

Smart Class- strong pipeline, growth on track

Smart Class -on track to achieve guidance

Post meeting with senior management team at Educomp & EduSmart (third party vendor) we retain our Buy rating on the stock. We believe the initial response to Smart Class advertisement has been extremely strong with school signs up exceeding 600 (vs. ~450 in 3Q) during the quarter and pipeline increasing to ~2000 (vs. 1500 in 3Q). While signs up remain robust, it expects nearly 500 schools to be implemented during 4Q, in line with its guidance. For FY11 management reiterated its guidance of adding 2500 schools. Strong pipeline provides upside risk to our assumptions for school sign up in FY11e. Forecast strong earnings CAGR of 42% over FY10-12E.

EduSmart- well placed to meet higher school signups

Our interaction with EduSmart management, reveal that the team is well placed to meet strong demand for Smart Class implementation. Educomp's guidance of implementing Smart Class in 2500 (FY11) schools implies installing hardware in ~50 schools per week. As EduSmart outsource nearly 50% of low end installation work to local vendors and given its ability to manage hardware installation at multiple schools concurrently, we believe the current team of 70 technicians can manage installations in nearly 80 schools per week. See minimal risk to implementation in FY11e.

Plans to enhance team strength at EduSmart

Besides 70 technicians the team includes eight zonal managers and ten regional managers and caters to hardware implementation in over 128 cities. Management highlighted that it intends to ramp up operations and would more than double its team strength over next one year. Educomp is also implementing ERP systems which will further strengthen hardware procurement, optimize inventory levels and improve service levels.

Estimates (Mar)

(Rs)	2008A	2009A	2010E	2011E	2012E
Net Income (Adjusted - mn)	707	1,429	2,739	4,514	5,511
EPS	7.11	14.38	27.56	45.42	55.45
EPS Change (YoY)	146.3%	102.2%	91.7%	64.8%	22.1%
Dividend / Share	0.586	0.618	0.618	0.618	0.618
Free Cash Flow / Share	(19.93)	(45.04)	(11.39)	11.52	25.64

Valuation (Mar)

	2008A	2009A	2010E	2011E	2012E
P/E	108.05x	53.44x	27.88x	16.92x	13.86x
Dividend Yield	0.076%	0.080%	0.080%	0.080%	0.080%
EV / EBITDA*	60.17x	24.24x	14.76x	10.09x	8.44x
Free Cash Flow Yield*	-2.25%	-5.10%	-1.48%	1.51%	3.38%

* For full definitions of *iQmethod*SM measures, see page 4.

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Stock Data

Price	Rs768.50
Price Objective	Rs1,000
Date Established	2-Nov-2009
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs386.66-Rs1,020
Mrkt Val / Shares Out (mn)	US\$1,678 / 99.4
Average Daily Volume	2,310,163
BofAML Ticker / Exchange	EUSOF / BSE
Bloomberg / Reuters	EDSL IN / EDSO.BO
ROE (2010E)	27.7%
Net Dbt to Eqty (Mar-2009A)	135.5%
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.

23 March 2010

iQprofileSM Educomp Solutions Ltd.

Key Income Statement Data (Mar)	2008A	2009A	2010E	2011E	2012E
(Rs Millions)					
Sales	2,861	6,371	10,616	17,172	19,870
Gross Profit	1,575	4,205	7,994	10,492	12,602
Sell General & Admin Expense	(301)	(1,061)	(1,443)	(1,349)	(1,690)
Operating Profit	935	2,329	4,011	6,749	8,302
Net Interest & Other Income	129	(41)	935	174	183
Associates	NA	NA	NA	NA	NA
Pretax Income	1,065	2,289	4,945	6,922	8,484
Tax (expense) / Benefit	(351)	(773)	(1,635)	(2,215)	(2,715)
Net Income (Adjusted)	707	1,429	2,739	4,514	5,511
Average Fully Diluted Shares Outstanding	99	99	99	99	99

Key Cash Flow Statement Data

Net Income	711	1,447	3,220	4,514	5,511
Depreciation & Amortization	331	814	1,154	807	724
Change in Working Capital	(730)	(1,023)	(1,338)	(859)	(897)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	193	1,118	70	674	824
Cash Flow from Operations	505	2,357	3,107	5,137	6,162
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	4,800	3	4
Cost of Dividends Paid	(40)	(58)	(61)	(62)	(62)
Cash Flow from Financing	3,461	3,872	6,422	860	426
Free Cash Flow	(1,719)	(3,892)	(1,132)	1,151	2,579
Net Debt	862	6,786	(409)	(1,020)	(2,975)
Change in Net Debt	(1,634)	4,238	(3,205)	(611)	(1,954)

Key Balance Sheet Data

Property, Plant & Equipment	2,714	8,126	11,212	14,390	17,250
Other Non-Current Assets	318	1,966	1,955	1,955	1,955
Trade Receivables	1,157	2,765	3,981	4,669	5,356
Cash & Equivalents	2,912	1,902	7,183	9,194	12,198
Other Current Assets	570	1,833	1,653	1,932	2,250
Total Assets	7,671	16,592	25,984	32,140	39,009
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	16,444	21,090	26,798
Total Equity & Liabilities	7,647	16,550	26,184	32,337	39,202

iQmethodSM - Bus Performance*

Return On Capital Employed	16.1%	17.0%	20.1%	19.8%	19.3%
Return On Equity	35.1%	40.3%	27.7%	25.4%	24.2%
Operating Margin	32.7%	36.6%	37.8%	39.3%	41.8%
EBITDA Margin	44.3%	49.3%	48.6%	44.0%	45.4%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	0.7x	1.6x	1.1x	1.1x	1.1x
Asset Replacement Ratio	6.7x	7.7x	3.7x	4.9x	5.0x
Tax Rate (Reported)	33.0%	33.8%	33.1%	32.0%	32.0%
Net Debt-to-Equity Ratio	28.0%	135.5%	-2.5%	-4.8%	-11.1%
Interest Cover	19.5x	8.7x	10.0x	14.0x	14.7x

Key Metrics

* For full definitions of iQmethodSM 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 4.9x

Price objective basis & risk

Educomp Solu (EUSOF)

Our PO of Rs1000 based on a 2 yr PEG of 0.9x and implies target multiple of 22x FY11e. Our PO reflects potential de rating given Smart Class revenue stream now likely to be volatile. Retain Buy given strong 42% 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.

Analyst Certification

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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
	Infosys Tech	INFYF	INFO IN	Mitali Ghosh
	Infosys Tech - A	INFY	INFY US	Mitali Ghosh
	Mphasis Ltd	MPSSF	MPLH IN	Pratish Krishnan

India - Software & IT Services Coverage Cluster

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
	Patni	PATIF	PATNI IN	Mitali Ghosh
	Patni Computer	PTI	PTI US	Mitali Ghosh
	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
	Wipro	WIPRF	WPRO IN	Mitali Ghosh
	Wipro	WIT	WIT US	Mitali Ghosh
	Zee Entertainment	XZETF	Z IN	Pratish Krishnan
NEUTRAL				
	Tech Mahindra	TMHAF	TECHM IN	Pratish Krishnan
	WNS (Holdings) L	WNS	WNS US	Mitali Ghosh
UNDERPERFORM				
	Hexaware Tech	XFTCF	HEXW IN	Pratish Krishnan
	Infotech Enterprises Ltd	IFKFF	INFTC IN	Pratish Krishnan
	Mastek	MSKDF	MAST IN	Pratish Krishnan
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	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
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
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	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

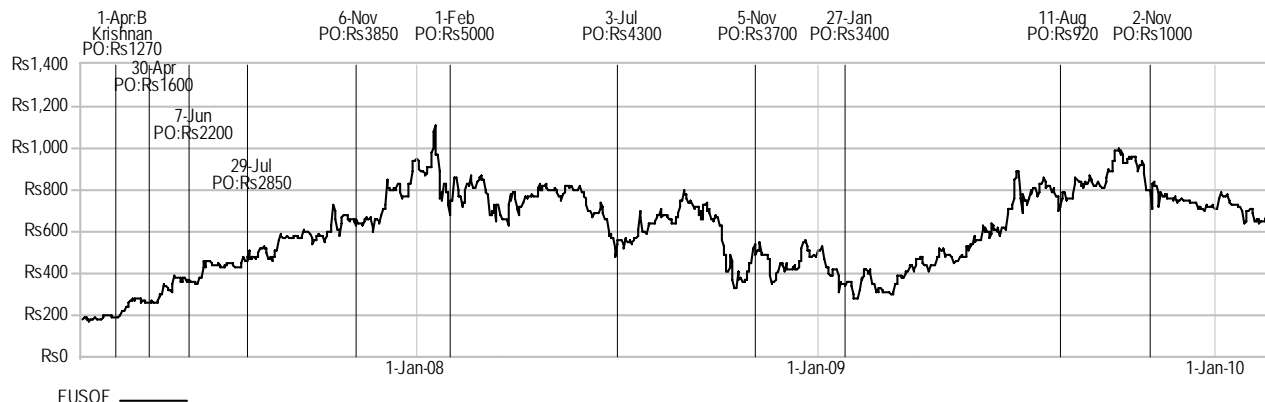
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EUSOF Price Chart



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

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Investment Rating Distribution: Education & Training Services Group (as of 01 Jan 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	14	73.68%	Buy	8	57.14%
Neutral	4	21.05%	Neutral	3	75.00%
Sell	1	5.26%	Sell	1	100.00%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1699	50.78%	Buy	904	58.82%
Neutral	841	25.13%	Neutral	491	65.03%
Sell	806	24.09%	Sell	368	49.80%

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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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