

Rating matrix		
Rating	:	Buy
Target	:	₹ 420
Target Period	:	12 months
Potential Upside	:	15%

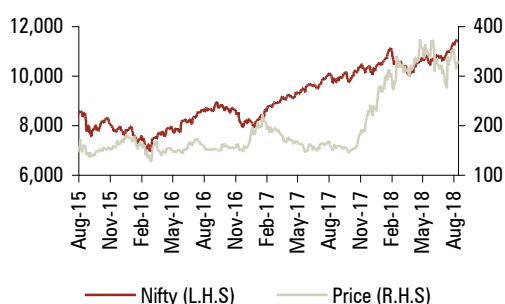
What's changed?	
Target	Changed from ₹ 390 to ₹ 420
EPS FY19E	Changed from ₹ 21.0 to ₹ 21.9
EPS FY20E	Changed from ₹ 24.2 to ₹ 25.4
Rating	Unchanged

Key financials				
₹ Crore	FY17	FY18	FY19E	FY20E
Net Sales	2,371	2,454	2,684	2,934
EBITDA	192	231	297	347
Net Profit	157	192	230	267
EPS (₹)	15.1	18.5	21.9	25.4

Valuation summary				
	FY17	FY18	FY19E	FY20E
P/E	25.4	19.8	16.6	14.4
Target P/E	27.9	22.7	19.2	16.6
EV / EBITDA	6.5	5.8	5.2	4.6
P/BV	18.2	14.5	11.4	9.5
RoNW (%)	26.8	29.4	31.5	32.4
RoCE (%)	35.7	38.6	42.0	43.3

Stock data	
Particular	Amount
Market Capitalization (₹ Crore)	3,814.8
Total Debt (₹ Crore) (FY18)	18.7
Cash and Investments (₹ Crore) (FY18)	477.2
EV (₹ Crore)	3,356.3
52 week H/L	386 / 145
Equity capital	653.3
Face value	1.0

Price Chart



Research Analysts

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Sonata Software (SONSOF)

₹ 364

Healthy performance...

- Sonata Software reported Q1FY19 earnings wherein international IT services revenues grew 3% in constant currency terms on account of higher contribution from IP led revenues. Services dollar revenues grew 1.1% sequentially to \$37.8 million on account of currency headwinds mainly due to GBP. Consolidated rupee revenues grew 10% QoQ to ₹ 688.3 crore, with international revenues growing 6.3% QoQ to ₹ 257.1 crore and domestic business growing 12.5% sequentially to ₹ 437.1 crore
- EBITDA margins witnessed a healthy performance and expanded 50 bps QoQ to 10.7% supported by 120 bps expansion in international IT services business to 26%. It was mainly driven by a decline in employee expenses as a percentage of sales (19.2% as percentage of sales vs. 20.6% in Q4FY18)
- Reported PAT grew 5.7% QoQ to ₹ 57.4 crore

Strong double digit YoY growth in IP offerings & digital...

Sonata reported 1.1% QoQ growth in international IT services (IITS) in Q1FY19 while it continued to post healthy double digit growth YoY (up 15.6% YoY) led by continued traction in its IP led offerings like Rezopia (travel), Brick and Click (retail). IP led contribution as a percentage of IITS revenues continued to witness an upward trajectory and formed 16.3% of revenues (vs. 13.7% in Q1FY18). It grew 5.6% QoQ and for the second consecutive quarter grew strongly by 37.5% YoY in the quarter. Digital also grew at a healthy rate of 23.1% YoY and comprised 33% of revenues. The management highlighted that ~30 clients were identified as strategic customers, which can scale up to US\$3-5 million (mn) from current US\$1 mn revenues. If these accounts scale up, it would significantly boost its services revenues in three years. For FY19E, the management sounded optimistic due to its strong traction its IP offerings, larger system integration contracts, currency tailwinds (in H2FY19) and scaling up of existing clients. Hence, we expect IITS dollar revenues to grow at a healthy CAGR of 15% to US\$190.3 million in FY18-20E.

Another healthy performance at margin level...

Sonata witnessed an upward trajectory on the EBITDA margin front for the second straight quarter and expanded 50 bps QoQ to 10.7%. Margin in IITS has been on an expansion spree since Q2FY18 and has expanded from 22.5% in Q2FY18 to 26% currently. Margins in the domestic business came in at 3.8% (vs. 4.1% in Q4FY18 and 3.5% in Q1FY18) in the quarter. We expect IITS margins to be in the range of 24-24.5% in FY19-20E. Hence, consolidated margins are expected at 11.1%, 11.8% in FY19E and FY20E, respectively.

Several kickers to drive profitability; maintain BUY...

Scaling up of existing clients and new client addition along with expansion in Europe are expected to be the kickers of growth, going ahead. Continued traction in its IP offerings and rupee benefit would drive margins upwards and improve profitability. Hence, we expect Sonata to report PAT CAGR of 17.7% in FY18-20E. Moreover, a healthy payout ratio (~65-70% of PAT) would keep its dividend yield attractive. Currently, it is trading at attractive valuation of ~13x FY20E EPS. Hence, we maintain our **BUY** rating on Sonata with a revised target price of ₹ 420 (i.e. 17x FY20E P/E).

Variance analysis

	Q1FY19	Q1FY18	YoY (%)	Q4FY18	QoQ (%)	Comments
Revenue	688.3	634.5	8.5	625.8	10.0	International IT services (IITS) revenues grew 3% sequentially in constant currency
Employee expenses	132.1	121.7	8.5	128.8	2.6	
Purchase of stock-in trade & other	419.1	409.7	2.3	374.0	12.0	
Gross Margin	137.2	103.1	33.1	123.1	11.5	
Gross margin (%)	19.9	16.2	368 bps	19.7	27 bps	
Other expenses	63.9	55.4	15.2	59.5	7.3	
EBITDA	73.4	47.7	53.9	63.5	15.4	
EBITDA Margin (%)	10.7	7.5	314 bps	10.2	50 bps	EBITDA margins witnessed a healthy performance and grew 50 bps QoQ to 10.7% supported by 120 bps QoQ expansion in IITS
Depreciation & amortisation	2.9	3.0	-4.8	3.0	-2.7	
EBIT	70.5	44.6	57.9	60.6	16.3	
EBIT Margin (%)	10.2	7.0	320 bps	9.7	56 bps	
Other income (less interest)	7.2	14.1	97.1	10.9	-34.1	
PBT	77.6	58.8	32.1	71.5	8.6	
Tax paid	22.1	16.6	33.4	17.2	28.5	
PAT	57.4	43.2	33.0	54.3	5.7	Reported PAT grew 5.7% QoQ led by a healthy operating performance

Source: Company, ICICI Direct Research

Change in estimates

(₹ Crore)	Old	FY19E New	% Change	Old	FY20E New	% Change	Comments
Revenue	2,628	2,684	2.1	2,867	2,934	2.3	
EBITDA	279	297	6.6	318	347	9.0	
EBITDA Margin (%)	10.6	11.1	46 bps	11.1	11.8	72 bps	
PAT	221	230	4.3	255	267	4.6	
EPS (₹)	21.0	21.9	4.3	24.2	25.4	4.6	

Source: Company, ICICI Direct Research

Analyst Meet highlights...

Sonata Software held an analyst day wherein the management detailed its three-year strategy and engines to drive the growth.

- **Next three year strategy till 2021** – The management indicated its three year strategy till 2021 to drive growth, going ahead. It said it would continue its focus on Platformation strategy with its IP offerings and its alliance with Microsoft. Sonata has connected its Microsoft ecosystem in all geographies and possesses significant opportunities in the pipeline with 50% of its long term enterprise accounts expected to come from Microsoft alliance accounts. Among geography, Europe share in IITS revenue pie has increased from 26% in Q1FY18 to 29% in Q1FY19 and witnessed an average growth of 28.6% YoY during the same period. It expects to expand its operations in Europe and sees good traction in the geography. Investing in talent with skills of newer age technologies, transformation of India business and strategic M&A would be other key areas to focus upon
- **Engines to drive growth and value-** Five engines were illustrated to drive growth- 1) Existing customers- Becoming a strategic partner to its clients with increased wallet share and getting ~ 30 clients into US\$5 million bucket 2) Alliances- Grow by leveraging technology alliance partners 3) Vertical transformation deals- win new customers through industry specific expertise 4) IP & platform- growth of IP led offerings 5) Digital Tech Infra- gain value and profit by extending leadership to new digital tech infra. The company has new additions to the leadership team recently with head of International services business and practice head of Platformation
- **IP offerings and cash utilisation-** IP led contribution as a percentage of IITS revenues continues to witness an upward trajectory and formed 16.3% of revenues (vs. 13.7% in Q1FY18) and grew strongly by 37.5% YoY in Q1FY19 for a second consecutive quarter. Out of total incremental revenues, ~60% came from IP led revenues, which is margin accretive as it is non-linear. This could act as a kicker from the profitability perspective. Taking into account cash position, the company has cash & equivalents of ₹ ~477 crore while another ~₹ 70 crore can be added in FY19E, which could be paid as dividend and used as an acquisition opportunity

Financial summary

Profit and loss statement				
₹ Crore				
(₹ crores)	FY17	FY18	FY19E	FY20E
Total Revenues	2,371	2,454	2,684	2,934
Growth (%)	22.2	3.5	9.4	9.3
Total Operating Expenditure	2,179	2,223	2,387	2,587
EBITDA	192	231	297	347
Growth (%)	(0.2)	20.6	28.7	16.7
Depreciation & Amortization	11	12	13	15
Other Income	47	45	36	38
Interest costs	9	5	5	5
PBT before Exceptional Items	218	259	315	365
Growth (%)	(1.4)	18.6	21.7	15.7
Tax	69	68	85	99
PAT before Exceptional Items	149	191	230	267
Exceptional items	8	1	-	-
PAT before MI	157	192	230	267
Minority Int & Pft. from associates	-	-	-	-
PAT	157	192	230	267
Growth (%)	(1)	22	20	16
EPS	15.1	18.5	21.9	25.4
EPS (Growth %)	(0)	23	18	16

Source: Company, ICICI Direct Research

Balance sheet				
₹ Crore				
(₹ crores)	FY17	FY18	FY19E	FY20E
Equity	11	10	10	10
Reserves & Surplus	574	643	722	813
Networth	585	653	732	823
Minority Interest	-	(0)	(0)	(0)
LT liabilities & provisions	19	13	13	13
Total Debt	34	19	19	19
Source of funds	638	685	763	855
Net fixed assets	29	33	31	28
Goodwill	91	81	81	81
Long term loans and advances	78	-	-	-
Other non current assets	14	166	166	166
Loans and advances	34	-	40	44
Inventories	-	-	-	-
Current Investments	118	130	180	230
Debtors	523	396	483	528
Cash & Cash equivalents	248	347	266	306
Other current assets	60	80	54	59
Current liabilities	523	535	510	557
Provisions	34	14	27	29
Net current assets	425	405	486	580
Application of funds	638	685	763	855

Source: Company, ICICI Direct Research

Cash flow statement				
₹ Crore				
(₹ crores)	FY17	FY18	FY19E	FY20E
Net profit before Tax	226	260	315	365
Depreciation & Amortization	11	12	13	15
WC changes	24	90	(113)	(4)
Other non cash adju.	(6)	(10)	(32)	(33)
Income taxes paid	(65)	(55)	(85)	(99)
CF from operations	191	298	99	244
Capital expenditure	(10)	(6)	(11)	(12)
Δ in investments	(64)	(61)	(50)	(50)
Other investing cash flow	19	10	36	38
CF from investing Activities	1	95	(25)	(24)
Issue of equity	-	1	2	3
Δ in debt funds	(121)	(21)	-	-
Dividends paid	(45)	(115)	(152)	(175)
Other financing cash flow	(9)	(4)	(5)	(5)
CF from Financial Activities	(175)	(140)	(156)	(180)
Δ in cash and cash bank balance	17	253	(82)	40
Effect of exchange rate changes	(3)	1	-	-
Opening cash	295	248	347	266
Closing cash	248	347	266	306

Source: Company, ICICI Direct Research

Key ratios				
(Year-end March)	FY17	FY18	FY19E	FY20E
Per share data (₹)				
EPS-diluted	15.1	18.5	21.9	25.4
Cash per share	23.8	33.5	25.3	29.1
BV	56.1	63.0	69.6	78.3
DPS	9.0	10.5	12.3	14.2
Operating Ratios (%)				
EBITDA Margin	8.1	9.4	11.1	11.8
Adjusted PBT Margin	9.2	10.6	11.8	12.4
Adjusted PAT Margin	6.6	7.8	8.6	9.1
Return Ratios (%)				
RoNW	26.8	29.4	31.5	32.4
RoCE	35.7	38.6	42.0	43.3
RoIC	66.5	105.5	89.4	104.3
Valuation Ratios (x)				
P/E	25.4	19.8	16.6	14.4
EV / EBITDA	18.2	14.5	11.4	9.5
Price to Book Value	6.5	5.8	5.2	4.6
EV/Total Revenues	1.5	1.4	1.3	1.1
MCap/Total Revenues	1.6	1.6	1.4	1.3
Turnover Ratios				
Debtor days	81	59	66	66
Creditors days	69	64	62	62
Solvency Ratios				
Total Debt / Equity	0.1	0.0	0.0	0.0
Current Ratio	1.8	1.7	1.9	2.0
Quick Ratio	1.8	1.7	1.9	2.0
Debt / EBITDA	0.2	0.1	0.1	0.1

Source: Company, ICICI Direct Research

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Strong Buy: >15%/20% for large caps/midcaps, respectively, with high conviction;

Buy: >10%/15% for large caps/midcaps, respectively;

Hold: Up to +/-10%;

Sell: -10% or more;



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