

Sonata Software

On the path to recovery

Sonata posted a weak quarter; the fall in IT services (IITS) revenue (-19.6% QoQ organic) was higher-than-estimated, but margin expansion of 104bps QoQ came as a positive surprise. The impact on IITS was due to an issue in one large travel client (down ~80% QoQ); ex-travel, its revenue was up 1.2% sequentially. Sonata has invested in strengthening the Microsoft relationship, which has yielded positive results (4Y CAGR of 19%). Dynamics D365 related services (34% of revenue) has grown at an eight-quarter CQGR of 7.8%. Furthermore, the margin expansion in IITS was led by a reduction in cost, offshoring and higher IP-Led revenue. The IITS margin will be maintained in the range of 21-22%. DPS growth was strong (+12.2% QoQ), but higher discounts impacted margins. Higher cloud license sales should lead to growth in DPS, but discounts could impact profitability. We like Sonata's IP-led business model, highest margin (IITS) in Tier-2 IT, focus on high growth Microsoft ecosystem, healthy RoE (~38%), and high dividend yield (~5%). We cut our EPS estimate by 2.3/6.2% to factor in the near-term growth challenges and lower DPS margin. The stock is trading at a P/E of 13/11x FY21/22E, in line with the five-year average multiple. We increase our target multiple to 12x (vs. 11x) to arrive at a target price of Rs 320, based on June-22E EPS.

- **1QFY21 highlights:** IITS revenue declined 17.8% QoQ to USD 36.5mn vs. estimate of USD 38mn. The decline was led by travel (-85% QoQ) and non-essential retail (-17.8% QoQ) verticals. The recovery in travel will be gradual and will reach ~50% of 4QFY20 level by 4QFY21. IP-led revenue was up 5.5% QoQ and supported margins. Consolidated revenue was up 2.6% QoQ, and EBITDA margin stood at 8.2% (vs. the estimate of 8.3%). Microsoft (SI + Product Engineering + AX up-gradation) is ~60% of IITS revenue.
- We expect IITS revenue to recover from 2QFY21; IITS growth ex-TUI for 2/3/4Q is expected to be 0.4/1.7/1.8% QoQ. IITS margin is expected to be at 21.1/21.4% for FY21/22E.

Quarterly financial summary

YE March (Rs Bn)	1Q FY21	1Q FY20	YoY (%)	4Q FY20	QoQ (%)	FY19	FY20	FY21E	FY22E	FY23E
IITS USD Revenue	36.5	44.3	-17.7	44.4	-17.8	161	181	153	171	186
Net Sales	9.52	8.75	8.9	9.29	2.6	29.61	37.43	37.39	41.41	45.37
EBIT	0.68	0.81	-15.9	0.74	-8.0	3.23	3.36	2.80	3.28	3.65
APAT	0.50	0.67	-25.5	0.74	-33.0	2.47	2.77	2.27	2.68	2.99
Diluted EPS (Rs)	4.8	6.5	-25.5	7.2	-33.0	23.7	26.7	21.8	25.7	28.7
P/E (x)						11.9	10.6	13.0	11.0	9.8
EV / EBITDA (x)						8.3	7.5	8.5	7.1	6.2
RoE (%)						34.7	38.5	31.9	33.5	33.3

Source: Company, HSIE Research, Consolidated Financials

Change in Estimates

Rs Bn	FY21E Old	FY21E Revised	Change %	FY22E Old	FY22E Revised	Change %
Revenue (USD mn)	159	153	-3.6	175	171	-2.2
Revenue	36.9	37.4	1.4	40.7	41.4	1.9
EBIT	2.9	2.8	-2.5	3.5	3.3	-6.8
EBIT margin (%)	7.8	7.5	-30bps	8.7	7.9	-73bps
APAT	2.3	2.3	-2.3	2.9	2.7	-6.2
EPS (Rs)	22.3	21.8	-2.3	27.5	25.7	-6.2

Source: Company, HSIE Research

BUY

CMP (as on 11 Aug 2020)	Rs 283
Target Price	Rs 320
NIFTY	11,323

KEY CHANGES	OLD	NEW
Rating	BUY	BUY
Price Target	Rs 300	Rs 320
EPS %	FY21E	FY22E
	-2.3	-6.2

KEY STOCK DATA

Bloomberg code	SSOF IN
No. of Shares (mn)	105
MCap (Rs bn) / (\$ mn)	30/399
6m avg traded value (Rs mn)	99
52 Week high / low	Rs 355/147

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	36.4	(15.6)	(16.3)
Relative (%)	14.7	(8.8)	(18.5)

SHAREHOLDING PATTERN (%)

	Mar-20	Jun-20
Promoters	28.17	28.17
FIs & Local MFs	13.32	12.93
FPIs	11.66	10.37
Public & Others	46.85	48.53
Pledged Shares	0.00	0.00

Source : BSE

Pledged shares as % of total shares

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