EVERONN EDUCATION

Edelweiss
Ideas create, values protect

Steady quarter

January 28, 2010

Reuters : EVSI.BO *Bloomberg : EEDU IN*

Strong numbers; Vitels shows strong growth

Everonn reported a steady quarter with PAT of INR 121 mn (up 54% Y-o-Y, 3% Q-o-Q). Consolidated sales, at INR 799 mn, were up 83% Y-o-Y and 9% Q-o-Q, in Q3FY10. Growth came from the Vitels segment (up 93% Y-0-Y) and Eduresource . The company seems to be making progress with its I-school business.

EBITDA up; margins show a decline

EBITDA was higher by 62% Y-o-Y; EBITDA margins, while flat Q-o-Q, showed Y-o-Y decline of 460bps due to a higher proportion from Eduresource (an extremely low-margin business). Also, profitability of the ICT segment remains under pressure, with PBT margins showing 300bps Y-o-Y decline. We believe margins in ICT will continue to remain under pressure as competition intensifies amongst the existing players.

Plans to move up the education value chain; execution key concern

Everonn has announced an ambitious plan of venturing into management of education institutions (schools & colleges) through its 'Educating India' project. Currently, the project is at the conceptual stage, with the exact timelines and business model still unclear. We believe execution will remain a key challenge in this venture, especially since Everonn has little experience in managing educational institutions.

Outlook and valuations: Risk reward favourable; maintain **'BUY'**

We maintain our revenue and sales estimate for Everonn and expect a consolidated topline CAGR of 47% and net profit CAGR of 68%, over FY10-11E. Everonn is currently trading at P/E of 16x FY10E and 9x FY11E. Adjusting for aggressive revenue recognition, the company is trading at P/E of 11x FY11E. The Vitels segment remains key driver for the company's valuation. We believe continued strong performance will drive a re-rating in the stock. We maintain **'BUY'** on Everonn.

EDELWEISS RATING	
Absolute Rating	BUY

MARKET DATA		
CMP	:	INR 383
52-week range (INR)	:	479 / 79
Share in issue (mn)	:	15.1
M cap (INR bn/USD mn)	:	5.8 / 124.9
Avg. Daily Vol. BSE ('000)	:	1,551.8

SHARE HOLDING PATTERN (%)		
Promoters*	:	26.3
MFs, FIs & Banks	:	18.2
FIIs	:	20.8
Others	:	34.7
** Promoters pledged shares (% of share in issue)*	:	*Nil*

RELATIVE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	(6.4)	(7.2)	(0.8)
3 months	0.0	(9.9)	(10.0)
12 months	76.0	98.5	22.6

Financials

Year to March	Q310	Q309	*% change*	Q210	*% change*	FY09	FY10E
Net revenues (INR mn)	799	436	*83.5*	731	*9.3*	1,447	2,184
EBITDA (INR mn)	279	172	*62.0*	263	*6.0*	512	909
Net profit (INR mn)	121	79	*54.0*	118	*3.1*	221	405
Diluted EPS (INR)	8.0	5.2	*54.0*	7.8	*3.1*	14.6	26.8
Diluted P/E (x)						26.2	14.3
EV/EBITDA (x)						11.0	6.4
ROAE (%)						14.3	17.3

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Financial snapshot - (Consolidated) **(INR mn)**

Year to March	Q310	Q309	*% change*	Q210	*% change*	FY09	FY10E	FY11E
Revenues	799	436	*83.5*	731	*9.3*	1,447	2,184	3,101
Raw material	167	83	*100.9*	196	*(14.5)*	218	326	489
Staff costs	106	68	*54.7*	87	*21.6*	278	406	588
Other Expenses	247	112	*121.3*	185	*33.3*	439	542	664
Total expenditure	520	263	*97.6*	468	*11.1*	935	1,274	1,741
EBITDA	279	172	*62.0*	263	*6.0*	512	909	1,360
Interest	22	13	*74.1*	21	*5.2*	52	54	54
Depreciation	68	48	*40.4*	63	*8.3*	159	258	370
Other income	1	12	*(91.0)*	1	*(5.7)*	39	16	15
PBT	190	123	*54.5*	180	*5.2*	341	613	952
Tax	68	44	*55.5*	62	*9.3*	120	208	324
Adjusted net profit	121	79	*54.0*	118	*3.1*	221	405	628
Net profit	121	79	*54.0*	118	*3.1*	221	405	628
as % of net revenues								
Raw material	21.0	19.1		26.8		15.1	14.9	15.8
Staff expenses	13.2	15.7		11.9		19.2	18.6	19.0
Other expenses	30.9	25.6		25.3		30.3	24.8	21.4
EBITDA	34.9	39.5		36.0		35.4	41.6	43.9
Net profit	15.2	18.1		16.1		15.3	18.5	20.3

Company Description

Everonn is a fully integrated knowledge management, education and training company, offering a range of services that include creating educational and training content, designing and executing large learning initiatives, setting up the needed infrastructure for learning and training.

It is one of the leaders in computer education in schools and colleges. It is also one of the leading players in setting up virtual and interactive learning classroom networks across India.

Investment Theme

Everonn Systems (Everonn), through usage of VSAT-based technology in education, has made distance and quality of teaching in classroom irrelevant through its Vitels segment. The company has used the same technology platform to service multiple markets, be it schools, colleges or retail. In the near term, we do not foresee any serious competition for Everonn, especially in its college segment and estimate revenues to post CAGR of 57% over the next two years in this segment (iSchools+colleges combined). Vitels, as a business, is in early stages of its lifecycle. As the segment's investment phase nears completion and becomes relatively mature, the business model has a built in large operating leverage delta, which could spur significant margin expansion.

Everonn is the third largest player in ICT in the schools business, following Educomp and NIIT (these two are substantially larger players). Currently, the company has implemented ICT projects in 4,442 schools, which contribute 33% to overall revenues. We expect the company to continue to remain a key player in ICT projects; it is likely to post CAGR of 30% in school additions and 33% in revenues over FY10-11E.

Key Risks

Entry barriers remain low in Vitels

Entry barriers in Everonn's Vitels segment remain low with technology easily replicable. Hence, despite Everonn being the first player to make use of VSAT-based technology, unless it establishes a strong brand recall and is associated with certain key courses, we believe the model's scalability could be at risk.

Substantial working capital investment in ICT

ICT is a tender-driven business, requiring upfront capex, which is recouped via payments from the government (received quarterly or half yearly over the contract period). This results in substantially high debtor days (~180 days). As the ICT business scales up, we believe funding debtors is will be a substantial issue.

ischools: Cashflows significantly lag revenue recognition

Everonn tends to book 40% of the sum total of revenues to be received from schools over five years upfront as content charges. The balance 60% is recognised evenly over the contract period. However, cash flows received from schools are even throughout the contract period (20% p.a. for a five-year contract), resulting in significant mismatch between reported revenues and actual cash flows in the first year of implementation in a new school.

Financial Statements

Income statement **(INR mn)**

Year to March	FY08	FY09	FY10E	FY11E	FY12E
Income from operations	916	1,447	2,184	3,101	4,149
Total operating expenses	582	935	1,274	1,741	2,373
Materials costs	93	218	326	489	733
Course execution & delivery expenses	306	292	321	353	389
Employee cost	119	278	406	588	845
Other expenses	64	147	221	310	405
EBITDA	334	512	909	1,360	1,776
Depreciation and amortisation	99	159	258	370	497
EBIT	235	354	651	990	1,279
Interest	33	52	54	54	54
Total other income	15	39	16	15	7
Profit before tax	218	341	613	952	1,232
Provision for tax	80	120	208	324	419
Profit after tax	138	221	405	628	814
Profit after minority interest	138	221	405	628	814
Shares outstanding (mn)	14	15	15	15	15
EPS (INR) diluted	9	15	27	42	54

Common size metrics- as % of net revenues

Year to March	FY08	FY09	FY10E	FY11E	FY12E
Operating expenses	63.6	64.6	58.4	56.1	57.2
Material cost	10.1	15.1	14.9	15.8	17.7
Course execution & delivery expenses	33.4	20.2	14.7	11.4	9.4
Employee cost	13.0	19.2	18.6	19.0	20.4
Other expenses	7.0	10.1	10.1	10.0	9.8
Depreciation and amortisation	10.8	11.0	11.8	11.9	12.0
Interest expenditure	3.6	3.6	2.5	1.7	1.3
EBITDA margins	36.4	35.4	41.6	43.9	42.8
Net profit margins	15.1	15.3	18.5	20.3	19.6

Growth metrics (%)

Year to March	FY08	FY09	FY10E	FY11E	FY12E
Revenues	112.9	57.9	50.9	42.0	33.8
EBITDA growth	84.6	53.3	77.5	49.6	30.5
PBT	207.2	56.6	79.9	55.2	29.5
Core net profit	184.2	60.0	83.2	55.2	29.5
EPS	184.2	60.0	83.2	55.2	29.5

Balance sheet (INR mn)

As on 31st March	FY08	FY09E	FY10E	FY11E	FY12E
Equity capital	139	151	151	151	151
Reserves & surplus	812	1,986	2,391	3,019	3,831
Shareholders funds	950	2,137	2,542	3,171	3,984
Secured loans	453	482	482	482	482
Unsecured loans	6	5	5	5	5
Borrowings	459	487	487	487	487
Deferred tax (Net)	60	91	91	91	91
Sources of funds	**1,469**	**2,715**	**3,120**	**3,750**	**4,563**
Gross block	787	1,376	2,070	2,865	3,760
Depreciation	292	450	709	1,079	1,576
Net block	495	926	1,362	1,786	2,184
Capital work In progress	126	250	0	0	0
Intangible assests	5	5	5	5	5
Investments	87	234	234	50	50
Sundry debtors	424	764	1,155	1,640	2,194
Cash and bank balances	385	403	181	111	46
Loans and advances	133	576	811	1,053	1,282
Total current assets	942	1,742	2,147	2,804	3,522
Sundry creditors and others	117	310	419	572	780
Provisions	70	132	208	324	420
Total current liabilities & provisions	187	442	627	896	1,200
Net current assets	756	1,301	1,520	1,909	2,322
Uses of funds	**1,469**	**2,715**	**3,120**	**3,750**	**4,563**
Book value per share (INR)	69	141	168	210	263

Free cash flow (INR mn)

Year to March	FY08	FY09	FY10E	FY11E	FY12E
Net profit	138	221	405	628	814
Depreciation	99	159	258	370	497
Deferred tax	6	31	0	0	0
Gross cash flow	243	411	663	998	1,310
Less:Changes in working capital	123	527	441	459	478
Operating cash flow	121	(117)	222	539	832
Less: Capex	(356)	(713)	(444)	(794)	(896)
Free cash flow	**(235)**	**(829)**	**(222)**	**(255)**	**(64)**

Cash flow metrics

Year to March	FY08	FY09	FY10E	FY11E	FY12E
Operating cash flow	121	(117)	222	539	832
Financing cash flow	665	995	0	0	(1)
Investing cash flow	(443)	(860)	(444)	(610)	(896)
Net cash flow	343	19	(221)	(71)	(65)
Capex	(356)	(713)	(444)	(794)	(896)
Share issuance/(Buyback)	36	13	0	0	0

Ratios

Year to March	FY08	FY09	FY10E	FY11E	FY12E
ROAE (%)	21.0	14.3	17.3	22.0	22.7
ROACE (%)	23.1	18.3	24.2	30.1	31.2
Inventory (days)	2	0	0	0	0
Debtors (days)	140	150	160	164	169
Payable (days)	126	121	140	130	124
Cash conversion cycle	16	28	21	34	44
Current ratio	5.0	3.9	3.4	3.1	2.9
Debt/EBITDA	1.4	1.0	0.5	0.4	0.3
Interest cover (x)	7.1	6.8	12.1	18.5	23.9
Fixed assets turnover (x)	2.1	2.0	1.9	2.0	2.1
Total asset turnover(x)	0.9	0.7	0.7	0.9	1.0
Equity turnover(x)	1.4	0.9	0.9	1.1	1.2
Debt/Equity (x)	0.5	0.2	0.2	0.2	0.1
Adjusted debt/Equity	0.5	0.2	0.2	0.2	0.1

Du pont analysis

Year to March	FY08	FY09	FY10E	FY11E	FY12E
NP margin (%)	15.1	15.3	18.5	20.3	19.6
Total assets turnover	0.9	0.7	0.7	0.9	1.0
Leverage multiplier	1.6	1.4	1.2	1.2	1.2
ROAE (%)	21.0	14.3	17.3	22.0	22.7

Valuation parameters

Year to March	FY08	FY09	FY10E	FY11E	FY12E
Diluted EPS (INR)	9.1	14.6	26.8	41.5	53.8
Y-o-Y growth (%)	*184.2*	*60.0*	*83.2*	*55.2*	*29.5*
CEPS (INR)	16.7	23.0	43.9	66.0	86.6
Diluted P/E (x)	41.9	26.2	14.3	9.2	7.1
Price/BV(x)	5.6	2.7	2.3	1.8	1.5
EV/Sales (x)	5.8	3.9	2.7	2.0	1.5
EV/EBITDA (x)	15.8	11.0	6.4	4.5	3.5
EV/EBITDA (x)+1 yr forward	10.3	6.2	4.3		

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Coverage group(s) of stocks by primary analyst(s): Miscellaneous

Bharat Electronics, Educomp Solutions. Everonn Education, Lakshmi Energy Opto Circuits and Page Industries.

Everonn Education

Recent Research

Date	Company	Title	Price (INR)	Recos
27-Jan-10	**TIL**	Healthy perofrmance; *Result Update*	317	Buy
19-Jan-10	**Shree Renuka Sugars**	High trading profits drive the performance; *Result Update*	222	Hold
13-Jan-10	**Jain Irrigation**	Thrust on rural economy; *Initiating Coverage*	841	Buy
31-Dec-09	**Escorts**	On a turnaround; *Initiating Coverage*	130	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	95	54	11	162

* 2 stocks under review

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	104	46	12

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	depreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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