

# CYIENT

## Weak quarter but outlook positive

India Equity Research | IT



Cyient reported Q1FY19 revenue of USD160.8mn (down 2.3% QoQ) versus Street's estimate of a 1.3% decline. EBITDA margin at 12.2% (down 190bps QoQ) is lower than the expectation of 13.5%. Management attributed the miss to the anticipated slowdown in certain projects, but maintained the FY19 guidance for revenue and profitability amid robust demand outlook. Key highlights: 1) services revenue inched up 1.1% QoQ (in cc terms); 2) Aerospace & Defence (A&D) returned to double-digit growth; 3) the communication business faced a challenging quarter, but healthy growth is likely to return on the back of a strong pipeline; 4) margins undershot owing to certain one-offs and are likely to recover. Cyient's superior services portfolio (ER&D) along with a robust demand environment and significant sector tailwinds underpin our higher target multiple of 18x (16x earlier). Maintain 'BUY' with a revised TP of INR913.

### Return of robust growth in A&D assures revenue momentum

The robust 26% growth (organic growth ~20%) in A&D is key positive. All verticals, except Utilities and Industrials (where worst is behind too), are witnessing strong growth. Communications would also return to high-growth trajectory driven by a robust pipeline. Competencies in Semiconductor and the demand in Transportation should drive traction therein. Management maintained a double-digit revenue growth guidance for the Services business and ~20% organic growth for the DLM business.

### Margin-miss temporary, recovery on the cards

Operating margins slid 190bps QoQ despite a 60bps tailwind from currency movements owing to an unfavourable revenue mix and utilisation (120bps), wage hike (70bps), M&A (40bps) and higher SG&A (30bps). However, higher offshore revenue along with an uptick in utilisation will lift EBIT margin to 14.1% in FY19E.

### Outlook and valuations: Superior services offerings; maintain 'BUY'

The return to double-digit growth in A&D (~37.1% of revenue), turnaround in Industrial and Utilities, and accelerating traction in other verticals give us confidence that Cyient would clock USD revenue CAGR of 11.9% over FY18–20E. Considering superior services offerings (led by ER&D and IoT) and a robust demand outlook, we are raising the target multiple to 18x from 16x. Retain 'BUY/SP' with a TP of INR913 (18x FY20E EPS).

#### Financials

(INR mn)

Year to March	Q1FY19	Q4FY18	% Chg	Q1FY18	% Chg	FY18	FY19E	FY20E
Net revenues	10,800	10,618	1.7	9,070	19.1	39,176	46,480	52,486
EBITDA	1,317	1,492	(11.7)	1,160	13.5	5,492	6,614	7,587
Adjusted Profit	825	1,215	(32.1)	877	(5.9)	4,004	4,764	5,712
Diluted EPS (INR)	7.3	10.8	(32.1)	7.8	(5.5)	35.6	42.3	50.7
Diluted P/E (x)						19.5	17.5	14.6
EV/EBITDA (x)						13.5	11.0	9.4
EV/Revenues (x)						1.9	1.6	1.4

#### EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	High
Sector Relative to Market	Overweight

#### MARKET DATA (R: CYIE.BO, B: CYL IN)

CMP	: INR 742
Target Price	: INR 913
52-week range (INR)	: 887 / 474
Share in issue (mn)	: 112.9
M cap (INR bn/USD mn)	: 84 / 1,221
Avg. Daily Vol.BSE/NSE('000)	: 451.1

#### SHARE HOLDING PATTERN (%)

	Current	Q4FY18	Q3FY18
Promoters *	22.2	22.2	22.2
MF's, FI's & BK's	27.4	27.4	20.3
FII's	40.4	40.4	41.4
Others	10.0	10.0	16.1
* Promoters pledged shares (% of share in issue)	:		NIL

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Technology Index
1 month	(2.4)	1.7	4.9
3 months	16.2	5.4	12.7
12 months	41.4	12.3	41.6

#### Sandip Agarwal

+91 22 6623 3474  
sandip.agarwal@edelweissfin.com

#### Pranav Kshatriya

+91 22 4040 7495  
pranav.kshatriya@edelweissfin.com

#### Nikunj Mandowara

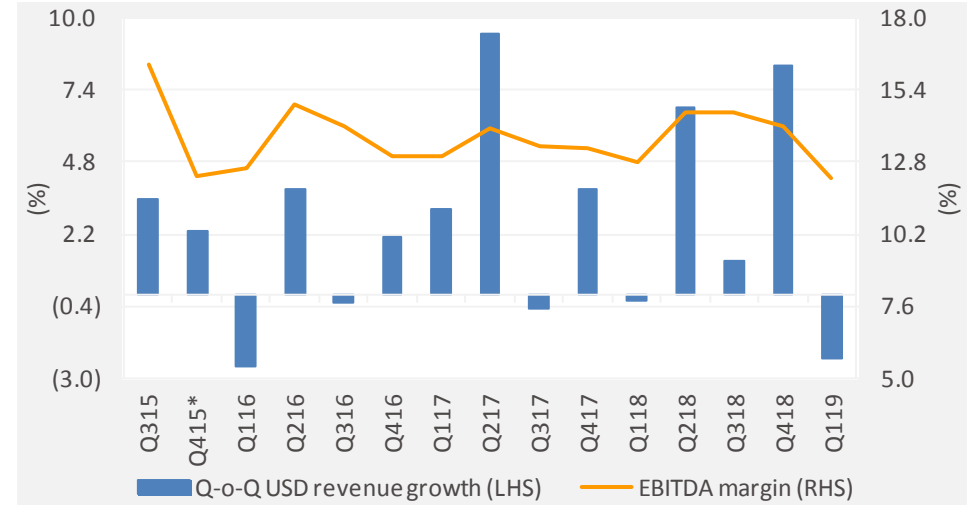
+91 22 2286 7431  
nikunj.mandowara@edelweissfin.com

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## Key highlights

- Revenue grew 1.7% QoQ to INR10.8bn. In USD terms, revenue declined 2.3% QoQ to at USD160.8mn.
- EBITDA stood at INR1,316mn; EBITDA margin dipped 190bps QoQ to at 12.2%.

Chart 1: USD revenue growth trend (QoQ)



Source: Company, Edelweiss research

Note: Q415 includes DLM revenues

- **Adjusted net profit** came in at INR825mn versus INR1,215mn in Q4FY18.
- **Segmental performance:** While services revenue was flat, up 0.1% QoQ, DLM revenue slid 18.1% QoQ (in USD terms).
- **Utilisation** decreased 170bps QoQ to 75.0%.
- **Client additions:** 11 clients were added versus 12 in the previous quarter.
- **Employee metrics:** Headcount rose by 294 QoQ to 15,056.
- **DSO** during the quarter rose by eight days to 88; we do not see any specific problems and expect it to normalise over the next quarter.
- **Top-5 and -10 clients:** Top-5 and -10 clients de-grew by 2.6% and 1.0% QoQ, respectively.
- **Capex** stood at INR397mn (INR476mn in Q4FY18).
- **Hedge:** Cyient has outstanding hedges worth USD59.1mn, EUR27.4mn, GBP8.8mn and AUD21.3mn.
- **Cash & cash equivalents in hand** stood at INR11.0bn, i.e. ~INR98/share.

## Financial snapshot

(INR mn)

Year to March	Q1FY19	Q4FY18	% Change	Q1FY18	% Change	FY18	FY19E	FY20E
Net revenues	10,800	10,618	1.7	9,070	19.1	39,176	46,480	52,486
Employee expenses	7,100	6,919	2.6	5,904	20.3	25,388	29,967	33,857
Cost of purchases	662	646	2.5	618	7.1	2,456	2,803	3,170
Operating & admin expenses	1,721	1,561	10.2	1,388	24.0	5,840	7,096	7,873
Total expenditure	9,483	9,126	3.9	7,910	19.9	33,684	39,866	44,900
EBITDA	1,317	1,492	(11.7)	1,160	13.5	5,492	6,614	7,587
Depreciation	285	257	10.9	261	9.2	1,052	1,177	1,224
EBIT	1,032	1,235	(16.4)	899	14.8	4,440	5,437	6,363
Interest	82	67	22.4	52	57.7	232	286	286
Other income	169	409	(58.7)	351	(51.9)	1,440	966	1,124
Profit before tax	1,119	1,609	(30.5)	1,198	(6.6)	5,648	6,117	7,201
Tax	304	336	(9.5)	373	(18.5)	1,381	1,376	1,512
Minority interest	(9)	28	NA	(27)	NA	(23)	(23)	(23)
Reported net profit	823	1,245	(33.9)	825	(0.2)	4,290	4,764	5,712
Share of IASI profit	(1)	-	-	25	NA	-	-	-
Adjusted Profit	825	1,215	(32.1)	877	(5.9)	4,004	4,764	5,712
Diluted EPS (INR)	7.3	10.8	(32.1)	7.8	(5.5)	35.6	42.3	50.7
Diluted P/E (x)	-	-	-	-	-	19.5	17.5	14.6
EV/EBITDA (x)	-	-	-	-	-	13.5	11.0	9.4
EV/Revenues (x)	-	-	-	-	-	1.9	1.6	1.4
<b>As % of net revenues</b>	-	-	-	-	-	-	-	-
Employee cost	65.7	65.2	-	65.1	-	64.8	64.5	64.5
Operating & admin exp.	15.9	14.7	-	15.3	-	14.9	15.3	15.0
EBITDA	12.2	14.1	-	12.8	-	14.0	14.2	14.5
EBIT	9.6	11.6	-	9.9	-	11.3	11.7	12.1
Reported net profit	7.6	11.4	-	9.7	-	10.2	10.2	10.9
Tax rate	27.2	20.9	-	31.1	-	24.5	22.5	21.0

## Company Description

Cyient is a 15,000-plus employee software services company with competencies in: a) UT&DA services (catering to utility, transportation and government segments); b) engineering design services (in engineering, manufacturing, and industrial products verticals); and c) software services (to clients in data and technology services, engineering design, and IT services). The company's past 12-month revenue stood at INR40.9bn (USD627.5mn).

## Investment Theme

According to a Nasscom-Booz Allen Hamilton study, outsourcing of engineering services is expected to be worth USD38–50bn by 2020 compared with USD2bn at present. As one of the leading offshore engineering services firms for the manufacturing industry, Cyient is poised to tap such opportunities in our view. The company has strong domain knowledge and comprehensive solutions capability in the GIS segment along with a healthy pipeline of deals. The company's skills in areas of mapping and designing across diversified segments and in a variety of end-user IT environments give it an edge.

## Key Risks

- Significant INR appreciation against USD, EUR and GBP
- Inadequate availability of skilled manpower
- Persistent slowdown in engineering services spending

## Financial Statements

### Key Assumptions

Year to March	FY17	FY18	FY19E	FY20E
<b>Macro</b>				
GDP(Y-o-Y %)	6.6	6.5	7.1	7.6
Inflation (Avg)	4.5	3.8	4.5	5.0
Repo rate (exit rate)	6.3	6.0	6.0	6.5
USD/INR (Avg)	67.1	64.5	68.0	69.0
<b>Company</b>				
Total employees	13,084	14,762	15,956	17,156
Net additions	586	1,678	1,194	1,200
<b>Cost assumptions</b>				
Cost per emp. (INR '000)	1,849	1,823	1,929	2,045
Cost per emp. YoY gr.	17.0	(1.4)	5.8	6.0
G&A expenses (% of rev.)	14.4	14.9	15.3	15.0
Tax rate as % of PBT	22.9	24.5	22.5	21.0
<b>Financial assumptions</b>				
Depreciation	6.9	7.0	7.0	7.0
Cash yield (%)	7.0	7.5	7.0	8.3
Debtor days	64	63	61	62
Payable days	55	58	54	53
Cash conversion cycle	9	5	6	10
Capex (INR mn)	1,038	1,200	1,300	1,200

### Income statement

(INR mn)

Year to March	FY17	FY18	FY19E	FY20E
Net revenue	36,066	39,176	46,480	52,486
Cost of revenues	23,650	25,388	29,967	33,857
Gross profit	12,416	13,788	16,513	18,630
Total SG&A expenses	7,569	8,296	9,899	11,043
EBITDA	4,847	5,492	6,614	7,587
Depreciation	953	1,052	1,177	1,224
EBIT	3,894	4,440	5,437	6,363
Less: Interest Expense	188	232	286	286
Add: Other income	874.1	1,440.00	965.94	1,124.22
Profit Before Tax	4,580	5,648	6,117	7,201
Less: Provision for Tax	1,047	1,381	1,376	1,512
Less: Minority Interest	(43)	(23)	(23)	(23)
Associate profit share	123	-	-	-
Reported Profit	3,699	4,290	4,764	5,712
Adjusted Profit	3,699	4,290	4,764	5,712
Shares o /s (mn)	112	113	113	113
Adjusted Basic EPS	32.9	38.1	42.3	50.7
Diluted shares o/s (mn)	113	113	113	113
Adjusted Diluted EPS	32.8	38.1	42.3	50.7
Adjusted Cash EPS	41.4	47.4	52.8	61.6
Dividend per share (DPS)	10.0	13.0	16.0	17.0
Dividend Payout Ratio(%)	35.3	39.6	37.8	33.5

### Common size metrics

Year to March	FY17	FY18	FY19E	FY20E
Cost of revenues	65.6	64.8	64.5	64.5
Gross margin	34.4	35.2	35.5	35.5
SG&A expenses	21.0	21.2	21.3	21.0
EBITDA margins	13.4	14.0	14.2	14.5
EBIT margins	10.8	11.3	11.7	12.1
Net Profit margins	10.1	10.9	10.2	10.8

### Growth ratios (%)

Year to March	FY17	FY18	FY19E	FY20E
Revenues	16.5	8.6	18.6	12.9
EBITDA	14.5	13.3	20.4	14.7
PBT	8.9	23.3	8.3	17.7
Adjusted Profit	10.1	16.0	11.0	19.9
EPS	10.1	16.2	11.0	19.9

Balance sheet		(INR mn)			
As on 31st March	FY17	FY18	FY19E	FY20E	
Share capital	563	563	563	563	
Reserves & Surplus	20,610	22,991	25,954	29,752	
Shareholders' funds	21,173	23,554	26,517	30,315	
Short term borrowings	1,159	1,043	939	845	
Total Borrowings	1,883	1,695	1,525	1,373	
Def. Tax Liability (net)	201	201	201	201	
<b>Sources of funds</b>	<b>23,283</b>	<b>25,476</b>	<b>28,269</b>	<b>31,914</b>	
Gross Block	14,385	15,585	16,885	18,085	
Net Block	3,017	3,165	3,288	3,264	
Capital work in progress	265	265	265	265	
Intangible Assets	4,493	4,493	4,493	4,493	
Total Fixed Assets	7,775	7,923	8,046	8,022	
Non current investments	1,032	1,238	1,486	1,783	
Cash and Equivalents	9,706	11,120	12,199	13,447	
Sundry Debtors	6,496	7,084	8,405	9,491	
Loans & Advances	3,013	3,442	4,130	4,956	
Other Current Assets	3,241	3,888	4,277	4,704	
Current Assets (ex cash)	12,750	14,414	16,811	19,151	
Trade payable	4,021	4,031	4,888	4,888	
Other Current Liab	3,959	5,189	5,386	5,601	
Total Current Liab	7,980	9,219	10,274	10,489	
Net Curr Assets-ex cash	4,770	5,195	6,537	8,662	
<b>Uses of funds</b>	<b>23,283</b>	<b>25,476</b>	<b>28,269</b>	<b>31,914</b>	
BVPS (INR)	188.3	209.2	235.5	269.3	

Free cash flow		(INR mn)			
Year to March	FY17	FY18	FY19E	FY20E	
Reported Profit	3,699	4,290	4,764	5,712	
Add: Depreciation	953	1,052	1,177	1,224	
Interest (Net of Tax)	145	175	221	226	
Others	(664)	(2,657)	(1,005)	(1,177)	
Less: Changes in WC	(813)	425	1,343	2,124	
Operating cash flow	4,945	2,435	3,814	3,861	
Less: Capex	1,038	1,200	1,300	1,200	
<b>Free Cash Flow</b>	<b>3,907</b>	<b>1,235</b>	<b>2,514</b>	<b>2,661</b>	

Cash flow metrics					
Year to March	FY17	FY18	FY19E	FY20E	
Operating cash flow	4,945	2,435	3,814	3,861	
Financing cash flow	(657)	(844)	(2,153)	(2,240)	
Investing cash flow	(1,803)	(41)	(582)	(373)	
Net cash Flow	2,485	1,550	1,080	1,248	
Capex	(1,038)	(1,200)	(1,300)	(1,200)	
Dividend paid	(1,492)	(424)	(1,698)	(1,801)	

Profitability and efficiency ratios					
Year to March	FY17	FY18	FY19E	FY20E	
ROACE (%)	21.6	24.3	24.0	25.0	
ROAE (%)	18.1	19.1	18.9	20.0	
Debtors Days	64	63	61	62	
Payable Days	55	58	54	53	
Cash Conversion Cycle	9	5	6	10	
Current Ratio	2.8	2.8	2.8	3.1	

Operating ratios					
Year to March	FY17	FY18	FY19E	FY20E	
Total Asset Turnover	1.6	1.6	1.7	1.7	
Fixed Asset Turnover	5.1	5.2	6.0	6.8	
Equity Turnover	1.8	1.7	1.9	1.8	

Valuation parameters					
Year to March	FY17	FY18	FY19E	FY20E	
Adj. Diluted EPS (INR)	32.8	38.1	42.3	50.7	
Y-o-Y growth (%)	10.1	16.2	11.0	19.9	
Adjusted Cash EPS (INR)	41.4	47.4	52.8	61.6	
Diluted P/E (x)	22.6	19.5	17.5	14.6	
P/B (x)	3.9	3.5	3.2	2.8	
EV / Sales (x)	2.1	1.9	1.6	1.4	
EV / EBITDA (x)	15.6	13.5	11.0	9.4	
Dividend Yield (%)	1.3	1.8	2.2	2.3	

## Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Cyient	1,221	17.5	14.6	11.0	9.4	18.9	20.0
ECLERX SERVICES	733	16.8	13.9	9.8	7.4	20.4	21.3
HCL Technologies	20,425	14.5	13.1	10.3	9.2	24.9	24.7
Hexaware Technologies	2,141	25.5	22.0	18.7	16.0	27.0	26.9
Info Edge	2,335	48.9	40.4	39.1	31.5	15.3	16.4
Infosys	41,219	18.2	16.4	12.6	11.1	24.4	26.4
L&T Infotech Ltd	320,289,948	24.3	20.4	19.1	15.2	32.9	32.9
L&T Technology Services Ltd	133,475,633	21.9	18.1	17.2	13.5	31.4	31.9
Persistent Systems	985	16.8	14.1	9.9	7.9	17.7	18.4
Tata Consultancy Services	110,045	24.6	22.3	18.6	16.5	35.9	39.7
Tech Mahindra	9,258	14.0	12.2	8.5	7.2	20.3	20.6
Wipro	18,433	15.0	13.5	11.6	10.7	16.8	17.5
Median	-	17.9	15.5	12.1	10.9	22.4	23.0
AVERAGE	-	21.5	18.4	15.5	13.0	23.8	24.7

Source: Edelweiss research

## Additional Data

### Directors Data

B. Sucharitha	Non -Executive Director	B.V.R. Mohan Reddy	Executive Chairman
M.M. Murugappan	Independent Director	G.V. Prasad	Independent Director
K. Ramachandran	Independent Director	Vikas Sehgal	Independent Director
Alain De Taeye	Non-Executive Director	Krishna Bodanapu	Managing Director & CEO
SHANKAR NARAYANAN	Non-Executive Director	THOMAS W. PRETE	Non-Executive Director
HARSH MANGLIK	Independent Director	SOM MITTAL	Independent Director

Auditors - Deloitte Haskins and Sells, Chartered Accountants

*\*as per last annual report*

### Holding – Top10

	Perc. Holding		Perc. Holding
Vineyard point softw	9.97	Amansa holdings priv	6.41
Commonwealth bank of	5.00	Icici prudential lif	4.98
Infocad enter pvt lt	4.98	Infocad enterprises	4.98
Deutsche sec mauriti	4.83	Aditya birla sun lif	4.69
Reliance capital tru	3.89	T rowe price group i	3.86

*\*in last one year*

### Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
13 Oct 2017	Reliance Mutual Fund A/C Reliance Growth Fund	Buy	1167000	520.00
13 Oct 2017	Reliance Mutual Fund A/C Reliance Small Cap Fund	Buy	1167000	520.00
13 Oct 2017	Lavender Investments Ltd	Sell	2423578	520.08

*\*in last one year*

### Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

*\*in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Cyient	BUY	SP	H	ECLERX SERVICES	HOLD	SP	M
HCL Technologies	BUY	SP	H	Hexaware Technologies	HOLD	SP	M
Info Edge	BUY	SP	M	Infosys	BUY	SO	L
Just Dial	BUY	SU	M	L&T Infotech Ltd	BUY	SO	M
L&T Technology Services Ltd	BUY	SO	M	Persistent Systems	BUY	SP	L
Redington India Ltd	BUY	SO	L	Tata Consultancy Services	HOLD	SP	L
Tech Mahindra	BUY	SP	M	Wipro	HOLD	SP	L

### ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

### RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

### RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

### SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return



**Edelweiss Securities Limited**, Edelweiss House, off C.S.T. Road, Kalina, Mumbai – 400 098.

Board: (91-22) 4009 4400, Email: [research@edelweissfin.com](mailto:research@edelweissfin.com)

Aditya Narain

Head of Research

[aditya.narain@edelweissfin.com](mailto:aditya.narain@edelweissfin.com)

### Coverage group(s) of stocks by primary analyst(s): IT

Cyient, ECLERX SERVICES, HCL Technologies, Hexaware Technologies, Infosys, Info Edge, Just Dial, L&T Infotech Ltd, L&T Technology Services Ltd, Persistent Systems, Redington India Ltd, Tata Consultancy Services, Tech Mahindra, Wipro

#### Recent Research

Date	Company	Title	Price (INR)	Recos
10-Jul-18	<b>Tata Consultancy Services</b>	Results, BFSI revival embarks on Most bullish in a decade journey; <i>Result Update</i>	1875	Hold
02-Jul-18	IT	Optimistic outlook ; <i>Q1FY19 Result Preview</i>		
28-Jun-18	IT	Most bullish in a decade – Conviction gets stronger; <i>Sector Update</i>		

#### Distribution of Ratings / Market Cap

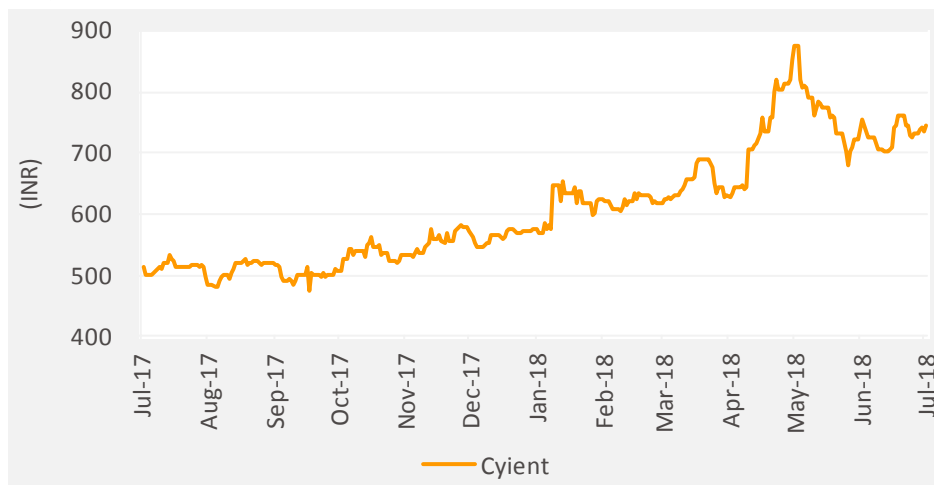
##### Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

#### Rating Interpretation

Rating	Expected to
<b>Buy</b>	appreciate more than 15% over a 12-month period
<b>Hold</b>	appreciate up to 15% over a 12-month period
<b>Reduce</b>	depreciate more than 5% over a 12-month period

#### One year price chart



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