

Educomp Solutions Ltd-----Maintain OUTPERFORM
New smartclass innovations should help maintain leadership
EPS: ◀▶ TP: ▶▶

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- We attended Educomp's annual smartclass sales meet on Monday, where the company unveiled its strategy for FY3/12. Educomp has significantly changed its smartclass product configuration. The new product is more user friendly, has some innovative features and is easier to implement versus the existing version (or any competing product).
- Further, the company is bypassing branded OEMs, and procuring the modules directly from component makers. This helps to customise the entire product as per Educomp's own designs.
- Management also announced that the sales force could rise in FY3/12 by 45% (after a 70% rise in FY3/11). In a business where feet-on-street are crucial for growth, we believe these investments will likely help the company sustain high growth rates.
- With these changes, Educomp takes back the lead in product innovation in the smartclass business, in our view. We believe these should help the company sustain its dominant market share. Retain OUTPERFORM and a Rs675 target price.

the implementation team.

- The earlier system's problem of the teacher's shadow blocking the projected image is handled by positioning the projector in a unit attached to the whiteboard (and close to it).
- The content/ animation can now be controlled from a distance by the teacher using a remote. Previously, the teacher had to stand next to the whiteboard to control content flow.
- A camera system permits images of any documents/ small objects placed near the whiteboard to be projected onto the whiteboard. Thus, any paper workings of students or small live experiments can be projected for the whole class to view.
- But most of all, we believe that the company's biggest innovation is in bypassing branded OEMs. The product is designed by Educomp and directly procured from component manufacturers (largely China based, with some Japan and US based). This helps in (1) better customisation to suit Indian classroom needs and (2) driving better bargains on pricing given the increasing scale of purchases by the company.

Bbg/RIC	EDSL IN / EDSO.BO	Price (13 May 11, Rs)	441.25		
Rating (prev. rating)	O (O) [V]	TP (Prev. TP Rs)	675 (675)		
Shares outstanding (mn)	95.90	Est. pot. % chg. to TP	53		
Daily trad vol - 6m avg (mn)	0.25	52-wk range (Rs)	683.90 - 405.15		
Daily trad val - 6m avg (US\$ mn)	2.7	Mkt cap (Rs/US\$ mn)	42,314.1/ 943.1		
Free float (%)	45.1	Performance	1M	3M	12M
Major shareholders	Promoters - 50%	Absolute (%)	(5.6)	1.4	(29.7)
		Relative (%)	0.3	(3.0)	(34.5)
Year	3/09A	3/10A	3/11E	3/12E	3/13E
Revenues (Rs mn)	6,371	10,394	13,464	15,363	17,974
EBITDA (Rs mn)	3,044	4,748	5,976	7,588	9,034
Net profit (Rs mn)	1,329	2,664	3,577	4,642	5,511
EPS (Rs)	15.0	26.5	35.5	46.1	54.7
- Change from prev. EPS (%)	n.a.	n.a.	0	0	0
- Consensus EPS (Rs)	n.a.	n.a.	33.9	37.3	46.7
EPS growth (%)	96.8	76.4	34.3	29.8	18.7
P/E (x)	29.4	16.7	12.4	9.6	8.1
Dividend yield (%)	0.2	0.6	0.8	2.6	3.1
EV/EBITDA (x)	15.5	9.0	6.8	5.2	3.8
P/B (x)	9.3	2.7	2.3	1.9	1.6
ROE (%)	37.5	25.8	19.8	21.7	21.8
Net debt (net cash)/equity (%)	99.8	1.4	(8.1)	(12.9)	(25.8)

Note 1: Educomp Solutions is a leading player in the K-12 educational services segment in India. Its activities encompass learning content, learning infrastructure, teacher training, online tutoring and brick-and-mortar schools.

We attended Educomp's annual sales meet, where management unveiled the new smartclass product version, along with its key business strategies for FY12. Smartclass is the largest business segment and accounts for 62% of Educomp's consolidated sales.

Nice to see the market leader innovate

Management unveiled a new smartclass product to replace the existing hardware configuration. While the basic configuration remains the same – an interactive whiteboard – a number of innovative design changes have been made. These include:

- All the different hardware components (projector, whiteboard, CPU etc.) – earlier separate units – have been moulded into a single compact unit. This increases the ease of use for the teacher (single button switch on) and also reduces the installation time for

On earlier occasions, we have felt Educomp has been slow to adopt new technology in the smartclass business (despite having pioneered the product). For instance, at least two smaller competitors had started selling interactive whiteboards 6-18 months before Educomp (while Educomp was still selling TV-based smartclass). However, with today's announced changes, we believe Educomp has once again taken the lead in product innovation.

Moving from concept-based to curriculum-based content

Further, management indicated that the Smartclass content – which was concept based this far – is now mapped to a number of central/state curricula. This curriculum-based content (i.e., content flow follows the text book flow) could help increase the competitiveness of the product versus competitors (many of whom were already selling curriculum-based products).

Further increase in sales force should help consolidate market share

Educomp saw a significant increase in sales force size during 2010 (70% rise in six months to June 2010) – which we felt was a good investment given the nature of the business (for details see our 15 November 2010 report *Back to School: key concerns addressed*). Management announced that this number could rise by another 45% this year to approximately 550 sales personnel by end of FY3/12. We believe that these investments will likely help Educomp sustain and improve its market share (which we estimate at 80%).

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Companies Mentioned (Price as of 13 May 11)

Educomp Solutions Ltd (EDSO.BO, Rs441.25, OUTPERFORM [V], TP Rs675.00)

Disclosure Appendix

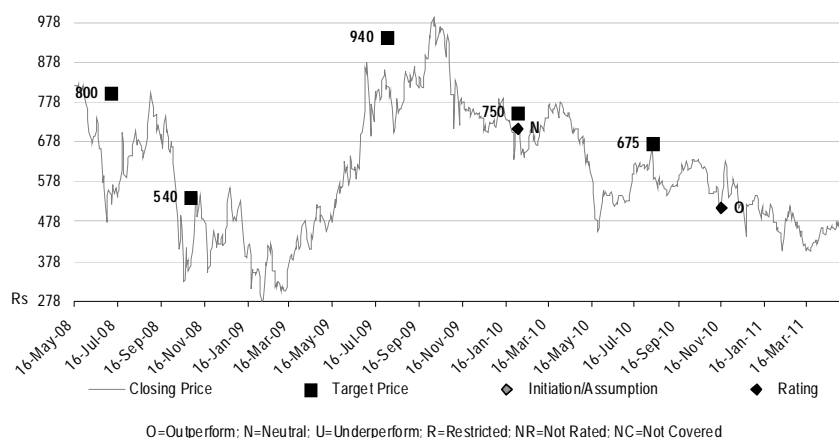
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3-Year Price, Target Price and Rating Change History Chart for EDSO.BO

EDSO.BO	Closing Price	Target Price	Initiation/
Date	(Rs)	(Rs)	Rating Assumption
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	
15-Nov-10	511.5		O



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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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