Cyient Limited

Q1 FY24 Earnings Conference Call

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MANAGEMENT: **MR. KRISHNA BODANAPU – EXECUTIVE VICE CHAIRMAN AND MANAGING DIRECTOR – CYIENT LIMITED**
MR. KARTHIK NATARAJAN – CHIEF EXECUTIVE OFFICER AND EXECUTIVE DIRECTOR – CYIENT LIMITED
MR. PRABHAKAR ATLA – PRESIDENT & CHIEF FINANCIAL OFFICER – CYIENT LIMITED

Moderator: Ladies and gentlemen, good day, and welcome to the Cyient Limited Q1 FY24 Earnings Conference Call.

As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call, please signal an operator by pressing star, then zero on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Krishna Bodanapu, Executive Vice Chairman and Managing Director. Thank you, and over to you, sir.

Krishna Bodanapu: Thank you, Aman. Good evening, ladies and gentlemen, and welcome to Cyient Limited's earnings call for the first quarter of financial year 2024. I am Krishna Bodanapu, the Executive Vice Chairman and Managing Director. Present with me on this call are Mr. Karthik Natarajan, CEO and Executive Director, and Mr. Prabhakar Atla, President & Chief Financial Officer.

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

As you know, Cyient DLM Limited listed on 10, July 2023. I want to take this opportunity to thank you for the overwhelming response to our IPO. Over the past several years, we have demonstrated Cyient DLM's credibility and capability in a wide range of design-led manufacturing solutions. And we are now with your support well positioned to leverage the tailwinds in this space. I'd also like to take a moment to thank the Cyient team that made the IPO possible and for doing this in a very short and compressed time frame.

I also wanted to share an important update on the US Department of Justice case. The case against the Cyient's executive on grounds of alleged violation of the Sherman Act has been dismissed in April 2023. Cyient has always conducted business with strict adherence to our 'Values First framework'. The acquittal of our executive further proves the highest standards of ethics our business adheres to. We remain confident that this will have no materially adverse impact on the company's operations, finances or liquidity.

At Cyient, sustainability is also important to the way we operate and underpins our overall vision. It is also one of the five megatrends that we are focusing on. Cyient has demonstrated, it's dedication to sustainability by participating in the Dow Jones Sustainability Index, a renowned benchmark for sustainable business practices that generate short-term and long-term value. We scored a great score of 66, surpassing the industry average in all categories, and we are confident that we will increase on this number going forward.

With this, I would like to hand over this call to Prabhakar Atla, who will take you through the financial performance for the quarter. Thank you, and over to you, Prabhakar.

Prabhakar Atla: Hello everyone. Firstly, let me thank you for joining the call today. We greatly appreciate your time, we greatly appreciate your interest and very importantly your active participation in today's call. Before I proceed to present the results, please allow me to provide a quick overview of how Cyient's business is currently classified into various segments today.

In this page, you will find the nomenclature and current classification of Cyient's business segments. As you can see, we now have three business segments into Cyient Group - Cyient DET, which is a short form for Digital, Engineering and Technology segment at Cyient, Cyient DLM, and Others. On Cyient DET, the rationale for this nomenclature is that most, if not all, of what was traditionally engineering and engineering services has already significantly transformed in the recent past with adoption of digital transformation and this is now further rapidly evolving into adoption of advanced technology such as generative AI. Therefore, as we stand here at a point of inflection, we see ourselves as a strong and growing player in the rapidly evolving space and therefore, also the evolution of nomenclature at Cyient as Cyient DET.

Cyient DET, as we will represent this segment from today includes the erstwhile Services business of Cyient that includes core services plus acquisitions as we were calling it before, plus a small portion of engineering parts business, which was earlier classified under DLM. I repeat Cyient DET business as we will represent this segment from today, includes the erstwhile services businesses of Cyient plus a small portion of engineering parts business, which was earlier classified under DLM.

Apart from evolution of segment nomenclature from services to DET for reasons explained earlier, the additional item here is the reclassification of Engineering parts business and this reclassification is based on business and client adjacency and was done prior to DLM divestiture. This reclassification does not have a major impact on Cyient's DET business, just as a measure of quantum, engineering parts business, which is now merged into DET has a revenue of about $0.9 million per quarter, I repeat $0.9 million per quarter, which is about 0.5% of Cyient DET revenue.

We have not reclassified the previous periods for this segment, given that the impact is minor and then some comparison may not be like-to-like, and we will attempt to provide a clarification in such instances in this call. The second segment is Cyient DLM which is a DLM part of our business, which was divested after the reclassification of engineering parts business as above and the third segment is others, which now includes Cyient's Aerospace tooling business, which was earlier classified under DLM and has been reclassified prior to the divestiture.

The classification of business units within Cyient DET remains the same as earlier in services, which are basically Transportation, Connectivity, Sustainability and NGA. Today's presentation and discussion is on Cyient DET only. All the numbers and the data are for DET only, unless mentioned otherwise as Group. We have received quite some valuable feedback from most of you on the content of this presentation with a request to simply and focus on highlights. So going forward, we will adopt a dashboard-model for this presentation and financial performance with relevant details already shared in annexure. In the dashboard model, you will see that we are revisiting our performance across six key metrics, which basically are revenue in US dollar terms, revenue in INR terms, EBIT in percentage terms, PAT in INR terms, EPS in INR terms, and FCF in INR terms. And for each of these metrics, you'll also see that we have depicted the movement on Q-o-Q and Y-o-Y basis.

Before I walk you through the commentary, let me just summarize that we strongly believe that our Q1 FY24 witnessed a well-balanced performance, which was in line with our expectations. In terms of Q1 FY24 revenue, the Q1 FY24 revenue for DET stood at $177.1 million and a growth of 0.3% quarter-on-quarter in constant currency and 30.6% year-on-year in constant currency. This, of course, includes the engineering parts business. We have not restated the previous period numbers since the impact was not significant. But the like-to-like movement for what was Services revenue earlier would be the movement of minus 17 bps quarter-on-quarter in constant currency on sequential quarter basis. In INR terms, the Q1 FY24 DET revenue stood at INR1,455 crores with a growth of 0.4% quarter-on-quarter and 37.2% year-on-year. I repeat, the growth of 0.4% quarter-on-quarter and 37.2% year-on-year. We have two key growth drivers behind this performance. The first is that our core segments aerospace, automotive and sustainability, continue to witness a very strong growth Q-o-Q and Y-o-Y. And also our key clients, top 5 and top 30 continue to witness strong Q-o-Q and Y-o-Y growth. Mr. Karthik Natarajan will address these in more detail in the business outlook presentation.

In terms of normalized EBIT margin, the Q1 normalized EBIT margin for DET business stood at 16.1%, which is the highest we've had in the last nine years, and also grew by 93 bps quarter-on-quarter and 327 bps year-on-year. I repeat, this services EBIT margin, which was called Services earlier, DET, is at 16.1%, which is the highest in the last nine years, which expanded by 93 bps quarter-on-quarter and 327 bps year-on-year.

In Rupee terms, the Q1 FY24, DET normalized EBIT is highest ever at INR 234 crores with a growth of 72.1% year-on-year. This margin expansion is driven by continued improvements in SG&A costs, resulting from optimization initiatives that we've undertaken in the previous quarter. In terms of normalized PAT, the Q1 FY24 normalized PAT stands at INR170 crores, translating into a normalized PAT growth of 6% quarter-on-quarter and 56.3% year-on-year. I repeat, the normalized PAT growth for this business is at 56.3% year-on-year. And this then translates into normalized EPS of INR15.5 for Cyient DET.

In terms of free cash flow, the Q1 FY24 FCF stood at INR176 crores, a growth of 150.5% year-on-year. This translates into a conversion of 108.9% on reported PAT. As I close this chart, I also like to draw your attention, that the balanced performance that one can see across several metrics, with revenue growth of 30% year-on-year in constant currency terms and EBIT expansion of 327 bps Y-o-Y, the PAT grew by 56% Y-o-Y while retaining focus on FCF, which also handsomely grew by 150% Y-o-Y.

And hence, our opening comment on this being a balanced performance in the beginning of my presentation. In terms of group numbers, the group numbers we see here are a combination of all three segments we spoke before and I will just call out a few comments. At $205.3 million, group revenue for Q1 FY24 grew by 28.6% year-on-year in constant currency. And the sequential growth was impacted by cyclicality in DLM business, which would recover in the subsequent quarters. The Q1 FY24 normalized EBIT margin is at 14.7%, higher than what we've had in the last nine years, up by 322 bps year-on-year and Q1 FY24 PAT stands at INR177 crores, up by 52% year-on-year, while the FCF has also improved by 60% year-on-year. And therefore, also at the group level, we believe that this is well rounded performance in line with our expectations, and this also gives us with a very strong start into the financial year.

With this I now hand it over to Karthik Natarajan for an update of the business performance and outlook.

Karthikeyan Natarajan: Thank you, Prabhakar, and good day, everyone. I'm trying to deep dive on some of the vertical performances that I will cover in the next few minutes. And we had an all-round operational good quarter for us. And if you look at the four segments that Prabhakar detailed out as part of the Digital, Engineering & Technology business. And starting with Transportation, which has grown by constant currency, 3.2%, and year-on-year 19%. Connectivity business, which is affected by the wireless telecom operator business has shrunk slightly compared to Q4. So that has taken about 2.4% degrowth in Q1. Sustainability business, enabled by growth in energy, mining and the utility business has had a solid quarter of 4.5% growth quarter-on-quarter. And this business has grown, including Citec at 112.3% year-on-year. And New Growth Areas, which are at $30.5 million in Q1 FY24, has had a degrowth of 6.5% QoQ. And this is attributed to the high-tech and semicon degrowth that we have seen, while we continue to see momentum in our automotive business, which has really grown very well as compared to the last quarter.

In terms of order intake, and this is more of a seasonality that we see on Q-o-Q. Y-o-Y is the right measurement to be compared with and we had $193.2 million of order intake, which has grown by 32.5% year-on-year in terms of constant currency. Our offshore mix continued to stay at 44.4%. As we remember, the earlier core business of Cyient, which has moved to 54% over the last eight quarters to 10 quarters. We have an opportunity to improve on this with all the acquired entities put together, which is back to 44.4%.

We won six large deals in the last quarter, which is amounting to about $49 million. And interestingly enough, some of these deals include the software defined vehicle for trucks and autonomous perception systems for construction equipment and grid analytics and also floating production, storage offloading for LNG and for one of the oil and gas customers. So a very interesting quarter in terms of our performance on large deals and what we have seen on the operation.

To move on and to share more of outlook for rest of the year. We continue to see investments around the Green Transportation, Energy Transition, Defense & Security, Digital Health and

Automotive as well as on the decarbonization areas. We have seen a significant momentum on the Aerospace growth, which will probably continue to be there throughout this year. And both on new aircraft demand as well as on the MRO side of the business, I think both are looking strong for the rest of the year. We also started seeing momentum around advanced air-mobility solutions and this is one of the diversifications from our core Aerospace business into urban air mobility, and this probably gives us an acceleration over the next three years to five years as the business evolves.

In terms of Connectivity business, I think wireline business, which is definitely on a stronger footing with some of the funding coming from the US government on RDOF, which is called as the Rural Digital Opportunity Fund, and BEAD, which is the Broadband Equity Access Deployment programs, where there are likely to be about $60 billion-plus spend over the next three years to five years, and these continue to be the drivers of growth apart from the public and private wireless that we have spoken about in the past.

In terms of Sustainability, the energy minerals are at an all-time high in terms of demand, whether it is lithium, nickel, cobalt, copper. And also the decarbonization related investments are continuing to increase from our customers. And we've also seen hydrogen and ammonia based green energy and carbon capture utilization, and these are the investment areas we are seeing momentum and we'll talk about more in the subsequent slides.

And New Growth Areas, and this is -- the growth is led by automotive, again, by software-defined vehicle and the electrification. And we have seen some softness in the semiconductor business. We hope that gets better during the later part of this year. And semiconductor business is expected to see momentum from high-performance computing, artificial intelligence and auto segments. And Healthcare and Life Science business has been flat as compared to the last quarter. We expect that to start getting into the growth trajectory in the second half of this financial year.

With that said, our investments around technology solutions and digital areas continue to really yield better results for us and to share some of the success stories. We won a very large program on semi-autonomous drive, collision and obstacle avoidance system for a construction equipment major from Europe. And this is one of the prestigious programs for Cyient-based on the capabilities that we've built over the last three years, and we are actively working with the customers to convert most of their products to be enabled for autonomous systems. And we also have won some of the projects from customers on ADAS feature development and integration with the EV truck and software-defined vehicles, our core embedded vehicle application software for one of the European truck manufacturers. And these are some of the terrific wins that we had in the last quarter, and we expect the growth in automotive and off-road highway, we will continue to expand based on some of the recent wins.

Network analytics and automation led by cloud enabled and AI-driven analytics and zero-touch provisioning have really given us some of the results and new wins that we had. The pipeline that we have seen in this area is very strong. Enhanced grid analytics to integrate AMI data with some of the ESRI tools that we have created some integration programs. I think they are continuing to play well for us, and we continue to build momentum on the creativity business that we are in.

Generative AI. This has been one of the interesting areas of topic over the last six months to nine months, and we started seeing a lot of interest from our customers in terms of implementing conversational AI systems and distributing that contextual content to various stakeholders in a human-like national language. And whether this is about product support, customer experience and trying to help them through the complete aftermarket life cycle.

And CyVision, which is one of the video intelligence platform that we have built and how this can help to identify the objects such as vehicles and persons from live videos using deep learning modules. And we are continuing to make progress on AI-powered software testing and industrial data fabric with AWS as one of the key partnerships that we've built and also continue to make progress on operational grid analytics.

So with that, I will just move on to the next topic, which is about our guidance that we have shared in the past and for DET business, which is Digital Services-plus a very small parts business. We are keeping our guidance at 15% to 20% year-on-year in constant currency terms. And in terms of EBIT margins, and we have guided earlier at 100 basis points to 200 basis points improvement. And based on the operational efficiency that we have seen in the first quarter, we are revising it upwards to 150 basis points to 250 basis points year-on-year.

With that, we'll stop here, and probably throw it open for Q&A.

Moderator: Thank you very much. The first question is from the line of Mukul Garg from Motilal Oswal Financial Services.

Mukul Garg: Karthik, firstly, on the growth outlook. Given that the first quarter was fairly muted, where are you getting the confidence for delivering that 15-20% type of growth in services. Especially if you can speak about the Connectivity part of the business because that's an area where we are seeing weakness across regions from companies in the space. Is that something which will remain a drag and you will kind of deliver despite weakness in that space?

Karthikeyan Natarajan: Thanks, Mukul. To answer your first question, I think we understand the ask rate would be anywhere between 2.5% to 3.5% Q-o-Q for the next three quarters. I think that's definitely in the reach of what we are looking at. That's the reason why we kept our revenue guidance intact. And to answer your second question, Connectivity has two parts - One is the wireline. The second is the wireless part. The wireless is only about 20% of our business. And what we are seeing is the softness is from one of the customers. And we hope we can probably see a pipeline that we already have, getting converted during the later part of Q2, which will probably give us a reprieve in H2 of this financial year. On the wireline part and some projects which got shifted to the right and the investment still continues to be robust. And especially the government funding, which has been talked about a year ago, has been assigned to all the states and the states are in the process of being able to distribute the work during some time in Q2 and Q3. We expect to see the growth coming back in the second half of this financial year.

Mukul Garg: Right. But just a follow-up on that. Is there a risk in case that space remains under pressure to our full year guidance, or we have built in some buffers? And then I have a follow-up for Prabhakar.

Karthikeyan Natarajan: Yes. I think whatever we see at this point of time, we are keeping that 15% to 20% range, Mukul. That's the reason why we are keeping a wide range. So I would just hold at that level.

Mukul Garg: Sure. Thanks. Prabhakar was there any reclassification during this quarter, the gross margin were down very sharply on the Services side. And similarly, your G&A was also kind of down almost 300 basis points?

Prabhakar Atla: So Mukul, thank you for the good question. No, there was no reclassification during the quarter. Firstly, like we spoke, the significant improvement we have seen in the EBIT in the quarter is basically because we've been driving SG&A improvements for the last several quarters. We've been doing this expense for most of last year, but we also had costs that we incurred in the last year as we drove this initiative. And now we start seeing the full benefit of what we have done last year in the current year. Therefore, you see the improvement in SG&A translating into EBIT. That's the first part.

In terms of gross margin movement quarter-on-quarter, this is basically coming out of two things. One is the merit increase that we had to counter in Q1, and also a little bit of unfavourable revenue mix we had in Q1 basis how the global scenario is evolved. But this was two different things, there was no reclassification in the quarter.

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

Mohit Jain: First is on New Growth Areas. I got some of the commentary, but can you just split the growth rate there because we were down sequentially in a big way. So that's one. And second, our margin outlook got revised, meaning the initial guidance was also on the higher side compared to peers, but now it got revised further up. So where are we in terms of utilization, and it appeared to me that attrition is still high. So how do we get such high synergies or say margin expansion opportunities during the year?

Karthikeyan Natarajan: So Mohit, I'll answer the first one. Maybe I'll pass it to Prabhakar to answer the second one. On the first one, there are four subsegments as part of the new growth areas. One is Automotive and second is Healthcare & Life Sciences and third is Semiconductor and fourth is HiTech. Like what I shared in my brief, in HiTech and silicon they, had a weak Q1, and that's the reason why you're seeing the drop in terms of minus 6.5%. And Healthcare & Life Sciences has been flat, and Automotive has seen a significant growth compared to last quarter. So sum of all this is what I've described it as at minus 6.5%.

Mohit Jain: Sir, Automotive is flat, is it?

Karthikeyan Natarajan: Automotive has seen a significant growth

Mohit Jain: Okay. Got it. And broadly, how is the split between these four? Like should we assume more or less equal? Or do you think it will be tilted towards one particular segment?

Karthikeyan Natarajan: Yes, you can assume it to be almost all in the similar range of probably about 7.5 million to 8.5 million.

Mohit Jain: Okay. Got it. And second one for Prabhakar?

Prabhakar Atla: Thank you for the question once again. See if you recollect the commentary we made in Q4 investor call, Krishna used the words pragmatic conservatism when you were given the outlook for the full year in terms of revenue and margin guidance. I'd say the pragmatic conservatism we had in terms of the full year outlook for margin has played in our favor, as you could see, we already delivered a good quarter, 327 bps year-on-year.

And we also see the potential roadmap ahead of us to extract the value of the various initiatives which we are running in SG&A. But also, as you've seen, this performance in Q1 is even when -- back to earlier question, there was a marginal degrowth in the gross margin, but we still maintain the numbers that we have maintained right now in margin front. Therefore, as we recover across those gross margin segments and as we continue to extract the margin from the SG&A initiative, we feel fairly confident with the upgraded guidance that we've covered earlier so. Still being a bit pragmatic, conservatism, I would say.

Mohit Jain: For the wage hikes, will it hit us in Q2, or are you going to spread it across multiple quarters?

Prabhakar Atla: We would spread it across multiple quarters. Part of it is already coming in Q1. The rest of it we'll spread across various quarters.

Mohit Jain: So, we may not see that one quarter hit is what you're saying. It should gradually improve.

Prabhakar Atla: Yes. You will not see a one quarter hit like what we have seen in the previous years earlier. It will be spread throughout the year.

Mohit Jain: Right. And last one, I could not find utilization. Do you have a ballpark number where are we currently?

Karthikeyan Natarajan: Yes, I think we are about 86% in terms of our utilization and apple-to-apple comparison from last quarter. As we are in the process of getting all the companies that we acquired to be integrated, and we will probably not provide the detailed breakup like, what we have done in the past. And since this process will take some time in the quarter of Q2 and we would just state as the overall margins and gross margin, which kind of indicates the level of utilization.

Mohit Jain: Including the target, 86% consolidated -- utilization is broadly what we should assume for the quarter?

Karthikeyan Natarajan: Yes.

Moderator: Thank you. The next question is from the line of Vibhor Singhal from Nuvama Equities.

Vibhor Singhal: So just -- I know you've built a bit upon it, but just wanted to understand a bit more about the optimism that we have about the Transportation segment. I mean the last call also, we've kind of spoken about a very strong demand environment coming up in the aerospace vertical. So how do you see this industry demand shaping up let's say, in the remaining part of this financial year, not I think for a quarterly number, but do you think it's going to be a positive momentum as we have seen in this quarter to continue in the remaining part of the year? And specifically in the Aerospace vertical, do you believe this cycle could actually last beyond FY24 as well in terms of the opportunity that we see and capitalize on?

Karthikeyan Natarajan: I think the momentum on the Aerospace business, if we were to really classify into three subsegments, whether it is commercial aerospace - new aircraft, new engines, new sale. And second is the MRO part, and third is the defense business. I think all three businesses have come back with a bang as far as this year is concerned. And there is definitely a very robust and strong demand, and with China joining this party about six months ago and the number of aircrafts that are flying at any given point of time is probably closer to what we have seen in 2019. So the similar levels of air passenger miles is similar to what we have seen in 2019. So that's definitely driving the demand. However, the customers are continuing to face challenges on the supply chain and labour productivity. And those two are definitely plaguing the growth that they want to achieve during this year. And we hope it gets better during later part of this year. And in terms of demand outlook for the next 18 months, we are positive about how this segment will look for us.

On the defense side, we have seen significant growth in defense because of the conflict that we've seen in Europe. I think that has really made every government to spend significant amount of money around the defense and security part, and that is likely to continue for a few more years as the internal security is becoming one of the key challenge for many countries. They want to strengthen their internal security part.

Vibhor Singhal: Got it. So as a broad number, if I were to ask, I mean, in our guidance of 20% growth, would the Transport vertical be higher than the company average, or do you believe it could probably be in a similar range?

Karthikeyan Natarajan: I think we are interested to really make all of these four segments to grow in double digit. I think that's the intent on which we are operating. Some would be on the higher end and some would be on the lower end.

Vibhor Singhal: Got it. And on the Connectivity side, if I were just to maybe pick your brains for a couple of minutes. I think we've seen this vertical actually being the problem area for almost all the companies, be it in the IT services business or in the ER&D space. I think the telcos are globally are continuing to bleed and there's not much of a spend either on technology or on the research part that they're undertaking at this point of time. Do we also see the same things driving this segment and it should probably keep this vertical under pressure in the near term as well?

Karthikeyan Natarajan: I would say, as I mentioned in the previous question, Vibhor. I think specific to wireless part, we have seen some softness. And with some of the pipeline that we have today, and we hope it will come back during the later part of this financial year. Broadly, what you are seeing is correct across the CSPs. The communication service providers are muted in terms of their spending around wireless and 5G, as they've already started spending money on it for the last five years, they want to monetize some of them, while there is a pause that is seen on the wireless side. But like what I mentioned, the wireline part, which is continuing to see momentum and supported by the government funding programs on RDOF and BEAD. And these two in US are likely to create significant demand over the next 18 months to 24 months.

Vibhor Singhal: Got it. And just like Transportation, you expect Connectivity also to be, in a positive growth territory for the full year?

Karthikeyan Natarajan: Yes, which is expected to be back ended, as compared to what we have seen on the Transport side.

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

Sandeep Shah: Thanks for the opportunity and congrats on the good execution especially on the margins.

Sandeep Shah: Yes. The first question is in terms of the guidance again. As per my calculation, the ask rate is actually 2% at the lower end and 5% at the upper end. So even 2% is not conservative looking at the macro environment and your commentary about semiconductor, high-tech and communication may have some gradual recovery rather than a fast recovery. So how confident we are in terms of growth pickup starting from Q1. Do you believe 3Q, 4Q growth rates would be higher versus 2Q?

Karthikeyan Natarajan: Yes. At this point of time, Sandeep, like, what I guided on each of the sub-segments and the growth is aided by what we have seen in aerospace, automotive and energy and utility segment. And we expect the growth in these segments and supported by health care and life sciences and Connectivity during the second half of this year. We expect to keep our guidance in the same range of 15% to 20%.

Sandeep Shah: Okay. So whether growth rates could be slightly back-ended this year versus maybe 2Q may have slightly gradual recovery as of now?

Karthikeyan Natarajan: So we are not guiding specific on Q2. And I understand the ask rate that you talked about, and we are aware of it and we are working towards meeting our overall guidance of 15% to 20%.

Sandeep Shah: And Prabhakar, just in terms of question on nature of SG&A optimization. Why I'm asking this is actually the support staff has not gone down in Q1, Q2. What is the nature of such a big optimization which we have achieved in the 1Q and your expectation to continue going forward? And your 1Q EBIT margin is already 240 bps higher versus your FY23 EBIT margin for services business. So that means on the next three quarters, margin may be more or less flattish, which is still a very good execution, but that is the way directionally one should think about despite wage hikes?

Prabhakar Atla: I think this cuts across a number of levers, Sandeep, which we've already worked in the last year. But you've not seen the impact of it last year because there were also costs that we incurred around it, you have seen the full benefit or the fullish benefit in the current quarter. Therefore, our construct that whatever we have done, we'll continue to maintain if not further improve on that. Therefore, we will continue to realize same benefit to the full year. And you're right, it's also caused for continued execution excellence of which we are confident of.

Moderator: The next question is from the line of Shradha from Asian Market Securities.

Shradha: Hi, congrats on a good quarter. A couple of questions within transportation, would it be possible for you to split the growth between aero and rail transportation?

Karthikeyan Natarajan: No, Shradha, we are not breaking down beyond what we have categorized in these four areas.

Shradha: No, sir, the reason I'm asking is because we were facing some issues with one of our top accounts in rail. So, are we out of that issue or are we still facing some softness in that particular client leading to overall subdued growth in rail transportation?

Karthikeyan Natarajan: No, we are not seeing any issues that we have spoken about on this customer over the last two quarters. I think that continues to be doing well. And we don't see any negative surprise as far as the customer is concerned.

Shradha: Great. And another question on sustainability, given the fact that we've shown a very strong 4.5% growth. Is there any seasonality in the Citec business wherein 1Q is higher and -- or is it business as usual growth in the sustainability segment for us?

Karthikeyan Natarajan: Sorry, can you repeat the question, Shradha?

Shradha: I'm asking whether the 4.5% growth that we reported in sustainability, does it have to do anything with the seasonality in this Citec portfolio or is it business as usual growth for us in this segment?

Karthikeyan Natarajan: Yes, I think it is business as usual. And typically, what we have seen for Citec, they tend to have a high impact on Q4 that seems to be their best quarter. So, Q1 is not necessarily their best of the quarters based on what we have seen in the last three years of data.

Shradha: Right. And just one thing on the minority interest I think the minority interest number seems to be a bit lower than what comes from calculation of what you reported for DLM financials. So, I was just checking if there's anything else in minority interest that has gone beyond DLM?

Prabhakar Atla: Shradha, there is nothing beyond minority interest in the calculation, but our team will reach out to you to see what numbers you have.

Shradha: Sure.

Krishna Bodanapu: I think, Shradha, just to add quickly on that, if you look at what has happened. Only a very small amount would have come because that's from the pre-IPO placement. The majority would only start from July 10. That's why you'll see the full impact only in this quarter. Last quarter, only that sort of small percentage of IPO or pre-IPO placement that had happened would have come, and that too for a short term.

Moderator: The next question is from the line of Abhishek Shindadkar from InCred Capital.

Abhishek Shindadkar: Hi. Thanks for the opportunity and congrats on a good quarter. This may be a repeat question. I'm sorry I got dropped in between I was not clear why the gross margins dropped this quarter. So that's one question and the second thing is on the SG&A rationalization, Karthik, I recollect that we had been investing in SG&A after you came in in 2020. So, is it like we have reached or completed that program in terms of investment in SG&A, or is it that we view that the macro is challenging and that's why we are driving this SG&A rationale? How should we read the SG&A rationalization. Thank you for taking my questions.

Karthikeyan Natarajan: Sure. Thanks, Abhishek, and I'll answer the second part, and request Prabhakar to answer the first one. Yes, the second one, whatever investment that we wanted to make towards growth in terms of sales and technology and digital investments, they continue to be there and we will continue to make those investments, which are very critical for our journey for the next 3 years to 5 years. So, that is absolutely intact. And as you remember we did Investor day sometime in November last year and Krishna did talk about how we wanted to look at some of the spends that we have on G&A related to the buildings and computer hardware, software. We made certain investments around COVID, and some of them are not necessary, for example, everybody had two laptops, one in the office, one at home, and some of them are getting rationalized in terms of what we wanted to do. So that exercise has begun almost 8 months ago. They are starting to see results in terms of the output from Q1 onwards.

Prabhakar Atla: And Abhishek, to your question on gross margin movement, right?

Abhishek Shindadkar: Yes.

Prabhakar Atla: The gross margin movement between two quarters is because of primarily two reasons. One is the merit increase that we had in Q1 and also an unfavourable revenue mix in the current quarter that we hope that we expect to renormalize in the rest of the year.

Abhishek Shindadkar: Okay, that’s helpful.

Management: Thank you Abhishek.

Moderator: Thank you. The next question is from the line of Mihir Manohar from Carnelian Asset Management.

Mihir Manohar: Hi, thanks for giving the opportunity. Sir, just largely wanted to understand on the aero side, I mean, are customers talking about any major programs being undertaken, any major development or any major upgrades happening, just wanted to get an understanding around that on the aero side?

Karthikeyan Natarajan: Mihir, I think, I'm sure the entire industry is waiting for upgrade of what is called as the single aisle program. I think both A320 and 737 from Boeing, I think both are almost 25-30-year old platforms and they both need upgrade. And interestingly, what I was hearing from some of our customers I've met in the last 8-10 weeks, they were really looking for a decision around the sustainability initiative that is going to impact the commercial aerospace industry, whether it is using more of a sustainable air turbine fuel or whether it is about hybrid, whether it is electric or hydrogen. I think some of those bigger decisions have not been made and that is one of the reasons why the programs are getting delayed. And we do believe it's a matter of time in the next couple of years that there will be announcement around new programs. And the super cycle, which happens once in every 10 years is likely to kick in any time between 24-26, and both the platforms definitely require significant upgrade, and I'm sure it's a matter of time before both of them will come forward with the upgrade programs.

Like what I also mentioned, this is the first time many of the customers are seeing the robust demand coming from both commercial and defense side. And this is something they always manage one being on the high, one on the lower end, they can really manage the demand. And now they have definitely seen significant demand on both defense as well as on the commercial side. Just to put things in context, if you really look at the F-35 program launched by Lockheed Martin, and they are coming up for MRO now. In the next 5 years, there will be at least about 500 aircrafts to 600 aircrafts will come up for maintenance, repair and overhaul. So, that's the level of demand that is coming from defense side on top of some of the new programs that are being announced to upgrade F-35 over the next 5 years to 7 years.

Krishna Bodanapu: If I may just add, if you circle back to 2007-08 timeframe, that was the start of a super cycle essentially in the aerospace design business, and we're seeing a lot of the signs of that now happening. And I think this time, there's also a bit of a -- sort of a happy convergence in the sense that both defense to Karthik's point about F-35, the tanker, mid-range transport, etc. happening. And also on the commercial side, they're teeing up for some of the new programs. So, we're quite confident that the aerospace sector will go through that super cycle in the coming years.

Mihir Manohar: Sure. That's absolutely helpful. Thank you very much.

Moderator: Thank you. The next question is from the line of Dipesh Mehta from Emkay Global.

Dipesh Mehta: Thanks for the opportunity. Two questions. First of all, just want to understand the new breakup which you provided, what Cyient others includes because if I want to add Cyient

DET, Cyient DLM, then there is some gap. So, if you can provide some sense about it and why we are keeping it separate? Second question is about the new growth areas. Now HiTech, I think some of your peers indicated some kind of recovery is playing out. So, if you can provide some sense about how you expect HiTech recovery to play out over the next few quarters and semiconductors, sir, I think earlier, you indicated second half of recovery. So, any tangible kind of things or it is more hope than tangible kind of outcome which you are expecting?

Krishna Bodanapu: So I'll answer the first part of the question before handing over to Karthik. So, basically within our-- if you look at it, there are two sectors here, one is DLM, which is Design Led Manufacturing and the second thing is DET, which is Digital, Engineering and Technology, which is essentially the Services type of businesses that we have.

Now the Others, basically, if you look at the Cyient DLM business, there is one business within that, which is a tool manufacturing business primarily centered in North America, which is about USD10 million yearly run rate, slightly lower than that, but about there, which does not fit into the DLM framework nor within the DET framework. So, we've kept it as Cyient Others because we did not want to put it in either organizations because, obviously, we need to first figure out where the fit is and strategically what we want to do with that business. It is potentially a business that we will consider for a carve-out sale in the next few quarters, but we are evaluating the options for that. When we had acquired the business, there was a certain hypothesis around design of tools and manufacture of tools, which has not played out. And when we did this split, we found that it didn't really fit into either businesses in the split and therefore, we've held it in a different unit to figure out what the options for that business are.

Karthikeyan Natarajan: So, Dipesh, to answer your second part of the question, and in the new growth areas, I think your question was on two parts. One is the HiTech. And we do expect HiTech be flat and soft throughout this year, and we don't expect that to really recover back based on the customer profile that we have and the pipeline that we see. As far as semiconductor is concerned, we do see momentum from semiconductor for automotive and driven by significant demand on ADAS and the electrification. And we are seeing -- we have won one of the large deals that we announced last quarter and that is ramping up. And we have seen softness from consumer and data center part, but we do expect that the automotive business to be the robust during the rest of the year. We have seen momentum from some of the pipeline that we have seen and how they are moving through the decision-making cycle. And we are confident that, that should probably bounce back during the second half of this year.

Moderator: Thank you. The next question is from the line of Prolin Nandu from Goldfish Capital. Please go ahead.

Prolin Nandu: Hi, team. Thanks a lot for taking my question. Couple of questions, again continuing with the previous question on new growth areas. Now the reason we have probably put in this as a new growth areas is this is something which we are venturing into. Then when we talk about some of these macro weakness, I mean, I'm just trying to figure out whether there is a scope to gain market share here. And again, I mean, as some of the larger peers have mentioned that HiTech is probably recovering and that we have seen in some of the HiTech stocks as well. And we are still guiding for a flat kind of a year. So just on an overall basis, can you just comment on -- I mean, is there not a scope to gain market share. I mean will the macro weakness continue to hit us for the entire year across all the different four new growth areas?

Karthikeyan Natarajan: Yes. I think Prolin like what we mentioned, I think automotive business is on a very strong growth momentum that we have seen over the last 18-24 months. We continue to see momentum there and like what we talked about two of the large deals that we announced this quarter come from automotive and especially on software define vehicle for a commercial truck as well as the autonomous perception system development for a construction equipment major. So, that indicates the robustness of growth that is seen from automotive.

Healthcare and Life Sciences, like what I mentioned, we see softness in Q1. We expect that to recover in the second half of this financial year. Semiconductor, which has shown a muted Q1, we expect to recover again in the second half of this year, aided by automotive and artificial intelligence, edge compute based silicon that need to be built up and thus driving the growth during the second half of this year.

And HiTech is one of the four businesses in NGA. We expect that to be soft during the year. And when you talk about HiTech, just to remind you that this is part of the erstwhile geospatial business and we are also wanting to really not focus a significant amount of growth in that area, while we wanted to drive more around customers from utilities and communications and mining and how do you think we are able to cross-sell and drive growth in those segments and starting to see that as a horizontal and more and more than a vertical moving forward.

Prolin Nandu: Yes, thanks a lot, that clarifies the HiTech part. Now second is on this legal charges, right? In some sense, as we - I mean, what I understand is that one of the cases is over and one of the cases is still going on. So, how do we see this legal charge is spanning out for the remainder of the year? Do we see them coming down significantly or do we still need to incur the kind of legal charges that we have incurred this quarter and in the last financial year as well?

Krishna Bodanapu: So, if you look at the two elements of that case, there was a criminal element and a civil element. The more sort of risky one and the more sort of serious one was the criminal case. The criminal case is the one where -- again, Cyient was never charged as Cyient was never accused of anything. It was one of our executives, but that's been cleared. So, that takes out a humongous risk from the business. And therefore, -- it also gives us a much stronger basis to fight the civil case. So, from a risk perspective, I want to say, the matter is closed and we find ourselves in a good spot because the matter was not just closed, but it was closed very strongly in our favour where the judge even dismissed the case.

Now coming to the civil matter, it will take another quarter or two to resolve. We will have some legal fees still for the next -- we believe, for the next two quarters, that's for Q2 and Q3 at a level that is lower than what we've seen in the past. We are working on expediently resolving it. But I want to say we don't anticipate any great risk. And also, we don't anticipate a very large quantum of legal fee for the foreseeable future. It will continue for another quarter or two at least.

Prolin Nandu: Cool. Thanks a lot and all the best.

Moderator: Thank you. The next question is from the line of Chirag Kachhadiya from Ashika Institutional Equities. Please go ahead.

Chirag Kachhadiya: I have one strategic question. After this corporate event, like we listed separately the DLM vertical. What are the growth areas in the long-term strategy and place to grow this Cyient Limited business. I understand that we have a presence in the high-growth areas, be it aerospace, automotive, defense and all. But from a long-term perspective, like, let's say, three years, four years down the line, when this cyclical sector starts getting flat curve on growth side, how we should see this company as a standalone entity?

Krishna Bodanapu: Are you talking about Cyient or Cyient DLM?

Chirag Kachhadiya: I'm talking about Cyient.

Krishna Bodanapu: Sorry.

Chirag Kachhadiya: Cyient Limited.

Krishna Bodanapu: Okay Cyient Limited. So see I think the idea that we had is that there are two elements to our business. There's the manufacturing element and again, not to talk about that here, poised for some good growth. It finds itself in a good spot. The market that it operates in is going through a transformation, and we want to make sure it has its capital structure and ability to grow.

Now coming to the Cyient business, I think the key element if you look at there is the way that we've classified the business as digital engineering and technology. Engineering is the core to what we do. That is what we do well, be it mechanical engineering, electronic, network design, etc. we do various elements of engineering there. But the two elements that are converging with engineering as a digital, again, you may have heard a lot of technology speak like an IoT or machine learning, etc., but really, there is a lot more there in terms of the application of technology and how we convert this with engineering and the product. So, that's the whole digital play.

And then, of course, putting all this together is the technology play, which is pointed solutions that we can take to the customer, I think Karthik recently talked about. We won our first deal for a very large perception management system but this is taking all the skills and technology that we have. On one side, there is a whole engineering piece that we brought to the table with mechanical-embedded software, etc. And on the other side, we bought the digital piece to the table with the elements like artificial intelligence and connected devices and so on and so forth.

So, technology really brings the digital element, digital and engineering elements together. So, net-net, while we were in various industries and all of them go through their various trajectories -- these industries are seeing a very significant convergence of digital, which is the technology piece with engineering, which is the core of what they do. And they have been very strong at enabling the convergence between digital and engineering. So, if I were to summarize it, I would say, this convergence is what we're accelerating.

And okay, pure engineering might go up and down, technology might go up -- or digital technologies might go up and down, but this reality of convergence between digital and engineering is only going to accelerate, and that's what we do for our customers. And therefore, we're quite confident in the next 4 years, 5 years, as more and more technology convergence happens into products and networks, we are very well positioned in that convergence.

Moderator: All the participants are requested to limit your questions to one per participant. The next question is from the line of Vikrant Gupta from ICICI PruLife.

Vikrant Gupta: So I just have a couple of questions. The first one is on the wireless or rather the wireline part of our connectivity portfolio. So, as per my understanding, at least in U.S., it seems like the fiber rollout targets sort of peaked out in calendar 2022. They don't seem to be getting revised downwards at least by the major telcos over the last three months. So, if you could provide some color whether my understanding is correct and what you are seeing on the ground? And secondly, what would be our geographic exposure within the wireline portfolio? Are you seeing the same tailwinds that you have seen in U.S., maybe also in other geographies, your major geographies?

Karthikeyan Natarajan: Thanks, Gupta, for putting these questions. And to answer your first question and what we have seen is the fiber penetration today in North America is about 50-55%. And what is happening with cable and media and plus the wireless connectivity enabled through 5G and all of them need fiber as a backhaul for the last mile. So, that's going to be critical. And three, enabled by the rural connectivity initiative from the U.S. government, along with rural plus the urban low-income area, which is covered through the BEAD program. And these are government-funded programs and these are going to be awarded to many companies beyond the large telcos and based on the location that they operate in, and they go through a bidding process.

And that is underway as we speak. And that's likely to drive this penetration of 50-55% to probably 65% to 70% over the next two, three years. And interestingly, we are also seeing similar initiatives across U.K., Germany and Netherlands and even in European geography. And this is going to be a global initiative in terms of increasing the fiber rollout. And as you cannot really say whether it is wireline versus wireless, I think you need both even for wireless to be successful.

And with cable and media companies trying to ride on the streaming initiatives through wireline. I think it makes a lot more important across all the geographies and everyone realizes the critical infrastructure cannot function just through wireless, and they definitely want to depend on creating redundancies with wireline as well as wireless. So, we do believe this will probably run for a few more years before it really runs out of steam. And also, there is a significant initiative around replacing copper with fiber optic. So, that's something which is like a legacy modernization, which is happening. Even within the existing fiber which has been done over the last 15 years would need an upgrade, and that's another cycle that is happening across many of the geographies.

Moderator: Thank you. The next question is from the line of Nitin Sharma from MC. Pro Research. Please go ahead.

Nitin Sharma: Hi, thanks for taking my question. So, can you please help us understand if you're seeing any deal closure delays in any of these segments?

Krishna Bodanapu: Sorry, can you repeat your question.

Karthikeyan Natarajan: Yes. So, I think that's going to be a start stop, right? What we also looked at was out of our top 40 customers, there are 5 or 6 of them are going through some unique issues which are not necessarily industry specific, but it is customer specific. So, some of them, we do see delays. And we started seeing better decision-making maybe in the last 4 weeks or so as compared to what we have seen in the initial part of Q1, and again, this is too difficult to generalize across all segments. In some segments like what we have seen on aerospace, automotive, energy, I think they definitely have a compelling reason for them to invest, and some of the discretionary areas where they can defer, and we have seen some delays and not necessarily significant delays.

Moderator: Ladies and gentlemen, that was the last question for today. I now hand the conference back to the management for their closing remarks. Thank you, and over to you.

Krishna Bodanapu: Thank you very much. Thank you for joining the call this evening. It has been a very important quarter for Cyient. As we've talked about, we've been able to list the DLM business and now have a clear focus in both our businesses on this side with Digital, Engineering and Technology, and on the other side, with manufacturing.So we're very excited about where things stand. We had a good start to the quarter. Revenue moderated a bit, but that was expected, but we're still holding to our guidance from the revenue perspective and also the 50 bps or so increase in guidance from a margin perspective. We are very confident where things stand. Thank you for the support, and we'll again speak next quarter. Thank you.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of Cyient Limited, that concludes this conference. Thank you all for joining us, and you may now disconnect your lines. Thank you.