Tata Elxsi Limited

March 25, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term – Fund based/CC	45.00	45.00	[ICRA]AA (Stable); Reaffirmed
Short term – Non-fund based	10.00	10.00	[ICRA]A1+; Reaffirmed
Total	**55.00**	**55.00**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation of the ratings considers the strong business profile of Tata Elxsi Limited (TEL), supported by its long operational track record, diversified geographical presence, reputed clientele, and experienced and professional management team. The ratings remain underpinned by TEL's strong financial risk profile marked by healthy profitability, sizeable net worth, strong cashflow, and debt-free status. During FY2018 and 9M FY2019, TEL's revenues grew 12.0% and 17.9% YoY, respectively, on the back of sustained orders from existing customers apart from the addition of new customers. With an enhanced scale and focus on margin-accretive businesses, TEL's operating profit margins expanded to 25.2% in FY2018 and 26.6% in 9M FY2019. Higher operating profits, coupled with an increase in interest income on the cash surplus and foreign exchange gain, resulted in expansion in the net profit margins (17.3% and 18.3% in FY2018 and 9M FY2019, respectively).

The ratings also consider the moderately high customer concentration with the top five clients contributing ~42% to revenues as well as the exposure of earnings to protectionist policies in some of the regions where the company operates. The ratings have also taken into account exchange rate fluctuations, wage inflation and intense competition in the industry, characterised by the presence of large players who can offer managed services.

Outlook: Stable

ICRA believes that TEL will continue to benefit from its strong operational and financial profile. The outlook may be revised to Positive with a sustained growth in revenues and earnings, thus strengthening the overall financial risk profile. The outlook may be revised to Negative with a sharp deterioration in cash accruals or debt-funded capital expenditure or an acquisition that has a sharp impact on the debt coverage metrics.

Key rating drivers

Credit strengths

Strong business profile - TEL has an established presence in the designing and development of systems and software for varied end-user industries (transportation, broadcasting, communication, healthcare, consumer electronics, semiconductors, etc). The company's business profile is strong, aided by a diversified geographical presence across Europe, USA, India, Japan, the Far East, etc, its reputed clientele, and professional management team. TEL is uniquely positioned among its peers and offers relatively complex services supported by its expertise, execution capabilities and long-standing relationships with clients. This not only strengthens its value proposition, it also aids the company in generating higher margins.

Robust financial profile - TEL's financial profile is robust with sustained growth in revenues and earnings with a 3-year (FY2016-18) revenue and profit CAGR of 17.7% and 32.6%, respectively, and high profitability with operating margins and RoCE of 25.2% and 56.4%, respectively, in FY2018. The financial profile is also supported by TEL's sizeable net worth of Rs. 738 crore as of March 2018, strong cashflows, and debt-free status. The company's liquidity position is strong with cash and liquid investments of Rs. 407.3 crore as of September 2018. This apart, its working capital lines remain unutilised. TEL's debt indicators are expected to remain comfortable going forward, in the absence of any large debt-funded capital expenditure.

Favourable long-term outlook for product engineering industry to support TEL's business prospects - TEL's end-user industries range across sectors such as auto, broadcasting, consumer electronics, medical electronics and telecom, which are witnessing increased penetration of software components and technological advancements. This, in turn, resulted in the growing propensity of these players to outsource certain specialised areas. The outlook on engineering research & development is favourable with increasing R&D budgets of original equipment manufacturers towards software solutions and services. Given its expertise and established presence in this segment, the company is likely to benefit from the industry's growth.

Credit challenges

Increasing competition from large players - The industry is characterised by intense competition from players enjoying benefits of scale and higher bargaining power. Nevertheless, the company is well placed in terms of niche service offerings, multi-disciplinary designing capabilities and an established presence.

Moderate customer concentration - In FY2018, the share of the top five customers was ~42% of revenues, reflecting moderate customer concentration. This apart, with over half of the revenues being derived from the automotive segment, the earnings are exposed to any slowdown in the automotive industry. However, given the diversified regional profile, the vulnerability is considered to be low. Also, the growth in segments like broadcasting, communication and healthcare has been strong in the last one year, thus insulating the company from concentration-related risks.

Vulnerability of earnings to demand in end-user industries and foreign exchange fluctuations - With exports contributing to ~87% of its revenues, TEL is susceptible to exchange rate fluctuations. Nevertheless, the same is mitigated to some extent by an active hedging mechanism. The earnings are also susceptible to protectionist policies in some key geographies and wage inflation.

Liquidity position

The company's liquidity position continues to be strong with large cash and liquid investments of Rs. 407.3 crore as of September 2018. This apart, TEL has unutilised working capital lines of Rs. 55 crore.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for entities in Information Technology Industry
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the standalone financial profile of the company

About the company

Incorporated in 1989, Tata Elxsi Limited predominantly designs and develops systems and software for industry verticals such as automotive, aerospace, broadcast, communication, consumer electronics and semiconductors. It also provides systems integration and industrial design services across industries. The larger business segment – Software Development & Services - can be further categorised into the Embedded Product Design (EPD) and Industrial Design & Visualisation (IDV) divisions. While the EPD division provides hardware, software and embedded system designs and development services across the product lifecycle, the IDV division addresses the industrial design, user experience and service design, branding and digital content marketing requirements of customers.

With the merger of the erstwhile Visual Computing Labs (VCL) division with ID, the company offers digital content creation including 3D computer graphics, animation and special effects for corporate films and the entertainment industry under the IDV division. TEL, headquartered in Bangalore, has a presence across the US, Europe, Asia Pacific and Japan. In India, the company has global development centres and studios in cities like Bangalore, Thiruvananthapuram, Mumbai and Pune.

Key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	1,237.3	1,386.3
PAT (Rs. crore)	174.8	240.0
OPBDIT/OI (%)	24.2%	25.2%
RoCE (%)	56.5%	56.4%
Total Debt/TNW (times)	NA	NA
Total Debt/OPBDIT (times)	NA	NA
Interest Coverage (times)	395.3	437.4

Source: TEL, ICRA research; OPBDIT: Operating Profit before Depreciation, Interest and Taxes; PAT: Profit after Tax; RoCE: Return on Capital Employed; TNW: Tangible Net Worth; TEL is debt free

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

		Current Rating (FY2019)				Chronology of Rating History for the Past 3 Years			
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating March 2019	Date & Rating in FY2018 March 2018	Date & Rating in FY2017 April 2017	Jan 2017	Date & Rating in FY2016 October 2015
1	Fund based	Long Term	45.00		**[ICRA]AA (Stable)**	**[ICRA]AA (Stable)**	**[ICRA]AA (Stable)**	**[ICRA]AA (Stable)**	**[ICRA]AA (Stable)**
2	Non-fund based	Short Term	10.00		**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN No.	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	-	45.00	[ICRA]AA (Stable)
NA	Non-fund Based	NA	NA	-	10.00	[ICRA]A1+

Source: Tata Elxsi Limited

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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