

CMP: ₹ 813

Target: ₹ 915 (13%)

Target Period: 12 months

August 5, 2021

HOLD

IT services revenues to improve in coming quarters...

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, manufacturing and software vendors
- Net debt free and healthy double digit return ratio (with RoCE of >30%)

Q1FY22 Results: Sonata reported Q1FY22 results.

- IT services dollar revenues increased 1.5% QoQ to US\$44.5 million
- Overall EBITDA margin declined 162 bps QoQ to 8.0%
- Overall PAT increased 4% QoQ to ₹ 86.7 crore led by higher other income

What should investors do? Sonata's share price has grown by ~5x over the past five years (from ~₹ 150 in August 2016 to ~₹ 813 levels in August 2021).

- However, we downgrade the stock from BUY to HOLD

Target Price and Valuation: We value Sonata at ₹ 915 i.e. 21x P/E on FY23E EPS

Key triggers for future price performance:

- Improved traction in retail, commodity & manufacturing and healthy demand for its travel client. We expect FY22E to witness robust growth in revenues
- Upgrades in Microsoft Dynamics and taking 1000 clients from the medium to large category bodes well for revenue growth
- Robust hiring trend and inorganic growth prompt us to build IT service dollar revenue growth of 23.4% CAGR over FY21-23E

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

- Growth in new logo acquisition, increasing deal size, expansion of sales & marketing and market share gains to drive revenues
- BUY with a target price of ₹ 2,900



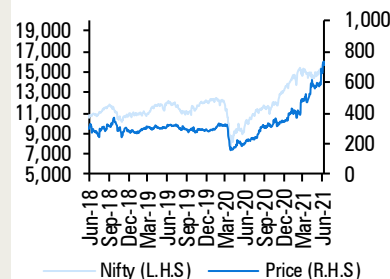
Particulars

Particular	Amount
Market Capitalization (₹ Crore)	8,431.4
Total Debt(₹ Crore)	89.7
Cash and Investments (₹ Crore)	742.5
EV (₹ Crore)	7,778.6
52 week H/L	884 / 268
Equity capital	10.4
Face value	1.0

Shareholding pattern

	Sep-20	Dec-20	Mar-21	Jun-21
Promoters	28	28	28	28
FII	10	12	14	15
DII	14	14	13	13
Public	48	46	45	44

Price Chart



Recent event & key risks

- IT service to witness improved growth
- Key Risk:** (i) Deceleration in travel & retail vertical, (ii) Higher than expected margins.

Research Analyst

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Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	5 year CAGR (FY16-21)	FY22E	FY23E	2 year CAGR (FY21-23E)
Net Sales	2,961	3,743	4,228	16.9%	5,606	6,724	26.1%
EBITDA	336	373	379	14.6%	520	623	28.2%
EBITDA Margin (%)	11.3	10.0	9.0		9.3	9.3	
PAT	249	277	244	9.0%	369	444	34.9%
EPS (₹)	24.0	26.7	23.5		35.5	42.7	
P/E (x)	34	31	35		23	19	
RoNW (%)	32.4	41.4	26.9		35.0	36.1	
RoCE (%)	42.3	44.7	33.5		41.2	43.2	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

Q1FY22 Earnings Conference Call highlights

- IT service segment dollar revenues increased 1.5% QoQ to US\$44.5 million (₹ 324 crore). IT service core EBITDA margin (excluding other income) declined 115 bps QoQ to 21.3%
- Domestic revenues increased 24.3% QoQ to ₹ 946.2 crore but EBITDA margin declined 75 bps QoQ to 3.4%
- Hence, overall revenues increased 17.5% QoQ to ₹ 1,268.5 crore and EBITDA margin declined 162 bps QoQ to 8%. Overall PAT increased 4% QoQ to ₹ 86.7 crore due higher other income (led by reversal of provisions)
- The current quarter was impacted by supply side challenges (led by Covid and attrition). The company's margins were also impacted by Covid related expenses and capacity expansion
- The company has hired leadership for digital tech, head of Australia and 12 sales guys onsite, which will help drive growth
- The company is seeing healthy deal flow and order pipeline, which we believe will enable Sonata to grow IT services at 4% CQGR and 5% CQGR for domestic business
- The company's acquisition of Encore is expected to contribute US\$3 million for quarter and US\$500,000 in EBITDA. Encore specialises in cloud apps and on premise app modernisation. The acquisition will help the company in driving end to end cloud services
- In the domestic business the company generates major revenues from Microsoft Azure in cloud followed by AWS and Google. The majority of revenues in cloud is cloud hosting

Peer comparison

Exhibit 1: Peer Comparison

Company	Cmp (₹)	TP (₹)	Rating	Mcap (₹ Cr)	Revenue growth				Margins			P/E			
					FY20	FY21	FY22E	FY23E	FY19	FY20	FY21	FY20	FY21	FY22E	FY23E
Sonata Software*	813	915	Hold	8,431	13.6	(7.0)	29.1	20	26	27	26	40	46	31	26
Accelya	1,394	1,070	Buy	2,090	(4.8)	(22.0)	25.0	20	39	37	29	24	52	29	22
Mastek	2,499	2,900	Buy	6,346	4.0	61.0	24.0	15	13	15	21	48	31	26	22

Source: Company, ICICI Direct Research, * IT services

We expect Sonata's IT services growth to improve, led by a revival in the travel vertical. However, the current valuation factors in most of the positives.

Financial summary

Exhibit 2: Profit and loss statement		₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E	
Total Revenues	3,743	4,228	5,606	6,724	
Growth (%)	26.4	13.0	32.6	19.9	
Total Operating Expenditure	3,370	3,849	5,086	6,101	
EBITDA	373	379	520	623	
Growth (%)	11.1	1.8	37.0	19.9	
Depreciation & Amortization	37	40	45	54	
Other Income	58	28	38	45	
Interest costs	15	15	14	14	
PBT before Exceptional Items	380	352	498	600	
Growth (%)	9.5	(7.2)	41.5	20.4	
Tax	103	108	130	156	
PAT before Exceptional Items	277	244	369	444	
Exceptional items	-	-	-	-	
PAT before MI	277	244	369	444	
Minority Int & Pft. from associate	-	-	-	-	
PAT	277	244	369	444	
Growth (%)	11	(12)	51	20	
EPS	26.7	23.5	35.5	42.7	
EPS (Growth %)	11	(12)	51	20	

Source: Company, ICICI Direct Research

Exhibit 3: Cash flow statement		₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E	
Net profit before Tax	379	352	498	600	
Depreciation & Amortization	37	40	45	54	
WC changes	100	184	(0)	(0)	
Other non cash adju.	(18)	0	(23)	(31)	
Income taxes paid	(129)	(133)	(130)	(156)	
CF from operations	370	443	390	467	
Capital expenditure	(8)	(2)	(67)	(24)	
Δ in investments	138	(110)	-	-	
Other investing cash flow	9	9	38	45	
CF from investing Activities	139	(102)	(30)	21	
Issue of equity	-	-	-	-	
Δ in debt funds/lease liabilities	47	(18)	(24)	(24)	
Dividends paid	(354)	(41)	(221)	(266)	
Other financing cash flow	(3)	(3)	(14)	(14)	
CF from Financial Activities	(311)	(62)	(259)	(305)	
Δ in cash and cash bank balance	198	279	101	184	
Effect of exchange rate changes	(1)	2	-	-	
Opening cash	199	396	677	778	
Closing cash	396	677	778	961	

Source: Company, ICICI Direct Research

Exhibit 4: Balance sheet		₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E	
Equity	10	10	10	10	
Reserves & Surplus	659	895	1,043	1,220	
Networth	670	905	1,053	1,231	
Minority Interest	-	-	-	-	
LT liabilities & provisions	128	102	102	102	
Total Debt	86	90	90	90	
Source of funds	884	1,097	1,245	1,422	
Net fixed assets	142	148	194	188	
Goodwill	156	176	176	176	
Long term loans and advances	-	-	-	-	
Other non current assets	129	154	195	227	
Loans and advances	-	-	-	-	
Inventories	-	-	-	-	
Current Investments	5	65	65	65	
Debtors	700	616	816	979	
Cash & Cash equivalents	396	677	778	961	
Other current assets	88	111	147	176	
Current liabilities	710	823	1,091	1,308	
Provisions	23	27	36	43	
Net current assets	457	620	680	831	
Application of funds	884	1,097	1,245	1,422	

Source: Company, ICICI Direct Research

Exhibit 5: Key ratios		₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E	
Per share data (₹)					
EPS-diluted	26.7	23.5	35.5	42.7	
Cash per share	38.2	65.2	74.9	92.5	
BV	64.5	87.2	101.4	118.5	
DPS	20.3	14.0	21.3	25.6	
Operating Ratios (%)					
EBITDA Margin	10.0	9.0	9.3	9.3	
Adjusted PBT Margin	10.1	8.3	8.9	8.9	
Adjusted PAT Margin	7.4	5.8	6.6	6.6	
Return Ratios (%)					
RoNW	41.4	26.9	35.0	36.1	
RoCE	44.7	33.5	41.2	43.2	
RoIC	69.7	95.8	118.3	144.0	
Valuation Ratios (x)					
P/E	30.5	34.6	22.9	19.0	
EV / EBITDA	21.8	20.5	14.8	12.0	
Price to Book Value	12.6	9.3	8.0	6.9	
EV/Total Revenues	2.2	1.8	1.4	1.1	
MCap/Total Revenues	2.3	2.0	1.5	1.3	
Turnover Ratios					
Debtor days	68	53	53	53	
Creditors days	55	56	56	56	
Solvency Ratios					
Debt/EBITDA	0.2	0.2	0.2	0.1	
Total Debt / Equity	0.1	0.1	0.1	0.1	
Current Ratio	1.6	1.7	1.6	1.6	
Quick Ratio	1.6	1.7	1.6	1.6	
Debt / EBITDA	0.2	0.2	0.2	0.1	

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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