Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Intellect Design Arena Ltd

Weak Q2, Downgrade to Hold

IT & ITeS	Sharekhan code: INTELLECT

Reco/View: Hold ↓	CMP: **Rs. 501**	Price Target: **Rs. 560** ↓

↑ 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 Oct 08, 2022

Medium Risk

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

Source: Morningstar

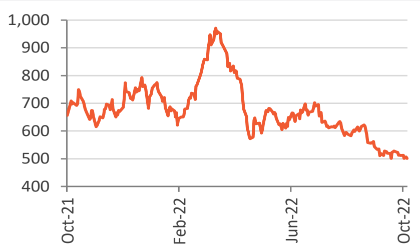
Company details

Market cap:	Rs. 6,781 cr
52-week high/low:	Rs. 986 / 493
NSE volume: (No of shares)	5.0 lakh
BSE code:	538835
NSE code:	INTELLECT
Free float: (No of shares)	9.3 cr

Shareholding (%)

Promoters	30.7
FII	24.5
DII	2.2
Others	42.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-6.4	-24.9	-38.6	-23.7
Relative to Sensex	-12.4	-30.3	-42.9	-24.8

Sharekhan Research, Bloomberg

Summary

- Intellect Design reported revenues of $66.1 million in Q2FY23, a decline of 5.6% q-o-q due to a shortfall in accounting for $6million of revenues. This was due to $3.1 million of revenues were contracted in Q2FY23 but will be reflected in Q3FY23 and due to transitioning of $2.9 million of revenues to Platform revenues over the subsequent quarters.
- EBIT margins plunged to 15.9% from 21.6% due to higher talent costs, higher travel, and SG&A expenses.
- Management has indicated a visibility of an annual growth of 20% for FY23 while lowering its EBITDA margin guidance to 20%+ from 22-25% for FY2023E citing slowdown due to macro concerns and transition of certain License revenues to Platform revenues.
- We downgrade Intellect Design to Hold with a revised PT of Rs. 560, given near-term concerns on growth and margins.

Intellect Design missed our revenue expectations due to a shortfall in booking $6 million (Revenues of $3.1 million - contracted in Q2FY23 but will be reflected in Q3FY23 and moreover on account of transitioning of $2.9 million of revenues to Platform segment that would be spread over subsequent quarters). Margin missed our estimates owing to increasing talent and travel expenses. EBITDA margins contracted by 570 bps to 15.9% from 21.6% on q-o-q basis. Consequently, Net profit declined by 33.4% q-o-q to Rs. 45.8 crore and was 42.1% below our estimate, owing to miss in revenues, margin, and higher tax provision (26% versus 12% in Q2FY2022). Management have indicated a visibility of an annual growth of 20% for FY23 while lowering its EBITDA margin guidance to 20%+ from 22-25% for FY2023E citing slowdown due to macro concerns and transition of License revenues to Platform revenues. The management have indicated they are seeing deal closure cycle time getting elongated due to macro concerns but they remain cautiously optimistic as their products are well matched with competitors. While the management mentioned they are seeing wide window moments from large deal wins, Core Banking Space and Consumerization of Corporate Banking we believe the near-term growth concerns and margins pressure would keep the upside capped.

Key positives

- Deal pipeline momentum strong – company won 14 deals in Q2FY23 versus 10 deals in Q1FY23
- Launched 2 AI-based Platforms - Magic Invoice and iESG

Key negatives

- Revenue at $66.1 million sharply missed our estimates by 860 bps.
- EBITDA margins plunged to 15.9% for Q2FY23 from 21.6% in Q1FY23. Management lowered its EBITDA margin guidance to 20%+ for FY2023E from earlier 22-25%.
- Net DSO increased to 128 in Q2FY23 from 114 in Q1FY23.

Management Commentary

- Management conservatively expects to achieve 20% full year growth aided by continued deal wins however increase in transition to Platform deals to slow the growth momentum.
- Management cited that deal closure cycle time is getting elongated due to slowdown in technology spends due to macro concerns
- Management has revised downward its EBITDA margin guidance to 20%+ for the full year from the earlier 22-25% given in Q1FY23.
- Management stated that they are cautiously optimistic as their products are well matched with the competitors.

Revision in estimates – We have revised our estimates downward for FY23E/FY24E by 20-22% due to margin and revenue miss in Q2FY23 and owing to downward revision in its growth and margin guidance

Our Call

Valuation – Downgrade Intellect Design to Hold with revised PT of Rs. 560: Continued deal wins and investment in platforms are long-term drivers, but margin pressure continues to persist given the macro headwinds. Hence, we downgrade Intellect Design to Hold with a revised PT of Rs. 560, given near term concerns on growth and margins

Key Risks

Rupee appreciation and/or adverse cross-currency movements and/or constraint in local talent supply in the US would affect earnings. Further, macro headwinds and possible recession in the US are likely to moderate the pace of technology spends.

Valuation Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	1,878.2	2,253.0	2,509.5	2,845.9
OPM (%)	25.1	20.7	23.7	24.0
Adjusted PAT	349.1	288.5	376.4	443.7
% YoY growth	32.8	(17.4)	30.5	17.9
Adjusted EPS (Rs.)	25.1	20.7	27.1	31.9
P/E (x)	19.9	24.2	18.5	15.7
P/B (x)	3.9	3.3	2.8	2.8
EV/EBITDA (x)	14.5	14.4	11.0	9.8
RoNW (%)	21.8	14.8	16.5	17.9
RoCE (%)	22.7	17.8	20.1	22.1

Source: Company; Sharekhan estimates

Key Results Highlights

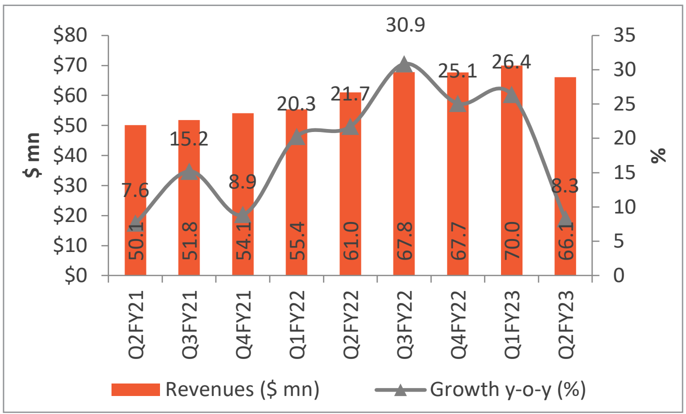
- **Weak License revenues, Platform and AMC revenues stable:** License revenues continued to decline, falling 27.4% y-o-y and 14.4% q-o-q. Platform revenues at $14.9 grew by 25.6% y-o-y however, it declined 0.6 % q-o-q. AMC grew by 2.6% y-o-y and 0.2% q-o-q.
- **Annual recurring revenue to drive growth:** Annual recurring revenue – ARR (on annualised basis) was at Rs. 836 crore in Q2FY23 as against Rs. 684 crore in Q2FY22 – rising 22% y-o-y.
- **Strong deal pipeline:** The company's deal pipeline remained healthy at $849 million, up 31% y-o-y. Further, the company's destiny deals improved to 65 in Q2FY23 from 54 in Q2FY22. Average deal size fell to $5.5 million from $5.6 million in Q2FY22. The company won 14 deals versus 10 deals in Q1FY23, including nine platform deals. During Q1FY23 the company went live in 14 new digital transformations. The number of deal wins and implementation go-lives picked up sequentially, providing strong revenue visibility.
- **AI-based Platform- iESG:** iESG, is the latest platform launched on its Fabric Data services for the very large ESG space for investment banks in Europe and the Americas. It is an AI-powered solution for institutional investors, asset managers, corporate banks, and insurance carriers. iESG brings together the benefits of all market-wide data sources and real-time media coverage into a single, composable and contextual ESG data catalogue, with supporting raw data.
- **Travel and talent cost:** Management stated that they expect travel cost to moderate while they would continue to invest in talent cost
- **Cash balance dips in Q2FY23:** Cash balance dipped to Rs 501 Cr for Q2FY23 vs Rs. 558 crores for Q1FY23. DSO days increased by 14 days to 128 days compared to previous quarter
- **ETR remained elevated at 26%:** The company's effective tax rate increased to 26% in Q2Y23 from 12%/26% in Q2FY22/Q1FY23.

Results Rs cr

Particulars	Q2FY23	Q2FY22	Q1FY23	% YoY	% QoQ
Revenues ($ mn)	**66.1**	**61.0**	**70.0**	**8.3**	**-5.6**
Net sales	**527.5**	**452.1**	**541.3**	**16.7**	**-2.5**
Software development expenses	251.6	190.3	240.3	32.2	4.7
Gross Profit	**275.9**	**261.8**	**301.0**	**5.4**	**-8.3**
Selling & marketing and General & Administrative expenses	149.4	115.3	144.2	29.6	3.6
Research & Engineering expenses	42.5	28.3	39.8	50.2	6.7
EBITDA	**84.0**	**118.2**	**117.0**	**-29.0**	**-28.2**
Depreciation & amortisation	29.5	23.7	28.1	24.3	4.9
EBIT	**54.5**	**94.5**	**88.9**	**-42.3**	**-38.7**
Other income	8.5	-2.7	5.4	-414.4	55.5
Finance cost	0.8	1.2	1.3	-33.4	-37.3
PBT	**62.2**	**90.6**	**93.1**	**-31.4**	**-33.2**
Tax provision	16.2	10.8	24.2	49.2	-33.3
Net profit	**45.8**	**79.2**	**68.8**	**-42.2**	**-33.4**
EPS (Rs)	**3.3**	**5.7**	**4.9**	**-42.1**	**-33.4**
Margin (%)					
EBITDA	15.9	26.1	21.6	-1,023	-570
EBIT	10.3	20.9	16.4	-1,057	-609
NPM	8.7	17.5	12.7	-885	-403

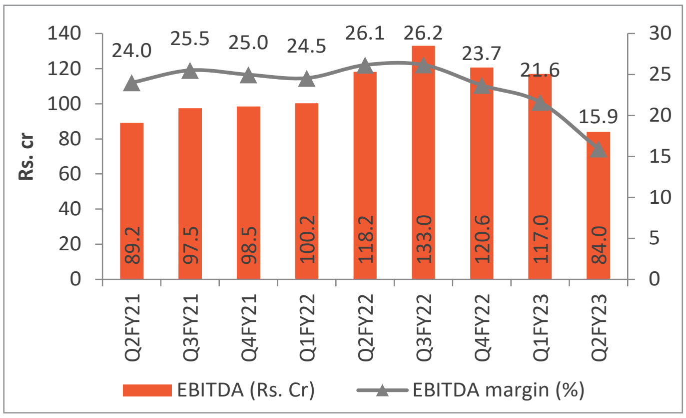
Source: Company, Sharekhan Research

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



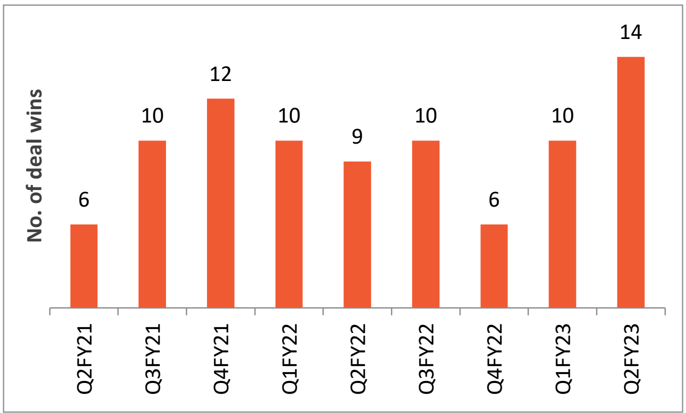
Source: Company, Sharekhan Research

EBITDA margin expansion continued on a y-o-y basis



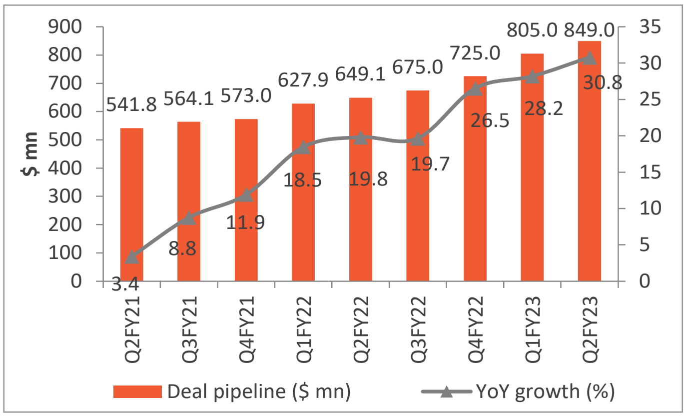
Source: Company, Sharekhan Research

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.

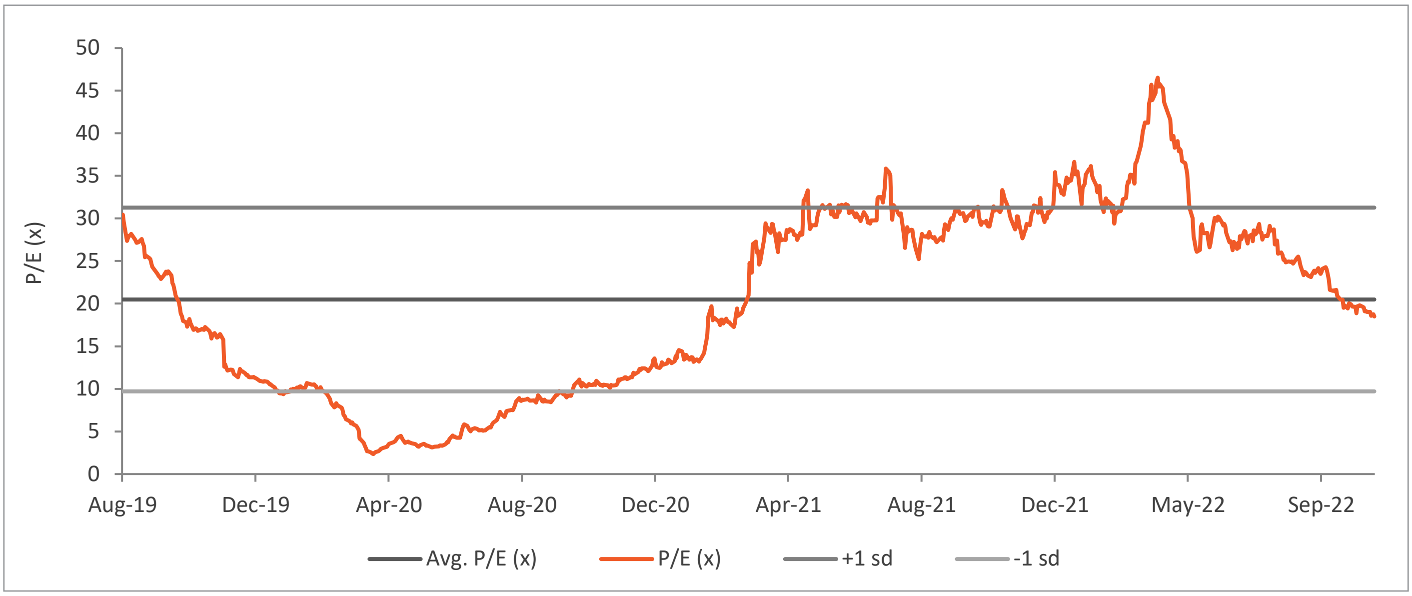
■ **Company outlook - Quality of revenue to drive profitability and cashflow**

Intellect Design has been focusing on increasing its license-linked revenue, as a higher license-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 robust 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 - Downgrade Intellect Design to Hold with revised PT of Rs. 560**

Continued deal wins and investment in platforms are long-term drivers, but margin pressure continues to persist given the macro headwinds. Hence, we downgrade Intellect Design to Hold with a revised PT of Rs. 560, given near term concerns on growth and margins

One-year forward P/E (x) band



Source: Sharekhan Research

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) Rupee appreciation and/or adverse cross-currency movements, 2) constraint in local talent supply in the US would have an adverse impact on its earnings and 3) macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

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: Bloomberg

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

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