

Educomp Solutions Ltd

INR:1797

Smart Performance by Smart Class

BUY



We have analyzed the Q3FY09 results of Educomp Solutions Ltd and our key findings are:

Q3FY09 Result Snapshot:

- Net sales: Rs.145.3 Crore (↑103% y-o-y and ↑48% q-o-q)
- EBITDA: Rs.66.6 Crore (↑100% y-o-y and ↑31% q-o-q),
- PAT: Rs. 31.5 Crore (↑66% y-o-y and ↑24% q-o-q),

Comments & Analysis:

- **Net Sales:** Net sales increased 103% y-o-y to Rs 145.3 Crore in Q3FY09. This was mainly due to the strong growth across key business segments. Smart class, which contributed 60% to the total revenue, showed an impressive revenue growth of 152% y-o-y. Further the retail and consulting segment which contributed 8% in Q3FY09 showed a robust growth of 82% y-o-y.
- **Operating Performance:** The company, inspite of making a forex exchange loss of Rs 10.1 crore showed a healthy growth of 100% y-o-y from Rs 33.4 crore to Rs 66.6 crore on the operating levels. The Operating margins have decreased by 82 bps y-o-y to 45.9% and declined by 580 bps q-o-q. The decline in the operating margins sequentially was mainly due to the forex loss of Rs 10.1 crore. The Forex loss in this quarter was mainly on account of MTM for zero coupon FCCB due July, 2012.
- **Net Profit:** Net profit showed a robust growth of 66% y-o-y and 24% q-o-q to Rs 31.5 crore. Net profit margin dipped by 489 bps y-o-y to 21.7% and decreased by 415 bps sequentially. Lower depreciation which got offset by high financial cost tumbled the profit margins.

Outlook and valuation

On market rumours that the company's Accounts were forged, the management has completely denied the same stating it baseless rumour. The management aims to have the best corporate governance practices to gain stakeholders confidence. This being the time of crisis, Educomp is well placed due to its recession free model and a strong annuity based cash flow in the range of 5-12 years. Educomp is best placed to tap the opportunity that the education sector provides through its offerings in the K-12 segment. Further Smart Class additions would be the key trigger to boost the revenues of the company. At CMP of Rs 1797, the stock is trading at 21.9x on FY09E EPS of Rs 70.8. We maintain our "BUY" recommendation on this stock with target price of Rs 2170, which represents an upside potential of 21%.

Financial Performance

(Rs crore)

Particulars	Q3FY09	Q3FY08	y-o-%	Q2FY09	q-o-q%
Net Sales	145.3	71.5	103%	98.1	48%
EBITDA	66.6	33.4	100%	50.7	31%
Net Profit	31.5	19.0	66%	25.4	24%
EPS	18.3	11.0	65%	14.7	24%
OPM (%)	45.9%	46.7%	(82) bps	51.7%	(580) bps
NPM (%)	21.7%	26.6%	(489) bps	25.9%	(415) bps

Source: KRC Research, Company Data

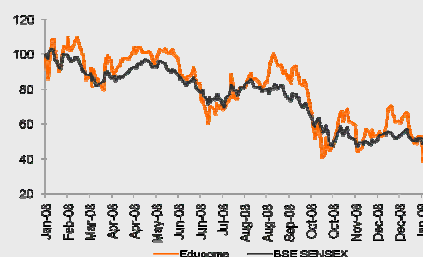
Price Outlook: Rs 2170**Market Data**

January 29, 2009

Shares outs (Cr)	1.72
Mkt Cap (Rs. Cr)	3071.8
52 Wk H/L	4562/1375
Avg Vol (1yr avg)	192924
Face Value	10
Bloomberg Code	EDSL IN

Market Info:

Sensex: 9,236
NIFTY: 2,824

Price Performance**Share Holding (%)**

Particulars	Dec-08	Sep-08	Change
Promoters	55.00	55.00	0.0
Institutions	0.88	1.59	-0.71
FII's	37.65	35.59	2.06
Body Corporate	2.08	1.88	0.20
Public	4.00	6.00	2.00
Total	100.00	100.00	-

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Detailed Result Analysis

(Rs crore)

Net Sales have shown a robust performance on the back of impressive performance of Smart Class

OPM have been affected due to Forex Losses

Interest paid increase by 92% y-o-y

NPM declined by 489 bps on the back of increase in the financial charges

Particulars	Q3FY09	Q3FY08	y-o-y%	Q2FY09	q-o-q%
Net Sales	145.3	71.5	103%	98.1	48%
Other Income	1.7	5.9	-72%	5.5	-70%
Total Income	146.9	77.4	90%	103.7	42%
Total Expenditure	78.6	38.1	106%	47.4	66%
(As a % of Sales)	54%	53%		48%	
Increase/Decrease in stock	-18.5	-28.1	-34%	-0.7	2438%
(As a % of Sales)	-13%	-39%		-1%	
Purchases of traded goods	53.2	50.5	5%	11.6	359%
(As a % of Sales)	37%	71%		12%	
Employee Expenses	17.2	9.5	81%	13.9	24%
(As a % of Sales)	12%	13%		14%	
Selling & Admin Exp	16.7	6.2	171%	10.5	58%
(As a % of Sales)	11%	9%		11%	
Foreign Exchange Fluctuation	10.09	-	0%	12.1	-17%
(As a % of Sales)	7%	-		12%	
Operating Profits (Excl OI)	66.6	33.4	100%	50.7	31%
<i>OPM (Excl Oi)</i>	45.9%	46.7%	(82) bps	51.7%	(580) bps
Operating Profits (Incl OI)	68.3	39.3	74%	56.2	21%
<i>OPM (Incl Oi)</i>	47%	55%	(791) bps	57%	(1027) bps
Interest	2.4	1.3	92%	1.7	39%
As a % of sales	2%	2%		2%	
Gross profit	65.9	38.0	73%	54.5	21%
<i>GPM %</i>	45%	53%		56%	
Depreciation	19.2	9.1	110%	15.7	23%
As a % of sales	13%	13%		16%	
EBIT	49.1	30.2	63%	40.6	21%
EBIT %	34%	42%		41%	
PBT	46.7	28.9	62%	38.8	20%
Total Tax	15.2	9.87	53%	13.4	13%
Effective Tax Rate	32%	34%		35%	
Net profit	31.5	19.0	66%	25.4	24%
NPM%	21.7%	26.6%	(489) bps	25.9%	(415) bps
Extra-ordinary Items	-	-	0%	-	0%
Adjusted PAT	31.5	19.0	66%	25.4	24%
EPS	18.3	11.0	65%	14.7	24%

Source: KRC Research, Company Data

Smart Class showed a robust growth of 152% y-o-y

Has its presence across 1479 schools

Capex for the quarter stood at Rs61 crore

Detailed Result Analysis

(Rs crore)

Revenue	Q3FY09	Q3FY08	y-o-y%	Q2FY09	q-o-q%
Professional Development	8.6	6.6	30%	6.7	29%
Smart Class	87.6	34.7	152%	68.6	28%
ICT Solutions	37.5	23.9	57%	12.1	211%
Retail & Consulting	11.6	6.4	81%	10.8	8%
Total Net Sales	145.3	71.5	103%	98.1	48%
EBIT	Q3FY09	Q3FY08	y-o-y%	Q2FY09	q-o-q%
Professional Development	5.2	4.2	25%	4.4	18%
Smart Class	51.8	19.2	170%	40.8	27%
ICT Solutions	8.6	6.8	26%	4.2	104%
Retail & Consulting	4.1	3.9	5%	7.6	-46%
	69.7	34.1	104%	57.0	22%
Less: Interest	2.4	1.3	85%	1.7	39%
Other un-allocable expenses	20.6	3.9	428%	16.5	25%
Total PBT	46.7	28.9	62%	38.8	20%
EBIT Margins	Q3FY09	Q3FY08	y-o-y	Q2FY09	q-o-q
Professional Development	61.0%	63.6%	(262) bps	66.3%	(525) bps
Smart Class	59.2%	55.3%	385 bps	59.5%	(27) bps
ICT Solutions	22.8%	28.5%	(563) bps	34.8%	(1195) bps
Retail & Consulting	35.3%	60.9%	(2568) bps	70.8%	(3557) bps

Source: KRC Research, Company Data

Segmental Performance

Smart Class – Marks its presence across 1,479 schools and has a reach of 1.7 million students

- During the quarter the additional schools signed were 212 of which 182 were under the BOOT model and 30 under the outright buy
- During the quarter the additional schools implemented were 200 of which 170 were under the BOOT projects and 30 under Outright Buy
- This brings the total number of schools signed to 1479 and 1433 total schools implemented as on 31st December, 2008
- The total staff strength in this quarter stood at ~180 employees which was the same in the sequential quarter
- Sales resulted in 152% growth y-o-y to Rs87.6 crore in Q3FY09. EBIT of this segment showed a robust growth of 170% y-o-y and EBIT margins grew by 385 bps Y-o-Y. The capex for this segment during the quarter stood at Rs60.6 crore

Marked its presence in 8915 schools

Capex for the segment stood at Rs1.8 crore

Trained 1,05,333 teachers during Q3FY09

Strength of 180+ teacher training team

Mathguru contributed 25% of the total revenue of Retail Segment

ICT Solutions: Has reach of 8,915 schools and 5 million + students

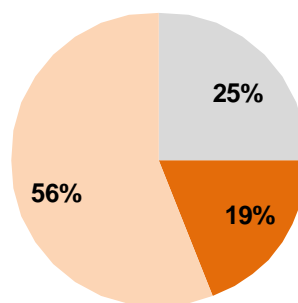
- During this quarter additional schools signed were 1055 of which 347 (Chattisgarh) were under BOOT projects and 708 (Karnataka) under Outright Buy
- This makes the cumulative schools covered to 9970 and cumulative number of students covered to over 5.5 million as on December, 2008
- The total strength of sales and project management team for the quarter stood at 40+
- Sales resulted in 57% growth y-o-y to Rs37.5 crore in Q3FY09. EBIT of this segment showed a growth of 26% y-o-y and EBIT margins declined by 563 bps Y-o-Y. The margins witnessed a decline as most of the schools signed were under the outright buy to provide hardware which enjoys less margins
- The capex for this segment during the quarter stood at Rs1.8 crore

Professional Development: Trained 1.3 million teachers

- The revenues derived from this segment has increased by 31% y-o-y to Rs8.6 crore
- The company has trained 1,05,333 teachers during this quarter taking the total teachers strength to 1.3 million showing a y-o-y growth of 50%
- Company has recently Signed a services agreement with Michael & Susan Dell Foundation, a US based private charitable foundation, to create a model to transform learning levels of poor children served by private schools in Hyderabad for an amount of Rs.4.78cr for a term starting September 01, 2008 till March 31, 2012
- The company has strength of 180+ teacher training team.

Retail and Consulting: Roots –to-wings have presence in 105 schools

Revenue Break-up



■ Mathguru ■ Roots-to-Wings ■ Miscellaneous (Licensing/ Retail)

60% of the total revenue in Q3FY09 was contributed by Smart Class

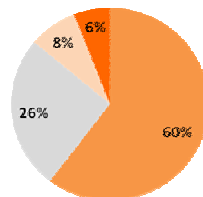
Educomp now has presence in 17 cities covering 14,000+ students through K-12

In process of making IPR registrations in Middle East and South East Asia

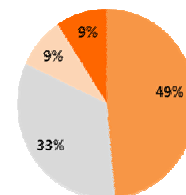
- Sales resulted in 82% robust growth y-o-y to Rs11.6 crore in Q3FY09. EBIT of this segment showed a growth of 5% y-o-y
- Roots-to-Wings has been awarded 'Emerging Franchisor of the Year 2008' for excellence in Franchising and Business Development, by Franchise India Holdings Ltd.

Revenue Break-Up

Revenue Mix - Q3FY08



Revenue Mix- Q3FY09



Smart Class ICT Retail Professional Development

Smart Class ICT Retail Professional Development

Source: KRC Research, Company Data

K-12 Initiatives: *presence being expanded to 17 cities*

- The company now has presence in 17 cities through 11 K-12 schools (7 schools are owned) covering 14,000+ students
- The company has acquired 51% stake in Takshila Management Services with 3 schools coming up in Tier III cities Hoshiarpur (Punjab), Ahmednagar (Maharashtra) and Gaya (Bihar) by June 2009.
- There are 6 schools under construction one each in Lucknow, Noida, Panipat, Amritsar and two in Chennai.
- Agreement with 5 schools on Dry Management basis have already been signed by Euro Kids India in which Euro Kids will have 50% stake

Pre-School Education: *Leverage leadership position through Euro Kids*

- EuroKids runs 400+ Preschools (Of which 28 are owned) having Pan India presence and caters to 25,000+ kids from age 2-4
- Company is in the process of making IPR registrations in Middle East and South East Asia for pre-schools
- Entered into arrangements for commencement of 5 Euroschools (K12 schools); one each in Meghalaya, Guwahati, Bangalore and two in Maharashtra, by June 2009 on Dry Management Basis

Increased disclosure to investor taken positively

Clarifications against Claims and detail disclosure

On market rumours that the company's Accounts were forged, the management has completely denied the same stating it baseless rumour. The management aims to have the best corporate governance practices to gain stakeholders confidence. To achieve the same, Educomp increased its disclosures by including, for the first time, the consolidated quarterly balance sheet, P&L A/cs of various subsidiaries, details of bank deposits, and names of Smart Class schools, among others. The company is in the process of appointing reputed auditors and certifications from authorities confirming non-pledging of shares.

Financial Performance

(Rs crore)

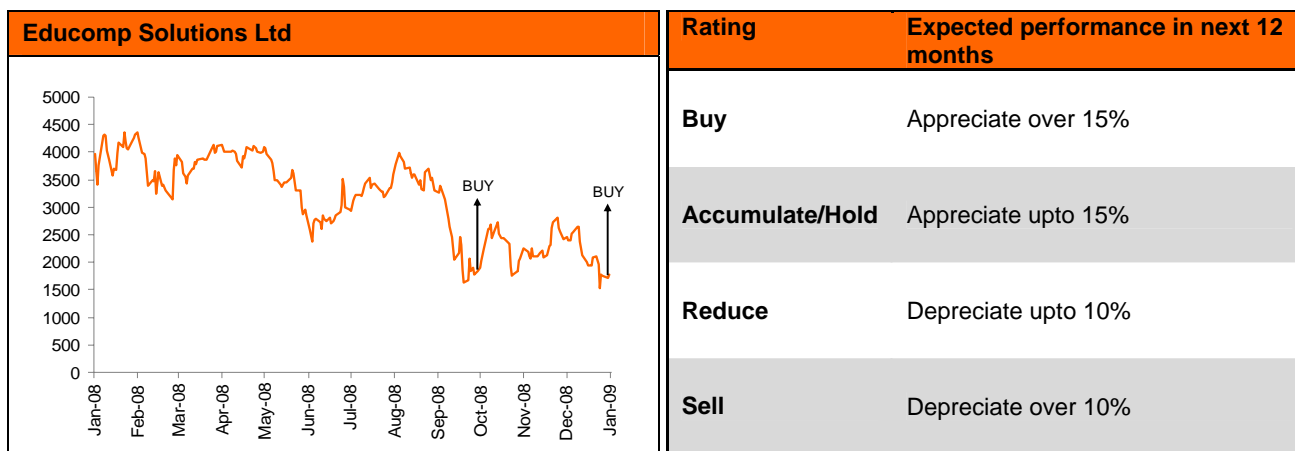
Particulars	FY08	FY09E	FY10E
Net Sales	262.1	508.0	685.0
% Growth		94%	35%
EBITDA	124.7	242.3	330.0
% Growth		94%	36%
Net Profit	70.1	122.3	178.8
% Growth		75%	46%
OPM (%)	47.6%	47.7%	48.2%
NPM (%)	26.7%	24.1%	26.1%
EPS	40.6	70.8	103.4
P/E	43.8	25.1	17.2

Source: KRC Research, Company Data

Valuations

This being the time of crisis, Educomp is well placed due to its recession free model and a strong annuity based cash flow in the range of 5-12 years. Educomp is best placed to tap the opportunity that the education sector provides through its offerings in the K-12 segment. Further Smart Class additions would be the key trigger to boost the revenues of the company. At CMP of Rs 1797, the stock is trading at 21.9x on FY09E EPS of Rs 70.8. We maintain our "BUY" recommendation on this stock with target price of Rs 2170, which represents an upside potential of 21%.

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Other Stocks in the sector under our active coverage: Diversified

Ticker	Company	Reco.	As of	Return	Bmk	Outperformer	BAAR
Summary	Coverage 10	Avg Rating: 4		0.98%	-27.35%	28.32%	
APNT	IN Asian Paints Ltd	hold	01/28/09	-12.8%	-14.9%	2.1%	
BLSTR	IN Blue Star Ltd	buy	01/27/09	-5.6%	-45.0%	39.4%	2nd
KKB	IN Kirloskar Brothers Ltd	buy	01/21/09	29.7%	-30.9%	60.6%	1st
ABNL	IN Aditya Birla Nuvo Ltd	hold	12/31/08	0.0%	-54.8%	54.8%	1st
MMTC	IN MMTC Ltd	hold	12/31/08	0.0%	0.0%	0.0%	1st
CENT	IN Century Textile & Industries Ltd	hold	12/31/08	0.0%	-39.7%	39.7%	1st
KSB	IN KSB Pumps Ltd	buy	12/31/08	5.4%	-20.2%	25.6%	1st
EDSL	IN Educomp Solutions Ltd	buy	12/31/08	-23.9%	-26.5%	2.6%	
ESIL	IN Everonn Systems India Ltd	buy	12/31/08	-14.5%	-14.1%	-0.4%	
SAGL	IN Sejal Architectural Glass Ltd	buy	12/31/08	-11.0%	-11.0%	0.0%	1st

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