

July 26, 2022

## Q1FY23 Result Update

Change in Estimates |  Target |  Reco

### Change in Estimates

	Current		Previous	
	FY23E	FY24E	FY23E	FY24E
<b>Rating</b>	<b>HOLD</b>		<b>ACCUMULATE</b>	
<b>Target Price</b>	<b>704</b>		<b>694</b>	
Sales (Rs. m)	70,069	75,800	67,267	77,258
% Chng.	4.2	(1.8)		
EBITDA (Rs. m)	5,651	6,433	5,440	6,543
% Chng.	3.9	(1.7)		
EPS (Rs.)	41.3	47.0	38.3	46.3
% Chng.	8.0	1.5		

### Key Financials - Consolidated

Y/e Mar	FY21	FY22	FY23E	FY24E
Sales (Rs. m)	42,281	55,534	70,069	75,880
EBITDA (Rs. m)	3,794	4,638	5,651	6,433
Margin (%)	9.0	8.4	8.1	8.5
PAT (Rs. m)	2,440	3,765	4,291	4,879
EPS (Rs.)	23.5	36.2	41.3	47.0
Gr. (%)	(11.9)	54.3	14.0	13.7
DPS (Rs.)	11.7	18.1	20.6	23.5
Yield (%)	1.6	2.4	2.8	3.1
RoE (%)	31.0	37.6	36.2	35.7
RoCE (%)	38.8	39.1	42.0	42.1
EV/Sales (x)	1.7	1.2	1.0	0.9
EV/EBITDA (x)	18.8	14.9	11.9	10.2
PE (x)	31.9	20.7	18.2	16.0
P/BV (x)	8.6	7.1	6.1	5.3

### Key Data

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52-W High / Low	Rs.1,030 / Rs.610
Sensex / Nifty	55,766 / 16,631
Market Cap	Rs.79bn/ \$ 989m
Shares Outstanding	105m
3M Avg. Daily Value	Rs.103.66m

### Shareholding Pattern (%)

Promoter's	28.17
Foreign	12.87
Domestic Institution	14.97
Public & Others	43.99
Promoter Pledge (Rs bn)	-

### Stock Performance (%)

	1M	6M	12M
Absolute	12.0	(8.2)	(4.1)
Relative	5.9	(4.7)	(8.9)

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## Headwinds on both growth and margins in IITS to persist

### Quick Pointers:

- Supply side constraints continued to limit growth in Q1 at 3.9% QoQ CC, 2% QoQ USD in IITS
- Segmental IITS EBITDA margin of 26.6% declined by -91bpsQoQ/-340bpsYoY led by supply side pressures and wage hike for senior management.

**We downgrade Sonata to HOLD (earlier Accumulate) as we believe revenue growth will continue to be modest in IITS going forward – 1) as it is likely to take 2-3 quarters to overcome supply side constraints and 2) potential impact of weak macro environment. Margins in IITS business are also expected to remain under pressure due to investments in 1) freshers, 2) sales teams, 3) development centres in Canada, Ireland, Mexico and 4) leadership team.**

**Sonata reported IITS revenue of USD 56.8 mn, 3.9% QoQ CC, 2% QoQ USD (Ple: 2.8%). Growth this quarter was impacted by supply side constraints, project specific delays and cross-currency headwinds. Net-headcount in IITS business grew just 1% QoQ. Sonata plans to on-board 600 freshers over Q2 and Q3. Growth in DPS business continued to be strong at 42% YoY (in INR terms). Sonata continues to focus on growing cloud services revenue across three major cloud providers in domestic market.**

**Our revenue estimate increase by 8.5%/1.5% in FY23/24 led by increase in DPS revenue and expected benefit from INR depreciation. We value Sonata 15x (unchanged) on FY24 EPS to arrive at changed TP of INR 704 (earlier: 694). The company is currently trading at 18x/16x on FY23/24 earnings of INR 41/47 with Revenue/EPS CAGR of 13.5%/13.8% over FY22-24E.**

- IITS revenue growth driven by digital and Platformation services:** International IT services (IITS) revenue growth was led Managed Cloud Services (5.6% QoQ USD), Modern Validation and Dev Eng Mgmt Ser (5.1% QoQ USD) and IMS (3.2% QoQ USD). Microsoft digital platform services (2.2% QoQ USD) and Microsoft Dynamic services (0.7% QoQ USD) was soft this quarter. In terms of verticals, growth was driven by ISV (4.5% QoQ USD). Management mentioned deal wins and deal pipeline continue to be healthy.
- Investments in leadership team:** Sonata is investing in senior leadership and has appointed Mr. Roshan Shetty (previously worked in Infosys) as Chief Revenue Officer and Mr. Balaji Kumar as Chief Human Resource Officer. It will continue to invest further in senior leadership, sales and pre-sales teams.
- Strong growth momentum in DPS:** Domestic Product Services (DPS) revenue grew by +42% YoY much higher than average 31% YoY growth for last four quarters. Growth was driven by multiyear cloud-based annuity deals. Share of cloud led revenue remained dipped slightly to 76%, -200bps QoQ. Annuity revenue remained stable at 76%.
- Bonus issue:** The Board approved a bonus issue of 1 (one) equity share for every 3 (three) equity shares held by the shareholders. Rs. 35 mn will be required from share premium account for implementing the bonus issue.

**Exhibit 1: Q1FY23 Result Summary**

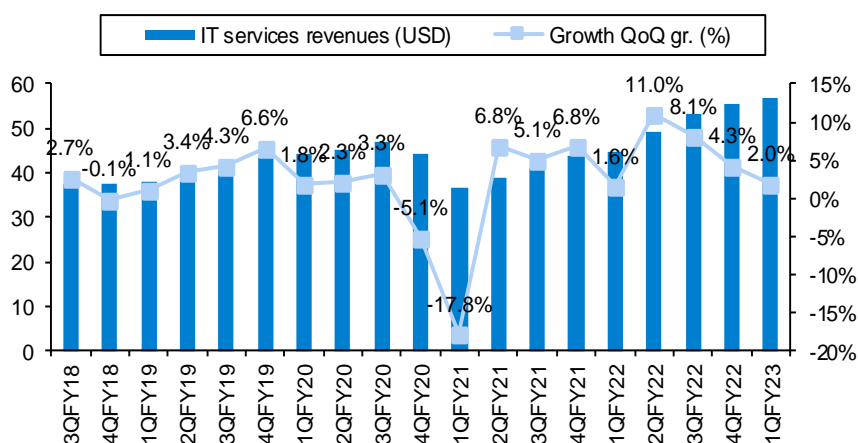
Particulars (Rs mn)	1QFY23	4QFY22	QoQ gr.	1QFY22	YoY gr.	PL Est	Var (Act vs Pl)
IT services Revenues (USD mn)	56.8	55.7	2.0%	44.5	27.6%	57.3	-0.8%
IT services Revenues (INR mn)	4368	4139	5.5%	3239	34.9%	4351	0.4%
Domestic Products (USD mn)	175	141	23.5%	130	34.4%	148	18.0%
Domestic Products (INR mn)	13431	10510	27.8%	9462	41.9%	11246	19.4%
<b>Total consol Revenues(INR mn)</b>	<b>17789</b>	<b>14636</b>	<b>21.5%</b>	<b>12685</b>	<b>40.2%</b>	<b>15597</b>	<b>14.1%</b>
<b>Consol EBITDA</b>	<b>1416</b>	<b>1081</b>	<b>31.0%</b>	<b>1010</b>	<b>40.3%</b>	<b>1208</b>	<b>17.2%</b>
<i>Consolidated EBITDA Margins (%)</i>	<i>8.0%</i>	<i>7.4%</i>	<i>58 bps</i>	<i>8.0%</i>	<i>0 bps</i>	<i>7.7%</i>	<i>22 bps</i>
PAT	1078	1009	6.8%	867	24.2%	879	22.6%
EPS	10.4	9.7	6.9%	8.3	24.3%	8.5	22.7%

Source: Company, PL

**Exhibit 2: Change in Estimates**

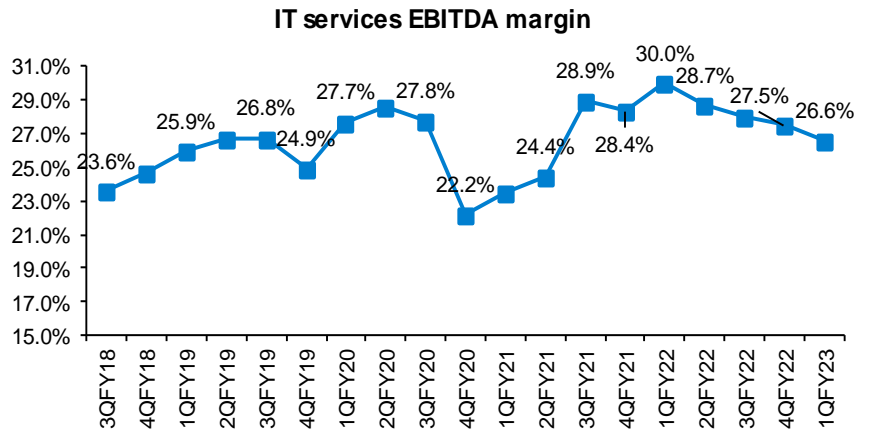
	FY23E	FY24E
<b>USD revenues (US\$ m)</b>		
- New	910	973
- Old	885	1,003
<i>Change (%)</i>	<i>2.9%</i>	<i>-3.0%</i>
<b>EBIT Margin</b>		
- New	7.3%	7.8%
- Old	7.5%	8.0%
<i>Change (%)</i>	<i>-17 bps</i>	<i>-16 bps</i>
<b>Recurring EPS - Fully diluted (Rs)</b>		
- New	41.3	47.0
- Old	38.2	46.3
<i>Change (%)</i>	<i>8.0%</i>	<i>1.5%</i>

Source: PL

**Exhibit 3: Moderation in IT services growth momentum**


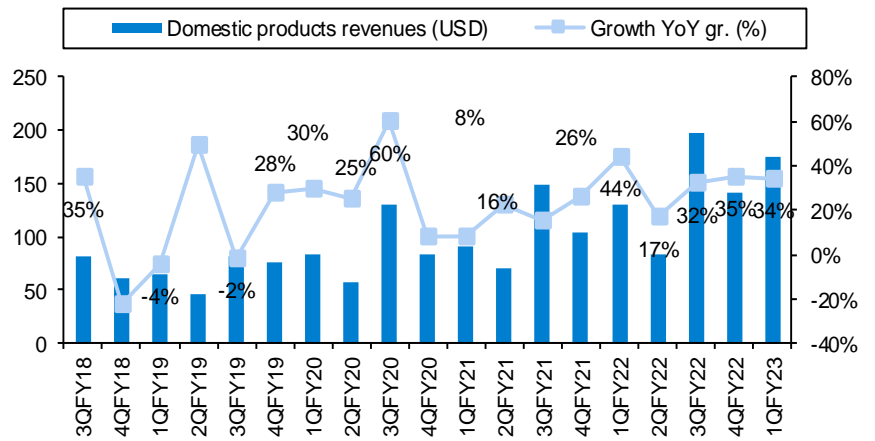
Source: Company, PL

**Exhibit 4: Down trend in IITS segmental EBITDA margins**



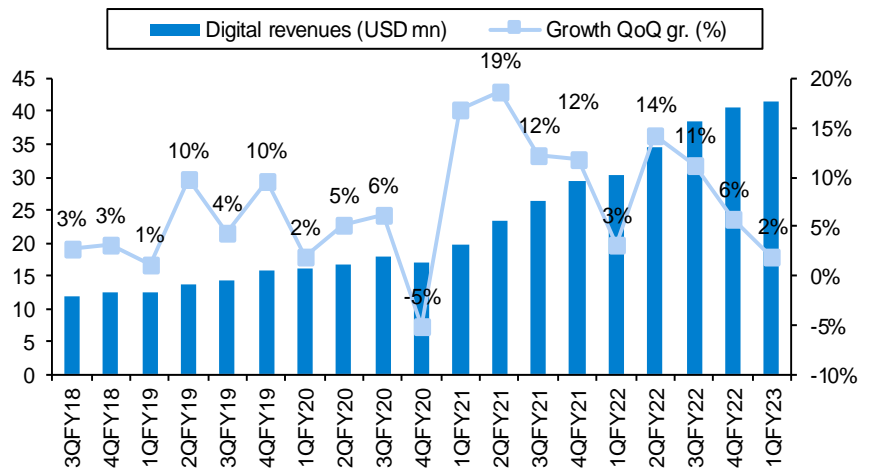
Source: Company, PL

**Exhibit 5: Continued strong growth in domestic products business**



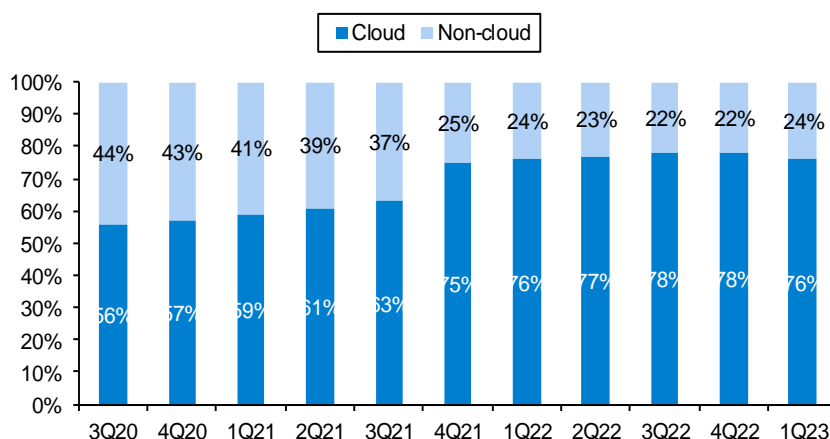
Source: Company, PL

**Exhibit 6: Moderation in IITS digital revenue growth**



Source: Company, PL

Exhibit 7: Slight dip in share of cloud in DPS revenues



Source: Company, PL

Exhibit 8: IITS vertical wise revenues

USD in Mn	1QFY23	4QFY22	QoQ gr.	1QFY22	YoY gr.
ISV	18.9	18.0	4.5%	14.6	29.2%
Travel	5.2	5.2	-1%	4.6	13%
Others	6.6	6.9	-3.8%	7.9	-17%
Distribution & Manufacturing	11.8	11.5	2%	9.3	26%
Retail (Essential)	5.7	5.6	2%	4.0	40%
Retail (Non-essential)	2.3	2.3	0%	0.9	162%
Commodity business and Service industry	4.1	4.1	1%	3.1	33%
Healthcare	2.2	2.0	10%	-	NA
<b>Total</b>	<b>56.8</b>	<b>55.7</b>	<b>2%</b>	<b>44.5</b>	<b>28%</b>
<b>-as a % of sales</b>					
ISV	33%	32%	80 bps	33%	40 bps
Travel	9%	9%	-30 bps	10%	-120 bps
Others	12%	12%	-70 bps	18%	-620 bps
Distribution & Manufacturing	21%	21%	10 bps	21%	-20 bps
Retail (Essential)	10%	10%	0 bps	9%	90 bps
Retail (Non-essential)	4%	4%	-10 bps	2%	210 bps
Commodity business and Service industry	7%	7%	-10 bps	7%	30 bps
Healthcare	4%	3.6%	30 bps	0	390 bps

Source: Company, PL

**Exhibit 9: International IT business service line wise revenues**

USD in Mn	1QFY23	4QFY22	QoQ gr.	1QFY22	YoY gr.
Data & Analytics	8.0	7.80	3%	5.83	37%
Managed Cloud Services	6.9	6.52	5%	4.32	59%
IMS & Cloud	2.6	2.45	4%	2.00	28%
Microsoft Digital Platformation Services	11.7	11.47	2%	9.12	28%
Microsoft Dynamic Services	17.1	16.99	1%	13.04	31%
Modern Validation and Dev Eng Mgmt Ser	4.4	4.23	5%	4.36	2%
Open Source Digital Platform Services	6.1	6.13	-1%	5.16	18%
Other ERP Services	0.1	0.06	2%	0.36	-84%
Other Services	0.0	0.06	-100%	0.31	-100%
<b>Total</b>	<b>56.8</b>	<b>55.7</b>	<b>2%</b>	<b>44.5</b>	<b>28%</b>
<b>-as a % of sales</b>					
Data & Analytics	14%	14%	10 bps	13%	100 bps
Managed Cloud Services	12%	12%	40 bps	10%	240 bps
IMS & Cloud	5%	4%	10 bps	5%	0 bps
Microsoft Digital Platformation Services	21%	21%	0 bps	21%	10 bps
Microsoft Dynamic Services	30%	31%	-40 bps	29%	80 bps
Modern Validation and Dev Eng Mgmt Ser	8%	8%	20 bps	10%	-200 bps
Open Source Digital Platform Services	11%	11%	-30 bps	12%	-90 bps
Other ERP Services	0.1%	0.1%	0 bps	1%	-70 bps
Other Services	0.0%	0.1%	-10 bps	1%	-70 bps

Source: Company, PL

**Exhibit 10: Low headcount addition, Stable DSO**

Headcount	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20	1QFY21	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23
IT Services	3886	4000	4036	4028	4066	3966	3744	3851	3956	4101	4693	4868	4998	5034
Products	156	150	143	149	145	145	141	146	146	149	157	157	160	174
<b>Total</b>	<b>4042</b>	<b>4150</b>	<b>4179</b>	<b>4177</b>	<b>4211</b>	<b>4111</b>	<b>3885</b>	<b>3997</b>	<b>4102</b>	<b>4250</b>	<b>4850</b>	<b>5025</b>	<b>5158</b>	<b>5208</b>
<b>DSO Days</b>														
International Services	41	41	44	42	47	57	47	36	36	37	38	43	40	41
Domestic Products	47	33	43	47	52	59	63	57	49	39	32	33	38	38
<b>Total DSO Days</b>	<b>44</b>	<b>37</b>	<b>44</b>	<b>45</b>	<b>50</b>	<b>58</b>	<b>55</b>	<b>47</b>	<b>43</b>	<b>38</b>	<b>35</b>	<b>38</b>	<b>39</b>	<b>40</b>

Source: Company, PL

## Financials

### Income Statement (Rs m)

Y/e Mar	FY21	FY22	FY23E	FY24E
<b>Net Revenues</b>	<b>42,281</b>	<b>55,534</b>	<b>70,069</b>	<b>75,880</b>
YoY gr. (%)	13.0	31.3	26.2	8.3
Employee Cost	29,916	40,231	51,420	55,499
Gross Profit	12,365	15,303	18,649	20,381
Margin (%)	29.2	27.6	26.6	26.9
SG&A Expenses	-	-	-	-
Other Expenses	2,317	3,295	4,006	4,173
<b>EBITDA</b>	<b>3,794</b>	<b>4,638</b>	<b>5,651</b>	<b>6,433</b>
YoY gr. (%)	1.8	22.3	21.8	13.8
Margin (%)	9.0	8.4	8.1	8.5
Depreciation and Amortization	396	473	519	519
<b>EBIT</b>	<b>3,398</b>	<b>4,165</b>	<b>5,133</b>	<b>5,915</b>
Margin (%)	8.0	7.5	7.3	7.8
Net Interest	154	180	172	180
Other Income	277	1,020	728	728
<b>Profit Before Tax</b>	<b>3,522</b>	<b>5,004</b>	<b>5,688</b>	<b>6,462</b>
Margin (%)	8.3	9.0	8.1	8.5
Total Tax	1,082	1,239	1,397	1,583
Effective tax rate (%)	30.7	24.8	24.6	24.5
<b>Profit after tax</b>	<b>2,440</b>	<b>3,765</b>	<b>4,291</b>	<b>4,879</b>
Minority interest	-	-	-	-
Share Profit from Associate	-	-	-	-
<b>Adjusted PAT</b>	<b>2,440</b>	<b>3,765</b>	<b>4,291</b>	<b>4,879</b>
YoY gr. (%)	(11.9)	54.3	14.0	13.7
Margin (%)	5.8	6.8	6.1	6.4
Extra Ord. Income / (Exp)	-	-	-	-
<b>Reported PAT</b>	<b>2,440</b>	<b>3,765</b>	<b>4,291</b>	<b>4,879</b>
YoY gr. (%)	(11.9)	54.3	14.0	13.7
Margin (%)	5.8	6.8	6.1	6.4
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	2,440	3,765	4,291	4,879
<b>Equity Shares O/s (m)</b>	<b>104</b>	<b>104</b>	<b>104</b>	<b>104</b>
<b>EPS (Rs)</b>	<b>23.5</b>	<b>36.2</b>	<b>41.3</b>	<b>47.0</b>

Source: Company Data, PL Research

### Balance Sheet Abstract (Rs m)

Y/e Mar	FY21	FY22	FY23E	FY24E
<b>Non-Current Assets</b>				
<b>Gross Block</b>	<b>1,477</b>	<b>2,062</b>	<b>2,162</b>	<b>2,262</b>
Tangibles	1,000	1,233	1,313	1,393
Intangibles	477	829	849	869
<b>Acc: Dep / Amortization</b>	-	-	-	-
Tangibles	-	-	-	-
Intangibles	-	-	-	-
<b>Net fixed assets</b>	<b>1,477</b>	<b>2,062</b>	<b>2,162</b>	<b>2,262</b>
Tangibles	1,000	1,233	1,313	1,393
Intangibles	477	829	849	869
Capital Work In Progress	1	0	0	0
Goodwill	1,759	2,207	2,207	2,207
Non-Current Investments	301	518	618	718
Net Deferred tax assets	189	261	261	261
Other Non-Current Assets	1,050	1,101	1,101	1,101
<b>Current Assets</b>				
Investments	654	1,448	1,498	1,548
Inventories	-	-	-	-
Trade receivables	6,158	8,926	11,262	12,196
Cash & Bank Balance	6,771	7,696	9,587	11,458
Other Current Assets	383	296	296	296
<b>Total Assets</b>	<b>19,469</b>	<b>25,552</b>	<b>30,028</b>	<b>33,084</b>
<b>Equity</b>				
Equity Share Capital	104	104	104	104
Other Equity	8,951	10,888	12,604	14,556
<b>Total Networkth</b>	<b>9,055</b>	<b>10,992</b>	<b>12,708</b>	<b>14,660</b>
<b>Non-Current Liabilities</b>				
Long Term borrowings	-	-	-	-
Provisions	-	-	-	-
Other non current liabilities	-	-	-	-
<b>Current Liabilities</b>				
ST Debt / Current of LT Debt	897	380	380	380
Trade payables	6,510	10,547	13,308	14,412
Other current liabilities	1,987	1,973	1,973	1,973
<b>Total Equity &amp; Liabilities</b>	<b>19,469</b>	<b>25,551</b>	<b>30,028</b>	<b>33,084</b>

Source: Company Data, PL Research

**Cash Flow (Rs m)**

Y/e Mar	FY21	FY22	FY23E	FY24E
PBT	3,521	5,004	5,688	6,462
Add. Depreciation	396	473	519	519
Add. Interest	146	171	172	180
Less Financial Other Income	277	1,020	728	728
Add. Other	(145)	(320)	(728)	(728)
Op. profit before WC changes	3,919	5,329	5,651	6,433
Net Changes-WC	1,840	1,004	424	170
Direct tax	(1,332)	(1,559)	(1,397)	(1,583)
<b>Net cash from Op. activities</b>	<b>4,426</b>	<b>4,774</b>	<b>4,679</b>	<b>5,020</b>
Capital expenditures	(523)	(594)	(100)	(100)
Interest / Dividend Income	95	167	728	728
Others	(713)	(762)	(150)	(150)
<b>Net Cash from Inv. activities</b>	<b>(1,141)</b>	<b>(1,189)</b>	<b>478</b>	<b>478</b>
Issue of share cap. / premium	-	-	-	-
Debt changes	(181)	(809)	-	-
Dividend paid	(407)	(1,869)	(2,575)	(2,927)
Interest paid	(34)	(27)	(172)	(180)
Others	(611)	-	-	-
<b>Net cash from Fin. activities</b>	<b>(1,232)</b>	<b>(2,706)</b>	<b>(2,747)</b>	<b>(3,107)</b>
<b>Net change in cash</b>	<b>2,054</b>	<b>878</b>	<b>2,410</b>	<b>2,390</b>
Free Cash Flow	3,903	4,180	4,579	4,920

Source: Company Data, PL Research

**Quarterly Financials (Rs m)**

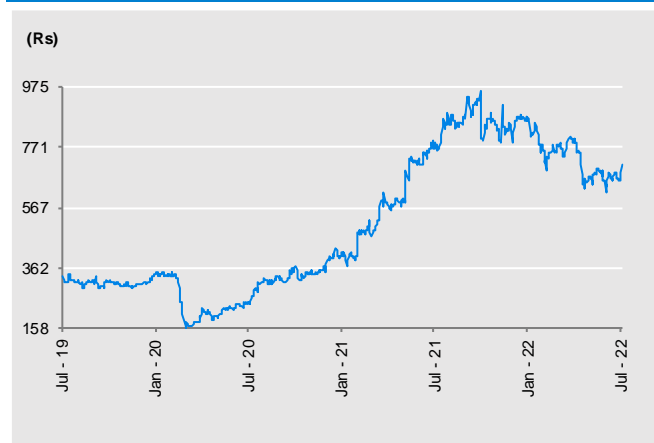
Y/e Mar	Q2FY22	Q3FY22	Q4FY22	Q1FY23
<b>Net Revenue</b>	<b>9,632</b>	<b>18,580</b>	<b>14,636</b>	<b>17,789</b>
YoY gr. (%)	19.8	33.1	36.1	40.2
Raw Material Expenses	5,956	14,568	10,361	13,207
Gross Profit	3,676	4,012	4,276	4,582
Margin (%)	38.2	21.6	29.2	25.8
<b>EBITDA</b>	<b>1,231</b>	<b>1,317</b>	<b>1,081</b>	<b>1,416</b>
YoY gr. (%)	41.0	18.7	4.9	40.3
Margin (%)	12.8	7.1	7.4	8.0
Depreciation / Depletion	117	127	131	130
<b>EBIT</b>	<b>1,114</b>	<b>1,190</b>	<b>950</b>	<b>1,287</b>
Margin (%)	11.6	6.4	6.5	7.2
Net Interest	47	47	42	37
Other Income	135	153	450	182
<b>Profit before Tax</b>	<b>1,202</b>	<b>1,296</b>	<b>1,358</b>	<b>1,431</b>
Margin (%)	12.5	7.0	9.3	8.0
Total Tax	290	319	349	354
Effective tax rate (%)	24.1	24.6	25.7	24.7
<b>Profit after Tax</b>	<b>912</b>	<b>977</b>	<b>1,009</b>	<b>1,078</b>
Minority interest	-	-	-	-
Share Profit from Associates	-	-	-	-
<b>Adjusted PAT</b>	<b>912</b>	<b>977</b>	<b>1,009</b>	<b>1,078</b>
YoY gr. (%)	59.4	81.4	21.5	24.2
Margin (%)	9.5	5.3	6.9	6.1
Extra Ord. Income / (Exp)	-	-	-	-
<b>Reported PAT</b>	<b>912</b>	<b>977</b>	<b>1,009</b>	<b>1,078</b>
YoY gr. (%)	59.4	81.4	21.5	24.2
Margin (%)	9.5	5.3	6.9	6.1
Other Comprehensive Income	-	-	-	-
<b>Total Comprehensive Income</b>	<b>912</b>	<b>977</b>	<b>1,009</b>	<b>1,078</b>
Avg. Shares O/s (m)	104	104	104	104
<b>EPS (Rs)</b>	<b>8.8</b>	<b>9.4</b>	<b>9.7</b>	<b>10.4</b>

Source: Company Data, PL Research

**Key Financial Metrics**

Y/e Mar	FY21	FY22	FY23E	FY24E
<b>Per Share(Rs)</b>				
EPS	23.5	36.2	41.3	47.0
CEPS	27.3	40.8	46.3	52.0
BVPS	87.1	105.8	122.3	141.1
FCF	37.6	40.2	44.1	47.4
DPS	11.7	18.1	20.6	23.5
<b>Return Ratio(%)</b>				
RoCE	38.8	39.1	42.0	42.1
ROIC	93.2	140.6	193.2	219.5
RoE	31.0	37.6	36.2	35.7
<b>Balance Sheet</b>				
Net Debt : Equity (x)	(0.7)	(0.8)	(0.8)	(0.9)
Debtor (Days)	53	59	59	59
<b>Valuation(x)</b>				
PER	31.9	20.7	18.2	16.0
P/B	8.6	7.1	6.1	5.3
P/CEPS	27.3	40.8	46.3	52.0
EV/EBITDA	18.8	14.9	11.9	10.2
EV/Sales	1.7	1.2	1.0	0.9
Dividend Yield (%)	1.6	2.4	2.8	3.1

Source: Company Data, PL Research

**Price Chart**
**Recommendation History**


No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	04-Jul-22	Accumulate	694	655
2	30-Apr-22	Accumulate	833	748
3	05-Apr-22	BUY	1,065	765
4	18-Jan-22	BUY	1,011	858
5	04-Jan-22	BUY	994	869
6	20-Oct-21	BUY	994	918
7	05-Oct-21	BUY	936	883
8	07-Aug-21	BUY	927	842
9	06-Aug-21	BUY	834	842

**Analyst Coverage Universe**

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Affle (India)	BUY	1,342	1,009
2	Coforge	BUY	4,031	3,726
3	Cyient	Hold	776	799
4	HCL Technologies	Hold	982	928
5	Infosys	Accumulate	1,630	1,506
6	L&T Technology Services	Hold	3,184	3,093
7	Larsen & Toubro Infotech	Accumulate	4,280	3,874
8	Mindtree	Accumulate	3,131	2,901
9	Mphasis	Hold	2,382	2,276
10	Persistent Systems	Hold	3,500	3,633
11	Redington (India)	BUY	162	127
12	Sonata Software	Accumulate	694	655
13	Tata Consultancy Services	Accumulate	3,607	3,265
14	TeamLease Services	Accumulate	3,642	3,300
15	Tech Mahindra	Hold	1,042	1,017
16	Wipro	Hold	418	412
17	Zensar Technologies	Hold	279	270

**PL's Recommendation Nomenclature (Absolute Performance)**

<b>Buy</b>	: > 15%
<b>Accumulate</b>	: 5% to 15%
<b>Hold</b>	: +5% to -5%
<b>Reduce</b>	: -5% to -15%
<b>Sell</b>	: < -15%
<b>Not Rated (NR)</b>	: No specific call on the stock
<b>Under Review (UR)</b>	: Rating likely to change shortly



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