

Educomp Solutions Ltd – BUY

CMP Rs627, Target Rs735

Sector: Education

Sensex:	17,266
CMP (Rs):	627
Target price (Rs):	735
Upside (%):	17.2
52 Week h/l (Rs):	1017 / 472
Market cap (Rscr) :	5,964
6m Avg vol ('000Nos):	2,010
No of o/s shares (mn):	95
FV (Rs):	2
Bloomberg code:	EDSL IB
Reuters code:	EDSO.BO
BSE code:	532696
NSE code:	EDUCOMP

Prices as on 13 May, 2010.

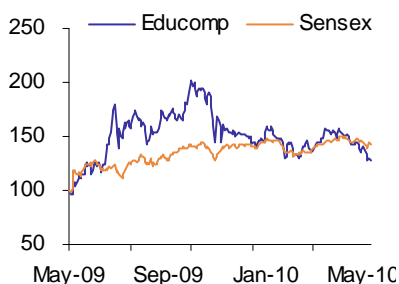
Shareholding pattern

March '10	(%)
Promoters	50.1
Institutions	42.2
Non promoter corp hold	2.5
Public & others	5.2

Performance rel. to sensx

(%)	1m	3m	1yr
Educomp	(13.4)	(10.8)	(18.6)
Everonn	2.7	(10.5)	83.5
Core Proj	(4.1)	1.9	74.2
NIIT	(0.4)	(7.4)	94.3

Share price trend



- ⊕ Smart Class revenues below estimate in Q4 FY10; company guides for healthy 32-40% growth in FY11
- ⊕ Margin in the K-12 segment contract sharply while revenue performance was strong; HLS segment continues to be in investment mode
- ⊕ Overall consolidated performance below expectations; Management guides for modest 25-30% revenue growth and 22-25% earnings growth in FY11
- ⊕ Downgrade earnings estimates but maintain BUY on recent stock price correction

Result table

(Rs mn)	Q4 FY10	Q3 FY10	% qoq	Q4 FY09	% yoy
Net sales	3,331	2,601	28.1	2,265	47.1
Operating profit	1,590	1,363	16.7	916	73.6
OPM (%)	47.7	52.4	(470) bps	40.4	730 bps
Depreciation	201	338	(40.5)	284	(29.3)
Interest	128	139	-	80	-
Other income	99	131	(23.9)	387	(74.3)
PBT	1,360	1,017	33.8	938	44.9
Tax	755	375	101.4	372	102.8
Effective tax rate (%)	55.6	36.9	-	39.7	-
Minority interest	3	(30)	-	(12)	-
Adjusted PAT	607	611	(0.7)	554	9.6
Adj. PAT margin (%)	18.2	23.5	(530) bps	24.5	(620) bps
Extra ordinary items	(7)	1	-	-	-
Reported PAT	600	612	(2.0)	554	8.3
EPS (Rs)	6.3	6.5	(2.1)	6.4	(1.5)

Segmental Performance

Revenues (Rs mn)	Q4 FY10	Q3 FY10	% qoq	Q4 FY09	% yoy
SLS	2,690	1,987	35.4	1,665	61.5
HLS	78	78	(0.4)	87	(10.8)
K-12 Schools	302	251	20.4	237	27.1
OS&G	262	285	(8.3)	275	(4.7)
Total	3,331	2,601	28.1	2,264	47.1
Revenue Share (%)	Q4 FY10	Q3 FY10	chg qoq	Q4 FY09	chg qoq
SLS	80.8	76.4	4.4	73.5	7.2
HLS	2.3	3.0	(0.7)	3.9	(1.5)
K-12 Schools	9.1	9.6	(0.6)	10.5	(1.4)
OS&G	7.9	11.0	(3.1)	12.1	(4.3)
EBIT (%)	Q4 FY10	Q3 FY10	chg qoq	Q4 FY09	chg qoq
SLS	60.5	61.2	(0.8)	43.4	17.0
HLS	(50.0)	(52.7)	2.7	14.6	(64.6)
K-12 Schools	29.3	41.1	(11.8)	41.1	(11.8)
OS&G	(15.2)	(16.5)	1.3	2.4	(17.6)
Total	49.1	47.3	1.8	37.1	12.0

Source: Company, India Infoline Research

Smart Class revenues below estimate in Q4 FY10; company guides for healthy 32-40% growth in FY11

In Q4 FY10, Smart Class revenues stood significantly below our expectations at Rs2.41bn. It comprised of Rs831mn under the new Edusmart model, Rs1.55bn on account of the transfer of the remaining BOOT contracts (content deferment revenues) and Rs31mn of export revenues. During the quarter, company signed 720 schools (6,000 classrooms) and completed implementation of 503 schools (4,038 classrooms). With an average of eight classrooms per school, the size of the schools added was significantly small. Revenue recognized/classroom was Rs205,800 being 52.5% (recognition in the 1st year under the new model) of the contract price of Rs392,000 (implying per student per month charge of Rs145). Full-year revenues of the Smart Class business were Rs6.45bn representing a yoy growth of 41% after eliminating the impact of transfer of existing schools and Edusmart model.

In FY11, management has guided for revenues of Rs8.5-9bn implying a healthy growth of 32-40% yoy. Of the above, Rs5.5-6bn is expected via organic growth ie addition of new classrooms while the balance would pertain to the content revenues deferment of the previous year relating to the contracts transferred. The organic growth guidance is based on expectation of 25,000-30,000 classrooms addition during the year, a 50-80% growth over last year. Over the next 6-7 years, Educomp targets to cover 300,000 classrooms under the Smart Class business compared to 65,000-70,000 at the end of FY10.

ICT revenues were in-line; segmental revenue share to decline over next two years

Revenues under the ICT segment were Rs271mn in Q4 FY10 being 50% lower yoy on account of weak school addition in the past three quarters. During the quarter, company added 600 schools through a project from the Government of Bihar for implementation of computer education across 13 districts over the period of three years on BOOT basis. For the full-year, revenues were up 40% yoy to Rs1.58bn. Going ahead, ICT's revenue share would come down materially as company has decided to allocate limited capital towards this business and be more selective in bidding for upcoming projects.

Margin in the K-12 segment contract sharply while revenue performance was strong

At the end of FY10, Educomp had 43 operational K-12 schools (including Dry Management schools), of which, 29 high schools were under Edu Infra and 14 were under Eurokids (Euroschools). Overall, these schools have over 24,000 students. In Q4 FY10, 7 new schools became operational. Presently, company has a total visibility of 69 schools with 26 land sites and under-construction sites. Management hopes to end FY11 with 75 operational schools implying that all the 26 schools in the pipeline would become operational in the current year itself.

Edu Infra revenues grew by robust 67% yoy Rs149mn in Q4 FY09 while it was stable on qoq basis. OPM contracted sharply qoq from 75% to 58% which can be attributed to the 7 schools commencing operation in the quarter. For the full-year, revenues grew by 42% to Rs551mn while margin declined to 67%. Management expects 70-80% growth in revenues from high schools over the next few years. The current capacity utilization of the company's high schools is less than 20%. Eurokids operational performance after having deteriorated in the past three quarters sprung a positive surprise with ~100% revenue growth and significant margin improvement on sequential basis. Partially, this was driven by improved utilization of the 14 Euroschools that became operational in the first half of the year. Consolidation continues in company's Roots-to-Wings pre-school business with the number of franchised schools declining. Revenues were flat qoq while the business managed to record profit for the second consecutive quarter. Overall, K-12 segment revenues were up 20% qoq driven by Eurokids while margin declined sharply by 12ppt qoq impacted by the profitability fall in Edu Infra and higher revenue contribution of Eurokids (41% v/s 28%).

HLS segment continues to be in investment mode

The HLS segment of Educomp comprising professional development business, Raffles JV for higher education and Pearson JV for vocation training remains in the investment mode. Revenues were flat qoq while loss at the operating level continues due to huge expansionary investments in the latter two ventures.

By the end of Q4 FY10, Educomp had three 'Raffles Millennium International' colleges operational in Delhi, Bangalore and Chandigarh. There are lease agreements signed for 4 new colleges in Kolkata, Hyderabad, Ahmedabad and Chennai and these colleges are ready to begin sessions in June 2010.

Under the ETEN CA initiative, company has 100 operational centers with ~11,000 enrollments for the May batch. Educomp is planning to offer a course in Civil Services in the future. Purple Leap has a network of 80 operational centers with total enrolments under various programs at over 3700 students. Current course offerings include various IT programs, summer certification programs and professional development programs. For vocational training, company has a network of 40 operational centers. Current course offerings include Basic IT & English Foundation and intermediate programs. New programs under development include Media, Sales & Retail, Pilot Travel, Tourism and Ticketing. Management targets to reach over 100 centers by the end of Q1 FY11 including 30 centers to be owned by the company.

Overall consolidated performance below expectations; Management guides for modest 25-30% revenue growth and 22-25% earnings growth in FY11

Educomp's consolidated revenues grew by 28% qoq and 47% yoy to Rs3.33bn. Revenue growth continues to be driven by the Smart Class and high schools (under Edu Infra and Euroschools) businesses. The SLS and K-12 segments combined revenue contribution increased to 90% from 86% in the previous quarter. Consolidated OPM contracted by ~500bps on qoq basis to 47.7% mainly driven by the sharp margin decline in the K-12 segment. Depreciation was significantly lower qoq due to reduction in the net fixed assets on transfer of the old contracts to Edusmart. Net profit stood at Rs604mn reflecting a decline of 6% on sequential basis and a modest 7% growth yoy. For FY11, management has guided for revenues of Rs13-13.5bn (25-30% yoy growth) and net profit of Rs3.3-3.35bn (22-25% yoy growth).

Downgrade earnings estimates but maintain BUY on recent stock price correction

Post the lower-than-expected Q4 FY10 results and more clarity with respect to revenue recognition under the new model of Smart Class, we revise downwards FY11 and FY12 revenue, OPM and earnings estimates. While revenues have been downgraded by 19% and 5% respectively, the profits have been lowered by 29% and 7% respectively. However, a compensating 20% stock price correction in the past two months keeps valuations attractive at 12x FY12 P/E. We maintain BUY with a revised target price of Rs735. We expect Educomp to become FCF positive from FY11 as the new securitization model in Smart Class business would lead to higher cash profits generation, contraction in working capital cycle and reduction in capex intensity.

Financial summary

Y/e 31 Mar (Rs m)	FY09	FY10E	FY11E	FY12E
Revenues	6,371	10,405	14,486	18,167
Yoy growth (%)	122.7	63.3	39.2	25.4
Operating profit	3,044	4,859	6,953	9,084
OPM (%)	47.8	46.7	48.0	50.0
Reported PAT	1,339	2,719	3,612	5,082
Yoy growth (%)	88.3	104.2	33.1	40.7
EPS (Rs)	15.5	28.7	36.0	50.7
P/E (x)	40.5	21.9	17.4	12.4
P/BV (x)	12.6	3.5	3.1	2.5
EV/EBITDA (x)	20.1	12.8	8.5	6.3
RoE (%)	36.3	25.5	19.2	22.1
RoCE (%)	23.3	23.0	21.6	29.6

Source: Company, India Infoline Research

Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

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