

Tata Elxsi

High quality, low growth, high valuation

Tata Elxsi (TELX) posted a soft quarter with a ramp-down in a Media & Communication client and a delayed program ramp-up in the Transportation vertical. TELX's growth has normalized, impacted by market-share loss in the transportation vertical (50% of its revenue) on account of a higher mix of Tier-1s vs. OEMs, increased captive intensity, business mix challenges in the Healthcare vertical and macro factors impacting media & telco enterprise client spend. The company has integrated the sales/front end of the erstwhile EPD and IDV business to drive larger annuity programs. TELX's ER&D credentials/niche remain favourable, but the hyper-accelerated growth trajectory (both revenue/margin) is very clearly behind – valuations remain high. We factor 15% EPS CAGR over FY24-26E following mid-single-digit EPS growth in FY24 after doubling of earnings over FY21-23. Maintain SELL on TELX based on 38x FY26E EPS - TELX trades at 54x and 44x FY25/26E.

- **Weak revenue on drop in Media & Communication vertical:** Tata Elxsi's Q4 revenue print was weak at USD 109mn, -0.6% QoQ CC and 7.2% YoY CC (USD 111mn HSIE est.) and FY24 revenue growth stood at 9.9% at USD 429mn. Revenue in Q4 was impacted by a decline in the Media & Comms vertical which dropped sequentially on a ramp-down of a non-T10 customer (-3% QoQ impact). T5 and T10 (56% of revenue) accounts posted strong increases at 4.5% QoQ and 5.4% QoQ and client concentration has gone back up over the last two years following reduction until FY22. Within geography, the decline in US geo is in sync with the decline in the Media & Communication vertical, while growth was strong in India/RoW.
- **Growth dichotomy within Transportation vertical:** TELX's transportation vertical posted +1.2% QoQ, impacted by a delay in the ramp-up of a large program (expected to ramp-up from end-Q1FY25E). The transportation vertical (51% of revenue) at USD 200mn+ revenue grew at 20% in FY24 – while the OEM segment within the vertical posted a robust growth of 40%, the tier-1 segment declined. TELX has historically been over-indexed in the tier-1 customer segment which has now tilted towards OEMs (including the T1 Transportation customer) and adjacencies such as off-highway & rail – the faster-growing segment as OEMs are increasing spending in areas of software-defined vehicles. Tata Elxsi is currently in SDV programs with five global OEMs. We've factored 15.5% and 16.8% growth for the Transportation vertical over FY25/26E.
- **Muted performance in Media & Communication vertical:** The Media & Communication segment (34% of revenue) for the company has not witnessed any growth for nearly two years impacted by the devices sub-segment and macro factors driving cost optimization, following a surge in the prior period driven by spend in adjacent areas such as OTT & new media. TELX has brought in new leadership in the vertical and restructured the sales organization which can stabilize the vertical. The key deal that can improve the growth is a multi-year UX transformation deal for a leading operator in the MEA region. We've factored flat growth for FY25E and a 12% recovery for FY26E for the Media & Comms vertical.

Financial Summary

YE March (INR bn)	Q4FY24	Q4FY23	YoY (%)	Q3FY24	QoQ (%)	FY23	FY24	FY25E	FY26E
Revenue (USD Mn)	109	102	6.7	110	-1.0	390	429	470	541
Net Sales	9.06	8.38	8.1	9.14	-0.9	31.45	35.52	38.61	45.70
EBIT	2.34	2.29	2.2	2.45	-4.5	8.80	9.47	10.24	12.50
APAT	1.97	2.02	-2.3	2.06	-4.6	7.55	7.92	8.63	10.54
Diluted EPS (INR)	31.6	32.4	-2.3	33.1	-4.6	121.3	127.2	138.6	169.3
P/E (x)						61.0	58.1	53.3	43.7
EV / EBITDA (x)						46.6	42.5	39.0	31.8
RoE (%)						41.0	34.5	32.0	33.7

Source: Company, HSIE Research

SELL

CMP (as on 23 Apr 2024)	INR 7,395
Target Price	INR 6,435
NIFTY	22,368

KEY CHANGES	OLD	NEW
Rating	SELL	SELL
Price Target	INR 6,660	INR 6,435
	FY25E	FY26E
EPS %	-2.4	-3.4

KEY STOCK DATA

Bloomberg code	TELX IN
No. of Shares (mn)	62
MCap (INR bn) / (\$ mn)	461/5,527
6m avg traded value (INR mn)	1,204
52 Week high / low	INR 9,200/6,218

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	(9.8)	0.8	17.7
Relative (%)	(14.6)	(13.4)	(5.9)

SHAREHOLDING PATTERN (%)

	Dec-23	Mar-24
Promoters	43.92	43.92
FIs & Local MFs	5.71	6.06
FPIs	15.02	14.56
Public & Others	35.35	35.46
Pledged Shares	0.00	0.00

Source : BSE

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Healthcare & Lifesciences vertical: TELX's Healthcare & Lifesciences vertical was the strongest growth driver on a smaller base until it was impacted by the regulatory & compliance changes in the medical devices industry. Since then, growth in the vertical has normalized and is now expected to grow closer to the company average. The company's recent deal with 'Drager' for an offshore development centre to drive R&D in the medical devices segment (similar to the Aesculap deal from an earlier period) can aid growth. We've factored growth at 9.5% and 14.5% for FY25E and FY26E respectively in Healthcare & Lifesciences vertical.

Industry-leading margins: TELX's operating margins remain industry-leading on account of a superior delivery mix, pricing supported by design-led differentiation and platforms, and lower third-party dependence. We expect TELX's margins to remain at current levels, supported by improvement in utilisation and SG&A leverage from better growth in T10 accounts. We've factored EBITDAM at 29.3% and 30.2% for FY25E and FY26E following 29.5% in FY24. The drop in Q4 margin by 70bps to 28.8% (29% HSIE est.) was largely on account of flat revenue and increased headcount.

Growth in headcount: Tata Elxsi net hired 178 in Q4 and 1,535 in FY24 to take the total headcount to 13.4k. The increase in capacity creation by 13% in FY24 can partially address the demand for FY25E. The company plans to induct 1,500 to 2,000 freshers in FY25E and is expanding its presence both offshore (Pune) and onshore.

Outlook: We expect the Transportation vertical to drive growth and FY25E and the Media & Communication vertical to recover in FY26E translating to 9.6% growth and 15.0% growth for the company over FY25E and FY26E respectively. Notwithstanding the business cyclicity, large accounts in the Transportation and Media & Comms vertical are expected to remain steady in the near term (*exhibit: 9*). Factored EBITDAM at 29.3% and 30.2% (29.5% in FY24), translating to an EPS CAGR of 15.5% over FY24-26E. Maintain SELL on TELX with a TP of INR 6,435 based on 38x FY26E EPS (INR 169) near its 5Y average multiples. At CMP, TELX trades at 53x and 44x FY25E and FY26E.

Exhibit 1: Quarterly Financial Snapshot

Particulars (INR bn)	Q4	Q4	YoY	Q3	QoQ	FY24	FY23	YoY (%)
	FY24	FY23	(%)	FY24	(%)			
Net Revenues (USD mn)	109	102	6.7	110	(1.0)	429	390	9.9
Net Revenues	9.06	8.38	8.1	9.14	(0.9)	35.52	31.45	13.0
Employee benefit expense	4.96	4.29	15.6	4.93	0.6	19.10	15.98	19.5
Gross Profit	4.10	4.09	0.2	4.21	(2.7)	16.43	15.47	6.2
Other Expenses	1.48	1.59	(6.7)	1.51	(1.5)	5.96	5.86	1.8
EBITDA	2.61	2.50	4.6	2.70	(3.3)	10.46	9.61	8.9
Depreciation	0.28	0.21	30.8	0.25	8.4	0.99	0.81	22.2
EBIT	2.34	2.29	2.2	2.45	(4.5)	9.47	8.80	7.6
Other Income	0.34	0.26	31.1	0.35	(3.6)	1.22	0.74	65.2
Interest expense	0.05	0.04	20.8	0.06	(10.4)	0.20	0.16	25.1
PBT	2.62	2.50	4.9	2.74	(4.3)	10.49	9.38	11.9
Tax	0.65	0.49	34.4	0.68	(3.2)	2.56	1.82	40.7
APAT	1.97	2.02	(2.3)	2.06	(4.6)	7.92	7.55	4.9
E/o (adj for tax)	-	-	-	-	-	-	-	-
RPAT	1.97	2.02	(2.3)	2.06	(4.6)	7.92	7.55	4.9

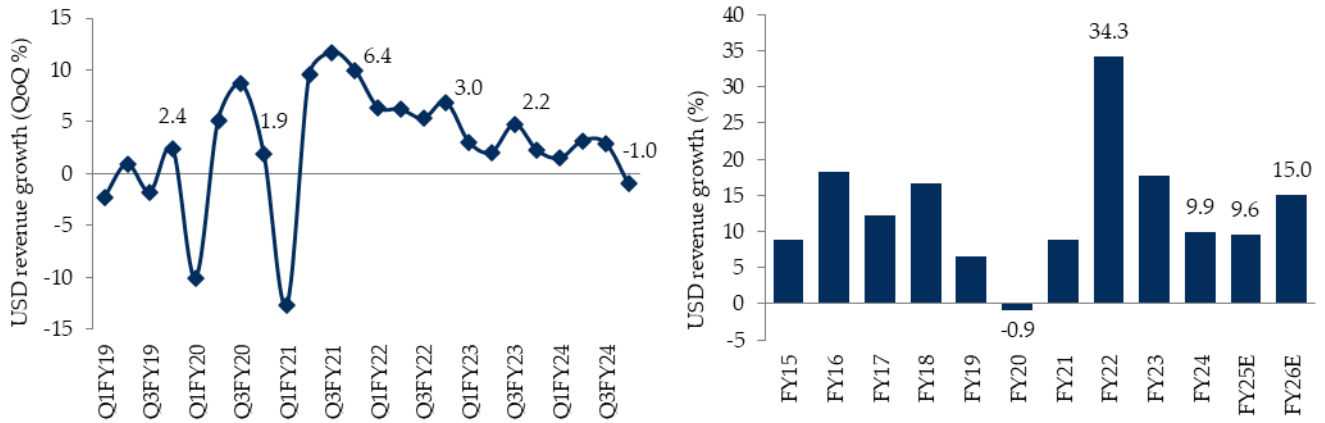
Source: Company, HSIE Research

Margin Analysis

	Q4	Q4	YoY	Q3	QoQ	FY24	FY23	YoY (%)
	FY24	FY23	(bps)	FY24	(bps)			
Employee expense % Net Revenues	54.8	51.2	356	54.0	81	53.8	50.8	295
Gross Profit Margin (%)	45.2	48.8	(356)	46.0	(81)	46.2	49.2	(295)
Other Expenses % Net Revenues	16.4	19.0	(260)	16.5	(10)	16.8	18.6	(184)
EBITDA Margin (%)	28.8	29.8	(96)	29.5	(71)	29.5	30.6	(111)
EBIT Margin (%)	25.8	27.3	(149)	26.8	(97)	26.7	28.0	(132)
Tax Rate (%)	25.0	19.5	549	24.7	27	24.5	19.4	501
APAT Margin (%)	21.7	24.0	(231)	22.6	(84)	22.3	24.0	(171)

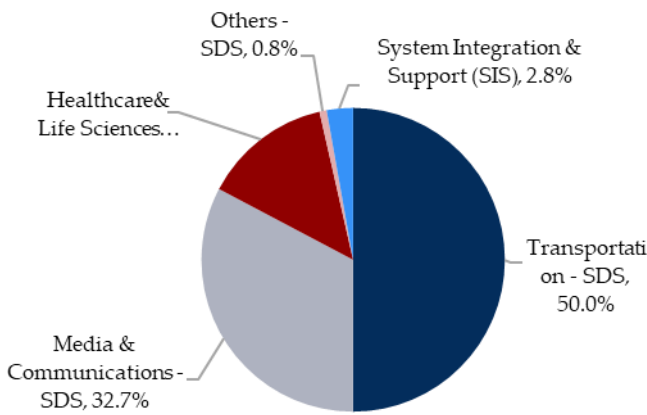
Source: Company, HSIE Research

Exhibit 2: Cyclicity in revenue growth



Source: Company, HSIE Research

Exhibit 3: New segmental structure (SDS)



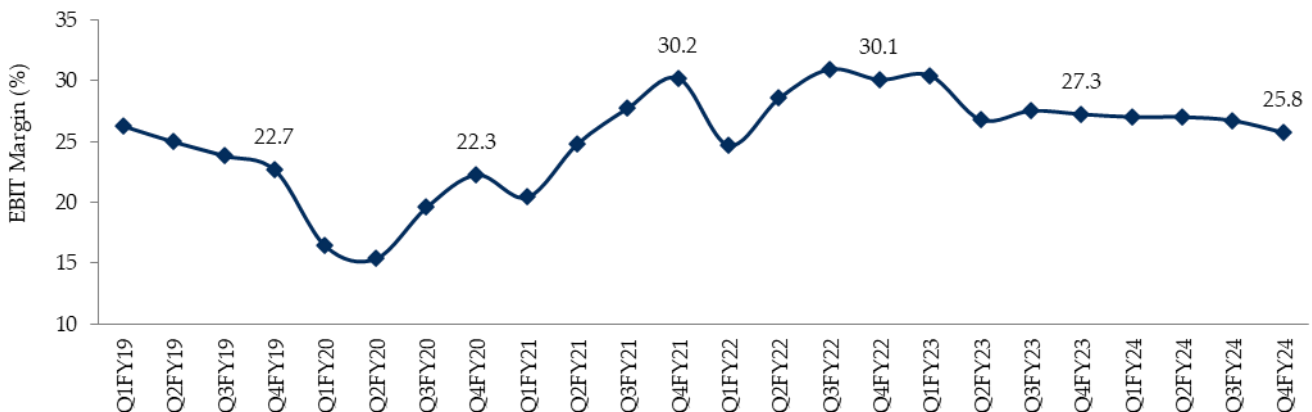
Source: Company, HSIE Research, Note SDS denotes Software Development & Services (erstwhile EPD+IDV)

Exhibit 4: EPD & IDV combined to drive larger programs

	Q4FY24 (Revenue USD mn)	QoQ %, CC	YoY %, CC	FY24 (Revenue USD mn)	YoY %, CC
Transportation - SDS	54.4	1.2	16.4	207.9	20.4
Media & Communications - SDS	35.6	-4	-4.6	147.1	-2.6
Healthcare & Life Sciences - SDS	14.9	0.2	7.2	58.3	7.6
Others - SDS	0.8	48.4	19.4	3.3	2.9
Total Software Development & Services (SDS)	105.7	-0.4	7.2	416.7	9.3
System Integration & Support (SIS)	3.0	-6.4	4.6	12.0	18.6
Total Revenue	108.8	-0.6	7.2	428.7	9.6

Source: Company, HSIE Research

Exhibit 5: Steady and industry leading margins



Source: Company, HSIE Research

Exhibit 6: TELX - Performance by geography

% of revenue	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	Q4FY24
Europe	34.7	35.5	37.5	40.0	40.5	40.4
USA	42.8	41.4	40.3	39.6	37.4	36.1
India	16.2	17.3	17.0	15.5	16.4	17.3
RoW	6.3	5.8	5.3	4.9	5.7	6.3
Total	100.0	100.0	100.0	100.0	100.0	100.0

Growth QoQ %	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	Q4FY24
Europe	6.6	4.6	7.0	10.2	4.2	-1.3
USA	3.8	-1.1	-1.3	1.5	-2.8	-4.5
India	2.2	9.2	-0.3	-5.9	8.9	4.5
RoW	8.2	-5.9	-7.3	-4.6	19.7	9.5
Total	4.7	2.2	1.5	3.2	2.9	-1.0

Growth YoY %	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	Q4FY24
Europe	24.5	17.6	26.2	31.5	28.5	21.3
USA	19.1	13.1	4.3	2.7	-3.8	-7.1
India	14.2	18.1	4.7	4.7	11.5	6.7
RoW	-9.6	-21.3	-6.7	-10.0	-0.4	15.9
Total	17.7	12.6	10.9	12.1	10.1	6.7

Source: Company, HSIE Research

Exhibit 7: Client metrics – concentration has increased

	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	Q4FY24
Top-5 % of revenue	38.4	39.8	42.0	44.5	43.8	46.2
Top-10 % of revenue	48.0	49.4	51.9	53.2	52.5	55.9

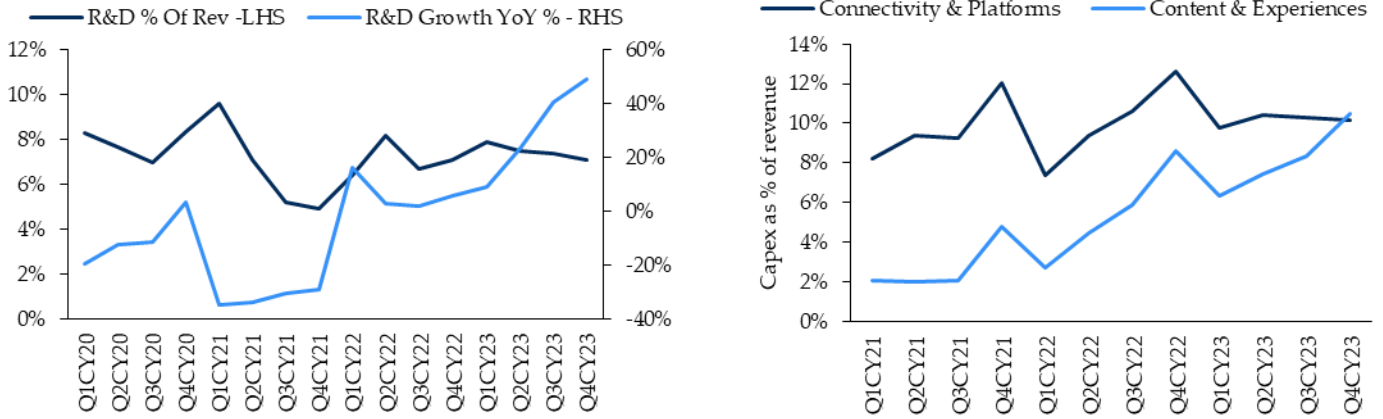
Source: Company, HSIE Research

Exhibit 8: Supply side metrics

(Nos)	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	Q4FY24
Total employees	11,607	11,864	12,286	12,871	13,221	13,399
Net addition (nos)	(72)	257	422	585	350	178
Attrition (%)	18.4	17.3	15.6	13.7	12.9	12.4

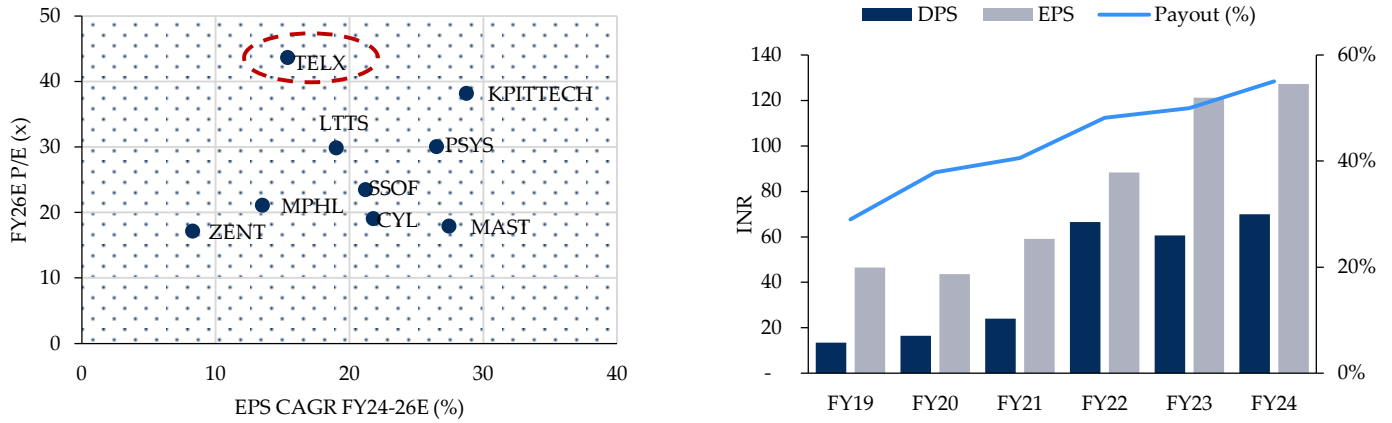
Source: Company, HSIE Research

Exhibit 9: Strong growth indicators from enterprise clients (JLR & Comcast)



Source : Company, HSIE Research

Exhibit 10: Improving payout, yet valuations expensive



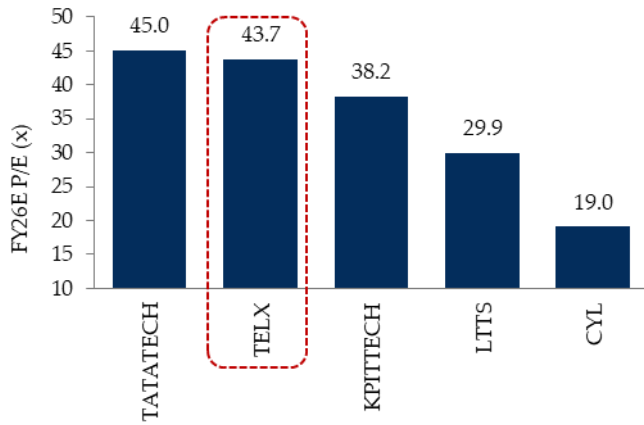
Source: Company, HSIE Research, Note: FY22 included special dividend of INR 24, KPITTECH (Not rated) as per Bloomberg Consensus

Exhibit 11: Change in estimates

YE March (INR bn)	FY25E Old	FY25E Revised	Change %	FY26E Old	FY26E Revised	Change %
Revenue (USD Mn)	477	470	(1.5)	555	541	(2.6)
Revenue	39.86	38.61	(3.1)	47.17	45.70	(3.1)
EBIT	10.54	10.24	(2.9)	13.01	12.50	(3.9)
EBIT margin (%)	26.5	26.5	7bps	27.6	27.4	-24bps
APAT	8.85	8.63	(2.4)	10.92	10.54	(3.4)
EPS (INR)	142.0	138.6	(2.4)	175.3	169.3	(3.4)

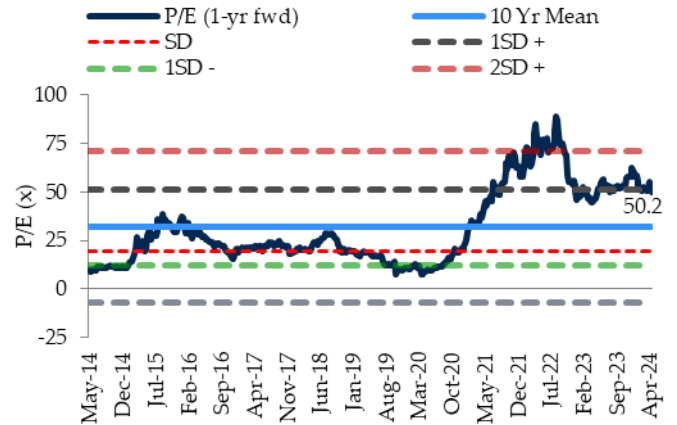
Source: Company, HSIE Research

Exhibit 12: TELX trading at higher valuations vs peers



Source: Company, Bloomberg, HSIE Research

Exhibit 13: TELX P/E (1-yr fwd) Trend



Source: Bloomberg, HSIE Research

Financials

Consolidated Income Statement

YE March (INR bn)	FY22	FY23	FY24	FY25E	FY26E
Net Revenues (USD mn)	331	390	429	470	541
<i>Growth (%)</i>	34.3%	17.7%	9.9%	9.6%	15.0%
Net Revenues	24.71	31.45	35.52	38.61	45.70
<i>Growth (%)</i>	35.3%	27.3%	13.0%	8.7%	18.4%
Employee Expenses	12.88	15.98	19.10	21.19	24.32
SG&A Expenses	4.17	5.86	5.96	6.10	7.59
EBITDA	7.66	9.61	10.46	11.32	13.78
<i>EBITDA Margin (%)</i>	31.0%	30.6%	29.5%	29.3%	30.2%
<i>EBITDA Growth (%)</i>	46.6%	25.5%	8.9%	8.2%	21.7%
Depreciation	0.55	0.81	0.99	1.08	1.28
EBIT	7.10	8.80	9.47	10.24	12.50
Other Income (Including EO Items)	0.45	0.74	1.22	1.32	1.57
Interest	0.09	0.16	0.20	0.20	0.20
PBT	7.45	9.38	10.49	11.36	13.87
Tax (Incl Deferred)	1.96	1.82	2.56	2.73	3.33
RPAT	5.50	7.55	7.92	8.63	10.54
APAT	5.50	7.55	7.92	8.63	10.54
<i>APAT Growth (%)</i>	49.3%	37.4%	4.9%	9.0%	22.1%
Adjusted EPS (INR)	88.3	121.3	127.2	138.6	169.3
<i>EPS Growth (%)</i>	49.3%	37.4%	4.9%	9.0%	22.1%

Source: Company, HSIE Research

Consolidated Balance Sheet

YE March (INR bn)	FY22	FY23	FY24	FY25E	FY26E
SOURCES OF FUNDS					
Share Capital - Equity	0.62	0.62	0.62	0.62	0.62
Reserves	15.39	20.23	24.43	28.32	33.06
Total Shareholders Funds	16.01	20.86	25.06	28.94	33.69
Total Debt	-	-	-	-	-
Net Deferred Taxes	(0.09)	(0.12)	(0.24)	(0.24)	(0.24)
Long Term Provisions & Others	1.58	1.99	2.35	2.35	2.35
TOTAL SOURCES OF FUNDS	17.50	22.73	27.17	31.06	35.80
APPLICATION OF FUNDS					
Net Block	2.51	3.17	3.83	3.31	3.57
Goodwill & intangibles	0.20	0.16	0.13	0.16	0.19
Other Non-current assets	0.33	0.28	0.34	0.34	0.34
Total Non-current Assets	3.26	3.69	4.32	3.83	4.12
Debtors	5.54	8.57	9.72	10.56	12.50
Other Current Assets	1.76	2.65	2.07	2.25	2.66
Cash & Equivalents	11.04	12.61	15.51	19.21	22.12
Total Current Assets	18.34	23.83	27.31	32.03	37.30
Creditors	0.84	1.03	0.86	0.93	1.10
Other Current Liabilities & Prov.	3.26	3.75	3.60	3.88	4.51
Total Current Liabilities	4.10	4.79	4.46	4.81	5.61
Net Current Assets	14.24	19.04	22.85	27.22	31.68
TOTAL APPLICATION OF FUNDS	17.50	22.73	27.17	31.06	35.80

Source: Company, HSIE Research

Consolidated Cash Flow

YE March (INR bn)	FY22	FY23	FY24P	FY25E	FY26E
Reported PBT	7.45	9.38	10.49	11.36	13.87
Non-operating & EO items	(0.21)	(0.54)	(0.74)	(1.32)	(1.57)
Interest expenses	0.09	0.16	0.20	0.20	0.20
Depreciation	0.55	0.81	0.99	1.08	1.28
Working Capital Change	(1.00)	(3.10)	(1.35)	(0.71)	(1.62)
Tax Paid	(2.06)	(1.85)	(2.58)	(2.73)	(3.33)
OPERATING CASH FLOW	4.83	4.87	7.01	7.89	8.83
Capex	(0.71)	(0.64)	(0.83)	(0.56)	(1.54)
Free cash flow (FCF)	4.12	4.23	6.18	7.33	7.29
INVESTING CASH FLOW	(1.08)	(2.02)	(2.70)	0.76	0.04
Interest Expenses	(0.09)	(0.16)	(0.20)	(0.20)	(0.20)
FCFE	4.02	4.07	5.98	7.13	7.09
Dividend	(2.99)	(2.65)	(3.78)	(4.75)	(5.80)
FINANCING CASH FLOW	(3.08)	(2.81)	(3.98)	(4.95)	(6.00)
NET CASH FLOW	0.66	0.03	0.33	3.70	2.87
Closing Cash & Equivalents	11.04	12.61	15.51	19.21	22.12

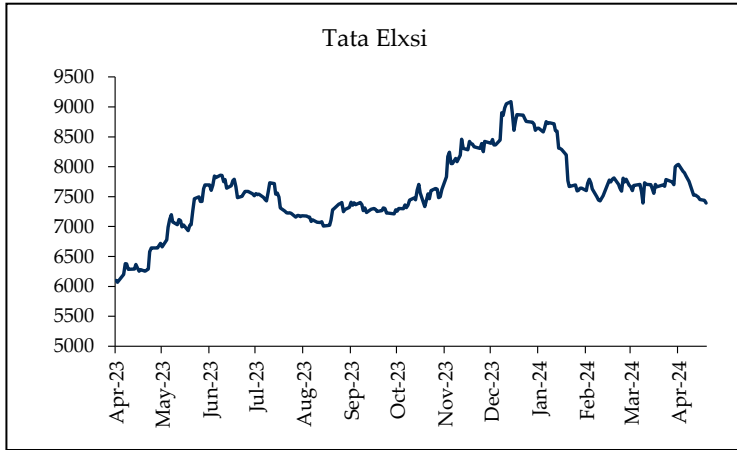
Source: Company, HSIE Research

Key Ratios

	FY22	FY23	FY24	FY25E	FY26E
PROFITABILITY (%)					
GPM	47.9	49.2	46.2	45.1	46.8
EBITDA Margin	31.0	30.6	29.5	29.3	30.2
APAT Margin	22.2	24.0	22.3	22.4	23.1
RoE	37.2	41.0	34.5	32.0	33.7
RoIC (or Core RoCE)	93.0	85.5	65.7	66.2	74.4
RoCE	34.9	38.2	32.4	30.2	32.0
EFFICIENCY					
Tax Rate (%)	26.3	19.4	24.5	24.0	24.0
Fixed Asset Turnover (x)	8.2	8.4	8.4	8.4	8.4
Debtors (days)	82	99	100	100	100
Other Current Assets (days)	26	31	21	21	21
Payables (days)	12	12	9	9	9
Other Current Liab & Provns (days)	45	40	33	33	33
Cash Conversion Cycle (days)	50	78	80	80	80
Debt/EBITDA (x)	-	-	-	-	-
Net D/E (x)	(0.7)	(0.6)	(0.6)	(0.7)	(0.7)
Interest Coverage (x)	75	54	47	51	63
PER SHARE DATA (INR)					
EPS	88.3	121.3	127.2	138.6	169.3
CEPS	97	134	143	156	190
Dividend	67	61	70	76	93
Book Value	257	335	402	465	541
VALUATION					
P/E (x)	83.8	61.0	58.1	53.3	43.7
P/BV (x)	28.8	22.1	18.4	15.9	13.7
EV/EBITDA (x)	58.7	46.6	42.5	39.0	31.8
OCF/EV (%)	1.1	1.1	1.6	1.8	2.0
FCF/EV (%)	0.9	0.9	1.4	1.7	1.7
FCFE/Mkt Cap (%)	0.9	0.9	1.3	1.5	1.5
Dividend Yield (%)	0.9	0.8	0.9	1.0	1.3

Source: Company, HSIE Research

1 Yr Price Movement



Rating Criteria

- BUY: >+15% return potential
- ADD: +5% to +15% return potential
- REDUCE: -10% to +5% return potential
- SELL: > 10% Downside return potential

Disclosure:

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