

Background & Business

Tata Elxsi 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 Tata Group of Companies. In FY18, the Company achieved total revenue of Rs.13.8 bn and its current market capitalization is Rs. 86.1 bn.

Investment Thesis

- a) **Robust R&D spends by large enterprises provides TELX with a unique growth opportunity:** TELX is an embedded software development company with focus on designing. Its fortunes are linked closely to R&D spends of large enterprises unlike other Indian IT companies, which depend on IT maintenance capex. This unique focus has helped the company defy sectoral downtrend, which affected most of the Indian IT companies over the last 2 years.
- b) **Focus on high growth niche segments:** Telex derives 53% of the total revenue by offering electronics, software development and system design services for the automotive companies. This is a fast growing sector, as OEMs are looking to develop futuristic products and solutions in a rapidly changing environment. 31% of revenue comes from broadcasting and communication segment, wherein TELX helps clients design and enhance user experience in using setup boxes and smart TV. Additionally, it is also providing design services to the high potential medical equipment industry, which can contribute significantly to the revenue upon achieving critical mass. It is also looking to increase revenue contribution from Intellectual property from current 5% to 10% which can provide the company with non-linear growth opportunity.
- c) **De-risked business model:** Telex has geographically balanced revenue profile with ~30% revenue coming from US, 44% from Europe and 26% from ROW. This helps the company reduce dependency on the economic prospects of a particular region.
- d) **Best in class margin profile:** TELX has a strong balance sheet with zero debt and Rs. 3.9 bn of cash in hand. Presence in high growth segments has enabled the company to have 25% margins along with high return ratios (RoCE 48.4% in FY18).

Outlook

Business segments that TELX operates in, has strong correlation with the Engineering R&D spends of large enterprises globally. 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. With strong balance sheet, presence in high growth segments, and high free cash flow generation, we believe that its premium valuations will sustain. We thus, continue to have a positive view on the company.

