Stock Update

Cyient Ltd.

Nov 20, 2023

RETAILRESEARCH

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Cyient Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
IT Consulting & Software	Rs. 1733.30	Buy in the Rs 1716-1750 band & add more on dips to Rs. 1526-1556 band	Rs. 1891	Rs. 2055	2-3 quarters

HDFC Scrip Code	CYILTD
BSE Code	532175
NSE Code	CYIENT
Bloomberg	CYL IN
CMP Nov 17, 2023	1733.3
Equity Capital (Rs Cr)	55.0
Face Value (Rs)	5.0
Equity Share O/S (Cr)	11.0
Market Cap (Rs Cr)	19,156.2
Book Value (Rs)	365.0
Avg. 52 Wk Volumes	497,043
52 Week High	1945.5
52 Week Low	765.0

Share holding Pattern % (Sept, 2023)	
Promoters	23.2
Institutions	57.3
Non Institutions	19.5
Total	100.0

* Refer at the end for explanation on Risk Ratings

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Our Take:

Cyient (formerly known as Infotech Enterprises Ltd) is a global Digital, Engineering and Technology solutions company. It operates through eight strategic business units: Aerospace; Rail Transportation; Communications; Mining; Energy and Utilities; Medical; Semiconductor; Hi-Tech & Automotive. Its subsidiary Cyient DLM (earlier Rangsons) listed separately in the July-2023 in the 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$ 184 mn in Q2FY24 vs. US$ 193.2 mn in Q1FY24 amid a challenging demand environment, it grew by 40% YoY, however it fell 4.8% QoQ. The company added 5 large deals in DET business with total contract potential of $51.4 mn in Q2FY24, however the company had won 6 large deals in DET business with total contract potential of $48.8 Mn in Q1FY24. 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 two largest acquisition to date were 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.

Despite a weak discretionary spend outlook across the verticals and geographies, we believe revenue growth for FY25E could surprise positively. Cyient maintained DET revenue growth guidance to be in the range of 15 –20% YoY in constant currency terms for FY24E though expects to be at the lower end of the range and the company expects FY24E EBIT margins to improve by 150–250 bps YoY.

On Aug 07, 2023, we had issued a stock update on Cyient Ltd. (Link) and recommend to buy in the Rs. 1547-1577 band & add more on dips to Rs. 1403-1423 band for base case target of Rs 1695 and bull case target of Rs 1816 over the next two to three quarters. The stock achieved its both targets before expiry of the period. Given healthy growth outlook and expectation of strong set of numbers in H2FY24, we have now increased earnings estimates and target price.

Valuation & Recommendation:

We like Cyient in the ER&D space, Cyient offers niche products and process engineering services in domains such as Transportation (Aerospace & Railway), Communication, Utilities, semiconductors etc. The company's growth in large accounts and new client additions, pricing trends in existing clients and stable spending by clients in the engineering services vertical, are growth drivers. Revenue growth is becoming broad-based with aerospace leading the show, the rail vertical bottoming, and the other verticals continuing to generate faster-than-company-average growth.

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 and profit growth. Recent upcoming listing of Tata Technologies at a higher valuation which is in similar space could lead to rerating of stocks like Cyient. **Investors can buy in the Rs 1716-1750 band and add on dips in the Rs 1526-1556 band (16.5x Sept 25E EPS). We believe the base case fair value of the stock is Rs 1891 (20.25x Sept 25E EPS) and the bull case fair value of the stock is Rs 2055 (22x Sept 25E EPS) over the next 2-3 quarters. At the LTP of Rs 1733.30, the stock is trading at 18.6x Sept 25E EPS.**

Financial Summary (Consolidated)

Particulars (Rs cr)	Q2FY24	Q2FY23	YoY-%	Q2FY23	QoQ-%	FY22	FY23	FY24E	FY25E	FY26E
Total Operating Income	1779	1396	27.4	1687	5.5	4,534	6,016	7,189	8,190	9,563
EBITDA	326	205	59.2	316	3.2	822	1,024	1,357	1,567	1,844
Depreciation	66	63	4.4	68	-2.7	192	257	273	262	269
Other Income	14	20	-31.5	10	32.4	112	81	68	49	48
Interest Cost	27	31	-13.5	28	-2.9	43	100	110	103	98
Tax	57	29	92.9	53	7.6	176	184	240	319	392
APAT	178	79	125.4	168	6.0	522	514	789	932	1,133
Diluted EPS (Rs)						47.2	46.5	71.4	84.3	102.5
RoE-%						17.2	15.6	21.3	22.2	23.4
P/E (x)						36.7	37.3	24.3	20.6	16.9
EV/EBITDA (x)						21.6	18.4	13.6	11.5	9.4

(Source: Company, HDFC sec)

Q2FY24 Result Update

- Cyient's numbers were above expectations in Q2FY24, Consolidated revenue grew by 5.5% on QoQ basis, and 27.4% YoY to Rs to Rs 1779 in Rupee terms. Its DET (Digital, Engineering & Technology) revenue grew by 0.8% QoQ and 18.1% YoY to USD 178.4 mn. In CC terms, revenue grew by 1% QoQ and 17.1% YoY. Group revenue came at $215 mn; growth of 22.3% cc YoY.

- EBIT increased by 4.8% QoQ and 56.6% YoY to Rs 260 crore and EBIT margin was at 14.6%, down by 10bps QoQ and up by 270 bps YoY. Net Profit grew 6% QoQ to Rs 184 crore and it was stood at Rs 79 crore in Q2FY23. PAT margin was at 10% in Q2FY24, unchanged QoQ and it was 5.7% in Q2FY23.
- Cyient won 5 large deals in DET business with total contract potential of $51.4 mn in Q2FY24 vs. 6 large deals in DET business with total contract potential of $48.8 Mn in Q1FY24. Order total order intake stood at US$ 184 mn in Q2FY24 vs. US$ 193.2 mn in Q1FY24.
- The company witnessed robust performance in key verticals including Transportation (+2.7% cc QoQ), Sustainability (+4.8% cc QoQ) and New Growth Areas (+5.7% cc QoQ). However, connectivity underperformed (-8.1% cc QoQ).

Key Updates

Strong deal momentum and recovery in vertical to drive growth

Cyient's service order intake stood at US$ 184 mn in Q2FY24 vs. US$ 193.2 mn in Q1FY24 amid a challenging demand environment, it grew by 40% YoY, however it fell 4.8% QoQ. The company won 5 large deals in DET business with total contract potential of $51.4 mn in Q2FY24, however the company had 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 H2FY24.

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 its first acquisition 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 19.5%/13.9%/16.8% in FY24E/FY25E/FY26E, 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 clubbed 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.
- Defence: Increased spend on defense and upgrades, Manufacturing efficiency enhancements, Supply chain, Aftermarket and MRO activities and new players in Urban Air Mobility space could propel growth in this sector.

Connectivity:

- Investments in Fibre supported by Government spending around RDOF & BEAD programs continue to be the drivers of growth.
- Process modernization using ITSM through technology Partners, Network Management / Testing, Network densification and slicing, digitalization and pervasive use of data driven applications will drive more growth.

Sustainability:

- As governments across the globe take initiatives to boost sustainability, enterprises will continue to increase their sustainability initiatives and efforts.
- For Energy and Utilities company, transition to a lower carbon integrated energy systems and the increase in distributed generation would mean transition of Distribution Network Operators (DNOs) to become Distribution System Operators (DSOs).
- Hydrogen &Ammonia based green energy and Carbon Capture Utilization and Storage, Skid based packages for carbon capture for FPSO's are also becoming the growth agents for new business opportunities

New Growth Areas:

- Auto: Shift towards electrification, autonomous and connected vehicles will bring in more opportunities for engineering services in the areas of design and development of EV components, battery technologies, charging infrastructure, electric drivetrains, advanced driver-assistance systems (ADAS), sensor technologies, and connectivity solutions.
- 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.

Transportation vertical to see growth momentum in medium term

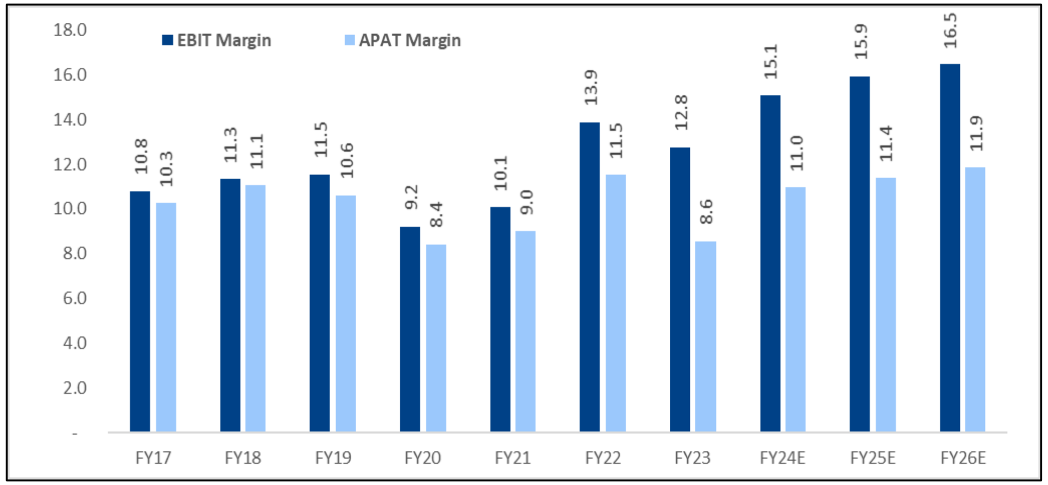
Cyient Ltd is optimistic to see the continued growth momentum in Transportation verticals driven by healthy demand within the Commercial Aerospace. The Aerospace demand of the Maintenance, Repair and Overhaul (MRO) and engineering services is relatively strong and gaining strength due to strong Air Traffic volume. While the design engineering service is volatile, once development cycle with a new platform starts, the design service is expected to gain momentum. However, the timeline of development cycle is uncertain. The company could see some delay in decision making and approvals by clients and adverse effects due to furloughs.

Margins stability led by operational efficiencies

Cyient witnessed an improvement in operating margin despite the wage hike impact in Q2FY24. Its EBIT margin was at 14.6%, down by 10bps QoQ and up by 270 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 unchanged QoQ at 10% in Q2FY24 and 5.7% in Q2FY23.

The impact of wage hike is expected to flow through Q3 and Q4. However, the company remained confident enough to absorb the impact through multiple margin levers. 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. The company remains confident to deliver margins within the guidance band. The company has maintained the normalized EBIT margin improvement guidance to 150-250bp for FY24E. Hence, we expect EBIT margins at a range of 15% to 16.5% for FY24E to FY26E and PAT margins at a range of 11% to 12% for FY24E to FY26E.

EBIT and PAT Margins (%)



(Source: Company, HDFC sec)

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 16.7% CAGR and net profit to grow at a 30% over FY23-FY26E.
- The company has reported EBITDA margin at 13.5-18% band over the past and we expect margin at 18.5-19.5% in next three years, supported by cost rationalisation efforts.
- Debt protection metrics are robust, backed by minimal debt of Rs 959 crore and sizeable networth of Rs 4331 crore, and total debt to equity ratio stood at 0.2x as on Sept 30, 2023.
- Cash and cash equivalents, including long-term treasury investments, at Rs 1179 crore at the end of Sept 2023. Normalised Free Cash Flow generation of DET for FY23 was Rs 154 crore, a conversion of 51% on Normalised EBITDA (conversion of 89% 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 receivables days stood at 65 days in H1FY24 vs. 68 days in FY23 and 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 21-23.5% and RoCE at 19-22% over FY23E to FY26E, respectively.
- The company has recommended an interim Dividend of Rs 12/- per equity share on par value of Rs. 5 per share for FY24E, and the company had recommended total net dividend of Rs 24.8 per share in FY23, dividend payout stood at 53.3% and dividend yield is 1.4%.

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 (though falling) at 20.4% in Q2FY24, 23% in Q1FY24, 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 developments in this regard could impact its order inflow. Both domestic and international travel are important for the industry to bounce back. Cyient 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 30.9% of its revenue from Transportation including aerospace and rail industries and about 23.2% from Connectivity (communication) sector in Q2FY24, while its top 5 and top 10 customers contributed 29.5% and 39.2% of its revenue in Q2FY24. 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 just 23.2% as on Sept 30, any stake sale by promoter in near future could hit investor sentiment towards the company.

Subsidiaries Overview

Rs in Cr	Year End	Holding -%	Sales Turnover	Profit After Tax	Country
Citec India Pvt Ltd	202303	100	85.1	10.1	India
Citec Engineering India Pvt Ltd	202303	100	0	0	India
Cyient DLM Ltd	202303	100	832	31.7	India
Cyient KK, Japan	202303	100	95	1.8	Japan
Cyient Inc., USA	202303	100	2173.6	30.2	U.S.
Cyient Gmbh, Germany	202303	100	180.7	4.7	Germany
Cyient Isreal India Ltd	202303	100	1.8	0.3	Israel
Cyient Insights Pvt Ltd	202303	100	6.6	-3.1	India
Cyient Singapore Pvt Ltd	202303	100	104.6	16.2	Singapore
Cyient Australia Pty Ltd	202303	100	421.6	8.2	Australia
Cyient Europe Limited, UK	202303	100	1159.9	62.6	U.K.
Cyient Solutions & Systems Pvt Ltd	202303	51	0	-0.1	India

(Source: Company, HDFC sec)

Peer Comparison

Rs in Cr	Mkt Cap, Rs in Cr	Revenue			EBIT			PAT			RoE-%			P/E (x)		
		FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Cyient	19166	7189	8190	9563	1084	1305	1575	789	932	1133	21.3	22.2	23.4	24.3	20.6	16.9
LTTS	47068	9693	11292	13152	1667	2017	2409	1319	1577	1898	24.6	25.3	26.2	35.7	29.8	24.8
Tata Elxsi	51731	3631	4367	5188	993	1188	1439	812	975	1183	35.5	35.6	36.1	63.8	53.1	43.7

(Source: Company, HDFC sec)

Financials (Consolidated)

Income Statement

(Rs Cr)	FY22	FY23	FY24E	FY25E	FY26E
Net Revenues	**4534**	**6016**	**7189**	**8190**	**9563**
Growth (%)	**9.7**	**32.7**	**19.5**	**13.9**	**16.8**
Operating Expenses	3713	4992	5832	6623	7719
EBITDA	**822**	**1024**	**1357**	**1567**	**1844**
Growth (%)	**34.6**	**24.6**	**32.4**	**15.5**	**17.7**
EBITDA Margin (%)	**18.1**	**17.0**	**18.9**	**19.1**	**19.3**
Depreciation	192	257	273	262	269
EBIT	**630**	**768**	**1084**	**1305**	**1575**
Other Income	112	81	68	49	48
Interest expenses	43	100	110	103	98
PBT	**698**	**749**	**1042**	**1251**	**1525**
Tax	176	184	240	319	392
RPAT	**522**	**565**	**802**	**932**	**1133**
APAT	**522**	**514**	**789**	**932**	**1133**
Growth (%)	40.5	-1.5	53.4	18.1	21.6
EPS	**47.2**	**46.5**	**71.4**	**84.3**	**102.5**

Balance Sheet

As at March, Rs Cr	FY22	FY23	FY24E	FY25E	FY26E
SOURCE OF FUNDS					
Share Capital	55	55	55	55	55
Reserves	3061	3411	3871	4423	5142
Shareholders' Funds	**3117**	**3467**	**3926**	**4479**	**5197**
Long Term Debt	2	494	444	414	384
Net Deferred Taxes	10	35	10	10	10
Long Term Provisions & Others	375	485	509	495	520
Minority Interest	**-3**	**-3**	**-3**	**-3**	**-3**
Total Source of Funds	**3500**	**4477**	**4886**	**5394**	**6108**
APPLICATION OF FUNDS					
Net Block & Goodwill	1345	2866	2831	2829	2864
CWIP	13	3	3	3	3
Other Non-Current Assets	149	93	79	67	51
Total Non Current Assets	**1507**	**2962**	**2913**	**2899**	**2917**
Inventories	279	436	355	404	472
Trade Receivables	733	1127	1241	1414	1651
Cash & Equivalents	1711	1238	1552	1937	2484
Other Current Assets	532	737	663	597	537
Total Current Assets	**3255**	**3538**	**3811**	**4352**	**5143**
Short-Term Borrowings	324	440	390	365	340
Trade Payables	526	714	788	898	1048
Other Current Liab & Provisions	412	869	660	594	565
Total Current Liabilities	**1262**	**2023**	**1838**	**1857**	**1952**
Net Current Assets	1993	1515	1973	2495	3191
Total Application of Funds	**3500**	**4477**	**4886**	**5394**	**6108**

(Source: Company, HDFC sec)

Cash Flow Statement

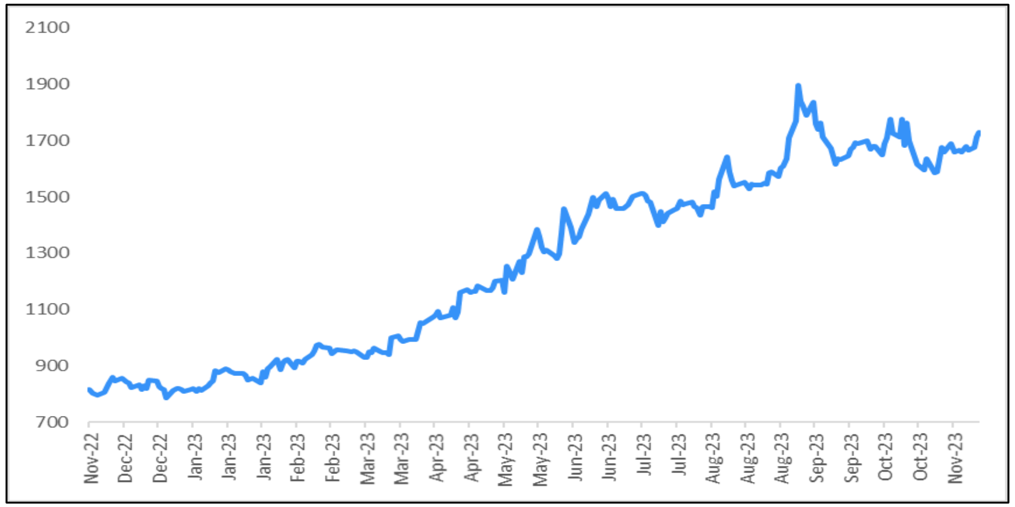
(Rs Cr)	FY22	FY23	FY24E	FY25E	FY26E
Reported PBT	698	681	1,042	1,251	1,525
Non-operating & EO items	-33	-7	-68	-49	-48
Interest Expenses	39	100	110	103	98
Depreciation	192	257	273	262	269
Working Capital Change	-97	-349	-94	-112	-124
Tax Paid	-165	-129	-240	-319	-392
OPERATING CASH FLOW (a)	**635**	**554**	**1,023**	**1,136**	**1,328**
Capex	-85	-964	-237	-262	-262
Free Cash Flow	549	-410	786	874	1,066
Investments	0	0	0	0	0
Non-operating income	28	-69	68	49	48
INVESTING CASH FLOW (b)	**-57**	**-1,033**	**-169**	**-213**	**-214**
Debt Issuance / (Repaid)	-55	212	-100	-55	-55
Interest Expenses	-17	-66	-110	-103	-98
FCFE	478	-264	576	716	913
Share Capital Issuance	12	8	0	0	0
Dividend	-295	-263	-330	-380	-415
FINANCING CASH FLOW (c)	**-354**	**-109**	**-540**	**-538**	**-567**
NET CASH FLOW (a+b+c)	**223**	**-588**	**315**	**385**	**547**

Key Ratios

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Profitability Ratio (%)					
EBITDA Margin	18.1	17.0	18.9	19.1	19.3
EBIT Margin	13.9	12.8	15.1	15.9	16.5
APAT Margin	11.5	8.6	11.0	11.4	11.9
RoE	17.2	15.6	21.3	22.2	23.4
RoCE	16.6	15.0	19.1	20.1	21.6
Solvency Ratio (x)					
Debt/EBITDA	0.4	0.9	0.6	0.5	0.4
D/E	0.1	0.3	0.2	0.2	0.1
PER SHARE DATA (Rs)					
EPS	47.2	46.5	71.4	84.3	102.5
CEPS	64.6	69.7	96.0	108.0	126.8
BV	277.7	313.5	355.1	405.0	470.0
Dividend	23.6	24.8	29.8	34.3	37.0
Turnover Ratios (days)					
Debtor days	59	68	63	63	63
Inventory days	22	26	18	18	18
Creditors days	42	43	40	40	40
VALUATION (x)					
P/E	36.7	37.3	24.3	20.6	16.9
P/BV	6.2	5.5	4.9	4.3	3.7
EV/EBITDA	21.6	18.4	13.6	11.5	9.4
EV / Revenues	3.9	3.1	2.6	2.2	1.8
Dividend Yield (%)	1.4	1.4	1.7	2.0	2.1
Dividend Payout (%)	50.0	53.3	41.8	40.7	36.1

(Source: Company, HDFC sec)

One Year Price Chart



(Source: Company, HDFC sec)

HDFC Sec Retail Research Rating description

Green Rating stocks

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.

Yellow Rating stocks

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.

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Date: 2023.11.20 07:28:34 +05'30'

Disclosure:

Disclosure:

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