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ILX Group* - Final Results Initiate Coverage: Buy at 21.5p with a 47.1p target price

The publication of results for the year to March 31st 2010 by vocational training provider ILX Group contained no surprises at a trading level but demonstrated once again how cash generative this business is and how it has transformed itself during the past three years from a provider of training services to a creator of e-learning software products. The effect of this transformation is to open up new international prospects for growing sales while also widening margins. There must be some concern that with around 20% of revenues historically generated from sales to the UK public sector, that budget cuts will restrict growth this year. However, we feel that this will be offset by increasing overseas and private sector software sales and, moreover, that any risks to forecasts are more than discounted in an undemanding valuation. We initiate our coverage at 21.5p valuing ILX on a multiple of eight times forecast March 2012 earnings per share of 5.89p, at 47.1p, and at 21.5p our stance is **buy**.

Key	Data
EPIC	ILX
Share Price	21.5p
Spread	20p – 23p
Total Number of issued shares	23.6 million
Market Cap	£5.07 million
12 Month Range	19p – 41p
Market	AIM
Website	www.ilxgroup.com
Sector	Support Services
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In the year to March 31st 2010 revenues at ILX declined from £15.6 million to £14.7 million with the shortfall entirely down to problems within Corporate Training Group the largest part of the Finance Division. Clearly demand for training services in the global investment banking industry was depressed by the general financial malaise but CTG appears to have more fundamental problems and its revenues fell by 40% to £2.8 million to which ILX responded by cutting costs in the second half with a number of measures including the departure of CEO Peter Evans. Despite these moves the company has prudently included a £2.29 million write-down in the carrying value of CTG in its 2010 numbers. Underlying EBITDA fell from £2.22 million to £1.566 million reflecting the reduction in revenues and underlying pre-tax profits fell from £1.7 million to £1.068 million – a fall of 37%.

While the problems at CTG and the general macroeconomic climate might make 2010 a year to forget there are clear positives to be drawn from the numbers, chiefly the strong cash flows generated by the group which allowed ILX, assisted - it should be acknowledged - by a £900,000 placing in January, to repay £1.5 million of its borrowings leaving year end net debt at £3.2 million. This was achieved despite maintaining the dividend at 1.5p per share (which costs around £400,000) and the company states that it intends to maintain that level of payout, while offering a scrip alternative to those who elect to choose it. Perhaps of longer term significance is the increasing proportion of revenues which come from sales of licenses to ILX's increase range of branded e-learning products where it holds the IP - in the year just ended such products accounted for 44% of revenues (up from 34%) and 62% of gross profit (up from 49% in 2008/9). The company continues to launch new software applications based on its management learning tools such as Prince2 - where it is the market leader - and the growth in sales of such products, notably in overseas markets - continues apace in the current year. As the percentage of revenues from software sales as opposed to classroom learning increases we expect the ILX group gross margin also to increase steadily, from the 49% achieved last year.

The company acknowledges that there must be some uncertainty about sales to the UK public sector which accounted for a fifth of group revenues in the year just ended. However its sales are spread across more than 300 different clients and there is some evidence that when headcount is reduced, the need for training actually increases.

At this stage our forecast for current year sales are that in the Best Practice division there will be some reduction in revenues from the UK public sector but that this will be offset by increasing sales, notably of Prince2 product which now generates in excess of 50% of group income, overseas. We do not expect any material pickup in activity in the Financial Services division as the investment banks are yet to start hiring graduate recruits on the scale seen in the past. As such we forecast current year revenues of £15 million and that with a small increase in the gross margin that EBITDA will increase from £1.6 million to £1.8 million while pre-tax profits will increase from £1.1 million to £1.4 million as interest costs are reduced by a further reduction of £1.3 million in net debt. In the year to March 31st 2012 we expect an acceleration of the growth of Best Practice overseas (and corresponding widening of gross margins) and that as a result, sales will increase to £16.2 million, EBITDA to £2.2 million and - as debt is virtually eliminated - pre-tax profits will increase to £1.9 million. Historically ILX has been highly acquisitive but with the strong organic growth at Best Practice and the stated desire to clear borrowings we think further acquisitions are unlikely during the next 18 months.

The tax charge is likely to fall from 30% in the year just ended to 28% this year and to 27% next year in line with the changes announced in the Emergency Budget of 22nd June and hence we forecast that earnings will increase from 3.75p last year to 4.28p this year and to 5.89p in the year to March 31st 2012 which will more than support a maintained 1.5p dividend.

ILX shares have underperformed the small cap market during the past three years but we regard these results as the cue for a material re-rating. Investors who were hitherto unnerved by the high level of debt relative to EBITDA should be comforted that the

debt/EBITDA ratio for last year fell to less than 2 and should be almost down to 1:1 by the end of the current financial year. The company has not always hit forecasts but can now point to having met expectations for two sets of results and a continuation of this trend will provide growing comfort about forward earnings. And the increasing dominance of software sales, rather than low margin, poor visibility classroom learning, within ILX should also add to the attractions of the investment proposition. At 21.5p the shares are underpinned by a safe dividend yield of 6.67% and trade on a derisory current year multiple of 5.02 falling to just 3.65. We value ILX on eight times forecast 2012 earnings of 5.89p, at 47.1p but we regard our forecasts as cautious with regard to UK sales at Best Practice and therefore regard the risks to estimates and valuation as on the upside and we would also argue that if ILX can meet expectations for another two sets of results and continue to clear its borrowings, a further re-rating to a double digit multiple is more than likely and as such our target price should be viewed as a base case scenario. At 21.5p we initiate our coverage with a stance of **buy**.



Forecasts Table

Year to 31 March	Sales (£million)	Pre-Tax Profit (£million)	Earnings Per Share (p)	Price Earning Ratio (x)	Dividend (p)	Yield (%)
2009A	15.6	1.7	6.0	3.58	1.5	6.97
2010A	14.7	1.1	3.75	5.73	1.5	6.97
2011E	15.0	1.4	4.28	5.02	1.5	6.97
2012E	16.2	1.9	5.89	3.65	1.5	6.97

Source: Company and Growth Equities & Company Research

*The SF t1ps Smaller Companies Growth Fund, managed by another subsidiary of Rivington Street Holdings the owner of GE&CR, owns shares in ILX.

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