# "Cyient Limited Q4 FY2018 Earnings Conference Call"

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**ANALYST:** **MR. SANDIP AGARWAL –EDELWEISS SECURITIES LIMITED**

**MANAGEMENT:** **MR. BVR MOHAN REDDY – EXECUTIVE CHAIRMAN – CYIENT LIMITED**
**MR. AJAY AGGARWAL – PRESIDENT & 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 Q4 FY2018 Earnings Conference Call, hosted by Edelweiss Securities Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sandip Agarwal from Edelweiss Securities Limited. Thank you and over to you Sir!

**Sandip Agarwal:** Thanks Rio. Good evening to everyone. On behalf of Edelweiss, let me welcome you to the Cyient Q4 FY2018 Earnings Call. We have with us the senior management of Cyient, headed by Mr. B.V.R. Mohan Reddy, along with senior members of the management team. Without further ado, I will handover the call to Mr. Ajay Aggarwal to start the proceedings. Thanks and over to you Ajay!

**Ajay Aggarwal:** Thank you, Sandip. Good evening, ladies and gentlemen. Welcome to Cyient Earnings Call for the Q4 of financial year 2018 ended March 31, 2018. I am Ajay Aggarwal, CFO. Present with me on this call are our Executive Chairman, Mr. Mohan Reddy and Managing Director and CEO, Mr. Krishna.

Before we begin, I would like to make the customary statement that all 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 e-mailed to you and is also posted in our corporate website. This call will be accompanied with earnings call presentation. Details on the same have already been shared with you. I now invite Mr. Mohan Reddy to provide a brief overview of company's performance for the quarter and the year ended March 31, 2018.

**BVR Mohan Reddy**: Thank you, Ajay. Good evening, ladies and gentlemen. Before Krishna and Ajay make the presentation, let me make some brief remarks on our performance for Q4 as well as the financial year 2018. Both of them the Q4 performance as well as the FY2018 performance were in line with our expectations both in terms of revenue as well as margin.

Our revenues have grown to $607 million. It is a very strong growth, 12.9% in dollar terms whereas 11.7% growth in constant currency terms and this would be observed across all the eight business units we have in the company.

The operating profit for the year stood at Indian Rupees Rs.594.2 Crores, which is a growth of 13.3% compared to the previous year. The net profit for the year was at Rs.429.6 Crores, a growth of 16.1% over the last year. We continued to have for healthy cash position. We now have Rs.1093.7 Crores of cash. We also declared a final dividend, which is Rs.4 per share, which takes the total dividend for this financial year or the financial year 2017-2018 to Rs.13 per share for the full year, which is the highest and a comparable number to that I believe the previous year we declared Rs.8 per share.

Coming to the financial performance of the Q4 of financial year 2018, the growth here is too strong across the board. We saw the quarterly revenue at $164.6 million, the highest ever in a single quarter, signifying a growth of 16.8% year-on-year, 8.3% quarter-on-quarter in dollar terms.

All the eight based business units have witnessed a similar growth year-on-year basis. The services revenue came up at $142.7 million signifying a strong growth 14.3% in year-on-year term. Operating profit for the quarter stood at Indian Rupees Rs.1492 million or Rs.149.2 Crores, which is 19.6% growth on a year-on-year basis.

We also saw our DLM/Design Led Manufacturing having the highest ever-quarterly revenue and the operating margins in the recent years. Net profit for the quarter stood at Rs.121.5 Crores with the growth of 16.2% year-on-year terms over the last financial year.

Few comments on the CSR, as a part of the ongoing CSR initiatives, we continue to support 25 government schools for education of the underprivileged children. As a part of our initiative to increase IT literacy, we have added one more Cyient Digital Learning Center, which now takes the total to 57. It had several recognitions during the current quarter. Cyient was recently recognized by the Telangana Government for the green initiative wherein 6000 sampling have been planted in our facility. On the above the front, further Cyient was recognized by the Boeing Supplier Year Award for the fourth time in a row actually it is in a block of six years.

On the infrastructure front, we moved two of our business units up to SEZ and setup from post Silicon Validation Lab in Hyderabad for a customer. We are also planning to expand our Pune facility to about 100 FTE. On the operation front, Cyient and Bluebird Aero Systems Limited of Israel signed a MoU to address the opportunities in the Indian UAV space and subsequently have entered into a joint venture on April 11, 2018.

We also became the founding member of Xynteo India, 2022 consortium; this is the government of India initiative to enable affordable medical facility to widest section of the society. Cyient celebrated the 10-year partnership with IHS as 20 years as a global partner with ESRI Inc. Our IRIS certification was extended to comply with ISO TS22163:2017 after its successful audit.

With this, I would like to hand over this call to Ajay, who will take you over the details of financial presentation and thereafter Krishna will talk about the business. Ajay, over to you!

**Ajay Aggarwal:** Thank you, Mohan. Let me start with revenue as Chairman mentioned, this has been really a very well rounded performance for us where all across the business unit across all the eight business units as well as the three geographies, we have seen the growth and as we go forward I think we are expecting the traction to continue across all the industries.

In terms of the quarter, I would say that again we have clocked good revenue of 164.6, which is the highest ever. Also we had another milestone in terms of DLM where we also did the highest ever revenue in the quarter. Here I would like to just mention this revenue also includes both for the group and for the DLM about a million dollar of revenue from our recent acquisition for B&F that was acquired in January and it has been consolidated for two months.

In terms of the income statement, I would say you would observe that we have a handsome growth of 13.3% during the year in the operating profit. In services, we continue to have good operating margin at about 15.4% and overall I think between the two years, we have improved the margins by about 60-basis points. So when we see internally, I think you see, it has a good achievement that the situation where we had the wage hike and not so many price increases coming from the customers, our focus on operating profit and the drivers of it has really helped us.

I would also like to mention the exit quarter margin for DLM is also the highest ever. We have clocked about 7% and we are expecting the traction also to continue in case of DLM. In terms of the profit after tax as we saw we have been delivered like-to-like growth of about 16% between the two periods and in terms of other income, also we had a good quarter, but it is all between the treasury and the forward cover gains income.

Tax rate I would like to make a comment that the tax rate for the exit quarter of like-to-like is truly one of is about 25% and we do see with the focus on the SEZ, the whole of the new growth in business units, we are planning for SEZ in the next year and also we are looking at the full year benefit of US taxation, so definitely we are looking at much reduced tax rate in the next year.

In terms of the Q4, I think this will also on the expected lines. We did have in the services a margin of 15.2%, but I would say that for all practical purposes, we are at about 15.7%. We did have about 0.5% of some of the fixed costs that came at the year-end, some of them driven by higher performance and order intake in terms of the sales commissions and some other variables, but actually it is very nice that we are exiting service, business at a good margin. I already mentioned that in case of DLM also, we have done about 7% margin during the quarter and I already mentioned about the tax that the exit tax is about 45% on like-to-like business, which is very gratifying.

In terms of the cash position as we already saw, we have good cash of about 10,937 million. This is after paying the dividends at the enhanced payout of about 40% for this year; we have also spent money on various investments during the period. You can see some of the numbers on this particular slide. In terms of our services business, we continue to have a good conversion of about 45% and in case of DLM we had extraordinary growth in between the two quarters and because of that we had consumed the working capitals, so the free cash flow has been negative, but we are working on generating the free cash flow in case of DLM.

In terms of the other income if you see for the quarter, we have made 408 million of other income and for the year 1,489. This comprise of between treasury income, the realized gain from forward contracts and other items. I would like to say that we continue to follow the same policy, which we believe it is prudent for all the times and we have total exposure of about $128 million which is 70% of the net inflows for the next 12 months and you can see the position of various forward covers as we see the position as on date.

With this, I will hand over to Krishna to give more updates on the business and also share the outlook for future.

**Krishna Bodanapu**: Thank you, Ajay. Good evening everybody and I will share the business update for the next few minutes. The first thing I want to highlight is we signed the joint venture between ourselves and Bluebird Aero Systems effective April 11 of this year. The joint venture is 51% owned by Cyient and 49% by Bluebird. What this encompasses is the transfer of technology and manufacturing know-how from Bluebird to the joint venture, which is called CSS or Cyient Systems and Solutions to support the manufacturing and maintenance of UAVs for the Indian market.

Specifically, why UAVs in India, it is because we believe that there is a significant market within various aspects be it the military, the paramilitary, the surveillance, the police forces and also some commercial applications there is a significant opportunity for addressing this market. Also as many of you know there is not dearth of players in the UAV space, but we believe there are solution that Bluebird brings, which are these three, being the SpyLite, ThunderB, MicroB are quite unique, and some of the things applications that they can be used in, a) are very relevant for India, for example high attitude or the varied conditions that exists across the country or rather long coastline that we have in the country. For those kind of situation, the products are actually very apt and very good and therefore we believe that there is a significant value proposition for the Bluebird products in the Indian market.

Therefore, the JV after the transfer of technology will indigenize, manufacture, integrate, test, support UAV systems and where in the process of building up a factory projects for this in Hyderabad with 100 systems a year. So it is a very small batch manufacturing because the systems are quite complicated. So that is one.

The second thing I also want to update you on NBA, New Business Accelerator. We created this initiative called the New Business Accelerator to facilitate innovations within Cyient to really focus on developing new products service and solution. As you from the S3 strategy a key tenant of the S3 strategy is to move some services to solutions and therefore it becomes quite important for us to be able to clearly define and create these solutions. The solutions are little bit different from just packaged services. Therefore, it becomes important to have the right ecosystem, to have the right innovation, development, framework, etc., and therefore we create this thing called the New Business Accelerator.

Where this becomes relevant, we are committing this year that is about 100 basis points of revenue or margin, so about $7 million plus will go towards the NBA initiative and therefore we will call it out going forward in terms of what we spend because it will have a material impact on the profit that I will explain that in little bit more detail going forward.

I also wanted to say that $7 million number is a combination of opex and capex and some of these will also be quite capex intensive because how the technology is being developed and so on and so forth, but I will talk about it in the little bit more detail when we talk about the outlook for the year ahead, but the reason I wanted to highlight that this is an important initiative for the future. We are committed to about 100-basis points of revenue or 1% of our revenue going towards this next year and we would really gear up actually and a lot of the impact will also start with Q4 though the initiative has been in place for the last year. We saw lot of the impact in Q4, which is one the reasons why the operating margins were flat in spite of a very good revenue performance.

In terms of the investment pipeline and focus area, nothing really changes. I will just say the three deals that we closed this year, there is one in a LOI stage, which will happen at some point in the next few months, there is some corporate investments and also nothing has really changed in terms of what the focus area for the end of the year.

In terms of the industrial outlook, we believe aerospace and defense is expected to grow by 10%. There is a strong demand and for an industry like aerospace and defense 10% and that is a very significant number.

We are also seeing a lot of disruption in the supply chain of Boeing and also some of the other large OEMs and therefore we believe the market is looking quite good, which will also be good for us, which is what drives growth ultimately for us.

In the communication sector, obviously there is a lot of growth in traffic in terms of the amount of mobile traffic and the amount of bandwidth and data that is being consumed and we believe that this is actually translating into some good demand for upgrading of networks and creating various services on these networks.

The utilities and geospatial market is also seeing some good traction and both because of things like electrical vehicles, which are now becoming a lot more common, the demand for electricity has improved quite a bit. Also because of the distributed energy sources, which is essentially to say that every house has a potential generating point, the grid itself has to be looked at and designed a little bit differently because historically grids have been designed to carry electricity one day that is for the generation point to a home, whereas now from a generation point to a consumption point and now you also have the ability to put our consumption point back into the grid, so therefore that along with the newer technologies is driving a lot of business for us. We have actually put together a very interesting solutions there for example the solution called IDMS that went on big data cloud computing and analytics and IDMS was a good example of how digital technology we are playing out in the utility sector and we have actually seen some of the first wins there, which we expect it to continue to translate quite well into the longer term growth.

The rail market is expected to grow 2.6%. Most of the growth will come in services that is rail services and also in rolling stocks, which is the train itself. We would also see a lot of investments here in newer and emerging technologies because the focus is now not just on building a better asset that maintaining it and running it more effectively, which means that people are embedding a lot more in terms of IoT and distributed computing and so on and so forth into the train itself. I think that industry is also recovering, albeit it is a slowish recovery, but we see a lot of opportunity in some of the areas there.

The upstream, which is essentially the exploration part is also, the exploration part actually consumes a lot of capital in areas in which we can be of services going on quite well, mining is also seeing an uptick. We are seeing a lot more demand from our customers in this segment and a lot of the projects which will go live in 2020 onwards are starting to kick off now and given that we are in the early part of that value chain it is good for us.

Semiconductors I can say it is a great industry to be in at the moment because a lot of the new technology be it AI, be it the 5Gs, cloud computing, etc., then it is on a chip and the chip that should work effectively and work very fast and therefore we will continue to see some good growth.

Healthcare will also grow. I think we have a very targeted strategy there, which has two prongs to it, one is to service the large OEMs which is in our traditional business and we continue to do well there, but equally important is to look at the emerging low cost healthcare market because that is where we believe we could really make a big difference by supporting, enabling, design and manufacture of low cost devices and the repair platform that the Chairman talked about a few minutes ago is to enable that it is to make sure that we create a platform into which the devices that we design and manufacture go into and therefore hopefully have a little ubiquitous market across cost-sensitive countries.

I will just take a moment to recap what happened last year from an outlook perspective. At the beginning of the year, just to see the outlook that we had suggested or that we have talked about, in terms of growth which is double-digit growth in the core business or for the services business that ended up with 12.9%. We said DLM will witness growth in the ballpark of 20%, 19% includes B&F and in segments we should take out the B&F or that was not anticipated at the beginning of the year, so without B&F and adjusting for the tax because the way the tax is accounted for exchange growth has been 16.1% in DLM which obviously is a little bit lower than expected at the beginning of the year but again I am not too unhappy about where we are ended and more importantly we would see when I talk about the outlook going forward in fact the margins it is a group margin will see an improvement between 50 and 100 BPS. The actual number came in at 58-BPS.

Lower part of the range was anyways within the range. Services we said, also would be 50 to 100 BPS then we came in a little bit lower at 43-BPS and we said we expect to see a double-digit earnings growth in FY2018 and that came in at 16.1%. So net-net we are quite pleased that we were able to post what happened and we were able to deliver overall what was a very, very good year in both revenue and in terms of earnings growth.

In the same spirit, the outlook for FY2019 the revenue growth in the services business will be double-digit again and again obviously we will have an endless debate on what can double-digit mean that is going to be in line with what we saw this year. The legacy DLM business which is Cyient DLM or the old name Rangsons, we expect will grow at about 20% and again while we were a little bit lower than that last year or in FY2018, basis the pipeline, the opportunities, etc., I am quite confident that it will be at least 20% this year.

I will again put a caveat there, Q4 was very strong so Q1 will see a dip, but for the year I am quite confident of 20% number. Overall DLM there will be about 35%, which includes B&F, which is the true design build and manufacturing company that we acquired a few months ago. In terms of operating profits, we will see double-digit growth in operating profit again in FY2019. OPM, which is the margin itself, will be flat. We will see at least a 100-BPS improvement due to operational efficiency and this will get offset by the investments that we are making in the NBA. That is why I want to be clear that while it is a significant investment, we are earning that investments in making the investment, the margin would not dip as we see it right now. So in that sense the additional that we get because of efficiency, we will invest in the NBA.

Obviously it also gives a little bit of leeway in terms of how we plan those investments because as we see better profits will accrue then we will plan those investments. DLM margins will also improve. It was 7% in operating margin for DLM was 7% in Q4. We do not anticipate that it will come down slightly for the year but it will still be in the low single digits from an operating margin perspective. In terms of tax, the tax rate will be lower by 200 to 300 BPS to the point that Ajay made earlier, I think two things are happening, one is obviously the US tax rate is quite beneficial given a fair amount of hard profit is also there, but also more importantly we have been aggressively replanning such that growth happens in the special economic zones and we see one of the things we did is both MTH and semiconductor will have good growth in this year and before the growth happens we will move a lot of the components there in the new special economic zones.

So net-net, I do not have a comment on earnings because they are still working out on how some of the other things with other income specially with the Rupee, etc., will work up, but what I can commit is that as we see things, we will see a double-digit growth in operating profit in FY2019.

With that I will wrap it here and just say quickly thank you very much for your patience and support in FY2018. Obviously we had at least what we consider a very good year it was a year that we anticipated and therefore I think the ratings has clammed well because again we almost had $70 million or $80 million of net new revenue so that buzz takes some planning for a company of our size but we were able to anticipate, and therefore we were able to grow in a very structured manner which then helps with things like margin and operating profit. So thank you very much for your patience and also for your support and I want to assure you that things look quite good for FY2018 along the lines of the outlook and I look forward to your continued support.

**Moderator:** Thank you very much. We will now begin with the question and answer session. We have the first question from the line of Pankaj Kapoor from JM Financial. Please go ahead. We seem to have lost the line for Mr. Pankaj Kapoor. We will move on to the next question. The next question is from the line of Gaurav Rateria from Morgan Stanley. Please go ahead.

**Gaurav Rateria:** Thanks for taking my question. Question for Krishna, if you could give a color in terms of is the revenue growth in services going to be more broad based and do you expect the client which was dragging growth or not growing in the aero space to start leading growth in the vertical?

**Krishna Bodanapu**: I mean the growth itself will be upright broad based. We do not see anything that is going to stand out or that any business that is going to stand out. The medical business will grow at a fairly good way just because it is a small business unit, similarly semiconductors, but also when I look at some of the larger business units we have seen double-digit from communications for example aerospace would also be there or thereabouts so I think the growth itself will be quite broad based. We are not premising it on any specific customer growing to get quickly.

In terms of the aerospace customer, I think at least this year we have a small dip there, but I think going forward we will at least see that revenue sustaining. There are some opportunities where we are seeing new growth coming in because various things have happened there, but we do see new growth coming in but at least the sustainability is there therefore we are able to address the new opportunities. The commentary that I gave is not premised on that customer growing significantly, if that happens that is a bonus and I think we are doing all the right things to that to happen.

**Gaurav Rateria:** Krishna second question on where are we in this transition of just providing designs services to design and build because order intake number in DLM kind of does not reflect that so if you could provide some colour on where are we in that process and do we expect large orders to control over the next few quarters?

**Krishna Bodanapu**: We do expect that. I think, we are in the process of closing some fairly significant orders. The DLM order intake was a little bit lower this quarter because Q3 we had some good orders that we sustained for at least this year is also going forward, but the total pipeline in DLM is about quarter billion dollar, probability adjusted will be about 50%, 60% of that. So net-net the pipeline is there. We will close this in the next quarter, but again working off very significant pipeline.

**Gaurav Rateria:** Last question for Ajay if you could provide is there any one of which you referred on services margins in this quarter or is this just a year-end phenomenon? And for the next year, the bulk of the investments in NBA, will that be reflected more in services or will that be a part of that DLM margins?

**Ajay Aggarwal:** First when you look at the exit margin for services, I said while the reported number is 15.2%, if you consider these one-off it is more like 15.7%. And as I said, we will always have some correction for the things like annual sales commission and things like that, that is the first point. When we look at the spend that is going to be on NBA there is a lot of focus on solution so from the perspective of the outcome, I think it is going to be more on solutions and it will encompass both services and DLM, but if you are asking some perspective of where it will reflect we will take it at a group level on SG&A basis. So we are going to carve out investment funds and we are going to show you separately at the corporate level in terms of that.

**Gaurav Rateria:** Thank you.

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

**Pankaj Kapoor**: Thanks for the opportunity and good quarter. Krishna can you give some colour on the Bluebird JV that you mentioned in terms of the plan investments that you are going to be do over there. I presume that is over and above these several million investments in the Accelerator program so what kind of production and revenue cycle when is that expected to start? Also what kind of financial impact do you see and the excepted payback period from that investment?

**Krishna Bodanapu**: Pankaj, I think, it is little bit early for that. You know the JV was formed because there are a lot of opportunities in India that we are seeing to come up. There are a number of financials and a lot of this is obviously in the public knowledge on the various paramilitary forces, the military forces that it has put out or in the process of putting out RFPs or RFQs for the UAV. So in that context, I say it is little bit early, but what I will say is that the investments will actually be relatively minimal because the factory for example to produce UAV is quite it is not very capital intense. The skill that is required is actually quite unique and therefore the people that you need are quite capable etc., so in that context the capital investment is going to be quite limited. I think $2 million is what we have planning at most, but the payback will be quite attractive, but I can say it is still a little bit too early to talk about the specific numbers. We believe we have a very good proposition and we are working through the details.

**Pankaj Kapoor**: So this 2 million is over and above 7 million?

**Krishna Bodanapu**: It is all capitalised. It is capex because the factory will need some equipment, we will need some chips, fixtures, tooling; having said that, actually a lot of the mechanics of UAV are quite straightforward. The electronics will still be manufactured in time dealing. So it is quite small of investment and would be capital investment. It is a product that is based on steel rather than on packets.

**Pankaj Kapoor**: Sure and I mean if you look at the order booking that we did in the last couple of quarters post that do you think that there is kind of blind spots how they, which may prevent the growth accelerating from what we did this year?

**Krishna Bodanapu**: I would not say I mean again the problem is with blinds spots is we do not know what they are when they hit us, as we see things to quite confident because the order book is quite strong. Customers connect the quite strong and we are getting some good feedbacks. So as thing stand, I cannot at least do where the outlook that I gave we do not see significant risk. We see the usual business shifts that we believe that those are all things that we understand have been mitigated.

**Pankaj Kapoor**: Sure and Ajay what would be the likely capex for FY2019 including the $2 million investment in JV and any part of the 7 million that we might be putting on the capex?

**Ajay Aggarwal:** The way we look at it is that one we look at the normal capex and I think that normal capex will be line it what we have spent in need current year. I think we have been blocking for the last couple of years between 2.5% to 3% that is the normal capex. Second I think what investments e will make as Krishna said as far as the Bluebird is concerned I think that is an investment that you have acquisitions on so what we do is when we look at these number we try to look at net of these investments neither we take the benefits of them nor the cost and all of them are going to be capitalized so right now I would say it should just consider the normal capex and rest of it, it is also fruit bearing so as you get the investment number end we will also get the benefits of it over the years.

**Pankaj Kapoor**: Sure and lastly on the FY2019 margin guidance that you spoke of which will be flat Y-o-Y what kind of exchange rate assumption that we have factored in there?

**Ajay Aggarwal:** We have started our budgeting exercise in Q4, early Q4 so whatever are the exiting rates that is what we have taken at that particular time.

**Pankaj Kapoor**: Okay hypothetically if the rupee continues to weaken beyond 65 and 65.5 then that could be incremental to the margins?

**Ajay Aggarwal:** I think we had considered something like 64 and then of course weighed through various cross currency that is right, but you never know what currency as Krishna said, as it is very difficult to base anything on the currency outlook, so whatever guidance is based on Q4 average rate that what you can consider.

**Pankaj Kapoor**: Thank you and 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. Sir I have couple of questions for Krishna. My first question is on the services order intake for this quarter, it was a bit soft so what was the reason for the softness and what gives you comfort on achieving full year growth guidance which you have for services business?

**Krishna Bodanapu**: Just a cyclical nature of how order intake comes from because if you look at Q3 was actually very, very strong quarter. It was an extraordinarily strong quarter. If just if I look at the order backlog and look at where we stand with the order backlog which is about $400 million I think that this makes me confident and then I look at the previous year's of how things pan out that is need confidence so I think the backlog is probably better way to look at it because Q3 was actually very strong quarter.

**Nitin Jain:** Because I look at the LTM numbers so even on LTM basis this number looks quite soft so that is what reason I asked this question?

**Ajay Aggarwal:** If I may just add to what Krishna said if you look at there are two ways of looking. Typically if you see that at any time we have a backlog of about six to seven months so that parameter would be enhanced. Forward-looking revenue targets is in place that there is no such decline if you look at full-year or intake to full year order intake that is quite in the similar ranges and also if you look at the overall pipeline that is the highest ever and we do have more than billion dollar of pipeline and maybe adjusted for probability, and this is how we look at our business so when we are getting the guidance we have already taken into consideration, the order intake, the backlog in the pipeline.

**Nitin Jain:** Second question again on the services business and the margins what are your aspirations in the next two to three years so currently you are around 16% level and for the next year you have guiding flat margin trajectory but if you look for the next two to three years can this go up to 17% or more or 16% is there the level where you tried to keep it?

**Ajay Aggarwal:** I think it depends I mean there is potential absolutely exists because if you look at this year also we will see a lot of things that we are doing will pan out over the period of time. Therefore, even this year there is the potential to increase margin absolutely, but because of the opportunity has also exists there is some real opportunity. I mean is also not investing for the very future etc., there is a certain solution that we are in the process of developing where we see a market and market customer and so on so forth, so that taking back into account, which was that 100 basis points, which you will get because of operational efficiency we will put it back into building these capabilities so that the growth acceleration at that point will be very significant. We have to look at the margin from that context going forward is what the growth opportunities that we have. I mean if we had to grow margin by 100 or 200 basis points it is absolutely there, but then we have to cut investments and with this point at least the way I look at it if we make those investments now the acceleration of growth in FY2020, we see significant opportunity that is why their making the investments now.

**Nitin Jain:** In which segments are we making these investments if you can just elaborate?

**Ajay Aggarwal:** I think there is two buckets where the investments are being made. One is I will see in the emerging technology. For example, there is a lot of work that is being done in machine learning in areas of interest to us for example for the geospatial business machine learning from extrapolating features from a map or automatically which will bring in significant amount of efficiency and automation or if you look at the aerospace business this machine learning system builds very specific applications in aerospace that is one step. IoTs and another thing these will be emerging technologies that we are working on for certain areas. The second step is products and these are not product in the sense that they are not necessarily signed, branded consumers products, but these are products where subsystem level or assembly or sports system level and we are able to actually completely design and own a subsystem. There is a few of those examples that we are working on where again our subsystem will plug into a larger system that the OEM themselves but we have built the capability of doing the entire design, beyond the IP, we will do the manufacturing etc. So these are two buckets into which the investments are going. The one is complete subsystems and the second is emerging technology.

**Nitin Jain:** The second component that is subsystem this will be part of DLM right?

**Ajay Aggarwal:** Some of it will be DLM, but a lot of value capture will still happen in Cyient because this is design and then manufacture and the value capture happens at the design stage because that is where the intellectual property so and on so forth. Therefore, it will reside in Cyient still because that is where a lot of value capture is. The execution, which is manufacturing might be done in DLM, but again the idea is that we would not do manufacturing without owning the intellectual property, which is captured in Cyient.

**Nitin Jain:** That is it from my side. Thank you.

**Moderator:** Thank you. We take the next question from the line of Prakash Chellam from Marathon Edge. Please go ahead.

**Prakash Chellam:** Good evening Krishna and Ajay. Congratulates on a great set of results. Two questions I had; one for Krishna could you just gives us some colour you had fantastic growth on your transportation unit. Could you give us some colour is to how much of this came from your topline there vis-à-vis the best spread out diversified and the second question was for Ajay free cash flow conversion, which is something you are doing really well on seems to have fallen off a little bit. Free cash flow to EBITDA conversion could you just comment on that and specifically there could you just comment on how long more do you see free cash flow negative sort of situation for the DLM portion of the business? Thank you.

**Krishna Bodanapu**: Prakash, I think on the first part a lot of the growth will come from large customer, but it was also quite broad-based. I mean we are basically we have five customers there given that it is concentrated industry and I think four out of that five grew in double-digits so of course but with the largest growth in double-digit is the effect of disproportion, but it has been quite broad-based and going forward we see that will continue. The largest customers become quite large so slow down a little but, we have also as wanted to other opportunity that are just going to further make up for this. On the cash flow, I will let Ajay speak.

**Ajay Aggarwal:** On the free cash flow I would say that for us our business free cash flow for services business typically we are targeting about 40% to 50%. Now let me explain to you what happened in the previous years. A DSO of about 100 days; and over a period it has somewhere between 75 and 80 days. If you look at last year for example we had significant drop in DSO by about six days that gives you extra conversion of about 5% to 10%. So when we have already reached a particular level of 75 to 80, I think the conversion that we can target is about 45% to 50%. So we are very confident that with this reduction now sustaining DSO between the 75 and 80 and of course some of the other drivers in terms of the SEZ, capex and other things will have a handle so I would say that internally I feel satisfied that we have done 45% free cash flow in services and we will continue to target 40% to 50% and growth is another area that you know if we have higher growth working capital consumption is higher which happened in case of DLM. Coming to DLM I think we are working on making sure that first when we generate the positive EBITDA and then over a period of time, we will also get a conversion like 40% of EBITDA to free cash flow in DLM and may be next year we are targeting something like breakeven for the next year.

**Prakash Chellam:** So the next one year anticipate that DLM would be free cash flow negative, could I assume that will be the approximately the same order of magnitude, which is there today or do you think it will be a little bit more than?

**Ajay Aggarwal:** For full year we can expect the breakeven but since you have seen there is cyclicity there so in the quarters where you have growth, you will see the working capital consumption and whereby negative free cash flow and other quarter for overall we expect breakeven at free cash flow level in the next year.

**Prakash Chellam:** Okay you are saying FY2019 you anticipate overall for the year DLM business could become free cash flow breakeven?

**Ajay Aggarwal:** Yes.

**Prakash Chellam:** Great. Thank you so much for taking my questions.

**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. Krishna, just wanted more clarity on the new business Accelerator Program. You have mentioned that over the long-term 10% to 15% of incremental earning but do we have plan in place or the target as to how much of our revenues in the next two to three years should be coming from this program led initiatives?

**Krishna Bodanapu**: Yes absolutely Urmil, we have plan on how it will evolve because ultimately like I said, the key is for us to move away from the services to solution so there is a clear target and there is some KRAs that are set around those target for this year and we will continue to do that. Therefore, while this year investment plan, there is also pretty clear revenue plan because for something to get funded through the NBA there is process that is followed and one of the key elements that the processes or business case wherein we have clear anticipation of what is the revenue that it is going to generate out of particular business, because again a lot of these are there are application technology, they are not new research for example so therefore there has to be clear business case in terms of how we monetise that solution or that intellectual properties, so there is clear plan both in terms of revenue and also obviously cost and but importantly in terms of revenue.

**Urmil Shah:** Secondly in FY2018 communication and transportation offset the softness in the aerospace in the sense for a double-digit growth in FY2019 and beyond while you said medical and semiconductor could go faster but relatively to the smaller vertical so which are the verticals you still think can not just for the one year for couple of years can still grow at double-digits?

**Krishna Bodanapu**: The comment I made on medical and semiconductor was that growth rates would be much higher, but of course they are smaller piece, so we have passed that. I think still we see communications will continue to be a growth driver. We are seeing a lot of opportunities there. We are seeing that the aerospace and defense is also coming back quite a bit because of the new pipeline, new customers that we have added, we have rejigged a lot of sales team there. We have invested a lot in competency. So we believe that both A&D and Comms will also have a good year. Now Comms, this year, I think ended up with about a 24% or 25% something like that and next year they will be a little lower, but it would not be double-digit. There would not be one in double-digit let me put it that way.

**Urmil Shah:** Thanks and all the best.

**Moderator:** Thank you. The next question is from the line of Abhishek S from Equirus Securities. Please go ahead.

**Abhishek S**: Thanks for the opportunity. Just a quick question on margins; so just trying to understand the math here are you guys spending in flat margin for services business next year outside of currency?

**Ajay Aggarwal**: Yes we are, yes.

**Abhishek S**: Okay and just a followup on that is there any particular reason to say so, or are there any headwinds that you are foreseeing in the next couple of quarters? Thanks for taking it.

**Ajay Aggarwal**: Let me again clarify. What we are saying is the overall group margin is going to be flat. Now that the major portion of revenue almost 90% from services, which is very fair and the margins of DLM is improving to assume that the services margin is flat, but I think we are expecting that overall in terms of the margin it will improve by 100 basis points and then we will invest in investment some of it could be capex also to the extent that it will not be P&L. So let me again clarify we will have the wage headwinds. We are confident with the operational improvements are going to be such that we will improve despite the wage hike, the services margins by 100-basis points and when we have the investments and net-net we will be flat.

**Abhishek S**: That is helpful. Thank you for taking my questions.

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

**Mohit Jain:** Sir just one clarification on the same thing for FY2019 what you are saying is that 2.5% of revenue is a normal capex and then we should add 9 million additional capex for the investment that is why you are taking about and apart from that 1% of revenue will go to P&L is that the right understanding or 1% includes just 9 million of investments that you are talking?

**Ajay Aggarwal:** Let me just clarify. What we are saying is that in terms of capex that is the normal capex in line with the last year normal capex. For example, when you look at our free cash flow also there is a normal capex, which is before the free cash flow from the operations right that has been historically between 2.5% and 3% and we said that the normal capex is going to be 2.5% to 3%. Now in terms of the investments in NBA, we said they would be up to 1% with our investments. These are investments over and above this capex and most of it will hit the P&L, but some of it will also be capex.

**Mohit Jain:** So 1% is the total of capex plus opex investment?

**Ajay Aggarwal:** No, let me again say 1% of revenue, which is over and above 2.5% to 3% of normal capex is going to be opex plus capex and whatever is the opex portion will hit the P&L which could be majority of it may be less say about two-third of it or three-fourth of it is going to be opex. We do not know the details, but I am just saying for your broad understanding this could be impact.

**Mohit Jain**: Understood. Second is, is there any investments, which was done in both quarter because they will some increase in capex?

**Ajay Aggarwal:** I think this year you have to look at it from the whole year perspective. I think there is no backend and lot of facilities that we make or talked about for the special economic zones and I think a lot of earning has taken place in this quarter. So it is all good this thing and as Krishna said it is also cyclic.

**Mohit Jain:** Nothing related to the JV or to the accelerated program?

**Ajay Aggarwal:** No nothing. That is all saying that when you look at our free cash flow we are showing up the investment.

**Mohit Jain:** Actually that was the next one, your cash flow for operations was weak this time, see we had this double-digit EBITDA growth for cash flow from operations was quite weak for FY2018? Cash flow from operations only, if you remove the capex?

**Ajay Aggarwal:** Free cash flows to operations again I clarify that we have seen very handsome growth in this particular year. We have also seen that year-on-year our DSO has reduced. There is no headwind on capex. There was a slight headwind on the tax this year, but we have already said behind that so I look from free cash flow that is no concern and overall I think we are at 45% conversion also now that we are going in detail we have also this impact of the foreign exchange fluctuation on March 31 wherever receivables are restated to the extent of about Rs.20 to Rs.23 Crores, which should I think honestly we are internally not at all worried on free cash flow, we are on the right track, we have delivered a good conversion of about 50%. We will continue to do that and DLM is already going to breakeven both on EBITDA side and free cash flow side worse is behind us.

**Mohit Jain:** Sir this change in receivables if you restate it as of March 31, 2018 that will also have impact our cash flow from operation?

**Ajay Aggarwal:** That is right because you take the Rupee number of receivables between March 31, 2017 and March 31, 2018 is done.

**Mohit Jain:** The actual cash transaction has not happened. This is just a restatement right?

**Ajay Aggarwal:** No but in our case for the receivables so why we do not take it offline. We will fractioned that. Whatever is it restatement is where we look at the free cash flow is the change in the receivable in absolute INR number.

**Mohit Jain**: We will take it offline Sir. Thank you.

**Ajay Aggarwal:** It will show us the working capital change definitely.

**Moderator**: Due to time constraints, we will be able to take one last question. The last question is from the line of Madhu Babu from Prabhudas Lilladher. Please go ahead.

**Madhu Babu**: Sir I just want some view on some of the verticals like semiconductor, off-highway and medical so all the three segments currently are subscale so how do we see scalability here I mean would look at big time acquisitions there?

**Krishna Bodanapu:** That is part of it but I think we had also seen some traction in terms of customers and I think each one of the businesses different strategies, medical is quite bullish on design to build so we design, build manufacturing is a part of it, so which means we are seeing a very strong transaction there so I think a lot of that growth will be internal, but we are also looking at potential acquisition. Semiconductor is also in a similar situation. Of course the strategy is different, but a lot of the emerging technologies fall there, so the semiconductor is also trying to beef up both internally and externally. Off-highway equipment I will say we will do that internally. We have some good customers and we are seeing traction there, so it is bit of both. I think both semiconductor and medical especially are very, very important for the long-term growth because those are emerging areas and we see some very strong traction there. Off-highway and industrial, it is core to us. It is a part of what we do very, very well, mechanical engineering, centric engineering. So I think we will continue to scale there. So while they are subscale, I think we are seeing some very good traction.

**Madhu Babu**: Sir one more than want to this new business initiative so is it client pull or how are we going to develop something and then if at all we develop and then how is the sales cycle and how do have approach that client because that looks a bit we will be have to put additional sales investment for selling those IP or products?

**Krishna Bodanapu:** No I will say it is convergence of client pull and what we see as the opportunity in the market so ultimately we do not want to go to different type of clients, we do not want to sell different types of services, we do not want to open up new fronts in terms of different verticals. So in that construct this is really the whole premise of the strategy if you look at it is built on expansion in terms of the wallet share, in terms of the capability and the value chain, not expansion in terms getting more customers and view the market, in that construct if we look at where we are making the investments, we are triangulating between what the market wants, what the customers wants and what we are capable of delivering and a lot of it will be to exiting customers goes to new service and therefore we believe the exiting sales force etc., of course has to scale, has to be trained will need to bring in new people, but we are not going to come back and say now we have to make haste investments which are different that what we thought.

**Madhu Babu:** Just one last one from my side. Now Sir the way the business is transforming more into design led manufacturing you are all putting this JV, a lot of onsite centers have been put up in for aerospace as well as other verticals so would we say that 14% is the new margin target for the company overall. I mean that earlier margin was at different profile of the business. Now with business moving more to end-to-end, 14% margin would be the new normal can we imply that?

**Krishna Bodanapu:** I said for the year, but I think once thing stabilizes and scales start coming up we will reset it, but I think for the year 14% is the near normal.

**Madhu Babu:** Thanks a lot.

**Moderator:** Thank you very much. We will take that as last question. I would now like to hand the conference over to Mr. Sandip Agarwal for closing comments.

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

**BVR Mohan Reddy**: Thank you Sandeep. I just want to take this opportunity again to thank all our investors; all the analysts who continuously track our company, participate in various discussions with us, spending time with us. We appreciate all that you do for us, a big thank you. Whatever the leadership team led by Krishna, Ajay and others have committed to you during the financial year 2017-2018 they delivered so trust in us and we will deliver what we tell you.

As the last comment we also our going to have Investor Day on May 4, 2018. This is the initiative, which was started off Ajay Aggarwal. This is the seventh time we are doing it in the company. We will showcase some of our customers, some of our capabilities; answer some of your questions. Some of you have still have some questions to be answered by Ajay. Ajay said he will take it offline, but I think it is a great opportunity come and see what we are doing here so we welcome all of you to come to Hyderabad for the Investor Day on May 4, 2018. Thank you again for your participation. Thank you Sandip.

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