"Cyient Limited
Q1 FY2021 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to Q1 FY2021 Cyient Limited 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 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. Thank you and over to you Sir.

Krishna Bodanapu: Thank you very much. Good evening, ladies and gentlemen and firstly my apologies for having this call late in the evening. As you know given the current situation logistics are becoming quite a bit of a challenge, so our Board meeting only closed about an hour ago, so this was the best time that we could do and I really appreciate you taking the time to be on this call today evening.

Welcome to the Cyient Limited's Earnings Call for the First Quarter of FY2021. I am Krishna Bodanapu, Managing Director and Chief Executive Officer of Cyient. Present with me on this call are our Executive Chairman, Dr. BVR Mohan Reddy; President and Chief Financial Officer, Mr. Ajay Aggarwal; and President and Chief Operating Officer, Mr. Karthik Natarajan. Before we 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 has been e-mailed to you and is also posted on our corporate website. This call will be accompanied with an earnings call presentation. Details of the same have already been shared with you. With this let me take you through the highlights for the quarter.

We posted quarterly revenue of Rs.9917 million. This signifies degrowth of 7.6% on a Q-on-Q basis. In U.S. dollar terms we posted revenue of $130.6 million, which is degrowth of 12.5% on a Q-on-Q basis and 11.6% in constant currency terms. Services revenue stood at $112.2 million, which signifies degrowth of 15.2% on a Q-on-Q basis and 14.3% in constant currency. EBIT margin stood at 5.2% for the quarter lower by 328 bps on a Q-on-Q basis. Services EBIT however was at 6.7% for the quarter, which is lower Q-on-Q by 283 bps primarily because of lower volume. DLM revenue for the quarter stood at $18.4 million, which was up 8.5% on a sequential basis. DLM EBIT stood at -4.6% for the quarter. Net profit for the quarter stood at Rs.814 million or Rs.81.4 Crores, which was a growth of 8% on a Q-on-Q basis. Free cash flow for the quarter stood at Rs.2163 million or Rs.216.3 Crores. Free cash flow to EBITDA conversion for this quarter stood at 138.1% and Ajay will explain the details a lot more in his presentation.

Now coming to the business highlights for the quarter. I think we had a very good quarter in terms of some of the deals that we have signed. One that we achieved was a deal that we signed with Hitachi Rail where we signed an agreement to deliver a series of engineering service projects to support and accelerate evolution of their signaling technology. We will operate a Central Delivery Center for them in India and a Regional Delivery Center for them in the US. You would have seen a press release to this effect a few months ago.

In addition to Hitachi, there were two other new deals that we signed, which are multiyear, multimillion dollar deals and what I would like to report on that is that in spite of all the challenges that we face I think our sales pipeline is doing very well and we are being able to drive momentum into the sales process and into closures in spite of the challenges that we face with not necessarily being able to travel. We also signed a collaboration agreement with Microsoft for we have an IoT Edge Gateway 5400. It is a very unique solution in the sense that it combines hardware and software together and it has been a very interesting solution and now that it is certified by Microsoft to be Azure compatible, it can go into a lot of applications where the data also has to go into the cloud.

We also commissioned the Hyderabad DLM factory. This is one of the most advanced electronics manufacturing facilities in India and it is underpinned by the latest technology in factory automation, Industry 4.0 and supply chain management. It gives us a very good advantage because it is located close to our design centers and also it gives us the advantage of being able to showcase some of the services technologies that we are implementing for our customers in terms of automation, Industry 4.0 and so on and so forth.

I will also say that what you see in front of you are some pictures from the facility, it has been commissioned, we are now doing qualification runs, and serial production will start from August 2020. We have added 25 total new customers including the 3 that I talked about, which are strategic long-term deals. On top of that we have added another 22 new customers which is again a good reflection of the fact that closures are continuing. We are cognizant of our dependence on the top 5 customers and we are looking at derisking this concentration in the long run, of course this is easier said than done, but growing the next set of customers is a strategic goal and we remain focused on that.

Also I want to reiterate that we are very confident in the long-term future of the organization and in that context we have also made 3 very senior hires. Felice Gray-Kemp joined us in the US, but she will be the Senior Vice President and Global General Counsel, so she has a global responsibility and she comes with a significant amount of experience in the number of general counsel areas such as legal, compliance, risk management and so on and so forth. We also added Meenu Bagla as Vice President and Chief Marketing Officer. Meenu also comes with about 20 years of experience in marketing and the mandate to her is really to strengthen both the outward facing marketing and also the communication that we do internally because while the Cyient brand is very strong, probably we could do a little bit more in terms of communicating more forcefully and effectively. Lastly we also added Richard Palm as the Vice President of Supply Chain for DLM. As we had talked about previously in many instances the key to the success of the DLM business and the key to competitiveness of the DLM business is a strong supply chain. We believe that Rick actually comes with 25 plus years in this area, having managed multibillion dollar electronic supply chains for organizations like Jabil and he is based in the US, but he will be responsible for our global supply chain as we procure a number of components from a number of places that can ultimately be manufactured in India or elsewhere.

What I would like to reiterate on this is that we continue to be very confident about the business and therefore we are bringing in some very competent individuals in some new roles that have been created, but also into roles where we can show significant amount of difference to our business and really participate in the growth that is going to happen going forward.

I also want to quickly highlight the fact that we have been a very good corporate citizen in these rather difficult times. The first priority or the first and foremost priority has been associate health and associate safety. We have done a number of things to make sure that both physically associates are safe, but also this is a unique situation where people are not able to go about their daily routines, which means that mental health also becomes quite important, and therefore we have done a number of things over there. We have worked with the government in deploying technology for effective management of COVID-related issues, for example we worked with the Telangana government in deploying drones to help them manage the areas that are affected or potentially affected by COVID a lot more effectively.

For one of our key customers Molbio, we have significantly ramped up manufacturing for them to produce COVID testing devices and that is something that we have done very quickly and we continue to double down on our existing commitments though as many of you know primary education and child education is an important aspect for us though that has come down because a number of schools are closed. We continue to do a number of things in supporting communities that we work both in India and outside of India. So that is where our commitment to our corporate responsibility continues and as things return to normal we will continue that commitment. With this I would like to hand this over to Ajay who will take you through detailed financial performance for the quarter and the year. Thank you. Ajay over to you!

Ajay Aggarwal: Thank you Krishna and greetings to all of you and again thank you so much for taking this call a little late especially for the people from India, so I will present to you the financial update. Let us go to the revenue slide please.

First I would say that this quarter I think internally has been very satisfying. We have delivered in-line results in terms of what we were expecting. The predictability for us to plan our revenues and cost has improved during the quarter and we had initiated and we had talked in the last earnings call our focus on cost optimization and cash conservation and you would see that some of that is showing up in the results. So let me start with revenue as Krishna already spoke about, these are some of the numbers in terms of the revenue, $130.6 million, quarter-on-quarter change of minus 12.5% in constant currency that is a little better, year-on-year about minus 16.6%, at services level it is minus 15%, and for DLM it is 8.5%. In terms of geographies in line, only thing I have to report is in terms of APAC we are seeing significant upside and the traction in communications in APAC is really coming back and Karthik will talk more about the segment. In terms of the profitability, I would say that we had a lot of focus in this quarter in terms of cost optimization and we worked both on revenue and cost to the plan and that is reflected in some of the numbers that you have seen. If you see our reported margin for the quarter is 5.2% in terms of EBIT and in terms of the EBIT that is reported as Rs.511 million and if you look at this margin let me give you some sense of it that from the perspective and we have provided annexure on the details of the margin movement, which you can read. The gist of it is that there have been headwinds and tailwinds and there have been one-offs and some of those one-offs will not be there in the next quarter.

We have worked on the cost optimization that involves restructuring cost. We definitely had some headwinds on the absorption with a decline of 12%, 13%. We also had one-time adverse revenue mix, which is not expected in next quarter and then in absolute terms there has been significant reduction in SG&A. We have improvement on the operational metrics and obviously we got some benefit from the FX also. So that is why if you look at, at a services level we have 6.7%. My sense is if you take off some of the one-offs because these comparisons are to the Q4, if I look ahead to next quarter I think the 6.7% could go to 9.5% for services plus/minus 0.5% that is what it means in terms of the one-offs because some of the restructuring costs and other elements will not be there in next quarter and for the group I would say that some of the gap, which is there in DLM is a one-off. We had some write-off of inventory. Also we had more mix of low-margin jobs in this particular quarter. We expect that gap to go down and at least we expect for the group to go around about 8.5% plus/minus 0.5%. So as we had said in the last time we will be back to the Q4 level of margins in Q2 with these initiatives.

In terms of profit after tax I think it has been a good quarter for us. We have also got some export incentives. We have disclosed the amount of that, that is about Rs.510 million we have disclosed that as part of the other income and that is showing up both in profitability and cash, but I think in these tough times we have focused on various recoveries both from the government as well as from the customers and that focus has helped us both on P&L as well as on the cash flow. ETR I would say quite normal, a little bit higher because of the tax on the export incentives that is there and I would say that is the reflective tax rate.

Quickly I will go to the cash flow. I think we have generated during Q1, one of the historical high cash flows for a quarter Rs.2163 million or Rs.216.3 Crores and the conversion is 138.1%. I already talked about the export incentives that has helped us. This is an annual incentive, which is there, so this will not be there in the rest of the year and also some of it is also when you have the decline the potential to recover on the working capital is high, so these are two things, which have helped us, but in terms of the cash conservation we have really applied ourselves on various incentives, be it collections from government, collections from the customers we have looked at various incentives either from the government side or any other incentives. We have also looked at working capital management there is a significant drop in inventory, we are trying to improve so there is a lot of focus and that is how both in terms of our cash position and cash flow generation we are doing fine and I can assure you that both for H1 as well as for the year this focus will continue and we will generate a cash flow at higher rates than what we have generated in the last year and last couple of years.

I just want to also mention here that some of you had a problem in reconciling the free cash flow with the SEBI format of results so we have aligned that and now you will find that our free cash flow is aligned to the SEBI format. We have stated all the numbers in the same line, but again I would say because of the restatements, the impact for the current period is about 7 Crores for any of the periods in the earlier also is not more than 10 Crores and it works both the sides, so just saying that recast is just to make sure that we follow and do not have any confusion as per your request, but in terms of the numbers it is not going in one side or the other side so if you have any questions more than happy to explain that, but the cash flow is Rs.2163 million had we continued with the earlier method the change would not have been more than Rs.10 Crores.

I just want to say one more thing in terms of some of the details like other income and hedge book, we have moved them to the annexures so that we can spend more time on the questions and answers. In terms of hedge book, we continue with the same policy and the trends are similar to what we discussed in the last quarter nothing to worry and details are provided in the annexure, so there is no reduction in the disclosures just we have moved them to the backup so that we get more time to talk to you. With that I hand over to Karthik to give the insights into the business side.

Karthikeyan Natarajan: Thanks Ajay and good day everyone. Hope all you are safe and your loved and near ones are all safe and secure. I would like to take a quick deep dive into the vertical details and as you can see from what Ajay talked about the overall services revenue at $112.2 million and

DLM revenue at $18.4 million and overall revenue at $130.6 million, which is about 11.6% drop in Q-o-Q in constant currency and in dollar terms it is 12.5% de-growth. The key thing that I would like to highlight is about what we are seeing on aerospace and defense, which has seen the maximum impact as we can expect it to be so and due to significant amount of ramp-downs in terms of the customer programs getting delayed. They were really impacted heavily on the commercial aviation side while the defense continued to be robust. We have seen that the travel had dropped to the extent of 90% in April while it has recovered to less than 40% by June, but we are continuing to see this challenge in the near-term as well.

Coming to the other verticals whether it is communications and E&U, both have seen moderate de-growth and we expect them to start getting to the growth path as we move forward in Q2.

Coming to transportation and we have seen an impact with one of the customers and we see that this is likely to get to the growth trajectory from Q2 onwards. In Medical technologies, the pipeline is looking robust and we expect the growth to continue in Q2 and Q3 as well. Portfolio and semiconductor would be muted as the demand is completely uncertain how things are going to really pan out and in summary what we would like to call out is communications and utilities and medical technologies are likely to see a robust pipeline and growth for Q2, Q3 and Q4 and the rest of the verticals would probably be muted. A&D would be impacted even in Q2 to some extent and I would also like to highlight some of the key trends that we are looking at and what we are really hearing from customers across each of the verticals. Aerospace and defense will continue to see a challenge even in Q2 due to the passengers travel demand reduction and we are actively working with customers on digital, defense and DLM. I think these are the three strong propositions we are taking to the customers.

Coming to the communications part, we are seeing the network upgrade and fixed wire line to wireless and the technology upgrades from customers. There is a natural tendency of network expansion by 15% in terms of demand, and that needs to be addressed by telecom operators and they need to invest on upgrading their network and we are excited to participate in some of the investments in 5G rollouts. We are also looking at the expansion in fiberization across Europe and other geographies, and we are also looking at investments in technology areas within communication vertical whether it is on SD-WAN or IoT and some of the inventory management areas.

So moving along transportation we continue to see a positive traction and as Krishna talked about we are able to enter two new customers during this crisis. We are seeing momentum in Q2 and we hope to continue for rest of the year and most of the customers do not see a shift in right in terms of project execution. They are wanting to really keep the projects on schedule, which is a good news.

Energy and Utilities, we have seen strong momentum in utilities and especially on the RFPs, which were stuck for a while in Q1. They have started getting back to normal mode of execution and we hope some of the pipeline will get converted in Q2 and Q3.

Medical technologies side, I talked about this earlier and we are definitely seeing momentum in both the DLM as well as on the services business. We are already supporting one of the medical device customer in terms of expanding on the manufacturing requirements on the COVID-related diagnostic equipment.

Semiconductors has been mixed in terms of what we have seen and some products and medical devices related ASIC design has seen momentum and digital ASIC designs have seen the momentum. At the same time some of the verticals like automotive and industrial are seeing muted demand. So we are seeing a mixed reaction from customers on the semiconductor domain.

Design-led manufacturing, there is a robust opportunity that we see both in terms of demand as well as improving our operational efficiency. What I would really like to highlight, the focus for the next one to two quarters is to bring down our cost of operations, the inventory reduction, and ensuring that we are able to increase the cash flow generation for this business. That is a key priority that we have for the DLM business.

Net-net, overall what I would like to summarize is the pipeline is robust and the sales and customer engagements have been happening at higher levels than what we have seen before and operational and delivery levers are gaining momentum. We are confident that you will probably look at Q1, Q2 as our bottom and expect to really start getting back to growth.

Except for A&D we are confident on all other verticals to see a momentum in Q2. Maybe A&D will start getting back to the normalcy by Q3 and we hope the growth coming back to the levels that we have seen before from Q3 onwards. So that is a quick summary on the business outlook. I really wish to request all of you to continue to be safe and wherever you are and we will be happy to answer any of the questions.

Krishna Bodanapu: If I may just add one more comment before we go to the questions, I just want to give a quick color on the outlook for Q2 and FY2021. As you saw the revenue for Q1 was better than what we had expected. We had originally said we were looking at potentially between 15% and 20% degrowth that really came at 11.6% in constant currency. We are seeing growth coming back in all industries in Q2 except in aerospace and defense, which will degrow in Q2 and overall this will be a tough year for aerospace and defense and taking all that into account and also the fact that while there will be growth in most other industries like I said we still expect a double-digit degrowth in revenue for the year. In terms of EBIT margin, most of the onetime cost actions are done in Q1, there are a few things in Q2, but most of them are done in Q1, but as we mentioned in the last call we still hold that, that is in Q2 we will be back to at least our Q4 FY2020 levels, which was about 8.6% or so and we will be back to the first half of FY2020, which was in the closer to 10% range in the second half of this year. Q2 PAT will not have the benefit of export incentives, which we received in Q1 and taxes will also therefore be marginally lower in Q1, so this is the outlook for the rest of the year.

Moderator: Thank you. We will now begin the question and answer session. First question is from the line of Urmil Shah from IDBI Capital Markets. Please go ahead.

Urmil Shah: Thanks for sharing the segment wise outlook especially for the second quarter. Krishna my first question is regarding the same while we understand as regards aerospace and defense could be weak, but would any of the verticals see strong growth to the extent that they can overcome the cut, which was visible in Q1?

Krishna Bodanapu: Urmil I think what we are seeing is that aerospace and defense will have a fairly significant cut, so I do not think any of the verticals can make up for that at least through the year. Now some of the verticals will make up for the cut that is there in Q1, so which means that net-net for the year that they will still have a growth, so we are still working on that and we believe that some of the verticals have a line of sight towards that. Karthik do you want to add anything to that?

Karthikeyan Natarajan: No, I agree, Krishna, what we are seeing is it would still not be possible to cover all the gaps, but our intent is to really get as close to the gap as possible that we can mitigate. The way that we are really looking at is Q3 being a soft quarter and we expect the growth to really get back to the normal levels by Q4 and by the time it will be a little too late for the first 9 months of de-growth to be covered so that is a concern that we have at this point of time. But we are definitely seeing the pipeline across all the areas and especially around digital. Whether it is helping the customers on digital asset management or Industry 4.0 or grid modernization. I think there are a lot of interesting areas where we are seeing opportunities coming up from various customer segments, which is definitely giving us positive momentum in Q2. We are also seeing that the decisions, which were passed somewhere in middle of Q1 have started getting back to the normal mode end of Q1 and early Q2. We hope the momentum to continue and we are also concerned about some of the changes that were happening in terms of the COVID wave 2 or wave 3, whichever way you may call it as, the lockdowns in various cities in India, and we are absolutely keeping a close tab in ensuring that our people are safe, and we are able to really operate at a very lean percentage of people operating from office. We still continue to have more than 90% working from home, and we thought we can probably get to about 10%, 15% by early Q2, but we are deferring that decision because we are able to operate them at more than 90% productivity levels, so keeping that in mind we are able to continue the way in which we were doing earlier. We are keeping a close tab on changes that are happening around us, and we hope some of the field-related issues that we have seen in the early part of Q1 do not occur in Q2. That is another part that we are keeping a close tab on.

Urmil Shah: Given this outlook as regards double digit decline for the full year are we talking about mid-teens kind of decline or lower than that?

Krishna Bodanapu: No, it would not be mid-teens, but it will be closer to 10%, we do not know where exactly, but it would not be in a sort of a mid-teens kind of a number.

Urmil Shah: Got that and you related an interesting point as regards to focusing on the non-top 5 clients, it would be good if you could share which would be the key verticals to be looked at because if I am not wrong it is not only about derisking top 5 concentration, but also derisking the A&D dependency.

Krishna Bodanapu: Karthik do you want to address that?

Karthikeyan Natarajan: I think you are absolutely right. I think what we are definitely looking at is to double down on some of the verticals like communications, utilities and med tech. I think we definitely have about 2 dozen customers in those segments, which can probably be mined better. I think that is definitely what we are looking at and as Krishna said do you want to really look at the customer concentration. I think we have gold standard customer base in many of the verticals and the intent is to really bring in more mining within these customers and bring more digital deals, engage the customers more positively with proactive ideas and making them to realize how we can really co-develop some of the products and solutions. I think those are the areas we are really focusing on in terms of expanding our growth from the top 30 accounts. We are looking at how do we really grow from the 6 to 30 accounts higher than what we can do from the top 5 accounts. I think that is what Krishna meant.

Urmil Shah: My last question if I can pitch in. Krishna as regards to capital deployment more on the point of view of M&A how should we look at it FY2021, you would want it to be more of a year of stabilization as regards to the organic growth?

Krishna Bodanapu: Urmil the way that we are looking at it is obviously right now all hands are on deck for the organic growth, so we are continuing to be very focused on that. Going forward though we understand that there will be some good assets that are available at a reasonable price, so we are making sure that we are doing the pre-work that is required to be ready when the opportunity arises. So I would say, in the immediate term we are backing off a little bit because I think some of the assets need to be evaluated in their new construct we cannot just assume it is the old construct, but the idea is that we are using this time to really scan the market, understand the market while we focus on the core operations, but my view is sometime towards the end of the year we will start to see a lot more activity on that.

Urmil Shah: Thank you, all the best and stay safe.

Moderator: Thank you very much. Next question is from the line of Madhu Babu from Centrum Broking Limited. Please go ahead.

Madhu Babu: So on one of our large verticals will have anyway the structural issues for some time, so in terms of communication when we are saying a growth, so could we tell them in which geography like in the large Australian client, what are the new opportunities we are pursuing or what are the typical deal sizes, which we can expect from the large Australian client as well as the large US clients in communication vertical?

Karthikeyan Natarajan: We are definitely seeing growth all around as far as the communication is concerned. I think we have definitely seen a momentum from APAC, which is what Ajay also talked about. What we are seeing is the 5G rollout and we have been able to secure about 60 sites and we expect if you are able to do this you can probably grow multifold and we have seen something similar across North America as well. I talked about the expansion that we are looking at is what can we do on the wire line and fixed line and also expanding into wireless and technology areas and we are seeing growth momentum across all the three segments. From Europe side we are really trying to get a right level of partnership to ensure we can expand in the European geography. The fiber density in Europe is likely to grow by 5x in the next 6 to 8 years and we are thinking of ways to expand on our existing offering on network planning and design that can be expanded in that geography. We are looking at this vertical as a growth engine for this financial year and also for fiscal 2022.

Madhu Babu: Whom would we encounter in competition, would we see the typical Indian IT service providers in these deals because it is not completely engineering side so when network and all maybe companies like Tech Mahindra or typical other IT vendors, so who would be the competitors in this deal and how would we need to expand the delivery team to allow in to tap these opportunities because relatively we have been not much into this space?

Karthikeyan Natarajan: Yes, that is a fair question, Madhu. I think we have been internally debating about how do we get ourselves prepared for and we are definitely looking to build partners as an approach that we are looking at for expansion. Especially on the partnership we are looking at IT and platform-based growth and that would really give us significant headway into right to win. We would come across some of the larger sites and what we are trying to expand is from our existing base to adjacencies and that is where we see a growth that is coming in, whether it is from network planning and design to asset management and expanding into the inventory management, how do we think we can really expand on the service fulfillment, service assurance, and those are the areas that we are seeing as natural adjacencies and trying to expand on the technology side.

Madhu Babu: One last question on the semiconductor, which typically is a large vertical and with large deal opportunity, so last time we have done one acquisition AnSem. Would we require further acquisitions to bolster the scale of this vertical and so how do we see, probability of winning more large deals in this vertical because it is a sizable vertical?

Karthikeyan Natarajan: Yes, that is a fair question Madhu and what I would really answer is we want to really go about some of the investments that we made. How do you think we can really make that to grow significantly for us and we want to really take the capabilities, which are very unique and niche and much differentiated as compared to any of the Indian SI. I think we really want to take those capabilities and expand our presence in medical devices and defense electronics and industrial side of the business. I think that is where we will see a growth coming in, though we talked about semiconductor and these are the ASIC custom design for customers who need to design their own chipsets because of the need that they see that they want to create a secret sauce of their IP to be embedded and that is where we come into picture and we are really seeing that the opportunity we want to expand or cross-sell even into verticals like aerospace and defense and automotive, industrial and medical technology areas.

Madhu Babu: Okay Sir, thanks.

Moderator: Thank you very much. Next question is from the line of Sandip Agarwal from Edelweiss Securities. Please go ahead.

Sandip Agarwal: Krishna and Karthik I have one question particularly on the outlook, which we are talking about, so it is looking like we are going to have a significant event over the next three quarters on a quarter-on-quarter basis because what you are saying is a 10% decline. It looks like there is significant deal pipeline, which you will see quickly materialize or there is something else, which is giving so much of confidence, so if you can put some light on that will be helpful, secondly on the margin front we have achieved quite a bit of restructuring so I would like to know Ajay will this not structurally improve our margins by Q3 and Q4 to that extent because probably we would have achieved the right fit number of employees with this restructuring effort or you think there are some costs, which are unpredictable right now?

Ajay Aggarwal: Sandip you are absolutely right I think the kind of cost structure that we have created gives us a lot of confidence for a good margin for H2 and that is why Krishna also said that in the outlook that H2 I think we can get back to the levels of 9%, moving towards 10% kind of a margin and this is assuming the not extraordinary growth because the growth also has an impact, so I think it could be a little better than this depending on some of the growth, which is a little uncertain right now in terms of saying what will be that, but I leave Krishna and Karthik to take that, so your observation is right on the margin.

Krishna Bodanapu: It is not going to be just 10%, it would not be 15% it will be somewhere in the middle, so we are still working through to see how the numbers will pan out for the year, so I will say that first and the second thing I will say is look we do see a fairly decent pipeline, we see a fair amount of opportunities that are still there. Obviously we also have to be very careful because the macro situation can still change, so we do need to be careful that we are not just going whole hog in and making some large investments, so we are treading it cautiously, but I want to say that the de-growth will be in double digits, which means it will be greater than 10% perhaps not quite 15%, but somewhere in the middle and we do see a fair deal above pipeline and opportunities to be able to get there because aerospace fine we will have a challenge I think we have to brace for that, but like Karthik said there are other verticals such as communications, medical, etc., where the opportunities are also there. Karthik, do you want to add anything to that?

Karthikeyan Natarajan: No, I think you covered it, Krishna. I think it is true. What we are seeing is a good momentum. The decision-making will depend on multiple other parameters from customers, and customers are also bracing for their cash position and their readiness to continue the investment so it is definitely not just what we can do with them, it is also their readiness to make decisions. So there are decisions that are getting delayed, there are decisions that are getting pulled up, and we are seeing a mixed response from various customers. On the medical devices side, we are working on two deals where we are in the last leg and we hope some decision will come through in Q2. Similarly we are looking at a couple of deals in utilities and couple of deals in communication. We are expecting the decision cycle to improve in Q2 if macro situation remains stable as we are seeing today.

Sandip Agarwal: Okay great, thank you. That is all from my side.

Moderator: Thank you very much. Next question is from the line of Sudheer Guntupalli from Motilal Oswal Financial Service. Please go ahead.

Sudheer Guntupalli: Krishna, our revenue dropped almost 15% over the last couple of quarters since COVID situation started if you have to dissect this decline further what part of it would have been supply-led and what part of it is demand-led?

Karthikeyan Natarajan: What we have seen is Sudheer the early part of Q1 between April first to April third week there were issues related to the supply side at both on the DLM as well as on the services part, but I think most of the services-related disruption have been recovered through the quarter and the team has done a phenomenal job in pulling things up in May and June and to that extent I think we do not have much of issues on the supply side. We still have one or two odd cities where we are not able to have the field-related activities, which is affecting us slightly, but we do not see that as a major issue on the supply side and what we have seen the issue on the second part of Q1 is on the demand side of the challenges and that is the reason why we have seen a drop in the revenues.

Sudheer Guntupalli: Okay, but it looks like work from home in case of engineering services is not being as convenient as in the case of IT services, so with the entire medical situation still remaining fragile and possibility of re-imposition of lockdowns, so do you think supply side will not be a big bottleneck going forward I think you are confident that supply side will not be a big bottleneck going forward?

Karthikeyan Natarajan: Yes. I would answer it slightly different. The way that we have looked at it is you would have asked us around late March whether you think you can get to 92% work from home at 95% productivity levels, the answer would have been maybe. But I think we are confident to say that now that we have been able to bring in all the processes in place and ensuring that people are able to work productively and be able to manage their working hours and we have been able to clearly overcome most of the challenges that we are seeing in the early part of Q1. Having said that when we talk about supply side I would also look at our ability to hire locally especially in US and we have close to 80% plus people that we have in North America who are hired locally, so we have a strong resourcing engine that can help in hiring people locally. The travel part could probably pose some issues in the H2 since we are not able to really get people to move from one place to other place that is where the local resourcing engine will comes into picture, so to that extent we hope whatever visibility that we have for Q2, Q3, we do not see the supply side to come in for any challenge.

Sudheer Guntupalli: Sure Sir between DLM and services how would your annual outlook be spread, whatever, 10% to 15% in between you are talking about let us say 12%, 13% sort of a decline for the full year, so any individual color on these two segments, separate color on these two segments, services and DLM?

Krishna Bodanapu: I would say it is a little bit early on that. I think we are seeing opportunities in both cases. I think DLM looks a little bit better, but I think at this point considering how volatile the situation is I would say let us look at it quarter-by-quarter and I would say overall it is quite well-balanced.

Sudheer Guntupalli: Sure Krishna, thanks, all the best.

Moderator: Thank you very much. Next question is from the line of Sandeep Shah from CGS-CIMB. Please go ahead.

Sandeep Shah: Yes. Just wanted to understand Krishna under your and the joint leadership with Mr. Karthik, is there any major restructuring, which we are planning to do in some of the department to improve the predictability of the revenues and also the revised strategy may also target focusing more on the large deals because at a scale that may be required so can you throw some light, which will help us as a long-term strategy?

Krishna Bodanapu: Yes absolutely. So I will say a couple of things on that. I think we have done a lot of work and especially Ajay and the finance team more than anybody else have done a lot of work on bringing predictability based on some clear metrics, be it order book or pipeline and so on and so forth, and Karthik has really used that very effectively to make sure that we are having reviews and cadences, which gives us a much better visibility into what is going on. So one is I would say we have already done a lot of work in terms of making sure that we have a scientific way and obviously we are not finished yet, we still need to do some more work, but we will continue on that and I think that was one of the big challenges that we had especially in the last four quarters or so. The second thing is we are also looking at a few options of how we can get large deals going effectively. Again restructuring can come in with many formats I would not venture on that. I will say that we are looking at ways in which we can bring focus to large deals and I think even over the last quarter or so, both Karthik and also the BU heads have put in a lot more effort on bringing those kind of deals into focus, which we perhaps did not do in the last four, six quarters, which I think is happening. So we understand a couple of things both in terms of where we should focus on and the outcomes, which are areas of focus, and we are working on how we can support those areas of focus.

Sandeep Shah: Fair enough and just to clarify if I am not wrong are we seeing in the services business in 2Q the decline in aerospace and defense would be higher, which will not be compensated by the growth in the other areas and also in 3Q because of furlough, services business may be tapered so it may be largely the services business may see a recovery only in 4Q is it a right way of looking at it?

Krishna Bodanapu: No, no. What I said that was for the year. I will say Q2 is looking better than Q1 as things stand, but for the year what I said is there.

Sandeep Shah: But services business will see a positive growth in 2Q as well?

Krishna Bodanapu: Yes.

Sandeep Shah: Krishna just last thing as even at a midpoint at 12.5%, the compounded Q-on-Q growth comes out to be close to 3% in the 2Q to 4Q, the services part you believe may be slightly lower than that and this may be more dependent on the DLM part?

Krishna Bodanapu: Not necessarily, I think again like I said it is too early I think both groups are looking very similar right now. Yes we do see more opportunities in DLM, but services is also looking reasonable, but I would say DLM might be slightly higher, it is not all DLM-led rebound.

Sandeep Shah: Thanks and congratulations on the good execution.

Moderator: Thank you very much. Next question is from the line of Mohit Jain from Anand Rathi Shares and Stock Brokers. Please go ahead.

Mohit Jain: Two questions, one is on your order intake so this number includes Hitachi for the quarter or where will you book it will come in the next quarter?

Krishna Bodanapu: No, the way that we do order intake is Hitachi is not one large deal our order intake that we report is only on committed purchase orders, so Hitachi is not one large PO, so it will happen over a period of time it is not one-time. Even when we sign multiyear deals we only take what is actually committed from the customer as a PO

Mohit Jain: So that is already included in the quarter's intake number is it?

Krishna Bodanapu: Only what is committed.

Mohit Jain: Only what is committed and signed is already part of it, is it?

Krishna Bodanapu: Which is not a very large number.

Mohit Jain: That I understood and second...

Krishna Bodanapu: Yes, because committed is not what is committed in the MSA, but what is committed through a purchase order which is a legal document.

Mohit Jain: Given our order intake this number while you have added a footnote saying that it could be more than one year is it safe to assume this is broadly for a 12-month period?

Ajay Aggarwal: No. I think when you look at our order intake backlog I think we look at two metrics, one is what is executable within the year and what is beyond this, so this is a sigma of both of them.

Mohit Jain: Sir, on a weighted average basis, because as Krishna mentioned we only take POs, which could be of shorter duration. Like any ballpark will do like one, one-and-a-half years because you have specifically added, it could include more than 12 months kind of a business also?

Ajay Aggarwal: So that is the technical definition of order intake and typically if you look at whenever backlog is 6 months you will find that, I think it depends on any particular typical deal, but I would say that it is just to explain that the order intake comprised of both executable in FY2021 and beyond, do not read too much into it beyond that.

Mohit Jain: On the headcount reduction is it like complete now because going forward we are also looking at growth on a sequential basis or do you think some of it may come in second quarter as well as part of restructuring?

Krishna Bodanapu: See we have had to take some decisions, which we obviously implemented in Q1 so we believe we have the right base and we also have the right number of people for the growth that is going to come. Obviously in a volatile situation like this things keep changing so we will have to make corrections, but broadly we think from a wider structural restructuring basis we are done.

Mohit Jain: So is it like safe to assume our cost base, as of today, given that we have an outlook as of today, our cost base is more or less fixed and your margin outlook is basically a function of how much incremental revenues can we generate in the second half?

Ajay Aggarwal: As Krishna said I think more or less we have done that, but when you do these exercises there are always spillovers I would say it is a little bit of spillover that is there and I would say that we are continuously working on utilization and that is what we are doing, so I think some of the growth can come with existing cost structure also, but beyond a particular point it would mean additional costs and right now we really do not know precisely that how much is the growth, but definitely if the growth comes back we will have to increase some of the costs, but whatever margin we are saying that we will get to Q2 at the Q4 levels in H2 to the annual level I think that is factoring in incremental variable cost that will come back to the growth so that is net of that.

Mohit Jain: Lastly on utilization like what could be our range of utilization as of today or as of 1Q?

Karthikeyan Natarajan: I think that there is an additional 3% or 4% potential opportunity for us to improve on the utilization part and I will also add one more point Mohit, which is to do with automation. I think we are starting to really bring focus on automation and we see an opportunity as a lever of productivity through automation, so that is something we are trying to really put in place as part of key initiatives that we are trying to drive on the operational performance side. Also on the order intake, I will just add one point Mohit because of multiple challenges and turbulence that we have seen in Q1, I would not read much into the order intake that you have seen on the three months because a lot of things would have got corrected by the time the Q2 had begun so this was only whatever as on June 30, 2020 that has been reported by us.

Mohit Jain: Understood Sir that is all from my side. Thank you very much.

Moderator: Thank you very much. Next question is from the line of Rajin Rajan from Geojit Financial Service. Please go ahead.

Rajin Rajan: I have a question like in which particular sector will be your focus like segments like DLM or whether it will be services going ahead?

Krishna Bodanapu: See, it will be a balance of DLM and services. Services is still the core of what we do, so proportionately a lot of our focus does go into services, so we are, like I said, it is the core of what we do. DLM really supports the services business for the most part, so the focus will continue to be on services.

Rajin Rajan: Regarding the A&D is this especially related to COVID or like any client--specific concerns?

Krishna Bodanapu: No. See if you look at the global aerospace industry it is down very significantly it is related to COVID, so therefore the customers put off a lot of their spend, had put off a lot of their engineering and therefore it is very related to COVID from a demand perspective not necessarily from a supply perspective.

Rajin Rajan: Sir on the semiconductor division like we are focusing on IoT also, so how do you see this IoT going ahead?

Krishna Bodanapu: See that is a very broad way to look at it, there is many specific things that we do over there and the growth opportunity is really on how we position and package these things like connected vehicles, like I said we did an IoT device, which is a very unique hardware, software solution, so net-net is I think there are some huge opportunities for us in IoT and we will continue to focus on that and I think the key I will say for us is not to focus on the technology, which is IoT or digital, but to really focus on the outcome, which is connected vehicles, predictive maintenance, asset management, factories of the future, etc., so it is an important play, but it is an enabling technology to a wider play.

Rajin Rajan: Sir one more clarity regarding this margin, like 9.5%, like you said, it is for full year, I think somewhere Ajay Sir told that like 6.7% to 9%?

Ajay Aggarwal: So what I talked about first I explained that whatever will be margin in excluding the one-offs if everything was same then how the Q2 will look at, looking at the one-offs between Q1 and Q2 so all comments were about Q2 and I said we will get back to the level of Q4 that is about 8.5% plus/minus 0.5% then I said H2 will be better than that and we will move closer to 9% to 10% I think rest of it will be depending on the rates of the revenue, which I do not have right now, but as we prepare it is a simple mathematics.

Rajin Rajan: Thanks a lot Sir. That is all from mine.

Moderator: Thank you very much. Next question is from the line of Prakash Chellam from Marathon Edge. Please go ahead.

Prakash Chellam: Just a quick question on the aerospace and defense, last time you had indicated roughly 20% in defense, 80% in aerospace I am talking only about the services business here. Within the services portion aerospace alone not the defense part of the aerospace could you give me some sense as to whether how much of this is linked up to, is there any linkage to what Boeing and Airbus delivery schedules look like, is there any connection with that, have you ever studied a correlation between the two and is the nature of your work kind of linked to that or is it kind of dependent on something else, could you give us some color on aerospace and defense recovery, what metrics we can look at?

Karthikeyan Natarajan: No, I think this is one area that we are also trying to work along with our customers. What we have seen is it has to start with the domestic travel. About 70% of our revenue on the commercial aviation will be linked to the domestic travel. When I say domestic travel within US, within China and within countries in Europe, and the second recovery would be based on the inter-region travel whether it is within North America, within Europe, within ASEAN. Third would be the intercontinental whether it is transatlantic or transpacific would be the recovery that we expect. Each of the phases could be anywhere between three to four quarters, is what we are anticipating and probably I would say 70, 20 and 10 is what I would really say how our revenues are linked to that because we work with a lot of customers who are into the short haul flights as compared to the long haul and that is where our revenue recovery would be linked to.

Prakash Chellam: So when you say short haul flights and you say travel as opposed to deliveries of aircraft in production, is the nature of your work more linked to maintenance sort of work when flights take off land in terms of data, continuous monitoring and so on and you are saying it is not quite linked to delivery schedules of the main aircraft manufactures like Boeing and Airbus, could you explain why it is linked more to travel as opposed to deliveries of aircraft?

Karthikeyan Natarajan: That is an interesting question where one of the customers did share with us saying that if they got 100 planes and they are only requiring to put 50 planes to service and they do not need to get the maintenance done for this 50 even if they demand one because they can really put them back into the warehouse and start getting the other planes to be put into service. So it is going to be an interesting time that we live in, so we really have to look at how things would evolve, it is a combination of all the three, it is the number of new aircrafts required to be delivered, it is also ensuring that many of our customers do have linkage to the aircraft that flies what they call it as a pay per hour and kind of contracts and the third will be linked to the MRO and maintenance side of the business. So all three have to be looked at in total and you will find that it is a combination of all three factors that determine the revenue recovery for our customers.

Krishna Bodanapu: Prakash, just to add to that, I would say a lot of the work that we do is MRO-related work, which means that only as the planes are flying they need to get repaired and we do a lot of the associated engineering, so to Karthik's point a significant portion is that is why planes need to start flying and also I would say the other thing is only when that starts happening will the deliverables also go up because the second big dependency for us is also on manufacturing starting to kick up because a lot of the work that we do is also supporting manufacturing engineering, so unless manufacturing comes back on stream, which would not happen unless the aircraft or airlines are taking deliveries and now they are not taking any deliveries they are rather paying the penalties than take the deliveries so I think the air traffic has to pick on because right now there are not many new programs that are going on. There are not too many sort of new design programs that Boeing or Airbus are undertaking, which means that the long-term kind of engineering, which is not dependent on any of this, is very little anyway, even that was the case over the last two years that is why aerospace business has been flat for the last year, year-and-a-half.

Prakash Chellam: Got it. So just to make sure that I understood it you are saying majority of it on the commercial side is probably MRO-related work so the combination of it will be manufacturing engineering. Manufacturing engineering portion is linked to deliveries of aircraft being taken on by airlines in production and MRO work is related to the client. Alright great, thank you so much for your comments. Thank you.

Moderator: Thank you very much. Next question is from the line of Hitesh Chugh from Federal Bank. Please go ahead.

Hitesh Chugh: My question is regarding Cyient DLM there were negative increase in the EBIT what would be the reason for that?

Ajay Aggarwal: No, there were one-offs, so I think you should not worry too much about it. We anticipate in the next quarter itself a swing of about 7% to 9% quarter-on-quarter on this EBIT and the reason for this negative EBIT was the inventory write-off that was onetime. I would say that was more of a provision as part of the prudent policy we have about 365 days and also the mix of the revenue where we got more of low-margin work in this quarter, there was a change in the mix last minute, but I think both of them will change in the next quarter so you would see a huge swing in Q2 to the levels of 7% to 8% quarter-on-quarter, so minus 4% should be more like 4% plus/minus 1%.

Hitesh Chugh: Thank you.

Moderator: Thank you very much. The next question is the last question from the line of Sonaal Kohli from Bowhead Investment Advisors. Please go ahead.

Sonaal Kohli: I had two questions. In the last couple of years we have done a significant amount of capex and we have not seen too much of hiring in the last couple of years that was one, secondly apologies if this has been answered I joined late did you give any guidance on Q-on-Q growth for the next quarter in your services business?

Krishna Bodanapu: So let me answer the second one. We said Q2 will be slightly better than Q1.

Sonaal Kohli: Would you expect Q3 to be better than Q2..

Krishna Bodanapu: See, at this point the way things are, even looking a quarter ahead at this point, what I tell you now would not hold for Q3 so I think we are also trying to look at our business, we know what is going to happen between rest of the year broadly speaking, but I think it would not be very prudent to guess in great detail on how different Q3 will be from Q2.

Sonaal Kohli: You did substantially better than what you had guided for so where did the surprise come from, are you building in much more supply disruption or did the demand surprise positively or any particular segment that surprised you positively.

Krishna Bodanapu: It was a combination of all the above and honestly we were expecting a lot more disruption from the supply side. For example we did not think that we could get to 95% work from home with 95% efficiency within four weeks. I think Karthik mentioned this before at the beginning of the quarter if somebody said we would be in this situation at the end of the quarter we would have been quite happy with it, at least from efficiency and work from home perspective. Similarly I think there were areas where we were expecting sharper drop in demand that has not necessarily happened or there are also areas where there was a drop in demand, but it has come back, so it has just been a combination of sort of all the above and I think we have to realize that our customers are also working through a lot of uncertainty in their business, so it is not like they are able to give us the predictability that they used to be say even three months back.

Ajay Aggarwal: See if you look at our capex a lot of it is maintenance capex. For the services business we end up spending about 2.5% to 3.5% of revenue. A lot of it would be the maintenance capex and some of it is the expansion capex. Then it depends which number you are referring to in terms of capex, we have some investments, which also come in, in some kind of expansion, look at Hyderabad capex that is a new investment, some capex that we have investments we have made in defense side on the SDR. In terms of our normal capex I think we should look at this number of 3% to 3.5% where it will stabilize. Any investment we will give you some guidance. Right now I think the large one was Hyderabad, other than that I do not think we have any major numbers that will have an impact on our capex investment in short-term at least for this year.

Sonaal Kohli: Sir, let us say, last year what would have you been your maintenance capex broadly speaking in absolute terms because revenue is fluctuating a lot, so percentage of revenues may be difficult for us to figure out, if you could just give broadly an absolute number for last year what was the maintenance capex for this year?

Ajay Aggarwal: See, typically some of it is fixed so keeping that in mind this will be more Rs.100 Crore plus/minus Rs.10 Crores and in terms of the software, hardware and some of the other modifications that we carry out I would say roughly and many of this is mandated by our customers as part of the productivity improvement, etc., so roughly I would say that 67% is quite fixed, it does not vary with the hiring or volumes, so that would be about Rs.60 Crores, Rs.70 Crores of that, but if you really want to deep dive you can have a separate call on that. I am just trying to give you a sort of order of magnitude.

Sonaal Kohli: Great and Sir lastly you had this one-off income of Rs.50 Crores what was in this account of and is it one-off in the sense that it happens once in a year or is it like one-off in true sense of it?

Ajay Aggarwal: Yes, it happens once in a year so far I think every year and this is dependent on government policy and announcement of the government policy, this is towards the export incentives for software and I think we keep providing the guidance on this from time to time. As of now we do not anticipate any such income especially on the services side for rest of the year.

Moderator: Thank you very much. I will now hand the conference over to Mr. Krishna Sir for closing comments.

Krishna Bodanapu: Thank you very much and again once again thank you to all the participants for joining us this late in the day. As you know it was a slightly better quarter than what we anticipated, but there is still a lot of uncertainty out there and we just need to be prudent. On one side we are quite confident of where we stand and also we have a very strong and healthy pipeline that we are working towards which gives us an opportunity to take advantage of this disruption. On the other side I think the macroeconomic situation is still very fluid, so we still have to maintain the agility. I just want to assure you that it is a very difficult balance, but I think we have an extraordinary management team that is maintaining that balance as well as we can and we will have some much better quarters going forward. Thank you for your support so far, thank you for your questions and if there are any follow-ups we will be happy to answer them off-line tomorrow, but otherwise have a good evening, stay safe, and we will again speak soon. Thank you.

Moderator: Thank you very much. On behalf of Cyient Limited that concludes this conference. Thank you for joining us. You may now disconnect your lines. Thank you.
