

Steady show! H2 to witness growth recovery...

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

Q2FY25 Performance: Revenue for International IT services (IITS) at US\$ 84.6 mn, was up 2.3% QoQ/4.6% YoY (up 1.5% QoQ/3.7% YoY in CC terms). IITS EBITDA came at ₹128.9 crore, with an EBITDA margin of 18.2%, down ~52 bps QoQ. At the company level, revenue was ₹ 2,170 crore, down 14.5% QoQ/ up 13.4% YoY. EBITDA came at ₹177.2 crore, flattish QoQ translating to an EBITDA margin of 8.2%, up 120 bps QoQ while PAT (before exceptional items) stood at ₹106.5 crore.

Investment Rationale:

- H2 to be better, positive long-term outlook maintained:** Sonata indicated that it expects H2 to be better than H1 on the back of the large deal ramp up. It also reiterated its ambition of achieving US\$ 1.5 bn revenues by FY27. While TMT and Retail remained weak, BFSI, Healthcare & Life Sciences (HLS) segment along with large deals from the Hi-Tech segment, drove the growth in the quarter. With a strong deal pipeline across HLS, banking and Hi Tech, the company is poised for a future growth. We expect IT services to grow at a CAGR of 11.6% over FY24-27E in dollar terms with ~8% growth in FY25 (largely back ended).
- Margin recovery likely in FY26:** The management Indicated that margins headwinds in FY25 include ~200 bps on account of investment in the business for and likely ~110 bps from the wage hike impact. It remained hopeful of achieving its steady state margins of low 20s by Q1FY26, given the large deal ramp ups and absorption of residual wage hike (50-60 bps) by then.
- Large deal wins, and strong GenAI deal pipeline to sustain growth:** The company for the second consecutive quarter won 3 large deals. Additionally, it also won 2 midsized deals. It reported a strong GenAI deal pipeline of US\$ 67 million across 110 clients. It is also actively working to increase its GenAI capabilities as 83% of its employees are GenAI trained vs. 67% in Q1.

Rating and Target Price

- Sonata's long term growth momentum hinges on its large deal wins, robust pipeline, and advancements in AI. We maintain a positive outlook on the company, factoring in the near-term margin challenges amid ongoing growth initiatives
- We maintain a BUY rating, **valuing it at a target price of ₹ 760, with a multiple of 28x P/E on FY27E EPS.**

Key Financial Summary

(₹ Crore)	FY22	FY23	FY24	5 year CAGR (FY19-24)	FY25E	FY26E	FY27E	2 year CAGR (FY24-26E)
Net Sales	5,553	7,449	8,613	23.8%	9,793	11,235	12,880	14.4%
EBITDA	464	604	727	3.5%	787	1,011	1,185	17.7%
EBITDA Margin (%)	8.4	8.1	8.4		8.0	9.0	9.2	
PAT	376	452	308		494	684	828	
Adjusted PAT	376	452	483	14.4%	494	684	828	19.7%
EPS (Rs.)	27.2	32.6	11.1		17.8	24.6	29.8	
P/E (x)	23.0	19.1	35.9		35.0	25.3	20.9	
RoNW (%)	34.2	34.7	21.9		29.3	32.1	31.0	
RoCE (%)	39.8	25.9	31.4		28.2	31.7	32.2	

Source: Company, ICICI Direct Research



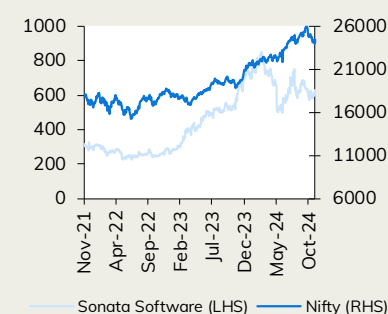
Particulars

Market Cap (₹ Crore)	17,331
Total Debt (₹ Crore)	674
Cash and Invts (₹ Crore)	1,097
EV (₹ Crore)	16,908
52 week H/L	870 / 469
Equity capital (₹ Crore)	27.8
Face value	1.0

Shareholding pattern

	Sep-23	Dec-23	Mar-24	June-24	Sep-24
Promoters	28.2	28.2	28.2	28.2	28.2
FII	15.0	14.5	13.9	12.4	12.1
DII	16.4	17.6	17.6	21.6	23.4
Other	40.5	39.8	40.3	37.9	36.3

Price Chart



Key risks

- Lower than expected revenue due to delay in deal closures
- Lower than expected margin growth

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Performance highlights and outlook

- Revenue Performance:** Revenue for IITS services in Q2FY25 stood at US\$ 84.6 mn, up 2.3% QoQ / 4.6% YoY (up 1.5% QoQ/ 3.7% YoY in CC terms). In rupee terms, the IITS revenue stood at ₹708 crore, up 2.9% QoQ. At the company level the revenue came at ₹2,170 crore, down 14.5% QoQ/ up 13.4% YoY. **The QoQ decline in company level revenues was owing to seasonality in its product business.**
- Margin Performance:** IITS reported an EBITDA margin of ₹128.9 crore, marginally up QoQ. **The EBITDA margin came at 18.2%, down ~52 bps, due to the wage hike impact (~110 bps) which was offset by the savings in operational improvements and SG&A leverage in the quarter.** The PAT for the quarter stood at ₹105.6 crore, translating to a PAT margin of 4.9%, up ~70 bps QoQ.
- Geography Performance:** Geography wise, on a QoQ basis, **the growth was led Europe (14% of the mix) and USA (72% of the mix) up 10.2% and 2.3% respectively, while RoW (14% of the mix) declined by 4.5% QoQ. The US geography is expected to grow faster than the other geographies.**
- Segmental Performance and Outlook:** Segment wise, BFSI (22% of the mix) Emerging (5% of the mix), Healthcare (10% of the mix) grew by 40.6%, 28% and 2.3% respectively. Whereas, TMT (32% of the mix), Retail & Manufacturing (31% of the mix), declined by 9.07% and 6.73% respectively.
 - BFSI/HLS:** The management mentioned that its healthcare life sciences and banking segments combined now contribute ~32% to its revenue, up from ~13% ten quarters back. Both the segments have cumulatively added ~18% of its client revenue, over the last 2.5 years back. They further expect to achieve a cumulative revenue of ₹ 25 crores from the segments. Moving forward, the company expects to achieve growth from these segments.
 - Retail & Manufacturing:** This segment saw a substantial decline because of the discretionary spend slowdown and delayed deal closures. The management mentioned that all the consumer facing companies are expected to remain muted for the next 2-3 quarters.
 - Hi-Tech:** The large deal wins in the quarter are seen from HiTech and the Healthcare segment, however apart from that it has seen a decline in the quarter.
- Revenue and Margin Outlook:** The management aims to level the EBITDA margins back to low 20s from its current 18.5% by Q1FY25. **This growth will be achieved on the back of large deals ramp up and absorption of the wage hikes declared in the quarter.** It reiterated its aspiration of achieving US\$ 1.5 bn (₹150 crore) at the end of FY27 for the international business. **It also indicated that margins for Q3 are expected to be muted due to the residual impact of wage hikes (40-50 bps). Nonetheless, the company is expected to see a better H2FY25, both on revenues and margins front.**
- GenAI/AI:** On the AI front the company aims to achieve its target of generating ~20% of its revenues from AI enabled services by the end of CY27. They're leveraging their Harmoni.AI platform actively across clients and continue to deepen the partnership with hyper-scalers (for AI, Gen AI products). **On the people front ~83% of its employees are GenAI trained, a significant increase from 67% last quarter.**
- Microsoft Fabric:** The company since its launch in Nov'23 saw a significant pipeline build amounting to US\$ 91 mn, across 110 clients. In the quarter it won one of its two mid-sized deal in the data transformation space leveraging Microsoft Fabric.

- **Deal Wins and Pipeline:** Sonata in the quarter won 3 large deals and 2 mid-sized deals. The company has ~36% of its large deal pipeline with Fortune 500 companies.
- **Client mix:** The top 10 clients (63% of the mix), top 20 clients (77% of the mix) grew by 8% and 15% respectively. It added 8 new clients in the quarter, down from 14 in the previous quarter.
- **Cloud & Data:** The cloud and data pipeline is now ~51% of its overall pipeline, up from 15%, 2.5 years back. They're seeing increased traction in the segment as it saw a growth of ~120% over the previous year.
- **Attrition rate:** The headcount in the quarter stood at 6,485 employees, a net increase of 284 employees. The attrition for the quarter stood flat at 13%.

Exhibit 1: Quarter Performance

	Q2FY25	Q2FY24	YoY (%)	Q1FY25	QoQ (%)	Comments
Revenue	2,170	1,913	13.5	2,527	(14.1)	IT services reported 1.5% QoQ CC growth while rupee revenues were up by 2.3% QoQ while Domestic Products business declined by 21% QoQ
Employee expenses	405	340	19.1	369	9.6	
Purchase of stock-in trade	1,399	1,210	15.6	1,787	(21.7)	
Gross Margin	366	363	0.9	371	(1.3)	
Gross margin (%)	16.9	19.0	-210 bps	14.7	219 bps	
Other expenses	189	165	14.1	195	(3.1)	
EBITDA	177	197	(10.2)	176	0.6	
EBITDA Margin (%)	8.2	10.3	-215 bps	7.0	120 bp	EBITDA margins for IT services declined ~52 bps QoQ to 18.2% due to the wage hikes impact in the quarter
Depreciation & amortisation	33	33	(1.3)	33	(1.1)	
EBIT	144	164	(12.0)	143	1.0	
EBIT Margin (%)	6.7	8.6	-192 bps	5.7	100 bps	
Other income (less interest)	0	3	(99.6)	(1)	(100.9)	
PBT	144	167	(13.3)	142	1.8	
Tax paid	38	42	(10.6)	36	4.8	
PAT	106	124	(14.2)	106	0.6	

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 2: Profit and loss statement					₹ crore
(Year-end March)	FY24	FY25E	FY26E	FY27E	
Total Revenues	8,613	9,793	11,235	12,880	
Growth (%)	15.6	13.7	14.7	14.6	
Total Op Expenditure	7,886	9,005	10,224	11,695	
EBITDA	727	787	1,011	1,185	
Growth (%)	20.4	8.2	28.4	17.2	
Depr & Amortization	132	137	146	167	
Other Income	126	76	93	130	
Interest costs	85	72	58	58	
PBT before Excep Items	636	655	900	1,090	
Growth (%)	6.5	2.9	37.5	21.1	
Tax	153	160	216	262	
PAT before Excep Items	483	494	684	828	
Exceptional items	(175)	-	-	-	
PAT before MI	308	494	684	828	
Minority Int & Pft. from ass	-	-	-	-	
PAT	308	494	684	828	
Growth (%)	(32)	60	38	21	
EPS	11.1	17.8	24.6	29.8	
EPS (Growth %)	(66)	60	38	21	

Source: Company, ICICI Direct Research

Exhibit 3: Cash flow statement					₹ crore
(Year-end March)	FY24	FY25E	FY26E	FY27E	
Net profit before Tax	461	655	900	1,090	
Depreciation & Amortization	132	137	146	167	
WC changes	(209)	78	95	109	
Other non cash adju.	159	(5)	(35)	(72)	
Income taxes paid	(262)	(160)	(216)	(262)	
CF from Operations	281	705	891	1,032	
Capital expenditure	0	(34)	(39)	(45)	
Δ in investments	(88)	-	-	-	
Other investing cash flow	33	76	93	130	
CF from Investing Activities	(54)	42	53	85	
Issue of equity	14	-	-	-	
Δ in debt funds/lease liab.	139	(24)	(24)	(24)	
Dividends paid	(215)	(216)	(239)	(290)	
Other financing cash flow	(46)	(72)	(58)	(58)	
CF from Financial Activities	(109)	(311)	(321)	(372)	
Δ in cash & bank balance	118	436	623	746	
Effect of exchange rate	1	-	-	-	
Opening cash	417	865	1,301	1,924	
Closing cash	865	1,301	1,924	2,670	

Source: Company, ICICI Direct Research

Exhibit 4: Balance Sheet					₹ crore
(Year-end March)	FY24	FY25E	FY26E	FY27E	
Equity	28	28	28	28	
Reserves & Surplus	1,379	1,657	2,102	2,640	
Networth	1,406	1,685	2,130	2,668	
Minority Interest	-	-	-	-	
LT liabilities & provisions	219	219	219	219	
Total Debt	674	674	674	674	
Source of funds	2,299	2,578	3,023	3,561	
Assets					
Net fixed assets	558	478	396	297	
Goodwill	1,113	1,113	1,113	1,113	
Long term loans	-	-	-	-	
Other non current assets	403	444	494	552	
Loans and advances	-	-	-	-	
Inventories	98	111	128	147	
Current Investments	232	232	232	232	
Debtors	1,605	1,825	2,094	2,400	
Cash & Cash equivalents	865	1,301	1,924	2,670	
Other current assets	275	313	359	412	
Current liabilities	2,813	3,198	3,669	4,207	
Provisions	37	42	48	55	
Net current assets	226	542	1,019	1,599	
Application of funds	2,299	2,578	3,023	3,561	

Source: Company, ICICI Direct Research

Exhibit 5: Key ratios				
(Year-end March)	FY24	FY25E	FY26E	FY27E
Per share data (₹)				
EPS-diluted	11.1	17.8	24.6	29.8
Cash per share	31.1	46.8	69.2	96.0
BV	50.6	60.6	76.6	96.0
DPS	7.9	7.8	8.6	10.4
Operating Ratios				
EBITDA Margin	8.4	8.0	9.0	9.2
Adjusted PBT Margin	7.4	6.7	8.0	8.5
Adjusted PAT Margin	3.6	5.0	6.1	6.4
Return Ratios (%)				
RoNW	21.9	29.3	32.1	31.0
RoCE	31.4	28.2	31.7	32.2
RoIC	49.5	62.2	99.8	154.4
Valuation Ratios (x)				
P/E	35.9	35.0	25.3	20.9
EV / EBITDA	23.2	20.9	15.7	12.7
Price to Book Value	12.3	10.3	8.1	6.5
EV/Total Revenues	2.0	1.7	1.4	1.2
MCap/Total Revenues	2.0	1.8	1.5	1.3
Turnover Ratios				
Debtor days	68	68	68	68
Creditors days	60	60	60	60
Solvency Ratios				
Debt/EBITDA	0.9	0.9	0.7	0.6
Total Debt / Equity	0.5	0.4	0.3	0.3
Current Ratio	1.1	1.2	1.3	1.4
Quick Ratio	1.0	1.1	1.2	1.3

Source: Company, ICICI Direct Research

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Sell: <-15%



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