INDIA RESEARCH

Indian Education Sector

Long way from graduation!

January 2009

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Class of 20??

IDFC SSKI

INDIA RESEARCH

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Sector report

Indian Education

Long way from graduation!

"Over-regulated and under-governed" best describes the largest sector in India – Education (IES). In a failed public education system, *aspirations* are meeting *affluence* and taking private IES through a phase of Price Discovery. Ironically, the gargantuan potential (estimated private spend of US$50bn; $80bn by 2012) is trapped! The 'not-for-profit' nature of the $40bn formal IES has deterred for-profit private participation while inability to transform education into a 'process-driven' model curtails scalability in non-formal IES ($10bn). Our investment thesis in IES rests on 4Cs – players with Credibility (management intent & ability), Capital (built to last), Creativity (to 'manage' the over-regulated environment) and Content (to differentiate and build annuity). We see limited value creation potential in the space, mainly due to scale issues. However, Educomp Solutions and Manipal Universal Learning (unlisted) exhibit the 4KSFs with strong pricing power as indeed ability to create an annuity pool and are our bets in the sector.

IES – the 'Largest'…inefficiencies the 'Highest': IES is by far the largest capitalized space in India with $30bn of government spend (3.7% of GDP; at global average), and a large network of ~1m schools and 18,000 higher education institutes. Yet, the public education system is 'insufficient' and 'inefficient', leading education-hungry and affluent Indians to spend $50bn on private education (14% CAGR over FY08-12E).

Investability Quotient – the 'Lowest': The 'not-for-profit' diktat, a poor regulatory framework and low risk-appetite have discouraged for-profit participation in the lucrative private formal IES. With no structural change in sight (rampant corruption and low political will), IES has attracted limited capital. Meanwhile, non-formal IES – while non-regulated and faster-growing – fails the scalability test (barring a few pockets).

Betting on mavericks: Though a few smaller players have attracted some capital, we see limited value creation potential in IES due to regulatory and scalability issues. Armed with creativity, certain for-profit players are using innovative two-tier structures to unlock the 'surplus' generated and, more importantly, plough it into scalable (as also transparent) business models. Exhibiting the 4Cs, we like Educomp Solutions and Manipal Universal Learning (unlisted) – players with scaled-up and annuity businesses as also strong pricing power.

Valuations

				FY10E				
Company	Price (Rs)	Mkt Cap (Rs m)	Reco	PER (x)	RoCE (%)	ROE (%)	Target (Rs)	Upside (%)
Educomp Solutions	1,936	33,389	Outperformer	15.8	28	38.7	2,800	45
Everonn Systems	199	3,008	Neutral	8.4	20.3	16.4	238	19
NIIT	23	3,755	Neutral	7.2*	9.5	16.7	27	18

*Prices as on 15 January 2008; *Valuing NIIT on core earnings ex-share of associate*

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INVESTMENT ARGUMENT

India's well-capitalized public education system has failed miserably due to remarkably high level of inefficiency (37% net enrolment at school level!). This has led to a whopping $50bn annual spend on private education ($80bn by 2012E). But while money attracts more money, it has ironically eluded IES (just $180m of private equity capital chase) – a function of limited value creation potential. We met around 45 players in the space and conclude that IES is a long way from graduation. While formal IES (80% of total) is lost in a regulatory maze (not-for-profit mandate), the highly fragmented non-formal segments are in a scalability bind. With Credibility, Content, Capital and Creativity separating the ayes from nays, only players working to acquire the 4Cs would show higher Investability Quotient (IQ). With few 'relevant' players above the $20m mark, Educomp Solutions (FY08 revenues of Rs2861m) and Manipal Universal Learning (Rs8631m) are the two scaled-up and annuity businesses that we like.

Exhibit 1: Indian Education Sector (IES) – an interesting class

IES - The Largest	Inefficiencies - The Highest	Investability Quotient (IQ) - The Lowest
Largest Capitalized space • Public spend of $30bn (3.7% of GDP) • Private spend of $50bn (14% CAGR over FY08-12E)	**'Insufficient' funds** • Free product (public schools) loses market share – 40% of the student base enrolled in private schools (7% of the total school network)	**$40bn:'overregulated & under-governed'** • For 80% of the private spends (formal IES), regulations (not-for -profit mandate) a big deterrent • Low political will to bring about the much required structural change
Largest Supply • A network of ~1m schools and 18,000 HEIs • First Indian satellite - EDUSAT (launch Sep-04) to serve the education sector	**'Inefficient' supply** • 66% of the school network only till primary level • Only 0.85% of USD 30bn spent on capital expenditure	
Largest Demand • Globally the largest population of 572m within the 0-24 years age group	**Lowest enrollments, highest dropouts** • 61% of target population enrolled, 40% dropout at school level (a mere 37% net enrolled) • Lowest GER* globally of 9.97 at higher education level	**$10bn: Scores low on scalability** • For remaining 20% (non-formal IES), scalability remains a big issue

Players exhibiting the four key success factors (4Cs) - Credibility (management intent & ability), Capital (built to last), Creativity (to 'manage' an over-regulated environment) and Content (ability to differentiate and build annuity) offer maximum value creation potential

*Source: IDFC-SSKI Research; *GER – General enrollment ratio*

Exhibit 2: IES – a factsheet

Govt spend (Centre + states) on education: $30bn; at 3.7% of GDP, comparable to global average; 0.82% as capital expenditure, 80% on teachers' salaries; >90% spend on K12 (kindergarten to 12th grade). Centre's budgetary allocation up 6x in 11th Plan period

Private spend on education: 5% of average HH income (12% in USA, 15% in China). CAGR of 8.6% vs 3.2% in consumption; 8% CAGR over FY08-20E (growing fastest globally)

Network: ~1m schools, of which 75,000 (7%) are private – 40% of enrolled population attends private schools; 18,000 HEIs (largest globally)

Regulatory framework: K12 and HEIs required to be run as not-for-profit institutes set up under a Trust/ Society; also, though 100% FDI allowed through automatic route, no rules/ regulations in place for foreign universities to be recognized under UGC (University Grants Commission)

Source: IDFC- SSKI Research, MHRD

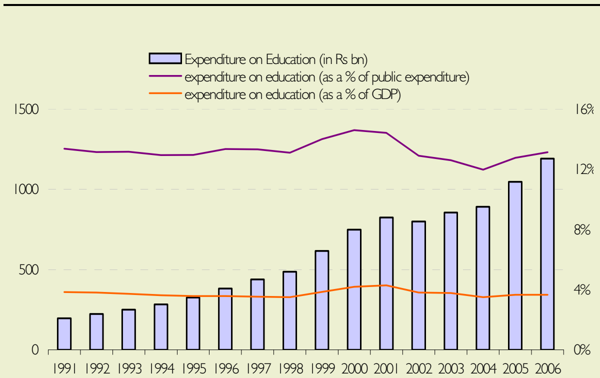
Largest capitalized space – annual public spend of $30bn and private spend of $50bn

IES: THE 'LARGEST'…

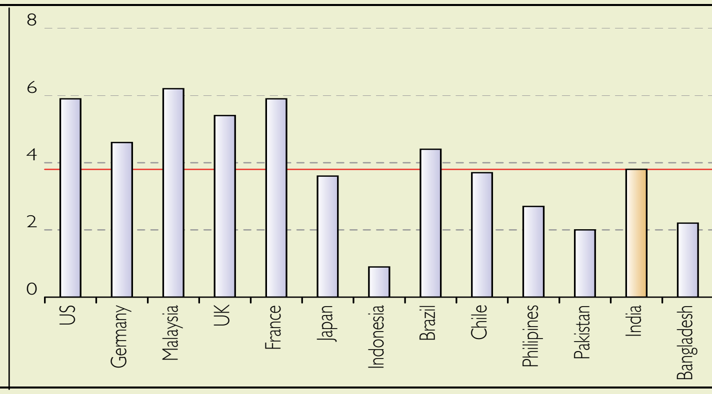
IES is by far the largest capitalized space in India with government spend of $30bn (2006; at ~3.7% of GDP, it is in line with the global average). For the 11th 5-year Plan, the Centre has allocated a 6x higher spend on education. Importantly, the extent of the spends have created one of the 'largest' education networks globally of ~1m schools and 18,000 higher education institutes (HEIs) in India, home to the largest population within the age group 0-24 years.

Exhibit 3: The 'inefficient' equation – 'Largest' capitalized = Largest demand = 'Largest' supply

IES – Largest capitalized space



Government spend as % of GDP – India at the global average

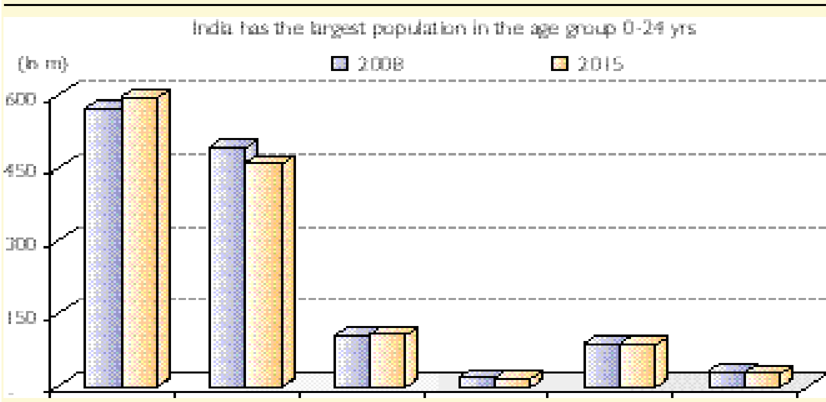


Source: (1) GDP figures are taken from National Accounts Statistics

(2) Budgeted Expenditure on Education published by D/o Secondary and Higher Education

Source: UNESCO

Exhibit 4: Largest demand



'Largest' supply

Total no. of schools
1,025,000
Total no. of students enrolled
219m

=

Total no. of colleges
18,000
Total no. of students enrolled
11m

Source: UN Database

Source: MHRD

...yet the system highly 'insufficient' & 'inefficient'

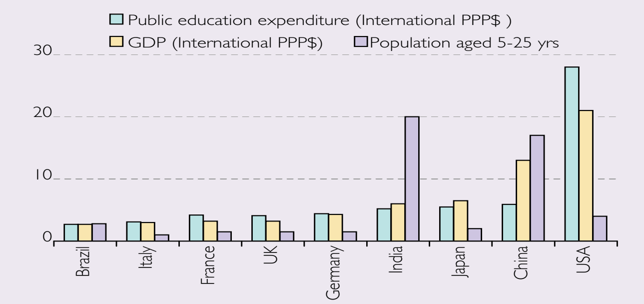
The statistics are indeed impressive, but a closer look reveals that these spends are not only 'insufficient' but also 'inefficient'. Considering global distribution patterns of public education expenditure (international PPP$) and population, India's spend on education is highly disproportionate! While countries in North America and Western Europe account for more than half of the global spend on public education, less than 10% of the world's school-age population (5-25 years of age; from primary to tertiary levels) lives in these countries. USA's assigned public spend amounts to 25% of the cumulative spend on just 4% of the target population group. In sharp contrast, India's public spend on education amounts to ~5.2% of the world's cumulative public spend, but the country is home to 20% of the population in the target group.

India spends 5.2% of global spends on education…on 20% of world population

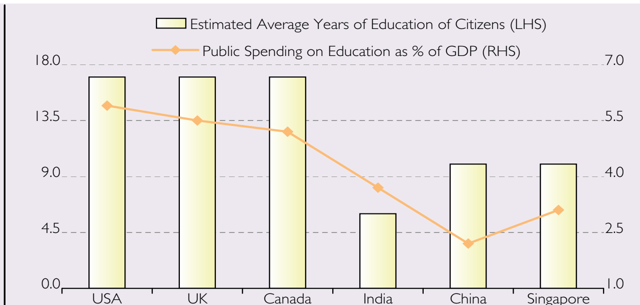
66% of 1m+ schools only till primary level; just 37% of target population enrolled

Further, a break-up of government spend shows that only a miniscule 0.82% component goes towards capital expenditure. A whopping 80% of the revenue expenditure on teachers' salaries leaves little to be spent on infrastructure creation, which eventually translates into 'ineffective' infrastructure/ quality of education. While India has a network of more than 1m schools, 66% of these are only till the primary level. Inefficiency of the public education system is amply captured in the fact that only 61% of the target group is enrolled in schools and with dropouts as high as 40%, net enrollment levels are a dismal 37%.

Exhibit 5: IES – an 'insufficient' and 'inefficient' public education system



Even though India spends 3.5% of GDP ($30bn) on education, spends are highly disproportionate



While China spends 2.2% of GDP, its estimated average years of education of citizens is 10yrs (6 yrs for India)

Source: UNESCO Institute for Statistics database

$50bn private spend – a large opportunity canvas

❑ 'Private' players – balancing the 'inefficient' equation

Given the dismal state that IES (read government-run schools/ institutions) is in, consumers are increasingly veering towards private institutions, typically perceived as hallmarks of quality (even though quality comes at a price). In this backdrop, the market for private formal education has grown to a stupendous $40bn in size over the past few decades. Not only that, a $10bn market has evolved around the formal education segment.

We have divided the private spend of $50bn (IES opportunity) into two segments: Formal ($40bn) and Non-Formal ($10bn) IES. Below we give the broad structure followed by formal IES and the key non-formal segments flanking it.

Formal IES: The formal educational system in India broadly comprises schools (often classified as K12 – kindergarten to 12th) and higher education (HE) level. All the levels, from school to higher education, fall under the purview of the Ministry of Human Resource Development (Department of School Education and Literacy & Department of Higher Education). Schools cater to the '3-17 years' age group. With no central governing body for K12, they are ruled by state boards/ ICSE/ CBSE/ International Boards. Higher education institutes cater to the '18-22 years' & above age group. With a single governing body (UGC), HE comprises graduate/ diploma/ professional courses. This may be followed by post graduation courses.

Non-formal IES: The non-formal education segments flanking the formal ones include preschools (1.5-3 years), coaching classes, multimedia/ IT to schools and colleges (catering to both private and public institutions), vocational training and the books market. The segments are free of any regulations (i.e. no governing/ regulatory bodies for this segment).

Only 7% of total schools dispense education to 40% of students enrolled

Private institutes in the formal education space (K12 and HE) have proliferated rapidly over the past many decades – and as many as 75,000 schools out of the total 1m existing schools are privately-run. The importance of private participation is underlined by the fact that even as only 7% of the total schools are private, they dispense education to 40% of India's total students enrolled. This is despite K12 (schools) being a focus area for the government as less than 10% of the total public expenditure on education is assigned to higher and university education. As a result, 77% of India's ~18,000 HEIs are private.

Exhibit 6: Private IES – big growing bigger

($ m)	Revenues (2008E)	% share of total	Revenues (2012E)	CAGR (%)
Formal IES	**40,000**	**80**	**65,250**	**13**
K12	20,000	40.00	33,779	14
Higher Education*	20,000	40.00	31,470	12
Non-formal IES	**10,110**	**20.00**	**19,608**	**18**
Preschool	300	0.60	1,026	36
Multimedia in private schools	70	0.14	459	60
ICT in govt schools	90	0.18	752	70
Coaching classes	6,400	12.77	11,194	15
Vocational training	1,500	2.99	3,662	25
Books	1,750	3.49	2,516	10
Total IES	**50,110**		**84,858**	**14**

*Source: IDFC-SSKI Research; *Higher Education spends include $13bn spent annually to export education*

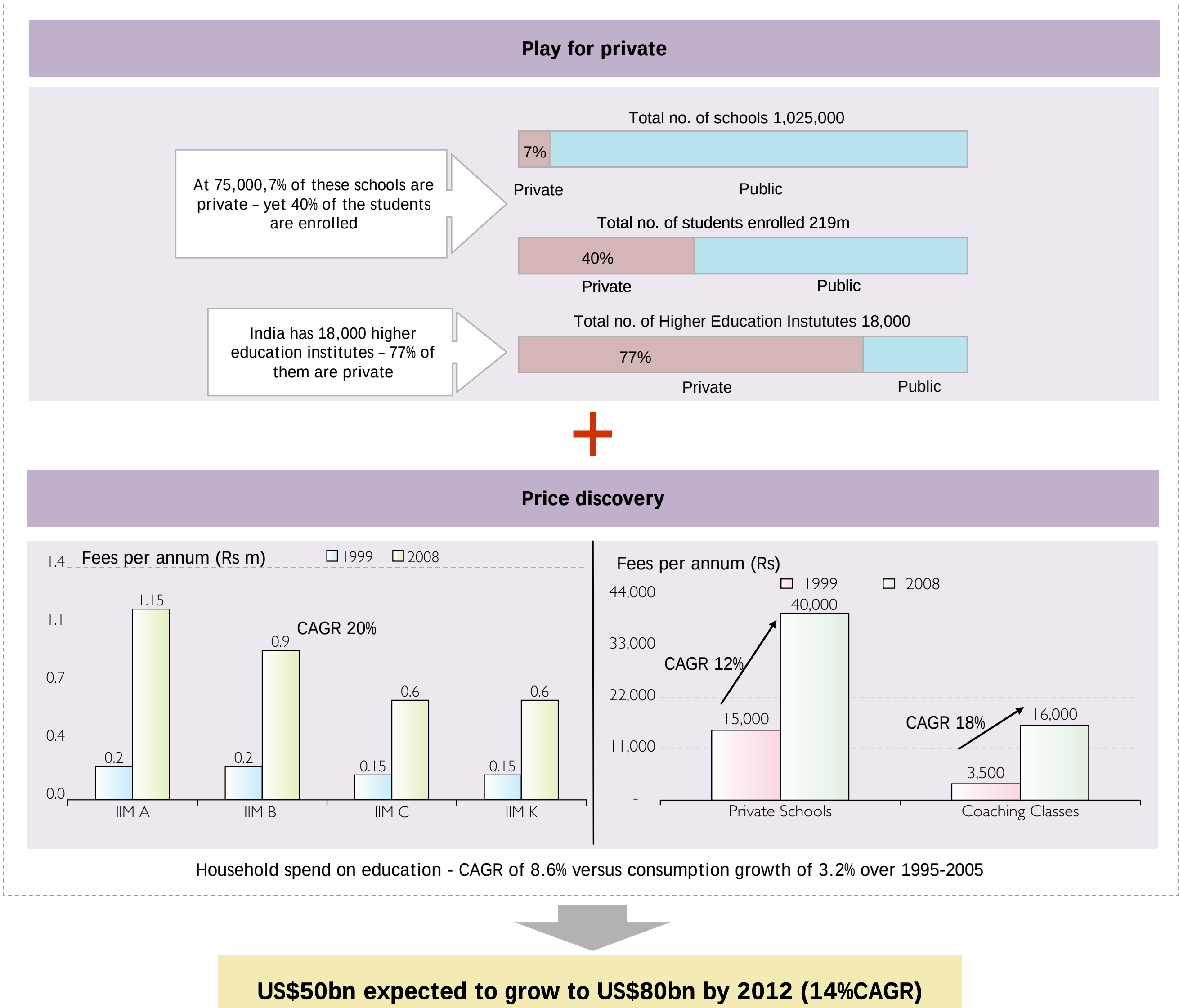
Growing aspirations backed with increasing affluence leading to price discovery…

Spends on private education to increase to $80bn by 2012E: India's current spend on education is at 5% of average household (HH) income, showing a CAGR of 8.6% versus consumption growth of 3.2% over 1995-2005. Going forward, we expect the consuming class, i.e. HHs with annual income >Rs90,000, to burgeon from 28% of the total population in 2002 to 48% in 2010. Increasing affluence has been fostering higher aspirations for India's populace, and the ability as also willingness to pay are guiding its education sector through a phase of price discovery. The $13bn spent annually by Indians on higher education in the overseas markets asserts the pay power of the education-hungry Indians.

…private IES – a USD80bn opportunity by 2012E

With an inefficient public education system, a growing young population, a bourgeoning middle class (with the intent and ability to spend) and price discovery that the IES has seen over the past decade, we expect 14% CAGR in private spends on education ($80bn by 2012). Non-formal segments are fast-growing areas of the education landscape – we expect 18% CAGR for them over the next few years against 13% CAGR for the formal education space. (For further details on formal and non-formal segments of IES, refer to page 20 and 21.)

Exhibit 7: India spends $50bn annually on private education, estimated to grow to $80bn by 2012



Source: MHRD, IDFC-SSKI Research

…YET IES A LONG WAY FROM GRADUATION

A failed public education system, high socio-aspirational value attached to education and increasing affordability have all converged to drive demand for quality education (synonymous with private institutes). The $50bn education market, estimated to expand to $80bn by 2012, portends a great opportunity at hand for wealth creation. BUT the ground reality is in stark contrast.

IES – up against scalability issues and regulations

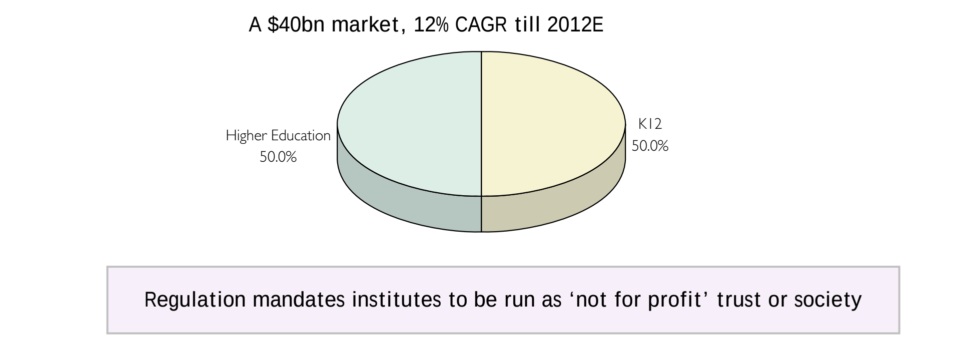
While private players have been active in the formal IES for a few decades, the 'not-for-profit' mandate has kept profit-driven corporates away from the $40bn opportunity. In the $10bn non-formal space, scalability remains an issue in most pockets. Inability to transform the businesses into a 'process-driven' model from 'people-driven', as also lumpy nature of revenues, has materially curtailed scalability in the highly fragmented and largely regional markets. While scale is attainable in a few pockets, we maintain education is a difficult business to scale – our stand is vindicated by the dearth of scaled-up players in the space.

‘Not-for-profit’ mandate restrict investments in the space

❑ Formal IES – regulations a ‘big bully’

While India has been proactive on liberalization, IES has remained largely untouched by the reforms process. A ‘priority sector’ status does ensure fund flow to an extent, but the government’s agenda of ‘social inclusion’ has trapped IES in a regulatory maze. Archaic rules mandate all formal educational institutes in India to be run as ‘not-for-profit’ centers under a society (registration under the Societies Registration Act 1860) or a public trust (Registration Act 1908). Any surplus funds generated in the process of running formal schools/ HEIs have to be ploughed back into the same school/ HEI and no dividends can be distributed.

Exhibit 8: Formal IES – regulations the big bully



Source: IDFC-SSKI Research

K12 schools need affiliation/ recognition by boards for students to be part of education system

K12 segment: At $20bn, schools (also popularly known as K12, i.e. from Kindergarten to 12th standard) form a core of the total market. A student can continue to be a part of the education system – or his/ her 10th or 12th grade scores would be recognized – only if he/ she passes out from a K12 institute affiliated to a board recognized by the system. Hence, all K12 institutes have to be affiliated to an education board – either central boards like ICSE and CBSE or a state board. While a few states confer on schools the right to act as profit-generating entities, educational boards still demand strict adherence to the not-for-profit structure.

Of late, a trend has emerged wherein some schools have been seeking affiliations with various international boards such as IGCSE (International General Certificate of Secondary Education) and IB (International Baccalaureate from Geneva); in terms of operating structure, while these schools can opt for either a not-for-profit trust or a for-profit company, they can do so only after evaluating the state laws (e.g. Haryana allows schools to be run for-profit while most states do not).

HEIs (Higher Education Institutes): At $6.5bn ($20bn including cash transactions of ~$1.5bn and the $13bn spend outside the country), HE is the second largest opportunity in IES. HEIs seeking recognition by the apex regulatory authority named UGC (University Grants Commission) also need to be run in the form of a trust/ society. Technical education institutes find themselves regulated under various professional councils as well – e.g. AICTE (All India Council for Technical Education) is the regulating authority for engineering and MBA colleges.

HEIs can opt to not affiliate to the system; but industry acceptance is mandatory

With most of these bodies perceived as extremely corrupt and bureaucratic (a typical case of 'over-regulation but under-governance'), it is difficult for new players to enter and existing players to expand in the space. *However, an HEI (unlike K12) can do without recognition from these bodies – as long as they are a quality institute with acceptance from the industry (a student typically joins the industry after passing out from HEIs). A case in point is ISB (Indian School of Business, Hyderabad – a premiere business school), which has proved that a quality institute with strong industry acceptance does not require the stamp of affiliation with these bodies.*

Much required structural changes look difficult to achieve

This implies that 80% (formal IES) of the market potential is not directly exploitable by corporates with profit-driven business models. Due to the high involvement of politicians with respect to ownership and the shortage of quality institutes leading to lucrative cash transactions, the much-required structural change in education does not appear to be in sight. Other issues that plague the sector are high land prices and little clarity on FDI pertaining to this space.

Exhibit 9: Formal IES – structural changes required

	What is the issue?	What needs to change?
'Trust' Issues	• Regulations require all educational institutions (school or college) to be run as a trust or a society • No dividends can be distributed and the 'reasonable surplus' needs to be ploughed back into the system	• A structural change required to allow for-profit schools and colleges. The regulatory bodies need to act as only 'quality controllers' and check fly-by-night operators
Political Quagmire	• More than 75% of the educational institutes (in Maharashtra) are run by politicians. Low political will to realign the 'not -for-profit' education system	• Strong political will to realign education policies • Vested interests need to take a back-seat
Land Blues	• A large portion of subsidized land demarked for schools is hoarded and resold to schools at much higher prices; High land prices make economics unviable	• State development authorities need to put a system in place to ensure only genuine bidders get land
Low FDI	• Even though 100% FDI through the automatic route is allowed since 2000, no regulations formulated for recognizing foreign HEIs under UGC	• Clear regulations need to be put in place for recognition of foreign universities

Source: IDFC-SSKI Research

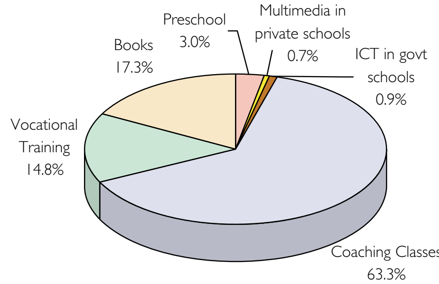
Less than 5% of $10bn non-formal IES offers scalability

❑ Non-formal IES – scores low on scalability

While we expect the non-regulated $10bn non-formal market to witness 18% CAGR till 2012, the market broadly consists of segments that are inherently difficult to scale. In fact, scalability can be achieved only in less than 5% of the market while three of the largest segments (95% of the opportunity – coaching class; ~64%, vocational training; 15% and books; 17%) offer limited value creation potential.

Exhibit 10: Non-formal IES – failing the scalability test

- A $10bn market, 18% CAGR till 2012E



A highly fragmented and largely regional space; ~95% of market inherently difficult to scale

Source: IDFC-SSKI Research

Market remains regional and fragmented…

At 64% of opportunity, coaching classes dominate non-formal IES

India's non-formal education market is currently dominated by coaching class business (accounting for 64% of the total). However, the business ($6.4bn; 15% CAGR till 2012E) is inherently regional in nature and person-centric (a people-driven model), which implies high dependence on a 'brand-teacher', or a low degree of stability and scalability.

High dependency on people mars scalability within coaching classes…

We believe ~80% of the coaching class market arises from subject/ concept-based school and tertiary level coaching, which has to be localized to suit the dynamic needs of various institutions and has high dependence on 'brand teachers'. Mahesh Tutorials (revenues of Rs700m in FY09E) is one of the few coaching class players that have managed to achieve some 'scale' in this non-scalable segment.

Exhibit 11: Coaching class market (64% of non-formal IES)

	Market ($ m)	Dependence on people	Scalability
6-12 and tertiary education – subject/ concept-based	5,088	High	Low
Grad test prep – based on concept application	1,078	Medium	Low-Medium
Post grad test prep – aptitude-based	216	Low	Medium-High
Total Coaching Class Market	6,382		Medium

Source: Coaching class players, IDFC-SSKI Research

…but 20% of coaching class market scores medium to high on scalability

Notably, the remaining 20% of the coaching class market has lower dependence on people and a larger focus on national level content, making it relatively easier for players to attain scale. Against this backdrop, players in the test prep space – like FIIT-JEE (revenues of Rs1.2bn), IMS (Rs1bn), Career Launcher (Rs900m) and TIME (Rs1bn) – have attained a relatively higher scale.

Hardly any scaled up players within the vocational training market

The vocational training market ($1.5bn, 25% CAGR) accounts for 15% of the non-formal IES pie. Though the market is continuously evolving with emergence of a host of new avenues beyond IT trainings (financials, retail, aviation, management certifications and spoken-English trainings), scalability remains low. Given the dominance of unorganized segment, and inconsistent revenue flows in the corporate and retail training verticals (trainings is a discretionary spend), there are hardly any scaled-up/ scalable players.

In the books business ($1.7bn, 9% CAGR), high reusability of books has been instrumental in capping the growth potential for players.

…scalability only in pockets

Barring a few like Educomp Solutions and NIIT that have acquired the 'relevant' scale, the 'largest' players across the space are still small. Some scalability has been seen within the coaching class space focusing on the post-grad test prep space (medium-high scalability in our view).

Models that promise scale – NIIT and Educomp Solutions

Going forward, we expect a few relevant players to be able to create scale and value within the nascent organized preschool market ($300m; 36% CAGR till 2012E). Multimedia for private schools, though currently a small market ($70m, ~60% CAGR till 2012E), offers value creation potential given that it is highly underpenetrated and a technology-driven model. Educomp Solutions has a lion's share (~45%) of the multimedia for private schools market and a distinct first mover advantage in the space. ICT (Information and Communication Technology – $90m, ~70% CAGR till 2012E), at market penetration of <11% suggests high potential, but ability to create value is relatively limited in view of L1 bidding followed for award of contracts.

Exhibit 12: Largest players still small

Preschool	Rs253m (Private)	Rs240m (Listed)	Rs60m (Private)	Rs60m (Private)	
Multimedia/IT in schools	**Rs2861m (Listed)**	Rs932m (Listed)			
Coaching Classes	Rs1200m (Private)	Rs1000m (Private)	Rs1000m (Private)	Rs900m (Private)	Rs700m (Private)
Vocational Training	**Rs10068m (Listed)**	Rs1200m (Private)	Rs995m (Listed)	Rs800m (Private)	
Books Market	Rs4111m (Listed)				

Source: Company, IDFC-SSKI Research

LOW IQ OF IES, BUT WE ARE BETTING ON MAVERICKS

$50bn space but only $210m of private equity till date

While inefficiencies in the public education system and price discovery have created a substantial opportunity in the private IES space, there is a dearth of players across segments offering scale. We believe this is the key reason for the sector to have attracted limited capital chase (private equity of *$180m till date).*

Notably, there have been no significant investments in the formal education space (except Manipal Universal Learning). Also, ~20% of the investments in the unlisted space have been in US-centric e-learning companies which cater to the outsourcing needs of publishing houses and training needs of companies. Other deals have been in non-formal areas such as preschools, tutoring, test prep, Multimedia/ ICT and vocational training.

Exhibit 13: An education 'Blitzkrieg' – private equity deals in IES (Jan-06 to date)

PE Firm	Target	Segment	Stake (%)	Deal size (US $m)	Period
WestBridge Capital Partners (Now Sequoia Capital)	Brainvisa	E-learning (US-focus)		5.5	Jan-06
Sequoia Capital	TutorVista	online tutoring (US-focus)		2	Jun-06
Lightspeed Venture Partners & Sequoia Capital	TutorVista	online tutoring (US-focus)		10	Dec-06
IDFC Private Equity	Manipal Universal Learning	Higher education	10	31	May-07
Capital	Manipal Universal Learning	Higher education		40	May-07
Manipal Education & Medical Group (HSBC PE Asia)	Meritrac	Corporate recruitment testing	88	18	May-07
Helix Investments	Mahesh Tutorials	Tutorials	30	12	Aug-07
Gaja Capital	Career Launcher	Test Prep		8.3	Oct-07
Helion Ventures	Hurix Systems	e-learning (US-focus)		5.1	Oct-07
SAIF Partners	ICA	Vocational Training			Oct-07
Manipal Education Group	Tutorvista	Online tutoring (increasing India focus)		2.5	Oct-07
SAIF Partners	VETA	Vocational training, English speaking		10	Dec-07
Aditya Birla Group	Core Projects	Multimedia ICT		3.5	Jan-08
KPCB, Sherpalo Ventures & Infoedge	StudyPlaces	Education portal		3	Jan-08
Capital18, the venture capital arm of media group Network18	24x7 Learning Solutions Pvt. Ltd	e-learning - training solutions		4	Oct-08
Lightspeed Venture Partners & Sequoia Capital	TutorVista	Tutoring		18	Jul-08
Matrix Partenrs India	Tree House	Preschools		7.5	Aug -08
Total				180	Till date

Source: Websites

While IES exhibits low Investability Quotient (IQ), we have identified four key attributes (4Cs) that players must possess to acquire scale and create value. Our 4Cs comprise – Credibility (management intent and ability), Capital (built to last), Creativity (ability to 'manage' the over-regulated environment) and Content (ability to differentiate and build annuity). In the entire space, we find models of Educomp Solutions and Manipal Universal Learning exhibiting these key attributes.

The 4Cs – Credibility, Capital, Creativity, Content

❑ 4Cs differentiate the 'men' from boys

With few scalable players, the lucrative IES market possesses low IQ. We have identified some unique KSFs which, according to us, equip players to attain a higher IQ; thus, our investment thesis in IES rests on the 4Cs – Credibility (management intent and ability), Capital (built to last), Creativity (ability to 'manage' the over-regulated environment) and Content (ability to differentiate and build annuity).

MUL and Educomp Solution possess the KSFs

Based on these criteria, we like Manipal Universal Learning (unlisted) and Educomp Solutions (market cap of Rs42.3bn), which have successfully scaled up their business platforms (Credibility), managed to create a substantial balance sheet size with financial muscle to fund future growth (Capital), evolved as multi-tiered structures to 'manage' the over-regulated environment (Creativity), and offer a differentiated product with strong pricing power as also an annuity pool (Content).

Exhibit 14: IQ of MUL and Educomp Solutions

Investability Quotient

	Credibility	Creativity	Capital	Content
	Management intent & ability	**Innovative structure**	**Build to last**	**Differentiate & build annuity**
Educomp Solutions	**Established credibility** Scaled-up operations, investments across the value chain & tying up with renowned players like PSBB, DPS and Raffles	A subsidiary (previously EduInfra and EduManage) provides land and services to own schools run under a trust	Balance sheet size of **Rs7.1bn** (FY08); access to Rs7.5bn of debt in order to fund growth over FY09-10	Creating an **annuity pool** - first mover to implement a product called 'Smart Class' in 1267 schools (3-5 year lock-in), creating an order book of Rs9.8bn

	Credibility	Capital	Content
	Management intent & ability	**Build to last**	**Differentiate & build annuity**
Manipal Universal Learning	**Established credibility** over last five decades with world class institutions like Kasturba Medical College	Balance sheet size of **Rs24.5bn** (FY08); Funded by Capital ($40m); IDFC Private Equity ($30m)	**Strong pricing power** (a function of high quality courses) and students captive for 3-6 years

Source: IDFC-SSKI Research

❑ Credibility – management intent and ability

A management's 'intent' and 'ability' to attain scale and create value are the key factors to determine its IQ in IES. While the success of Educomp Solutions (among world's top 15 companies by market capitalization within the education space; excluding the books market) has lured many a players to join the fray, we believe just a handful of them has it in them to compete in the long haul.

Exhibit 15: Educomp within the top 15 education companies (by market cap)

Company	Country	Market Cap ($ m)
Apollo Group	US	13,017
Mcgraw-Hill	US	7,177
Pearson Plc	GB	6,914
Benesse Corp	JP	4,496
Devry Inc	US	3,824
ITT Educational	US	3,714
Strayer Education	US	2,969
New Oriental	Ch	1,937
Career Education	US	1,767
Corinthian College	US	1,292
Capella Education	US	965
Raffles Education	SI	826
Mega Study	SK	759
Educomp Solution	IN	683
Skillsoft	US	668

Source: Bloomberg

Players with established credibility will score over younger peers

Only a few players have been able to earn credibility in terms of ability to scale. Players that have managed to do so as also create a BRAND will be at a distinct advantage going forward (in education sector, brand creation is a tough and long-term game – a minimum of three batches, i.e. six years, should pass out and be successfully placed within the industry before an HEI creates a brand). Thus, we see incumbent leaders with strong brands in respective segments scoring over peers.

Presence across the value chain and acquisitions – the way forward

Given that most segments of IES offer limited scalability, some players – to expedite scale – are increasingly looking to lever their established credibility in one part of the value chain to other areas of the education landscape. For example, preschool operators like Kidzee, Euro Kids and Kangaroo Kids are levering their brands to enter into the K12 space, while NIIT is extending its brand in IT trainings to BFSI, spoken-English and BPO training segments. Coaching class players like IMS are planning to straddle the HE spectrum (vocational training and HEIs), and Career Launcher is working on attaining a footprint across the value chain. Going forward, consolidation (acquisitions) could be adopted as a way to grow faster in existing and new operations within IES.

Exhibit 16: Players straddling the value chain in quest of scale

	K12	Higher Education	Preschools	Multimedia in private schools	ICT in public schools	Coaching Classes	Vocational Training	Books	Elearning
Career Launcher	Existing	Existing	Existing			Existing			
Educomp Solutions	Existing		Existing	Existing	Existing	Existing	Existing	Existing	
Euro Kids	Existing		Existing					Existing	
Everonn Systems	Plans			Existing	Existing	Existing			
Excel soft							Plans		Existing
Hurix				Plans					Existing
IMS		Existing				Existing	Existing	Existing	
Kangaroo Kids	Existing		Existing					Existing	
Kid Zee (ETCN)	Existing		Existing				Existing		
Mahesh Tutorials	Plans	Plans	Existing			Existing	Plans		
Manipal Universal Learning		Existing					Existing		
Navneet Publications				Plans				Existing	
NIIT Ltd				Existing	Existing		Existing		
Shloka Infotech	Plans		Plans	Existing	Plans				
Tata McGraw				Plans				Existing	
Tutor Vista				Existing		Existing	Plans		

Existing Plans

Source: Company, IDFC-SSKI Research

With few 'scaled up' players, funding key challenge in the capital-intensive space

❑ Capital – built to last

Education is a capital-intensive business with majority of the formal and non-formal segments requiring heavy upfront investments. Setting up a K12 school entails a cost of ~Rs100m (excluding land cost) while HEIs require much higher investments (a medical college would typically require Rs4bn-5bn). A few businesses in the non-formal space also call for heavy upfront investments – e.g. upfront capex of ~Rs85,000 per class per school for Multimedia in private schools and Rs250,000-300,000 per school in the ICT business.

With very few 'scaled up' players across the IES and the entire space having seen private equity funding of only $180m till date, we feel the ability to raise capital is a critical success factor. Players like Manipal Universal Learning, Educomp Solutions and NIIT have managed to create a scale built to last.

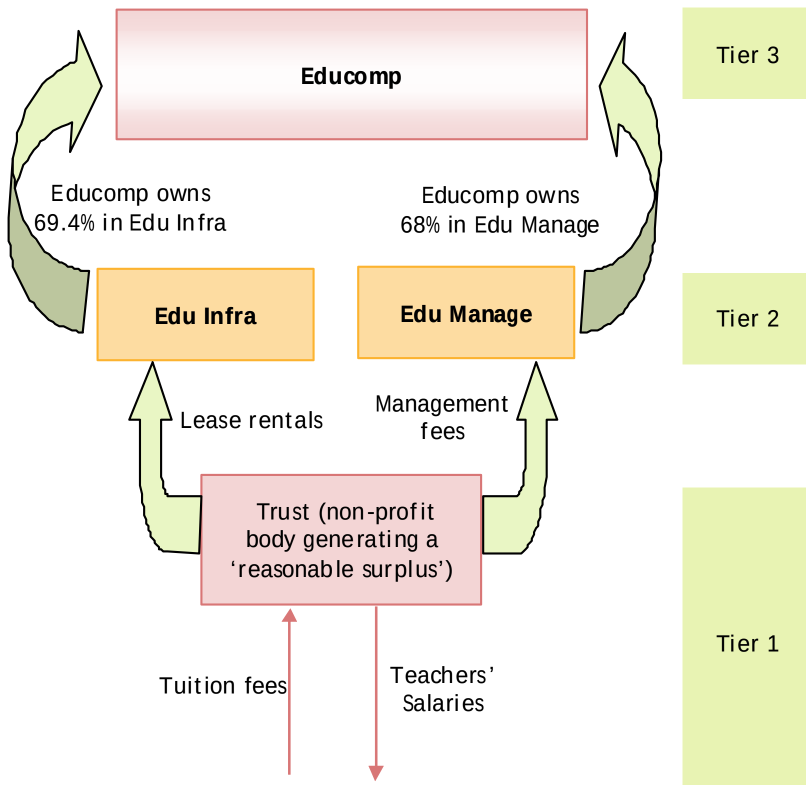
Creative Kids use two-tier structures – a for-profit body extracting surplus from the not-for-profit trust

❑ Creativity – 'manage' the over-regulated environment

Taking a cue from independent school-owners 'extracting' profits from trusts (schools and HEIs) in the form of lease rentals and management fee, some players have taken the age-old informal structure to the next level. The nascent corporate activity in the formal education space is using a two-level structure to circumvent the 'not-for-profit' diktat. While multi-layered regulations have meant that 80% of the opportunity (formal education) remains elusive to commercial activity, 'innovative' players like Educomp in K12 space are successfully using these structures to scale up. A host of other players like Kidzee, Euro Kids, Kangaroo Kids and Career Launcher are also looking to scale up within the K12 space by using similar structures.

Innovative structures – The 'innovative structures' have emerged to break the 'trust' issue. The company creates a trust (a not-for-profit body) that runs the educational institute at one level. It further creates a subsidiary that supplies land, services and infrastructure to the trust in lieu of rental/ fees. In this way, the entity manages to unlock the 'surplus' and distribute it as dividends or use it to fund other ventures.

Exhibit 17: Creative Kids – innovative structures



For each owned school, Educomp Solutions forms a trust that runs the school's operations

Educomp has two formed two subsidiaries -

Educomp Infrastructure (69.4% stake with Educomp Solutions) - owns the real estate and leases it out to the schools

Edu Infra gets: i) Returns of 14.5% on capital employed in setting up schools ii) 4.5% of annual tuition fee and iii) one-time fee of Rs5m per school

Educomp School Management (68% stake with Educomp Solutions) provides IP/ content and management services (content, delivery, canteen, transportation, text books etc) to the schools

Source: Company, IDFC-SSKI Research

Clearing the air on 'Regulatory Ambiguity'

With strong social connotations attached to education, the risk associated with two-tier corporate structures cannot be completely eliminated. In this direction, we sought views of various industry and legal experts on the survival quotient of these structures. The key highlights are as follows:

Regulations governing the K12 space: The CBSE/ ICSE and state board regulations stipulate running of a K12 institution ONLY as a trust or society. Income from the trust is non-taxable but the 'reasonable surplus' (not defined) can be used only for development of the same institution and cannot be distributed as dividends.

Regulations governing the Higher & Technical Education space: The rules are more stringent here than for K12 as an HEI is simultaneously governed by a central body (University Grants Commission – UGC) and a regulatory body specific to the field of specialization offered by the HEI (e.g. AICTE for engineering and medical colleges). The UGC stipulates that the Higher and Technical Education institutions be run as a trust or society where all the infrastructure and capital goods have to be on the books of the university. AICTE further has its own set of rules wrt infrastructure and curriculum – in case an HEI fails to comply with the same, it is blacklisted (110 universities blacklisted as on date).

However, taking UGC or AICTE's approval is the prerogative of a University. For example, ISB and Amity have been running as not-for-profit structures but without seeking recognition from AICTE.

Regulations governing a corporate entity providing management services and land/ capital goods on lease to a K12 institution running as a trust: A company set up to offer services and land/ capital on lease can be run as a for-profit body and does not fall under the purview of the school education boards. The trust will have teachers on the rolls and collect fees from students while the remaining services are outsourced. This structure has been in existence for years and has not been challenged. However, it is recommended for the trust and the managing company not to be run by the same management and common directors, and that the transactions are done at an arm's length. (The transactions have to be done at a fair market value, as if the two parties were unrelated.)

Differentiated product with an annuity model – the 'right content' to scale

❑ Content – ability to differentiate and build annuity

While education is a difficult business to scale up due to high dependence on people and low revenue visibility, scale can be achieved with the 'right' content/ offerings. Thus, we believe players with the ability to create a differentiated product/ process with annuity business model can break the scalability barrier.

Manipal Universal Learning has carved a niche for itself within the HE space and strong pricing power has helped it establish an annuity business model (18,000 students in campus education and 140,000 students in distance education programmes; students captive for 3-6 years). Educomp Solutions has pioneered a well-packaged product (Smart Class – a multimedia product to aid teaching in private schools) in order to tap the paying propensity. A first mover in the space, Educomp has implemented the product in 1,267 schools with a 3-5 year lock-in period and acquired strong revenue visibility (order book of Rs9.8bn as of Q2FY09).

Exhibit 18: IES – Report Card

	Current size	Growth	Non Regulated	Scalability	Value creation	Comment
Preschool	✗	✓	✓	✓	✓	Euro Kids (50% stake acquired by Educomp) and Kangaroo Kids are the relevant players
K-12	✓	✓	✗	✓	✓	Innovative structures evolving; Educomp Solutions and a host of private players looking to acquire scale
HE	✓	✓	✗	✓	✓	Innovative structures evolving; a long term game; Manipal Universal Learning the only investable player
Multimedia in private schools	✗	✓	✓	✓	✓	Annuity business model; Educomp Solutions has first mover advantage
ICT in govt schools	✗	✓	✓	✓	✗	L1 bidding and a long receivables cycle
Coaching Classes	✓	✓	✓	✗	✗	80% of the market difficult to scale!
Vocational Training	✗	✓	✓	✗	✗	NIIT the only scaled-up model
Books	✗	✗	✓	✗	✗	Low-growth market (reusability at 70%)

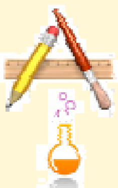
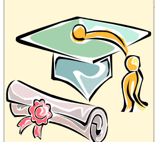
Source: IDFC-SSKI Research

Exhibit 19: Key players – Report Card

	Creativity	Content	Capital	Credibility	IQ
Educomp Solutions	●	●	●	●	●
NIIT	◔	◔	●	◕	◔
Everonn Systems	◐	◐	◐	◐	◐
Manipal Education	●	◕	●	●	●

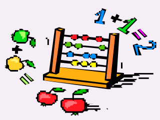
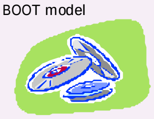
Source: IDFC-SSKI Research

Exhibit 20: Formal IES – a snapshot

Segment	Revenues ($ m)		Growth Drivers	Key risks	Key Players	Our View
	2008E	2012E				
K-12 (School) •Cater to 3-17 yrs age group 	20,000 CAGR 14%	34,000	•Largest population globally (and growing) in the K-12 age group •Inefficient public school system •Increasing preference for private schools •20000-25000 'quality' schools required (NCERT) •Various states demark land at subsidized rates which can be used only for schools. •Potential opportunity - PPP to manage public schools	•Regulatory overhang- only a non-profit Trust/ Society can run a school •Rising land prices can lead to large capital investment and low RoCE	•Millennium Schools (part of Educomp) •Kid Zee High (Part of ZILS) •Billabong High (Part of Kangaroo Kids) •GEMS (Dubai based) •Plans to foray - IMS, Career launcher, Euro Kids	**A No brainer? Not yet!** •Largest potential among the education space •While regulations are deterrent to most players - innovative structures are getting corporatized •Healthy margins, an annuity business •Models in the space - Greenfield projects/taking over existing schools; joint ventures with developers; providing management services to existing schools
Higher Education •Cater to >18yrs age group 	20,000 CAGR 12%	31,500	•India is one of the largest importers of education ($13bn is spent every year outside the country for HE) •Demand supply gap - NKC estimates the need for 1,500 universities •A low focus area for the government •Abysmally low GER of 9.97 •Government indications of opening up medical colleges to 'for profit' entities	•Regulatory overhang - UGC (University Grants Commission) mandates all HEIs to run in the form of a non-profit trust •An overregulated space •Large political involvement •Very capital intensive •Time to build brand equity (minimum of 6 yrs)	•Manipal Education (Manipal University, Sikkim Manipal University) •Amity •IIPM •ICFAI •Plans to foray – Career Launcher, IMS	**Time to 'degree shop'?** •While regulations are deterrent to most players, innovative structures are getting corporatized to work around the trust regulation •We feel that entities like Manipal Education that have already established scale and a brand have a competitive advantage

Source: IDFC-SSKI Research

Exhibit 21: Non-formal IES – a snapshot

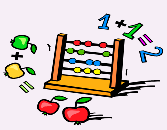
Segment	Revenues ($ m) FY08E	Revenues ($ m) FY12E	Growth drivers	Key risks	Key players	Our view
Preschool • Caters to 1.5-3 yrs age group 	300 CAGR 36%	1000	• Growth has been largely using the franchisee route - low upfront investment by franchisee • Highly underpenetrated market; 1 out of every 100 preschool-aged children enrolled	• Target audience is limited to a 2km radius • Under high lease rentals, economics can be challenging for standalone preschools	• KidZee • Euro Kids • Apple Kids • Shemrock • Kangaroo Kids • Tree House • Bachpan • Podar Jumbo Kids • Mother's Pride • DRS Kids • Sunshine	**Play time** • A high growth market, we expect a shift from unorganized to organized (50% CAGR over FY08-12E) • With a host of players crowding the space – we expect to see scalability in a dominant player like Euro Kids and players using innovative models like Kangaroo Kids
Multimedia in private schools • Providing technology as an aid to chalk & talk in K12 classrooms under the BOOT model 	70 CAGR 60%	500	• 5% of private unaided schools have been covered – a highly underpenetrated market • Market potential in excess of $1.5bn • Existing model set to witness high growth due to infinite return on investment for schools • An annuity model	• Large upfront investment • Duplication of content	• Educomp - Smart Class • Everonn – Vitels • NIIT – EGuru • ILFS - Kyan • Plans to foray : Navneet - E-book	**Beyond chalk & talk!** • A high growth market, we expect the momentum to continue for some time on the back of the currently low penetration • Educomp has a strong first mover advantage with Smart Class
ICT in public schools • PPP in education • Providing IT infrastructure and training • Funded by Centre / states under Sarva Sikshiya Abhiyan (SSA) 	90 CAGR 70%	750	• Underpenetrated market with 11% of government schools covered • Government to increase spends (allocation for SSA increased 4X in 11th Plan) • 29,000 schools expected to be up for bidding in FY09	• Large upfront investment • L1 bidding leading to commoditization & low margins • Long receivables cycle	• Educomp • Everonn • NIIT • Compucom • Core Projects • Various Regional Players	**Gains but with pains** • An underpenetrated market, the opportunity is large enough to build scale • L1 commoditized business with low RoCEs, leads to low value creation capability
Vocational Training • Caters to age group of >14 years; ($500m for domestic IT training; $1bn for vocational trainings such as retail, aviation, English and FMT) 	1,500 CAGR 25%	3,660	• New opportunities apart from IT - retail, BFSI, English and Life skills trainings • Employers demand productivity from day one • India's demographic dividend - surplus of 47m working age population (India) while shortage of 56m for ROW by 2020E	• Slowdown in IT and other services sectors • Corporate training revenues have low margins; revenues lumpy in nature	• NIIT • Aptech -IT and Aviation (Avalon) • Jet King • ICA • CMS • VETA English Training • Russell English Training • Frank Finn • K10	**New vistas** • Growing acceptability of non- formal education and new opportunities. But limited scalability • Players offering skills that have flexibility (such as aviation, hospitality, BPO and retail) are equipped to handle changing trends/ preferences
Coaching Classes • ~64% of non-formal market • Caters to three distinct sub segments **Tuitions - $51bn** **Graduation TestPrep- $1bn** **Post Graduation Test Prep - $216m** 	6,400 CAGR 15%	11,200	• Poor quality of teaching in existing education system • Shortage of quality formal education institutes - increasing competition for admissions at grad and post grad level	• A person-centric business; scale difficult to achieve unless business becomes process-driven	• Agarwal classes • Sinhal Classes • Chate Classes • JK Shah • Sukh Sagar • Brilliance • Karla Shukla • Mahesh Tutorial • FIITJEE • Bansal Classes • Career Launcher • TIME • Career Forum • IMS	**Is the 'coach' scalable?** • Scalability is a challenge in 80% of the market (tuitions). It is less of a challenge in smaller sub-segments where coaching is dependent more on content rather than individual 'brand teacher'
Books • With >8,000 publishers, private text books market is highly fragmented 	1750 CAGR 9%	2500	• A spurt in the number of private schools offering 'quality' books • A change in syllabus pushes sales of text books and supplementary books in that particular year	• Large second hand books market - 70% of the target market reuses books • 95% of school text books market not up for free play (the state and NCERT print the books)	*Text book publishers* • Tata Mcgraw Hill • Cengage (formerly Thompson) • John Wiley • SChand • BPPLaxmi Publications • Oxford • Macmillan • Orient • Longman *Suplementary Books* – Navneet Publications	**Less free play, low growth** • 95% of the school text book market is not available to a private publisher as the state or NCERT prints the curriculum. Market available for private players is $1bn • We expect low growth due to the high reusability of books

Source: IDFC-SSKI Research

PRESCHOOLS: PLAY TIME

A part of non-formal IES, the $300m preschool segment is expected to be a $1bn market by 2012 (36% CAGR) led by low penetration (1 out of 100 preschool-aged children enrolled) and further price discovery. With low entry barriers, corporate activity has gathered pace and 11 major chains and ~10 smaller players are active in the space. While the scale-up has so far been on the franchisee platform, corporates are increasingly forming JVs with builders/ partners and moving up the value chain by upgrading to K12 schools. The strategy imparts resilience to the model against high lease rentals besides ensuring scalability. With players planning aggressive rollouts, the organized segment is growing faster than the industry (50% vs 36% CAGR). Within this highly fragmented market, we expect Euro Kids (one of the largest preschool chains) and Kangaroo Kids (an innovative player) to be relevant players going forward.

Exhibit 22: Preschools – a snapshot

Segment	Revenues ($ m) FY08E	Revenues ($ m) FY12E	Growth drivers	Key risks	Key players	Our view
Preschool •Caters to 1.5-3 yrs age group 	300	1000	•Growth has been largely using the franchisee route - low upfront investment by franchisee •Highly underpenetrated market; 1 out of every 100 preschool-aged children enrolled	•Target audience is limited to a 2km radius •Under high lease rentals, economics can be challenging for standalone preschools	•KidZee •Euro Kids •Apple Kids •Shemrock •Kangaroo Kids •Tree House •Bachpan •Podar Jumbo Kids •Mother's Pride •DRS Kids •Sunshine	**Play time** •A high growth market, we expect a shift from unorganized to organized (50% CAGR over FY08-12E) •With a host of players crowding the space – we expect to see scalability in a dominant player like Euro Kids and players using innovative models like Kangaroo Kids
	CAGR 36%					

Source: IDFC-SSKI Research

PRESCHOOL MARKET: MULTIFOLD GROWTH

Market to expand 3x to $1bn by 2012E

Playschools, more popularly known as preschools, traditionally cater to the 1.5-3 years age group. Increasing awareness among parents about the benefits of a quality preschool education has been driving penetration levels and price discovery in the segment. Led by these factors, we expect the market to expand by more than 3x in size by 2012. While the market is currently highly fragmented and unorganized in nature, increasing prosperity is driving a shift towards the organized segment. A largely urban phenomenon, there has been rapid proliferation of organized preschool chains beyond metros and tier 1 cities in the last five years.

❑ Getting more organized

Households with annual income in excess of Rs200,000, which form an estimated 8% of India's total population, are the primary target customers for preschools. We estimate a target market of 5.5m preschoolers, of which 12% are currently enrolled. Considering an average annual spend of Rs18,000 per student (price discovery still in initial stages), we estimate the segment to be $300m in size.

Preschool market

	2008
Total population	1.15bn
HHs with income >Rs200,000 (8%)	91m
2-4 yrs (6%)	5.5m
2-4 yrs enrolled (12%)	661,246
Average spend (Rs pa)	18,000
Market size (Rs m)	11900
Market size ($ m)	300

Source: IDFC-SSKI Research

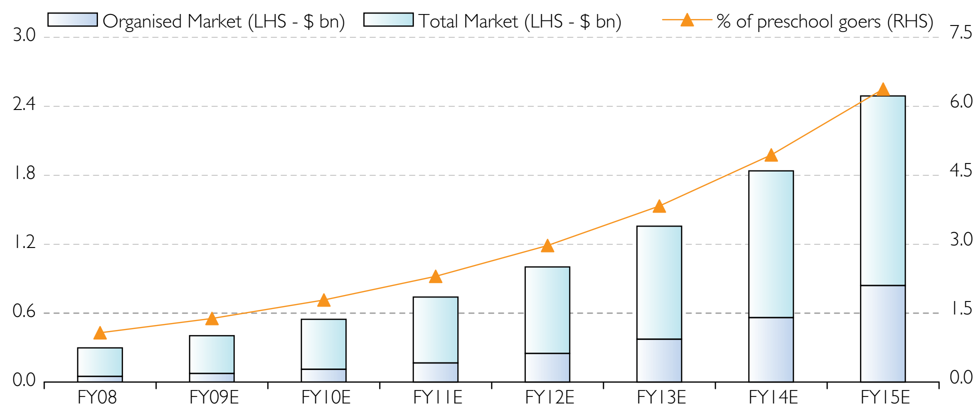
Going forward, we expect the preschool market to grow on the back of low penetration, increasing paying propensity and organized supply creating awareness about the importance of preschool education. We expect the total preschool market to touch $1bn (on a low base of ~1,700 schools and 200,000 students) by 2012. Interestingly, the organized market is likely to grow faster, at a CAGR of 50% over

Currently 17% of the market is organized

FY08-12 compared to 36% CAGR for the overall market. We expect the organized segment to grow to $250m by FY12, and account for 25% of the total market.

36% CAGR for overall market over FY08-12E; organized market to grow faster (50% CAGR)

Exhibit 23: Preschool market – $1bn by 2012E

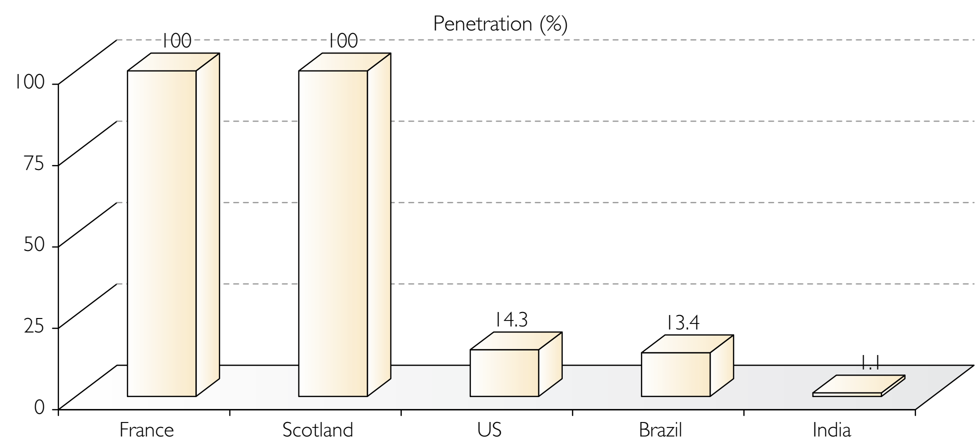


Source: IDFC-SSKI Research

At $2.5bn (2015E), penetration would still be at 17% of potential market

Despite the exponential growth expected in preschool market (>3x over the next five years), penetration would increase to just 3% of the total preschool-age population and ~17% of the potential affluent target market.

Exhibit 24: India's preschool market penetration – much below global comps



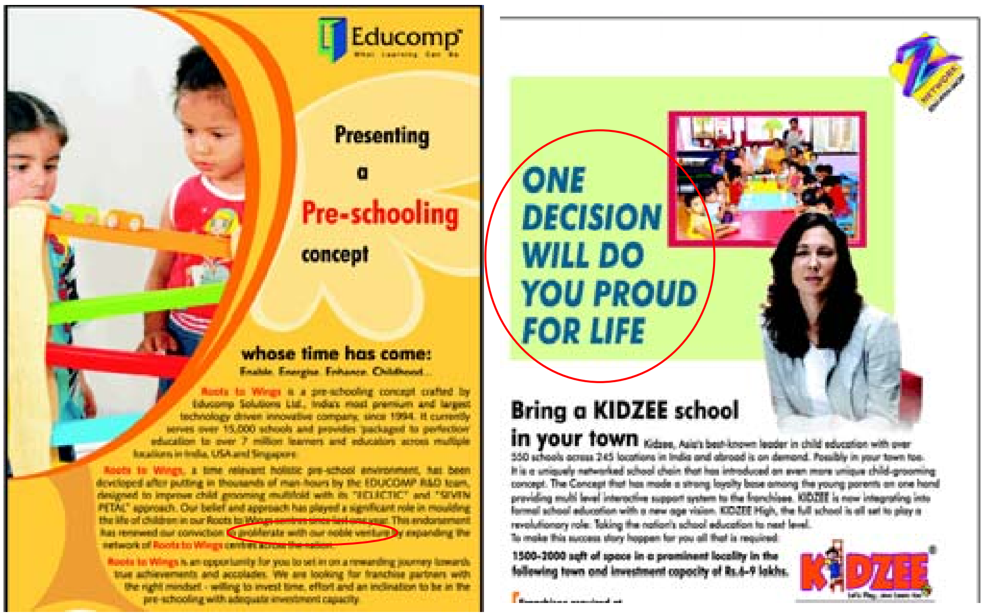
Source: UNESCO, US Department of Education

ORGANIZED MARKET: SUPPLY CREATING DEMAND

Shift to organized market; Kidzee the largest player with 623 preschools

The preschool market has, over the last 5-6 years, seen a shift towards organized players. KidZee (recently renamed as Zee Learn) – India's largest preschool chain – has set up 623 preschools in just five years since inception and plans to add another 1,000 preschools over the next two years. There are 11 major preschool chains in India including KidZee, Euro Kids, Bachpan, Apple Kids, Shemrock, Kangaroo Kids, Podar Jumbo Kids, Tree House, Mother's Pride, DRS Kids and Sunshine, and around 10 smaller players. Organized players have largely scaled up using the franchisee route (~1,700 schools catering to 200,000 students).

Exhibit 25: A shiny package!



Publication – Economic times Mumbai, Dated 26 Jun 2008, Publication: Times of India Nagpur, Dated: 25 Apr 2007

These preschools cater to segments across income groups ranging from consuming to affluent. While Kangaroo Kids is primarily a premium brand at an average annual fee of Rs35,000-45,000, Tree House charges an average annual fee of Rs18,000.

'Quality' preschools driving demand in the segment…

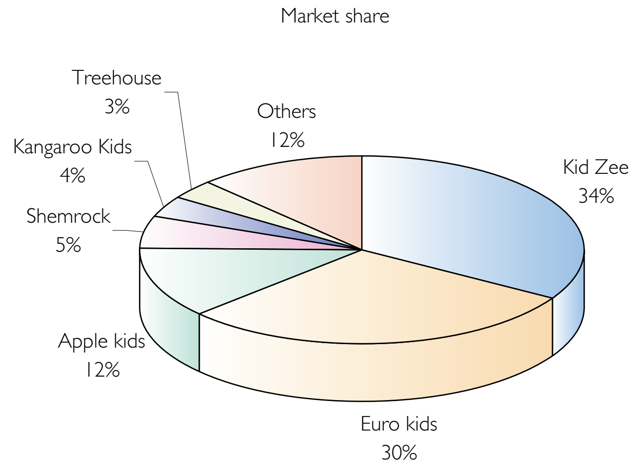
Players in other segments of the education value chain are also entering this space – e.g. Mahesh Tutorials' (a brand in the private tuitions space) 'Little Tigers' and Career Launcher's (test prep) 'Ananda'. The trend of rapid rollouts indicates that 'quality' supply of preschools is bringing latent demand to the fore. Further, education major Educomp has forayed into the space under the brand 'Roots to Wings' (60 preschools at present) and has also acquired a 50% stake in Euro Kids (~484 centers) for Rs390m.

…but the market is highly fragmented and regional

Despite the increasing share of organized segment (currently 17% of the total market), the preschool market remains highly fragmented and regional in nature. Though the shift is clearly evident, the largest player (Kid Zee) holds only 7% share of the total market.

Largest player at 34% of organized market and 7% of total market

Exhibit 26: Major players – KidZee the largest



Source: Company, IDFC-SSKI Research

Exhibit 27: Organized preschool market in India

Player	History	Status	Current network	Business model	Key strengths
KIDZEE	Started in 2003	Part of Zee group. Listed under ETCN	623-pan India. Plans 1,000 in the next two yrs	Franchisee model	Ready access to KidZee High - 9 operational, 23 signed up
EURO KIDS	1997 – JV between Indian Express & Egmont; 2001 - Egmont International Holdings, Denmark bought back shares of Indian Express in JV; Egmont exited Euro Kids, now an Indian private co.	Private (50% stake acquired by Educomp)	484-pan India. Plans to have 1000+ schools in next 3 yrs	50% publishing, 50% preschools (Franchisee model)	Plans to have K12 schools
APPLE KIDS International Pre-Schools		Private	200 - primarily in South India	Franchisee model	-
SHEMROCK	Started in 1989	Private	90 - primarily in North India	Franchisee model	Strong brand in North India
Kangaroo Kids Education Ltd.	Started in 1993	Private	60 - expanding pan India	JV model. Niche player expanding to a basic model through 'Brainworks' and mall schools through 'Kangaplay'	Strong brand in western urban areas. Opting for a mix of pure franchisee and JV model for better economics, quality control & lower attrition. Ready to access Billabong High schools; 6 operational
TreeHouse	Started in 2003	Private	55 - primarily in Maharashtra	Primarily owned model	High operating margins due to accounting for nominal lease (promoter owns property) & ability to compete on a price war
Roots to Wings	Started in June 2008	Listed under Educomp	Plans to target 250 centers by end-FY09	Franchisee model	8am to 8pm - includes day care

Source: Company, IDFC-SSKI Research

...BUT, THE BUSINESS NOT A CHILD'S PLAY

There is enough demand for preschools (as reflected by the rapid proliferation) and capex requirements are also relatively lower, which means that it is play time for preschool chains. However, the model is fraught with risks including the inability to attract preschoolers beyond a catchment area of 2km, high lease rentals, intense competition from the unorganized segment (at considerably lower cost to customer) and increasing competition among organized players.

❑ Limit to lever infrastructure for preschool children

Preschools have a limited target area – maximum of 2km radius

Any preschool, however strong the brand, ideally has a customer pull within a 2km radius (parents prefer to send toddlers within a limited radius for safety/ comfort reasons). Also, the segment caters only to customers who can afford annual fees of Rs20,000-45,000, which further limits the scope of the market.

❑ Tail wags the dog – rental costs!

...proliferation largely driven by housewife occupation and low capex requirement (levering existing premises)

Preschools are currently being run primarily on the franchisee model, which has so far evolved largely on the back of two factors – low cost of setting up a franchisee, and housewife occupation that typically does not consider the opportunity cost of lease rentals (schools are being set up on existing premises which otherwise also do not generate returns).

Considering the economics of the preschool business, lease rent forms the largest expense for running a preschool and can eat into profitability of the business.

Lease rentals – a risk to profitability

Exhibit 28: Soaring rental costs – mounting pressure on cost structures

City	Increase (%)	Average rent (Rs/ sq. ft/ month)
Bangalore	15-20	27-70
Mumbai	45-60	290-400
Delhi	35-70	159-317
Chennai	15-30	33-65
Kolkatta	30-55	45-85
Hyderabad	10-45	35-50
Gurgaon	70-75	110-120
Noida	18-20	45-50
Mumbai Suburban	70-75	70-160
Pune	15-40	30-70

Source: IDFC-SSKI Research

❑ The unorganized neighbor

Unorganized player provides 'same' care but at a lower price

With awareness levels still low, the unorganized market provides 'the same' care but at a much lower price. With more than 80% of the target market still with the 'trustworthy' neighbor, it may take some time before organized players are able to establish the importance of a quality preschool education.

❑ A non-regulated market – low entry barriers

Low entry barriers – increasing competition

The preschool market is non-regulated and hence entails no regulatory barriers for new entrants. Given the relatively low investment required, competition is intensifying in this segment.

Franchisee model the most favoured…

❑ Economics of a preschool

Except for a few preschool chains (Kangaroo Kids going in for JVs with developers and Tree House with largely owned schools), all other players have opted for the franchisee model to scale up. Under this model, a franchisee has to pay a brand/ franchisee fee (Rs60,000-70,000 pa) as also some part of the revenues to the franchisor (~20% of total) in lieu of using the latter's brand name and for the hand-holding required to run a preschool.

Assumptions: We have assumed a model premise of 1,200 sq. ft with rent at Rs70 per sq. ft. (Only 60% of the total area can be used for classrooms and a minimum of 10-15 sq. ft per student is considered optimal). The one-time capex broadly comprises furniture and fittings cost and excludes brand fee (we have assumed an average franchisee fee of Rs200,000, which is renewable every three years and amortized over a period of three years).

We have assumed three classes and two batches a day, which translates into a maximum capacity of 20 students per class (thereby a maximum of 120 students per preschool) and an annual fee of Rs25,000.

Exhibit 29: Economics of a preschool

Area (sq. ft)	1200
Rent (Rs per sq. ft)	70
3 classrooms @ 250 sq. ft	750
Activity room/ Play area	300
Reception	100
Pantry	50

Source: IDFC-SSKI Research, Company

…with one-time capex requirement of ~Rs500,000

Exhibit 30: One-time capex	(Rs)
Furniture and fittings	400,000
Misc expenditure	100,000
	500,000

Source: IDFC-SSKI Research, Company

Using these assumptions, the model breaks even at the operational level at a fairly high occupancy level of ~70%. This has led to a trend wherein most of the preschools are levering the infrastructure for children beyond the age group of 1.5-3 years with programmes like mother-toddlers (children aged between 6-12 months) and for activities like dance, music, pottery classes, etc (children aged 3 years and above).

At annual fee of Rs25,000 and lease rental of Rs70 per sq ft, breakeven at 70% occupancy

Exhibit 31: Revenue model

	Occupancy			
(Rs m)	70%	80%	90%	100%
No. of students	84	96	108	120
Revenues @max capacity of 20 per class	2.1	2.4	2.7	3.0
Expenses				
Less Personnel Cost	0.35	0.4	0.44	0.49
Less Administrative & Marketing Expenses	0.25	0.25	0.25	0.25
Less Royalty payable @ 20	0.42	0.48	0.54	0.60
Less Franchisee Fee - Amortized	0.07	0.07	0.07	0.07
Less Rent	1.01	1.01	1.01	1.01
Operating profit	0.0	0.2	0.39	0.58
EBITDA margin (%)	-	8	14	19
RoCE (%)	-	39	77	116

Source: IDFC - SSKI Research

IQ: HIGH (SUBJECT TO BENIGN LEASE RENTALS)

A non-regulated space, preschool chains have largely grown using the franchisee route. Low upfront investment requirements by a franchisee (ideal for housewife occupation) and an underpenetrated market have led to the emergence of a high-growth market.

Players levering infrastructure beyond preschools to improve economic viability

However, the limited catchment area for a preschool implies limited scalability per branch; also, with a large section of the franchisees being run on owned premises, the model ignores lease rentals – a major cost-head. Thus, the business for a franchisee runs the risk of becoming economically unviable in a scenario of high rentals (it has been observed that while franchisees keep mushrooming, there has also been a considerable churn in existing franchisors under high rental costs). To improve economic viability of the model, some franchisors are seen to be levering the existing infrastructure beyond the 1.5-3 year age group for programmes like mother-toddlers (children aged between 6-12 months) and activities like dance, music, pottery classes, etc (children aged three years and above).

High IQ offered by Euro Kids and innovative players like Kangaroo Kids

Going forward, increasing clutter in the organized segment would mean further fragmentation. Having said that, dominant players like Euro Kids (50% acquired by Educomp) and those using innovative models (like Kangaroo Kids) are expected to emerge as relevant players going forward. Kangaroo Kids, besides expanding through the pure franchisee route, is also using a JV model for further scale-up. The company has signed 400 such JVs with developers and key partners. Also, preschool chains that have their own high schools get a benefit premium over standalone preschools. Kidzee, Euro Kids and Kangaroo Kids among others are upgrading to K12 schools, with the preschool population acting as a feed for the higher classes.

Globally, Kinder Care (USA), ABS Learning Centres (Australia, New Zealand and UK) and Bright Horizons (USA, Europe and Canada) are a few scaled-up success stories among preschool chains. But these models cannot be superimposed on the Indian market as the cost structure and business models are quite different. Globally, preschools are primarily day-care centres while in India they are perceived as early training grounds for children to develop skills and secure admission into a good school.

Exhibit 32: International players in the preschool segment

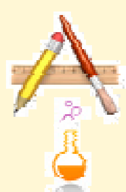
($ m; CY07)	Market cap	Revenues	Net profit	No. of branches
ABC Learning Solutions	2,427	1,285	112	2,238
Bright Horizons (acquired for $1.3bn)	907	744	39	642

Source: Bloomberg

K12 (SCHOOLS): A NO BRAINER? NOT YET!

K12, the largest segment ($20bn) within IES, is expected to grow to $30bn by 2012 (14% CAGR) on the back of world's largest school-aged population and price discovery. While dominated by standalone schools and chains confined to charitable, political and religious individuals/ groups, corporate activity is catching up in this annuity business free from recessionary pressure. Though regulations mandate K12 to be 'not-for-profit' structures run by only Trusts/ Societies, 2-tier structures (a trust and a managing entity) are being adopted to unlock the surplus as lease rentals, management fee, etc (an age-old practice followed by standalone schools). Going forward, we believe serious players intent on gaining scale and credibility should help dispel investor concerns on under-reporting of cash. The space will realize its full potential the day favourable regulations fall into place. We find 'commercial' K12 chains like Educomp Solutions (11 operational schools, 150 planned by FY12), Zee Learn (23 operational, 100 by FY11E), GEMS (6 schools under a management contract) and Kangaroo Kids (6 operational schools) as interesting plays in this space.

Exhibit 33: K12 – a market snapshot

Segment	Revenues ($ m)		Growth Drivers	Key risks	Key Players	Our View
	2008E	2012E				
K-12 (School) •Cater to 3-17 yrs age group 	20,000 CAGR 14%	34,000	•Largest population globally (and growing) in the K-12 age group •Inefficient public school system •Increasing preference for private schools •20000-25000 'quality' schools required (NCERT) •Various states demark land at subsidized rates which can be used only for schools. •Potential opportunity - PPP to manage public schools	•Regulatory overhang- only a non-profit Trust/ Society can run a school •Rising land prices can lead to large capital investment and low RoCE	•Millennium Schools (part of Educomp) •Kid Zee High (Part of ZILS) •Billabong High (Part of Kangaroo Kids) •GEMS (Dubai based) •Plans to foray - IMS, Career launcher, Euro Kids	**A No brainer? Not yet!** •Largest potential among the education space •While regulations are deterrent to most players - innovative structures are getting corporatized •Healthy margins, an annuity business •Models in the space - Greenfield projects/taking over existing schools; joint ventures with developers; providing management services to existing schools

IDFC-SSKI Research

K12: THE LARGEST IN IES

Schools need to be affiliated to a board for its students to be recognized by the education system

Schools, globally known as K12 (Kindergarten to 12th grade), come under the formal education space. These schools broadly address education needs of students between the age group of 3-17 years. Some states in India follow the system of K-10 + 2 (in which case, the last two years form a part of higher education). Following a preschool stint (an optional course), a child has to be enrolled in a recognized school (affiliated to/ registered with either a state board or central boards like ICSE/ CBSE) in order to be considered as a part of the formal education system.

A quality and quantity gap in K12

❑ Public K12 schools – short on efficiency

Globally, India has one of the lowest enrollment and highest dropout ratios, translating into net enrollment levels among the lowest in the world. The 1,025,000 schools in India are clearly not enough to meet the demand in terms of both quality and quantity. Notably, 66% of these schools are only till the primary level. With only 132m (37%) of the Indian K12 population net enrolled in schools, the system has apparently failed. According to NCERT, at least 200,000 schools are required to plug this gap.

Exhibit 34: High dropout rates

	Enrolled	drop out rate*	no. of drop outs(m)	net enrolled (m)
Grade 9-12	37	62	23	14
Grade 6-8	52	50	26	26
Grade 1-5	130	29	38	92
Total	219			132

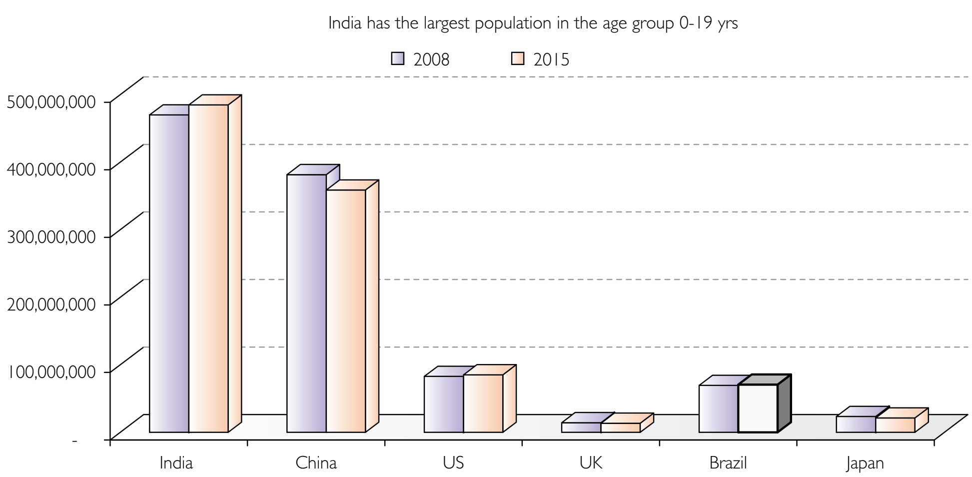
*Source: Selected Education Statistics 2004-2005, GoI, IDFC-SSKI Research; Note:*The drop-out rate represents percentage of pupils who drop out from a given grade or cycle or level of education in a given school year. There are certain limitations of this method in providing precise estimates, as it does not take into account the data on repeaters*

Largest K12 aged population globally (5.5x in US) form the largest $20bn opportunity in the space

❑ Private market – large is attractive…

At 361m, India has the largest population globally in the K12 age group (5.5x USA's K12 population). Despite a mere 37% of the K12 age group net enrolled on school rosters, private spends on K12 schools stand at an astounding $20bn – which makes the segment the largest within IES. The large market can be explained by a consistent shift towards private schools – catalyzed by the absence of quality public schools and growing awareness about importance of quality education as also increasing ability and willingness of Indians to pay.

Exhibit 35: Largest K12 population globally – a young India versus greying countries



Source: US Census International database

Out of the total 1m schools in the country, ~75,000 are private. With considerable preference for private schools, the average number of students in a private school stands at a much higher 1,200 versus 146 for a public school. The private schools can be classified into private aided (that receive aid from the government in order to run the school), private unaided standard and private unaided premium schools. The private aided schools charge an average fee of Rs5,000-6,000 per annum till the primary stage (5th grade), after which students are charged a nominal fee. The private unaided standard schools charge an average tuition fee of Rs10,000 per annum while private unaided premium schools charge Rs15,000 (up to Rs45,000 per annum in some cases). We estimate an annual total spend of $3bn in the private aided segment and $18bn in the private unaided segment of K12.

Exhibit 36: Market size – private K12 segment

		Average no. of students	Average spend (Rs pa)	Market size ($bn)
Private aided	30,660	1,200	3,000	3
Private unaided standard	15,000	1,200	10,000	5
Private unaided premium	29,400	1,200	15,000	13
Total market				20

Source: MHRD Website, Company estimates, IDFC-SSKI Research

❑ …a $30bn market by 2012E

Aspirations + awareness + affordability = price discovery

With aspirations and awareness meeting affordability, the K12 segment is in a price discovery phase. To put this in perspective, Jamnabai Narsee Monjee School – a premium and prestigious private school in the suburbs of Mumbai – has shown a 12% CAGR in annual fees over the last 10 years. The school has recently also started an IB (International Baccalaureate) division which charges an average annual fee of Rs600,000. The relatively new trend of international schools is catching up slowly but steadily across the country with K12 fees ranging from Rs500,000-800,000 per annum. This underpins the increasing paying propensity of the Indian populace.

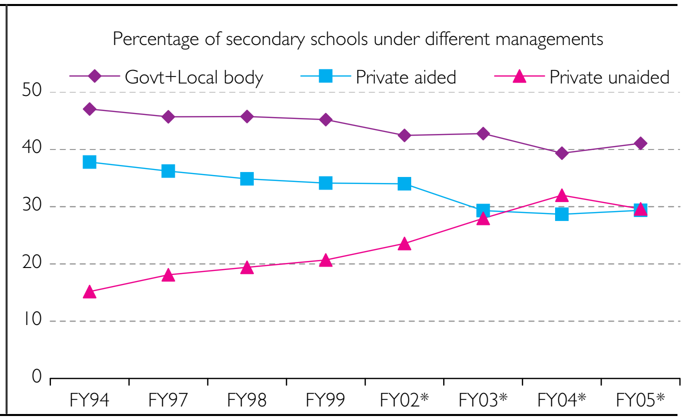
40% of students within 7% of schools (private)

Pay ability of education-hungry Indians is also indicated by the growing preference for private schools – 40% of students enrolled in the K12 system attend private schools, which are just 7% of total schools in the country. With public schools unlikely to become efficient in the near future, we expect the shift to continue.

Exhibit 37: K12 – 40% of students attend 7% of schools (private)

Total no. of schools	1,025,000
Privately run schools	75,000
Private aided	30,660
Private unaided	44,400
Private unaided premium	15,000
Private unaided standard	29,400
Public	950,000
Total children (up to grade 12)	361m
No of students enrolled in public and private	219m
No of students enrolled in public	139m
No of students per public school	**146**
No of students enrolled in private	90m
No of students per private school	**1,200**

Growth in private unaided schools



Source: MHRD Website, IDFC-SSKI Research

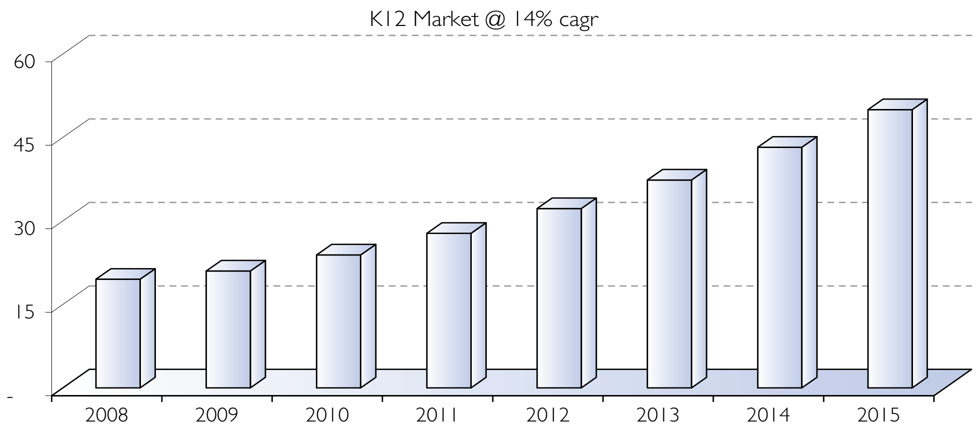
Consistent shift towards private unaided schools

Within the private K12 space, the last decade has seen a gradual shift from private aided to private unaided (i.e. costlier) schools. This clearly indicates that more and more parents now prefer to spend substantially higher amounts in their quest for better quality of education for their children.

Driven by such price discovery and growing acceptance of private schools as the medium for quality education, we expect K12 to grow to a $30bn market by 2012 (14% CAGR).

K12 – a $30bn market by 2012E

Exhibit 38: K12 – a $30bn market by 2012E-change to 14%



Source: IDFC-SSKI Research

THE 'BIG BAD' CORPORATE: RULED WITH AN IRON HAND

Schools have to run as a trust and cannot distribute profits

Education has strong social connotations in any economy (more so in India). Thus, schools have traditionally been a state responsibility to be run with a 'noble' cause and without being tarnished by the 'ulterior motive' of making monetary profit out of the activity. In this backdrop, it has always been mandatory by regulation that all schools be registered as a trust or society; also, the educational trust/ society cannot distribute dividends, or even invest the surplus to fund another school (refer to the judgment in the *Modern School versus Union of India* case given below). Further, the surplus generated is necessarily to be used for running the same school and only towards its development.

Modern school vs Union of India: Missing the woods for trees?

A three-judge bench of the Supreme Court – comprising Chief Justice VN Khare, Justice SB Sinha and Justice SH Kapadia, in a 2:1 majority judgment delivered on 27 April 2004 – ruled that the Society or Trust running a school CANNOT invest the surplus generated in running that school in another school (i.e. surplus money generated by one school cannot be transferred to the parent society administering the school and has to be kept for that very school). Regulations like these have prevented the emergence of any major chains in the K12 space as a corporate running various schools cannot create a common pool (internal accruals) to be used across schools of that particular chain and every new school/ branch opened requires fresh capital infusion. The rationale given is that if a society/ trust running schools has to ring-fence each school separately in a financial sense, and is not allowed to transfer funds from one school to another, it has no reason to try and generate a surplus in any school (translating into low tuition fees in each school). We see this as a perfect example of missing the woods (increasing the supply of high-quality education) for trees (keeping fees as low as possible in each and every school).

No central regulatory body – Indian boards mandate a trust structure, while states may/may not

❑ School 'rule book'

With no regulatory central body governing the K12 space, regulations vary from state to state. A student can continue to be a part of the education system – or his/ her 10th or 12th grade scores would be recognized – only if he/ she passes out from a K12 institute affiliated to a board recognized by the system; hence, all K12 institutes have to be affiliated to an education board – either central boards like ICSE and CBSE or a state board. While states may or may not relax the 'not-for-profit' stipulation, the boards mandate the schools to be run as a society/ trust.

While a school can be affiliated to any board, it needs to secure an NOC from the state and has to abide by any additional rules imposed by the state. In order to get the NOC and affiliation to a board, schools are mandated to be established by societies registered under the Societies Registration Act 1860 of the Government of India or under Acts of the state governments as educational, charitable or religious societies having non-proprietary character or by Trusts (some states like Haryana do not follow this structure and allow 'for-profit' activity in the segment).

Exhibit 39: School rules – very stringent

Step I	Formation and registration of society/trust
Step II	Minimum one acre land is required, whether owned or leased for a minimum period of 30 years. Land is demarked by state development authority for schools and auctioned at a significant discount to market price
Step III	NOC from state (for affiliation to any board)
Step IV	Construct school (~20 classes) and start operations within a year
Step V	Apply for board affiliation when first batch of 6th grade commences

School boards in India

State Education Boards	**CBSE**	**CISCE**	**NIOC**	**IB**	**IGCSE**
	The Central Board of Secondary Education	The Council for the Indian School Certificate Examinations	National Open School (stop-gaps for the schooling systems)	International Boards such as IB (International Baccalaureate from Geneva)	International General Certificate of Secondary Education

Source: CBSE Website

Once a school crosses the elementary level (8th grade), it needs to be affiliated with a Board of Education in order to conduct 10th and 12th grade exams for its students to be accepted for jobs or higher studies.

Checklist for securing affiliation from a board (CBSE)

The school needs to fulfill the following essential conditions

A) 'No Objection Certificate'/ Recognition Letter from the state government

B) Ownership or lease of requisite land in the name of the school or Society/ Trust running the school (if the land has been taken on lease, acceptable lease period is a minimum of 30 years).

C) Availability of well-qualified staff as per qualifications detailed. Payment of salaries to staff cannot be less than the corresponding categories of state/ central government employees. The salaries need to fixed as per the 6th Pay Commission (that implies a 40-70% increase on 5th Pay Commission levels).

D) Non-proprietary character of the Trust or Society running the school (to be shown by way of an affidavit)

Non-profit mandate keeps serious for-profit players away

❑ If there's a rule, there must be a way to bend it!

The not-for-profit mandate is the single-largest deterrent that has kept serious corporate activity at a bay in the otherwise attractive K12 segment. Most schools in India are standalone and any chains till recently were usually set up by private charitable, political and/ or religious groups – including Vidya Bharti schools (affiliated to the right wing political organization RSS) with more than 18,000 schools, Dayanand Anglo Vedic (DAV) schools with >600 schools and Chinmaya Vidyalaya with 75 schools among others. DPS (Delhi Public School) with its 120 schools – 107 in India and 13 outside – is a franchisee chain.

Corporate structures take a cue from existing 'non-profit' schools

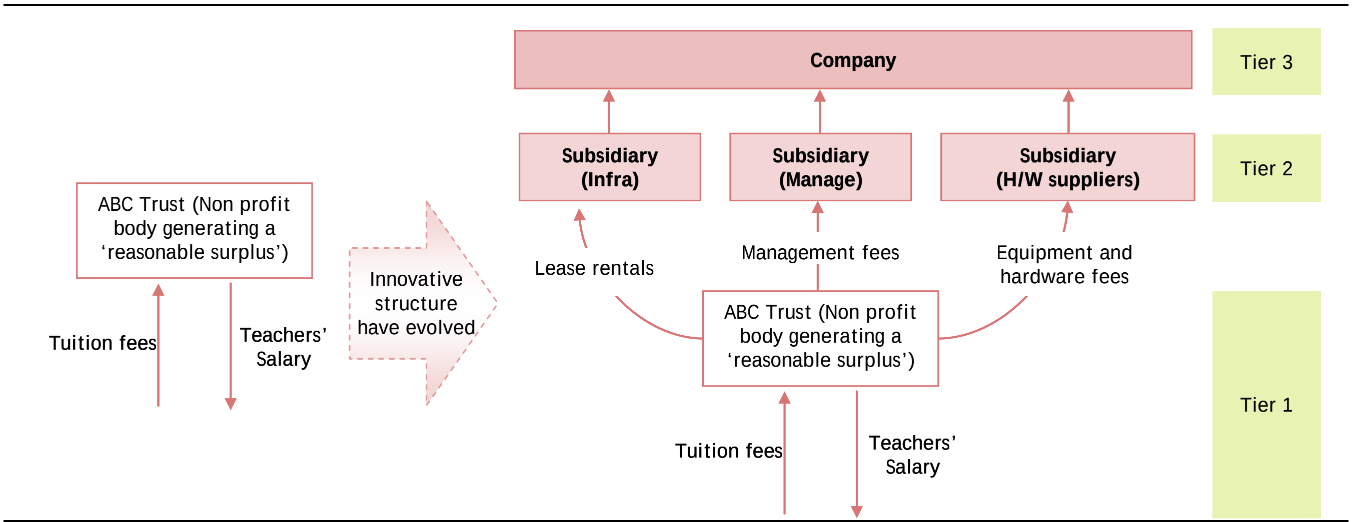
Two-tier structures – a norm in the making?

Ironically, when corporates looking to set up large for-profit chains have been cautious to tread here, individual schools have been 'profit-making' propositions since long. The entities have been using indirect means like lease rentals, management fee, etc to extract the surplus stuck in the trust. Taking a cue from these schools, IES has been witnessing some corporate activity in the K12 space on similar lines, but in formal version of these age-old structures. Archaic regulations have been surmounted through an innovative two-tier structure, which bypasses the 'trust' regulation and enables promoters (on corporate level) to generate profits from the venture.

Two level structures – company supplies services/ land to trust

In order to own and operate schools, companies like Educomp Solutions have created a structure wherein a trust (non-profit body) is created to run the school at one level. At another level, the company creates an entity that supplies the trust with land, services and infrastructure for a rental/ fee. In this way, the 'surplus' profit flows to the latter entity in the form of fees for providing these services and is at its disposal to be then distributed as dividend or used to fund another venture. The model runs the risk of being struck down in view of education being a 'socially sensitive' sector, more so at K12 level. However, the structure has been in existence for a long time at the standalone school level and we believe the model could become the norm till regulations change for the better.

Exhibit 40: Innovative structures getting corporatized



Source: IDFC-SSKI Research

Players across IES eyeing the space

Chain reaction

More recently, K12 has witnessed increased corporate activity – mostly based on the two-tier structure. Various players that have created a brand in non-formal areas of education have extended footprint into the K12 segment. Educomp, earlier a pure multimedia supplier to schools, is now aggressively extending itself across the value chain with 11 K12 schools operational and plans to set up 150 schools by FY12. Similarly, some players in the preschool segment – Kid Zee (nine operational schools, planning to have 100 schools by FY11) and Kangaroo Kids (six operational schools) – too have moved up the value chain and forayed into this large market. Further, Career Launcher (operational in the test prep space) and various other players are reportedly soon to enter the segment.

Exhibit 41: Key players in the K12 segment

Player	Status	Network	Comments
KIDZEE HIGH	Part of the Zee Interactive Learning Solutions (ZILS) – Listed	23 schools currently; expects to grow the base to 100 schools over next 3 years	Franchisee model - growth via greenfield projects/ conversion model, wherein companies take over an existing school
GEMS EDUCATION	Private	80 schools across the globe - 33 in Middle East, 6 in India	Management contracts – wherein the company provides only management services. GEMS plans to have 100 schools in India (including owned)
Billabong High International School	Private - part of Kangaroo Kids (KKEL)	6 schools operational; 14 signed up	
The Millennium School	Part of Educomp Solutions - Listed	11 schools operational; plans to have 150 schools by FY12	Various models - owned, managed and JVs with reality players
IMS	Private		Plans to foray into K12
CAREER LAUNCHER Inspiring leadership	Private	3 schools in Delhi	Plans to foray into K12
EURO KIDS	Private	4 schools operational; 6 signed up	Plans to foray into K12

Source: IDFC-SSKI Research

❑ Models in the core K12 segment

Various models are being used by for-profit players to gather scale in the segment. Most of these companies are using a mix of franchisee and owned-schools in order to scale up. Within the franchisee model, companies are helping schools set up the two-tier structure, to bypass the 'trust' regulation and extract profits without breaking any rules. Further, companies are also looking at an alternative option of providing management services to existing schools.

Players going in for greenfield projects/ 'taking over' existing schools

Owned Schools: Within this model, companies either set up greenfield projects or take over the trusts of existing schools for a consideration (Educomp has recently acquired a residential school in Mussoorie, UP). For a greenfield project, a school can apply for subsidized land reserved for schools by the state development boards; however, a big chunk of this land has been hoarded and leased/ sold to schools at high rates. Thus, prohibitive land costs (Rs170m-180m for a 1-acre plot in Delhi

DDA), coupled with high construction costs, have hurt the economic viability of a school under this model, more so as the payback period is long and IRRs are low.

Tie-ups with real estate developers to neutralize effects of land costs

To improve economic viability, many entities adopting this model are setting up schools in joint ventures with real estate developers. This is a win-win situation for both the parties as quality schools within residential complexes make the properties more attractive and the corporate entities running the schools do not have to commit huge funds for acquiring land. Educomp has entered into two strategic tie-ups with DLF and Ansal Properties. Under the agreements, while Educomp gets land at a significant discount to the market price from DLF (capex, and hence assets, resting with Educomp), the tie-up with Ansals does not entail any capex on Educomp's side (it just manages the school for a fee).

Exhibit 42: Indicative strategic tie-ups under the owned school model

Developers	Model
DLF	Educomp to purchase land which will be at a discount to market price. DLF will not commit any funds
Ansal Properties	Ansal to invest Rs2.5bn in a subsidiary Knowledge Tree Infrastrcuture (KTIL) and is expected to roll out 15-17 schools over the next 3-4 years. No capex for Educomp; to manage the schools for a fee

Source: IDFC-SSKI Research

Management contracts – a pure services model

Managing schools: Management of existing or new schools is another model being used by private players to capitalize on K12's market potential. Under the model, a company undertakes the day-to-day operations, admissions, hiring, and advertising and offers products or processes (IP of the company) in lieu of a management fee. Dubai-based GEMS (Global Education Management Systems; 80 schools worldwide) is following this model to gain a foothold in India. Players like Educomp too have entered into contracts for managing schools.

Besides these two models, another potential model or opportunity in the K12 space that could unfold for private players is managing of government schools (outsourced for a fee). This model is prevalent in the US (charter schools).

ECONOMICS IN SCHOOL: HEALTHY MARGINS

~Rs100m (ex-land) required to set up a 2,000 student capacity school

K12 is a capital-intensive business and requires a hefty one-time investment of ~Rs100m (excluding land cost) to construct and furnish a school with a capacity of 2,000 students. An annuity business, a school generates consistent returns with little or no incremental capex required.

Below we give indicative economics of running a school. While CBSE regulations mandate an area requirement of 25 sq. ft per student, we have assumed 30 sq. ft per student to accommodate larger classes and halls at a construction cost of Rs1,200 per sq. ft. Land cost is the other key one-time component for developing a school. CBSE requires a school to either own the land or have a 30-year land lease on a minimum 2-acre plot. As plots of land are reserved by the state development boards for educational institutions and are available at a considerable discount to the market price, we have assumed an average cost of Rs32m per acre (or Rs750 per sq. ft).

While capex (~Rs160m) can be staggered over 2-3 years, operations can start within 1st year

Based on our assumptions, we have estimated a one-time capital expenditure of ~Rs160m (including land) to build a 2,000-student facility. This capex has been staggered over a period of three years while operations can start in year-1 itself. (Assumption – entire project has been debt funded).

Exhibit 43: Capex assumptions

	Area	Rate per sq ft (Rs)	Total (Rs m)
Land	87,120	750	65.34
Playground	5,000	750	3.75
Construction	60,009	1200	72.00
Furniture	30,000	300	9.00
Additional Capex			12.72
Total capex			163.0

Source: IDFC-SSKI Research, Conversations with school owners

Exhibit 44: K12 Economics – an annuity business

(Rs m)	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Occupancy year wise (%)	30	50	70	80	90	90	90	90	90	90
No. of students	600	1000	1400	1600	1800	1800	1800	1800	1800	1800
Annual fee per student pa	35,000	35,000	36,750	36,750	38,588	38,588	40,517	40,517	42,543	42,543
Admission fee per student	25,000	25,000	26,250	26,250	27,563	27,563	28,941	28,941	30,388	30,388
Annual fee	21.0	35.0	51.5	58.8	69.5	69.5	72.9	72.9	76.6	76.6
Admission fee	15.0	10.0	10.5	5.3	3.9	3.9	3.9	3.9	3.9	3.9
Revenues	**36.0**	**45.0**	**62.0**	**64.1**	**73.4**	**73.4**	**76.9**	**76.9**	**80.5**	**80.5**
Salary and wages (Teacher student ratio 1:24)	7.1	10.9	15.7	18.3	21.8	21.8	23.5	23.5	25.3	25.3
% of revenues	*19.8*	*24.2*	*25.4*	*28.5*	*29.8*	*29.8*	*30.6*	*30.6*	*31.4*	*31.4*
Elec. water telephone	3.0	3.0	3.2	3.2	3.3	3.3	3.5	3.5	3.6	3.6
% of revenues	*8.3*	*6.7*	*5.1*	*4.9*	*4.5*	*4.5*	*4.5*	*4.5*	*4.5*	*4.5*
Overheads	10.8	12.6	17.3	17.3	19.8	19.8	20.8	20.8	21.7	21.7
% of revenues	*30.0*	*28.0*	*28.0*	*27.0*	*27.0*	*27.0*	*27.0*	*27.0*	*27.0*	*27.0*
Operating costs	21.2	26.7	36.5	39.0	45.3	45.3	48.0	48.0	51.0	51.0
EBITDA	**14.8**	**18.2**	**25.4**	**25.0**	**28.1**	**28.1**	**28.8**	**28.8**	**29.5**	**29.5**
EBITDA margins (%)	*41.1*	*40.5*	*41.0*	*39.0*	*38.3*	*38.3*	*37.5*	*37.5*	*36.6*	*36.6*
Depreciation	7.4	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2
EBIT	7.4	8.0	15.2	14.8	17.9	17.9	18.6	18.6	19.2	19.2
EBIT margin (%)	*20.5*	*17.7*	*24.5*	*23.0*	*24.3*	*24.3*	*24.1*	*24.1*	*23.9*	*23.9*
Interest cost	12.0	12.9	14.2	12.3	11.3	9.6	8.9	7.7	6.8	5.3
PBT	**(4.6)**	**(4.9)**	**0.9**	**2.4**	**6.5**	**8.3**	**9.7**	**10.9**	**12.5**	**13.9**
Tax	(1.4)	(1.5)	0.3	0.7	2.0	2.5	2.9	3.3	3.7	4.2
Tax rate (%)	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0
PAT	**(3.24)**	**(3.43)**	**0.66**	**1.70**	**4.58**	**5.79**	**6.76**	**7.60**	**8.72**	**9.74**
PAT margins (%)	*(9)*	*(8)*	*1*	*3*	*6*	*8*	*9*	*10*	*11*	*12*
Land Cost + Construction Capex (staggered over 3 years)	104.2	111.9	96.7	90.0	80.1	80.1	76.9	76.9	73.6	73.6
RoCE (%)	7	7	16	16	22	22	24	24	26	26

Source: IDFC-SSKI Research

Capacity build up takes around four years

We have assumed a capacity build-up over the first four years of operations (30% in year-1, 50% in year-2, 70% in year-3) with two sources of revenues – annual tuition fees of Rs30,000 per annum and a one-time admission fee of Rs25,000. (the admission fee is paid upfront and the annual fee is paid on a quarterly basis leading to a negative working capital, and lowering incremental funding requirements).We deduce from our interaction with industry sources that a school can generate healthy EBITDA margins of ~40%. Land cost is the key variable and could swing the breakeven period considerably.

IQ: HIGH

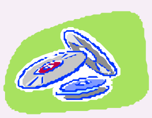
Regulatory ambiguity, under-reporting of cash key issues; players with credible management have high IQ

At $20bn, K12 is the largest opportunity within the IES. While the true potential of this space will be unlocked with a change in regulations, corporate structures have found a way around regulatory deterrents and we expect to see increased activity in the space going forward. Notably, an asset heavy model, healthy EBITDA margins and annuity cash flows (coupled with a negative working capital cycle) make K12 a value creating proposition. While 'regulatory ambiguity' and under-reporting of cash generation (and absorption) emerge as concerns for investors, we assign high IQ to K12 schools run by a superior and credible management. Educomp Solutions (11 operational schools, 150 planned by FY12), Zee Learn (23 operational, 100 by FY11E), GEMS (6 schools under a management contract) and Kangaroo Kids (6 operational schools) are a few scalable and noteworthy players that have emerged within this space.

MULTIMEDIA IN K12: BEYOND CHALK & TALK

Increasing need and awareness for 'quality education', willingness to spend in the K12 segment and an aggressive supply (254% CAGR in schools over FY05-FY08 for Smart Class, Educomp Solutions' Multimedia product for schools) have created a market for a complementary teaching delivery mechanism beyond the traditional black board (multimedia uses 2-D and 3-D images to explain concepts to enhance effectiveness of teaching). We have estimated the currently nascent market at $70m and expect it to grow swiftly (~60% CAGR) as less than 5% of private unaided schools have been tapped. With 75,000 private schools (44,400 unaided), the market offers a potential in excess of $1.5bn. With a host of players swarming the market, Educomp Solutions, Everonn Systems and NIIT are the largest players within the space.

Exhibit 45: Multimedia in K12 market – a snapshot

Segment	Revenues ($ m) FY08E	Revenues ($ m) FY12E	Growth drivers	Key risks	Key players	Our view
Multimedia in private schools • Providing technology as an aid to chalk & talk in K12 classrooms under the BOOT model 	70	500	• 5% of private unaided schools have been covered – a highly underpenetrated market • Market potential in excess of $1.5bn • Existing model set to witness high growth due to infinite return on investment for schools • An annuity model	• Large upfront investment • Duplication of content	• Educomp - Smart Class • Everonn – Vitels • NIIT – EGuru • ILFS - Kyan • Plans to foray : Navneet - E-book	**Beyond chalk & talk!** • A high growth market, we expect the momentum to continue for some time on the back of the currently low penetration • Educomp has a strong first mover advantage with Smart Class
	CAGR 60%					

Source: IDFC-SSKI Research

❑ Schools get tech-savvy fast!

Audio and visual (2-D & 3-D digital educational content) used as teaching aids in private schools

Private schools are working on evolving and improving their teaching delivery mechanisms by going beyond the traditional chalk & talk. Multimedia in schools uses digital educational content and infrastructure solutions as a teaching aid in classrooms by using audio and visuals means across various subjects.

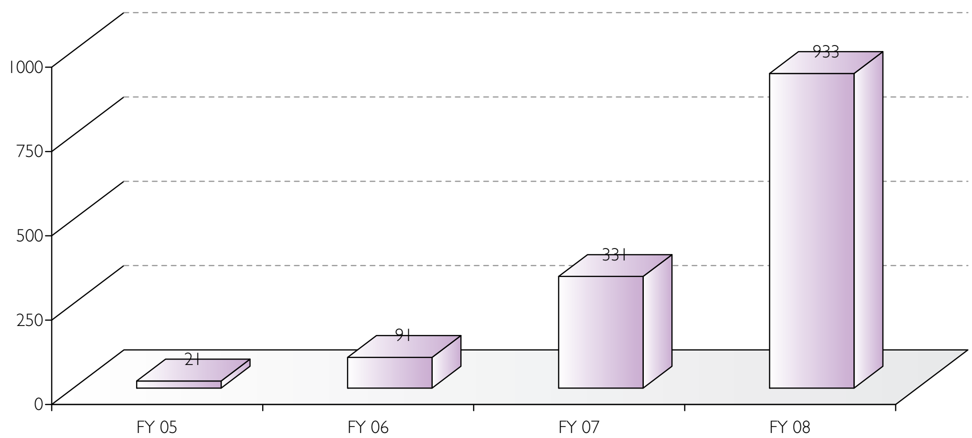
No capex or opex on schools' part

While implementation of such products adds to differentiation and ability to charge higher fees by private schools, the trend is gaining acceptability as the model does not require schools to invest any capex or incur operating/ maintenance expenses. With multimedia companies charging students directly, some schools even get a revenue share, which makes the proposition economically beneficial for the latter.

Educomp Solutions is the most scaled-up player

Educomp Solutions has been the first one to establish relevant scale in the space and has a strong first mover advantage (251% CAGR in revenues over the last three years).

Exhibit 46: Educomp's Smart Class (a multimedia product) – a smart move



Source: Company; IDFC-SSKI Research

Besides incumbent leaders including Educomp Solutions, Everonn Systems and NIIT, many players like Navneet Publications, Tutor Vista (Edurite) and Shloka Infotech have recently forayed into the segment.

Exhibit 47: Key players in the multimedia to schools segment

	Business model	Revenue model	No. of schools (FY08)
Educomp	Plasma TV in each class room with a main server in each school (H/W & content solution)	Rs150 per student pm	933
everonn	Using VSAT, a well-trained teacher delivers lectures from a remote location (studio) to different schools/colleges that are connected (Virtual Classrooms). (H/W & content solution)	Rs125-180 per student pm	180
NIIT	Multimedia based pure content solutions for IT and other mainline subjects including Mathematics, Science, Social Sciences, English, etc. Recently launched complete H/W & content solution product	Rs40-250 pm	981
IL&FS	Multimedia projector with content modules	Schools pay one-time fee of Rs130,000	800
NAVNEET	Digital version of the textbook – a content solution	Plans to foray	-

Source: IDFC- SSKI Research

An underpenetrated market offering potential in excess of $1.5bn

Given the low market penetration (less than 5% of private schools) and growing acceptability of such products, we expect the nascent $70m market to grow swiftly (~60% CAGR over FY08-12E). With 75,000 private schools (44,400 unaided), the market offers a potential in excess of $1.5bn.

Smart Class a benchmark within the industry

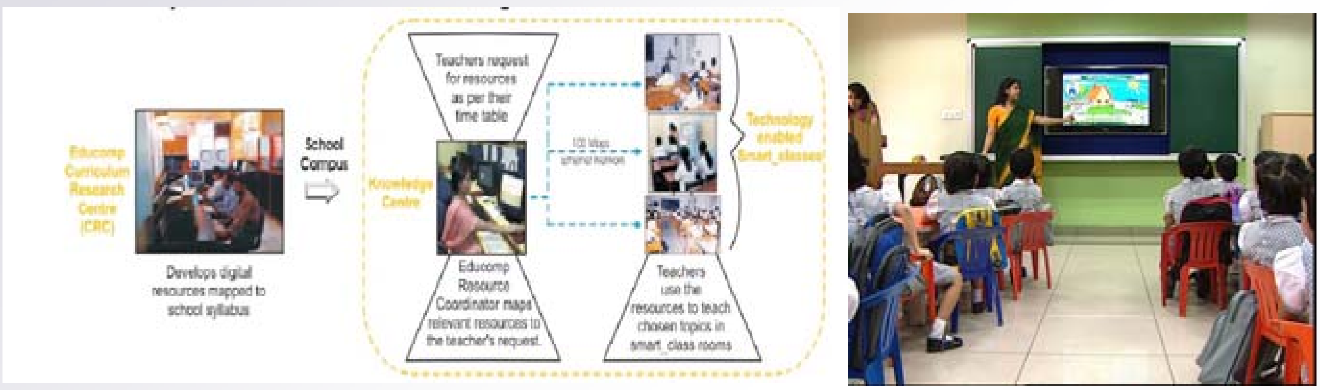
❑ A high returns business

While various products – from purely content-based to complete interactive solutions (content & hardware), or only IT subject training to a complete subjects solution are jostling for space, Educomp Solutions has pioneered Smart Class – a high-return and annuity business model. Competitors are increasingly adopting the model – hence, we have used Smart Class as a benchmark to understand the economics of multimedia in schools.

Smart Class Model

A widely accepted product in the Multimedia for schools space is Educomp's patent 'Smart Class'.

Exhibit 48: Smart_Class Mechanism



Source: Company

Exhibit 49: Smart Class Mechanism

An existing room/space inside the school campus is converted into Smart_Class Knowledge Center. A full time Resource coordinator is deployed by Educomp at the knowledge center to train and support teachers to work with the program.

↓

The knowledge center server is connected to the existing classrooms through a campus wide structured Ethernet network.

↓

The classrooms are converted to Smart_Class rooms. Each Smart_Class room has a plasma TV. The blackboard can slide over the plasma TV enabling the teacher to switch between the black board and the plasma TV.

↓

The required content is sent to the school written on a CD which is then uploaded on the server in the knowledge center. The cd content is encrypted and has a hardware lock. The hardware unlock code is with the resource coordinator, should be attached with the school server for access to the modules

Source: Company; IDFC-SSKI Research

A BOOT model, contract for 3-5 years, fee of Rs150 per student per month

The multimedia in schools business commonly works on the BOOT (Build-Own-Operate-Transfer) model. Schools opting for this product enter into a 3-5 year duration contract with multimedia-product suppliers that provide infrastructure, digital content for teaching and maintenance services. While it does not involve any capital/ operating cost at the school's end, infrastructure is transferred to the school at a nominal cost at the end of the contract period. Companies typically charge on a per student basis (average Rs150 per month; usually payable quarterly).

High margin, high RoCE business

The business offers good returns – Smart Class generates EBIT margins of 58% and a high RoCE of 49%. While upfront capex is high (Rs85,000 per class), at Rs 150 per student per month, the capital cost is recovered in a little over a year. Increasingly players like Educomp Solutions and Everonn Systems plan to implement this model with a digital white-board and projector model to lower the capex costs by ~20% and further improve the RoCE. However, renewal of such contracts may be a challenge after the initial contract period is over, as the infrastructure has to be transferred to the schools and content can be duplicated.

Exhibit 50: Economics for Smart Class

Revenue per student pm (Rs)	150
No. of students per class	40
Revenue per class pm (Rs)	72,000
EBIT (Rs)	41,760
EBIT margin (%)	58
Investment per class (Rs)	85,000
RoCE (%)	49

Source: Company; IDFC-SSKI Research

IQ: HIGH

Technology based model and an underpenetrated market ensure scalability

The segment offers a high value creation proposition as a technology-based product and an underpenetrated market ensure scalability. The existing model followed by Educomp Solutions (Smart Class) and Everonn Systems (I-schools) leads to high return on capital employed and an annuity revenue stream as most of these products have a contract (3-5 year lock-in) with the schools. Key risks in the segment are duplication of content and excessive competition. Going forward, we see the pioneer Educomp Solutions (with a strong content library and wide distribution network) well placed to sustain its dominance in this market.

ICT IN PUBLIC K12: GAIN BUT WITH PAIN

The government, with the aim of improving computer literacy in public schools, is opting for public private partnerships (PPP) to source IT infrastructure and training. We expect the nascent $90m ICT (Information & Communication Technology) market to grow 10x by 2015 (penetration below 11% of public schools). Though the scale of opportunity is large, it is a low-margin business with high upfront investment (Rs200,000-300,000 per lab) and a long receivables cycle (150-200 days). The contracts are awarded to players on L1 bidding basis, which implies no product differentiation and hence commoditization. While Educomp Solutions, Everonn Systems, NIIT and Compucom are the largest players, a host of regional players are also active in the space.

Exhibit 51: ICT in public K12 – a snapshot

Segment	Revenues ($ m) FY08E	Revenues ($ m) FY12E	Growth drivers	Key risks	Key players	Our view
ICT in public schools • PPP in education • Providing IT infrastructure and training • Funded by Centre / states under Sarva Sikshiya Abhiyan (SSA) 	90	750	• Underpenetrated market with 11% of government schools covered • Government to increase spends (allocation for SSA increased 4X in 11th Plan) • 29,000 schools expected to be up for bidding in FY09	• Large upfront investment • L1 bidding leading to commoditization & low margins • Long receivables cycle	• Educomp • Everonn • NIIT • Compucom • Core Projects • Various Regional Players	**Gains but with pains** • An underpenetrated market, the opportunity is large enough to build scale • L1 commoditized business with low RoCEs, leads to low value creation capability
	CAGR 70%					

Source: IDFC-SSKI Research

Increasing SSA spend (up 4x in 11th Plan) means higher allocation for ICT

❑ Public schools proactively adopting technology

The government is taking concrete steps to improve the quality of public education system. The efforts are in earnest as is shown by the Centre's increased allocation of spend towards education in the 11th Plan period ($68bn; 6x higher than in the 10th Plan period). A part of this outlay ($18bn; 4x higher than in the 10th Plan period) would go to SSA (Sarva Shiksha Abhiyan), a multipronged initiative to weed out inefficiencies in the public education space and upgrade education by including computer literacy (ICT). With 60% of the spend committed to SSA by the state governments provided by the Centre, we expect $125m to be spent on ICT out of the total SSA funds of $3.3bn for FY09. In the coming years, we expect spend on ICT to rise in line with the increasing allocation on SSA.

The underpenetrated market expected to grow to ~$750m by 2012

ICT is being implemented in schools through the PPP route. To date, various states have auctioned ICT contracts to private suppliers for ~100,000 schools (indicating a market size of $90m). With the government increasing spend for ICT (29,000 schools expected to be up for bidding in FY09) and low market penetration (currently 11% of total public schools), we expect this market to exhibit ~70% CAGR in the years to come.

❑ ICT mechanism – low RoCE

Based on L1 & TI bidding; commonly structured as BOOT model

With government's increased focus on computer literacy in public schools, private companies are lining up to service the demand. For awarding the contracts, tenders are floated by state governments for a number of schools in a district. The contracts are awarded to 2-3 private players based on L1 and TI bidding. While some state governments follow the 'outright buy' model, wherein the government pays upfront (at the beginning of the contract) for the hardware, the contracts are commonly structured as BOOT contracts for a period of 3-6 years.

A 5-year contract is typically valued at ~Rs1m with capex requirement at ~30% of contract value

In most contracts, a private company sets up infrastructure of computers in labs (one lab per school), and provides maintenance services and training. Unlike the per student per month revenue in private schools, ICT payments are cleared on quarterly basis throughout the duration of the contract at a predetermined contract value (estimated at ~Rs200,000 per school per year). Against this, an ICT player has to commit a one-time investment of ~Rs300,000 (~30% of the contract value) for setting up a lab and incur the recurring running and maintenance costs.

Economics of the business

A pure hardware contract generates ~13% RoCE

On a normative basis, an ICT contract generates ~13% RoCE, which improves with pure services contracts and extensions of existing hardware contracts into service contracts. Further, some contracts have additional software and services, which bring in higher revenues and better RoCE.

Exhibit 52: Economics – hardware and service contract

Value of contract	Rs1m
Period of contract	5 years
Average revenue per lab pa	Rs200,000
EBIT	Rs40,000
EBIT margin	20%
Investment per lab (30% of Value of contract)	Rs300,000
RoCE	13%

Source: Industry; IDFC-SSKI Research

❑ Key concerns

Even though the segment offers high growth potential, the following issues make the business less attractive for players:

- **L1 contracts imply lower margins and commoditization:** The contracts follow an L1 bidding process, which leaves no room for product differentiation. Also, increasing competition would exert further pressure on margins.

Average receivable days at 150-200 days

- **Long receivables cycle:** The contract terms typically stipulate payment release on quarterly basis. However, payments invariably take longer than a quarter to be released, which means a longer receivables cycle. While the payment-release cycle time by state governments has become shorter of late, receivable days are still high at 150-200 days.

High upfront investment of ~Rs300,000 per lab

- **High capex per lab per school:** ICT contracts are structured in a way that companies have to provide the entire infrastructure at the beginning of the contract period. Given the asset-heavy nature of the business (investment of ~Rs300,000 per lab per school), some players have decided to shift their focus from ICT to other opportunities in the space.

IQ: Low

Economics improving but low value creation potential

Unlike most segments of the IES, dynamics of the small but high-growth ICT segment allow players to scale up. Yet, the L1 bidding process followed for contracts and a long receivables cycle imply low RoCE of ~13%, and thus limited value creation capability. On the positive side, the government has changed the bidding process from exclusively L1 to a mix of L1 and T1 (technical bidding). Further, with the Centre bearing ~70% of the cost on ICT, payment cycles too have improved. Various players also manage to generate higher RoCE by opting for non-investment contracts (i.e. purely service contracts without deploying hardware).

While organized players form ~2% of the total market, there are a host of regional players in the segment.

Exhibit 53: Key organized players in the ICT space

Players	No. of schools with ICT (till FY08)
Educomp	6,004
Everonn	3,164
NIIT	4,652
Compucom	2,860

Source: Company; IDFC-SSKI Research

We expect dominant players to grow faster

Even though the space is getting crowded with entry of new organized as also regional players in the segment, we believe the market (11% penetration among the 950,000 schools in the public domain) would continue to be dominated by leaders like Educomp Solutions, NIIT and Everonn Systems. Also, the high capex requirement per school would prevent a monopoly situation (every contract divided among 2-3 players).

Exhibit 54: Each ICT contract divided among players

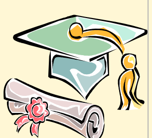
States	No. of schools	Companies
Gujarat	4,075	Educomp (2,817), Everonn (1,256)
Karnataka	1,000	NIIT (700), Aptech (250), Educomp (50)
West Bengal	1,055	Everonn (555), Educomp (500)
Andhra Pradesh	1,000	NIIT (663), Everonn (183), Aptech (154)

Source: Companies; IDFC-SSKI Research

HIGHER EDUCATION: TIME TO 'DEGREE SHOP'?

India's private HEIs have grown to be a $6.5bn market (excluding $1.5bn-2bn 'capitation' spends), with 12% CAGR estimated over FY08-12. Of late, private HEIs have mushroomed with the trend veering towards professional courses with high payback potential (engineering, medical and MBA colleges). However, the not-for-profit mandate, regulatory obeisance to multiple bodies, hefty investments required to set up an HEI and longer gestation cap IQ of the segment. Given the high participation of politicians in the field (vested interests), we do not see any structural change in the near term. With a head-start in the capital- and time-intensive business, we believe Manipal Universal Learning (equipped with the 4Cs) is the only player in the space promising value creation potential.

Exhibit 55: Higher Education market – a snapshot

Segment	Revenues ($ m)		Growth Drivers	Key risks	Key Players	Our View
	2008E	2012E				
Higher Education •Cater to >18yrs age group 	20,000	31,500	•India is one of the largest importers of education ($13bn is spent every year outside the country for HE) •Demand supply gap - NKC estimates the need for 1,500 universities •A low focus area for the government •Abysmally low GER of 9.97 •Government indications of opening up medical colleges to 'for profit' entities	•Regulatory overhang - UGC (University Grants Commission) mandates all HEIs to run in the form of a non-profit trust •An overregulated space •Large political involvement •Very capital intensive •Time to build brand equity (minimum of 6 yrs)	•Manipal Education (Manipal University, Sikkim Manipal University) •Amity •IIPM •ICFAI •Plans to foray – Career Launcher, IMS	**Time to 'degree shop'?** •While regulations are deterrent to most players, innovative structures are getting corporatized to work around the trust regulation •We feel that entities like Manipal Education that have already established scale and a brand have a competitive advantage
	CAGR 12%					

Source: IDFC-SSKI Research

HIGHER EDUCATION: HIGHER PRIVATE SPENDS

Higher education = graduation + post graduation courses

A part of the formal education system, the Indian Higher Education market – at $8bn – is next only to the K12 segment in size. Considering the $13bn spent on importing education, we estimate the paying propensity of Indians within the HE space to be at ~$20bn. The HE segment consists of graduation (targeting population between 18-21 years) and post graduation (>22 years) courses, offered after completion of K12 stint. The graduation market can further be classified based on the nature of education into graduate courses (18-20 years), diplomas/ non-graduate courses (16-20 years) and professional courses (18-21 years) such as Engineering (4-year tenure at graduate level) and Medical (5-year).

Central regulatory body – University Grants Commission (UGC)

While indirectly controlled by the Ministry of Human Resource Development, all colleges offering these courses need to be affiliated to a University (in turn under the purview of the central regulatory body called UGC – University Grants Commission). While most universities are administered by the state government, there are 24 Central Universities maintained by the Centre. Further, each stream is monitored by an apex body (e.g. AICTE is the regulatory body for Engineering and Management colleges).

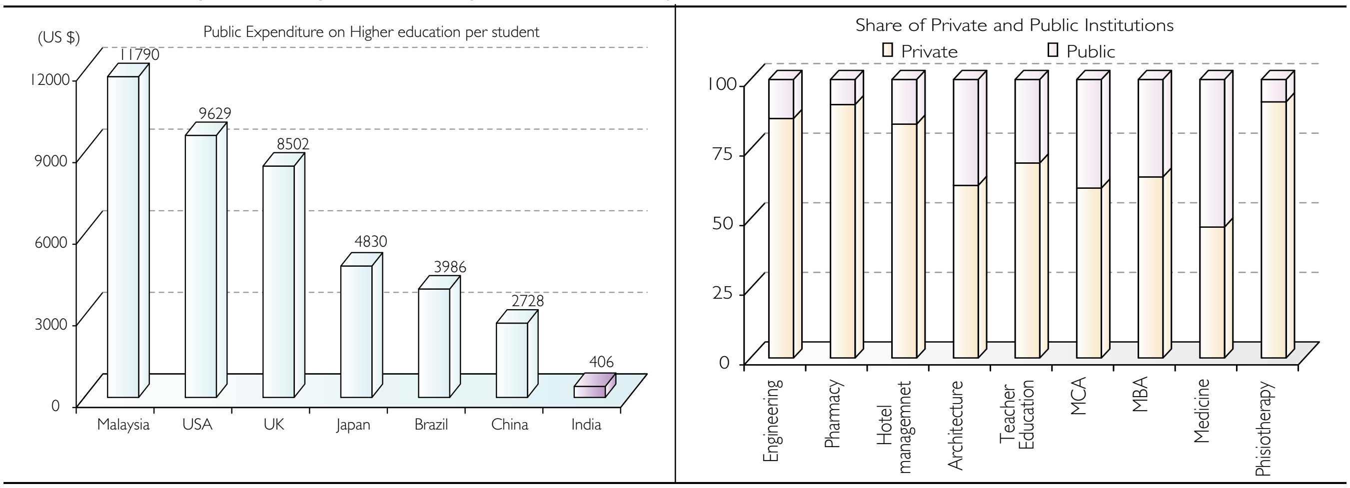
While India may have one of world's highest enrollments for HE (11m) as also networks of HEIs (currently estimated at 18,064), it has abysmally low GER of 9.97.

❑ Private HEIs dominate

India has the lowest spend per student on higher education globally

Over the years, public spend on higher education has been gradually reducing – and rightly so as the focus of governments globally is (and should be) on primary education. But the strategy has resulted in India having one of the lowest public spends per student on higher education.

Exhibit 56: Public spends on higher education per student – a comparison with other economies

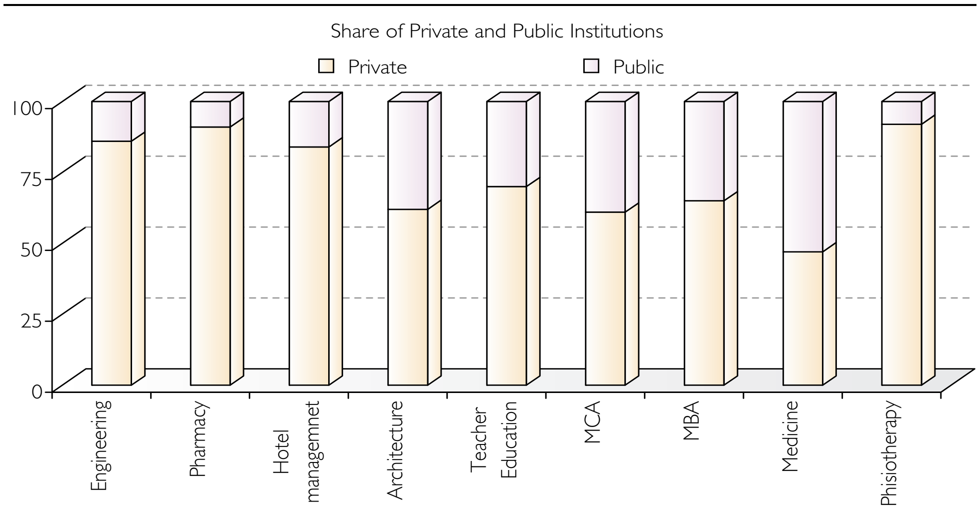


Source: Edge report

Post 2004, private HEIs have sprouted led by a growing middle class and provision for deemed university status

Given the dearth of quality institutes, private HEIs have boomed since 2004 and the number is growing. With liberalization opening up newer and better job avenues, the proliferation of private institutions has largely been in the area of professional courses like Engineering and Medical as also post graduation courses like MBA. Other factors that have contributed to the phenomenon include the increasing pay propensity of Indians and prospects of higher returns (payback in the form of fat salary packages) offered by these career-focused products. Today, more than 40% of India's HEIs are privately owned and funded (77% are privately owned).

Exhibit 57: Dominance of private HEIs



Source: IDFC-SSKI Research

Exhibit 58: Key milestones of the higher education system

• After 2000, spurt in deemed-to-be universities after a provision to be a de-novo institution	**2006**	• Indian Institute of Science Education and Indian Institute of Research established at Kolkata and Pune respectively
• Most of the new universities being set up by private players	**2004**	• Education Cess levied for raising additional funds. EDUSAT, a satellite dedicated to education, launched
• During this period, very few universities and colleges were set up by the government sector	**1994**	• NAAC established by IGC to access and accredit HEIs
• Government almost withdrew from taking additional responsibility for higher education	**1993**	• NCTE vested with statutory status by an Act of Parliament
• Growing middle class and rise in entrepreneurship accelerated pace of growth of private HEIs	**1985**	• IGNOU established by an Act of Parliament
• Universities largely confined to arts, science and commerce streams	**1961**	• IIT Act passed by the Parliament to provide a common legal framework for all IITs. First two IIMs set up at Ahmedabad and Kolkata
• The government not only supported higher education by setting up universities and colleges but also took over responsibility of running private institutions	**1956**	• UGC established by an Act of Parliament
• Public Funding accompanied with considerable regulation of private institutions	**1951**	• First IIT established at Kharagpur, Maharashtra

1948: University Education Commission constituted

Source: Edge Report

Quality gap exists – demand for HEIs

However, more is necessarily not enough. Despite the speed and extent of privatization in the segment, there still exists a yawning demand-and-QUALITY supply gap which is apparent in the high cash transactions (donations/ capitation fees) within quality institutes. This gives rise to the need for more conventional as also alternative modes (such as distance learning) of disseminating higher education.

❑ India goes degree shopping!

80% of the spend ($6.5bn) is on engineering courses

The HE space is bestowed with high potential volumes. The increasing ability as also intent to pay in return for securing a 'good career', and hence a 'good future', has led to a $6.5bn private spend – primarily on career-focused courses (more than 80% of the estimated spends on engineering courses). Interestingly, even though India has more than 1,600 engineering colleges (1,200 of these are private), most of the colleges have seats which are 'sold' at as high as 5x the regular fee. High capitation fee – currently deemed illegal – and black marketing of 'NRI Quota' seats are estimated to account for $1.5bn-2bn of additional spend in the space.

Exhibit 59: Higher education market

(no.)	Private colleges	Average no. of students per college	Total no. of engineering students (private)	Average spend per student pa (Rs)	Market size ($ bn)
Engineering colleges	1,200	1,200	1,440,000	150,000	5.40
MBA	300	300	90,000	300,000	0.68
Medical	140	400	56,000	250,000	0.35
Total					**6.50**
Including 'Cash Market'					8.00
Spends on HE outside India					13.00
Total spending potential					**21.00**

Source: AICTE, IDFC-SSKI Research

$6.5bn of spend within India+$1.5bn of cash transactions+$13bn spent outside India = $21bn spend!

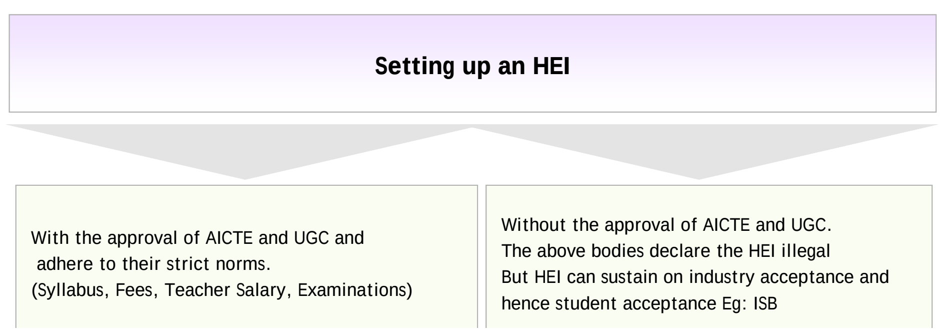
Also, a large number of Indian students opt for further education outside the country and spend a whopping $13bn every year on securing quality education. This further underpins the paying propensity of Indians. At 30% of the total inbound US HE traffic, India is one of the largest exporters of education globally.

HIGHER EDUCATION: RULES, RULES AND MORE RULES

While 'recognized' HEIs need to be affiliated to the system

HEIs are a part of the formal education system and in order to seek recognition from the central regulatory body (UGC) are required to be run under a not-for-profit trust/ society (Rules are more stringent than at the K12 level). In contrast to the K12 segment wherein a school has to be affiliated to a board recognized by the formal education system, it is possible to set up an HEI outside the purview of UGC regulations (applicable only in case of niche world class institutions that find acceptance with industry and academic circles; but cannot be superimposed on the entire segment).

Exhibit 60: Options to set up an HEI



Source: IDFC-SSKI Research

Part of formal education – HEIs required to be run under a trust

The higher education segment is a part of the formal education system, and like other segments in the space, is required to be run under a not-for-profit trust/ society. However, regulations are more stringent here vis-à-vis the K12 segment. The process of securing registration/ affiliation with a regulatory body is long-drawn and a single HEI is simultaneously governed by various bodies. While UGC (University Grants Commission) is the central governing body, there are individual regulatory bodies for specific professional courses, e.g. AICTE (All India Council for Technical Education) for management and engineering colleges and MCI (Medical Council of India) for medical colleges.

Accreditation for universities in India is required by law unless it has been created through an Act of Parliament. Without accreditation, "these fake institutions have no legal entity to call themselves as University/ Vishwvidyalaya and to award 'degrees' which are not treated as valid for academic/ employment purposes" - *University Grants Commission Act 1956.*

HEI governed by various bodies; archaic rules and known to be corrupt

These bodies not only have very stringent and archaic rules, they are considered highly corrupt by most industry factions. As of date, AICTE has black-listed 110 universities for not seeking recognition from the body. Further, regulations within the space are not clear – as can be seen in the ambiguity in judgments for private HEIs in the past.

Exhibit 61: Ambiguity in judgments for private institutions in higher education

Year	Cases	Brief description
1992	Mohini Jain vs State of Karnataka	Fees in private colleges need to be charged in parity with govt colleges; else termed as capitation fee. Capitation fee is illegal
1993	Unni Krishnan vs State of AP	Private colleges can charge fees higher than govt colleges but will be regulated by the state. Definition of capitation fee changed but capitation fee still declared illegal
2002	TMA Pai vs State of Karnataka	Apart from some regulations set by the state on reservation of socially backward classes, private institutes run by linguistic and religious minorities will have complete freedom to administer the institute
2003	Islamic Academy vs Union of India	Contrary to the judgment a year ago, a committee to be set up for admission and fees regulation
2005	Chhattisgarh University versus Union of India	Declared unconstitutional a provision in the Chhattisgarh Private Sector Universities Act (2002) permitting establishment of private universities, as no UGC recognition was present and >100 universities had sprung up in the state with dubious quality and poor infrastructure

Source: Websites

While much needed structural changes not in sight, liberalization, if and when it occurs, would start with HE

Regulatory conditions are unlikely to change in a hurry as education is a highly politically and socially sensitive sector. If the government does decide to throw open the formal education sector to for-profit private players, we expect the liberalization process to start with HE. Though there have been talks of liberalizing private HE entities (especially Medical Colleges), there is no single bill pending in the Parliament with the intent. Further, the high involvement of politicians (~70% of HEIs in Maharashtra are run by politicians) given the segment's high profit generation potential (though indirect) make the much-needed realignment and a structural shift look too difficult to achieve.

❑ No regulations – an option

World-class quality HEIs can shirk the system if they find industry acceptance

Unlike in the K12 segment wherein a school HAS to be affiliated to one board or the other for its pass-outs (grades 10^{th} and 12^{th}) to be recognized as part of the formal education system and eligible for further studies, it is possible to set up an HEI outside the purview of UGC regulations. The products of these institutes (students passing out) do not have to conform to acceptance standards of the education system but of the industry. As long as industry quarters perceive the products to be of superior quality, the HEI can do without these cumbersome affiliations. For example, ISB (Indian School of Business, Hyderabad) is a venerated name in the industry corridors despite it not being affiliated to any regulatory board. The diploma offered by ISB holds as much (arguably more) value as any UGC-accredited certification. But importantly, this status requires maintenance of world-class quality and strong industry support. Thus, it cannot be superimposed on the entire segment.

HIGH HOPES FROM INNOVATIVE STRUCTURES

Two-tier structures – company supplies services to trust

Issues related to trust formation, regulatory ambiguity and vested political interest are the key barriers to capital commitment from for-profit organizations. Setting up an HEI is an investment-heavy proposition (~Rs5bn for a medical college). However, there are some players that, despite being affiliated and hence recognized by the relevant regulatory bodies, have managed to extract legitimate profits from these universities through innovative structures.

MUL (the corporate entity) offers services to students of SMU (a trust) in lieu of payments from SMU

For example, Manipal Universal Learning (the corporate entity) offers various services to students of Manipal University and Sikkim Manipal University in lieu of payments from its two universities (refer pg no 113 for details). The company has been in the higher education space for the last five decades and has acquired scale (18,000 students in its campus education programmes at Manipal University and 100,000 students in distance education programmes at Sikkim Manipal University).

❑ Distance Education – an alternate mode

India's low GER renders a greater need for a higher number of conventional institutions as also an alternative mode of HEIs such as ODL (Open and Distance Learning) institutes. One way to improve GERs is to allow foreign universities to set up shop in India. FDI in education, including higher education, has been allowed under the automatic route without any sectoral cap since 2000; yet there is ambiguity around the space and degrees awarded by foreign universities are not recognized by the UGC or AICTE.

Alternative forms like open and distance learning institutes can fill the gap

This further underscores the need for alternative forms of learning. Supplementing the brick-and-mortar educational institutes, Distance Education can be considered an effective and low-cost alternative to on-campus HEIs. The DEC (Distance Education Council), set up under a clause within IGNOU (Indira Gandhi National Open University), has till date extended approval to more than 130 institutions to offer distance education. Also, the ODL model does not impose any limits on the number of students in terms of infrastructure.

IGNOU is the largest distance education provider in India

Currently, IGNOU is India's largest distance education provider with ~500,000 students enrolled for 1,100 courses through 129 programmes, 64 regional sub-centers and 1,621 study centers. The body is also the regulator in the space, which has led to certain quarters raising demand for an autonomous body to govern the space (a bill is pending approval pertaining to the same).

Exhibit 62: Distance Learning

	Semester enrollments	Study centers
SMU	140,000	550
IGNOU – India's largest distance education provider	468,444	1621

Source: IGNOU

Low brand perception mars potential to scale

There is large untapped potential in the segment as out of the ~10% population enrolled in HEIs in India, a miniscule ~7% go in for Distance Education. Though this portends a huge opportunity, perception of low quality has led to Distance Learning being treated inferior to on-campus education.

While Distance Education has low entry barriers for suppliers, the industry too has low regard for this medium. However, given that quality of a course can be controlled by improving the input and thus the output, we feel that an apt model and superior pedagogic measures can establish a strong brand. By doing all the right things, Sikkim Manipal University (SMU; a distance learning institute) has managed to achieve significant scale with ~100,000 students enrolled for its various programmes.

IQ: HIGH (BUT LONG-GESTATION PERIOD)

Globally, largest value creating education companies are in HE space

Globally, most of the top education companies by market cap belong to the US (where 'for-profit' education is permitted) and also to the HE space where they have managed to create strong brand equity over the years. Extrapolating the returns that these companies have generated over a period of time, we observe that most of them have outperformed the benchmark index performance consistently and significantly.

Exhibit 63: Players in HE space outperform the index

	Current Mkt Cap ($ m)	Key business	Period	Returns over the benchmark index
Apollo Group	13017	Higher Education	Jan98-Dec08	460%
Devry	3824	Higher Education	Jan98-Dec08	34%
ITT Educational Services	3714	Higher Education	Jan98-Dec08	404%
Strayer Education	2969	Higher Education	Jan98-Dec08	506%
Career Education	1767	Higher Education	Jan98-Dec08	323%
Corinthan Colleges	1292	Higher Education	Oct99-Dec08	312%
Capella Education	965	Higher Education	Nov 06-Dec08	164%
Raffles Education	826	Higher Education	Jan 02-Dec08	3385%
Megastudy	759	Online Learning	Jan04-Dec08	634%
Educomp Solutions Ltd	683	Multimedia in schools	Jan 06-Dec08	758%

Source: Bloomberg (Period is max (period of existence, 10 years)

Manipal Universal Learning is the only 'large' player within HE space

While Indian HE space is dominated by private institutions, we do not see any Apollos (revenues at $2.7bn) or Devrys (revenues at $933m) in the country. This is largely due to HE being a part of the formal education and mandated to be run as not-for-profit trusts and over-regulated by bodies like AICTE. The largest player within the space is Manipal Universal Learning (revenues at $180m).

An annuity model but a long-term game; requires considerable capital and time investments

Overall, higher education is a long-term game and players in the space will have to invest considerable assets and time to gain credibility. The capital-intensive nature (a medical college entails an investment of ~Rs5bn) and long gestation (minimum six years required to build a worthwhile brand) make this a long-term game.

Value creation only for players with 4Cs

Scalability and value creation can be achieved only by those players that have managed to establish creativity (to circumvent the regulatory requirements), capital (built to last), content (reputed courses with pricing & annuity power) and credibility (of the management to build a long-term value proposition). Having earned a name in the field, it then becomes an annuity model. Due to the lower capex requirements for setting up MBA colleges, we expect maximum private participation in this part of the opportunity.

Exhibit 64: Key players in the HE segment

HEIs	Status	Model
Manipal	12 professional streams; 17 institutions, 18,000+ students from 53 nationalities	On-campus - Medicine, Engineering, Information Sciences, Allied Health Sciences, Biotechnology, Dental, etc
Sikkim Manipal University of Health, Medical & Technological Sciences	Located in the north-eastern state of Sikkim; Distance Education provided through satellite; 550+ Learning Centres, 100,000+ students	India's first university in India to be built on PPP Model. Diploma, Bachelors and Masters courses in InfoTech, Management, Allied Health, etc
AMITY UNIVERSITY	38 colleges	Engineering, Management, Law, Biotechnology, etc
IIPM	HQ- New Delhi (3), branches in Mumbai, Chennai, Ahmedabad, Bangalore, Pune and Hyderabad; Total 9 colleges, 5,100 students (4,500 post grads, 600 undergrads)	Management and Corporate Trainings
Rai University INTERNATIONAL	25 campuses (across India, UK, USA and Dubai)	13 Under-grad and post-grad courses
GYAN VIHAR UNIVERSE	6,000 students in 32 different courses	Engineering, Management (ISBM), Hotel Management, Pharmacy, College of Post Graduation
ICFAI UNIVERSITY	7 campuses	Engineering, Law, Management

Source: Websites, Company; IDFC-SSKI Research

Players like MUL, with established scale and brand, will have competitive advantage

While distance education (as against setting up brick-and-mortar institutes) is an alternative and less capital-intensive model to build scale, time taken to build a brand and the low brand perception emerge as the key concerns.

While it is not yet time for degree shops in India, we believe players like Manipal Universal – that have an already-established scale and brand in the HE space – are at an advantage vis-à-vis new players moving up the value chain (like IMS and Career Launcher – two strong brands in the coaching class market).

VOCATIONAL TRAINING: NEW VISTAS

The imperative for students/ employees to draw on skill sets to effectively compete in a dynamic business environment has given birth to vocational training – a parallel $1.5bn education system. Also, the increasing relevance of services sector in the Indian economy calls for enhanced technical/ soft skill sets. Corporates (across industries) too are gleaning from their global counterparts the culture of continuous upgradation in skill sets of employees at all levels. While the factors suggest rapid growth (25% 3-year CAGR) as new training areas (retail, aviation, hospitality, management, English language/ soft skills trainings, etc) emerge, the space remains highly fragmented. Also, non-sticky nature of corporate trainings implies low revenue visibility, thereby hampering scale. At this stage, only a few players like NIIT and Aptech (leaders in IT trainings) have managed to accumulate mass. Others players with the potential to 'scale' include VETA (English training) and ICA (financials trainings).

Exhibit 65: Vocational training market – a snapshot

Segment	Revenues ($ m) FY08E	Revenues ($ m) FY12E	Growth drivers	Key risks	Key players	Our view
Vocational Training • Caters to age group of >14 years; ($500m for domestic IT training; $1bn for vocational trainings such as retail, aviation, English and FMT) 	1,500	3,660	• New opportunities apart from IT - retail, BFSI, English and Life skills trainings • Employers demand productivity from day one • India's demographic dividend - surplus of 47m working age population (India) while shortage of 56m for ROW by 2020E	• Slowdown in IT and other services sectors • Corporate training revenues have low margins; revenues lumpy in nature	• NIIT • Aptech -IT and Aviation (Avalon) • Jet King • ICA • CMS • VETA English Training • Russell English Training • Frank Finn • K10	**New vistas** • Growing acceptability of non-formal education and new opportunities. But limited scalability • Players offering skills that have flexibility (such as aviation, hospitality, BPO and retail) are equipped to handle changing trends/ preferences
	CAGR 25%					

Source: IDFC-SSKI Research

VOCATIONAL TRAINING PROVIDERS: NEW KIDS ON THE BLOCK

Vocational training assuming growing importance in India's growth story

Vocational training has been broadly defined as training that prepares individuals for specific vocations or jobs. Vocational training has assumed growing importance in India's growth story. The economy's 8%+ growth for three consecutive years can largely be attributed to increasing contribution from its services sector (up to ~55% in the last decade or so).

New areas of trainings emerge

Further, vocational training has moved beyond IT/ ITES into verticals like financials, retail, media, aviation, hospitality, etc. In any services business, human capital is the key asset and upgradation of workers' skills at all levels becomes an imperative to sustain growth. In developed economies, a month per year is reserved for training/ re-training/ re-education of employees right up to the age of 55-60 years. Also, corporates are laying ever-increasing emphasis on productivity from day one, which is prompting employees to work on enhancing their skill sets.

Only 5% of Indians (19-24 years) are trained

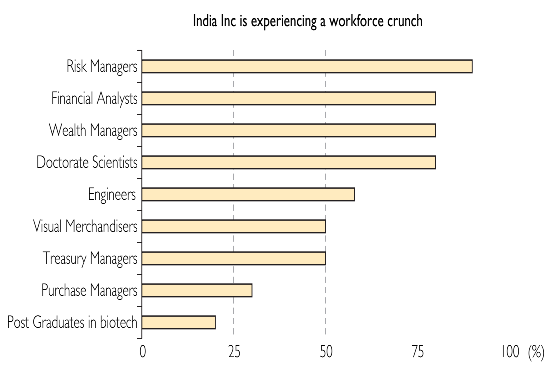
❑ India a largely untrained nation

Nearly 95% of the youth in the 15-25 years age group formally learn a trade or acquire a skill/ competency in most of the developed world. In contrast, only 5% of India's young labour force (19-24 years) is estimated to have acquired formal training.

Low enrollments and a high dropout rate – dire need for trainings

Low enrollments and high dropout rates throughout the education chain result in an inefficient supply of workforce. With a net 37% enrollment at school level, ~230m Indians are not equipped to work in the organized sector. Further, 87% of the people drop out after the school level. This leads to only 10% of college-aged population actually attending HEIs; further, 80% of the graduates in general streams (i.e. non-career specific courses) like BSc/ BA are unemployable. Due to the high dropout rates and inefficiencies rampant in the system, a large chunk of the population needs to be trained.

Exhibit 66: Workforce crunch in India Inc



Apart from a quantity shortage the primary concern in India today is a quality crunch. According to industry estimates only a quarter of all graduates are employable and ~80% of the job seekers in employment exchange are without any professional skills

Companies are able to select only eight or nine people out of 100 who apply and that's a pretty low selection ratio... In my estimate only a third of the pool has the right skilld to be absorbed into the industry right away – Kiran Karnik, President, NASSCOM

The issue is no longer about finding jobs for people, but of ensuring that there are enough people with relevant skills for the jobs at hand – KV Kamath MD ICICI

There is huge gap in the specialiszed skilled front and we are constantly faced with the question as to how we get highky qualified people – Kiran Mazumdar Shaw, MD Biocon

Source: FICCI, NASSCOM, IDFC-SSKI Research

Government's network of ~5,500 ITIs is not enough

The government, to provide vocational training at various levels, has set up a network of ITIs (Industrial Training Institutes) falling under the purview of the labour ministry. The ~5,500 government-run ITIs impart vocational training covering 110 trades including carpentry, electricians, masonry, etc and offer a collective capacity of 749,000 seats. Also, there are 500 polytechnic colleges offering diplomas in technical courses. However, quality and capacity constraints as also growing relevance of new-age trades mean that this network is not sufficient to meet the demand.

❑ A $1.5bn private market; growing rapidly

$1.5bn market expected to witness 25% CAGR over FY08-12

The space encompasses training services at all levels, be it for students passing out from schools and colleges or re-training needs of the employed set. We estimate the $1.5bn market to grow rapidly (~25% CAGR) in the coming years. The following exhibit points to the high underlying demand for vocational training across sectors like IT, financial services, retail, aviation, hospitality and English language training.

Exhibit 67: Key vocational training segments – IT, BFSI, Retail, Aviation, English, etc

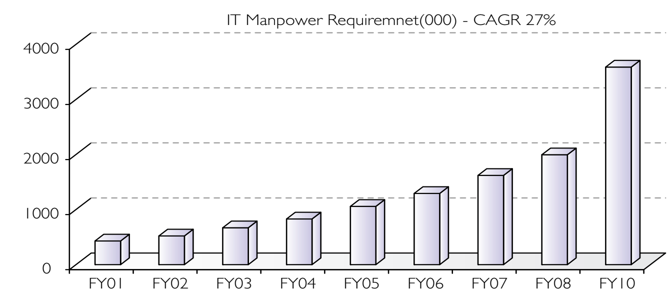
- Indian IT-ITES is a $50bn market. Indian IT-ITES training market is estimated at $525m; with Indian IT-ITES expected to cross $70bn in revenues by 2010, IT manpower requirement should witness 27% CAGR
- Non-IT graduates employed in IT sector growing faster than the number of IT graduates, fuelling demand for private institutes offering IT education in languages, networking and multimedia
- The US corporate training market estimated at a whopping $60bn; 5-7% of the market is outsourced, implying a $3bn-4bn potential.
- The animation industry needs over 30,000 people while supply is a mere 10% of the requirement
- The financial and management training space, estimated to be a $300m space, expected to show 30% CAGR
- Other areas like retail offer an opportunity with 2m employees required within organized retail industry by 2010E)
- Aviation and English language training market estimated at ~$1bn

IT - ITES training market

	$m
Indian IT training Market	525.00
Indian Corporate Training (10% of the IT Training market)	50.0
Hardware & Networking Training (30% of the IT Training Market)	160.0

Source: company estimates

IT workforce requirement



Source: IDFC-SSKI Research

Corporate training market potential has not been completely realized

While the importance of Corporate trainings has not been completely realized in the Indian market, it forms 10% of the Indian IT training market and is expected to grow. Infosys (one of the largest recruiters in India) has set up a Rs2.6bn Global Education Center in Mysore (Karnataka) in 2005 with a further Rs6bn planned to be spent on the facility for expansion. Also, the company spends Rs200,000 on every graduate selected for the global training programme. While this presents a large opportunity for private players in the space of training before and after employment, it does not convert/ translate into opportunity if not outsourced. Currently, the corporate training market (predominantly in IT) stands at ~$50m.

Employers want productivity from day one

A new order setting in – formal education meets vocational: The ever-changing dynamics of education and employability in a knowledge-driven economy are throwing up interesting trends. Employers are increasingly seeking employees that can contribute to the company's topline/ bottomline from day-one and skill sets have to be continuously updated to remain competitive.

IMA – ICICI Manipal Academy – an interesting trend

In this backdrop, the lines between formal and non-formal education have started to blur. To ensure quality training, employer companies are joining hands with private players to impart customized training to future employees. An interesting example of the same is the arrangement between ICICI and Manipal University to form ICICI-Manipal Academy (IMA) – a 1-year campus programme that is employer (ICICI) sponsored and guarantees employment to students after completion of the course. Manipal University charges a mutually agreed fee to ICICI for the same.

Exhibit 68: IMA (ICICI-Manipal Academy)

Structure of collaboration	• ICICI takes charge of admissions. Curriculum designed by Manipal and ICICI together and course delivered by IMA • Manipal invests in exclusive campus, faculty and facilities; it charges a mutually agreed fees per student to ICICI • 5-year lock in for both parties
Programme design	• Applicants require to be graduates from any discipline; admissions based on a written entrance test and interview • Students deemed employees of ICICI on admission into IMA; join ICICI as Assistant Manager (Band 1 grade) after completion of course • 1-year residential programme – nine months of classroom training and three months of internship • ICICI provides students with a monthly stipend during classroom training and internship • PG Diploma in Banking awarded at end of programme with an opportunity to carry credits and continue for MBA in Banking through distance education mode
Infrastructure	• Facilities in Hyderabad and Bangalore • Hyderabad facility is a leased building. Bangalore facility is a campus (also leased) of 11 acres near Jakur, with 150,000 sq. ft of built-up area • A teacher student ratio of 1:15/20 is targeted. Full-time faculty having minimum five years of relevant industry experience. Guest faculty includes people from ICICI Bank and senior industry professionals

Source: Company, IDFC-SSKI Research

NIIT too has formed ventures like IFBI (Institute of Finance, Banking and Insurance) in collaboration with ICICI and various other corporations.

Center has approved a scheme to upgrade 1,396 ITIs; mainly through PPPs

PPP – a beginning has been made: Another opportunity, though small in size, is on the horizon for private players in the space. The Centre has approved PPP, or Public Private Partnership, Scheme to upgrade 1,396 ITIs and transform them into Centres of Excellence. Educomp has taken over running of 18 ITIs as well as 12 skill development centers erstwhile run by the state government in Gujarat. More such arrangements are expected to follow.

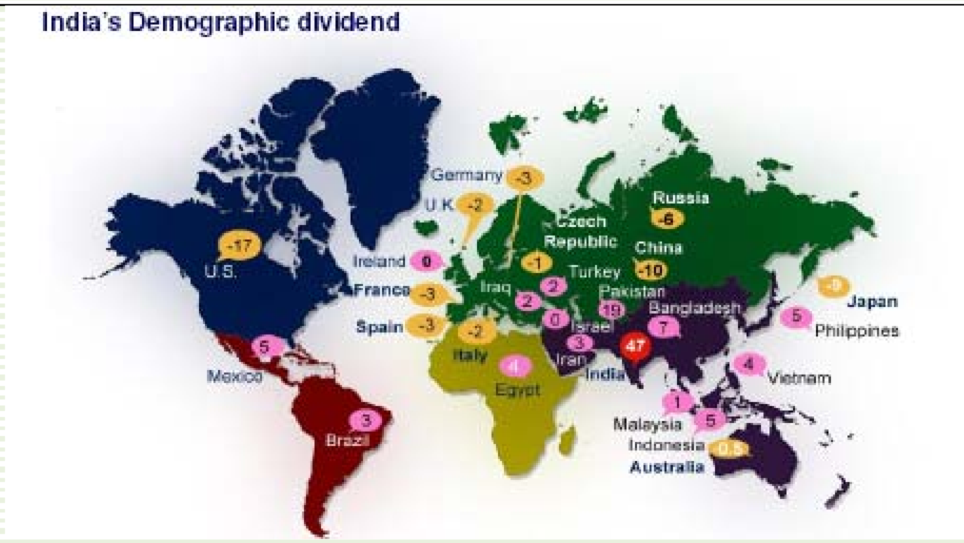
Rs310bn allocated for National Skill Development Programme; to open 250,000 vocational schools run in PPP

The focus of the Indian government is to dispense education with stress on employment. The 11th Plan has allocated Rs721bn to be spent on ICT and Vocational training. Of this, Rs411bn has been earmarked for setting up ICT labs for computer aided learning and Edusat Centers for distance learning programmes while Rs310bn has been allocated to National Skill Development Programme for training through Virtual Centers for Vocationalization. According to the statement of Mr. N. K. Singh, Deputy Chairman, Planning Commission, 250,000 vocational schools will be opened in India in next five years in PPPs, wherein the corporate sector will play a major role.

With quality skills-related training, India could capitalize on potential global workforce shortage

Based on current and estimated population demographics, India would have a surplus of 47m people in the working age group by 2020 while RoW would see a shortage of 56m in this age group. In this backdrop, increasing mobility of the Indian workforce and its unique demographic dividend (a young working age population) can work in India's favour, subject to the country upgrading the quality of its education and skill set development.

Exhibit 69: India to fund a global workforce shortage



Note: Potential surplus is calculated keeping the ratio of working population (age group 15-59) to total population constant
Source: US Census Bureau; BCG analysis

IQ: Low (still to scale)

Shortage of skilled teachers, people-centric models and lumpy revenues in corporate training cap scalability

Vocational training, a non-formal and non-regulated segment of IES, has emerged into a $1.5bn market. We expect 25% CAGR in the market over 2008-12. With the high degree of dropouts and non skilled workforce, there is a substantial need for vocational trainings. However, the market has not evolved to its full potential yet as the importance of training over the lifecycle of an employee has not been fully realized in India. Further, a shortage of quality trained personnel to dispense this education and lack of process-driven models have kept scalability at bay. While corporate spends on training are discretionary and based on competitive pricing, a lumpy stream of revenues within this space is another deterrent to scalability.

NIIT and Aptech the only players with scale

The market has remained largely fragmented barring a few like NIIT and Aptech (leading players in IT training space). In the English Language training space, VETA (revenues of Rs1.2bn) has grown by using a mix of owned and franchisee outlets with smaller players like Liqvid tapping the opportunity through the product licensing route. ICA in the accounting training space as also Frankfinn in aviation and hospitality trainings are other leading players in their respective categories.

Exhibit 70: Key players in the vocational training segment

Players	History	Status	Revenues (Rs m)	Business model
NIIT	Started in 1981	Listed	10,068	IT Training (90% of individual training revenues), IFBI (NIIT has 81% stake; remaining with ICICI) for banking certifications, Imperia (tie-up with IIM A,I,C,L) for management programmes, Corporate Training (90% of revenues come from the US)
APTECH	Acquired Avalon in 2006	Listed	992 (standalone)	Retail Business - IT & Multimedia training. Non-retail business - learning services, training and testing solutions. Avalon is present in aviation, hospitality and personality development training
Jetking	Started in 1990	Listed	390	110 centers (104 franchisees); Hardware and Networking Training
ica	Founded in 1999-2000	Private	1200	350 centers (30 owned). Focus on Financial Training
cms	Started in 1976	Private	230	60 centers. Training in H/W, Networking and IT
veta	Started in 1981	Private	>600	175+ centers; both franchised and owned (expected to go up to 500 by FY10)
Russell's Spoken English	Started in 1986	Private	70	30 centers (25 owned, 5 franchised)
Frankfinn	Started in 1993	Private	750	120 centers. Aviation and Hospitality training; ~17,000 students
K10	Started in 2003	Private	-	32 centers. Training in retail, marketing, HR, English

Source: IDFC-SSKI Research

COACHING CLASSES: IS THE 'COACH' SCALABLE?

The $6.4bn coaching class market is growing at ~15% yoy led by a dearth of quality institutions in India and cut-throat competition for entry into professional colleges. Notably, 80% of the market lies in 'subject-based tutoring in schools and colleges' – and thus is highly dependent on local 'brand-teachers'. Despite its non-regulated nature, people-centric models make scalability onerous in the space and cap value creation. Mahesh Tutorials is the only player to have achieved a relatively higher scale (revenues of ~Rs700m) on the back of some process-driven effort. While the Grad and Post-Grad test prep market ($1.2bn) offers limited scalability as it is more content-driven, FIITJEE, Bansal Classes, IMS, TIME and Career Launcher have achieved scale within the segment and are extending their presence across segments to expand the addressable market.

Exhibit 71: Coaching class market – a snapshot

Segment	Revenues ($ m) FY08E	Revenues ($ m) FY12E	Growth drivers	Key risks	Key players	Our view
Coaching Classes • ~64% of non-formal market • Caters to three distinct sub segments **Tuitions - $51bn** **Graduation TestPrep- $1bn** **Post Graduation Test Prep - $216m**	6,400	11,200	• Poor quality of teaching in existing education system • Shortage of quality formal education institutes - increasing competition for admissions at grad and post grad level	• A person-centric business; scale difficult to achieve unless business becomes process-driven	• Agarwal classes • Sinhal Classes • Chate Classes • JK Shah • Sukh Sagar • Brilliance • Karla Shukla • Mahesh Tutorial • FIITJEE • Bansal Classes • Career Launcher • TIME • Career Forum • IMS	**Is the 'coach' scalable?** • Scalability is a challenge in 80% of the market (tuitions). It is less of a challenge in smaller sub-segments where coaching is dependent more on content rather than individual 'brand teacher'
	CAGR 15%					

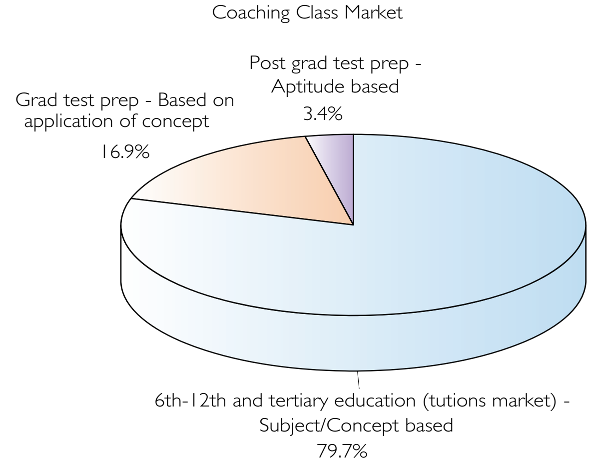
Source: IDFC-SSKI Research

THE QUALITY CONUNDRUM: GENESIS OF COACHING CLASS MARKET

Poor quality institutions and a score-centric exam system fuelling growth of coaching classes market

India's already inadequate education system is being further stretched due to its increasing population. So much so that a $6.4bn segment (64% of the total non-formal IES; next only to K12 and HE) – coaching classes – has sprouted around formal IES. The market is rapidly growing as the Indian education system lays heavy emphasis on marks scored in an exam. A shortage of quality HEIs is further fuelling growth. This is evident in the fact that the number of seats in Indian IIMs (Indian Institutes of Management) has increased merely 3% (2003-2008) but the number of CAT aspirants has shown a CAGR of 19% in the same period.

Exhibit 72: Coaching class market



Source: IDFC-SSKI Research

15% CAGR over FY08-12E

We have segmented the market into three broad categories – subject/ concept-based tuitions catering to K12 and HE segments (estimated at $5.1bn), Graduation test preparation market ($1.1bn) and Post Graduation test prep market (~$220m). While we expect some pockets to grow faster, we estimate 15% CAGR for the segment over FY08-12. Interestingly, players are also looking to provide coaching through online media – a model quite popular in the global markets, especially developed ones. However, the model would take time to evolve in India given the negligible broadband connectivity (< 1%).

A highly fragmented market as it is people-centric and not process-driven

The coaching class market is typically fragmented and regional in nature as a big chunk, i.e. tuitions (6^{th}-12^{th} grades and tertiary level), is subject-based and thus highly people-driven with high dependence on a local 'brand-teacher'. However, pockets like grad and post grad test prep are more process-driven as content assumes higher relevance than teachers, and content can be standardized across centers.

❑ Tuitions market– low scalability

Tuitions market (subject based) characterized by lack of stability and scalability

At $5.1bn, the tuitions market forms 80% of the coaching class opportunity and is inherently difficult to scale. A highly fragmented market, the business is person-centric and individual teachers attached to schools/ colleges are much in demand. For exams held on a national level (10^{th}, 12^{th} and university exams at tertiary level), our interactions with industry players throw up instances of students moving en-masse to another coaching class, to follow the brand-teacher who has joined a particular institute. Thus, crowd-pulling ability in this segment rests with brand-teachers (especially attached to schools/ colleges) and not brand-institutes. This, in turn, translates into lack of stability and scalability for coaching classes.

Exhibit 73: Subject-based tuitions – the largest in coaching class market

	Total students (m)	% taking coaching	Students enrolled (m)	Average fee pa (Rs)	Market ($ m)
School subject tutoring (6th-12th)	90	22	19.8	10,000	4,950
Tertiary education	11	5	0.55	10,000	138
Total subject based tuition market			20.35		5,088

Source: Interaction with industry sources, IDFC-SSKI Research

Mahesh Tutorials – most scaled in a non-scalable business

By reducing their overdependence on individual teachers (more than one teacher teaching one subject) and adopting a more process-driven approach, a few players have managed to gather relative scale. MT Educare (brand name – Mahesh Tutorial), a renowned name in Maharashtra, has managed to reach revenues of ~Rs700m. However, we believe the company would find it difficult to scale-up further in this particular business as despite being one of the 'largest' players, it holds only 3% share of the state's total tuitions market.

❑ Grad Test Prep market – medium scalability

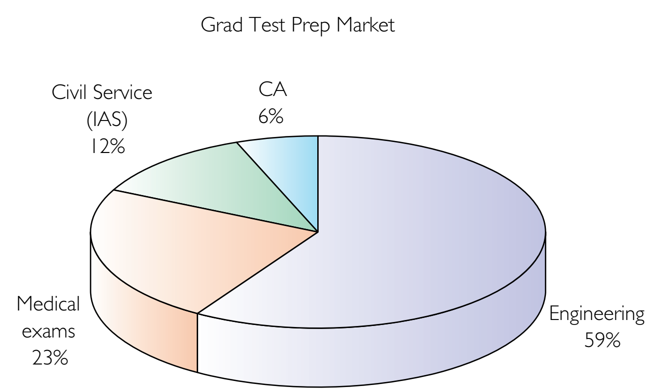
Engineering test prep commands a majority share

At $1bn, the Grad Test Prep market accounts for 17% of the coaching class opportunity. The test prep market for entry into a graduation course is dominated by the engineering segment (IIT-JEE, AIEEE and CET market together form 60% of the segment), followed by the next most-coveted profession of medical services (~23%).

Any change in testing standard – a key risk

In the past, the eligibility criteria for a few HE professional courses have been seen to change with new political parties assuming office. For example, admissions to these courses could be based on the score/ marks secured in 12th grade exams or aspirants could have to take AIEEE and CET entrance tests depending on the preference of the incumbent state government. This presents a key risk to coaching class players operating within the segment as when admissions are based on the merit list of 12th grade, coaching for AIEEE and CET is rendered redundant. On the other hand, IIT-JEE market players do not face this risk as entrance exams are always conducted on a national level.

Exhibit 74: Grad Test Prep Market



Source: Coaching class companies, IDFC-SSKI Research

Grad test prep market based on application of concepts; thus, offers some scalability

Most segments in the market have entrance tests that are conducted on a national level, which means that players can scale up to an extent. Further, the tests are based on application of concepts and with test preparation worksheets and materials forming the study curriculum, dependence on 'brand-teacher' is relatively lower.

Exhibit 75: Graduation test prep market – IIT-JEE market dominates

	Total students	% being coached	Students enrolled	Average fee (Rs)	Market size ($ m)
IIT- JEE	400,000	95	380,000	45,000	428
AIEEE	600,000	50	300,000	20,000	150
CET	120,000	90	108,000	20,000	54
Engineering	*1,120,000*				*632*
CLAT	25,000	50	12,500	4,000	1.25
BBA/BMS	25,000	50	12,500	7,000	2.19
Medical exams	500,000	80	400,000	25,000	250
Civil Service (IAS)	180,000	95	171,000	30,000	128
SAT*	5,000	50	2,500	30,000	2
CA	250,000	80	200,000	12,600	63
Total grad test prep market			**1,586,500**		**1,078**

Source: Coaching class companies, IDFC-SSKI Research

Kota Economics – a Rs5bn market around coaching classes!

Indians attach high aspirational value to IITs (Indian Institute of technology), the meccahs of graduate engineering courses. While implying tough competition for securing admission into these institutes, a unique phenomenon has emerged in a town called Kota in Rajasthan. With 50,000 students from all over India going to Kota for IIT preparation, the average spend including accommodation comes to Rs100,000 per student (average fee of Rs56,000) and translates into a market of Rs5bn!.'*Kota mein coaching classes nahin hoti to kuchh nahin hota*' ('but for coaching classes, Kota would have been any other non-descript Indian town') – that's the response of the local population in Kota.

Kota's entire economy rests on the coaching class market – be it owners of food stalls, grocery shops and autorickshaws, or the growing hotel industry, residents who rent out rooms and publishing companies that print study material. Interestingly, there are classes to coach students to crack entrance tests for these coaching institutes. (Players offering Classes for IIT-JEE preparation like Bansal and Resonance accept only those students for coaching who have cleared their own entrance exams.) For example, Nipuna Academy at Talwandi offers a 45-day crash course to prepare students for Bansal Classes, which have a very high hit ratio of 21% – i.e. 1,538 out of the total 7,209 students from Bansal Classes have made it into IITs.

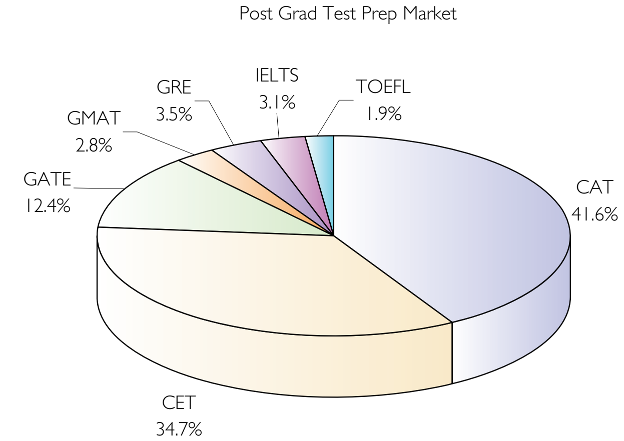
Post grad test prep market (aptitude-based) is relatively more scalable

❑ Post Grad Test prep market– scalable but small

At $200m, the Post Grad Test prep market is relatively easier to scale but forms only ~3% of the coaching class opportunity. Apart from being held at a national level, the entrance tests of these courses are more aptitude-based. Thus, this category of coaching classes has relatively lower dependence on 'individuals', and higher focus on standardized content and study material (a key differentiator). With ~300,000 applicants every year, the market is dominated by CAT aspirants (market at $90m).

Space dominated by CAT (MBA) preparation market

Exhibit 76: Post Grad Test Prep Market



Source: Coaching classes, IDFC-SSKI Research

Exhibit 77: Market size – Post Grad test prep market

	Total students	% taking coaching	Students enrolled	Average fee (Rs)	Market size ($ m)
Post grad test prep - Aptitude based					
CAT	300,000	80	240,000	15,000	90
CET	600,000	50	300,000	10,000	75
GATE	168,000	80	134,400	8,000	27
GMAT	15,000	80	12000	20,000	6
GRE	40,000	95	38000	8,000	8
IELTS	100,000	90	90000	3,000	7
TOEFL	60,000	90	54000	3,000	4
Total after grad test prep market			**868,400**		**216**

Source: IDFC-SSKI Research

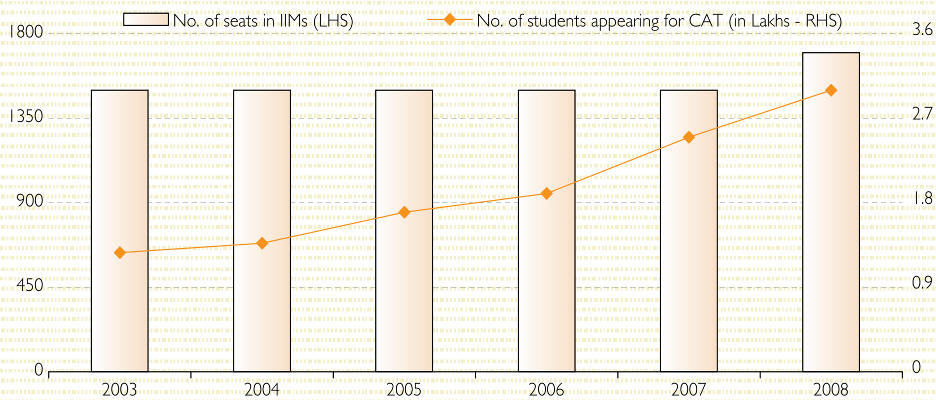
Incumbent leaders – IMS, Career Launcher and TIME – control 60% of the market

One of the largest markets in the post grad test prep space, the CAT is expected to go online in 2009 (IIMs administering and conducting the tests have invited bids for IT-infrastructure providers). Notably, the change in the test-taking mode should not affect operations of the existing players IF the content remains unchanged. The incumbent leaders in the MBA test prep space – IMS, Career Launcher and TIME – have a cumulative 60% share of the market.

With 300,000 students appearing for the test every year, Delhi (40,000 aspirants) is the largest market followed by Bangalore (30,000) and Mumbai (15,000).

The CAT Fight: The number of seats in Indian IIMs (Indian Institute of Management) has increased merely 3% (2003-2008) but the number of CAT aspirants has shown a CAGR of 19% in the same period! Hence, the acceptance ratio (admitted to applicants ratio) has been declining – and this serves the cause of coaching classes targeted at this group.

Exhibit 78: CAT Fight



Source: Industry; IDFC-SSKI Research

Exhibit 79: Key players in the coaching classes segment

	History	Status	Current Network	Revenues Rs mn	Business Model
IMS	Started in 1977	Private	185	1000	Strong focus on MBA test prep, diversifying into Certification Programmes, Publications, Language Training & Formal Education
Career Launcher	Started in 1995	Private	135	900	Strong focus on MBA test prep, diversifying into preschools, K12 schools, HE institutes, vocational training to providing coaching and counseling at all levels
T.I.M.E.	Started in 1992	Private	150	1000	Focus on MBA/ Engg/ MCA entrance tests
careerforum.in	Started in 1989	Private	57	120	Focus on Post Graduate (MBA test prep)
Mahesh Tutorials	Started in 1988	Private	168	430	Focus on 10th,12th grades (Science and Commerce streams), AIEEE, Engg/ Medical, CET, CA
FIITJEE	Started in 1992	Private	35	1200	Focus on IIT-JEE entrance test

Source: Companies, IDFC-SSKI Research

Exhibit 80: School (tuitions) and grad test prep – a fragmented market

	Focus Area	Region	Current Network	No of Students
Sinhal classes	ICSE, HSC	Mumbai	10	1000
Chate Classes	10th,12th (Science and Commerce)			
	AIEEE, Engg CET, Medical CET	Maharashtra	89	-
JK Shah	Commerce and CA	Mumbai	-	6500
Sukh Sagar	Commerce and CA		24	-
Brilliance classes	Science	Mumbai		3500
Karla Shukla	Science	Mumbai	6	2000
Brilliant Tutorials	Engg, Medical, Law	Mumbai	10	-
Vidyasagar	Engg, Medical		-	10000
Bansal Classes	IIT-JEE	Kota	3	8000

Source: IDFC-SSKI Research

Online tutoring in India not yet scaled up due to very low internet broadband penetration

❑ Online tutoring market – in its infancy

The phenomenon of online tutoring is very new in India. With ~3m broadband connections (less than 1% penetration), India is way behind the global average. In the coming few years, penetration is expected to double as the national Broadband and Wireless Policy targets to bring 25m subscribers to the broadband fold by 2012. Players like Tutor Vista that have a pure online model in the US are looking to follow a hybrid model in India to tap the potential in this segment.

Exhibit 81: Broadband penetration

Year Ending	Internet subscribers	Broadband subscribers
2005	6m	3m
2007	18m	9m
2010	40m	20m

Source: Trai

IQ: Low

Limited value creation in coaching class segment due to lack of scalability

A non-regulated space, the $6.4bn coaching class market is one of the largest opportunities within the IES (following K12 and HE) and is expected to witness 15% CAGR till 2012. Yet, we see limited value creation potential in the space as scalability is a challenge in 80% of the market (tuitions). In the remaining 20% of the market offering coaching for aptitude-based entrance exams to engineering/ professional courses, players find it relatively easier to attain scalability.

Exhibit 82: Coaching class market

	Tuitions	Test prep for entry into graduation courses	Test prep for entry into post graduation courses
Description	Caters to school & college level subject tutoring	Caters to aspirants preparing for admissions into a quality under-graduate course	Caters to aspirants preparing for admissions into a quality post-graduate course
Unique feature	Content specified by schools & colleges. Style of teaching the only differentiating factor. Key risk – students could follow a 'brand teacher' en-masse to another institute	Content not defined. Questions based on application of concepts. Segment less dependent on 'brand teacher'	Aptitude testing – largely honed through self practice and taking different types of tests. Segment depends on content and material
Dependence on brand teacher	High	Medium	Low
Scalability	Low	Low-Medium	Medium-High
Size ($ m)	5,088	1,078	216

Source: IDFC-SSKI Research

While the coaching class market remains largely regional and highly fragmented, the Post Graduation test prep segment has seen emergence of a few national chains – namely IMS (revenues of Rs1bn), Career Launcher (Rs900m), Career Forum (Rs900m) and TIME (Rs1bn). Players like Mahesh Tutorial in the tuitions market (Rs700m) and FIITJEE (Rs1.2bn) in the IIT Grad Test prep market have managed to establish scale to some extent.

While the space has seen some PE activity, lack of process-driven models will prevent scalability

Interestingly, the space has seen some PE activity including by Helix Investments ($12m for a 30% stake in Mahesh Tutorials), Gaja Capital ($8.3m in Career Launcher), and Lightspeed Venture Partners and Sequioa Capital ($30m in Tutor Vista in three rounds). We believe scalability can be improved by companies that manage to create strong process-driven model by reducing dependency on brand-teachers, or by formulating strategies to retain brand-teachers (strong incentives such as ESOPs or revenue share).

BOOKS: LESS FREE PLAY, LOW GROWTH

The Indian books market, estimated to be $1.75bn in size, can be divided into two segments – text books ($1.2bn) and supplementary books ($510m). However, private publishers have access to just 60% ($1bn) of the market given the monopoly of state boards and NCERT (National Council of Education Research and Training) in 95% of the school text book market. Further, the market is characterized by low growth due to low sell-through (100% students do not buy books and refer to class notes, etc) and presence of a large second-hand books market (70% of the target market reuses books). With a truncated school text book market and growth of just ~9%, we assign low IQ to the segment. Within a highly fragmented market, Navneet Publications is a leader in the supplementary books market.

Exhibit 83: Books market – a snapshot

Segment	Revenues ($ m) FY08E	Revenues ($ m) FY12E	Growth drivers	Key risks	Key players	Our view
Books •With >8,000 publishers, private text books market is highly fragmented 	1750	2500	•A spurt in the number of private schools offering 'quality' books •A change in syllabus pushes sales of text books and supplementary books in that particular year	•Large second hand books market - 70% of the target market reuses books •95% of school text books market not up for free play (the state and NCERT print the books)	*Text book publishers* •Tata Mcgraw Hill •Cengage (formerly Thompson) •John Wiley •SChand •BPPLaxmi Publications •Oxford •Macmillan •Orient •Longman *Suplementary Books* – Navneet Publications	**Less free play, low growth** •95% of the school text book market is not available to a private publisher as the state or NCERT prints the curriculum. Market available for private players is $1bn •We expect low growth due to the high reusability of books
	CAGR 9%					

Source: IDFC-SSKI Research

State boards and NCERT have monopoly in school text books market – 40% of the total books market

❑ Indian books market – less free play

We estimate the Indian books (text and supplementary) market to be at $1.75bn. However, a large part of the school text books market ($740m) is out of reach of private publishers given the monopoly of state boards and NCERT. Around 95% of schools in a state are typically under the state board and follow books printed by the SCERT (State Council for Education Research & Training). The remaining 5% of schools are under the CBSE and ICSE boards – while CBSE uses books published by NCERT (National Council of Education Research and Training - providing academic and technical support to the Ministry of Education), only ICSE and a few CBSE schools use text books published by private players such as Tata McGraw Hill, Oxford, Macmillan, etc. In this backdrop, private players have access to a truncated Rs1bn books market.

Exhibit 84: Indian Book Market

	Age (years)	Text books (US $m)	Supplementary books ($ m)	No. of publishers	Text books prepared by
Pre primary	3 to 5		30	1000+	Private publishers
Primary	6 to 9	200	90	400+	SCERT (state boards), NCERT (CBSE Board), ICSE, International publishers (International schools), private publishers (some CBSE schools)
Secondary	10 to 15	450	200	150+	
Higher Secondary	16 to 17	90	90	100+	
Graduation	18 to 21	200	100	100+	Private players
Post Graduation	21 onwards	100	na	na	Private players
Professional Books	working professionals	200			Private players
Total Market ($ m)	1,750	1240	510		
Total accessible market $m (only 5% of the school books market is currently accessible due to market distortions)	1047	537	510		

Source: Company, IDFC-SSKI Research

Private players enjoy free play in the higher education books space

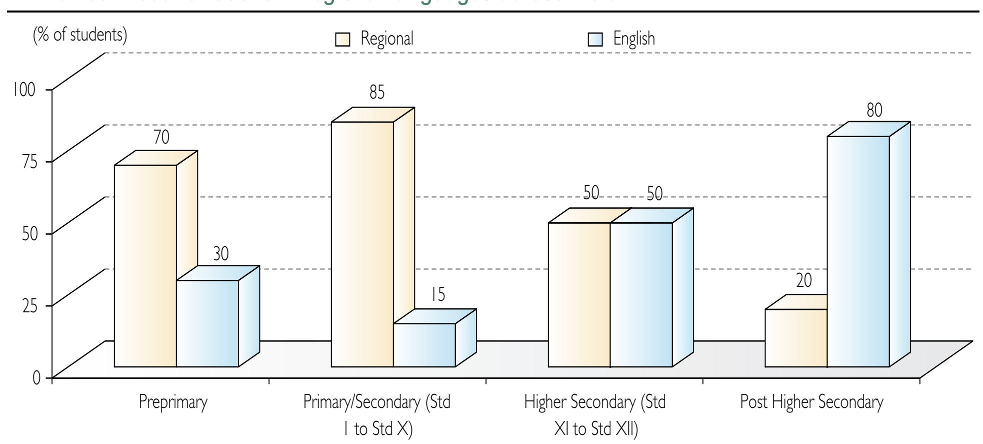
The higher education space offers more free play (except the distance education curriculum provided by IGNOU) to private players and is estimated to be $300m in size. The supplementary books market is a complete free play for a private player, and at $510m is one of the largest markets. Navneet Publications, with revenues of Rs4bn (FY08), is the leader in this market.

❑ Book worms grow slow

Scalability a challenge due to a large base of vernacular schools

The books market has failed to grow at healthy rates despite increasing enrolments and decreasing dropout rates in schools. This is primarily due to the low sell-through (100% students do not buy books and refer to class notes, etc) as also presence of a large second-hand books market (70% of the target market reuses books). Further, scalability in the school text books market poses a challenge to national players as a large chunk of the schools are vernacular, and thus text books used in these schools are in various regional languages.

Exhibit 85: Need for books in regional languages across India



Source: Companies, IDFC-SSKI Research

IQ: LOW

Various SCERTs (State Council of Educational Research and Training) and the NCERT (National Council of Educational Research and Training) have a monopoly in school text books, which caps the size as also growth of the highly fragmented books market. The inherently low growth rates associated with the space imply that the segment has the lowest IQ within IES.

Exhibit 86: Key players in the Indian books segment

	History	Status	Revenues (Rs m)	Business model
Mc Graw Hill Education	Formed a JV with McGraw Hill in 1970	Private	2,000	70% from HE text books, 25% from professional books and 5% from school text books
NAVNEET	Incorporated in 1959	Public	4,111	65% of revenues from publishing (supplementary and reference books) and 35% from stationary (paper and non-paper)
MACMILLAN PUBLISHING SOLUTIONS	Incorporated in 1970	Public	2,097	Publishes school and college text books, reference books. Provides typesetting and ITES services. Manages education portals
S. CHAND	Incorporated in 1930	Private	NA	Books and CD ROMS

Source: Websites

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COMPANIES

Initiating coverage

Educomp Solutions

Rs1936
BUY

Leading the way!

Mkt Cap: Rs33.5bn; US$682.7m

16 January 2009

BSE Sensex: 9047

Educomp Solutions (Educomp) is morphing into a full-service education provider within the 'restrictive and regulated' IES. The company has expanded its addressable market to $30bn from $100m in FY06 by moving beyond licensing (multimedia) into direct intervention (preschools, schools, vocational to online vocational education). Albeit its shift from an asset light to asset heavy model, we see the evolution as an intent to create a strong back-ended growth engine with annuity attached. Strong execution track record, adequate capitalization and a near-recession free environment are compulsive arguments which we find difficult to ignore. Educomp's success will be defined by a sticky (5 year lock-in) and scalable (5x in five years) model with 'Smart Class' driving the 64% CAGR in earnings. Consistently higher earnings should obliterate investor concerns with regards near-term premium valuations. Outpeformer

An annuity business with scale..: Educomp has pioneered 'Smart Class' – a differentiated and well-packaged annuity product. Implemented in 1,267 private schools as of date, the product imparts high revenue visibility (current order book of Rs9.8bn). We expect Smart Class to remain the key value generator (78% CAGR over FY08-11E; 57% of revenues) as the multimedia to schools market offers potential in excess of ~$1.5bn.

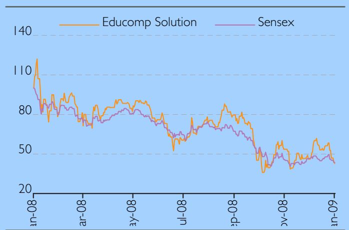
…investing in longevity: Educomp's aggressive foray into the K12 segment (11 schools operational), while turning the asset light model to an asset heavy one, would lend further resilience to the annuity model. While we do not expect significant value accretion from the venture in the near term (7% of FY11E revenues based on our conservative assumption of 37 schools), it would help Educomp secure a strong backended growth engine.

Strong getting stronger…Buy! Educomp operates in a space where it has created scale on the back of a sticky business model with annuity attached, followed by the intent to create a strong back-ended growth vehicle. At 16x FY10E earnings and 8.5x EV/EBITDA, we see value in the stock. With 64% earnings CAGR over FY08-11E, we initiate coverage on the stock with an Outpeformer rating and a target price of Rs2,800 (PEG of 0.35x FY10E); a 45% upside from the CMP.

Stock data

Reuters	EDSO.BO
Bloomberg	EDSL IN
1-yr high/low (Rs)	5679/1515
1-yr avg daily volumes (m)	0.84
Free Float (%)	45.0

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
Educomp	(16.5)	(28.3)	(61.1)	581.6
Sensex	(16.3)	(28.6)	(55.3)	(3.5)

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Key financials

As on 31 March	FY07	FY08	FY09E	FY10E	FY11E
Net sales (Rs m)	1,101	2,861	5,179	8,406	12,579
Adj. net profit (Rs m)	283	707	1,382	2,111	3,123
Shares in issue (m)	16	17	17	17	17
Adj. EPS (Rs)	17.7	41.0	80.1	122.4	181.1
% change	-	*131.4*	*95.4*	*52.7*	*48.0*
PE (x)	109.2	47.2	24.2	15.8	10.7
Price/ Book (x)	24.3	10.9	7.6	5.1	3.5
EV/ EBITDA (x)	61.7	27.1	12.9	8.5	5.8
RoE (%)	44.4	32.5	36.9	38.7	38.9
RoCE (%)	31.7	19.5	24.2	28.0	31.1

**FCCB worth $80m not converted*

INVESTMENT ARGUMENT

We like Educomp's business model as it possesses all the key success factors required to create scale and value in IES – *the 4Cs*. The company has *Content* in Smart Class – a differentiated product with annuity attached (5-year lock-in), *Credibility* with proven scale on the back of successful execution, *Creativity* to generate profit from the not-for-profit K12 market ($20bn – largest within IES) by using an innovative corporate structure and *Capital* to fund future growth (balance sheet size of Rs7bn; underwritten debt funding at Rs7.3bn inorder to fund the growth over next two years). While evolving as a full-service education provider, Educomp is on a strong growth trajectory (64% CAGR in revenues as also earnings over FY08-11E). At 16x FY10E earnings and 8.5x EV/EBITDA, we see value creation potential in the stock.

EDUCOMP: MOVING BEYOND LICENSING

Present across 60% of the $50bn IES

Educomp has expanded its addressable market from $160m (IT in private and public schools space) to ~$30bn. With this, the company addresses ~60% of the IES value chain and does not have a footprint only in the books and HE segment. A dominant player in 'multimedia for private schools' and leader in 'ICT for public schools' businesses, Educomp is also operational in other ancillary segments of IES (preschools, coaching class and vocational training). To provide longevity to its business model, the company has recently forayed into the formal education business (11 K12 schools currently operational).

Exhibit 1: Presence across the value chain (~60% of the $50bn opportunity)

	Current Size	Growth	Non Regulated	Scalability	Value Creation	Educomp Solutions	Comment
Preschool	✗	✓	✓	✓	✓	✓	Roots to wings (60 preschools). Acquired 50% stake in Euro Kids (second largest preschool chain, 484 preschools)
K-12	✓	✓	✗	✓	✓	✓	Key presence going ahead. At USD 20bn, the largest space across IES. Currently 11 schools (14,000) students. Acquired 50% stake in Takshila Management Services (low cost schools).
HE	✓	✓	✗	✓	✓	✗	-
Multimedia in private schools	✗	✓	✓	✓	✓	✓	Key presence with 'Smart Class'. High growth market ~70%CAGR till 2012 (Underpenetrated at <5%). Educomp is the market leader (1267 schools till date; an annuity business model)
ICT in govt schools	✗	✓	✓	✓	✗	✓	Key presence. High growth market ~90%CAGR till 2012. Educomp is the market leader(8915 schools coevered till date). L1bidding and long receivable cycles lower value creation capability
Coaching Classes	✓	✓	✓	✗	✗	✓	Mathguru (A company online initiative with 28,929 subscribers).Set up seven brick and motar learning centers in NCR.
Vocational Training	✗	✓	✓	✗	✗	✓	Professional development (Teacher Training)- Trained 1.2m teachers till date. Joint venture with Raffles Education in India
Books	✗	✗	✓	✗	✗	✗	-

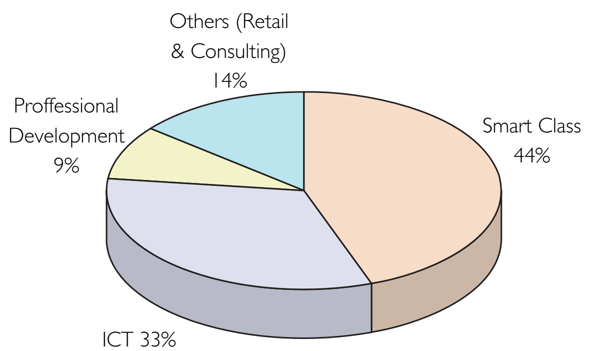
Present across 60% of US 50bn IES

Source: IDFC-SSKI Research

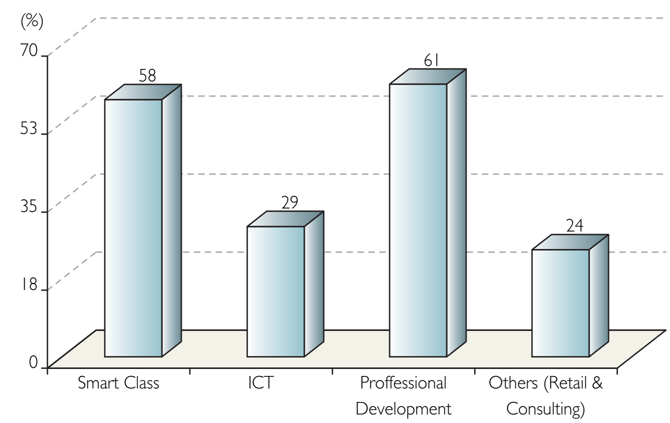
86% of revenues from B2B initiatives; increasing focus on direct initiatives

Educomp derives 86% of its revenues (Rs2.86bn in FY08) from B2B initiatives including Smart Class (a multimedia product; 44% of revenues), ICT Solutions (33%) and professional development, i.e. teachers' training (9%). The remaining 14% of the revenues accrue from direct initiatives like sale of educational aids, CD-ROMs and learning content pertaining to various online initiatives (*Mathguru* and *Learning Hour*) as also offline ventures – preschools and K12 schools.

Exhibit 2: Revenue mix (FY08)



EBIT margins



Source: IDFC-SSKI Research

'SMART CLASS' IS EDUCOMP'S TRUMP CARD!

Educomp has seen a 127%CAGR over FY06-08 pivoted around 'Smart Class' and ICT

Educomp has seen 127% CAGR in revenues over FY06-08, primarily on the back of its multimedia product offering called 'Smart Class' (44% of revenues in FY08) and ICT solutions (33%). While ICT is an undifferentiated product offering (providing computer hardware and IT training in public schools using the L1 bidding process), 'Smart Class' will continue to be the key value generator for Educomp in the years to come.

❑ Multimedia in private schools (Smart Class) – key value generator

With expected CAGR of 60% over FY08-12, the market offers potential in excess of $1.5bn

Multimedia in private schools uses digital educational content and infrastructure solutions in schools as a teaching aid. Educomp has pioneered a well-packaged multimedia product called Smart Class and implemented it in 1,267 private schools till date. The product has been very well received and has created a $70m market (~$31m is with Smart Class, remaining with competitors). Going forward, we expect the multimedia for schools market to register 60% CAGR as penetration levels rise. Currently, less than 5% of the 44,000 private unaided schools in India have embraced multimedia, which indicates that the market potential is in excess of $1.5bn!

A well packaged product – no capex/ opex for the school; strong annuity with 3-5 year lock in

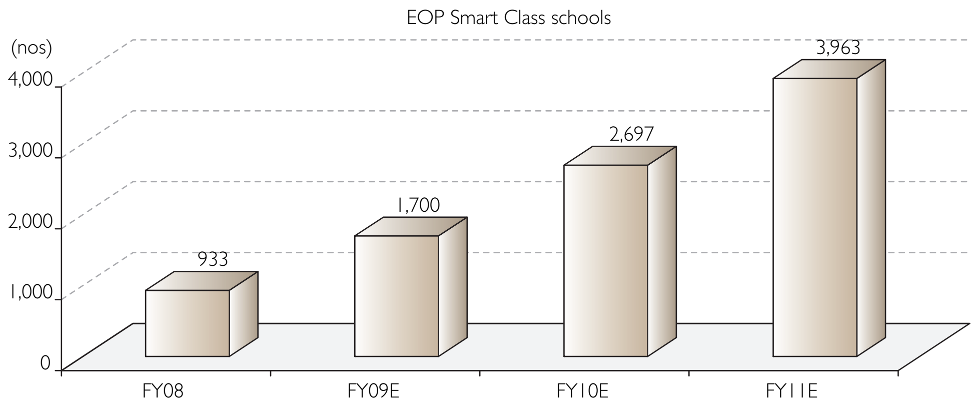
Multimedia products are typically targeted at unaided private schools, where paying propensity of parents is comparatively higher (at an average fee of Rs150 per student per month – *less than the cost of a pizza*, it constitutes a miniscule price of the total monthly fees while making the teaching-learning process clear, fun and interactive). The product does not involve any capex or opex cost for the school and students are charged on a monthly basis (Rs150 per student). Contracts are typically for a duration of five years, which makes Smart Class an annuity product. As of date, Smart Class has been implemented in 1,267 private schools (current order book at Rs9.8bn).

Educomp has a strong first mover advantage with >40% market share

Educomp has shown 251% CAGR over FY05-08 in Smart Class revenues. With >40% of the market, it has a strong first mover advantage in the space and the product scores high on *Content (a differentiated and annuity product)*. Over the years, Educomp has managed to build a strong content library comprising 16,000 modules and an extensive distribution network with a 185-people sales team. Given the under-penetration and strong first mover advantage, we expect Smart Class to remain the key value creator (78% CAGR over FY08-11E) for Educomp.

Underpenetrated market (<5%) and first mover advantage will lead to an 78% CAGR over FY08-11E

Exhibit 3: Strong growth in Smart Class



Source: Company, IDFC-SSKI Research

Smart Class a high RoCE business

High margin (58% at EBIT level) & high RoCE (49%) expected to expand

The upfront capital cost (~Rs85,000 per class) is borne by Educomp. Assuming an average of 40 students per class (Rs150 per student per month; payments usually on quarterly basis), the investment is recovered in just over a year. The product fetches high margins (58% at EBIT level) and superior RoCE (49%). Going forward, players in this space are working on lowering their capex requirements. Towards this end, Educomp plans to substitute the plasma/ LCD screens used in classrooms with digital whiteboards and projectors. As players expect to cut capex by ~20%, this would lead to RoCE expansion. To further reduce its capex requirement, Educomp plans to lease the hardware for new contracts as against owning the assets.

Exhibit 4: Smart Class – smart economics

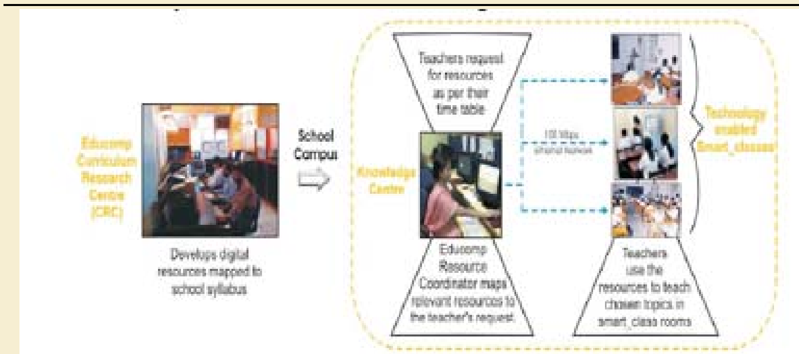
Revenue per student pm	Rs150
No of students per class	40
Revenue per class	Rs72,000
EBITDA	Rs41,760
Margin	58%
Investment per class	Rs85,000
RoCE	49%

Source: Company, IDFC-SSKI Research

Smart Class Model

The product is offered on the BOOT model (Build, Operate, Own and Transfer) with a contract life of five years, after which the hardware belongs to the school.

Smart Class mechanism



Smart_Class Mechanism

An existing room/space inside the school campus is converted into Smart_Class Knowledge Center. A full time Resource coordinator is deployed by Educomp at the knowledge center to train and support teachers to work with the program.

The knowledge center server is connected to the existing classrooms through a campus wide structured Ethernet network.

The classrooms are converted to Smart_Class rooms. Each Smart_Class room has a plasma TV. The blackboard can slide over the plasma TV enabling the teacher to switch between the black board and the plasma TV.

The required content is sent to the school written on a CD which is then uploaded on the server in the knowledge center and can be used by the teachers as per requirement. The cd content is encrypted and has a hardware lock. The hardware unlock code is with the resource coordinator, which needs to be attached with the school server for access to the modules

Source: Company, IDFC-SSKI Research

Educomp has set up three content development facilities based in Gurgaon (NCR), Greater Noida (NCR) and Bangalore. A new facility is coming up at Parwanoo (Himachal Pradesh) and is expected to commence operations in FY09.

Educomp acquiring 'competitors' to fortify its leadership

Even though Educomp provides for a hardware and software-lock in order to protect the IP, content replication/ duplication by competitors or the schools remains a risk. Also, high returns have been attracting players to the space, which means increasing clutter. However, we see Educomp well placed to protect its leadership as besides having a head-start in the business with a strong brand, it has also been acquiring 'competitors'. Thus, we expect the growth momentum to continue for at least 3-4 years.

❑ ICT (Instructional & Computing Technology) – gains with pains

A PPP initiative – Educomp is a market leader

With the objective of improving computer literacy, the government has allocated dedicated funds for ICT, i.e. setting up of computer labs and providing training in computer literacy, in public schools. Funds amounting to $125m have been earmarked towards the ICT initiative for FY09 and ~29,000 schools are expected to come up for bidding within the year (~100,000 schools already covered). The government tenders contracts for public schools within a district to private players and the contract is typically distributed among 2-3 players. Educomp (leader in the space with 8,915 schools till date), Everonn, NIIT, Compucom and Aptech are the dominant players with a host of regional players also operational in the space.

Exhibit 5: ICT contracts in a state – shared by 2-3 players

States	No. of schools	Companies
Gujarat	4,075	Educomp (2,817), Everonn (1,256)
Karnataka	1,000	NIIT (700), Aptech (250), Educomp (50)
West Bengal	1,055	Everonn (555), Educomp (500)

Source: Companies, IDFC-SSKI Research

High growth potential, but L1 bidding and a long receivables cycle cap returns

While the business offers high growth potential to established players like Educomp (with penetration at less than 11% of public schools, we expect the market to grow 10x by 2015), the L1 nature of projects (L1+T1 of late) and a long receivables cycle (150-200 days) reduce its attractiveness. Also, the business entails high upfront investments (~Rs300,000 per lab per school), but margins are low as contracts are awarded on L1 basis.

Low RoCEs of ~13% can be improved with a mix of pure services contracts

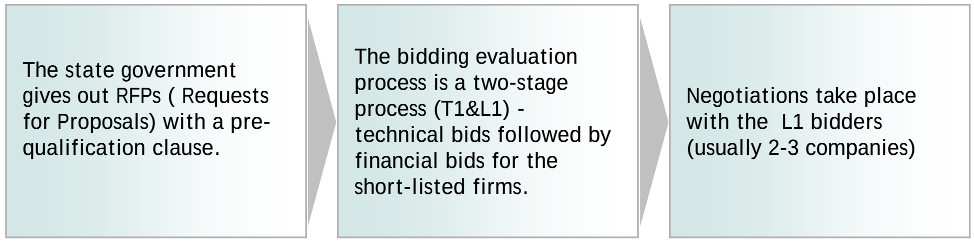
A lab in a public school requires an investment amounting to ~30% of the value of the contract. Assuming that the value of a contract (typically 5-year duration) is Rs1m, an upfront investment of Rs300,000 is required. A hardware and services contract over the period would generate EBIT margins of ~20%. Thus, on a normative basis, an ICT contract has 13% RoCE, which can be improved by extending the scope of contracts from just hardware to providing software/ additional services in some states (higher revenues) or by bagging pure service contracts.

Exhibit 6: Economics – a hardware and services contract

Value of contract	Rs1m
Period of contract	5 years
Average revenue per lab pa	Rs200,000
EBIT	Rs40,000
EBIT margin	20%
Investment per lab (30% of Value of contract)	Rs300,000
RoCE	13%

Source: Interaction with industry sources, IDFC-SSKI Research

Exhibit 7: ICT Mechanism



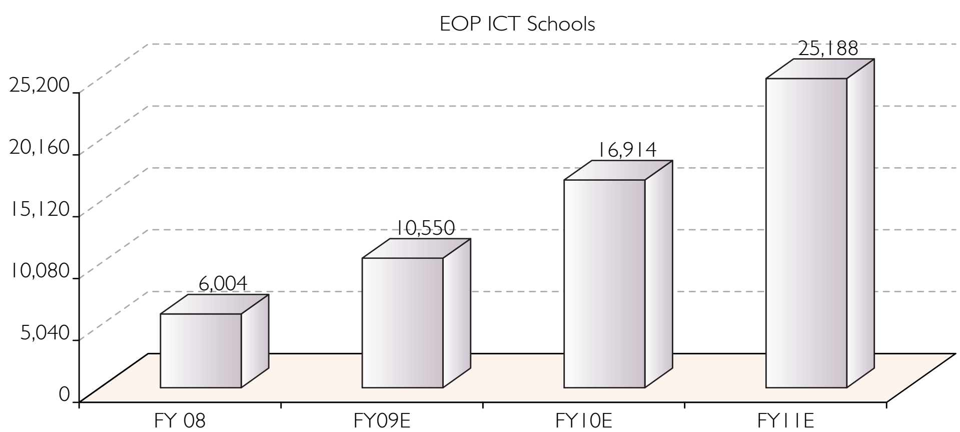
Source: Company, IDFC-SSKI Research

We expect incumbents to sustain the lead – Educomp expected to see 57% CAGR over FY08-11

Educomp – market leader in ICT

Educomp is the market leader in the ICT space and has serviced 8,915 schools till H1FY09 (~10% market share). Based on its prior experience, Educomp will be able to easily meet all the pre-qualification criteria required by various states going ahead. With 29,000 schools coming up for bidding in FY09, we expect the company to capture a substantial share of the market going forward. We see 57% CAGR for Educomp in its ICT business over FY08-11E.

Exhibit 8: Growth in ICT@ public schools this is for Educomp



Source: Company, IDFC-SSKI Research

ICT market – leading players

Players	No. of schools (till FY08)
Educomp	6,004
NIIT	4,652
Everonn	3,164
Compucom	2,860

Source: company

Educomp currently earns an EBIT margin of 29%, which is higher than for peers (average EBIT margins at ~20%) – as according to the management, besides providing 'computer education' (i.e. hardware), Educomp also services the schools with 'computer aided learning' (i.e. additional training and software).

Having trained over 1m teachers, the initiative is expected to grow

❑ Professional development

Professional development involves teacher-training initiatives. Educomp trained 305,570 teachers during FY08 and has trained a cumulative 1.13m teachers till date. Educomp runs its own training programme under the brand *QUEST* (Quality Education for Students & Teachers) and trains teachers in partnerships with various foundations (Learning Links Foundation and Learning Leadership Foundation). Professional development accounts for 9% of Educomp's revenues but fetches high EBIT margin of 61%. Going forward, we expect ~10% CAGR for Educomp in this business over the next three years.

ENTRY IN K12: AN 'ASSET LIGHT' TO 'ASSET HEAVY' MODEL

Having established presence in the smaller but high-growth areas of IES, Educomp has been working aggressively on expanding its addressable market so as to garner scale. The company has recently forayed into K12 – the largest segment of IES. Educomp has till date has access to 11 schools with 14,000 students. While we do not expect the venture to materially contribute to revenues over the next 2-3 years (7% of revenues by FY11E), it would help Educomp secure its backended growth funnel as also annuity for the longer term.

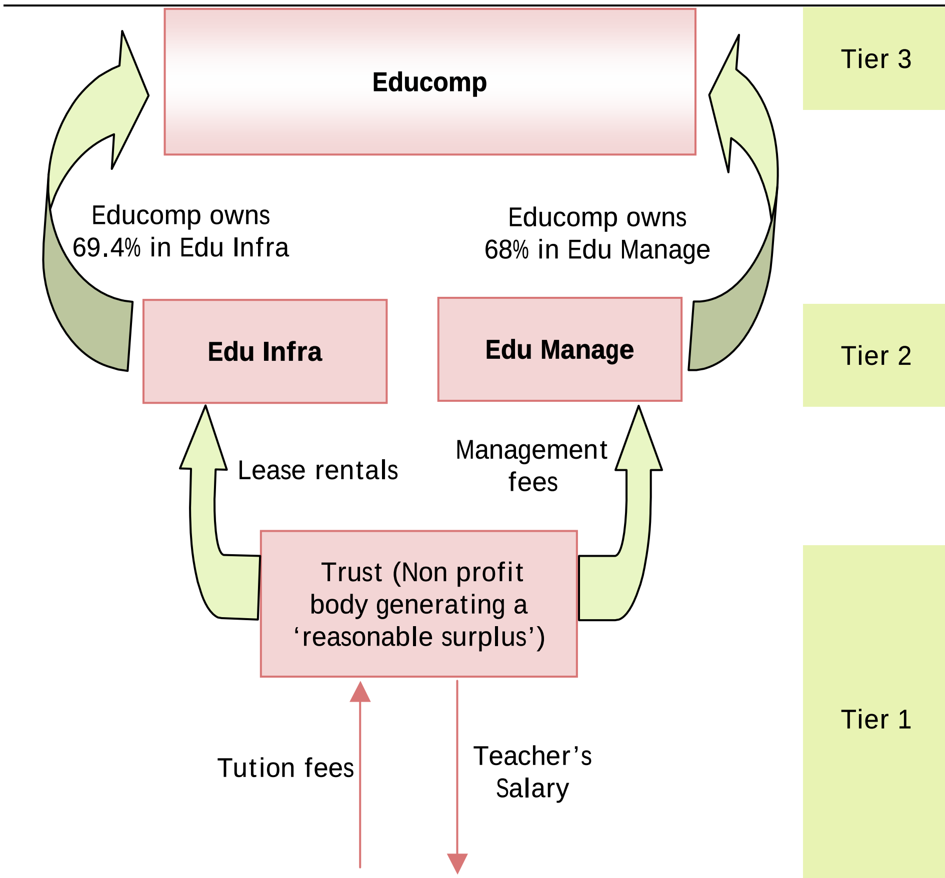
❑ Creative kid – innovative structuring

Educomp has forayed into K12 – the largest market within IES

All K12 schools have to be set up as a trust/ non-profit body under the jurisdiction of the education boards and/or state boards, which means that the profit generated is locked within the same school and no dividends can be distributed out of the same. Educomp has established a 3-tier structure in order to 'legally' bypass the regulation stipulating that the 'reasonable surplus' be ploughed back into the same school.

A three-level structure in order to extract the surplus generated by the trust

Exhibit 9:K12 - Innovative structure



Source: Company, IDFC-SSKI Research

For each owned school, Educomp Solutions forms a trust that runs the school's operations
Educomp has two formed two subsidiaries -
Educomp Infrastructure (Educomp Solutions invested Rs500m for a 69.4% stake) - owns the real estate and leases it out to the schools
Edu Infra gets: i) Returns of 14.5% on capital employed in setting up schools ii) 4.5% of annual tuition fee and iii) one-time fee of Rs5m per school
Educomp School Management (Educomp has invested Rs50m for s 68% stake) provides IP/ content and management services (content, delivery, canteen, transportation, text books, etc) to schools
Edu Manage gets residual earnings of the school, based on various agreements between the schools and Edu Manage

Educomp Infrastructure Pvt Ltd (EduInfra) and Educomp School Management Ltd (EduManage) were incorporated by Educomp's promoters in FY07 with a seed capital of Rs1.8m and Rs0.2m respectively. Within the same year, Educomp invested Rs500m and Rs50m in each of the subsidiaries for a 69.4% and 68% stake respectively.

The company has recently merged the two subsidiaries to form Educomp Infrastructure & School Management Services Ltd – EISMSL, which will now provide both infrastructure and content/ IP /services to the Millennium Schools (own schools) and only IP (Millennium Schools Learning System) to other schools.

❑ Rapid scale-up planned – we estimate 50 schools by FY12

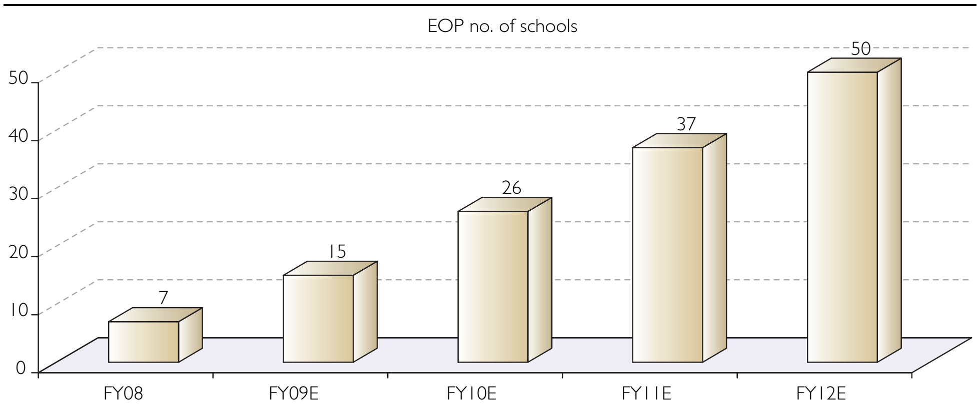
Educomp expects another 22 schools to be operational by the next academic year and plans to reach a base of 150 schools by FY12, of which ~60% would be owned. However, based on the pace of expansion so far, we have estimated addition of 11-12 new schools every year and 50 schools to be operational over the same period.

Exhibit 10: 11 K12 already operational

PSBB Millennium	Chennai
PSBB Learning Leadership Academy	Hulimavu, Bangalore
PSBB Learning Leadership Academy	Lakshmipura Village, Bangalore
Millennium school	Noida
Millennium school	Mohali
Chiranjeev Bharati School	Palam Vihar, Gurgoan
Chiranjeev Bharati School	Sushant Lok, Gurgaon
Residential school	Mussoorie
DPS	Patna, Pune, Ludhiana (Management services)

Source: Company, IDFC-SSKI Research

Exhibit 11: Growth in K12



Source: Company, IDFC-SSKI Research

Enough demand for schools…but high land costs can make the economics unattractive

There is enough demand for quality private schools in India (according to NCERT, 200,000 additional schools are required to meet the existing demand; according to various industry estimates, scope for 20,000 additional private schools even at higher price points). Further, every state demarks land to be used only for building schools and these plots of land are to be given at a substantial discount to market price. While this implies huge potential for the business, high land costs (hoarding and reselling of the demarked land at higher costs and unavailability of such plots) can make the proposition economically unviable.

Educomp has tie-ups with real estate developers that lead to low land cost

We see Educomp in a relatively stronger position given that the company plans to form strategic tie-ups with leading developers like DLF and Ansal Properties & Infrastructure for setting up schools within the townships. Further, Educomp has indicated that it has a potential land bank of ~70 properties in the form of various strategic alliances.

Exhibit 12: Strategic tie-ups

Developers	Model
DLF	Educomp will purchase land which will be at a discount to market price. DLF will not invest any capex
Ansal	Collaboration with Ansal Properties & Infrastructure along with associate company. KTIL (Ansal will invest Rs2.5bn in a subsidiary Knowledge Tree Infrastructure), which would provide land and infrastructure on a 60-year lease basis on 15-17 identified sites for the schools segment

Source: Company, IDFC-SSKI Research

Going forward, ~60% of schools are expected to be owned

While ~60% are expected to be owned schools (greenfield or acquisitions of existing operational schools), the remaining are expected to be pure management service contracts. Educomp has offered its Millennium Schools Learning system (which includes comprehensive school management services) under management services contracts to schools like PSBB (Padma Seshadri Bala Bhavan) and DPS(Delhi Public School).

Educomp looking to acquire footprint across price points in K12

Educomp has recently acquired a 50% stake in Takshila Management Services Pvt Ltd (a company looking to establish high quality schools in Tier II and Tier III cities) at relatively lower price points (average fee Rs18,000 per annum). Takshila owns six parcels of land and plans to set up three schools in Hoshiarpur (Punjab), Ahmednagar (Maharashtra) and Gaya (Bihar) by coming academic year (June 2009).

❑ K12 – a back-ended growth funnel though limited value in near term

K12 business expected to generate EBIT of 35% of gross revenues (Rs76m at full capacity per school)…

Assuming a 2,000-student capacity school (run as a trust) with annual fee of Rs35,000 and a one-time admission fee of Rs25,000 (Industry average at ~Rs2000), we have estimated a gross revenue of ~Rs76m per school (running at full occupancy). Net of operating costs, (EBITDA margin at ~40%), we expect each school to do net revenue of ~Rs30m at full capacity. Adjusting for operating cost at the company level, the venture generates EBIT at ~90% of the net revenues (~35% of gross revenues).

…a positive over the longer term, but we do not see significant value in the near term

While creating a strong annuity proposition within the largest space of IES, the move is positive in the longer term, though we do not expect this business to add any significant value in the near term. Under our assumption of 50 schools by F11, we expect the K12 business to contribute 7% to Educomp's revenues by FY11. A step-up in acquisition or management contracts may provide an upside to our numbers.

Economics per school

Minimum requirement by boards – 2 acres of land and 25 sq. ft of constructed area per student

CBSE regulations mandate a minimum land area of two acres for setting up a K12 school (one acre for metros) with a minimum requirement of 25 sq. ft per student. For our calculations, we have assumed a capital expenditure of Rs163m per school towards a 2-acre plot @ Rs750 per sq. ft (assuming a significant discount to market price; state development authorities reserve plots of land to be used only for schools) and constructed area of 30 sq. ft per student. For the calculations below, we have assumed the entire project to be debt funded.

Capex for a school (ex-land) is high at Rs90m-100m

Exhibit 13: Capex assumptions

	Area (sq. ft)	Rate per sq ft (Rs)	Total (Rs m)
Land	87,120	750	65.3
Playground	5,000	750	3.8
Construction	60,009	1,200	72.0
Furniture	30,000	300	9.0
Additional Capex			12.7
Total capex			163.0

Source: Conversations with school owners, IDFC-SSKI Research

With a capacity of 2,000 students per school, we expect ~Rs76m in revenues at full capacity (annual fee at Rs35,000 and a one-time admission fee of Rs25,000). We have estimated 30% occupancy in year-1, gradually rising to 90% in year-5 for a school. While the admission fee is paid upfront and the annual fee is paid on quarterly basis, it leads to a negative working capital which lowers incremental funding requirements. We expect EBIDTA margin of ~40% at the school level.

Exhibit 14: Economics - a for-profit school simulation (an annuity business)

(Rs m)	year 1	year 2	year 3	year 4	year 5	year 6	year 7	year 8	year 9	year 10
Occupancy year wise (%)	30	50	70	80	90	90	90	90	90	90
No of students	600	1,000	1,400	1,600	1,800	1,800	1,800	1,800	1,800	1,800
Annual fee per student pa (Rs)	35,000	35,000	36,750	36,750	38,588	38,588	40,517	40,517	42,543	42,543
Admission fee per student (Rs)	25,000	25,000	26,250	26,250	27,563	27,563	28,941	28,941	30,388	30,388
Annual fee	21.0	35.0	51.5	58.8	69.5	69.5	72.9	72.9	76.6	76.6
Admission fee	15.0	10.0	10.5	5.3	3.9	3.9	3.9	3.9	3.9	3.9
Revenues	**36.0**	**45.0**	**62.0**	**64.1**	**73.4**	**73.4**	**76.9**	**76.9**	**80.5**	**80.5**
Salary and wages (Teacher student ratio 1:24)	7.1	10.9	15.7	18.3	21.8	21.8	23.5	23.5	25.3	25.3
% of revenues	*19.8*	*24.2*	*25.4*	*28.5*	*29.8*	*29.8*	*30.6*	*30.6*	*31.4*	*31.4*
Elec water telephone	3.0	3.0	3.2	3.2	3.3	3.3	3.5	3.5	3.6	3.6
% of revenues	*8.3*	*6.7*	*5.1*	*4.9*	*4.5*	*4.5*	*4.5*	*4.5*	*4.5*	*4.5*
Overheads	10.8	12.6	17.3	17.3	19.8	19.8	20.8	20.8	21.7	21.7
% of revenues	*30.0*	*28.0*	*28.0*	*27.0*	*27.0*	*27.0*	*27.0*	*27.0*	*27.0*	*27.0*
Operating costs	21.2	26.8	36.5	39.1	45.3	45.3	48.1	48.1	51.0	51.0
EBITDA	**14.8**	**18.2**	**25.4**	**25.0**	**28.1**	**28.1**	**28.8**	**28.8**	**29.5**	**29.5**
EBITDA margin (%)	*41.1*	*40.5*	*41.0*	*39.0*	*38.3*	*38.3*	*37.5*	*37.5*	*36.6*	*36.6*
Depreciation	7.4	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2
EBIT	7.4	8.0	15.2	14.8	17.9	17.9	18.6	18.6	19.2	19.2
EBIT margins (%)	*20.5*	*17.7*	*24.5*	*23.0*	*24.3*	*24.3*	*24.1*	*24.1*	*23.9*	*23.9*
Interest cost	12.0	12.9	14.2	12.3	11.3	9.6	8.9	7.7	6.8	5.3
PBT	(4.6)	(4.9)	0.9	2.4	6.5	8.3	9.7	10.9	12.5	13.9
Tax	(1.39)	(1.47)	0.28	0.73	1.96	2.48	2.90	3.26	3.74	4.17
Tax rate (%)	*30.0*	*30.0*	*30.0*	*30.0*	*30.0*	*30.0*	*30.0*	*30.0*	*30.0*	*30.0*
PAT	**(3.24)**	**(3.43)**	**0.66**	**1.70**	**4.58**	**5.79**	**6.76**	**7.60**	**8.72**	**9.74**
PAT margins (%)	*(9)*	*(8)*	*1*	*3*	*6*	*8*	*9*	*10*	*11*	*12*
Land Cost + Construction Capex (staggered over the years)	104.2	111.9	96.7	90.0	80.1	80.1	76.9	76.9	73.6	73.6
RoCE (%)	7	7	16	16	22	22	24	24	26	26

Source: IDFC-SSKI Research

OTHER BUSINESSES: IN SCALE-UP MODE

Educomp operates in various other segments of IES including preschools, vocational training and tutoring – primarily through acquisitions and strategic alliances.

❑ Preschools – acquired 50% stake in second largest player

Educomp has acquired a 50% stake in EuroKids – a preschool chain with 484 centers

Educomp has nascent operations in the preschool segment, which it is planning to expand aggressively. The company has 60 preschools operational under the brand 'Roots to Wings' which is being expanded using the franchisee model. Educomp has also acquired a 50% stake in EuroKids – India's second largest chain of preschools with 484 centers (reported revenues of Rs200m and PBT of Rs10m in FY07). Acquired for a consideration of Rs390m, the move will help Educomp consolidate its position as one of the market leaders in the preschool space (market size –$300m, 36% CAGR over FY08-11E). The agreement has a provision for Educomp to increase its stake to 74% over a period of time.

❑ Vocational training – a start with acquisition and PPPs

Plans to set up career centers offering trainings with focus on employability

Educomp has acquired a strategic stake in A-plus Education Solutions Pvt Ltd and plans to invest Rs107.5m over the next two years to acquire a 76% stake in the company. Educomp, operating under the brand 'Purple Leap', plans to set up career centers in colleges to impart vocational training to students with various courses targeted at enhancing their employability.

Educomp has also established PPPs with 18 ITIs (public vocational training institutes) as also 12 skill development centers run by the Gujarat state government. The Centre is opting for the PPP route to upgrade 1,396 ITIs and transform them into Centers of Excellence. According to the statement of Mr N. K. Singh, Deputy Chairman, Planning Commission, 250,000 vocational schools will be opened in India in next five years under PPP (PPP), where the corporate sector will play a major role. Educomp has made a good start here and the opportunity could translate into big gains, though in the longer term.

❑ Online initiatives

Building up a presence in the online coaching class market

Educomp has set up various online initiatives (such as *Mathguru* – a mathematics-help online programme catering to grade 6-12 students). Based on an annual subscription fee, the portal has 28,929 paying subscribers and is expected to see robust growth going forward. Educomp is further building up presence in the coaching class market with online tutoring portals called *ThreeBrix* and *Learning Hour*. Educomp also plans to proactively set up more brick-and-mortar coaching centres across India (eight centres operational in NCR).

Educomp has also acquired a 51% stake in AuthorGen Technologies for Rs27m. *Authorstream.com*, an initiative of AuthorGen, is a web platform for connecting students and teachers. Educomp also has a 70% stake in Savvica for $2m, an e-learning company in Canada, which builds online communities around e-learning. Educomp has acquired a 51% stake in US-based *Learning.com* for $24.5m in May 2008, a premier provider of Web-delivered curriculum and assessment with more than 2m students in its portfolio.

Raffles – one of the leading players within the HE space

❑ JV with Raffles – India and China

Educomp has formed two strategic joint ventures with Raffles Education, Singapore. With revenues of $80m, Raffles caters to the higher education space. The company established its first college in Singapore in 1990 and the group today operates three universities and 20 colleges across nine countries in the Asia-Pacific Region – Singapore, China, India, Vietnam, Malaysia, Thailand, Mongolia, Australia and New Zealand. The group also owns the Oriental University in Langfang, China – a 3.31m sq. ft campus with 19 colleges and 57,000 students.

2 JVs for vocational training in India and K12 initiatives in China

Raffles and Educomp will together invest $100m-150m over the over the next 2-3 years. The JV would be in force at two levels – one for providing professional education development programmes in India and the other for K12 initiatives in China. The JV in India will offer the already well-established (localized to cater to Indian needs) professional development programmes in design, executive management and hospitality. The 50:50 partnership programmes will be rolled out over the next 2-3 years. The existing Raffles Design Institute in Mumbai will be merged into the JV operations. In China, the JV will leverage Raffles' existing pool of intellectual property of over 16,000 digital curriculum content modules as well as its team of 400 developers and three development centers within the Chinese market. China, like India, has one of the largest K12 markets globally (~1m schools).

❑ Acquisition in Singapore; a cross-selling opportunity

Educomp has recently acquired ASKNLearn, a Singapore-based educational services company, for $3.9m. With strong presence in Singapore, China, Thailand, the Philippines, Japan, Brunei, Vietnam and Kuwait, ASKNlearn provides content and services to ~140 schools and offers Educomp an opportunity to cross-sell its content.

FINANCIAL ANALYSIS

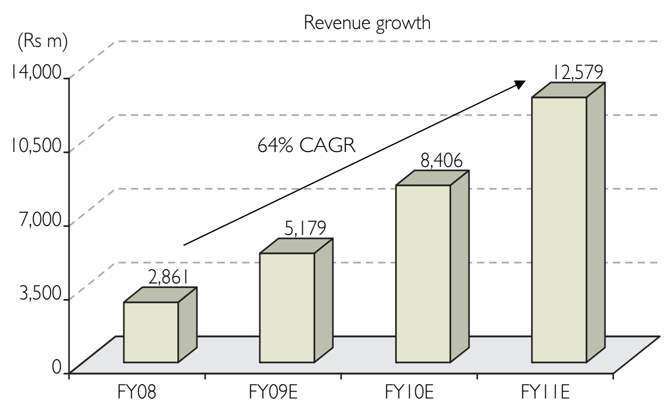
We expect Smart Class to be the key growth driver for Educomp over the next 3-4 years. Though Educomp has consistently been investing in future growth engines and expanding them aggressively, material contribution is still some time away in these ventures. We expect 64% revenue CAGR for Educomp over FY08-11 with significant margin expansion (~1200bp) over the same period driven by the increasing proportion of revenues from Smart Class (highest EBIT margins of 58%). Overall, we expect a 64% CAGR in earnings over the period as Educomp's K12 business (capital-intensive) is in ramp-up mode.

At ~85% of revenues in FY11, Smart Class and ICT to remain key contributors

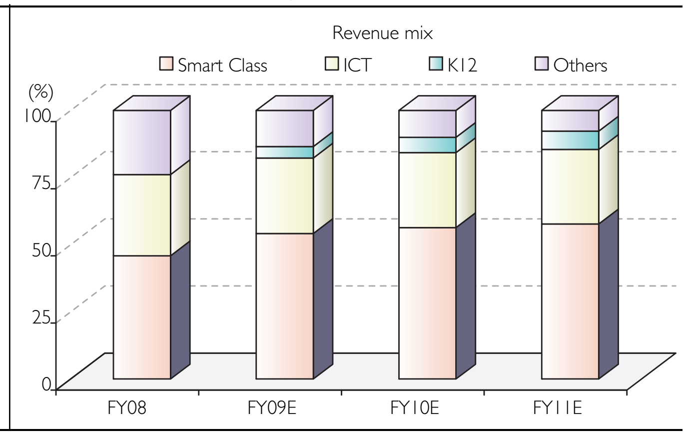
❑ Expect 64% revenue CAGR over FY08-11E

With presence in underpenetrated and high-growth markets as also proven execution capabilities, we expect robust 64% revenue CAGR for Educomp over FY08-11. Growth would primarily be driven by Smart Class (57% of total revenues by FY11; 78% CAGR). Going forward, we expect Smart Class and ICT businesses to remain the key contributors (cumulative share of ~85%) to revenues till FY11. The K12 business is still in ramp-up mode and is expected to gain relevance only from FY11 (7% of total revenues by the year).

Exhibit 15: Revenue growth



Revenue mix – dominated by Smart Class



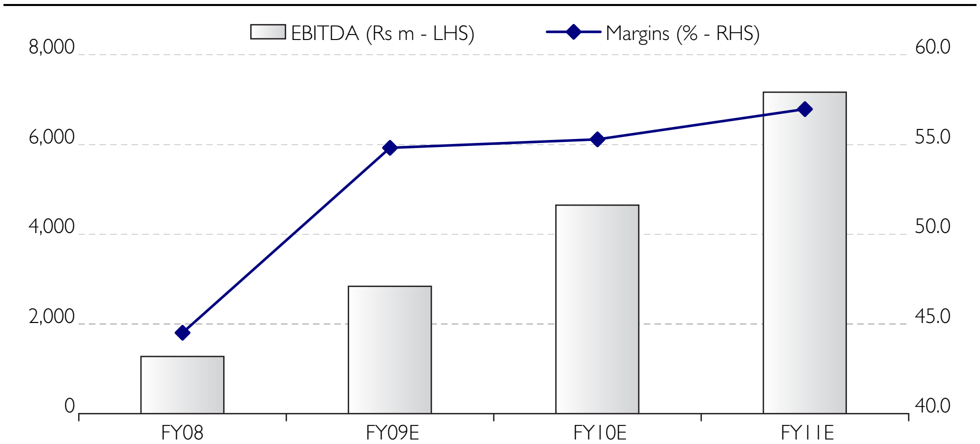
Source: IDFC-SSKI Research

Expanding share of high margin segment (Smart Class) to lead to overall margin expansion

❑ Margin expansion ahead

Having attained critical mass in Smart Class, we expect a margin uptick for Educomp. A high-margin business (~58% at EBIT level), we expect Smart Class's share in revenues to expand from 44% currently to ~57% in FY11, and thus ~1200bp margin (EBITDA) expansion over the period.

Exhibit 16: Margin expansion



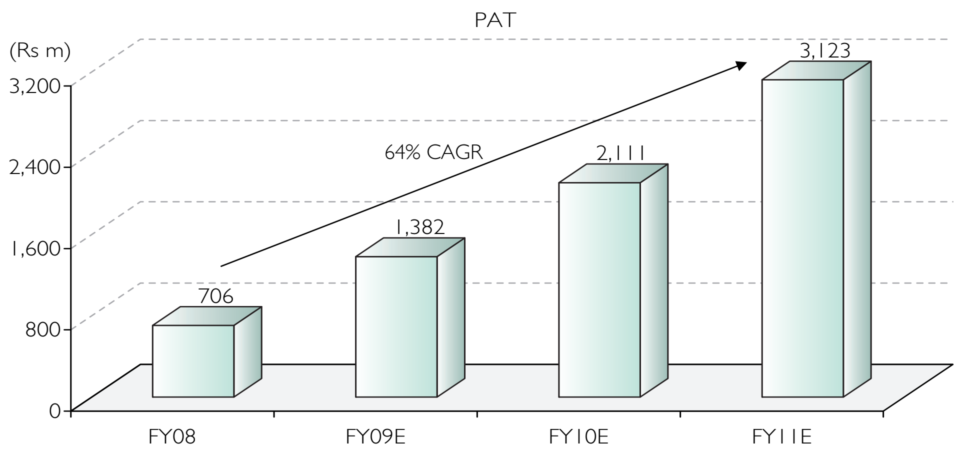
Source: IDFC-SSKI Research

Investments in asset heavy businesses to restrict earnings growth

❑ Earnings to register 64% CAGR over FY08-11E

Despite the ~1200bp expansion in EBITDA margins over FY08-11, we expect earnings growth to be restricted to 64% CAGR over the period given that various businesses (like K12) are in the investment phase and Educomp will have to incur hefty interest expenses on these.

Exhibit 17: PAT growth



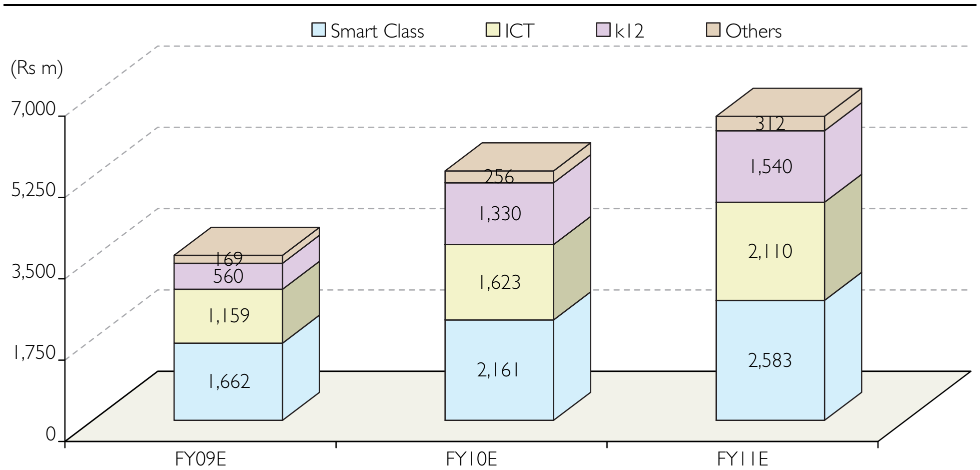
Source: IDFC-SSKI Research

❑ Funded for growth

With the recently issued NCD and underwritten debt, Educomp is adequately funded

Educomp is aggressively expanding its business across segments. We have estimated a total capex requirement of ~Rs15bn for Educomp over FY09-11. Apart from the ~Rs140m per school investment for its two investment-heavy businesses of multimedia (Smart Class) and ICT in schools (we have assumed ~15% of the contracts as outright buys), Educomp needs to commit capex of ~Rs3.4bn for the K12 business (as per our estimates of 37 schools by FY11E). While the requirement is hefty, we see the company adequately funded for the targeted growth. Educomp has issued non-convertible debentures of Rs1bn with another Rs6.25bn underwritten by Axis Bank (Rs2.5bn drawn till date).

Exhibit 18: Capex requirements



Source: IDFC-SSKI Research

While we have assumed ~15% of Multimedia and ICT contracts as 'outright buys' with schools/ government paying upfront for the hardware, the capex requirements could be lower as Educomp switches to the lease model for the hardware component of these contracts (currently owned assets model).

A sticky business model with annuity attached; evolving as a full education service provider

VALUATIONS AND VIEW: HIGH IQ – BUY

Within a largely non-scalable space, Educomp has been one of the few players to have acquired scale and create value. With the company investing in creating future growth engines that would strengthen its annuity model, we believe it exhibits all the traits of a winner. Educomp has created scale on the back of a sticky business model with an annuity attached. As it morphs from being an education ancillary into a full service education provider by moving beyond licensing (Multimedia) to direct intervention (schools, preschools and online to vocational education), we see the from an asset light to an asset heavy model as the intent to create a strong back-ended growth model.

Exhibit 19: Investability Quotient

	Creativity	Content	Capital	Credibility	IQ
Educomp Solutions					

Source: IDFC-SSKI Research

Exhibit 20: Educomp's 4Cs

Credibility	Creativity	Capital	Content
Scaled operations; investments across the value chain; tying up with renowned players like PSBB, DPS and Raffles	Subsidiary (erstwhile EduInfra & EduManage) provides land & services to own schools run by a trust	Balance sheet size of Rs7bn (FY08); access to Rs7.3bn of debt to fund growth over FY09 and FY10	Creating an annuity - first mover to implement a product (Smart Class) in 1,267 schools with 3-5 year lock-in, order book of Rs9.8bn

Source: IDFC-SSKI Research

At 16x FY10E earnings, high visibility in revenues and 4Cs lead to a high IQ – we see 45% upside from current levels

We expect 64% CAGR in Educomp's revenues as also earnings over FY08-11. Considering high visibility for ~80% of the revneues, proven track record in execution and ability to fund future growth, the stock offers high value creation potential at current valuations (16x FY10E earnings and 8.5x EV/EBITDA). We initiate coverage on the stock with an Outperformer rating and a target price of Rs2,800 (PEG of 0.35x FY10E) proividng a 45% upside from the current levels.

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Earnings model

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
Net sales	**1,101**	**2,861**	**5,179**	**8,406**	**12,579**
% growth	-	*159.9*	*81.0*	*62.3*	*49.6*
Operating expenses	594	1,587	2,340	3,759	5,413
EBITDA	**506**	**1,273**	**2,839**	**4,647**	**7,166**
% change	-	*151.4*	*122.9*	*63.7*	*54.2*
Other income	59	178	178	178	178
Net interest	14	48	240	473	711
Depreciation	96	331	700	1,186	1,961
Pre-tax profit	**454**	**1,061**	**2,076**	**3,165**	**4,672**
Current tax	170	351	685	1,045	1,542
Profit after tax	285	710	1,391	2,121	3,130
Minorities	(1)	(3)	(9)	(10)	(7)
Net profit after non-recurring items	**283**	**707**	**1,382**	**2,111**	**3,123**
% change	-	*149.6*	*95.4*	*52.7*	*48.0*

Key ratios

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
EBITDA margin (%)	46.0	44.5	54.8	55.3	57.0
EBIT margin (%)	37.3	32.9	41.3	41.2	41.4
PAT margin (%)	25.7	24.7	26.7	25.1	24.8
RoE (%)	44.4	32.5	36.9	38.7	38.9
RoCE (%)	31.7	19.5	24.2	28.0	31.1
Gearing (x)	1.0	1.2	1.4	1.1	1.0

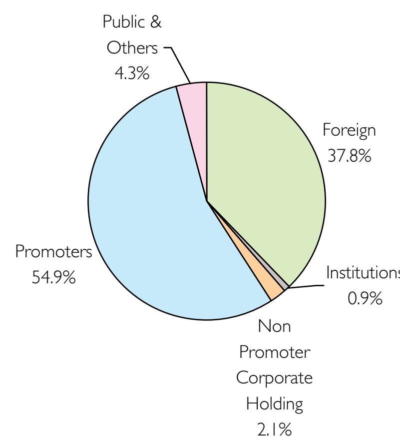
Valuations

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
Reported EPS (Rs)	17.7	41.0	80.1	122.4	181.1
Adj. EPS (Rs)	17.7	41.0	80.1	122.4	181.1
PE (x)	109.2	47.2	24.2	15.8	10.7
Price/ Book (x)	24.3	10.9	7.6	5.1	3.5
EV/ Net sales (x)	28.4	12.0	7.0	4.7	3.3
EV/ EBITDA (x)	61.7	27.1	12.9	8.5	5.8
EV/ CE (x)	12.1	4.9	3.4	2.8	2.2

Balance sheet

As on 31 March	FY07	FY08	FY09E	FY10E	FY11E
Paid-up capital	160	172	172	172	172
Reserves & surplus	988	2,712	4,044	6,104	9,176
Total shareholders' equity	1,275	3,077	4,417	6,488	9,568
Total current liabilities	242	610	1,029	1,612	2,367
Total debt	1,255	3,773	5,990	7,365	9,637
Deferred tax liabilities	59	210	210	210	210
Total liabilities	1,556	4,593	7,228	9,187	12,214
Total equity & liabilities	**2,831**	**7,669**	**11,646**	**15,675**	**21,782**
Net fixed assets	831	2,714	5,565	9,748	14,332
Investments	102	36	36	36	36
Total current assets	1,761	4,638	5,764	5,610	7,133
Other non-current assets	137	280	280	280	280
Working capital	1,519	4,028	4,735	3,997	4,766
Total assets	**2,831**	**7,669**	**11,646**	**15,675**	**21,782**

Shareholding pattern



As of December 08

Cash flow statement

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
Pre-tax profit	454	1,061	2,076	3,165	4,672
Depreciation	96	331	700	1,186	1,961
Chg in working capital	(413)	(703)	(536)	(744)	(961)
Total tax paid	(170)	(351)	(685)	(1,045)	(1,542)
Ext ord. items	-	-	-	-	-
Operating cash inflow	(33)	338	1,555	2,563	4,130
Capital expenditure	(1,057)	(2,205)	(3,551)	(5,370)	(6,545)
Free cash flow (a+b)	(1,090)	(1,866)	(1,996)	(2,807)	(2,415)
Chg in investments	(102)	63	-	-	-
Debt raised/ (repaid)	1,255	2,518	2,216	1,375	2,273
Capital raised/ (repaid)	665	991	-	-	-
Dividend (incl. tax)	(39)	(51)	(50)	(50)	(50)
Misc	127	62	-	-	(0)
Net chg in cash	817	1,717	170	(1,482)	(193)

Initiating coverage

Everonn Systems

Rs199
NEUTRAL

From vanilla to 'value'?

Mkt Cap: Rs3.04bn; US $62m

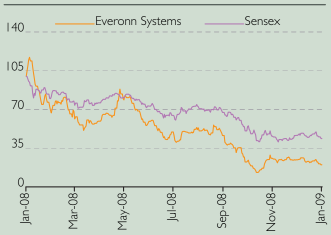
16 January 2009

BSE Sensex: 9047

Stock data

Reuters	EDSO.BO
Bloomberg	ESIL IN
1-yr high/low (Rs)	1236/123
1-yr avg daily volumes (m)	0.24
Free Float (%)	71.1

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
Everonn	(6.5)	(52.9)	(82.0)	-
Sensex	(16.3)	(28.6)	(55.3)	(3.5)

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Everonn Systems (Everonn) has a dominant position in the ICT to public schools space (58% of FY08 revenues). The company is currently focusing on the VITELS platform (40% of revenues) – its multimedia product targeted at schools and colleges. While the product offers operating leverage, lumpy revenues in the vCollege format limit value creation potential. Once VITELS gathers scale on the iSchool platform (~25% of revenues by FY11E), Everonn would have created an annuity business as the contracts have a 4-5 year lock-in. However, in the absence of annuity in majority of the revenues over our forecast period, low value creation potential in the ICT business and execution risk in iSchool, we initiate coverage on the stock (8.5x FY10E earnings) with a Neutral recommendation with a price target at Rs238.

Vanilla topline: With just 11% of public schools under the ICT programme, we expect the $90m market to grow 10x by 2015 and thus 48% CAGR in Everonn's ICT revenues over FY08-11. While the business dynamics are improving, the commoditized business offers inherently low returns (~13% RoCE for a typical BOOT contract) and thereby limited value creation potential.

'Value' in VITELS, but still struggling for annuity: Everonn's revenue mix is expected to gradually tilt towards VITELS, its multimedia product offering strong operating leverage. On the VITELS platform, Everonn is turning its focus from colleges (lumpy and non-sustained revenues) to 'iSchools' (an annuity product). However, we do not see material contribution from iSchools to the topline at least for 2-3 years (~25% of revenues by FY11E).

Low visibility on 'value' business till FY11; Neutral: With presence in nascent high-growth markets, we expect 44% earnings CAGR for Everonn over FY08-11 and revenues to inch towards annuity. However, ICT (a commoditized business) would dominate the revenue mix (~50% of total) till FY11 and cap returns (RoCE of 20% and RoE of 16%). In view of the low return ratios as also visibility on value-accretive businesses, we believe the stock is fairly valued.

Key financials

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
Net sales (Rs m)	430	932	1,869	2,869	3,425
Adj. net profit (Rs m)	41	138	242	359	451
Shares in issue (m)	10	14	15	15	15
Adj. EPS (Rs)	4.0	10.0	16.0	23.8	29.8
% change	-	*152.1*	*60.7*	*48.3*	*25.6*
PE (x)	50.3	20.0	12.4	8.4	6.7
Price/ Book (x)	5.6	2.9	1.5	1.3	1.1
EV/ EBITDA (x)	12.5	8.1	4.7	3.0	2.4
RoE (%)	22.3	21.1	16.2	16.4	17.8
RoCE (%)	25.2	23.7	19.8	20.3	21.9

INVESTMENT ARGUMENT

Everonn is a relevant player in the ICT space (58% of FY08 revenues; 48% CAGR over FY08-12E), but the L1 bidding process in the business caps value creation potential. While the revenue mix is increasingly veering towards VITELS (a value product) with focus on extending the product to schools (iSchools with a 4-5 year lock-in), the management's ability to create a stream of strong annuity cash flows remains to be seen. We currently see low 'Investability Quotient' for Everonn and await visibility on new high-growth businesses. Neutral

ICT: VANILLA OFFERING DOMINATES REVENUE MIX

We expect ICT market to grow 10x in size by 2015

ICT (Information & Communication Technology) is a PPP initiative by the government for setting up infrastructure to provide IT training in public schools, most commonly structured as BOOT contracts for a period of 3-6 years. Given that only 11% of total public schools have implemented ICT till date, we expect the $90m market to grow 10x in size by 2015.

❑ Everonn – a dominant player in ICT for schools space…

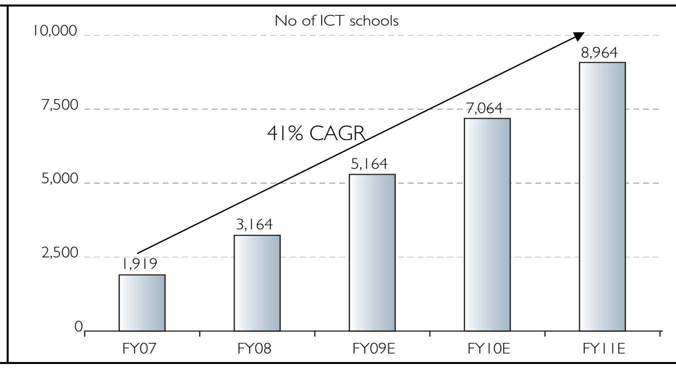
Everonn well placed to capture the opportunity…

Being one of the frontrunners in the space (4,442 schools as of Q2FY09), we see Everonn Systems well placed to take advantage of the high growth opportunity. Going forward, we expect 41% CAGR in the number of ICT contracts for Everonn over FY08-11E.

Exhibit 1: Everonn – a dominant player in ICT space

Players	No. of schools (FY08)
Educomp	6,004
NIIT	4,652
Everonn	3,164
Compucom	2,860

High growth in ICT for Everonn



Source: Company, IDFC-SSKI Research

❑ …but the business offers low RoCE

…but value creation opportunity limited with low RoCE of ~13%

The ICT business offers scalability, but it promises limited scope for value creation with RoCE as low as ~13% (for a typical BOOT contract).

Exhibit 2: Economics of a typical BOOT contract - hardware and services

Value of contract	Rs1m
Period of contract	5 years
Average revenue per lab pa	Rs200,000
EBIT	Rs40,000
EBIT margin (%)	20
Investment per lab (30% of value of contract)	Rs300,000
RoCE (%)	13

Source: Industry, IDFC-SSKI Research

Lower capex requirements and shorter receivable days improve economics...

Of late, RoCE has been improving in the business on the back of two key factors: (i) some state governments follow the 'outright buy' model, wherein the government pays upfront (at the beginning of the contract) for the hardware, which leads to higher returns. Everonn currently has 1,700 schools out of the 4,442 schools under the outright buy model; and (ii) the company plans to increasingly move towards the leased asset model, which would translate into lower (by ~20%) capex requirements vis-à-vis the owned asset model. We have assumed that going ahead, 50% of the incremental hardware required will be on lease.

..yet L1 bidding restricts differentiation and returns

Despite this, we believe the business offers limited value creation potential as most of the contracts are still awarded on L1 bidding (thus commoditization and no scope for product differentiation), and the receivables cycle is high (~150 days). These factors make the business less attractive in terms of value creation capability.

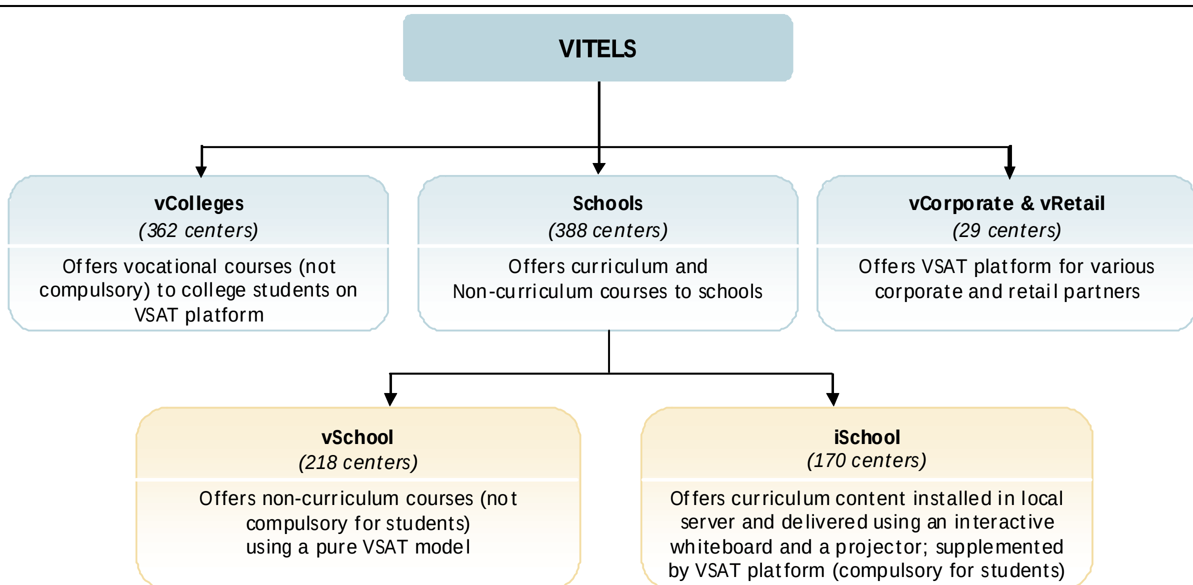
VITELS: A 'VALUE' PROPOSITION

VSAT based model offers operating leverage

VITELS (Virtual & Technology Enabled Learning Solutions) can potentially emerge as a key value generator for Everonn. The company has set up seven studios (plans to add 9 additional studios in FY09) that offer virtual education and training courses to colleges and schools using the VSAT (Very Small Aperture Terminal) technology. As the infrastructure can be levered to an unlimited number of institutions (Everonn uses each studio across ~50 institutions at a time to avoid clutter in the interactive sessions), the model – if scaled – offers strong operating leverage.

Present with the high-growth multimedia to schools (and colleges in this case) space, Everonn has a unique product offering in the form of VITELS. This product is targeted at colleges, schools and for corporate and retail activities.

Exhibit 3: Product offerings



Source: Company, IDFC-SSKI Research

What is VITELS?

Everonn System provides educational courses and lectures to colleges and schools through a virtual mechanism.

Exhibit 4: VITELS Mechanism

The infrastructure consists of studios and virtual classrooms (set up by Everonn in every schools and colleges).

Everonn's studios are equipped with the requisite audio, video and computer systems. Instructors use the studio set-up to effectively communicate ideas (using presentations and animations) and interact with students across institutions.

Everonn provides a virtual classroom set-up to schools and colleges where students can view lectures that are transmitted from an Everonn studio via VSAT. The session is interactive as it allows a two-way audio-visual access.

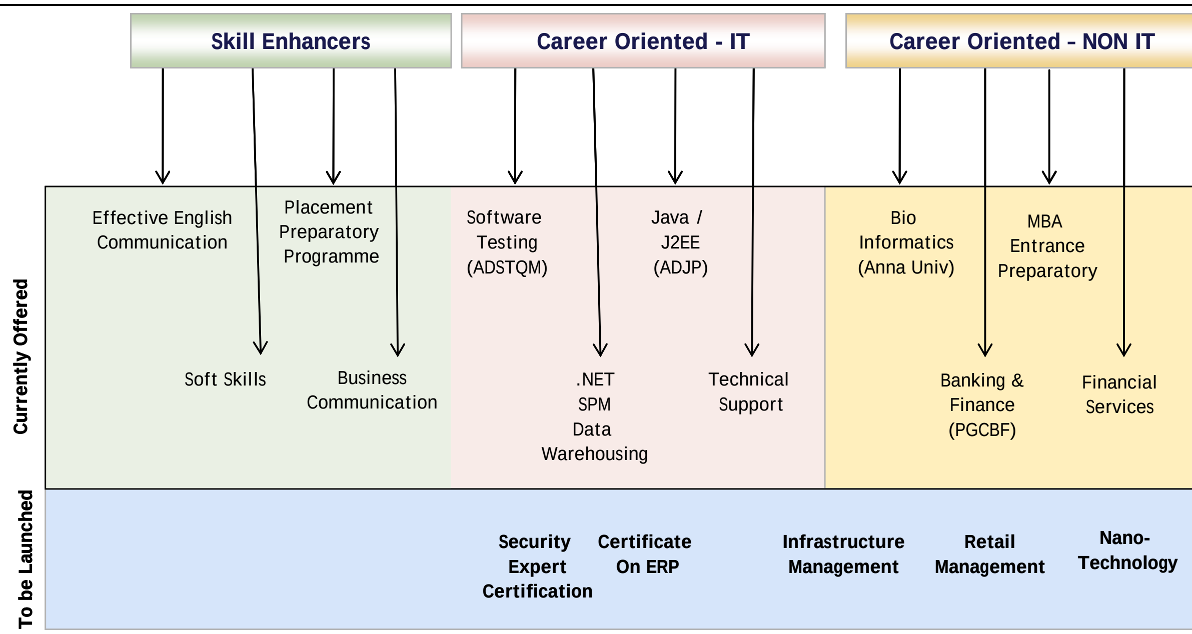
Source: Company, IDFC-SSKI Research

Optional vocational training through the multimedia product

❑ Colleges – operating leverage but little scalability

Under the VITELS portfolio, Everonn provides vocational training to college students in the form of career-oriented and skill enhancement courses. Priced between Rs1,000-40,000, these courses need to be marketed to students and are not compulsory in nature.

Exhibit 5: Various courses extended to college students



Source: Company

Economics – operating leverage

Entire capex is borne by Everonn

Everonn sets up a virtual classroom within a college that offers a two-way audio and video model. The cost of setting up the infrastructure is borne entirely by Everonn. The infrastructure comprises **studios** entailing capital investment of Rs4m per studio (generally, one studio caters to 50 colleges) and a **virtual classroom** (Everonn Learning Centre) at a cost of Rs250,000 per college.

With 18,000 HEIs and 11m students enrolled, we have assumed 600 students enrolled per college. Assuming 20% of the students take up a course at an average price of Rs4,000, every college is expected to generate ~Rs500,000 per annum.

Operating leverage leads to healthy margins...

With operating leverage kicking in (shared studio and bandwidth costs), VITELS generates a healthy EBITDA margin of ~45%.

Exhibit 6: Economics on a per college basis

	(Rs)
Capex per college (i.e. per lab)	250,000
Studio (Rs4m shared by 50 colleges)	80,000
Total capex per college	330,000

Source: Company, IDFC SSKI research

Exhibit 7: Economics per college

Revenue per college	Rs500,000
College level costs	Rs135,000
Operating margin at college level	73%
Field level per college costs	Rs84,000
Studio per college cost	Rs54,000
Bandwidth cost (Rs2.1m for the year shared among ~50 colleges)	Rs42,000
Studio and other op costs (Rs600,000 for the year shared among ~50 colleges)	Rs12,000
Total expenditure	Rs273,000
EBITDA	Rs227,000
EBITDA margin	45%

Source: Company, IDFC SSKI research

But model short on scalability

…yet irregularities in revenue stream from colleges limit scalability...

As the number of colleges in the fold increases, costs at studio level (>50 colleges linked to a single studio) as well as at corporate level comes down per college, thereby yielding an EBITDA margin expansion. However, the product is not compulsory in colleges and needs to be marketed to students as well. This means high degree of irregularity in revenues (in contrast to products like Smart Class that offer a large student base and a strong 5-year annuity in cash flows).

...which Everonn looking to stem out by extending the offering to private schools

Currently, a majority of the courses offered through VITELS are not compulsory for students, which exposes Everonn to the risk of inconsistent revenues. In an effort to build a steadier stream of revenues, the company is increasingly focusing on its schools proposition – i-Schools. Under this model, contracts are for a duration of 4-5 years – which imparts higher revenue visibility. Everonn has so far implemented i-Schools in 170 schools.

❑ vSchool going to iSchool

Multimedia to schools space – high growth, underpenetrated market

Everonn is present within the high-growth Multimedia to private schools space. With 75,000 private schools, the current market penetration is less than 3%. Given the low penetration, we expect the $90m market to see a 60% CAGR over FY08-12. While Educomp Solutions leads the market with its product 'Smart Class', Everonn has relaunched its schools business (vSchool and iSchool) to get a pie of the action.

vSchool – non-curriculum based optional courses

What is vSchool? Within its schools offering, Everonn sets up (one or more) virtual classrooms within the school and offers non-curriculum based lectures and courses to students via VSAT. Like in colleges, these courses are optional for students and therefore do not bring in annuity revenues.

iSchool - getting 'smart' with an annuity product…

What is iSchool? With the recent acquisition of the content division of Aban Informatics ('Class on the Web'), Everonn has access to an entire set of K12 curriculum content (6th to 12th grades) and has relaunched the offering within schools under 'iSchool'. This product offers curriculum content which is compulsory for students within the schools.

...and improving its score on Content parameter

Under this model, a few classrooms (as per the choice of the schools) within the school are equipped with an interactive whiteboard, a computer and an LCD projector. The curriculum content is stored on the local server within the school. The teacher in the classroom can utilize the contents as and when required. Every iSchool is also equipped with a webcam, cordless mike and a set of speakers, and is VSAT-enabled to facilitate live and interactive special sessions. With this model, Everonn has improved its score on the parameter of Content (annuity and differentiated product) – but for the longer term. Everonn plans to extend this offering to after-school coaching as well (Everonn has acquired Toppers Tutorial and has access to IIT-JEE content).

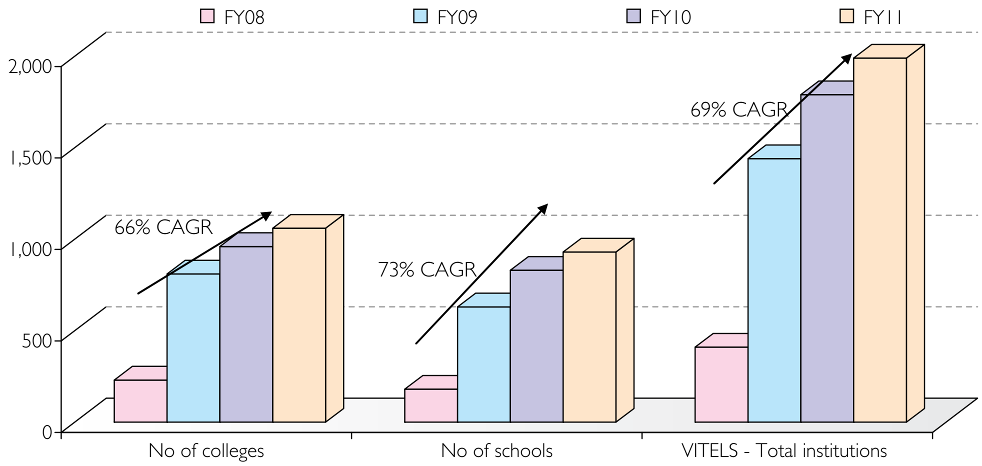
Economics of iSchool – low operating costs and healthy EBITDA margins

Each class within a school requires an investment of Rs135,000 (we have assumed 10 classes per school). Assuming 1,000 students in grades 6th to 12th, at an average fee of Rs100 per student per month, every school is expected to generate revenues of ~Rs1.2m. Given higher volumes and lower marketing expenses (the product needs to be marketed only to schools and not to both colleges and students as in VITELS for colleges) and a strong operating leverage (each studio offering VSAT facility to colleges can be used across ~200 schools), the product is expected to generate EBITDA margins in excess of 70%. Currently in a scale-up mode, iSchools business offers an EBIDTA margin of 56% and RoCE of 47% to Everonn.

Increased focus on iSchools

While the content offering (VITELS in colleges) is unique and has operating leverage, the employment-focused courses have a short life and are not compulsory for students. While we expect 60% CAGR in VITELS revenues over FY08-11; lack of annuity and lumpiness in numbers is a key risk going ahead. We expect increased focus on the iSchool model (contracts having a lock-in period of 4-5 years, thus ensuring annuity cash flows) and expect it to form ~55% of VITELs revenues by FY11.

Exhibit 8: Increasing focus on schools



Source: Company, IDFC-SSKI research

Smart Class (Educomp Soltuions) vs iSchool (Everonn Sytems) – Who's Smarter?

Different models, same returns – but iSchool a laggard in capturing annuity

A comparison between Smart Class (a multimedia product by Educomp Solutions) and i-School reveals that though both the products offer comparable EBIT margins and RoCEs, Smart Class has a strong first mover advantage and Educomp has already proved its ability to scale up.

Exhibit 9: Who is 'Smarter'?

	Smart Class	**iSchool**
Company	Educomp Solutions	Everonn Systems
Model	LCD/ Interactive whiteboard in every class accessing content stored on local server 4-5 year contract	Implemented in a few classes used by all students from 6^{th}-12^{th} grades. An interactive whiteboard accessing content stored on local server and VSAT-enabled to view virtual courses 4-5 year contract
Revenue	Rs150 per student pm	Rs125-180 per student pm
No. of schools (Q2FY09)	1,267	170
Key advantage	First mover advantage Strong distribution network Quality content developed Annuity business to form 57% of revenues by FY11E	Offers VSAT facility with classroom product Model enjoys operating leverage
Key disadvantage	-	Laggard in the segment Execution risks remain Annuity business to form 25% of revenues by FY11E

Source: Company, IDFC SSKI research

❑ Extending VITELS – a retail initiative

Levering the vocational training content…

Everonn, through 29 leased centers, provides VITELS services to retail customers as well. Leveraging its existing content, the company offers various certificate and skill-enhancing courses to cater to the vocational training needs of corporates and students.

…as also the infrastructure

Other revenue streams under the retail initiative include leasing the infrastructure to corporates for their training activities, and for conducting various tests and certifications. Everonn has tie-ups with ETS (Education Testing Services) and Thompson Prometric for the use of its centers for various tests conducted by these entities. ETS is world's largest private (non-profit) body for conducting GRE and TOEFL exams around the globe while Thompson Prometric is a leading testing service for providing IT certifications like Microsoft.

Everonn has also tied up with IIM-Indore in order to provide management programmes to executives (seated in Everonn centers) through VSAT technology. Everonn is looking at various other ways to lever the centers and plans to bid for an alliance with IIMs (Indian Institutes of Management) to conduct the CAT (Common Entrance Test) when it goes online in FY09.

❑ Other businesses

Entry into IIT trainings – the largest market within coaching classes segment

Everonn has acquired Toppers Tutorial, an IIT coaching center (test prep market), for Rs10m. With 400,000 students vying for a seat in the premiere institute, we estimate the IIT training market to be $420m. Going forward, the company plans to tap into the IIT and AIEEE training markets (for entry into engineering courses) more aggressively. With low revenue visibility for the year ending FY09, the business is expected to contribute substantially only FY10 onwards. With an estimated capex of ~Rs250m, the company expects to provide coaching within its new centers and through existing schools under its portfolio.

Going forward, Everonn has identified vocational training and school management as key focus areas.

FINANCIAL ANALYSIS AND VALUATIONS

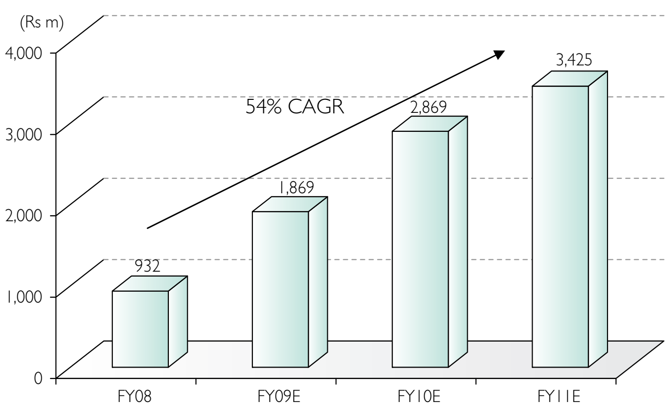
We expect 54% revenue CAGR and 44% earnings CAGR for Everonn over FY08-11. While a relevant player in the ICT space, the L1 business offers limited value creation potential. With the annuity offering (iSchools) forming ~25% of revenues till FY11 and the need to expand its portfolio, we initiate coverage on the stock with a Neutral recommendation (8.4x FY10E earnings).

❑ Expect 54% CAGR in revenues over FY08-11…

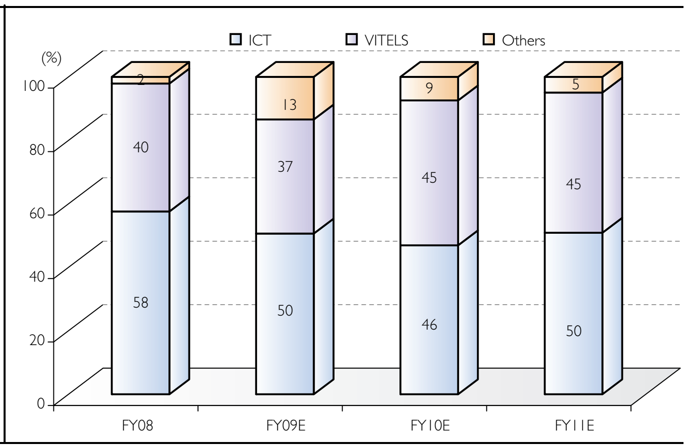
A robust 54% CAGR in revenues over FY08-11E…

Everonn Systems, the third largest player in the high-growth ICT market, is well placed to tap the opportunity. At 58% of revenues, ICT business currently dominates the revenue mix and we expect 48% CAGR in the business over FY08-11. With Everonn's increasing focus on VITELS (colleges and especially schools), we expect the segment to witness aggressive 60% revenue CAGR till FY08-11. We expect Toppers Tutorial to add significant revenues post FY10; overall, we see 54% revenue CAGR for Everonn over the next three years.

Exhibit 10: Robust revenue growth



Shift in revenue mix



Source: Company, IDFC-SSKI Research

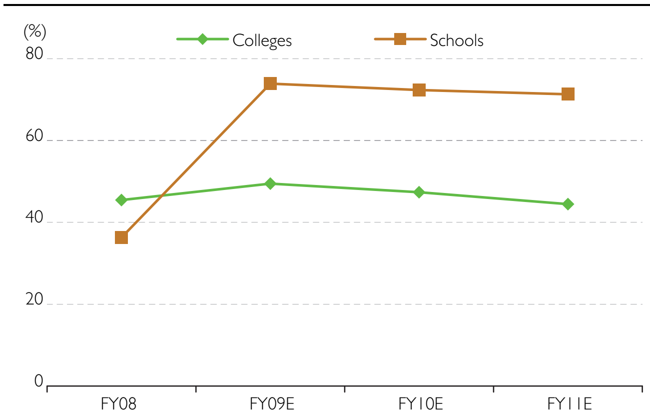
...non trading revenues result in 44% earnings growth over FY08-11...

From FY10, we expect the revenue mix to change in favor of VITELS business with iSchools (the annuity and value creation proposition) accounting for 25% of revenues by FY11. At ~50% of the total in FY11, ICT continues to dominate a significant portion of Everonn's revenues.

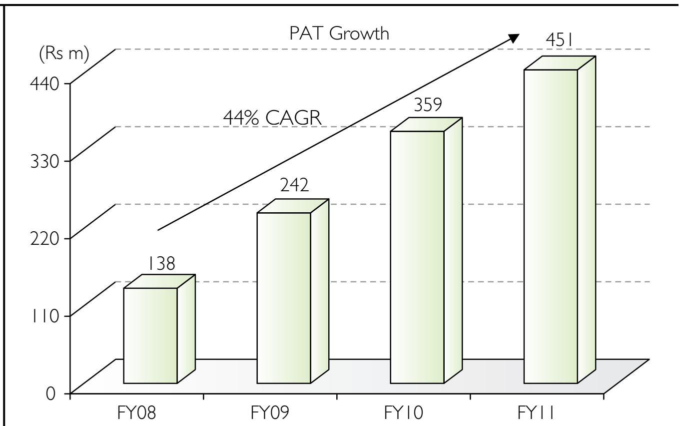
❑ ...and a 44% CAGR in earnings

While we expect trading revenues to account for 10-15% of the total annually, we do not expect it to trickle down to the earnings. In the face of declining margins within the ICT segment (due to stiffer competition and increasing number of 'outright buy' contracts leading to lower revenues), VITELS would drive a 70bp expansion in overall EBITDA margin over our investment horizon. Within the VITELS segment, we expect an overall margin expansion of ~1000bp as the model evolves in favour of iSchools (offering a high EBITDA margin of ~70%).

Exhibit 11: VITELS – strong improvement in EBITDA margins



Overall PAT growth



Source: IDFC-SKKI Research

Overall, we expect 44% CAGR in Everonn's earnings over FY08-11 driven by the strong revenue growth and higher margins with the changing business model.

...yet low IQ – ICT continues to dominate topline (low RoE); annuity to form ~25% of revenues by FY11E

❑ Model needs higher annuity and wider portfolio; Neutral

Everonn's high dependence on ICT (a commoditized L1 business) is expected to come down in favour of 'value creating businesses' such as VITELS (colleges and schools). While we have assumed a recurring revenue stream from the existing and additional colleges, the model lacks annuity inherent in other Multimedia products (Educomp's Smart Class). The lumpy and non-annuity based revenue stream from VITELS is a key risk to our numbers. While the company is aggressively focusing on iSchools (an annuity product), we expect the stream to contribute ~25% to revenues by FY11. In our view, Everonn needs to expand its portfolio and create a stronger annuity business model to reduce dependence on the non-value creating ICT business. At 8.4x FY10E earnings, we initiate coverage on Everonn with a Neutral recommendation and a price target of Rs238 (19% upside from the CMP).

Exhibit 12: IQ - Low

	Creativity	Content	Capital	Credibility	IQ
Everron Systems	◐	◐	◐	◐	◐

Source: Company, IDFC-SSKI Research

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Income statement

Year to Mar 31 (Rs m)	FY07	FY08	FY09E	FY10E	FY11E
Net sales	**430**	**932**	**1,869**	**2,869**	**3,425**
% growth	-	*116.5*	*100.6*	*53.5*	*19.4*
Operating expenses	252	582	1,147	1,746	2,116
EBITDA	**179**	**349**	**722**	**1,123**	**1,308**
% change	-	*95.7*	*106.7*	*55.5*	*16.5*
Other income	0	0	0	0	0
Net interest	(23)	(33)	(74)	(128)	(144)
Depreciation	96	99	302	482	520
Pre-tax profit	59	218	346	513	645
Deferred tax	0	0	0	0	0
Current tax	18	80	104	154	193
Profit after tax	**41**	**138**	**242**	**359**	**451**
Net profit after non-recurring items	41	138	242	359	451

Balance sheet

Year to Mar 31 (Rs m)	FY07	FY08	FY09E	FY10E	FY11E
Paid-up capital	103	138	151	151	151
Preference share capital	0	0	0	0	0
Reserves & surplus	262	808	1,888	2,201	2,565
Total shareholders' equity	365	947	2,039	2,352	2,716
Total current liabilities	94	187	280	445	555
Total debt	235	459	685	1,103	900
Deferred tax liabilities	54	60	60	60	60
Other non-current liabilities	0	0	0	0	0
Total liabilities	384	706	1,025	1,607	1,515
Total equity & liabilities	749	1,653	3,064	3,960	4,231
Net fixed assets	365	621	1,880	1,962	1,846
Investments	0	87	87	87	87
Total current assets	384	943	1,092	1,906	2,293
Other non-current assets	0	5	5	5	5
Working capital	290	756	812	1,462	1,739
Total assets	749	1,656	3,064	3,960	4,231

Cash flow statement

Year to Mar 31 (Rs m)	FY07	FY08	FY09E	FY10E	FY11E
Pre-tax profit	59	218	346	513	645
Depreciation	96	99	302	482	520
Chg in working capital	(247)	(123)	(142)	(263)	(211)
Total tax paid	(18)	(80)	(104)	(154)	(193)
Ext ord. items	-	-	-	-	-
Operating cash inflow	(111)	114	402	579	760
Capital expenditure	(562)	(351)	(1,582)	(564)	(404)
Free cash flow (a+b)	(673)	(237)	(1,180)	15	356
Chg in investments	(0)	(87)	-	-	-
Debt raised/ (repaid)	235	223	226	418	(203)
Capital raised/ (repaid)	103	36	13	-	-
Dividend (incl. tax)	-	-	-	-	-
Misc	-	-	-	-	-
Net chg in cash	(335)	(65)	(942)	433	153

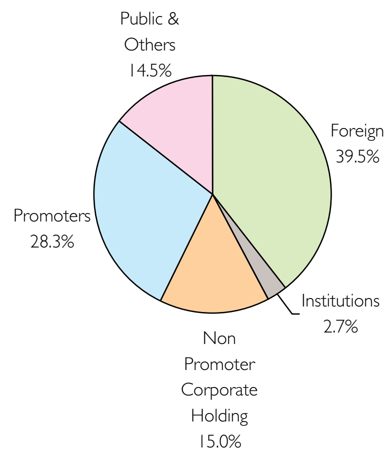
Key ratios

Year to Mar 31	FY07	FY08	FY09E	FY10E	FY11E
EBITDA margin (%)	41.5	37.5	38.6	39.1	38.2
EBIT margin (%)	19.1	26.9	22.5	22.3	23.0
PAT margin (%)	9.4	14.8	13.0	12.5	13.2
RoE (%)	22.3	21.1	16.2	16.4	17.8
RoCE (%)	25.2	23.7	19.8	20.3	21.9
Gearing (x)	0.6	0.5	0.3	0.5	0.3

Valuations

Year to Mar 31	FY07	FY08	FY09E	FY10E	FY11E
Reported EPS (Rs)	4.0	10.0	16.0	23.8	29.8
Adj. EPS (Rs)	4.0	10.0	16.0	23.8	29.8
PE (x)	50.3	20.0	12.4	8.4	6.7
Price/ Book (x)	5.6	2.9	1.5	1.3	1.1
EV/ Net sales (x)	5.2	3.0	1.8	1.2	0.9
EV/ EBITDA (x)	12.5	8.1	4.7	3.0	2.4
EV/ CE (x)	3.4	1.9	1.2	1.0	0.9

Shareholding pattern



As of December 08

Initiating coverage

NIIT

Rs23
NEUTRAL

Flatters to deceive

Mkt Cap: Rs3.81bn; US$77m

16 January 2009

BSE Sensex: 9047

NIIT, India's largest education company with Rs10bn of revenues in FY08, is the leader within the individual learning solutions (ILS) space, specifically in IT trainings. We see NIIT hitting the slow lane as the ongoing global slowdown lops off growth (55% of revenues from corporate learning solutions (CLS) – focus on USA, Europe, etc; 35% from ILS – India, China, etc). In the high-growth school learning solutions business (ICT and multimedia; 10% of revenues) too, NIIT has a lot of catching up to do despite its renewed aggression. With an overall 11% CAGR expected in revenues over FY08-11, we initiate coverage on the stock with a Neutral call.

Around 90% of business is slowing: The ongoing global meltdown has cast a dark shadow across geographies and sectors. With the IT and financials sectors bearing the maximum brunt, we expect NIIT to see just ~4% CAGR in its corporate learning solutions business (55% of FY08 revenues) and 16% CAGR for IT trainings business (32% of revenues and 64% of EBITDA) over FY08-11.

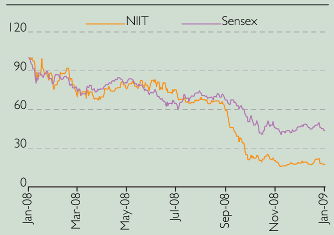
Renewed aggressiveness in schools, too little but not too late: After going slow on ICT (public schools) contracts due to delayed payments by some states, NIIT has resumed bidding as the business dynamics are improving. Also, NIIT is revamping its product portfolio in multimedia for schools space. While NIIT has conceded its headstart to peers, we expect the company to clock 30% CAGR over FY08-11 (with potential to scale up).

Crunch time; Neutral: While NIIT operates in two high-growth areas of IES and is the largest player, its business is bogged down by the prevailing economic turbulence. Offering just 11% revenue CAGR over FY08-11, we initiate coverage on NIIT with a Neutral rating (current valuations of 7x FY10E core earnings) and a target price of Rs27.

Stock data

Reuters	NIIT.BO
Bloomberg	NIIT IN
1-yr high/low (Rs)	139/19
1-yr avg daily volumes (m)	1.01
Free Float (%)	68.8

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
NIIT	(24.6)	(75.8)	(83.1)	(39.1)
Sensex	(16.3)	(28.6)	(55.3)	(3.5)

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Key financials

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
Net sales (Rs m)	7,951	10,068	11,128	12,282	13,716
Adj. net profit (Rs m)	573	756	707	804	930
Shares in issue (m)	99	165	165	165	165
Adj. EPS (Rs)*	5.8	4.6	4.3	4.9	5.6
% change	-	*(20.8)*	*(6.5)*	*13.7*	*15.7*
PE (x)	3.9	5.0	5.3	4.7	4.0
Price/ Book (x)	0.7	0.9	0.8	0.7	0.7
EV/ EBITDA (x)	8.0	4.9	4.6	3.9	3.4
RoE (%)	36.4	21.1	16.5	16.7	17.1
RoCE (%)	11.0	8.5	8.5	9.5	10.7

**Bonus issue & FCCB conversion in FY08*

INVESTMENT ARGUMENT

In a difficult-to-scale business, NIIT has established itself as the largest player in the vocational trainings space of IES with focus on IT/ ITES using the franchisee model. While the IT services business was hived-off, the company is now active in the $1.5bn vocational training space (~25% CAGR over FY08-12E) and has renewed focus on the $160m school learning solutions business (70% CAGR). However, with NIIT generating 90% of revenues from retail IT and corporate trainings verticals, it is bound to feel the heat of the global meltdown. In view of the 11% revenue CAGR expected over FY08-11, we initiate coverage on NIIT with a Neutral rating (7x FY10E core earnings – excluding profit from associates).

NIIT: LEADER IN THE INDIAN IT TRAINING MARKET

NIIT 4.5x the second largest player within the IT training space

A pioneer with a three-decade presence in non-formal IES (IT trainings), NIIT has built formidable scale relative to peers (revenues of Rs10bn in FY08; 4.5x that of Aptech – the second largest player). While the Indian IT training industry witnessed rapid growth 41% CAGR) over FY96-01, NIIT rode the wave as a leader in retail IT trainings. Subsequently, to focus on pure education training, the company spun off its IT services business into a separate entity named NIIT Technologies in FY04 (NIIT currently holds a 25% stake in the associate).

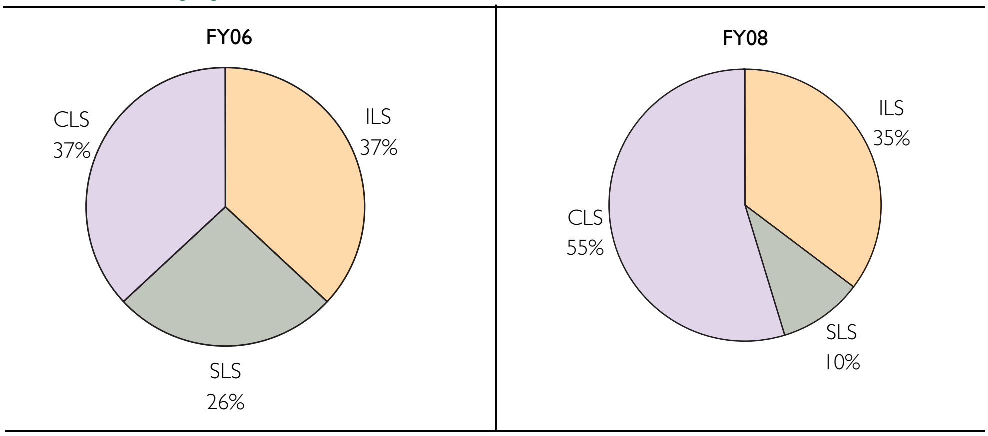
❑ Business overview

NIIT strengthening its portfolio within ILS, SLS and CLS

NIIT has extended its retail IT training offerings (ILS – Individual Learning Solutions) to other emerging economies apart from India, entered into the ICT space – a PPP initiative with the state governments to provide IT infrastructure and services to public schools (SLS – School Learning Solutions), and into the corporate trainings market in the US (CLS – Corporate Training Solutions). The company has recently extended its footprint to new businesses within retail trainings to FMT – Financial Management Trainings and BPO/ KPO Trainings.

NIIT's revenue mix has undergone a sea change after the acquisition of Element K – a US corporate training company (the second largest corporate training delivery company globally) in August 2006.

Exhibit 1: A changing revenue mix



Source: Company, IDFC-SSKI Research

Post Element K acquisition and with low growth in ICT, revenue mix has changed substantially

Currently, CLS contributes 55% to its revenues from 37% in FY06. Further, share of SLS business in revenues has dropped from 26% of revenues in FY06 to 10% in FY08, primarily because NIIT has been going slow on bidding for any new ICT (Information and communication technology, a PPP in public schools) projects (due to delayed payments by a few states for its services).

CLS now dominates the topline (55% of revenues in FY08), followed by ILS

With revenues at Rs10bn, NIIT is not only the largest player within the IT Training space but across the USD 50bn IES. ILS contributes to 32% of the revenues - NIIT has pioneered a content driven franchisee approach to achieve scale (828 centers till date) within a largely fragmented and regional space. With the revival of the IT industry NIIT Ltd has seen a 49%CAGR in revenues from ILS over FY06 to FY08. At 51% of revenues currently, CLS dominates the topline (55% of revenues in FY08). Remaining 10% is contributed by SLS.

Exhibit 2: NIIT – revenue model (FY08)

	ILS (Individual Learning Solutions)	SLS (School Learning Solutions)	CLS (Corporate Learning Solutions)
Key areas	• Retail IT Training (91% of ILS) • BFSI Training (IFBI-Institute for finance, banking & insurance) • Executive management (NIIT Imperia) • BPO/KPO training – (NIPE - NIIT Institute of Process Excellence,-a JV with Genpact (75-25))	• Public schools – ICT (2nd largest player) • Private schools - Multimedia Learning Content (Eguru, Math Lab, nComputing alliance). • Teacher Training	• Learning Products • Training delivery & administration • Custom projects • English language (Acquired Evolve in Delhi)
Geographic Coverage	India, China, Other emerging economies	India	USA, Europe (92% of revenues) and India
Revenues contribution	32%	10%	55%
EBITDA Margins	21%	13%	5%
Other players	Aptech, Jetking Infotrain	Educomp Solutions, Everonn Systems, Compucom, various regional players	Skillsoft, ExcelSoft etc

Source: IDFC-SSKI Research

RUNTIME ERROR! HARSH MACRO-ECONOMIC ENVIRONMENT

Slowdown across sectors to affect retail IT and corporate training revenues – 90% of NIIT's topline

The global meltdown has cast its shadow across geographies and sectors. Besides IT/ITeS, the corporate trainings market is also reeling under the impact of the widespread recessionary trends. With 90% of NIIT's revenues coming from the retail IT and corporate trainings verticals, the company is bound to feel the heat – while CLS is expected to register only ~2% CAGR over FY08-11, growth in ILS too would be tempered (16% CAGR over FY08-11E against 46% CAGR over FY06-08).

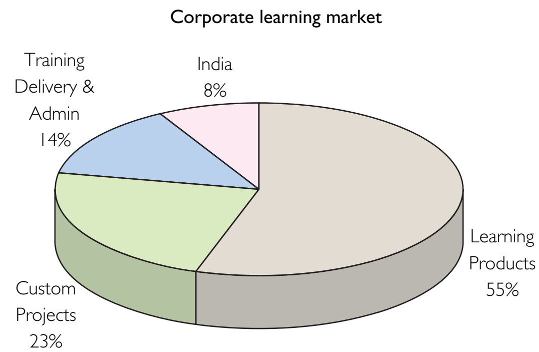
❑ Corporate trainings – the drag effect

CLS business primarily US focused; slowdown to cap growth – we expect ~2% revenue CAGR till FY11

Unlike NIIT's other businesses, corporate training solutions (55% of revenues in FY08) caters primarily to the US and EU geographies with only ~8% of segment revenues accruing from India. The slowdown across these economies has led organizations to trim their training budgets, which has resulted in single-digit growth for the business over the last two years. Going forward, we expect ~2% CAGR in NIIT's CLS business over FY08-11. In this space, NIIT caters to universities, technology and non-technology companies, training corporations and publishing houses. The three sources of revenue within this segment include learning products, custom projects and training delivery.

Within learning products, NIIT implements an e-learning system for clients on its learning technology platform; here, it competes with Skillsoft – the largest player in the space after acquisition of NETg. Within custom projects, NIIT develops custom content for clients and leverages on the offshore labor costs (competitors within the space include Tata Interactive Services and Excelsoft). A small part of its revenues comes from training delivery that involves training employees/stakeholders of client companies.

Exhibit 3: Corporate Learning Solutions market



Source: Company, IDFC-SSKI Research

Custom projects market to remain flat with sluggish growth within learning products and trainings market

Out of USA's ~$60bn spend on corporate trainings every year, $3bn-4bn is estimated to be outsourced. However, corporate trainings are classified under discretionary spending and hence vulnerable to slowdowns in macroeconomic environment. With the learning products and training market bound to be sluggish, the custom projects market would remain flat (with a negative bias) in the coming years. We expect CLS to grow at ~2% (in rupee terms) in the coming years.

While NIIT has also forayed into the English training segment and acquired Evolv (47.9% stake) in January 2008, we feel NIIT should exploit the potential offered by the Indian and other high growth markets.

Element K – good acquisition, bad timing

Post Element K, NIIT has the second largest content library in the US

With the entire corporate training space within the US witnessing consolidation, NIIT acquired Element K at $40m (~0.5x revenues) in August 2006. With the acquisition, NIIT has access to the second largest content library in the US after Skillsoft (which acquired NETg – a USD 150m company at ~1.5x revenues and became the single largest player within the space).

A sharp economic downturn clouds synergy benefits in the near term

At the time of the acquisition (CY05), Element K had revenues of $83m and an operating loss. With one of the largest e-learning content libraries and its own technology platform (K-Hub) as also an existing client base, NIIT had expected to derive synergy benefits and thus improve profitability over three years. However, despite a stronger product portfolio within CLS, the sharp economic downturn in the US will now not allow the expected benefits to be realized over the estimated period. Nevertheless, we expect the acquisition to be positive for NIIT over the longer term.

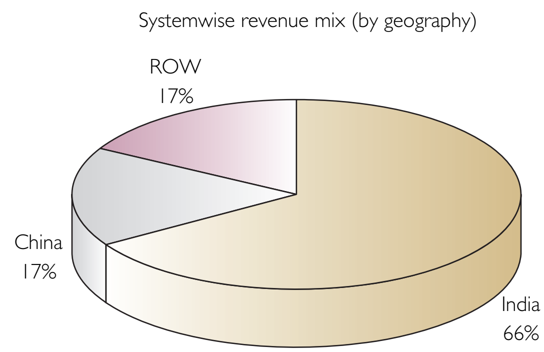
❑ Retail IT trainings business – sedate growth

NIIT is the largest player within the retail IT training space (4.5x Aptech, the second largest player). It has scaled up primarily on the back of the IT/ ITES space emerging as one of the largest employers in the country and the continuous need to adapt to newer technology through trainings.

NIIT has 828 centers globally; 66% of system-wide revenues from India

At 91% of ILS revenues, IT trainings dominate the segment. Within this segment, NIIT caters to IT training needs of non-engineers (GNIIT – a 3-year diploma done usually simultaneously with graduation courses) and engineers (various short-term courses). With 828 centers globally, NIIT earns ~35% of its system-wide revenues (revenues collected by all – owned and franchisee – centers) from China and ROW.

Exhibit 4: Retail IT Trainings market

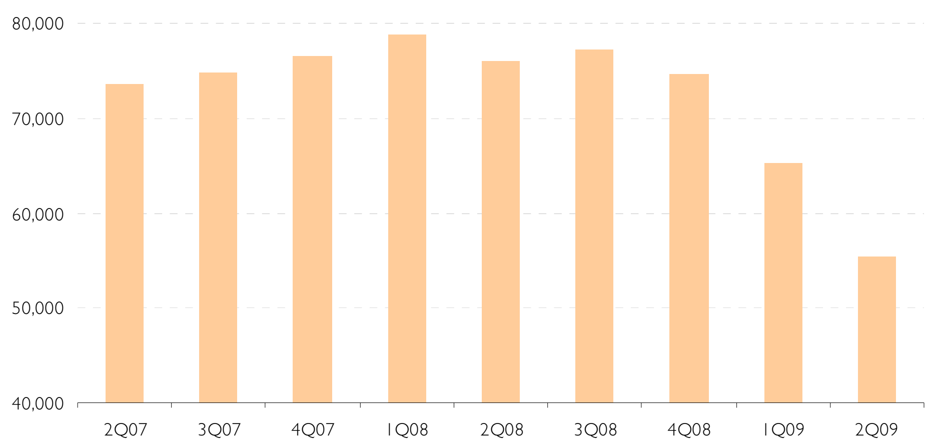


Source: Company, IDFC-SSKI Research

A drop in net IT hirings in H1FY09 – slowdown in IT training revenues

In view of slowdown on fresh recruitments in the IT sector in H1FY09, we expect sluggish growth for retail IT trainings market in H2FY09 followed by a significant slowdown in FY10.

Exhibit 5: Slowdown in IT hirings



Source: IDFC-SSKI Research, TTM hiring data for Infosys, TCS, Wipro global services, Satyam IT and HCL Tech.

While the short-term courses offered by NIIT will support growth to an extent, we estimate 16% CAGR in revenues from retail IT trainings till FY11 (46% CAGR over FY06-08).

NIIT levering its presence to BFSI, management and soft skills training

New opportunities in retail (vocational) training – short-term pain

With strong presence in IT trainings, NIIT is now levering its credibility to new 'high-growth' areas of the individual trainings segment such as BFSI (banking, financial services and insurance), management and soft skills trainings. To strengthen its offerings, NIIT has tied up with key partners in each of these segments.

Exhibit 6: New businesses – tie-ups with key partners

IFBI (Institute of Finance Banking & Insurance)	Imperia	NIPE (National Institute of Process Excellence) - Uniqua
Financial (BFSI) Training	Executive Management Training	BPO/ KPO Training
81% stake in IFBI; remaining held by ICICI	In association with leading educational institutions such as IIM A, I, C and L	A 75:25 JV with Genpact (the largest BPO)

Source: Company, IDFC-SSKI Research

Growing presence in BFSI trainings through IFBI (19% held by ICICI)

IFBI (Institute of Finance Banking & Insurance): NIIT invested Rs40m (80% stake, 19% held by ICICI) to set up a subsidiary (IFBI) in August 2006 in order to address the training needs within the financial, banking and insurance space. NIIT now has partnerships with various banks such as HDFC, YES Bank, Kotak Mahindra Bank, ICICI Prudential ICICI Lombard and Infosys (providing training on its banking software platform – Finacle).

NIIT offers virtual trainings in management through Imperia

Imperia (management trainings): NIIT has also launched *Imperia* in association with leading educational institutions such as IIM Ahmadabad, Indore, Calcutta and Lucknow. Imperia offers executive management programmes in the field of finance, marketing or HR using virtual classrooms. Live sessions are delivered by IIM professors in their respective cities to students sitting in specially designed classrooms in six cities across India.

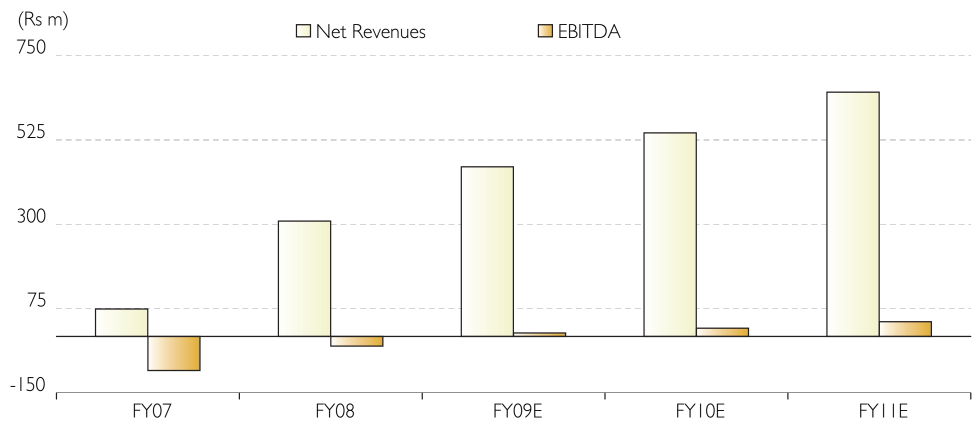
A JV with Genpact for BPO trainings

Further, NIIT has launched *NIPE (National Institute of Process Excellence),* which is a 75:25 JV with Genpact (the largest BPO), for providing training to the ITES industry under the brand *NIIT Uniqua.*

In view of slowdown, especially within financial services, management has cut its estimates

In H1FY09, NIIT saw a 56% increase in enrollments, leading to revenue growth of ~62% yoy. While these businesses are expected to be profitable this year, there is a significant slowdown likely in the verticals due to the prevailing tough economic environment. To account for the same, the management has downgraded its target revenues from Rs750m to Rs450m for FY09. Going forward, we expect a subdued 20% CAGR in the business over FY08-11 as it is quite sensitive to macroeconomic conditions, especially any slowdown in the financials sector.

Exhibit 7: New business expected to turn profitable in FY09



Source: Company, IDFC-SSKI Research

❑ Renewed aggressiveness in schools – too little but not too late

School learning solutions business (ICT in public schools and Multimedia in private schools) contributes 10% to NIIT's revenues. NIIT has provided computer-based learning to over 7,803 schools till date (including 1,138 private schools).

ICT – once again a dominant player

NIIT second largest player within ICT; improving dynamics elicit renewed aggressiveness

With NIIT having implemented ICT in 6,665 public schools, it is second only to Educomp Solutions (market leader with 8,915 public schools till date). While NIIT was going slow on bidding in the ICT space due to unfavorable economics (delayed payments from various states, etc), the improved business dynamics have prompted it to show renewed aggressiveness. The bidding method is now no more purely on L1 basis, but has evolved into a two-stage process of L1 and T1 (technical bid). Further, ~60% of a state's ICT cash outflow is assured by the Centre, which means speedier clearance of dues for ICT suppliers.

Exhibit 8: NIIT – a dominant player in ICT

Players	No. of schools (till FY08)
Educomp	6,004
NIIT	4,652
Everonn	3,164
Compucom	2,860

Source: Company, IDFC-SSKI Research

Volumes to rationalize the costs leading to improvement in margins

Going forward, we expect margins to expand in the business (~13% currently; sub-industry average due to high operating costs and flat volumes) as more schools come to NIIT's ICT fold. In addition, the existing contracts would roll into pure services contracts and thereby drive an improvement in overall margins.

Multimedia in private schools – creating a new product portfolio

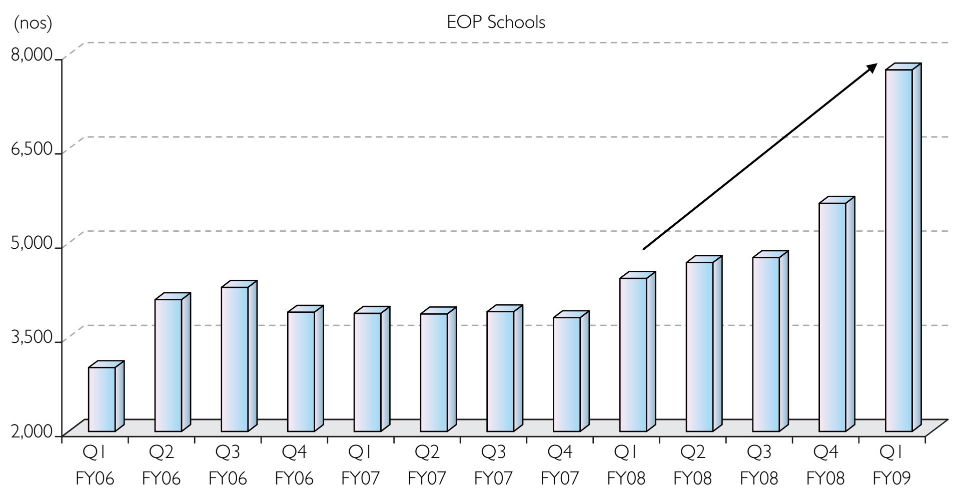
Moving from low-yield IT content offerings to complete interactive solutions across subjects

While NIIT has implemented multimedia products in 1,131 private schools till date, they have been primarily pure IT content products. With 981 schools by FY08 (22% yoy growth), NIIT has been a laggard in the highly underpenetrated, and thus high-growth, segment. However, NIIT is strengthening its product portfolio with newer content. Under the brand e-guru, NIIT now offers a bouquet of products such as IT Labs, MathLab and others labs (English, Science, etc), and has recently launched an interactive classroom product (an integrated product with hardware and software similar to 'Smart Class' by Educomp Solutions). The schools can choose from the bouquet or opt for the entire product offering at Rs40-250 per student per month.

Though a laggard, market offers immense potential to grow

While the high-yield integrated product has been implemented in 12 schools so far, it holds scale-up potential. Though we expect NIIT to lag stronger peers having well-entrenched content and distribution networks, we estimate ~30% revenue CAGR for NIIT in this business over FY08-11E on the back of an improving product portfolio and underpenetrated market (<3% of private schools) offering a potential in excess of $1.5bn.

Exhibit 9: Realigning focus towards the schools business



Source: Company, IDFC-SSKI Research

High growth businesses yet to contribute substantially to consolidated growth

Despite realigned focus on the high-growth, underpenetrated ICT space and a better product portfolio in the Multimedia to private schools market, the contribution of the annuity businesses (at 16% of revenues till FY11E) is not significant to boost growth at the consolidated level.

FINANCIAL ANALYSIS AND VALUATIONS

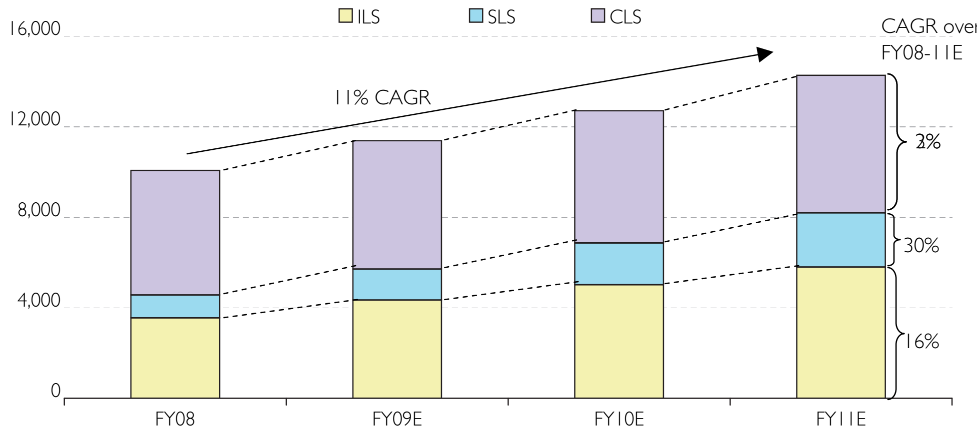
NIIT is expected to show a sedate 11% CAGR in revenues over FY08-FY11E as growth in CLS, the largest segment in terms of revenues, is restricted to low single digits in view of the recessionary environment in the US and EU. In other segments too, we expect growth rates to be tempered or slower than for stronger peers.

❑ Expect 11% CAGR in revenues over FY08-11

Single-digit growth in CLS and slowdown in ILS to impact overall growth

NIIT derives a large chunk (55% in FY08) of its revenues from CLS – a US-focused business. Given that the geography is in the throes of a long and deep recession, we expect ~2% CAGR in the business over FY08-11. Growth pangs would further be compounded by the considerable slowdown in retail trainings space (16% CAGR in NIIT's retail IT training revenues over FY08-11E as against 46% CAGR over FY06-08), leading to an overall 11% CAGR in revenues over FY08-11E.

Exhibit 10: ILS and CLS see a sharp fall in growth rates



Source: Company, IDFC-SSKI Research

❑ Margins expansion to prop earnings growth

Higher capacity utilization in retail training centers progress in schools business to rationalize costs

NIIT is expected to witness a ~160bp margin expansion over FY08-11, driven by increasing capacity utilization in IT trainings (management has indicated a slowdown in capacity additions) and new businesses turning EBITDA-positive for the year. Margins would also expand as the high-margin school learning solutions business scales up and the currently high operating cost base rationalizes.

❑ Flatters to deceive – stock fairly valued; Neutral

Lacking creativity and strong content; the stock appears to be fairly valued

NIIT, with highest revenues in IES and an unleveraged balance sheet size of Rs6bn, exhibits *Credibility* (management intent & ability) and *Capital* (built to last). However, NIIT has not exhibited strong *Content* (to differentiate and build annuity) and *Creativity* (to 'manage' the over-regulated environment in order to address the larger formal IES). While the company is working on building an annuity business model (SLS), we do not expect significant contribution from these businesses over our forecast period. More importantly, given the prevailing economic slowdown (90% of business highly sensitive to the macroeconomic environment), NIIT offers low IQ at current valuations. At 7x FY10E core earnings (excluding the value of 25% stake in NIIT Technologies and a 50% holding company discount), we initiate coverage with a Neutral rating and a price target of Rs27.

Exhibit 11: IQ – low

	Creativity	Content	Capital	Credibility	IQ
NIIT					

Source: IDFC-SSKI Research

Income statement

Year to Mar 31 (Rs m)	FY07	FY08	FY09E	FY10E	FY11E
Net sales	**7,951**	**10,068**	**11,128**	**12,282**	**13,716**
% growth	*#DIV/0!*	*26.6*	*10.5*	*10.4*	*11.7*
Operating expenses	7,158	9,033	9,978	10,916	12,088
EBITDA	**793**	**1,035**	**1,150**	**1,366**	**1,628**
% change	-	*30.5*	*11.1*	*18.8*	*19.2*
Other income	61	73	73	73	73
Net interest	(135)	(178)	(178)	(191)	(196)
Depreciation	473	529	595	682	787
Pre-tax profit	**570**	**735**	**784**	**900**	**1,052**
Deferred tax	-	-	-	-	-
Current tax	4	(20)	77	96	122
Profit after tax	566	756	707	804	930
Minorities	7	1	-	-	-
Net profit after non-recurring items	**573**	**756**	**707**	**804**	**930**
% change	-	*32.0*	*(6.5)*	*13.7*	*15.7*

Balance sheet

As on Mar 31 (Rs m)	FY07	FY08	FY09E	FY10E	FY11E
Paid-up capital	198	329	329	329	329
Preference share capital	-	-	-	-	-
Reserves & surplus	2,948	3,691	4,190	4,744	5,424
Total shareholders' equity	3,148	4,034	4,534	5,088	5,768
Total current liabilities	3,203	3,611	3,806	4,018	4,283
Total debt	2,698	2,057	2,404	2,367	2,538
Total liabilities	5,901	5,668	6,210	6,386	6,821
Total equity & liabilities	**9,050**	**9,701**	**10,744**	**11,474**	**12,588**
Net fixed assets	3,847	3,981	4,286	4,539	5,016
Investments	611	892	1,226	1,560	1,894
Total current assets	4,511	4,578	4,982	5,125	5,429
Deferred tax assets	81	250	250	250	250
Working capital	1,308	967	1,176	1,106	1,146
Total assets	**9,050**	**9,701**	**10,744**	**11,474**	**12,588**

Cash flow statement

Year to Mar 31 (Rs m)	FY07	FY08	FY09E	FY10E	FY11E
Pre-tax profit	570	735	784	900	1,052
Depreciation	473	529	595	682	787
Chg in working capital	(572)	404	(103)	(75)	(93)
Total tax paid	(4)	20	(77)	(96)	(122)
Ext ord. items	-	-	-	-	-
Operating cash inflow	467	1,689	1,199	1,411	1,624
Capital expenditure	(5,836)	(454)	(900)	(936)	(1,263)
Free cash flow (a+b)	(5,369)	1,234	299	476	361
Chg in investments	(287)	53	0	0	0
Debt raised/ (repaid)	2,698	(641)	347	(37)	171
Capital raised/ (repaid)	198	132	-	-	-
Dividend (incl. tax)	(167)	(251)	(251)	(251)	(251)
Misc	11	12	-	-	-
Net chg in cash	(2,916)	539	396	189	281

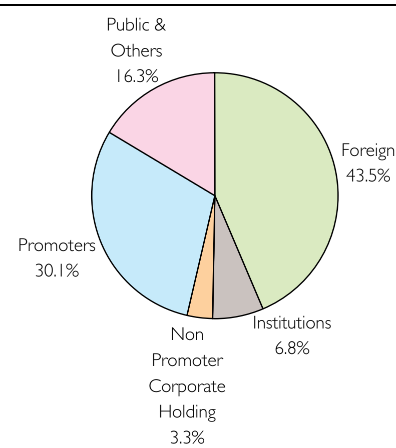
Key ratios

Year to Mar 31	FY07	FY08	FY09E	FY10E	FY11E
EBITDA margin (%)	10.0	10.3	10.3	11.1	11.9
EBIT margin (%)	4.0	5.0	5.0	5.6	6.1
PAT margin (%)	7.2	7.5	6.4	6.5	6.8
RoE (%)	36.4	21.1	16.5	16.7	17.1
RoCE (%)	11.0	8.5	8.5	9.5	10.7
Gearing (x)	0.9	0.5	0.5	0.5	0.4

Valuations

Year to Mar 31	FY07	FY08	FY09E	FY10E	FY11E
Reported EPS (Rs)	5.8	4.6	4.3	4.9	5.6
Adj. EPS (Rs)	5.8	4.6	4.3	4.9	5.6
PE (x)	3.9	5.0	5.3	4.7	4.0
Price/ Book (x)	0.7	0.9	0.8	0.7	0.7
EV/ Net sales (x)	0.5	0.5	0.5	0.4	0.4
EV/ EBITDA (x)	8.0	4.9	4.6	3.9	3.4
EV/ CE (x)	0.7	0.8	0.8	0.7	0.7

Shareholding pattern



As of September 08

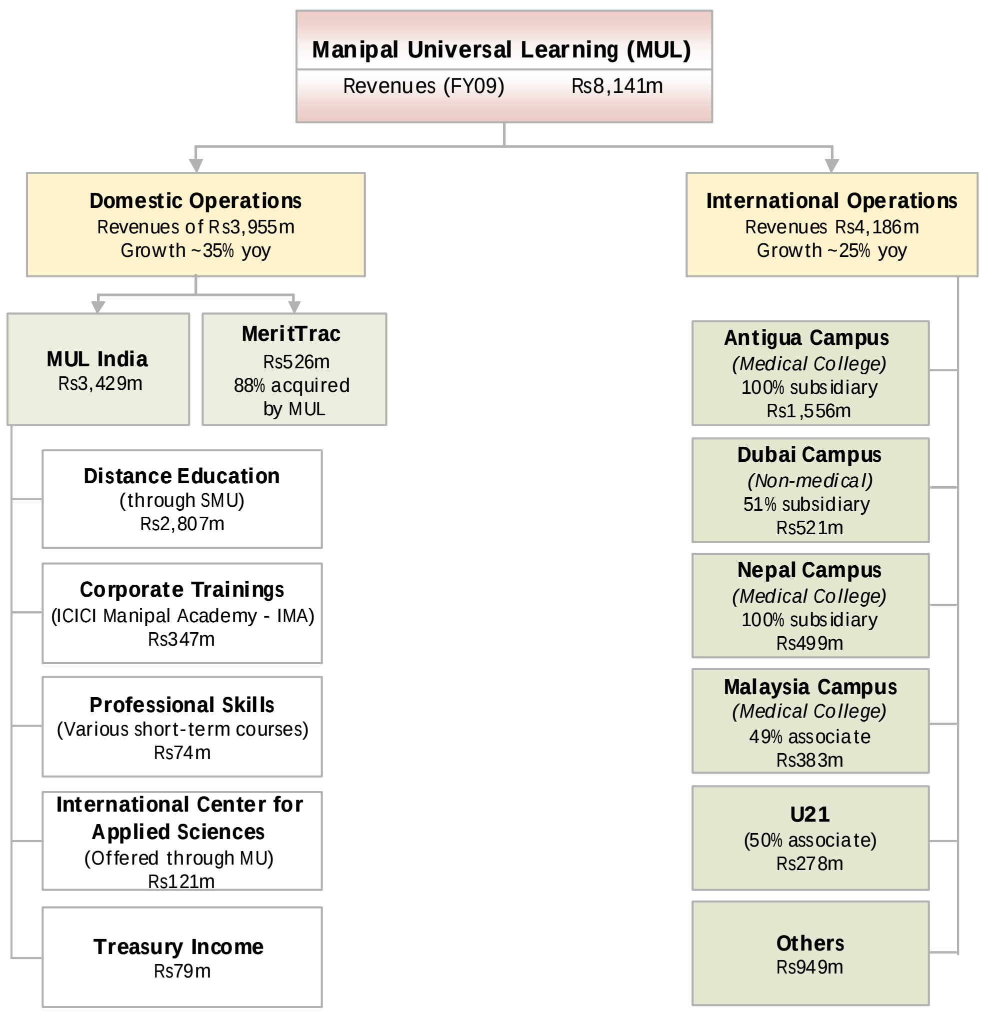
Manipal Universal Learning (MUL)

UNLISTED

Maverick in Higher Education

Manipal Universal Learning (MUL) has strong brand equity within the HE space through Manipal University and Sikkim Manipal University (MUL sells services to the two Indian universities within the Manipal Education group). While the Indian operations are at ~49% of revenues, its international HE businesses dominate the topline (revenues primarily from four institutes in Nepal, Dubai, Antigua and Malaysia, run as private limited companies). Going forward, MUL plans to grow through both the organic and inorganic routes, across geographies within the HE and vocational training space. Given that HE is a long-term and a very capital-intensive business (~Rs5bn required to set up a medical college), we believe that it's established *Credibility* (management intent and ability; consolidated balance sheet size at Rs20bn) and brand will be MUL's key strengths. With a strong *Content* offering (an annuity business model), MUL has gross revenues of Rs8,141m (net margins at ~8-10%); yet, the modular nature of majority of the business makes it capital-intensive. MUL is the only formal education player to have received sponsor-funding ($30m from IDFC Private Equity and $40m from Capital till date). Having achieved significant scale within IES, MUL is well placed to create a rich growth funnel across the HE space.

Exhibit 1: Revenue mix – FY09

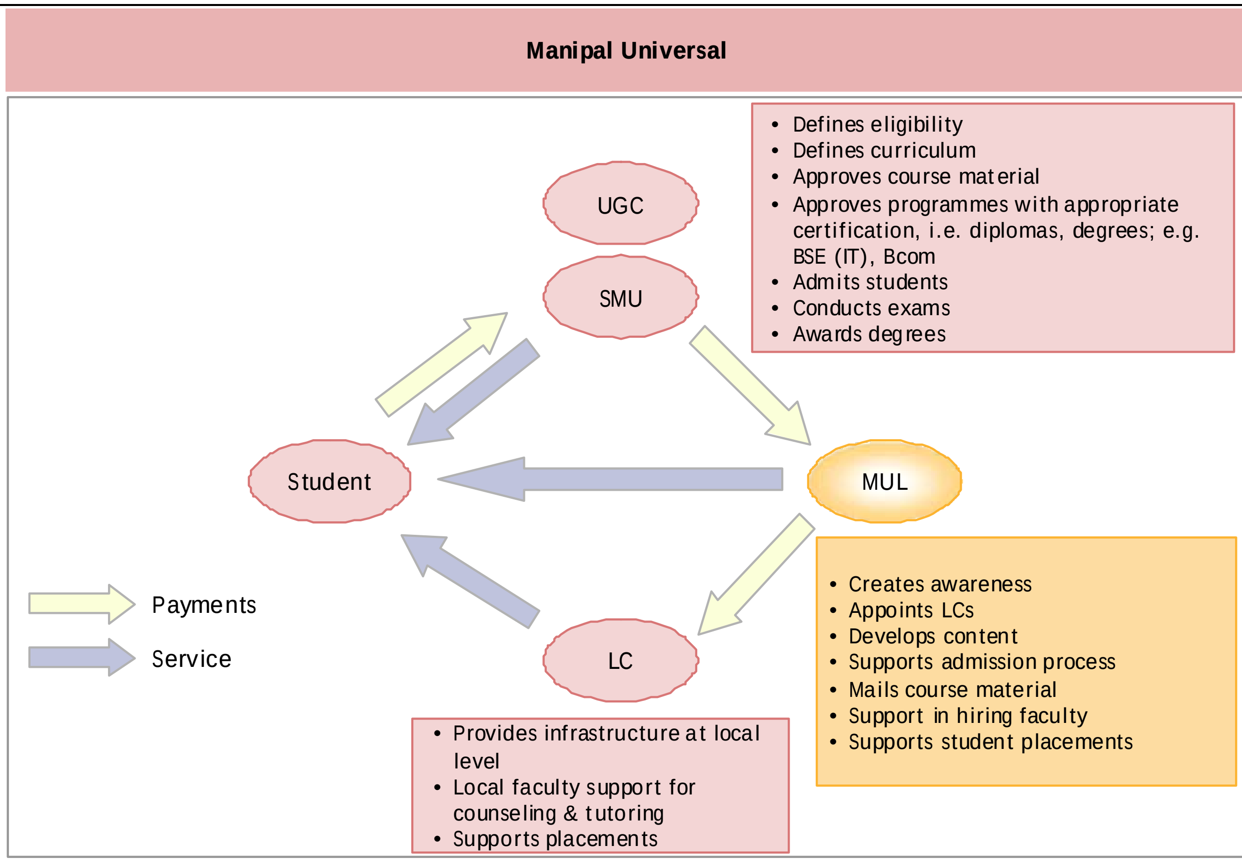


Source: Company, IDFC-SSKI Research

DISTANCE EDUCATION: STRONG ANNUITY; HIGH LEVERAGE

Manipal Universal Learning (MUL) is the corporate entity of the Manipal Education Group (India's largest private player in the higher education space). The company extends services to the two universities in the Manipal fold – Manipal University (MU, offering campus programmes) and Sikkim Manipal University (SMU, offering distance education programmes). With 18,000 students under campus programmes and ~140,000 students enrolled for distance education courses, MUL has a strong annuity cash flow (~70% of the domestic revenues from services to SMU; a distance education programme using education delivery partners called Learning Centers). With no incremental capex on the its books, growth within SMU rests on expansion of its base of Learning Centers (LCs). Going forward, we expect higher yield per center and additional ~70 LCs per year to lead to ~35% CAGR in reveneus over the next few years .

Exhibit 2: Distance Education - service provider to students of SMU (Sikkim Manipal University)



SMU - Sikkim Manipal University;
MU - Manipal Universal Learning Pvt Ltd
LC – Learning Centers (local franchisee partners)

Source: Company, IDFC-SSKI Research

❑ SMU – a significant player within distance education

With ~140,000 enrollements and 550 LCs, SMU is a significant player in the distance education space. MUL's primary competitor and the largest distance education provider in the country is IGNOU (Indira Gandhi National Open University) – a government entity with a base of 500,000 students.

Exhibit 3: SMU - a significant player in the HE space

	Semester Enrollments	Study centers
SMU	140,000	550
IGNOU	468,444	1,621

Source: IGNOU

GLOBAL APPROACH: NEEDS CAPITAL TO GROW

MUL has grown outside India using both the organic and inorganic routes and currently has significant presence in the international HE space with campuses in Dubai, Malaysia, Antigua and Nepal – countries where 'for-profit' education is permitted. Though an annuity business, significant capital is required by MUL to add to/ acquire capacities to sustain future growth (~25% over the next 2-3 years). Further, a significant part of the investment for the international business (~$30m) is expected to be used for extending loans to students in Antigua as funding options for private education have dried up in the current global cash crunch.

Currently, MUL has the following international campuses:

- American University of Antigua (Antigua, Caribbean) is a medical college and a 100% subsidiary expected to grow at ~30% going forward driven by improving yields and higher capacity (MUL plans to invest $25m in a new campus). One of the key growth drivers for the international business, Antigua is a popular destination for American students to pursue medical education at substantially lower rates as compared to their home country.
- Manipal University, Dubai is a non-medical college – expected to grow at ~30% as capacity expands (MUL plans to invest $20m in a new campus).
- Manipal College of Medical Sciences, Pokhra (Nepal) is a 100% subsidiary, expected to grow at ~15% on the back of improving yields.
- Melaka-Manipal Medical College, Malaysia is a 49% associate which is expected to see single-digit growth (led purely by higher yield per student).

MUL manages education programs for its Malaysia and Antigua campuses wherein a student has the opportunity to complete part of his/her studies at the Manipal campus and the balance at Antigua or Malaysia. It also runs a unique programme for engineering through its International Centre for Applied Sciences (ICAS) at Manipal Campus, for which it has entered into tie-ups with various universities in USA, UK and Australia. Under this program , through tie-ups with international colleges, students can do part of their course locally and the remaining on the overseas campus.

NON-FORMAL EDUCATION INITIATIVES: IN INFANCY

In order to capitalize on India's growing need for vocational training, MUL is diversifying into non-formal education areas. Currently, the programmes offered by MUL cover six key sectors: Banking, Telecom, Infrastructure Services, Information Technology / BPO, Media and Retail.

MUL has illustrated the potential for industry-academia collaborations by establishing ICICI-Manipal Academy (IMA), which is a 1-year campus programme for new recruits sponsored by the employer (guaranteed employment with ICICI after completion of the course). The first batch of 480 students commenced on 21 January 2008 in Hyderabad.

MUL is currently in talks with other corporates for similar collaborations. While the cost of content development is prohibitively high at present and the business has yet to turn profitable, we expect costs to be recovered faster as economies of scale set in with a growing customer base. The only risk is the sensitivity of corporate training spends to economic cycles.

Exhibit 4: IMA (ICICI - Manipal Academy)

Structure of collaboration	• ICICI takes charge of admissions. Curriculum designed by Manipal and ICICI together and course delivered by IMA • Manipal invests in exclusive campus, faculty and facilities; it charges a mutually agreed fees per student to ICICI
Programme design	• Applicants require to be graduates from any discipline; admissions based on a written entrance test and interview • Students deemed employees of ICICI on admission into IMA; join ICICI as Assistant Manager (Band 1 grade) after completion of course • 1-year residential programme – nine months of classroom training and three months of internship • ICICI provides students with a monthly stipend during classroom training and internship • PG Diploma in Banking awarded at end of programme with an opportunity to carry credits and continue for MBA in Banking through distance education mode
Infrastructure	• Facilities in Hyderabad and Bangalore • Hyderabad facility is a leased building. Bangalore facility is a campus (also leased) of 7 acres near Jakur, with 200,000 sq. ft of built-up area • A teacher student ratio of 1:15/20 is targeted. Full-time faculty having minimum five years of relevant industry experience. Guest faculty includes people from ICICI Bank and senior industry professionals

Source: Company

❑ Inorganic is the way to grow

MUL has used the inorganic route within the formal education space, it has also expanded its non-formal initiatives with two key acquisitions.

MUL has acquired an 88% stake in **MeritTrac** – India's largest testing and skills-assessment company – providing quantitative inputs in order to measure the competencies of corporates. MeritTrac has recently tied up with NASSCOM to provide a common testing standard for IT recruitments all across India. At Rs526m, the venture is currently profitable at the operational level but loss-making at the net profit level. MUL has also acquired a stake in **U21 Global** (revenues of $4.2m) – a Singapore-based online education company providing online MBA programmes. Currently clocking revenues of ~Rs278m, the venture is loss making at operating level. Both these acquisitions are expected to grow at 25-30% yoy going forward.

Exhibit 5: High I Q

Credibility	Capital	Content
Management intent & ability	**Build to last**	**Differentiate & build annuity**
Established credibility over last five decades with world class institutions like Kasturba Medical College	Balance sheet size of **Rs20bn** (FY08); Funded by Capital ($40m); IDFC Private Equity ($30m)	**Strong pricing power** (a function of high quality courses) and students captive for 3-6 years

Source: IDFC-SSKI Research

MUL has attained considerable scale and with a consolidated balance sheet size of Rs20bn and revenues of Rs8,141m, we expect the company to emerge as one of a dominant player within IES. While 49% of its revenues come from India operations (predominantly through the distance education programmes offered by SMU, which has high operating leverage), we expect ~30% growth going forward. Other businesses lack the operating leverage enjoyed by SMU and need substantial capital in order to grow. While ability to raise capital is the key monitorable going forward, MUL has been the only player in formal IES to have seen private equity funding ($30m from IDFC Private Equity and $40m from Capital till date) and this infuses confidence in its ability to fund its future growth.

Exhibit 6: Investability Quotient

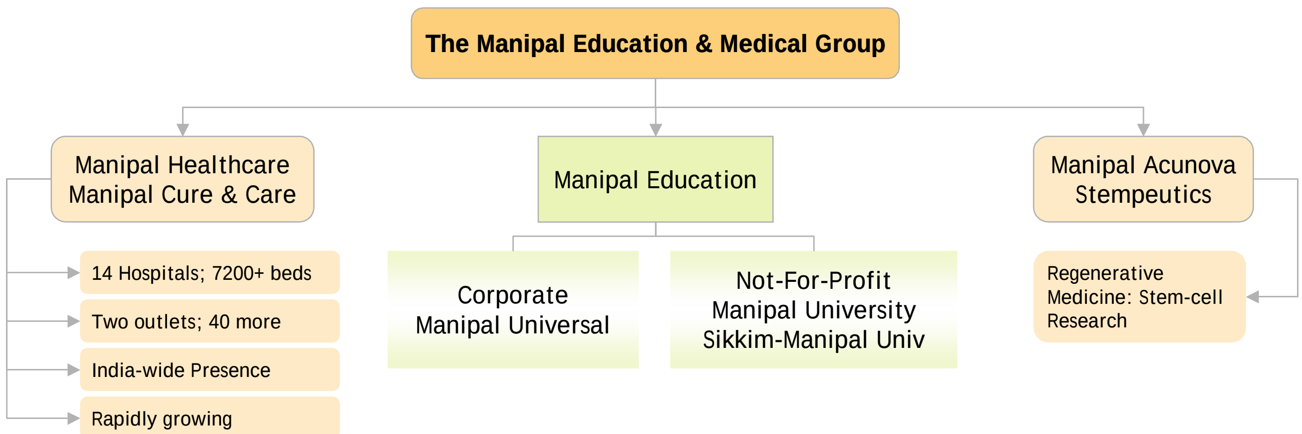
	Creativity	Content	Capital	Credibility	IQ
Manipal Education					

Source: IDFC-SSKI Research

GROUP BACKGROUND

MUL (Manipal Universal Learning – the corporate entity) belongs to Manipal Education (a part of the Manipal Education & Medical Group). While MUL houses the 'for-profit' education interests of the group, 'not-for-profit' education initiatives are carried out through Manipal University (a deemed university) and Sikkim Manipal University (a state university). One of the few profitable players in the private higher education market, Manipal Education has been used an innovative structure to capitalize on spends on HE (Indians spend $20bn annually on HE in India and outside).

Exhibit 7: Company structure



Source: Company

With two universities and more than 30 institutions/ colleges in its fold, Manipal Education has a base of 158000+ students across campuses in India, Antigua, Dubai, Malaysia and Nepal (footprint in 19 countries).

Exhibit 8: World Class Infrastructure

Source: Company

Manipal University – world-class infrastructure

Manipal University: It is India's first private university offering 12 professional streams through its 17 institutions. The university offers various programmes in the areas of medicine, engineering, information sciences, allied health sciences, biotechnology, dental, etc to 18,000+ students of 53 nationalities.

The university has strong focus on research and is the largest private recipient of funds for research from the Government of India. The statistic assumes significance in the backdrop of the fact that there is little private sector or foundation-driven funding available for research in India, and almost all universities rely entirely on the Government of India for funding of research. The university has close working relationships with the corporate sector for applied research programmes – these include MNCs such as Philips, GE and Intel.

Sikkim Manipal University: The first university in India to be built on the Public-Private-Partnership (PPP) model, Sikkim Manipal University is located in the north-eastern state of Sikkim. Apart from campus-based programmes in medical and engineering, the state university offers distance education courses through 550 Learning Centers (20+ overseas in the Middle East and Africa) using VSAT technology (2-way audio and 1-way video).

The Learning Centers are located in various parts of India in collaboration with a local entrepreneur. These Learning Centers cannot provide content or hold exams. A blended pedagogy combining study-and-instruction material, satellite lectures and face-to-face coaching is used to impart education.

Management Profile

Manipal Universal is a board-directed corporation. The Board of Directors is as follows:

- Dr Ramdas Pai, Chairman: A pioneer in higher education in the country. Leading Manipal Education for the last 25+ years
- Dr Gajraj Dhanrajan: A leading educator from Malaysia, with specific expertise in distance education. He also heads the Academic Council
- Mr E A Kshirsagar: Former Chief of A F Ferguson, one of India's leading accounting & consulting firms. He also heads the Audit Committee
- Mr Luis Miranda: CEO of IDFC Private Equity. IDFC is a leading Indian infrastructure fund
- Mr Vivek Kalra: Partner – Global Private Equity; Capital International, Singapore
- Dr Ranjan Pai: Executive Chairman, Manipal Education & Medical Group
- Dr H S Ballal: Pro-Chancellor, Manipal University
- Mr Anand Sudarshan: Managing Director & CEO

Manipal University has an eminent and active Board of Governors. Its roster includes:

- Dr Ramdas Pai, Chancellor: A pioneer in higher education in the country. Leading Manipal Education for the last 25+ years
- Dr Pai Panandikar: A leading Indian economist. Former Member of the Planning Commission, former Advisor to the Prime Minister of India, and the Founder of Centre for Policy Research .
- Mr Suresh Prabhu: Member of Parliament, and former Union Power Minister
- Mr K V Kamath: Chairman & CEO of ICICI Bank (2nd largest private bank in India).
- Mr T V R Shenoy: A veteran journalist, and a leading member of the Indian intelligentsia
- Mr Mohandas Pai: A member of the board, and Head of HR & Administration at Infosys – a leading Indian Information Technology firm

Navneet Publications

Rs41.5
UNRATED

Book worms grow slow

Mkt Cap: Rs3.9bn; US$79m

Navneet Publications is a publisher of syllabus-based supplementary/ reference books in Maharashtra and Gujarat (66% of FY08 revenues), and also operates in stationery (33%) and the multimedia in schools (e-books, CD-ROM, etc) spaces. In the publishing business, the company is a leader in a segment that offers free play to private publishers (unlike for textbooks, where state boards and NCERT have a monopoly). However, scalability is difficult to achieve in this business given the high level of market fragmentation and low-growth as reusability of books is high (a large second-hand books market). While we expect a sedate 12% CAGR for Navneet in its publication business over FY08-12, we expect overall growth to be slightly higher (16% CAGR) driven by the stationery segment and the new initiative to tap the high-growth Multimedia to schools space.

❑ Publishing segment – 'leader' in supplementary books market

Primarily a provider of domestic supplementary books within Maharashtra and Gujarat, Navneet Publications also has small presence in the international children's and general books segments. The Indian education system is examination-centric, and success is equated with high marks. In this backdrop, supplementary books (reference books/ books with exam-focused questions and answers) have gained high significance. Even as Navneet Publications is a leader in this market, we expect low growth (12% CAGR over FY08-12) for the company in the coming period as the market is highly fragmented and there is a large second-hand books market (an estimated ~70% of the target customers reuse books).

Supplementary books market – a free play

We estimate the books market in India to be $1.75m with textbook market at $1.2bn and supplementary books market at $510m.

Exhibit 9: Indian books market – a snapshot

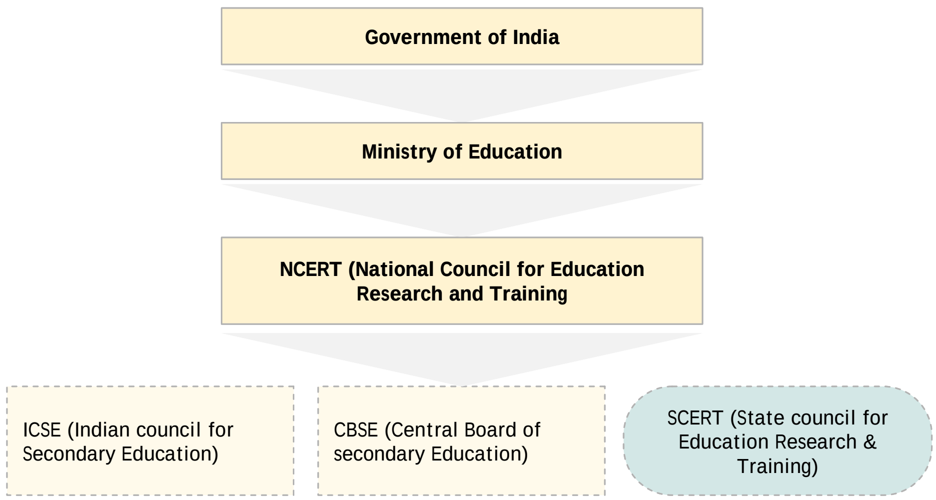
	Age (years)	Text books (US $m)	Supplementary books (US$ m)	No. of publishers	Text books prepared by
Pre primary	3-5		30	1000+	Private publishers
Primary	6-9	200	90	400+	SCERT (state boards), NCERT (CBSE board), ICSE, International publishers (international schools), private publishers (some CBSE schools)
Secondary	10-15	450	200	150+	
Higher Secondary	16-17	90	90	100+	
Graduation	18-21	200	100	100+	Private players
Post Graduation	21 onwards	100	na	na	Private players
Professional Books	Working professionals	200			Private players
Total Market ($ m)	1,750	1,240	510		
Total accessible market ($ m) (only 5% of the school books market is currently accessible due to market distortions)	1,047	537	510		

Source: Company, IDFC-SSKI Research

While a large part of the school text books market is out of reach of private publishers (text books are generally published by the various state boards and NCERT – National Council of Education Research and Training), Navneet Publications is present in the $510m supplementary books market which offers a free play to private players.

A leader in the highly fragmented supplementary books market, Navneet Publications has been catering primarily to state board school students (following the SCERT – State council for Education Research & Training – curriculum) in Maharashtra and Gujarat since 1959.

Exhibit 10: Navneet's prime focus – SCERT curriculum

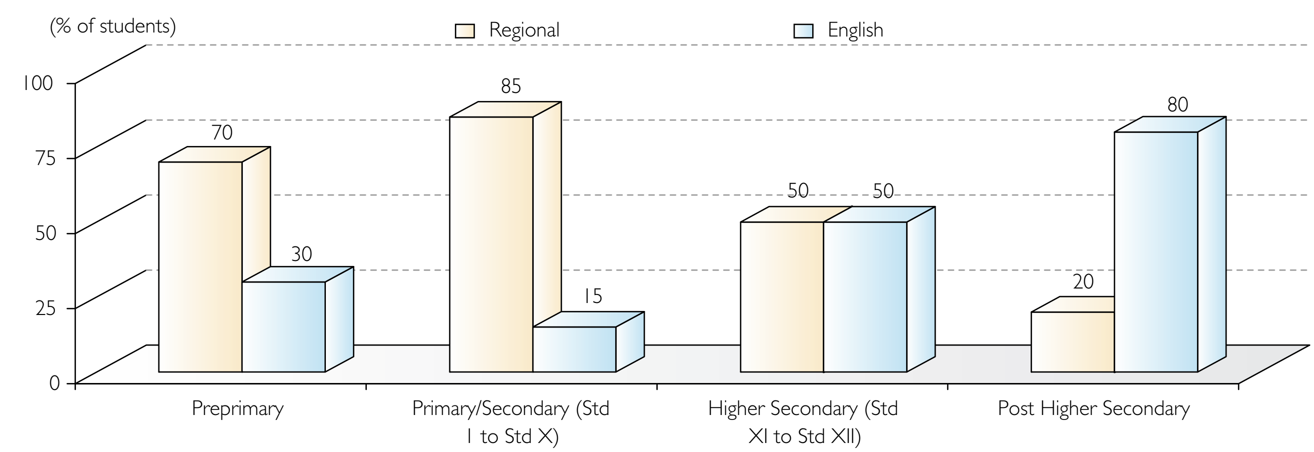


Source: Company

Strong regional language content – a key strength

As a large chunk of school students attend vernacular institutions, publishers need to produce text books/ supplementary books in various regional languages. As of date, Navneet has over 5,000 owned titles in English and 11 other Indian languages with ~200 new titles being added every year.

Exhibit 11: Need for books in regional languages



Source: Company, IDFC-SSKI Research

Low growth market

Navneet has five manufacturing facilities (one each at Vasai, Silvassa, Daman, Santej and Dantali) and 25 branches across India. With 60,000 retail outlets for its various products, Navneet has a strong distribution network. To further expand its reach, the company acquired 'Grafalco' (a 30-year old brand) through a subsidiary in Spain, which is in the business of publishing children's books in Spanish and other European languages. Though Navneet's publication business grew by 23%yoy in FY08, we see it as an aberration as the state school boards in Maharashtra and Gujarat had changed the syllabus for SSC schools in the year. Despite its strong positioning, we expect only 12% CAGR for Navneet over FY08-12 as the overall books market is inherently a low growth business. This is primarily due to the low sell-through (100% students do not buy books and refer to class notes, etc) and presence of a large second-hand books market (70% of the target market reuses books).

e-learning (Multimedia in private schools) – a new initiative

Navneet is a leader in the supplementary books space in Maharashtra and Gujarat. However, instead of expanding to other regions of the country, the company has chosen to expand vertically in the multimedia for private schools space in these regions. Of the 23,000 secondary schools in the two states, 95% are run by state boards – most of them being vernacular. For its new initiative, Navneet plans to cater to this segment.

While the segment offers market potential in excess of $1.5bn with just 5% penetration, execution remains a key monitorable as Navneet will have to contend with strong and established players like Educomp, Everonn and NIIT.

As a part of this initiative, Navneet has created an e-book (restricted to the content in text books) in order to tap the lucrative high-growth Multimedia in schools market. The company expects to spend ~Rs90m to launch the product. With plans to focus on Maharashtra (10th grade) and Gujarat (1-10 grades) and on content in English, Marathi and Gujarati, the project is currently in the pilot phase.The company has also stated its intent to introduce examination-oriented CD-ROM products (a product for Gujarat CET launched in January 2008; 2,000 copies already sold). Navneet expects to sell 20,000 CD-ROMS by the end of the year.

❑ Stationery segment – exports expected to boost growth

The stationery segment primarily comprises domestically sold paper products (75% of Navneet's segment revenues). The company has recently launched non-paper products (3% of segment revenues) and the remaining 22% of revenues come from exports. Navneet is a leader in premiere stationery markets of India, the Middle East, parts of Africa, USA and Europe. Going forward, the company expects 50% growth in the export business, which would boost its overall growth. The stationery business lacks scalability as it is seasonal in nature with majority of sales accruing within the first quarter (i.e. when new academic sessions commence in schools). Overall, we expect 30% CAGR in Navneet's stationery business over FY08-12.

Exhibit 12: Key financials

(Rs m)	FY04	FY05	FY06	FY07	FY08
Net Sales	2530	2748.3	2962.6	3322.8	4111.2
Other Income	85	14.6	24.2	14.2	50
Stock Adjustments	142.3	-159.3	117.7	177.4	158.3
Total Income	2757.3	2603.6	3104.5	3514.4	4319.5
Operating Profit	615.3	579.2	614.5	743	889
Interest	21.1	27.7	25.4	21.7	40.8
Gross Profit	594.2	551.5	589.1	721.3	848.2
Depreciation	90.8	89.6	92.1	85.4	104.6
Profit Before Tax	503.4	461.9	497	635.9	743.6
Tax	159.5	157	143.5	206.5	196
Adjusted Net Profit	336.6	303.6	352	425.9	541.7

Source: Companies, SSKI Research

ETCN (Zee Learn)

Rs74
UNRATED

Leader in Preschool

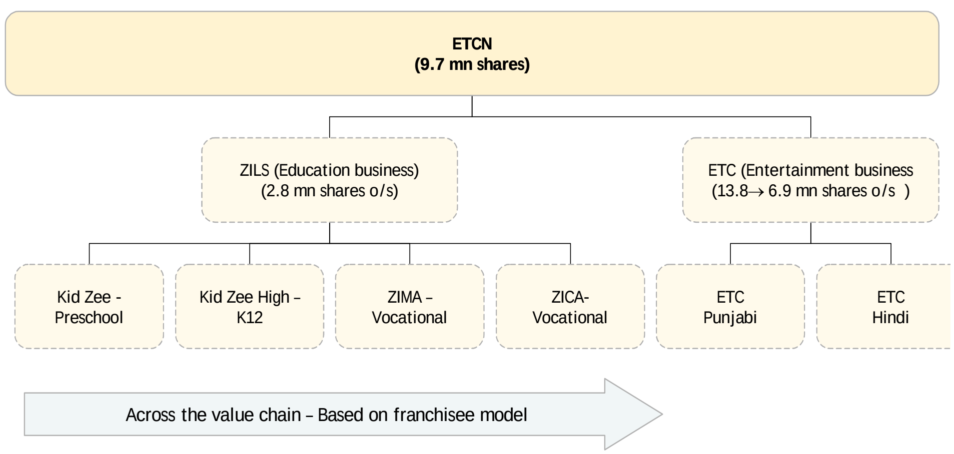
Mkt Cap: Rs721m; US$14.7m

ETC Networks (ETCN) derives 32% of its revenues (Rs 778 in FY08) from its education venture Zee Learn with the remaining coming from the boradcasting businesses. With 623 preschools across India, Zee Learn has the largest chain of preschools under the brand Kidzee (60% of education revenues in FY08) and aims to grow the base to 1,000 preschools in the next two years. Zee Learn has also ventured into the K12 segment with 23 Zee High schools (8% of revenues in FY08) and aspires to grow to 100 schools over the next three years using a combination of JVs and consulation (franchisee model). With the scale-up planned in Zee Learn, the education business's share in total revneues of ETCN is expected to increase to 50% by FY10. ETCN has estimated revenue growth of 25% for FY09 and expects margins to improve as capacity utilization builds up in its schools. Churn in existing franchisees and growing competition are the key risks going forward.

❑ Company background

ETCN began its journey as Zee Education, set up in 1994, and morphed into Zee Interactive Learning Systems in 1999 (ZILS; recently renamed Zee Learn). Subsequently, Zee Learn was amalgamated with ETC Networks on 28 March 2008 under the name ETCN.

Exhibit 13: ETCN – corporate structure



Amalgamation details - ETCN issued and allotted one equity share of Rs10 each for every two equity shares of Rs10 each held in ETC. The issued, subscribed and paid-up equity capital of the company post arrangement comes to Rs97.4m consisting of 9,744,456 equity shares of face value of Rs10 each. The promoter's shareholding has gone up from 50% pre-merger to 70% post-merger.

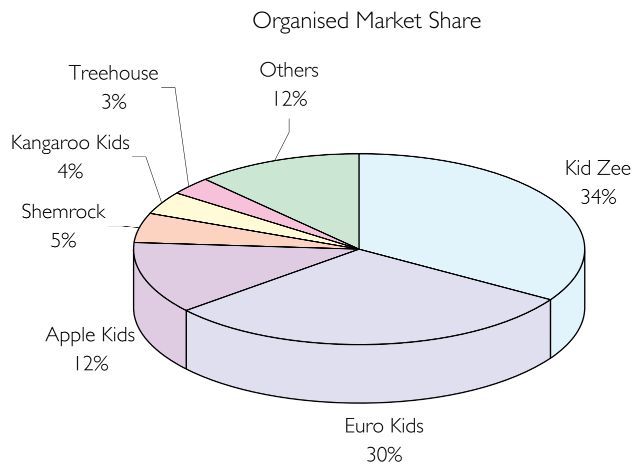
Source: Company, IDFC-SSKI

Zee Learn is present across the value chain of IES with significant presence in the preschool market under the brand *Kidzee (*currently 60% of education revenues*).* The company has also ventured into the high school segment under the brand *Zee High* and plans to enter the vocational training market. While t**he company has a small presence with the USD 1.5bn vocational training space with ZIMA (Zee Institute of Media Arts), ZICA (Zee Institute of Creative Animation) and ZedCA (IT training), the management expects to aggressively focus to scale up these venture. (Management has said it is too early to give any comments on the details of the new business).**

❑ Kidzee – leader in preschools

Kidzee is India's largest chain of preschools – an estimated $300m market offering 36% CAGR over FY08-12E. Stared in 2003, Kidzee has presence in 275 cities through 623 centers (34% of the organized market and 7% of the total preschool market). Outside India, Kidzee has started preschools in Singapore, Kuwait, Bangladesh and Nepal with plans to enter Sharjah.

Exhibit 14: Major players – the largest player in the segment Kidzee has 7% of the *total* market



Source: Company, IDFC-SSKI estimates

Kidzee plans to scale up to 1,000 preschools over the next two years under the franchisee model. Though the scale-up plans are encouraging, we believe increasing competition would put a spanner in the proposed expansion.

❑ Zee High (K-12) – 100 schools planned over three years

At $20bn, K12 is the largest and most lucrative segment in IES. Since 2006, 23 Zee Highs have been signed up, of which nine are currently operational. The company expects to have 100 Zee Highs operational over the next three years – primarily based on the "Hub & Spoke" model, wherein Kidzee centers will act as feeders to Zee High schools. Thus, extending the preschool initiative to K12 schools means that Zee Learn has a ready-made base of students for Zee Highs.

Zee High plans to expand in two ways – either through *greenfield projects* or by using the *conversion model* (schools have trusts that are defunct and/ or the bodies are looking to offload the venture). Of the existing base of 23 K12 schools, 14 schools are greenfield projects. For Zee High, the company (or franchisees) is using the same two-tier structure deployed for preschools, wherein a trust is set up to run the school and a managing company provides land and other management services in lieu of a fee.

❑ Utilization of funds

Zee Learn requires an estimated Rs1bn to fund its ventures and an additional Rs350m for working capital over the next three years. The company is looking to meet this requirement through internal accruals of Zee Learn and the remaining from a cash-rich erstwhile ETCN. The funds will be used to develop three 'Centers of Excellence' across the country, which will be owned by Zee Learn and act as a model to other franchisors running Kidzees and Zee Highs. Further, the funds will be used for developing content for higher classes and to develop content for the youth training programmes in the vocational training segment.

❑ ETC – broadcasting

ETC Networks is a broadcasting subsidiary of Zee Entertainment Enterprises with two free-to-air channels – ETC Hindi and ETC Punjabi. Both the channels have a strong presence in their respective niches – ETC Hindi has a 42% share in the film/ music promos segment while ETC Punjabi (65% share of the Punjabi channels market) has exclusive rights for 11 years to telecast the *Gurbani* live from the Golden temple, Amritsar.

❑ Future outlook

Zee Learn plans to extend its operations to the vocational training space where it is already present in a small way through ZICA, ZIMA, and ZedCA. While it has been one of the first movers in IES, execution and ability to sustain its lead remains to be seen. A pure franchisee play, the model has the risks of seeing increasing competition and franchisees churn if economics are not favorable.

Exhibit 15: Management team

Name	Designation	Past work experience	Educational qualification
Sumeet Mehta	CEO	Ex- P&G	IIM-A
Ashish Deb	National Sales head	Ex- Nestle, NIIT	Bsc Physics
Mukund S	R&D Strategy	Ex - Bajaj	BITS Pillani
Swati Sinha	HR	Ex- Eicher	TechBooks MBA HR
Nitin Pandey	Kidzee Business Head	Ex- Loreal & Apollo Tyres	IMI – Delhi
Naveet Anhal	Zee High Business Head	Ex-Piramal & Wockhardt	IIM-I
Nitya R	Academics	Ex- Bombay Cambridge principal	Med, PG ECE

Source: Company, IDFC-SSKI Research

Exhibit 16: Key financials

(Rs m)	FY07	FY08
Net Sales	205.471	778.17
Other Income	9.831	41.71
Total Income	215.302	819.88
Total Expenditure	-193.366	-647.8
Profit before interest and tax	21.936	172.08
Finance cost	-1.902	-2.93
PBT	20.034	169.15
Tax	-3.027	64.49
Net Profit	17.007	233.64
Paid up Equity Capital (FV Rs 10 per share)	7.325	97.45
Reserves (Net) Excluding revaluation reserves	9.06	869.47

Source: Company, IDFC-SSKI Research

Exhibit 17: Segmentwise break-up

Segment revenues	FY 08 (Rs m)
Broadcasting	525.807
Education	252.366
	778.173
Segmental EBIDTA	
Broadcasting	142.98
Education	5.439
	148.419
Less interest expense	2.478
add interest income	23.209
Total PBT	169.15
Capital employed	
Broadcasting	827.385
Education	84.857
Others	54.676

Source: Company, IDFC-SSKI Research

EuroKids

UNLISTED

Preschool and books

EuroKids is the second largest player in the Indian preschools market with 484 centres operational pan-India (30% of the organized market). The company is also the largest publisher of children's books in India (>10% market share) and has licenses from marquee international names (like Disney, BBC worldwide, Mattel, Nickelodeon among others) in this segment. Going forward, the company expects 30-40% CAGR in its revenues (Rs200m in FY08; 50% from preschools and 50% from publishing) and to achieve a PBT of Rs250m-300m over FY08-12 (Rs16m in FY08). Also, EuroKids plans to strengthen its brand within the K12 segment. Educomp Solutions (one of the pioneers in the education space) has acquired a 50% stake in Eurokids for Rs390m.

❑ Company background

- 1997 – JV formed between Indian Express and Egmont International (Indian Express Egmont Publications Ltd)
- 2000 - Egmont International Holdings, Denmark, bought back the shares of Indian Express in this joint venture making EuroKids its 100% subsidiary. The company was renamed Egmont Imagination India
- 2001 – Company ventured into the preschool segment with two pilot preschools in Mumbai
- 2004- Egmont exits India and other Asian markets due to consolidation pressures in Scandinavia. A management buy-out is effected with an employee trust. The company exited its loss making segments of toys and children's magazines.
- 2008 – Educomp acquires 50% stake in the company for Rs390m

❑ Publishing business – leader in children's books

The Indian publishing industry sales are estimated at ~Rs70bn annually and the children's book segment comprises 30-35% of these sales. The children's book market is expected to maintain its pace of growth at over 15%yoy. The market is largely driven by growth in organized retail (22% of total retail market by 2010E, i.e. to $93.9bn from $12.4bn at present – source: FICCI).

Started in 1998, this was the original business that Egmont Publications, a Denmark media and publishing company wanted to expand in India. Catering essentially to children's books segment (age group 2-12 years), EuroKids has 60% of the licensed book publishing market in India. The company is a licensed book publisher in India for Disney, Mattel, Enid Blyton, Noddy and Tintin. While 30-40% of EuroKids' sales are through the retail stores, the management feels that this business will grow on the back of the 35% CAGR in malls.

Licensed book publishing – This business entails securing a license from leading children's brands and printing the content in India. The difference in price points is significant, which expands the scope of market as affordability increases.

Exhibit 18: Licensed book publishing

	Imported Disney hardbound book in India	Disney hardbound book printed in India
MRP	Rs 250	Rs 130

EuroKids has a strong content library of 1,000 titles and expects to add 200-300 titles every year.

❑ Preschools – a relevant player

Started with two pilot preschools in Mumbai in 2001, EuroKids has 484 preschools across 160 cities of India and its preschool franchisee chain is second only to KidZee (623 preschools). With 29,000 students enrolled in its schools in FY08, a total of 80,000 students have been a part of EuroKids till the year. The chain forms 30% of the very nascent and small organized market in the preschool segment. Going forward, the company plans to have 1,000 preschools in its fold over the next five years, primarily through using the franchisee route (franchisee to owned preschools ratio of 98:2; planned to be rebalanced to 80:20). Educomp Solutions – a leading company in IES with presence across the value chain – has recently picked up a 50% stake in EuroKids for Rs390m.

To make the business more attractive for franchisees as also to generate incremental revenues for itself, EuroKids is offering the franchisees support to lever the existing infrastructure beyond the preschool hours for different activities under a revenue share model. Under this initiative, EuroKids has introduced programmes such as EuroGym, Summer Club, EuroSmart, etc.

EuroKids currently has three campuses under the teacher training initiative, one each in Jodhpur, Jaipur and Hyderabad. Built on a 2,500 sq. ft area each, these centers have been set up at a cost of Rs2m ex-land. Going forward, EuroKids plans to generate an additional source of revenue as well as train its teacher requirement under this programme.

❑ Future Outlook

EuroKids is planning to expand its education portfolio into the K12 segment. The move would be a logical extension for EuroKids as it has a large feeder base of preschoolers that can be tapped for K12 schools. Also, we believe that preschools with high school models will emerge stronger than standalone preschools. EuroKids currently operates four K12 schools in Hyderabad, Hassan, Tumkur and Davangere through the franchisee model and has also tied up for another six schools in Bangalore, Jodhpur, Guwahati, Tura, Nadiad and Jalna. All these six schools are expected to be operational by June 2009.

❑ Management Profile

Uday Mathur – B.E. and MBA (IIM-Kolkata). He has been associated with kids' brands throughout his career. After a successful tenure with TI Cycles as General Manager-Marketing, he joined Indian Express Egmont in 1997 as Country Head.

Ganesh Viswanathan – CA, CS. He was heading the Finance function in an RPG group company before joining Egmont India in 1998.

Vikas Phadnis – MBA-Marketing (Mumbai University). After spending nine years heading Advertising & Marketing functions in Telecom and Automobile industries, he joined Egmont India as Head of Sales & Marketing in 1998.

Prajodh Rajan – BBA (Madras University). He has extensive experience in marketing & operations within the Automobile & Auto-finance industries and joined Egmont India in 1999 as Project Head.

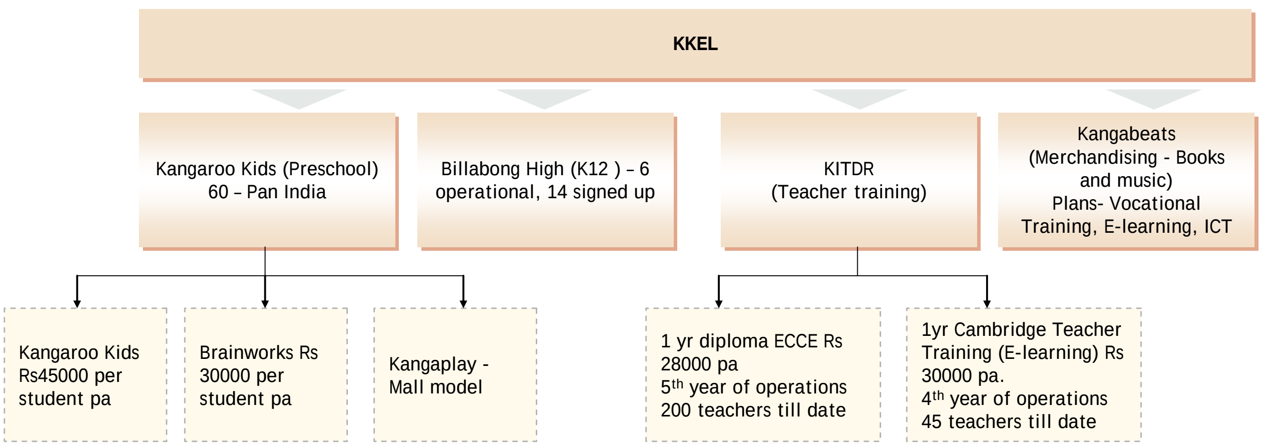
Kangaroo Kids Education

UNLISTED

Innovative Preschooler

Kangaroo Kids Education (KKEL), operates 65 schools in India situated in 17 cities. The schools are a mix of preschools (90% as pure franchisees; two preschools in Dubai), Kangaroo Kids Toddlers Club Centers and Billabong High International Schools (K-12; seven operational schools). Primarily a niche player, KKEL is expanding its preschool presence to a wider market with a relatively less-frills model under the brand 'Brainworks'. An innovator in the preschool space, KKEL is using not only the pure franchisee route but also a JV model (400 JVs signed with developers and key partners). The strategy, we believe, would allow KKEL to improve the overall economics and make the preschool model more economically viable. The company also has a small presence in teachers' training and merchandising (books and music) segments.

Exhibit 19: Business overview



Source: Company, IDFC-SSKI Research

❑ Company background

KKEL had set up its first preschool in Bandra, Mumbai with an initial capacity of 25 students. Interesting and age-appropriate activity-based curriculum is the key factor behind the school becoming extremely popular with parents as also children. By 1994, the school was running two shifts and had a capacity of 125 students. The popularity of the school and its concepts encouraged Ms Lina Ashar (the founder) to explore new expansion avenues. In 1995, KKEL appointed its first franchisee partner for Santa Cruz, Mumbai.

Exhibit 20: Company history

1997	Ms Ashar opened the first Kangaroo Kids Toddlers Club in Khar, Mumbai. This unique concept of mother-toddler activity club was introduced for the first time in India
1999	KKEL embarked upon an expansion phase in 1999, starting with a Kangaroo Kids Club centre in Worli, Mumbai and the first Kangaroo Kids Club centre in a mainstream school – G. D. Somani Memorial School at Cuffe Parade, Mumbai.
2000	Started with the opening of Kangaroo Kids Preschool at G D Somani Memorial School, the opening of the first outstation franchise partner in Delhi and the opening of the first Kangaroo Kids Primary School in Juhu, Mumbai.
2002	• Franchise partners were appointed for the cities of Kanpur, Jaipur, Bangalore, Chennai and Pune. In December • A merger was effected between Kangaroo Kids and Kangaroo Kids Club centres, and gave birth to KKEL.

Source: Company, IDFC-SSKI Research

❑ Preschools – innovative models are the winners

Since 1993, Kangaroo Kids has established ~60 preschools across India (and two in Dubai) and a brand name as a niche player catering to the upper middle class with per student revenue of Rs45,000 per annum. The preschoolers are offered an average class size of 18-20 and a teacher student ratio of 1:6 for nursery and 1:8 for preschool. The content comes across as thoroughly researched and there seems to be a conscious effort to use innovative teaching styles to get across to the children. KKEL is using different models in order to lever the changing mind set associated with preschools.

- *Kangaroo Kids* – With average fees of Rs45,000 pa per student, this brand will continue to cater to the upper middle class.
- *Brainworks* – With average fees of less than Rs30,000 pa per student, this brand caters to a wider market. Under a tie-up with Star TV, these centers are expected to grow to more than 400 in number in the next four years.
- Kangaplay (Mall model) – Levering the retail boom. KKEL plans to tie up with major retailers with the objective to run preschools during the mornings and day-care centers for the remaining part of the day. We feel that these facilities can be further utilized as play-pens for kids even in the late evenings when parents come to watch movies or shop in the malls. The retail space is expected to grow from 25m sq. ft in 2006 to 300m sq. ft by 2015. While KKEL would be the first mover in the mall school model, the economics of this model will play out depending on the JV terms with mall developers.

In order to supplement children's learning with high quality and innovative resources such as CD-ROMs, books and audio aids, **Kangabeats Entertainment Pvt Ltd** has been set up by KKEL in association with Rachel Productions (promoted by Raju Singh, a music composer).

❑ K12

Under the brand name of Billabong High International Schools, KKEL currently has seven schools in cities of Mumbai, Chennai, Kanpur, Vadodra, Jaipur, Bhopal and Noida. KKEL plans to have IGCSE/ ICSE recognized schools, which we believe is a better strategy than having IB schools as acceptability of IB education is not yet attuned to Indian competiveness.

❑ Teachers' Training

To ensure development of teachers who can adapt to and incorporate the innovative learning solutions, KKEL has set up a Teachers' Training Center in Bandra (KITDR) that offers one-year certificate programme in ECCE (Early Child Care & Education). The programme offers a part time one-year diploma in ECCE @ Rs28,000 with 70% of on-ground training in the existing schools. The course is in its fourth year and 200 teachers have been trained here till date. KITDR has also tied up with Cambridge University in order to launch an online teachers training programme @ Rs30,000 pa. The course is in its third year and 15 teachers have trained in the last year.

❑ Future outlook

While K12 is expected to be the largest revenue contributor for KKEL going forward, the company plans to operate across IES including vocational courses, e-learning, ICT to schools and other areas related to merchandising (books and music).

❑ Management Profile

Lina Asher (Founder, Director and Educationalist): Ms. Lina Ashar has educated and trained in Australia. She has experience in teaching in Australian High Schools. Equipped with a Bachelor in Education degree from Victoria College Melbourne, Lina began her career as a secondary school teacher in Australia. Lina underwent training for four years in theoretical and practical knowledge and gathered experience in all kinds of primary, secondary, technical and special needs schools. In 1993, she came back to India with a dream of making a much-needed difference in the field of education. As a teacher in Mumbai, she soon realized her limitations in providing individual attention to each of the 60 odd students cramped in a single classroom. This led her to start her first preschool in Bandra (Mumbai), India with a teacher student ratio of 1:6 for nursery and 1:8 for preschool.

Paul Solomon (CEO since January 2008): He has refinanced KKEL, established a major JV (Brainworks), and restructured KKEL to build bandwidth and execution strategy. His qualifications include Bachelor of Commerce, Masters of Commerce, Senior Fellow of Institutes of Accounting, Management and Company's Director. Previously Professor of Management with a University in Australia. He has 20 years of worldwide experience as a senior executive including:

- Managing Director – Health Department (Australia); five years
- CEO – One of Australia's largest Hospital centres; three years
- Executive General of Spotless Group (a listed ASX company with market capitalization of AUD $1 billion and revenue of AUD $3 billion per annum; nine years
- Director of International Management – Consulting a Business Recovery Company (Dubai); two years

Advisory Board

The advisory board assists in activities and projects, and helps ensure that the objectives set by KKEL in its mission statement are being fulfilled. The board comprises eminent personalities from diverse fields, including Ms Tina Anil Ambani, Mr Ravi Shastri, Mr Prahlad and Ms Mitali Kakkar, Mr Keith Butler, Ms Sonia Grinceri, Dr Ishverlal Desai, Ms Kiran Bajaj, Dr Richard Johnson and Mr Andrew Houghton.

Tree House

UNLISTED

Largest non-franchised preschool

Started in 2003, Tree House is the largest non-franchised branded preschool chain in India (90% of its centers are run by the company). With an existing base of ~65 centers (50 centers in Mumbai), the company has achieved significant presence and is currently one of the largest players in the organized preschool market. With a firm grip on day-to-day operations of its schools, Tree House enjoys high operating margins, which gives it enough leeway to compete in a price-war scenario. Going forward, Tree House is working to achieve a 50% CAGR in its revenues over FY08-12. With a balance sheet size of ~Rs450m, Tree House plans to finance its growth through additional channels like private funding (Matrix Partners has invested $7.5m in August 2008) and subsequently through an IPO.

❑ Preschools all the way

One of the few players in the preschool segment opting for a 'non-franchised model', Tree House has ~65 centers with an average of 80-100 students per center and caters to children in the age group of 1.5-5.5 years. The company has created strong entry barriers in Mumbai as it is sitting on expensive commercial real estate at prime locations of the city. Given that location is a key advantage in the preschools business, this implies less competition for Tree House – at least in Mumbai. Tree House has, over the last five years, not only created strong brand equity but also set high standards in preschool education. With around 200 qualified teachers on its roster, the company focuses on delivering quality. To get access to a base of low cost-high quality teaching staff, Tree House has backward-integrated into the teachers training business. This gives the company sufficient control on pricing as well as costs.

In the $300m preschool market, expected to expand at 36% CAGR in the coming years, Tree House has set a target of achieving 50% CAGR over the next three years. The company has drawn a three-pronged strategy for its future growth:

Replicate the Mumbai growth model in other large Indian cities

Tree House plans to open self-operated centers in some of the large cities of India. This will ensure strict control on service delivery, thus enhancing its brand equity. According to the management, this strategy helps it maintain profitability ratios and also ensures healthy revenue growth.

Build on the franchising business

Having recently entered the franchising space aggressively, Tree House plans to extend its footprint in Tier-3 and Tier-4 cities in the country through the franchisee route. With a healthy mix of franchised as well as non-franchised centres, Tree House is set to redefine the preschool business.

Increase offerings at the centre

There lies significant opportunity for preschool centres to improvise on revenue generating avenues by adding to the bouquet of services. Tree House has recently introduced various value-added services, which would help it improve the average revenue per center.

To gain incremental market share, Tree House is planning to tap customers across segments at various price points and service requirements. In this regard, the company has also diversified into a low-cost, no-frill chain of preschools (branded as 'Titli') targeted at the mass market and has started day-care centres (branded as 'Muskaan'). Titli and Muskaan are still nascent ventures and the management sees huge growth potential in these two brands.

There is increasing awareness for preschool education even in the low income strata of the population which, if addressed well, can emerge as an attractive avenue for generating incremental revenues. Titli addresses this segment of the market and facilitates high-quality preschool education at an affordable price. Muskaan, meanwhile, addresses the increasing demand for day-care from parents with double income. The new-age India is witnessing rapid proliferation of the nuclear family culture where both the parents are working and there is a dearth of high-quality branded day-care centers in the country to address this increasing demand. Muskaan is one of the early entrants in this business and it gives Tree House a head-start to emerge as a large chain of branded day-care centers in the country.

❑ Funding plans

Tree House plans to finance the aggressive growth through private funding (recently received private equity funding worth $7.5m by Matrix Partners), internal accruals and subsequently through an IPO.

❑ Management Details

Mr. Rajesh Bhatia (Chairman and MD): Mr. Bhatia is a BE in Computer Science and an MBA. He started his career as a Fund Manager with 20th Century Finance Corporation in 1993, and later worked with Sigma Capital, Motilal Oswal and Indsec Securities before launching Tree House.

Mrs. Geeta Bhatia (Director): Mrs. Bhatia is the co-founder of Tree House and has played a key role in the company's growth story. She currently oversees curriculum design and supply chain management.

Mr. Rishi Navani (Nominee Director): Mr. Navani is the co-founder and MD of Matrix India and has been investing in India since 1996. Previously, he was MD at WestBridge Capital Partners – now known as Sequoia India.

Mahesh Tutorials (MT Educare Pvt Ltd)

UNLISTED

Most scaled up in a non-scalable business

Mahesh Tutorials is a relatively scaled up player (revenues of Rs700m by FY09E) in the subject-based tuitions market ($5bn in size but highly fragmented) and the only player to get funded in the segment ($12m from Helix Investments for a 30% stake). The tuitions market is so fragmented that MT Educare has only a 3% share in Maharashtra despite being a leader in SSC school tutoring and 90% share of the market. The management expects Mahesh Tutorials to grow to ~Rs1bn by FY10 with 40% growth in its existing tuitions business (schools, and science and commerce streams for colleges) and more than 100% growth in its nascent businesses – vocational training and preschools. Due to low scalability in tuitions market, we feel the inorganic route as also diversification into high-potential and scalable segments of IES are logical moves. Execution and ability to build scale are the key monitorables.

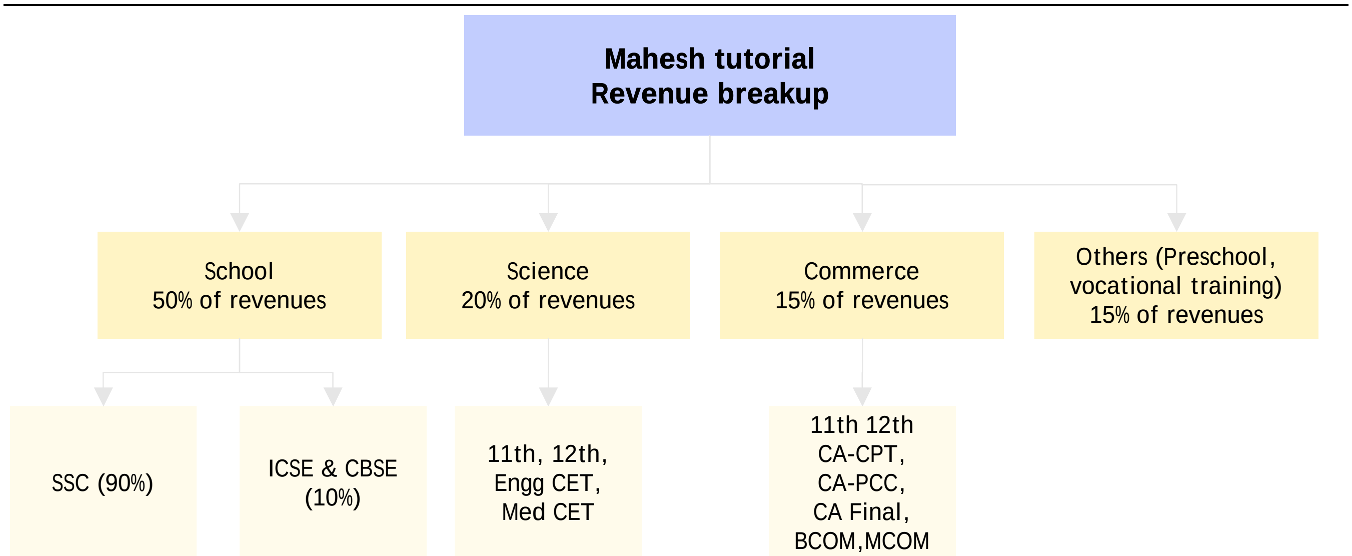
❑ Company background

Started in 1988 with a single center, seven teachers and 300 students, Mahesh Tutorials has scaled up to 153 centers, 1,200 teachers and ~30,000 students over a period of two decades. Currently, the company's scope of operations is restricted largely to Maharashtra (concentrated in Mumbai). It has a small presence in the South India market, Gujarat and a single center in Dubai. Going forward, the company has stated its intent to tap the Middle East and South East Asia regions. In August 2007, Helix Investments picked up a 30% stake in Mahesh Tutorials for $12m, which values the company at ~$38m, i.e. Rs1.6bn.

❑ Business overview

MT Educare is present predominantly in subject-based tutoring across school and college levels. While 50% of its revenues accrue from the schools tuitions market, 35% are accounted for by college level tuitions (Science and Commerce), and the remaining 15% by its new businesses.

Exhibit 21: Business Overview



Source: Company

Subject-based tuitions: MT Educare generates one-half of its revenues from subject-based tutoring in schools. While we estimate this market to be at $5bn, the space is inherently non-scalable and regional in nature. Mahesh Tutorials, one of the largest players in the space with 15,000 students enrolled for its classes, has captured only 3% of the SSC tuitions market in Maharashtra.

Exhibit 22: Maharashtra school SSC Market

	No. of Students	% enrolling for classes	Target market (Students)	Average fee (Rs pa)	Target market (Rs m)
SSC	1,200,000	60%	720,000	10,000	7,200

*source: industry; * English medium fee -12-15k; * Marathi medium fee - 8-10 k*

For Mahesh Tutorials, around 90% of the revenues within this segment come from SSC students. From the next academic year, these students will now be offered multimedia based classroom coaching (60 students per batch) and offered a compulsory all-subject package at Rs30,000 per annum. On the other hand, ICSE students are offered tuitions only in mathematics and science for Rs49,500 per annum (LCD-equipped classrooms with 25 students per batch).

The company derives another 35% of its revenues from subject-based tuitions targeted at college students. In the recent past, the segment has seen an uptick in student base, specifically in the commerce stream, on account of a change in examination pattern for students appearing for CA entrance exams (format has shifted from CA foundation to CPT – a multiple choice format making the test paper much easier to crack). This has pushed up the number of students taking the CA entrance test by more than 50% yoy.

Exhibit 23: CA market – an uptick in student base

	No. of students	% enrolling for classes	Target market (students)	Average fee (Rs pa)	Target mkt (Rs m)	Target mkt ($ m)
CPT	150,000	80	120,000	10,000	1,200	30
PCC	70,000	80	56,000	15,000	840	21
CA Final	30,000	80	24,000	20,000	480	12
Total CA market	250,000				2,520	63

Source: Company, IDFC-SSKI Research

❑ Most scaled up in a non-scalable business

Mahesh Tutorials has established relative scale within the subject based tuitions market in Maharashtra. Mahesh Tutorials has successfully transformed the 'people-driven' model into a 'process-driven' one (to an extent) by standardizing content delivery, training workshops for teachers, MIS, periodic reviews, mapping the organization's performance from the results, 360° appraisals and succession planning with growth opportunities for the staff.

Exhibit 24: Mumbai classes snapshot – Mahesh most scaled in a non-scalable business

School level	Category	No of students
Sinhal classes	ICSE	1000
Mahesh Tutorial	SSC, ICSE, CBSE	15000
College Level		
JK Shah	Commerce and CA	6500
Mahesh	commerce and CA	7500
Brilliance Classes	science	3500
Karla Shukla	science	2000

Source: SSKI Research

❑ Future outlook – exploring newer markets

MT Educomp plans to grow organically within Maharashtra and inorganically outside the state in the tuitions segment. Further, the company is testing waters in various new segments (online tutoring, vocational training, etc) to check their viability and scalability. MT Educare has also forayed into the preschool segment under the brand 'Little Tigers' (10 owned-preschools operational in Mumbai). Going forward, it plans to adopt the franchisee route for a quicker scale-up. With limited scalability in the tuitions market, acquisitions and moving up the value chain of IES is clearly a logical step in the right direction. However, execution and ability to scale remain the key monitorables.

Exhibit 25: Management Profile

Name	Designation	Educational qualification
Mahesh Shetty	Founder & CMD/ (Director in Neptune Constructions)	B.Sc, B.Ed
B-Narayanan Iyer	Senior Director	B.E
H. Murali	Director - School Division	B.E
Chandesh Fooria	Director – Science Division	B.E.
Anish Thakar	Director – Commerce Division	CA
Vipul Shah	Director – Marketing	B.E., MBA-Marketing
Shrenik Kotecha	Director – Business Development – New Initiatives	MBA-Finance, MPhil, M.A., M.Com
Sujeet Koyoot	Director – Business Development	M.Sc.
Mahtab Khan	Director – Business Development	M.Sc
Dr. Chhaya Shastri	Chief Strategy Officer	MBA, Ph.D
Dr. Satish Pai	Chief People Officer	B.Sc,, MBA(HRM) M.A (Psy), Ph.D

Source: Company, IDFC-SSKI Research

IMS

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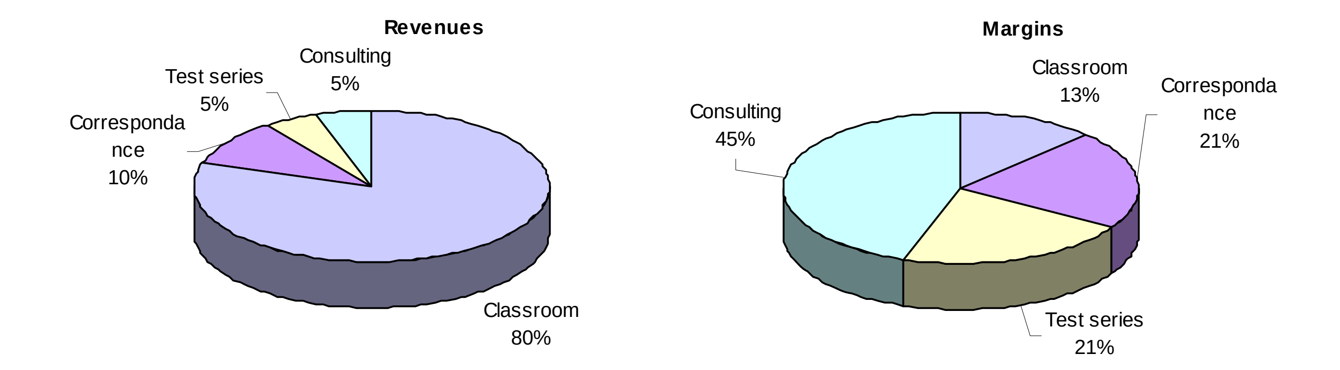
Entire Bandwidth of Higher Education

With revenues of ~Rs1bn in FY08, IMS is one of the largest unlisted players in the education space. The company is a leader in the test prep market (90% of revenues) with strong brand equity in the western and northern regions. In the MBA test preparation space, mock tests called SIMCATS are a differentiator for IMS and a key strength. IMS has extended its offering to certification programmes (finance and retail), publications, language training and formal higher education. With limited scalability possible in the $200m graduation test prep space, the company plans to straddle the entire higher education bandwidth by investing in B-schools and other vocational training ventures in the future.

❑ Test prep classes – the largest business segment for IMS

One of the largest players in the test prep space, IMS is a strong brand in the western and northern regions of India. IMS has a total of 185 centers with 135 centers in partnership (100 partners; one partner has more than one center) and 50 owned centers (owned to franchisee ratio of 30:70). While most of its owned centers are located in key metros and towns, 40-50% of the total students are within the owned centers.

Exhibit 26: Revenue and margin mix



Source: Company, IDFC-SSKI Research

IMS generates revenues within the test prep space through classroom teaching, correspondence classes, test series and consulting. Around 80% of revenues are accounted for by classroom trainings with the remaining coming from correspondence, test series and consulting. Even though consulting offers the highest margins, its contribution to revenues is at 5%. One of IMS's key strengths lies in its mock tests called SIMCATS, which are very popular across the MBA aspirant market. Additionally, IMS has ~50% share in the international test preparation market (GMAT, GRE, SAT and consulting), though contribution to revenues is still not material.

IMS has also started various vocational courses in financial planning, wealth management, investment banking and retail management. In future, IMS expects to extend these to other high growth areas as well.

❑ Future outlook – to cover the entire bandwidth of higher education

While growth in the coming three years would come primarily from test prep business and certification programmes, inorganic initiatives, franchising model and new products would also contribute.

Expanding its horizons in Higher Education - IMS has invested in an MBA school under the brand name Praxis (started in 2007 in Kolkata) with a capacity of 160 seats (50 students currently enrolled). The company sees good prospects for the school as only a handful of B-schools are present in the East (IIM C, IIM Shillong and XLRI

Bhubhaneshwar). In the next five years, IMS plans to set up three more business schools in non-metros but high-growth areas such as Chandigarh and Gurgoan.

❑ Management Profile

- Mrs Lila Nagesh Rane (wife of late Mr Nagesh Rane, founder of IMS) owns 85% of the company.
- Mr Kamlesh Sajanani (Managing Director): A key driving force for IMS; a hotel management graduate (and Mr Rane's nephew)
- Mr Sanjay Choudhary (COO): An engineering graduate from Delhi College of Engineering and a management graduate from IIM, Bangalore.
- Mr Nilesh Sarawate (Director for Test Prep): An engineer and management graduate from TAPMI
- Mr Gejo Shreenivasan (GM for Non-Metro Partners): An engineer from IIT Madras and MBA from IIM, Calcutta

Career Launcher

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Spanning across the value chain

One of the leading players in the post grad test prep market ($200m), Career Launcher clocked revenues of ~Rs900m in FY08. Going forward, the company plans to extend its footprint across the education spectrum spanning preschools, K12 schools, higher education institutes and vocational training to providing coaching and counseling at all levels. To raise funds for the ventures, Career Launcher has indicated its plans to tap the capital markets (also, Career Launcher has so far seen private equity of $8.3m by Gaja Capital in October 2007).

❑ Leading player in post grad test preparation space

Incorporated in 1995, Career Launcher currently runs 135 coaching class centers with 70% of them franchisees; a mix of tuition classes, grad test preparation centers – mainly for IIT-JEE trainings and post-grad test preparation centres. Having established strong brand equity in the northern states, Career Launcher plans to scale up to 250+ centers over the next two years. Career Launcher is a leader in the post-grad test prep space ($200m market) with a 30% share in the MBA test prep market. The company trained 50,000 students in FY08, which it estimates to go up to 75,000 students in the current year. More than 70% of its revenues (Rs900m in FY08) come from the MBA test prep segment – the largest within the post-grad test prep space.

❑ Moving up the value chain

To achieve scalability, Career Launcher has ventured beyond the coaching class market – into K12 schools and higher education institutes in the formal education space (a $40bn market), and preschools ($300m) in the non-formal space. To start with, it has set up two standalone model Ananda schools (preschools) and five K12 schools – Indus World School. Currently, three out of these five schools are owned and two are franchisees. The company has also recently set up an MBA College in Noida – Indus World School of Business.

Exhibit 27: Business Overview

Segment	Description
Post Grad Test Prep Market	MBA Prep - CAT, XAT,MAT, IIFT, State Exams (eg. CET in Maharashtra), GMAT (JV with Veritas – 3rd largest GMAT company globally)
Grad Test Prep Market	IIT – Market leader in Mumbai (tie up with Arun Roy classes),LST - Law Student Tutorial,BBA/BMS
Tuitions	Lohana test series - 10th-12th boards, I-V Vedic maths
Preschools	Under the Career Launcher Education Infrastructure and Services (CLEIS) Ananda – A chain of preschools
Schools K12	Under CLEIS - Indus World School (currently 5 schools)
MBA College	Indus World School of Business started in June 2008

Source: Company, IDFC-SSKI Research

❑ Future outlook

Career Launcher plans to set up 125 playschools, 150 K12 schools and ~25 finishing schools (vocational training centres) in the next few years. It is also planning to set up coaching centres in other countries including Singapore, Hong Kong and South Korea – the centres are planned to be set up under its joint venture with Veritas (the third largest GMAT education company globally). To fund these initiatives, Career Launcher plans to come out with an IPO in the next couple of years.

Exhibit 28: Management Profile

Name	Designation	Past work experience	Educational qualification
Satya Narayanan	Chairman	Ranbaxy Laboratories in 1995	alumnus of St. Stephen's College, Delhi and IIM-Bangalore

Source: Company, IDFC-SSKI Research

Tutor Vista

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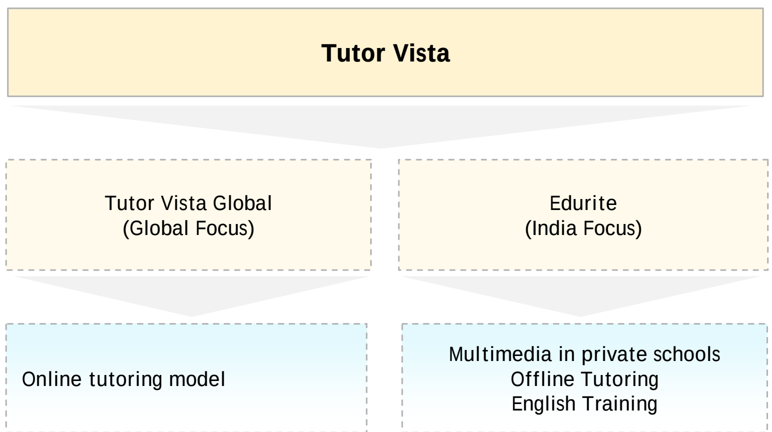
Wants to tutor India

Founded in July 2005 by entrepreneur K. Ganesh, Tutor Vista (primarily an online coaching service provider in the US as Tutor Vista Global) is now increasing its focus on India with the acquisition of Edurite (a multimedia content provider) in order to tap the high growing multimedia to private schools space and other opportunities in IES.

Exhibit 29: Tutor Vista - Business Model



Source: Companies, SSKI Research

Tutor Vista (Global): An online tutoring model, Tutor Vista Global offers low cost tutoring to students world over. The student can connect to an online tutor based in India and for $100 a month, gets access to unlimited tutoring hours for subjects like English, Maths and Science.

The USP of the model is the cost arbitrage that it offers – in the US, tutoring rates are in the range of ~$100 per hour for face to face tutoring and ~$40 per hour for online tutoring. With Tutor Vista's offerings, a student opting for two hours a day five days a week has to pay only $2.5 per hour of tutoring.

Edurite (India-focused): In order to increase its India focus, Tutor Vista has acquired an Indian company called Edurite, which has developed multimedia content for K12. With this acquisition, the company has created a presence for itself in the Multimedia for private schools space.

Tutor Vista is extending its presence in 'offline school-level tutoring' with ~25 centers (majority using the franchisee route) and using the same infrastructure to diversify into English trainings as well.

Funding: Tutor Vista has had four rounds of funding till date.

Exhibit 30: Funding till date

Sequoia Capital	Online tutoring (US focus)	2	Jun-06
Lightspeed Venture Partners & Sequoia Capital	Online tutoring (US focus)	10	Dec-06
Manipal Education	Online tutoring (increasing India focus)	2.5	Oct-07
Lightspeed Venture Partners	Tutoring	18	Jul-08

Source: IDFC-SSKI Research

❑ Management Profile

K Ganesh (Founder and CEO): His previous venture, CustomerAsset, was started in mid-2000 targeted at the international Call Center / BPO sector. In May 2002, ICICI (India's largest bank) acquired CustomerAsset for ~$22m. Post the acquisition, Ganesh headed the Contact Center Business as President, ICICI OneSource (handling over 4,000 people and annual revenues of $30m). The company has now been renamed FirstSource and is listed on Indian bourses. Apart from founding and successfully growing the three ventures, Ganesh has worked as CEO of Bharti British Telecom – a British Telecom JV in India, and in HCL, where he held several key managerial positions. Ganesh is MBA from IIM, Calcutta and is currently on the panel of Venture Advisors of UTI Venture Funds and a charter member of TiE (The Indus Entrepreneurs).

VETA

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'Leader'in English trainings

With revenues of ~Rs600m, VETA is India's largest English training institute with 175 centers (planned to be scaled up to 500 by FY10). The centers have a 50:50 mix with respect to owned and franchisee centers. VETA has more than 90% of its revenues accrue from the Indian operations, it has a small international presence using the franchisee route. The only player to be funded within the English training space, the company has received private equity to the tune of $ 10m from SAIF capital.

❑ Company background

Founded in 1981 by V .Rajagopalan as Vivekananda Institute, the academy has focused on expansion beyond South India and developed a nationwide footprint in the past three years. VETA, which belongs to Amoha Education Pvt. Ltd. (formerly known as Vivekananda Institute), has trained more than 1.9m students, job-seekers, employed people, business people and housewives in spoken English over the last 25 years through a combination of direct class coaching and distance education courses.

❑ English training market

VETA sees a potential of 130m students in the English training market based on the number of people who can read and write English but cannot speak the language fluently. The company offers short-term courses including those of one-month duration priced at Rs2,500 and two-month duration for Rs6,000. VETA caters to the English training needs of retail students, corporates through in-house training and the home-study pack. The company has recently also forayed into soft-skill and personality development training.

Franchisee economics – In locations with population in excess of 400,000, the franchisee is required to have a 1,200-1,800 sq. ft area. The area needs to be divided into three classrooms of 300 sq. ft each and a fully-furnished front office. Initial investment is ~Rs1.2m, which entails a Rs0.5m franchisee fee for a 5-year contract period. The main operating costs include outgo on teachers' salaries and rentals. Teachers are paid Rs120-150 per hour in metros. Notably, rental costs are the key variable for ascertaining profitability of a centre.

Locations with population of 100,000-300,000 would require a 500 sq. ft area with one classroom and a fully furnished front office. This would entail an investment of Rs300,000-500,000 per centre.

Liqvid

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E-learning to Spoken English trainings

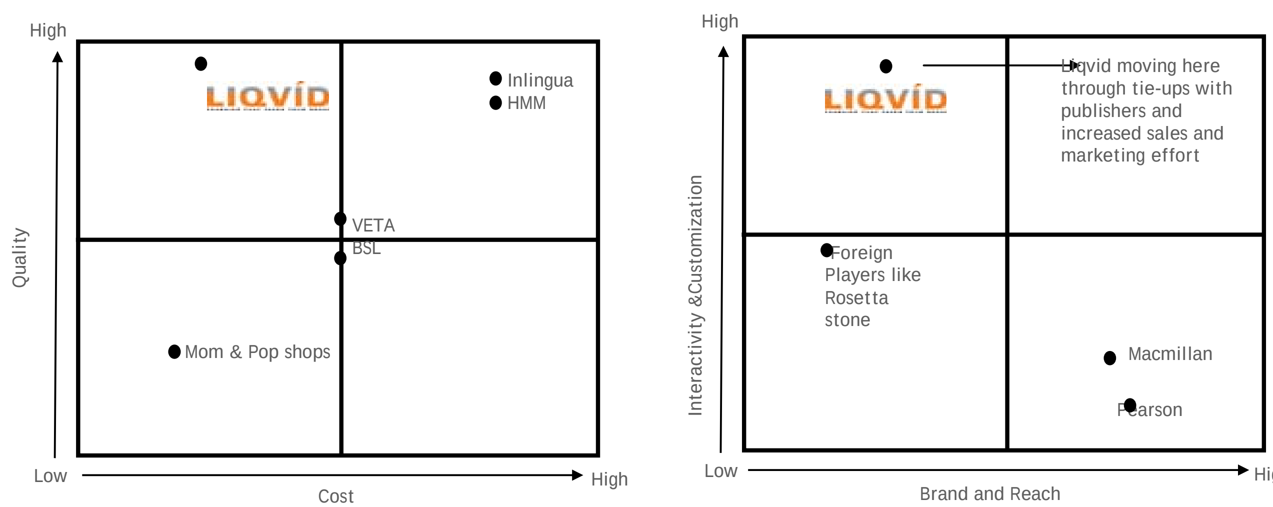
Liqvid is operational in the e-learning space and is building up its presence in the English training space in India using the product licensing route. With revenues of ~Rs80m (primarily from e-learning initiative), Liqvid expects ~70% CAGR in its business for the next five years on the back of rising demand for English trainings.

❑ Focus on English training – product licensing

Liqvid plans to derive its growth from the niche English training market. Within the market (estimated size at ~$0.5bn), the company has developed a product 'English Language Edge'. The company has invested in creating 200 hours of content in association with BBC Active (a significant brand in language trainings) targeted at customers that require English training for social, work-related and academic needs. With estimated revenues of Rs90m, the company expects revenue from English trainings to account for ~40% of the total by FY09. Currently, Liqvid's product users include players like Frankfinn (aviation and hospitality training), Jetking (IT hardware trainings) and STG.

While ~80% of the revenues are from the e-learning business (global clients such as HP, Cisco and Adobe), the company expects the services business to run in an auto-pilot mode and plans to focus aggressively on licensing its English training products.

Exhibit 31: Liqvid – growth strategy



General & Social segment – addressed through retail channel
Technology-centric approach – high-quality, low-cost model

Work & academic segments – addressed in content license mode; publisher tie-ups to provide brand awareness and reach to Liqvid

Source: Company, IDFC-SSKI Research

❑ Management Profile

Mr Vivek Agarwal (Founder and CEO): An MBA from IIM, Calcutta (1995). Keen interest in promoting education & training with the use of technology. Founder-promoter of 'eGurucool' – raised $11m in PE. Later sold to NIIT

Manish Upadhyay (Co-founder, COO and V.P.): MBA from Indian Institute of Technology, Delhi and Engineering Graduate from Birla Institute of Technology, Mesra. More than 12 years of experience in the e-learning industry.

Russell Spoken English

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Spoken English trainings

Started in 1986, Russell Spoken English is in the business of Spoken English training. Traditionally a family-run business, the company is now planning to consolidate its presence in the English language training segment using various new delivery models. With revenues in the estimated range of Rs60m-70m currently, the company expects to grow at a rate of 50 – 75% consistently, every year, for the next 5 years.

Business overview

Present withtin a highly fragmented market, the company has a presence within the spoken English training space (estimated to be at ~$0.5 bn) with 30 centers (25 owned centers, five franchisees) and 60,000-70,000 students. The company generates estimated revenues of Rs60m-70m and a net profit margin of 20%. Within the market of English and life skills training, Russells (employee strength of 300) concentrates on the spoken English segment that to the basic English speaking needs. The company delivers training using three forms:

C – Classroom. The typical profile of the customer is 18-25 years of age who is looking for a first job. A two-month course, it is priced at Rs4,000. The revenue per student differs as the company offers various short term courses as well.

D – Distance. The typical profile of the customer is between 27-35 years of age who is looking to grow within the current organization or sector.

E – e-learning. This model is typically a B2B model where corporates would invest in e-learning modules for employees.

The differentiating factor between a local unorganized player and Russels is volumes, leading to the ability to customize the course. However, revenues are inconsistent during a year – which is a key risk for the company.

Future outlook

Russell adopted the franchisee route quite recently in 2007 and has five franchisees till date. The business is seasonal in nature and a price-sensitive market (inability to charge premium to the target segment). With the franchisee business just about getting into expansion gear and the e-learning business about to start off, execution of scale remains to be seen in the business.

Management Profile

Mr. Russell Zaheer (Executive Director) is an International Diploma holder in Marketing from University of California: Berkley (Class of 2006).

Shloka Infotech

Rs24
UNRATED

Brand advantage

Mkt Cap: Rs93m; US$1.9m

A part of the Yash Birla Group, Shloka Infotech plans to extend its presence in the education space with Multimedia in private schools, ICT in government schools, preschools and K12, while moving away from the IT business that currently dominates the topline. From Rs300m in FY08, the company expects its revenues to grow to ~Rs700mn in FY09 as the education business offers high growth. While execution in various segments and ability to raise funds (estimated capex of ~Rs2.5bn over the next 5-7 years) remains to be seen a cash rich parent company and brand (Birla Group) are its key advantages.

❑ Current businesses – multimedia to private schools

Within the education vertical, Shloka has invested Rs130m in creating 3-D animated multimedia content targeted at private schools (implemented at 50 schools in Maharashtra till date) and plans to invest a further Rs500m in upgrading the existing content. While the space offers immense untapped opportunity (a $70m market with expected CAGR of 60% till 2012), execution is the key monitorable. The company has set a target of bringing 200 schools to its fold by the end of the academic year 2009-10 and 3,000-4,000 schools over the next five years.

❑ Future outlook – presence across the value chain

After making a start in the multimedia for schools space, Shloka plans to pursue ICT projects in public schools as well (a $90m market; 70% CAGR over FY08-12E). While incumbent leaders including Educomp Solutions, Everonn Systems and NIIT make it a difficult proposition, Shloka plans to bid aggressively for ICT projects against the odds. A foothold in this segment also implies another longer-term advantage for players – as it would help them consolidate their position as and when the government aggressively adopts the PPP route for public schools (recently, operations/ management of a few public schools have been handed over to private players).

Shloka is also looking to foray into the $300m preschool and the $20bn K12 (formal education) space by using a mix of owned, franchised and managed schools and plans to deploy ~Rs2.5bn in these ventures over the next five years.

❑ Management Profile

Mr. YashBirla, Chairman : He took over the reins of the group at an early age of 23 and has been heading the group successfully by setting very high standards of performance in all areas of businesses for the past 16 years. He has been successfully heading The YashBirla Group which consists of various group companies in Engineering, Lifestyle, Health, Education and Travel.

Mr. N. Srikrishna, Chief Executive Officer :A Civil Engineer with over 16 years of experience in various fields like Education, Infrastructure and Media. He is been instrumental in implementing various education projects for various prestigious universities like Anna university.

Mr. PVR Murthy, Group Finance Director : A Chartered Accountant and an MBA. Has worked as a part of the top management team in companies like Sunflag Group of Companies, Aryaman Financial Securities Ltd.

Mr. Devang Vyas, Group President, Strategy & Business Development : An MBA from Stanford University and a Chemical Engineer from UDCT, with an experience of over 14 years in of management consulting & industry.

Mr. Kedar Lathkar, Vice President, Finance & Strategy: A Chartered Accountant with over 10 years of experience in Finance & Operations in Education and IT industry. He heads the finance and strategy function in education business of The YashBirla Group.

Exhibit 32: Financials

Year to 31 March (Rs m)	FY04	FY05	FY06	FY07	FY08
Operating Income	10.5	10.5	10.7	5.7	384
Other Income	0.7	1.5	0	4.7	4
Stock Adjustments	0	0	0	(0.1)	0
Total Income	11.2	12	10.7	10.3	388
Operating Profit	**-8.5**	**3.2**	**3**	**3**	**13.4**
Interest	1.1	0	0	0	0.1
Gross Profit	(9.6)	3.2	3	3	13.3
Depreciation	2.2	2.1	2.4	2.5	2.3
Profit Before Tax	**(11.8)**	**1.1**	**0.6**	**0.5**	**11**
Tax	0	0	0	0	0.4
Fringe Benefit tax	0	0	0	0	0
Deferred Tax	(0.2)	0.5	0.1	(0.1)	(0.8)
Reported Net Profit	(11.6)	0.6	0.5	0.6	11.4
Extraordinary Items	(5.3)	0	0	0	0
Adjusted Net Profit	**(6.3)**	**0.6**	**0.5**	**0.6**	**11.4**

Source: Conpany

Hurix

UNLISTED

E-learning to multimedia

A content service provider, Hurix is a provider of e-learning solutions with focus on content creation, digital conversion, management and delivery of content services. The company operates in the education space as it offers content services largely to global publishing houses for digitizing their content. All of Hurix's revenues come from the US. Hurix has been one of the fastest growing companies in a highly fragmented market (more than 100 companies operational with less than $2m in revenues). Going forward, Hurix is planning to invest in an assessment product that will be licensed to corporates with testing and assessment needs. With revenues of ~$11m in FY08, Hurix expects to grow at 40-50% in the coming period (management has lowered its expectation in view of the slowdown) and a recent foray into the Multimedia for schools space within IES.

❑ Focus on the education e-learning market

Though the corporate e-learning market is larger at an estimated $300m-500m, it offers low margins and little scalability as also lack of earnings visibility as contracts are short-term in nature. Hence, Hurix has limited its focus to the education e-learning space. The company generates its revenues entirely from the US market. The US e-learning (publishing) market is estimated to be $12bn-15bn in size, of which 10% is accounted for by digital content (e-books). In the US, sales of text books have seen a decline and there is a correspondingly higher demand for e-content for various devices, phones, etc.

E-books – Publishers want to lever the internet to provide interactive e-content to their customers. For example, a reader buys a hard copy of a book on DSP (digital signal processing) with an access code within the book, which enables the customer to log on to the website and view an interactive e-section on DSP at no additional cost (embedded in price of the hard copy).

❑ Planned entry in IES

Hurix is also focusing on IES and has entered into a tie-up with a leading System Integrator in India to address opportunities in the digital education content (for schools) market. This relationship leverages Hurix's world-class content development capability.

Hurix has employee strength of 500+ and sales offices in Chicago, Dallas, New Jersey, London and Singapore.

❑ Management Profile

Subrat Mohanty (Co-founder & CEO): He has more than 12 years of experience in the field of e-learning and digital content. Mr Mohanty holds a bachelor's degree in technology from IIT, Kharagpur, and an MBA from IIM, Ahmedabad.

Viswamitra Hariharan (Co-founder & CEO): Mr Hariharan started his career in the technology sector. He has also worked as an equity analyst in the Indian IT services sector. Following this, he was an investment banker with the Bank of America, Hong Kong in its technology banking and M&A practice. In 2000, Mr Hariharan quit his investment banking job to set up Hurix along with Mr Mohanty. Mr Hariharan holds an MBA degree from IIM, Ahmedabad.

Excel Soft

UNLISTED

E-learning to trainings

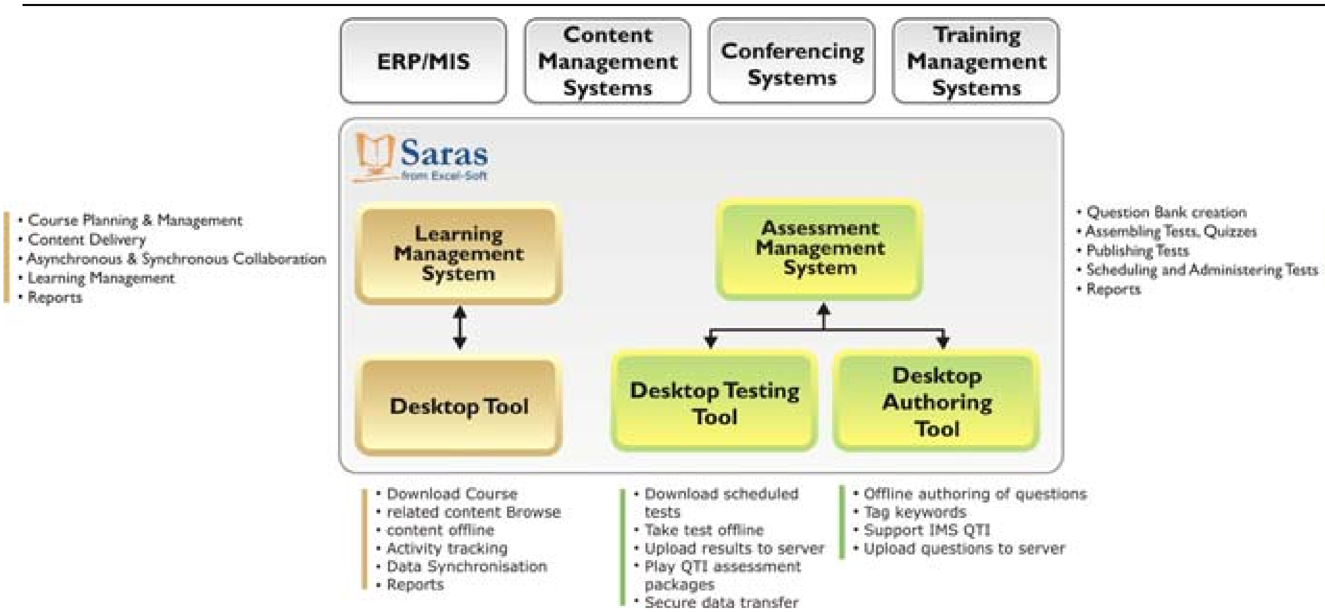
Started in 2001, Excel Soft provides e-learning (technology and content) solutions to players within the education and training space. A product and services business, the target customer segments include text book publishers, corporates and academic institutions offering e-learning systems to their customers, employees and students. Going forward, Excel Soft plans to tap the potential offered by the vocational training space in India. The company expects to generate revenues of Rs800m and PAT of Rs400m for FY09.

❑ E-learning space – primarily export revenues

Within the e-learning space, Excel Soft is primarily a technology and content solutions company with ~95% of its revenues from overseas markets including USA, UK, Europe, Middle East and the Asia Pacific region.

- **Technology solutions (e-learning systems):** A products business, margins range between 50-55%. The business involves licensing technical platforms (e.g. SARAS under the product suite of Excel Soft) that enable clients (companies/ institutions) to implement their learning and training programmes. The product is licensed typically for a period of five years. The revenues in this business come in the form of a yearly license fee, which is escalated by 50-100% yoy. Depending on the nature of the contract, additional revenues could accrue from AMC and other services as also a revenue sharing arrangement.

Exhibit 33: Product suite - SARAS



Source: Company

- **Content solutions:** Excel Soft is moving from being a pure technology provider to a content development player. A services business, it earns margins of 30-40% from this activity. The company largely works on a hire and produce model for content development based on the storyboard provided. *e-books* is one of Excel Soft's content solution services for clients (publishers) that want to lever the internet to provide interactive e-content to buyers of their books. For example, a reader buys a hard copy of a book on DSP (digital signal processing) that contains an access code within the book. The reader can use the access code to log on to the website and view an interactive e-section on DSP, and at no additional cost (embedded in price of the hard copy).

With a view to move up the value chain in content solutions, Excel Soft has begun to develop its own IP content. The company is currently working on a project in India which involves developing curriculum design for numerous courses. A B2C model in the infancy stage and execution remains to be seen.

❑ Future outlook; setting up vocational training centers is the next step

Excel Soft plans to lever its technology strengths to own brick-and-mortar vocational training institutes. The management is looking to initially set up a few Centers of Excellence and then grow using the franchisee route. The company has identified retail, media, construction and finance as the key areas for the ventures. Excel Soft is also scouting for a suitable foreign partner to source quality content (for the start-up centers; later, it plans to produce its own curriculum and content) and is also in talks with Indian institutes like CII and NIOS for certifications to provide value to users going abroad.

Exhibit 34: Management Profile

Name	Designation	Past work experience	Educational qualification
Mr D. Sudhanva	CEO & MD	teaching, software development, and e-governance	Bachelor's Degree in Instrumentation Technology, and Master's Degree in Electrical Engineering

Source: Company, IDFC-SSKI Research

IDFC - SSKI INDIA

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Explanation of Ratings:

1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

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