Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 723**	
Price Target: **Rs. 900**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 9,669 cr
52-week high/low:	Rs. 847 / 104
NSE volume: (No of shares)	6.5 lakh
BSE code:	538835
NSE code:	INTELLECT
Free float: (No of shares)	9.1 cr

Shareholding (%)

Promoters	31.2
FII	29.7
DII	5.6
Others	33.4

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-6.5	-2.3	126.7	547.2
Relative to Sensex	-7.6	-8.3	116.5	496.9

Sharekhan Research, Bloomberg

Intellect Design Arena Limited

Clicking on the right opportunities

IT & ITeS | Sharekhan code: INTELLECT | Company Update

Stock Update

Summary

- We believe Intellect Design has invested well in its product portfolio and platforms over time, which positions it to capture opportunities across segments. Company recorded 32 digital-led wins in FY2021.
- We expect Intellect Design to report 21.3% y-o-y revenue growth in Q1FY2022 led by traction for products and strong growth momentum in SaaS revenue. EBITDA margin would also improve on q-o-q.
- The management expects EBITDA margin to gradually improve to 30% by Q4FY2022. Revenue/earnings are expected to clock a 17%/29% CAGR over FY2021-FY2023E, aided by strong traction for products and rise in margins.
- We maintain a Buy on stock with an unchanged PT of Rs. 900, given strong earnings growth potential and increasing adoption of digital offerings.

Intellect Design Arena Limited (Intellect Design) ended FY2021 with significant scale up in SaaS revenue (grew 47% y-o-y), improvement in EBITDA margin (to 23.9% from 5.5% in FY2020), increased digital-led wins (32 versus 27 in FY2020), strong improvement in net cash (Rs. 211 crore versus negative Rs. 121 crore in FY2020), and healthy cash conversion. We believe the low penetration of third-party banking software products (27% third party penetration in banking versus 70-80% in other industries at maturity), opening of new markets including fraud and solutions would increase addressable markets for banking software products companies, including Intellect Design. We believe Intellect Design has invested well over time in its product portfolio as its real-time, API-enabled and cloud-native products are powered by AI and ML and has developed three contextual and compostable platforms, which position the company to capture opportunities across sub-segments of banking. The company recorded 32 digital-led wins (including 15 large digital transformation deal wins) and 52 implementation go lives across the world in FY2021. Management intends to scale up iGTB products in the US and iGCB products in European markets. Intellect Design's six large liquidity management services (LMS) large deals in iGTB segment during FY2021 provide strong revenue visibility in the transaction banking segment for 3-5 years, while 18 deals in iGCB segment against strong competitions in a pandemic year and competitive pricing of its products give us confidence for sustained growth momentum in GCB business. Management indicated that FY2022 would be the first year of monetisation for Intellect SEEC as about 30-40 deals are in its pipeline with a deal size of $1 million - $2 million per annum. Management highlighted that the company has invested in Upgraded Underwriting end-to-end solutions in Intellect SEEC segment, which opens up opportunities for the company to team up with large vendors in the US, which have capabilities in the policy management space. We expect Intellect Design to report 21.3% y-o-y (and 3.2% q-o-q) revenue growth in Q1FY2022 due to traction for its products and continued strong growth momentum in SaaS revenue. EBITDA margin is expected improve by 80 bps q-o-q/614 bps y-o-y to 25.8% during Q1FY2022.

Our Call

Valuation – The company's consistent large deal wins in liquidity management in the iGTB space, strong traction for its iGCB in European market, and improving demand for its Intellect SEEC products would drive its revenue growth momentum in FY2022. Further, management expects gradual improvement in EBITDA margin to 30% by Q4FY2022 and 30% growth in earnings in the medium term. The company's revenue and earnings are expected to post a 17% and 29% CAGR, respectively, over FY2021-FY2023E. At the CMP, the stock is trading at a valuation of 30x/22x its FY2022E/FY2023E earnings. We continue to like the stock given favourable industry tailwinds, its future-ready integrated product portfolio, increasing SaaS revenue contribution, and possibilities of improving financial metrics. Hence, we maintain our Buy rating on the stock with an unchanged PT of Rs. 900.

Key risk

(1) Slower adoption of its products, 2) introduction of superior products by peers or technology disruptions, and 3) higher DSO days impacting working capital.

Valuation Rs cr

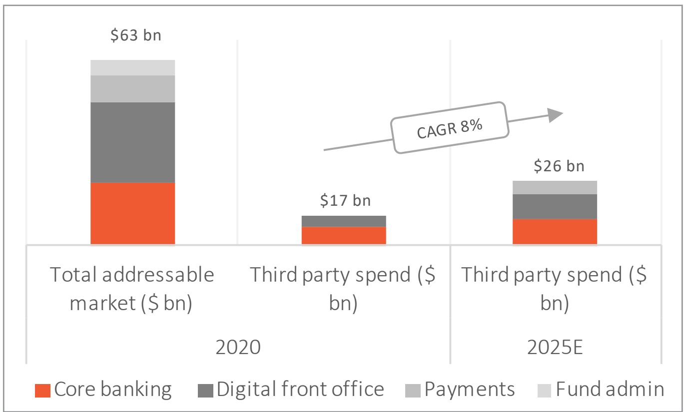
Particulars	FY20	FY21	FY22E	FY23E
Revenue	1,350.9	1,499.2	1,761.2	2,099.2
OPM (%)	5.5	23.9	26.3	29.0
Adjusted PAT	16.0	262.8	334.4	444.9
% YoY growth	*(87.8)*	*1,544.1*	*27.3*	*33.0*
Adjusted EPS (Rs.)	1.2	19.6	24.5	32.6
P/E (x)	592.5	37.0	29.5	22.2
P/B (x)	9.4	7.1	5.7	4.5
EV/EBITDA (x)	133.8	27.3	20.5	15.0
RoNW (%)	1.5	21.6	21.4	22.8
RoCE (%)	0.5	20.1	22.9	24.4

Source: Company; Sharekhan Research

Acceleration of digital shift would drive growth

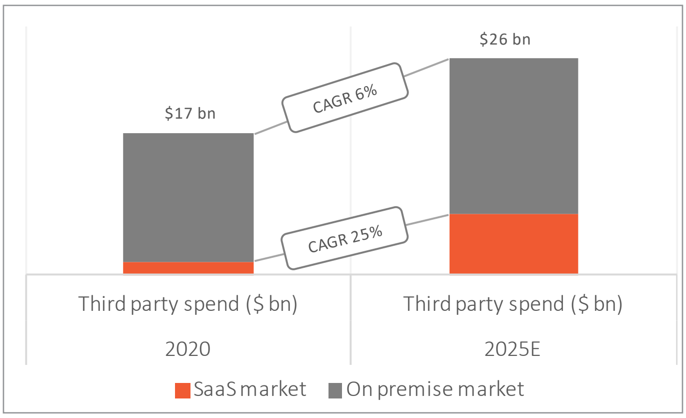
COVID-19 has been a catalyst in accelerating demand for digital transformation among enterprises across the world. Technology spends by major US and UK banking clients have accelerated after the pandemic, led by adoption of online channels by customers. Banks are leveraging technology for both cost reduction and improving customer experience. Managements of many large BFS companies remain optimistic on economic recovery going forward, which would lead to releasing of earlier credit-loss provisions. We believe the improving economic environment would result in higher discretionary spending by BFS firms. Further, banks need to accelerate digital transformation and customer experience across complex products and customer journeys given increased consumer digital adoption, reduction in cash usage, and change in consumer mindsets. We believe low penetration (27% third party penetration in banking versus 70-80% in other industries at maturity) and opening of new markets including fraud and solutions would increase addressable markets for banking software products companies such as Intellect Design. Third party software spend by banks is expected to increase at a CAGR of 8% to $26 billion over 2020-2025E.

Third party software spends continue to grow



Source: IDC, Ovum, Sharekhan Research

SaaS market to grow at a rapid pace



Source: Company, Sharekhan Research

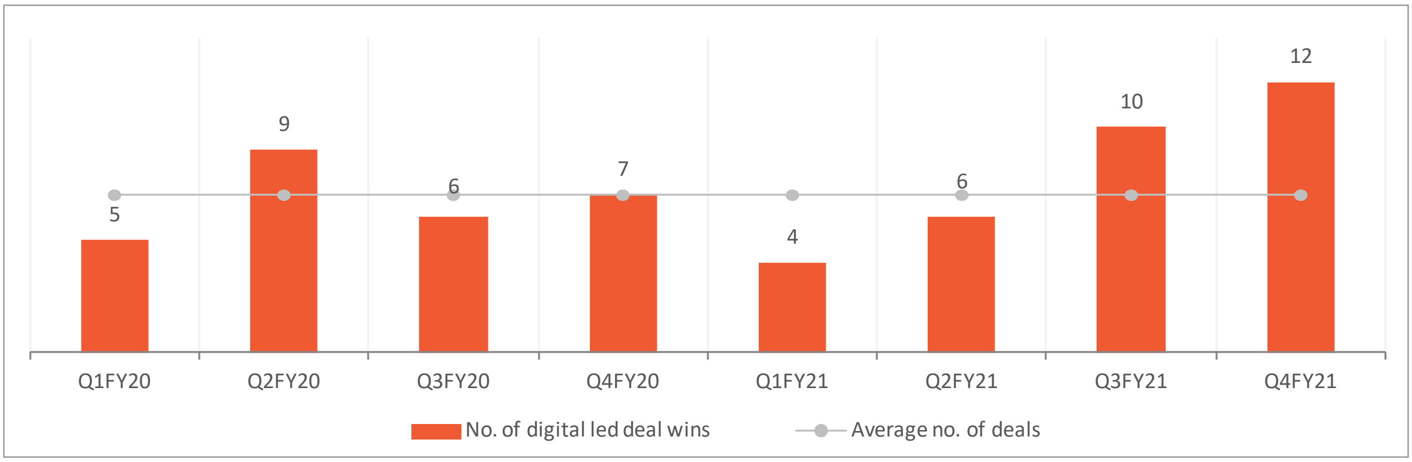
Diversified product portfolio; Well positioned to capture opportunities across segments

Intellect Design has a diversified bouquet of offerings across the sub-segments of the BFSI vertical. The company has around 12-14 product offerings across its four business segments as against 1-2 product offerings of its peers. The company goes through five stages to drive sustainable and scalable product businesses. Since the demerger in FY2014, the company has significantly invested in R&D (Rs. 1,200 crore) and sales and marketing (Rs. 1,900 crore) to increase the acceptability of its product offerings across markets. Management highlighted that it has invested $40 million+ on data and Cloud technology capabilities in the US. We believe the company has invested well over time in its product portfolio as its real-time, API-enabled, and cloud-native products are powered by AI and ML. Further, Intellect Design has developed three contextual and compostable platforms such as (1) iTurmeric API Ecosystem, (2) iFinCloud, and (3) Contextual Banking Experience in the consumer and corporate banking segment to participate in the digital transformation journey of banks. Management highlighted that the company has an edge by expanding its execution capability to 5,000 transactions per second (TPS) versus TPS of 100-200 in the industry. During FY2021, the company won 32 digital-led wins including 15 large digital transformation deal wins.

Optimistic on sustainable growth momentum; Digital-led wins remained strong

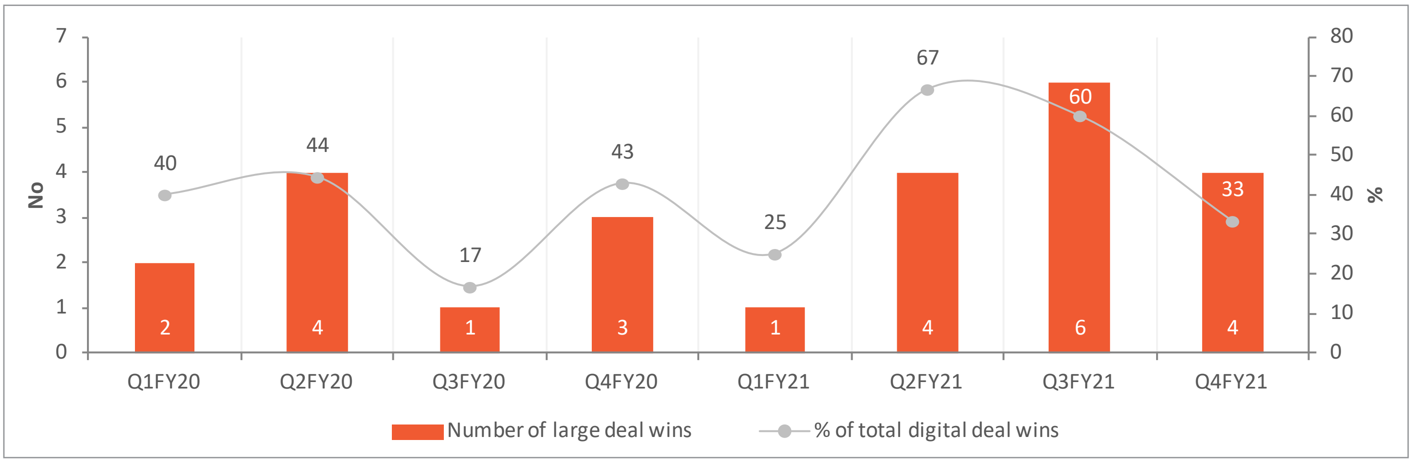
Intellect Design reported revenue of $202 million in FY2021, implying growth of 6% in a pandemic year. Growth was driven by strong 47% y-o-y growth in SaaS/Cloud revenue, 35% y-o-y growth in license revenue, and 18% growth in AMC revenue. Effectively, license-linked revenue grew by 31% y-o-y, which accounted for 54% of total revenue in FY2021 from 46% of total revenue in FY2020. OCF to net profit and OCF to EBITDA stood at 176% and 130%, respectively, in FY2021. The company recorded 32 digital-led wins (including 15 large digital transformation deal wins) and 52 implementation go lives across the world in FY2021. Management remains confident on delivering sustainable growth momentum in the coming quarters because of strong traction for its products across segments, monetisation of products under Intellect SEEC segment, cross-selling opportunities, large digital-led wins, and strong deal pipeline (up 12% y-o-y). Management intends to scale up iGTB products in the USA and iGCB products in the European markets. Further, the company has been investing in sales team, GTM strategy, capabilities in certain businesses, and new technologies to drive growth. Management expects revenue to be doubled in the next five years, implying a 14% CAGR.

Digital-led deal wins remain strong



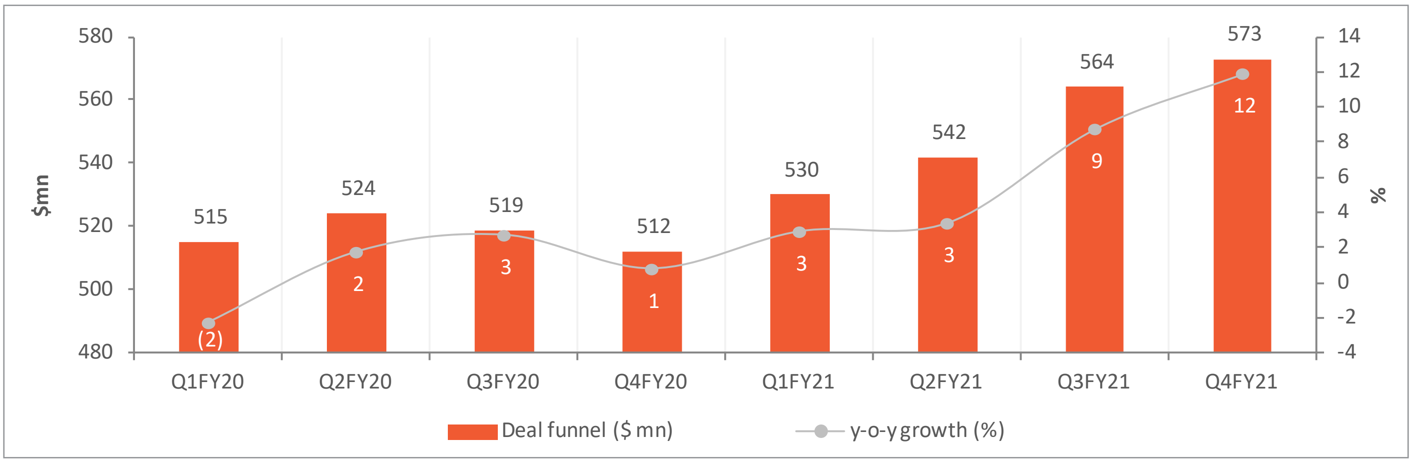
Source: Sharekhan Research

Large deal wins stay strong



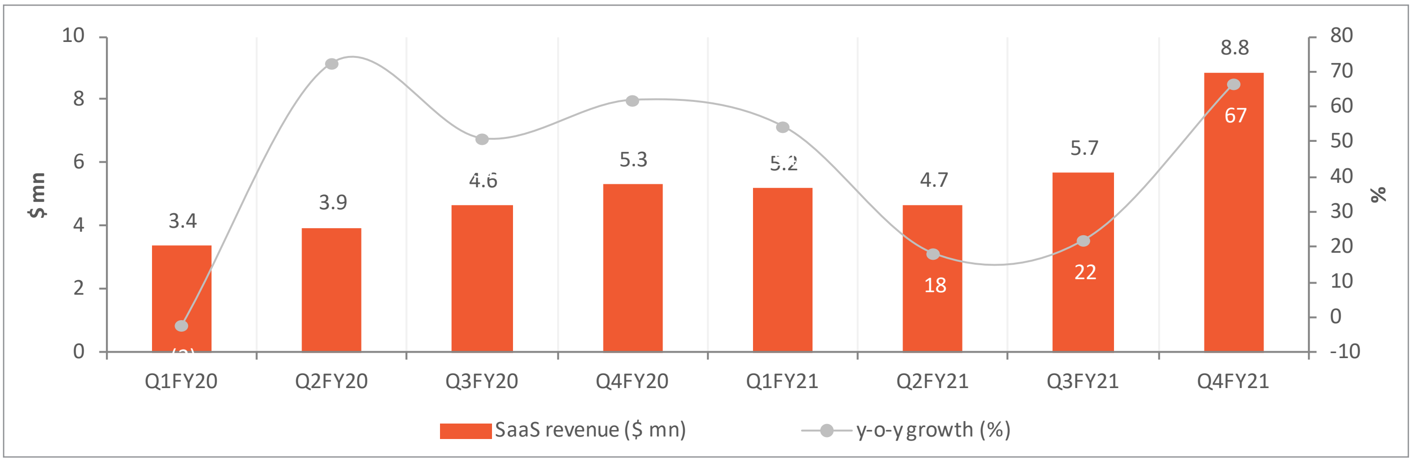
Source: Sharekhan Research

Strong current funnel, grew 12% y-o-y



Source: Sharekhan Research

Strong growth in its SaaS revenue to continue



Source: Sharekhan Research

Deal win momentum likely to continue in Q1FY2022

The company has 25 customers in America, 23 in Europe, 53 in APAC, and 139 in IMEA. This is helping the company to grow at a faster rate as it has built the regulatory framework in these countries. During FY2021, the company won six liquidity management services (LMS) large deals in iGTB segment, which provides strong growth outlook for the next 3-5 years. The company has won 18 deals in iGCB segment during FY2021, while its competitors and peers have muted growth in this segment. Management highlighted that implementation costs of its products (TCO) in iGCB segment are 10-12% cheaper compared to its competitors. Management indicated that business growth momentum in iGCB would continue in the European market. Management highlighted all of its customers in Intellect SEEC are on Cloud and subscription based. Intellect Design has invested in iSEEC with Upgraded Underwriting end-to-end solutions, which have gone live for two large US insurers during FY2021. Management indicated that FY2022 would be the first year of monetisation for Intellect SEEC as about 30-40 deals are in its pipeline with deal size of $1 million - $2 million per annum.

During Q1FY2022, the company has declared its large deals in iGTB and Intellect SEEC space, while the public disclosure for deals in iGCB is almost negligible. Management highlighted that the company has invested in Upgraded Underwriting end-to-end solutions in iSEEC segment, which opens up opportunities to team up with large vendors, which have capabilities in the policy management space.

Expect decent revenue growth in Q1FY2022, while EBITDA margin to expand

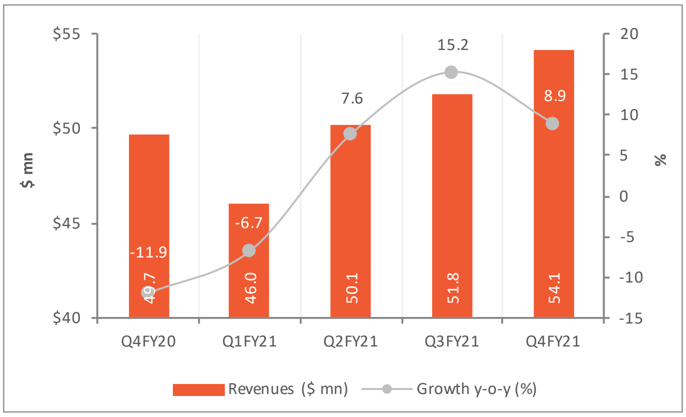
We expect Intellect Design would report 21.3% y-o-y (and 3.2% q-o-q) revenue growth in Q1FY2022 on account of strong deal wins, traction for its products, and continued strong growth momentum in SaaS revenue. AMC revenue is expected to grow around 15% y-o-y in Q1FY2022. We expect EBITDA margin would improve by 80 bps q-o-q/614 bps y-o-y to 25.8% during Q1FY2022. As a result, net profit is expected to grow at 80% y-o-y to Rs. 76.8 crore in Q1FY2022.

Expect EBITDA margin to touch 30% by Q4FY2022

Management guided 14% y-o-y revenue growth in FY2022, while it expects EBITDA margin would improve to 30% by Q4FY2022 from 25% in Q4FY2021. Note that EBITDA margin improved substantially to 25% in Q4FY2021, from 0.9%/17.8% in Q3FY2020/Q4FY2020. Margin would expand on account of change in revenue mix, higher subscription revenue, and lower R&D expenses. Management also guided earnings would post a 30% CAGR over the medium term, given strong revenue growth, led by sustained traction in iGTB business, improved momentum in iGCB segment. and potential incremental contribution from monetisation of Intellect SEEC segment.

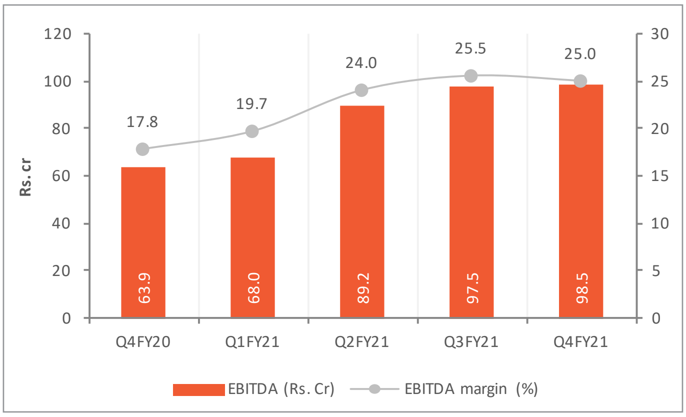
Financials in charts

Revenue ($ mn) and y-o-y growth (%)



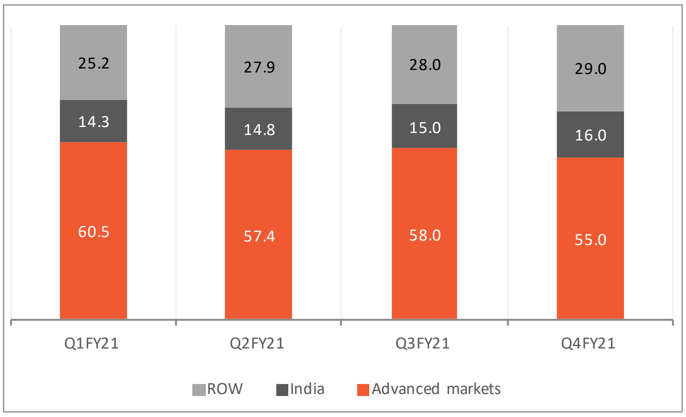
Source: Company, Sharekhan Research

Margin expansion continued



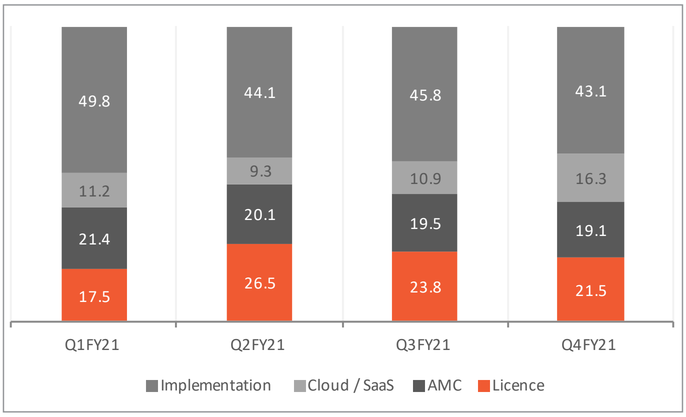
Source: Company, Sharekhan Research

Geography-wise contribution



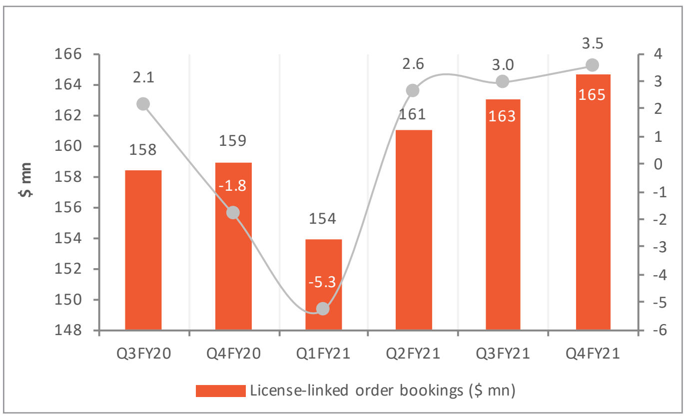
Source: Company, Sharekhan Research

Service lines-wise contribution



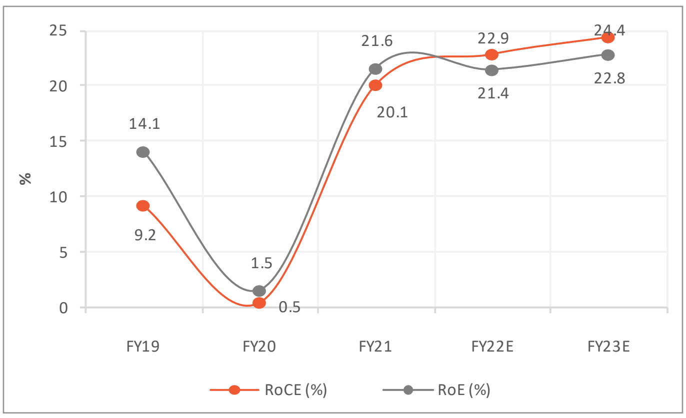
Source: Company, Sharekhan Research

Order bookings ($ mn) and y-o-y growth (%)



Source: Company, Sharekhan Research

RoE and RoCE trends (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector View – Higher adoption of digital technologies across sub-segments of BFSI**

The financial services industry is on the cusp of adopting digitisation, new-age technologies, and products as these firms have sharpened their focus on proving a seamless, real-time, and hyper-personalised banking experience to their customers. The global financial technology market is expected to register a 22% CAGR over 2020-2025, reaching a market value of $305 billion by 2025. However, third party software spend by banks is expected to increase at a CAGR of 8% to $26 billion over 2020-2025E.

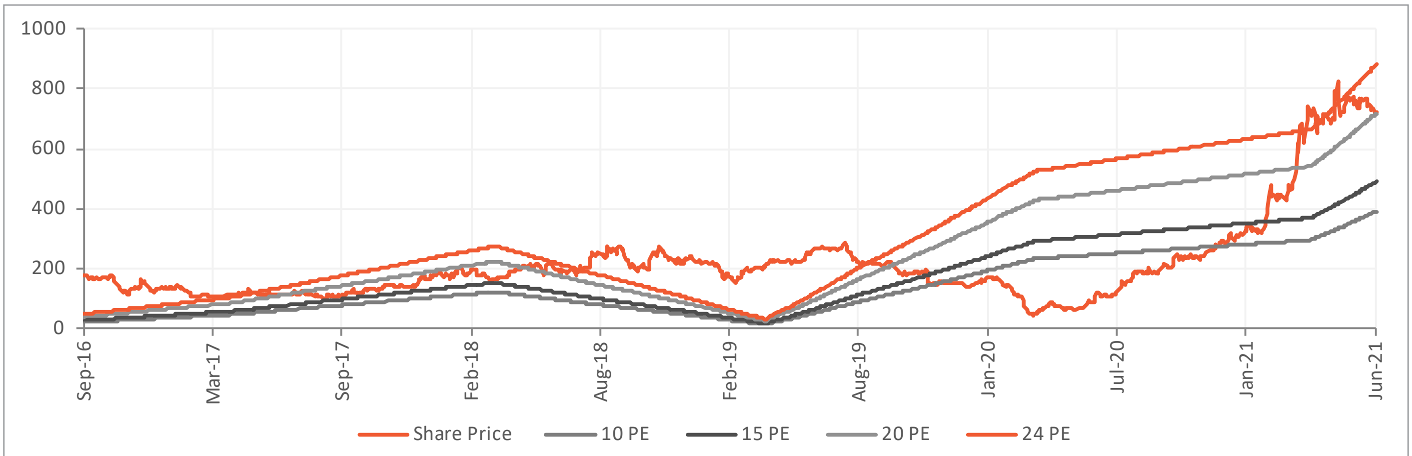
■ **Company Outlook – Quality of revenue to drive profitability and cashflow**

Intellect Design has been focusing on increasing the license component in total deal TCVs as higher license revenue would lead to higher AMC revenue. This, in turn, would improve overall lifecycle revenue from the engagement. The company's annuity revenue (AMC+ SaaS) contributes around 35% to total revenue and is expected to post a 20% CAGR over FY2021-FY2023E. Improving contribution of annuity revenue would help the company to drive its profitability and cash flow generation as well.

■ **Valuation – Best play in fintech space**

The company's consistent large deal wins in liquidity management in the iGTB space, strong traction for its iGCB in the European market, and improving demand for its Intellect SEEC products would drive its revenue growth momentum in FY2022. Further, management expects gradual improvement in EBITDA margin to 30% by Q4FY2022 and 30% growth in earnings in the medium term. The company's revenue and earnings are expected to post a 17% and 29% CAGR, respectively, over FY2021-FY2023E. At the CMP, the stock is trading at a valuation of 30x/22x its FY2022E/FY2023E earnings. We continue to like the stock given favourable industry tailwinds, its future-ready integrated product portfolio, increasing SaaS revenue contribution, and possibilities of improving financial metrics. Hence, we maintain our Buy rating on the stock with an unchanged PT of Rs. 900.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBIDTA (x)		P/BV (x)		RoE (%)	
				FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Newgen	637	7	4,454	33.1	26.7	22.4	18.3	5.9	5.0	19.1	20.2
OFSS	3,650	9	31,438	16.7	15.2	9.9	9.1	4.4	4.2	26.7	28.6
Intellect Design	723	14	10,067	29.5	22.2	20.5	15.0	5.7	4.5	21.4	22.8

*Source: Company; Sharekhan Research * Bloomberg estimates*

About company

Intellect Design de-merged from Polaris Consulting Services in October 2014. Intellect Design is a Digital Financial Technology Products Company addressing the business needs of the banking and financial services domains. The company caters to the three main verticals in the banking industry – 1) retail banking, 2) corporate banking, and 3) treasury and capital markets and the insurance industry. The company has four business units that are aligned with verticals such as Global Consumer Banking (iGCB), Global Transaction Banking (iGTB), Risk, Markets and Treasury (iRTM), and Insurance (iSEEC).

Investment theme

Intellect Design offers a wide spectrum of products across banking and insurance, which are built on microservices-based architecture, powered by AI and ML. With 12-14 products across four lines of business, the company is well placed to accelerate the digital roadmaps of financial institutions. The company has made substantial investments on talents, R&D, sales, and infrastructure to increase the acceptance of its products across geographies. Management is focusing more on profitability and cash conservation than on growth by improving the contribution of annuity revenue to overall revenue.

Key Risks

(1) Slower adoption of its products, 2) Introduction of superior products by peers or technology disruptions, 3) and Higher DSO days impacting working capital.

Additional Data

Key management personnel

Arun Jain	Chairman & Managing Director
Manish Maakan	Chief Executive Officer, iGTB
Rajesh Saxena	Chief Executive Officer, iGCB
Banesh Prabhu	Chief Executive Officer, Intellect SEEC
TV Sinha	Head – Risk, Treasury and Capital Markets
Venkateswarlu Saranu	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Amansa Capital	7.29
2	Vanguard Group	2.65
3	Gothic Corp	2.53
4	Atyant Capital India Fund	1.97
5	Ashoka India Opp FD	1.66
6	Nippon Life India Asset Management	1.60
7	Emirate of Abu Dhabi United Arab Emirates	1.27
8	AL MEHWAR COMM INVESTMENTS	1.20
9	Vanderbilt University	1.17
10	Dimensional Fund Advisors	0.90

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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