KRChoksey | RESEARCH by DEVEN CHOKSEY

Sonata Software Ltd
Q3FY25

Result update 10th Feb 2025

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**

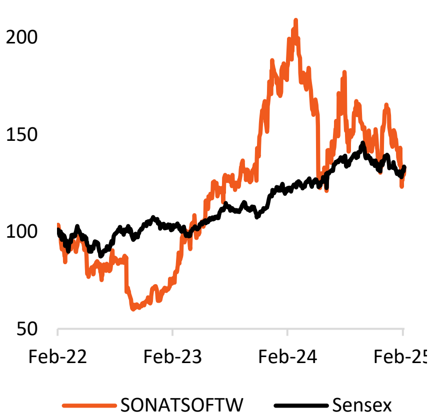
Result Highlights:

- 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
FIIs	12.3	12.1	12.4
DIIs	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

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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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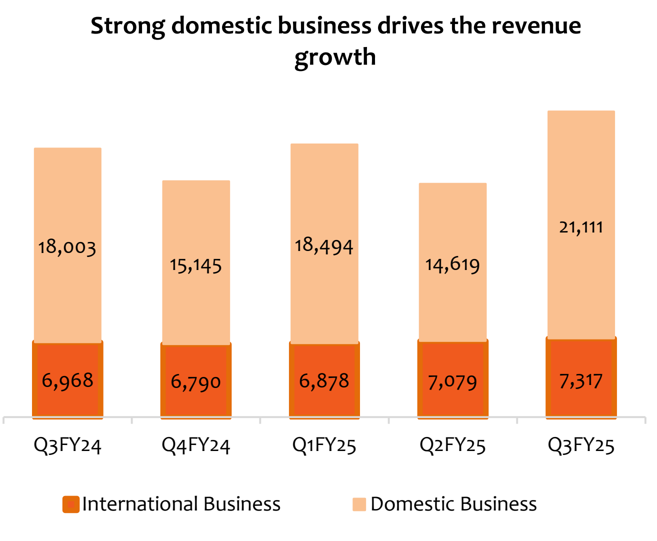
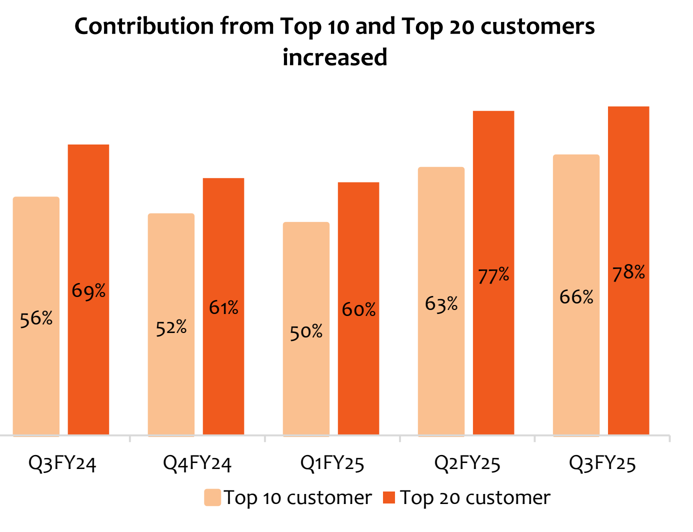
RESULT SNAPSHOT

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





Source: Company, DevenChoksey Research

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
Oher 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.			
Date	CMP (INR)	TP (INR)	Recommendation
10-Feb-25	489	517	ACCUMULATE
06-Nov-24	632	679	ACCUMULATE
06-Aug-24	627	694	ACCUMULATE
14-May-24	510	603	BUY
07-Feb-24	823	870	ACCUMULATE

Rating Legend (Expected over a 12-month period)	
Our Rating	Upside
Buy	More than 15%
Accumulate	5% – 15%
Hold	0 – 5%
Reduce	-5% – 0
Sell	Less than – 5%

ANALYST CERTIFICATION:

I, **Dipak Saha** (MBA, Finance), Research Analyst, author and the name subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my views about the subject issuer(s) or securities. I also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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