Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Annual Report Review

Tata Elxsi Ltd

Poised to grab right growth opportunities

IT & ITeS	Sharekhan code: TATAELXSI
Reco/View: Buy ↔	CMP: Rs. 8,605
	Price Target: Rs. 9,750 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 19.56

Updated Apr 08, 2022

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

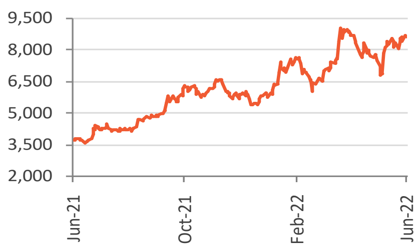
Company details

Market cap:	Rs. 53,589 cr
52-week high/low:	Rs. 9420/3558
NSE volume: (No of shares)	6.1 lakh
BSE code:	500408
NSE code:	TATAELXSI
Free float: (No of shares)	3.5 cr

Shareholding (%)

Promoters	44
DII	7
FII	13
Others	36

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	19.1	22.9	45.7	129.9
Relative to Sensex	18.3	22.4	50.4	124.9

Sharekhan Research, Bloomberg

Summary

- Tata Elxsi Ltd (TEL), in its annual report, highlighted its differentiated capabilities in design-led engineering and strong delivery capability that help it drive the customers' transformation agendas in its focused verticals.
- TEL's investments in platforms have increased its ability to scale efficiencies. Besides providing services, TEL eyes enterprises who want to outsource platforms on subscriber-based business model.
- Given its strong digital engineering capabilities, TEL would benefit from the current upcycle in ERD spends. TEL is expected to deliver industry-leading margin in FY2023, led by a higher offshore mix, and currency tailwinds.
- We retain a Buy on Tata Elxsi with a revised PT of Rs. 9,750, given its strong growth potential, robust deal wins and consistent dividend payouts. USD revenue and PAT are likely to clock a CAGR of 23% and 20%, respectively, over FY22-24E.

Tata Elxsi Limited's (TEL's) annual report for FY2022 put the spotlight on its differentiated offerings and design-led approach across selected industries, rising focus on subscriber-based platform business, offshore delivery capabilities and favorable sector tailwinds. TEL focuses on design thinking and application of digital technologies in high-growth verticals that are expected to see strong growth driven by rising ERD spends. According to Zinnov, the share of Indian ERD service providers is expected to increase from $16 billion in 2021 to $58 billion in 2031, implying an over 13% CAGR. Given its wide array of digital engineering-led services, robust platform portfolios, deep domain expertise and solid offshore delivery capability, we believe Tata Elxsi would be one of the key beneficiaries among the global peers from the current upcycle in ERD spends.

- **Capitalising on growth opportunities:** Among the pure-play Indian ERD companies, TEL has been reporting industry-leading USD revenue growth over last two years (a 24% CAGR despite the fact that 2021 was severely hit by the pandemic). After reporting a decline in transportation revenue (down 4.6% y-o-y) in FY2021 due to significant disruptions in automotive sector, TEL reported strong rebound (up 32.3% y-o-y) in transportation segment in FY2022 with the gradual recovery in automobile demand. In addition, the revenue growth in its media, broadcast, and communications, and healthcare vertical accelerated in FY2022 given rapid shifts towards digitalisation. This reflects the company's differentiated technology capabilities, domain expertise and strong delivery capability, which enable it to address emerging opportunities across the focused verticals and to drive the transformation program of the customers.
- **Strong pick-up in platform segment:** TEL's investments in both existing and new platforms such as *TEPlay, FalconEye, iCX, QoEtient*, and *Autonomai* have increased its ability to scale and build efficiencies. Apart from customers whom it provides services, the company targets those enterprises who don't have engineering/financial strength to develop platforms and/or potential customers who only look for outsourcing platforms for the offerings to their customers. The business model of these standalone platform deals is subscriber-based and linked to growth.
- **Superior margin performance to continue in FY2023E:** Management remains optimistic on sustenance of higher offshore mix in FY2023E (90% in Q4FY2022) given its strong delivery model and cost-savings to customers, although we believe the mix would taper off marginally in FY2023E due to opening of travel. Attrition is expected to slow down going ahead given rising layoff in start-ups, hiring freeze and strong industry-wide fresher hiring (during FY2022). Further, the company has brought forward wage hikes in January 2022 (which covered 65-70% of the workforce) from July (rolled out 7-8% wage hike in 2021), which would benefit TEL in FY2023E. We believe the company would continue to deliver industry-leading margin in FY2023E, led by pricing, higher offshore mix, pyramid balancing and currency tailwinds.

Our Call

Valuation – Strong growth outlook intact: TEL is well poised to capture market opportunities across the selected industries given its unique capabilities in design-led engineering. TEL's USD revenue and earnings are likely to clock a CAGR of 23% and 20%, respectively, over FY2022-FY2024E. Under our coverage, Tata Elxsi is the only company whose stock performance (up 22%) has significantly outperformed CNX IT (down 17%) over last three months despite interest rate hikes by the US Federal Reserve, rising inflation in developed markets, the Russia-Ukraine conflict and potential recession in the US. At CMP, stock is trading at 78x/67x its FY2023E/FY2024E earnings, which is expensive. However, we continue to prefer TEL, given its strong growth potential, market share gains, superior margin profile, differentiated capabilities in digital engineering and strong balance sheet (cash and investments was 51% of total assets). We maintain a Buy rating on TEL with a revised price target (PT) of Rs. 9,750.

Key Risks

Rupee appreciation and/or adverse cross-currency movements would adversely impact its earnings. Further, the reversal of offshore effort mix could impact its margins.

Valuation Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	2,470.8	3,172.4	3,849.6	4,573.9
OPM (%)	31.0	30.3	29.4	29.1
Adjusted PAT	549.7	683.2	797.6	936.0
% YoY growth	*49.3*	*24.3*	*16.7*	*17.4*
Adjusted EPS (Rs.)	88.3	109.7	128.1	150.3
P/E (x)	97.5	78.4	67.2	57.3
P/B (x)	33.5	26.7	21.3	16.9
EV/EBITDA (x)	68.7	54.4	45.9	38.5
RoNW (%)	34.3	34.1	31.6	29.5
RoCE (%)	38.2	39.3	36.9	34.5

Source: Company; Sharekhan estimates

Key takeaways

Tata Elxsi's FY2022 annual report highlighted the following– (1) Its differentiated offerings and design-led approach in the selected verticals and seamless delivery capability, (2) Preferred ERD partner of leading manufacturers, OEMs and tier-I suppliers, (3) Focus on applications of digital technologies which has solid growth prospects, (4) diversification strategy to de-risk revenue dependency, (5) continued investments in IPs to scale and build efficiencies. It also started targeting customers for its platform deal in subscriber-based operating model, (6) robust deal wins across the verticals and (7) a strong balance sheet. Given its strong capabilities in the digital engineering-led technologies across transportation (including automotive), broadcast and communications, and healthcare, robust products and platforms portfolios, healthy deal wins and solid delivery capability, we believe Tata Elxsi would be one of the key beneficiaries from the current upcycle in ERD spend and forecast its USD revenue and earnings to clock strong CAGR of 25% and 20%, respectively, over FY2021-FY2024E.

Comprehensive suite of services in select verticals

Tata Elxsi is one of the leading pure-pay engineering, research and design (ERD) providers of design and technology services across industries including automotive, broadcast, communications, healthcare, and transportation. It focuses on design thinking and application of digital technologies such as autonomous systems, robotics, securely connected machines and personal devices, digitalisation and electrification of automobiles and infrastructure, advanced communications equipment and networks, and connected healthcare platforms, to deliver innovative solutions to customers. We believe these applications are expected to grow strongly in the next few years. With a leadership position in technology areas and strong delivery capability, Tata Elxsi positions itself as a strategic design digital partner that can help enterprises to reimagine and innovate their products and services.

Fueling growth through investing on platforms and partnerships

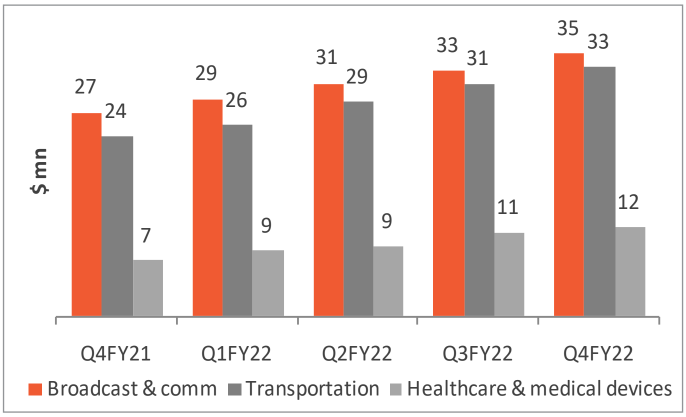
As Tata Elxsi focuses on delivering digital engineering-led transformation to its customers, the company has invested and expanded its products and platforms portfolios across the industries. The company's investments in both existing and new IPs such as TEPlay, FalconEye, iCX, QoEtient, and Autonomai have increased its ability to scale and build efficiencies. During FY2022, the company's platforms in OTT (TEPlay) and customer experience (iCX) segment were selected by leading global enterprises. Other platforms such as Autonomai (driverless car platform), eMobility HILS (framework for validation of EV systems), and TEDREG (global regulatory intelligence platform) are gaining traction among the customers. The management indicated that the company has been winning large multi-million deals by leveraging its in-house platforms by providing solutions to the customers. The business model of these platforms are subscriber-based and linked to growth. TEL would target those customers who don't have engineering/financial strength for developing the platform or potential customers who only look for outsourcing platforms for their offerings. Further, the company has built partnerships and alliances with leading companies globally to deliver industry specific digital solutions to its customers.

Adjacencies to drive next level of growth; diversification strategy playing out well

The company's investments in adjacencies such as rail, commercial vehicles, farm equipment, off-road vehicle, new media and digital health are expected to drive its growth going ahead given strong demand. Adjacencies such as farm equipment, commercial vehicles and railways are expected to maintain strong growth momentum in the coming quarters, as the skills are complementary. The revenue contribution from the adjacencies of its transportation, media and communication and healthcare and medical devices vertical is expected to increase to 20% of total revenue of the respective vertical from 5% currently over the next three years. We believe the company is well on track to achieve this target, given higher spending on digital engineering in these adjacencies. Over the next two years, management expects contribution of the transportation, broadcast, and medical devices vertical to be 40:40:20 from the current contribution of 42:44:15.

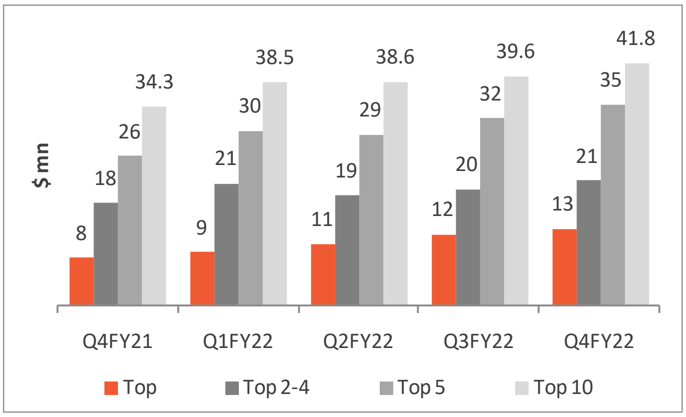
Besides investments in adjacencies of its focused industries, the Company's diversification strategy focuses on the reduction of exposure to top 10 customers. Further, the company has expanded its offerings across verticals and strengthened its position in major markets, in line with its strategies. The company's exposure towards the US, Europe and India stayed at 42%, 31% and 16% respectively in FY2022 as compared to 37%, 35% and 13% in FY2021. The company has recently entered into new geographies such as Middle East, Africa and Latin America as the company witnessed strong customer addition in all three regions especially in media segment. We believe the company's diversification strategy is yielding results by reducing the contribution of the automotive segment to total Embedded Project Design (EPD) revenue, de-risking revenue dependency from a particular customer and expanding its footprint in major markets.

Top verticals' revenue ($ mn) trend



Source: Company, Sharekhan Research

Top accounts' revenue ($ mn) trend

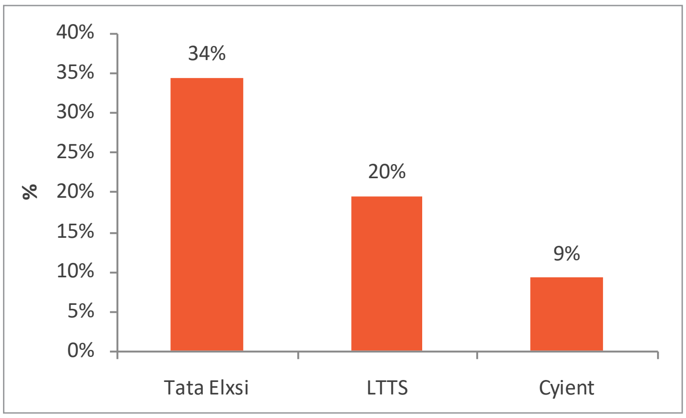


Source: Company, Sharekhan Research

Another year of industry-leading performance

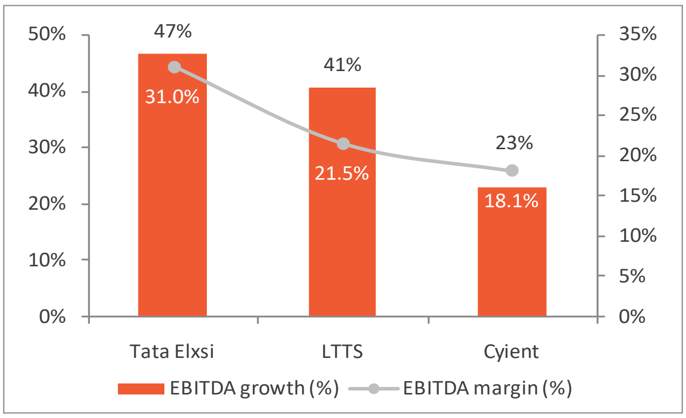
After strong performance in a pandemic year, the company has reported another year of strong revenue growth with market-leading operating profitability in FY2022, led by broad-based growth across verticals and geographies. Tata Elxsi reported its highest-ever incremental revenue addition in a year with overall revenue growth standing high at 35.3% at Rs. 2,470.8 crores due to volume growth. Volume growth was majorly driven by Embedded Project Design (EPD) vertical growth, which grew by 34.7% y-o-y on constant currency (CC). Industrial Design & Visualization (IDV) and System Integration & Support (SIS) business revenue grew by 34.9% y-o-y and 17.8% y-o-y respectively on CC basis. Within EPD vertical, the company's healthcare business continued to grow strongly (up 71.4% y-o-y), while both transportation, and media and communications reported another year of sustained growth of 29.4% y-o-y and 30.6% y-o-y respectively on CC basis. The company's EBITDA margin improved 238 bps y-o-y- to 31% despite wage revision, high costs to backfill attrition and supply-side challenges, led by strong growth, higher offshoring and cost efficiencies. Net profit grew by 49.3% y-o-y to Rs. 549.7 crore. Free cash flows (FCF) declined by 7% y-oy to Rs. 370 crore. FCF to net profit ratio during FY2022 stood at 48% as compared to 76% in FY2021. The company declared the final dividend of Rs. 42.5 per share versus Rs 48 per share in FY2021.

USD revenue growth of ERD companies in FY22



Source: Company, Sharekhan Research

EBITDA growth and margin of ERD companies in FY22



Source: Company, Sharekhan Research

Higher offshore effort mix likely to stay in FY2023E, but likely to remain below FY2022 level

As COVID-19 struck, Tata Elxsi supported the business continuity of its customers through its offshore delivery capability. As a result, the company's offshore effort mix shifted to 90% from 70% in pre-COVID times. Though the current offshore effort mix is expected to reach at the peak level, we believe that the offshore effort mix would not move to pre-COVID era given its strong delivery model and cost benefit to customers. During Q4FY2022, the company was selected by a leading German Tier-1 supplier for establishing an Offshore Development Center for Autonomous Driving and ADAS technologies.

Management remains confident in maintaining margin performance in medium-term

EBITDA margins improved by 240 bps on y-o-y at 31% in FY2022 despite higher compensation revision to control attrition, high costs to backfill attrition and supply-side challenges, led by faster growth in the high-margin medical devices vertical, higher offshoring, increasing utilisation, quality of revenue mix (including multi-year contracts with focus on high-margin deals), operational efficiencies, and delivery excellence. Management remains confident in maintaining EBITDA margin (31% in FY2022) in FY2023E on the back of pricing, favorable offshore mix, pyramid balancing, and currency tailwinds. We believe attrition could reduce in the coming quarters given increasing layoff of employees in start-ups, hiring freeze and higher fresher hiring in last few quarters. Further, the company has brought forward the wage hike in January 2022 (wage hikes covered 65-70% of the workforce) and the remaining employees will get hikes in Q1FY2023E. However, we believe the company's offshoring effort mix would come down in FY2023 (90% in FY2022) as business travel will start gradually. Further, investments in building capability, lateral hiring in niche areas, and higher discretionary spends in the area of travel and facility would weigh on margins. Further, the company is expanding its presence into SEZs, which would lower its effective tax rate in FY2023. We forecast the company would deliver EBITDA margin of 30.3% and 29.4% in FY2023E and FY2024E, respectively.

Industry overview: Well-placed to capture benefits from current upcycle in ERD spend

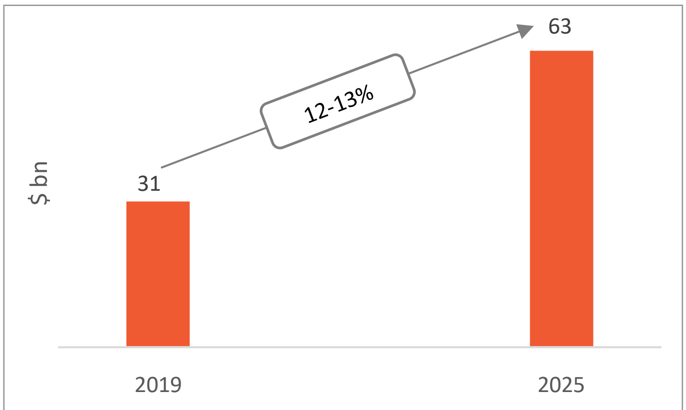
Recent geopolitical tensions between Ukraine and Russia has generated severe concerns around the supply-chain disruption and economic slowdown. Further, a rise in crude oil prices affects automotive sales. However, industries like healthcare, broadcasting and communications are likely to experience minimal impact from the outbreak of current geopolitical tension.

Over the last couple of decades, India has established itself as the premier location for offshoring of ERD services. With the availability of large talent pool, India has an edge in addressing the opportunities and demands emerging from the offshore ERD service market. With a 10-15% market share, India is gradually establishing itself as an engineering and design centre for automobiles, aerospace, consumer electronics, machinery, and semiconductors. According to NASSCOM, India's contribution to the global ERD market is likely to increase to $63 billion by CY2025 from $31 billion in CY2019, translating to a CAGR of 12-13%. Of this, it is expected that Indian ERD service provider's market would be witnessing at an impressive CAGR of ~17%.

According to Zinnov, the Indian ERD offshoring market is expected to increase from $36 billion in 2020-21 to $117 billion in 2030-31. Correspondingly, the share of Indian ERD service providers is expected to increase from $ 16 billion in 2020-21 to $58 billion in 2030-31, implies a CAGR of over 13%.

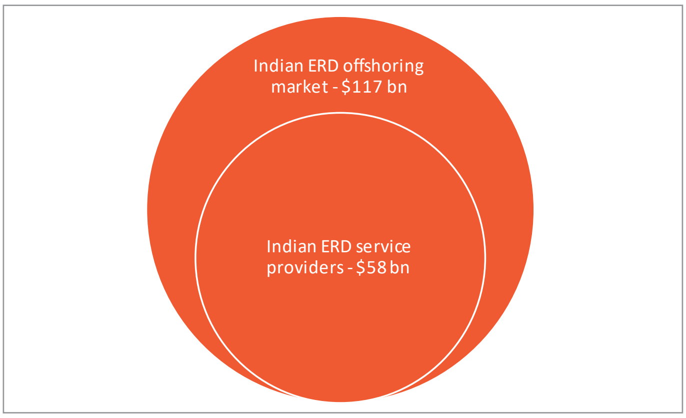
Tata Elxsi offers ERD services across transportation, media & broadcasting and healthcare verticals, which would benefit it from the current upcycle in ERD spend. We believe Tata Elxsi has invested in building capabilities to cater to the growing demand for various technology and integrated services in a post-pandemic world.

India's ERD market to touch $63bn by CY2025



Source: Nasscom; Sharekhan Research

Indian ERD offshoring market in 2031



Source: Zinnov; Sharekhan Research

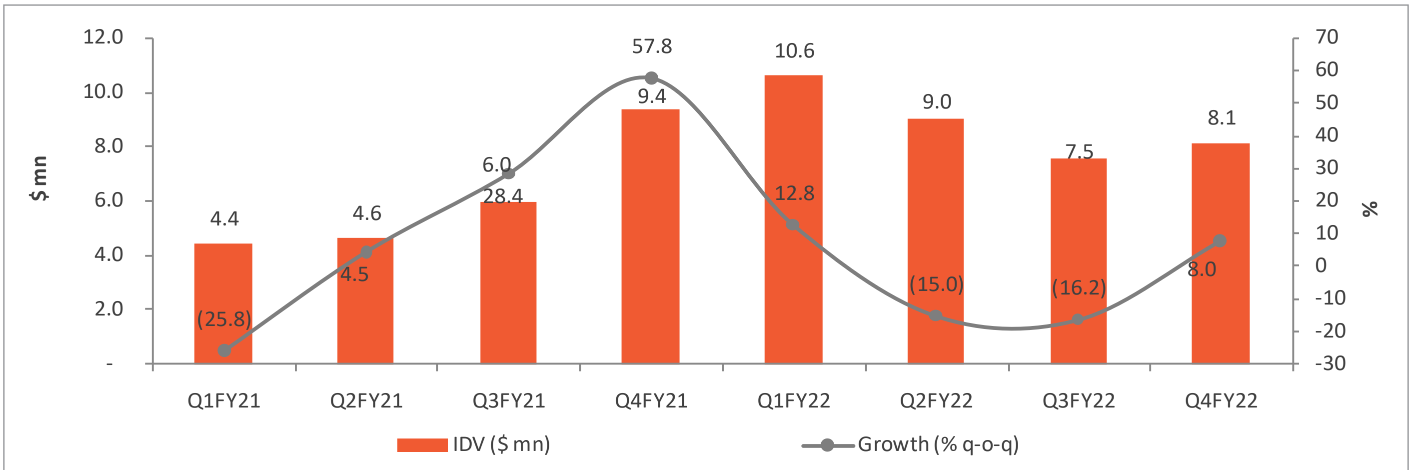
- **Automotive:** Following a challenging CY2020, new passenger car sales have grown at a modest 3.9% in CY2021, which is still below CY2019 levels. The growth in passenger vehicles would be primarily driven by EV sales going ahead. With a gradual shift to EVs, the demand for automated driving/ advanced driver assistance systems and CASE technologies is likely to remain strong. According to Deloitte, new electric vehicles (EVs) is expected to grow from 2.5 million units in CY2020 to 31.1 million by CY 2030. Given its strong capabilities in CASE technologies in the automotive industry, the company would able to provide services and solutions in next-generation mobility area.
- **Media, broadcast and communications:** The adverse effect of the pandemic on the global Media and Communications industry has been relatively less due to the surge in data and communication services available during lockdowns. According to Grand View Research, the global telecom services market is estimated to record a CAGR of 5.4% from CY2021 to CY2028, led by higher demand from OTT applications and increasing mobile users. The OTT market is currently valued at $44.5 billion and is expected to reach $ 139 billion in CY2028, with a CAGR of 17.7%. With better cloud streaming services, and strong demand for online streaming channels, the market is likely to drive investments in OTT and software-based network architecture for managing high traffic and network loads. Tata Elxsi's continuous investments in creating next-gen solutions like TEPlay (an OTT/IPTV platform), QoEtient (an agentless test and automation platform for video quality of experience), and iCX (for management and monitoring of customer premises equipment like set-top boxes and gateways) would help the company to cater the need for innovative solutions in the media, broadcast and communication space.
- **Healthcare and medical devices:** The global healthcare industry has been moving towards digitalization at a rapid pace given growing range of tools and approaches (including digital health records, smartphone apps, and video consultations with health workers). Over the years, the medical devices, pharmaceutical, and healthcare industries have all expedited their adoption of digital technologies due to highly competitive marketplaces and dynamic business requirements. Digital health market is expected to grow to more than US$ 400 billion by CY2025. Tata Elxsi's TEngage (cloud-first digital health platform for omnichannel care) and TEDREG (a regulatory intelligence platform) platforms and solutions help the customers to create new business opportunities with new product launches.

Business overview

Industrial design and visualisation (IDV): Tata Elxsi works with customers to provide consumer research and strategy, branding and graphics, product design, service design, user experience design, transportation design, 3D prototyping, visualisation and manufacturing support. The revenue of IDV grew by 36% y-o-y to Rs. 262 crores, led by design-led digital deal wins.

- IDV helps the company to create traction through design-led deals, which multiplies the multiplier effect on winning deals for these three verticals. Tata Elxsi's capabilities in product portfolio redesign helped it to win large deal by a leading Asian appliances company.

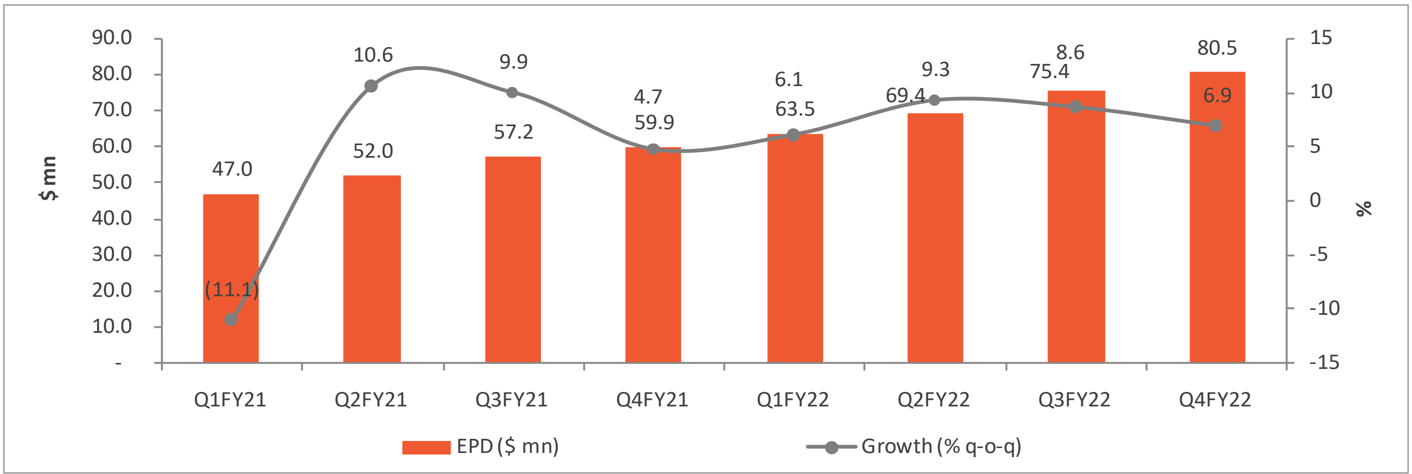
IDV business growth trend



Source: Company, Sharekhan Research

Embedded product design (EPD): The EPD division provides technology consulting, new product design, development, and testing services for the transportation, media, broadcast and communication, and healthcare and medical devices verticals. During FY2022, this division's revenue grew by 35.9% y-o-y to Rs. 2,421 crore.

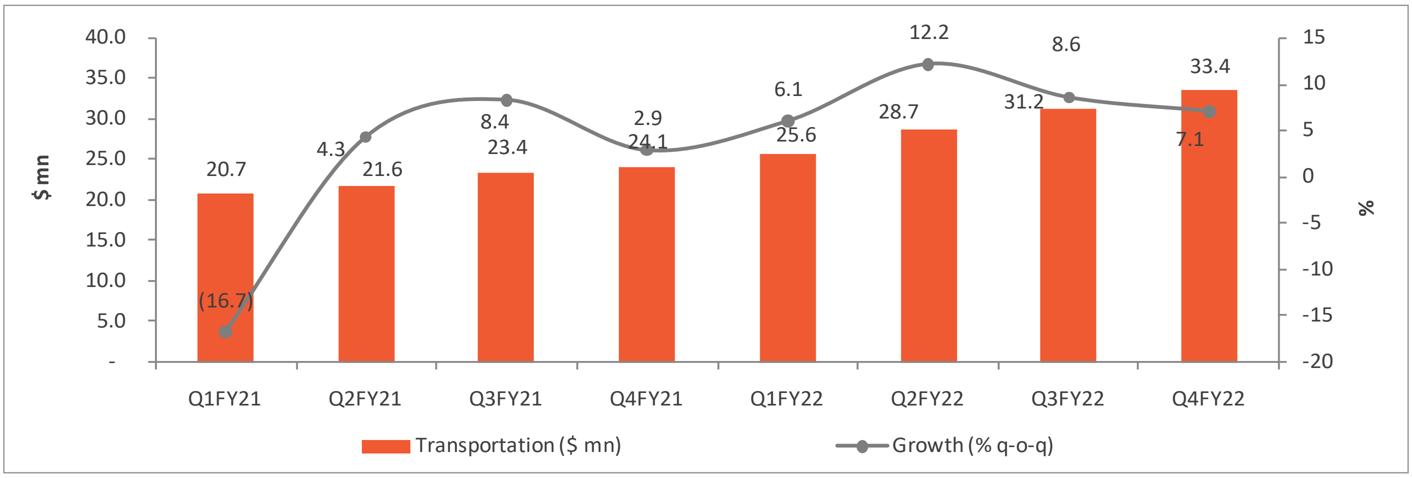
EPD business growth trend



Source: Company, Sharekhan Research

- **Transportation:** Tata Elxsi is a preferred partner for leading car manufacturers, OEMs, and suppliers to develop electronics and software for power train, infotainment, connectivity, active safety, and comfort. Tata Elxsi provides R&D, design, and product engineering services to leading global automotive and transportation industry players. The transportation vertical posted strong growth of 29% y-o-y, generating Rs. 887 crore, which is 36% of Tata Elxsi's total revenue.
  - o The company's focus on adjacencies in the off-road (including agriculture, construction equipment and mining) and rail industries, accelerated customer acquisition. This has also helped the company to de-risk revenue dependency from customers, segments and regions.
  - o Growth was secular across autonomous and connected technologies, infotainment, connectivity and security and electric vehicle platforms with both original equipment manufacturers (OEMs) and suppliers.
  - o Tata Elxsi is expected to actively engage with its customers to drive projects around Autonomous Driving (AD), ADAS (Advanced Driver Assistance Systems), electrification projects and digitalisation.
  - o TEL's design-led approach proved to be a great differentiator for its services as a leading Japanese OEM awarded it a deal to develop next-gen HMI for infotainment and in-cockpit interface for their range of vehicles.
  - o In FY22, Tata Elxsi was selected by a world-leading systems supplier to develop an autonomous driving platform for commercial vehicles.
  - o The Company also has invested in developing a leading Connected Vehicle Platform (CVP) called Tether. It is a cloud-based Internet of Things (IoT) data platform providing off-the-shelf dashboards for insights and actions for vehicle maintenance, accurate real-time vehicle location tracking, driver behaviour monitoring, navigation, electric vehicle battery management, and fleet management etc

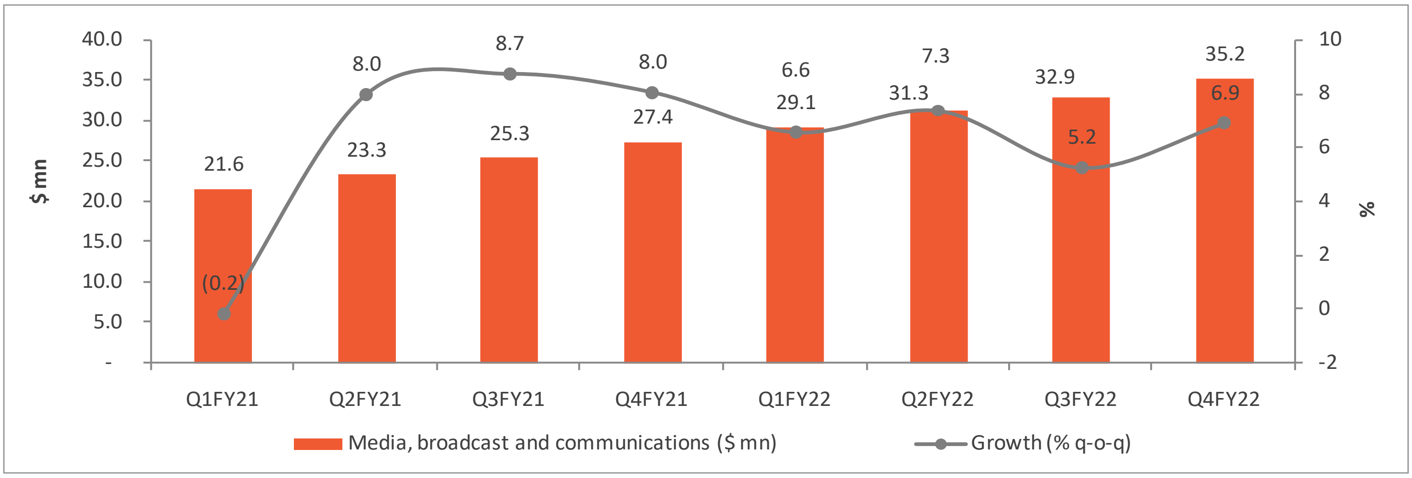
Transportation vertical growth trend



Source: Company, Sharekhan Research

- **Media, Broadcast & Communications:** Tata Elxsi addresses the complete product development lifecycle from R&D, new product development, and testing to maintenance engineering for Broadcast, consumer electronics and communications. The division revenue grew by 32% y-o-y to Rs 960 crores and accounted for 39% of its overall revenue.
  - o Tata Elxsi was awarded a 3-year $20 million deal by a leading global MSO to support and manage its network operations across data, mobile and video service delivery.
  - o Tata Elxsi was selected as the platform provider and system integrator for a multi-region Android TV launch for a leading US-based operator.
  - o TEL selected to deploy iCX for a leading global telecom operator across multiple countries.

Media, Broadcast and communications vertical growth trend

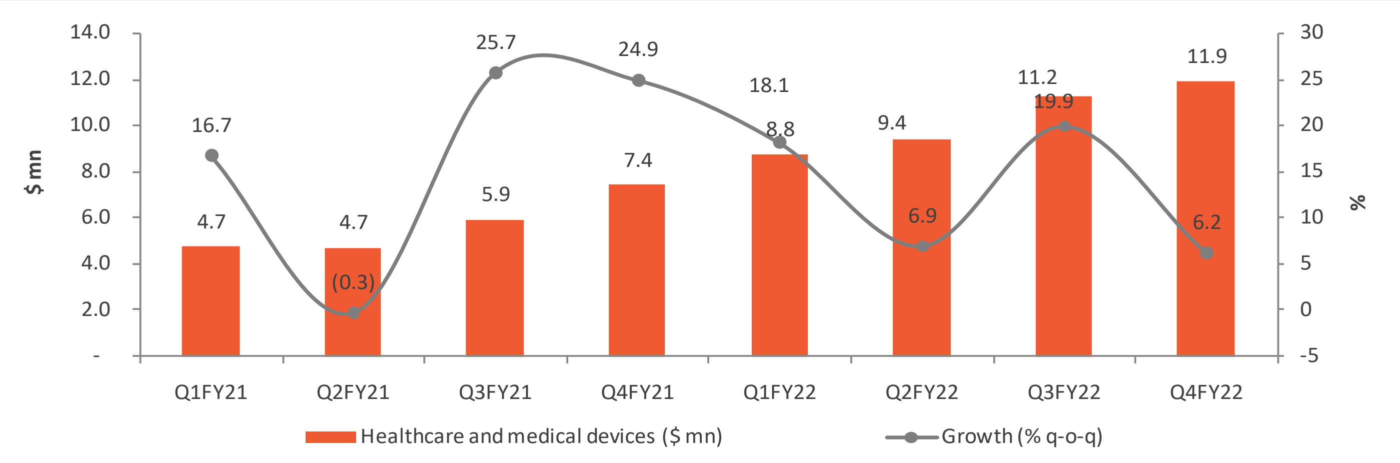


Source: Company, Sharekhan Research

- **Healthcare and medical devices:** TEL supports global MedTech, digital health, pharmaceuticals, and biotech businesses. The company helps clients conceptualise, launch, and sustain products in the world's most regulated industries. The healthcare segment revenue at Rs 308 crores contributed 12.5% to total revenues and continues to be the fastest-growing segment, registering 72% y-o-y revenue growth in FY2022.
  - o Tata Elxsi's unique capabilities in design led engineering has helped several global enterprises enhance productivity by streamlining existing operations and generating new revenue streams.
  - o A leading global healthcare provider selected Tata Elxsi as their strategic digital partner for the next-gen digital health platform.

- o In the digital transformation space, a US-based healthcare technology leader was awarded a long-term multi-million-dollar deal for its digital transformation and cloud migration program.

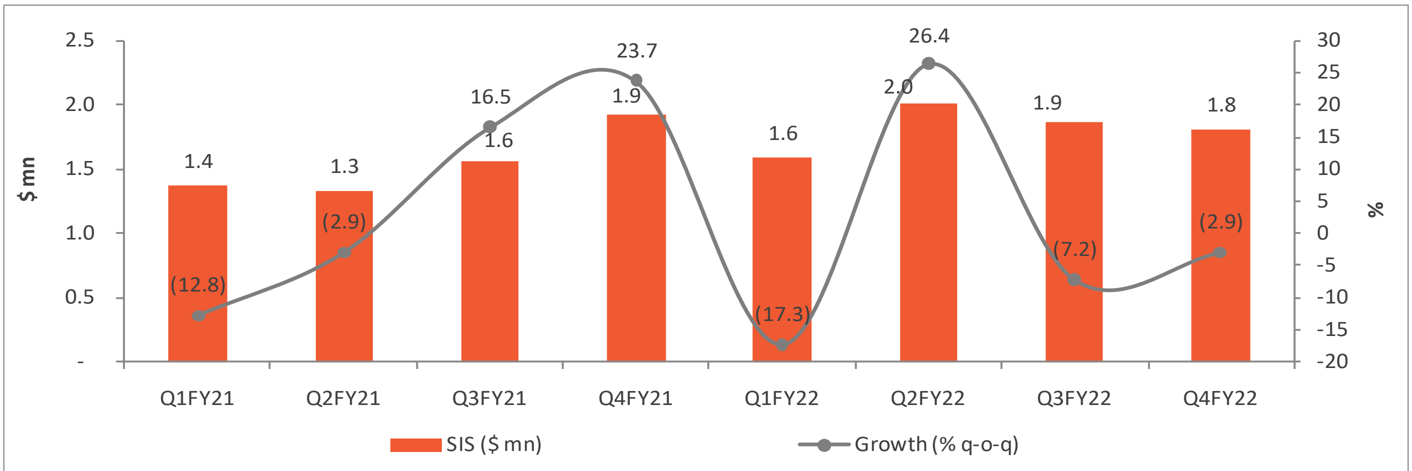
Healthcare and medical devices vertical growth trend



Source: Company, Sharekhan Research

System Integration and Support (SIS): Under system integration, Tata Elxsi combines design, technology, and content to assist corporate brands in building experience centres to enhance communication about their business impact and brand with customers, stakeholders and the community. Tata Elxsi has successfully conceptualised and built several such experience centres for its medical devices, transportation, consumer products, and industrial customers. Tata Elxsi's SIS segment revenue grew by 18% y-o-y to Rs. 54 crore in FY2022.

SIS business growth trend



Source: Company, Sharekhan Research

- o Customers in industries like automotives, aerospace, entertainment, manufacturing, Government, and education benefit from its expertise in implementing complicated design solutions.
- o The company is continuously expanding its portfolio to provide various solutions to meet customers' evolving digital technology needs.
- o The company offers solutions and services, including professional services for cloud and infrastructure management, virtual reality (VR), and 3D printing.

Financial performance in FY2022

- Revenues grew strongly by 35.3% y-o-y to Rs. 2,470 crore in FY2022, led by volume. Constant currency revenue growth stood at 34% y-o-y.
- EBITDA margins improved 240 bps y-o-y to 31% in FY2022, aided by higher offshoring, cost efficiency measures and strong growth. Effectively, EBITDA grew by 47% y-o-y to Rs. 766 crore.

Analysis of overheads **(Rs. crore)**

Analysis of Overheads	FY2021	FY2022	Variance (%)
Communication expenses	5.9	5.1	-14.2%
Inland travel and conveyance	2.0	2.6	27.3%
Overseas travel	26.9	28.6	6.1%
Advertisement and Sales Promotion	6.7	12	78.2%
Legal and Professional Expenses	10.8	17.2	59.0%
Consultant fees for software development	71.5	139.3	94.7%
Total	**124.0**	**204.8**	**65.16%**

Source: Company

- EBIT margin improved 257bps y-o-y to 28.8% in FY2022, led by lower depreciation expenses to revenue. Effectively, EBIT grew by 49% y-o-y to Rs. 710 crore.
- Profit before tax grew by 46% y-o-y to Rs. 745 crore in FY2022. Tax provision stood at 26.3% in FY2022 versus 28.1% in FY2021. Effectively, the company's net profit came at Rs. 549.7 crores (up 49% y-o-y). The company's net margin increased by 209 bps y-o-y to 22.2% in FY2022.
- The company's offshore revenue share stood at 74.5% versus 66.5% in FY2021. This showcased the company's proven offshore delivery processes and project management capabilities. Management believes that the offshore effort mix would not back to pre-COVID levels given higher demand for offshoring by its clients.
- The company's total headcount stood at 9,376, implying its net hiring of 2,014 employees during FY2022. The net hiring during the year was stood at 27% of total employee base at the end of FY2021.
- The company's attrition rate in the past twelve months stood at 20.8% in Q4FY2022 versus 7.4% in Q4FY2021. The sharp increase in attrition rate was due to supply-side issues, higher demand for digital talents and strong demand.

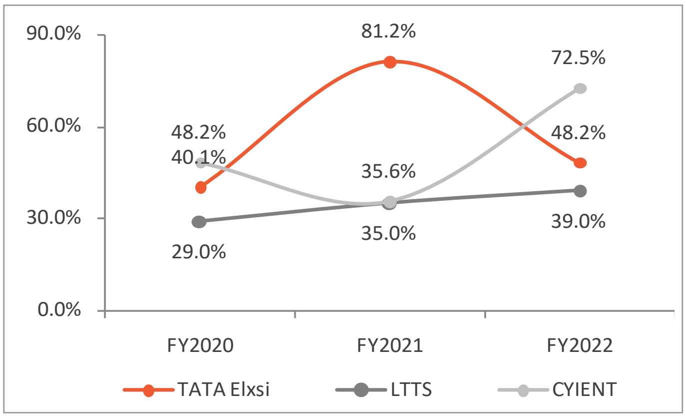
Balance sheet analysis

- Total investments and cash and cash equivalents increased by 12.4% y-o-y to Rs. 1,104 crore (cash balance was Rs. 982 crore) in FY2022. Cash per share stood at Rs. 155.
- The company's total cash and cash equivalents remained at 51% of total assets and 2.1% of current market capitalization.
- The company's current ratio stood at 4.1x, which indicates the company is trying to maintain healthy working capital while ensuring that it does not have idle liquidity.
- PPE increased by 34% y-o-y to Rs. 2,498 crore, while the capex for PPE increased by 178% y-o-y to Rs. 669 crore (36% of the opening PPE).
- The company's intangible assets remained at Rs. 52.1 crore, which was 3.3% of total networth.
- Receivable days (billed + unbilled) remained stable at 86 days in FY2022 versus 88 days in FY2021.
- Current liability increased by 55% y-o-y to Rs. 410.2 crore in FY2022 from Rs. 264.5 crore in FY2022.
- Working capital cycle reduced by 6 days to 76 days in FY2022.
- The company's RoE and RoCE stood at 34.3% and 38.2% in FY2022 versus 27.2% and 30.8% in FY2021.

Cash flow analysis

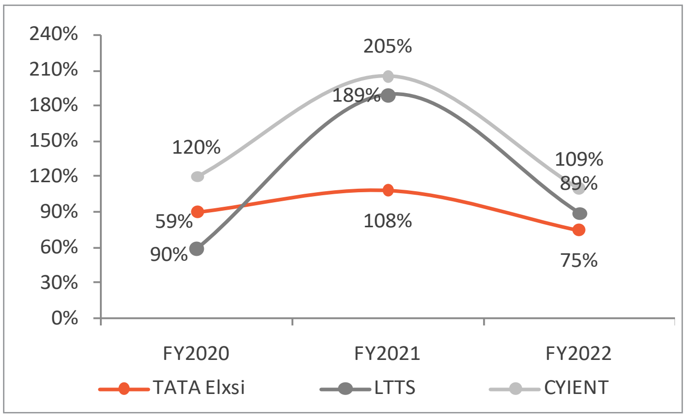
- OCF before change in working capital increased by 44% y-o-y to Rs. 765.7 crore, while OCF increased by 10.4% y-o-y to Rs. 483 crore in FY2022 from Rs. 437.4 crore in FY2021.
- FCF remained stable at Rs. 397 crore in FY2022. FCF to EBITDA ratio fell to 52% in FY2022 from 76% in FY2020.
- The company declared a dividend per share of Rs. 42.5 in FY2022 compared to Rs. 48 per share (including special dividend) in FY2021. The payout ratio stood at 48% of total net profit (81% of net profit in FY2021).

Dividend payout ratio among peers



Source: Company, Sharekhan Research

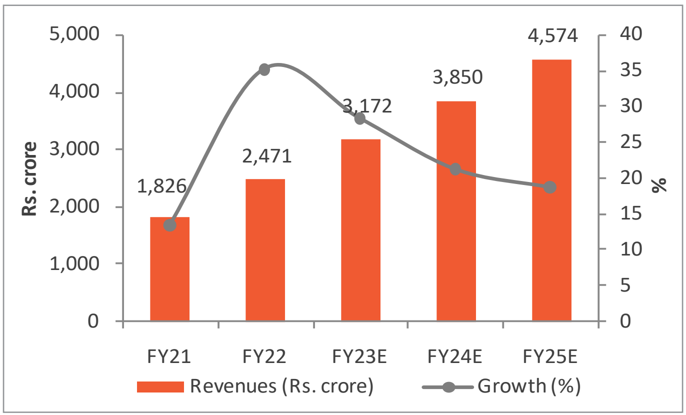
FCF to net profit among peers



Source: Company, Sharekhan Research

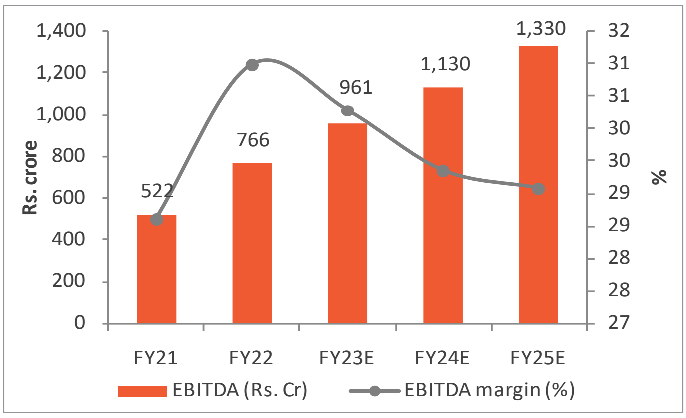
Financials in charts

Revenue (Rs. crore) and growth (%)



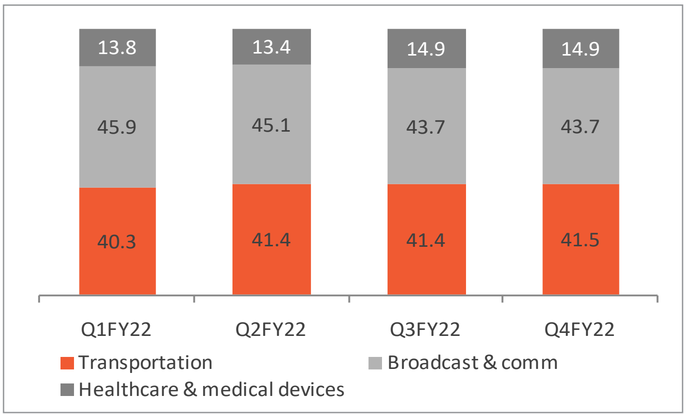
Source: Company, Sharekhan Research

EBITDA (Rs. cr) and EBITDA margin (%)



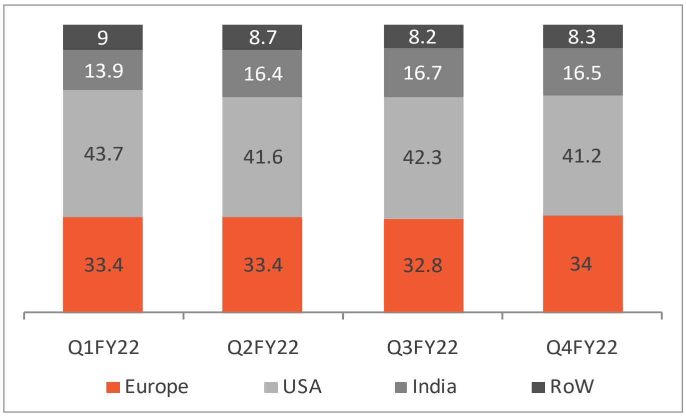
Source: Company, Sharekhan Research

Vertical breakdown (%)



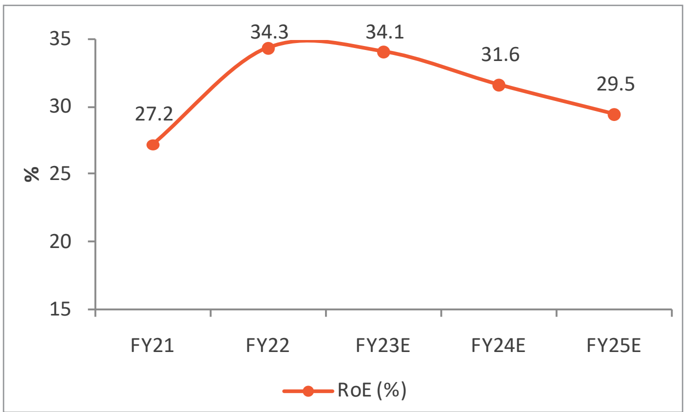
Source: Company, Sharekhan Research

Geography breakdown (%)



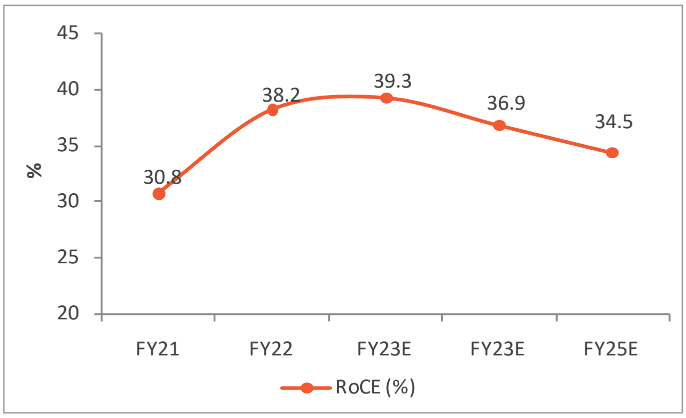
Source: Company, Sharekhan Research

RoE trend (%)



Source: Company, Sharekhan Research

RoCE trend (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Large addressable market provides sustainable growth opportunities

Total global ERD spends stood at $1.3 trillion in 2021 and are expected to touch $1.6 trillion by 2024. With a 10-15% market share, India is gradually establishing itself as an engineering and design centre for automobiles, aerospace, consumer electronics, machinery, and semiconductors. According to NASSCOM, India's contribution to the global ERD market is likely to increase to $63 billion by CY2025 from $31 billion in CY2019, translating at a CAGR of 12-13%. Indian ESPs will grow at a faster rate as compared to global peers owing to their ability to leverage robust digital engineering talent chains. According to Zinnov, the share of Indian ERD service providers is expected to increase from $ 16 billion in 2020-21 to $58 billion in 2030-31, implies 13%+ CAGR.

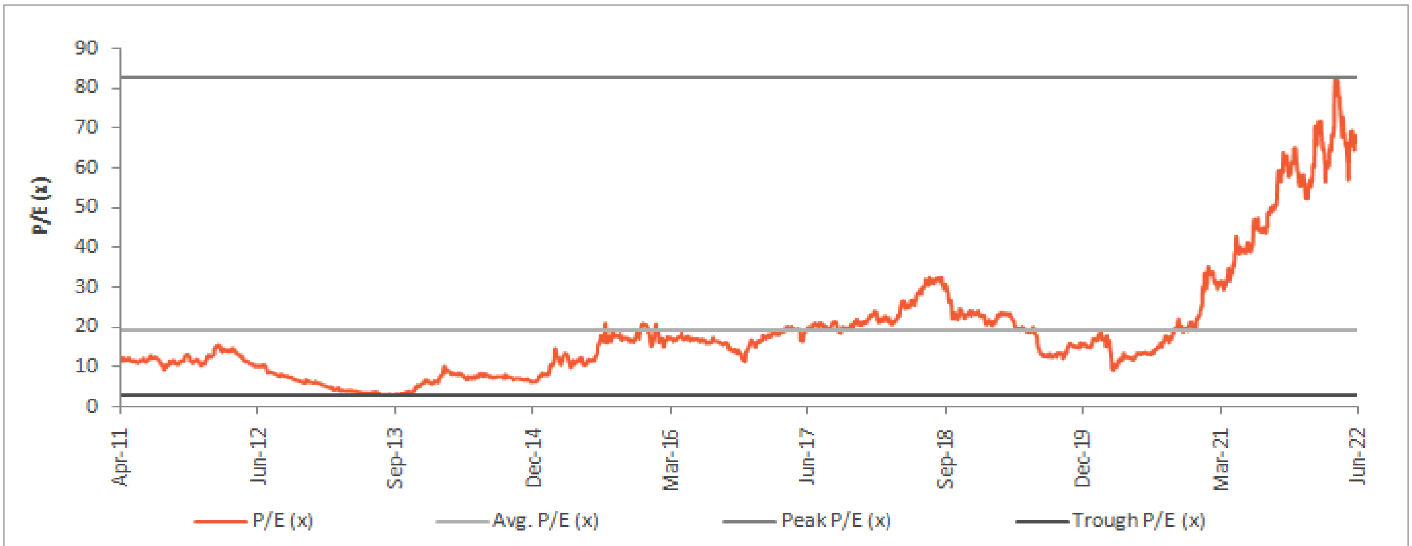
■ Company outlook - Growth prospects promising

TEL's key verticals have a huge growth opportunity, considering an increase in R&D spends in automotive, consumer electronics, and medical devices. TEL is a specialist vendor for top OEMs and tier-I suppliers. This along with recent re-allocation of R&D budgets towards electronics and software, a large addressable market, and differentiated product offerings is expected to drive the company's revenue growth going ahead. The company's strong capabilities in digital engineering, domain expertise and robust platform portfolio have helped it to strengthen its market position and win wallet share from existing customers.

■ Valuation - Strong growth outlook intact

TEL is well poised to capture market opportunities across the selected industries given its unique capabilities in design-led engineering. TEL's USD revenue and earnings are likely to clock a CAGR of 23% and 20%, respectively, over FY2022-FY2024E. Under our coverage, Tata Elxsi is the only company whose stock performance (up 22%) has significantly outperformed CNX IT (down 17%) over last three months despite interest rate hikes by the US Federal Reserve, rising inflation in developed markets, the Russia-Ukraine conflict and potential recession in the US. At CMP, stock is trading at 78x/67x its FY2023E/FY2024E earnings, which is expensive. However, we continue to prefer TEL, given its strong growth potential, market share gains, superior margin profile, differentiated capabilities in digital engineering and strong balance sheet (cash and investments was 51% of total assets). We maintain a Buy rating on TEL with a revised price target (PT) of Rs. 9,750.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	Market cap ($ mn)	CAGR (FY20-FY22)			CAGR (FY22-FY24E)			PE (x)			EV/EBITDA (x)		
		Revenue	EBITDA	PAT	Revenue	EBITDA	PAT	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Bertrandt*	472	-10.6%	-9.1%	-57.9%	13.5%	34.9%	166.7%	73.2	14.0	9.0	9.0	6.0	4.9
Desay SV*	12,202	33.9%	82.3%	68.9%	32.0%	33.8%	39.0%	93.7	70.6	51.0	68.7	51.7	38.4
Alstom*	10,473	4.3%	7.0%	-39.8%	37.1%	35.1%	40.8%	46.4	10.5	17.0	25.3	13.2	13.9
Cyient*	1,188	1.2%	28.2%	23.5%	17.1%	17.2%	14.2%	19.4	15.6	13.5	11.6	9.7	8.4
LTTS	4,692	5.8%	12.9%	8.1%	18.1%	18.1%	21.2%	38.1	31.0	26.0	23.9	20.3	16.7
Tata Elxsi	6,897	20.9%	49.4%	46.5%	22.8%	21.5%	20.5%	97.5	78.4	67.2	68.7	54.4	45.9

*Source: Sharekhan Research, *Bloomberg estimates*

About company

Incorporated in 1989, Bengaluru-based Tata Elxsi is a global design and technology services company. The Company provides digital design and engineering services, and systems integration and support services in India, the US, Europe, and Rest of the World. It also provides solutions and services for emerging technologies such as IoT, big data analytics, cloud, mobility, virtual reality, and artificial intelligence and brings together domain experience across infotainment, autonomous driving, telematics, powertrain, and body electronics. Tata Elxsi also works with leading OEMs and suppliers in the automotive industries for R&D, design, and product engineering services from architecture to launch. The company has been investing in platforms to scale and build efficiencies.

Investment theme

TEL is an integrated engineering services company with a strong expertise in the automotive, media, broadcast and communication, and healthcare verticals. The complex innovation requirements for OEMs need to be cost-effective, which makes a good case for offshoring to India due to its capabilities along with cost advantage and talent pool. TEL has a strong debt-free balance sheet with a robust cash balance that provide an inorganic growth opportunity. The company's differentiated technology capabilities, domain expertise and strong delivery capability enable it to address the emerging opportunities across the key verticals.

Key Risks

(1) Geopolitical risks, but TEL has no exposure to the Russia-Ukraine conflict; (2) currency risks; (3) industry risks; and (4) reversal of offshore effort mix could impact its margin performance.

Additional Data

Key management personnel

NG Subramanian	Non-Executive Chairperson
Manoj Raghavan	Managing Director cum Chief Executive Officer
Nitin Pai	CMO and Chief Strategy Officer
Gaurav Bajaj	Chief Financial Officer

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Axis Asset Management	2.06
2	Tata Investment Corp Limited	1.77
3	Vanguard Group Inc.	1.75
4	Wasatch Advisors Inc	1.17
5	Life Insurance Corp of India	1.04
6	BlackRock Inc.	1.03
7	William Blair & Co LLC	0.57
8	Dimensional Fund Advisors LP	0.55
9	Norges Bank	0.35
10	Invesco Ltd.	0.19

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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