"Tata Elxsi Limited

Q1 FY '24 Earnings Conference Call"

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MODERATOR: **MR. SHASHANK GANESH – ERNST & YOUNG**

Moderator: Ladies and gentlemen, good day and welcome to Tata Elxsi Limited Q1 FY2024 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call, please signal an operator by pressing star then zero on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Shashank Ganesh from EY. Thank you and over to you Mr. Ganesh.

Shashank Ganesh: Thank you very much. Good evening to all the participants on the call. Good morning if you're logging in from the Western side. Before we proceed to the call, let me remind you that the discussion may contain forward-looking statements that may involve known or unknown risks, uncertainties and other factors. Therefore, it must be viewed in conjunction with the business risk that could cause further result performance or achievements that differ significantly from what is expressed or implied by such forward-looking statements.

To take us through the results and answer your questions today, we have the senior management of Tata Elxsi, represented by Mr. Manoj Raghavan, Managing Director and CEO; Mr. Nitin Pai, Chief Marketing and Chief Strategy Officer; Mr. Gaurav Bajaj, Chief Financial Officer; and Ms. Cauveri Sriram, Company Secretary.

We will start the call with a brief overview of the past quarter by Mr. Raghavan, followed by a Q&A session. We would appreciate your cooperation in restricting yourselves to 2 questions to allow participants an opportunity to interact. If you have any further questions, you may join the queue, and we will be happy to respond to them if time permits. With that, I would like to hand over the call to Mr. Manoj Raghavan. Over to you, Manoj.

Manoj Raghavan: Thank you, Shashank. A very good evening to everyone. Thank you all for joining us this evening for the earnings call. We are happy to report a healthy operating revenue growth of 17.1% year-on-year in the current macroeconomic environment, while delivering an EBITDA margin of 29.6%. In constant currency terms, our revenue grew by 1.2% quarter-on-quarter and 11.9% year-on-year.

During the quarter, our Healthcare and Life Sciences business reported a healthy quarter-on-quarter growth of 3.2% in constant currency terms, which is a significant improvement over the performance during the earlier 2 quarters. This vertical also reported new product development deal wins for medical diagnostics and smart hospital equipment. In the Transportation business, we continue to see good traction and a strong deal pipeline, especially in software-defined vehicles and electric vehicles.

The transportation business grew by 1.8% quarter-on-quarter and 17% year-on-year in constant currency terms. While some deal closures were delayed in this quarter, we won new deals, including a strategic multiyear multimillion dollar SDV deal with a leading Asian OEM for SDV platform and software development. We also won a multicurrency licensing and deployment of our Connected Vehicle Platform deal with a global top 5 OEM.

Our Media and Communication business performed creditably to retain and grow market share even though absolute revenue growth was muted. The quarter-on-quarter revenue growth was at 0.2% in constant currency terms. We won our first multiyear deal for our 5G network orchestration and automation suite with the leading telecom operator. This is an important milestone for the renewed portfolio we are building for this industry vertical. However, the media telecom and technology sector is still soft globally, and we remain cautious on the short-term growth in the sector while staying close to our key customers and focusing on intelligent AI-powered solutions and technologies, that will drive the next wave of transformation in this industry.

I am delighted by the all-round customer excellence demonstrated by Elxsians that has allowed us to grow strongly with our key customers and position us well for competitive differentiation and new project considerations around our customer base. Our successes in growing our business with our large accounts resulted in a share of revenue from our top 5 accounts increasing from 39.8% in the previous quarter to 42% in the first quarter of FY '24. Similarly, our revenue share from top 10 accounts grew from 49.4% in Q4 of the previous financial year to 51.9% in Q1 of this financial year.

On the people front, we continue to invest in our talent base with a net add of 422 Elxsians in this quarter. The Elxsi family is now 12,000-plus strong with attrition dropping further to 15.6%. We have driven strong operational excellence across the organization and protected our EBITDA margins despite wage hikes and strong employee additions in the quarter.

Our effective tax rate in this quarter has increased on account of lower tax exemption due to the completion of 5 years for a couple of SEZ units, impacting our PAT margins. Our PAT margin for the quarter stood at 21.6%. It's a matter of great pride for all of us at Tata Elxsi to partner with ISRO and play a role in the Gaganyaan project. This collaboration will help push the boundaries of technology and provide us a unique opportunity to advance our capabilities while strengthening India's space mission. We wish ISRO the very best as it progresses further in the ambitious Human Space Flight mission.

As we step into the second quarter of this financial year, the confidence of our customers in our differentiated Design Digital proportion and delivery excellence and a strong deal pipeline, especially in automotive, health care and design businesses, provide us the confidence and foundation for accelerating our growth throughout the year. With this, I will hand over the floor to Shashank for the Q&A session.

Nitin Pai: Shashank, before you go, this is Nitin Pai here. I have a brief update for the entire audience who's joining us today. We moved to a new fact sheet format and my apologies because I think we missed reporting the constant currency growth for the overall company. So, the intent, of course, was to move to a new format to make it more readable, more user-friendly, but I believe that we had a lapse on that front, that will be corrected. So, you will continue to see a constant currency report at the company level too. So, my bad on that. Thanks.

Moderator: Thank you very much. The first question is from the line of Bhavik Mehta from JPMorgan. Please go ahead.

Bhavik Mehta: Thank you. A couple of questions. Firstly, one was on the Transportation vertical. Obviously, you mentioned that the deal closures are delayed, but have you also seen deal conversion getting pushed out because of the macro and clients being a bit cautious? Because the growth has been a bit soft over the last 2 quarters in a row now. So, what's the outlook over there going forward?

And secondly, to Gaurav, if you can give us the margin walk for this quarter and are the wage hikes completely done in 1Q? Or can we expect some part of the wage hikes to come into 2Q as well. Thank you.

Manoj Raghavan: Sure. Regarding the Transportation business, yes, you're right. I think some of the deals closure is taking time but I think the deal pipeline is still pretty strong. There are large opportunities that we are chasing. And we are really hopeful that we will have those closures in Q2 and the subsequent quarters.

To that extent, I think that lack of conversion is really reflecting in the soft revenue growth. But I think we are pretty confident that come Q2 and Q3, we will see accelerated pipeline closures.

Gaurav Bajaj: On the margin, our EBITDA is 20 basis points lower compared to the last quarter in spite of the wage hike that has been rolled out during the quarter for the significant amount of the Tata Elxsi employees. In terms of the brief margin walk, we have an impact of 140 basis points from the salary hikes plus the ESOP cost that we have taken for a month in this quarter because, as we mentioned in the last quarter, that we went ahead and we got an approval for the employee stock option plan. So that has been rolled out and communicated to the employees in this quarter.

The cost for 1 month has come in. So, including both wage hike and the ESOP, the impact is about 140 basis points. We continue to reduce our contractors since we have better bench strength and the training on campus is available to us. So that provides us a leverage of about 40 to 50 basis points to do that reduction and rollover from the TPC contractors to our own employees. We have exchange movement gain of about 20-odd basis points on to the margin walk.

Another 50 basis points coming from the other operating leverage in terms of the pyramid rationalizations and improvement in the utilization with the volume growth and the scale. So that makes a total of 20 basis point impact on a quarter-to-quarter sequential basis on our operating margins.

Moderator: Thank you. Next question is from the line of Vimal Gohil from Alchemy Capital. Please go ahead.

Vimal Gohil: My question is again on automotive. Sir, how should we see the performance in the last 2 quarters versus what we are experiencing and reading about in the overall automotive industry, given the fact that most of the OEMs and Tier 1, Tier 2 suppliers are also talking of areas where we are heavily invested in. These are high-growth areas and there is an urgency of investments over there being spoken about by our potential and existing customers.

So how should we reconcile our relatively softer performance there? And what gives us the confidence that Q2 should be much better? Is it all related to macro because macro clearly tells us that, things are moving probably faster than what we expected in the automotive space, especially. Thanks.

Manoj Raghavan: Yes. I think I've answered that question. So, the deal pipeline is pretty strong. We still have pretty large opportunities that we have placed bids on and what was supposed to be closed in early part of Q1 is still open. So, customers are definitely taking their time, especially on large bids and so on. So, I think it is natural during the current macroeconomic situation. Customers are being careful before they roll out, especially the large deals and so on. So, I think the fact is that we have a good pipeline, and we see closures happening in Q2. That's the discussion we've had with a number of our customers. we really hope that additional revenues will kick in during Q2. So that's the confidence that we have.

Vimal Gohil: Understood. And sir, within Broadcast and Comms, have we essentially bottomed out will things continue to remain soft for the entire year? And lastly, just one point on Transportation as well. Given our last 2 quarters of performance, do we expect FY '24 growth rates in transportation to be lower than what we had in, let's say, '23. Would that be a fair assessment? Thanks, that’s all from my side.

Manoj Raghavan: No, we wouldn't want to call out anything at this point in time given that we are only in the Q1 of the financial year. I think we would definitely want to wait and see at least a quarter or more, right, to make that sort of a conclusion. But we still remain pretty confident that we are in a good wicket as far as our transportation or automotive business goes.

Regarding the Media and Communications business, it's not just us, it's the entire industry. You see multiple of our competition has also shown either degrowth or significant degrowth in that business. Thankfully for us, we have held our ground. Even though we have not grown significantly, but I think we have done a very good creditable effort to maintain our business directives.

And especially if you look at our top 5, top 10 customers, I think we've actually won deals and improved our market share as compared to our competition. Having said that, Media and Communication industry is still pretty soft. I wouldn't want to call it a washout for the full financial year, I think we would want to wait watch and see how the deal closures happen in Q2 and then take a call on how the industry is.

Moderator: Thank you. The next question is from the line of Anika Mittal from Nvest Analytics. Please go ahead.

Anika Mittal: Sir, my question is from the Healthcare segment side. So, what is your near-term outlook on this particular segment for FY 2024?

Manoj Raghavan: I think over the last 2 quarters, I think the Healthcare and Life Sciences business did not show the growth that we were expecting, and I think that is also because of the transition in the Euro MDR activities and that has taken us a couple of quarters to get over that. But I think this quarter, we have demonstrated good new deals and good product wins there. So that has really helped us to show a good growth.

We are pretty optimistic that we will be able to show this continued growth in the subsequent quarters also. But I will not be able to give you a number for the financial year. We don't give that projections. But I think we are on the recovery path, and we hope to grow back to our earlier growth rates in this business pretty soon.

Moderator: Thank you. Next question is from the line of Bhavik Mehta from JPMorgan. Please go ahead.

Bhavik Mehta: Thank you once again. Just on the margin bit, is wage hikes done for a large part of the employees or should we expect some wage hikes to come in 2Q as well?

And secondly, your net employee addition has seen an uptick this quarter. So how should we read that? I mean, is there a sign of improving demand do you see going forward? Or is this a way to optimize the cost by reducing the dependence on subcontractor where you want your own employees to be utilized more on the projects.

Manoj Raghavan: So, I'll answer that. So, I think we have given wage hikes in Q1 for all our junior staff. I think almost 70% of the headcount, we have given the wage hikes. For the senior staff, the wage hikes would come in this quarter from July 1 onwards, right.

So, the new hires that we have been doing, I think it's something that we continue to do, we're not looking at a quarter-on-quarter basis to really squeeze the hiring. These are offers that we have made, and we continue to honor all the offers that we have made. We strongly believe that we need to build our resource pipeline for the future quarters. And I think this is an ongoing…, we're not really diluting that focus of stopping hiring and so on, we continue to hire at our normal rate. That's also because of our confidence that the industry will recover and the bench that we build today will be useful for us moving forward.

So, we are not taking a very short term-ish approach here. And I think since we have maintained our EBITDA margins and we are doing reasonably well, that also gives us a cushion to really go ahead and not take those knee-jerk reactions.

Bhavik Mehta: Okay. Got it. And just lastly, on generative AI, how should we look at the impact of generative AI on the engineering services business? Any color over there will be very helpful.

Nitin Pai: Absolutely. This is Nitin here, Bhavik, maybe I'll take that. The way we see it, is twofold. On one hand, in products per se, especially because of the fact that we deal with physical products, whether it's a car, whether it's network equipment, boxes and services on medical equipment, the direct impact of generative AI on such products is very limited. Why? Because they all deal with, if I may use the word specific AI.

So therefore, the kind of training that you do, the kind of models that you build, the kind of algorithms that power an autonomous car, or medical diagnosis, or recommendation engine are quite different from what would classically use ChatGPT or generative AI for. So, to that extent, AI becomes more and more relevant. AI becomes more and more predominant within the portfolio of customers, but it's not coming from generative AI per se.

In our view, generative AI has some impact on product development to the extent that we are working on how can you aid coding, especially as a starting point rather than starting from scratch, how we can improve testing using generative AI, especially where you had to spend time on creating test cases, describing use case scenarios, there are certain benefits to using generative AI, which are already in the works for us in each of our segments.

But the overarching comment would be that in the product engineering business, it has lesser impact. It has far greater impact when you talk of areas like marketing, customer experience, customer care and so on. These are typical BPO/KPO activities. You can straight away imagine that the impact there is far, far higher, and we have no play in those.

Moderator: Thank you. Next question is from the line of Rohan Nagpal from Helios Capital. Please go ahead.

Rohan Nagpal: Could you talk a little bit about the demand trends that you're seeing across North America and Europe? I see a decline in the revenue mix coming from the U.S. and an increase in Europe. So, can you give some color on the differential demand that you see?

Manoj Raghavan: Yes. I think just based on 1 quarter's data, it's very difficult to make any very clear reasons as to why demand is lower in 1 region or another. If you look at it, maybe a couple of quarters ago, I think our demand from North America was fairly strong and so on. So that keeps happening. But in general, let me tell you, a lot of our Europe revenue is transportation-led, whereas a lot of our North America is Media and Communication-led. So, to that extent, the relative slowing down in Media and Communication vertical can be directly correlated to the North America market.

Having said that, the medical business is also pretty strong in North America. So, we're really hopeful that, that piece will pick up. So, we look at it, both North America and Europe as very, very key strategic geographies for us. And we continue to invest in those geographies. You would have seen the press releases and we talked about opening a new office in Troy. So, we continue to invest in these geographies. And we are hopeful that growth will return eventually.

Moderator: Thank you. Next question is from line of Arun from Subh Labh Research. Please go ahead.

Arun: First of all, congratulations to the management team for continuing with the steady good set of numbers in a tough economic environment…

Moderator: Arun, your voice is not coming clearly.

Arun: First of all, congratulations to the management team for continuing with a steady operating performance in the tough macro-economic situation. My question is to Mr. Gaurav. In the current quarter's financials, we can see in both the segments, especially in software development segment, our absolute profit has increased much more than the revenue. But some unallocated expenses have impacted our overall profitability. So, if you can share some more detail on the increase in unallocated expenses that will be quite helpful.

And the second question is, this quarter our effective tax rate has increased due to tax already paid completed in two of SEZ. So, can you guide for this financial year as a whole, whether this will be the benchmark rate? Or do you see any further changes in the effective tax rate?

Gaurav Bajaj: On your first question on the segment results. I think you are bringing it from the segment results. Under segments, since we embarked on the digital transformation, we did a little bit of reclassification with internal changes in the methodology of the allocated and non-allocated expenses. To that extent, you see that there is a difference from quarter-to-quarter. But what we have published in Q1 would be the basis going forward in the future. So, you should do the benchmarking and compare it on the quarter 1 basis going forward.

On your second question on the effective tax rate, I think we have been highlighting in the last couple of quarters that we will be coming out of couple of undertakings in the SEZ where our tax bracket exemption will move from 100% to 50% and you will see the impact of the same coming in this financial year. So, whatever is the ETR for the current quarter would be the threshold and the range for the tax rate going forward in this financial year.

Moderator: Thank you. Next question is from the line of Satadru Chakraborty from Chakraborty Family Office. Please go ahead.

Satadru Chakraborty: Congratulations on a decent set of numbers. I don't have a lot of finance-related questions, but a bit more on the macro side. So, the first question maybe is on the Transportation vertical per se. The question is really around software-defined vehicles because I see a lot of Tier 1, Tier 2 OEMs going from a product to a solution side. A lot of them are now trying to sell SaaS solutions.

So, my question really was how do you guys see all of this integration into the global market going ahead? Because it seems to me that the market is just not having a lot of standardization. And then if you have a brake supplier, if you have a battery supplier, if you have an engine component for you or they are doing their own solutions, how easy or difficult is it to integrate all of these in the digital stack and then give this out as a package, if you will, to an OEM client?

Nitin Pai: Hi Satadru. This is Nitin Pai here. Maybe I'll take that. On one hand, if you look at software-defined vehicles, I think it's fundamentally driven by OEMs, and it has been driven precisely with that point in mind, which is that ultimately, the car is an amalgamation of software, hardware and mechanical elements coming from thousands of suppliers. And a lot of these are black boxes.

And therefore, if you're trying to drive performance out of all of those, if you're trying to speed it up or create agility out of how you update functionality and features in the car, you not only have to work with the same thousands of suppliers, but each of those changes cost you money and each of the changes require you to go through a full validation and certification cycle.

So, to that extent, I think the premise of SDV is exactly that, there are 2 opportunities. One, the opportunity to create agility in the features and functionality of the vehicle, both what is going to be delivered and produced newly, but also what is available already in the field through software updates. So that's part one.

And I think part 2, which is more interesting, is equally the monetization opportunity. Now you have a connection to the consumer directly, which was otherwise not available to OEMs, they were only connected through dealers. It's only dealers who had a relationship. So that relationship now create opportunities to monetize. And that monetization can take completely different paths, right, from subscription-based features to over-the-top services that you can deliver and so on so forth.

So, I think the point remains that software-defined vehicles are here to stay. The level of software defined is always a question. I'll just call it software-centric because different OEMs will require and can afford different levels of ownership. In some cases, it may not even be necessary to try and own everything. You may just choose to take a selective view on what software you own, what software you run. But I think the premise is very clear, agility and monetization. So that's, I think, a one-way street. You will see that change. So, I hope I kind of addressed what you want to do understand.

Satadru Chakraborty: Yes, absolutely. That's very helpful. Similar sort of question on the healthcare and life sciences space. I was sort of trying to read up on balance sheets of a few global medical device companies. For some reason, the last 2, 3 quarters have been very choppy for them. I mean the pharma companies are struggling, but the med devices are struggling even more. I just had a very generic question on how do you guys see the creativeness of this space going ahead?

Because I know that gross profit margins are high. And I know that there are a lot of software definition happening in the med devices space, a lot of connected devices, IoT and then running analytics on top. So just give me a sense of how do you see the overall market getting better or worse? And how are you guys planning to play in this market, basically setting up and yourself for the future?

Nitin Pai: Sure Satadru. This is Nitin again. So, I'll take that. If you look at the premise on which we, in fact, even built a focus around the medical devices and the health care industry, it was based on the fundamental presumption that in general, the health care industry has been fairly conservative. Product life cycles are very, very long. In fact, there are devices that were designed 15, 20, 25 years back that continue to run.

And the advent of cloud, AI connected devices essentially means that you can actually afford to deliver a far more superior customer experience, far more data-led insights that directly affect patient outcomes and health. And therefore, it is essential that all products actually pivot to, in some sense, equivalent of the car. You need to be connected, you need to be automated, I'll not call it autonomous, and you definitely need to look at electronification because a lot of the previous generation medical devices were electromechanical rather than electronic.

So that's the premise on which we've built the business, and you'll see that over the last 5 years, from the time we started, we have moved from 0 revenue to about 15%, right? And that's been a business that's grown almost 10% quarter-on-quarter for a few years. So to that extent, I think there is confidence that the industry is actually behind the automotive industry in terms of the transition that it needs to make, even though there are no regulations that are driving it, unlike in the automotive industry, where you have sustainability, you have ESG concerns that put stakes in the ground as far as countries are concerned.

This is really an opportunity to change because that is what will sell in the future. That is what will create monetization in the future. So, to that extent, I think there is great confidence that, that pivot has to continue. Software, cloud, IoT, connected devices, intelligence. That is an inexorable path for medical devices. All of them have to get there.

The pharma industry has to adopt it to some extent, too, in the sense that as pharma industry moves from prescription-based billing to outcome-based billing, you will need to then monitor patient vitals, you will need to provide for patient tracking and so on. All these are devices that will do it, because the drugs will be then decided based on the markers and that will be personalized based on the actual patient profile. So, in our view, I think the fundamentals of electronics and software becoming the dominant part of what medical devices company you need to do, is a given.

The rate that we'll do it at is not driven at the same rate as automotive because automotive has priorities coming from regulatory and regional or country-based decisions that have been made on when they will stop or turn off eyes and so on. The medical device industry does not have that trigger but has a trigger of 'how do I make money in the future'. So that is what creates absolute confidence. And I think this is just the start of that.

We know it's the conservative industry. It's difficult to get in. There are barriers of entry, but we have a marquee set of logos that we work with, we are quite confident of our ability to stay incredibly relevant to these companies.

Satadru Chakraborty: Maybe just 1 last question from my side. This is let's say, mix of talent management/key factor that you guys train. It always fascinates me how a company can play in these 3 diverse EPD verticals and still be successful. I know the broad-based argument that if 1 sector doesn't go good, then you can diversify and so on and so forth. But if I look at a company -- if I look at the big, big outsourcing firms such as the Accentures, the Capgeminis or even a big brother like TCS. So, for them, that makes sense.

But I'm always curious how you guys think of talent because these are 3 are so diverse verticals where the domain knowledge is very different. The software standards are so different. So apart from the fact that, of course, you can have some basic level of integration, how do you guys just manage talent and just see these 3 very diverse vertical sustaining?

Because I'll be very frank, I haven't seen another company like Tata Elxsi doing so diverse verticals and still having so great returns over so many years. So how do you guys look at talent management and these 3 diverse verticals in general?

Nitin Pai: So, Nitin, again. Again, just like Coke or KFC, I'm not going to reveal all our secrets. But having said that, maybe I'll start with the fundamental point, right, that when you have been doing this for 25 years and more, and this is the only business that you do, believe me, there's a whole lot of ingrained company knowledge that reflects in its processes and its quality systems in the way we both hire and manage talent. So that's the first fundamental building block that we build on.

Equally, we also acknowledge the fact that these 3 industries are so different that the domain knowledge, especially as we move quickly up the seniority and experience levels, demands that you have training programs, you have training methodologies, you have quality systems, you have everything that is different for each of these verticals. And to our advantage, I think that's also a core competency. That's also what makes it very difficult for a generic IT player who depend on fungibility, who depend on training that is industrialized. I mean you would have trainings that people take us for 15 days, 1 month and they are ready for billing. For us, it's nowhere close to that. For us, it's multiples of that timelines to get people ready. But I think that's the way we do business. And hopefully, that's the secret sauce that we bring.

Moderator: Thank you. Next question is from the line of Chirag from as Ashika Institutional Equities. Please go ahead.

Chirag: Sir, I want to understand the development that is happening in the India across the sector like the EMS, defense, automotive and rail. Order bidding is going to the global players, some of them are our clients. So, I want to understand our relationship with them - how are we going to benefit by taking orders from the global OEMs, which are fueling the growth of the Indian economy for the diverse sectors?

Nitin Pai: Yes. Maybe I could take that. Very quick view is we definitely have this for multiple sectors, whether it's automotive or whether it is rail and adjacencies, where there are programs that are won by suppliers to supply to OEMs or to programs in India, including rail. We find that we are supporting those programs. And our relevance becomes even higher, especially if you're competing with regional- or overseas-based competition.

So, to that extent, the fact that we are in India, within proximity, understanding of those customers, ease of communication, ease of coordination, I think only adds to our attractiveness. But please note, having said that, any program in India obviously comes from past equations that are quite different from, let's say, doing the same project for a deal in Spain or a deal in the U.S. and so on. So, you also have to live with that challenge, which is that you will have that much more of a pressure on the pricing and the deal value. So, it's a conscious balance that we have to strike in terms of what is right for us, what is relevant and despite the fact that we can win almost anything that we bid for.

Chirag: And how is the supply side scenario situation in Europe and the U.S.A. for manpower and other related sir?

Manoj Raghavan: Yes. I think as you know, 90% of our resources are based in India. It's only 10% that are based overseas. So, to that extent, I think we are less dependent on resources in the overseas market. Having said that, I think the resource situation definitely has become a lot easier. We are able to hire resources on need basis. But in general, as Gaurav said, we are reducing the dependency on third-party contractors and filling positions using our own internal resources for better margins. So that will continue that approach.

Moderator: Thank you. Next question is from Akshay Ramnani from Axis Capital. Please go ahead.

Akshay Ramnani: So, first question for Manoj. So, you said that the deal pipeline gives you the confidence of growth acceleration going through FY '24. Now this is despite another comment of soft Media and Communications at least in the near term. So, I just want to understand - is the strength of transportation and medical enough to power that growth acceleration going forward? And while you're talking about demand, if you can also talk about how do you see the IDV business going forward?

Manoj Raghavan: Sure. So, I think, yes, as I said, growth has come back in our medical business, and we definitely hope that we will see some acceleration in our transportation business moving forward. Media and Communication, yes, we are still hopeful though it is very difficult to give a comment in terms of how much of recovery will happen. But definitely, as compared to a lot of our peers and other global players, we still continue to deliver value to our customers and at least not degrow in that Media and Communication business. So that's something that we will constantly keep a watch on.

Regarding the Industrial Design business, as I said, it's a smaller business. It's a very, very critical business for us. As compared to last financial year, it has grown significantly. But however, on a quarter-to-quarter basis, we see some amount of flatness and some amount of ups and downs. It's still in the early stages to see how we can have a steady quarter-on-quarter growth there, but that's something that we are working on. We definitely are hopeful that the Industrial Design business will also continue to grow significantly over the next 3 quarters for the financial year.

So, I think all of that gives us the confidence that despite the Media and Communication business being a little soft, the other businesses that we have should definitely be able to continue the growth path and essentially help us to show a decent growth in the financial year.

Akshay Ramnani: Right. So, on IDV business, over the past 2 quarters we have seen a flattish performance. So, is this more to do with stand-alone IDV customers? Or is it some EPD vertical-specific customers where we have seen some softness on the IDV side?

Manoj Raghavan: It is a combination of both. IDV also does a lot of work for the Media and Communication business. So that part of the business is a little slow, similar to our EPD business. But however, IDV also has their own independent customers. And we are really focusing on that to see how we can grow that business.

Akshay Ramnani: Got it. Next question is for Gaurav. You talked about 1 month of ESOP cost impacting this quarter. When I look at the release, the release shows that about INR40 lakh of ESOP cost was recognized in Q1. So even for 1 month, that number appears quite low. So, if you can please help me understand this quarter's ESOP expenses and how do you see the sustainable cost which we should think about going forward?

Gaurav Bajaj: The first month, the cost is low. It depends upon the number of the grant units that has been communicated to the employees. There is still some communication, which is left to be done, which will be done in quarter 2. Hence, what we talked about in the previous quarter earning call also, that going forward, the impact for the PSOP grants once done completely to all the employees would be about 0.4% to 0.5%.

Akshay Ramnani: Got it. And since we have also rolled out the wage hikes for the next 30% employees, so, what kind of margin impact would that have in Q2?

Gaurav Bajaj: So, we are still in the process of working out rate hikes and the impact for the remaining employees, which will happen effective quarter 2. But I think with the scale and the growth that we expect to have in the next quarter also, we don't see any significant impact. There will be some wage hike impact. But at the same time, we feel that can be compensated with the other operating leverage and the growth in the total volumes.

Akshay Ramnani: Got it. And then coming to the utilization part. Sir if you can just touch upon what level of utilization are we operating at? And what's the sustainable level which you think is good for the company.

Manoj Raghavan: I think currently, we are operating at 72%, 72.5% utilization. I think that is also because of the fact that a number of fresh engineers that we have hired have come out of their training period and now they are on the bench. So, the good part for us is we have pretty good bench strength now. As the business picks up, all the training investments and all the hiring investments that we have put in, we will be able to use them and grow our revenues.

So, for us, we would be really comfortable to see how we can push this utilization from 72% to 72.5% over a period of time to somewhat closer to 80% or so, right? So that will be something we are aiming for. And so, as you see, we have enough headroom and leeway to utilize these trained resources. And that's something that we will focus on in the next few quarters.

Moderator: Thank you. The next question is from the line of Nitin Gupta, Individual Investor. Please go ahead.

Nitin Gupta: Yes. My question is with respect to hiring - what are the plans for the complete financial year?

Manoj Raghavan: So, for the complete financial year, if you look at hiring of freshers, we would be hiring around anywhere between 1,800 to 2,000 engineers, of course, depending on the joining ratios and so on. Lateral hiring will be always need-based, based on specific projects or engagements, but given the fact that we have enough bench strength, I think we will first focus on utilizing the bench strength before going out and hiring laterals.

Nitin Gupta: And the last question would be - can we expect these kind of margins going ahead for the full financial year?

Manoj Raghavan: We don't give margin guidelines. You must look at our track record over the last 8 to 12 quarters. You will get the answers for your question.

Moderator: Thank you. Next question is from the line of Rajak Kumar, individual investor. Please go ahead.

Rajak Kumar: Just 2, 3 macro questions. The first one is on the ADAS technology. So, I just want to know, given that we are part of the Tata Group, how do you make insights with other vendors given our exposure with JLR and others, with competition like Samsung who are better placed compared to Tata Elxsi. So how do we overcome this?

Nitin Pai: Yes. So maybe I'll take that. Technically, we don't compete with Samsung. We are a potential supplier to Samsung. And when you say Samsung, I presume you mean it in the context of HARMAN. So, to that extent, HARMAN is a customer rather than a competitor.

So, in that sense, there is no conflict of interest here. And it's not to do with whether we work with Tata Motors or JLR or not. The question is, do we have capabilities on the software side that add to what they are trying to do in terms of product engineering and product development. And to that extent, we're incredibly relevant.

Rajak Kumar: Okay. Got it. And second thing, are we developing any robots linked to the Da Vinci, over on the medical side? Because I've seen your website, it talks about the industrial robotics. So, I just want to know what work we are doing on the medical side?

Nitin Pai: Yes. So there is automation - I'm not call it fully robotized surgery or fully automated surgery, but there is a fair amount of work that we're doing, both with AI as well as robotics that has to do with automating and bringing in precision surgery. But at this time, that is all that I can tell you.

Rajak Kumar: Currently, that is the only US FDA approved robotic system, right?

Nitin Pai: That's right. So, to that extent, that's why I'm hesitant to say that we are working with fully robotized systems. But there is some level of automation and precision surgery that happens in multiple other spaces. Think about eye care, for example. You will see that there are laser-guided surgeries that work on cataracts and so on so. It's not that there is no robotic surgery in other areas.

If you look at cancer there are equally guided robotic treatments that happen for chemo, radiation and so on. So, I would encourage you to look at is the fact that robotics and automation applies in many levels, just like in cars, from Level 1 to Level 5.

Rajak Kumar: Okay. No, my question is more from a strategic standpoint. So, like on a 3-5-year standpoint, will we be challenging Da Vinci systems?

Nitin Pai: No, no. So please note, again, like we made the comment on Samsung and so on. We would hope that we work with Da Vinci and create many more Da Vincis by supporting them.

Rajak Kumar: And lastly, how is the opportunity from the in-flight entertainment, given that Air India is now part of the Tata Group? And there's a lot of things happening on the aviation sphere. So, are we going to leverage any of this and get more work in this space?

Manoj Raghavan: In-flight entertainment is a very niche area, and I think there is just a couple of companies that work on it. So, the opportunity is not very big in that sense. But however, as you rightly said, Air India definitely is a group company and there are a lot of other opportunities that we are working with Air India and supporting them, not necessarily on the in-flight entertainment. But yes, if there is an opportunity, we would definitely get involved because we bring in enough competencies on audio, video, the play out, the entire video capabilities that we have in the Media and Communication business is fully relevant to this use case.

But then there are definitely a lot of regulations, safety and a number of standards that you need to understand. So, to that extent, yes, the opportunity is not as big to really focus and go after that. And the number of players are also very, very limited. But we are in discussions with Air India for a lot of other opportunities. And yes, we will leverage Air India to see what we can do in the avionics or airline industry.

Moderator: Thank you. Next question is from the line of Rohan Nagpal from Helios Capital. Please go ahead.

Rohan Nagpal: You break out your vertical exposure for the Embedded Product Design segment. And you briefly touched on the vertical exposure to the IDV segment. Could you flesh out the vertical exposure in the IDV and SI segments as well?

Manoj Raghavan: I think about 3 to 4 years ago, IDV had its own set of customers and they used to go around. But we consciously took a decision to focus IDV capabilities around the same 3 verticals that we have, which is Transportation, Media & Communication and Healthcare. So today, if you ask me a majority of our revenues in the IDV space come from these 3 verticals. Of course, there are a number of other verticals that we go after that EPD doesn’t service.

So yes, so there is a lot of effort and focus that we have brought in, including from a sales perspective, to really cross-sell IDV into all our EPD customers. So that's something that we continue.

SI is a totally different business. SI is primarily based out of India. It provides system integration services to a different set of customers, not necessarily the 3 verticals. And that's something I think would be a little more opportunistic. And of course, even in SI, what we're trying to do is to see how we can leverage SI capabilities to address the 3 verticals in EPD. It's at an early stage. IDV has progressed a lot, but SI is still at a very early stage.

As we look at building our own products and so on, SI place a very, very key role on the run management part, especially on the cloud and data center and so on. That is where we intend to use their capabilities. But again, as I said, it is still pretty early stage there.

Nitin Pai: I'll just add one comment. At this time, the fact is IDV is a little volatile, it's not exactly a constant number quarter-on-quarter and does not allow us to publish a mix because you cannot read very much from it. I think if you give us a few quarters, and that's something that we're consciously deciding, we'll be able to draw a clear signature to say, okay, this much percentage you can trust to come from automotive. This much you can trust to come from media. And we have a certain amount of sustainability or rather lack of volatility that makes it meaningful to publish the breakdown.

Moderator: Thank you very much. Ladies and gentlemen, we'll take the last question from the line of Satadru Chakraborty from Chakraborty Family Office. Please go ahead.

Satadru Chakraborty: Just 1 final follow-up question. And maybe feel free to answer it as you see fit or not. This is really around the IPO of Tata Technologies, which is coming out. So maybe my preliminary observation is very bad. But I do see there are a lot of similarities. I mean, from the very quantitative stuff, I have seen that our related-party transactions happened in '21 and '22. Just help me understand why should we treat it as 2 different companies? And what is really the strategic differentiation within the Tata organization that we have to really differentiate between the two. And I know the history on the corporate structure and Tata Motors wants to spin this off. But just what is your two cents on this? What does an external investor look at?

Manoj Raghavan: Yes. So, as you rightly pointed out, Tata Technologies is a subsidiary of Tata Motors. And they also have a significant portion of their revenues coming in from group companies, which is Tata Motors and JLR and so on. And they primarily play in the mechanical engineering space. They do work on ERP, which is SAP and so on. And recently, they have built capabilities in the avionics industry with Airbus and so on. So that is what Tata Technologies stands for.

Tata Elxsi, on the other hand, is a full-fledged product engineering business. Majority of our business comes on electronics and embedded software domain. And we work across 3 different verticals, right, Automotive, Healthcare and Media & Communications. So, to that extent, if you look at it, if you look at the automotive industry, it might seem as if there is a clash or a conflict situation. But actually, we are pretty orthogonal, the service offering is pretty orthogonal. So, there are customer places where we work together and provide services and solutions to the customer. So, to that extent, I would say, we definitely can continue to co-exist as 2 different companies.

Moderator: Thank you very much. I now hand the conference over to the management for closing comments.

Manoj Raghavan: Thank you all for taking the time out for this Q1 conference call. We definitely hope to see you again in the Q2 conference. And definitely, there is a lot of commitment from our side, from our employees, to ensure that we deliver good results in the coming quarters. So that's something that we are very much aware of, and we continue to pursue these large strategic deals that will really help to show consistent quarter-on-quarter growth. And that's something that definitely we will stay focused on. Thank you so much once again and look forward to seeing you again next quarter.

Moderator: Thank you very much. On behalf of Tata Elxsi Limited, that concludes this conference. Thank you for joining us. You may now disconnect your lines. Thank you.

Audio recording of Q1 Earnings Conference Call

Note: This transcript has been edited for readability and does not purport to be a verbatim record of the proceedings.