

On a song

Despite the appreciating rupee, rising costs and the US sub-prime crisis Sonata has come out with encouraging results

The Bangalore-based Sonata Software, a mid-sized IT services company, managed to survive the scare post the dotcom bust in the new millennium. This time around despite a slowing economy, financial sector crisis in the US and the likelihood of the US slipping into a recession together with the sharp appreciation of the rupee vis-à-vis the dollar for the better part of last financial year, this Rs1,428 crore consolidated; (stand-alone Rs201 crore) company has put up an encouraging performance for the year to March 2008.

"The key is not just surviving, but thriving," says B. Ramaswamy, president and managing director, Sonata Software Ltd (SSL). He recalls that during the dotcom bust, most people wrote the company off as it would not be able to withstand the carnage that engulfed the sector. "We managed to re-strategise to offer premium services and also enter into alliances with global players. The alliances proved to be door-opener for us in offering niche services to mid-sized clients."

To tide over the earlier crisis, Sonata tied up with the likes of Microsoft, IBM, Intel, Oracle, Sun, Novell and Scala to name a few. These alliances did help the company in getting application outsourcing contracts. For example, TechTarget, a US-based IT integrated media publisher, stated how San Antonio-based Church's Chicken benefited after it switched to a mid-sized outsourcer. This fast-food chain's first outsourcing partner was IBM. However, IBM's performance left much to be desired, according to Church's CEO Harsha V. Agadi. He was quoted as saying: "We found that IBM's style of dealing with us was to dictate what our needs were, rather than listening to us." This he attributed to the size of Big Blue. "I find, mid-sized companies do best with mid-sized outsourcing partners,"



It's been the best year, says Ramaswamy

he adds. So when the contract with IBM was due to expire, the fast food chain called in for competitive requests from outsourcing firms. It eventually zeroed in on Sonata, which "was willing to go the extra mile." According to Agadi, switching to Sonata brought about savings of around 40 per cent compared with the IBM arrangement and from mere IT operations and infrastructure, Church's decided to extend the arrangement to include management of business-critical systems such as global sales, as well as software design, testing and maintenance.

According to Ramaswamy, the post-dotcom bust saw "some of our peers disappear and these multi-relationships helped us in generating money which was redeployed in business." Simultaneously, Sonata also took the

inorganic route to grow. It picked up a 50.1 per cent stake in TUI infotec GmbH, Germany through its wholly-owned subsidiary Sonata Europe. TUI infotec, is the IT service provider for the €20 billion TUI AG, a major German company and its subsidiaries in Germany, France, Sweden, UK, Spain and other parts of Europe. It specialises in infrastructure management and has domain knowledge in verticals like travel, tourism, airlines and hospitality as well as expertise in horizontals like enterprise applications, Web applications, business intelligence and legacy applications.

Sonata bought 50.1 per cent stake in TUI infotec in October 2006 for €18 million. This came with a five-year revenue commitment from the German firm along with 450 German-speaking people. "All these helped us in our goal of achieving strategic objective of entering new geographies in the European market," says Ramaswamy.

India offers a good bundle of benefits sought from global sourcing and with significant potential still untapped, it is expected that the global sourcing phenomenon will continue to expand in scope, scale and geographies, feel industry analysts. The Nasscom's annual study 'Strategic Review 2008' shows that Indian IT/BPO industry is in good health but could get better. Despite the currency fluctuations, the industry showed grit, logging in double-digit revenue growth. The diversified geographic market exposure, continued expansion of product/service portfolio and scaling up of operations have all seen the sector getting strong, states the study.

Despite the rupee appreciating, rising costs and the US sub-prime crisis raising its ugly head together with talk of the impending US recession, Sonata has come out with encouraging results. Says Ramaswamy, "It's been the best year yet. We've not only ridden out the storm unscathed, but continue undaunted on our progression towards long term growth through aggressive expansion."

The company is setting up its fourth software development facility in Bangalore at a cost of Rs20 crore. It

Spreading the net

Sonata Software Ltd, together with its subsidiaries Sonata Information Technology Ltd (SITL), Offshore Digital Services Incorporated, Sonata GmbH (collectively the company) is a provider of IT services globally. SSL was flagged off to provide IT solutions, consulting and development services globally, also provides both on-site and offshore services in ERP customisation, data warehousing, Web development and infrastructure management.

SITL is a wholly-owned subsidiary of

SSL which distributes and implements packaged software from leaders like Microsoft, Oracle, IBM and SCO. This company has built alliances and partnerships with leaders in packaged software products. The IT consulting group focuses in areas of groupware, data warehousing and e-com applications.

ODSI, is a wholly-owned subsidiary of SSL in the US. This company provides computer programming services to firms in the US.

Sonata Software GmbH is a wholly-owned subsidiary of SSL. Incorporated in Germany, the company provides com-

puter programming services throughout the country.

Sonata Europe is a wholly-owned subsidiary of SSL. Incorporated in the UK, it provides computer programming services throughout Europe.

TUI infotec GmbH is a subsidiary of SEL. Incorporated in Germany it provides software services and IT infrastructure management throughout Europe. SEL holds a 50.1 per cent stake in the company with the rest held by TUI AG. TUI info in turn holds 79 per cent stake in Travel BA. Sys and 50 per cent in ACCON RVS, which in turn holds a 9 per cent stake in Travel BA.

already has three facilities with a combined area of 1.2 lakh sq ft seating 1,200 employees and the fourth facility would be measuring 1 lakh sq ft to be expanded in phases and would house about 800 employees. Besides, the company is putting up a facility in Hyderabad at a cost of Rs100 crore. This seven acre plot would also have a campus and the facility would be able to house about 2,500 employees. It should be fully operational in about a little over two years. Ramaswamy is also on the lookout for growing inorganically as its business generates about Rs20 crore of cash annually. "We have fairly aggressive inorganic growth," he says.

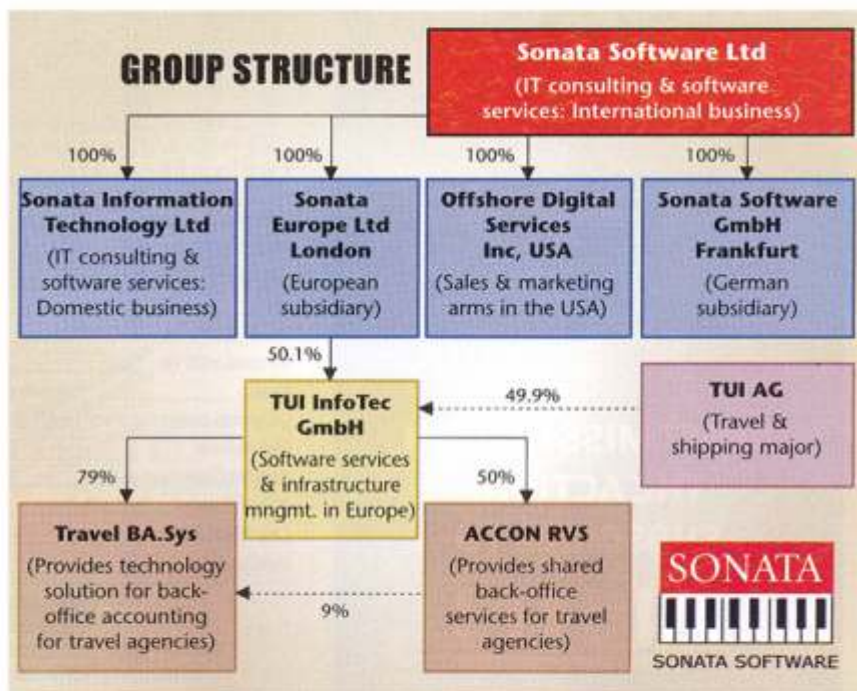
Though Sonata's consolidated accounts for the year to March 2008, shows total debt at Rs28.3 crore, its standalone accounts shows the company as zero-debt. So raising debt on Sonata's books should not be a major headache. Also the break-up of revenues from the US and Europe has changed for the better. For the year to March 2005, revenues from both the divisions were almost equal. Over the years, the company has brought down its exposure to the US market and as on March 2008, revenues from the US stand at 37 per cent and those from Europe at 62 per cent. While both the currencies are firm in the short term, in the longer term, the euro, according to financial market sources, won't be as badly hit as the dollar.

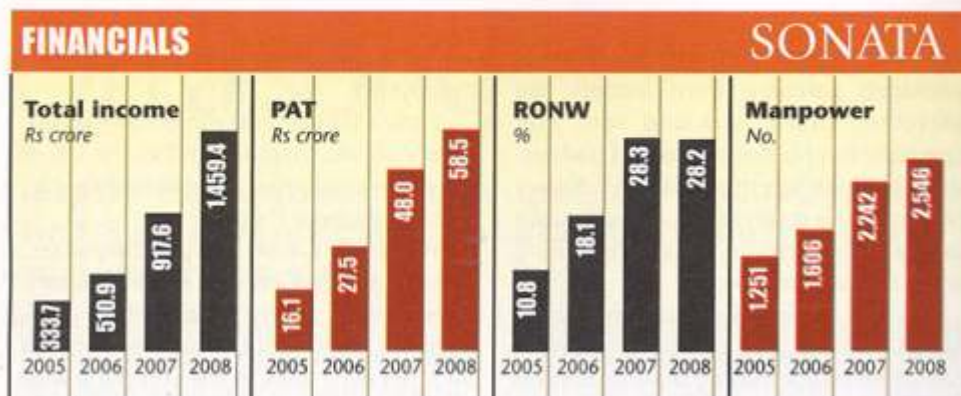
On the report card for the year to March 2008, on a consolidated basis, revenues saw a jump of 59 per cent

over that of last year to Rs1,428 crore and post-tax profit saw a rise of 21 per cent over the corresponding period to Rs58.5 crore (see flow chart of wholly-owned subsidiaries and joint ventures). On a standalone basis, the topline saw a mere 7 per cent growth over that of last year to Rs201 crore. The bottom-line just managed to crawl 4.5 per cent to Rs3.67 crore. The earnings per share on an equity base of Rs10.5 crore works out to Rs3.49 (on Re1 paid-up). The market price discounts the earnings by just about seven times, way below the industry average P/E. While large software companies enjoy an

average P/E of around 20 times, the mid and small software companies are quoting at an average multiple of 11 times. Sonata, even during trying times, has not skipped dividends and even during the current year has paid out 110 per cent. The company could be a bonus candidate if one looks at its reserves position at more than 17 times its equity capital.

However, the stockmarket is not enthused at all. The Sonata scrip is hovering around Rs24.5 (Re1 paid-up) on the exchanges. Ask any analyst and he or she would just tell you that in times when the markets are on a





Consolidated figures for financial years

downswing it is better to look at some of the frontline stocks. According to an analyst at Angel Broking, though the Indian rupee has depreciated significantly against major currencies, one of the biggest beneficiaries is the IT sector. Most of the frontline IT companies' management have assumed a rupee rate of around Rs40 to a dollar for their 2009 guidance. At current levels of the rupee (at Rs43-plus) vis-à-vis the dollar, there is no doubt that the earnings of these IT companies would be boosted. However, most analysts feel the rupee depreciation is

short term in nature because of record high crude oil prices, uncertain capital inflows and a possible end to rate cuts by the US Fed. "Going forward, we expect the domestic currency to resume its appreciating trend," says the Angel Broking analyst.

A major problem facing the IT sector is the high attrition rate. The industry suffers anywhere between 10 and 15 per cent attrition rate. "One of the major risks causing concern is attracting and retaining talent. Touchwood, we are in a much better position than our peers in the mid-

sized segment," says Ramaswamy.

Ramaswamy, for one is confident of maintaining the CAGR (compounded average growth rate, see table) over the next three to five years "on a larger base." Says he: "We have managed to ride out the passing turbulence by focusing on emerging opportunities, offering de-risked portfolio, varied services to a variety of segments, targeting repeat customers, forging long-term alliances and retaining talent. Not for us the short term 'fix' or the reactive measure based on expediency. We've acted on our hopes and not reacted to our fears."

For a professional manager at Sonata, which had been jointly promoted by S.B. Ghia (as a subsidiary of Indian Organic and subsequently spun off into a separate entity) and Rajan Raheja way back in 1986 with both holding about 44 per cent equally, it would be a daunting task to take its current market cap of Rs257 crore to an average industry P/E multiple. Clearly, the company's stock is only meant for the marathon-runners.

• ROY PINTO