Sonata Software (SONSOF)

₹ 285

IP led offerings continue to witness traction

- **Sonata Software reported Q3FY18 earnings wherein international IT services revenues grew 2.7% QoQ to $37.4 million in dollar terms. Consolidated rupee revenues grew 79.6% QoQ to ₹ 766.8 crore mainly on account of domestic business which witnessed a sharp increase of 165.5% QoQ**
- **EBITDA margins declined 430 bps QoQ to 8.5% mainly on account of higher contribution from low margin domestic business in the quarter. However, international services business reported a healthy 110 bps expansion in margins to stand at 23.6%**
- **Reported PAT grew ~9% QoQ to ₹ 49.3 crore**

Travel & retail lead growth in international business…

Sonata witnessed growth of 2.7% to $37.4 million in international IT services (IITS) in Q3FY18 led by the continued traction in its IP led offerings. Vertical-wise, travel and retail led the IITS sequential growth with 6.6% and 6.7%, respectively. OPD segment was soft with 0.8% de-growth QoQ. However, the management expects it to witness growth in coming quarters owing to some deal wins at quarter end. Domestic business grew 165.5% QoQ to ₹ 530.3 crore and continues to witness volatility. Owing to its volatile nature of business, the management indicated at focusing on EBITDA margins over revenue growth. Digital which is 32% to revenues grew at a healthy rate of 27.4% YoY. In terms of client metrics, top five, top 10 clients continue to witness healthy growth and grew 6.2%, 5.7% QoQ and 29.7%, 25.2% YoY, respectively. Client additions continue to be steady as the company added four clients in the quarter. The management continues to target double digit growth in international services business backed by growth in its verticals and traction in its IP offerings as Rezopia (travel), Brick and Click (retail) platform, which forms 15.2% of IITS revenues. We now expect IITS dollar revenues to grow at a healthy CAGR of 13% in FY18E-20E.

Healthy expansion in IITS business margins…

EBITDA margins declined 433 bps QoQ to 8.5% mainly on account of higher contribution from low margin domestic business (69.2% of revenues in Q3FY18 vs. 46.8% in Q2FY18) in the quarter. However, international services business reported a healthy 110 bps expansion in margins to 23.6% on the back of productivity enhancements. Margins in domestic business came in at 2.9% (vs. 7% in Q2FY18) in the quarter. We expect IITS margins to be in the range of 23-24% during FY18-20E and drive overall margins to 8.7%, 9.4%, 10.3% margins in the same period.

Platformation strategy to drive growth; maintain BUY…

Sonata reported a decent set of Q3FY18 numbers with international IT services revenues witnessing sequential growth of 2.7%. IITS topline has grown at 17.4% in 9MFY18 over the same period last year. Going ahead, uptick in OPD revenues and continued traction in its IP led offerings would lead to gradual scale up in revenues. Improving business mix towards high margin international services business would be the key driver for margin expansion. Hence, we expect Sonata to report PAT CAGR of 15.2% during FY18-20E. Also, it is currently trading at attractive valuation of 12.4x FY20 EPS. We roll our valuations to FY20E and maintain our **BUY** rating on Sonata with revised target price of ₹ 340 (15x FY20E EPS).

Rating matrix

Rating	:	Buy
Target	:	₹ 340
Target Period	:	12 months
Potential Upside	:	19%

What's changed?

Target	Changed from ₹ 260 to ₹ 340
EPS FY18E	Changed from ₹ ₹ 17.6 to ₹ 17.2
EPS FY19E	Changed from ₹ 20.2 to ₹ 20.1
EPS FY20E	Introduced at ₹ 22.9
Rating	Unchanged

Key financials

₹ Crore	FY17	FY18E	FY19E	FY20E
Net Sales	2,521	2,621	2,776	2,914
EBITDA	192	229	261	299
Net Profit	154	181	211	240
EPS (₹)	14.6	17.2	20.1	22.9

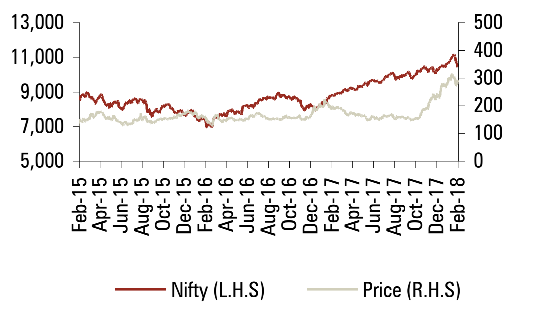
Valuation summary

	FY17	FY18E	FY19E	FY20E
P/E	20.5	16.7	14.3	12.5
Target P/E	23.3	19.8	16.9	14.9
EV / EBITDA	5.1	4.7	4.3	3.9
P/BV	13.8	11.3	9.6	8.2
RoNW (%)	26.3	28.4	30.1	31.2
RoCE (%)	35.0	37.0	39.4	40.9

Stock data

Particular	Amount
Market Capitalization (₹ Crore)	2,986.9
Total Debt (Mar-17) (₹ Crore)	34.3
Cash and Investments (Mar-17) (₹ Crore)	365.5
EV (₹ Crore)	2,655.7
52 week H/L	322 / 143
Equity capital	584.6
Face value	1.0

Price Chart



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Financial summary

Profit and loss statement				₹ Crore
(₹ crores)	FY17	FY18E	FY19E	FY20E
Total Revenues	2,521	2,621	2,776	2,914
Growth (%)	29.9	3.9	5.9	5.0
Total Operating Expenditure	2,329	2,392	2,515	2,615
EBITDA	192	229	261	299
Growth (%)	0.2	19.0	14.1	14.5
Depreciation & Amortization	9	13	14	12
Other Income	40	40	50	50
Interest costs	9	9	9	9
PBT before Exceptional Items	214	247	288	328
Growth (%)	(3.3)	15.2	16.8	13.9
Tax	68	67	78	89
PAT before Exceptional Items	146	180	210	239
Exceptional items	8	1	1	1
PAT before MI	154	181	211	240
Minority Int & Pft. from associates	-	-	-	-
PAT	154	181	211	240
Growth (%)	(3)	18	17	14
EPS	14.6	17.2	20.1	22.9
EPS (Growth %)	(3)	18	17	14

Source: Company, ICICIdirect.com Research

Cash flow statement				₹ Crore
(₹ crores)	FY17	FY18E	FY19E	FY20E
Net profit before Tax	222	248	289	329
Depreciation & Amortization	9	13	14	12
WC changes	24	20	(2)	(2)
Other non cash adju.	(6)	(31)	(41)	(41)
Income taxes paid	(65)	(67)	(78)	(89)
CF from operations	185	183	182	209
Capital expenditure	(10)	(10)	(11)	(11)
Δ in investments	(64)	(50)	(50)	(50)
Other investing cash flow	19	40	50	50
CF from investing Activities	1	(20)	(11)	(11)
Issue of equity	-	1	2	3
Δ in debt funds	(121)	-	-	-
Dividends paid	(45)	(128)	(149)	(169)
Other financing cash flow	(9)	(9)	(9)	(9)
CF from Financial Activities	(175)	(137)	(158)	(178)
Δ in cash and cash bank balance	11	27	13	19
Effect of exchange rate changes	(3)	-	-	-
Opening cash	295	248	275	288
Closing cash	248	275	288	307

Source: Company, ICICIdirect.com Research

Balance sheet				₹ Crore
(₹ crores)	FY17	FY18E	FY19E	FY20E
Equity	11	11	11	11
Reserves & Surplus	574	627	690	761
Networth	585	638	700	771
Minority Interest	-	-	-	-
LT liabilties & provisions	19	19	19	19
Total Debt	34	34	34	34
Source of funds	638	691	753	824
Net fixed assets	29	26	22	22
Goodwill	91	91	91	91
Long term loans and advances	78	78	78	78
Other non current assets	14	14	14	14
Loans and advances	34	39	41	44
Inventories	-	-	-	-
Current Investments	118	168	218	268
Debtors	523	469	497	522
Cash & Cash equivalents	248	275	288	307
Other current assets	60	52	55	58
Current liabilities	523	496	525	551
Provisions	34	26	28	29
Net current assets	425	482	547	618
Application of funds	638	691	753	824

Source: Company, ICICIdirect.com Research

Key ratios				
(Year-end March)	FY17	FY18E	FY19E	FY20E
Per share data (₹)				
EPS-diluted	14.6	17.2	20.1	22.9
Cash per share	23.6	26.1	27.4	29.2
BV	55.6	60.7	66.6	73.3
DPS	9.0	10.3	12.0	13.7
Operating Ratios (%)				
EBITDA Margin	7.6	8.7	9.4	10.3
Adjusted PBT Margin	8.5	9.4	10.4	11.3
Adjusted PAT Margin	6.1	6.9	7.6	8.2
Return Ratios (%)				
RoNW	26.3	28.4	30.1	31.2
RoCE	35.0	37.0	39.4	40.9
RoIC	40.4	42.6	43.4	44.9
Valuation Ratios (x)				
P/E	20.5	16.7	14.3	12.5
EV / EBITDA	13.8	11.3	9.6	8.2
Price to Book Value	5.1	4.7	4.3	3.9
EV/Total Revenues	1.1	1.0	0.9	0.8
MCap/Total Revenues	1.2	1.1	1.1	1.0
Turnover Ratios				
Debtor days	76	65	65	65
Creditors days	65	62	62	62
Solvency Ratios				
Total Debt / Equity	0.1	0.1	0.0	0.0
Current Ratio	1.8	1.9	2.0	2.1
Quick Ratio	1.8	1.9	2.0	2.1
Debt / EBITDA	0.2	0.1	0.1	0.1

Source: Company, ICICIdirect.com Research

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