

November 5, 2018

Q2FY19 Result Update

☑ Change in Estimates | ☑ Target | ■ Reco

Change in Estimates

	Current		Previous	
	FY19E	FY20E	FY19E	FY20E
Rating	BUY		BUY	
Target Price	410		420	
Sales (Rs. m)	25,615	28,328	28,140	31,842
% Chng.			(9.0)	(11.0)
EBITDA (Rs. m)	3,154	3,709	3,212	3,676
% Chng.			(1.8)	0.9
EPS (Rs.)	23.2	26.4	23.1	26.4
% Chng.			0.0	0.0

Key Financials

	FY17	FY18	FY19E	FY20E
Sales (Rs. m)	25,211	24,539	25,615	28,328
EBITDA (Rs. m)	1,923	2,310	3,154	3,709
Margin (%)	7.6	9.4	12.3	13.1
PAT (Rs. m)	1,538	1,923	2,410	2,735
EPS (Rs.)	14.8	18.5	23.2	26.4
Gr. (%)	(3.1)	24.9	25.3	13.5
DPS (Rs.)	9.1	10.7	11.6	13.2
Yield (%)	2.9	3.4	3.7	4.2
RoE (%)	28.8	30.9	34.4	34.0
RoCE (%)	23.2	27.7	31.5	31.5
EV/Sales (x)	1.1	1.1	1.1	0.9
EV/EBITDA (x)	15.1	12.1	8.5	7.0
PE (x)	21.1	16.9	13.5	11.9
P/BV (x)	5.5	5.0	4.3	3.8

Key Data

SOFT.BO | SSOF IN

52-W High / Low	Rs.429 / Rs.182
Sensex / Nifty	34,951 / 10,524
Market Cap	Rs.33bn / \$ 450m
Shares Outstanding	105m
3M Avg. Daily Value	Rs.261.48m

Shareholding Pattern (%)

Promoter's	30.95
Foreign	16.64
Domestic Institution	6.98
Public & Others	45.43
Promoter Pledge (Rs bn)	-

Stock Performance (%)

	1M	6M	12M
Absolute	(1.1)	(7.2)	68.0
Relative	(2.7)	(7.3)	61.9

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Steady Quarter, other income aids PAT beat

Steady revenue growth: Sonata Software delivered a steady performance for 2QFY19 with inline IT services USD revenues and beat on consolidated PAT aided by higher other income. IT services revenues came at USD39.1mn up 3.4% QoQ and in line with our estimates (PLe: 39.1mn). Sonata derives ~20% from GBP and hence cross currency movement was a headwind for the quarter. Constant Currency revenue growth for IT services business stood at 4% for 2QFY19. IT services adjusted EBIDTA margin came at 20.6% down 230bps QoQ and below our estimates (PLe: 21.7%). IT services business Headcount of company came at 3679 employees which is net addition of 225 employees. Travel vertical (29% of total revenues) up 11% QoQ, Retail &CPG vertical (up 7.6% QoQ) aided growth on vertical fronts. During 2QFY19, the company had higher effort mix shift towards offshore. Revenues from offshore accounted to 58% of total revenues in 2QFY19 (vs 56% in 1QFY19).

Other income aids PAT: Consolidated revenues came at Rs5931mn down 14% QoQ and up 39% YoY (PLe: Rs6918mn). IT services revenues came at Rs2753mn up 7.1% QoQ and accounted to 46% of total revenues. IT products business (Reselling business) revenues came at Rs3259mn down 25.4% QoQ and accounted to 54% of total revenues. Consolidated EBIDTA margin came at 12.5% up 182bps QoQ and above our estimates (PLe: 12%). Absolute Consolidated EBIDTA came at Rs740mn is 10% below our estimates owing to lower revenues from IT products business and softer margin in IT services business (PLe: Rs832mn). IT services adjusted EBITDA margin came at 20.6% up 230 bps QoQ. IT products adjusted EBITDA margin came at 5.4% up 200 bps QoQ. Consolidated PAT for 2QFY19 came at Rs622mn which is 2.6% above our estimates led by higher other income.

Valuation and View: Sonata continued focus on "Platformation" strategy within its focused verticals (Retail/CPG and Travel). Sonata's IP offering include Rezopia, Brick and Click platform, Retina Platform, Halosys are aiding the company get traction into new accounts. Digital contributed to 35% of total revenues as on 2QFY19. Sonata has been recently named as a member of Inner circle for Microsoft Dynamics. This further strengthens Sonata's positioning in Microsoft Dynamics which can enable further deal wins from Enterprises implementing Dynamics.

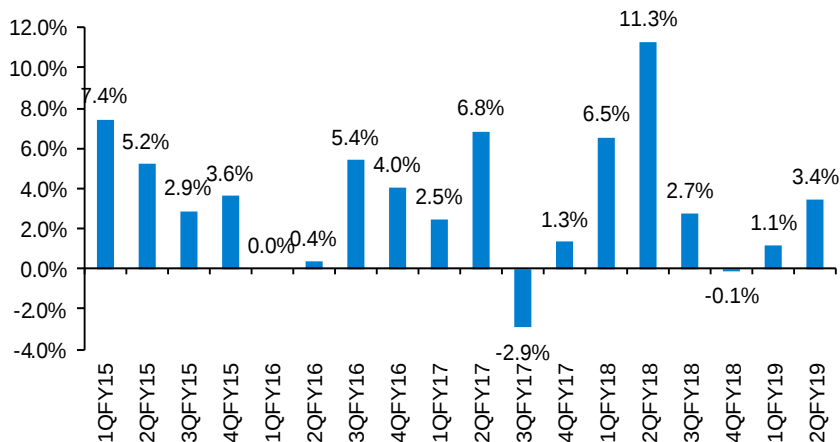
Led by steady 2Q, we expect Sonata's IT services revenues to grow by 11/13.5% for FY19/FY20E (vs 11/14% modeled earlier). Hence, FY19 USD revenue growth could be a tad softer than FY18 (Sonata Software IT services business grew by 18.5% USD revenue growth in FY18). We retain our EPS estimates at Rs23.2/26.4/sh for FY19/FY20. Net cash on balance sheet is Rs3445mn (Rs33/sh which is 10.5% of Mcap). Stock trades at 11.7x FY20E EPS. Robust balance sheet and strong free cash flow has helped company maintain superior pay-out ratios (~70% of PAT paid as dividend in FY18). Dividend yield stands at 3.5% at CMP. We value stock at 15.5x FY20E EPS which yields a TP of Rs 410/sh (15.5x FY20E EPS). Retain BUY.

Exhibit 1: Q1FY19: Consolidated P&L

Fig in mn	Q2FY19	Q1FY19	QoQ	Q2FY18	YoY	PL Est	Var (Act vs Ple)
IT services Revenues (USD mn)	39.1	37.8	3.4%	36.4	7.4%	39.1	0.0%
IT services Revenues (INR)	2753	2571	7.1%	2346	17.3%	2766	-0.5%
IT services Products (INR)	3259	4371	-25.4%	1997	63.2%	4152.5	-21.5%
Total consol Revenues(INR mn)	5931	6883	-13.8%	4269	38.9%	6918.4	-14.3%
Consol EBITDA	740.0	733.5	0.9%	547.4	35.2%	832.2	-11.1%
EBITDA Margins (%)	12.5%	10.7%	182 bps	12.8%	-35 bps	12.0%	45 bps
PAT	622	574	8.3%	454	37.0%	606.1	2.6%
EPS (Rs)	6.0	5.6	7.7%	4.4	36.6%	5.8	2.4%

Source: Company, PL

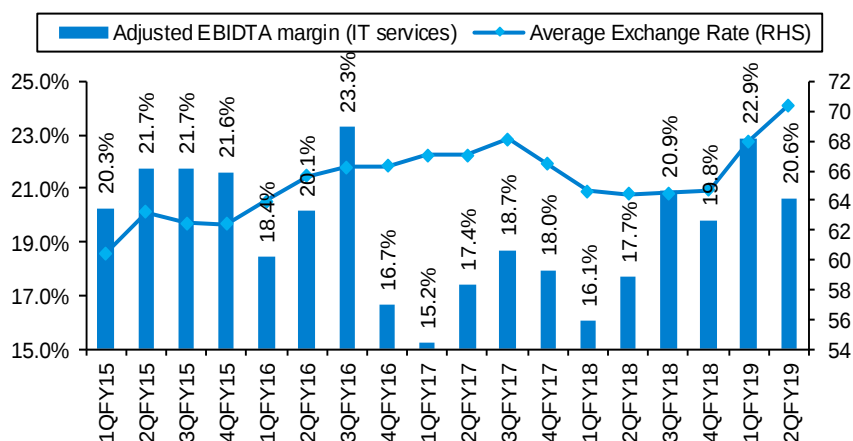
- Consolidated revenues of Sonata Software came at Rs5931mn down 14% QoQ and up 39% YoY and below our estimates (PLe: Rs6918mn). Lower revenues from IT Product business has led to revenue miss for the quarter. IT products revenues (Trading of Software Licenses) came at Rs3259mn down 25% QoQ and up 63% YoY and below our estimates (PLe: Rs4153mn). IT services revenues came at Rs2753mn up 7.1% QoQ and 17.3% YoY and inline with our estimates (PLe: Rs2766mn). For 2QFY19, IT services and IT products accounted to 46/54% of total revenues.
- Consolidated EBITDA /PAT came at Rs740/622mn for 2QFY19 (vs our estimates of Rs833/606mn). Consolidated EBITDA margin came at 12.5% up 182bps QoQ. Consolidated EBITDA came 10% below our estimates owing to lower revenues from IT products business and softer margin in IT services business. PAT is 2.6% above our estimates led by higher other income.
- IT Services USD revenues grew by 3.4% QoQ after two consecutive quarters of tepid growth. For IT services, Offshore Product Engineering/Travel/Retail &CPG vertical USD revenues grew by 3.4/11.1/7.6% QoQ and accounted to 28/29/26% respectively of the total revenues.

Exhibit 2: Sonata Software's IT services USD revenue growth QoQ


Source: Company, PL

Sonata Software reports forex gain and Interest Income in the segmental EBIDTA margin of IT services business. For 2QFY19, Sonata's segmental EBIDTA margin stood at 26.7%. However, we present the adjusted EBIDTA margin (Excluding interest income and Forex gain). For 2QFY19, Adjusted EBIDTA margin stood at 20.6% down 230bps QoQ.

Exhibit 3: Adjusted IT services EBIDTA Margins



Source: Company, PL

- During the quarter company added 11 new customers (vs 8 new customer added in 1QFY19) across North America, Europe and Asia. Digital Revenues accounts for 35% of total revenues for 2QFY19. Revenues from top 10 clients stands at USD27mn, grew by 2% QoQ and account for 69% of total revenues. Number of customers with more than USD1mn increased to 26 (vs 24 in 1QFY19).



Key Metrics:

Exhibit 4: Headcount Metrics

Headcount	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19
IT Services	2889	2908	3139	3111	3144	3147	3161	3213	3418	3464	3296	3313	3454	3679
Products	130	142	140	140	147	156	153	153	157	164	163	163	161	157
Total	3019	3050	3279	3251	3291	3303	3314	3366	3575	3628	3459	3476	3615	3836
Net additions	1	31	229	-28	40	12	11	52	209	53	(169)	17	139	221

Source: Company, PL

Exhibit 5: Revenue by Delivery centers

	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19
Onsite	34%	38%	42%	43%	42%	45%	40%	43%	43%	45%	45%	41%	44%	42%
Offshore	66%	62%	58%	57%	58%	55%	60%	57%	57%	55%	55%	59%	56%	58%

Source: Company, PL

Exhibit 6: Vertical mix of revenues (%)

Vertical Mix of Revenues	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19
OPD	29	28	30	31	30	29	30	29	28	28	28	28
Travel	33	31	29	28	26	27	28	27	28	27	27	29
CPG	21	24	24	23	27	26	24	26	27	25	25	26
Others	17	17	17	17	17	18	18	18	17	20	20	17

Source: Company, PL

Exhibit 7: Revenue from Top 10 Clients

	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19
Client Concentration	72	67	70	71	70	70	70	69	71	69	70	69

Source: Company, PL

Exhibit 8: Consolidated Model sheet of Sonata Software

	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
USD revenues of IT services (USD mn)	98.3	107.8	121.4	143.9	159.7	181.3	206.1
Growth (%)	23.0%	9.7%	12.6%	18.5%	11.0%	13.6%	13.7%
Average Rate (USD vs INR)	61.7	65.6	67.2	64.5	70.1	72.0	70.0
IT services Revenues (Rs mn)	6068	7067.8	8153	9285	11198	13055	14430
Growth (%)	25.5%	16.5%	15.4%	13.9%	20.6%	16.6%	10.5%
IT Products Revenues (Rs mn)	10926	12501	17342	15528	14557	15273	16138
Growth (%)	0.7%	14.4%	38.7%	-10.5%	-6.3%	4.9%	5.7%
Consolidated Revenues (Rs mn)	16,821	19,404	25,211	24,539	25,615	28,328	30,567
Growth (%)	7.4%	15.4%	29.9%	-2.7%	4.4%	10.6%	7.9%
Mix of Revenues							
IT Services	36%	36%	32%	38%	44%	46%	47%
Products (Reseller of Licenses)	65%	64%	69%	63%	57%	54%	53%
EBIDTA (Rs mn)							
IT Services	1294	1406	1415	1737	2525	2984	3335
IT Products	383	547	517	591	637	725	726
Total Adjusted EBIDTA	1677	1954	1931	2328	3162	3709	4061
Adjusted IT services EBIDTA margin (%)	21.3%	19.9%	17.4%	18.7%	22.5%	22.9%	23.1%
Adjusted IT products EBIDTA margin (%)	3.5%	4.4%	3.0%	3.8%	4.4%	4.8%	4.5%
Total Consolidated EBIDTA margin (%)	10.0%	9.9%	7.6%	9.4%	12.3%	13.1%	13.3%
PAT (Rs mn)	1337	1586	1537	1922	2410	2735	3002
APAT (Rs mn)	1305	1549	1460	1922	2410	2735	3002
Adjusted EPS	12.4	14.7	13.9	18.3	23.2	26.3	28.9
Growth (%)	84.9%	18.7%	-5.8%	31.7%	26.9%	13.5%	9.8%
P/E	25.0	21.0	21.2	16.9	13.4	11.8	10.7
DPS	7.0	9.0	9.0	10.6	11.6	13.2	14.5
Dividend Payout Ratio (Excluding dividend tax)	56.4%	61.0%	64.7%	58.2%	50.0%	50.0%	50.0%
Dividend Yield(%)	2.3%	2.9%	2.9%	3.4%	3.7%	4.2%	4.7%
ROE (%)	32.5%	34.5%	28.8%	30.9%	34.4%	34.0%	32.7%
Consolidated Balance sheet (Rs mn)							
Net cash on Balance sheet	2375	1600	3457	5269	6171	7224	8383
Net Cash per Share	22.6	15.2	32.9	50.1	59.4	69.5	80.7
Net Cash per share/Mcap	7.0%	4.7%	10.1%	15.4%	19.2%	22.4%	26.0%
Consolidated cash flows (Rs mn)							
Cash Flow from Operations	768	1581	1845	2978	2225	2632	2867
Capex+ Acquisition	140	848	97	65	90	90	90
FCF	627	733	1748	2913	2135	2542	2777
FCF/EBIDTA	37.4%	38.2%	90.9%	126.1%	67.7%	68.5%	68.4%

Source: x, Company, PL

Financials

Income Statement (Rs m)

Y/e Mar	FY17	FY18	FY19E	FY20E
Net Revenues	25,211	24,539	25,615	28,328
YoY gr. (%)	29.9	(2.7)	4.4	10.6
Employee Cost	16,477	14,881	14,662	16,404
Gross Profit	8,734	9,659	10,953	11,924
Margin (%)	34.6	39.4	42.8	42.1
SG&A Expenses	-	-	-	-
Other Expenses	2,256	2,211	2,455	2,550
EBITDA	1,923	2,310	3,154	3,709
YoY gr. (%)	0.2	20.2	36.5	17.6
Margin (%)	7.6	9.4	12.3	13.1
Depreciation and Amortization	93	124	112	109
EBIT	1,830	2,186	3,041	3,600
Margin (%)	7.3	8.9	11.9	12.7
Net Interest	90	48	32	28
Other Income	403	454	345	280
Profit Before Tax	2,220	2,604	3,373	3,852
Margin (%)	8.8	10.6	13.2	13.6
Total Tax	682	681	963	1,117
Effective tax rate (%)	30.7	26.2	28.6	29.0
Profit after tax	1,538	1,923	2,410	2,735
Minority interest	-	-	-	-
Share Profit from Associate	-	-	-	-
Adjusted PAT	1,538	1,923	2,410	2,735
YoY gr. (%)	(3.1)	25.0	25.3	13.5
Margin (%)	6.1	7.8	9.4	9.7
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	1,538	1,923	2,410	2,735
YoY gr. (%)	(3.1)	25.0	25.3	13.5
Margin (%)	6.1	7.8	9.4	9.7
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	1,538	1,923	2,410	2,735
Equity Shares O/s (m)	104	104	104	104
EPS (Rs)	14.8	18.5	23.2	26.4

Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Mar	FY17	FY18	FY19E	FY20E
Non-Current Assets				
Gross Block	489	565	655	745
Tangibles	311	387	459	531
Intangibles	178	179	197	215
Acc: Dep / Amortization	109	233	345	454
Tangibles	74	155	229	300
Intangibles	35	78	116	154
Net fixed assets	380	332	310	291
Tangibles	237	232	230	231
Intangibles	143	101	80	60
Capital Work In Progress	4	3	3	3
Goodwill	803	807	807	807
Non-Current Investments	144	896	996	1,096
Net Deferred tax assets	45	124	124	124
Other Non-Current Assets	658	636	636	636
Current Assets				
Investments	1,279	1,300	1,350	1,400
Inventories	-	-	-	-
Trade receivables	5,199	3,964	4,138	4,577
Cash & Bank Balance	2,530	3,472	4,324	5,326
Other Current Assets	332	360	360	360
Total Assets	11,977	12,336	13,489	15,061
Equity				
Equity Share Capital	104	104	104	104
Other Equity	5,800	6,429	7,393	8,487
Total Network	5,904	6,533	7,497	8,591
Non-Current Liabilities				
Long Term borrowings	336	187	187	187
Provisions	-	-	-	-
Other non current liabilities	92	103	103	103
Current Liabilities				
ST Debt / Current of LT Debt	18	-	-	-
Trade payables	4,482	4,323	4,512	4,990
Other current liabilities	1,093	1,167	1,167	1,167
Total Equity & Liabilities	11,977	12,336	13,489	15,061

Source: Company Data, PL Research

Cash Flow (Rs m)

Y/e Mar	FY17	FY18	FY19E	FY20E
PBT	2,262	2,604	3,355	3,852
Add. Depreciation	109	124	112	109
Add. Interest	83	44	32	28
Less Financial Other Income	403	454	345	280
Add. Other	(370)	(146)	(345)	(280)
Op. profit before WC changes	2,084	2,626	3,154	3,709
Net Changes-WC	408	904	16	40
Direct tax	(646)	(552)	(963)	(1,117)
Net cash from Op. activities	1,845	2,978	2,206	2,632
Capital expenditures	(96)	(64)	(90)	(90)
Interest / Dividend Income	170	97	345	280
Others	(78)	918	(150)	(150)
Net Cash from Invst. activities	(4)	952	105	40
Issue of share cap. / premium	0	0	-	-
Debt changes	(1,208)	(215)	-	-
Dividend paid	(437)	(1,146)	(1,446)	(1,641)
Interest paid	(83)	(44)	(32)	(28)
Others	-	-	-	-
Net cash from Fin. activities	(1,727)	(1,404)	(1,478)	(1,669)
Net change in cash	114	2,525	833	1,003
Free Cash Flow	1,748	2,913	2,116	2,542

Source: Company Data, PL Research

Key Financial Metrics

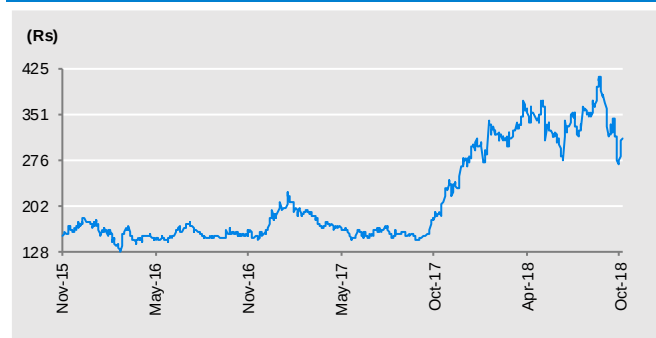
Y/e Mar	FY17	FY18	FY19E	FY20E
Per Share(Rs)				
EPS	14.8	18.5	23.2	26.4
CEPS	15.7	19.7	24.3	27.4
BVPS	56.9	63.0	72.2	82.8
FCF	16.9	28.1	20.4	24.5
DPS	9.1	10.7	11.6	13.2
Return Ratio(%)				
RoCE	23.2	27.7	31.5	31.5
ROIC	36.8	66.5	120.3	136.7
RoE	28.8	30.9	34.4	34.0
Balance Sheet				
Net Debt : Equity (x)	(0.6)	(0.7)	(0.7)	(0.8)
Debtor (Days)	75	59	59	59
Valuation(x)				
PER	21.1	16.9	13.5	11.9
P/B	5.5	5.0	4.3	3.8
P/CEPS	15.7	19.7	24.3	27.4
EV/EBITDA	15.1	12.1	8.5	7.0
EV/Sales	1.1	1.1	1.1	0.9
Dividend Yield (%)	2.9	3.4	3.7	4.2

Source: Company Data, PL Research

Quarterly Financials (Rs m)

Y/e Mar	Q3FY18	Q4FY18	Q1FY19	Q2FY19
Net Revenue	7,667	6,258	6,883	5,931
YoY gr. (%)	25.2	(11.6)	8.5	38.9
Employee Expenses	5,171	3,740	4,191	3,063
Gross Profit	2,497	2,518	2,693	2,868
Margin (%)	32.6	40.2	39.1	48.4
EBITDA	651	635	733	740
YoY gr. (%)	18.8	(2.3)	15.4	0.9
Margin (%)	8.5	10.2	10.7	12.5
Depreciation / Depletion	31	30	29	29
EBIT	619	606	704	711
Margin (%)	8.1	9.7	10.2	12.0
Net Interest	9	10	7	10
Other Income	65	119	79	167
Profit before Tax	675	715	776	869
Margin (%)	8.8	11.4	11.3	14.6
Total Tax	181	172	221	247
Effective tax rate (%)	26.8	24.0	28.4	28.4
Profit after Tax	494	543	555	622
Minority interest	-	-	-	-
Share Profit from Associates	-	-	-	-
Adjusted PAT	494	543	574	622
YoY gr. (%)	27.9	34.2	33.0	37.0
Margin (%)	6.4	8.7	8.3	10.5
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	494	543	574	622
YoY gr. (%)	27.9	34.2	33.0	37.0
Margin (%)	6.4	8.7	8.3	10.5
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	494	543	574	622
Avg. Shares O/s (m)	104	104	104	104
EPS (Rs)	4.8	5.2	5.5	6.0

Source: Company Data, PL Research

Price Chart

Recommendation History

No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	14-Nov-17	BUY	230	190
2	10-Jan-18	BUY	-	283
3	8-Feb-18	BUY	325	289
4	13-Apr-18	BUY	330	327
5	10-Jul-18	BUY	350	300
6	20-Aug-18	BUY	390	365
7	5-Oct-18	BUY	420	330

Analyst Coverage Universe

Sr. No.	CompanyName	Rating	TP (Rs)	Share Price (Rs)
1	Cyient	BUY	810	669
2	HCL Technologies	BUY	1,255	952
3	Hexaware Technologies	Accumulate	430	351
4	Infosys	BUY	790	695
5	L&T Technology Services	Accumulate	1,780	1,455
6	Mindtree	BUY	1,140	978
7	Mphasis	Accumulate	1,220	1,068
8	NIIT Technologies	BUY	1,460	1,192
9	Persistent Systems	Accumulate	725	560
10	Redington (India)	BUY	140	92
11	Sonata Software	BUY	420	330
12	Tata Consultancy Services	Accumulate	2,300	1,980
13	TeamLease Services	Hold	2,740	2,219
14	Tech Mahindra	BUY	885	685
15	Wipro	Accumulate	350	309
16	Zensar Technologies	BUY	290	235

PL's Recommendation Nomenclature (Absolute Performance)

Buy	: > 15%
Accumulate	: 5% to 15%
Hold	: +5% to -5%
Reduce	: -5% to -15%
Sell	: < -15%
Not Rated (NR)	: No specific call on the stock
Under Review (UR)	: Rating likely to change shortly

ANALYST CERTIFICATION

(Indian Clients)

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