MOTILAL OSWAL FINANCIAL SERVICES

26 July 2023

1QFY24 Results Update | Sector: Technology

Cyient

Estimate change	↑
TP change	↑
Rating change	↔

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Bloomberg	CYL IN
Equity Shares (m)	113
M.Cap.(INRb)/(USDb)	162.2 / 2
52-Week Range (INR)	1553 / 724
1, 6, 12 Rel. Per (%)	-5/63/70
12M Avg Val (INR M)	470

Financials & Valuations (INR b)

Y/E Mar	2023	2024E	2025E
Sales	60.2	71.0	81.5
EBIT Margin (%)	12.8	14.6	15.1
PAT	5.8	7.8	9.5
EPS (INR)	52.4	70.5	85.7
EPS Gr. (%)	9.6	34.7	21.5
BV/Sh. (INR)	314.6	340.9	375.2
Ratios			
RoE (%)	17.5	21.6	24.0
RoCE (%)	14.7	16.7	18.1
Payout (%)	49.7	60.0	60.0
Valuations			
P/E (x)	28.0	20.8	17.1
P/BV (x)	4.7	4.3	3.9
EV/EBITDA (x)	15.9	11.9	9.8
Div Yield (%)	1.8	2.9	3.5

Shareholding pattern (%)

As On	Jun-23	Mar-23	Jun-22
Promoter	23.4	23.4	23.4
DII	21.3	24.9	23.9
FII	37.5	33.6	32.7
Others	17.8	18.2	20.0

FII Includes depository receipts

CMP: INR1,466 TP: INR1,730 (+18%) Buy

Stable demand and strong margin performance to drive FY24

Pickup in Communications still under cloud

- CYL reported 1QFY24 Service business (reclassified as DET) revenue growth of 0.3% QoQ in CC. Excluding the business shifted from DLM, it declined 0.2% QoQ CC, marginally below our estimate of 0.3% QoQ CC. 1Q growth was led by the Sustainability vertical (up 4.5% QoQ CC), followed by Transportation (3.2% QoQ CC). Growth was weak in Connectivity (down 2.4% QoQ CC) and New Growth Areas (-6.5% QoQ CC). Normalized EBIT margin for the DET business came in at 16.1%, 60bp above our estimates, mainly led by the cost rationalization measures and efficiency gain in 1Q despite the impact from an adverse business mix during the quarter.
- Service order intake was modest at USD193.2m, down 12.2% QoQ/up 32.5% YoY in 1Q. However, the deal pipeline remained strong, with six large deals signed in 1Q. CYL has reiterated its confidence of delivering Service FY24 revenue growth of 15-20% YoY CC, but has increased DET EBIT margin growth forecast to 150-250bp YoY.
- Overall, management commentary indicated continued momentum in the Transportation and sustainability verticals, driven by continued client spending. Within Transportation, demand was intact in the Commercial Aerospace and MRO segments on strong Air Traffic volume. Growth under Sustainability should continue with Citec complementing the service offerings on hydrocarbon and green energy. However, it indicated continuation of softness in the connectivity segment until 2HFY24, along with new growth areas where there is some impact. We expect DET business to grow at the lower end of CYL's FY24 revenue growth guidance (our est. of 15.2% YoY CC), which should lead to an FY23-25 USD revenue CAGR of 15.6%.
- On EBIT margin, with better 1Q performance and an increase in management guidance by 50bp, we expect the company to deliver FY24 EBIT margin of 15.8% (+220bp YoY). This should help DET deliver an FY23-25 INR PAT CAGR of 28%, which we see as attractive.
- Post the successful IPO of Cyient DLM earlier this month, we move our valuation methodology to SOTP basis, valuing its stake in DLM at market valuation with a holding company discount of 25%. We value the DET business at 20x FY25E EPS.
- Given the margin beat in 1Q, we raise our FY24/FY25 Consol PAT estimates by 1%/5% respectively. We maintain our **Buy** rating on the stock on attractive valuations. Our SOTP based target of INR1,730, implies a potential upside of 18%.

In-line Service revenues, margin guidance up on 1Q beat

- Service revenues grew 0.3% QoQ CC to USD177.1m. Comparable growth (excl. business moved from DLM) was -0.2%, marginally below our estimate of 0.3% QoQ.

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- Sustainability and Transportation grew 4.5% and 3.2% QoQ CC, while connectivity and New Growth Areas down 2.4% and 6.5% QoQ CC, respectively.
- Service margin was at 16.1% (+93bp QoQ/327bp YoY), above our estimate of 15.5%.
- The order intake was moderated at USD193.2m (-12.2% QoQ). It won six large deals in the service business with total contract potential of USD48.8m in 1Q.
- Adjusted PAT at INR1,767m was flat QoQ, vs. our estimate of INR1,898m. The miss was on account of a loss in other income at INR176m.

Key highlights from the management commentary

- Under Aerospace, the management is seeing strong signs of spending super-cycle (which happens once in a decade) as the current aircraft platforms (25 years old) are due for upgrades, along with other new programs.
- Demand in the commercial and defense was quite strong, driven by the government-led projects on the national security front.
- Connectivity was soft on account of client-specific issues in wireless business. The management is quite optimistic and expects a recovery in 2HFY24 on the back of a healthy deal pipeline and strong demand from government projects in the wireline business
- The company has revised its FY24 margin guidance to 150-250bp YoY (vs. 100-200bp earlier), as it sees operating leverage and efficiency to drive further improvement from the current level.

Valuation and Outlook

- CYL's service segment is shaping up quite well, with positive momentum in most of its growth engines. Conversely, other segments are on the verge of recovery and should incrementally contribute to its overall growth in FY24E.
- Post the successful IPO of Cyient DLM earlier this month, we are moving our valuation methodology to SOTP basis, valuing its stake in DLM at market valuation with a holding company discount of 25%. We value the DET business at 20x our FY25E EPS.
- Given the margin beat in 1Q, we raise our FY24/FY25 Consol PAT estimates by 1%/5%. We maintain our BUY rating on the stock on attractive valuations. Our SOTP-based target price of INR1,730 implies a potential upside of 18%.

Quarterly performance (INR m)

Y/E March	FY23				FY24				FY23	FY24E	FY24E	Var.
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE			1QE	(%/bp)
Revenue (USD m)	162	175	197	213	205	211	218	230	746	865	207	-0.6
QoQ (%)	3.1	8.2	12.7	8.1	-3.6	2.9	3.3	5.7	22.7	15.9	-3.0	-62bp
Revenue (INR m)	12,501	13,962	16,182	17,514	16,865	17,320	17,887	18,899	60,159	70,971	16,984	-0.7
YoY (%)	18.1	25.6	36.7	48.3	34.9	24.1	10.5	7.9	32.7	18.0	35.9	-95bp
GPM (%)	36.8	38.4	37.8	38.0	36.6	36.2	36.8	37.3	37.8	36.7	38.8	-222bp
SGA (%)	21.2	22.0	20.6	19.6	17.9	18.1	18.2	18.4	20.8	18.2	20.0	-213bp
EBITDA	1,946	2,290	2,785	3,222	3,156	3,135	3,327	3,572	10,243	13,190	3,193	-1.2
EBITDA margin (%)	15.6	16.4	17.2	18.4	18.7	18.1	18.6	18.9	17.0	18.6	18.8	-9bp
EBIT	1,435	1,660	2,086	2,496	2,480	2,442	2,611	2,816	7,677	10,350	2,446	1.4
EBIT margin (%)	11.5	11.9	12.9	14.3	14.7	14.1	14.6	14.9	12.8	14.6	14.4	31bp
Other income	160	-148	60	-257	-176	35	36	38	-185	-68	68	-359.1
ETR (%)	27.2	19.4	24.1	21.3	22.9	24.0	24.0	24.0	23.0	23.7	24.5	
Adj. PAT	1,161	1,218	1,628	1,762	1,767	1,872	2,002	2,159	5,769	7,800	1,898	-6.9
QoQ (%)	-24.7	4.9	33.7	8.2	0.3	6.0	6.9	7.8			7.7	-742bp
YoY (%)	0.9	0.5	23.7	14.3	52.2	53.7	23.0	22.5	10.5	35.2	63.4	-1127bp
EPS (INR)	10.6	11.1	14.8	16.0	16.0	16.9	18.1	19.5	52.4	70.5	17.2	-7.2

Key performance indicators

Y/E March	FY23				FY24				FY23	FY24
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Margins (%)										
Gross Margin	36.8	38.4	37.8	38.0	36.6	38.4	37.8	38.0	37.8	37.8
EBIT Margin	11.5	11.9	12.9	14.3	14.7	11.9	12.9	14.3	12.8	12.8
Net Margin	9.3	8.7	10.1	10.1	10.5	8.7	10.1	10.1	9.6	9.6
Operating metrics										
Headcount	13,581	15,004	14,693	15,172	15,306				15,172	
Attrition (%)	27.9	28.4	26.5	25.0	23.0				25.0	
Key geographies (YoY %)										
North America	17%	16%	15%	12%	5%				15%	
Europe	-9%	23%	52%	79%	104%				37%	

Key highlights from the management commentary

Commentary on verticals

- **Transportation:** Under Aerospace, the management is seeing strong signs of spending super-cycle (which happens once in a decade) as the current aircraft platforms (25 years old) are due for upgrades, along with other new programs.
- **Connectivity:** Connectivity was soft on account of client-specific issues in the wireless business, which is expected to recover in a couple of quarters. Although the wireline business remains strong, telecom providers have reduced their spending on 5G as they are awaiting earlier investments to get monetized.
- **Sustainability:** There is a strong demand form EN&U companies on the green energy and hydrocarbon. The overall pipeline remains strong, which is expected to drive incremental growth going forward.
- **Growth Areas:** Demand for Auto remains strong and the outlook remains robust with two large deals singed during the quarter (software defined vehicle for commercial vehicle manufacturing company and perception management system for a construction major).
- On the other side, the **Hi-tech and semi-conductor** business dragged down growth. Hi-Tech is expected to remain weak. Demand in healthcare was also soft; however, growth is expected in the latter half of the year. The management remains hopeful of demand improvement in FY24.
- While **Healthcare** has taken a pause in specific areas, demand for predictive and personalized healthcare remains healthy. Semicon is expected to be little volatile in FY24.
- The current Fiber penetration is 55% in the US and is expected to go up to 65% on the back of government projects. There are similar projects in other geographies as well.
- Overall, from a macro standpoint, there is no material impact on the business, except in few sub-segments. CYL has maintained some caution on Healthcare, Semicon and Hi-Tech.

Commentary on Margin

- CYL was able to deliver strong margin performance on the back of a sharp decline in SG&A expenses. This included rationalization of some office infrastructure and computer hardware and equipment.
- Gross margin (DET business) was negatively impacted by merit increases and adverse business mix. The business mix is expected to reverse going forward.

- On the back of strong margin performance in 1QFY24, the management has revised the normalized EBIT margin guidance to 150-250bp vs. 100-200bp earlier.
- The wage hikes will be spread over the quarters and the management remains confident to deliver margins within the guidance band.

Exhibit 1: Growth from key geos was weak in 1QFY24

Geographies	Contribution to revenue (%)	QoQ growth (%)	YoY growth (%)
Americas	43.2	(5.6)	5.3
Europe	34.4	0.5	103.8
Asia Pacific	22.4	14.9	14.8

Source: Company, MOFSL

Valuation and view

- CYL's service segment is shaping up quite well, with positive momentum in most of its growth engines. Conversely, other segments are on the verge of recovery and should incrementally contribute to its overall growth in FY24E.
- Post the successful IPO of Cyient DLM earlier this month, we are moving our valuation methodology to SOTP basis, valuing its stake in DLM at market valuation with a holding company discount of 25%. We value the DET business at 20x our FY25 EPS estimate.
- Given the margin beat in 1Q, we raise our FY24/FY25 Consol PAT estimates by 1%/5%. We maintain our Buy rating on the stock on attractive valuations. Our SOTP-based target price of INR1,730 implies a potential upside of 18%.

Exhibit 2: SOTP

	Valuation Metric	Tgt Multiple	Value (FY25E)
Cyient Service (INR m)	P/E	20	1,72,727
DLM (INR m)	Market Cap (25% holdco discount)		18,984
Total Market Cap (INR m)			**1,91,711**
O/S			110.6
Target Price (INR)			**1,730**
CMP (INR)			**1,466**
Upside %			**18.0 %**

Source: MOFSL

Exhibit 3: Revisions to our estimates

	Revised estimates		Earlier estimates		Change in estimates	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
USD:INR	82.0	82.0	82.1	82.0	0.0%	0.0%
Revenue (USD m)	865	994	866	990	-0.1%	0.4%
Growth (%)	15.9	14.9	16.1	14.3	-10bps	60bps
EBIT margin (%)	14.6	15.1	14.0	14.3	60bps	80bps
PAT (INR m)	7,800	9,477	7,702	9,011	1.3%	5.2%
EPS	70.5	85.7	69.9	81.8	0.9%	4.8%

Source: MOFSL

Exhibit 4: DET P&L Statement (INR m)

Y/E March	FY21	FY22	FY23	FY24E	FY25E
Sales	**34,242**	**37,544**	**50,936**	**60,348**	**69,290**
Cost of Services	21,071	21,808	29,535	36,250	41,228
Gross Profit	13,170	15,736	21,401	24,099	28,063
EBITDA	**5,514**	**7,470**	**9,309**	**12,136**	**14,205**
% of Net Sales	16.10%	19.90%	18.30%	20.10%	20.50%
EBIT	**3,754**	**5,740**	**6,970**	**9,547**	**11,225**
% of Net Sales	11.00%	15.30%	13.70%	15.80%	16.20%
Net Income	**3,254**	**4,696**	**5,243**	**7,253**	**8,636**
Change (%)		44.30%	11.70%	38.30%	19.10%

Source: MOFSL

Financials and valuations

Income Statement								(INR m)
Y/E March	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**
Sales	**39,176**	**46,175**	**44,275**	**41,325**	**45,344**	**60,159**	**70,971**	**81,499**
Change (%)	8.6	17.9	(4.1)	(6.7)	9.7	32.7	18.0	14.8
Cost of Services	25,387	30,125	28,964	27,162	28,453	37,415	44,899	50,937
SG&A Expenses	8,296	9,606	9,352	8,056	8,675	12,501	12,882	14,996
EBITDA	**5,493**	**6,444**	**5,959**	**6,107**	**8,216**	**10,243**	**13,190**	**15,566**
As a percentage of Net Sales	14.0	14.0	13.5	14.8	18.1	17.0	18.6	19.1
Depreciation	1,051	1,692	1,878	1,944	1,923	2,566	2,840	3,260
Other Income	1,207	864	734	684	687	-185	-68	163
PBT	**5,649**	**5,616**	**4,815**	**4,847**	**6,980**	**7,492**	**10,282**	**12,469**
Tax	1,381	2,327	1,076	1,133	1,761	1,723	2,442	2,993
Rate (%)	24.4	41.4	22.3	23.4	25.2	23.0	23.7	24.0
Net Income	**4,268**	**3,307**	**3,726**	**3,714**	**5,219**	**5,769**	**7,800**	**9,477**
Change (%)	20.8	-22.5	12.7	-0.3	40.5	10.5	35.2	21.5

Balance Sheet								(INR m)
Y/E March	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**
Share Capital	563	552	550	550	552	553	553	553
Reserves	22,876	25,089	25,059	29,023	30,614	34,114	37,149	40,940
Net Worth	**23,439**	**25,641**	**25,609**	**29,573**	**31,166**	**34,667**	**37,702**	**41,493**
Other liabilities	1,636	2,240	4,194	3,812	4,061	5,644	6,664	7,657
Loan	2,410	3,253	3,738	2,755	3,264	9,336	9,336	9,336
Capital Employed	**27,485**	**31,134**	**33,541**	**36,140**	**38,491**	**49,647**	**53,702**	**58,486**
Applications								
Gross Block	12,217	13,289	17,388	18,558	19,223	21,776	22,776	23,776
Less: Depreciation	7,791	8,766	9,712	10,779	11,959	14,525	17,365	20,625
Net Block	**3,220**	**3,530**	**6,909**	**7,181**	**6,787**	**7,251**	**5,411**	**3,151**
CWIP	213	300	800	113	134	27	27	27
Intangibles	5,057	6,990	6,800	7,191	6,662	21,413	21,413	21,413
Other assets	2,380	2,219	2,638	1,925	5,318	4,877	5,073	5,265
Curr. Assets	**23,456**	**25,853**	**24,650**	**28,518**	**28,972**	**31,913**	**41,471**	**50,209**
Debtors	6,913	8,137	7,262	8,026	7,333	11,271	12,055	13,844
Cash and Bank Balance	9,604	9,073	8,995	14,408	12,157	6,215	11,205	14,430
Other Current Assets	5,809	8,365	8,393	6,084	8,616	12,709	14,993	17,217
Current Liab. and Prov.	**6,841**	**7,758**	**8,256**	**8,788**	**9,382**	**15,834**	**19,693**	**21,578**
Trade payables	3,813	3,712	3,729	4,532	5,259	7,142	10,694	12,281
Other liabilities	2,799	3,757	4,150	3,872	3,709	7,555	7,657	7,757
Provisions	229	289	377	384	414	1,137	1,341	1,540
Net Current Assets	**16,615**	**18,095**	**16,394**	**19,730**	**19,590**	**16,079**	**21,778**	**28,631**
Application of Funds	**27,485**	**31,134**	**33,541**	**36,140**	**38,491**	**49,647**	**53,702**	**58,486**

Financials and valuations

Ratios

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Basic (INR)								
EPS	**38.0**	**30.0**	**33.8**	**33.8**	**47.8**	**52.4**	**70.5**	**85.7**
Cash EPS	47.4	45.3	50.8	51.5	65.3	75.6	96.2	115.2
Book Value	209.8	232.3	232.0	269.1	285.1	314.6	340.9	375.2
DPS	13.0	13.0	27.0	24.5	24.0	26.0	42.3	51.4
Payout (%)	34.2	43.4	80.0	72.5	50.3	49.7	60.0	60.0
Valuation (x)								
P/E ratio	38.5	48.9	43.4	43.4	30.7	28.0	20.8	17.1
Cash P/E ratio	30.9	32.4	28.9	28.5	22.4	19.4	15.2	12.7
EV/EBITDA ratio	28.3	24.2	26.3	24.5	18.3	15.9	11.9	9.8
EV/Sales ratio	4.0	3.4	3.5	3.6	3.3	2.7	2.2	1.9
Price/Book Value ratio	7.0	6.3	6.3	5.4	5.1	4.7	4.3	3.9
Dividend Yield (%)	0.9	0.9	1.8	1.7	1.6	1.8	2.9	3.5
Profitability Ratios (%)								
RoE	19.1	13.5	14.6	13.5	17.2	17.5	21.6	24.0
RoCE	13.8	10.2	10.6	9.9	13.6	14.7	16.7	18.1
Turnover Ratios								
Debtors (Days)	62	59	63	68	62	68	62	62

Cash Flow Statement (INR m)

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
CF from Operations	4,622	5,411	5,496	5,872	7,318	9,024	10,680	12,737
Cash for Working Capital	-1,659	-1,710	328	2,686	-973	-3,485	1,614	-1,325
Net Operating CF	**2,963**	**3,701**	**5,824**	**8,558**	**6,345**	**5,539**	**12,295**	**11,411**
Net Purchase of FA	-1,469	-1,440	-2,138	-949	-626	-625	-1,000	-1,000
Free Cash Flow	**1,494**	**2,261**	**3,686**	**7,609**	**5,719**	**4,914**	**11,295**	**10,411**
Net Purchase of Invest.	600	-767	568	-58	-3,197	-9,675	-1,500	-1,500
Net Cash from Invest.	**-869**	**-2,207**	**-1,570**	**-1,007**	**-3,823**	**-10,300**	**-2,500**	**-2,500**
Proc. from equity issues	9	22	17	37	121	79	0	0
Proceeds from LTB/STB	526	549	-916	-2,134	-1,994	1,458	0	0
Dividend Payments	-1,894	-2,892	-3,564	-10	-2,952	-2,630	-4,680	-5,686
Cash Flow from Fin.	**-1,359**	**-2,321**	**-4,463**	**-2,107**	**-4,825**	**-1,093**	**-4,680**	**-5,686**
Exchange difference	298	296	131	-31	52	-88	-125	0
Net Cash Flow	**1,033**	**-531**	**-78**	**5,413**	**-2,251**	**-5,942**	**4,990**	**3,225**
Opening Cash Bal.	**8,571**	**9,604**	**9,073**	**8,995**	**14,408**	**12,157**	**6,215**	**11,205**
Add: Net Cash	1,033	-531	-78	5,413	-2,251	-5,942	4,990	3,225
Closing Cash Bal.	**9,604**	**9,073**	**8,995**	**14,408**	**12,157**	**6,215**	**11,205**	**14,430**

NOTES

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

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall be within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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