



Sonata Software Ltd

Q2FY25



Sonata Software Ltd.

Near-term margin challenges to impact earnings

CMP* INR 632	Target INR 679	Potential Upside 7.5%	Market Cap (INR Mn) INR 1,75,840	Recommendation ACCUMULATE	Sector Internet Software & Services
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Result Highlights:

- SSOF's Q2FY25 result exceeded expectations. The company reported revenue of INR 21,698 Mn, up 13.5% YoY (-14.1% QoQ), primarily driven by strong YoY revenue growth in domestic business.
- EBIT stood at INR 1,443 Mn, down 12.0% YoY (+1.0% QoQ). EBIT margin stood at 6.7%, down 192bps YoY (+100bps QoQ), beating our expectations.
- PAT stood at INR 1,065 Mn, down 14.2% YoY (+0.8% QoQ). PAT margin stood at 4.9%, down 158bps YoY (+73bps QoQ).
- SSOF's EBIT margins remain under pressure in comparison to historical levels (YoY), on the back of elevated operating expenses. The company has highlighted margins to continue facing headwinds, on account of ramp-up in large deals, ongoing investments in the Healthcare and BFSI sectors, salary increases, and the rebadging of onsite personnel resulting in increased operating expenses. Consequently, we lower our FY26E EPS estimate to INR 26.1 (previously: INR 26.7) while maintaining FY26E P/E multiple of 26.0x. Accordingly, we lower our target price to INR 679 (previously: INR 694) and maintain an ACCUMULATE rating on the share of Sonata Software Ltd.

MARKET DATA

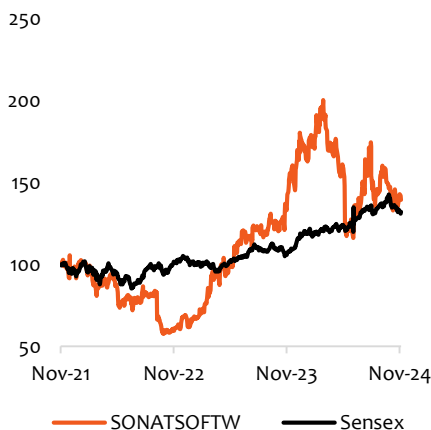
Shares outs (Mn)	280
Mkt Cap (INR Mn)	1,75,840
52 Wk H/L (INR)	870/469
Volume Avg (3m K)	826
Face Value (INR)	1
Bloomberg Code	SSOF IN

KEY FINANCIALS

INR Millions	FY23	FY24	FY25E	FY26E	FY27E
Revenue	74,491	86,131	101,755	120,960	143,968
EBIT	5,450	5,955	7,021	9,707	11,702
Adj. PAT	4,519	4,832	5,302	7,337	8,898
OPM (%)	7.3%	6.9%	6.9%	8.0%	8.1%
NPM (%)	6.1%	5.6%	5.2%	6.1%	6.2%

Source: Company, KRChoksey Research

SHARE PRICE PERFORMANCE



Revenue growth led by Technology, Media and Telecom (TMT) and BFSI vertical; Margin pressures expected ahead

- International IT Services revenue for Q2FY25 stood at INR 7,079 Mn, up 5.7% YoY (+2.9% QoQ) while domestic revenue stood at INR 14,619 Mn, up 17.5% YoY (-21.0% QoQ), driven by strong growth in USA.
- In terms of region, USA (72.0% of revenue) posted robust growth of 17.2% YoY (-14.7% QoQ) in USD terms, while Europe (14.0% of revenue) posted a moderate growth of 4.8% YoY (-8.1% QoQ).
- RoW (14.0% of revenue) declined 1.7% YoY (-20.4% QoQ).
- In terms of vertical, revenue growth was primarily driven by the TMT segment (32.0% of revenue), which reported a robust growth of 33.1% YoY (-24.2% QoQ). The BFSI segment (22.0% of revenue), delivered a solid growth of 17.6% YoY (+17.3% QoQ).
- Retail and manufacturing (31.0% of revenue), experienced a slight YoY decline of 3.3%. Healthcare (HLS) segment (10.0% of revenue) saw a marginal growth of 2.0% YoY (-5.2% QoQ) with the Emerging vertical (5.0% of revenue) reporting a growth of 12.3% YoY (-14.7% QoQ).
- As of Q2FY25, Healthcare and BFSI verticals together contribute 32.0% of revenue, up from 13.0%, 10 quarters back led by continuous investment in HLS and BFSI.
- The company expects revenue HLS and BFSI vertical to bring together close to USD 250.0 Mn in the coming three to five years from now.
- SSOF continues to aspire to reach USD 1.5Bn revenue by end of FY27E.
- The company expects a temporary margin impact from large deals over the next 3-4 quarters as these contracts ramp up.
- This is primarily due to upfront investments, rebadging of onsite personnel, and salary hikes. However, once these deals fully mature, margins are expected to align with the company's historical standards.

MARKET INFO

SENSEX	80,378
NIFTY	24,484

SHARE HOLDING PATTERN (%)

Particulars (%)	Sep-24	Jun-24	Mar-24
Promoters	28.2	28.2	28.2
FIIIs	12.1	12.4	14.0
DIIIs	23.4	21.6	19.0
Others	36.3	37.8	38.8
Total	100	100	100

*Based on the previous closing
Note: All the market data is as of previous closing

18.5%

Revenue CAGR between FY24 and FY26E

25.1%

Adj. PAT CAGR between FY24 and FY26E

Sonata Software Ltd.

Key Concall Highlights:

Secures key strategic wins in Q2FY25

- SSOF secured 3 large deal wins.
- **US Financial Sector:** Sonata Software has been selected as a strategic partner by one of the top financial corporations in the U.S. to lead its data modernization program, including the migration from Netezza to Snowflake. This multi-year data and cloud modernization initiative is with a leading U.S. bank, ranked among the top 10 in the country.
- **Global Tech Giant:** The second large deal is with a U.S. technology giant, where Sonata Software will implement an optimal global delivery model to provide AI, cloud, and data services through its global delivery centers in India, Mexico, and Malaysia.
- **Food Safety Systems Leader:** The third win is with a leading provider of food safety systems, where Sonata has been chosen as a strategic partner to design, build, manage, and continuously modernize their consumer-facing automation platform. The platform will leverage a combination of Microsoft, Android, and iOS technologies.
- In addition to the three large wins, **Sonata Software secured two strategic mid-sized deals**, both representing new client logos.
- The first deal is with an **Australia-based reseller and wholesaler, where Sonata has been awarded a multi-year data modernization program as a strategic partner.** Notably, this marks Sonata's largest TCP-based Microsoft Fabric win in the data transformation space to date.
- The second mid-sized deal is with a **leading U.S. food service company, where Sonata has been selected for a multi-year ERP modernization and integration program.** This represents the second new logo secured by Sonata in the quarter, further underscoring the company's ability to win new clients with its differentiated capabilities.

Sonata Software Continues Workforce Growth and AI Training, Maintains Strong Utilization

- Employee count stood at 6,485, up 393 YoY (+284 employees QoQ), while attrition rate remain constant sequentially at 13.0%.
- Approximately **83.0% of Sonata's engineers are now trained in Generative AI**, a notable increase from 67.0% reported last quarter. This highlights the company's ongoing commitment to workforce upskilling and its strategic focus on integrating AI across operations.
- The company implemented a **salary increase for junior management in July and plans a further adjustment for mid- and senior management in Q3FY25E.**
- The company mentioned a **furlough**, which is expected to have a very minimal impact.
- Sonata continues its campus recruitment drive, onboarding 150 new graduates during the quarter, signaling a commitment to long-term talent acquisition despite market conditions.
- Utilization remained strong at 87.0% for Q2FY25, consistent with Q1FY25 levels, reflecting effective resource management.

Doubles Down on AI, Targets 20% Revenue from AI-Enabled Services by 2027

- The company has a strategic bet on AI, **aiming for 20.0% of revenue to come from AI enabled services by the end of FY27E.**
- SSOF has a robust AI pipeline of USD 67.0 Mn across 110 customers, including a significant win with a large pharmaceutical client leveraging Gen-AI capabilities.
- **Sonata's cloud and data pipeline now represents 51.0% of its overall pipeline**, a significant increase from 15.0% just two-and-a-half years ago, reflecting the company's strong focus on these high-growth areas.
- The company is implementing an agentic AI strategy with select clients to further enhance automation and decision-making capabilities across business processes.

AI Macro Economic Conditions

- SSOF is experiencing slowdown across certain verticals due to ongoing macroeconomic challenges and geopolitical issues.
- Industry analysts project sustained high inflation in the U.S. with no significant improvement expected for at least 2-3 quarters.
- Customers postponing discretionary spending, leading to delays in deal closures and potentially impacting revenue growth in the near term.
- **Specific verticals, particularly retail and manufacturing, showing signs of contraction due to decreasing consumer demand and cautious spending behavior.**

Valuation and view:

Sonata Software Ltd Q2FY25 earnings exceeded our projections. The company secured 3 large deals and 2 mid-sized strategic deals. SSOF would continue its focus on ramping up large deals and investing in AI projects. In the long term, key growth drivers are expected to include traction in AI, with the Company projecting 20.0% of its revenue from AI in 3 years, progress in Microsoft Fabric, strong growth in Quant, large deals, and effective client mining. However, in short term, company anticipates margin pressure in near term due to ramping up of large deals, rebadging of onsite personnel, and salary hikes resulting in elevated operating expenses. **Factoring in the near-term margin pressures, we curb our FY26E EPS to INR 26.1 (previously: INR 26.7) but retain our FY26E P/E multiple of 26.0x. Consequently, we lower our target price to INR 679 (previously: INR 694), factoring in near term margin pressures. The stock offers an upside potential of 7.5% from current levels, therefore, we reiterate our "ACCUMULATE" rating on the share of Sonata Software Ltd.**

Sonata Software Ltd.

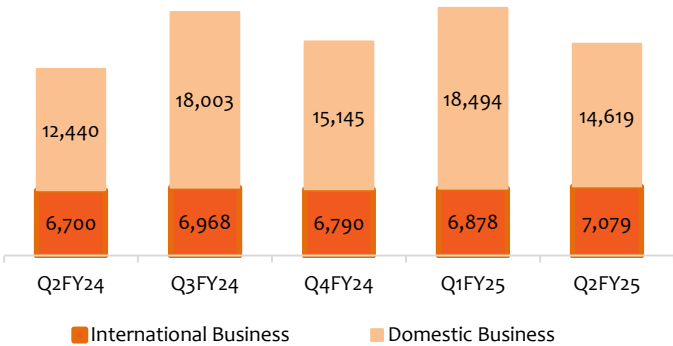
RESULT SNAPSHOT

Particulars (INR Mn)	Q2FY25	Q1FY25	Q2FY24	QoQ	YoY
Sales	21,698	25,274	19,126	(14.1%)	13.5%
Total Expenditure	19,926	23,513	17,153		
Purchase of stock-in-trade (traded goods)	13,206	18,057	13,789		
Changes in inventories of stock-in-trade	784	-184	-1,689		
Employee benefits expense	4,048	3,692	3,398		
Other Expenses	1,888	1,948	1,654		
EBITDA	1,773	1,762	1,973		
EBITDA Margin (%)	8.2%	7.0%	10.3%		
Depreciation and Amortization expense	329	333	333		
EBIT	1,443	1,429	1,640	1.0%	(12.0%)
EBIT Margin (%)	6.7%	5.7%	8.6%	100bps	-192bps
Finance Costs	192	200	207		
Other Income	192	189	232		
Exceptional items	0	0	0		
Profit before tax	1,443	1,417	1,665		
Tax expense	379	361	423		
Net profit	1,065	1,056	1,242	0.8%	(14.2%)
Net profit margin (%)	4.9%	4.2%	6.5%	73bps	-158bps
Adj. EPS	3.8	3.8	4.5		

Source: Company, KRChoksey Research

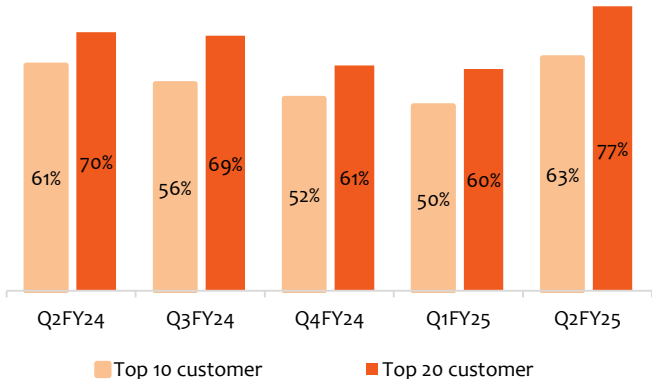
Quarterly Trends

Domestic business declined sequentially



Source: Company, KRChoksey Research

Contribution from Top 10 customers and Top 20 customer inched up QoQ



Sonata Software Ltd.

KEY FINANCIALS

Exhibit 1: Profit & Loss Statement

INR Millions	FY23	FY24	FY25E	FY26E	FY27E
Revenue	74,491	86,131	101,755	120,960	143,968
Total operating Expenses	68,450	78,856	93,627	109,888	130,484
Reported EBITDA	6,750	8,530	8,993	11,978	14,492
Adj. EBITDA	6,041	7,274	8,128	11,071	13,484
Depreciation	591	1,319	1,107	1,364	1,782
EBIT	5,450	5,955	7,021	9,707	11,702
Other income, net	708	1,256	865	907	1,008
Finance costs	185	850	817	831	846
Exceptional Items	0	1,747	0	0	0
Pre-tax Income	5,973	4,614	7,069	9,783	11,864
Income tax expense	1,454	1,529	1,767	2,446	2,966
PAT	4,519	3,085	5,302	7,337	8,898
Adj. PAT	4,519	4,832	5,302	7,337	8,898
Adj. EPS (INR)	16.3	17.4	18.9	26.1	31.7

Exhibit 3: Cash Flow Statement

INR Millions	FY23	FY24	FY25E	FY26E	FY27E
CFFO	2,684	2,805	8,936	9,162	10,522
CFFI	-8,553	-543	-2,965	-3,652	-4,351
CFFF	1,868	-1,085	-2,600	-3,946	-4,720
Net Inc/Dec	-4,002	1,177	3,371	1,565	1,451
Others	876	0	66	0	0
Exchange rate difference	-37	9	0	0	0
Opening Balance	7,337	4,174	5,360	8,797	10,362
Closing Balance	4,174	5,360	8,797	10,362	11,812

Exhibit 4: Key Ratios

Key Ratio	FY23	FY24	FY25E	FY26E	FY27E
EBIT Margin (%)	7.3%	6.9%	6.9%	8.0%	8.1%
Tax rate (%)	24.3%	33.1%	25.0%	25.0%	25.0%
Net Profit Margin (%)	6.1%	5.6%	5.2%	6.1%	6.2%
RoE (%)	37.7%	22.8%	36.7%	48.4%	56.2%
RoCE (%)	34.4%	33.4%	36.4%	48.1%	55.4%
RoA (%)	10.4%	6.0%	9.3%	11.4%	12.3%
EPS (INR per share)	16.3	17.4	18.9	26.1	31.7
P/E (x)	38.8	36.3	33.5	24.2	19.9

Source: Company, KRChoksey Research

INR Millions	FY23	FY24	FY25E	FY26E	FY27E
Equity					
Equity Share Capital	139	278	278	278	278
Other Equity	12,868	13,785	14,559	15,183	15,939
Total Equity	13,007	14,063	14,837	15,461	16,217
Long term Debts	3,051	4,310	4,353	4,397	4,441
Other Long-Term Liabilities	5,878	2,185	4,062	6,711	10,011
Total noncurrent liabilities	8,929	6,496	8,415	11,108	14,452
Trade Payables	12,949	14,160	16,930	19,870	23,594
Short Term Borrowings	1,885	2,433	2,506	2,581	2,658
Other Current Liabilities	6,799	14,340	14,587	15,214	15,711
Total Current Liabilities	21,633	30,933	34,023	37,665	41,964
Total liabilities	43,569	51,491	57,275	64,234	72,633
Property Plants and Equipment's	488	518	1,039	1,731	2,397
Right of use of Assets	828	810	891	980	1,078
Intangible Assets	5,031	4,248	4,248	4,248	4,248
Goodwill	10,984	11,135	11,135	11,135	11,135
Other current assets	2,087	4,026	4,818	5,767	6,904
Total Non-Current Assets	19,418	20,736	22,130	23,860	25,762
Current Assets					
Inventories	288	980	1,078	1,186	1,304
Cash & Cash Equivalent	7,303	8,650	12,087	13,652	15,103
Trade Receivables	12,362	16,051	15,891	18,227	21,694
Other current assets	4,198	5,075	6,090	7,308	8,770
Total Current Assets	24,151	30,756	35,145	40,373	46,871
Total Assets	43,569	51,491	57,275	64,234	72,633

Sonata Software Ltd.

Sonata Software Ltd.				Rating Legend (Expected over a 12-month period)	
Date	CMP (INR)	TP (INR)	Recommendation	Our Rating	Upside
07-Nov-24	632	679	ACCUMULATE	Buy	More than 15%
06-Aug-24	627	694	ACCUMULATE	Accumulate	5% – 15%
14-May-24	510	603	BUY	Hold	0 – 5%
07-Feb-24	823	870	ACCUMULATE	Reduce	-5% – 0
24-Nov-23	652	702	ACCUMULATE	Sell	Less than – 5%

ANALYST CERTIFICATION:

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