

## Tata Elxsi Ltd

### Supply side pressures could impact growth

We met the management of Tata Elxsi recently. The company provides product design, industrial design and system integration services. In addition, it is venturing into visual computing to make animation designs for Hollywood and Bollywood movies. Tata Elxsi reported revenues/profits of Rs 3882mn/Rs 488mn in FY10. The company is seeing good growth in design services (~20%). We, however, believe that the animation business will be a key for marked improvement in the company's scale/growth/profitability over the next 12-24 months. In the normal services business, the company has cited attrition issues that are hindering growth. The stock is trading at P/E of 15x FY10 EPS with a limited EPS growth expected in FY11. As such, the stock is placed towards the higher end of trading range of its mid-cap IT services peers.

**Product design services:** This division forms ~85% of Tata Elxsi's software services revenues. The company serves the transportation (~20% of revenues), broadcast (~40%) and communications (~40%) verticals in this division. It is currently executing a WiMAX networks contract of BSNL. Besides, it is also developing its own IP for WiMAX and trying to build a service base around it. The management expects this division to report a c.20% growth, going ahead.

**Industrial Design and Engineering (IDE):** Tata Elxsi provides product prototyping, industrial design and mechanical engineering services which range from designing the packaging for leading FMCG companies to designing the metro signages. Currently, the division forms ~10% of the company's software and services revenues. The management expects this division to grow at 20%. While most current engagements are point engagements, the company is trying to introduce an element of sustained engagements over time.

**Visual computing:** Last year, the company opened a VFX studio in Hollywood, USA, to design animation clips for Hollywood movies. Besides, it also has design studios in India—and had made the movie Roadside Romeo last year. So far, the studio has not had much success and the division is still reporting losses. However, as per management, the studio in Hollywood is gaining visibility and will be executing some small contracts in the near future.

**SI business:** SI currently accounts for 10% of Tata Elxsi's total revenues and largely provides engineering based solutions. The management is not very aggressive in this business and is becoming selective in taking new projects in this space.

**Supply side pressures curtailing growth:** The management cited high attrition to captive operations of foreign companies as the reason for shortfall in bench strength because of which they are not able to fulfil some projects which is hindering growth. We believe that this phenomenon will affect the mid cap more and could lead to growth lagging compared to large cap names.

#### Financial highlights

(Rs mn)	FY07	FY08	FY09	FY10
Revenue	3,080	4,020	4,194	3,882
Growth (%)	30.7	30.5	4.3	(7.4)
Adj net income	521	529	582	488
Growth (%)	51.8	1.5	10.0	(16.1)
FDEPS (Rs)	16.7	17.0	18.7	15.7
Growth (%)	51.8	1.5	10.0	(16.1)

#### Profitability and return ratios

(%)	FY07	FY08	FY09	FY10
EBITDA margin	22.6	19.2	19.5	17.8
EBIT margin	19.7	15.8	15.7	13.5
Adj PAT margin	16.9	13.2	13.9	12.6
ROE	65.8	50.0	42.9	29.9

#### What's New? Target Rating Estimates

CMP	RATING
Rs 262	NOT RATED

BSE	NSE	BLOOMBERG
500408	TATAELXSI	TELX IN

#### Company data

Market cap (Rs mn / US\$ mn)	8166/175
Outstanding equity shares (mn)	31
Free float (%)	48.7
Dividend yield (%)	-
52-week high/low (Rs)	347 / 145
2-month average daily volume	168,418

#### Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Tata Elxsi	262	4.8	1.8	(7.3)
CNX IT	6,288	0.4	9.5	6.9
Sensex	18,667	2.9	12.3	9.1

#### Valuation matrix

(x)	FY07	FY08	FY09	FY10
P/E @ CMP	15.7	15.4	14.0	16.7
P/BV @ CMP	8.8	6.9	5.4	4.7



## Consolidated financials

### Profit and Loss statement

Y/E March (Rs mn)	FY07	FY08	FY09	FY10
<b>Revenues</b>	<b>3,080</b>	<b>4,020</b>	<b>4,194</b>	<b>3,882</b>
<i>Growth (%)</i>	30.7	30.5	4.3	(7.4)
<b>EBITDA</b>	<b>695</b>	<b>771</b>	<b>817</b>	<b>689</b>
<i>Growth (%)</i>	46.8	10.9	5.9	(15.6)
Depreciation & amortisation	87	134	160	166
EBIT	608	637	657	524
<i>Growth (%)</i>	49.7	4.7	3.2	(20.3)
Interest	-	-	-	-
Other income	-	-	-	-
EBT	605	615	619	506
Income taxes	84	87	38	18
Effective tax rate (%)	13.9	14.1	6.1	3.6
Extraordinary items	-	-	-	-
Min into / inc from associates	-	-	-	-
Reported net income	521	529	582	488
Adjustments	-	-	-	-
<b>Adjusted net income</b>	<b>521</b>	<b>529</b>	<b>582</b>	<b>488</b>
<i>Growth (%)</i>	51.8	1.5	10.0	(16.1)
Shares outstanding (mn)	31.1	31.1	31.1	31.1
<b>FDEPS (Rs) (adj)</b>	<b>16.7</b>	<b>17.0</b>	<b>18.7</b>	<b>15.7</b>
<i>Growth (%)</i>	51.8	1.5	10.0	(16.1)

### Cash flow statement

Y/E March (Rs mn)	FY07	FY08	FY09	FY10
Net income + Depreciation	608	663	741	654
Non-cash adjustments	0	0	0	0
Changes in working capital	31	(527)	23	(542)
Cash flow from operations	640	136	764	112
Capital expenditure	(329)	(413)	(138)	(86)
Change in investments	0	0	0	0
Other investing cash flow	0	0	0	0
Cash flow from investing	(329)	(413)	(138)	(86)
Issue/repay debt	0	553	(422)	209
Dividends paid	(245)	(245)	(245)	(245)
Other financing cash flow	(10)	(18)	(10)	(10)
Change in cash & cash eq	55	14	(52)	(20)
Closing cash & cash eq	201	215	163	143

### Balance sheet

Y/E March (Rs mn)	FY07	FY08	FY09	FY10
Cash and cash eq	201	215	163	143
Accounts receivable	602	1,046	919	1,305
Inventories	4	2	0	1
Other current assets	178	269	354	549
Investments	0	0	0	0
Gross fixed assets	1,041	1,530	1,675	1,501
Net fixed assets	726	1,005	984	904
CWIP	0	0	0	0
Intangible assets	0	0	0	0
Deferred tax assets, net	0	0	0	0
Other assets	0	0	0	0
<b>Total assets</b>	<b>1,711</b>	<b>2,537</b>	<b>2,419</b>	<b>2,902</b>
Accounts payable	487	448	449	488
Other current liabilities	298	344	322	323
Provisions	0	0	0	0
Debt funds	0	553	131	340
Other liabilities	0	0	0	0
Equity capital	311	311	311	311
Reserves & surplus	614	880	1,207	1,440
Shareholder's funds	926	1,191	1,518	1,751
<b>Total liabilities</b>	<b>1,711</b>	<b>2,537</b>	<b>2,419</b>	<b>2,902</b>
BVPS (Rs)	30	38	49	56

### Financial ratios

Y/E March	FY07	FY08	FY09	FY10
<b>Profitability &amp; Return ratios (%)</b>				
EBITDA margin	22.6	19.2	19.5	17.8
EBIT margin	19.7	15.8	15.7	13.5
Net profit margin	16.9	13.2	13.9	12.6
ROE	65.8	50.0	42.9	29.9
ROCE	66.0	40.6	35.7	26.7
<b>Working Capital &amp; Liquidity ratios</b>				
Receivables (days)	71.3	95.0	80.0	122.8
Payables (days)	57.8	40.6	39.0	45.9
Current ratio (x)	1.3	1.9	1.9	2.5
Quick ratio (x)	1.0	1.6	1.4	1.8



### Company profile

Tata Elxsi provides product design services, industrial design services and System Integration services. In addition, the company is venturing into visual computing to do animations designs for Hollywood and Bollywood movies.

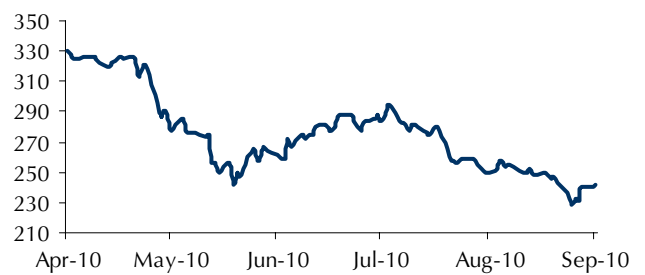
### Shareholding pattern

(%)	Dec-09	Mar-10	Jun-10
Promoters	44.6	44.6	44.6
FIs	0.3	0.3	0.2
Banks & FIs	8.3	9.1	9.4
Public	46.9	46.1	45.8

### Recommendation history

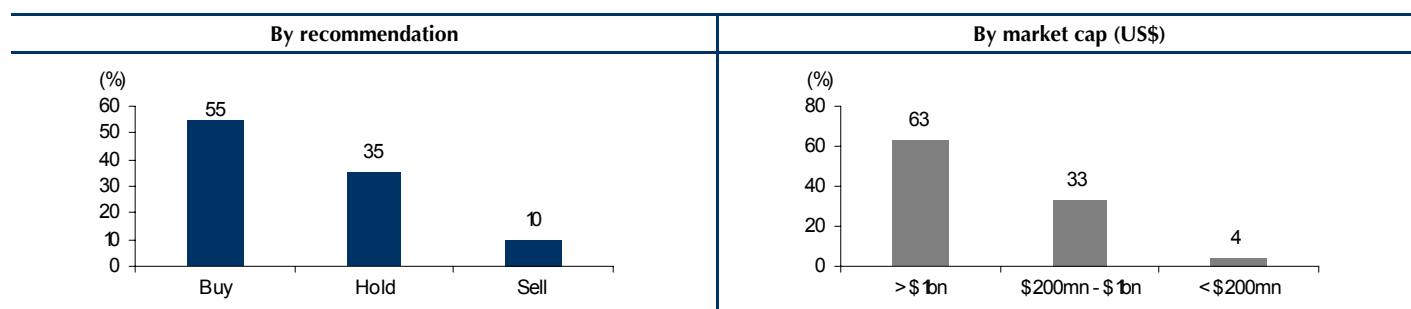
Date	Event	Reco price	Tgt price	Reco
8-Sep-10	Visit Note	262	NA	Not Rated

### Stock performance





### Coverage Profile



### Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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