ANANDRATHI

India I Equities

Technology

Company Update

Change in Estimates ☐ Target ☐ Reco ☐

28 November 2022

Cyient

Wider services and Sales investments to improve FY24 growth; Buy

Rating: **Buy**
Target Price: Rs.1,030
Share Price: Rs.796

To reduce concentration and thus raise expectations of steady organic revenue growth, Cyient diversified its services portfolio in FY23 via acquisitions. It is working toward building a sharper sales organization to benefit from its wider services. Order intake (in Q2) has yet to improve notably but the large-deal pipeline ($1bn+) reflects early gains. Services margins are likely to touch 15% with operational rigor (mostly higher offshore) and capex is likely to be lower, converging to peers, thus raising FCF. DLM would be an additional value driver, with growth acceleration ahead, suggested by Q2 orders. TP unchanged at Rs1,030, 15x FY25e EPS.

15% Services growth with 15% EBIT margins to be the yardstick. Cyient believes its 5x5 (five industry verticals and five service lines) operating model, reduced portfolio drags (Rail down 24% y/y as in Q2), brighter outlook in Aero (up 8% y/y) and investments in large deals ($530m won in H1, $1bn+ pipeline) should help it grow 15% organically. Besides, it believes it can operate at 15% EBIT margin with ~3% gains expected in operational efficiency (50% offshore offers opportunity). In Q2, Cyient had 12.5% (adj.) Services margins (15.3% in FY22).

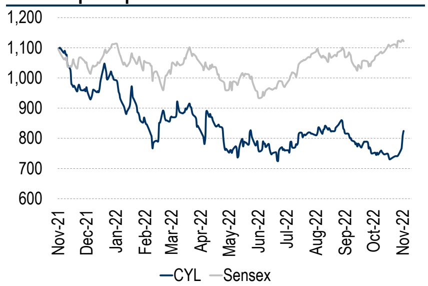
DLM to be growth driver ahead, closes large deals in Q2. Cyient has not seen growth in DLM in the last three quarters. However, improvement is likely as it has signed large orders in Q2. TTM order intake in Q3 FY22 was $150m, which came down to $104m in Q1. However, in Q2, it rose to $189m, with Q2 intake of $118m. This will accelerate growth to a ~17% FY23-25 CAGR. The company has decided to carve out this division to capture better scale-up opportunities and sharpen management's focus on the Services division. DLM's EBITDA margins are likely to be ~11-12%.

Buy, with unchanged target of Rs.1,030. The stock quotes at 12x FY25e EPS of Rs.68, attractive, given expectations of rising organic growth, potential value creation opportunities in the DLM carve out, and after factoring in some risks due to the company's acquisitive nature. Cyient is currently net-debt, which restricts its ability to wade through in a tough environment. Therefore, we value the stock at 15x FY25e EPS. **Risk:** M&A-integration-related.

Key data	CYL IN / CYIE.BO
52-week high / low	Rs.1,128 / 720
Sensex / Nifty	62294 / 18513
3-m average volume	$1.9m
Market cap	Rs.88bn / $1,077.5m
Shares outstanding	110m

Shareholding pattern (%)	Sep'22	Jun'22	Mar'22
Promoters	23.4	23.4	23.4
- of which, Pledged			
Free float	76.6	76.6	76.6
- Foreign institutions	32.6	32.7	34.0
- Domestic institutions	23.7	23.9	23.3
- Public	20.3	20.0	19.2

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY21	FY22	FY23e	FY24e	FY25e
Sales (Rs m)	41,325	45,344	59,216	71,133	79,815
Net profit (Rs m)	3,641	5,219	4,567	6,679	7,447
EPS (Rs)	33.1	47.8	41.6	60.8	67.8
P/E (x)	24.2	16.7	19.2	13.2	11.8
EV / EBITDA (x)	12.7	9.4	7.9	6.5	5.9
P/BV (x)	3.0	2.8	2.6	2.3	2.1
RoE (%)	13.2	17.2	14.1	18.7	18.7
RoCE (%)	9.1	12.5	13.0	15.2	16.0
Dividend yield (%)	2.1	3.0	2.2	3.2	3.5
Net debt / equity (x)	-0.4	-0.3	0.1	0.0	-0.0

Source: Company, Anand Rathi Research

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Research Analyst

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Research Associate

Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
Revenues (USm)	**556.9**	**608.2**	**732.2**	**859.6**	**964.6**
Growth (%)	**-10.9**	**9.2**	**20.4**	**17.4**	**12.2**
Net revenues (Rs m)	41,325	45,344	59,216	71,133	79,815
Employee & Direct Costs	27,161	28,456	36,883	44,950	51,337
Gross Profit	14,164	16,888	22,332	26,183	28,479
Gross Margin %	34.27	37.24	37.71	36.81	35.68
SG&A	8,056	8,672	12,568	14,298	15,253
EBITDA	**6,108**	**8,216**	**9,764**	**11,885**	**13,226**
EBITDA margins (%)	14.8	18.1	16.5	16.7	16.6
- Depreciation	1,944	1,923	2,388	2,792	2,998
Other income	1,091	1,121	158	906	808
Interest Exp	481	434	1,215	972	972
PBT	4,774	6,980	6,319	9,026	10,064
Effective tax rate (%)	24	25	28	26	26
+ Associates/(Minorities)	-	-	-	-	-
Net Income	3,641	5,219	4,567	6,679	7,447
WANS	110	109	110	110	110
FDEPS (Rs/share)	33.1	47.8	41.6	60.8	67.8

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
Share capital	550	552	552	552	552
Net worth	29,541	31,134	33,789	37,671	42,000
Total debt (including Pref)	2,755	3,264	4,264	3,264	2,264
Minority interest	-	-	-	-	-
DTL/(Asset)	-137	97	-27	-27	-27
Capital employed	**32,159**	**34,495**	**38,026**	**40,908**	**44,237**
Net tangible assets	7,181	6,787	10,036	8,972	7,756
Net Intangible assets	598	477	577	677	777
Goodwill	5,830	6,185	14,101	15,460	16,818
CWIP (tangible and intangible)	876	134	436	436	436
Investments (Strategic)	344	3,582	3,582	3,582	3,582
Investments (Financial)	-	866	-	-	-
Current Assets (ex Cash) Incl LT	15,130	16,928	24,135	27,231	29,183
Cash	14,650	12,666	1,985	1,684	2,670
Current Liabilities (ex ST Loan/	12,450	13,130	16,827	17,133	16,985
Working capital	2,680	3,798	7,308	10,098	12,198
Capital deployed	**32,159**	**34,495**	**38,026**	**40,908**	**44,237**
Contingent Liabilities	566	553	-	-	-

Fig 3 – Cash Flow statement (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
PBT	4,774	6,980	6,319	9,026	10,064
+ Non-cash items	2,390	1,990	3,445	2,859	3,162
Operating profit before WC	7,164	8,970	9,764	11,885	13,226
- Incr./(decr.) in WC	-2,686	973	3,634	2,790	2,100
Others incuding taxes	-1,292	-1,652	-1,751	-2,347	-2,617
Operating cash-flow	8,558	6,345	4,378	6,748	8,509
- Capex (tangible + Intangible)	985	647	1,776	1,828	1,882
Free cash-flow	7,573	5,698	2,602	4,920	6,627
Acquisitions	721	225	12,179	1,358	1,358
- Dividend (including buyback &	10	2,952	1,912	2,797	3,119
+ Equity raised	37	-829	-	-	-
+ Debt raised	-1,921	-1,498	1,000	-1,000	-1,000
- Fin Investments	-21	3,229	-866	-	-
- Misc. Items (CFI + CFF)	-153	-1,051	1,057	67	164
Net cash-flow	5,132	-1,984	-10,681	-301	986

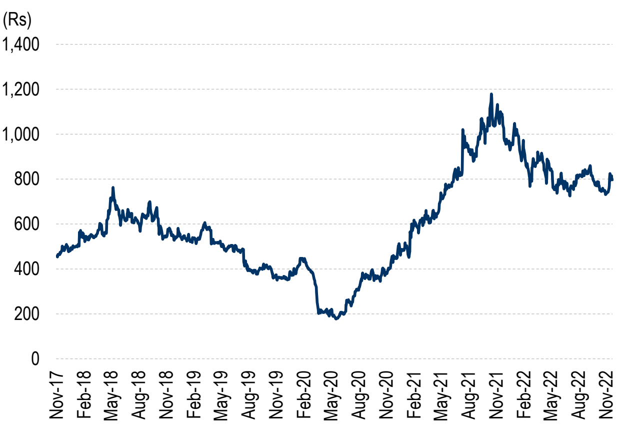
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year end Mar	FY21	FY22	FY23e	FY24e	FY25e
P/E (x)	24.2	16.7	19.2	13.2	11.8
EV/EBITDA (x)	12.7	9.4	7.9	6.5	5.9
EV/sales (x)	1.88	1.71	1.31	1.09	0.97
P/B (x)	3.0	2.8	2.6	2.3	2.1
RoE (%)	13.2	17.2	14.1	18.7	18.7
RoCE (%) - After tax	9.1	12.5	13.0	15.2	16.0
RoIC (%) - After tax	13.8	19.9	16.0	15.8	16.7
DPS (Rs per share)	17.0	24.0	17.4	25.5	28.4
Dividend yield (%)	2.1	3.0	2.2	3.2	3.5
Dividend payout (%) - Inc. DDT	51.4	50.2	50.2	50.2	50.2
Net debt/equity (x)	-0.4	-0.3	0.1	0.0	-0.0
Receivables (days)	91	83	93	95	95
Payables (days)	47	52	47	44	41
CFO:PAT %	235.0	121.6	95.9	101.0	114.3
FCF:PAT % - includ M&A payou	188.2	104.9	-209.7	53.3	70.7

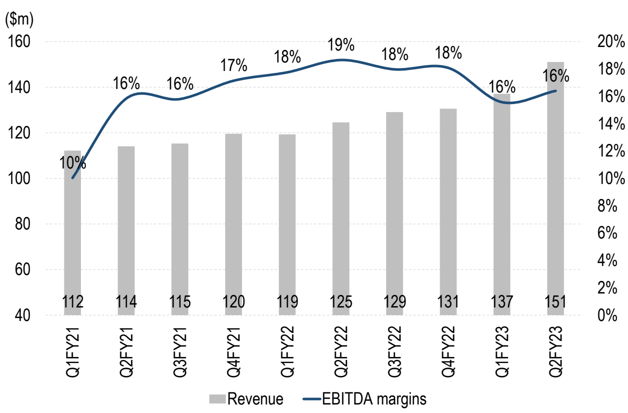
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Cyient's performance



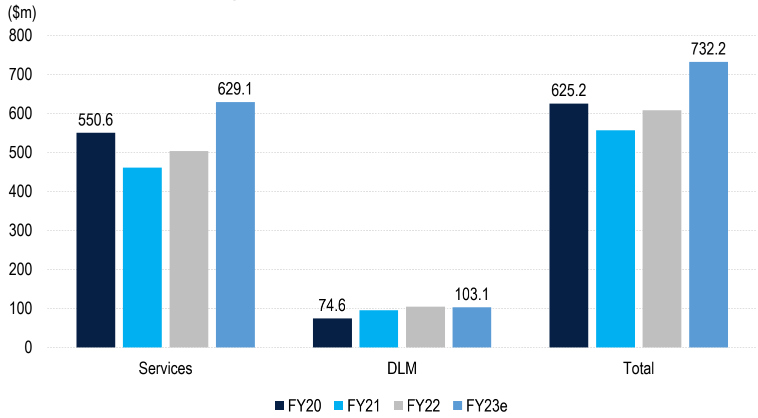
Source: Company, Anand Rathi Research

Analyst Meet takeaways

Diversified revenue base, large-deal pipeline strong

- Services revenue growth improved in FY22 and the company has diversified its services in H1 FY23. The diversified revenue base is likely to provide it a more steady revenue stream in H2 and beyond. The company is aiming to grow 15% organically.
- DLM is expected to be flattish in FY23 but has secured orders in Q2. Therefore, the present trajectory is likely to improve in FY24. We expect it to move to $139m in FY25, from $103.1m in FY23.

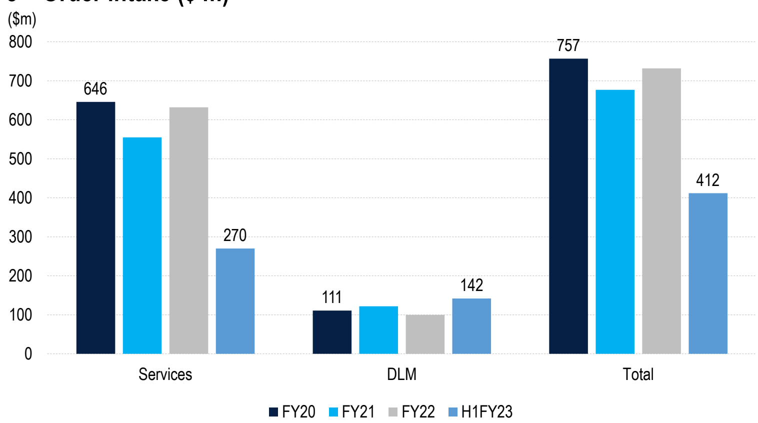
Fig 7 – Services revenue growth to be more broad-based



Source: Company, Anand Rathi Research

- Order intake for Services is steady but the large-deal pipeline is $1bn+ and the company is optimistic about improving the order intake ahead. DLM order intake has improved in Q2 FY23 to $118m (up 402% q/q, 253% y/y) and the company closed a large deal from Honeywell in Q2.

Fig 8 – Order intake ($ m)



Source: Company, Anand Rathi Research

- The company is focusing on key account growth; 95% is repeat business. Cyient's longest relationship with a client is of 20 years and that company has grown 20% this year. Top accounts growth has been slow but the company expects this to improve.
- A few industry verticals (such as Rail) have fallen sharply in H1 FY23 impacting key client performance. Management expects it to start growing in H2.

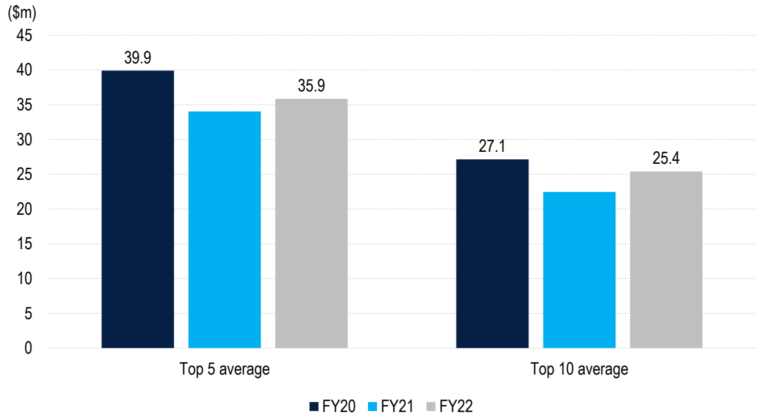
Fig 9 – Top clients growth y/y

Y/Y growth	FY20	FY21	FY22	H1FY23
Top 5	-8.0%	-14.7%	5.3%	-4.9%
Top 10	-7.0%	-17.3%	13.1%	1.2%

Source: Company, Anand Rathi Research

- Accelerate large deals. The large-deal pipeline (60% of the total pipeline) is $1 billion+ across 12 themes. The company closed a $200m large deal with Honeywell Anthem – Transforming Aviation, where it is providing full-lifecycle support. The Honeywell Anthem is an aircraft cockpit system, the first in the industry built with an always-on, "cloud"-connected experience which improves flight efficiency, operations, safety and comfort. Large deals were at $530m H1 FY23.
- In the Transport vertical, the largest customer has grown 20% y/y but the rest of the clients have not grown as fast. A large North American OEM is still struggling and the company expects low double-digit growth for Aerospace for FY23.
- 75% of the services business grew 20-22% y/y, while 25% of the services business (Utilities & Rail) declined 10%-25% y/y in Q2 FY23. Cyient is focusing on "green" energy-related initiatives to improve growth in the utilities vertical. As discussed earlier, Railways is also expected to grow in H2.
- The company would expand on the following five pillars, which have delivered 33-35% y/y growth in Q2 FY23 and a 40% y/y increase in order intake (TTM basis).
  - Digital
  - Networks
  - Geo-Spatial
  - Embedded
  - VLSI/Chip design
- Accelerate on mega trends. These mega trends contribute 20% to total revenue and the company aspires to take this to 50% by 2025.
  - Smarter ops (7% of revenue)
  - Intelligent mobility (4-5% est)
  - Sustainability (3-4% est)
  - Digital healthcare (2-3% est)
  - Space systems (2 %)
- The company has strong client relationships. The top 5 have been the top 5 for many years. Therefore, the weakness is perceived to be related to client mining, which should be addressed through wider services. Besides, it could also be on account of sales weakness, which is also being addressed by the management.

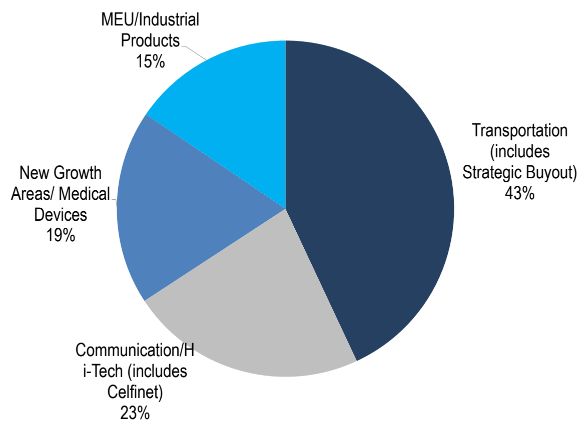
Fig 10 – Average revenue per client from Top 5, Top 10 ($ m)



Source: Company, Anand Rathi Research

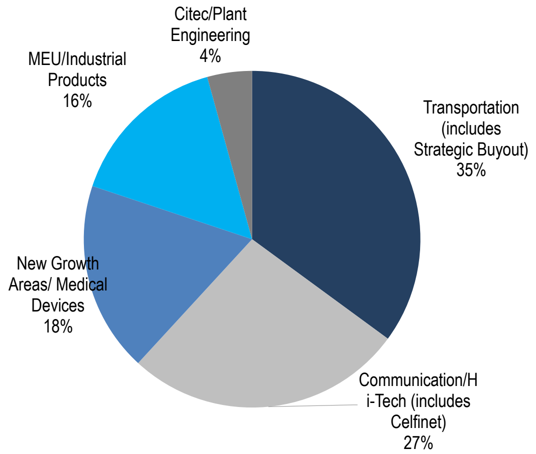
- The company is diversifying beyond Aerospace, which has helped it cushion the decline in Aerospace. Its exposure to the Transportation vertical decreased to 35% in Q2 FY23, from 43% a year ago, and the Communications vertical grew from 23% of revenues to 27% in the same period. Further, through the acquisition of Citec (4% of revenue in Q2 FY23), the company is exposed to plant engineering as well, which it previously was not. The contribution from other verticals is largely unchanged when compared y/y.

Fig 11 – Q2 FY22 revenue split for Cyient (consolidated)



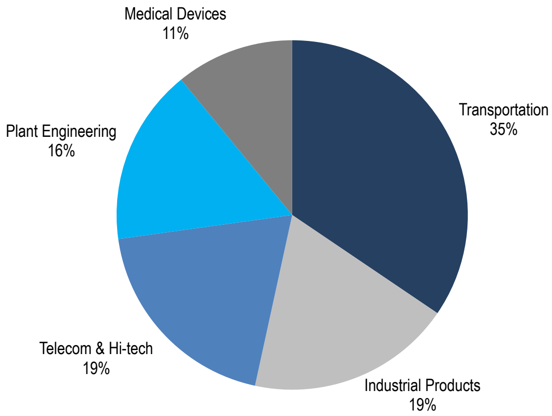
Source: Company, Anand Rathi Research

Fig 12 – Q2 FY23 revenue split for Cyient (consolidated)



Source: Company, Anand Rathi Research Note: Citec was integrated for one month.

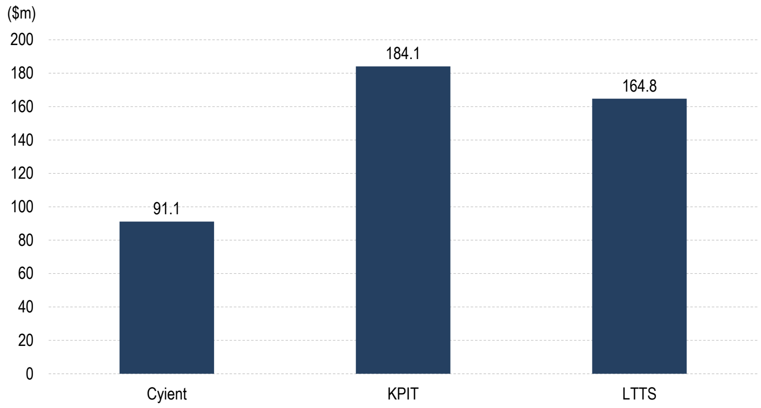
Fig 13 – Q2 FY23 revenue split for LTTS



Source: Company, Anand Rathi Research

- Some of the industries Cyient was focusing on were not growing great. For example, Transportation (Within that Rail in particular). Compared to its peers, Cyient's transportation is smaller and heavily tilted toward Aerospace.

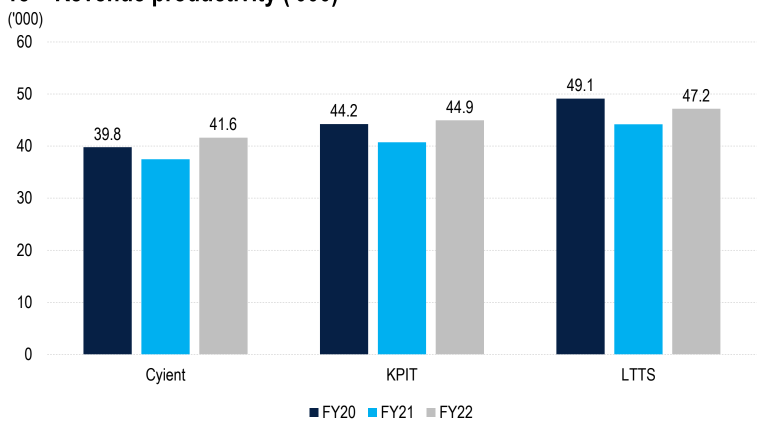
Fig 14 – Transportation $ m in H1 FY23



Source: Company, Anand Rathi Research Note: Transportation revenue (from services business for Cyient)

- The company aspires to do better in terms of utilisation of resources and talent. In terms of revenue productivity, it is slightly lower than peers KPIT and LTTS.

Fig 15 – Revenue productivity ('000)



Source: Company, Anand Rathi Research

- The company is aiming at 15% organic growth and 15% inorganic growth (assuming full-year consolidation) in FY23. We have baked in 20% growth (GAAP consolidated) in dollar terms for FY23.

The company has identified four verticals as focus areas

Healthcare and Life sciences

- In this vertical, Cyient has strong domain expertise, global regulatory expertise and innovative solution accelerators.
- It has had two logo wins in Q3 till now and is averaging 1-2 wins each quarter
- This vertical is growing 60-70% y/y
- Roughly 4-5% of revenue (~35m p.a. at the Q2 FY23 consolidated revenue rate) today, to become a $100m business in two years.

Mining, Energy and Utilities

- Green energy contributes 30% ($30m p.a. at the Q2 FY23 consolidated revenue rate) to revenue for this vertical and the company expects to double it in 36 months.
- Focus is on
  - Alternative fuels
  - Balancing capacity plants
  - Carbon capture and storage
- Clients are committing much toward their carbon goals
- Delivered 50 projects amounting to $100m in this space
- Cyient is involved in the Norway government Northern Lights project.
- It is working on a digital solution to monitor carbon emissions from industries and checking if reducing carbon goals are being met or not. This solution is being made with the help of Microsoft, where Cyient is bringing its domain and engineering expertise

Automotive and mobility

- This vertical has been in focus for Cyient for 2-3 years now.
- It is now 5% of revenue (~Rs35m p.a. at the Q2 FY23 consolidated revenue rate) and is expected to grow immensely. The company is aspiring to take this to a $100m business in 2-3 years, of which $20m-40m could come from inorganic initiatives.
- Cyient is focusing on connectivity and automated driving not so much on electrification and shared mobility.
- Growth would come from tier-1s and off-highway companies. The cost of business doing with OEMs is higher than Tier 1 suppliers.
- This vertical has higher offshoring (~70%) and the company said that the margins are similar to those of peers in this practice.

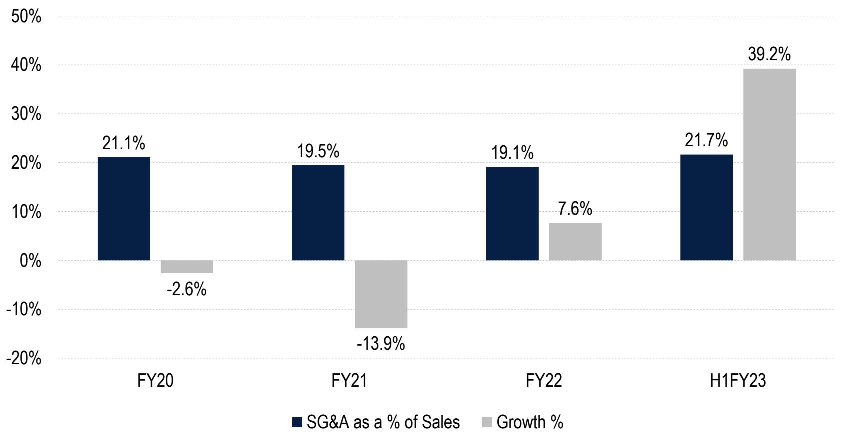
Communication

- "Smart" FTTx (fibre)
  - Talent shortage has been high
  - TCV for LTM was $250m in Fibre
- Transforming Telco operations and enterprise networks
  - TCV of $35m in LTM from key accounts
- The company aims to take the yearly rate to $220-250m in FY24 for this vertical.
- Wire practice is 70% and wireless is 30% of its communications business.

Margins

- The company to make up 350bps (H1 FY23 EBIT margin at ~11.7%) over the rest of the year. It might see some one-time costs due to broken leases.
- Automation and efficiency to benefit margins by 2.5-3%.
- Sales focus on existing and new accounts.

Fig 16 – SG&A ticked up in H1FY23



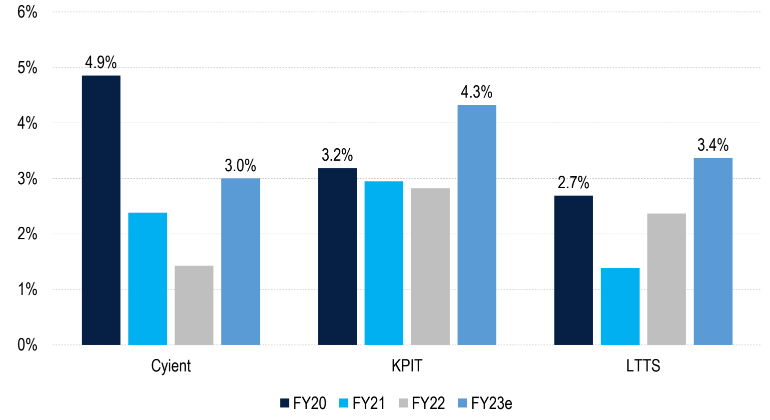
Source: Company, Anand Rathi Research

- It aims to deliver 15% EBIT for FY23.

Balance sheet, Cash flows

- **Capex control.** The company guided to capex being in line with competitors from H2. This should improve FCF generation.

Fig 17 – Capex as percent of sales



Source: Company, Anand Rathi Research

Other updates

- Cyient is looking to slide into the revenue cycle of customers and not merely stay on their cost cycles.
- Added 2,500 employees in LTM in Embedded.
- No significant furloughs seen in Q3 so far.

Factsheet

Fig 18 – Revenue, by area, %

	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
US	49	49	54	51	50
Europe	25	25	25	23	26
APAC	26	26	22	26	24

Source: Company, Anand Rathi Research

Fig 19 – Revenue, by industry, %

	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
Aerospace & Defense	32	35	32	31	27
Transportation	11	9	9	8	7
Communications	23	22	24	25	23
Portfolio	28	27	29	28	28
Energy and Utilities	7	6	6	5	5
Others (incl. M&A)	-	-	-	3	10

Source: Company, Anand Rathi Research

Fig 20 – Onsite-offshore revenue mix, %

	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
Offshore	50	50	48	50	48
On-site	50	50	52	50	52

Source: Company, Anand Rathi Research

Fig 21 – Client concentration, %

	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
Top 5	32	28	27	28	25
Top 10	43	42	39	39	37
Client bucket growth rates %					
Top 5	19	9	(17)	(2)	(7)
Top 6-10	44	58	24	15	22
Beyond Top 10	3	6	14	21	29

Source: Company, Anand Rathi Research

Fig 22 – Number of employees

	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
Services	12,035	12,173	12,834	13,581	15,004
Total	12,707	12,845	13,428	14,147	15,598

Source: Company, Anand Rathi Research

Fig 23 – Employee parameters, %

	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
Attrition %	24.3	29.3	26.9	27.9	28.4
Utilisation	85.0	86.2	86.1	80.9	84.6

Source: Company, Anand Rathi Research

Fig 24 – Key segments' growth Y/Y, %

	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
Region					
US	8.7	12.1	17.7	20.6	20.3
Europe	-4.6	10.8	4.5	-10.0	22.1
APAC	38.5	11.7	-17.6	23.5	4.1
Industry					
Aerospace & Defense	13%	19%	-2%	7%	-1%
Transportation	0%	-12%	-14%	-23%	-31%
Portfolio	18%	15%	14%	20%	17%
Communications	5%	4%	7%	15%	20%

Source: Company, Anand Rathi Research

Valuations

The stock trades at 13x FY24e EPS of Rs61 and 12x FY25e EPS of Rs68. Revenue grew 9% in FY22, slower than the industry on account of a gradual recovery in Aero and sustained weakness in Rail. However, the company seems to be returning to growth, with the deal momentum building up on the Services side, more so in the Communications vertical, which is now its largest Services vertical.

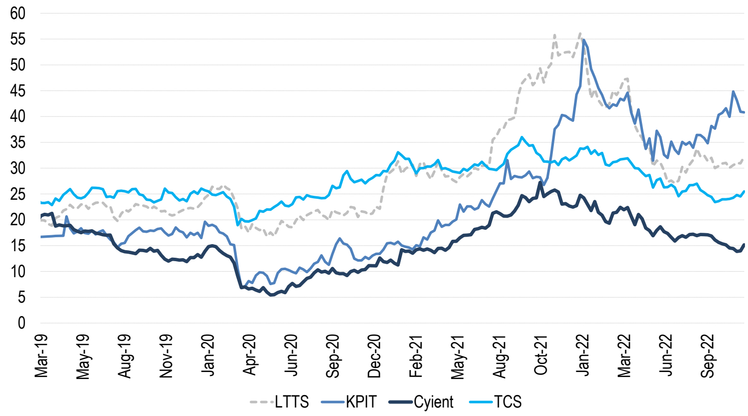
Ahead, we expect revenue to clock 19% compound annual growth (incl. acquisitions) over FY22-24. On a positive note, management is seeing demand increasing steadily in A&D and expects it to clock 10% cc (low double digit) growth for the year.

The EBIT margin expanded 380bps in FY22 (to 13.9%) but is expected to slip to 12.5% in FY23 before stepping up to ~13% in FY24 and staying at ~13% in FY25. This reflects high wage pressure, attrition, re-opening costs, and M&A expenses. Cyient will have offshoring and utilisation (to a small extent) as levers to offset some of these cost pressures. Given its better execution on the margin front (compared to growth) and, taking into consideration our expectations of it reducing the gap with industry level growth in FY23, the stock offers good potential. We, however, read the company's acquisitive strategy as less capital-efficient, reflected in the lower target multiple.

Our FY23, FY24 and FY25 estimates are largely unchanged. Our target is Rs1,030 (unchanged), reflecting slower growth and order intake at present, leading to delays in growth picking up. The company recently made three acquisitions and one strategic buyout, which should add 14-15% to FY23 revenue, included in our estimates. Clearly, Cyient's track record in acquisition is mixed at best; hence, we believe the company carries some integration risks.

Our target price is based on 15x FY25e EPS. At this price, Cyient will trade at a ~40% discount to the sector leader, LTTS, which we think is fair, given the difference in portfolio and performance of the two large pure-play engineering-services companies.

Fig 25 – PE band



Source: Bloomberg, Anand Rathi Research

Risk

- M&A-integration-related

Appendix

Analyst Certification

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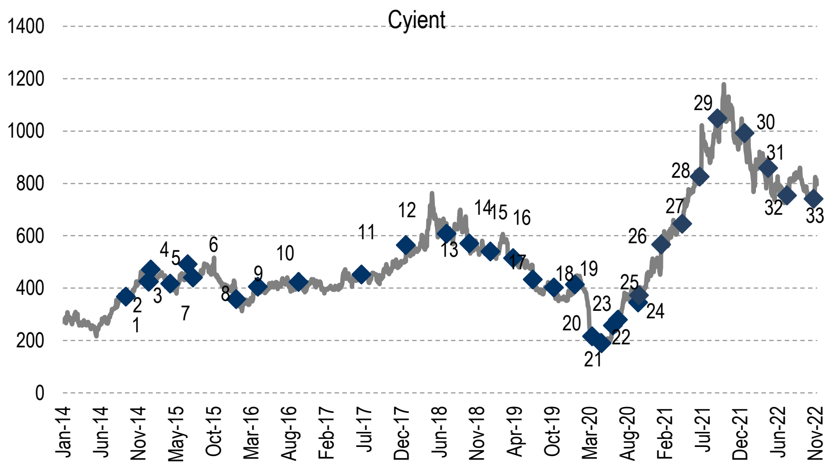
Rating and Target Price History (as of 25 November 2022)



	Date	Rating	TP (Rs)	Share Price (Rs)
18	18-Oct-19	**Hold**	505	447
19	17-Jan-20	**Hold**	500	452
20	31-Mar-20	**Buy**	350	452
21	11-May-20	**Hold**	210	200
22	29-Jun-20	**Sell**	230	276
23	20-Jul-20	**Sell**	250	284
24	15-Oct-20	**Sell**	355	375
25	19-Oct-20	**Hold**	400	388
26	25-Jan-21	**Hold**	690	603
27	25-Apr-21	**Buy**	900	688
28	17-Jul-21	**Buy**	1240	1057
29	17-Oct-21	**Buy**	1585	1158
30	27-Jan-22	**Buy**	1460	940
31	25-Apr-22	**Buy**	1250	900
32	25-Jul-22	**Buy**	1160	778
33	17-Oct-22	**Buy**	1030	762

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Ratings Guide (12 months)

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