

IT services revenue recovery from Q2FY23 onwards

About the stock: Sonata Software (Sonata) offers IT services (30%) and product licensing & deployment (70%).

- The company provides IT services to travel, retail, agri & commodities and manufacturing and software vendors
- Net debt free and healthy double digit return ratio (with RoCE of >30%)

Q4FY22 Results: Sonata reported weak Q4FY22 numbers.

- IT services dollar revenues increased 4.7% QoQ while product revenues declined 28.2% QoQ
- EBITDA margins in IT services declined 50 bps QoQ while that of product business improved 130 bps QoQ
- Digital revenues contribute 73% of IT services

What should investors do? Sonata's share price has grown by ~5.4x over the past five years (from ~₹ 137 in April 2017 to ~₹ 741 levels in April 2022).

- We maintain **BUY** rating on the stock

Target Price and Valuation: We value Sonata at ₹ 900 i.e. 20x P/E on FY24E EPS.

Key triggers for future price performance:

- With improved traction in retail, commodity & manufacturing and healthy demand for its travel client, we expect FY24E to witness robust growth in revenues
- Upgrades in Microsoft Dynamics and tapping 1000 clients in the medium to large category bode well for revenue growth
- Robust hiring trend & inorganic growth prompt us to build IT service dollar revenue growth of over 18% CAGR over FY22-24E

Alternate Stock Idea: Apart from Sonata, in our IT coverage we also like Infosys.

- Strong revenue guidance prompts us to be positive on the stock
- HOLD with a target price of ₹ 2,000

Key Financial Summary

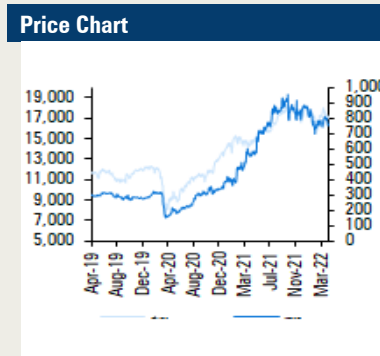
(₹ Crore)	FY20	FY21	FY22	5 year CAGR (FY17-22)	FY23E	FY24E	2 year CAGR (FY22-24E)
Net Sales	3,743	4,228	5,553	18.6%	6,682	7,799	18.5%
EBITDA	373	379	464	19.3%	524	648	18.2%
EBITDA Margin (%)	10.0	9.0	8.4		7.8	8.3	
PAT	277	244	376	19.1%	374	469	11.6%
EPS (₹)	26.7	23.5	36.2		36.0	45.1	
P/E (x)	28	32	20		21	16	
RoNW (%)	41.4	26.9	34.2		29.9	32.6	
RoCE (%)	44.7	33.5	39.8		35.5	39.2	

Source: Company, ICICI Direct Research



Particulars	
Particular	Amount
Market Capitalization (₹ Crore)	7,699.0
Total Debt (₹ Crore)	38.0
Cash and Investments (₹ Crore)	914.4
EV (₹ Crore)	6,822.6
52 week H/L	1024 / 562
Equity capital	10.4
Face value	1.0

Shareholding pattern				
	Jun-21	Sep-21	Dec-21	Mar-22
Promoters	28	28	28	28
FII	15	16	14	14
DII	13	13	14	15
Public	44	42	44	43



- Recent event & key risks**
- Appointed new CEO
 - Key Risk:** (i) Higher than expected employee costs (ii) Higher than expected attrition

Research Analyst
Sameer Pardikar
sameer.pardikar@icicisecurities.com

Key takeaways of recent quarter & conference call highlights

- IT service segment dollar revenues increased 4.3% QoQ to US\$55.7 million, (4.7% in CC terms) while rupee revenue came in at ₹ 414 crore, 4.7% QoQ growth. Product business revenues declined 28.2% QoQ to ₹ 1,051 crore. Total revenues declined 21.2% QoQ to ₹ 1,464 crore
- IT service EBITDA margin (including other income) declined 50 bps QoQ to 27.5% while that of product business improved 130 bps to 3.8%. Consolidated EBITDA margins improved 260 bps to 10.5%
- IT services revenues were aided by the US, which reported 8.1% QoQ growth. There was decline in QoQ growth in Europe and RoW by 0.2% & 0.4%, respectively
- The company indicated that demand environment continue to be strong. It also indicated that revenue for the quarter was impacted due to supply side challenges and there was a loss of 2-2.5% revenue for the quarter due to this. Sonata is addressing the issue as it opened new delivery centre in Canada, Ireland and aggressively creating the capacity in Tier II and Tier III towns in India. The company expects supply side crunch to be fixed by Q2FY23
- Sonata indicated that EBITDA margins for Q4FY22 were impacted due to salary hikes in January 2022. The company expects near term margin pressure and guided for 22% EBITDA margins (net of other income) for FY23 due to some top level hiring as well as investments in delivery centres, sales & marketing etc. Sonata appointed Samir Dhir as CEO. He would be based out of the US and also appointed chief revenue officer, based out of London
- The company indicated that attrition continue to be at elevated level for the company. Attrition for Q4FY22 was 30% while that of FY22 was ~27%
- In the product business, the company generates major revenues from Microsoft Azure in cloud followed by AWS and Google. The majority of revenues in cloud are cloud hosting. The company continues to invest in building digital capabilities and also started focusing on non-Microsoft stack (Google & Amazon)
- Growth of top five clients was muted at 1% QoQ. However, top 6-10 clients grew strong 19% QoQ. Top 11-20 clients grew 30% QoQ. Digital revenue now accounts for 73% of revenue (vs. 72% in Q3FY22)
- Digital revenues' contribution continues to rise QoQ and now forms 73% of IT services revenues vs. 67% in Q4FY21
- The company distribute 60% of its net income as dividend. Sonata indicated that it may look at M&A activity, going ahead, but its capital allocation would be prudent as it is not aggressive on inorganic opportunities
- Sonata indicated that other income for the quarter was high as it includes reversal of earn outs related to sopris acquisitions (₹ 26 crore) as certain milestones were not achieved, which were part of the deal three years ago
- The company hired 405 freshers in FY22 and expects to hire 45% more freshers in FY23

Exhibit 1: P&L

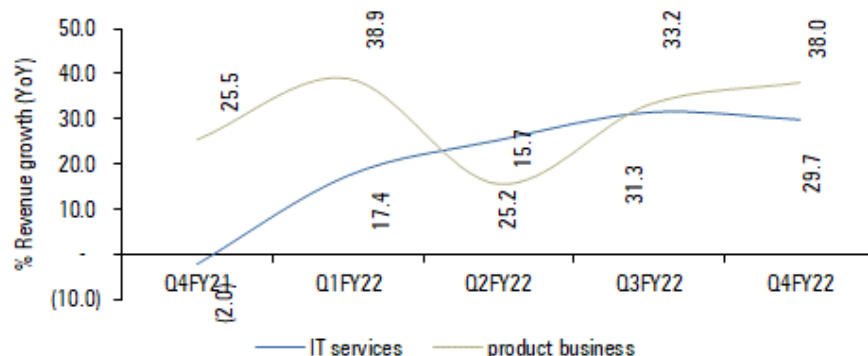
	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)	Comments
Revenue	1,464	1,076	36.1	1,858	(21.2)	IT services revenue grew by 4.7% QoQ while product revenues declined by 28.2% QoQ, resulting in 21.2% QoQ decline
Employee expenses	205	168	22.2	189	8.7	
Purchase of stock-in trade & other	1,036	743	39.4	1,457	(28.9)	
Gross Margin	222	164	35.2	212	4.7	
Gross margin (%)	15.2	15.3	-9 bps	11.4	376 bps	
Other expenses	114	61	86.3	81	41.6	
EBITDA	108	103	4.9	132	(17.9)	
EBITDA Margin (%)	7.4	9.6	-220 bps	7.1	30 bps	EBITDA margin for IT services declined by 50bps QoQ while that of product business was up 124bps QoQ
Depreciation & amortisation	13	9	39.3	13	3.1	
EBIT	95	94	1.4	119	(20.1)	
EBIT Margin (%)	6.5	8.7	-222 bps	6.4	9 bps	
Other income (less interest)	41	15		11	284.9	
PBT	136	109	24.5	130	4.8	
Tax paid	35	26	34.3	32	9.4	
PAT	101	83	21.5	98	3.3	

Source: Company, ICICI Direct Research

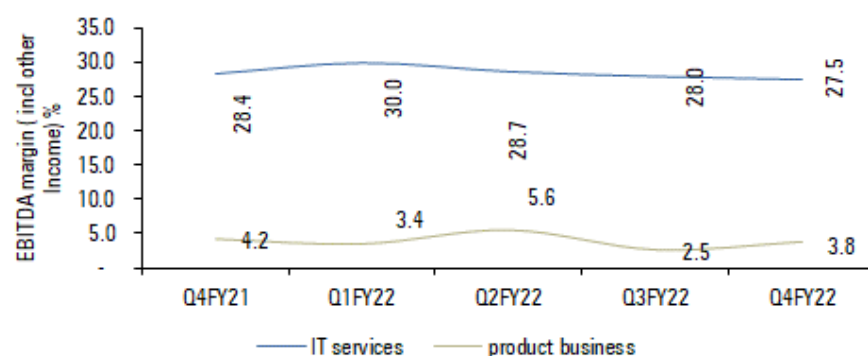
Exhibit 2: Change in estimates

	FY23E			FY24			Comments
(₹ Crore)	Old	New	% Change	Old	New	% Change	
Revenue	6,481	6,682	3.1	7,454	7,799	4.6	Re-aligned as per FY22 performance
EBITDA	597	524	-12.2	711	648	-8.9	
EBITDA Margin (%)	9.2	7.8	-137 bps	9.5	8.3	-123 bps	Margins trim down in IT services as per management guidance
PAT	435	374	-14.1	518	469	-9.5	
EPS (₹)	42.0	36.0	-14.1	50.0	45.1	-9.5	

Source: Company, ICICI Direct Research

Exhibit 3: Revenue growth trend business wise


Source: Company, ICICI Direct Research

Exhibit 4: EBITDA (including other income) margin (%), business wise


Source: Company, ICICI Direct Research

Financial summary

Exhibit 5: Profit and loss statement ₹ crore				
(Year-end March)	FY21	FY22	FY23E	FY24E
Total Revenues	4,228	5,553	6,682	7,799
Growth (%)	13.0	31.3	20.3	16.7
Total Operating Expenditure	3,849	5,090	6,158	7,152
EBITDA	379	464	524	648
Growth (%)	1.8	22.2	13.0	23.6
Depreciation & Amortization	40	47	53	62
Other Income	28	102	46	58
Interest costs	15	18	18	18
PBT before Exceptional Items	352	500	498	625
Growth (%)	(7.2)	42.1	(0.4)	25.4
Tax	108	124	125	156
PAT before Exceptional Items	244	376	374	469
Exceptional items	-	-	-	-
PAT before MI	244	376	374	469
Minority Int & Pft. from associates	-	-	-	-
PAT	244	376	374	469
Growth (%)	(12)	54	(1)	25
EPS	23.5	36.2	36.0	45.1
EPS (Growth %)	(12)	54	(1)	25

Source: Company, ICICI Direct Research

Exhibit 6: Cash flow statement ₹ crore				
(Year-end March)	FY21	FY22	FY23E	FY24E
Net profit before Tax	352	500	498	625
Depreciation & Amortization	40	47	53	62
WC changes	184	100	(81)	(0)
Other non cash adju.	0	(6)	(28)	(40)
Income taxes paid	(133)	(156)	(125)	(156)
CF from operations	443	486	319	491
Capital expenditure	(2)	(10)	(23)	(27)
Δ in investments	(110)	(126)	-	-
Other investing cash flow	9	17	46	58
CF from investing Activities	(102)	(119)	22	30
Issue of equity	-	-	-	-
Δ in debt funds/lease liabilities	(18)	(81)	(24)	(24)
Dividends paid	(41)	(187)	(224)	(281)
Other financing cash flow	(3)	(3)	(18)	(18)
CF from Financial Activities	(62)	(271)	(266)	(323)
Δ in cash and cash bank balance	279	96	75	198
Effect of exchange rate changes	2	(3)	-	-
Opening cash	396	677	770	845
Closing cash	677	770	845	1,043

Source: Company, ICICI Direct Research

Exhibit 7: Balance sheet ₹ crore				
(Year-end March)	FY21	FY22	FY23E	FY24E
Per share data (₹)				
EPS-diluted	23.5	36.2	36.0	45.1
Cash per share	65.2	74.1	81.3	100.4
BV	87.2	105.8	120.2	138.2
DPS	14.0	21.7	21.6	27.1
Operating Ratios (%)				
EBITDA Margin	9.0	8.4	7.8	8.3
Adjusted PBT Margin	8.3	9.0	7.5	8.0
Adjusted PAT Margin	5.8	6.8	5.6	6.0
Return Ratios (%)				
RoNW	26.9	34.2	29.9	32.6
RoCE	33.5	39.8	35.5	39.2
RoIC	95.8	107.1	101.6	129.4
Valuation Ratios (x)				
P/E	31.6	20.5	20.6	16.4
EV / EBITDA	18.5	14.7	12.9	10.1
Price to Book Value	8.5	7.0	6.2	5.4
EV/Total Revenues	1.7	1.2	1.0	0.8
MCap/Total Revenues	1.8	1.4	1.2	1.0
Turnover Ratios				
Debtor days	53	59	53	53
Creditors days	56	69	56	56
Solvency Ratios				
Debt/EBITDA	0.2	0.1	0.1	0.1
Total Debt / Equity	0.1	0.0	0.0	0.0
Current Ratio	1.7	1.5	1.6	1.6
Quick Ratio	1.7	1.5	1.6	1.6
Debt / EBITDA	0.2	0.1	0.1	0.1

Source: Company, ICICI Direct Research

Exhibit 8: Key ratios ₹ crore				
(Year-end March)	FY21	FY22	FY23E	FY24E
Per share data (₹)				
EPS-diluted	23.5	36.2	36.0	45.1
Cash per share	65.2	74.1	81.3	100.4
BV	87.2	105.8	120.2	138.2
DPS	14.0	21.7	21.6	27.1
Operating Ratios (%)				
EBITDA Margin	9.0	8.4	7.8	8.3
Adjusted PBT Margin	8.3	9.0	7.5	8.0
Adjusted PAT Margin	5.8	6.8	5.6	6.0
Return Ratios (%)				
RoNW	26.9	34.2	29.9	32.6
RoCE	33.5	39.8	35.5	39.2
RoIC	95.8	107.1	101.6	129.4
Valuation Ratios (x)				
P/E	31.6	20.5	20.6	16.4
EV / EBITDA	18.5	14.7	12.9	10.1
Price to Book Value	8.5	7.0	6.2	5.4
EV/Total Revenues	1.7	1.2	1.0	0.8
MCap/Total Revenues	1.8	1.4	1.2	1.0
Turnover Ratios				
Debtor days	53	59	53	53
Creditors days	56	69	56	56
Solvency Ratios				
Debt/EBITDA	0.2	0.1	0.1	0.1
Total Debt / Equity	0.1	0.0	0.0	0.0
Current Ratio	1.7	1.5	1.6	1.6
Quick Ratio	1.7	1.5	1.6	1.6
Debt / EBITDA	0.2	0.1	0.1	0.1

Source: Company, ICICI Direct Research

RATING RATIONALE

ICICI Direct endeavours to provide objective opinions and recommendations. ICICI Direct assigns ratings to its stocks according to their notional target price vs. current market price and then categorizes them as Buy, Hold, Reduce and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock

Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruiti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

ANALYST CERTIFICATION

I/We, Sameer Pardikar, MBA, Research Analysts, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. It is also confirmed that above mentioned Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months and do not serve as an officer, director or employee of the companies mentioned in the report.

Terms & conditions and other disclosures:

ICICI Securities Limited (ICICI Securities) is a full-service, integrated investment banking and is, inter alia, engaged in the business of stock brokering and distribution of financial products.

ICICI Securities is Sebi registered stock broker, merchant banker, investment adviser, portfolio manager and Research Analyst. ICICI Securities is registered with Insurance Regulatory Development Authority of India Limited (IRDAI) as a composite corporate agent and with PFRDA as a Point of Presence. ICICI Securities Limited Research Analyst SEBI Registration Number – INH000000990. ICICI Securities Limited SEBI Registration is INZ000183631 for stock broker. ICICI Securities is a subsidiary of ICICI Bank which is India's largest private sector bank and has its various subsidiaries engaged in businesses of housing finance, asset management, life insurance, general insurance, venture capital fund management, etc. ("associates"), the details in respect of which are available on www.icicibank.com.

ICICI Securities is one of the leading merchant bankers/ underwriters of securities and participate in virtually all securities trading markets in India. We and our associates might have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. ICICI Securities and its analysts, persons reporting to analysts and their relatives are generally prohibited from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

Recommendation in reports based on technical and derivative analysis centre on studying charts of a stock's price movement, outstanding positions, trading volume etc as opposed to focusing on a company's fundamentals and, as such, may not match with the recommendation in fundamental reports. Investors may visit icicidirect.com to view the Fundamental and Technical Research Reports.

Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.

ICICI Securities Limited has two independent equity research groups: Institutional Research and Retail Research. This report has been prepared by the Retail Research. The views and opinions expressed in this document may or may not match or may be contrary with the views, estimates, rating, and target price of the Institutional Research.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on a reasonable basis, ICICI Securities is under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities might be acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and shall not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgment by any recipient. The recipient should independently evaluate the investment risks. The value and return on investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities accepts no liabilities whatsoever for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities or its associates might have managed or co-managed public offering of securities for the subject company or might have been mandated by the subject company for any other assignment in the past twelve months.

ICICI Securities or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory service in a merger or specific transaction.

ICICI Securities or its associates might have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the companies mentioned in the report in the past twelve months.

ICICI Securities encourages independence in research report preparation and strives to minimize conflict in preparation of research report. ICICI Securities or its associates or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither ICICI Securities nor Research Analysts and their relatives have any material conflict of interest at the time of publication of this report.

Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions.

ICICI Securities or its subsidiaries collectively or Research Analysts or their relatives do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

Since associates of ICICI Securities and ICICI Securities as a entity are engaged in various financial service businesses, they might have financial interests or actual/ beneficial ownership of one percent or more or other material conflict of interest various companies including the subject company/companies mentioned in this report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Neither the Research Analysts nor ICICI Securities have been engaged in market making activity for the companies mentioned in the report.

We submit that no material disciplinary action has been taken on ICICI Securities by any Regulatory Authority impacting Equity Research Analysis activities.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.