

# JV CAPITAL SERVICES PVT. LTD

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**Tata Elxsi**

**CMP: 162**

**BUY**

**INDUSTRY: Software**

**Risk Profile: Medium**

**TARGET:290**

NSE Symbol :

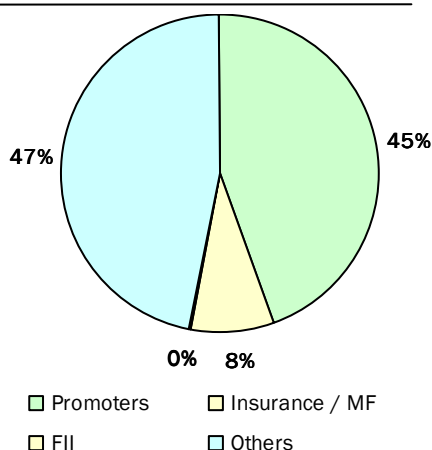
TATA ELXSI

Tata Elxsi Ltd, the product design arm of the Tata Group, is a company focused on delivering outsourced product design and R&D services and solutions to customers worldwide. The company provides systems integration and software development services. The businesses constituting Software Development and Services segment are embedded product design services (design and development of hardware and software), innovation design engineering (mechanical design with a focus on industrial design) and visual computing labs division. Systems Integration and Support offers a range of technical computing solutions spanning high-end computing platforms, networking, mechanical design automation tools, enterprise storage solutions, digital media and life sciences solutions through their tie-ups with global leaders in these respective areas.

## Key Data

52 Week High	174
52 Week Low	76
Market Cap	504.28 crores
Face Value	10
Beta	0.65
P/E Ratio	8.67
Dividend Yield %	4.32%
Book Value	48.64

## Share Holding Pattern (%)

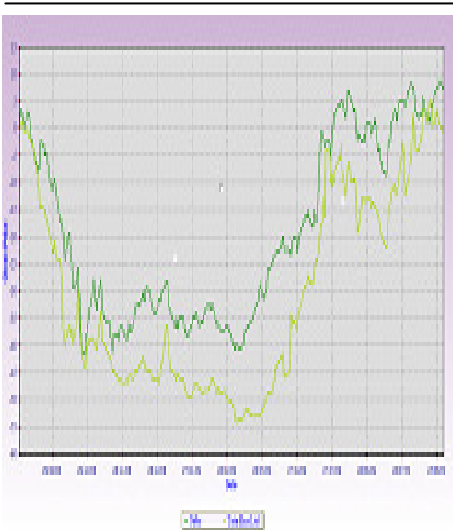


## Investment Rationale

### Moving up the value chain

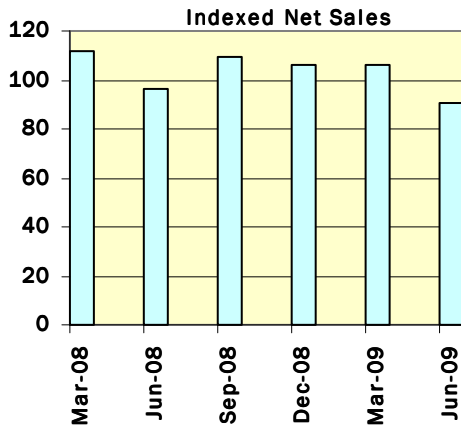
Indian design organizations are rapidly moving from simple labour cost arbitrageurs to product innovators. Along with captive design centers by the OEMs, third party design centers are coming up rapidly. This coupled with inherent benefit of labour cost arbitrage the Indian design market is moving very fast because of the strategic focus of the designing work by the OEMs and secondly the strength of the Indian designers to enable the OEMs to fast market their products.

## Relative Performance Analysis

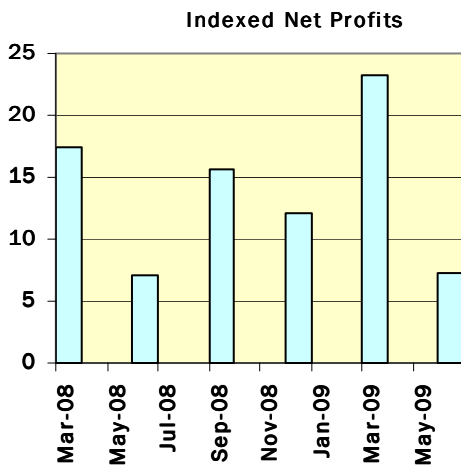


### Revenues expected to bounce back

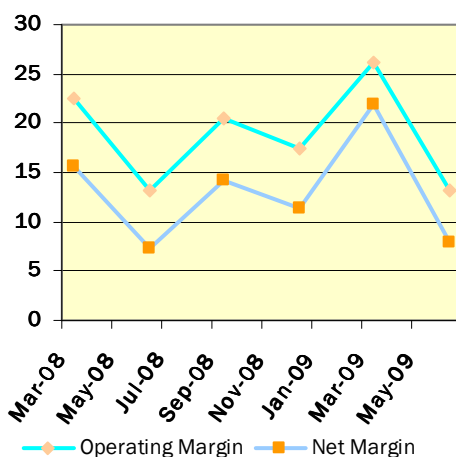
Gartner reports indicate that semi-conductor revenue in 2010 is expected to bounce back to the same revenue level as 2008 at \$255 billion, a 13% increase from 2009. In another report, Gartner also predicts that worldwide smartphone sales will grow by 29% year-over-year to reach 180 million units in 2009. Car manufacturers around the world are increasingly adopting "electronics" for more comfort features and design and also for new concepts such as electric and fuel-efficient cars. Studies by Strategy Analytics Automotive Electronics suggest that electronics is likely to account for 35% of the total cost of a car by 2010. All these point to the possibility of increasing outsourcing of design services to companies such as Tata Elxsi.



Sales at a bottom, most negatives are priced in, recovery in coming quarters



Profits at a trough, sharp recovery ahead in the offing



Margins have fallen in this quarter, expect it to recover strongly in coming quarters

### Product Design Services: The JLR Effect

Product Design services (PDS) involves designing technology products and related hardware & software. This segment has had good growth over the past few quarters. Company serves four major verticals - Consumer Electronics, Multimedia, Wireless Communication and Automotive Electronics.

In a minor way, it also serves medical electronics and semiconductor industries. The company works with British car brands Jaguar and Land Rover (JLR) and now that the brands have come within its promoter group, management expects JLR business to grow at least three-fold.

### Design & Engineering Services: Opening newer centers abroad

Design and Engineering services (DES) involves industrial design and engineering (ex. new auto models, FMCG cartons etc). Company has opened up a studio in UK, which will offer innovative and creative design solutions across wide range of industries. Italy and UK are the best industrial design centers of the world. Company can do the same work that it is doing in India over there and get much higher billing rates.

### Visual Computing Labs: The fastest growth arm

Visual Computing Labs (VCL) creates visual special affects & animation for films and commercials. Company has signed 3 films deal with Yash Raj Films, of which first film (Road side Romeo, first animated film co-produced by Yash Raj Films and Walt Disney Company) is nearing completion in Q3 FY 2009 and 2nd film is expected to be completed by December 2009.

It has got order for one more film in India. It is UTV motion pictures' animated project "Arjun". Part of this multi-crore film or even the entire film itself is going to be outsourced to VCL division of the company. Thus, this fastest growing arm is expected to contribute 20% (5%) of company's revenues in three years time.

### System Integration: Profiting from niche segments

In SI, company works in niche hi-tech segments, which have grown over time but not as much as overall plain vanilla SI market. Here Tata Elxsi's strategy in is two fold:

- Trying to increase service component and also exploring to increase share of annuity based revenues therein.
- Attempting to build competence in specialised areas like storage systems, news room consultancy in Indian market, which the company later on can take to international markets.

## Valuation

In terms of client and industry focus, the business of the company is quite comparable with the business of companies like Sasken Communication Technologies and that of KPIT Cummins. But so far as the kind of services goes, the company does not hold a long term association with the customers for the products it designs or customizes. Other companies provide both application and maintenance services to their clients and thus have long-term revenue visibility from its clients for the kind of design service they provide. We believe, when the company plans to move its focus from customer driven to technology driven, the client association may undergo a change. Looking at the growth of design outsourcing into the country and increased global product design need for the convergence applications, we expect the sales of the company to grow at a rate of 3% and 10% in the coming two quarters. The profits are expected to increase at a faster clip driven by decrease in operating expenses. The company is currently trading at a PER of 8.64. We expect the company to report an EPS of Rs.18.64 for the CY09. The stock should trade at its historical PER of 15.5 as we believe that the market is not factoring in an improvement in operating performance in the coming quarters. We also believe that all negativity is already factored into the current stock price. Also, there has been informed buying into the stock by stronger hands. This is also a reason of optimism. We remain bullish on the results of this quarter and in the coming quarters. Our target price for the stock is Rs.289 based on a historical PER of 15.5 and a CY09 EPS of Rs.18.64.

(Rs. Crores)	Mar 09	Jun 09	Sep 09E	Dec 09E
Net Sales	106.34	90.47	92.5	101.75
Total Expense	78.50	78.50	74.0	82.00
Operating Income	27.84	11.97	18.5	19.75
Other Income	-	-	-	-
Gross Profit	27.84	11.97	18.5	19.75
Interest	0.68	0.31	0.50	0.50
Depreciation	4.06	4.04	4.10	4.20
PBT	23.11	7.62	13.90	15.05
Tax	-0.16	0.41	0.65	0.75
Net Profit	23.27	7.21	13.25	14.30
EPS (Rs/Share)	7.47	2.32	4.26	4.59

Source: Company, JVCS

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**RISK PROFILE:**

**Low Risk:** Fundamentally Sound companies, with low beta. Expected market out-performance is 0–10%

**Medium Risk:** Expected market out-performance is 10-20%. Preferably for the Investors with a maximum time frame of 6 months.

**High Risk:** High Beta Stocks, expected market out-performance is more than 20%, Preferably for the investors willing to take advantage of market momentum and are aggressive in nature.

**Disclaimer Appendix**

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