

Earnings surprise likely; stock correction overdone

Reconfirm multi year growth story; Buy

Meeting with key zonal heads in Smart Class reconfirms our view that Smart Class is a multi year growth story. We believe FY11 management guidance for Smart Class is conservative. We cut FY11E and FY12E earnings by 13% and 12% to factor higher than anticipated losses in new initiatives i.e. Raffles & Pearson JV and cut PO to Rs850. We retain BUY given our view that 1) earnings trajectory remains strong at 34% CAGR FY10-12E and 2) valuation at 13x FY11PE and 10x FY12PE is compelling.

Smart Class will surprise in our view

Management has guided at 25,000-30,000 class room additions for FY11 which we believe is conservative given 1) upside from recent addition of over 100 people to its sales team of 225, enhancing market reach 2) brand enhancement over last six months due to TV promos resulting in lower sales cycle 3) upside from same school expansion & better than expected pricing environment.

PAT guidance; upside revisions likely

We believe management guidance for PAT of Rs3.3bn, 14% lower than BofAMLe is conservative given it is based on Smart Class addition of 25,000 classrooms at the lower end of its band of 25,000-30,000, leaving room for upside. At 30,000 schools we estimate 10% upside to PAT guidance.

Improved disclosure level, FCF turnaround positive

Educomp has now improved granularity of disclosures in Smart Class and now provides data on class room additions and realization per class room. We believe disclosure methodology from here on is likely to be consistent. Also under the new business model, FCF is likely to turnaround from FY11E. Further, it is in talks with banks to securitize receivables without providing corporate guarantees.

Estimates (Mar)

(Rs)	2008A	2009A	2010E	2011E	2012E
Net Income (Adjusted - mn)	707	1,429	2,748	3,935	4,838
EPS	6.99	14.14	27.19	38.93	47.87
EPS Change (YoY)	146.3%	102.2%	92.3%	43.2%	23.0%
Dividend / Share	0.586	0.618	0.618	0.618	0.618
Free Cash Flow / Share	(19.93)	(45.04)	(16.98)	7.39	21.19

Valuation (Mar)

	2008A	2009A	2010E	2011E	2012E
P/E	71.99x	35.61x	18.52x	12.93x	10.52x
Dividend Yield	0.116%	0.123%	0.123%	0.123%	0.123%
EV / EBITDA*	39.55x	15.94x	10.24x	7.68x	6.54x
Free Cash Flow Yield*	-3.38%	-7.65%	-3.37%	1.48%	4.26%

* For full definitions of *iQmethod*SM measures, see page 13.

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Stock Data

Price	Rs503.45
Price Objective	Rs850.00
Date Established	21-May-2010
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs497.10-Rs1,020
Mrkt Val / Shares Out (mn)	US\$1,097 / 101.1
Average Daily Volume	1,065,096
BofAML Ticker / Exchange	EUSOF / BSE
Bloomberg / Reuters	EDSL IN / EDSO.BO
ROE (2010E)	26.8%
Net Dbt to Eqty (Mar-2009A)	135.5%
Est. 5-Yr EPS / DPS Growth	20.0% / 20.0%
Free Float	35.0%

Key Changes

(Rs)	Previous	Current
Price Obj.	1,000.00	850.00
2010E EPS	27.56	27.19
2011E EPS	45.42	38.93
2012E EPS	55.45	47.87
2010E EBITDA (m)	5,164.5	4,893.1
2011E EBITDA (m)	7,556.1	6,522.2
2012E EBITDA (m)	9,025.3	7,666.0

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Refer to important disclosures on page 14 to 16. Analyst Certification on Page 12. Price Objective Basis/Risk on page 12. Link to Definitions on page 12.10940755

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iQprofileSM Educomp Solutions Ltd.

Key Income Statement Data (Mar)	2008A	2009A	2010E	2011E	2012E
(Rs Millions)					
Sales	2,861	6,371	10,405	15,796	17,672
Gross Profit	1,575	4,205	6,991	9,663	10,773
Sell General & Admin Expense	(301)	(1,061)	(2,116)	(2,067)	(2,183)
Operating Profit	935	2,329	3,755	5,715	6,992
Net Interest & Other Income	129	(41)	678	76	213
Associates	NA	NA	NA	NA	NA
Pretax Income	1,065	2,289	4,433	5,791	7,205
Tax (expense) / Benefit	(351)	(773)	(1,625)	(1,795)	(2,306)
Net Income (Adjusted)	707	1,429	2,748	3,935	4,838
Average Fully Diluted Shares Outstanding	101	101	101	101	101

Key Cash Flow Statement Data

Net Income	711	1,447	2,748	3,935	4,838
Depreciation & Amortization	331	814	1,138	807	674
Change in Working Capital	(730)	(1,023)	(1,474)	(544)	(356)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	193	1,118	111	539	594
Cash Flow from Operations	505	2,357	2,522	4,737	5,751
Capital Expenditure	(2,224)	(6,249)	(4,239)	(3,986)	(3,584)
(Acquisition) / Disposal of Investments	85	(367)	0	0	0
Other Cash Inflow / (Outflow)	141	150	0	0	0
Cash Flow from Investing	(1,998)	(6,467)	(4,239)	(3,986)	(3,584)
Shares Issue / (Repurchase)	0	0	6,066	3	4
Cost of Dividends Paid	(40)	(58)	(62)	(63)	(63)
Cash Flow from Financing	3,461	3,872	7,600	859	454
Free Cash Flow	(1,719)	(3,892)	(1,717)	751	2,168
Net Debt	862	6,786	(1,002)	(1,212)	(2,783)
Change in Net Debt	(1,634)	4,238	(3,798)	(210)	(1,571)

Key Balance Sheet Data

Property, Plant & Equipment	2,714	8,126	11,227	14,406	17,316
Other Non-Current Assets	318	1,966	1,955	1,955	1,955
Trade Receivables	1,157	2,765	4,117	4,536	4,735
Cash & Equivalents	2,912	1,902	7,776	9,386	12,007
Other Current Assets	570	1,833	1,653	1,887	2,151
Total Assets	7,671	16,592	26,729	32,170	38,164
Long-Term Debt	3,773	8,688	6,774	8,174	9,224
Other Non-Current Liabilities	210	639	639	639	639
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	586	2,214	2,327	2,434	2,541
Total Liabilities	4,569	11,542	9,740	11,247	12,404
Total Equity	3,078	5,007	17,189	21,123	25,960
Total Equity & Liabilities	7,647	16,550	26,928	32,370	38,364

iQmethodSM - Bus Performance*

Return On Capital Employed	16.1%	17.0%	17.2%	16.7%	16.7%
Return On Equity	35.1%	40.3%	26.8%	21.5%	21.4%
Operating Margin	32.7%	36.6%	36.1%	36.2%	39.6%
EBITDA Margin	44.3%	49.3%	47.0%	41.3%	43.4%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	0.7x	1.6x	0.9x	1.2x	1.2x
Asset Replacement Ratio	6.7x	7.7x	3.7x	4.9x	5.3x
Tax Rate (Reported)	33.0%	33.8%	36.7%	31.0%	32.0%
Net Debt-to-Equity Ratio	28.0%	135.5%	-5.8%	-5.7%	-10.7%
Interest Cover	19.5x	8.7x	7.7x	11.9x	13.0x

Key Metrics

* For full definitions of iQmethodSM measures, see page 13.

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

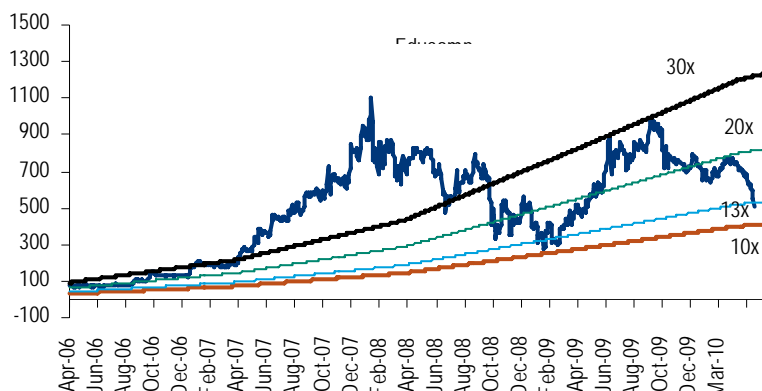
3.1x

Reconfirm multi year growth story

Post meeting with zonal sales heads, national head of Smart Class recently at Educomp's annual sales meet, we reconfirm our view of a multiyear growth story in Smart Class. We believe the macro environment is more favorable to Smart Class and Educomp is well geared to capture the growth.

Post 4Q results and weaker than expected guidance announcement the stock is down 20%. At our revised estimates stock is trading at 13x FY11PE and 11X FY12PE which we believe is attractive given strong earnings growth of 34% CAGR over FY10-12E. We retain Buy given the following.

Chart 1: Educomp PE Chart



Source: Bloomberg, Company, BofA Merrill Lynch Global Research est

#1) Upside in Smart Class.. guidance conservative

40% expansion in sales team and significant brand enhancement should drive outperformance

We believe Educomp's guidance of adding 25,000-30,000 classrooms in FY11 is conservative given

- 1) Educomp recently expanded its sales team strength by 100 people to 325 and is likely to end the year with 360 people. Assuming average productivity of 12-15 school additions per year (current run rate) and ten class rooms per school, Educomp should be able to close the year with atleast 32,500 class rooms in our view.
- 2) Significant brand enhancement: Educomp initiated a series of advertisement promos across major TV channels. Our channel checks indicate that brand recognition today for Smart Class is significant as compared to a few years back. This has resulted in sales cycle being reduced to around 2-3 months as compared to 2 months to one year earlier.
- 3) Pricing environment better than expected. During 4Q Educomp reported monthly pricing of Rs145 per class room/ per student vs. our assumption of Rs135. Management reiterated that pricing remains stable and given strong response from schools it is unlikely to offer price discount to penetrate schools in Tier 2/3 cities. We have now assumed average price of Rs144-143 in our estimates.

- 4) Upside from same school expansion. Currently many of the tier 3 / 4 schools are subscribing to Smart Class for 4-8 class rooms, though they have 30 class rooms. We expect existing schools to also contribute to growth in class room additions from FY12E.

Significant scope to improve penetration

We believe Smart Class remains a significant opportunity and Educomp is well geared to tap into this market. At target market of ~75,000 schools (50% of private unaided school market), the potential market is at least two mn class rooms.

Based on current school wins (3000 schools), Educomp currently has penetration of less than 4% in terms of number of schools and 2-3% in terms of number of class rooms. Our channel checks indicate limited competition as yet and we believe market share for Educomp would be in the range of ~98%, providing significant growth opportunity.

Renewal cycle to kick in from FY12

One of the key investor concerns relate to long term growth for Educomp, given significant expansion in Smart Class over last 3-4 years. While we remain bullish on penetration opportunities for Smart Class, we note that renewal cycles for schools signed from FY08 would commence from FY12 onwards.

Even assuming 6-7% CAGR in new school wins over next five-six years and benefits from renewals, we expect profits in Smart Class to grow at 15-18% CAGR over next five to six years.

#2) Strong earnings CAGR of 34% ...

We forecast earnings CAGR of 34% during FY10-12E driven by strong growth in Smart Class revenues and K-12 operations. Our assumptions factor

- 1) Additions of 32,500 Smart Class rooms vs. management guidance of 25,000-30,000, given our view that recent additions to the sales team and brand enhancement should drive outperformance in Smart Class and traditionally management has exceeded its guidance in Smart Class by 10-15%.
- 2) Losses of Rs600-700mn in new initiatives in FY11e.

Table 1: Segment accounting estimates

Revenues	FY09	FY10E	FY11E	FY12E
Smart Class	3172	6329	10198	10814
K-12 schools	623	983	1330	1870
New Initiatives	1415	1382	1585	1855
Total Net Sales/ Income from operations	6341	10440	15796	17672
PBIT				
Smart Class	1875	4180	6645	6883
K-12 schools	306	331	685	1105
New Initiatives	274	-274	-678	-343
Total	2699	4544	7198	8335
Total PBT	2227	4402	5791	7205

Source: Company, BofA Merrill Lynch Global Research est

... Despite cut in earnings

Post 4Q results, we cut FY11 & FY12E by 12% to 13% to factor higher than anticipated losses in new initiatives i.e. higher learning & vocational studies. We have now factored in losses of Rs650-700mn in its new initiatives vs. our assumption of Rs300-400mn earlier.

Table 2: Earnings revision

Revised Estimates (Rs.mn)	Earlier FY11E	Revised FY11E	Change (%)	Earlier FY12E	Revised FY12E	Change (%)
Sales	17172	15796	-8%	19870	17672	-11%
EBIT	6749	5715	-15%	8302	6992	-16%
Reported PAT	4511	3935	-13%	5514	4838	-12%
EPS (Rs.)*	44.6	38.9	-13%	54.6	47.9	-12%

Source: BofA Merrill Lynch Global Research estimates

3#) PAT Guidance ... upward revision likely

Educomp guided FY11E revenues of Rs13-13.5bn and PAT guidance of Rs3.3bn, lower than BofAMLe. In Smart Class it has guided 25,000-30,000 class room additions and revenues of Rs8.5-9bn. PAT guidance also bake in loss of Rs600-650mn in new initiatives, higher than was earlier anticipated by us.

Conservative in our view

We believe the PAT guidance is conservative given 1) it is based on lower end of Smart Class guidance and 2) see upside to Smart Class additions given strong pipeline and our view that traditionally management has exceeded its guidance by 10-15%.

We understand PAT guidance is based on Smart Class room additions of 25,000, at the lower end of its guidance band of 25,000-30,000. At 30,000 class rooms, we estimate profit to be at Rs3.6-3.7bn, an increase of 9-10% on its guidance.

Table 3: Variation with guidance

Guidance vs. BofAMLe	Guidance	BofAMLe	Comments
Smart Class Revenues	Rs.8500-9000mn	Rs.10198	Driven by higher assumptions for Smart class additions PAT could be at Rs3.7bn at upper end of Smart Class guidance. We estimate PAT of Rs4bn
Company PAT	Rs3.35bn	Rs3.9bn	

Source: BofA Merrill Lynch Global Research estimates

#4) Improved disclosure level, FCF turnaround positive

Educomp has now improved granularity of disclosures and now provides data on Smart Class room additions per quarter and average realization per class room. We believe disclosure methodology from here on is likely to be consistent.

Also under the new business model, FCF is likely to turn around from FY11E. Further, management indicated that it is also in talks with banks to with regard to securitization of schools without providing corporate guarantees to third party vendors.

Key risk to our assumptions

Smart class implementation: While Educomp is well geared to meet demand for Smart Class, we believe implementation & effective logistics for equipment remains a challenge. Any delay in implementation of Smart Class would impact revenues in the segment.

Higher content costs: Given content is at the core of Educomp, it constantly acquires content from other providers to enhance its repository of content. Higher than anticipated spend in content cost would impact profit estimates.

FY10: core business on track; new initiatives drag profit

For the full year Educomp reported PAT of Rs2.7bn in line with revised guidance of Rs2.7bn (post adoption of new model). However excluding the benefits from the new model and revenues/ profit from transfer of old schools, its PAT would have been at Rs1.9bn, lower than its earlier guidance of Rs2.1bn-2.2bn.

The miss was largely driven by higher losses in new initiatives, which has been factored in its guidance for FY11

Table 4: Consolidated Financials

Rs m	4Q FY09	3Q FY10	4Q FY10	YoY %	FY09	FY10	yoy %	BofAMLe	Variance (%)
Net Sales	2265	2601	3331	47%	6371	10405	63%	10616	-2%
Total Expenditure	1349	1239	1741	29%	3227	5548	72%	5451	2%
EBITDA	916	1362	1590	74%	3144	4857	55%	5165	-6%
Depreciation & Ammortisation	284	338	201	-29%	814	1138	40%	1154	-1%
EBIT	631	1025	1389	120%	2329	3719	60%	4011	-7%
Other Income	17	158	101	490%	227	1167	413%	1336	-13%
Forex Losses	370	-28	2	-99%					
Interest	80	139	128	60%	268	489	82%	401	22%
PBT	938	1016	1364	45%	2289	4397	92%	4945	-11%
Tax	373	375	755	103%	773	1625	110%	1635	-1%
PAT	554	610	604	9%	1429	2712	90%	2739	-1%
EBITDA margin	40%	52%	48%	728.6	49%	47%	-266.4	49%	-197.3
EBIT margin	28%	39%	42%	1381.3	37%	36%	-81.8	38%	-203.9
PAT margin	24%	23%	18%	19%	22%	26%	363.4	26%	26.1

Segment accounts

Revenues (Rs.mn)	4Q FY09	3Q FY10	4Q FY10	YoY %
School Learning Solutions	1665	1987	2690	61%
Higher Learning	87	78	78	-11%
K-12 Schools	237	251	302	27%
Online Supplemental & Global	275	285	262	-5%
Total	2264	2601	3331	47%

PBIT

School Learning Solutions	723	1216	1626	125%
Higher Learning	13	-41	-39	-399%
K-12 Schools	98	103	88	-10%
Online Supplemental & Global	7	-47	-40	-669%
Total	841	1231	1636	94%

PBIT %

School Learning Solutions	43%	61%	60%
Higher Learning	15%	-53%	-50%
K-12 Schools	41%	41%	29%
Online Supplemental & Global	3%	-17%	-15%

Source: Company, BofA Merrill Lynch Global Research

Strong growth in core business

#1) Smart Class: Adjusted revenues up 50% yoy

During FY10, Smart Class revenues grew by 101% yoy to Rs6.3bn, contributing 61% of revenues. While FY10 revenues includes the impact of new model and benefits from transferring old contracts to the new model, even adjusting for transfer and the new accounting model, revenues would have been at Rs4.3bn as per BofAMLe, growth of 48%yoy.

For FY11, management has guided at revenues of Rs8.5-Rs9.0bn, growth of 30-40% yoy of which it expects Rs5.5-6bn to come from new wins and Rs3bn to come from follow on revenues of old contracts.

Table 5: Smart Class performance

	FY09	FY10	yoy
Smart Class	3157	6329	101%
PBIT	1860	4307	132%
PBIT %	59%	68%	

Source: Company

Robust school additions

During FY10 Educomp implemented Smart Class in 1325 schools as against its guidance of 1060-1160.

During 4Q Educomp added 720 schools in Smart Class with over 6000 class rooms and implemented Smart Class in 503 schools. During 4Q Educomp also transferred all its existing contracts to the new model. Smart Class revenues during 4Q grew by 118% yoy to Rs2.4bn.

Table 6: Key operational metrics

No of Classrooms signed	6000
No of classrooms implemented	4038
Avg selling price per class room (Rs.)	392000
	(Rs.mn)
Edusmart model	831
Transfer of old contracts	1546.8
Export revenues	30.9
Total Revenues	2408.7

Source: Company

Tier one cities continue to dominate.

During 4Q average number of class room additions declined to eight vs. fifteen in the previous quarter. This we believe is reflective of faster penetration in Tier 3/4 cities where average class room additions are lower than Tier one cities. However, even in 4Q we believe nearly 60% of class room additions were in Tier one city which reconfirms our view of strong potential in Tier one cities.

Also management highlighted that while traditionally Educomp had a cut off of at least 10 class room additions for a new school win, it has now relaxed its criteria given many schools in tier 3 /4 cities would like to start off with 3-4 class rooms and later on adopt the product for an additional number of class rooms.

Table 7: 4Q School wins

City	Schools added	Avg class room	Total Additions
Tier one	180	20	3600
Tier two	255	6	1530
Tier three	285	3	855

Source: BofA Merrill Lynch Global Research estimates

However, decision making process in Tier 3/4 cities is less than a month as compared to six months and potential to scale remains huge, making it a lucrative market.

#2) K-12 School: building scale

Educomp reported strong growth in its K-12 operations. Revenues grew by 42% yoy to Rs550mn, driven by improved student intake numbers in existing schools and setting up of new schools.

Number of schools under operation improved from 20 last year to 43 during the current year. Management indicated that an additional 26 new land sites have been identified taking the potential number of schools to 69. K-12 now contributes ~10% to revenues as compared to nil two years back.

Table 8: K-12 Schools

	No of Schools
PSSB Millennium (Co branding)	5
The Millennium (Own brand)	10
Takshila	4
Vidya Prabhat (budget schools)	3
Others (Including Dry mgt)	7
Euro Schools	14

Source: BofA Merrill Lynch Global Research

Table 9: K-12 School performance

K-12 School	FY09	FY10
No of operational schools	20	43
Revenues	389	550.6
EBITDA	293	371.1
PAT	108.8	178.2
EBITDA %	75%	67%
PAT %	28%	32%

Source: Company

#3) New initiatives - higher than anticipated losses

Higher learning comprising of professional development, Raffles JV and Pearson JV reported revenue of Rs285mn, a decline of 7% yoy, largely driven by a decline in professional development (teacher training). It reported EBIT losses of Rs107mn, as compared to EBIT profit of Rs95mn last year.

This was largely driven by higher investments in its Raffles and Pearson JV. In Raffles it currently has two design institutes, which are fully operational and another five which are likely to commence operations from June 2010. Management plans to set up an additional 15 new institutes over next 12-15 months. With break even duration of 18 to 24 months and losses of nearly Rs30-40mn per institute, Raffles JV is likely to report loss of Rs200-300mn in FY11E.

Table 10: Raffles JV performance

Raffles JV	Comments
	3 Schools operational currently in Delhi, Bangalore and Chandigarh
	Lease agreements signed for 4 new colleges- Kolkata, Hyderabad, Ahmedabad & Chennai
	Additional 15 new colleges likely to be set up over next 12-15 months
	Break even-18-24 months.

Source: Company

In Pearson JV, Educomp plans to set up nearly 100 Indian Can centres in 1Q FY11E and double its base over next one year. Management has guided at operational loss of Rs200mn in this JV for FY11e. Overall we have factored in loss of Rs600-700 mn in its new initiatives i.e. higher learning and supplemental business in line with the company.

Table 11: Pearson JV performance

Pearson JV	Comments
Pearson JV	ETEN- Course for CA exams. 100 centres operational, 11000 enrollments Purple Leap- IT programs, summer certification programs, professional development programs. 80 centres, 3700 students Vocational- Basic IT & English foundation. 40 operational centres, target to reach 100 centres by 1QFY11 and double base over next one year. New programs- Media, sales & retail, Pilot travel, tourism and ticketing

Source: Company

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Financials

Table 12: Profit and Loss statement

Rs mn (year-end March)	FY08	FY09	FY10E	FY11E	FY12 E
Sales	2861	6371	10405	15796	17672
Other income	177	227	1167	558	750
Total Income	3038	6598	11572	16354	18422
Cost of goods sold	798	1110	1621	4169	4609
Personnel expenses	488	1055	1793	1965	2291
Administration and other expenses	301	1061	2116	2067	2183
Total Expenditure	1594	3227	5548	9274	10006
EBITDA	1267	3144	4857	6522	7666
Depreciation	331	814	1138	807	674
EBIT	935	2329	3719	5715	6992
Finance charges	48	268	489	481	537
EBT	887	2061	3230	5233	6455
PBT	1065	2289	4397	5791	7205
Total Taxes	351	773	1625	1795	2306
PAT	714	1516	2772	3935	4838

Source: Company, BofA Merrill Lynch Global Research

Table 13: Balance Sheet

	FY08	FY09	FY10E	FY11E	FY12 E
Shareholders' funds					
Share capital	172	173	202	203	205
Reserves and surplus	2629	3886	6073	9945	14720
Net worth	2884	4203	16324	20197	24974
Minority Interest	194	804	864	925	986
Loan funds					
Secured Loans	622	4689	6774	8174	9224
Term Loan from Bank	438	4315	6400	7800	8850
Deferred tax Liability	210	439	439	439	439
Total Sources of funds	7061	14342	24402	29736	35624
Goodwill	280	1225	1225	1225	1225
Fixed assets					
Gross Block	2890	6499	10738	14724	18307
Less: Accumulated Depreciation	548	1335	2473	3280	3954
Net Block	2342	5164	8265	11444	14354
Capital Work in Progress	372	2962	2962	2962	2962
Total	2714	8126	11227	14406	17316
Investments	36	729	729	729	729
Current assets, loans and advances					
Inventories	18	316	366	416	466
Sundry debtors	1157	2765	4117	4536	4735
Cash	2912	1902	7776	9386	12007
Loans and Advances	490	1138	1287	1469	1682
	4639	6153	13547	15809	18893
Less current liabilities and provisions					
Less current liabilities and provisions	610	2251	2327	2434	2541
Net current assets	4029	3903	11220	13375	16353
Miscellaneous expenditure	1	13	1	1	1
Total Applications	7061	14342	24402	29736	35623

Source: Company, BofA Merrill Lynch Global Research

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Table 14: Cash flow statement

Cash flows from operating activities	FY08	FY09	FY10E	FY11E	FY12 E
Net profit before taxation and after prior period items as per P&L	1072	2108	4397	5791	7205
Depreciation	331	814	1138	807	674
Forex exchange fluctuation	13	546	0	0	0
interest exps	48	268	489	481	537
Operating profit before working capital changes	1419	3721	5622	7076	8412
Trade & other receivables	-657	-1603	-1352	-419	-199
inventory	15	-298	-50	-50	-50
loans & advances	-426	-613	-148	-183	-213
Trade & other payables	338	1491	76	107	107
Cash Generated from operations	689	2698	4148	6532	8057
Taxes paid (Net of TDS)	-184	-329	-1625	-1795	-2306
Net cash from operating activities	505	2357	2522	4737	5751
Cash flows from investing activities					
Purchases of fixed assets	-2224	-6249	-4239	-3986	-3584
Net cash used in investing activities	-2102	-7215	-4239	-3986	-3584
Csh flows from financing activities					
Net proceeds from fresh issue of capital through IPO	0	0	6066	3	4
Proceeds/ repayment of long term borrowings	334	4000	2085	1400	1050
interest on borrowings	-48	-268	-489	-481	-537
Dividend paid	-40	-58	-62	-63	-63
FCCB raised	3109	8	0	0	0
Net Cash from financing activities	3393	3846	7600	859	454
Net increase in cash and cash equivalents	1796	-1011	5883	1610	2621
Opening cash and cash equivalents	1109	2905	1893	7776	9386
Closing cash and cash equivalents	2905	1893	7776	9386	12007

Source: Company, BofA Merrill Lynch Global Research

Table 15: Ratios

Year Mar 31 (Rs mn)	FY08	FY09	FY10E	FY11E	FY12E
Valuation ratios					
P/CEPS	54	25	19	14	12
P/BV (x)	19	13	4	3	3
EV/EBITDA (x)	40	16	10	8	7
EV/EBIT (x)	54	22	14	9	7
EV/ Revenues	18	8	5	3	3
Growth %					
Revenue	160	123	63	52	12
EBIT	128	149	60	54	22
Net Profit	146	102	90	45	23
Profitability %					
EBIT	33	37	36	36	40
Net Profit	25	22	22	25	27
Return %					
RONW	35.0	40.3	21.9	21.5	21.4
ROCE	19.4	21.8	19.2	21.1	21.4
Per Share Data (Rs.)					
EPS -diluted	7	14.1	26.8	38.9	47.9
CEPS	12	26	34	47	54
BVPS	33	49	162	199	244
DPS	1	1	1	1	1

Source: Company, BofA Merrill Lynch Global Research

Price objective basis & risk

Educomp Solu (EUSOF)

Our PO of Rs850 based on a 2 yr PEG of 0.9x and implies target multiple of 18x FY12e. Our PO reflects potential de rating given Smart Class revenue stream now likely to be volatile. Retain Buy given strong 34% CAGR in earnings FY10-12E, and sharp 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 a 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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India - Software & IT Services Coverage Cluster

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
BUY				
	Educomp Solu	EUSOF	EDSL IN	Pratish Krishnan
	Firstsource	FSSOF	FSOL IN	Mitali Ghosh
	Genpact Ltd	G	G US	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
	Mphasis Ltd	MPSSF	MPHL IN	Pratish Krishnan
	Rolta India	RLTAF	RLTA IN	Pratish Krishnan
	Rolta India-GDR	XLROF	RTI LI	Pratish Krishnan
	Sun TV Network Ltd	SUTVF	SUNTV IN	Pratish Krishnan
	Tata Consultancy	TACSF	TCS IN	Mitali Ghosh
	Wipro	WIPRF	WPRO IN	Mitali Ghosh
	Wipro	WIT	WIT US	Mitali Ghosh
	Zee Entertainment	XZETF	Z IN	Pratish Krishnan
NEUTRAL				
	Patni	PATIF	PATNI IN	Mitali Ghosh
	Patni Computer	PTI	PTI US	Mitali Ghosh
	Tech Mahindra	TMHAF	TECHM IN	Pratish Krishnan
UNDERPERFORM				
	Infotech Enterprises Ltd	IFKFF	INFTC IN	Pratish Krishnan
	Mastek	MSKDF	MAST IN	Pratish Krishnan
	WNS (Holdings) L	WNS	WNS US	Mitali Ghosh
RVW				
	Balaji Tele	BLJIF	BLJT IN	Bharat Parekh
	ExlService Holdi	EXLS	EXLS US	Mitali Ghosh

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + 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
Quality of Earnings		
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
Valuation Toolkit		
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	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

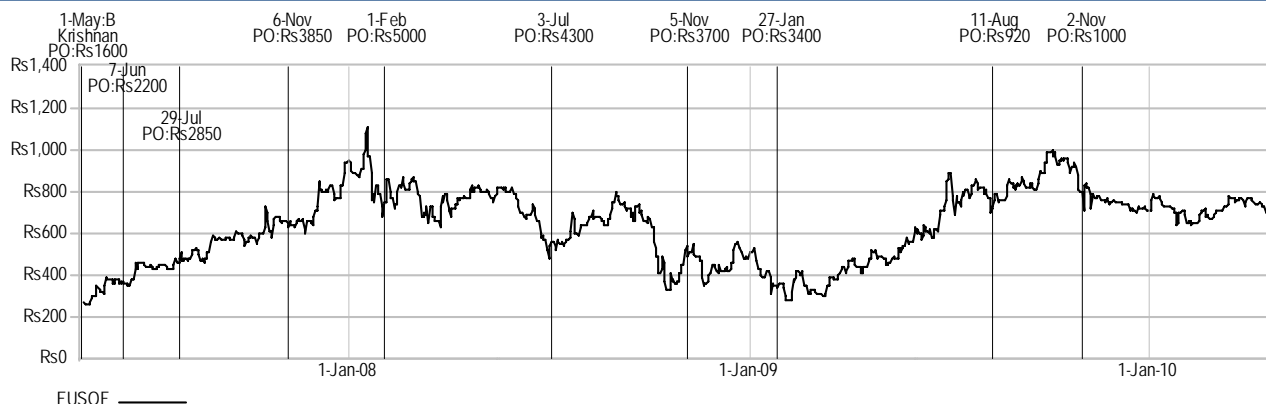
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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	10	58.82%	Buy	5	50.00%
Neutral	5	29.41%	Neutral	5	100.00%
Sell	2	11.76%	Sell	2	100.00%

Investment Rating Distribution: Global Group (as of 01 Apr 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1818	52.41%	Buy	952	58.01%
Neutral	873	25.17%	Neutral	490	61.95%
Sell	778	22.43%	Sell	355	49.72%

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

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