

Company Flash

28 January 2008 | 7 pages

Educomp Solutions (EDSO.BO)

Sell: In-line Quarter; Valuation Expensive

- Quarter broadly in-line** — Company reported standalone EPS of Rs9.28 (up 81% yoy); net profit for the quarter was Rs190m. Standalone revenue was Rs715m (up 159% yoy) while EBIT margin declined 670bps to ~34%. EBIT of Rs243m was marginally lower than expectations of Rs246m despite higher sales. Higher other income led to net profit marginally ahead of expectations.
- Consolidated results** — Company reported consolidated revenue of Rs883m and net profit of Rs197m – broadly in-line with expectations. Under K-12 initiative, company is on plan to add three more schools by the end of FY08.
- Segment-wise performance** — SmartClass revenue was Rs347m with 55.4% EBIT margin while ICT Solution revenue was Rs239m with EBIT margin of 28.4%. Both segment recorded good revenue growth though margin declined by 7.2% and 9.3% yoy.
- FY08 guidance revised marginally** — The company revised its full-year guidance marginally – revenue of Rs2.3-2.4b (from Rs2.2-2.3b earlier) and net profit of Rs650-700m (from Rs650m earlier). Net profit guidance is lower than our net profit expectations.
- Reiterate Sell; execution risks remain** — Trading at ~100x FY08E and ~56x FY09E earnings, the stock looks expensive despite high growth expectations. We believe the street is pricing in perfect execution of 100 schools in the K-12 segment in the next three years – which could be challenging in our view.

Sell/High Risk	3H
Price (28 Jan 08)	Rs3,939.05
Target price	Rs2,380.00
Expected share price return	-39.6%
Expected dividend yield	0.1%
Expected total return	-39.5%
Market Cap	Rs67,935M US\$1,727M

Price Performance (RIC: EDSO.BO, BB: EDLS IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	139	11.16	82.4	nm	70.2	24.8	0.0
2007A	287	15.93	42.7	nm	54.9	28.1	0.1
2008E	723	39.58	148.4	99.5	36.9	48.7	0.1
2009E	1,324	69.84	76.5	56.4	22.0	53.9	0.1
2010E	2,247	118.56	69.7	33.2	12.9	53.8	0.1

Source: Powered by dataCentral

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Figure 1. Educomp – Key Financial

Rs m	3Q07	3Q08	YoY
Revenue	276	715	159.4%
COGS	87	225	159.1%
Personnel expenses	19	95	400.8%
Gross profit	170	395	132.5%
SG&A expenses	28	62	118.5%
EBITDA	142	334	135.3%
Depreciation & Amortization	30	91	206.9%
EBIT	112	243	116.3%
EBIT margin	40.7%	33.9%	-675bp
Other income, net	12	46	291.4%
PBT	124	289	133.0%
Provision for tax	42	99	135.9%
Profit after tax	82	190	131.6%
Basic EPS	5.14	11.04	114.8%
Diluted EPS	5.14	9.28	80.5%

Source: Company Reports

Figure 2. Educomp – Segment-wise Financials

	3Q07	3Q08	Change
Professional Development			
Revenue	31.0	65.6	111.6%
EBIT	20.0	41.7	108.0%
EBIT margin	64.6%	63.6%	-108bp
Smart Class			
Revenue	144.9	347.0	139.5%
EBIT	90.7	192.2	111.8%
EBIT margin	62.6%	55.4%	-724bp
ICT Solutions			
Revenue	80.1	238.7	197.9%
EBIT	30.2	67.7	124.4%
EBIT margin	37.6%	28.4%	-929bp
Others			
Revenue	19.7	63.8	223.6%
EBIT	4.6	38.8	737.3%
EBIT margin	23.5%	60.8%	3731bp
Unallocated expenses	33.5	97.8	192.3%

Source: Company Reports

Margins decline on yoy basis across three major segments

Educomp Solutions

Company description

Educomp is one of India's largest market-listed educational service providers focused on the K-12 space (both IT and IT-enabled education). Based in New Delhi, the company operates across various metros and mini metros for private schools and partners various state governments for IT education. The company has three primary business segments: (1) Smart Class is an online learning aid targeted towards private educational institutes; (2) ICT Solution is targeted

towards government-aided schools for IT infrastructure and training; and (3) Professional Development instructor-led training targeted at school teachers. Apart from these key segments, the company has also ventured into retail initiatives with a) MathGuru.com, a retail online offering; b) online tutoring (through ThreeBrix acquisition); and c) K-12 schools (Roots-to-Wings), pre-schools and high schools.

Investment strategy

We rate Educomp (EDSO) as Sell/High Risk as we believe its valuations are expensive despite its strong revenue and earnings growth. We forecast strong top-line growth of 110% CAGR and 95% EPS CAGR over FY07-10 as the company penetrates beyond tier 1 & 2 cities. We see stable margins as pressure in school ventures and the ICT business is countered by leverage in Smart_Class and MathGuru. However, we believe the market has been ignoring the high valuations.

Valuation

We value Educomp on a P/E basis. Our target price of Rs2,380 is based on 35x FY09E EPS, derived using the stock's historical trading band. Since listing in Dec 2005, the stock has traded in a range of 15-58x one-year forward P/E, with an average of 29x. Over the past year, the average P/E has been 34x. Our target multiple of 35x is at 20% premium to the stock's average historical valuation to factor in the company's stronger growth prospects. It is supported by valuation multiples of other educational services companies in the Asia Pacific region. We believe 35x is fair as we expect strong revenue CAGR of 102% and an earnings CAGR of 95% over FY07-10E. We believe P/E remains the most appropriate valuation measure given Educomp's profitable track record and the widespread use of this methodology.

Risks

Our quantitative risk-rating system, which tracks 260-day historical share-price volatility, rates Educomp Solutions as High Risk. We believe this risk rating is appropriate as there are execution risks in recent initiatives like Edu-Infra and Edu-Manage. Also, the company still has negative free cash flow and high receivable days on its balance sheet. The key upside risks to our target price include: (1) higher-than-expected sign-ups for Smart_Class; (2) faster-than-expected fresh orders in the ICT and professional development businesses; (3) higher-than-expected enrollment in retail initiatives such as MathGuru.com and online/home tutoring; (4) lower-than-expected inflation in fixed/corporate costs; and (5) better-than-expected EBIT margins in various business segments.

Appendix A-1

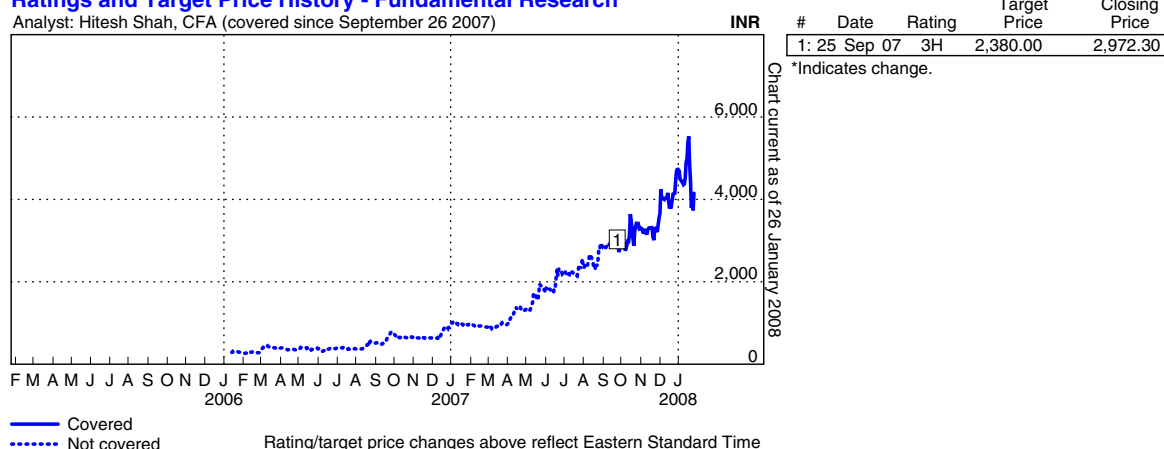
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Analyst: Hitesh Shah, CFA (covered since September 26 2007)



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