September 30, 2020

Tata Elxsi Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based - Working Capital Facilities	45.00	45.00	[ICRA]AA (Stable); Reaffirmed
Non-fund Based Working Capital Facilities	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 long-standing presence of Tata Elxsi Limited (TEL/the company) in the designing and development of systems and software for varied end-user industries, its strong business profile supported by a diversified geographical presence, its reputed clientele, and experienced and professional management team. The ratings remain underpinned by TEL's strong financial risk profile marked by stable revenues, healthy profit margins, sizeable net worth, strong cashflows and debt-free status.

In FY2020, TEL's revenue growth was almost flat (up 0.8% YoY) due to the slowdown in global automotive demand, which resulted in subdued research and development (R&D) spend by the original equipment manufacturers (OEMs). In Q1 FY2021, TEL posted Rs. 400.5 crore of revenues (up 10.7% YoY and down 8.7% QoQ) amid the impact of the Covid-19 pandemic. Its operating profit margin (OPM) contracted by 470 bps to 21.7% in FY2020 owing to a sharp rise in employee costs. Nevertheless, the company's financial profile is strong, characterised by a strong net worth position, healthy cash reserves and a debt-free status.

The ratings also consider the moderate customer concentration with the top five clients accounting for 36.2% of the revenues in Q1 FY2021 and the vulnerability of the company's earnings to end-user demand and protectionist policies in some of the regions where it operates. The ratings have also taken into account the exchange rate fluctuations and intense competition in the industry, characterised by the presence of large players that offer managed services.

The Stable outlook on the [ICRA]AA rating reflects ICRA's opinion that the company will continue to benefit from its long-standing presence in the industry, catering to various end-user industries, its diversified client profile, professional management team and robust financial profile.

Key rating drivers and their description

Credit strengths

Long-standing presence in designing and development of systems and software for varied end-user industries – 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). Its major verticals have a huge growth opportunity considering the increase in R&D spends in the automotive, consumer electronics, and medical devices segments. As TEL is a specialist vendor for the top OEMs and Tier-I suppliers, the recent reallocation of R&D budgets towards electronics and software, which is a large addressable market, and its differentiated product offerings increase the growth opportunities for the company.

Strong business profile supported by diversified geographical presence, reputed clientele and professional management team – The company's business profile is strong, aided by a diversified geographical presence across Europe, the US, 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 its clients. This not only strengthens its value proposition, it also helps in generating higher margins.

Robust financial profile with stable earnings, debt-free status and strong cash reserves – TEL's financial profile is robust with stable revenues of Rs. 1,609.9 crore in FY2020 and healthy margins (OPM of 21.7% and net profit margin (NPM) of 15.9% in FY2020). The financial profile is also supported by TEL's sizeable net worth of Rs. 1,090 crore as on March 31, 2020, strong cashflows, and debt-free status (excluding lease liabilities). The company's liquidity position is strong with a cash balance of Rs. 664.2 crore as on March 31, 2020. This apart, its working capital facilities of Rs. 45 crore remain unutilised. TEL's debt indicators are expected to remain comfortable going forward, in the absence of any large debt-funded capital expenditure.

Credit challenges

Increasing competition leads to pricing pressure – The industry is characterised by intense competition from players enjoying the benefits of scale and higher bargaining power. Nevertheless, TEL is well placed in terms of niche service offerings, multi-disciplinary designing capabilities and an established presence. Given the Covid-19 pandemic, ICRA expects a contraction in the OEMs' spend towards R&D, which would increase the competitive intensity in the business and lead to pricing pressure.

Moderate customer concentration – In FY2020, the share of the top five customers was 38.5% of the overall revenues (36.2% in Q1 FY2021), reflecting moderate customer concentration. This apart, the transportation vertical, which has been the major contributor to TEL's revenues, witnessed a degrowth owing to the ongoing slowdown in the global automotive sector coupled with the impact of the pandemic. However, the company's other segments like broadcast & communication and healthcare & medical devices have been growing at a healthy rate with the former supported by the increased usage of over-the-top (OTT) platforms and telecom services (given the work-from-home situation across the globe).

Vulnerability of earnings to demand in end-user industries and foreign exchange fluctuations – With exports contributing 88.1% to 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 a few key geographies and wage inflation.

Liquidity position: Strong

TEL's liquidity position is **strong** with a cash balance of Rs. 664.2 crore as on March 31, 2020 and a Rs. 45.0-crore buffer available as working capital facilities, which have largely remained unutilised. Despite regular dividend payouts, the company's liquidity position has remained strong on the back of healthy operating cashflows, which are expected to continue in future as well. TEL remains debt free and has relatively low capex costs, mostly for maintenance.

Rating sensitivities

Positive triggers – The rating could be upgraded on a sustained improvement in the financial profile, an increasing scale of operations and improved business diversification.

Negative triggers – Pressure on the ratings could arise on a significant deterioration in the credit metrics due to any large debt-funded acquisition or capex or any large impact on operations amid the Covid-19 pandemic.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Information Technology (IT) Services Industry
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the standalone financial statements of the rated entity

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. 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)

	FY2019	FY2020
Operating Income (Rs. crore)	1,596.9	1,609.9
PAT (Rs. crore)	290.0	256.1
OPBDIT/OI (%)	26.4%	21.7%
PAT/OI (%)	18.2%	15.9%
Total Outside Liabilities/Tangible Net Worth (times)	0.2	0.3
Total Debt/OPBDIT (times)	-	-
Interest Coverage (times)	406.3#	51.3*

*Source: Company financials; Note: #Bank charges classified as finance costs * Unadjusted for Ind-AS 116 (lease liabilities)*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding 31-Mar-2020	Current rating 30-Sep-2020	FY2020 -	FY2019 25-Mar-2019	FY2018 26-Mar-2018
1	Fund Based	Long Term	45.00	-	[ICRA]AA (Stable)	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2	Non-fund Based	Short Term	10.00	-	[ICRA]A1+	-	[ICRA]A1+	[ICRA]A1+

Amount in Rs. crore

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	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund-based Facilities	NA	NA	-	45.00	[ICRA]AA (Stable)
NA	Non-fund Based Facilities	NA	NA	-	10.00	[ICRA]A1+

Source: Company

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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About ICRA Limited:

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