

Everonn Education

Attractive play on a secular story

Ignored by investors in favour of its better known and richly rated peer Educomp, Everonn has evolved into a niche but attractive education firm. However, it continues to trade at a 50% discount. We expect this to change due to: (a) stronger drivers in classroom software; (b) improving colleges focused business model; and (c) capital light entry into the brick and mortar K-12 and business school segments that has not been priced in. We initiate with a "Buy".

Victim of analyst and investor neglect

Everonn has been able to scale up its education business by growing revenues at 67% FY06-09 CAGR and EBITDA by 52% FY06-09 CAGR supported by increasing penetration of satellite enabled courses in colleges and schools, classroom software in schools and government contracts. However, due to analyst (investor) neglect, Everonn trades at 11x FY11 earnings, a 50% discount to sector leader Educomp in spite of a sound business model. With slowing growth in Educomp, does Everonn provide a superior play on the structurally attractive story of the increasing penetration of quality education in India?

A high quality education business

Everonn is astutely positioned to benefit from increasing consumer and government spending on education due to:

- **VITELS iSchool which is driven by twin forces:** Everonn's revenue growth in this business is driven by the twin forces of increasing penetration within existing school customers and increasing its number of school customers. Whilst Everonn has 867 school customers (Educomp has 2574), its average footprint within schools is still low at ~2 classrooms per school (Educomp has 15). Thus Everonn has substantial headroom for growth by selling more classrooms to existing schools. Secondly, with affordable price-points and curriculum based content, it is likely to continue to increase its national school footprint strongly.
- **New college distribution model which can accelerate adoption:** Whilst Everonn's college satellite based model has helped it increase college revenues by 45% p.a. between FY07-09; its growth has been tempered by the need to sell courses directly to students. A new distribution model that ensures colleges sell courses on to students and the launch of curriculum based courses is likely to accelerate adoption.
- **K-12 and business schools are free options:** Everonn is working on launching several brick & mortar K-12 schools and business schools over the next 3 years. Whilst this is unproven, our estimates suggest that the underlying IRRs (~28%) and defensive annuity revenues are attractive. Whilst establishing brand and scale takes time, Everonn's focus on managed schools is likely to provide higher ROI and higher margins in the medium term in addition to longer term franchise creation.

Potholes in the road ahead

- **ICT- low quality and low visibility:** Whilst the government funded ICT@School project seems to represent a substantial opportunity, the low visibility of contract wins, longer repayment cycles, high competition, and lack of material competitive advantages besides Everonn's lack of substantial balance sheet strength make this business less attractive for Everonn.
- **Edures- synergies not apparent:** This reselling business involves low incremental investment. However, synergies are not apparent due to sales to non-educational institutions, lack of differentiation and low margins.

Valuation

Everonn is astutely positioned to gain from the improving quality of education in India and rising demand for quality schools. Unlike its better known peer, it trades at an inexpensive 11x FY11 earnings multiples, that doesn't price in Everonn's growth potential, the non-discretionary nature of its businesses and its competitive advantages. Our 3-stage DCF points to Rs.513, 36% upside.

Accounting & corporate governance	Yellow
Franchise Strength	Yellow
Earnings Momentum	Yellow

BUY

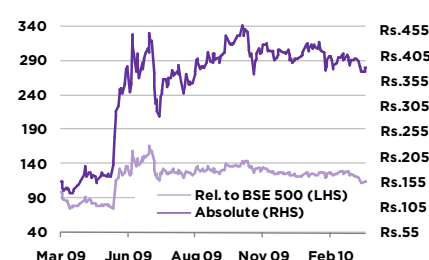
36% Upside

Fair Value (Rs) **513**

Bloomberg Code	EEDU.IN			
Share Price (Rs)	376			
Market Cap (Rs mn / US\$ mn)	5,726 / 125			
Free Float / FII holding	73% / 20%			
ADV (Rs mn/ \$mn)	181 / 4			
Year to 31 March, Rs mn	2009	2010ex	2011ex	2012ex
Revenue	1,447	2,697	3,683	4,629
Growth	57.9%	86.4%	36.5%	25.7%
EBITDA	512	974	1,310	1,926
Margin	35.4%	36.1%	35.6%	41.6%
Pre tax profit	324	638	783	1,164
EPS (Rs)	14.1	27.8	34.6	51.4
CFO	6	186	710	1,477

Year to 31 March	2009	2010ex	2011ex	2012ex
EV / Sales (x)	3.8	2.1	1.5	1.2
EV / EBITDA (x)	10.8	5.7	4.2	2.9
PE (x)	26.7	13.5	10.9	7.3
P/BV (x)	2.7	2.2	1.5	1.3

Historic share price performance



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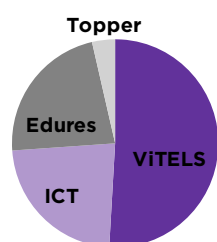
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Company snapshot

Incorporated in year 2000, Everonn is a leading Indian education service provider. It operates in two major segments – ICT that accounted for 33% of revenues and 31% of PBT in FY09 and ViTELS that accounted for 51% of revenues and 66% of PBT in FY09. The remaining (16% of revenue and 4% of PBT) is contributed by its two subsidiaries EDURES and Toppers Tutorial. Predominantly focussed on ICT for its revenues, Everonn has carved a niche for itself over the last three years through its satellite based (Very Small Aperture Terminal or VSAT in industry parlance) course offerings for colleges and digital curriculum for school in its 'iSchools' (multimedia content for private schools) segment which it acquired from Aban Informatics in FY08. Aiming to become a full fledged education service provider, Everonn is also working on building K12 schools on a brick and mortar model and business schools over the next 3 years. Everonn operates through two major segments:

- **ICT@schools (33% of FY09 sales):** Everonn's ICT segment involves setting up of computer laboratories in government schools on a BOOT model typically for a period of 5 years. The customer here are the schools which are run by the state governments and the payment terms are structured equally over the period of contract but receivable cycles are higher as it involves procedural issues and payments have to be cleared by state governments. Everonn has 5,862 schools in this segment spanning across 10 states and 2 Union Territories.
- **ViTELS (52% of FY09 sales):** Everonn ViTELS segment involves delivering non curriculum courses in colleges through VSAT (satellite) based platforms and providing multimedia based curriculum content in schools through its iSchool product. Non-curriculum courses in colleges mainly include courses on English speaking and personality development. The customers in the colleges are the students who opt for the course.

Figure 1 Segment Wise Revenue Q3FY10



Source: Company filings, Execution Noble

Figure 2 Changing revenue composition

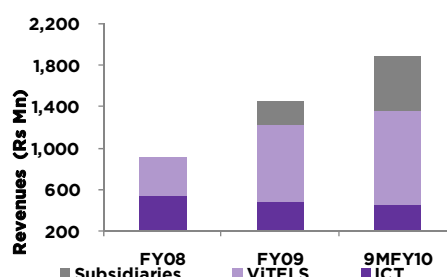
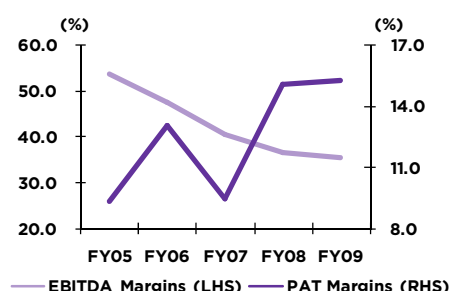


Table 1 Everonn-Timeline

Year	Event
2000	Incorporated as public company & contracted for 332 government schools in Tamil Nadu
2002	Partnered Hughes Net Global Education and started management education through virtual classrooms
2004-06	Launched Zebra Cross and Retail Centres. Point of Presence in ICT segment crosses 1500 schools
2007	Raised Rs 500 mn through IPO
2008	Acquired Aban Informatics to cater to private schools by providing digital content. Raised Rs 914 mn through a private placement.
2009	Launched iSchool product using Aban content. Acquired Toppers Tutorial to cater to private coaching classes.

Source: Company Filings, Execution Noble

Figure 3 EBITDA and PAT Margins



Source: Company filings, Execution Noble

Key risks and sensitivities

Table 2 DCF Valuations Sensitivity to key assumptions

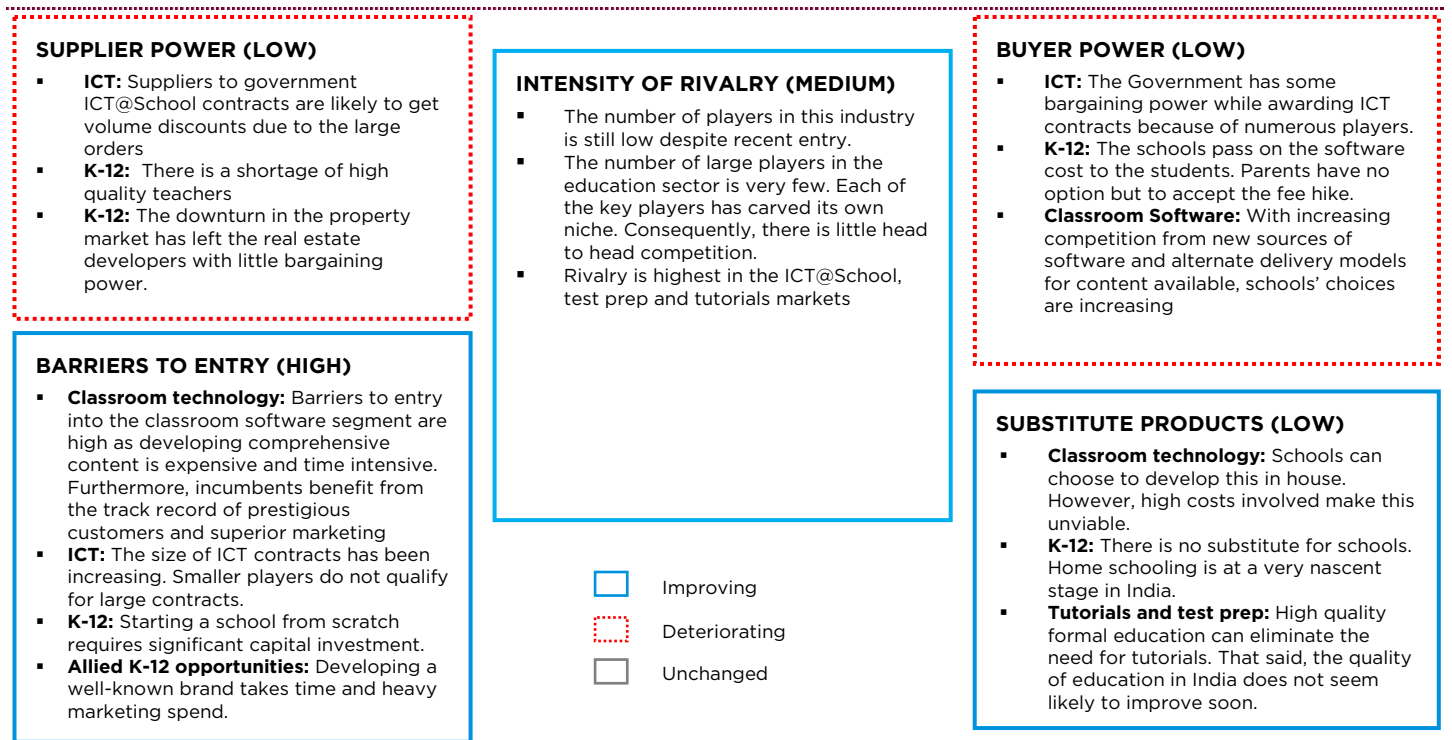
	High Case	Base Case	Low Case
Revenue	We model revenues to grow at a faster CAGR of 52% in FY09 - FY12 driven by stronger than expected school adoption. We also assume that Everonn competes better with competition resulting in lower attrition. Our FY13 - 17 growth rate is 16%.	Revenue CAGR of 50% modelled for FY09 - FY12 driven by strong growth in ViTELS schools and colleges. We model this to moderate to 14% for FY13 - FY17 resulting from slowing market growth rates and increase in competition that results in attrition.	We assume slower revenue growth of 47% CAGR over FY09 - FY12 as Everonn faces teething problems in scaling up its business and slower market adoption. Similarly our longer term growth rates are 12% for FY13 - FY17 as we model higher attrition from older schools and colleges.
Operating Margins	We model EBITDA margins to be higher by 50 bps over FY11 to FY15 driven by increased adoption of high margin iSchool product resulting in margin expansion. Post FY15 we model margins to moderate to 25% as competition forces Everonn to keep investing in sales and staff.	We model EBITDA margins to expand from 36% in FY10 to 41% in FY14 driven by increasing proportion of higher margin iSchool business and operational efficiencies in other businesses. We model this margin to moderate to 25% at the end of the forecast period driven by increasing competition.	We model EBITDA margins to be lower by 25 bps over FY11 to FY15 due to slower than expected adoption of iSchool and also Everonn inability to penetrate deeper into the existing schools. Post FY15 we model margins to fall to 25% over the forecast period due to increasing competition.
Fair Value (Rs)	678	513	418
Upside	80%	36%	11%

Source: Company filings, Execution Noble,

SWOT analysis

Strengths	Weaknesses
<ul style="list-style-type: none"> Strong presence in establishing and managing VSAT based platforms in schools and colleges. Curriculum focussed digital content for school and relationships with them. Relationship with state governments through ICT contracts. 	<ul style="list-style-type: none"> Relatively higher dependence on ICT for annuity revenues resulting in stretched cash flows (Negative operating cash flow in FY09). Proportion of revenues from non core business (EDURES) steadily increasing. Operating margin of EDURES range between 5% - 6%. No past track record of managing business schools.
Opportunities	Threats
<ul style="list-style-type: none"> Increasing the penetration of classes per school in the iSchool segment (Currently 3 classes per school versus Educomp's 15 classes per school). New Model in VITELS College, approaching colleges instead of students, will reduce the lumpiness in the revenues of this segment. Working on models to start K-12 and business schools. 	<ul style="list-style-type: none"> L1 bidding in ICT segment may put further pressure on margins and IRR. In event of failure of the new model in the college segment, Everonn will have to get back to its older model of approaching students instead of approaching the colleges.

Figure 4 Porters analysis- Indian Education Companies



Source: Execution Noble, Michael Porter

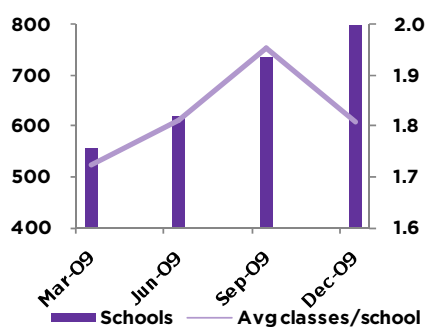
Higher quality growth drivers in iSchools (10% of revenues)

Everonn's revenue growth in this business is driven by the twin forces of increasing penetration within existing school customers and increasing its number of customers. Whilst Everonn has 837 school customers, its average footprint within schools is still low at ~2 classrooms per school (Educomp has 15). Firstly, with schools increasingly accepting the solution, Everonn has substantial headroom for growth by selling more classrooms to its existing schools. Secondly, with Everonn's affordable price-points (starting at Rs 0.9 mn per school vs. Rs 5.2 mn for Educomp), curriculum based content and strengthened sales team, it is likely to continue to increase its national school footprint strongly.

Everonn's earlier school model was named 'vSchool' which involved delivering lectures through the VSAT Platform using teachers employed with Everonn. The key issue in this segment was that Everonn was trying to replace the school teachers with its own teachers called 'Star Teachers'. The acceptance of the product reduced as teachers felt that they will eventually be replaced by the 'Star Teachers'. At the same time Educomp had made significant inroads through its Smart_Class product for private schools as through smart class Educomp was assisting teachers to deliver lectures effectively though digitized content. This compelled Everonn to make changes in its school model and it launched the 'iSchool' Product along the lines of Educomp's Smart_Class. The revenue growth of VITELS is likely to be driven by iSchools due to the following three reasons:

- 1. Increasing penetration in existing schools:** Everonn's average footprint within each school is ~2 classes per school compared to Educomp's 15 classes per school and there is significant headroom to increase the footprint in every school in which they operate. Our interaction with most of the schools indicates that they are eager to increase the number of classes under iSchool. For instance, DAV Chennai, one of Everonn's largest installations has increased its footprint from 15 classrooms in FY09 to 23, whilst another school increased from 4 classrooms to 16. Everonn has also received an order for 43 classrooms from a school in Tamil Nadu.

Figure 7 Classes per school - present situation



Source: Execution Noble Estimates

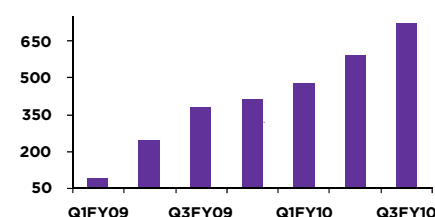
- 2. Willingness to start with even a couple of classrooms:** Unlike Educomp, which looks at a minimum of 10 classes per school, Everonn is willing to go ahead with its "iSchool" product even if a school wants to start with just a couple of classes. This makes the product more affordable to schools and students and at the same time allows Everonn to leverage its VSAT platform for interactive session as every "iSchool" classroom is VSAT enabled. As a result, moving forward penetrating the existing schools becomes easier for Everonn.

Table 3 Economics of iSchool based on number of classes (in Rs mn unless otherwise mentioned)

Component	3 classes	10 classes	20 classes
Initial Capex	0.30	0.85	1.50
Revenues over five year contract	1.44	3.90	5.63
Opex is 47% of sales	0.68	1.48	2.24
Net Cash	0.46	1.3	1.9
IRR	73%	65%	51%
Cost of Capital	13.5%	13.5%	13.5%
NPV Per School	0.45	1.08	1.37
NPV of 723 School	327	784	990

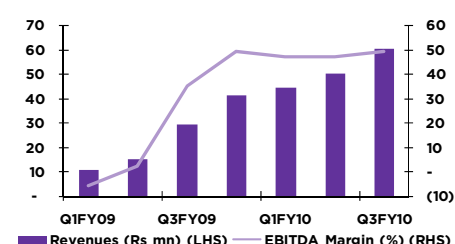
Source: Execution Noble Estimates

Figure 5 Number of schools with Everonn



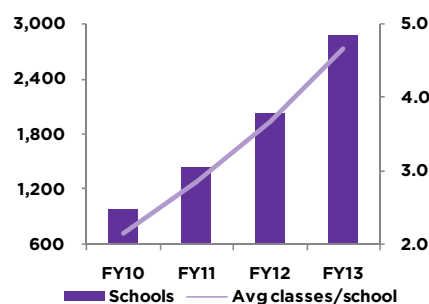
Source: Company Reports

Figure 6 Revenues and margins in School



Source: Company Reports

Figure 8 Classes per school - Our Expectations



Why fewer classroom schools make business sense: As the capex in iSchool is on a per class basis, it makes sense for Everonn to go in even for couple of classroom in order to expand its reach given that the larger two competitors, Educomp and Edurite, don't bid for schools with less than 10 classrooms

3. Expanding the sales team to add more schools: Everonn is investing in its sales team for the iSchool product. It has already increased its sales force by 30 people in FY10 taking the overall size to 140 (Educomp has ~230 sales people). The twin forces in iSchool, increasing penetration in existing schools and adding new schools, are thus being applied in the iSchool segment.

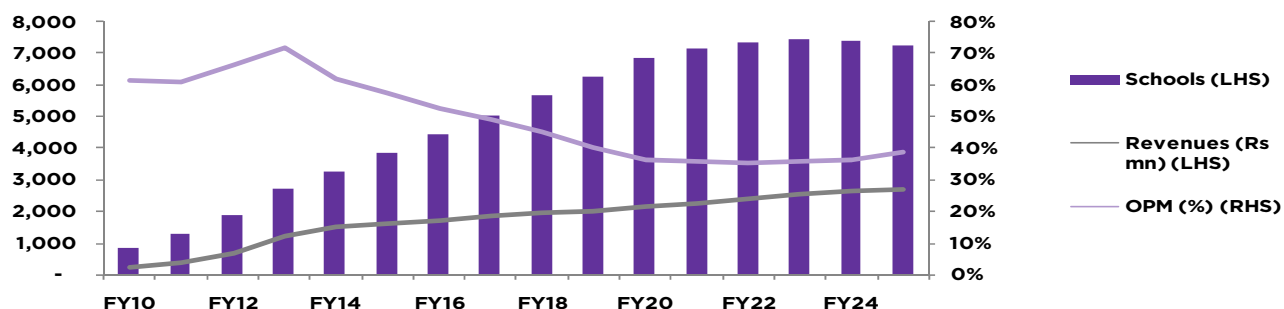
Different focus helps Everonn is countering Educomp’s price war

These twin forces will enable Everonn penetrate the private segment further and with Everonn ready to set up even couple of classes in a school initially, it will ensure that it does not become a victim to Educomp’s price discount. Everonn’s key competitor Educomp has historically focused on the premium end of the market, with schools that could take ~22 classrooms on average in Tier 1 cities. As this market has begun to saturate, Educomp’s focus has shifted to schools in Tier 2/3 cities and smaller schools in Tier 1 cities that could not afford its pricing and need to take at least 20 classrooms for setting up. Given Everonn’s existing focus on smaller towns and readiness to take schools with fewer classrooms it hasn’t felt the impact of Educomp’s decline in pricing. Given Educomp’s focus on schools that can add >10 classrooms per school, Everonn is unlikely to see a direct impact on its addressable market of schools that prefer multimedia in less than 10 classrooms on an average. Indeed, we don’t model Everonn’s footprint on a per school basis to exceed 10 over FY10-25.

Given Educomp’s focus on schools that can add >10 classrooms per school, Everonn is unlikely to see a direct impact on its addressable market of schools that prefer multimedia in less than 10 classrooms on an average.

Our long term assumption of 20% attrition in number of iSchools also captures the possibility of few schools opting for their own hardware and internet resources once the contract ends. We also factor 10% price erosion for Everonn every year until FY16 and 5% thereafter as pricing will get affected once the business gets commoditized. Our resulting school addition, revenues and margin assumptions are highlighted in the chart below.

Figure 9 Execution Noble long term estimates for growth in schools, revenues and margins



Source: Execution Noble estimates

New college distribution model can accelerate adoption

Whilst Everonn’s college satellite based model has helped it increase revenues by 45% p.a. between FY07-09, its growth has been tempered by the need to sell courses directly to students. A new distribution model that ensures that colleges sell courses on to students as opposed to Everonn selling such courses and the launch of curriculum based courses is likely to accelerate adoption.

New college model will ensure than revenues are annuity in nature rather than lumpy.

Everonn’s VSAT model of delivering non-curriculum courses in colleges witnessed initial success in FY06-8. While college addition kept pace, the incremental students per college reduced as Everonn had to target students in every college thereby witnessing a decline in revenues from this segment in the first three quarters of FY09. Revenues declined as these were short term courses with no revenue guarantees to fall back on. This prompted Everonn to make structural changes in its college model. The newer college model is more likely to succeed due to following three reasons:

1. Course mapped to tenure of college education: Under the new model, while the courses will still be non-curriculum, the lumpiness in the revenue model will reduce as the students will have to take up the course for the entire tenure of their college education which range from 4 years in engineering colleges and 3 years in other streams. The college will ensure that a minimum of 200 students take up the course failing which Everonn will not make the initial capex of Rs

Table 4 VITELS Renewal assumptions

Long term growth assumptions	
Schools	Renewals of ViTELS Schools at 80% at the end of five years. 20% of colleges opt out.
Colleges (New Model)	We assume 20% of colleges opt out every four years due to lack of traction or competition.
Colleges (Old Model)	We assume 30% of colleges opt out every four years due to lack of traction or competition.

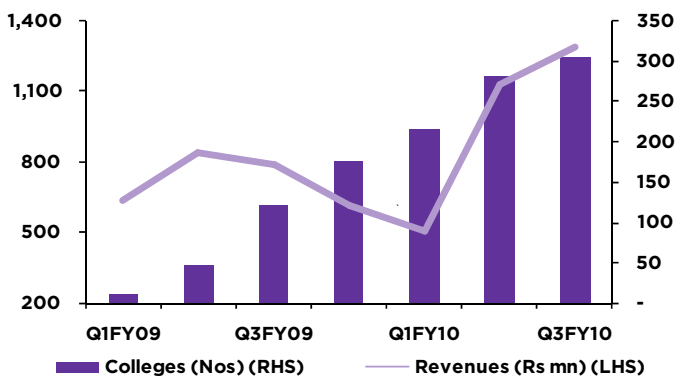
Source: Execution Noble

0.3mn to set up the VSAT Classroom. These courses will find greater acceptance as the major courses offered (English speaking and personality development) are job oriented and students in the interior of the country are less proficient in these skills. Indeed, our channel checks indicate that students are ready to pay as much as Rs 1,800 to Rs2,000 for a 40 hour long course (typically help over two months) in English and presentation skills. Lack of success in job interviews for those who don't have the spoken English or the requisite personality skills drives enrolments in such courses.

2. Changing customer profile to help optimize resources: Under the new model, Everonn's customers are the colleges unlike the old model where the students were Everonn's customers. Thus, once a college registers with Everonn, the college ensures that students get registered for the courses. This results in a) greater resource utilization as a result of guaranteed enrolments and b) lower (in college) marketing personnel. This further frees up the sales team to focus on adding more colleges.

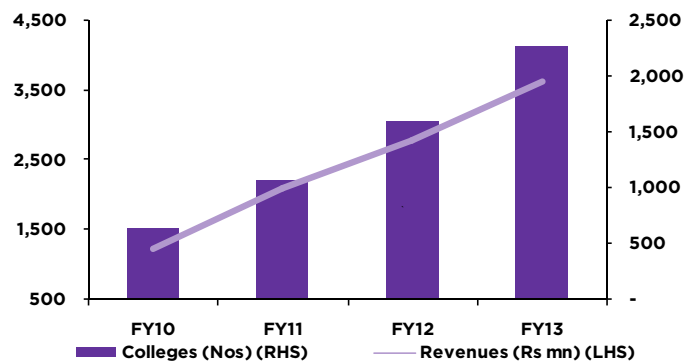
With college assuring a minimum number of students, it removes the headache from Everonn to reach out to students to increase its revenues

Figure 10 Colleges & Revenues - Present situation



Source: Company filings, Execution Noble

Figure 11 Colleges & Revenues - Our expectations



Source: Company filings, Execution Noble

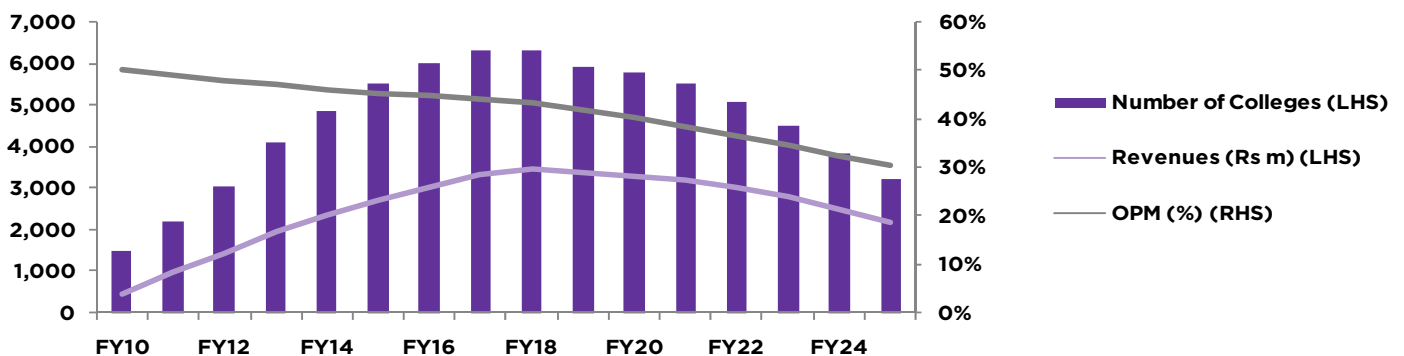
3. Curriculum based content for complex topics: Everonn is expected to launch curriculum based courses for colleges from the next academic year, Q1FY11 onwards. Here Everonn's star teacher will assist the college teachers (and not replace) in delivering lectures effectively for complex topics in the fields of science and engineering. Assisting the colleges in curriculum based courses will enable Everonn to cross sell its non curriculum courses.

Assisting the colleges in curriculum based courses will enable Everonn to cross sell its non curriculum courses

While Everonn will be giving the option to colleges to opt for any of the two models, a greater revenue share (up to 15% vs. 5-10% earlier) to colleges reduces the challenge of adverse selection. Our long term assumptions for this segment factors the following:

1. 30% attrition rate in the old model from FY14 to FY19 and 20% thereafter.
2. 20% attrition rate in the new model from FY14 to FY19 and 10% thereafter.
3. No hike in fees for the courses offered.

Figure 12 Execution Noble long term estimates for growth in colleges, revenues and margins



Source: Execution Noble estimates

K-12 and business schools are “free options”

Brick & mortar K-12 and business school opportunity

We noted in our 18 Dec 2008 thematic (“*Education & Training: Defensive Opportunities?*”), as a result of a significant shortage in high quality schools in India, firms that own, lease or manage schools can benefit directly from defensive recurring fees revenues. As schools need to be run as “not for profit”, firms typically monetise schools by leasing infrastructure and land to an independent trust and charging management fees. A recent government directive for providing inexpensive education loans to students is likely to support increasing enrolments in higher education such as business schools. The education minister has highlighted the intention of setting up an education loan fund via several banks and large lenders have taken initial steps towards increasing student loans (e.g. HDFC acquired student loan vendor Credila Financial Services in November 2009).

A significant shortage in high quality educational institutions in India, make brick & mortar K-12 and business schools a lucrative business.

Attractive unit level economics if executed successfully

Setting up K-12 schools and business schools is an attractive business if executed successfully as indicated by the relatively high IRRs (28%-32%) in such projects. We use the example of a K-12 school to illustrate the economics. The table below indicates the pro-forma P&L of a typical private K-12 school in India. This assumes that the school takes about 7 years to reach peak capacity and reaches break-even in the 7th year.

Table 5 School IRR (In Rs mn unless mentioned otherwise)

	-Year 1	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
No. of students	-	-	500	800	1,000	1,300	1,500	1,800	2,000	2,000	2,000	2,000
Annual fess (Rs/student)	-	-	36,000	37,440	38,938	40,495	42,115	43,800	45,551	47,374	49,268	51,239
Admission fees (Rs/student)	-	-	25,000	25,500	26,010	26,530	27,061	27,602	28,154	28,717	29,291	29,877
EBITDA margin - fees (%)	-	-	10	20	30	40	50	50	50	50	50	50
EBITDA margin - admission (%)	-	-	95	95	95	95	95	95	95	95	95	95
EBITDA margin - other services	-	-	25	25	25	25	25	25	25	25	25	25
Annual fees (Rs mn)	-	-	18	30	39	53	63	79	91	95	99	102
Admission fees (Rs mn)	-	-	13	8	5	8	5	8	6	6	6	6
Other services	-	-	5	7	10	13	16	20	23	24	25	26
Total revenues	-	-	35	45	54	74	84	107	120	124	129	134
EBITDA	-	-	15	15	19	32	41	52	57	59	61	63
EBITDA margin (%)	-	-	42	34	35	43	48	49	47	47	47	47
Depreciation	-	-	7	7	7	7	7	7	7	7	7	7
EBIT	-	-	8	8	12	25	34	45	50	52	54	56
Interest	-	-	9	8	6	5	4	3	1	-	-	-
PBT	-	-	(1)	1	6	20	30	43	48	52	54	56
Tax	-	-	(0)	0	2	7	10	15	16	18	18	19
Effective tax rate (%)	-	-	34	34	34	34	34	34	34	34	34	34
PAT	-	-	(1)	0	4	13	20	28	32	34	36	37
FCF	-	-	6	7	11	20	27	35	39	41	43	44
Capex	(70)	(21)	(21)	(14)	(14)	-	-	-	-	-	-	-
Project cash flows	(70)	(21)	(9)	(2)	1	23	29	37	40	41	43	44
Terminal Value												471
Debt to Equity	1.0											
Discount rate	14%											
Equity IRR	32%											
School IRR	23%											

Source: Noble Research

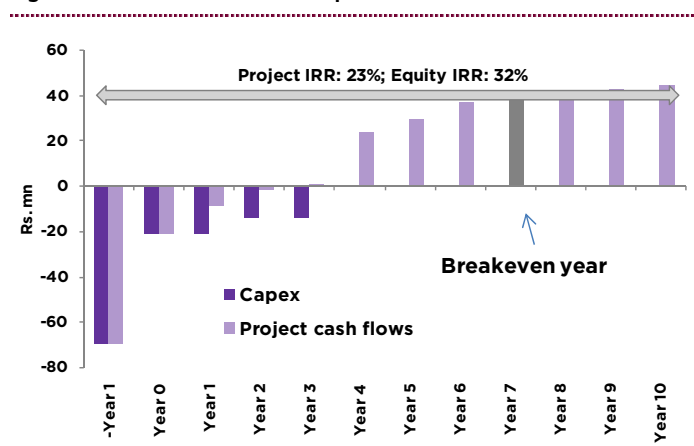
Our primary research indicates that schools typically need 6-8 years to reach peak capacity from scratch. This is due to:

- Organic growth:** Schools typically start as K-5 or K-8, as it is difficult to attract students at higher classes without a good track record. Furthermore, induction is weighted towards the lower classes initially and the peak capacity is reached as the initial classes slowly graduate higher.
- Board affiliation rules:** CBSE bye-laws require a school to be operational for 3 years before allowing X-XII grades.
- Building a brand:** Whilst new schools do resort to advertising, long term patronage is built by word of mouth as parents choose schools based on the trust in the brand name.

Schools take 6-8 years to break even due to affiliation rules, challenges in scaling up and building a brand

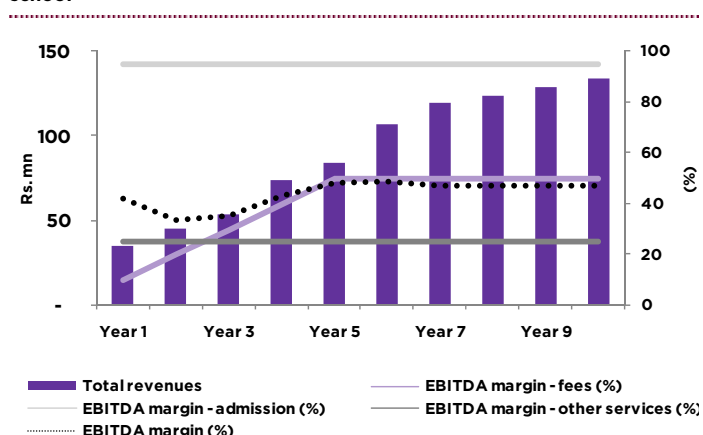
That said successful schools typically become cash cows with strong margins and high barriers to entry from new competition. Figures 9 and 10 below indicate the cash flow, revenue and profit profile of a typical school.

Figure 13 Attractive cash flow profile for a successful K-12 school



Source: Execution Noble

Figure 14 Revenue and margin profile of a typical successful K-12 school



Source: Execution Noble

As owning land and building schools is often highly capital intensive, private firms can also monetise the K-12 schools opportunity by partnering with land-owners or real estate developers to manage schools. In this case, managers make no capital investments and earn profits based on the profits generated by the school after paying for the cost of the lease and a percent of profits to the landlord. Managing schools can be akin to managing a branded hotel chains business due to:

- **Entrepreneur fatigue:** A number of privately run K-12 schools suffer from entrepreneur fatigue, as the next generation of promoter families is not interested in running schools. Whilst these schools have been established for a long time, their performance suffers due to the lack of imaginative management.
- **Improve realisation:** As in the branded hotel management businesses, such as the Taj Group chain, a new management company can substantially increase the average revenue per student (ARPS) substantially.
- **Low capital investment:** As opposed to owning K-12 schools, 'managing schools' may not involve any initial capex. A school manager can charge the promoter a proportion of top or bottom line. The key cost for the school manager would be the cost of branding and advertising.

A large number of Indian schools need improved management. Our industry sources indicate that the profit margins are significantly higher in such businesses with the added benefit that such schools have low capex requirements compared to owned schools. Given the Everonn has a long history as a vendor to schools, its strength lies in running schools rather than in managing real estate. That said, whilst profit margins are higher in managing schools, the biggest absolute profits do lie in owning schools.

Everonn's ambitions

Everonn management aspires to set up and manage several brick & mortar K-12 schools and business schools over the next 3 years. Management has hired senior members (including an ex-director from IIM Indore) who have developed content for business schools and schools. It expects to begin at least one business school in the coming academic year and several K-12 schools (>10) in the following year. Everonn plans to partner with existing landowners to set such schools up and expects to infuse equity at the project level by partnering with private equity funds. If successfully executed, Everonn can potentially emulate chains of branded schools (e.g. DPS or GEMS) and colleges (e.g. Manipal University, Amity etc.), which have the advantages of substantial pricing power, negative working capital and long term annuity revenues.

Everonn aspires to open a chain of K-12 schools and business schools in partnership with landowners.

However, capabilities remain unproven

Whilst Everonn has a long history as a supplier of content, teaching, hardware and equipment to schools, its experience in managing turnkey projects such as full-fledged schools are unproven. Thus we don't model any revenues from Everonn's

schools, pre-schools or business schools, leaving the value creation from this business as a free option at current valuations.

Potholes in the road ahead

ICT- low quality and low visibility

Whilst the government funded ICT@School project seems to represent a substantial opportunity, the low visibility of contract wins, longer repayment cycles, high competition, and lack of material competitive advantages besides Everonn's lack of balance sheet strength make this opportunity less attractive for Everonn.

With more than 5,850 schools under its belt, Everonn is the second largest player after Educomp in the ICT segment. Although revenue growth has tapered off over the last eight quarters due to lack of new school wins and due to pricing pressure resulting from L1 bidding (as explained below). The situation is unlikely to change going ahead due to the following two reasons:

- L1 bidding gives little room for improvement in IRR:** A typical ICT contract operates on a BOOT model where the lowest bidder gets the contract. Everonn has to make initial investments ranging from Rs0.2m to Rs0.45m to set up the computer lab in schools and it bills the school on a quarterly basis. While the hardware costs on computers and peripherals have come down significantly over the last two years, the pricing per school has also come down. Our calculations indicate that the IRR over the contract period works out to 20.4% as against a cost of capital of 13.5% for Everonn. ICT would continue to be a drag on overall financials as the IRR in the ViTELS segment is significantly higher than that of ICT.
- Strain on cash flows to continue:** As the ICT segment involves dealing with the government it has always been marred by procedural delays and debtor's day's stand well above 210 days for the segment. This strain on Everonn's cash flows are likely to continue as the basic premise of the ICT contract is unlikely to change going ahead.

That said, the ICT@school remains a large opportunity considering that out of the total 1.1 mn schools in India, the three key players in total had a little over thirty five thousand schools. Also, with over 60,000 schools coming up for bidding over the next three years, the opportunity is too big to ignore. Moreover, with a pro-reform government at the centre and with a pledge to reform the education system in India, state governments will eventually move towards more technology enabled teaching. Everonn therefore would be able to leverage its VSAT platform and experience to assist the schools in improving the quality of teaching.

Edures - Synergies not apparent

Edures is involved in the trading of books, CD ROMs, school uniforms and computers to private schools and corporates where operating margins are lower. Everonn initially clubbed Edures revenues in its standalone figures. However, from Q1FY09 revenues from trading business was shown under subsidiary EDURES which stands for Everonn Educational Resources. The synergies are not apparent from this segment due to following two reasons:

- 30% of sales are to corporates:** In Edures, 30% of sales come from non-education institutions and low margins. Here Everonn sells computers and other peripherals to corporates which are not related with Everonn core business of providing education.
- Operating margins are in the range of 5% to 6%:** The operating margins in Edures are in the range of 5% to 6% which is significantly below the consolidated margins of 35%.

Although management highlights low incremental investment, the synergies from reselling are not immediately apparent with ~30% of sales from non-education institutions, lack of differentiation over other school & college suppliers and low margins. We model the share in overall revenues from corporates to fall to 20% by Q4FY12 from current levels of 30%.

Table 6 Key Players in ICT Segment

Company	Number of Schools
Educomp Solutions	14,826
Everonn Education	5,862
NIIT	14,837

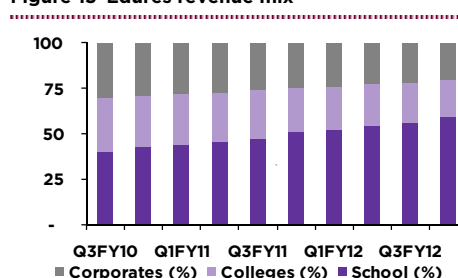
Source: Company Filings, Execution Noble

Table 7 The economics of an ICT Contract

Component	Rs mn
Initial Capex	0.20
Revenues over five year contract	0.75
Opex is 55% of sales	0.41
Net Cash	0.14
IRR	20.4%
Cost of Capital	13.5%

Source: Company Filings, Execution Noble

Figure 15 Edures revenue mix



Source: Execution Noble estimates

Valuation: Stark discount to Educomp

Everonn is astutely positioned to gain from the improving quality of education in India and demand for high quality schools. Unlike its better known peer (Educomp), Everonn trades at an inexpensive 11x FY11 earnings multiple, which does not price in the non-discretionary nature of Everonn's businesses and its competitive advantages. Everonn missed its aggressive FY09 guidance spectacularly as revenues were 24% below guidance and PAT was 29% below the guidance given at the beginning of the year. Underperformance in VITELs was higher (-41%), whilst ICT revenues were in line. This "miss" was primarily as a result of trying to do too much too soon. With more achievable targets and having learnt from past mistakes, Everonn seems to be on track to run a more sustainable annuity focussed business. Our 3-stage DCF points to Rs.513, 36% upside.

Revenue recognition in iSchools is aggressive

Everonn recognises revenues in its School business in the following format:

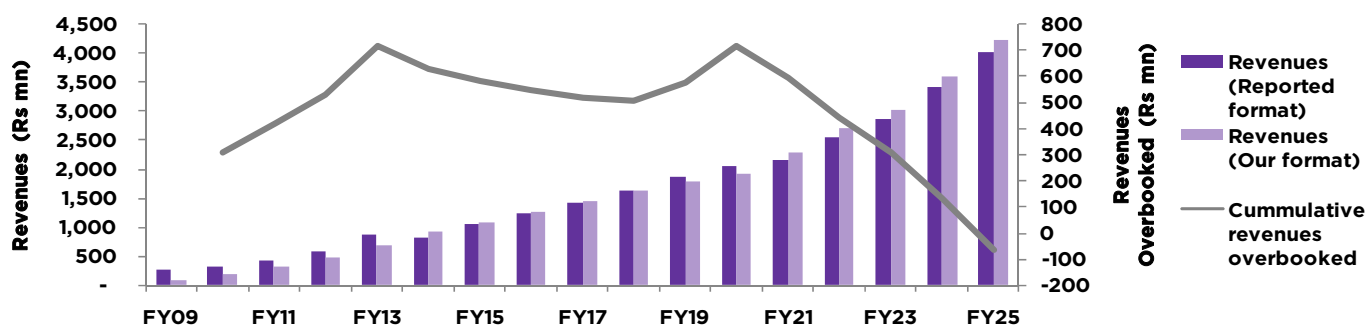
- **Product License fees:** Rs.320K (or ~35% of revenues for a single classroom contract) is recognised on installation. Incremental license revenues recognised for >1 classrooms is ~Rs30K per classroom.
- **Equipment and Services fees:** ~65% of revenues is recognised over the period of the contract.

However, Everonn's payments from schools are on a quarterly basis in equal monthly instalments. As a result, Everonn books 36-48% of revenues in the first year (depending on the number of classrooms a school takes), although it is only paid 20% in that year.

Management view: Management highlight that its revenue recognition policy is in line with the accounting standard as license revenues are recognised only once: (a) the equipment is installed in the school, (b) the school is given complete access to the content, and (c) there is surety of payment as the school has signed the contract. As a result cash conversion is likely to be weak, given upfront revenue recognition, whilst debtor days are likely to remain meaningfully high in this business. Management also concede that Everonn carries the risk of revenue restatements should schools discontinue usage before the contract period ends. Everonn has only seen over 5-10 such drop out cases so far (out of total client base of 867 schools).

Execution Noble view: We find this revenue recognition policy aggressive, given that Everonn signs a five year BOOT contract and gets paid on a quarterly basis. This is likely to inflate revenues and profits in the initial years due to aggressive booking. As a result we have forecast our iSchool revenues based on an annuity revenue recognition policy that is in line with the cashflow profile of the business. The chart below highlights Everonn's iSchool revenues under both cases. In the initial years Everonn will report higher revenues due to upfront booking of license and content fees. Over the longer term, Execution Noble revenues will be higher than Everonn's revenues and cumulative overbooking of revenues in initial years by Everonn will reduce to zero.

Figure 16 Differences in Everonn's reported revenue recognition vs. our forecasts



Source: Execution Noble estimates

The key risks around our Positive stance are:

1. Everonn's success lies in making further inroads in the existing schools by adding more classrooms under iSchool. Currently this number stands at 2 and our estimates factor in an average of 4 classrooms per school by FY12E. Everonn's failure to make further inroads in existing schools remains the key risk to our positive stance.
2. Everonn new model for colleges is relatively new and untested and is yet to find acceptance from colleges failing which Everonn may have to focus on its older model thereby putting our estimates under risk.

Table 8 Key assumptions and estimates (consolidated) (All figures in Rs mn unless otherwise mentioned)

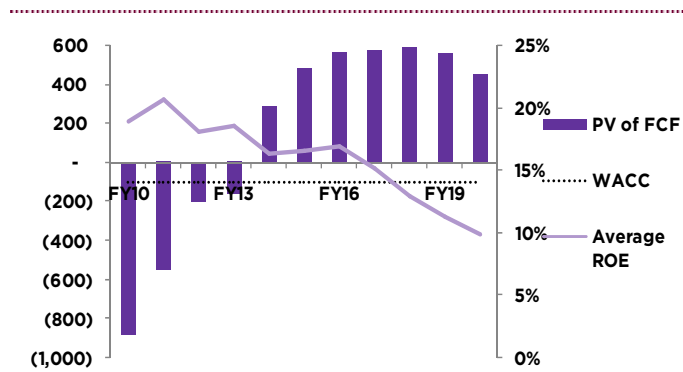
	FY09	FY10E	FY11E	FY12E	Comments
ICT					Assumed sequential addition of 9% in number of schools in FY11, 6% in FY12.
Ending Schools	4,442	5,979	8,440	10,656	
Revenues	472	675	989	1,217	Revenue growth in FY11 mainly triggered by Rs920m UP contract. Growth slows down in FY12 as certain schools moves to service contract
EBITDA	267	296	336	562	EBITDA margins comes under pressure due to L1 bidding
VITELS - Schools					Assumed sequential addition of 10% in number of schools for FY11 and 8% for FY12
Ending Schools	557	975	1,440	2,021	
Revenues (Ex Noble Estimates)	274	265	334	505	Revenue growth faster than school addition as average classroom per school increases
Revenues (Everonn may report)	249	314	418	584	Operating margins improves as classes per school rises
EBITDA	188	160	175	292	
VITELS - Colleges					Assumed 4% sequential growth in colleges under old model and 30 college addition per quarter in new model
Ending Colleges	800	1,551	2,199	3,052	
Revenues	164	458	999	1,424	Revenue buoyancy driven by new model in colleges
EBITDA		172	514	732	
VITELS - Retail					Revenue buoyancy driven by addition of new centres and more tests conducted
Ending Centres	30	47	55	63	
Revenues	304	566	539	648	
EBITDA		254	242	292	
EDURES					Revenue growth driven by more orders from private schools. Contribution of corporates is expected to fall to 40% by Q4FY12
Revenues	229	621	708	686	
EBITDA	29	25	21	20	Margins contracts from 5% to 4% due to increase in revenues from private schools
Toppers Tutorial					
Revenues	4	112	113	149	47 centres at the end of FY10, 57 in FY11 and 71 in FY12
EBITDA	-	-	17	28	
Consolidated Revenues	1,447	2,697	3,683	4,629	Revenue growth driven by colleges and school segment
Consolidated EBITDA	512	974	1,310	1,926	Margin contracts by 120 bps in FY11 due to wage inflation
Depreciation	159	253	324	462	Depreciation rises mainly on account of capex for iSchool and VSAT classrooms in colleges
Consolidated EBIT	354	721	986	1,464	
PBT	324	638	783	1,164	
PAT	204	421	523	778	
PAT Margin (%)	14.1%	15.6%	14.2%	16.8%	
Fully Diluted EPS	14.1	27.8	34.6	51.4	
Change in Working Capital	(585)	(859)	(669)	(520)	Most of the capex is for the ICT segment
Capex	(710)	(855)	(1,036)	(1,169)	
FCF	(704)	(669)	(325)	307	Company likely to turn FCF positive in FY12

Source: Execution Noble

Table 9 Execution Noble versus Consensus

	Execution Noble	Consensus	% difference
Revenue (Rs mn)			
FY10	2,697	2,607	3.0
FY11	3,683	3,657	1.0
FY12	4,629	5,022	(8.0)
EBITDA (Rs mn)			
FY10	974	937	4.0
FY11	1,310	1,285	2.0
FY12	1,926	1,785	8.0
EPS (Rs)			
FY10	27.8	26.0	7.0
FY11	34.6	36.0	4.0
FY12	51.4	51.8	(1.0)

Source: Reuters, Execution Noble

Figure 17 FCF profile (Rs mn)

Source: Execution Noble estimates

Execution Noble versus consensus

Our Income and EBITDA estimates for FY10 are 3% and 4% higher than consensus as we expect revenues to start flowing in from UP government contract. Our FY11 revenue and EBITDA estimates are 1% and 2% ahead of consensus as we expect increase in classrooms in the iSchool segment. Our FY12 revenue estimates are 8% lower than consensus as we factor a 10% volume discount in iSchool content fees as the number of classrooms increases and also model iSchool revenues on an annuity basis rather than the upfront basis Everonn is likely to report.

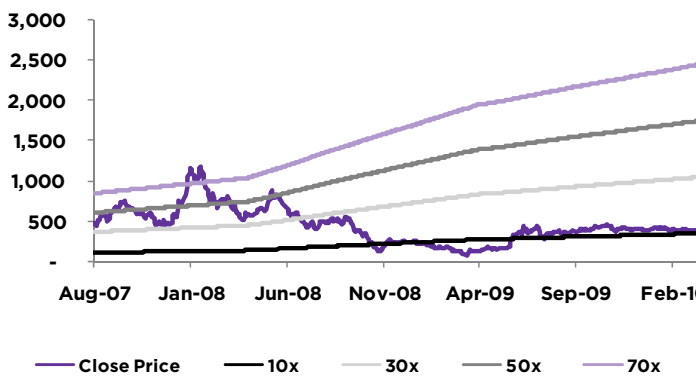
Relative valuation

Everonn has traded at an average discount of 40% to Educomp. This discount has widened to 50% due to the fact that Everonn is relatively small and concentrated business with higher focus on ICT for revenues than Educomp. We expect this to change due to (a) stronger drivers in classroom software (b) improving colleges focused business model; and (c) capital light entry into brick and mortar K-12 and business schools.

Euphoria in the sector has come off – Right time to get in?

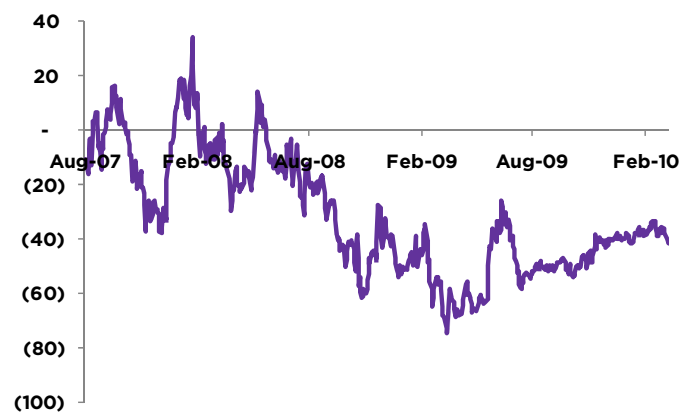
Over the last three years, Everonn has traded at an average PE of 40x while Educomp has traded at >60x driven by the hype around exponential growth expected. However, shares have since underperformed, as inflated expectations were not met. Although sector leader, Educomp was also punished for aggressive accounting practices, Everonn's valuation has suffered in sympathy. Everonn shares now trade at 11x FY11 earnings in spite of more achievable expectations of 45% CAGR. While the business is likely to remain FCF negative over the next two years, this is more than priced in at current valuations that however miss out on the secular longer term potential driven by increasing penetration of quality education in India.

Figure 18 Everonn PE Band



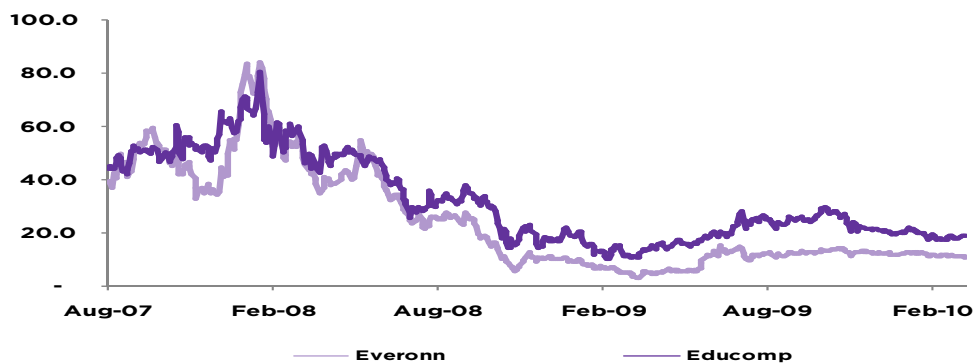
Source: Execution Noble, Bloomberg

Figure 19 Everonn PE discount to Educomp has begun to narrow



Source: Execution Noble, Bloomberg

Figure 20 Euphoria from the sector has come off with PE contracting to meaningfully low levels



Source: Execution Noble, Bloomberg

Table 10 Comparative valuation

	Curr	Price	Mkt Cap	EV	Sales CAGR		EV/Sales			EBITDA CAGR		EV/EBITDA		EPS CAGR		P/E	
					(CY09-11)	CY10	CY11	(CY09-10)	CY10	CY11	(CY09-10)	CY10	CY11				
India																	
EDUCOMP SOLUTIONS LTD	INR	781.2	33,800	82,358	37%	5.8	4.5	38%	12.0	9.4	33%	22.4	17.6				
EVERONN SYSTEMS INDIA LTD	INR	376.0	5,685	5,535	50%	1.5	1.1	56%	4.2	2.9	57%	10.8	7.3				
NIIT LIMITED	INR	62.9	10,385	12,753	10%	1.0	0.9	18%	7.1	6.3	19%	12.1	10.3				
	Median				37%	1.7	1.3	38%	7.1	6.3	33%	12.1	10.3				
	Mean				36%	2.8	2.2	39%	8.0	6.4	36%	15.3	12.0				
US																	
AMERICAN PUBLIC EDUCATION	USD	45.7	837	762	35%	3.7	2.8	36%	12.4	9.2	36%	26.3	19.5				
APOLLO GROUP INC-CL A	USD	64.7	10,013	9,366	16%	1.8	1.6	14%	6.3	5.6	14%	12.3	10.5				
BLACKBOARD INC	USD	42.5	1,415	1,403	14%	3.2		30%	11.9	9.9	39%	23.5	19.9				
CAPELLA EDUCATION CO	USD	88.8	1,484	1,312	23%	3.1	2.6	31%	12.0	9.8	34%	25.3	19.9				
CAREER EDUCATION CORP	USD	31.4	2,639	2,157	14%	1.0	0.9	30%	5.1	4.3	39%	12.3	10.0				
CORINTHIAN COLLEGES INC	USD	18.3	1,602	1,369	17%	0.7	0.7	24%	4.0	3.6	16%	10.0	8.8				
DEVRY INC	USD	67.0	4,770	4,485	20%	2.2	1.9	28%	9.0	7.4	23%	16.9	13.4				
ITT EDUCATIONAL SERVICES INC	USD	114.5	4,059	3,937	16%	2.5	2.2	17%	6.2	5.6	21%	11.0	9.7				
K12 INC	USD	22.8	687	669	22%	1.6	1.3	32%	9.7	7.6	23%	33.1	24.3				
LINCOLN EDUCATIONAL SERVICES	USD	27.3	737	748	14%	1.1		19%	5.1	4.7	23%	11.5	10.0				
PRINCETON REVIEW INC	USD	4.0	135	200	37%	0.9		133%	6.5	4.1	NA	NA	NA				
STRAYER EDUCATION INC	USD	246.6	3,441	3,325	23%	5.2	4.3	23%	14.5	11.9	23%	26.0	21.3				
	Median				18%	2.0	1.9	29%	7.8	6.5	23%	16.9	13.4				
	Mean				21%	2.3	2.0	35%	8.6	7.0	26%	18.9	15.2				
South Korea																	
CREDU CORP	KRW	45700.0	257,218	198,530	16%	2.6	2.3	74%	17.8	13.0	55%	26.3	20.0				
DAEKYO CO LTD	KRW	5640.0	477,724	344,031	4%	0.4	0.4	4%	3.3	3.0	2%	10.4	9.2				
MEGASTUDY CO LTD	KRW	182500.0	1,157,172	1,013,788	16%	3.6	3.2	17%	9.4	8.2	18%	13.9	11.9				
	Median				16%	2.6	2.3	17%	9.4	8.2	18%	13.9	11.9				
	Mean				12%	2.2	2.0	32%	10.2	8.1	25%	16.9	13.7				
Others																	
ANHANGUERA EDUCACIONAL PART	BRL	26.9	3,298	3,417	33%	3.8	3.0	15%	20.0	13.4	310%	33.3	20.0				
BENESSE CORP	JPY	4110.0	437,113	365,462	3%	0.9	0.8	2%	6.6	6.4	15%	18.4	16.5				
BPP HOLDINGS PLC	GBP	169.0	158	155	4%	0.4	0.4	11%	5.3	4.8	14%	10.8	923.5				
KROTON EDUCACIONAL SA	BRL	17.7	1,105	709	46%	1.3	0.9	352%	6.8	4.6	499%	13.5	10.6				
NAVITAS LTD	AUD	5.3	1,811	1,786	14%	3.0	2.6	17%	17.2	15.0	14%	26.9	23.3				
NEW ORIENTAL EDUCATIO-SP ADR	USD	85.0	3,202	2,992	27%	6.9	5.5	44%	26.3	19.0	32%	33.9	24.9				
RAFFLES EDUCATION CORP LTD	SGD	0.4	1,075	1,362	10%	6.1	5.5	17%	15.3	12.4	22%	17.1	12.8				
	Median				14%	3.0	2.6	17%	15.3	12.4	22%	18.4	20.0				
	Mean				20%	3.2	2.7	65%	13.9	10.8	129%	22.0	147.4				

Source: Bloomberg, Execution Noble

Table 11 Traffic Lights: criteria for judgement

Parameter	Traffic signal	Reasons
Accounting & governance	YELLOW	We note that Everonn's cash conversion was negative in FY09, substantially below that of listed peers NIIT and Educomp that averaged 80% in FY09. Also, Everonn recognizes revenues from iSchool aggressively (36-48% in the first year of a five year contract) when it is paid rateably over five years.
Franchise strength	YELLOW	Whilst Everonn has close to 6,000 government schools under ICT, 1400 colleges and 867 schools under ViTELS, it has not been able to establish a leading position in its major businesses outside of VSAT training in colleges. I does have a leading position in college training. Also relatively low margin businesses such as EDURES form 18% of its revenues
Earnings momentum	YELLOW	Bloomberg and Reuters show that there have been marginal upgrades in the earnings estimates for the company following the strong Q3 results.

Source: Execution Noble, Bloomberg, Company data. For more details on how the traffic lights work, please refer to our 7 Jan 2010 note

Financials

(All figures in Rs mn unless mentioned otherwise. Year end is March)

Income Statement	2007A	2008A	2009A	2010E	2011E	2012E
ICT	0	537	471	675	989	1,217
ViTELS - Schools	0	0	274	265	334	505
ViTELS - Colleges	0	0	164	458	999	1,424
ViTELS - Retail	0	0	304	566	539	648
Edures	0	0	229	621	708	686
Toppers Tutorial	0	0	4	112	113	149
Net income	430	916	1,447	2,697	3,683	4,629
Total expenses	256	582	935	1,723	2,373	2,703
EBITDA	175	334	512	974	1,310	1,926
Depreciation	96	99	159	253	324	462
EBIT	78	235	354	721	986	1,464
Interest & financial exp	26	40	68	118	238	334
Other income	4	15	39	35	35	35
PBT (before EO)	56	210	324	638	783	1,164
Provision for Tax	18	80	120	217	260	387
Reported PAT	38	131	204	421	523	778
Adjusted PAT	38	131	204	421	523	778
Weighted avg shares (mn)	10	14	15	15	15	15
Adjusted EPS (Rs)	3.7	9.4	14.1	27.8	34.6	51.4

We model revenues to grow 50% CAGR over FY09 to FY12E driven by addition in schools and colleges

We model net profits to grow at a CAGR of 56% between FY09-12 driven by ViTELS segment.

Balance Sheet	2007A	2008A	2009A	2010E	2011E	2012E
Equity Share Capital	103	139	151	151	151	151
Reserves & Surplus	262	811	1,986	2,407	3,608	4,385
Net Worth	365	950	2,137	2,558	3,759	4,536
TOTAL debt	235	459	487	1,487	2,487	3,087
Capital Employed	600	1,408	2,624	4,045	6,246	7,623
Net Block	365	495	926	1,528	2,240	2,947
Capital Work in Progress	-	126	250	250	250	250
Goodwill	0	5	5	5	5	5
Investments	-	87	235	235	235	235
Total Current Assets	340	557	1,340	2,549	3,481	4,122
Cash and Bank Balance	44	386	403	364	1,184	1,335
Total Current Liabilities	149	247	534	885	1,147	1,269
Total Assets	600	1,408	2,624	4,046	6,246	7,624

We estimate debt to increase from Rs487m in FY09 to Rs3.1bn in FY12E to fund its growth in the ViTELS segment.

Cash Flow	2007A	2008A	2009A	2010E	2011E	2012E
PBT before EO items	56	210	324	638	783	1,164
D & A	96	99	159	253	324	462
Dividend and Other income	4	15	39	35	35	35
Interest expense	26	40	68	118	238	334
CFO before WC changes	183	365	590	1,045	1,380	1,996
WC changes	(109)	(171)	(585)	(859)	(669)	(520)
Cash flow from operations	74	194	6	186	710	1,477
Capex	(127)	(346)	(710)	(855)	(1036)	(1169)
FCF	(53)	(152)	(704)	(669)	(325)	307
Interest/dividend received	4	15	39	35	35	35
Cash flow from investing	(127)	(433)	(858)	(855)	(1,036)	(1,169)
Long term borrowings	(33)	217	29	1,000	1,000	600
Interest paid	(26)	(40)	(68)	(118)	(238)	(334)
Dividends paid (incl. tax)	0	0	0	0	0	0
Cash flow from financing	(60)	177	(39)	882	762	266
Net change in cash	(113)	(62)	(892)	212	437	573

Operating Metrics	2007A	2008A	2009A	2010E	2011E	2012E
Net income	1%	113%	58%	86%	37%	26%
EBITDA growth	19%	91%	53%	90%	34%	47%
Op. profit growth	-6%	201%	50%	104%	37%	48%
EPS growth	-13%	158%	49%	98%	24%	49%
Margins						
EBITDA margin	40.5%	36.5%	35.4%	36.1%	35.6%	41.6%
Operating/EBIT margin	18.2%	25.7%	24.4%	26.7%	26.8%	31.6%
Net margin	8.7%	14.3%	14.1%	15.6%	14.2%	16.8%
Returns						
ROCE	6.3%	13.0%	10.1%	12.6%	10.2%	11.2%
ROE	26.8%	33.8%	39.2%	38.9%	35.4%	17.3%
Equity value						
P/E	109.2	42.3	26.7	13.5	10.9	7.3
Enterprise value						
EV/Sales	9.4	5.8	3.8	2.1	1.5	1.2
EV/EBITDA	23.2	15.8	10.8	5.7	4.2	2.9
EV/EBIT	51.8	22.4	16.3	9.4	7.1	5.1

EBITDA Margins to contract by 120 bps in FY11E due to pricing pressure

Visible earnings growth and available at inexpensive valuations

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The relevant sector index is the DJ Stoxx sector subgroup which includes the subject company.

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Sell 43 (38%)

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