"Cyient Limited Q3 FY22 Earnings Conference Call"

January 20, 2022

MANAGEMENT: **MR. KRISHNA BODANAPU – MANAGING DIRECTOR AND CHIEF EXECUTIVE OFFICER, CYIENT LIMITED**
MR. AJAY AGGARWAL – EXECUTIVE DIRECTOR AND CHIEF FINANCIAL OFFICER, CYIENT LIMITED
MR. KARTHIK NATARAJAN – EXECUTIVE DIRECTOR AND CHIEF OPERATING OFFICER, CYIENT LIMITED

Moderator: Ladies and gentlemen, good day and welcome to the Q3 FY22 Earnings Conference Call of Cyient Limited. As a reminder, all participant lines will be in the listen-only mode. 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. Krishna Bodanapu – Managing Director and CEO. Thank you and over to you, sir.

Krishna Bodanapu: Thank you very much. Good evening everyone. Welcome to Cyient Limited Earnings Call for Q3 FY2022. I am Krishna Bodanapu – Managing Director and Chief Executive Officer of Cyient. Present with me on this call are Mr. Ajay Aggarwal – Executive Director and Chief Financial Officer and Mr. Karthik Natarajan – Executive Director and Chief Operating Officer.

Before we begin, I would like to mention that some of the statements made in today's discussions maybe forward-looking in nature and may involve risks and uncertainties. A detailed statement in this regard is available in our investor update that has been emailed to you and is posted on our corporate website. This call will be accompanied with an Earnings Call Presentation; the details of the same have been shared with you.

With that, let me take you through the highlights for the quarter.

In US dollar terms we posted a revenue of $157.9 million which is a growth of 11.7% year-on-year and 5.2% quarter-on-quarter. This translates to a 5.9% QoQ growth in constant currency terms. In rupee terms we posted a quarterly revenue of INR 1,183 crores. This signifies a growth of 13.3% year-on-year and 6.5% QoQ. The services revenue stood at $129.1 million which is a growth of 11.9% YoY and 3.6% QoQ or 4.4% in constant currency. DLM revenue stood at 28.8 million, growth of 10.6% YoY and 12.8% QoQ.

We posted the highest ever group EBIT in Q3 at INR 1,642 million that is 164.2 crores. Group EBIT margin stood at 13.9% up 272 bps year-on-year, marginally down by 14 bps quarter-on-quarter. Free cash flow for the quarter is at 1,596 million, a conversion of 71% on EBITDA and a conversion of 121% on PAT. Profit after tax stood at 131.7 crores or 1,317 million which is a growth of 38% year-on-year and 8.5% quarter-on-quarter. Also adjusting for one quarter where we had some extraordinary items. If you remove that quarter this is also the highest profit that we have delivered after tax ever.

Coming to some other highlights for the quarter:

We secured a leadership position in digital engineering in ER&D study conducted by Zinnov. I am happy to announce that Cyient has been recognized as an established player in ER&D and IoT services. Cyient has been ranked in the leadership zone across aerospace, communication, semiconductor, industrial and medical devices, all of which are growth verticals and very important verticals for us.

We launched the management consulting practice, which will allow us to leverage our engineering domain expertise to solve business critical problems. As more and more of our customers are also looking towards us to articulate their challenges in terms of the operational and technological challenges and we will make sure that we first articulate the solution and then execute the solution. The consulting practice that we have focuses primarily on organization efficiency, asset optimization, digital transformation, technology adoption and so on so forth and not necessarily on the management consulting side. It is a very good synergy and we are already seeing good wins because of that and a flow through to the services revenue.

We have been positioned as a major contender in Everest Group's 5G Engineering PEAK Matrix Assessment. This is because we have been able to combine our domain expertise in network design, and also the latest technologies like digital twin, geospatial intelligence etc. and we are able to position ourselves very well in the 5G roll out which as you know is a huge growth opportunity going forward.

We also hived off our SDR which is a software defined radio division to ICS, Innovation Communication solutions. This company specializes in communications products and solutions. We have been developing the SDR in reply to a tender from the government of India, Ministry of Defense. It is a huge opportunity that runs into thousands of crores over many years, but it also will take some time for the opportunity to come to fulfillment. Therefore we believe that it was best that we let a specialist player like ICS in this space who also has a core portfolio of products, not just one communication radio but a core portfolio of communication products and that positions ICS very well to be successful in this space. Cyient will get 15% stake in ICS. We have a longer-term interest in this, which will also bode very well for us, and we will remain their manufacturing partner. Cyient DLM will remain their manufacturing partner. We also have a royalty that will come because of the product that we have delivered. Also the advantage with this divestment is we no longer have an obligation to restrict foreign ownership in Cyient which was previously capped at 49% and now we don't need to have a cap because we will not be directly bidding on India defence business any more.

With that I will just say that it has been a very good quarter. I want to thank everybody for your trust and your patience. We will give you more details in the next 40 minutes or so through the rest of this conversation. Thank you for your support this quarter and I will hand it over to Ajay who will take you through the detailed financial performance of the company.

Ajay Aggarwal: Thank you, Krishna. Hello everyone. Wish you all a very happy new year. I hope you and your families are staying safe. We have a good quarter in front of us. I think what we have seen is a very well rounded performance. We have always said if you remember in our investor day that our focus as a company is on achieving the industry leading earnings growth. I think if you look at year-on-year numbers of our earnings growth, they are reflective of the journey that we expect for the full year and we are very happy that we are getting for the current year and we will continue to work to remain in that particular spot. You would see that in terms of the cash generated in the company, I think this provides us the ability to growth through the M&A. We have good pipeline. We can talk more about it in the Q&A and that also gives us this kind of 38% profit growth, also gives us the ability to improve the investor returns to the similar extent. The point I was making there is a well-rounded effort in the company and as Krishna highlighted focus on profitable growth, getting to the industry leading earnings growth focusing on the cash flow.

Now let me come to the revenue statement as such:

I think we had reasonable achievement in terms of constant currency at 5.9% growth and in terms of dollar growth it stands at 5.2%. If you look at in terms of services we have given constant currency growth of 4.4% at $129.1 million. In terms of DLM we have a growth of 12.8% QoQ growth at $28.8 million, YoY we are at 10.6%. We expect the traction to continue and we have some healthy double-digit growth across services and DLM. DLM definitely has been impacted by little bit of supply chain challenges that are happening across the world and this is impacting some of the semiconductor related industries. We are definitely getting impacted by that. But in terms of the capacity as well as the demand, we are very well set year-on-year growth can be 20%-30% each year. But this year we may have a marginal growth. But I think DLM is also doing very well. The last one on the regional growth, you will see in each of the three geographies as of now are growing in double digits. So it is a well-rounded growth.

If we come to the profitability statement, I think one of the commitments that we had made was that in services we want to stay at 15% to 15.5% kind of a margin. We have achieved 15.6% in this quarter and you will see this is despite the fact that we had some headwinds from the lower billing days versus the pay days. We have additionally provided for some of the investments that are there into retaining the people. We continue to do the investments around improving the offerings for the customers. But despite that without compromising into any of the growth areas we have been able to generate 15.6% the EBIT margin that is also highest in the recent past and you would see that year-on-year there is an expansion of margin which is also very nice. DLM we continue to be at single digits, 6% is the margin in DLM. But overall based on this we have given 13.9% as the group margin and we definitely are confident that these are sustainable levels and in medium terms we can definitely continue to improve them. So we are confident for the year we will be growing and there will be huge expansion in the EBIT margin as an outlier in the industry in line with some of the trends that we are seeing for the 9 months they will continue for the full year. In terms of the profit after tax, as Krishna said, a growth of 38% year-on-year quite sustainable for the full year. It is really very nice performance and as I said this really gives us lot of opportunity to increase the investor returns as well.

I would let all of you go through the margin bridge. What I would like to highlight is that there were the headwinds of 80 bps in some of the product based business especially in our semiconductor area and some of the area, which is low margin versus high margin in the field. From lower billing days I talked about, about 107 bps. In terms of tailwinds, I think it is very nice that we are continuously getting the improvement in operational matrix and I am sure Karthik will talk about it but we are hitting very nice utilization number. Offshoring improved by about 5% YoY and that is all adding up. I think these volumes coming back do help us and there is a good focus on SG&A. So we are getting the help of 1% plus in terms of the scale and the SG&A and other items. So I would say overall the margin is sustainable and these are some of the reasons and we can take more during the question and answer session.

Apart from profitable growth there continues to be focus on the cash generation. In terms of one of the important levers that is DSO, we are tracking very nicely. We are also doing well on capex. We would see that when we look at the investor update our DSO is one of the lowest that we are tracking and we feel that there is a scope for further improvement. On basis of this we have generated a cash, currently our cash balance is 14,768 million, close to 1,500 crores and what cash we have generated is about INR 1,596 million or about 160 crores which is a conversion at 71%. We still have some improvement scope in DLM where we have consumed some cash. As we move forward we are also trying to make it definitely cash positive. So I am assured that we will continue to be having the good conversion levels of 70% plus for the group and the services. With this I will hand over to Karthik to provide the business update.

Karthik Natarajan: Thank you, Ajay. Very good morning, good evening everyone and wish you all a fantastic new year. I will probably give more details about each of the verticals. I am trying to take the last column of the table that is on the topmost chart. We have seen a growth of 5.6% year-on-year from transport business led by aerospace growing at 14.5% compared to Q3 FY21. I think aerospace is slowly coming back. We don’t really call this as a full blown recovery. We are seeing green shoots from few of our top accounts and we want it to be a broad based for the next 3 or 4 quarters. Rail transportation has shown a degrowth and this is led by significant amount of work moving to offshore. There are also some challenges in the industry in terms of consolidation. The communication and utilities continued to get a growth of 10% plus YoY and we have seen 3.2% growth QoQ. We are also having few large deal wins that we will talk about in the next few slides. Portfolio of sectors has grown by 24.5% YoY and leading to a services growth of 11.9%. Portfolio of services, which comprises of 6 segments and 4 of the segments are leading with growth in excess of 20% YoY. I think that is definitely a great sign for us to gain momentum for the year as well as the year to come. In terms of order intake, our services order intake is up by 12.8% and group order intake is up by close to 16%. I think this gives us confidence as we start heading into 2022. We have closed 7 large deals, we have been talking about it last two quarters. I think we are gaining momentum. We are still on course to bring more large deals for the next few quarters and incidentally there are 4 deals which are more than $10 million and the number of deals that we are participating in the large deals have tripled in the last 12 months. I think that gives us confidence on accelerated growth over the next few years. Our $5 million plus customers has grown from 24 to 27 and million dollar customers have grown from 76 to 77. I think this is also showing that the account mining that it is really starting to happen.

We are also trying to give a color of the growth that we are seeing. Our pipeline is up by 25%-27% as compared to the same time last year. Our order intake is up by 16%. Our revenue is up by 12%. Interestingly the top 30 customers have grown by 15% year-on-year. I think this is showing the effect of account mining. This is also led by new age tech. We started talking about it from last quarter and digital software and networks lead this essentially. I think we are seeing that this business is growing twice the growth rate of the company and this is definitely something that we are excited about. We are continuing to make investments and we will talk about some of the new projects that we are doing and also the kind of solutions that we are building in the next few slides. So if you really look at it 15% growth from top 30 accounts, 12% growth from new age tech areas is helping us to grow at 12% year-on-year.

So this is the slide that I was referring to and if you really look at it, some of the key highlights are**,** the cloud migration of multi-model transport billing platform. This is for one of the customers who really want to bring this for major city in US. They were really moving for it, this is the revenue for the customers and their customers too. We are a part of building an innovative solution that will really have a very high uptime and this is going to be the industry benchmark for the customer. As far as the digital is concerned, we started working on intelligent and connected products, automation, Edge AI and sustainable energy. I think some of these areas are giving us more momentum in the form of customer engagements. In medical, we had couple of key project wins and patient monitoring systems where we are building the test automation, which will switch between the sensor probes and the companion modules along with the patient monitors. Also in the form of automotive embedded software factory and this is going to be another growth engine that we are looking to accelerate for the next 12-18 months. Some of the wins in communications on the 5G where there is small cells design and deployment I think is coming into play. In aerospace we are trying to bring more digital led growth and this is shown with a global command centers that we have set up for one of the customers for aftermarket services.

Moving on to specific industry verticals. In transportation, aerospace continued to see a challenge especially for the long distance, but the regional aircraft recovery is getting better and we are starting to see some green shoots in the aftermarket, embedded and digital areas. In the rail business as I shared earlier, we are seeing growth on the aftermarket and digital. There are cost efficiency and supply chain optimization initiatives from some of the customers who are getting consolidated and there will be some synergy benefits they want to draw upon and that is going to have some short term impact. We expect the long-term growth to be intact and we continue to see momentum in this business as well. DLM continued to show sequential growth in Q3 and the challenges continue on the order fulfillment due to the materials availability due to longer lead time from the suppliers and will continue to be a challenge even in for Q4.

Moving on to communication side, we are seeing the sequential growth in comms. This will continue to expand and we announced two major deals that are coming from communication vertical. And some of the areas which is going to really grow is led by a rural digital opportunity front, RDOF which is called in US and also the fiberization and 5G private wireless. I think this is going to create a significant opportunities for us to work upon. Utilities has shown a continuous growth for the last 2-3 quarters and we also won a major program for a customer to deploy cloud native next generation spatial information system for them. This is another segment, which will continue to grow for the quarter to come. In Portfolio of sectors, automotive I think the outlook remains very positive and we starting to see significant opportunities around electrification and softwarization and these two are the key areas of the growth that we are really betting on as far as automotive is concerned. Mining and natural resources are continuing to see a growth led by digital as well as some of the engineering areas. Medical is another segment which continues to show a positive momentum. We are likely to see growth in this vertical for the next few more quarters. It is essentially led by software and digital. I think these are the two things that are really driving the growth and we also announced a deal which allows us to do a quality and regulatory services for a customer. We added about three new logos from Medtech and Lifesciences segments. We are continue to be bullish on the medical technology areas.

Semiconductor has witnessed a positive growth and we are also seeing momentum from some of the large customers that we have been able to make an entry into. While we continue to be bullish on the demand, the supply needs to be managed as far as making the fulfillment happen in this domain. In Energy, industrial and plant Engineering and we are continuing to see a growth as we have seen in the first half of this year and we will start seeing some of these areas to get into growth trajectory in the next year to come. Geospatial has had some challenges, as there were some issues that we had in terms of customer mix. I think this is likely to start getting into growth trajectory in the next two quarters. We are starting to see lot of opportunities within our existing engagements like mining, communication and utilities and we continue to see that with automation and artificial intelligence combined with spatial systems we will see a growth for the year to come.

With that back to you, Krishna.

Krishna Bodanapu: So, taking all that into account, the outlook for the rest of the year is essentially that we will grow in double digits in the services business, at least in dollar terms and constant currency should also be more or less there. We are now seeing some significant impact in the DLM business due to supply side challenges, We will be able to mitigate some of the good, the profitable revenue against it. While there is some revenue challenge with the DLM business into Q4 where we might not deliver the 15% to 20% numbers that we thought we would earlier in the year but from a profit perspective we don't see any change because we have prioritized the higher margin businesses and we have prioritized delivery on the higher margin businesses. So if anything the slightly lower revenue number on DLM will lead to a better EBIT margin and the same EBIT number irrespective of the DLM revenue. So overall I think we are in good shape and we seem to be doing quite well against the target. From an EBIT perspective the full year EBIT will improve by 350 bps, obviously this will lead to being among the best EBIT performance in the sector. So we are quite proud of that. And lastly we will maintain our FY22 effective tax rate around 25% or slightly lower but around that number. So with that I will hand it back for questions and answers.

Moderator: Thank you very much. We will now begin the question and answer session. First question is from the line of Vikas Ahuja from Antique Stock Broking.

Vikas Ahuja: My first question was on the DLM guidance, which was about 15%-20%, and now it seems like it is more like 12%-13%. We have been seeing some positive momentum on the services side. Do we think that overall, when we look at the consolidated revenue, the miss on DLM would be somehow offset by the positive momentum in services. And secondly the miss we are expecting in Q4 because of the global chip shortage, do you think it will go into Q1 of FY23 as well or this is more of a one quarter phenomenon?

Krishna Bodanapu: So to answer your question on the first part, absolutely I think the services businesses is very strong and we continue to see the momentum in it. I think there we are very confident on what is happening and based on the order intake which is up by 15% year-on-year. I mean quarter-on-quarter it was up much higher but Q2 is a bit of an aberration. So even, like for like the order intake is very good and therefore the momentum that is there in the business is quite strong from the services business perspective. On the DLM business also, again I want to say that there is a significant shortage and I am sure you heard all about the semiconductor shortage and the chip shortage and that is something that is also impacting us. We believe that it will continue at least for another 12-15 months and therefore this uncertainty will remain in the DLM business.

But again I want to say our team has done a fantastic job on prioritizing where the margin is and where the money is and therefore what are the customers that we need to prioritize. While there is a bit of a change on the revenue outlook for DLM, from a profit perspective for the group, we don't have much of a change in outlook because we are able to mitigate it by making sure that we are still delivering on the right kind of contracts.

Vikas Ahuja: Also on headcount growth which is largely flat and it has been on the lower side in past quarters as well. Is it because we were not anticipating such a high attrition or is it some hiring challenges or maybe we may think growth maybe lower, next year as well? On the growth outlook, I know for formal FY23 guidance we may have to wait for Q4, but any qualitative commentary you would like to give? We have underperformed peers on revenue growth this year and our growth in FY22 has been inline or maybe tad lower than pre-COVID averages. We do appreciate that the growth in Q2 and Q3 has picked up significantly, but how should we look at the growth in coming years versus peers or maybe industry, any qualitative commentary would be really helpful.

Krishna Bodanapu: On the net headcount addition I will say couple of things. One is I think attrition has been a little bit higher and that showed up on the headcount growth being a little bit lower. But also I will say we had some operational challenges in the past that we are addressing. If you look at utilization, our utilization was definitely much lower than where it should be and now of course utilization is quite high. And if anything I think we have pushed utilization as high as we can. So one is, I wouldn’t read too much into the future because I think we for the first half of the year, first 3 quarters, we really needed to use that capacity that we had efficiently and we had to push the utilization numbers, etc., otherwise we wouldn’t have shown the margin increases that we have shown. The second thing is, having said that we also have some good ways of building that capacity which doesn't show up as headcount increase which includes working with partners, working with subcontractors in some cases and so on and so forth. So the overall capacity that we have that is available to us actually has increased more than what the headcount shows. The last thing, having said all that in Q4 we are ramping up quite a bit in terms of the headcount addition. I think a lot of operational things that we could have done and we should have done, we have done. That is utilization, effective use of subcontracting in India and so on and so forth. Again this is not subcontracted revenue where it is a flow through. This is really the work responsibility is with us and for parts of the projects we use external resources to execute. So this is good subcontracting in that sense. But we have used all the operational tools at our disposal such as this and now we are ramping up quite significantly on the headcount. The net headcount addition in Q4 will be in line with the first 3 quarters of the year or will be equal to the first 3 quarters of the year. So we needed to stabilize operations and also make them efficient before we went out and added too many people which is where we are at the moment.

Karthik Natarajan: On the demand side, because what will say that is, I think demand is definitely getting more robust and clear as we start moving into the next financial year. I would really say is what are the demand drivers? The customers want to get products faster, they want to add more technology digitally into the products and how we are going to deliver the products to the customers including the customer experience. Hyper connectivity, is going to be another major pull that is likely to happen whether it is satellites, whether it is rural connectivity, whether it is about 5G leading to densification of urban cities or private wireless. I think there are multitude of connectivity technologies that are going to be at play and we are definitely bullish on how the connectivity would drive significant amount of growth. And the sustainability part, whether it is electrification, smart grid, renewables, I think that is another segment that is likely to see a significant growth. The supply chain resiliency, I think many customers want to have some form of redundancy, some form of, if they have some silicon can they really manufacture out of two fabs rather than one. I think these are likely to create some newer opportunities for us and so the demand is definitely robust and we do see structural change in the form of demand for the next 3 to 5 years where the growth of industry could be in the range of mid-teens. I think we are really gearing ourselves to get to that. And some of the indications of pipeline growth, order intake and then the revenue growth are giving us confidence that we really want to get ourselves to be along with the industry or ahead of the industry.

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

Sulabh Govila: I had a couple of questions. First one is that, with respect to the divergence in growth with respect to the top 5 clients as well as the company average, so the divergence what you say is driven by the top client in rail transportation or if you could provide some color as to what led to that softness in top 5?

Karthik Natarajan: I would say I think it is a mix of both. So I think what we are seeing is definitely a combination of that. We have seen our top five clients as compared to that the rest of the 15 and next 10 have really shown significant growth and that is where we have seen the top 30 accounts grown at 15%. And in some form it helps us to derisk the client concentration that we had earlier and which doesn't mean that we won't really grow the top 5 accounts. I think we do see that there would be some form of consolidation that has happened which is likely to get us back to the growth path in the next 2 to 3 quarters as I mentioned earlier.

Sulabh Govila: That is helpful. And the second one is that, with respect to the order intake that if you put it, if you could provide some directional sense as to how much of this is executable over the next 12 months and any directional color as to how that would have moved over the past couple of quarters?

Karthik Natarajan: Like what Krishna has talked about earlier, I think we have seen 16% growth in terms of order intake. If you take even YTD which is year to date for first nine months of the year, we have seen a similar trend of 16.5% or so. So we are continuing to see that the order intake is growing which is a sign of how things would happen. I think it is a function of ability of fulfill, customers wanting to make this done in the next 12 months and I would say about 80%-90% of this business will get executed in the 12 months. Some may get carried forward beyond that. But what we are reporting is essentially how much of it would get converted, I would say about 85% to 90%.

Sulabh Govila: Then on the guidance bit. Again, on the service guidance bit. The change from the CC revenue growth double digit to the USD growth. So this change in guidance, what sort of is leading to this negative surprise on the guidance on the revenue front?

Krishna Bodanapu: First of all, the difference between the CC and dollar will be very marginal, it is not very significant. Now in terms of just looking at where things stand and looking at what can be executable for the rest of the quarter, that is where the change is. Again like I said the difference between USD and CC will be very marginal.

Sulabh Govila: One last bit from me is, given that the attrition rates are holding on, would you say that the wage hikes or the intervention that we would need to do in CY22 would be higher than usual that we do in a year. And if that is the case then what would be the margin levers, given that offshoring is already higher than 50% and utilization is at peak levels?

Krishna Bodanapu: I think that is a realistic assumption, I think. The interventions will be higher and salary corrections will be higher. I think there are other levers that now our customers are very receptive to. I think automation is one big lever, I think there are a number of things that our customers are now allowing us to do, in terms of automation because even to run some of these scripts, run some of bots, etc., having access to data used to be a challenge previously. Now because of the imperatives of automation, we are seeing that access and therefore our ability to do automation more**.** The second thing is price increases, were starting that to see the customers are being quite realistic and receptive. Because they are facing the same challenges that we are facing and therefore that is the second opportunity. I will say the third opportunity, which also in our case is quite significant, is, as we started ramping up our capabilities and competencies in digital, we had to do a lot of external hiring this year. Over the last year through a program called Bridge we have also done a lot of training internally and some of these resources are now becoming ready. And similarly because we are built externally and the lateral hires were really for the higher order capability, now that we have built a higher order capability we will be able to hire a lot more of the more junior resources for these skills. So we can also correct the pyramid in some of our growth areas which we couldn’t do last year because we were really in a sort of a mad dash to build that capability which honestly we may be a little bit behind the curve. As we are now on par with in terms of capability, we can become a lot more rational in terms of how the pyramid works.

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

Sandeep Shah: Karthik, just wanted to understand what is happening in railways and also in the aerospace. If it does not recover in the next couple of quarters to the full pace as a whole, does that make you worry as FY23 growth could not be as big as the services revenue growth which we have achieved in FY22 because the aspiration is to grow at a mid-teen as a whole. Does that worry you or you believe there are enough tailwinds in the rest of the other segments, which make us comfortable that we can easily surpass what we have done in FY22 in FY23 as a whole?

Karthik Natarajan: Sandeep, I would say, I think what we are starting to see is, if you take aerospace, I think the regional aviation has definitely recovered to 90% of pre COVID level. And if you really start looking at it the intercontinental and long haul flights are still about 50%-60%. I think that probably would take another 12-18 months. We hope that pandemic is moving towards the endemic in the next 6 months that will lead to opening up of the airspace. This should probably be sometime around late 2022 or early 2023. So that is the kind of assumption that we already have in our planning. We talked about this earlier, we don’t expect the recovery of aviation to come back in a hurry and we are starting to see some green shoots. We are seeing that the digital adoption in aerospace is definitely high and the aftermarket side of the business is definitely getting into a growth trajectory. We are tapping into some of these areas of growth that we are seeing. One of the deals that we announced as part of the large deal is for helping the customers with aftermarket repair development through digital solutions with augmented and virtual reality. How do you think we can start predicting the failures and how do we help them with the repair solution. So some of them are definitely interesting for customers to look at with digital and that is something we are likely to see as potential opportunities for us to tap into. On the rail, we do have about probably top 6 out of 7 customers as part of our client base. So we do see that is likely to come back to growth trajectory maybe in the next couple of quarters. So whatever we talked about is taken it into our planning.

Sandeep Shah: The new gen tech which is growing double the pace of the company's revenue. Any approximation in terms of what is the revenue contribution today and what was it one year back?

Karthik Natarajan: It is about 25%-27% currently, Sandeep and that used to be about 18%-19% earlier. That is the growth that we are starting to see for the last 12 months.

Sandeep Shah: And just a book keeping question to Ajay. Depreciation and amortization cost has come down. So should we build this going forward in terms of percentage to revenue or you believe there is some amount of aberration as a whole?

Ajay Aggarwal: We can build it going forward.

Sandeep Shah: And just Ajay, wanted to understand, I think ESOP related cost may start coming to P&L starting from 4Q of this financial year plus attrition at 29%-30%. So your guidance indicates a marginal dip in the fourth quarter EBIT margin. So do you believe the margin could continue to remain in a narrow band in the fourth quarter and that may give you an exit rate to even remain confident for FY23 the whole?

Ajay Aggarwal: When we are giving the ESOPs we do have to accrue quarterly in terms of the amortization of those ESOPs. We have started with very small amount in this particular quarter and it started around 27th of December. For the next quarter when we are talking of 350 basis point improvement year-on-year, we have already taken that in our forecasting. When we are saying that we will be able to sustain the margin, we are confident that there are some headwinds but there are some tailwinds. For example we did have some one-time things in terms of the western holiday related extra pay days and things like that. So what we are saying is, after taking into account, these items, we are looking at Q4 as stable margins and 350 basis points is more like a round off, so to that extent you are right, there could be 10-20 basis points here and there for Q4 and for the year. We will be able to sustain it.

Sandeep Shah: Just last thing, on the DLM, are we saying the growth could go to mid-single digit to high single digit or it is a double digit and similar to revenue growth for the full year of FY22?

Ajay Aggarwal: For this full year of FY22, I think we are looking at I would say low single digit kind of a growth based on some of the challenges specifically that we have in Q4. But I think in medium term we are saying that both from capacity and demand perspective subject to some of the things stabilizing on semiconductor we should be able to get to 15-20% kind of a growth in medium and long term.

Sandeep Shah: And Krishna's comment about EBIT being largely there for the whole year with no change in target. Are we talking on EBIT margin or are we talking on absolute EBIT as a whole, because EBIT margin continues to remain at a mid-single digit to 6% as a whole versus our earlier target of reaching to a double digit kind of an EBIT?

Krishna Bodanapu: I mean absolute EBIT, which means that EBIT margin should actually go up with some of the revenue going down, because the revenue that we have deprioritized is actually low margin revenue.

Moderator: Thank you. Next question is from the line of Mukul Garg from Motilal Oswal.

Mukul Garg: Krishna, just wanted to follow up on this DLM issue which is there for the next few quarters. You said for the full year FY22 the DLM growth rate will be in low single digit. That implies that we are going to lose quite a bit of business in Q4. So where exactly is this challenge coming in and what we can kind of do to contravene that over next few quarters?

Krishna Bodanapu: See, like I said we have to prioritize the product that we are going to shift, because the biggest challenge that we have is the availability of the chips and that has not changed and is only getting worse in many cases. So my point there is that, we have a business. If you look at the spread of business that contributes to DLM, there is business which is quite good margin, I mean the business where we make more than 10-15% EBIT kind of business and there is a business where we basically break-even maybe make a little bit of EBIT but we still do it because of capacity absorption, legacy contracts and so on. So what we are doing now is, we are making sure that whatever chip availability that we are getting and we are sourcing really goes towards the businesses that can do 8-10% kind of EBIT at least at a minimum. Obviously that is not ideal and I think that also leads to the question of longer term fit and sustainability of DLM in Cyient. We are also looking through that to make sure that there is a logical reason in what would the logic look like going forward in terms of how Cyient and DLM would fit together. But leaving that aside for now, what I would say is the chip problem won't get solved in a hurry. It is going to be, all estimates are that it will be another 12-18 months and therefore we will have to wait for another 12-18 months for some of that stability. But two things will happen, one is whatever we have planned in terms of the absolute EBIT we have a clean line of sight. I mean, while revenue growth will be, I would say more in the mid-single digits range but having said that whatever the original EBIT growth was in DLM from an absolute perspective that will actually still hold, so therefore the EBIT margin growth will be a little bit more in Q4 and therefore for the year which is the good news. Now some of the demand or all the demand is actually getting pushed out. So we will see this demand in FY23 and going forward. But taking into account the hypothesis around how we are managing our business, we also want to drop some of the lower margin business using this opportunity, because that is really not a right business in the longer term. So net-net there will be a little bit of a revenue challenge, but like I said the revenue will get made up through the next few quarters as chip availability gets eased, but it will be more than a few quarters because like I said it is another 12-18 months. But having said that what was supposed to get delivered in Q4 still have to get delivered in Q4 which is that we won't be able to deliver it. And therefore in Q1,Q2 we will see better growth because some of the components have 25-30-40 weeks, even the worst that I heard is we are ordering some components now with a two year lead time, which means that as the components come we will still be able to deliver.

Mukul Garg: Sorry, just to dig a bit deeper into it. If you look at the Q4 implied number and the run rate that would imply that, taking into consideration that the supply scenario will remain challenging for at least next one year. How confident you are that you will still be able to grow in FY23 assuming that the same kind of decision making in terms of priority towards higher margin DLM business will continue in rest of FY23.

Krishna Bodanapu: See, we will still be able to grow because the supply that we have sourced now is starting to come in. If you look at it the problems really started about 6-8 months ago. So a lot of the supplies that we now are supposed to get especially in Q3 and Q4 have been disrupted. So the supply will be there. At least for delivering a 15% to 20% growth like Ajay said next year. We are confident because the demand is absolutely there and the demand is booked and it is sealed. It is really about the supply and given that we have 15 months from now till the end of next year, we are quite confident that 15% to 20% growth is there for sure. And at the same time, again like I said previously, the growth would have been much higher if we didn't choose the right kind of business and deprioritize lower margin business. So as we add newer, better business and there is some good pipeline, which will convert this quarter. As we add those businesses, we will deprioritize. Again, I want to assure you that from an EBIT perspective we do not have a problem in DLM, from an absolute number that we were planning to deliver for the year. We will still deliver it and we will show at least a 20%-25% growth in EBIT for next year because not only that 15% to 20% revenue growth is there, margins will continue to get better because of the quality of revenue.

Mukul Garg: And the second question was on the supply side of the services portion of business. We continue to manage our profitability quite well there. Given the constraints, which are there on the supply, is it likely that you have to take some near term interventions in either Q4 or like you know higher than expected historical hikes the next year, which can materially impact your profitability?

Krishna Bodanapu: I think both sides of that equation as I explained earlier. In some areas the hikes will be higher than what they were historically. But also I think there are some good opportunities for us like I said pricing is one lever, pyramid correction is another lever, automation is the third lever and all of them are also starting to play out. So while we will have headwinds in terms of, you know, hikes will be a little bit higher than what they are usually. But I think the opportunity to correct those with the tailwinds is also quite significant and therefore I don't see margins under pressure going into FY23.

Moderator: Thank you. Next question is from the line of Abhishek Shindadkar from InCred Capital.

Abhishek Shindadkar: My question is for Krishna. Krishna, I appreciate your support and patience that you highlighted for the DLM business. My question is, it would have been prudent for us to kind of lower the DLM number in the previous quarter rather than doing it this quarter. I mean anything changed substantially in this quarter for you to kind of move from 15 to low single digits and wouldn't it be a little prudent to kind of do it in the previous quarter to improve the predictability of the business?

Krishna Bodanapu: No Abhishek, I think the reality of that business is what it is, right? We had a line of sight, we had supplies coming in and in the last minute the supply got held. That is just the reality that we are facing in that business. So in that context I don't think we could have set the expectations any differently and also if you look at the most important matrix which is on the profitability side of the P&L, we are still doing what we can to maintain that guidance and we have been very prudent and smart about how we manage it. So in that context I don't think it would have been any more prudent to have taken just the lowest because we can always set expectations very low but I don't think that is our intent. Our intent is to be realistic. I am looking at what was happening at 3 months ago this quarter and that is how we set the expectations. Of course the supply side of the chips has changed quite dramatically. At the same time I want to reiterate that I think we are doing what we can in that business to remain competitive. Also make sure that the most important part of that equation which is cash flow and EBIT we are still keeping to what we said we would do. So I think this is the best we could have done and we will be prudent and we have always been prudent, but I think we also have to realistic.

Moderator: Thank you. Next question is from the line of Sandeep Shah from Equirus Securities.

Sandeep Shah: Sorry to dig slightly deeper on railways. Karthik, I wanted to understand as we work with most of the OEMs, so what is happening with client where consolidation is happening because we work with both side of the M&A as a whole. So you also said that there is an offshoring which is happening. Is it the volumes from both the clients are coming down or is it more offshoring which is leading to a predictability issue even for the next couple of quarters for the railways as a whole. How do you see this sector panning out in FY23. It will take almost second half in terms of recovery or it can start recovering on a Q-on-Q basis starting from 2Q itself or 1Q itself?

Krishna Bodanapu: So Sandeep, I think this was led by probably very significant amount of work being done at onsite that is structurally moving towards offshore. So obviously it is good for us in terms of margins. So we continue to see that expanding. It is not about the volume. I think we are still doing the same volume or slightly ahead of the volume that we have done earlier, but the sheer nature of onsite to offshore changes by 3 to 1. So I think that is where we were really seeing the impact. But moving forward I think we would continue to see in terms of onsite to offshore change, I think that is definitely good for our margin. But probably the second half of next year we will start seeing the growth coming back in terms of revenue because when we really start shifting the work from onsite to offshore there is going to be an impact on the revenue and that would probably start setting up for a better year next year.

Sandeep Shah: And just on the M&A, as we have said in the presentation, lot of M&As in the pipeline. So just wanted to understand one message, which is coming from auto companies as connected vehicles, electrical vehicles are driving growth for many of the players from India as a whole. So any of such kind of an aberration because we are a late entrant in high growth area like auto?

Krishna Bodanapu: I think the intent of the question is clear and I will answer that. That is the intent Sandeep, I think we want to focus on areas that can provide us disproportionate growth where we are also maybe not as strong as we would like to be. So we have clearly articulated the area. There is both elements, strengthening the core element where we were still looking at opportunities in sort of more traditional areas where we are strong but it gives us consolidation opportunity and with the transformation that is going on; it enables us to bring our digital capabilities. So we are looking at, sort of we call it strengthen the core, but we also are looking at accelerating on the new areas. We call it '5 pillars of growth' that we have articulated and we will talk about it a little bit more in the investor day which we hope to do this time in May. But in these five pillars we are looking at this kind of acquisition. And say the vehicles, the next generation vehicles because it could include many things including electric vehicles, autonomous driving, ADAS and so on and so forth. That is definitely a part of the focus of M&A and also I will say there are some good opportunities in the pipeline there also. So it is, we have a good thought out strategy. It is clearly defined. We know what we will pay, we know how we will integrate based on which bucket it falls into and this is definitely a focus area for us.

Sandeep Shah: And sir, what is the reason for QoQ dip in cash because we had a good cash flow conversion and is it dividend or anything else to call out for a decline of QOQ? And just one suggestion in presentation we could be slightly more consistent to include even a long-term treasury which we used to include in the fact sheet but from this quarter we excluded the same in details about cash and bank balance.

Ajay Aggarwal: Sandeep, definitely I think I take your inputs and we will work with you. We want to maintain the highest levels of disclosures. We will definitely align on that and look into it. In terms of the net cash, I think interim dividend is complete otherwise I think there is no other unusual item and some outflow would be in terms of investment in case of the SDR which would be about 10 crores. Otherwise there are no significant outflows other than that.

Sandeep Shah: I didn't get. Your voice was feeble, so what was the investment apart from dividend?

Ajay Aggarwal: The SDR radio which we have done the arrangement, there is an outflow of about 10 crores during the quarter.

Sandeep Shah: Is this is related to M&A related investment banking charges?

Ajay Aggarwal: This is related to our arrangement on the software defined radio (SDR)

Sandeep Shah: But I think, Ajay, we are selling the business, right? So why to have an outflow here?

Krishna Bodanapu: No, we are not selling the business. We transferred the technology and the product needs to be finished in the development phase for which that was the amount that would be roughly required. So we gave them the technology and 10 crores investment for the 15% stake.

Sandeep Shah: And just last thing, Ajay. Here there would be entry which would be reduced from the intangible asset which is sitting as a net block in the balance sheet for this radio business which we are using as a whole or divesting as a whole?

Ajay Aggarwal: Yes, I think it will be somewhere in the capital work in progress and now it will go into investments.

Moderator: Thank you. As there are no further questions I now hand the conference over to the management team for closing remarks. Over to you.

Krishna Bodanapu: Thank you very much and thanks to everyone for participating this evening. Like I said it has been a good quarter. I really appreciate your support and your patience through this journey. We have positioned ourselves really well and we see the momentum behind us into Q4 and more importantly into the next year. I think while there are always one-off niggles, I think we are managing through them. I think the chip shortage for example in the DLM business is an unforeseen event. But we are managing profitability quite well to balance off for that in the DLM business. Of course, the services business is doing quite well from both revenue growth and profitability perspective. So, I think we are well positioned into the next quarter and going forward and we are quite committed to making sure that we build on this and deliver superior performance like we have in Q3 and for this to continue into the future. So, with that thank you very much for your support. Thank you very much for your trust. And we will speak again soon. Thank you.

Moderator: Thank you very much members of management. Ladies and gentlemen, on behave of Cyient Limited that concludes today's conference call. Thank you all for joining us and you may now disconnect your lines.
