

INDIA RESEARCH
EDUCATION
RESULT NOTE: Q4FY11
BSE SENSEX: 18232
MAY 30, 2011

Educomp

Game changer!
OUTPERFORMER
Rs475
Mkt Cap: Rs47.9bn; US\$1.06bn

Key financials

(Rs m)	Net Sales	yoy chg (%)	Net profit	yoy chg (%)	EPS (Rs)	yoy chg (%)	EV/E (x)	PER (x)
FY08	2,861	159.9	706	146	8.2	128	32.8	58.0
FY09	6,371	122.7	1,329	88	15.4	88	15.7	30.9
FY10	10,395	63.2	2,759	108	29.0	89	9.8	16.4
FY11	13,509	30.0	3,348	21	35.0	21	10.0	13.6
FY12E	17,573	30.1	4,001	20	39.6	13	7.8	12.0
FY13E	21,350	21.5	4,709	18	46.7	18	5.9	10.2

Source: Company, IDFC Securities Research

Key highlights of Q4FY11 results and our interaction with the management

- Educomp reported its Q4FY11 results. While numbers for the quarter are strong, we see the improvement in financial disclosures across all business units as a key positive. Reported numbers are not comparable on a yoy basis due to change in the business model (tripartite agreement with Edusmart).
- During the quarter, Educomp has reported consolidated revenues of Rs4.88bn (estimates of Rs4.3bn), EBITDA of Rs2.05bn (estimates of Rs1.8bn), and a PAT of Rs1.45bn (estimates of Rs1.4bn).
- The operational performance during the quarter is ahead of estimates on account of higher than expected deliverance in the School Learning Solutions (SLS) and the Higher Learning Solutions (HLS) businesses.
- SLS reported revenues of Rs3.78bn and EBIT of Rs1.97bn in Q4FY11. The financials are not comparable to Q4FY10 on account of change of business model of smart class.
- Within the SLS segment, Smart Class reported revenues of Rs3.49bn and EBIT of Rs2.01bn in Q4FY11. The revenues recognized in the quarter include Rs1.54bn on account of deferred revenue pertaining to contracts transferred to EduSmart.
- Smart class additions** - During the quarter Educomp added 8,010 classrooms with 7.9 classrooms per school, at an average price of Rs0.377m per classroom. In full year FY11, Educomp has added 27,154 classrooms and 3,461 schools. The renewal cycle for earlier smart class contracts (~300 schools) of Educomp will commence from FY12.
- Educomp has launched an improved product of the Smart Class. We attended the Educomp annual sales meet held last week, wherein the new product was unveiled. We believe the new product would help Educomp differentiating in the increasingly competitive multimedia space. Further, the significant technological enhancements reflect the potential to improve yields from the current ~Rs150 per student per month. On the back of the improved product as also renewal cycle for older contracts, Educomp is estimated to add 40,000+ classrooms in FY12.

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- **Margins improving** - During the quarter, Smart Class EBIT margins stood at a strong 58% primarily on account booking of deferred revenue from EduSmart. As per the new revenue recognition policy, as Educomp starts reporting the balance 22.5% of contracts of new schools addition (margins of 80-90%), overall EBIT margins of the smart class segment will improve.
 - **Securitization structure – more transparency!** – In Q2FY11, Educomp had announced a change in arrangement with Edusmart, wherein the recourse on Educomp for all further securitization done by Edusmart was reduced from 100% earlier to 20%. This move addressed our apprehensions on the structure to a large extent. Incrementally, Educomp has now added one more vendor – a subsidiary of Gurgaon based CorporateServe - to partner in the smart class business. Importantly, the management has indicated that for securitization done by these new vendors the recourse would remain 20% or less. This imparts further comfort on the structure as also enhances the transparency in the system. The management has also indicated that eventually Educomp would not have any recourse to the securitization done by third party vendors. These recent developments impart higher comfort on the business as also the management.
 - **K12 Schools – funding back ended growth:** Educomp has demonstrated strong execution in the K-12 space which is the largest annuity stream in the Education sector. With 60% of total capital employed deployed towards the K-12 segment at Rs16.1bn, Educomp is demonstrating the ability to leverage on the sticky nature of the education space. During the quarter, the K12 business (EISML+Euro Kids+RTW) reported a revenue growth of 35% at Rs427m and an EBIT of Rs124m.
 - Educomp has increased its stake in the K-12 subsidiary – EISML – from 69.4% in FY10 to 80.4% now. This transaction has valued EISML at Rs16.4bn or at Rs664 per share. In FY11, EISML has reported revenues of Rs849m, EBITDA of Rs617m and PAT of Rs161m.
 - Educomp now has 56 schools operational (45 under EISML; 11 under its JV with Euro Kids) and has visibility for 83 schools till date (including dry management, land sites and under construction sites). Educomp is adopting an aggressive strategy in expanding its K-12 network and expects to reach 150 schools by FY13. Around 50% of the schools are expected to be owned under various models and price points – Millennium (capex at ~Rs350m), Takshila (capex at ~Rs100m) and Vidya Prabhat (capex at ~Rs10m). The remaining 50% will follow the content licensing/ management services to schools route. Educomp has also signed a JV with Lavasa Corporation to set up a residential school in Lavasa.
 - Educomp has recently tied up with the Great Lakes Institute of Management (GLIM), Chennai. GLIM, founded by US-based management guru, Dr Bala V Balachandran, offers post graduate courses in management. Bala is also the co-founder of two very reputed B-schools, ISB Hyderabad and MDI Gurgaon and was conferred Padma Shri in 2001. In February 2011, Educomp had launched a PE fund for the education sector which made its first investment in Beacon Learning, a management and services provider for higher education institutions, led by Mohan Lakshamraju (former Tiger Global Management MD). Beacon Learning has now acquired a 51% stake in the Company which runs GLIM (similar 3 tier structure as Educomp). With this Educomp now has an indirect investment in GLIM and has also signed an arrangement to open co-branded B-Schools with GLIM (as in the case with Raffles, Singapore). Given the strong credibility of GLIM's founder as also its board members (Azim Premji, Narayan Murthy, etc), we believe this tie-up will have a positive rub-off on Educomp.
 - **HLS (Higher Learning Solutions)** reported revenues of Rs281m (5x jump from Q4FY10) and an EBIT loss of Rs123m. Educomp in JV with Raffles operates 7 Raffles Millennium International institutes in the country. While the JV is not looking at adding more institutes, is it focused towards improving the occupancies across the existing network. IndiaCan (Educomp's JV with Pearson) now has a presence across 339 centers reaching 63,000 students.
 - Online and supplemental segment reported a revenue growth of 53% at Rs392m and an EBIT loss of Rs32m.
 - As on 31st March 2011, gross debt stood at Rs14.4bn (this includes FCCB worth \$78.5m) and cash at Rs4.5bn. Educomp has taken an enabling resolution to raise US\$250m. Further, Educomp is looking to restructure the US\$78.5m FCCB, which is due for redemption in July 2012. These corporate actions will be a critical monitorable.

Unmatched scale, strong earnings momentum, enhanced visibility and stickiness in the business and most importantly significant improvement in disclosures across financial parameters form key reasons for our positive bias towards Educomp. Evolution of Educomp from a 3-5year annuity business (in the digital content space) to a 10year annuity in business (K12 schools) reflects the innate ability of Educomp to capitalize on the sticky nature of the Education space. With 60% of the total capital committed in the business (or Rs16 bn) deployed towards K-12 schools (steady state RoCEs of 20%+), we see Educomp transforming to an extremely 'scalable', 'profitable' and 'value accretive' business in the longer run. Given the current business momentum and past deliverances by the management, our sense is that over next 4-5 years Educomp will be nearly 3-5x the scale of the nearest competitor in the country! Incrementally, our apprehensions towards the new structure in smart class have been further alleviated with the management having added another vendor during the quarter (with recourse to Educomp at 20% or less). With highest transparency levels, increasing visibility in the business and value drivers clearly identified, Educomp is looking well placed across all parameters. We believe that markets in general have been overtly apprehensive on Educomp and have ignored the strong execution that the largest player in the space (USD50bn) has achieved. We see investor sentiment turning positive with incremental transparency in the system as also continued traction in almost all of Educomp's business operations. At 10x FY13E earnings, we see value. Maintain outperformer with a price target of Rs780.

Segmental revenues

(Rs m)	Q4FY11	Q4FY10	% growth
School Learning Solutions	3,786	2,692	41
Higher Learning Solutions	281	57	392
K12 Schools	427	316	35
Online, global & supplemental	392	256	53
Total	4,887	3,320	47

Source: Company, IDFC Securities Research

Segmental contribution to revenues

(%)	Q4FY11	Q4FY10	Change in bp
School Learning Solutions	77	81	(360.2)
Higher Learning Solutions	6	2	403.3
K12 Schools	9	10	(75.8)
Online, global & supplemental	8	8	32.7

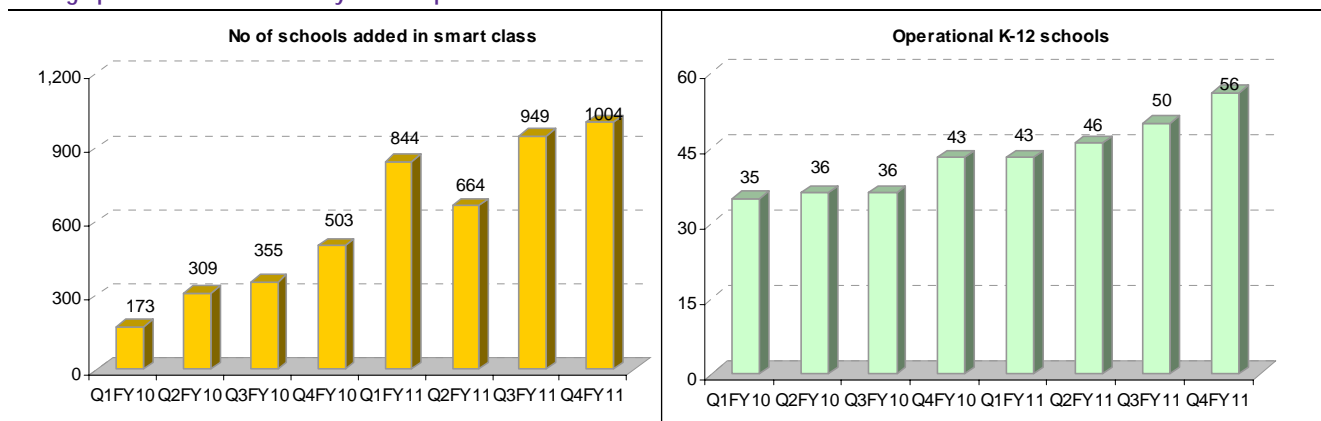
Source: Company, IDFC Securities Research

Segmental EBIT

(Rs m)	Q4FY11	Q4FY10	% growth
School Learning Solutions	1974.8	1645.3	20
Higher Learning Solutions	(123.0)	(43.1)	-
K12 Schools	124.3	79.7	56
Online, global & supplemental	(31.8)	(29.8)	-
Total	1944.3	1652.1	18

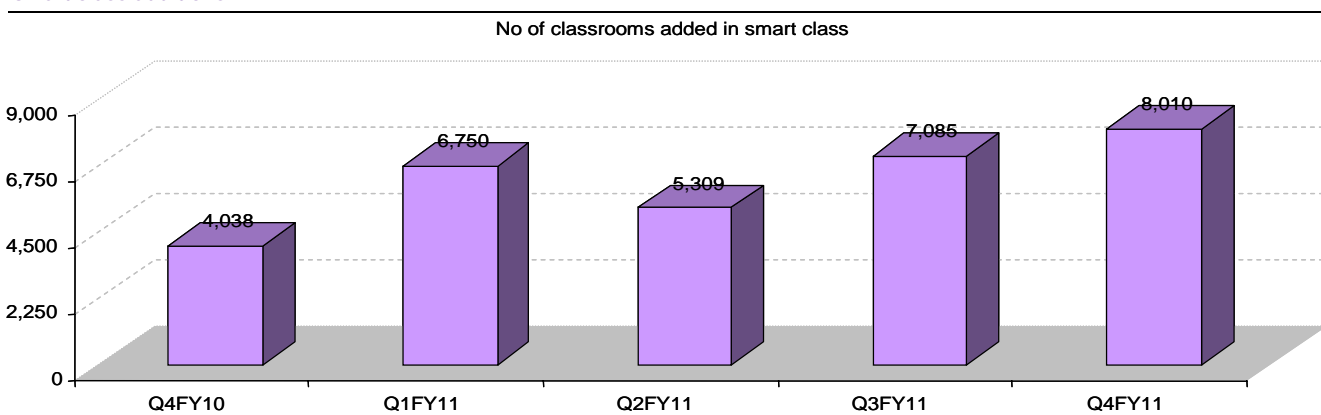
Source: Company, IDFC Securities Research

Strong operational deliverance by Educomp



Source: Company, IDFC Securities Research

Smart class additions



Source: Company, IDFC Securities Research

Higher Learning Solutions

	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11
No of Raffles Millennium Institutes	2	2	2	3	7	7	7	7
No of IndiaCan points of presence	40	105	122	220	251	277	279	339

Source: Company, IDFC Securities Research

Financial performance

	Q4FY10	FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11	FY11	FY12E	FY13E
Net Sales	3,320	10,395	2,279	2,767	3,575	4,887	13,509	17,573	21,350
%yoy	47	63.2	18	9	37	47	30	30	21
Operating profit	1,582	4,861	693	1,037	1,631	2,052	5,425	7,542	9,313
EBITDA %	48	47	30	37	46	42	40	43	44
Depreciation	205	1,142	198	208	201	234	841	1,278	1,494
EBIT	1,377	3,718	495	829	1,430	1,818	4,584	6,264	7,819
Interest	178	539	161	212	279	310	962	1,202	1,202
Other Income	158	1,255	100	84	87	191	461	996	498
Profit before tax	1,357	4,421	405	723	1,257	1,698	4,083	6,058	7,114
Tax	714	1,584	39	141	253	245	678	1,999	2,348
PAT	643	2,837	366	582	1,003	1,454	3,405	4,059	4,767
PAT post minority interest	649	2,759	365	578	967	1,457	3,348	4,001	4,709
%yoy	17	108	7	(50)	58	124	21.4	19.5	17.7

Source: IDFC Securities Research

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2. Neutral: Within 0-5% to Index (upside or downside)
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