



“Educomp Solutions Limited Q3 FY13 Earnings
Conference Call”

February 13, 2013



**MANAGEMENT: MR. SHANTANU PRAKASH – CHAIRMAN & MANAGING
DIRECTOR.**

MR. SANJAY JAIN – GROUP CEO.

MR. ABHINAV DHAR – EXECUTIVE DIRECTOR.

MR. ASISH GUPTA – SENIOR VP, FINANCE

**MR. RAMAN BAJAJ – SENIOR VP, BUSINESS
TRANSFORMATION & CORPORATE AFFAIRS**

**MODERATOR: MR. NIKHIL VORA – ANALYST, IDFC SECURITIES
LIMITED.**

Moderator Ladies and gentlemen good day and welcome to the Q3 FY13 Earnings Conference Call Educomp hosted by IDFC Securities. As a reminder for the duration of this conference, 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 this conference call, please signal an operator by pressing '*' and then '0' on your touch tone phone. Please note that this conference is being recorded. At this time, I would like to hand the conference over to Mr. Nikhil Vora from IDFC Securities.

Nikhil Vora Welcome you all to the Q3 FY13 Earnings Conference Call of Educomp Solution. We have with us, senior management team of Educomp, Shantanu Prakash – Chairman and Managing Director; Sanjay Jain – Group CEO; Abhinav Dhar – Executive Director; Ashish Gupta – Senior VP, Finance; and Raman Bajaj – Senior VP, Corporate Affairs. I hand it over to Shantanu to make the opening remarks,, the way forward and I guess, Shantanu has the new roadmap lined up for, you could elaborate on that and then we will open it for Q&A.

Shantanu Prakash Good evening everybody and welcome to our 3rd quarter Earnings Call for FY13. Nikhil has already introduced my team on this call today. So let me get straight to the business at hand. We are very happy to share with you our numbers for the 3rd Quarter FY13 ending 31st December, as well as talk about the business transformation initiatives going on. We are approaching our 20th anniversary next year and we are gearing up for our next chapter of growth that we call Educomp 2.0. As I reflect back over the last 20 years, we have bought unmatched innovation to the education sector in India and created and maintained our leadership position for several years in a row. We started with digital content as our core competency and established our leadership in the space through a product SmartClass. Of course, you have seen that we have had exponential growth and rapid expansion in SmartClass to reach over 14,500 schools. Post that, we have diversified into Pre-K and K-12 Schools and established a leadership position in these segments. Then the higher and the vocational education sector as well as supplemental education. We today have leadership position in Test Prep and have funded innovative online education models. On one hand while we are offering these products and services as our core offering, on the other hand we made timely and suitable investments with a 3 to 5 years roadmap in fast-growing budding education companies, synergetic to our overall objective and thus creating multiple avenues for value creation of our shareholders.

From the beginning of FY13, we have been in a phase of consolidation. We have been focusing our energies on operational efficiencies, strengthening our balance sheet, focusing on cash flows and launching new products and services through existing sales distribution and leveraging our service backbone franchise. From a start up to expansion, to diversification, to consolidation, Educomp has come around a whole circle. Now it is a time for Educomp 2.0, a time for new chapter of the company and today we wish to share with you our six-point agenda to transform your company and take it to the next level. I'm sure you would have

received the Q3 investor update that was circulated just a while back. I will request Sanjay to give you the details financial highlights in just a while.

I would first request your attention to the business transformation section and to Slide #4 to begin with. Educomp has been a story of entrepreneurship and leadership over the last 20 years. Now as you can see we are ready to take a leap into the next phase of growth. On one hand Educomp 2.0 is focused on digital content and our intellectual property base offerings where we plan to take our innovative IP-based products across our presence in 14,500 schools and migrate from being the products company to a solutions company. And on the other hand, Educomp 2.0 is focused on asset backed offerings that solve the access and capacity problems for India. This is the place where we have our school and colleges, where we have annuity style long-term cash flows and very long duration customer lock in's with very visible revenues stream.

So let us look at what is the six-point agenda and I request you to go to Slide #5, number one, Educomp 2.0 is about focus. We are the largest company in almost all segments in which we operate but going forward we want to focus on our core competencies, our core businesses and our top strength. We have already begun the process of exiting non-core businesses and monetizing these assets to strengthen our balance sheet. What must be noted also is the fact that businesses which we are focusing on actually constitute the bulk of the large-scale education opportunity in India. Secondly, Educomp 2.0 is about growth but cautious growth. While we have grown rapidly over the last few years from a mere 300 schools in FY07 to over 14,500 schools, our operational backbone hasn't kept pace with the growth. We will focus on improvement, in operational efficiencies, strong backbone and then grow rapidly with solid operating capability in place. We will focus not only on acquiring the quality customer base in terms of profitability and collection but also focus on building a backbone that can service our customers. Thirdly, Educomp 2.0 is a solution company and not just a product company. While so far we have done well, focusing our energies on selling products to school for example SmartClass, with a base of over 14,500 schools we realized that the franchise we have created across these schools brings us at an arm length to over 16 million sets of high end parents across the country and we wish to leverage this franchise through a wider portfolio products and solutions and reaching out to them is indeed an opportunity that will receive our prime focus going forward and you will see this reflected in a slew of new IP-based products that we have launched. We will cross sell, up sell additional products and solutions to a customer base using our existing sales and distribution network. The strategy simply is to migrate from a product company to a solutions company. Educomp 2.0 will require balance sheet strengthening including correction of asset liability mismatch. While we have assets that have long-term cash flow profile, they need to be matched with liabilities of a similar profile. With relatively sticky domestic credit environment, the access to receivables back securitization financing has also started to fade away. Thus, we have worked upon alternate sources of long-term credit.

Sanjay Jain

The forth focus area for us is balance sheet strengthening including correction of asset liability mismatch. The business that we are doing and we endeavor to focus, our long-term cash flow profile should very cautiously match up with liabilities of similar profile. Due to tough domestic credit environment, there is need to go beyond receivable backed securitization. We have worked upon alternate sources of long-term credit including vendor financing and also financing of our schools, which are our customers for purchase of our products and we will talk about this in more detail in just a while.

In terms of our fifth focused item – Educomp 2.0 will be a leaner organization. We are working on streamlining our operations, integrating technology into the supply chain and servicing components to replace and optimize our existing cost structure. We would be looking at outsourcing all identified non-critical activities. To that extent, we have already undertaken specific measures in K-12 business wherein we have already slashed down our corporate expenses by 50% and the effect of that will be visible in our financials from April 2013 onwards. As a last and very important priority Educomp 2.0 is a mix of experienced and new leadership. I am very delighted to announce the joining of Anand Ekambaram as President of the SmartClass business. Anand brings over 18 years of experience in management and sales in the IT and education industry. He joined us from HCL InfoSystems and will now be leading the SmartClass business. With Anand now coming on board, we will have Abhinav's leadership bandwidth available as an executive director of the company and as part of the Corporate Management committee to continue to provide mentorship to our flagship SmartClass business and also help drive strategic initiatives, innovation and thought leadership across all Educomp Group of Companies.

It is important to take a few minutes here and talk about of each of our strategic agenda items and what have we achieved so far. Let me first focus on our largest business that is SmartClass. As you have noted in the investor update which is already with you that we have only added 3084 classrooms across 269 schools in this quarter. Does this imply that there is not enough of a market opportunity out there? The answer is a clear and an empathetic "NO". The market opportunity is huge; the research study conducted by BCG shows SmartClass has almost 80% to 90% headroom available for growth ahead. This is available on Slide #7. According to BCG, India has a potential to add another 45,000 schools over the next five years. So the market opportunity is quite large but growth on one hand requires upfront capital investment from our side and on the other hand such a huge growth potential needs to be tapped on the backbone of strong processes and systems. Till now for all practical purposes Educomp has been funding this growth through its own balance sheet with its system and processes having a need to scale up to handle such a volume. Going forward, Educomp will embark upon this growth journey through a partnership and alliance route wherein these partners would share our vision on one hand and these partners will be our vendors who can go with us by providing suitable supplier credit and providing us suitable high quality products which we aggregate with our IP content for supplying as a solution to our customers. These partners would have education as a higher priority and are willing to structure our liabilities to

match the cash flow profile of our assets. These partners will be technology companies who are looking at partnering with us to create a platform to enable on one hand, provide a strong backbone to scale up the operations and on the other hand launch new products and service offerings. If we can build an ecosystem of high quality partners like these we can grow as much as we want. Since our focus currently and very importantly is profitability and cash, we are picking up only the key contracts that have a high customer quality, better credit rating so that our collection are well on schedule and so on. The quality here is a combination of profitability and cash flow. At the same time there are strenuous efforts on improving the implementation and collection processes and systems. I'm pleased to inform you that on the backbone of focus implementation over the last few months or so, not only the end customer billing on a per month basis has increased from Rs. 28 crores to about Rs. 48 crores, an increase of 65%, our collection efficiency in the last two months was at a staggering 99% up from 69% six months back. The collection efficiency here, we refer to how much amount are we collecting vis-à-vis how much amount are we billing. So in the last two months we have collected 99% amount that we have billed up from 69 % about six months back. This is a record level of monthly-collections from our customers in the history, this has happened because of the new system and processes that has been deployed by our collection teams over the last few quarters. The inherent value in the business is essentially the recurring annuity style cash EBITDA that our business is currently generating and has the potential to make going forward. In fact, if you glance over Slide #29, you will note that our monthly billing of both SmartClass and ICT put together is approximately Rs. 580 million and our operating expenses which are identifiable to a SmartClass and ICT business are about Rs. 225 million and given the run rate of collections, being at an average at level of billing that we are making, the business in the current form and shape at the level that it is running right now is giving a cash EBITDA of Rs. 355 million per month and an annualized cash EBITDA of Rs. 4260 million. We're working towards improving this monthly collection run rate even faster, going forward in order to improve this cash EBITDA. So while collections are improving rapidly there is a focus on better quality of orders that we want to procure. We are also working on aligning the right kind of sources over the last few months to identify the best way forward. Some of the few initiatives or some of the few milestones that we have achieved thus far, first one, we went back to our largest hardware vendors in China and have been working with them diligently over the last six months or so to structure an agreement that would allow us to pay over a period of five years, in turn they would be backed by one of China's largest export and credit insurance Corporation. Not only will they be providing us five years credit for their part of the SmartClass, they will also act as aggregators and supply us with the equipments for the entire SmartClass assemblies. This is mentioned on Slide #10 for your quick reference. This kind of vendor financing is a great source of financing for SmartClass business as the liabilities are matched with the collection cycle from the school and does not create any potential asset liability mismatch of any nature. While the master agreement is in place, we expect to conclude the agreement in terms of the financing nuts and bolts over the next few weeks and will actually see the start of this happening in terms of the 1st Quarter of next financial year.

Secondly, we have recently tied up a Rs. 200 crore school financing from a leading private sector bank. Under this facility, the bank will finance the schools directly for the purchase of hardware and content from Educomp. The loans would reside on the balance sheet of schools and therefore would not only actually be sitting on Educomp's balance sheet. Now, I would request your attention to Slide #12, now. Educomp shifted to the securitization model in financial year 2009-10 on the back of a more receptive securitization market and some very strong other incidental indirect tax benefits. The earlier benefit of indirect tax has now become a disincentive since the direct education has come under the preview of negative list of service tax which is totally exempt. Now, any sale of services that Educomp would actually be making to the educational institutions would actually be totally exempted from service tax. Although the existing model in place has led to upfront higher earnings and cash realization, it does involve relatively speaking a rather complex structure of revenue booking and tax flows. A change in SmartClass business model back to BOOT which is a CAPEX model will enable the company to pitch for a long-term financing from the conventional term lenders. Almost all key financial stakeholders of the company in unison have expressed preference for a conventional asset based financing. Several sources of long-term credit require as a prerequisite, capitalization of hardware on the balance sheet of the company. SmartClass business is akin to one annuity base infrastructure project and fit for a kind of infrastructure loan where after initial CAPEX there is a visible stream of cash flows over the contracts horizons. The key is that the initial infrastructure loans repayment obligations are actually well matched with the cash flow horizons that would be come in from the customers. This capitalization of hardware on the balance sheet would not only facilitate asset based financing from a domestic bank but also open up the vast ECB route of financing. There are lots of multilateral institutions of whom India and education in specific are a priority yet part of their agenda to be pursued. The nine-year long term exposure taken by IFC and Proparco during the current financial year has already endorsed a long-term viability of the business and really facilitate our efforts to secure more such financing going forward. While the final details about the proposed realignment are still under finalization, we believe this is the right direction not only from a financing perspective but also making the structure leaner, making the full benefits of the new changes in the service tax regime wherein there is a potential of good few hundred basis points on the margins on a steady state bases. The company is seriously evaluating and exploring the consolidation of the entire SmartClass operation, the one which is done under the Listed Educomp Solution Ltd. and the part of the implementation cycle which we are getting executed through our third-party vendor of EduSmart. I think, the consolidation on one hand will facilitate a clear visibility on the end to end cash flows profitability cycles and on the other hand, from an operational perspective, it would also enable us improve the underlying operational backbone and the cash flow impact thereof. This thought process is being pursued on a very serious and a priority basis and in a total arm's-length manner and any crystallization of this thought process, I emphasize would be on arms length basis and under a suitable advice from finance, tax and legal experts. The other significant initiative that is being driven in the SmartClass business is the enhanced focus on bottom-line. An important change that is being institutionalized going forward is that Educomp will not be providing the

resource coordinators to schools on the roles of Educomp. If at all our customers wish to have a resource coordinator, Educomp would be very happy to facilitate identification of such a resource, training of such a resource and handle the resources for the customer but this resource would be actually on the rolls of the customers and not on Educomp. We are also in discussion to get into a strategic relationship with a technology partner, strengthen our operational backbone and leverage technology to improve our operational efficiencies on one hand and on the other hand offer additional products and services to our customers and thus become a solution company.

So if I have to just quickly recap these three or four initiatives that I have mentioned, we have the master agreement with Haier (Our Chinese Vendor) in place, we have a Rs. 200 crores committed line of funding for schools, we do have a MoU in place from a technology provider for giving us an solution platform and improving operational backbone and we should soon be heading towards a enforceable master agreement.

Finally, in order to capture a larger share of customer's wallet, we are in the process of launching several new products over the course of few quarters wherein we will cross sell to our existing base of customers using our existing sales and distribution network. Fact that we have the benefit of Abhinav's vast experience in this sector, the fact that we also have now Anand as the new leader on board for taking the SmartClass leadership forward, we believe that while we are developing new products and services to be launched, we also have the requisite leadership now, a strengthened leadership to actually take this course forward. An important point to note here is that we are currently operating at just under 5% of the total wallet share of our market wherein Shantanu already mentioned earlier that we have an access towards 16 million parents today and we will very rapidly expand that share with new products and solutions that can consume through B2B engagement with schools or direct to home offering such as SmartClass Tab that we are launching in a few weeks. In fact, our aspiration that we are carefully working upon that could be of tangible measure of Educomp having migrated to a solutions company is that, all our chosen actions in terms of product offerings, operational backbone, leadership should enable the company to at least generate 30% of the consolidated revenue in about 3 to 4 years from the new product offerings. That 30% target, in our humble view would actually be a parameter of weather Educomp had actually migrated to a solutions company in a 3 to 4 years horizon. We know that the next big wave of our digital revolution in learning will be created around an educational tablet in the hands of students eventually replacing the school bags. This revolution, similar to the SmartClass that was launched by Educomp many years ago, will also be led by us. Tablet will offer the entire content for the specific grade and will allow students to stay connected to their teachers, peers and to the students. The solution is expected to redefine the very use of tablets for a purpose that entirely educational and would be sold direct to the schools through a B2B model and to the consumers through our distribution chain. I would like to clarify here that we have a sales fleet of 600 people across almost as many districts across the country, we have a strong fleet of nearly 5000 to 6000 people who are deployed across various schools providing

the services post the sale. When we launch these new products and services our objective and focus would be to actually leverage this franchise and launch these service almost on a gross margin basis, rather than incurring any incremental meaningful fixed cost in launch of these products. We know at this stage having set up a vision some years ago to make every school adopt SmartClass and seeing it realized very rapidly we have now envisioned that SmartClass Tabs will also go into the hands of every student and become an integral part of their academic life. Some of these products are mentioned on Slide #14. Our tablet product SmartClass Tab has just been very carefully launched in certain select schools, we already have picked up some early orders in that space and while we believe there is immense potential, there is a potential explosion of orders pipeline but we would rather go very cautious, very selective and gradually scale it up in the coming few quarters, the response so far is positive. Then a series of solutions such as our recently launched English Mentor Lab, given the appetite for English learning that truly is impactful across all the schools in India and given the very highly differentiated features of our lab solution we are confident of a very new and exciting opportunity that should open up for Educomp. Also on the backbone of this are the mandates whereby the government is making the mandatory for schools to have English lab in the schools thus unfolding an exciting opportunity for Educomp. Beside this we will be launching an assessment product as well as school curriculum product based on our existing IP that the Educomp R&D has created over many years. As we are also looking at moving onto the next important aspect, we are also looking at a larger reorganization in the business with a goal of becoming solution company. Instead of function centric structure, we are putting together a customer centric structure by merging the function of sales, customer servicing and collections and by giving the teams, revenue and profitability targets instead of mere revenue targets. Concrete plans are underway to make this re-organization a reality very soon. In the process, we will be increasing the span of control for management and making the organization lean and more efficient and this will also gradually get reflected in the OPEX per month that is identifiable for SmartClass and ICT business. Our submission to all our stakeholders, the customers, the employees as well as the lenders is that we want to be a cash flow savvy business with a focus on value creation i.e. the return on capital employed. We know there is a tough journey ahead but we have a clear focus, we have chosen a roadmap and we know what we have to do to get us into that stage that I just mentioned to you. Going forward, with respect to SmartClass, operating metrics that we are supposed to set as an agenda for ourselves is order booking and its composition thereof i.e. how much of this order booking is coming in from new products and services. Then order booking to billing efficiency, quality of order booking both in terms of profitability and cash flow, working capital efficiency, covering inventory and receivables and finally OPEX optimization, we should gradually get reflected in the per month OPEX. We believe these five key operating parameters or metrics would soon over the period of next few months gradually start reflecting into the way we will be internally conducting our business and we try and communicate to our stakeholders as to how the efforts of the internal conduct have been. And I believe friends, all these five parameters should eventually see in due course of time, a net reduction in the net debt of the company.

The other focus area for us is the K-12 business. As you are aware, we no longer set up schools in the asset heavy Greenfield model, as a result we have taken stringent measures to cut down our corporate overheads by a sharp 50%. The Corporate overheads to put a number to it are actually Rs. 25 crores on an annualized basis, they have been brought down to a level of Rs. 12.5 crores on an annualized basis. On the enrolment side, we have heightened our efforts to significantly increase the number on new enrolments for the financial year 2014 and given the early signals, we feel positive at this stage with the progress made so far. Of course, the results of the new enrolments would be completed only by March- April, we are at present in the midst of the admission season and the progress so far as compared to the corresponding period of January and mid February last year is encouraging. Importantly, given that at a consolidated school level, the business operates much above operating breakeven, any increase in revenue from fresh enrolments would largely straight go to the bottom line of the company.

Let me talk a little bit about the other part of our six-point agenda, about exiting the non-core businesses and monetizing those assets to deleverage our balance sheet. Earlier this year, we finalized our sale of entire 50% shareholding in a preschool subsidiary EuroKids to a group of investors led by GPE India, one of the leading investors in education in India. As I recall, Educomp acquired its 50% shareholding in EuroKids in FY09 for a sum of approximately Rs. 40 crores and thus has created significant value for our stakeholders upon the exit wherein we would actually be exiting at a value of about Rs. 120 crores. Similarly earlier this year, this year means calendar year, we also signed an agreement with Kaizen Private Equity, India's first private equity focused fund on the education sector and Bertelsmann, a global media company with interest in publishing media and Internet services to raise primary capital investment of Rs. 22 crores in our subsidiary, AuthorGEN, an e-tutoring and online education company. With this fund raise, Educomp shareholding is diluted and we will still retain a minority 22% holding in the company which on one hand has ring fenced Educomp from the need of putting in further capital, as I recall, over the last few years we have been putting in about Rs. 10 crores per annum to sustain and grow the business. With this fund raise which is about Rs. 22 crores should make this business reach the stage of cash self-sufficiency and our 22% stake as the business do well in the next couple of years holds the potential of value creation for us. We believe we have brought the company to a level and now it is better placed in the good hands of Kaizen and Bertelsmann to take it forward. There are some loss-making assets in our supplemental portfolio as well. We have taken the difficult steps to shut down some of these businesses as they have continued to remain loss-making and we can no longer continue to fund them as well. We are better off channelizing our resources on the chosen two verticals which Shantanu mentioned in his opening remarks. The process of winding down has been initiated and will be executed over the next couple of quarters. Given our plans, we reasonably believe that by the end of FY14 except for one business we would have almost exited this entire online supplemental group or we would have shut it down. The only business where we would stay invested is Learning.com business which is being done through a company in US that we have acquired a couple of years back. Some changes in the laws of

land have brought down the financial and operating performance of the business but we have taken stringent measures to address it and we believe the business has potential and will come back to the profitability parameter that it deserves in about 8 to 10 quarters and that may be the time to then actually take the next level of call for that particular business but for everything else, we have set out the next 12 to 14 months to really not being existing in our overall portfolio.

Given this background of the transformation agenda for Educomp 2.0, I will now come to the detail quarterly financials.

In the second section of the presentation starting from Slide #number 17. On a consolidated basis the total revenue for the quarter is Rs. 3390 million compared to Rs. 3790 million during the same period last year. The EBITDA for the quarter is Rs. 985 million with a margin of 40%. The EBIT for the quarter is Rs. 663 million compared to the Rs. 723 million last year. I would like to add here that the EBITDA here includes the profit due to sale of EuroKids business, posts tax, there is a profit of Rs. 66 million for consolidated Educomp Solution results compared to a PAT of Rs. 246 million last year. Coming now to the quarterly stand-alone results from Slide #18. The total revenue is Rs. 2002 million which is down by 25% on a year-over-year basis. EBITDA is Rs. 687 million with an EBITDA margin of 55%. EBIT for the quarter is Rs. 548 million includes the profit due to the sale of EuroKids business as well. Let me now go into the segmental results for the quarter on Slide #24, as you can see except for the SLS segment, we have achieved an improvement in both revenue and profitability for all other three segments. The fact that we focused on lesser volumes of classrooms which is about 3084 that we sold during the quarter, it is impacting the revenue for the segment and the overall EBIT but as we mentioned earlier in this call, the agenda that we have chosen we would gradually scale up this volumes but we would first focus on cash flow profitability than actually for volume.

Let me now turn to a K-12 school business. In this part of business our total number of operational schools at the end of Q3 excluding EuroSchools which were part of the EuroKids subsidiary stands at 43 schools, the number of Greenfield and acquired schools are 37 while the number of asset light schools is 6. We also took steps to exit 3 franchises schools as we have discontinued the franchising model going forward since we want to focus on only on the JV model that brings us to a total of 46 schools at the end of Q3. Our future aspirations is to grow the portfolio to 100 JV schools in about five years horizon while this opportunity is huge and waiting to be tapped but we would tap it only on the back of suitable availability of capital. In fact when we are making this decision, we are being guided by the second part of the six-point agenda, yes, there would be growth but there would be cautious growth. In the immediate future we want to focus our energy on enhancing revenue and cash flows from our existing schools and given the enrolment visibility for the next coming season we believe that K-12 business is well on track, which is also getting reflected in the financials of the business subsidiary Educomp Infrastructure School Management Ltd. There is a growth of 28% in the

revenue and the EBIT margin is at 64% this quarter as compared to 58% in the same period last year.

Moving on to higher learning solutions, this segment comprises of two joint ventures in the year of higher education and vocational education. I'm delighted to share that both these businesses are gradually heading towards EBITDA breakeven in the next two or three quarters, while these businesses are strategic to us in an asset backed vertical approach, we want to really focus on bringing these businesses to EBITDA breakeven and cash self sufficiency.

Coming out to the fourth and last segment, Online Supplemental and Global, this segment includes Test Prep business VMC, Gateforum and the other online businesses and our global subsidiaries. Our Test Prep business VMC continued with another solid quarter ended with 8273 students compared with 4648 students at the end of Q3 last year. Company during the quarter had a revenue of Rs. 131million, a jump of 45% on a year-over-year basis. There was a similar heartening performance in Gateforum business as well where in the revenue at Rs. 100 million had witnessed a of jump of 59% over the same period last year. The enrolment in Gateforum business stands at 26,723 as compared to 18,673 in the corresponding period last year.

These were some of the operating and financial highlights of the 3rd quarter FY13 and we would now be requesting if any of you have any questions, we will be happy to take them.

Moderator

We will now begin the question and answer session. The first question is from the line of Nikhil Salvi from IDFC, please go ahead.

Nikhil Salvi

The plan that you have explained was pretty detailed in terms of how you are seeing the next phase for Educomp, what I was interested to know is how will it affect the way the financials are reported and the segmental data is being reported, so we will have new segments coming in completely different from the way the existing segments and their performance has been reported or how it would be?

Sanjay Jain

I think that should get reported as coming closer to cash, so therefore if we have done cumulatively a little less than 100,000 classrooms over the last few years, there is an order book of Rs.3000 crores or so that we have contracted which has to be executed over 60 months which leads to approximately about Rs. 50 crores plus minus small percentages here and there, about Rs. 50 crores per month of average billing, so the key parameter to watch is that the business of SmartClass should actually have a current monthly annuity of about Rs. 50 crores which is somewhere getting reflected in what we're collecting in the last three months on an enhanced collection efficiency level, so that is one parameter in terms of reporting as to how much you see revenue from the current annuity revenue in hand. Another thing that would be added to this revenue and could be a key metrics to watch for, is that for all new

orders that we are adding up, they would have a value in terms of the life of the contract divided by 60 months, there would be a monthly revenue or a quarterly revenue, so an opening balance of about Rs. 50 odd crores plus the additions in terms of the conversions of the order books to billing that would be a kind of revenue add to it the current ICT revenues of about Rs. 10 to 15 crores that is the revenue of the SLS segment. At present there is a Rs. 22.5 crores OPEX of conducting this business and given that we have a plan to bring down the OPEX, so to answer your question it would be a current opening balance of annuity revenue plus the addition due to new SmartClass rollouts. Any hardware that we are using now would go to the balance sheet because this is going to be non-eventuality in both models less the OPEX would actually give us the clear operating margins from the SmartClass business that is how we actually want to clearly and closely monitor the business on a cash basis.

Nikhil Salvi

You have said that the operating costs will be brought down to half from Rs. 25 crores to Rs. 12.5 crores, so what kind of measures are you planning bring in, where are you are reducing the cost and in what manner?

Sanjay Jain

I think firstly, allow me to mention that we are actually mentioning two separate figures there, when I mentioned Rs. 25 crores of corporate overheads that pertain on an annual basis to the school business and here we are talking about Rs. 23 crores of OPEX for the SmartClass and ICT business identifiable to the SmartClass there is a corporate overhead as well and separately, so there is 25 per annum for the school which has been brought down to nearly 12.5 which is 50% reduction. The specific measures taken are given that we have focused on JV model, given that we have ceased to construct our own schools, any construction related activity is non-core for us therefore all related costs which related to construction which were sitting in house we have done away with that. Number two, in the support functions like HR finance, admin and IT while we believe all our subsidiaries are being conducted at arm's length basis therefore there would be leadership driving these common functions but there are a lot of routine functions which we have gradually made a common source platform, this as well has resulted in to cost reduction. The third is that, on the first two factors leading to a smaller cost structure, we were using a much larger facility for conducting the K-12 corporate, we have vacated the premises and actually shifted the team to the current location where Educomp Solution and other group companies are, as a result not only we are saving the cost of running a whole 6 floor building for conducting the K-12 business, there is also a potential that we are creating for earning our rentals which are not factored in when I'm saying that there is a 50% reduction. The leasing out the building will generate another recurring stream of rentals to come in for the business and I think while we are doing this, we are very cautious that we are in the midst of enrolment season and progress so far as I mentioned is making us believe we are on the right track in terms of enrolment targets.

Moderator

The next question is from the line of Pankaj Chopra from Shanti Asset Management. Please go ahead.

Pankaj Chopra My question is with regards to the statement just may use you said, we have a annuity revenue of Rs. 50 crores per month from SmartClass but if I see the last quarter it is three months of reporting a Rs. 107 crores of revenues, so what is the disconnect and it doesn't even add the new order which you booked, so is there something I missed?

Sanjay Jain That is a valid observation, the key point to note here is that these financial reported are on the existing basis wherein there is a revenue recognition of 75% in the first two years and remaining in the four or five year horizon and when we mentioned in our opening remarks in terms of the agenda of migration to BOOT or an annuity basis is what we gradually migrate to and as we migrate to a stage the annuity that is the end customer billing actually Educomp is billing to EduSmart under the securitization route and EduSmart is doing the end customer billing given the fact that we wish to consolidate the two operations. The end customer billing would actually be about Rs. 50 crores annuity per month.

Pankaj Chopra Just moving on, the number of school additions have been pretty low and you said it is an emphatic no that there is decline in demand or the opportunity. Could you elaborate on that a little bit more, it is extremely distressing to see or see number like this once our post call after call when we have said what kind of traction and expectation of school additions should be there and you see a number which is so low? Could you give your thoughts on that please?

Shantanu Prakash I think you have read these numbers in perspective, I think, firstly as Sanjay mentioned earlier these numbers are not really reflective either of demand or of our ability to execute the demand. We spent a lot of time today speaking about a transition phase in the business and sometimes in a transition phase you have to slow down to speed up and some of the things that we are essentially doing in terms of retooling or reengineering the business for example, moving to a more cash-based system for selling, changing the way we finance the business and so on, business process reengineering, organizational restructuring which we spoke at length about, so we have really taken a breather and a pause to see how do we reconfigure ourselves to take advantage of the large growth opportunities and there is a particular reason we mentioned the results of the BCG (Boston Consulting Group) Research and that will be reason is to emphasize that there is 10x demand for a Educomp in this opportunity, so we don't really want to keep running at a unsustainable pace, we have taken a breather, re-tool our selves so that we are ready for the large growth opportunities that come and therefore these results have to be read in a longer term context of where Educomp business is actually heading.

Pankaj Chopra Just follow-up on that, could you give a sense of, when do you see this slowdown kind of giving way back to growth which you think would be a sustainable growth or more stable situation? Do you expect a couple of quarters before this happens?

Shantanu Prakash I would say one or two quarters at most but I would refrain from using the word slow down, I would really like to use a word like reconfigure, retool and so on but I guess we are already in

Q4 of the year, so getting onto Q1 of next year, we will build up a clarity on how things are going to pan out but I would say at most one or two quarters.

Pankaj Chopra The second question is with regards to your development of the tabs, etc., in which part of your cost or CAPEX, do you capture that as a CAPEX or do you incur that as an operational cost?

Shantanu Prakash Actually our entire emphasis when we think about releasing new products is to make sure that it is a zero CAPEX, that is point number one. And point number two is, not just zero CAPEX but also zero working capital. Number three, leveraging existing IT. Number four, leveraging existing sales team and number five leveraging our existing customers. So essentially it is selling our IP at very little incremental cost to us. So really when we are selling the tablet we are selling of the hardware on a cash only basis to the parents, to the students and they pay for our IP, IP is something that EDUCOMP already has, we have the largest content library in India, perhaps in the world, we have technically reengineered our content to rest on tablet devices and why we are so excited about it, it is just a SmartClass got into classrooms, I think, it is time for these devices now to find their way into students' backpacks and that is what the whole initiative is all about, so from a revenue earnings profile this is really selling existing Educomp intellectual property to our customer base of over 7 million SmartClass customers.

Pankaj Chopra But the issue is that the development cost of this product, I guess you would have incurred cost of having some developments done, has that been accounted as a CAPEX for yourself or has it been part of the OPEX?

Shantanu Prakash This is expensed off. We already have an existing R&D team so there is no instrumental addition to the R&D team.

Pankaj Chopra So it is part of your operational expenditure, it comes in your P&L, am I right in that?

Shantanu Prakash That is correct.

Pankaj Chopra The second thing about the same business is my apprehension is that the business of tabs or hardware has associated issues of servicing and a service network which I'm not so sure whether is part of business of Educomp and probably could lead to a bad press, bad branding or whatever, slippage in some sense, I'm sure the management have given thought to it, I would be happy if you could comment on these issues?

Shantanu Prakash When we think of tablets or we think of even SmartClass these are really containers for us to show our content. Educomp is basically a content company, we will tie up with best in class partners who make tablets, there are a zillion companies out there who do tablets today and we have chosen companies that have a good service network but we are being very transparent with the customer saying that "look this is not an Educomp tablet, this is the tablet belongs to

company X or company Y and while we are simply facilitating the sales, the company is responsible for the hardware maintenance and warranty and customers understand this. They understand and appreciate the value of buying a content from Educomp and buying a standardized ruggedized tablets from a standard well-known manufacturer.

Pankaj Chopra

So it is a branded tab?

Shantanu Prakash

We are not in any case different from anybody else who is selling the tablet in the market.

Pankaj Chopra

No, I just wanted to check whether it is a branded tab, someone who is known nationally the last time we checked, use that the vendor is in China who where you have...?

Shantanu Prakash

Most of the vendor's are actually in China but I think the central point of your question is, does that vendor have a good support network to back it? That is really the key point and we are extremely sensitive to that aspect, it is one thing to put the hardware inside the classroom the other thing is to give it in the hands of 500,000 students who use it 6 to 7 hours a day so extremely sensitive to that aspect and you can rest assure that the company has taken all possible measures to ensure good quality service to our clients.

Pankaj Chopra

The last question is about Learning.com, that is being a very major pain point for more than a year now, I am surprised that you still want to continue with it. Could you give us a little bit more info on what this company is now doing, what are the issues and how do we intent to resolve on this?

Shantanu Prakash

I would really encourage everybody on the call to really go and check out the company at least on the website, it is a leading provider of web curriculum services in the United States of America. The US has gone through a regulatory change in terms of how they fund the school districts and fund the States and all companies including learning.com have been adversely impacted by contraction of available funding in the US. We have very rapidly reconfigured the model of Learning.com and we have now the new CEO for the Learning.com, his name is Keith Olerich and he comes with vast experience in the education industry, very well-known person in the United States and there is a plan on the table to bring the company back to profitability. Again this company has the intellectual property and assets. They have a very well known product which does learning management. They have a very well-known product which is a content marketplace for several states, it has state wise adoption for several states. So we have taken a very careful evaluation of where we think the prospects of the company will be in another year, year and half and based on that the board of the company has approved a business plan so we are quite confident that this will result in value creation for Educomp shareholders.

Pankaj Chopra

When you think it will become EBIT positive, should be over six months?

- Shantanu Prakash** I would say four quarters.
- Moderator** The next question is from the line of Bhadresh Shah, an individual investor, please go ahead.
- Bhadresh Shah** My first question is regarding your exit from EuroKids, could you explain as what is the strategy is regarding that?
- Shantanu Prakash** The strategy is already an announced strategy of exiting our non-core assets and investments. We had made an investment about 3.5 years back in EuroKids and we found that this investment was giving good value to us at this stage so the decision to exit from EuroKids. As you know that as long as the company was in the Educomp fold the company had shown very impressive growth and you will be happy to know that we will be exiting this investment at close to 3x return to our shareholders.
- Bhadresh Shah** Does that mean that we will also look at exiting from preschool as a segment?
- Shantanu Prakash** If you look at our six-point agenda of the business transformation plan. The very first point I had talked about focus, it says that focus on big opportunities and I read from there, digital content, schools solutions, and K-12 and schools. So to the extent the preschools is part of the K-12 schools, we will continue to be there EuroKids was an investment, Educomp owned 50% of it hence we have exited it. We have always considered that to be an investment and a good investment at that.
- Bhadresh Shah** My next question is on the competitive intensity in the SmartClass segment, how do you view that has present and does that reflect in terms of pricing?
- Shantanu Prakash** For a few quarters the pricing was coming down and for the past two quarters the pricing has actually been flat to up and that is reflective of the lower competitive intensity in the SmartClass business. This is my personal reflection that the rest of the industry is coming to terms with the special expertise that is required to execute this business with certain level of customer satisfaction and quality. Because of the fact that Educomp has far greater scale today than any of our competitors and my estimate would be that we are anywhere from 3x to 5x bigger than most of the competition, we have understood or gone through some of the challenges of consumer behavior, how we need to service the schools, how we need to train the teachers, much earlier on in the curve, so there is a level of business intelligence that is embedded in the SmartClass team. A lot of our new competitors when they came in, as is natural that there was price discounting and in response to that we had lower selling prices as well but if you look at the past couple of quarters I think there is a realization across the industry that there is a realistic and a sane way to do this business and therefore the prices have started firming up. This is something that we had predicted about three or four quarters back and we are very happy to see that it is already happening in the market and we also hear of competitors slowing down in this space. So, all in all much reduced competitive intensity.

- Bhadresh Shah** What are the debt levels that you expect for the end of the year and how do you see that through FY14?
- Sanjay Jain** I think we may not see any delta increase between now and the year end, it could be minor variations at the current debt levels. But our endeavor in the coming four quarters to answer your questions specific to FY14 and we should see a small reduction in the net debt.
- Moderator** The next question is from the line of Nikhil Vora from IDFC Securities, please go ahead.
- Nikhil Vora** Sanjay did talk about the EduSmart integration along with it some of the vendor integration, what does that really mean for Educomp specifically in the context of what the business has been doing for the last three years where there has been apprehensions regarding EduSmart, how does an investor get comfortable with the potential integration of EduSmart into Educomp?
- Shantanu Prakash** Our intention in thinking about any such integration or any consolidation is really based on few important business parameters that we want to drive at. The first is the model that works for Educomp should be a model that is simple to understand, number one. Number two, it is a model that should be transparent. Number three, we want to take advantage of some of the recent regulatory change for example as you know and the service tax regime in India has changed and changed service tax regime essentially motivates us to have a model where we can directly bill to school and fourthly, we want to make sure that the way we recognize revenue should be as close as possible to the actual cash that comes into the business, so our thinking is motivated by few of these things and Sanjay you want to add something in terms of how investors should think about it or look at it?
- Sanjay Jain** Nikhil while we are under evaluation phase in terms of how we are going to execute the potential integration of EduSmart and the SmartClass enterprise of Educomp Solutions, the initial thoughts are that the entire business which emanated from the sale done by Educomp, the entire business which is now resting post-implementation in EduSmart should actually get demerged from there and come as part of Educomp Solutions and therefore for all practical purposes there may not be anything left behind in EduSmart and we would have integrated the whole cycle in terms of the end billing on the executive contracts also been visible in Educomp Solutions.
- Nikhil Vora** So we're not really looking at buying EduSmart, we are looking at integrating the revenue curve which was on word reflected EduSmart into our books right now is it?
- Sanjay Jain** I think it will be a little premature to say whether we are buying or not, the adjective is that on arms length basis the entire SmartClass enterprise portion which is sitting in EduSmart demerged from there and brought under the fold of Educomp Solutions and there is X+Y constituting the total part, the Y part is sitting in ESL, the X part which is the post-

implementation billing and collection to the customer is actually sitting in EduSmart and on one hand as Shantanu mentioned for the simplification and other benefits we migrate to BOOT and we want to recognize the venue in terms of near cash, so if you bring that piece of X from EduSmart into ESL, so we have the whole piece here with us. Now the final execution plan in terms of how we are going to execute it, it would be under a suitable tax fiscal advice but on a pure pure arm's-length basis with I think our preliminary calculation are that there would be insignificant consideration if it all for bringing this enterprise into the fold of Educomp Solutions.

Nikhil Vora

And you expect this to happen over the next two or three month's period I presume?

Sanjay Jain

Yes, we want to use the next two or three months to do a careful evaluation and start the next financial year on a new basis.

Nikhil Vora

Second part was, revenues have been significantly lower than what it was corresponding period or even sequential it is pretty much flattish what is the reason for the debt to increase so significantly during the same period?

Sanjay Jain

In fact if you see our cash flow statement which is on Slide #22, on a nine-month basis cumulative we have cash deficit of about Rs. 500 crore which actually got funded through nearly half through equity and the balance half increased from borrowed funds and it is largely the change in the working capital which has mainly led to the cash deficit and the reason the change in the working capital is very significant and thus eating away cash is a fact that there is an up fronting of revenue recognition the way the current model is, where in, when I am actually I have done the implementation and I have done the billing nearly about 52.5% of the revenue gets booked in the first year and that is what get booked here as an account receivable and if EduSmart is in a position to securitize those receivables from a potential third-party bank, the money comes to Educomp and thus its receivables does not stand. The fact that there has been a little slow down in securitization the sales that are there are actually resulting into receivables and the other thing is that while gradually in the SmartClass business there is reduction in the inventory which we are covering in Slide #23, when you would actually see that the SmartClass inventory is marginally down almost stagnant but there is a Rs. 44 crores increase in the ICT and other inventory which is primarily the Assam project where in we would actually be putting this inventory to use in the current quarter in terms of actual billing to the customers, so these two things are actually the main reason that there is a increase in borrowings.

Nikhil Vora

What does it really mean in terms of steady-state quantifiable parts of the business, Shantanu you did talk about the demand side which obviously remains robust and so on, but how does one really presume and should look at this on a steady state basis assuming that we are able to really execute on this business transformation point, what is the scale of the business that one should really feel comfortable with? Educomp has always been a moving parts business, so

where does one really take a pause and say okay this is where it is and this is what one can expect for the next couple of years?

Shantanu Prakash

It is good that you're thinking in terms of couple of years and that is how we want our shareholders to start thinking of Educomp in the next couple of years rather than couple of quarters so that is the good thing to start off with firstly. Secondly, if you look at our six-point agenda we have very clearly articulated that our greatest presence is going to be in the digital content and the K-12 space. The way we define digital content is SmartClass, plus tablets plus English language lab plus E-DAC and assessments and so on and so forth all IT-based products coming out of system, so there is a migration from a product based company to a solution based company, so I think of course need greater modeling and greater in-depth answer than the time available on this call but the picture in which I want to paint for you is, that in the digital content bucket Educomp over the next few quarters will not have just 1 but 4 to 5 different products. We will have a very robust K-12 business where our focus will be to expand our amazing school franchise, the Millennium School franchise by adding a large number of joint ventures which is again zero capital to Educomp and that is as you know very well that is the business that everybody loves it is the business of long-term cash annuity, playing into middle-class consumption in India and then we would have perhaps our higher education business which is a joint venture with Raffles, so it is really those three major businesses that you focus on and any research, any analysis on the education opportunity in India says that 80% of the opportunity, 85% of the opportunity is really in these three sectors, so that is what Educomp in a couple of years is going to look like a very strong stable company, cash surplus, hopefully three years or four years time zero debt.

Sanjay Jain

Nikhil let me try and quantify this for you, in one of the questions that was asked earlier where in I mentioned that we have sold closer to 100,000 classrooms leading to a current building of around Rs. 50 CR in a month and I have about Rs. 10 to 15 course of ICT billing, so Rs. 60 to 65 crores per month billing at an OPEX of about Rs. 23 crores. In about three years assumedly we grew cautiously and we sell another 100,000 classrooms and we generate almost an equal amount of billing, so we would have actually taken our billing from current Rs. 60 to 65 crores to actually Rs. 110-115 crores. The fact that we have a stringent focus on the OPEX and assuming on a conservative basis that reduction only offsets the inflation, so there is no net benefit then after three years from now my revenue base would have doubled up from 62 close to 120 and my OPEX level would have been the same, so if I'm generating 60-23 which is about Rs. 37 crores as an EBITDA I would actually generate 120-23 as a potential that is the curve we want to travel over the next three years in terms of, now that key is how we are booking orders, cautious growth 100,000 means average 33,000 per annum, the key is how are we converting this actually booking to billing that is what I said operating metrics and then the key how it is getting effected in the monthly collections. There is not just the SmartClass sales cautiously grown and any effort to push in additional services products through the existing franchise could be a niche additional upside. So I think this probably could be an extrapolation of how things may pan out in terms of quantifiable terms 3 to 4 years from now.

- Moderator** The next question is from the line of Krupal Maniar from ICICI Securities, please go ahead.
- Krupal Maniar** In the past since we have booked the revenue up front in the SmartClass segment, what would happen to that number and what about the funds we have received against those revenues?
- Sanjay Jain** I think the exact fiscal accounting taxation, other structuring aspects we would be guided by the experts at present we have chosen a business direction for ourselves but I think from a practical viewpoint if I have sold some contracts to EduSmart and I do have a right to receive money, so as and when there is an actual realization from customer over the remaining life of the current contracts I will keep getting those cash flows.
- Krupal Maniar** But in terms of revenue recognition you would have to write-off some of the revenues in that case because since you have already booked that reviews in advance?
- Sanjay Jain** I think while I just said the actual framework, evaluation is underway there does not appear to be any case for writing off or anything. I think the existing contracts have been executed, revenues have been booked, the key is for us going forward that there is a monthly cash equivalent that needs to accrue to us going forward on the executed contracts and the fresh ones getting executed and being realized on a monthly basis. So I guess in a short while from now to the next two months or so, the exact detail would start to unfold but the guiding principles would be largely similar to what we just shared with you.
- Krupal Maniar** From what date we will be moving to this BOOT model, is this from the next quarter or it would take some time?
- Sanjay Jain** As I said in response to an earlier question, we really want to use the intervening period upto March to do a careful evaluation and therefore we may eventually move from April onwards.
- Moderator** The next question is from the line of Pankaj Chopra from Shanti Asset Management, please go ahead.
- Pankaj Chopra** When you do this merger your balance sheet would look extremely bloated because of debt. Would that be a correct assessment because EduSmart was to securitize it and hasn't had managed to do it and the second part which is attached is, in your future intent that the schools will take debts on themselves, isn't that are very difficult thing to do and why wasn't this happening earlier?
- Sanjay Jain** Let me take you latter part of the question first. Yes it is a difficult thing to do to actually on one hand you have been funding your customer through your own balance sheet, on the other hand now you are motivating the customer to actually take loan on its own balance sheet and buy the product and couple of things we have to manage our own business, so there are some terms of selling that we have chosen for ourselves and the other important aspect is that then we were selling to the customer in the past there was a cost of financing that we had built up,

so we would not be close to sharing a part of that cost to the customer as well, so the third thing is that this is just one of the avenues of financing, vendor financing, pool financing, ECB, so I think somewhere I am in agreement with you that one should not really expect a very significant success out of these financing if 100 is my base any potential 15 to 20 to 30% migration to usage of this facility would be a good way to move forward, that is the second part. And on the first part, it is just this consolidation of two SmartClass which is enterprises happen together I think the debt would include subject to the final structuring evolving, along with the debt as a liability but on the asset side the receivables and the right to receive money, so both may actually come together but to that extent in a debt-equity ratio that we share with our investor every quarter not only we have a debt equity which is based on all balance sheet debt we also capture debt equity with congenial liabilities as well, so that to the extent it is already captured and conveyed to our stakeholders. Whatever liabilities come in nutshell would have corresponding assets coming in as well.

Moderator As there are no further questions I would now like to hand over the floor back to Mr. Nikhil Vora, over to you, sir.

Nikhil Vora Thank you all the participants and specially the Management Team at Educomp. Mr. Shantanu in case you want to make a closing remark on this.

Shantanu Prakash I would like to thank everyone who has attended the call and goodnight everybody.

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