



Company Name	: SONATA SOFTWARE
BSE Code	: 532221
Time Duration	: 1 year
CMP	: ₹294.00 (as on 10 October, 2019)
Target Price	: ₹355

Our Value Pick for the month of October 2019 is Sonata Software Limited, an information technology (IT) services and solutions company. Sonata enables successful platform based digital transformation initiatives for enterprises, to create businesses that are connected, open, intelligent and scalable. It provides solutions for software, retail and distribution and travel companies with integrated technological solutions like mobility, analytics, cloud and enterprise resource planning. In terms of geographical mix, the company's 65 per cent of total consolidated revenue was from the Domestic- Products & Services while rest was from the International IT services. In terms of vertical mix of International IT services, OPD and retail distribution contributed 28 per cent each in Q1FY20, followed by TTL (travel) and other which contributed nearly 26 per cent and 19 per cent respectively. Geographically, company's international IT services revenues are contributed by USA (56 per cent), Europe (30 per cent) and Rest of the world (14 per cent). Its services segment contains application lifecycle services that deliver facilities for application management like application development and application migration; retail IT services, such as Dynamics AX retail, and technology infrastructure services.

Platformation to be a key growth driver for the company

Couple of years ago, Sonata had developed a proprietary model for digital transformation of enterprises called Platformation. Through this Platformation, the company looks to extend its services beyond just IT vendor to use platforms and IP as business transformation drivers and become a long-term partner. The company's investment in creating and acquiring end to end digital platforms aligned to the Platformation method and creating custom platforms is getting good responses. In last fiscal, Sonata witnessed strong traction in the implementation of the Platformation agenda across both its existing clients and new clients. This is likely to result in customer stickiness, which, in turn, would aid revenue going forward.

Focus on inorganic growth

In last fiscal, Sonata entered into some acquisitions and partnership agreements to improve and consolidate its position, with an aim to be the most preferable partners of choice for their customers. In FY19, the company acquired Australia-headquartered Microsoft Dynamics 365 partner, Scalable Data Systems and US-headquartered Sopris Systems. These acquisitions have resulted in geographical expansion and strengthened the company's position as a strong Dynamics 365 partner globally with additional services capabilities. Furthermore, Sonata's partnerships with AutonomIQ and investment in Retail10X have added cutting edge technological capabilities to their existing and new offerings. The company's management has guided that with ample amount of cash on its balance sheet, the company will go for inorganic growth going ahead.

Growing domestic industry

In today's world, the organizations have increased their focus on providing better customer experience which has resulted in higher spending on enterprise application software. India's IT spending is expected to reach at a mark of US\$ 89.2 billion in 2019, a growth of 6.7 per cent from previous year. India's IT spending continues to be driven by digital business transformation initiatives from both private and public organizations. With increasingly focus and changing business models are paving path of growth for companies involved in digital space like Sonata Software.

IP-Led revenue to aid revenue growth

The company's key area of focus is leveraging its IP-led offering which is helping Sonata to win new clients and expand its business operation from its existing customers. In the recent quarter, the IP led revenue accounted for 24 per cent of its services revenue and it has been growing more than the International IT Services. Thus, the company continues to focus on increasing its

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IP revenue though it's offering like Microsoft Dynamics, e-Commerce (SAP Hybris) and digital. We believe the company's focus on IP led offering differentiate it from others and also helps it to grow rapidly.

Microsoft Dynamics to be another growth engine

The company provides services on Microsoft's Modern Workplace (Office 365), Applications Dynamics, Data & AI and Azure Cloud. Notably, Sonata is Microsoft AX's second-largest service after ADM since 2QFY18 and was its largest service in 1QFY20 (26 per cent of IITS revenue). The company has established an ISV development centre for Microsoft, one of 6 globally, which indicates Sonata's focus on this ecosystem and Microsoft's recognition of the Sonata's work as an IT vendor and strategic partner. Going forward, apart from IP-led and Platformation, the company believes that this division would also add to its growth. Also, the company's recent acquisition - Scalable Data Systems - is a Microsoft Dynamics 365 partner.

Financial performance

The company has clocked a CAGR of 17 per cent in revenue over the last 4 years. Also, PAT has replicated the revenue growth and recorded 17 per cent CAGR over the same period.

In the first quarter of FY20, Sonata Software reported 5 per cent qoq and 27 per cent yoy growth in revenue to Rs. 874.63 crore.

EBITDA on sequential basis remained largely flat (1.4 per cent QoQ growth) but on yoy basis the company reported 22.2 per cent growth in EBITDA that stood at Rs. 89.61 crore with corresponding margin contraction of 41 bps. EBITDA margin for Q1FY20 stood at 10.25 per cent. Higher employee cost added in margin contraction. Profit after tax for the period stood at Rs. 67.1 crore, up by 2.6 per cent QoQ and 16.8 per cent yoy. PAT margin for the quarter stood at 7.67 per cent.

The company has a strong balance sheet and it has been paying continuous dividend to its shareholders and in last 6 years, the company has maintained average dividend payout ratio of around 55 per cent. Also, the company has strong cash and bank balance of around Rs. 199.21 crore.

Valuation & outlook

In terms of return ratios, the company enjoys strong RoE and RoCE of 35 per cent and 48 per cent respectively. Apart from this the company's robust dividend yield of nearly 4.4 per cent gives further income to shareholders. Company's focus on IP and Platform differentiates its business model, while its high dividend yield, quality balance sheet and high return ratios augurs well for the company. In terms of valuation, the stock of Sonata Software is available at attractive valuation of 11.9x which is close to its five-year median P/E of 12.5x. Considering all these we recommend a **BUY** on the stock and we it has potential to touch mark of Rs. 355, which represent almost 21 per cent return.

Inc/Exp Statement(Consolidated) (Rs in Crore)

Description	201903	201803	201703	201603	201503
Net Sales	2960.90	2453.94	2370.78	1940.50	1682.13
Total Income	2988.15	2499.39	2417.89	1984.28	1708.85
Total Expenditure	2625.29	2222.95	2179.23	1748.61	1521.34
PBIDT	362.86	276.44	238.66	235.68	187.51
PAT	248.88	192.13	156.92	158.59	133.28
Dividend %	1275.00	1050.00	900.00	900.00	700.00
Adj. EPS(Rs)	23.99	18.55	15.07	15.08	12.71

Quarter On Quarter (Consolidated) (Rs in Crore)

Particulars	201906	201903	Q on Q Var%	201806	Y on Y Var%
Net Sales	874.63	835.55	4.68	688.32	27.07
Total Expenditure	785.02	747.13	5.07	614.97	27.65
PBIDT (Excl OI)	89.61	88.42	1.35	73.35	22.17
PAT	67.05	65.35	2.60	57.41	16.79
PBIDTM% (Excl OI)	10.25	10.58	-3.12	10.66	-3.85
PBIDTM%	12.16	11.48	5.92	11.80	3.05
PATM%	7.67	7.82	-1.92	8.34	-8.03
Adj. EPS(Rs)	6.45	6.29	2.54	5.55	16.22



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