HOLD

CMP: **INR 7,759** Target Price: **INR 7,590** ▼ -2%

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11 October 2024 | **India | Equity Research | Re-initiating Coverage**

Tata Elxsi

Technology

Non-auto portfolio drags growth

Tata Elxsi (TELX) reported muted growth of 0.2% QoQ CC in Q2FY25. While the Auto vertical continues to grow at a healthy pace, challenges persist in Communication and Healthcare. Given softer growth in H1F25, at ~6.5% YoY CC, management's earlier guidance of double-digit CC growth in FY25 requires ~7% CQGR in H2FY25, seems a tall ask. We model 7.9%/15.1%/14.8% YoY CC revenue growth in FY25E/26E/27E. We expect EBITDA margin to remain range-bound at ~29–30% and has downside risk if growth moderates further. We value TELX at a 5-year average multiple of 49x on Q2FY26E–Q1FY27E EPS of INR 158 and arrive at a TP of INR 7,590 with potential 2% downside. We like the company given its presence in high growth service lines of design, embedded and digital engineering, diversified vertical exposure and superior margins. We assign **HOLD** rating given premium valuations on backdrop of moderating growth.

Muted revenue growth in Q2; H2 to be better than H1, but target of double-digit cc growth in FY25 seems a tall ask

TELX reported muted revenue growth of 0.2% QoQ CC in Q2FY25. Growth was driven by Transportation (4.4% QoQ CC), whereas challenges persisted in the other two verticals. Media and Communication declined 1.9% QoQ CC due to completion of projects and delay in deal closures. Healthcare and Life sciences saw a sharp decline due to delay in ramp-up of new programs with a leading US-based client. Given softer growth in H1F25 at 6.5% YoY CC, management's earlier guidance of double-digit cc growth in FY25 requires ~7% CQGR in H2FY25, seems a tall ask in our view given challenges in two of the three verticals (~43% of portfolio)

Transportation growth to continue at healthy pace despite slowdown for the overall industry

Transportation continued to grow at a healthy pace led by ramp up of large deals won with auto OEMs in earlier quarters. Revenue share from auto OEMs has now increased to 68% of total transportation revenue. Whereas demand from tier-1 suppliers remains muted. Despite slowdown for the overall auto industry, TELX's auto business is on a strong footing. It won a USD 50mn five-year deal from a global OEM headquartered in Europe. Its deal pipeline is also strong in Asia and Japanese markets where auto OEMs are late to catch-up EV and autonomous trends.

Financial Summary

Y/E March (INR mn)	FY24A	FY25E	FY26E	FY27E
Net Revenue	35,521	39,221	45,557	52,291
EBITDA	10,464	11,415	13,556	15,558
EBITDA Margin (%)	29.5	29.1	29.8	29.8
Net Profit	7,922	8,509	9,850	11,326
EPS (INR)	127.2	139.8	158.2	181.9
EPS % Chg YoY	4.9	9.9	13.1	15.0
P/E (x)	61.0	55.5	49.1	42.7
EV/EBITDA (x)	44.9	41.0	34.2	29.4
RoCE (%)	31.2	27.9	27.2	25.8
RoE (%)	34.5	30.3	30.0	28.5

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Market Data

Market Cap (INR)	483bn
Market Cap (USD)	5,758mn
Bloomberg Code	TELX IN
Reuters Code	TTEX.BO
52-week Range (INR)	9,200 /6,407
Free Float (%)	56.0
ADTV-3M (mn) (USD)	33.3

Price Performance (%)	3m	6m	12m
Absolute	9.0	(1.1)	5.4
Relative to Sensex	6.9	(9.9)	(18.1)

Media and communication impacted by focus on cost take-outs and consolidation

Media and communication declined because of completion of couple of projects and delay in large deal closures. Clients in media and communication have tight budgets and are focussing on cost-takeout and consolidations. Management expects growth to return in H2. We expect growth in this vertical to be muted, as challenges for the industry persists.

Healthcare and Life sciences growth has bottomed out in Q2

Management mentioned that the Healthcare vertical has bottomed out and new programs that were delayed in Q2 should partially re-start in Q3; and ramp-up in Q4. The company added some new marquee customers – including a global renal care leader and a US-headquartered health-tech AI leader, which are expected to scale up over the next few quarters.

Margin

EBITDA margin declined ~150bps QoQ to 27.9%. (excluded impact of one-off expense, Q1FY25 margin is 29.4%). EBITDA margin was impacted by headwinds of: 1) 120bps from wage hike; 2) 100bps because of lab set-ups reflected in cost of materials consumed; and 3) higher other expenses ~60bps QoQ. These were partially offset by cross-currency benefits of 160bps QoQ. Management expects margin to improve in H2FY25 driven by recovery in revenue growth.

Headcount

Net headcount declined 2.7% QoQ and 0.6% YoY because the company is cautious in hiring laterals in the Media & Communication and Healthcare verticals. Also, utilisation, at 69%, still has scope to inch up. The company will on-board freshers in Q3 and Q4FY25.

Other highlights

- The company has taken Related Party Transaction (RPT) approval of INR 10 bn for JLR from a medium-term perspective. JLR is growing at a healthy pace, but other OEMs are growing faster, as per management.
- TELX did RDK Broadband implementation for Qualcomm, which allows global telecom operators to adopt this first-of-its kind solution to deliver high-speed home and enterprise broadband services through their 5G networks. This helps TELX to gain entry in to telecom operators.
- TELX's strategic focus on expanding business in Japan, India and other emerging markets is yielding results. Revenue from India grew by 9.6% QoQ USD, 29.6% YoY USD, while Japan and emerging markets grew by 31% QoQ, 81% YoY USD.
- Top 5 clients declined by 1.9% QoQ USD (possibly due to delays by Healthcare client) and Top 6–10 were flat at -0.2% QoQ USD.
- Offshore revenue mix improved by 190bps QoQ to 74.7%.

Key risks

Downside risks: 1) high top 5 client concentration, 2) delay in recovery in Media and Communication and Healthcare segments

Upside risks: 1) Faster ramp ups of existing and new large deal wins

Exhibit 1: QoQ and YoY movement during the quarter

INR mn	Q2FY25	Q1FY25	QoQ	Q2FY24	YoY	Consensus	YoY
Sales (USD mn)	114	111	2.6%	107	6.8%	113.03	0.9%
Sales	9,551	9,265	3.1%	8,817	8.3%	9470	0.9%
EBITDA	2,664	2,720	-2.1%	2,635	1.1%	2725	-2.2%
EBITDA Margin	27.9%	29.4%	-147 bps	29.9%	-200 bps	28.8%	-88 bps
EBIT	2,393	2,450	-2.3%	2,385	0.3%	2449	-2.3%
EBIT Margin	25.1%	26.4%	-139 bps	27.1%	-200 bps	25.9%	-81 bps
Reported PAT	2,294	1,841	24.6%	2,000	14.7%	2002	14.6%
EPS	36.8	29.6	24.6%	32.1	14.6%	32.179	14.5%
Average (USD rate)	83.8	83.4	0.4%	82.6	1.4%	83.8	

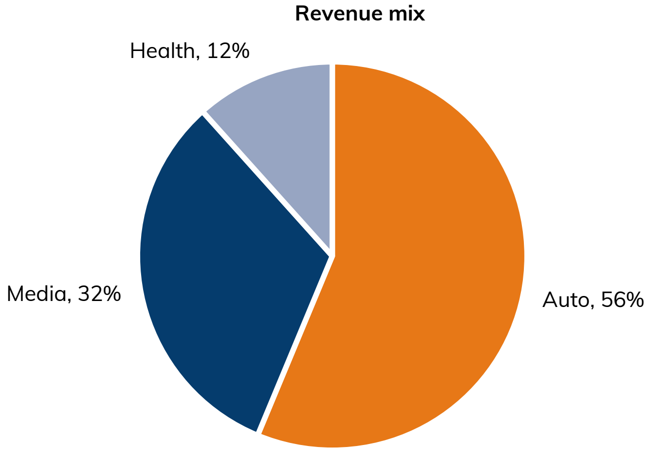
Source: I-Sec research, Company data

Exhibit 2: Auto on strong footing, non- auto portfolio continues to decline in Q2FY25

QoQ CC	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	Q4FY24	Q1FY25	Q2FY25
Auto	14.1%	9.7%	8.3%	7.8%	4.6%	7.3%	1.7%	1.8%	6.9%	1.9%	1.2%	5.3%	4.4%
Media	8.6%	6.3%	7.2%	3.7%	1.0%	-2.6%	1.7%	0.2%	-0.4%	-0.1%	-4.0%	0.5%	-2.6%
Health	6.9%	20.7%	6.8%	7.4%	5.2%	-1.9%	1.0%	3.2%	3.2%	3.9%	0.2%	4.3%	-11.2%
YoY CC													
Auto	28.4%	31.2%	38.6%	46.3%	34.2%	30.9%	23.2%	0.2%	19.1%	12.9%	16.4%	20.3%	16.0%
Media	31.2%	30.2%	31.6%	27.8%	19.6%	9.8%	3.9%	-0.1%	-1.3%	1.3%	-4.6%	-3.8%	-5.1%
Health	72.7%	71.5%	62.4%	47.6%	45.1%	18.3%	11.2%	0.0%	4.8%	11.2%	7.2%	-0.5%	-11.8%

Source: Company data, I-Sec research

Exhibit 3: Well diversified revenue mix



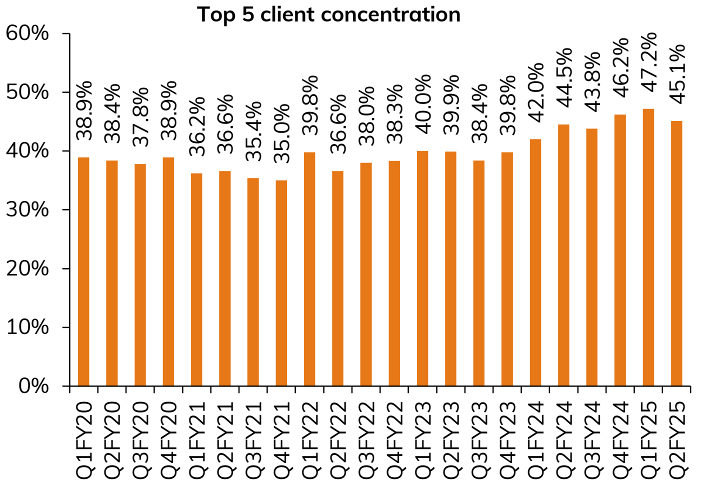
Source: I-Sec research, Company data

Exhibit 4: EU continues to lead growth; India and Japan and emerging markets(captured in RoW) grew strongly in Q2FY25

QoQ USD	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	Q4FY24	Q1FY25	Q2FY25
EU	6.6%	3.7%	10.5%	0.8%	5.0%	6.5%	3.3%	7.9%	10.3%	4.2%	-1.3%	6.7%	3.9%
USA	1.5%	7.4%	3.8%	8.2%	2.3%	3.7%	-1.8%	-1.1%	1.6%	-2.8%	-4.5%	-4.6%	-7.7%
India	25.8%	7.5%	5.3%	13.6%	-6.6%	2.2%	8.5%	0.1%	-5.9%	8.9%	4.7%	3.7%	9.6%
RoW	3.1%	-0.5%	7.9%	-22.2%	-0.3%	8.1%	-6.5%	-6.9%	-4.6%	19.7%	9.7%	5.2%	31.1%
YoY USD													
EU	21.7%	17.7%	26.4%	23.1%	21.2%	24.5%	16.5%	24.7%	31.0%	28.1%	22.5%	21.1%	14.1%
USA	67.9%	53.9%	30.6%	22.4%	23.3%	19.1%	12.7%	3.1%	2.4%	-4.1%	-6.7%	-10.0%	-18.3%
India	88.1%	68.5%	44.7%	61.8%	20.2%	14.2%	17.6%	3.6%	4.3%	11.1%	7.3%	11.2%	29.6%
RoW	-21.6%	-25.3%	-5.8%	-13.9%	-16.8%	-9.6%	-21.6%	-6.2%	-10.3%	-0.7%	16.5%	31.7%	81.0%

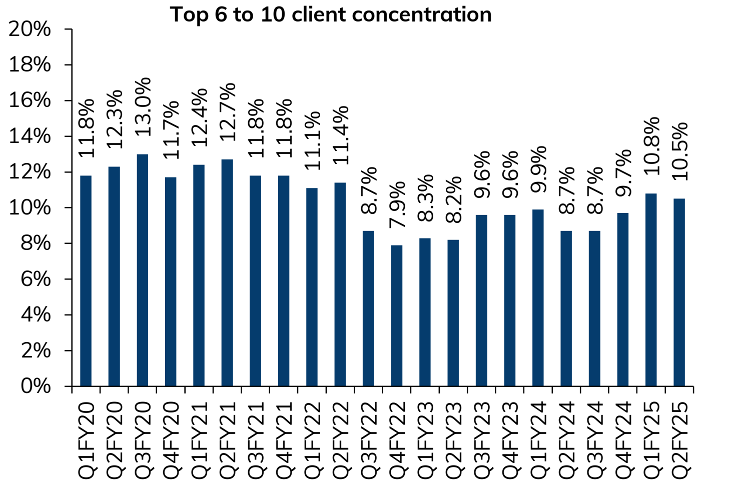
Source: Company data, I-Sec research

Exhibit 5: Top 5 concentration declined by 210bps QoQ



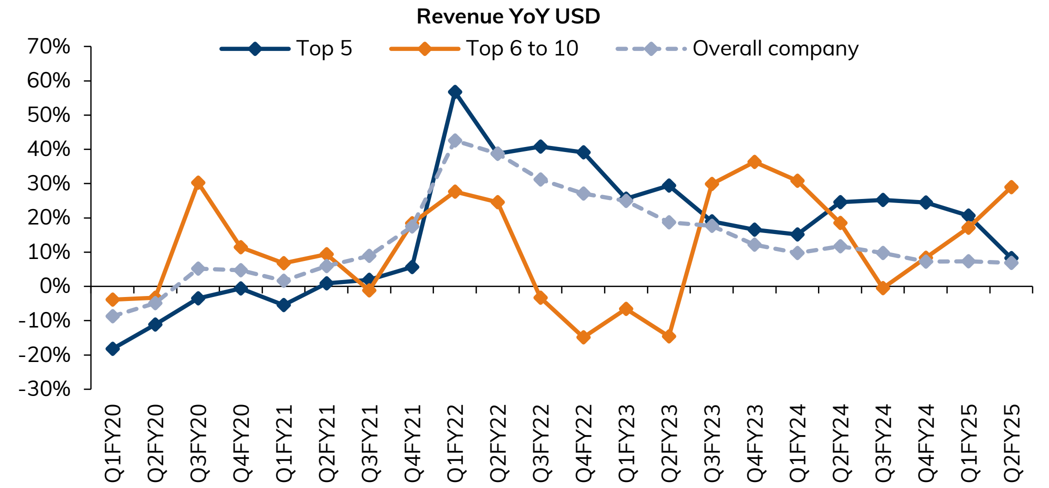
Source: I-Sec research, Company data

Exhibit 6: Top 6 to 10 concentration inched up



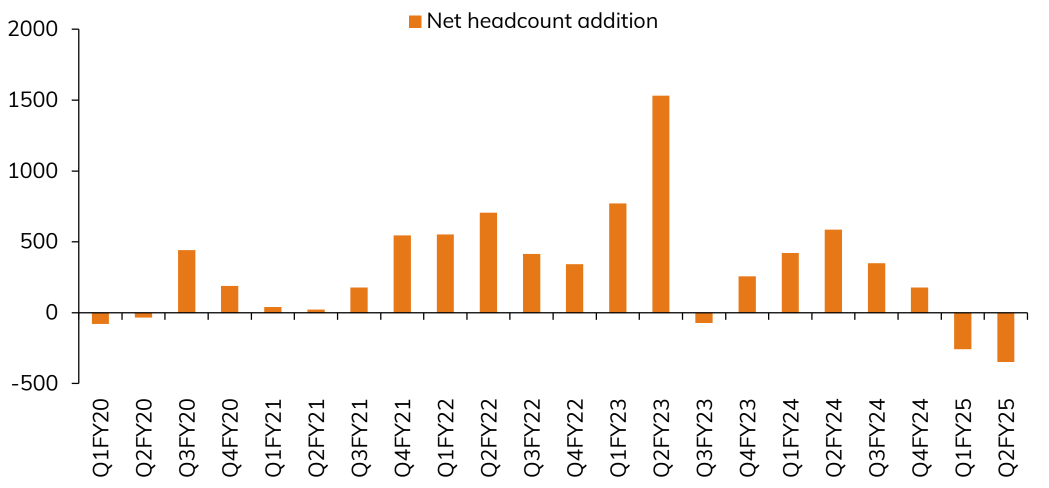
Source: I-Sec research, Company data

Exhibit 7: Top 6 to 10 client revenue grew ~29% YoY USD



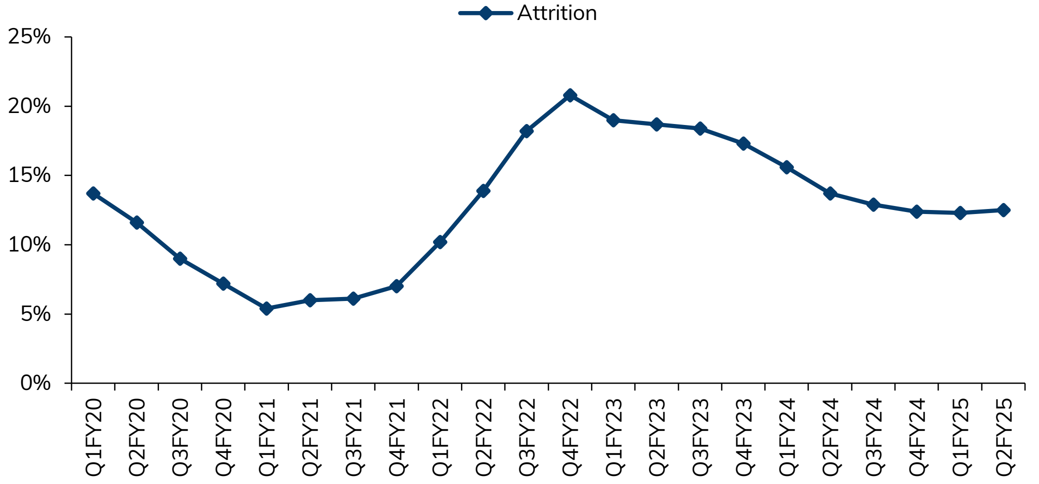
Source: I-Sec research, Company data

Exhibit 8: Net headcount declined because company is cautious in doing lateral hiring



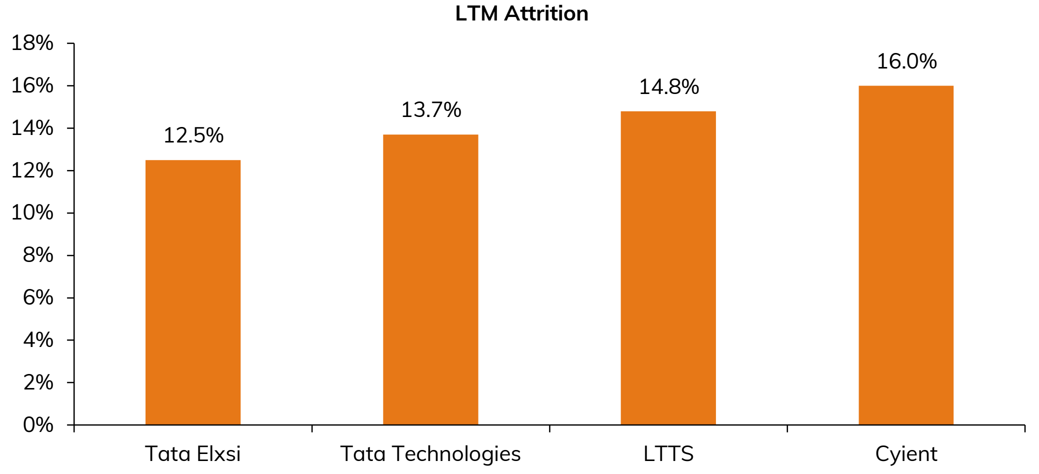
Source: I-Sec research, Company data

Exhibit 9: LTM Attrition is largely flat QoQ



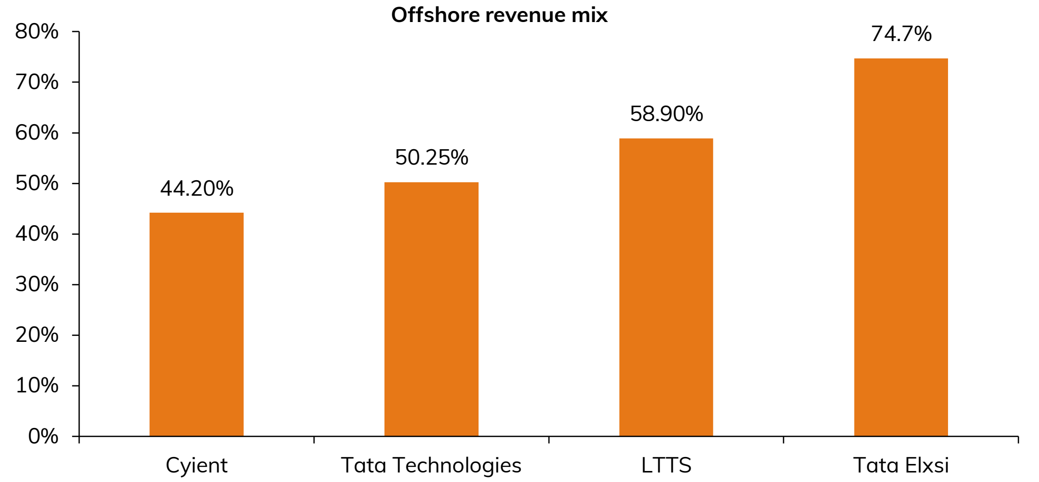
Source: I-Sec research, Company data

Exhibit 10: TELX has lowest attrition vs peers



Source: I-Sec research, Company data

Exhibit 11: TELX has highest offshore revenue mix vs. peers



Source: I-Sec research, Company data

Exhibit 12: Shareholding pattern

(%)	Dec'23	Mar'24	Jun'24
Promoters	56.1	56.1	56.1
Institutional investors	20.7	20.5	19.6
MFs and others	2.7	1.9	1.1
FIs/Banks	0.2	0.1	0.1
Insurance	2.8	3.9	4.7
FIIs	15.0	14.6	13.7
Others	23.2	23.4	24.3

Source: Bloomberg, I-Sec research

Exhibit 13: Price chart

Source: Bloomberg, I-Sec research

Financial Summary

Exhibit 14: Profit & Loss

(INR mn, year ending March)

	FY24A	FY25E	FY26E	FY27E
Net Sales (US$ mn)	**429**	**469**	**542**	**623**
Net Sales (Rs. mn)	**35,521**	**39,221**	**45,557**	**52,291**
Operating Expense	25,057	27,806	32,000	36,733
EBITDA	**10,464**	**11,415**	**13,556**	**15,558**
EBITDA Margin (%)	29.5	29.1	29.8	29.8
Depreciation & Amortization	994	1,134	1,321	1,516
EBIT	9,470	10,281	12,235	14,042
Interest expenditure	203	197	200	200
Other Non-operating Income	1,220	1,617	1,458	1,673
Recurring PBT	**10,487**	**11,701**	**13,493**	**15,515**
Profit / (Loss) from Associates	-	-	-	-
Less: Taxes	2,564	2,994	3,643	4,189
PAT	7,922	8,707	9,850	11,326
Less: Minority Interest	-	-	-	-
Net Income (Reported)	**7,922**	**8,509**	**9,850**	**11,326**
Extraordinaries (Net)	-	(198)	-	-
Recurring Net Income	**7,922**	**8,311**	**9,850**	**11,326**

Source Company data, I-Sec research

Exhibit 15: Balance sheet

(INR mn, year ending March)

	FY24A	FY25E	FY26E	FY27E
Total Current Assets	25,367	30,554	36,968	44,944
of which cash & cash eqv.	13,571	15,478	20,147	25,851
Total Current Liabilities & Provisions	4,026	4,419	4,720	5,107
Net Current Assets	**21,341**	**26,135**	**32,248**	**39,838**
Investments	-	-	-	-
Net Fixed Assets	1,923	1,973	2,023	2,073
ROU Assets	1,903	1,903	1,903	1,903
Capital Work-in-Progress	22	-	-	-
Goodwill	-	-	-	-
Other assets	2,521	2,521	2,521	2,521
Deferred Tax Assets	-	-	-	-
Total Assets	**27,843**	**32,666**	**38,829**	**46,469**
Liabilities				
Borrowings	-	-	-	-
Deferred Tax Liability	-	-	-	-
provisions	547	597	647	697
other Liabilities	2,240	2,240	2,240	2,240
Minority Interest	-	-	-	-
Equity Share Capital	623	623	623	623
Reserves & Surplus*	24,434	29,206	35,320	42,909
Total Net Worth	**25,057**	**29,829**	**35,943**	**43,532**
Total Liabilities	**27,843**	**32,666**	**38,829**	**46,469**

Source Company data, I-Sec research

Exhibit 16: Quarterly trend

(INR mn, year ending March)

	Dec-23	Mar-24	Jun-24	Sep-24
Net Sales	9,142	9,059	9,265	9,551
% growth (YOY)	3.7	-0.9	2.3	3.1
EBITDA	2,701	2,613	2,720	2,664
Margin %	29.5	28.8	29.4	27.9
Other Income	294	287	272	595
Adjusted Net Profit	2,064	1,969	1,841	2,294

Source Company data, I-Sec research

Exhibit 17: Cashflow statement

(INR mn, year ending March)

	FY24A	FY25E	FY26E	FY27E
CFO before WC changes	10,943	11,217	13,556	15,558
CFO after WC changes	**9,592**	**8,330**	**12,113**	**13,672**
Capital Commitments	(830)	(1,162)	(1,371)	(1,566)
Free Cashflow	**7,842**	**6,499**	**9,841**	**11,050**
Other investing cashflow	(1,871)	1,617	1,458	1,673
Cashflow from Investing Activities	**(2,701)**	**454**	**87**	**107**
Issue of Share Capital	-	-	-	-
Interest Cost	-	-	-	-
Inc (Dec) in Borrowings	-	-	-	-
Cash flow from Financing Activities	**(4,278)**	**(3,884)**	**(3,887)**	**(3,887)**
Dividend paid	(3,781)	(3,737)	(3,737)	(3,737)
Others	(498)	(147)	(150)	(150)
Chg. in Cash & Bank balance	**33**	**1,907**	**4,670**	**5,704**
Closing cash & balance	1,332	3,239	7,909	13,612

Source Company data, I-Sec research

Exhibit 18: Key ratios

(Year ending March)

	FY24A	FY25E	FY26E	FY27E
Per Share Data (INR)				
Reported EPS	127.2	139.8	158.2	181.9
Diluted EPS	127.2	133.5	158.2	181.9
Cash EPS	143.2	151.7	179.4	206.2
Dividend per share (DPS)	70.0	60.0	60.0	60.0
Book Value per share (BV)	402.3	479.0	577.1	699.0
Dividend Payout (%)	55.0	42.9	37.9	33.0
Growth (%)				
Net Sales	13.0	10.4	16.2	14.8
EBITDA	8.9	9.1	18.8	14.8
EPS	4.9	9.9	13.1	15.0
Valuation Ratios (x)				
P/E	61.0	55.5	49.1	42.7
P/CEPS	54.2	51.2	43.3	37.6
P/BV	19.3	16.2	13.4	11.1
EV / EBITDA	44.9	41.0	34.2	29.4
P/S	13.6	12.3	10.6	9.2
Dividend Yield (%)	0.9	0.8	0.8	0.8
Operating Ratios				
EBITDA Margins (%)	29.5	29.1	29.8	29.8
EBIT Margins (%)	26.7	26.2	26.9	26.9
Effective Tax Rate (%)	24.5	25.6	27.0	27.0
Net Profit Margins (%)	22.3	22.2	21.6	21.7
Inventory Turnover Days	0.1	0.1	0.1	0.1
Fixed Asset Turnover (x)	19.7	20.0	22.8	25.5
Receivables Days	100	106	111	111
Payables Days	10	10	11	12
Working Capital Days	74	86	91	91
Net Debt / EBITDA (x)	(13.6)	(13.6)	(15.2)	(17.0)
Profitability Ratios				
RoCE (%)	31.2	27.9	27.2	25.8
RoIC (%)	72.6	59.9	62.6	63.3
RoNW (%)	34.5	30.3	30.0	28.5

Source Company data, I-Sec research

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