

# Analyst meet takeaways

## Focus on asset light model

Educomp hosted its first analyst meet since listing. Management highlighted that most key businesses will in asset light mode over next 2-3 years. Smart Class requires no capex currently and capital intensity in K-12 too would reduce over next 2-3 years given focus on expanding dry management. Other key takeaways :

- Management highlighted that market opportunity in Smart Class remains large given its plan to target over 35000 schools in phase one. Given presence in 5500 schools currently and 98% market share, it believes a 30% yoy growth is achievable. Retains guidance of adding 25000-30000 class rooms in FY11 and over 300000 class rooms over next 5-6 years.
- Secures leadership position in content through launch of 3D content. It intends to price 3D offering at a premium to other Smart Class content. Believe there is scope for margin expansion in Smart Class given economies of scale and increase in sales productivity.
- Management reiterated that all new deals would be at 20% corporate guarantee levels. Recently received funding approval at 15% corporate guarantee for lower fund amount.
- K-12: Strong focus on execution. Has 50 operational schools and visibility for another 30 schools. Has set up teacher training academy to cater to training and recruitment demand for Educomp K-12 schools. Likely to sign up JV with another strong brand.
- We retain Buy rating with PO of Rs760. Addition of second outsourcing vendor, further reduction in debtors & recent success in securing limited recourse funding should help re rate the stock. Forecast EPS CAGR of 27% (FY11-13e).

## Estimates (Mar)

(Rs)	2009A	2010A	2011E	2012E	2013E
Net Income (Adjusted - mn)	1,345	2,779	3,631	4,438	5,813
EPS	14.14	29.21	35.51	43.40	56.85
EPS Change (YoY)	90.3%	106.6%	21.6%	22.2%	31.0%
Dividend / Share	0.618	2.24	2.24	2.50	2.50
Free Cash Flow / Share	(44.80)	(48.97)	16.78	13.76	28.46

## Valuation (Mar)

	2009A	2010A	2011E	2012E	2013E
P/E	34.15x	16.53x	13.60x	11.12x	8.49x
Dividend Yield	0.128%	0.465%	0.465%	0.518%	0.518%
EV / EBITDA*	15.66x	9.89x	7.65x	6.45x	4.89x
Free Cash Flow Yield*	-7.84%	-9.44%	3.48%	2.85%	5.90%

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 4.

## Bank of America Merrill Lynch

Pratish Krishnan >>

+91 22 6632 8679

Research Analyst  
DSP Merrill Lynch (India)  
pratish.krishnan@baml.com

## Stock Data

Price	Rs482.80
Price Objective	Rs760.00
Date Established	13-Feb-2011
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs386.00-Rs790.70
Mrkt Val / Shares Out (mn)	US\$1,085 / 102.3
Average Daily Volume	960,179
BofAML Ticker / Exchange	EUSOF / BSE
Bloomberg / Reuters	EDSL IN / EDSO.BO
ROE (2011E)	16.8%
Net Dbt to Eqty (Mar-2010A)	-4.4%
Est. 5-Yr EPS / DPS Growth	20.0% / 20.0%
Free Float	35.0%

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Refer to important disclosures on page 5 to 7. Analyst Certification on Page 3. Price Objective Basis/Risk on page 3. Link to Definitions on page 3. 11021631

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## iQprofile<sup>SM</sup> Educomp Solutions Ltd.

### Key Income Statement Data (Mar)

(Rs Millions)	2009A	2010A	2011E	2012E	2013E
Sales	6,371	10,395	14,316	16,345	20,885
Gross Profit	4,105	6,999	9,082	10,209	12,664
Sell General & Admin Expense	(1,043)	(2,138)	(2,116)	(2,031)	(2,060)
Operating Profit	2,248	3,704	5,459	6,757	9,085
Net Interest & Other Income	(61)	717	(388)	(288)	(318)
Associates	NA	NA	NA	NA	NA
Pretax Income	2,186	4,421	5,070	6,469	8,768
Tax (expense) / Benefit	(773)	(1,584)	(1,378)	(1,970)	(2,893)
Net Income (Adjusted)	1,345	2,779	3,631	4,438	5,813
Average Fully Diluted Shares Outstanding	95	95	102	102	102

### Key Cash Flow Statement Data

Net Income	1,345	2,779	3,631	4,438	5,813
Depreciation & Amortization	814	1,142	807	671	716
Change in Working Capital	(1,023)	(1,910)	783	(243)	(1,129)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	777	184	963	926	1,105
Cash Flow from Operations	1,914	2,195	6,184	5,793	6,505
Capital Expenditure	(5,786)	(6,855)	(4,468)	(4,386)	(3,594)
(Acquisition) / Disposal of Investments	(367)	1,145	0	0	0
Other Cash Inflow / (Outflow)	150	2,308	0	0	0
Cash Flow from Investing	(6,003)	(3,402)	(4,468)	(4,386)	(3,594)
Shares Issue / (Repurchase)	(18)	6,000	3	4	5
Cost of Dividends Paid	(58)	(166)	(229)	(256)	(256)
Cash Flow from Financing	3,826	7,515	943	577	97
Free Cash Flow	(3,872)	(4,660)	1,716	1,407	2,911
Net Debt	6,786	(959)	(1,507)	(1,682)	(3,182)
Change in Net Debt	4,263	(4,454)	(548)	(175)	(1,500)

### Key Balance Sheet Data

Property, Plant & Equipment	8,126	10,656	14,317	18,031	20,909
Other Non-Current Assets	1,966	6,385	6,385	6,385	6,385
Trade Receivables	2,765	5,530	5,213	5,839	7,119
Cash & Equivalents	1,902	7,887	10,545	12,529	15,537
Other Current Assets	1,833	2,399	2,601	2,813	3,057
Total Assets	16,592	32,857	39,061	45,597	53,008
Long-Term Debt	8,688	6,928	9,038	10,847	12,355
Other Non-Current Liabilities	639	22	22	22	22
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	2,214	3,956	4,581	5,126	5,471
Total Liabilities	11,542	10,906	13,642	15,996	17,848
Total Equity	5,007	21,797	25,274	29,456	35,014
Total Equity & Liabilities	16,550	32,703	38,915	45,452	52,862

### iQmethod<sup>SM</sup> - Bus Performance\*

Return On Capital Employed	16.0%	17.7%	17.1%	16.5%	17.5%
Return On Equity	38.0%	23.1%	16.8%	17.5%	19.2%
Operating Margin	35.3%	35.6%	38.1%	41.3%	43.5%
EBITDA Margin	48.1%	46.6%	43.8%	45.4%	46.9%

### iQmethod<sup>SM</sup> - Quality of Earnings\*

Cash Realization Ratio	1.4x	0.8x	1.7x	1.3x	1.1x
Asset Replacement Ratio	7.1x	6.0x	5.5x	6.5x	5.0x
Tax Rate (Reported)	35.4%	35.8%	27.2%	30.5%	33.0%
Net Debt-to-Equity Ratio	135.5%	-4.4%	-6.0%	-5.7%	-9.1%
Interest Cover	7.8x	6.9x	5.8x	6.9x	7.8x

### Key Metrics

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 4.

### Company Description

Set up in 1994, Educomp is India's largest provider of technology driven education solutions. It provides end to end solutions for K12 through licensing of digital content to enhance the teaching process. It aims to be a comprehensive provider of solutions in India's school education economy and has expanded its offerings to cater to pre schools, online tutoring, professional development for teachers etc.

### Investment Thesis

We expect Educomp to be one of the fastest growing companies in our universe. Key positives include growing adoption of technology-based education in K-12 (Kindergarten to Class12) private schools, low market penetration of under 5% among private schools in India and increased spending by state governments on technology adoption in public schools. Moreover, revenue visibility will be enhanced as the company enters into five-year contracts with private schools.

### Stock Data

Price to Book Value 2.1x

## Price objective basis & risk

### Educomp Solu (EUSOF)

Our PO of Rs760 is based on a 2-year PEG of 0.8x and implies a target multiple of 18x FY12e. Our PO reflects potential de-rating given that the Smart Class revenue stream is now likely to be volatile. We retain our Buy given the strong 27% CAGR in earnings FY11-13E, and the turnaround in FCF on shift to new business model. Besides Educomp remains the only listed education service provider with offerings in K-12 and is an emerging player in vocational/ supplemental education.

Risks to our valuation are higher losses in new initiatives, higher-than-anticipated cut in Smart Class pricing, acquisition-related risks and managing multiple growth initiatives.

## Link to Definitions

### Industrials

Click [here](#) for definitions of commonly used terms.

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SEBI Regn no. : BSE - INB/INF 011348134 NSE – INB/INF 231348138

Address – Mafatlal Centre, 8th Floor, Nariman Point, Mumbai, India. 400021

Tel : +91 22 6632 8000

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India - Software & IT Services Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	D.B.Corp Ltd	XDDCF	DBCL IN	Pratish Krishnan
	Educomp Solu	EUSOF	EDSL IN	Pratish Krishnan
	Firstsource	FSSOF	FSOL IN	Mitali Ghosh
	HCL	XHCLF	HCLT IN	Mitali Ghosh
	Hexaware Tech	XFTCF	HEXW IN	Pratish Krishnan
	Infosys Tech	INFYF	INFO IN	Mitali Ghosh
	Infosys Tech - A	INFY	INFY US	Mitali Ghosh
	Jagran Prakashan Ltd	JGRPF	JAGP IN	Pratish Krishnan
	Persistent Systems	XPSYF	PSYS IN	Kunal Tayal
	Rollta India	RLTAF	RLTA IN	Pratish Krishnan
	Rollta India-GDR	XLROF	RTI LI	Pratish Krishnan
	Sun TV Network Ltd	SUTVF	SUNTV IN	Pratish Krishnan
	Tata Consultancy	TACSF	TCS IN	Mitali Ghosh
	Zee Entertainment	XZETF	Z IN	Pratish Krishnan
<b>NEUTRAL</b>				
	ExlService Holdi	EXLS	EXLS US	Mitali Ghosh
	Infotech Enterprises Ltd	IFKFF	INFTC IN	Pratish Krishnan
	Wipro	WIPRF	WPRO IN	Mitali Ghosh
	Wipro	WIT	WIT US	Mitali Ghosh
<b>UNDERPERFORM</b>				
	Genpact Ltd	G	G US	Mitali Ghosh
	Mastek	MSKDF	MAST IN	Pratish Krishnan
	Mphasis Ltd	MPSSF	MPHL IN	Pratish Krishnan
	Tech Mahindra	TMHAF	TECHM IN	Pratish Krishnan
	WNS (Holdings) L	WNS	WNS US	Mitali Ghosh

iQmethod<sup>SM</sup> Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

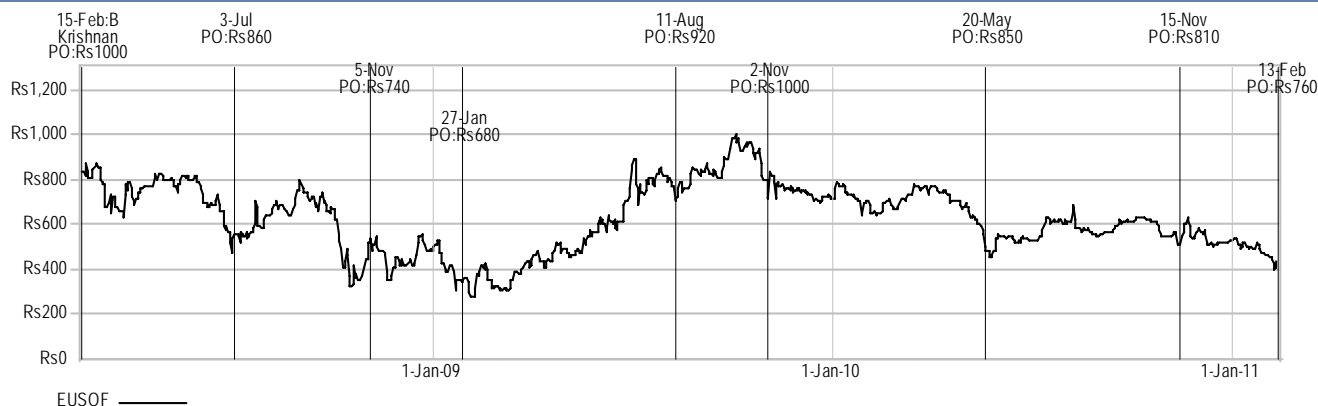
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### EUSOF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of January 31, 2011 or such later date as indicated.

### Investment Rating Distribution: Education & Training Services Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	11	47.83%	Buy	6	54.55%
Neutral	7	30.43%	Neutral	2	28.57%
Sell	5	21.74%	Sell	2	40.00%

### Investment Rating Distribution: Global Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2011	53.86%	Buy	874	48.31%
Neutral	925	24.77%	Neutral	444	52.30%
Sell	798	21.37%	Sell	276	36.75%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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