

Exposure to travel, retail vertical impacts Q4...

Sonata Software reported poor Q4FY20 results. IT service revenues in dollar terms fell 5.1% QoQ mainly due to Covid-19 pandemic and its exposure to impacted vertical like travel (down 12.7% QoQ, accounts for 23% of revenues) & retail (down 5.1% QoQ, accounts for 28% of revenues). IT service EBITDA margin also declined ~560 bps QoQ while PAT declined 22% QoQ. Overall revenues declined 25% QoQ mainly led by 33% decline in domestic product business. Overall PAT declined 19% QoQ to ₹ 61.8 crore, mainly led by 22% QoQ decline in IT service revenues and one-time provision of IL&FS of ₹ 12.7 crore. The DSO also increased by five days to 50 days led by an increase in DSO days in IT service and domestic segment.

Covid crisis to severely impact FY21E, FY22E to see revival

The company has exposure to travel (23% of revenues) and retail (28% of revenues), which were severely impacted by the current crisis. Top client (~20% of topline) is in travel. The company expects only 85% of Top Client's revenues to be lost in the near term. In addition, Sonata has exposure to non-essential retail like fashion and jewellery, which have been severely impacted by Covid and is expected to witness pressure. We believe FY21E revenues will be impacted by pricing pressure, lower utilisation, project ramp downs, project cancellation and lower discretionary spend leading to an anticipated decline in IT service revenues of 19.0% YoY in dollar terms. In addition, we expect domestic business to be impacted by lack of new sales, leading to overall decline in FY21E revenues by 11.1% YoY. However, we expect revenues to improve in FY22E by 10.0% YoY led by a recovery in sectors across business lines and higher license sale in domestic business.

Pricing pressure, lower utilisation to impact margins

Sonata is undertaking various measures for cost rationalisation like adjusting compensation, pay reduction in top management, lower travel cost and no salary hikes. However, subdued revenues in travel vertical that has ~500 employees will impact near term utilisation. Also, we expect Sonata to witness pricing pressure due to exposure to troubled verticals. Hence, we expect FY21E EBIT margins to decline 300 bps YoY to 5.8% and see a recovery in FY22E leading to an improvement of ~160 bps YoY to 7.4%.

Valuation & Outlook

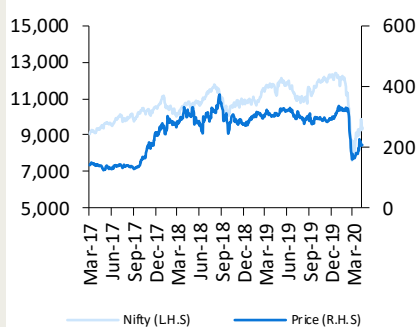
The company reported a subdued Q4FY20 performance. Further, considering its exposure to troubled verticals, we expect FY21E revenues, margins to remain under pressure. Although we expect Sonata's partnership with Microsoft, exposure to Outsourced Product Development (26% of revenues) could boost revenue and margin, we remain cautious on company's recovery in travel and retail vertical. Hence, we have lowered our eps estimates for FY21E and FY22E, prompting us downgrade the stock from BUY to HOLD with a revised target price of ₹ 205/share.



Particulars

Particular	Amount
Market Capitalization (₹Crore)	2,053.4
Total Debt(₹Crore)	86.0
Cash and Investments (₹Crore)	401.2
EV (₹Crore)	1,738.2
52 week H/L	363 / 148
Equity capital	768.3
Face value	1.0

Price Performance



Key Highlights

- We expect the company to face multiple headwinds in revenues in the near term due to exposure to troubled verticals
- We expect margins to improve in FY22E
- Downgrade to HOLD from BUY rating with target price of ₹ 205

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Key Financial Summary

(₹Crore)	FY18	FY19	FY20	FY21E	FY22E	CAGR (FY20-22E)
Net Sales	2,454	2,961	3,743	3,327	3,659	-1.1%
E BITDA	231	336	373	229	311	-8.6%
E BITDA Margin (%)	9.4	11.3	10.0	6.9	8.5	
PAT	192	249	277	170	232	-8.5%
EPS (₹)	18.3	24.0	26.7	16.4	22.3	
P/E (x)	11	8	7	12	9	
RoNW (%)	29.4	32.4	41.4	22.5	27.6	
RoCE (%)	38.6	42.3	44.7	25.1	33.1	

Source: Company, ICICI Direct Research

Financial summary

Exhibit 1: Profit and loss statement				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
Total Revenues	2,961	3,743	3,327	3,659
Growth (%)	20.7	26.4	(11.1)	10.0
Total Operating Expenditure	2,625	3,370	3,098	3,348
EBITDA	336	373	229	311
Growth (%)	45.3	11.1	(38.7)	36.2
Depreciation & Amortization	13	37	37	40
Other Income	27	58	51	55
Interest costs	3	15	15	15
PBT before Exceptional Items	347	380	228	311
Growth (%)	33.8	9.5	(39.9)	36.3
Tax	101	103	58	79
PAT before Exceptional Items	246	277	170	232
Exceptional items	3	-	-	-
PAT before MI	249	277	170	232
Minority Int & Pft. from associa	-	-	-	-
PAT	249	277	170	232
Growth (%)	30	11	(39)	36
EPS	24.0	26.7	16.4	22.3
EPS (Growth %)	31	11	(39)	36

Source: Company, ICICI Direct Research

Exhibit 2: Cash flow statement				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
Net profit before Tax	350	379	228	311
Depreciation & Amortization	13	37	37	40
WC changes	(235)	100	(25)	1
Other non cash adju.	(47)	(18)	(36)	(40)
Income taxes paid	(87)	(129)	(58)	(79)
CF from operations	(6)	370	146	233
Capital expenditure	(8)	(8)	(43)	(48)
Δ in investments	26	138	-	-
Other investing cash flow	5	9	51	55
CF from investing Activities	11	139	8	8
Issue of equity	2	3	4	5
Δ in debt funds	(20)	47	-	(66)
Dividends paid	(143)	(354)	(85)	(148)
Other financing cash flow	(3)	(3)	(15)	(15)
CF from Financial Activities	(166)	(311)	(100)	(229)
Δ in cash and cash bank balanc	(161)	198	54	11
Effect of exchange rate changes	1	(1)	-	-
Opening cash	347	199	396	450
Closing cash	199	396	450	462

Source: Company, ICICI Direct Research

Exhibit 3: Balance sheet				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
Equity	10	10	10	10
Reserves & Surplus	758	659	744	828
Networth	768	670	755	839
Minority Interest	-	-	-	-
LT liabilities & provisions	44	128	128	128
Total Debt	16	86	86	20
Source of funds	827	884	969	986
Net fixed assets	55	142	149	156
Goodwill	145	156	156	156
Long term loans and advances	-	-	-	-
Other non current assets	81	129	100	106
Loans and advances	-	-	-	-
Inventories	-	-	-	-
Current Investments	140	5	5	5
Debtors	811	700	682	732
Cash & Cash equivalents	199	396	450	462
Other current assets	96	88	80	88
Current liabilities	682	710	632	696
Provisions	19	23	20	22
Net current assets	546	457	564	568
Application of funds	827	884	969	986

Source: Company, ICICI Direct Research

Exhibit 4: Key ratios				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
Per share data (₹)				
EPS-diluted	24.0	26.7	16.4	22.3
Cash per share	19.2	38.2	43.3	44.4
BV	74.1	64.5	72.6	80.7
DPS	12.8	20.3	8.2	14.2
Operating Ratios (%)				
EBITDA Margin	11.3	10.0	6.9	8.5
Adjusted PBT Margin	11.7	10.1	6.9	8.5
Adjusted PAT Margin	8.4	7.4	5.1	6.3
Return Ratios (%)				
RoNW	32.4	41.4	22.5	27.6
RoCE	42.3	44.7	25.1	33.1
RoIC	66.2	69.7	37.4	52.1
Valuation Ratios (x)				
P/E	8.3	7.4	12.1	8.9
EV / EBITDA	5.2	4.7	7.4	5.2
Price to Book Value	2.7	3.1	2.7	2.5
EV/Total Revenues	0.6	0.5	0.5	0.4
MCap/Total Revenues	0.7	0.5	0.6	0.6
Turnover Ratios				
Debtor days	100	68	75	73
Creditors days	72	55	55	55
Solvency Ratios				
Total Debt / E equity	0.0	0.1	0.1	0.0
Current Ratio	1.8	1.6	1.9	1.8
Quick Ratio	1.8	1.6	1.9	1.8
Debt / EBITDA	0.0	0.2	0.4	0.1

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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