

Intellect Design Arena

BUY

Stumbled, recovery awaited

We maintain BUY on Intellect despite a weak 2QFY20. Deferral of few large deals and accelerated shift to cloud has impacted growth. Large deal funnel remains healthy but decision making is taking longer than expected. 2H will witness growth and margin recovery but we cut our FY20/21E revenue est. by 6.6/6.7% to factor in weak 1H and delay in deal conversion. We have a TP of Rs 288, assigning 2.0x EV/rev multiple to Sep 21E revenue.

HIGHLIGHTS OF THE QUARTER

- Revenue stood at USD 46.6mn -5.7/-14.2% QoQ/YoY (vs est. of USD 54mn). Revenue miss was due to drop in licence revenue (-20% QoQ) and delay in decision making. Two large deals got deferred and the cloud wins had negligible revenue contribution.
- Order backlog is down 2.5% QoQ to Rs 11.00bn due to weak licence revenue. On a TTM basis USD revenue is up 9.0% YoY and licence is up only 2.3% YoY (vs. ~50-55% YoY). AMC and SI revenue will recover gradually.
- EBITDA margin contracted 507bps QoQ to -1.5% (vs our est. of 9.2%) led by drop in revenue. GM stood at 45.3% down 179bps QoQ, margins will recover with growth led by cost control and non-linearity.
- Intellect is chasing ~41 large deals, eight are more than Rs 0.5bn in size and 13 are in the range of Rs 0.3-0.5bn. The company has become selective in chasing deals due to elongated sales cycle. Destiny deals contribute ~54% of the active funnel (USD 471mn).

Financial Summary

YE Mar (Rs bn)	2QFY20	2QFY19	YoY (%)	1QFY20	QoQ (%)	FY18	FY19	FY20E	FY21E	FY22E
Net Revenue	3.28	3.80	(13.9)	3.43	(4.6)	10.87	14.50	14.80	17.48	20.78
EBIT	-0.21	0.28	NM	-0.04	NM	0.52	0.98	0.66	1.35	1.87
APAT	-0.17	0.31	NM	-0.02	NM	0.47	1.01	0.61	1.14	1.55
Adjusted EPS (Rs)	(1.3)	2.4	NM	(0.1)	NM	3.5	7.7	4.6	8.7	11.8
P/E (x)						52.8	24.4	40.2	21.6	15.9
EV / Revenue (x)						2.2	1.7	1.7	1.4	1.2
RoE (%)						6.7	11.1	5.8	10.0	12.2

Source: Company, HDFC sec Inst Research

- Intellect Digital core (IDC) and IGTB is witnessing traction, has a pipeline of USD 45mn and USD 90mn respectively for 2HFY20. Intellect iSEEC (Insurance Tech) pipeline is also building up (USD 20mn+).
- Cloud (SaaS) is ~5% of revenue and has an order backlog of Rs 3.75bn (+56% YoY). Partnership with AWS and IBM cloud will drive cloud wins.
- DSO stood at 126 days vs. 119 days last quarter. Net cash stood at Rs 0.32bn vs. Rs 0.26bn in 1QFY20.

STANCE: Hitting a road block, deal pipeline healthy

Intellect's growth engine has witnessed slowdown due to delay in decision making (Brexit), deferral of large deals, accelerated shift to cloud (iGCB and iGTB) and absence of licence component in cloud wins. Shift to cloud model will impact near term growth but building of annuity SaaS revenue will improve predictability and profitability. Cost control measures have been satisfactory and margins will recover with growth. The deal funnel stands at healthy USD 524mn with 134 opportunities. We maintain our positive stance based on (1) Huge addressable market opportunity (2) Highly-rated and digital-ready product portfolio, (3) Healthy funnel, and (4) Focus on large deal wins. We estimate USD revenue growth of 1.5/16.0% for FY20/21E. Risk to our thesis includes prolonged delay in decision making and US/UK slowdown.

INDUSTRY	IT
CMP (as on 04 Nov 2019)	Rs 187
Target Price	Rs 288
Nifty	11,941
Sensex	40,302
KEY STOCK DATA	
Bloomberg	INDA IN
No. of Shares (mn)	132
MCap (Rs bn) / (\$ mn)	25/350
6m avg traded value (Rs mn)	77
STOCK PERFORMANCE (%)	
52 Week high / low	Rs 292/151
	3M 6M 12M
Absolute (%)	(15.4) (13.8) (25.0)
Relative (%)	(24.0) (17.3) (40.1)
SHAREHOLDING PATTERN (%)	
	Jun-19 Sep-19
Promoters	31.47 31.41
FIs & Local MFs	7.26 5.09
FPIs	19.12 22.37
Public & Others	42.15 41.13
Pledged Shares	3.95 1.86
Source : BSE	

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Revenue declined 5.7% QoQ led by licence (-20.3% QoQ), and SI (-4.0% QoQ) while AMC was up 4.4% QoQ

On TTM basis revenue was down 3.6% QoQ led by 17.3% fall in licence revenue

Gross margin contracted 179bps QoQ on due to non-linearity and decline in licence revenue, GM target is ~50-55%

Overall cost was under control, total cost was flat QoQ and down 2.8% YoY

Other income was down due to absence of onetime gain (Rs 53mn for sale of property), adjusted it was up 12% QoQ

Quarterly Consolidated Financials Snapshot

Particulars (Rs mn)	2QFY20	2QFY19	YoY (%)	1QFY20	QoQ (%)
Net Revenue USD mn	46.6	54.3	(14.2)	49.4	(5.7)
Net Revenue	3,275	3,804	(13.9)	3,434	(4.6)
Software development expenses (SDE)	1,791	1,927	(7.1)	1,816	(1.4)
SG&A	1,166	1,143	2.0	1,140	2.3
R&D	333	237	40.2	336	(0.8)
Provisions & Write-off	35	113	(69.5)	20	76.9
EBITDA	-49	383	NM	122	NM
Depreciation	162	107	51.1	165	(2.0)
EBIT	-211	276	NM	-43	NM
Other Income	106	156	(32.1)	147	(28.2)
Interest Cost	48	34	40.1	39	21.3
PBT	-154	397	NM	65	NM
Tax	7	58	NM	3	153.3
Minority Interest	10	24	(60.5)	28	(65.8)
RPAT	-170	315	NM	34	NM
EO Items (Adj For Tax)	0	0	NM	53	NM
APAT	-170	315	NM	-19	NM

Source: Company, HDFC sec Inst Research

Margin Analysis

MARGIN ANALYSIS %	2QFY20	2QFY19	YoY (%)	1QFY20	QoQ (%)
Employee Expenses % Net Revenue	54.7	50.7	401	52.9	179
SG&A Expenses % Net Revenue	35.6	30.1	555	33.2	240
R&D Expenses % Net Revenue	10.2	6.2	392	9.8	40
Gross Margin %	45.3	49.3	(401)	47.1	(179)
EBITDA Margin (%)	(1.5)	10.1	(1,157)	3.6	(507)
EBIT Margin (%)	(6.5)	7.2	(1,370)	(1.3)	(520)
Tax Rate (%)	(4.5)	14.5	(1,901)	4.2	(869)
APAT Margin (%)	(5.2)	8.3	(1,348)	(0.6)	(463)

Source: Company, HDFC sec Inst Research

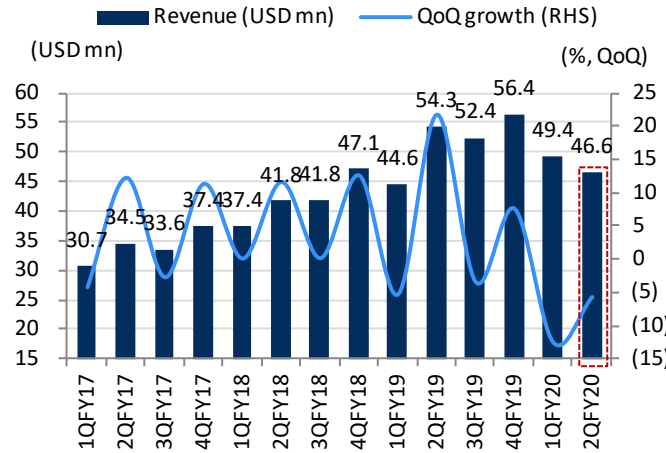
Intellect growth was impacted due to deferment of two large deals; total licence revenue expected from these deals was ~USD 10-12mn

YoY growth is down for the fifth consecutive quarter, steep fall this quarter was due to high base impact. On TTM basis revenue is up 9% YoY

SG&A as a percentage of revenue has inched up to ~36%. Major sales and marketing investments are behind and total cost will remain under control

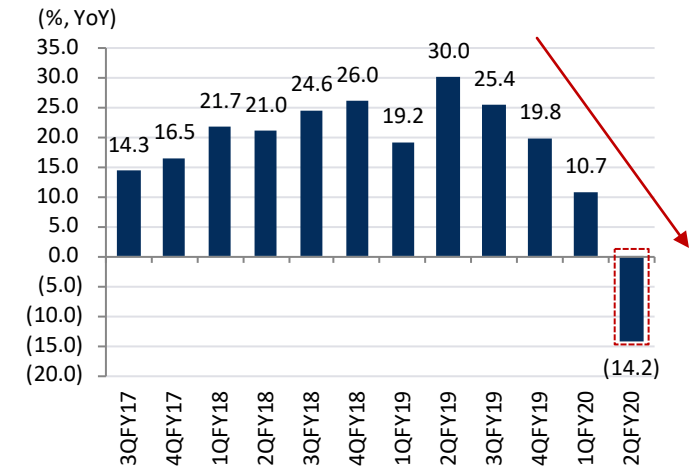
R&D expense remained flat in the quarter, we don't see any uptick in R&D cost in the near future

Intellect USD Revenue Trend



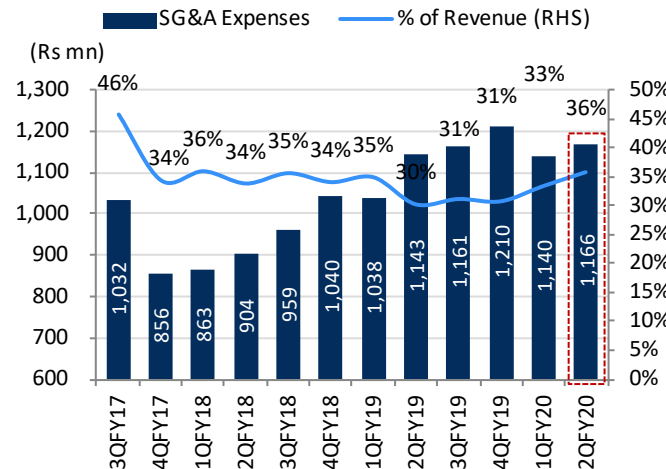
Source: Company, HDFC sec Inst Research

USD Revenue YoY Growth Rate



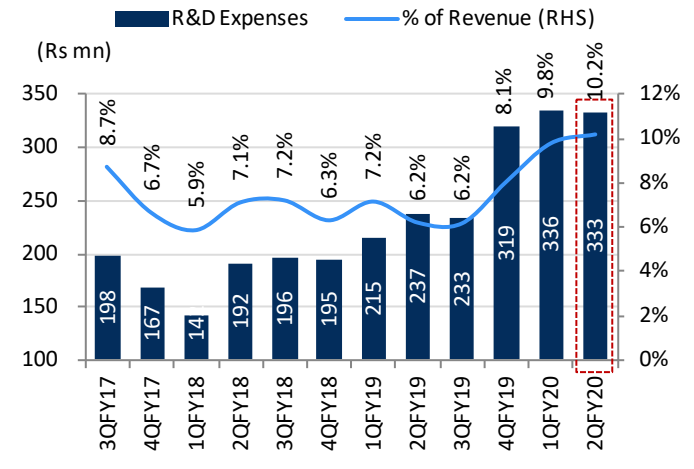
Source: Company, HDFC sec Inst Research

SG&A Trend



Source: Company, HDFC sec Inst Research

R&D Expense Is Steady For the Past Two Qtrs



Source: Company, HDFC sec Inst Research

Total R&D spends (including capitalisation) decreased 2.1% QoQ to Rs 0.62bn (18.8% of revenue vs. 14.0% a year ago)

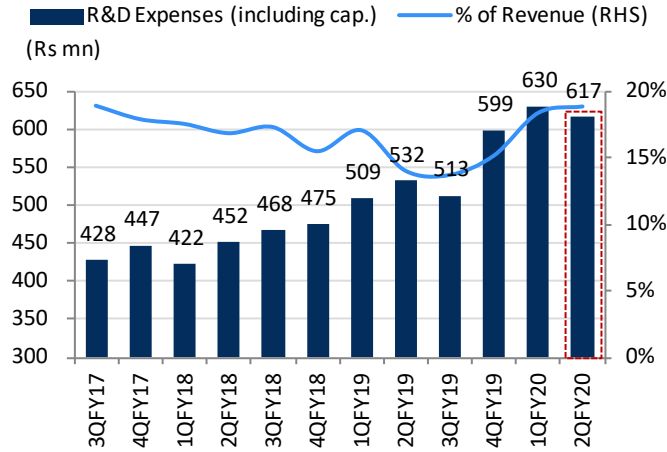
Order backlog growth is led by cloud wins. Ex cloud order book remains muted due to deferment of deals and lower licence revenue

AMC revenue generally comes after a lag of 1-2 years post licence booking

Cloud deals has no near term revenue impact. These are back-ended but generate higher revenue and margins over the total deal tenure

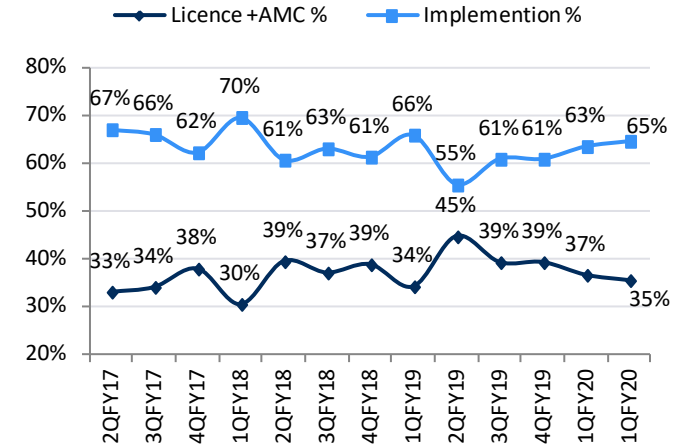
The total go-lives was 13 vs. 9 last quarter

R&D Expenses (Including Capitalisation)



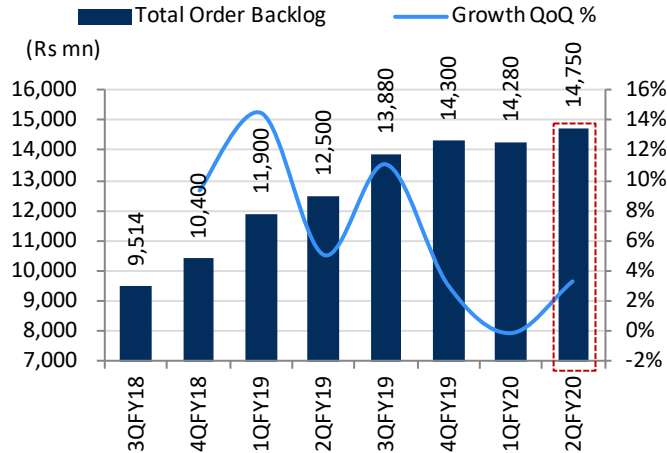
Source: Company, HDFC sec Inst Research

License & Implementation Fee As % Of Revenue



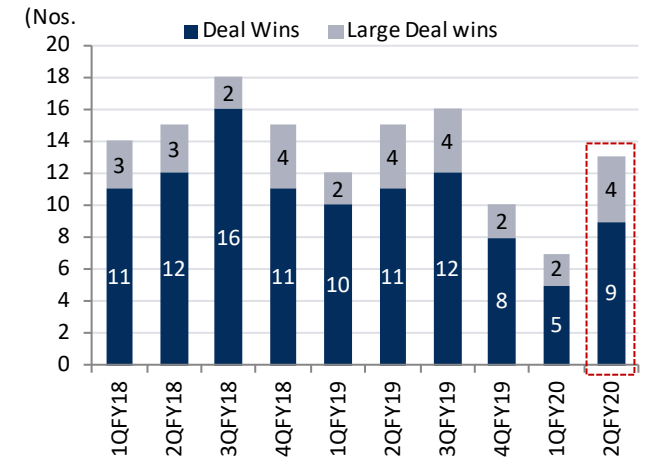
Source: Company, HDFC sec Inst Research

Order Backlog (Licence+AMC+Cloud)



Source: Company, HDFC sec Inst Research

Deal Wins (Traction In Cloud Deals)



Source: Company, HDFC sec Inst Research

We cut estimate for FY20/21E by 6.6/6.7% due to muted performance in 1H. We expect recovery in 2H (-0.9% YoY vs -12.4% YoY in 1H)

Margin and profits will get impacted due to non-linearity

We expect licence+AMC revenue to recover in FY21/22E and SI growth will follow

Change In Estimates

Particulars	Earlier estimates	Revised estimates	% change
FY20E			
Revenue (USD mn)	226	211	(6.6)
Revenue (Rs bn)	15.85	14.80	(6.6)
EBIT (Rs bn)	1.24	0.66	(46.4)
EBIT margin (%)	7.8	4.5	(333) bps
EPS (Rs)	7.6	4.6	(38.5)
FY21E			
Revenue (USD mn)	262	244	(6.7)
Revenue (Rs bn)	18.73	17.48	(6.7)
EBIT (Rs bn)	1.93	1.35	(30.2)
EBIT margin (%)	10.3	7.7	(259) bps
EPS (Rs)	11.7	8.7	(25.6)
FY22E			
Revenue (USD mn)	307	285	(7.2)
Revenue (Rs bn)	22.38	20.78	(7.2)
EBIT (Rs bn)	2.67	1.87	(29.9)
EBIT margin (%)	11.9	9.0	(292) bps
EPS (Rs)	16.4	11.8	(28.1)

Source: Company, HDFC sec Inst Research

Assumptions

Particulars	FY18	FY19	FY20E	FY21E	FY22E
License & AMC Growth (%)	30.7	33.4	(6.4)	23.4	18.2
System Integration Growth (%)	19.6	18.0	6.6	11.8	15.4
Total USD Revenue Growth (%)	23.4	23.6	1.5	16.0	16.4
USD/INR Rate	64.7	69.7	70.2	71.5	73.0
EBIT Margin (%)	4.8	6.7	4.5	7.7	9.0

Source: Company, HDFC sec Inst Research

Peer Set Comparison

Relative Valuation	Mcap (Rs bn)	CMP (Rs)	Rating	Target (Rs)	EV/Revenue (x)				EV/EBITDA (x)				EBIT Margin (%)			
					FY18	FY19	FY20E	FY21E	FY18	FY19	FY20E	FY21E	FY18	FY19	FY20E	FY21E
Intellect	24.7	187	BUY	288	2.2	1.7	1.7	1.4	6.7	11.1	5.8	10.0	4.8	6.7	4.5	7.7
Majesco	12.0	420	BUY	700	1.1	0.8	0.7	0.6	(1.0)	8.4	8.3	11.4	0.6	7.4	9.0	13.4

Source: Company, HDFC sec Inst Research

Income Statement (Consolidated)

YE March (Rs bn)	FY18	FY19	FY20E	FY21E	FY22E
Net Revenues (USD mn)	168.1	207.7	210.7	244.5	284.7
Growth (%)	23.4%	23.6%	1.5%	16.0%	16.4%
Net Revenues (Rs bn)	10.87	14.50	14.80	17.48	20.78
Growth (%)	19.0%	33.3%	2.1%	18.1%	18.9%
Software development expenses (SDE)	5.49	7.37	7.27	8.12	9.32
SG&A	3.87	4.73	4.87	5.76	6.99
R&D	0.72	1.00	1.34	1.54	1.82
EBITDA	0.79	1.39	1.32	2.06	2.65
EBITDA Margin (%)	7.2%	9.6%	8.9%	11.8%	12.8%
EBITDA Growth (%)	NM	77.2%	-5.5%	56.4%	28.8%
Depreciation	0.27	0.42	0.65	0.71	0.78
EBIT	0.52	0.98	0.66	1.35	1.87
EBIT Margin (%)	4.8%	6.7%	4.5%	7.7%	9.0%
Other Income (Including EO Items)	0.20	0.51	0.41	0.21	0.21
Interest	0.14	0.11	0.18	0.16	0.20
PBT	0.59	1.37	0.90	1.39	1.88
Tax (Incl Deferred)	0.07	0.09	0.16	0.21	0.28
Minority Interest	0.05	-0.03	0.08	0.04	0.04
RPAT	0.47	1.31	0.67	1.14	1.55
EO (Loss) / Profit (Net Of Tax)	0.00	0.30	0.05	0.00	0.00
APAT	0.47	1.01	0.61	1.14	1.55
APAT Growth (%)	NM	116.0%	-39.3%	86.7%	35.8%
Adjusted EPS (Rs)	3.5	7.7	4.6	8.7	11.8
EPS Growth (%)	NM	116.0%	-39.3%	86.7%	35.8%

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

YE March (Rs bn)	FY18	FY19	FY20E	FY21E	FY22E
SOURCES OF FUNDS					
Share Capital - Equity	0.63	0.66	0.66	0.66	0.66
Reserves	7.39	9.54	10.20	11.35	12.90
Total Shareholders' Funds	8.02	10.20	10.86	12.01	13.56
Total Debt	1.29	1.01	1.01	1.01	1.01
Net Deferred Taxes	(0.16)	(0.44)	(0.44)	(0.44)	(0.44)
Long Term Provisions & Others	0.00	0.00	0.00	0.00	0.00
TOTAL SOURCES OF FUNDS	9.25	10.85	11.60	12.78	14.38
APPLICATION OF FUNDS					
Net Block	2.39	2.98	2.62	2.26	1.89
CWIP	1.96	2.28	3.42	4.58	5.80
Goodwill	0.35	0.36	0.36	0.36	0.36
Investments	0.47	0.52	0.52	0.52	0.52
LT Loans & Advances	1.20	1.37	1.48	1.75	2.08
Total Non-current Assets	6.37	7.51	8.41	9.48	10.65
Debtors	2.41	2.03	2.43	2.87	3.42
Other Current Assets	2.96	5.25	5.35	5.74	6.37
Cash & Equivalents	1.72	1.08	0.47	0.61	0.96
Total Current Assets	5.37	7.28	7.78	8.61	9.78
Creditors	1.17	1.66	1.66	1.90	2.23
Other Current Liabilities & Provns	3.04	3.35	3.40	4.02	4.78
Total Current Liabilities	4.20	5.02	5.07	5.92	7.01
Net Current Assets	1.16	2.26	2.71	2.69	2.77
TOTAL APPLICATION OF FUNDS	9.25	10.85	11.60	12.78	14.38

Source: Company, HDFC sec Inst Research

Cash Flow Statement (Consolidated)

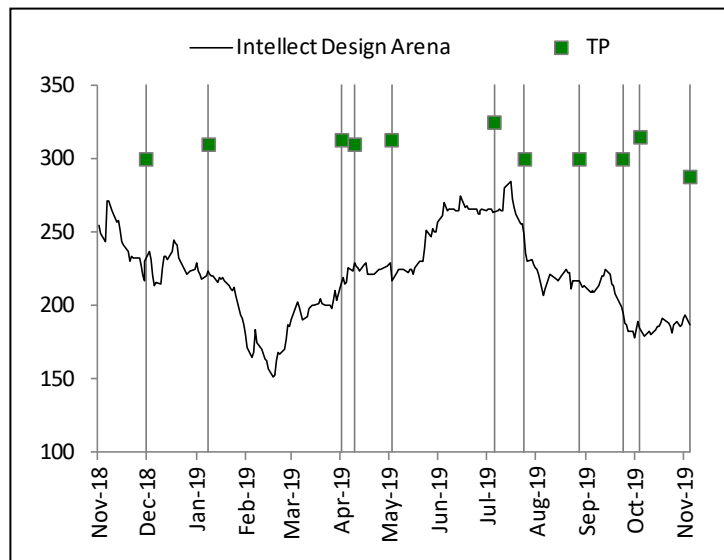
YE March (Rs bn)	FY18	FY19	FY20E	FY21E	FY22E
Reported PBT	0.59	1.37	0.90	1.39	1.88
Non-operating & EO items	(0.02)	(0.51)	(0.41)	(0.21)	(0.21)
Interest expenses	0.14	0.11	0.18	0.16	0.20
Depreciation	0.27	0.42	0.65	0.71	0.78
Working Capital Change	(0.77)	(1.27)	(0.56)	(0.25)	(0.41)
Tax Paid	(0.28)	(0.09)	(0.16)	(0.21)	(0.28)
OPERATING CASH FLOW (a)	(0.08)	0.04	0.59	1.60	1.96
Capex	(2.05)	(1.33)	(1.44)	(1.51)	(1.63)
Free cash flow (FCF)	(2.13)	(1.29)	(0.85)	0.09	0.34
Investments	(0.45)	0.05	0.00	0.00	0.00
Non-operating Income	0.06	0.51	0.41	0.21	0.21
INVESTING CASH FLOW (b)	(2.44)	(0.77)	(1.03)	(1.30)	(1.42)
Debt Issuance/(Repaid)	1.04	(0.28)	0.00	0.00	0.00
Interest Expenses	(0.14)	(0.11)	(0.18)	(0.16)	(0.20)
FCFE	(1.23)	(1.69)	(1.02)	(0.07)	0.14
Share Capital Issuance/Rights Issue	2.00	0.03	0.00	0.00	0.00
Dividend	0.00	0.00	0.00	0.00	0.00
FINANCING CASH FLOW (c)	2.89	(0.36)	(0.18)	(0.16)	(0.20)
NET CASH FLOW (a+b+c)	0.37	(1.10)	(0.61)	0.14	0.35
EO Items, Others	0.29	(0.46)	0.00	0.00	0.00
Closing Cash & Equivalents	1.72	1.08	0.47	0.61	0.96

Source: Company, HDFC sec Inst Research

Key Ratios (Consolidated)

	FY18	FY19	FY20E	FY21E	FY22E
PROFITABILITY (%)					
GPM	49.5	49.1	50.9	53.5	55.2
EBITDA Margin	7.2	9.6	8.9	11.8	12.8
APAT Margin	4.3	7.0	4.1	6.5	7.5
RoE	6.7	11.1	5.8	10.0	12.2
RoIC (or Core RoCE)	6.6	10.7	5.3	10.0	12.6
RoCE	4.7	7.6	4.7	7.2	8.6
EFFICIENCY					
Tax Rate (%)	12.0	6.5	17.5	15.0	15.0
Fixed Asset Turnover (x)	2.1	2.3	2.3	2.6	2.9
Debtors (days)	81	51	60	60	60
Other Current Assets (days)	99	132	132	120	112
Payables (days)	42	46	45	45	45
Other Current Liab & Provns (days)	102	84	84	84	84
Cash Conversion Cycle (days)	36	53	63	51	43
Debt/EBITDA (x)	1.6	0.7	0.8	0.5	0.4
Net D/E (x)	(0.0)	0.0	0.1	0.0	0.0
Interest Coverage (x)	5.7	12.2	7.4	12.7	13.5
PER SHARE DATA (Rs)					
EPS	3.5	7.7	4.6	8.7	11.8
CEPS	5.6	10.8	9.6	14.1	17.7
Dividend	0.0	0.0	0.0	0.0	0.0
Book Value	60.8	77.3	82.3	91.0	102.8
VALUATION					
P/E (x)	52.8	24.4	40.2	21.6	15.9
P/BV (x)	3.1	2.4	2.3	2.1	1.8
EV/EBITDA (x)	31.1	17.8	19.3	12.2	9.4
EV/Revenues (x)	2.2	1.7	1.7	1.4	1.2
OCF/EV (%)	(0.3)	0.2	2.3	6.4	7.9
FCF/EV (%)	(8.7)	(5.2)	(3.3)	0.4	1.4
FCFE/Mkt Cap (%)	(5.0)	(6.8)	(4.2)	(0.3)	0.6
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0

Source: Company, HDFC sec Inst Research; N.A – Not Applicable, NM – Not Meaningful

RECOMMENDATION HISTORY


Date	CMP	Reco	Target
30-Nov-18	217	BUY	300
8-Jan-19	223	BUY	310
1-Apr-19	203	BUY	313
9-Apr-19	223	BUY	310
3-May-19	229	BUY	313
5-Jul-19	263	BUY	325
25-Jul-19	249	BUY	300
27-Aug-19	217	BUY	300
22-Sep-19	205	BUY	300
4-Oct-19	188	BUY	315
5-Nov-19	187	BUY	288

Rating Definitions

- BUY** : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

INSTITUTIONAL RESEARCH
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