

Country: India

Sector: Indian Education

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Key Data

Market cap (bn)	Rs 26 bn/US\$0.5 bn
Shares in issue (mn)	17.2
Diluted share (mn)	18.8
3-mon avg daily val (mn)	Rs2,328.7/US\$47.7
52-week range	Rs4,562/1,375
BSE Sensex (03/02/09)	9,149
Nifty (03/02/09)	2,784
Rs/US\$	48.8

Shareholding Pattern (%)

	3Q FY09	3Q FY08
Promoters	55.0	56.1
FIIs	37.7	32.8
MFs/FIs/Banks	0.9	1.6
Others	6.4	9.6

Price Performance (%)

	1M	3M	12M
Absolute	(41.5)	(42.7)	(60.3)
Relative*	(33.4)	(31.2)	(10.5)

* To the BSE Sensex

Daily Performance



(As of 3 February 2009)

3 February 2009

Result Update

Educomp Solutions

Bloomberg: EDSL IB

Buy

Price: Rs1,500

Target Price (Dec 09): Rs2,030

Still on track

- In line 3Q FY09:** Educomp reported 3Q FY09 largely in line with estimates; standalone revenue at Rs1.45 bn increased by 103.1% YoY (vs. estimate of 66.6%). Standalone EBITDA margin at 45.9% declined by 82 bps YoY. Excluding Rs100.9 mn on forex fluctuation, EBITDA margin increased by 6.1% YoY. Standalone PAT at Rs315.5 mn increased by 66.0% YoY (vs. estimate of 64.7%). Consolidated revenue at Rs1.89 bn increased by 130.7% YoY, EBITDA margin at 38.0% declined by 6.4% YoY (led by 11.2% fall in ICT margins) while PAT at Rs318.3 mn increased by 61.4% YoY, in line with estimate.
- ICT on track in FY09E, cutting FY10E to reflect slower economic growth:** ICT school addition came in at 1,055 out of which 708 was from Karnataka (Outright buy) and 347 from Chhattisgarh (BOOT). We expect the installed base of schools to touch 12,000 (addition of 6,000), in line with management guidance for FY09. However, we have toned down our estimates for ICT schools in FY10E to 19,000 from 20,000 earlier due the sharp downgrades to the GDP growth rates.

Exhibit 1: ICT is on track for FY09E

ICT (Rs mn)	9M FY09	FY09E
Revenue	576	1,419
EBITDA	155	333
EBITDA (%)	26.9	23.5
Number of schools	9,970	12,004

Source: Company data, JM Financial

- IMF has recently cut India GDP forecast to 5.1% vs. its earlier projection of 6.5% in November 2008.** With the sharper dip in GDP estimates, we expect the pressure on government budgets to mount. Hence we are lowering our ICT school addition assumptions to 7,000 in FY10E (vs. 8,000 earlier). We expect the upfront hardware buyouts to reduce (60% of total addition in FY10E vs. 70% in FY09E) due to tighter budgets. Despite this, we have factored in lower margins in ICT to reflect increased competitive pressures, as well as budgetary pressures on state governments. We have also been conservative on hardware margins in ICT at 8% vs. management input of 12%.

Exhibit 2: Gross Budgetary Support is not immune to decline

Rs mn	2006-2007			2007-2008			2008-2009		
	GBS	PSK	Total	GBS	PSK	Total	GBS	PSK	Total
SSA	51,690	58,310	110,000	36,780	69,930	106,710	54,100	76,900	131,000
% allocation	47.0%	53.0%		34.5%	65.5%		41.3%	58.7%	
Mid Day meal scheme	24,330	29,150	53,480	39,240	34,000	73,240	28,730	51,270	80,000
% allocation	45.5%	54.5%		53.6%	46.4%		35.9%	64.1%	
Total	76,020	87,460	163,480	76,020	103,930	179,950	82,830	128,170	211,000

Source: Education ministry; Note: GBS–Gross Budgetary Support; PSK–Prarambik Shiksha Kosh

- Smart Class remains steady:** Educomp added 212 schools under Smart Class in 3Q FY09 (182 under BOOT and 30 under Outright Buy). While this is lower than the addition in 2Q FY09 (231 schools), we expect the company to achieve 1,700 schools by end FY09E, in line with guidance. We have marginally toned down our estimates to management guidance of 1,700 schools versus our earlier estimate of 1,800 to reflect slower than expected growth in the current quarter. Accordingly, we have revised the FY10E target to 2,650 schools vs. earlier target of 3,000.

Exhibit 3: Smart Class is expected to remain strong in FY09E

Smart Class (Rs mn)	9M FY09	FY09E
Revenue	2,034	3,159
EBITDA	1,221	1,896
EBITDA (%)	60.0	60.0

Source: Company data, JM Financial

- K-12 estimates ahead of expectations, estimates revised to reflect a relatively capex light model:** Management increased the number of expected operational K-12 schools 27 vs. 22-24 earlier. This is due to the signing up of 5 additional schools under 'Euroschoools' brand, which would operate on a franchisee basis. Out of the 27 schools, 8 schools (5 'Euroschoools' & 3 DPS schools) would be on a brown field model (only school management without owning the assets) while the rest would be owned schools. Management intends to focus on an asset light model given the tighter liquidity conditions versus close 90% owned schools target earlier. We have revised our estimates to reflect 75% schools on owned basis and the rest on management contracts. Accordingly, while our revenue estimates would reduce (as Educomp gets ~30% of school fee as the management fee), PAT margins would be higher as it is a completely asset light model (refer Exhibit 3).

Exhibit 4: We now expect more school management contracts

(Nos)	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E
Total K-12 schools	27	50	60	70	80	90	100
Owned built up schools	19	36	44	52	60	68	76
Owned operational schools	8	19	36	44	52	60	68
Managed schools signed	8	14	16	18	20	22	24

Source: JM Financial

Exhibit 5: Change in K-12 assumptions

Change in K-12 assumptions	New estimates		Old estimates	
	FY09E	FY10E	FY09E	FY10E
Revenue (Rs mn)	450	924	494	1,138
EBITDA (Rs mn)	360	754	440	1,011
PAT	77	148	36	94
Capex	2,148	1,594	2,693	1,819

Source: JM Financial

- New auditor, improved disclosures to bring back investor confidence:** Educomp has unveiled a corporate governance roadmap to address the recent concerns on the issue. A part of the roadmap, the company will shortly appoint Grant Thornton as internal auditor for the company. The company is also looking to expand its board (5-member board at present) and include higher level of disclosures in its quarterly announcements. The company is also trying to get independent verification by NSDL and CSDL that no shares have been pledged by the promoter. Educomp is also co-operating with government authorities to verify its books and hopes to get a clean chit soon. In addition, Educomp's promoter group would intimate intent, if any, to sell promoter shares in advance of the actual sale. We believe that the success of the above measures would serve to bolster investor confidence in the company.
- Maintain Buy with a revised target price of Rs2,030:** Factoring in the changes in (1) ICT school addition assumptions (2) Smart Class school addition assumptions and (3) K-12 to reflect for higher PAT contribution, we are revising our EPS estimates to Rs71.6 (-0.8%) for FY09E and Rs124.1 (-10.8%) for FY10E. Our EPS estimate for FY11E stands at Rs174.3. We have now valued Educomp at a target multiple of 15.0x versus our earlier target multiple of 25x. The stock currently trades at 21.0x and 12.1x FY09E and FY10E EPS. Maintain Buy with a revised target price of Rs2,030 (Dec 09).

Exhibit 6: Change in assumptions

Change in assumptions	New estimates		Old estimates	
	FY09E	FY10E	FY09E	FY10E
Smart Class school addition (Nos)	767	950	867	1,000
ICT school addition (Nos)	6,000	7,000	6,000	8,000
Revenue (Rs mn)	5,914	9,710	5,813	10,654
PAT (Rs mn)	1,344	2,331	1,355	2,613
EPS (Rs)	71.6	124.1	72.1	139.1
EPS growth (%)	102.2	73.4	103.7	92.9
Implied multiple (x)		18.0		25.5
Target price (Rs)		2,030		3,545

Source: JM Financial

Exhibit 7: Segmental revenue contribution

Revenue contribution (%)	FY08	FY09E	FY10E	FY11E
ICT	32.6	24.0	20.2	18.9
Smart Class	44.3	53.4	53.5	52.3
Professional development	9.0	4.8	3.2	2.6
K-12	2.4	7.6	9.5	11.4
Others	11.7	10.1	13.6	14.8
Total (Rs mn)	2,861	5,914	9,710	13,414

Source: Company data, JM Financial

Exhibit 8: Segmental margin contribution

EBITDA contribution (%)	FY08	FY09E	FY10E	FY11E
ICT	21.7	11.3	9.0	8.0
Smart Class	58.1	64.1	62.3	59.9
Professional development	12.5	5.8	3.8	3.0
K-12	0.0	12.2	15.4	19.1
Others	7.7	6.7	9.5	10.1
Total (Rs mn)	1,266	2,958	4,880	6,680

Source: Company data, JM Financial

Exhibit 9: Quarterly results						(Rs mn)			
Y/E MARCH	3Q 08	4Q 08	1Q 09	2Q 09	3Q 09	YoY (%)	FY08	FY09E	YoY (%)
Revenues	715	1,181	694	981	1,453	103.1	2,621	5,110	95.0
Operating expenses	381	630	315	474	786	106.3	1,374	2,567	86.8
EBITDA	334	551	379	507	666	99.5	1,247	2,543	104.0
<i>EBITDA Margin (%)</i>	<i>46.7</i>	<i>46.7</i>	<i>54.6</i>	<i>51.7</i>	<i>45.9</i>	<i>-82</i>	<i>47.6</i>	<i>49.8</i>	<i>220</i>
Depreciation	91	110	135	157	192	110.3	323	612	89.6
Other Income	59	14	27	55	17	-71.4	148	151	1.8
Interest charges	13	16	14	17	24	91.3	42	248	493.2
PBT	289	439	257	388	467	61.7	1,030	1,833	78.0
Provision for Tax	99	125	89	134	152	53.5	329	642	94.8
<i>% of PBT</i>	<i>34.2</i>	<i>28.4</i>	<i>34.7</i>	<i>34.6</i>	<i>32.4</i>	<i>-173.5</i>	<i>32.0</i>	<i>35.0</i>	<i>302</i>
PAT	190	315	168	254	315	66.0	701	1,192	70.1
Less: Exchange gain on FCCB (net of taxes)							51	0	
PAT(Reported)	190	315	168	254	315	66.0	650	0	
<i>PAT Margin (%)</i>	<i>26.6</i>	<i>26.6</i>	<i>24.2</i>	<i>25.9</i>	<i>21.7</i>	<i>-486</i>	<i>24.8</i>	<i>1,192</i>	<i>83.2</i>

Source: JM Financial

Financial Tables

Profit & loss statement					(Rs mn)
Y/E March	FY08	FY09E	FY10E	FY11E	
Net sales	2,861	5,914	9,710	13,414	
Growth (%)	159.9	106.7	64.2	38.1	
Other operational income	0	0	0	0	
EBITDA	1,266	2,958	4,880	6,680	
EBITDA (%)	44.2	50.0	50.3	49.8	
Growth (%)	168.1	85.3	63.4	39.4	
Other non-operational income	178	177	388	537	
Depreciation & amortisation	331	653	713	1,005	
EBIT	1,112	2,483	4,555	6,211	
Interest (income)/expense (net)	48	347	853	1,008	
Pre tax profit	1,064	2,136	3,702	5,203	
Taxes	351	748	1,296	1,821	
Net profit (before MI)	713	1,388	2,406	3,382	
Minority interest and others	7.2	44.1	75.4	107.8	
Reported Net profit (after MI)	655	1,344	2,331	3,274	
Net profit (%)	22.9	22.7	24.0	24.4	
Diluted share capital (mn)	18.5	18.8	18.8	18.8	
EPS (Rs)	35.4	71.6	124.1	174.3	
Growth (%)	104.4	102.2	73.4	40.5	

Source: Company, JM Financial

Balance sheet					(Rs mn)
Y/E March	FY08	FY09E	FY10E	FY11E	
Share capital	172	172	172	172	
ESOP O/S	83	83	83	83	
Reserves & surplus	2,629	3,892	6,125	9,300	
Net worth	2,884	4,147	6,380	9,555	
Minority Interest	194	238	313	421	
Total loans	3,773	7,205	9,353	10,153	
Sources of funds	6,851	11,590	16,045	20,128	
Intangible assets	280	280	280	280	
Fixed assets	2,890	6,250	9,564	13,340	
Less: Depreciation/amortisation	548	1,201	1,914	2,920	
Net block	2,342	5,048	7,649	10,420	
CWIP	372	772	1,322	1,672	
Investments	36	804	804	804	
Deferred tax assets/(liability)	-210	-530	-1,085	-1,866	
Current assets	4,639	6,185	8,743	10,854	
Inventories	18	30	49	67	
Sundry debtors	1,157	1,931	3,089	4,231	
Cash & bank balance	2,912	3,219	3,974	4,302	
Loans & advances	490	887	1,457	2,012	
Other current assets	62	118	175	241	
Current liabilities & provisions	610	971	1,669	2,038	
Current liabilities	517	797	1,400	1,688	
Provisions and others	92	175	270	349	
Net current assets	4,029	5,213	7,073	8,816	
Others (net)	1	1	1	1	
Application of funds	6,851	11,590	16,045	20,128	

Source: Company, JM Financial

Cash flow statement					(Rs mn)
Y/E March	FY08	FY09E	FY10E	FY11E	
Net profit	1,072	2,136	3,702	5,203	
Depreciation/amortisation	331	653	713	1,005	
(Inc)/dec in working capital	-730	-942	-1,169	-1,459	
Others	-168	-268	-304	-631	
Net cash from operations (a)	505	1,579	2,941	4,117	
(Inc)/dec in investments	85	-389	0	0	
Capex	-2,224	-3,760	-3,864	-4,126	
Others	122	-591	388	537	
Cash flow from inv. (b)	-2,102	-4,350	-3,476	-3,589	
Inc/(dec) in capital	0	0	0	0	
Dividends paid + dividend tax	-40	-51	-81	-99	
Inc/dec in loans	3,549	3,431	2,148	800	
Others	-116	-303	-778	-900	
Financial cash flow (c)	3,393	3,078	1,289	-199	
Net inc/dec in cash (a+b+c)	1,796	307	755	329	
Opening cash balance	1,106	2,912	3,218	3,973	
Closing cash balance	2,912	3,218	3,973	4,302	

Source: Company, JM Financial

Key ratios				
Y/E March	FY08	FY09E	FY10E	FY11E
ROCE (%)	19.4	24.0	28.5	29.0
ROE (%)	35.0	38.2	44.3	41.1
Debt-equity ratio (x)	1.3	1.7	1.5	1.1
Valuation ratios (x)				
PER	42.4	21.0	12.1	8.6
PBV	8.8	6.2	4.1	2.7
EV/EBITDA	20.8	10.1	6.4	4.8
EV/Sales	9.2	5.1	3.2	2.4
Turnover ratios (no.)				
Debtor days	105	95	94	100
Inventory days	3	1	1	1
Creditor days	31	31	31	31

Source: Company, JM Financial

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