

Raise estimates to reflect new model; Buy

Raise estimates/ PO; 25% upside

Post 2Q results we raise FY11& FY12 ests by 26% & 22% to factor potential upside from new revenue model in Smart Class, partly offset by higher investment in subsidiaries. Under the new model Educomp would securitize and recognize revenues upfront through a third party vendor as compared to five-year revenue recognition earlier. Raise PO by 9% to Rs1000, to factor upside to earnings. Our PO is at 0.9x FY10/FY10-12E PEG, lower than 1x earlier and reflects potential derating given revenue streams in Smart Class now likely to be lumpy in nature.

Adopts new model; cash flows set to improve

As highlighted in our earlier note "B/S, cash flows set to improve", Educomp announced adoption of a new revenue model in Smart Class from 3Q FY10. Under the new model Educomp will securitize revenue streams, leading to one-time recognition of revenue. Consequently FCF should turn positive from FY11 itself. However revenue volatility is likely to be high given revenue growth is now linked to growth in school adds per year.

2Q: new initiatives drag margins

2Q revenues increased 92% YoY, 2 % ahead of BofAMLe. EBITDA margins stood at 41%, 300bps lower than BofAMLe. While margins in core business improved, losses in new initiatives (higher learning & online supplemental) increased QoQ, impacting margins. Management commented that investments in new initiatives will continue during the next 2-3 quarters.

Multi-year growth story

With less than 10% penetration in the Smart Class market, 98% market share and strong growth potential in the K-12 market, Educomp remains a multi-year growth story, in our view. Forecast 37% CAGR in earnings over FY10-12E. Retain Buy

Estimates (Mar)

(Rs)	2008A	2009A	2010E	2011E	2012E
Net Income (Adjusted - mn)	707	1,329	2,814	4,601	5,462
EPS	7.11	13.38	28.31	46.30	54.96
EPS Change (YoY)	146.3%	88.1%	111.7%	63.5%	18.7%
Dividend / Share	0.586	0.618	0.600	0.600	0.600
Free Cash Flow / Share	(19.93)	(45.04)	(16.13)	18.55	27.14

Valuation (Mar)

	2008A	2009A	2010E	2011E	2012E
P/E	112.56x	59.86x	28.28x	17.29x	14.57x
Dividend Yield	0.073%	0.077%	0.075%	0.075%	0.075%
EV / EBITDA*	63.12x	26.27x	14.66x	9.96x	8.53x
Free Cash Flow Yield*	-2.16%	-4.89%	-2.02%	2.33%	3.43%

* For full definitions of *iQmethod*SM measures, see page 11.

Bank of America Merrill Lynch

Pratish Krishnan >>	+91 22 6632 8679
Research Analyst DSP Merrill Lynch (India) pratish.krishnan@baml.com	
Mitali Ghosh >>	+91 22 6632 8661
Research Analyst DSP Merrill Lynch (India) mitali.b.ghosh@baml.com	
Kunal Tayal >>	+91 22 6632 8663
Research Analyst DSP Merrill Lynch (India) kunal.tayal@baml.com	

Stock Data

Price	Rs800.60
Price Objective	Rs1,000
Date Established	2-Nov-2009
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs266.20-Rs1,020
Mrkt Val / Shares Out (mn)	US\$1,694 / 99.4
Average Daily Volume	3,717,044
BofAML Ticker / Exchange	EUSOF / BSE
Bloomberg / Reuters	EDSL IN / EDSO.BO
ROE (2010E)	28.3%
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.	920.00	1,000.00
2010E EPS	24.42	28.31
2011E EPS	36.92	46.30
2012E EPS	44.93	54.96
2010E EBITDA (m)	4,964.3	5,454.4
2011E EBITDA (m)	7,294.7	8,024.2
2012E EBITDA (m)	9,185.2	9,371.9

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Refer to important disclosures on page 12 to 14. Analyst Certification on Page 10. Price Objective Basis/Risk on page 10.

iQprofileSM Educomp Solutions Ltd.

Key Income Statement Data (Mar)	2008A	2009A	2010E	2011E	2012E
(Rs Millions)					
Sales	2,861	6,371	12,848	17,519	20,148
Gross Profit	1,575	4,105	8,753	11,502	12,746
Sell General & Admin Expense	(301)	(1,061)	(1,899)	(2,078)	(2,225)
Operating Profit	935	2,229	4,573	7,111	8,399
Net Interest & Other Income	129	(41)	620	89	213
Associates	NA	NA	NA	NA	NA
Pretax Income	1,065	2,189	5,193	7,200	8,612
Tax (expense) / Benefit	(351)	(773)	(1,714)	(2,376)	(2,842)
Net Income (Adjusted)	707	1,329	2,814	4,601	5,462
Average Fully Diluted Shares Outstanding	99	99	99	99	99

Key Cash Flow Statement Data

Net Income	711	1,347	3,295	4,601	5,462
Depreciation & Amortization	331	814	882	913	973
Change in Working Capital	(730)	(1,023)	(2,317)	(380)	(1,013)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	193	1,218	586	704	874
Cash Flow from Operations	505	2,357	2,445	5,839	6,296
Capital Expenditure	(2,224)	(6,249)	(4,049)	(3,986)	(3,566)
(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)	(4,049)	(3,986)	(3,566)
Shares Issue / (Repurchase)	0	0	4,800	3	4
Cost of Dividends Paid	(40)	(58)	(12)	(12)	(12)
Cash Flow from Financing	3,461	3,872	6,472	910	476
Free Cash Flow	(1,719)	(3,892)	(1,604)	1,853	2,730
Net Debt	862	6,786	12	(1,350)	(3,505)
Change in Net Debt	(1,634)	4,238	(2,783)	(1,362)	(2,156)

Key Balance Sheet Data

Property, Plant & Equipment	2,714	8,126	11,294	14,367	16,961
Other Non-Current Assets	318	1,966	1,955	1,955	1,955
Trade Receivables	1,157	2,765	4,573	4,837	5,669
Cash & Equivalents	2,912	1,902	6,761	9,524	12,729
Other Current Assets	570	1,833	1,619	1,839	2,124
Total Assets	7,671	16,592	26,202	32,522	39,438
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	16,662	21,475	27,234
Total Equity & Liabilities	7,647	16,550	26,402	32,722	39,638

iQmethodSM - Bus Performance*

Return On Capital Employed	16.1%	15.9%	20.9%	20.0%	19.1%
Return On Equity	35.1%	37.5%	28.3%	25.6%	23.8%
Operating Margin	32.7%	35.0%	35.6%	40.6%	41.7%
EBITDA Margin	44.3%	47.8%	42.5%	45.8%	46.5%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	0.7x	1.8x	0.9x	1.3x	1.2x
Asset Replacement Ratio	6.7x	7.7x	4.6x	4.4x	3.7x
Tax Rate (Reported)	33.0%	35.3%	33.0%	33.0%	33.0%
Net Debt-to-Equity Ratio	28.0%	135.5%	0.1%	-6.3%	-12.9%
Interest Cover	19.5x	8.3x	11.4x	14.8x	14.8x

Key Metrics

* For full definitions of iQmethodSM measures, see page 11.

Company Description

Set up in 1994, Educomp is India's largest provider of technology driven education solutions co. 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 Indias 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

5.1x

Raise estimates/PO; 25% upside

Post 2Q results we raise FY11& FY12 estimates by 26% & 22% to factor potential upside from the new revenue model in Smart Class, partly offset by higher investment in subsidiaries. Under the new model Educomp would securitize and recognize revenues upfront through a third party vendor as compared to five-year revenue recognition earlier. Raise PO by 9% to Rs1000, to factor upside to earnings estimates. Our PO is at 0.9x FY10/FY10-12E PEG, lower than 1x earlier and reflects potential derating given revenue streams in Smart Class are now likely to be lumpy in nature.

Announces new business model

As highlighted in our earlier note "Balance sheet, cash flows set to improve" Educomp announced adoption of a new business model from 3Q onwards.

Key highlights of the new model:

Edu Smart services: This company has been formed by ex employees of Educomp to implement hardware & provide services to Smart Class schools. Employees in hardware implementation have been transferred to Edu Smart and bank funding for securitization has been tied up. All centre employees will be transferred to Edu Smart.

- All hardware implementation and services to be outsourced to third party vendor, Edu Smart services. Educomp will enter in to tripartite agreement with schools and Edu Smart for Smart Class.
- Edu Smart to securitize revenue streams and pay Educomp upfront for H/W and content at a discounted rate. Edu Smart has already secured in principle approval from State Bank of India for securitization. All new contracts from 3Q would be signed under this model.
- Educomp will receive and recognize revenues in year one itself. All hardware cost will be expensed in year one itself. Effectively Educomp transitions to be a pure content and sales organisation with all implementation and outsourcing now being outsourced.
- Debtors days in Smart Class will reduce from current 140-150 days to 90 days.

Why new model?

As per management the new model was necessary in view of the strong growth potential in Smart Class. As per management there is a huge addressable market of over 28,000 private schools and penetration level is less than 10% currently.

Educomp is gearing up to further expand market reach and accelerate schools adds. It will roll out promotional campaigns to further enhance its reach and communicate its offerings. It has engaged leading Advertising agency Saatchi & Saatchi for thi,s and TV promos are slated to commence from next quarter.

Given the asset light model and rollout of promotional schemes, management expects school adds to accelerate during FY11. With implementation now outsourced to third party vendors, scalability concerns are addressed.

Financial implications of the new model

Edu Smart will pay Educomp nearly 74% of the value of a contract upfront. After providing for hardware cost, SG&A, we believe Educomp should still derive EBIT margins of 56%.

As per management it will save 10% of revenues which it currently pays as service tax as both content and H/W are now sold upfront as against five year services revenue earlier.

Raise Estimates

We raise estimates by 26% and 22% for FY11 and FY12 to factor potential upside from the new model, partly offset by higher losses in new initiatives.

Table 1: Revised Estimates

Revised Estimates (Rs.mn)	Earlier FY10E	Revised FY10E	Change (%)	Earlier FY11E	Revised FY11E	Change (%)	Earlier FY12E	Revised FY12E	
Sales	10083	12848	27%	13654	17519	28%	17578	20148	15%
EBIT	4964	5454	10%	7295	8024	10%	9185	9372	2%
PAT	3985	4573	15%	5871	7111	21%	7299	8399	15%
EPS (Rs.)	2427	2816	16%	3669	4605	26%	4465	5467	22%
FCF	24	28	16%	36.9	46	26%	44.9	55	22%

Source: BofA Merrill Lynch Research

Working of new model

Table 2: Per School Model (Rs.mn)

Current Revenue Model	Year 1	Year 1	Year 1	Year 1	Year 1
Capex (Rs.mn)	-8.1				
Revenues	1.512	1.512	1.512	1.512	1.512
Operating Cost	0.3	0.3	0.3	0.3	0.3
SG&A	0.08	0.08	0.08	0.08	0.08
Deprn (H/W capitalised)	0.34	0.34	0.34	0.34	0.34
EBIT	0.79	0.79	0.79	0.79	0.79
EBIT %	53%	53%	53%	53%	53%

New Model

	Year 1
Revenue	5.59
Hardware cost	1.7
SG&A	0.5
Other cost	0.28
PBIT	3.11
PBIT%	56%

Securitized revenue stream net of third party operating expenditure. Assumed discounted value at 11%
H/W to be expensed upfront
In line with current level
Inline with current levels

Source: BofA Merrill Lynch Research

Key Positives

Cash flow improves, may not need to raise funds at regular intervals

Given management's intent to securitize revenue streams in Smart Class, we expect FCF to turn positive in FY11, coming in at Rs1.9bn as opposed to current estimate of negative FCF of Rs-1.97bn. In addition, Educomp may not need to raise funds at regular intervals to finance its Smart Class growth.

Accelerated growth in school adds

With capex funding in place and enhanced focus on sales & marketing, we expect school adds to accelerate during FY11. We now expect the number of schools additions to be at 1400 for FY11 and 1600 for FY12 as against our earlier assumption of 1300 for FY11/FY12E.

However, given increased penetration in Tier 3 and Tier 4 cities, where number of classrooms is likely to be lower than Tier 1, we have baked in 18 classroom additions and lower fee structure in our model.

Key concerns

Service levels by third party need to be monitored

In our view schools valued the role of centre employee and service levels provided by Educomp. While the third party model should enable the company to ramp up implementation, Educomp will have to closely monitor service levels provided by the third party.

Quarterly Revenues

Table 3: Quarterly revenues

	2Q FY09	2Q FY10	YoY	Bof AML	
				E	Variance
Net Sales	1938	2535	31%	2489	2%
Total Expenditure	1081	1487	38%	1372	8%
EBITDA	857	1048	22%	1117	-6%
Depreciation & Amortisation	293	306	5%	245	25%
EBIT	564	742	31%	872	-15%
Other Income	35	250	608%	61	310%
Forex Losses	-37	-33	-12%	0	#DIV/0!
Interest	102	120	17%	83	44%
PBT	579	1440	149%	1340	7%
Tax	225	270	20%	442	-39%
PAT	342	1155	237%	852	36%
Profit before minority int./equity in earnings of affiliates					
Reported profit					
Recurring Profit	263	753	186%	523	44%
EBITDA margin	44%	41%		45%	
EBIT margin	29%	29%		35%	
Recurring PAT margin	14%	30%		21%	
	Consol	Consol			
Revenues (Rs.mn)	2Q FY09	2Q FY10	YoY %		
School Learning Solutions	807	2004	148%		
Higher Learning	69	61	-11%		
K-12 Schools	142	209	47%		
Online Supplemental & Global	303	261	-14%		
Total	1322	2535	92%		
				bps	
School Learning Solutions	55%	51%	-393		
Higher Learning	46%	-32%	-7792		
K-12 Schools	77%	25%	-5184		
Online Supplemental & Global	25%	-27%	-5116		

Source: BofA Merrill Lynch Research

Strong momentum in core operations

#1. Smart class. Momentum continues

Smart Class revenues increased 99% YoY to Rs1.36bn, driven by strong growth in school additions and partial adoption of the new business model. Management indicated that 2Q revenues included Rs600mn from securitization of a few existing and new contracts and hence year on year comparison is not meaningful. It implemented 309 schools during the quarter, in line with our estimate of 300 schools.

EBIT margins improved from 59% last year to 70% currently driven by SG&A leverage and positive impact of new business model.

In ICT, it added 671 schools during the quarter, taking the school base to 14,463. Management reiterated that it continues to focus on high margin deals. However in the long term, it is likely to de focus on this segment, in our view.

Table 4: 2Q Smart Class revenues

	Smart Class	ICT	Total
Revenues	1368	635	2003
PBIT %	68%	16%	51%
PBIT	923.4	101.6	1025
Smart Class Revenue Split (Rs.mn)			
BOOT Revenues	750		
Old contracts shifted to new model (300 schools)	400		
New contracts signed in new model (60 schools)	200		

Assuming PBIT margins of 70% for new model, implied margin for BOOT stood at 67%, implying margin increase QoQ

#2. K-12 progress on track; stake increases

Educomp commenced one more school during the quarter, taking the number of schools to 36 with nearly 16,000 students on roll. It currently has visibility of 48 schools for FY10. Management commented that it acquired land for seven new schools and in addition construction work for four new schools is underway.

Educomp increased its stake in Educomp Infrastructure & School management ltd (Edu Infra) from 69.4% to 75.2%. This is in lieu of advances given to Edu infra over the last two years. Valuation was based on independent opinion report from SBI Capital Markets and Grant Thornton.

Table 5: Edu Infra Financials

(Rs.mn)	8-Dec	9-Mar	9-Jun	9-Sep
Revenues	129	89	120	126
EBITDA	104	61	94	74
PAT	52	32	42	38
EBITDA %	81	69	78	59
PAT %	40	36	35	30

Source: BofA Merrill Lynch Research

New initiatives drag profitability

Table 6: New initiatives – QoQ PBIT movement

	1Q FY10	2Q FY10
Higher Learning (Professional Development + Vocational education & Higher education business)		
		Revenues flat, losses higher indicating higher investments. Mgt expects losses to continue during next few quarters
Revenues	68	61
PBIT	-7	-20
Online Supplemental & Global- New (incl Retail & Consulting)	263	261
PBIT	-10	-69

Source: BofA Merrill Lynch Research

Recurring PAT up 51% YoY

Educomp's reported PAT increased by 297% YoY to Rs1155mn. However, this includes benefits from new revenue model and one-time gains of Rs650 mn from stake sales in subsidiary to Pearson.

We have attempted to derive normalized PAT for the quarter. This assumes recurring BOOT revenues for Smart Class and revenues from new contracts signed under BOOT model.

Table 7: Normalised PAT for 2Q

	Consol 2Q FY09	Consol 2Q FY10	BofAMLE 2Q FY10	
PBIT (Rs.mn)				
School Learning Solutions	446	1029	722	Assuming revenue booking under old model
Higher Learning	32	-20	-20	
K-12 Schools	110	53	53	
Online Supplemental & Global	75	-69	-69	
Total	662	992	686	
Less : interest	32	120	120	
Less: other unallocable exps (net of un allocable income)	220	274	274	
Un allocable income	108	850	850	
Total PBT	518	1448	1142	
Tax	160	270	270	
Minority interest	67.1	11.3	14.9	
PAT	291	1155	855	
YoY %		297%	189%	
Recurring PAT	291	667	438	
YoY %		129%	51%	

Source: BofA Merrill Lynch Research

Other key highlights

Pre schools: number of franchisees under Roots to wings, its own pre school business, stood at 204 vs. 60 last year. Euro kids, where Educomp owns 50%, now runs 394 franchises and 30 owned pre schools.

Raffles JV: Educomp plans to set up 5 more colleges during the year. These would be set up at Chandigarh, Ahmedabad, Kolkatta, Hyderabad and Chennai. Raffles already has centres in Delhi and Bangalore.

Supplemental education: Management articulated its plan to tap the supplemental education market. Key focus areas include tutoring, counseling & test preparation segments. As per management, supplemental education is a US\$7bn opportunity in India and is growing at a CAGR of 16%. Ernst & Young has been appointed as consultant to provide strategic advice on this segment.

Financials

Table 8: Profit and loss statement

Rs mn (year-end March)	FY08	FY09	FY10E	FY11E	FY12 E
Sales	2861	6371	12848	17519	20148
Other income	177	227	1024	576	785
Total Income	3038	6598	13872	18095	20933
Cost of goods sold	798	1110	1960	3000	3711

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Table 8: Profit and loss statement

Rs mn (year-end March)	FY08	FY09	FY10E	FY11E	FY12 E
Personnel expenses	488	1155	2135	3017	3690
Administration and other expenses	301	1061	1899	2078	2225
Total Expenditure	1594	3327	7394	9495	10776
EBITDA	1267	3044	5454	8024	9372
Depreciation	331	814	882	913	973
EBIT	935	2229	4573	7111	8399
Finance charges	48	268	401	481	566
EBT	887	1961	4171	6630	7833
PBT	1065	2189	5196	7206	8618
Total Taxes	351	773	1715	2378	2844
Profit after tax and before prior period items	714	1416	3481	4828	5774
Profit after tax, minority interest & pre-acquisition profits	706	1329	2816	4605	5467

Source: BofA Merrill Lynch Research

Table 9: Balance Sheet

	FY08	FY09	FY10E	FY11E	FY12 E
Shareholders' funds					
Share capital	172	173	199	200	201
Reserves and surplus	2629	3886	6688	11277	16727
Net worth	2884	4203	15673	20263	25715
Minority Interest	194	804	989	1211	1519
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	23875	30088	36897
Goodwill	280	1225	1225	1225	1225
Fixed assets					
Gross Block	2890	6499	10548	14534	18100
Net Block	2342	5164	8332	11405	13999
Capital Work in Progress	372	2962	2962	2962	2962
Total	2714	8126	11294	14367	16961
Investments	36	729	729	729	729
Current assets, loans and advances					
Inventories	18	316	366	416	466
Sundry debtors	1157	2765	4573	4837	5669
Cash	2912	1902	6761	9524	12729
Loans and Advances	490	1138	1252	1421	1655
	4639	6153	12953	16200	20522
Less current liabilities and provisions					
Liabilities	517	1995	2071	2178	2285
Sundry creditors	415	599	649	699	749
Employee payables	36	95	100	105	110
Other liabilities	27	196	198	200	202
Advance from customers	16	632	632	632	632
Less current liabilities and provisions	610	2251	2327	2434	2541
Net current assets	4029	3903	10626	13766	17981
Total Applications	7061	14342	23875	30088	36897

Source: BofA Merrill Lynch Research

02 November 2009

Table 10: Cash Flow Statement

	FY08	FY09	FY10E	FY11E	FY12 E
Cash flows from operating activities					
Net profit before taxation and after prior period items as per P&L	1072	2108	5193	7200	8612
Depreciation	331	814	882	913	973
interest exps	48	268	401	481	566
Operating profit before working capital changes	1419	3721	6476	8594	10151
Trade & other receivables	-657	-1603	-1808	-264	-832
inventory	15	-298	-50	-50	-50
loans & advances	-426	-613	-114	-169	-234
Trade & other payables	338	1491	76	107	107
others	0	0	-421	-3	-4
Cash Generated from operations	689	2698	4159	8215	9138
Taxes paid (Net of TDS)	-184	-329	-1714	-2376	-2842
Net cash from operating activities	505	2357	2445	5839	6296
Cash flows from investing activities					
Purchases of fixed assets	-2224	-6249	-4049	-3986	-3566
Net cash used in investing activities	-2102	-7215	-4049	-3986	-3566
cash flows from financing activities					
Net proceeds from fresh issue of capital through IPO	0	0	4800	3	4
Proceeds/ repayment of long term borrowings	334	4000	2085	1400	1050
interest on borrowings	-48	-268	-401	-481	-566
Dividend paid	-40	-58	-12	-12	-12
FCCB raised	3109	8	0	0	0
Net Cash from financing activities	3393	3846	6472	910	476
Net increase in cash and cash equivalents	1796	-1011	4868	2762	3206
Opening cash and cash equivalents	1109	2905	1893	6761	9524
Closing cash and cash equivalents	2905	1893	6761	9524	12729

Source: BofA Merrill Lynch Research

Table 11: Ratios

Year Mar 31 (Rs mn)	FY07	FY08	FY09	FY10E	FY11E	FY12E
Valuation ratios						
P/E (x)	275	111.9	59.5	28.1	17.2	14.5
P/CEPS	166	66	32	21	14	12
P/BV (x)	55	24	16	5	4	3
EV/EBIT (x)	153	67	28	14	9	7
EV/ Revenues	57	22	10	5	4	3
Growth %						
Revenue	98	160	123	102	36	15
EBITDA	89	150	140	79	47	17
EBIT	94	128	138	105	56	18
Net Profit	106	146	88	112	64	19
Profitability %						
EBIT	37	33	35	36	41	42
Net Profit	26	25	21	22	26	27
Return %						
RONW	28.1	35	37.5	28.3	25.6	23.8
ROCE	22.7	19.4	20.8	23.9	26.4	25.1
Per Share Data (Rs.)						
EPS -diluted	3	7	13.4	28.3	46.3	55
CEPS	5	12	25	37	55	64
BVPS	14	33	49	158	203	256
DPS	0	1	1	1	1	1
FCF/Share	-26	-80	-243	-80	93	137
DSO	125	105	112	104	98	95

Source: BofA Merrill Lynch Research

Price objective basis & risk

Educomp Solu (EUSOF)

Our PO of Rs1000 is based on a P/E of 21x FY11E and is based on a 2 yr PEG of 0.9x vs 1x earlier and reflects potential derating given the Smart Class revenue stream is now likely to be volatile. Retain Buy given strong 37% CAGR in earnings FY10-12E, and sharp turnaround anticipated in FCF on shift to the 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 delays in execution of contracts in government schools, acquisition-related risks and managing multiple growth initiatives.

Analyst Certification

I, Pratish Krishnan, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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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
	Mphasis Ltd	MPSSF	MPHL IN	Pratish Krishnan
	Rolta India	RLTAF	RLTA IN	Pratish Krishnan
	Rolta India-GDR	XLROF	RTI LI	Pratish Krishnan
	WNS (Holdings) L	WNS	WNS US	Mitali Ghosh
NEUTRAL				

India - Software & IT Services Coverage Cluster

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
	Genpact Ltd	G	G US	Mitali Ghosh
	Patni	PATIF	PATNI IN	Mitali Ghosh
	Patni Computer	PTI	PTI US	Mitali Ghosh
	Tech Mahindra	TMHAF	TECHM IN	Pratish Krishnan
UNDERPERFORM				
	ExlService Holdi	EXLS	EXLS 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
	Infotech Enterprises Ltd	IFKFF	INFTEC IN	Pratish Krishnan
	Mastek	MSKDF	MAST IN	Pratish Krishnan
	Tata Consultancy	TACSF	TCS IN	Mitali Ghosh
	Wipro	WIPRF	WPRO IN	Mitali Ghosh
	Wipro	WIT	WIT US	Mitali Ghosh

iQmethodSM Measures Definitions

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

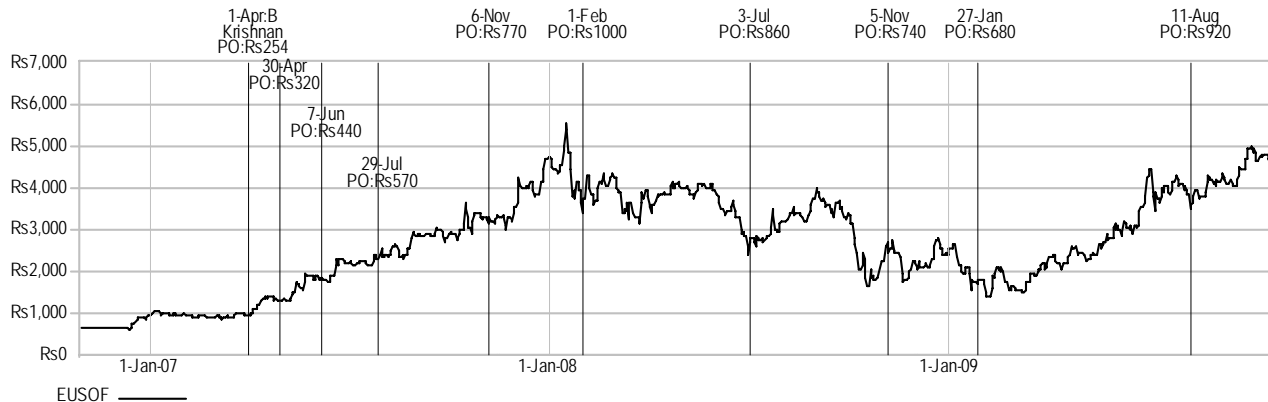
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EUSOF Price Chart



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

*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 September 30, 2009 or such later date as indicated.

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Investment Rating Distribution: Education & Training Services Group (as of 01 Sep 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	14	77.78%	Buy	8	57.14%
Neutral	3	16.67%	Neutral	1	33.33%
Sell	1	5.56%	Sell	1	100.00%

Investment Rating Distribution: Global Group (as of 01 Sep 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1528	47.19%	Buy	740	53.86%
Neutral	815	25.17%	Neutral	436	60.39%
Sell	895	27.64%	Sell	378	45.99%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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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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