Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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 Updated Dec 08, 2022				19.56
Low Risk				
NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 41,083 cr
52-week high/low:	Rs. 10760/5708
NSE volume: (No of shares)	3.0 lakh
BSE code:	500408
NSE code:	TATAELXSI
Free float: (No of shares)	3.5 cr

Shareholding (%)

Promoters	44
FII	14
DII	3
Others	39

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	13.0	-8.2	-22.6	-8.0
Relative to Sensex	12.4	-9.3	-30.6	-12.1

Sharekhan Research, Bloomberg

Tata Elxsi Ltd

Persisting Headwinds, Maintain Reduce

IT & ITeS	Sharekhan code: TATAELXSI
Reco/View: Reduce ↔	CMP: Rs. 6,597
Price Target: Rs. 6,185 ↓	

↑ Upgrade ↔ Maintain ↓ Downgrade

Stock Update

Result Update

Summary

- Tata Elxsi Limited's Q3FY23 revenue increased by 3.5% q-o-q/29% y-o-y in cc but missed our estimates of 4.1% q-o-q in cc. Revenues was impacted by furloughs and lower working days. Sequential CC revenue growth continued to moderate to 3.5% from 4.7% in Q2FY23.
- EBITDA margin for the quarter improved by 50 bps q-o-q to 30.2%. Utilization of billable employees and INR depreciation provided tailwinds for margin improvement.
- Management indicated that while demand outlook for Media & communications and Healthcare & Medical devices would be soft, they are more optimistic on Healthcare & Medical Devices to recover faster. On the demand outlook Management stated among Top 10 clients they are seeing some large deals not moving forward and seeing caution in the market. Clients prefer to adopt wait and watch policy. The company stated that it will take a couple of quarters before they get some clarity.
- We expect the outlook for FY24 to be uncertain on account of global headwinds and any recovery is most likely to be gradual. Given the continuing macro uncertainties and tapering of earning growth trajectory for Tata Elxsi, we maintain Reduce rating and revise our PT to Rs. 6,185. We advise investors to wait for a better entry point for long-term investment.

Tata Elxsi Limited's Q3FY23 revenue increased by 3.5% q-o-q/29% y-o-y in cc but missed our estimates of 4.1 q-o-q in cc terms. Revenues were impacted by furloughs and lower working days. Sequential CC revenue growth continued to moderate to 3.5% from 4.7% in Q2FY23. The company reported revenue growth of 7.1% q-o-q and 28.7% y-o-y to Rs. 817.7 crore, beating our estimates. EBITDA margin improved by 50 bps q-o-q to 30.2%. Margins improved as fresher additions from previous quarters became billable and the company was able to replace contractors with new employees. Utilisation of billable employees and rupee depreciation provided tailwinds for margin improvement. Q3FY23 growth was led by strong and sustained growth in the Automotive and adjacent segments in Transportation. Among divisions IDV and SIS recorded strong growth of 19% and 9.3% q-o-q respectively, while among verticals Transportation witnessed strong growth 7.3% q-o-q in cc supported by strong order book and pipeline, while Media& communications and Healthcare & Medical devices reported a decline of 2.6% and 1.9% q-o-q in cc respectively. Management indicated that while demand outlook for Media& communications and Healthcare & Medical devices would be soft, they are more optimistic on Healthcare & Medical Devices to recover faster. Both were impacted by furloughs & fewer working days. Net additions declined by 72 employees, taking total headcount to 11,607. The company plans to add freshers in the next two quarters and will add 400-500 engineers per quarter for the next four quarters. On the demand outlook, the management stated among Top 10 clients they are seeing some large deals not moving forward and seeing caution in the market. Clients prefer to adopt wait and watch policy. The company stated that it will take couple of quarters before they get some clarity. We expect the outlook for FY24 to be uncertain on account of global headwinds and any recovery is most likely to be gradual. Given the continuing macro uncertainties and tapering of earning growth trajectory for Tata Elxsi, we maintain Reduce rating and revise our PT to Rs. 6,185. We advise investors to wait for a better entry point for long-term investment.

Key positives

- EBITDA margins improved to 30.2% q-o-q, up 50 bps.
- Attrition rate moderated by 30 bps in the last twelve months to 18.4% from 18.7%
- Industrial Design & Visualization and System Integration (IDV) and Support(SIS) recorded strong growth of 19%and 9.3% q-o-q in cc respectively.

Key negatives

- Net additions declined by 72 taking the total headcount to 11607.
- Embedded Product Design (EPD) reported muted growth of 1.6% q-o-q in cc.

Management Commentary

- The management indicated that while demand outlook for Media & communications and Healthcare & Medical devices would be soft, they are more optimistic on Healthcare & Medical Devices to recover faster. Both were hit by furloughs and fewer working days.
- On demand outlook, the management stated among Top 10 clients they are seeing some large deals not moving forward and seeing caution in the market. Clients prefer to adopt wait and watch policy. The company stated that it will take couple of quarters before they get some clarity.

Revision in estimates – We have fine-tuned our estimates for FY2023/FY2024/FY2025 owing to macro overhang and INR-USD reset.

Our Call

Valuation – Persisting headwinds, Maintain Reduce: We expect the outlook for FY24 to be uncertain on account of global headwinds and any recovery is most likely to be gradual. Given the continuing macro uncertainties and tapering of earning growth trajectory for Tata Elxsi, we maintain our Reduce rating on and revise our PT to Rs. 6,185. We advise investors to wait for a better entry point for long-term investment.

Key Risks

Rupee appreciation and/or adverse cross-currency movements and/or constraints in local talent supply in the US would affect earnings. Further, macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

Valuation Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Total Revenue	2,470.8	3,118.5	3,471.7	4,161.6
EBITDA margin %	31.0	30.2	30.0	29.7
Adjusted Net Profit	549.7	721.1	770.2	909.5
% YoY growth	49.3	31.2	6.8	18.1
EPS (Rs.)	88.3	115.8	123.7	146.0
PER (x)	74.7	57.0	53.3	45.2
P/BV (x)	25.7	20.1	16.2	13.0
EV/EBITDA	52.4	42.2	37.7	31.4
ROE (%)	34.3	35.3	30.4	28.8
ROCE (%)	38.2	41.2	34.8	33.2

Source: Company; Sharekhan estimates

Key earnings call highlights

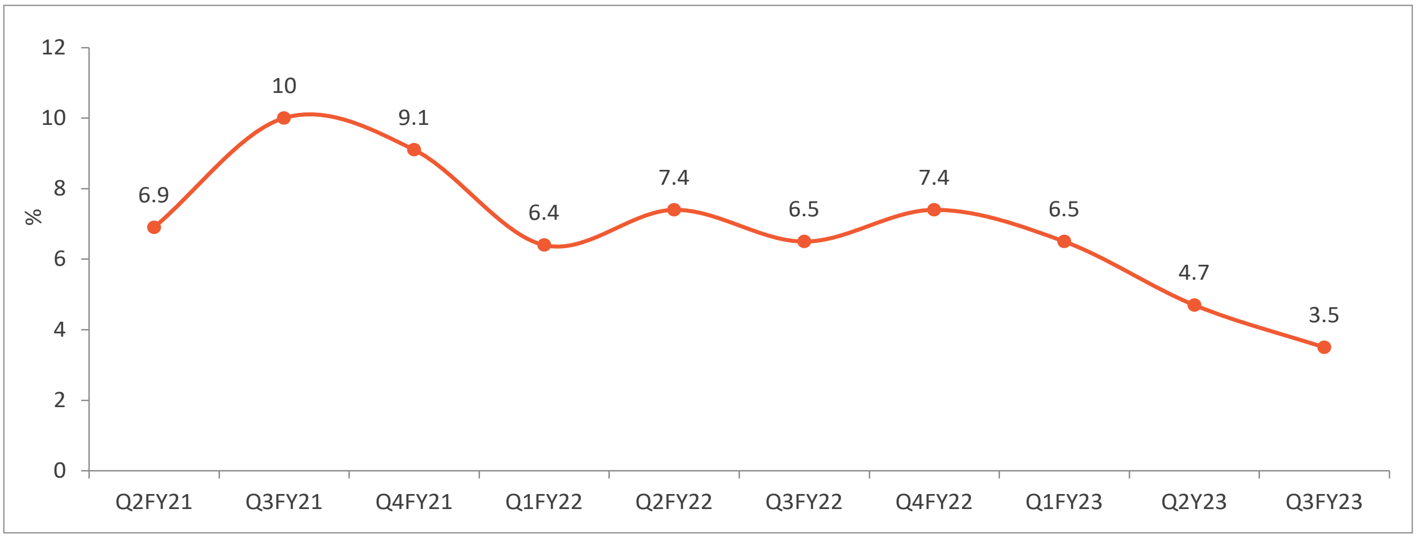
- **Steady revenue growth:** Q3FY23 revenue increased by 3.5% q-o-q/29% y-o-y in cc missed our estimates of 4.1 q-o-q in cc and was impacted by furloughs and lower working days. Sequential CC growth continued to moderate to 3.5% from 4.7% in Q2FY23. Growth for Q3FY23 was led by strong and sustained growth in the Automative and adjacent segments in Transportation. Among divisions IDV and SIS recorded strong growth of 19%. and 9.3% q-o-q respectively while among verticals Transportation witnessed strong growth 7.3% q-o-q in cc supported by strong order book and pipeline, while Media& communications and Healthcare & Medical devices reporting degrowth of 2.6% and 1.9% q-o-q in cc respectively.
- **Strong growth in the Europe and Row:** Europe and RoW grew strongly by 6.6% and 8.2%, respectively, q-o-q while US and India grew 3.8% and 2.3% q-o-q. Europe witnessed better growth as it is Automotive centric whereas US was impacted due to it being Media & Medical centric.
- **Demand Outlook:** The management indicated that while demand outlook for Media& communications and Healthcare & Medical devices would be soft, they are more optimistic on Healthcare & Medical Devices to recover faster. Both were impacted due to furloughs & lower working days in the quarter.On the demand outlook, the management stated among Top 10 clients they are seeing large deals not moving forward and seeing caution in the market. Clients prefer to adopt a wait & watch policy. The company stated that it will take couple of quarters before they get clarity.
- **EBITDA margin improves:** EBITDA margins improved by 50 bps q-o-q to 30.2%.Margins improved as fresher additions of previous quarters became billable and the company was thus able to replace contractors with new employees. Utilisation of billable employees and INR depreciation provided tailwinds for margin improvement.
- **Net additions & attrition:** Net additions declined by 72 taking the total headcount to 11,607. The company plan to add freshers in the next 2 quarters and will add 400-500 engineers per quarter for the next 4 quarters.
- **Strong Deals wins & order pipeline:** Transportation witnessed stellar growth aided by large deals and market share gains in EV, Software Defined Vehicles and adjacencies while growth in Media and was aided by new wins in Android TV and AdTech, and platform-led deals with operators.
- **Offshore revenue strengthened, while onsite revenue lagged:** Offshore mix further improves to 75.4% from 75.2% in Q2FY23.

Results | Rs cr

Particulars	Q3FY23	Q3FY22	Q2FY23	YoY (%)	QoQ (%)
Revenues in USD (mn)	**99.7**	**84.8**	**95.2**	**17.6**	**4.8**
Net sales	**817.7**	**635.4**	**763.2**	**28.7**	**7.1**
Employee expenses	410.7	329.5	392.2	24.6	4.7
Total purchases	49.2	22.3	41.6	120.5	18.2
Other expenses	111.0	72.8	102.9	52.5	7.9
EBITDA	**246.9**	**210.8**	**226.6**	**17.1**	**9.0**
Depreciation	21.4	14.0	21.8	52.6	-1.6
EBIT	**225.4**	**196.8**	**204.8**	**14.5**	**10.1**
Other income	19.1	6.5	18.7	193.9	2.5
Finance cost	4.5	3.0	4.3	48.5	4.9
PBT	**240.1**	**200.3**	**219.2**	**19.9**	**9.5**
Total tax	45.4	49.4	44.9	-8.0	1.2
Net profit	**194.7**	**151.0**	**174.3**	**29.0**	**11.7**
EPS (Rs)	31.3	24.2	28.0	29.0	11.7
Margin (%)			**BPS**		**BPS**
EBITDA	30.2	33.2	29.7	-299	50
EBIT	27.6	31.0	26.8	-341	74
NPM	23.8	23.8	22.8	5	97
Tax rate	18.9	24.6	20.5	-572	-156

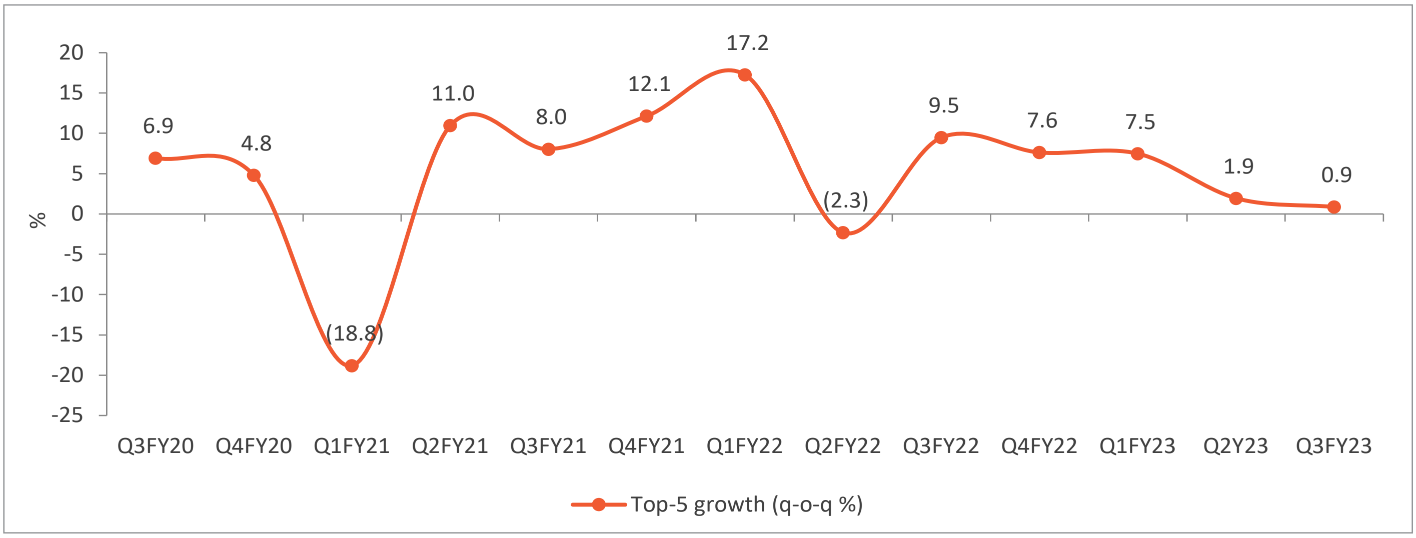
Source: Company, Sharekhan Research

CC revenue growth trend (q-o-q)



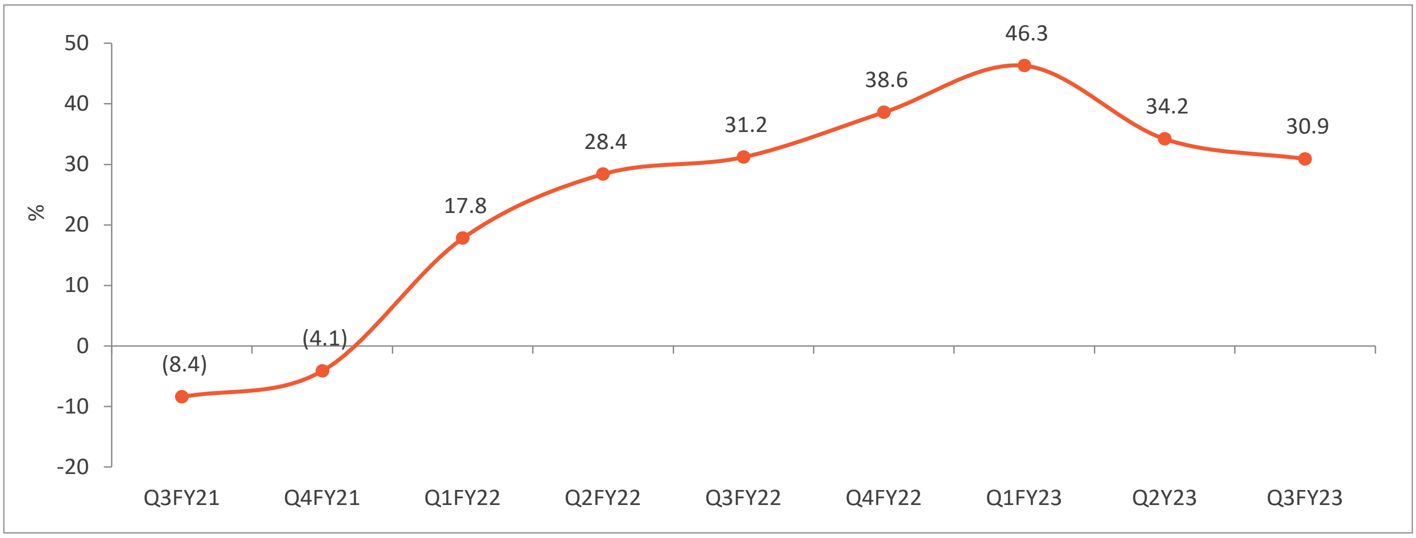
Source: Company, Sharekhan Research

Top five accounts growth trend (q-o-q)



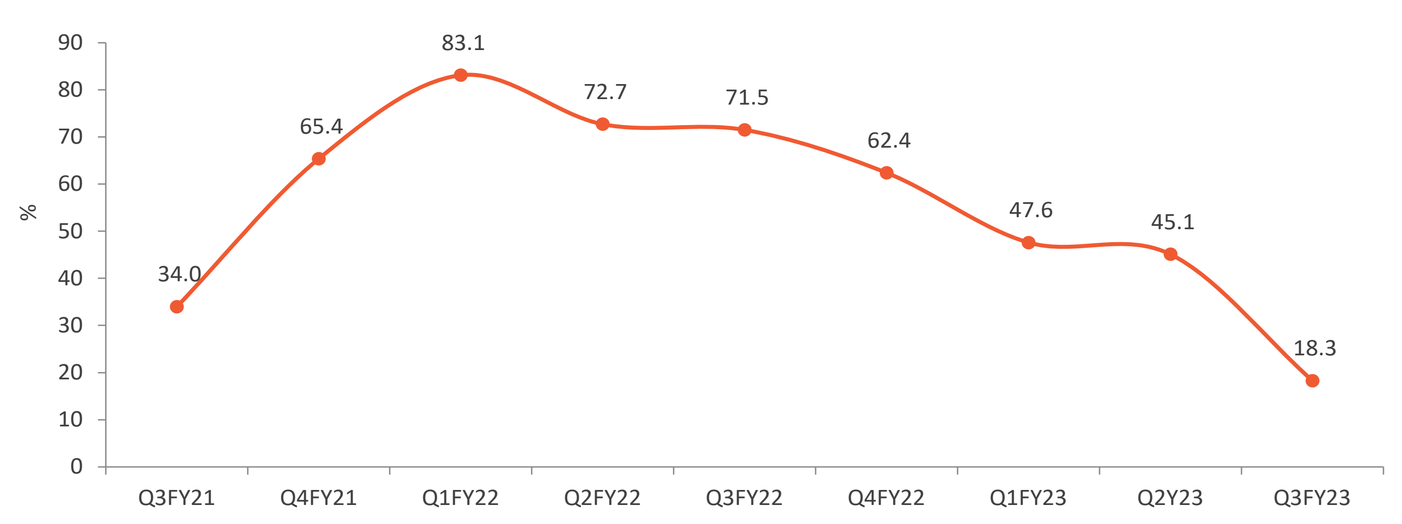
Source: Company, Sharekhan Research

Transportation vertical growth trend (q-o-q)



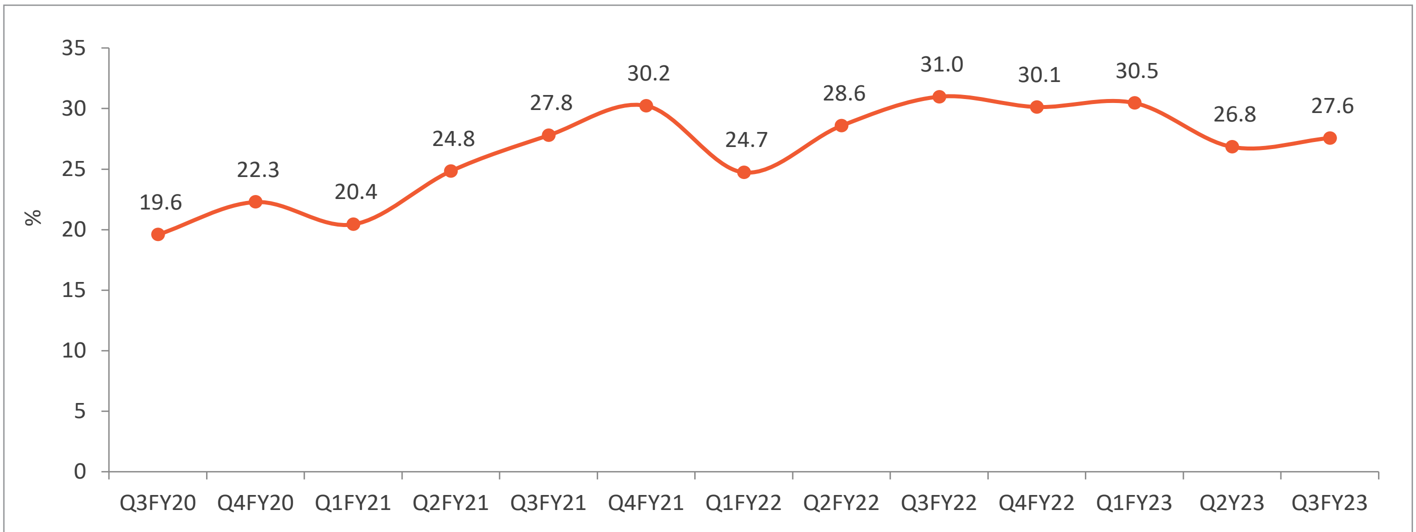
Source: Company, Sharekhan Research

Healthcare and medical devices growth trend (q-o-q)



Source: Company, Sharekhan Research

EBIT margin trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Persisting multiple global headwinds turning outlook for FY24E uncertain

Owing to multiple global headwinds the outlook for FY24E looks uncertain, and the recovery could be gradual in the coming quarters. Hence, concerns relating to macro headwinds are unlikely to abate anytime soon thus restricting any material outperformance for Indian IT companies.

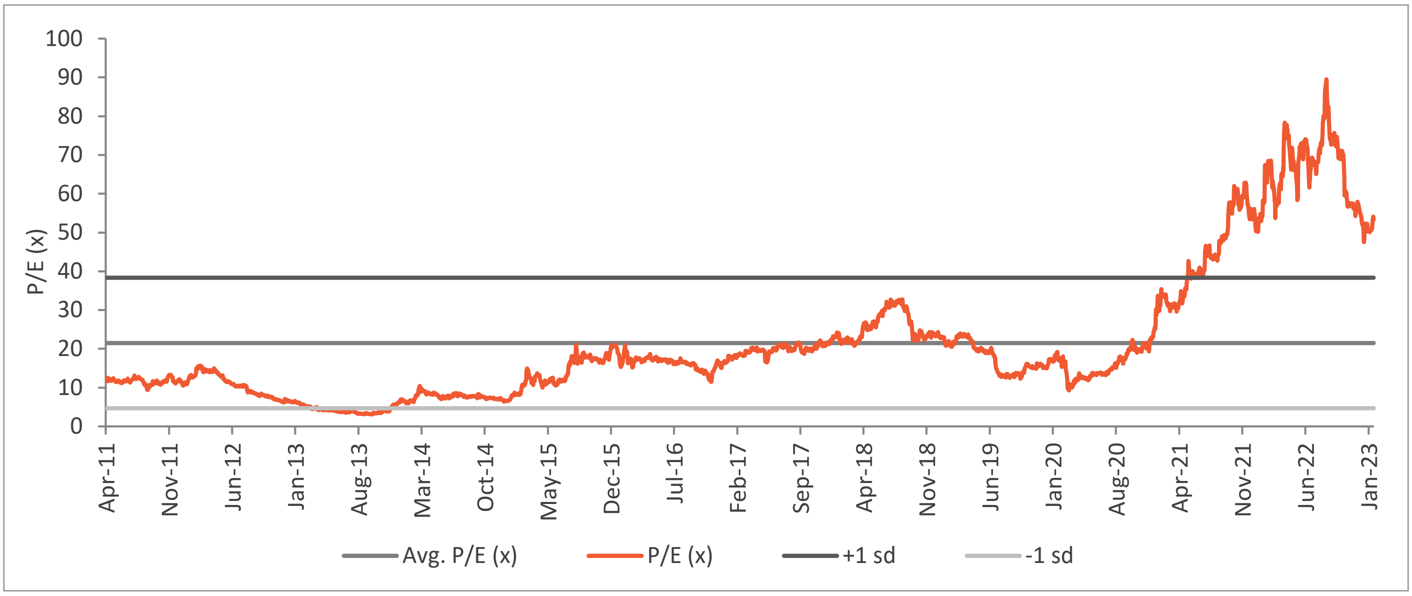
■ Company outlook - Growth prospects promising

TEL's key verticals have a huge growth opportunity, considering an increase in research and development (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 - Persisting headwinds, Maintain Reduce

We expect the outlook for FY24 to be uncertain on account of global headwinds and any recovery is most likely to be gradual. Given the continuing macro uncertainties and tapering of earning growth trajectory for Tata Elxsi, we maintain Reduce rating and revise our PT to Rs. 6,185. We advise investors to wait for a better entry point for long-term investment.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Incorporated in 1989, Bengaluru-based TEL 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 RoW. The company provides solutions and services for emerging technologies such as internet of things (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. TEL 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 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 provides an inorganic growth opportunity. The company's differentiated technology capabilities, domain expertise, and strong delivery capability enable it to address the emerging opportunities across key verticals.

Key Risks

1) Rupee appreciation and/or adverse cross-currency movements, 2) constraint in local talent supply in the US would have an adverse impact on its earnings and 3) macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

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: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Vanguard Group Inc.	2.19
2	BlackRock Inc.	1.79
3	Axis Asset Management	1.44
4	Dimensional Fund Advisors LP	0.6
5	Norges Bank	0.35
6	Wasatch Advisors	0.27
7	FMR LLC	0.2
8	State Street Corp	0.18
9	Northern Trust Corp	0.16
10	Credit Agricole Group	0.16

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

Sharekhan

by BNP PARIBAS

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