

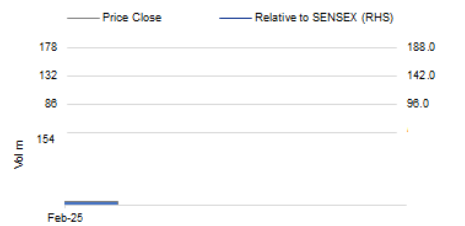
India

**HOLD** (no change)

Consensus ratings*:	Buy 8	Hold 2	Sell 0
Current price:	Rs550		
Target price:	Rs554		
Previous target:	Rs826		
Up/downside:	0.7%		
InCred Research / Consensus:	-20.9%		
Reuters:			
Bloomberg:	SSOF IN		
Market cap:	US\$1,568m		
	Rs137,128m		
Average daily turnover:	US\$3.8m		
	Rs334.0m		
Current shares o/s:	277.5m		
Free float:	70.8%		
*Source: Bloomberg			

**Key changes in this note**

- Expect ~8% revenue CAGR over FY25F-27F.
- Expect 18.6% EBIT CAGR over FY25F-27F driven by a cut in base-year estimates.
- Expect 22.5% PAT CAGR over FY25F-27F.



Source: Bloomberg

<b>Price performance</b>	1M	3M	12M
Absolute (%)	(21.0)	(21.6)	(39.3)
Relative (%)	(20.8)	(20.1)	(43.9)

<b>Major shareholders</b>	% held
Hemendra M Kothari	9.1
HDFC Mutual fund	7.1
HSBC Midcap Fund	3.2

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# Sonata Software

## Growth story pushed out by a year

- Customer-specific challenges impacted 3QFY25 performance
- Retail, more than hi-tech, appears weak. Lost US\$6.8m during 9MFY25.
- Weak commentary drives a revision in our estimates and a lower target price.

**Customer-specific challenges impact 3QFY25**

Sonata Software’s 3QFY25 constant currency (cc) revenue growth of 4.4% was encouraging, but an unplanned large client ramp-down and one-time discounts for a large hi-tech customer impacted 3Q EBITDA margin by ~350bp and also the outlook as 4QFY25F would see the full-quarter impact of customer-specific events, leading to a potential revenue decline of 2.5-3.5% qoq. We have adjusted our estimates accordingly, which drives our target price lower. Although the valuation is becoming reasonable than ever before, we would like to reassess the potential of any further customer-specific event before turning into a BUYer. Retain our HOLD rating on the stock.

**Retail, more than TMT vertical, drags quarterly performance**

The weakness in retail & manufacturing (US\$4.5m decline qoq and US\$6.8m during 9MFY25) and TMT (US\$1.8m/4.2m, respectively) vertical impacted qoq growth while the Quant seasonality-led growth in FSI (30%; up 40.2% qoq and 83.4% yoy) followed by healthcare (11%; up 13.1%/3.9%) and emerging markets (5%; up 2.8%/35%) were key offsets. Although we await management update on the timeline of its US\$500m revenue aspiration, we believe, it could be get pushed back by a year.

**Commentary says ~280bp of EBITDA margin impact is recoverable**

IT services’ EBITDA margin (down 360bp) was impacted by ramp-downs, one-time discounts, severance payouts and wage hikes (75bp). Although management stated that the impact, ex-wage hike, is recoverable, clarity will be provided only during FY-end.

**Deal wins decent**

Sonata Software signed two large deals (vs. 3 in 2QFY25 and 14 in FY24), of which one is with a Finland-based mining and construction technology company to drive modernization and transformation across 26 countries over three years, while the other is with a client that offers technology solutions for transportation, invoice management, data management and network optimization. The book-to-bill ratio stands at 1.23x (unchanged qoq). Cloud & data deal pipeline is 44% of the overall pipeline vs. 15% two years ago and 3Q saw Sonata Software winning its largest deal in AI & Fabric.

**Retain HOLD rating with a lower target price of Rs550**

We now expect IT services/overall revenue to grow at 8.2%/8.1% CAGR over FY25F-27F in US\$/Rsm terms, respectively, and expect a 22.5% PAT (Rs) CAGR over the same period. We now assign a multiple of 1x PE/G for IT services business and 1.3x PE/G for domestic business to arrive at target multiple of ~16x/26x, respectively, and a lower target price of Rs550 vs. Rs826 earlier. Upside risk: Better execution. Downside risk: Incremental customer-specific issues.

Financial Summary	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Revenue (Rsm)	74,491	86,131	101,237	106,363	118,258
Operating EBITDA (Rsm)	6,041	7,274	7,030	8,296	9,520
Net Profit (Rsm)	4,519	3,085	4,387	5,617	6,580
Core EPS (Rs)	16.3	15.3	15.8	20.2	23.6
Core EPS Growth	20.0%	(5.9%)	3.0%	27.8%	17.1%
FD Core P/E (x)	33.77	49.48	34.85	27.27	23.28
DPS (Rs)	15.8	7.9	9.9	13.3	15.9
Dividend Yield	1.43%	1.43%	0.91%	2.00%	2.00%
EV/EBITDA (x)	24.22	20.07	20.63	17.74	14.97
P/FCFE (x)	67.13	59.82	22.12	29.60	22.59
Net Gearing	(48.5%)	(47.4%)	(46.1%)	(30.6%)	(46.1%)
P/BV (x)	11.73	10.85	8.98	7.81	6.62
ROE	37.7%	31.4%	28.2%	30.6%	30.8%
% Change In Core EPS Estimates			(0.27%)	(0.26%)	
InCred Research/Consensus EPS (x)					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 1: Quarterly performance**

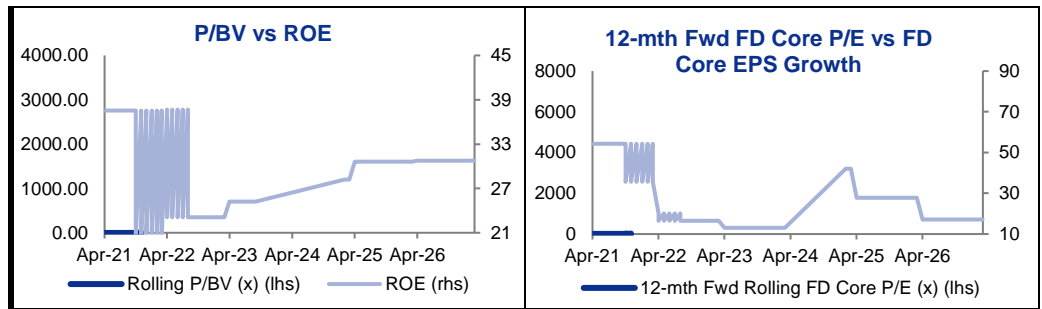
Y/E Mar (Rs m)	3QFY25	3QFY24	YoY (%)	2QFY25	QoQ (%)	3QFY25F	Var. (%)
IT services revenue (US\$ m)	87.0	83.7	3.9	84.6	2.8	87.0	0.0
Overall revenue (Rs m)	28,428	24,934	14.0	21,698	31.0	26,954	5.5
EBITDA	1,636	2,077	(21.3)	1,773	(7.7)	2,237	(26.9)
EBITDA margin (%)	5.8	8.3	(258 bp)	8.2	(241 bp)	8.3	(255 bp)
Depreciation	323	337	(4.3)	329	(2.0)	345	(6.5)
EBIT	1,313	1,740	(24.5)	1,443	(9.0)	1,892	(30.6)
EBIT margin (%)	4.6	7.0	(236 bp)	6.7	(203 bp)	7.0	(240 bp)
Net other income	55	-1,771	(103.1)	0	55100.0	33	69.2
PBT	1,368	-31	(4513.5)	1,443	(5.2)	1,925	(28.9)
Provision for tax	318	431	(26.1)	379	(16.0)	491	(35.2)
% tax rate	23.2	NM	NM	26.2	(297 bp)	25.5	(225 bp)
Net profit	1,050	-462	NM	1,065	(1.4)	1,434	(26.8)
EPS	3.8	(1.7)	NM	3.8	(1.3)	5.2	(26.7)

SOURCE: INCRED RESEARCH, COMPANY REPORTS

## Key conference-call highlights

- **Guidance:** 4QFY25F revenue could decline 2.5-3.5% due to seasonal weakness in Quant and the full-quarter impact of ramp-down at the hi-tech client. Although the one-time impact on margin is recoverable, the company would provide clarity towards the end of FY25F.
- YTD FY25, Sonata Software added 16 new enterprise logos, and aims to scale them over the next two-to-three years.
- Artificial Intelligence or AI:
  - Retains guidance of AI-enabled service revenue contribution of 20% (of the overall revenue) in the next three years.
  - Making significant progress in implementing GenAI using small language models for cost efficiency. Implementing agent AI for driving hyper automation in transformation programs.
  - The company achieved AWS's GenAI competency.
  - Announced the setting up of an AI Centre of Excellence in Melbourne, in partnership with the Victorian government, to meet the growing demand for GenAI and data solutions, and aims to create 100 skilled jobs over the next three years.
  - 87% of employees are GenAI-trained
- Onboarded 100 campus graduates during 3Q.
- Compensation increases for mid and senior management personnel impacted 3QFY25 EBITDA margin by ~75bp.
- Hardware purchase cycle by hi-tech customers is driving cost optimization in opex spends and could continue for the next one-two quarters.
- Across verticals, FSI and healthcare momentum could continue while retail and TMT could face headwinds driven by inflation and large customer-specific challenges.
- 44% of the large pipeline is from Fortune 500 clients and also from cloud and data-related modernization deals. The company is seeing increased demand for data-driven deals.

**BY THE NUMBERS**



**Profit & Loss**

(Rs mn)	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
<b>Total Net Revenues</b>	<b>74,491</b>	<b>86,131</b>	<b>101,237</b>	<b>106,363</b>	<b>118,258</b>
<b>Gross Profit</b>	<b>10,603</b>	<b>14,588</b>	<b>15,565</b>	<b>17,018</b>	<b>19,217</b>
<b>Operating EBITDA</b>	<b>6,041</b>	<b>7,274</b>	<b>7,030</b>	<b>8,296</b>	<b>9,520</b>
Depreciation And Amortisation	(591)	(1,319)	(1,305)	(1,374)	(1,464)
<b>Operating EBIT</b>	<b>5,450</b>	<b>5,955</b>	<b>5,725</b>	<b>6,923</b>	<b>8,056</b>
Financial Income/(Expense)	523	405	125	567	717
Pretax Income/(Loss) from Assoc.					
Non-Operating Income/(Expense)					
<b>Profit Before Tax (pre-EI)</b>	<b>5,973</b>	<b>6,360</b>	<b>5,850</b>	<b>7,490</b>	<b>8,773</b>
Exceptional Items		(1,747)			
<b>Pre-tax Profit</b>	<b>5,973</b>	<b>4,613</b>	<b>5,850</b>	<b>7,490</b>	<b>8,773</b>
Taxation	(1,454)	(1,529)	(1,463)	(1,872)	(2,193)
Exceptional Income - post-tax					
<b>Profit After Tax</b>	<b>4,519</b>	<b>3,085</b>	<b>4,387</b>	<b>5,617</b>	<b>6,580</b>
Minority Interests					
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
<b>Net Profit</b>	<b>4,519</b>	<b>3,085</b>	<b>4,387</b>	<b>5,617</b>	<b>6,580</b>
Recurring Net Profit	4,519	4,253	4,387	5,617	6,580
<b>Fully Diluted Recurring Net Profit</b>	<b>4,519</b>	<b>4,253</b>	<b>4,387</b>	<b>5,617</b>	<b>6,580</b>

**Cash Flow**

(Rs mn)	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
<b>EBITDA</b>	<b>6,041</b>	<b>7,274</b>	<b>7,030</b>	<b>8,296</b>	<b>9,520</b>
Cash Flow from Invt. & Assoc.					
Change In Working Capital	(1,766)	(2,094)	2,296	(724)	(36)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense	349	1,098			
<b>Other Operating Cashflow</b>					
Net Interest (Paid)/Received	(185)	(850)	(703)	(284)	(229)
Tax Paid	(1,754)	(2,623)	(1,463)	(1,872)	(2,193)
<b>Cashflow From Operations</b>	<b>2,684</b>	<b>2,805</b>	<b>7,161</b>	<b>5,416</b>	<b>7,062</b>
Capex	(411)	(254)	(250)	(241)	(280)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	(8,143)	(289)	(4,318)	(3,879)	946
<b>Cash Flow From Investing</b>	<b>(8,553)</b>	<b>(543)</b>	<b>(4,568)</b>	<b>(4,120)</b>	<b>666</b>
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	(1,766)	(284)	(229)
<b>Cash Flow From Financing</b>	<b>(2,150)</b>	<b>2,298</b>	<b>(3,155)</b>	<b>(3,340)</b>	<b>(3,285)</b>
Total Cash Generated	(8,019)	4,560	(562)	(2,044)	4,443
<b>Free Cashflow To Equity</b>	<b>2,274</b>	<b>2,552</b>	<b>6,911</b>	<b>5,175</b>	<b>6,782</b>
<b>Free Cashflow To Firm</b>	<b>(5,684)</b>	<b>3,112</b>	<b>3,296</b>	<b>1,580</b>	<b>7,957</b>

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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

<b>Balance Sheet</b>					
<b>(Rs mn)</b>	<b>Mar-23A</b>	<b>Mar-24A</b>	<b>Mar-25F</b>	<b>Mar-26F</b>	<b>Mar-27F</b>
Total Cash And Equivalents	9,361	10,971	10,089	7,266	11,938
Total Debtors	12,362	16,051	16,805	17,869	19,867
Inventories					
Total Other Current Assets	2,428	3,734	3,734	3,734	3,734
<b>Total Current Assets</b>	<b>24,151</b>	<b>30,756</b>	<b>30,629</b>	<b>28,870</b>	<b>35,540</b>
Fixed Assets	6,347	5,575	4,520	3,387	2,204
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
<b>Total Non-current Assets</b>	<b>19,418</b>	<b>20,736</b>	<b>19,680</b>	<b>18,547</b>	<b>17,364</b>
Short-term Debt					
Current Portion of Long-Term Debt					
Total Creditors	12,949	14,160	17,210	17,550	19,512
Other Current Liabilities	8,685	16,773	11,628	6,791	6,791
<b>Total Current Liabilities</b>	<b>21,633</b>	<b>30,933</b>	<b>28,838</b>	<b>24,341</b>	<b>26,304</b>
Total Long-term Debt	3,051	4,310	2,225	1,268	1,268
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	5,878	2,185	2,185	2,185	2,185
<b>Total Non-current Liabilities</b>	<b>8,929</b>	<b>6,496</b>	<b>4,410</b>	<b>3,454</b>	<b>3,454</b>
Total Provisions					
<b>Total Liabilities</b>	<b>30,562</b>	<b>37,428</b>	<b>33,248</b>	<b>27,795</b>	<b>29,757</b>
Shareholders Equity	13,007	14,063	17,061	19,623	23,147
Minority Interests					
<b>Total Equity</b>	<b>13,007</b>	<b>14,063</b>	<b>17,061</b>	<b>19,623</b>	<b>23,147</b>

<b>Key Ratios</b>					
	<b>Mar-23A</b>	<b>Mar-24A</b>	<b>Mar-25F</b>	<b>Mar-26F</b>	<b>Mar-27F</b>
Revenue Growth	34.1%	15.6%	17.5%	5.1%	11.2%
Operating EBITDA Growth	30.2%	20.4%	(3.4%)	18.0%	14.7%
Operating EBITDA Margin	8.1%	8.4%	6.9%	7.8%	8.0%
Net Cash Per Share (Rs)	22.74	24.00	28.24	21.54	38.31
BVPS (Rs)	46.87	50.68	61.26	70.46	83.11
Gross Interest Cover	29.40	7.00	8.15	24.39	35.21
Effective Tax Rate	24.3%	33.1%	25.0%	25.0%	25.0%
Net Dividend Payout Ratio	48.4%	45.3%	31.7%	54.4%	46.4%
Accounts Receivables Days	52.87	60.20	59.23	59.49	58.24
Inventory Days					
Accounts Payables Days	67.12	69.15	66.82	71.00	68.29
ROIC (%)	137.9%	37.6%	47.3%	47.8%	39.5%
ROCE (%)	30.5%	26.3%	22.8%	25.8%	26.7%
Return On Average Assets	11.9%	9.5%	8.4%	10.6%	12.0%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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CIN: U74999MH2016PTC287535



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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.