20 November 2022

Update | Sector: Technology

Cyient

BSE SENSEX	S&P CNX
61,663	18,308

CYIENT

Stock Info

Bloomberg	CYL IN
Equity Shares (m)	113
M.Cap.(INRb)/(USDb)	87.8 / 1.1
52-Week Range (INR)	1176 / 724
1, 6, 12 Rel. Per (%)	-1/-12/-34
12M Avg Val (INR M)	233
Free float (%)	76.6

Financials & Valuations (INR b)

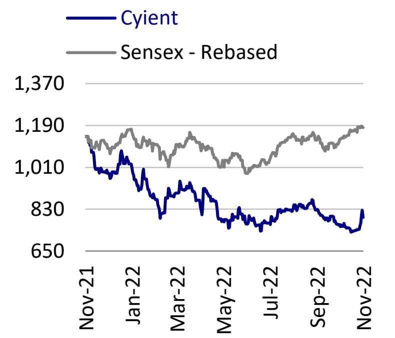
Y/E Mar	2022	2023E	2024E
Sales	45.3	58.3	68.9
EBIT Margin (%)	13.9	13.2	13.7
PAT	5.2	5.9	7.1
EPS (INR)	47.8	53.4	64.9
EPS Gr. (%)	41.3	11.8	21.5
BV/Sh. (INR)	285.1	287.2	313.2
Ratios			
RoE (%)	17.2	18.7	21.6
RoCE (%)	13.6	15.9	17.7
Payout (%)	60.0	60.0	60.0
Valuations			
P/E (x)	16.6	14.9	12.3
P/BV (x)	2.8	2.8	2.5
EV/EBITDA (x)	9.4	7.1	5.5
Div Yield (%)	3.6	4.0	4.9

Shareholding pattern (%)

As On	Sep-22	Jun-22	Sep-21
Promoter	23.4	23.4	23.4
DII	23.7	23.9	22.9
FII	33.6	32.7	35.6
Others	19.3	20.0	18.1

FII Includes depository receipts

Stock Performance (1-year)



CMP: INR795 TP: INR910 (+15%) Buy

Focus on newer areas to drive growth

We attended CYL's investor day, where the management said its focus is on five growth pillars to accelerate towards the five megatrends in its end-markets. It also discussed plans to double down on Automotive, Healthcare, Communication, and Sustainability, and shared its outlook on the DLM business. It reiterated its guidance, with a strong demand and growth outlook, and aims to improve EBITDA margin by 300-350bp over the next six quarters.

To focus on five pillars to tap the five megatrends

- CYL will focus on the five growth pillars: Digital, Embedded, Networks, Semiconductor design, and Geospatial.
- The management has identified five megatrends: Smart Operations**,** Intelligent Mobility, Digital Healthcare, the Sustainable business, and Meta Mobility and Space. These are expected to grow at 20-40% and will contribute 50% to FY25 revenue (v/s 20% at present).
- It also shared its S3 strategy, where it aims to strengthen services and accelerate solutions.
- Along with its 15-15-15 model (organic growth-inorganic growth–EBIT margin) it also shared its 5*5 operating model, with five GTM approaches co-related to the five delivery factories (*refer Exhibit 1*).

Renewed focus on newer growth areas

- Aerospace, being cyclical in nature, has not played out well for CYL.
- The management shared its plan to double down on newer areas of growth such as Automotive, Communication, Healthcare, and Sustainability.
- There is a lot of ITOT convergence happening, which is a huge opportunity. Industry 4.0 could be a USD1t market in a few years.
- The management also reiterated its focus on consulting and how it would help CYL to build client relationships.

Solid backlog to drive growth in DLM

- Despite the strong synergies between CYL and DLM, the management is carving out the business and evaluating options to meet its capital requirements as DLM's capital structure is different from CYL.
- There is a shift away from China (China+1) and the management's focus is on de-risking the supply chain.
- Domestic demand for high complexity electronics is set to exponentially increase over the next decade.
- DLM currently has a record high backlog to execute and is poised for a strong recovery in 2HFY23.

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Strong business outlook

- Technology is seeing a faster acceleration in the current decade vis-à-vis the past two decades. In Aerospace, revenue per passenger mile (v/s pre-COVID levels) stands at 80-90%/70% for domestic/international. Though it will see a double-digit growth recovery in 2HFY23, the recovery is slow.
- Non-Aerospace/Services is clocking 20%/11.5% organic growth in CC terms. Around 75% of the Services business is growing at 21-22%.
- DLM has the highest backlog and should see a good recovery in 2HFY23. Energy, Utilities, and Rail should also see a growth in 2HFY23.
- It has cut down on 150 non-strategic logos over the past 18 months and is rationalizing G&A to improve margin.
- CYL is on track to hit the guided run-rate of USD1b, and sees FY24 EPS at INR 60, with a good growth (organic + inorganic) and strong margin expansion.
- It aims to improve EBITDA margin by 300-350bp by FY24 from current levels.

Valuation and view – Maintain our Buy rating

- We continue to see a strong rebound in ER&D spending, led by increased outsourcing and larger deal sizes. The management plans to leverage these spends, led by a refreshed GTM strategy and increased focus on large deal wins should bode well for its growth performance.
- The growth momentum in verticals such as Communications, Utilities, Medical Devices, Automotive, and Mining is likely to continue for the next two-to-three years.
- We maintain our Buy rating led by attractive valuations. Our target multiple of 14x FY24E EPS implies a TP of INR910.

Business highlights

Things that went well for the company

- CYL has been able to maintain strong relationships with its customers. The top five accounts have performed well and have been with it for a long time.
- It has focused on and developed a very strong domain expertise. This, coupled with a strong execution rigor, will drive strong growth for the company.
- Diversification of its portfolio across Communication, Healthcare, and Automotive has helped CYL navigate the rough phase in Aerospace.

Things that did not go well for the company

- Aerospace was going through a challenging phase, and CYL was a late in accelerating Auto, Medical, and Communications.
- CYL was behind the curve in investing in new growth areas.
- It faced efficiency challenges in terms of talent, pyramid, and utilization, which it has started to address.
- It had a higher capex than usual, which will be brought in line to industry levels in 2HFY23 and FY24.

Changes and focus areas for the company

- It is refocusing on a strong sales team, which will allow strong growth for the company.
- It is placing a higher focus on large deals to drive growth. Around 60% of the current pipeline consists of large deals.
- The management sees large opportunities emerging from ITOT convergence. Its focus on Digital and Embedded capabilities makes it well poised to ride this trend. The Auto industry is seeing an ITOT convergence, and the management is seeing a strong opportunity there.
- It is placing a higher focus on new industries. The acquisition of Citech has boosted its capabilities in the Energy space.
- The management focus is on synergies to drive operating excellence.

The strategy going forward

Strengthening its core

- The management's focus in on **large deals** to provide value to its customers. It has a USD1b pipeline spread across 12 themes. It also has a long-duration USD200m deal from Honeywell Anthem in Aviation for cockpit transformation.
- It will **focus on key growth accounts.** Around 95% of its business accrues from repeat customers. One of its key customers grew 20% YoY in FY23.
- Internal target for **Automation and efficiency** is 3-4%. It also drives customer experience and productivity.
- It is promoting critical up-skilling and cross-skilling in the **talent** pool, and has inherited a strong management team from M&As.
- CYL has a continuous focus on an agile **culture**.

Expanding on the five pillars of growth

There is a shift in enterprise architecture towards ITOT and integrated models. Industry 4.0 is the largest opportunity at USD400b and is expected to be an USD1t opportunity over the next three-to-four years. The design model is becoming more agile and iterative, with shorter life cycles. It is focused on the five growth pillars:

- Digital
- Embedded
- Network
- Chip Designing
- Geospatial

The megatrends that will drive growth

The management has identified five megatrends that will drive growth in coming years:

- Smart Operations
- Intelligent Mobility
- Digital Healthcare
- Sustainable business
- Meta Mobility and Space

The identified megatrends are applicable across multiple industries and are not limited to a single industry. These megatrends are growing at 20-40% annually and are seeing significant investments from customers. It currently contributes 2-7% each to revenue, totaling 20%. The management expects a contribution of 50% from these megatrends by FY25, led by Digital Engineering. The current addressable market is USD8b and is expected to touch USD24b in a few years.

Exhibit 1: 5*5 operating model

GTM		Delivery factory
Aerospace/**Rail/Comm**unications	⟺	Mechanical/Industrial/ Plant Engineering
Mining/Energy/Utilities	⟺	Networks/Data/Geospatial
Healthcare and Hi-Tech	⟺	Digital Engineering
Auto and Mobility	⟺	Embedded Engineering
Semiconductor	⟺	Semiconductor design/VLSI

Source: MOFSL, Company

Key trends in Automotive, Communication, Healthcare, and Sustainability

Automotive and Mobility

- Automotive and Mobility contribute 5% to total revenue from 3% earlier.
- The management's focus is on connectivity and automated driving, and not on electrification or shared mobility.
- It sees a higher opportunity in client outsourcing due to the lack of software talent, which is a key challenge for clients.

- Regulatory challenges and innovation are key customer imperatives in this space.
- It is partnering with many startups and is also open to acquisitions.
- The management expects 2x growth in FY23 for a key European customer, who has potential to emerge as a top 10 customer.
- CYL has moved away from Mechanical, which was a big component earlier. Embedded and Digital constitute 80% of its current business.

Future of Communication

- Communication is growing at 6% CAGR.
- CYL works with six global CSPs, which includes Celfinet.
- The convergence of fixed and wireless networks is happening rapidly. There is a large market spend in the FTTx space across the US, the UK, and Europe.
- The customer imperative is to compress TTM, optimize TCO, and to address limited talent availability.
- It has rolled out its fiber practice and seeing a faster rollout through smart FTTx.
- CYL has a TCV of USD250m from key accounts in the FTTx space.
- It is designing a fiber network across 15 countries.
- In Telecom, it is strategically partnering with CSPs in their 5G rollout.
- It has delivered 15% energy consumption optimization for CSPs in six countries and is undertaking managed services projects for three CSPs.
- It clocked 15% growth in the last two years, and expects a revenue of USD250m over the next two years.

Delivering Digital Healthcare

- Demand in the Healthcare space is shifting towards value-based care.
- The focus is on better patient experience and behavioral changes, along with regulatory changes.
- The business imperatives for clients are point of care anywhere, device to platform, clinical innovation, and automation.
- CYL has delivered health platforms, remote monitoring solutions, and intelligent regulatory compliance to its customers.
- It contributes 4-5% of total revenue, and the management aims to grow it to USD100m over the next two years.

Designing sustainability industries

- It has gained this capability through the Citec acquisition.
- There is a massive energy investment opportunity to support net zero commitments.
- There is a lot of large customers across the ESG spectrum.
- Green energy plant, process, and digital engineering solutions constitute 30% of MEU revenue.
- It has successfully delivered more than 50 projects and is recognized as a rising start by ISG on the carbon free ecosystem.
- It currently has a revenue run-rate of USD100m.

Outlook on the DLM business

- Despite the strong synergies between the two, the management is hiving out the business and evaluating options to meet its capital requirements as the capital structure for DLM is different from CYL.
- Increased degree of electrification and the evolving needs of OEMs are impacting the EMS market.
- There is a shift away from China (China+1), and the focus is on de-risking the supply chain.
- Domestic demand for high complexity electronics is set to exponentially increase over the next decade.
- The mid-size player segment focuses on the growing high complexity, low volume segment and includes Cyient DLM.
- DLM currently has a record high backlog to execute and should do well in 2HFY23.
- The focus is on addressing specialization in safety critical electronics, experts in regulated industries, and to become an integrated solutions partner.

Financials and valuations

Income Statement								(INR m)
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Sales	**36,066**	**39,176**	**46,175**	**44,275**	**41,325**	**45,344**	**58,293**	**68,899**
Change (%)	16.5	8.6	17.9	(4.1)	(6.7)	9.7	28.6	18.2
Cost of Services	23,647	25,387	30,125	28,964	27,162	28,453	35,991	42,874
SG&A Expenses	7,569	8,296	9,606	9,352	8,056	8,675	12,049	13,573
EBITDA	**4,850**	**5,493**	**6,444**	**5,959**	**6,107**	**8,216**	**10,254**	**12,452**
As a percentage of net sales	13.4	14.0	14.0	13.5	14.8	18.1	17.6	18.1
Depreciation	953	1,051	1,692	1,878	1,944	1,923	2,542	3,032
Other Income	684	1,207	864	734	684	687	171	344
PBT	**4,581**	**5,649**	**5,616**	**4,815**	**4,847**	**6,980**	**7,883**	**9,765**
Tax	1,047	1,381	2,327	1,076	1,133	1,761	2,018	2,636
Rate (%)	22.9	24.4	41.4	22.3	23.4	25.2	25.6	27.0
Net Income	**3,534**	**4,268**	**3,307**	**3,726**	**3,714**	**5,219**	**5,866**	**7,129**
Change (%)	9.3	20.8	-22.5	12.7	-0.3	40.5	12.4	21.5

Balance Sheet								(INR m)
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Share Capital	563	563	552	550	550	552	552	552
Reserves	20,610	22,876	25,089	25,059	29,023	30,614	31,005	33,857
Net Worth	**21,173**	**23,439**	**25,641**	**25,609**	**29,573**	**31,166**	**31,557**	**34,409**
Other liabilities	1,408	1,636	2,240	4,194	3,812	4,061	5,390	6,377
Loan	1,651	2,410	3,253	3,738	2,755	3,264	3,264	3,264
Capital Employed	**24,232**	**27,485**	**31,134**	**33,541**	**36,140**	**38,491**	**40,212**	**44,050**
Applications								
Gross Block	11,107	12,217	13,289	17,388	18,088	18,838	19,588	20,338
Less: Depreciation	6,875	7,791	8,766	9,712	11,656	13,579	16,121	19,152
Net Block	**3,017**	**3,220**	**3,530**	**6,909**	**7,181**	**6,787**	**3,467**	**1,186**
CWIP	92	213	300	800	113	134	134	134
Intangibles	4,666	5,057	6,990	6,800	7,191	6,662	6,662	6,662
Other assets	2,876	2,380	2,219	2,638	1,925	5,318	5,554	5,753
Curr. Assets	**20,713**	**23,456**	**25,853**	**24,650**	**28,518**	**28,972**	**36,697**	**44,246**
Debtors	6,496	6,913	8,137	7,262	8,026	7,333	10,541	12,458
Cash and Bank Balance	8,571	9,604	9,073	8,995	14,408	12,157	15,709	18,778
Other Current Assets	4,721	5,809	8,365	8,393	6,084	8,616	8,582	10,144
Current Liab. and Prov.	**7,132**	**6,841**	**7,758**	**8,256**	**8,788**	**9,382**	**12,304**	**13,931**
Trade payables	4,021	3,813	3,712	3,729	4,532	5,259	7,985	9,438
Other liabilities	2,876	2,799	3,757	4,150	3,872	3,709	3,777	3,853
Provisions	235	229	289	377	384	414	542	640
Net Current Assets	**13,581**	**16,615**	**18,095**	**16,394**	**19,730**	**19,590**	**24,394**	**30,315**
Application of Funds	**24,232**	**27,485**	**31,134**	**33,541**	**36,140**	**38,491**	**40,211**	**44,050**

Financials and valuations

Ratios

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Basic (INR)								
EPS	**31.5**	**38.0**	**30.0**	**33.8**	**33.8**	**47.8**	**53.4**	**64.9**
Cash EPS	40.0	47.4	45.3	50.8	51.5	65.3	76.5	92.5
Book Value	189.5	209.8	232.3	232.0	269.1	285.1	287.2	313.2
DPS	10.5	13.0	13.0	27.0	24.5	28.7	32.0	38.9
Payout (%)	33.3	34.2	43.4	80.0	72.5	60.0	60.0	60.0
Valuation (x)								
P/E ratio	25.2	20.9	26.5	23.6	23.5	16.6	14.9	12.3
Cash P/E ratio	19.9	16.8	17.6	15.7	15.4	12.2	10.4	8.6
EV/EBITDA ratio	16.7	14.7	12.7	13.8	12.4	9.4	7.1	5.5
EV/Sales ratio	2.2	2.1	1.8	1.9	1.8	1.7	1.3	1.0
Price/Book Value ratio	4.2	3.8	3.4	3.4	3.0	2.8	2.8	2.5
Dividend Yield (%)	1.3	1.6	1.6	3.4	3.1	3.6	4.0	4.9
Profitability Ratios (%)								
RoE	17.9	19.1	13.5	14.6	13.5	17.2	18.7	21.6
RoCE	13.4	13.8	10.2	10.6	9.9	13.6	15.9	17.7
Turnover Ratios								
Debtors (Days)	64	62	59	63	68	67	66	66

Cash Flow Statement (INR m)

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
CF from Operations	3,833	4,622	5,411	5,496	5,872	7,318	7,980	10,161
Cash for Working Capital	366	-1,659	-1,710	328	2,686	-973	841	-1,065
Net Operating CF	**4,199**	**2,963**	**3,701**	**5,824**	**8,558**	**6,345**	**8,821**	**9,096**
Net Purchase of FA	-1,038	-1,469	-1,440	-2,138	-949	-626	-750	-750
Free Cash Flow	**3,161**	**1,494**	**2,261**	**3,686**	**7,609**	**5,719**	**8,071**	**8,346**
Net Purchase of Invest.	-765	600	-767	568	-58	-3,197	-1,000	-1,000
Net Cash from Invest.	**-1,803**	**-869**	**-2,207**	**-1,570**	**-1,007**	**-3,823**	**-1,750**	**-1,750**
Proc. from equity issues	16	9	22	17	37	121	0	0
Proceeds from LTB/STB	-203	526	549	-916	-2,134	-1,994	0	0
Dividend Payments	-746	-1,894	-2,892	-3,564	-10	-2,952	-3,520	-4,277
Cash Flow from Fin.	**-933**	**-1,359**	**-2,321**	**-4,463**	**-2,107**	**-4,825**	**-3,520**	**-4,277**
Exchange difference	277	298	296	131	-31	52	0	0
Net Cash Flow	**1,740**	**1,033**	**-531**	**-78**	**5,413**	**-2,251**	**3,552**	**3,069**
Opening Cash Bal.	**6,831**	**8,571**	**9,604**	**9,073**	**8,995**	**14,408**	**12,157**	**15,709**
Add: Net Cash	1,740	1,033	-531	-78	5,413	-2,251	3,552	3,069
Closing Cash Bal.	**8,571**	**9,604**	**9,073**	**8,995**	**14,408**	**12,157**	**15,709**	**18,778**

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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