

Tata Elxsi Limited: NEUTRAL (Target Price: Rs. 6,755)

Tata Elxsi is amongst the fastest growing premium engineering service provider with domain expertise across industries, including Automotive, Broadcast, Communications, Healthcare, and Transportation. The company has recently opened a Global Engineering Center (GEC) in partnership with Schaeffler Technologies, a world leader in providing mechatronics solutions for the Transportation industry. Apart from being one of the top five ADAS service providers globally, it is also a significant contributor to the media & communications industry with innovative designs for 5G use cases & medical health devices. In the recent past, the company has developed a niche clientele in the OTT media with rapid innovations in the AdTech space.

Given the rich valuation, despite the company's robust revenue growth & building pipeline of deal wins, we initiate a coverage on the stock with a NEUTRAL rating and a target price of Rs. 6,755.

Investment Thesis

- **Strong order book and health deal pipeline across key markets & industries provides revenue visibility over medium term.** CIER estimates indicate that Tata Elxsi's diverse portfolio of offerings coupled with the strong domain expertise and wide geographical presence will aid the company to maintain high top-line growth in medium term, having revenue CAGR c.23.8% over the period FY22-24E.
- **Industry leading margins in ER&D segment but headwinds of travel costs, wage-hikes & covid-related benefits reversing depicts stagnating margins over next twelve months.** The management's internal focus on disciplined execution & operational efficiency has resulted in the margin expansion benefits during the past few quarters. Our estimates indicate with return of travel costs as the pandemic resides, and having reaped the last offshore-on-site arbitrage the current supply side pressures may have deflationary impact on the current operating margins. The EBIT margins may have a downward trajectory in the near term inching towards ~26.5%, as the covid benefits reverse course. In the longer term the operational efficiencies due to scale will assist in EBIT margins being in the ~28%-30% range.
- **We value the stock based on DCF based methodology and ascribe a TP of Rs. 6755 implying a PE multiple of 68x on FY23E & 52x on FY24E EPS.** Increasing ramp up in the med-tech and transportation business segments to sustain revenue momentum however, stagnating margins in the near term pose a risk to high valuations. Current valuations leave no margin of safety, accordingly we ascribe an NEUTRAL rating on the stock.

Company Info

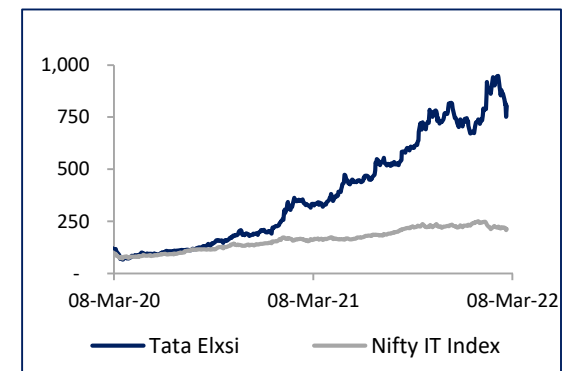
BB Code	TELX IN EQUITY
ISIN	INE670A01012
52 WKH	7,949
52 WKL	2,545
YTD Returns	10.34%
Market Cap (INR)	405Bn.
Shares.O.S/Float	62.23Mn/55.35%
TTM EPS	81.07
Est EPS FY23E	100.21
CMP (09-03-22)	Rs. 7,045

Shareholding Pattern (%)

	Dec-21	Sep-21	Jun-21
Promoters	44.32	44.53	44.53
FIIIs	11.93	12.71	11.81
DIIIs	5.55	4.96	5.77
Public	38.21	37.80	37.89

Relative Performance

	3Y	2Y	1Y
Nifty IT Index	109.2	102.1	34.6
Tata Elxsi	611.9	573.2	144.2



Revenue Profile: Key offerings by Embedded Product Design (EPD), the largest division (~86% of revenues) within the company

Transport

Key Offerings:

Infotainment; human machine interface (HMI); Powertrains & hybrid engines; Advanced driver assistance systems (ADAS), Connected Car

Key Marquee Clients:

Auto OEMS, Tier I & II Auto Ancillary which include Tata Motors – JLR, Toyota, Nissan, Ford, Panasonic, Hyundai, Mahindra, Schaeffler.

Broadcast & Communication

Key Offerings:

User Interface, UI & CX, Reference Design Kit (RDK), Integration of Android release, Proprietary software stacks, 5G device certification, testing

Key Marquee Clients:

Operators & broadcast partners such as Zee5 , Comcast, Sky, Time Warner Cable, Google, CISCO, Motorola, Qualcomm, Intel among others

Medical Devices

Key Offerings:

Product engineering, Value engineering, Modernization, Testing, Regulatory Compliances, and more

Key Marquee Clients:

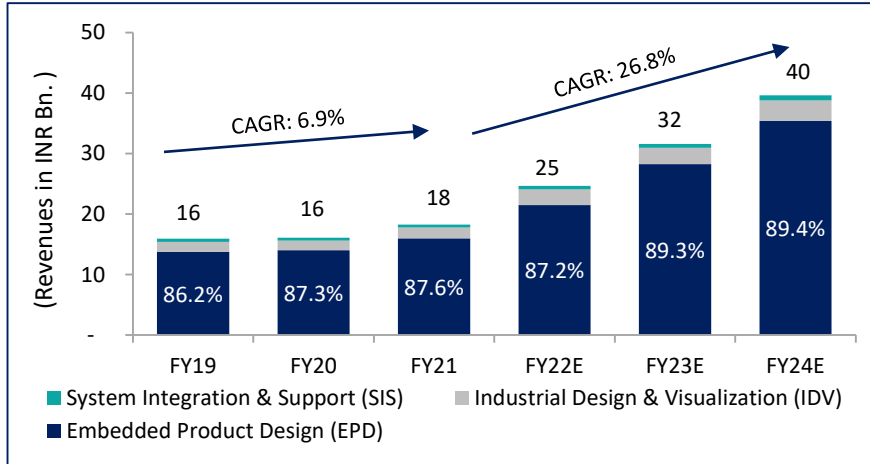
Aesculap, Hitachi, Becton Dickinson, Philips

Industrial Design & Visualization (IDV) division (~11.5% of revenues) harbours fastest growth potential – Illustrative list of projects include:

- T2 Airport Terminal Mumbai: Design aesthetics and customer experience touchpoints from security to boarding gates
- Comprehensive passenger experience design for Kochi Metro
- Orient electric tower cooler with IoT features
- POS and packaging design for BP Castrol, a leading global industrial and automotive lubricants brand
- Hindware Elara RO+UV Water Purifier design prototype
- Design engineering for cost-effective self-injection fixed dose pen

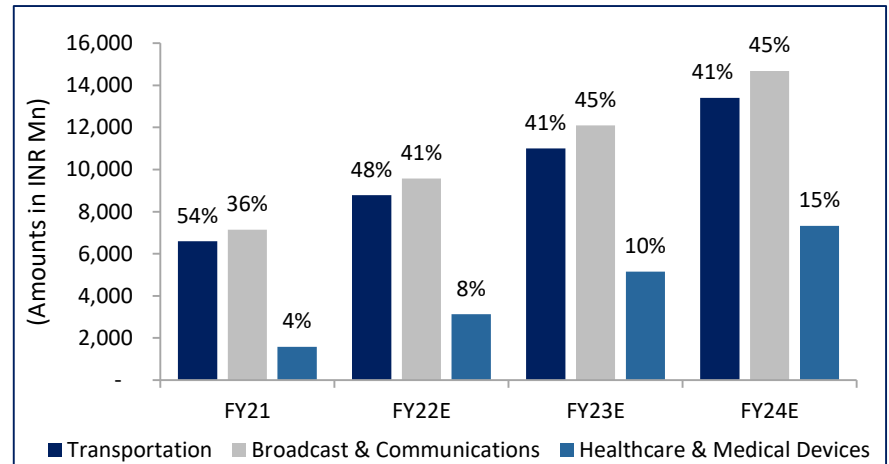
Building order book and healthy deal pipeline across key markets & industries, provides strong revenue visibility for upcoming quarters

Our estimates indicate TELX has entered a high growth phase



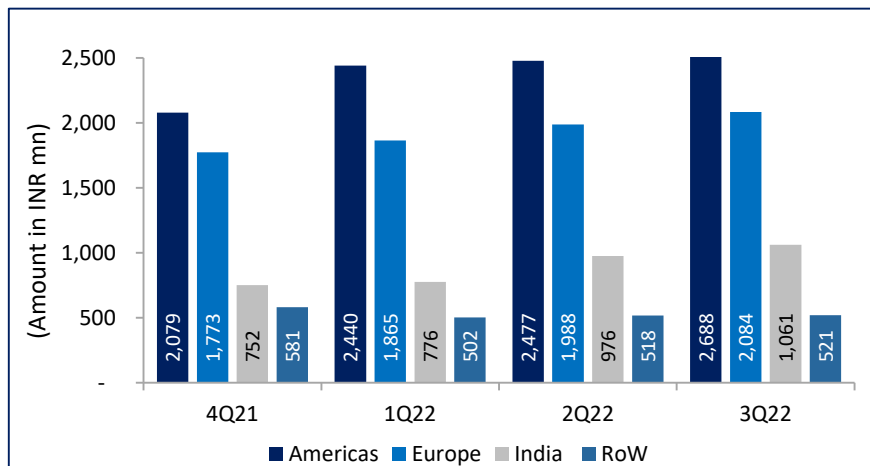
Source: Company Filings, Choice Institutional Equities Estimates

Broadcast & Communication vertical hoist accelerated growth



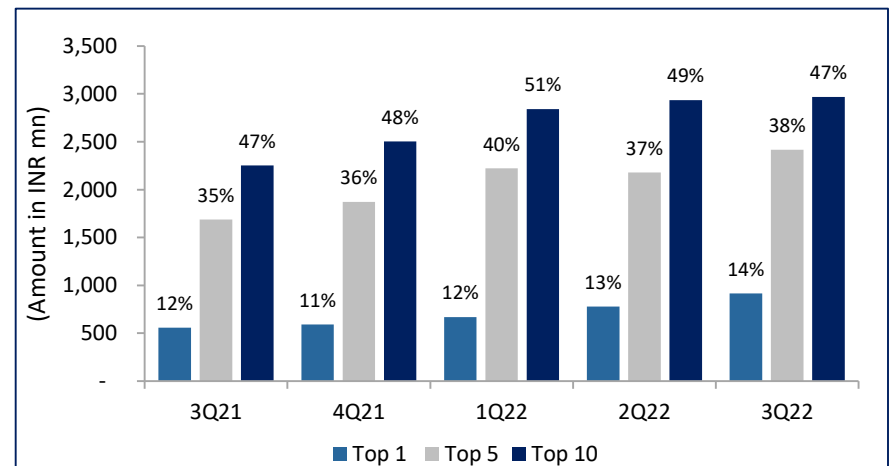
Source: Company Filings, Choice Institutional Equities Estimates

Robust demand across all key market segments witnessed



Source: Company Filings, Choice Institutional Equities Estimates

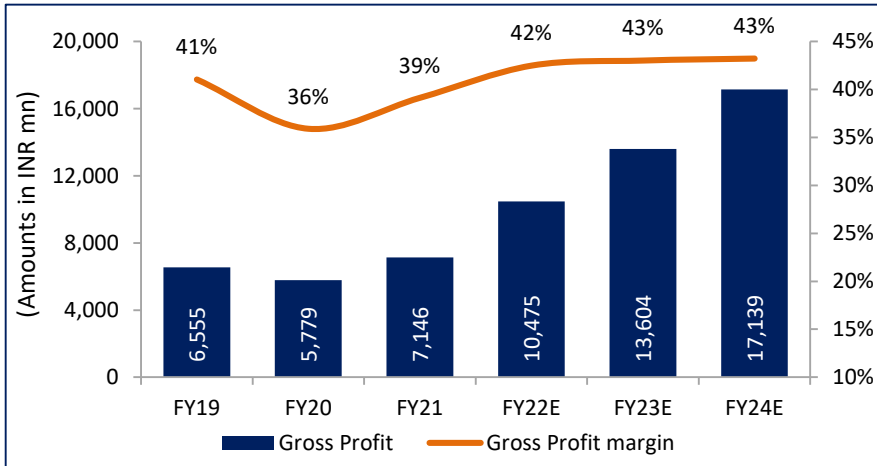
Deeper client mining & large deal wins have improved client-mix



Source: Company Filings, Choice Institutional Equities Estimates

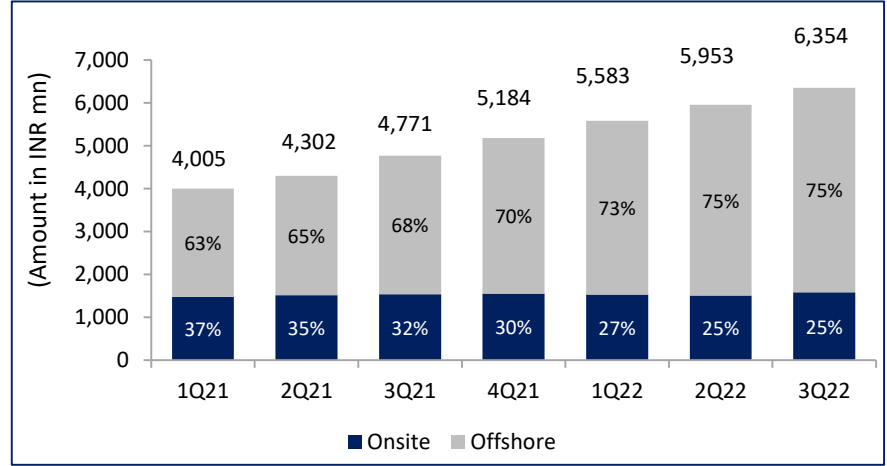
Management remains confident on sustaining margins on high value service mix, easing of supply side constraints and higher utilization levels

Emphasis on quality of revenue mix: better margin deals



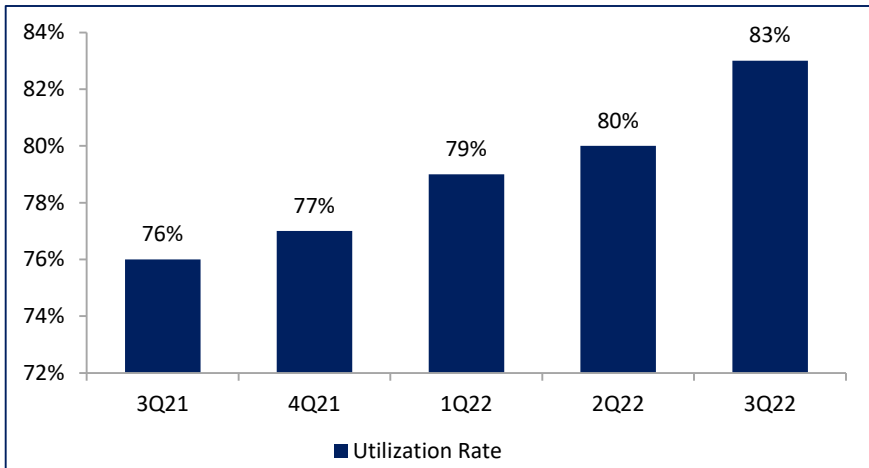
Source: Company Filings, Choice Institutional Equities Estimates

Reaping benefits of offshore – onsite arbitrage



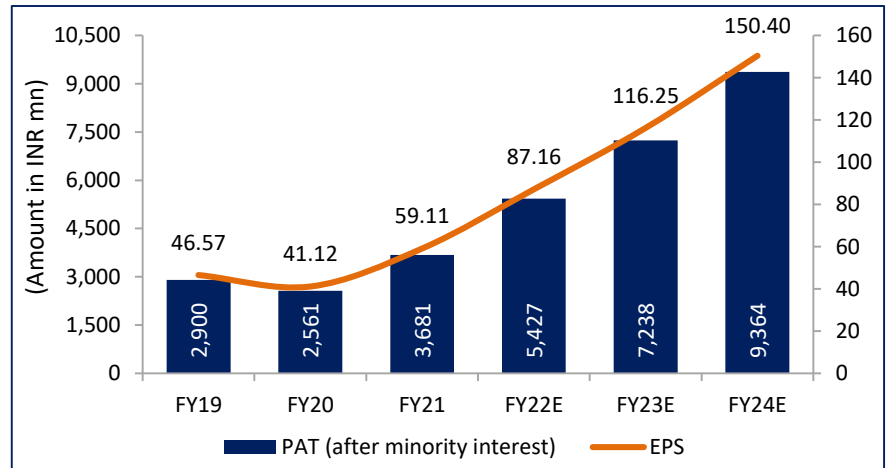
Source: Company Filings, Choice Institutional Equities Estimates

Operational efficiencies leading to higher utilization levels



Source: Company Filings, Choice Institutional Equities Estimates

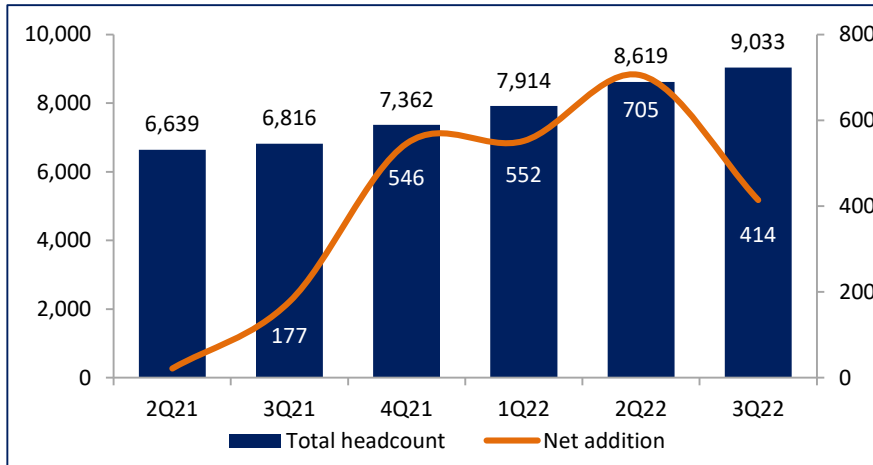
Economies of scale foray into bottom-line expansion



Source: Company Filings, Choice Institutional Equities Estimates

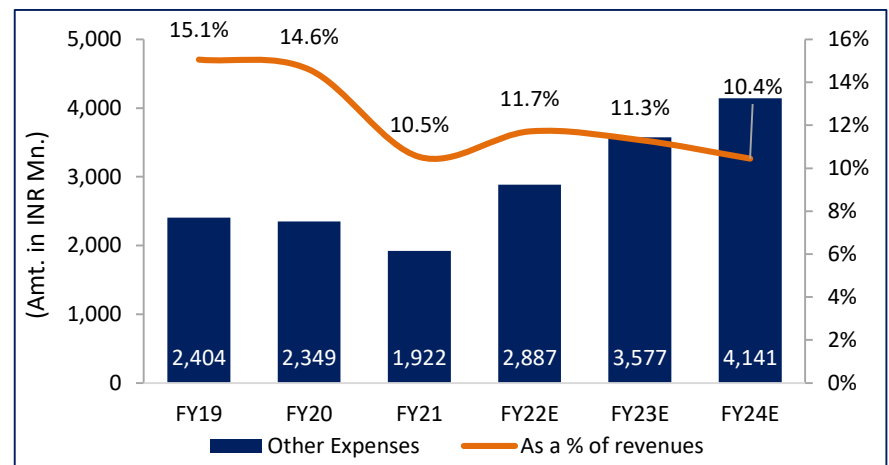
Headwinds of travel costs returning, wake-hikes & covid-related benefits reversing depicts possibility of stagnating margins in near term

Demand Supply mis-match in Industry leading to higher talent costs



Source: Company Filings, Choice Institutional Equities Estimates

Plausible cues for uptick in other expenses as covid benefits wane



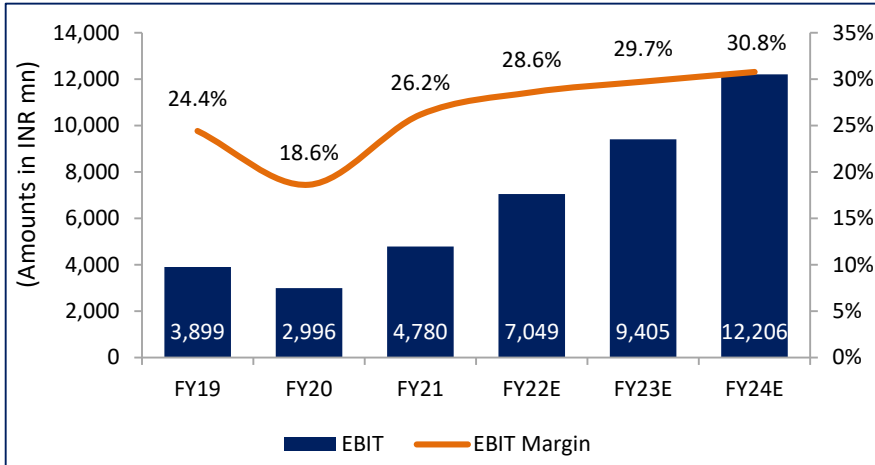
Source: Company Filings, Choice Institutional Equities Estimates

Key Risks

- Rise in fixed price contracts signed depicts a significant risk in terms of project management capabilities. If the internal controls of the company falter in delivering the required level of efficiency or delivery excellence, the margins may decline more so currently estimated.
- Rising supply side constraints in terms of talent supply, fresher intake & training, lateral hires are peaking out. We have estimated this situation to normalize in the next twelve months, failing which the gross margins in the projects undertaking make take a steep decline. Furthermore, lack of timely supply may hamper the ongoing work & delay the project completions which may lead to losing market share.
- The projects taken up deploying newer technologies, may be lead to higher development costs and may not be margin accretive in the long run. The costs incurred in the developing in-house capabilities may not be all fruitful.
- The company operates in a highly competitive environment, with many peers offering similar services and product integrations. Any key client migrating work to peers may hamper the robust revenue growth trajectory.

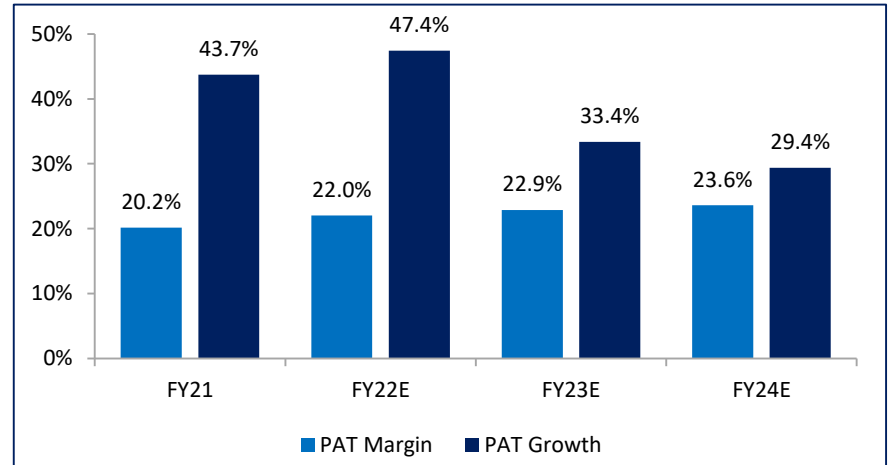
Underlying margin expansion, one of the key factors behind Tata Elxsi being a marathon runner at sprint speed

Healthcare vertical cornerstone for industry leading margins



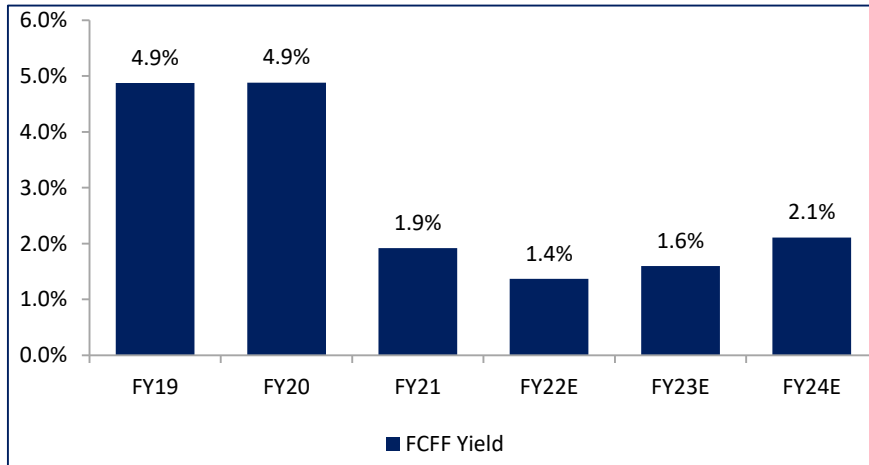
Source: Company Filings, Choice Institutional Equities Estimates

High growth trajectory expected to continue in medium term



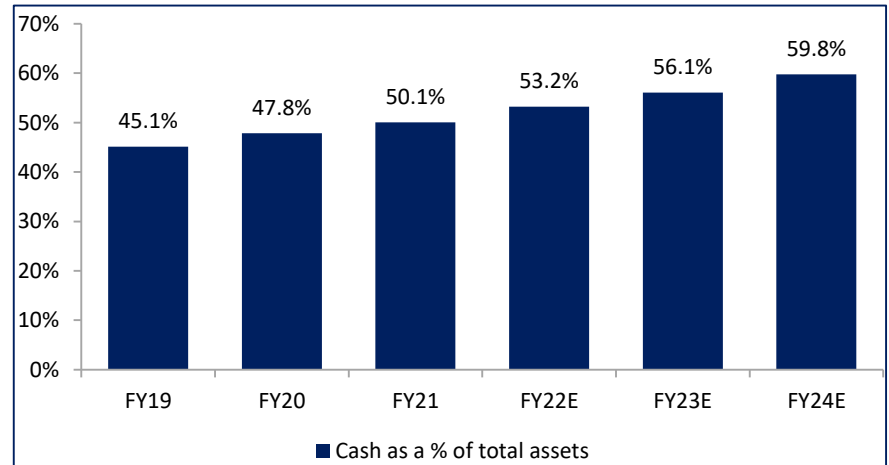
Source: Company Filings, Choice Institutional Equities Estimates

Favourable risk reward scenario



Source: Company Filings, Choice Institutional Equities Estimates

Strong balance sheet, well positioned to make acquisitions



Source: Company Filings, Choice Institutional Equities Estimates

Catalysts

Resurgence in JLR revenues (a key customer among top 10 clients)

JLR, as sub-segment within Tata Motors is one of the key legacy clients for the company. JLR revenues were impacted due to the pandemic & then by semiconductor chip shortage. As the situation evolves over time, they will have higher cash balances and their R&D budgets will see an uptick, leading to higher outsourcing work for TELX

Change in certification norms for manufacturers of medical devices

Medical devices & pharmaceutical products have been a key growth driver for the company. Healthcare companies are adhering to the regulatory framework of operating markets and continuously exploring new growth avenues, managing the high volume work. Containing the cost of compliance has become the key to sustainable business.

Any potential merger within Tata Group with TCS / Tata Technology

Although the management has vehemently denied the possibility of any such merger within Tata Group in the near term, any such consolidation will further assist the company to unlock synergy benefits. These companies operate in same industry with differentiated capabilities, and have many cross-sell opportunities within client base

Leadership & Management Team

Name and Designation

Brief description

Mr. Manoj Raghavan

CEO & Managing Director

Mr. Manoj Raghavan has been Managing Director, Chief Executive Officer and Director at Tata Elxsi Limited since October 2, 2019 and served as its Executive Vice President and Head of The Embedded Product Design until October 2, 2019.

Mr. Gaurav Bajaj

Chief Financial Officer

Mr. Gaurav Bajaj serves as Chief Financial Officer at Tata Elxsi Limited since August 1, 2021. Mr. Bajaj is a Chartered Accountant with experience in Business Finance - Financial Planning & Analysis, Deal structuring & Pricing, Financial Modelling, Contracting and negotiations.

Mr. Nitin Pai

Chief Marketing & Chief Strategy Officer

Mr. Pai Nitin, B.E. (Hons) serves as Head of Marketing and Senior Vice President at Tata Elxsi Limited. Mr. Nitin served as Vice President of Tata Elxsi Limited. Mr. Nitin served as General Manager of Marketing of Tata Elxsi Ltd. He was at Bajaj Auto Ltd - AM (PE) for 4 years.

Mr. G Vaidyanathan

General Counsel, Company Secretary & Compliance Officer

Mr. G. Vaidyanathan has been Company Secretary of Tata Elxsi Limited since August 1, 2010 and serves as its Compliance Officer and General Counsel.

DCF Based Valuation

Particulars (INR Mn.)	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	FY31E	FY32E	FY37E	FY42E	FY47E	Terminal Value
Revenue	31,623	39,647	47,654	56,709	66,916	79,296	91,190	1,04,869	1,19,550	1,35,092	2,38,078	4,19,575	6,75,729	
<i>growth (%)</i>	28	25	20	19.0	18.0	18.5	15.0	15.0	14.0	13.0	12.0	12.0	10.0	
EBIT	9,405	12,206	15,043	18,147	21,046	25,115	28,654	32,690	36,968	41,436	72,430	1,26,597	2,02,196	
<i>EBIT margin (%)</i>	29.7	30.8	31.6	32.0	31.5	31.7	31.4	31.2	30.9	30.7	30.4	30.2	29.9	
NOPAT	7,054	9,155	11,282	13,610	15,784	18,836	21,491	24,518	27,726	31,077	54,322	94,947	1,51,647	
<i>(1-tax) (%)</i>	75.0	75.0	75.0	75	75	75	75	75	75	75	75	75	75	
Depreciation	622	792	806	851	937	952	912	1,154	1,315	1,441	2,592	4,553	7,300	
<i>As a % of revenues</i>	2.0	2.0	1.7	1.5	1.4	1.2	1.0	1.1	1.1	1.1	1.1	1.1	1.1	
Capex	497	476	477	454	401	396	456	524	598	675	1,190	2,098	3,379	
<i>As a % of revenues</i>	1.6	1.2	1.0	0.8	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	
Working capital changes	1,972	2,036	1,617	1,720	1,837	2,290	1,784	2,052	2,055	2,020	12,358	21,780	25,615	
<i>As a % of revenues</i>	6.2	5.1	3.4	3.0	2.7	2.9	2.0	2.0	1.7	1.5	5.2	5.2	3.8	
FCFF	5,207	7,435	9,995	12,287	14,482	17,101	20,163	23,095	26,388	29,822	43,366	75,623	1,29,952	17,10,089
Discounted FCFF	4,857	6,458	8,072	9,235	10,129	11,122	12,193	12,983	13,784	14,469	14,622	17,692	21,061	2,77,156

Particulars	Amount
Discounted Free Cash flows (INR Mn.)	4,33,833
FY23E Net Debt / (Cash)	(13,267)
Equity Value	4,20,566
No of shares outstanding (Mn.)	62
Implied Share Price	6,755

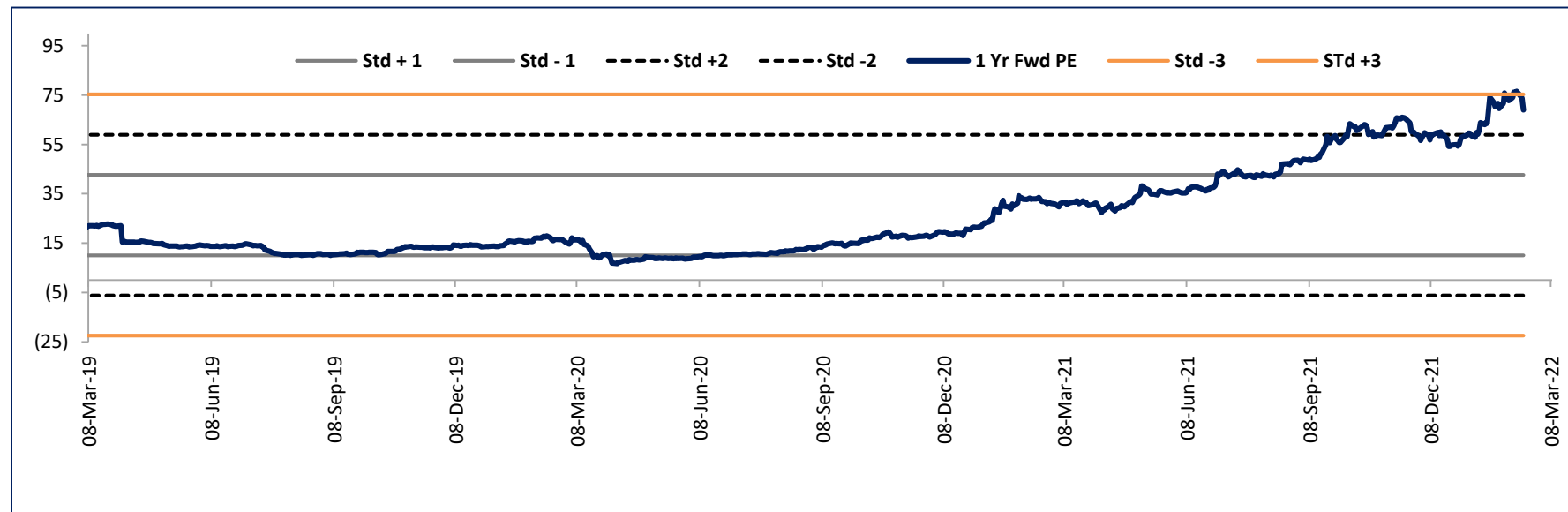
Tata Elsi Quarterly Performance Trend	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
Revenue in INR Mn	4,302	4,771	5,184	5,583	5,953	6,354
QoQ growth (%)	7.4	10.9	8.7	7.7	6.6	6.7
YoY growth (%)	11.5	12.7	18.1	39.4	38.4	33.2
Revenue by Segments (INR Mn.)						
Embedded Product Design (EPD)	3,794	4,213	4,427	4,684	5,144	5,649
Industrial Design & Visualization (IDV)	409	444	617	782	667	566
System Integration & Support (SIS)	99	115	140	117	143	140
EPD Revenue by Segments (INR Mn.)						
Transportation	1,578	1,727	1,784	1,888	2,135	2,339
Broadcast & Communications	1,700	1,866	1,979	2,150	2,320	2,468
Healthcare & Medical Devices	345	438	487	646	689	842
Others	171	181	177	-	-	-
Revenue by geography (in INR Mn.)						
Americas	1,480	1,718	2,079	2,440	2,477	2,688
Europe	1,639	1,741	1,773	1,865	1,988	2,084
India	521	620	752	776	976	1,061
Rest of the world	662	692	581	502	518	521
Revenue by effort mix (in %)						
Onsite	35.2	32.2	29.9	27.4	25.3	24.9
Offshore	64.8	67.8	70.1	72.6	74.7	75.1
Revenue by contract type (in %)						
Time & Material	58	56	53	52	51	50
Fixed Price	42	44	47	48	49	50
Client Concentration (in %)						
Top 1	13	12	11	12	13	14
Top 5	37	35	36	40	37	38
Top 10	48	47	48	51	49	47
Employee Metrics						
Total headcount	6,639	6,816	7,362	7,914	8,619	9,033
Attrition rate (LTM %)	6	6	7	10	14	18
Utilization Rate (%)		76	77	79	80	83

Tata Elxsi Limited	(Amounts in INR Mn.)	FY19	FY20	FY21	FY22E	FY23E	FY24E
Income Statement							
Revenue		15,969	16,099	18,262	24,651	31,623	39,647
Gross profit		6,555	5,779	7,146	10,475	13,604	17,139
EBITDA		4,150	3,430	5,224	7,588	10,028	12,998
Depreciation		251	434	444	539	622	792
EBIT		3,899	2,996	4,780	7,049	9,405	12,206
Other income		435	584	398	332	353	396
Interest expense		-	56	59	88	107	117
PBT		4,334	3,524	5,119	7,292	9,650	12,486
Reported PAT		2,900	2,561	3,681	5,427	7,238	9,364
EPS (INR)		46.57	41.12	59.11	87.16	116.25	150.40
Balance Sheet							
Net worth		9,428	10,900	13,522	16,778	21,120	26,739
Borrowings including lease liabilities		-	-	732	1,012	1,012	1,012
Other non-current liabilities		124	366	396	537	508	418
Other current liabilities		1,882	2,624	2,517	2,845	2,816	2,813
Total Net Worth & liabilities		11,434	13,890	17,167	21,172	25,457	30,983
Tangible fixed assets		877	832	933	1,174	1,671	2,147
Goodwill & intangible assets		139	648	836	1,117	1,117	1,117
Investments		-	-	-	-	-	-
Cash & Cash equivalents		5,158	6,642	8,596	11,270	14,279	18,518
Other non-current assets		337	398	1,484	639	639	639
Other current assets		4,922	5,370	5,317	6,971	7,750	8,561
Total Assets		11,434	13,890	17,167	21,172	25,457	30,983
Cash Flows							
Cash flows from operations		2,150	2,558	4,374	5,753	6,779	8,972
Cash flows from investing		(1,587)	390	(4,377)	(729)	(767)	(871)
Cash flows from financing		(826)	(1,237)	(1,265)	(2,259)	(3,003)	(3,863)

Tata Elxsi Limited	FY19	FY20	FY21	FY22E	FY23E	FY24E
Growth Ratios (%)						
Revenues	15.2	0.8	13.4	35.0	28.3	25.4
Gross Profit	17.6	(11.8)	23.7	46.6	29.9	26.0
EBITDA	19.9	(17.4)	52.3	45.2	32.2	29.6
EBIT	21.6	(23.2)	59.6	47.5	33.4	29.8
PBT	19.1	(18.7)	45.2	42.5	32.3	29.4
PAT	20.8	(11.7)	43.7	47.4	33.4	29.4
Margins (%)						
Gross Profit Margin	41.0	35.9	39.1	42.5	43.0	43.2
EBITDA Margin	26.0	21.3	28.6	30.8	31.7	32.8
EBIT Margin	24.4	18.6	26.2	28.6	29.7	30.8
PBT Margin	27.1	21.9	28.0	29.6	30.5	31.5
Tax rate	33.1	27.3	28.1	25.6	25.0	25.0
PAT Margin	18.2	15.9	20.2	22.0	22.9	23.6
Profitability (%)						
Return on equity (ROE)	46.0	32.3	37.9	43.5	45.7	46.7
Return on invested capital (ROIC)	71.5	60.6	80.6	84.6	93.7	103.9
Return on capital employed (ROCE)	30.8	23.5	25.8	30.5	32.7	33.7
Financial leverage (%)						
Pre-tax OCF/EBITDA	86.2	100.7	107.4	100.4	91.7	93.0
OCF / Net profit	74.1	99.9	118.8	106.0	93.7	95.8
OCF/IC	53.0	60.5	95.7	89.7	87.8	99.6
Earnings & Dividend						
EPS (INR)	46.57	41.12	59.11	87.16	116.25	150.40
Shares outstanding (in Mn.)	62	62	62	62	62	62
Adj. EPS (INR)	46.56	41.11	59.11	87.15	116.21	150.36

Tata Elxsi Limited	FY19	FY20	FY21	FY22E	FY23E	FY24E
Valuation Ratios						
Market Capitalization (INR Mn)	54,807	48,789	2,15,367	4,15,197	4,15,197	4,15,197
CMP (INR)	880	784	3,458	6,565	6,565	6,565
12MFPE (x)	21.4	13.3	39.7	56.5	43.7	35.4
Enterprise Value (INR Mn)	49,648	42,147	2,06,771	4,03,927	4,00,918	3,96,679
12MFEV/EBITDA (x)	14.47	8.07	27.25	40.28	30.84	25.03
Net worth (INR Mn)	9,428	10,900	13,522	16,778	21,120	26,739
Book Value Per Share (INR)	151.41	175.06	217.11	269.40	339.22	429.46
Price to Book (x)	5.81	4.48	15.93	24.37	19.35	15.29
FCFF (INR Mn)	2,672	2,382	4,138	5,672	6,625	8,744
FCF Yield (%)	5	5	2	1	2	2

1 Year Forward PE Band



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OUTPERFORM	The security is expected to generate more than 15% returns over the next 12 months
ADD	The security is expected to generate greater than 5% to less than 15% returns over the next 12 months
NEUTRAL	The security expected to show downside or upside returns by 5% over the next 12 months
REDUCE	The security expected to show less than -5% to greater than -15% over the next 12 months
UNDERPERFORM	The security is expected to generate returns in excess of -15% over the next 12 months

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