15 November 2010
Asia Pacific/India
Equity Research
Education Services

Educomp Solutions Ltd

(EDSO.BO / EDSL IN)

Rating	(from Neutral) **OUTPERFORM* [V]**
Price (12 Nov 10, Rs)	502.10
Target price (Rs)	675.00[1]
Chg to TP (%)	34.4
Market cap. (Rs mn)	46,440 (US$ 1,037)
Enterprise value (Rs mn)	44,909
Number of shares (mn)	92.49
Free float (%)	45.07
52-week price range	788.50 - 451.65

*Stock ratings are relative to the relevant country benchmark.
[1]Target price is for 12 months.
[V] = Stock considered volatile (see Disclosure Appendix).

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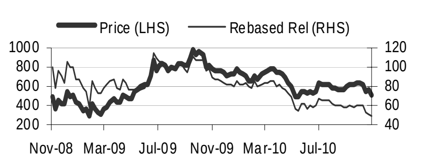
UPGRADE RATING

Back to school: key concerns addressed

- **Upgrade to OUTPERFORM.** We upgrade Educomp to OUTPERFORM, with Rs675 target price and 34% potential upside. With positive developments over the last couple of quarters and some important announcements recently, some of the pressing investor concerns around the stock have been encouragingly addressed. In this context, we see the recent underperformance of the stock as a buying opportunity.
- **Positive action on most issues.** A number of positive developments around the business were announced during results, such as reduction in corporate guarantee level for Edusmart loans, clearing of outstanding Smartclass receivables (leading to sharp fall in DSO) and turnaround in profitability in new businesses. Our own concerns are getting addressed, with: 1) the company's investments into Smartclass sales force expansion (now 4x of the nearest competition) – a key differentiator in the market, and 2) continued stability in pricing and classroom penetration in Smartclass. We found 2Q FY3/11 results decent and believe the correction is an overreaction (especially as 1H is seasonally less significant for full year).
- **Classroom additions a catalyst.** We expect strong classroom additions in 2H FY11, growth in coming quarters and increasing visibility into new business profitability to force consensus upgrades. Among events, we expect the announcement of additional implementation partners in Smartclass, such as Edusmart by end-FY3/11, to be a strong catalyst.
- **Attractive valuation.** At 10.4x our FY3/12 EPS, we find the stock attractive, given the three-year EPS CAGR of around 30% EPS CAGR. We upgrade the stock to OUTPERFORM, retaining our Rs675 target price (DCF based, 34% upside). Note that we do not build in any multiple expansion from our earlier target; this could be an upside risk with improving confidence on the business. Our EPS goes down 6%/4% for FY11/FY12, as we build in higher taxes/finance charges, which caused the 2Q miss on our EPS numbers.

Share price performance



The price relative chart measures performance against the BOMBAY SE 30 SHARE SENSITIVE index which closed at 20156.89 on 12/11/10
On 12/11/10 the spot exchange rate was Rs44.78/US$1

Performance Over	1M	3M	12M
Absolute (%)	-20.3	-14.0	-36.0
Relative (%)	-20.1	-22.9	-47.0

Financial and valuation metrics

Year	3/10A	3/11E	3/12E	3/13E
Revenue (Rs mn)	10,394.0	13,834.7	16,787.6	19,267.2
EBITDA (Rs mn)	4,845.4	6,487.9	8,147.4	9,709.8
EBIT (Rs mn)	3,703.1	5,406.4	6,861.0	8,346.9
Net income (Rs mn)	2,757.3	3,863.5	4,878.8	5,699.9
EPS (CS adj.) (Rs)	27.39	38.37	48.46	56.61
Change from previous EPS (%)	n.a.	-6.1	-4.3	-1.8
Consensus EPS (Rs)	n.a.	35.6	41.1	52.6
EPS growth (%)	82.6	40.1	26.3	16.8
P/E (x)	18.3	13.1	10.4	8.9
Dividend yield (%)	0.5	0.8	2.4	2.8
EV/EBITDA (x)	9.6	6.9	5.3	4.0
P/B (x)	3.1	2.5	2.1	1.8
ROE	26.7	21.2	22.4	22.1
Net debt/equity (%)	1.6	net cash	net cash	net cash

Source: Company data, Thomson Reuters, Credit Suisse estimates.

Focus charts and table

Figure 1: Educomp's incremental classroom penetration ratio has stabilised at 8 in the past three quarters

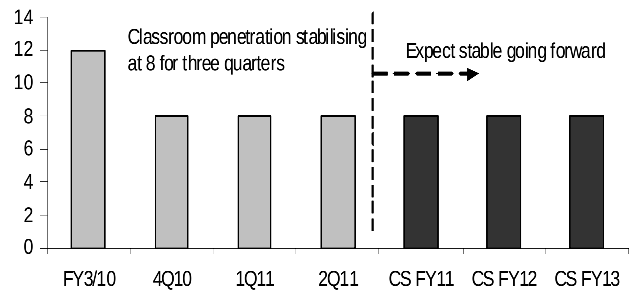


Figure 2: Pricing has remained stable, despite management's earlier caution on falling prices

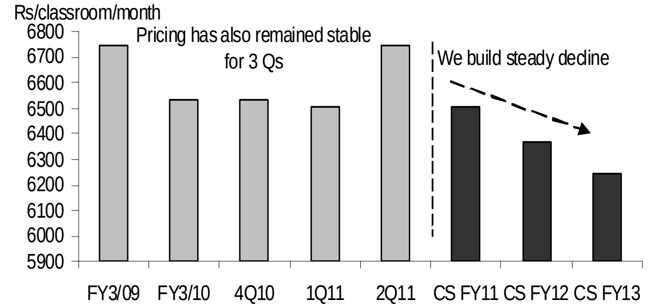
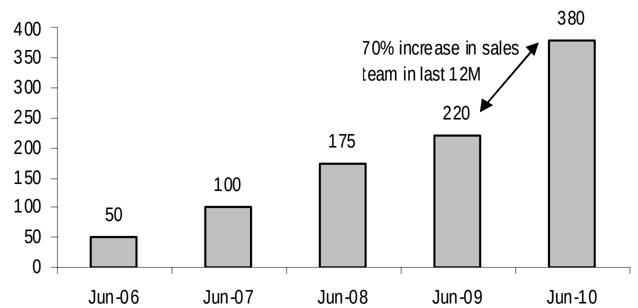
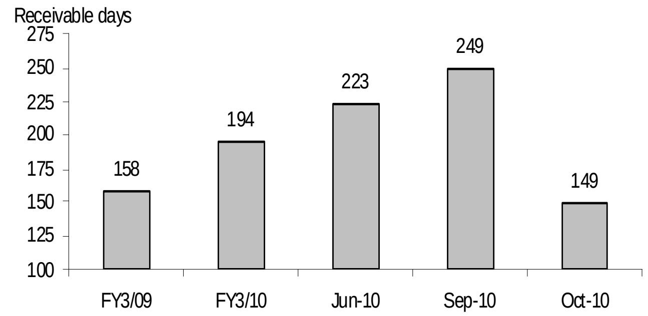


Figure 3: Recent investments into sales force gives us comfort on growth targets



Source: Company data, Credit Suisse estimates

Figure 4: Receivables are now down to normal levels



Source: Company data, Credit Suisse estimates based on industry discussions

Figure 5: 12M forward P/E (based on consensus)

Source: Bloomberg, Datastream, Company data

Figure 6: Educomp vs MSCI India 12M forward P/E YTD chart (based on consensus)

Source: Bloomberg, Datastream, Company data

Figure 7: Educomp's September 2010 consolidated results summary

(Rs mn)	Sep-09	Jun-10	Sep-10	YoY (%)	QoQ (%)	CS Est	Diff. (%)
Revenues	**2,535**	**2,279**	**2,768**	**9.2**	**21.5**	**2,931**	**-5.6**
EBITDA	**1,015**	**664**	**1,059**	**4.3**	**59.5**	**1,082**	**-2.1**
EBITDA margin (%)	40.1	29.1	38.3			36.9	
Net profits	**1,155**	**365**	**578**	**-49.9**	**58.5**	**745**	**-22.4**

Source: Company data, Credit Suisse estimates

Decent results with strong margin improvement

Educomp's September 2010 results was a mixed bag with decent operating performance and profit miss due to non-operating items. The highlight in the numbers was the strong margin improvement during the quarter.

Revenues grew 9% YoY and 22% QoQ to Rs2,768 mn, coming 6% below our estimates. However, EBITDA margins expanded 920 bp QoQ (around 140 bp higher than even our aggressive estimate). We note that 1Q FY11 had seen a sharp margin reduction due to induction of sales force in Smartclass segment, and management had indicated that margins would start recovering as growth brings in scale benefits. Thus, EBITDA came in line with our numbers at Rs1,059 mn.

Higher finance charges and taxes lead to profits coming 22% below our estimates.

Figure 8: **Educomp's September 2010 consolidated results summary**

(Rs mn)	Sep-09	Jun-10	Sep-10	YoY (%)	QoQ (%)	CS Est	Diff. (%)
Revenues	**2,535**	**2,279**	**2,768**	**9.2**	**21.5**	**2,931**	**-5.6**
EBITDA	**1,015**	**664**	**1,059**	**4.3**	**59.5**	**1,082**	**-2.1**
EBITDA margin (%)	40.1	29.1	38.3			36.9	
Depreciation	306	198	208	-32.1	5.0	200	3.9
EBIT	709	466	851	20.0	82.7	882	-3.5
EBIT margins (%)	28.0	20.4	30.8				
Net non-operating income	731	-61	-128			-61	109.6
PBT	1,440	405	723	-49.8	78.6	821	-11.9
Taxes	270	39	141			74	90.7
Minority	15	1	4			2	
Net profits	**1,155**	**365**	**578**	**-49.9**	**58.5**	**745**	**-22.4**

Source: Company data, Credit Suisse estimates

A look at the segment break-down shows that top-line weakness was driven by the school learning segment (Smartclass + ICT). We note that the ICT businesses disappointed with no new schools getting added.

QoQ margin expansion was visible across segments – the most important being the increase in School learning (primarily Smartclass) and a turnaround in profitability of online/supplemental/global business (a collection of new and acquired businesses).

Figure 9: **Segment-wise performance**

Revenues (Rs mn)	Sep-09	Jun-10	Sep-10	YoY (%)	QoQ (%)
School learning solutions	2,004	1,591	1,923	-4.0	20.9
Higher learning solutions	61	90	137	123.2	52.9
K-12 schools	209	305	321	53.9	5.4
Online supplemental and global	261	293	387	48.0	31.8
Total	**2,535**	**2,279**	**2,768**	**9.2**	**21.5**
PBIT margins (%)	**Sep-09**	**Jun-10**	**Sep-10**	**YoY (bp)**	**QoQ (bp)**
School learning solutions	51.3	41.5	46.2	-515	468
Higher learning solutions	-32.3	-48.9	-47.4	-1,508	149
K-12 schools	25.3	38.3	40.1	1,484	181
Online supplemental and global	-26.5	-21.3	8.0	3,446	2,929
Total	**39.1**	**29.4**	**35.5**	**-364**	**608**

Source: Company data, Credit Suisse estimates

Smartclass – time to relook as issues are getting addressed

Our downgrade on Educomp (1-Feb-2010) and our negative view on the company was based on the following factors: 1) weakening Smartclass economics with falling price-points and reducing order sizes, and 2) execution challenges in keeping up with growth expectations on Smartclass business. Further, there have been investor concerns around the revenue recognition policy in Smartclass, since Educomp was required to provide corporate guarantee for the loans taken by Edusmart (which eventually gets recognised by Educomp as revenues). In addition, in our Annual report note, we had highlighted the high level of receivables as another concern on the company, with a large chunk of Smartclass contracts not being securitised for a while.

We believe with developments over the last couple of quarters, and with some important announcements around 2Q11 results, the company has addressed most of these issues encouragingly.

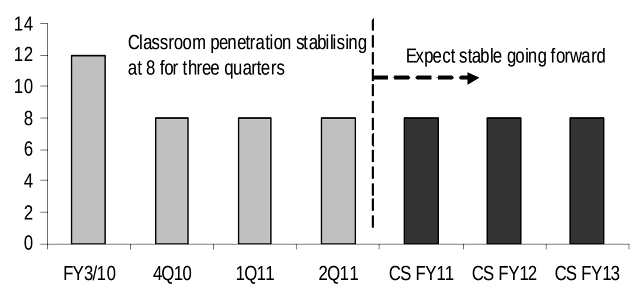
1) Smartclass metrics stabilising

The first concern causing us to downgrade our rating earlier this year was the rapid deterioration in operating metrics in Smartclass – on classroom penetration and pricing.

After falling sharply in FY3/10, we note that the incremental classroom penetration for Smartclass has stabilised at around 8 classrooms per school. We believe that the number should be stable around this level – smaller orders from new schools should get offset by repeat orders for more classrooms from existing schools, in our view. Educomp does not disclose this data separately, but we highlight that Everonn has started seeing significant repeat orders from existing schools for additional classroom – nearly 30% of the classrooms installed by the company in 2Q11 were from existing schools.

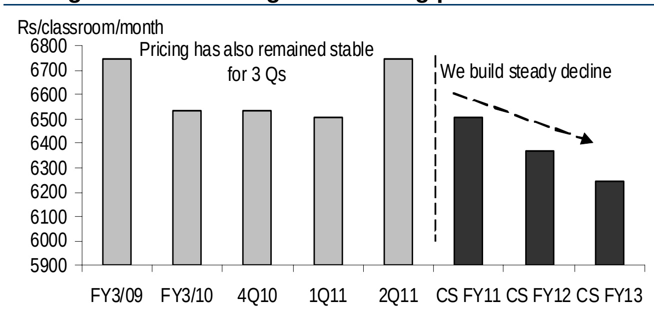
Further, the price-points have also stabilised at around Rs390,000/classroom for a five-year contract (Rs144 per month per student assuming 45 students per class). This is not different from the Rs150 levels seen a couple of years ago (in fact, September 2010 quarter touched Rs149 on pricing, but we would not take that as a trend). We expect pricing to decline in the coming years, and there could be upside risks to our numbers. We recall here that last year, management had cautioned investors to expect pricing to fall to Rs135 levels – a price point which has not been touched a year since that number was issued.

Figure 10: **Educomp's incremental classroom penetration ratio has stabilised at 8 in the past three quarters**



Source: Company data, Credit Suisse estimates

Figure 11: **Pricing has remained stable, despite management cautioning about falling prices earlier**



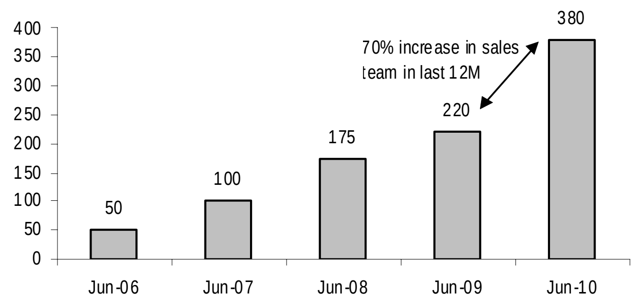
Source: Company data, Credit Suisse estimates

2) Recent investments reduce our concerns on ability to sustain growth

Our second concern was around the ability to sustain high growth rate since the size of orders from schools have gotten smaller. This business requires a vendor to repeatedly approach the school management before a contract is won. In other words, presence of a large number of feet-on-street is essential. Though one may argue that the business has moved to a classroom model, we hold that the size of sales force is still an important metric. Signing up of new contracts is still on a per school basis (irrespective of the number of classrooms signed). Hence, maintaining a healthy new contract signings rate requires a large sales team.

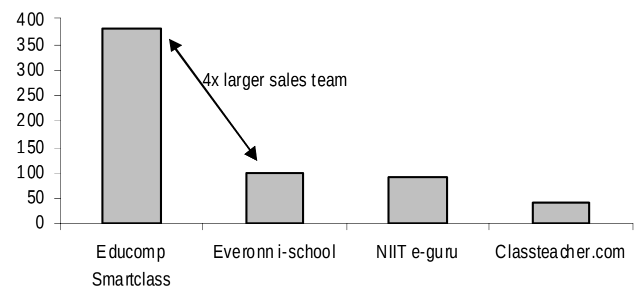
While Educomp already commands the largest salesforce in the industry, recent investments by the company have solidified this position – the company's sales force now is 4x that of the nearest competitor. We believe that this army of sales persons could help achieve the targets of school additions.

Figure 12: **Educomp has invested massively into sales team expansion recently...**



Source: Company data, Credit Suisse estimates

Figure 13: **...and now has a sales force army 4x as big as nearest competitor**



Source: Company data, Credit Suisse estimates based on industry discussions

Our current estimates for Smartclass

We expect Educomp to add 28,000 classrooms in FY3/11 in the Smartclass segment (guidance is for 25,000-30,000 classrooms). We build in a downward trend on pricing due to the rising competition. We expect margins to improve as scale effects begin offsetting the investments into sales team made this year.

Figure 14: **Smartclass estimates**

	FY3/10	FY3/11	FY3/12	FY3/13
Number of classrooms signed during the year	15,828	28,000	43,440	44,800
Price per classroom (Rs/month)	6,702	6,635	6,503	6,373
Revenues (Rs mn)	6,446	9,277	11,406	12,807
EBIT margin (%)	65.6	53.8	55.3	59.0

** Not disclosed by company, CS estimate*

Source: Company data, Credit Suisse estimates

Is the weak classroom additions in September 2010 quarter a cause for worry?

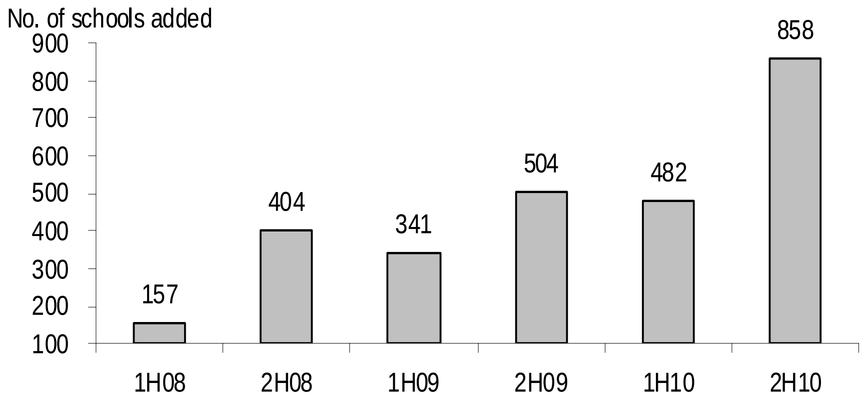
Educomp showed a dip in Smartclass classroom additions in the September 2010 quarter. Management explained that QoQ comparison is coloured by spill-over of some classroom orders from March quarter to June quarter, thus overstating June 2010 numbers. In addition, the first half of the year has historically been smaller than 2H in terms of order intake; hence, we would not be too worried about a minor weakness in a seasonally less significant quarter. We expect order booking to rebound sharply in the December 2010 and March 2011 quarters.

Figure 15: Quarterly classroom additions

	Mar-10	Jun-10	Sep-10
Classroom additions	4,038	6,750	5,309

Source: Company data, Credit Suisse estimates

Figure 16: Seasonal trend in order booking



Note: Classroom addition history is limited
Source: Company data, Credit Suisse estimates

3) Reduction in corporate guarantee lifts concerns on off-balance sheet debt and revenue recognition

When the Edusmart model was unveiled around the same time last year, Educomp was expected to provide a corporate guarantee to banks that were lending to Edusmart – to the tune of 100% of the loan amount. The effect of this was that the debt raised to fund Smartclass growth only moved from the balance sheet to become an off-balance sheet item. Further, upfront revenue recognition policy appeared aggressive when the full recourse in case of default was back to Educomp.

On Friday, management announced that it has negotiated down the corporate guarantee requirement with bankers to 20% of loan amount, and this is expected to go down to nil in future. The recourse to Educomp in case of default will be capped at 20%. This substantially reduces both the concerns above, in our view.

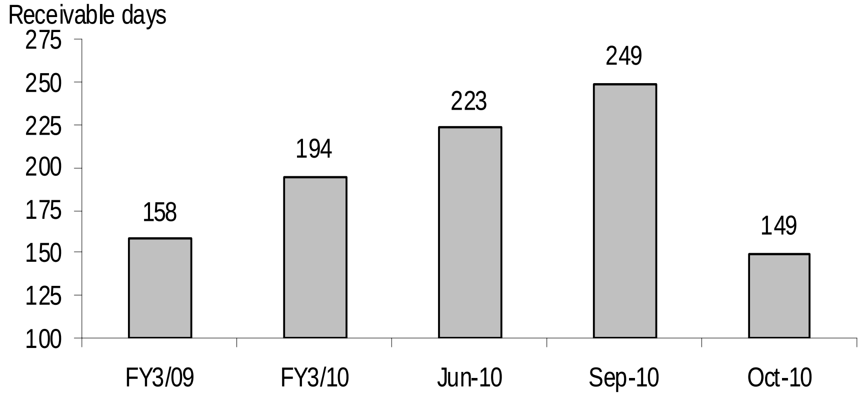
We note that as per the March 2010 annual report, Educomp had contingent liabilities of around Rs6.6 bn related to Smartclass contracts (or 40% of net worth). While this number may not go down in the near term, the risk of this shooting up to alarming levels is taken away by this development. Further, with this development, we believe Smartclass moves closer to becoming cash flow positive.

4) Smartclass outstanding receivables issue resolved

One of the concerns we highlighted in our Annual Report analysis note (24 September 2010) was on the unsecuritised contracts (on which revenues had been booked), which caused debtor days to increase sharply. While debtor days remained high as of 30 September 2010 at 249 days, management disclosed in the earnings release that the residual contracts have been securitised as of 5 October 2010, and the debtor days currently stands at 149 days.

Guidance is for debtor days to remain below 170 days.

Figure 17: **Educomp's receivable days back to normal levels**



Source: Company data, Credit Suisse estimates

Educomp is still a formidable force in the market

Competition has definitely increased…

Following Educomp's success in Smartclass, over the last two years, we have seen a number of new vendors come into the market with similar products. Some of these vendors are at price points at a third of what Smartclass costs (though with less sophisticated products).

Figure 18: **Competition profile for Smartclass**

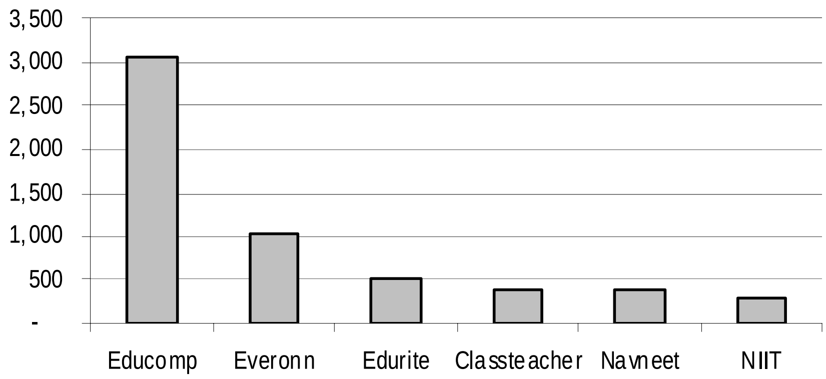
Vendor	Product name	Hardware description	Indicative price point (Rs/classroom/month)
Educomp	Smartclass	Interactive Whiteboard	6,600
Everonn	iSchool	Interactive Whiteboard	8,000
NIIT	e-Guru	Interactive Whiteboard	~6000
Classteacher	ePathshala	Interactive Whiteboard	~6000
Navneet	eSENSE	Portable box with built-in projector and content	2,250
Manipal K-12	Digiclass	Interactive Whiteboard	n.a
Sundaram	e-class	Various forms including portable projector, handheld device, pen-drive etc.	n.a
HCL Infosystems	Digiclass	Interactive Whiteboard	n.a
Next education (formerly Helix)	Teachnext	Portable box with built-in projector and content	n.a

Source: Company data, Credit Suisse estimates

…but Educomp's market share remains formidable

All said and done, Educomp – the pioneer in the 'Smartclass' segment – remains a formidable player in the market. The comparison on number of schools (Figure 19) clearly shows Educomp's leadership position.

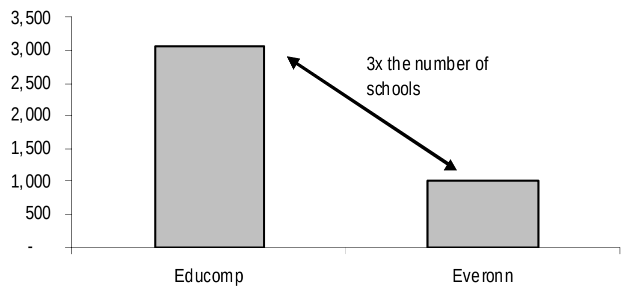
Figure 19: **Number of schools signed up in the 'Smartclass' segment (March 2010)**



Source: Company data, Credit Suisse estimates based on industry discussions

However, this picture misses the fact that Educomp's classroom penetration within its schools is way above industry average. We highlight here that while Educomp has 3x the number of schools than its nearest competitor Everonn, it has 22x the number of classrooms. In our estimates, Educomp has an 80% market share when seen in terms of installed classrooms.

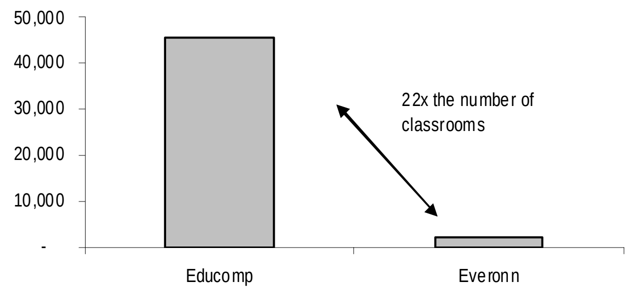
Figure 20: **Educomp has 3x the number of schools as the nearest competitor ...**



Note:Mar-10 data

Source: Company data, Credit Suisse estimates

Figure 21: **... and 22x the number of classrooms**



Note:Mar-10 data

Source: Company data, Credit Suisse estimates

Leadership should sustain due to recent investments

Our long-held belief (refer to our initiation report, *Indian Education Services: Be part of the revolution* published on 11 December 2007) on the Smartclass business is that content is not a differentiator between companies (though company managements may project a different view). In our view, the key differentiators for this business are strength of sales force and possession of a strong brand. We believe Educomp, over the last one year, has invested (further) into both these factors. We earlier highlighted Educomp's investments into expanding the sales team rapidly in recent quarters.

First-mover advantage in small towns

Our discussions with competitors in the market indicates that Educomp's strategy of being the first mover into an unpenetrated town helps the company establish firmly before other competitors can come in. One unlisted competitor we spoke to mentioned that Educomp normally carpet bombs a small town signing up 50-60% of schools in the vicinity, before other competitors even come into the picture (though the number of classrooms per school could be lower than larger towns and cities).

Brand has the 'pull' effect

Being the market creator and first mover, Educomp still enjoys a strong lead over other competitors in terms of brand awareness and recall. Recent investments of the company into high decibel-ad campaigns are also helping. We frequently come across ads in local press by schools which – among other attractions – boast of Smartclass. We present here an ad that came out a month ago in Mumbai.

Figure 22: Recent ad in Mumbai of a new school

(identity / tel. nos. / website hidden, highlight added by CS)

xxxxxxxxx INTERNATIONAL SCHOOL (IGCSE-A LEVEL)

xxxxx , SION (E), MUMBAI - 400 022 - TEL NO.: - Website:

Affiliated to University of Cambridge International Examinations

I. Admissions to Indian Universities:
- 5 Subjects at IGCSE with 60% marks in each and just 2 more subjects with English at A Level.
- For Professional Courses:
  5 Subjects at IGCSE with 60% marks in each + English, Physics, Chemistry & Biology/Mathematics at A Level + CET SCORES.

II. Admissions Abroad:
- IGCSE-A Level is a highly rated qualification abroad with even a concession of 1 to 2 terms at certain Universities.

Facilities and Privileges that our Pupils enjoy:
- Interactive classrooms with coveted Educomp Smart Class facility in each class room to make learning effective and enjoyable.
- State of the art computer laboratory (One Computer per child)
- Modern science-laboratories for Physics, Chemistry & Biology
- A well-stocked library with television & Internet facilities for enriched learning & reference
- A well equipped gymnasium
- A host of co-curricular & extra curricular activities such as:
  - Tae-kwon-do, Gym & Yoga training
  - Badminton, Table Tennis and Indoor games
  - Cricket at Indian Gymkhana in the Second Term
  - Dance Classes
  - Debates, Elocution competitions & Quizzes
- A smooth and efficient self-owned bus service
- Well qualified and CIE accredited staff
- Excellent teacher-pupil ratio of just 1:15
- A world class application based curriculum [IGCSE-A LEVEL] at a moderate cost

CREATIVE ACTIVITIES SPECIFIC TO PRE-PRIMARY DEPARTMENT

Painting: sand, leaf, magic & blow Thumb & vegetable printing Collage work Colouring Origami Fruit & vegetable activity, Cotton sticking

FEE RATES (2011 - 2012)

Standard	Tuition Fee per month	Term Fee Twice a year
Pre-Primary	₹ 2200	₹ 2200
Primary & Secondary	₹ 3950	₹ 3950

Note: i. There will be no charges for Stationery and educational trips.
ii. There will be Increase of 10% in fee rates every year.

For Admission to Nursery & Jr.K.G. please meet the Head Teacher of Pre-Primary Department in person on any working day from Monday the 11th October 2010 onwards between 10.00 & 11.00 a.m.

Source: Company data, Credit Suisse

And let us not forget, the market is still underpenetrated by a long way

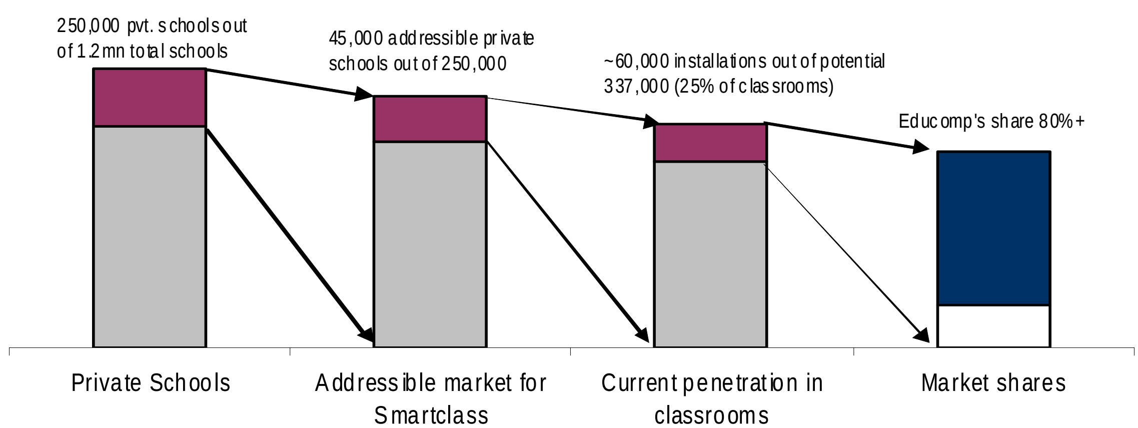
We place our estimate for the addressable market for Smartclass in India at 45,000 (given current price points, larger for vendors with lower-priced products). This compares with management estimate of 75,000 schools.

Assuming 30 classrooms in each of these schools (10 grades x 3 divisions each – conservatively), we get to an addressable market of 1.35 mn classrooms, who could purchase Smartclass or a similar product. Of these, we estimate that less than 5% of the market is penetrated, with Educomp accounting for around 80% share.

That brings us to the question – would schools purchase Smartclass for all their classrooms? – likely not. Looking across the globe for similar businesses, we note that statistics from the UK show that back in 2004 itself, over 26% of all primary classrooms (public and private) had interactive whiteboards installed in them, with findings pointing to positive impact on quality of learning and teaching (Source: BESA).

Given that we are restricting to only the cream of Indian private schools in our discussion here (versus the entire universe of schools in the UK study), we believe that we could work with similar number potential in India. Assuming that eventually 25% of classrooms in our set of 45,000 schools will have Smartclass (or similar) products installed in them, we are currently 20% penetrated.

Figure 23: **Penetration of the Smartclass business model is still low**



Source: Company data, Credit Suisse estimates

Our discussions with various players in the industry indicate that close to 7,000 schools will be deciding on purchases for Smartclass (or similar) products before the next academic year. Our assumptions require Educomp to sign up only around half those contracts to meet estimates.

Key risks

We see the following key risks to our estimates above:

- Educomp is currently dependant on only one implementation partner on its Smartclass business (Edusmart). We believe that the role of this partner will become increasingly important as the business achieves scale. Reliance on a single partner could lead to execution risk in our view. During 2Q11 earnings call, management indicated that it will be announcing more developments around new implementation partners. We expect an announcement by end of FY3/11.
- Our model assumes that the incremental classroom penetration has bottomed out at 8 CR/school. Any deterioration in this number could lead to downside risks to our numbers.

Is there a problem in diversifying?

Frequent questions are raised around Educomp's diversification strategy – whether the new business investments are required when Smartclass (the flagship business) is so successful. We differ in our opinion.

The Indian education industry is still in its nascent stages. Further, complex (and changing) regulations require equally different business models to capture the full potential of the market.

In this context, Educomp has achieved good success in its Smartclass business, establishing itself as a leader. However, this targets only a minor part of the market – that of teaching aids within the classroom. A number of new areas remain untouched/underpenetrated – vocational training, professional education and online education, to name a few. We agree that these require some regulations to change or other externalities to develop (e.g., broadband uptake). But the investments are better made earlier than later.

Smartclass is now cash flow positive, especially with the corporate guarantee to Edusmart coming down substantially. We believe that for a company in a sun-rise industry with one cash cow business, the right strategy is to invest into a number of potential start-ups. Many ventures may fail or face initial challenges; for instance we note that: 1) management had set a target of 100 schools for March 2010 for the K-12 segment, when the business was unveiled in 2007. Less than half that number has been achieved so far; 2) the number of pre-schools went down from 780 to 700 between December 2009 and June 2010, before rising back to 750 for September 2010 – indicating some schools were closed in the interim; 3) while the India leg of the JV with Raffles has taken off successfully, the China leg has been given a silent burial. Educomp has now found a new partner for the China business. On the other hand, we note that the supplemental and global businesses showed a positive trend by turning profitable on EBIT level in 2Q – management expects this to sustain.

We would look at the business investments outside of Smartclass in a portfolio approach – a few out of a number of investments may go on to become the next growth engine like Smartclass. Educomp, with its experience in the sector, has a better chance of incubating such ventures, with obvious scale benefits over existing businesses and brand name. Over the longer run, these investments would help Educomp target a greater share of the education spend in the country.

CS estimates for other businesses

Figure 24: **Estimates for other businesses**

Other segment estimates	FY3/10	FY3/11	FY3/12	FY3/13
ICT				
No. of schools (eop)	15,426	18,926	22,426	25,926
K-12 business				
No. of schools (for next academic year)	43	70	105	155
Total non-Smartclass business financials				
Revenues (Rs mn)	3,948	4,557	5,381	6,461
EBIT margin (%)	-13.3	9.2	10.2	12.3

Source: Company data, Credit Suisse estimates

Changes to CS estimates

Key changes to our assumptions include increase in revenue estimates (as we get greater confidence on the Smartclass business), reduction in margins as the company invests into achieving this growth, increase in profitability of new businesses longer term, and increase in tax rates and finance charges (reasons for 2Q11 profit miss). Our EPS number comes down 6%/4%/2% for FY11E/FY12E/FY13E.

Figure 25: Changes to CS estimates

	Old			New			Change (%)		
	FY11	**FY12**	**FY13**	**FY11**	**FY12**	**FY13**	**FY11**	**FY12**	**FY13**
Revenues (Rs mn)	13,393	15,968	18,015	13,835	16,788	19,267	3.3	5.1	6.9
YoY (%)	110.2	53.6	34.5	117.2	61.5	39.3			
EBITDA (Rs mn)	6,280	8,702	9,972	6,488	8,147	9,710	3.3	-6.4	-2.6
EBITDA margin (%)	46.9	54.5	55.4	46.9	48.5	50.4			
EPS	40.9	50.6	57.6	38.4	48.5	56.6	-6.1	-4.3	-1.8

Source: Company data, Credit Suisse estimates

From growth to value

The key investor concerns on the company (primarily around Smartclass business economics) are getting addressed encouragingly, as we have seen in previous sections.

The stock has underperformed the market significantly over the last 12 months, with around 20% underperformance in the past month alone (including a 9% correction on Friday). From trading at a significant premium to the market in early 2008 and a 20% premium beginning of 2010, the stock now trades at a 25% discount to the MSCI India (on consensus estimates).

We believe that with the high growth rates coming off with size of the company, we should start looking at Educomp as a value stock rather than a growth stock. Given the growth profile of Educomp (around 30% EPS CAGR over three years), we believe that the current valuations provide an opportunity.

Thus, at 10x FY3/12 CS estimates, we find risk-reward favourable for Educomp. While we retain our target price on the stock at Rs675, we upgrade our rating to OUTPERFORM – for a 34% upside.

We note that we have not built in any multiple expansions in our target price despite easing of a number of concerns. We expect multiple expansions to kick in as growth continues and contingent liabilities start becoming less significant.

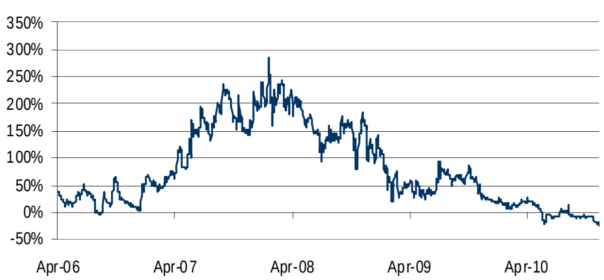
Figure 26: **12M forward P/E based on consensus**

Source: Bloomberg, Datastream, Company data

Figure 27: **12M forward EV/EBITDA based on consensus**

Source: Bloomberg, Datastream, Company data

Figure 28: **Educomp vs MSCI India 12M forward P/E (based on consensus)**



Source: Bloomberg, Datastream, Company data

Figure 29: **Educomp vs MSCI India 12M forward P/E YTD chart (based on consensus)**

Source: Bloomberg, Datastream, Company data

Financial tables

Figure 30: **Summary financial table**

Income statement (Rs mn)	FY08	FY09	FY10	FY11E	FY12E	FY13E
Revenues	2,861	6,371	10,394	13,835	16,788	19,267
Operating expenses	1,597	3,409	5,549	7,347	8,640	9,557
EBITDA	1,264	2,962	4,845	6,488	8,147	9,710
Depreciation	331	814	1,142	1,081	1,286	1,363
EBIT	933	2,147	3,703	5,406	6,861	8,347
Finance charges	48	268	539	782	749	924
Other income	178	227	1,255	789	1,222	1,294
PBT	1,062	2,107	4,420	5,413	7,335	8,717
Taxes	351	773	1,584	1,461	2,347	2,877
Prior period items/miscellaneous	4	18	21	-	-	-
Minority interest	-3	-68	-58	-88	-109	-141
Net profit	706	1,329	2,757	3,863	4,879	5,700
EPS (diluted)	7.6	15.0	27.4	38.4	48.5	56.6
Balance sheet						
Total current assets	4,639	8,149	16,364	22,419	28,125	31,946
Gross fixed assets	3,262	9,461	9,294	10,501	13,381	16,170
Accumulated depreciation	548	1,335	975	1,401	2,688	4,051
Net FA	2,714	8,126	8,319	9,100	10,694	12,119
Goodwill	280	280	6,031	6,031	6,031	6,031
Investments	36	36	354	354	354	354
Total assets	7,669	16,592	31,068	37,903	45,204	50,450
Current liabilities & provisions	610	2,251	3,963	5,274	6,400	7,346
Debt outstanding	3,773	8,895	8,693	10,693	13,193	13,193
Shareholder's equity	2,884	4,203	16,475	19,952	23,611	27,886
Minority interest	194	804	1,915	1,954	1,963	1,983
Deferred tax liability	210	439	22	30	36	41
Total liabilities and shareholder's equity	7,671	16,592	31,068	37,903	45,204	50,450
Cash flow						
Net profit	706	1,329	2,757	3,863	4,879	5,700
Adj. For						
Depreciation	322	786	-360	426	1,286	1,363
Interest expense	48	268	539	782	749	924
Other income	178	227	1,255	789	1,222	1,294
Working capital changes	-704	-883	-1,965	-953	-633	1,855
Cash flows from operations	194	1,272	-284	3,330	5,059	8,547
Capex	-2,205	-6,199	-1,150	-1,549	-4,146	-4,259
Change in other assets	139	840	-4,058	388	1,282	1,496
Other income	178	227	1,255	789	1,222	1,294
Cash flow from investing activities	-1,888	-5,131	-3,953	-372	-1,642	-1,469
Change in debt	2,518	5,122	-202	2,000	2,500	-
Change in equity	1,081	51	9,790	-	-	-
Dividends paid	51	61	276	386	1,220	1,425
Interest paid	48	268	539	782	749	924
Cash flow from financing	3,500	4,844	8,774	831	532	-2,348
Net cash flow	1,806	985	4,537	3,789	3,948	4,730

Source: Company data, Credit Suisse estimates

Companies Mentioned *(Price as of 12 Nov 10)*
Educomp Solutions Ltd (EDSO.BO, Rs502.10, OUTPERFORM [V], TP Rs675.00)
Everonn Education Ltd (EVED.BO, Rs640.00, OUTPERFORM [V], TP Rs850.00)

Disclosure Appendix

Important Global Disclosures

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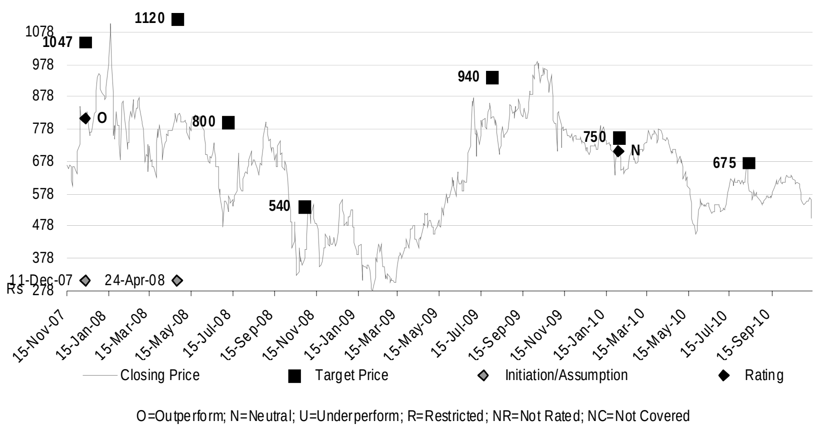
3-Year Price, Target Price and Rating Change History Chart for EDSO.BO

EDSO.BO Date	Closing Price (Rs)	Target Price (Rs)	Rating	Initiation/ Assumption
11-Dec-07	810.82	1047	O	X
24-Apr-08	801.06	1120		X
07-Jul-08	543.5	800		
27-Oct-08	369.27	540		
31-Jul-09	816.8	940		
01-Feb-10	710.2	750	N	
11-Aug-10	616	675		



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Restricted	2%	

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Price Target: (12 months) for (EDSO.BO)

Method: We value Educomp on a discounted cash flow (DCF) model. We assume strong near-term growth rates, 12.5% medium-term growth and 3% terminal growth, 12% weighted average cost of capital (WACC). This gives a target price of Rs675.

Risks: The key risks to our target price of Rs675 for Educomp are: 1) execution risks as the company is in early growth stage in its business lines, and is also launching new businesses like K-12 schools 2) change in regulation thereby impacting the business model

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