Technology

Company Update

Change in Estimates ☑ Target ☑ Reco ☐

16 January 2023

Cyient

Services growth picking up, margins improve; Buy

Rating: **Buy**
Target Price: Rs.1,060
Share Price: Rs.876

At $168m (1.4% q/q, ~8% y/y; both est. org.), Cyient's Services growth has persisted over the last few quarters amid the brighter outlook on Aerospace. Outside acquisitions, growth was higher in core services. Orders were $237m, up 18% y/y (LTM up 14% y/y) with management expecting higher growth in Q4. The Services EBIT margin was 13.9%, up from 12.5% in Q2 on stretched utilization though. The DLM Business grew well in Q3 but operating and order details were not published due to the ongoing IPO process. No major change to estimates, barring legal expense in FY23 and FY24. The TP is slightly higher at Rs1,060, 16x FY25e EPS.

Aerospace back in the groove, Rail drag to reduce. Aerospace (up 4.4% cc) grew the most in the last four quarters and the company is hoping for ~10% q/q growth in Q4, based on orders won and large client ramp-ups. Rail (down 4.9% q/q, 21% y/y) has dragged over the last six quarters but is now likely to return to growth in H1 FY24. Communications (up 1.3% q/q cc), its largest vertical, is likely to be steady to marginally slow (per industry outlook by peers). Cyient closed five large deals in Q3, adding $59.2m.

FY24 margin expansion could be limited, as utilisation cools. Cyient's Q3 Services EBIT margin was up q/q, aided by higher utilisation (90.9% vs 84.6% in Q2) but affected by lower offshoring (down 180bps q/q). Ahead, offshoring is a lever for margins but utilisation normalisation will generate headwinds. Headcount declined by 311 to 14,693, and LTM attrition is still high at 26.5%. Therefore, we expect limited margin expansion in FY24. The Q3 consolidated PAT margin was 9.6% (up 397bps q/q, down 147bps y/y), affected by legal expenses (Rs67m, post-tax) which are likely to continue in FY24.

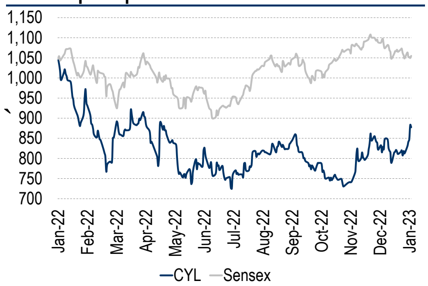
Buy, target revised to Rs.1,060 (from Rs.1,030). The stock quotes at 13x FY25e EPS of Rs.67, attractive given our expectation of a 14% revenue CAGR (Services 10.5%) and after factoring in risks due to the company's acquisitive nature. Reflecting these concerns, we value Cyient at 16x FY25e EPS. DLM (~15% revenue contribution, ~10% EBITDA contribution) value unlocking is going well. **Risk:** Slow growth in the communication vertical.

Key data	CYL IN / CYIE.BO
52-week high / low	Rs1052 / 720
Sensex / Nifty	60261 / 17957
3-m average volume	$2.2m
Market cap	Rs97bn / $1192.4m
Shares outstanding	111m

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

Estimates revision (%)	FY23e	FY24e	FY25e
Sales ($)	(0.2)	(0.6)	(1.0)
EBITDA	0.8	(1.8)	(1.0)
PAT	7.2	(3.1)	(0.7)

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY21	FY22	FY23e	FY24e	FY25e
Sales (Rs m)	41,325	45,344	58,952	70,117	78,146
Net profit (Rs m)	3,641	5,219	5,079	6,631	7,359
EPS (Rs)	33.1	47.8	46.6	60.8	67.5
P/E (x)	26.5	18.3	18.8	14.4	13.0
EV / EBITDA (x)	15.9	11.8	9.9	8.3	7.5
P/BV (x)	3.2	3.1	2.8	2.5	2.3
RoE (%)	13.2	17.2	15.6	18.4	18.4
RoCE (%)	9.1	12.5	13.2	14.9	15.5
Dividend yield (%)	1.9	2.7	2.2	2.9	3.2
Net debt / equity (x)	-0.4	-0.3	0.0	0.0	-0.0

Source: Company, Anand Rathi Research

Mohit Jain
Research Analyst

Krishna Thakker
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**	**731.9**	**853.6**	**951.3**
Growth (%)	**-10.9**	**9.2**	**20.3**	**16.6**	**11.5**
Net revenues (Rs m)	41,325	45,344	58,952	70,117	78,146
Employee & Direct Costs	27,161	28,456	36,721	44,785	50,777
Gross Profit	14,164	16,888	22,232	25,332	27,369
Gross Margin %	34.27	37.24	37.71	36.13	35.02
SG&A	8,056	8,672	12,403	13,579	14,450
EBITDA	**6,108**	**8,216**	**9,829**	**11,753**	**12,919**
EBITDA margins (%)	14.8	18.1	16.7	16.8	16.5
- Depreciation	1,944	1,923	2,494	2,765	2,965
Other income	1,091	1,121	551	806	824
Interest Exp	481	434	1,042	833	833
PBT	4,774	6,980	6,844	8,961	9,945
Effective tax rate (%)	24	25	26	26	26
+ Associates/(Minorities)	-	-	-	-	-
Net Income	3,641	5,219	5,079	6,631	7,359
WANS	110	109	109	109	109
FDEPS (Rs/share)	33.1	47.8	46.6	60.8	67.5

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	34,086	37,940	42,218
Total debt (including Pref)	2,755	3,264	4,264	3,264	2,264
Minority interest	-	-	-	-	-
DTL/(Asset)	-137	97	-151	-151	-151
Capital employed	**32,159**	**34,495**	**38,199**	**41,054**	**44,331**
Net tangible assets	7,181	6,787	9,920	8,858	7,638
Net Intangible assets	598	477	577	677	777
Goodwill	5,830	6,185	14,101	15,454	16,807
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 L	15,130	16,928	24,653	27,482	29,205
Cash	14,650	12,666	2,834	2,740	3,878
Current Liabilities (ex ST Loan/	12,450	13,130	17,904	18,175	17,992
Working capital	2,680	3,798	6,749	9,307	11,213
Capital deployed	**32,159**	**34,495**	**38,199**	**41,054**	**44,331**
Contingent Liabilities	566	553	-	-	-

Fig 3 – Cash Flow statement (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
PBT	4,774	6,980	6,844	8,961	9,945
+ Non-cash items	2,390	1,990	2,985	2,792	2,974
Operating profit before WC	7,164	8,970	9,829	11,753	12,919
- Incr./(decr.) in WC	-2,686	973	3,199	2,559	1,906
Others incuding taxes	-1,292	-1,652	-1,766	-2,330	-2,586
Operating cash-flow	8,558	6,345	4,865	6,865	8,428
- Capex (tangible + Intangible)	985	647	1,766	1,802	1,845
Free cash-flow	7,573	5,698	3,098	5,063	6,582
Acquisitions	721	225	12,179	1,353	1,353
- Dividend (including buyback &	10	2,952	2,127	2,777	3,082
+ 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	491	28	9
Net cash-flow	5,132	-1,984	-9,832	-94	1,139

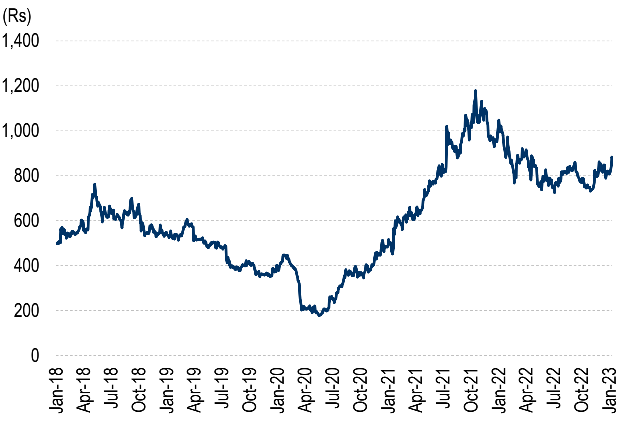
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year end Mar	FY21	FY22	FY23e	FY24e	FY25e
P/E (x)	26.5	18.3	18.8	14.4	13.0
EV/EBITDA (x)	15.9	11.8	9.9	8.3	7.5
EV/sales (x)	2.35	2.14	1.65	1.38	1.24
P/B (x)	3.2	3.1	2.8	2.5	2.3
RoE (%)	13.2	17.2	15.6	18.4	18.4
RoCE (%) - After tax	9.1	12.5	13.2	14.9	15.5
RoIC (%) - After tax	13.8	19.9	16.5	15.9	16.6
DPS (Rs per share)	17.0	24.0	19.5	25.5	28.2
Dividend yield (%)	1.9	2.7	2.2	2.9	3.2
Dividend payout (%) - Inc. DDT	51.4	50.2	50.2	50.2	50.2
Net debt/equity (x)	-0.4	-0.3	0.0	0.0	-0.0
Receivables (days)	91	79	92	94	94
Payables (days)	47	52	51	48	45
CFO:PAT%	235.0	121.6	95.8	103.5	114.5
FCF:PAT% - includ M&A payou	188.2	104.9	-178.8	55.9	71.1

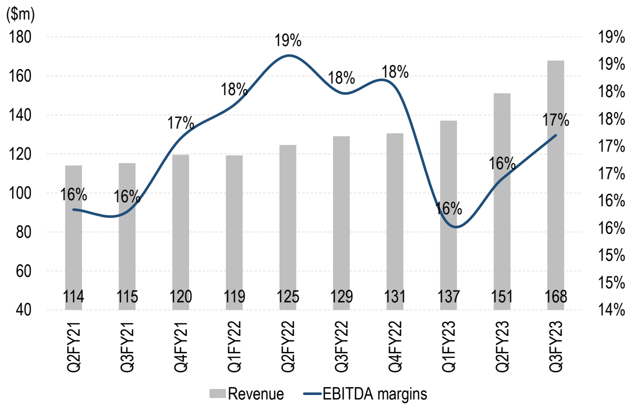
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Cyient's performance



Source: Company, Anand Rathi Research

Result Highlights

Q3 FY23 Results at a Glance

Fig 7 – Q3 FY23 results (Rs m)

	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q/Q	Y/Y%
Revenue Services ($ m)	129	131	137	151	168	11.1%	30.1%
Growth Y/Y %	11%	9%	12%	8%	8%		
Industry Y/Y % (est.)	21%	20%	16%	13%	9%		
Revenue (Rs m)	11,834	11,812	12,501	13,962	16,182	15.9%	36.7%
Effec. exchange rate	74.9	75.4	77.4	79.9	82.1	2.8%	9.6%
TCV Services ($ m)	201.0	188.0	141.0	129.0	237.1	83.8%	18.0%
TCV Services(LTM)	610.0	632.0	653.0	659.0	695.1	5.5%	14.0%
Y/Y %	13%	13%	18%	5%	18%		
TCV:Rev.	1.6	1.4	1.0	0.9	1.4		
Employees Services (EoP)	12,173	12,834	13,581	15,004	14,693	-2.1%	20.7%
Rev. prod. ($ '000/employee)	10.7	10.4	10.4	10.6	11.3	7.0%	6.0%
Utilisation % (IT Services)	86.2%	86.1%	80.9%	84.6%	90.9%	630 bps	470 bps
Attrition %	29.3%	26.9%	27.9%	28.4%	26.5%	-190 bps	-280 bps
CoR (excl. D&A)	7,534	7,293	7,900	8,595	10,063	17.1%	33.6%
As % of revenue	64%	62%	63%	62%	62%	63 bps	-148 bps
SG&A	2,173	2,383	2,654	3,077	3,336	8.4%	53.5%
As % of revenue.	18%	20%	21%	22%	21%	-142 bps	225 bps
EBITDA	2,127	2,136	1,947	2,290	2,783	21.5%	30.8%
EBITDA margins %	18%	18%	16%	16%	17%	80 bps	-78 bps
EBIT	1,640	1,707	1,436	1,660	2,084	25.5%	27.1%
EBIT margins %	14%	14%	11%	12%	13%	99 bps	-98 bps
Industry margins % (est.)	17.9%	17.3%	16.4%	15.1%	15.2%	12 bps	-275 bps
Other income (excl. forex)	111	285	161	128	96	-25.0%	-13.5%
Non-recurring / Forex	110	209	175	(358)	112	NM	1.8%
Interest expenses	(116)	(117)	(177)	(345)	(215)	-37.7%	85.3%
PBT	1,745	2,084	1,595	1,085	2,077	91.4%	19.0%
PBT margins %	15%	18%	13%	8%	13%	506 bps	-191 bps
Taxes	(430)	(543)	(435)	(294)	(517)	75.9%	20.2%
ETR %	-25%	-26%	-27%	-27%	-25%	221 bps	-25 bps
Associates / Minority	-	(0)	0	-	-		
Net income	1,315	1,541	1,160	791	1,560	97.2%	18.6%
Net margins %	11%	13%	9%	6%	10%	397 bps	-147 bps
Industry net margins %	14.0%	14.3%	12.5%	11.8%	11.8%	1 bps	-217 bps
EPS (Rs)	12.1	14.1	10.6	7.2	14.3	98.6%	18.2%

Source: Company, Anand Rathi Research. Note: Y/Y growth of 8% is estimated organic growth.

Fig 8 – Quarterly results

Year-end: Mar (Rs m)	Q3FY23	% chg. Q/Q	% chg. Y/Y	9M as % of FY23	FY23e	FY23e % chg. Y/Y	FY24e % chg. Y/Y
Sales ($ m)	168	11.1	30.1	73	628	24.7	16.9
Sales	16,182	15.9	36.7	72	58,952	30.0	18.9
EBITDA	2,783	21.5	30.8	71	9,829	19.6	19.6
EBITDA margin (%)	17.2	80bps	-78bps	-	16.7	-145bps	9bps
EBIT	2,084	25.5	27.1	71	7,335	16.6	22.5
EBIT margin (%)	12.9	99bps	-98bps	-	12.4	-144bps	38bps
PBT	2,077	91.4	19.0	70	6,844	(1.9)	30.9
Tax	(517)	75.9	20.2	71	(1,766)	0.3	32.0
Tax rate (%)	(24.9)	221bps	-25bps	-	(25.8)	-57bps	-20bps
Net income	1,560	97.2	18.6	69	5,079	(2.7)	30.6

Source: Company, Anand Rathi Research

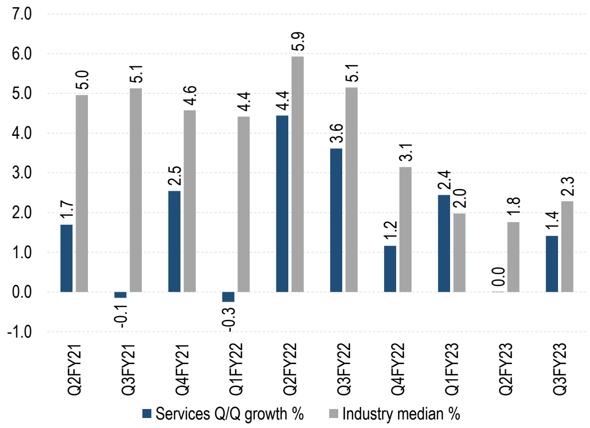
Aerospace back in the groove

In Q3, Services growth picked up for Cyient, driven by new growth areas (auto, healthcare, hi-tech, and semi) growing 8% q/q, MEU (mining, energy and utilities) growing 7%, and Aerospace delivering an impressive 4%. Communication was soft sequentially but should grow in line ahead, per management. Peer commentary on the vertical is not very optimistic, with many companies looking at slower growth in the vertical.

Overall, Cyient has covered up some ground on the growth side compared to peers (LTTS expected to grow 13% in FY23 vs Cyient at 9%), we expect more convergence in FY24 as Cyient accelerates on Aerospace. From a diversification standpoint, recent acquisitions will play an important role in improving Cyient's capabilities.

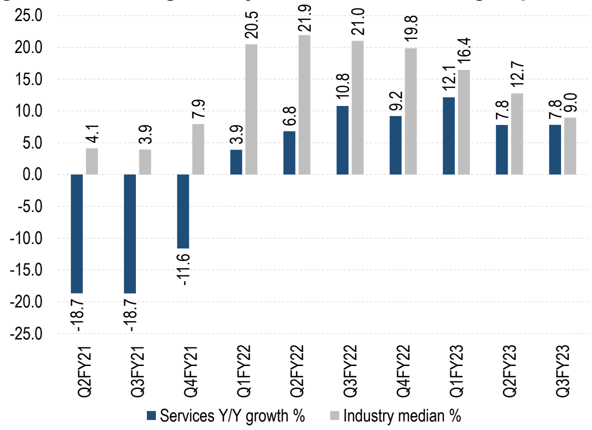
For the last two years, Cyient has been delivering 9% growth in Services in dollar terms. However, in FY23, in CC terms, growth has been higher for Cyient, thereby reducing the gap with the industry. In Q3 FY23, Cyient's Services business grew y/y for the seventh consecutive quarter. Management is confident of delivering 13% constant currency growth at the company level (excl. acquisitions).

Fig 9 – Services back to q/q growth, slightly behind industry



Source: Company, Anand Rathi Research

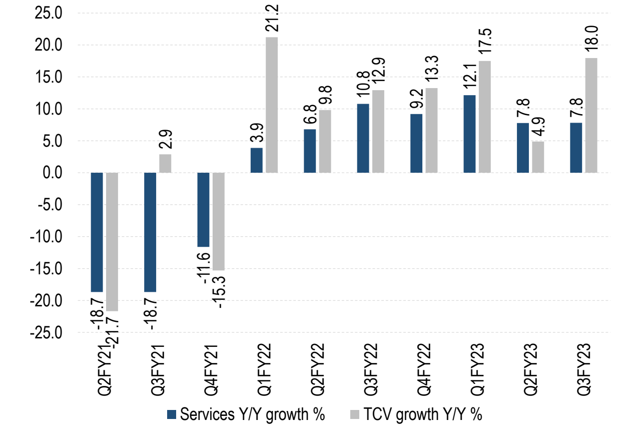
Fig 10 – Grows organically for the seventh straight quarter



Source: Company, Anand Rathi Research

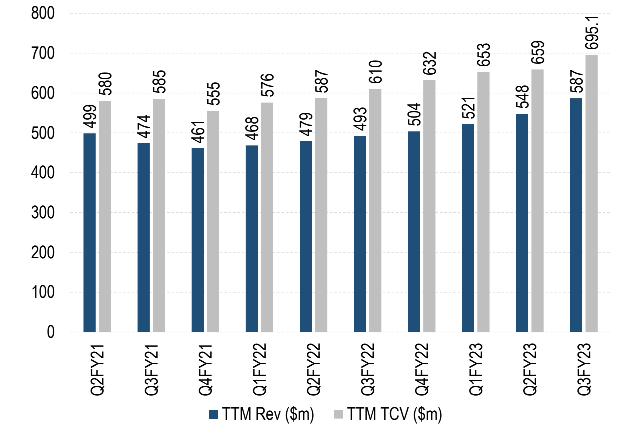
On orders, the company had a strong, Q3 at $237m (up 18% y/y). Notably, in Q3, order intake was ahead of revenue, reverting to the trend before Q2. A&D (up 6% y/y in dollar terms) has been growing (y/y) for the last six quarters. Rail (down 27% y/y) continues to be a drag due to consolidation of vendors, forex movements and more offshoring. However, management has guided to a return to growth in this segment from Q4 as the bulk of the ramp-downs are behind.

Fig 11 – TCV growth ahead of revenue growth in Q3



Source: Company, Anand Rathi Research

Fig 12 – TTM revenue and TTM TCV of Services



Source: Company, Anand Rathi Research

On a TTM basis, revenues and TCV have been moving up in the last seven quarters. In Q3, Cyient signed five large deals (Services), with TCV potential of $59.2m. In Q2, Cyient had signed five large deals (four in Services, one in DLM) with TCV potential of $105.2m.

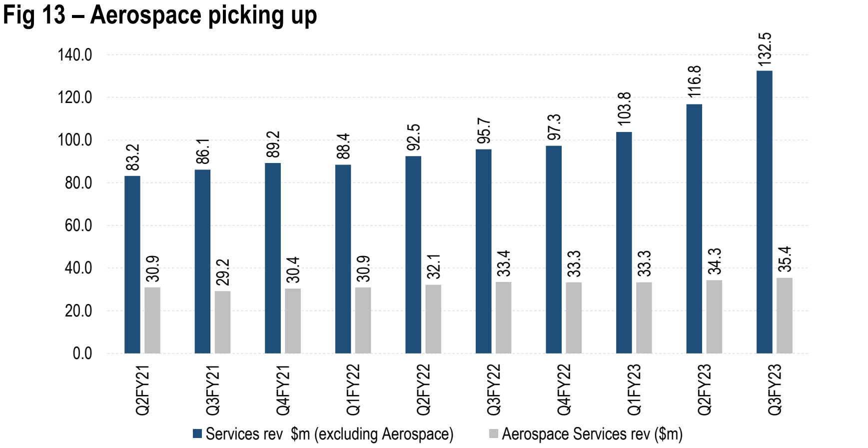
Aerospace, Communications, new growth areas drive y/y growth

Cyient's Services depends on two major verticals, Aerospace (21% of revenue) and Communications (24%). The rest is diversified across verticals with MEU adding 12% of revenue and new growth areas (a cluster of four industries) adding another 18%.

In Aerospace, management is seeing demand accelerating ahead as its key clients step up spending on digitisation, electrification, and new aircraft. Besides, as China opens up, Aerospace demand is likely to get a boost. This vertical was the highest contributor to revenue before the pandemic.

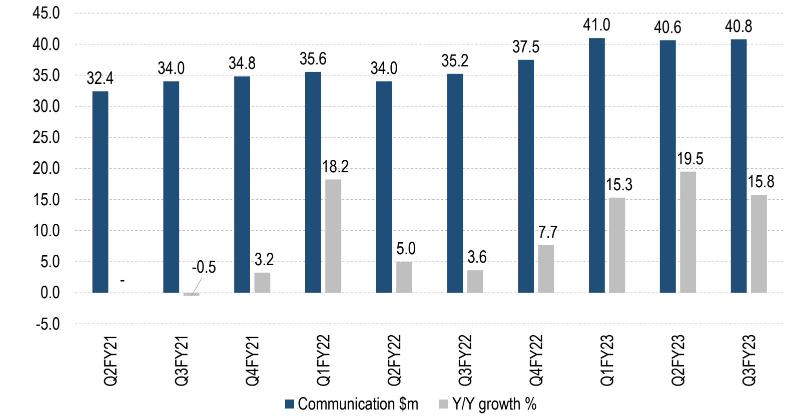
In Q3, Communications was flattish in dollar terms but grew ~1% in constant currency. Ahead, it is expected to grow at the company level. Per management, Q3 had some contracts coming to an end. The company is optimistic on network transformation and modernisation in the areas of fibre roll-out, wireless and 5G and, therefore, expects growth to continue.

Fig 13 – Aerospace picking up



Source: Company, Anand Rathi Research

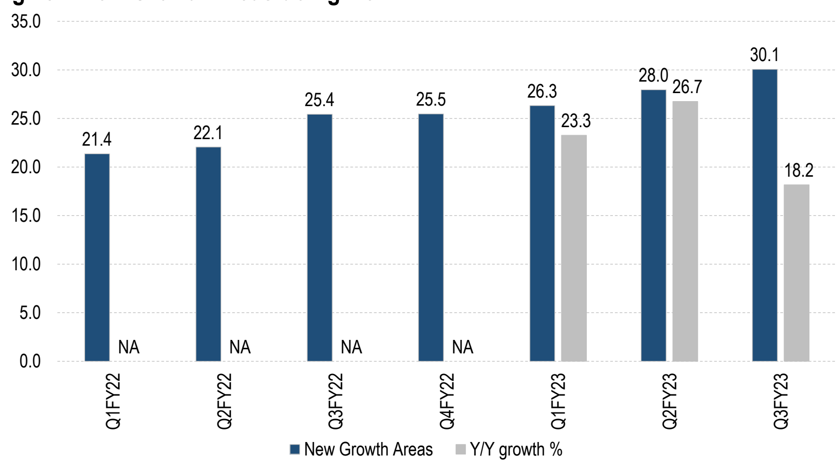
Fig 14 – Communication steady over last few quarters



Source: Company, Anand Rathi Research

In Q3, New Growth Areas grew 18% y/y, decelerating but still growing fast. Within this vertical, Automotive has been doing well and management shared that it is on track to double revenues in this sub-vertical. One of the five large deals closed in Q3 were from Automotive and the company expects it to be a growth driver ahead.

Fig 15 – New Growth Areas doing well



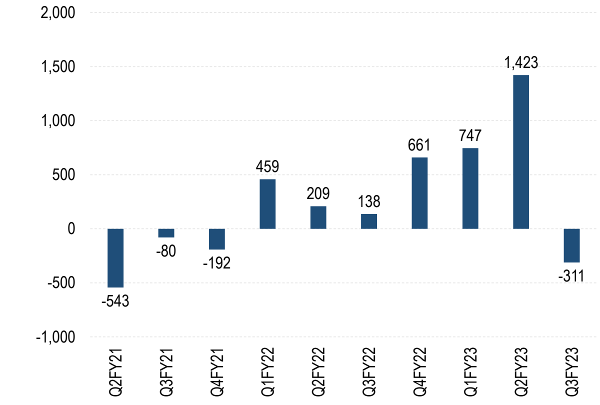
Source: Company, Anand Rathi Research

Manpower and attrition decline; productivity improves

Cyient added only 2,520 employees in the last twelve months (in Services, net decline of 311 in Q3), which led to utilisation moving up to a high 90.9% in Q3 FY23 (compared to 86.2% a year ago). Headcount declined in Q3 despite the easing supply situation, improving growth, high utilisation and attrition, surprisingly, perhaps due to possible business acceleration in the second half of the quarter. Since revenue visibility is higher currently (as measured by order intake and commentary), we expect hiring to accelerate in Q4 and in FY24, leading to some headwinds at the margin levels. These headwinds can be absorbed through higher offshore but the performance there so far has been a mixed bag.

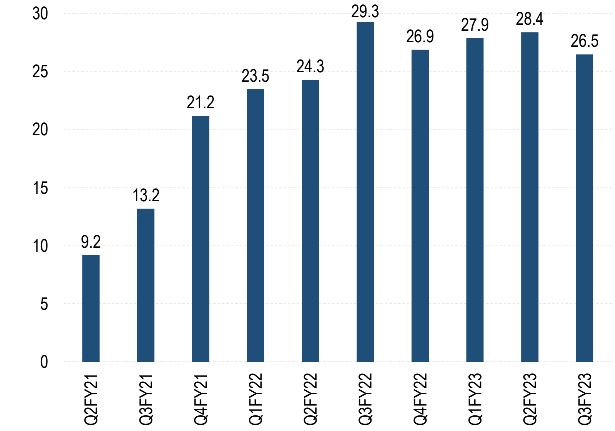
Therefore, while we estimate expansion in margins for many IT companies, we are keeping our margins steady for Cyient at the EBITDA level.

Fig 16 – Headcount declines, despite high utilisation and attrition



Source: Company, Anand Rathi Research

Fig 17 – Attrition beginning to cool off

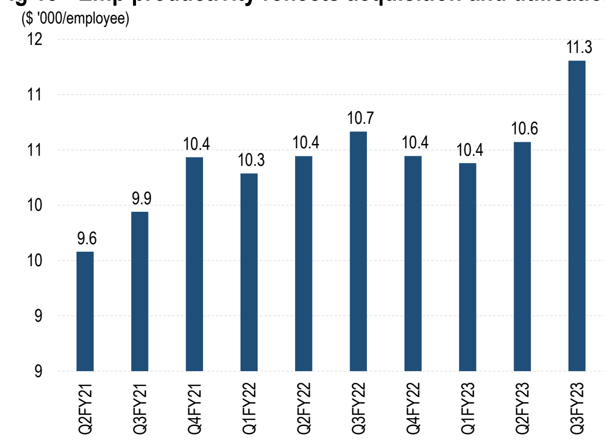


Source: Company, Anand Rathi Research

Attrition has moved down to 26.5% on an LTM basis, from 28.4% in Q2. Other companies are seeing improvements in attrition and slower net additions; on the back of this, we expect Cyient to benefit on the supply and the cost sides.

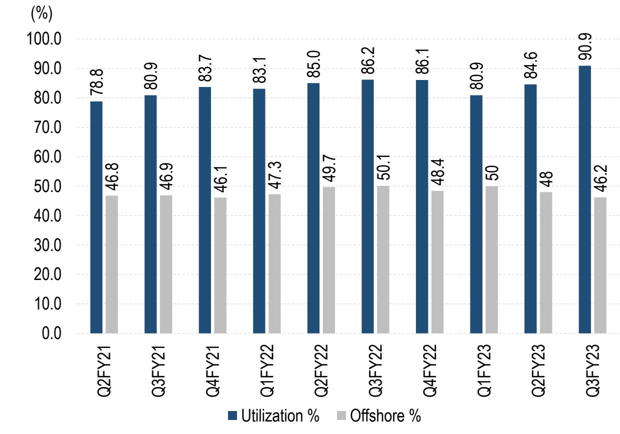
From an employee-productivity perspective, Cyient has improved substantially in Q3 (7% q/q, 6% y/y). This is on account of three factors – 1) Full three-month integration of the acquisition, 2) Utilisation going up substantially to 90%+ and 3) Higher onsite ramp-up. Ahead, we expect some moderation on account of our expectations of higher headcount addition leading to lower utilisation and on higher offshore to support margins. Offshoring for Cyient is still favourable as a lever compared to the industry, and can offer margin tailwinds.

Fig 18 - Emp productivity reflects acquisition and utilisation



Source: Company, Anand Rathi Research

Fig 19 – Utilisation at a high; offshoring, a lever for margins



Source: Company, Anand Rathi Research

EBIDTA / PAT growth

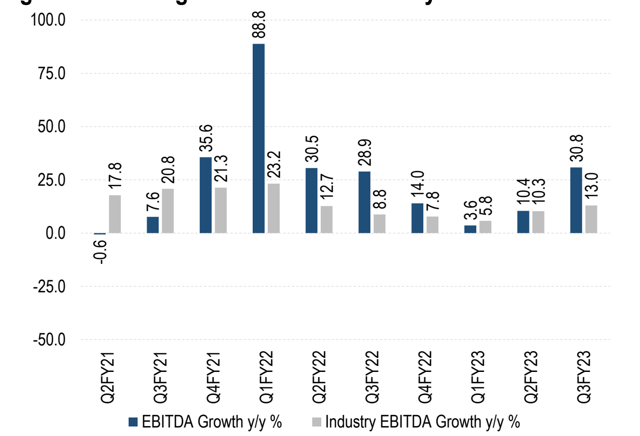
In Q3, Cyient recorded better EBITDA growth than the industry (up 30.8% y/y). This was possible due to the organic business growth and on integration of many acquisitions during the year, which are accretive at the EBITDA level. Hence, the performance is not strictly comparable.

In Q3, the company delivered a 12.9% EBIT margin (up 99bps q/q, down 98bps y/y). For FY23, Cyient guided to 13-14% EBIT margins at the consolidated level, unchanged. On the Services front, it delivered 13.9% margins, up 147bps q/q. Ahead, we expect consolidated margins to be at similar levels despite reduced supply-side pressures, as utilisation is unsustainably high in our opinion and due to the initial increase in project ramp-ups onsite.

Net income was up 19% y/y after taking into account legal fees of Rs89m in Q3. There is a civil class-action antitrust lawsuit filed against the company in the US alleging involvement of Cyient in restricting employment of individuals. There are other defendants as well in this case. The legal expenses are likely to persist in Q4 and in FY24. In our revised estimates, we have assumed similar expenses in each of the next three quarters.

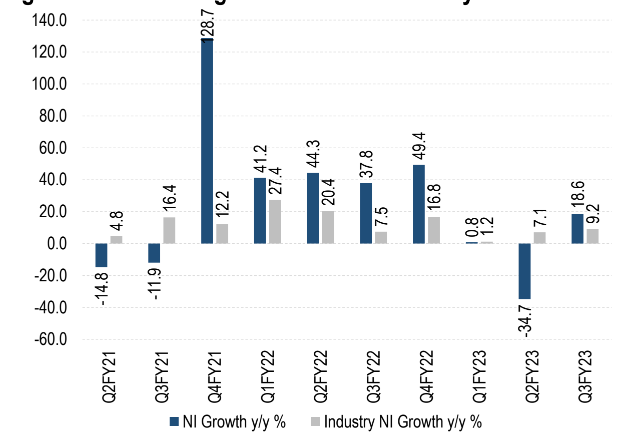
The Q3 NI margin was 9.6% (up 397bps q/q, down 147bps y/y). Sequential improvement was due to lower legal expenses in Q3 (Rs89m vs Rs216m in Q2) and absence of M&A-related expenses (Rs211m in Q2).

Fig 20 – EBITDA growth ahead of industry



Source: Company, Anand Rathi Research

Fig 21 – Net Income growth ahead of industry



Source: Company, Anand Rathi Research

Conference-call highlights

Q3 FY23 concall highlights

- Services CC growth without acquisition is 3.7% q/q, 10.6% y/y.
- Organic service growth in 9M FY23 is 11% cc.
- Automotive on track to double in revenue in FY23.
- Momentum in communication is good and the company is bullish on this segment.
- Aerospace to grow in double digits q/q in Q4, as OEMs have started spending money, Cchina is opening up and large customers are working on new engines and aircrafts.
- Expect Mining to grow very well ahead.
- Rail to come back to growth trajectory by Q4.
- Signed five large deals, two in Aerospace, two in E&U, and one from automotive, leading to a potential TCV of $59m.
- Order intake is up 18% organically, led by aerospace, communication, automotive and mining.
- Pipeline is up 1.5x y/y, with large deals accounting for 70% of the pipeline
- Acquisitions are accretive at the EBITDA level but not at the EBIT level.
- Legal charges to continue beyond Q4.
- One-off costs will be there in Q4 due to re-negotiation of hardware contracts/ giving up space.
- Company to increase bench.

Outlook

- Q4 growth to be higher than Q3 on cc basis. EBIT margin to expand.
- FY23: Organic business to grow close to 13% cc in FY23. Another 14-15% cc growth to be added from acquisitions announced so far.
- Normalised FY23 EBITDA to be 16-17%, higher end of this.
- FY24: Company to reach $1bn rate in FY24.
- FY24 EPS to be at least Rs60. ETR to be 25-26%.

Q2 FY23 concall highlights

- Cyient had the highest billed hours in Q2 and, in terms of volumes, grew 6.8% sequentially. Most of this growth was in offshore, leading to 3% revenue growth.
- In Aerospace, management is seeing demand increase steadily and sees opportunities in both, the commercial and defence arenas. It expects to clock 10% cc growth for the year in this business unit. Defence is 15-20% of Aerospace and should do well ahead.
- In the rail business, the company is cautious and expects to recover by the year-end.

- In communications, demand continues to be high in the network rollout momentum across fibre and 5G. In Q2, Communications BU had as one-off execution issue but that is now behind.
- Mining BU's growth momentum to continue.
- DLM to do better in H2 than in H1 as the company signed a really large order from Honeywell.
- All four acquisitions have been concluded in Q2. Citec has been integrated for a month and Celfinet for two.
- One or two projects have been deferred, not cancelled. Therefore, the impact on the business from macro is currently minimal.
- Margin experienced headwinds from wage hikes to the tune of 1.5% as 90% of wage hikes were done. This impact was cushioned by better pricing, automation and currency depreciation.
- All M&A are accretive at an EBITDA level.
- The margin was also affected by two items: an exceptional one (legal fee) had a 1.8% impact, and a one-time acquisition-related expense had a 1.7% impact. The former will persist for a few quarters, though not at the Q2 level.
- FY23 growth (organic) would be 13-15% cc. DLM to deliver high single-digits to 10% growth in FY23. Acquisitions to add 14-15% cc in revenue.
- Expect to reach $1bn run rate by Q2-Q3 FY24.
- Group EBITDA margin to be 16-17%.
- EBIT margin to be 13-14% for the organic business.
- FY23 ETR to be 27%.
- Q4 FY23 EPS to be Rs14-15.
- FY24 EPS to be at least Rs60.

Q1 FY23 concall highlights

- Inorganic services revenue growth came at 2.9% q/q and the strategic buyout (to accelerate a ramp-up with a strategic customer) contributed 1.1% q/q growth.
- Citec acquisition to be closed in Q2 FY23. This will enhance Cyient's position in the Plant and Product Engineering sector, strengthen its presence in the energy industry with a focus on clean energy and expand its European footprint.
- Grit Consulting extends capabilities of Cyient Consulting, further enabling Cyient's consulting-led, industry-centric and technology-solutions growth aspiration. Some part of Grit's revenue came in Q1.
- Celfinet to strengthen Cyient's Wireless Engineering practice, for a 5G roll-out specifically. Acquisition closed on the last day of quarter; hence, no revenue was recorded in Q1. Again, to contribute from Q2.
- Closed a large deal (MSA) with an automotive customer, expected to become one of the top-5 customers in 12-24 months. Strategic buyout done for this customer, and came with 500 employees.
- Aerospace seeing some green-shoots but growing slower than anticipated. Added two logos in Urban air mobility

- Rail & Transportation affected by consolidation of vendors, offshoring and forex. This should reverse in H2 FY23. Expanding into Rail signalling embedded and DT.
- The company is very bullish on Communications led by the network transformation and modernisation in fibre rollout, wireless and 5G.
- DLM won the largest multi-year deal in aerospace with the Farnborough air-show to build a digital cockpit for avionics; this is for a general aviation and business aviation aircraft system.
- Mining, Energy & Utilities was hit by the Utilities business as some contracts that ended in Q4 were not renewed/replaced fast enough. Ahead, mining growth will be driven by sustainable mining, clean-energy resources and Grit Consulting. E&U to recover in H2 FY23.
- Healthcare and Life-science added a customer (life-sciences), which is a new line of business for Cyient
- Hi-tech (earlier geospatial). The company is trying to take this to Enterprise customers in Mining, Communications, Automotive and Utilities.
- Margins down due to wage hikes in Q1 and lower utilisation as the company builds the bench. Margin levers include higher pricing in some pockets of customers, utilisation, automation and revenue mix.
- DLM EBIT margin had a one-off in Q1; without this, it would be 7%
- Citec's EBIT to be 10-11% in year one; then be at company average. Other acquisitions higher than the company's EBIT margin.
- Expect headwinds from wage hikes in Q2 and Q3. Hikes spread over three quarters, largest done in Q1.
- The company is likely to pause acquisitions as it concentrates on integrating the three recent acquisitions.
- DLM confident of delivering 50% FCF: NI was negative in Q1.
- Revenue growth in constant currency to be 13-15% in FY23. DLM to deliver high single-digit growth in FY23. Acquisitions (excluding Citec) to add 6-7% growth in FY23.
- Organic FY23 EBIT margin to be 13-14% (acquired entities have similar margins on a consolidated basis). DLM margin to be 7% in H1; could improve in H2.
- ETR to be ~27% for FY23

Q4 FY22 concall highlights

- Demand continues to be robust; supply side is an issue which the company is trying to address now.
- Within Services, the company expects Aerospace to grow faster and C&U continues to grow as it builds scale.
- Rail volume rose 7% in FY22 but revenue was down 3% due to a significant amount of offshoring. The company expects growth to resume in H2 FY23 on account of a few deals and on completion of consolidation at its top clients.
- The company is positive on the Communications vertical and hopes for double-digit growth in FY23.

- In Utilities, Cyient won a strategic program from a new client in APAC; in this it expects significant revenue growth in FY23 and beyond.
- DLM - Materials availability and longer lead-time continue to be a challenge in executing the order backlog. The company expects this to persist in Q1 FY23.
- The Automotive vertical is seeing robust demand, and expects significant growth in FY23 given investments made by Cyient.
- Attrition came down 250bps in Q4 to 26.9%, and 26.2% for the year. The company expects this to trend down.
- Salary hikes would be a major headwind in FY23. Wage hikes in FY22: 10% in India, 2% overseas. Hikes to be higher in FY23 (12% India, 4% overseas) than in FY22. Salary hikes over three quarters, as last year.
- Cyient to add 15-17% of workforce in FY23. Anticipate offshore to increase from current levels.
- ETR to be 27% in FY23. Will revisit the transition to the new tax regime in FY23 and take a call accordingly.
- Lawsuit filed against Cyient for employee-hiring process. Negative outcome now expected.
- Revenue growth 13-15% in cc. DLM growth in high single-digits.
- FY23 EBIT margin: 13-14%, hard to improve margins beyond this.
- ETR to be 27% in FY23.

Q3 FY22 concall highlights

- Launched consulting practice to aid companies with efficiency, asset optimization, DT, technology adoption, etc.
- Hived off SDR division to ICS (Invocation Communication Solutions). Cyient was developing SDR for a large opportunity from the department of defense (India). Cyient decided to let specialized player, ICS takeover this product. Cyient will get 15% stake in ICS and Cyient DLM will remain their manufacturing partner after the deal. Cyient will also earn a royalty because of the product given to them. An advantage of this divestment is that the company no longer has an obligation to restrict foreign ownership to 49%. SDR arrangement had an outflow of Rs.100m in exchange for the 15% stake. Cyient has transferred the technology and the product will be finished by ICS.
- DLM impacted due to supplychain challenges in semiconductor industry. DLM grew in Q3 challenge continues on order fulfilment due to material unavailability and longer lead times. These challenges will persist in Q4 and hence, Cyient may see steep decline in 4Q revenues (~20% y/y).
- Delivered 15.6% margin in Q3 despite headwinds from lower billing days and investment in retaining people. DLM at 6% EBIT margin.
- Aerospace vertical is seeing green shoots in top accounts. Regional 90% is back in aerospace compared to pre-covid, long haul and intercontinental at 50-60% and will take 12-18months to fully recover.
- Rail and transportation declined due to consolidation challenges in top accounts and due to work moving offshore. Expects growth to come back in FY23.Communication & Utilities won some large deals, outlook is positive for FY22. In Portfolio of services 4 out of 6 grew +20% y/y.

- Pipeline is up 25-27% y/y, Order intake 16% up y/y. Number of deals that Cyient is participating in increased by 3x over last 12 months. 85-90% of order intake executable over the next twelve months.
- New age tech this business growing twice the company's growth rate, continue to make investment here. New gen tech areas contribute 25-27% of revenue this was 18-19% a year ago
- Overall, capacity has increased more than what net addition shows as work is getting delivered through partners and Subcontractors. In Q4, company is ramping up headcount addition and expects net addition to be equal to first three quarters of the year.
- Top5 clients to get back to growth in 2-3 quarters.
- Compensation hikes in CY2022 higher than CY2021. Ability to move to automation, price hikes and pyramid optimization are levers for margin.
- DLM biggest challenge is chip availability. DLM there is business where they make 10-15% margin and there is some where they breakeven or make marginal EBIT margin.Now, prioritizing only 8-10% EBIT margin businesses due to chip shortage. Chip shortage to stabilize in 12-18months. Absolute EBIT guidance will be achieved. DLM to grow mid-single digit in FY22 now.
- Expect to grow double digit in Services.
- DLM will deliver mid-single digit growth (revised down from 15-20%) but will deliver better margin and similar EBIT.
- Full year EBIT margin to improve by 350bps
- FY22 ETR 25% or little lower.

Factsheet

Fig 22 – Revenue, by area, %

	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
US	49	54	51	50	48
Europe	25	25	23	26	30
APAC	26	22	26	24	22

Source: Company, Anand Rathi Research

Fig 23 – Revenue, by industry, %

	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Aerospace & Defense	35	32	31	27	27
Transportation	9	9	8	7	6
Communications	22	24	25	23	21
Portfolio	27	29	28	28	27
Energy and Utilities	6	6	5	5	5
Others (incl. M&A)	-	-	3	10	16

Source: Company, Anand Rathi Research

Fig 24 – Onsite-offshore revenue mix, %

	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Offshore	50	48	50	48	46
On-site	50	52	50	52	54

Source: Company, Anand Rathi Research

Fig 25 – Client concentration, %

	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Top 5	28	27	28	25	26
Top 10	42	39	39	37	37
Client bucket growth rates %					
Top 5	9	(17)	(2)	(7)	15
Top 6-10	58	24	15	22	(2)
Beyond Top 10	6	14	21	29	35

Source: Company, Anand Rathi Research Note: growth rates are y/y.

Fig 26 – Number of employees

	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Services	12,173	12,834	13,581	15,004	14,693
Total	12,845	13,428	14,147	15,598	15,355

Source: Company, Anand Rathi Research

Fig 27 – Employee parameters, %

	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Attrition %	29.3	26.9	27.9	28.4	26.5
Utilisation	86.2	86.1	80.9	84.6	90.9

Source: Company, Anand Rathi Research

Fig 28 – Key segments' growth Y/Y, %

	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Region					
US	12.1	17.7	20.6	20.3	20.7
Europe	10.8	4.5	-10.0	22.1	50.6
APAC	11.7	-17.6	23.5	4.1	7.3
Industry					
Aerospace & Defense	19%	-2%	7%	-1%	-4%
Transportation	-12%	-14%	-23%	-31%	-25%
Portfolio	15%	14%	20%	17%	22%
Communications	4%	7%	15%	20%	15%

Source: Company, Anand Rathi Research

Valuations

Revenue grew 9% in FY22 (FY23e, 20%, including acquisitions), slower than the industry on account of a gradual recovery in Aero and persistent weakness in Rail. However, the company seems to be returning to growth, with the deal momentum building up on the Services side, Aerospace is looking up and Rail would return to a growth trajectory by Q4 (or Q1 FY24).

Ahead, we expect revenue to clock 14% compound annual growth over FY23-25, of which ~11% should come from Services.

The EBIT margin expanded 380bps in FY22 (to 13.9%) but is expected to slip to ~12.4% in FY23 before stepping up to ~12.8% in FY24 and staying stable in FY25. Some part of margin gains here are coming from D&A while the EBITDA margins would be largely stable from FY23-25. This reflects our expectations of moderation in utilisation from current levels of 90%+. Cyient will have offshoring as a lever to offset some of these cost pressures but it has not been able to use offshoring in a big way over the last two years. 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 FY23e PAT has been increased (7%) largely due to lower legal fees than previously assumed, while FY24e PAT has been slightly reduced due to slightly lower margin expectations and on continuing legal expenses next year as well. Our target is revised up slightly to Rs1,060 (Rs1,030 previously). 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 acquisitions is mixed at best; hence, we believe the company carries some integration risks.

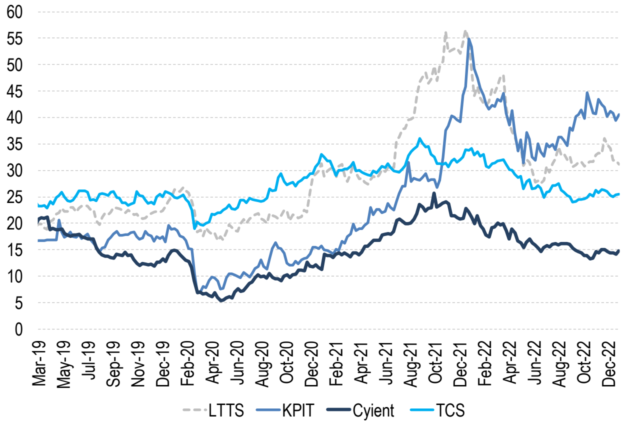
The stock trades at 13x FY25e EPS of Rs67. Our target price is based on 16x FY25e EPS. At this price, Cyient will trade at a ~40% discount to the sector leader, LTTS, which we think is fair given the difference in portfolio and performance of the two large pure-play engineering-services companies.

Fig 29 – Change in estimates

(Rs m)	FY23			FY24			FY25		
	New	Old	% Change	New	Old	% Change	New	Old	% Change
Revenue ($ m)	732	733	(0.2)	854	859	(0.6)	951	961	(1.0)
Revenues	58,952	59,053	(0.2)	70,117	70,494	(0.5)	78,146	78,909	(1.0)
EBITDA	9,829	9,747	0.8	11,753	11,965	(1.8)	12,919	13,047	(1.0)
EBITDA margins %	16.7%	16.5%	17 bps	16.8%	17.0%	-21 bps	16.5%	16.5%	0 bps
EBIT	7,335	7,359	(0.3)	8,989	9,174	(2.0)	9,954	10,053	(1.0)
EBIT margins %	12.4%	12.5%	-2 bps	12.8%	13.0%	-19 bps	12.7%	12.7%	0 bps
Net profit	5,079	4,737	7.2	6,631	6,842	(3.1)	7,359	7,410	(0.7)

Source: Anand Rathi Research

Fig 30 – PE band



Source: Bloomberg, Anand Rathi Research

Risk

- Slow growth in the Communication vertical.

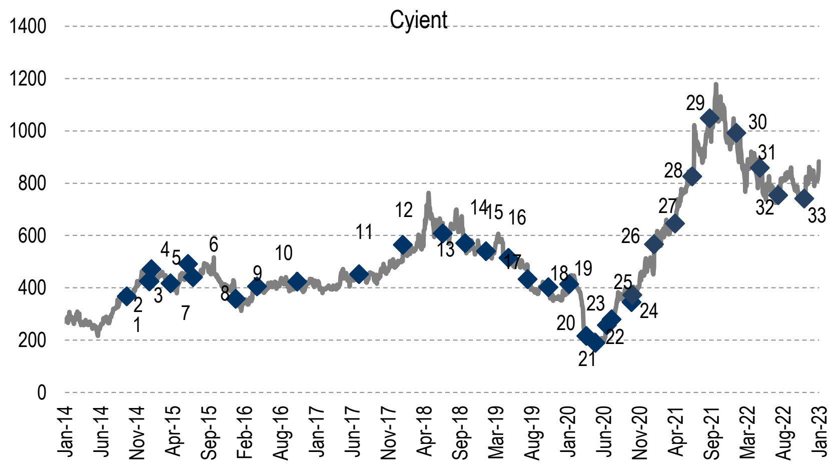
Appendix

Analyst Certification

The views expressed in this Research Report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. The research analysts are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter "SEBI") and the analysts' compensation are completely delinked from all the other companies and/or entities of Anand Rathi, and have no bearing whatsoever on any recommendation that they have given in the Research Report.

Important Disclosures on subject companies

Rating and Target Price History (as of 13 January 2023)



	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

Anand Rathi Ratings Definitions

Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US$1bn) and Mid/Small Caps (<US$1bn) as described in the Ratings Table below:

Ratings Guide (12 months)	Buy	Hold	Sell
Large Caps (>US$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US$1bn)	>25%	5-25%	<5%

Research Disclaimer and Disclosure inter-alia as required under Securities and Exchange Board of India (Research Analysts) Regulations, 2014

Anand Rathi Share and Stock Brokers Ltd. (hereinafter refer as ARSSBL) (Research Entity, SEBI Regn No. INH000000834, Date of Regn. 29/06/2015) is a subsidiary of the Anand Rathi Financial Services Ltd. ARSSBL is a corporate trading and clearing member of Bombay Stock Exchange Ltd, National Stock Exchange of India Ltd. (NSEIL), Multi Stock Exchange of India Ltd (MCX-SX), and also depository participant with National Securities Depository Ltd (NSDL) and Central Depository Services Ltd. ARSSBL is engaged into the business of Stock Broking, Depository Participant, Mutual Fund distributor.

The research analysts, strategists, or research associates principally responsible for the preparation of Anand Rathi research have received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors and firm revenues.

General Disclaimer: This Research Report (hereinafter called "Report") is meant solely for use by the recipient and is not for circulation. This Report does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. The recommendations, if any, made herein are expression of views and/or opinions and should not be deemed or construed to be neither advice for the purpose of purchase or sale of any security, derivatives or any other security through ARSSBL nor any solicitation or offering of any investment /trading opportunity on behalf of the issuer(s) of the respective security (ies) referred to herein. These information / opinions / views are not meant to serve as a professional investment guide for the readers. No action is solicited based upon the information provided herein. Recipients of this Report should rely on information/data arising out of their own investigations. Readers are advised to seek independent professional advice and arrive at an informed trading/investment decision before executing any trades or making any investments. This Report has been prepared on the basis of publicly available information, internally developed data and other sources believed by ARSSBL to be reliable. ARSSBL or its directors, employees, affiliates or representatives do not assume any responsibility for, or warrant the accuracy, completeness, adequacy and reliability of such information / opinions / views. While due care has been taken to ensure that the disclosures and opinions given are fair and reasonable, none of the directors, employees, affiliates or representatives of ARSSBL shall be liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way whatsoever from the information / opinions / views contained in this Report. The price and value of the investments referred to in this Report and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance. ARSSBL does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding taxation aspects of any potential investment.

Opinions expressed are our current opinions as of the date appearing on this Research only. We do not undertake to advise you as to any change of our views expressed in this Report. Research Report may differ between ARSSBL's RAs and/ or ARSSBL's associate companies on account of differences in research methodology, personal judgment and difference in time horizons for which recommendations are made. User should keep this risk in mind and not hold ARSSBL, its employees and associates responsible for any losses, damages of any type whatsoever.

ARSSBL and its associates or employees may; (a) from time to time, have long or short positions in, and buy or sell the investments in/ security of company (ies) mentioned herein or (b) be engaged in any other transaction involving such investments/ securities of company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) these and other activities of ARSSBL and its associates or employees may not be construed as potential conflict of interest with respect to any recommendation and related information and opinions. Without limiting any of the foregoing, in no event shall ARSSBL and its associates or employees or any third party involved in, or related to computing or compiling the information have any liability for any damages of any kind.

Details of Associates of ARSSBL and Brief History of Disciplinary action by regulatory authorities & its associates are available on our website i.e. www.rathionline.com

Disclaimers in respect of jurisdiction: This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject ARSSBL to any registration or licensing requirement within such jurisdiction(s). No action has been or will be taken by ARSSBL in any jurisdiction (other than India), where any action for such purpose(s) is required. Accordingly, this Report shall not be possessed, circulated and/or distributed in any such country or jurisdiction unless such action is in compliance with all applicable laws and regulations of such country or jurisdiction. ARSSBL requires such recipient to inform himself about and to observe any restrictions at his own expense, without any liability to ARSSBL. Any dispute arising out of this Report shall be subject to the exclusive jurisdiction of the Courts in India.

Statements on ownership and material conflicts of interest, compensation - ARSSBL and Associates

Answers to the Best of the knowledge and belief of ARSSBL/ its Associates/ Research Analyst who is preparing this report

Research analyst or research entity or his associate or his relative has any financial interest in the subject company and the nature of such financial interest.	No
ARSSBL/its Associates/ Research Analyst/ his Relative have actual/beneficial ownership of one per cent or more securities of the subject company, at the end of the month immediately preceding the date of publication of the research report?	No
ARSSBL/its Associates/ Research Analyst/ his Relative have actual/beneficial ownership of one per cent or more securities of the subject company	No
ARSSBL/its Associates/ Research Analyst/ his Relative have any other material conflict of interest at the time of publication of the research report?	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation from the subject company in the past twelve months	No
ARSSBL/its Associates/ Research Analyst/ his Relative have managed or co-managed public offering of securities for the subject company in the past twelve months	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past twelve months	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past twelve months	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation or other benefits from the subject company or third party in connection with the research report	No
ARSSBL/its Associates/ Research Analyst/ his Relative have served as an officer, director or employee of the subject company.	No
ARSSBL/its Associates/ Research Analyst/ his Relative has been engaged in market making activity for the subject company.	No

Other Disclosures pertaining to distribution of research in the United States of America

This research report is a product of ARSSBL, which is the employer of the research analyst(s) who has prepared the research report. The research analyst(s) preparing the research report is/are resident outside the United States (U.S.) and are not associated persons of any U.S. regulated broker-dealer and therefore the analyst(s) is/are not subject to supervision by a U.S. broker-dealer, and is/are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with U.S. rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

This report is intended for distribution by ARSSBL only to "Major Institutional Investors" as defined by Rule 15a-6(b)(4) of the U.S. Securities and Exchange Act, 1934 (the Exchange Act) and interpretations thereof by U.S. Securities and Exchange Commission (SEC) in reliance on Rule 15a 6(a)(2). If the recipient of this report is not a Major Institutional Investor as specified above, then it should not act upon this report and return the same to the sender. Further, this report may not be copied, duplicated and/or transmitted onward to any U.S. person, which is not the Major Institutional Investor.

In reliance on the exemption from registration provided by Rule 15a-6 of the Exchange Act and interpretations thereof by the SEC in order to conduct certain business with Major Institutional Investors, ARSSBL has entered into an agreement with a U.S. registered broker-dealer Marco Polo Securities Inc. Transactions in securities discussed in this research report should be effected through Marco Polo Securities Inc.

1. ARSSBL or its Affiliates may or may not have been beneficial owners of the securities mentioned in this report.

2. ARSSBL or its affiliates may have or not managed or co-managed a public offering of the securities mentioned in the report in the past 12 months.

3. ARSSBL or its affiliates may have or not received compensation for investment banking services from the issuer of these securities in the past 12 months and do not expect to receive compensation for investment banking services from the issuer of these securities within the next three months.

4. However, one or more of ARSSBL or its Affiliates may, from time to time, have a long or short position in any of the securities mentioned herein and may buy or sell those securities or options thereon, either on their own account or on behalf of their clients.

5. As of the publication of this report, ARSSBL does not make a market in the subject securities.

6. ARSSBL or its Affiliates may or may not, to the extent permitted by law, act upon or use the above material or the conclusions stated above, or the research or analysis on which they are based before the material is published to recipients and from time to time, provide investment banking, investment management or other services for or solicit to seek to obtain investment banking, or other securities business from, any entity referred to in this report.

Additional information on recommended securities/instruments is available on request.

ARSSBL registered address: Express Zone, A Wing, 9th Floor, Western Express Highway, Diagonally Opposite Oberoi Mall, Malad (E), Mumbai – 400097.
Tel No: +91 22 6281 7000 | Fax No: +91 22 4001 3770 | CIN: U67120MH1991PLC064106.