Stock Update

Cyient Ltd.

Aug 07, 2023

RETAILRESEARCH

Cyient Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
IT Consulting & Software	Rs. 1561.75	Buy in the Rs 1547-1577 band & add more on dips to Rs. 1403-1423 band	Rs. 1695	Rs. 1816	2-3 quarters

HDFC Scrip Code	CYILTD
BSE Code	532175
NSE Code	CYIENT
Bloomberg	CYL IN
CMP Aug 04, 2023	1561.75
Equity Capital (Rs Cr)	55.0
Face Value (Rs)	5.0
Equity Share O/S (Cr)	11.0
Market Cap (Rs Cr)	17,269.0
Book Value (Rs)	313.5
Avg. 52 Wk Volumes	3,184,078
52 Week High	1573.0
52 Week Low	724.0

Share holding Pattern % (June, 2023)	
Promoters	23.4
Institutions	57.9
Non Institutions	18.7
Total	100.0

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

Cyient (formerly known as Infotech Enterprises Ltd) is engaged in IT engineering services. It operates through eight strategic business units: aerospace and defence; transportation; industrial, energy and natural resources; semiconductor, internet of things and analytics; medical and healthcare; utilities and geospatial; communications; and design-led manufacturing (Cyient DLM). Cyient DLM (earlier Rangsons) listed separately in the July-2023 in Indian equity market, provides design integration and production facilities to designs created in the engineering stage, thus enabling Cyient to provide design-to-production solutions to its clients. Cyient has 300+ customers across 14 countries.

Cyient's service order intake stood at US$ 193.2 mn in Q1FY24 amid a challenging demand environment. The company added 20 new clients in Q1FY24 vs. 13 new clients in Q4FY23 and 8 new clients in Q1FY23. The company won 6 large deals in Digital, Engineering and Technology (DET) business with total contract potential of $48.8 Mn in Q1FY24. The company is focused to strengthen its sales teams for winning large deals and it will continue to invest to strengthen its digital portfolio. Under Aerospace, the company is seeing strong signs of spending super-cycle as the current aircraft platforms (25 years old) are due for upgrades, along with other new programs, this cycles happens once in a decade. Demand for Auto remains strong and the outlook remains robust with two large deals signed in the quarter.

Cyient has acquired 16 companies, including 6 in the last 5 years and has completed 20 acquisitions over its 32-year history. Cyient's largest acquisition to date was in 2022, when it acquired Celfinet– Consultoriaem Telecomunicações S.A. for $46M and acquired Citec for $101 million in Nov 2022, now fully integrated. Growth under Sustainability (Mining, Energy & Utilities) could continue with Citec complementing the service offerings on hydrocarbon and green energy. Besides, the company announced partnerships with Thingtrax and iBASEt to drive digital innovation in ER&D and aerospace and heavy engineering industries.

Cyient maintained DET (Digital Engineering, Technology) revenue growth to be in the range of 15 –20% YoY in constant currency terms for FY24E and expects FY24E EBIT margins to improve by 150–250 bps YoY; earlier the company had guided to improve by 100–200 bps YoY.

Valuation & Recommendation:

Cyient offers niche products and process engineering services in domains such as Transportation (Aerospace & Railway), Communication, Utilities, semiconductors etc. Cyient has also developed DLM (design led manufacturing) business to impart system integration and prototyping capabilities in engineering services and it provides design-to-production solutions to its clients. Cyient's focus on large deals, client mining, strong relationship with clients, healthy order book and timely acquisitions to support its product solutions profile could result in healthy revenue trajectory in coming years. This, coupled with recovery in aerospace division and healthy deal pipeline in DLM bodes well for revenue growth.

Investors can buy in the Rs 1547-1577 band and add on dips in the Rs 1403-1423 band (17.5x FY25E EPS). We believe the base case fair value of the stock is Rs 1695 (21x FY25E EPS) and the bull case fair value of the stock is Rs 1816 (22.5x FY25E EPS) over the next 2-3 quarters. At the LTP of Rs 1561.75, the stock is trading at 19.3x FY25E EPS.

Financial Summary (Consolidated)

Particulars (Rs cr)	Q1FY24	Q1FY23	YoY-%	Q4FY23	QoQ-%	FY21	FY22	FY23	FY24E	FY25E
Total Operating Income	1687	1250	34.9	1751	-3.7	4,132	4,534	6,016	7,179	8,255
EBITDA	316	195	62.2	322	-2.0	611	822	1,024	1,305	1,499
Depreciation	68	51	32.3	73	-6.9	194	192	257	244	258
Other Income	10	34	-69.7	1	1940.0	109	112	81	72	54
Interest Cost	28	18	57.1	26	6.1	48	43	100	104	97
Tax	53	44	20.6	44	19.0	113	176	184	252	305
APAT	168	116	45.3	163	3.1	372	522	514	764	892
Diluted EPS (Rs)						33.6	47.2	46.5	69.1	80.7
RoE-%						13.5	17.2	15.6	20.7	21.5
P/E (x)						46.5	33.1	33.6	22.6	19.3
EV/EBITDA (x)						26.3	19.3	16.6	12.7	10.8

(Source: Company, HDFC sec)

Q1FY24 Result Update

- Cyient’s revenue was inline with expectations and profit was below expectations in Q1FY24. Consolidated revenue was down by 3.7% on QoQ basis, and up by 34.9% YoY to Rs to Rs 1687 crore in Rupee terms.
- Its DET (Digital, Engineering & Technology) revenue grew by 0.4% QoQ and 37.2% YoY to Rs 1455 crore. In CC terms, revenue grew by 0.3% QoQ and 30.6% YoY to US$ 177.1 mn. Group revenue at $205.3 Mn; growth of 28.6% cc YoY.
- The company's core services have shown eight successive quarters of growth, with transportation showing 12.9% QoQ growth and connectivity showing 27.7% YoY growth.
- EBIT decreased by 0.6% QoQ and increased by 74.5% YoY to Rs 248 crore and EBIT margin was at 14.7%, up by 50bps QoQ and 330 bps YoY. Net Profit grew 3.1% QoQ and 45.3% YoY to Rs 168 crore and PAT margin was at 10% in Q1FY24 vs. 9.3% in Q4FY23 and Q1FY23.
- The company won 6 large deals in DET business with total contract potential of $48.8 Mn in Q1FY24, and total order intake stood at US$ 193.2 Mn in Q1FY24.
- The company witnessed robust performance in key verticals including Aerospace (+2.3% cc QoQ), Sustainability (+4.5% cc QoQ) and Automotive (+3.1% cc QoQ).

Key Updates

Strong deal momentum and recovery in vertical to drive growth

Cyient's service order intake stood at US$ 193.2 mn in Q1FY24 amid a challenging demand environment, it grew by 32.5% YoY, however it moderated 12.2% QoQ. The company added 20 new clients in Q1FY24 vs. 13 new clients in Q4FY23 and 8 new clients in Q1FY23 and won 6 large deals in DET business with total contract potential of $48.8 Mn in Q1FY24. The company is focused to strengthen its sales teams for winning large deals and it will continue to invest to strengthen its digital portfolio. The current order book or intake has not included any acquired entities but the integration process will provide a better view in H1FY24

The deal pipeline also remains healthy, adding to confidence in the company's guidance of delivering DET revenue growth in the range of 15-20% in FY24E. The company has not done M&A activity over the last two to three quarters. Cyient has fully integrated the Finland based acquired entity, Citec (acquired for $101 mn in Nov 2022) into Cyient. It was also it's first in the Nordics region and has provided expanded capabilities in sustainability services and plant engineering. Besides, the company is also winning incremental deals from OEMs and operators in the telecom space. We expect overall revenue growth 19.3% and 15% in FY24E and FY25E, respectively.

Robust demand across the majority of its verticals

Cyient has classified its business units into four key verticals, (1) Transportation: Aerospace + Rail Transportation, (2) Connectivity: Communication (3) Sustainability: Mining, Energy & Utilities (4) New Growth Areas: Medical, Semiconductor, Hi-Tech and Automotive.

Over all business segments are classified as;

Cyient DET (Digital, Engineering & Technology): Consolidated Services (Transportation: Aerospace + Rail Transportation, Connectivity: Communications, Sustainability: Mining, Energy & Utilities, New Growth Areas: Medical, Semiconductor, Hi-Tech and Automotive) + Engineering Parts business (Engineering Parts business was included in Cyient DLM segment earlier)

The company sees huge opportunity across its business verticals

Transportation

- Aerospace: Investments in modular designs, variants & upgrades of existing platforms, sustainability and Industry 4.0 technologies. Defense spending, Safe, Efficient and advanced air-mobility solutions.
- Rail: Focus continues to be on high-speed rail, predictive maintenance, advanced signalling systems, decarbonization, and Autonomous operations which will provide growth opportunities.
- Hybrid Propulsion Technologies for Aerospace and Rail applications

Connectivity:

- Continuous demand for development and deployment of private, public and enterprise networks and as well as enhanced usage of digital applications.

- Management / Testing and Network Operation & Optimization, digitalization and pervasive use of data driven applications

Sustainability:

- Intelligent, Safe, Autonomous and Sustainable Mine Operations.
- For Energy and Utilities Company, transition to a lower carbon energy system and the increase in distributed generation
- Autonomous Mining Operations, Autonomous job site / plant construction, AI enabled plant / site design, digital twins, Hydrogen & Ammonia based Digital Power Plants and Carbon Capture Utilization and Storage

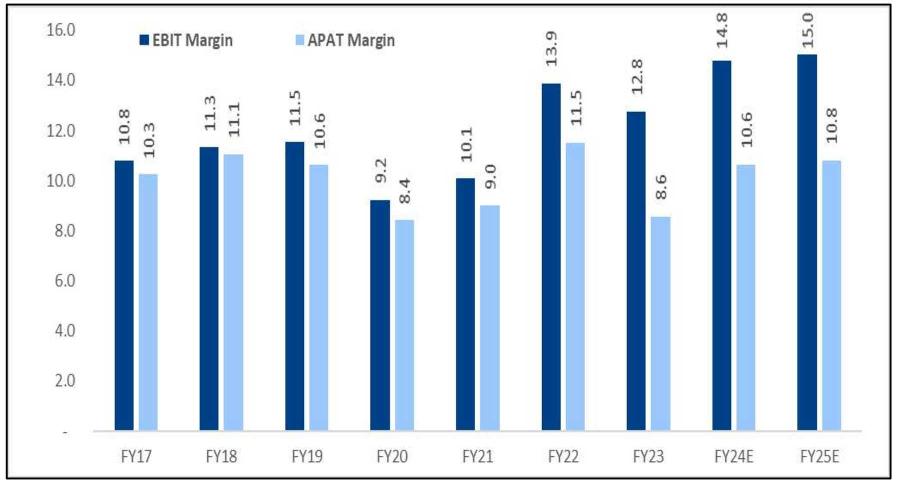
New Growth Areas:

- Auto: software-defined vehicle, with emphasis to connected vehicles, autonomous drive capabilities, EVs and other alternate energy vehicles.
- Healthcare sector: Continuous investments and opportunities in Predictive, Proactive and Personalized patient care, connected devices, Digital platforms, shift to value-based care and need for accelerated testing.
- Semiconductors: Propelled by miniaturization, next-gen chips, advanced packaging systems and increased usage of AI in Chip design and making. Low energy consumption chips will also drive growth.

Margins stability led by operational efficiencies

Cyient EBIT margin was at 14.7%, up by 50bps QoQ and 330 bps YoY, supported by a sharp decline in SG&A expenses. This included rationalization of some office infrastructure and computer hardware and equipment. PAT margin was at 10% in Q1FY24 vs. 9.3% in Q4FY23 and Q1FY23.

Margins (%)



Taking into the consideration the margin levers like cost rationalisation, favourable currency movement, increasing trend of utilisation, traction in digital technology, price hikes, hyper automation and other operational efficiencies, the margin improvement could continue in FY24E and beyond. However, we could see the impact of the wage hikes over the quarters and the company remains confident to deliver margins within the guidance band. The company has revised the normalized EBIT margin improvement guidance to 150-250bp vs. 100-200bp earlier guidance for FY24E. Hence, we expect EBIT margins at a range of 14.5% to 15.0% for FY24E to FY25E and PAT margins at a range of 10.5% to 10.8% for FY24E to FY25E.

Strong fundamentals led by healthy debt protection metrics and liquidity

- The company has reported stable and strong revenue growth in the past. In FY23, the company generated total revenue of Rs 6,016 crore and net profit of Rs 514 crore, which grew at a CAGR of 12.4% and 11.4% over the last decade. We expect consolidated revenue to grow at a 17.1% CAGR and net profit to grow at a 31.7% over FY23-FY25E.
- The company has reported operating margin at 13.5-18% band over the past and we expect margin at ~18% in next two years, supported by cost rationalisation efforts.
- Debt protection metrics are robust, backed by minimal debt of Rs 934 crore and sizeable networth of Rs 3467 crore, and total debt to equity ratio stood at 0.3x as on March 31, 2023.
- Cash and cash equivalents, including long-term treasury investments, at Rs 1258.6 crore at the end of June 2023. Normalised Free Cash Flow generation for the year at Rs 176 crore, a conversion of 60.9% on Normalised EBITDA (conversion of 108.9% on Normalised PAT).
- The company is expected to incur capex to the tune of 2-3% of revenues. Cyient has healthy cash on its balance sheet, which it plans to utilise for M&A, investment in digital capability (that the company lags in) and captive takeover. Further, the company may consider a buyback.
- The net receivable's days increased to 68 days in FY23 vs. 59 days in FY22.
- We expect the FCF to remain positive, going forward, even after factoring in annual capex. Because of cost rationalization efforts, the company could see growth in profitability as well as better return ratios in the future. Rise in net profit margin could help to increase its return ratios, we expect RoE at 20.5-21.5% and RoCE at 18.5-19.4% over FY24E to FY25E, respectively.
- The company has recommended Final Dividend of Rs 16/- per equity share on par value of Rs. 5 per share for FY23, dividend payout stood at 53% and yield is 1.6%.

What could go wrong?

- Indian rupee appreciation against the USD, pricing pressure, retention of the skilled headcount, strict immigration norms and rise in visa costs are key concerns.
- Attrition remained high at 23% in Q1FY24 vs. 25% in Q4FY23, 26.5% in Q3FY23 and 26.2% in Q4FY22, led by intense competition and demand for talent. However, the company is looking to reduce attrition through wage hikes.
- ER&D activity in key verticals (e.g., Aerospace and Rail, Transportation, and Semiconductors) witnessed a material slowdown in the past. Adverse development in this regard could impact its order inflow. Both domestic and international travel are important for the industry to bounce back. The company has started to see some early green shoots and hopes for continued traction in the coming quarters.
- Higher than expected debt funded capex or acquisition could lead to deterioration in profitability and could impact cash generation.
- Cyient generated about 30.3% of its revenue from Transportation including aerospace and rail industries and about 25.6% from Connectivity (communication) sector in Q1FY24, while its top 5 and top 10 customers contributed 29.6% and 39% of its revenue in Q1FY24. Continued slowdown in any of the large segments or delay in capex program by one or more of its top 5 clients could significantly impact its growth.
- Any non-renewal of contracts or higher discounts due to aggressive competition intensity can impact the sustainability and scalability from such clients.
- Promoter holding is 23.4% as on June 30, any stake sale by promoter in near future could hit investor sentiment towards the company.

Peer Comparison

Rs in Cr	Mkt Cap, Rs in Cr	Revenue			EBIT			PAT			RoE-%			P/E (x)		
		FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E
Cyient	17269	6016	7179	8255	768	1061	1241	514	764	892	15.6	20.7	21.5	33.6	22.6	19.3
Zensar Tech	11048	4848	5106	5705	369	709	781	328	582	633	11.3	17.8	17.6	34.1	19.1	17.6

Financials (Consolidated)

Income Statement

(Rs Cr)	FY21	FY22	FY23	FY24E	FY25E
Net Revenues	**4132**	**4534**	**6016**	**7179**	**8255**
Growth (%)	**-6.7**	**9.7**	**32.7**	**19.3**	**15.0**
Operating Expenses	3522	3713	4992	5874	6757
EBITDA	**611**	**822**	**1024**	**1305**	**1499**
Growth (%)	**2.5**	**34.6**	**24.6**	**27.4**	**14.9**
EBITDA Margin (%)	**14.8**	**18.1**	**17.0**	**18.2**	**18.2**
Depreciation	194	192	257	244	258
EBIT	**416**	**630**	**768**	**1061**	**1241**
Other Income	109	112	81	72	54
Interest expenses	48	43	100	104	97
PBT	**477**	**698**	**749**	**1029**	**1198**
Tax	113	176	184	252	305
RPAT	**364**	**522**	**565**	**777**	**892**
APAT	**372**	**522**	**514**	**764**	**892**
Growth (%)	-0.2	40.5	-1.5	48.5	16.8
EPS	**33.6**	**47.2**	**46.5**	**69.1**	**80.7**

Balance Sheet

As at March	FY21	FY22	FY23	FY24E	FY25E
SOURCE OF FUNDS					
Share Capital	55	55	55	55	55
Reserves	2902	3061	3411	3846	4358
Shareholders' Funds	**2957**	**3117**	**3467**	**3901**	**4414**
Long Term Debt	45	2	494	444	414
Net Deferred Taxes	-14	10	35	10	10
Long Term Provisions & Others	366	375	485	509	495
Minority Interest	**-3**	**-3**	**-3**	**-3**	**-3**
Total Source of Funds	**3352**	**3500**	**4477**	**4860**	**5330**
APPLICATION OF FUNDS					
Net Block & Goodwill	1361	1345	2866	2859	2862
CWIP	88	13	3	3	3
Other Non-Current Assets	126	149	93	79	67
Total Non Current Assets	**1575**	**1507**	**2962**	**2941**	**2932**
Inventories	159	279	436	354	407
Trade Receivables	803	733	1127	1180	1357
Cash & Equivalents	1499	1711	1238	1558	1900
Other Current Assets	426	532	737	663	597
Total Current Assets	**2886**	**3255**	**3538**	**3756**	**4261**
Short-Term Borrowings	230	324	440	390	365
Trade Payables	453	526	714	787	905
Other Current Liab & Provisions	426	412	869	660	594
Total Current Liabilities	**1109**	**1262**	**2023**	**1837**	**1864**
Net Current Assets	1777	1993	1515	1919	2397
Total Application of Funds	**3352**	**3500**	**4477**	**4860**	**5329**

(Source: Company, HDFC sec)

Cash Flow Statement

(Rs Cr)	FY21	FY22	FY23	FY24E	FY25E
Reported PBT	477	698	681	1,029	1,198
Non-operating & EO items	1	-33	-7	-72	-54
Interest Expenses	43	39	100	104	97
Depreciation	195	192	257	244	258
Working Capital Change	269	-97	-349	-34	-112
Tax Paid	-129	-165	-129	-252	-305
OPERATING CASH FLOW (a)	**856**	**635**	**554**	**1,019**	**1,082**
Capex	-167	-85	-964	-237	-262
Free Cash Flow	689	549	-410	782	820
Investments	0	0	0	0	0
Non-operating income	68	28	-69	72	54
INVESTING CASH FLOW (b)	**-99**	**-57**	**-1,033**	**-165**	**-208**
Debt Issuance / (Repaid)	-197	-55	212	-100	-55
Interest Expenses	-21	-17	-66	-104	-97
FCFE	470	478	-264	578	667
Share Capital Issuance	4	12	8	0	0
Dividend	-1	-295	-263	-330	-380
FINANCING CASH FLOW (c)	**-216**	**-354**	**-109**	**-534**	**-532**
NET CASH FLOW (a+b+c)	**541**	**223**	**-588**	**321**	**342**

Key Ratios

Particulars	FY21	FY22	FY23	FY24E	FY25E
Profitability Ratio (%)					
EBITDA Margin	14.8	18.1	17.0	18.2	18.2
EBIT Margin	10.1	13.9	12.8	14.8	15.0
APAT Margin	9.0	11.5	8.6	10.6	10.8
RoE	13.5	17.2	15.6	20.7	21.5
RoCE	13.2	16.6	15.0	18.4	19.4
Solvency Ratio (x)					
Debt/EBITDA	0.5	0.4	0.9	0.6	0.5
D/E	0.1	0.1	0.3	0.2	0.2
PER SHARE DATA (Rs)					
EPS	33.6	47.2	46.5	69.1	80.7
CEPS	51.2	64.6	69.7	91.1	104.0
BV	263.5	277.7	313.5	352.8	399.2
Dividend	17.0	23.6	24.8	29.8	34.3
Turnover Ratios (days)					
Debtor days	71	59	68	60	60
Inventory days	14	22	26	18	18
Creditors days	40	42	43	40	40
VALUATION (x)					
P/E	46.5	33.1	33.6	22.6	19.3
P/BV	5.9	5.6	5.0	4.4	3.9
EV/EBITDA	26.3	19.3	16.6	12.7	10.8
EV / Revenues	3.9	3.5	2.8	2.3	2.0
Dividend Yield (%)	1.1	1.5	1.6	1.9	2.2
Dividend Payout (%)	50.6	50.0	53.3	43.2	42.6

(Source: Company, HDFC sec)

One Year Price Chart

(Source: Company, HDFC sec)

HDFC Sec Retail Research Rating description

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This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

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This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

Disclosure:
Disclosure:
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