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INSTITUTIONAL RESEARCH

Sonata Software

Large deals, inorganic growth tailwinds

Sonata delivered a better-than-expected IT services (IITS) growth (+8% QoQ CC) while organic growth was 4.5% QoQ. The growth was led by Cloud and Microsoft Dynamics. The management remains optimistic and plans for its IITS revenue to be USD 500mn by FY26 (implied CQGR of ~4%) with EBITDA margins in the early 20s. The company won 3 large deals during the quarter which included one deal of USD 160mn for 10-year IT modernisation in the retail vertical (full ramp-up expected from Q2FY24). The IITS EBITDA margin contracted 331bps QoQ to 18.5% due to wage and M&A costs. The margins will continue to be under pressure due to senior management wage hikes in Q1 (-50bps) and continued investments to scale up in focus verticals like BFSI and healthcare. Large deal ramp and inorganic growth (Quant) will serve as tailwinds for FY24E revenue growth while softness in the hi-tech vertical will offset the growth to some extent. We increase our IITS revenue estimate by ~2% for FY24/25E but lower the IITS margin by ~55/70bps for FY24/25E. We maintain a BUY rating with a target price of INR 1,000, based on 20x Mar-25E EPS. The stock is trading at a P/E of 22/18x FY24/25E (5Y/10Y average P/E of 15/12x).

- **Q4FY23 highlights**: IITS revenue stood at USD 65.8mn, +8.8% QoQ growth, higher than our estimate of USD 64.1mn. Among the verticals, healthcare grew 32.9% QoQ (Quant acquisition), followed by BFSI growth at 24.3% QoQ (Quant acquisition), retail & manufacturing growth at 17% QoQ and TMT vertical growth at 2.3% QoQ (softness in hi-tech vertical). IITS EBITDA margin stood at 18.5%, declining -331bps QoQ due to a wage hike (-97bps) and M&A cost (-330bps), which were partially offset by FX (+56bps) and Quant profitability (+46bps). However, the normalised IITS EBITDA margin improved by 10bps QoQ to 21.9% and the DPS EBITDA margin stood at 3.9% (+99bps QoQ). Consolidated revenue witnessed a de-growth of 15.4% QoQ, mainly due to a decline in DPS revenue (-22% QoQ). The IITS headcount addition was healthy at 707 employees (excluding Quant headcount addition of 207 employees). The company added 15 new customers in Q4 vs 20 additions in Q3.
- **Outlook:** We expect IITS growth of ~42% (including Quant) /15% and DPS growth of ~20% for FY24/25E respectively. IITS margin will be at 21.4/22.6% and DPS margin at 3.5/3.6% for FY24/25E respectively. IITS revenue/consolidated EPS CAGR for FY23-25E are expected to be +28/24%.

Quarterly Financial Summary

YE Mar (INR bn)	Q4 FY23	Q4 FY22	YoY (%)	Q3 FY23	QoQ (%)	FY21	FY22	FY23	FY24E	FY25E
IITS Revenues (USD mn)	65.8	55.7	*18.1*	60.5	*8.8*	160	203	241	343	393
Net Sales	19.14	14.64	*30.7*	22.61	*(15.4)*	42.28	55.53	74.49	94.79	112.66
EBIT	1.33	0.95	*39.6*	1.43	*(7.0)*	3.40	4.16	5.45	7.22	8.97
APAT	1.14	1.01	*12.8*	1.18	*(3.3)*	2.44	3.76	4.52	5.54	6.99
Diluted EPS (INR)	8.1	7.2	*12.8*	8.4	*(3.3)*	17.4	26.8	32.2	39.5	49.8
P/E (x)						50.9	33.0	27.5	22.4	17.8
EV / EBITDA (x)						31.5	25.6	21.7	15.0	11.9
RoE (%)						31.0	37.6	37.7	38.5	39.9

Source: Company, HSIE Research, Consolidated Financials

Change in Estimates

YE Mar (INR bn)	FY24E Old	FY24E Revised	Change %	FY25E Old	FY25E Revised	Change %
IITS Revenue (USD mn)	336	343	*1.9*	386	393	*1.9*
Revenue	92.95	94.79	*2.0*	110.47	112.66	*2.0*
EBIT	7.18	7.22	*0.5*	8.97	8.97	*0.0*
EBIT margin (%)	7.7	7.6	-11bps	8.1	8.0	-16bps
APAT	5.42	5.54	*2.1*	6.79	6.99	*3.0*
EPS (INR)	38.7	39.5	*2.1*	48.4	49.8	*3.0*

Source: Company, HSIE Research

BUY

CMP *(as on 15 May 23)*	**INR 885**
Target Price	**INR 1,000**
NIFTY	**18,399**

KEY CHANGES	**OLD**	**NEW**
Rating	BUY	BUY
Price Target	INR 920	INR 1,000
EPS %	FY24E	FY25E
	+2.1	+3.0

KEY STOCK DATA	
Bloomberg code	SSOF IN
No. of Shares (mn)	140
MCap (INR bn) / ($ mn)	124/1,517
6m avg traded value (INR mn)	416
52 Week high / low	INR 903/458

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	34.1	62.4	80.2
Relative (%)	32.3	61.7	62.1

SHAREHOLDING PATTERN (%)

	Dec-22	Mar-23
Promoters	28.17	28.17
FIs & Local MFs	13.80	13.86
FPIs	12.85	12.95
Public & Others	45.18	45.02
Pledged Shares	0.00	0.00

Source : BSE

Pledged shares as % of total shares

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Disclosure:
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