

Sonata Software Limited



Sonata Software Limited.

Supply side pressure impacting growth; near term margin taking a downward shift

CMP INR 740	Target INR 931	Potential Upside ~26%	Market Cap (INR Mn) INR 77,802	Recommendation BUY	Sector Internet Software & Services
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Synopsis:

Sonata Software Ltd (SSOF) Q4FY22 performance was slightly lower than our estimate. Dollar Revenue was up materially by 4.3% QoQ to USD 55.7Mn (KRChoksey est. USD 56Mn). Rupee revenue grew by ~36% YoY to INR 14,636Mn (KRChoksey est. INR 14,251Mn). Reported operating margin stood at 6.5% and reported net profit grew by 3.3% QoQ to INR 1,009Mn (KRChoksey est. INR 942Mn) with margin of 6.9%. In Q4FY22, Domestic business (Product & services) performed well, up 38% YoY basis led by cloud based annuity deals. International IT business witnessed a strong growth momentum (+30% YoY) backed by strong execution in platform, IP and alliance led businesses. Growth was mainly backed by the US (+8.1% QoQ), mainly driven by ISV (+3.2% QoQ), Retail Non-Essential (+31% QoQ), Distribution & Manufacturing (+3.5% QoQ) and Healthcare (+24% QoQ). The deal pipeline continues to be healthy and strong through multiple new digital wins from existing and new customers. Our target price of INR 931 is based on 20x Mar-24E EPS with EPS CAGR of 13.4% over FY22-24E.

MARKET DATA

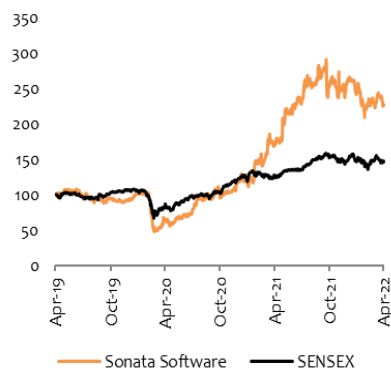
KEY FINANCIALS

Shares outs (Mn)	104
Mkt Cap (INR Mn)	77,802
52 Wk H/L (INR)	1,030/555
Volume Avg (3m K)	133.7
Face Value (INR)	1
Bloomberg Code	SSOF IN

(INR Mn)	Q4FY22A	Q3FY22A	Q4FY21A	QoQ	YoY	KRChoksey Est.	Variance (%)
USD Revenue	56	53	44	4.3%	26.6%	56	-0.5%
Revenue	14,636	18,580	10,757	-21.2%	36.1%	14,251	2.7%
EBIT	950	1,190	937	-20.1%	1.4%	1,230	-22.7%
PAT	1,009	977	831	3.3%	21.4%	942	7.1%
OPM (%)	6.5%	6.4%	8.7%	9	-222	8.6%	-214
NPM(%)	6.9%	5.3%	7.7%	164	-83	6.6%	28

Source: Company, KRChoksey Research

SHARE PRICE PERFORMANCE



Robust growth across board

Sonata Software (SSOF) Q3FY22 performance is higher than our estimates. For Q4FY22, company reported dollar revenue growth of ~27% YoY (up 4.3% QoQ) USD 55.7Mn. In Rupee terms, revenue was up by 36%YoY to INR 14,636Mn. Digital/platform revenue contributed 73/25% to IITS revenue and grew +5.8/13.4% QoQ, while IP-led revenue (29% of the revenue) declined 5.5% QoQ. Retail/distribution ISV/travel grew +15/8/8/4% QoQ. The Microsoft portfolio (~51% of IITS) is driving growth (+6/31% QoQ/YoY), the company remains optimistic about the opportunity (digital services + dynamics 365) and it can deliver >20% YoY growth consistently. Travel vertical will recover with higher travel activity in Europe (peak summer bookings), while revenue from TUI is still at ~50% of pre-COVID level. Digital revenue continued strong growth momentum and now accounts to 73% of total revenue (vs 67% in 4Q21). Platform led revenue also increased to 25% (vs 18% in 4Q21).

Strong deal wins to drive growth across geographies

Approach to digitizing business using platforms played well for Sonata and has successfully added 2 new clients (Fortune 500 category) in Q4. Sonata (including Encore) has a strong presence in developed regions as the majority of the customers are from USA (105 Clients), Europe (46 Clients), ANZ (39 clients) & India (28 clients). Focus area continues to be Distribution & Manufacturing (62 Clients), Retail Essential/Non-Essential (34/18 Clients), and Healthcare (17 Clients). Major portion of the domestic business is coming from annuity business driven by multi-year annuity enterprise sales and the average run rate for domestic cloud business is around +78%. Top 58 clients contribute to ~80% of the gross margin for domestic business. Sonata added ~100 freshers in FY22 and plans to hire 45% more freshers in FY23.

Higher attrition to drag the EBIT margin

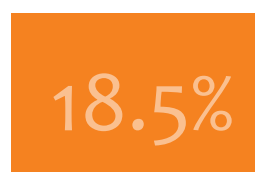
IITS EBITDA margin stood at 23% (-105bps QoQ) and DPS EBITDA margin stood at 3.8% (+124bps QoQ). due to ongoing supply side concerns, partially offset by higher offshoring/utilization. The attrition inched up to 28-30% level and the company will give wages hikes in Q1FY23E to counter it; The wage hike will impact by ~150bps in Q1 and attrition is expected to moderate in the next six months. The ongoing talent crunch led by supply side challenges, wage hikes, increasing sub-contracting costs and higher intake of fresher will keep margins under check in the near term.

MARKET INFO

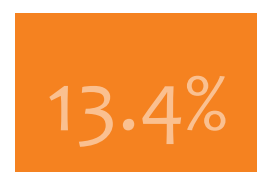
SENSEX	56,707
NIFTY	16,997

SHARE HOLDING PATTERN (%)

Particulars	Mar-22	Dec-21	Sep-21
Promoters	28.2	28.2	28.2
FIIIs	13.7	13.9	16.5
DIIIs	14.05	15.9	14.2
Others	44.0	42.0	41.1
Total	100.0	100.0	100.0



Revenue CAGR between FY22 and FY24E



PAT CAGR between FY22 and FY24E

Sonata Software Limited.

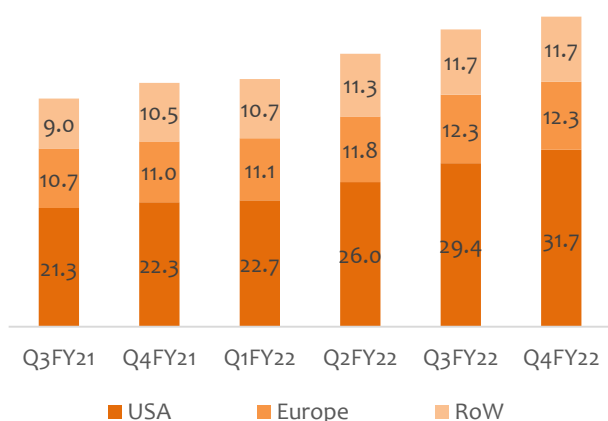
Key Concall Highlights:

(i) Travel vertical will recover with higher travel activity in Europe (peak summer bookings) (ii) Pipeline in the domestic business is growing with quality & we may see further improvement in profitability (iii) Pan India business is gradually shifting towards cloud and digital infrastructure contracts (iv) Newly appointed CEO (Mr. Samir Dhir, ex Virtusa) to lead with a newer strategy (v) Company is investing to build capabilities in digital (Microsoft practices) (vi) Offshoring is expected to increase in medium term (vii) In-spite of higher offshoring/utilization, ongoing supply side concerns to stay in the near term (viii) Company has set up global delivery centers in Canada and Ireland (ix) Higher other income in Q4 was the earnout part of Sopris acquisition reversed (x) Management also scaled down internal goodwill associated with Sopris leading to impairment of goodwill captured in other expenses

Valuation and view

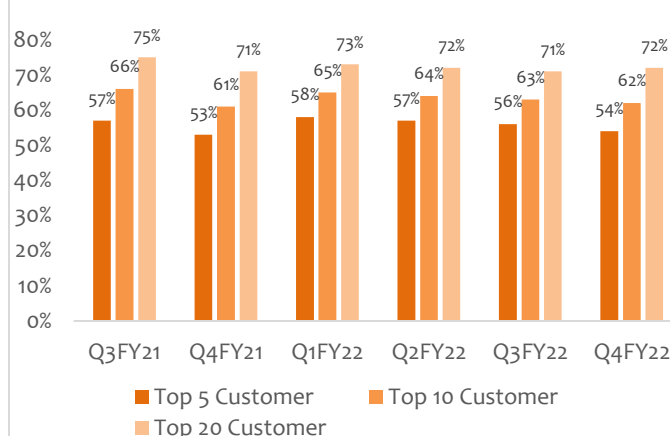
Sonata Software is currently trading at a valuation with a P/E multiple of ~18.5x/~15.8x on FY23E/FY24E earnings. We expect strong deal momentum across geographies, higher focus on ISV and Retail (Essential/Non-Essential), and tailwind in Managed Cloud Services will aid growth over the medium to long term in future and hence we are assigning a P/E multiple of 20x to the FY24 estimated EPS of INR 46.57 to arrive at a target price of INR 931 per share (Earlier Price INR 1087), an upside of ~26% over the CMP. Accordingly, we maintain our rating to a “BUY” to the stock.

Revenue Mix by Geography (USD Mn)



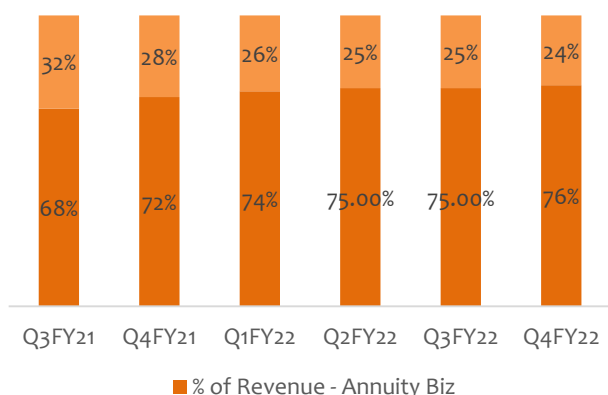
Source: Company, KRChoksey Research

Client Concentration



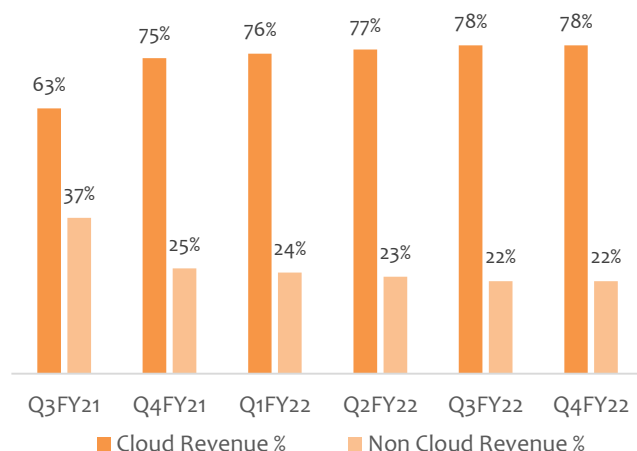
Source: Company, KRChoksey Research

Domestic Revenue (Annuity/Others)



Source: Company, KRChoksey Research

Domestic Revenue (Cloud/Non Cloud)



Source: Company, KRChoksey Research

Sonata Software Limited.

KEY FINANCIALS
Exhibit 1: Balance Sheet

Particulars (INR Mn)	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Property, Plant and Equipment	234	226	213	152	352	566	748
Right-of-use Asset	0	0	973	849	849	849	849
Intangible Assets	101	322	238	477	477	477	477
Goodwill on consolidation	807	1,452	1,558	1,759	1,759	1,759	1,759
Non-current Investments	685	62	87	106	106	106	106
Deffered tax assets	124	119	244	189	189	189	189
Other non current assets	848	632	956	1,245	1,245	1,245	1,245
Total non current assets	2,799	2,813	4,269	4,777	4,977	5,190	5,373
Cash & equivalent	3474	1992	3964	6771	7927	9672	12171
Trade Receivables	3,964	8,111	7,000	6,158	7,085	8,102	9,287
Current Investments	1,300	1,402	48	654	654	654	654
Unbilled Revenues	412	447	408	408	523	735	827
Other Current Assets	376	516	476	701	701	701	701
Total current assets	9,525	12,468	11,896	14,692	16,891	19,864	23,639
Total Assets	12,324	15,281	16,165	19,469	21,868	25,054	29,012
Equity Share Capital	104	104	104	104	104	104	104
Other Equity	6,429	7,579	6,593	8,951	10,601	12,574	14,923
Equity Attributable to Owners of the Company	6,533	7,683	6,697	9,055	10,705	12,678	15,027
Non controlling Interest	0	0	0	0	0	0	0
Total Equity	6,533	7,683	6,697	9,055	10,705	12,678	15,027
Long term Debts	187	0	0	0	0	0	0
Other Long TermLiabilities	127	435	1,157	1,021	1,417	1,812	2,208
Total non current liabilities	314	435	1,157	1,021	1,417	1,812	2,208
Trade Payables	4,323	5,873	5,619	6,510	7,257	7,980	9,125
ST-Term Borrowings	0	156	860	897	516	516	516
Other Current Liabilities	162	75	683	990	990	990	990
Others	60	133	0	0	0	0	0
Other Payables	391	316	560	282	282	282	282
Provision	543	611	589	715	701	796	864
Total Current Liabilities	5,478	7,163	8,311	9,394	9,746	10,564	11,778
Total liabilities	12,324	15,281	16,165	19,469	21,868	25,054	29,012

Source: Company, KRChoksey Research

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KEY FINANCIALS

Exhibit 2: Profit & Loss Statement

Particulars (INR Mn)	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Revenue	24,539	29,609	37,433	42,281	55,534	67,522	77,976
Total operating Expenses	22,230	26,253	33,705	38,487	50,896	62,277	71,759
EBITDA	2,310	3,356	3,728	3,794	4,638	5,245	6,217
Depreciation	124	127	365	396	473	512	547
EBIT	2,186	3,229	3,363	3,398	4,164	4,733	5,670
Other income, net	455	273	584	278	1,020	1,070	1,120
Finance costs	48	34	152	154	181	211	251
(Less)/ Add: (Extraordinary Item)	12	28	0	0	0	0	0
Interest Income							
Pre-tax Income	2,604	3,495	3,795	3,521	5,004	5,592	6,539
Income tax expense	682	1,006	1,026	1,082	1,239	1,454	1,700
Net profit Before MI	1,921	2,489	2,769	2,440	3,764	4,138	4,839
Minority Interest	4	4	0	0	0	0	0
Net profit After MI	1,925	2,493	2,769	2,440	3,764	4,138	4,839
Diluted EPS (INR)	18.31	23.70	26.65	23.48	36.23	39.83	46.57
Shares in Million	105	105	104	104	104	104	104

Source: Company, KRChoksey Research

Exhibit 3: Free Cash Flow Analysis

Particulars (INR Mn)	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Net Cash Generated From Operations	3,370	708	5,014	5,758	4,274	5,057	6,124
Net Cash Flow from/(used in) Investing Activities	1,018	113	1,391	-1,141	-192	-161	-182
Net Cash Flow from Financing Activities	-215	-195	465	-181	-381	0	0
Others	-3,230	-2,108	-4,897	-1,630	-2,545	-3,151	-3,443
Net Inc/Dec in cash equivalents	943	-1,481	1,972	2,807	1,157	1,744	2,499
Opening Balance	2,530	3,474	1,992	3,964	6,771	7,927	9,672
Closing Balance Cash and Cash Equivalents	3,474	1,992	3,964	6,771	7,927	9,672	12,171

Source: Company, KRChoksey Research

Exhibit 4: Ratio Analysis

Key Ratio	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
EBIT Margin (%)	8.9%	10.9%	9.0%	8.0%	7.5%	7.0%	7.3%
Tax rate (%)	26.2%	28.8%	27.0%	30.7%	24.8%	26.0%	26.0%
Net Profit Margin (%)	7.8%	8.4%	7.4%	5.8%	6.8%	6.1%	6.2%
RoE (%)	31.0%	35.1%	38.5%	31.0%	31.8%	32.9%	31.4%
RoCE (%)	24.8%	31.5%	33.8%	29.9%	31.0%	31.3%	30.0%
RoA (%)	15.6%	16.3%	17.1%	12.5%	14.4%	15.3%	15.0%
EPS (INR per share)	18.3	23.7	26.7	23.5	36.2	39.8	46.6

Source: Company, KRChoksey Research

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Sonata Software Limited				Rating Legend (Expected over a 12-month period)	
				Our Rating	Upside
Date	CMP (INR)	TP(INR)	Recommendation	Buy	More than 15%
02-May-22	736	931	BUY	Accumulate	5% – 15%
18-Jan-22	862	1087	BUY	Hold	0 – 5%
				Reduce	-5% – 0
19-Oct-21	975	1087	ACCUMULATE	Sell	Less than – 5%

ANALYST CERTIFICATION:

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