

## Deal ramp-up delay impacted growth, likely recovery in H2FY25...

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

**Q4 & FY24 Performance:** In Q4FY24, margins and revenue were hit by one-time impact from delay in healthcare deal closure in Q4. IT services revenue declined to US\$ 81.7 mn, a 2.4% decrease QoQ, with a decline of 2.2% in CC terms. EBITDA for IT services was ₹143.2 crore, down 15% QoQ, with an EBITDA margin of 21.1%, declining by ~310 bps QoQ. For FY24, company's IT services revenue reached US\$ 323.6 mn, marking a 34% increase YoY. EBITDA for IT services was ₹627.7 crore, up 30.2% YoY, with an EBITDA margin of 23.4%, down by ~170 bps YoY. At the company level, overall revenue was ₹ 8,613.1 crore, up 16% YoY. The company's EBITDA stood at ₹853 crore with an EBITDA margin of 9.9%, and PAT before exceptional items came to ₹483.2 crore with a PAT margin of 5.6%.

### Investment Rationale:

- **Revenue and Margin Growth to bounce back in Q3FY25:** Sonata indicated that its target of reaching US\$ 1.5 bn revenue by FY26 (~20% CAGR), has been delayed by a quarter or two, with accelerated growth to kick off from Q3FY25 onwards. Sonata expects AI services to contribute 20% of the IT Services revenue in three years' time led by traction seen in the GenAI and related engagements. On the margins front, management expects margins to stay range-bound and be in low 20's i.e., 20-22%.
- **Large deal wins, pipeline & client additions to sustain momentum:** Sonata sustained momentum with 1 large deal and 18 new clients in Q4, totalling 14 large deals and 45 new clients for FY24, including 7 Fortune 500 companies. The large deal pipeline increased by 34% QoQ. Although margins and revenue were hit by one-time impact from delay in healthcare deal closure in Q4, company indicated it remained active with no expected value change, and with ramp-up likely from Q2FY25 onwards.

### Rating and Target Price

- Sonata's growth momentum hinges on its large deal wins, robust pipeline, and advancements in AI. We have toned down our estimates, expecting IT services to grow at a 14.1% CAGR in dollars terms with ~8% growth in FY25. Overall revenues are anticipated to grow at ~14% CAGR during the same period.
- We maintain a BUY rating, valuing it at a target price of ₹ 670, with a lower multiple of 25x P/E on FY26E EPS compared to the previous 30x.

### Key Financial Summary

(₹ Crore)	FY22	FY23	FY24	5 year CAGR (FY19-24)	FY25E	FY26E	2 year CAGR (FY24-26E)
Net Sales	5,553	7,449	8,613	23.8%	9,582	11,199	14.0%
EBITDA	464	604	727	3.5%	883	1,087	22.2%
EBITDA Margin (%)	8.4	8.1	8.4		9.2	9.7	
PAT	376	452	308		562	748	
Adjusted PAT	376	452	483	14.4%	562	748	24.4%
EPS (Rs.)	27.2	32.6	11.1		20.2	26.9	
P/E (x)	19	16	30		26	19	
RoNW (%)	34.2	34.7	21.9		32.6	33.9	
RoCE (%)	39.8	25.9	31.4		31.1	33.6	

Source: Company, ICICI Direct Research



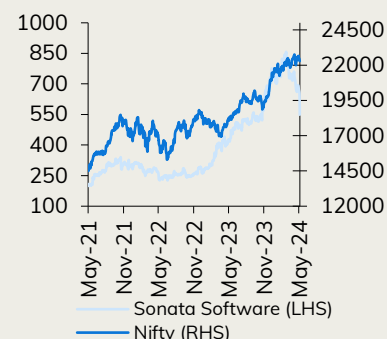
### Particulars

Particulars	Amount
Market Cap (₹ Crore)	14,483
Total Debt (₹ Crore)	674
Cash and Invt (₹ Crore)	1,097
EV (₹ Crore)	14,060
52 week H/L	870 / 401
Equity capital (₹ Crore)	27.8
Face value	1.0

### Shareholding pattern

	Jun-23	Sep-23	Dec-23	Mar-24
Promoters	28.2	28.2	28.2	28.2
FII	13.6	15.0	14.5	13.9
DII	14.3	16.4	17.6	17.6
Other	43.9	40.5	39.8	40.3

### Price Chart



### Key risks

- Lower than expected revenue growth due to delay in deal closure, weakness in the overall macro environment
- Lower than expected margin growth

### Research Analyst

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## Performance highlights and outlook

- Revenue Performance:** In Q4FY24, Sonata's IT services reported revenue of US\$ 81.7 mn, down 2.4% QoQ and up 24.1% YoY as it was hit by one-time impact from delay in healthcare deal closure in Q4. In CC terms revenue declined 2.2% QoQ and expanded 24.3% YoY. In rupee terms, IT services revenue was ₹ 679 crore, down 2.6% QoQ. At the company level, Sonata reported revenue of ₹ 2,191.6 crore, down 12% QoQ and up 15% YoY. Delays in closing large deals and seasonal weakness in Quant business led to sequential revenue decline. The long-term guidance of US\$1.5 bn revenues by FY26 has been slightly delayed by one to two quarters due to a large deal delay in the healthcare vertical.
- Margin Performance:** IT Services reported an EBITDA of ₹ 143.2 crore, down 15% QoQ, with an EBITDA margin of 21.1%, down by ~310 bps QoQ while at company level it reported EBITDA of ₹ 198.8 crore with EBITDA margin of 9.1% and PAT before exceptional items of ₹ 110.4 crore with PAT margin of 5%. For FY24, in IT services it reported EBITDA of ₹ 627.7 crore, up 30.2% with an EBITDA margin of 23.4%, down ~170 bps YoY. The company as a whole reported EBITDA of ₹ 853 crore with EBITDA margin of 9.9% and PAT before exceptional items of ₹ 483.2 crore with PAT margin of 5.6%.
- Demand Outlook:** Demand outlook remains positive despite short-term challenges in Q4, including delayed deal closures in healthcare and weakness in BFSI sector. Sonata expects IT Services EBITDA margins excluding other income to be range bound and be in low 20's i.e., 20-22%. It aims for rapid growth, targeting \$0.5 bn in international business by FY26 through winning large deals, diversifying client base, and scaling up in healthcare, BFSI, retail, and technology sectors.
- Margin and Gen AI outlook:** Margin declined by 300 bps due to pressure from higher onsite employee costs from a delayed deal, stagnant revenue from other deals, and ongoing investments in AI and Microsoft Fabric. Margin recovery is expected in one to two quarters as talent is redeployed and market conditions stabilize. For FY25, the company indicated flat to marginally up Q1 and Q2, with accelerated growth from Q3FY25. AI/Gen AI is projected to contribute 20% to IT Services revenue in three years, with a pipeline of US\$ 65 mn across 90+ clients.
- Deal Wins and Pipeline:** In the quarter, Sonata secured 1 large deal and added 18 new clients. Throughout FY24, it won 14 large deals and onboarded 45 new clients, including 7 Fortune 500 companies. The company's large deal pipeline grew by 34% QoQ. Sonata also closed a significant banking deal and highlighted its AI initiatives and secured notable deals in GenAI and Microsoft Fabric projects.
- Geographical/Segmental Performance:** In IT services, the US (70% of mix) and Europe (14% of mix) dec-grew by 3.8% and 2.4% QoQ respectively, while RoW (16% of mix) grew by 4.1% QoQ. TMT (36% of revenue mix) led segment growth with a 13% QoQ increase, followed by HLS (12% of mix) and Retail & Manufacturing (35% of mix) with 6.5% and 0.5% QoQ growth respectively. However, Emerging (4% of mix) segment declined by 51.20% QoQ, and BFSI (14% of mix) dropped by 19.6% QoQ, attributed to seasonal factors, especially in the Jan-March quarter. This dip is expected to be temporary, with significant recovery anticipated in subsequent quarters.
- Client mix:** Sonata's top 10 clients (52% of mix) grew by 19.6% YoY & top 20 clients (61% of mix) grew by 14.8% YoY. Sonata during the quarter added 18 new clients bringing the total clients added to 45 in FY24.
- M&A:** The company mentioned that it is not planning for any M&A activities at least in this calendar year and it shall revisit its stand on M&A activities in the next year only. The focus is on organic growth for FY25.

**Exhibit 1: Quarter Performance**

	Q4FY24	Q4FY23	YoY (%)	Q3FY24	QoQ (%)	Comments
Revenue	2,192	1,914	14.5	2,493	(12.1)	IT services reported 2.2% QoQ CC decline while rupee revenues fell by 2.6% QoQ while Domestic Products business declined by 15.9% QoQ
Employee expenses	331	257	29.0	337	(1.9)	
Purchase of stock-in trade	1,487	1,361	9.3	1,762	(15.6)	
Gross Margin	374	296	26.2	394	(5.2)	
Gross margin (%)	17.0	15.5	158 bps	15.8	125 bps	
Other expenses	229	144	58.9	186	23.2	
EBITDA	144	152	(4.9)	208	(30.6)	EBITDA margins for IT services declined ~310 bps QoQ to 21.1% primarily due to increased onsite employee costs associated with the delayed deal. Additionally, revenue stagnation from other deals and continued investments in AI and Microsoft Fabric contributed to margin pressure.
EBITDA Margin (%)	6.6	7.9	135 bps	8.3	-175 b	
Depreciation & amortisation	34	19	78.0	34	(0.1)	
EBIT	110	133	(16.8)	174	(36.5)	
EBIT Margin (%)	5.0	6.9	189 bps	7.0	-194 bps	
Other income (less interest)	33	18	86.1	(2)	#####	
PBT	144	150	(4.6)	172	(16.3)	
Tax paid	33	37	(9.5)	43	(22.9)	
PAT	110	114	(3.0)	(46)	(339.1)	

Source: Company, ICICI Direct Research

**Exhibit 2: Change in estimates**

	FY25E			FY26E			Comments
	Old	New	% Change	Old	New	% Change	
(₹ Crore)							
Revenue	10,448	9,582	-8.3	12,208	11,199	-8.3	Due to the cautious outlook given for FY25, we have cut our revenue estimates by 8.3%
EBITDA	963	883	-8.4	1,198	1,087	-9.3	We have reduced our EBITDA estimates due to continued pressure on margins owing to the delayed large deal in the healthcare vertical and revenue stagnation from other deals and continued investments in AI and Microsoft Fabric
EBITDA Margin (%)	9.2	9.2	-1 bps	9.8	9.7	-11 bps	
PAT	635	562	-11.5	830	748	-9.9	
EPS (₹)	22.9	20.2	-11.5	29.9	26.9	-9.9	

Source: Company, ICICI Direct Research

## Financial Summary

Exhibit 3: Profit and loss statement					₹ crore
(Year-end March)	FY23	FY24	FY25E	FY26E	
Total Revenues	7,449	8,613	9,582	11,199	
Growth (%)	34.1	15.6	11.3	16.9	
Total Op Expenditure	6,845	7,886	8,699	10,112	
EBITDA	604	727	883	1,087	
Growth (%)	30.3	20.4	21.3	23.2	
Depr & Amortization	59	132	117	101	
Other Income	71	126	48	56	
Interest costs	19	85	75	58	
PBT before Excep Items	597	636	739	984	
Growth (%)	19.4	6.5	16.2	33.1	
Tax	145	153	177	236	
PAT before Excep Items	452	483	562	748	
Exceptional items	-	(175)	-	-	
PAT before MI	452	308	562	748	
Minority Int & Pft. from ass	-	-	-	-	
PAT	452	308	562	748	
Growth (%)	20	(32)	82	33	
EPS	32.6	11.1	20.2	26.9	
EPS (Growth %)	20	(66)	82	33	

Source: Company, ICICI Direct Research

Exhibit 4: Cash flow statement					₹ crore
(Year-end March)	FY23	FY24	FY25E	FY26E	
Net profit before Tax	597	461	739	984	
Depreciation & Amortization	59	132	117	101	
WC changes	(177)	(209)	64	107	
Other non cash adju.	(36)	159	26	2	
Income taxes paid	(175)	(262)	(177)	(236)	
CF from Operations	268	281	769	958	
Capital expenditure	(41)	0	(34)	(39)	
Δ in investments	(852)	(88)	-	-	
Other investing cash flow	38	33	48	56	
CF from Investing Activities	(855)	(54)	15	17	
Issue of equity	-	14	-	-	
Δ in debt funds/lease liabilities	421	139	(24)	(24)	
Dividends paid	(232)	(215)	(245)	(262)	
Other financing cash flow	(2)	(46)	(75)	(58)	
CF from Financial Activities	187	(109)	(344)	(344)	
Δ in cash and cash bank bal	(400)	118	441	631	
Effect of exchange rate chan	(4)	1	-	-	
Opening cash	734	417	865	1,306	
Closing cash	730	865	1,306	1,937	

Source: Company, ICICI Direct Research

Exhibit 5: Balance Sheet					₹ crore
(Year-end March)	FY23	FY24	FY25E	FY26E	
Equity	14	28	28	28	
Reserves & Surplus	1,287	1,379	1,695	2,182	
Networth	1,301	1,406	1,723	2,209	
Minority Interest	-	-	-	-	
LT liabilities & provisions	588	219	219	219	
Total Debt	494	674	674	674	
Source of funds	2,382	2,299	2,616	3,102	
<b>Assets</b>					
Net fixed assets	635	558	498	460	
Goodwill	1,098	1,113	1,113	1,113	
Long term loans	-	-	-	-	
Other non current assets	209	403	436	493	
Loans and advances	-	-	-	-	
Inventories	29	98	109	127	
Current Investments	206	232	232	232	
Debtors	1,236	1,605	1,786	2,087	
Cash & Cash equivalents	730	865	1,306	1,937	
Other current assets	214	275	306	358	
Current liabilities	1,944	2,813	3,129	3,657	
Provisions	31	37	41	48	
Net current assets	440	226	568	1,036	
Application of funds	2,382	2,299	2,616	3,102	

Source: Company, ICICI Direct Research

Exhibit 6: Key ratios				
(Year-end March)	FY23	FY24	FY25E	FY26E
<b>Per share data (₹)</b>				
EPS-diluted	32.6	11.1	20.2	26.9
Cash per share	52.6	31.1	47.0	69.7
BV	93.7	50.6	62.0	79.5
DPS	15.8	7.9	8.8	9.4
<b>Operating Ratios (%)</b>				
EBITDA Margin	8.1	8.4	9.2	9.7
Adjusted PBT Margin	8.0	7.4	7.7	8.8
Adjusted PAT Margin	6.1	3.6	5.9	6.7
<b>Return Ratios (%)</b>				
RoNW	34.7	21.9	32.6	33.9
RoCE	25.9	31.4	31.1	33.6
RoIC	37.7	49.5	71.0	105.6
<b>Valuation Ratios (x)</b>				
P/E	16.0	30.0	25.8	19.4
EV / EBITDA	23.2	19.3	15.4	11.9
Price to Book Value	5.6	10.3	8.4	6.6
EV/Total Revenues	1.9	1.6	1.4	1.2
MCap/Total Revenues	1.9	1.7	1.5	1.3
<b>Turnover Ratios</b>				
Debtor days	61	68	68	68
Creditors days	63	60	60	60
<b>Solvency Ratios</b>				
Debt/EBITDA	0.8	0.9	0.8	0.6
Total Debt / Equity	0.4	0.5	0.4	0.3
Current Ratio	1.2	1.1	1.2	1.3
Quick Ratio	1.2	1.0	1.1	1.2
Debt / EBITDA	0.8	0.9	0.8	0.6

Source: Company, ICICI Direct Research

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