

Consumer & Retail
 IT Services
 Equity – India

Overweight (V)

Target price (INR)	625.00
Share price (INR)	436.45
Potential return (%)	43.2

Performance	1M	3M	12M
Absolute (%)	-12.5	-22.1	-32.8
Relative [^] (%)	-5.2	-9.5	-38.8

Index[^] BOMBAY SE IDX

RIC EDSO.BO
 Bloomberg EDSL IN

Market cap (USDm) 913
 Market cap (INRm) 41,693

Enterprise value (INRm) 51011
 Free float (%)

Note: (V) = volatile (please see disclosure appendix)

14 February 2011

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Educomp Solutions (EDSL)

OW(V): 3Q revs & profits inline with full-year guidance

- ▶ **3Q revenues and profits inline with full-year guidance**
- ▶ **Lower TP to INR625 from INR740 (led by both multiple and estimate cuts)**
- ▶ **Reiterate OW(V) as long-term prospects remain positive and we expect strong recovery in FY13**

3Q consolidated revenues/profits inline with guidance: Educomp reported revenues of INR3.6bn, up 37% y-o-y, and net profit of INR967m, up 58% y-o-y, and is well in on track to achieve full-year guidance (revenues of INR13-13.5bn and net profits of INR3.3-3.35bn).

K-12 disclosures improved: Educomp has started providing further granular data on its K-12 division. By end-December 2010, 50 schools were operational, with 30 green-field Educomp schools, 9 on dry management and 11 Euro-schools. Of the 30 green-field schools, 13 have still not completed one year of existence and therefore are reporting negative EBITDA. We expect the number of operational schools to increase to 71 by the end of FY12.

SmartClass reported revenue growth of 52% y-o-y, yielding revenues of INR2.5bn.

However, we assume nearly one-third of reported revenues are deferred revenues. The company added 7,085 classes across 949 schools in 3Q (7.5 classes per school, lower than our modelled 8) and is well on track to achieve its guidance of full-year addition of 25,000-30,000 classrooms. In the first 9MFY11, the company has added 19,144 classes and we expect further addition of nearly 8,000 classes in 4QFY11. The company has contracted with its second vendor to provide maintenance services for its SmartClass installation base and is scheduled to launch its 3D content on 1 April 2011.

Estimate revision: We have cut our FY12/13 revenue estimates by 10% and 14% respectively, EBIT forecasts by 20% for both the years and EPS forecasts by 29% and 28%. Key factors influencing this downward revision are 1) increase in tax in FY12 than earlier guided by the company, 2) lower EBITDA margin in the year 0/1 for K-12 schools than we modelled earlier, 3) investments in R&D and 4) cut down in ICT (government school) business.

Valuation: While FY12 is expected to see a muted growth due to base effect, we expect strong 20% revenue growth from FY13. We continue to remain positive on Educomp in the long-term and see it as the best proxy to play the Indian education sector and favourable demographics. We roll-over our valuation year to FY13 and now value the stock at 15x FY13e EPS at INR625 (from INR740 earlier). The stock is currently trading at 15x FY12e EPS and we believe it will continue to trade at these valuations.

Financials & valuation

Financial statements

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Profit & loss summary (INRm)				
Revenue	10,405	12,790	13,376	16,005
EBITDA	4,859	5,226	5,478	7,331
Depreciation & amortisation	-1,138	-1,023	-1,070	-1,120
Operating profit/EBIT	3,721	4,203	4,408	6,210
Net interest	489	687	400	320
PBT	4,399	3,790	4,274	6,206
HSBC PBT	4,399	3,790	4,274	6,206
Taxation	-1,625	-379	-1,325	-1,986
Net profit	2,713	3,337	2,885	4,128
HSBC net profit	2,713	3,337	2,885	4,128

Cash flow summary (INRm)

Cash flow from operations	2,196	1,140	4,124	4,475
Capex	-6,855	-5,342	-1,829	-1,619
Cash flow from investment	-3,722	-8,568	-1,829	-1,619
Dividends	-166	-143	-191	-215
Change in net debt	-2,916	6,578	-2,020	-2,529
FCF equity	-3,133	192	2,724	4,046

Balance sheet summary (INRm)

Intangible fixed assets	6,031	8,198	8,198	8,198
Tangible fixed assets	10,656	14,975	15,734	16,233
Current assets	15,816	14,813	12,342	14,034
Cash & others	7,887	4,451	1,915	2,525
Total assets	28,894	36,363	34,539	36,596
Operating liabilities	3,963	3,035	3,148	3,281
Gross debt	12,393	16,594	12,038	10,120
Net debt	4,152	10,731	8,711	6,182
Shareholders funds	16,475	19,769	22,501	26,476
Invested capital	18,622	25,922	26,634	28,080

Ratio, growth and per share analysis

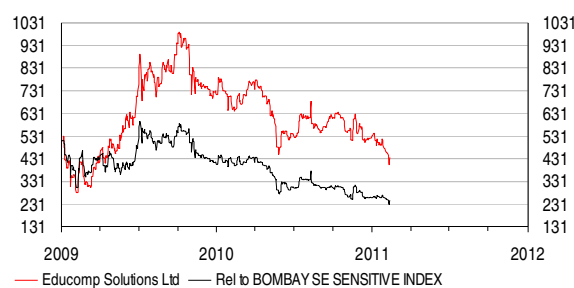
Year to	03/2010a	03/2011e	03/2012e	03/2013e
Y-o-y % change				
Revenue	63.3	22.9	4.6	19.7
EBITDA	60.3	7.6	4.8	33.8
Operating profit	67.8	13.0	4.9	40.9
PBT	102.1	-13.8	12.8	45.2
HSBC EPS	82.0	23.5	-13.5	43.1
Ratios (%)				
Revenue/IC (x)	0.7	0.6	0.5	0.6
ROIC	16.3	17.0	11.6	15.4
ROE	26.2	18.4	13.7	16.9
ROA	12.8	10.5	8.3	11.9
EBITDA margin	46.7	40.9	41.0	45.8
Operating profit margin	35.8	32.9	33.0	38.8
EBITDA/net interest (x)				
Net debt/equity	25.2	54.3	38.7	23.3
Net debt/EBITDA (x)	0.9	2.1	1.6	0.8
CF from operations/net debt	52.9	10.6	47.3	72.4
Per share data (INR)				
EPS reported (fully diluted)	27.32	33.74	29.17	41.74
HSBC EPS (fully diluted)	27.32	33.74	29.17	41.74
DPS	1.75	1.50	2.00	2.25
Book value	173.56	207.14	235.76	277.41

Valuation data

Year to	03/2010a	03/2011e	03/2012e	03/2013e
EV/sales	4.4	4.0	3.7	2.9
EV/EBITDA	9.4	9.8	8.9	6.3
EV/IC	2.4	2.0	1.8	1.7
PE*	16.0	12.9	15.0	10.5
P/Book value	2.5	2.1	1.9	1.6
FCF yield (%)	-7.6	0.5	6.8	10.0
Dividend yield (%)	0.4	0.3	0.5	0.5

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 11 Feb 2011

3QFY11 results highlights

Educomp segmental breakup

INRM	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11
Segment Revenues (Consolidated)											
School Learning Solutions	552	807	1,279	1,665	1,385	2,004	1,987	2,690	1,591	1,923	2,794
Higher Learning Solutions	60	69	89	87	68	61	78	78	90	137	146
K-12 Schools	46	142	198	237	222	209	251	302	305	321	304
Online supplemental & Global	202	303	329	275	263	261	285	262	293	387	331
Total	860	1,321	1,896	2,265	1,938	2,535	2,601	3,331	2,279	2,768	3,575
Proportion											
School Learning Solutions	64.2%	61.0%	67.5%	73.5%	71.5%	79.0%	76.4%	80.8%	69.8%	69.5%	78.2%
Higher Learning Solutions	7.0%	5.2%	4.7%	3.9%	3.5%	2.4%	3.0%	2.3%	3.9%	4.9%	4.1%
K-12 Schools	5.3%	10.8%	10.4%	10.5%	11.4%	8.2%	9.6%	9.1%	13.4%	11.6%	8.5%
Online supplemental & Global	23.5%	22.9%	17.4%	12.1%	13.6%	10.3%	11.0%	7.9%	12.9%	14.0%	9.3%
q-o-q											
School Learning Solutions	0.0%	46.1%	58.5%	30.2%	-16.8%	44.7%	-0.9%	35.4%	-40.8%	20.9%	45.3%
Higher Learning Solutions	0.0%	14.8%	29.5%	-2.5%	-22.3%	-9.6%	27.4%	-0.4%	15.7%	52.2%	6.6%
K-12 Schools	0.0%	213.0%	38.9%	20.0%	-6.5%	-5.9%	20.0%	20.4%	1.1%	5.3%	-5.4%
Online supplemental & Global	0.0%	50.0%	8.6%	-16.7%	-4.1%	-0.9%	9.3%	-8.3%	12.0%	31.9%	-14.4%
y-o-y											
School Learning Solutions	0.0%	0.0%	0.0%	0.0%	150.8%	148.4%	55.3%	61.5%	14.9%	-4.0%	40.6%
Higher Learning Solutions	0.0%	0.0%	0.0%	0.0%	12.6%	-11.3%	-12.7%	-10.9%	32.7%	123.4%	86.9%
K-12 Schools	0.0%	0.0%	0.0%	0.0%	387.7%	46.6%	26.7%	27.1%	37.4%	53.9%	21.3%
Online supplemental & Global	0.0%	0.0%	0.0%	0.0%	30.3%	-13.9%	-13.4%	-4.7%	11.2%	48.1%	16.0%
Segment EBIT profits (Consolidated)											
School Learning Solutions	318.1	445.8	613.6	723.3	612.2	1,028.6	1,216.3	1,625.9	660.0	888.1	1,709.0
Higher Learning Solutions	31.1	31.5	19.1	12.7	(7.0)	(19.8)	(41.1)	(38.9)	(44.0)	(64.9)	(60.0)
K-12 Schools	8.7	109.8	89.7	97.7	86.4	52.7	103.1	88.4	117.0	128.9	107.0
Online supplemental & Global	60.8	74.7	36.9	6.6	(10.3)	(69.2)	(47.1)	(39.8)	(63.0)	30.7	(44.0)
Total	418.7	661.8	759.3	840.3	681.3	992.3	1,231.2	1,635.6	670.0	982.8	1,712.0
EBIT margin											
School Learning Solutions	57.6%	55.3%	48.0%	43.4%	44.2%	51.3%	61.2%	60.5%	41.5%	46.2%	61.2%
Higher Learning Solutions	51.7%	45.6%	21.3%	14.6%	-10.3%	-32.3%	-52.6%	-50.0%	-48.9%	-47.4%	-41.1%
K-12 Schools	19.1%	77.1%	45.4%	41.2%	39.0%	25.2%	41.1%	29.3%	38.4%	40.1%	35.2%
Online supplemental & Global	30.1%	24.6%	11.2%	2.4%	-3.9%	-26.5%	-16.5%	-15.2%	-21.5%	8.0%	-13.3%

Source: Company, HSBC

Valuation: While FY12 is expected to see a muted growth due to base effect, we expect strong 20% revenue growth from FY13. We continue to remain positive on Educomp in the long-term and see it as the best proxy to play the Indian education sector and favourable demographics.

We value the company on P/E basis. We roll-over our valuation year to FY13 and now value the stock at 15x FY13e EPS at INR625 (from INR740 earlier). We have cut down our target multiple from 17x to 15x to factor in a slower recovery in earnings growth and the near-term uncertainty around pick-up in the K-12 business and long-term sustenance of the SmartClass business.

Risks: Execution risks in the K-12 business, increased competition in the SmartClass business, and requirement of higher capital to grow K-12 business.

Educomp Financial Statements

Educomp (INRm) Yr end 31 March	FY07	FY08	FY09	FY10	FY11E	FY12E	FY13E
Net Sales/Income from operations	1,101	2,861	6,371	10,405	12,790	13,376	16,005
COGS	430	1,286	2,265	3,413	5,006	5,223	5,473
EBIT	411	934	2,217	3,721	4,203	4,408	6,210
Net profit	285	706	1,403	2,773	3,411	2,949	4,220
Net profit after minority interest	288	698	1,329	2,713	3,337	2,885	4,128
EPS diluted (INR)	3.2	7.1	15.0	27.3	33.7	29.2	41.7
EBIT margin	37.3%	32.7%	34.8%	35.8%	32.9%	33.0%	38.8%
Net margin	26.1%	24.4%	20.9%	26.1%	26.1%	21.6%	25.8%
y-o-y							
Revenues	98.3%	159.9%	122.7%	63.3%	22.9%	4.6%	19.7%
EPS diluted (INR)	38.5%	122.2%	112.0%	82.0%	23.5%	-13.5%	43.1%
Balance Sheet	FY07	FY08	FY09	FY10	FY11E	FY12E	FY13E
Share Capital	160	172	173	190	191	191	191
ESOP outstanding account	-	83	145	147	124	124	124
Reserves Total	988	2,629	3,886	16,138	19,454	22,186	26,161
Total Shareholders Funds	1,148	2,884	4,203	16,475	19,769	22,501	26,476
Minority Interest	128	194	804	1,915	1,981	2,038	2,120
Secured Loans	184	622	4,689	6,928	14,613	5,000	4,000
Unsecured Loans	1,072	3,151	4,206	3,550	-	5,000	4,000
Total Debt	1,384	3,967	9,699	12,393	16,594	12,038	10,120
Deferred tax liability (net)	59	210	439	26	97	97	97
Total Liabilities	2,591	7,061	14,342	28,894	36,363	34,539	36,596
APPLICATION OF FUNDS :							
Goodwill	137	280	1,225	6,031	8,198	8,198	8,198
Fixed assets	831	2,714	8,126	10,656	14,975	15,734	16,233
Forex Translation difference	-	-	346	-	(19)	(19)	(19)
Investments	102	36	729	354	1,413	1,413	1,413
Inventories	33	18	316	368	353	353	353
Sundry Debtors	496	1,157	2,765	5,530	5,431	5,497	6,577
Cash and Bank	1,106	2,912	1,902	7,887	4,451	1,915	2,525
Loans and Advances	110	490	1,138	1,810	4,405	4,405	4,405
Other current assets	16	62	32	221	173	173	173
Total Current Assets	1,761	4,639	6,153	15,816	14,813	12,342	14,034
Current Liabilities	185	517	1,995	2,290	2,649	2,762	2,895
Provisions	57	92	256	1,673	386	386	386
Total Current Liabilities	242	610	2,251	3,963	3,035	3,148	3,281
Net Current Assets	1,519	4,029	3,903	11,853	11,777	9,194	10,752
Total Assets	2,590	7,061	14,342	28,894	36,363	34,539	36,596
Cash Flow, Indian GAAP, INR'm	FY07	FY08	FY09	FY10	FY11E	FY12E	FY13E
Cash flows from operating activities							
PBT and after prior period items as per P&L	454	1,072	2,108	4,392	3,856	4,332	6,288
Depreciation	96	331	814	1,142	1,023	1,070	1,120
Operating profit before WC changes	564	1,419	3,721	5,044	4,880	5,402	7,408
Trade & other receivables	(243)	(657)	(1,603)	(1,680)	(2,433)	(66)	(1,081)
Trade & Other Payables	108	338	1,491	277	(927)	113	133
Cash generated from operations	339	689	2,698	3,134	1,519	5,449	6,461
Taxes Paid	(174)	(184)	(329)	(909)	(379)	(1,325)	(1,986)
Net cash from operating activities	165	505	2,357	2,196	1,140	4,124	4,475
Cash flows from investing activities							
Purchase of fixed assets	(675)	(2,224)	(6,249)	(6,855)	(5,342)	(1,829)	(1,619)
Net cash used in investing activities	(719)	(2,102)	(7,215)	(3,722)	(8,568)	(1,829)	(1,619)
Cash flows from financing activities							
Proceeds from long-term borrowings	71	334	4,000	1,854	4,135	(4,613)	(2,000)
Payment of dividend	(27)	(40)	(58)	(166)	(163)	(218)	(245)
Interest on borrowings	(14)	(48)	(268)	(411)	-	-	-
Net cash from financing activities	1,088	3,393	3,846	7,462	3,973	(4,831)	(2,245)
Net increase in cash and cash equivalents	533	1,796	(1,011)	5,936	(3,455)	(2,536)	611
Closing cash and cash equivalents	1,105	2,911	1,902	7,887	4,451	1,915	2,525

Source: Company, HSBC estimates

Disclosure appendix

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*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However,

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Rating distribution for long-term investment opportunities

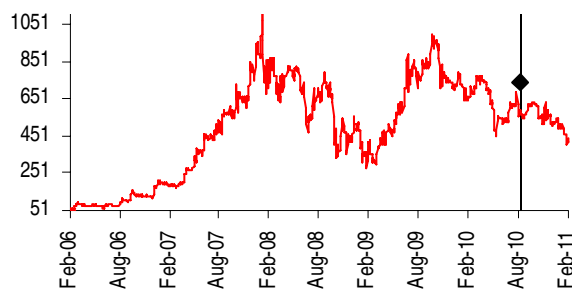
As of 13 February 2011, the distribution of all ratings published is as follows:

Overweight (Buy)	49%	(23% of these provided with Investment Banking Services)
Neutral (Hold)	36%	(20% of these provided with Investment Banking Services)
Underweight (Sell)	15%	(21% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Educomp Solutions Ltd (EDSO.BO) Share Price performance INR Vs HSBC

rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Overweight (V)	20 August 2010
Target Price	Value	Date
Price 1	740.00	20 August 2010

Source: HSBC

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None of the below disclosures applies to any of the stocks featured in this report.

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- 2 All market data included in this report are dated as at close 11 February 2011, unless otherwise indicated in the report.
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