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ASIA/PACIFIC

Morgan Stanley India Company Private Limited+

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Stock Rating
Equal-weight

Industry View
Attractive

Initiation

Educomp Solutions Ltd.

Recent Run-Up Limits Upside; Initiate with EW

Conclusion: We view the education sector in India as an attractive opportunity due to an increasing public/ private focus and the need for investments in the sector. Educomp has a dominant market share in key segments and is well entrenched in multiple segments of the education market in India. However, post the 34% run-up in the last 3 weeks, we see limited upside to the stock and initiate coverage with an EW rating and a price target of Rs4,025.

Education market in India: India has over a million schools with a potential base of ~300mn students growing at 1% p.a. Private schools account for 10-15% of total schools and are growing at 7-10% p.a.

Key investor debates: 1) Regulatory risks in K-12 schools: CBSE by-laws require accredited schools to be not-for-profit. Providing services to schools is not regulated but EDSL walks a fine line. This business accounts for <10% of revenues but over 50%+ of capex. In the worst case, EDSL's investments are not at risk.
2) P/E multiples have corroded but valuations are expensive: Rising capex, regulatory concerns, and logistics issues have diluted multiples. Scalability, lower capex, and favorable policy could lead to re-rating.
3) Is large government spending on education a key driver? It helps but is not the key driver. Private schools have emerged as the key to growth; we expect the govt's share of revenues to decline to 14% in F10e.

Valuations: The stock currently trades at 31x FY10e EPS for 67% EPS growth in FY10e. We expect consensus estimates to be revised upwards over the coming quarters. Our price target of Rs4,025 is based on a probability weighted average of our risk-reward analysis. We give a 30% probability to our bull case of Rs6,000; 50% to our base case of Rs3,850, and 20% to our bear case of Rs1,500. **Risks** include: 1) Regulatory, 2) difficulty managing logistics of hardware, 3) losses in some subsidiaries.

Key Ratios and Statistics

Reuters: EDSO.BO Bloomberg: EDSL IN
India Education Services

Price target	Rs4,025.00
Upside to price target (%)	3
Shr price, close (Jul 6, 2009)	Rs3,912.50
52-Week Range	Rs4,590.00-1,331.00
Sh out, dil, curr (mn)	18
Mkt cap, curr (mn)	Rs69,296
EV, curr (mn)	Rs76,364
Avg daily trading value (mn)	US$66

Fiscal Year ending	03/09	03/10e	03/11e	03/12e
ModelWare EPS (Rs)	75.76	126.56	185.44	245.20
Consensus EPS (Rs)§	70.61	116.68	173.52	-
Revenue, net (Rs mn)	6,371	10,678	16,213	23,077
EBITDA (Rs mn)	3,044	5,179	7,766	11,008
ModelWare net inc (Rs mn)	1,341	2,304	3,469	4,954
P/E	27.6	30.9	21.1	16.0
P/BV	8.8	11.1	7.5	5.3
RNOA (%)	37.2	22.1	25.6	26.2
ROE (%)	46.5	54.8	54.1	50.8
Div yld (%)	0.1	0.1	0.2	0.2
FCF yld ratio (%)	(10.5)	(0.7)	(2.2)	(0.4)
Leverage (EOP) (%)	149.0	113.0	96.3	70.7

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).
§ = Consensus data is provided by FactSet Estimates.
e = Morgan Stanley Research estimates

Financial Summary

Rs million; Years Ending March

Consolidated Profit and Loss Statement (Rs mn)

Year to March	FY08	FY09	FY10e	FY11e	FY12e
Net sales	**2,861**	**6,371**	**10,678**	**16,213**	**23,077**
Total consumption expenditure	798	1,110	2,082	3,243	4,731
Personnel Expenses	488	1,155	1,815	2,724	3,854
SG&A expenses	302	1,061	1,602	2,481	3,485
Prov/Misc exp written off	8	1	-	-	-
EBITDA	**1,266**	**3,044**	**5,179**	**7,766**	**11,008**
EBITDA Margin (%)	*44.2*	*47.8*	*48.5*	*47.9*	*47.7*
Depreciation/ amortzn	331	814	1,388	2,075	2,908
Operating Profit/ EBIT	**934**	**2,229**	**3,791**	**5,691**	**8,100**
Margin (%)	*32.7*	*35.0*	*35.5*	*35.1*	*35.1*
Interest expense	48	268	552	680	724
Other Income	178	227	534	649	692
Profit before Tax	1,064	2,189	3,773	5,659	8,068
Income Tax	351	773	1,332	1,998	2,849
Effective Tax Rate (%)	*33.0*	*35.3*	*35.3*	*35.3*	*35.3*
Min Int/Profit of Associates	(5)	(74)	(136)	(192)	(265)
Recurring Net Profit	**707**	**1,341**	**2,304**	**3,469**	**4,954**
Extra ordinaries (XO)	(2)	(12)	-	-	-
Net Profit incl XO	**706**	**1,329**	**2,304**	**3,469**	**4,954**
Net Margin (%)	*24.7*	*21.1*	*21.6*	*21.4*	*21.5*
Growth (%)	*146*	*88*	*73*	*51*	*43*
EPS (Diluted) before XO	**38.2**	**75.8**	**126.6**	**185.4**	**245.2**
DPS	**2.5**	**3.0**	**5.0**	**6.0**	**7.0**
Payout ratio (%)	*6.5*	*4.0*	*4.0*	*3.2*	*2.9*

Consolidated Cash Flow Statement (Rs mn)

Year to March	FY08	FY09	FY10e	FY11e	FY12e
Net profit before taxes	1,072	2,108	3,773	5,659	8,068
Depreciation	331	814	1,388	2,075	2,908
Taxes paid	(184)	(329)	(1,332)	(1,998)	(2,849)
Others	16	786	(118)	(160)	(234)
WC changes	(730)	(1,023)	(1,869)	(1,829)	(1,908)
Operating cash flow	**505**	**2,357**	**1,841**	**3,747**	**5,985**
Capex	(2,219)	(6,227)	(2,891)	(5,952)	(6,998)
Acquisition/Investment	(101)	(736)	-	-	-
(Purchase)/sale of inv	85	(367)	-	-	-
Int income	134	116	534	649	692
Investing cash flow	**(2,102)**	**(7,215)**	**(2,357)**	**(5,303)**	**(6,306)**
FCF	***(1,714)***	***(3,870)***	***(1,050)***	***(2,205)***	***(1,013)***
Issue of capital/Min Interest	-	-	141	197	276
Proceeds from FCCB net	3,041	(18)	-	-	-
Change in debt	440	4,190	4,295	839	902
Payment of dividend	(40)	(58)	(53)	(104)	(128)
Interest on borrowings/Fx	(38)	(267)	(552)	(680)	(724)
Financing cash flow	**3,393**	**3,846**	**3,831**	**252**	**326**
Opening cash & cash eq	1,106	2,912	1,902	5,218	3,912
Closing cash & cash eq	2,912	1,902	5,218	3,912	3,917

Consolidated Balance Sheet (Rs mn)

Year to March	FY08	FY09	FY10e	FY11e	FY12e
Share Capital	172	173	178	183	194
Share Premium	1,483	1,519	1,519	1,519	1,519
ESOPs outstanding	83	145	145	145	145
Reserves & Surplus	1,146	2,367	4,567	7,908	12,700
Shareholders' Funds	2,884	4,203	6,408	9,754	14,557
Minority Interest	194	804	940	1,132	1,398
Long term debt	3,589	8,521	12,817	13,655	14,557
Deferred tax liabilities	210	439	439	439	439
Current liabilities	794	2,625	2,933	4,258	5,986
TOTAL LIABILITIES	**7,671**	**16,593**	**23,537**	**29,239**	**36,937**
Goodwill/Misc Exp	281	1,237	1,225	1,225	1,225
Net Fixed Assets	2,714	8,126	9,642	13,518	17,609
Investments	36	729	729	729	729
Cash	2,912	1,902	5,217	3,912	3,917
Debtors	1,157	2,765	4,154	6,130	8,409
Inventory	18	316	146	222	316
Loans & advances	490	1,138	1,801	2,572	3,431
Other current assets	62	378	623	930	1,301
TOTAL ASSETS	**7,671**	**16,593**	**23,537**	**29,239**	**36,937**

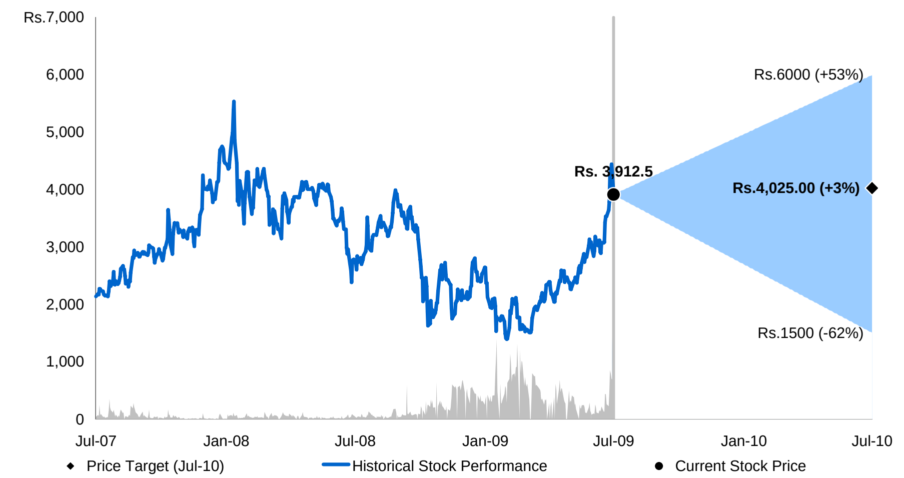
Key Ratios

Key Ratios	FY08	FY09	FY10e	FY11e	FY12e
Net sales growth (%)	159.9	122.7	67.6	51.8	42.3
EBITDA growth (%)	150.2	140.5	70.1	50.0	41.7
EBIT growth (%)	128.0	138.6	70.0	50.1	42.3
PAT growth (%)	146.0	88.3	73.4	50.5	42.8
ROAE (%)	35.0	37.5	43.4	42.9	40.8
Sales/Total Assets (x)	0.4	0.4	0.5	0.6	0.6
Debtor turnover (days)	148	158	142	138	133
Net debt/Equity (x)	0.3	1.6	1.2	1.0	0.7
P/E (x)	102.6	52.1	30.9	21.1	16.0
P/BV (x)	25.1	16.5	11.1	7.5	5.4
P/sales (x)	23.6	10.6	6.3	4.2	2.9
EV/EBITDA (x)	57.9	24.9	15.2	10.7	8.1

Source: Company data, Morgan Stanley Research; E = Morgan Stanley Research estimates

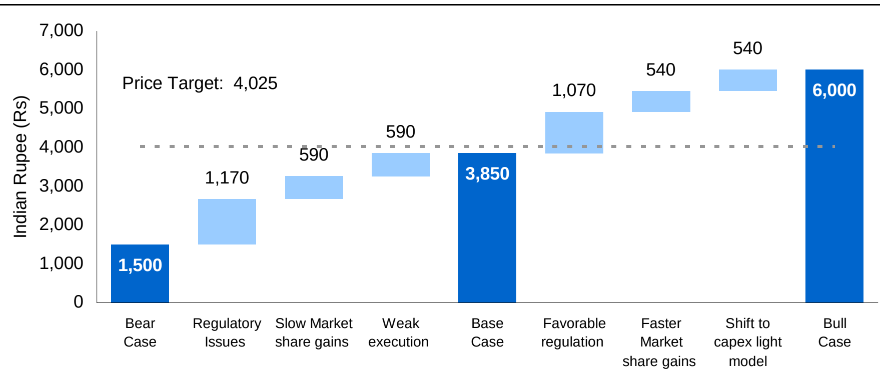
Risk-Reward Snapshot: Educomp Solutions Ltd. (EDSO.BO, Rs3,912, EW, PT Rs4,025)

Risk-Reward View: Recent Run-Up Limits Upside



Price Target Rs4,025		Derived from probability weighted average of the scenarios below
Bull Case Rs6,000	Implies 38x Sep10e EPS	**Gains faster acceptance and market share:** Public-private partnerships in education, shift to capex-light business model, and market share gains result in faster-than-expected revenue growth. F2010-12e revenue and EBIT CAGR of 28% and 27%, respectively. (Prob 0.3)
Base Case Rs3,850	Implies 25x Sep10e EPS	**Outperforms FY10e revenue and profit guidance:** Educomp grows revenues and profits ahead of its guidance, adding ~5,500 schools in ICT and over 1,200 schools in private segment. F2010-12e rev and EBIT CAGR of 21% and 20%, resp. (Prob 0.5)
Bear Case Rs1,500	Implies 10x Sep10e EPS	**Execution risks:** Logistical bottlenecks, regulatory risks in K-12 schools, rising capex, and weaker execution drag revenue/EPS growth. F2010-12e revenue and EBIT CAGR of 15% and 13%, resp. (Prob 0.2)

Bear to Bull: Regulations and Execution Are Key



Source: Morgan Stanley Research, FactSet

Investment Thesis:

- We believe the company is well positioned for strong growth, but the stock has priced in the following positives for now.
- First mover, established track record.
- Large government spending on education.
- Private school business growing faster as value proposition of Educomp's content is widely recognized by parents.
- Regulatory risks in K-12 school business appear limited and reforms in education sector could be favorable for Educomp.
- Opportunities in other areas like vocational training, online learning, etc.

Key Value Drivers

- Market share gains
- Favorable regulatory environment
- Strong execution
- Shift to capex-light business model

Potential Catalysts

- Strong execution and faster-than-expected scaling of SmartClass in schools.
- SmartClass content seen as "must have" vs. "good to have" by schools, leading to faster sales cycle.
- Education reforms supporting public-private partnerships.
- Weak results in 1H as performance is 2H loaded.

Risks

- Unfavorable government regulation in the education sector
- Large contract wins from government or private schools.
- Capital-intensive business.
- Limited scalability due to logistical bottlenecks as it grows in size.

Contents

Investment Case: Company Well Positioned for Growth; Stock Fully Valued for Now

We are initiating coverage of Educomp with an Equal-weight rating and a price target of Rs4,025, while initiating coverage of the India Education Services industry with an Attractive view. As the largest listed education service provider in India, Educomp is well positioned, in our view, because of the growing need for investments and public-private partnerships in the sector, an increasing government focus on improving the quality of education, and Educomp's first-mover advantage in its target segments. However, given the recent run-up in the stock, we would wait for better entry opportunities over the coming quarters.

Though education appears to be a recession-proof business, performance of education stocks globally has been mixed. Over the last one year and YTD, Career Education, Lincoln, and K12 in the US have outperformed the market, whereas most other stocks globally have underperformed their respective benchmarks. In India, we believe that Educomp is in an enviable position due to the growing opportunity, favorable demographics, and strong management execution.

Educomp is currently trading at a P/E of 31x FY10e EPS. Its P/E multiple has come down from 90x to 20-30x over the last year, but the stock still trades at a premium to its peers in Brazil and Asia-Pacific countries like Singapore and China. Since the education sector is an emerging investment opportunity in India with limited listed avenues to play the theme, we would expect Educomp to continue trading at a premium to regional peers. However, after the recent run-up (34% in the last three weeks), we would be cautious on the stock in the near term.

SmartClass provides visibility: Educomp's core service offerings (for multimedia classrooms) are gaining acceptance. Management believes that once 25-30% of private schools in a city are SmartClass enabled, the remaining schools could rush to catch up on "differentiation," resulting in a manifold jump in total schools covered, leading to accelerated demand. Educomp currently covers 1,700 of 80,000 private schools in India.

New initiatives present opportunities: Having started by selling digital content to private and government schools, the company has now diversified into services for brick-and-mortar schools and preschools, vocational training, and online initiatives in India and abroad. As the business model continues to evolve, the addition of new segments such as vocational training, preschools, a JV with Raffles Education for setting up diploma-granting colleges (not-regulated), and online initiatives present growth opportunities, in our view.

Strong revenue and earnings growth: Over the last three years Educomp has grown revenues at a CAGR of 125% to US$127mn in F2009 and net profits at a CAGR of 89% to US$ 26.5mn. We expect Educomp to boost its revenues and profits by 68% and 67%, respectively, in F2010e, for an earnings CAGR of 39% over F2010-12e. The key driver for strong growth has been its SmartClass business (50% of revenues; sets up digital classrooms and provides multimedia content to private schools in India), with a revenue CAGR of 150% over F2006-09.

Exhibit 1

Relative Performance of Education Stocks Globally:
Has been mixed, with very few stocks consistently outperforming over last year and on a YTD basis

RELATIVE PERFORMANCE	1d	1w	1m	3m	6m	1yr	YTD
US							
AMERICAN PUBLIC	-4	-5	9	-27	1	18	-2
CAREER EDUCATION	-3	-1	16	-1	33	87	30
DEVRY INC	-1	-2	6	-5	-9	14	-18
H&R BLOCK INC	1	14	11	-7	-21	4	-24
ITT EDUCATIONAL	-3	-5	4	-21	1	39	-2
JACKSON HEWITT	-6	0	-6	11	-62	-27	-64
K12 INC	-4	-12	10	11	19	18	1
LINCOLN	-3	-2	7	11	72	94	49
Latin America							
ANHANGUERA	-4	-2	-2	38	14	-21	6
ESTACIO	1	5	-8	35	6	NA	10
KROTON	1	13	1	50	0	-35	-11
SEB - SISTEMA	1	3	6	68	37	-20	29
India							
EDUCOMP	**-7**	**12**	**36**	**29**	**16**	**39**	**16**
EVERONN D	-9	-6	5	119	17	-22	19
NIIT LIMITED	-11	3	5	130	95	-44	76
Singapore							
RAFFLES EDUCATION	0	5	-13	15	-26	-28	-30
China							
NEW ORIENTAL	-3	-10	-6	-8	-32	-11	-58
South Korea							
MEGASTUDY CO LTD	-2	-7	3	-10	8	-6	-6

Source: Bloomberg, Morgan Stanley Research, Prices as of 6th July 2009 close; US stock performance relative to S&P 500 index, India relative to BSE Sensex, Latin America relative to Brazil Bovespa, Singapore relative to Straits Times Index, China relative to Shanghai Composite Index, South Korea relative to Kospi Index
Past performance is no guarantee of future results. Results shown do not include transaction costs.

The ICT business (sets up computer labs and provides content for government schools in India) contributes ~18% of total revenues, but growth (22% YoY) has slowed in F2009, and margins are lower than for the SmartClass segment. We expect ICT's revenue share to drop further to ~8% by F2012e, while the SmartClass contribution should increase to ~69.8% from~50% in F2009. Subsidiaries have helped diversify into newer areas. They continue to scale up and now contribute ~21% of revenues versus 3% two years back (FY07).

SmartClass business is likely to turn free cash flow positive in 2009. Management is focused on lowering capex requirements and is also looking to tie up with real-estate companies for setting up schools under revenue-sharing agreements. This would also ease the capex requirements for its K-12 initiatives.

Risks

Business model risks: We believe, with the existing model, 100%+ growth rates are unlikely to be maintained, as Educomp will find it difficult to increase pace of SmartClass roll-outs to a higher number of schools every year due to 1) the capex required, and 2) the complexity of installation logistics in the SmartClass/ICT segment.

Political/regulatory risk: A sudden change in the curriculum could lead Educomp's content library to become obsolete. K-12 schools in India should be run as a not-for-profit society/trust to get an affiliation with CBSE or ICSE councils. Educomp should service these schools on an arms- length basis, in our view, charging reasonable fee for its services.

Investment Positives

1) Falling hardware costs help lower relative capex and associated costs.

2) Driven by domestic demand: Educomp's growth is driven by domestic demand and is insulated from the global economic environment. Educomp got ~83% of its FY09 revenues from India.

3) Educomp is one of the leading players in the space of SmartClass and ICT, with very few direct large organized players as competitors.

Exhibit 2

Educomp: Competition Matrix

Company	Smart-Class	ICT	Teacher/ Student training	Pre-Schools	K-12 Schools
Educomp	**Yes**	**Yes**	**Yes**	**Yes**	**Yes**
Everonn	Yes	Yes	No	No	No
NIIT Ltd	Yes	Yes	Yes	No	No

Source: Company data, Morgan Stanley Research

4) Annuity revenues: SmartClass and ICT businesses enter into long-term contracts and hence provide locked-in annuity-like revenues.

5) Newer business segments present opportunity for Educomp: Educomp has been venturing into newer segments through joint ventures like vocational training and colleges, which increases the available market size and revenue potential for the company.

6) Setting up K-12 school business, in our view, is not a key value driver for the company, as we estimate it can at max get an average of ~US$1mn in revenues per school. (Private schools generate annual revenues in the range of US$0.5-2mn). **However, the real benefit comes from increasing acceptance of its SmartClass product** and forcing competing schools to catch up, leading to reduced sales cycle time for its flagship service offering.

7) Educomp will likely create 150k jobs in small towns and weaker sections of the economy by 2018. As an emerging sector creating opportunities for growth in smaller towns, regulations could be favorable for the sector.

Investment Concerns

1) Revenue growth is slowing in ICT despite the large market.

2) Educomp has a capital-intensive business model due to high debtor days and upfront capex investment on BOOT projects.

3) Regulatory concerns in education are a global issue: In India there is no regulation of for-profit schools/colleges. However, board accreditation requires schools to be run by trust or non-profit organizations, with surplus funds allowed to be invested for educational purposes. There is also no regulation of educational services like training, school management, tutoring, providing school supplies, brand fees, etc. We believe that as long as Educomp adopts an arms-length approach to the K-12 schools it sets up, it could continue providing services to schools.

4) Challenges in managing growth, as logistics complexity increases with scale: Educomp could easily have one of the largest logistics and transportation networks in the country over the next 10 years, in our view. We estimate it will need 800 new buses per year by 2018. We believe Educomp has been forced to moderate its growth expectations with the emergence of these logistical issues, and is preparing the necessary backbone.

Peripherals: While adding 1,200 schools to SmartClass and 5,500 under ICT in a year, Educomp has to track shipping of ~150-200,000 pieces of equipment/hardware peripherals in a year. This is why Educomp is opening up regional warehouses.

Transportation: Its plan of having 150 K-12 schools in three years would lead to total demand for 300-400 school buses. So if Educomp were to have 1,000 schools in 8-10 years, we estimate it would need a fleet of ~4,000 school buses, compared with a total fleet size of 16,000 buses for the entire state road transport of Maharashtra.

5) Internal rivalry in the education sector is likely to increase, and barriers to entry are relatively low for setting up schools and preschools.

Key Investment Debates

Debate 1. Regulatory risks in K-12 schools

Debate 2. P/E multiples have corroded but valuations are expensive.

Debate 3. Is large government spending on education a key driver?

Debate 1. Regulatory risks in K-12 schools: Why is Educomp setting up schools that lead to higher capex and how do regulations affect it?

Investor concern: Regulatory risks could hurt Educomp as schools are mandated to be run as not-for-profit in India.

Our view: We disagree. We believe Educomp provides services to the schools and hence operates in a non-regulated segment.

Where we could be wrong: If Educomp fails to maintain an arms-length relationship with the schools, then it could be susceptible to regulatory issues, in our view.

Accreditation by boards is regulated: CBSE (Central Board for Secondary Education) by-laws require K-12 schools to be run by non-proprietary societies as not-for profit institutions. Schools should not be run as a business, although any excess earnings from the school can be ploughed back into the advancement of facilities and related areas. If the above conditions are not met, board accreditation may be withdrawn. All Educomp schools are run by not-for-profit trusts/societies and have been board accredited.

But providing services to schools is not a regulated area: Schools are allowed to source school supplies, management/ maintenance services, transportation, and other related services from external vendors on a commercial basis. Educomp provides these services to its schools. We believe that as long as all the contracts between the company and school management are done on an arms-length basis with reasonable rates, regulations should not be an overriding concern.

Revenue potential from K-12 schools is relatively small: Setting up a K-12 schools business requires capital expenditure of ~US$1-2mn per school, involves higher regulatory risks, and is unlikely to be a key component of revenues over next three years. We estimate that on average a school generates revenues of US$1mn with 50-55% EBIT margins, so 150 schools over three years would contribute only US$50-75mn to Educomp at max. Revenue from schools thus does not seem to be the key driver behind the strategy.

But it could help increase acceptance with other schools: Although the captive revenue potential from these K-12 schools is unlikely to be significant for Educomp, it could be a growth trigger for its SmartClass business. Having captive schools with SmartClass would help EDSL establish a presence in each city, with a demo school for potential clients. Once they have a working model in front of them in the same city, other schools may be more eager to sign up for SmartClass. Once SmartClass achieves critical mass, we believe Educomp could shift its focus to partnerships in schools, leading to lower capex and higher scalability. Tie-ups with real-estate developers to brand and manage schools in their townships should also help lower capex requirements for Educomp. Any sectoral reforms inviting public-private partnerships should further help Educomp's business model, in our view.

Exhibit 3

151 K-12 Schools to Contribute ~6.5% of Revenue and ~9.5% of EBITDA by F2012e

K-12 Schools Business	FY09	FY10e	FY11e	FY12e
Revenues (Rs m)	**389**	**613**	**975**	**1,494**
% YoY	*NM*	*57.5%*	*59.1%*	*53.3%*
% of total	*6.1*	*5.7*	*6.0*	*6.5*
EBITDA (Rs m)	**293**	**429**	**663**	**1,046**
Margins (%)	*75.3*	*70.0*	*68.0*	*70.0*
% of total	*9.6*	*8.3*	*8.5*	*9.5*
PAT (Rs m)	**175**	**269**	**419**	**627**
Margins (%)	*45.0*	*44.0*	*43.0*	*42.0*
Total Schools	20	43	98	151
Total Students	15000	31,300	70,500	125,100
Students/School	750	728	719	828
Revenue/Student (Rs)	25,933	19,572	13,825	11,940
Revenue/School (Rs m)	19.5	14.2	9.9	9.9

Source: Company data, Morgan Stanley Research; e = Morgan Stanley Research estimates

Exhibit 4

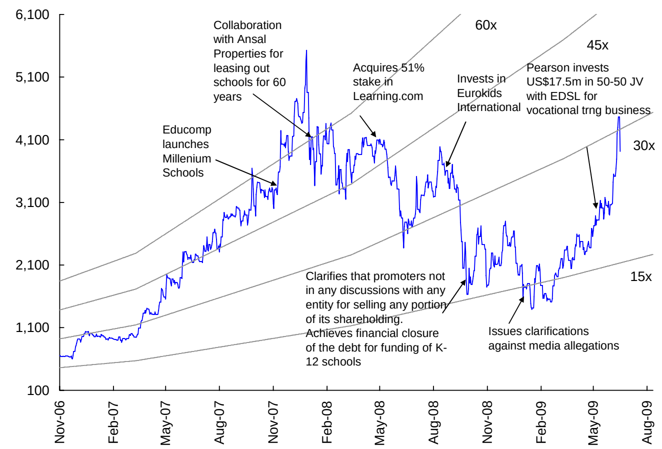
Higher Incremental Capex Attributed to Subsidiaries

Year to 31st March	FY06	FY07	FY08	FY09
Smart Class	21	481	1,332	2,182
% of total	*13.1*	*71.2*	*60.0*	*35.0*
ICT	37	41	4	56
% of total	22.6	6.1	0.2	0.9
Retail and Consulting	-	-	-	26
% of total	0.0	0.0	0.0	0.4
Professional Dev	-	-	-	2
% of total	0.0	0.0	0.0	0.0
Subsidiaries	2	15	399	3,620
% of total	1.1	2.2	18.0	58.1
Unallocated Capex	102	138	484	342
% of total	63.2	20.5	21.8	5.5
Total	**162**	**675**	**2,219**	**6,227**
% YoY	*83.7*	*316.5*	*228.6*	*180.6*

Source: Company data, Morgan Stanley Research; Professional Development and Retail & Consulting divisions did not have any capex till FY08

Exhibit 5

One-Year Forward P/E Multiples Have Corroded Over the Last One Year



Source: Bloomberg, Company Data, Morgan Stanley Research

Debate 2. P/E multiple has corroded but valuations are expensive.

Market view: Consensus appears to be skeptical of current P/E multiples, as consensus price targets appear to be significantly below the current market price for the stock.

Our view: Our price target is one of the highest on the Street. We believe EDSL's multiples were beaten down over the last few months but have been rerated due to sustainable earnings growth. Multiples are unlikely to improve materially unless the company demonstrates scalability.

Where we could be wrong: If Educomp's revenue and earnings trajectory decelerates materially due to issues of logistics, scalability, regulation, or competition hurting margins, then its multiples could be derated again.

P/E corrosion, in our view, has been led by rising capex, the increasing contribution of hardware revenues, regulatory concerns, and the increasing complexity of managing growth/logistics for the business, leading to lower scalability. We believe multiples could stay range bound unless 1) management lowers the capex requirements of the business, and 2) scalability of its logistics can be demonstrated. We believe a P/E rerating cannot be ruled out, as the business model could shift to capex-light with the emergence/addition of new business segments such as vocational training and online initiatives.

Over the last two years, Educomp's one-year forward P/E multiple has trended down from a peak of ~90x to 25-30x now. Over the near-medium term, we believe the company is likely to show strong revenue growth, and should remain an attractive investment opportunity.

Lack of scalability limits multiple upside as managing logistics could emerge as a bottleneck over time: Educomp's ability to scale up is key to managing its strong growth. As Educomp continues to sign up more schools (in ICT and SmartClass), managing the logistics is likely to become increasingly complex, in our view. Educomp expects to sign up 5,000 new government schools and ~1,200 private schools in FY10e. Based on this, we believe it may require an additional ~45,000-54,000 PCs during the year, equivalent to ~1.1% of total PCs shipped in India in CY08. To manage the challenging logistics, Educomp has already set up warehouses in various parts of the country.

Similarly, its chain of schools is likely to total ~150 in three years. If it continues to grow at the current rate, then Educomp could end up owning a fleet of 3,500-4,000 buses in 10 years, which could be larger than the fleet size of 70% of the states' road transport corporations in the country. As the fleet would be spread across hundreds of schools across India, it could be manageable due to the decentralized model. Moreover, the multi-purpose use of buses may make them profitable for the company as well.

Exhibit 6

Educomp Might Need 50,000 PCs in FY10e for 5,000 New Schools in ICT

ICT	
Total cumulative schools	12,012
Total cumulative students	6,500,000
Average students/school	541
New schools in FY10e	5,000
New students to be covered	2,705,628
Students/PC Ratio*	50-60
New PCs required	**45,000-54,000**

Source: Company data, Morgan Stanley Research; *Morgan Stanley Research estimates

Exhibit 7

Growing Number of Schools Adds to the Logistics Complexity over F2006-09

Educomp	FY06	FY07	FY08	FY09
Cumulative ICT Schools	613	2,808	6,004	12,012
Cumulative Smart Class Schools	91	331	933	1,737
Total	704	3,139	6,937	13,749
Total Computers & equip sold (nos)	10,463	86,318	157,944	263,866
Avg peripheral/school	*15*	*27*	*23*	*19*

Source: Company data, Morgan Stanley Research

Declining PE multiples due to contribution from Hardware sales, one of the key components of ICT and SmartClass revenues has low margins and higher volatility: Educomp has realized ~30-34% of its revenues on account of sales of equipment (computer and accessories) over the last three years (F2006-09). It supplies computers, printers, peripherals and other accessories as part of its contracts with schools under its SmartClass and ICT business segments. Apart from this the company gets revenues from trading of products like toys, compact discs (CDs) etc.

Sale of hardware forms a key component of any contract with the schools especially in both ICT segment (government schools) and SmartClass segment (private schools). As per the ICT scheme of government which helps government/ government-aided secondary/higher secondary schools in setting up computer labs, the hardware costs represent ~60% of the total cost of the contract over a period of five years. Revenues from trading of computers and other accessories is a lower margin activity and do not contribute significantly to the profitability.

Exhibit 8

Indicative Guideline for ICT Implementation Costs

Sl. No	Items	Cost (Rs)	% of total
1	10 PCs/Printer/CRT	405,000	60%
2	Operating System & Application Software	20,000	3%
3	Educational Software	45,000	7%
4	Furniture	16,000	2%
5	Computer Stationery	50,000	7%
6	Teachers' Training	60,000	9%
7	Internet	30,000	4%
8	Maintenance	20,000	3%
9	Monitoring Cost	24,000	4%
	Total	**670,000**	**100%**
10	Recurring Costs	134,000	

Source: Ministry of HRD, Morgan Stanley Research; 10 PCs/Printer/CRT per school. or one server with 10 workstations with accessories;

Exhibit 9

Educomp Gets ~30% of Revenues from Installing Hardware

Rs m	2007	2008
Total Revenues	**1,101**	**2,861**
Revenues from content and other services	726	1,881
Sale of Products/Equipments	**375**	**980**
% of total revenues	*34.0*	*34.3*
Breakup of Products/Equipment Sales		
SmartClass -Hardware Sales	169	306
% of total hardware/equipment sales	45.2	31.3
ICT-Hardware Sales	135	565
% of total hardware/equipment sales	36.0	57.6
Trading revenues (toys, CDs, books etc)	72	74
% of total hardware/equipment sales	19.3	7.6
Others	-2	35
% of total hardware/equipment sales	-0.5	3.5

Source: Company data, Morgan Stanley Research

Ability to manage growth and the environment (internal as well as external): We sense skepticism amongst investors on Educomp stock. Some of this uncertainty has been fed by various media reports that cast doubt on the company's financials, and subsequent detailed point-by-point clarifications by management. It has also taken substantial management bandwidth in trying to address the issues.

Our view: We believe the small size of the company and its relatively rapid growth will bring greater attention to the ability to manage growth and handle the internal as well as the external environment. However, we believe a strong financial performance over the coming months is likely to vindicate management's strategy, especially in view of the company's niche positioning, scale, first-mover advantage, and strong near-term growth prospects. In the interim, we would not rule out volatility in the stock.

Debate3. Is large government spending on education a key driver?

Market view: India spends 3-4% of GDP on education, and as the largest player, Educomp could benefit from huge government spending.

Our view: We disagree. We believe growth rates in its government school business (ICT) are likely to remain below the company average over the coming years. Margins could improve in FY10e after a 7% decline in EBIT margins in the segment in FY09.

Where we could be wrong: Better-than-expected execution could surprise positively

India government spends ~US$30bn annually on education: Educomp covers a total of 14,000 schools (12,000 in ICT and 1,700 in SmartClass) of ~1mn schools in India. Large government spending on education and low market penetration is beneficial but not the key driver of growth for the company, in our view.

Exhibit 10

Government Spent ~US$28bn on Education in 2006-07; Educomp's Revenue Share Was Just 0.1%

Year	US$bn	% YoY
2000-01	16.5	10.3%
2001-02	16.0	-3.2%
2002-03	17.1	7.1%
2003-04	17.8	4.2%
2004-05	19.3	8.5%
2005-06	22.6	17.1%
2006-07	27.6	21.9%

Source: Ministry of HRD, Morgan Stanley Research; US$ nos based on conversion rate of Rs50/US$

Private schools have driven growth for EDSL: Educomp's strong revenue growth has been driven by its ability to scale up its SmartClass business within the private schools space. The contribution from the government school business (ICT segment has declined from 40% of revenues in FY05 to 18% of revenues in FY09 (21.9% YoY growth in FY09).

Revenues for SmartClass have grown from 9% of revenues in FY05 to 50% of revenues in FY09 (150% YoY growth in FY09).

Strong revenue growth increased capex: SmartClass is a capital intensive business for Educomp. Although revenues have grown at a CAGR of ~150% over F2006-09, capital expenditure has grown even faster at ~368%, contributing to the negative free cash flow for the company.

Exhibit 11

Strong Revenue Growth to Be Driven by SmartClass, while ICT's Share Expected to Fall Further

Year to March (Rs m, %)	FY08	FY09	FY10e	FY11e	FY12e
Smart Class					
Revenues	1,268	3,157	6,464	10,816	16,100
% YoY	*172.2*	*149.0*	*104.8*	*67.3*	*48.9*
% of total revenues	*44.3*	*49.6*	*60.5*	*66.7*	*69.8*
ICT					
Revenues	933	1,137	1,505	1,620	1,842
% YoY	*209.3*	*21.9*	*32.4*	*7.6*	*13.7*
% of total revenues	*32.6*	*17.9*	*14.1*	*10.0*	*8.0*

Source: Company data, Morgan Stanley Research

In this segment, Educomp recovers its investments in the first year, and the annuity revenues over the remaining four years are very profitable for the company.

If fewer schools were added in a year than the cumulative number of schools so far, SmartClass would turn FCF positive: Revenue growth in SmartClass is driven by a) deeper penetration in existing schools (increasing number of classrooms using SmartClass), b) new school additions, and c) higher pricing – higher fees per student per month for the usage of the product. In the first two cases, revenue growth requires further capex by Educomp. Thus growth rates depend on the number of schools added.

For 100% revenue growth to continue, Educomp would have to add more schools every year than it already has. But the greater the number of schools added, the higher the growth, the higher the capex, and the lower the free cash flow. Similarly, the fewer the number of schools added, the slower the growth, the lower the capex, and the higher the free cash flow.

Market size and government education spending are extremely large compared with EDSL's revenue base and hence do not matter much, in our view. However, EDSL's ability to manage the logistics of its capex-intensive business does matter, in our view.

In F2010, EDSL plans to add 1,200 schools for SmartClass versus a total of 1,700 schools under coverage so far. Consequently, though the growth in SmartClass is likely to be ~105% YoY, the business should turn FCF positive in FY10e, in our view.

Valuation

We rate Educomp Overweight with a 12-month price target of Rs4,025 (3% upside). We use a DCF method to build our bull-, base-, and bear-case scenarios. However, to arrive at our price target, we use a probability weighted average of our risk-reward scenarios [Price Target Rs4,025 = 30%*Rs6000+50%*Rs3850+20%*Rs1500]. We also use other methodologies such as multiple comparison (P/E, EV/EBITDA, P/BV) to understand what our price target implies in terms of peer comparisons.

1. Risk-Reward Analysis

Exhibit 12

Revenue and EBIT Assumptions for Risk-Reward Scenarios

	Bull	Base	Bear
Revenue CAGR (F2010-20) (%)	27.5	21.2	15.1
EBIT CAGR (F2010-20) (%)	26.5	19.6	13.2
EBIT Margins (F2020) (%)	32.6	31.1	28.0

Source: Morgan Stanley Research

Execution so far: We use DCF to forecast long-term growth potential for the stock. EDSL has added a respective 600 and 800 schools in the SmartClass segment in the last two years. Management expects to add 1,200 schools in FY10e and covers a cumulative 1,737 schools so far.

In the ICT segment, it has added ~2,200, 3,200 and 6,000 schools, respectively, in the last three years, and covers a cumulative 12,000 schools so far. Management has guided the addition of 5,000 schools in FY10e.

Our bull case assumes that EDSL adds 1,600 private schools in FY10e and adds a larger number of schools every year. We assume it adds 1,900 schools in FY11e, and is able to add ~4,600 schools per year in 10 years and covers ~36,000 cumulative private schools in India with capex declining to 12% of revenues in 2020 vs. 98% in FY09.

In the ICT segment, EDSL adds 8,000 schools in the bull case, adding 10,000 schools in FY11e and 28,000 schools/year, covering 210k schools and 86mn students in ICT by F2020e

In total, our bull case assumes EDSL covers 245,000 government and private schools and ~124mn students in India in 10 years. Subsidiaries continue to account for ~20% of revenues with largely stable margins for the businesses (36k private schools).

Exhibit 13

Assumptions Underlying Risk-Reward Scenarios

F2020e	Bull	Base	Bear
Cumulative SmartClass schools signed	35,837	26,837	11,537
Total students covered (million)	37.4	26.7	12.1
Cumulative ICT Schools signed	210,012	73,012	57,512
Total students covered (million)	86.3	24.6	23.4
Teachers trained (total) million	7.7	7.1	6.0
K-12 Schools	510	351	202

Source: Morgan Stanley Research

Exhibit 14

Strong Market Share Gains in SmartClass Business Drives Value for Educomp

SmartClass		Bull	Base	Bear
	F2009	F2020e	F2020e	F2020e
Cumulative Schools	1,737	35,837	26,837	11,537
Total private schools (target market)	70,000	199,718	199,718	199,718
Market share (%)	*2.5*	*17.9*	*13.4*	*5.8*
Total students in private schools	60.5	159.8	159.8	159.8
Total students covered by Educomp	3.4	37.4	26.7	12.1
% share	*5.6*	*23.4*	*16.7*	*7.5*

Source: Company data, Morgan Stanley Research; Total Schools in F2020e based on 10% CAGR based on historical average; Total students in private schools at 49-72m (average is 60.5 million)

In our base case, we forecast EDSL adds 1,200 and 1,700 schools in FY10e and FY11e and ramps up net additions by 200 schools per year thereafter, covering 2,600 schools per year and a cumulative 27,000 schools by FY20. We assume EDSL covers 52mn cumulative students and 101,000 schools in India. We assume the contribution from subsidiaries declines from 17% of revenues to 12% of revenues over the next 10 years.

Our bear case assumes Educomp covers only 11-12000 private schools by FY20, 57,000 government schools, and a cumulative 35mn students in the next 10 years. Subsidiaries help make up for the slower growth in key businesses to some extent and account for ~24% of revenues by FY20e.

Exhibit 15
Base-Case DCF Model (Rs mn, %)

Yr to Mar 31	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenues (Rs m)	**10,703**	**16,252**	**23,133**	**29,554**	**35,941**	**42,624**	**49,114**	**55,318**	**61,502**	**67,522**	**73,382**
% y/y	*68.0*	*51.8*	*42.3*	*27.8*	*21.6*	*18.6*	*15.2*	*12.6*	*11.2*	*9.8*	*8.7*
EBIT	**3,800**	**5,704**	**8,120**	**10,226**	**12,256**	**14,322**	**16,257**	**18,034**	**19,742**	**21,337**	**22,822**
% chg	*70.4*	*50.1*	*42.3*	*25.9*	*19.9*	*16.9*	*13.5*	*10.9*	*9.5*	*8.1*	*7.0*
EBIT margin (%)	*35.5*	*35.1*	*35.1*	*34.6*	*34.1*	*33.6*	*33.1*	*32.6*	*32.1*	*31.6*	*31.1*
Effective Tax Rate (%)	*35.3*	*35.3*	*35.3*	*35.3*	*35.3*	*35.3*	*35.3*	*35.3*	*35.3*	*35.3*	*35.3*
Tax-adjusted EBIT	2,458	3,690	5,252	6,615	7,928	9,264	10,516	11,665	12,770	13,802	14,763
Adj. For Depreciation & Associates	1,391	2,080	2,915	3,842	4,636	5,456	6,237	6,970	7,688	8,373	9,026
% chg YoY	*70.9*	*49.5*	*40.1*	*31.8*	*20.7*	*17.7*	*14.3*	*11.7*	*10.3*	*8.9*	*7.8*
% of revenue	*13.0*	*12.8*	*12.6*	*13.0*	*12.9*	*12.8*	*12.7*	*12.6*	*12.5*	*12.4*	*12.3*
NOPLAT	**3,849**	**5,770**	**8,167**	**10,457**	**12,564**	**14,720**	**16,753**	**18,635**	**20,458**	**22,175**	**23,789**
Change in working capital	(1,869)	(1,829)	(1,908)	(2,018)	(2,124)	(2,225)	(2,319)	(2,406)	(2,485)	(2,553)	(2,623)
% chg YoY	*82.8*	*-2.2*	*4.3*	*5.8*	*5.3*	*4.8*	*4.3*	*3.8*	*3.3*	*2.8*	*2.8*
Capex	(2,898)	(5,966)	(7,015)	(6,992)	(7,411)	(7,845)	(7,831)	(7,818)	(7,810)	(7,809)	(7,808)
% of revenue	*27.1*	*36.7*	*30.3*	*23.7*	*20.6*	*18.4*	*15.9*	*14.1*	*12.7*	*11.6*	*10.6*
Unlevered Free Cash Flow	**(918)**	**(2,025)**	**(756)**	**1,447**	**3,029**	**4,650**	**6,603**	**8,411**	**10,164**	**11,813**	**13,357**

Source: Morgan Stanley Research

Base Case: Revenue growth moderates and margins decline gradually

We assume Educomp adds ~1,200 schools in SmartClass and ~5,500 schools in ICT in F2010e. Furthermore, Educomp continues to grow its K-12 schools and preschool business. We assume Educomp will have ~43 K-12 schools and over 1,120 preschools (650 Eurokids and 470 Roots to Wings) operational by F2010e. Based on these assumptions, Educomp's revenue growth in F2010e moderates to ~68% (~122% in F2009).

We assume revenue and EBIT CAGRs of 21% and 19.6%, respectively, over F2011-2020, with EBIT margins declining gradually to ~31% by F2020e. These numbers reflect Educomp reaching ~26,800 schools with ~27 million students in SmartClass and ~73,000 schools with ~25 million students in the ICT segment by F2020e. The subsidiaries (including the K-12 school business) contribute ~12% of total revenues by F2020e (~21% in F2009).

Our numbers for SmartClass assume that Educomp continues to increase its market share by F2020e, which we believe is achievable given its current dominant position in the market. For the K-12 schools business, we assume Educomp continues to add ~25 schools every year post F2012e.

We assign a 50% probability to our base-case scenario. Our base case of Rs3,850 implies a P/E of 30x FY10e EPS.

Exhibit 16
Base Case: DCF Value per Share

No of Equity Shares	17.7
Net (Debt)/Cash	(6,619)
Equity Value	68,164
Value of 100% equity stake	68,164
DCF Value Per Share	**3,850**

Source: Company data, Morgan Stanley Research

Exhibit 17

Bull-Case DCF Model (Rs mn, %)

Yr to Mar 31	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenues (Rs m)	**11,514**	**17,836**	**25,019**	**33,257**	**43,343**	**54,081**	**66,287**	**80,078**	**95,517**	**112,742**	**131,157**
% y/y	*80.7*	*54.9*	*40.3*	*32.9*	*30.3*	*24.8*	*22.6*	*20.8*	*19.3*	*18.0*	*16.3*
EBIT	**4,087**	**6,243**	**8,757**	**11,607**	**15,040**	**18,658**	**22,736**	**27,307**	**32,094**	**37,318**	**42,757**
% chg	*83.3*	*52.7*	*40.3*	*32.5*	*29.6*	*24.1*	*21.9*	*20.1*	*17.5*	*16.3*	*14.6*
EBIT margin (%)	*35.5*	*35.0*	*35.0*	*34.9*	*34.7*	*34.5*	*34.3*	*34.1*	*33.6*	*33.1*	*32.6*
Effective Tax Rate (%)	*33.0*	*33.1*	*33.1*	*33.1*	*33.1*	*33.1*	*33.1*	*33.1*	*33.1*	*33.1*	*33.1*
Tax-adjusted EBIT	2,739	4,176	5,858	7,765	10,062	12,482	15,211	18,268	21,471	24,965	28,604
Adj. For Depreciation & Associates	1,612	2,444	3,353	4,357	5,548	6,760	8,087	9,529	11,080	12,740	14,427
% chg YoY	*97.9*	*51.6*	*37.2*	*30.0*	*27.3*	*21.9*	*19.6*	*17.8*	*16.3*	*15.0*	*13.2*
% of revenue	*14.0*	*13.7*	*13.4*	*13.1*	*12.8*	*12.5*	*12.2*	*11.9*	*11.6*	*11.3*	*11.0*
NOPLAT	**4,351**	**6,620**	**9,211**	**12,122**	**15,610**	**19,242**	**23,298**	**27,797**	**32,551**	**37,705**	**43,032**
Change in working capital	(1,869)	(1,829)	(2,081)	(2,358)	(2,660)	(2,987)	(3,340)	(3,717)	(4,118)	(4,551)	(5,001)
% chg YoY	*82.8*	*-2.2*	*13.8*	*13.3*	*12.8*	*12.3*	*11.8*	*11.3*	*10.8*	*10.5*	*9.9*
Capex	(5,615)	(9,432)	(10,834)	(10,821)	(11,602)	(11,572)	(12,378)	(13,184)	(13,988)	(14,791)	(15,593)
% of revenue	*48.8*	*52.9*	*43.3*	*32.5*	*26.8*	*21.4*	*18.7*	*16.5*	*14.6*	*13.1*	*11.9*
Unlevered Free cash flow	**(3,134)**	**(4,641)**	**(3,704)**	**(1,058)**	**1,348**	**4,683**	**7,580**	**10,897**	**14,444**	**18,363**	**22,437**

Source: Morgan Stanley Research

Bull Case: Favorable regulation, higher market share gains, and shift to a capex-light business model trigger strong revenue growth

Our bull case assumes a favorable regulatory regime coupled with strong execution, leading to strong new school signups in F2010e (8,000 in ICT and 1,600 in SmartClass). Based on these assumptions, Educomp reaches ~37 million students in SmartClass and ~86 million students in ICT by F2020e. It would cover 36000 private schools and 210,000 government schools over the coming 10 years. These assumptions result in revenue and EBIT CAGRs of 27.5% and 26.5%, respectively. We forecast a gradual margin decline every year and margins of ~32.6% by F2020e.

We assign a lower probability of 30% to this scenario, as we believe this scenario would require strong execution on a sustainable basis for a longer term, with innovative methods to tide over the growing complexity of managing logistics for hardware/peripherals, while maintaining lower capex at the same time.

Exhibit 18

Bull Case: DCF Value per Share

No of Equity Shares	17.7
Net (Debt)/Cash	(6,619)
Equity Value	106,242
Value of 100% equity stake	106,242
DCF Value Per Share	**6,000**

Source: Company data, Morgan Stanley Research

Exhibit 19
Bear-Case DCF Model (Rs mn, %)

Yr to Mar 31	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenues (Rs m)	**8,546**	**10,917**	**13,532**	**16,383**	**18,944**	**21,499**	**24,138**	**26,771**	**29,419**	**32,094**	**34,800**
% y/y	*34.1*	*27.7*	*23.9*	*21.1*	*15.6*	*13.5*	*12.3*	*10.9*	*9.9*	*9.1*	*8.4*
EBIT	**2,820**	**3,547**	**4,329**	**5,160**	**5,871**	**6,556**	**7,240**	**7,896**	**8,530**	**9,145**	**9,759**
% chg	*26.5*	*25.8*	*22.0*	*19.2*	*13.8*	*11.7*	*10.4*	*9.1*	*8.0*	*7.2*	*6.7*
EBIT margin (%)	*33.0*	*32.5*	*32.0*	*31.5*	*31.0*	*30.5*	*30.0*	*29.5*	*29.0*	*28.5*	*28.0*
Effective Tax Rate (%)	*33.3*	*33.3*	*33.3*	*33.3*	*33.3*	*33.3*	*33.3*	*33.3*	*33.3*	*33.3*	*33.3*
Tax-adjusted EBIT	1,881	2,366	2,888	3,442	3,916	4,373	4,829	5,266	5,689	6,100	6,509
Adj. For Depreciation & Associates	1,196	1,518	1,867	2,245	2,576	2,902	3,235	3,560	3,883	4,204	4,524
% chg YoY	*46.9*	*26.8*	*23.1*	*20.2*	*14.8*	*12.7*	*11.4*	*10.1*	*9.1*	*8.3*	*7.6*
% of revenue	*14.0*	*13.9*	*13.8*	*13.7*	*13.6*	*13.5*	*13.4*	*13.3*	*13.2*	*13.1*	*13.0*
NOPLAT	**3,077**	**3,884**	**4,755**	**5,686**	**6,493**	**7,275**	**8,064**	**8,827**	**9,572**	**10,304**	**11,033**
Change in working capital	(1,386)	(1,413)	(1,470)	(1,529)	(1,590)	(1,654)	(1,720)	(1,788)	(1,860)	(1,934)	(2,012)
% chg YoY	*35.5*	*2.0*	*4.0*	*4.0*	*4.0*	*4.0*	*4.0*	*4.0*	*4.0*	*4.0*	*4.0*
Capex	(2,875)	(3,106)	(3,476)	(4,232)	(3,141)	(3,103)	(3,065)	(3,027)	(2,989)	(2,951)	(2,915)
% of revenue	*33.6*	*28.5*	*25.7*	*25.8*	*16.6*	*14.4*	*12.7*	*11.3*	*10.2*	*9.2*	*8.4*
Unlevered Free cash flow	**(1,184)**	**(636)**	**(191)**	**(75)**	**1,761**	**2,519**	**3,279**	**4,011**	**4,724**	**5,419**	**6,107**

Source: Morgan Stanley Research

Bear Case: Regulatory issues, weak execution, and lower market share gains

Weak execution leads Educomp to add fewer new schools than expected in its SmartClass and ICT segments in F2010e. We expect other businesses to grow relatively faster and contribute ~24% of total revenues by F2020e. Our bear case assumes Educomp signs up only 800 new schools in SmartClass and 3,000 new schools in ICT in F2010e. This implies that Educomp adds 900 new schools in SmartClass and 4,000 new schools in ICT every year from F2012e onwards. Based on these assumptions, Educomp reaches ~12 million students in SmartClass and ~23 million students in ICT by F2020e. We thus forecast revenue and EBIT CAGRs of 15.1% and 13.2%, respectively. We forecast a larger margin decline of 200bps in F2010e and a gradual decline thereafter to ~28% by F2020e. We assign a very low probability of ~20% to this scenario.

Exhibit 20
Bear Case: DCF Value per Share

No of Equity Shares	17.7
Net (Debt)/Cash	(6,619)
Equity Value	26,557
Value of 100% equity stake	26,557
DCF Value Per Share	**1,500**

Source: Company data, Morgan Stanley Research

Exhibit 21
Cost of Equity and WACC Assumptions

Cost of equity (%)	
India risk-free rate (%) (1)	6.0
risk premium (%)	6.0
Market return (2) (%)	12.0
Beta (3)	1.30
Cost of equity (%) {1+3*(2-1))	**13.8**
WACC	
Target Debt/Total Capital	0.30
Cost of equity (%)	13.8
Cost of debt (%)	9.7
Tax rate (%)	33.1
After-tax cost of debt (%)	6.5
WACC (%)	**11.6**

Source: Morgan Stanley Research

2. P/E Multiple Comparisons

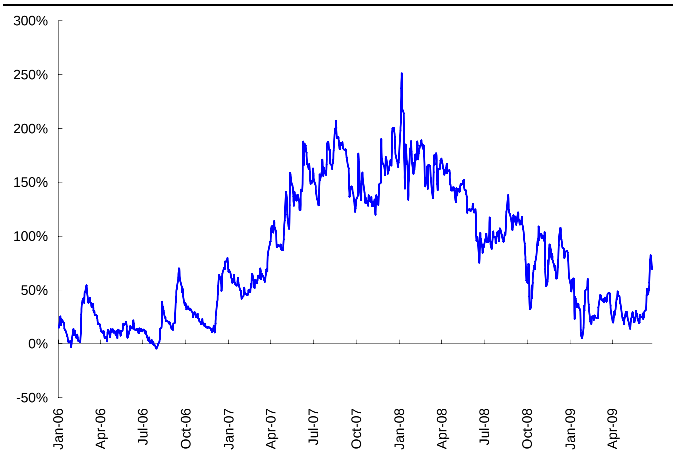
Educomp trades at P/E multiple of ~31x F2010e EPS, which is at a premium to the broader market and global peers.

Educomp has traded in a P/E band of 13x-80x since Jan-06 with an average of 32x and earnings growth of 90% over F2006-09. We expect Educomp to grow its earnings by 57% over F2009-11e. Based on our estimates, the stock is currently trading at a multiple of 31x F2010e EPS, with earnings growth of 67% in F2010e.

The current P/E of 31xF2010e EPS implies a premium of 70% over the broader market. Brazilian and Asian education stocks are currently trading in a range of 10-25x one-year forward earnings. Educomp also trades at a premium to its global peers. For peers with comparable revenue and net income CAGR over C2008-10 (F2009-11), i.e. Brazil stocks, Educomp is trading at a premium of 70-170%.

Exhibit 22

Educomp's Premium to Sensex Has Been Trending Down



Source: Bloomberg, Morgan Stanley Research

We note that Educomp has superior revenue growth, margin profile, and EPS growth compared with peers. We expect a revenue CAGR of 60% over F2009-11e for Educomp, compared with an average of 18% for Brazilian companies and 12% for US companies. Educomp had an EBITDA margin of 47.8% in F2009, compared with the range of 10-37% for its global peers. We forecast earnings growth of ~57% over F2009-11e, compared with an average of 18% for US companies, 41% for Brazilian companies, and 30-40% for companies in China and South Korea.

Exhibit 23

Educomp Near the High End on P/E, but Appears Cheaper Than Peers on EV/EBITDA Basis

	P/E			EV/EBITDA		
Company	**2008**	**2009**	**2010**	**2008**	**2009**	**2010**
US						
K12 Inc.	46.0	29.4	18.7	11.1	8.1	5.5
American Public	42.2	29.2	21.1	19.8	13.3	9.6
Career Education	22.0	26.2	15.9	8.1	8.6	6.1
Apollo Group	15.9	12.6	10.6	7.8	6.4	5.4
Lincoln Educational *	25.2	15.2	12.6	6.3	3.8	3.3
US Average	***17.9***	***15.3***	***12.8***	***9.3***	***7.9***	***6.8***
India						
Educomp	**52.1**	**30.9**	**21.1**	**22.0**	**12.9**	**8.6**
Everonn*	26.9	15.6	12.2	18.6	11.5	10.3
NIIT Ltd*	14.1	13.7	12.3	14.1	12.6	11.1
India Average	***36.8***	***24.9***	***17.6***	***19.6***	***12.7***	***9.1***
China						
New Oriental*	37.7	28.0	20.5	24.5	17.8	13.2
South Korea						
MegaStudy*	NA	21.0	17.0	14.4	12.4	10.3
Brazil						
Anhanguera	25.5	14.4	11.4	16.4	10.2	8.7
Estacio	22.0	14.3	10.1	13.8	10.5	7.6
SEB Sistema	11.8	10.4	10.2	7.1	6.8	6.2
Kroton	21.4	12.2	9.7	17.1	11.0	7.9
Brazil Average	***21.1***	***13.4***	***10.6***	***14.1***	***10.0***	***7.9***
Japan						
Benesse*	17.5	17.2	17.6	17.5	17.2	17.6
Singapore						
Raffles Education*	16.7	13.0	10.9	23.3	19.5	16.9

Source: Company data, FactSet, Morgan Stanley Research. e = Morgan Stanley Research estimates, except FactSet estimates for noncovered companies (*).
NA = Not Available. 2008 represent Calendar year 2008 (F2009 for March ending companies) and so on. US average represents average for the 14 US-based education companies shown in the valuation comparison table in Exhibit 28. Based on closing prices of 6th July 2009

Educomp has traded at an average premium of ~90% to Sensex since its listing. Educomp has grown its EPS at a CAGR of ~88% over F2006-09, compared with ~22% for Sensex. We expect it to grow at a CAGR of ~57%, compared with Sensex earnings growth of ~12% over F2009-11e. Based on a better earnings profile, Educomp should continue to trade at a premium to Sensex, in our view.

3. EV/EBITDA Comparison

Educomp is trading at a ~20% discount to its historical average since listing, but still at a premium of ~20-90% to its Brazilian peers. Educomp has traded in a range of 7-38x with an average of 17x since Jan-06. Currently, the stock is trading at a one-year forward EV/EBITDA of ~13x, which is ~20% below its historical average.

Educomp has traded at a premium to most of its regional peers in Brazil and Korea. The Brazilian peers currently trade in a range of 7-11x F2010e (C2009e) EBITDA with expected growth of 30-50% over F2009-11e. Educomp is currently trading at a premium of 20-90% to these companies for similar EBITDA growth of ~60% over F2009-11e.

Exhibit 24
Educomp: EV/EBITDA

Source: Bloomberg, Morgan Stanley Research

However, the stock trades at a discount of ~20-30% to its peers in Japan, Singapore, and China. These companies are expected to grow their EBITDA in the range of 17-40% over F2009-11e (C2008-10e).

4. Price-to-Book Value Comparison

Historically, Educomp has traded in the range of 4-25x one year forward book value. Currently, the stock is trading at ~9x, which is at a discount of ~15% to its historical average of ~10x. Our price target of Rs4,025 implies a one-year forward P/BV of ~11x, which is towards the lower end of its historical trading range.

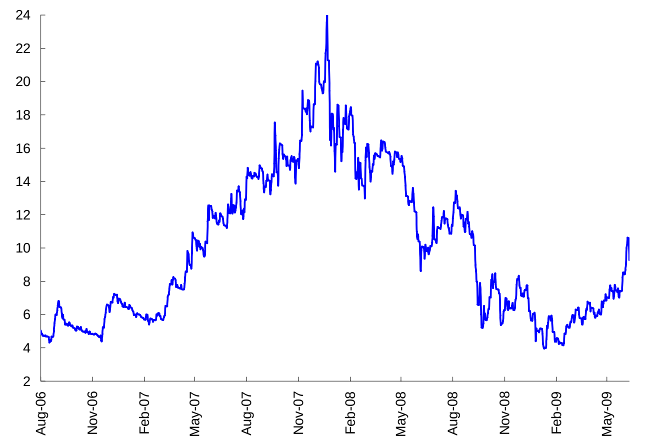
Risks

1) Highly working capital intensive: Delay in payment by government/schools could impact the cash flows adversely.

2) Any change in the current education system/curriculum could require Educomp to completely change its content.

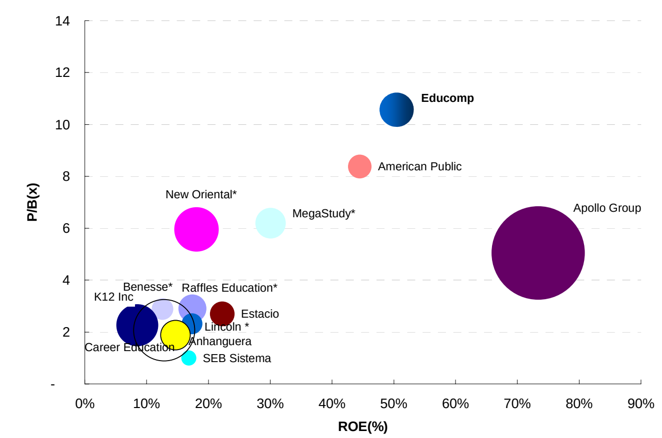
3) Unfavorable government regulations in the education sector: Educomp could be hurt by a cut in budget allocation or slowdown in education spending by the central or state governments.

Exhibit 25
Educomp: Price to Book Chart



Source: Bloomberg,, Morgan Stanley Research

Exhibit 26
P/B vs. ROE for Global Peers



Source: FactSet,, Morgan Stanley Research. Size of bubbles represent market cap relative to peers

4) Content piracy: Copyright infringement or piracy of Educomp's content could damage the business and reputation of the company.

5) Acquisition-related risks.

6) Slower-than-expected acceptance of software content as a learning/teaching medium, and delayed ramp-ups of online forays.

7) Attrition of key business unit heads and lack of scalability in brick-and-mortar initiatives remain the key concerns, in our view.

Exhibit 27

Global Education Valuation Comparables

Company	Ticker	Curr	Price	M Cap	EPS (in local currency)			PE			EPS Growth (%)			EPS CAGR	PEG
			(Local)	US$m	FY09	FY10	FY11	FY09	FY10	FY11	FY09	FY10	FY11	2009-11	
North America															
American Public	APEI US	USD	36	675	0.86	1.24	1.72	42.2	29.2	21.1	33.7	44.5	38.1	15.6%	2.7
Apollo Group	APOL US	USD	67	10,344	4.18	5.26	6.28	15.9	12.6	10.6	46.0	25.9	19.3	20.8%	0.8
Brink's Home	CFL US	USD	27	1,261	1.71	1.38	1.48	16.1	19.9	18.5	34.6	-19.0	7.2	16.0%	1.0
Capella Education	CPLA US	USD	60	1,054	1.66	2.24	2.72	36.0	26.7	22.0	26.7	35.0	21.2	12.6%	2.9
Career Education	CECO US	USD	23	2,096	1.06	0.89	1.46	22.0	26.2	15.9	18.3	-15.9	64.1	8.7%	2.5
Corinthian Colleges	COCO US	USD	16	1,352	0.78	1.10	1.41	20.0	14.2	11.0	103.0	41.2	28.7	42.5%	0.5
DeVry	DV US	USD	47	3,444	2.27	2.79	3.40	20.7	16.8	13.8	29.5	23.3	21.5	13.8%	1.5
H&R Block	HRB US	USD	17	5,858	1.53	1.64	1.84	11.2	10.5	9.3	10.3	6.8	12.6	5.0%	2.2
ITT Educational	ESI US	USD	92	5,032	5.17	7.20	8.40	17.9	12.8	11.0	39.5	39.2	16.7	18.1%	1.0
Jackson Hewitt	JTX US	USD	6	159	1.02	0.99	1.29	5.5	5.7	4.3	-25.1	-3.4	30.2	-13.5%	NM
K12 Inc.	LRN US	USD	19	559	0.41	0.64	1.01	46.0	29.4	18.7	-41.9	56.2	57.6	-23.8%	NM
Strayer Education	STRA US	USD	206	2,934	5.67	7.30	9.18	36.3	28.2	22.4	26.9	28.7	25.7	12.6%	2.9
Lincoln Educational *	LINC US	USD	20	526	0.78	1.29	1.56	25.2	15.2	12.6	143.8	65.9	20.9	56.1%	0.4
Universal Technical*	UTI US	USD	14	339	0.16	0.28	0.62	89.7	51.0	23.0	-71.4	75.7	121.7	-46.5%	NM
Latin America															
Anhanguera	AEDU11 BZ	BRL	17	1,053	0.67	1.19	1.50	25.5	14.4	11.4	NA	77.1	26.1	NM	NM
Estacio	ESTC3 BZ	BRL	18	728	0.82	1.27	1.78	22.0	14.3	10.1	NA	53.6	40.9	NM	NM
Kroton	KROT11 BZ	BRL	14	450	0.67	1.17	1.48	21.4	12.2	9.7	NA	75.5	26.1	NM	NM
SEB Sistema	SEBB11 BZ	BRL	13	272	1.11	1.27	1.29	11.8	10.4	10.2	NA	14.0	1.6	NM	NM
Japan															
Benesse	9783 JP	JPY	4,020	4,483	229.3	234.0	227.9	17.5	17.2	17.6	-4.1	2.1	NA	-2.1%	(8.4)
Asia Pacific															
India															
Educomp	EDSL IN	INR	3,913	1,394	75.8	126.6	185.4	51.6	30.9	21.1	98.3	67.1	46.5	40.8%	1.3
Everonn*	ESIL IN	INR	370	115	13.8	23.7	30.5	26.9	15.6	12.2	27.0	72.5	28.3	12.7%	2.1
NIIT Ltd*	NIIT IN	INR	59	201	4.2	4.3	4.8	14.1	13.7	12.3	-9.7	2.6	11.4	-5.0%	NM
Singapore															
Raffles Education*	RLS SP	SGD	0.6	933	0.03	0.04	0.05	16.7	13.0	10.9	-22.5	28.9	19.0	-12.0%	NM
China															
New Oriental*	EDU US	USD	62	2,368	1.65	2.22	3.04	37.7	28.0	20.5	33.2	34.6	36.7	15.4%	2.4

Source: FactSet, Company data, Morgan Stanley Research. Prices as of 6th July 2009 close
E = Morgan Stanley Research estimates, except FactSet estimates for stocks not covered by Morgan Stanley Research (*).
Note: American Public, Brink's Hime, Capella Education, Career Education, ITT Educational Services, Strayer Education, Anhanguera Educacional Participacoe, Estacio Participacoes SA, Kroton Educacional, S.A. , SEB Sistema Educacional Brasileiro have December ending fiscal year. Apollo Group has August ending fiscal year, Corinthian Colleges, DeVry, K-12 Inc have June ending fiscal year, H&R Block, Jackson Hewitt have April ending fiscal year, Benesse Corp, Educomp, Everron, NIIT have March ending fiscal year.
NR = Not Rated, NM = Not Meaningful, NA = Not Available

Educomp's Main Businesses

SmartClass: This business sets up digital classrooms and provides multimedia content to private schools in India. It is the largest business segment in terms of its revenue share (50% in FY09) and we expect it to continue to be the largest segment going forward. It has a vast repository of content on various subjects for K-12 segment (kindergarten to grade 12). SmartClass products cater to private schools in India. It is likely to add 1,200 private schools this year and should cover a total of 6,600 schools by FY12e, in our view. SmartClass should contribute ~69% of revenues and 79% of EBIT by F2012e.

ICT: This segment sets up computer labs and provides content for government schools in India. It is Educomp's second-largest business segment and contributed ~18% of revenues in FY09. Educomp sets up one computer lab per school, maintains them, and also provides the necessary infrastructure and services for the same to various government/semi-government schools. These schools get funding through various central/state government schemes earmarked for education.

Professional development: This segment has been growing relatively slower for Educomp and its revenue share has fallen from ~31% in 2004 to ~4.5% in FY09. Under this segment, Educomp provides training to school teachers. It also partners with various non-profit organizations and conducts seminars for the same purpose.

Retail and consulting: At ~7% of revenues in FY09, this segment has three key businesses: a) **Roots to Wings**: preschools (play schools for children in the age group 2-4 years), b) **distribution** of imported toys/CDs/books, c) **license fees** from its K-12 subsidiary for Educomp IP, and d) the **vocational training** business (ETEN – Educomp Tele Education Network). Educomp used to get revenues from its online math tutoring business, but this has been made a free service. Recently, Educomp announced plans to hive off its preschool business (Roots to Wings) and vocational training business (ETEN) into two separate subsidiaries.

Subsidiaries: Educomp's subsidiaries set up preschools and set up or lease K-12 schools in India and provide services to these captive schools. Subsidiaries also include its other online ventures, which are currently small. India accounts for ~83% of revenues (F09) while the rest comes from the US, Asia-Pacific, etc. Educomp has made some acquisitions to expand its presence into new activities and new geographies, such as providing animation led content to schools/institutions in Asia-Pacific through **ASKnLearn**, in the US and Canada through **Learning.com**, and in preschools in India through **Eurokids.** Most revenues (over 95%) contributed by the subsidiaries come from **a) ASKnLearn, b) Learning.com, c) Eurokids, and d) Educomp Infrastructure and Management (K-12 schools).** We expect subsidiaries to contribute ~20% of revenues by FY10e, up from ~9% in FY08.

Exhibit 28

Educomp Segment Revenue and Profits (Rs m, %)

Year to March	FY08	FY09	FY10e	FY11e	FY12e
Smart Class					
Revenues	1,268	3,157	6,464	10,816	16,100
% of total	*44.3*	*49.6*	*60.5*	*66.7*	*69.8*
Costs	537	1,297	2,804	4,597	7,004
EBITDA	731	1,860	3,659	6,219	9,097
Margins (%)	*57.7*	*58.9*	*56.6*	*57.5*	*56.5*
% of total	*58.1*	*69.4*	*71.7*	*77.0*	*78.7*
ICT					
Revenues	933	1,137	1,505	1,620	1,842
% of total	*32.6*	*17.9*	*14.1*	*10.0*	*8.0*
Costs	660	887	1,122	1,191	1,339
EBITDA	273	250	384	429	503
Margins (%)	*29.2*	*22.0*	*25.5*	*26.5*	*27.3*
% of total	*21.7*	*9.3*	*7.5*	*5.3*	*4.4*
Professional Dev					
Revenues	256	287	317	349	380
% of total	*9.0*	*4.5*	*3.0*	*2.2*	*1.6*
Costs	100	113	119	134	150
EBITDA	157	173	198	215	230
Margins (%)	*61.2*	*60.5*	*62.5*	*61.5*	*60.5*
% of total	*12.5*	*6.5*	*3.9*	*2.7*	*2.0*
Retail & Consulting					
Revenues	154	416	160	193	231
% of total	*5.4*	*6.5*	*1.5*	*1.2*	*1.0*
Costs	67	279	112	139	171
EBITDA	87	137	48	54	60
Margins (%)	*56.4*	*32.9*	*30.0*	*28.0*	*26.0*
% of total	*6.9*	*5.1*	*0.9*	*0.7*	*0.5*
Subsidiaries					
Revenues	250	1,359	2,231	3,235	4,523
% of total	*8.7*	*21.3*	*20.9*	*20.0*	*19.6*
Costs	240	1,100	1,420	2,072	2,861
EBITDA	10	259	811	1,164	1,662
Margins (%)	*4.1*	*19.1*	*36.3*	*36.0*	*36.7*
% of total	*0.8*	*9.7*	*15.9*	*14.4*	*14.4*
Total for Segments					
Revenues	2,861	6,371	10,678	16,213	23,077
EBITDA	1,258	2,680	5,100	8,080	11,552
Margins (%)	*44.0*	*42.1*	*47.8*	*49.8*	*50.1*

Source: Company data, Morgan Stanley Research; E = Morgan Stanley Research estimates; Sum of segment EBITDA here may not match Consolidated EBITDA due to unallocable items;

Financials

Educomp revenue base of ~US$218mn in F2010 comparable with global peers

Educomp's revenue base of Rs10.7bn (~US$218mn) and net income of Rs2.3bn (US$43mn) in F2010 would be comparable to peers in Latin America and Asia Pacific region. Educomp's EBITDA margin at ~48.5% in F2010 is one of the highest and second only to Raffles Education (~63%).

Exhibit 29

Educomp : Comparison with Peers

Company	F2009 (US$m)			CAGR F2009-11		
	Revenue	EBITDA	Net Income	Revenue	EBITDA	Net Income
Brazil						
Estacio	416	44	41	8.5%	35.0%	47.1%
Anhanguera	261	58	32	26.3%	37.5%	49.4%
SEB Sistema	123	22	20	9.5%	7.3%	7.6%
Kroton	121	24	22	37.0%	47.0%	48.8%
Singapore						
Raffles*	140	87	73	15.0%	17.3%	30.2%
India						
NIIT Ltd *	230	25	14	8.8%	12.8%	5.8%
Educomp	**127**	**60**	**27**	**59.5%**	**59.7%**	**60.8%**
Everonn*	30	9	5	43.9%	34.5%	41.5%
China						
New Oriental*	201	60	49	29.3%	36.2%	35.9%
South Korea						
MegaStudy*	161	60	41	19.3%	18.5%	28.3%

Source: Company data, FactSet, Morgan Stanley Research; *represent companies with estimates from FactSet; F2009 represent C2008 and so on; Brazilian companies and MegaStudy have December ending FY, Raffles has June ending FY, New Oriental has May ending FY and rest have March ending FY; Data represent C2008/F2009 actuals; For Everonn F2009 data represent FactSet estimates, For Brazilian companies C2008 represent Morgan Stanley Research estimates; Data for Raffles, New Oriental and Megastudy represent F2008 actual figures; Indian companies US$m figures based on conversion rate of Rs50/US$

Revenue model has seasonality, where 60-75% of revs come in the 2H: Educomp gets revenues from sale/licensing of digital content, software and services and from sale of hardware (computers and equipments). The hardware sales form ~33% of the total revenues of the company. Educomp's revenues exhibit a pattern of seasonality with December and March quarters are the strongest revenue generating quarters (~60-75% of total annual revenues).

Exhibit 30

Educomp's Revenue Pattern over Different Quarters

		% of revenues
Quarter I	April-June	10-12%
Quarter II	July-September	18-20%
Quarter III	October-December	25-30%
Quarter IV	January-March	38-50%

Source: Company data, Morgan Stanley Research

Revenue growth of 47% CAGR over F2010-12e: We forecast revenue growth of 68% in F2010 and a CAGR of 47% over F2010-12 compared with 125% earlier (F2006-09). We expect Educomp to meet and increase its guidance during the course of the year in F2010. We expect SmartClass to grow by 105% in F2010 (Rs3.3bn in incremental revenues vs. Rs1.9bn in F2009) and continue to remain the largest segment by revenues (~60%). We expect ICT revenue growth to be ~32% in F2010 with a limited number of schools signed in the government space owing to the election year.

Educomp's revenues from subsidiaries in F2009 were helped by acquisitions (Learning.com, Eurokids). These acquisitions together accounted for ~11% of revenues in FY09 (Learning.com 9% and Eurokids 2%) for Educomp.

Our revenue forecast for Educomp at a CAGR of 47% over F2009-11 (C2008-10) compares with the range of 10-40% for peer companies. We expect these subsidiaries to grow their revenues by 64% in F2010 and continue to be the second largest segment (~21% of revenues) after SmartClass. Based on our forecasts, Educomp will have revenue base of ~US$218mn in F2010.

EBITDA margins declined during F2006-09: Educomp's EBITDA margins have declined in F2006-09 largely due to margin erosion in ICT business segment and lower margins of subsidiaries. However EDSL, margins still remain one of the highest compared with global peers. The decline in margins has resulted from competition and increasing trend in costs of goods which followed from higher outright sale in ICT and SmartClass segments. Improved profitability of the ICT segment and subsidiaries should help margins in FY10e.

Exhibit 31

Trends in EBITDA Margins

Year to 31st March	FY08	FY09	FY10e	FY11e	FY12e
Professional Dev. (%)	61.2	60.5	62.5	61.5	60.5
Smart Class (%)	57.7	58.9	56.6	57.5	56.5
ICT (%)	29.2	22.0	25.5	26.5	27.3
Retail and Consulting (%)	56.4	32.9	30.0	28.0	26.0
Subsidiaries (%)	4.1	19.1	36.3	36.0	36.7
Total (%)	**44.2**	**47.8**	**48.5**	**47.9**	**47.7**

Source: Company data, Morgan Stanley Research; e=Morgan Stanley Research estimates

Room for further margin improvement: Increasing competition in ICT segment dented margins in the segment in FY09. Management has now mandated a floor of ~30% margins on all government contracts it undertakes going forward. This should help improve margins but might impact segment revenue growth, in our view.

SmartClass and subsidiaries are key margin drivers: We believe, as SmartClass penetrates deeper into tier 2 and tier 3 cities, the sales cycle may reduce due to faster adoption of the product in smaller schools. This could lead to lower overheads/selling expenses. The subsidiaries contributed ~21% of revenues in F2009 and 19% of total EBITDA. Other businesses (like Savicca, Threebrix, etc.) are still making losses and may take some time before moving towards profitability

Exhibit 32

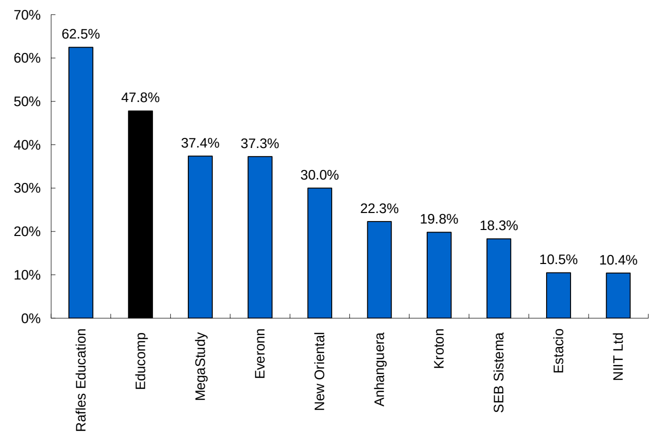
Educomp's Subsidiaries: K-12 Schools to Contribute ~10% of Total Revenues in Next 3 Years

Year to 31st March	FY09	FY10e	FY11e	FY12e
Educomp Infrastructure & School				
Total Schools	20	43	98	151
Total Students	15,000	31,300	70,500	125,100
Average students/school	750	728	719	828
Average revenue/student (Rs)	25,933	19,572	13,825	11,940
Total Revenues (Rs m)	389	613	975	1,494
% YoY		*57.5*	*59.1*	*53.3*
Roots to Wings				
Total No of Pre-Schools	169	469	769	1,069
Avg revenue/pre-school p.a.(Rs m)	NA	809,467	930,888	1,070,521
Total Revenues (Rs m)	56	380	716	1,144
% YoY	*NM*	*NM*	*88.6%*	*59.9%*
Learning.com				
Revenues (Rs m)	542	650	767	883
% YoY		*20.0*	*18.0*	*15.0*
Eurokids International Ltd.				
Total No of Pre-Schools	450	650	850	1050
Total No of Kids	27,000	42,250	59,500	78,750
Kids per pre-school	60	65	70	75
Avgrevenue per kid/month (Rs)	398	418	438	458
Total Revenues (Rs m)	129	212	313	433
% YoY		*64.3*	*47.6*	*38.4*
ASKnLearn				
Revenues (Rs m)	240	276	309	340
% YoY		*15.0*	*12.0*	*10.0*
Other revenues (Rs m)	**59**	**100**	**155**	**230**
% YoY		*70.0*	*55.0*	*48.0*
Subsidiaries revenues (Rs m)	**1,359**	**2,231**	**3,235**	**4,523**
% of total	*21.3*	*20.9*	*20.0*	*19.6*
% YoY	*444.0*	*64.2*	*45.0*	*39.8*

Source: Company data, Morgan Stanley Research; e=Morgan Stanley Research estimates; Roots to Wings revenues of Rs56mn in FY09 represent revenues in 2H09

Exhibit 33

Educomp Has the Best EBITDA Margins in F2009 Compared with Its Global Peers



Source: FactSet Company data, Morgan Stanley Research estimates

We forecast overall margins to improve in F2010e. We expect an EBITDA margin of 48.5% for Educomp in F2010e. We expect EBIT margins of 35.5% in FY10 driven by stable margins in SmartClass and improved performance of ICT business and its subsidiaries. Educomp has grown its EBIT at a CAGR of 118% over FY06-09 and we expect it to grow at a CAGR of 46% over FY10-12e.

Net income to grow by 72% in F2010e and 47% over F2010-12e: We expect Educomp to grow its earnings by 72% in F2010e. Lower earnings growth in F2010 could be attributed to declining revenue growth in key segments like SmartClass due to the growing scale and complexity of the businesses. Higher interest costs due to its total debt of ~US$253mn would also lead to lower net other income. We expect that the subsidiaries will contribute 15-16% to earnings in F2010e.

We believe that Educomp may remain free cash flow negative in Fy10e, though its SmartClass business is likely to turn FCF positive this year. The K-12 business would require additional debt, but the debt requirement is likely to fall in this segment as well. Educomp has a debt/equity ratio of 2.1x (1.1x excluding FCCB) and net debt/EBITDA of 2.2x as of 31 March 2009, and we expect D/E to decline marginally to 2x (1.4x excluding. FCCB) in FY10e.

Working capital driven by higher DSO improved from 169 days in FY07 to 159 days in FY08 and ~158 days in FY09; it still remains very high due to the nature of the business model. The SmartClass and ICT segments (~67% of total sales) require upfront investment by Educomp in the form of creating IT infrastructure (computers, servers, UPS, etc.) to deliver content to classroom. These schools make payment on a quarterly basis through out the life of the contract (~3-5 years).

Issuance of FCCBs: Educomp has done two FCCB issuances till date. Educomp issued US$25mn in 1% 2011 FCCBs during October 2006. The proceeds from the issue were used to finance an overseas acquisition and related expenditure. Educomp has already converted this issue into equity shares at Rs900/share, leading to an increase in the share count by 1.27mn and dilution of ~8%. Educomp made another issue of FCCB (zero coupon, 2012) of US$80mn in July 2007, which can be converted into equity shares at an exercise price of Rs2,950/share. These bonds may be redeemed in cash in whole prior to maturity any time after 25 July 2009 at the option of the company. We forecast that the conversion of the outstanding balance at the given exercise price could lead to further dilution of ~6-8% in FY12e

ESOP: Educomp amortized Rs100mn (~1.5% of revenues) in FY09 as ESOP amortization costs arising out of shares allotted to employees of the company. Under different employee stock option schemes, Educomp has granted 5,72,460 shares to its employees (with a vesting period of seven years starting from the date of grant) and a further 156,071 shares (with a vesting period of 10 years starting from the date of grant). The earnings dilution from the ESOP has not been material so far.

Recent Events

Change in accounting treatment of hedges boosted profits by Rs440mn in F2009: Educomp follows AS-11, and marks to market its hedge exposure every quarter and taking the impact through its P&L account. As per the recent amendment to AS-11, Educomp reversed its forex losses arising out of marking to market the hedges with retrospective effect (with effect from Dec-06) and booked a forex gain of Rs369mn during the Mar-09 quarter. By opting for this, Educomp's net income increased by Rs440mn for F2009.

Excluding the impact of gains on reversal of forex losses, net income growth in F2009 was 26%, compared with a CAGR of 119% over F2005-08. The subsidiaries contributed 21% to revenues in F2009, but their contribution to the bottom line was only ~4%.

Pearson has invested US$17.5mn in a 50:50 joint venture with Educomp for its existing vocational training business. The joint venture will use Pearson's existing educational content for providing training services, which will be delivered through Educomp's network.

Company Description

Incorporated in 1994, Educomp provides education technology solutions for the K12 segment. Educomp creates and delivers digital content to schools. It also provides training to professionals, and its retail business includes online tutoring portals. It has also ventured into running preschools and K-12 schools at various locations in India. Apart from India, Educomp is present in similar business segments in Singapore, the US, and Canada.

India Education Services

Industry View: Attractive

The education sector in India is an attractive opportunity due to an increasing public/private focus and the need for investments in the sector.

MSCI Country: India

MSCI Asia/Pac All Country Ex Jp Weight: 8.0%

Addressable Market

Educomp classifies its revenues amongst four major business segments, as discussed below:

1) SmartClass
Educomp provides digital content using graphics and animation, along with the required infrastructure (hardware and software) to schools for effective classroom teaching. Educomp books revenues under both outright sale and BOOT methods depending on the nature of the contract. **Under the BOOT (Build, Operate, Own and Transfer) model** Educomp enters into a long-term contract (~5 years) with schools for providing digital content and the required infrastructure. Schools make quarterly payments over the life of the contract. Educomp retains these assets on its books for the contract period, at the end of which it transfers the hardware/equipment at a nominal residual value to the schools.

The key revenue driver for SmartClass is the growing number of private schools, improving enrolment ratios (ratio of students enrolling and total estimated population within that age group) and increasing adoption of digital means of classroom teaching. Private schools have grown at a CAGR of ~7% over 2000-06 compared with ~3% for government schools and account for ~22% of the total schools (compared to 18% in 1997).

Addressable market size of ~US$2-2.5bn**:** Educomp charges Rs150 per student per month for its SmartClass product under the BOOT method and Rs75 per student per month under the outright sale method. Educomp targets private schools (unaided by the government) in the K-12 segment, which has at least 300 students and charges at least Rs300 per student per month. The total private schools (unaided) in K-12 segment were 175k (as of 2005-06), but Educomp's target market is ~70-80k schools. Based on the SmartClass charge of Rs150/student per month and assuming an average of 700-900 students per school, the potential market size for the product is ~US$2-2.5bn.

2) Instructional and Computing Technology (ICT)
Educomp partners with various state governments and union territories (UTs) for setting up and maintaining computer labs and providing computer-aided education in government and semi- government schools. The sale process involves floating of Request for Proposals (RFPs) by the government, bidding by vendors, short listing and negotiations. Educomp enters into long-term contracts (~5 years) which covers setting and implementing the infrastructure (hardware, software, accessories, etc.), maintaining the same, providing faculty/co-coordinator, digital content and training the teachers so as to equip them with the usage of the content. Revenues under this segment are booked under the outright sale or BOOT method, similar to that of SmartClass. The only difference in this BOOT contract from that of SmartClass is in this case the content is developed per the requirements of the government and Educomp does not own the intellectual property rights on the same. Hence, Educomp transfers the content to the schools at the end of the contract.

The single most important ***key revenue driver*** for this segment is allocation of funds and actual expenditure by the central/state governments towards IT education under various schemes like Sarva Shiksha Abhiyaan (SSA), Information and Communication Technology (ICT), etc. Similarly under SSA, the government runs a Computer Aided Learning (CAL) program through which it aims to impart computer education in elementary schools (Grade I-VIII).

Exhibit 34
Max Potential Revenues for SmartClass ~US$2-2.5bn

Total Private Schools (unaided)	175,175
2001-2006 CAGR in schools (%)	*10.6*
Target market for Educomp (schools) (a)	70-80,000
Average students per school (b)	700-900
Total students (millions) (c) =(a)*(b)	49-72
SmartClass charge per student per month (Rs)	150
Annual charge per student(d)	1,800
Total Available Market Size (Rs m) (e) =(c)* (d)	**88,200-129,600**
Market Size (US$m)	**1,800-2,650**

Source: Ministry of HRD, Morgan Stanley Research; US$ conversion based on Rs50/US$

Exhibit 35
Government Spends ~Rs135,000 p.a. per School in Setting up Computer Labs in Govt Schools under ICT Scheme for Secondary and Higher Secondary Schools

ICT	**2007-08**
BOOT Schools in FY08	*20,160*
Outright purchase Schools in FY08	*2,673*
Total Schools covered	22,833
Total Expenditure by Central Govt.(Rs m)	2,535
Average expenditure per school by center p.a. (Rs)	~111,000
Centre's contribution	75%-90%
Total Expenditure per school p.a. assuming 82.5% Centre's contribution	134,553

Source: Ministry of HRD, Morgan Stanley Research

***Total market size*:** We believe, in this case, the addressable market includes all government/government-aided schools at primary (Grade I-V), upper primary (Grade VI-VIII), secondary (Grade IX-X) and higher secondary (Grade XI-XII) levels.

Exhibit 36

Educomp's Target Market Is over 1mn Schools for ICT Segment

Schemes	Stage of Education	Govt/Govt aided Schools	Students Enrolled (million)	Average students/school
CAL under SSA	Primary/Upper Primary	937,650	171	182
ICT	Secondary/Higher Secondary	107,903	20	182

Source: Ministry of HRD, Morgan Stanley Research, CAL under SSA represents Computer Aided Learning programme under Sarva Shiksha Abhiyaan, ICT represent Information and Computing Technology, Total Schools data for government, local body and private aided schools as of 2005-06, Students enrolled based on average of 182 students per school

On average, government spent Rs1,35,000 per school under its ICT scheme for setting up computer labs in secondary/higher secondary schools during F2007-08. We use the total addressable market size of government/semi-government schools and the average spent per school to estimate the addressable market size at US$2.8bn for the ICT business segment of Educomp.

Exhibit 37

Addressable Market for ICT Segment at ~US$2.8bn

Stages	Schools	Avg expenditure / school (Rs)	Addressable Market (Rs m)	Addressable Market (US$m)
Primary/Upper Primary	937,650	135,000	126,583	2,532
Secondary/Higher Secondary	107,903	135,000	14,567	291
Total	**1,045,553**		**141,150**	**2,823**

Source: Ministry of HRD, Morgan Stanley Research; US$m nos converted at Rs50/US$

Educomp's share: Educomp has so far covered ~12,000 government schools cumulatively under ICT (< ~1% of the total potential market) and still remains one of the largest players in the organized segment. Educomp has a presence in a total of 13 states in India, with a reach of ~12,000 schools and ~6.5mn students. **These states together represent ~63% of the total K-12 schools in India and ~61% of the total children enrolled in the schools**.

Exhibit 38

Top 3 Players Cover ~2% of Total Govt/Govt-Aided Schools in India

Company	Schools
Educomp	12,012
NIIT Ltd.	6,710
Everonn	4,442
Total	**23,164**
Total target schools	1,045,553
Market share (%)	*2.2*

Source: Company data, Morgan Stanley Research; Educomp data as on Mar09 while for NIIT and Everonn data as on Dec08

Educomp recently won a contract to implement computer labs in ~1,800 schools in Andhra Pradesh worth over Rs830mn. Management indicated it plans to take the total schools under ICT to 17, 000 cumulatively by F2010e.

3) Professional Development

Educomp runs various developmental programs aimed to train school teachers. The training programs cover computer training, creative thinking, and problem solving skills., It runs its own training program called "QUEST" which aims to train private school teachers paid directly by the schools..

Key drivers: India's teacher-pupil ratio at the primary education level (Grade I-V) is very high at 46, compared with the range of 20-27 for other developing and developed countries, and should improve going forward, in our view. Approx. 37% of children in the age group of 4-18 years (~128 million) are not yet enrolled in the school, and greater enrolment of students in the future should drive demand for new teachers.

Market size: Educomp has generated an average of Rs800-840 p.a. per teacher trained in FY08 and FY09. Based on that, the total teacher training market **is close to US$90mn**.

Exhibit 39

Teacher Training Market Size of ~US$90mn

Total Teachers (million)	6.0
Untrained (%)	90-95
Untrained teachers (million)	**5.6**
Average revenue per teacher trained p.a.(Rs)	800
Market size (Rs mn)	**4,440**
Market size (US$mn)	**89**

Source: Company data, Morgan Stanley Research; Market size in US$m converted at Rs50/US$

4) Other Businesses

Educomp's other businesses include the retail and consulting segment (6.5% of revenues and 5% of EBITDA) and its subsidiaries. The retail and consulting segment includes running preschools (Roots to Wings), licensing of Educomp IP to Educomp K-12 schools business, retailing and distribution of toys/CDs. The subsidiaries include primarily ASKnLearn, Learning.com, Educomp Infrastructure and Management Ltd. and Eurokids. **The subsidiaries contributed ~21% of revenues but only ~3.5% of net income in FY09**. The major businesses under this segment are as follows:

Preschools – Roots to Wings/Eurokids: Educomp ventured into the business of running preschools in 2007. It is running ~169 preschools currently under the brand name of "Roots to Wings." Educomp became one of the largest chains of preschools after acquiring a majority stake of 50% stake in Eurokids (450 branches of pre-schools). Educomp plans to set up 2,000 preschools (Roots to Wings and Eurokids together) over the next three years until F2012e, which could contribute ~7% of revenues.

Educomp estimates the total potential market size for preschools is ~ 25,000-30,000 schools in the organized space, with a market size of over ~US$2bn.

K-12 schools (Eduschools): It runs K-12 schools and provides the basic infrastructure required to build and run a school. Its services include extending building leases, maintenance, and content licensing apart from other school management services.

Educomp runs its K-12 schools under three different price brackets: **a) Millennium Schools:** These schools are premium in nature and cater to higher-end students with fees in the range of Rs3,500-4,000 per student per month**. b) Takshila Schools:** This brand caters to tier 2 and tier 3 cities within the price range of Rs1,500-2,000 per student per month. **c) Vidya Prabhat Schools:** Low-budget schools with a fee of Rs800 per student per month.

Currently, it has 20 schools already operational and a further eight are under construction. This subsidiary achieved sales of Rs389mn and EBITDA margins of ~75% for F2009. High EBITDA margins are explained by the fact that it consolidates operating profit of the schools while costs are expensed at the school level. Educomp aims to build 150 schools by 2012. We expect K-12 schools to contribute 6.5% of revenues by F2012e.

Exhibit 40

K-12 Schools: Average Revenue of ~Rs2200 per Student per Month

K-12 Schools	2009
Total Schools (operational) (a)	20
Total students (b)	15,000
Average students per school (c) =(b)/(a)	750
Total Revenues (F09) Rs m (d)	389
Average revenue per student p.a.(Rs) (e) = (d)*1million/(b)	25,933
Average monthly revenue per student (Rs) (e)/12	2,161

Source: Company data, Morgan Stanley Research

Exhibit 41

Educomp's Shareholders as of Mar-09 (%)

Category	Mar-09
Promoters	55.0
Foreign Institutional Investors (FIIs)	39.7
Mutual Funds/UTI	0.4
Individuals and others	4.8
Total	**100.0**

Source: National Stock Exchange (NSE), Morgan Stanley Research

APPENDIX

Exhibit 42

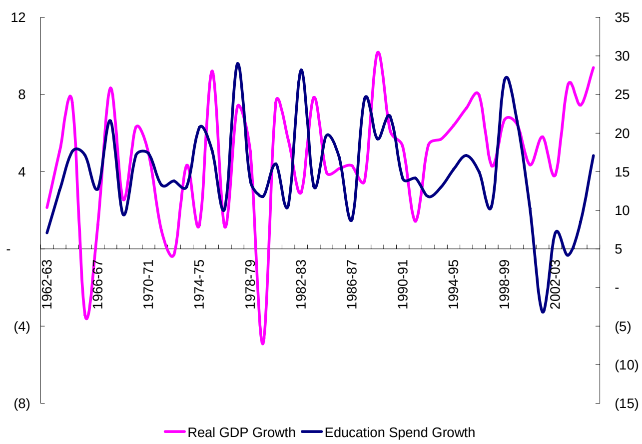
Educomp: Growing Scale Could Create 150,000 Jobs in Small Towns and Demand for 800 Buses/Year and Need to Ship ~1.5 mn Computers and Peripherals by 2018

	FY09	FY12e	FY15e	FY18e	Comments
Preschools	620	2000	4000	7000	
Kids covered	37200	120000	240000	420000	
Fee per kid	11,111	12,778	14,694	16,899	
Total Revenues	413	1,533	3,527	7,097	
Revs (US$m)	**8**	**31**	**72**	**145**	**Preschools alone would be the current size of the company in 10 years**
Jobs created (5 per school)	*3,100*	*6,900*	*10,000*	*15,000*	
K12 Schools	20	145	300	650	
Buses /School	3	4	5	6	Mah state transport has 16k buses
New Buses needed	**60**	**520**	**920**	**2,400**	
Jobs created (75 per school)	*1,500*	*9,375*	*11,625*	*26,250*	
No of ICT Schools	12,012	31,000	48,000	63,000	
No of SmartClass schools	1,737	6,637	13,837	21,637	
Total schools	13,749	37,637	61,837	84,637	
PC/Peripherals per school	*18*	*18*	*18*	*18*	
Total PC/Peripherals Shipped	247,482	677,466	1,113,066	1,523,466	*HP currently ships 1m PC in the country and has 10-15% mkt share; Dell and HCL together ship as many units*
Jobs Created		23,888	24,200	22,800	
TOTAL Jobs Created	4,600	40,163	45,825	64,050	Would create cumulative 150,000 low-paying jobs in the economy by 2018 mostly in small towns

Source: Company data, Morgan Stanley Research

Exhibit 43

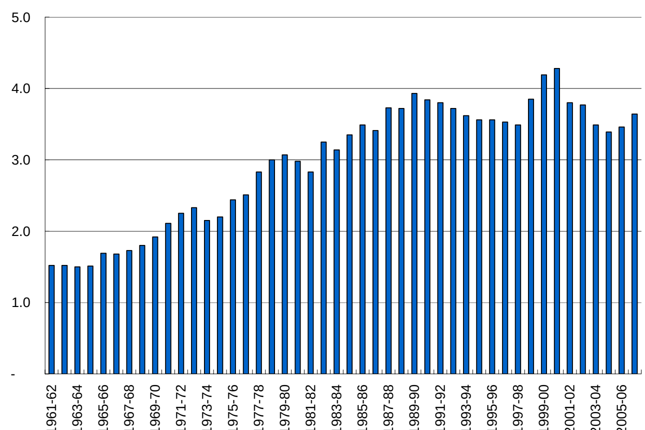
Growth in Public Expenditure on Education Goes in Line with Real GDP Growth



Source: Ministry of HRD, Morgan Stanley Research

Exhibit 44

India's Public Education Expenditure at ~3.6% of GDP in 2006-07



Source: Ministry of HRD, Morgan Stanley Research

Exhibit 45

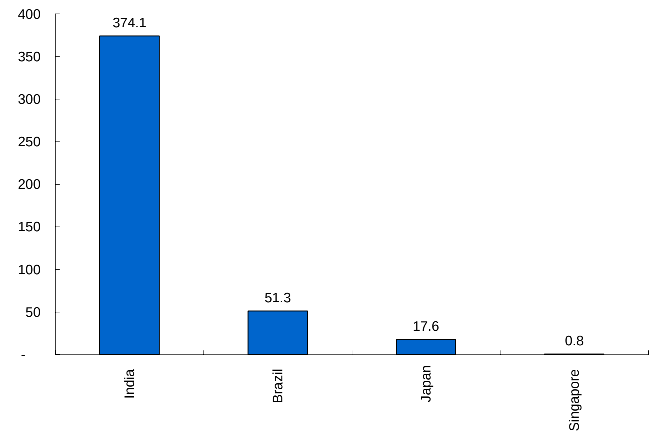
India's Expenditure on Education as % of GDP Is Still Low…

Country	All sources of funds (public, private, international)	Public sources
India	4.4	3.2
Republic of Korea	NA	4.2
Brazil	NA	4.4
UK	6.4	5.1
USA	7.5	5.0

Source: UNESCO Global Education Digest 2008, Morgan Stanley Research; Data as of 2006

Exhibit 46

…But Has a Huge Population Base in 0-14 Years of Age Group Compared to Few Other Countries



Source: UN Population Division, Morgan Stanley Research; Data as of 2005

Exhibit 47

Leading to One of the Lowest Expenditures on Education per Student (US$)

Country	US$
India	**626**
Brazil	1,542
Korea	6,212
UK	7,741
Japan	8,378
US	12,788

Source: UNESCO Global Education Digest 2008, Morgan Stanley Research; Data as of 2006; US$ Purchasing Power Parity (PPP)

Exhibit 48

India Has One of the Lowest Proportions of Private Spending on Educational Institutions

Country	Public	Private	Total
United Kingdom	80	20	100
India	**75**	**25**	**100**
Japan	69	31	100
United States	67	33	100
Republic of Korea	59	41	100

Source: UNESCO Global Education Digest 2008, Morgan Stanley Research; Data as of 2006

Exhibit 49

Seasonal Nature of Central Government Spending on ICT Scheme under Secondary School Education

Rs m	Total	% of total
Actual expenditure (Apr08-Jan09)	**1,663**	**55%**
Feb-09-Mar09	1,337	45%
Total Budgeted	**3,000**	**100%**

Source: Ministry of HRD, Morgan Stanley Research

Exhibit 50

Government's Actual Expenditure Far Lesser Than Outlay for ICT Scheme at Secondary/Higher Secondary Schools

ICT Scheme of Government	Rs m
Budgeted (Rs m)	8,000
Actual (Rs m)	1,340
Actual as % of budgeted	*16.8*

Source: Ministry of HRD, Morgan Stanley Research; Tenth five year plan data (2002-07)

Exhibit 51

Target Segment for Preschools Is Children in the Age Group of 2-4 Years Old

Age Group	Stages	Grades
2-4 years	Pre-Primary	Play/Pre Schools
5-10 years	Primary	I-V
11-13 years	Middle	VI-VIII
14-15 years	Senior Secondary	IX-X
15-16 years	Higher Secondary	XI-XII

Source: Company data, Morgan Stanley Research

Exhibit 52

Target Population for Preschools

Population (million)	Millions
0-4 years (1)	128
New births every year (2)	27.6
0<2 years (3) = (2) * 2	55
2-4 years (4) = (1) – (3)	73
Urban Population ratio (%) (5)	29.0
Urban kids in age group of 2-4 years (6) = (5) * (4)	**21**

Source: UN Population Database, Morgan Stanley Research; assuming constant birth rates, population in the age group of 0-2 years would be ~27.6*2

Exhibit 53

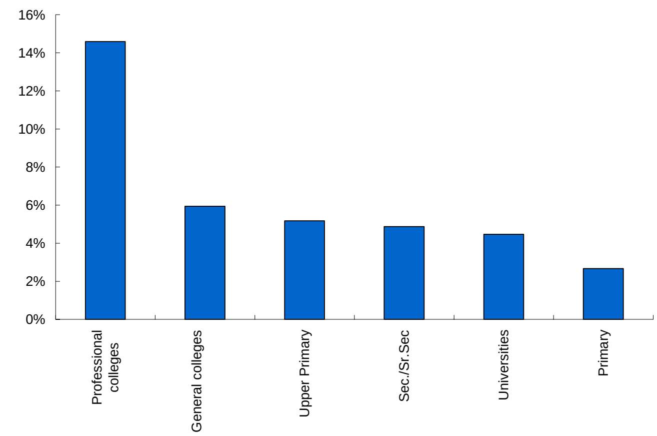
Preschools: Key Players

Playschools	Branches
Kidzee	623
Eurokids	***450***
Bachpan	300
Roots to Wings	***169***
Shemrock Kids	100
Kangaroo kids	56
Tree house	40
Mother's Pride	15

Source: Company data, Morgan Stanley Research

Exhibit 54

Primary Schools in India Have Grown the Slowest in Last 10 Years



Source: Ministry of HRD, Morgan Stanley Research; 10 year CAGR over 1995-96 to 2005-06

Exhibit 55

…But Has the Maximum Number of Students Enrolled

2005-06	Total Students Enrolled (million)	10 year CAGR (%)
Primary (Grade I-V)	132.1	2.1
Middle (Grade VI-VIII)	52.2	3.4
Secondary/Senior Sec. (Grade IX-XII)	38.4	5.3
Total	**222.7**	**2.9**

Source: Ministry of HRD, Morgan Stanley Research; 10 year CAGR over 1995-96 to 2005-06

Exhibit 56

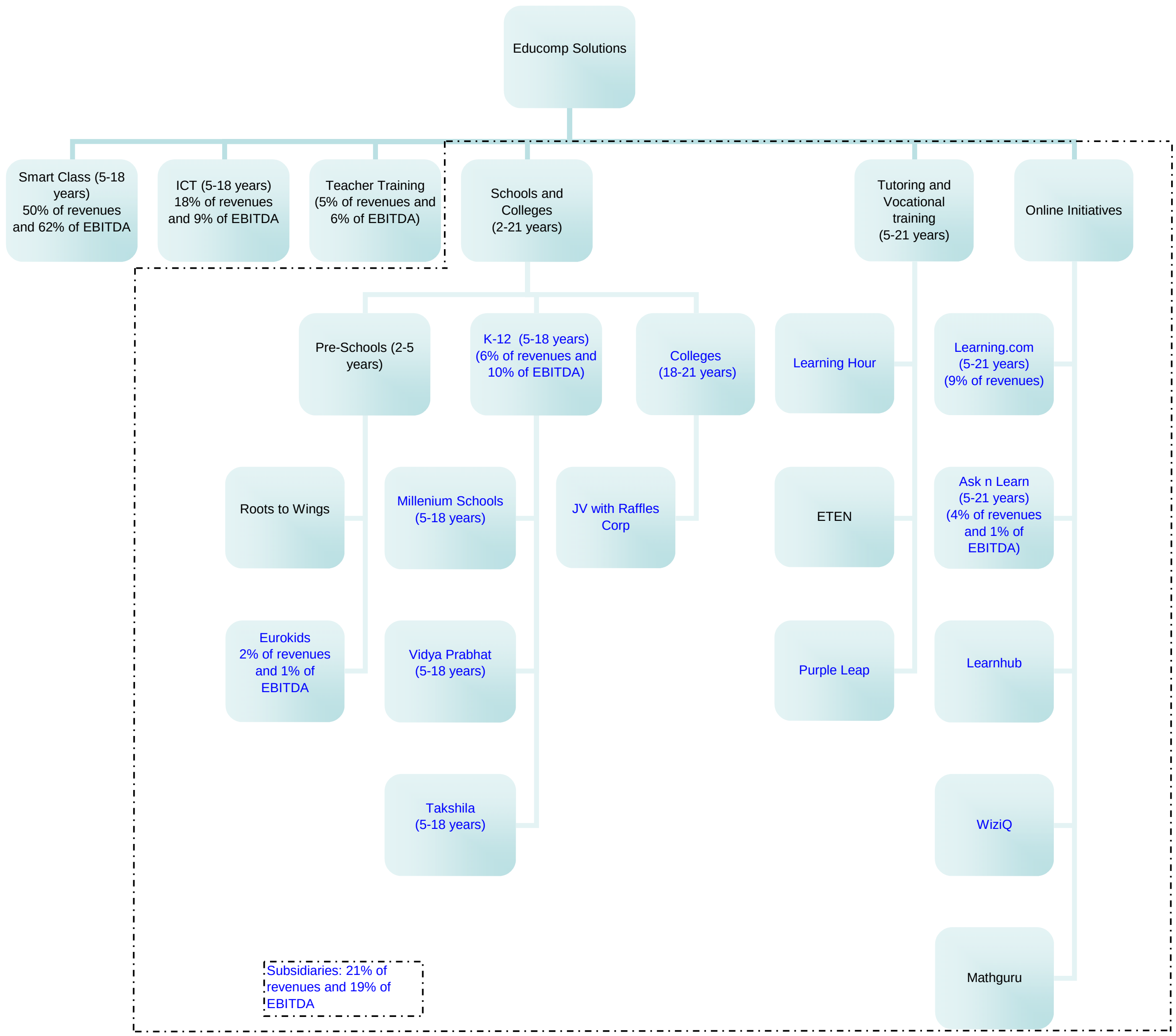
Primary Level Has 59% of Total Students While Only 36% of Total Teachers

2005-06	Total Teachers (million)	10 year CAGR (%)
Primary (Grade I-V)	2.2	2.3
Middle (Grade VI-VIII)	1.7	3.5
Secondary/Senior Sec. (Grade IX-XII)	2.2	3.4
Total	**6.0**	**3.0**

Source: Ministry of HRD, Morgan Stanley Research; 10 year CAGR over 1995-96 to 2005-06

Exhibit 57

Educomp: Retail Initiatives and Enterprise Online Business Through Subsidiaries



Source: Company data, Morgan Stanley Research; Blue color represent business at the subsidiaries levels; Revs and EBITDA for FY09

Exhibit 58

Educomp's Subsidiaries: Direct and Indirect

Direct	% holding of Educomp	Nature of business
Educomp Learning Private Limited	51	It is the production and content development arm of Educomp
Whitestone Productions Private Limited	51	It produces periodicals and children magazines
Educomp Infrastructure and School Management Ltd.	69	It provides the basic infrastructure required to build and run a school which covers building lease, maintenance, licensing of content etc.
Educomp Professional Education Limited	100	Runs professional education courses
Educomp Software Limited	100	Content development unit at Parwanoo, Himachal Pradesh for availing the tax benefits
Threebrix E-Services Private Limited	76	Acquired by Educomp, it provides online and offline tutoring services
Authorgen Technologies Private Limited	55	Acquired by Educomp, it provides online tutoring services
Edumatics Corporation Inc.	100	Offers SmartClass product in US apart from other on-line learning initiatives
Educomp Asia Pacific Pte. Limited	100	A SPV created to facilitate the buyout of ASKnLearn
Indirect		
ASKnLearn Pte ltd, Singapore	100	It is owned by Educomp Asia, a 100 subsidiary of Educomp. ASKnLearn is a pan Asian provider of online learning portals and content provider to various institutions.
Singapore Learning.com Pte. Ltd, Singapore *(Subsidiary of ASKnLearn Pte. Ltd)*	100	Owned by ASKnLearn, it runs online learning portals
Pave Education Pte Ltd, Singapore *(Subsidiary of ASKnLearn Pte. Ltd)*	100	Owned by ASKnLearn, it offers learning courses in IT and multimedia language enrichment
Wiz Learn Pte Ltd, Singapore *(Subsidiary of ASKnLearn Pte. Ltd)*	100	Owned by ASKnLearn, it offers online teaching programmes
Learning.com, U.S.A *(Subsidiary of Educomp Asia Pacific Pte. Ltd)*	51	Owned by Educomp Asia Pacific, it provides technology based on-line content and learning solutions. It has various products like Aha!Math and Aha!Science which provide math and science curriculum to the students through internet for Grades K-5
Shikhya Solutions Inc.,U.S.A *(Subsidiary of Authorgen Technologies Private Limited)*	100	It is owned by AuthorGen, which Educomp acquired. It acts as the marketing office of AuthorGen in the US
Educomp Infrastructure Services Private Limited	100	It is owned by Educomp Infrastructure. It was incorporated to cater specific projects under its parent company

Source: Company data, Morgan Stanley Research

Exhibit 59

Educomp: Inorganic Growth History

Date	Company	Stake acquired	Amount Paid (US$m)	Business	Benefits
Apr-07	Threebrix	76%	0.5	Online and Offline tutoring company with currently 8 learning centers	Potential entry into large untapped supplemental (out of class) learning market
Jul-07	AuthorGen	51%	0.5	Online tutoring company with leadership in the area of Wiziq learning platform 2.0	WiziQ had 1.2 million unique visitors and 1,78,000 registered users in 9M09
Jul-07	ASKnLearn	100%	4.0	A Singapore based education technology company which caters to 140 global institutions in about nine countries	Access to APAC market with a client base of over 140 institutions
Aug-07	Savicca/ Learnhub.com	70%	2.0	An e-learning company based out of Canada focused on Web based learning management systems	Foray into Social learning network domain with 50,000 registered users in Q309
May-08	Learning.com	51%	NA	US based e-learning company providing web based learning solutions with a reach of ~7500 schools and 2.5 million students in US in over 800 cities	Access to North America online learning market
May-08	Raffles Education Corp	JV	NA	Largest education group in the APAC region	Leverage on the brand to set up schools in India
Jul-08	A-Plus Education Solutions Pvt Ltd.	76%	2.2	Focus on assessment and testing, imparting training and providing placements	Leverage on existing students base and infrastructure to provide training and placement services
Sep-08	Eurokids	50%	7.8	Chain of preschools with over 400 branches	Together with Eurokids, Educomp is one of the largest chain of pre-schools in India
Oct-08	Takshila Management Services Pvt Ltd.	51%	NA	Focus on setting up high quality schools in Tier II & Tier III cities	Plans to set further 25 schools over next 2 years

Source: Company data, Morgan Stanley Research

MORGAN STANLEY ModelWare	**Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations.** For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

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Underweight/Sell	**485**	**21%**	**87**	**14%**	**18%**
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Company (Ticker)	Rating (as of)	Price (07/06/2009)
Vipin Khare		
Educomp Solutions Ltd. (EDSO.BO)	E (07/07/2009)	Rs3,912.5

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