

Sonata Software

Growth momentum to continue

Sonata posted better-than-expected growth in the IT services (IITS) and Domestic Product Services (DPS) segment. IITS revenue grew 5.1% QoQ (estimate +4%) and margin expanded 428bps QoQ to 27.9% (8 quarter high). The growth in IITS was led by a revival in ISV (+14.8% QoQ) and Retail (+13.7% QoQ). Travel also recovered (TUI was stable) but more clarity will emerge in April-21 (leisure travel is expected to resume). The Microsoft portfolio (~48% of IITS revenue) registered a strong growth of 7.1% QoQ, led by ISV and Dynamic 365. The Microsoft Dynamics modernisation program is a multi-year opportunity (~10K enterprises yet to upgrade) and Sonata is investing in R&D and sales capabilities to capture this opportunity. The IITS EBITDA margin expansion was led by offshoring and higher utilisation, the target range being ~23-24%. DPS growth was impressive (+20% YoY) and is driven by higher cloud adoption (~63% of DPS is cloud). We like Sonata's IP-led business model, the high margin in IITS, focus on high growth Microsoft ecosystem, healthy RoE (~35%), and high dividend yield (~4%). We increase our EPS estimate by +6.0/7.5% for FY22/23E to factor in growth acceleration. Our target price of Rs 460 is based on 14x Dec-22E EPS. Maintain BUY. The stock trades at a P/E of 16.9/14.0x FY21/22E.

- 3QFY21 highlights:** IITS revenue stood at USD 41mn (+4.5% QoQ CC) vs. an estimate of USD 40.6mn. Digital/IP-led/Platform revenue contributed 64/33/18% to IITS revenue and grew 12/5/5% QoQ. Utilisation at 89% (+200bps QoQ) and Offshoring (+300bps QoQ) led to IITS margin expansion. Consolidated revenue was up 73.7% QoQ due to DPS (+110% QoQ) and EBITDA margin stood at 7.9% vs. an estimate of 8.5%, due to the lower margin in DPS (-126bps QoQ). The salary hike will be effective Jan-21. Net cash is at INR 6bn (14% of mcap). The company partially settled the contingent liability on its balance sheet by INR 500mn by paying a tax of INR 218mn under the special tax settlement scheme.
- Outlook:** We expect IITS growth of -12.1/+13.4/+11.6% and DPS growth of +22.9/+18.2/+18.3% for FY21/22/23E. IITS margin will be at 24.2/23.2/23.6% and DPS margin at 2.8/2.8/2.9% for FY21/22/23E respectively. Revenue/EPS CAGR for FY21-23E is expected at +17/+19%.

Quarterly Financial summary

YE March (Rs Bn)	3Q FY21	3Q FY20	YoY (%)	2Q FY21	QoQ (%)	FY19	FY20	FY21E	FY22E	FY23E
IITS Net Revenues (US \$mn)	41	47	-12.4	39	5.1	161	181	159	180	201
Net Sales	13.96	12.37	12.9	8.04	73.7	29.61	37.43	42.22	49.59	58.06
EBIT	1.01	1.01	0.5	0.77	30.8	3.23	3.36	3.31	3.72	4.38
APAT	0.76	0.76	-0.3	0.57	32.2	2.47	2.77	2.49	3.02	3.54
Diluted EPS (Rs)	7.3	7.3	-0.3	5.5	32.2	23.7	26.7	24.0	29.0	34.1
P/E (x)						17.1	15.2	16.9	14.0	11.9
EV / EBITDA (x)						12.1	10.9	10.8	9.4	7.9
RoE (%)						34.7	38.5	35.1	37.5	38.5

Source: Company, HSIE Research, Consolidated Financials

Change in Estimates

YE March (Rs Bn)	FY21E Old	FY21E Revised	Change %	FY22E Old	FY22E Revised	Change %	FY23E Old	FY23E Revised	Change %
Revenue (USD mn)	158	159	0.6	177	180	2.0	197	201	2.1
Revenue	38.67	42.22	9.2	44.39	49.59	11.7	49.88	58.06	16.4
EBIT	3.09	3.31	6.9	3.49	3.72	6.5	4.05	4.38	8.2
EBIT margin (%)	8.0	7.8	-17bps	7.9	7.5	-37bps	8.1	7.5	-57bps
APAT	2.51	2.49	-0.6	2.85	3.02	6.0	3.29	3.54	7.5
EPS (Rs)	24.2	24.0	-0.6	27.4	29.0	6.0	31.7	34.1	7.5

Source: Company, HSIE Research

BUY

CMP (as on 5 Feb 2021)	Rs 406
Target Price	Rs 460
NIFTY	14,924

KEY CHANGES	OLD	NEW
Rating	BUY	BUY
Price Target	Rs 430	Rs 460
EPS %	FY21E	FY22E
	-0.6	+6.0

KEY STOCK DATA

Bloomberg code	SSOF IN
No. of Shares (mn)	105
MCap (Rs bn) / (\$ mn)	43/586
6m avg traded value (Rs mn)	170
52 Week high / low	Rs 435/147

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	19.7	42.4	20.5
Relative (%)	(3.0)	7.7	(2.8)

SHAREHOLDING PATTERN (%)

	Sep-20	Dec-20
Promoters	28.17	28.17
FIs & Local MFs	13.49	14.35
FPIs	10.41	11.88
Public & Others	47.93	45.60
Pledged Shares	0.00	0.00

Source : BSE

Pledged shares as % of total shares

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