

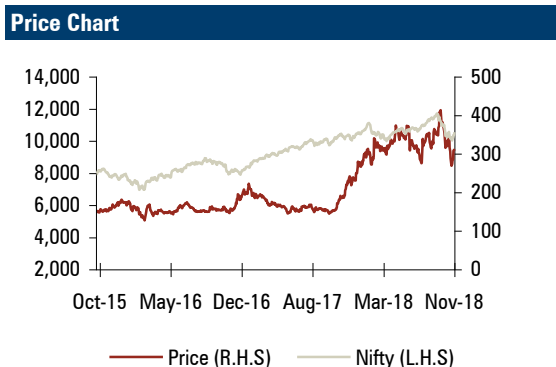
Rating matrix		
Rating	:	Buy
Target	:	₹ 400
Target Period	:	12 months
Potential Upside	:	26%

What's changed?		
Target	Introduced at ₹ 400	
EPS FY19E	Changed from ₹ 22.1 to ₹ 22.0	
EPS FY20E	Changed from ₹ 25.6 to ₹ 24.7	
Rating	Unchanged	

Key financials				
₹ Crore	FY17	FY18	FY19E	FY20E
Net Sales	2,371	2,454	2,714	2,896
EBITDA	192	231	295	334
Net Profit	157	192	229	257
EPS (₹)	15.1	18.5	22.0	24.7

Valuation summary				
	FY17	FY18	FY19E	FY20E
P/E	22.2	17.3	14.4	12.9
Target P/E	26.5	21.6	18.2	16.2
EV / EBITDA	5.7	5.0	4.5	4.1
P/BV	15.7	12.4	9.6	8.2
RoNW (%)	26.8	29.4	31.5	31.8
RoCE (%)	35.7	38.6	41.9	42.5

Stock data	
Particular	Amount
Market Capitalization (₹ Crore)	3,332.7
Total Debt(₹ Crore) (FY18)	18.7
Cash and Investments (₹ Crore) (FY18)	477.2
EV (₹ Crore)	2,874.2
52 week H/L	428 / 183
Equity capital	653.3
Face value	1.0



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Sonata Software (SONSOF)

₹ 318

Healthy performance...

- Sonata Software's IT service revenues in constant currency grew 4.0% QoQ. Further, the company's dollar revenues increased 3.4% QoQ to \$39.1 million mainly led by 9.7% QoQ growth in digital revenues. Vertically, the company's Dynamics AX business grew 14.9% QoQ. Geographically, Europe revenues grew 7.0% QoQ led by better growth & addition of two new clients and Rest of the World (RoW) revenues increasing 12.8%
- With healthy growth in IT service dollar revenues, rupee revenues increased 7.1% QoQ augmented by rupee depreciation. However, 25.4% QoQ decline in domestic revenues led to de-growth in overall rupee revenues (down 13.8% QoQ)
- EBITDA margins witnessed a healthy performance and expanded 180 bps QoQ to 12.5% supported by 70 bps expansion in international IT services business to 26.7%, 160 bps expansion in domestic business
- Reported PAT grew 7.9% QoQ to ₹ 62.2 crore mainly led by higher other income

Improving growth in IT services, healthy pipeline to boost revenues...

Sonata's IP led revenues increased 14.2% QoQ and 31.5% YoY mainly led by healthy traction in Rezopia, Halosys and Dynamics. Further, the company intends to scale up the IP led revenues to \$50-60 million over the next two to three years from current \$21 million led by higher cross selling and increase in traction from its IP products. In addition, the digital revenues have increased 9.7% QoQ and now contribute 35.0% of overall IT service revenues. We expect the company's digital revenues to gain traction over the coming years led by its platformisation and alliance led strategy. Further, the company has strong deal pipeline and has won \$1.5 million new deals in H1FY19E. We anticipate H2FY19 will be better than H2FY19. This coupled with rupee depreciation in FY20E, we expect overall IT service revenues in rupee terms to increase at a CAGR of 16.0% to ₹ 1,248.3 over FY18-20E.

Margin expansion to be curtailed by near term headwinds...

Despite higher offshoring, improved digital and IP led revenues, the company's IT service margin expanded merely by 70 bps in Q2FY19. In addition, the company is expected to reap the benefit of rupee depreciation only in H1FY20E. Hence, we revise our margin estimates for FY19E marginally downwards. Further, macro headwinds and higher labour cost prompt us to be cautious on FY20E margin expansion. Hence, although we expect margins to improve in FY18-20E, we have limited margin expansion to 210 bps vs 240 bps in our previous update.

Trading at attractive valuation; maintain BUY...

Improving IP led revenues, mining of existing clients, expansion in Europe (led by its platformisation and alliance led strategy) are expected to drive revenues over the next couple of years. Further, rupee benefit would drive the margins upwards. Moreover, a healthy payout ratio (~65-70% of PAT) would keep its dividend yield attractive. This coupled with recent correction in the stock price has made the valuation attractive (trading at 13x FY20E EPS). Hence, we maintain our **BUY** rating on Sonata with a revised target price of ₹ 400 (i.e. 16x FY20E P/E).

Variance analysis

	Q2FY19	Q2FY18	YoY (%)	Q1FY19	QoQ (%)	Comments
Revenue	593.1	426.9	38.9	688.3	-13.8	Despite healthy growth in international service revenues (up 7.0% QoQ), decline in domestic revenues (down 25.4% QoQ) led to de-growth in overall revenues
Employee expenses	146.4	132.1	10.8	132.1	10.9	
Purchase of stock-in trade & other	306.3	187.3	63.5	419.1	-26.9	
Gross Margin	140.4	107.5	30.7	137.2	2.3	
Gross margin (%)	23.7	25.2	-150 bps	19.9	374 bps	
Other expenses	66.4	52.7	26.0	63.9	4.0	
EBITDA	74.0	54.7	35.2	73.4	0.9	
EBITDA Margin (%)	12.5	12.8	-34 bps	10.7	182 bps	Domestic and international margins expanded QoQ leading to improvement in EBITDA margins
Depreciation & amortisation	2.9	3.2	-10.9	2.9	-0.3	
EBIT	71.1	51.5	38.2	70.5	0.9	
EBIT Margin (%)	12.0	12.1	-7 bps	10.2	176 bps	
Other income (less interest)	15.7	10.0	-36.6	7.2	119.2	
PBT	86.9	61.5	41.3	77.6	11.9	
Tax paid	24.7	16.3	51.4	22.1	11.7	
PAT	62.2	45.4	37.1	57.7	7.9	Higher other income drove PAT in the quarter

Source: Company, ICICI Direct Research

Change in estimates

	FY19E			FY20E			Comments
(₹ Crore)	Old	New	% Change	Old	New	% Change	
Revenue	2,684	2,714	1.1	2,934	2,896	-1.3	
EBITDA	297	295	-0.7	347	334	-3.7	
EBITDA Margin (%)	11.1	10.9	-20 bps	11.8	11.5	-29 bps	Macro headwinds and increase in labour cost prompt us to lower our margin estimates downwards
PAT	230	229	-0.6	267	257	-3.5	
EPS (₹)	22.1	22.0	-0.6	25.6	24.7	-3.5	

Source: Company, ICICI Direct Research

Financial summary

Profit and loss statement					₹ Crore				
(₹ crores)	FY17	FY18	FY19E	FY20E					
Total Revenues	2,371	2,454	2,714	2,896					
Growth (%)	22.2	3.5	10.6	6.7					
Total Operating Expenditure	2,179	2,223	2,419	2,562					
EBITDA	192	231	295	334					
Growth (%)	(0.2)	20.6	27.8	13.1					
Depreciation & Amortization	11	12	14	14					
Other Income	47	45	36	38					
Interest costs	9	5	5	5					
PBT before Exceptional Items	218	259	313	352					
Growth (%)	(1.4)	18.6	20.8	12.5					
Tax	69	68	85	95					
PAT before Exceptional Items	149	191	229	257					
Exceptional items	8	1	-	-					
PAT before MI	157	192	229	257					
Minority Int & Pft. from associates	-	-	-	-					
PAT	157	192	229	257					
Growth (%)	(1)	22	19	13					
EPS	15.1	18.5	22.0	24.7					
EPS (Growth %)	(0)	23	19	12					

Source: Company, ICICI Direct Research

Balance sheet					₹ Crore				
(₹ crores)	FY17	FY18	FY19E	FY20E					
Equity	11	10	10	10					
Reserves & Surplus	574	643	716	799					
Networth	585	653	727	810					
Minority Interest	-	(0)	(0)	(0)					
LT liabilities & provisions	19	13	13	13					
Total Debt	34	19	19	19					
Source of funds	638	685	758	841					
Net fixed assets	29	33	27	20					
Goodwill	91	81	81	81					
Long term loans and advances	78	-	-	-					
Other non current assets	14	166	176	182					
Loans and advances	34	-	41	43					
Inventories	-	-	-	-					
Current Investments	118	130	180	230					
Debtors	523	396	440	469					
Cash & Cash equivalents	248	347	333	369					
Other current assets	60	80	89	94					
Current liabilities	523	535	581	620					
Provisions	34	14	27	29					
Net current assets	425	405	474	557					
Application of funds	638	685	758	841					

Source: Company, ICICI Direct Research

Cash flow statement					₹ Crore				
(₹ crores)	FY17	FY18	FY19E	FY20E					
Net profit before Tax	226	260	313	352					
Depreciation & Amortization	11	12	14	14					
WC changes	24	90	(44)	(4)					
Other non cash adju.	(6)	(10)	(32)	(33)					
Income taxes paid	(65)	(55)	(85)	(95)					
CF from operations	191	298	167	235					
Capital expenditure	(10)	(6)	(7)	(8)					
Δ in investments	(64)	(61)	(50)	(50)					
Other investing cash flow	19	10	36	38					
CF from investing Activities	1	95	(21)	(20)					
Issue of equity	-	1	2	3					
Δ in debt funds	(121)	(21)	-	-					
Dividends paid	(45)	(115)	(155)	(175)					
Other financing cash flow	(9)	(4)	(5)	(5)					
CF from Financial Activities	(175)	(140)	(160)	(179)					
Δ in cash and cash bank balance	17	253	(14)	36					
Effect of exchange rate changes	(3)	1	-	-					
Opening cash	295	248	347	333					
Closing cash	248	347	333	369					

Source: Company, ICICI Direct Research

Key ratios				
(Year-end March)	FY17	FY18	FY19E	FY20E
Per share data (₹)				
EPS-diluted	15.1	18.5	22.0	24.7
Cash per share	23.8	33.5	32.1	35.5
BV	56.1	63.0	70.0	77.9
DPS	9.0	10.5	12.7	14.3
Operating Ratios (%)				
EBITDA Margin	8.1	9.4	10.9	11.5
Adjusted PBT Margin	9.2	10.6	11.5	12.2
Adjusted PAT Margin	6.6	7.8	8.4	8.9
Return Ratios (%)				
RoNW	26.8	29.4	31.5	31.8
RoCE	35.7	38.6	41.9	42.5
RoIC	66.5	105.5	115.2	132.3
Valuation Ratios (x)				
P/E	22.2	17.3	14.4	12.9
EV / EBITDA	15.7	12.4	9.6	8.2
Price to Book Value	5.7	5.0	4.5	4.1
EV/Total Revenues	1.3	1.2	1.0	1.0
MCap/Total Revenues	1.4	1.4	1.2	1.2
Turnover Ratios				
Debtor days	81	59	59	59
Creditors days	69	64	64	64
Solvency Ratios				
Total Debt / Equity	0.1	0.0	0.0	0.0
Current Ratio	1.8	1.7	1.8	1.9
Quick Ratio	1.8	1.7	1.8	1.9
Debt / EBITDA	0.2	0.1	0.1	0.1

Source: Company, ICICI Direct Research

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