Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Tata Elxsi Ltd

Muted Quarter, Maintain hold

IT & ITeS	Sharekhan code: TATAELXSI
Reco/View: Hold ↔	CMP: Rs. 7,543
	Price Target: Rs. 7,500 ↔

↑ 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	Neutral	↔	Neutral
RQ	Positive	↔	Positive
RV	Negative	↔	Negative

ESG Disclosure Score NEW

ESG RISK RATING 20.79

Updated Jul 08, 2023

Medium Risk

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

Source: Morningstar

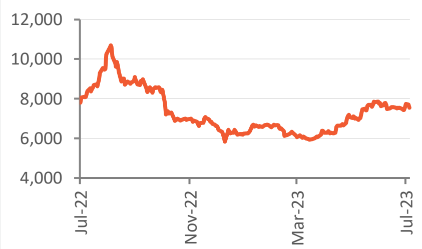
Company details

Market cap:	Rs. 46,974 cr
52-week high/low:	Rs. 10,760 / 5,708
NSE volume: (No of shares)	1.6 lakh
BSE code:	500408
NSE code:	TATAELXSI
Free float: (No of shares)	3.5 cr

Shareholding (%)

Promoters	44
FII	14
DII	4
Others	39

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-1.2	18.5	20.5	-6.9
Relative to Sensex	-6.6	6.7	11.1	-29.4

Sharekhan Research, Bloomberg

Summary

- Tata Elxsi reported constant currency (CC) revenue growth of 1.2% q-o-q and 11.9% y-o-y, missing our estimates of 2.5%. Revenue growth was led by a rise in revenues of industrial design & visualization and transportation divisions (up 41.1%/17% y-o-y in cc terms), respectively.
- EBIT margins dipped slightly by ~ 20 bps q-o-q to 27.1% in line with estimates despite wage hikes and strong employee additions in the quarter, Net profit was impacted by a higher effective tax rate (ETR).
- Company won significant new deals including a strategic multi-year multi-million US$ SDV deal with a leading Asian OEM and a multi-country licensing and deployment of connected vehicle platforms.
- Despite a soft quarter, the company continues to witness good traction and a strong deal pipeline, especially in software defined vehicles and EV and is well positioned to capture opportunities in Industrial design, Medical and other verticals . However, the recent run-up limits the upside with the stock trading at 57.9/50.0x its FY24/FY25E EPS . Hence, we maintain Hold with unchanged price target (PT) of Rs 7500.

Tata Elxsi reported constant currency revenue (CC) growth of 1.2% q-o-q and 11.9% y-o-y, missing our estimates of 2.5% cc revenue growth. reported Revenues from operations stood at Rs. 850.3 crore up 1.5% q-o-q/17.1% y-o-y but missed our estimates of Rs. 859.3 crore. Revenue growth was led by Industrial Design & Visualization and Transportation division up 41.1%/17% y-o-y in constant currency respectively. EBIT margin dipped slightly by ~ 20 bps q-o-q to 27.1% in line with estimates despite wage hikes and strong employee additions in the quarter. Net profit of Rs. 188.7 crore, up 2.1% q-o-q/ down 6.4% y-o-y) was below our estimates of Rs 201.2 crore. Net profit was impacted by a higher effective tax rate (ETR) in this quarter which increased on account of lower tax exemption due to completion of a five-year period for two of the SEZ units. The company won significant new deals including a strategic multi-year multi-million US$ software-defined vehicles (SDV) deal with a leading Asian OEM for their SDV platform and software development, and a multi-country licensing and deployment of connected vehicle platforms with a global Top 5 OEM. The company added 422 employees in the quarter, up 3.6%q-o-q. Attrition moderated to 15.6%, down 170 bps q-o-q. Despite a soft quarter the company continues to witness good traction and a strong deal pipeline, especially in Software Defined Vehicles and EV. However, the recent run-up limits the upside with the stock trading at 57.9/50.0x its FY24/FY25E EPS . Hence, we maintain Hold with unchanged price target (PT) of Rs 7500.

Key positives

- Attrition rate moderated 170 bps q-o-q to 15.6% from 17.3%
- Net additions improved by 422 taking the total headcount to 12,286.
- Healthcare and life sciences business reported a healthy q-o-q growth of 3.2% in constant currency

Key negatives

- System Integration & Support declined 2.8% q-o-q in cc.
- Media & Communication witnessed muted growth of 0.2% q-o-q in constant currency.

Management Commentary

- The management highlighted that the deal pipeline is still strong and hopeful for closures in subsequent quarters. The lack of conversion is affecting soft revenue growth. Management is confident that Q2 and Q3 will see more accelerated pipeline closures.
- The management expects growth in the medical, transportation, and industrial design businesses, although communication may be soft. Media and Communication industry remains soft, but maintaining market share

Revision in estimates – We have fine-tuned our estimates for FY24 /FY25E to factor muted Q1FY24 performance.

Our Call

Valuation – Muted Quarter, Maintain Hold: Despite a soft quarter the company continues to witness good traction and a strong deal pipeline, especially in SDVs and EVs. Further, it is well-positioned to capture opportunities in Industrial design ,Medical and other verticals due to its deep domain knowledge, scale and expertise. We expect a ~13%/12% Sales and PAT CAGR respectively over FY23-25E. However, the recent run-up limits the upside with the stock trading at 57.9/50.0x its FY24/FY25E EPS . Hence, we maintain Hold with unchanged PT of Rs. 7500.

Key Risks

Rupee appreciation and/or adverse cross-currency movements. Contagion impact of banking crisis, macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

Valuation Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Total Revenue	2,470.80	3,144.70	3,529.00	4,043.90
EBITDA margin %	31	30.6	30.7	30.9
Adjusted Net Profit	549.7	755.3	811.4	939
% y-o-y growth	49.3	37.4	7.4	15.7
EPS (Rs.)	88.3	121.3	130.3	150.8
PER (x)	85.5	62.2	57.9	50
P/BV (x)	29.3	22.5	18	14.3
EV/EBITDA	60.1	47.7	41.7	35.6
ROE (%)	34.3	36.2	31	28.7
ROCE (%)	38.2	42	35	32.2

Source: Company; Sharekhan estimates

Key earnings call highlights

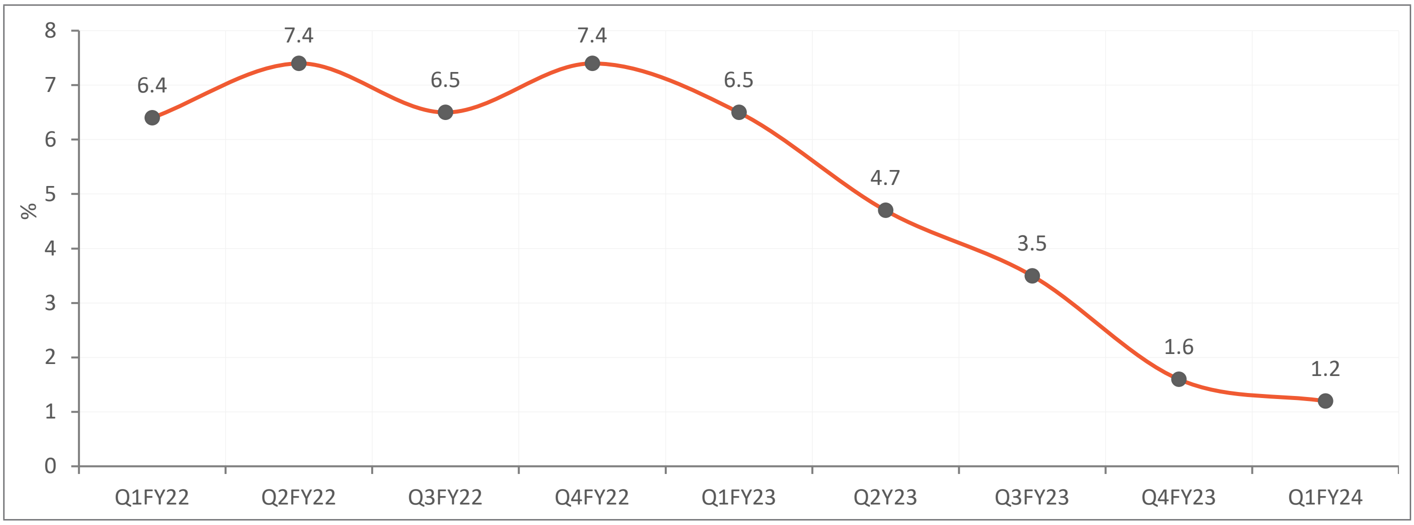
- **Growth across verticals:** The transportation vertical clocked 1.8% q-o-q in cc terms, Healthcare & Medical devices grew 3.2% q-o-q in cc terms while Media & Communications grew 0.2% q-o-q. Large deals aided transportation growth of 17% y-o-y. In contrast, some deal closures were delayed and the company won new contracts, including a strategic multi-year million SDV deal. The company won the first multiyear deal with the leading telecom operator for our 5G Network orchestration and Automation suite.
- **Growth across geographies and top clients:** Europe grew strongly by 6.9% q-o-q offset by degrowth in US, India and RoW by 1.5%/0.3% and 5.5% q-o-q respectively. For Q4FY23, Top 5 and Top 10 clients grew 7.1% and 6.6%, respectively.
- **Margins:** EBITDA margins dipped slightly by ~20 bps q-o-q to 29.6%, in-line with our estimate of 29.5% despite wage hikes and strong employee additions . The effective tax rate in this quarter has increased an account of lower tax exemption due to the completion of a five-year period for two SEZ units, impacting PAT Margins.
- **Hiring & attrition:** The company added 422 employees taking the total headcount to 12286. In this financial year, Tata Elxsi plans to hire approximately 1800-2000 new employees. The company will first focus on utilizing the bench strength before going out to hire.
- **Offshore - onsite revenue mix:** Offshore mix improved to 74.7% from 74.50% in Q4FY23.

Results Rs cr

Particulars	Q1FY24	Q1FY23	Q4FY23	Y-o-Y %	Q-o-Q %
Revenues in USD (mn)	**103.4**	**93.1**	**101.9**	**11.1**	**1.5**
Net sales	**850.3**	**725.9**	**837.9**	**17.1**	**1.5**
Employee expenses	442.4	365.7	429.2	21.0	3.1
Total purchases	58.2	39.7	55.8	46.4	4.2
Other expenses	98.2	82.3	103.1	19.3	-4.8
EBITDA	**251.5**	**238.2**	**249.7**	**5.6**	**0.7**
Depreciation	21.4	17.1	21.1	25.3	1.6
EBIT	**230.1**	**221.1**	**228.6**	**4.1**	**0.6**
Other income	22.0	10.3	25.7	113.3	-14.3
Finance cost	3.9	3.4	4.1	16.8	-4.7
PBT	**248.1**	**228.0**	**250.2**	**8.8**	**-0.8**
Total tax	59.5	43.3	48.7	37.4	22.1
Net profit	**188.7**	**184.7**	**201.5**	**2.1**	**-6.4**
EPS (Rs)	30.3	29.7	32.4	2.1	-6.4
Margin (%)			**BPS**		**BPS**
EBITDA	29.6	32.8	29.8	-323	-23
EBIT	27.1	30.5	27.3	-340	-23
NPM	22.2	25.4	24.0	-326	-186
Tax rate	24.0	19.0	19.5	498	451

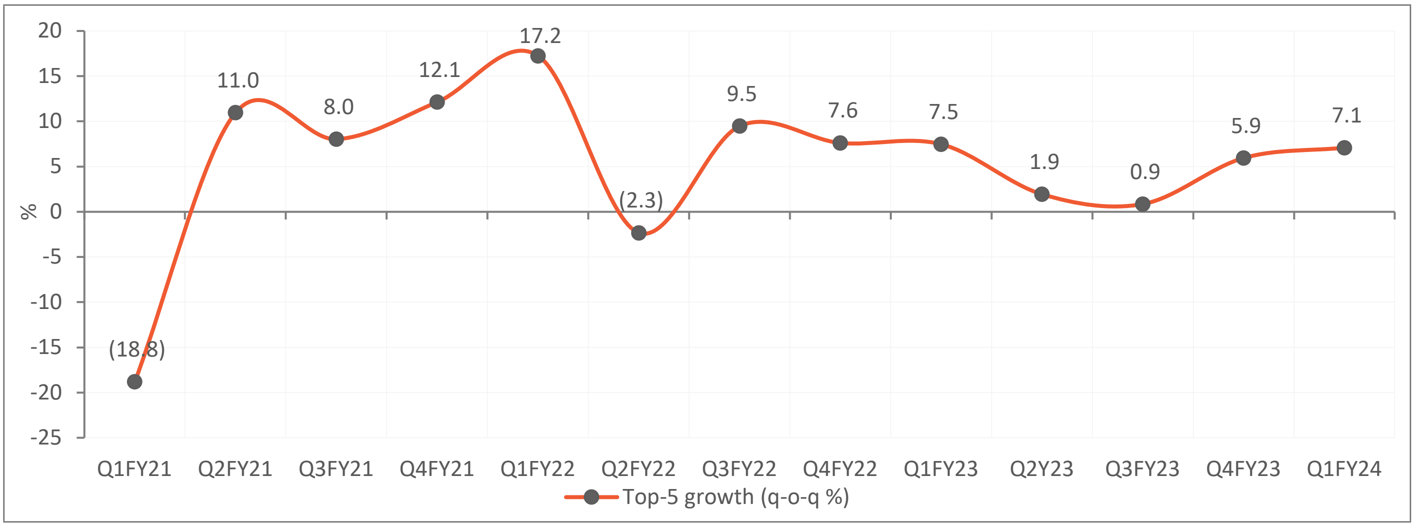
Source: Company; Sharekhan Research

CC revenue growth trend (q-o-q)



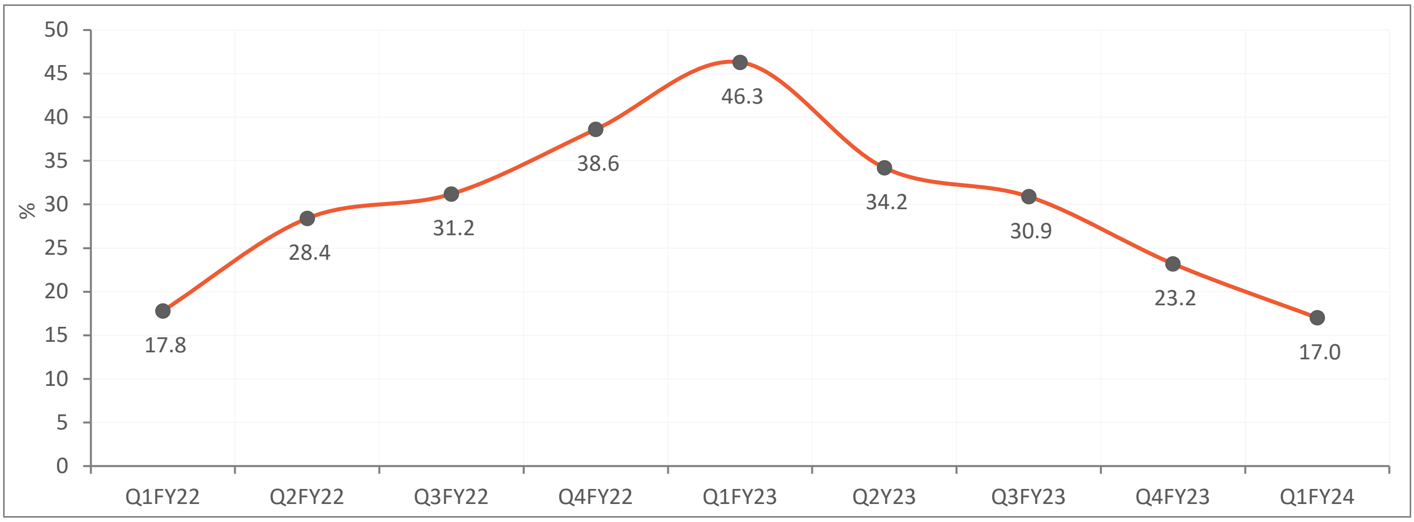
Source: Company; Sharekhan Research

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



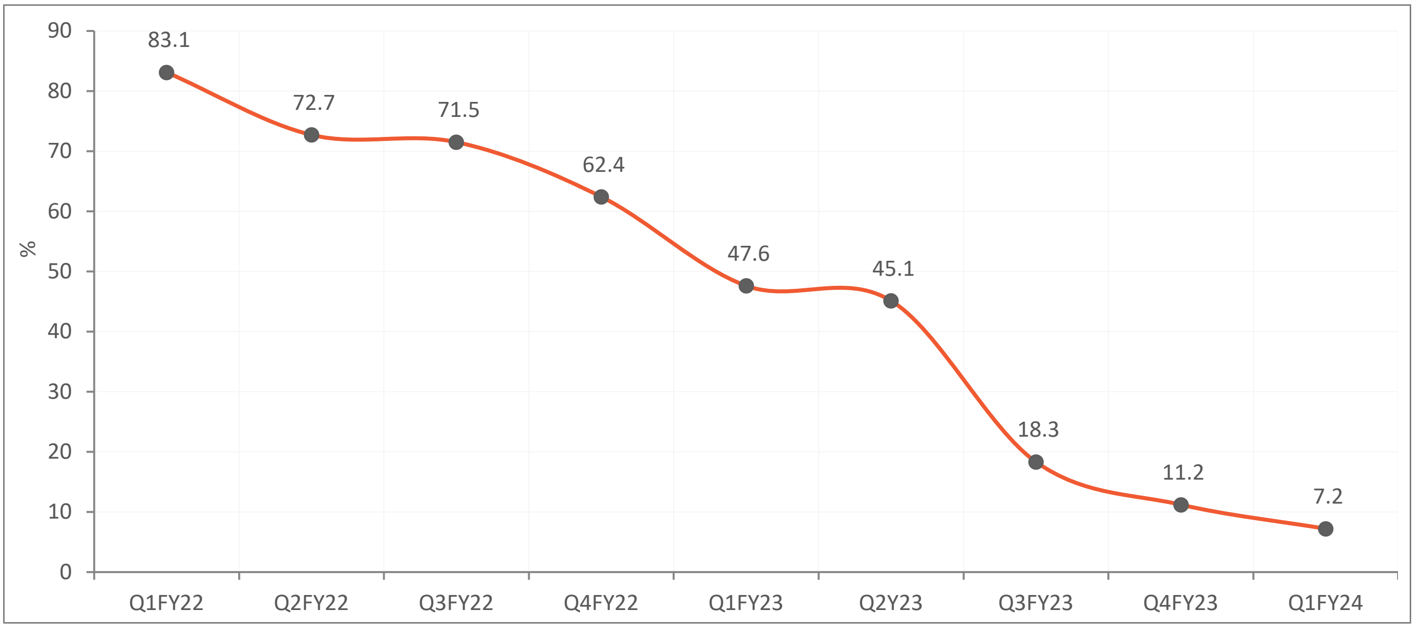
Source: Company; Sharekhan Research

Transportation vertical growth trend (q-o-q)



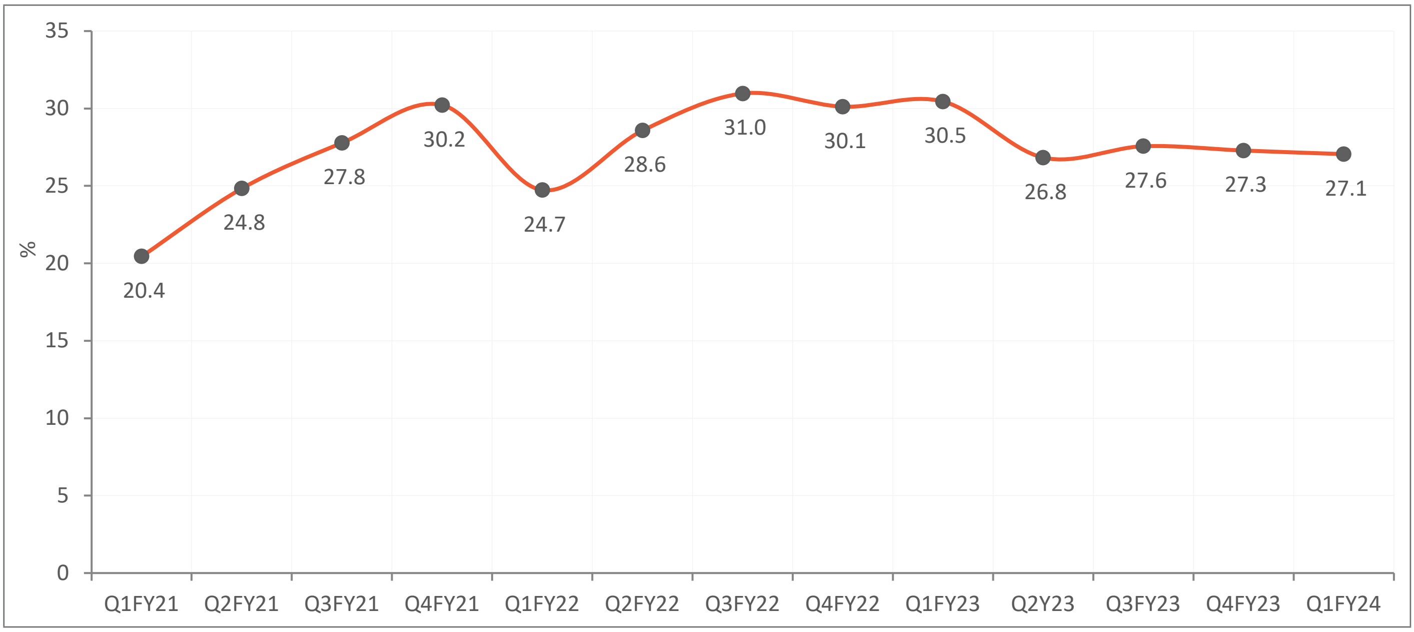
Source: Company; Sharekhan Research

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.

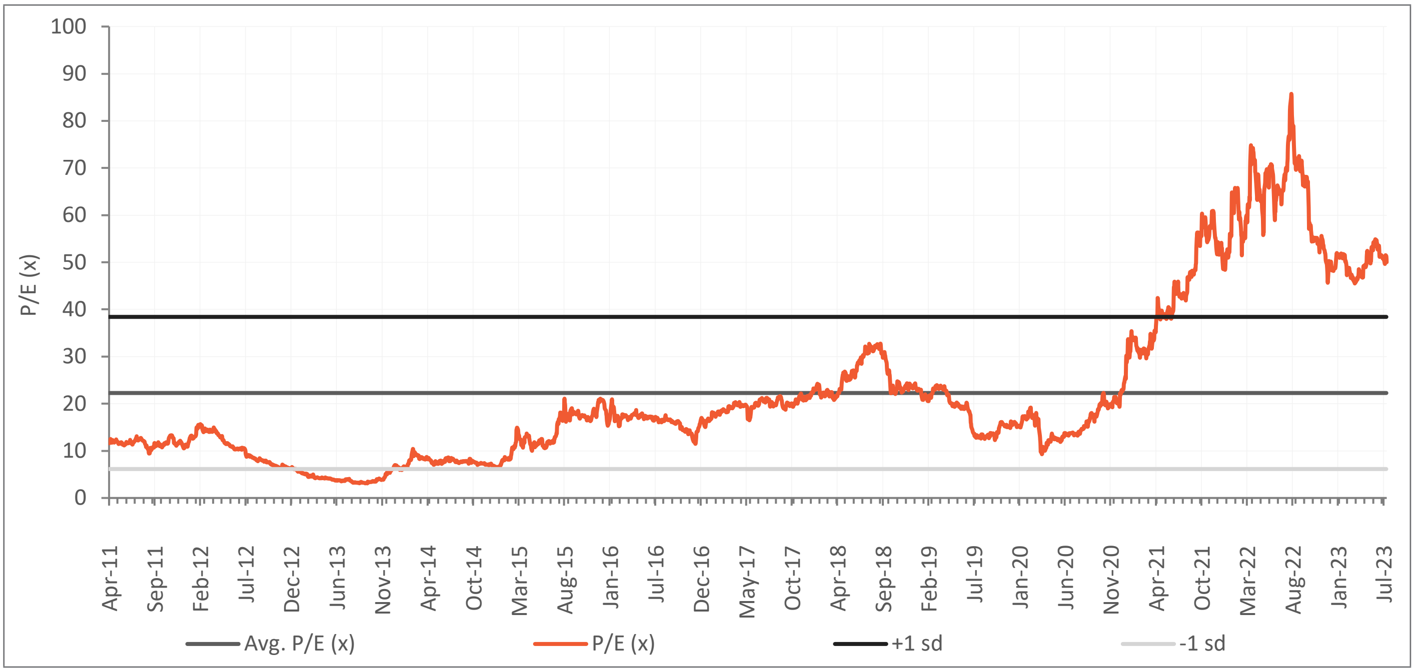
■ Company Outlook – Growth prospects promising

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 – Muted Quarter, Maintain hold

Despite a soft quarter the company continues to witness good traction and a strong deal pipeline, especially in Software Defined Vehicles and EV . Further, it is well positioned to capture opportunities in Industrial design ,Medical and other verticals due to its deep domain knowledge scale and expertise. We expect a ~13%/12% Sales and PAT CAGR respectively over FY23- 25E. However, the recent run-up limits the upside with the stock trading at 57.9/50.0x its FY24/FY25E EPS Hence, we maintain Hold with unchanged PT of 7500.

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, and 3) Contagion effect of banking crisis, 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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Vanguard Group Inc	1.93
2	Axis Asset Management Co Ltd	1.85
3	BlackRock Inc	1.85
4	Norges Bank	0.47
5	Dimensional Fund Advisors LP	0.43
6	FMR LLC	0.20
7	Northern Trust Corp	0.16
8	Wasatch Advisors Inc	0.14
9	State Street Corp	0.13
10	Invesco Asset Management India Pvt	0.13

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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