Intellect Design Arena (INTDES)

ICICI direct Research

CMP: ₹ 540 | Target: ₹ 575 (7%) | Target Period: 12 months | HOLD

May 16, 2023

Investments in platform journey continues; aiming for 20% revenue growth in FY24

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 ~20% in FY23)

Q4FY23 Results: Intellect reported robust revenue growth in Q4FY23.

- Revenue in rupee terms grew 20.8% YoY
- EBITDA margins improved ~450 bps QoQ & fell ~150 bps YoY to 22.2%
- Funnel was flattish QoQ at ₹ 7,041 crore

What should investors do? Intellect's share price has grown by ~2.6x over the past five years (from ~₹ 203 in May 2018 to ~₹ 540 levels in May 2023).

- We maintain our **HOLD** rating on the stock

Target Price and Valuation: We value Intellect at ₹ 575 i.e., 20x 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 47% in FY20 to 57% in FY23) 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 20.9% revenue growth over FY23-25E
- BUY with a target price of ₹ 660

intellect® Design for Digital

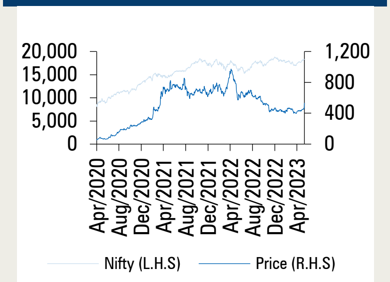
Particulars

Particular	Amount
Market Cap (₹ Crore)	7,181
Total Debt	-
CC&E (₹ Crore)	267
EV (₹ Crore)	6,914
52 week H/L	719 / 389
Equity capital	2,058
Face value	5.0

Shareholding pattern

	Jun-22	Sep-22	Dec-22	Mar-23
Promoter	31	31	31	31
FII	25	24	22	22
DII	3	2	4	4
Public	42	43	43	43

Price Chart



Recent event & key risks

- Declared dividend of ₹ 2.5 per share
- **Key Risk:** (i) Higher than expected revenue growth, (ii) Lower than expected margins

Research Analyst

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Company Update

ICICI Securities – Retail Equity Research

Key Financial Summary

₹ Crore	FY21	FY22	FY23	5 Year CAGR (FY18-23)	FY24E	FY25E	2 Year CAGR (FY23-25E)
Net Sales	1,497	1,878	2,231	15.5%	2,673	3,008	16.1%
EBITDA	355	472	435	43.2%	539	621	19.4%
EBITDA Margins (%)	23.7	25.1	19.5		20.2	20.6	
Net Profit	263	349	267	41.7%	339	404	23.0%
EPS (₹)	19.6	25.1	19.2		24.1	28.7	
P/E	27.6	21.5	28.4		22.4	18.8	
RoNW (%)	18.9	19.3	13.0		14.2	14.4	
RoCE (%)	20.2	22.7	17.5		18.8	19.1	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

- The company reported a revenue of ₹ 615.5 crore, up 12.5% QoQ & 20.8% YoY. License revenue (18% of mix) grew 56.9% QoQ & 39.9% YoY to ₹ 113 crore aiding in the strong revenue growth during the quarter. SaaS revenue (19% of mix) grew 2.7% QoQ & declined 4.4% YoY to ₹ 114 crore while AMC revenue came in at ₹ 106 crore, up 22.4% YoY
- License linked revenues (License+ SAAS+AMC). i.e. 54% of revenue mix grew 16.1% YoY to ₹ 333 crore
- EBITDA margin improved ~450 bps QoQ to 22.2% while on a YoY basis the EBITDA margin declined 150 bps. The company indicated that it capitalised ~₹ 34-35 crore of expenses during the quarter
- For FY23, revenue came in at ₹ 2,231.3 crore, up 18.8%. SaaS revenue increased 80 bps to 20.7% of revenue mix and reported revenue of ₹ 461 crore, up 23.3% while license revenue declined 430 bps to 14.8% of revenue mix, coming at ₹ 330 crore, down 8.1%. License linked revenue (License+ SAAS+AMC) now forms 52.5% of the revenue mix. It came in at ₹ 1,173 crore, up 10.3%. The company for FY23 reported an EBITDA margin of 19.5% compared to 25.1% due to the investments made in technology development during the year by the company
- The company mentioned that it offers its services in license & SaaS form as per the customers preference and the license revenue jump in Q4 was due to the client preference. The company mentioned that it has not set any target for license or SaaS revenue but its overall endeavour is to grow the license linked revenue which is a high margin business. On the SaaS revenue decline on YoY basis the company mentioned that GeM contribution is lower in Q4 and also mentioned that GeM is due for renewal & the company is competing for its renewal. The company also mentioned that the SaaS revenue has a time lag in booking after the deal win and the time lag could be in the range of 12-24 months, which has also impacted the revenue growth during the quarter
- The company mentioned that bank tech wave started in 1965. It is currently in phase 5 of bank tech wave wherein cloud and AI disruption is taking place. Intellect added that when tech disruption happens the companies have to realign themselves to tech stack and for that investment has to be done 3-4 years in advance. The company mentioned that it was able to see this signals that cloud & AI is going to disrupt the banking industry had started investment in these spaces since 2017
- By investing in the cloud & AI space the company has developed eMach.ai which is a composable platform that is almost zero code (less than 5% of codes) and includes all its products in retail, corporate & wealth banking. The company mentioned that it contains 285 microservices, which can be assembled to design a product related for a specific segment in specific market without employing an IT service company. The company mentioned that the platform can be integrated with GSI partner or the banks/FIs IT teams
- The company mentioned that in the last year it had announced that it will invest 5% of its margins for building the next generation technology, which impacted margins in FY23. Intellect added that it has almost completed the investments. Now it will focus on distributing and growing the business. The company mentioned that now its investment in business will come down however it will increase its marketing spend for branding & showcasing its products & platforms to grow the business. Intellect also mentioned that in the last 18 months it has focused on building strategic partnership. The company mentioned that it had already entered into a partnership with Microsoft and is now working with Accenture, which gives the company a strong cloud & AI partner and a digital partner. The company further mentioned that its partnership with IBM is also going strong. It is talks for multiple deals with IBM

- On the future growth outlook, the company mentioned that its business is designed to grow at 20% revenue growth. Intellect aims to grow at 20%+ revenue growth in FY24. The company mentioned that the company is designed for 25% EBITDA margins but it continues to invest back 5% into platform journey. The company, however, mentioned that five years down the line margins will be in the range of 40% aided by increase in AMC business. The company also mentioned that cash generation in FY24 will higher be compared to FY23 as the investment phase is behind but Q1FY24 cash generation will be impacted by bonus payout
- The company mentioned that margin maintenance & improvement will be there once the client is onboarded as the contract is for longer duration of 15-20 years. Intellect, however, mentioned that for growing the business client addition is a priority and it will pick up due to investments made by the company. The company also mentioned that it is not looking to diversify is business from BFSI space. Intellect also mentioned that multiple deals are happening in India and it looking to grow its business in India
- On the SaaS model, the company mentioned SaaS model is not fully matured. Intellect mentioned that in some deals the payment is in front end and some deals the payment is back ended. The company has healthy cash balance. Hence, the working capital is not a constraint for the company. The company's aim is to win sustained SaaS business. Intellect also mentioned that SaaS in a matured model that could provide margins as high as 70% but that takes about four to five years after the client is stabilised
- On R&D investment, the company mentioned that its cost of investment for developing a platform is one-tenth compared to competitors like Thought machine. The company mentioned that it has built new technology with US$5-10 mn investments compared to US$550-600 mn investments made by competitors
- The company also mentioned that it is seeing huge opportunity in core banking transformation space in large tier I banks & large regional banks. The company mentioned that some banks have legacy core architecture. Till now, banks were building new solutions around the old core, which was not giving them complete benefits. However, now the banks are more open to core transformation. With Intellect eMach.ai the risk of transforming the core is declining. The company hence is seeing large opportunity in this space and its unique offerings it is well placed to capture compared to competitors
- The company mentioned that it is still in top three contenders for large bank deals in Europe along with Temenos & Though Machine in a couple of deals while in one deal it in top two contenders now. The company mentioned that the results of the deals will be declared in a couple of quarters. Intellect also mentioned that it has entered into a few RFPs and the Europe market where it is competing is becoming a three company competition among Intellect, Temenos & Though Machine
- On the US banking crisis the company mentioned that it has seen many uncertain events in the last seven years like the UK Brexit, Covid pandemic, Russia-Ukraine conflict, regional banking crisis in US, etc. It is of the opinion that the market calibrates itself and the tech demand is back in two to three quarters. The company also mentioned that its exposure to US banks in minimal. Hence, the current banking crisis will have minimal impact on revenues. The company also mentioned that its exposure to developed markets in more in Europe & Canada. The company also mentioned that although its insurance business in US is growing it is still in single digit of revenue mix although the pipeline is growing is strong
- The company funnel remained flattish QoQ while on a YoY basis it was up 18.4% to ₹ 7,041 crore. The company also mentioned that out of the total funnel 173 opportunities account for ₹ 5,248 crore of funnel i.e. ~75% of the funnel. The company during the quarter added two destiny deals to its

pipeline taking the total destiny deals to 70. The company further mentioned that it focused on having right funnel instead of growing funnel size so that the deal wins are higher and sales effort are channelised in the right direction as deal closure takes ~18-24 months. The company also mentioned that is focused on growing its destiny deals wins

- The company mentioned that in Q4FY23 on sequential basis its Global DSO excl. India declined by 19 days to 107 while India DSO declined by 63 days to 119 bringing the total DSO to 110
- The company declared final dividend of ₹ 2.5 per share for FY23

Exhibit 1: P&L

	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	Comments
Revenue	615.5	509.4	20.8	546.9	12.5	License revenue grew by 56.8% QoQ & 39.8% YoY aiding strong revenue growth during the quarter
Employee expenses	310.9	250.0	24.4	297.8	4.4	
Gross Margin	304.6	259.4	17.4	249.1	22.3	
Gross margin (%)	49.5	50.9	-144 bps	45.5	394 bps	
Other expenses	168.0	138.8	21.0	152.4	10.2	
EBITDA	136.6	120.6	13.2	96.7	41.3	
EBITDA Margin (%)	22.2	23.7	-148 bps	17.7	452 bps	strong non-license revenues drives margin
Depreciation & amortisation	32.9	26.5	24.3	31.1	6.0	
EBIT	103.7	94.1	10.1	65.6	58.0	
EBIT Margin (%)	16.8	18.5	-163 bps	12.0	484 bps	
Other income	11.4	13.3	-14.0	20.2	-43.4	
PBT	115.1	107.4	7.2	85.8	34.1	
Tax paid	32.6	24.1	35.0	21.8	49.5	
PAT	90.7	95.3	-4.8	62.0	46.1	

Source: Company, ICICI Direct Research

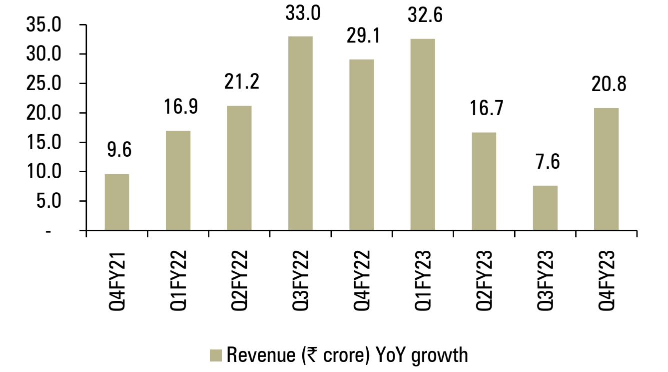
Exhibit 2: Change in estimates

	FY24E			FY25E			Comments
(₹ Crore)	Old	New	% Change	Old	New	% Change	
Revenue	2,387	2,673	11.9	2,559	3,008	17.6	Baking in sustainable growth in FY25E, as guided by management
EBITDA	487	539	10.7	535	621	16.1	
EBITDA Margin (%)	20.4	20.2	-22 bps	20.9	20.6	-26 bps	
PAT	368	339	-9.1	404	404	-1.3	
EPS (₹) -diluted	26.5	24.1	-9.1	29.1	28.7	-1.3	

Source: Company, ICICI Direct Research

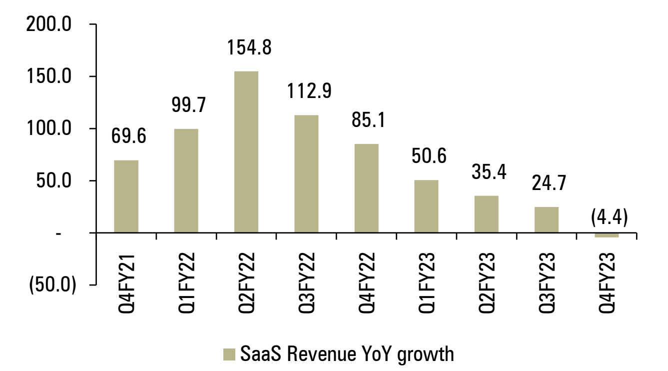
Key Metrics

Exhibit 3: Revenue grew due to jump in license revenue



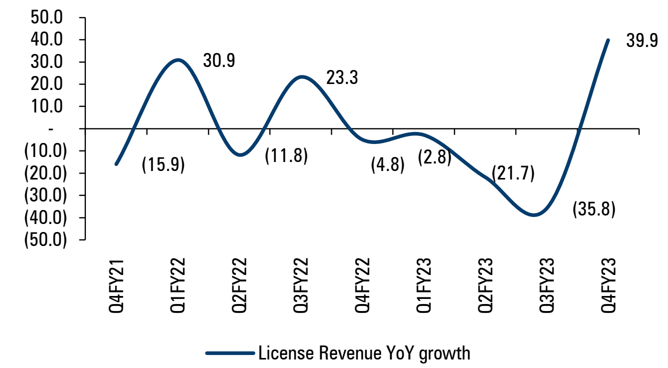
Source: Company, ICICI Direct Research

Exhibit 4: SaaS revenue declines for delay in some deals



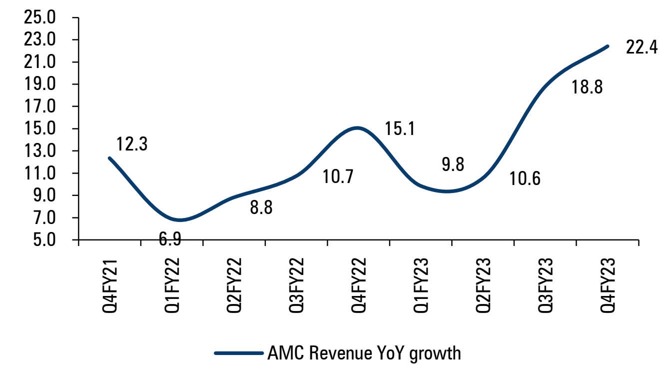
Source: Company, ICICI Direct Research

Exhibit 5: License revenue sees steep increase in Q4



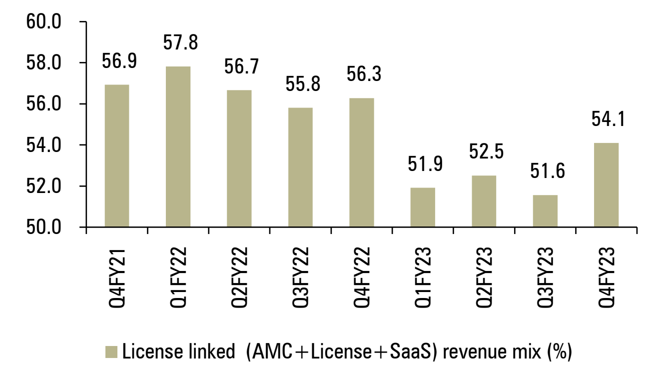
Source: Company, ICICI Direct Research

Exhibit 6: AMC revenue growth trend



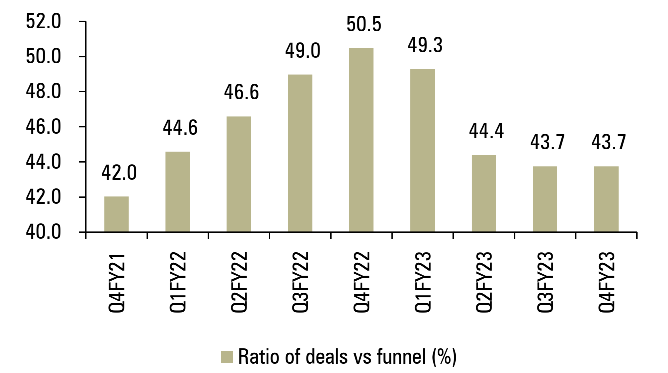
Source: Company, ICICI Direct Research

Exhibit 7: License linked revenue rebounds in Q4



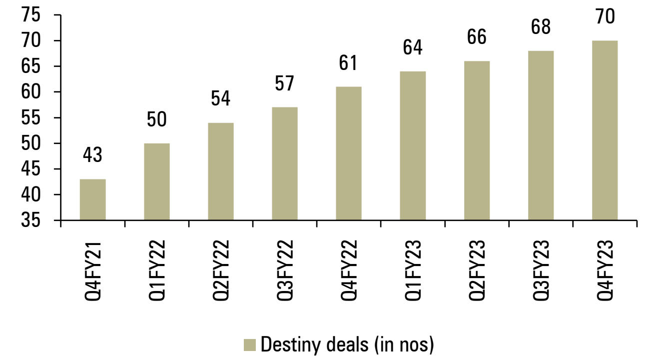
Source: Company, ICICI Direct Research

Exhibit 8: Ratio of deals to funnel continue to be low



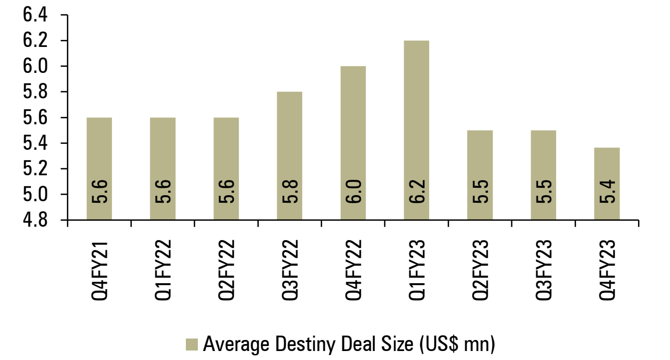
Source: Company, ICICI Direct Research

Exhibit 9: Destiny deals steady



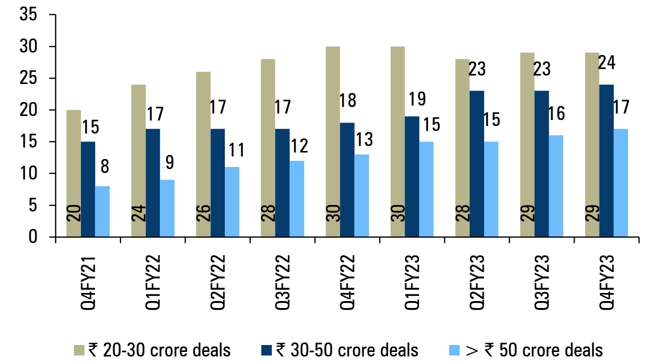
Source: Company, ICICI Direct Research

Exhibit 10: Average deal size continue to be low



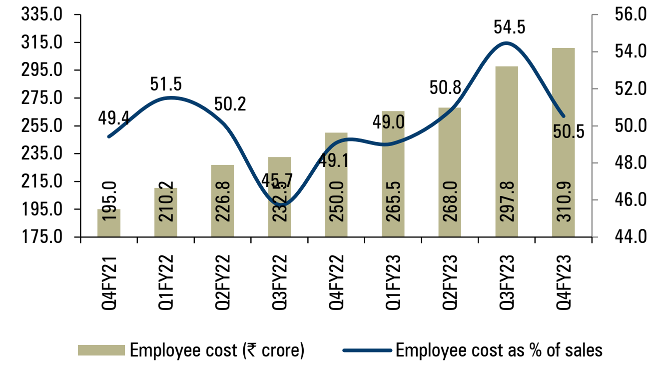
Source: Company, ICICI Direct Research

Exhibit 11: Destiny deal size mix trend



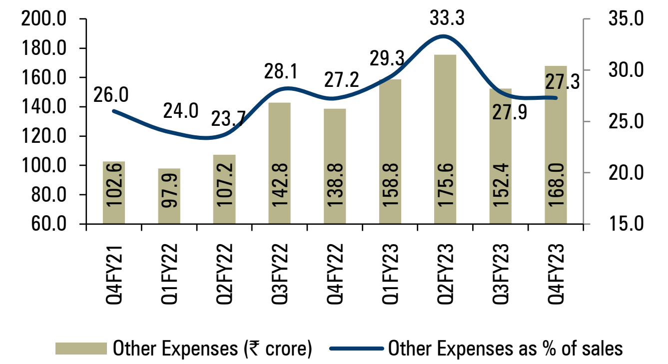
Source: Company, ICICI Direct Research

Exhibit 12: Employee cost to sales trend



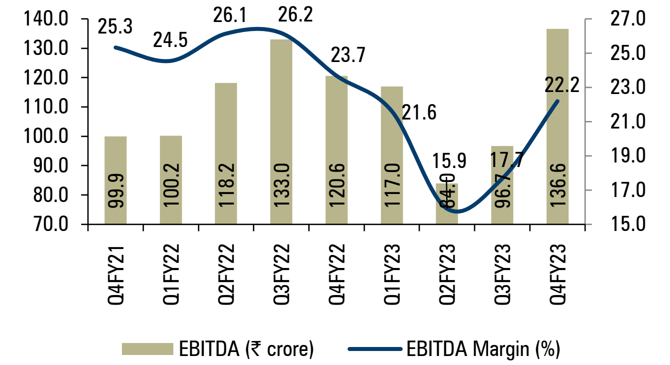
Source: Company, ICICI Direct Research

Exhibit 13: While other expensed remains steady



Source: Company, ICICI Direct Research

Exhibit 14: EBITDA margin down on YoY basis



Source: Company, ICICI Direct Research

Financial summary

Exhibit 15: Profit and loss statement ₹ crore

(Year-end March)	FY22	FY23	FY24E	FY25E
Total operating Income	**1,878**	**2,231**	**2,673**	**3,008**
Growth (%)	25.4	18.8	19.8	12.6
COGS (employee expenses)	921	1,144	1,373	1,529
Other expenses	485	652	760	858
Total Operating Expenditure	1,406	1,796	2,133	2,388
EBITDA	**472**	**435**	**539**	**621**
Growth (%)	33.0	(7.8)	23.9	15.1
Depreciation	98	122	134	135
Other income (net)	36	48	47	54
PBT	411	362	453	539
Total Tax	63	95	113	135
PAT after minority	**349**	**267**	**339**	**404**
Growth (%)	32.8	(23.4)	27.0	19.1
Diluted EPS (₹)	**25.1**	**19.2**	**24.1**	**28.7**
Growth (%)	28.6	(23.5)	25.4	19.1

Source: Company, ICICI Direct Research

Exhibit 16: Cash flow statement ₹ crore

(Year-end March)	FY22	FY23	FY24E	FY25E
PBT	411	363	453	539
Add: Depreciation	98	122	134	135
Others	52	57	(47)	(54)
Inc/(dec) in working capital	(94)	(296)	153	(58)
Taxes paid	(15)	(72)	(113)	(135)
CF from operating activities	**453**	**174**	**579**	**428**
(Inc)/dec in Fixed Assets	(129)	(166)	(214)	(241)
Others	(270)	(12)	50	56
CF from investing activities	**(399)**	**(177)**	**(164)**	**(185)**
Borrowings	(41)	(1)	-	-
Others	(11)	(49)	(3)	(2)
CF from financing activities	**(52)**	**(50)**	**(3)**	**(2)**
Net Cash flow	2	(53)	413	241
Exchange difference	(0)	0	-	-
Opening Cash	145	159	94	507
Closing cash balance	**159**	**94**	**507**	**748**

Source: Company, ICICI Direct Research

Exhibit 17: Balance sheet ₹ crore

(Year-end March)	FY22	FY23	FY24E	FY25E
Equity Capital	67	68	68	68
Reserve and Surplus	1,754	2,001	2,340	2,744
Total Shareholders funds	1,822	2,069	2,408	2,812
Total Debt	1	-	-	-
Lease liablity	7	15	15	15
Derivative Instruments	-	-	-	-
Other non current liabilties	2	4	4	4
Total Liabilities	**1,831**	**2,087**	**2,426**	**2,831**
Assets				
Property,plant and equipment	153	155	275	418
Investment in Property	2	2	2	2
Goodwill	30	33	33	33
Intangibles	570	643	603	566
Right-of-use assets	23	31	31	31
Other non current assets	400	621	643	660
Cash & bank balance	159	97	510	751
Current Investments	249	30	30	30
Trade receivables	257	416	498	561
Loans and deposits	3	1	1	1
Other financial assets	620	743	615	692
Other current assets	127	115	138	155
Total Current Assets	1,415	1,402	1,792	2,191
Trade payables	257	275	329	370
Lease liablity	12	12	12	12
OCL & provisions	494	513	612	688
Total Current Liabilities	763	800	954	1,070
Net Current Assets	652	601	838	1,120
Application of Funds	**1,831**	**2,087**	**2,426**	**2,831**

Source: Company, ICICI Direct Research

Exhibit 18: Key ratios ₹ crore

(Year-end March)	FY22	FY23	FY24E	FY25E
Per share data (₹)				
Diluted EPS	25.1	19.2	24.1	28.7
Cash EPS	33.6	28.9	35.1	40.1
BV	130	146	170	199
DPS	0.1	2.6	-	-
Cash Per Share	11	7	38	56
Operating Ratios (%)				
EBITDA margin	25.1	19.5	20.2	20.6
PBT Margin	22.0	16.3	16.9	17.9
PAT Margin	18.6	12.0	12.7	13.4
Debtor days	170	190	152	152
Creditor days	50	45	45	45
Return Ratios (%)				
RoE	19.3	13.0	14.2	14.4
RoCE	22.7	17.5	18.8	19.1
RoIC	36.0	21.7	29.2	31.1
Valuation Ratios (x)				
P/E	21.5	28.4	22.4	18.8
EV / EBITDA	14.3	15.9	12.1	10.1
EV / Net Sales	3.6	3.1	2.4	2.1
Market Cap / Sales	3.8	3.2	2.7	2.4
Price to Book Value	4.0	3.5	3.0	2.6
Solvency Ratios				
Debt/EBITDA	0.0	-	-	-
Debt / Equity	0.0	-	-	-
Current Ratio	1.3	1.6	1.3	1.3
Quick Ratio	1.3	1.6	1.3	1.3

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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