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Client Conference Call

Credit Suisse Speaker's Corner
Educomp Solutions Ltd.

Thursday, 4 August 2011 at 1730 hrs India / 1300 hrs UK / 0800 hrs NY / 2000 hrs HK

Thursday, 4 August 2011 at 05:30 pm India

Credit Suisse hosted the 1Q FY12 Earnings call with Educomp Solutions Management.

- Mr. Shantanu Prakash, MD and CEO
- Ms. Sangeeta Gulati, CFO
- Mr. Sonjoy Mohanty, President Corporate Affairs
- Mr. Raman Bajaj, VP Corporate Affairs

Operator:

Thank you for standing by and welcome to the Educomp Solutions' first quarter FY12 earnings conference call.

At this time, all participants are in a listen-only mode. There will be a presentation followed by a question and answer session at which time if you wish to ask a question please press *1 on your telephone keypad and wait for your name to be announced. Please be advised this conference is being recorded today.

Now, I would like to hand the conference over to Mr. Sunil Tirumalai. Over to you sir.

Mr. Sunil Tirumalai:

Thank you very much and a very warm welcome to everyone.

We are pleased to host Educomp Solutions management for their first quarter earnings call and I would not like to waste much time and I will be handing over the floor to Mr. Shantanu and Ms. Sangeeta.

Mr. Shantanu Prakash:

Thank you Sunil.

Good evening everyone and welcome to our first quarter earnings call for FY12. My name is Shantanu Prakash and I am the founder and CEO of the company. I am joined on this call by Ms. Sangeeta Gulati, the Chief Financial Officer of the company, Mr. Sonjoy Mohanty, President Corporate Affairs, and Mr. Raman Bajaj, Vice President, Corporate Affairs.

We are very happy to share with you our numbers for Q1 ending June 30, 2011. Financial year 2012 has started off well for us and we have increased the revenue by 28%. Smartclass continues to grow strongly from strength to strength and quite importantly the contribution from our other lines of businesses is also rapidly increasing as is evident in the financial results which are already with you. All subsidiaries have shown impressive growth. In a nutshell we have had a good start to FY12.

The financial highlights of the quarter are as follows. On a consolidated basis, the income from operations for the quarter ended 30th June is 292.4 crores, an increase of 28% over the corresponding quarter last year. EBITDA for the quarter is 102.6 crores, an increase of 48% over the same period last year resulting in an EBITDA margin of 35%. Net profit after tax for the quarter is 36.6 crores giving a PAT margin of 12%. We are thus on track for meeting our guidance for the year.

On a standalone basis, the income from operations for the quarter is 185.7 crores, an increase of 12%. The EBITDA for the quarter on a standalone basis is 77.5 crores, an increase of 28% on a year on year basis. EBITDA margin for the quarter on a standalone basis came in at 42% compared to 36% for the same period last year, and the net profit after tax for the quarter on a standalone basis is 43.5 crores resulting in a PAT margin of 23%.

Our EPS for the quarter is 3.82 basic and 3.60 diluted on a consolidated basis, and 4.54 basic and 4.28 diluted on a standalone basis.

As you are aware, our business exhibits certain predictable seasonality across the year and the first quarter is usually our leanest quarter. The key reason behind is that all schools are closed for two of the three months because of summer holidays and we use this quarter for the bulk of our hiring, training, and induction processes. The results for the year have to consider this seasonality.

I will now go into the segmental overview starting with our digital content solutions segment called School Learning Solutions. In the SLS segment, our total quarterly revenue came in at 180.7 crores which is a growth of 14% over the corresponding quarter in FY11. The EBIT for this segment was 84.5 crores, which is an increase of 28% on a year on year basis. In the SmartClass part of the business, we added 5288 classrooms during the quarter across 664 schools with a stable average of 8 classrooms per school. The pricing of the product remains robust with the average selling price per classroom for the quarter coming in at 4.04 lakhs. This excludes the additional classrooms sold to existing schools. I am happy to share that despite the noise around the competition, schools across the country continue to choose SmartClass over any other product because of:
- superior quality of the content,
- comprehensiveness of the library,
- ease of product use,
- state of the art technology and product infrastructure, and
- an unmatched after sales customer service

SmartClass is now a national phenomenon and is being used by 7202 schools and 4.5 million students every single day. With the launch of our SmartClass CTS and DTS products, which is our new innovation, we expect to make deeper and deeper inroads into the market and are confident of strengthening our leadership position for many years to come. We have geared up our resources to make sure we are able to capture the entire demand that is coming from private schools located all over the country. Our sales force is now 590 people, the addition to the sales force was successfully completed in Q1 and now we have a presence in every single school district of the country.

The rapid penetration of SmartClass in classrooms and schools in the country gives us comfort that we are on track to meet the FY12 guidance of 40,000 to 45,000 classrooms. SmartClass contributed revenues of 154 crores, and an EBIT of 79.6 crores in this quarter.

Let me now turn to the ICT business. In this quarter we were currently implementing the Maharashtra ICT contract of 540 schools. As you are aware, we have been pursuing a very selective and cautious growth strategy in this space and we will only be adding contract where we make very good margins.

Our second segment, the K12 Schools segment is a very strategic and fast growing business for us. This segment consists of our Root to Wings business, our EuroKids subsidiary and our brick and mortar K12 schools business. In this segment our quarterly revenue was 44 crores, which is an impressive increase of 44% over the corresponding period last year. The quarterly EBIT was 16.2 crores which is an increase of 39% on a year on year basis. In the preschools part of our business, our network of preschools is now spread across 841 preschools and we remain the largest preschools company in the country. Our preschool brands are divided across Roots to Wings (232 schools) and EuroKids (609 schools). In the K12 high schools part of the business, we have a visibility of 86 schools, up from 83 last quarter, with 59 schools operational. We are thus the number one corporate player in the country servicing K12 schools and our brands are fast becoming highly reputed brands in almost all the cities where we have launched. Our brand strategy is focused on creating high quality brands at a price point which is suitable for the diverse customer segments in India. Thus we have a portfolio of brands consisting of Millennium Schools, Takshila Schools, Universal Academy Schools, as well as our international school brand called Le Mont High in our portfolio. What makes our K12 schools operation unique is the fact that even though we are only a three and a half year old player in the space we have been able to do an impressive roll out of 59 live schools and 86 visible schools and also able to forge exclusive strategic relationships with country leading school brands that have been in existence for 30 to 50 years such as the Shriram School rated number one school of the country, the PSBB School, which is the number one school brand in South India, and Vasant Valley Schools in Delhi, one of the top five school brands in the country rated by the Education World Magazine. In the future we hope to partner with more leading brands as we continue to grow our presence in this space. We are conscious of the capital intensity involved in this business and consequently we have ramped up the asset light strategy of dry management and joint venture schools as well. These are schools where we look for partners who are passionate about setting up schools and who can bring in the capital assets with them. We sign long-term agreements, typically 30 years, with them to operate the school without owning the assets, thus leading to a very high return on capital employed once the schools reach steady state. Of the total 59 schools operational in our entire operational portfolio, 24 schools are currently operational in our asset light model. Our go-forward strategy is to have more schools in the JV and partnership model where the capital deployment is minimal. The schools business is structured under our subsidiary, EISML which has revenues of 27.2 crores this quarter, an EBITDA of 19.5 crores, and an EBITDA margin of 72%, PAT of 4.9 crores and a PAT margin of 17%.

Moving on to our Higher Learning Solutions segment, this comprises of our two joint ventures with world leading organizations, Raffles and Pearson in the areas of higher education and vocational education respectively. In the Raffles joint venture, our state of the art, AICTE approved campus in Greater Noida in the Delhi NCR region, is fully up and running and admissions for management and engineering have already begun. Intake for the first batch of engineering and PGDM programs has already started and the classes will begin in the middle of August. The other part of this joint venture of course is the 7 Raffles Millennium Colleges operational in cities like Delhi, Bangalore, Chandigarh, Kolkata, Hyderabad, Ahmedabad, and Chennai, and enrolments at these colleges which offer programs in design based areas are constantly increasing.

The ongoing regulatory changes in the higher education and the school education space, we believe are opening the way in this very tightly regulated market. We believe that by setting up a higher education business in partnership with Raffles, the vocational education business with Pearson, we will be among the first movers in the space which is characterized by large scale shortages. I would like to point out to you the news that many of you might have heard recently about the 100% cut off marks required to get admission in the current college session in some of the colleges in India. If a student cannot get admission in colleges unless they secure 100% marks, clearly something is not correct with the system. We believe that the government controls that have restricted the growth of private sector in higher education will start getting removed and will stand to benefit all the players and certainly Educomp with the early mover advantage. In the current session of parliament a bill called 'The National Council for Higher Education Research Bill' has been tabled which is the first step towards deregulating the sector.

In the other part of our business, our joint venture with Pearson called IndiaCan, we now have 365 points of presence across the country and are fast becoming the number one player in this segment too. We have started the year with close to 40,000 students enrolled in various programs under IndiaCan and just to give you a little bit of a snapshot, our Educomp Tele Education Network now has an operating network of 150 operational centres, our Purple Leap business currently reaches out to 120 colleges, and in our consumer vocational business we now have 95 IndiaCan centres. This segment had revenues of 23.6 crores which has grown 163% over the corresponding period last year and had an EBIT loss of 4.9 crores compared to an EBIT loss of 4.4 crores in the same quarter last year. As you are aware our joint venture businesses are currently in investment mode and we expect them to turn the corner in 15 to 18 months. Each of our subsidiaries in the core education business have shown tremendous traction. In the Higher Learning Solutions segment as is evident, the revenue has grown 163% in this segment on a year on year basis.

I now come to our last segment Online Supplemental and Global which comprises of our investments in the online and supplemental education space. Our online footprint is the largest in the country. We are number one in India with 3.5 million users growing at a very impressive 20% quarter-on-quarter over the last eight quarters in a row. WiZIQ our teacher-student marketplace has 1.47 million users and added 175,000 users in Q1 alone. Learnhub has 1.25 million registered users while studyplaces has over 700,000 users. Each of our three online properties have been scaling its reach amongst users aggressively and are already the top e-learning portals in the country.

On the supplemental education side, we now have a total of 69 Test Prep centres serving 10,500 students offering Vidyamandir classes, Leap and Gate forum programs. We are leveraging our expertise in technology to sell these brands in the test prep space in India. We are also actively in discussions with 3G, telecom and WiMax broadbrand players for innovative educational products such as SmartClass for direct consumption at home. As the penetration of telecom infrastructure increases in India, we hope to ride the wave with high quality content and services delivered directly to our very large number of clients and users.

This segment has revenues of 44.2 crores growing 51% over the corresponding period last year and had an EBIT of 1 crores as compared to an EBIT loss of 6.3 crores in the same quarter last year and you can see in this quarter the business has turned the corner and is in the positive EBITDA territory.

A quick summary of where Educomp stands today, we have 4.5 million customers across 7200 private schools, 5.8 million customers across 15,500 government schools, we run 843 pre-schools, 59 K12 schools, 7 colleges, 1 higher education campus, 365 vocational training centres, close to 70 test prep centres, and about 3.5 million users use our online education services. We have some of the best minds in the education space working with Educomp and are uniquely positioned in the market that is filled with acute shortages. As has been evident time and again our customer, middle class of India, is extremely hungry for high quality education. The environment that we work in is rapidly evolving with reducing regulatory hurdles and increasing PPP projects. Our focus on innovation and R&D in every part of our business continues to increase our sustainable competitive advantage and further we have shown solid execution over the years in each of our business lines.

With that short summary of our business in Q1, I will pause now and we will open for questions and answers.

Mr. Sunil Tirumalai:

Moderator, this is Sunil here, I would like to start with a couple of questions.

Operator:

All right sir, I will announce for the same.

Mr. Sunil Tirumalai:

Thank you very much. Sir, I had a couple of questions. Firstly, if I look at the SmartClass additions, there seems to be a weakness in the number of classrooms added on a year on year basis, sir 20% dip. I remember last year you guys has said that from Q4 to Q1 there were some school implementations that had got delayed, but I mean is there any other reason why we are seeing a decline in the SmartClass additions?

Mr. Shantanu Prakash:

Actually that is the only reason. As you know that in Q4 of FY10 we could not complete all the installations in Q4 itself which spilled over to Q1 of FY11, which was an unreasonably large number, and so if you look at the volume this year, we are completely on track. Typically we do 10 to12% of our additions or revenues in quarter one of each year. So I would say that this is completely in line with our projections of 40,000 to 45,000 classrooms this year, which is 55-60% up in terms of our guidance from approximately 27,100 odd classrooms that we did in FY11.

Mr. Sunil Tirumalai:

Okay. My second question is in the Edusmart model in terms of your revenue booking, I think a key variable is the interest rate because that is what determines what your share is. I mean in your usual example of 75 rupees split into 52.5 and 22.5, I think the interest rate which is the discount factor is very important. In a rising interest rate scenario do you see your share coming down, can you give some thoughts on that?

Mr. Shantanu Prakash:

Well as we are aware that interest costs in India have been rising for quite some time. In our business model our vendor which is Edusmart has some cushion to take the impact of rising interest rates and currently the cushion that they have can take care of the current interest rates that are there. However, if the interest rates rise in some unreasonable level later on in the future, we will have to essentially look at the model. However, having said that Sunil, rising interest rates essentially will impact every business in the country and whether we use the Edusmart model or take that directly in Educomp, we will be uniformly impacted by the rising interest rates. However, the advantage that we have in the SmartClass business is that the margins in the product are extremely robust. This is a product that is enjoying margins of approximately 55%, and with these levels of margins our capacity to buffer in rising interest rate scenario is much-much higher than other businesses that operate at much lower margins.

Mr. Sunil Tirumalai:

Okay, that was useful. And just one last question from my side. In the presentation in the place where you mentioned the average selling price per classroom, there is a footnote which says that the price of 4 lakhs excludes the classrooms sold to the existing schools, so are they being sold at a lower price to the existing schools, I mean for repeat orders?

Mr. Shantanu Prakash:

I am glad that you asked the question and you know we have been talking for a long time about the operating leverage in our business and as our business scales up how some of the operating leverage kicks in. One of the biggest advantages of our business is that once we have sold any number of classrooms to a school, usually the school comes back and asks for additional classrooms. Typically, the additional classroom we sell them at a lower rate which is between 2.2 lakhs to 2.6 lakhs per classroom depending on school to school; however, our margins in these additional classrooms are actually higher than opening an account in a new school for a couple of reasons. Firstly, we do not have to install a fresh server. These classrooms get plugged on to the existing server in the school and most importantly the quality assurance person from Educomp that is in the school does not have to be added on to the additional classrooms. So, actually the effective cost for putting up these classrooms is far less than the cost of putting up the fresh classrooms, and I would say that this is one of the great strengths of our business going forward as the operating leverage kicks in. We will in the future have revenue not just from selling to new schools but also selling additional classrooms to existing schools. Our vision as you know has always been to see SmartClass in every class in every school and we believe that this is a product that will have a 100% penetration across all the schools in India. In this quarter we are beginning to see the first example of this operating leverage coming in.

Mr. Sunil Tirumalai:

Okay, thank you. Moderator I will not take any more time. The floor is for you to take the questions, thank you.

Operator:

All right sir, thank you.

At this time, participants who wish to ask any question, please press *1 on your telephone keypad and wait for your name to be announced. If you wish to cancel your request, please press hash or the pound key.

Participants who are on the speaker phone are requested to pick up the handset and then ask the question.

We have Mr. Rishi K from India Capital Fund. Kindly proceed your question sir.

Mr. Rishi your line is on mute sir, you may proceed with your question.

Mr. Rishi K:

Hi, can you hear?

Mr. Shantanu Prakash:

Yes, please go ahead with your question.

Mr. Rishi K:

80 million bonds are going to be redeemed in July 2012, so what is the management strategy to redeem to arrange I mean how you are actually arranging these funds?

Ms. Sangeeta Gulati:

We have taken enabling resolution from the Board, where we are going to raise fresh executive bonds and proceeds from the fresh executive bonds will be used for the redemption of the earlier existing bond.

Mr. Rishi K:

Okay. The next question is that you have 3030 million parked in various banks, like PNB, Bank of India, HDFC; but still you are paying 20 crores as interest. So what is the logic behind that?

Ms. Sangeeta Gulati:

First of all, our consolidated cash and bank balance is 222 crores, and not 330 odd crores. This is at a consolidated basis and they are parked at different subsidiaries level. Obviously the company requires additional capital to grow and at one particular point of time the entire cash cannot be deployed, you know. I think it is always good to have some amount of capital in hand.

Mr. Rishi K:

And currently you are reaching to about 15 million learners and your target is about 20 million by 2012, which is very unaggressive given that you are in a very high growth pace?

Mr. Shantanu Prakash:

That is a good point. With 15 million customers we have the largest reach amongst all the education companies in the world. In fact there is no company in the world whether it is a New Oriental in China or it is Megastudy in Korea or Anhanguera in Brazil that has the kind of reach that Educomp has, and so going from 15 million we will be adding another 5 million learners in the next 12 months. So, I think that is actually a pretty impressive rate of growth as far as learners are concerned. In fact, at the end of this quarter, our total reach of learners has crossed 17 million.

Mr. Rishi K:

And who you think would be your competitors in the coming years apart from Everonn, Z-Learn and IIT and Career Point?

Mr. Shantanu Prakash:

Well, you know you have seen the unique portfolio of businesses that we have and I would essentially leave it to the judgment of the people who are on the call to make a comparison between the kind of education platform that Educomp has built and the kind of strategy being pursued by our peers in India as well as outside of India. We do believe that our education ecosystem strategy is fairly unique and compelling, and in a market like India where there are such big shortages, it is not so much about competition actually, it is about reaching out to the customer and providing truly value added products. I think we will talk about competition in 8 to 9 years when the market is reaching towards saturation. The current penetration levels across all the segments in India are characterized by very low penetration. So right now the focus is not so much on tackling competition, it is about reaching out and serving the customer.

Mr. Rishi K:

Okay. Do you think that education spend per family will go up even with higher interest rates in India and do you think that value offered by Educomp justifies the price in the current market scenario?

Mr. Shantanu Prakash:

Actually, in our belief the interest rates have no impact on education budget whatsoever. Firstly because most of the people are not borrowing money to finance their children's education, it is coming from the disposable capital of the family. You have touched upon a very important point. The cost of education in India has shown a tremendous increase over the past few years. If you look at the higher education segment, there has been approximately 300% increase in cost of education in the past five years as subsidies have gone, and this increase of education cost is not only in the private institutions, the increase in education cost is also in the government institutions such as IIMs and IITs, and so on. I think people are getting more and more used to paying between 25 to 30% of their family income toward education in India.

Mr. Rishi K:

Apart from branding, we understand that the success of your preschools depends upon the success of the franchisee model. What kind of quality controls or standards do you have set to beat your local competitors?

Mr. Shantanu Prakash:

Actually, it will be very difficult to give a very long answer on the quality control models on this call. We will be very happy to connect you with our management team who runs the preschool business for you to get a deeper insight into the quality control procedures and so on. But you must appreciate we are running 841 centers and having an impressive 841 centers is impossible to manage without very strict controls on quality, on branding, on pedagogical processes. So, all these processes are in place. I am happy to share them with you on an off line basis.

Mr. Rishi K:

Okay. So, could you please share the email id of your investor relation department?

Mr. Shantanu Prakash:

It is in the last page of our investor update, it is investor.relations@educomp.com.

Mr. Rishi K:

And one more request, could you please put up the transcript on your web site?

Mr. Shantanu Prakash:

We always put it, it is a normal practice in Educomp to put it up on the web site.

Mr. Rishi K:

Thank you.

Operator:

Thank you. Next question is from Mr. Pratish Krishnan from Bank of America. Kindly proceed with your question sir.

Mr. Pratish Krishnan:

Yes, thanks. Can you hear me?

Mr. Shantanu Prakash:

Yes, Pratish, please go ahead.

Mr. Pratish Krishnan:

Yes, just wanted to clarify, in terms of the new classrooms that you add in the existing schools, what is the revenue model with Edusmart?

Mr. Shantanu Prakash:

The revenue model remains the same. There is no change in the revenue model.

Mr. Pratish Krishnan:

So your margin profile, I mean this would clearly be much lower than the normal course, right, because one your ASP is lower than the actual pricing.

Mr. Shantanu Prakash:

No not at all Pratish. Actually, the margin is basically revenue minus cost, so our cost is also much lower; therefore, our margins are actually higher than the fresh classrooms.

Mr. Pratish Krishnan:

Okay, fine. And second is your debt in the balance sheet has increased around 180 crores on a sequential basis. What is the key reason for this and where was this deployed?

Mr. Shantanu Prakash:

Actually there is a slight increase in the debtors.

Mr. Pratish Krishnan:

No, I am referring to Debt.

Mr. Shantanu Prakash:

Debt, I think Sangeeta, would you like to answer that.

Ms. Sangeeta Gulati:

Pratish, we have only place to deploy that is the K12 business so the entire money is deployed there.

Mr. Shantanu Prakash:

We have currently about 27 projects which are in hand which comprise our visibility from 59 schools to 86 schools, so basically the money is going towards completing these projects.

Ms. Sangeeta Gulati:

And just to give you a sense that by the end of March 2012, we will be having anything between 54 and 56 live schools.

Mr. Pratish Krishnan:

Yes, but in terms of the number of schools that you have visibility, that hasn't really increased so much on a sequential basis. So I am just curious. I mean like the schools have moved up from 83 to 86 yes but the quantum of debt

Mr. Shantanu Prakash:

See basically in the schools business, the schools become live only in a certain time during the year. So the schools will not go live in quarter two and quarter three, they will go live in quarter one of next year, quarter two of next year.

Ms. Sangeeta Gulati:

When we have spoken that we will have about 54 to 56 schools that will be the greenfield schools which Educomp has constructed itself. As on date while we talk, more than 19 to 20 schools are under various stages of construction, and you know they will be all live on either first of April or first of June depending upon whether the school is in North India or is in South India. The entire money is getting deployed under this and we have also spent in order to acquire more land, for example if you look at our partnership with Vasant Valley, Shriram and PSBB, where good pieces of lands are to be acquired upon.

Mr. Pratish Krishnan:

Sure, further on the K12 side, typically we have seen that during 1Q there is a jump into the revenues for you, we have not really seen that in this particular year, I mean any reason for that and should we expect increase in revenue traction going forward?

Ms. Sangeeta Gulati:

The reason is very simple because in this year there are schools which have been live already. Because if you recall that in North India the school session has already started, that is the reason. The moment the schools are live, the revenue will start kicking in, and now you will also find that growth may be in June when we will have the South India schools ready and similar pattern also again in the April 1 of 2012 and June 1 of 2012.

Mr. Pratish Krishnan:

Okay, fine. Thanks a lot.

Operator:

Thank you. Next on line we have Ms. Divya Nagarajan from UBS. Kindly proceed with your question madam.

Ms. Divya Nagarajan:

Hi, Shantanu and Sangeeta. Could you give us a sense of what average realization for classroom is including the schools that you have excluded the old renewals?

Mr. Shantanu Prakash:

We have not done that calculation because we wanted to give a like to like comparison, so we will have to do that and get back to you later.

Ms. Divya Nagarajan:

Would you be able to give a sense on how much of your classroom sign this quarter were renewals?

Mr. Shantanu Prakash:

We do not have that number currently, but you know we can share that number with you later.

Ms. Divya Nagarajan:

Great. And just recently I think the Maharashtra State Assembly has passed a regulation that says that schools cannot increase fees every year, they are allowed to do so only every two years and parents have to approve the fee hike. How do you view this, do you think this is a set back for your K12 segment, do you see the possibility of this spilling into other states as well?

Mr. Shantanu Prakash:

No, actually we are not really concerned about some of these things and let me also tell you that some of this noise that you hear is not exactly sometimes relevant for our kind of schools because some of these regulations only apply to government aided schools and not to the purely private schools the kind that we are running. To give you an example in the state of Maharashtra itself, we are running the Le Mont High School where the fees is 7 lakh rupees a year. So, this fee increase regulation does not affect us.

Ms. Divya Nagarajan:

Got that. And lastly what are your targets for margins in the SmartClass segment this year?

Mr. Shantanu Prakash:

Our target for margins remain similar. We have earlier guided that our margins in SmartClass will be in the 51 to 58% range and our target is the same.

Ms. Divya Nagarajan:

Sure. Thanks and all the best for the rest of the year.

Operator:

Thank you. Next on line we have Mr. Anshu Govil from Flowering Tree. Kindly proceed with your question sir.

Mr. Anshu Govil:

Hi, I just wanted to know that there is a 20 crores quarter on quarter jump in good will. What does that pertain to?

Ms. Sangeeta Gulati:

This actually pertains to the acquisition of Gateforum. If you recall that we acquired Gateforum quite recently and that is pertaining to that only.

Mr. Anshu Govil:

And the second question was, there is a 220 crores quarter on quarter jump in the fixed asset block. Now, how would that work out?

Ms. Sangeeta Gulati:

I will just get those details for you.

Mr. Anshu Govil:

Actually if you can give me a breakup that will be helpful.

Ms. Sangeeta Gulati:

Yes, definitely I will just answer that question to you.

Mr. Anshu Govil:

Okay thank you.

Operator:

Thank you. Next question is from Mr. G.V. Giri from IIFL. Proceed with your question sir.

Mr. G.V. Giri:

Hi, Shantanu. You are able to hear me?

Mr. Shantanu Prakash:

Yes, please go ahead.

Mr. G.V. Giri:

Hi, Shantanu, you said that in the incremental sales of classrooms to existing schools you apply a lower rate of 2.2 to 2.6, so when schools come up for renewal will the school keep track of which classrooms got added at 2.2 and which got added at 3.9 or would have to renew at a lower rate or a low blended rate? When these come for renewals, how will it work?

Mr. Shantanu Prakash:

No that is a good question but the answer is very simple. That it is a five year contract. So, they do not have to keep track of the renewals, Educomp keeps track of the renewals as to when the contract is expiring because the content license will expire at the time when the renewal has to be done, so that technology is already built into the content, and at the time of renewal they have to pay the current market price of SmartClass, whatever the price may be at that point in time. So, let us say the renewal is going to come up in 2016 or 17, if the price at that time is 250 rupees per student, that is the price they have to pay.

Mr. G.V. Giri:

So, if into a school you are having some renewals and you are also selling incremental classrooms in direct school, you cannot have two prices right, one at 3.9 for renewals and one at 2.2 for incremental into the same school?

Mr. Shantanu Prakash:

No, our entire tracking strategy is very sophisticated and . . .

Mr. G.V. Giri:

So, but how will the school have a grip on how to tackle this, because you cannot have one vendor quoting two prices for identical classrooms merely because one is in incremental sale, and one is a renewal.

Mr. Shantanu Prakash:

No it does not work like that. I appreciate the question. However, there is a process for quoting for school with five classrooms, with ten classrooms and 20 classrooms and 50 classrooms, and there are different levels of pricing for that, so all of this has been already factored. You must appreciate that we are currently working with more than 7000 schools, so we have encountered this kind of situation multiple times. If you are interested in finding out the intricacies of the sale process, we can do that off line with you.

Mr. G.V. Giri:

Sure. And the other question was that you know you have told that you will have more detailed explanation on your Capex but very broadly speaking when I look at the gross block the 220 crores increase and when you talked about the fact that most of it pertains to K12 and there will be an increase of 20 schools, what I want to understand is that you know 20 schools even if you take 30 to 40 it should only be about 600 crores for the whole year. So, on a quarterly basis, it should be no more than 150 crores, so are we going to see a reduction in this 220 crores gross block debt going forward or will it be sustaining at this level.

Mr. Shantanu Prakash:

I can give an insight into the approximate Capex spend for the year for the K12 business will be in the range of approximately 200 – 300 crores, and there will be some additional Capex in the higher education and the vocational business, which is not extremely significant. So just purely in terms of guidance it should look at between 350 to 400 crores for the year overall much of which has already been spent in Q1.

Mr. G.V. Giri:

But you have already done a huge amount this quarter itself, so are we going to see a serious drop?

Mr. Shantanu Prakash:

In the beginning of the year, we typically do more and I have given you the guidance for the rest of the year.

Mr. G.V. Giri:

Sure, thanks a lot.

Operator:

Thank you. Next question comes from Ms. Arthi Mishra from CLFA. Proceed with your question madam.

Ms. Arthi, your line is on mute. You may proceed with your question.

Ms. Arthi Mishra:

Hello, am I audible now?

Mr. Shantanu Prakash:

Yes, please go ahead.

Ms. Arthi Mishra:

Yes, hi. My questions have been largely answered. I just wanted to check, you did discuss about 24 of your new schools being fairly asset light and looking for dry management. For the schools where these 220 crores Capex have already occurred, I am assuming it is a full bottom up to the extent that you even bought the land. Is that the level of asset intensity we are looking at?

Mr. Shantanu Prakash:

Yes, of course.

Ms. Arthi Mishra:

And these would be strictly for something like three to four schools which account for the full 220 crores?

Mr. Shantanu Prakash:

No, we are going to give you the breakup of 220.

Ms. Arthi Mishra:

All right excellent, but this is primarily K12, if I am not mistaken?

Mr. Shantanu Prakash:

Yes, so our gross block is across the company and is consolidated. Sangeeta will shortly answer the question about the breakup.

Ms. Sangeeta Gulati:

Okay, I have the figures regarding the capex. There is an increase of about 250 odd crores. This actually includes the capital work in progress also. When we are constructing about 80 to 90 schools in this year, you know majority of the portion, about 130 odd crores is pertaining to the K12 and this depicts the capital work in progress for the schools which are under construction as of now. And when we do a capitalization then the earliest capital work in progress moves to the FA block and this belongs to the schools which are under construction as on date. And the 250 crores has got two breakups. 130 crores has been deployed for the K12 business and 120 crores has been deployed for our higher education business. If you recall that under the high education business, we are running eight colleges. Seven design centers, and one AICTE approved campus. So that money has gone there, towards the capitalization only.

Ms. Arthi Mishra:

Sure, thanks.

Operator:

Thank you. Next in line we have Mr. Rohan Gala from Shivcom Capital. Kindly proceed with your question sir.

Mr. Rohan Gala:

Hello.

Mr. Shantanu Prakash:

Yes.

Mr. Rohan Gala:

Actually I wanted to ask you on the SmartClass for the quarter you had 4 lakhs as a revenue per classroom, so going ahead for the whole year what is the average pricing can we just take in?

Mr. Shantanu Prakash:

As you can see it is pretty stable. The pricing Q1 of last year was 3.9, Q1 of this year is 4.04, and Q4 of last year was 3.77, so it is typically expected to be in the same range.

Mr. Rohan Gala:

So, you do not see any reduction over there?

Mr. Shantanu Prakash:

No, we do not see any major reduction, but quarter to quarter there could be a slight fluctuation. So if it is 4.04 this quarter which is very robust, next quarter it could be a little up or little down. We have given in our fact sheet a detailed quarter by quarter pricing for the past eight quarters, so if you have a look at that you will notice that the pricing has been fairly stable in the range of 3.8 to 4.05 per classroom.

Mr. Rohan Gala:

Okay. Sure, another things sir can you just throw light on your tax or what would be the tax for the whole year, I assume taxes have been increased this quarter.

Mr. Shantanu Prakash:

The tax rate?

Mr. Rohan Gala:

Yes, tax rate yes.

Ms. Sangeeta Gulati:

The ETR will be the full tax rate which is applicable, 34.9%.

Mr. Rohan Gala:

Ok. Just the last question. Sir, can you just give the occupancy in your schools for the quarter, I guess you went live, so can you just give a ballpark figure?

Mr. Shantanu Prakash:

Typically the average occupancy across the entire portfolio of schools is approximately around 20%.

Mr. Rohan Gala:

20%?

Mr. Shantanu Prakash:

That is by design, it does not mean that 80% of the seats are vacant, typically a school starts from kindergarten to grade five, then it goes from five to eight, eight to ten, and ten to twelve. So it is a multi stage process based on the regulatory system in India. So when we say 20% it means that the campus is designed for 2500 or 2200 students but currently the capacity created is only for the number of students who come in.

Mr. Rohan Gala:

Okay sir, that is it, thank you.

Operator:

Thank you. Next in line we have Mr. Abhishek Anand from Centrum. Kindly proceed sir.

Mr. Abhishek Anand:

Yes, thank you for the opportunity. Sir two-three questions I have with regard to SmartClass. One is just to improve the understanding of the way the SmartClass revenue is calculated, if I exclude the 22.5% from the corresponding year's Q1 number and then when I calculate the blended realization per class, then it comes to round 340,000. So, just wanted to understand is that the right way to look at it or how will the full year realization work when we do the math for the incremental addition?

Mr. Shantanu Prakash:

Yes, that is the correct way to do it.

Mr. Abhishek Anand:

Which means that the impact can be significant. So, what is the blended realization per class we should look at?

Mr. Shantanu Prakash:

No, when we talk of 40,000 to 45,000 classrooms we are talking of just the fresh classrooms, they do not even include the additional. This is the first time we are seeing the operating leverage of additional classrooms kicking in, and we have not yet included that in our guidance.

Mr. Abhishek Anand:

Sure. And one more thing, can we have the number for contingent liability arising out of SmartClass as on date?

Ms. Sangeeta Gulati:

Yes, as on date it is 915 odd crores.

Mr. Abhishek Anand:

And just one last question, we acquired this Great Lakes Management Institute, so when will we see the revenue flowing in for us and when will we start consolidating this and what kind of revenue and profit it would have?

Mr. Shantanu Prakash:

Actually, we have not acquired Great Lakes. Great Lakes has been acquired by our investee portfolio company called Beacon Learning. We have invested in Beacon Learning, so you will not see a direct reflection of Great Lakes in our P&L.

Mr. Abhishek Anand:

Sure. Thanks. That is it.

Operator:

Thank you sir. Next we have Mr. Vishal Bhojani from Equitutorial. Proceed with your question sir.

Mr. Vishal Bhojani:

Hello, my name is Vishal, and thank you for the opportunity. I just wanted to ask, is there any plan to enhance the online business, as you told that it has been increasing consistently from the last eight quarters quarter on quarter basis, and it has been increasing on a 20% consistent basis, so are there any plans to enhance the online business?

Mr. Shantanu Prakash:

Well as you can see the answer is evident in your question, that it is growing at an average of 20% quarter on quarter cumulative for the past eight quarters. Now we have 3.5 million students using our online services, so clearly the business is on a major upswing and with the increasing broadband penetration in India we see a further exponential growth in this business. If you in fact look at page 2 or 3 of our investor update, we have given you the list of the online portals that Educomp currently owns. They are basically studyplaces.com, learnhub.com, wiziq.com, mathguru.com and educomponline.com. These put together make us the number one e-learning company in India. So, clearly the growth is already there and it will continue.

Mr. Vishal Bhojani:

Okay, thank you so much.

Operator:

Thank you. Next we have Mr. Nikhil Vora from IDFC. Kindly proceed with your question sir.

Mr. Nikhil Vora:

Hi, Nikhil here. A couple of things. One was on the K12 part. Our invested capital is right now 40% of our balance sheet, and you did talk about moving away from asset heavy to asset light. What is the rationale for it? Is it purely because you think that incremental capital is becoming slightly much expensive to get?

Mr. Shantanu Prakash:

No, it is the part of our strategy Nikhil. Our strategy was we were the first and the pioneering company in India to establish this portfolio of schools, so we had to establish a significant presence across the company using our own capital, which we have done so far, we have 59 schools in our portfolio. The brands that we have established Millennium, Universal, Takshila, Le Monte, these brands have become famous in their respective areas and are attracting price premium of 25 to 40% in the respective markets where they are operating. So we are now shifting to phase II of our strategy. Phase II of our strategy is to leverage our branding and intellectual property and use other people's capital. But other people's capital cannot be attracted until your own brands are famous. So we have invested our capital to make our brands famous. In phase II we are going to use the capital of our joint venture partners and others to expand this schools business which will be done in a very tightly controlled manner by us using our own brands and intellectual property. So, this I would say is part of our strategy.

Mr. Nikhil Vora:

Okay, so effectively what should one really read into in the next couple of years if we move from the current 60 odd schools that we have to possibly around 100 odd in the next couple of years. What should one read into the capital deployment in this business?

Mr. Shantanu Prakash:

It will incrementally keep going down, the capital deployment in K12 business will incrementally keep going down.

Ms. Sangeeta Gulati:

For example, this year we are going to spend around 150 to 200 odd crores more and may be from the next year it will be significantly low. Because you know by that time you would actually have about 50 to 60 of our own greenfield schools and they can become our show case schools as Mr. Prakash has already explained to you.

Mr. Shantanu Prakash:

So two things are going to happen, capital incrementally is going down and revenues are incrementally going to expand at an exponential rate.

Mr. Nikhil Vora:

Okay. And what does that literally lead us into in terms of free cash addition for the company?

Mr. Shantanu Prakash:

Well I think you know given the kind of growth profile, we have not given any specific guidance on the free cash flow. As you know we have earlier spoken that on a standalone basis, on the SmartClass business, the company as a whole on annualized basis has already turned free cash flow. Currently we are investing in schools, in higher education and in vocational, which is only natural because we are building these businesses up and I said in my opening speech, that in the 15 to 18 month range, the other businesses are also going to move towards being cash flow positive, and therefore that is the direction that the company is clearly taking and our strategy as you can see is working quite well because in most of our other lines of businesses the revenue growth has been quite impressive in the range of 150% to 160%.

Ms. Sangeeta Gulati:

I think that may be by 2014 and 2015, the company will actually have very good status in terms of the cash flow.

Mr. Nikhil Vora:

Okay, just a couple of more things. One was on the skill development part of the business, where government seems to be moving pretty fast on that. We do not seem to have done too much work there as of now, specifically with the NSDC. So, any thoughts on that and how is that part of the business shaping up?

Mr. Shantanu Prakash:

I think our thoughts on some of the parts of the education business comes from very deep experience. Educomp has been in the business for about 18 years now and some of the proposals that we give to the government are structured in a way that they should lead to a positive margin for Educomp, so yes we will be working with NSDC and our proposal is currently at a very advanced stage in NSDC, and so at this stage I would like to say that only. But the proposal is structured in a very different manner than a pure vanilla NSDC kind of proposal as you are aware. For the benefit of other people on the call, NSDC is an organization that funds vocational training organizations. You can either go to the bank and take a loan or you can take a loan from NSDC. The advantage of taking a loan from NSDC is that it comes at a 6% interest rate, but it is still a loan, and in return for giving that loan NSDC also takes 24% equity in the company that they give a loan to. So, we recognize this issue and we have tailored our proposal keeping in mind some of the highly cash flow positive and high traction areas of the vocational business, which is in the hard skills area, and I think shortly the proposal is likely to be approved and we will make an announcement in that regard.

Mr. Nikhil Vora:

Okay. Just lastly, if I may, in a couple of our businesses we have already got like in higher and vocational we have got Raffles and Pearson participating with us. Is there any move on the same for our e-learning part of the business?

Mr. Shantanu Prakash:

Well, our business is very attractive right now and Educomp is the go-to partner in India for any large player wanting to create a go to India market strategy. We regularly keep talking to everyone, some of the largest education companies in the world, and we will carefully select our partners keeping in mind the shareholder value that we want to derive from these businesses because the hard work of building the businesses Educomp has already done on its own over the past many-many years, and this is the time when we are in a position to monetize our investments in these businesses, and I think our shareholders will see that going forward, the monetization happening.

Mr. Nikhil Vora:

Okay, cool. Sir, just one last thing, you know, there has been a fair bit of apprehension from investors side as also and from a lot of us regarding the scalability of the business and also the moving pieces which Educomp obviously wants to capture in a lot of their domains. Is it fair to presume that right now you have broadly, your presence is there across the board and one should look at the current core business as remaining pretty much on track and not too many other pieces coming into this?

Mr. Shantanu Prakash:

You know, Nikhil, I am glad you asked that question and we have been very consistently and very credibly following a certain strategy and the strategy has actually been executed almost flawlessly and if you see the leadership position that we currently have in the various parts of the business. I will just take one minute to basically say that in all the part of the education business in India, in multimedia content we are number one, in ICT we are number one, in preschools we are number one, in K12 we are number one corporate player, in professional development we are number one, in vocational education we are among the top two players, we do not have the data to say we are either number one or number two, but we are sure we are among the top two players. In online also we are number one. That leadership has basically come because of our focus on execution, innovation, and so on and so forth, and I think we are clearly moving ahead on that path when there is certain value in being number one in a business which is bound to grow by leaps and bounds in India, so going forward I think the strategy continues, there is no change in the strategy. In terms of scalability, I think it is quite obvious that all these businesses in India are highly scalable. I do not have to really talk about a lot of data, but if you look at just two aspects of the business, one is the penetration levels in some of these areas and the shortages that currently exist. All the investors and the shareholders can do the math on their own. All these businesses are essentially high growth, high margin, and highly scalable businesses.

Mr. Nikhil Grover:

Yes, so are we comfortable with the current line of business and do you think there are still some more missing pieces which you need to add in the businesses?

Mr. Shantanu Prakash:

I think we are quite comfortable. I do not think you will see the addition of any new pieces. You will essentially see further scale amongst the current businesses at the year end.

Mr. Nikhil Grover:

Fair point, okay. Thanks, Shantanu, all the best to you.

Operator:

Thank you sir. Due to time constraint, we will be taking a last question for today from Mr. Samir Dalal from Natwarlal and Sons. Please proceed with you question sir.

Mr. Samir Dalal:

Yes, hi. I have one question. You said that you added about 5000 classrooms in the current quarter, does this include the addition of classrooms to existing schools or as these only for the fresh schools that are added?

Mr. Shantanu Prakash:

Could you repeat the question?

Mr. Samir Dalal:

You added 5000 classrooms in the quarter and the average revenue you gave us was four lakh rupees for new classrooms added, the classrooms in new schools. Does this 5000 include the additional classrooms in schools that you are already present in?

Mr. Shantanu Prakash:

Yes, it includes that number as well and this is really the first time and first quarter we are adding on lot of additions.

Mr. Samir Dalal:

Is there anyway you can give us a breakup on what was the fresh addition of new schools and what was the added classrooms?

Mr. Shantanu Prakash:

We have not shared that number currently, but certainly we will share that number in due course of time.

Mr. Samir Dalal:

Okay and the second question, you said that your occupancy for your K12 is about 20%, but this 20% is only taken because you have only set up a certain number of seats. So, are you saying for the current number of seats that you have set up your working at a 100% or what is the utilization for the number of seats you have set up?

Mr. Shantanu Prakash:

Yes, more or less 100% I would say.

Mr. Samir Dalal:

And the scaling up of that would happen by when, from the 20% schools I mean number of seats for a particular school to the higher levels?

Mr. Shantanu Prakash:

See the way this works is that when you build a school you buy the land for the entire school and you make the building, you cannot keep building every year, and then you announce admissions to certain number of classes. You will announce admissions to KG, 1, 2, 3, like that, and typically in the first year you will fill up the seats that you have typically on offer when there could be you know 80% to 100% depending upon school to school. In some school, we are running at 120% also. We have had to admit more students because so much pressure on the admission coming in, and every year we increase the capacity by adding new classrooms.

Mr. Samir Dalal:

Okay. So, how fast can we expect a ramp up from these current existing schools?

Mr. Shantanu Prakash:

You will expect that a typical school will fill up the entire capacity in about five years.

Mr. Samir Dalal:

In five years time?

Mr. Shantanu Prakash:

Yes.

Mr. Samir Dalal:

Okay, that is it from my end at the moment, thanks.

Operator:

At this time, I would like to hand the floor back to the speaker for final remarks. Over to you sir.

Mr. Sunil Tirumalai:

I would like to thank everyone who attended our earnings call today and like to wish everybody good night.

Operator:

That does conclude our conference call for today. Thank you all for participating. You may all disconnect now. Thank you sir.