

## Exposure to travel vertical dents revenues...

Sonata Software reported poor Q1FY21 results. IT service revenues in dollar terms fell 17.8% QoQ mainly due to 85.1% QoQ dip in travel vertical (mainly impacted by top client that is in travel vertical). However, IT service EBITDA margin improved 125 bps QoQ to 23.5% mainly led by lower travel cost and higher offshoring. IT service PAT declined 15% QoQ mainly due to lower other income. Domestic revenues increased 12.0% QoQ while PAT fell 30% QoQ mainly due to higher discounting. Consequently, overall revenues increased 3% QoQ to ₹ 952.4 crore while PAT fell 19.0% QoQ to ₹ 49.9 crore.

### Travel client bottoms out; improvement expected ahead

The travel vertical contribution to revenues declined from 22% in Q4FY20 to 4% in Q1FY21 mainly due to its exposure to top client (~20% of revenues), which is in the travel vertical from European region. The company expects a gradual improvement in revenues from top client from Q2FY21E onwards and expects its contribution to improve from current ~3% of topline to ~10% of topline by Q4FY20E. Further, we expect other verticals like Independent Software Vendor (ISV), essential retail, utility and commodity service to improve in coming quarters. However, considering the significant dip in Q1FY21 dollar revenues, we expect IT service dollar revenues to decline 14.0% YoY in FY21E and then see an improvement of 12.0% YoY in IT service in FY22E. In addition, we expect domestic business revenues to increase 10% YoY in FY21E and FY22E. Hence, we expect revenues to increase at a CAGR of 7.4% over FY20-22E.

### Offshoring, cost rationalisation to drive margins in FY22E

The company is undertaking various measures for cost rationalisation like adjusting compensation, pay reduction in top management, lower travel cost and no salary hikes. Sonata has also rationalised its manpower in the travel vertical, which will help in improving utilisation, going forward. Also, higher offshoring will benefit IT service margins. However, subdued margins in the domestic business (led by pricing pressure) will impact overall margins. Hence, we expect EBITDA margins to decline 107 bps YoY to 8.9% and then improve 81 bps in FY22E to 9.7%.

### Valuation & Outlook

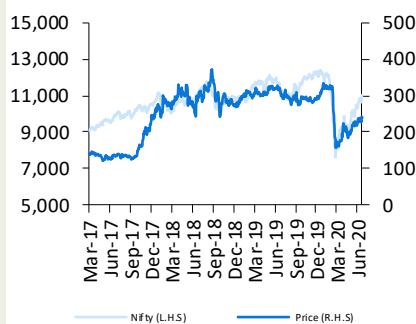
We expect the company to see improving revenues in coming quarters led by improvement in contribution from top client and traction in ISV vertical, essential retail, utility and commodity service. In addition, scaling of IP led revenues, rising proportion of digital and Sonata's partnership with Microsoft could boost revenue and margin in coming quarters. Hence, we increase our EPS estimates for FY21E and FY22E, prompting us to upgrade the stock from HOLD to **BUY** with a revised target price of ₹ 330/share.



#### Particulars

Particular	Amount
Market Capitalization (₹Crore)	2,925.1
Total Debt(₹Crore)	86.0
Cash and Investments (₹Crore)	401.2
EV (₹Crore)	2,609.8
52 week H/L	354 / 148
Equity capital	10.4
Face value	1.0

#### Price Performance



#### Key Highlights

- Expect company to register improved revenues in coming quarters
- Expect margins to improve in FY22E
- Upgrade from HOLD to BUY rating with target price of ₹ 330

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### Key Financial Summary

(₹Crore)	FY18	FY19	FY20	FY21E	FY22E	CAGR (FY20-22E)
Net Sales	2,454	2,961	3,743	3,908	4,322	7.4%
E BITDA	231	336	373	347	419	6.0%
E BITDA Margin (%)	9.4	11.3	10.0	8.9	9.7	
PAT	192	249	277	242	293	2.9%
EPS (₹)	18.3	24.0	26.7	23.3	28.2	
P/E (x)	16	12	11	12	10	
RoNW (%)	29.4	32.4	41.4	30.7	34.5	
RoCE (%)	38.6	42.3	44.7	34.6	41.8	

Source: Company, ICICI Direct Research

## Financial summary

Exhibit 1: Profit and loss statement				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
<b>Total Revenues</b>	<b>2,961</b>	<b>3,743</b>	<b>3,908</b>	<b>4,322</b>
Growth (%)	20.7	26.4	4.4	10.6
Total Operating Expenditure	2,625	3,370	3,560	3,903
<b>EBITDA</b>	<b>336</b>	<b>373</b>	<b>347</b>	<b>419</b>
Growth (%)	45.3	11.1	(6.9)	20.7
Depreciation & Amortization	13	37	43	48
Other Income	27	58	43	46
Interest costs	3	15	15	15
PBT before Exceptional Items	347	380	332	402
Growth (%)	33.8	9.5	(12.5)	21.1
Tax	101	103	90	109
PAT before Exceptional Items	246	277	242	293
Exceptional items	3	-	-	-
PAT before MI	249	277	242	293
Minority Int & Pft. from associa	-	-	-	-
<b>PAT</b>	<b>249</b>	<b>277</b>	<b>242</b>	<b>293</b>
Growth (%)	30	11	(12)	21
EPS	24.0	26.7	23.3	28.2
EPS (Growth %)	31	11	(12)	21

Source: Company, ICICI Direct Research

Exhibit 2: Cash flow statement				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
Net profit before Tax	350	379	332	402
Depreciation & Amortization	13	37	43	48
WC changes	(235)	100	(55)	(0)
Other non cash adju.	(47)	(18)	(28)	(31)
Income taxes paid	(87)	(129)	(90)	(109)
<b>CF from operations</b>	<b>(6)</b>	<b>370</b>	<b>202</b>	<b>310</b>
Capital expenditure	(8)	(8)	(51)	(43)
Δ in investments	26	138	-	-
Other investing cash flow	5	9	43	46
<b>CF from investing Activities</b>	<b>11</b>	<b>139</b>	<b>(8)</b>	<b>3</b>
Issue of equity	2	3	4	5
Δ in debt funds	(20)	47	-	(66)
Dividends paid	(143)	(354)	(121)	(235)
Other financing cash flow	(3)	(3)	(15)	(15)
<b>CF from Financial Activities</b>	<b>(166)</b>	<b>(311)</b>	<b>(136)</b>	<b>(316)</b>
Δ in cash and cash bank balanc	(161)	198	58	(3)
Effect of exchange rate changes	1	(1)	-	-
Opening cash	347	199	396	455
<b>Closing cash</b>	<b>199</b>	<b>396</b>	<b>455</b>	<b>451</b>

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	780	839
Networth	768	670	791	850
Minority Interest	-	-	-	-
LT liabilities & provisions	44	128	128	128
Total Debt	16	86	86	20
<b>Source of funds</b>	<b>827</b>	<b>884</b>	<b>1,005</b>	<b>997</b>
Net fixed assets	55	142	150	146
Goodwill	145	156	156	156
Long term loans and advances	-	-	-	-
Other non current assets	81	129	111	120
Loans and advances	-	-	-	-
Inventories	-	-	-	-
Current Investments	140	5	5	5
Debtors	811	700	801	864
Cash & Cash equivalents	199	396	455	451
Other current assets	96	88	94	104
Current liabilities	682	710	743	822
Provisions	19	23	24	26
Net current assets	546	457	588	576
<b>Application of funds</b>	<b>827</b>	<b>884</b>	<b>1,005</b>	<b>997</b>

Source: Company, ICICI Direct Research

Exhibit 4: Key ratios				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
<b>Per share data (₹)</b>				
EPS-diluted	24.0	26.7	23.3	28.2
Cash per share	19.2	38.2	43.8	43.4
BV	74.1	64.5	76.1	81.8
DPS	12.8	20.3	11.7	22.6
<b>Operating Ratios (%)</b>				
EBITDA Margin	11.3	10.0	8.9	9.7
Adjusted PBT Margin	11.7	10.1	8.5	9.3
Adjusted PAT Margin	8.4	7.4	6.2	6.8
<b>Return Ratios (%)</b>				
RoNW	32.4	41.4	30.7	34.5
RoCE	42.3	44.7	34.6	41.8
RoIC	66.2	69.7	55.8	68.6
<b>Valuation Ratios (x)</b>				
P/E	11.9	10.6	12.1	10.0
EV / EBITDA	7.8	7.0	7.4	6.0
Price to Book Value	3.8	4.4	3.7	3.5
EV/Total Revenues	0.9	0.7	0.7	0.6
MCap/Total Revenues	1.0	0.8	0.8	0.7
<b>Turnover Ratios</b>				
Debtor days	100	68	75	73
Creditors days	72	55	55	55
<b>Solvency Ratios</b>				
Total Debt / E equity	0.0	0.1	0.1	0.0
Current Ratio	1.8	1.6	1.8	1.7
Quick Ratio	1.8	1.6	1.8	1.7
Debt / EBITDA	0.0	0.2	0.2	0.0

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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