CYIENT

8 November 2021

The BSE Limited
PJ Towers, 25th Floor,
Dalal Street
Mumbai 400001.
Scrip Code: 532175

The National Stock Exchange of India Ltd
Exchange Plaza,
Bandra-Kurla Complex, Bandra (E)
Mumbai-400 051.
Scrip Code: CYIENT

Dear Sir/ Madam,

Sub: Transcripts of the earnings conference call

Please find enclosed the transcripts of the Q2 FY22 earnings conference call conducted after the Meeting of board of directors held on 14 October 2021.

Thanking you,
For Cyient Limited

N. Ravi Kumar

Ravi Kumar Nukala
Dy. Company Secretary

"Cyient Limited Q2 FY22 Earnings Conference Call"

October 14, 2021

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

Moderator: Ladies and gentlemen, good day and welcome to the Q2 FY22 Earnings Conference Call of Cyient Limited. As a reminder, all participant lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. I now hand the conference over to Mr. Krishna Bodanapu – M.D. and CEO. Thank you and over to you sir.

Krishna Bodanapu: Thank you very much. Good evening, ladies and gentlemen and welcome to Cyient Limited's Earning Call for the Second Quarter of Financial Year 2022. I am Krishna Bodanapu, Managing Director and Chief Executive Officer of Cyient. Present with me on this call are Mr. Ajay Aggarwal, Executive Director and Chief Financial Officer and Mr. Karthik Natarajan, Executive Director and Chief Operating Officer.

Before we begin, I would like to mention that some of the statements made in today's discussions maybe forward-looking in nature and may involve risks and uncertainties. A detailed statement in this regard is available in our 'Investor Update' which has been e-mailed to you and is also available on our 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. In US dollar terms, we posted revenue of $150.1 million which was a growth of 11.2% YoY and 4.6% QoQ, 5.6% QoQ in constant currency. In rupee terms, we posted quarterly revenue of INR 1,112 crores. This signifies a growth of 10.8% YoY and 5.1% QoQ. Services revenues stood at $124.6 million, a growth of 9.2% YoY, 5.5% QoQ in constant currency and 4.5% in dollar terms. Workforce Delta, which was an acquisition, contributed to about 0.5% to this growth. DLM revenue stood at $25.5 million, a growth of 22.3% YoY and 5.4% QoQ. Group EBIT margin stood at 14%, up 301 basis points YoY and 90 basis points QoQ. In the last seven years, this is the highest EBIT margin that we have delivered. Free cash generation for the quarter was at INR2,050 million or Rs.205 crores, a conversion of 97% on EBITDA and 169% on PAT. Finally, PAT stood at INR121.3 crores or INR1,213 million for the quarter; this is a growth of 44.7% YoY or 5.5% QoQ and this also is among the highest PAT that we have delivered purely from operations.

Coming to the highlights of the quarter, we strengthened our Digital Solutions Suite, which we have branded as IntelliCyient, through the acquisition of Workforce Delta. Workforce Delta is a consulting company with expertise in advising and executing workforce management programs for companies globally. This acquisition is in line with our strategic part of enabling digital transformation for our clients through the IntelliCyient framework.

We expanded our Digital Solutions portfolio for the Aerospace industry with PPAP4Aero which is a global AS9145, which is aerospace certification supplier compliant software framework. The Microsoft Azure ITAR is the compliant framework for aerospace and defense in the US. The ITAR compliant SaaS cloud app and global support services solution reduces costs while ensuring the quality of manufactured parts for aerospace and again with the anticipated ramp up and with what's happening in aerospace this positions our digital offering for aerospace very well.

We were recognized as a Rising Star in the Connected Mobility Consulting and Services in the ISG Provider Lens Internet of Things -- Services and Solutions Study.

We enhanced our Additive Manufacturing solutions with the implementation of an SLM 280 System in Florida. The additive manufacturing is again a key aspect of digital offerings for us given that a number of our customers are very high precision, high-end manufacturing companies. The ability for them to manufacture just in time especially for aftermarket replacement parts and prototype becomes very-very important and therefore this is a key element of our digital offering and this is a system that actually is quite unique, in the sense that it has the ability to create parts from five different metals like titanium, magnesium, of course, steel alloy, so on and so forth.

We achieved Select Tier Status in the Amazon Web Services Partner Network. This partnership differentiates Cyient as a provider of specialized demonstrated technology proficiency and customer success.

We also joined the TM Forum to collaborate with global service providers. The TM Forum is a forum of 850 members including 10 of the world's largest telecom service providers and we will become a member of a very small group within that which helps define the future of networking standards, technologies, etc.,

We continue to significantly strengthen the management team. I'm also very happy and proud to announce that Rajaneesh Kini joined us as the Senior Vice President and Chief Technology Officer. Rajaneesh will lead the technology development at Cyient and be responsible for our technology vision building competency and the relevant market-ready solutions. Rajaneesh comes with a lot of background in engineering and R&D. I'm quite confident that with his leadership in place we will continue to accelerate our solution development into the future and for many years to come.

With this I would like to hand the call over to Mr. Ajay Aggarwal, who will take you through the detailed financial performance for the quarter. Thank you and over to you, Ajay.

Ajay Aggarwal: Thank you, Krishna. In the beginning, let me say it is well-rounded performance that we have got in this quarter in line with our anticipation. On all the lines, revenue, profit and cash, I will talk about all three of them.

Let me start by talking about the revenue. As Krishna said, we have $150.1 million as the total revenue in this quarter and quarter-on-quarter if you look at the constant currency growth, it's about 5.6%. What we have got from our new acquisition, Workforce Delta that we had announced, that has been about $900,000 or 0.7% of the revenue that's also included in this.

In terms of the DLM, we have a growth of about 5.4% and we have clocked $25.5 million. And the way we are looking at the demand, the order intake and pipeline we are very confident of being able to continue this growth traction and it is quite well rounded. You can see a little blip in EMEA but that's because of some cyclicality of orders in DLM. On the services side, the EMEA is also positive.

In terms of our profitability, this has been extremely, extremely gratifying quarter for us. We have clocked 14% as the EBIT margin which is about 90 bps higher quarter-on-quarter and 301 bps higher year-on-year. What has happened in terms of margin is that we have got extremely good set of operational improvements that have come in. We have got the benefit of the growth which has also kicked in and we are confident about all the parameters which are building up to this kind of 14% margin which also includes our services margin of 15.5%. I think that structural build will continue to around 15-15.5% margin in this year and get back to 17% in the next two years, that's very much there.

In terms of DLM, we have done about 6.8% as the margin. The profit after tax as Krishna said is Rs.121.3 crores or Rs. 1,213 million INR and this is an increase of 5.5% quarter-on-quarter and 44% year-on-year. Our earliest highest profit also included some of the one-offs including the government benefits and things like that. So, we are getting quite close to what we have done in the past and you will see the journey from here will be the new milestones only. In fact there are no surprises, we are doing well in line with what we had anticipated and what we guided for.

Let me go through EBIT. We have provided you what exactly has happened. Primarily I think company's focus remains on the operational improvements. We are also letting go of some revenue. You would see that our offshoring is moving very nicely; I think in the last 4-6 quarters we have moved about 6% in offshoring, currently we are at about 52% of offshoring and we are continuing to see offshoring will improve. That also creates a little bit of headwind on the revenue but our focus is on profitability. We're also trying to see that how can we let go of some of the less profitable business. So, all these initiatives are really helping us.

In terms of the headwinds, I would say there are two things which are happening; one is looking at the whole dynamics in the market and the attrition rates, we continue to make sure that we are providing differentiated merit increases and we will continue to do some of it in Q3 and Q4 also and we are also making sure that Krishna talked about this technology landscape, the new chief technology officer joining us and we will continue to invest about 1-1.5% of our revenue into the investment.

Last comment I would make is that if you look at this margin, this is after bringing in some expenses like travel and other overheads which are not normal in the earlier quarters but we are also making sure that we are back to normal training, normal retention initiatives, normal investments in the business and we will be continuing in the next two quarters and headwinds will also remain in terms of making sure we have the retention of people and some investments in technology in the coming quarters.

In terms of the free cash flow which is coming up we have a cash balance of Rs.1,403 crores. I think this is the highest that we have done and we have done extremely good conversion in this quarter. We did have a muted Q1, but if you look at overall for H1 we have clocked 70%-plus kind of conversion and we will continue to have that kind of conversion. One thing I want to mention is we have really got a good reduction of about nine days in our DSO and we are confident that not only we will sustain it, but also further improve it.

With this, I hand over the call to Karthik for the business update.

Karthikeyan Natarajan: Thank you, Ajay, thank you, Krishna. Good evening, everyone and I hope all of you are safe and healthy. And I just want to start off by saying that I hope you remember that our company had announced an organization structure same time last year in October and we said we are really structuring ourselves as transportation, communications, utilities and portfolio of sectors and I think that's really playing off in terms of what we expected. We expected the portfolio of sectors to be the fastest growing followed by communications with utilities and transport due to the challenges that we have seen on aerospace. And also from a broad-based demand driver standpoint, I think engineering and R&D is probably on a cusp of secular long-term growth aided by the sustainability which is around the 2050 carbon-neutral program. I think everybody wants to accelerate that. I don't think we as a community can wait till 2050. It has to be accelerated in a big way. And also followed by the supply chain disruptions caused by semiconductor. I think that's really creating a significant of opportunities for players like us.

And third is of course the digital transformation. I think this is definitely on the cards and we are really seeing growth on digital as we started setting up the dedicated business unit last year. If you remember we have shared around the same time last year and also followed by hyper connectivity. I think the world would be a lot more connected and thanks to fiber and 5G and I think pandemic has taught all of us how a lot of things can be done remotely with e-commerce growing, I think people can be connected to supply and demand irrespective of all of them needing to be at the same place. I think this is going to drive a significant amount of investments especially in US and other geographies on the connectivity part.

And having said that, our current performance on Q2 and if you look at Transportation has shown a 2.6% quarter-on-quarter growth and if you look at the third column from the left and the Aerospace has come back to growth trajectory like what we have said it is not in a hyper growth mode but at least it started coming back as compared to what we thought about a year ago and which is a good sign.

Communications and Utilities continues to grow and we are confident that this will grow double digit for year-on-year as you can see we have 12.5% growth as of Q2. And portfolio of sectors, I think this is where the acceleration is happening and aided by Semiconductor, Automotive, Medical Devices, Mining, I think all of them are seeing all-round growth, I think that's definitely visible in terms of what we have seen in Q2. And overall we have grown about 11.2% year-on-year in Q2 as compared to 9.9% that we have shown in Q1 which is definitely an acceleration that we are seeing on the demand side. And also, we have talked about setting up a large deal factory. We are still halfway through and we started seeing some early green shoots and we have closed about six deals of $63.5 million and four from services and one from DLM and another one what we call the composite B2S deal which is the engineering to manufacturing, and that's something which is definitely an early signal that we will be able to unlock more deals on the B2S side.

So, if we really start getting down to specific verticals, communications and utilities I think this is definitely going to be on the hyper connected world that we are talking about and we will see investments across the broadband networks especially in NAM and Europe. And also, as you would have seen the TM Forum and other investment that we are making I think it is definitely starting to pay off. And we also set out a network transformation led by technology. I think that's going to be our growth trajectory over the next three to five years. And we are also recognized by Peak Metrix from Everest Group as a 5G contender. I think that's definitely a great recognition from analysts. And many of our investments are around the private wireless and technology transformation called networks. I think all of them are paying out as we anticipated.

Utilities have definitely started coming back to the party which is a good sign and we have been able to work on some of the cloud native next generation spatial information system and we have been able to bring in data transformation, system integration kind of projects and we are continuing to see a momentum from the utilities side across UK, Australia as well as in North America.

DLM has seen a quarter-on-quarter growth. And we talked about last quarter there was a specific issue. But I think it is joining the growth trajectory as we anticipated. The supply constraints continue to be a challenge around semiconductors and some of the electronic components. But I think this is definitely robust trajectory as we expected.

Transportation, I think Aerospace, I am sure this question is definitely going to come, "How are you seeing the aerospace growth?" And I think the domestic travel has come back to 70% to 75% which is still patchy globally, for example, US could be about 85-90% and Europe could be about 70-75% and the rest of Asia could be around 60-65%. But the intercontinental flights have still not come back and they are still less than 50%. I think both are important for the industry to come back to growth trajectory. We started seeing some early green shoots and we hope it continues to grow for us in the next 2-3 quarters.

On rail we have seen some of the couple of customer specific issues and that's the reason why you are seeing a negative growth for this quarter, but I think we are confident that we should be able to really get this issue fixed in the next 2-3 quarters.

Portfolio of Services. As you can imagine the medical devices and technology, I think this is going to be again a high growth segment for us and we are confident that we'll see more than 20% growth in this particular segment though it is small but we are confident that this is going to be an area that we are strengthening and across digital, embedded and the design led manufacturing services.

And semiconductors, this is going to see a patchy growth and we are seeing huge demand, we are also constrained by supply and we are trying to see how we balance it out. And due to the semiconductor glut that was seen in the last 12 months, it's likely to continue for two more years and that is creating some new demand and we are trying to prepare ourselves to address this demand. And we are confident that this will also start seeing a double-digit growth for the year.

Continuing on the portfolio of sectors, Automotive and Off Highway, will be driven by the sustainability. I talked about electrification and two-thirds of the new vehicles sold will be electric and we are close to one of the large deals in this quarter on the electric platform customer and very interested to look at disrupting the whole electric vehicle platforms. We will share more details as we get the confirmation from customer to talk about it.

I am continuing to see momentum across Mining and Natural Resources. And this is one of the acquisitions that if you remember we have done with IG Partners. I think that's really playing off well and we are seeing the growth from both consulting and engineering services as well as on the digital transformation. I think this is a sector which will continue to grow at more than 40-50% year-on-year.

Geospatial barring one customer I think this has seen about 15% growth but still this is yet to get into the growth trajectory. Probably rail and geospatial are the two segments which has to really start getting into the growth trajectory as we exit this financial year.

So, with that I would just summarize saying that I think we have a good organization structure and the leadership team in place. And we have a great strategy and we started talking about pillars of growth. And interestingly, our pillars of growth which is about one-fourth of our revenue is growing at 30%. And if we are able to get that to about third of our business growing at 30%, I think that would really help us to confidently say that we'll start seeing the double-digit growth for the next few years. So, that's what I would really summarize.

Krishna Bodanapu: Thank you, Karthik. If I may just give a quick outlook for the rest of the year, we continue to expect that the services business will grow in double digit for the year; we have a line of sight to that and the mathematics also supports that that we will have a good growth in Q3 also. As you know that Q3 is a little bit of a challenge for us because of number of working days but this time around we're quite confident that the demand that is there and the ramp ups that have happened that challenge will be overcome. Of course, like-for-like there will be a dip in the capacity which will put a little bit of pressure on margin because now for the same person we have fewer number of days that we can be productive, but that's a point in time thing but overall as a company we are confident that we will grow quite nicely in Q3 and of course in double digits for the year.

DLM will be in the range of 15% to 20%. We do continue to have some significant supply chain challenges there. So, there's a little bit of a right shift that is now impacting us and that's why we're a little bit muted there but we're very confident it will be in that 15% to 20% range.

For the year, we expect margins to improve by at least 300 basis points compared to 200 basis points that we've talked about that we saw at the beginning of the year.

Like I said there's still some interesting dynamics at play given the attrition, we are re-looking at our salary structures, etc., as we speak. And also like I said while overall there will be growth in Q3, per person productivity or per person availability of capacity actually comes down and therefore that also puts a bit of pressure on margin. That's why we are quite confident that we will do at least 300 basis points. In the current steady state margins are between 13.5% and 14%, of course, this quarter we were at the higher end of that range and will continue to be there for the rest of the year within that range. So, these are good sustainable margins. And we also believe that once there's a little bit more stability that comes to the recruiting side of the market, margins will then further increase but also I want to say, the services margins are looking quite good at about 16% and we will continue within that range for the rest of year. Other income will be in line with previous years and the effective tax rate will be in this 25% to 26% range. So, overall net-net, I think we're going to have a reasonably strong year on growth but a very strong year on profitability and we're quite confident that we have the line of sight towards these numbers for the rest of the year.

With that I'll hand it back to the moderator to moderate the questions-and-answers. Thank you.

Moderator: Ladies and gentlemen, we will now begin the question-answer session. The first question is from the line of Sandeep Shah from Equirus Securities.

Sandeep Shah: Just the question in terms of the services business growth, I think we are reiterating our double-digit growth. I believe this is in US dollar terms and that requires close to a 4% compounded QoQ. So, you still believe that despite furloughs can achieve this run rate as a whole or you believe 4Q could be heavy lifting and 3Q could be slightly softer as a whole? And a question in terms of margins, are we saying the second half at consol level could be between 13-14%, what could be the tailwinds and the headwinds which could be there? And at services, I think what I get to understand for the second half, we are riding for close to 16% range as a whole.

Krishna Bodanapu: On the growth of services, we continue to be confident. You're right, Q3 has a bit of a headwind with the number of working days, etc., but also that's quite negated by the number of new people that we're adding, that is the capacity increase.

Like I said, the challenge is really in the capacity per person because of number of working days but total capacity we are actually hiring quite aggressively and of course it is a difficult market and therefore we have to be a little bit prudent. We are still giving up a few percent of growth every quarter because of the supply side challenges but we'll park that aside. But net-net to answer your question, we are quite confident that we will hit double digit for the year based on the demand, based on what is going on at the moment. Also on the margin, I'll say for the year we're saying 300 basis points will be improvement in margin but really this 13.5 to 14% is the range that we will be for the rest of the year, I mean, we started off a little bit pessimistically, we've done much better, but there are a couple of headwinds that we will start to run into. First is that there is some degree of normalcy that's returning, so some of the costs around travel, marketing, events, etc., are coming back, that's a relatively smaller one. But more importantly, one is we will have to do one more round of salary corrections. I wouldn't say one more round of hikes in general because I think we will do it in a nuanced manner, so it doesn't put things out of control, but we will have to do one more level of corrections which will have an impact. And the second thing is we also continue to invest quite aggressively, I mean, I think one of the things that I'll also point out and perhaps Karthik will talk a little bit more detail is if you look at our growth, our growth has really come from some of the newer technologies and areas that we focus on. We call it the five pillars of growth and the two obvious ones are digital and embedded software. That's where a lot of our growth is coming and combination of that business is growing almost 30% year-on-year. We were a little bit late to some of these technologies and some of this game but we're really catching on and it has given us a lot of confidence that we are going to be very strong players. The acknowledgement from ISG who are leaders in ranking technology companies, we are a strong player gives us a lot of confidence that we should continue to aggressively invest in building technology, building capability, capacity, bring the right people for the newer areas which is what we'll continue to do. So, a combination of normalcy returning, salary adjustments and investments are the headwinds that we're going to face.

Sandeep Shah: In the last few quarters, we were highlighting there is a scarcity of talent for us in terms of digital engineering. So, can you give us some color in terms of how are we making sure that those things do not occur. What are the plans in terms of reskilling, upskilling on digital engineering as a whole?

Krishna Bodanapu: The shortage of the digital and embedded software, that part of the equation continues. But having said that though we are getting a lot better at creating our own supply that is reskilling people, upskilling people, taking people with maybe half the capability but spending 3-6 months on training them, I think that's one. The second thing is in this business it also is a virtuous cycle in the sense that if we get the right kind of people then we can hire more people and I think we're also in that virtuous cycle now because we've built a reasonable sort of C-team and therefore we're able to attract better people. And the third thing is I think we're also able to go to different sources, not just the traditional sources of either laterals or freshers but also train people, get people with similar backgrounds but then be able to get them on with the right training, etc., So, that's helped. I don't want to say we are out of the woods yet. I think there's still a lot of pressure on these skills. And like I said we're giving up at least a point or two or 100 or 200 basis points of growth every quarter, but we're working hard on solving that

Sandeep Shah: Just on the aerospace, wanted to understand because last few quarters we are showing a positive growth and this quarter it has picked up. So, is it largely concentrated towards defense or commercial aerospace and within commercial aerospace, is it more towards the Avionics and the maintenance overall, can you throw some colors on the nature of growth which is coming within aerospace?

Karthikeyan Natarajan: What we are seeing is the aftermarket revenue which is coming back, that's what we expect first to recover and followed by new aircraft manufacturing that is going to come back to the previous level. So, the ramp up is happening. So, manufacturing, engineering is the second one. And third, the Avionics upgrade and working on integrated area mix with cloud. I think some of these areas are going to be seeing growth. And also with electrification on mobility across aero, rail and auto and we will also see that's going to come back because sustainability is going to be critical for this whole industry. So, there is an investment led by a lot of governments and that's going to really drive the next set of growth. So, the profile of growth will be a lot different than what we have lost in the last 18-months, but we are really confident that this will really start bouncing back in the next 12-months.

Moderator: The next question is from the line of Vikas Ahuja from Antique Stock Broking. Please go ahead.

Vikas Ahuja: Just one broader question I have that is with so much of momentum around ER&D space and most industry analysts talking about meaningful pickup in spend, do you think maybe next year we may see meaningful pickup in bookings or growth profiles which could be for multiple years to follow? And we can come in line with somewhere closer to some of what your peers are reporting or do you think that we are still some time away from that kind of growth?

Karthikeyan Natarajan: Vikas, what I would really say that is some of them are secular for the next three, four years. For example, communications, utilities, semiconductors, automotive, medical devices and mining. We are seeing that I think this growth will continue for the next two to three years. As far as the other segments whether it is rail or aero, I covered in terms of what I talked about and we need to recover back to the previous levels of 2019 which is likely to happen by 2023. I think the real demand drivers are essentially led by what I talked about the hyper connectivity, the digital transformation and the time-to-market which is one of the key elements the customers realize that this is an opportunity for them to significantly reduce their time to market, some of the cases they are talking about 30-50% reduction and that's something which is likely to continue for this entire decade. In fact, what I would really call it as this is going to be a decade of century as far as the engineering and R&D is concerned and led essentially by technology transformation and with sustainability big on the agenda and apart from the digital transformation.

Vikas Ahuja: Some little colors on bookings. Do you think that bookings can actually meaningfully accelerate maybe next year or maybe the current kind of a run rate?

Karthikeyan Natarajan: I would say we'll wait for another two more quarters before we start doing the pull up and I think definitely the momentum is back and purse is open for many of the customers which is a good news. We need to see the size of the deals and the opportunities that are going to come out of the table and digital is still probably small to start with and then it becomes big. We need to see how the digital transformation is going to really start getting big.

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

A Shindadkar: A couple of questions: The first one is on the transportation growth on a YoY basis and especially for the services business. Anything to call out in terms of the weakness for that practice. I mean, is it centered on any customer or any comment could be helpful? The second question is on the bookings number. Now, the services bookings on a H1 basis are up 15% and you are doing the $120 million per quarter. Can you segregate this how much of it is because of the change in the organization structure because of recovery from the clients? What I'm trying to understand is the changes in the organization structure whether it is reflected in the booking number or we are yet to see that? And the third is more a strategy question on the DLM piece. Krishna, with the PLI opportunity in India and we have a DLM business, is there a strategy where we can capture that market, just wanted to get your thoughts, I mean, have we thought in that direction or are there any conversations?

Karthikeyan Natarajan: I would really say that is order book is not necessarily a reflection of the structure because I think it really started coming along well. We have the right leadership in place. We are happy with the progress that we made in the last 12 months and I think we are really trying to put the company on three specific core growth objectives; one is driving large deal and second is driving the five pillars of growth that Krishna talked about and third is about how do we really take our top 25-accounts and make them to grow disproportionately. I think that's essentially what is playing out. I will really say that I'll wait for another two or three quarters to see that this is secular. I think the structure has really played out well because there is a clear accountability in the front end and everybody is absolutely excited to really drive the growth independently. I think that has really played out well so far. On your other question on transport, I would say the aerospace is going to see about 3% to 5% growth and rail also will see around the same number and probably we could have grown by double digit on rail and it is driven by a couple of customers project shifting together and we hope it starts coming back by end of this financial year. I think probably we'll see definitely a better growth for the next year to come with aero recovery from steel and rail also starting to join the growth trajectory and we are confident that next year will be a lot better than this year for transport.

Krishna Bodanapu: Last part of your question around DLM. The problem with some of the India businesses we have to be very careful with the margin. We've taken a very conscious call that we need DLM to be at about a 10% EBIT. We still have about 200 basis points to make up. Much of the India business comes at a much lower margin and therefore we have to be very careful in terms of what we go after and what we choose to go after. I think our play has been more a global play because I think that's only way that we will make margins that are acceptable to all of us frankly. And therefore our focus is not so much so on the India business, I mean, when there is a good opportunity and there is a good margin that we could make in the sustainable business, we will go after it. But the idea is not to just focus on the India business because then the margins will not be something that either you or I will be happy about it and that's just the reality of the pressures that the India based products and services do face. And therefore we've consciously chosen to be very-very careful. I wouldn't say stay out of it but very careful. Having said that I'll say given the growth in some of the spend in India like defense for example that's driving a lot of our global business because a global OEM for example has offset obligations in India and therefore would purchase a fair degree of equipment from India and therefore from us. So, I would say it's a combination we have to be focused on the right kind of business but also focus on the global OEM source implementation.

A Shindadkar: Just a follow up to what Karthik answered on transportation. So, the right shifting of business, is it because the client challenges at the client end or whether it's a fulfillment challenge at our end or it's a combination of both. If you can just highlight that that could be helpful?

Karthikeyan Natarajan: Yes, I would say about 70% is to do with the customer shifting it to the right and about 30% to do with our supply too. So, I think that's where it is.

Moderator: The next question is from the line of Mukul Garg from Motilal Oswal. Please go ahead

Mukul Garg: I just wanted to focus on the supply side again. This quarter your net adds were a bit lower versus what you did in Q1 despite your attrition and utilization both picking up a bit. Is there some element of incremental departures being higher than what they usually have been versus you guys adding up less people because of availability issues? If you can help us kind of dissect between these two? And if you can quantify the revenue impact in Q2 and potential shift to Q3 because of this?

Krishna Bodanapu: I think that would be difficult to quantify. Like I said, we are growing about 200 bps lower than what we would if we had a perfect supply situation. So, I would still stick with that number. I think for the most part the revenue is not lost, it's being right shifted and therefore it is still there but we just have to anticipate. Our challenge continues to be the fact that we are hiring in newer areas, so it's taking a little bit of time to catch up. Last quarter we had net hires, I think about 300 people for the quarter. So, yes, incrementally, attrition has picked up a little bit and there's reasons for it. Net-net, we are adding people and that will continue into Q3 and Q4. Attritional challenge also is driving the net being lower than what need or what we would like it to be. But I think some of the attrition challenges are also being addressed and those will also mean that in Q3 and Q4 we will have a better net outcome of resources. So, net-net I'd say we are giving up a little bit growth, but even for the most part I think right shifted rather than loss and there is a business that if we can't tackle, we are also being a little bit choosy because we also need to use this opportunity to build momentum, so we're not going after any available business but really business that we consider strategic in the longer-term.

Mukul Garg: The second question was on the direct cost side. If we look at the direct salary cost, it was flat versus last quarter and even on a YoY basis it was up only 5%. And if we include the other cost and subcon as well the YoY compare goes down to 3.5% which is in line with the workforce addition of about 400 people versus Q2 FY21. So, how much support are you getting from the shift to offshore in the salary cost as a percentage of revenue and where else are you being able to absorb this cost because we have at least seen three merit increases over the last one year, so if you can just clarify that part?

Ajay Aggarwal: I would say that the way we internally look at it is we look at the whole business on gross margin and if you look at the charts that we have circulated, you will find there is an improvement of about 300 basis points in margin year-on-year. That has the complete effect of whatever has happened in terms of utilization that has a mix impact, I think we are doing less work on the subcontracting and of course the reason is to be able to focus on the quality of margin, and of course the offshoring where you see year-on-year, we have improved by 5-6%. And when it comes to the merit increases, if you see that the gain that we would have in terms of the offshoring possibly will take care of most of the merit increases. So, the way I would look at is net of the headwind and tailwind in terms of utilization, change in mix, also the impact of merit increases, year-on-year, we have improved our margin about 300 basis points. That's what I would like to comment on.

Mukul Garg: Just to clarify, you are saying that the offshore shift has kind of compensated for most of the merit increases over the last one year and I'm just trying to dig into this because the attrition is clearly at extremely elevated levels and as you mentioned also you need to do monetary interventions to control and that should be reflected in the direct cost. For last both the quarters we have seen merit increases play out but that has not really impacted your gross margins, in fact it has improved only?

Ajay Aggarwal: The way we look at it is not from the cost angle, I will again say that if you look at year-on-year between the operational efficiency, utilization offshoring, everything, we would have improved by 5% to 6% and then the investment that we have made in terms of the increases and other headwind, net-net the effect is about 3%.

Moderator: The next question is from the line of Sulabh Govila from Morgan Stanley. Please go ahead.

Sulabh Govila: I had a couple of questions. So, first one is regarding the margin expansion this quarter. So, if Ajay, if you could highlight the reason for sharp expansion in gross margins this quarter? And for the coming quarters we understand the headwinds that are there which is in the form of higher attrition and the intervention that you're planning for specific skill sets and travel cost increase apart from lower billing days. If you could also highlight what are the tailwinds which could offset some of these headwinds in the coming quarters please?

Ajay Aggarwal: I would say that from the quarter perspective, if you look at our earnings update itself, we have provided the bridge very specifically in terms of what has happened in terms of the margins. I would say, net-net, the expansion is on account of the operational improvement. I'm just bringing that up, if you see this in terms of the revenue mix plus change in operational margin plus optimization levels where we have let go of some accounts are low margin and other things, so all this adds up to about 4%. This is the increase that's there from the operational improvement. In terms of the headwinds, we are very clear about the 300 basis points out of that, we have invested between the investments and the merit increases and net-net we have improved by about 100 basis points or 97 basis points. Most of it is from the operational improvement. You have a question about what will happen going forward. You are right, we will have a little headwind in Q3. I think if you look at this impact of merit increases as well as higher investments, I would say SG&A will not increase substantially because we already started normal travel in some of the areas that we talked about. But in terms of merit increases I think similar level of investment will continue. In terms of the operational improvements, we will be able to compensate at least the merit increases, but in terms of other headwind on number of billing days and all that, net-net the best case could be we get very close to where we are and worst case it could be 50-75 bps reduction quarter-on-quarter and then again Q4 you get back to the normal days availability, again, I think some part of the merit increases, investments will continue and then we will get again the benefit of the volume and the efficiency. So, I would say, as we said earlier, on the services side between 15% and 15.5% we will be able to sustain that margin. There are going to be a few changes in these numbers in case of H2, a) because we are making accelerated investments for long term and b) we have two headwinds; one is in terms of number of days in Q3 and also the ESOP plan that the shareholders have approved that will also take about 40-50 basis points in Q4.

Sulabh Govila: And then the other bit is on the head count growth again. So, the kind of growth that we've seen in the past couple of quarters let's say on the headcount bit, do you think there is enough for the kind of growth that we are envisaging for the year or for the coming quarters? And would we be comfortable in achieving the guidance with the kind of run rate that is there? So, what are you assuming in terms of the additions in the next couple of quarters?

Krishna Bodanapu: I think we have to increase our intake and we are continuing to work on that. We've made the right progress this quarter after a long time. We have added meaningful number of net new additions and not just because of freshers or anything like that, and much of them are laterals too. So, when we talk about what happens through the rest of the year I think we're taking these things into account and we're also maintaining a degree of prudence on the addition of manpower because again till it happens I don't want to say it has happened. At the same time not just sandbagging but just being prudent I think these are the numbers we've come up with and we are quite confident that we'll achieve them as a minimum and really the idea is to do better than that but at least let's start with the minimum of what we will achieve.

Sulabh Govila: One last bit as a clarification from my side. On the revenue growth guidance that we've talked about it wasn't clear to me earlier. Is it is it on a cc basis or a reported basis?

Krishna Bodanapu: It's on a CC basis.

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

Mohit Jain: Two things: One, I heard Ajay in the opening remarks, did you speak about 17% kind of margin over medium term is it correct?

Ajay Aggarwal: I did say in the short term, our objective is to remain 15%, 15.5% kind of margin for services and get back to 17% in next couple of years.

Vivek Jain: 17% EBIT for services, is that so?

Krishna Bodanapu: That is correct. And what will happen is between services and group, there will be about 150 bps drop because of DLM and we think that'll continue and we won't let it be much different than that.

Vivek Jain: So, 15.5% approximately for the group over a medium term kind of a margin?

Krishna Bodanapu: Yes.

Vivek Jain: Ajay sir, our depreciation and the gap between EBITDA and EBIT is also little on the higher side while on the EBITDA side we are doing quite well. The translation to profitability or net profit is on the lower side. So, given the kind of intangible assets you have on the book, is there a path wherein you can sort of reduce the D&A or should we expect this kind of elevated D&A to continue for a few more years?

Ajay Aggarwal: As far as the intangible assets amortization is concerned, that will purely depend on what acquisitions we do and what proportion they have of intangible assets. But in terms of the capex, I can definitely say from a level of 2.5% to 3% we have come to a level, if you see this quarter we have reported about 1.7% kind of capex on services side and overall also for the group I think we are just 2%, I am very sure this year we will be really tracking to that, that will also play out in the depreciation, that's my only comment. Intangible assets are absolutely dependent on which acquisition and what composition they have in terms of goodwill and intangibles.

Moderator: The next question is from the line of Neerav Dalal from Maybank Kim Securities. Please go ahead.

Neerav Dalal: A couple of questions: One, what would be our current mechanical versus embedded mix and what would that have been over the last couple of years?

Karthik Natarajan: It's about 60:40 and changing towards 50:50 now in terms of the growth in embedded and mechanical. I think that's where currently we are bullish about the growth of these five pillars. So, that's definitely seen in terms of what we are looking at.

Neerav Dalal: In terms of the investments that we've made, that is showing up in the G&A if I'm not wrong. So, I just wanted to understand what would be these investments and how should one look at it going ahead?

Karthik Natarajan: We are definitely doubling down on digital and technology solutions areas. I think Krishna talked about. We have already onboarded a CTO and we are definitely driving a tech solution. I think as I said this decade is going to be led by technology investments and solutions. I think that's when it's about people, it's about building solutions, it's about partnerships and it's about trying to really invest in some of the customer engagements. I think it covers all of them. And the same thing is true for digital as well. I think we have definitely identified about six solutions that we want to build which is going to be critical for our growth and we are really making that as part of our investment strategy and also embedded and the networks and semiconductors. So, we said we have identified those five pillars on growth and we realized the importance of having the investments about the subject matter experts and the solution that we need to build and as well as the partnership that we need to build. So, that's where the investments are currently going on.

Neerav Dalal: If there are subject matter experts and we are working on certain softwares and all of that, so we are still showing that as part of G&A and not the part of gross margins or S&M?

Ajay Aggarwal: You are absolutely right. The perspective of the account is this is mainly the time and effort of the people as you rightly pointed out and what we are trying to do is to be able to capture it, we internally have another line item called investment. But you're right it's all mainly people cost, deferred cost and it will all be part of SG&A, while SG&A has become investments now. At this stage of development, where it doesn't have a corresponding customer, it makes a lot of sense to expense it and not to capitalize it or deal it in any other manner.

Moderator: The next question is from the line of Amit Chandra from HDFC Securities. Please go ahead.

Amit Chandra: My question is on the supply side issue that is there in the market. So, we have been seeing the subcontracting cost rising across the industry, but we have been saving on the subcontracting side over the last two quarters. So, what is driving that and what's the strategy here. Are we likely to ramp up deals at the onsite location, are we not hiring subcontracting or is it any like project-specific issue that is impacting the expenses on the subcontracting side?

Krishna Bodanapu: There's two things going on; one is the reason why we do sub-contracting is primarily not just for onsite but field work in onsite. I mean its onsite design work then we're doing ourselves. So, one was structurally we've brought down the contracts where there's a lot of dependence on subcontracting because they tend to be of a lower margin and if subcontracting is 80% of a project it doesn't make sense, if it's 20% it might still make sense because on the design we end up making up the numbers. So, one is structurally we've brought down the subcontracting and that remains and that will continue. Last quarter and this quarter we've had one or two projects where because of the lockdowns in Australia there hasn't been much progress on field work and that further brought it down. It will go up a little bit in the coming quarters because some of these projects again, we're doing those projects because there is enough engineering work, there's overall the project has a fairly good margin and something that is acceptable to us but again because of the lockdowns, because subcontracting is really the field work not the sort of the office or engineering work. The field work because of lockdowns has come down and that has actually depressed them, but again I want to say structurally at one point I think we were even at 11-12 % that won't happen again, we will remain at sort of 6-7% kind of a number.

Amit Chandra: The second question is on the aerospace vertical. So, how has been the performance of the top client there and how has the ramp up in growth ex of that, so if you can clarify and is there any like new engagements that we are entering into with the top client?

Krishna Bodanapu: I think what Karthik has also said about aerospace is we are seeing some early signs of recovery down happening on aftermarket which is essentially to support the operations of existing fleet. That is starting to pick up which is a good sign because actually traffic is starting to pick up. Of course inter-continental traffic, the very long-distance traffic has not picked up as much and will take some more time but actually the way our business works that has less dependence on this, I mean, we end up working a lot of programs which are for these single aisle which is the short haul aircrafts. Now that's happened but I would say year-on-year I think we've had a bit of a growth also in aerospace but I would say we still are a few quarters of it before we can say that aerospace is now back from a $30 million quarter run rate to a $50 million a quarter run rate. I think all the green shoots are there, I mean things are lining up but I'd say it's still a couple quarters away before we can say it up with confidence. I would say obviously the worst is over, that is a fact, but more importantly the green shoots have started to happen and there will be a slow acceleration in the next couple of quarters also.

Moderator: The next question is from the line of Karan Uppal from Phillip Capital. Please go ahead.

Karan Uppal: One question on margins. So, we have seen very significant shift to offshore in last few quarters. Now with the reopening of the economies in west, do you think that offshore can scale back to previous levels and whether it will have any implications to the 15% to 15.5% service margin time in the medium term?

Krishna Bodanapu: I think the offshore shift is structural and I think that's where the demand is and that's where we've also put in a lot of effort to make sure that happens. There'll always be a little bit of swing in either direction. But we're quite confident that this is continuing, I mean just to give you a flavor, if you look at the jobs that we're currently recruiting for, 92% of the jobs are offshore and only 8% are onsite. At the peak we would have even had a sort of 25-30% onsite when our onsite was 60% and offshore 40%. So, therefore we're quite confident that this will be there and for two reasons, right, one is I think we've got a lot better at making sure we take the right kind of business and secondly that's where the demand is. What work from home has done has shown people that remote working is possible. Now unless there is some regulatory views like in aerospace where you have to have US citizens on US soil. But in general most customers are saying if you can work from home, why does home have to be in the US, home can be in India and I think that has been a fundamental shift and we'll see a lot more of that going forward.

Ajay Aggarwal: When we have looked at it internally in terms of our exercise of budgeting, actually in the H2 that it will further improve, so not only it is sustainable, it will be another driver of improvement for our margin. And when we are looking at some of these key goals as Krishna said what we need to do for profitability. There are two things with our sales teams have been focused on; one is on the offshoring and also what we have not baked in is the conversations with the customers in terms of the pricing because right now if you see the challenges of attrition are global in this space and the in-house cost of our customers is also going up. So, that's another area we will work in H2, we have not baked in into this currently but we are sure that whatever efforts we make in H2 part of it will come in H2 and that will definitely be a driver of margin improvement in the next year.

Karan Uppal: Just a follow-up. So, you said that you are further expected to improve, so right now we are at 50/50 onsite/offshore. So, how much more can it improve from here on?

Ajay Aggarwal: 50% is our internal budget. Normally we don't talk about our internal budget, but we have taken about 2-3%. That's what we have seen. Over a longer period of time, still I think there is a room here.

Moderator: Ladies and gentlemen, due to time constraints we take that as a last question. I would normally like to hand the conference back to the management for closing comments.

Krishna Bodanapu: Once again thank you for your time and listening to this call and for your engagement. Obviously, things continue to get much better. Like I said last time I think we had turned the corner both from a growth and an efficiency perspective and we will continue to focus on that. I think there are some good things that are going on in our business at a fundamental level. We do have a challenge in supply and we have addressed a number of those things and we'll continue to do. I want to assure you that things are looking quite good and things are looking much stronger than where we were six or technically 12 months ago. I'll say a big thank you to all of you for your support and confidence, without which we might not have survived the onslaught that was happening last year where the markets were. Of course, the recovery has been good and we are also riding on that wave of recovery but I can assure you that this time we're thinking how to make it a lot more sustainable and not just the points that the market is giving us. So, this time it will be a long run. We're quite confident of how things are evolving and thank you for the support and we will keep you engaged on how things evolve.

Moderator: On behalf of Cyient Limited, we conclude today's conference. Thank you all for joining. You may now disconnect your lines.
