

27th September 2024

Sonata Software – BUY

CMP : Rs.632.0

Target Price : Rs.759.0

Upside : 20%+

Stop Loss : Rs.544.0 (Closing basis)

Investment Thesis

- Sonata Software Ltd. (Sonata) is a global IT services and solutions company and emerged as leading provider of IT consulting, software development, and digital transformation services, catering to an array of retail, manufacturing, distribution, travel and software product companies.
- Post Mr. Samir Dhir appointed as new CEO in 2022, Sonata has set a target to double its international revenues in the next 4 years and be known in the industry as a specialized firm in modernization and digital engineering. To achieve the same, Sonata plans to make investments in sales, investments in large deals, capability build as well as partner ecosystems. Further, Sonata also plans to invest in building brand building exercise, invest in resources to move up in quadrants and invest in identified campus and lateral hires.
- Sonata has classified verticals in 'invest vertical' and 'harvest vertical'. It has placed BFSI, Healthcare/Life Sciences under invest vertical whereas Telecom, Media, High-Tech, Retail & Manufacturing are under harvest vertical. Sonata plans to double down to scale BFSI and Healthcare/Life Sciences verticals and continues to build strong sales, delivery and domain capabilities in these verticals. Further in harvest verticals Sonata continues to see strong pipeline build and order book momentum across all the harvest verticals. In harvest vertical the focus is more on dynamics with geo focus of West US, UK, India and Australia and generate large deal pipeline in existing accounts. In invest verticals the focus is on East US and Nordics countries region with central hunting team, global delivery centers, deal origination & deal desk.
- In FY23, Sonata has acquired Texas-based Quant Systems for US\$160mn, which helped Sonata accelerate its capabilities in Enterprise Data Analytics, Cloud modernization, Cyber security, Salesforce, Data Privacy, Adobe and Digital & Mobile App solutions, including differentiated IPs for Salesforce and Chatbot technologies as well as expand its domain expertise in banking and financial services, healthcare & life sciences, consumer/retail, etc. As per order book visibility, Sonata expects Quant to post 65% and 45% growth in revenue and EBITDA for CY24, respectively.

Financials

- Sonata's revenue & PAT grew by CAGR of 23.8% and 4.4%, respectively during FY19-24 led by focus on large deals and acquisitions.

Consol. (Rs.Mn)	FY22	FY23	FY24	FY25E	FY26E
Revenue	55,534	74,491	86,131	95,605	1,07,078
EBITDA	4,541	5,998	7,274	8,147	9,288
EBITDA Margin (%)	8.2%	8.1%	8.4%	8.5%	8.7%
PAT	3,764	4,519	3,085	3,455	3,939
EPS (Rs.)	13.6	16.3	11.1	12.5	14.2
P/E (x)	46.7	38.9	56.9	50.8	44.6
RoE (%)	33.8%	34.6%	22.1%	22.6%	23.4%

Stock Data

Market Cap (Rs. Mn)	1,77,218
Market Cap (\$ Mn)	2,119.8
Shares O/S (in Mn)	278.0
Avg. Volume (3 month)	13,51,740
52-Week Range (Rs.)	870.00 / 469.60

Shareholding Pattern

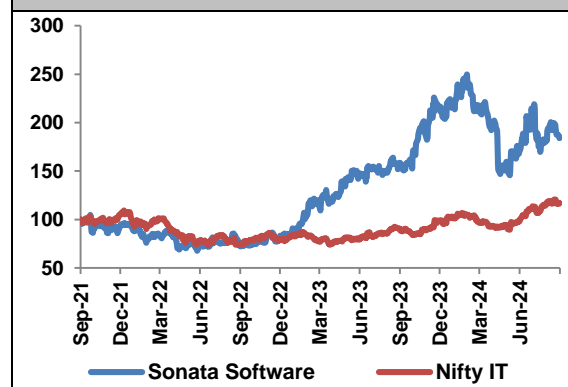
Promoters	28.17%
FIIIs	12.41%
Institutions	21.56%
Others (incl. body corporate)	37.86%

Key Ratios

Div Yield	1.8%
TTM PE	60.3x
ROE	30.3%
TTM EPS (Rs.)	10.48/-

Stock Performance

Performance (%)	1M	6M	1Yr
ABSOLUTE	1.8%	7.9%	19.3%
NIFTY IT	1.2%	19.1%	29.8%



- Sonata has reported 15.3% QoQ and 25.4% YoY growth in revenue to Rs.25,274mn in Q1FY25 led by growth in domestic business. Sequentially, all the geographical regions witnessed growth with the USA grew by 18.6%, Europe by 7.1% and RoW by 8.1% QoQ.
- Sonata's EBIT declined by 2.8% YoY (+29.4% QoQ) to Rs.1,429mn. As a result, EBIT margin was down by 164bps YoY but improved by 61bps QoQ. Management guided for margin pressure throughout FY25 due to delay in ramp-up of certain deals, wage hike implementation, upfront cost for ramping-up for large deals and continued investment in sales and delivery. It also guided for recovery in margin for IT services from Q4FY25/Q1FY26.

Key Business Highlights

- Sonata is a leading IT company which provides modernization services using its proprietary Platformation approach. It specializes in cloud and data modernization, Microsoft Dynamics Modernization, Digital contact center setup and management, managed cloud services and digital transformation services.
- Sonata has presence in North America, Europe, ANZ and Asia-Pacific. In terms of industries, Sonata's revenue mix in Q1FY25 is as follows – 36% from TMT, 34% from retail, 16% from BFSI, 10% from healthcare and balance 4% from emerging sectors. Sonata has partnerships with leading technology providers such as Microsoft, Amazon, Google, among others.
- In Domestic Products and Services (DPS), Sonata is engaged in of buying and selling of packaged software in India. While in International IT Services (IITS), it is engaged in Cloud, Data, Dynamics, Managed Services, and Contact Centre catering to US, UK, Europe and Rest of the World (RoW).

Valuation

Sonata is targeting large deals which are in the range of US\$5-50 mn with a 3-4 years range. These deals will be multiyear and annuity based which will improve margin profile over a period of time. Post the new CEO, Sonata has seen spat of large deal and during the last 4 quarters Sonata has won 16 large deals. With its focus on large deals, currently large deal pipeline is 48% of its total pipeline, which is a 3x jump in dollar terms over last year. During FY23, it won its largest ever deal of \$160 mn for 10 years from a client which is backed by one of the largest PE firms with a very strong cash flow.

Sonata aims to lead the AI wave by modernizing tech and ops for its client. It is helping clients on three dimensions: a) leveraging AI to drive efficiencies for clients like, blended automation and AI to drive intelligent content generation with workflows to reduce manual effort; b) leveraging AI to drive higher consumer experience and modernize sales for example, enabling contact center sale staff to drive cross sell and upsell opportunities and c) driving innovative business models, for example, generating new content from existing content using AI. Management has highlighted that it has over US\$50mn pipeline on AI based projects across 90 plus clients and prospects and expect 20% of its revenue from AI services in the next 3 years.

With leading provider of IT consulting, software development and digital transformation, target to double its international revenues in the next 4 years, classified verticals in 'invest vertical' and 'harvest vertical', acquisition of Quant Systems to increase its capabilities and targeting large deals in the range of US\$5-50 mn with a 3-4 years' annuity revenue, we are assigning **BUY** rating to Sonata Software Ltd. (Sonata) and value at 53.5x FY26E EPS of Rs.14.20 to arrive at target price of Rs.759.00, an upside of ~20.0%+.

Risk & Concern

- Sonata is investing in sales, capabilities and partnership to drive long term growth, any failure to secure deal or revenue generation may have adverse impact on margin of the company.
- Sonata is consistently getting large deal and improving its annuity revenues, if it is unable to scale its existing logos or win fresh large deals, it may affect growth going ahead.
- Sonata generates ~85% of its revenue from the US and the Europe, any slowdown in these regions may affect future growth prospect of Sonata.

Graphs & Charts

Figure 1: Net Sales Trend

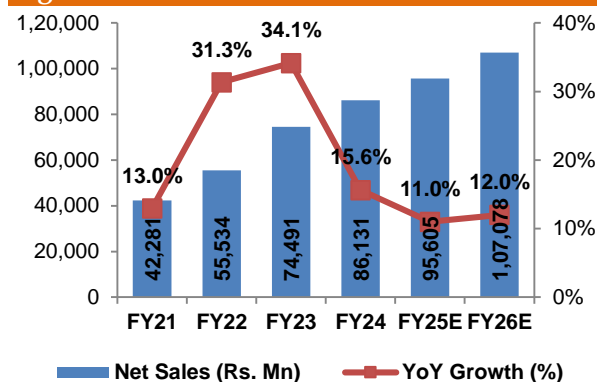


Figure 2: EBITDA & EBITDA Margin Trend

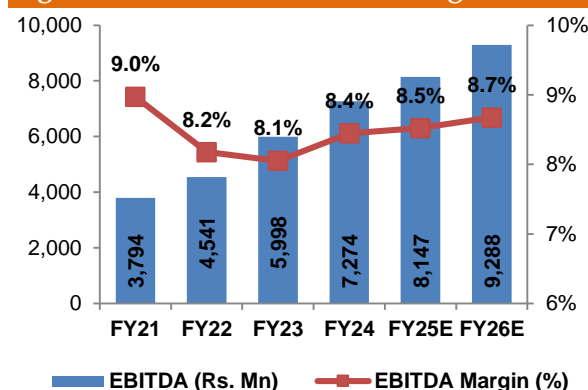


Figure 3: PAT Trend

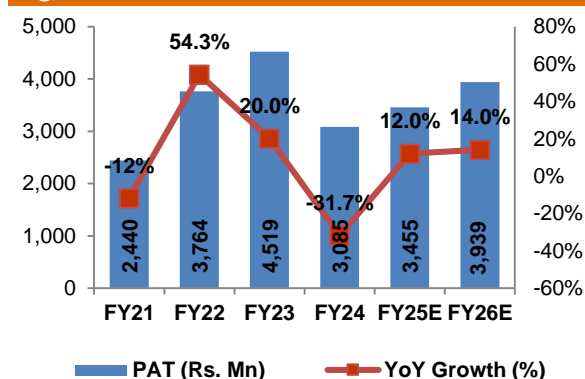
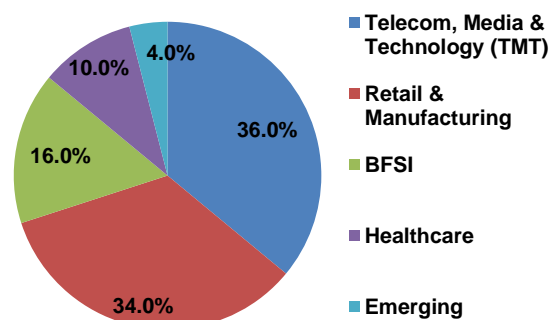


Figure 4: Verticals-wise Revenue (Q1FY25)



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