

## Portfolio diversification may accelerate growth

**About the stock:** Cyient Ltd (Cyient) offers engineering & development services to aerospace & defence, transportation, E&U, communication and others.

- Cyient has 300 customers across 14 countries
- Net debt free and healthy cash flow with OCF/EBITDA ~80%

**Q1FY23 Results:** Cyient reported strong revenue growth in Q1FY23 results.

- Services revenue grew by 6.5% in CC, overall revenue growth of 5% QoQ in dollar terms
- Services EBIT margin came in at 12.8% while DLM margins came in at 4.2%, resulting in EBIT margins of 11.5%, down by ~300 bps QoQ
- Won 6 large deals with total contract potential of US\$424.3 million (mn)

**What should investors do?** Cyient's share price has grown by ~1.5x over the past five years (from ~₹ 524 in July 2017 to ~₹ 780 levels in July 2022).

- We change our rating on the stock from HOLD to **BUY**

**Target Price and Valuation:** We value Cyient at ₹ 935 i.e. 17x P/E on FY24E EPS

### Key triggers for future price performance:

- Acquired entities to provide diversification, which in turn is expected to provide growth, which has been lacking over the year
- Improved demand from large deals, healthy order book, rebound in DLM business and organisation restructuring to accelerate growth
- Strategic buyout a multi-year arrangement with an auto major

**Alternate Stock Idea:** Apart from Cyient, in our IT coverage we also like Infosys.

- Strong revenue guidance prompts us to be positive
- BUY with a target price of ₹ 1,745

CYIENT

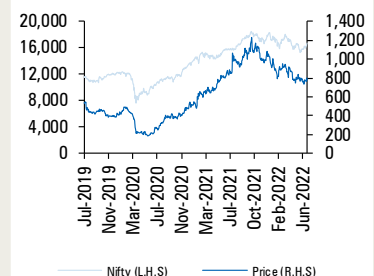
### Particulars

| Particular                | Amount     |
|---------------------------|------------|
| Market Cap (₹ Crore)      | 8,791.3    |
| Total Debt (₹ Crore)      | 326.4      |
| Cash and Invest (₹ Crore) | 1,266.6    |
| EV (₹ Crore)              | 7,851.1    |
| 52 week H/L               | 1292 / 670 |
| Equity capital            | 55.2       |
| Face value                | ₹ 5        |

### Shareholding pattern

|          | Sep-21 | Dec-21 | Mar-22 | Jun-22 |
|----------|--------|--------|--------|--------|
| Promoter | 23.4   | 23.4   | 23.4   | 23.4   |
| FII      | 35.6   | 34.7   | 34.0   | 32.7   |
| DII      | 22.9   | 21.4   | 23.3   | 23.9   |
| Public   | 18.1   | 20.5   | 19.2   | 20.0   |

### Price Chart



### Recent Event & Key risks

- Acquisitions of Citec, Grit consulting, Celfinet
- **Key Risk:** (i) diversification not bringing in expected revenue growth (ii) Lower-than-expected margins

### Research Analyst

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### Key Financial Summary

| Financials (₹ crore) | FY20  | FY21  | FY22  | 5 Year CAGR (FY17-22) | FY23E | FY24E | 2 year CAGR (FY22-24E) |
|----------------------|-------|-------|-------|-----------------------|-------|-------|------------------------|
| Net Sales            | 4,427 | 4,132 | 4,534 | 4.7                   | 5,501 | 6,161 | 16.6                   |
| EBITDA               | 596   | 611   | 822   | 11.1                  | 919   | 1,041 | 12.6                   |
| EBITDA Margins (%)   | 13.5  | 14.8  | 18.1  |                       | 16.7  | 16.9  |                        |
| Net Profit           | 343   | 364   | 522   | 8.7                   | 535   | 608   | 7.9                    |
| EPS (₹)              | 33.9  | 33.1  | 47.3  |                       | 48.5  | 55.1  |                        |
| P/E                  | 25.0  | 23.6  | 16.5  |                       | 16.1  | 14.1  |                        |
| RoNW (%)             | 13.4  | 12.3  | 16.8  |                       | 16.7  | 17.3  |                        |
| RoCE (%)             | 15.9  | 14.5  | 19.3  |                       | 19.4  | 20.3  |                        |

## Key takeaways of recent quarter & conference call highlights

- Services revenues came in US\$137.1 mn (up 5% QoQ, 6.5% QoQ in CC) while DLM business reported decline of 6.3% QoQ to US\$24.5 mn. This resulted in overall revenue growth of 3.1% QoQ at the company level to US\$161.6 mn (up 4.4% QoQ in CC). Organic revenue growth in the quarter was 1.1% as Grit consulting and strategic buyout contributed US\$3.7mn and US\$1.4mn revenue for the quarter respectively. Since Celfinet acquisition was completed on the last day of the quarter, no revenue was booked in Q1 and its revenues will be accounted from Q2 onwards.
- Overall EBIT margin at the company level declined by ~300 bps to 11.5%, services EBIT margin came in at 12.8%, down ~260 bps QoQ while DLM margins came in at 4.2%, down ~300 bps QoQ. The EBIT margin was impacted by wage hike rolled in the quarter, lower utilization & increase in travel expenses. The company also indicated that DLM margin was 7% ex-one off for the quarter against reported 4.2%
- The company indicated that wage hike impact will continue as it is given in staggered manner but it also mentioned that majority of the wage hike impact has been accounted in Q1. The company reported utilization of 80.9%, down by 520 bps QoQ. The company indicated that because of elevated fresher hiring, utilisation number has come down, but as in when they become billable, the numbers are expected to improve from there.
- Guidance:** The company guided for 13-15% CC revenue growth at the group level in FY23 while it expects DLM to grow in high single digit due to supply side challenges. The company expects incremental revenue (over and above the guidance) of 6-7% from the acquisitions (excluding Citec) in FY23.
- The company guided EBIT margin guidance in the band of 13-14% for FY23 despite the various headwinds. It has indicated the following levers for margin improvement i) pricing: The company is signing new deals with increased pricing wherein its already passing on the elevated cost to clients and successfully negotiating with client's renewals ii) the company indicated that the significant drop in utilization was due to it investing in its talent pool for last 3 quarters for the anticipated demand to make them ready for growth. iii) The company has let go some low margin projects iv) automation
- The company won 6 large deals with total contract potential of ~US\$424.3 million (4 from services and 2 from DLM). The company indicated that it won its largest ever multiyear deal in aerospace industry to build cloud connected cockpit deal. The company added 2 new logos in aerospace vertical. The company indicated that the semiconductor vertical is facing supply side challenges but it has reiterated the demand remains strong
- The company indicated that Citec acquisition did not complete as per earlier expectation as they are yet to receive regulatory clearance in India from RBI. The company indicated that there are minor procedural issues which is causing delay and it is expected to receive approval in Q2FY23. The company expects Citec EBIT margin to be in the range of 10-11% in the first year of acquisition and it is expected to gradually improve from there.
- The company has mentioned that it signed a multi-year multi million deal with an auto major. Under the initial part of the deal, it has strategically buyout 500 resources for the client for which it has incurred a cost of ₹85 crore. The company did mention that over the next 2 years, the client is expected to be in the top 5 customers for the company.
- The company added 747 net employees in the quarter (including 500 from strategic buyout arrangement) taking its employee strength to 13,581. The company's attrition increased by 100 bps to 27.9% for Q1FY23

**Exhibit 1: P&L**

|                              | Q1FY23  | Q1FY22  | YoY (%)  | Q4FY22  | QoQ (%)  | Comments  |
|------------------------------|---------|---------|----------|---------|----------|---|
| Revenue                      | 1,250.1 | 1,058.2 | 18.1     | 1,181.2 | 5.8      | Overall revenue grew by 4.4% QoQ in CC terms. Services reported growth of 6.5% QoQ in CC terms while DLM reported decline of 6.3% QoQ |
| Cost of revenue              | 790.0   | 678.2   | 16.5     | 729.3   | 8.3      |   |
| Gross Margin                 | 460.1   | 380.0   | 21.1     | 451.9   | 1.8      |   |
| Gross margin (%)             | 36.8    | 35.9    | 90 bps   | 38.3    | -145 bps |   |
| SG&A expenses                | 265.4   | 192.1   | 38.2     | 238.3   | 11.4     |   |
| EBITDA                       | 194.7   | 187.9   | 3.6      | 213.6   | -8.8     |   |
| EBITDA Margin (%)            | 15.6    | 17.8    | -218 bps | 18.1    | -260 bps |   |
| Depreciation & amortisation  | 51.1    | 49.0    | 4.3      | 42.9    | 19.1     |   |
| EBIT                         | 143.6   | 138.9   | 3.4      | 170.7   | -15.9    |   |
| EBIT Margin (%)              | 11.5    | 13.1    | -164 bps | 14.5    | -296 bps | EBIT margin impacted by following headwinds: a) Wage hike, b) Lower utilization & c) higher SGA expenses                              |
| Other income (less interest) | 16.0    | 14.7    | 8.8      | 37.7    | -57.6    |   |
| PBT                          | 159.6   | 153.6   | 3.9      | 208.4   | -23.4    |   |
| Tax paid                     | 43.5    | 38.5    | 13.0     | 54.3    | -19.9    |   |
| PAT                          | 116.0   | 115.0   | 0.8      | 154.2   | -24.8    |   |

Source: Company, ICICI Direct Research

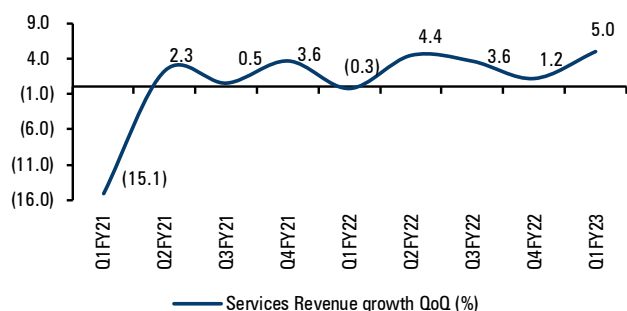
**Exhibit 2: Change in estimates**

|                 | FY23E |       |          | FY24E |       |          | Comments  |
|-----------------|-------|-------|----------|-------|-------|----------|---|
| (₹ Crore)       | Old   | New   | % Change | Old   | New   | % Change |   |
| Revenue         | 5,269 | 5,501 | 4.4      | 5,954 | 6,161 | 3.5      | Incorporate numbers from recent acquisitions                                    |
| EBIT            | 722   | 688   | -4.8     | 786   | 782   | -0.5     |   |
| EBIT Margin (%) | 13.7  | 12.5  | -120 bps | 13.2  | 12.7  | -50 bps  | Margin trim downward due to higher employee, SG&A and integration related costs |
| PAT             | 560   | 535   | -4.6     | 610   | 608   | -0.4     |   |
| EPS (₹)         | 50.8  | 48.5  | -4.6     | 55.3  | 55.1  | -0.4     |   |

Source: Company, ICICI Direct Research

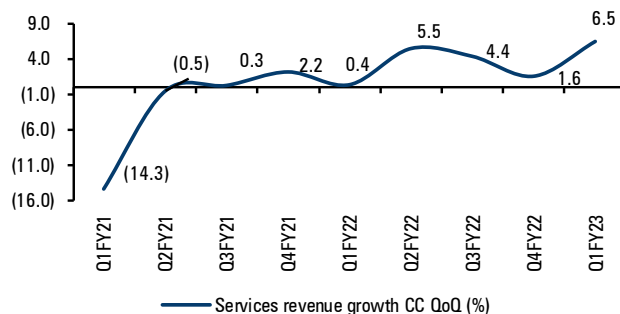
## Key Metrics

**Exhibit 3: Services Revenue QoQ growth**



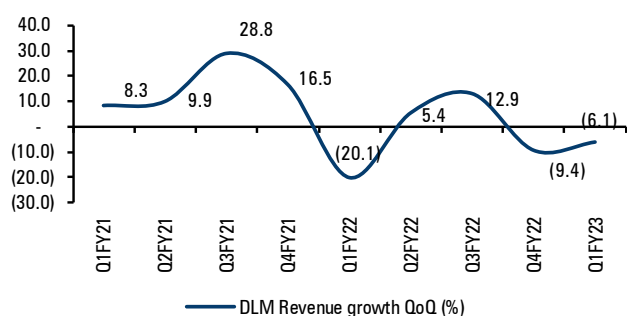
Source: Company, ICICI Direct Research

**Exhibit 4: Services Revenue QoQ CC growth**



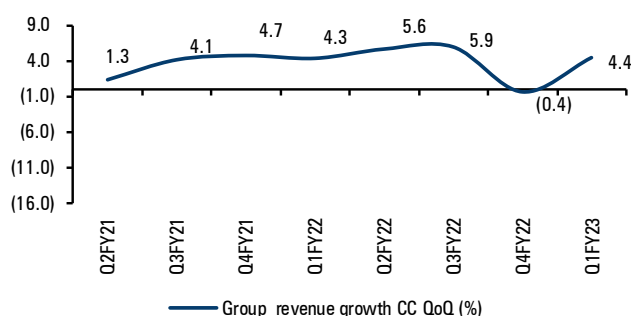
Source: Company, ICICI Direct Research

**Exhibit 5: DLM Revenue QoQ growth**



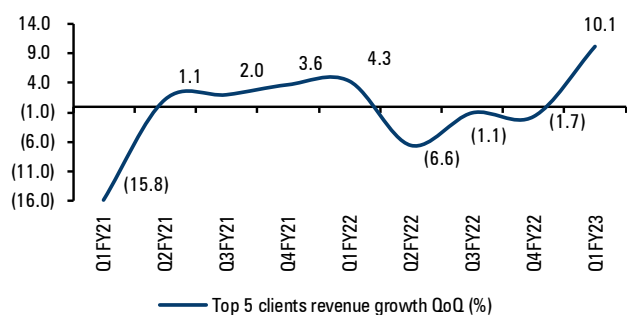
Source: Company, ICICI Direct Research

**Exhibit 6: Group Revenue QoQ growth**



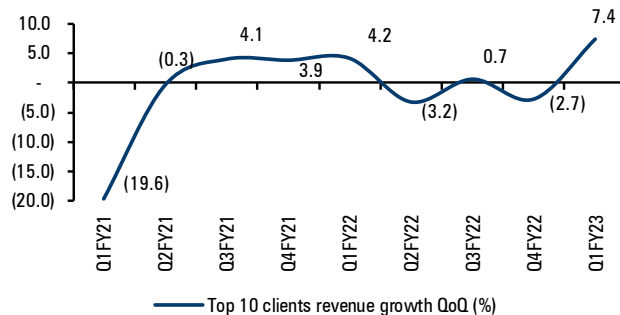
Source: Company, ICICI Direct Research

**Exhibit 7: Top 5 clients revenue QoQ growth**



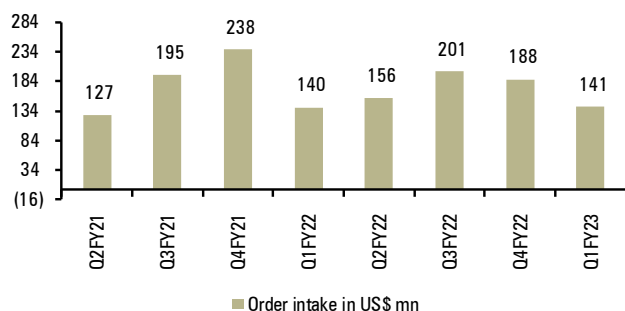
Source: Company, ICICI Direct Research

**Exhibit 8: Top 10 clients revenue QoQ growth**



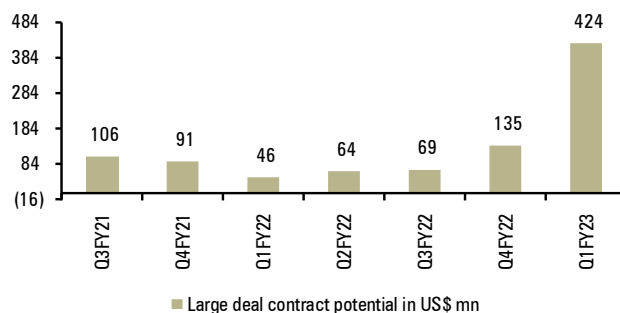
Source: Company, ICICI Direct Research

**Exhibit 9: Order intake trend**



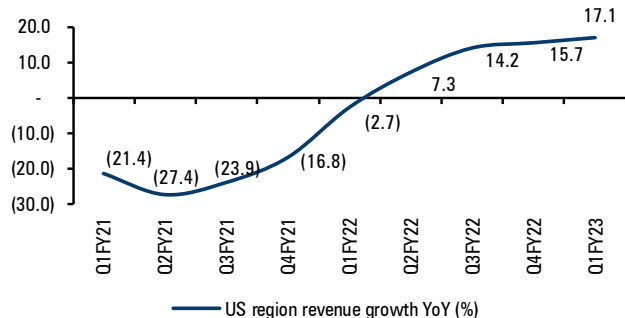
Source: Company, ICICI Direct Research

**Exhibit 10: Large deal contract potential**



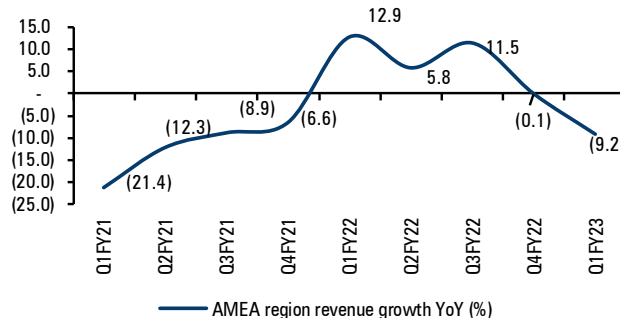
Source: Company, ICICI Direct Research

**Exhibit 11: US Revenue QoQ growth**



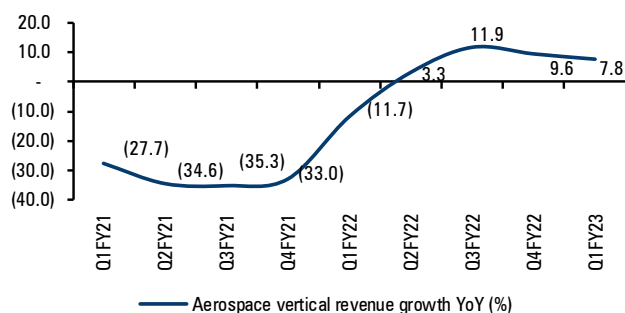
Source: Company, ICICI Direct Research

**Exhibit 12: EMEA Revenue QoQ growth**



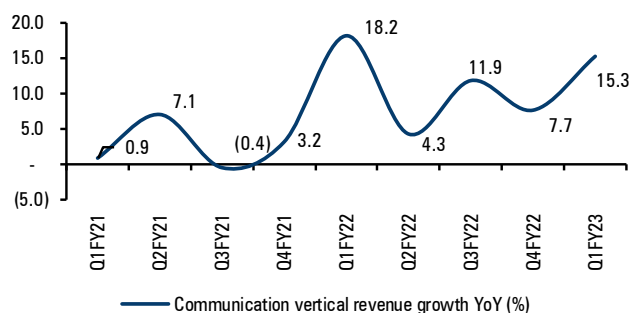
Source: Company, ICICI Direct Research

**Exhibit 13: Aerospace revenue QoQ growth**



Source: Company, ICICI Direct Research

**Exhibit 14: Communications revenue QoQ growth**



Source: Company, ICICI Direct Research

## Financial summary

| Exhibit 15: Profit and loss statement |              |              |              |              | ₹ crore |
|---------------------------------------|--------------|--------------|--------------|--------------|---------|
|                                       | FY21         | FY22         | FY23E        | FY24E        |         |
| <b>Total Revenues</b>                 | <b>4,132</b> | <b>4,534</b> | <b>5,501</b> | <b>6,161</b> |         |
| Growth (%)                            | (6.7)        | 9.7          | 21.3         | 12.0         |         |
| COGS                                  | 2,716        | 2,846        | 3,498        | 3,949        |         |
| Other expenditure                     | 806          | 867          | 1,084        | 1,171        |         |
| <b>EBITDA</b>                         | <b>611</b>   | <b>822</b>   | <b>919</b>   | <b>1,041</b> |         |
| Growth (%)                            | 2.5          | 34.6         | 11.8         | 13.3         |         |
| Depreciation                          | 195          | 192          | 231          | 259          |         |
| Other Income                          | 109          | 112          | 74           | 77           |         |
| Interest                              | 48           | 43           | 43           | 43           |         |
| PBT before Exceptional Items          | 477          | 698          | 718          | 815          |         |
| Tax                                   | 113          | 176          | 183          | 208          |         |
| PAT before Exceptional Items          | 364          | 522          | 535          | 608          |         |
| Exceptional items                     | -            | -            | -            | -            |         |
| PAT before MI                         | 364          | 522          | 535          | 608          |         |
| <b>PAT</b>                            | <b>364</b>   | <b>522</b>   | <b>535</b>   | <b>608</b>   |         |
| Growth (%)                            | 6.2          | 43.6         | 2.4          | 13.6         |         |
| Adjusted EPS                          | 33.1         | 47.3         | 48.5         | 55.1         |         |
| EPS (Growth %)                        | (2.4)        | 43.1         | 2.4          | 13.6         |         |

Source: Company, ICICI Direct Research

| Exhibit 16: Cash flow statement     |              |              |              |              | ₹ crore |
|-------------------------------------|--------------|--------------|--------------|--------------|---------|
|                                     | FY21         | FY22         | FY23E        | FY24E        |         |
| PBT                                 | 477          | 698          | 718          | 815          |         |
| Depreciation                        | 195          | 192          | 231          | 259          |         |
| WC changes                          | 269          | (97)         | (152)        | (110)        |         |
| Other non cash adju.                | 45           | 6            | (30)         | (33)         |         |
| Income taxes pd.                    | (129)        | (165)        | (183)        | (208)        |         |
| <b>CF from operations</b>           | <b>856</b>   | <b>635</b>   | <b>584</b>   | <b>723</b>   |         |
| Other Investments                   | (2)          | (318)        | 74           | 77           |         |
| Acq. Of business                    |              |              |              |              |         |
| (Purchase)/Sale of Fixed Assets     | (99)         | (65)         | (182)        | (203)        |         |
| <b>CF from investing Activities</b> | <b>(101)</b> | <b>(382)</b> | <b>(108)</b> | <b>(127)</b> |         |
| Inc / (Dec) in Equity Capital       | 4            | 12           | -            | -            |         |
| Change in debt funds                | (163)        | (70)         | (43)         | (43)         |         |
| Dividend & DDT                      | (1)          | (295)        | (298)        | (298)        |         |
| <b>CF from Financial Activities</b> | <b>(253)</b> | <b>(545)</b> | <b>(386)</b> | <b>(386)</b> |         |
| Exchange rate differences           | (3)          | 5            | -            | -            |         |
| Opening cash balance                | 900          | 1,267        | 1,202        | 1,201        |         |
| Cash as margins/associates          |              |              |              |              |         |
| <b>Cash c/f to balance sheet</b>    | <b>1,465</b> | <b>1,267</b> | <b>1,201</b> | <b>1,411</b> |         |

Source: Company, ICICI Direct Research

| Exhibit 17: Balance sheet        |              |              |              |              | ₹ crore |
|----------------------------------|--------------|--------------|--------------|--------------|---------|
|                                  | FY21         | FY22         | FY23E        | FY24E        |         |
| <b>Liabilities</b>               |              |              |              |              |         |
| Equity                           | 55           | 55           | 55           | 55           |         |
| Reserves & Surplus               | 2,902        | 3,061        | 3,143        | 3,453        |         |
| Networth                         | 2,957        | 3,117        | 3,199        | 3,508        |         |
| Minority Interest                | (3)          | (3)          | (3)          | (3)          |         |
| Borrowings                       | 276          | 326          | 326          | 326          |         |
| Long term Liabilities & provisio | 384          | 409          | 409          | 409          |         |
| <b>Source of funds</b>           | <b>3,614</b> | <b>3,849</b> | <b>3,931</b> | <b>4,241</b> |         |
| <b>Assets</b>                    |              |              |              |              |         |
| Net fixed assets                 | 718          | 679          | 674          | 664          |         |
| Net intangible assets            | 136          | 48           | 48           | 48           |         |
| CWIP                             | 11           | 13           | 13           | 13           |         |
| Goodwill                         | 583          | 619          | 619          | 619          |         |
| Other non current assets         | 158          | 174          | 178          | 183          |         |
| Non current Investments          | 34           | 358          | 358          | 358          |         |
| Inventories                      | 159          | 279          | 211          | 236          |         |
| Debtors                          | 803          | 733          | 1,070        | 1,198        |         |
| Cash & Cash equivalents          | 1,465        | 1,267        | 1,201        | 1,411        |         |
| Other current assets             | 426          | 618          | 670          | 731          |         |
| Trade payables                   | 453          | 526          | 596          | 667          |         |
| Current liabilities              | 387          | 371          | 455          | 500          |         |
| Provisions                       | 38           | 41           | 60           | 54           |         |
| <b>Application of funds</b>      | <b>3,614</b> | <b>3,849</b> | <b>3,931</b> | <b>4,241</b> |         |

Source: Company, ICICI Direct Research

| Exhibit 18: Key ratios      |       |       |       |       | ₹ crore |
|-----------------------------|-------|-------|-------|-------|---------|
|                             | FY21  | FY22  | FY23E | FY24E |         |
| <b>Per share data (₹)</b>   |       |       |       |       |         |
| Adjusted EPS (Diluted)      | 33.1  | 47.3  | 48.5  | 55.1  |         |
| Cash per Share              | 133.2 | 114.8 | 108.9 | 127.9 |         |
| BV per share                | 268.9 | 282.5 | 289.9 | 318.0 |         |
| DPS                         | 32.0  | 23.0  | 27.0  | 27.0  |         |
| <b>Operating Ratios (%)</b> |       |       |       |       |         |
| EBITDA Margin               | 14.8  | 18.1  | 16.7  | 16.9  |         |
| PAT Margin                  | 8.8   | 11.5  | 9.7   | 9.9   |         |
| Debtor days                 | 71    | 59    | 71    | 71    |         |
| Creditor days               | 40    | 42    | 40    | 40    |         |
| <b>Return Ratios (%)</b>    |       |       |       |       |         |
| RoE                         | 12.3  | 16.8  | 16.7  | 17.3  |         |
| RoCE                        | 14.5  | 19.3  | 19.4  | 20.3  |         |
| RoIC                        | 19.5  | 24.5  | 25.3  | 27.8  |         |
| <b>Valuation Ratios (x)</b> |       |       |       |       |         |
| P/E                         | 23.6  | 16.5  | 16.1  | 14.1  |         |
| EV / EBITDA                 | 12.4  | 9.6   | 8.6   | 7.4   |         |
| EV / Net Sales              | 1.8   | 1.7   | 1.4   | 1.3   |         |
| Market Cap / Sales          | 2.1   | 1.9   | 1.6   | 1.4   |         |
| Price to Book Value         | 2.9   | 2.8   | 2.7   | 2.4   |         |
| <b>Solvency Ratios</b>      |       |       |       |       |         |
| Debt/EBITDA                 | 0.5   | 0.4   | 0.4   | 0.3   |         |
| Debt / Equity               | 0.1   | 0.1   | 0.1   | 0.1   |         |
| Current Ratio               | 1.6   | 1.7   | 1.8   | 1.8   |         |
| Quick Ratio                 | 1.4   | 1.4   | 1.6   | 1.6   |         |

Source: Company, ICICI Direct Research

## RATING RATIONALE

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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