



## Rating Rationale

April 08, 2020 | Mumbai

### Sonata Software Limited

Rating outlook revised to 'Stable', rating reaffirmed

#### Rating Action

<b>Total Bank Loan Facilities Rated</b>	<b>Rs.50 Crore</b>
<b>Long Term Rating</b>	<b>CRISIL A+/Stable (Outlook revised from 'Positive' and rating reaffirmed)</b>

1 crore = 10 million

Refer to annexure for Details of Instruments & Bank Facilities

#### Detailed Rationale

CRISIL has revised its outlook on the long-term bank facility of Sonata Software Limited (SSL) to 'Stable' from 'Positive', while reaffirming the 'CRISIL A+' rating.

The outlook revision reflects the expected impact on SSL's business risk profile, following the outbreak of Novel Coronavirus or Covid-19. Temporary suspension of operations by a major client, may lead to a decline in profit by up to 40% in the first half of fiscal 2021. SSL is likely to recover gradually from this slowdown, aided by demand for digitisation of businesses, increasing contribution from SSL's earlier acquisitions, and sustained revenue from its domestic software distribution business. Operating margin will improve post fiscal 2021, supported by an increasing share of the high-margin intellectual property (IP) business and improving employee utilisation.

SSL's revenue grew 32% in the nine months through fiscal 2020, over the corresponding period in the previous fiscal, driven by large deals in the domestic products and services business, and addition of new clients in the international information technology (IT) services business. Earnings before interest, tax, depreciation, and amortisation (EBITDA) margin declined to 10.3% in the nine months through fiscal 2020, from 11.6% in the previous fiscal. This was a result of increased contribution from the low-margin domestic products segment, driven by a large deal.

The rating continues to reflect SSL's comfortable business risk profile, marked by its established position in the IT services sector and software distribution business, and improving revenue diversity. The rating also factors in the strong financial risk profile, backed by a healthy capital structure and liquidity. These strengths are partially offset by exposure to risks arising from geographical and customer concentration in revenue, changes in regulations such as restrictions on H1B visas, and intense competition, especially in the software distribution business.

#### Analytical Approach

\* For arriving at the rating, CRISIL has combined the business and financial risk profiles of SSL, its domestic subsidiary, Sonata Information Technology Ltd (SITL; 'CRISIL A+/Stable'), and its overseas subsidiaries. This is because all the entities operate under a common management, with significant business and financial linkages.

\* Goodwill arising from consolidation of SSL's subsidiary (Rs 90 crore in fiscal 2016, and Rs 61 crore in fiscal 2019) has been amortised over five years.

Please refer Annexure - List of entities consolidated, which captures the list of entities considered and their analytical treatment of consolidation.

#### Key Rating Drivers & Detailed Description

##### Strengths:

\* **Comfortable business risk profile, driven by established market position:** SSL has an established position in the IT services sector, and is one of the leading players catering to the travel, tourism, and logistics verticals. It also services the manufacturing, retail, and consumer packaged goods verticals, and offers outsourced research and development services to independent software vendors. The company is also building capability to cater to the fast-growing social, mobility, analytics, and cloud (SMAC) solutions space. It operates a software distribution business for companies such as Microsoft, Oracle, and IBM. It has longstanding relationships with customers and has been actively adding clients. CRISIL believes SSL will continue to benefit from its established market position in the international IT services business and the domestic software distribution business, driven by a diversified range of service offerings, alliances with leading software vendors, and longstanding customer relationships.

\* **Strong financial risk profile:** Financial risk profile is marked by a healthy capital structure and debt protection metrics. Gearing was low at 0.02 times as on March 31, 2019 (0.06 times as on March 31, 2018), supported by healthy network of Rs 649 crore. Debt protection metrics were comfortable, indicated by net cash accrual to total debt ratio of 7.4 times in fiscal 2019. Financial risk profile is also supported by comfortable liquidity of Rs 442 crore as on December 31, 2019. Besides organic growth, SSL intends to expand through acquisitions in complementary service lines. CRISIL believes the acquisitions will be funded largely through internal accrual, thereby keeping the financial risk profile strong.

##### Weaknesses:

\* **Geographical and customer concentration in revenue:** Similar to other players in the IT services industry, SSL drew bulk of its revenue from the US (57%) and Europe (31%) in fiscal 2019. This exposes the company to the risk of economic slowdown in these regions, as well as regulatory changes such as restriction on H1B visas. SSL also faces client concentration risk. The travel and tourism sector, which contributed to almost 27% of revenue in fiscal 2019, may be adversely impacted in the near term, due to the Covid-19 pandemic. For fiscal 2019, the top 10 customers accounted for 69% of SSL's revenue (70% in fiscal 2018). Given its modest scale of operations (compared to larger peers), SSL's

business risk profile will remain vulnerable to client concentration risk.

**\* Exposure to intense competition, especially in the software distribution business:** With rapid evolution of the Indian IT-enabled services sector, competition is intensifying as more companies vie for a share of the outsourcing pie. SSL has to compete with multiple players in most of the verticals within the IT services business. Additionally, a large portion of revenue comes from the software distribution business where price competition is high. CRISIL believes SSL's profitability will remain constrained over the medium term as increasing competition curbs the hike in realisations. Availability of low-cost skilled talent also remains a concern.

**Liquidity Strong**

SSL had a liquid surplus of Rs 442 crore as on December 31, 2019, against negligible debt. The fund-based limit of around Rs 50 crore, remained largely unutilised in the 12 months through March 2020. Annual cash accrual of over Rs 100 crore, expected over the medium term, will support annual capital expenditure of around Rs 45 crore.

**Outlook: Stable**

CRISIL believes SSL's credit risk profile will continue to benefit from its moderate business risk profile, supported by recovery in orders from key customers, moderate client addition and strong financial risk profile.

**Rating Sensitivity factors**

**Upward factors:**

- \* Substantial and sustained growth in revenue (compound annual growth rate of over 15% in the medium term) and EBITDA margin of over 14%
- \* Steady improvement in business risk profile, with material increase in revenue share of the high-margin IT services business

**Downward factors:**

- \* Slowdown in key markets, leading to significant pressure on revenue and decline in EBITDA margin below 10%
- \* Any large, debt-funded acquisition, impacting the financial risk profile, and cash and cash balance falling below Rs 250 crore
- \* Negative outcome regarding large contingent liabilities

**About the Company**

SSL, incorporated in 1986, provides IT consulting, product engineering services, application development, application management, managed testing, business intelligence, infrastructure management, packaged applications, and travel solutions. The company derives most of its revenue from overseas, with the US and Europe accounting for over 88%. SITL primarily distributes software products and is focused on the Indian market.

**Key Financial Indicators**

As on / for the period ended March 31		2019	2018
Operating income	Rs crore	2,961	2,455
Profit after tax (PAT)	Rs crore	219	174
PAT margin	%	7.4	7.1
Adjusted debt / adjusted networth	Times	0.02	0.06
Interest coverage	Times	105.93	57.58

**Any other information:** Not applicable

**Note on complexity levels of the rated instrument:**

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**Annexure - Details of Instrument(s)**

ISIN	Name of Instrument	Date of Allotment	Coupon rate (%)	Maturity Date	Issue size (Rs Cr)	Rating Assigned with Outlook
NA	Working Capital Facility*	NA	NA	NA	50.00	CRISIL A+/Stable

\*Fully interchangeable between fund- and non-fund-based limits

**Annexure - List of entities consolidated**

Name of Entity	Extent of Consolidation	Rationale for consolidation
Sonata Software Limited	Full	Holding
Sonata Information Technology Limited	Full	Subsidiary
Sonata Software North America Inc.	Full	Subsidiary
Sonata Europe Limited	Full	Subsidiary
Sonata Software GmbH	Full	Subsidiary
Sonata Software FZ LLC	Full	Subsidiary
Sonata Software (Qatar) LLC	Full	Subsidiary
Rezopia Inc.	Full	Subsidiary
Halosys Technologies Inc.	Full	Subsidiary
Interactive Business Information Systems Inc.	Full	Subsidiary
Scalable Data Systems Pty Ltd	Full	Subsidiary
Sopris Systems LLC	Full	Subsidiary

**Annexure - Rating History for last 3 Years**

Instrument	Current		2020 (History)		2019		2018		2017		Start of 2017
	Type	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating

		Outstanding Amount										
<b>Fund-based Bank Facilities</b>	LT/ST	50.00	CRISIL A+/Stable		30-11-19	CRISIL A+/Positive	20-08-18	CRISIL A+/Stable	13-07-17	CRISIL A+/Positive	CRISIL A+/Positive	

All amounts are in Rs.Cr.

#### Annexure - Details of various bank facilities

Current facilities			Previous facilities		
Facility	Amount (Rs.Crore)	Rating	Facility	Amount (Rs.Crore)	Rating
Working Capital Facility*	50	CRISIL A+/Stable	Working Capital Facility*	50	CRISIL A+/Positive
<b>Total</b>	<b>50</b>	<b>--</b>	<b>Total</b>	<b>50</b>	<b>--</b>

\*Fully interchangeable between fund- and non-fund-based limits

#### Links to related criteria

[CRISILs Approach to Financial Ratios](#)

[CRISILs Bank Loan Ratings - process, scale and default recognition](#)

[Rating Criteria for Software Industry](#)

[CRISILs Criteria for Consolidation](#)

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