Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Intellect Design Arena Ltd

Weak quarter, investing for next leg of growth

IT & ITeS	Sharekhan code: INTELLECT
Reco/View: Buy ↔	CMP: **Rs. 667**
	Price Target: **Rs. 780** ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 25.06

Updated Jul 08, 2022

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

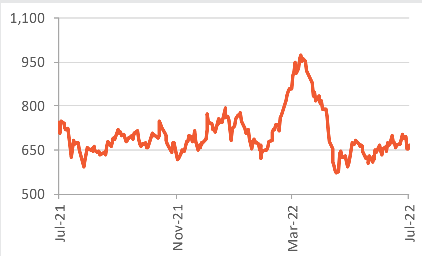
Company details

Market cap:	Rs. 9,000 cr
52-week high/low:	Rs. 986 / 564
NSE volume: (No of shares)	5.7 lakh
BSE code:	538835
NSE code:	INTELLECT
Free float: (No of shares)	9.3 cr

Shareholding (%)

Promoters	30.8
FII	28.2
DII	6.2
Others	34.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.3	-18.3	-9.0	-10.4
Relative to Sensex	-6.6	-17.1	-8.3	-18.8

Sharekhan Research, Bloomberg

Summary

- Margins weakened due to rising investments on capacity and higher travel expenses; but Q1 saw steady growth in deal pipeline, pick-up in deal wins and deal sizes and stable attrition.
- Management expects to achieve a $75 million quarterly revenue run-rate in the next couple of quarters ($70 million in Q1FY23), while it targets to achieve $90 - $100 million revenue run-rate over 8-12 quarters. Growth would be driven by strong deal wins, market expansion and investments in platforms.
- Management lowered EBITDA margin guidance to 22-25% for FY2023E from earlier 25-30% as it plans to reinvest around 4-5% of its profitability in building platform and capacity for the next level of growth.
- We maintain Buy on Intellect Design with a revised PT of Rs. 780, given strong revenue growth visibility, expansion in new markets and a strong deal pipeline.

Q1FY23 revenues beat expectations despite a $1.5 million revenue loss due to cross-currency headwinds (strong appreciation of USD against EUR and GBP), while margins missed our estimates owing to increasing talent and travel expenses. The company revenue grew by 33% y-o-y on constant currency (CC) and 26.4% y-o-y on USD terms to $70 million. EBITDA margins fell by 290 bps y-o-y to 21.6%, below our estimates, higher travel expenses and increasing investments in its platforms. Net profit declined by 6.8% y-o-y to Rs. 68.8 crore and was 28% below our estimate, owing to miss in margin, lower net other income (down 53% y-o-y) and higher tax provisions (26% versus 15.9% in Q1FY2022). Management expects to achieve a $75 million quarterly revenue run-rate in the next couple of quarters ($70 million in Q1FY23), while it targets to achieve a $90-100 million revenue run-rate over next 8-12 quarters. As a result, the company has lowered its EBITDA margin guidance sharply to 22-25% for FY2023E from 25-30% earlier as the company plans to re-invest 4-5% of its profitability in building platform and capacity for this next level of growth. We believe the company is well-poised to achieve the revenue targets given strong deal wins, healthy deal pipeline, and additional investments in building products and capacity.

Key positives

- Deal pipeline remained healthy at $805 million, up 28% y-o-y; won 10 deals in Q1 versus 6 deals in Q4FY22
- Company launched AI-based Magic Invoice Platform
- Attrition rate was less than 10%

Key negatives

- Lowered its EBITDA margin guidance to 22-25% for FY2023E from earlier 25-30%
- Platform revenue declined 5.4% q-o-q, owing to strong seasonality in GeM business in Q4FY22

Management Commentary

- Management expects to achieve $75 million quarterly revenue run-rate in the next two quarters and a run-rate of $90-100 million in the next 8-12 quarters.
- Intellect Design selected four countries for market expansion and plans to achieve at least $10 million in annual revenue in these regions over the next three years.
- Management lowered its EBITDA margin guidance to 22-25% given higher investments in building platform and capacity for the next level of growth. It hopes that the company will be able to achieve 30-35% of EBITDA margin at the $100 million quarterly revenue run-rate.
- The company has a good pipeline for its wealth products in India.

Revision in estimates – We revised our estimates downward for FY23E/FY24E by 12-15% due to margin miss in Q1FY23, sharp downward revision in its margin guidance and higher effective tax rate.

Our Call

Valuation – Strong growth outlook intact: Strong deal wins, healthy deal pipeline, continued increase in deal sizes, expanding markets into new regions, and additional investments in platforms will position the company to report market leading growth among its peers in the medium term. However, margins are likely to remain under pressure in next couple of quarters given initial phase of investments in products. At CMP, the stock trades at a valuation of 26x/19x its FY2023E/FY2024E earnings. We continue to prefer the stock, considering its differentiated capabilities in products and platforms, focus on partnerships to capture opportunity in the marketplace, continued investments in products and platforms, and strong cash balance. Hence, we maintain our Buy rating on the stock with a revised price target (PT) of Rs. 780.

Key Risks

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	FY21	FY22	FY23E	FY24E
Revenue	1,497.5	1,878.2	2,336.4	2,725.8
OPM (%)	23.8	25.1	24.0	27.0
Adjusted PAT	262.8	349.1	360.9	485.1
% YoY growth	*1,544.1*	*32.8*	*3.4*	*34.4*
Adjusted EPS (Rs.)	19.6	25.1	25.9	34.9
P/E (x)	34.1	26.5	25.7	19.1
P/B (x)	6.7	5.1	4.3	3.5
EV/EBITDA (x)	25.8	19.4	16.1	11.8
RoNW (%)	21.6	21.8	18.1	20.1
RoCE (%)	20.0	22.7	22.1	24.8

Source: Company; Sharekhan estimates

Revenue beat estimates but margins weak

Constant currency revenue grew by 33% y-o-y, ahead of our estimates, led by strong growth in platform and implementation revenue. Reported USD revenue grew by 26.4% y-o-y to $70 million despite $1.5 million revenue loss due to cross-currency headwinds (23% exposure to GBP and EUR, which were depreciated against USD). Revenue growth was driven by 40% y-o-y growth in platform business and a 45.8% y-o-y growth in implementation revenue. AMC revenue grew by 4.7% y-o-y, while licence revenue declined by 7.3% y-o-y in USD terms. Notably, the company's platform revenue declined by 5.4% q-o-q during Q1FY2023. Gross profit margin contracted by 60 bps y-o-y and 150 bps q-o-q to 55.6%, a way below our expectations, owing to higher employee costs to revenue (includes ESOP costs of Rs. 13 crore). EBITDA margin contracted by 290 bps y-o-y to 21.6%, below our estimates, higher travel expenses and increasing investments in its platforms. EBITDA grew by 16.7% y-o-y to Rs. 117 crore, but remained 8.5% below our estimate. Net profit declined by 6.8% y-o-y (but declined by 27.8% q-o-q) to Rs. 68.8 crore and was 28% below our estimate, owing to a miss in margin, lower net other income (down 53% y-o-y) and higher tax provision (26% versus 15.9% in Q1FY2022).

Growth outlook intact

The company has been clocking a strong revenue CQGR of 4.5% over the past ten quarters that has led to a strong improvement in quarterly revenue run-rate to $60 million+ in Q2FY2022 from around $45 million revenue rate in Q3FY2020. Management now expects to achieve a $75 million quarterly revenue run-rate in next couple of quarter ($70 million in Q1FY23), given strong deal wins, healthy deal pipeline, and traction for its products and platforms across geographies. Though management stopped providing revenue growth guidance, management expects to achieve $75 million quarterly revenue run-rate in next two quarters and $90 - $100 million revenue run-rate over next 8-12 quarters. The deal pipeline increased by 28% y-o-y to $805 million in Q1FY2023 with acceleration in deal wins, deal size and implementation of go-lives. Intellect Design has selected four countries in Asia, Europe, Middle East and Africa, and North America for market expansion and plans to achieve at least $10 million annual revenue in these regions over the next three years. Steady growth in license-linked revenue, deepening relationship with large accounts, and entry into new markets would help it to sustain its strong revenue growth momentum going ahead.

Accelerated investments for next level of growth; lowered margin guidance to 22-25%

EBITDA margin declined by 290bps y-o-y to 21.6% due to higher investments on platforms, increased travel and talent costs. The company has lowered its EBITDA margin guidance to 22-25% from 25-30% earlier as the company plans to reinvest around 4-5% of its profitability in building platforms and capacity (primarily talents) for the next level of growth. The company expects to achieve $90 million quarterly revenue run-rate at a faster pace by investing on talents and technologies. Further, R&D costs usually rise in the initial phase of building a platform. Around $5 million is required to build a platform and it requires 3-4 years to achieve the breakeven with around 5-7 customers with $1 million in annual subscription revenue on the platform. Management cited that company will be able to achieve a 30-35% EBITDA margin at the $100 million quarterly revenue run-rate.

Key conference call highlights

- **Strong growth in platform revenues:** The company renamed its SAAS revenue to platform revenue. Platform revenue grew by 40% y-o-y in USD terms and 47% y-o-y in INR terms. However, it declined 5.4% q-o-q because of strong seasonality for the GEM business in the base quarter. Licence revenue declined 7.3% y-o-y and 3% y-o-y in INR terms. AMC grew by 4.7% y-o-y in Q1FY23. Licence-linked revenue (licence, platform and AMC revenue) increased by 18% y-o-y in INR terms.

- **Expect annual recurring revenue to drive growth:** The management highlighted that its annual recurring revenue consists of subscription revenue, transaction revenue and AMC revenue. The company's annual recurring revenue (ARR) grew by 28% y-o-y to Rs. 815 crore (35% of FY2023E revenue estimates).

- **Strong deal pipeline, quality of deals and deal sizes continue to increase:** The company's deal pipeline remained healthy at $805 million, up 28% y-o-y. Further, the company's destiny deals improved to 64 in Q1FY23 from 50 in Q1FY22. Average deal size increased to $6.2 million from $5.6 million in Q1FY22. The company won 10 deals versus 6 deals in Q4FY22, including five platform deals. During Q1FY23, the company went live in 11 new digital transformations. The number of deal wins and implementation of go-lives picked up sequentially, provides strong revenue visibility. Further, the number of deals of more than

$10 million have increased by 60% y-o-y in Q1FY2023, while the pipeline of such large deals increased to 15 from 9 in Q1FY22. Hence, both quality of deals and deal sizes have been increasing for the company.

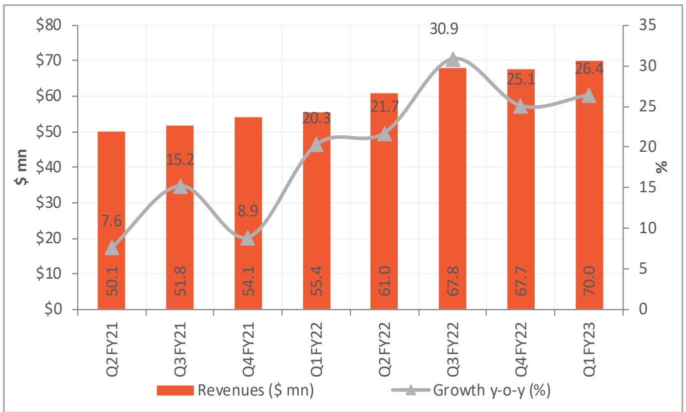
- **Wealth and quantum products gaining traction:** Management cited that its wealth and quantum products are gaining traction among clients. The company has strong deal pipeline in its wealth products in India, while it won two new deals in Quantum. Intellect is getting significant mind share in the market by winning deals in the quantum area. The company secured the deals in the North America and Canadian market.
- **Launched a new platform during the quarter:** The company launched AI based Magic Invoice Platform in Q1FY2023. Hence, the company has now six platforms - (1) iGov (GEM) – growing at a healthy pace, (2) CashPower'22 powered by GTB – micro-services platform, (3) iKredit360 – launched in Germany for European customers, (4) underwriting platform (Xponent) for document extraction, (5) iColumbus.ai and (6) Magic invoice platform. Management indicated that the Xponent platform has started gaining traction among customers, though it has not started generating revenue yet. The company has won 18 platform deals over the past four quarters.
- **Entry into South America:** The company won a small deal with one of the large banks in the Argentina, which helped the company to make an entry into South America.
- **Platform investments strategy:** The management indicated that ~$5 million is required to build a platform. Usually, it requires around 3-4 years to achieve the breakeven with 5-7 customers of $1 million annual subscription revenue on the platform. With an increase in the number of subscribers on the platform, the additional investments on the platform tapers off. Platform revenue is a recurring revenue and it has 10 years lifecycle value.
- **Focuses on country-specific platforms, looking to expand in the US:** (1) US market - management indicated that the company has two platforms i.e Xponent (working with 22 prospects) and iGTB (working with 24 prospects) in the US. North America market to grow by more than 50%. Further, Canada has been already delivering good results in treasury and core banking. Canada has become a wholesale market for Intellect Design. (2) Europe - Europe has many deals in Core banking transformation segment as the region is looking to upgrade its legacy systems. The company plans to increase its hiring in Europe as it sees strong demand for its products in the region despite strong competition. (3) Company having strong presence in UAE as seven out of nine banks are its customers. The company is now expanding its presence in Saudi market and has signed five banks as their customers in Saudi. (4) Quantum product is driving the growth in Africa. (5) Company has strong presence in India as well as Sri Lanka and Bangladesh. Sri Lanka business has not been affected by the current economic situation.
- **Stable attrition rate:** Management stated that attrition rate is less than 10% which strengthens the company's execution capability.
- **Four pivots of business strategy during the quarter:** The four fundamental pivots of business are (1) focus on IP-led business – it would be both products and platforms, (2) calibrated growth with predictable profitability – focus on selected markets in chosen accounts, (3) industry leading growth – geared up for a 20% kind of growth and the growth requires continuous investments on IP, and (4) efficient capital allocation – it does not intend any capital dilution.
- **Higher capitalized amount:** Company capitalised Rs. 35 crores in Q1FY23 and guided for Rs. 140 crores for FY2023 which translates to around $18-19 million per year.
- **Strong cash balance, strong collection from Indian government:** Cash balance remained flat sequentially at Rs. 558 crores. Company stated they would like to keep a cash level of Rs 500-600 crore on its books and will look out for inorganic opportunities when cash balance exceeds Rs. 1,000 crores. DSO days declined by 17 days to 114 days as it collected Rs. 100 crore from the Indian Government during the quarter.
- **Effective tax rate to remain at 26%:** The company's effective tax rate increased to 26% in Q1FY23 from 15.9%/20.2% in Q1FY22/Q4FY22 respectively. Management expects the ETR would remain at 26% in FY2023. However, the company has a MAT credit which will help the company to reduce cash outflows. The management indicated that the cash flow would be around 10%.

Results Rs cr

Particulars	Q1FY23	Q1FY22	Q4FY22	Y-o-Y %	Q-o-Q %
Revenue ($ mn)	**70.0**	**55.4**	**67.7**	**26.4**	**3.4**
Net sales	**541.3**	**408.3**	**509.4**	**32.6**	**6.3**
Software development expenses	240.3	178.8	218.5	34.4	10.0
Gross Profit	**301.0**	**229.5**	**290.9**	**31.1**	**3.5**
SG&A expenses	144.2	105.1	135.3	37.2	6.6
Research and engineering expenses	39.8	24.2	35.2	64.6	13.2
EBITDA	**117.0**	**100.2**	**120.4**	**16.7**	**-2.8**
Depreciation and amortisation	28.1	22.7	26.5	23.8	6.0
EBIT	**88.9**	**77.6**	**93.9**	**14.6**	**-5.3**
Other income	5.4	11.6	26.4	-53.0	-79.4
Finance cost	1.3	1.2	1.0	9.4	27.5
PBT	**93.1**	**88.0**	**119.3**	**5.8**	**-22.0**
Tax provision	24.2	14.0	24.1	72.9	0.3
Net profit	**68.8**	**73.7**	**95.3**	**-6.8**	**-27.8**
EPS (Rs.)	**4.9**	**5.2**	**6.8**	**-5.0**	**-27.7**
Margin (%)				**BPS**	**BPS**
EBITDA	21.6	24.5	23.6	-294	-202
EBIT	16.4	19.0	18.4	-257	-201
NPM	12.7	18.1	18.7	-536	-600

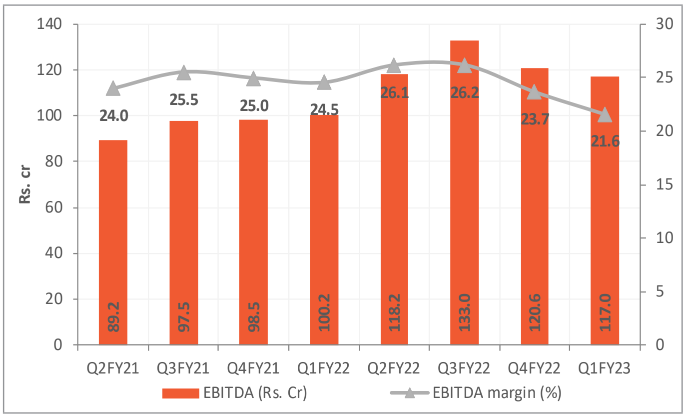
Source: Company; Sharekhan Research

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



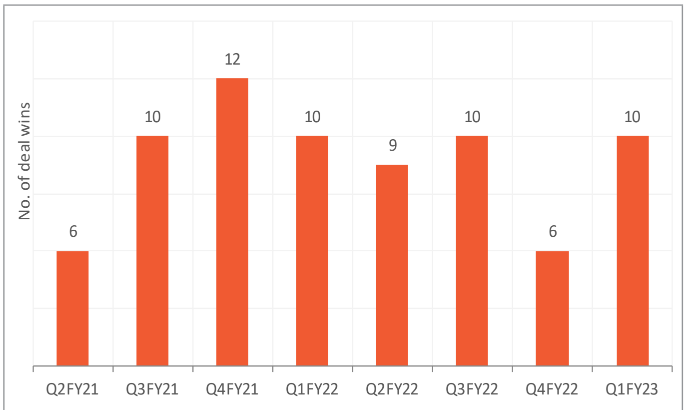
Source: Company, Sharekhan Research

EBITDA margin to remain under stress



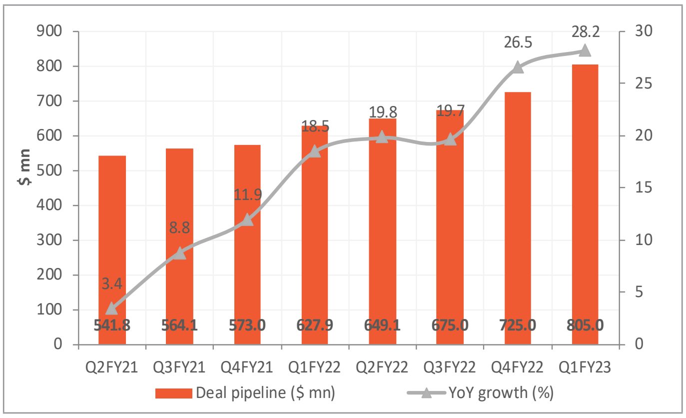
Source: Company, Sharekhan Research

Digital deal wins (in numbers)



Source: Company, Sharekhan Research

Deal pipeline ($ mn) and y-o-y growth (%)



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 clients. The global financial technology market is expected to register a 22% CAGR over 2020-2025, reaching a market value of $305 billion by 2025. The fintech industry's growth is expected to outpace revenue growth expectations of the overall financial sector.

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

Intellect Design has been focusing on increasing its licence-linked revenue, as a higher licence-lined revenue would lead to steady revenue growth. The company's annuity revenue (AMC+ SaaS) contributes around 40% of total revenue and is expected to post strong growth going ahead, given its early investments in Cloud capability. Improving contribution of annuity revenue would help the company drive its profitability and cash flow generation as well.

■ Valuation – Strong growth outlook intact

Strong deal wins, healthy deal pipeline, continued increase in deal sizes, expanding markets into new regions, and additional investments in platforms will position the company to report market leading growth among its peers in the medium term. However, margins are likely to remain under pressure in next couple of quarters given initial phase of investments in products. At CMP, the stock trades at a valuation of 26x/19x its FY2023E/FY2024E earnings. We continue to prefer the stock, considering its differentiated capabilities in products and platforms, focus on partnerships to capture opportunity in the marketplace, continued investments in products and platforms, and strong cash balance. Hence, we maintain our Buy rating on the stock with a revised price target (PT) of Rs. 780.

One-year forward P/E (x) band

Source: Company, Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
				FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Newgen Software	364	7	2,545	15.5	12.9	11.0	9.2	2.7	2.4	18.2	19.0
OFSS	3,103	9	26,791	12.8	11.4	7.8	7.1	3.6	3.4	29.0	31.0
Intellect Design	667	13	9,000	25.7	19.1	16.1	11.8	4.3	3.5	18.1	20.1

Source: Company, Sharekhan 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 four main verticals in the banking industry – 1) retail banking, 2) corporate banking, 3) insurance, and 4) treasury and capital markets. 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 micro-services-based architecture, powered by AI and ML. With 12 products and four platforms across four business lines, the company is well placed to accelerate 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) 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	7.11
2	Vanguard Group	2.64
3	Gothic Corp	1.92
4	Atyant Capital India Fund	1.71
5	Emirate of Abu Dhabi United Arab Emirates	1.70
6	Carne Global Fund Managers IRE	1.64
7	Ashoka India OPP FD	1.32
8	Nippon Life India Asset Management	1.32
9	Blackrock Inc.	0.87
10	Dimensional Fund Advisors	0.83

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

Sharekhan

by BNP PARIBAS

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