Note Updated on:

1. Oct 2020
2. Dec 2020
3. Mar 2021

Intellect Design Arena (CMP: INR625)

Key Financials

Profit & Loss A/c (Rs Mn)	FY18	FY19	FY20	FY21E	FY22E	FY23E	FY24E
USD revenue (US$ mn)	**168**	**208**	**191**	**203**	**235**	**258**	**282**
USD INR rate	64.6	70.2	70.9	74.2	72.8	72.9	73.7
Revenue	**10,873**	**14,587**	**13,509**	**15,060**	**17,125**	**18,790**	**20,794**
Expenditure							
Software development expenses	5,490	7,372	6,987	6,631	7,088	7,560	8,317
Gross Profit	**5,383**	**7,216**	**6,522**	**8,428**	**10,038**	**11,230**	**12,476**
SG&A Expenses	3,766	4,553	4,213	3,358	3,557	3,747	4,028
R&D Expenses	724	1,004	1,219	929	935	960	1,000
ESOP Cost	0	0	170	297	296	296	296
Provision for Debts and Write offs	106	174	172	150	175	200	235
Total Expenditure	**10,087**	**13,102**	**12,760**	**11,365**	**12,050**	**12,763**	**13,877**
EBITDA	**786**	**1,485**	**748**	**3,694**	**5,075**	**6,027**	**6,917**
Depreciation	265	416	690	770	835	880	920
EBIT	**521**	**1,069**	**59**	**2,924**	**4,240**	**5,147**	**5,997**
Other Income	204	417	280	95	81	115	230
Finance Cost	138	114	174	90	40	30	22
Share of profit/(loss) of associates a	50	30	62	60	238	238	238
PBT	**637**	**1,402**	**227**	**2,989**	**4,519**	**5,470**	**6,443**
Tax	70	89	51	276	904	1,094	1,611
PAT	**567**	**1,313**	**176**	**2,713**	**3,615**	**4,376**	**4,832**

Cash Flow (Rs Mn)	FY18	FY19	FY20	FY21E	FY22E	FY23E	FY24E
Profit before tax	**637**	**1,402**	**227**	**2,989**	**4,519**	**5,470**	**6,443**
Depreciation & Amortisation	265	416	690	770	835	880	920
Net Interest Expense	90	63	82	90	40	30	22
Direct taxes paid	-285	-329	71	-276	-904	-1,094	-1,611
Chg in Workg Capital	-193	-1,775	-803	54	-349	-314	-266
Other	-21	-280	168	0	0	0	0
CF from Operations	**495**	**-503**	**436**	**3,628**	**4,141**	**4,971**	**5,508**
CF from Investing	**-1,495**	**11**	**-999**	**-1,445**	**-1,450**	**-1,450**	**-1,500**
CF from Financing	**1,425**	**630**	**801**	**-1,659**	**-179**	**-19**	**52**
Closing Cash balances	**615**	**753**	**997**	**1,521**	**4,033**	**7,535**	**11,596**

Important Ratios	FY18	FY19	FY20	FY21E	FY22E	FY23E	FY24E
Measures of Performance (%)							
Gross Profit Margin	49.5	49.5	48.3	56.0	58.6	59.8	60.0
EBIDTA Margin	7.2	10.2	5.5	24.5	29.6	32.1	33.3
EBIT Margin	4.8	7.3	0.4	19.4	24.8	27.4	28.8
Tax/PBT	11.0	6.4	22.4	9.2	20.0	20.0	25.0
Net Profit Margin	5.2	9.0	1.3	18.0	21.1	23.3	23.2
As Percentage of Net Sales							
Software Development Expenses	50.5	50.5	51.7	44.0	41.4	40.2	40.0
SG&A Expenses	34.6	31.2	31.2	22.3	20.8	19.9	19.4
R&D Expenses	6.7	6.9	9.0	6.2	5.5	5.1	4.8
Provision for Debts and Write offs	1.0	1.2	1.3	1.0	1.0	1.1	1.1
Total Opex	92.8	89.8	93.2	73.5	68.6	66.4	65.3
Depreciation	2.4	2.8	5.1	5.1	4.9	4.7	4.4
Measures of Investment							
EPS (Rs.)	4.5	10.0	1.3	20.5	27.3	33.0	36.5
RoANW (%)	7.8	14.1	1.7	23.0	24.1	23.1	20.7
RoACE (%)	5.8	10.4	0.5	22.7	27.9	27.1	25.6

Valuation Ratios	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
CMP (Rs.)	625	625	625	625	625	625	625
P/E (x)	137.8	62.6	465.9	30.5	22.9	18.9	17.1
EV/Sales (x)	7.1	5.6	6.1	5.4	4.6	4.0	3.4
EV/EBDITA (x)	98.1	54.9	110.0	21.9	15.4	12.4	10.2

I. Background and Company Description

- Intellect Design Arena (INDA) is a fast growing banking software company in the world with offerings across multiple segments in the BFSI sub-segments.

- INDA is a product business spun off from Polaris Financial Technology. INDA got listed in Dec 2014. Management felt INDA required separate focus and go-to-market strategy.

- INDA is a rare company that has created specialized software catering to the entire spectrum of BFSI sub segments such as Transactional Banking (product name: iGTB), Consumer Banking (iGCB), Central Banking, Risk & Treasury (iRTB) and Insurance (SEEC).

- Client Profile

Region	Clients
Europe	Barclays, Llyods Bank, HSBC, RBS, Banco Santander, DNB, SEB, Societe General, Deutsche Leasing, Elavon, Migrosbank, Euro Exim Bank, Raiffeisen Bank
Americas	Bank of Montreal, CIBC, JP Morgan, Citi, Northern Trust, Fifth Third Bank
India	HDFC Bank, ICICI Bank, Axis, PNB, IDFC, BoB, Bank of India, IDFC, ING, Kotak, Dhanalaxmi Bank
Asia-Pacific	Bangkok Bank, BIDV, BCA, Mizuho, SHB, DBP, Hong Leong Bank, ANZ, Westpac, UOB
ME & Africa	NBK, QNB, ADIB, ADCB, Firstbank, ABSA, Housing Finance Bank, Arab Bank, Bank Muscat, Fedbank, FNB, GIB, Mashreq

- Geographic Exposure – INDA gets about 60% of exposure from advanced markets (EU, US, Japan, Australia). Among advanced markets, it is particularly strong in EU as can also be seen from the client list above. US is one of the most challenging market and INDA has now tied up with IBM to take this challenge of entering the US market.

II. Summary of the Investment Case

- **INDA is a product company with a wide range of product suite spanning across transaction banking, consumer banking, insurance, wealth management, treasury and catering to secular opportunity of increasing role of digitization and technology in BFSI space –** Higher adoption of technology and role of software in banking is getting the backing of regulators and this is required not only from perspective of ease of use, transparency, fraud detection, less corruption but this is also required for capabilities enhancement and use of analytics.

- **Has Intellect reached an inflexion point in terms of operating leverage, cash flow generation? YES.**
  The key metric to monitor in every software product company is the stage in which the products currently lie in the product life cycle (incubation -> catalyst -> adoption -> monetization). **INDA has 6-7 out of the 12 suites of products in the monetization stage**. The remaining are in adoption stage with more products expected to reach monetization stage. Next year, company expects that two its products in the insurance segment will also reach monetization phase and that will enhance recurring revenues visibility, aid in margin improvement and better cash flow generation.

  Earlier products in GTB were in monetization phase and investment spending on other products was being funded through only one successful segment (GTB). Now, INDA has gained success in GCB (consumer banking) and thus operating cash flow has improved. iGCB has just gained success in Europe and Intellect has won a big deal in Germany.

  AMC revenues are expected to provide very high margins as the costs associated with these revenue streams is minimal. Margins on AMC revenues can be as high as 80%. I expect overall EBITDA margins to reach 30% level sometime in FY22 and do not rule out the possibility of company reaching even 40% margin in the long term although the same has not been built yet in the numbers due to the possibility that company may continue to keep investing at a decent pace in order to capture future growth owing to big addressable opportunity. We are building 34.7%/37%+ margin by FY27E in our base/bull case.

Notice the profitability improvement in last 4 quarters.

PROFIT AND LOSS ACCOUNT	FY16	FY17	FY18	FY19	FY20	FY21E	Q1FY22E	Q2FY22E	Q3FY22E
Summary (Rs mn)									
Revenue (in US$ mn)	**123.8**	**136.3**	**168.3**	**207.7**	**190.6**	**202.9**	**55.0**	**57.2**	**59.6**
INR Revenue	8,095	9,110	10,873	14,587	13,509	15,060	4,013	4,165	4,340
Expenditure									
Software development expenses	3,913	4,633	5,490	7,372	6,987	6,631	1,699	1,734	1,774
Selling & marketing and General & Administrative ex	3,403	3,956	3,766	4,553	4,213	3,358	858	876	896
Research & Engineering expenses	1,063	719	724	1,004	1,219	929	230	235	235
ESOP Cost	0	0	0	0	170	297	74	74	74
Provision for Debts and Write offs	0	77	106	174	172	150	40	40	45
Total Expenditure	**8,379**	**9,385**	**10,087**	**13,102**	**12,760**	**11,365**	**2,901**	**2,959**	**3,025**
EBITDA	**-283**	**-276**	**786**	**1,485**	**748**	**3,694**	**1,112**	**1,205**	**1,315**
Depreciation & Amortisation	208	241	265	416	690	770	200	210	210
EBIT	**-491**	**-517**	**521**	**1,069**	**59**	**2,924**	**912**	**995**	**1,105**
Other Income	239	349	204	417	280	95	20	20	20
Finance Cost	12	113	138	114	174	90	10	10	10
Share of profit/(loss) of associates and joint venture	5	66	50	30	62	60	60	60	60
PBT	**-259**	**-215**	**637**	**1,402**	**227**	**2,989**	**982**	**1,065**	**1,175**
Tax	-91	28	70	89	51	276	196	213	235
PAT	**-168**	**-243**	**567**	**1,313**	**176**	**2,713**	**785**	**852**	**940**

- **Differentiated Sales Strategy**: In order to achieve this goal of selling more products to existing clients, thereby taking products to the monetization phase, INDA has been spending 25% of its revenues on S&M over the last 3 years by getting its sales strategy right i.e. hiring local sales people rather than Indians and hiring people either from large competitors or banks. Additionally, to drive profitable growth, INDA has partnered with multiple System Integrators (SIs) to implement the products. Agreement with SIs would increase the size of deal wins and also improve margins, as professional services have lower margins.

- **Large Deal Wins, deal wins in advanced markets and higher recurring revenues are enhancing the visibility.**

- Growth levers –
  - **Cross Sell**: Bouquet of 12 products will allow INDA to cross sell to boost scale as new client acquisition is most expensive proposition. Good software companies such as Oracle find new ways to get more from same client every year somehow. INDA has the opportunity to do the same in future.
  - **Upgrades of products over time.**
  - **Leverage on increasing the customers in relatively newer markets that it entered in last 12 months:** INDA hires top banker/top competitor to target the key bank in any new market it enters. Later on it builds customer base over time. Entering a new market is not easy. Currently, INDA is present with 1-2 customers in so many countries and thus now it may find easier to penetrate those markets and add more customers. Instead of going for completely new markets now, INDA may look to now leverage its base in existing markets.

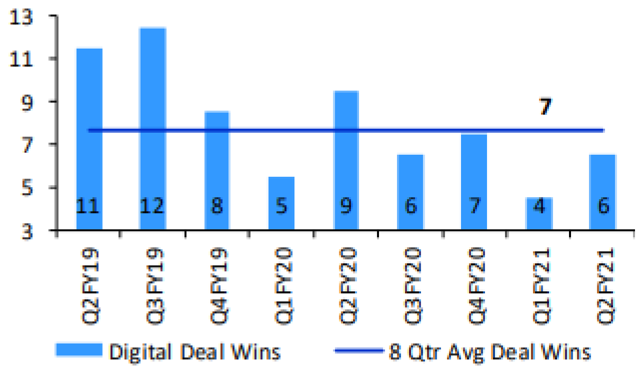
- **Gartner Reviews and Novarica rating are positives**: We checked the Gartner reviews for INDA. Although the reviews are limited and are restricted to reviews by Chief Information Officer and IT/Technology Heads of firms in Asia Pacific, the rating and ranking generally is good. Intellect ranks well at Gartner. Novarica rates Intellect's SEEC's IDX as an intelligent text ingestion solution for advanced underwriting with AI and machine learning playing a great role.

- **Growth for India's SAAS business**: According to Bain & Company, Indian software product companies should gain share in the global SAAS market to around 7-9% by 2022. Lower personnel costs, engineering talent, around the clock service and acceptance of products developed by Indian entrepreneurs are few reasons which can drive this market share gain. Temenos recently highlighted the advantage of lower personnel costs and having base in India.

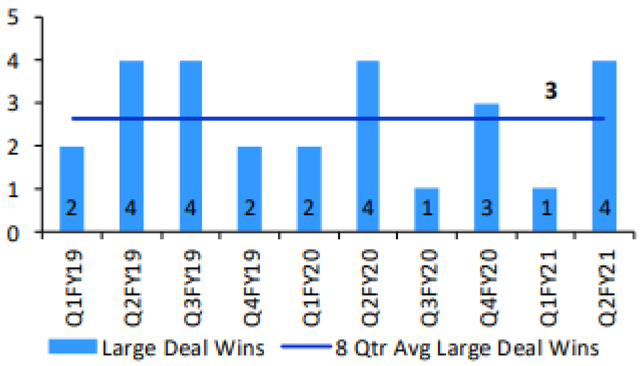
- **Why is Intellect winning against competition:** 1) Strong domain knowledge; 2) Company has been built organically which makes the product experience and integration between products more seamless; 3) Very strong sales strategy; 4) Leadership and advisory team from the industry; 5) Premium positioning of products even after cost advantage compared to global peers.

III. Supporting Data of the Investment Thesis – Story through charts

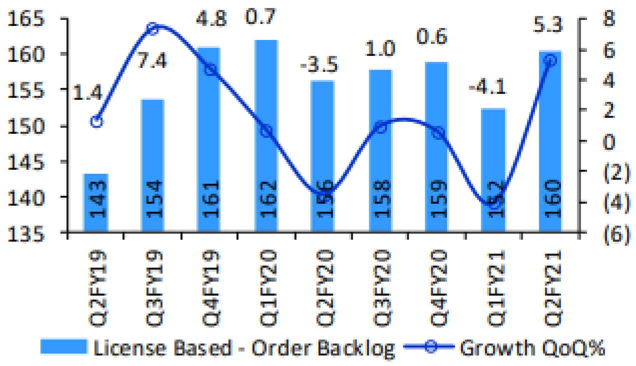
Digital Deal Wins



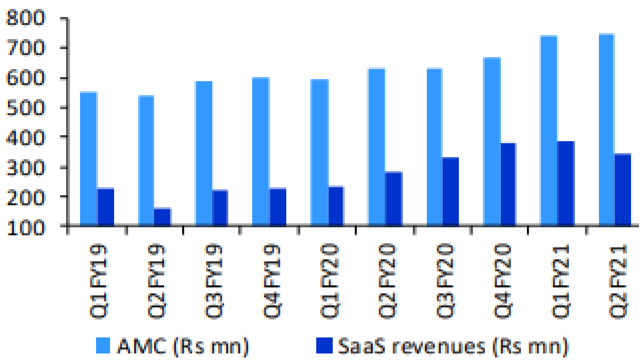
Large deal wins



License based Order Backlog at $160.5m

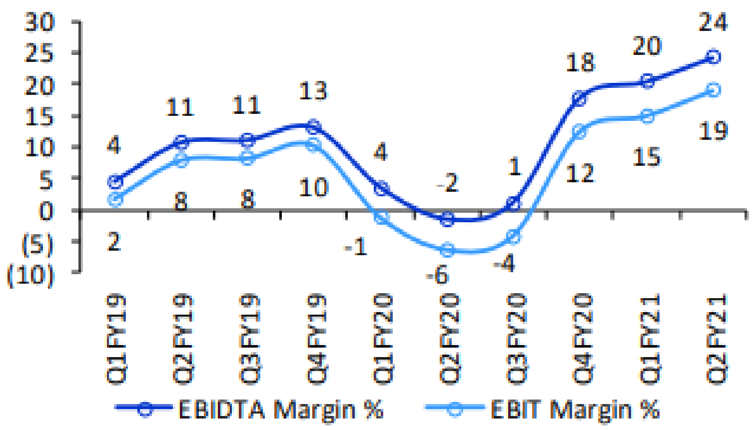


Recurring revenues improving



Source: Dolat Capital

Tight cost control, operating leverage, more number of products in monetization stage driving OPM gains.



<u>Active Deal Pursuits</u>

High value active pursuits

41

9 Pursuits > INR 50 Cr
12 Pursuits between INR 30 Cr to INR 50 Cr
20 Pursuits between INR 20 Cr to INR 30 Cr

	Q1 FY21 Active Pursuits	Won	Lost	Added	Q2 FY21 Active Pursuits	Remarks
> INR 50 Cr	8		-	1	9	8 deals from Q1 FY21 + 1 new deal added
INR 30 Cr - INR 50 Cr	12	2	1	3	12	2 deals Won 1 deal Lost 9 deals from Q1 FY21 + 3 new deals added
INR 20 Cr - INR 30 Cr	20	2	3	5	20	2 deals Won 3 deals Lost 15 deals from Q1 FY21 + 5 new deals added

Particulars	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21
Revenue ($mn)	45	54	52	56	49	47	45	50	46	50.1
QoQ (%)	(5.3)	21.7	(3.4)	7.6	(12.5)	(5.7)	(3.4)	10.5	(7.4)	8.9
YoY (%)	21.5	32.3	27.5	19.8	10.7	(14.2)	(14.2)	(11.9)	(6.7)	7.6
Revenue Breakup ($mn)										
Licence	5	15	11	12	8	6	7	14	8	13
AMC	8	8	8	9	9	9	9	9	10	10
Implementation & Customisation	32	30	34	36	33	31	29	26	28	27
Cloud / SaaS (subset of above)	3	2	3	3	3	4	5	5	5	5
Revenue Breakup ($mn) (YoY)										
Licence	44.0	71.1	31.6	19.2	69.3	(60.4)	(35.6)	13.1	(0.9)	116.5
AMC	(10.4)	3.6	6.2	5.0	4.4	17.1	8.5	8.5	13.9	12.2
Implementation & Customisation	24.9	22.2	32.6	24.3	3.5	4.9	(12.9)	(25.5)	(13.6)	(14.8)
Cloud / SaaS (subset of above)					(2.7)	77.3	51.8	60.9	54.3	15.3
Order Backlog ($mn)										
License Based	141	143	154	161	162	156	158	159	152	160
Saas and Subscription based	36	34	39	42	43	53	120	117	125	NA
Order Backlog Total	177	177	193	203	205	210	278	276	278	160
Order Backlog ($mn) (YoY)										
License Based				16.4	14.9	9.3	2.7	(1.3)	(6.0)	2.6
Saas and Subscription based				79.5	20.9	56.8	207.9	180.6	190.4	NA
Order Backlog Total				25.5	16.1	18.4	44.1	36.2	35.3	(23.5)
Geographic Mix (%) (LTM)										
Adv Markets	49.3	61.7	61.7	65.4	65.3	0.0	61.6	59.3	60.5	57.4
India	14.4	11.9	11.4	11.5	10.6	0.0	12.6	13.2	14.3	14.8
Rest of the world	36.3	26.4	26.8	23.2	24.1	0.0	25.8	27.5	25.2	27.9
Deals										
Deal Wins	10	11	12	8	5	9	6	7	4	6
Large Deal Wins	2	4	4	2	2	4	1	3	1	4
Implementation go lives	7	21	15	18	9	13	17	5	12	19
Active Pursuit ($ mn)										
Current Funnel	527	515	505	508	515	524	536	512	530	540
Accounted by Large deals Opportunities	448	415	416	397	474	471	456	376	399	407
Avg. deal size in mn $	1.8	1.8	1.9	1.9	2.3	1.8	2.3	2.0	2.0	2.4
Total large deals	134	134	130	122	133	134	133	120	119	117
Destiny Deals ($ mn)										
Avg deal size of destiny in mn $					5.9	6.2	5.6	5.0	5.7	
% Contribution to total opportunity funnel					69.0	65.0	64.0	57.0	54.0	
Total destiny deals					41	41	41	41	40	41
Collections Data										
Collections (In Rs. Mn)	3,152	2,902	3,761	3,294	3,382	3,120	3,345	2,985	4,365	3,343
Net DSO	111	131	115	124	119	126	132	0	126	127
Investment in Product Development Capitalized										
Amount in INRmn	295	295	283	295	295	284	287	240	269	284
YoY (%)				4.2	(0.1)	(3.8)	1.6	(18.7)	(8.7)	0.1

Source: Dolat Capital

IV. What we will be monitoring

Key metrics that one should be monitoring for INDA's investment case to sustain –

- Improvement in recurring revenues (AMC+SAAS) – This continues to happen. I expect AMC revenues to grow by 18%+ in FY22. SAAS/cloud revenues can potentially double in FY22 given some traction from SEEC, iGCB and GeM.
- Deal flow and ability to sign large deals in advanced markets – Pipeline on iGTB and iGCB is good.
- Lower receivable days, higher operating cash flow. Net DSO reduction, albeit slowly, in each of the market.

- Consistent accounting policy with regard to capitalization of R&D spend and controlled R&D spend. Any change in account policy on capitalization should be looked closely.
- Low attrition rate especially in senior management.

V. Risks

- Lockdowns in Europe and US may affect deal closure. Arun Jain in some of the interviews has highlighted that so far pipeline for FY22 is fine but should the lockdowns in Europe persist or make a comeback in future, it may impact company's ability to close larger deals in the short term.
- Among various revenue streams, AMC, implementation and cloud/SAAS are more predictable. Licenses revenue stream can be more unpredictable and any delay in closing new deals of larger size can affect license revenue growth and make it more volatile.
- Faster shift to SAAS/subscription based revenues across products can turn out to be a headwind for license revenues and affect overall revenue growth in the short run.
- Delay in payment from developing market customers where DSO is higher or bad debt.

VI. Overall Assessment of the Business

- <u>Opportunity Size</u>

  Intellect today has a market cap of $1.1bn. This is at the enterprise level but within Intellect there are several business units which have large addressable market and potential to be $1bn valuation individually. For example, with the addressable market growing at healthy rate, both iGTB and iGCB can potentially be $1b valuation in future. Some of the other business units can be $500m valuation individually. Some of the products with focus on AI and big data have scope of extension beyond BFSI.

  Intellect has one of the widest portfolio among software product companies focusing on BFSI. Many companies focus only on 1-2 business units within BFSI.

  For reference, OFSS today has market capitalization of $3.7b.

  Indian software product companies have room to grow market share in global SAAS market.

  Thus, in the context of Intellect's current market-capitalization, the opportunity size is fairly large.

  Rating (2/3)

- <u>Business Model and Strategy</u>

  Digital adoption is increasing in financial services. It is almost a necessity. Wide gamut of product offerings across corporate banking, retail banking, insurance, capital markets allows Intellect to focus more on cross sell.

  Intellect's sales strategy has been a great success with its tie up with universities and SIs, strong advisory and leadership board consisting of leaders with backgrounds in their target customer industries. While the product development reaps the benefits of low personnel costs and wide engineering talent in India, Intellect positions itself like a global company and sales strategy has a very go-local approach for each of the target markets.

  Company is looking to grow in a measured way and is adding more predictability to a business which can be more volatile. This strategy may result in a more consistent profitability improvement. While license linked streams are more predictable, license revenue growth can still be unpredictable and growth in that stream can be volatile.

  Currently, the share of advanced markets is lower compared to its global peers which also results in higher DSO days. While iGTB is strong in Europe and iGCB is now starting to get traction in Europe, the US exposure is very less for Intellect. Company has gained initial traction in US through iGTB and iSEEC but meaningful contribution from US may take couple of years. US remains a tough market but Intellect is cautiously optimistic about cracking the market in medium term through its AI/ML focus. Emerging market PSU banks can end up choosing lower price over quality (design, features and capability).

Business model is exposed to pricing pressure due to high competitive intensity and presence of large number of players. This is a future risk although currently Intellect is positioning itself as a premium player and is not looking to win deals on cost. Intellect's wide gamut of offerings and strong domain knowledge mitigates this risk.

Industrialization stage is behind for Intellect and currently large number of products are in monetization phase which is leading to healthy EBITDA margin generation. This should continue even in Intellect 3.0 journey.

Economics especially as more products come in monetization phase will be good. This is a business which is likely to sustain high RoCE in future. Reinvestment rate may be lower in future but high RoCE + strong earnings growth potential atleast for next 2-3 years makes it a good business, if not great.

Rating (2/3)

- <u>Promoter, Management and Leadership</u>
  Intellect was born after Polaris demerged its software product division. Promoters and senior leadership have strong domain knowledge. Team's DNA is quite strong as far as creating products in BFSI domain is concerned. Arun Jain has a reputation of empowering employees and creating leaders. The same is evident from the interactions with company in quarterly and conference calls. Arun Jain does not come out as someone who is a control freak.

  Decentralized leadership, many leaders within the organization, low attrition at senior leadership level, senior leadership hiring from the target industry (for example, company had hired two senior leaders from insurance industry and customer sometime back) are some of the strong points for Intellect. These characteristics are important for the business to scale.

  Communication with investors has been improving over time.

  Rating (2.5/3)

- <u>Earnings Growth and Cash Generation</u>
  Earnings and free cash flow generation is likely to be healthy over next 2 years from FY21 level. Earnings growth can be around 30% level with high FCF growth of around 25%+. This is after a strong earnings growth in FY21.

  Rating (3/3)

- <u>Earnings Volatility</u>
  Earnings growth is expected to be high but volatility cannot be rule out due to volatility in deal closures and thus volatility in license revenue growth. Growth rate in other revenue streams is more predictable but it is possible some of the bigger size deals may slip in a quarter which can make earnings growth volatile.

  Spend on new technologies has been designed in a way to keep the cost structure controlled. Company is trying to grow in measured way and is looking to add more predictability in a business where revenue growth can be volatile.

  Rating (2/3)

VII. Company Information

Directors	Designation
Arun Jain	Chairman & Managing Director
Anil Kumar Verma	Executive Director
Arun Shekhar Aran	Independent Director
Andrew England	Non-Executive Director
Vijaya Sampath	Independent Director
Abhay Gupte	Independent Director
Auditors	
S.R. Batliboi & Associates (EY)	Statutory Auditors

Promoter, Arun Jain's Background

- Serial Entrepreneur with engineering background.
- After graduating, Arun, along with friends Vishnu Dusad and Yogesh Andlay started International Information Systems (IIS) in 1983 as a partnership firm. In 1986, IIS was renamed as Nucleus Software, another India listed product software company. Later after parting ways with Nucleus (where he is still a shareholder), Arun set up Polaris.
- He was the founder, Chairman and CEO of Polaris. Polaris piped the likes of big IT giants in winning big for a project for Citibank and later Citibank became Polaris' longest standing client. Polaris Software focused on software projects for BFSI and Insurance.
- Arun Jain then moved towards winning global clients.
- 2002 Set Back (Indonesian Nightmare): The Indonesia saga, which was played out in the premises of Bank Artha Graha, Jakarta detention centres and the Indian embassy premises, was brought to an end by some hectic behind-the-scene efforts by Indian government officials, influential businessmen. The bank demanded $10m in damages for release of one product by the company and had detained Polaris officials and were later shifted to policy custody.
- In 2015, Virtusa acquired 53% stake in Polaris held by Arun Jain and certain other minority shareholders for about $180m (INR1173cr).
- He then went on to set up Intellect Design.
- Arun Jain has a reputation of decentralizing the company and empowering employees. He is also known to pay well to attract top talent. We see evidence of both these points in INDA's strategy also.
- Arun is the Chief Mentor of the Centre of Excellence for FinTech set up by MeitY, Govt of India.

VIII. Valuation and View

Valuation Ratios	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
CMP (Rs.)	625	625	625	625	625	625	625
P/E (x)	137.8	62.6	465.9	30.5	22.9	18.9	17.1
EV/Sales (x)	7.1	5.6	6.1	5.4	4.6	4.0	3.4
EV/EBDITA (x)	98.1	54.9	110.0	21.9	15.4	12.4	10.2

View: INDA is one of the promising software companies in India, building products for the financial services domain. Market's perception about Intellect has changed as operating leverage is visible and market's disbelief regarding various aspects and lack of understanding of software product companies is behind. This has led to rerating in the stock.

Intellect comprises of multiple business units and several business units within the company have huge headroom for growth. With addressable market growing at healthy pace for multiple business units coupled with Intellect's potential to grow faster and increase share in advanced markets, many of the business units in particular iGTB and iGCB have potential to become $1bn valuation each on their own.

In last several quarters, since we started tracking the company, company's communication with regards to its standing versus competition has changed. For example, the conversation has moved from being matching Temenos and admiring Temenos as the gold standard, Intellect today is winning deals against Temenos in the advanced markets.

While the easy return on account of extremely attractive valuations earlier is behind, Intellect's story has become more promising due to expanding addressable opportunities, traction and potential in its cloud accelerator offerings, higher share of advanced markets going forward for multiple product segments, widening opportunity due to focus on AI, ML and data platform which can extend beyond BFSI.

The key to INDA's further rating would be 1) How INDA scales its business in Advanced Markets especially US; 2) Continuous improvement in OCF due to higher recurring revenues and lower receivables 3) Success of iGCB in Europe; 4) Traction in data platforms

Mar-23 (2 year) Target Price Calculation (Base Case)

Methodology	Multiple	FY24E Relevant Value	Value (INR m)	Mar-23 TP	Comments on multiple
P/S	5.5	20,794	1,14,365	863	1. Assigned 30% premium to OFSS owing to faster sales growth and higher growth in license revenues which adds visibility for future growth. 2. Temenos trades at ~11x. Company has started challenging Temenos now in some of the deals in advanced markets. Organic Sales growth for INDA is higher than Temenos. Multiple is still 50% lower compared to Temenos as advanced market share for Intellect is smaller. 3. Higher share of business in advanced markets (lower DSO) would be a further rerating trigger as fintech product companies with higher share of advanced markets business trade at higher valuations. 4. Palantir which is a big data analytics company in US trades at 22x. There are some overlapping areas and INDA is focusing on big data, analytics, AI/ML in some of its products.
P/E	23.0	36		839	1. At INR625, INDA trades at 22.9x/18.9x FY22E/FY23E EPS. Company can grow its earnings by 30% over next few years due to margin expansion. 2. Temenos trades at 31x 1 year forward and is likely to grow earnings at low to mid teens rate. 3. Some of the US focused disruptive fintech, product companies are trading at as high as 100x
DCF				769	WACC: 12.5%, EBITDA CAGR (FY32E-21E): 13.5%, FCF CAGR: 14%, Terminal Growth post FY32: 6.5%
Average				**823**	

Base	Bear	Bull
823	648	967

- Bear case factors in lower license revenue growth in near term as well as medium to long term. Near term lower growth has been assumed to factor the risk if lockdowns in advanced markets were to persist for a longer time thereby affecting large deal closure. Over the medium term, license revenue growth may turn out to be lower due to accelerated shift towards subscription based revenues across products. Additionally this case, factors slower traction in advanced market share thereby resulting in little improvement on DSO. Additionally, this case assumes 10% lower multiples than that for base case.
- The bull case assumed factors slightly higher growth rate than base case (EBITDA CAGR FY21E-32E: 15.8% for bull case vs 13.4% for base case). It assumes FY24E revenue of $292m vs $282m for base case. It also assumes slightly less than 10% higher multiples than that for base case.
- See higher likelihood of bull case assumptions playing out than bear case assumptions in the near term.

IX. Takeaways from Calls with Company

March 2021 - Technology Day

- Retail Banking Business
  - At the point of inflection.
  - This was a key part of the investment thesis earlier. Results visible now. Company is cautiously optimistic about FY22 and quite optimistic over medium term. Cautiously optimistic probably because of worry over lockdowns which may affect deal closures.
  - IDC, IDL and QCBS have hit critical mass.
  - iGCB division starting to get traction in advanced markets. Share of revenue in advanced markets is less than 50% but this will increase over next 2 years and may share of advanced markets may go over 60% in 2 years.
  - Pipeline seems healthy and it is in last 2 in several deals.

    - US journey for iGCB has just started. Company has reiterated several times that US is one of the most difficult market and it may take 1.5-2 years to crack it and see more traction.

- iGTB
    - 94 customers with max customers in Middle East region. Company has indicated that GTB is v strong in ME. All the top banks in GCC region are company's customers.
    - 14 customers in EU, 10 in Americas.
    - Retail Banking - Even the addressable market here is growing 10% CAGR and is currently around ~11b.
    - Growth here would be driven by addition of more customers and cross sell of products.
    - Target to double this in 5 years. Growth will come from addition of customers and more cross-sell (more products per customer)
    - Top Products: DTB, CBX, LMS, Payment Services Hub (PSH), Trade and Supply Chain Finance (TSH)

- SEEC
    - INDA has started leveraging its learnings around large amount of unstructured data for insurance segment into many more industry use cases.
    - Technology that is used for underwriting in insurance can be extended to assessing credit risk while lending.
    - So going forward SEEC may not be seen as just for Insurance vertical.

- FABRIC
    - Intelligent Data platform for extracting and processing contextual data. Uses AI.
    - Fabric connects with 22 leading data partners and data platforms
    - INDA also has IDX, a platform for contextual and intelligent information classification.

- iTurmeric Platform
    - Cloud acceleration platform. How can a customer integrate between on premise and cloud applications? Can a marketplace be built from it?
    - Platform on which customer can develop business processes on drag and drop tool. This is the Experience Studio front end which the customer sees.

- GeM
    - 1Lcr GMV possible.
    - High double digit $m revenue is possible.
        - Read through: Vaguely recall that MSTC is making 10p-20p on INR100 GMV. Assuming Intellect makes 15-20p on INR100 GMV, potential revenue could be INR150-200cr ($20m-$27m) from GeM. Anyhow, within this range, cloud based revenues is can potentially double in FY22.

- Others
    - More products will enter monetization phase in FY23. In the Q3 concall, Intellect had alluded that 3.0 journey would be an extension of 2.0 monetization phase and we will see more products entering monetization phase.
    - In last 9 months, one could easily gauge that confidence of Intellect is increasing as it is now winning deals in Europe against the likes of Temenos. Winning deals against a company which Intellect used to refer as gold standard few quarters back is a positive.
    - SAAS/Subscription revenues % sales could potentially go to 30%.
    - R&D team: 800 out of which 40 are in US. This team was 1100 at peak.
    - Anticipate no further increase in investment to run its existing product lines. Annual R&D spend could continue to be around INR200cr for a while out of which INR80cr might be expensed and INR120cr might be capitalized. Upgrade work is expensed. Spend on new technology is capitalized.
    - Company has been built organically which makes the product experience and integration between products more seamless.

March 1 – HDFC Sec Conference

- Company is optimistic about Intellect delivering high-teens growth in revenue terms & 30%+ EBITDA margin going forward.
- Look at 6 key markets -- US, EU, UK, Canada, Middle-East & Africa, APAC & India.
- 2 category of demand – 1) delivered by API ecosystem & 2) contextual (using data platform). Customers look for hyper scale -- Intellect technologies able to deliver scale to 5000 customers, they are high performance.
- Have a team in US to build data platforms. These technologies are used by 5 product lines in GTB.
- Cash management (DTB) was a unique proposition included all services as a single solution -- 50%+ market share in Asian markets.
- GCB -- 4 product lines. Sold core banking system to Otto, 2nd largest e-commerce player in Germany (after Amazon).
- Strategy was to go to advanced market via GTB route and then offer other products under GCB. Driving innovation in iGCB.
- Implementation cycle time has been reducing. An American bank went live in 8 months.
- Investment in cloud tech in 2018-19 (120cr per quarter in R&D) -- this budget has come down to ~INR200cr per year.
- EBITDA margin has moved to 25% -- looking to increase it to 30% in next 3 quarters.
- AMC revenue comes at 80% margin.
- Business is becoming sustainable, predictable & repeatable. Company is looking to grow in a measured way and is prioritizing predictability over higher growth (which can also result in higher costs and mistakes)
- Wealth product (API based) gaining momentum.
- GeM business gaining momentum.
- Risks / challenges substantially mitigated. Covid times -- have been able to sign deals & reduce costs. Expect accelerated growth in FY22/FY23. Although post this conference, Arun Jain did mention that one of the risk that hopefully will not play out is the risk of lockdowns in Europe which can affect deal closures. Right now company is fine but if lockdowns persist for longer duration,
- Started winning in advanced markets. Otto deal -- customer did proof of concept for 4 months (with 4 squads) looking at Intellect's architecture in detailed. Recall that in Q4FY20 presentation, company had mentioned that it is doing PoC with one big retail player. Cloud-enabled tech architecture helped win the deal (could do 7k iterations, much larger than avg). Won this deal against other large peers. Working as joint team in the deal & client also working for implementation. Have license + AMC component & implementation on Time & Material.
- Demand for cloud is high. Looking to get into a hybrid model (cloud + licensed model). Almost 50% of new revenue of GTB can come on cloud in future. Have good pipeline for cloud in N. America.
- 20 of top-150 banks are customers. Focusing on large Asset Management companies also. Growing in this space.
- DTB -- doing well in EMs (50+ customers live).
- Trade & Supply chain finance -- EU implementation is done + Asian one is coming to end in 1 quarter. Expect to pickup across markets.
- Focusing on digital & payments in N. America -- will create something like paytm there -- on verge of closing 1st deal in N. America (will announce).
- SaaS platform -- consolidate the data & give to under-writers -- sold per data packet (USD 1 to 5). Data for half a million SMEs in US.
- Cloud opportunity for Seek product in US. Looking at significant growth for this business.
- GeM -- SaaS revenue with Govt of India. Growing q-q. Can be a substantial business -- Govt looking at 1 lakh crore procurement via portal.
- 42cr revenue in a single quarter (Q3FY21) (run-rate of 160cr) -- is healthy in context of cloud.
- Thesis for US business -- Underwriting space is very manual. Companies take time to execute. Decision taking time is long. Data was one bottleneck.

- 2 new hires -- 1 was Chief Operating Office for a customer (has 30yr experience) -- he will help expand, alreadt started conversing with 5-7 large prospects. The 2nd hire is from a data company (Varis) -- understands how machine learning on data works.
- There is a fragmented competition, thus, chances of winning are better for an integrated solution.
- Takes time from Step-2 to 4. There are 3 products in Step-5 -- getting into monetization phase now.
- Have 5 products in step-4 (IDC, Lending, Underwriting, supply-chain finance). Would have entered in last 9 months.
- 60-60-60: Have defined 60% of revenues should be from advanced market, license linked revenue should increase to 60% and 60% GM.
- Strengths of the company are much superior vs. Temenos.
- Advantage is that cost is stable at $40mn level so topline growth drives EPS growth. 20% growth can mean 50% growth in EPS.
- 120cr R&D investment (8% of revenues) -- will further reduce as % of sales as scale improves further.
- 250cr FCF generated YTD in FY21. Self-sufficient in terms of cash requirements.
- Face to face meetings are effective in early stage transformation (when customer has not floated RFP yet). Then, during final closing of the deal -- final signing can get delayed in case of no F2F meeting.
- Summary from the management --
    - Organization is growing in a calibrated, predictable way. There are 3 phases in development (Investment, Industrialization, Monetization) -- now in monetization phase -- it is an operating leverage play. Trick will be to identify inflection points. Broken 50% threshold (above 53%) for license linked revenue (vs. 30% previously) -- this is driving margin growth which is seen.
    - It is a dis-service to see Intellect only as a tech company -- should be seen as an innovative & digitization play. Real value is in the embedded value of IP assets + value of people. They control the IP & have various ways of monetization. Have 12-14 products of which 3 are in stage-5. The built-in optionality in the business has not given its true value -- it will emerge in coming years.

<u>Dec 2020</u>
<u>Questions</u>

1. *One of the thing that we have noticed is Intellect's presence in terms of product suite offerings in multiple areas be it transaction banking, consumer banking, insurance, wealth etc. What is the Intellect's USP when we go and compete with the bigger players say a Temenos or OFSS say in core banking.*

Response: Product design, quality, sales together make lot of difference. Last 1% extra effort in each of the things makes a significant difference. Wider product suite will help in cross-sell. Pointed out unique aspects in the sales strategy like investment in local sales team, hiring people from target banks in target geography. Don't sell products on lower pricing. Sell on quality.

Entire senior team is hungry for success. Attrition has been quite low.

Two large deals in 2018 and 2019 of $10m were a game changer for us. Shows that we don't want to just do small deals. Idea is to go after large banks in a new target geography. This can be difficult which is why investments in the past have been high, sales cycle can also be high but if you usually crack a bigger bank, then it is easier for you to get more customers.

2. *With one of the leaders, OFSS, what we have seen in last few years is that top line growth has been muted but margins are really high. We look at the trend of digitization, AI, ML in financial services. That has been picking. So why is it that for one of the leader growth has slowed. Is it a function of some gap in product or just base from which it is difficult to grow. Also could you share the competition in each of the spaces where you have a product offering.*

Response: OFSS seems to be highly dependent on parent. For Larry Ellison, OFSS seems to be a cash cow. It seems to be more keen on milking the existing products which is why the margins are high and increasing. Regarding growth, leadership agility and hunger also plays a role. Even for Temenos, exclude acquisitions and the growth is muted. Some of it could be base but many companies want to milk AMC part.

Competitors
Many competitors in general. Some have a wide product suite, some don't. INDA has a wide product suite.
iGTB – Biggest competition is Finastra. OFSS is not a competition here.
Core banking – Big guys Temenos, Finastra, OFSS, big IT giants.

3. *What has worked in Europe. Can the same approach work in US? Why is US the toughest market to crack?*

Response: In London, we have office in Canary Wharf. All the EU banks are based there. Meetings are easy. Trust has been built easily. Last 1% focus (in terms of investment, spend, quality of producy design, sales effort) makes lot of difference.
EU banks have more acceptance to change right now. In Americas region, we find Canada is more prone to change, adoption of new technologies, vendors.

US is less prone to change. It is also ahead in terms of digitization journey. There is a bigger ego around US companies. You need to seriously challenge them on technologies in AI/ML/Cloud. We have worked on that and are doing that. Like we said, last 1% effort makes lot of difference. We have done that in Europe.

In US, INDA's likelihood of success is more in SEEC than in GCB.

Will you set up an office in US? It is a more spread out market, not like you have in Canary Wharf.

4. *Some color on US business. What it could be like 2 years from now.*

Response: Inda has 12 clients in US today. It is difficult to say about US market. For INDA, it could be somewhere $30-50m to 100m annual run rate. Wide range is there. Depends if we get traction in AI/ML. Cloud and Machine Learning would be two focus areas for US market.

GeM: Share is increasing. RBI, AMFI, LIC are all doing business with Intellect. Recognize that collection from govt can be an issue.
Intellect business can be broken into

- Digital banking platform
- AI/ML platform
- GeM - Ecommerce. Completely non linear platform. Think of it as PE play in a listed company.

Net DSO for industry standard is 90-120d. Intellect is currently at 127d.

<u>Nov 2020</u>

Discussion on GeM

- Portal built for Govt, the only non-BFSI product. Intellect is much ahead of peers in terms of tech. They work for LIC, RBI etc. It is an online portal. B2G portal, have many projects (RFPs).
- Have buyers / sellers on the portal. Any govt dept can register & buy/sell from vendors which are also registered.
- Company gets a % on the total value of transaction. Consortium with Infibeam, Tata Communication.
- Intellect gets revenue from Govt and distributes it to vendors. Margins are low in this business as of now.
- About to break-even on this business (likely this quarter). In few years, can have 40% EBITDA from this portal. Fixed expenses made, expenses will not grow much as volumes grow -- margins can be 40% at peak levels.
- Daily turnover is available on Govt website for the RFPs. Debtors are high at times because of this business (delay in getting money from Govt).
- It is small part of revenues, receivable days will not come down in this segment. Some improvement keen in receivables from Govt.
- Might venture out of BFSI but not at this stage.
- GeM is part of subscription based revenues.
- Because of GeM, debtor days can be high at times due to delay in collection from Govt. Both Govt / Intellect are new in this space. Dont see a faster recovery in receivable days at this stage, but can improve in longer-term.
- The moment they get money from Govt, they pay to the vendors -- **Debtor days matching payable days in GeM.**
- Hiving off GeM will need Govt approval, will not be easy to get Govt permission.

Discussion on DSO and overall OCF

- Decline in DSO days from venturing into developed economies. DSO days in India are higher vs. US/EU.
- OCF improvement was good in 1QFY21 and a bit weak in 2QFY21. Got lot of advances in 1QFY21 + got some collections of 4QFY20 in 1QFY21.
- Need to look at last quarter EBITDA for OCF comparison. If they get same revenue in 3Q as 2Q, OCF will improve.
- Receivables in absolute terms will remain similar; as revenue goes up, DSO days will come down.

Strategy

- Not to be too aggressive as far as new markets are considered. Strategy is to consolidate in countries where they have won few deals.
- Strategy is to concentrate on those markets where they are already present and are seeing some traction.
- Secondly, for clients with some deals (presence), higher cross-selling is happening.
- US -- have entered mostly for GTB (not much in GCB). US is a challenging market where even EU companies find it difficult.
- EU -- Intellect is very strong in EU, large portion of business comes from EU. Post Covid, deal signings have been good in Middle-East / Asia.
- Idea is to reach 30% EBITDA margin in next couple of quarters.
- Intellect 1.0 -- Strategy was to invest. 2.0 -- strategy is to monetize (till FY22/FY23). Post 2.0, will review strategy. In review phase, will **not** go aggressively into investment phase as was seen in 1.0. Will not go into investment phase at this stage, will evaluate only when they reach a substantial scale.
- Monetization in Insurance will start next year, and it will start in RTM in next to next year.
- Have structured the company for a 30% EBITDA margin (internal target). May reach 32-33% also.
- There is lumpiness in the business. Have visibility for next few quarters, difficult to predict for next few years.
- Once licenses come, AMC revenues come. Take some time for implementation after winning deals (higher for bigger deals).
- Saas -- compare y-y and not q-q, growing on y-y basis.
- R&D -- 50cr per quarter (30cr for capitalization phase for a particular product).