

BUY
CMP: 814
Target: 950
Upside: 17%
VALUE PARAMETERS

Face Value (Rs.)	1.00
Mrk.Cap (Rs. in Cr)	11,391
Enterprise value (Rs in Cr)	10978
52-Week High/Low	820/458
EPS (TTM)	31.1
P/E Ratio (TTM)	26.0
Book Value per share (Rs)	83.1
Industry P/E	31.5
P/B Ratio (calc at CMP)	9.78
Dividend Yield (%)	1.94
Cash equivalents (Rs. Cr)	625
Debt (Rs. Cr)	213

SHAREHOLDING PATTERN (%)

Promoters	28.17
FIIs	12.84
DIIIs	13.79
Public	44.09

FINANCIAL PERFORMANCE

Consolidated	FY22	FY23E	FY24E
Revenue (Rs. Cr)	5553.4	6752	7797
Growth (%)	31.00%	21.60%	15.47%
Expenditures	5089.6	6227	7175
EBITDA (Rs. Cr)	463.8	525	622
Growth (%)	22%	13.40%	18.47%
Margin (%)	8.35%	7.78%	7.98%
PAT (Rs. Cr)	376.4	409	482.5
Growth (%)	54.00%	8.77%	17.80%
Margin (%)	6.78%	6.06%	6.19%
EPS (Rs)	26.9	28.5	36.5
RoE (%)	31.80%	32.90%	31.50%
RoCE (%)	31%	31.40%	30%
RoA	14.40%	15.40%	15%

PRICE PERFORMANCE


Our Recommendation: Acquisition of QS will further improve Sonata's offering in Healthcare and BFSI verticals and will help revenue growth of company. This will strengthen Sonata's pricing power because Quant System led data analytics and data engineering is already commanding premium prices. Revenue growth is expected to be over 23.8% CAGR over FY22-25E aided by large deals won and digital spending by clients. We value the stock at Rs. 950, i.e., 26x P/E on FY24E. We recommend **Buy** in price range Rs. 800-820 with target price 950 (Upside 17%).

Investment Rationale:

About Company: Sonata Software Ltd is primarily engaged in the business of providing Information Technology (IT) Services and Solutions to its various customers in the United States of America, Europe, Middle East, Australia and India. Sonata Software offers IT services (30%) and product licensing & deployment (70%). The company provides IT services to travel, retail, agri & commodities and manufacturing and software vendors

Q3FY23 Results:

- The IT company posted 4.39% rise in consolidated net profit to Rs 117.66 crore on a 51.12% jump in revenue from operations to Rs 2,260.78 crore in Q3 FY23 over Q2 FY23.
- As compared to Q3 FY22, the IT firm's net profit increased by 20.47% while revenue from operations advanced 21.68%.
- Consolidated EBITDA grew by 4% quarter on quarter and 18% year on year to Rs 172.8 crore in Q3 FY23.
- Cash and cash equivalents (net of borrowings) stood at Rs 585 crore as on 31 December 2022.

Robust growth across the board: Among the business verticals, ISV accounted for more than 36% of the revenue, followed by distribution and manufacturing, which accounted for 22%. TMT, manufacturing and retail/TTH are the industry verticals which witnessed a strong growth during the quarter. Management remains optimistic about the Microsoft opportunity and expects to deliver 15-20% YoY growth in the medium term. The project pipeline continues to be healthy due to scaling of international business with a target of doubling its revenue in the next four years.

Strategic acquisition of Quant System:

- Sonata's wholly owned US subsidiary to acquire 100% stake in US based Quant Systems (QS) for total consideration of US\$ 160 mn (4.3x sales), US\$65 mn to be paid upfront while rest US\$95mn to be paid in next 2 years.
- The acquisition is in line with the company's strategy to accelerate IT services growth from hereon as well as strengthening its offering in BFSI and Healthcare vertical.
- Quant Systems's sales grew 4x in last 2 years and growth in future is also expected to be robust. EBITDA margins for the company are also healthy i.e., upwards of 30%.

Key Risks:

- Lower-than expected revenue growth.
- Lower than expected margins.

Conference call highlights

New CEO in Q3FY23 earnings call said that the company is looking to double its IT services revenue growth in next 3-4 years and important leverage points are:

- I) Winning large deals/contracts & large accounts;
- II) Continue to expand its services portfolio & develop a strong ecosystem to guide modernization outcomes,
- III) Strengthen its presence in BFSI and Healthcare & Life science segments.

Rationale of QS Acquisition

- QS started operations in 2008 as a consulting company. In initial years, QS did small projects on consulting in the range of US\$100-150K. In the last 4-5 years, it expanded its operations by doing downstream operations like data engineering, data transfer & data modernization to cloud. QS has also built its capabilities across Enterprise Data Analytics, cloud modernization, cyber security, salesforce, AWS, Data privacy, Adobe, Snowflake and digital mobile apps.
- QS has domain of expertise and marquee clients in different verticals like BFSI, Healthcare & Lifesciences, consumer and retail. QS has more than 300 employees across its centres in USA, India & Costa Rica.
- QS reported greater than 100 percent CAGR revenue growth in CY20-22, reaching US\$37mn in CY22. The company indicated that EBITDA margin for the QS is greater than 30%. Sonata indicated that for CY23 & CY24, QS's sales is expected to increase by 30-35% and EBITDA margin is expected to be in range of 30-35%.
- QS will enable Sonata's key strategic driver to win large block deals & it will also strengthen its presence in BFSI and healthcare verticals.
- With this acquisition, Sonata has got 2 of the Top 5 clients from day 1 each from BFSI and Healthcare segments. Both of these accounts have annual digital spending of US\$ 1+bn.
- With this acquisition, Sonata could strengthen its technical capabilities in enterprise data analytics, cloud modernization, cyber security, salesforce & data privacy. Sonata also mentioned that the acquisition will help to build its partnership with Salesforce, Snowflake & multiple data partners.
- QS's Lisachatbot will expand Sonata's platformation strategy. It would help Sonata to enable omnichannel experience integrating enterprise systems, contact centre and support system solutions. Workbox IP will help to expand digital document management for banking & healthcare clients.
- Sonata stated that data platform & data services are multi-year contracts. QS has expertise in data & analytics and Sonata can built a strong pipeline of annuity contracts that may reduce the volatility impact of its platformation business.

Funding & Future M&A plans

- Upfront payment of US \$65 mn will be paid by availing a short-term loan which will be repaid in next 12-15 months. Sonata indicated that despite having enough cash, they opted for short-term loan due to operational issues related to approval from RBI to transfer funds to US subsidiary.
- The company also indicated that they hope both Sonata and QS will continue to generate strong cash flow in the future and will take care of the deferred payment to be paid.
- On the future dividend policy, the company described that going forward the company to maintain dividend in absolute amount but the dividend pay-out % is going to be moderate.
- On future M&A strategy, the company described that they will continue to look assets currently they will focus on integration of QS.

Quarterly financial result, consolidated (Rs. Cr)

Y/E March (INR Crore)	Q3FY23	Q3FY22	Yoy chang (%)	Q2FY23	QoQ chang (%)
Revenue	2,260.78	1,858.02	21.68	1,495.98	51.12
Expenditure	2,104.52	1,726.35	21.91	1,341.35	56.90
<i>% of Sales</i>	93.1	92.9		89.7	
EBITDA	156.26	131.67	18.68	154.63	1.05
<i>Margin (%)</i>	6.9	7.1	-0.2 bps	10.3	-320 bps
Depreciation	13.62	12.68		13.62	
EBIT	142.64	118.99	19.88	141.01	1.16
Int. and Finance Charges	3.85	4.67		3.79	1.58
Other Income	16.55	15.27		11.11	
PBT bef. EO Exp.	155.34	129.59	19.87	148.33	4.73
EO Items					
PBT	155.34	129.59	19.87	148.33	4.73
Tax	37.68	31.92		35.62	
<i>Tax Rate (%)</i>	24.3	24.6		24.0	
PAT	117.66	97.67	20.47	112.71	4.39
<i>Margin (%)</i>	5.2%	5.3%	-10 bps	7.5%	-220 bps
Net Profit	117.66	97.67	20.47	112.71	4.39
Adj. EPS	8.48	7.05		8.13	

Income statement, consolidated (Rs. Cr)

Particulars (INR Cr)	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Revenue	2453.9	2960.9	3743.3	4228.1	5553.4	6752	7797
Total operating Expenses	2223	2625.3	3370.5	3848.7	5089.6	6227	7175
EBITDA	231	335.6	372.8	379.4	463.8	525	622
Depreciation	12.4	12.7	36.5	39.6	47.3	51	55
EBIT	218.6	322.9	336.3	339.8	416.4	474	567
Other income, net	45.5	27.3	58.4	27.8	102	100	110
Finance costs	4.8	3.4	15.2	15.4	18.1	21.1	25.1
(Less)/ Add: (Extraordinary Item) Interest Income	1.2	2.8	0	0	0	0	0
Pre-tax Income	260.4	349.5	379.5	352.1	500.4	552.9	652
Income tax expense	68.2	100.6	102.6	108.2	123.9	143.7	169.5
Net profit Before MI	192.1	248.9	276.9	244	376.4	413.8	482.5
Minority Interest	0.4	0.4	0	0	0	0	0
Net profit After MI	192.5	249.3	276.9	244	376.4	409.2	482.5
Adj. diluted EPS (INR)	13.8	17.8	19.8	17.8	27.2	28.5	36.5

Balance Sheet, consolidated (Rs Cr)

Particulars (INR Cr)	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
PP&E	23.4	22.6	21.3	15.2	35.2	56.6	74.8
Right-of-use Asset	0	0	9.73	8.49	8.49	84.9	84.9
Intangible Assets	10.1	32.2	23.8	47.7	47.7	47.7	47.7
Goodwill on consolidation	80.7	145.2	155.8	175.9	175.9	176	176
Non-current Investments	68.5	6.2	8.7	10.6	10.6	10.6	10.6
Deferred tax assets	12.4	11.9	24.4	18.9	18.9	18.9	18.9
Other non-current assets	84.8	63.2	95.6	124.5	124.5	125	125
Total non-current assets	279.9	281.3	426.9	477.7	497.7	519	537
Cash & equivalent	347.4	199.2	396.4	677.1	792.7	967.2	1217.1
Trade Receivables	396.4	811.1	700.0	615.8	708.5	810	929
Current Investments	130	140	4.8	65.4	65.4	65.4	65.4
Unbilled Revenues	41.2	44.7	40.8	40.8	52.3	73.5	82.7
Other Current Assets	37.6	51.6	47.6	70.1	70.1	70.1	70.1
Total current assets	952.5	1,246.8	1,189.6	1,469.2	1,689.1	1,986	2,364
Total Assets	1,232.4	1,528.1	1,616.5	1,946.9	2,186.8	2,506	2,901
Equity Share Capital	10.4	10.4	10.4	10.4	10.4	10.4	10.4
Other Equity	642.9	757.9	659.3	895.1	1,060.1	1,257	1,492
Equity Attributable to Owners	653.3	768.3	669.7	905.5	1,070.5	1,268	1,503
Non-controlling Interest	0	0	0	0	0	0	0
Total Equity	653.3	768.3	669.7	905.5	1,070.5	1,268	1,503
Long term Debts	18.7	0	0	0	0	0	0
Other Long-Term Liabilities	12.7	43.5	115.7	102.1	141.7	181	221
Total noncurrent liabilities	31.4	43.5	115.7	102.1	141.7	181	221
Trade Payables	432.3	587.3	561.9	651.0	725.7	798	913
ST-Term Borrowings	0	15.6	86	89.7	51.6	51.6	51.6
Other Current Liabilities	16.2	7.5	68.3	99	99	99	99
Others	6	13.3	0	0	0	0	0
Other Payables	39.1	31.6	56	28.2	28.2	28.2	28.2
Provision	54.3	61.1	58.9	71.5	70.1	79.6	86.4
Total Current Liabilities	547.8	716.3	831.1	939.4	974.6	1,056	1,178
Total liabilities	1,232.4	1,528.1	1,616.5	1,946.9	2,186.8	2,505	2,901

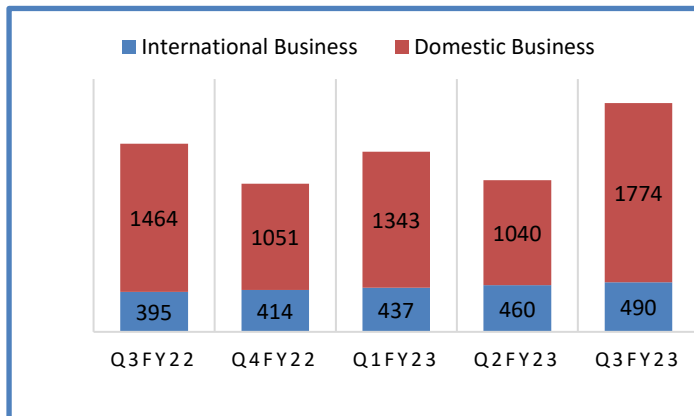
Cash Flow Statement, consolidated (Rs. Cr)

Particulars (INR Cr)	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Net Cash Flow from Operations	337.0	70.8	501.4	575.8	427.4	505	605
Net Cash Flow from/(used in) investing Activities	101.8	11.3	139	-114	-19.2	-15	-17
Net Cash Flow from Financing Activities	-21.5	-19.5	46.5	-18.1	-38.1	0	0
Others	-323	-211	-490	-163	-255	-310	-340
Net Inc./Dec. in cash equivalents	94.3	-148.1	197.2	280.7	115.7	180	248
Opening Balance	253.0	347.4	199.2	396.4	677.1	793	967
Closing Balance Cash and Cash	347.4	199.2	396.4	677.1	792.7	973	1,215

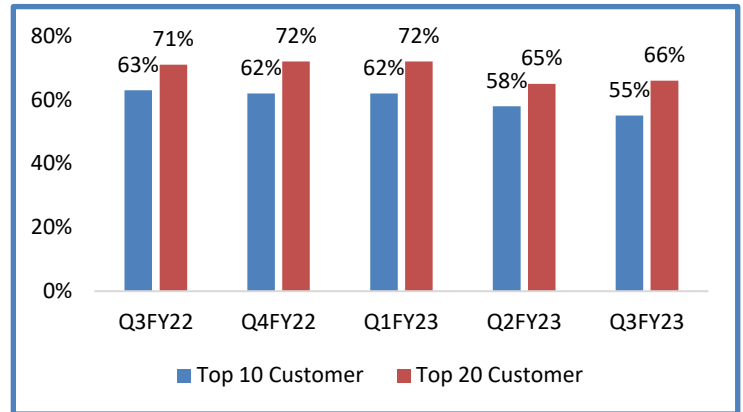
Key Ratios

Key Ratio	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
EBIT Margin (%)	8.9%	10.9%	9%	8%	7.5%	7%	7.3%
Net Profit Margin (%)	7.8%	8.4%	7.4%	5.8%	6.8%	6.1%	6.2%
RoE (%)	31%	35.1%	38.5%	31%	31.8%	32.9%	31.4%
RoCE (%)	24.8%	31.5%	33.8%	29.9%	31%	31.3%	30%
RoA (%)	15.6%	16.3%	17.1%	12.5%	14.4%	15.3%	15%
EPS (INR per share)	13.8	17.8	19.8	17.4	26.9	29.6	34.6

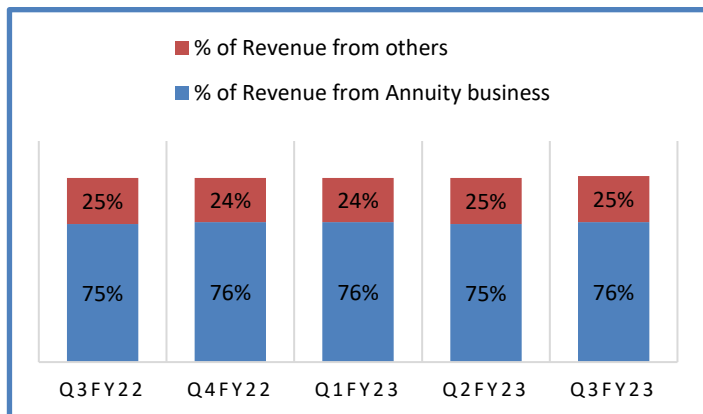
Revenue Bifurcation (Domestic vs international)



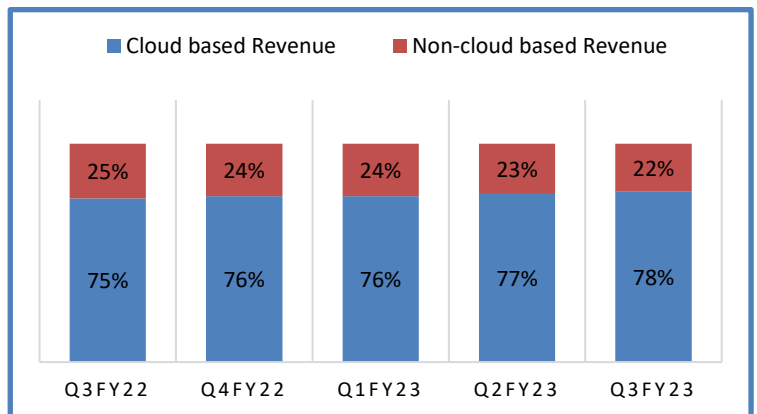
Client Concentration



Domestic Revenue Bifurcation



Revenue from Cloud vs Non-cloud



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