"Educomp Solutions Limited Q3 FY12 Results Conference Call"

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MODERATORS: **MR. SHANTANU PRAKASH – CEO & MANAGING DIRECTOR, EDUCOMP**
MS. SANGEETA GULATI – CFO, EDUCOMP
MR. ABHINAV DHAR – DIRECTOR K-12 & OPERATIONS, EDUCOMP
MR. SONJOY MOHANTY – PRESIDENT CORPORATE AFFAIRS, EDUCOMP
MR. RAMAN BAJAJ – VP CORPORATE AFFAIRS, EDUCOMP
MS. SWATI NANGALIA – ANALYST, IDFC SECURITIES LIMITED

Moderator Ladies and gentlemen, good evening and welcome to the Q3 FY12 Earnings Conferences Call of Educomp hosted by IDFC Securities Ltd. As a reminder for the duration of this call, all participants' 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. Should you need assistance during the conference, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Ms. Swati Nangalia of IDFC Securities Ltd. Thank you and over to you.

Swati Nangalia Thanks Mohsin**.** Good evening everyone and welcome to the Q3 FY12 Earnings Call for Educomp Solutions. Today, we have with us the senior management team of Educomp, represented by Shantanu Prakash, the CEO and Managing Director, Sangeeta Gulati, the CFO, Sonjoy Mohanti, President Corporate Affairs and Raman Bajaj, the Vice President of Corporate Affairs. I will hand over to Shantanu to give us an overview on the business and also the quarter performance, post which we will move on to the Q&A. Over to you Shantanu.

Shantanu Prakash Thank you Swati and good evening everyone. Welcome to Educomp 3rd Quarter earnings call for FY12. I am Shantanu Prakash, the CEO of the company. I am joined on this call by Sangeeta Gulati, the CFO, Abhinav Dhar – Director K12 and operations, Sonjoy Mohanty, President Corporate Affairs and Raman Bajaj, Vice President Corporate Affairs. We are very happy to share with you our numbers for the third quarter of this financial year ending December 31st, 2011. We have continued to cement our leadership position in almost all segments of our business. In terms of sales and revenues, we have had our best ever sales quarter in the history of the company. As you are aware, the company's strategy is focused on turning the business asset light and moving towards free cash flow generation. I will share more details on these broad strategic focus areas in a short while. But first let me share the detailed financial highlights of the quarter.

On a consolidated basis – the operating revenue for the quarter ended 31st December is 365.5 crores, an increase of 41% over the corresponding quarter last year. As you recall, we had an exceptional one-time revenue due to a Business Transfer Agreement, BTA, during the last financial year due to the transfer of old BOOT contracts to our new smart class model in FY10. We have detailed out the one-time BTA revenues for each quarter of FY11 in the investor update. The EBITDA for the quarter is 96.2 crores, an increase of 21% on a YoY basis. EBITDA margin for the quarter is 26% as compared to 31% in the same quarter last year. The net profit after tax after exceptional ForEx items is 24.6 crores, an increase of 5% on a YoY basis and the PAT margin comes in at 7% compared to 9% in the same quarter last year. On the standalone basis, the operating revenue for the quarter is 263.4 crores, an increase of 48% over the corresponding quarter last year, again this growth has been calculated excluding the exceptional one-time BTA revenue in the previous year quarter. The EBITDA for the quarter is 83.5 crores, an increase of 30% on a YoY basis. The EBITDA margin for the quarter is at 32% as compared to 36% in the same quarter last year. The net profit after tax and after exceptional

ForEx items is 41 crores, an increase of 20% on a YoY bases and the PAT margin has come in at 15% compared to 19% in the same quarter last year. Our EPS for the quarter is 2.56 basic and 1.86 diluted on a consolidated basis and 4.27 basic and 3.46 diluted on a standalone basis.

You would have observed the impact on our margins in this quarter, which was in part contributed by the ForEx exceptional item and the lower average smart class pricing. I would like to say that this reflects a very strategic shift and movement in our smart class pricing and product mix. For quite some time now, we have observed that the smart class market is expanding very rapidly and schools of all varieties large, small, and medium are now trying to accept digital content inside their classroom as a part of their day-to-day curriculum transaction. When we look at the market, we see potential of very large expansion even beyond what we have imagined before. Our strategy in response to this consumer behavior has been to launch new product variants in the market to cater to schools of every economic criteria. Thus we have launched a Smart Class 3D product for premium schools, our regular Smart Class Classic and we have now launched a product called Educlass, the new lower price variant. This has resulted of course in the average price realization for smartclass going down and as a result sales for a number of schools have really taken off. We anticipate an increase in volumes in the coming financial year and we estimate that any margin contraction in this quarter will be more than offset by higher volumes in the future. The growth of course is very impressive. As you are aware, the five-year CAGR in smart class is 136% with respect to the number of schools. Consider this data, in Q4 of FY10, the number of schools we sold to were 504. In Q4 FY11, we sold to 1004 schools and in the last quarter, we have sold to 1923 schools that is doubling each year and the growth continues. You would have also noticed that the average number of classrooms per school has come down to 5.3. This is because simultaneously, we have set a new record in the number of classrooms that we have sold to this quarter. From our perspective, this is indeed good news. It means that we have now a beachhead, an entry into an additional 1923 schools in this quarter. Each of these will buy more classrooms in the future till they reach complete coverage. While competitive dynamics in the Smart Class business have continued to remain, we are the leading players with a market share of over 85% and more importantly, we also have the industry-leading price realization. Our estimate is that on an average we sell between 25% to 40% more than the competition. What we are seeing now in the market is typical of a fast growing attractive market segment of any industry. Competition will come in, with lower pricing, but while we are seeing some more competition coming in, we are also very hopeful that we will also soon see some competition exit from the market.

I want to assure our shareholders that Educomp is an industry-leading product in the Smart Class category and over the medium term, we hope that the position of Educomp within this segment can only strengthen and it is not out of place for me to mention that average price realization for the entire Smart Class portfolio may also go up in the very new future. From our perspective, what is also exciting is the fact that we are taking Smart Class into completely new and exciting direction. As you know, we have got about 5.3 million users of our product right now in India, a very large number by any account. For a long time, these consumers have been demanding of us that we provide them access to our content directly from their homes. And for a long time, we have hesitated to do that because we felt that the ecosystem in terms of connectivity and in terms of devices was not ready. Simultaneously, our portfolio schools have been pushing up to shift them to a more web enabled model. And we have launched Educomp Online about a year back in keeping with the demands from these schools. As you are aware, Educomp Online currently has about 2.5 million users and is installed in over 3000 schools. Shortly, Educomp proposes to launch a very well-researched initiative to put tablet PCs in the hands of our consumers. The new tablet initiative in Educomp combines both are content as well as Educomp Online application. Our rough estimate is that given the size of the market opportunity, we should be able to sell about 3 million tablets over the next three years. This is the next big leap in Educomp that we are talking about and has the potential to completely change the revenue and the margin profile of the company and take us into high-growth, high-margin trajectory.

Let me now go into the segmental overview – starting with our school learning solutions segment that comprises of Smart Class and the ICT business. In the SLS segment, our quarterly operating revenue came in at 249.8 crores, this is a growth of 38% over the corresponding operating revenue of the segment in the same quarter last year excluding exceptional one-time BTA revenue. The EBIT on operating revenue for this segment was 90.1 crores compared to 87.6 crores on a YoY basis. In the Smart Class part of the business, we added 10,102 classrooms during the quarter. For the first time ever, we have added over 10,000 classrooms in a single quarter. The number of schools added during the quarter was 1923 a jump of 103% over the same period last year, a new record at Educomp. The number of schools added in this single quarter is almost 1.5 times the total number of schools we added in the entire year FY10. With the addition of 10,102 classrooms this quarter, we have added so far 22,208 classrooms in nine months of FY12 and we are well on track to meet our guidance of 40,000 to 45,000 classrooms by the end of the financial year on March 31st.

I'm also very happy to share that our securitization position has become very comfortable now. We have received sanctions of 590 crores from private and PSU banks on our reduced guarantee model. Since some of this was received towards the end of quarter three, we have had partial utilization of 96 crores so far, leading to a temporary increase in debtor day. Our requirement for securitization for all of our estimated contracts for 100% of our contracts for FY12 is now complete and more term sheets are now awaited for FY13 contracts.

I'm also happy to share that Smart Class as a product idea is now evolving. As you have noticed in this quarter, we now have a multi-variant product strategy with three product variants of Smart Class for schools in India. At the premium end, our product Smart Class 3D is designed to offer the most cutting-edge multimedia technology ever consumed by school children in India. In addition, in the Smart Class 3D labs, children will be able to engage and enjoy 3D content which will lead to high learning outcomes. On the other hand of the spectrum, our product called Educlass is designed to penetrate the budget private schools of the country, who may not have the wallet to install Smart Class in every classroom, but still have the aspiration of using digital content by having it installed in 1, 2 or 3 classrooms. With the launch of our multi-variant product strategy, we now offer complete coverage to every kind of school. And with the impending launch of Smart Class tablet version, we will be able to successfully monetize the home segment too, which promises to be a vast market much greater than even the Smart Class business potential.

Average pricing for Smart Class came in at 3.36 lakhs per classroom for the quarter and 3.57 lakhs for the nine months of FY12. Smart Class is now present in 10,030 schools and about 5.3 million students use the product every day. Smart Class operating revenue was 219.1 crores this quarter, up 44% from the operating revenue in the same quarter last year excluding the exceptional one-time BTA revenue. The EBIT on operating revenue this quarter was 86.8 crores compared to 82.1 crores on a YoY basis.

Let me now turn to the other part of the school learning solution segment, which is the ICT business, where we have added a new contract of 185 schools in the State of Gujarat. With the addition of this contract, our ICT program now covers a total of 11,122 schools and over 6.1 million students. As you might have noted earlier, we will continue to pursue a selective bidding strategy in the ICT business.

Let me now turn to the K through 12 schools part of Educomp's business – In this part of our business, our total number of operational school has gone up to 69. As you are aware, for the future growth of this business, we have been shifting to the asset-light model, which does not require extensive capital expenditure. We had signed 18 new deals for joint-venture schools in the last quarter and in this quarter, we have added 10 more to our portfolio. With that, our total visibility of schools across the portfolio has gone up to 112 schools, which include operational schools, land parcels, and signed joint ventures. The breakup in terms of brand, site, and year of operation is available in the fact sheet with you. Our K through 12 school business is now one of the largest in India. In fact, it is the largest single owned school chain in the country. The schools of course continue to do very well and it must be noted that the true cash and earnings profile of this business does not yet reflect on the financials in this quarter. Our schools are operating at an average capacity utilization of close to 25% because our portfolio is fairly young and because the regulation in the country demands that. Hence even if we were to do nothing more, add no more new schools, we will increase our revenues by about four times in this segment over the next 3 to 4 years with most of the revenues flowing into the bottom line. The free cash flow profile of the Educomp group will substantially change over the years with the schools starting to throw out free cash as they reach closer to maturity. The attached investor update provides details on the aging of the schools. The reason we are now seeing a high interest from our partners willing to sign joint venture contracts with us, is because our school brands are now becoming famous and are among the leading brands in the country. We are aware that a sizable part of the capital is employed in the K-12 business. But the fruits of spending the CapEx in the first phase of our business are now beginning to show. We expect to grow the business entirely on an asset-light model henceforth and believe that all the necessary CapEx is behind us. As you can see, the capacity for us to grow in the joint venture model is far greater. 28 new joint ventures have been signed in the last two quarters itself and it is not unreasonable to assume that in FY13, we could sign over 150 joint ventures, in fact if you recall 150 schools was our five-year target when we started the business and we are now looking at adding an additional 150 joint ventures in FY13 itself. You would've noticed that a sharp decline in CapEx in this business has already started happening. We spent 115 crores in Q1 of the year, 48 crores in Q2 and only 40 crores in Q3 of which only 22 crores were towards construction while 18 crores were towards interest capitalization. We further believe that by the end of Q4 almost all the pending constructions for the school business would be over. We believe that the CapEx needs of the business will continue to go down as we focus more and more on the asset light model.

The school business is structured in a subsidiary, Educomp Infrastructure and School Management Ltd. which had revenues of 24.6 crores this quarter a growth of 21% from the same quarter last year, an EBITDA of 18.2 crores, up 18% on a YoY basis, an EBITDA margin of 74%, PAT of 4.5 crores which is up 23% on a YoY basis and a PAT margin of 15%.

The other business, in our K-12 segment, is our preschool business which now has a network of 842 preschools operating across the country. We have two brands operating in this field, EuroKids and Little Millennium. EuroKids is the country's number one brand with a network of 600 preschools and Little Millennium has 242 preschools in its portfolio. Together, we serve over 53,500 students in preschool space, and are the number one operator in the country.

The K-12 segment had total quarterly revenue of 42.7 crores, an increase of 41% over the corresponding period last year. The quarterly EBIT was 15 crores, again up 40% on a YoY basis. The EBIT margin of the segment was 35% this quarter, the same as the third quarter of last year.

Moving on to the Higher Learning Solution Segment of our business – HLS. This segment comprises our two fast-growing joint ventures in the area of higher education and vocational education respectively. In the higher-ed part of our business, which is a joint venture with the Raffles Corporation of Singapore, our state-of-the-art, AICTE approved campus for Engineering and PGDM have started off very well. We have a good batch of students both in Engineering and MBA, and our campus is fully residential with all state-of-the-art facilities. In the forthcoming years, we expect our campus to become a hub of student activity and we are very excited at the future prospects of this high-quality facility. Our seven Raffles Millennium International Colleges, which are focused on design courses and are also fully operational and are ramping up well.

In our vocational business called IndiaCan, which is a joint venture with Pearson, we now have 343 point of presence across the country reaching over 93,000 students through different programs, courses, and delivery models. This is a jump of 54% over the previous quarter. Within the vocational business, our ETEN business is the largest trainer of CA coaching in India and has now started programs in CS, IAS, Banking and CFA. ETEN has 158 centers operational with about 53,400 students enrolled. The other part of the vocational business PurpleLeap has 90 operational centers and over 30,000 students enrolled.

The HLS segment as a whole had revenues of 15.1 crores, an increase of 57% on a YoY basis and an EBIT loss of 12.5 crores compared to an EBIT loss of 7.9 crores during the same period last year. As you might have noted that EBIT loss in this business has increased from 7.9 crores to 12.5 crores.

Coming now to our fourth and the last segment – Online Supplemental and Global. Our online footprint continues to be the largest in the country and we now reach 4.2 million users across our various Internet properties. WiZiQ, the teacher-student marketplace now has over 1.8 million users. It added 185,000 users in quarter three alone. WiZiQ has had the highest traffic of any quarter with a 50% jump in unique visitors on a YoY basis. And WiZiQ conducted over 117,000 live classes in the quarter which is a growth of 70% on a YoY basis and it is fast growing to becoming one of the largest teacher-student marketplaces worldwide. LearnHub and StudyPlaces our admission advisory services business together, have over 2.2 million registered users. Educomp Online, our platforms for users of Smart Class, has now reached out to over 2.5 million users bringing them to a common platform.

On the supplemental education side – we have a total of 74 test prep centers serving over 23,900 students, an increase of 32% over the last quarter. These test prep center offer Vidya Mandir classes, LEAP and Gate Forum programs, all of them market-leading brands in that category. The supplemental business has revenue of 15.1 crores, up by 148% on a YoY basis.

The online supplemental and global segment had revenues of 57.9 crores growing 52% over the corresponding period last year and had an EBIT loss of 4.6 crores.

Let me now share with you some key balance sheet highlights. I have already addressed the issue of debtor days in my speech here. I just want to add that we will be able to avail the entire sanctioned amount of securitization by the financial year end, which will lead to a normalization of debtors by the end of Q4. Secondly, our FCCB which is due in July 2012 will be paid off using a combination of internal cash accruals and ECB/RTL financing. The process of raising external commercial borrowing or rupee term loan is going on and we expect shortly to have raised the required amount. On the debt-equity side, our ratios look very reasonable. Our standalone debt to equity is 0.59:1. Consolidated debt to equity without contingent liability is 0.89:1 and even if you were to add all the contingent liabilities together the debt equity ratio will stand at 1.45:1.

The company has a healthy high-margin core business and our strongest quarter is ahead of us that is Q4. With the K-12 business requiring lesser and lesser capital and with the Smart Class business growing from strength to strength, there seems to be a comfort in the cash flow situation of the company. The fundamentals of the business of course remain extremely solid.

This brings me to the end of my speech and before I end, I want to spend a little time on the guidance update for FY12. The updated consolidated revenue guidance for FY12 is Rs. 1500 to 1550 crores. The guidance has been updated as a result of the impact due to Smart Class pricing change. Legislative rule change in Texas, which temporarily impacted Learning.com business as well as lower business in ICT because of our strategy for selective bidding and of course lower average pricing in the Smart Class business. The updated consolidated PAT guidance for FY12 is Rs. 250 crores which includes a profit from an anticipated stake sale. The PAT guidance has been updated as a result of impact of the foreign exchange mark to market loss, Smart Class pricing change and continued losses in some of the subsidiaries, which continue to be in the investment mode. We also believe that FY13 is going to be a much brighter year for the company. The macro sentiments are showing signs of improvement, interest rates seem to have peaked, inflation is coming under control and weakness in currency seems to have stalled. Even though, we have adjusted our FY12 guidance, our core business as you have observed is very solid and the fundamentals are very strong.

I would like to end by summarizing where we have reached so far – We are India’s largest education company. We reach 5.3 million students across over 10,000 private schools, 6.1 million students across 11,100 government schools. We currently run 840 preschools, 69 K-12 schools, 7 colleges, 1 higher education campus, 343 vocational training centers, 74 test prep centers and we have over 4.2 million users of our online education services. You might have noted that Educomp has market leadership in almost every segment that we operate in with a proven track record of execution and we are a powerhouse of strong IPs, products and brands. With that, I will now pause and open up for your questions.

Moderator Thank you sir. We will now begin the question and answer session.The first question is from the line of Ankur Rudra from Ambit. Please go ahead.

Ankur Rudra Good evening. I just wanted to understand the margin change a bit better. I noticed several cost lines went up quite substantially, I guess the COGS sort of tracks the business performance. But can you help me understanding personal expenses that have gone up quite a bit both QoQ and YoY?

Shantanu Prakash Our personal expenses have gone up because of the typical wage inflation in the business, but there is nothing unusual about the personal expenses.

Ankur Rudra I understand in the overall business, you would have seen more losses as you are growing parts of your business, but and 8 crores increase, 25% QoQ?

Shantanu Prakash I think the way to look at it is 8 crores increase and not do it on a QoQ basis. If you look at it from an annual basis to compare FY12 annual at the end of Q4 to what was there in FY11 and then compare it to the headcount in FY12 and FY11, you will find that in our industry the compensation increases have been fairly normal, nothing exceptional this year.

Ankur Rudra Is it maybe reactive to competition? Is that probably what is increasing the difficulty in retaining staff, something like that is happening?

Shantanu Prakash Well, Abhinav would you like to talk about that a little bit?

Abhinav Dhar The answer to that is yes. We have witnessed some of the players coming into the market kind of, replicate our strategy etc. What we have discovered is that the largest numbers of schools are still with us. We are maintaining the momentum of our sales, maintaining the momentum of even our market share at this point of time both in number of classrooms and in terms of number of schools. The very reason that we have had historic number of schools signed up this quarter, where even in that competitive environment, there is dominant preference for the market leader at this point of time. Like Shantanu mentioned in his talk that there is the difference between the prices offered by most of these competitors and nearly about 25% to 40% lesser. Despite that, we have had the best quarter so far historically. So that is the scenario at this point of time, but progressively we are very clear in our mind and we do witness most developments in marketplace. We are going to probably witness a lot of these competitors exit out of the market space because of the intensive competitive pressure that they face from us, both in terms of the value proposition and our delivery in domestic industries.

Shantanu Prakash But we haven't really lost, to answer your question on personnel, we haven't lost any unusual number of people in the business.

Abhinav Dhar Are you talking about attrition of people?

Ankur Rudra Yeah.

Abhinav Dhar **Oh, that is** absolutely negligible. Our attrition rates have been absolutely ignorable and we maintain that.

Ankur Rudra A book-keeping question from my end while we are on this, I wanted to ask another question on Smart Class, I'll come back for that. But on the headcount, could you maybe highlight what is the total headcount for the firm now and how that changed YoY?

Shantanu Prakash Headcount, if I get the numbers right now, what is our headcount?

Sangeeta Gulati One of the major reasons is typically the inflation, which we have already spoken about and the other reason is the addition of headcount. So we have people who are making the contents So as and when the number of schools sign up, we also have more people who ensure the quality of the content and that is one of the major reason for our increase in the personnel cost.

Shantanu Prakash We deploy people in most of these schools, so when we add number of schools our headcount will increase, that is the part of our variable expense.

Ankur Rudra **So** all the school administrators sit on your books? that's what's going up.

Sangeeta Gulati Yes. We call them Quality Assurance team.

Ankur Rudra Right, get it, fair enough. Maybe I'll come back for headcount later. Just on Smart Class Clearly you have done a very strong quarter in terms of absolute number of classrooms and its commendable given that competition is increasing, you are still being able to grow this strongly. But your guidance for the full year especially on Smart Classes addition remains quite robust. So you are saying you can increase this record high by another 100% almost. What gives you the confidence there?

Shantanu Prakash This is a data that we have from our field sales and in my short speech, I was talking about how the market has expanded, which is not really surprising for us because we are very closely connected to what is going on the field and I outlined how, in the same quarter every year, starting from FY10 the number of schools we have covered have doubled. So we doubled within FY10 and FY11 and we have again doubled within FY11 and FY12. So essentially, the market momentum is really strong and while we have done over 22,000 classrooms in the first nine months, currently we are in the middle of quarter four and we are very confident that we will be able to meet the guidance numbers.

Ankur Rudra This is what you have been hearing from the field?

Abhinav Dhar Absolutely, so even if you look at historical trends, we nearly added about 54% or 55% of our total annual guidance in the last quarter itself and if we clock about 22,000 classrooms now and even if we were to kind of maintain historical patterns, which I personally believe we are going to over exceed essentially because our footprint has almost increased 40%. We increased our sales team to 600 people in the first quarter, a large number of those took a couple of quarters to kind of set their feet. So if you look at all the coordinates the kind of prospects that we have, the kind of presence that we have at the moment what we get to hear from the marketplace, our competitive position, our historical patterns, I am very confident that the number is going to be met and exceeded.

Sangeeta Gulati I just want to add Ankur, if you look at the Slide 7 of our presentation, we have given the entire snapshot of the seasonality pattern and even if you calculate on that basis, we still have to sign 38% to 50% of our annual guidance. So definitely, you will see the numbers.

Ankur Rudra Okay you have done this. I am just saying that this is from a record high quarter to another almost 100% QoQ jump, so fair enough you have got the confidence I understand that. Thanks for that, I will come back later.

Moderator Thank you. The next question is from the line of Anshu Govil from Flowering Tree, Please go ahead.

Anshu Govil Hi, my question is regarding the debt position. You mentioned that you have got around 500 crores of undrawn securitization line. So is it fair to assume that whatever incremental sales in the Smart Class business would be covered by these substantial lines and we can see the debt sequentially that is high, that's something close to what is your undrawn line to 500 crores?

Shantanu Prakash Yes, as you have noticed, we have said that we have got 590 crores of securitization signed up and by the end of Quarter three, we have availed 96 crores only, so definitely you will see an appreciable difference at the end of Quarter four.

Sangeeta Gulati You are right, all these sanctions, what we have got, they will cater to the entire additional revenue which are going to go in this quarter so that is going up, and we are also looking at further securitization sanctions which will be required for the coming financial year FY13. So maybe we will also announce shortly that we have still more securitization sanctions in hand.

Anshu Govil And for the 20,000 additional classrooms in Q4 are already in place right?

Shantanu Prakash Yeah, that is, right already in place.

Anshu Govil And my second question was on the tablet strategy, you want to do it as a hardware or you want to do it as apps?

Shantanu Prakash Actually, right now essentially what we have announced is sort of like a teaser to the fact that we are launching a tablet strategy. You will have to wait for a more detailed announcement from the company. As you know Educomp's basic strength is our intellectual property and the kind of solution that we are going to present to the marketplace is coming out of our R&D labs with a lot of research and development over almost 12 to 18 months of time that we have been working on it. And I can assure you that the focus is going to be more on providing better learning outcomes to students, using our proprietary, educational contents and so on and not as much focus on the hardware that is obviously not our core strength.

Anshu Govil Basically, my question was that if you want to do it as hardware then there is again a lot of capital which would be involved in the entire process.

Shantanu Prakash I think my short answer to that question essentially was the fact that our solution is going to focus on IT and leveraged our educational content than focus on hardware.

Anshu Govil Okay, thank you.

Moderator Thank you. Next question is from Pratish Krishnan from Merrill Lynch. Please go ahead.

Pratish Krishnan Hi, Shantanu, I just want to understand when you give the guidance of start of the year which is like 40,000 to 45,000 classrooms. I clearly believe that you had assumed good market expansion. So why cut pricing now, because what has changed the marketplace?

Shantanu Prakash That is really good question Pratish and I am really glad that you asked this question. Smart Class is in a fast moving product environment. Smart Class is at the beginning of like a J curve expansion, massive expansion. You can see for yourself, the numbers speak for themselves. How the number of classrooms is moving or how the numbers of schools is moving in Smart Class. We just spoke about crossing 10,000 classrooms in Quarter three and now we are talking about 20,000 plus classrooms in Quarter four, doubling between Q3 and Q4. So clearly, something is going on here and the market dynamics are changing very rapidly, but in our favor for the better. So as we look at the market very-very closely, we track almost on a daily or weekly basis as to what is going on in the marketplace and we realize that the market is expanding much faster than what we thought the market is going to expand. At some point of time, Educomp would have had a calibrated strategy of launching different variants to cater to the changing or the shifting consumer behavior. Essentially, what we thought we will do in FY13, we have done in Quarter three of FY12. So we have launched a lower-priced variant, so that even schools who want to buy one classroom or two classrooms can be addressed. We don't want to leave even that part of the market in the hands of anybody else. Therefore, now we have a complete range of products for budget schools, mid-level schools and for premium schools. So as far as we are concerned the product or the thought of changing our pricing strategy has always been with us. When we saw the right timing, we moved in very quickly with the right product variant.

Pratish Krishnan Effectively, I mean is the cut in pricing because of the mix of products sale or it is like overall you had a pricing cut?

Abhinav Dhar Pratish, I would like to add to what Shantanu said, this is how it is, we expanded our sales presence to about 600 districts in the early part of this year and then over the last 2-3 quarters, we discovered another completely out of sight layer of schools across the country and tier 2 and tier 3 cities which have predominantly been outside of our radar screen at all times. And then the market demanded that these set of schools which have been completely out of our line of sight can consume a product at this point of time which is going to be a lower price variant, so therefore it is a choice between should we completely ignore that layer of schools or should we introduce a variant which will help us put a foot in the door in the schools. And it was a midcourse strategic decision that we made. We said so there is a large number of these lower end schools, let’s say schools with lower affordability, could they consume another variant of Smart Class which is little lower in its value and lower in its pricing, so that over a period of time they can consume more classrooms and eventually evolve into Smart Class schools. Now this is a discovery that we made during this year and having found that, I am very clear in my mind that, in that layer of segment that we have discovered now, opens up entirely another opportunity for Educomp to actually look at growth numbers, which are completely unprecedented because all our business plans and all our guidance is based on what we saw till such time we discovered this new layer of schools which opens up another opportunity for us, so that is what we have done.

Pratish Krishnan What is the mix in terms of the portfolio like how many of the classroom additions are probably in EduClass and the same in Smart Class?

Shantanu Prakash No we haven't given that level of disclosure because that would be just too complicated to do right now, so we will stick to a simpler disclosure.

Sangeeta Gulati Pratish, I just wanted to add in something in response to your question, the pricing when we talk about different average pricing it is dependent on the product mix. So it is not that the product price has actually gone down significantly. We are looking at a product mix, which will give an average pricing of 3.6 or 3.4 this is what we are mentioning and that is the reason, we have said that okay, our guidance stands updated accordingly.

Pratish Krishnan What is the price range that you have for these three products, if you can just help us understand that?

Abhinav Dhar The Smart Class segment continues to be in the region of 3.8 lakhs for new classrooms for five years plus minus a little depending on the number of classrooms that a school adds. Then we have a variant of 3D lab solution which is close to about 7 to 8 lakhs per classroom and then we have the EduClass that looks at about 3-3.05 odd lakhs a classroom.

Pratish Krishnan Okay fine. And lastly in terms of the overall guidance, if you can just help us reconcile the gap in the revenue, like you have cut on the revenue currently for almost 200 crores, where as it seems like based on the lower pricing, at least a 130-140 crores gap is still left, if you can help us?

Shantanu Prakash We haven't really cut it down by that number, you can say that our revenue guidance is 1550 crores and earlier, it was 1760 crores which included our potential stake sale inherent in that, but happy to lead you through a reconciliation separately. We haven't provided a guidance reconciliation at this stage, because the earlier guidance number is not so relevant right now, so what we have done is we have given you what our new guidance is, given so many other factors for instance, our temporary loss in revenue from learning.com because of the legislative change, the foreign exchange movement that has been pretty exceptional and unprecedented as well as the product mix change in Smart Class.

Pratish Krishnan Fine sir. I will come back if I have questions. Thanks a lot.

Moderator Thank you. The next question is from Sandeep Shah from RBS Equities. Please go ahead.

Sandeep Shah Sir, last time, we reported numbers by mid of November, so we were already one and half months into the quarter and we reiterated guidance. What has changed in the last one and half months for us to have a strategically or totally different view in terms of pricing, the mix of sales and revenues? Why we have not realized this at the mid of November?

Shantanu Prakash That is a good question. When we were in mid November, we were talking about our Q2 numbers firstly and if you notice very carefully, we reiterated our guidance for the number of classrooms in terms of unit sales. We had no commentary on our financial guidance in our last quarter's earnings call, the transcript of which is available on our website.

Sandeep Shah Sir, the PPT had one of the slides where we have given the full-year revenues, we have given a full year PAT also.

Shantanu Prakash No, we have not probably done that last quarter in the last earnings call. But anyhow, I think, the point that I want to make is, right now we are in the middle of quarter four and we are talking about quarter three, so many things have changed between quarter three and quarter two. First is the launch of new EduClass Smart Class variant, second is the exceptional movement in terms of the foreign exchange, the third is the whole learning.com episode in Texas. So we really took a holistic view and said now we are one quarter away from the end of the year, how does the guidance really look and we wanted to really be conservative and stay very upfront what we believe was the more likely scenario, so that our investors are fully updated.

Sandeep Shah Okay, that means that the incremental sales growth in terms of volumes is likely to come out of EduClass kind of a product rather than Smart Class?

Abhinav Dhar See, we don't know yet. Like I said, it was a midcourse strategic call that we made and this is the variant we have just launched and we don't know what is the depth of that layer of schools that we are talking about. The very reason that we have given a different guidance this time is based on an assumption that EduClass is a variant that will continue to have same proportion of contribution to Smart Class as we witnessed in quarter three. There is a likelihood of that changing as we go forward.

Sandeep Shah Sir, any color in terms of penetration within Smart Class and Smart Class 3D?

Abhinav Dhar Smart Class 3D?

Sandeep Shah Yeah, in terms of the two segments where our selling price is 3.8 lakhs which is Smart Class. So the penetration in that kind of product, has it now reached to a matured stage?

Abhinav Dhar See, if you completely ignore the lower segment of the market, which could consume our EduClass equivalent kind of a product and only look at the market opportunity available to us as Smart Class, our penetration today is standing at about 9% or 10%, which is just the tip of the iceberg at this point of time, both in terms of the new schools that exists and also progressively in future the opportunities that open up for up-selling to our existing schools as well.

Sandeep Shah Sir, when the penetration is just 9% to 10%, why the efforts are for low margin rather than high margin?

Shantanu Prakash I think while it is 9% to 10%, the demand profile is such that the product is heading towards a tipping point, so it is very important for us to also be present in other segments of the market which were not consumers earlier. So earlier, schools that wanted to buy this one classroom or two classrooms, Educomp ignored the schools because those schools were forming a very small percentage of the total population of schools that had the aspiration to own a premium product like Smart Class. Now because this has become such a magnetic trend, we see schools of all shapes and sizes wanting to put digital content in the classrooms. Clearly, we can't ignore these schools. Therefore, it is for these consumers, the entry-level consumers who want to consume Smart Class for the first time, but can only afford to buy a slightly lower price solution we had to come and launch EduClass. It is a very strategic move, and we are very happy to be in that segment as well because schools grow over a period of time and the same school today who is buying two or three Smart Class or EduClass, the same school could tomorrow end up buying 25 to 30 classrooms from us.

Sandeep Shah Sir, just a last thing, even for a fourth quarter, we are saying that the securitization is already in the place in terms of the volume which we are expecting for the fourth quarter of Smart Class?

Shantanu Prakash Yes.

Sandeep Shah Okay. And this is done at calculation of 54% or for the 45% in terms of what we have achieved in securitization?

Sangeeta Gulati We have done at 45%.

Sandeep Shah Okay, Thanks I will come for follow-up.

Moderator Thank you. The next question is from the line of Sunil Tirumalai from Credit Suisse. Please go ahead.

Sunil Tirumalai Hi, thank you very much. I have few questions just following up on the previous questions on the Smart Class and the guidance. I think what is perplexing to us is that revenue guidance was brought down, but the number of classrooms were not increased, so which kind of contracts the statement in your presentation which says that because of the reduction in the pricing, you will see an increase in the volumes, so that is the part that we are struggling?

Shantanu Prakash No, what we have mentioned is that in quarter three, we have launched this product and you will see an increase in volumes in the future. We mentioned that right up front in the first slide itself, where we essentially say that the margin contraction in the quarter is expected to be compensated by increased volumes in the coming FY, so we are looking at higher volumes in the future because we launched this new product now.

Sunil Tirumalai So from what you are saying the five or six months that the new product has been launched in this year is not having an impact on volumes?

Shantanu Prakash Yeah, we just launched it in quarter three, so clearly some impact hopefully will be felt in quarter four as well as going forward into FY in the next financial year.

Sunil Tirumalai Okay. And the securitization on 28th of November last year, we saw a press release saying that about 400 crores of new sanctions had been obtained. Any reason, till now it is not been used up and why the delay is over there?

Shantanu Prakash Well, by the end of 31st December, we had used 96 crores out of that. We announced on the 28th of November that we have received the sanctions. By the time, we completed the paperwork and were ready to receive the money, it was closer to 15th of December, we could receive 96 crores by 31st of December further to which we have received a further amount of money in quarter four as well. Sangeeta, would you like to add some more comment?

Sangeeta Gulati Yeah. This sanction is from a PSU bank and this is what the PSU bank is doing, they are doing the DD of each and every single school and we are very happy about that and the entire DD is really taking time. So what we do is, we give them the list of the schools and tell them okay, whatever DD you want to do, please do it. They do a school visit, they go talk to the school, see everything whatever they want to see, and that is what exactly is taking time. So apart from the documentation, everything is there. And we are really happy about it because now herein there is a limited recourse, so that is the reason we want to give the confidence to the bank, okay, these are the schools for which the receivables are assigned to you, so now do your DD before giving any recourse back to Educomp. Earlier, the banks were not doing to that extent because they had 100% corporate guarantee but now since the recourse is limited, so we are building up their confidence.

Sunil Tirumalai And how much of the drop of your share of the contract value from 54 to 45 is because of interest rate and how much because of reduction in the guarantee?

Shantanu Prakash No, the interest rate currently is around 13.5% and earlier it used to be around 12%. So the movement in interest rate is about 1.5% and the other is due to increased cash cover by the bank.

Sunil Tirumalai Okay. And I have a book keeping question, rather a silly one, the difference between the basic and diluted shares is all-time high, I'm just trying to understand what is happening there and how we should look at that?

Shantanu Prakash I think you can probably do that off-line with our CFO.

Sunil Tirumalai Okay sure, I will come back.

Sunil Tirumalai Okay. And just finally on the tablet initiative that you guys are talking about, I mean, 3 million tablets for 3 years is quite a large number. Based on last year's sales in India you are talking about nearly a 10% share of entire PC/laptop/tablet sales over the next three years going to Educomp. So it would be really helpful if you could give some details because it is important for us to know what kind of investments and what kind of involvement will Educomp have in such a large business?

Shantanu Prakash That is really a good question and I am glad that you asked the question, Sunil. Before we came to sort of release these numbers, we did a pretty detailed research on where we believe the number of users of a Smart Class product honestly would be. And while the numbers may seem large by using traditional metrics to compare them, so what you are doing, you are using metrics on current PC sales population to estimate what tablet sales might be. They may not be comparable metrics at all, is my humble opinion there. If you look at Smart Class itself, for instance, in 2005, the company had an installed base of just about 100 schools, now we have 10,000 schools, so in five years we have had unprecedented growth. So some of these new market segments which are more solutions based and not just hardware-based can actually go in a very different trajectory and our numbers we believe are reasonable and conservative based on what we feel will be the total number of Smart Class consumers and how many of them we can convert to consuming our educational content on a tablet like device and from the home. So even if we estimate very reasonable penetration levels, we would be able to have the 3 millions kind of number, but do take this number more as a sort of guideline from our side.

Abhinav Dhar I think another major trigger for that optimism is that, we know that schools have a natural progression cycle, so moving from technology in classrooms to technology in hand and the largest segment of the schools that have students who can afford a tablet solution in the next 24 to 36 months to come are in direct line of visibility with us. So we know that there is a large segment of schools who are Smart Class consumers at this point of time, it is a natural progression for them to move into one-on-one device which they will carry into the schools and out of. So those numbers coupled with various other market assumptions, I think that is a very-very logical and achievable number.

Sangeeta Gulati What we are talking about is a retail strategy; so there is no end to the retail market. So if you look at the retail market, I think the number will actually look very low.

Sunil Tirumalai Thank you very much.

Moderator Ladies and gentlemen, due to time constraints only one last question would be taken. The last question is from the line of Ravi Gupta from UTI Asset Management. Please go ahead.

Ravi Gupta I just need a little clarification on the securitization. If I understood it correctly; you were saying that the 590 crores sanctions that you have got till date will be sufficient to cover for the whole Smart Class part of the business for FY12, including quarter four as well. Is my understanding correct?

Sangeeta Gulati Yes, what we are saying is that you have to calculate on 45% because all these are on 45%.

Ravi Gupta Okay fine, that's all. Thanks

Moderator Thank you. Ladies and gentlemen, that was the last question. I would now like to hand over the floor to Ms. Swati Nangalia for closing comments.

Swati Nangalia Thanks to the management for their time for this call. Also, thanks to the participants for joining in today. Shantanu, any closing comments you would like to make?

Shantanu Prakash No, I would like to thank everyone who attended our conference call today and if there are any further questions, please e-mail us at investor relations e-mail address and we will be very happy to address them, either by e-mail or one-on-one conversations. Thank you so much.

Moderator Thank you. On behalf of IDFC Securities Ltd that concludes this conference. Thank you for joining us.