

BSE SENSEX	S&P CNX
39,052	11,586
Bloomberg	CYL IN
Equity Shares (m)	113
M.Cap.(INRb)/(USD\$)	49.1 / 0.7
52-Week Range (INR)	693 / 414
1, 6, 12 Rel. Per (%)	-8/-24/-46
12M Avg Val (INR M)	138
Free float (%)	77.3

Financials & Valuations (INR b)

Y/E Mar	FY19	FY20E	FY21E
Net Sales	46.2	46.0	50.3
EBITDA	6.4	6.7	8.0
PAT	4.9	4.4	5.5
EPS (INR)	43.4	39.6	49.4
Gr. (%)	11.6	(8.6)	24.7
BV/Sh (INR)	232.1	252.7	278.4
RoE (%)	18.7	15.7	17.8
RoCE (%)	17.8	15.0	16.9
P/E (x)	10.3	11.3	9.0
P/BV (x)	1.9	1.8	1.6

Estimate change

TP change

Rating change



CMP: INR446 TP: INR600 (+34%)

Buy

Margins weak, expect notable pick-up only beyond FY20

- **In-line Services revenue; beat in DLM:** CYL's 2QFY20 revenue of USD164m was down 3% YoY (our estimate: -4.4%), EBIT of INR1.1b declined 17% YoY (our estimate: -8%) and PAT of INR0.97b came in lower by 22% YoY (our estimate: flat YoY). Services revenue increased 1.8% QoQ (in-line) to USD140.4m, while DLM revenue of USD23.8m was above our estimate of USD22m. Sequentially, revenue increased across verticals within Services, barring Aerospace (-1.7% QoQ) and Semiconductors (-9.6% QoQ).
- **Expect Services revenue to be flat at best, slower growth in DLM:** Despite good Services revenue prospects, growth for full year appears a far cry given the underperformance in the first half. The outlook on DLM is also tepid as the company looks to restructure the business.
- **Meaningful margin benefit only beyond FY20:** 2Q saw some uptick in the sequential margin. However, most of the benefit was offset by fixed and variable payment to the external consultant. Margin expansion hereon should be delta between the fees and the value created by optimization. Hence, the impact will be only gradual. Recovery is now expected to be in its full scale FY21 onward.
- **Valuation view:** Our revenue estimates for FY20/21 are largely unchanged. While there can be some growth in Services in 3Q (seasonally weak), the odds are against the company growing Services revenues in FY20, given the required run-rate. Our earnings estimates for FY20/21 are downgraded by 10%/3%. This is because the expected uptick in margins from cost rationalization will likely be largely offset by external consultant fees in FY20. Our revised TP of INR600 discounts forward earnings by 12x, instead of 13x, due to expectations of a slower margin expansion and also the risk in longer-term stability in margins. Maintain **Buy**.

Quarterly performance

Y/E March	FY19				FY20E				FY19E	FY20E	(INR M)	
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			Est. 2QFY20	Var. (% / bp)
Revenue (USD m)	161	169	165	165	157	164	163	170	660	654	161	1.7
QoQ (%)	-2.3	5.0	-2.2	0.1	-5.2	4.9	-0.6	4.1	8.6	-0.9	3.1	180bp
Revenue (INR m)	10,800	11,870	11,876	11,629	10,890	11,589	11,520	11,998	46,175	45,997	11,226	3.2
YoY (%)	19.1	23.0	20.8	9.5	0.8	-2.4	-3.0	3.2	17.9	-0.4	-5.4	306bp
GPM (%)	34.3	34.5	35.0	35.3	34.4	34.4	34.4	35.3	34.8	34.6	34.6	-16bp
SGA (%)	22.1	20.8	20.3	20.2	21.2	20.6	19.1	19.5	20.8	20.1	19.7	94bp
EBITDA	1,316	1,627	1,749	1,752	1,445	1,599	1,756	1,897	6,444	6,697	1,672	-4.4
EBITDA Margin (%)	12.2	13.7	14.7	15.1	13.3	13.8	15.2	15.8	14.0	14.6	14.9	-110bp
EBIT Margin (%)	9.5	11.3	12.4	12.8	9.2	9.6	11.3	11.9	11.5	10.5	11.0	-142bp
Other income	170	568	-187	789	283	264	302	400	1,340	1,249	543	-51.4
ETR (%)	27.2	29.8	22.4	14.5	22.0	22.4	23.0	23.0	22.6	22.7	23.5	
PAT	825	1,272	921	1,770	904	986	1,157	1,329	4,788	4,376	1,266	-22.1
QoQ (%)	-30.1	54.2	-27.6	92.2	-48.9	9.1	17.4	14.8			40.0	-3093bp
YoY (%)	-5.8	14.0	-15.2	49.9	9.6	-22.5	25.7	-24.9	11.6	-8.6	-0.5	-2198bp
EPS (INR)	7.4	11.4	8.2	16.0	8.2	8.9	10.5	12.0	43.4	39.6	11.5	
Headcount	13,851	13,845	14,002	13,916	13,912	13,800	14,180	14,650	13,916	14,650	14,062	-1.9
Util incl. trainees (%)	75.0	78.0	78.1	77.8	78.0	78.0	76.0	77.0			78.0	0bp
Attrition (%)	16.9	16.9	18.4	19.9	17.4	18.0						
Offshore rev. (%)	41.9	42.8	42.4	42.7	43.5	44.7	42.7	42.7			43.5	120bp

Anmol Garg – Research analyst (Anmol.Garg@MotilalOswal.com); +91 22 7193 4271

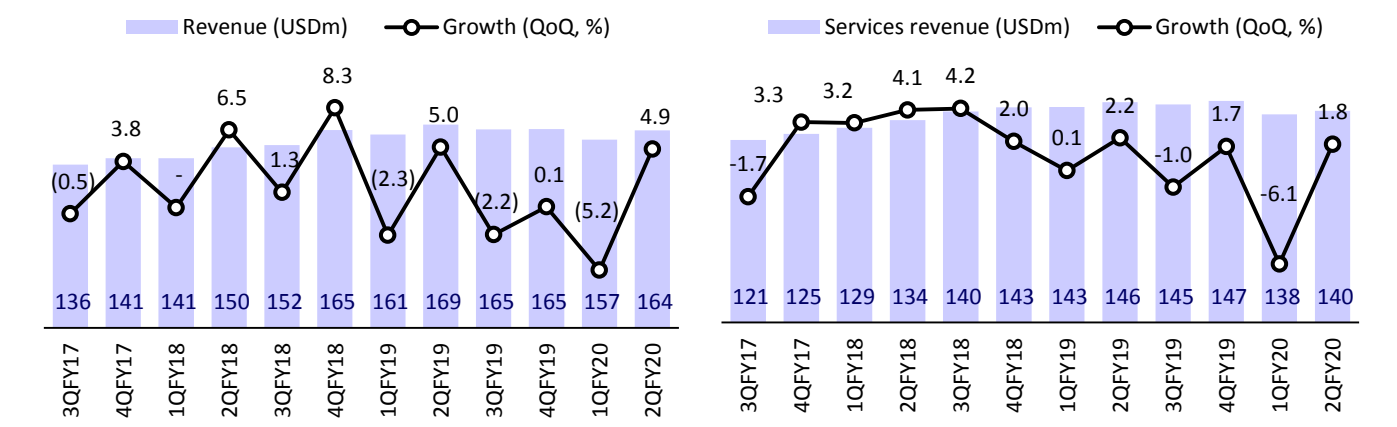
Mohit Sharma – Research analyst (Mohit.Sharma@MotilalOswal.com); +91 22 6129 1531

Investors are advised to refer through important disclosures made at the last page of the Research Report.

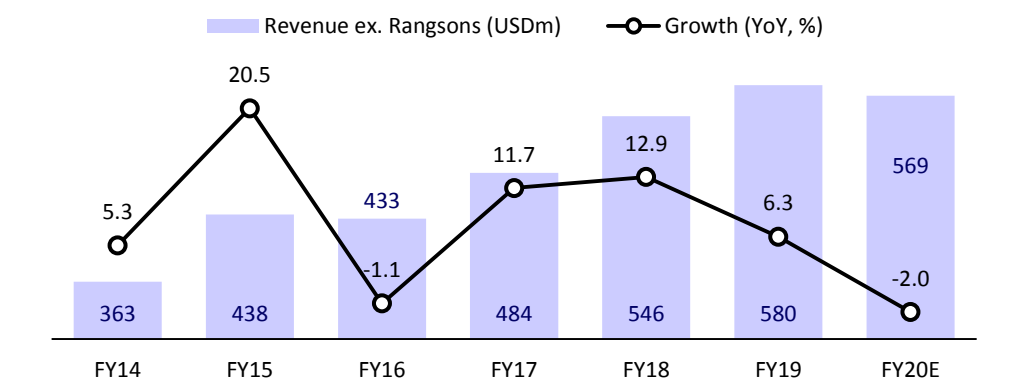
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2QY20: In-line Services revenue; beat in DLM

- Revenue grew by 4.9% QoQ versus our estimate of +3.1% QoQ.
- Revenue in Services was in line with our estimate, growing by 1.8% QoQ (2.6% QoQ CC) (estimate of 1.1% QoQ).
- DLM revenue at USD23.8m was higher than our estimate of USD22m, and drove above-estimated consolidated revenue.

Exhibit 1: Revenue in line with estimates

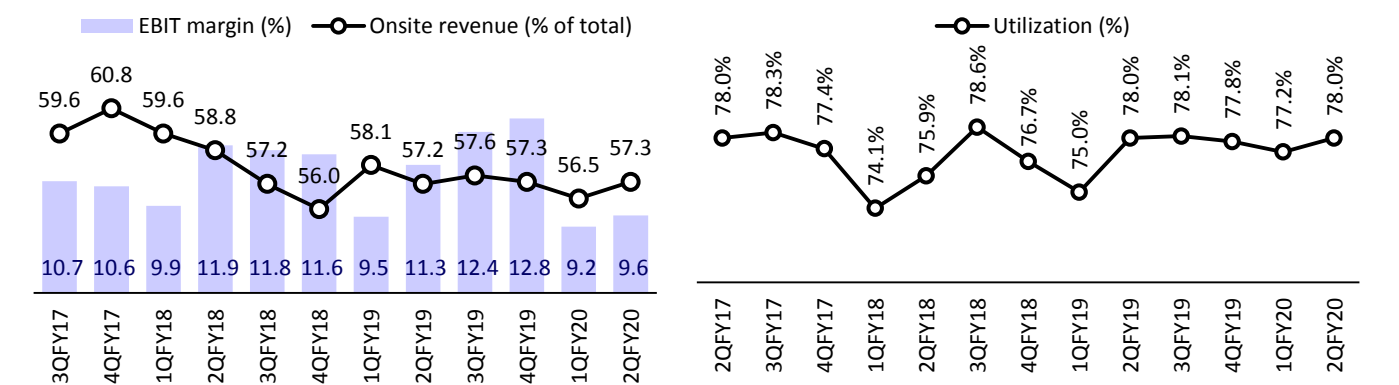
Source: Company, MOFSL

Exhibit 2: We now expect Services revenues to decline 1% YoY in FY20

Source: Company, MOFSL

Profitability below expectations

- EBIT margin was 9.6%, up 40bp QoQ, lower than our estimate of 11.0% (-140bp QoQ).
- Benefits of cost optimization (130bp), volume impact (70bp) and operational efficiency (60bp) were offset by wage hike (110bp) and restructuring costs (90bp).
- PAT of INR985m (+9.1% QoQ) missed our estimate by 22% due to a decline in operating income and lower-than-expected other income.

Exhibit 3: EBIT up 40bp QoQ, growth to be gradual

Source: Company, MOFSL

Segmental performance: Weakness in Communication and Semiconductors

- In Services, growth was driven by the verticals of Energy and Natural Resources (9.8% QoQ), Portfolio (+6.9% QoQ), Transportation (+3.3% QoQ) and Medical (8.6% QoQ). Growth was soft in the verticals of Aerospace (-1.7% QoQ) and Semiconductors (-9.6% QoQ).
- In the Services business, revenue declined by 15% sequentially from clients in the range of Top 6-10; also CYL lost two clients in USD5m+ category.
- Growth in Services was almost entirely driven by the Americas (+4.3% QoQ), while revenue from Europe remained flat sequentially. Revenue from APAC declined 3% QoQ.

Takeaways from Management Commentary**Cost optimization**

- CYL expects margins to expand on a sustainable basis, led by an improvement in SG&A cost and gross margins. In terms of restructuring cost, it will be incurred in each quarter till 4QFY20. Exit margins are expected to be much better than current trajectory. Ex. of one-time restructuring cost, the exit margins will be 200-300bp higher. Cost-optimization program runs on risk reward with both fixed and variable fees to external consultant. Net savings will be positive in 3Q and 4Q.

ETR

- Tax is expected to be in the range of 22-23%. CYL will continue having incentive for 1-2 years. Post that, it will take a decision on the new tax regime.

M&A

- It will continue to be a focus area. Two deals are in LOI stage.

Aerospace

- There is commercial backlog in large OEMs. CYL will be partially immune from the issues in the industry as it works on MRO Eng. and post delivery services. No new program in the pipeline and also defence is picking up. Growth is expected in future in the vertical.

Communication

- A lot of new technologies are coming in, and the vertical has become very dynamic. However, 5G deployment will be little slower as the cost benefit structure is yet not clear.

E&U

- Outlook remains strong. Momentum will continue in the future.

Transportation

- Rail roads has been a static industry in terms of technology. Growth will come once new technologies come in.

Semiconductor

- Industries will de-grow 15% and therefore effect will come to CYL also. Analog business will grow but will be tepid.

Revenue growth

- Growth is coming back into the business. 1Q was tepid, 2Q saw good growth and 3Q and beyond will likely see good growth as well. Even though Q3 is seasonally weak, CYL expects growth in services businesses. Q4 onward momentum will pick up.

Deal wins

- Deal wins declined YoY due to a high base. 2Q last year had multiyear orders and effect will be visible going forward also.

Change in estimates

Exhibit 4: Change in estimates

	Revised			Earlier			Change		
	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
INR/USD	70.0	70.3	71.0	70.0	69.6	71.0	0.0	1.1	0.0
USD Revenue - m	660.0	654.0	708.5	660.0	654.3	708.4	0.0	0.0	0.0
USD revenue growth (%)	8.6	-0.9	8.3	8.6	-0.9	8.3	0bp	0bp	10bp
EBITDA Margin (%)	14.0	14.6	15.8	14.0	15.3	16.5	0bp	-70bp	-60bp
EBIT Margin (%)	11.5	10.5	12.0	11.5	11.4	12.6	0bp	-80bp	-60bp
Adjusted EPS - INR	43.4	39.6	49.4	43.4	43.9	51.0	0.0	-9.7	-3.2

Source: Company, MOFSL

Valuation and view – a combination of industry leading growth and long-term prospects

- CYL is a market leader in Engineering Services in the Aerospace and Railways verticals, which constitute 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).
- Growth performance turned around in FY18 following two years of subdued numbers caused by client-specific headwinds. However, organic growth turned relatively soft in FY19, resulting in expectations of 11% CAGR over FY18-20.
- Margins shrank by ~400bp in FY15, thanks to pricing pressure, change in business mix, reinvestments in the restructuring, and acquisition of lower margin business, and by a further 100bp in FY16. We expect stability in margins at 14% led by double-digit growth and a steady environment.
- Our revenue estimates for FY20/21 are largely unchanged. While there can be some growth in Services in 3Q (seasonally weak), the odds are against the company growing Services revenues in FY20, given the required run-rate. Our earnings estimates for FY20/21 are downgraded by 10%/3%. This is because the expected uptick in margins from cost rationalization will likely be largely offset by external consultant fees in FY20. Our revised TP of INR600 discounts forward earnings by 12x, instead of 13x, due to expectations of a slower margin expansion and also the risk in longer-term stability in margins. Maintain **Buy**.

Key triggers

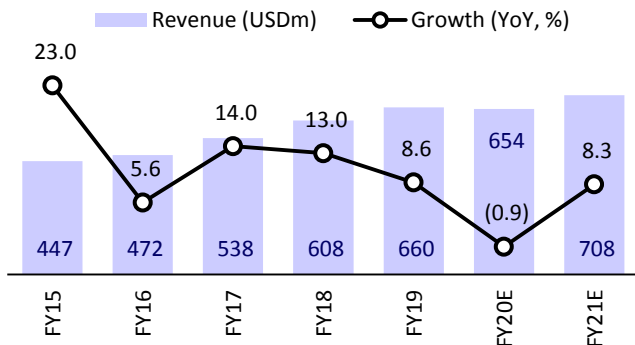
- Increased momentum in organic revenue growth.
- Pick-up in Aerospace and other relatively soft verticals.
- Uptick in margins led by operational efficiency.

Key risk factors

- Continuum of client-specific issues leading to sustained weak revenue momentum.
- Dampening of outlook in Rangsons hampering confidence in S3 strategy.
- Aggravated pressure in the softer verticals.

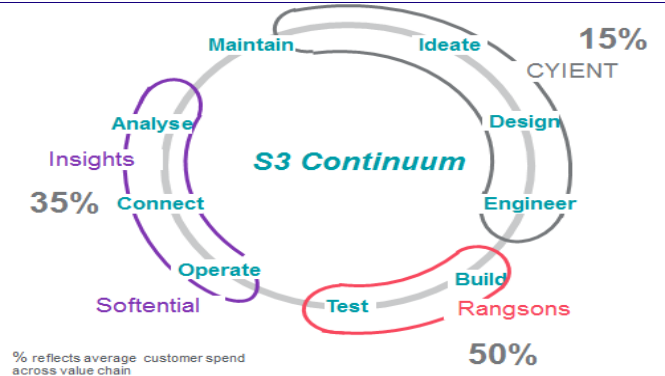
Story in charts

Exhibit 5: Growth is expected to inch up in FY21



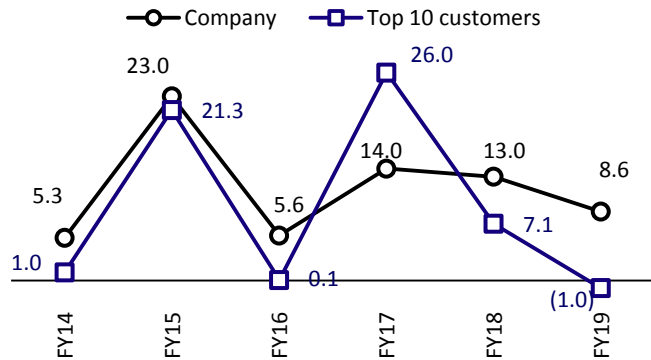
Source: Company, MOFSL

Exhibit 6: S3 strategy to propel positioning



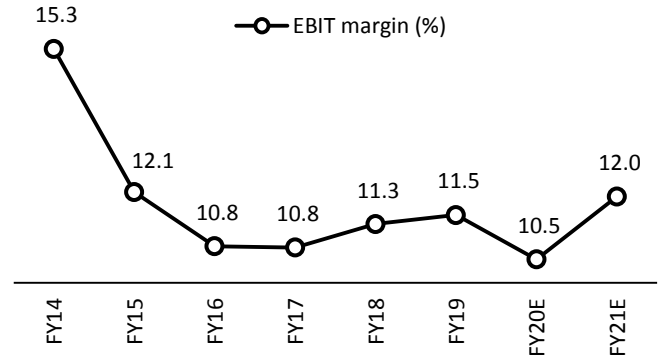
Source: Company, MOFSL

Exhibit 7: Some slowdown in top clients seen in FY19



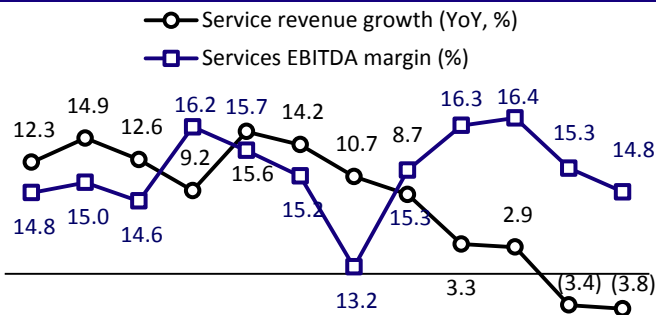
Source: Company, MOFSL

Exhibit 8: Long-term stability in margin outlook



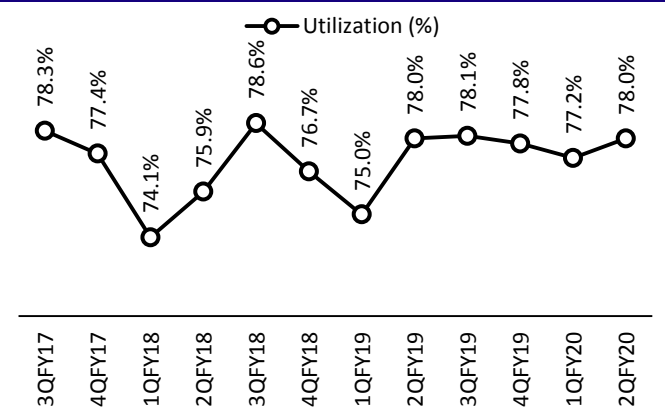
Source: Company, MOFSL

Exhibit 9: Margins to inch up hereon



Source: Company, MOFSL

Exhibit 10: ...partly led by improved operational efficiency



Source: Company, MOFSL

Exhibit 11: Operating metrics

	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
Geographic Mix - %											
Americas	57.1	55.8	54.2	55.1	53.3	55.3	56.2	58.2	52.0	58.8	60.2
Europe	25.1	26.6	26.7	27.7	29.2	26.3	26.4	24.1	24.0	26.9	26.3
Asia Pacific	17.8	17.6	19.1	17.2	17.5	18.4	17.4	17.7	24.0	14.3	13.6
Revenue Mix - %											
Onsite	60.8	59.6	58.8	57.2	56.0	58.1	57.2	57.6	57.6	56.5	57.3
Offshore	39.2	40.4	41.2	42.8	44.0	41.9	42.8	42.4	42.4	43.5	42.7
Utilization - %											
Overall	77.4	74.1	75.9	78.6	76.7	75.0	78	78.1	78.1	78.	78
Client Buckets											
USD1m+	62	57	65	66	63	65	68	73	73	85	91
USD5m+	20	21	22	23	24	25	27	27	27	28	27
USD10m+	9	9	9	11	12	11	13	13	13	12	12
USD20m+	5	5	5	5	4	4	4	4	4	4	4
Client Contribution - %											
Top 5	42.9	37.6	41.6	40.1	33.8	37.9	37.9	37.9	37.9	36.5	36.2
Top 10	56.9	50.2	55.0	54.0	45.4	51.8	51.0	51.0	51.0	49.8	47.3
Product Realization Business											
Geographic Mix - %											
Americas	11.2	14.7	18.2	15.4	17.5	20.6					
EMEA & India	88.1	84.3	69.6	84.2	81.7	78.0					
Asia Pacific	0.7	1.0	12.1	0.4	0.8	1.4					
Vertical Mix - %											
Aerospace and Defense	46.3	9.2	17.0	23.6	30.3	57.0					
Industrial	17.1	20.6	29.1	20.7	28.2	19.9					
Medical	11.3	9.7	12.5	9.3	16.1	12.5					
Communication	24.0	59.3	40.4	45.9	24.4	9.8					
Transportation	1.3	1.2	1.0	0.5	1.0	0.6					

Source: MOFSL, Company

Financials and Valuations

Key Assumptions

(INR Million)

Y/E March	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
INR/USD Rate	61.2	65.6	67.0	64.5	70.0	70.3	71.0
Revenues (USD m)	447	472	538	608	660	654	708
Offshore Revenue (%)	45.6	42.9	40.1	42.2	42.5	42.6	42.4
Total Headcount	11,529	11,626	12,048	13,087	13,916	14,650	15,210
Per Capita Productivity (USD)	38,757	40,599	44,655	46,435	47,427	44,642	46,580

E: MOFSL Estimates

Income Statement

(INR Million)

Y/E March	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Sales	27,359	30,955	36,066	39,176	46,175	45,997	50,302
Change (%)	24.0	13.1	16.5	8.6	17.9	(0.4)	9.4
Cost of Services	17,129	20,083	23,647	25,387	30,125	30,062	32,488
SG&A Expenses	6,217	6,626	7,569	8,296	9,606	9,237	9,850
EBITDA	4,014	4,247	4,850	5,493	6,444	6,697	7,964
% of Net Sales	14.7	13.7	13.4	14.0	14.0	14.6	15.8
Depreciation	713	893	953	1,051	1,113	1,852	1,947
Interest	80	199	189	232	362	491	462
Other Income	1,236	1,065	873	1,439	1,340	1,249	1,603
PBT	4,457	4,220	4,581	5,649	6,309	5,604	7,158
Tax	1,096	986	1,047	1,381	1,427	1,270	1,702
Rate (%)	24.6	23.4	22.9	24.4	22.6	22.7	23.8
Eq. in earnings of affiliates	150	121	123	44	1	0	0
Minority Interest	0	-6	43	-21	17	42	0
PAT	3,511	3,349	3,700	4,291	4,900	4,376	5,456
Extraordinary	0	97	-261	0	-112	0	0
Net Income	3,511	3,446	3,439	4,291	4,788	4,376	5,456
Change (%)	32.0	-1.9	-0.2	24.8	11.6	-8.6	24.7

Balance Sheet

(INR Million)

Y/E March	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Share Capital	562	562	563	563	552	552	552
Reserves	17,879	18,536	20,610	22,876	25,070	27,345	30,183
Net Worth	18,441	19,098	21,173	23,439	25,622	27,897	30,735
Minority Interest	122	128	26	3	0	0	0
Loan	1,300	1,467	1,874	2,263	3,375	3,475	3,575
Capital Employed	19,863	20,693	23,073	25,705	28,997	31,372	34,310
Gross Block	9,318	10,511	11,107	12,217	11,091	12,091	13,091
Less : Depreciation	-5,696	-6,535	-6,875	-7,791	-5,528	-7,380	-9,327
Net Block	3,622	3,975	4,232	4,426	5,563	4,711	3,764
CWIP	96	108	265	515	0	450	450
Other LT Assets	6,372	5,339	6,154	5,929	7,476	7,576	7,419
Curr. Assets	15,696	17,947	20,713	23,456	25,853	29,567	34,252
Current Investments	336	790	925	1,130	278	478	678
Inventories	606	979	935	1,312	1,833	2,108	2,424
Debtors	5,336	6,145	6,496	4,139	8,137	7,687	8,407
Cash & Bank Balance	5,704	6,833	8,781	9,807	9,705	9,891	12,923
Loans & Advances	1,356	1,089	0	0	0	0	0
Other Current Assets	2,358	2,111	3,576	7,068	5,900	9,402	9,821
Current Liab. & Prov	5,923	6,676	8,291	8,621	9,895	10,932	11,576
Current Liabilities	3,566	4,253	5,180	5,593	5,849	6,586	6,930
Other liabilities	1,401	1,843	2,876	2,799	3,333	3,533	3,733
Provisions	956	579	235	229	713	813	913
Net Current Assets	9,773	11,271	12,422	14,835	15,958	18,635	22,677
Application of Funds	19,863	20,694	23,073	25,705	28,997	31,372	34,310

E: MOFSL Estimates

Financials and Valuations

Ratios						(INR Million)	
Y/E March	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Basic (INR)							
EPS	31.3	30.7	30.6	38.2	43.4	39.6	49.4
Cash EPS	37.6	38.7	39.1	47.6	53.5	56.4	67.1
Book Value	164.3	170.2	188.7	208.9	232.1	252.7	278.4
DPS	8.0	7.0	10.5	13.0	13.0	13.0	15.0
Payout %	25.6	22.8	34.3	34.0	30.0	32.8	30.4
Valuation (x)							
P/E	14.3	14.6	14.6	11.7	10.3	11.3	9.0
Cash P/E	11.9	11.6	11.4	9.4	8.4	7.9	6.7
EV/EBITDA	11.3	10.4	8.7	7.6	6.7	6.4	5.0
EV/Sales	1.7	1.4	1.2	1.1	0.9	0.9	0.8
Price/Book Value	2.7	2.6	2.4	2.1	1.9	1.8	1.6
Dividend Yield (%)	1.8	1.6	2.3	2.9	2.9	2.9	3.4
Profitability Ratios (%)							
RoE	19.0	18.0	16.2	18.3	18.7	15.7	17.8
RoCE	17.2	16.4	15.9	17.3	17.8	15.0	16.9
ROIC	21.9	19.3	23.1	24.5	24.8	18.9	22.5
Turnover Ratios							
Debtors (Days)	91	92	84	64	64	88	88
Fixed Asset Turnover (x)	1.1	1.1	1.1	1.1	1.2	1.1	1.1
Cash Flow Statement						(INR Million)	
Y/E March	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
CF from Operations	3,282	3,715	3,833	4,622	5,411	6,020	7,036
Cash for Working Capital	335	-931	366	-1,659	-1,710	-2,291	-553
Net Operating CF	3,617	2,785	4,199	2,963	3,701	3,729	6,483
Net Purchase of FA	-803	-1,282	-1,038	-1,469	-1,440	-1,450	-1,000
Free Cash Flow	2,814	1,503	3,161	1,494	2,261	2,279	5,483
Net Purchase of Invest.	-4,479	434	-765	600	-767	499	630
Net Cash from Invest.	-5,282	-848	-1,803	-869	-2,207	-951	-370
Proc. from equity issues	66	22	15	9	-1,609	0	0
Proceeds from LTB/STB	399	490	-203	526	549	-491	-462
Dividend Payments	-784	-1,619	-746	-1,894	-1,261	-2,100	-2,619
Cash Flow from Fin.	-319	-1,107	-934	-1,359	-2,321	-2,591	-3,081
Exchange difference	802	300	488	502	929	0	0
Net Cash Flow	-1,183	1,129	1,950	1,237	102	186	3,031
Opening Cash Bal.	6,886	5,704	6,831	8,570	9,603	9,705	9,891
Add: Net Cash	-1,183	1,129	1,950	1,237	102	186	3,031
Closing Cash Bal.	5,704	6,833	8,781	9,807	9,705	9,891	12,923

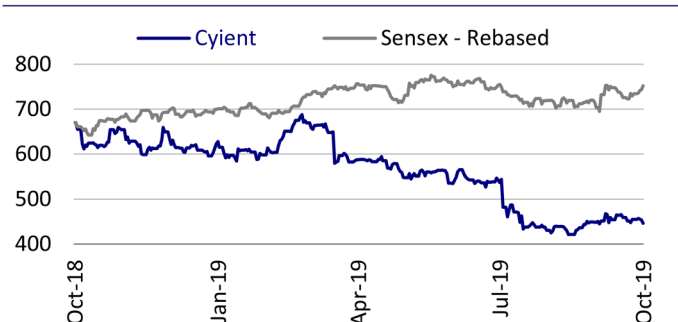
E: MOFSL Estimates

Corporate profile

Company description

Cyient Limited provides engineering services, data analytics, and data, networks and operations solutions. The Company offers its services to the aerospace and defense, energy, heavy machinery, consumer, medical utility, communications, semiconductor, and transportation industries around the world.

Exhibit 1: Sensex rebased



Source: MOFSL/Bloomberg

Exhibit 2: Shareholding pattern (%)

	Jun-19	Mar-19	Jun-18
Promoter	22.7	22.5	22.1
DII	20.1	21.9	22.9
FII	45.6	44.5	43.1
Others	11.5	11.1	11.9

Note: FII Includes depository receipts

Source: Capitaline

Exhibit 3: Top holders

Holder Name	% Holding
Amansa Holdings Private Limited	6.8
T. Rowe Price International Discovery Fund	4.0
First State Investments Ivc- Stewart Investors As	3.6
Reliance Emergent India Fund	3.6
Fidelity Investment Trust Fidelity Series Emerging	3.5

Source: Capitaline

Exhibit 4: Top management

Name	Designation
B V R Mohan Reddy	Executive Chairman
Krishna Bodanapu	Managing Director
Alan De Taeye	Director
M M Murugappan	Director
Sudheendhra Putty	Company Secretary
Alan De Taeye	Director

Source: Capitaline

Exhibit 5: Directors

Name	Name
Andrea Bierce	Som Mittal
John Paterson	Vinai Thummalapally
K Ramachandran	Vivek Narayan Gour
Matangi Gowrishankar	Vikas Sehgal

*Independent

Exhibit 6: Auditors

Name	Type
Deloitte Haskins & Sells LLP	Statutory
Ernst & Young LLP	Internal
S Chidambaram	Secretarial Audit

Source: Capitaline

Exhibit 7: MOFSL forecast v/s consensus

EPS (INR)	MOFSL forecast	Consensus forecast	Variation (%)
FY20	39.6	42.2	-6.1
FY21	49.4	47.0	5.2

Source: Bloomberg

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

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