

Growth momentum to sustain...

About the stock: Sonata Software (Sonata) provides IT services and product licensing services to its clients. Sonata provides IT services to its clients in the segments of BFSI, HLS (Healthcare & Lifesciences), RMD (Retail, Manufacturing, Travel & Distribution) & TMT (Technology, Media & Telecom) segments.

- Sonata's revenue grew at 24.9% CAGR between FY2018-23 and PAT grew by 18.6% CAGR. The IT services revenue grew at 10.9% CAGR over FY2018-23 in dollar terms while in rupee terms it grew at CAGR of 15.6%.

Q3FY24 Performance: Sonata reported robust Q3FY24 performance with overall revenue coming at ₹ 2,497.1 crore, up 30.6% QoQ & 10.5% YoY. IT services reported revenue of US\$ 83.7 mn, up 3.5% QoQ & 38.3% YoY while in CC terms it grew by 3% QoQ. Sonata reported EBITDA margin of 24.2% in IT services and at company level EBITDA margin came at 9.1%.

Investment Rationale:

- Growth Momentum to continue:** Sonata's growth momentum is likely to continue to achieve revenue of US\$ 500 mn in IT services by FY2026. Sonata's acquired companies Quant Systems & Encore Software are fully integrated and both the companies has performed better than the company's expectations leading to payment of additional earnout indicating the acquired companies are contributing significantly to Sonata's growth. Sonata also expects AI services to contribute 20% to revenue by FY26E. We believe that Sonata IT services will grow at 25.5% CAGR over FY23-26E in dollar terms and 27.4% CAGR in rupee terms. We expect Sonata overall revenues to grow at ~18% CAGR over FY23-26E.
- Large deal wins, pipeline & client additions to sustain momentum:** Sonata had made investments to wins large deals to sustain & accelerate its growth momentum. The company in YTD FY24 won 13 large deals and it actively pursuing 49 large deals of which 45% deals are with Fortune 500 clients. Of the 49 deals, 15 deals are in the newly formed HLS & BFSI segments. Sonata in 9MFY24 added 27 new clients. Sonata's large deal wins & pipeline will aid in sustaining the growth momentum.
- Stable Margin as its plans to reinvest in business:** Sonata indicated that its margins in IT services are expected to be in the low 20's as its aims to invest in to accelerate the growth momentum. We expect the EBITDA margins at company level to improve from 8.1% in FY23 to 9.8% in FY26E as the revenue growth continues & large deals ramps up.

Rating and Target Price

- Sonata is well placed to sustain its medium and long-term growth momentum driven by large deal wins and healthy pipeline.
- We maintain **BUY** rating and value it at target price of ₹ 900; at 30x P/E on FY26E EPS.

Key Financial Summary

(Rs. Crore)	FY22	FY23	5 year CAGR (FY18-23)	FY24E	FY25E	FY26E	3 year CAGR (FY23-26E)
Net Sales	5,553	7,449	24.9%	8,779	10,448	12,208	17.9%
EBITDA	464	604	21.2%	808	963	1,198	25.6%
EBITDA Margin (%)	8.4	8.1		9.2	9.2	9.8	
PAT	376	452	18.7%	350	635	830	22.5%
EPS (Rs.)	27.2	32.6		12.6	22.9	29.9	
P/E (x)	26	22		38	31	24	
RoNW (%)	34.2	34.7		25.0	36.1	36.1	
RoCE (%)	39.8	25.9		31.0	31.7	33.8	

Source: Company, ICICI Direct Research



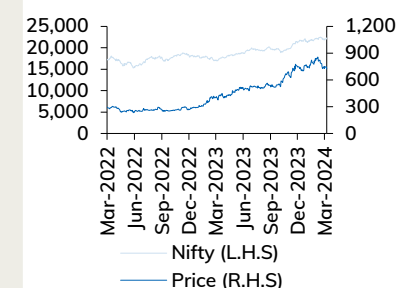
Particulars

Particulars	Amount
Market Capitalization (Rs. Crore)	19,937.8
Total Debt (Rs. Crore)	493.6
Cash and Investments (Rs. Crore)	936.1
EV (Rs. Crore)	19,495.3
52 week H/L	870 / 369
Equity capital (Rs. Crore)	28.0
Face value	1.0

Shareholding pattern

	Mar-23	Jun-23	Sep-23	Dec-23
Promoters	28	28	28	28
FII	13	14	15	14
DII	14	14	16	18
Public	45	44	40	40

Price Chart



Key risks

- Lower than expected revenue & margin growth;
- Delay in decision making in large deals

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Performance highlights and outlook

- Demand Outlook:** On the demand front, it expects growth momentum to continue in the long term despite the headwinds in industry. The company however indicated that it expects headwinds in short term due to weakness in BFSI segment, seasonally weak quarter for Quant in Q4 and delay in decision making in large deals. However, it expects the headwinds to be mitigated by tailwinds of large deals ramp up
- Margin and Gen AI outlook:** Sonata expects IT Services EBITDA margins excluding other income to be in low 20's i.e., 20-22% as it will continue to invest in the business. Sonata expects AI/Gen AI to contribute 20% of the IT Services revenue by FY26. The company indicated that it has pipeline of US\$50 mn in AI/Gen AI projects across 90+ clients & prospects
- Deal Wins and Pipeline:** Sonata during the quarter won 3 large deals, out of which 2 deals are with Fortune 25 clients. The company in 9MFY24 won 13 large deals. The company indicated that large deal pipeline is healthy and it is currently pursuing 49 large deals. Furthermore, 45% of the large deals pursued are with Fortune 500 clients. Sonata 15 large deals pursued were from the segments of Healthcare and BFSI which the company had aimed to expand
- Revenue Performance:** Sonata Software in IT Services in Q3FY24 reported revenue of US\$ 83.7 mn, up 3.5% QoQ & 38.3% YoY while in CC terms it grew by 3% QoQ. At company level it reported revenue of ₹ 2,497.1 crore, up 30.6% QoQ & 10.5% YoY. For 9MFY24 it reported revenue of ₹ 6,421.5 crore, up 16% compared to 9MFY23.
- Geographical/Segmental Performance:** In IT Services, US region (71% of the mix) grew by 7.1% QoQ during the quarter while Europe (13% of mix) & RoW (15% of mix) declined by 10.3% & 7.1% respectively. The company indicated that Europe region revenue in the last 2-3 quarters was impacted due completion of certain projects. Segment wise in IT services, growth was led by TMT (31% of revenue mix) which grew by 18.8% QoQ while HLS (11% of mix) & Emerging (8% of mix) grew by 3.5% & 65.5% QoQ respectively. BFSI (17% of mix) declined by 16.3% QoQ due to sectoral weakness while RMD (34% of mix) declined by 2.3% QoQ.
- Margin Performance:** The company during the quarter in IT Services reported EBITDA (including other income) of ₹168.5 crore with EBITDA margin of 24.2% while at company level it reported EBITDA of ₹ 227.2 crore with an EBITDA margin of 9.1%. The company excluding exceptional items reported a PAT of ₹ 128.5 crore.
- Client mix/additions internals:** Sonata top 10 clients (56% of mix) grew by 40.9% YoY & top 20 clients (69% of mix) grew by 44.6% YoY. Sonata during the quarter added 13 new clients bringing the total clients added to 27 in 9MFY24. The company in 9MFY24 added 11 Fortune 500 clients.
- New acquisition outperformance leads to additional payout:** The company during the quarter made a provision of ₹ 174.7 crore (US\$ 20.99 mn) towards payment of additional payout to the acquired companies Quant System (US\$ 17.12 mn) & Encore Software (3.87 mn). The company mentioned that both the acquired companies were entitled for payout based on their performance. Sonata indicated that both the company's financial performance was better than expected and hence they both were entitled for additional pay out for which it made the necessary provision during Q3FY24. The company further mentioned that no additional provision is required in the future for the additional pay out as all necessary provisions were booked in Q3.
- Bonus issue:** The company in Q3FY24 issued bonus shares in ratio of 1:1.

Financial Summary

Exhibit 1: Profit and loss statement				
	₹ crore			
(Year-end March)	FY23	FY24E	FY25E	FY26E
Total Revenues	7,449	8,779	10,448	12,208
Growth (%)	34.1	17.8	19.0	16.8
Total Operating Expenditure	6,845	7,971	9,485	11,010
EBITDA	604	808	963	1,198
Growth (%)	30.3	33.7	19.2	24.3
Depreciation & Amortization	59	129	110	98
Other Income	71	90	48	43
Interest costs	19	84	65	50
PBT before Exceptional Items	597	685	836	1,093
Growth (%)	19.4	14.7	22.0	30.7
Tax	145	161	201	262
PAT before Exceptional Items	452	524	635	830
Exceptional items	-	(175)	-	-
PAT before MI	452	350	635	830
Minority Int & Pft. from associ	-	-	-	-
PAT	452	350	635	830
Growth (%)	20	(23)	82	31
EPS	32.6	12.6	22.9	29.9
EPS (Growth %)	20	(61)	82	31

Source: Company, ICICI Direct Research

Exhibit 2: Cash flow statement				
	₹ crore			
(Year-end March)	FY23	FY24E	FY25E	FY26E
Net profit before Tax	597	511	836	1,093
Depreciation & Amortization	59	129	110	98
WC changes	(177)	54	67	71
Other non cash adju.	(36)	(6)	17	7
Income taxes paid	(175)	(161)	(201)	(262)
CF from operations	268	526	830	1,006
Capital expenditure	(41)	(31)	(37)	(43)
Δ in investments	(852)	-	-	-
Other investing cash flow	38	90	48	43
CF from investing Activities	(855)	60	12	0
Issue of equity	-	14	-	-
Δ in debt funds/lease liabilitie:	421	(24)	(24)	(24)
Dividends paid	(232)	(250)	(277)	(291)
Other financing cash flow	(2)	(99)	(65)	(50)
CF from Financial Activities	187	(358)	(366)	(365)
Δ in cash and cash bank bala	(400)	228	476	642
Effect of exchange rate chang	(4)	-	-	-
Opening cash	734	730	958	1,433
Closing cash	730	958	1,433	2,075

Source: Company, ICICI Direct Research

Exhibit 3: Balance Sheet				
	₹ crore			
(Year-end March)	FY23	FY24E	FY25E	FY26E
Equity	14	28	28	28
Reserves & Surplus	1,287	1,372	1,731	2,270
Networth	1,301	1,400	1,759	2,299
Minority Interest	-	-	-	-
LT liabilities & provisions	588	588	588	588
Total Debt	494	494	494	494
Source of funds	2,382	2,482	2,840	3,380
Assets				
Net fixed assets	635	561	511	480
Goodwill	1,098	1,098	1,098	1,098
Long term loans and advances	-	-	-	-
Other non current assets	209	243	287	333
Loans and advances	-	-	-	-
Inventories	29	34	40	47
Current Investments	206	206	206	206
Debtors	1,236	1,457	1,734	2,026
Cash & Cash equivalents	730	958	1,433	2,075
Other current assets	214	252	300	351
Current liabilities	1,944	2,291	2,726	3,185
Provisions	31	37	44	51
Net current assets	440	579	944	1,469
Application of funds	2,382	2,482	2,840	3,380

Source: Company, ICICI Direct Research

Exhibit 4: Key ratios				
(Year-end March)	FY23	FY24E	FY25E	FY26E
Per share data (₹)				
EPS-diluted	32.6	12.6	22.9	29.9
Cash per share	52.6	34.4	51.5	74.6
BV	93.7	50.4	63.2	82.7
DPS	15.8	9.0	10.0	10.5
Operating Ratios (%)				
EBITDA Margin	8.1	9.2	9.2	9.8
Adjusted PBT Margin	8.0	7.8	8.0	9.0
Adjusted PAT Margin	6.1	4.0	6.1	6.8
Return Ratios (%)				
RoNW	34.7	25.0	36.1	36.1
RoCE	25.9	31.0	31.7	33.8
RoIC	37.7	51.5	71.0	100.1
Valuation Ratios (x)				
P/E	22.0	38.0	31.4	24.0
EV / EBITDA	32.3	23.8	19.5	15.2
Price to Book Value	7.6	14.2	11.3	8.7
EV/Total Revenues	2.6	2.2	1.8	1.5
MCap/Total Revenues	2.7	2.3	1.9	1.6
Turnover Ratios				
Debtor days	61	61	61	61
Creditors days	63	63	63	63
Solvency Ratios				
Debt/EBITDA	0.8	0.6	0.5	0.4
Total Debt / Equity	0.4	0.4	0.3	0.2
Current Ratio	1.2	1.2	1.3	1.5
Quick Ratio	1.2	1.2	1.3	1.4
Debt / EBITDA	0.8	0.6	0.5	0.4

Source: Company, ICICI Direct Research

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