ANAND RATHI

India I Equities

Technology

Company Update

Change in Estimates ☑ Target ☑ Reco ☐

19 January 2022

Sonata Software

Rating: Buy
Target Price: Rs.1050
Share Price: Rs.862

Strong IT Services growth, margins resilient; retaining a Buy

Sonata delivered $53.4m IT Services Q3 revenue, up 5.5% q/q (organic est.), 21% y/y, accelerating from Q2. Net hiring was 175, utilisation went up to 90% on supply crunch. Q3 Services revenue was driven by demand in the CPG/Retail and OPD/ISV verticals, Sonata's strongholds. The Domestic business ($198m, up 32% y/y) continues to shine. IT Services margins were flattish q/q, adj. for forex, and after absorbing Q3 wage rises. We, however, trim FY22e/23e profit ~5%/4%, easing expectations of margin expansion and slower recovery in Travel. We revise our target to Rs.1,050 (from Rs.1,070), 21x FY24 EPS.

Strong Q3 for IT services. IT Services was strong in Q3 and the full three-month Encore integration further boosted it to 8% q/q, 30% y/y. Growth was driven by CPG/Retail (up 11% q/q) and OPD/ISV (up 8% q/q) while Travel grew 5% q/q. Management expects Q4 to be flattish for Travel and growth resuming in Q1 FY23. The top-5 and -10 clients continued to grow (both up 6% q/q, 30%+ y/y). Headcount was up 26% (~19% organic); net hiring was a strong 175. Utilisation upped 1% q/q to 90% while offshore was a steady 69%, flat q/q, up 400bps y/y. Overall, company level growth is likely to hold at 4-5% q/q.

IT Services margins, steady 27.4%; wage hikes may hit Q4 by ~100bps. IT Services' Q3 EBITDA margin was 27.4% (flat q/q, down 157bps y/y) absorbing wage hikes via higher utilisation and steady offshoring. Ahead, Utilisation may come off a little while offshoring is likely to be steady. Sonata announced wage hikes in Q4 FY22 (for certain grades) and in Q1 FY23 (for the rest) as attrition touches 22-23%. Domestic business was on a strong footing with Abs Ebitda (domestic) rising 9.5% q/q, 35.2% y/y.

Target revised to Rs1050; retaining a Buy. Sonata's IT business is likely to clock a 17% (organic) CAGR over FY22-FY24 and may see segment margins of ~25.6% by FY24 (FY22e 26.4%) on global delivery build out and higher wage hikes. On the domestic front, it is likely to record a 21% CAGR, taking the consolidated FY24e EPS to Rs50. The stock trades at 17x FY24e EPS (5.3% FCF yield), which we find attractive. **Risk:** Supply-side disruptions in the next few quarters.

Key financials (YE Mar)	FY20	FY21	FY22e	FY23e	FY24e
Sales (Rs m)	37,433	42,281	55,259	67,691	80,128
Net profit (Rs m)	2,770	2,440	3,793	4,592	5,175
EPS (Rs)	26.3	23.5	36.5	44.2	49.7
PE (x)	32.5	36.9	23.7	19.6	17.4
EV / EBITDA (x)	21.6	22.0	16.7	13.5	11.9
PBV (x)	13.5	9.9	8.7	7.5	6.5
RoE (%)	38.5	31.0	39.0	41.1	40.1
RoCE (%)	29.8	23.8	30.4	34.8	34.7
Dividend yield (%)	2.3	1.6	2.7	3.3	3.7
Net debt / equity (x)	-0.5	-0.7	-0.8	-0.8	-0.8

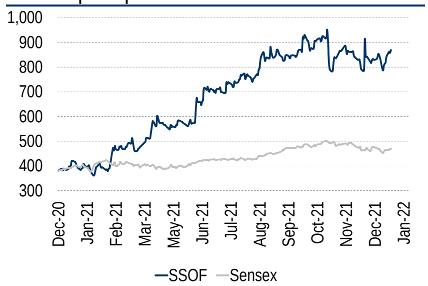
Source: Company, Anand Rathi Research

Key data	SSOF IN / SOFT.BO
52-week high / low	Rs.1030 / 354
Sensex / Nifty	60755 / 18113
3-m average volume	$4.1m
Market cap	Rs.90bn / $1212.3m
Shares outstanding	105m

Shareholding pattern (%)	Dec'21	Sep'21	Jun'21
Promoters	28.2	28.2	28.2
- of which, Pledged			
Free float	71.8	71.8	71.8
- Foreign institutions	13.9	16.5	15.4
- Domestic institutions	14.7	13.0	12.9
- Public	43.2	42.3	43.5

Estimates revision (%)	FY22e	FY23e
Sales ($)	3.4	5.8
EBITDA	(5.5)	(6.6)
Net profit	(5.1)	(4.0)

Relative price performance



Source: Bloomberg

India Research Team

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY20	FY21	FY22e	FY23e	FY24e
Revenues (US$m)	534.4	575.7	752.1	914.7	1,082.7
Growth (%)	24.1	7.7	30.6	21.6	18.4
Net revenues (Rs m)	37,433	42,281	55,259	67,691	80,128
Employee & Direct Costs	30,761	36,171	47,325	57,804	69,056
Gross Profit	6,672	6,110	7,935	9,888	11,072
Gross Margin %	17.82	14.45	14.36	14.61	13.82
SG&A	2,817	2,317	2,950	3,687	4,062
EBITDA	3,855	3,794	4,985	6,200	7,010
EBITDA margins (%)	10.3	9.0	9.0	9.2	8.7
- Depreciation	365	396	470	533	577
Other income	457	277	698	634	634
Interest Exp	152	154	184	178	167
PBT	3,795	3,522	5,029	6,123	6,899
Effective tax rate (%)	27	31	25	25	25
+ Associates/(Minorities)	-	-	-	-	-
Net Income	2,770	2,440	3,793	4,592	5,175
WANS	105	104	104	104	104
FDEPS (Rs/share)	26.3	23.5	36.5	44.2	49.7

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY20	FY21	FY22e	FY23e	FY24e
Share capital	104	104	104	104	104
Net worth	6,697	9,055	9,907	10,940	12,103
Total debt (incl. Pref)	860	897	-	-	-
Minority interest	-	-	-	-	-
DTL/(Asset)	-244	-189	-133	-133	-133
Capital employed	7,313	9,762	9,775	10,807	11,970
Net tangible assets	1,186	999	901	891	997
Net Intangible assets	238	477	748	685	600
Goodwill	1,558	1,759	1,759	1,759	1,759
CWIP (tang. & intang.)	-	1	1	1	1
Investments (Strategic)					
Investments (Financial)	135	760	836	919	1,011
Current Assets (ex Cash)	8,840	8,512	9,972	12,108	14,276
Cash	3,964	6,771	7,187	7,863	8,621
Current Liabilities	8,608	9,517	11,629	13,418	15,295
Working capital	232	-1,006	-1,657	-1,311	-1,019
Capital deployed	7,313	9,762	9,775	10,807	11,970
Contingent Liabilities	7,542	5,966	-	-	-

Fig 3 – Cash Flow statement (Rs m)

Year-end: Mar	FY20	FY21	FY22e	FY23e	FY24e
PBT	3,795	3,522	5,029	6,123	6,899
+ Non-cash items	205	397	-44	77	111
Operating profit before WC	4,000	3,919	4,985	6,200	7,010
- Incr./(decr.) in WC	-976	-1,775	-895	132	45
Others incuding taxes	-1,291	-1,267	-1,423	-1,746	-1,972
Operating cash-flow	3,686	4,426	4,458	4,323	4,993
- Capex (tangible + Intangible)	85	19	136	256	395
Free cash-flow	3,601	4,408	4,322	4,067	4,598
Acquisitions	-	-505	-506	-204	-204
- Dividend (including buyback &	3,541	407	2,941	3,560	4,011
+ Equity raised	-	-	0	-	0
+ Debt raised	704	37	-897	-	-
- Fin Investments	-1,382	591	76	84	92
- Misc. Items (CFI + CFF)	167	137	-514	-456	-466
Net cash-flow	1,978	2,806	416	676	758

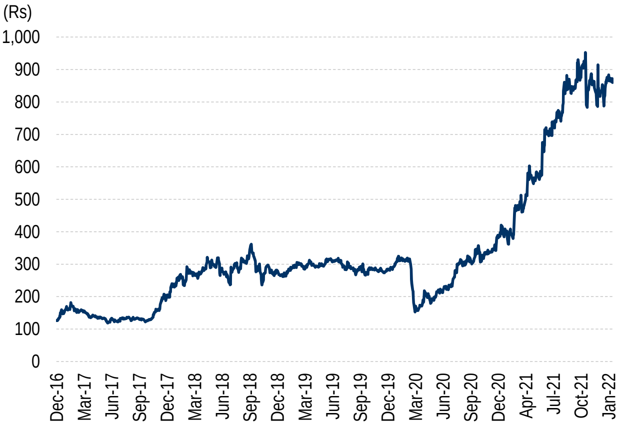
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year end Mar	FY20	FY21	FY22e	FY23e	FY24e
P/E (x)	32.5	36.9	23.7	19.6	17.4
EV/EBITDA (x)	21.6	22.0	16.7	13.5	11.9
EV/sales (x)	2.32	1.97	1.48	1.19	0.98
P/B (x)	13.5	9.9	8.7	7.5	6.5
RoE (%)	38.5	31.0	39.0	41.1	40.1
RoCE (%) - After tax	29.8	23.8	30.4	34.8	34.7
RoIC (%) - After tax	53.3	57.6	107.3	139.7	144.7
DPS (Rs per share)	20.3	14.0	23.7	28.7	32.3
Dividend yield (%)	2.3	1.6	2.7	3.3	3.7
Dividend payout (%) - Inc. DDT	92.3	59.7	65.0	65.0	65.0
Net debt/equity (x)	-0.5	-0.7	-0.8	-0.8	-0.8
Receivables (days)	72	56	50	50	50
Inventory (days)					
Payables (days)	61	62	62	62	62
CFO:PAT%	133.1	181.4	117.5	94.1	96.5
FCF:PAT% - includ M&A payou	130.0	160.0	100.6	84.1	84.9

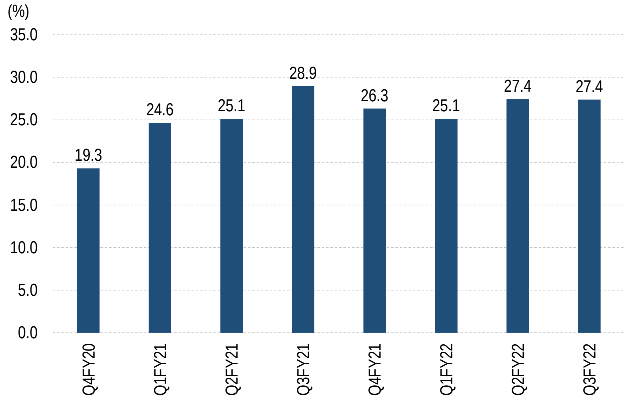
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6– IT Services' EBITDA margin (%)



Source: Company, Anand Rathi Research

Result Highlights

Q3FY22 Results at a Glance

Fig 7 – Q3 FY22 results

	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q/Q %	Y/Y %
Revenue ($ m)	191	148	174	132	251	90%	32%
Growth Y/Y %	8%	17%	38%	20%	32%		
Industry Y/Y % (est.)	3%	6%	21%	21%	21%		
Revenue (Rs m)	13,962	10,757	12,685	9,632	18,580	93%	33%
Effec. exchange rate	73.4	72.8	72.8	73.0	74.0	1%	1%
Rev($m) – IT Services	41.0	43.8	44.5	49.4	53.4	8%	30%
Growth Y/Y %	-12%	-1%	22%	27%	30%		
Rev($m) – Reselling Services	149.8	104.6	130.0	82.9	197.8	139%	32%
Growth Y/Y %	16%	26%	44%	17%	32%		
Employees (EoP)	3,997	4,102	4,250	4,850	5,025	4%	26%
Rev. prod. ($ '000/employee)	10.8	11.2	11.0	11.2	11.2	-1%	3%
Utilisation (%)	89%	89%	88%	89%	90%	100 bps	100 bps
Attrition est. %	14%	18%	18%	21%	23%	200 bps	900 bps
CoR (excl. D&A)	(12,407)	(9,114)	(11,024)	(7,706)	(16,458)	114%	33%
As % of revenue	-89%	-85%	-87%	-80%	-89%	-858 bps	29 bps
SG&A	(446)	(613)	(652)	(696)	(806)	16%	81%
As % of revenue.	-3%	-6%	-5%	-7%	-4%	289 bps	-114 bps
EBITDA	1,109	1,031	1,010	1,231	1,317	7%	19%
EBITDA margins %	7.9%	9.6%	8.0%	12.8%	7.1%	-569 bps	-86 bps
IT Svcs EBITDA margins %	28.4%	24.5%	23.2%	25.2%	24.7%		
EBIT	1,010	937	911	1,114	1,190	7%	18%
EBIT margins %	7.2%	8.7%	7.2%	11.6%	6.4%	-516 bps	-83 bps
IT Svcs EBIT margins %	25.9%	22.3%	20.9%	22.8%	22.4%		
Industry margins % (est.)	17.8%	17.6%	16.8%	17.2%	17.2%	-3 bps	-55 bps
Other income (excl. forex)	33	124	124	89	130	45%	299%
Non-recurring / Forex	-	65	158	46	23	-50%	NA
Interest expenses	(46)	(36)	(44)	(47)	(47)	-1%	1%
PBT	996	1,091	1,148	1,202	1,296	8%	30%
PBT margins %	7.1%	10.1%	9.1%	12.5%	7.0%	-550 bps	-16 bps
Taxes	(458)	(260)	(281)	(290)	(319)	10%	-30%
ETR %	-46%	-24%	-24%	-24%	-25%	-51 bps	2138 bps
Associates / Minority	-	-	-	-	-		
Net income	538	831	867	912	977	7%	82%
Net margins %	3.9%	7.7%	6.8%	9.5%	5.3%	-421 bps	140 bps
Industry net margins %	13.4%	12.6%	13.8%	13.9%	13.6%	-32 bps	17 bps
EPS (Rs)	5.2	8.0	8.3	8.8	9.4	7%	81%

Source: Company, Anand Rathi Research Note: Attrition is estimated.

Fig 8 – Quarterly results (Rs m)

Year-end: Mar (Rs m)	Q3FY22	% chg. Q/Q	% chg. Y/Y	9MFY22 as a % of FY22	FY21	FY21 % chg. Y/Y	FY22e % chg. Y/Y
Sales ($ m)	53	8.1	30.2	72%	160	(11.3)	26.8
Sales	18,580	92.9	33.1	74%	42,281	13.0	30.7
EBITDA	1,317	7.0	18.7	71%	3,794	(1.6)	31.4
EBITDA margin (%)	7	-569bps	-86bps	-	9	-133bps	5bps
EBIT	1,190	6.9	17.8	71%	3,398	(2.6)	32.9
EBIT margin (%)	6	-516bps	-83bps	-	8	-129bps	13bps
PBT	1,296	7.8	30.1	72%	3,522	(7.2)	42.8
Tax	(319)	10.1	(30.4)	72%	(1,082)	5.5	14.2
Tax rate (%)	(25)	-51bps	2138bps	-	(31)	-370bps	615bps
Net income	977	7.1	81.6	73%	2,440	(11.9)	55.5

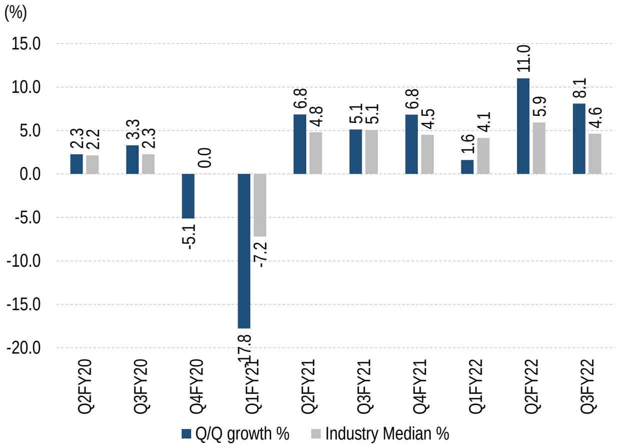
Source: Company, Anand Rathi Research

IT services on steady growth path

Sonata's IT Services revenue was good. In Q3 FY22, it grew 8% sequentially (5.5% organic, est.) and has been growing for the previous six quarters after Q1 FY21, mostly above the industry level. The exception here was Q1 FY22 as the company faced supply-side challenges during the pandemic and delivered just 1.6% q/q growth. Its delivery centres were concentrated regionally and, hence, were more affected.

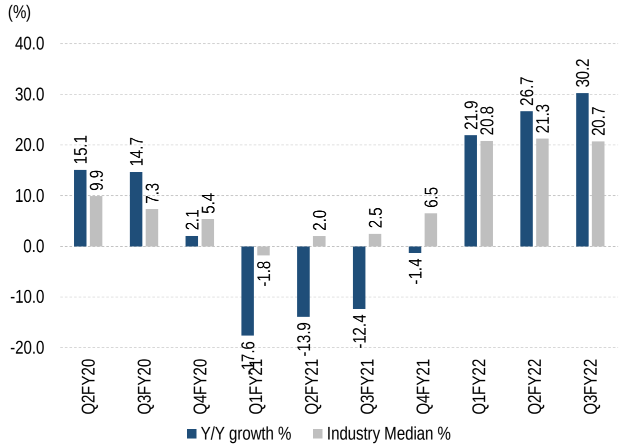
Encore was fully integrated in Q3 and contributed $4.3m-4.4m in Q3. The company benefitted from accelerated growth in the CPG and OPD/ISV verticals during the quarter. Both of these are doing well for most midcap IT companies. From a y/y perspective, it delivered 30% (21% organic) revenue growth, beating industry growth for the third successive quarter and accelerating for the sixth consecutive quarter. On a y/y basis, its organic growth was on par with that of the industry.

Fig 9 – Growing faster than industry



Source: Company, Anand Rathi Research

Fig 10 – Strong y/y growth



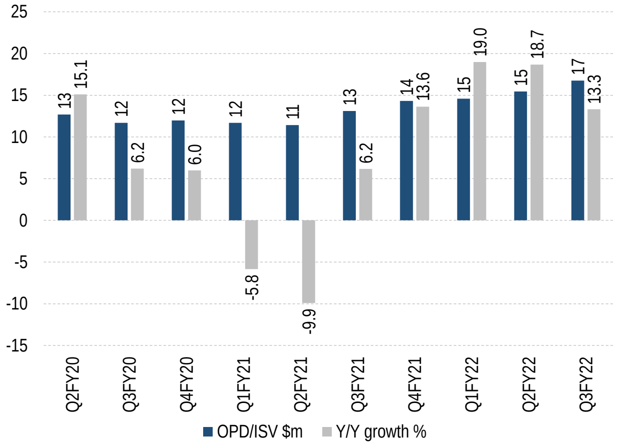
Source: Company, Anand Rathi Research

ISV, CPG/Retail doing well; Travel likely to slow again in Q4

Sonata's strength lies in three verticals: ISV (31%), CPG/Retail (32%), and Travel (9%). The first recorded 13% y/y growth and relied on Microsoft as a key client. Growth here should persist as this is currently a high growth vertical for the industry, more so after the pandemic on accelerated cloud adoption.

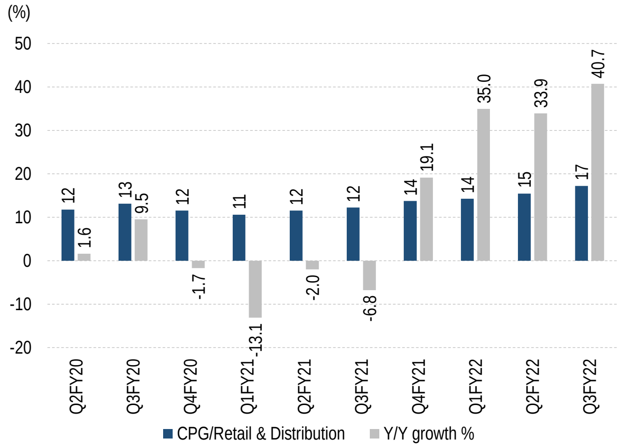
CPG/Retail growth was a commendable 41% y/y, benefitting from the industry upswing, driven by opening up of economies and from the Encore acquisition (bulk of the Encore revenues was accounted for in this vertical). The growth outlook here is strong across industry participants and is likely to hold up for Sonata as well. The type of demand here is more for package implementation or customized solutions to add digital and e-commerce capabilities to retailers. Sonata is also a play here on Microsoft Dynamics' adoption as its implementation partner. Since Dynamics essentially operates on cloud, its implementation and support assignments also open up opportunities for other digital services of Sonata.

Fig 11 – ISV doing well; expecting momentum to continue



Source: Company, Anand Rathi Research

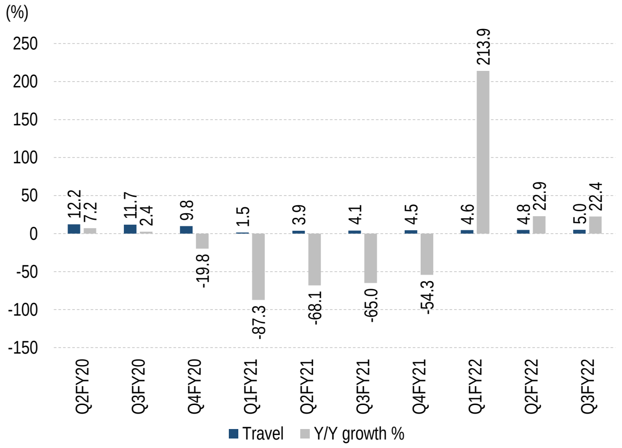
Fig 12 – CPG/Retail growth includes Encore



Source: Company, Anand Rathi Research

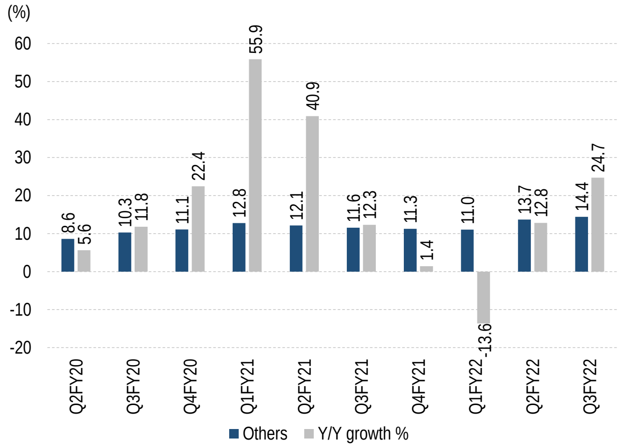
The Travel vertical grew 22% y/y in Q3. However, due to the ongoing situation, the company is seeing a slowdown here in Q4 FY22 and expects recovery by Q1 FY23 as things normalise again. On a relatively longer view, the Travel vertical is likely to grow ~25% over FY23-FY24. The Others vertical grew 25% y/y, including Encore.

Fig 13 – Travel to continue to grow y/y



Source: Company, Anand Rathi Research

Fig 14 – Others growing slower than the company



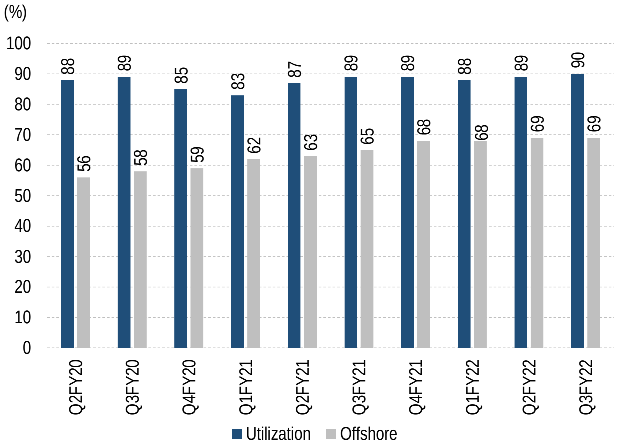
Source: Company, Anand Rathi Research

Manpower addition strong, Productivity steady

Sonata added 175 employees in Q2 (912 in nine months), but still ended with higher utilisation, 90% in Q3 FY22, a four-year high. Hiring was high (the second-highest in the last twelve quarters) as Services revenue grew fast. Q2 FY22 net additions include Encore employees. The company has not revealed any target related to net hiring but stated that 20% of FY23 hiring will be freshers, 40% higher than in FY22.

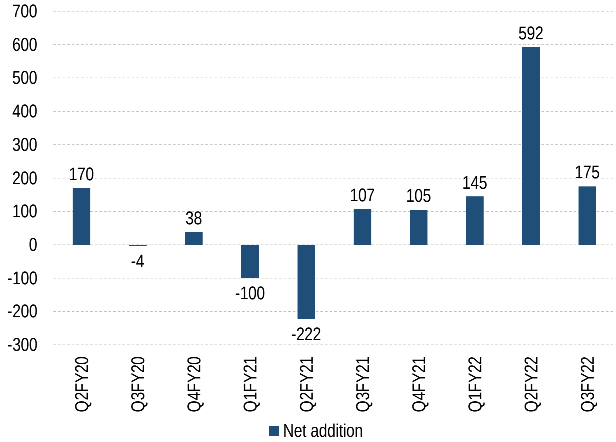
Sonata expanded margins to 27% (from 25.1% in Q1), a reflection of cost absorption through operating levers like utilisation and offshoring. It revised compensation in Q3 and is planning wages hikes in Q4 and Q1. Attrition was 22-23% (per management) and is flattening out on a quarterly annualized basis.

Fig 15 – Utilization and Offshore at highs



Source: Company, Anand Rathi Research

Fig 16 – Net addition high

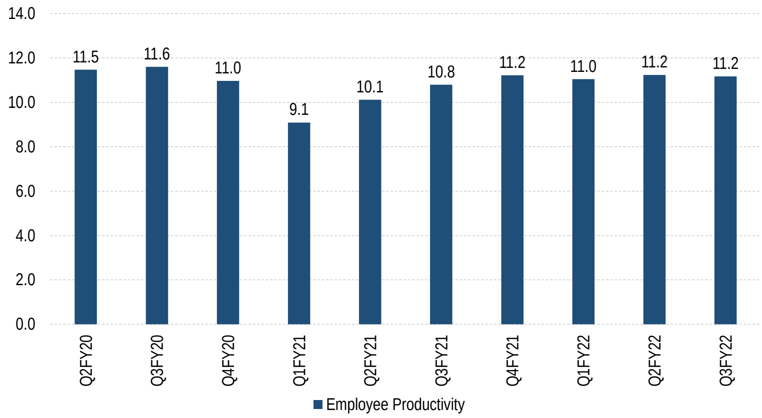


Source: Company, Anand Rathi Research

From an employee-productivity perspective, Sonata is ~4% lower than in Q3 FY20, reflecting the interplay of higher offshoring and utilisation.

In revenue, it currently delivers 69% of its services from offshore (up from 65% a year back). From a utilisation perspective, it appears that it has no headroom to further improve margins, and is a reflection of current supply-side constraints. Productivity was steady in the quarter, but over the medium term, company is looking for higher realisations. Management is looking to pass on certain cost increases to clients; if that happens, it could pave the way to greater revenue productivity. Offshore productivity has gone up in the last four quarters and the company is more likely to see price increases ahead given its shorter-duration contracts. Onsite productivity is also showing signs of sustained price increases in the recent past.

Fig 17 – Productivity steady, should improve ahead



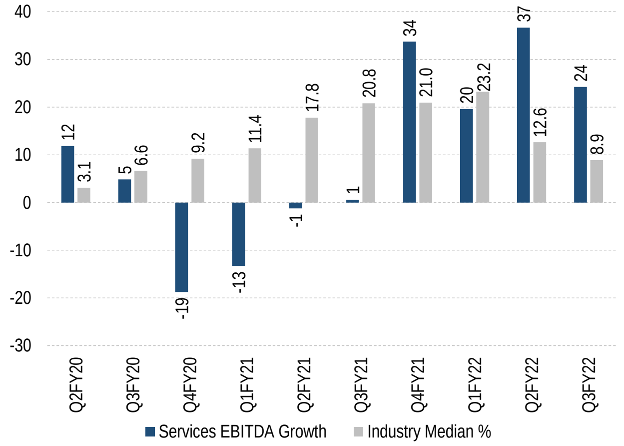
Source: Company, Anand Rathi Research

IT Services EBITDA, NI growth higher than industry

Sonata delivered 24% y/y EBITDA growth in Q3 FY22 and 27% in 9M FY22, outpacing the industry. Y/Y, it contracted margins by 157bps to 27.4% in Q3 FY22. Compared to pre-pandemic (Q3 FY20) levels, Sonata is operating at ~100bps higher margins.

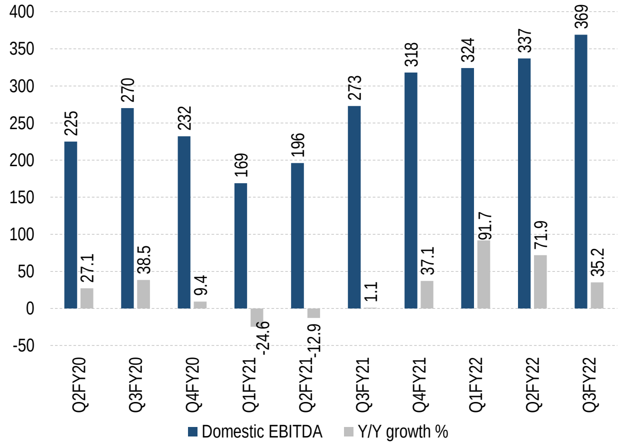
Domestic Services EBITDA grew 35% y/y and has been growing y/y for the last five quarters. The margin was 2.5% (5.6% in Q2, 2.5% a year ago) but this division's performance is measured on absolute EBITDA growth, which held strong.

Fig 18 – EBITDA growth higher than industry



Source: Company, Anand Rathi Research

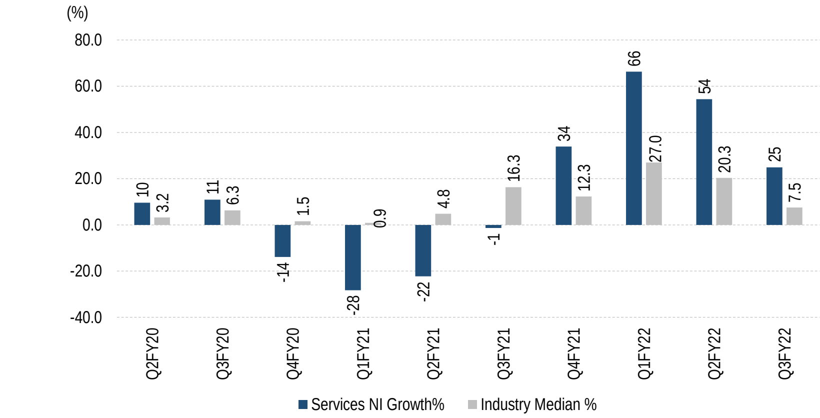
Fig 19 – Domestic EBITDA growth strong



Source: Company, Anand Rathi Research

NI (IT Services) growth was good, ahead of the industry and further supported by the Encore acquisition and lower tax rates. Ahead, it is likely to reflect EBIT growth more closely as Encore is already integrated into the base of Q3 FY22 and the tax rate is likely to be steady. There was just one year (FY21) when Sonata had to pay higher taxes. After that, it moved to the new tax regime.

Fig 20 – NI growth higher than industry

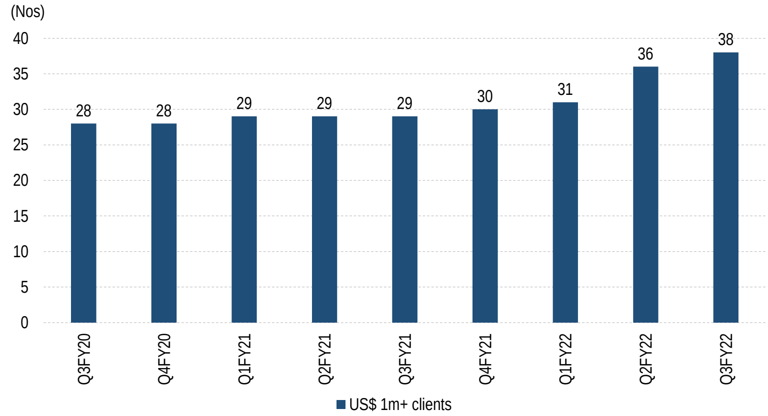


Source: Company, Anand Rathi Research

From a client perspective, Sonata operates in mid-segment clients and hence only discloses $1m+ clients. It added nine in the $1m+ bracket in the last 12 months, taking the count of such clients to 38. Five clients were added in this bracket in Q2, on account of Encore.

Sonata also counts 36 Fortune-500 companies as clients and this number has steadily risen (30 in Q3 FY21, 24 in 3QFY20).

Fig 21 – $1m+ clients



Source: Company, Anand Rathi Research

Conference-Call Takeaways

Q3 FY22

Company

- The company expects attrition to start tapering from the next quarter.
- Margins were flattish despite strong revenue growth due to compensation correction and employee addition.
- Salary corrections done in Q3. Have announced wage hikes for FY23 in Q4 (for certain band of employees) and Q1 (for the other employees).
- Travel slowed down; should return in Mar/Apr. Q4 to be flattish; expect growth to bounce back in Q1.
- Development centres not growing at anticipated pace due to travel restrictions. This should start kicking in.
- Confident of strong growth in the domestic business.
- Offshore mix to hold at current level for some time.
- Attrition at 22-23%; seeing it flatten during the quarter.
- Impact of Rs35m-40m due to compensation hikes in Q3.
- DSO higher in Q3 on account of holidays; expect it to come down in Q4.
- Domestic DSO to be 32-33 days (34 in Q3).
- Sub-contracting costs were $4.5m in Q3.
- IP-led revenue contribution has come down as other revenues grew faster, driven by acquisitions.
- FY23 fresher hiring to be 20% of total, 40% higher than in FY22.
- Encore revenue was $4.3m-4.4m in Q3.
- Evaluating M&As on an ongoing basis.

Business Outlook

- Medium-term EBITDA margin of 23-25% for IT Services
- Expect annual earnings growth of 10-15% in the Domestic business

Notes from the last quarters' conference calls

Q2 FY22

- In Q2 invested in cloud and cyber security side of the practice
- The company continues to see growth in digital business
- Management has decided to continue to invest in senior talent
- Domestic business seeing growth as many Indian companies are doing deals around cloud adoption
- Domestic business has good cash collection and very good RoCE
- Management to continue to invest in sales and marketing
- Organic growth on International services was 5-5.5% in Q2

- Travel client stagnated due to supply-side issues; otherwise outlook good. Europe travel recovering, can reach 100% of FY19 levels in 1-2 quarters, demand is picking up.
- Seeing unified distribution of growth; no one vertical to be driver
- International business subcontracting costs came down this quarter compared to Q1.
- Utilization to be stable at current level for the next 2-3 quarters
- Net addition of 300 people in Q2 (excluding Encore), expect net addition at similar levels ahead. Hiring gross 600 people a quarter for the next few quarters
- Compensation review partially to be done in Q3 and Q4
- Increased recruiting team from 15 to 50
- Domestic business to grow steadily
- International business growth outlook is robust; continues to grow at revenue and PAT level as the company manages supply-side constraints
- Overall, management is seeing robust demand
- Margin to be retained at current levels but needs to be cautious of supply-side challenges; long-term margins to be better

Q1 FY22

- IT Services growth promising on the back of deals won and demand pipeline. Demand is robust, expect 3-4% q/q growth in revenue (international business) ahead.
- Encore has a largeannuity business and ~18%EBITDA margin. Encore revenues consolidated with Sonata from 1stAug; per quarter likely to add $3m revenue and $500,000 in EBITDA approx. in Q2.
- Domestic business 4-5% growth in absolute EBITDA q/q is what the company is targeting.
- EBITDA at 25-26% pre-foreign exchange and other income for its international services.
- Azure offering is currently number one in cloud mixfor Sonata on the domestic side. It is growing fast and is likely to be a growth driver.
- Encore IT gives it delivery operations in Chennai will be helpful to Sonata from diversity and attrition-management perspectives.
- Growth to resume from Q2
- Margins to be maintained at current levels for IT Services.

Q4 FY21

- There is an improvement in hedemand environment and more so in the Retail/Manufacturing verticals and on Microsoft/Open stack-related technologies. Sonata is well positioned to capture this demand.
- The top-travel client is likely to see normalcy in business by Sep/Oct (European summer travel time). Volumes are likely to go up along with their business picking up; Q3-Q4 should see the uptick.
- GBW has seen a turnaround and added marquee clients in Q3 and Q4.

- Reclassified revenues from the Others segment to ISV (1.5% of IT services revenue for Q3 and Q4). Expect steady growth in ISV at ~10-12% p.a.
- Domestic business had positive cash-flows in the past four quarters without any investment in working capital.
- The offshore mix has maxed out as per management and is likely to see some reversal ahead. That may put some pressure on the margins but at the same time will offer revenue tailwinds. Dynamics implementation services saw a high shift to offshore during the pandemic; it is expected to come down after the pandemic.
- Front-loading employees;net hiring at least 300 people in the hnext couple of months
- Pay-out to be steady at 50-60% (consolidated); the company is evaluating M&A opportunities.
- Attrition at 18-19% for Q4.
- DSO for the Services business: 36 days in Q4 (same as in Q3).
- Domestic business DSO came down from 57 days in Q3 to 49 in Q4.
- Wage hike of 11-12% (usually 6%) on average was done to take into account industry-level wage hikes.
- Continue to deliver 22-25% segment margins (IT Services)

Factsheet

Fig 22 – Revenue split (IT Services only)

	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
ADM	25.5	26.4	27.1	26.1	25.8
Test	11.7	10.7	9.8	9.9	9.0
AX	28.1	29.2	29.3	29.4	30.1
ERP	1.7	1.0	0.8	0.6	0.3
IMS	14.0	14.2	14.2	15.2	15.8
BI	12.0	12.0	13.1	13.2	13.7
E commerce	5.0	5.0	5.0	5.0	5.0
Rezopia	2.0	1.5	0.7	0.6	0.3
Digital	64.0	67.0	68.0	70.0	72.0

Source: Company, Anand Rathi Research

Fig 23 – Revenue-split, by domain (IT Services only)

	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
OPD / ISV	32.0	32.7	32.8	31.3	31.4
Travel & Tourism	10.0	10.2	10.3	9.7	9.4
CPG/Retail & Distribution	29.8	31.4	32.1	31.3	32.2
Others	28.2	25.7	24.8	24.9	24.1
Healthcare	0.0	0.0	0.0	2.8	2.9

Source: Company, Anand Rathi Research

Fig 24 – Revenue-split, by region (IT Services only)

	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
North America	52.0	51.0	51.0	53.0	55.0
Europe	26.0	25.0	25.0	24.0	23.0
RoW	22.0	24.0	24.0	23.0	22.0

Source: Company, Anand Rathi Research

Fig 25 – Revenue-split, by segment

	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
IT services	21	30	26	37	21
Domestic Business	79	70	74	63	79

Source: Company, Anand Rathi Research

Fig 26 – Client profiles (LTM) (IT Services only)

	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
Client profiling					
Top 5	54.0	53.0	58.0	57.0	56.0
Top 10	62.0	61.0	65.0	64.0	63.0
Top 20	71.0	71.0	73.0	72.0	71.0
$1m+	29	30	31	36	38
Active Clients	154	164	177	214	225

Source: Company, Anand Rathi Research

Fig 27 – Workforce

	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
Employee Movement					
Employees (EoP) - IT Services	3,851	3,956	4,101	4,693	4,868
Employees (EoP)- Domestic	146	146	149	157	157
Net Adds (Qtr)	107	105	145	592	175
Utilisation (%)	89.0%	89.0%	88.0%	89.0%	90.0%
Attrition % est.	14.0%	18.0%	18.0%	21.0%	23.0%

Source: Company, Anand Rathi Research

Fig 28 – Revenue-split, by delivery location

	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
Delivery Type(%)					
On-site	35	32	32	31	31
Offshore	65	68	68	69	69

Source: Company, Anand Rathi Research

Fig 29 – Key segments' growth Y/Y (%)

	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
Domain					
OPD / ISV	6%	14%	19%	19%	13%
Travel & Tourism	-65%	-54%	214%	23%	22%
CPG/Retail & Distribution	-7%	19%	35%	34%	41%
Others	12%	1%	-14%	1%	11%
Region					
North America	-16%	-7%	-3%	32%	38%
Europe	-24%	-18%	90%	17%	15%
RoW	20%	48%	46%	27%	30%

Source: Company, Anand Rathi Research

Valuations

We introduce FY24e and roll forward our valuation to FY24. The stock quotes at 17x FY24e EPS of Rs50. In FY21 Sonata's IT Services revenue was down 11% (up 5.2% q/q, 20% y/y in Q2). We expect this division to register a 17% CAGR over FY22-24 despite the Travel division's FY24e revenue at 67% of FY20. The domestic segment is expected to register a 21% CAGR over FY22-24, with the focus being only on margins and RoE. In IT Services, ISV and Retail are looking better even as Travel recovers somewhat. Despite these challenges, consolidated EBIT and PAT are likely to register 19% and 17% CAGRs respectively over FY22-24.

We value the stock on a PE basis as the bulk of profits arises from IT Services. We expect the company to end FY24 with an EPS of Rs50. We expect a 20% revenue CAGR (20% organic) over FY22-24. The IT Services' margin should hold at 26%, even after considering expectations of higher on-site ramp-ups in the next two years and current supply-side constraints, which would result in higher short-term costs.

In IT Services, given that the loss of revenue from its top Travel client has already been factored in, we hope for steady momentum in FY23 and beyond. Also, there is the likelihood of the top client bringing tailwinds to growth in the next two years.

In its domestic business, Sonata is seeing strong growth in revenue and margins, outstripping competition. Notably, working capital has come down steeply and RoEs have shot up, leading to a case of a higher multiple to the domestic business, while taking a sum-of-parts approach to the two businesses.

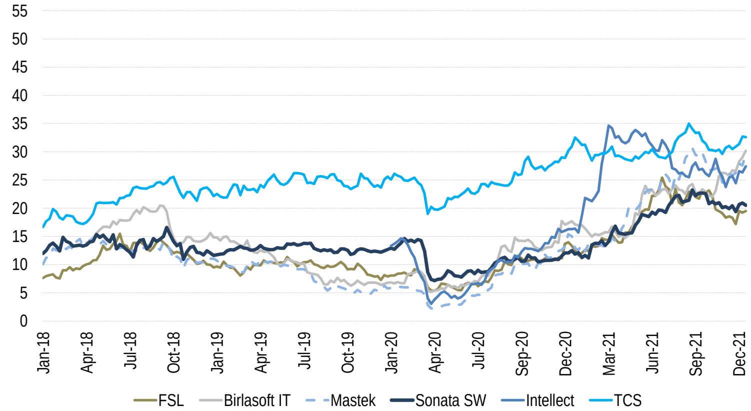
We value the company at a target consolidated PE of 21x FY24e, which implies 25x PE for IT Services (on a sum-of-parts basis).

Fig 30 – Change in estimates (Rs m)

(Rs m)	FY22			FY23		
	New	Old	% Change	New	Old	% Change
Revenue ($ m)	752	727	3.4	915	865	5.8
Revenues - IT ($ m)	203	204	(0.3)	245	247	(1.0)
Revenues	55,259	53,842	2.6	67,691	64,867	4.4
EBITDA	4,985	5,274	(5.5)	6,200	6,640	(6.6)
EBITDA margins %	9.0%	9.8%	-77 bps	9.2%	10.2%	-108 bps
EBIT	4,515	4,818	(6.3)	5,667	6,133	(7.6)
EBIT margins %	8.2%	8.9%	-78 bps	8.4%	9.5%	-108 bps
PBT	5,029	5,307	(5.2)	6,123	6,379	(4.0)
Net profit	3,793	3,997	(5.1)	4,592	4,785	(4.0)

Source: Anand Rathi Research

Fig 31– PE band



Source: Bloomberg, Anand Rathi Research

Risk

- Supply-side disruptions in the next few quarters.

Appendix

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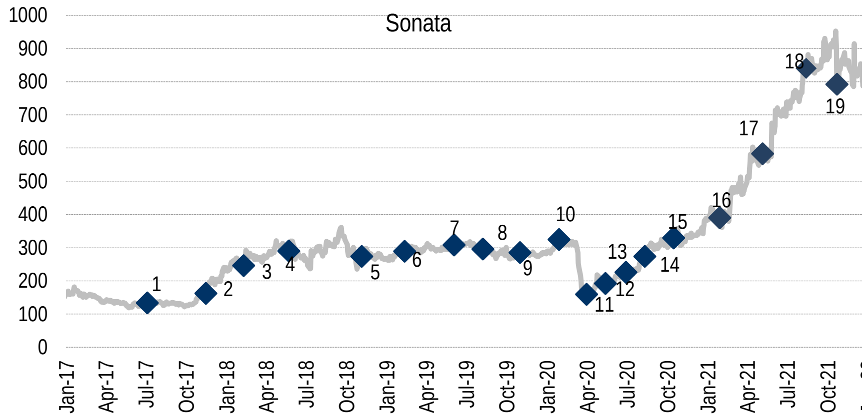

	Date	Rating	TP (Rs)	Share Price (Rs)
4	23-May-18	Hold	380	341
5	5-Nov-18	Buy	370	310
6	11-Feb-19	Buy	400	310
7	1-Jun-19	Hold	400	355
8	8-Aug-19	Buy	390	315
9	31-Oct-19	Buy	380	315
10	28-Jan-20	Hold	390	349
11	31-Mar-20	Buy	250	164
12	13-May-20	Buy	230	197
13	29-Jun-20	Hold	270	226
14	11-Aug-20	Buy	330	283
15	15-Oct-20	Buy	410	357
16	7-Feb-21	Buy	500	406
17	14-May-21	Hold	680	588
18	6-Aug-21	Hold	860	813
19	20-Oct-22	Buy	1,070	920

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