

ONE YEAR OUTLOOK

BUSINESS & EARNINGS ◀▶

- We retain negative outlook and SELL rating on Tata Elxsi (TELX) given steep valuations of 35x Mar-22 EPS, although the 3QFY21 results surprised us positively on all parameters.
- The management remains confident about sustaining growth trajectory and we have increased our revenue estimates by 11% for FY22 in order to build it into our estimates. However, there have been relatively higher historical volatility in sequential revenue growth due to the short-term nature of projects, and we believe these risks are not getting adequately factored into.
- Strong revenue growth and 6% points increase in utilization to 76% led to beat on EBITDA & our estimates are up by 25% for FY22. Wage revision was implemented effective Oct 01 and FY22 would see a normal wage revision cycle (Q1/Q2). Upgrade to margins due to stellar margins in 3QFY21 (up 300bps qoq) and given negligible onsite effort & ~70% offshore revenue mix, Tata Elxsi should be able to manage the next wage revision cycle without impacting margins.
- EBIT estimates up by 19% for FY21 and 28% for FY22. PAT estimates up by 20%/23.5% for FY21/FY22 and Revenue estimates are up by 6%/11% for FY21/FY22.
- Average duration of projects has increased from 8 months to 12 months over the last 2 years.

VALUATION MULTIPLES ▲

- We use 22x multiple (17x earlier) based on FY23 EPS to arrive at 1Yr FW TP of Rs. 1650. The increase in multiple is led by improved expectations on revenue growth and profitability.

FINANCIAL SUMMARY

Year	Revenues (Rs. mn)	EBIT Margins (%)	EPS (Rs.)	P/E (x)	EV/EBITDA (x)	ROE (%)
FY20	16,099	18.6%	41.1	58.3	41.6	25.2%
FY21E	18,070	25.4%	57.9	41.4	28.1	30.1%
FY22E	21,042	25.6%	68.2	35.2	23.8	29.6%
FY23E	23,288	25.0%	74.8	32.1	21.7	27.4%

THREE YEAR OUTLOOK

BUSINESS & EARNINGS ◀▶

- The sluggish growth of Tata Elxsi seen over the last three years was due to client-specific issues as Tata Elxsi's fortunes were tied to JLR's fortunes. We believe the profitable revenue growth over the next 3 years would be led evenly by Non JLR automotive segment as well as Broadcasting segment which together constitutes ~75% of revenues.
- The negative impact from top client, JLR, saw EBITDA margins declining to 21.3% in FY20. We estimate that currently the onsite effort is less than 10% and onsite revenues are ~30%. Historically, Tata Elxsi has managed to keep average salary per employee as well as attrition under good control, which is surprising but aids margins.
- Over the medium to long-term, Auto OEMs would partner and pool the R&D budgets with a few OEMs even taking the ownership of the software. This is likely to impact Tata Elxsi as the business would shift from Tier 1 suppliers to OEMs since Tata Elxsi gets ~65% of auto vertical revenues from Tier 1 vendors.
- We believe TELX can derive synergies by merging either with TCS or Tata Technologies. This is because TCS is a leader in both Mechanical and Embedded systems, while Tata Technologies has strong capabilities in the Mechanical Systems and can complement the strengths of TELX in the Embedded systems.

VALUATION MULTIPLES ▲

- We use exit multiple of 22x (17x earlier) to arrive at our 3-year target price. Expect revenue and earnings to grow at a CAGR of 12% and 13% respectively with cash conversion at ~85-90%.

KEY ESTIMATES REVISION

Rs.mn	FY21E			FY22E		
	Old	New	Chg (%)	Old	New	Chg (%)
INR Rev	17,059	18,070	5.9%	18,945	21,042	11.1%
EBIT	3,861	4,590	18.9%	4,208	5,395	28.2%
Margins	22.6%	25.4%	277bps	22.2%	25.6%	343bps
PAT	3,007	3,607	20.0%	3,441	4,249	23.5%
EPS	48.3	57.9	20.0%	55.3	68.2	23.5%
Target P/E	Before Result		17x	After Result		22x

OUTLOOK REVIEW 3QFY21 14 JANUARY 2021

Industry	TECHNOLOGY
CMP	Rs. 2,399
Target Price	Rs. 1,650
Key Stock Data	
Bloomberg	TELX IN
Shares o/s	62mn
Market Cap	Rs. 149bn
52-wk High-Low	Rs. 2,423-500
3m ADV Daily Vol	Rs. 1,019mn
Index	S&P BSE 200

	Jun'20	Sep'20	Dec'20
Promoters	44.5	44.5	NA
Institutions	14.6	16.4	NA
Public	40.9	39.1	NA

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Quarterly Financial Statement

Rs. mn\Period	Dec-20	Dec-19	yoy growth	Sep-20	qoq growth	9MFY20	9MFY21	yoy growth
Revenues	4,771	4,234	12.7%	4,302	10.9%	11,710	13,078	11.7%
Cost of revenues	2,847	2,647	7.5%	2,649	7.4%	7,576	8,159	7.7%
Gross profit	1,924	1,587	21.3%	1,652	16.5%	4,134	4,919	19.0%
Other expenses	488	645	-24.3%	472	3.5%	1,790	1,375	-23.2%
EBITDA	1,436	942	52.5%	1,181	21.7%	2,344	3,544	51.2%
Depreciation	111	112	-1.5%	112	-1.4%	326	331	1.4%
EBIT	1,326	830	59.8%	1,068	24.1%	2,018	3,213	59.2%
Other Income	151	205	N.A	44	242.3%	450	329	N.A
PBT	1,463	1,021	43.3%	1,100	33.1%	2,427	3,502	44.3%
Tax	411	266	54.3%	311	32.3%	687	972	41.6%
PAT	1,052	754	39.5%	789	33.4%	1,740	2,530	45.4%
Diluted EPS	16.9	12.1	39.5%	12.7	33.3%	27.9	40.6	45.4%
Margins								
EBITDA Margin	30.1%	22.2%	786bps	27.4%	266bps	20.0%	27.1%	708bps
PAT Margin	22.1%	17.8%	424bps	18.3%	371bps	14.9%	19.3%	448bps

Financial Summary

Abridged Financial Statements								
Rs. mn	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Profit & Loss								
Revenue	10,752	12,330	13,863	15,969	16,099	18,070	21,042	23,288
Gross Profit	4,287	4,890	5,603	6,555	5,779	6,908	8,177	8,882
EBITDA	2,471	2,720	3,460	4,150	3,430	5,033	5,863	6,320
Depreciation	226	269	254	251	434	444	467	491
EBIT	2,245	2,451	3,207	3,899	2,995	4,590	5,395	5,829
Other Income	119	164	432	435	584	465	568	706
Interest expense	0	0	0	0	56	54	54	54
Exceptional items	0	0	0	0	0	0	0	0
PBT	2,363	2,615	3,639	4,334	3,524	5,001	5,909	6,481
Reported PAT (after minority interest)	1,548	1,733	2,400	2,900	2,561	3,607	4,249	4,661
Adj PAT	1,548	1,733	2,400	2,900	2,561	3,607	4,249	4,661
EPS (Rs.)	24.9	27.8	38.5	46.6	41.1	57.9	68.2	74.8
Balance Sheet								
Net Worth	3,857	5,590	7,384	9,428	10,900	13,065	15,614	18,411
Deferred Tax liabilities	0	0	91	14	0	0	0	0
Total debt	0	0	0	0	0	0	0	0
Other liabilities and provisions	1,374	805	1,524	1,438	2,518	2,539	2,825	3,076
Total Net worth and liabilities	5231	6395	8999	10879	13418	15604	18439	21486
Gross Fixed assets	2603	2836	2954	3274	3649	3999	4349	4699
Net fixed assets	1070	1078	943	1012	952	859	741	600
Goodwill	0	0	0	0	0	0	0	0
Capital Work in Progress	19	10	21	4	9	9	9	9
Investments	0	0	0	0	0	0	0	0
Cash and bank balances	1825	2515	3943	5158	6642	8108	10092	12451
Loans & advances and other assets	931	1095	1512	1677	2345	2454	2736	3046
Net working capital	1387	1696	2580	3027	3470	4174	4861	5380
Total assets	5231	6395	8999	10879	13418	15604	18439	21486
Capital Employed	3,857	5,590	7,384	9,428	10,900	13,065	15,614	18,411
Invested Capital (CE- cash-CWIP)	2,014	3,064	3,419	4,265	4,249	4,948	5,513	5,950
Net Debt	-1825	-2515	-3943	-5158	-6642	-8108	-10092	-12451
Cash Flows								
Cash flows from Operations (Pre-tax)	1,966	2,405	3,106	3,577	3,461	4,170	5,125	5,688
Cash flows from Operations (post-tax)	1,211	1,443	1,971	2,149	2,565	2,777	3,466	3,868
Capex	382	261	118	315	231	350	350	350
Free cash flows	829	1,182	1,853	1,834	2,334	2,427	3,116	3,518
Free cash flows (post interest costs)	829	1,182	1,853	1,834	2,278	2,373	3,062	3,464
Cash flows from Investing	-289	-134	-2,472	-1,587	390	115	218	356
Cash flows from Financing	-411	-525	-600	-826	-1,244	-1,443	-1,700	-1,864
Total cash & liquid investments	1,825	2,515	3,943	5,158	6,642	8,108	10,092	12,451

Financial Summary

	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Key variables								
Revenues per employee (Rs. in thousands)	2,291	2,502	2,679	2,811	2,548	2,688	2,957	3,058
EBITDA per employee (Rs. in thousands)	527	552	669	731	543	749	824	830
PAT per employee (Rs. in thousands)	330	352	464	511	405	537	597	612
Growth ratios								
Revenue	26.6%	14.7%	12.4%	15.2%	0.8%	12.2%	16.4%	10.7%
EBITDA	39.3%	10.1%	27.2%	19.9%	-17.4%	46.8%	16.5%	7.8%
Adj PAT	51.7%	11.9%	38.5%	20.8%	-11.7%	40.9%	17.8%	9.7%
Margin ratios								
Gross	39.9%	39.7%	40.4%	41.0%	35.9%	38.2%	38.9%	38.1%
EBITDA	23.0%	22.1%	25.0%	26.0%	21.3%	27.9%	27.9%	27.1%
Adj PAT	14.4%	14.1%	17.3%	18.2%	15.9%	20.0%	20.2%	20.0%
Performance ratios								
Pre-tax OCF/EBITDA	79.6%	88.4%	89.8%	86.2%	100.9%	82.9%	87.4%	90.0%
OCF/IC (%)	60.1%	47.1%	57.6%	50.4%	60.4%	56.1%	62.9%	65.0%
RoE (%)	46.3%	36.7%	37.0%	34.5%	25.2%	30.1%	29.6%	27.4%
ROCE (%)	46.3%	36.7%	37.0%	34.5%	25.6%	30.4%	29.9%	27.6%
RoCE (Pre-tax)	70.6%	55.4%	56.1%	51.6%	35.2%	42.2%	41.6%	38.4%
RoIC (Pre-tax)	111.5%	80.0%	93.8%	91.4%	70.5%	92.8%	97.9%	98.0%
Fixed asset turnover (x)	10.5	11.5	13.7	16.3	16.4	20.0	26.3	34.7
Total asset turnover (x)	2.3	2.1	1.8	1.6	1.3	1.2	1.2	1.2
Financial stability ratios								
Net Debt to Equity (x)	-0.5	-0.4	-0.5	-0.5	-0.6	-0.6	-0.6	-0.7
Net Debt to EBITDA (x)	-0.7	-0.9	-1.1	-1.2	-1.9	-1.6	-1.7	-2.0
Interest cover (x)	N.A	N.A	N.A	N.A	N.A	N.A	N.A	N.A
DSO days	73	72	81	81	89	95	95	95
Working capital days	47	50	68	69	79	84	84	84
Valuation metrics								
Fully Diluted Shares (mn)							62	62
Market cap (Rs.mn)							1,49,383	1,49,383
P/E (x)	96.5	86.2	62.2	51.5	58.3	41.4	35.2	32.1
P/OCF(x)	123.4	103.5	75.8	69.5	58.2	53.8	43.1	38.6
EV (Rs.mn)	1,47,559	1,46,868	1,45,440	1,44,225	1,42,741	1,41,275	1,39,292	1,36,932
EV/ EBITDA (x)	59.7	54.0	42.0	34.8	41.6	28.1	23.8	21.7
EV/ OCF(x)	121.9	101.8	73.8	67.1	55.7	50.9	40.2	35.4
FCF Yield			1.2%	1.2%	1.6%	1.6%	2.1%	2.4%
Price to BV (x)	38.7	26.7	20.2	15.8	13.7	11.4	9.6	8.1
Dividend payout (%)	28.2%	28.8%	28.5%	29.0%	40.1%	40.0%	40.0%	40.0%
Dividend yield (%)	0.6%	0.7%	0.5%	0.6%	0.7%	1.0%	1.1%	1.2%

Crystal Ball Gazing

Tata Elsi's revenues and PAT are expected to grow by 12.4% and 12.9% CAGR respectively over FY21-24E. EBIT margins are likely to improve from 18.6% in FY20 to 25.4% in FY21E and remain stable at ~25% by FY24E. RoE is expected to decline from 30% in FY21E to 26% in FY24E while cash conversion is likely to hover around 90%

Revenue growth of 12%

Moderate growth in EBITDA will result in

Revenue growth driven by strong capabilities in embedded systems

Moderate cash flow from operations

Lower multiple

	FY05-FY11	FY11-FY15	FY15-FY20	FY20-FY24E		FY05-FY11	FY11-FY15	FY15-FY20	FY20-FY24E	P/E multiple	FY25E EPS (Rs.)	Price target
Revenues CAGR	14.4%	19.5%	13.6%	12.4%	RoE (%)	43.9%	25.6%	35.9%	28.3%	22	92.9	2,044
Gross Margin	35.7%	36.1%	39.4%	38.3%	RoCE (%)	40.7%	25.7%	36.0%	28.5%	20	92.9	1,858
EBITDA CAGR	4.7%	39.2%	14.1%	19.2%	RoIC (%)	51.4%	33.4%	66.5%	73.4%			
EBITDA margin	18.2%	16.0%	23.5%	27.5%	Average 1 yr fwd							
EPS CAGR	3.2%	12.6%	20.2%	19.3%	PE (x)			23.7	21.5			
Total Asset Turnover (x)	2.0	2.2	1.8	1.2	EV/EBITDA (x)			14.7	14.0			
Total WC days	51.0	46.7	62.6	84.3	Peak 1 yr fwd							
Pre-tax OCF/EBITDA (%)	91.0%	96.9%	89.0%	87.5%	PE (x)			31.1	40.1			
Post Tax OCF as a % of IC	49.5%	55.5%	55.1%	62.3%	EV/EBITDA(x)			20.5	30.5			
Net Debt/EBITDA	0.0	-0.1	-1.2	-1.9								

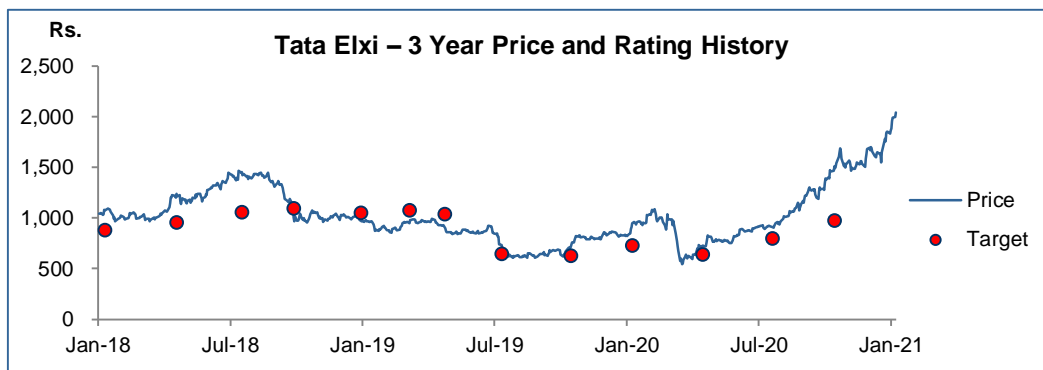
Entry = Rs. 2399@ 35x FY22E EPS

Cumulative Dividends of Rs.114

Exit multiple of 22x FY25E

TOTAL RETURN OF -10%

Spark Recommendation History



Absolute Rating Interpretation

BUY	Stock expected to provide positive returns of >15% over a 1-year horizon
ADD	Stock expected to provide positive returns of >5% – <15% over a 1-year horizon
REDUCE	Stock expected to provide returns of <5% – -10% over a 1-year horizon
SELL	Stock expected to fall >10% over a 1-year horizon

Symbol Interpretation

◀▶ No Change | ▼ Downgrade | ▲ Upgrade

Report Date	CMP (Rs.)	TP (Rs.)	Reco.
16-Oct-20	1,468	980	Sell
23-Jul-20	915	800	Sell
21-Apr-20	720	640	Sell
15-Jan-20	911	730	Sell
23-Oct-19	702	630	Sell
19-Jul-19	725	650	Sell
02-May-19	931	1,040	Add
14-Mar-19	960	1,080	Add
09-Jan-19	972	1,050	Add
09-Oct-18	988	1,100	Add
30-Jul-18	1,452	1,060	Sell
30-Apr-18	1,202	960	Sell
23-Jan-18	1,082	880	Sell
26-Oct-17	863	730	Sell

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