Educomp Solutions Ltd.

Price Objective Change BUY

Equity | India | Education & Training Services
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Balance sheet, cash flows set to improve; Buy

Bank of America Merrill Lynch

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Raise estimates/PO; ~30% upside potential

Post robust 1Q results, we raise Educomp's EPS for FY10E/FY11E by 6%/9% to reflect the strong Smart Class school adds. We forecast EPS to grow at a CAGR of 66% over FY09-11. Additionally, we re-rate the stock to 25x FY11E P/E (vs the 20x target P/E earlier) and raise the PO to Rs4,600 (from Rs3,400) with ~30% upside potential. Our target P/E is based on a 2-yr PEG of 1x, higher than the 0.9x earlier, to reflect strengthening of the balance sheet and the company's move to improve FCF. There could be a further 10% potential upside to our PO from a step jump in earnings given management plans to shift to an one-time-license Smart Class model from the 5-year charge model and reduce capital intensity in Smart Class.

Balance sheet strengthened; well funded for growth now

Given the capital intensity of the business, the ability to raise funds and the high debt/equity ratio were our key concerns. Post US$125mn fund raising, our concerns have been adequately addressed. Educomp's net debt is now negative and provides room for further leverage to fund growth opportunities.

FY11 EPS to jump; FCF to turn around under new model

In the 1Q earnings call, management highlighted plans to move to an one-time content licensing in Smart Class, securitize revenue streams, and outsource hardware implementation and the ongoing non-core service activity to third-party firms. If these measures are adopted, we expect a step jump in FY11 EPS for Educomp and a sharp turnaround in its FCF.

Continues to be a multi-year growth story

With less than 10% penetration in the Smart Class market, 98% market share, and a strong growth potential in the K-12 market, Educomp remains a multi-year growth story, in our view. Strong 1Q results, with revenue 9% ahead of BAS-MLe (up 113% YoY) and recurring PAT 12% ahead (up 70% YoY), support our view.

Estimates (Mar)

(Rs)	2008A	2009A	2010E	2011E	2012E
Net Income (Adjusted - mn)	707	1,329	2,434	3,672	4,465
EPS	35.56	66.88	122.45	184.71	224.61
EPS Change (YoY)	146.3%	88.1%	83.1%	50.8%	21.6%
Dividend / Share	2.93	3.09	3.00	3.00	3.00
Free Cash Flow / Share	(99.66)	(225.18)	(106.33)	(106.74)	(16.03)

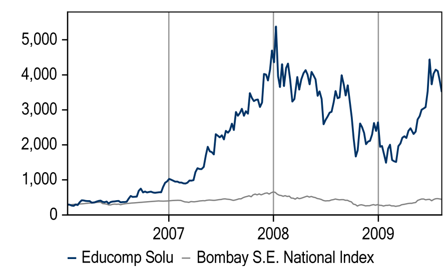
Valuation (Mar)

	2008A	2009A	2010E	2011E	2012E
P/E	100.56x	53.47x	29.20x	19.36x	15.92x
Dividend Yield	0.082%	0.086%	0.084%	0.084%	0.084%
EV / EBITDA*	49.38x	20.55x	12.59x	8.58x	6.81x
Free Cash Flow Yield*	-2.79%	-6.31%	-3.43%	-3.46%	-0.523%

* For full definitions of *iQmethod* SM measures, see page 13.

Stock Data

Price	Rs3,576
Price Objective	Rs3,400 to Rs4,600
Date Established	12-Aug-2009
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs1,331-Rs4,590
Mrkt Val / Shares Out (mn)	US$1,290 / 17.2
Average Daily Volume	1,446,345
ML Symbol / Exchange	EUSOF / BSE
Bloomberg / Reuters	EDSL IN / EDSO.BO
ROE (2010E)	25.0%
Net Dbt to Eqty (Mar-2009A)	135.5%
Est. 5-Yr EPS / DPS Growth	25.0% / 25.0%
Free Float	45.0%



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Refer to important disclosures on page 14 to 16. Analyst Certification on Page 12. Price Objective Basis/Risk on page 12.

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iQprofile SM Educomp Solutions Ltd.

Key Income Statement Data (Mar)	2008A	2009A	2010E	2011E	2012E
(Rs Millions)					
Sales	2,861	6,371	9,829	13,640	17,565
Gross Profit	1,575	4,105	7,196	10,178	13,238
Sell General & Admin Expense	(301)	(1,061)	(1,786)	(2,479)	(3,355)
Operating Profit	935	2,229	3,988	5,866	7,295
Net Interest & Other Income	129	(41)	520	(53)	(172)
Associates	NA	NA	NA	NA	NA
Pretax Income	1,065	2,189	4,508	5,812	7,123
Tax (expense) / Benefit	(351)	(773)	(1,488)	(1,918)	(2,351)
Net Income (Adjusted)	707	1,329	2,434	3,672	4,465
Average Fully Diluted Shares Outstanding	20	20	20	20	20
Key Cash Flow Statement Data					
Net Income	711	1,347	2,836	3,672	4,465
Depreciation & Amortization	331	814	979	1,424	1,886
Change in Working Capital	(730)	(1,023)	(1,079)	(1,595)	(2,052)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	193	1,218	515	601	770
Cash Flow from Operations	505	2,357	3,251	4,102	5,069
Capital Expenditure	(2,224)	(6,249)	(5,365)	(6,234)	(5,392)
(Acquisition) / Disposal of Investments	85	(367)	0	0	0
Other Cash Inflow / (Outflow)	141	150	0	0	0
Cash Flow from Investing	(1,998)	(6,467)	(5,365)	(6,234)	(5,392)
Shares Issue / (Repurchase)	0	0	4,800	3	4
Cost of Dividends Paid	(40)	(58)	(60)	(60)	(60)
Cash Flow from Financing	3,461	3,872	5,494	962	527
Free Cash Flow	(1,719)	(3,892)	(2,113)	(2,132)	(322)
Net Debt	862	6,786	500	3,071	3,916
Change in Net Debt	(1,634)	4,238	(2,296)	2,571	845
Key Balance Sheet Data					
Property, Plant & Equipment	2,714	8,126	12,512	17,322	20,828
Other Non-Current Assets	318	1,966	1,955	1,955	1,955
Trade Receivables	1,157	2,765	3,415	4,898	6,772
Cash & Equivalents	2,912	1,902	5,274	4,103	4,308
Other Current Assets	570	1,833	1,619	1,839	2,124
Total Assets	7,671	16,592	24,774	30,117	35,987
Long-Term Debt	3,773	8,688	5,774	7,174	8,224
Other Non-Current Liabilities	210	639	639	639	639
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	586	2,214	2,327	2,434	2,541
Total Liabilities	4,569	11,542	8,740	10,247	11,404
Total Equity	3,078	5,007	16,234	20,070	24,783
Total Equity & Liabilities	7,647	16,550	24,974	30,317	36,187
iQmethod SM **- Bus Performance***					
Return On Capital Employed	16.1%	15.9%	18.9%	17.4%	17.3%
Return On Equity	35.1%	37.5%	25.0%	21.5%	21.2%
Operating Margin	32.7%	35.0%	40.6%	43.0%	41.5%
EBITDA Margin	44.3%	47.8%	50.5%	53.4%	52.3%
iQmethod SM **- Quality of Earnings***					
Cash Realization Ratio	0.7x	1.8x	1.3x	1.1x	1.1x
Asset Replacement Ratio	6.7x	7.7x	5.5x	4.4x	2.9x
Tax Rate (Reported)	33.0%	35.3%	33.0%	33.0%	33.0%
Net Debt-to-Equity Ratio	28.0%	135.5%	3.1%	15.3%	15.8%
Interest Cover	19.5x	8.3x	12.0x	15.4x	15.6x

Key Metrics

* For full definitions of *iQmethod* SM measures, see page 13.

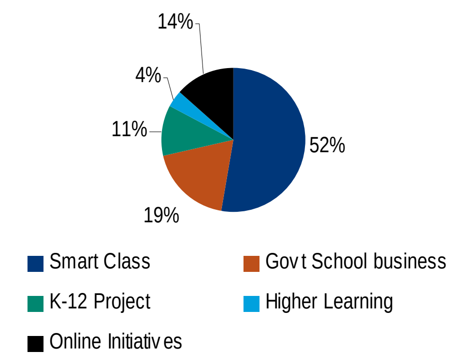
Company Description

Set up in 1994, Educomp is India's largest provider of technology driven education solutions co. It provides end to end solutions for K12 through licensing of digital content to enhance the teaching process. It aims to be a comprehensive provider of solutions in Indias school education economy and has expanded its offerings to cater to pre schools, online tutoring, professional development for teachers etc.

Investment Thesis

We expect Educomp to be one of the fastest growing companies in our universe. Key positives include growing adoption of technology-based education in K-12 (Kindergarten to Class12) private schools, low market penetration of under 5% among private schools in India and increased spending by state governments on technology adoption in public schools. Moreover, revenue visibility will be enhanced as the company enters into five-year contracts with private schools.

Chart 1: 1Q FY10 Revenue Split



Source: Company

Stock Data

Price to Book Value	4.0x

B/S & cash flow concerns easing, strong growth momentum ahead

Raise ests and PO for ~30% upside potential

Following its robust 1Q results, we raise earnings estimates by 6% for FY10 and 9% for FY11 to reflect the strong additions of Smart Class schools during the quarter. Additionally, we re-rate the stock to 25x FY11E PE (vs. 20x target PE earlier) and raise PO to Rs4600 (from Rs3400) for ~30% upside potential.

Our target PE is based on a 2-yr PEG of 1x higher than the 0.9x earlier, to reflect balance sheet strengthening and the move by the company to improve FCF. There could be further 10% potential upside to our PO from step jump in earnings given management plans to shift to a one-time-license Smart Class model vs. a five-year charge and reduce capital intensity in Smart Class.

Table 1: Revised earnings estimates

(Rs mn)	Earlier FY10E	Revised FY10E	Change (%)	Earlier FY11E	Revised FY11E	Change (%)	Revised FY12E
Sales	9403	9829	5%	12880	13640	6%	17565
EBITDA	4560	4967	9%	6603	7290	10%	9181
EBIT	3621	3988	10%	5284	5866	11%	7295
PAT	2145	2434	13%	3151	3672	17%	4465
EPS (Rs)	115	122	6%	169.4	184.7	9%	224.6

Source: Banc of America Securities- Merrill Lynch estimates

Well funded for growth now

After the recent US$125mn equity fund raising, the firm's net debt is now negative and provides scope for further leverage to fund high growth. Given the capital intensity of key businesses ie Smart Class & K-12 project, ability to fund growth and leveraged balance sheets were our key concerns for the stock. We believe management has adequately addressed these issues through it recent fund raising program.

Cash flow pressures could ease further

Educomp plans to adopt new business model in Smart Class where in it intends to securitize revenue streams in Smart Class and out source all non core activities to third party firms. If adopted we expect a sharp turnaround in FCF during FY12E, which could help ease cash flow pressures further.

Trading on par with Asian peers

While there are no direct comparables for Educomp, we note that the stock is trading at par with average PE multiple for Asian education stocks such as New Oriental, Raffles etc for a much higher growth of 66% (FY09e-11e) vs 33% for Asian peers.

Table 2: Valuations at par with Asian peers

	Description	Yr End	2009 E	2010E Y	2011E Y	CAGR (09-11E)	PE2010E Y	PE2011E Y
MEGASTUDY CO LTD	Leading online education provider in Korea	Dec	10,849	13,479	16,299	23%	17	14.1
NEW ORIENTAL EDUCATIO-SP ADR	Largest private education provider in China	May	1.71	2.29	2.93	31%	33	25.7
ATA INC-ADR	Leading examination test service provider	Mar	0.16	0.28	0.37	53%	27.9	21.4
Average						34%		18.15
EDUCOMP SOLUTIONS LTD	India's largest provider of technology driven education soln	Mar	66.88	122.45	184.71	66%	28.7	19.0

Note : Consensus EPS est for Asian peers

Source: Banc of America Securities- Merrill Lynch, Bloomberg estimates

Further 10% potential upside to our PO from shift to new model

There could be further 10% potential upside to our PO given management plans to shift to a one-time-license Smart Class model vs a five-year charge and reduce capital intensity in Smart Class. If implemented FCF could sharply turnaround in FY12, as discussed below. We have assumed gradual move to outsourcing keeping quality control considerations in mind.

However, as management would be shifting to one-time content licensing and securitizing revenue streams, we believe earnings volatility would increase as growth would depend on the number of schools signed per year, effectively lowering Smart Class revenue visibility.

Shift to new model could boost FY11 & 12 EPS

Sharp turn around in FCF from FY12e under the new model. Educomp may not be required to tap capital markets to fund growth.

Step jump in earnings in FY11e to Rs220 assuming 30% Smart class signed in new model

Management articulated its three-point plan for the Smart Class model: (1) reduce capex intensity, (2) securitize revenue streams, and (3) outsource non-core activity. While it is negotiating with banks to adopt this model, we have attempted a simplistic scenario analysis for FY11E.

Educomp said that the new model was necessary in view of the strong growth in its Smart Class offering and the fact that there is a huge addressable market of over 28,000 private schools and penetration levels of less than 10% currently. It felt that the time has come to outsource non-core activity and shift to a capital-light model.

Assuming even 30% of school contracts are signed under this model, we expect a step jump in Smart Class revenues to 82% YoY in FY11 and, accordingly, company earnings to increase 79% YoY. We expect sharp improvement in FCF on adoption of this model.

We anticipate accelerated growth on successful adoption of this model. Table 4 illustrates the key assumptions of the new revenue model.

Table 3: EPS scenario analysis*: Steep jump in earnings in FY11E and sharp FCF improvement in FY12E

(Rs mn)	Current Est FY11E	Scenario FY11E	Change (%)	Current Est FY12E	Scenario FY12E	Change (%)
Sales	13640	15614	14%	17565	19477	11%
EBITDA	7290	8181	12%	9181	9782	7%
EBIT	5866	6832	16%	7295	8130	11%
PAT	3672	4373	19%	4465	5163	16%
EPS (Rs.)	184.7	220	19%	224.6	260	16%
FCF	-2129	-623.9	nm	-319	1766.1	nm

*Assumes adoption of new model in FY11 and at least 30% of schools to be contracted under this model.

Source: Banc of America Securities- Merrill Lynch estimates

New business model in Smart Class

In Smart Class, management plans to securitize revenue streams, rope in third-party firms to handle non-core activities such as hardware implementation and support services at school, and reduce capital intensity. While we await clarity on the new deal, we have attempted a simplistic scenario analysis for FY11.

Our scenario analysis assumes the following:

1. At least 30% of Smart Class school contracts in FY11E will be based on the new model, increasing thereafter.

2. NPV discount at 11% and bank charges of 10%. Educomp is in talks with banks and is yet to take a final call on the rate.

Table 4: Earnings scenario: Per school basis

Number of Schools	One	
HW cost/ School (Rs mn)	1.7	
Rs mn	**Year 1-5**	**Comments**
Potential revenue stream per year,	1.62	Revenue potential per year under current model
NPV (@11%) – discounted val	5.99	Discounted at 11%
Less: Bank charges 10%	0.60	Assumed BK charges of 10% for securitization
Reported Revenues for Educomp in Yr 1	5.39	Assumes securitization at Educomp level
Key cost items		
H/W cost	1.7	Upfront cost & P&L impact
Outsourcing Cost- 10%	0.54	Assumed 10% for third-party service provider. Actual charges could vary
Other Cost	0.55	Content/other administrative cost based on current run rate
Total Cost	2.79	
PBIT	2.60	
PBIT %	48	

P&L Comparison	New Model	Existing 5-yr model	Increase %
Revenues (Rs mn)	5.39	1.62	233%
PBIT %	48	54	
PBIT (Rs mn)	2.6	0.9	190%

Source: Banc of America Securities- Merrill Lynch Research

Key implications of the new model

Key positives

- **Cash flow improves, may not need to raise funds at regular intervals**

Given management's intent to securitize revenue streams in Smart Class, we expect FCF to turn positive in FY12, coming in at Rs1.76bn as opposed to current estimate of negative FCF of Rs319mn. In addition, Educomp may not need to raise funds at regular intervals to finance its Smart Class growth.

- **Scalable model, may have to invest in quality control**

Management plans to outsource hardware implementation and non-core services to third-party firms. This move makes sense especially since management intends to increase presence in Tier 2/Tier 3 cities. While so far Educomp has deployed its own resources for hardware installation in 1,900 schools, it believes it could address scalability better via outsourcing.

Key concerns

- **Smart Class revenue model would turn lumpy**

One of the key highlights of the Smart Class model is the strong revenue visibility it provides as schools pay Educomp over five years. Post securitization with revenues booked upfront (though at a discounted rate), growth would need to be driven by the increase in the number of schools added.

- **Nature of third-party firm as yet unclear**

In our view, providing a center employee at the school was one of the key differentiators for Educomp. As Educomp plans to outsource this activity to third-party firms, it will have to put in place adequate quality control measures to ensure satisfaction levels at schools. But we have no clarity yet on the nature of such third-party firms. Also margins on per school basis may decline if third-party firms are included in the deal. However, at the company level, Educomp may benefit from scale of operations as non core operations would be outsourced.

But PE could de-rate to factor higher earnings volatility

Key concerns : Earnings volatility, Quality control issues

As management would be shifting to one-time content licensing and securitizing revenue streams, we believe earnings volatility would increase as growth would depend on the number of schools signed per year, effectively lowering Smart Class revenue visibility.

1Q results: Another strong quarter

Educomp's 1Q results came in better than expected. Parent revenue increased 113% YoY, beating our estimate by 9%. EBITDA margin declined from 65% to 53%, primarily affected by the higher contribution of hardware revenue and investment in the sales team. Educomp expanded its sales force by 40 to 225 employees in 1Q. Recurring PAT increased 70% YoY to Rs285mn, 12% ahead of our estimate.

Table 5: 1Q results analysis

	Standalone nos					Consolidated		
Rs mn	1Q FY09	1Q FY10	YoY	BAS-MLe	Variance	1Q FY09	1Q FY10	YoY
Net Sales	694	1480	113%	1358	9%	860	1938	125%
EBITDA	449	777	73%	666	17%	488	857	76%
EBIT	314	511	63%	431	19%	344	564	64%
Other Income	27	124	360%	15	723%	31	153	395%
Forex Losses	-70	-31	-55%	0	nm	-77	-37	-52%
Interest	14	54	278%	60	-10%	23	102	346%
PBT	257	550	114%	386	42%	276	579	110%
PAT	168	363	116%	255	42%	165	342	107%
Recurring Profit	168	285	70%	255	12%	165	270	63%
			bps		bps			bps
EBITDA margin	64.7%	52.5%	-1,213	49.0%	349.5	57%	44%	-1247.7
EBIT margin	45.3%	34.5%	-1,071	31.7%	280.8	40%	29%	-1090.4
PAT margin	34.3%	24.5%	-974	18.8%	573.5	19%	18%	-99.1

Source: Company, Banc of America Securities- Merrill Lynch estimates

Strong growth across key segments

Educomp reported strong growth across key segments. While new initiatives, such as higher learning and the online supplemental and global division, remain in the investment phase, management said its subsidiaries would turn profitable this year and most would be self-sustaining large businesses in 2-3 years.

Table 6: Segment accounts

Revenues (Rs mn)	Standalone 1Q FY09	Standalone 1Q FY10	YoY %	Consol 1Q FY09	Consol 1Q FY10	YoY %
School Learning Solutions	552	1385	151%	552	1385	151%
K-12 Schools	12	31	150%	46	222	387%
Higher Learning	60	64	6%	60	68	13%
Online Supplemental & Global	69	0	-100%	202	263	30%
Total	694	1480		860	1938	
PBIT- Total	363	636		419	681	63%
PBIT %			bps			bps
School Learning Solutions	58%	45%	-1326	58%	44%	-1341
K-12 Schools	0%	-19%	-1933	19%	39%	1977
Higher Learning	67%	27%	-3978	52%	-10%	-6199
Online Supplemental & Global	0%	nm	nm	30%	-4%	-3404

Note: Educomp regrouped and renamed its key segments. School Learning Solutions now includes Smart Class & ICT. Higher Learning includes Professional Development, Raffles JV, Pearson JV. K-12 School includes Roots to wings pre-schools, Euro Kids pre-schools & K-12 schools, and Online Supplemental & Global includes Learning.com, Ask N learn, AuthorGEN, Learnhub.com, learninghour.com

Source: Company, Banc of America Securities- Merrill Lynch research

Given strong pipeline, see scope for guidance revision in Smart Class additions post 2Q results

Smart Class

The company implemented 173 schools vs our expectation of 188 schools in 1Q. Given the strong pipeline of over 800 schools for the year, we see upside potential to management's guidance of adding 1,060-1,160 schools in FY10.

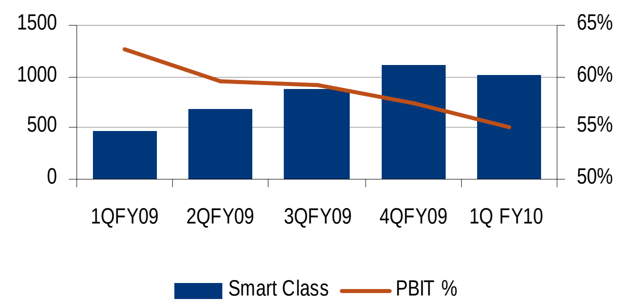
Management plans to outsource hardware implementation and service component to third-party firms and rope in banks to fund capex. Given the target segment of nearly 28,000+ private schools, it is critical that Educomp puts in place a scalable and efficient delivery model.

We raise our forecast for school additions in FY10 from 1,000 to 1,200 schools.

ICT

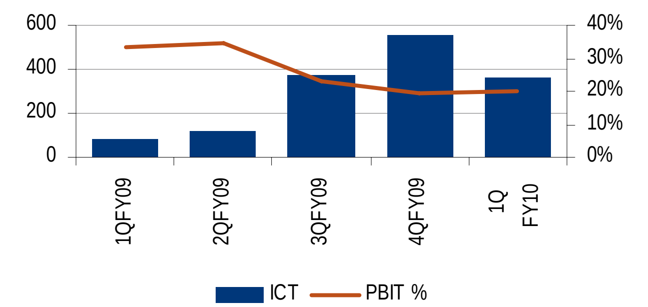
Revenue increased 351% YoY in 1Q, driven by implementation of the Gujarat order. However, EBIT margins declined from 34% in 1Q FY09 to 20% given a higher proportion of hardware revenue. ICT revenue was Rs80mn in 1Q and only comprised content revenue, a high-margin business. Management plans to bid only for high-margin businesses henceforth.

Chart 2: Smart class revenue, PBIT trends



Source: Company

Chart 3: ICT revenue, PBIT trends



Source: Company

K-12 project

Educomp reported revenues of Rs120mn from its K-12 initiative. It said that it currently has 35 operational schools including 12 under Euro Kids. Management reiterated its guidance of starting 43 schools by year June 2010 Overall management currently has visibility for 50 schools.

Table 7: K-12 revenue, profitability trends

Rs mn	Dec-08	Mar-09	Jun-09	FY09
Revenues	129	89	120	389
EBITDA	104	61	94	293
PAT	52	32	42	175
EBITDA %	81%	69%	78%	75%
PAT %	40%	36%	35%	45%
PAT %	40%	36%	35%	45%
No of Students	NA	13350	16000	13350
No of Operational Schools	11	20	35	20

Source: Company

Other initiatives

1. Vocational training

Educomp reported strong progress in other new initiatives. It recently sold a 50% stake in vocational training subsidiary Educomp Vocational Education to Pearson for US$17.5mn. Pearson will provide its leading certification tool, Edexcel, and will provide educational content, faculty and assessor development services. According to management, India has a working population of nearly 400mn, of which less than 10% have received any formal training.

Its ETEN CA program, which offers chartered accountancy coaching classes via satellite, is currently running in 40 centers across India and has nearly 4,000 student enrollments.

2. Higher learning

Its JV with Raffles providing design courses is progressing on track. Educomp recently inaugurated its Bangalore center and now has two centers in India. Management plans to set up four more colleges this year to take the total to six.

Could see upside potential to our FY11E/FY12E numbers from vocational training & Higher learning business.

Strong balance sheet to fund growth

In 1Q, Educomp raised US$125mn through a qualified institution placement program. As a result, its net debt situation has improved from Rs7bn to Rs1.9bn. Excluding FCCB (convertible bonds), its net debt is currently negative.

We believe Educomp is well positioned to exploit new opportunities in the Indian education space.

Table 8: Improving balance sheet

Rs mn	March-09	June-09	Comments
Debt	4,689	5334	
FCCB	4000	4000	Conversion price of Rs2950. Conversion likely given stock is trading at premium of 35%
Cash	1902	7440	

Source: Company, Banc of America Securities- Merrill Lynch estimates

Financials

Table 9: Profit and Loss statement

Rs mn (year-end March)	FY08	FY09	FY10E	FY11E	FY12 E
Sales	2861	6371	9829	13640	17565
Other income	177	227	851	328	295
Total Income	3038	6598	10680	13969	17860
Cost of goods sold	798	1110	1053	1443	1762
Personnel expenses	488	1155	1580	2019	2565
Administration and other expenses	301	1061	1786	2479	3355
Total Expenditure	1594	3327	4861	6351	8384
EBITDA	1267	3044	4967	7290	9181
Depreciation	331	814	979	1424	1886
EBIT	935	2229	3988	5866	7295
Finance charges	48	268	331	381	466
EBT	887	1961	3657	5484	6829
PBT	1065	2189	4508	5813	7123
Total Taxes	351	773	1488	1918	2351
Profit after tax and before prior period items	714	1416	3020	3894	4773
Recurring Profit after tax	706	1329	2434	3672	4465

Source: Company, Banc of America Securities- Merrill Lynch estimates

Table 10: Balance sheet

Rs mn (year-end March)	FY08	FY09	FY10E	FY11E	FY12 E
Shareholders' funds					
Share capital	172	173	199	200	201
Reserves and surplus	2629	3886	6260	9872	14276
Net worth	2884	4203	15246	18858	23264
Minority Interest	194	804	989	1211	1519
Loan funds					
Secured Loans	622	4689	5774	7174	8224
Term Loan from Bank	438	4315	5400	6800	7850
Deferred tax Liability	210	439	439	439	439
Total Sources of funds	7061	14342	22447	27683	33446
Goodwill	280	1225	1225	1225	1225
Fixed assets					
Gross Block	2890	6499	11864	18098	23490
Less: Accumulated Depreciation	548	1335	2314	3738	5624
Net Block	2342	5164	9550	14360	17866
Capital Work in Progress	372	2962	2962	2962	2962
Total	2714	8126	12512	17322	20828
Investments	36	729	729	729	729
Current assets, loans and advances					
Inventories	18	316	366	416	466
Sundry debtors	1157	2765	3415	4898	6772
Cash	2912	1902	5274	4103	4308
Loans and Advances	490	1138	1252	1421	1655
	4639	6153	10307	10839	13204
Less current liabilities and provisions	610	2251	2327	2434	2541
Net current assets	4029	3903	7981	8406	10664
Total Applications	7061	14342	22447	27683	33446

Source: Company, Banc of America Securities- Merrill Lynch estimates

Table 11: Cash flow statement

Rs mn (year-end March)	FY08	FY09	FY10E	FY11E	FY12E
Cash flows from operating activities					
Net profit before taxation and after prior period items as per P&L	1072	2108	4508	5812	7123
Depreciation	331	814	979	1424	1886
Interest exps	48	268	331	381	466
Operating profit before working capital changes	1419	3721	5818	7615	9472
Trade & other receivables	-657	-1603	-650	-1483	-1875
inventory	15	-298	-50	-50	-50
loans & advances	-426	-613	-114	-169	-234
Trade & other payables	338	1491	76	107	107
Cash Generated from operations	689	2698	4739	6020	7420
Taxes paid (Net of TDS)	-184	-329	-1488	-1918	-2351
Net cash from operating activities	505	2357	3251	4102	5069
Cash flows from investing activities					
Purchases of fixed assets	-2224	-6249	-5365	-6234	-5392
Net cash used in investing activities	-2102	-7215	-5365	-6234	-5392
cash flows from financing activities					
Net proceeds from fresh issue of capital through IPO	0	0	4800	3	4
Proceeds/ repayment of long term borrowings	334	4000	1085	1400	1050
interest on borrowings	-48	-268	-331	-381	-466
Dividend paid	-40	-58	-60	-60	-60
FCCB raised	3109	8	0	0	0
Net Cash from financing activities	3393	3846	5494	962	527
Opening cash and cash equivalents	1109	2905	1893	5274	4103
Closing cash and cash equivalents	2905	1893	5274	4103	4308

Source: Company, Banc of America Securities- Merrill Lynch

Table 12: Ratios

Year-end March	FY08	FY09	FY10E	FY11E	FY12E
Valuation ratios					
P/CEPS	68	33	24	16	13
P/BV (x)	25	17	5	4	4
EV/EBITDA (x)	51	21	13	9	7
EV/EBIT (x)	69	29	16	11	9
EV/ Revenues	23	10	7	5	4
Growth %					
Revenue	160	123	54	39	29
EBIT	128	138	79	47	24
Net Profit	146	88	83	51	22
Profitability %					
EBIT	33	35	41	43	42
Net Profit	25	21	25	27	25
Return %					
RONW	35.0	37.5	25.0	21.5	21.2
ROCE	19.4	20.8	21.7	23.4	23.9
Per Share Data (Rs.)					
EPS -diluted	36	66.9	122.5	184.7	224.6
CEPS	60	124	172	255	316
BVPS	167	243	767	944	1,156
DPS	3	3	3	3	3
DSO	105	112	115	111	121

Source: Company, Banc of America Securities- Merrill Lynch estimates

Price objective basis & risk

Educomp Solu (EUSOF)

Our PO of Rs4,600 is baed on a P/E of 25x and is based on a 2 yr PEG of 1x higher than the 0.9x earlier, to reflect Balance Sheet strengthening and the move by the company to improve FCF.
We see further upside to earnings and PO given management's intention to securitize revenue streams and improve cash flow in Smart Class. We believe premium valuations are fair considering the high 66% earnings growth expected over FY09-11E and derisked revenue model given focus on non-discretionary education spend and high exposure to the domestic economy.

Risks to our valuation are delays in execution of contracts in government schools, acquisition-related risks and managing multiple growth initiatives.

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India - Software & IT Services Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
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	MphasiS Ltd	MPSSF	MPHL IN	Pratish Krishnan
	Rolta India	RLTAF	RLTA IN	Pratish Krishnan
	Rolta India-GDR	XLROF	RTI LI	Pratish Krishnan
	WNS (Holdings) L	WNS	WNS US	Mitali Ghosh
NEUTRAL				
	Genpact Ltd	G	G US	Mitali Ghosh
	Patni	PATIF	PATNI IN	Mitali Ghosh
	Patni Computer	PTI	PTI US	Mitali Ghosh
	Tech Mahindra	TMHAF	TECHM IN	Pratish Krishnan
UNDERPERFORM				
	ExlService Holdi	EXLS	EXLS US	Mitali Ghosh
	Firstsource	FSSOF	FSOL IN	Mitali Ghosh
	HCL	XHCLF	HCLT IN	Mitali Ghosh
	Hexaware Tech	XFTCF	HEXW IN	Pratish Krishnan
	Infosys Tech	INFYF	INFO IN	Mitali Ghosh
	Infosys Tech - A	INFY	INFY US	Mitali Ghosh
	Infotech Enterprises Ltd	IFKFF	INFTC IN	Pratish Krishnan
	Mastek	MSKDF	MAST IN	Pratish Krishnan
	Tata Consultancy	TACSF	TCS IN	Mitali Ghosh
	Wipro	WIPRF	WPRO IN	Mitali Ghosh
	Wipro	WIT	WIT US	Mitali Ghosh

iQmethod SM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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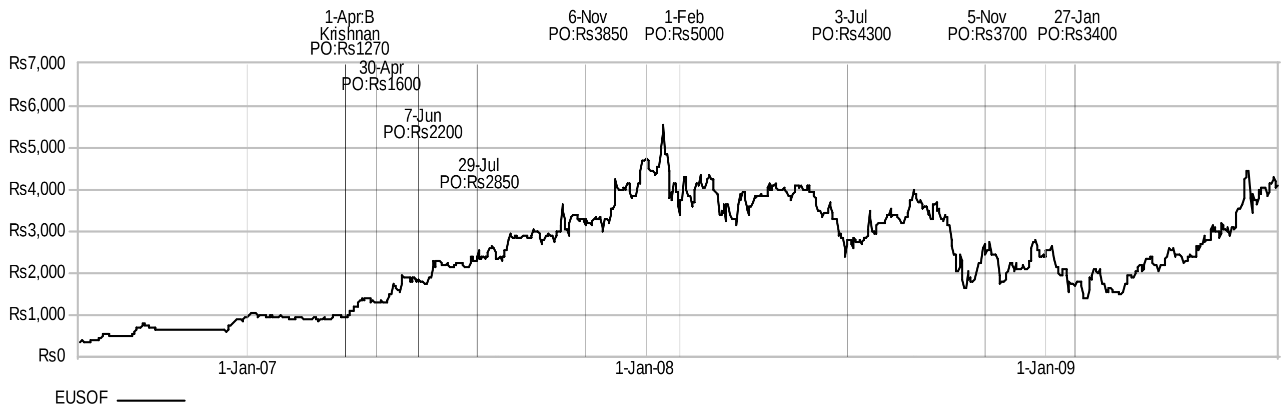
EUSOF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	13	76.47%	Buy	8	61.54%
Neutral	3	17.65%	Neutral	2	66.67%
Sell	1	5.88%	Sell	1	100.00%

Investment Rating Distribution: Global Group (as of 01 Jun 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1303	40.83%	Buy	602	51.10%
Neutral	807	25.29%	Neutral	362	51.49%
Sell	1081	33.88%	Sell	394	39.96%

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