

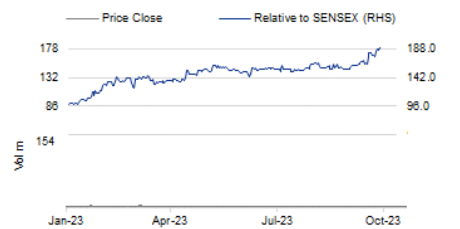
India

**HOLD** (no change)

Consensus ratings*:	Buy 5	Hold 1	Sell 0
Current price:	Rs765		
Target price:	Rs826		
Previous target:	Rs826		
Up/downside:	8.0%		
InCred Research / Consensus:	0.4%		
Reuters:			
Bloomberg:	SSOF IN		
Market cap:	US\$2,584m		
	Rs214,427m		
Average daily turnover:	US\$7.5m		
	Rs624.7m		
Current shares o/s:	277.5m		
Free float:	70.8%		
*Source: Bloomberg			

**Key changes in this note**

- Expect 17.6% revenue CAGR over FY24F-26F.
- Expect 22.5% EBIT CAGR over FY24F-26F.
- Expect 25% APAT CAGR over FY24F-26F.



Source: Bloomberg

<b>Price performance</b>	1M	3M	12M
Absolute (%)	5.8	33.7	146.6
Relative (%)	6.1	19.5	106.3

<b>Major shareholders</b>	% held
Hemendra M Kothari	9.1
HDFC Mutual fund	8.2
HSBC Midcap Fund	3.8

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# Sonata Software

## Revenue momentum likely to continue

- Top client ramp-up, led by traction in GenAI, could aid IT services revenue in the medium term.
- Revised contingent consideration for outperformance in Quant Systems and Encore Software Services acquisition impacted reported PAT in 3QFY24.
- Retain our HOLD rating with an unchanged target price of Rs826, given the valuation at +2SD.

### Earnings summary

Sonata Software's 3QFY24 IT services revenue was in line with our estimate, with 3% qoq and 37% yoy growth in constant currency (CC) terms and domestic business performance healthy aided by seasonality. IT services revenue could witness tailwind in 4QFY24F from ramp-up of large deals and recovery in the Hitech vertical led by traction in a Top client but weak seasonality in Quant Systems and softness in the BFSI vertical could be a headwind. Consolidated EBITDA margin (8.3%; down 199bp qoq but up 142bp yoy) was impacted sequentially due to higher growth in low-margin domestic business and lower EBITDA margin in the IT services business (down 50bp qoq at 22.6%). Going ahead, management has retained its medium-term target of low 20s EBITDA margin in the IT services business led by growth leverage and employee pyramid correction offset by investments in capabilities.

### IT services large deal momentum continues

Sonata Software won three large deals in 3QFY24, with the first deal being US\$8.7m over one year, the second deal being US\$6.5m over five years and the third deal being US\$4.8m over three years. The large deal pipeline now accounts for 48% of the total pipeline and up 3x on a yoy basis, in value terms. The focus on winning large deals (13 large deals on a YTD basis) and client mining (12 clients in US\$ 5m+ in 3QFY24 vs. 5 in 3QFY23) could continue to aid the momentum in the company's IT services business.

### Seasonality aided domestic business

Domestic business gross contribution was up 14.3% qoq and 25.7% yoy at Rs713m, aided by seasonality. PAT was up 5.2% qoq and 17.4% yoy at Rs426m and contributed 33.2% to consolidated PAT (vs. 30.9% in 3QFY23). Domestic business DSO (36 in 3QFY24 vs. 38 in 3QFY23) and RoCE (45.4% on a YTD basis vs. 47.2% in FY23) remained healthy.

### Retain HOLD rating with an unchanged target price of Rs826

We largely retain our FY24F-26F IT services revenue/domestic business gross contribution CAGR of 17.6%/15.3% in US\$/Rsm terms, respectively, and expect ~25% adjusted PAT CAGR over the same period. We retain our target price of Rs826 by retaining ~1.1x PE/G multiple for the IT services business and ~1.5x PE/G multiple for the domestic business. Material revenue beat is an upside risk while weakness in top clients, leadership attrition and valuation, which is above +2SD, are key downside risks.

Financial Summary	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Revenue (Rs m)	55,534	74,491	86,613	103,898	121,674
Operating EBITDA (Rs m)	4,638	6,041	7,793	9,312	11,158
Net Profit (Rs m)	3,765	4,519	4,850	6,013	7,581
Core EPS (Rs)	13.6	16.3	17.5	21.7	27.3
Core EPS Growth	54.3%	20.0%	7.3%	24.0%	26.1%
FD Core P/E (x)	56.36	46.96	43.75	35.29	27.99
DPS (Rs)	11.5	7.9	5.4	11.9	15.0
Dividend Yield	1.38%	1.03%	0.70%	1.56%	1.97%
EV/EBITDA (x)	43.78	33.57	25.91	21.99	18.42
P/FCFE (x)	52.71	100.48	38.66	32.05	25.13
Net Gearing	(83.2%)	(72.0%)	(70.1%)	(42.7%)	(32.3%)
P/BV (x)	19.30	16.31	14.51	12.25	10.23
ROE	37.6%	37.7%	35.1%	37.6%	39.8%
% Change In Core EPS Estimates					
InCred Research/Consensus EPS (x)					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 1: Quarterly performance**

Y/E Mar (Rs m)	3QFY24	3QFY23	YoY (%)	2QFY24	QoQ (%)	3QFY24F	Var. (%)
IT services revenue (US\$ m)	83.7	60.5	38.3	80.9	3.5	83.8	(0.1)
Overall revenue (Rs m)	24,934	22,608	10.3	19,126	30.4	23,097	8.0
EBITDA	2,077	1,563	32.9	1,973	5.3	2,181	(4.8)
EBITDA margin (%)	8.3	6.9	142 bp	10.3	(199 bp)	9.4	(111 bp)
Depreciation	337	136	147.6	333	1.1	333	1.3
EBIT	1,740	1,426	22.0	1,640	6.1	1,848	(5.8)
EBIT margin (%)	7.0	6.3	67 bp	8.6	(160 bp)	8.0	(102 bp)
Net other income	-24	127	(119.1)	25	(196.0)	-88	(72.5)
PBT	1,716	1,553	10.4	1,665	3.0	1,760	(101.8)
Provision for tax	431	377	14.3	423	1.3	440	(2.1)
Net Profit	(462)	1,177	NA	1,242	NA	1,320	NA

SOURCE: INCRED RESEARCH, COMPANY REPORTS

NOTE: PAT IMPACTED DUE TO AN EXCEPTIONAL ITEM OF RS1,747M IN 3QFY24

## Key earnings-call takeaways

- Sonata Software leveraging artificial intelligence or AI to drive efficiency, higher consumer experience & modernization of sales and driving innovative business models. The company has ~US\$50m in pipeline from over 90 clients. Management expects AI-led services to contribute ~20% of IT services revenue over the next three years.
- The company is building solutions on Fabric in collaboration with Microsoft, which may be the infrastructure for AI in the medium term.
- Sonata Software's Harmony.AI enterprise platform is listed on Microsoft Azure and Amazon Web Services and is well acknowledged by partners, industry bodies, and clients.
- Joint go-to-market programs continue to witness good traction with Microsoft and other ecosystem partners.
- Management stated that it is witnessing green shoots in the Hitech vertical, with a likely ramp-up from 4QFY24F, including a top client expected to aid growth. Softness in the BFSI vertical impacted growth in 3QFY24 and further weakness is not likely in 4QFY24F.
- Quant Systems' acquisition has exceeded management expectations on the revenue front by 1.2x and EBITDA by 1.8x over a two-year period, which led to an increase in the contingent consideration by ~US\$17m. Encore Software Services' acquisition have exceeded management's expectations on the revenue front by 1.9x and EBITDA by 2x over a three-year period, which led to increased contingent consideration by ~US\$3.8m.

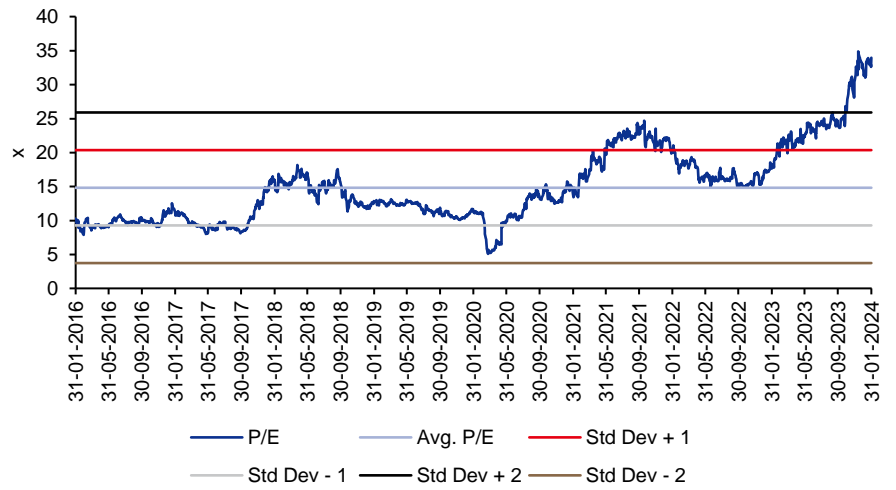
**Figure 2: Our revised earnings estimates**

Y/E Mar (Rs m)	FY24F			FY25F			FY26F		
	New	Old	% change	New	Old	% change	New	Old	% change
IT services revenue (US\$m)	330	330	0.0	390	389	0.3	456	455	0.2
Overall revenue (Rsm)	86,613	83,196	4.1	1,03,898	1,02,132	1.7	1,21,674	1,21,128	0.5
EBIT	6,467	6,446	0.3	7,916	7,973	-0.7	9,707	9,773	-0.7
EBIT margin (%)	7.5	7.7	(28) bp	7.6	7.8	(19) bp	8.0	8.1	(9) bp
Net PAT	3,103	4,794	-35.3	6,013	6,094	-1.3	7,581	7,628	-0.6
EPS (Rs)	11.2	17.3	-35.2	21.7	21.9	-1.2	27.3	27.5	-0.5

SOURCE: INCRED RESEARCH, COMPANY REPORTS

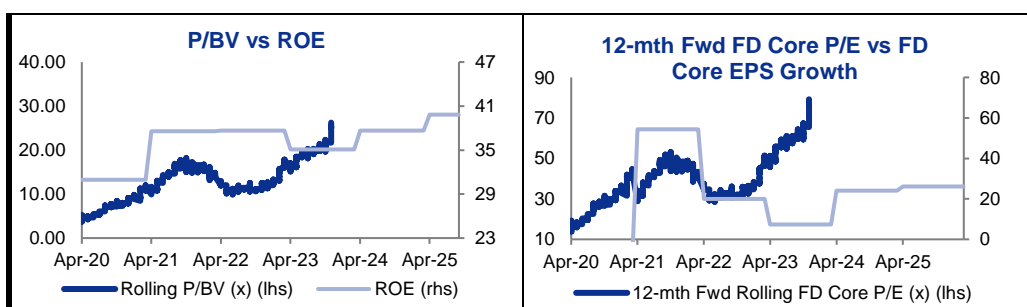
NOTE: FY24F PAT LARGELY IMPACTED DUE TO AN EXCEPTIONAL ITEM OF RS 1,747M

Figure 3: Sonata Software trades at ~34x one-year forward P/E



SOURCE: INCRED RESEARCH, BLOOMBERG

**BY THE NUMBERS**



**Profit & Loss**

(Rs mn)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
<b>Total Net Revenues</b>	<b>55,534</b>	<b>74,491</b>	<b>86,613</b>	<b>103,898</b>	<b>121,674</b>
<b>Gross Profit</b>	<b>7,933</b>	<b>10,603</b>	<b>14,761</b>	<b>17,644</b>	<b>20,283</b>
<b>Operating EBITDA</b>	<b>4,638</b>	<b>6,041</b>	<b>7,793</b>	<b>9,312</b>	<b>11,158</b>
Depreciation And Amortisation	(473)	(591)	(1,325)	(1,396)	(1,450)
<b>Operating EBIT</b>	<b>4,165</b>	<b>5,450</b>	<b>6,467</b>	<b>7,916</b>	<b>9,707</b>
Financial Income/(Expense)	839	523	(47)	101	401
Pretax Income/(Loss) from Assoc.					
Non-Operating Income/(Expense)					
<b>Profit Before Tax (pre-EI)</b>	<b>5,004</b>	<b>5,973</b>	<b>6,420</b>	<b>8,018</b>	<b>10,108</b>
Exceptional Items					
<b>Pre-tax Profit</b>	<b>5,004</b>	<b>5,973</b>	<b>6,420</b>	<b>8,018</b>	<b>10,108</b>
Taxation	(1,239)	(1,454)	(1,571)	(2,004)	(2,527)
Exceptional Income - post-tax					
<b>Profit After Tax</b>	<b>3,765</b>	<b>4,519</b>	<b>4,850</b>	<b>6,013</b>	<b>7,581</b>
Minority Interests					
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
<b>Net Profit</b>	<b>3,765</b>	<b>4,519</b>	<b>4,850</b>	<b>6,013</b>	<b>7,581</b>
Recurring Net Profit	3,765	4,519	4,850	6,013	7,581
<b>Fully Diluted Recurring Net Profit</b>	<b>3,765</b>	<b>4,519</b>	<b>4,850</b>	<b>6,013</b>	<b>7,581</b>

**Cash Flow**

(Rs mn)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
<b>EBITDA</b>	<b>4,638</b>	<b>6,041</b>	<b>7,793</b>	<b>9,312</b>	<b>11,158</b>
Cash Flow from Invt. & Assoc.					
Change In Working Capital	623	(1,766)	193	(52)	124
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense	600	187			
<b>Other Operating Cashflow</b>					
Net Interest (Paid)/Received	(180)	(185)	(845)	(536)	(195)
Tax Paid	(1,559)	(1,754)	(1,571)	(2,004)	(2,527)
<b>Cashflow From Operations</b>	<b>4,122</b>	<b>2,522</b>	<b>5,570</b>	<b>6,719</b>	<b>8,560</b>
Capex	(96)	(411)	(82)	(98)	(118)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	(737)	(8,143)	115	(4,084)	(3,919)
<b>Cash Flow From Investing</b>	<b>(833)</b>	<b>(8,553)</b>	<b>33</b>	<b>(4,182)</b>	<b>(4,036)</b>
Debt Raised/(repaid)					
Proceeds From Issue Of Shares					
Shares Repurchased					
Dividends Paid	(1,869)	(2,324)	(1,490)	(3,307)	(4,170)
Preferred Dividends					
Other Financing Cashflow	(837)	4,191	(2,324)	(2,612)	(1,258)
<b>Cash Flow From Financing</b>	<b>(2,706)</b>	<b>1,867</b>	<b>(3,814)</b>	<b>(5,920)</b>	<b>(5,428)</b>
Total Cash Generated	583	(4,164)	1,790	(3,382)	(904)
<b>Free Cashflow To Equity</b>	<b>4,026</b>	<b>2,112</b>	<b>5,488</b>	<b>6,621</b>	<b>8,442</b>
<b>Free Cashflow To Firm</b>	<b>3,469</b>	<b>(5,846)</b>	<b>6,448</b>	<b>3,073</b>	<b>4,719</b>

SOURCE: INCRED RESEARCH, COMPANY REPORTS

**BY THE NUMBERS...cont'd**

<b>Balance Sheet</b>					
<b>(Rs mn)</b>	<b>Mar-22A</b>	<b>Mar-23A</b>	<b>Mar-24F</b>	<b>Mar-25F</b>	<b>Mar-26F</b>
Total Cash And Equivalents	9,144	9,361	10,248	7,402	6,693
Total Debtors	9,220	12,362	14,378	17,455	20,441
Inventories					
Total Other Current Assets	1,080	2,428	2,428	2,428	2,428
<b>Total Current Assets</b>	<b>19,443</b>	<b>24,151</b>	<b>27,054</b>	<b>27,285</b>	<b>29,562</b>
Fixed Assets	2,062	6,347	5,104	3,807	2,474
Total Investments	518	559	559	559	559
Intangible Assets	2,207	10,984	10,984	10,984	10,984
Total Other Non-Current Assets	1,362	1,528	1,528	1,528	1,528
<b>Total Non-current Assets</b>	<b>6,149</b>	<b>19,418</b>	<b>18,175</b>	<b>16,877</b>	<b>15,545</b>
Short-term Debt					
Current Portion of Long-Term Debt					
Total Creditors	10,547	12,949	15,157	18,182	21,293
Other Current Liabilities	2,393	8,685	6,522	4,162	1,798
<b>Total Current Liabilities</b>	<b>12,940</b>	<b>21,633</b>	<b>21,680</b>	<b>22,344</b>	<b>23,091</b>
Total Long-term Debt					
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	1,660	8,929	8,929	4,492	1,278
<b>Total Non-current Liabilities</b>	<b>1,660</b>	<b>8,929</b>	<b>8,929</b>	<b>4,492</b>	<b>1,278</b>
Total Provisions					
<b>Total Liabilities</b>	<b>14,600</b>	<b>30,562</b>	<b>30,609</b>	<b>26,836</b>	<b>24,369</b>
Shareholders Equity	10,992	13,007	14,620	17,326	20,738
Minority Interests					
<b>Total Equity</b>	<b>10,992</b>	<b>13,007</b>	<b>14,620</b>	<b>17,326</b>	<b>20,738</b>

<b>Key Ratios</b>					
	<b>Mar-22A</b>	<b>Mar-23A</b>	<b>Mar-24F</b>	<b>Mar-25F</b>	<b>Mar-26F</b>
Revenue Growth	31.3%	34.1%	16.3%	20.0%	17.1%
Operating EBITDA Growth	22.3%	30.2%	29.0%	19.5%	19.8%
Operating EBITDA Margin	8.4%	8.1%	9.0%	9.0%	9.2%
Net Cash Per Share (Rs)	32.95	33.73	36.93	26.67	24.12
BVPS (Rs)	39.61	46.87	52.69	62.44	74.73
Gross Interest Cover	23.09	29.40	7.65	14.77	49.78
Effective Tax Rate	24.8%	24.3%	24.5%	25.0%	25.0%
Net Dividend Payout Ratio	77.5%	48.4%	30.7%	55.0%	55.0%
Accounts Receivables Days	51.74	52.87	56.34	55.92	56.84
Inventory Days					
Accounts Payables Days	65.40	67.12	71.39	70.54	71.05
ROIC (%)	133.4%	137.9%	40.7%	46.6%	52.5%
ROCE (%)	31.3%	34.4%	35.4%	37.2%	38.3%
Return On Average Assets	13.9%	11.9%	11.0%	13.3%	16.3%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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	Analyst/ Relative	Entity/ Associates
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any other material conflict of interest at the time of publication of the research report or at the time of public appearance	NO	NO
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received any compensation or other benefits from the subject company or third party in connection with the research report	NO	NO
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been engaged in market making activity for the subject company	NO	NO

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