

CMP: ₹ 875

Target: ₹ 1050 (20%)

Target Period: 12 months

January 18, 2022

BUY

## IT services growth impressive...

**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%)

**Q3FY22 Results:** Sonata reported strong numbers in IT services while product business margins were weak.

- IT services dollar revenues increased 9.5% QoQ to US\$53.5 million
- EBITDA margin for IT services were down 70 bps QoQ due to increase in employee costs
- The company is looking to increase fresher hiring by 40% in FY23

**What should investors do?** Sonata's share price has grown by ~5x over the past five years (from ~₹ 174 in January 2017 to ~₹ 875 levels in January 2022).

- We maintain BUY rating on the stock

**Target Price and Valuation:** We value Sonata at ₹ 1,050 i.e. 21x 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 21.7% CAGR over FY21-24E

**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
- BUY with a target price of ₹ 2,300



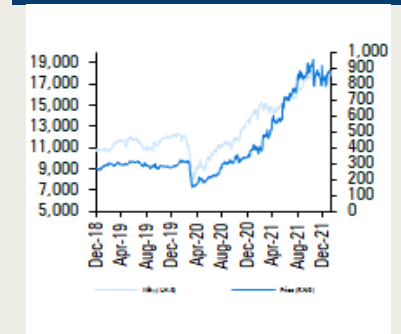
### Particulars

Particular	Amount
Market Capitalization (₹ Crore)	9,074.4
Total Debt(₹ Crore)	89.7
Cash and Investments (₹ Crore)	742.5
EV (₹ Crore)	8,421.6
52 week H/L	1030 / 354
Equity capital	10.4
Face value	1.0

### Shareholding pattern

	Mar-21	Jun-21	Sep-21	Dec-21
Promoters	28	28	28	28
FII	14	15	16	14
DII	13	13	13	14
Public	45	44	42	44

### Price Chart



### Recent event & key risks

- IT services growth continued to be strong
- Key Risk:** (i) Higher than expected employee costs ii) Higher than expected attrition

### Research Analyst

Sameer Pardikar  
sameer.pardikar@icicisecurities.com

### Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	5 year CAGR (FY16-21)	FY22E	FY23E	FY24E	3 year CAGR (FY21-24E)
Net Sales	2,961	3,743	4,228	16.9%	5,337	6,481	7,454	20.8%
EBITDA	336	373	379	14.6%	469	597	711	23.3%
EBITDA Margin (%)	11.3	10.0	9.0		8.8	9.2	9.5	
PAT	249	277	244	9.0%	333	435	518	28.5%
EPS (₹)	24.0	26.7	23.5		32.0	41.9	49.9	
P/E (x)	37	33	37		27	21	18	
RoNW (%)	32.4	41.4	26.9		32.0	35.9	36.5	
RoCE (%)	42.3	44.7	33.5		37.7	42.3	43.7	

Source: Company, ICICI Direct Research

## Key takeaways of recent quarter & conference call highlights

- IT service segment dollar revenues increased 8.1% QoQ to US\$53.4 million. Our calculation suggests organic growth was 7% QoQ while inorganic growth was 17% QoQ. Rupee revenue came in at ₹ 395 crore, 9.5% QoQ growth. IT service EBITDA margin (including other income) declined 70 bps QoQ to 28.0%
- IT services revenues were aided by the US, which reported 12.2% QoQ growth, followed by Europe and RoW, which reported 3.6%, 3.4% QoQ growth, respectively
- Product revenues grew 142% QoQ to ₹ 1,464 crore, which came on a low base of 36% QoQ decline in Q2. Compared to Q1FY22, it was up 49% QoQ. EBITDA margins (including other income) declined 300 bps QoQ to 2.5% and were the lowest in the last four quarters
- Hence, overall revenues grew 92.9% QoQ to ₹ 1,858 crore (some of it aided by favourable base) and EBITDA margin declined 628 bps QoQ to 7.9%. Overall PAT increased 7.0% QoQ to ₹ 97 crore
- The company indicated that the demand pipeline continues to be strong, especially on the cloud side. The company added 11 new logos for the quarter, out of which two were of >US\$1 million
- The company indicated that employee expenses are rising due to supply side challenges as they have to rationalise compensation. Sonata indicated that there was an impact of ₹ 3.5-4 crore in Q3 due to this. The company also indicated that they are looking to give salary hikes in Q4FY22, Q1FY23 and approximate impact would be around ₹ 7-8 crore, ~₹ 2 crore, respectively
- Sonata also indicated that in FY23, they are looking to increase fresher's hiring by 40% vs. FY22 and also indicated that out of total hiring for FY23, 15% would be freshers
- The management indicated that due to rise in costs, they are guiding for EBITDA margin of 23-25% for IT services business in FY22 while revenue growth would be in the range of 15-20% to be aided by cloud revenues
- The company indicated that the travel vertical has been partly impacted by the new variant but the management is confident of that vertical doing well from Q4FY22 onwards
- 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
- Subcontractor costs for the quarter were US\$4.5 mn, which is 8.5% of the IT services revenue
- Attrition for IT services business was at 22%. The management indicated that it has increased QoQ but they are seeing it stabilising in the next quarter
- Top five customers contribute 56% of revenues while top 20 customers contribute 71% of revenues. Net cash was at ₹ 637 crore for the quarter

Exhibit 1: Variance Analysis

	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	Comments
Revenue	1,858	1,396	33.1	963	92.9	Revenue growth in product business looks higher on low base ( 36% QoQ decline in Q2) while IT services grew by 9.5% QoQ
Employee expenses	189	165	14.4	175	8.0	
Purchase of stock-in trade & other	1,457	1,075	35.5	596	144.6	
Gross Margin	212	156	36.5	193	10.2	
Gross margin (%)	11.4	11.1	29 bps	20.0	-858 bps	
Other expenses	81	45	80.7	70	15.8	
EBITDA	132	111	18.7	123	7.0	
EBITDA Margin (%)	7.1	7.9	-86 bps	12.8	-569 bps	Margins were lower due to base effect, normalised margins impacted by increase in employee costs
Depreciation & amortisation	13	10	27.8	12	8.4	
EBIT	119	101	17.8	111	6.9	
EBIT Margin (%)	6.4	7.2	-83 bps	11.6	-516 bps	
Other income (less interest)	11	(1)		9	20.5	
PBT	130	100	30.1	120	7.8	
Tax paid	32	46	(30.4)	29	10.1	
PAT	98	54	81.6	91	7.1	

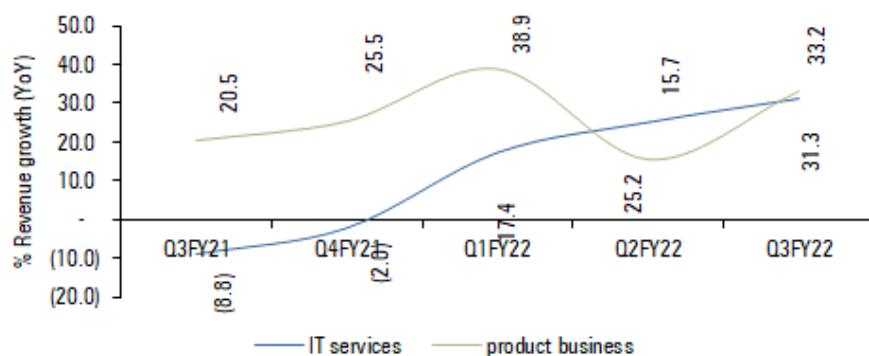
Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

	FY22E			FY23E			FY24	Comments
(₹ Crore)	Old	New	% Change	Old	New	% Change	Introduced	
Revenue	5,606	5,337	-4.8	6,724	6,481	-3.6	7,454	We realigned our numbers on 9MFY22 performance
EBITDA	520	469	-9.8	619	597	-3.6	711	
EBITDA Margin (%)	9.3	8.8	-49 bps	9.2	9.2	0 bps	9.5	We trim EBITDA numbers due to elevated employee costs in FY23 which should be normalised in FY24E
PAT	369	333	-9.8	450	435	-3.4	518	
EPS (₹)	35.5	32.0	-9.8	43	42	-3.3	50	

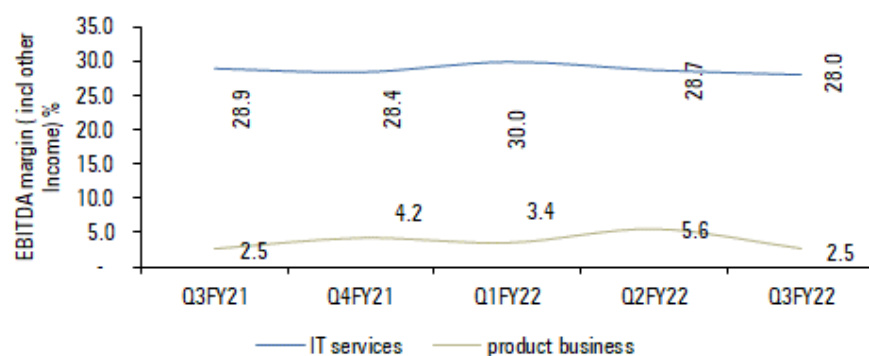
Source: Company, ICICI Direct Research

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	FY22E	FY23E	FY24E	
<b>Total Revenues</b>	<b>4,228</b>	<b>5,337</b>	<b>6,481</b>	<b>7,454</b>	
Growth (%)	13.0	26.2	21.4	15.0	
Total Operating Expenditure	3,849	4,868	5,885	6,743	
<b>EBITDA</b>	<b>379</b>	<b>469</b>	<b>597</b>	<b>711</b>	
Growth (%)	1.8	23.6	27.2	19.2	
Depreciation & Amortization	40	43	52	60	
Other Income	28	38	49	53	
Interest costs	15	14	14	14	
PBT before Exceptional Items	352	450	580	691	
Growth (%)	(7.2)	27.7	29.0	19.1	
Tax	108	117	145	173	
PAT before Exceptional Items	244	333	435	518	
Exceptional items	-	-	-	-	
PAT before MI	244	333	435	518	
Minority Int & Pft. from associates	-	-	-	-	
<b>PAT</b>	<b>244</b>	<b>333</b>	<b>435</b>	<b>518</b>	
Growth (%)	(12)	36	31	19	
EPS	23.5	32.0	41.9	49.9	
EPS (Growth %)	(12)	36	31	19	

Source: Company, ICICI Direct Research

Exhibit 6: Cash flow statement					₹ crore
(Year-end March)	FY21	FY22E	FY23E	FY24E	
Net profit before Tax	352	450	580	691	
Depreciation & Amortization	40	43	52	60	
WC changes	184	(0)	(0)	(0)	
Other non cash adju.	0	(23)	(35)	(39)	
Income taxes paid	(133)	(117)	(145)	(173)	
<b>CF from operations</b>	<b>443</b>	<b>352</b>	<b>451</b>	<b>538</b>	
Capital expenditure	(2)	(64)	(23)	(26)	
Δ in investments	(110)	-	-	-	
Other investing cash flow	9	38	49	53	
<b>CF from investing Activities</b>	<b>(102)</b>	<b>(26)</b>	<b>27</b>	<b>27</b>	
Issue of equity					
Δ in debt funds/lease liabilities	(18)	(24)	(24)	(24)	
Dividends paid	(41)	(200)	(261)	(311)	
Other financing cash flow	(3)	(14)	(14)	(14)	
<b>CF from Financial Activities</b>	<b>(62)</b>	<b>(238)</b>	<b>(299)</b>	<b>(349)</b>	
Δ in cash and cash bank balance	279	87	179	216	
Effect of exchange rate changes	2	-	-	-	
Opening cash	396	677	765	943	
<b>Closing cash</b>	<b>677</b>	<b>765</b>	<b>943</b>	<b>1,160</b>	

Source: Company, ICICI Direct Research

Exhibit 7: Balance sheet					₹ crore
(Year-end March)	FY21	FY22E	FY23E	FY24E	
Equity	10	10	10	10	
Reserves & Surplus	895	1,028	1,202	1,409	
Networth	905	1,039	1,213	1,420	
Minority Interest	-	-	-	-	
LT liabilities & provisions	102	102	102	102	
Total Debt	90	90	90	90	
<b>Source of funds</b>	<b>1,097</b>	<b>1,230</b>	<b>1,404</b>	<b>1,611</b>	
Net fixed assets	148	193	188	178	
Goodwill	176	176	176	176	
Long term loans and advances	-	-	-	-	
Other non current assets	154	187	220	249	
Loans and advances	-	-	-	-	
Inventories	-	-	-	-	
Current Investments	65	65	65	65	
Debtors	616	777	944	1,086	
Cash & Cash equivalents	677	765	943	1,160	
Other current assets	111	140	170	195	
Current liabilities	823	1,038	1,261	1,450	
Provisions	27	34	42	48	
Net current assets	620	675	820	1,008	
<b>Application of funds</b>	<b>1,097</b>	<b>1,230</b>	<b>1,404</b>	<b>1,611</b>	

Source: Company, ICICI Direct Research

Exhibit 8: Key ratios					₹ crore
(Year-end March)	FY21	FY22E	FY23E	FY24E	
<b>Per share data (₹)</b>					
EPS-diluted	23.5	32.0	41.9	49.9	
Cash per share	65.2	73.6	90.8	111.6	
BV	87.2	100.0	116.7	136.6	
DPS	14.0	19.2	25.1	29.9	
<b>Operating Ratios (%)</b>					
EBITDA Margin	9.0	8.8	9.2	9.5	
Adjusted PBT Margin	8.3	8.4	8.9	9.3	
Adjusted PAT Margin	5.8	6.2	6.7	6.9	
<b>Return Ratios (%)</b>					
RoNW	26.9	32.0	35.9	36.5	
RoCE	33.5	37.7	42.3	43.7	
RoIC	95.8	106.5	137.8	168.7	
<b>Valuation Ratios (x)</b>					
P/E	37.3	27.3	20.9	17.6	
EV / EBITDA	22.2	17.8	13.7	11.2	
Price to Book Value	10.0	8.8	7.5	6.4	
EV/Total Revenues	2.0	1.6	1.3	1.1	
MCap/Total Revenues	2.1	1.7	1.4	1.2	
<b>Turnover Ratios</b>					
Debtor days	53	53	53	53	
Creditors days	56	56	56	56	
<b>Solvency Ratios</b>					
Debt/EBITDA	0.2	0.2	0.2	0.1	
Total Debt / Equity	0.1	0.1	0.1	0.1	
Current Ratio	1.7	1.6	1.6	1.7	
Quick Ratio	1.7	1.6	1.6	1.7	
Debt / EBITDA	0.2	0.2	0.2	0.1	

Source: Company, ICICI Direct Research

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Reduce: -15% to -5%;

Sell: <-15%



Pankaj Pandey

Head – Research

[pankaj.pandey@icicisecurities.com](mailto:pankaj.pandey@icicisecurities.com)

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

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