

## DATAGROUP

### IT services one-stop shop for Mittelstand companies

DATAGROUP has established an interesting niche providing Mittelstand companies with a modular suite of technology solutions. The group's CORBOX "cloud-enabling platform" is highly scalable, benefiting from a centralised approach and employing long-term, fixed-price contracts, which ensure stable recurring revenues (66% of FY16 revenues, which related to 85% of gross profit). This gives DATAGROUP a significant advantage over smaller domestic players, while large international IT services competitors are focusing their energy on larger enterprises.

#### Focusing on long-term, fixed-price contracts

DATAGROUP is a full IT outsourcing provider, focused on the German Mittelstand market. It focuses on three- to five-year fixed-price contracts, targeting companies with 250-5,000 IT users. DATAGROUP believes there is a huge opportunity in the Mittelstand space, as these companies typically rely on their own expensive in-house IT departments and have difficulty adapting to new technologies such as mobility and cloud security. Customers can select from a range of solutions, such as Service Desk, Network Services, Application Management Services and SAP services. These solutions are based on standardised processes that are certified according to ISO 20000 and backed by service level agreements (SLAs). The broad range of services allows customers to fully outsource their IT operations. Much of the work is done remotely, and the group can scale its data centre services and shared services desk to support a large number of customers.

#### Q2 organic growth accelerates to 10%

Organic revenue growth accelerated to 10% in Q2, up from 6% in Q1. Including the HPE acquisition, total revenue lifted by 33% to €54.6m. Q2 EBITDA surged by 77% to €6.3m as the margin rose from 8.6% to 11.5%, reflecting the benefits of the acquisition of IT specialists from Hewlett-Packard. In April the group raised €21.7m (gross) in a capital increase to strengthen the balance sheet to finance further acquisitions. Given the strong performance and the recent HanseCom acquisition, management increased FY17 revenue guidance by €5m and EBITDA by €0.5m.

#### Valuation: Premium reflects strong business drivers

While the shares are trading on more expensive metrics than historically, at 1.4x consensus FY18 sales and 12x EBITDA, the outlook remains underpinned by attractive business drivers, which provides a compelling case for acquisitions.

##### Consensus estimates

| Year end | Revenue (€m) | EBITDA (€m) | EPS (€) | DPS (€) | P/E (x) | Yield (%) |
|----------|--------------|-------------|---------|---------|---------|-----------|
| 09/15    | 157.6        | 15.3        | 0.65    | 0.25    | 57.8    | 0.7       |
| 09/16    | 174.9        | 19.1        | 0.75    | 0.30    | 50.1    | 0.8       |
| 09/17e   | 223.0        | 23.0        | 1.15    | 0.38    | 32.7    | 1.0       |
| 09/18e   | 248.3        | 27.2        | 1.54    | 0.43    | 24.4    | 1.1       |

Source: Thomson Reuters

#### IT services

23 May 2017

Price €37.59  
Market cap €314m

##### Share price graph



##### Share details

Code D6H  
Listing Deutsche Börse Scale (Xetra)  
Shares in issue 8.33m  
Last reported net debt (€m) at 31 March 2017 €23.9m

##### Business description

DATAGROUP is a full IT outsourcing provider, focused on the German Mittelstand market. The company offers the full range of IT services on a modular basis, through its CORBOX "cloud-enabling platform". Services include service desk, end-user services, data centre services, application management and SAP services.

##### Bull

- A compelling growth strategy, scaling the business across the Mittelstand sector.
- Cloud services business model gives it a clear advantage over competitors.
- Centralised SLA-based approach with a focus on customer satisfaction puts company in strong position to consolidate a fragmented market.

##### Bear

- The group's valuation metrics are more expensive than they have been.
- Highly exposed to the German economy.
- Acquisitions bring risks, but DATAGROUP has a proven track record in integrating acquisitions.

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## Company description: IT services one-stop shop for Mittelstand companies

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DATAGROUP is a leading German IT service company with c 1,800 employees based at more than 30 locations across Germany. DATAGROUP designs, implements and operates IT infrastructure and business applications such as SAP. DATAGROUP is a full-service IT provider, through its CORBOX platform, which has c 136 clients, serving more than 600,000 IT workstations across the globe. In addition, the group has many smaller customers (c 100-250 seats), many of which are fixed-term project based, taking the customer base to more than 1,000. DATAGROUP provides IT services according to industry standards, and is certified with ISO 20000 (IT service management) and ISO 27001 (information security management). This differentiates the business from many smaller players.

The group has c 470 IT consultants, c 420 system engineers, c 60 service managers/project managers, c 600 first- or second-level support staff, c 60 trainees and c 170 working in sales, marketing, management and administration.

The group rents space in four data centres. However, it is focusing on two mirrored data centres in Frankfurt where it is renting state-of-the-art co-location facilities of Interxion and Zenium. As DATAGROUP does not own the properties, it can focus on its IT operations without worrying about buildings, climate and electricity and capex requirements are limited to IT infrastructure. Co-location provides DATAGROUP with a state-of-the-art and highly secure data centres facilities and gives it the flexibility to expand its capabilities in line with the requirements of its customers, ie, the facilities are virtually scalable at will. The company's data centre in Bremen will be closed in FY17 while Nuremberg will be closed in the next two years. This will generate annualised savings of at least €0.5m per annum per data centre. Additionally, the HanseCom acquisition has added some small data centre assets that will also be closed.

### Business model

The primary focus is to shift existing customers and new customers with 250-5,000 IT users to the group's CORBOX "cloud enabling platform". With CORBOX, DATAGROUP offers companies a one-stop service for their IT operations. Out of 12 combinable and compatible CORBOX service families, customers choose exactly those services which optimally support their business. Defined service level agreements guarantee maximum performance and cost transparency. DATAGROUP currently has c 136 CORBOX customers paying an average of €0.75m per annum.

There is a transition, or set up, phase, a period of which depends on the complexity of the chosen portfolio of services. If the customer just takes Service Desk, the transition period will be around three months, but if it involves an entire outsourcing, it will typically take six to nine months. The group is on target to onboard 20 new CORBOX customers in FY17, which would take total CORBOX customers to c 144. The group currently has the capacity to onboard 20-25 new customers per year, but onboarding more than that would be challenging, given the current level of resources. As the group's headcount and skills base grows, it will increase its capacity to onboard new customers. This includes acquisitions, which also bring new specialist skills. Customer churn is very low at c 2%, and the vast majority of customers roll onto a second term. Some customers have been with DATAGROUP for more than 20 years.

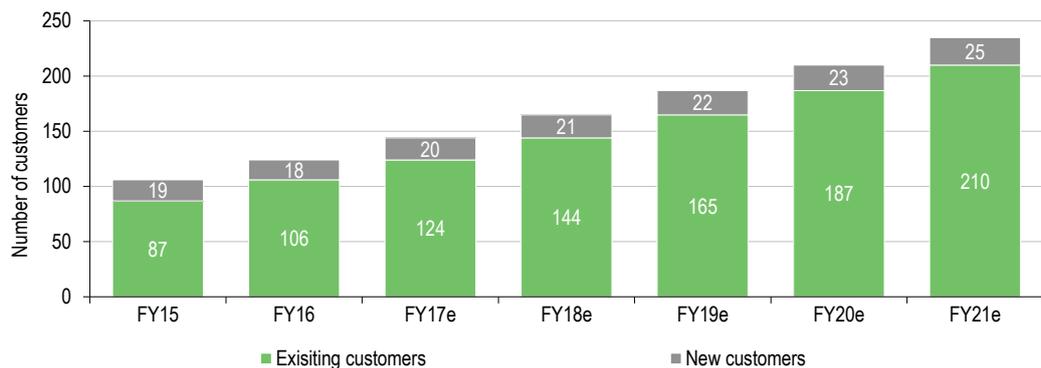
Once the transition phase is completed, a 36-60 month fixed-term contract starts, along with a comprehensive service level agreement (SLA). The cost of the contract relates to a defined set of reference points, eg the number of IT users or IT systems and a chosen level of quality. The charge for Data Centre Services can be related to the size of user storage or dedicated or shared servers,

while Network Services relates to the number of connections. Each service can be provided at different levels of quality, eg the level of availability from standard up to business critical. As a Service Desk example, an IT user's call or email ("incident" or "request") might be charged €12/month, so for 500 calls or emails the basic rate would be €6,000/month for an average of one IT user call to the desk per month. Should this rise to say 1.2 calls/month then there would be an additional pre-defined cost.

The contract also involves an SLA, and each service has a defined set of indicators for this purpose. An SLA requirement for Service Desk will be related to the solution rate for incoming calls. For example, an SLA might require that 90% of all incoming calls must be answered in 30 seconds. Alternatively, a customer might be happy with this set at 80% (of incoming calls) but require a high response rate and 24x7 availability. Another example is Cloud Services – downtime might be limited to 0.1% each month, while another customer might be happy with 1% for less business critical applications. Fees are paid on a monthly basis and generate steady and predictable cash flows.

The defined set of indicators and basic fixed plus variable components give safety to both parties. This is completely different to the traditional time and materials (T&M) approach, and means there is significant saleability in this business. This can be demonstrated by Service Desk, where the group operates on a virtual centralised basis and holiday cover alone is much more efficiently handled. Two personnel operating on a T&M basis could be replaced by 1.8 service people, which would result in a 10% margin increase.

**Exhibit 1: Growth in CORBOX customers**



Source: DATAGROUP

The group has four revenue categories, as follows:

**Recurring cloud services (€76m or 44% of FY16 revenues)**

This is the bulk of the group's CORBOX recurring revenue streams, as outlined above.

**Recurring non-cloud services (€39m or 22% of FY16 revenues)**

This includes c €15m of legacy low-margin T&M business, which DATAGROUP is seeking to shift to CORBOX. The other €24m mostly relates to many smaller customers along with a small part of CORBOX including the onsite installation of IT workstations.

**Other services (€21m or 12% of FY16 revenues)**

This includes non-recurring projects and consulting work (c €5-10m) and is related to the onboarding of new customers and the onboarding of new services to existing customers.

It also involves software development work (€10-15m), which is not directly related to CORBOX customers. While this is not a core part of the business, it has attractive margins, and DATAGROUP can cross-sell this activity to its client base, and vice versa. The focus is on B2B apps and the software solutions can be resold to other customers.

**Trade and others (€39m or 22% of FY16 revenues)**

This is primarily hardware and software resales. However, this is low-margin activity, and DATAGROUP now only offers this function when CORBOX customers request it. This activity can be requisite for maintaining business relationships.

**Strategy**

DATAGROUP is focused on delivering cloud solutions to Mittelstand companies. The group chooses to focus entirely on Germany, given that the market is so large (BITKOM – IT services €38bn) and DATAGROUP estimates the Mittelstand sector alone is worth c €20bn, while CORBOX revenues are just c €80m.

The group's strategy has involved improving the quality of revenues, by shifting to recurring cloud-based revenues on higher-margin, fixed-term contracts from the traditional time & materials (T&M) based work. By offering a centralised and standardised SLA-based approach, the group has been able to establish a significant competitive advantage over smaller competitors. Further, its strong focus on customer satisfaction gives it an advantage over larger players, which tend to focus their efforts on their bigger global customers. DATAGROUP has been highly active in the German IT service sector's consolidation process, acquiring inefficiently run businesses as well as strategic assets and it has made 19 acquisitions since its IPO in September 2006. Merger drivers include benefits from the centralised support, virtually centralised Service Desk, along with economies of scale from accounting, HR, management, marketing and scaling data centre assets.

The plan remains to grow both organically and through acquisitions, which could take group revenues to c €500m by FY21, including c €170m from acquisitions. A prime objective is to lift EBITDA margins to 13-14% by FY21 (11.5% in Q217) by focusing on growing the group's high-margin CORBOX business, with potentially 111 new customers being added by then (from FY16 levels). Growth will also come from upselling to existing customers.

Several market characteristics have enabled the group to establish a strong competitive advantage

- Above-average customer satisfaction (as evidenced by a report on IT outsourcing in Germany by Whitelane Research & Navisco) is one of its most important competitive advantages.
- It has a highly standardised approach, which makes it more efficient for onboarding new customers.
- Smaller competitors offer suffer from high customer concentration while businesses operating on a T&M basis struggle to benefit from economies of scale. DATAGROUP can acquire these businesses (tempering any customer concentration) and transition them to fixed-price cloud services. HPE operated mainly on a T&M basis while HanseCom partly operated on a T&M basis.

**Acquisition strategy**

Since its IPO, DATAGROUP has acquired 19 companies or parts of companies. The acquisitions have been a key component in driving a revenue CAGR of 20% since FY06, and an EBITDA CAGR of 26%. Given the revenue growth and margin progression, the acquisition strategy has been highly earnings accretive as well as value creating in our view. Buying underperforming businesses and turning them around is a key part of the acquisition strategy. However, management is also looking to acquire more strategic assets in the cloud services space and also to expand the SAP implementation skills base. Management is conservative about leverage, hence the recent capital increase, which leaves the group with plenty of headroom to make bolt-on acquisitions.

The most recently acquired business is Hamburg-based IT service provider HanseCom, which was announced in early April, for an undisclosed price. HanseCom has c 70 employees and generates annual revenue of c €16m, and it will be consolidated into DATAGROUP accounts from May 2017.

In September 2016, DATAGROUP acquired 306 SAP and application management experts from Hewlett-Packard Enterprise, and signed an agreement for DATAGROUP to provide defined SAP and application management services for HPE's customers. The deal guarantees revenues of €150m over five years, which can be extended, while DATAGROUP took on some pension liabilities. This was a very significant and important acquisition for DATAGROUP, as SAP Services is a part of CORBOX and this was a unique opportunity to acquire skills that are not available on the market. The deal will add €33m to DATAGROUP's FY17 revenues, most of which will be in recurring cloud services.

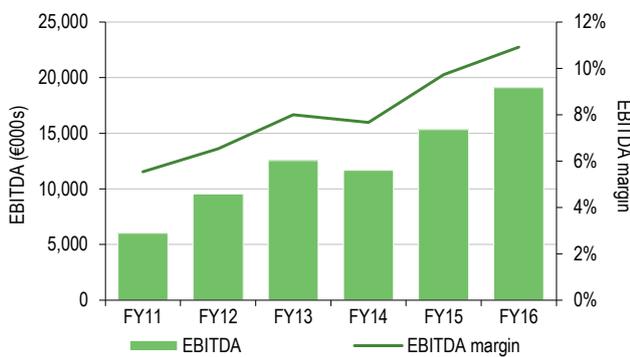
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### Q2 results

Performance was strong in Q2 with organic revenue growth accelerating to 10%, up from 6% in Q1. Consequently, management increased guidance for FY17. Including the HPE acquisition, total revenue lifted by 33% to €54.6m. This was up from 29% in Q1, and provided for 31% growth over the whole six months to €108.0m. Q2 EBITDA surged by 77% to €6.3m with the margin rising from 8.6% to 11.5% and EPS nearly trebled to 36c. For H1, EBITDA rose by 92% to €11.5m and EPS jumped from 17c to 59c.

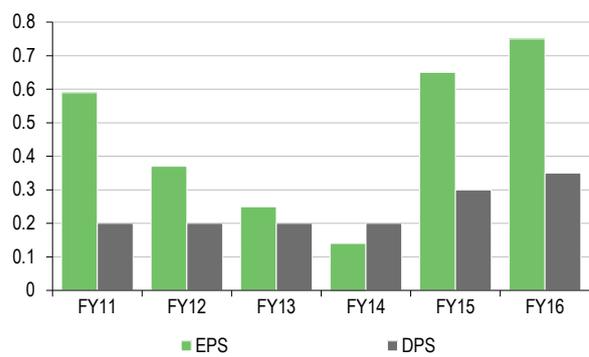
Given the strong performance and also considering the acquisition of HanseCom, management lifted FY17 revenue guidance to €215-225m (previously €210-220m) and EBITDA to €22.0-23.0m (previously €21.5-22.5m).

**Exhibit 2: EBITDA and margin progression**



Source: DATAGROUP accounts

**Exhibit 3: EPS and DPS progression (€)**



Source: DATAGROUP accounts

### Fund-raising

In early April 2017, DATAGROUP placed 759,000 new shares with investors at €28.6 raising €21.7m gross. The purpose of the capital increase was to strengthen the group's balance sheet, in order to give the group greater financial flexibility to make additional acquisitions. The equity ratio stood at 18% at the end of March, and the pro forma equity ratio, after including the capital increase, was 28%, while pro forma net debt fell from €23.9m to just €2.7m (prior to the HanseCom acquisition). The placement increased the number of shares outstanding from 7.572m to 8.331m. This was the group's first capital increase since May 2012, when DATAGROUP placed 690,000 shares at €5.50, raising gross proceeds of €3.8m. In addition to the placement, DATAGROUP's majority shareholder, HHS, agreed to sell 400,000 shares due to the strong demand. In combination with the capital increase, HHS's shareholding in DATAGROUP SE has fallen from 61.1% to 50.8%.

## Market overview

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DATAGROUP has identified c 11,000 potential CORBOX customers in Germany and wants to serve 250-300 of them in FY21. These numbers are based on data from the German Statistics Bureau, representing the enterprises in Germany that have 250-5,000 IT seats. This is not the same as number of employees – a typical enterprise has 0.6-0.7 seats per employee, ranging from 0.2-0.3 in some basic industries to above one in some financial services firms.

The market in Germany is very fragmented and DATAGROUP competes with many small regional players, some of which might only have one or a few customers. DATAGROUP estimates there are more than 1,000 small companies with 5-200 employees. These companies cannot provide the same level of service to their customers – indeed it is all but impossible for them to build up their own offering like CORBOX based on SLA services – and they typically suffer from high levels of customer concentration. DATAGROUP's main SAP competitor is All for One Steeb.

DATAGROUP also competes with larger players, but these typically are focused on customers with above 5,000 IT seats, targeting customers who generate revenue of at least €5m per annum. As a consequence, this leads to low customer satisfaction from smaller customers, and DATAGROUP can target these enterprises. Part of DATAGROUP's pitch is that DATAGROUP is a Mittelstand company also. The group's main quoted competitors include T-Systems (a subsidiary of Deutsche Telekom), IBM, Computacenter, and Frankfurt-listed IT services companies Bechtle and Cancom.

DATAGROUP estimates that around 75% of new DATAGROUP customers are switching their supplier. Most come from bigger competitors such as T Systems, IBM and Computacenter. The remaining 25% come from outsourcing their IT. DATAGROUP typically wins 40% of requests for proposals and the average new customer generates annual revenue of €750k.

## Management

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### **Max H.-H. Schaber (CEO)**

Mr Schaber founded DATAPEC, a data processing company, in 1983, which later became DATAGROUP. Mr Schaber has been a member and chairman of the executive board (CEO) of DATAGROUP since 16 February 2006. He is responsible for finance, legal affairs, human resources and company development.

### **Dirk Peters (COO)**

Mr Peters founded HDT Hanseatische Datentechnik in 1992, which evolved from being a classic systems house to an IT service management business and was acquired by DATAGROUP in 2008. Since 2008, he has served as managing director of DATAGROUP Hamburg GmbH (formerly HDT), and is also active in the management of DATAGROUP SE as COO.

### **Heinz Hilgert (chairman of the supervisory board)**

Heinz Hilgert is CEO and founder of TransVise GmbH, senior management consultant in the financial services industry. Before that Mr Hilgert was CEO of WestLB in Düsseldorf and deputy CEO of DZ Bank in Frankfurt.

## Financials

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DATAGROUP has an impressive track record, having generated a 20% CAGR in revenue over the 10 years from FY06 to FY16 and a 26% CAGR in EBITDA. H117 saw revenues jump by 31% to

€108m and EBITDA by 93% to €11.5m, aided by the acquisition of IT specialists from Hewlett-Packard in September 2016. Organic revenue growth was 10% in Q217, up from 6% in Q117.

The group added 18 new CORBOX customers in FY16, along with eight significant upsells, and the target is for at least 20 new CORBOX customers in FY17. DATAGROUP has a clear objective for onboarding new customers, with a target of 235 CORBOX customers to be achieved by 2021, prior to any acquisitions, including HanseCom.

#### Exhibit 4: Financial summary

| (€000s)                            | FY11     | FY12     | FY13     | FY14     | FY15     | FY16      |
|------------------------------------|----------|----------|----------|----------|----------|-----------|
| Year ended 30 September            | IFRS     | IFRS     | IFRS     | IFRS     | IFRS     | IFRS      |
| <b>Income statement</b>            |          |          |          |          |          |           |
| Group revenue                      | 108,550  | 146,183  | 156,935  | 152,380  | 157,574  | 174,918   |
| Services & maintenance revenue     | 66,391   | 102,980  | 116,082  | 114,413  | 120,773  | 135,907   |
| % group revenue                    | 61%      | 70%      | 74%      | 75%      | 77%      | 78%       |
| Trade revenue                      | 41,838   | 42,923   | 40,541   | 37,707   | 36,592   | 38,821    |
| Other/consolidation                | 321      | 280      | 312      | 260      | 209      | 190       |
| EBITDA                             | 6,016    | 9,549    | 12,553   | 11,686   | 15,339   | 19,103    |
| EBITDA margin                      | 5.5%     | 6.5%     | 8.0%     | 7.7%     | 9.7%     | 10.9%     |
| EBIT                               | 3,650    | 3,792    | 6,091    | 6,213    | 9,604    | 12,675    |
| Year-end number of shares (000s)   | 5,722    | 6,892    | 7,572    | 7,572    | 7,572    | 7,572     |
| EPS (€)                            | 0.59     | 0.37     | 0.25     | 0.14     | 0.65     | 0.75      |
| DPS (€)                            | 0.20     | 0.20     | 0.20     | 0.20     | 0.25     | 0.30      |
| <b>Balance sheet</b>               |          |          |          |          |          |           |
| Total non-current assets           | 36,861   | 69,647   | 66,109   | 60,754   | 68,062   | 92,178    |
| Total current assets               | 23,132   | 31,019   | 35,590   | 34,345   | 35,285   | 67,568    |
| Total assets                       | 59,993   | 100,666  | 101,699  | 95,099   | 103,346  | 159,746   |
| Total non-current liabilities      | (17,075) | (32,416) | (49,420) | (44,056) | (39,013) | (97,367)  |
| Total current liabilities          | (24,855) | (45,552) | (29,767) | (29,778) | (40,283) | (34,012)  |
| Total liabilities                  | (41,929) | (77,968) | (79,188) | (73,834) | (79,296) | (131,379) |
| Net assets                         | 18,064   | 22,698   | 22,511   | 21,264   | 24,051   | 28,367    |
| <b>Cash flow</b>                   |          |          |          |          |          |           |
| Net cash from operating activities | 1,253    | 8,456    | 10,947   | 9,286    | 9,431    | 9,518     |
| Net cash from investing activities | (6,373)  | (17,950) | (5,210)  | (4,301)  | (9,295)  | (3,711)   |
| Net cash from financing activities | 5,897    | 12,056   | 2,778    | (6,937)  | (7,513)  | 16,545    |
| Net cash flow                      | 778      | 2,562    | 8,516    | (1,951)  | (7,375)  | 22,352    |
| Cash & cash equivalent end of year | 321      | 2,883    | 11,398   | 9,448    | 2,072    | 22,424    |

Source: DATAGROUP accounts

## Sensitivities

We highlight the following points:

**Economic downturn.** IT budgets are subject to pressure in economic slowdowns. However, slowdowns can also speed up the pace of outsourcing as customers seek to reduce costs. We note Datagroup has long-term-relationships with its customers, including a high level of recurring work.

**Country, sector and customer concentration.** All revenues are generated from Germany, though many of the group's customers have international operations. The customer base is well spread across sectors, and customer concentration is limited, with the largest customer generating 6% of revenue in FY17, while the top 10 customers generated 16-17% of revenue. Hewlett-Packard is expected to be the largest customer in FY17 and FY18, generating an estimated 15% of revenue, but this revenue is on behalf of HP's own customers.

**Operational risk.** There is the risk of fixed-price projects going over budget or deadlines not being met.

**Competitive environment.** While competition in German IT services is fierce, it could intensify; for example, larger international rivals could make headway in continental Europe and shift focus on the Mittelstand market.

**Customer considerations.** IT departments might be reluctant to outsource, in particular mission-critical tasks. DATAGROUP's growth might be limited by potential conflicts of interest related to supply of services to competing firms in similar key business areas.

**Acquisitions.** There is implementation risk in the acquisition strategy, though the group has established a proven track record in integrating acquisitions.

## Valuation

DATAGROUP shares have had an impressive run, rising from €2 in 2009 to €38 without any major corrections. Nevertheless, the business is still small, with a market capitalisation of c €300m, while the target market is a growth market and huge.

## Peer valuation

The shares trade on higher ratings to its peers, which reflects the superior growth prospects, healthy recurring revenues (66% of revenues) and strong business drivers.

| Exhibit 5: Peers                   |              |            |              |             |               |             |             |             |
|------------------------------------|--------------|------------|--------------|-------------|---------------|-------------|-------------|-------------|
|                                    | Share price  | Market cap | EV/sales (x) |             | EV/EBITDA (x) |             | PE (x)      |             |
|                                    | local curr   | (€ m)      | Year 1       | Year 2      | Year 1        | Year 2      | Year 1      | Year 2      |
| <b>DATAGROUP</b>                   | <b>36.99</b> | <b>309</b> | <b>1.51</b>  | <b>1.38</b> | <b>13.4</b>   | <b>11.6</b> | <b>23.6</b> | <b>19.3</b> |
| Allgeier                           | 19.145       | 174        | 0.47         | 0.43        | 8.3           | 7.3         | 26.0        | 19.5        |
| ATOS                               | 122          | 12,848     | 1.01         | 0.98        | 7.9           | 7.4         | 14.7        | 13.6        |
| Bechtle                            | 111.6        | 2,344      | 0.68         | 0.63        | 11.9          | 10.9        | 20.5        | 18.5        |
| Cancom                             | 50.6         | 828        | 0.67         | 0.63        | 9.0           | 7.9         | 20.1        | 17.7        |
| CENIT                              | 21.24        | 178        | 0.93         | 0.83        | 9.9           | 8.0         | 22.4        | 18.5        |
| GFT                                | 20.735       | 546        | 1.41         | 1.29        | 12.9          | 11.3        | 18.8        | 15.9        |
| QSC                                | 2.01         | 250        | 0.90         | 0.89        | 8.3           | 7.6         | N/A         | 44.7        |
| Realtech                           | 1.5          | 8          | N/A          | N/A         | N/A           | N/A         | N/A         | N/A         |
| S&T                                | 13.08        | 640        | 0.92         | 0.83        | 15.3          | 11.6        | 28.3        | 20.9        |
| SNP Schneider                      | 41.785       | 208        | 1.94         | 1.66        | 19.8          | 14.0        | 42.3        | 27.1        |
| USU Software                       | 22.8         | 240        | 2.45         | 2.17        | 16.9          | 13.2        | 24.1        | 18.4        |
| All for One Steeb                  | 64.49        | 321        | 1.11         | 1.04        | 11.2          | 10.4        | 24.0        | 21.5        |
| <b>Medians excluding DATAGROUP</b> |              |            | <b>0.93</b>  | <b>0.89</b> | <b>11.2</b>   | <b>10.4</b> | <b>23.2</b> | <b>18.5</b> |

Source: Bloomberg. Note: Prices as at 22 May 2017.

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