



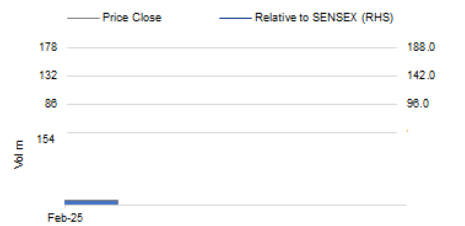
India

ADD (previously HOLD)

Consensus ratings*:	Buy 8	Hold 3	Sell 0
Current price:	Rs359		
Target price:	Rs399		
Previous target:	Rs554		
Up/downside:	11.1%		
InCred Research / Consensus:	-34.3%		
Reuters:			
Bloomberg:	SSOF IN		
Market cap:	US\$1,157m		
	Rs100,645m		
Average daily turnover:	US\$4.1m		
	Rs356.3m		
Current shares o/s:	277.8m		
Free float:	70.8%		
*Source: Bloomberg			

Key changes in this note

- Expect 4.7% revenue CAGR over FY25F-27F.
- Expect 14.2% EBIT CAGR over FY25F-27F.
- Expect 17.9% PAT CAGR over FY25F-27F.



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	(14.6)	(46.8)	(50.7)
Relative (%)	(12.1)	(41.9)	(51.5)

Major shareholders	% held
Hemendra M Kothari	9.1
HDFC Mutual fund	7.1
Tata Equity Savings Fund	3.5

Research Analyst(s)



Abhishek SHINDADKAR
T (91) 22 4161 1543
E abhishek.shindadkr@incredresearch.com

Vikas SWAMI
T (91) 22 4161 1544
E vikas.swami@incredresearch.com

Sonata Software

Understanding the impact on EA revenue

- MSFT direct sales taking over partner accounts could impact domestic biz.
- The impact may be sometime away but Sonata undertaking control measures.
- Trimming our estimates but upgrading to ADD post recent price correction.

Understanding the impact on EA revenue for Microsoft LSPs

We spoke to Mr. Jagannathan CN, chief financial officer (CFO) of Sonata Software to understand the authenticity and potential impact of losing the right to sell Enterprise Agreements (EAs) on its domestic business. Although the policy changes are not new, the potential loss of enterprise agreement (EA) revenue for Microsoft Enterprise Licensing Solution Providers (LSPs) could be material.

Background

As per the policy change, Microsoft (MSFT) direct sales could take over partner accounts as large EAs are due for renewal. This, in turn, could impact LSPs' revenue stream from commissions (~1-1.5%) on each EA. Also, as per our understanding, Microsoft may no longer pay commission to partners after 31 Dec 2025. Our discussions with Sonata Software suggest that it is undertaking control measures to limit the potential impact, if any.

Interventions to offset the potential impact

Sonata Software's (SSOF) key interventions include 1) renewal of contracts ahead of time, 2) impress upon clients the value of added services (requirement-based consulting, optimization of licenses, implementation and managed services, and multi-geography invoicing), 3) expanding the scope of alternate products (Amazon Web Services, Google Cloud Platform), 4) concentrating on managed services/security operations centre business, and 5) focusing on small and medium companies.

We trim our estimates as a matter of prudence

Although the exact impact is unknown, we trim our estimates as Microsoft accounts for ~60-70% of SSOF's domestic revenue and large enterprise concentration could be ~50-60% of the same. We now model a domestic business gross contribution CAGR of 6.5% over FY25F-27F vs. 11.5% earlier, which, in turn, drives a ~5%-7 cut in FY26F/27F EPS. Though we await better clarity to adjust the EBITDA margin, the interventions could demand investments in feet-on-the-street and higher work capital, in our view.

Upgrade to ADD, given the recent price correction

We now expect IT services/overall revenue to grow at 8.2%/4.7% CAGR (8.2%/8.1% CAGR earlier) over FY25F-27F in US\$/Rsm terms, respectively, and expect a 17.9% (22.5% earlier) PAT (Rs) CAGR over the same period. We now assign a multiple of 1x PE/G on the overall business (vs. 1x/1.3x PE/G for IT services/domestic business earlier) to arrive at a target multiple of ~18x and a lower target price of Rs399 vs. Rs554 earlier. We upgrade the rating to ADD (from HOLD) as the recent price correction provides a better entry point. Downside risk: Incremental client-specific challenges.

Financial Summary

	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Revenue (Rsm)	74,491	86,131	101,209	101,894	110,903
Operating EBITDA (Rsm)	6,041	7,274	7,028	7,948	8,928
Net Profit (Rsm)	4,519	3,085	4,386	5,321	6,093
Core EPS (Rs)	16.3	15.3	15.8	19.1	21.9
Core EPS Growth	20.0%	(5.9%)	3.0%	21.1%	14.5%
FD Core P/E (x)	22.04	32.29	22.75	18.78	16.41
DPS (Rs)	15.8	7.9	9.9	13.3	15.9
Dividend Yield	2.20%	2.20%	1.39%	3.06%	3.06%
EV/EBITDA (x)	15.44	12.78	13.08	11.86	10.09
P/FCFE (x)	43.80	39.03	14.44	20.24	15.71
Net Gearing	(48.5%)	(47.4%)	(46.1%)	(29.4%)	(44.2%)
P/BV (x)	7.66	7.08	5.86	5.17	4.47
ROE	37.7%	31.4%	28.2%	29.2%	29.2%
% Change In Core EPS Estimates			(0.27%)	(0.30%)	
InCred Research/Consensus EPS (x)					

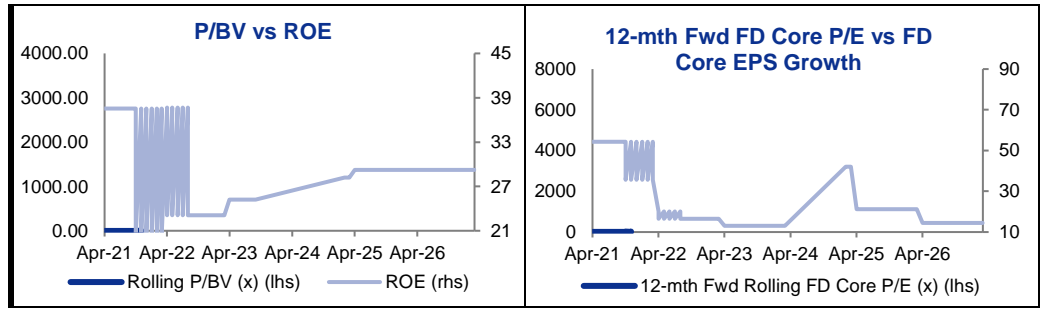
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 1: Change in InCred estimates

Y/E Mar (Rsm)	FY25F			FY26F			FY27F		
	New	Old	% change	New	Old	% change	New	Old	% change
IT services revenue (US\$m)	338	339	-0.1	363	363	-0.1	396	396	-0.1
Overall revenue (Rsm)	1,01,209	1,01,237	0.0	1,01,641	1,06,363	-4.4	1,10,903	1,18,257	-6.2
EBIT	5,724	5,725	0.0	6,555	6,923	-5.3	7,465	8,056	-7.3
EBIT margin (%)	5.7	5.7	0bp	6.4	6.5	(6)bp	6.7	6.8	(8)bp
Net PAT	4,386	4,387	0.0	5,313	5,617	-5.4	6,093	6,580	-7.4
EPS (Rs)	15.8	15.8	0.0	19.1	20.2	-5.4	21.9	23.7	-7.4

SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS



Profit & Loss

(Rs mn)	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Total Net Revenues	74,491	86,131	101,209	101,894	110,903
Gross Profit	10,603	14,588	15,561	16,303	18,022
Operating EBITDA	6,041	7,274	7,028	7,948	8,928
Depreciation And Amortisation	(591)	(1,319)	(1,304)	(1,384)	(1,463)
Operating EBIT	5,450	5,955	5,724	6,564	7,465
Financial Income/(Expense)	523	405	125	531	658
Pretax Income/(Loss) from Assoc.					
Non-Operating Income/(Expense)					
Profit Before Tax (pre-EI)	5,973	6,360	5,849	7,095	8,124
Exceptional Items		(1,747)			
Pre-tax Profit	5,973	4,613	5,849	7,095	8,124
Taxation	(1,454)	(1,529)	(1,463)	(1,774)	(2,031)
Exceptional Income - post-tax					
Profit After Tax	4,519	3,085	4,386	5,321	6,093
Minority Interests					
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	4,519	3,085	4,386	5,321	6,093
Recurring Net Profit	4,519	4,253	4,386	5,321	6,093
Fully Diluted Recurring Net Profit	4,519	4,253	4,386	5,321	6,093

Cash Flow

(Rs mn)	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
EBITDA	6,041	7,274	7,028	7,948	8,928
Cash Flow from Invt. & Assoc.					
Change In Working Capital	(1,766)	(2,094)	2,296	(711)	(27)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense	349	1,098			
Other Operating Cashflow					
Net Interest (Paid)/Received	(185)	(850)	(703)	(284)	(229)
Tax Paid	(1,754)	(2,623)	(1,463)	(1,774)	(2,031)
Cashflow From Operations	2,684	2,805	7,159	5,180	6,641
Capex	(411)	(254)	(250)	(241)	(280)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	(8,143)	(289)	(4,318)	(3,953)	887
Cash Flow From Investing	(8,553)	(543)	(4,568)	(4,194)	607
Debt Raised/(repaid)					
Proceeds From Issue Of Shares					
Shares Repurchased					
Dividends Paid	(2,324)	(2,189)	(1,389)	(3,056)	(3,056)
Preferred Dividends					
Other Financing Cashflow	175	4,487	(1,774)	(284)	(229)
Cash Flow From Financing	(2,150)	2,298	(3,163)	(3,340)	(3,285)
Total Cash Generated	(8,019)	4,560	(572)	(2,354)	3,963
Free Cashflow To Equity	2,274	2,552	6,909	4,939	6,361
Free Cashflow To Firm	(5,684)	3,112	3,293	1,269	7,477

SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS...cont'd

Balance Sheet					
(Rs mn)	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Total Cash And Equivalents	9,361	10,971	10,087	6,945	11,137
Total Debtors	12,362	16,051	16,801	17,118	18,632
Inventories					
Total Other Current Assets	2,428	3,734	3,734	3,734	3,734
Total Current Assets	24,151	30,756	30,622	27,797	33,503
Fixed Assets	6,347	5,575	4,521	3,379	2,196
Total Investments	559	512	512	512	512
Intangible Assets	10,984	11,135	11,135	11,135	11,135
Total Other Non-Current Assets	1,528	3,513	3,513	3,513	3,513
Total Non-current Assets	19,418	20,736	19,681	18,539	17,356
Short-term Debt					
Current Portion of Long-Term Debt					
Total Creditors	12,949	14,160	17,205	16,813	18,299
Other Current Liabilities	8,685	16,773	11,628	6,752	6,752
Total Current Liabilities	21,633	30,933	28,833	23,564	25,051
Total Long-term Debt	3,051	4,310	2,225	1,260	1,260
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	5,878	2,185	2,185	2,185	2,185
Total Non-current Liabilities	8,929	6,496	4,410	3,446	3,446
Total Provisions					
Total Liabilities	30,562	37,428	33,243	27,010	28,497
Shareholders Equity	13,007	14,063	17,060	19,326	22,363
Minority Interests					
Total Equity	13,007	14,063	17,060	19,326	22,363

Key Ratios					
	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Revenue Growth	34.1%	15.6%	17.5%	0.7%	8.8%
Operating EBITDA Growth	30.2%	20.4%	(3.4%)	13.1%	12.3%
Operating EBITDA Margin	8.1%	8.4%	6.9%	7.8%	8.0%
Net Cash Per Share (Rs)	22.74	24.00	28.23	20.41	35.46
BVPS (Rs)	46.87	50.68	61.26	69.39	80.30
Gross Interest Cover	29.40	7.00	8.15	23.13	32.63
Effective Tax Rate	24.3%	33.1%	25.0%	25.0%	25.0%
Net Dividend Payout Ratio	48.4%	45.3%	31.7%	57.4%	50.2%
Accounts Receivables Days	52.87	60.20	59.24	60.75	58.83
Inventory Days					
Accounts Payables Days	67.12	69.15	66.83	72.53	68.99
ROIC (%)	137.9%	37.6%	47.3%	45.3%	36.6%
ROCE (%)	30.5%	26.3%	22.8%	24.7%	25.3%
Return On Average Assets	11.9%	9.5%	8.4%	10.2%	11.5%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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Research Analyst SEBI Registration Number: INH000011024

Registered Office: Unit No 1203, 12th Floor, B Wing, The Capital, C-70, G Block, BKC, Bandra (E), Mumbai – 400051

Phone: +91-22-6844-6100

Corporate Office: 05th floor, Laxmi Towers, Plot No. C-25, G Block, Bandra – Kurla Complex, Bandra (East), Mumbai – 400051

Phone: +91-22-4161-1500

Name of the Compliance Officer: Mr. Yogesh Kadam

Email ID: compliance@incredresearch.com, Phone No: +91-22-41611539

For any queries or grievances, you may contact the Grievance Officer.

Name of the Grievance Officer: Mr. Rajarshi Maitra

Phone no. +91-022-41611546

Email ID: rajarshi.maitra@incredresearch.com

CIN: U74999MH2016PTC287535

Recommendation Framework

Stock Ratings

Definition:

- Add** The stock's total return is expected to exceed 10% over the next 12 months.
- Hold** The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
- Reduce** The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings

Definition:

- Overweight** An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
- Neutral** A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
- Underweight** An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings

Definition:

- Overweight** An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
- Neutral** A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
- Underweight** An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.