

# Sonata Software

BUY

Near term headwinds, long term attractive

## Summary

**Sonata Software (Sonata)** reported subdued Q4 services revenues (down 2.4% QoQ) due to delay in large deal in healthcare. Going forward, the company expects macro challenges will lead to delay in decision making (elongated from 3-6 months to 6-9 months) and in large deal closure. Hence, the company expect flat to positive growth in H1FY25E and expect stronger H2FY25E. However, the company expects to grow above industry in FY25E. Further, subdued revenue growth in H1FY25E will lead to flat margins in H1FY25E and improvement in H2FY25E. Consequently we have downgraded our EPS estimates downwards for by 12% each for FY25E & FY26E. Hence, we lower our target price downwards from Rs 915 to Rs 770. However, considering the recent fall in price we maintain Buy rating on the stock.

## Key Highlights and Investment Rationale

- Near term challenges, long term intact:** Although the company continues to win large deals and has 67 large deals in pursuit, the conversion to pipeline is being delayed. Hence, we have tapered our revenue estimates for FY25E by 6%. However, in long term considering traction in AI ( company expects 20% of topline from AI in 3 years), traction in Microsoft fabric, strong growth in Quant (65% YoY for FY25E),large deals, client mining , entry of fortune 20 clients in top 10 accounts and geo expansion (Poland, Mexico, Egypt & Malaysia) are expected to be key long term growth drivers. Hence we remain positive on the company from long term perspective.
- Margins to be subdued in near term:** Tapering of revenue is expected to impact services margins by 80 bps in FY25E. However, we expect margins to improve by 70 bps in FY26E led by higher IP revenues from quant and operating leverage partially offset by investments in sales and marketing.

TP	Rs770			Key Stock Data	
CMP	Rs637			Bloomberg/Reuters SSOF IN / SOFT.BO	
Potential upside/downside	21%				
Previous Rating	BUY				
Price Performance (%)					
	-1m	-3m	-12m		
Absolute	(14.0)	(20.8)	48.2		
Rel to Sensex	(13.1)	(22.7)	27.8		
V/s Consensus			Shareholding Pattern (%)		
EPS (Rs)	FY25E	FY26E	Promoters	28.2	
IDBI Capital	20	27	FII	13.9	
Consensus	23	29	DII	18.4	
% difference	(13.2)	(6.8)	Public	39.5	

## Financial snapshot

Year	FY22	FY23	FY24E	FY25E	FY26E	(Rs mn)
Revenue	55,534	74,491	86,131	98,363	1,15,176	
Change (yoY, %)	31	34	16	14	17	
EBITDA	4,638	6,041	7,274	8,814	10,311	
Change (yoY, %)	22	30	20	21	17	
EBITDA Margin(%)	8.4	8.1	8.4	9.0	9.0	
Adj.PAT	3,765	4,519	4,831	5,657	7,495	
EPS* (Rs)	27	33	17	20	27	
Change (yoY, %)	16	20	(47)	17	32	
PE(x)	23	20	37	31	24	
Dividend Yield (%)	3.3	2.5	1.8	0.0	0.0	
EV/EBITDA (x)	17	14	24	19	16	
RoE (%)	38	38	36	34	32	
RoCE (%)	35	27	23	35	44	

Source: Company, IDBI Capital Research,\* EPS is bonus adjusted

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### Con-call Highlights

- International services revenue stood at \$81.7mn which de-grew by 2.4% QoQ and in CC terms de-grew by 2.2% QoQ. The sequential decline was mainly due to seasonally soft quarter for Quant and delay in healthcare large deal. Domestic business revenue showed sequential decline, however, management expects 10-15% growth in coming years.
- EBITDA margin of international services stood at 21.1% dipped by 310bps mainly due to de-growth in revenue and higher other expenses (cost associated with large deal ramp down). EBITDA margin of domestic business stood at 3.7% declined by 40bps QoQ.
- **Large deals:** Large deal pipeline is 34% up QoQ. Total 67 large deals are in pipeline which consists of 31 in Retail & manufacturing, 13 in TMT & HLS each, 4 in BFSI and 6 in emerging vertical. 52% of large deal pipeline are with fortune 500 clients. Company expects 20% of revenue in 3years to come from Microsoft fabric & Gen AI on the back of pipeline of +75 clients and +90 clients respectively. Delayed healthcare large deal would ramp up till Q2FY25E.
- Management stated that finance cost would be on the higher side in short term due to delay in receiving regulatory approvals for repayment of borrowings.
- **Demand Outlook:** Management expects delays in decision making from client's end. Vertically, demand in healthcare & hi-tech to be in good momentum; BFSI and Hi-tech to show flattish to slight growth in near term and emerging to be continue in pressure. Company sees strong growth from digital based competencies like Managed cloud services and Digital Platformation Services (Microsoft & Open source) and focused verticals like TMT, Healthcare & Life Sciences, Manufacturing, Retail / CPG/ TTH and BFSI.
- **Guidance:** Management expects flattish revenue growth for H2FY25E, however, confident to achieve above industry leading growth (5-6%) in FY25E. Company expects delay of few quarters in achieving long term target (3-4years) of \$1.5bn revenue. It would be on the back of new large deals and growth drivers like Microsoft sell-to; Dynamics Sustain SITL momentum retail, manufacturing, travel and TMT. Management would continue to invest in sales, large deals, AI capabilities and existing verticals. Also, on margins side, company expects it to be in lower range of 20's and to improve in H2FY25E.

## Exhibit 1: Financial snapshot

(Rs mn)

Year-end: March	Q4FY24	Q3FY24	QoQ (%)	Q4FY23	YoY (%)
<b>International Revenue (US\$mn)</b>	<b>82</b>	<b>84</b>	<b>(2.4)</b>	<b>66</b>	<b>24.2</b>
<b>Revenues</b>	<b>21,916</b>	<b>24,934</b>	<b>(12.1)</b>	<b>19,135</b>	<b>14.5</b>
COGS	18,181	20,995	(13.4)	16,175	12.4
Gross profit	3,735	3,939	(5.2)	2,960	26.2
SG&A	2,294	1,861	23.2	1,444	58.9
<b>EBITDA</b>	<b>1,441</b>	<b>2,077</b>	<b>(30.6)</b>	<b>1,516</b>	<b>(4.9)</b>
Depreciation & amortization	337	337	(0.1)	189	78.0
EBIT	1,105	1,740	(36.5)	1,327	(16.8)
Other income	547	195	180.4	250	119.1
PBT	1,436	1,716	n.m	1,505	n.m
Tax	332	431	(22.9)	367	(9.5)
Minority interest					
Adjusted net profit	1,104	1,285	(14.1)	1,138	(3.0)
Extraordinary items	0	-1747	n.m	0	n.m
<b>Reported net profit</b>	<b>1,104</b>	<b>-462</b>	<b>n.m</b>	<b>1138</b>	<b>n.m</b>
<b>Recurring EPS (Rs) *</b>	<b>3.98</b>	<b>4.6</b>	<b>(14.1)</b>	<b>8.2</b>	<b>n.m</b>
<hr/>					
<b>As % of net revenue</b>					
Gross profit	17.0	15.8		15.5	
SG&A	10.5	7.5		7.5	
EBITDA	6.6	8.3		7.9	
EBIT	5.0	7.0		6.9	
Reported net profit	5.0	5.2		5.9	
Tax rate	30.1	25.1		24.4	

Source: Company; IDBI Capital Research, \*EPS is bonus adjusted

### Exhibit 2: Earnings Revision

Year-end: March	FY25E			FY26E		
	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (Rs mn)	98,363	1,04,703	-6%	1,15,176	1,27,185	-9%
EBIT margin (%)	7.8%	8.3%	-55 bps	7.9%	8.9%	-96 bps
EPS (Rs)	20.4	23.2	-12%	27.0	30.7	-12%

Source: Company; IDBI Capital Research

### Exhibit 3: Actual vs. estimates

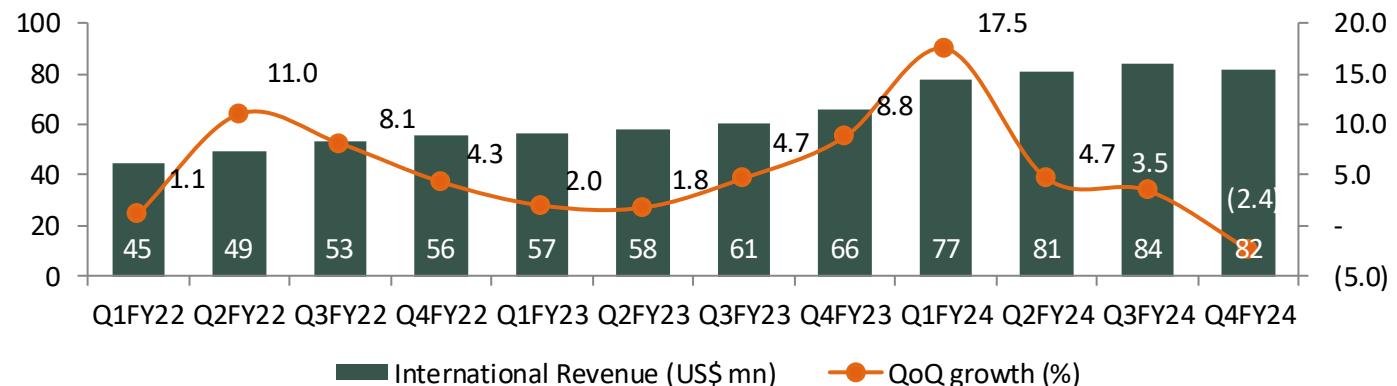
Year to March	Q4FY24	Q4FY24E	Variance (%)
International Revenue (US\$mn)	82	85	-3%
Revenue (Rsmn)	21,916	22,234	-1%
EBIT (Rsmn)	1,105	1,612	-31%
EBIT margin (%)	5.0%	7.0%	-196 bps
PAT (Rsmn)	1,104	1,192	-7%
PAT margin (%)	5.0%	5.4%	-33 bps
EPS (Rs)	4.0	4.3	-8%

Source: Company; IDBI Capital Research

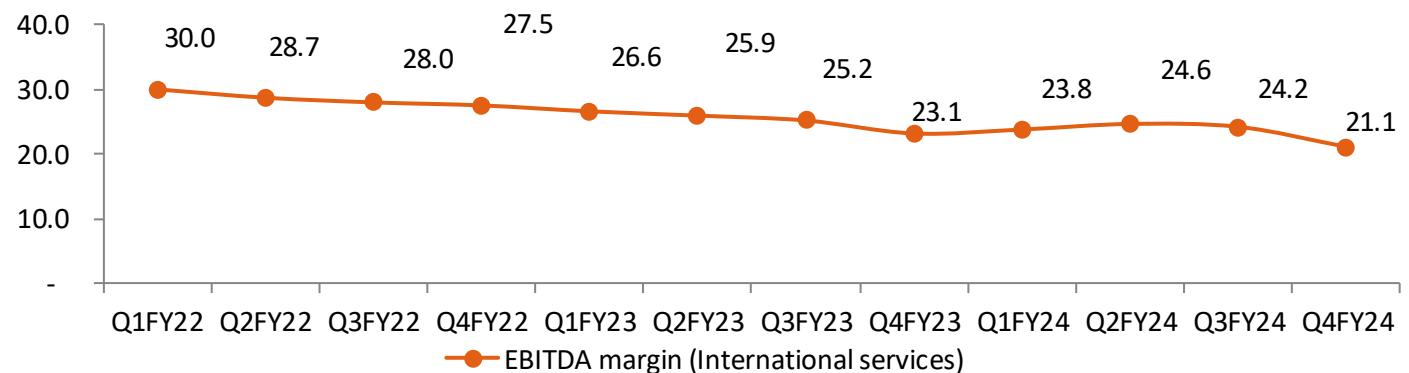
### Exhibit 4: Large client metrics

Year-end: March	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	Q4FY24
Top 10	62	62	58	55	54	58	61	56	52
Top 20	72	72	65	66	66	69	70	69	61
Top 10-20	10	10	7	11	12	11	9	13	9
Non top 20	28	28	35	34	34	31	30	31	39

Source: Company; IDBI Capital Research

**Exhibit 5: Q4FY24 International revenue de-grew by 2.4% QoQ to \$81.9mn**


Source: Company; IDBI Capital Research

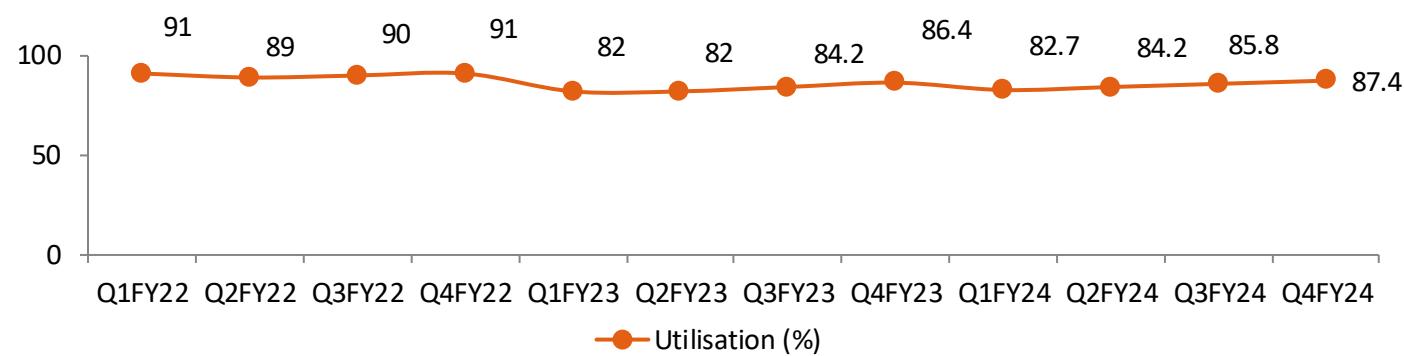
**Exhibit 6: Q4FY24 International services EBITDA margin decline by 281bps to 21.1%**


Source: Company; IDBI Capital Research

**Exhibit 7: Revenue growth across various segments (%)**

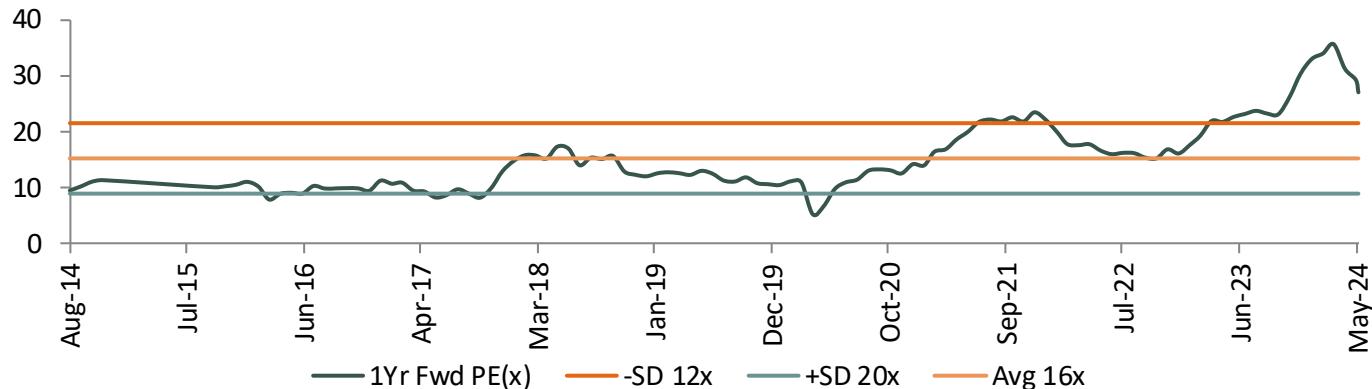
Parameters	% of revenue	growth (QoQ)	growth (YoY)
IT revenue growth		-2.2%	34%
<b>Geography</b>	<b>(QoQ)</b>		
USA	70	-3.8%	
Europe	14	5.1%	
ROW	16	4.1%	
<b>Verticals</b>	<b>(QoQ)</b>		
Retail and Manufacturing	35	0.5%	
TMT	36	13.4%	
Healthcare	12	6.5%	
BFSI	14	-19.6%	
Emerging	4	-51.2%	

Source: Company; IDBI Capital Research

**Exhibit 8: Utilization (*International Services*) improved QoQ by 160bps at 87.4%**


Source: Company; IDBI Capital Research

## Exhibit 9: One-year forward PER trend



Source: Company; IDBI Capital Research

## Financial Summary

### Profit & Loss Account

(Rs mn)

Year-end: March	FY21	FY22	FY23	FY24	FY25E	FY26E
<b>Net sales</b>	42,281	55,534	74,491	86,131	98,363	1,15,176
<i>Change (yoY, %)</i>	13.0	31	34	16	14	17
Operating expenses	(38,487)	(50,896)	(68,450)	(78,856)	(89,549)	(1,04,865)
<b>EBITDA</b>	<b>3,794</b>	<b>4,638</b>	<b>6,041</b>	<b>7,274</b>	<b>8,814</b>	<b>10,311</b>
<i>Change (yoY, %)</i>	1.8	22	30	20	21	17
<i>Margin (%)</i>	9	8	8	8	9	9
Depreciation	(396)	(473)	(591)	(1,319)	(1,191)	(1,163)
<b>EBIT</b>	<b>3,398</b>	<b>4,165</b>	<b>5,450</b>	<b>5,955</b>	<b>7,623</b>	<b>9,148</b>
Interest paid	(154)	(180)	(185)	(850)	(666)	(318)
Other income	277	1,020	708	1,255	486	1,033
<b>Pre-tax profit</b>	<b>3,522</b>	<b>5,004</b>	<b>5,973</b>	<b>4,614</b>	<b>7,443</b>	<b>9,862</b>
Tax	(1,082)	(1,239)	(1,454)	(1,529)	(1,786)	(2,367)
<i>Effective tax rate (%)</i>	31	25	24	33	24	24
Minority Interest	-	-	-	-	-	-
<b>Net profit</b>	<b>2,440</b>	<b>3,765</b>	<b>4,519</b>	<b>3,085</b>	<b>5,657</b>	<b>7,495</b>
Exceptional items	-	-	-	(1,747)	-	-
<b>Adjusted net profit</b>	<b>2,440</b>	<b>3,765</b>	<b>4,519</b>	<b>4,831</b>	<b>5,657</b>	<b>7,495</b>
<i>Change (yoY, %)</i>	(11.9)	54	20	7	17	32
EPS	23.5	27.2	32.6	17.4	20.4	27.0
Dividend per sh	14.0	21.0	15.8	11.4	0.2	0.3
<i>Dividend Payout %</i>	60	77	48	65	1	1

Balance Sheet							(Rs mn)
Year-end: March	FY21	FY22	FY23	FY24	FY25E	FY26E	
<b>Shareholders' funds</b>	<b>9,055</b>	<b>10,992</b>	<b>13,007</b>	<b>14,063</b>	<b>19,663</b>	<b>27,083</b>	
Share capital	104	104	139	278	278	278	
Reserves & surplus	8,951	10,888	12,868	13,785	19,386	26,806	
<b>Total Debt</b>	<b>897</b>	<b>380</b>	<b>4,936</b>	<b>6,743</b>	<b>2,993</b>	<b>433</b>	
Other liabilities	1,021	1,660	9,876	2,185	(2,380)	(6,115)	
<b>Curr Liab &amp; prov</b>	<b>8,497</b>	<b>12,560</b>	<b>15,750</b>	<b>28,500</b>	<b>32,547</b>	<b>38,111</b>	
Current liabilities	8,225	12,275	15,440	28,130	32,125	37,616	
Provisions	272	285	311	370	422	495	
<b>Total liabilities</b>	<b>10,415</b>	<b>14,600</b>	<b>30,562</b>	<b>37,428</b>	<b>33,161</b>	<b>32,429</b>	
<b>Total equity &amp; liabilities</b>	<b>19,469</b>	<b>25,593</b>	<b>43,569</b>	<b>51,491</b>	<b>52,824</b>	<b>59,513</b>	
Net fixed assets	3,238	4,269	17,331	16,710	16,054	15,475	
Investments	1,350	1,619	2,087	3,141	3,569	4,157	
Other non-curr assets	189	261	-	884	884	884	
<b>Current assets</b>	<b>14,692</b>	<b>19,443</b>	<b>24,151</b>	<b>30,756</b>	<b>32,317</b>	<b>38,997</b>	
Inventories	-		288	980	1,119	1,310	
Sundry Debtors	6,158	9,220	12,362	16,051	18,330	21,464	
Cash and Bank	7,425	9,144	9,361	10,971	9,722	12,539	
Other current assets	1,109	1,051	2,140	2,754	3,146	3,683	
<b>Total assets</b>	<b>19,469</b>	<b>25,593</b>	<b>43,569</b>	<b>51,491</b>	<b>52,824</b>	<b>59,513</b>	

Cash Flow Statement							(Rs mn)
Year-end: March	FY21	FY22	FY23	FY24	FY25E	FY26E	
Pre-tax profit	3,522	5,004	5,973	4,614	7,443	9,862	
Depreciation	(396)	(473)	(591)	(1,319)	(1,191)	(1,163)	
Tax paid	(1,027)	(1,311)	(1,193)	(2,413)	(1,786)	(2,367)	
Chg in working capital	2,009	973	(212)	8,369	1,629	2,239	
Other operating activities	892	1,788	6,772	(7,309)	(4,956)	(4,273)	
<b>Cash flow from operations (a)</b>	<b>5,791</b>	<b>6,927</b>	<b>11,932</b>	<b>4,580</b>	<b>3,520</b>	<b>6,624</b>	
Capital expenditure	(652)	(1,505)	(13,653)	(698)	(534)	(585)	
Chg in investments	(307)	(268)	(469)	(1,054)	(428)	(588)	
Other investing activities	-	-	-	-	-	-	
<b>Cash flow from investing (b)</b>	<b>(1,565)</b>	<b>(2,567)</b>	<b>(14,732)</b>	<b>(2,015)</b>	<b>(962)</b>	<b>(1,172)</b>	
Equity raised/(repaid)	-	-	35	139	-	-	
Debt raised/(repaid)	37	(517)	4,556	1,807	(3,750)	(2,560)	
Dividend (incl. tax)	(1,457)	(2,917)	(2,185)	(3,164)	(57)	(75)	
Chg in minorities	-	-	-	-	-	-	
Other financing activities	-	-	-	-	-	-	
<b>Cash flow from financing (c)</b>	<b>(1,419)</b>	<b>(3,435)</b>	<b>2,406</b>	<b>(1,218)</b>	<b>(3,807)</b>	<b>(2,635)</b>	
<b>Net chg in cash (a+b+c)</b>	<b>2,807</b>	<b>925</b>	<b>(394)</b>	<b>1,347</b>	<b>(1,248)</b>	<b>2,817</b>	

### Financial Ratios

Year-end: March	FY21	FY22	FY23	FY24	FY25E	FY26E
Book Value (Rs)	87.2	79	94	51	71	98
<i>Adj EPS (Rs)</i>	23.5	27.2	32.6	17.4	20.4	27.0
<i>Adj EPS growth (%)</i>	-11.9	16	20	-47	17	32
<i>EBITDA margin (%)</i>	9.0	8.4	8.1	8.4	9.0	9.0
<i>Pre-tax margin (%)</i>	8.3	9.0	8.0	5.4	7.6	8.6
<i>Net Debt/Equity (x)</i>	-0.7	-0.8	-0.3	-0.3	-0.3	-0.4
<i>ROCE (%)</i>	34.3	35	27	23	35	44
<i>ROE (%)</i>	31.0	38	38	36	34	32
<b>DuPont Analysis</b>						
Asset turnover (x)	2.4	2.5	2.2	1.8	1.9	2.1
Leverage factor (x)	2.3	2.2	2.9	3.5	3.1	2.4
<i>Net margin (%)</i>	5.8	6.8	6.1	5.6	5.8	6.5
<b>Working Capital &amp; Liquidity ratio</b>						
Inventory days	0	0	1	4	4	4
Receivable days	53	61	61	68	68	68
Payable days	62	76	69	66	66	66

### Valuations

Year-end: March	FY21	FY22	FY23	FY24	FY25E	FY26E
PER (x)	27	23	20	37	31	24
Price/Book value (x)	7	8	7	13	9	7
EV/Net sales (x)	1	1	1	2	2	1
EV/EBITDA (x)	16	17	14	24	19	16
<i>Dividend Yield (%)</i>	2.2	3.3	2.5	1.8	0.0	0.0

Source: Company; IDBI Capital Research



# Notes

Dealing

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**Key to Ratings Stocks:****BUY:** 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below.**IDBI Capital Markets & Securities Ltd.****Equity Research Desk**

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