

21 April 2007

BUY

Price **Rs 329** Target Price **Rs381**

Sensex - 13,897

Price Performance

(%)	1M	3M	6M	12M
Absolute	17	8	52	62
Rel. to Sensex	9	11	38	40

Source: Bloomberg

Stock Details

Sector	IT Services
Reuters	TTEX.BO
Bloomberg	TELX@IN
Equity Capital (Rs mn)	312
Mkt. Cap (Rs bn)	10.3
Face Value (Rs)	10
52 Week H/L (Rs)	350/147
Daily Avg Volume (No of shares)	143825
Daily Avg Turnover (US\$ mn)	1.0

Shareholding Pattern (%)

Promoters	38.1
FII's /NRI's	5.6
Institutions	19.3
Private Corp	3.3
Public	33.7

Source: BSE, 31.03.2007

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Tata Elxsi

Q4 in line with expectations

Results

Tata Elxsi posted revenue growth of 10.7% qoq to Rs 891.5 mn driven by 35.7% qoq in system integration services. Historically, Q4 is the best quarter for the company due to higher share of revenues from system integration services. Software development services (which include product design services, industrial engineering and visual computing lab) grew by 6.6% qoq, in line with our expectations.

EBITDA margins further expanded by 160 bps to 24.4% mainly due to incremental revenues from system integration services. EBITDA increased by 18.5% qoq to Rs 217 mn, above our expectations of Rs 200 mn. However, due to higher depreciation and taxes, PAT grew by 14.8% qoq to Rs 160 mn, broadly in line with our expectations.

Strong FY07 results – PAT grew by 52%

Tata Elxsi posted revenue growth of 30.5% yoy to Rs 3,081 mn driven by 39.1% growth in software development services. The company has made conscious efforts to reduce share of revenue from low margin system integration (SI) services. It has successfully reduced the share of SI services from 39% in FY04 to 15% in FY07. The result is EBITDA margins have expanded by 700 bps from 15.5% in FY04 to 22.5% in FY07. EBITDA have grown by 47% yoy to Rs 693 mn. PAT have shown a strong growth of 52% yoy to Rs 521 mn. EPS for the year stood at Rs 16.7. The company has declared dividend of Rs 7/-

Business transformation to continue

We believe the share of SI to further reduce to 10% of the total revenues by FY09E. With its focus in the embedded systems based product design services and continuing strong client relationship (Canon, Cisco, Hitachi, Motorola, Texas Instruments etc), we believe TEL is well positioned to capitalize on the robust market opportunity. We expect engineering services to post a CAGR of 36% over FY06-09E. Similarly, we expect visual computing lab to grow at 35-40% over next couple of years.

New growth drivers

TEL is among the world's first product solution providers to come out with mobile TV on the laptop (HandyDVR). Similarly, TEL has built a rich IP portfolio of ready-to-deploy product frameworks and reusable software components in the areas of multimedia, networking, semiconductors, storage, WiMax and mobile TV. We expect contributions from IP and product solutions to increase from 7% of the total revenues currently to 10-12% going forward.

Comprehensive Expansion plan

TEL is strengthening its presence in India, not only by adding at least two new development centres but also by expanding some of its existing four development centers within the next 18 months. Its development centre outside India is expected to come up at Tokyo in Japan very soon, which will house 30 people in the initial phase. Besides strengthening its reach and presence, the company is also looking to double its headcount from the current level of 2300+ employees within the next 24 months.

Margin levers available

We believe TEL has multiple margin levers in the form of (a) strong volume growth, (b) increased contributions from IP and product solutions currently from 7% of the total revenues to 10-12% going forward, (c) increased contributions from engineering services revenues from 80% in FY06 to 90% by FY09E, (d) more hiring of freshers – about 60% of the total hiring, and (e) better SG and A leverage.

Future outlook and Valuations

We maintain our estimates for FY08E and FY09E. We expect the company to post a CAGR of 31% in revenues and 39% in profits for FY06- 09E. EBITDA margins shall expand by 340 bps from 20% in FY06 to 23.4% in FY09E (already at 22.5% for FY07). We expect healthy ROEs of 61% and 55% for FY08E and FY09E respectively. With strong growth and expansion plan in place, robust order book position, expected improvement in margins, high dividend yield and healthy ROE, we believe TEL offers an attractive investment opportunity. At CMP of Rs 330, the stock is available at P/E of 14.8x FY08E and 11.3x FY09E and EV/EBITDA of 11.0x FY08E and 8.3x FY09E. We maintain BUY with a target price of Rs 381 (13x FY09E EPS of Rs 29.3).

Q4FY07 Results Analysis

Consolidated	Q3FY07	Q4FY07
Total Revenue (Rs mn)	805	891
Growth (%) q-o-q	7.3	10.7
System Integration	115	157
Growth (%) q-o-q	2.0	35.7
Software development	690	735
Growth (%) q-o-q	8.3	6.6
Cons of raw materials	92	104
Staff cost	404	444
Other Exp	127	127
EBIDTA	183	217
Growth (%) q-o-q	17.1	18.5
Growth (%) y-o-y	69.3	38.7
EBIDTA (%)	22.8	24.4
Add:Other Income	0	1
Less:Depreciation	22	26
PBT	161	191
Less:Tax	20	31
PAT	141	161
Growth (%) q-o-q	17.4	14.8
Growth (%) y-o-y	83.1	38.8
PAT (%)	17.3	18.0
EPS	4.5	5.1

Source: Company

Profit & Loss Statement					Balance Sheet				
Mar end (Rs mn)	FY06	FY07E	FY08E	FY09E	Mar end (Rs mn)	FY06	FY07E	FY08E	FY09E
System Integration	473	456	478	502	Equity Capital	311	311	311	311
Growth (%)	17.6	(3.8)	5.0	5.0	Reserves	348	621	1,049	1,678
Software development	1,888	2,626	3,647	4,754	Networth	659	932	1,360	1,989
Growth (%)	28.9	39.1	38.9	30.4	Deferred Tax Liability	35	35	35	35
Total Revenues	2,362	3,081	4,125	5,256	Total Liabilities	694	967	1,395	2,024
Growth (%)	26.5	30.5	33.9	27.4	Gross Block	777	997	1,297	1,657
Cons of raw materials	351	361	417	460	Less Depreciation	324	411	523	671
Staff cost	1,197	1,543	2,109	2,718	Net Fixed Assets	453	586	774	986
General & Admin. Expenses	341	485	666	846	CWP	31	31	31	31
EBITDA	472	693	933	1,232	Debtors	466	633	848	1,080
Growth (%)	28.4	46.7	34.7	32.0	Cash and Bank	145	262	475	862
EBITDA margin (%)	20.0	22.5	22.6	23.4	Inventories	1	3	4	5
Other Income	2	3	3	4	Loans & Advances	358	462	619	788
Interest Exp	2	3	6	6	Total Curr. Assets	971	1,360	1,946	2,735
Depreciation	67	87	112	147	Current Liabilities	375	462	619	788
PBT	404	605	817	1,083	Provisions	387	555	743	946
Tax	61	84	122	169	Total Curr. Liabi. & Prov.	761	1,017	1,361	1,735
PAT	343	521	695	913	Net Current Assets	210	344	584	1,001
Growth (%)	30.6	51.8	33.3	31.4	Total Assets	694	961	1,389	2,018
PAT margin (%)	14.5	16.9	16.8	17.4					

Source : Company, Emkay Research

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Cash Flow					Ratios				
Mar end (Rs mn)	FY06	FY07E	FY08E	FY09E	Mar end	FY06	FY07E	FY08E	FY09E
Profit Before Tax	404	605	817	1,083	Profitability (%)				
Depreciation	67	87	112	147	EBITDA margin	20.0	22.5	22.6	23.4
Interest Expenses	2	3	6	6	PAT margin	14.5	16.9	16.8	17.4
Operating CF	474	695	936	1,236	ROCE	58.5	62.9	59.0	53.8
Change in working capital	(29)	(41)	(45)	(48)	ROE	52.1	55.9	51.1	45.9
Less:Direct Taxes	(61)	(84)	(122)	(169)	Per Share Data (Rs.)				
CF from Operating	395	570	768	1,019	EPS	11.0	16.7	22.3	29.3
CF from Investing					CEPS	13.2	19.5	25.9	34.1
(Purchase)/Sale of Fixed Asset	(193)	(220)	(300)	(360)	BVPS	21.2	29.9	43.7	63.9
Net CF from Investing	(193)	(220)	(300)	(360)	DPS	6.5	7.0	7.5	8.0
CF from Financing					Valuation (x)				
Dividend Paid	(196)	(231)	(249)	(266)	P/E	29.9	19.7	14.8	11.3
Interest Paid	(2)	(3)	(6)	(6)	Cash PE	25.0	16.9	12.7	9.7
Net CF from Financing	(198)	(234)	(255)	(273)	P/BV	15.6	11.0	7.6	5.2
Net Increase/(Decrease) in Cash	4	117	213	387	EV/EBITDA	21.8	14.8	11.0	8.3
Opening Balance	141	145	262	475	EV/Sales	4.4	3.3	2.5	2.0
Closing Balance	145	262	475	862	PEG	1.0	0.4	0.4	0.4
					Dividend Yield %	2.0	2.1	2.3	2.4

Source : Company, Emkay Research

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