

Intellect Design Arena (INTDES)

CMP: ₹ 501

Target: ₹ 525 (5%)

Target Period: 12 months

October 30, 2022

HOLD

Revenue, EBITDA margin guidance revised downward

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

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

Q2FY23 Results: Intellect reported weak numbers in Q2FY23.

- Revenue was down 2.5% QoQ
- EBITDA margins declined ~570 bps QoQ to 15.9%
- Ratio of deals to funnel declined to 44.4%

What should investors do? Intellect's share price has grown by ~3.9x over the past five years (from ~₹ 130 in October 2017 to ~₹ 501 levels in October 2022).

- We change our rating on the stock from BUY to **HOLD**

Target Price and Valuation: We value Intellect at ₹ 525 i.e. 18x P/E on FY25E.

Key triggers for future price performance:

- Strong deal wins as well as continued healthy funnel are 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 the 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 16.2% revenue growth over FY22-25E
- BUY with a target price of ₹ 445



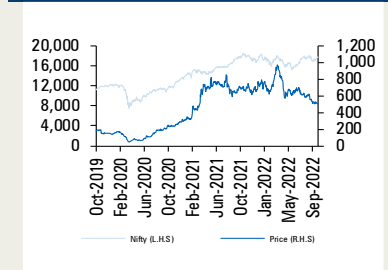
Particulars

Particular	Amount
Market Cap (₹ Crore)	6,649
Total Debt	0.8
CC&E (₹ Crore)	558.9
EV (₹ Crore)	6,091
52 week H/L	986/492
Equity capital	67.3
Face value	5.0

Shareholding pattern

	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	31	31	31	31
FII	26	25	25	24
DII	2	3	3	2
Public	41	41	42	43

Price Chart



Recent event & key risks

- Revenue guidance revised downward
- **Key Risk:** (i) Higher than expected revenue growth, (ii) Lower than expected margins

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Key Financial Summary

₹ Crore	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	FY25E	3 Year CAGR (FY22-25E)
Net Sales	1,497	1,878	15.5%	2,186	2,387	2,559	10.9%
EBITDA	355	472	NA	437	487	535	4.2%
EBITDA Margins (%)	23.7	25.1		20.0	20.4	20.9	
Net Profit	263	349	NA	330	368	404	5.0%
EPS (₹)	19.6	25.1		23.8	26.5	29.1	
P/E	25.6	19.9		21.0	18.9	17.2	
RoNW (%)	18.9	19.3		15.4	14.7	13.9	
RoCE (%)	20.2	22.7		17.8	17.0	16.1	

Key takeaways of recent quarter & conference call highlights

- Reported revenue of ₹ 527.5 crore for the quarter, down 2.5% QoQ. The company indicated that there was an impact of US\$6.1 mn on revenue out of which US\$2.9 million (mn) was on account of shifting of the contract from product to platform while US\$3.1 mn was on account of one of the deals, which was closed but revenue for the same was not booked in Q2 (which is likely to be recognised in Q3). The company also indicated that depreciation of the GBP against the dollar impacted dollar revenue of the company for Q2 (not disclosed dollar revenue for Q2)
- SAAS revenues (22.6% of mix) increased 35.4% YoY to ₹ 119 crore while license revenues (lumpy in nature) declined 21.8% YoY to ₹ 68 crore. AMC revenues grew 10.6% YoY to ₹ 90 crore while implementation revenue reported 27.9% YoY growth to ₹ 251 crore
- License linked revenues (License+ SAAS+AMC). i.e. 53% of revenue mix reported YoY growth of 8.1% to ₹ 277 crore. There was moderation of license linked revenues
- The company indicated that though the funnel remains steady at US\$818 mn, up 1.6% QoQ, deal conversion is slowing down (44% currently vs. 50% a couple of quarters back). Intellect, during the quarter, won 14 new deals including nine platform deals. The company's destiny deals increased by two during the quarter taking it to 66. However, the average size of destiny deals declined to US\$5.5 mn from US\$6.2 mn in Q1FY23
- The company indicated the following factors impacting its growth i) demand environment is slowing down, ii) clients are taking longer for decision making, iii) deals sizes have either shrunken or clients demand stretched deals to conserve cash on their side. It mentioned that there has been a change in the client evaluation process for vendors where earlier decision making was rather quick (through dance & drama sessions) while now clients demand on site validation and run through of the product for some time before taking the final decision. Intellect further indicated that destiny deals are taking even longer to get closed due to the longer process of selection by clients, which is about four to six months. It is also indicated that since it is now aiming for large size deals and competing with some of the large peers like Thought Machine & Temenos, the timeline is longer
- It expects the issues mentioned above to have an impact for a few quarters before settling down. Hence, it is now guiding for ~15% dollar revenue growth for FY23 (vs. earlier guidance of 20% growth)
- EBITDA for the quarter declined sharply by 28.2% QoQ to ₹ 84 crore while EBITDA margins for the quarter declined ~570 bps QoQ to 15.9%. The company indicated that the decline in margin was due to negative operating leverage. Intellect indicated it gives quarterly wage hike instead of annual wage hike & wage hike in Q3 & Q4 will be similar to one rolled out in H1. It will incur additional cost on employee addition particularly in sales & marketing team to the tune of US\$2 mn & US\$3 mn in Q3 & Q4, respectively. The company further indicated that it will likely incur ~₹ 3 crore on marketing spend on SIBOS event where Intellect will be participating in Q3. The company is now guiding ~20% EBITDA margins for FY23 vs. 22-23% range guided earlier
- The company mentioned that they used to incur R&D expenses to the tune of ₹ 120 crore on an annual basis. However, it is now indicating ₹ 150 crore due to rupee depreciation against dollar. The company capitalised ₹ 35-40 crore this quarter and is in line what they indicated earlier
- Intellect indicated that operating cash flow for H1 was down due to i) bonus payout since it grew 27% in FY22, ii) travel costs increase, iii) continued elevated employee expenses

Exhibit 1: P&L

	Q2FY23	Q2FY22	YoY (%)	Q1FY22	1oQ (%)	Comments
Revenue	527.5	452.1	16.7	541.3	-2.5	The company indicated that it lost potential revenue of US\$ 6 mn during the quarter
Employee expenses	268.0	226.8	18.2	265.5	0.9	Employee cost includes ₹ 11.8 crore of Esop compensation for Q2
Gross Margin	259.6	225.4	15.2	275.8	-5.9	
Gross margin (%)	49.2	49.8	-65 bps	51.0	-175 bps	
Other expenses	175.6	107.2	63.8	158.8	10.6	
EBITDA	84.0	118.2	-29.0	117.0	-28.2	
EBITDA Margin (%)	15.9	26.1	-1022 bps	21.6	-570 bps	EBITDA declined due to muted revenue growth & higher operating costs
Depreciation & amortisation	29.5	23.7	24.3	28.1	4.9	
EBIT	54.5	94.5	-42.3	88.9	-38.7	
EBIT Margin (%)	10.3	20.9	-1057 bps	16.4	-609 bps	
Other income	10.9	0.1		9.8	11.6	
PBT	65.4	94.6	-30.8	98.7	-33.7	
Tax paid	16.2	10.8	49.2	24.2	-33.3	
PAT	45.8	79.2	-42.2	68.8	-33.4	

Source: Company, ICICI Direct Research

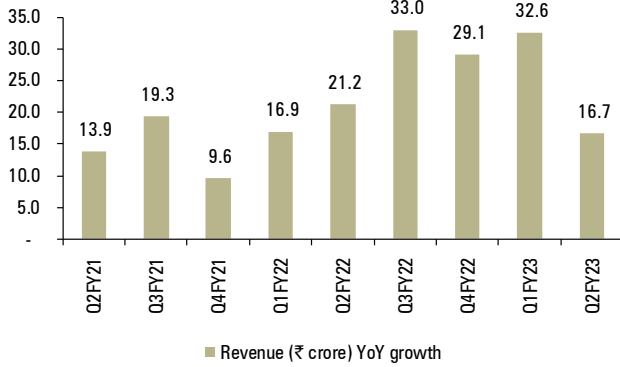
Exhibit 2: Change in estimates

(₹ Crore)	FY23E			FY24E			FY25E	Comments
	Old	New	% Change	Old	New	% Change	Introduced	
Revenue	2,228	2,186	-1.9	2,519	2,387	-5.2	2,559	Numbers realigned as per revenue guidance downgraded from 20% to 15% and delay in decision making, going forward
EBITDA	512	437	-14.6	579	487	-15.9	535	
EBITDA Margin (%)	23.0	20.0	-298 bps	23.0	20.4	-259 bps	20.9	Margins realigned as per guidance downgraded from 22-23% to 20% and elevated costs for medium term
PAT	394	330	-16.2	447	368	-17.7	404	
EPS (₹) -diluted	28.4	23.8	-16.2	32.2	26.5	-17.7	29.1	

Source: Company, ICICI Direct Research

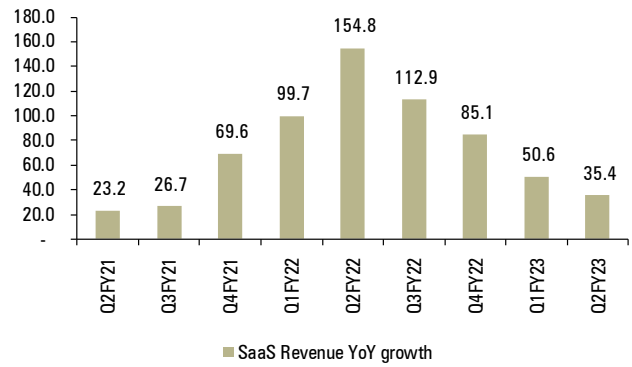
Key Metrics

Exhibit 3: Revenue growth declines in Q2 QoQ



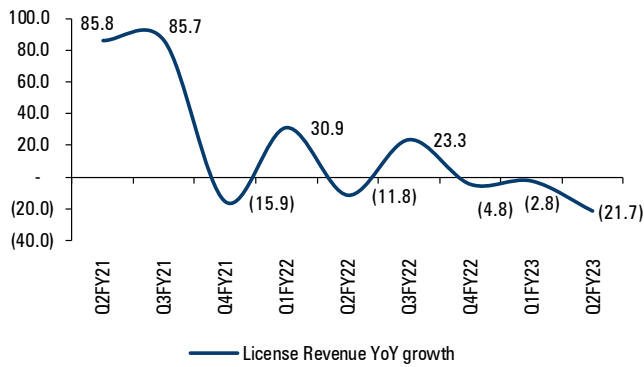
Source: Company, ICICI Direct Research

Exhibit 4: SaaS revenue growth trend



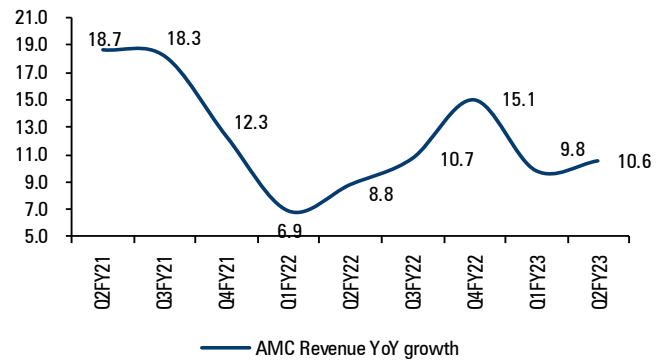
Source: Company, ICICI Direct Research

Exhibit 5: License revenue continues to be lumpy



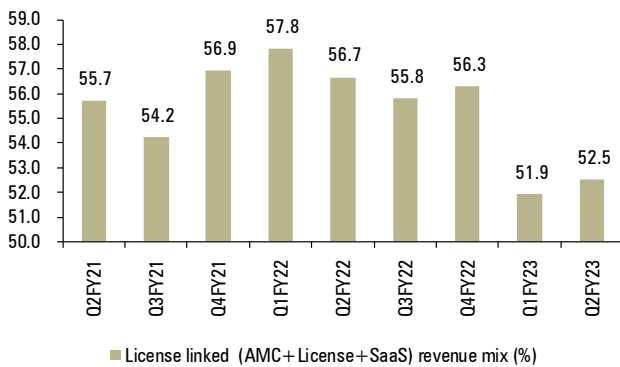
Source: Company, ICICI Direct Research

Exhibit 6: AMC revenue growth trend



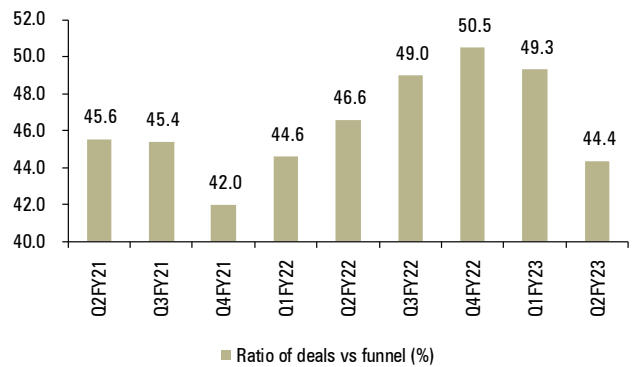
Source: Company, ICICI Direct Research

Exhibit 7: License linked revenue moderating



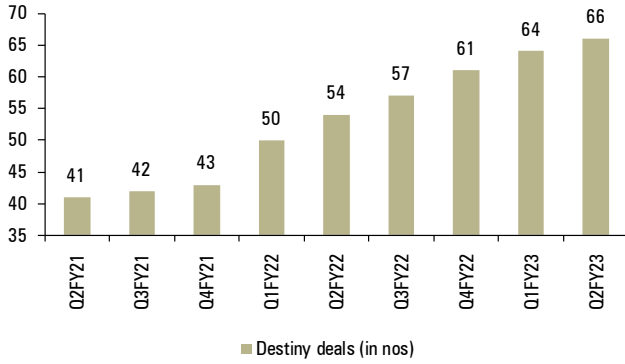
Source: Company, ICICI Direct Research

Exhibit 8: Ratio of deals to funnel declined



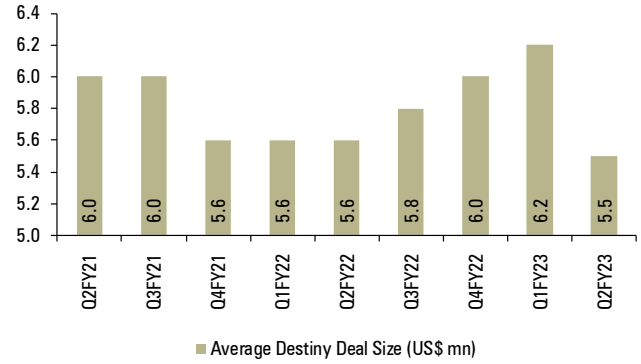
Source: Company, ICICI Direct Research

Exhibit 9: Destiny deals steady



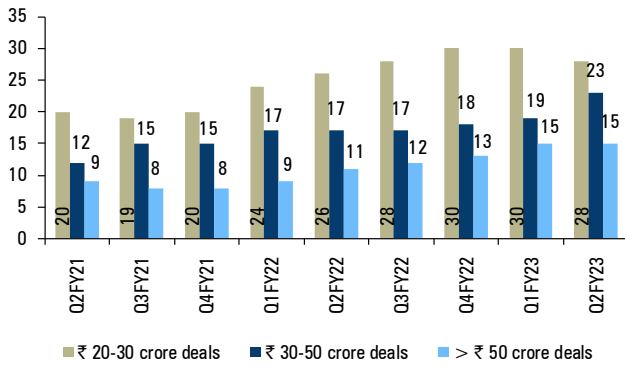
Source: Company, ICICI Direct Research

Exhibit 10: But average size of deal declines in Q2



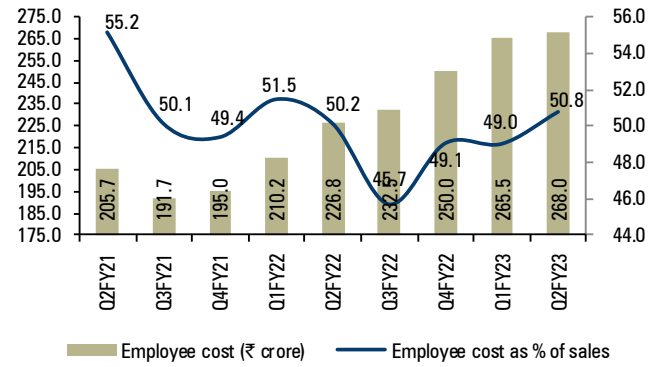
Source: Company, ICICI Direct Research

Exhibit 11: Destiny deal size mix trend



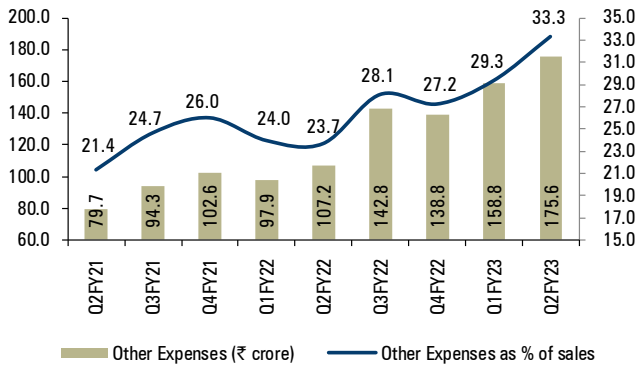
Source: Company, ICICI Direct Research

Exhibit 12: Employee cost to sales gradually rising



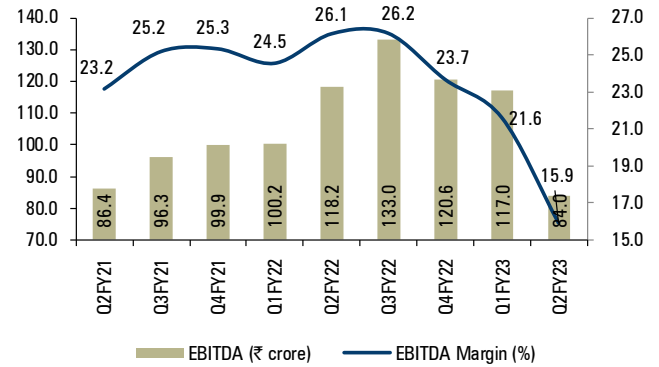
Source: Company, ICICI Direct Research

Exhibit 13: As is other expenses



Source: Company, ICICI Direct Research

Exhibit 14: Impacting EBITDA margins



Source: Company, ICICI Direct Research

Financial summary

Exhibit 15: Profit and loss statement					₹ crore
(Year-end March)	FY22	FY23E	FY24E	FY25E	
Total operating income	1,878	2,186	2,387	2,559	
Growth (%)	25.4	16.4	9.2	7.2	
COGS (employee expenses)	919	1,224	1,332	1,423	
Other expenses	487	525	568	601	
Total Operating Expenditure	1,406	1,749	1,900	2,024	
EBITDA	472	437	487	535	
Growth (%)	33.0	(7.4)	11.4	9.8	
Depreciation	98	102	108	113	
Other income (net)	36	46	46	46	
PBT	411	381	425	468	
Total Tax	63	59	65	72	
PAT after minority	349	330	368	404	
Growth (%)	32.8	(5.4)	11.4	9.7	
Diluted EPS (₹)	25.1	23.8	26.5	29.1	
Growth (%)	28.6	(5.4)	11.4	9.7	

Source: Company, ICICI Direct Research

Exhibit 16: Cash flow statement					₹ crore
(Year-end March)	FY22	FY23E	FY24E	FY25E	
Profit	413	391	435	478	
Add: Depreciation	98	102	108	113	
Others	52	(47)	(47)	(48)	
Inc/(dec) in working capital	(94)	106	(27)	(23)	
Taxes paid	(15)	(59)	(65)	(72)	
CF from operating activities	453	493	403	449	
(Inc)/dec in Fixed Assets	(129)	(209)	(229)	(245)	
Others	(270)	(250)	(250)	(250)	
CF from investing activities	(399)	(459)	(479)	(495)	
Borrowings	(41)	-	-	-	
Others	(11)	(3)	(3)	(2)	
CF from financing activities	(52)	(3)	(3)	(2)	
Net Cash flow	2	30	(78)	(49)	
Exchange difference	(0)	-	-	-	
Opening Cash	145	146	177	99	
Closing cash balance	146	177	99	50	

Source: Company, ICICI Direct Research

Exhibit 17: Balance sheet					₹ crore
(Year-end March)	FY22	FY23E	FY24E	FY25E	
Equity Capital	67	67	67	67	
Reserve and Surplus	1,754	2,086	2,456	2,862	
Total Shareholders funds	1,822	2,154	2,524	2,929	
Total Debt	1	1	1	1	
Lease liability	7	7	7	7	
Derivative Instruments	-	-	-	-	
Other non current liabilities	2	2	2	2	
Total Liabilities	1,831	2,163	2,533	2,939	
Assets					
Property, plant and equipment	153	132	121	111	
Investment in Property	2	2	2	2	
Goodwill	30	30	30	30	
Intangibles	570	689	821	964	
Right-of-use assets	23	23	23	23	
Other non current assets	247	347	365	381	
Cash & bank balance	159	189	111	63	
Current Investments	364	664	964	1,264	
Trade receivables	189	273	298	319	
Loans and deposits	3	7	7	8	
Other financial assets	726	503	549	589	
Other current assets	127	166	181	194	
Total Current Assets	1,567	1,802	2,111	2,437	
Trade payables	257	246	269	288	
Lease liability	12	12	12	12	
OCL & provisions	493	613	670	718	
Total Current Liabilities	762	871	951	1,018	
Net Current Assets	805	930	1,161	1,419	
Application of Funds	1,831	2,163	2,534	2,939	

Source: Company, ICICI Direct Research

Exhibit 18: Key ratios					₹ crore
(Year-end March)	FY22	FY23E	FY24E	FY25E	
Per share data (₹)					
Diluted EPS	25.1	23.8	26.5	29.1	
Cash EPS	33.6	32.5	35.8	38.9	
BV	130	154	181	210	
DPS	(0.1)	-	-	-	
Cash Per Share	11	13	7	4	
Operating Ratios (%)					
EBITDA margin	25.1	20.0	20.4	20.9	
PBT Margin	22.0	17.9	18.2	18.7	
PAT Margin	18.6	15.1	15.4	15.8	
Debtor days (billed + unbilled)	135	130	130	130	
Creditor days	50	41	41	41	
Return Ratios (%)					
RoE	19.3	15.4	14.7	13.9	
RoCE	22.7	17.8	17.0	16.1	
RoIC	40.8	41.0	44.5	47.6	
Valuation Ratios (x)					
P/E	19.9	21.0	18.9	17.2	
EV / EBITDA	12.9	13.2	11.4	9.9	
EV / Net Sales	3.2	2.6	2.3	2.1	
Market Cap / Sales	3.5	3.0	2.8	2.6	
Price to Book Value	3.7	3.1	2.7	2.3	
Solvency Ratios					
Debt/EBITDA	0.0	0.0	0.0	0.0	
Debt / Equity	0.0	0.0	0.0	0.0	
Current Ratio	1.4	1.1	1.1	1.1	
Quick Ratio	1.4	1.1	1.1	1.1	

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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