

Rating Rationale

August 20, 2018 | Mumbai

Sonata Software Limited

Rating upgraded to 'CRISIL A+/Stable'

Rating Action

Total Bank Loan Facilities Rated	Rs.50 Crore
Long Term Rating	CRISIL A+/Stable (Upgraded from 'CRISIL A/Positive')

1 crore = 10 million

Refer to annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL has upgraded its rating on the long-term bank facility of Sonata Software Limited (SSL; part of the Sonata group) to 'CRISIL A+/Stable' from 'CRISIL A/Positive'.

The upgrade reflects the expected improvement in business risk profile driven by increasing opportunities in the digital space with 'Platformation' and steady contribution from software distribution business. The company has been able to sustain growth momentum in International IT business with continued improvement in the profitability during fiscal 2018, leading to a substantial increase in the group's cash accruals.

The rating continues to factor in SSL's strong financial risk profile backed by almost debt-free capital structure and strong liquidity. These strengths are partially offset by geographical and customer concentration in its revenue profile; susceptibility to changes in regulations such as restrictions on H1B visas and intense competition in the areas of its business especially the software distribution business.

Analytical Approach

* For arriving at its 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, Sonata Europe Ltd, Sonata Software GmbH, Sonata Software FZ LLC, Sonata Software North America Inc, and Sonata Software Qatar LLC. This is because all the entities, collectively referred to as the Sonata group, operate under a common management and have significant business and financial linkages.

* Goodwill arising out of consolidation of SSL's subsidiary has been amortised over a period of five years.

Key Rating Drivers & Detailed Description

Strengths

* **Comfortable business risk profile marked by established market position:** SSL has an established market position in the IT services sector and is among the leading players catering to the travel, tourism and logistics (TTL) vertical. SSL also provides services to the manufacturing, retail and consumer packaged goods (CPG) verticals. In addition, the company provides outsourced research and development (R&D) services to independent software vendors (ISVs). SSL is also building capabilities to cater to the fast-growing social, mobility, analytics and cloud solutions (SMAC) space. The group also operates a software distribution business for companies which include Microsoft, Oracle, and IBM. The company enjoys long standing relationships with its customers and has strong client addition capabilities which further benefits the business risk profile. CRISIL believes SSL will continue to benefit from its established market position, both in the international IT services business as well as domestic software distribution business over the medium term driven by a strong set of service offerings, alliances with leading software vendors, and longstanding customer relationships.

* **Strong financial risk profile:** SSL's financial risk profile is marked by healthy capital structure and debt protection metrics. The company's gearing remained low at 0.05 time as on March 31, 2018 (0.10 time as on March 31, 2017) with nil short term borrowings. Gearing is also supported by healthy network of Rs.627 crore as on March 31, 2018. The financial risk profile is also supported by strong liquidity of Rs 554 crore as on March 31, 2018. Besides organic growth, the Sonata group intends to expand through acquisitions in complementary service lines. CRISIL believes that the acquisitions will be largely funded through internal accruals thereby by maintaining its strong financial risk profile.

Weakness

* **Geographical and customer concentration in revenue:** The business risk profile is constrained by geographical concentration at SSL. In line with the Indian IT services industry, SSL registered most of its revenue from the US (59%) and Europe (24%) in fiscal 2018. This exposes SSL to risks relating to economic slowdown in the region, regulatory changes like restriction on H1B visas etc. Furthermore, SSL is exposed to risks related to client concentration in revenue. For fiscal 2018, top 10 customers accounted for 70% of its overall revenue (compared to 70% in fiscal 2017). Given a moderate scale of

operations (compared to larger peers), business risk profile is vulnerable to client concentration risks.

*** Intense industry competition to acquire customers especially in the software distribution business:** With rapid evolution of the Indian ITeS sector, competition is becoming increasingly intense as companies compete for a share of the outsourcing pie. The company has to compete with multiple players in most of the verticals they operate in within the IT services business. Further, a large portion of its revenues are derived from the software distribution business which is essentially a segment where price competition is very high. CRISIL believes that SSL's revenue growth would remain constrained over the medium term as competition limits increases in realisation and volumes. This is mitigated by long years of established relationships with top customers and vendors.

Outlook: Stable

CRISIL believes Sonata group's credit risk profile will continue to benefit from its comfortable business risk profile, supported by healthy client additions and strong financial risk profile.

Upside Scenario:

- * Substantial and sustained growth in the group's revenue and profitability
- * Improvement in its business risk profile with material increase in share of high margin IT services business

Downside Scenario

- * Slowdown in its key markets or impact of proposed reduction in H1B visas leading to significant pressure on its revenue and profitability
- * Large debt-funded acquisition impacting financial risk profile and liquidity.
- * Negative outcome on the group's 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 export markets, with the US and Europe accounting for over 83% of its revenue. SITL primarily distributes software products and is currently focused on the Indian market.

For the three month period ended June 30, 2018, SSL (on a consolidated basis) reported a PAT of Rs.58 crores (Rs.43 crores in the corresponding period of fiscal 2017), on net revenues of Rs 688 crores (Rs.635 crores).

Key Financial Indicators

Particulars	Unit	2018	2017
Revenue	Rs.Crore	2455	2372
Profit After Tax (PAT)	Rs.Crore	174	139
PAT Margins	%	7.1	5.8
Adjusted debt/Adjusted networkth	Times	0.05	0.10
Interest coverage	Times	57.58	26.13

Any other information: Not applicable

Note on complexity levels of the rated instrument:

CRISIL complexity levels are assigned to various types of financial instruments. The CRISIL complexity levels are available on www.crisil.com/complexity-levels. Users are advised to refer to the CRISIL complexity levels for instruments that they consider for investment. Users may also call the Customer Service Helpdesk with queries on specific instruments.

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 - Rating History for last 3 Years

		Current		2018 (History)		2017		2016		2015		Start of 2015
Instrument	Type	Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Fund-based Bank Facilities	LT/ST	50.00	CRISIL A+/Stable			13-07-17	CRISIL A/Positive	08-07-16	CRISIL A/Positive	13-03-15	CRISIL A/Positive	CRISIL A/Stable

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
Total	50	--	Total	50	--

*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](#)

For further information contact:

Media Relations	Analytical Contacts	Customer Service Helpdesk
<p>Saman Khan Media Relations CRISIL Limited D: +91 22 3342 3895 B: +91 22 3342 3000 saman.khan@crisil.com</p> <p>Naireen Ahmed Media Relations CRISIL Limited D: +91 22 3342 1818 B: +91 22 3342 3000 naireen.ahmed@crisil.com</p>	<p>Anuj Sethi Senior Director - CRISIL Ratings CRISIL Limited B: +91 44 6656 3100 anuj.sethi@crisil.com</p> <p>Sameer Charania Director - CRISIL Ratings CRISIL Limited D: +91 22 4097 8205 sameer.charania@crisil.com</p> <p>Preetham Sharma Rating Analyst - CRISIL Ratings CRISIL Limited B: +91 44 6693 3600 preetham.sharma@crisil.com</p>	<p>Timings: 10.00 am to 7.00 pm Toll free Number: 1800 267 1301</p> <p>For a copy of Rationales / Rating Reports: CRISILratingdesk@crisil.com</p> <p>For Analytical queries: ratingsinvestordesk@crisil.com</p>