



KEY HIGHLIGHTS

1. RESULTS OVERVIEW:

- Sonata Software Q4 FY22 consolidated revenues came in at ₹1464 Cr, up 36.06% YoY and down 21.23% QoQ.
- PBIDT (Exc OI) for Q4FY22 stood at ₹108.1 Cr, up 4.87% YoY and down 17.90% QoQ.
- PBIDTM (Ex OI) for Q4FY22 came at 7.39%, -219 bps YoY and +30 bps QoQ.
- PAT for Q4FY22 stood at ₹100.9 Cr, up 21.48% YoY and up 3.31% QoQ.

2. MANAGEMENT COMMENTARY:

- Deal pipeline continues to be healthy and strong through multiple new digital wins from existing and new customers.
- India business has continued to show robust growth with increasing percentage of cloud and digital infrastructure contracts.
- Company has set up global delivery centers in Canada and Ireland to serve international clients better
- Management announced the appointment of Samir Dhir as new CEO of the company. Management mentioned that they have invested significantly in attracting senior talent globally in Marketing, Business Development and Delivery, to be announced shortly and during the current year.

3. SEGMENTAL ANALYSIS:

- Q4 FY22 Revenue Breakup: International IT Services (28.3%), Domestic Product and Services (71.7%).
- Q4FY22 Geographical Revenue Breakup: USA (57%), Europe (22%), Rest of World (21%).

4. CONCALL SUMMARY

- International IT services revenues came at \$55.7 mn, +4.3% QoQ, +27.1% YoY. Management mentioned that supply side challenges may exist in Q1FY23, this issue will subside from Q2FY23.
- Domestic Product Services grew +38% YoY in Q4.
- Digital revenues continued its momentum with 73% of revenue contribution. Platformation revenue increased to 25%.
- Net addition of 133 employees in Q4FY22. Total headcount at 5,158.
- Company added 12 new customers in Q4FY22.
- Attrition for Q4FY22 is ~30% and for FY22 is ~27%.
- Utilization at 82%, +100 bps QoQ.

5. OTHER DEVELOPMENTS:

- Higher other income includes liabilities written back of ₹ 2,663 lakhs relating to earn out payments no longer payable to sellers of Sopris Sytems.
- Other expense includes ₹ 2,293 Lakhs of impairment of goodwill pertaining to Sopris Systems.
- The management is continuously investing in building digital capabilities and focusing on non-Microsoft tech stack (Amazon and Google).

6. VALUATION AND OUTLOOK:

The supply side pressure had impacted the growth and IITS margins in Q4FY22. Management believe that supply side challenges will start subsiding from Q2FY23. Growth in digital revenue and platformation revenue continued to be strong. Company is investing aggressively in building digital capabilities and on-boarding senior talent.

We initiate a "BUY" rating on the stock and value the stock at 17.5x FY24E earnings to arrive at the target of ₹839.

RECOMMENDATION - BUY

CMP – 713

TARGET – 839 (18%)

Industry	IT - Software
NSE CODE	SONATSOFTW
BSE CODE	532221
Market Cap (₹ Cr)	7795.99
Shares Outstanding (in Cr)	10.52
52 wk High/Low (₹)	1024.9 / 565
P/E	20.61
P/BV	7.06
Face Value (₹)	1.00
Book Value (₹)	104.54
EPS (FY21) (₹)	23.48
Dividend Yield (%)	2.75
Debt / Equity	0.10
Interest Coverage	23.88

SHAREHOLDING PATTERN

	Mar 22	Dec 21	Sep 21
Promoters	28.17	28.17	28.17
MF/ DII	14.05	13.83	12.50
FII/FPI	13.71	14.00	16.56
Retail & Others	43.43	43.18	42.30
Promoter Pledging	0.00	0.00	0.00

FINANCIAL SNAPSHOT (₹ Cr)

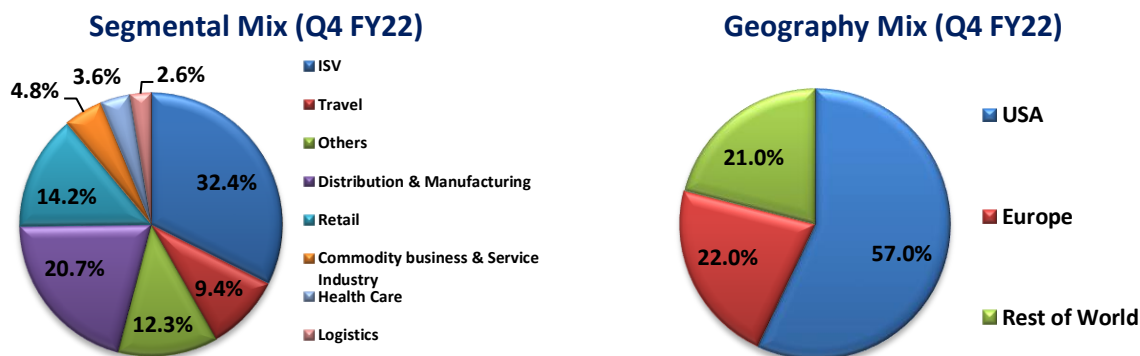
Y/E March	2022A	2023E	2024E
Crore			
Sales	5553	6664	7664
Sales Gr. (%)	31.3	20.0	15.0
EBITDA	464	566	690
EBITDA %	8.4	8.5	9.0
PAT	376	406	498
EPS (₹)	36.23	39.06	47.96
EPS Gr. (%)	54.3	7.8	22.8
BV/Sh. (₹)	105	122	140
Ratios			
RoE (%)	37.6	35.2	35.8
RoCE (%)	40.9	42.1	43.2
Valuation			
P/E (x)	20.6	19.2	17.5
P/BV (x)	6.99	6.5	5.8
EV/EBITDA	14.9	12.2	10.4

Historical & Industrial Val Ratios

Historical P/E	20.61
Industry P/E	31.39
Historical P/B	7.06
Industry P/B	9.42



REVENUE SPLIT (Q4 FY22)



QUARTERLY PERFORMANCE (CONSOLIDATED)

(₹ Cr)

Y/E March	FY21			FY22				FY23	FY22	FY23E*
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1E*		
Net sales	804	1,396	1,076	1,269	963	1,858	1,464	1,522	5,553	6,664
YoY change (%)	14.32%	12.88%	15.83%	33.19%	19.83%	33.08%	36.06%	20%	31.34%	20.00%
Total Expenditures	716	1,285	973	1,168	840	1,726	1,356	1,401	5,090	6,098
EBITDA	87	111	103	101	123	132	108	122	464	566
Margins (%)	11%	8%	10%	8%	13%	7%	7%	8%	8%	8.5%
Depreciation	10	10	9	10	12	13	13	13	47	47
Interest	4	5	4	4	5	5	4	4	18	18
Other income	2	3	19	28	14	15	45	15	102	40
PBT	76	100	109	115	120	130	136	120	500	541
Rate (%)	25%	46%	24%	24%	24%	25%	26%	25%	25%	25%
Adjusted PAT	57	54	83	87	91	98	101	90	376	406
EPS in Rs	5.44	5.12	7.9	8.25	8.67	9.29	9.59	8.64	35.80	39.06
Digital Revenue %	60	64	67	68	70	72	73			
Headcount	3,885	3,997	4,102	4,250	4,850	5,025	5,158			
Onsite/Offshore Rev Mix %	37/63	35/65	32/68	32/68	31/69	31/69	28/72			
Top 20 Client Contribution %	71%	71%	71%	73%	71%	71%	72%			
Platformation Revenue %	18%	18%	18%	20%	22%	23%	25%			
Utilization	87%	89%	89%	88%	89%	81%	82%			
Cloud/Non Cloud %	61/39	63/37	75/25	76/24	77/23	78/22	78/22			

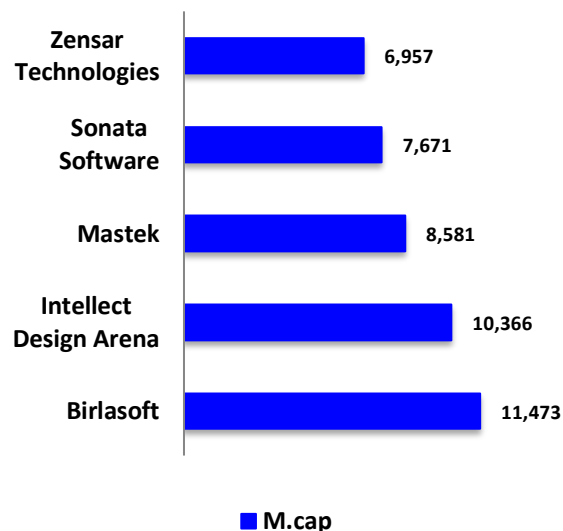
Source: Company, Hem Securities Research.



INDUSTRY OVERVIEW

- India is the world's largest sourcing destination with largest qualified talent pool of technical graduates in the world.
- The IT sector is the largest employer within the private sector.
- The Indian IT industry accounted for 19.2% of the total global IT spend in FY21.
- Indian technology industry contributes ~8% share to the national GDP, with a 52% share of services exports, and a 50% share in total FDI.
- The priority tech spending areas are expected to be augmented reality and virtual reality (AR/VR), mixed reality, Internet of Things (IoT), artificial intelligence (AI), robotics and cloud.
- This push towards cloud services has boosted hyper-scale data centre investments, with global investments estimated to exceed ~US\$ 200 billion annually by 2025.
- The digital transformation deals have seen a 30% jump since the pandemic.
- In Budget 2022-23, the government has allocated Rs. 88,568 crore (US\$ 11.58 billion) to the IT and telecom sector.
- Leading small cap players in Indian IT Industry includes Sonata Software, Birla Soft, Mastek, Zensar Tech, Cyient, Newgen software etc.

KEY PLAYERS in Small Cap IT Space



PEER PERFORMANCE

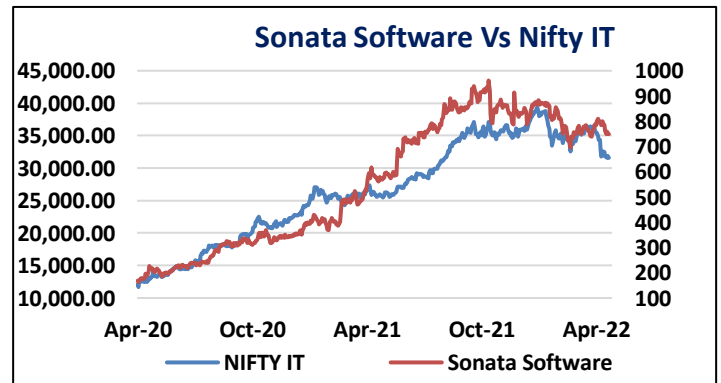
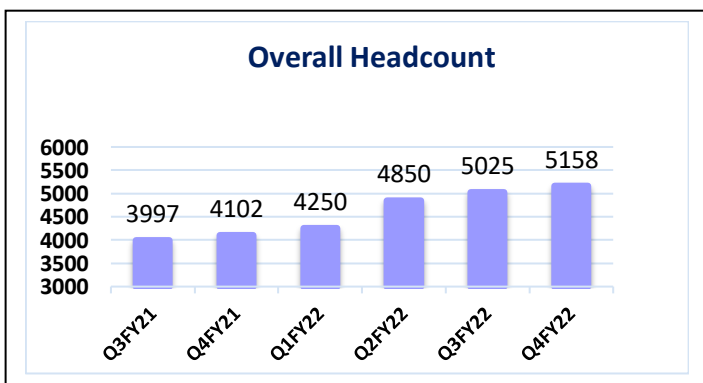
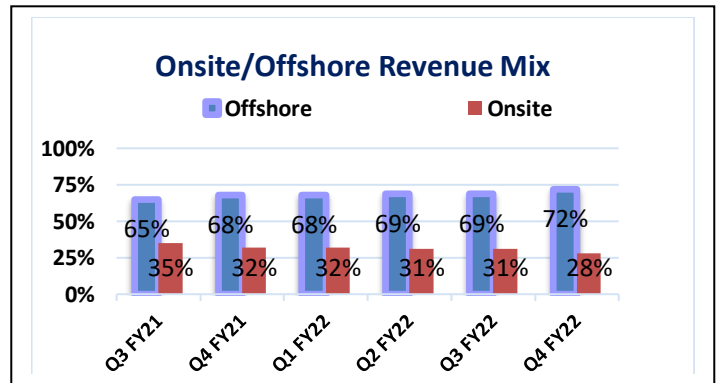
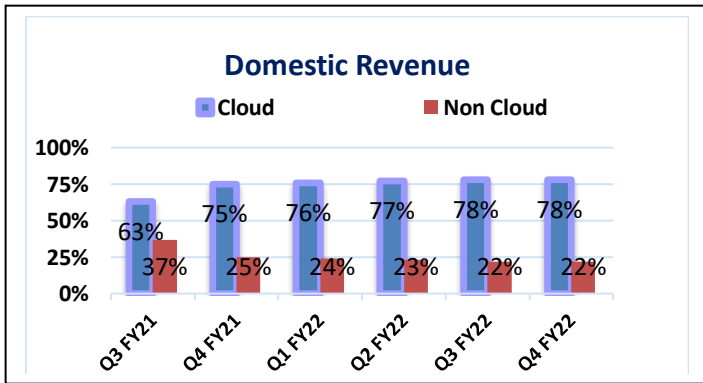
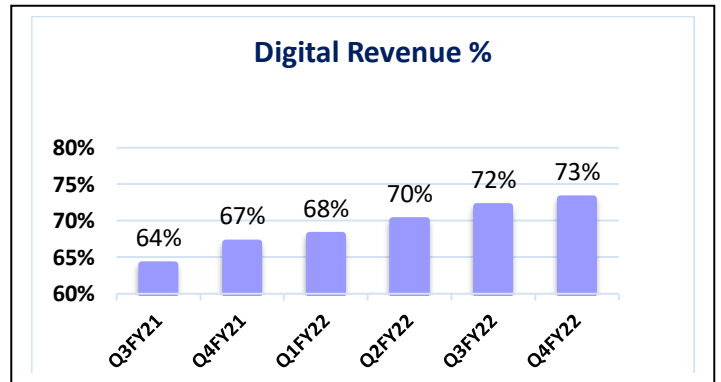
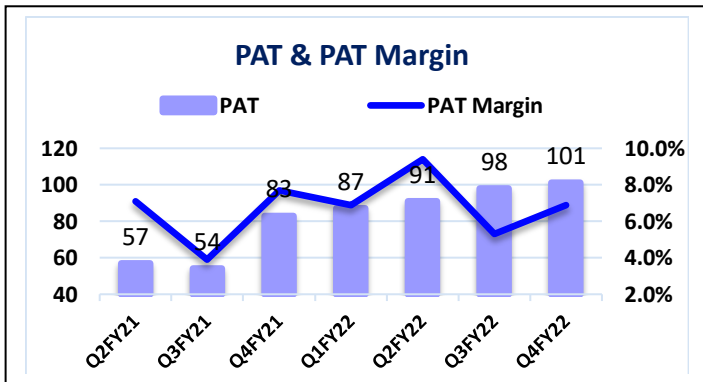
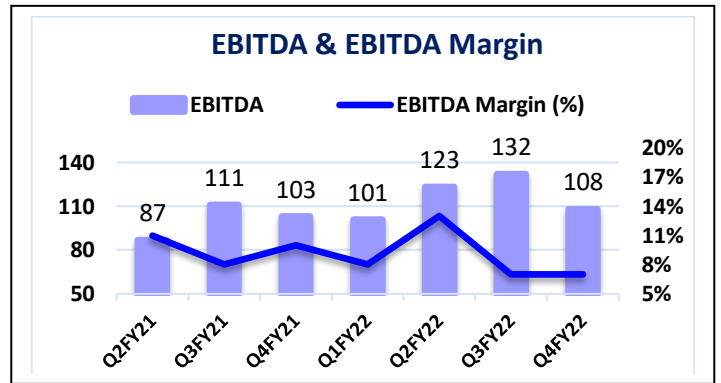
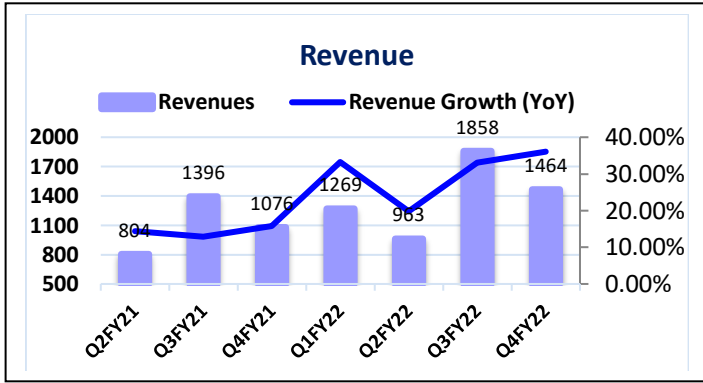
(₹ Cr)

Particulars				Zensar Technologies Ltd.	Intellect Design Arena Ltd.
	Sonata Software Ltd.	Birlasoft Ltd.	Mastek Ltd.		
Market Cap	7,671	11,473	8,581	6,957	10,366
EBITDA MARGIN %	8.36	15.72	21.20	16.74	24.97
PAT MARGIN %	6.77	10.94	13.51	9.46	18.91
ROCE %	46	21.5	38.0	22.2	21.6
ROE %	37.6	15.8	30.6	14.9	21.6
P/E TTM	20.6	26.7	29.0	18.5	31.0
P/B TTM	6.99	4.93	8.0	2.77	6.58
EV/EBITDA	12.5	16.1	16.2	8.81	21.5
Current Ratio	1.50	3.6	1.78	2.46	2.09
Dividend Yield %	1.91	0.84	0.50	1.14	0.00
Int Coverage	28.7	48.1	59.3	14.4	83.5
EPS TTM(₹)	35.80	15.46	98.32	16.59	24.99
3 Y Sales CAGR%	23	16	28	7	11

Source: Company, Hem Securities Research.



STORY IN CHARTS





INVESTMENT RATIONALE:

- Sonata Group's robust business profile comprises a mix of software distribution and the IT software service businesses.
- Strong growth in Domestic Product Services business (+38% YoY), higher than average of last 3-4 quarters.
- Digital revenues continues its strong growth momentum and is currently contributing 73% of total revenues (67% in same quarter last year).
- Management believes that travel vertical is expected to deliver strong growth in FY23.
- Management believes that supply crunch will start subsiding from Q2FY23.
- Sonata plans to aggressive hire freshers and experienced talent in FY23.
- Company has set up global delivery centers in Canada and Ireland to serve international clients better.
- Management mentioned that they have invested significantly in attracting senior talent globally in Marketing, Business Development and Delivery, to be announced shortly and during the current year.
- Encore acquisition is helping company in getting expertise in cloud.
- Company had initiated a number of initiatives to improve employee training and development, engagement and retention, building up capacity for future growth through new hires and upgrading of existing capabilities.

RISK / NEGATIVE FACTORS:

- Geographical Concentration Risk: Around 80% of revenues comes from USA & Europe. So any political risk related to USA, Europe or slowdown in their economic growth is a key concern.
- INR appreciating against USD, pricing pressure and retention of the skilled employees are other concerns. So any loss of clients can negatively impact their business.
- Client Concentration risk: Around 70% revenue comes from Top 20 clients while 60% revenue comes from Top 10 Clients.
- The Indian IT service industry is facing high attrition rates at this point of time, if attrition continues to increase for next few more quarters it may negatively impact company's business.

COMPANY RECAP

- Sonata is a global technology company specializing in platform-based digital transformation, supporting businesses to become connected, open, intelligent and scalable.
- The Company completed 5 years in March 2022 of Platformation, the unique and revolutionary approach of Sonata to help incumbent companies achieve their mandates for digital transformation.
- Key industry verticals on which Sonata focuses are Independent Software Vendors, Travel & Tourism, Retail, CPG, Manufacturing, Agri Commodity Business, Energy and Utilities.
- Major services that company provides are Data & Analytics, Managed Cloud Services, IMS, Digital Platformation Services, ERP services, Modern Validation and Dev Eng Management Services.
- Major revenue generating geographies are USA, Europe, Middle East, India and ANZ.
- ~70% of its international business revenue comes from digital.
- ~78% of domestic business revenue comes from cloud based services.
- As of March 2022, Company has 5158 employees and company is aggressively hiring every quarter given robust demand environment.
- Company has very experienced and skilled leadership team including P Srikar Reddy (MD), Samir Dhir (CEO), Radha Krishnan (President of Encore Software Services), Sujit Mohanty (Head - Sonata India Business), Jagannathan Chakravarthy (CFO) etc.



ANNUAL PERFORMANCE

Financials & Valuations

Income Statement							(₹ Cr)
Y/E March	2018	2019	2020	2021	2022	2023E	2024E
Revenue from operations	2,453.94	2,960.90	3,743.26	4,228.08	5,553.37	6,664.04	7,663.65
Growth YoY (%)	3.51	20.66	26.42	12.95	31.3	20.00	15.00
Total Expenditure	2,222.95	2,625.29	3,370.45	3,848.73	5,089.62	6,097.60	6,973.92
(%) of sales	90.59	88.67	90.04	91.03	91.65	91.50	91.00
EBITDA	230.99	335.61	372.81	379.35	463.8	566.44	689.73
EBITDA Growth (%)	15.83	31.26	18.84	-5.59	22.3	22.13	21.76
EBITDA Margin (%)	11.27	12.26	11.52	9.63	8.4	8.50	9.00
Depreciation	12.41	12.74	36.54	39.57	47.32	47.32	47.32
EBIT	265.18	352.88	394.67	367.53	416.5	519.12	642.41
EBIT Growth (%)	12.60	33.07	11.84	-6.88	13.32	24.64	23.75
Net Interest Expenses	4.81	3.39	15.18	15.39	18.05	18.05	18.05
Other Income	45.45	27.25	58.40	27.75	1019.8	40	40
Earnings before Taxes	260.37	349.49	379.49	352.14	500.4	541.07	664.36
EBT Margin (%)	10.61	11.80	10.14	8.33	9.0	8.12	8.67
Tax-Total	68.24	100.61	102.56	108.18	123.9	135.27	166.09
Rate of tax (%)	26.21	28.79	27.03	30.72	24.8	25	25
Net Profit	192.13	248.88	276.93	243.96	376.5	405.81	498.27
PAT Growth (%)	22.44	29.54	11.27	-11.91	54.3	7.78	22.79
PAT Margin (%)	7.83	8.41	7.40	5.77	6.8	6.09	6.50
Minority Interest	0.40	0.38	0.00	0.00	0.00	0	0
Adjusted PAT	192.53	249.26	276.93	243.96	376.5	405.81	498.27
EPS	18.55	23.99	26.65	23.48	36.5	39.06	47.96
EPS Growth (%)	23.06	29.34	11.10	-11.91	55.45	7.80	22.79

Balance Sheet

Y/E March	2018	2019	2020	2021	2022
Share Capital	10	10	10	10	10
Reserves	643	758	659	895	1,089
Net Worth	653	768	669	905	1099
Borrowings	34	16	86	90	159
Other Liabilities	545	744	861	952	1,297
Total Liabilities & Equity	1,232	1,528	1,616	1,947	2,555
Fixed Assets	114	199	298	324	427
CWIP	0	1	0	0	0
Investments	198	146	14	76	159
Other Assets	920	1,182	1,305	1,547	1,970
Total Assets	1,232	1,528	1,616	1,947	2,555

Source: Company, Hem Securities Research.



Ratios					
Y/E March (Basic (INR))	2018	2019	2020	2021	2022
Profitability and return ratios					
Net profit margin (%)	7.83	8.41	7.40	5.77	6.8
EBITDA margin (%)	11.27	12.26	11.52	9.63	8.4
EBIT margin (%)	10.81	11.92	10.54	8.69	7.49
ROE (%)	30.90	35.07	38.65	31.08	37.6
ROCE (%)	39.80	47.98	51.27	41.98	40.97
Working Capital & liquidity ratios					
Payables (Days)	78.72	77.01	66.01	73.99	71.6
Inventory (Days)	0.00	0.00	0.00	0.00	0.00
Receivables (Days)	68.15	74.43	73.67	56.79	58.7
Current Ratio (x)	1.74	1.74	1.43	1.56	1.50
Valuations Ratios					
EV/sales (x)	1.20	1.12	0.37	1.11	1.2
EV/EBITDA (x)	10.61	9.18	3.25	11.56	14.9
P/E (x)	16.87	14.10	6.18	21.69	20.6
P/BV (x)	4.97	4.59	2.57	5.86	6.99
Dividend Yield (%)	3.36	3.77	12.28	2.75	1.9
Leverage Ratio					
Debt/Equity (x)	0.05	0.02	0.13	0.10	0.0

Cash Flow Statement					
Y/E March	2018	2019	2020	2021	2022
CF from Operating activities (A)	290	-6	369	443	486
CF from Investing Activities (B)	104	12	139	-112	-119
CF from Financing Activities (C)	-140	-166	-310	-62	-271
Net Cash Flow	253	-160	198	268	96
Add: Opening Bal.	81	334	174	372	640
Closing Balance	334	174	372	640	734

Source: Company, Hem Securities Research.



RATING CRITERIA

INVESTMENT RATING	EXPECTED RETURN
BUY	>=15%
ACCUMULATE	5% to 15%
HOLD	0 to 5%
REDUCE	-5% to 0
SELL	<-5%

RECOMMENDATION SUMMARY

DATE	RATING	TARGET
4 May 2022	Buy	839

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Name of the Research Analyst: ABHISHEK SHARDA

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4.	Research Analyst has served as an officer, director or employee of the subject company(ies)	No
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10.	Research Analyst or HSL has been engaged in market making activity for the subject company(ies)	No

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