ANANDRATHI

India I Equities

Technology

Company Update

Change in Estimates ☑ Target ☑ Reco ☑

20 October 2021

Sonata Software

Rating: Buy

Target Price: Rs. 1,070

Share Price: Rs. 920

IT Services growth to accelerate, margin outlook cautious; Buy

Sonata delivered IT Services revenue of $49.4m, up 5.2% q/q (organic est), 20% y/y, recovering from a soft Q1. Net hiring (incl. Encore) was 592 while utilization went back to 89% as pandemic-related challenges subside. The company sees demand in Retail CPG and Travel verticals ahead and is hiring in greater numbers. The Domestic business ($83m, up 17% y/y) was slower than in the last four quarters (average 27%). Encore was integrated for two months in Q2. We raise FY22e/23e profit 3%/4% and target to Rs1,070 (24x FY23e), factoring in Encore.

Steady Q2 for IT services. The IT Services business was steady in Q2 as the company bounced back from a soft Q1, benefiting from the two-month integration of Encore, and expanded into healthcare. The growth outlook improved with acceleration in Retail (up 8% q/q) and expecting a sharp recovery in Travel (up 5% q/q)/top client (up 9% q/q) in the next four quarters. Net hiring was high with ~300 employees added organically and associated higher costs were absorbed through higher offshore. Global delivery centres will be opened to enhance global presence.

IT Services margins at 27%; outlook cautious. IT Services' Q2 EBITDA margin at 27% (up 192 bps q/q, 190bps y/y) was on the higher side due to increased utilisation (up 100bps q/q) and offshoring (100bps q/q). Ahead, utilisation will be steady while offshoring will offer leverage in margins. Supply side remains challenging and the next round of wage hikes is scheduled in Jan'22 as attrition runs at 22-24%. Consequently, the margin outlook is cautious and is likely to be lower (est. 150bps) than in Q2 FY22. Domestic margins were 5.6% (3.4% in Q1), higher but on lower sales volume.

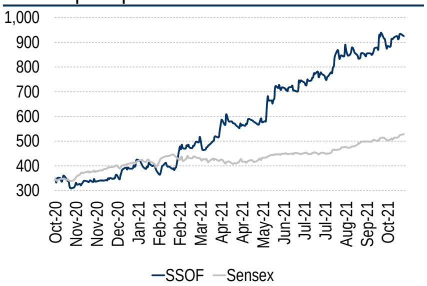
Target raised; upgrading to a Buy. Sonata's IT business is likely to clock a 24% CAGR in the next two years and may see segment margins of ~25.5%. On the domestic front, it is likely to grow 22% (accelerating from Q2 FY22), taking consolidated FY23e EPS to Rs45. The stock trades at 21x FY23e EPS (4.6% FCF yield), which we find attractive. **Risk:** Supply-side disruptions in the next few quarters.

Key data	SSOF IN / SOFT.BO
52-week high / low	Rs1030 / 300
Sensex / Nifty	61260 / 18267
3-m average volume	$5.2m
Market cap	Rs96bn / $1288.8m
Shares outstanding	105m

Shareholding pattern (%)	Sep'21	Jun'21	Mar'21
Promoters	28.2	28.2	28.2
- of which, Pledged			
Free float	71.8	71.8	71.8
- Foreign institutions	16.5	15.4	13.8
- Domestic institutions	13.0	12.9	13.1
- Public	42.3	43.5	44.9

Estimates revision (%)	FY22e	FY23e
Sales ($)	1.1	2.8
EBITDA	3.3	5.6
Net profit	3.2	3.9

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY19	FY20	FY21	FY22e	FY23e
Sales (Rs m)	29,609	37,433	42,281	53,053	63,217
Net profit (Rs m)	2,492	2,770	2,440	3,887	4,648
EPS (Rs)	23.7	26.3	23.5	37.4	44.7
PE (x)	38.4	34.5	39.2	24.6	20.6
EV / EBITDA (x)	26.5	23.1	23.5	17.4	13.7
PBV (x)	12.4	14.3	10.6	9.6	8.7
RoE (%)	35.1	38.5	31.0	41.0	44.5
RoCE (%)	30.4	29.8	23.8	32.1	39.1
Dividend yield (%)	1.4	1.8	1.6	2.6	3.1
Net debt / equity (x)	-0.4	-0.5	-0.7	-0.8	-0.8

Source: Company, Anand Rathi Research

Mohit Jain
Research Analyst

Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY19e	FY20e	FY21e	FY22e	FY23e
Revenues (US$m)	430.8	534.4	575.7	727.6	865.6
Growth (%)	12.1	24.1	7.7	26.4	19.0
Net revenues (Rs m)	29,609	37,433	42,281	53,053	63,217
Employee & Direct Costs	23,517	30,761	36,171	45,129	53,733
Gross Profit	6,092	6,672	6,110	7,924	9,484
Gross Margin %	20.57	17.82	14.45	14.94	15.00
SG&A	2,736	2,817	2,317	2,796	3,001
EBITDA	3,356	3,855	3,794	5,128	6,483
EBITDA margins (%)	11.3	10.3	9.0	9.7	10.3
- Depreciation	128	365	396	456	507
Other income	301	457	277	671	397
Interest Exp	34	152	154	183	176
PBT	3,494	3,795	3,522	5,160	6,197
Effective tax rate (%)	29	27	31	25	25
+ Associates/(Minorities)	4	-	-	-	-
Net Income	2,492	2,770	2,440	3,887	4,648
WANS	105	105	104	104	104
FDEPS (Rs/share)	23.7	26.3	23.5	37.4	44.7

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY19e	FY20e	FY21e	FY22e	FY23e
Share capital	104	104	104	104	104
Net worth	7,683	6,697	9,055	9,928	10,973
Total debt (incl. Pref)	156	860	897	-	-
Minority interest	-	-	-	-	-
DTL/(Asset)	-119	-244	-189	-133	-133
Capital employed	7,720	7,313	9,762	9,796	10,841
Net tangible assets	220	1,186	999	908	910
Net Intangible assets	322	238	477	751	699
Goodwill	1,452	1,558	1,759	1,759	1,759
CWIP (tang. & intang.)	6	-	1	1	1
Investments (Strategic)					
Investments (Financial)	1,464	135	760	836	919
Current Assets (ex Cash)	9,706	8,840	8,512	9,631	11,416
Cash	1,992	3,964	6,771	7,150	7,772
Current Liabilities	7,442	8,608	9,517	11,240	12,636
Working capital	2,264	232	-1,006	-1,609	-1,220
Capital deployed	7,720	7,313	9,762	9,796	10,841
Contingent Liabilities	7,267	7,542	5,966	-	-

Fig 3 – Cash Flow statement (Rs m)

Year-end: Mar	FY19e	FY20e	FY21e	FY22e	FY23e
PBT	3,494	3,795	3,522	5,160	6,197
+ Non-cash items	-339	205	397	-33	286
Operating profit before WC	3,155	4,000	3,919	5,128	6,483
- Incr./(decr.) in WC	2,350	-976	-1,775	-847	175
Others incuding taxes	-867	-1,291	-1,267	-1,460	-1,764
Operating cash-flow	-62	3,686	4,426	4,515	4,544
- Capex (tangible + Intangible)	80	85	19	136	256
Free cash-flow	-142	3,601	4,408	4,379	4,289
Acquisitions	-383	-	-505	-502	-201
- Dividend (including buyback &	1,434	3,541	407	3,013	3,603
+ Equity raised	0	-	-	-	-0
+ Debt raised	-195	704	37	-897	-
- Fin Investments	-643	-1,382	591	76	84
- Misc. Items (CFI + CFF)	-32	168	137	-489	-221
Net cash-flow	-1,480	1,978	2,806	379	622

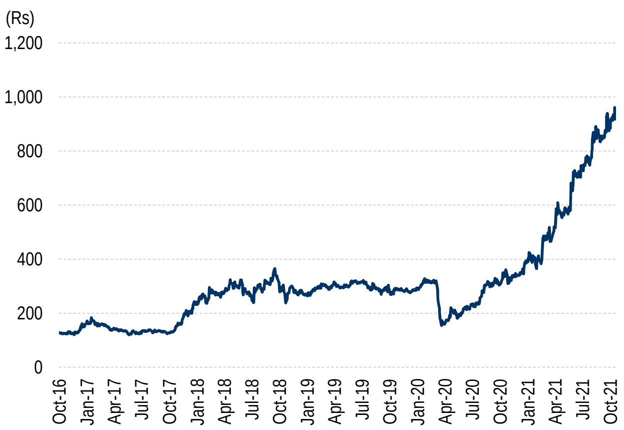
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year end Mar	FY19e	FY20e	FY21e	FY22e	FY23e
P/E (x)	38.4	34.5	39.2	24.6	20.6
EV/EBITDA (x)	26.5	23.1	23.5	17.4	13.7
EV/sales (x)	3.12	2.47	2.11	1.65	1.38
P/B (x)	12.4	14.3	10.6	9.6	8.7
RoE (%)	35.1	38.5	31.0	41.0	44.5
RoCE (%) - After tax	30.4	29.8	23.8	32.1	39.1
RoIC (%) - After tax	74.0	53.3	57.6	109.9	143.1
DPS (Rs per share)	12.8	17.0	15.2	24.2	28.9
Dividend yield (%)	1.4	1.8	1.6	2.6	3.1
Dividend payout (%) - Inc. DDT	64.6	64.6	64.6	64.6	64.6
Net debt/equity (x)	-0.4	-0.5	-0.7	-0.8	-0.8
Receivables (days)	105	72	56	50	50
Inventory (days)					
Payables (days)	82	61	62	62	62
CFO:PAT%	-2.5	133.1	181.4	116.2	97.8
FCF:PAT% - includ M&A payou	-21.1	130.0	160.0	99.7	88.0

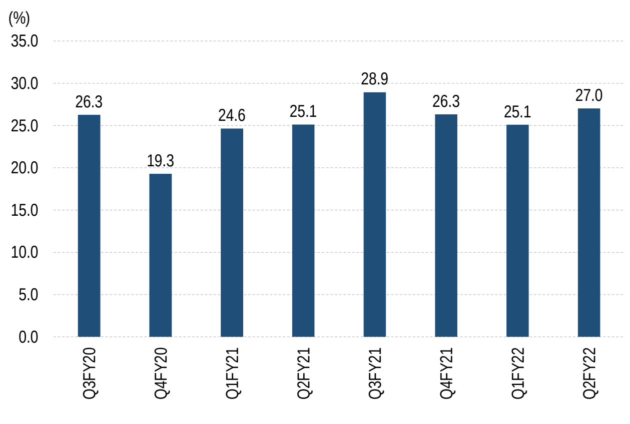
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6– IT Services' EBITDA margin (%)



Source: Company, Anand Rathi Research

Result Highlights

Q2FY22 Results at a Glance

Fig 7 – Q2FY22 results

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q/Q %	Y/Y %
Revenue ($ m)	110	191	148	174	132	-24%	20%
Growth Y/Y %	7%	8%	17%	38%	20%		
Industry Y/Y % (est.)	2%	3%	6%	20%	21%		
Revenue (Rs m)	8,038	13,962	10,757	12,685	9,632	-24%	20%
Effec. exchange rate	73.9	73.4	72.8	72.8	73.0	0%	-1%
Rev($m) – IT Services	39.0	41.0	43.8	44.5	49.4	11%	27%
Growth Y/Y %	-14%	-12%	-1%	22%	27%		
Rev($m) – Reselling Services	70.9	149.8	104.6	130.0	82.9	-36%	17%
Growth Y/Y %	23%	16%	26%	44%	17%		
Employees (EoP)	3,885	3,997	4,102	4,250	4,850	14%	25%
Rev. prod. ($ '000/employee)	10.1	10.8	11.2	11.0	11.2	2%	11%
Utilisation (%)	87%	89%	89%	88%	89%	100 bps	200 bps
Attrition %	12%	14%	18%	18%	23%	500 bps	1110 bps
CoR (excl. D&A)	(6,565)	(12,407)	(9,114)	(11,024)	(7,706)	-30%	17%
As % of revenue	-82%	-89%	-85%	-87%	-80%	690 bps	168 bps
SG&A	(600)	(446)	(613)	(652)	(696)	7%	16%
As % of revenue.	-7%	-3%	-6%	-5%	-7%	-208 bps	24 bps
EBITDA	873	1,109	1,031	1,010	1,231	22%	41%
EBITDA margins %	10.9%	7.9%	9.6%	8.0%	12.8%	482 bps	192 bps
IT Svcs EBITDA margins %	24.7%	28.4%	24.5%	23.2%	24.9%		
EBIT	772	1,010	937	911	1,114	22%	44%
EBIT margins %	9.6%	7.2%	8.7%	7.2%	11.6%	438 bps	195 bps
IT Svcs EBIT margins %	21.9%	25.9%	22.3%	20.9%	22.5%		
Industry margins % (est.)	16.2%	17.8%	17.6%	16.8%	16.7%	-12 bps	49 bps
Other income (excl. forex)	44	33	124	124	75	-39%	71%
Non-recurring / Forex	(20)	-	65	158	60	-62%	NM
Interest expenses	(38)	(46)	(36)	(44)	(47)	25%	29%
PBT	759	996	1,091	1,148	1,202	5%	58%
PBT margins %	9.4%	7.1%	10.1%	9.1%	12.5%	342 bps	303 bps
Taxes	(187)	(458)	(260)	(281)	(290)	3%	55%
ETR %	-25%	-46%	-24%	-24%	-25%	-54 bps	-37 bps
Associates / Minority	-	-	-	-	-		
Net income	572	538	831	867	912	5%	59%
Net margins %	7.1%	3.9%	7.7%	6.8%	9.5%	263 bps	235 bps
Industry net margins %	12.5%	13.4%	12.6%	13.8%	13.5%	-36 bps	95 bps
EPS (Rs)	5.5	5.2	8.0	8.3	8.8	5%	59%

Source: Company, Anand Rathi Research Note: Attrition is estimated.

Fig 8 – Quarterly results(Rs m)

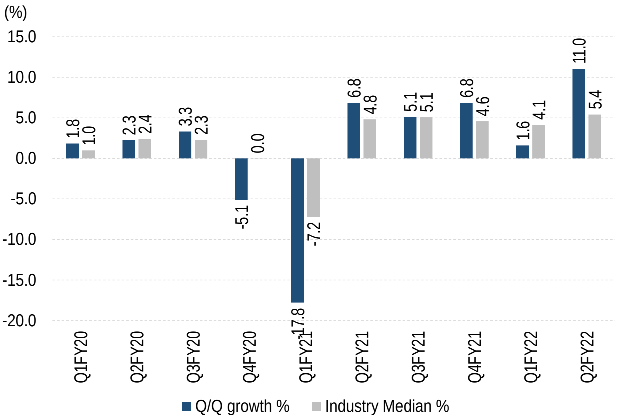
Year-end: Mar (Rs m)	Q2FY22	% chg. Q/Q	% chg. Y/Y	H1 as a % of FY22	FY21	FY21 % chg. Y/Y	FY22e % chg. Y/Y
Sales ($ m)	49	11.0	26.7	46%	160	(11.3)	27.5
Sales	9,632	(24.1)	19.8	42%	42,281	13.0	25.5
EBITDA	1,231	21.9	41.0	44%	3,794	(1.6)	35.2
EBITDA margin (%)	13	482bps	192bps	-	9	-133bps	69bps
EBIT	1,114	22.3	44.2	43%	3,398	(2.6)	37.5
EBIT margin (%)	12	438bps	195bps	-	8	-129bps	77bps
PBT	1,202	4.7	58.3	46%	3,522	(7.2)	46.5
Tax	(290)	3.2	55.1	45%	(1,082)	5.5	17.7
Tax rate (%)	(24)	34bps	50bps	-	(31)	-370bps	604bps
Net income	912	5.1	59.4	46%	2,440	(11.9)	59.3

Source: Company, Anand Rathi Research

IT services on a steady growth path

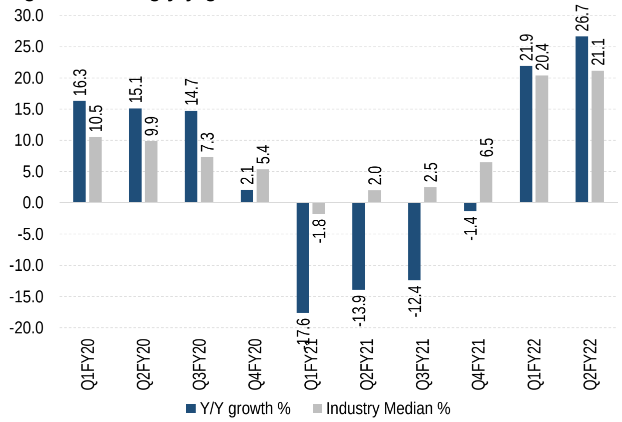
Sonata's IT services revenue is getting into a good stride. In Q2 FY22, it grew 11% sequentially (5.2% organic est) and has been growing for the previous five quarters after Q1 FY21, most of which was above the industry level. The exception here was Q1 FY22 as the company faced supply-side challenges during the pandemic. Its delivery centres were concentrated regionally and, hence, were more impacted. Encore, its recent acquisition, was integrated from 1st Aug'21. The company benefitted from accelerated growth in the CPG and Travel verticals during the quarter. Both these are doing well for most midcap IT companies. From a y/y perspective, it delivered 27% revenue growth, beating industry growth for the second consecutive quarter.

Fig 9 – Growing faster than industry



Source: Company, Anand Rathi Research

Fig 10 – Strong y/y growth



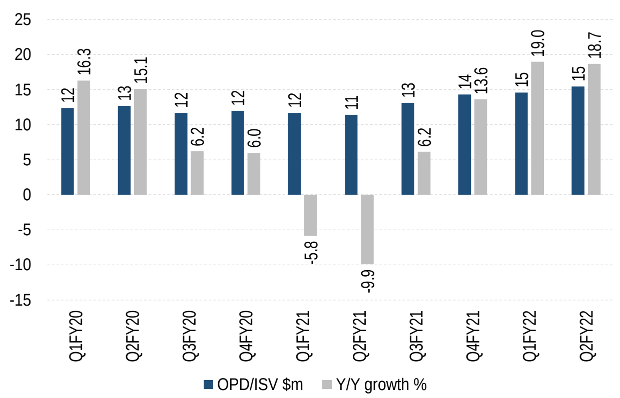
Source: Company, Anand Rathi Research

ISV, CPG/Retail and Travel growing well

Sonata's strength lies in three verticals: ISV (31%), CPG/Retail (31%), and Travel (10%). In the ISV vertical, the company recorded 19% y/y growth. Growth here should be persist for the foreseeable future as the company works on the Dynamics side of the business, which is growing ~40% for Microsoft.

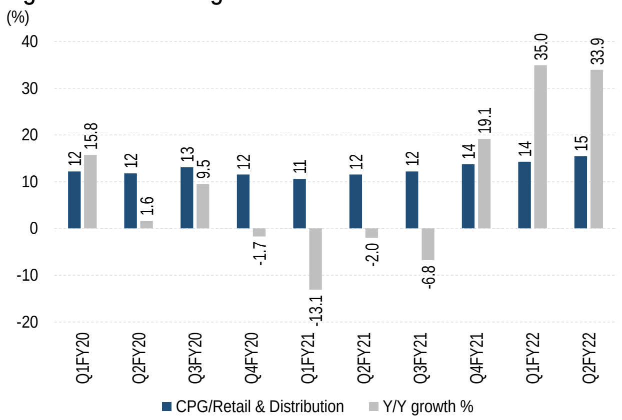
CPG/Retail had a commendable quarter, growing 34% y/y. The CPG/Retail vertical is expected to see accelerated growth ahead and be the growth driver. The type of demand here is more for package implementation or of customized solutions to add digital and ecommerce capabilities to retailers.

Fig 11 – ISV growing well, expect momentum to continue



Source: Company, Anand Rathi Research

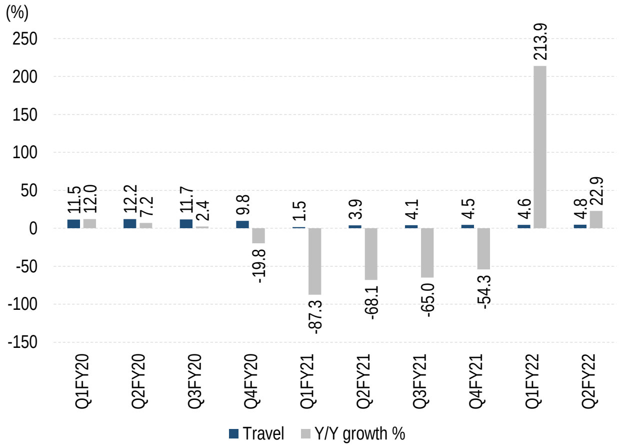
Fig 12 – CPG/Retail growth robust



Source: Company, Anand Rathi Research

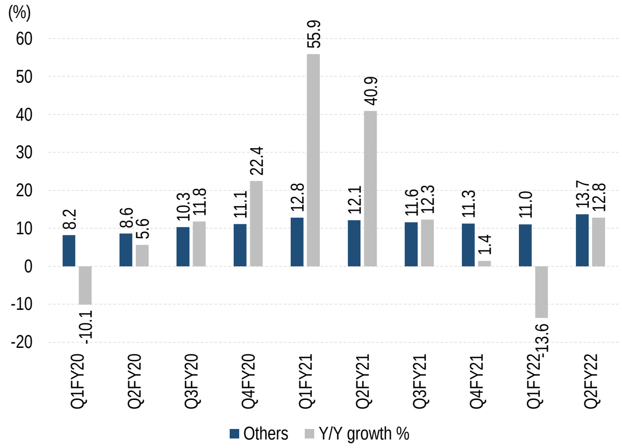
Travel vertical grew 23% y/y, company is seeing demand picking up here. The only reason for lackluster sequential growth in Q2 was that the company could not hire and deploy resources on time. The top client (travel) is expected to reach FY19 levels sometime in FY23 and is looking to accelerate in the next four quarters. The Others vertical grew 13% y/y incl. Encore (flat y/y excl. Encore).

Fig 13 – Travel to continue to grow y/y basis



Source: Company, Anand Rathi Research

Fig 14 – Other growing slower than company

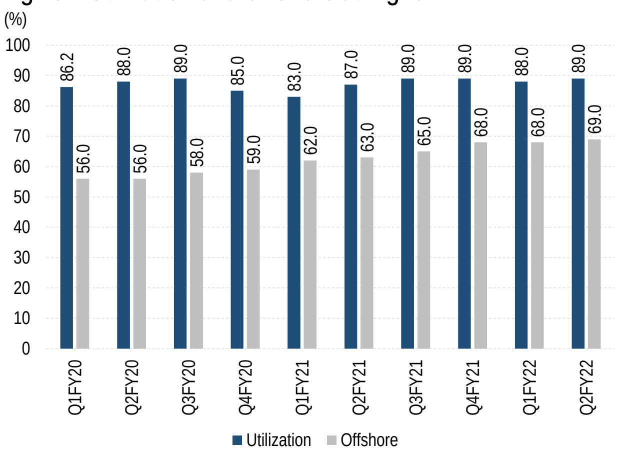


Source: Company, Anand Rathi Research

Manpower addition strong, Productivity to remain steady

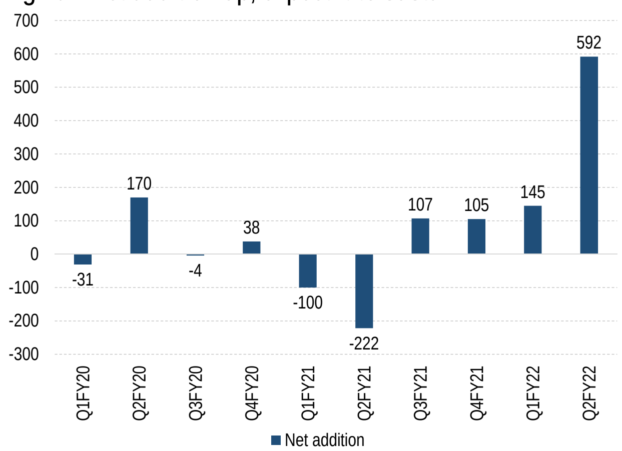
Sonata added 592 employees in Q2 (737 in six months), resulting in higher utilisation, 89% in Q2 FY22, a four-year high. Hiring was also at a four-year high as Services revenue recovered. The company has not revealed any target related to net hiring for the year but said it will be hiring gross 600 employees in Q3. Sonata has expanded margins to 27% (from 25.1% in Q1), a reflection of cost absorption through operating levers like utilization and offshoring. It is expected to review compensation in Q3 and is planning to hike wages in Q4. Attrition on the other hand climbed to 23-25% (per management)

Fig 15 – Utilization and Offshore at highs



Source: Company, Anand Rathi Research

Fig 16 – Net addition up, expect it to sustain



Source: Company, Anand Rathi Research

From an employee-productivity perspective, Sonata is ~4% lower than the recent past, reflecting the interplay of higher offshoring and utilization.

In terms of revenues, it currently delivers 69% of its services from offshore (up from 63% a year back). From a utilization perspective, it appears that it has no headroom to deliver on margins, adding to supply-side constraints. Productivity and utilisation are expected to be steady at levels now. Management is looking to pass on certain cost increases to clients; if that happens, it could pave the way to better revenue productivity. Offshore productivity has gone up in the last four quarters and the company is more likely to see price increases ahead given its shorter duration contracts.

Fig 17 – Productivity to be steady

Source: Company, Anand Rathi Research

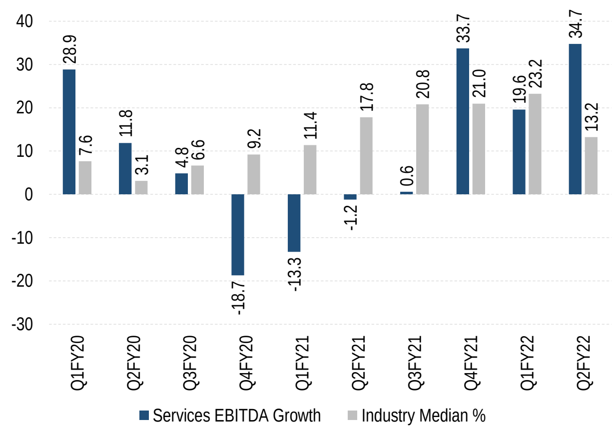
IT Services EBITDA and NI growth higher than industry

Sonata delivered 35% y/y EBITDA growth in Q2 FY22 and 27% in H1 FY22, outpacing the industry. Y/Y, it expanded margins by 190bps to 27% in Q2 FY22. Compared to pre-pandemic (Q2 FY20) levels, Sonata is operating at ~359bps higher margins, a much better performance than the industry.

NI growth was good, far ahead of the industry and is expected to stay that way. This is just a reflection of high EBIT growth. There was just one year FY21 when Sonata had to pay higher taxes. After that, it moved to the new tax regime.

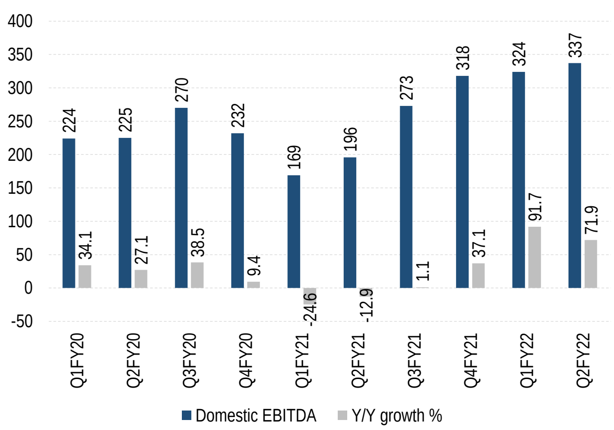
Domestic Services EBITDA grew 72% y/y and has been growing y/y for the last four quarters. The margin was 5.6% (3.4% in Q1, 3.7% a year ago).

Fig 18 – EBITDA growth higher than industry



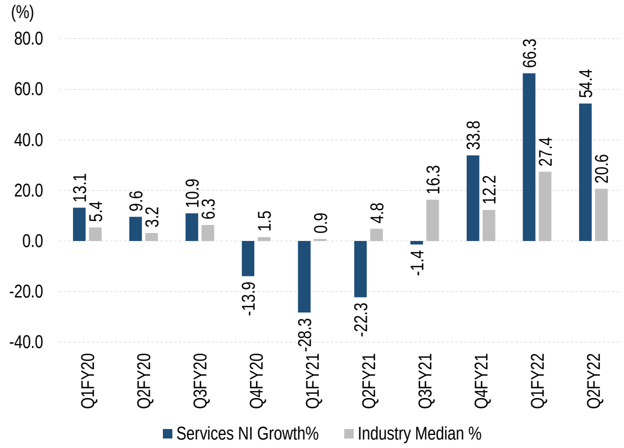
Source: Company, Anand Rathi Research

Fig 19 – Domestic EBITDA growth strong



Source: Company, Anand Rathi Research

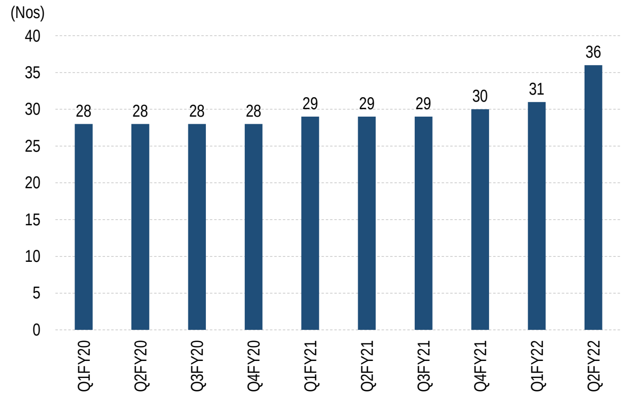
Fig 20 – NI growth higher than industry



Source: Company, Anand Rathi Research

From a client perspective, Sonata operates in mid-segment clients and hence only discloses $1m+ clients. It added seven clients in the $1m+ bracket in the last 12 months, taking the count of such clients to 36. Client addition has accelerated in the last two quarters. Five new clients were added in this bracket during Q2, on account of Encore.

Fig 21 – US$ 1m + Clients



Source: Company, Anand Rathi Research

Conference-Call Takeaways

Q2 FY22

Company

- In Q2 invested in cloud and cyber security side of the practice
- The company continues to see growth in digital business
- Management has decided to continue to invest in senior talent
- Domestic business seeing growth as many Indian companies are doing deals around cloud adoption
- Domestic business has good cash collection and very good RoCE
- Management to continue to invest in sales and marketing
- Organic growth on International services was 5-5.5% in Q2
- Travel client stagnated due to supply-side issues; otherwise outlook good. Europe travel recovering, can reach 100% of FY19 levels in 1-2 quarters, demand is picking up.
- Hiring to stay at Q2 levels
- Seeing unified distribution of growth; no one vertical to be driver
- Attrition at 23-25% in Q2
- International business subcontracting costs came down this quarter compared to Q1.
- Utilization to be stable at current level for the next 2-3 quarters
- Net addition of 300 people in Q2 (excluding Encore), expect net addition at similar levels ahead. Hiring gross 600 people a quarter for the next few quarters
- Compensation review partially to be done in Q3 and Q4
- Increased recruiting team from 15 to 50
- Considering M&As actively

Business Outlook

- Domestic business to grow steadily
- International business growth outlook is robust; continues to grow at revenue and PAT level as the company manages supply-side constraints
- Overall, management is seeing robust demand
- Margin to be retained at current levels but needs to be cautious of supply-side challenges; long-term margins to be better
- Q3 to grow 20%+ y/y

Notes from the last quarters' conference calls

Q1 FY22

- IT Services growth promising on the back of deals won and demand pipeline. Demand is robust, expect 3-4% q/q growth in revenue (international business) ahead.
- Encore has a largeannuity business and ~18%EBITDA margin. Encore revenues consolidated with Sonata from 1stAug; per quarter likely to

add $3m revenue and $500,000 in EBITDA approx. in Q2.

- Domestic business 4-5% growth in absolute EBITDA q/q is what the company is targeting.
- EBITDA at 25-26% pre-foreign exchange and other income for its international services.
- Azure offering is currently number one in cloud mixfor Sonata on the domestic side. It is growing fast and is likely to be a growth driver.
- Encore IT gives it delivery operations in Chennai will be helpful to Sonata from diversity and attrition-management perspectives.
- Growth to resume from Q2
- Margins to be maintained at current levels for IT Services.

Q4 FY21

- There is an improvement in hedemand environment and more so in the Retail/Manufacturing verticals and on Microsoft/Open stack-related technologies. Sonata is well positioned to capture this demand.
- The top-travel client is likely to see normalcy in business by Sep/Oct (European summer travel time). Volumes are likely to go up along with their business picking up; Q3-Q4 should see the uptick.
- GBW has seen a turnaround and added marquee clients in Q3 and Q4.
- Reclassified revenues from the Others segment to ISV (1.5% of IT services revenue for Q3 and Q4). Expect steady growth in ISV at ~10-12% p.a.
- Domestic business had positive cash-flows in the past four quarters without any investment in working capital.
- The offshore mix has maxed out as per management and is likely to see some reversal ahead. That may put some pressure on the margins but at the same time will offer revenue tailwinds. Dynamics implementation services saw a high shift to offshore during the pandemic; it is expected to come down after the pandemic.
- Front-loading employees;net hiring at least 300 people in the hnext couple of months
- Pay-out to be steady at 50-60% (consolidated); the company is evaluating M&A opportunities.
- Attrition at 18-19% for Q4.
- DSO for the Services business: 36 days in Q4 (same as in Q3).
- Domestic business DSO came down from 57 days in Q3 to 49 in Q4.
- Wage hike of 11-12% (usually 6%) on average was done to take into account industry-level wage hikes.
- Continue to deliver 22-25% segment margins (IT Services)

Q3 FY21

- The compensation hike across the board, effective 1st Jan, will result in some headwinds to margins, but the company will try to absorb them through growth.
- Hiring plans intact, with net additions of 207 during the quarter.
- Looking at investments in sales & marketing, M&A and people.

- Attrition in IT services is currently at 14% (15% the quarter prior).
- International margins to hold at similar levels in the short term, as travel and on-site costs gradually return. Over the medium term, the company expects to operate somewhere between pre-Covid and post-Covid margins.
- Preferred partner of Microsoft for Dynamics and believes that its tool to speed up implementations is one of the best in the industry currently.
- The ”Other” vertical is classified that way because sales there are more technology-driven than domain-driven. Therefore, classifying them as sector-based revenues may not depict the true state of the business.
- Europe bouncing back, expect strong trajectory in coming quarters.
- Through M&A, seeking to strengthen Dynamics, Europe, Data, Cloud and Healthcare
- Margins to see some headwinds as costs return (travel and on-site).

Factsheet

Fig 22 – Revenue split (IT Services only)

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
ADM	23.8	25.5	26.4	27.1	26.1
Test	12.3	11.7	10.7	9.8	9.9
AX	27.9	28.1	29.2	29.3	29.4
ERP	2.3	1.7	1.0	0.8	0.6
IMS	14.0	14.0	14.2	14.2	15.2
BI	12.4	12.0	12.0	13.1	13.2
E commerce	5.0	5.0	5.0	5.0	5.0
Rezopia	2.3	2.0	1.5	0.7	0.6
Digital	60.0	64.0	67.0	68.0	70.0

Source: Company, Anand Rathi Research

Fig 23 – Revenue-split, by domain (IT Services only)

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
OPD / ISV	29.3	32.0	32.7	32.8	31.3
Travel & Tourism	10.0	10.0	10.2	10.3	9.7
CPG/Retail & Distribution	29.6	29.8	31.4	32.1	31.3
Others	31.1	28.2	25.7	24.8	24.9
Healthcare	0.0	0.0	0.0	0.0	2.8

Source: Company, Anand Rathi Research

Fig 24 – Revenue-split, by region (IT Services only)

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
North America	51.0	52.0	51.0	51.0	53.0
Europe	26.0	26.0	25.0	25.0	24.0
RoW	23.0	22.0	24.0	24.0	23.0

Source: Company, Anand Rathi Research

Fig 25 – Revenue-split, by segment

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
IT services	35	21	30	26	37
Domestic Business	65	79	70	74	63

Source: Company, Anand Rathi Research

Fig 26 – Client profiles (LTM) (IT Services only)

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Client profiling					
Top 5	55.0	54.0	53.0	58.0	57.0
Top 10	61.0	62.0	61.0	65.0	64.0
Top 20	71.0	71.0	71.0	73.0	72.0
$1m+	29	29	30	31	36
Active Clients	146	154	164	177	214

Source: Company, Anand Rathi Research

Fig 27 – Workforce

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Employee Movement					
Employees (EoP) - IT Services	3,744	3,851	3,956	4,101	4,693
Employees (EoP)- Domestic	141	146	146	149	157
Net Adds (Qtr)	-222	107	105	145	592
Utilisation (%)	87.0%	89.0%	89.0%	88.0%	89.0%
Attrition % est.	11.9%	14.0%	18.0%	18.0%	21.0%

Source: Company, Anand Rathi Research

Fig 28 – Revenue-split, by delivery location

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Delivery Type(%)					
On-site	37	35	32	32	31
Offshore	63	65	68	68	69

Source: Company

Fig 29 – Key segments' growth Y/Y (%)

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Domain					
OPD / ISV	-10%	6%	14%	19%	19%
Travel & Tourism	-68%	-65%	-54%	214%	23%
CPG/Retail & Distribution	-2%	-7%	19%	35%	34%
Others	41%	12%	1%	-14%	1%
Region					
North America	-17%	-16%	-7%	-3%	32%
Europe	-25%	-24%	-18%	90%	17%
RoW	16%	20%	48%	46%	27%

Source: Company

Valuations

The stock quotes at 21x FY23e EPS of Rs45. In FY21 Sonata's IT Services revenue was down 11% (up 5.2% q/q, 20% y/y in Q2). We expect this division to register a 24% CAGR (22% organic) over FY21-23 despite the Travel division's FY23e revenues at 66% of FY20. The domestic segment is expected to register a 22% CAGR over FY21-23, with the focus being only on margins and RoE. In IT Services, ISV and Retail are looking better even as Travel recovers somewhat. Despite these challenges, consolidated EBIT and PAT are likely to register 33% and 38% CAGRs respectively over FY21-23. This includes benefits from the Encore acquisition and integration.

We value the stock on a PE basis as the bulk of profits arises from IT Services. We expect the company to end FY23 with an EPS of Rs.45. We expect a 23% revenue CAGR (22% organic) over FY21-23. The IT Services' margin should be maintained at 26%, even after taking into consideration expectations of higher on-site ramp-ups over the next two years and current supply-side constrains that will result in higher costs in the near term.

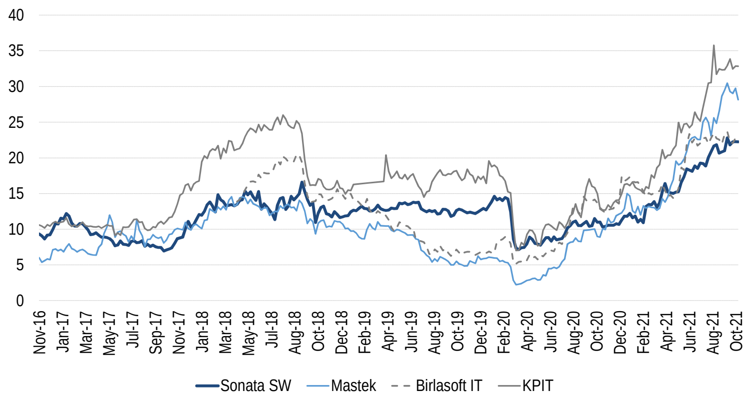
Given that the loss of revenue from its top Travel client has already been factored in, we are hoping for steady momentum in FY22 and beyond. Also, there is a likelihood of the top client offering tailwinds to growth in the next two years. We value the company at a target PE of 24x FY23e (20x earlier), which implies 30x for IT services (on a sum-of-parts basis). Encore is integrated into the revised estimates below.

Fig 30–Change in estimates(Rsm)

(Rs m)	FY22			FY23		
	New	Old	% Change	New	Old	% Change
Revenue ($ m)	728	720	1.1	866	842	2.8
Revenues - IT ($ m)	204	199	2.7	248	234	6.1
Revenues	53,053	52,369	1.3	63,217	61,309	3.1
EBITDA	5,128	4,965	3.3	6,483	6,139	5.6
EBITDA margins %	9.7%	9.5%	17 bps	10.3%	10.0%	26 bps
EBIT	4,672	4,562	2.4	5,976	5,707	4.7
EBIT margins %	8.8%	8.7%	11 bps	9.5%	9.3%	15 bps
PBT	5,160	5,015	2.9	6,197	5,962	3.9
Net profit	3,887	3,767	3.2	4,648	4,472	3.9

Source: Anand Rathi Research

Fig 31– PE band



Source: Bloomberg, Anand Rathi Research

Risk

- Delayed recovery in the Travel business.

Appendix

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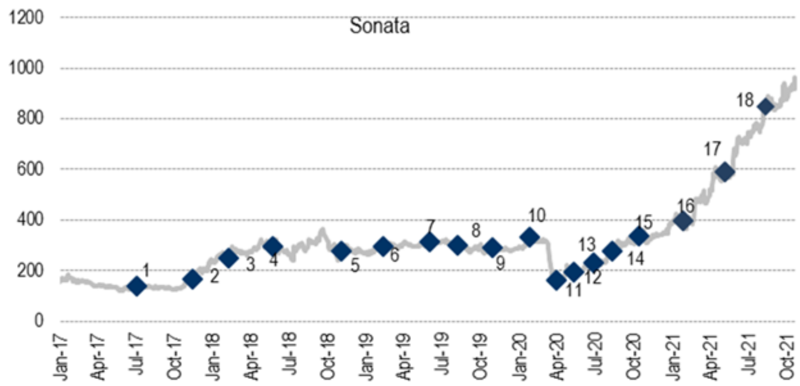

	Date	Rating	TP (Rs)	Share Price (Rs)
5	05-Nov-18	Buy	370	310
6	11-Feb-19	Buy	400	310
7	01-Jun-19	Hold	400	355
8	08-Aug-19	Buy	390	315
9	31-Oct-19	Buy	380	315
10	28-Jan-20	Hold	390	349
11	31-Mar-20	Buy	250	164
12	13-May-20	Buy	230	197
13	29-Jun-20	Hold	270	226
14	11-Aug-20	Buy	330	283
15	15-Oct-20	Buy	410	357
16	07-Feb-21	Buy	500	406
17	14-May-21	Hold	680	588
18	06-Aug-21	Hold	860	813

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