

# Intellect Design Arena (INTDES)

CMP: ₹ 630

Target: ₹ 740 (17%)

Target Period: 12 months

BUY

August 1, 2022

## Future investments to impact EBITDA margins...

**About the stock:** Intellect Design Arena (Intellect) provides software products to retail, corporate banking, insurance & treasury.

- The company is a transition from a product company to a platform company
- Intellect generates 55% of revenues from developed markets and rest from emerging markets
- Recently, it saw a turnaround in margins (from 5% in FY20 to 25.1% in FY22)

**Q1FY23 Results:** Intellect reported Q1FY23 results.

- US\$ revenues grew 26.4% YoY to US\$70 mn
- EBITDA margins declined ~290 bps YoY to 21.6%. Ex-Esop expenses, margins were at 24%
- Funnel is up 28% YoY to US\$805 mn

**What should investors do?** Intellect's share price has grown by ~5.7x over the past five years (from ~₹ 111 in July 2017 to ~₹ 630 levels in July 2022).

- We maintain **BUY** rating on the stock

**Target Price and Valuation:** We value Intellect at ₹ 740 i.e. 23x P/E on FY24E.

**Key triggers for future price performance:**

- Strong deal wins as well as continued healthy funnel is expected to aid future revenue growth
- Improving quality of revenues (licence + AMC + Cloud) from 46% in FY20 to 57% in FY22) bode well for long term revenue growth
- The company is making investments to improve quarterly revenue run rate to US\$90-100 mn in 10-12 quarters from now

**Alternate Stock Idea:** Apart from Intellect, in our IT coverage we also like Newgen.

- Strong logo additions with continuous focus on enhancing annuity revenues would aid 17.2% revenue growth over FY22-24E
- BUY with a target price of ₹ 440



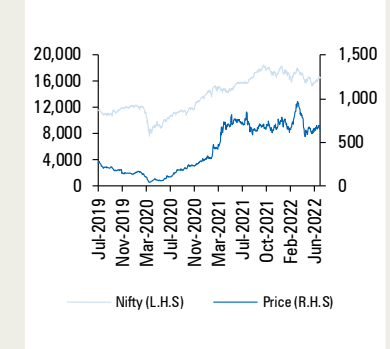
### Particulars

| Particular           | Amount    |
|----------------------|-----------|
| Market Cap (₹ Crore) | 8,378     |
| Total Debt           | 1         |
| CC&E (₹ Crore)       | 559       |
| EV (₹ Crore)         | 7,820     |
| 52 week H/L          | 986 / 564 |
| Equity capital       | 1,809     |
| Face value           | 5.0       |

### Shareholding pattern

|          | Sep-21 | Dec-21 | Mar-22 | Jun-22 |
|----------|--------|--------|--------|--------|
| Promoter | 31     | 31     | 31     | 31     |
| FI       | 27     | 26     | 25     | 25     |
| DII      | 2      | 2      | 3      | 3      |
| Public   | 40     | 41     | 41     | 42     |

### Price Chart



### Recent event & key risks

- Strong Funnel of US\$805 mn
- **Key Risk:** (i) Deterioration in funnel, (ii) Lower than expected margins

### Research Analyst

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## Key Financial Summary

| ₹ Crore            | FY20  | FY21  | FY22  | 5 Year CAGR (FY17-22) | FY23E | FY24E | 2 Year CAGR (FY22-24E) |
|--------------------|-------|-------|-------|-----------------------|-------|-------|------------------------|
| Net Sales          | 1,347 | 1,497 | 1,878 | 15.5%                 | 2,228 | 2,519 | 15.8%                  |
| EBITDA             | 71    | 355   | 472   | NA                    | 512   | 579   | 10.8%                  |
| EBITDA Margins (%) | 5.3   | 23.7  | 25.1  |                       | 23.0  | 23.0  |                        |
| Net Profit         | 16    | 263   | 349   | NA                    | 394   | 447   | 13.1%                  |
| EPS (₹)            | 1.2   | 19.6  | 25.1  |                       | 28.4  | 32.2  |                        |
| P/E                | 529.4 | 32.2  | 25.1  |                       | 22.2  | 19.6  |                        |
| RoNW (%)           | 1.0   | 18.9  | 19.3  |                       | 17.9  | 16.9  |                        |
| RoCE (%)           | 2.1   | 20.2  | 22.7  |                       | 20.7  | 19.5  |                        |

## Key takeaways of recent quarter & conference call highlights

- Revenue for the quarter increased 32.6% YoY to ₹ 541.3 crore while in dollar terms revenue increased 26.4% YoY to US\$70 mn. The company has 19% revenue mix in GBP. Hence, its depreciation against US\$ had an impact of US\$1.5 mn on revenues for the quarter
- SAAS revenues (21.6% of mix) increased 50.6% YoY to ₹ 117 crore while license revenues declined 2.8% YoY to ₹ 77 crore. AMC revenues grew 9.8% YoY to ₹ 117 crore while implementation grew 51.2% YoY to ₹ 260 crore
- License linked revenues (License+ SAAS+AMC). i.e. 52% of the revenue mix grew 19% YoY
- EBITDA for the quarter declined 3% QoQ to ₹ 117 crore while margins for the quarter were down ~210 bps QoQ to 21.6%. EBITDA margins excluding Esop were at 24%. The company indicated the following headwinds for decline in margins: i) higher employee costs & ii) higher SGA expenses led by increase in travel expenses
- The company indicated majority of their wage hikes do happen in Q1 and Q2 but they have a quarterly wage hike. Hence, some impact would also be visible in Q3 and Q4. The company indicated that salary hikes this year have been higher than last year
- Intellect's current portfolio consists of 10 products & six platforms. The company continues its journey from product to platform based business. Intellect indicated that its current investments are calibrated to reach US\$75 mn quarterly revenue run rate, which it is expected to hit in a couple of quarters. The company further indicated that their current focus is on growth. Hence, it requires further investments into platforms in terms of manpower and technology for its next leg of growth as it is looking to hit US\$90-100 mn quarterly revenue run rate in eight to 12 quarters from now
- The company mentioned that it refrains from giving any revenue growth guidance for FY23. However, its current investments suggest that 20% revenue growth in FY23 is achievable. The company reiterated that it can achieve market leading growth with its planned investments
- On EBITDA margin front, the company mentioned that it earlier guided for EBITDA margins in the range of 25-30% but as it is looking to step up investments for the next leg of growth and looking to invest 4-5% of EBITDA back in the business. On the basis of elevated investments, it is now guiding for EBITDA margins in the range of 22-25% in FY23
- The company indicated that it has not made any meaningful progress in North America region in the last few years but is now seeing traction and expects 50% revenue growth in that region in FY23 without disclosing the revenue mix from the region. After success of GeM platform, it is seeing strong traction in platform strategy in the US with AI and data based underwriting platform as well as other announced platforms with quite a few deals in POC stage. The company indicated that Canada is emerging as holistic market for Intellect with iGTB, iGCB and iRTM products as reference able products in the market
- The company also indicated that it believes that Europe region can provide massive opportunity led by legacy platforms upgradation which are few decades old. The Europe market has many deals in Core banking transformation. With integrated MACH compliant Digital Core, Lending and Credit cards, Intellect is positioned to compete with larger peers like Temenos and Thought Machine. Intellect's differentiation is depth of functionalities. The company is planning to increase its sales footprint in Continental Europe to meet increasing demands

- The company indicated that the demand is robust & the funnel has grown healthily to US\$805 mn, up 11% QoQ. Intellect indicated the number of destiny deals for the company is at 64 from 61 deals in Q1FY23. Average deal size also continue to grow as it was around US\$6.2 mn (+3.3% QoQ). The winning rate also improved from by 100 bps QoQ to 65% in Q1FY23. The company during the quarter won 10 new deals including five platform deals. The indicated that 11 Go Lives programs during the quarter
- The company does not provide the attrition numbers but indicated that the attrition is declining gradually. It also indicated that attrition at senior level is less than 10%
- **Collections and DSO:** Collections for Q1FY23 were at ₹ 473 crore. Net days of sales outstanding have declined by 17 days YoY to 114 days in Q1FY23, as the company collected ₹100 crore by Government of India
- **Cash position:** Cash & cash equivalent was ₹ 558 crore at the end of the quarter

Exhibit 1: P&L

|                            | Q1FY23 | Q1FY22 | YoY (%)  | Q4FY22 | loQ (%)  | Comments  |
|----------------------------|--------|--------|----------|--------|----------|---|
| Revenue (USD mn)           | 70     | 55     | 26.4     | 68     | 3.4      | Revenue improved on continued healthy funnel      |
| Revenue                    | 541.3  | 408.3  | 32.6     | 509.4  | 6.3      |   |
| Employee expenses          | 265.5  | 210.2  | 26.3     | 250.0  | 6.2      |   |
| Gross Margin               | 275.8  | 198.1  | 39.2     | 259.4  | 6.3      |   |
| Gross margin (%)           | 51.0   | 48.5   | 244 bps  | 50.9   | 3 bps    |   |
| Other expenses             | 158.8  | 97.9   | 62.2     | 138.8  | 14.4     |   |
| EBITDA                     | 117.0  | 100.2  | 16.7     | 120.6  | -3.0     |   |
| EBITDA Margin (%)          | 21.6   | 24.5   | -293 bps | 23.7   | -206 bps | ex-ESOP costs of ₹13.2 crore, Margins were at 24% |
| Depreciation & amortisatio | 28.1   | 22.7   | 23.7     | 26.5   | 6.0      |   |
| EBIT                       | 88.9   | 77.5   | 14.7     | 94.1   | -5.5     |   |
| EBIT Margin (%)            | 16.4   | 19.0   | -256 bps | 18.5   | -205 bps |   |
| Other income               | 9.8    | 16.3   | -40.2    | 13.3   |          |   |
| PBT                        | 98.7   | 93.9   | 5.1      | 107.4  | -8.1     |   |
| Tax paid                   | 24.2   | 14.0   | 72.9     | 24.1   | 0.3      |   |
| PAT                        | 68.8   | 73.7   | -6.7     | 95.3   | -27.8    | PAT was also impacted by higher tax rate          |

Source: Company, ICICI Direct Research

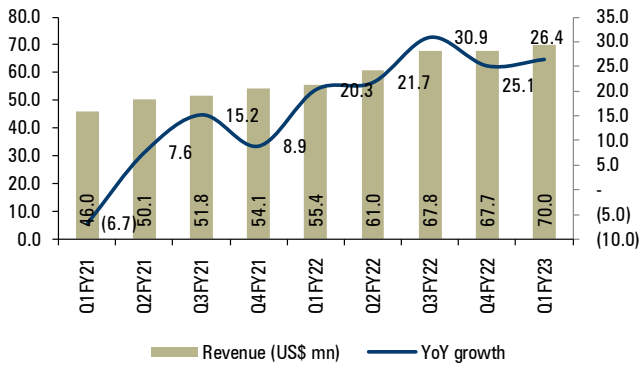
Exhibit 2: Change in estimates

| (₹ Crore)         | FY23E |       |          | FY24E |       |          | Comments                                   |
|-------------------|-------|-------|----------|-------|-------|----------|--|
|                   | Old   | New   | % Change | Old   | New   | % Change |  |
| Revenue           | 2,218 | 2,228 | 0.5      | 2,652 | 2,519 | -5.0     | Numbers re- aligned as per Q1 performance  |
| EBITDA            | 588   | 512   | -12.8    | 716   | 579   | -19.1    |  |
| EBITDA Margin (%) | 26.5  | 23.0  | -350 bps | 27.0  | 23.0  | -400 bps | Margins aligned as per management guidance |
| PAT               | 458   | 394   | -17.6    | 563   | 447   | -24.0    |  |
| EPS (₹) -diluted  | 34.5  | 28.4  | -17.6    | 42.3  | 32.2  | -24.0    |  |

Source: Company, ICICI Direct Research

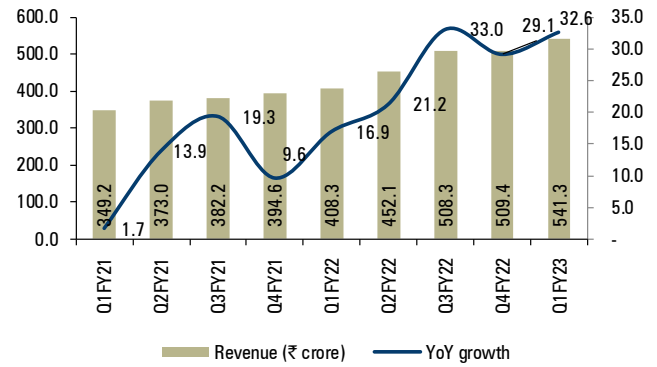
### Key Metrics

Exhibit 3: Revenue in US\$ million trend



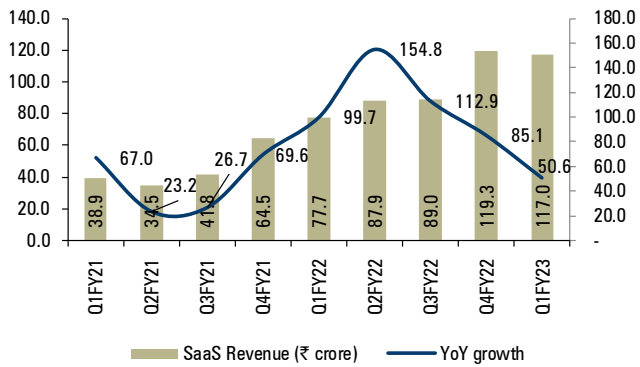
Source: Company, ICICI Direct Research

Exhibit 4: Revenue in ₹ crore trend



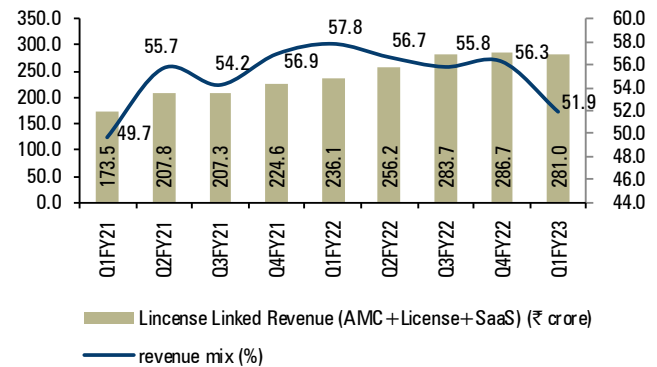
Source: Company, ICICI Direct Research

Exhibit 5: SaaS revenue trend



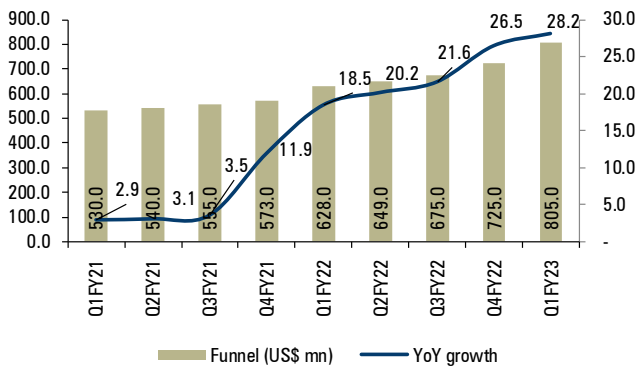
Source: Company, ICICI Direct Research

Exhibit 6: License linked revenue trend



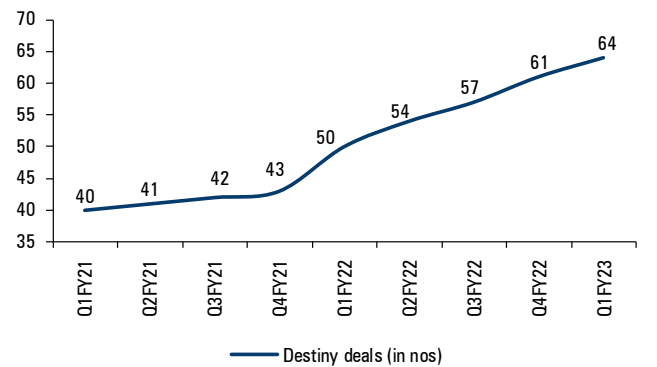
Source: Company, ICICI Direct Research

Exhibit 7: Funnel (in US\$ mn)



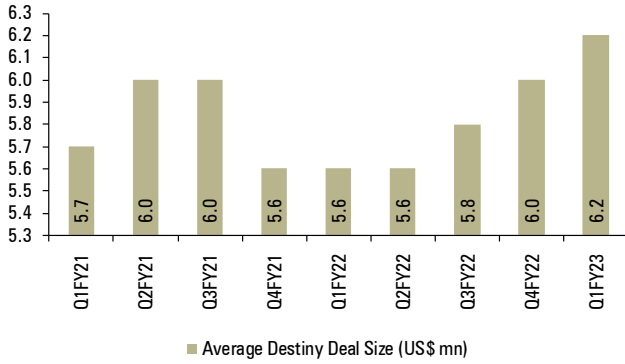
Source: Company, ICICI Direct Research

Exhibit 8: No. of Destiny deals



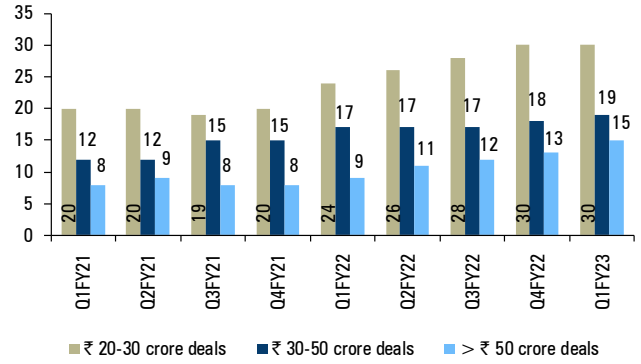
Source: Company, ICICI Direct Research

Exhibit 9: Average Destiny deal size (in US\$ mn)



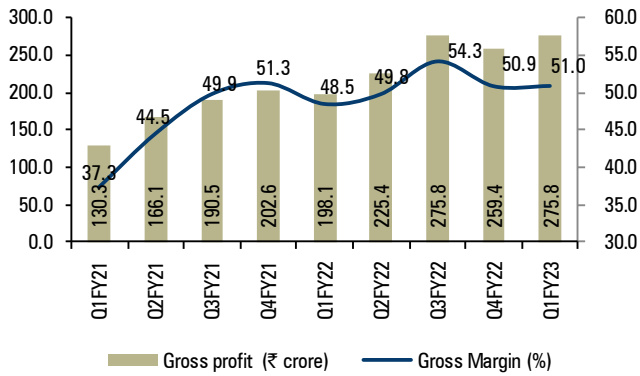
Source: Company, ICICI Direct Research

Exhibit 10: Destiny deal size mix trend



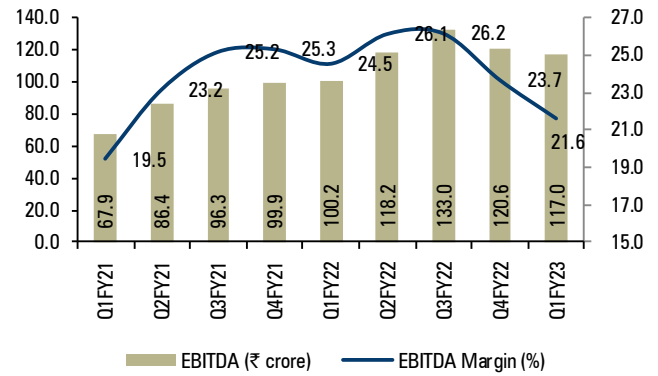
Source: Company, ICICI Direct Research

Exhibit 11: Gross profit & gross margin trend



Source: Company, ICICI Direct Research

Exhibit 12: EBITDA & EBITDA margin trend



Source: Company, ICICI Direct Research

## Financial summary

| Exhibit 13: Profit and loss statement |              |              |              |              | ₹ crore |
|---------------------------------------|--------------|--------------|--------------|--------------|---------|
| (Year-end March)                      | FY21         | FY22         | FY23E        | FY24E        |         |
| <b>Total operating income</b>         | <b>1,497</b> | <b>1,878</b> | <b>2,228</b> | <b>2,519</b> |         |
| Growth (%)                            | 11.2         | 25.4         | 18.6         | 13.1         |         |
| COGS (employee expenses)              | 808          | 919          | 1,203        | 1,360        |         |
| Other expenses                        | 335          | 487          | 512          | 579          |         |
| Total Operating Expenditure           | 1,143        | 1,406        | 1,716        | 1,940        |         |
| <b>EBITDA</b>                         | <b>355</b>   | <b>472</b>   | <b>512</b>   | <b>579</b>   |         |
| Growth (%)                            | 400.9        | 33.0         | 8.6          | 13.1         |         |
| Depreciation                          | 77           | 98           | 102          | 108          |         |
| Other income (net)                    | 4            | 36           | 46           | 46           |         |
| PBT                                   | 282          | 411          | 456          | 518          |         |
| Total Tax                             | 25           | 63           | 70           | 79           |         |
| <b>PAT after minority</b>             | <b>263</b>   | <b>349</b>   | <b>394</b>   | <b>447</b>   |         |
| Growth (%)                            | 1,543.2      | 32.8         | 13.0         | 13.3         |         |
| <b>Diluted EPS (₹)</b>                | <b>19.6</b>  | <b>25.1</b>  | <b>28.4</b>  | <b>32.2</b>  |         |
| Growth (%)                            | 1,542.9      | 28.6         | 13.0         | 13.3         |         |

Source: Company, ICICI Direct Research

| Exhibit 14: Cash flow statement     |              |              |              |              | ₹ crore |
|-------------------------------------|--------------|--------------|--------------|--------------|---------|
| (Year-end March)                    | FY21         | FY22         | FY23E        | FY24E        |         |
| Profit                              | 290          | 413          | 466          | 528          |         |
| Add: Depreciation                   | 77           | 98           | 102          | 108          |         |
| Others                              | 71           | 52           | (47)         | (47)         |         |
| Inc/(dec) in working capital        | 78           | (94)         | 100          | (38)         |         |
| Taxes paid                          | (53)         | (15)         | (70)         | (79)         |         |
| <b>CF from operating activities</b> | <b>463</b>   | <b>453</b>   | <b>551</b>   | <b>470</b>   |         |
| (Inc)/dec in Fixed Assets           | (114)        | (129)        | (213)        | (241)        |         |
| Others                              | (77)         | (270)        | (250)        | (250)        |         |
| <b>CF from investing activities</b> | <b>(190)</b> | <b>(399)</b> | <b>(463)</b> | <b>(491)</b> |         |
| Borrowings                          | (204)        | (41)         | -            | -            |         |
| Others                              | (22)         | (11)         | (3)          | (3)          |         |
| <b>CF from financing activities</b> | <b>(225)</b> | <b>(52)</b>  | <b>(3)</b>   | <b>(3)</b>   |         |
| Net Cash flow                       | 48           | 2            | 85           | (24)         |         |
| Exchange difference                 | (2)          | (0)          | -            | -            |         |
| Opening Cash                        | 100          | 145          | 146          | 231          |         |
| <b>Closing cash balance</b>         | <b>145</b>   | <b>146</b>   | <b>231</b>   | <b>207</b>   |         |

Source: Company, ICICI Direct Research

| Exhibit 15: Balance sheet     |              |              |              |              | ₹ crore |
|-------------------------------|--------------|--------------|--------------|--------------|---------|
| (Year-end March)              | FY21         | FY22         | FY23E        | FY24E        |         |
| Equity Capital                | 66           | 67           | 67           | 67           |         |
| Reserve and Surplus           | 1,338        | 1,754        | 2,150        | 2,599        |         |
| Total Shareholders funds      | 1,405        | 1,822        | 2,218        | 2,666        |         |
| Total Debt                    | 17           | 1            | 1            | 1            |         |
| Lease liability               | 18           | 7            | 7            | 7            |         |
| Derivative Instruments        | -            | -            | -            | -            |         |
| Other non current liabilities | 3            | 2            | 2            | 2            |         |
| <b>Total Liabilities</b>      | <b>1,442</b> | <b>1,831</b> | <b>2,227</b> | <b>2,676</b> |         |
| <b>Assets</b>                 |              |              |              |              |         |
| Property, plant and equipment | 159          | 153          | 133          | 124          |         |
| Investment in Property        | -            | 2            | 2            | 2            |         |
| Goodwill                      | 29           | 30           | 30           | 30           |         |
| Intangibles                   | 522          | 570          | 693          | 835          |         |
| Right-of-use assets           | 36           | 23           | 23           | 23           |         |
| Other non current assets      | 253          | 247          | 351          | 377          |         |
| Cash & bank balance           | 153          | 159          | 244          | 220          |         |
| Current Investments           | 96           | 364          | 664          | 964          |         |
| Trade receivables             | 187          | 189          | 278          | 314          |         |
| Loans and deposits            | 5            | 3            | 7            | 8            |         |
| Other financial assets        | 491          | 726          | 513          | 580          |         |
| Other current assets          | 114          | 127          | 169          | 191          |         |
| Total Current Assets          | 1,045        | 1,567        | 1,874        | 2,277        |         |
| Trade payables                | 169          | 257          | 251          | 284          |         |
| Lease liability               | 13           | 12           | 12           | 12           |         |
| OCL & provisions              | 420          | 493          | 625          | 707          |         |
| Total Current Liabilities     | 602          | 762          | 888          | 1,002        |         |
| Net Current Assets            | 443          | 805          | 986          | 1,275        |         |
| <b>Application of Funds</b>   | <b>1,442</b> | <b>1,831</b> | <b>2,227</b> | <b>2,676</b> |         |

Source: Company, ICICI Direct Research

| Exhibit 16: Key ratios          |       |       |       |       | ₹ crore |
|---------------------------------|-------|-------|-------|-------|---------|
| (Year-end March)                | FY21  | FY22  | FY23E | FY24E |         |
| <b>Per share data (₹)</b>       |       |       |       |       |         |
| Diluted EPS                     | 19.6  | 25.1  | 28.4  | 32.2  |         |
| Cash EPS                        | 25.6  | 33.6  | 37.4  | 41.7  |         |
| BV                              | 104   | 130   | 159   | 191   |         |
| DPS                             | (0.1) | (0.1) | -     | -     |         |
| Cash Per Share                  | 11    | 11    | 17    | 16    |         |
| <b>Operating Ratios (%)</b>     |       |       |       |       |         |
| EBITDA margin                   | 23.7  | 25.1  | 23.0  | 23.0  |         |
| PBT Margin                      | 19.4  | 22.0  | 20.9  | 20.9  |         |
| PAT Margin                      | 17.5  | 18.6  | 17.7  | 17.7  |         |
| Debtor days (billed + unbilled) | 165   | 135   | 130   | 130   |         |
| Creditor days                   | 41    | 50    | 41    | 41    |         |
| <b>Return Ratios (%)</b>        |       |       |       |       |         |
| RoE                             | 18.9  | 19.3  | 17.9  | 16.9  |         |
| RoCE                            | 20.2  | 22.7  | 20.7  | 19.5  |         |
| RoIC                            | 33.4  | 40.8  | 49.8  | 53.9  |         |
| <b>Valuation Ratios (x)</b>     |       |       |       |       |         |
| P/E                             | 32.2  | 25.1  | 22.2  | 19.6  |         |
| EV / EBITDA                     | 22.9  | 16.6  | 14.5  | 12.4  |         |
| EV / Net Sales                  | 5.4   | 4.2   | 3.3   | 2.8   |         |
| Market Cap / Sales              | 5.6   | 4.5   | 3.8   | 3.3   |         |
| Price to Book Value             | 6.0   | 4.6   | 3.8   | 3.2   |         |
| <b>Solvency Ratios</b>          |       |       |       |       |         |
| Debt/EBITDA                     | 0.0   | 0.0   | 0.0   | 0.0   |         |
| Debt / Equity                   | 0.0   | 0.0   | 0.0   | 0.0   |         |
| Current Ratio                   | 1.3   | 1.4   | 1.1   | 1.1   |         |
| Quick Ratio                     | 1.3   | 1.4   | 1.1   | 1.1   |         |

Source: Company, ICICI Direct Research

## RATING RATIONALE

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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