

# Sonata Software

## Changing orbit

Sonata Software announced its largest acquisition of Quant Systems, which involves a cash payout of USD 65mn and an earn-out of USD 95mn payable over the next two years. The deal is valued at P/S of 4.3x (1.8x excluding earn-out), which we believe is on the higher side but it is justified by Quant's (1) high growth profile (3Y organic CAGR of 113%); (2) superior margin of >25%; (3) excellent partnership network (Salesforce, AWS, Adobe, Snowflakes, etc.); and (4) domain capabilities in the BFSI and healthcare verticals. The acquisition is in line with management's target to double IITS revenue (hit half a billion) in four years (organic CAGR of ~15%), supported by higher investments in new verticals and geographies and expanding partnerships beyond Microsoft. The acquisition will also add two new clients to the top-5 list of Sonata's and will help expand its presence in the BFSI and healthcare verticals. We like Sonata based on (1) growth acceleration in IITS; (2) strong Microsoft relationship; (3) new CEO focus on improving sales engine; (4) continued growth in DPS; and (5) high RoE of >35%. The deal is EPS accretive and will boost FY24/25E EPS by +2/6% respectively. We maintain our BUY rating and increase our TP to INR 775, based on 18x Dec-24E EPS.

**Details of the transaction:** The acquisition is expected to close in March 2023 (second half) and the full impact will be visible in Q1FY24E. The total acquisition cost of USD 160mn includes an earn-out of USD 95mn payable in three tranches. The first earn-out component of USD 55mn will be paid on achieving predefined revenue and profitability targets for Mar-24E and the remaining (USD 20+20mn) will be based on the Mar-25E performance. The deal will be funded by internal accruals and short-term debt. The net cash position stands at INR 6.90bn.

**Quant Systems:** Quant was founded in 2008 by Srinivas Veeravelli, who is based in Texas. Quant has expertise in enterprise data analytics, cloud modernisation, cyber security, and data privacy. It has partnerships with top hyper scalers like AWS and GCP and major tech companies like Adobe, Snowflakes, Mulesoft, Collibra, Workday, etc. It also has differentiated IPs for Salesforce (workbox.io) and Chatbot (Lisa) technologies. Quant clocked a revenue of USD 37mn in CY22 and has grown at an organic CAGR of ~115% over CY20-22. It has ~300 employees (onsite ~125) across India, Mexico and Costa Rica. The revenue/employee is impressive at ~USD 123K due to its IP and consulting capabilities resulting in higher billing rates.

**Financial impact:** We have assumed ~25% YoY revenue growth for Quant Systems with a margin of 25%. The IITS and consolidated revenue will increase by +17/19% and +4/5% for FY24/25E respectively. The IITS and consolidated EBITDA margin will expand by 55/36bps and 71/75bps for FY24/25E. The intangibles will be amortised over eight years and depreciation will increase by 87/76%, leading to +6/8% EBIT and +2/6% PAT increase for FY24/25E. We expect revenue/EPS CAGR of 23/21% over FY23-25E.

### Financial Summary

YE March (INR bn)	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
IITS Revenue (USD mn)	144	161	181	160	203	238	315	361
Net Sales	24.54	29.61	37.43	42.28	55.53	73.10	91.08	108.29
EBIT	2.19	3.23	3.36	3.40	4.16	5.51	6.71	8.40
APAT	1.91	2.47	2.77	2.44	3.76	4.37	5.07	6.36
Diluted EPS (INR)	13.6	17.6	19.8	17.4	26.8	31.2	36.2	45.4
P/E (x)	51.7	40.2	35.7	40.6	26.3	22.6	19.5	15.6
EV / EBITDA (x)	41.2	29.0	26.2	24.9	20.2	16.8	12.4	9.7
RoE (%)	30.8	34.7	38.5	31.0	37.6	36.1	35.0	36.7

Source: Company, HSIE Research

**BUY**

CMP (as on 24 Feb 2023)	INR 706
Target Price	INR 775
NIFTY	17,466

KEY CHANGES	OLD	NEW
Rating	BUY	BUY
Price Target	INR 705	INR 775
EPS %	FY24E +2.3	FY25E +5.9

### KEY STOCK DATA

Bloomberg code	SSOF IN
No. of Shares (mn)	140
MCap (INR bn) / (\$ mn)	99/1,197
6m avg traded value (INR mn)	83
52 Week high / low	INR 753/458

### STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	33.1	33.6	35.4
Relative (%)	37.6	33.0	26.4

### SHAREHOLDING PATTERN (%)

	Sep -22	Dec-22
Promoters	28.17	28.17
FIs & Local MFs	13.98	13.80
FPIs	12.96	12.85
Public & Others	44.89	44.09
Pledged Shares	0.00	0.00

Source : BSE

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**Exhibit 1: Impact of Quant Systems acquisition**

Sonata Software (INR bn)	Pre		Post		Change (%/bps)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Revenue IITS (USD mn)	269	304	315	361	17%	19%
IITS Revenue	22.31	25.51	26.15	30.37	17%	19%
DPS Revenue	64.93	77.92	64.93	77.92	0%	0%
<b>Total Revenue</b>	<b>87.24</b>	<b>103.43</b>	<b>91.08</b>	<b>108.29</b>	<b>4%</b>	<b>5%</b>
IITS EBITDA	4.75	5.81	5.71	7.02	20%	21%
DPS EBITDA	2.27	2.75	2.27	2.75	0%	0%
<b>EBITDA</b>	<b>7.02</b>	<b>8.56</b>	<b>7.98</b>	<b>9.77</b>	<b>14%</b>	<b>14%</b>
IITS EBITDA %	21.3%	22.8%	21.8%	23.1%	55bps	36bps
DPS EBITDA %	3.5%	3.5%	3.5%	3.5%	-	-
<b>Consolidated EBITDA%</b>	<b>8.0%</b>	<b>8.3%</b>	<b>8.8%</b>	<b>9.0%</b>	<b>71bps</b>	<b>75bps</b>
Depreciation & amortisation	0.68	0.78	1.27	1.37	87%	76%
% of revenue	0.8%	0.8%	1.4%	1.3%		
<b>EBIT</b>	<b>6.34</b>	<b>7.78</b>	<b>6.71</b>	<b>8.40</b>	<b>6%</b>	<b>8%</b>
EBIT%	7.3%	7.5%	7.4%	7.8%	10bps	24bps
Other income	0.55	0.56	0.33	0.409	-39%	-27%
Interest	0.24	0.27	0.24	0.27	0%	0%
PBT	6.65	8.07	6.81	8.54	2%	6%
PBT %	7.6%	7.8%	7.5%	7.9%	(15)bps	9bps
<b>PAT</b>	<b>4.96</b>	<b>6.01</b>	<b>5.07</b>	<b>6.36</b>	<b>2%</b>	<b>6%</b>
PAT %	5.7%	5.8%	5.6%	5.9%	(11)bps	6bps
<b>EPS (INR)</b>	<b>35.3</b>	<b>42.9</b>	<b>36.2</b>	<b>45.4</b>	<b>2%</b>	<b>6%</b>

**Exhibit 2: Change in estimates (consolidated)**

YE March (INR bn)	FY24E Old	FY24E Revised	Change %	FY25E Old	FY25E Revised	Change %
IITS Revenue (USD mn)	268.8	315.1	17.2	303.7	361.5	19.0
Revenue	87.24	91.08	4.4	103.43	108.29	4.7
EBIT	6.34	6.71	5.8	7.78	8.40	8.0
EBIT margin (%)	7.3	7.4	10bps	7.5	7.8	24bps
APAT	5.0	5.1	2.3	6.0	6.4	5.9
EPS (INR)	35.3	36.2	2.3	42.9	45.4	5.9

**Exhibit 3: Change in estimates (IITS only)**

YE March (INR bn)	FY24E Old	FY24E Revised	Change %	FY25E Old	FY25E Revised	Change %
Revenue (USD mn)	269	315	17.2	304	361	19.0
Revenue	22.31	26.15	17.2	25.51	30.36	19.0
EBITDA	4.75	5.71	20.2	5.81	7.02	20.9
EBITDA margin (%)	21.3	21.8	54bps	22.8	23.1	36bps

Source: HSIE Research

**Exhibit 4: Sonata Software acquisition history – Quant Systems is the largest acquisition**

Date	Acquired Company	Area of Operation	Purchase Consideration	Revenue	Enterprise value (P/S)
25-Aug-14	Rezopia	Cloud based SAAS Travel solution	NA	NA	NA
05-Aug-15	Halosys	Cloud Enabled Enterprise Mobility Enablement Platform	USD 5mn	USD 9mn	0.6
29-Oct-15	IBIS Inc	Supply Chain software and service provider	USD 14mn	NA	NA
06-Dec-18	Scalable Data Systems Pty Ltd	Microsoft Dynamics	AUD 5.5mn	AUD 5mn	1.1
13-Dec-18	Sopris Systems, LLC.	Microsoft Dynamics	USD 7mn	USD 7mn	1.0
23-Mar-19	Retail 10x (10% stake)	Data platforms, products and services to Retail	USD 0.8mn (10% stake)	NA	NA
04-Mar-20	GAPbusters Limited (GBW)	ERP, CRM	USD 4.8mn including USD 0.5mn deferred consideration	GBP 8mn	0.6
21-May-20	Treeni Sustainability Solutions Inc (24%)	IT Services	USD 1mn	NA	NA
28-Jul-21	Encore IT Services Solutions Private Limited	user experience, data insights, and real time collaboration services	USD 1.2mn	USD 5mn	0.3
28-Jul-21	Encore Software Services, Inc	user experience, data insights, and real time collaboration services	USD 14.62mn	USD 16mn	0.9
22-Feb-23	Quant Systems	Enterprise Data & Cloud Migration	USD 160mn including deferred consideration of USD 95mn	USD 37mn	4.3

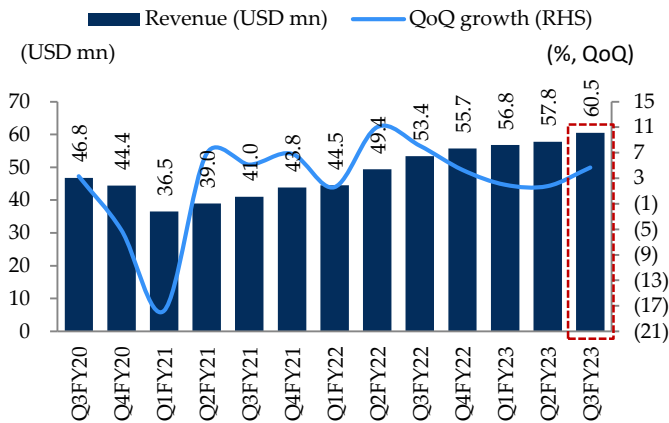
Source: Company, HSIE Research

**Exhibit 5: Acquisition history of other small cap companies – Cyient and Mastek have done large acquisitions in 2022**

Date	Company	Acquired Company	Area of Operation	Revenue	Purchase Consideration	Enterprise value (P/S)
07-Nov-16	Cyient	Blom Aerofilms	Ground Surveying & Digital mapping	GBP 6mn	NA	NA
10-Sep-17	Cyient	B&F Design Inc	Aerospace & Defence	USD 8.5mn	USD 5.5mn	0.6
24-Jan-17	Cyient	Certon Software	Engineering Services	NA	USD 7.5mn	NA
26-Apr-18	Cyient	AnSem NV	semiconductor company	USD 10mn	USD 17mn	0.6
31-Aug-20	Cyient	Integrated Global Partners Pty Limited (IG)	Technology Consulting (Digital capability in Energy & Mining Industry)	AUD 14.8mn	AUD 11.6mn	0.8
27-Jul-21	Cyient	Workforce Delta	Digital workforce management	USD 2.9mn	USD 2.7mn	0.9
25-Apr-22	Cyient	Sentiec Oyj/Citec	Plant & Product engineering services company	EUR 80mn	EUR 94mn	1.2
28-Apr-22	Cyient	Grit Consulting	Mining, Utilities, Asset Intensive industries	USD 18.1mn	USD 37mn	2.0
06-Jun-22	Cyient	Celfinet	Wireless Communication	EUR 17.1mn	EUR 41mn	2.4
02-Nov-16	Zensar	Foolproof	Digital Services	USD 8mn	NA	NA
30-Mar-17	Zensar	Keystone Logic Solutions	ITES	INR 826mn	INR 1324mn	1.6
21-Mar-18	Zensar	Cynosure Interface Solution	IT/ITES	INR 750mn	INR 130mn	1.7
27-Jul-18	Zensar	Indigo Slate	Digital marketing	NA	NA	NA
15-May-21	Zensar	M3bi, LLC	IT & ITES	USD 26.75mn	USD 44mn	1.6
05-Jan-17	Mastek	TAISTech	Digital Commerce Service	USD 30mn	USD 25mn	0.8
08-Feb-20	Mastek	Evosys Group	Oracle services and ERP	USD 70mn	USD 88mn	1.3
18-Jul-22	Mastek	Metasoftech Solutions LLC	Salesforce consulting partner	USD 29.4mn	USD 76.6mn	2.6

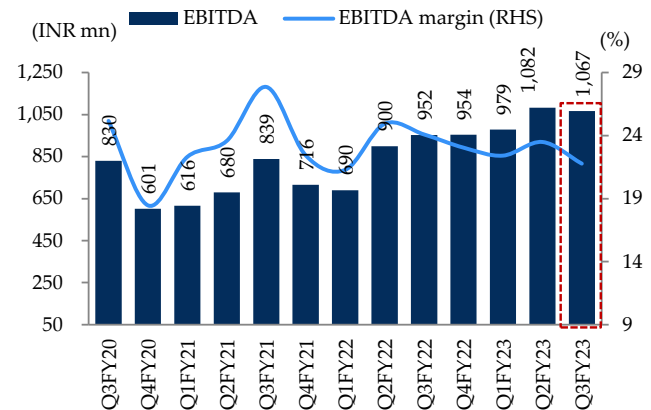
Source: Company, HSIE Research

**Exhibit 6: IITS Revenue – 8qtr CQGR of 5%**



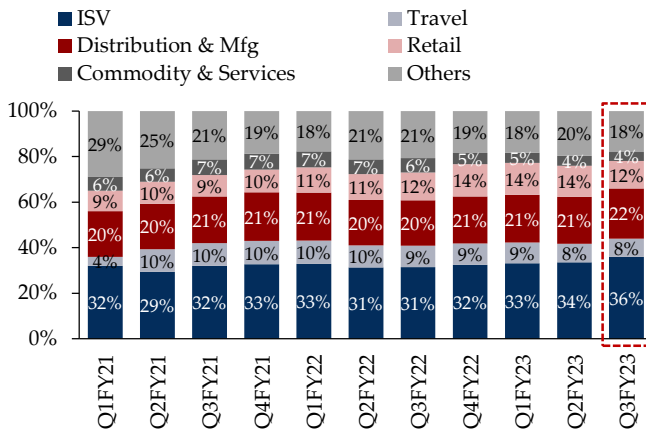
Source: Company, HSIE Research

**Exhibit 7: IITS EBITDA trend – 8qtr CQGR of 6%**



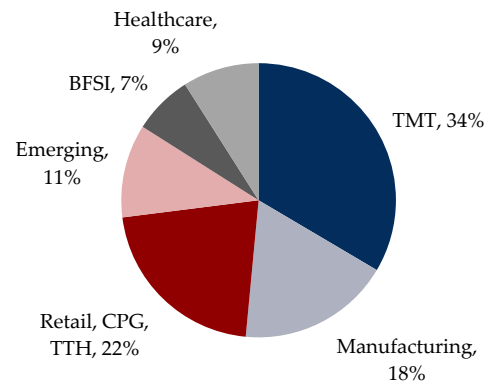
Source: Company, HSIE Research

**Exhibit 8: Vertical mix – ISV/retail clocked 8qtr CQGR of 7/8% driving IITS growth**



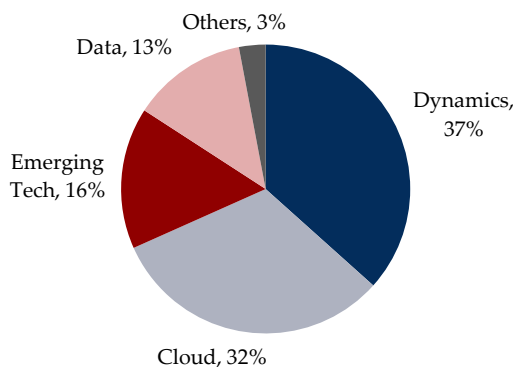
Source: Company, HSIE Research, others included Healthcare 4%, Logistics 3% & others 11% in Q3FY23

**Exhibit 9: New vertical mix – Quant systems will enhance BFSI and healthcare presence**



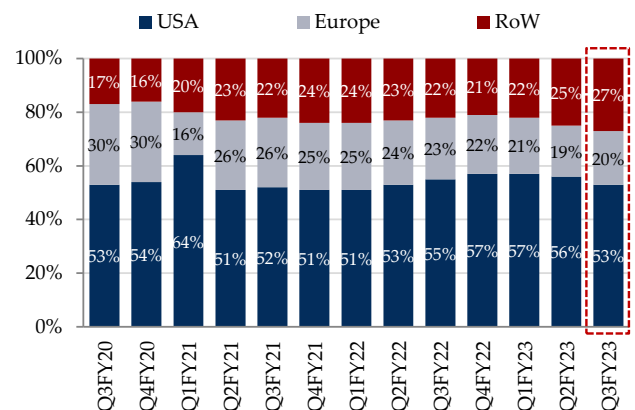
Source: Company, HSIE Research

**Exhibit 10: Revenue by top GTMs (Q3FY23)**



Source: Company, HSIE Research

**Exhibit 11: Geography mix**



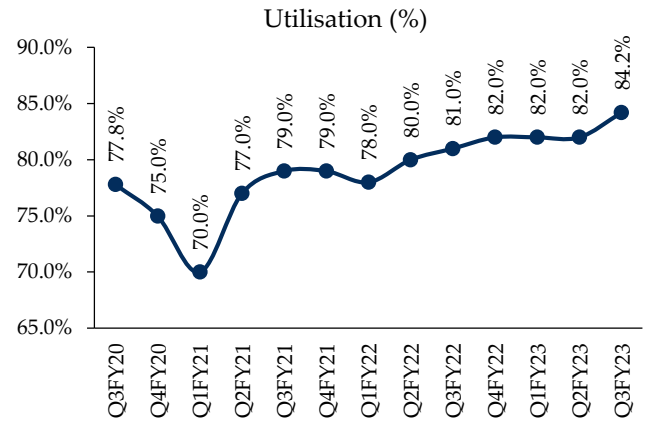
Source: Company, HSIE Research

**Exhibit 12: New customers added – highest customer addition in Q3**



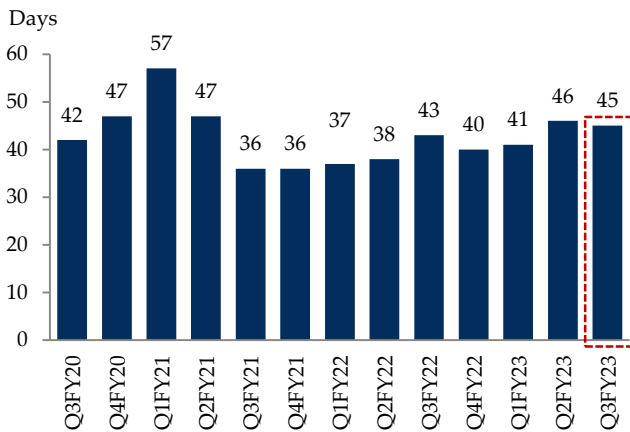
Source: Company, HSIE Research

**Exhibit 13: Utilisation trend (%)**



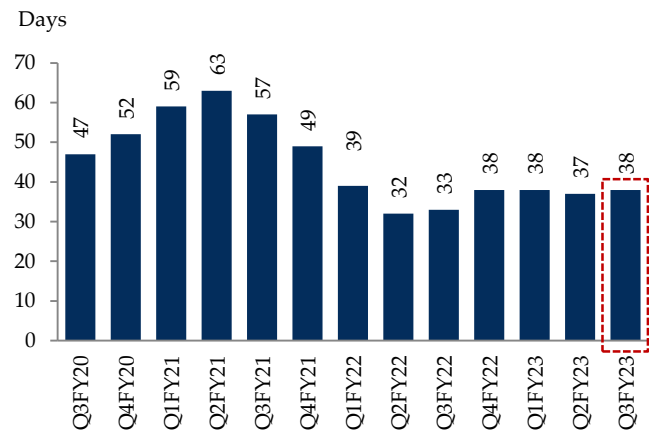
Source: Company, HSIE Research

**Exhibit 14: IITS debtors days – best in class**



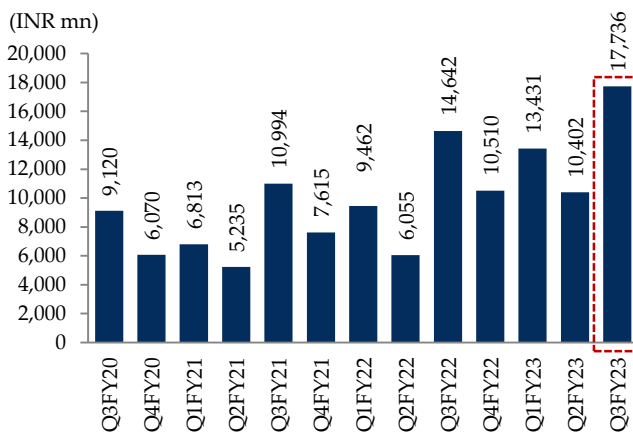
Source: Company, HSIE Research

**Exhibit 15: DPS debtors days - stable**



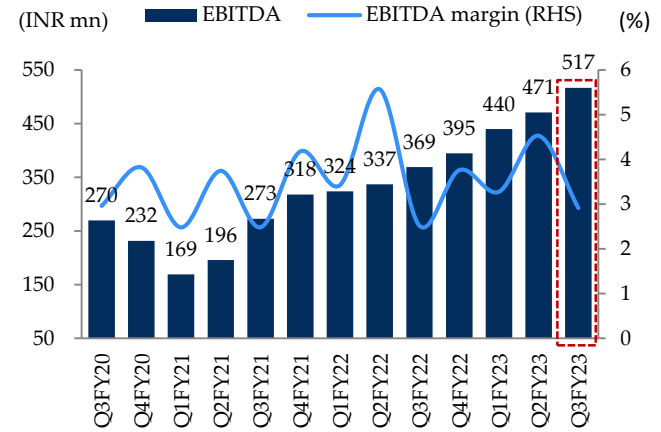
Source: Company, HSIE Research

**Exhibit 16: DPS revenue trend – clocking >25% YoY growth**



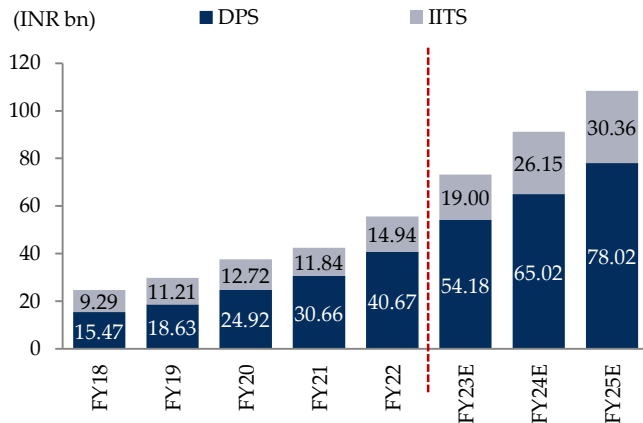
Source: Company, HSIE Research

**Exhibit 17: DPS EBITDA and margin trend – consistent increase in profitability**



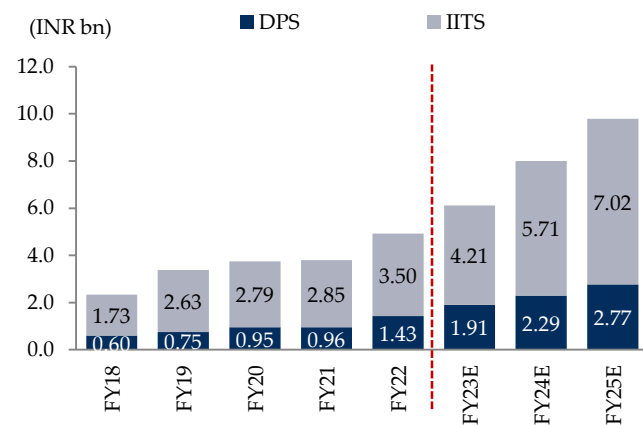
Source: Company, HSIE Research

**Exhibit 18: IITS & DPS annual revenue trend – ITTS/DPS 5Y CAGR of 13/19%, +27/24% over FY22-25E**



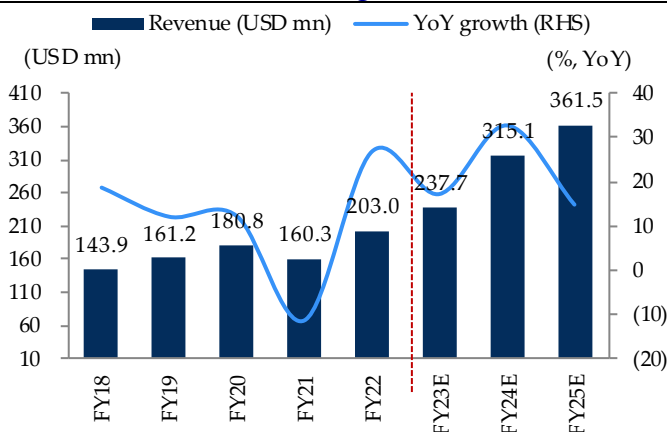
Source: Company, HSIE Research

**Exhibit 20: IITS & DPS annual EBITDA trend**



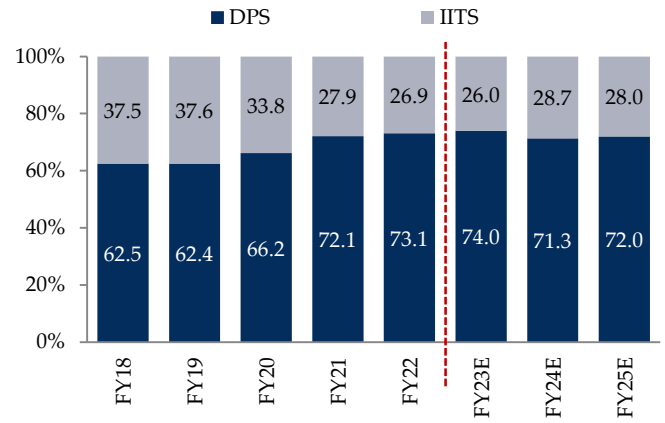
Source: Company, HSIE Research

**Exhibit 22: IITS USD revenue growth**



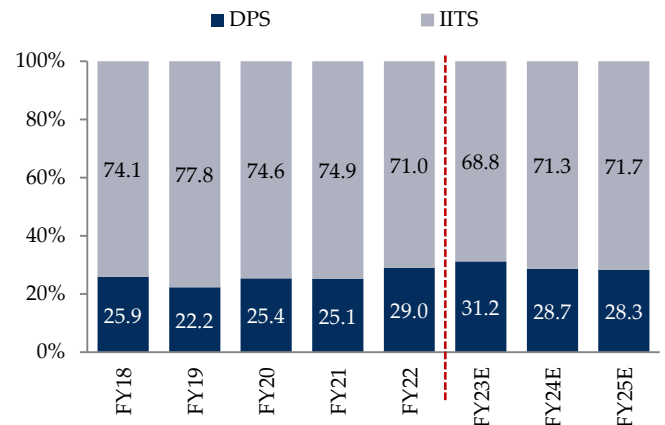
Source: Company, HSIE Research

**Exhibit 19: Annual revenue contribution - IITS contribution increasing**



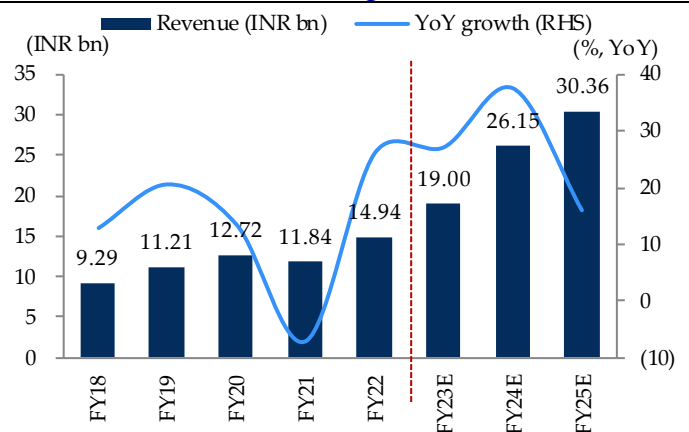
Source: Company, HSIE Research

**Exhibit 21: Annual EBITDA contribution – ITTS is the major contributor**



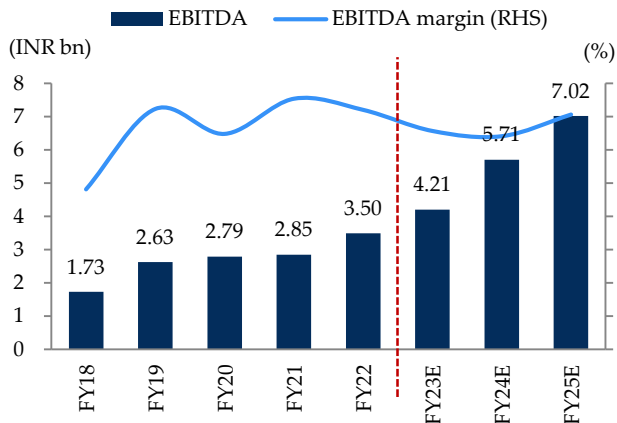
Source: Company, HSIE Research

**Exhibit 23: IITS INR revenue growth**



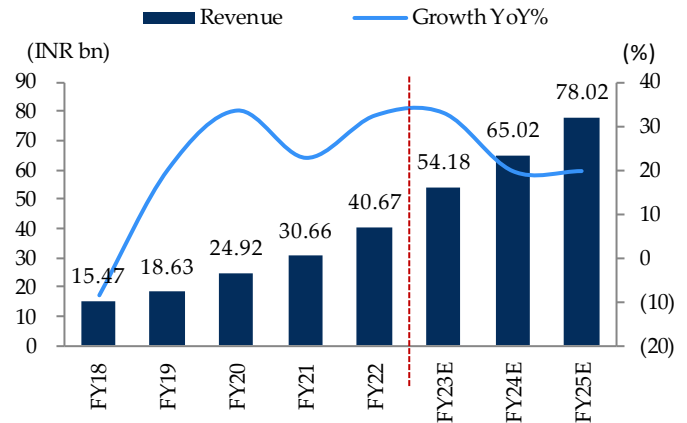
Source: Company, HSIE Research

**Exhibit 24: IITS annual EBITDA trend**



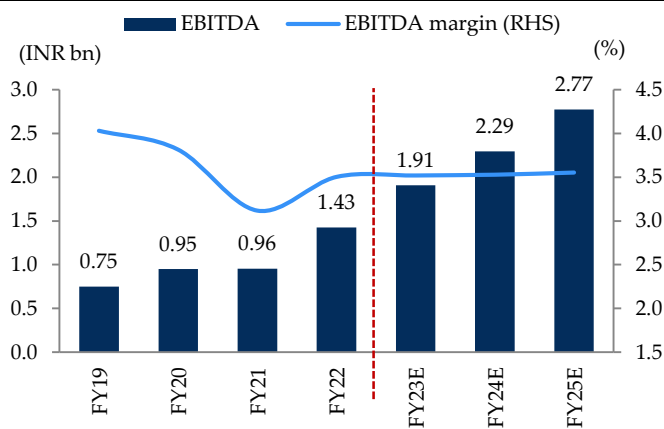
Source: Company, HSIE Research

**Exhibit 25: DPS revenue growth**



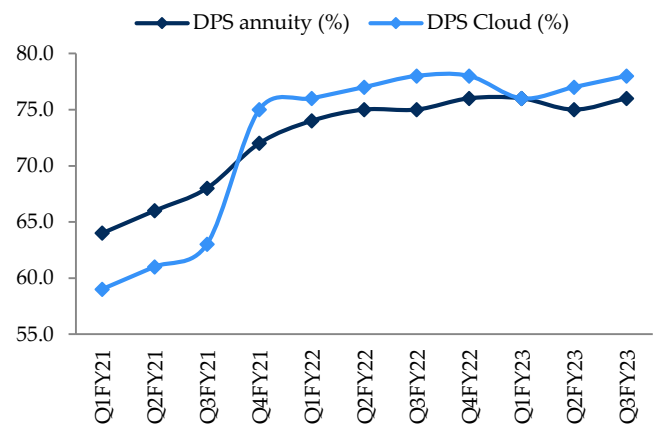
Source: Company, HSIE Research

**Exhibit 26: DPS annual EBITDA trend**



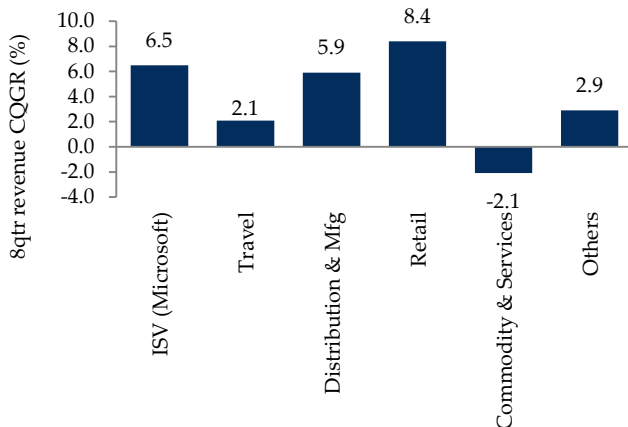
Source: Company, HSIE Research

**Exhibit 27: DPS annuity and cloud contribution trend**



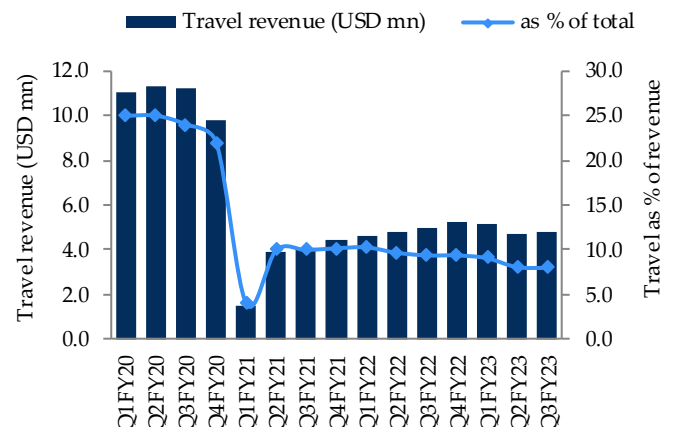
Source: Company, HSIE Research

**Exhibit 28: Vertical 8qtr CQGR, ISV and Retail driving IITS growth**



Source: Company, HSIE Research

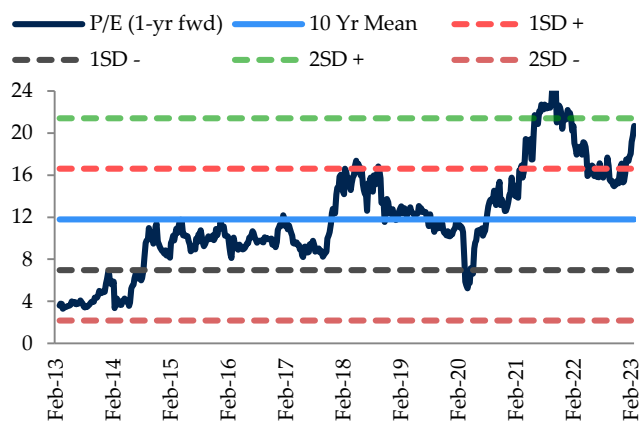
**Exhibit 29: Travel vertical recovery due, still at ~50% of pre-covid levels**



Source: Company, HSIE Research

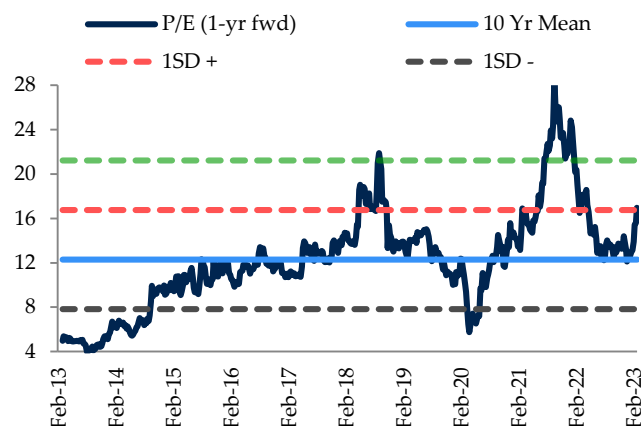


**Exhibit 30: Sonata P/E (1-yr fwd) Trend**



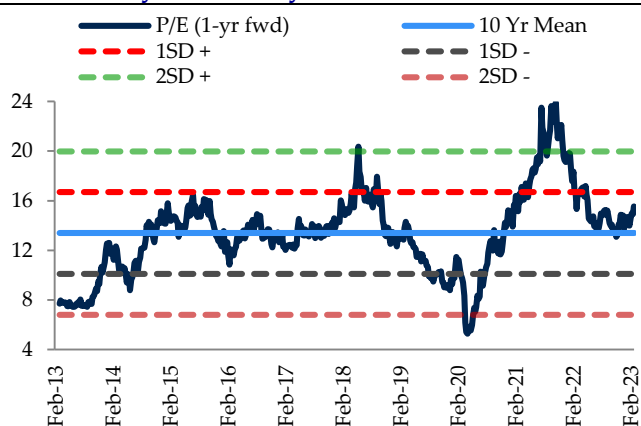
Source: Bloomberg, HSIE Research

**Exhibit 31: Zensar P/E (1-yr fwd) Trend**



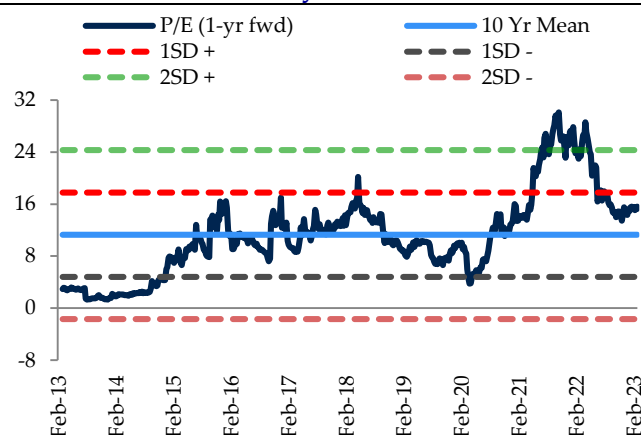
Source: Bloomberg, HSIE Research

**Exhibit 32: Cyient P/E (1-yr fwd) Trend**



Source: Bloomberg, HSIE Research

**Exhibit 33: Mastek P/E (1-yr fwd) Trend**



Source: Bloomberg, HSIE Research



## Financials

### Income Statement (Consolidated)

YE March (INR bn)	FY19	FY20	FY21E	FY22	FY23E	FY24E	FY25E
IITS revenue (USD mn)	161	181	160	203	238	315	361
Growth (%)	12.0	12.2	-11.3	26.6	17.1	32.5	14.7
Total Revenues (IITS+DPS)	29.61	37.43	42.28	55.53	73.10	91.08	108.29
EBITDA	3.36	3.73	3.79	4.64	6.10	7.98	9.77
EBIT	3.23	3.36	3.40	4.16	5.51	6.71	8.40
EBIT (%)	10.9	9.0	8.0	7.5	7.5	7.4	7.8
PBT	3.49	3.79	3.52	5.00	5.87	6.81	8.54
APAT	2.47	2.77	2.44	3.76	4.37	5.07	6.36
EPS (INR)	17.6	19.8	17.4	26.8	31.2	36.2	45.4

### Balance Sheet (Consolidated)

	FY19	FY20	FY21E	FY22	FY23E	FY24E	FY25E
Cash & Equivalents	3.46	4.10	7.53	9.28	7.02	10.62	14.78
Debtors	8.11	7.00	6.16	8.93	11.62	14.47	17.21
Other Current Assets	0.96	0.88	1.11	1.33	1.53	1.76	2.03
<b>Total Current Assets</b>	<b>12.53</b>	<b>11.98</b>	<b>14.80</b>	<b>19.54</b>	<b>20.17</b>	<b>26.86</b>	<b>34.01</b>
Net Block	0.54	1.42	1.48	2.06	6.78	6.24	5.74
Goodwill & Other Intangible Assets	1.45	1.56	1.76	2.21	9.29	9.29	9.29
Other Non-current Assets	0.64	0.96	1.25	1.48	1.56	1.71	1.88
<b>Total Non-Current Assets</b>	<b>2.63</b>	<b>3.94</b>	<b>4.48</b>	<b>5.75</b>	<b>17.63</b>	<b>17.24</b>	<b>16.91</b>
Creditors	5.87	5.62	6.51	10.55	13.77	17.08	20.24
Other Current Liabilities & Provns	1.09	1.27	1.71	1.63	1.91	2.19	2.46
<b>Total Current Liabilities</b>	<b>6.97</b>	<b>6.89</b>	<b>8.22</b>	<b>12.18</b>	<b>15.68</b>	<b>19.27</b>	<b>22.71</b>
<b>TOTAL APPLICATION OF FUNDS</b>	<b>8.19</b>	<b>9.03</b>	<b>11.07</b>	<b>13.12</b>	<b>22.11</b>	<b>24.83</b>	<b>28.21</b>
Total Shareholders' Funds	7.68	6.70	9.05	10.99	13.21	15.75	18.93
Total Debt	0.52	2.58	2.20	2.39	9.16	9.35	9.55
Other Liabilities + Minority	-0.01	-0.24	-0.19	-0.26	-0.26	-0.26	-0.26
<b>TOTAL SOURCES OF FUNDS</b>	<b>8.19</b>	<b>9.03</b>	<b>11.07</b>	<b>13.12</b>	<b>22.11</b>	<b>24.83</b>	<b>28.21</b>

### Cash Flow (Consolidated)

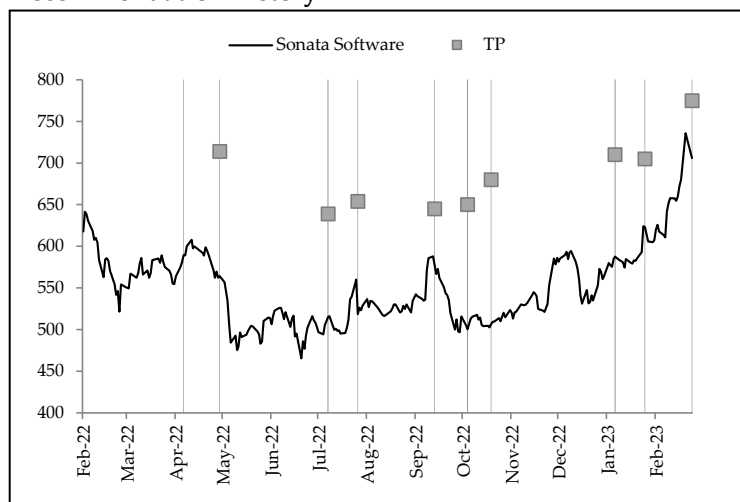
	FY19	FY20	FY21E	FY22	FY23E	FY24E	FY25E
<b>Operating Cash Flow (OCF)</b>	<b>-0.06</b>	<b>3.69</b>	<b>4.43</b>	<b>4.86</b>	<b>5.14</b>	<b>6.59</b>	<b>7.86</b>
Capex + Acq	-0.46	-0.08	-0.52	-0.59	-12.39	-0.73	-0.87
<b>Free Cash Flow (FCF)</b>	<b>-0.52</b>	<b>3.60</b>	<b>3.90</b>	<b>4.26</b>	<b>-7.25</b>	<b>5.86</b>	<b>7.00</b>
Investing Cash Flow	-0.41	0.00	-0.43	-0.43	-11.82	-0.40	-0.46
Financing Cash Flow	-1.66	-3.10	-0.62	-2.71	4.41	-2.59	-3.25
<b>Closing Cash &amp; Equivalents</b>	<b>3.46</b>	<b>4.10</b>	<b>7.53</b>	<b>9.28</b>	<b>7.02</b>	<b>10.62</b>	<b>14.78</b>

### Key Ratios

	FY19	FY20	FY21E	FY22	FY23E	FY24E	FY25E
<b>RoE (%)</b>	<b>34.7</b>	<b>38.5</b>	<b>31.0</b>	<b>37.6</b>	<b>36.1</b>	<b>35.0</b>	<b>36.7</b>
<b>RoIC (%)</b>	<b>48.4</b>	<b>49.8</b>	<b>66.6</b>	<b>81.7</b>	<b>27.2</b>	<b>35.2</b>	<b>46.6</b>
Tax Rate (%)	29.0	27.0	30.7	24.8	25.5	25.5	25.5
Debtors (Billed days)	100	68	53	59	58	58	58
DPS (INR/sh)	12.8	20.3	14.0	18.0	15.6	18.1	22.7
P/E (x)	40.2	35.7	40.6	26.3	22.6	19.5	15.6
EV/EBITDA (x)	29.0	26.2	24.9	20.2	16.8	12.4	9.7
<b>Payout Yield (Dividend + Buyback) %</b>	<b>1.4</b>	<b>3.6</b>	<b>0.4</b>	<b>1.9</b>	<b>2.2</b>	<b>2.6</b>	<b>3.2</b>

Source: Company, HSIE Research

### Recommendation history



Date	CMP	Reco	Target
6-Apr-22	583	BUY	805
30-Apr-22	565	BUY	714
7-Jul-22	495	BUY	639
26-Jul-22	562	BUY	654
13-Sep-22	588	BUY	645
4-Oct-22	506	BUY	650
19-Oct-22	502	BUY	680
6-Jan-23	575	BUY	710
25-Jan-23	624	BUY	705
27-Feb-23	706	BUY	775

### Rating Criteria

BUY:  $\geq +15\%$  return potential

ADD:  $+5\%$  to  $+15\%$  return potential

REDUCE:  $-10\%$  to  $+5\%$  return potential

SELL:  $> 10\%$  Downside return potential

**Disclosure:**

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