

Technology

Target price Rs675

Earnings revision

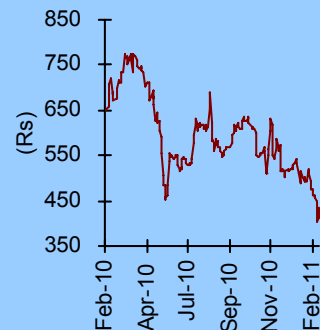
(%)	FY11E	FY12E	FY13E
Sales	↓ 1.2	↓ 0.3	↑ 0.3
EBITDA	↓ 1.2	↑ 0.8	↑ 0.6
EPS	↓ 0.8	↓ 1.5	↓ 0.5

Shareholding pattern

	Jun '10	Sep '10	Dec '10
Promoters	49.8	49.8	49.8
Institutional investors	38.5	40.0	38.6
MFs and UTI	1.6	1.5	1.5
Insurance Cos.	0.0	0.0	0.0
FII	36.9	38.5	37.1
Others	11.7	10.2	11.6

Source: www.nseindia.com

Price chart



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INDIA

Educomp Solutions

BUY

Maintained

Rs436

Smart pace

Reason for report: Q3FY11 results review and earnings revision

Educomp Solutions (Educomp) continued strong momentum in *SmartClass* with addition of 7,085 classrooms during Q3FY11 taking the total number of classrooms added in 9MFY11 to 19,144. The company has already achieved 64% of the higher-end of guidance of 25,000-30,000 classroom additions in 9MFY11 and is on track to achieve the full year guidance, which would imply 50-80% growth in classroom additions with stable pricing. Hence, we believe that the management's FY11 revenue guidance of Rs13-13.5bn and the PAT guidance of Rs3.3-3.35bn are likely to be exceeded. The management announced introduction of another independent third-party vendor for the implementation of *SmartClass*, besides Edusmart, from FY12 with the same condition of 20% recourse to the bank. This should likely increase the credibility of securitisation model and address investors concern on the same. We believe that Educomp's strategy of utilising the *SmartClass* cashflow / profitability to fund K-12 growth and other businesses and increase its presence across the education value chain would bear fruit in the long term. **Maintain BUY.**

- ▶ **Maintain estimates and target price of Rs675** (based on P/E of 16x average of FY12-13E). We believe presence in 100,000+ *SmartClass* classrooms, 10,000+ ICT government schools and visibility of 100+ K-12 schools by FY12E would be a unique early mover advantage and key differentiator for Educomp. Valuations at FY12E P/E of 12.5x and EV/E of 8.3x are attractive given the revenues, EBITDA and EPS CAGR of 25%, 21% and 22% respectively over FY10-13E.
- ▶ ***SmartClass* growth momentum intact** with implementation in 949 schools backed by successful TV advertising campaign and a large sales team of 350, taking the tally to 5,534 schools. Average pricing per classroom got marginally reduced to Rs3.82lacs versus Rs3.9lacs in Q1FY11.
- ▶ **Introduction of 3D content.** Educomp announced the introduction of 3D interactive multimedia content from FY12. While the business economics of the same is yet to be disclosed, the company has a ready target market with presence in more than 5,534 schools, ~65,000 classrooms and 3.9mn students.
- ▶ **Further capital infusion of ~Rs2bn in K-12 schools** raising Educomp's stake to 80.4% from 78.5%. The company has spent ~Rs15bn (including ~Rs6bn in 9MFY11) as capex on K-12 schools till date and is seeking shareholders' approval to increase the investment limit to Rs25bn from Rs15bn. Other newer businesses are expected to remain in investment mode for the next 12-18 months.
- ▶ **Q3FY11 results in line** with consolidated revenues increasing 37% YoY to Rs3.58bn with EBITDA margin of 46% and PAT growth of 58% YoY to Rs967mn (I-Sec: Rs968mn). Educomp now has 50 operational K-12 schools (46 schools in Q2FY11) with visibility of 81 schools. Three school franchisee contracts under Euroschools JV got terminated during the quarter. ICT contracts with government of Gujarat (2,819 schools) and Chhattisgarh (445 schools) expired during the contracts.

Market Cap	Rs41.7bn/US\$0.9bn
Reuters/Bloomberg	EDSO.BO/EDSL IN
Shares Outstanding (mn)	95.5
52-week Range (Rs)	791/386
Free Float (%)	50.2
FII (%)	37.1
Daily Volume (US\$'000)	15,490
Absolute Return 3m (%)	(14.8)
Absolute Return 12m (%)	(32.8)
Sensex Return 3m (%)	(12.1)
Sensex Return 12m (%)	9.8

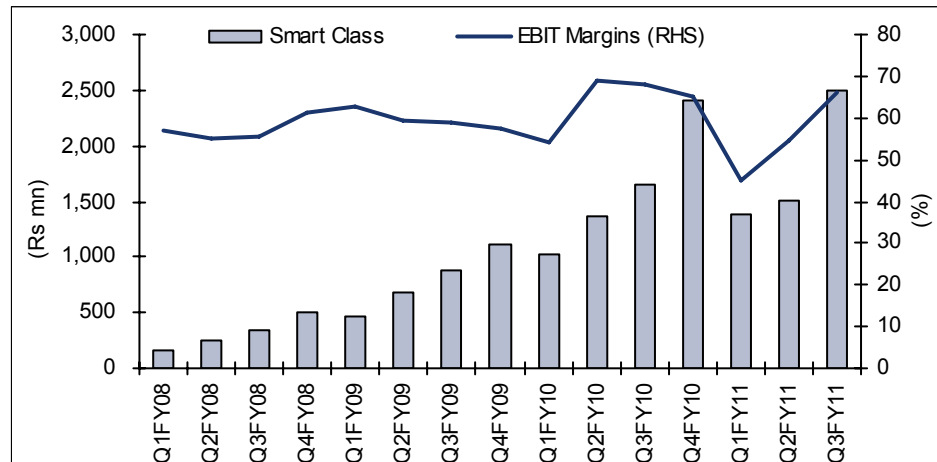
Year to March	FY10	FY11E	FY12E	FY13E
Revenue (Rs mn)	10,404	13,696	16,384	20,469
Net Income (Rs mn)	2,758	3,430	3,512	4,950
EPS (Rs)	27.3	34.0	34.8	49.0
% Chg YoY	90.7	24.3	2.4	40.9
P/E (x)	16.0	12.8	12.5	8.9
CEPS (Rs)	38.6	42.1	43.7	58.8
EV/E (x)	9.9	9.2	8.3	6.5
Dividend Yield (%)	0.6	0.6	0.6	0.6
RoCE (%)	11.1	11.5	9.5	11.5
RoE (%)	27.1	18.1	15.3	18.4

Please refer to important disclosures at the end of this report

Table 1: Q3FY11 results review (consolidated)*(Rs mn, year ending March 31)*

	Q3FY11	Q2FY11	Q3FY10	% chg (QoQ)	% chg (YoY)	I-Sec estimates	% Variance
Total revenues	3,575	2,768	2,601	29.2	37.5	3,814	(6.3)
(a) Consumption of raw material	802	412	211	94.7	279.1	850	(5.7)
(b) Increase/decrease in stock in trade	(103)	183	37	(156.5)	(380.9)		
(c) Staff cost	651	632	468	2.9	39.0	687	(5.3)
(d) Forex loss	(19)	(21)	28	(13.0)	(166.6)	24	(177.2)
(e) Admin & other exp	595	504	522	18.1	13.8	645	(7.9)
Total operating expenses	1,925	1,709	1,266	12.7	52.0	2,206	(12.8)
EBIDTA	1,650	1,059	1,334	55.8	23.7	1,608	2.6
Depreciation	201	208	338	(3.4)	(40.5)	218	(8.0)
EBIT	1,449	851	997	70.3	45.4	1,390	4.3
Interest	279	212	139	31.6	100.9	225	24.2
OPBT	1,171	639	858	83.1	36.4	1,165	0.5
Other income	87	84	158	3.5	(45.3)	92	(5.9)
PBT	1,257	723	1,016	73.9	23.7	1,257	(0.0)
Less: Tax provision	253	141	375	79.8	(32.5)	289	(12.4)
Net income	1,004	582	641	72.4	56.5	968	3.7
Less: Minority Int./pre-acquisition loss	32	(2)	29		8.2		
Less: Share of loss in associates	5	6	-	(16.2)			
Net profit after minority interest	967	578	612	67.3	58.0	968	(0.1)
Ratios (%)							
EBITDA margin	46.2	38.3	51.3			42.2	
EBIT margin	40.5	30.8	38.3			36.4	
OPBT margin	32.7	23.1	33.0			30.5	
PBT margin	35.2	26.1	39.1			33.0	
Net margin	27.1	20.9	23.5			25.4	
Effective tax rate	20.1	19.5	36.9			23.0	

Source: Company data, I-Sec Research

Chart 1: SmartClass – Revenues and margins

Source: Company data, I-Sec Research

Table 2: Strong performance in SmartClass*(No's)*

	Mar-10	Jun-10	Sep-10	Dec-10
No. of classroom implemented	4,038	6,750	5,309	7,085
No. of schools	503	844	664	949
No. of classroom per schools	8.0	8.0	8.0	7.5
Average fee per classroom	392,000	390,690	404,819	381,910
Total no. of students (mn)	3.1	3.4	3.6	3.9

Source: Company data

SmartClass was implemented in 7,085 classrooms across 949 schools during Q3FY11

Table 3: SmartClass assumptions based on new model

(Rs mn)

Smart Class	FY10	FY11E	FY12E	FY13E
No. of schools (at the end) – Educomp	3,294	6,886	12,505	19,529
Total no. of addressable private school – assumed	75,000	77,250	79,568	81,955
as a % of addressable private school	4.4	8.9	15.7	23.8
Total no. of schools added / renewed	1,577	3,683	5,618	7,025
Total no. of addressable classrooms – Industry (in mn) - 75,000 private schools with avg of 15 classrooms per school (assumed)	1.13	1.16	1.19	1.23
Total no. of classrooms (at the end) – Educomp	42,648	70,274	1,12,411	1,61,583
as a % of addressable classrooms	3.8	6.1	9.4	13.1
No. of classrooms – SmartClass implementations	16,600	27,182	38,866	47,584
YoY growth (%)		66	53	17
Average realisation per classroom (Rs)	2,05,800	1,99,371	1,93,390	1,87,589
Average fee per student per month (Rs)	145	141	136	132
Revenue in Q1FY10 and Q2FY10 excluding upfront	1,870			
Revenue from schools signed that year – Edusmart model	1,605	5,508	8,149	9,224
Revenue from schools signed previous year – Edusmart model		688	2,360	3,492
Revenue from erstwhile BOOT model securitised now	2,970	2,939		
Revenues (Rs mn)	6,446	9,135	10,509	12,716
YoY growth (%)	105	42	15	21
EBIT	4,180	5,481	5,791	7,167
YoY growth (%)	125	31	6	24
EBIT margin (%)	65	60	55	56

Source: Company data, I-Sec Research

Deferred content revenues arising from transfer of BOOT contracts to Edusmart would bloat revenues / earnings in FY10 and FY11, resulting in likely reported lower growth in SmartClass revenues in FY12.

FY12 SmartClass guidance holds the key. Deferred content revenues arising from transfer of BOOT contracts to Edusmart would bloat FY10-11 revenues/earnings, resulting in likely reported lower growth in SmartClass revenues in FY12. Around Rs3bn of such deferred content revenues are likely to be booked in FY11. Rs980mn of such revenues got booked in Q3FY11 and Rs1.54bn would be booked in Q4FY11.

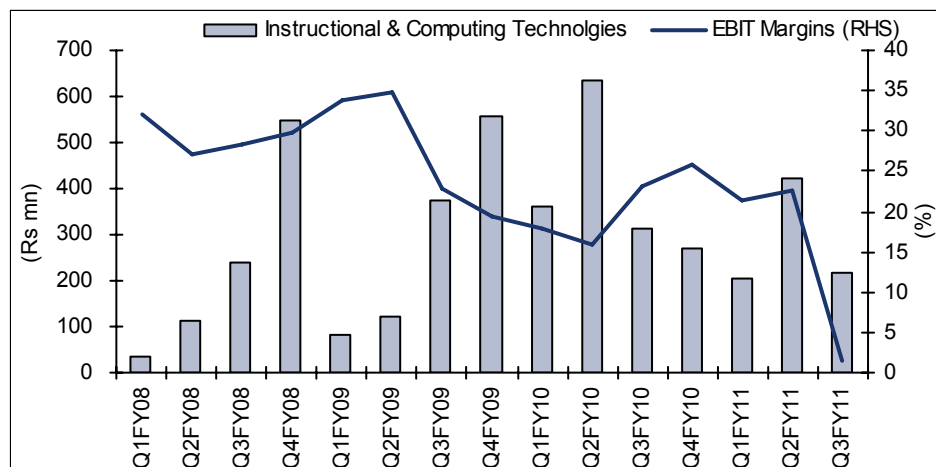
Table 4: Financials – Like-to-like comparison

(Rs mn)

	Q3FY11*	Q3FY10*	YoY (%)	Q3FY11#	Q3FY10#	YoY (%)
	Reported	Reported		Reconciled	Reconciled	
Consolidated revenues	3,575	2,601	37	3,486	2,503	39
Standalone Revenues	2,764	2,039	36	2,675	1,940	38
Subsidiaries Revenue	811	562	44	811	562	44
Consolidated Profit Before Tax	1,257	1,016	24	1,431	1,016	41
Consolidated Profit after Tax	967	612	58	819	612	34

* Revenues reported under securitization led sale model including deferred content revenue arising from transfer of BOOT contracts to EduSmart starting from Q2 of FY 2010 # Depicts that numbers are restated now on earlier BOOT model to effect the right comparison, assuming as if model change has not happened
Source: Company data

Chart 2: Instructional & Computing Technologies (ICT) – Revenues and margins



Source: Company data, I-Sec Research

Total number of schools went down to 10,550 in Q3FY11 due to the expiry of contracts in Gujarat (2,819 schools) and Chhattisgarh (445 schools)

Table 5: ICT – School additions

(No's)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10
School additions	363	600	-	-	-
Cumulative no. of schools	14,826	15,426	15,426	13,814	10,550

Source: Company data

Table 6: ICT – Losing significance

(Rs mn)

	FY10	FY11E	FY12E	FY13E
No. of school (at the end)	15,426	10,500	15,000	19,000
No. of school (avg) assumed	15,243	12,963	12,750	17,000
Revenue per school per month	8,663	6,930	7,277	7,277
Revenues (Rs mn)	1,583	1,078	1,113	1,484
YoY growth (%)	39	(32)	3	33
EBIT (Rs mn)	309	237	234	297
YoY growth (%)	17	(23)	(1)	27
EBIT margin (%)	20	22	21	20

Source: Company data, I-Sec Research

Table 7: Perpetuity in growth provided by K-12 initiative

(Rs mn)

K-12 school set up	FY10	FY11E	FY12E	FY13E
No. of K-12 school (EOP)	35	55	75	100
No. of K-12 school (avg)	23	43	65	86
Students per K-12 school at full capacity	2,100	2,100	2,100	2,100
Capacity utilisation	0.4	0.33	0.36	0.4
No. of students	18900	29799	48457.5	79002
Recurring fee per students	2,500	2,500	2,500	2,500
Total recurring fee	567	894	1,454	2,370
One-time admission fee per student	35,000	30,000	30,000	30,000
New additions / admissions	4,935	10,899	18,659	30,545
Total admission fee	173	327	560	916
Total collection by school	740	1,221	2,013	3,286
YoY growth	5	65	65	63
Revenue models for Edu Infra and Edu Manage				
Revenues (net fees after meeting costs)	555	855	1,409	2,300
as a % of gross collections	75	70	70	70
EBIT	325	537	886	1,446
EBIT margin (%)	59	63	63	63
as a % of gross collections	44	44	44	44
PAT	170	281	463	756
YoY growth (%)	(3)	65	65	63
PAT margin (%)	31	33	33	33
as a % of gross collections	23	23	23	23

Source: Company data, I-Sec Research

Table 8: Better financial performance expected from subsidiaries / acquisitions

(Rs mn)

Revenues	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
K-12 initiative	156	149	205	212	203
Eurokids	69	125	86	91	91
Learning.com	190	189	193	285	279
Ask n Learn	72	57	62	64	68
Others	75	76	75	125	170
Total	562	597	621	776	811

Source: Company data, I-Sec Research

Educomp has 50 operational K-12 schools. The company has visibility of total 81 schools.

K-12 and pre-schools posted revenue growth of 30% YoY and 32% YoY respectively

Table 9: Segmental revenues and EBIT (standalone)

(Rs mn)

Segment revenues – Standalone	Q3FY10	Q3FY11	YoY growth (%)
School Learning Solutions	1,960	2,719	38.7
Higher Learning Solutions	53	38	(27.2)
K-12 schools	26	3	(89.3)
Online supplemental and global	0	4	
Total	2,039	2,764	35.6
Segment results – EBIT			
School Learning Solutions	1,200	1,657	38.1
Higher Learning Solutions	17	10	(42.0)
K-12 schools	8	2	(69.9)
Online supplemental and global	(1)	(17)	
Total	1,224	1,653	35.0
Segment results – EBIT (%)			
School Learning Solutions	61.2	61.0	
Higher Learning Solutions	32.4	25.8	
K-12 schools	30.9	86.9	
Online supplemental and global	(328)	(419.3)	
Total	60.1	59.8	
Less:			
Interest (net)	108	174	
Other unallocable expenses	237	255	
Unallocable Income	121	60	
PBT	1,000	1,284	
Capital employed			
School Learning Solutions	8,388	6,174	
Higher Learning Solutions	(158)	(180)	
K-12 schools	23	12	
Online supplemental and global	50	77	
Total	8,303	6,082	

Source: Company data, I-Sec Research

Table 10: Segmental revenues and EBIT (consolidated)

(Rs mn)

Segment revenues – Consolidated	Q3FY10	Q3FY11	YoY growth (%)
School Learning Solutions	1,987	2,794	40.7
Higher Learning Solutions	78	146	86.9
K-12 schools	251	304	21.1
Online supplemental and global	285	331	16.0
Total	2,601	3,575	37.5
Segment Results – EBIT			
School Learning Solutions	1,216	1,709	40.5
Higher Learning Solutions	(41)	(60)	46.7
K-12 schools	103	107	3.3
Online supplemental and global	(47)	(44)	(6.0)
Total	1,231	1,711	39.0
Segment Results – EBIT (%)			
School Learning Solutions	61	61	
Higher Learning Solutions	(53)	(41)	
K-12 schools	41	35	
Online supplemental and global	(17)	(13)	
Total	47	48	
Less:			
Interest (net)	139	279	
Other unallocable expenses	234	261	
Unallocable Income	158	87	
PBT	1,016	1,257	
Capital employed			
School Learning Solutions	8,433	6,327	
Higher Learning Solutions	393	1,999	
K-12 schools	7,394	15,571	
Online supplemental and global	1,402	1,865	
Total	17,623	25,762	

Source: Company data, I-Sec Research

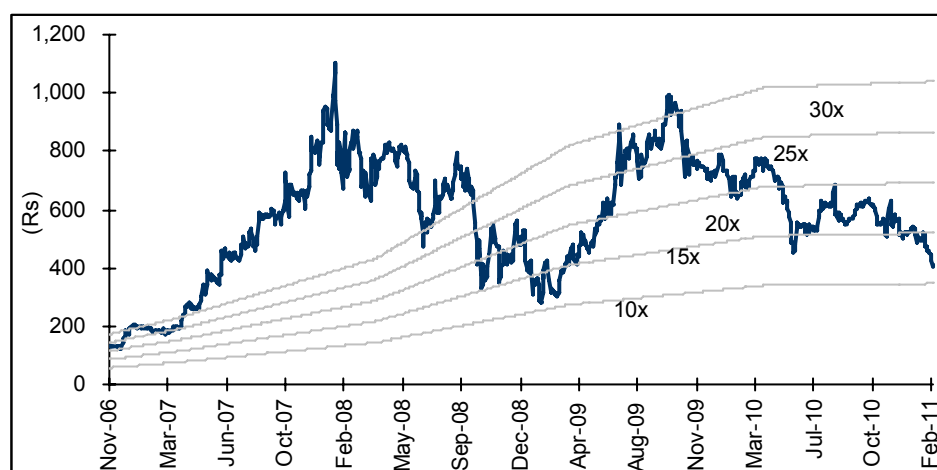
Table 11: Operating metrics for K-12 schools and new businesses

	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Pre-schools							
No of 'Roots to Wings' Pre Schools	193	204	240	220	224	228	220
No of 'Eurokids' Pre Schools	450	424	539	555	506	535	579
No of Total Pre Schools	643	628	779	775	730	763	799
K-12 SCHOOLS							
No of K12 Schools operational	35	36	36	43	43	46	50
-No of K12 Schools operational under Educomp (Greenfield)	23	22	22	29	29	25	30
-No of K12 Schools operational under Educomp (Dry Mgmt/JV)						7	9
No of K12 Schools operational under Euroschools	12	14	14	14	14	14	11
No of K12 Schools with visibility	43	48	59	69	73	79	81
Breakup of Greenfield schools under Educomp:							
No of K12 Schools operational in 0th year	ND	ND	ND	ND	ND	ND	5
No of K12 Schools operational in 1st year	ND	ND	ND	ND	ND	ND	8
No of K12 Schools operational in 2nd year	ND	ND	ND	ND	ND	ND	12
No of K12 Schools operational in 3rd year and above	ND	ND	ND	ND	ND	ND	5
Higher Education - Raffles JV							
No of Colleges (Raffles Millennium International)	2	2	2	3	7	7	7
Vocational Education - Pearson JV							
No of Total IndiaCan points of presence	40	105	122	220	251	277	279
No of Students covered by IndiaCan	ND	ND	ND	ND	ND	34,600	52,500
ONLINE & SUPPLEMENTAL EDUCATION							
Online Users							
No of New registered users added (in Million)	0.16	0.18	0.18	0.22	0.41	0.34	0.34
Total No of registered users (in Million)	0.80	1.00	1.20	1.40	1.80	2.10	2.50
Vidyamandir Classes / LEAP							
No of VMC + LEAP centres operational	5	5	5	5	17	17	30
No of students enrolled in VMC & LEAP programs	1,100	1,100	1,100	1,100	1,150	1,150	3,170

ND – Not Disclosed; Source: Company data

Valuation methodology and key risks

Maintain BUY with a target price of Rs675 based on P/E of 16x average of FY12-13E. Key risks are lower than expected addition of schools under *SmartClass* and declining ICT business.

Chart 3: Rolling P/E bands

Source: I-Sec Research

Financial Summary (Consolidated)

Table 12: Profit and Loss statement

(Rs mn, year ending March 31)

	FY10	FY11E	FY12E	FY13E
Operating Revenues (Sales)	10,404	13,696	16,384	20,469
of which Standalone	8,321	10,554	12,032	14,681
of which subsidiaries	2,083	3,142	4,352	5,788
Operating Expenses	5,546	8,065	9,884	11,841
EBITDA	4,858	5,630	6,500	8,628
% margins	46.7	41.1	39.7	42.2
Depreciation & Amortisation	1,138	821	907	993
Gross Interest	539	925	1,008	1,083
Other Income	1,208	360	432	518
Recurring PBT	4,390	4,244	5,017	7,071
Less: Taxes	1625	814	1505	2121
Net Income (Reported)	2,758	3,430	3,512	4,950
Recurring Net Income	2,758	3,430	3,512	4,950

Source: Company data, I-Sec Research

Table 13: Balance sheet

(Rs mn, year ending March 31)

	FY10	FY11E	FY12E	FY13E
Assets				
Total Current Assets	15,859	19,635	20,355	21,956
of which cash and deposits	7,930	8,254	6,543	5,341
Total Current Liabilities & Provisions	3,963	5,070	5,932	6,794
Net Current Assets	11,896	14,565	14,423	15,162
Investments	354	1,504	2,204	3,004
of which Strategic/Group	354	1,504	2,204	3,004
Net Fixed Assets	13,948	19,841	23,728	28,025
Goodwill	6,031	8,351	8,351	8,351
Capital Work-in-Progress	2,739	2,939	3,139	3,339
Other Long Term Assets				
Total Assets	28,937	38,850	43,494	49,530
of which cash and equivalents	7,930	8,254	6,543	5,341
Liabilities				
Borrowings	10,478	14,971	15,821	16,626
Deferred Tax Liability	22	22	22	22
Minority Interest	1,915	2,489	3,112	3,734
Equity Share Capital	190	190	190	190
Face Value per share (Rs)	10	10	10	10
Reserves & Surplus*	16,332	21,177	24,350	28,958
Net Worth	16,522	21,367	24,540	29,148
Total Liabilities	28,937	38,850	43,494	49,530

*Excluding revaluation reserves

Source: Company data, I-Sec Research

Table 16: Quarterly trend - Consolidated

(Rs mn, year ending March 31)

	Mar-10	Jun-10	Sep-10	Dec-10
Net sales	3,331	2,279	2,768	3,575
% growth (YoY)	47.1	17.6	9.2	37.5
EBITDA	1,592	664	1,059	1,650
Margin (%)	47.8	29.1	38.3	46.2
Other income	97	99	80	50
Extraordinaries Inc / (Loss)	0	0	1	2
Recurring Net Income	604	365	578	967

Source: Company data, I-Sec Research

Table 14: Cashflow statement

(Rs mn, year ending March 31)

	FY10	FY11E	FY12E	FY13E
Operating Cash flow before W Cap changes	3,944	4,251	4,419	5,942
Working Capital Inflow / (Outflow)	(2,395)	(2,346)	(1,568)	(1,940)
Capex	(7,051)	(6,914)	(4,994)	(5,490)
Free Cash flow	(5,503)	(5,009)	(2,144)	(1,487)
Cash Flow from other Invst Act (Ex Capex)	375	(1,150)	(700)	(800)
Proceeds from Issue of Share Capital	9,905	1,750	0	0
Inc/(Dec) in Borrowings	1,583	5,068	1,471	1,427
Dividend paid	(332)	(335)	(338)	(342)
Increase/(Decrease) in Cash	6,028	324	(1,710)	(1,202)

Source: Company data, I-Sec Research

Table 15: Key ratios

(Year ending March 31)

	FY10	FY11E	FY12E	FY13E
Per Share Data (Rs)				
EPS	27.3	34.0	34.8	49.0
Recurring Cash EPS	38.6	42.1	43.7	58.8
Dividend per share (DPS)	2.8	2.8	2.8	2.8
Book Value per share (BV)	163.7	211.5	243.0	288.6
Growth Ratios (%)				
Operating Income (Sales)	64.0	31.6	19.6	24.9
EBITDA	60.9	15.9	15.4	32.7
Recurring Net Income	108.0	24.3	2.4	40.9
Recurring EPS	90.7	24.3	2.4	40.9
Recurring CEPS	67.5	9.0	4.0	34.5
Valuation Ratios (x)				
P/E	16.0	12.8	12.5	8.9
P/CEPS	11.3	10.4	10.0	7.4
P/BV	2.7	2.1	1.8	1.5
EV / EBITDA	9.9	9.2	8.3	6.5
EV / Sales	4.6	3.8	3.3	2.7
EV / FCF	NA	NA	NA	NA
Operating Ratio				
Operating Expenses/Sales (%)	53.3	58.9	60.3	57.8
Other Income / PBT (%)	27.5	8.5	8.6	7.3
Effective Tax Rate (%)	37.0	19.2	30.0	30.0
NWC / Total Assets (%)	36.2	33.2	29.2	26.9
Fixed Asset Turnover (x)	0.7	0.7	0.7	0.7
Receivables (days)	194	162	154	142
Payables (days)	151	155	159	159
D/E Ratio (x)	0.6	0.7	0.6	0.6
Return/Profitability Ratio (%)				
Recurring Net Income Margins	26.5	25.0	21.4	24.2
RoIC	11.4	13.4	11.3	13.0
RoCE	11.1	11.5	9.5	11.5
RoNW	27.1	18.1	15.3	18.4
Dividend Payout Ratio	12.0	9.8	9.6	6.9
Dividend Yield	0.6	0.6	0.6	0.6
EBITDA Margins	46.7	41.1	39.7	42.2

Source: Company data, I-Sec Research

I-Sec investment ratings (all ratings relative to Sensex over next 12 months)

BUY: +10% outperformance; **HOLD:** -10% to +10% relative performance; **SELL:** +10% underperformance

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