15 July 2016

Q1FY17 Results Update | Sector: Technology

Cyient

BSE SENSEX	S&P CNX
27,942	8,565

Bloomberg	CYL IN
Equity Shares (m)	112.5
M.Cap.(INRb)/(USDb)	55.7 / 0.8
52-Week Range (INR)	641/371
1, 6, 12 Rel. Per (%)	-4/-2/-12
Avg Val, INRm/ Vol m	46.3 / 0.1
Free float (%)	77.8

Financials & Valuations (INR b)

Y/E Mar	2016	2017E	2018E
Net Sales	31.0	36.1	42.1
EBITDA	4.2	5.0	6.0
PAT	3.3	3.8	4.7
EPS (INR)	30.7	34.2	41.6
Gr. (%)	(1.9)	11.4	21.7
BV / Sh INR	186.6	210.6	239.7
ROE (%)	16.5	16.2	17.4
ROCE (%)	15.1	15.3	16.4
P /E (x)	16.0	14.3	11.8
P / BV (x)	2.6	2.3	2.0

Estimate change

TP change

Rating change

CMP: INR495 TP: INR550(+11%) Buy

Services traction offset by margin outlook

- **Broad-based services traction**: CYL's 1QFY17 revenue grew 2.6% QoQ (and 2% QoQ in constant currency) to USD124m, compared to our estimate of USD123m. Services business grew 5.4% QoQ to USD115m (v/s our estimate of USD113m), registering the highest growth in 7 quarters. Services business grew across the board with the exception of Utilities & Geospatial.
- **Margin beat led by deferral of some wage hikes…**: CYL's EBIT margin during the quarter was 13.1%, flat QoQ, above our estimate of 12%. This was mainly due to deferral of part of the wage hikes to 2Q (~80bp impact), adjusted for which, the margin performance was in line. PAT was INR740m, -1% QoQ excluding exceptional item in 4Q, and was below our estimate of INR790m, mainly due to lower other income.
- **…and dampened by outlook for full year:** CYL retained its expectation of double digit growth in services business for the full year and 50% growth in Rangsons. However, it now expects full year EBITDA margin to remain flat YoY (at 13.7%) v/s earlier guidance of 150bp expansion. Incremental dent in confidence is a function of continuing sluggishness in Softential business (USD2.8m v/s guidance of USD20m in FY17), and limited success in improving onsite: offshore mix.
- **Marginal revenue upgrade and margin downgrade**: We have cut our earnings estimates by 4%/2% for FY17/18, more pronounced in FY17 due to other income miss this quarter. Revenue visibility suggests CYL's turnaround on that front is playing out on expected lines, and over the longer term it remains well placed to address opportunities in the Engineering and Defense segments. Our price target of INR550 discounts FY18E earnings by 13x. Maintain Buy.

Quarterly Performance (INR Million)

Y/E March	FY16				FY17				FY16	FY17E	Est.	Var. (%
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE			1QFY17	/ bp)
Revenue (USD m)	114	118	118	121	124	132	136	142	472	533	123	1.2
QoQ (%)	-2.6	3.6	0.0	2.1	2.6	6.5	2.8	4.4	5.6	13.0	1.3	129bp
Revenue (INR m)	7,263	7,717	7,818	8,158	8,306	8,977	9,230	9,633	30,955	36,146	8,197	1.3
YoY (%)	16.8	14.8	9.8	11.7	14.4	16.3	18.1	18.1	13.1	16.8	12.9	151bp
GPM (%)	35.4	36.6	34.4	34.2	35.2	33.3	33.3	34.5	35.1	34.1	32.8	239bp
SGA (%)	22.7	21.6	20.3	21.1	22.1	20.5	19.5	19.3	21.4	20.3	21.0	109bp
EBITDA	918	1,164	1,102	1,063	1,090	1,151	1,280	1,458	4,247	4,979	969	12.5
EBITDA Margin (%)	12.6	15.1	14.1	13.0	13.1	12.8	13.9	15.1	13.7	13.8	11.8	130bp
EBIT Margin (%)	10.1	12.6	11.3	9.4	10.4	10.6	11.6	12.9	10.8	11.4	9.3	114bp
Other income	298	299	246	222	116	276	245	257	1,065	893	319	-63.8
ETR (%)	28.7	23.5	20.8	20.4	25.5	24.0	24.0	24.0	23.4	24.3	24.0	
PAT	748	985	869	844	740	937	1,010	1,150	3,446	3,838	783	-5.5
QoQ (%)	-20.3	31.7	-11.8	-2.8	-12.3	26.7	7.8	13.8			-7.2	-510bp
YoY (%)	9.2	9.2	-13.9	-10.1	-1.1	-4.8	16.3	36.3	-1.9	11.4	4.7	-575bp
EPS (INR)	6.7	8.8	7.7	7.5	6.6	8.4	9.0	10.2	30.7	34.2	7.0	
Headcount	11,507	11,311	11,481	11,569	12,297	12,647	12,997	13,247	11,569	13,247	12,069	1.9
Util incl. trainees (%)	75.4	76.1	76.7	73.3	75.5	76.3	74.7	76.3			75.3	25bp
Attrition (%)	18.8	21.6	20.6	18.4								
Offshore rev. (%)	44.7	44.6	43.3	41.0	44.6	45.1	44.3	45.1			44.3	24bp

E: MOSL Estimates

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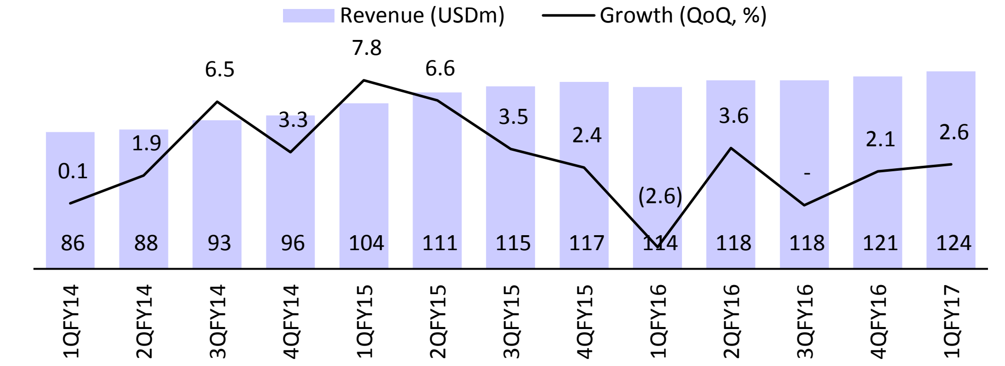
1QY17: Organic growth revival continues after commencing in 4QFY16

- CYL's 1QFY17 revenues at USD124m grew 2.6% QoQ v/s est. of 1.3% QoQ. CC revenue growth was ~2% QoQ, implying a tailwind of ~60bp because of cross currency movements.
- In Rupee terms, revenues were INR8.31b, +1.8% QoQ, compared to our estimate of flattish revenue QoQ.

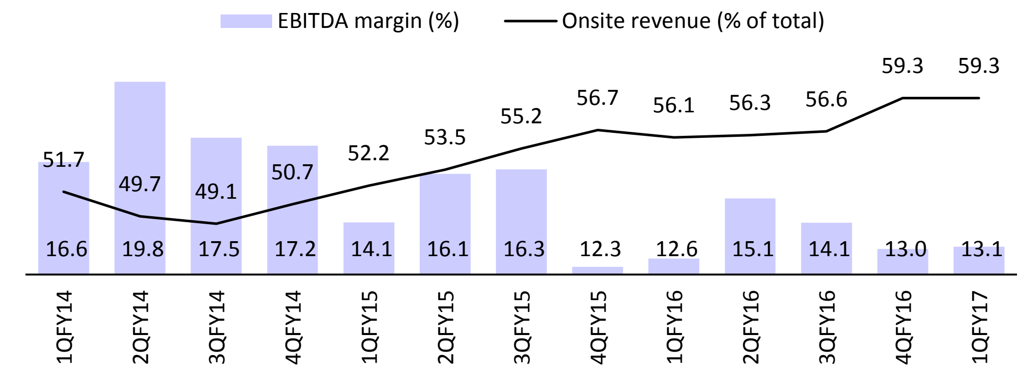
Exhibit 1: Traction in Services business was broad based



Source: Company, MOSL

- The Engineering business grew by 5-6% QoQ, DNO declined by 6% and Product Realization decline by ~22% QoQ.
- During the quarter, Softential saw only some recovery in business, with revenue of USD2.8m on the back of USD2.1m last quarter. This is against the guidance of USD20m in FY17 full year as cited by the management.
- EBITDA margin was flat QoQ at 13.1%, above our estimate of 12.1%. This was mainly due to deferral of part of the wage hikes to 2QFY17.

Exhibit 2: EBITDA was above estimate due to partial implementation of wage hikes



Source: Company, MOSL

- PAT was INR740m, -1% QoQ excluding exceptional item in 4Q, and was below our estimate of INR790m, mainly due to lower other income
- CYL also share deal wins for the quarter. Total order intake during the quarter was USD147.6m, growth of 33% YoY. Order intake was lower QoQ v/s USD171.6m in 4Q, which is due to seasonality of bookings where 2H is stronger. Order intake in Rangsons doubled YoY

Guidance: Revenue outlook retained, margin outlook tapered

- CYL retained its outlook of double digit growth in organic business given a strong start to the year and healthy bookings too
- Rangsons is expected grow 50% YoY, despite a sluggish start. The growth will be more back-ended in nature.
- Expect overall margin to be flat, with 100bp expansion in Services offset by investments in Design-led manufacturing business

Segmental performance: Communications, transportation, aerospace shine

- Aerospace (+5% QoQ), Communications (+13% QoQ) and Transportation (+9% QoQ) were leading industries, while Medical too grew on a small base
- Among geographies, North Americas (+6.9%) and APAC (+20.6%) were strong while EMEA & India (-11.5%) was weak, in line with Rangsons decline.

Exhibit 3: Segmental performance

Business Units	QoQ	YoY
Aerospace and Defense	4.9%	14.5%
Communications	13.4%	23.4%
Industrial & ENR	2.0%	-10.2%
Medical & Healthcare	16.0%	46.1%
Semiconductor	2.5%	-19.5%
Transportation	9.3%	5.6%
Utilitiesand Geospatial	-1.0%	-6.7%
Design Led Manufacturing	-22.2%	56.4%

Geographies	QoQ	YoY
North Americas	6.9%	0.9%
EMEA and India	-11.5%	9.9%
Asia Pacific	20.6%	45.6%

Source: Company, MOSL

Takeaways from management commentary

- **Outlook for core business:** With the exception of Utilities & Geospatial, all the other industries grew the services business this quarter. Expect this traction to sustain going forward as well, with uptick expected in utilities & geospatial services too.
- **Margin:** Expect 100bp expansion in services margins, to be offset by 100bp headwind contributed from increase in business mix of Rangsons.
- **Design-led Manufacturing:** 1Q was weak on expected lines. Still retaining outlook of 50% YoY growth in business. Bulk of the growth in come in 2H, while 2Q too will grow QoQ from 1Q's base.
- **Softential business:** Revenue during the quarter was USD2.8m, v/s USD2.1m in the previous quarter. This casts a doubt over attainability of USD20m revenues in the segment, which also plays some role on the incrementally cautious margin outlook.
- **Impact from Brexit:** The only vertical potentially at risk from Brexit is Transportation, given the dependency of the segment in UK. That too, is a medium to long term risk and growth should be sanguine in the near term.

Change in estimates: Factoring Services traction and margin outlook

- Following a strong show in Services in 1QFY17, and outlook of continued momentum in most of the segments, we have upgraded our overall revenue estimates for FY17 / 18 by 1% / 1.2%.
- However, following the management's commentary of flattish overall margins, we have revised our margin estimates down by 50bp in FY17 and FY18. Consequently, the earnings cut are 4% / 2%. Greater cut in FY17 is also a function of lower other income this quarter.

Exhibit 4: Change in estimates

	Revised		Earlier		Change	
	FY17E	FY18E	FY17E	FY18E	FY17E	FY18E
INR/USD	67.8	70.0	67.7	70.0	0.0	0.0
USD Revenue - m	533.4	602.1	528.0	595.2	1.0	1.2
USD revenue growth (%)	13.0	12.9	11.8	12.7		
EBITDA Margin (%)	13.8	14.3	14.2	14.8	-50bp	-50bp
EPS - INR	34.2	41.6	35.6	42.4	-4.0	-1.9

Source: Company, MOSL

Valuation and view – Organic business traction continues on expected lines

- CYL is a market leader in Engineering Services in the Aerospace and Railways verticals, which constitute to 50% of its total revenue. Its relationships with marquee clients, years of experience, and partnering with customers in critical parts of their development programs have helped CYL sustain its leadership position.
- To further boost its positioning, CYL is geared to tap the potential in three areas that are all at the cusp of a multi-year growth trajectory: [1] Electronic Manufacturing Services, [2] MRO, and [3] Defense. Together, these three areas increase its addressable market by ~12x (from USD1b in Aerospace Engineering Outsourcing to USD12.3b in the three additional areas).
- This should help turn around growth performance going ahead, following two years of subdued numbers caused by client-specific headwinds. With most issues behind, we expect revenue growth to bounce back going ahead, leading to 11% CAGR over FY16-18, in the core business, and 12% in overall revenue. Revival of growth has showed up in performances of the last two quarters, and validates the expectation of continued improvement over the course of FY17.
- Margins declined by ~400bp in FY15, thanks to pricing pressure, change in business mix, reinvestments in the restructuring, and acquisition of lower margin business; and a further 100bp in FY16. We had cited challenges to CYL's FY17 margin target of 150bp expansion last quarter, and expected margin recovery to be more gradual and play out over time – expansion of 100bp over FY16-18 on the back of revenue growth revival, turnaround in Rangsons, higher offshoring, improved utilization, and lower subcontracting costs. Company's margin outlook this quarter off flattish performance YoY is therefore, on expected lines.
- Although the margin recovery story seems to be taking longer than earlier anticipated, revenue visibility suggests CYL's turnaround on that front is playing out as epected, and over the longer term it remains well placed to address opportunities in the Engineering and Defense segments. Our 1-year target price

of INR550 discounts forward earnings by 13x, at a discount to peers such as PSYS and MTCL (which demonstrate potential in newer services), but at a premium to peers such as MPHL, KPIT, and NITEC (given strong competitive positioning, well defined niche and strategy to drive next leg of growth).

Key triggers

- Continued momentum in organic revenue growth
- Revival in Softential and improved outlook for Rangsons
- Uptick in margins led by operational efficiency

Key risk factors

- Prolonged client specific issues leading to a pause in recovery
- Dampening of outlook in Rangsons hampering confidence in S3 strategy
- Impact from Brexit in Transportation vertical

Exhibit 5: 1-year forward PE band

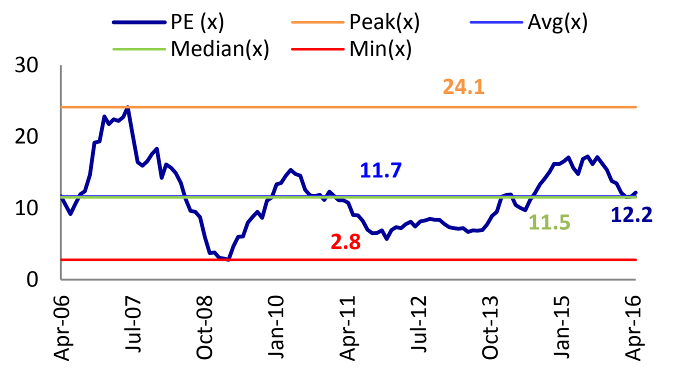
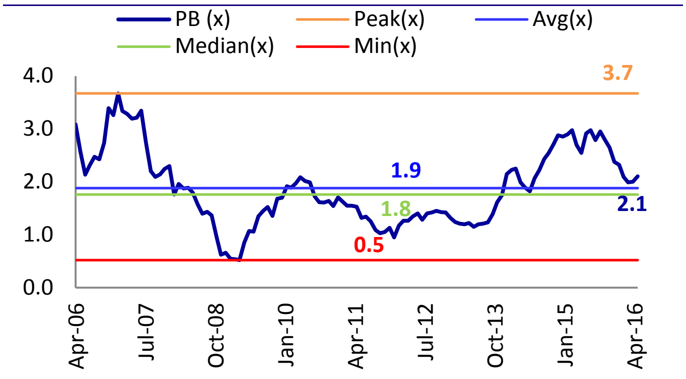
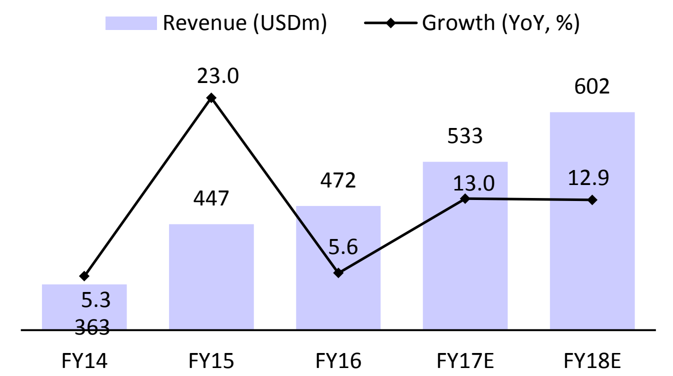


Exhibit 6: 1-year forward PB band



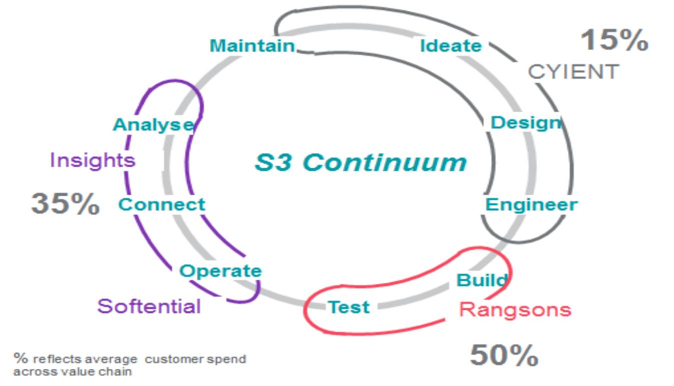
Story in charts

Exhibit 7: Expect revenue growth to pick-up



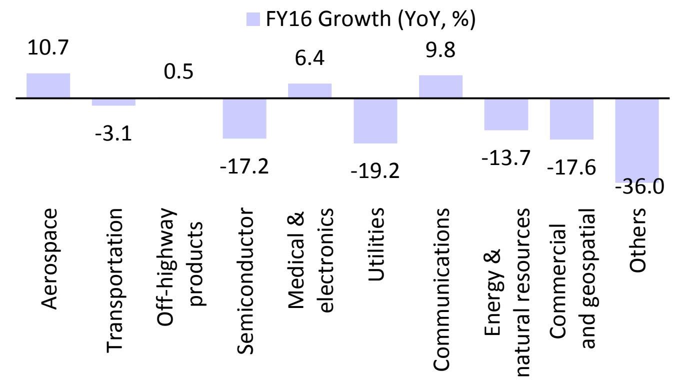
Source: Company, MOSL

Exhibit 8: S3 strategy to propel positioning



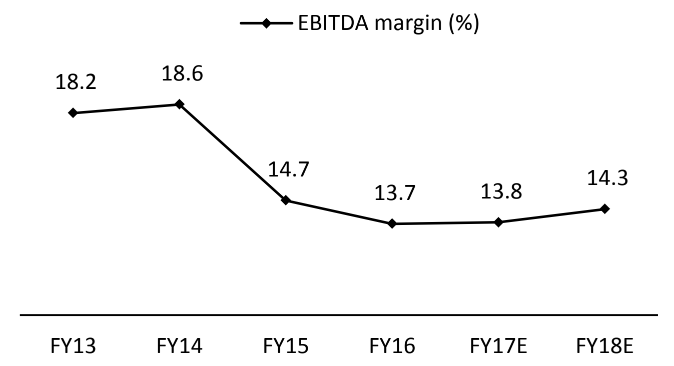
Source: Company, MOSL

Exhibit 9: Most client specific issues now behind



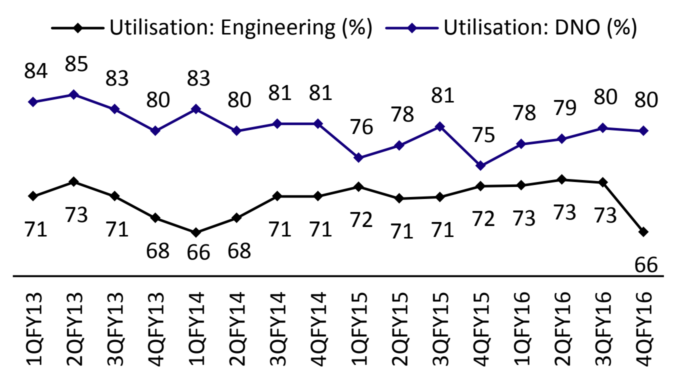
Source: Company, MOSL

Exhibit 10: Margin recovery expected gradually…



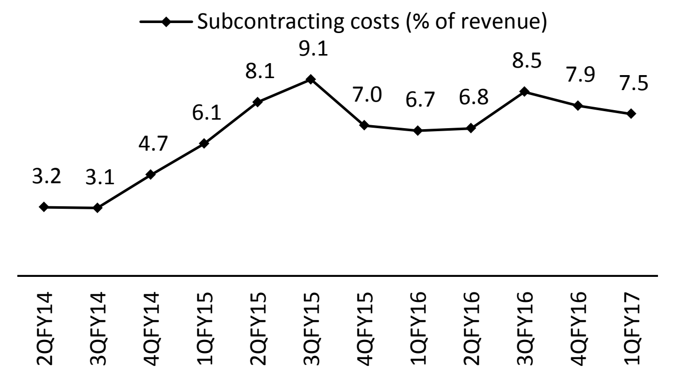
Source: Company, MOSL

Exhibit 11: …led by utilization



Source: Company, MOSL

Exhibit 12: And reduction in subcontracting, apart from other levers



Source: Company, MOSL

Financials and Valuations

Income Statement							(INR Million)
Y/E March	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17E**	**FY18E**
Sales	**15,530**	**18,731**	**22,064**	**27,359**	**30,955**	**36,146**	**42,148**
Change (%)	30.7	20.6	17.8	24.0	13.1	16.8	16.6
Cost of Services	9,691	11,261	12,756	17,129	20,083	23,833	27,781
SG&A Expenses	3,149	4,054	5,208	6,217	6,626	7,334	8,331
EBITDA	**2,689**	**3,416**	**4,101**	**4,014**	**4,247**	**4,979**	**6,036**
% of Net Sales	17.3	18.2	18.6	14.7	13.7	13.8	14.3
Depreciation	494	635	720	713	893	842	949
Interest	7	12	29	80	199	211	207
Other Income	175	398	187	1,236	1,065	893	1,014
PBT	**2,363**	**3,166**	**3,538**	**4,457**	**4,220**	**4,820**	**5,895**
Tax	835	967	1,030	1,096	986	1,171	1,415
Rate (%)	35.3	30.5	29.1	24.6	23.4	24.3	24.0
Eq. in earnings of affiliates	100	129	152	150	121	151	151
Minority Interest	0	0	0	0	-6	38	38
PAT	**1,628**	**2,329**	**2,660**	**3,511**	**3,349**	**3,838**	**4,669**
Change (%)	15.5	43.3	15.1	32.0	-1.9	11.4	21.7

Balance Sheet							(INR Million)
Y/E March	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17E**	**FY18E**
Share Capital	557	558	560	562	562	562	562
Reserves	11,018	12,667	15,325	17,879	20,382	23,069	26,337
Net Worth	**11,575**	**13,225**	**15,885**	**18,441**	**20,944**	**23,631**	**26,899**
Minority Interest	0	0	0	122	0	0	0
Loan	486	426	433	1,103	1,504	1,233	1,333
Capital Employed	**12,060**	**13,651**	**16,318**	**19,666**	**22,448**	**24,864**	**28,232**
Gross Block	6,404	7,301	7,976	9,318	10,618	11,618	12,618
Less : Depreciation	-3,345	-3,973	-4,634	-5,696	-6,589	-7,431	-8,380
Net Block	**3,059**	**3,328**	**3,342**	**3,622**	**4,029**	**4,186**	**4,238**
CWIP	198	228	71	96	70	70	70
Other LT Assets	1,251	1,350	1,605	6,365	5,352	5,452	5,552
Curr. Assets	**9,529**	**11,194**	**14,448**	**15,703**	**19,136**	**22,082**	**26,141**
Current Investments	222	610	400	336	800	1,000	1,200
Inventories	0	0	0	606	819	991	1,139
Debtors	3,675	4,007	4,800	5,336	6,191	7,229	8,430
Cash & Bank Balance	4,496	4,939	6,886	5,704	7,808	8,888	10,902
Loans & Advances	353	589	786	1,363	1,000	1,100	1,200
Other Current Assets	784	1,048	1,575	2,358	2,518	2,874	3,270
Current Liab. & Prov	**1,976**	**2,449**	**3,147**	**6,120**	**6,138**	**6,926**	**7,768**
Current Liabilities	1,132	1,215	1,802	3,566	3,940	4,428	4,970
Other liabilites	367	749	721	1,598	1,598	1,798	1,998
Provisions	477	484	625	956	600	700	800
Net Current Assets	**7,553**	**8,745**	**11,300**	**9,583**	**12,998**	**15,156**	**18,373**
Application of Funds	**12,060**	**13,651**	**16,318**	**19,666**	**22,449**	**24,864**	**28,233**

E: MOSL Estimates

Financials and Valuations

Ratios							(INR Million)
Y/E March	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17E**	**FY18E**
Basic (INR)							
EPS	**14.5**	**20.7**	**23.7**	**31.3**	**30.7**	**34.2**	**41.6**
Cash EPS	42.4	49.7	64.9	53.8	76.7	88.1	107.8
Book Value	103.9	118.3	141.5	164.3	186.6	210.6	239.7
DPS	2.5	4.5	5.0	8.0	7.0	10.3	12.5
Payout %	17.3	21.7	21.0	25.6	22.8	30.0	30.0
Valuation (x)							
P/E			20.7	15.7	16.0	14.3	11.8
Cash P/E			7.5	9.1	6.4	5.6	4.5
EV/EBITDA			11.6	12.5	11.3	9.3	7.3
EV/Sales			2.2	1.8	1.6	1.3	1.1
Price/Book Value			3.5	3.0	2.6	2.3	2.0
Dividend Yield (%)			1.0	1.6	1.4	2.1	2.5
Profitability Ratios (%)							
RoE	13.9	17.5	16.7	19.0	16.5	16.2	17.4
RoCE	12.7	16.2	15.5	17.4	15.1	15.3	16.4
ROIC	20.3	25.7	28.5	22.1	18.8	21.8	25.0
Turnover Ratios							
Debtors (Days)	100	95	99	91	91	91	91
Fixed Asset Turnover (x)	1.1	1.2	1.1	1.1	1.1	1.1	1.2

Cash Flow Statement							(INR Million)
Y/E March	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17E**	**FY18E**
CF from Operations	2,008	2,397	2,941	3,282	3,584	3,931	4,747
Cash for Working Capital	-749	-799	-669	335	495	-1,248	-1,003
Net Operating CF	**1,259**	**1,599**	**2,272**	**3,617**	**4,079**	**2,682**	**3,744**
Net Purchase of FA	-790	-922	-761	-803	-1,274	-1,000	-1,000
Free Cash Flow	**469**	**676**	**1,511**	**2,814**	**2,805**	**1,682**	**2,744**
Net Purchase of Invest.	721	-13	585	-4,479	239	760	877
Net Cash from Invest.	**-69**	**-935**	**-176**	**-5,282**	**-1,035**	**-240**	**-123**
Proc. from equity issues	17	29	52	66	1	0	0
Proceeds from LTB/STB	14	-27	41	399	1	-211	-207
Dividend Payments	-324	-422	-521	-784	-943	-1,151	-1,401
Cash Flow from Fin.	**-294**	**-419**	**-427**	**-319**	**-941**	**-1,362**	**-1,607**
Exchange difference	107	168	279	802	0	0	0
Net Cash Flow	**1,003**	**412**	**1,947**	**-1,183**	**2,104**	**1,081**	**2,014**
Opening Cash Bal.	**3,492**	**4,528**	**4,939**	**6,886**	**5,704**	**7,808**	**8,888**
Add: Net Cash	1,003	412	1,947	-1,183	2,104	1,081	2,014
Closing Cash Bal.	**4,496**	**4,939**	**6,886**	**5,704**	**7,808**	**8,888**	**10,902**

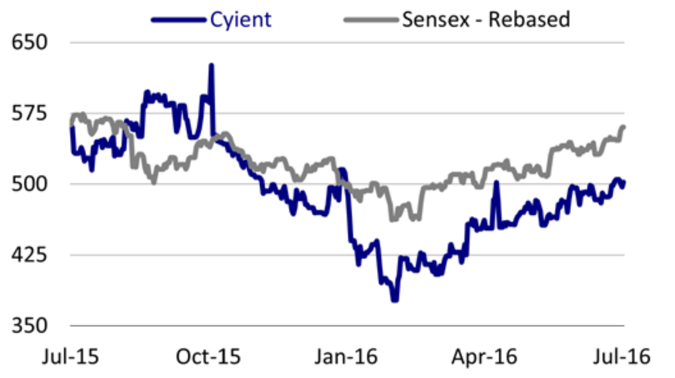
E: MOSL Estimates

Corporate profile

Company description

Cyient (Bloomberg: CYL) is a provider of Engineering Services, and Data, Network and Operation Services in the fields of Aerospace, Consumer, Energy, Medical, Oil & Gas, Mining, Heavy Equipment, Hi-tech, Rail Transportation, Telecom, and Utilities. Its solutions include product development and life cycle support, process and network engineering, along with data transformation and analytics.

Exhibit 1: Sensex rebased



Source: MOSL/Bloomberg

Exhibit 2: Shareholding pattern (%)

	Mar-16	Dec-15	Sep-15
Promoter	22.2	22.2	22.2
Public	77.8	77.8	77.8
FII	-	-	-
Others	-	-	-

Note: FII Includes depository receipts Source: Capitaline

Exhibit 3: Top holders

Holder Name	% Holding
Carrier Interational Mauritius Ltd	13.6
First Carlyle Ventures Mauritius	9.9
Oppenheimer International Small Company Fund	4.9
Deutsche Securities Mauritius Ltd.	4.9
ICICI Prudential Life Insurance Company Ltd	4.3

Source: Capitaline

Exhibit 4: Top management

Name	Designation
B V R Mohan Reddy	Executive Chairman
Krishna Bodanapu	Managing Director & CEO
Sudheendhra Putty	Company Secretary

Source: Capitaline

Exhibit 5: Directors

Name	Name
Andrea Bierce	Harsh Manglik
K Ramachandran	M M Murugappan
Thomas W Prete	Alan De Taeye
Jayanth Sabnis	

Exhibit 6: Auditors

Name	Type
Delloite Haskins & Sells	Statutory
Ernst & Young LLP	Internal
G P Associates	Tax

Source: Capitaline

Exhibit 7: MOSL forecast v/s consensus

EPS (INR)	MOSL forecast	Consensus forecast	Variation (%)
FY17	34.2	-	-
FY18	41.6	-	-

Source: Bloomberg

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