

Estimate change



TP change



Rating change



Bloomberg	CYL IN
Equity Shares (m)	113
M.Cap.(INRb)/(USDb)	85.4 / 1
52-Week Range (INR)	1292 / 726
1, 6, 12 Rel. Per (%)	-5/-9/-23
12M Avg Val (INR M)	269

#### Financials & Valuations (INR b)

Y/E Mar	2022	2023E	2024E
Sales	45.3	58.3	68.9
EBIT Margin (%)	13.9	13.2	13.7
PAT	5.2	5.9	7.1
EPS (INR)	47.8	53.4	64.9
EPS Gr. (%)	41.3	11.8	21.5
BV/Sh. (INR)	285.1	287.2	313.2

#### Ratios

RoE (%)	17.2	18.7	21.6
RoCE (%)	13.6	15.8	17.5
Payout (%)	60.0	60.0	60.0

#### Valuations

P/E (x)	16.2	14.5	11.9
P/BV (x)	2.7	2.7	2.5
EV/EBITDA (x)	9.1	6.8	5.3
Div Yield (%)	3.7	4.1	5.0

#### Shareholding pattern (%)

As On	Jun-22	Mar-22	Jun-21
Promoter	23.4	23.4	23.5
DII	23.9	23.3	21.3
FII	32.7	34.0	38.3
Others	20.0	19.3	16.9

FII Includes depository receipts

**CMP: INR773**
**TP: INR910 (+18%)**
**Buy**

### Good margin performance and valuation adds to comfort

#### Its FY24 revenue guidance looks ambitious

- CYL reported a 2QFY23 revenue growth of 10% QoQ in USD CC terms (largely due to acquisition-related benefits), 110bp below our estimate. Excluding the inorganic impact, its Services business grew 3% QoQ CC (in line). DLM remained weak, declining by 3.3% QoQ.
- The management maintained its organic revenue growth guidance of 13-15% in CC terms in FY23. With the closure of the Citec acquisition in 2Q, it expects acquisitions to add an additional 14-15% to growth in FY23. With supply challenges easing in DLM and improved deal flows, it reiterated its high single-digit growth guidance in DLM.
- Operating profit in 2QFY23 was impacted by one-off cost from a US class action suit (CYL is contesting it) and a one-time fee related to acquisitions. The adjusted EBIT margin was broadly stable in 2QFY23 at 12.5% (down 30bp QoQ) and was 120bp above our estimate, despite a wage hike impact. The management maintained its FY23 EBIT margin guidance of 13-14%.
- CYL guided at an initial revenue run-rate of USD1b for FY24, along with an EPS of at least INR60/share. While we expect it to achieve its EPS guidance, we remain skeptical of it meeting its revenue outlook.
- Strong deal pipeline and order book in 1HFY23 should support its growth trajectory for FY23. Moreover, the company should see a big inorganic growth component with recent acquisitions. This should result in a strong reported USD growth of 28.6% YoY.
- CYL should improve margin with better pricing, pyramid rationalization, and operating leverage, which should result in improved profitability over 2HFY23. We expect it to deliver an EBIT margin within its guidance range of 13-14% (MOFSL of 13.2%).
- We continue to see a long-term growth in spends in the ER&D industry, although there are near-term concerns emanating from a macro slowdown. We view current valuations as attractive as it factors in all concerns on the macro and execution front, but not on long-term business opportunities.
- We increase our FY23/FY24 EPS estimate by 6%/5% on better growth and margin. We maintain our Buy rating on the stock on attractive valuations. Our target multiple of 14x FY24 EPS implies a TP of INR910, with a potential upside of 18%.

#### Good margin performance and order book

- Revenue grew 20.4% YoY in CC terms, EBIT in INR terms rose 6.6%, and PAT in INR terms grew 0.5% in 2QFY23.
- In USD terms, revenue grew 10% QoQ to USD174.8m in CC terms largely driven by acquisitions, 110bp below our estimate.
- Revenue from Services rose 12.3% QoQ in CC terms (3% QoQ organic). DLM declined by 3.3% QoQ.

- The management maintained its FY23 organic revenue growth guidance at 13-15% YoY in CC terms. It said it will add 14-15% from acquisitions in CC terms.
- CYL maintained its EBIT margin guidance at 13-14% for the organic business. EBITDA will be in the 16-17% range as acquisitions are marginally accretive.
- PAT grew 5% QoQ to INR1.2b, above our estimate of INR1.14b on better margin.

#### Key highlights from the management commentary

- The management sees significant growth opportunities in Europe and America in the Defense space. Around 15-20% of its Aero-related orders are in the Defense industry and CYL is seeing opportunities there.
- Shortages continue to impact the Rail vertical, and a recovery is expected by 4QFY23.
- Though there are some delays and hiring freezes from customers that need to work with external partners, CYL is not seeing any meaningful impact as of now.
- It expects DLM to do well in 2HFY23 due to seasonality and supply-chain visibility. It sees opportunities to grow the DLM business by five times in five years.

#### Maintain our Buy rating

- We continue to see a strong rebound in ER&D spending, led by increased outsourcing and larger deal sizes. The management's plan to leverage these spends, led by a refreshed GTM strategy and increased focus on large deal wins, should bode well for its growth performance.
- The growth momentum in verticals such as Communications, Utilities, Medical Devices, Automotive, and Mining is likely to continue for the next two-to-three years.
- We maintain our **Buy** rating led by attractive valuations. **Our target multiple of 14x FY24E EPS implies a TP of INR910, with a potential upside of 18%.**

#### Quarterly performance

Y/E March	FY22				FY23E				FY22	FY23E	(INR m)	
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			FY23E	Var. (%/bp)
Revenue (USD m)	144	150	158	157	162	175	190	196	608	722	177	-1.0
QoQ (%)	-4.3	4.6	5.2	-0.8	3.1	8.2	8.7	3.0	9.2	18.7	9.3	-114bp
Revenue (INR m)	10,582	11,116	11,834	11,812	12,501	13,962	15,681	16,149	45,344	58,293	14,078	-0.8
YoY (%)	6.7	10.8	13.3	8.0	18.1	25.6	32.5	36.7	9.7	28.6	26.7	-105bp
GPM (%)	35.9	38.4	36.3	38.3	36.8	38.4	38.5	39.0	37.3	38.3	36.0	244bp
SGA (%)	18.2	19.8	18.4	20.2	21.2	22.0	20.0	19.7	19.1	20.7	21.0	104bp
EBITDA	1,878	2,074	2,128	2,136	1,946	2,290	2,901	3,117	8,216	10,254	2,112	8.4
EBITDA margin (%)	17.7	18.7	18.0	18.1	15.6	16.4	18.5	19.3	18.1	17.6	15.0	140bp
EBIT	1,388	1,557	1,641	1,707	1,435	1,660	2,211	2,406	6,293	7,712	1,506	10.2
EBIT margin (%)	13.1	14.0	13.9	14.5	11.5	11.9	14.1	14.9	13.9	13.2	10.7	119bp
Other income	147	58	105	377	160	-148	78	81	687	171	56	-362.8
ETR (%)	25.1	25.0	24.6	26.1	27.2	19.4	27.0	27.0	25.2	25.6	27.0	
Adj. PAT	1,150	1,212	1,316	1,541	1,161	1,218	1,671	1,816	5,219	5,866	1,141	6.8
QoQ (%)	3.9	5.4	8.6	17.1	-24.7	4.9	37.2	8.6			-1.7	665bp
YoY (%)	41.3	44.4	37.9	39.3	0.9	0.5	27.0	17.8	40.5	12.4	-5.9	637bp
EPS (INR)	10.5	11.1	12.1	14.1	10.6	11.1	15.2	16.5	47.8	53.4	10.4	6.4

## Key performance indicators

Y/E March	FY22				FY23E				FY22	FY23E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Margins (%)										
Gross Margin	35.9	38.4	36.3	38.3	36.8	38.4	38.5	39.0	37.3	38.3
EBIT Margin	13.1	14.0	13.9	14.5	11.5	11.9	14.1	14.9	13.9	13.2
Net Margin	10.9	10.9	11.1	13.0	9.3	8.7	10.7	11.2	11.5	10.1
Operating metrics										
Headcount	12,433	12,707	12,845	13,428	14,147	15,598			13,428	
Attrition (%)	23.5	24.3	29.3	26.9	27.9	28.4			26.9	
Key verticals (YoY %)										
Aerospace and Defense	-3%	13%	19%	-2%	7%	-1%			3%	3%
Transportation	23%	0%	-12%	-14%	-23%	-31%			1%	1%
Communications	18%	5%	4%	7%	15%	20%			8%	8%
Key geographies (YoY %)										
North America	1%	9%	12%	18%	21%	20%			10%	10%
Europe	30%	-5%	11%	5%	-10%	22%			9%	9%



## Key highlights from the management commentary

## Performance in 2QFY23

- CYL reported a 10% QoQ CC growth in revenue. The Services business grew 12.3% in CC, while DLM fell 3.3%. A large part of the revenue growth was driven by acquisitions.
- Order intake grew 58.6% YoY in 2QFY23. It won five large deals (four in Services and one in the DLM business), with a potential TCV of USD105m.
- All recent acquisitions have concluded, and integration is progressing well. All acquisitions are margin accretive and will add ~USD150m in revenue on an annualized basis.

## Commentary on verticals

- The growth was led by Aerospace and Communication, while the same in the Rail vertical was weak.
- Mining performed well on a QoQ basis. New growth areas are ramping up well.
- In the Aerospace vertical, demand is steadily increasing, although supply-chain challenges continue. It is seeing a lot of opportunity in aftermarket as many aircrafts are coming to shop for aftermarket work. The management expects 10% growth in this vertical for FY23.
- It bagged a very large deal from Honeywell Anthem for a digital cockpit.
- The management sees significant growth opportunities in Europe and America in the Defense space. Around 15-20% of its Aero-related orders are in the Defense industry and CYL is seeing opportunities there.
- Shortages continue to impact the Rail vertical, and a recovery is expected by 4QFY23.
- In the Communications vertical, the network rollout momentum remains strong. Though 2QFY23 had one execution issue, it expects strong growth there.
- It sees good opportunities for growth in the Energy and Utilities space. Mining should continue to do well going forward.
- The board approved the formation of a sub-committee to look at DLM due to opportunities in the EMS space in 2QFY23.

- CYL derives significant synergies and there are common clients and engineering capabilities between the DLM and the Services vertical. Hence, it will maintain its relationships with DLM clients. It saw a good deal win traction in the DLM business.

### Margin

- CYL delivered a normalized EBITDA margin (excluding exceptional and M&As) of 16.4%.
- There was a class action lawsuit against CYL in 2QFY23, which added USD2.7m to its cost. It will continue to incur costs, although at a lower value.
- The management does not see any material margin headwind for the remainder of FY23.
- In 2QFY23, it saw a 150bp wage hike impact and it has been able to offset the same by offshoring, price increases, and its automation initiatives.
- EBIT margin has been impacted by 3.5% due to a one-off case in 2QFY23.

### Outlook

- Though there are some delays and hiring freezes from customers that need to work with external partners, CYL is not seeing any meaningful impact as of now.
- The management guided at organic revenue growth of 13-15% CC in FY23, while DLM will grow in the high single-digits.
- Revenue from recent acquisitions should add 14-15% to FY23 revenue in CC terms.
- It expects DLM to do well in 2HFY23 due to seasonality and supply-chain visibility. It sees opportunities to grow the DLM business by five times in five years.
- Normalized EBITDA for the group should be 16-17% in FY23.

### Exhibit 1: Strong growth in Europe on the back of the Citec acquisition

Geographies	Contribution to revenue (%)	QoQ growth (%)	YoY growth (%)
Americas	50.4	6.3	20.3
Europe	26.0	23.9	22.1
Asia Pacific	23.6	(1.8)	4.1

Source: Company, MOFSL

### Valuation and view

- We continue to see a strong rebound in ER&D spending, led by increased outsourcing and larger deal sizes. The management's plan to leverage these spends, led by a refreshed GTM strategy and increased focus on large deal wins, should bode well for its growth performance.
- The growth momentum in verticals such as Communications, Utilities, Medical Devices, Automotive, and Mining is likely to continue for the next two-to-three years.
- We maintain our **Buy** rating led by attractive valuations. **Our target multiple of 14x FY24E EPS implies a TP of INR910, with a potential upside of 18%.**

### Exhibit 2: Revisions to our estimates

	Revised estimates		Earlier estimates		Change in estimates (%)	
	FY23	FY24	FY23	FY24	FY23	FY24
USD:INR	80.5	82.5	80.2	81.8	0.5	0.9
Revenue (USD m)	722	835	727	811	-0.7	3.0
Growth (%)	18.7	15.6	19.6	11.5	-80bp	410bp
EBIT margin (%)	13.2	13.7	12.3	13.5	100bp	20bp
PAT (INR m)	5,866	7,129	5,497	6,777	6.7	5.2
EPS	53.4	64.9	50.2	61.9	6.4	4.9

Source: MOFSL

## Operating metrics

Exhibit 3: Operating metrics

	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23	2QFY23
<b>Geographic mix (%)</b>									
Americas	49.9	49.1	47.4	47.9	48.8	49.2	53.5	51.3	50.4
Europe	28.9	25.3	24.6	28.4	24.8	25.1	24.6	22.7	26.0
Asia Pacific	21.2	25.6	28.0	23.7	26.4	25.7	22.0	26.0	23.6
<b>Vertical mix (%)</b>									
Aerospace and Defense	31.6	32.6	34.1	32.1	32.1	34.6	31.9	30.5	27.3
Transportation	12.1	11.5	11.0	11.5	10.9	9.1	9.0	7.9	6.5
Semiconductor	4.5	4.3	5.0	5.4	6.6	6.4	6.2	5.0	5.0
Medical and Electronics	8.2	7.1	6.5	0.0	0.0	0.0	0.0	0.0	0.0
Communications	24.0	24.1	23.3	24.8	22.7	22.4	23.9	25.4	23.3
<b>Utilization (%)</b>									
Overall	78.8	80.9	83.7	83.1	85.0	86.2	86.1	80.9	84.6
<b>Client contribution (%)</b>									
Top five	29.5	28.8	33.5	31.9	31.7	28.1	30.6	27.7	25.2
Top 10	38.4	38.4	44.1	43.3	43.2	41.7	42.6	39.3	37.2
<b>Number of clients (USD m)</b>									
Over USD1m	95	94	90	89	92	93	93	94	98
Over USD5m	32	32	30	30	32	36	34	32	37
Over USD10m	7	7	8	10	10	10	11	11	12
Over USD20m	3	3	3	3	3	3	3	4	4
<b>Voluntary attrition (%)</b>	9.2	13.2	21.2	23.5	24.3	29.3	26.9	27.9	28.4

Source: Company, MOFSL

## Financials and valuations

Income Statement							(INR m)	
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
<b>Sales</b>	<b>36,066</b>	<b>39,176</b>	<b>46,175</b>	<b>44,275</b>	<b>41,325</b>	<b>45,344</b>	<b>58,293</b>	<b>68,899</b>
Change (%)	16.5	8.6	17.9	(4.1)	(6.7)	9.7	28.6	18.2
Cost of Services	23,647	25,387	30,125	28,964	27,162	28,453	35,991	42,874
SG&A Expenses	7,569	8,296	9,606	9,352	8,056	8,675	12,049	13,573
<b>EBITDA</b>	<b>4,850</b>	<b>5,493</b>	<b>6,444</b>	<b>5,959</b>	<b>6,107</b>	<b>8,216</b>	<b>10,254</b>	<b>12,452</b>
As a percentage of Net Sales	13.4	14.0	14.0	13.5	14.8	18.1	17.6	18.1
Depreciation	953	1,051	1,692	1,878	1,944	1,923	2,542	3,032
Other Income	684	1,207	864	734	684	687	171	344
<b>PBT</b>	<b>4,581</b>	<b>5,649</b>	<b>5,616</b>	<b>4,815</b>	<b>4,847</b>	<b>6,980</b>	<b>7,883</b>	<b>9,765</b>
Tax	1,047	1,381	2,327	1,076	1,133	1,761	2,018	2,636
Rate (%)	22.9	24.4	41.4	22.3	23.4	25.2	25.6	27.0
<b>Net Income</b>	<b>3,534</b>	<b>4,268</b>	<b>3,307</b>	<b>3,726</b>	<b>3,714</b>	<b>5,219</b>	<b>5,866</b>	<b>7,129</b>
Change (%)	9.3	20.8	-22.5	12.7	-0.3	40.5	12.4	21.5

Balance Sheet							(INR m)	
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Share Capital	563	563	552	550	550	552	552	552
Reserves	20,610	22,876	25,089	25,059	29,023	30,614	31,005	33,857
<b>Net Worth</b>	<b>21,173</b>	<b>23,439</b>	<b>25,641</b>	<b>25,609</b>	<b>29,573</b>	<b>31,166</b>	<b>31,557</b>	<b>34,409</b>
Other liabilities	1,408	1,636	2,240	4,194	3,812	4,061	5,390	6,377
Loan	1,651	2,410	3,253	3,738	2,755	3,264	3,264	3,264
<b>Capital Employed</b>	<b>24,232</b>	<b>27,485</b>	<b>31,134</b>	<b>33,541</b>	<b>36,140</b>	<b>38,491</b>	<b>40,212</b>	<b>44,050</b>
<b>Applications</b>								
Gross Block	11,107	12,217	13,289	17,388	18,088	18,838	19,588	20,338
Less: Depreciation	6,875	7,791	8,766	9,712	11,656	13,579	16,121	19,152
<b>Net Block</b>	<b>3,017</b>	<b>3,220</b>	<b>3,530</b>	<b>6,909</b>	<b>7,181</b>	<b>6,787</b>	<b>3,467</b>	<b>1,186</b>
CWIP	92	213	300	800	113	134	134	134
Intangibles	4,666	5,057	6,990	6,800	7,191	6,662	6,662	6,662
Other assets	2,876	2,380	2,219	2,638	1,925	5,318	5,554	5,753
<b>Curr. Assets</b>	<b>20,713</b>	<b>23,456</b>	<b>25,853</b>	<b>24,650</b>	<b>28,518</b>	<b>28,972</b>	<b>37,124</b>	<b>44,672</b>
Debtors	6,496	6,913	8,137	7,262	8,026	7,333	10,541	12,458
Cash and Bank Balance	8,571	9,604	9,073	8,995	14,408	12,157	16,136	19,204
Other Current Assets	4,721	5,809	8,365	8,393	6,084	8,616	8,582	10,144
<b>Current Liab. and Prov.</b>	<b>7,132</b>	<b>6,841</b>	<b>7,758</b>	<b>8,256</b>	<b>8,788</b>	<b>9,382</b>	<b>12,304</b>	<b>13,931</b>
Trade payables	4,021	3,813	3,712	3,729	4,532	5,259	7,985	9,438
Other liabilities	2,876	2,799	3,757	4,150	3,872	3,709	3,777	3,853
Provisions	235	229	289	377	384	414	542	640
<b>Net Current Assets</b>	<b>13,581</b>	<b>16,615</b>	<b>18,095</b>	<b>16,394</b>	<b>19,730</b>	<b>19,590</b>	<b>24,821</b>	<b>30,741</b>
<b>Application of Funds</b>	<b>24,232</b>	<b>27,485</b>	<b>31,134</b>	<b>33,541</b>	<b>36,140</b>	<b>38,491</b>	<b>40,638</b>	<b>44,476</b>

## Financials and valuations

### Ratios

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
<b>Basic (INR)</b>								
<b>EPS</b>	<b>31.5</b>	<b>38.0</b>	<b>30.0</b>	<b>33.8</b>	<b>33.8</b>	<b>47.8</b>	<b>53.4</b>	<b>64.9</b>
Cash EPS	40.0	47.4	45.3	50.8	51.5	65.3	76.5	92.5
Book Value	189.5	209.8	232.3	232.0	269.1	285.1	287.2	313.2
DPS	10.5	13.0	13.0	27.0	24.5	28.7	32.0	38.9
Payout (%)	33.3	34.2	43.4	80.0	72.5	60.0	60.0	60.0
<b>Valuation (x)</b>								
P/E ratio	24.5	20.3	25.8	22.9	22.9	16.2	14.5	11.9
Cash P/E ratio	19.3	16.3	17.1	15.2	15.0	11.8	10.1	8.4
EV/EBITDA ratio	16.2	14.2	12.3	13.4	12.0	9.1	6.8	5.3
EV/Sales ratio	2.2	2.0	1.7	1.8	1.8	1.6	1.2	1.0
Price/Book Value ratio	4.1	3.7	3.3	3.3	2.9	2.7	2.7	2.5
Dividend Yield (%)	1.4	1.7	1.7	3.5	3.2	3.7	4.1	5.0
<b>Profitability Ratios (%)</b>								
RoE	17.9	19.1	13.5	14.6	13.5	17.2	18.7	21.6
RoCE	13.8	13.8	10.2	10.6	9.9	13.6	15.8	17.5
<b>Turnover Ratios</b>								
Debtors (Days)	64	62	59	63	68	67	66	66

### Cash Flow Statement

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
<b>(INR m)</b>								
CF from Operations	3,833	4,622	5,411	5,496	5,872	7,318	8,407	10,160
Cash for Working Capital	366	-1,659	-1,710	328	2,686	-973	841	-1,065
<b>Net Operating CF</b>	<b>4,199</b>	<b>2,963</b>	<b>3,701</b>	<b>5,824</b>	<b>8,558</b>	<b>6,345</b>	<b>9,248</b>	<b>9,095</b>
Net Purchase of FA	-1,038	-1,469	-1,440	-2,138	-949	-626	-750	-750
<b>Free Cash Flow</b>	<b>3,161</b>	<b>1,494</b>	<b>2,261</b>	<b>3,686</b>	<b>7,609</b>	<b>5,719</b>	<b>8,498</b>	<b>8,345</b>
Net Purchase of Invest.	-765	600	-767	568	-58	-3,197	-1,000	-1,000
<b>Net Cash from Invest.</b>	<b>-1,803</b>	<b>-869</b>	<b>-2,207</b>	<b>-1,570</b>	<b>-1,007</b>	<b>-3,823</b>	<b>-1,750</b>	<b>-1,750</b>
Proc. from equity issues	16	9	22	17	37	121	0	0
Proceeds from LTB/STB	-203	526	549	-916	-2,134	-1,994	0	0
Dividend Payments	-746	-1,894	-2,892	-3,564	-10	-2,952	-3,520	-4,277
<b>Cash Flow from Fin.</b>	<b>-933</b>	<b>-1,359</b>	<b>-2,321</b>	<b>-4,463</b>	<b>-2,107</b>	<b>-4,825</b>	<b>-3,520</b>	<b>-4,277</b>
Exchange difference	277	298	296	131	-31	52	0	0
<b>Net Cash Flow</b>	<b>1,740</b>	<b>1,033</b>	<b>-531</b>	<b>-78</b>	<b>5,413</b>	<b>-2,251</b>	<b>3,979</b>	<b>3,068</b>
<b>Opening Cash Bal.</b>	<b>6,831</b>	<b>8,571</b>	<b>9,604</b>	<b>9,073</b>	<b>8,995</b>	<b>14,408</b>	<b>12,157</b>	<b>16,136</b>
Add: Net Cash	1,740	1,033	-531	-78	5,413	-2,251	3,979	3,068
<b>Closing Cash Bal.</b>	<b>8,571</b>	<b>9,604</b>	<b>9,073</b>	<b>8,995</b>	<b>14,408</b>	<b>12,157</b>	<b>16,136</b>	<b>19,204</b>

## 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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