

# Sonata Software Limited



**Sonata Software Limited.** Seasonally weak quarter but strong evidence of execution in Platform, IP & Alliance businesses

CMP <b>INR 975</b>	Target <b>INR 1,087</b>	Potential Upside <b>11.5%</b>	Market Cap (INR Mn) <b>INR 98,676</b>	Recommendation <b>ACCUMULATE</b>	Sector <b>Internet Software &amp; Services</b>
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**Synopsis:**

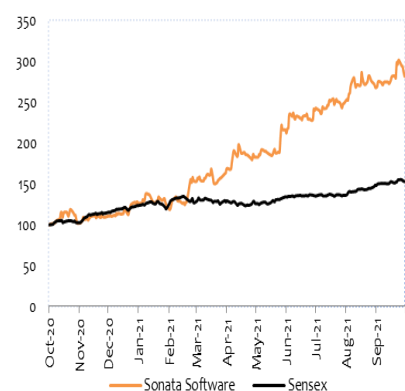
Sonata Software Ltd (SSOF) Q2FY22 performance was lower than our estimate. Dollar Revenue was up materially by 11% QoQ to USD 49.4Mn (KRChoksey est. USD 48Mn). Rupee revenue grew by ~20% YoY to INR 9,632Mn (KRChoksey est. INR 13,884Mn). Reported operating margin witnessed a sharp uptick of 438bps to 11.6% QoQ and reported net profit grew by 5.1% QoQ to INR 912Mn (KRChoksey est. INR 928Mn) with margin of 9.5%, up 263bps. In spite of a seasonally weak quarter (Q2FY22), domestic business performed well on YoY basis. International IT services witnessed a strong growth momentum backed by strong execution in platform, IP and alliance led businesses. Growth was broad based across the US (+13.7% QoQ), Europe(+7.3% QoQ) and RoW (+9.5%), mainly driven by ISV (+5.9% QoQ), Retail Essential (+8.7% QoQ), Distribution & Manufacturing (+5.3% QoQ) and Commodity business & services (+3.6% 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 1,087 is based on 26x Mar-24E EPS with EPS CAGR of 17.5% over FY22-24E.

**MARKET DATA**
**KEY FINANCIALS**

Shares outs (Mn)	104
Mkt Cap (INR Mn)	98676
52 Wk H/L (INR)	1,030/300.8
Volume Avg (3m K)	384.454
Face Value (INR)	1
Bloomberg Code	SSOF:IN

(INR Mn)	Q2FY22A	Q1FY22A	Q2FY21A	QoQ	YoY	KRChoksey Est.	Variance (%)
USD Revenue (International IT services)	49	45	39	11.0%	26.7%	48	2.9%
Revenue	9,632	12,685	8,038	-24.1%	19.8%	13,884	-30.6%
EBIT	1,114	911	772	22.3%	44.2%	1,014	9.8%
PAT	912	867	572	5.1%	59.4%	928	-1.8%
OPM (%)	11.6%	7.2%	9.6%	438bps	195bps	7.3%	426bps
NPM(%)	9.5%	6.8%	7.1%	263bps	235bps	6.7%	278bps

Source: Company, KRChoksey Research

**SHARE PRICE PERFORMANCE**

**Robust growth across verticals in spite of seasonally weak quarter**

Sonata Software (SSOF) Q2FY22 performance is lower than our estimates. For Q2FY22, company reported dollar revenue growth of 26.7% YoY (up 11% QoQ) USD 49.4Mn. In Rupee terms, revenue was up by 19.8%YoY to INR 9,632Mn. International IT services witnessed a strong growth momentum backed by strong execution through platform led growth, IP led growth and alliance led growth. Growth was broad based across the US (+13.7% QoQ), Europe(+7.3% QoQ) and RoW (+9.5%), mainly driven by ISV (+5.9% QoQ), Retail Essential (+8.7% QoQ), Distribution & Manufacturing (+5.3% QoQ) and Commodity business & services (+3.6% QoQ). In spite of a seasonally weak quarter (Q2FY22), domestic business grew by +16 YoY basis to INR 6,055Mn. Significant growth in digital business was backed by Managed Cloud Services (+22.9% QoQ), MSFT Digital Platform Services (+9.5% QoQ) and Open Source Digital Platform services (+4.4% QoQ).

**Strong deal wins to drive growth across geographies**

The deal pipeline continues to be healthy and strong through multiple new digital wins from existing and new customers. Approach to digitizing business using platforms played well for Sonata and has successfully added 8 new clients in Q2. Sonata (including Encore) has a strong presence in developed regions as the majority of the customers are from USA (93 Clients), Europe (42 Clients) & ANZ (37 clients). Company has successfully added 7 new Fortune 500 clients to 35 on YoY basis. Focus area continues to be Distribution & Manufacturing (59 Clients), Retail Essential/Non-Essential (35 Clients), ISV (27 Clients) and Healthcare (14 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 +77%. Top 93 clients contribute to ~80% of the gross margin for domestic business.

**MARKET INFO**

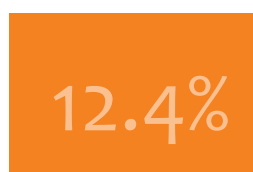
SENSEX	61,716
NIFTY	18,419

**Higher attrition to drag the EBIT margin**

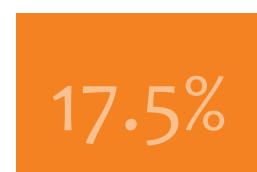
In Q2FY22, the company registered EBIT margin of 11.6% which is higher by 195 bps YoY. The ongoing talent crunch led by supply side challenges, wage hikes, increasing sub-contracting costs and higher intake of fresher will keep margins under check in the near term.

**SHARE HOLDING PATTERN (%)**

Particulars	Sep-21	Jun-21	Mar-21
Promoters	28.2	28.2	28.2
FIIIs	16.5	15.4	13.8
DIIIs	14.2	14.1	14.3
Others	41.1	42.4	43.7
Total	100	100	100



Revenue CAGR between FY22 and FY24E



PAT CAGR between FY22 and FY24E

## Sonata Software Limited.

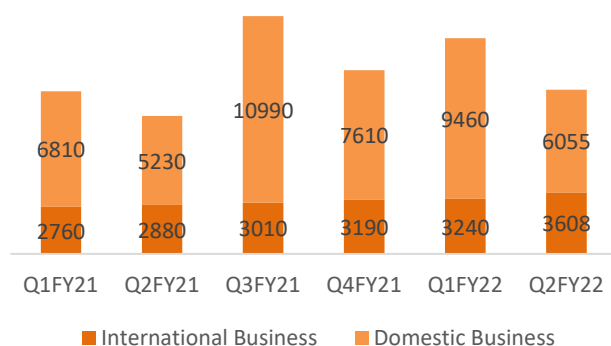
### Key Concall Highlights:

(i) International IT services grew 5.5%QoQ in constant currency term (ii) The deal pipeline continues to be healthy and strong through multiple new digital wins from existing and new customers(iii) ISV and Retail Essential are expected to contribute more in revenue (in absolute term) (iv) As Europe has eased the travel restriction, we expect travel to go back to Pre-Covid level in the coming quarters (v) Company has added 8 new clients in Q2FY22, out of which Encore contributed 5 new clients(vi) Company is focusing on building employee bench strength for Microsoft practices and has started hiring ~600 people per quarter for the last 2-3 quarters and will continue in the near term (vii) Sub-contracting cost for the International IT services came below the last quarter (viii) Offshoring is expected to increase in medium term (ix) DSO is coming down every quarter.

### Valuation and view

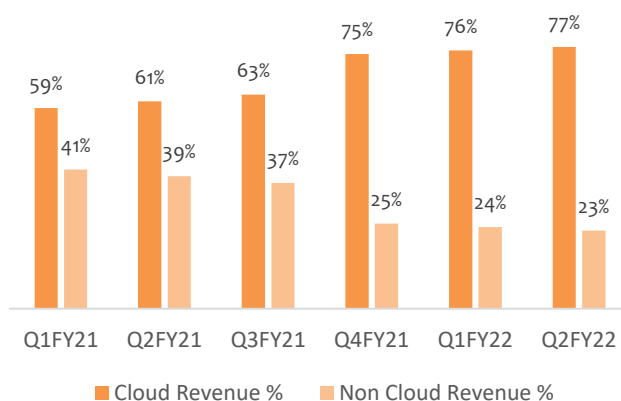
Sonata Software is currently trading at a valuation with a P/E multiple of 26.4x/23.3x on FY23E/FY24E earnings. We expect strong deal momentum across geographies, higher focus on ISV and Retail (Essential/Non-Essential), and tailwind in Managed Cloud Services will aid growth over the medium to long term in future and hence we are assigning a P/E multiple of 26x to the FY24 estimated EPS of INR 41.8 to arrive at a target price of INR 1,087 per share (earlier target of INR 1,001), an upside of 11.5% over the CMP. Accordingly, we maintain our rating to an “ACCUMULATE” to the stock.

### Consolidated Business (INR Mn)



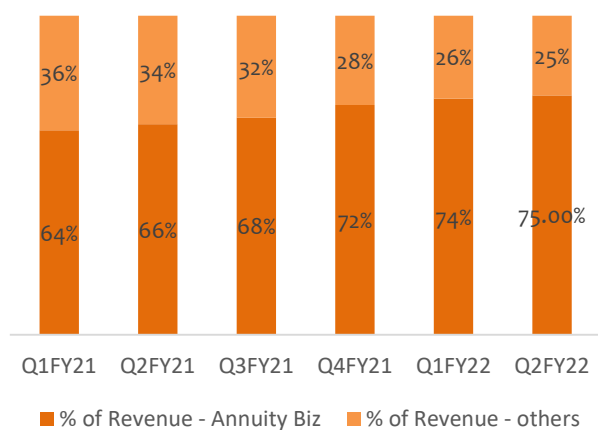
Source: Company, KRChoksey Research

### Domestic Revenue (Cloud/Non Cloud)



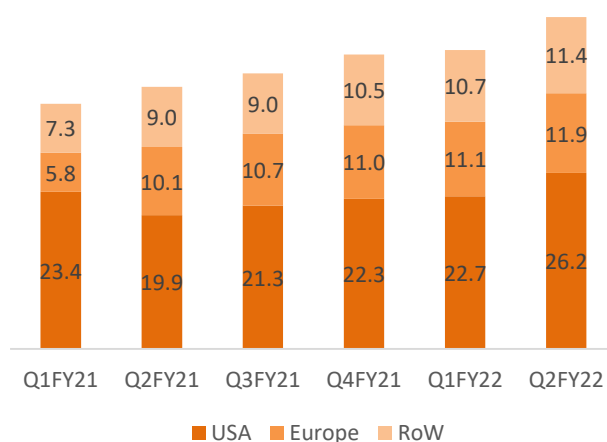
Source: Company, KRChoksey Research

### Domestic Revenue (Annuity/Others)



Source: Company, KRChoksey Research

### Revenue Mix by Geography (USD Mn)



Source: Company, KRChoksey Research

## Sonata Software Limited.

### KEY FINANCIALS

#### Exhibit 1: Balance Sheet

Particulars (INR Mn)	FY18	FY19	FY20	FY21	FY22E	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
<b>Total non current assets</b>	<b>2,799</b>	<b>2,813</b>	<b>4,269</b>	<b>4,777</b>	<b>4,977</b>	<b>5,190</b>	<b>5,373</b>
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
<b>Total current assets</b>	<b>9,525</b>	<b>12,468</b>	<b>11,896</b>	<b>14,692</b>	<b>16,891</b>	<b>19,864</b>	<b>23,639</b>
<b>Total Assets</b>	<b>12,324</b>	<b>15,281</b>	<b>16,165</b>	<b>19,469</b>	<b>21,868</b>	<b>25,054</b>	<b>29,012</b>
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	<b>6,533</b>	<b>7,683</b>	<b>6,697</b>	<b>9,055</b>	<b>10,705</b>	<b>12,678</b>	<b>15,027</b>
Non controlling Interest	0	0	0	0	0	0	0
<b>Total Equity</b>	<b>6,533</b>	<b>7,683</b>	<b>6,697</b>	<b>9,055</b>	<b>10,705</b>	<b>12,678</b>	<b>15,027</b>
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
<b>Total non current liabilities</b>	<b>314</b>	<b>435</b>	<b>1,157</b>	<b>1,021</b>	<b>1,417</b>	<b>1,812</b>	<b>2,208</b>
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
<b>Total Current Liabilities</b>	<b>5,478</b>	<b>7,163</b>	<b>8,311</b>	<b>9,394</b>	<b>9,746</b>	<b>10,564</b>	<b>11,778</b>
<b>Total liabilities</b>	<b>12,324</b>	<b>15,281</b>	<b>16,165</b>	<b>19,469</b>	<b>21,868</b>	<b>25,054</b>	<b>29,012</b>

Source: Company, KRChoksey Research

## Sonata Software Limited.

### KEY FINANCIALS

#### Exhibit 2: Profit & Loss Statement

Particulars (INR Mn)	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Revenue	24,539	29,609	37,433	42,281	47,887	53,769	60,528
Total operating Expenses	22,230	26,253	33,705	38,487	43,421	48,542	54,600
<b>EBITDA</b>	<b>2,310</b>	<b>3,356</b>	<b>3,728</b>	<b>3,794</b>	<b>4,466</b>	<b>5,227</b>	<b>5,928</b>
Depreciation	124	127	365	396	388	344	395
<b>EBIT</b>	<b>2,186</b>	<b>3,229</b>	<b>3,363</b>	<b>3,398</b>	<b>4,078</b>	<b>4,883</b>	<b>5,533</b>
Other income, net	455	273	584	278	259	339	357
Finance costs	48	34	152	154	141	98	98
(Less)/ Add: (Extraordinary Item)							
Interest Income	12	28	0	0	0	0	0
<b>Pre-tax Income</b>	<b>2,604</b>	<b>3,495</b>	<b>3,795</b>	<b>3,521</b>	<b>4,196</b>	<b>5,124</b>	<b>5,791</b>
Income tax expense	682	1,006	1,026	1,082	1,049	1,281	1,448
<b>Net profit Before MI</b>	<b>1,921</b>	<b>2,489</b>	<b>2,769</b>	<b>2,440</b>	<b>3,147</b>	<b>3,843</b>	<b>4,344</b>
Minority Interest	4	4	0	0	0	0	0
<b>Net profit After MI</b>	<b>1,925</b>	<b>2,493</b>	<b>2,769</b>	<b>2,440</b>	<b>3,147</b>	<b>3,843</b>	<b>4,344</b>
Diluted EPS (INR)	18.31	23.70	26.65	23.48	30.29	36.99	41.81
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	FY22E	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	FY22E	FY23E	FY24E
EBIT Margin (%)	8.9%	10.9%	9.0%	8.0%	8.5%	9.1%	9.1%
Tax rate (%)	26.2%	28.8%	27.0%	30.7%	25.0%	25.0%	25.0%
Net Profit Margin (%)	7.8%	8.4%	7.4%	5.8%	6.6%	7.1%	7.2%
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	30.3	37.0	41.8

Source: Company, KRChoksey Research

**Sonata Software Limited.**

Sonata Software Limited				Rating Legend (Expected over a 12-month period)	
Date	CMP (INR)	TP(INR)	Recommendation	Our Rating	Upside
19-Oct-21	975	1087	ACCUMULATE	Buy	More than 15%
25-Aug-21	878	1001	ACCUMULATE	Accumulate	5% – 15%
30-Jun-21	746.6	810	BUY	Hold	0 – 5%
				Reduce	-5% – 0
				Sell	Less than – 5%

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