

Services Group
Knowledge Services

India

Everonn Systems India (BSE: ESIL IN)

Initiating Coverage: Enhanced Capabilities Offer Competitive Edge

Initiating Coverage

Rating: BUY
Price: INR821.85
Price Target: INR975.00
Bloomberg: BSE: ESIL IN

Market Data

52-Week Range: INR1,235.75-INR140.00
Total Entprs. Value (MM): INR11,215.0
Market Cap. (MM): INR11,209.0
Insider Ownership: 31.1%
Institutional Ownership: 15.9%
Shares Out. (MM): 13.8
Float (MM): 8.8
Avg. Daily Vol.: 303,603

Financial Summary

Book Value (MM): INR935.6
Book Value/Share: INR67.50
Net Debt (MM): INR6.0
Return on Avg. Equity: 16.6%
Net Debt/Capital: 0.5%
Long-Term Debt (MM): INR151.7
LTD/Cap: 13.9%
Dividend Yield: 0.0%
Cash & ST Investments (MM): INR145.7
Avg. Daily Vol.: 6 months average

INR	2007A	2008E	2009E	2010E
Rev. (MM)	403.4	877.4	1320.7	2378.5
EV/Rev.	27.8x	12.8x	8.5x	4.7x

EPS

Jun	—	—	—	—
Sep	—	—	—	—
Dec	—	—	—	—
Mar	—	—	—	—
FY Mar	5.63	7.78	12.90	23.50
FY P/E	NM	NM	63.7x	35.0x

Basic EPS

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Investment Summary

Everonn has a truly scalable and robust education business model including VSAT, internet, and intranet capabilities. India's second-largest education company can close its gap with market-leader Educomp through more robust product offerings and fresh capital, in our view.

Event

We are initiating coverage on Everonn Systems Ltd. (ESIL IN) with a Buy rating and one-year price target of INR975/share.

Key Points

- **The company has two broad business verticals** — IEIS and ViTELS. IEIS caters to computer education needs (ICT) in government schools; ViTELS provides IT-enabled educational content and services to private schools, colleges, and corporate entities.
- **Cash infusion needed to boost ICT segment's revenue growth.** Everonn has 3,156 ICT school contracts spread across nine states. We expect robust revenue growth in this segment in coming years, given the government-funded investment push to computerize public schools in India. Thus far, Everonn's ICT business growth was constrained by lack of capital. Future growth in this segment crucially depends on the company's ability to raise fresh capital.
- **Enhanced capability to boost ViTELS revenues.** Acquisition of Aban Informatics (P) Ltd. greatly enhances Everonn's business prospects in the "Smart Classrooms" business segment. The company is now on better footing to compete with Educomp's SmartClass product. We believe ViTELS will be Everonn's fastest-growing business. This segment's share in total revenues should rise from 31% in FY07 to 45% in FY12.
- **Need to raise US\$50-75mn fresh capital soon.** The company raised INR500mn in its July 2007 IPO. However, currently, Everonn has less than US\$4mn cash in hand. We expect Everonn's revenues to expand at an 81% CAGR between FY2006/07 and FY2009/2010, and exponential business growth would expand the company's working capital requirements at a 100% CAGR during this period, in our view.
- **Less prone to economic cyclicality.** Amid our less enthusiastic equity market outlook on India, we believe that the education sector should fare relatively well, with its fundamentals less susceptible to the broader economic down cycle.

Valuation/Risks

Our price target for Everonn is based on P/E and PEG multiple measures — benchmarked against Educomp's valuations. At our price target of INR975, the stock would quote at a PEG multiple of 0.5x on FY2009/10, and at 40x March 2010 earnings. Risks include a delay in raising capital, which would constrain ESIL's growth prospects and profitability. The IEIS business segment is dependent on government policy. Everonn is yet to prove its capability in the Smart Classroom segment. The initial few contracts, beyond its existing contract with 120 schools in Tamil Nadu, may pose a considerable hurdle.

Executive Summary: Everonn Systems Limited (ESIL IN)

Everonn is India's second-largest technology-aided knowledge services company, offering comprehensive learning solutions across the education value chain. The company has two broad business verticals — IEIS and ViTELS. The IEIS business segment caters to computer education needs in government schools. The other business unit, ViTELS, develops and provides software educational contents and technology services to private schools, colleges, and corporate entities.

The leading players in the ICT business segment are in a sweet spot. Currently around 45,000 schools are under the ICT (Information and Communication Technology) program, and another 29,000 fresh ICT tenders should be launched during FY2008/09. **We expect robust revenue growth in this segment in coming years.** Educomp leads the ICT education market with 14% market share, followed by Everonn and NIIT with 7% and 6.7% market shares, respectively. Everonn has ICT contracts across nine states, covering more than 3,000 schools in India. The IEIS business segment contributed 69% of the company's total revenues in FY2007.

Cash-Constrained ICT Segment's Growth. The ICT business for public schools is a highly competitive business segment, and order execution is capital intensive. ICT service providers are all "price-takers." Everonn has been a slow mover in the ICT segment, compared to Educomp Solutions (EDSL IN, INR4362.6, Underperform). **Everonn's business growth was constrained by lack of capital, and future growth crucially depends on the company's ability to raise fresh capital.**

Enhanced Capability to Boost ViTELS Revenues. The key disadvantage of Everonn's ViTELS model for schools with virtual classrooms was that it challenged the authorities of participating school teachers, with the virtual classrooms controlled by the 'star' teachers. In contrast, Educomp's SmartClass *supplemented* classroom teachings with software audiovisual content that made life easier for individual teachers in subscribing classes. We believe that the rights to the content library for K–12 curriculum that came with the **acquisition of Aban Informatics (P) Ltd. should greatly enhance Everonn's business prospects in the "Smart Classrooms" business segment.** The company is now on better footing to compete with Educomp's SmartClass product. We believe that ViTELS will be Everonn's fastest-growing business. We estimate this segment's share in total revenues will rise from 31% in FY2007 to 45% in FY2012.

Everonn Needs to Raise US\$50–\$75mn of Fresh Capital Soon. The company raised INR500mn (US\$12.2mn) in July 2007, through an initial public offering. Currently, Everonn has less than US\$4mn cash in hand, and exponential business growth would expand the company's working capital requirements at a CAGR of 100% between 2007 and 2010, in our view.

Less susceptible to economic down cycle. Amid our less enthusiastic equity market outlook on India, we believe that the education sector should fare relatively well, with its fundamentals less susceptible to any possible broader economic down cycle.

Valuation

Everonn has a truly scalable and more robust education business model including VSAT and internet technology, while Educomp is charting out ambitious brick-and-mortar K–12 schools business — where margins may suffer, in our view. Our price target for Everonn is based on P/E and PEG multiple measures — benchmarking against Educomp's valuations. At our price target the stock would quote at a PEG multiple of 0.5x on FY2009/10. Everonn quotes at 63x March 2009 earnings and 35x March 2010 earnings, respectively. At our price target of INR975/share, the stock would quote at 73x March 2009 earnings and 40x March 2010 earnings. We expect Everonn's revenues to expand at an 81% CAGR between FY2006/07 and FY2009/2010.

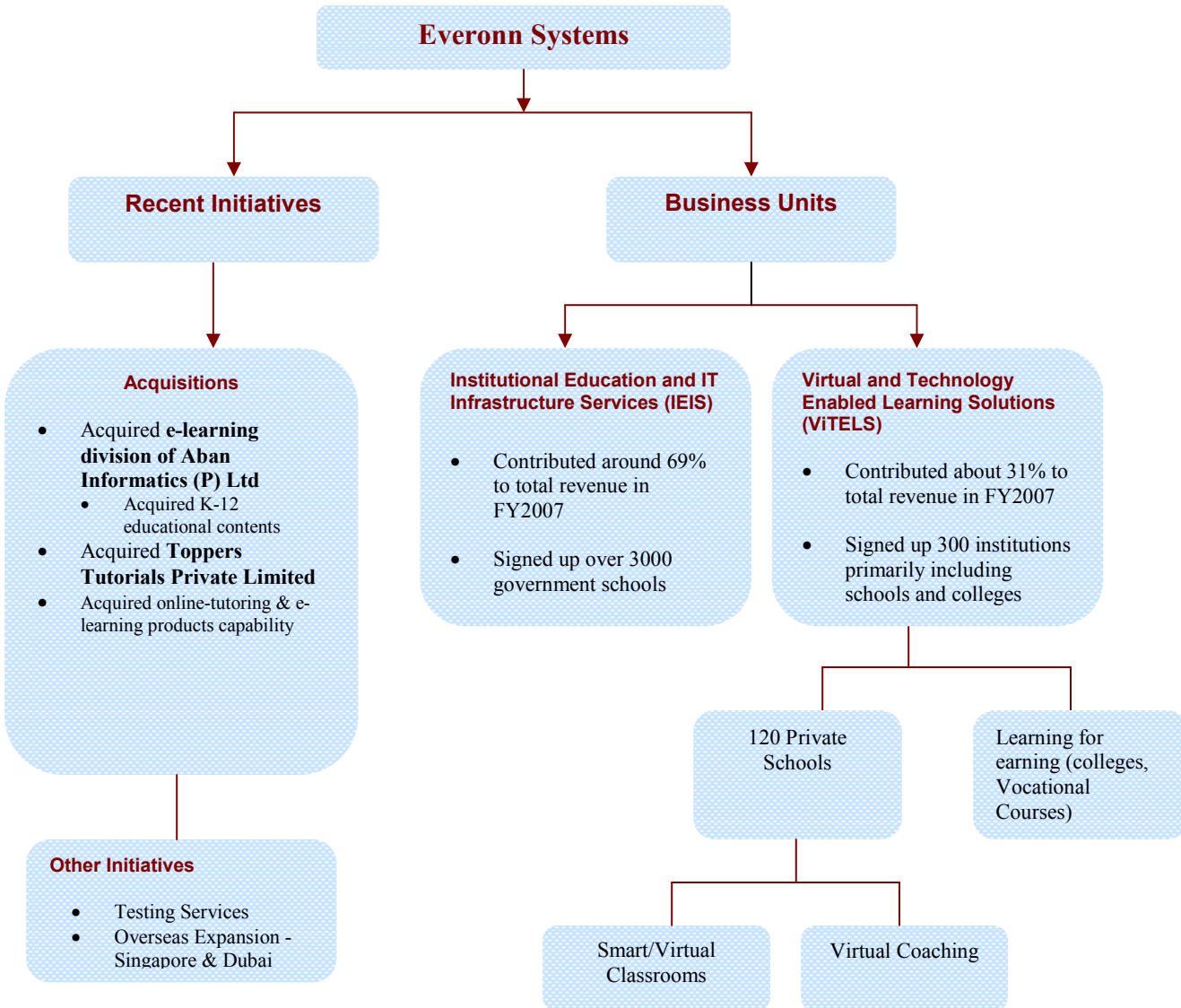
Investment Risks

A delay in raising capital will constrain the company's growth prospects and profitability. The IEIS business segment is dependent on government policy and the pace of implementation of stated federal plans — the process involves bureaucratic red tape, renewal uncertainties, and, last but not least, political bearings at the local and regional levels. Forward projections in this business segment can have large margins of error. Everonn is yet to prove its capability in the "Smart Classroom" segment and compete against more established Educomp solutions. The initial few contracts, beyond its existing contract with 120 schools in Tamil Nadu, may pose a considerable hurdle.

Everonn Systems: Business Model and Product Line

Everonn is India’s second-largest technology-aided knowledge services company, offering comprehensive learning solutions across the education value chain. The company has two broad business verticals — IEIS and ViTELS. The IEIS business segment caters to computer education needs in government-funded public schools. Everonn’s other business unit, ViTELS, develops and provides software educational contents and technology services at private schools, colleges, and corporate entities using *very small aperture terminal* (VSAT) linkages, as well as on-site intranet facilities. More recently, the company has further expanded the ViTELS business segment to include retail (B-to-C) initiatives including e-learning and online tutoring services. **Everonn’s product capabilities have been enhanced by two key recent acquisitions — Toppers Tutorials and Aban Infomatics (P) Ltd.**

Chart 1: Everonn’s Current Business Model and Future Plans

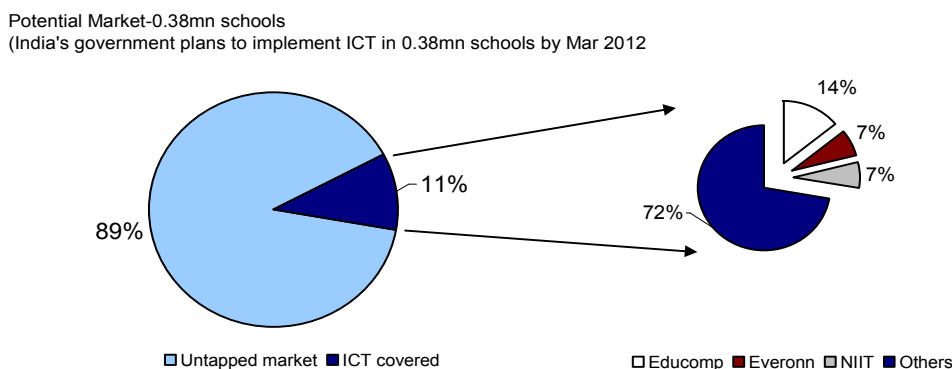


Source: Company data; Jefferies Research

A. Institutional Education and IT Infrastructure Services (IEIS)

Education has moved up in India's public spending priority list. The government plans to boost education spending from the current 2.8% of GDP to a targeted 6% of GDP by March 2012¹. The government also has robust spending plans to wire-up public schools, and the federal budget for Instructional Computing and technology (ICT) implementation during the Eleventh Five Year Plan (2007–12) tops INR290bn (US\$7.25bn). The government also plans to allocate INR740mn during the plan period to provide training and technology education for school teachers. Regional and local governments' resources would further supplement the federal education budget. Currently around 45,000 schools have already come under the ICT program, and another 29,000 fresh ICT tenders would be launched during FY2008/09. **Thus, the leading players in the ICT business segment are in a sweet spot. We expect robust revenue growth in this segment in the coming years.** Educomp leads the ICT education market with 14% market share, followed by Everonn and NIIT (NIIT IN, INR120.9, NC) with 7% and 6.7% market shares, respectively.

Chart 2: IEIS – Potential Market Size and Competitive Landscape



Source: Company data; Jefferies Research

Everonn has IEIS (ICT) contracts spread across nine states, covering more than 3,000 schools in India. The IEIS business segment contributed 69% of the company's total revenues in FY2007. Under this segment, Everonn provides complete infrastructure — including hardware, software, computer instructors, and staff support, for computer training courses in government schools. The company operates with a BOOT (build-operate-own-transfer) model, entering into a three- to five-year contract with the schools. Each school requires 5–15 computers, and the ownership of the hardware infrastructure is typically transferred to the school's management at the end of the contract period. However, the schools also have the option to buy the hardware infrastructure upfront, and enter into a service contract with the company to run the instruction courses². Hardware implementation takes about a month for fresh contracts, and the cost per school ranges from INR0.2mn to INR0.6mn, depending on the contract details. The infrastructure sale component has low margins and the profitability of service contracts depends on the scale and size of the contracts.

The Instructional Computing and technology (ICT) business for government schools is a highly competitive business segment, and order execution is capital intensive. Everonn competes with Educomp, NIIT, and a host of regional and local service providers, and the ICT service providers are all "price-takers." **Everonn has been a slow mover in the ICT segment, compared with Educomp Solution.** Everonn ventured into this segment in 1998 and currently has only 3,156 school contracts. In comparison, Educomp, making an entry well after Everonn, has already secured more than 6,000 school ICT contracts. Everonn's business growth was constrained by lack of capital. Future growth will crucially depend on the company's ability to raise fresh capital.

¹ Source: Economic Survey 2006-07

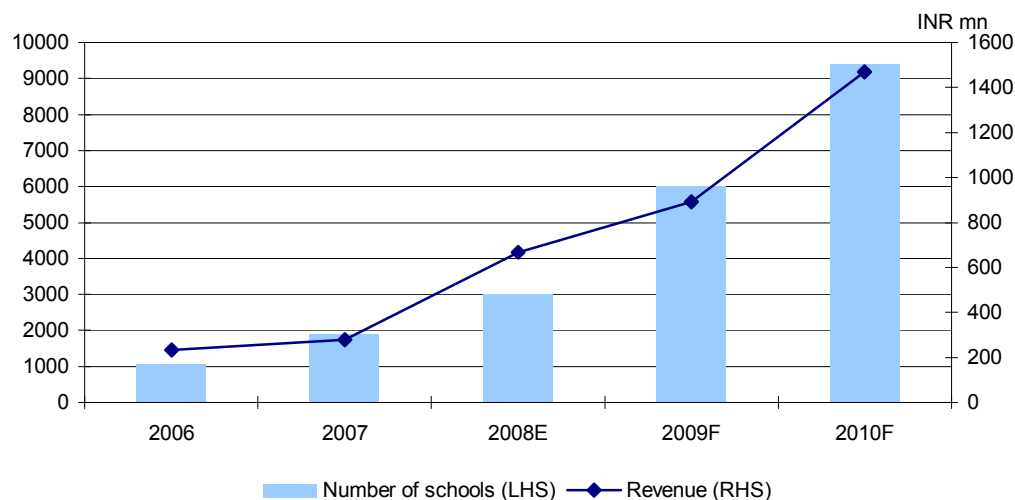
² The recent Gujarat Government's ICT contract involved upfront sale of hardware

Table 1: IEIS Segment- States and Number of Schools Under Contract with Everonn

State Government	Number of schools
West Bengal	555
Delhi	267
UP	223
Goa	238
Karnataka	216
Jharkhand	206
Andhra Pradesh	183
Andaman	12
Gujarat	1256
Total schools signed up under IEIS	3156

Source: Company data; Jefferies Research

ICT contracts are typically awarded at the state level, through a competitive bidding process that requires pre-qualifications. Thus the order sizes are large and result in lumpy revenues. We highlight that the “infrastructure sale” component of the ICT business inflates the top line of the service providers during growth phase. The “front ended revenue recognition” of hardware sales for multi-year contracts results in deceiving growth rates. We also note that the ICT contract renewals are not automatic, and require fresh tender/bidding. It is interesting to note that Everonn’s first ICT contract with the state of Tamil Nadu did not get renewed. However, the company’s IEIS business has gathered considerable momentum in FY2007/08, adding more than 1,200 new school contracts during the fiscal year. The ICT business contracts require upfront capital expenditure for the company on installation of hardware infrastructure, unless the schools buy the infrastructure. **Everonn would need as much as INR2.7bn over the next three years to fund business growth in the IEIS segment, in our view.** Equity would be the natural funding path, given valuations.

Chart 3: Everonn’s IEIS Segment – Projections

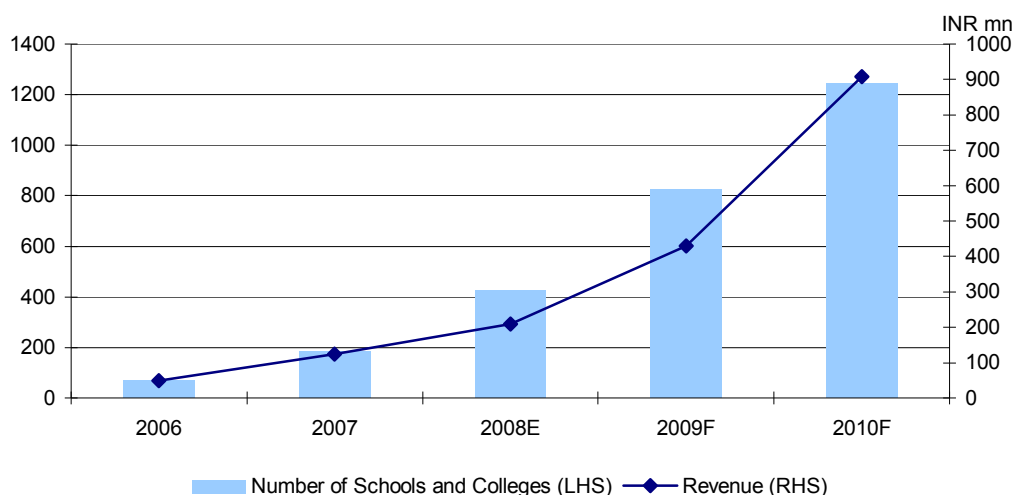
Source: Company data; Jefferies Research

B. Virtual and Technology Enabled Learning Solutions (ViTELS)

The ViTELS programs are live and interactive, and the business model is unique and scalable. Everonn sets up virtual classrooms and delivers interactive educational content from studios to remote learning centers, via satellite linkages. The satellite-based learning model is unique, and scalable — both in terms of enrollments and geographic reach. The company currently has three studios in Chennai, and plans to set up five more in different locations. Presently Everonn has dominance in the Southern states in India, but with an increasing number of studios, the company should be able to spread its reach in the other parts of the country. The VSAT-based virtual classrooms would enable students, spread across the country, to attend and (virtually) participate in classes conducted by “star” teachers.

The company charges monthly subscriptions based on student enrollments. Presently, Everonn has subscriptions from more than 300 institutions primarily including private schools and colleges. Everonn enjoys the first-mover’s advantages in this segment, and does not have any direct competition at this point. Management aims to raise the number of institutions under this program to 1,000 by FY2008/09. The ViTELS program includes both curriculum and supplementary courses for school students (Smart Classrooms); in addition ViTELS also offers vocational courses in colleges, corporate training sessions, and short-term diploma courses.

Chart 4: Everonn’s ViTELS Segment – Our Projections



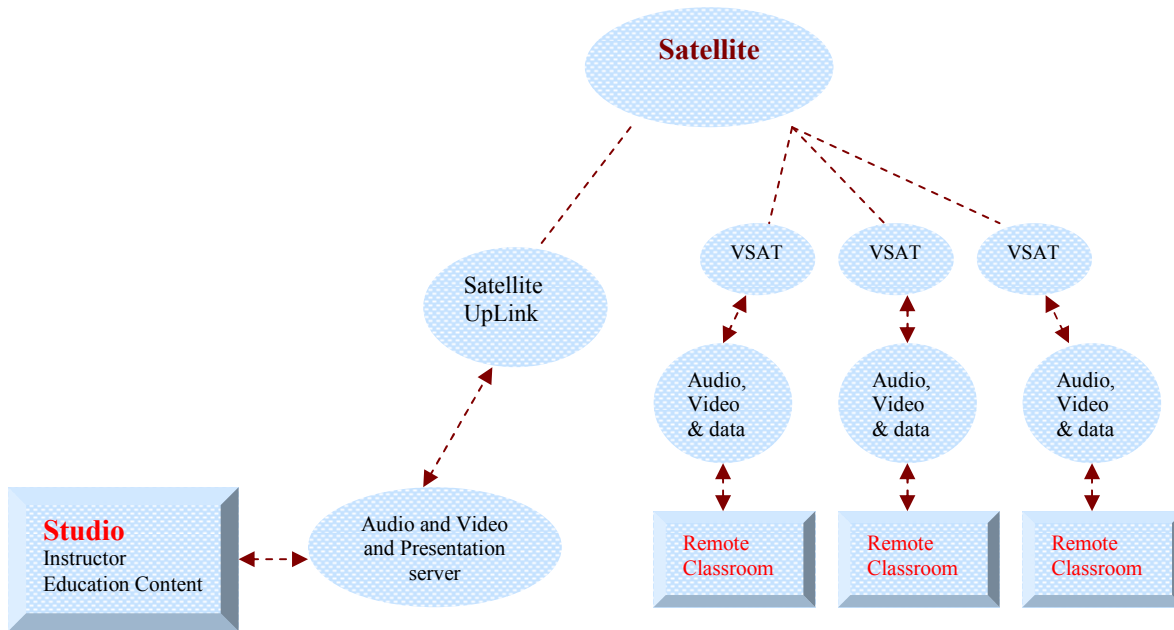
Source: Company data; Jefferies Research

The key disadvantage of Everonn’s ViTELS model and virtual classrooms for the “Smart Classroom” business, in our view, was that it threatened or challenged somewhat the authority of participating school teachers, with virtual classrooms controlled by the “star” teachers. In contrast, Educomp’s SmartClass *supplemented* classroom teachings with software audiovisual content that made life easier for individual teachers in subscribing classes. Teachers’ inhibition against the concept of virtual classrooms restricted the growth in ViTELS school enrolments. While Educomp’s SmartClass product presently services more than 650 schools, Everonn has only 120 schools enrolled that began as a pilot project.

We believe that the rights to the content library for K–12 curriculum that came with the **acquisition of Aban Informatics (P) Ltd.** would greatly enhance Everonn’s business prospects in the “Smart Classrooms” business segment; our projections (see chart above) incorporate that. **There are more than 50,000 private schools in India, and we believe that more than 5000 schools (10% of the population) are currently potential candidates for the ‘Smart Classroom’ business** (note that Educomp already has more than 13% share of that market). **We expect Everonn’s revenues in this segment to expand at a CAGR of 104% during FY2010–12 to reach INR1.27bn.**

The satellite-linked studios typically comprise a control room, administrator terminal, presentation server, and other communication equipments, and require a capital expenditure of approximately INR10–15mn. A typical classroom is wired with VSAT satellite linkages, computer system, and a projector. The hardware infrastructure costs to set up a ViTELS classroom vary between INR0.25–0.30mn.

Chart 5: ViTELS- VSAT-Based Delivery Model



Source: Company data; Jefferies Research

Everonn defines its colleges and corporate training segment as the “learning for earning segment.” This segment of ViTELS focuses on enhancing employability skills of the subjects by offering language and communication courses and various technical and vocational courses.

Everonn leases satellite linkage capability from Hughes Communication India Ltd, and also partners with the company for the Hughes Net (Direcway) Global Education services in the southern parts of India. The Hughes Direcway offers distance learning programs that have tie-ups with reputable management institutes. The program runs 10 franchisee-run learning centers for the virtual classrooms, and has more than 500 registered students.

Table 2: List of Some Institutes Working in Partnership With Hughes Net (Direcway)

- Indian Institute of Management, Bangalore (IIMB)
- Indian Institute of Management, Kolkata (IIMC)
- Indian Institute of Foreign Trade (IIFT)
- Xavier Labour Research Institute (XLRI), Jamshedpur
- Indian Institute of Management, Kozhikode (IIMK)

Source: Company data; Jefferies Research

C. New Ventures and Key Acquisitions – *Unleashing the Growth Potential*

Smart Classroom Product Capability with “Aban” Acquisition

Everonn acquired the e-learning division of Chennai-based Aban Informatics (P) Ltd in January 2008, paying INR73mn (US\$1.83mn) in cash. The acquired division owned an education portal, “Classontheweb.com,” launched in 2000. The portal hosted highly animated educational content of curriculums for grades VI to XII. With this acquisition, Everonn also secured access to over 30,000 students in the 40 schools registered with Aban.

We maintain that the above acquisition greatly enhances Everonn’s product capability. The company is now on better footing to compete with Educomp’s SmartClass product. Everonn plans to offer course contents to its existing schools signed up for the ViTELS virtual classroom programs. The company will set up hardware infrastructure in 10–20 classrooms per subscribing school, depending on enrollments. Management plans to implement the new model offering software content, supplementing teachers, to navigate school curriculum through grades 6 to 12. The product would be similar to Educomp’s SmartClass. In addition, Everonn would continue to offer the virtual classroom option for special and advanced classes, allowing students to participate in inter-school interactive lesson sessions conducted by acclaimed and reputable teachers. The latter would be Everonn’s edge over Educomp in the “Smart Classroom” business segment, in our view.

Everonn plans to charge monthly fees of around INR120–150 per student for its Smart Classroom product under ViTELS business segment. The company expects to register an average of 700–750 students per school. **We expect Everonn’s revenues in this segment to expand at a CAGR of 104% during FY2010–12 to reach INR1.27bn.** We believe that the company will need around INR1bn in the next three years to wire up schools under this new model.

Toppers Tutorials Private Limited

Everonn acquired a Patna-based coaching company, Toppers Tutorials Private Limited (TTPL), in February 2008. TTPL prepares students for the entrance examinations for engineering colleges like the Indian Institute of Technology, and local and regional engineering colleges. We do not have the details of the economics of this acquisition. With this acquisition, Everonn would be capable of offering online tutoring for competitive college entrance examinations.

School Management

Everonn has signed a Memorandum of Understanding (MOU) with Heavy Alloy Penetrator Project (HAPP) in Tamil Nadu to manage the entire school operations. The school has 350 students enrolled from Class I-X. The company will manage all aspects of the operation of the schools including appointment of teachers, teaching methods, administration, and other functions. The revenue will come from the students’ fee collected, of which the company will charge all the operating cost along with paying lease rental to the owner of the school. The company has not disclosed financial details of this model; hence, this is not incorporated in our price target. The company does not have any plan to build its own schools at the moment, but intends to move ahead step by step by first gaining experience in school management.

Testing Centers

Everonn is collaborating with Educational Testing Services, US (ETS) to administer TOEFL (Test of English as a Foreign Language) and GRE (Graduate Record Examination) tests in India. Everonn is a Certified Test Administrator Site (CATS) with ETS. Everonn has 42 testing centers in India. The company has also partnered with ETS to promote and market various English language learning products. Everonn also conducts certification tests administered by Prometric through its testing centers for certification examinations offered by Microsoft, IBM, SUN Microsystems, CompTIA, APPLE, EXIN, TERA Data, etc.

Overseas Expansion

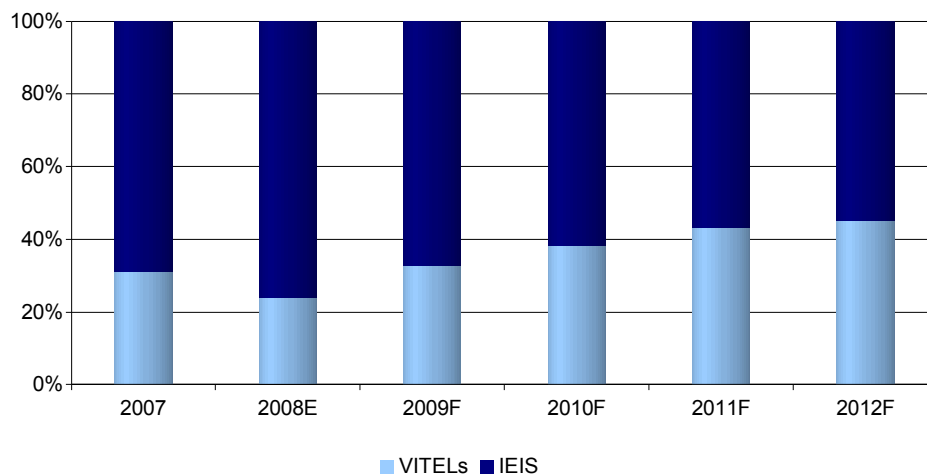
Everonn plans to expand in Singapore and Dubai through its ViTELS and e-learning initiative. The company will be setting up a studio for ViTELS classes in Singapore. It has already entered a strategic alliance with Centre of Excellence, an affiliate of PMC School of Logistics in Singapore. Through this alliance, Everonn plans to expand in other Southeast Asian countries.

Change in Revenue Mix

VITeLS to Lead Growth With Enhanced Product Capability

The revenue composition that is skewed in favor of IEIS at present probably will change in the coming years, in our view. We believe that ViTeLS will be the fastest-growing business segment backed by an increasing number of studios and institutes, and with the new content-based “Smart Classroom” product capability. This segment’s share in total revenues is expected to rise from 31% in FY2007 to 45% in FY2012.

Chart 6: Everonn Revenue Composition



Source: Company data; Jefferies Research

Need to Raise Fresh Capital

Background: IPO Funds Absorbed

Everonn’s INR500mn IPO in July 2007 was 30x oversubscribed, and the stock ended up 242% on the first trading day of listing on August 1, 2007. Inadequate cash reserves have constrained the company’s ability to leverage and fund business growth, in our view.

Business Expansion Would Require Fresh Capital Infusion

Everonn has less than US\$4mn cash in hand, and exponential business growth would expand the company’s working capital requirements at a CAGR of 100% between 2007 and 2010, in our view. **The company needs to raise US\$50–\$75mn of fresh capital sooner rather than later.** Everonn’s stock price has corrected 35% since the recent January 2008 peak. An equity or equity-linked capital raising plan remains the only feasible option, despite the sharp correction in stock price.

Raising fresh capital with a secondary equity offering or with an equity-linked issue would neither be easy nor ideal under current market circumstances. However, debt would be a very expensive option — hurting the company’s profitability. Nonetheless, our model assumes equity dilution in FY2008/09 to raise INR2bn (US\$50mn, approx.)

Backed by Long-term Institutional Investors

Everonn’s key investors include India China Pre-IPO Equity Fund (owned by Singapore’s Temasek Holding), JP Morgan Asset Management Co., Birla Sun Life Asset Management Co., and Life Insurance Co. Mutual Fund of India, among other local and foreign institutional investors.

Peer Comparison

High-Margins Business

Knowledge management and IT-enabled education services companies typically enjoy higher margins than the IT/Software training companies like NIIT and Aptech (see table below). The relatively higher margins in education business primarily reflect the less competitive early-stage market evolution. Further, the government's direct positive initiatives have significantly boosted market opportunities for the IT-enabled education companies. Everonn's EBITDA margins are comparable to the sector leader Educomp's; however, the former's net income margins are lower because of its higher cost of capital and low cash reserves position. On a relatively lower base, we expect Everonn's revenue growth to outstrip that of Educomp's in the coming years. Further, if Everonn manages to raise fresh funds through equity dilution, its margins would significantly improve in the coming years with an improved scale of operations. We expect Everonn's net profit margins to improve from 12% in 2007 to 16.2% in 2010.

Table 3: Peer Comparison

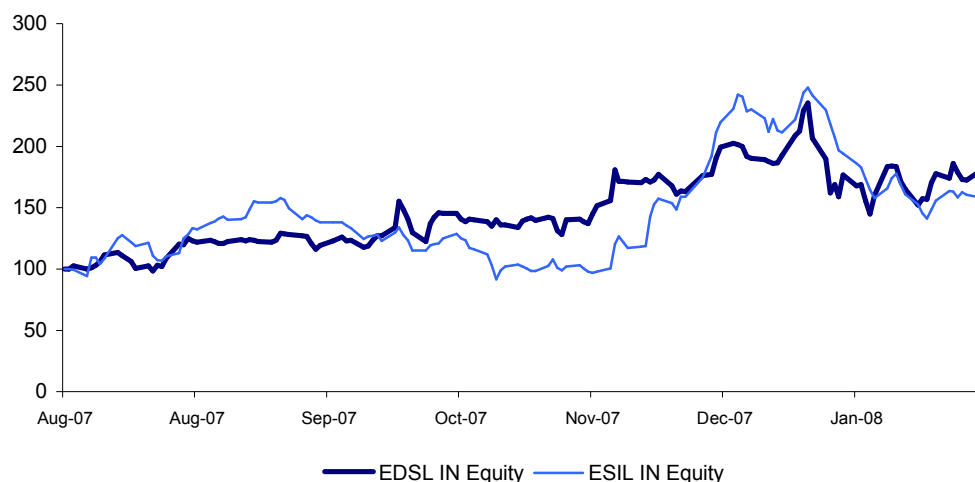
Company	Bloomberg Ticker	Current Market Cap (US\$ mn)	Net Sales (US\$m)	EBITDA margin	Net margin	Forward P/E (FY2009)	EV/Sales	EV/EBITDA
Educomp Solutions	EDSL IN Equity	1,800	28	47.7%	26.1%	62.7	67.4	141.2
NIIT Limited	NIIT IN Equity	458	199	8.5%	7.2%	17.9	2.7	31.8
Aptech Limited	APTR IN Equity	237	44	21.6%	9.3%	52.1*	5.6	26.0
New Oriental Education & Technology group	EDU US Equity	2,001	136	32.0%	21.7%	32.4	14.7	152.1
Everonn Systems	ESIL IN Equity	261	10	44.6%	16.2%**	73.3	26.5	59.3

* The forward P/E for Aptech is not available on Bloomberg; therefore we have taken the actual P/E from Bloomberg

** Everonn's net margin pertains to FY2010F

Source: Bloomberg; Jefferies Research

Chart 7: Price Performance EDSL vs. ESIL (since listing) – Normalized Chart



Source: Bloomberg; Jefferies Research; Note: Data starts from Aug 2, 2007 closing prices (eliminating the Aug 1 first trading day's 241.8% jump in ESIL's price)

Sector less susceptible to economic down cycle. Amid our less enthusiastic equity market outlook on India, we believe that the education sector should fare relatively well, with its fundamentals less susceptible to any possible broader economic down cycle.

Table 4: Everonn Income Statement

INR mn	2006	2007	2008E	2009F	2010F
Revenue	281.4	403.4	877.4	1320.7	2378.5
Manpower	52.8	75.9	108.4	215.2	384.6
Education and training expenses	110.0	176.0	468.4	605.0	999.2
Deferred revenue expenditure	2.8	2.3	6.8	10.2	18.3
Depreciation & amortisation	45.6	84.4	99.0	222.1	454.9
Total expenditure	211.2	338.6	682.6	1052.5	1857.1
Operating income	70.2	64.8	194.8	268.2	521.4
Interest and finance charges/(income)	15.5	23.4	28.5	-60.2	-72.8
Earnings before tax	82.6	70.8	166.3	328.4	594.2
Tax	33.5	22.3	58.5	115.6	209.1
Net Income	49.1	48.6	107.8	212.8	385.1
Basic EPS	6.6	5.6	7.8	13.0	23.5
Diluted EPS	6.6	5.6	7.8	13.0	23.5
Weighted average of basic number of shares (in mn)	7.4	8.6	13.9	16.4	16.4
Weighted average of diluted number of shares (in mn)	7.4	8.6	13.9	16.4	16.4
P/E at Target Price			125.3	75.2	41.6
P/E at Current Market Price			105.6	63.4	35.0

Source: Company data; Jefferies Research

Table 5: Key Numbers and Key Ratios

INR mn	2006	2007	2008E	2009F	2010F
Revenue	281.4	403.4	877.4	1320.7	2378.5
Operating Income	70.2	64.8	194.8	268.2	521.4
EBIT	98.1	95.7	187.2	341.1	599.7
EBITDA	143.7	180.1	286.3	563.2	1054.6
Net Profit	49.1	48.6	107.8	212.8	385.1
Total Share Capital Equity	180.4	365.9	935.6	3129.7	3496.1
Total Debt	268.9	235.4	151.7	82.3	285.0
Total Assets	583.9	749.0	1380.5	3641.6	4511.6
Cash Balance	29.7	42.2	145.7	1062.0	10.0
<i>Operating margin</i>	<i>24.9%</i>	<i>16.1%</i>	<i>22.2%</i>	<i>20.3%</i>	<i>21.9%</i>
<i>EBITDA margin</i>	<i>51.1%</i>	<i>44.6%</i>	<i>32.6%</i>	<i>42.6%</i>	<i>44.3%</i>
<i>Net margin</i>	<i>17.4%</i>	<i>12.0%</i>	<i>12.3%</i>	<i>16.1%</i>	<i>16.2%</i>
<i>Return on Assets</i>	<i>11.3%</i>	<i>7.3%</i>	<i>10.1%</i>	<i>8.5%</i>	<i>9.4%</i>
<i>Return on Equity</i>	<i>31.3%</i>	<i>17.8%</i>	<i>16.6%</i>	<i>10.5%</i>	<i>11.6%</i>
<i>Debt/Equity</i>	<i>1.49</i>	<i>0.64</i>	<i>0.16</i>	<i>0.03</i>	<i>0.08</i>
<i>Current Ratio</i>	<i>3.3</i>	<i>5.2</i>	<i>4.6</i>	<i>7.4</i>	<i>3.9</i>

Source: Company data; Jefferies Research

Valuation and Investment Risks

Educomp vs. Everonn

Educomp is India's largest education company — its top line for the fiscal year ending March 2007 was 2.7x that of Everonn's, and Educomp enjoys higher net income margins. Hence, Educomp deserves to get a premium over Everonn's valuations. On the other hand, Everonn is now better equipped to compete with Educomp with its recent acquisitions and K–12 contents capabilities. Further, we expect the company to raise fresh capital to fund the business expansion optimally. Thus, Everonn's revenue prospects have greatly improved both in the IEIS segment as well as in the VITELS segment. As investors become more cognizant of the enhancement in Everonn's revenue model, and the improved growth and profitability prospects — the company's valuation multiples should expand. We also note that Everonn has a truly scalable and more robust education business model including VSAT and internet technology, while Educomp is charting out ambitious brick-and-mortar K–12 schools business, where margins may suffer in our view. Nonetheless, the supply-overhang of Everonn's fresh capital issue may hurt investors' sentiment in the near term.

Everonn's stock has corrected 34.5% since the recent January 17, 2008, high — creating opportunity for fresh entry. We note that Everonn's *enhanced business model* should yield full results next year, and thus one needs to take a longer-term perspective and look at FY2009/10 earnings. We expect modest multiple expansion for the company, as investors get more aware and confident of Everonn's growth prospects in the coming quarters. Our price target for Everonn is based on P/E and PEG multiple measures — benchmarking against Educomp's valuations. Everonn quotes at 63x March 2009 earnings and 35x March 2010 earnings, respectively. At our price target of INR975/share, the stock would quote at 73x March 2009 earnings and 40x March 2010 earnings. We expect Everonn's net income to expand at a 99% CAGR between FY2006/07 and FY2009/2010. At our price target the stock would command a PEG multiple of 0.5x on FY2009/10.

Table 6: Everonn Stock Valuation

	Everonn At Current Mkt Pr	Educomp At Current Mkt Pr	Everonn At Target Pr	Everonn's Valuation Premium (+)/Discount (-) over Educomp's at Target Pr
Multiple on Mar 2009 earnings	60.9	62.7	73.3	
Multiple on Mar 2010 earnings	33.6	44.8	40.5	-9.5%
PEG: FY2010	0.42	1.1	0.50	-55.3%

Multiple comparable to Educomp's on 2009 earnings

Enhanced business model to boost 2010

Our forecasts incorporate Everonn's enhanced business model. We expect the company's net income to jump 81% in FY2009/10. Hence the "PEG" is attractive ...

Source: Company data; Jefferies Research

India's education sector valuations are rich. Investors' interest stems from the sector's high growth rates, enormous market potential, and limited competition. However, we believe that the sector's margins will continuously come under pressure with rising competition, and the growth rates would start tapering off for most companies beyond FY2011/2012 — warranting a contraction in valuation multiples well ahead of that.

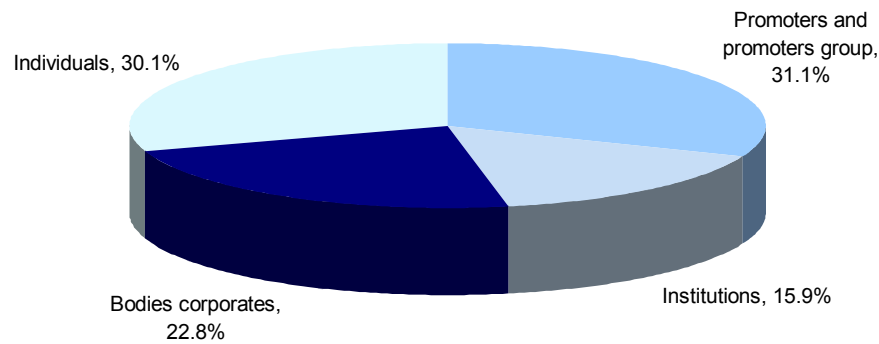
Everonn needs to raise US\$50–\$75mn as soon as feasible to scale up its business, in our view. A delay in raising capital will constrain the company's growth prospects and profitability. The IEIS business segment is dependent on government policy and the pace of implementation of stated federal plans — the process involves bureaucratic red tape, renewal uncertainties, and, last but not least, political bearings at the local and regional levels. Forward projections in this business segment can have large margins of error. Everonn is yet to prove its capability in the "Smart Classroom" segment and compete against the more established Educomp solutions. The initial few contracts, beyond its existing contract with 120 schools in Tamil Nadu, may pose a considerable hurdle, in our view.

Appendix

Table I: Fact Sheet

Everonn- Fact Sheet	
Business Description	Everonn is a knowledge management and education company. The company develops and provides educational contents through satellite to schools, colleges, retail and corporate. It also set up the infrastructure and provides computer education to government schools
Segment	<p>Everonn has two business segments: IEIS and VITELs</p> <p>* IEIS- This segment basically caters to government schools. It set up the infrastructure and provides computer education on a contractual basis.</p> <p>* VITELs- Through this segment, the company develops and provides educational contents through satellite.</p>
Year of Incorporation	Incorporated as Public Limited Company in FY2000
Stock Listing	BSE, NSE
Registered Office	Chennai

Source: Company data

Chart I: Shareholding Pattern (as on 31 Dec 2007)


Source: BSE

Table II: Board of Directors

Name	Designation	Status	Age	Brief Profile
Mr. P. Kishore	Managing Director	Executive	45	He holds a diploma in commerce and is the promoter of Everron. He started Everron in 1987 and is responsible for setting the mission and goals of the company.
Mr. R. Kannan	Director cum Consultant	Non-Executive	44	He holds a CA degree and has 19 years of experience in project funding, taxation, and audit.
Ms. Susha John	Whole Time Director	Executive	41	She has 17 years of experience in the field of computer education. She is responsible for the overall business planning and operation and entering into contracts with schools.
Mr. R. Sankaran	Director	Non-Executive and Independent	73	He holds a CA degree and has over 40 years of experience in financial management. He was Senior Financial Advisor in Tata Iron and Steel Company Ltd.
Dr. VK Vijavaraghavan	Director	Non-Executive and Independent	49	He is a post graduate in chemistry and has worked for Procter and Gamble.
Mr. Joe Thomas	Director	Non-Executive and Independent	76	He is an M. Tech from IIT Kharagpur and has served many universities in India and abroad as professor.
Dr. KM Marimuthu	Director	Non-Executive and Independent	72	He is a PhD from Bombay universities. He has worked in the pharmaceutical division of Rallis India Ltd. and became Executive Director of Protein Products of India.

Source: Company data

Company Description

Everonn Systems India Ltd. offers technology-enabled knowledge management and learning solutions in India.

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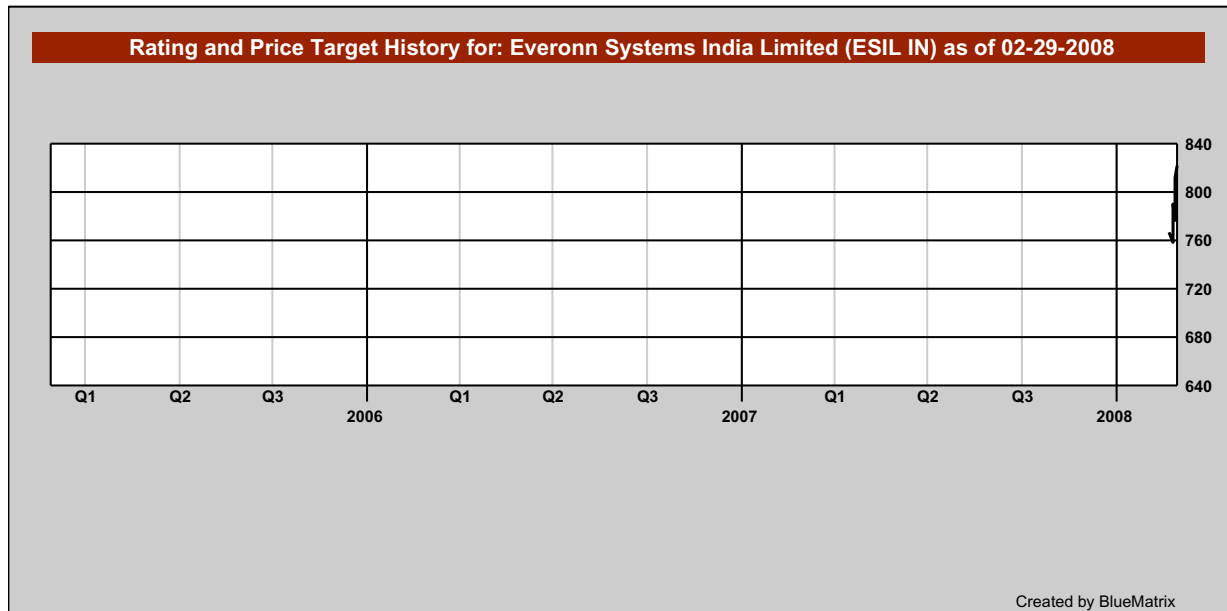
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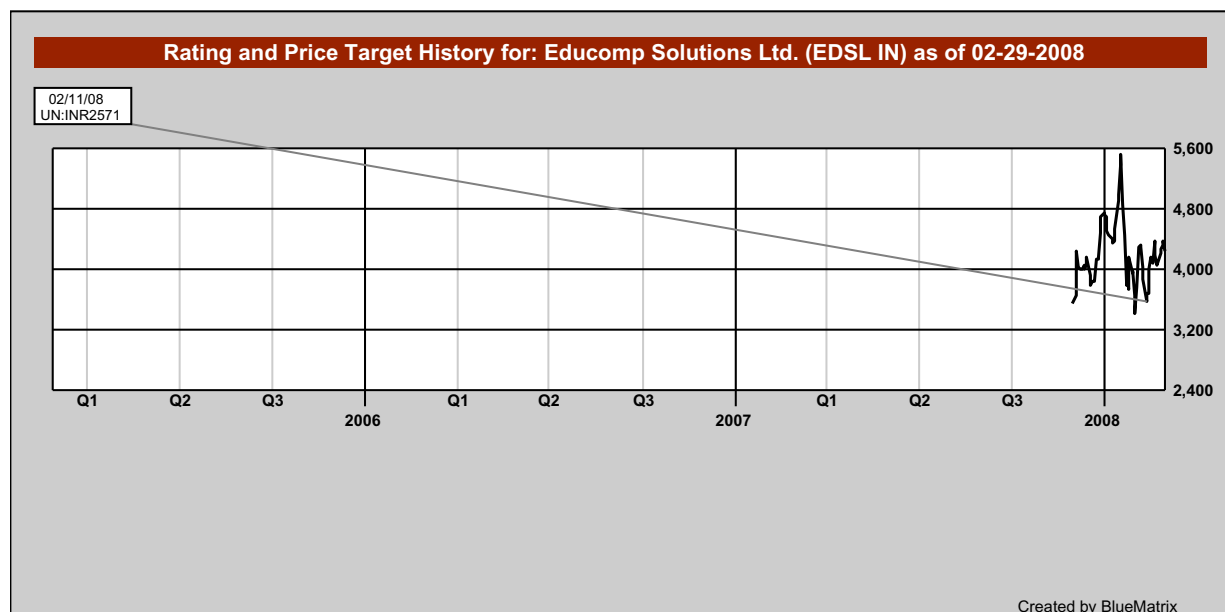
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			Count	Percent
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