

Educomp Solutions Ltd-----Maintain OUTPERFORM
Dec-08 results: in-line results, increased disclosures
EPS: ▼ TP: ◀▶

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- Educomp reported broadly in-line 3Q FY3/09 results. Revenues grew 103% YoY, 3% below estimates, while EBITDA and net margins came in line with our estimates.
- Smart_Class grew sharply by 150% YoY. The company has added 54% of our full-year school target in 9M FY3/09 compared with 54% that it had achieved during the same period last year. Management spoke about a large pipeline that is expected to be closed by March 2009 quarter.
- While the ICT segment added 1,055 schools in the quarter, we should expect an announcement from the company in view of the expected large Gujarat government order.
- During the quarter, Educomp increased its disclosures in investor communication, giving quarterly balance sheet and subsidiary financials among other items. This step could be seen positively by the market, in our view.
- We maintain our OUTPERFORM rating and a target price of Rs2,700 on the stock. We lower our FY3/09 EPS estimate by 5% as we incorporate 3Q's forex losses into our numbers.

exceptionally strong in school additions and there could have been some shift from 3Q to 2Q. School additions in 9M FY3/09 as a percentage of full-year target at 54% is at the same level as last year. An interesting trend in Smart_Class is the increasing number of outright buys – 13% of schools added in the last two quarters have been on outright purchase. This has positive implications for capex requirement for the company.

The company added 1,055 ICT schools during the quarter, and management hinted at an expected large contract win. We believe this is in reference to the 20,000 school Gujarat state contract expected to be finalised by early February 2009.

Increased disclosures could be seen positively

In the investor release for the quarter, Educomp increased its disclosures by including, for the first time, the consolidated quarterly balance sheet, subsidiary P&Ls, details of bank deposits, and names of Smart_Class schools, among others. Further steps outlined by the management, if implemented, could increase investor comfort. These include the appointment of reputed auditors and certifications from authorities confirming non-pledging of shares. We believe that the speedy implementation of these measures could be seen positively by the market.

Investment conclusion

We believe that, in the Indian context, educational spending is fairly insulated from economic cycles. Educomp with its end-to-end offering in the attractive K-12 segment is best positioned to tap the opportunity that the education sector provides. Over the short term, we expect announcements of large ICT contracts and March 2009 Smart_Class additions to be positive triggers for the stock.

We retain our OUTPERFORM rating with a target price of Rs2,700. We lower our FY3/09 EPS estimate by 5% as we incorporate 3Q09's forex losses.

Bbg/RIC	EDSL IN / EDSO.BO		Price (27 Jan 09, Rs)		1,747.35
Rating (prev. rating)	O (O) [V]	TP (Rs) (prev. TP)	2,700 (2,700)		
Shares outstanding (mn)	16.93	Est. pot. % chg. to TP	55		
Daily trad vol-6m avg (mn)	0.3	52-wk range (Rs)	4362.60 - 1534.90		
Daily trad val-6m avg (US\$ mn)	0.5	Mkt cap (Rs/US\$ mn)	29,584.9/ 609.7		
Free float (%)	43.8	Performance		1M	3M
Major shareholders		Absolute	(27.5)	(1.8)	(57.9)
		Relative	(22.0)	(1.5)	(10.9)
Year	3/07A	3/08A	3/09E	3/10E	3/11E
Revenues (Rs mn)	1,101	2,861	6,485	12,412	17,471
EBITDA (Rs mn)	506	1,266	3,027	7,045	10,994
Net profit (Rs mn)	287	706	1,245	2,755	4,230
EPS (Rs)	18	42	74	163	250
- Change from prev. EPS (%)	n.a.	n.a.	-5	0	0
- Consensus EPS (Rs)	n.a.	n.a.	77	129	204
EPS growth (%)	61.0	132.2	76.3	121.2	53.5
P/E (x)	97.2	41.9	23.8	10.7	7.0
Dividend yield (%)	0.1	0.2	0.6	1.4	2.1
EV/EBITDA (x)	58.8	24.1	12.1	5.9	4.0
P/B (x)	24.3	10.3	7.5	4.7	3.0
ROE (%)	28.1	35.0	36.5	53.9	52.3
Net debt/equity (%)	13	30	178	185	143

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

In-line results

Educomp reported broadly in-line 3Q FY/09 results. Revenues grew 103% YoY to Rs1,453 mn, 3% below our estimated numbers. EBITDA margins came in line with our estimates at 46%. As expected, EBITDA margins were affected by forex translation losses (-Rs100 mn taken above EBITDA line) and hardware sales in ICT. Lower depreciation, offset by higher finance costs, resulted in the reduction of profits by 3% below estimates. Net margins were in line at 22%.

Strong revenue growth in Smart_Class

Smart_Class segment showed a 150% YoY revenue growth to touch Rs876 mn during this quarter. School additions, at 212 (up 40% QoQ), were a bit weak during the quarter, but we note that 2Q was

Figure 1: Educomp Dec-08 results

(Rs mn)	Dec-07	Sep-08	Dec-08	YoY (%)	QoQ (%)	CS Est.	diff (%)
Revenues	715	981	1,453	103	48.1	1,503	-3.3
EBITDA	334	507	668	100	31.8	689	-3.1
EBITDA margin	46.7%	51.7%	46.0%			45.9%	
EBIT	243	350	476	96.2	36.0	461	3.3
EBIT margin	33.9%	35.7%	32.8%			30.7%	
PAT	190	254	315	65.7	24.0	325	-3.2

Source: Company data, Credit Suisse estimates

Figure 2: Segment-wise results

Segment revenues (Rs mn)	Dec-07	Sep-08	Dec-08	YoY (%)	QoQ (%)
Smart_Class	347	686	876	152	27.7
ICT	239	121	375	57	209.9
Teacher training	66	67	86	31	28.4
Retail and others	64	108	116	82	7.4
Segment PBIT (%)					
Smart_Class	55.4	59.5	59.1		
ICT	28.4	34.7	22.9		
Teacher training	63.6	65.7	60.5		
Retail and others	60.8	70.4	35.3		

Source: Company data, Credit Suisse estimates.

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Companies Mentioned (Price as of 26 Jan 09)

Educomp Solutions Ltd (EDSO.BO, Rs1747.35, OUTPERFORM [V], TP Rs2700.00)

Disclosure Appendix

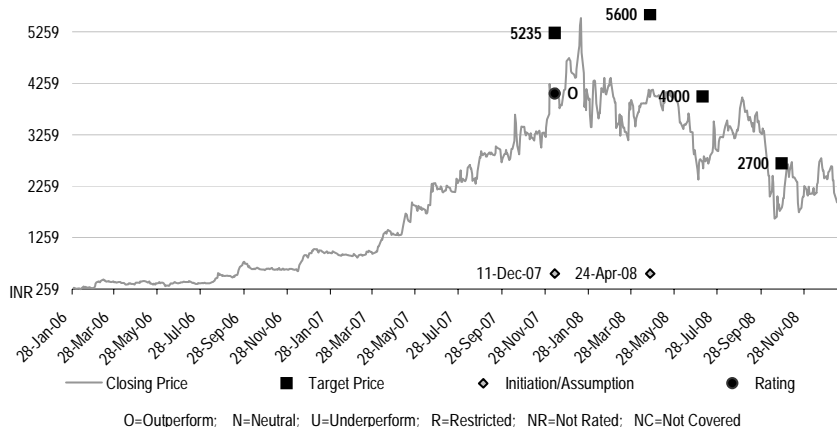
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3-Year Price, Target Price and Rating Change History Chart for EDSO.BO

EDSO.BO Date	Closing Price (INR)	Target Price (INR)	Rating	Initiation/Assumption
11-Dec-07	4,054.1	5235	O	X
24-Apr-08	4,005.3	5600		X
07-Jul-08	2,717.5	4000		
27-Oct-08	1,846.35	2700		



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Price Target: (12 months) for (EDSO.BO)

Method: We value Educomp on a discounted cash flow (DCF) model. We assume strong near-term growth rates, 12.5% medium-term growth and 3% terminal growth, 14% weighted average cost of capital (WACC). This gives a target price of Rs2700.

Risks: The key risks to our target price of Rs2700 for Educomp are: 1) execution risks as the company is in early growth stage in its business lines, and is also launching new businesses like K-12 schools 2) change in regulation thereby impacting the business model

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