



“Educomp Solutions Limited Q2 Results Conference Call”

November 11, 2011



MODERATORS:

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Moderator

Ladies and gentlemen, good day and welcome to the Q2 FY12 results conference call of Educomp hosted by IDFC Securities Limited. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during the conference call, please signal an operator by pressing “*” and then “0” on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Nikhil Vora from IDFC. Thank you and over to you sir.

Nikhil Vora

Thanks Marina. Thanks to all the participants for being on the call for Educomp. We have the senior management team of Educomp: Shantanu, CEO and Managing Director. Sangeeta, CFO, Sonjoy Mohanty, President Corporate Affairs, Raman Bajaj, VP Corporate Affairs and the business head of SmartClass business. I will hand it over to Shantanu to make the opening remarks and the way forward and also open the floor for Q&A. Over to you Shantanu.

Shantanu Prakash

Thank you Nikhil. Good evening everyone and welcome to Educomp's 2nd Quarter earnings call for FY12. I am joined on this call by Ms.Sangeeta Gulati the Chief Financial Officer of the company. Mr. Abhinav Dhar, Director K12 and Operations, Mr. Sonjoy Mohanty, President Corporate Affairs and Mr. Raman Bajaj, Vice President Corporate Affairs. I am very happy to share with you our numbers for the 2nd Quarter of the financial year ending September 30. Our business is very much on track despite unfavorable macro events happening all around the world as well as in India. I am happy to share that even though markets and economy has gone through a tough period, the fundamentals of our business and the education business are as strong as ever. The 2nd Quarter for us has been a relevant quarter where we have grown our revenues by 16% on a Y-O-Y basis. There has been one exceptional item that has affected our reported financials negatively in this quarter. This is the exceptional Forex mark-to-market and is approximately 37 crores pertaining to our FCCB of \$78.5 million on account of foreign exchange fluctuations. The other is the legislative rule change in government education policy in Texas that has impacted our subsidiary Learning.com business. I will share more details on both these items shortly.

Let me first start with the detailed financial highlights of the quarter. On a consolidated basis income from operations for the quarter ended 30th September is 319.8 crores, an increase of 16% over the corresponding quarter last year. EBITDA for the quarter is 105.4 crores, EBITDA margin for the quarter is 33% as compared to 37% in the same quarter last year. The exceptional item of 37.2 crores due to Forex losses has hit our consolidated P&L in this quarter and as a result the reported net profit after tax for the quarter is 12.8 crores. The cash profit for the quarter is 78.8 crores as compared to 79.1 crores during the same quarter last year thus showing a very healthy resilience. The impact due to currency fluctuation has been considered on the entire \$78.5 million FCCB in the current quarter. The other reason behind the decline in

margin is the legislative change in the US that has impacted our subsidiary Learning.com's business about which I will talk in more detail later.

On a standalone basis, income from operations for the quarter is 219.3 crores, an increase of 10.1% over the corresponding quarter last year. EBITDA for the quarter is 97.5 crores and increase of 12% on the Y-O-Y basis. EBITDA margin for the quarter is at 44.5% as compared to 43.9% in the same quarter last year thereby the margins have increased marginally. EBIT margin for the quarter is 39.3% as compared to 38.8% in the same quarter last year. Both EBITDA and EBIT margins before exceptional items have been maintained thus highlighting the resilience in earnings in our core business. This exceptional item of 37.4 crores due to Forex losses has hit our standalone P&L as well and as a result the net profit after tax for the reporting purposes for the quarter is 26.1 crores although the cash profits for the quarter on a standalone basis is 77.6 crores.

Our EPS for the quarter is 1.33 basic and 1.32 diluted on a consolidated basis. On a standalone basis the EPS for the quarter is 2.72 basic and 2.70 diluted.

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 218.7 crores, on a growth of 14% over the corresponding quarter in FY11. The EBIT for the segment was 102.2 crores an increase of 15% on Y-O-Y basis. In the SmartClass part of the business, we added 6818 classrooms during the quarter across 905 schools with an average of 8 classrooms per school. The pricing of the product remains strong with the average selling price for the classroom for the quarter coming in at 4.04 lakhs. Given that we are able to add thousands of classrooms every quarter on quarter and still maintain our robust pricing, is proof of the fact that customer in education (which are schools, teachers and parents) always choose a better quality product over a cheaper product and that this is a relatively price inelastic customer segment where what matters above all is brand equity, trust and credibility of the provider.

SmartClass has now reached a total of 8107 schools countrywide and 4.8 million students are using it on a day-to-day basis. We have certainly come a long way. And yet, we are just getting started as the road ahead is long and full of opportunities. While we are present in over 8000 schools the opportunity for us is the fact that we are not present in almost 70,000 schools and that tells us that we can grow several times from here. And with technology becoming all-important, all-pervasive and ever-changing, we believe that the road ahead for SmartClass is bright and full of opportunities. We are excited to observe the onslaught of tablets and its increased adoption in India which will only open more and more avenues for use of SmartClass content and thereby create multiple monetization opportunities for us. We are likely to launch a tablet PC product bundled with Educomp content soon. The addition of classrooms to our SmartClass kitty is as per the plan and we are on track to meet the FY12 guidance of 40,000 to 45,000 class room. So far in the first half of FY12 we have added 12,106

classrooms which is 27-30% of our annual targets which is on track given the seasonal nature of our business. SmartClass attributed revenues of 191.3 crores, up 28% from the same quarter last year and EBIT of 100.1 crores, up 23% on a Y-O-Y basis.

Let me now turn to the other part of the school learning solution segment which is the ICT business. We have won a new contract from the state government of Chhattisgarh of 582 schools. The ICT program now covers a total of 10,937 schools and 6 million students. We continue to pursue a selective high margin bidding strategy for this part of our business.

Coming now to our K-12 schools business – As you are aware we have been pursuing a two pronged strategy in this part of our business. On the one hand we have invested our capital in setting up our Greenfield schools and on the other hand we have been looking to sign partnerships for the asset-light joint venture model. You will be happy to know that after almost 3 years of setting up a large number of our own schools, we have now become the top reputable school brand in almost every location in which we operate schools. Using this brand equity and leadership position we have now shifted completely to the asset-light joint venture model for the future growth of this business. Over the last few months we have signed 18 new term sheets with joint venture partners for schools in asset-light model of which some schools are already operational.

This is a great thrust in our K-12 business. We are seeing an unprecedented interest from partners across all tiers and all strata who now know of our brands and the educational quality they depict, that they want to partner with us, for a business which will provide annuity streams of revenue to the partners till perpetuity. A detailed list of the term sheets that we have signed is already appended in the investor update which is there with you now.

Our total visibility of schools now stands at 101 schools, a new record at Educomp and one we are very proud of. There are 65 schools operational, 21 land and construction sites, and 15 new joint ventures signed. The break-up in terms of brand, type and year of operation is also available in the fact sheet that has been circulated along with the investor update. As you would notice there has been a sharp decline in Capex in our K-12 business. From 115 crores in Q1, to 48 crores in Q2. Out of this 30 crores has gone towards construction while 18 crores is towards interest capitalization. We believe Capex needs for this business will continue to go down every subsequent quarter as we move completely to the asset-light model. We expect Capex of only 40 crores in the next quarter for ongoing construction in the schools expected to be live in the forthcoming academic term. This figure of 40 crores also includes the interest capitalization.

The school business is structured in our subsidiary, Educomp Infrastructure and School Management Limited, EISML which had revenue of 27 crores this quarter, a growth of 27% on the same quarter last year, an EBITDA of 19.7 crores up 26% on a Y-O-Y basis, EBITDA margin of 73%, PAT of 4.5 crores, up 20% on a Y-O-Y basis and a PAT margin of 15%.

Our Pre-Schools business has also been strengthening quarter-on-quarter. We have been focusing on processes and systems that are constantly improving the quality of our partners and our franchisees to make sure the quality of earnings is robust. I am happy to share that EuroKids, our leading brand in this space continues to be the number one pre-school player in the country with 595 preschools operational. Our other preschool brand which is now called Little Millennium, it was previously known as Roots-To-Wings, also had 233 pre-schools operational making us the largest pre-school operator in the country with a 828 schools network across the country. Between both the brands we now have almost 50,000 students enrolled in the pre-schools business.

The K-12 segment had a quarterly revenue of 44.2 crores, an increase of 38% over the corresponding period last year. Quarterly EBIT was 13.6 crores implying an EBIT margin of 31%.

Moving on now to the Higher Learning Solutions segment -- This segment comprises of our two fast growing joint ventures with world leading organizations, Raffles and Pearson respectively in the areas of higher education and vocational education.

In the Raffles joint venture part of the business, our state-of-the-art, AICTE approved campus for Engineering and PGDM has started off very well. Our focus is going to be on industry relevant curriculum, technology and high end studies. Within days of its launch, we had senior faculty from University of Southern California visiting our campus to discuss faculty exchange programs. We are very excited about the future prospects of this fine higher education campus in the making. Our 7 Raffles Millennium International colleges are fully operational across the country and are also ramping up very well.

In our other part of this segment, which is a joint venture with Pearson called IndiaCan, we now have 308 vocational training centers operational across the country. The total number of students signed across all the various courses for the quarter was 60,815, a 56% jump over the last quarter. Within this segment our ETEN business is already profitable and has become the largest trainer for CA coaching in India. ETEN students secured 10 ranks in the CA final results last month and had an overall 70% pass rate. The IPCC result declared day before yesterday had our students securing 9 ranks with a 72% pass rate. The ETEN business has 136 centers operational and has now launched programs in civil services and bank PO as well. Purple Leap has 100 centers operational and over 13,000 students enrolled. This business is currently in investment mode and is under business restructuring. Our retail vocational model within the vocational business had 72 centers operational on a franchise mode. This part of the business is also making losses currently but the losses are coming down sharply. The loss in the retail vocational business was down 20% on a Q-O-Q basis and we expect this business to break even in FY14. The entire IndiaCan business is estimated to break even in FY14 as well.

The HLS segment had revenues of 8.9 crores and an EBIT loss of 10.7 crores.

I will now come to our fourth and last segment called Online Supplemental and Global which comprises of our investments in the online and supplemental educational space. I am happy to share and we have now completed the grouping of all of our investments in online and supplemental into one company called Educomp Online and Supplemental Services Limited. This company will focus on all areas in the online space and the supplemental space. We are currently in discussion with various private equity players to augment the capital base of this company. Our online footprint in India is the largest across the country where currently we have 3.8 million registered users for our various online properties. WiziQ the teacher-student marketplace has over 1.6 million registered users and added 180,000 users in the last quarter alone. LearnHub and StudyPlaces together have over 2 million registered users. EducompOnline, our platform for users of SmartClass schools plans to link principals, parents, teachers and students on a single common platform. Each of our online properties has been scaling its reach aggressively and adding value to our customers in innovative ways.

On the supplemental education side, we have a total of 73 Test Prep centers, now serving over 18,100 students offering Vidya Mandir classes, LEAP and the Gate Forum branded programs. The supplemental business had revenues of 14.9 crores which is up 5x times on a Y-O-Y basis. The losses in this part of the business are also coming down sharply. H1 losses are down 61% from 6.86 crores in FY11 to 2.68 crores in FY12. This business is estimated to break even and turn cash flow positive in FY14. The Online Supplemental and Global segment had revenues of 48 crores growing 21% over the corresponding period last year and had an EBIT loss of 8.5 crores.

Let me now give you a little color on the legislative change in the US that impacted our Learning.com subsidiary. In August 2011 the government in Texas changed the rules for schools for buying technology literacy products. Previously the schools were provided with federal funds and were mandated to use those funds to buy technology learning products from a core set of products that were “adopted” by the state. Learning.com’s product called EasyTech is one of the few adopted products by the state. In August 2011 the rules changed giving schools more freedom to decide how they want to use the funds available to them. In effect the schools are still provided with the funds and Learning.com’s product is still one of the few adopted products, but the schools are no longer mandated to spend their money on technology literacy products and can choose to spend on other buckets such as training, etc. This has coincided with an year of extreme budget cuts in education in the US. As a result for many schools technology literacy has fallen down in the priority list. Interestingly Learning.com’s market share in Texas has actually increased since its product remains the number one choice of products in schools and those schools who are choosing to use that allocated Federal budgets on technology learning are increasingly choosing products from Learning.com.

We are closely monitoring the developments in the state of Texas and we are hopeful that in a few months the state as well as the school districts will resume their purchase orders for Learning.com's products.

This brings me to the end of my presentation today evening. I want to spend a few more minutes discussing the cash flow situation in the company and any lingering concerns arising thereof. The company has a healthy and comfortable cash flow situation. With the K12 business shifting completely to the asset-light model we expect the Capex burn to sharply reduce as is evident from this quarter's Capex numbers. The entire Capex required to set up schools and colleges is already done and is behind us. The schools are up and running and the college campus is up and running. Each of these campuses will become huge cash flow generating engines for Educomp in the years ahead. Capex was a necessary pill that we had to swallow in the first few years of our business so that we can set up a strong foundation and a strong positioning and as is evident our brands have been established now as the top brands in the country in their respective domains. We believe we have now reached that milestone. We see no reason to invest in any more real estate and the growth ahead will be focused on partnerships, joint ventures and asset-light models. Secondly, our FCCB which is due in July 2012, will be paid off using a combination of internal cash accruals and ECB financing. We have started the process of refinancing and are very well placed to be able to secure ECB financing to pay off the bond holders. We are also applying to the Reserve Bank of India to take the necessary permissions and in parallel we are also talking to various bankers too. Our discussions so far have been very comforting and we do not see any concerns on this account.

In summary, I want to assure our investors that our cash flow position is strong. The fundamentals of the business are very strong which is evident from the strong additions and the robust sales growth that you see in our results. Our leadership position in the education market in India is only getting stronger. The market opportunity in India is really limitless. Our customers see us as the top choice for all products and segments we are present in, which is a reflection of the kind of value that we are able to offer to them. I would like to end by summarizing where we have reached so far. We are India's largest education company reaching now to 4.8 million students across 8100 private schools, 6 million students across 11,000 government schools. We run over 825 preschools, 65 high schools, 7 colleges, 1 higher education campus, 308 vocational training centers, 73 test prep centers and have over 3.8 million users of our online educational services.

With that I will pause now and open for questions and answers.

Moderator

Thank you very much. Ladies and gentlemen we will now begin the question and answer session. The first question is from Priyanka Joshi from SKS Capital. Please go ahead.

Priyanka Joshi

Good afternoon, sir. The loans have risen from 1400 level to 1990 level. Is it only because of the expansion reason or some other reason is there for the higher loan?

- Sangeeta Gulati** We have mentioned in the investor update that the increase in the loans is on account of a) the working capital environment and b) the term loans and the commercial papers that we have taken for the purpose of expansion.
- Shantanu Prakash** So that is there for the normal course of the business.
- Priyanka Joshi** The interest cost is higher at 31. In Quarter 1 it was at around 30. So can I assume that this will remain same in H2 as well?
- Sangeeta Gulati** It all depends upon the rate of interest. Interest rates are actually in a rising phase. Although we are rated by CARE rating have got the highest rating, we are applying to the banks for a cut down. But as on date the effective rate of interest is high. It might come down but we cannot given any commitments because it all depends upon how the monetary policy is adopted by the RBI and all that.
- Priyanka Joshi** What is your average cost of debt as of now?
- Sangeeta Gulati** We have got different loans. There are certain loans which are from 10 to 13 years. Then there are loans which are ranging from 5 years. On an average that cost is about 13.5% if I taken into account all the loans put together.
- Priyanka Joshi** The target to debt to equity is still going up and is in the upper trend. It was 0.5 in FY11 and now it is hovering at 0.84. So what is the debt to equity ratio you target for the future?
- Sangeeta Gulati** The acceptable debt equity is about 2:1, which is a standard market practice. And our debt to equity is much lower than that. Even if you include the contingent liabilities our debt to equity is 1.27:1. We do not expect the leverage ratio to increase much from these levels. So we are well under standard market ratios.
- Abhinav Dhar** As the Capex of the company is going down, the debt is not likely to go up in the future as you can see.
- Priyanka Joshi** If I say what will be expected, can be said it will be in the same range?
- Sangeeta Gulati** Yes, it will be. Since we have gone for a reduced corporate guarantee structure, so with this 20% as compared to the earlier 100% corporate guarantee definitely the debt to equity will be much lower than 2:1.
- Priyanka Joshi** Can I ask the tax rate you are targeting for the full year? I think it will be in the range of 33-36%?
- Sangeeta Gulati** Yes the tax rate will be the normal tax as applicable to our company.

- Priyanka Joshi** You are saying that the Capex will be going down because you have shifted to Capex light model now. So what is the full year guidance for the Capex now?
- Sangeeta Gulati** In Quarter 1, we had said that for the remainder of the year, the capex would be 150 to 200 crores. Then we said it is going to be much lower than that. And this is what exactly we are projecting. You have to eliminate the interest during construction. IDC is actually a P&L item, however, as per the accounting standard you have to capitalize. So from our perspective capital deployed will be the capital which we are going to incur on the construction activities.
- Priyanka Joshi** What is the quantum?
- Sangeeta Gulati** We have given a guidance that in Quarter 3, for K12 schools construction possible capex will be 30 crores. And this is for the schools which are going to be live in the forthcoming academic session.
- Priyanka Joshi** For the Quarter 4 any value for this ?
- Sangeeta Gulati** It all depends, if the joint ventures model goes ahead in a very big way then we might not do any capital.
- Priyanka Joshi** I am also aware that you have started on the vocational front like CFA Preparatory Courses, if I am not wrong, so how you think this Vocational segment to do going forward.
- Shantanu Prakash** You can see from our results that the sales growth in the Vocational segment is very robust. So certainly we expect to do extremely well.
- Priyanka Joshi** Thank you, that is all from my side.
- Moderator** Thank you. The next question is from Sunil Tirumalai from Credit Suisse. Please go ahead.
- Sunil Tirumalai** Shantanu, I have a couple of questions especially on the Smart Class securitization. If I remember right you have been disclosing the DSO number for each of the businesses for the last four quarters now and the current quarter number of about 156 days, in my mind the right way to look at it would be to look at the revenue base of Smart Class and not the consolidated business. And of that calculation I get about 240 days as the DSO for Smart Class business. For each of the last four quarters its only been going up. It started from 130 and now it is progressively increasing and reached to 240 days. And in between that earlier a couple of quarters ago you said that the process of signing the contract and getting the loans sanctioned is taking some time etc., but this seems to be a continuous process actually. It is only going up. When can we get comfort on this number?
- Shantanu Prakash** Actually you can also take this as a strength of the business. For the past three quarters you will see that our total contingent liabilities have not increased which means we have not done

fresh securitization and we have mentioned very explicitly on page 12 of the investor update that the securitization sanctions on a reduced guaranteed model are under way, in fact we expect to close them over the next two weeks and the moment we close them that entire amount will be knocked off from the debtors and the debtors will become in line with the model which would be in the range of approximately 150 to 155 days.

Sunil Tirumalai

I agree, but it only means that for close to a year now we have the booking revenues without the cash flows actually coming through.

Shantanu Prakash

No, it is not like that actually because what we have said is that securitization amount has not come but the schools are continuing to pay the cash as per the normal schedule. So it will not be accurate to say that the cash is not coming in. That will not be a right interpretation of this. We have done over 12,000 classrooms in the first two quarters of the year, so all those schools are paying as per the normal schedule. So there is no problem in payments from the customer at all.

Sangeeta Gulati

Sunil, we have been talking about a reduced corporate guarantee model and if you look at the mindset of the bankers, the security given to the bankers for the previous securitization is already 100%. So now when we are talking to other banks for a reduced security, we obviously have to put in more efforts to convince the banks as other banks are already enjoying full security. That is the only cause of delay. The sanctions are underway and I am happy to say that we have been able to convince the bankers to accept this reduced liability. Bankers only understand one thing and that is the security should be tangible. We are only talking about a receivable financing and without any other security at the backend. And that is the reason it is taking a little longer time but now we have been able to convince. We have been able to prove that without any tangible security the banks have to rely only on the receivables which are collected from the schools. So I think we should be able to announce something very shortly. I must say that, if we go back to 100% corporate guarantee I would immediately get the securitization for more than 1000 crores right away, but we are not looking at that. We are looking at a reduced guarantee structure and our own terms,

Sunil Tirumalai

Just a follow-up on that, so correct me if I am wrong, it was in November last year after your September 2010 results that you had first indicated to us that the corporate guarantee levels could come down to about 20%. So till now we have not been able to finalize anything and sign?

Shantanu Prakash

We have received Rs. 3 billion on 20% model earlier and that was the time when we had announced the 3 billion. After that 3 billion we have not done incremental securitization.

Sangeeta Gulati

We have received one more sanction from Sicom which is a small sanction and which we have not announced.

- Shantanu Prakash** Yes, this is too small a sanction but yes, we are waiting on the big ticket sanction of 400-500 crores.
- Sangeeta Gulati** And even Sicom is offering 15% currently.
- Sunil Tirumalai** Secondly on the Texas change in the rule. I am just trying to understand over here, so the rule earlier was that schools could spend only on technology products but could not train teachers but now they are allowed to train teachers?
- Shantanu Prakash** I will give you another layer of understanding on this. So every state has a set of adopted products so basically the school can only buy the products that are approved or adopted. So Learning.com is one of the adopted products. We have over 80% market share in the Texas market. A change in the rule essentially gives schools, the freedom to decide whether to spend the money on buying the adopted products or to spend the money on doing other things such as teacher trainings, support and technology support and so on. Because the schools are starting there in September, so in this school year the schools have deferred their decisions. About \$700 million is the revenue budget for buying technology products in Texas and this budget is in place, it is intact and we hope that the schools will resume the ordering from the next quarter.
- Sunil Tirumalai** So it is more of a deferment of the decision rather than re-allocating funds?
- Shantanu Prakash** Exactly, it is more of a deferment of the decision. That is true.
- Sunil Tirumalai** My last question is given this event and your performances of first two quarters, stripping out the Forex impact which is MTM one-off, where are we on the profit guidance?
- Shantanu Prakash** I think we are doing pretty well on the profit guidance. We have given in our investors' update that if this was not the case then what our profit would have been. So on a consolidated basis the profit after tax for Q2 would have been 41.2 crores, had the exceptional one-off items would not have been there. So in that case we are on target. The case of Educomp is very simple, if we meet our numbers on Smart Class and the other parts of the business we will meet our profit target. If you look at the operating performance of the company, the operating performance of the company is rock solid. Smart Class, higher education, vocational, K-12, the revenue growth in all these areas has been quite impressive and the losses have actually come down.
- Sangeeta Gulati** Just to add, this is a mark-to-market loss that we have booked. When we re-state our liabilities on 31st of December, there could be an equal probability maybe there could be gain, so that is the reason we are not doing anything on our profitability guidance. I think one of the important concern is that whether the company is making the operating profitability or not. We have shown that our EBITDA is high. Operating efficiencies are there in the company and these are

all non-cash items, over which we do not have any control. So we are not doing anything to our profit guidance at this stage. We are just waiting and watching and hopefully over the rest of the year, maybe the Rupee will strengthen and everything will back to normal.

- Sunil Tirumalai** Thank you very much. I will come back later for questions.
- Moderator** Thank you. The next question is from David Kungsen from Pine River Capital. Please go ahead.
- David Kungsen** I am trying to clarify a bit more on your securitization program. Are there any current headroom in the securitization program or it is fully utilized?
- Shantanu Prakash** It is clearly not been fully utilized. That is the answer that I was giving to the previous questioner that in the first two quarters of the year we have really not done the securitization. So the entire headroom is available at the moment we get our securitization funds coming in that will immediately add to the cash balance of the company as well as knock off the debtors. So the answer to your question is there headroom, yes there is complete headroom right now.
- David Kungsen** How big is this headroom?
- Shantanu Prakash** We have not disclosed that number in the investor update but that is a matter of fairly simple arithmetic calculation which we can get back to you later.
- David Kungsen** Another question is, your currency exposure, are you naturally hedged between your revenues versus your liability?
- Shantanu Prakash** No, we are not hedged. The particular loan is not hedged.
- Sangeeta Gulati** We cannot even hedge the FCCB because there is no particular day, because FCCB are the quasi debt and assuming that the swap comes back there could be equal probability of getting it converted to equity. That is the reason we have decided not to take any forward covers. As of now we might have to go for a reduction of the FCCB but we are not taking any cover because still the stock markets are pretty volatile and we do not have any natural hedge which could even offset our foreign currency exposure.
- David Kungsen** Very lastly, what is the default rate generally on your receivables and have you seen any increase at all recently?
- Shantanu Prakash** The default rate is 0.03%.
- David Kungsen** Thank you.
- Moderator** Thank you. The next question is from Ankur Rudhra from Ambit Capital. Please go ahead.

- Ankur Rudhra** Thanks for taking my question. The first question is a bit on the book keeping side, just to clarify, the mark-to-market charge taken on your FCCB loan, this does not include the accrued interest component of the loan, does it?
- Sangeeta Gulati** Yes, because this is not advised as per the IRF. However, we have to provide it as a contingent liability and if you look at the last year's annual report also, it is coming into the loan.
- Ankur Rudhra** So it is part of your contingent liability calculations when you provide the debt to equity, is it a part of that?
- Shantanu Prakash** Yes.
- Ankur Rudhra** Secondly, on the Smart Class side, clearly you have only done about 14,000 class rooms as compared to your guidance which is maintained for 40,000 to 45,000. So you need to do almost 2x of the class rooms in the second half versus first half, which would probably be the strongest growth you have seen since FY08. So what is the confidence there and is it that you are probably slowing it down till you get securitization funding because of the working capital requirements?
- Abhinav Dhar** No, there are no voluntarily actions of any kind of slowdown what we are doing. Historically, the pattern is that the largest number of sign-ups happens in the 3rd and the 4th Quarters, because both these quarters by default fall pretty close to the academic sessions that the schools run. And if you look at the historical pattern, nearly about 60% - 70% of our numbers have come in the Quarter 3 and Quarter 4. So looking at that we internally had looked at the kind of numbers that we have done, in fact marginally exceeded our internal ambitions. So we are pretty much on track to meet our guidance.
- Ankur Rudhra** Even if I assume that cyclicity that you mentioned, 60:40, there would still be a substantial shortfall compared to the 40,000-45,000 number you are indicating. So I was just wondering if that number needs to be re-looked at in terms of what we are looking for the full year?
- Abhinav Dhar** That has been a historical pattern. If you look, we expanded our penetration early on this financial year with about 200 additional territories covered with our salespeople who have generated an enormous amount of prospects that are kind of ripe and ready to be harvested during Quarter 3 and 4 for us. So it's not looking at the historical numbers but basically if you were to look at the prospect line up that we have at the moment, we are pretty confident to achieve that number.
- Ankur Rudhra** From the PAT guidance perspective, any changes for the PAT guidance adjusting, of course, for the mark-to-market loss?
- Shantanu Prakash** As Sangeeta just mentioned, we are not currently changing the profit guidance and we will look at it next quarter based on what happens to the foreign exchange. And as you know the

mark-to-market is notional, there is no real cash loss right now. So on an operating basis we are not making any changes right now in our guidance.

Ankur Rudhra Finally on the interest rates could you maybe give us a sense of a) what the ECB interest rates are likely that you are negotiating right now? And b) given you are trying to negotiate for lower corporate guarantee, how much would be interest rates on securitization go up as a result of that?

Shantanu Prakash Well, the current average interest rate is about 13.5% or so on the securitization that is the kind of interest that you should expect. For us to give a guidance on likely ECB rate for July 2012, I think it is a little premature to do that.

Sangeeta Gulati Just to add on, there are the ECB guidelines and companies who are looking at raising ECB, they have to adhere to the guidelines. And as per the guidelines it is Libor plus 50 bps all inclusive of the cost. Over and above this will be hedging cost. So the interest rate will actually be in the range of, let us say, 11 to 11.5% or around 12% depending upon the interest rates because the hedging cost is also governed by the liquidity position. I think all corporates are concerned about the rising interest rates and even RBI is looking at it. Maybe there will be changes in fiscal and monetary measures as the country expects a cut in the interest rates. We hope it happens soon still we have two quarters. Let us see, it is a wait and watch situation.

Ankur Rudhra Just on the securitization interest rate though what we have noticed is in other industries when corporate guarantees come down, the like-to-like securitization interest rates go up actually. So 13.5% is that what you currently have on your existing book, or is that slightly lower in the current existing loans?

Shantanu Prakash We are in advanced stages of negotiations on the securitization. So I can say that the interest rate will be around what is the average that we have entertained.

Ankur Rudhra Lastly on the points of presence in IndiaCan and number of centers for Eurokids, this has come down a bit this quarter. Any particular reason?

Shantanu Prakash We keep realigning because many of these are franchisee centers and if a franchisee is not performing either we terminate or cancel the franchisee. So you will see some variation quarter-on-quarter which are non-material, it is just normal business.

Ankur Rudhra So nothing structurally different in your approach yet?

Shantanu Prakash No. Nothing to worry about.

Ankur Rudhra Thanks a lot and best of luck for the remaining quarters.

- Moderator** Thank you. The next question is from Pratish Krishnan from Bank of America. Please go ahead.
- Pratish Krishnan** Just in terms of the securitization, just to clarify, Shantanu, you mentioned that you have not really securitized so far. What is the quantum of classrooms which were signed over the last two quarters which is still pending to be securitized?
- Shantanu Prakash** We had basically done only one securitization that is Sicom which is about 50 crores, the rest are all unsecuritized.
- Pratish Krishnan** Broadly maybe the both 1Q and 2Q number would still be in debtors
- Shantanu Prakash** We can give the exact number on one-on-one basis, we have not disclosed the exact number right now, but those are the broad guidelines.
- Pratish Krishnan** Secondly, when EduSmart does the securitization process, typically what is the tenure of the debt that is signed?
- Shantanu Prakash** Five years.
- Pratish Krishnan** The duration of the debt?
- Sangeeta Gulati** Which debts are you referring to? The company overall debt?
- Sangeeta Gulati** We will raise the debt for 5.25 years. 5 years is a typical cycle and normally there is always a gap of implementation and all that. So we have just kept three months. So it is five years and three months.
- Pratish Krishnan** Thanks a lot.
- Moderator** Thank you. The next question is from Pankaj Chopra from Shanti Asset Management. Please go ahead.
- Pankaj Chopra** Thank you very much for taking my question. The question is what I asked last time. I was wanting to know what is the level of rollover success from the previous schools which were signed on five years earlier to now? Could you give us a percentage on that please?
- Shantanu Prakash** It is almost 100%.
- Pankaj Chopra** The second is about one slide in your presentation which talked about a China initiative with a partnership. Could you give us some elaboration of what that is and how do we expect that? What kind of revenue traction could come in from there?

- Shantanu Prakash** We have a 50:50 venture with a CDEL, China Distance Learning, CDEL is a listed company. We had mentioned this about two quarters back that we have signed this venture and we will shortly be launching. This quarter as you can see from the attached photograph we have already started marketing selectively to schools in China. We have currently not given any guidance as to how big this venture can become but the fact that we already have 10,000 modules translated into Mandarin and the product is already rolling out. We certainly hope for the best and once we are able to capture the trend of what the China business might mean we will certainly come back with guidance and projection.
- Pankaj Chopra** Is it a similar Smart Class model that we have in India? And what kind of investments would we envisage here?
- Shantanu Prakash** We are not investing in the hardware, the way we do it in India, because most of the Chinese classrooms already have a projector or some form of interactive whiteboard already in place. Educomp's role is to provide the educational content for which we are one of the best providers in the world and we will be getting our revenues in terms of the content license revenues so, therefore, we do not anticipate any investments in hardware or even in sales and marketing because the sales and marketing will be done by our Chinese partner.
- Pankaj Chopra** You have complete comfort on the IPR, the knowledge base transfer to China to be distributed or for whatever?
- Shantanu Prakash** We have spent significant amount of time and effort in basically scoping out that part of the agreement and there are several technological and other ways that we are protecting ourselves. So, of course, we are quite confident about that.
- Sangeeta Gulati** One more thing I would like to add is that the content IP belongs to Educomp and what we are giving them is only the localization rights and that too not to China, that of course, belongs to our subsidiary which is AsknLearn. The CDEL contract is directly with our wholly owned subsidiary AsknLearn. So even the localization rights have not been given to our joint venture partner, it has been given to AsknLearn but the entire sourcecode is available at the Educomp level, so we are protecting our IP in every respect.
- Pankaj Chopra** My final question, I request you to kindly repeat the guidance for the year which would have been given, I seem to have missed that?
- Shantanu Prakash** So we have given a guidance of 1760 crores on the top-line and 325 crores operating profit and we had also said that we are anticipating a stake sale which could potentially bring an additional profit of 75 crores.
- Pankaj Chopra** Operating profit at the EBIT level?
- Shantanu Prakash** 325 crores was the PAT guidance for the year.

- Pankaj Chopra** Thank you very much. That is it from me.
- Moderator** Thank you. The next question is from Sandeep Shah from RBS. Please go ahead.
- Sandeep Shah** Just on the securitization, why just for the purpose of reduced guarantee from 100% to 20% we are delaying the inflow when the need is higher as well as we are confident of the receivables?
- Shantanu Prakash** Yes, that is a good question. But as you can see we have a healthy position. So we are able to do a business without any restriction even now. So we do not really have a pressing issue that we have to accept 100% and we have been in talks with a number of bankers and you will see very soon that we will announce that our securitization has been done on our own terms. So we adopted a very tactical approach that we would rather wait to get the things on our own terms rather than on the old terms.
- Sandeep Shah** Secondly in terms of the K-12 schools. Can you give us the color in terms of any new JV partners we are looking at because now it is an incremental execution which would be there even on the JV part?
- Shantanu Prakash** We have circulated a list of the recently signed JVs, we have signed 18 joint ventures over the past one-and-a-half months. We are constantly looking at new joint venture partners. If you look at page 8 of our investor update, it is very clearly mentioned the list of new term sheets signed across the entire country. We have a very strong portfolio of brands. And you will see that we will sign many more joint ventures, much beyond this number in the future. So certainly we are looking for joint venture partners and they are coming to us.
- Sandeep Shah** Last question, by the Q4 whatever Smart Class execution we might have done, do you expect most of that to be securitized?
- Shantanu Prakash** Certainly. Why not?
- Sandeep Shah** So by Q4 there should be a substantial reduction in the debtor days?
- Shantanu Prakash** Yes.
- Sandeep Shah** Okay, thanks.
- Moderator** Thank you. The next question is from Sharad Laddha from Subhkhm Capital. Please go ahead.
- Sharad Laddha** I had a query on the content side of the Smart Class. I wanted to know as per my understanding, we have third-party vendors for our content so how much of our content today is from the third party, say like, Designmate?

Shantanu Prakash In terms of the number of modules?

Sharad Laddha Yes, maybe module or on totality.

Shantanu Prakash Number of modules, hardly 20%.

Sharad Laddha 20% from third party vendors?

Shantanu Prakash Yeah, less than 20%.

Sharad Laddha 80% is our in-house content?

Shantanu Prakash Yes. Our in-house content.

Sharad Laddha So to reach at the 100% base in terms of having in-house, what kind of capital we have to deploy further to have a 100% in-house content?

Shantanu Prakash That is not the way we look at it, even if it is third party, we have contracted out these content providers, whether it is Crocodile Clips or Designmate, on a very long-term basis. When these agreements are going to run through for the next 15 to 20 years, so in practical, these are our own content only. So the way we have planned our content development strategy is not in this way, the way you are mentioning. We plan it on the basis of what are the future needs. For example, currently we are very focused on language translation and rolling out a product in many other languages. And content development in an ongoing activity for the company. We are having two content development centers, one is on Noida and the other one is in Bangalore and this is going to be a constant expense, as we upgrade our content we add new technology, new kind of modules and so on and so forth.

Sharad Laddha So how much we earmark, on a year-on-year basis for content development? Any rough-cut estimate which you can provide?

Shantanu Prakash I cannot provide you a rough-cut estimate right now. You can look at our content development expense last year as a guidance. So we will spend at least a minimum of that amount.

Sharad Laddha So when you say that the kind of arrangements you have with companies like Designmate, in terms of numbers of years for which you have the content. So at the time of renewal and all, you have that similar integration as you have in the first kind of sale?

Shantanu Prakash These are all perpetual licenses. So if once we have supplied the content to the school we own a perpetual license to that content.

Sharad Laddha So that stays with you?

- Shantanu Prakash** That always stays with us.
- Sharad Laddha** Irrespective of being supplied by a third party vendor?
- Shantanu Prakash** Yes, that is way the license agreements are structured.
- Sharad Laddha** Thanks a lot.
- Moderator** Thank you. The next question is from Manish Sarawagi from Edelweiss. Please go ahead.
- Manish Sarawagi** I just have one question. If you can throw some more right on the stake sale which you are thinking of in terms of which business and the timelines?
- Shantanu Prakash** Well, we will not be able to give you an exact timeline but I can broadly share that as Educomp has some of the leading brands in India in the education space, whether it is our supplemental business where we have brands like Vidya Mandir, Gateforum, EuroKids, Learning.com, our school business itself is a number one school business in the country. So we are broadly looking at many opportunities and we will not be able to say as to whether we can conclude something in the next 45 days or one month but the discussions that are going on are, I would say, very satisfactory.
- Manish Saraogi** The fund which is going to be raised it is going to come into the listed company? As in it will not be a promoter stake say for example?
- Shantanu Prakash** We are not looking at any secondary sales, we are only looking at earning that income in Educomp balance sheet.
- Manish Saraogi** Thank you.
- Moderator** Thank you. Ladies and gentlemen that was the last question. I would now like to handover the conference back to Mr. Nikhil Vora for closing comments.
- Nikhil Vora** Marina, we just have one more question. I would just like to ask one question to the management. Just take one more question.
- Moderator** Sure we will move onto the next question. The next question is from Suranjoy Singh from Frontier Capital Advisors. Please go ahead.
- Suranjoy Singh** I have a few basic questions I would like to start with. I had been seeing for the last two quarters the net profit margin is coming down, profit is coming down and I want to see when the stability is going to come in this downward side or will we be seeing this type of situation for a longer period of time?

- Shantanu Prakash** Let me answer your question, if you have actually noticed the EBITDA margin and the EBIT is actually not falling down. It is actually, as I mentioned to you in the speech, our EBITDA margin for the quarter was 44.5% as compared to 43.9% in the same quarter last year and the EBIT margin was 39.3 as compared to 38.8. So these margins even if you look it over a period of 3 to 4 years, are broadly in the range of approximately 43 to 45% for the EBITDA and approximately 38 to 40% for EBIT. So broadly speaking those are the kind of margins that we make. There could be quarter-on-quarter little bit variation, but there is no big change in these numbers.
- Sangeeta Gulati** Please refer to Page #5 of the investor update and this information has already been captured there.
- Suranjoy Singh** My next question is, I have been seeing that in the last three months the loan size has been increased by around Rs. 3 billion whereas if you see the asset size, the fixed asset has been increased by 717 million, goodwill has been increased by 382 million. So I want to know how this \$3 billion has been utilized in actually creating value for the shareholders.
- Sangeeta Gulati** Please refer Page #15 of the investor presentation, we have already replied what has led to this and where are the assets. So it is already there on Page #15.
- Shantanu Prakash** If you look at last quarter, this has gone towards creating the assets and so on.
- Suranjoy Singh** Another thing is in the sundry debtors, sundry debtors has been increased by Rs. 2103 million whereas the sales has not been increased as much as the sundry debtors. Does it show that the cash conversion cycle is a bit tight at this time?
- Sangeeta Gulati** No, it is definitely not the cash conversion cycle. If you look at Page #15 of the investor update, it has already been mentioned that why debtors are increased. They have increased only due to the securitization and if you want to discuss more about the securitization model, we can discuss it offline.
- Nikhil Vora** Suranjoy, sorry to interrupt but we will need to conclude right now. You can take the other questions offline please.
- Suranjoy Singh** Okay fine, thank you.
- Nikhil Vora** Thanks. Thanks everyone for being on the call. Thanks Shantanu and the management team there. Shantanu, just in case you want to make any closing remarks?
- Shantanu Prakash** I would like to thank everybody who has joined in today's earnings call and would like to wish everybody a very goodnight.
- Sangeeta Gulati** Thank you.



*Educomp Solutions Limited
November 11, 2011*

Nikhil Vora Thanks everyone.

Moderator Thank you. On behalf of IDFC Securities Limited that concludes this conference call. Thank you for joining us and you may now and you may now disconnect your lines.