

UBS Investment Research

Educomp Solutions

Corporate guarantee reduces to 20%

■ 2Q FY11 revenue and profit ahead of UBS estimates

Educomp reported 2Q FY11 consolidated revenue of Rs2.8bn, up 9.2% YoY, 7% ahead of estimates. EBITDA margins improved 700bp QoQ, in line with our estimate. Net profit declined 50% YoY to Rs578mn, but was higher than our estimate of Rs553mn. The YoY decline was due to higher profits in 2Q FY10 on account of the move to the upfront license fee sales model in smartclass.

■ Corporate guarantee reduces to 20% for incremental securitisation

On 5th October 2010, Educomp securitised receivables to the tune of Rs3bn, outstanding from the transfer of smartclass contracts to Edusmart. This incremental securitisation has recourse to Educomp's balance sheet only to the extent of 20%, down from 100% earlier. We view this as a major positive step towards moving to a recourse-free securitisation model for Educomp.

■ Margins improve QoQ, guidance for FY11 reiterated

Segmental operating margins in the School Learning Solutions segment (smartclass and ICT) improved by 470bp to 46.2%, in line with our expectations. We are also comforted by management reiteration FY11 guidance of Rs13.0-13.5bn in revenue and Rs3.30-3.35bn in profit.

■ Valuation: drop in corporate guarantee, 2H likely catalysts, maintain Buy

We view the reduction in corporate guarantee terms as a positive catalyst for the stock. We expect 2H FY11 to be much stronger in terms of growth, given 70-80% of profits typically get booked in the second half of the fiscal year. We maintain our estimates and Buy rating on the stock. Our PT is based on DCF.

Highlights (Rsm)	03/09	03/10	03/11E	03/12E	03/13E
Revenues	6,371	10,405	12,301	15,701	21,030
EBIT (UBS)	2,212	3,721	4,319	6,035	8,611
Net Income (UBS)	1,322	2,713	3,006	3,833	5,686
EPS (UBS, Rs)	15.21	29.33	31.66	40.36	59.87
Net DPS (UBS, Rs)	0.70	1.00	2.00	2.00	2.00

Profitability & Valuation	5-yr hist av.	03/10	03/11E	03/12E	03/13E
EBIT margin %	-	35.8	35.1	38.4	40.9
ROIC (EBIT) %	-	18.3	14.5	18.1	23.3
EV/EBITDA (core) x	-	14.4	10.1	7.6	5.6
PE (UBS) x	-	24.5	17.6	13.8	9.3
Net dividend yield %	-	0.1	0.4	0.4	0.4

Source: Company accounts, Thomson Reuters, UBS estimates. (UBS) valuations are stated before goodwill, exceptionals and other special items. Valuations: based on an average share price that year, (E): based on a share price of Rs558.65 on 11 Nov 2010 23:41 HKT

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Global Equity Research

India

Consumer Services

12-month rating **Buy**
Unchanged

12m price target **Rs775.00/US\$17.44**
Unchanged

Price **Rs558.65/US\$12.57**

RIC: EDSO.BO BBG: ED5L IB

12 November 2010

Trading data (local/US\$)

52-wk range	Rs792.10-452.05/US\$17.34-9.48
Market cap.	Rs53.3bn/US\$1.20bn
Shares o/s	95.4m (ORD)
Free float	50%
Avg. daily volume ('000)	939
Avg. daily value (m)	Rs555.0

Balance sheet data 03/11E

Shareholders' equity	Rs18.8bn
P/BV (UBS)	2.8x
Net Cash (debt)	(Rs13.1bn)

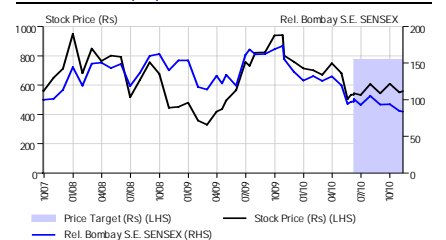
Forecast returns

Forecast price appreciation	+38.7%
Forecast dividend yield	0.4%
Forecast stock return	+39.1%
Market return assumption	13.0%
Forecast excess return	+26.1%

EPS (UBS, Rs)

	03/11E	03/10	Actual
Q1E	5.70	-	4.38
Q2E	6.96	-	13.18
Q3E	8.55	-	6.78
Q4E	10.45	-	6.38
03/11E	31.66	31.66	
03/12E	40.36	40.36	

Performance (Rs)



Source: UBS

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This report has been prepared by UBS Securities India Private Ltd

ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 6.

UBS does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

Table 1: 2Q FY11 financial performance snapshot

Year end March (Rs mn)	2Q FY11	YoY	UBSe	Actual vs. estimate
Revenues	2,768	9.2%	2,583	7.2%
EBITDA	1,038	-1.0%	978	6.1%
EBITDA Margin (%)	37.5%		37.9%	-38 bp
PAT	578	-49.9%	553	4.6%

Source: Company data, UBS estimates

Table 2: Segmental revenue and growth

Segmental Revenue (Rs mn)	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10
School Learning Solutions	1,385	2,004	1,987	2,690	1,591	1,923
Higher Learning Solutions	68	61	78	78	90	137
K-12 Schools	222	209	251	302	305	321
Online Supplemental & Global	263	261	285	262	293	387
Total	1,938	2,535	2,601	3,331	2,279	2,768
Segmental growth (YoY)						
School Learning Solutions	150.8%	148.4%	55.3%	61.5%	14.9%	-4.0%
Higher Learning Solutions	12.6%	-11.2%	-12.7%	-10.9%	32.1%	123.2%
K-12 Schools	387.4%	46.6%	26.8%	27.1%	37.4%	53.9%
Online Supplemental & Global	30.4%	-13.9%	-13.4%	-4.7%	11.3%	48.0%
Total	125.3%	91.8%	37.2%	47.1%	17.6%	9.2%

Source: Company data

Table 3: Segmental profitability

Segmental EBIT (Rs mn)	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10
School Learning Solutions	612	1,029	1,216	1,626	660	888
Higher Learning Solutions	-7	-20	-41	-39	-44	-65
K-12 Schools	86	53	103	88	117	129
Online Supplemental & Global	-10	-69	-47	-40	-63	31
Total	681	992	1,231	1,636	671	983
Segmental EBIT Margin						
School Learning Solutions	44.2%	51.3%	61.2%	60.5%	41.5%	46.2%
Higher Learning Solutions	-10.2%	-32.3%	-52.7%	-50.0%	-48.9%	-47.4%
K-12 Schools	38.9%	25.3%	41.1%	29.3%	38.3%	40.1%
Online Supplemental & Global	-3.9%	-26.5%	-16.5%	-15.2%	-21.3%	8.0%
Total	35.1%	39.1%	47.3%	49.1%	29.4%	35.5%

Source: Company data

Educomp Solutions

Income statement (Rsm)	-	03/07	03/08	03/09	03/10	03/11E	% ch	03/12E	% ch	03/13E	% ch
Revenues	-	1,101	2,861	6,371	10,405	12,301	18.2	15,701	27.6	21,030	33.9
Operating expenses (ex deprecn)	-	(595)	(1,595)	(3,344)	(5,546)	(6,713)	21.0	(8,306)	23.7	(10,965)	32.0
EBITDA (UBS)	-	506	1,266	3,027	4,859	5,588	15.0	7,395	32.3	10,065	36.1
Depreciation	-	(96)	(331)	(814)	(1,138)	(1,269)	11.5	(1,360)	7.2	(1,454)	6.9
Operating income (EBIT, UBS)	-	410	935	2,212	3,721	4,319	16.1	6,035	39.7	8,611	42.7
Other income & associates	-	59	175	220	1,161	369	-68.2	785	112.7	1,051	33.9
Net interest	-	(14)	(48)	(268)	(489)	(648)	32.6	(784)	21.0	(724)	-7.7
Abnormal items (pre-tax)	-	(23)	(50)	0	0	0	-	0	-	0	-
Profit before tax	-	432	1,011	2,164	4,393	4,040	-8.0	6,036	49.4	8,938	48.1
Tax	-	(170)	(351)	(773)	(1,626)	(970)	-40.4	(2,113)	117.9	(3,129)	48.1
Profit after tax	-	262	660	1,391	2,767	3,070	11.0	3,923	27.8	5,810	48.1
Abnormal items (post-tax)	-	4	(2)	2	0	0	-	0	-	0	-
Minorities / pref dividends	-	(1)	(3)	(68)	(54)	(64)	19.0	(90)	40.4	(124)	37.8
Net income (local GAAP)	-	265	655	1,324	2,713	3,006	10.8	3,833	27.5	5,686	48.3
Net Income (UBS)	-	283	708	1,322	2,713	3,006	10.8	3,833	27.5	5,686	48.3
Tax rate (%)	-	39	35	36	37	24	-35.1	35	45.8	35	0.0
Pre-abnormal tax rate (%)	-	37	33	36	37	24	-35.1	35	45.8	35	0.0
Per share (Rs)	-	03/07	03/08	03/09	03/10	03/11E	% ch	03/12E	% ch	03/13E	% ch
EPS (local GAAP)	-	3.31	7.74	15.23	29.33	31.66	10.8	40.36	27.5	59.87	48.3
EPS (UBS)	-	3.55	8.35	15.21	29.33	31.66	7.9	40.36	27.5	59.87	48.3
Net DPS	-	0.48	0.60	0.70	1.00	2.00	100.0	2.00	0.0	2.00	0.0
Cash EPS	-	4.75	12.27	24.58	41.63	45.01	8.1	54.69	21.5	75.18	37.5
BVPS	-	14.38	33.54	48.87	170.16	198.48	16.6	235.77	18.8	292.33	24.0
Balance sheet (Rsm)	-	03/07	03/08	03/09	03/10	03/11E	% ch	03/12E	% ch	03/13E	% ch
Net tangible fixed assets	-	831	2,714	8,126	11,794	14,061	19.2	16,415	16.7	18,779	14.4
Net intangible fixed assets	-	138	281	1,584	1,237	1,237	0.0	1,237	0.0	1,237	0.0
Net working capital (incl. other assets)	-	1,621	4,047	4,302	14,557	17,640	21.2	17,311	-1.9	21,317	23.1
Other liabilities	-	(59)	(210)	(439)	(439)	(419)	-4.6	(872)	108.0	(1,542)	76.9
Operating invested capital	-	2,532	6,832	13,573	27,149	32,519	19.8	34,092	4.8	39,791	16.7
Investments	-	0	19	329	329	329	0.0	329	0.0	329	0.0
Total capital employed	-	2,532	6,851	13,903	27,478	32,848	19.5	34,421	4.8	40,121	16.6
Shareholders' equity	-	1,148	2,884	4,203	16,145	18,832	16.6	22,370	18.8	27,736	24.0
Minority interests	-	128	194	804	858	922	7.5	1,012	9.8	1,136	12.3
Total equity	-	1,276	3,078	5,007	17,003	19,754	16.2	23,382	18.4	28,873	23.5
Net debt / (cash)	-	1,255	3,773	8,895	10,475	13,094	25.0	11,039	-15.7	11,248	1.9
Other debt-deemed items	-	0	0	0	0	0	-	0	-	0	-
Total capital employed	-	2,532	6,851	13,903	27,478	32,848	19.5	34,421	4.8	40,121	16.6
Cash flow (Rsm)	-	03/07	03/08	03/09	03/10	03/11E	% ch	03/12E	% ch	03/13E	% ch
Operating income (EBIT, UBS)	-	410	935	2,212	3,721	4,319	16.1	6,035	39.7	8,611	42.7
Depreciation	-	96	331	814	1,138	1,269	11.5	1,360	7.2	1,454	6.9
Net change in working capital	-	(225)	(730)	(1,023)	(3,934)	(984)	-75.0	(1,310)	33.0	(1,252)	-4.4
Other (operating)	-	72	201	950	802	596	-25.6	707	18.6	619	-12.4
Operating cash flow (pre tax/interest)	-	353	737	2,954	1,726	5,200	201.2	6,793	30.6	9,433	38.9
Net interest received / (paid)	-	(14)	(48)	(268)	(489)	(648)	32.6	(784)	21.0	(724)	-7.7
Dividends paid	-	(27)	(40)	(58)	(51)	(109)	115.5	(224)	105.3	(224)	0.0
Tax paid	-	(174)	(184)	(329)	(1,685)	(1,000)	-40.7	(1,606)	60.7	(2,380)	48.2
Capital expenditure	-	(675)	(2,219)	(6,227)	(4,805)	(3,536)	-26.4	(3,714)	5.1	(3,818)	2.8
Net (acquisitions) / disposals	-	0	0	0	0	0	-	0	-	0	-
Other	-	-	69	(1,255)	372	(215)	-	91	-	451	397.1
Share issues	-	0	0	0	9,496	0	-	24	-	0	-
Cash flow (inc)/dec in net debt	-	(596)	(1,685)	(5,183)	4,564	(308)	-	578	-	2,738	373.4
FX / non cash items	-	-	(832)	61	(6,144)	(2,312)	-62.4	1,477	-	(2,947)	-
Balance sheet (inc)/dec in net debt	-	-	(2,518)	(5,122)	(1,580)	(2,619)	65.8	2,056	-	(209)	-
Core EBITDA	-	506	1,266	3,027	4,859	5,588	15.0	7,395	32.3	10,065	36.1
Maintenance capital expenditure	-	(101)	(334)	(937)	(721)	(530)	-26.4	(557)	5.1	(573)	2.8
Maintenance net working capital	-	0	0	0	0	0	-	0	-	0	-
Operating free cash flow, pre-tax	-	405	932	2,089	4,138	5,057	22.2	6,838	35.2	9,492	38.8

Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill, exceptionals and other special items. Note: For some companies, the data represents an extract of the full company accounts.

12-month rating

Buy

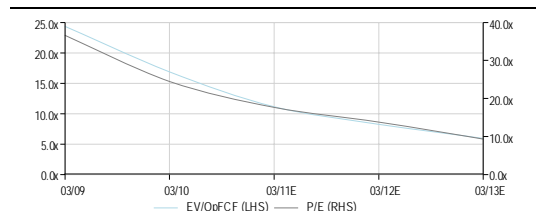
12m price target

Rs775.00

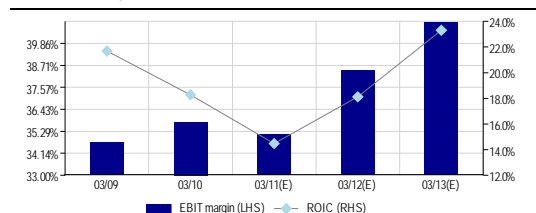
Company profile

Educomp Solutions (Educomp) is India's leading provider of multimedia course content to private schools, as well as a leading education services provider to the public education system. The company also has presence in the kindergarten to twelfth grade and pre-school segments, with more than 40 schools operating under multiple brand names. The company has recently entered the higher education segment through its tie-up with Raffles Education Corp, a Singapore-based provider of educational services. In addition to the above, Educomp has also has interests in online tutoring and vocational training.

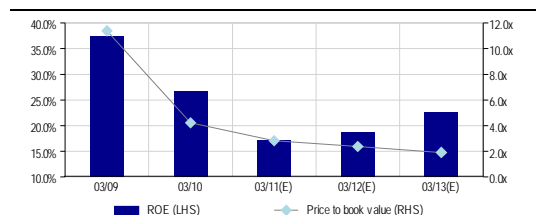
Value (EV/OpFCF & P/E)



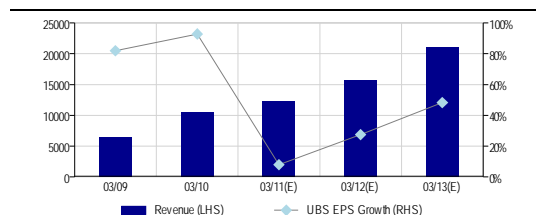
Profitability



ROE v Price to book value



Growth (UBS EPS)



Valuation (x)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
P/E (local GAAP)	-	39.5	26.3	18.5	14.5	9.8
P/E (UBS)	-	36.6	24.5	17.6	13.8	9.3
P/CEPS	-	22.7	17.3	12.4	10.2	7.4
Net dividend yield (%)	-	0.1	0.1	0.4	0.4	0.4
P/BV	-	11.4	4.2	2.8	2.4	1.9
EV/revenue (core)	-	8.0	6.7	4.6	3.6	2.7
EV/EBITDA (core)	-	16.8	14.4	10.1	7.6	5.6
EV/EBIT (core)	-	23.0	18.8	13.1	9.4	6.6
EV/OpFCF (core)	-	24.4	16.9	11.2	8.3	6.0
EV/op. invested capital	-	5.0	3.4	1.9	1.7	1.5

Enterprise value (Rsm)	03/09	03/10	03/11E	03/12E	03/13E
Average market cap	47,893	66,755	53,312	53,312	53,312
+ minority interests	804	858	922	1,012	1,136
+ average net debt (cash)	2,514	2,514	2,514	2,514	2,514
+ pension obligations and other	0	0	0	0	0
- non-core asset value	(329)	(329)	(329)	(329)	(329)
Core enterprise value	50,882	69,798	56,419	56,509	56,634

Growth (%)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
Revenue	-	122.7	63.3	18.2	27.6	33.9
EBITDA (UBS)	-	139.1	60.5	15.0	32.3	36.1
EBIT (UBS)	-	136.7	68.2	16.1	39.7	42.7
EPS (UBS)	-	82.0	92.9	7.9	27.5	48.3
Cash EPS	-	100.4	69.4	8.1	21.5	37.5
Net DPS	-	17.1	43.1	100.0	0.0	0.0
BVPS	-	45.7	NM	16.6	18.8	24.0

Margins (%)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
EBITDA / revenue	-	47.5	46.7	45.4	47.1	47.9
EBIT / revenue	-	34.7	35.8	35.1	38.4	40.9
Net profit (UBS) / revenue	-	20.8	26.1	24.4	24.4	27.0

Return on capital (%)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
EBIT ROIC (UBS)	-	21.7	18.3	14.5	18.1	23.3
ROIC post tax	-	14.0	11.5	11.0	11.8	15.2
Net ROE	-	37.3	26.7	17.2	18.6	22.7

Coverage ratios (x)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
EBIT / net interest	-	8.2	7.6	6.7	7.7	11.9
Dividend cover (UBS EPS)	-	21.8	29.3	15.8	20.2	29.9
Div. payout ratio (% , UBS EPS)	-	4.6	3.4	6.3	5.0	3.3
Net debt / EBITDA	-	2.9	2.2	2.3	1.5	1.1

Efficiency ratios (x)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
Revenue / op. invested capital	-	0.6	0.5	0.4	0.5	0.6
Revenue / fixed assets	-	1.0	0.9	0.9	1.0	1.1
Revenue / net working capital	-	1.5	1.1	0.8	0.9	1.1

Investment ratios (x)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
OpFCF / EBIT	-	0.9	1.1	1.2	1.1	1.1
Capex / revenue (%)	-	NM	NM	28.7	23.7	18.2
Capex / depreciation	-	7.6	4.2	2.8	2.7	2.6

Capital structure (%)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
Net debt / total equity	-	NM	64.9	69.5	49.3	40.6
Net debt / (net debt + equity)	-	67.9	39.4	41.0	33.0	28.9
Net debt (core) / EV	-	4.9	3.6	4.5	4.4	4.4

Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill, exceptionals and other special items.

Valuations: based on an average share price that year, (E): based on a share price of Rs558.65 on 11 Nov 2010 23:41 HKT Market cap(E) may include forecast share issues/buybacks.

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■ Educomp Solutions

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■ Statement of Risk

Any slowdown in the broader economy could affect spending levels on education, in terms of inability to increase school fees, lower spending on out-of-school instruction etc. This in turn could impact revenue growth and profitability for Educomp. Any incremental regulations on fee structures or capacity constraints could also adversely impact the company.

■ Analyst Certification

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UBS Investment Research: Global Equity Rating Allocations

UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	51%	37%
Neutral	Hold/Neutral	40%	33%
Sell	Sell	9%	22%
UBS Short-Term Rating	Rating Category	Coverage ³	IB Services ⁴
Buy	Buy	less than 1%	20%
Sell	Sell	less than 1%	0%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 30 September 2010.

UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

Short-Term Ratings reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case.

Equity Price Targets have an investment horizon of 12 months.

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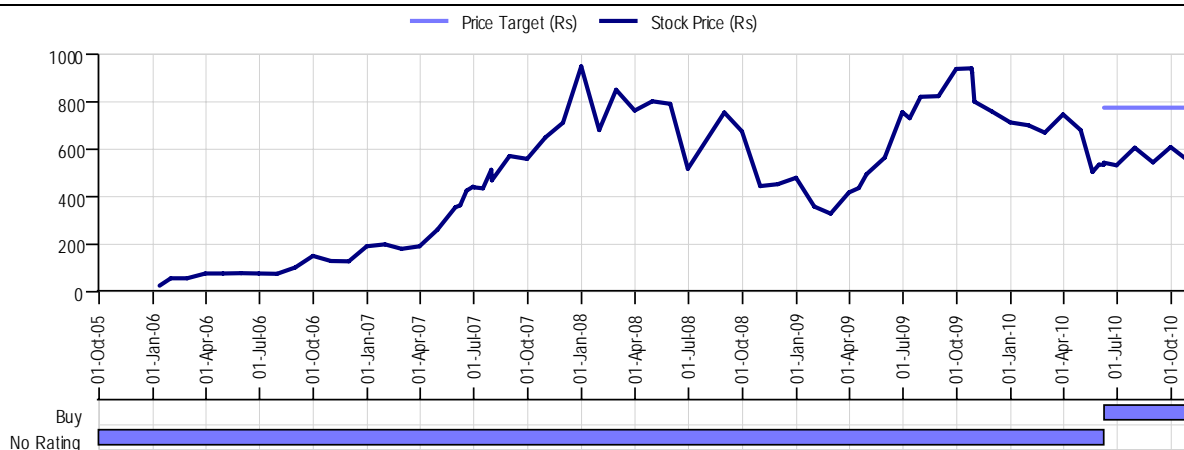
Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
Educomp Solutions	EDSO.BO	Buy	N/A	Rs558.65	11 Nov 2010

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Educomp Solutions (Rs)



Source: UBS; as of 11 Nov 2010

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