"Cyient Limited Q2 FY2018 Results Conference Call"

October 12, 2017

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Moderator: Good day, ladies and gentlemen, and welcome to the Q2 FY2018 Earnings Conference Call of Cyient Limited 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, Margaret. Good evening to everyone. On behalf of Edelweiss, let me welcome you to the Cyient Q2 FY2018 Earnings Call. We have with us the senior management of Cyient, headed by Mr. B.V.R. Mohan Reddy, along with other senior members of the team. Without further ado, I will hand over the call to Mr. Ajay Aggarwal to start the proceedings. Over to you, Ajay! Thanks.

Ajay Aggarwal: Thank you, Sandip, and good evening and good afternoon and good morning, depending on wherever you are, ladies and gentlemen. Welcome to the Cyient Limited earning call for second quarter of financial year 2018 ended September 30, 2017. I am Ajay Aggarwal, CFO. Present with me on the call are also our Executive Chairman, Mr. Mohan Reddy; and our Managing Director and CEO, Krishna Bodanapu.

Before we begin, I would like to mention that some of the statements made in today's presentations may be forward-looking in nature and may involve risks and uncertainties. A detailed statement in this regard is available in our investor update, which has been e-mailed to you and also posted on our corporate website. This call will be accompanied with an earnings call presentation. The same has also been shared with you.

I will now like to invite Mr. Mohan Reddy to provide a brief overview of company's performance for the quarter ended September 30, 2017.

B.V.R. Mohan Reddy: Thank you, Ajay. Good evening to all of you, ladies and gentlemen. I once again welcome you all to this earnings call of Cyient for the second quarter. In Q2 of financial year 2018, we achieved many milestones. We saw the highest ever-quarterly revenues at $150.1 million with a strong quarter-on-quarter growth of 6.7% on a year-on-year growth of 10%.

For services business, the revenues stood at $134.3 million, which again is the highest ever with a robust quarter-on-quarter growth of 4.2% and a year-on-year growth of 9.2% in U.S. dollar terms. The growth in our services business was driven by Transportation and Communications business units. The Design-Led Manufacturing business continues to improve its performance and delivered double-digit growth at 33.7% quarter-on-quarter with revenues of $15.8 million.

The operating profit was highest ever at Rs.140.9 Crores with a quarter-on-quarter growth of 21.5% and an operating margin expansion of 181 basis points quarter-on-quarter and 56 basis points year-on-year. Net profit for the quarter stood at Rs.111.4 Crores, which is the highest ever with a quarterly growth of 26.9%.

Cash and cash equivalents continued to remain healthy at Rs.986.7 Crores. The attrition came down to 16.8%. This is the lowest ever in the last 15 quarters. Taking feedback from investors, company declared an interim dividend of Rs.5 per share, the highest ever for an interim dividend, revised the dividend policy to pay out 40% from the current payout ratio of 30%, barring unusual circumstances. This takes into account the future capital needs and also the peer group payout.

As a part of our CSR initiatives, we continue to support 25 government schools, supporting an education of underprivileged children. As a partner initiative to increase IT literacy, we have further added one more Cyient digital learning center, taking the total of 55. We have collaborated in Haritha Haram, a tree plantation program of Telangana government and planted more than 5000 trees as a part of this initiative.

Certon was awarded a Platinum Premier ranking as a part of the Trusted Supplier Program of Rockwell Collins. We were also awarded with Boeing Test and Evaluation Excellence in Quality Award in the category of Use Standard Work for Completing 737-7 Project. We signed a definitive agreement to acquire B&F Design Inc., a tooling and precision engineering company and an agreement to divest Cyient's 49% stake in our joint venture with Pratt & Whitney on the Island of Puerto Rico. We also had UTC selling 12.2% of its stake in Cyient during the current quarter.

With this, I would like to hand over the call to Ajay, who will take you over with the detailed financial performance of this quarter. Thank you.

Ajay Aggarwal: Thank you, Mohan. Let me start by giving a commentary around the revenue. As we saw, we had a growth of 6.7% in terms of the dollar quarter-on-quarter and 10.0% year-on-year. What I would like to highlight is the growth has been very well rounded in terms of where it has come. If you look at year-on-year, every single business unit has shown extremely good growth, leading to a total growth of 10%. Most of them are growing at double-digit. Also the growth has come quite across the geographies. We are showing the good traction in Asia Pacific as well as EMEA. And also it is good to see that the dependence on America as the largest geography is also coming down with the growth from EMEA and Asia Pacific.

In terms of the income statement, as Chairman mentioned, I think it has been a quarter with a number of milestones. In terms of operating profit, we had an extremely good growth from quarter-to-quarter, where the overall operating profit has gone up by about 22%. Also we had an expansion of 181 bps in the margin. Let me just explain where this has come from. I think there has been a good set of initiatives to improve the operational efficiencies. This quarter was also impacted by the wage impact. As you would recall, last quarter we had talked about the wage hike being given in Q1 and Q2. In Q1, we had a wage impact of 80 basis points. In this quarter, we had another impact of 70 basis points. In total, 150 basis points has been the wage hike. Wage hike is behind us. If you look at the overall quarter, the exchange rate also has not really helped.

So with all these trends, 181 bps is mainly coming from the operations both in terms of improvement in utilization, pyramid and also the improvement in margins for the on-site jobs. And also volumes have helped on SG&A absorption.

Coming to the profit after tax is in line with operating profit growth, we had quarter-on-quarter 26.9% net profit growth, which is really nice. As I said, there are no one-offs in this quarter. Both the growth in operating profit and growth in net profit is coming from operations. And these are sustainable performances that we can look forward to going ahead.

On ETR, you will see our tax rate has come down by about 300 basis points quarter-on-quarter. This is because of the changes in revenue mix and the profit mix, where the profit has come from the geographies in higher proportion where the tax rates are lower. And also the impact of Special Economic Zone is helping us. And that will further help us during the year. So we expect, as we said last time, we are on track to make sure that the tax rate will be somewhere between 26% to 28%, depending on the final mix and the traction in the Special Economic Zones.

In terms of cash generation, I would say we had this quarter an increase of one day in terms of the DSO. And we have always said that basically we are a 75 to 80 days DSO company. We always try to focus and get the DSO to be a number between 75 and 80. If you look at all other parameters in terms of free cash flow generation, they have been tracking to the plan. So you see going forward, while we have done something like 41% conversion in H1, we will try to take this again upward of 45% conversion in H2. And I think we should repeat our conversion going forward. So there is no particular concern that you should have either in terms of what happened on free cash flow this quarter or in terms of what happened in terms of DSO.

In terms of DLM, yes, we had a free cash flow consumption of about Rs.191 million. There is a number of one-offs, some of the advances from customers that were expected have moved on to the Q3. Some of the payments from the vendors have moved to Q2 from Q3. So because of that, I think we are very sure of the next quarter being cash-neutral or cash-positive. So I would say, finally, I would like to conclude by saying that in terms of the free cash flow, we will continue the traction in terms of conversion in services as well as we'll make sure that H2, we are positive on free cash flow in DLM.

Total cash continues to be good. We are at $150.9 million for this quarter versus $159.4 million last quarter. The change in between the quarters is mainly because we had paid the dividend during the quarter, the final dividend of the last financial year.

Hedge book. If you look at, firstly, we talk about the other income. Treasury income is fairly at a similar level. In terms of the realized gains, we continue to make the gains on forward contracts. We have made a gain of Rs.161 million in this particular quarter. The other income, if you see the increase from Rs.351 million to Rs.406 million, mainly it is driven by the notional restatement of the items on the balance sheet. But otherwise, all other parameters in terms of the treasury income, realized forward contracts, they are showing the right trends.

In terms of our hedging position, you can see on the chart, totally we have $121 million. We continue to be hedged for 70% of the net inflows for the next 12 months. And if you look at, depending on how we look at the gap between the current forward position versus the exchange rates prevailing now or the spot rates or the forecasted rates, we could have somewhere between $3.6 million to $5 million of forward contract gains in the next 12 months.

With this, I will hand over to Krishna to take us through the rest of the presentation.

Krishna Bodanapu Thank you, Ajay. So as always, I will first quickly take you through the investment pipelines with the M&A. I will talk about it in a few minutes, but there has been obviously good traction over the last few quarters on M&A. We continue to keep that focus. What we have here is an overview of how many things are being discussed across the pipeline and also focus on the various industries, be it the A&D, Communications, etc. So I will leave this with it.

But having said that, there has also been a couple of good developments on the M&A front, both in terms of acquisitions, divestments but also partnerships. The first one is we signed a definitive agreement to acquire B&F Design, a company that specializes in tool designs, manufacturing and more importantly precision engineering. The deal has been done. We are going through the closing conditions. And we expect closure hopefully by the end of the year.

The second one is we also signed an agreement to divest the 49% equity ownership that we had in a company called Infotech Aerospace Services in Puerto Rico. This was a joint venture with Pratt & Whitney. Looking at our portfolio and looking at our involvement, etc., in the IAS and also the longer-term plan that we had in terms of how our business would grow, we decided that it was best that we divest that stake. Obviously, Pratt & Whitney bought the stake. And they are also going to run this as a captive engineering center going forward. So it all came together in that sense. Again, this transaction will also close some time in Q3. As most of you know that Puerto Rico is going through some issues with connectivity, electricity, etc. So we are helping Pratt work through that. But the transaction will close in Q3.

The next one is we also entered into an agreement with a company called Elpis. We essentially licensed Elpis' intellectual property and create a solution around it. The solution helps us better manage the assets on a utilities network. It is quite an interesting way of capturing the data on a network. It brings in a significant amount of automation into the process because real-time signals from the network are captured and then translated into a database rather than somebody going out into the field and looking. So while we licensed the core IP from Elpis, the solution has been developed by us and we own the IT solution.

The next thing is, as you probably also know, UTC divested its stake in Cyient. With this, 100% of their stake has been sold off to various financial investors. But what I want to say is I want to assure you that our relationship with UTC remains the same, if not, has gotten stronger. There is a number of proof points of that, including what Peter Longo, who is the Senior VP of Operations and essentially controls all the purchasing that UTC does, what Peter has had to say; also more importantly, the actions in terms of extension of our master terms agreement to 2020;

the qualification of Cyient DLM as approved supplier to provide electronic design and manufacturing; B&F, which is also a Pratt customer, would be a good fit for us. Certon, which is also a good fit for what we do with UTC.

I want to say that overall, I strongly believe that the relationship with UTC is stronger than ever. And we have also been repeatedly assured that the stake sale has nothing to do with the business, which continues to remain strong. And while we're looking at some of the things that I talked about, there is also a number of things that I haven't talked about, which will continue only to add to the relationship so from that context, while UTC was a great equity partner in the sense that when we were a much smaller company, they came in and they supported us and they gave us a lot of credibility. From the equity perspective they are obviously a very important customer and nothing has changed in that context.

Having said that, I will go into the industry outlook.

A&D market will experience good growth. We are seeing that in various places. While the year-on-year growth was a little bit benign, I would say quarter-on-quarter, we had good growth, 3.2%. And now we see this continuing. Even in Q3, which historically is a weak quarter for the A&D business, we believe we will see growth, which is a very good sign because that means that we are making up for a significant amount of downside that we see in Q3. And honestly, I think growth in Aerospace will now continue off this pace.

The Communication Industry obviously has had a fantastic run. And the momentum continues into FY2018. And I see that continuing going forward because of all the fiber rollouts and the NBN program in Australia, CAF-II in America, we are seeing a lot of traction. And I see that continuing at least for the foreseeable future.

The U&G Business continues to do well. In this business, even the start, the anticipated strong H2 was, as I said, on a relatively slower H1. And that is what is happening. H1 was essentially flat. Or I think it was some a little bit of growth. But here, we are very confident that H2 will be very strong. We have the pipeline, the orders have started, the work has started. We have won some really good deals. So this business will have a very strong H2.

The Rail Transportation business also has had a very, very strong H1. I think it was almost a 30% growth over last year in spite of the some of the currency challenges we have been having there. And that growth will continue. We see that our clients ultimately are making some very large-scale investments in rail transport. And that translates to good work for us and we see this continuing. The industry is also going through some very interesting dynamics. CRRC, which is China Rail, is now the largest rail transportation company in the world. Also Alstom and Siemens, which are, I guess, the third and the fourth largest rail transportation companies, have announced a merger, so now they have become the second largest rail transport company. But we have a very strong relationship with both with Alstom and Siemens. And the way things are panning out, we believe the mergers will actually give us an opportunity to leverage on both of the relationships and actually multiply on that.

Industrial, Energy and Natural Resources and Infrastructure continues to continues to be a little bit weak. That is one area where we have essentially had a flat year and that will continue through the rest of the year. The demand is soft. But I would say while that is one area where we have had some challenges, we are seeing some good green shoots come up. We are seeing that there is new spend, especially not necessarily in just the old technology but in new technology with things like analytics, etc. And we are well positioned. So while FY2018 will be a rough year there. A best case will be flat compared to what it was last year. But going forward, it looks quite good.

The Semiconductor industry is going through a very, very strong year. That is also translating to good business for us. We had a good Q1. And that momentum sustained. We essentially had a flat Q2. But that is also because the Q1 number was very, very good. And even sustaining that took some work. But we believe that through the rest of the year, we will have a strong year over there.

The Medical business again is doing quite well. At least from a pure percentage point of view, that is the best growth. But again, they are coming off a small number. So I think we are going to do quite well in that business. We have won some very good deals. The macro dynamics in that industry are such that our services and our value proposition become quite compelling. And we see this to continue.

DLM had a good quarter. We had a very strong growth. But again, as you know, there is cyclicality. But having said that, Q2 was expected to be a strong quarter and it is a strong quarter. But we are continuing to work on building the pipeline, so we do not get affected by the cyclicity, at least in FY2019. And there is various things that are going on.

Having said all that, the way I will summarize it is the outlook for FY2018 continues to be quite good. And I will reiterate what I said previously. We see double-digit growth in the services business. DLM will be around 20%. Margin expansion will be about 50 basis points. I would say earlier, we thought it would be flat but having looked at all the operational initiatives, we believe that 50 basis points for the year is what we are looking at. Utilization has given us 50 BPS. Higher offshore mix has given us 50 bps. On-site margins have gotten better, pyramid correction, etc., and then that is offset by some wage increases and also some investments that we are making, especially in the new business accelerator, which is essentially our technology business, etc. So net-net, we will see about a 50 bps improvement in operating profit for the year.

Our DLM will breakeven at an operating level in terms of investments. I do want to say, fundamentally we are back to about 5% or a 6% operating margin there. But that is all going back into investments. And I see that continuing through the rest of the year. So net-net, we will have a double-digit earnings growth as we have previously committed to. And we believe that what's happened in Q2 reiterates the strength of the business and that we will have a good year also in FY2018.

So with this, we will open it up for questions. Thank you.

Moderator: Thank you. We will now begin with the question and answer session. The first question is from the line of Mohit Jain from Anand Rathi. Please go ahead.

Mohit Jain: Just two questions. First is on order intake. So this is continuously flattish or going down. In this quarter, it goes down on a Y-o-Y basis. So how should we read that number?

Krishna Bodanapu So Mohit, I think order intake this quarter was lower than what it was last quarter Y-o-Y. But we track it quite closely. We are not concerned about it because it is just the cyclicality of the orders and how they're coming in. There are a few things that got pulled in from Q2 into Q1. And there are a few things that got pushed out from Q2 to Q3. So net-net, these things coming together, Q2 has just been a tough quarter from an order intake perspective. But having said that and the way that the order pipeline works in our case, I would say that I am not very concerned about where the order intake stands. Backlog continues to be strong. We have about 6 months' worth of backlog. So therefore, I think what we see is it is an aberration and nothing to be very concerned about. And the second thing is H2 typically has a much stronger order intake and that is backed by the pipeline that we see at this point. So in that sense, I am not too worried about all this.

Mohit Jain: Is there a change in business environment from your perspective, like deals getting pushed out or maybe in the last four quarters?

Krishna Bodanapu No, I think it is just a point-in-time thing. I think from the order intake at least, there are obviously certain areas where things get pushed out, etc., but from the overall order intake number, I would not read that at all. I think it is just a point-in-time thing.

Mohit Jain: Second was for Ajay. So what was the cross currency impact in this quarter Q-o-Q?

Ajay Aggarwal: The cross currency impact Q-o-Q is about 1.6%.

Mohit Jain: The 5% would be the constant currency number. Is that correct?

Ajay Aggarwal: That is right.

Mohit Jain: That is all from my side. Thank you.

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

Urmil Shah: Congrats on a strong quarter. A couple of questions; Krishna, if you could provide more details on we know which are the verticals which are not doing well in the U.S. and we can see an improvement going forward?

Krishna Bodanapu Well, I think in the U.S. specifically, I think IENR, which is mostly U.S. centric we still have some challenges. Also the A&D business in the U.S. has some challenges just because UTC is in their rebalance mode. That is why we have had a challenge in Q2. But non-UTC, the A&D business continues to do actually very, very well. And UTC, also we see the recovery will happen in Q4 onwards so it is just a rebalance issue. That the whole equity stake and all that is just relooking at that portfolio. But having said that, I think U&G is another area where we have had a little bit of a slowdown in the U.S. Again, there is one project where the work got pushed out. But again, that is primarily because of some of the things on the ground in California with weather conditions, etc., where we need to go do some field study work, etc., So I would say these are the three things. UTC a little bit, IENR and U&G is what is driving the slowness in the U.S. at this point. But again, I would say all this is nothing that is systemic, all of it, which will recover in Q3 and Q4.

Urmil Shah: Sure. And as regards on the growth in large clients as a bucket, it has grown faster than the company growth rate. Anything to bother about or across all the clients the growth has been broad-based?

Krishna Bodanapu It has been quite broad-based across the clients. I think if you look at the numbers in terms of the top clients, if you look at the contribution of the top clients, it has been about the same, which means that the top 10 clients I am talking about. It has been about the same, which means that the growth has been pretty much in line with the rest of the company so again, nothing too much to read into it, I would say. As with any quarter, there will be ups and downs. But there is not, the great thing about this quarter and, I think, going forward is there is not one customer that is really driving any aberration. It has been quite broad-based. Having said that, there will always be ups and downs. But it has not been one aberration that is driving all of this.

Urmil Shah: Sure. And lastly, Ajay, if you could provide some details as regards the tailwinds on the EBITDA margin in this quarter because you mentioned that wages had a negative impact of 70 bps; if you could highlight what is the contribution on the positive side?

Ajay Aggarwal: If you see, as I mentioned briefly, the utilization has improved quarter-on-quarter. The offshoring has been a favorable movement during the quarter. Some of the margins that came in on-site jobs, they were higher. That has been the tailwind. And fourth one, I would say is the SG&A absorption has a combination of cost control as well as the absorption has been better. So I would say these are the four things, which have led to the expansion of the margin.

Urmil Shah: Thanks. All the best.

Moderator: Thank you. The next question is from the line of Sagar Lele from Motilal Oswal Securities.

Sagar Lele: Thanks for the opportunity. Krishna, from your comments on most of the verticals, whether it is Utilities or Transportation, Communications, Aerospace, even Semiconductor for that matter, it looked like you're quite bullish on the second half of this year and expecting a material pickup there. Should we assume that the seasonality that you normally see in the second half will not really play out as usual and probably the strength in all these verticals would keep your growth afloat in the next two quarters as well?

Krishna Bodanapu See, the thing is in Q3, we will start with a minus 5%. That is the challenge. So even for us to, say, get to a flat quarter means that there is a 5% growth inherently in the business. So that is the challenge that we face. We believe that we will make up that 5% in this Q3. So in that sense, I think there is some good momentum and there is good growth. Now to grow at, say, similar rate in Q3 means that essentially you are growing minus 5% plus something else. And that becomes quite a challenge. But I would say the momentum continues. I would say meaningful acceleration we have to see. But at least the current pace will continue.

Sagar Lele: Also now that your offerings in Aerospace are getting transformed materially because of recent acquisitions, do you see a time when the Pratt account probably could see double-digit growth again mainly because of an expansion of addressable market within that account? And that is excluding the DLM business; only the services business is what I am talking about?

Krishna Bodanapu Yes, absolutely; I think that there is various things in services that we are looking at. If you look at it, actually we were looking at the last 5 years the CAGR in the Pratt business is about 10%. And we believe that, that momentum is absolutely there. It is just a point-in-time thing. I do want to reiterate that whatever is happening in UTC is a very point-in-time thing. The relationship is as strong as ever. The momentum is behind us. We will get back to double-digit kind of growth in the coming years.

Sagar Lele: That is helpful. Thanks a lot.

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

Pankaj Kapoor: Congrats on a good quarter. At least three of your large clients, you mentioned about Siemens, Alstom and, of course, UTC is also engaged in their merger with Rockwell. So at this point of time, does it in some which way lowers your visibility in terms of the business flow from these clients? And do you expect that maybe in some part of the second half or maybe even flowing into the next fiscal, there could be some impact on the business because of the clients undergoing the acquisitions or mergers?

Krishna Bodanapu I do not think so. I think if you look at it, while they are going through a merger, they also have their end obligations, which do not really change. So in that context, if even I look back into some of the previous acquisitions, and I mean, some previous very large acquisitions that our clients have done. For example, when Siemens had bought Invensys Rail, for example, or when another good example is when UTC bought Goodrich. So while at some point, things settle down. But through the transition, we would not necessarily see any change in how our business works because ultimately they have obligations to their end customers. And those end obligations cannot really be overlooked. So in that context, we typically have not seen again, these are the two examples, and I am sure there is others, but these are the two large examples that come to mind that as Siemens buying Invensys, where Invensys was our client, or UTC buying Goodrich, where the acquirer in this case was our client. We did not really see any significant impact on our business, at least through the acquisition phase.

Pankaj Kapoor: Sure, that is helpful. And second question is in terms of Pratt itself you were hopeful of some recovery there in the second half or later in the second half flowing into FY2019 now. So any color, if you can give what exactly is happening there. And does it have to do with the concerns that Pratt is having with their own line of business? Or is it just some sort of rationalization of work, which is undergoing over there?

Krishna Bodanapu Two things are happening. One is just rationalization of work. They are cutting down the number of suppliers. They are relooking at how much outsourcing they do. But the suppliers that remain, and obviously we are at the top of that list, will actually get consolidated more business. So in that sense, that is actually turning out quite good for us. It is just that in Q3, we are starting to see some of that work. But again, just the way that Q3 works, we won't see material pickup just because you have Thanksgiving and then Christmas holidays. So you just go and get momentum. So Q4 and going into FY2019 that will play up quite a bit. And the second thing is also while their civil aerospace has slowed down their military aerospace is going to pick up quite a bit. And we are also very well positioned for the military aerospace, be it through our engineering center in Hartford or some of the acquisitions with Certon in Melbourne or with also we have an engineering center in West Palm in Florida. All these put together will give us actually some very, very good momentum on the military program. So therefore, Q3, we are seeing some things happen, which will really translate into good momentum into Q4 but more importantly, into next FY.

Pankaj Kapoor: Thank you and all the best.

Moderator: The next question is from the line Ravi Menon from Elara Securities. Please go ahead.

Ravi Menon: Employee costs were very well contained despite very strong employee additions. So how we read this in a way the additions back-ended for the quarter? Or should we see next quarter maybe a bit of a spike in employee costs? Or was there something more structural, like a reduction in on-site proportion, something else that helped lower it?

Krishna Bodanapu No, I think a couple of things happened. One is there is an offshoring, after some sort of after a while and after some struggle, is now growing, which means that a lot of the employee addition is offshore rather than on-site. The other thing is a large proportion of the additions are also fresh college graduates. So obviously, the cost that is associated with them as a proportion comes down. So these are the two things, more additions offshore for that revenue because offshoring has actually gone up. And the second thing is these are fresh college graduates. So we would not see any sort of unexpected spike or anything because of this in Q3 or going forward.

Ravi Menon: Right. And I thought sales and marketing, too. And I have seen a slight decline in absolute terms. So that's very unusual for you. I mean, I have seen you invest back into the business. So should we see that move back up?

Ajay Aggarwal: Very marginal changes. I can say that, Ravi, I think we were spending around Rs.61 Crores, Rs.62 Crores. This quarter, it was close to Rs.60 Crores. I do not think some of it could be certain movements here and there about certain events and other things. So I think our focus on sales and marketing continues, continue to spend about 6.5% to 7%. These trends are just a question of how the events and some of the discretionary expenses are taking place. The focus has not changed.

Ravi Menon: Great. And so just some more color on the DLM side. So you did talk about how you were targeting 20% growth for the year. So is there any progress on some of the Defence offset or engaging more in Aerospace & Defense, some progress towards that? Or should we continue to see Communications driving and Med tech driving most of your capacity there?

Krishna Bodanapu So I think we are starting to win some very good Aerospace deals that will drive some of the growth going forward. The offsets, etc., is still way out there. I think we are still not going to see any marginal change because of that. I think the changes that we will see is Aerospace & Defense is picking up, so we're going to see some good, well-known Aerospace customers drive revenue going forward. Communications, we will see that business flatten out or even come down a little bit because our intent again it was really more of an interim thing as we build out the rest of the business. So we are not going to grow that too much, especially given how the profitability in that business works. Medical also will continue to grow. That is another area where we have had a lot of focus. So Aerospace and Medical will be the growth, Communications would slow down a little bit.

Ravi Menon: All right. And for the third straight quarter, I think we have seen pretty good growth outside of the non-top 10. If I look at the non-top 10 players, they have done really well. So is there any specific vertical that's done well for you? Or is there some particular customer who is actually out of the top 10 but growing very strongly? Or it is very broad-based?

Krishna Bodanapu It is quite broad-based. I cannot think of any single customer. Because the other thing if you look at it, the million-dollar customers improved quite a bit, I think, from 57, they improved to 65, which is quite a good number. So they are coming through the funnel. So it is not somebody with a very large one-off project. It is we are going through the logical funnel. So I cannot think of anybody who is one-off. It is quite broad-based.

Ravi Menon: Right. And you expect these clients can be mined further and they can move further up the funnel?

Krishna Bodanapu Yes, absolutely. I mean, that is the intent. I mean, I will say that everybody will have the potential to be a $20 million customer. But I think one of the good things that happened in the last two years is the quality of customers has significantly improved. So all of these customers has the potential to be $5-plus million, $10-plus million kind of customers.

Ravi Menon: Thank you. All the best.

Moderator: Thank you. The next question is from the line of Nitin Jain from Credit Suisse. Please go ahead.

Nitin Jain: Thanks for taking my question. I have two questions. So first question is a follow-up on a deal win question that was asked earlier. So the first two quarters have been very soft. I think the last quarter you had made a comment that you are expecting 10% growth in order intake in FY2018. So do you think that is still doable, given last H2 which was very strong? And how is the correlation between your order intake and revenue growth? I am asking this more from a medium-term growth perspective.

Krishna Bodanapu See, I think for the year, we still see good traction on order intake. I think H2 will be a very strong quarter for orders. I mean, a lot of our customers key up in H2. And there is also a lot of new things that are lining up to accommodate. And I think in that sense, we will see some good growth in order intake. Now honestly, we still struggle a little bit with the direct correlation between order intake and revenue. Now I see there's a correlation because ultimately order intake becomes revenue. But in terms of when does it exactly become revenue, what is the lag between a PO to Bill, we struggle with that. I think the data is still a little bit raw in the sense that we only started collecting meaningful data about a year ago. So we are still trying to analyze that. But having said that though, my confidence also comes from all the qualitative inputs that I get from the BUs and also from the customers directly, more importantly. But while there is a little bit of a challenge with order intake in Q2, overall, the business continues to be very, very strong. So in that context, I would say there is a correlation, but I don't know what exactly is the correlation. But I am not concerned at this point.

Nitin Jain: Okay. There is no even last quarter you had indicated that the pipeline is very strong. So is there any challenge in converting that pipeline into revenue or it is taking longer than what you expected earlier?

Krishna Bodanapu Not necessarily. I mean, again if you look at both Q1 and Q2 have been quite strong quarters. So that is the sort of the strength in the market is converting into good revenue. I think it is just the direct correlation between order intake and revenue we still need to establish just because we are a little bit new to this data and how this works. But I will say it again that qualitatively, the markets are very, very strong, at least our market, I will say, rather than a broad-based statement.

Nitin Jain: The second question is on the margins. So in the services business, this quarter, you have done very well. So 16%-plus margins, I think it is very good. So do you think this is sustainable then? So in FY2018, you have guided to 50 basis points expansion. But going forward within the next two years, do you think this 16% margin could be sustainable?

Krishna Bodanapu I think it is. I think there is a lot of overheads that have built up into the system and we have cleaned up a lot of those things. At the same time, we brought in a lot of focus on productivity and there is a set of initiatives there. The third thing is we have also brought in a lot of focus on where margins should improve. So it is a broad-based thing we could look on. For example, on-site, if we have to continue certain businesses on-site, then they cannot continue at existing rates. So we have already done some of these. But there is also an opportunity to do a lot more. So taking that into account, I would say the margin is sustainable in the services business going forward. Also in the DLM business, we have done a lot of things around identifying the right type of customers, making sure that the business is really growing from these customers. And actually that is why even if you look at the year, we are having a muted year because we stopped working with a lot of the lower margin customers. So taking all those into account, I think the margin is sustainable.

Nitin Jain: And is that process over now, of rationalization of those low margin accounts?

Krishna Bodanapu The first round is over. I think there is still one or two more rounds that we have to do. And basically, what I mean by rounds, I mean as newer customers come in, we are stopping to work with the lower margin customers. We laid out a roadmap for that what type of customers or what industries would we stop working first, next, next, next. And we are somewhere in the process. There is a lot more that we can do over there. But again, we can only do it when the newer business comes in because we also need the revenue to at least breakeven.

Nitin Jain: Thanks and all the best for the rest of the year.

Moderator: Thank you. We will move to our next question, which is from the line of Gaurav Rateria from Morgan Stanley. Please go ahead.

Gaurav Rateria: Krishna, congratulations on a strong execution. Two questions. Firstly, on the Aerospace, you still showed a pretty decent growth during the quarter despite the challenge of UTC account. So what was the offsetting factor? What led to that growth? And secondly, do you think that for the full year, the outlook for Aerospace has kind of tapered down versus last quarter because of this challenging UTC account? And what is kind of offsetting that to maintain the drivers for services business growth?

Krishna Bodanapu Gaurav, I think a couple things. One is the others in Aerospace & Defense are growing quite nicely at this point. There are other clients in North America; there is some in Europe. All of them are starting to pick up and therefore, in spite of UTC having a weak-ish quarter overall, things look quite okay. And I think that kind of growth continues. And also UTC growth comes back. That is why for the rest of the year also, we are quite bullish. We will be a little bit lower than where we had started at the beginning of the year with Aerospace & Defense. But I would say a couple of things. One is while we are a little bit lower in UTC, the rest of the A&D is pulling through quite significantly. And there are also other areas, like Transportation, which will be where we thought we would be. So net-net, that is why the services guidance still remains what it is. Also I think UTC is again a transient problem. So we believe in Q4 at some point, we will see the pickup again. So therefore, we are not discounting it in any sense, in the sense that there is no crisis on its way, which means that we can really focus on growing some other parts of the business, where there is a lot of opportunity at this point.

Gaurav Rateria: Secondly, could you help us get some colour on the kind of pipeline you have in the DLM business in terms of size of those orders or what kind of work you are pursuing? And maybe you can kind of put that in the context of what work maybe you will be doing in UTC because that kind of addresses both the questions in terms of growth opportunities over the longer term with UTC account and also with respect to traction in the DLM business?

Krishna Bodanapu If you look at historically when we bought DLM, a lot of the capability there was designed to print, which means that somebody already did the design. They gave us the print, which are essentially the manufacturing instructions. But going forward and the intent to buy Rangsons at that point and signed DLM now was that we could then translate it to a build-to-spec, which is somebody give us the specification, we design and then we manufacture. So a lot of the pipeline that is building up is in this B2S space. And what that does is: a, it gives us a lot more stickiness in terms of the whole process. But more importantly, since we also own the design piece, it gives us a much better control over margins. We can make significantly better margins in build-to-spec kind of projects than build-to-print. So that is where the pipeline is building. A good example with UTC would be UTAS, which is the electronics business or the electronics-intensive business of UTC. If you look at it historically, Cyient has been doing a lot of design for them. Rangsons or Cyient DLM has been doing manufacturing for them but in two different isolated buckets. What we are seeing now with UTAS is that we are bidding on projects where we have the ownership of the entire cycle. We are responsible for the design. We are responsible for the certification and prototype and some element of volume manufacturing. Again, it is very high volume, we can't or don't want to do it. So if you look at how the pipeline is building up, it is really building up in these build-to-spec aspects of DLM, which give us much better margin and much better stickiness. So UTAS is a good example of that. Other examples are people like Honeywell, Thales, etc., where the buildup is also on the build-to-spec kind of projects.

Gaurav Rateria: Krishna, last question maybe if I can. So when do you think this pipeline materializes in terms of order intake? Maybe revenues will follow after that. And do you think that this kind of the whole position of UTC and UTAS acquiring Rockwell is more of an opportunity for you over the longer term?

Krishna Bodanapu I will say absolutely that is where things are evolving. I think we see a significantly higher opportunity. If you look at our pipeline today, which is in excess of $1 billion, about 30%, 35% of that pipeline is these Design-Led Manufacturing kind of projects. So I would say that is the whole intent. And that is where the pipeline is building. And similarly to your point, when UTC will close this Rockwell transaction, Rockwell is another very electronics-intensive organization. So our ability to do build-to-spec in electronics for Rockwell becomes that much more appealing. So in that sense, what you said is absolutely true. We see that, that gives us a lot more opportunity in a lot more customers. And that was the intent and that's playing out at this point. Now what I will say is FY2018, we have started a lot of the design aspects. 2018-2019 is when the design will have to get design completed, validated, prototype certified. So 2019-2020, we will start to see some of the volume pick up.

Gaurav Rateria: Thank you.

Moderator: Thank you. The next question is from the line of Abhishek Shindadkar from Equirius Securities. Please go ahead.

Abhishek Shindadkar: Thanks for the opportunity. The first question is regarding your UTC account. Krishna, is there a possibility that the projects, which come up in the next few years, the competitive intensity on those projects, could go up, especially on the UTC accounts?

Krishna Bodanapu I do not think so. I think the competition is there and we compete quite well. At the same time, I think while UTC has a very competitive process upfront, once you are a supplier, it is actually quite a fair process and quite a robust process both from their side and our side. So in that context, we have a master services agreement until 2020. And actually, if you talk to them, they will tell you that even in the negotiation phase, typically we are the first supplier that gets all the negotiations done because we know what UTC is. We have a sense of a significant amount of respect for them. They have a significant amount of respect for us. So we are able to come to a conclusion that works for both of us. We believe that will continue. I would not say that we get the best rates from them or we get the worst rates from them. But we get rates that work very well for us and them. Typically, the negotiations with us also start before any other suppliers just because they lay out what their objectives are, what their intent is. And we are able to really get to a situation that works for them. I think that is one of the things that our customers also tell us quite a bit, not just in UTC, but also across the board, we work with them to get to the ultimate objective that negotiations that we have on MSAs, for example, and not just about price, there are many things. And we are quite good about it. So in this specific case, we believe that we understand them. We understand their objectives. They understand us, they understand our objectives. So in that sense, a, from a shorter-term perspective until 2020, we are set until the end of 2020 with the MSA in place. And after that also, I think we know how to manage their situation.

Abhishek Shindadkar: That is helpful. And on the second question, Ajay, I mean, 90% of the business is today operating at 16.2% margin. And we are having a roadmap on improvement in DLM margins. So to reiterate the question asked earlier, are we kind of building in a buffer when we say only 50 basis points of improvement in the margin? Or there are investments on acquisitions that that is kind of limiting our scope in terms of margin improvement?

Ajay Aggarwal: I would say that this is quite a realistic forecast or guidance in terms of 50-basis points. I think this is the most likely scenario. Sure, we can always have an upside. As you rightly said, it is driven by their investments. Also in Q3, you do get some challenges in terms of the pay days and the billed days gaps and things like that. So I think keeping everything in mind, I would say 50-basis points is quite a realistic thing. And we will work towards maybe improving it by a few basis points here and there.

Abhishek Shindadkar: That is helpful. And just to follow up that in this Q1, you had highlighted that the impact of wage hikes could be 180 or 190 basis points. And in this quarter, you are actually getting this further to 150 basis points. So should we assume that the wage hikes were softer than what you had planned or anything that we should read more into it?

Ajay Aggarwal: Just to clarify, again I will tell that originally we had planned an impact of about 180 basis points. The actual hike has been given between Q1 and Q2. The total impact of that is 150 basis points.

That includes 70-basis points in Q2. You always have a few corrections here and there. 10, 20-basis points in H2 could possibly be there in terms of market correction and other things. So I would say not really. We were very careful. We already talked about it. We were very innovative in terms of the way we dealt with the wage hikes, trying to take care of outliers and outperformers and things like that. So I would say it has not really been soft. It has been in line with the plan.

Moderator: Ladies and gentlemen, due to time constraints, that was the last question. I now hand the conference over to Mr. Sandip Agarwal for closing comments.

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

B.V.R. Mohan Reddy: Thank you, Sandip. Thanks to all of you for participating in the call today. Thanks to Edelweiss for hosting us. As Krishna spoke earlier, we feel very confident about the business. We feel that we will certainly achieve double-digit growth for this year. The manufacturing grew about 20%. So on that count, I will say that the leadership team, led by Krishna, Ajay and the rest of the people who were present at our review with the Board of Directors, feel very upbeat about the business. So I would like to assure our investors that business is in good shape and we will continue to perform. Thanks again for being present in the call today. Thank you.

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