

Background & Business

Tata Elxsi(TELX) is a mid-cap software design company that generates its revenue by providing integrated design and embedded software services. The company specializes in leveraging its technological expertise in developing embedded software to provide design led solutions. TELX was incorporated in 1989, as part of the Tata Group of Companies. In FY19, the company achieved total revenue of Rs.16 bn and its current market capitalization is Rs.53bn.

Investment Thesis

From : 29-01-2016
 To : 31-05-2019
 Performance : -16%
 Recommendation : OPEN

- 1) **Presence in niche segments enables TELX to counter industry headwinds** - TELX has positioned itself as a niche player in the IT sector because of its focus on Engineering Product R&D and designing. This has enabled the company to grow consistently with 5-year revenue and PAT growth of 16% and 32%, respectively. This is despite the slowdown seen by larger pure play IT companies in this period.
- 2) **Presence in high growth verticals** - TELX is an engineering design company with strong developmental capabilities, around 86% of its revenue is generated by Embedded Product Design services. Its business growth potential is closely linked to the Engineering R&D spend of large global enterprises, a space that is expected to grow at ~9% CAGR over the next 5 years. TELX also works with healthcare companies to design and build medical products. This is a still a small vertical but can potentially contribute significantly going forward.
- 3) **Diversified Revenue base** - TELX's focus on niche growth segments has aided the company to post strong revenue and PAT growth and expand operating margins from 14.6% in FY14 to 26.0% in FY19. It also has a geographically well-diversified revenue base, with 31% revenue coming from US, 44% from Europe and remaining 25% from ROW. Presence across multiple locations and operations spanning different verticals, enables the company to mitigate the risk emanating from country level policy changes and cyclicity of any one industry segment.
- 4) **Best-in-class margin profile** - TELX has a strong balance sheet with zero debt and comfortable working capital (18% sales) position, with cash conversion cycle of 60-70 days. Strong domain focus and presence in high growth segments has enabled the company to have 25%+ margins along with high return ratios (ROE 30.7% in FY19).

Outlook

Business segments that TELX operates in, has strong correlation with the Engineering R&D spends of large enterprises globally, which is growing at a healthy rate. With strong domain focus, we expect TELX to benefit from the rising offshoring opportunities both in automobiles and broadcasting segments. Further, its healthcare operations can be a strong revenue booster once it achieves critical mass. Strong business momentum, best-in-class margin profile and superior return parameters makes TELX our favoured pick in the IT/ITES space. We thus, continue to have a positive view on the company.

