



Sonata Software Ltd

Q3FY25



Sonata Software Ltd.

Near-term margin challenges to impact earnings

| | | | | | |
|---------|---------|------------------|---------------------|----------------|------------------------------|
| CMP* | Target | Potential Upside | Market Cap (INR Mn) | Recommendation | Sector |
| INR 489 | INR 517 | 5.7% | INR 1,36,006 | ACCUMULATE | Internet Software & Services |

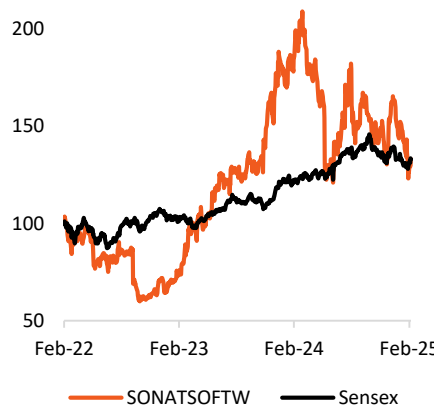
Result Highlights:

- SSOF's Q3FY25 result missed our expectations. The company reported revenue of INR 28,428 Mn, up 14.0% YoY (+31.0% QoQ).
- EBIT stood at INR 1,313 Mn, down 24.5% YoY (-9.0% QoQ). EBIT margin stood at 4.6%, down 236bps YoY (-203bps QoQ).
- Adj. PAT stood at INR 1,050 Mn, down 18.3% YoY (-1.4% QoQ). PAT margin stood at 3.7%, down 146bps YoY (-121bps QoQ).
- We reduce our FY26E/FY27E estimates by 20.7%/16.8% to INR 26.1/31.7, factoring in weaker than anticipated Q3FY25 performance and persistent margin pressures stemming from a large ramp-down in the TMT vertical. The spillover is likely to extend for 2-3 quarters, with an anticipation that margins would likely recover from H2FY26E. We roll over our valuation to FY27E and assign a P/E multiple of 25.0x, to arrive at a target price of INR 517 (previously: INR 679). Despite these near-term headwinds, we believe this represents a temporary setback, given Sonata Software's strategic expansion into AI-driven modernization, cloud transformation, and enterprise partnerships. The company's cost optimization measures and operational efficiencies are expected to aid in margin stabilization, supporting long-term growth. While we remain cautiously optimistic, we will closely monitor the pace of margin recovery in the coming quarters and maintain our ACCUMULATE rating on SSOF.**

MARKET DATA

| | |
|-------------------|----------|
| Shares outs (Mn) | 280 |
| Mkt Cap (INR Mn) | 1,36,006 |
| 52 Wk H/L (INR) | 870/446 |
| Volume Avg (3m K) | 531 |
| Face Value (INR) | 1 |
| Bloomberg Code | SSOF IN |

SHARE PRICE PERFORMANCE



MARKET INFO

| | |
|--------|--------|
| SENSEX | 77,860 |
| NIFTY | 23,560 |

KEY FINANCIALS

| INR Mn | FY23 | FY24 | FY25E | FY26E | FY27E |
|----------|--------|--------|----------|----------|----------|
| Revenue | 74,491 | 86,131 | 1,00,087 | 1,18,204 | 1,39,153 |
| EBIT | 5,450 | 5,955 | 5,390 | 7,310 | 9,326 |
| Adj. PAT | 4,519 | 4,832 | 4,068 | 5,813 | 7,405 |
| OPM (%) | 7.3% | 6.9% | 5.4% | 6.2% | 6.7% |
| NPM (%) | 6.1% | 5.6% | 4.1% | 4.9% | 5.3% |

Source: Company, DevenChoksey Research

Q3FY25 witnessed margin pressure due to one-time factors

- International IT Services (IITS) revenue for Q3FY25 stood at INR 7,317 Mn, up 5.0% YoY (+3.4% QoQ) while domestic revenue stood at INR 21,111 Mn, up 17.3% YoY (+44.4% QoQ).
- EBITDA margins for International IT services stood at 14.6%, down 793bps (-357bps QoQ) while for domestic business EBITDA margin stood at 2.7%, up 12bps YoY (-64bps QoQ). The QoQ margin contraction in IITS was attributed to a large ramp-down in Q3FY25, a one-time discount to a major hi-tech client, and severance payouts (impacting 280bps). Salary increments for mid and senior-level employees contributed 75bps to the EBITDA margin compression.
- SSOF expects that the one-time discount will not recur in the upcoming quarters, but the impact of the ramp-down will likely persist for one to two more quarters.
- In terms of vertical, Technology, Media and Telecom (TMT – 29.0% of revenue) reported a growth of 5.1% YoY (+17.8% QoQ). SSOF vertical witnessed a slowdown in TMT vertical due to a sudden ramp-down in its TMT vertical, as a major high-tech client reduced its IT spending by 25.0 – 30.0%.
- Retail (25.0% of revenue) declined by 17.4% YoY (+4.8% QoQ) due to macroeconomic pressures while BFSI (30.0% of revenue) demonstrated robust growth of 98.4% YoY (+77.3% QoQ). Earlier, BFSI contributed 17.0% of revenue in Q3FY24.

Expected spillover and recovery timeline

- Management anticipates continued revenue pressure in Q4FY25E, primarily due to the full impact of the ramp-down, which may extend into Q1FY26E.
- Additionally, Quants Systems, a subsidiary of SSOF, is expected to experience its typical seasonality weakness in Q4FY25E, further contributing to the anticipated decline in revenue.

SHARE HOLDING PATTERN (%)

| Particulars (%) | Dec-24 | Sep-24 | Jun-24 |
|-----------------|--------|--------|--------|
| Promoters | 28.2 | 28.2 | 28.2 |
| FIIIs | 12.3 | 12.1 | 12.4 |
| DIIIs | 24.3 | 23.4 | 21.6 |
| Others | 35.2 | 36.3 | 37.8 |
| Total | 100 | 100 | 100 |

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

17.3%

Revenue CAGR between FY24 and FY27E

15.3%

Adj. PAT CAGR between FY24 and FY27E

Sonata Software Ltd.

- The company has revised its Q4FY25E revenue guidance downward by 2.5%-3.5% QoQ, reflecting the full-quarter impact of the ramp-down. However, management remains optimistic that client spending will normalize within the next 4-5 months, with growth recovery expected in Q1FY26E.
- Although margin recovery is anticipated in Q4FY25E, weak performance in Quants Systems may delay a full rebound. Growth expectations have been tempered, resulting in a delay of the company's USD 500 Mn IITS revenue target by one to two quarters.
- Despite these near-term challenges, SSOF is confident in a margin recovery, supported by ongoing cost optimization efforts and AI-driven automation initiatives.

Key Concall Highlights:

Secures two strategic wins in Q3FY25

- SSOF secured 2 large deal wins, strengthening its presence in AI-driven modernization and cloud transformation.
- The first deal was with a Finland-based mining and construction technology leader, where Sonata will drive the modernization and transformation of the client's global ERP platform.
- The initiative aims to standardize business processes, enhance operational transparency, and simplify the IT landscape by leveraging AI-powered solutions and Copilot integration. The project, which spans 30+ countries, is expected to be deployed over a three-year period, helping the client improve productivity and streamline decision-making.
- The second significant win was with a U.S.-based transportation technology provider, where Sonata will undertake a comprehensive modernization of the client's 20+ year old SaaS-based platform. The transformation will focus on enhancing scalability and integrating AI-driven automation to improve customer onboarding and self-service capabilities.
- The solution will incorporate a configurable, feature-driven SaaS model, along with an AI-powered data and cloud modernization framework, enabling the client to optimize its network, invoice management, and advisory services.

Region-wise performance

- In terms of region, USA (78.0% of revenue) posted robust growth of 23.5% YoY (+40.8% QoQ) in USD terms, while Europe (11.0% of revenue) declined by 11.7% YoY (+2.1% QoQ). RoW declined 17.6% YoY (+2.1% QoQ).

Sonata software continues workforce growth, and the utilization rate remains stable

- Employee count stood at 6,643, up 509 YoY (+158 employees QoQ), while the attrition rate inched up 100bps sequentially to 14.0% (12.0% in Q3FY24).
- Utilization rate remained constant sequentially at 87.0% (+120bps YoY).
- The company also implemented salary hikes for mid- and senior-level employees during the quarter, resulting in a 75bps impact on EBITDA margins.
- Additionally, Sonata incurred a one-time severance payout for employees in nearshore geographies, in compliance with local labor regulations.
- These severance costs were not reimbursed by the affected client, as the project operated under a fixed-price model, thereby exerting further pressure on profitability.

Strategic Growth in Cloud, AI, and Enterprise Partnerships

- SSOF continues to expand its presence in cloud and data services, which now contribute approximately 61.0% of total revenue.
- These services account for 44.0% of the company's active deal pipeline, underscoring its strategic focus on modernization and digital transformation.
- The company has strengthened partnerships with major technology providers, including Microsoft and AWS, enhancing its ability to secure new enterprise clients while deepening engagements with existing accounts.
- SSOF remains committed to AI-driven modernization, with a targeted goal of deriving 20.0% of its revenue from AI-enabled services within the next three years.
- Currently, the company has a USD 58.0 Mn AI-focused pipeline across 100+ clients, reflecting increasing demand for automation, AI-driven analytics, and digital transformation solutions.

Valuation and view:

Sonata Software Ltd Q3FY25 earnings missed our projections. EBITDA margins for IITS declined 793 bps YoY (-357 bps QoQ) to 14.6%, impacted by a large-scale client ramp-down in the TMT vertical, one-time discounts extended to a major hi-tech client, and severance payouts related to workforce restructuring in nearshore geographies. Additionally, salary increments for mid and senior management accounted for 75 bps of the EBITDA impact. Revenue growth for Q4FY25E is expected to decline by 2.5%-3.5% QoQ, as the company absorbs the full-quarter impact of the TMT client ramp-down, alongside seasonal weakness in its Quants Systems subsidiary. While some margin recovery is anticipated in Q4FY25E, the lingering impact of the ramp-down and ongoing cost pressures may delay a full rebound until H1FY26E.

Based on the recent developments, we reduce our FY26E/FY27E estimates by 20.7%/16.8% to INR 26.1/31.7. We roll over our valuation to FY27E and assign a P/E multiple of 25.0x, to arrive at a target price of INR 517 per share (previously: INR 679).

Despite these near-term headwinds, we believe the current scenario represents a temporary setback rather than a structural issue, given Sonata Software's strategic expansion into AI-driven solutions and enterprise partnerships. The company's cost optimization measures and operational efficiencies are expected to aid in margin stabilization, supporting long-term growth. While we remain cautiously optimistic, we will closely monitor the pace of margin recovery and revenue stabilization in the coming quarters. Consequently, we maintain our ACCUMULATE rating on SSOF.

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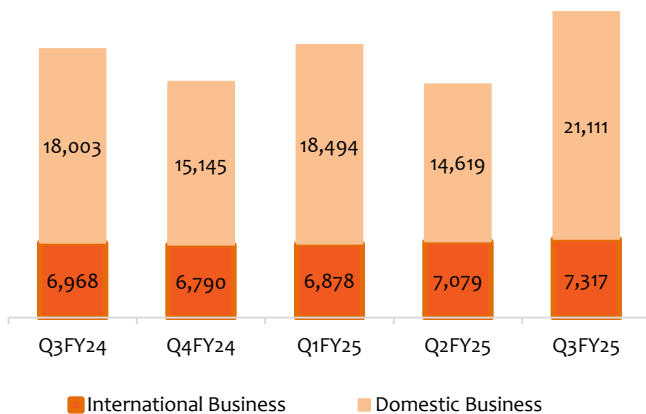
RESULT SNAPSHOT

| Particulars (INR Mn) | Q3FY25 | Q2FY25 | Q3FY24 | QoQ | YoY | 9MFY25 | 9MFY24 | YoY |
|---|---------------|---------------|---------------|----------------|-----------------|---------------|---------------|----------------|
| Sales | 28,428 | 21,698 | 24,934 | 31.0% | 14.0% | 75,401 | 64,215 | 17.4% |
| Total Expenditure | 26,792 | 19,926 | 22,856 | 34.5% | 17.2% | 70,231 | 58,381 | 20.3% |
| Purchase of stock-in-trade (traded goods) | 20,152 | 13,206 | 16,869 | 52.6% | 19.5% | 51,415 | 44,104 | 16.6% |
| Changes in inventories of stock-in-trade | 171 | 784 | 752 | (78.2%) | (77.3%) | 771 | -776 | (199.3%) |
| Employee benefits expense | 4,043 | 4,048 | 3,374 | (0.1%) | 19.8% | 11,783 | 10,034 | 17.4% |
| Other Expenses | 2,426 | 1,888 | 1,861 | 28.5% | 30.3% | 6,262 | 5,020 | 24.7% |
| EBITDA | 1,636 | 1,773 | 2,077 | (7.7%) | (21.3%) | 5,170 | 5,833 | (11.4%) |
| EBITDA Margin (%) | 5.8% | 8.2% | 8.3% | -241bps | -258bps | 6.9% | 9.1% | -223bps |
| Depreciation and Amortization expense | 323 | 329 | 337 | (2.0%) | (4.3%) | 985 | 983 | 0.2% |
| EBIT | 1,313 | 1,443 | 1,740 | (9.0%) | (24.5%) | 4,185 | 4,851 | (13.7%) |
| EBIT Margin (%) | 4.6% | 6.7% | 7.0% | -203bps | -236bps | 5.6% | 7.6% | -200bps |
| Finance Costs | 160 | 192 | 219 | (16.7%) | (27.2%) | 552 | 634 | (13.1%) |
| Other Income | 215 | 192 | 195 | 12.0% | 10.1% | 596 | 708 | (15.9%) |
| Exceptional items | 0 | 0 | 1,747 | NA | (100.0%) | 0 | 1,747 | (100.0%) |
| Profit before tax | 1,368 | 1,443 | -31 | (5.2%) | (4,513.5%) | 4,229 | 3,178 | 33.1% |
| Tax expense | 318 | 379 | 431 | (16.0%) | (26.1%) | 1,058 | 1,197 | (11.6%) |
| Net profit | 1,050 | 1,065 | -462 | (1.4%) | (327.5%) | 3,171 | 1,981 | 60.1% |
| Net profit margin (%) | 3.7% | 4.9% | -1.9% | -121bps | 555bps | 4.2% | 3.1% | 112bps |
| Adj. Net profit | 1,050 | 1,065 | 1,285 | (1.4%) | (18.3%) | 3,171 | 3,728 | (14.9%) |
| Adj. Net profit margin (%) | 3.7% | 4.9% | 5.2% | -121bps | -146bps | 4.2% | 5.8% | -160bps |
| Adj. EPS | 4 | 4 | 5 | (1.4%) | (18.3%) | 11 | 13 | (14.9%) |

Source: Company, DevenChoksey Research

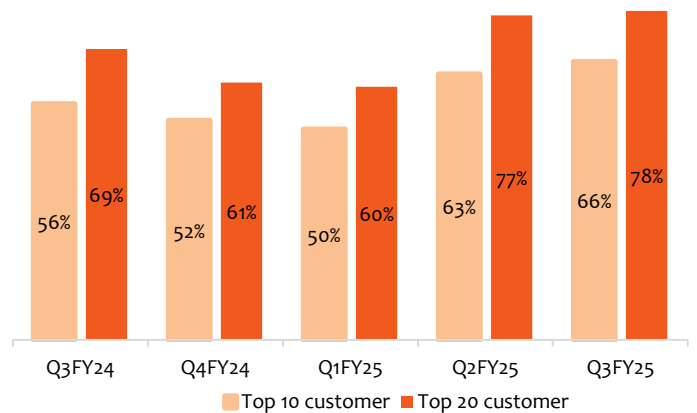
Quarterly Trends

Strong domestic business drives the revenue growth



Source: Company, DevenChoksey Research

Contribution from Top 10 and Top 20 customers increased



Sonata Software Ltd.

KEY FINANCIALS

Exhibit 1: Profit & Loss Statement

| INR Mns | FY23 | FY24 | FY25E | FY26E | FY27E |
|---------------------------|--------------|--------------|--------------|--------------|---------------|
| Revenue | 74,491 | 86,131 | 1,00,087 | 1,18,204 | 1,39,153 |
| Op expense | 68,450 | 78,856 | 93,489 | 1,09,512 | 1,28,313 |
| EBITDA | 6,041 | 7,274 | 6,599 | 8,692 | 10,840 |
| Depreciation | 591 | 1,319 | 1,209 | 1,382 | 1,514 |
| EBIT | 5,450 | 5,955 | 5,390 | 7,310 | 9,326 |
| Other income, net | 708 | 1,256 | 851 | 1,064 | 1,252 |
| Finance costs | 185 | 850 | 817 | 624 | 705 |
| Exceptional Items | 0 | 1,747 | 0 | 0 | 0 |
| Pre-tax Income | 5,973 | 4,614 | 5,424 | 7,750 | 9,874 |
| Income tax expense | 1,454 | 1,529 | 1,356 | 1,938 | 2,468 |
| PAT | 4,519 | 3,085 | 4,068 | 5,813 | 7,405 |
| EPS (INR) | 16.3 | 17.4 | 14.5 | 20.7 | 26.4 |
| Adj. PAT | 4,519 | 4,832 | 4,068 | 5,813 | 7,405 |

Exhibit 3: Cash Flow Statement

| INR Mns | FY23 | FY24 | FY25E | FY26E | FY27E |
|-----------------|--------|--------|--------|--------|--------|
| CFFO | 2,684 | 2,805 | 7,689 | 7,685 | 8,756 |
| CFFI | -8,553 | -543 | -2,939 | -3,605 | -4,270 |
| CFFF | 1,868 | -1,085 | -1,958 | -3,080 | -3,898 |
| Net Inc/Dec | -4,002 | 1,177 | 2,793 | 1,000 | 588 |
| Others | 876 | 0 | 66 | 0 | 0 |
| Forex | -37 | 9 | 0 | 0 | 0 |
| Opening Balance | 7,337 | 4,174 | 5,360 | 8,219 | 9,220 |
| Closing Balance | 4,174 | 5,360 | 8,219 | 9,220 | 9,808 |

Exhibit 4: Key Ratios

| Key Ratio | FY23 | FY24 | FY25E | FY26E | FY27E |
|-----------------------|-------|-------|-------|-------|-------|
| EBIT Margin (%) | 7.3% | 6.9% | 5.4% | 6.2% | 6.7% |
| Tax rate (%) | 24.3% | 33.1% | 25.0% | 25.0% | 25.0% |
| Net Profit Margin (%) | 6.1% | 5.6% | 4.1% | 4.9% | 5.3% |
| RoE (%) | 37.7% | 22.8% | 28.3% | 39.0% | 47.9% |
| RoCE (%) | 34.4% | 33.4% | 28.2% | 36.8% | 45.2% |
| RoA (%) | 10.4% | 6.0% | 7.2% | 9.3% | 10.6% |
| EPS (INR per share) | 16.3 | 17.4 | 14.5 | 20.7 | 26.4 |
| P/Ex | 30.3 | 28.4 | 34.0 | 23.8 | 18.7 |

| INR Mns | FY23 | FY24 | FY25E | FY26E | FY27E |
|-------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Equity | | | | | |
| Equity Share Capital | 139 | 278 | 278 | 278 | 278 |
| Other Equity | 12,868 | 13,785 | 14,379 | 14,873 | 15,503 |
| Total Equity | 13,007 | 14,063 | 14,657 | 15,151 | 15,780 |
| Long term Debts | 3,051 | 4,310 | 4,353 | 4,397 | 4,441 |
| Other Long-Term Liabilities | 5,878 | 2,185 | 3,651 | 5,771 | 8,527 |
| Total noncurrent liabilities | 8,929 | 6,496 | 8,004 | 10,167 | 12,967 |
| Trade Payables | 12,949 | 14,160 | 16,905 | 19,802 | 23,202 |
| Short Term Borrowings | 1,885 | 2,433 | 2,506 | 2,581 | 2,658 |
| Other Current Liabilities | 6,799 | 14,340 | 14,237 | 14,781 | 15,287 |
| Total Current Liabilities | 21,633 | 30,933 | 33,648 | 37,165 | 41,147 |
| Total liabilities | 43,569 | 51,491 | 56,308 | 62,483 | 69,895 |
| Property Plants and Equipment's | 488 | 518 | 910 | 1,538 | 2,389 |
| 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 | 22,001 | 23,667 | 25,754 |
| Current Assets | | | | | |
| Inventories | 288 | 980 | 1,078 | 1,186 | 1,304 |
| Cash & Cash Equivalent | 7,303 | 8,650 | 11,509 | 12,510 | 13,098 |
| Trade Receivables | 12,362 | 16,051 | 15,630 | 17,812 | 20,968 |
| Other current assets | 4,198 | 5,075 | 6,090 | 7,308 | 8,770 |
| Total Current Assets | 24,151 | 30,756 | 34,307 | 38,816 | 44,141 |
| Total Assets | 43,569 | 51,491 | 56,308 | 62,483 | 69,895 |

Source: Company, DevenChoksey Research

Sonata Software Ltd.

| Sonata Software Ltd. | | | | Rating Legend (Expected over a 12-month period) | |
|----------------------|-----------|----------|----------------|---|----------------|
| Date | CMP (INR) | TP (INR) | Recommendation | Our Rating | Upside |
| 10-Feb-25 | 489 | 517 | ACCUMULATE | Buy | More than 15% |
| 06-Nov-24 | 632 | 679 | ACCUMULATE | Accumulate | 5% – 15% |
| 06-Aug-24 | 627 | 694 | ACCUMULATE | Hold | 0 – 5% |
| 14-May-24 | 510 | 603 | BUY | Reduce | -5% – 0 |
| 07-Feb-24 | 823 | 870 | ACCUMULATE | Sell | Less than – 5% |

ANALYST CERTIFICATION:

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CIN-U67120MH1997PTC108958
Registered Office: 1102, Stock Exchange Tower, Dalal Street, Fort, Mumbai – 400 001.
Phone: 91-22-6633 5000; Fax: 91-22-6633 8060
Corporate Office: 701-702, DLH Plaza, Opp Shoppers Stop, SV Road, Andheri (W), Mumbai 400 058
Phone: 91-22-66535000
Compliance Officer: Varsha Shinde
Email: varsha.shinde@krchoksey.com