bodanapu: I think first in the business, let us say there have been a lot of conversations on the synergy revenue from our existing customers and there is just a number of conversations in aerospace, in defense, in medical, because these are two focus areas, there maybe transport to some extent, three focus areas. So we are seeing some meaningful conversations and between Q2 and Q3, we

will also start a talk about them because right now we are still have not delivered anything, so it would not be prudent to talk about it, but in Q3 onwards especially we will see us delivering to those contracts, so that is what gives us the confidence that we will have a strong Q3, actually Q2 onwards it will be pretty descent.

Now in terms of the margins, we are still in an investment mode there, so from an operating margin perspective we will be about a breakeven for the year. Cash we will be better because as right now we are consuming cash because we building up inventory and we are building up a lot of product for Q2 onwards, so once we start liquidating that product and that inventory the cash will turn positive, but again like I said we are still in a pretty significant investment phase, so margin will be in the breakeven range, is what we are looking at right now.

Gaurav Rateria: Sure lastly on the tax rate this is largely unanticipated because last time the discussion was that the tax rates will keep coming down on a year-on-year basis and this SEZ is coming out of the five year window would have been largely known so what is the disconnect?

Ajay Agarwal: I think what we have, where the challenge has been it is the last two quarters we have anticipated in Q4 as well as in this year as per our internal plans, we anticipated 300 people each to be further added into the SEZ and this is where we have not been able to. In some ways it is a good news because if you see a lot of growth is coming without proportionate addition of the headcount, which is helping us on the margin side, but yes you are right, Gaurav when we looked at the actual impact some of it we had not expected to this extent, but I would say that is water under the bridge, going forward as we say we do nothing, tax rate of 28% is new reality and depending on the initiatives and the SEZ ramp up it could be 26% to 28%.

Gaurav Rateria: Thank you.

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

Mohit Jain: This first is on your order intake that you disclose on quarterly basis so there is no growth if I look it for y-o-y perspective so how should be read that?

Krishna Bodanapu: I think order intake from a services business perspective, there is no growth y-o-y. Overall I think there is about 9% growth.

Mohit Jain: It is exactly opposite of what we are building in terms of growth like we are building in 20% sort of growth in DLM and 10% in services?

Krishna Bodanapu: But it is also there is just a cyclicity there. I would not read too much into it because just a way that are orders come in because backlog if you look at it is higher by \$20 million compared to the last quarter. It is just that intake is little bit lower in Q1, but again there is nothing to be concerned about in that because when we look at customers and we look at it by sector and

customers, we do not see any challenges in terms of delivering the growth that have commented on so it is just a cyclical thing and we will make it up in Q2 and second half of this year.

Mohit Jain: So what I am looking at is executable in the current fiscal year, which is FY2018 so 127 million will be into services versus 125 in 1Q 2017 so this includes total backlog right or is that only the order intake part of?

Krishna Bodanapu: This is just the order intake. Backlog we have not been disclosing externally because we still cleaning up the system in a little bit, but this is just the intake it is not the backlog.

Mohit Jain: We should probably look at it on the TTM basis?

Krishna Bodanapu: Exactly and also Q1 is always a low quarter because what happens in Q4 a lot of big orders for the year come in, TomTom, Pratt & Whitney, all those come in so Q3 and Q4 are typically the big quarters, I would not worry too much about it.

Mohit Jain: Second is on your DLM front, if I look at the raw material cost that is going up sharply as a percentage of revenue so I was just wondering why would that happen in that particular business so does that directly impact our gross margin?

Krishna Bodanapu: It is just a mix issue, I mean; this quarter we delivered a lot of the business where it is more material.

Mohit Jain: On full year basis do you anticipate a decline in gross margin in DLM, just excluding the employee cost?

Ajay Agarwal: As we already explained we are 100% confident both in terms of margin and cash, this is the worst, worst quarter. We are going to be in terms of margin at least where we were last year the breakeven. That is what I would say so only site is only up and do not look into the cost components what we have to track is the operating profit and the gross margin because the rest of it is depending on the type of order and how much is in content of value addition and things like that. I think just to that I will reiterate, this happens every year in Q1. It has happened in last two quarters. We are very, very confident of the year.

Mohit Jain: Thank you. All the best.

Moderator: Thank you. We take the next question from the line of Sagar Lele from Motilal Oswal Securities Limited. Please go ahead.

Sagar Lele: Thanks for the opportunity. Krishna apart from the top two-three customers in aerospace have got several marquee names that have large potentially for scaling up and at the same time I guess here you would not have to worry too much about new programmes getting dried out because already small in size so how do you look at penetrating these customers over a slightly longer

duration with more relevant service offerings and hence scaling them up referring to your purely services business and not DLM?

Krishna Bodanapu: I think there is number of opportunities there, which we are addressing because to your point the new programmes are not there, but there is just a lot of things around existing programmes or programmes that are ramping up. There are things like a significant portion of our business if you look at how is around after markets, manufacturing engineering. Also there is a large portion of our business, which is electronics and avionics. Avionics refreshed cycle is actually much, much quicker than mechanical so even if there is no new programme if you look at an aircraft, electronics are typically three to four years old whereas the actual aircraft might even be 30 years old so therefore if you look at the strategy of the aerospace business and again just in the services, the two areas of focused are aftermarket and MRO that is one set and second set is avionics and electronics so these are two areas that we are really focused on and we have seen some good traction in both these areas.

Sagar Lele: So it would be safe to say that probably barring this year you could return to that 10% CAGR that you have been historically witnessing in the vertical?

Krishna Bodanapu: We should be back. I think this year it is just a reset a little bit in where things are, but I think that kind of potential is definitely there and if you look at even today there is a very significant conversation that is happening with one of the large OEMs on just that issue.

Sagar Lele: Great and also could be having a quick update on Softential as well. They are probably just in terms of revenue as well as stability if they are back to where the business was a few quarters ago?

Krishna Bodanapu: The honest truth it is not in great shape. We are making sort of around a 10% operating margin at about around \$3 to \$3.5 million of revenue. Again I will say it is not in great shape to put it really on bluntly but I think the Comms business given the traction that were seeing in the Coms business the plan now is to really dovetail on that traction because we are becoming a very significant player on the network side of the business. We are winning some very good deals so that is giving us the credibility to also pitch the service management and assurance. It is one area if you look at the Comms business which is grown 20% plus last year and will also go to 20% plus at least this year that is the one heartburn for Sanjay Krishna and team and again all I say we are working on it.

Sagar Lele: Thanks a lot.

Moderator: Thank you. We will take the next question from the line of Nitin Jain from Credit Suisse.

Nitin Jain: Thanks for taking my question. The first question is on the order intake so the last quarter it was bit softer than what we expected so does it lower order intake and particularly for the next year, does it reflect any kind of impact on visibility on the next year for FY2019?

Krishna Bodanapu: No. I mean just Q1 usually is a weak quarter. I would not worry about it at all honestly because Q1 this always happens like we are saying after strong Q3 and Q4, Q1 typically is a little bit lower and a few orders make the difference. I mean for some orders in Q1 might have just coming in end of Q4 etc., so the backlog is on the qualitative visibility is great. We will not read too much into it. I think to an earlier point look at the last 12 months order intake rather than just a quarterly order intake.

Nitin Jain: Got it and the second question Ajay was on the tax rate so you have already answered the question, but just the movement of 300 employees does this make such a large difference in tax rate because early you were talking about 24% tax rate and some improvement in that in next year FY2018, and now looking about 26% to 28%?

Ajay Agarwal: Yes, it does make a lot of impact and as I said the reason for it is that the ramp up in SEZs has not been happening in the pace that you were expecting on site work has been coming more, the net addition have been less or more so those net additions have been at on site so I think these are reasons where ramp up could not take place so if we get let us say 300 to 600 people, we move towards 26%. If we go to let us say 1000 people in SEZ we will move towards 24% to 25%. That is a huge backlog to be cleared for this Q4 of last year and Q1 of this year. Let us take 26% to 28% as the new normal that is what we should take into account.

Nitin Jain: Thank you.

Moderator: Thank you. We will take the next question from the line of Ravi Menon from Elara Securities. Please go ahead.

Ravi Menon: Thank you. Two questions; first question is on DLM I know it has been asked in other forms before, but to just elaborate on DLM order intake was pretty strong for last quarter and this quarter again we got strong order intake but this is not really translating into revenues so when should we see this pickup?

Krishna Bodanapu: So Q2 you will say good pickup and from there onwards you will some good revenue. I think problem with DLM is once we get in order for us to do the NPI, engineering the NPI and then get the materials etc., in place, it is at least three to six month runway and we do not typically order materials till we are actually get PO because so we do not want to be left with that inventory. Unlike services business, where we recruit people anticipating growth, here we cannot really either do NPI because we would not have the specification still the PO is there or order material because there is a big bearing on cash and inventory so that being the case you will see some good numbers Q2 onwards.

Ajay Agarwal: So Ravi by if I may just to add what Krishna said I know sometime back we have not met our expectation while we were learning about this business. I would be very surprised if there is no positive surprise on 20% ballpark growth that is how we see it internally.

Ravi Menon: Great Sir and secondly according to my calculation we saw about 3% growth in billing rates realization q-o-q, there is a factoring for the new way that you have reported utilization including your paid leave and overtime so how much of this is due to cross currency gains and how much would you say is really an improvement because even onsite has not really gone up so this really looks like sustainable realization improvement to you?

Ajay Agarwal: I think the way we look at it is one I think for everybody benefit, we were looking if situation where we utilization was not giving as the right ability to manage the improvements so what was happening when you used to look at the overtime having done in many of the situations especially onsite that you are referring to, we will cross the utilization to 100%. That made us think that it should be part of the capacity. So the new definition is in the capacity we are also counting the overtime on so that both numerator and denominator have it. Having said that typically it has brought down our utilization by 2% so if you look at this quarter like-to-like basis we have reduction of about 1.1% quarter-on-quarter and as I said earlier that we expect 2% to 3% utilization improvement during the year, so I think the growth coming in with limited net additions what it means is that there is huge lever for utilization improvement. I would not like to too much on the realization side. I think it is just on doing more with the same or with less.

Ravi Menon: All right Sir. Thank you. Best of luck.

Moderator: Thank you. We take the next question from the line of Urmil Shah from IDBI Capital. Please go ahead.

Urmil Shah: Thanks for the opportunity. Ajay my question as regards the full year basis the improvement in the operational margin, should we expect it to be very strong improvement in the second half or Q2 onwards when apart from the half of the impact of the salary increase, we should see a gradual improvement from Q2 itself.

Ajay Agarwal: I think you have seen our trends so as we said in Q2 you would see that our margins will significantly improve despite half of the impact of wage increase because we are really seeing the good traction in Q2, it is going to be much, much better than the current quarter on services itself not only that DLM will pickup what they should have done for H1 for this we would see so I think you will see good improvement in Q2 and then continuously with the guided growth, SG&A absorption opportunities for operational efficiencies as we grow you will see definitely gradual increase, it cannot straight go in services from 14.6% to let us say 16.6% or 17%, it will be gradual at the rate of about 0.7% to 1% per quarter.

Urmil Shah: Thanks. That was helpful and I know it is unpredictable on the currency part, but looking into FY2019 on the services business, are we confident that we can at least maintain margin despite the currency headwinds?

Ajay Agarwal: I think it is difficult for us to comment about financial year 2019. What we are saying is the impact of the currency at the current rate let us say about 64.5 or 64.7 are already baked into what we have seen for Q1. It is already baked into our commentary of 50-basis points

improvement year-on-year. I think when we come to financial year 2019 we will look at the challenges and opportunities and margins, at this time to make any comment on the impact of currency beyond that is very difficult.

Urmil Shah: Thanks. That was helpful.

Moderator: Thank you. Next question is from the line of Harit Shah from Reliance Securities.

Harit Shah: Thank you. My question has been answered.

Moderator: Thank you. We take the next question from the line of Ashish Chopra from Motilal Oswal Securities.

Ashish Chopra: Thanks for the opportunity. Krishna, one question to you was with respect to DLM. It is good to know that you stay put on the 20% guidance, but just from a longer-term strategic roadmap for you, so while that is roughly \$65-odd million of revenues could you throw some light on how much of that would actually currently be syncing in with your S3 strategy or wherein your services and products combined versus what would still be pretty much standalone Rangsons, so to speak?

Krishna Bodanapu: I think, like you said, it is a small part of our business, so therefore, and the synergy part is even smaller. Right now it is about 10% this year. Going forward, it will get bigger, but right now it is about 10% to the revenues because of combined services and manufacturing.

Ashish Chopra: Okay and would that be concentrated in a particular segment or vertical?

Krishna Bodanapu: Primarily aerospace, it is mostly aerospace and some medical.

Ashish Chopra: Got it and the second question was around that transportation vertical, so I mean we saw a pickup after quite a long time I think almost eight to nine quarters of \$11 to \$12 million revenue range, so just wanted to understand from you, this 3% growth in the overall market, how do you see this transpire into growth for Cyient from here on and what are your views on the sustainability of that growth trend?

Krishna Bodanapu: I think Q1 was good, Q2 onwards also we see some reasonable growth. I think the thing is when we get a disproportionate sort of tailwind when the market grows by 3%, which means that there is a lot of new programs that are being designed and which is good for us, I will say this momentum will continue.

Ajay Agarwal: Let me just add. I think like we have seen based on the market pickup extremely good growth in communication, I think looking at the traction in the market, I think you should expect another kind of communication story for transport in this particular year.

- Ashish Chopra:** Understood and just lastly from my side this has been addressed before, but on the aerospace side, while you mentioned that there is a lot of demand in the aftermarket and manufacturing segment and you have also established your presence, but growth for Cyient has been a little bit on the softer side for sometime now. So I just wanted to know how do you see that pickup going forward or is there anything that needs to be achieved for this to really accelerate from current numbers?
- Krishna Bodanapu:** No, we are doing what needs to be done. I think well positioned. We will continue to see some reasonable growth in aerospace. It is a continuous process because obviously we need to learn and adapt and get better but I think we are well positioned for this.
- Ajay Agarwal:** Just to add Krishna, I think if you see that all this is leading to, you are trying to understand whether we can get to the growth of last year levels. I think some of the mixed change for example that you know we had two businesses, which were in negative last year growth, this year we do not expect anyone should be the same except I&ENR, which could be probably flat. The number of businesses which will grow in double-digit, it is going to be probably one of the best. I think we have to look at that in our kind of business serving so many industries some of the compositions will change that is why I highlighted. For example, communication, transport, medical and healthcare, semiconductor, U&G all of them are really firing in double-digit. So that is why we have to see the overall picture.
- Ashish Chopra:** Thanks. That is it from my side and all the best.
- Moderator:** Thank you. That was the last question. I now hand the floor over to Mr. Sandip Agarwal for his closing comments.
- Sandip Agarwal:** Thank you everyone for participating the call. I will hand over the call to Mr. Reddy for final remarks. Thank you.
- BVR Mohan Reddy:** Thank you very much for participating the call today. As Krishna and Ajay have told you, we delivered a good quarter consistent with what we have so far committed to you and we are still seeing positive traction for business in coming quarters and certainly we continue to look forward to your support. Thank you very much for being on the call today. Have a good day.
- Moderator:** Thank you. Ladies and gentlemen on behalf of Edelweiss Securities we conclude today's conference. Thank you for joining. You may now disconnect your lines.