

Multiple Growth Drivers

Raising Estimates & PO

We raise our FY08 and FY09 EPS earnings estimates by 4% and 8% post strong 4Q and almost 90% jump in order book in 4Q. We raise our PO to Rs1600 (from Rs1270) on our higher estimates and increased FY09E PE target of 25x (vs 22x earlier) given strong EPS CAGR of 96% (FY07-09E) and potential upside from the recently launched consultancy product for schools, pre school initiative and online/ offline tutoring.

Leader in nascent, but highly scaleable education industry

We believe Educomp is at an inflexion point where it is seeing accelerating acceptance of its product, as reflected in its Smart_Class order flows and accelerated sign ups in government schools. It now intends to leverage its IP to be a mainstream player in the Kindergarten to class 12 segments through its pre school initiative, online content and school management systems.

Strong 4Q results; impressive outlook in ICT

4Q revenue and profit grew 97% yoy, beating MLe by 18% driven by out performance in its Smart_Class segment. While government school signups in 4Q (~1200) surpassed our expectations, management guidance of additional 4000 schools in FY08 is higher than our expectations of 2600 schools.

Retain Buy on secular growth story; Q1 seasonally weak.

We believe Educomp is a play on growing adoption of computer aided learning solution by schools in India. It is a leader and pioneer in this nascent and highly scaleable sector. It also stands out amongst our coverage as being insulated from the US macro and Rupee appreciation risks. However, we note that Q1 is a seasonally weak quarter and school sign ups are likely to be low.

Estimates (Mar)

(Rs)	2005A	2006A	2007E	2008E	2009E
Net Income (Adjusted - mn)	71	133	270	625	1,087
EPS	16.01	8.41	15.71	36.33	63.17
EPS Change (YoY)	NA	-47.5%	86.9%	131.3%	73.9%
Dividend / Share	0	1.71	2.46	5.45	9.48
Free Cash Flow / Share	(4.57)	(1.60)	(28.49)	(51.34)	(16.25)

Valuation (Mar)

	2005A	2006A	2007E	2008E	2009E
P/E	82.25x	156.67x	83.84x	36.25x	20.85x
Dividend Yield	0%	0.130%	0.187%	0.414%	0.719%
EV / EBITDA*	137.26x	82.25x	43.90x	17.07x	9.44x
Free Cash Flow Yield*	-0.090%	-0.113%	-2.16%	-3.90%	-1.23%

* For full definitions of *iQmethod*SM measures, see page 10.



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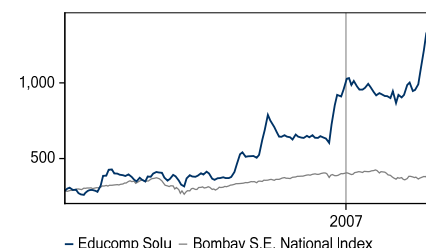
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Stock Data

Price	Rs1,317
Price Objective	Rs1,600
Date Established	30-Apr-2007
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs291.00-Rs1,454
Mrkt Val / Shares Out (mn)	US\$552 / 17.2
Average Daily Volume	40,700
ML Symbol / Exchange	EUSOF / BSE
Bloomberg / Reuters	EDSL IN / EDSO.BO
ROE (2007E)	17.1%
Net Dbt to Eqty (Mar-2006A)	-55.6%
Est. 5-Yr EPS / DPS Growth	53.0% / 53.0%
Free Float	35.0%



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Refer to important disclosures on page 11 to 12. Analyst Certification on page 9. Price Objective Basis/Risk on page 9.

30 April 2007

*iQprofile*SM Educomp Solutions Ltd.

Key Income Statement Data (Mar)

(Rs Millions)	2005A	2006A	2007E	2008E	2009E
Sales	332	555	1,065	2,183	3,451
Gross Profit	231	369	653	1,548	2,641
Sell General & Admin Expense	(74)	(107)	(163)	(287)	(361)
Operating Profit	105	205	394	908	1,625
Net Interest & Other Income	12	9	36	39	22
Associates	NA	NA	NA	NA	NA
Pretax Income	118	214	430	947	1,647
Tax (expense) / Benefit	(45)	(79)	(159)	(322)	(560)
Net Income (Adjusted)	71	133	270	625	1,087
Average Fully Diluted Shares Outstanding	4	16	17	17	17

Key Cash Flow Statement Data

Net Income (Reported)	72	134	270	625	1,087
Depreciation & Amortization	51	56	97	353	655
Change in Working Capital	(59)	(100)	(225)	(324)	(527)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	34	46	25	0	(1)
Cash Flow from Operations	98	137	167	654	1,215
Capital Expenditure	(118)	(162)	(658)	(1,538)	(1,495)
(Acquisition) / Disposal of Investments	(10)	(11)	0	0	0
Other Cash Inflow / (Outflow)	31	6	0	0	0
Cash Flow from Investing	(98)	(167)	(658)	(1,538)	(1,495)
Shares Issue / (Repurchase)	0	557	0	0	1
Cost of Dividends Paid	0	0	(42)	(94)	(163)
Cash Flow from Financing	12	616	1,070	(94)	329
Free Cash Flow	(20)	(26)	(490)	(883)	(280)
Net Debt	22	(499)	(1,079)	(102)	340
Change in Net Debt	3	(580)	(580)	977	442

Key Balance Sheet Data

Property, Plant & Equipment	146	252	813	1,997	2,836
Other Non-Current Assets	15	23	23	23	23
Trade Receivables	191	260	465	735	1,177
Cash & Equivalents	23	609	1,189	211	260
Other Current Assets	42	66	94	155	247
Total Assets	417	1,210	2,583	3,122	4,544
Long-Term Debt	45	110	110	110	600
Other Non-Current Liabilities	20	16	16	16	16
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	125	187	194	202	209
Total Liabilities	190	313	320	328	826
Total Equity	227	897	2,263	2,794	3,718
Total Equity & Liabilities	417	1,210	2,583	3,122	4,544

*iQmethod*SM - Bus Performance*

Return On Capital Employed	NA	21.2%	16.3%	23.8%	30.1%
Return On Equity	62.6%	23.8%	17.1%	24.7%	33.4%
Operating Margin	31.8%	37.0%	37.0%	41.6%	47.1%
EBITDA Margin	47.2%	47.2%	46.1%	57.8%	66.1%

*iQmethod*SM - Quality of Earnings*

Cash Realization Ratio	1.4x	1.0x	0.6x	1.0x	1.1x
Asset Replacement Ratio	2.3x	2.9x	6.8x	4.4x	2.3x
Tax Rate (Reported)	38.3%	36.9%	37.1%	34.0%	34.0%
Net Debt-to-Equity Ratio	9.8%	-55.6%	-47.7%	-3.6%	9.1%
Interest Cover	NM	34.6x	29.7x	NM	NM

Key Metrics

* For full definitions of *iQmethod*SM measures, see page 10.

Company Description

Set up in 1994, Educomp is India's largest provider of technology driven education solutions co. It provides end to end solutions for K12 through licensing of digital content to enhance the teaching process. It aims to be a comprehensive provider of solutions in Indias school education economy and has expanded its offerings to cater to pre schools, online tutoring, professional development for teachers etc.

Stock Data

Price to Book Value 10.0x

Raising Estimate, Raising PO

Post impressive 4Q wherein Educomp reported record school signups in both private school and government school segment, we raise FY08 and FY09 estimates by 4% and 8% on back of strong outlook on Smart_Class and likely increase in government school sign ups.

Table 1: Revised Estimates

Revised Estimates (Rs.mn)	Earlier FY08E	Revised FY08E	Change (%)	Earlier FY09E	Revised FY09E	Change (%)
Sales	2150	2183	2%	3160	3451	9%
PAT	599	625	4%	1011	1087	8%
EPS (Rs)	35	36	4%	59	63	8%

Source: Merrill Lynch Estimates

Our revised PO of Rs1600 is set at 25x FY09E (vs our earlier PE target of 22x) which we believe is justified on strong EPS CAGR 07-09E (96%). Our higher PE target is also supported by growing leadership status in relatively nascent but highly scaleable education content industry, likely earnings upside from its new Intellectual Property based initiative (Learning Leadership System) and thought leadership in K-12 space.

Strong order book..maintain Buy

We maintain our Buy on the stock given strong earnings growth and visibility of earnings. Its quarter end order book increased to Rs3170mn up from Rs1700mn during last quarter.

...But 1Q seasonally weak quarter.. Prices could be range bound near term

We note that 1Q is seasonally a weak quarter for Educomp as school sign up in Smart_Class are likely to be low (due to school closure) and tend to pick up only from 2Q. Besides, 1Q historically contributes only 10-15% of yearly profits.

Stock prices too have appreciated by 39% since our initiation in early April and could be range bound in near term.

Expanding IP/service offerings to be end-to-end providers for school education

4Q also reflected Educomp's ambition to be a mainstream player in India's school education economy (K-12, Kindergarten to Class 12). Key strategy is to leverage its service offerings and IP including Learning Leadership system, Pre school initiative and online/offline tutoring market.

Learning leadership system

Learning Leadership System aims to transform the functioning of schools by providing a one stop solution to schools for teaching methodology, comprehensive and well planned text books and teacher training.

Created in association with DPS Ghaziabad, one of India's leading group of schools, Educomp has already licensed the product to two schools in Chennai and Bangalore. This would enable Educomp to garner larger share of school fees.

Pre School initiative

It has already set –up three preschools in Delhi. At the core of this offering is its research driven curriculum which outlines a well planned schedule for students/teachers to follow. It now expects to set up 15-20 own schools across India over next one year and would later look at franchisee route to leverage its brand across India.

Online/offline tutoring market - large market, increased pricing

A highly fragmented market Educomp expects the offline domestic tutoring market at US\$1bn. While we await clarity on its offering on offline tutoring, it continues to make steady progress in online content market.

Mathguru subscriber base crossed 9500 recently (up from ~4300) and management has also upped its fee by 50% to Rs1800 p.a. Mathguru contributed over Rs10mn during FY07, with EBITDA margins in excess of over 85%.

Guidance in line with MLe

Post impressive 4Q Educomp has guided at revenue growth of 97-107% and PAT growth of 94-112%. It expects Smart_Class to contribute 45% to revenues and ICT to contribute 32% to revenues during FY08.

Table 2: FY08 Guidance

Guidance (Rs.mn)	FY08	yoy (%)	Mle
Sales	2100-2200	97-107	2183
PAT	550-600	94-112	629

Source: Company, Merrill Lynch Research

4Q results...ahead of MLe

Educomp reported 4Q results, where revenues grew by 97% to Rs499mn, 10% ahead of MLe and Profits grew by 97% yoy to Rs131mn, 18% ahead of MLe.

Growth was largely driven by 159% growth in Smart_Class, which contributed 50% to revenues up from 38% last year.

Table 3: FY07 analysis

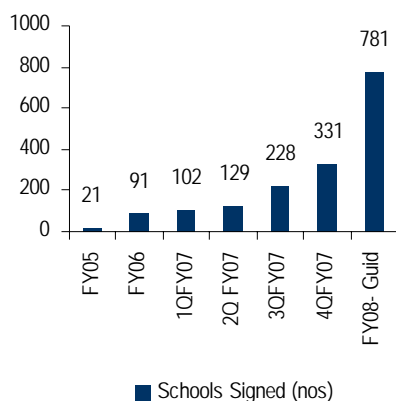
Educomp (Rs.mn)	FY07	FY06	YoY	MLe	Variance
Revenue	1065	555	91.8%	1019	5%
Segment Sales break up	FY07	FY06	YoY	MLe	
Smart_Class	466	201	131.9%	419	11%
ICT	301	159	89.9%	329	-9%
Professional Dev	175	123	42.6%	180	-3%
Retail/ Others	123	73	68.6%	90	36%
Total	1065	555	91.8%	1019	5%
Total Expenditure	562	288	95.3%	551	2%
EBITDA	503	267	88.1%	468	7%
Depreciation	97	56	71.6%	92	5%
EBIT	406	211	92.5%	376	8%
Other Income	49	15	236.5%	30	63%
Interest	13	6	123.1%	9	52%
PBT	442	220	101.2%	397	11%
Tax	159	79	101.5%	135	18%
PAT	283	141	101.0%	262	8%
Other adj	0	2	-100.0%	0	
PAT	283	139	103.9%	262	8%

Table 3: FY07 analysis

Margins			bps		
EBITDA Margin	47.2%	48.2%	(94.6)	45.9%	
EBIT Margin	38.2%	38.0%	12.5	36.9%	
PAT Margin	26.6%	25.3%	121.4	25.7%	
Effective Tax Rate	36.0%	36.0%	4.9	34.0%	
Quarterly analysis	4Q FY07	4Q FY06	YoY	MLe	Variance
Segment Sales break up					
Smart_Class	249	96	159%	203	23%
ICT	124	107	16%	152	-19%
Professional Dev	42	46	-10%	46	-10%
Retail/ Others	84	5	1756%	51	64%
Total	499	254	97%	452	10%
PAT	131	66.62	97%	111	18%

Source: Company

Chart 1: Expects 2x growth in sign ups



■ Schools Signed (nos)

Source: Company

Strong Smart_Class guidance

Educomp reported yet another strong quarter in its Smart_Class segment, with revenue growth of 159% yoy and PBIT margin of 58%. Year ending school signups stood at 331 higher than our estimate of 303 schools.

Management commented that interest levels for its offering remains high and closure rates have improved in the recent past. It believes Smart_Class is likely to be the norm for schools going forward.

Large deals happening

Few of its recent sign ups include Rs90mn contract from South India- based State Bank Officer association (SBOA) chain for implementing Smart_Class in two schools (272 class rooms) and order from Bhartiya Vidya Bhavan Chain.

It has now guided at 450 school additions for FY08. We retain our stance of 5 fold increase in school sign ups to 1250 schools by FY09E.

ICT could surprise... order flows improving

While ICT revenue growth of 16% yoy was lower than MLe by 19%, quantum of deal closure surpassed our expectation. Number of government schools signed up increased from 613 to 2946 during the year.

FY08 could surprise

With current backlog of 1200 schools to be implemented, Educomp is starting its FY08 on strong note. Management commented that adoption of computer aided learning (CAL) in schools by state governments was gaining traction and it expects three fold increase in tenders to be released during FY08.

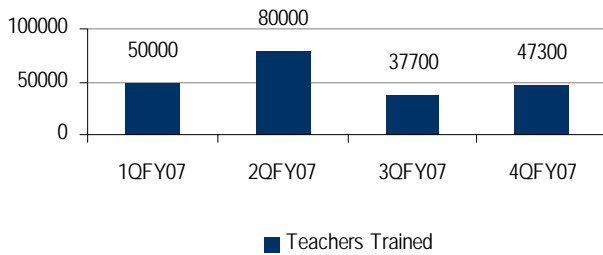
It has already bid for Tender from Government of Gujarat for CAL implementation in 4800 schools. It expects to add 4000 additional schools during FY08 vs our expectations of 2600 school additions. Besides it expects most of these to be content oriented vs just computer literacy.

Other initiatives on track

Professional Development Program

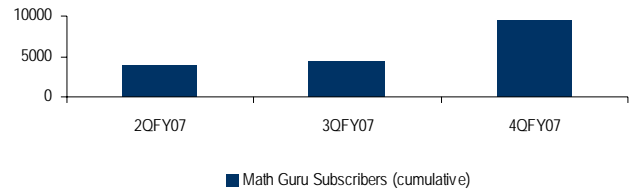
It reported 43% yoy increase in its professional development program during FY07, in line with MLe. It trained 215,000 teachers during the year and has trained nearly 655,000 to date. With nearly five million teachers, Educomp expects this division to grow at 30-35% yoy.

Chart 2: Teachers trained during the last 4 quarters



Source: Company

Chart 3: Math guru.com subscriber trends



Source: Company

Pre School Initiative

It commenced three preschools under its Roots to Wings brand and aims at setting up 15-20 own schools during FY08.

Retail initiative - MathGuru

Its online portal- mathguru.com saw its subscriber base increasing to 9500. Management also increased the fees to Rs1800 from Rs1200 for the current fiscal. It expects overall subscriber base to cross 30,000 + over the next one year.

Financial Tables

Table 4: Profit and Loss

Rs mn (year-end March)	FY05	FY06	FY07E	FY08E	FY09E
Sales	332	555	1065	2183	3451
Other income	13	15	49	48	31
Total Income	345	570	1114	2231	3482
Cost of goods sold	34	95	237	344	404
Personnel expenses	68	91	174	291	406
Salaries, allowances and bonus	65	87	112	194	266
Administration and other expenses	74	107	163	287	361
Total Expenditure	179	288	562	922	1171
EBITDA	153	267	503	1261	2281
Depreciation	51	56	97	353	655
EBIT	102	211	406	908	1625
Finance charges	0	6	13	9	9
EBT	102	205	393	899	1617
PBT	114	220	442	947	1647
Total Taxes	45	79	159	322	560
Profit after tax, minority interest & pre-acquisition profits	67	139	283	625	1087

Source: Company, Merrill Lynch estimates

Table 5: Balance Sheet Details

Shareholders' funds Rs mn (year-end March)	FY05	FY06	FY07E	FY08E	FY09E
Share capital	45	160	172	172	172
Reserves and surplus	181	736	2089	2620	3544
Net worth	226	895	2261	2792	3716
Minority Interest	1	2	2	2	2
Loan funds					
Secured Loans	44	109	109	109	600
Term Loan from Bank	28	109	109	109	600
Deferred tax Liability	20	16	16	16	16
Total Sources of funds	293	1023	2389	2920	4335
Fixed assets					
Gross Block	259	375	1032	2570	4065
Less: Accumulated Depreciation	133	190	286	640	1295
Net Block	126	185	746	1931	2770
Capital Work in Progress	20	67	67	67	67
Total	146	252	813	1997	2836
Investments	10	21	21	21	21
Current assets, loans and advances					
Inventories	10	17	19	21	23
Sundry debtors	191	260	465	735	1177
Cash	23	609	1189	211	260
Loans and Advances	32	49	74	134	224
	257	935	1747	1101	1685
Less current liabilities and provisions					
Liabilities	86	81	88	95	103
Provisions	38	106	106	106	106
Less current liabilities and provisions	125	187	194	202	209
Net current assets	132	748	1553	900	1475
Miscellaneous expenditure	1	1	1	1	1
Total Applications	293	1023	2389	2920	4335

Source: Company, Merrill Lynch estimates

Table 6: Cash Flow Statement

	FY05	FY06	FY07E	FY08E	FY09E
Cash flows from operating activities					
Net profit before taxation and after prior period items as per P&L	114	221	442	947	1647
Depreciation	45	56	97	353	655
Operating profit before working capital changes	164	282	551	1301	2301
Trade & other receivables	-61	-70	-205	-270	-442
loans & advances	-13	-17	-26	-59	-90
Trade & other payables	16	-6	7	7	8
Cash Generated from operations	106	182	327	976	1775
Taxes paid (Net of TDS)	-7	-46	-159	-322	-560
Net cash from operating activities	98	137	167	654	1215
Cash flows from investing activities					
Purchases of fixed assets	-118	-162	-658	-1538	-1495
Net cash used in investing activities	-98	-167	-658	-1538	-1495
cash flows from financing activities					
Net proceeds from fresh issue of capital through IPO	0	557	0	0	1
Proceeds/ repayment of long term borrowings	16	5	0	0	491
Dividend paid	0	0	-42	-94	-163
FCCB raised	0	0	1113	0	0
Net Cash from financing activities	12	616	1070	-94	329
Net increase in cash and cash equivalents	12	586	580	-977	49
Opening cash and cash equivalents	11	23	609	1189	211
Closing cash and cash equivalents	23	609	1189	211	260

Source: Company, Merrill Lynch estimates

Table 7: Ratios

Year Mar 31 (Rs mn)	FY05	FY06	FY07E	FY08E	FY09E
P/CEPS	50	107	60	23	13
P/BV (x)	26	23	10	8	6
EV/EBIT (x)	212	102	53	24	13
EV/ Revenues	65	39	20	10	6
Growth %					
Revenue	28	67	92	105	58
EBITDA	130	75	88	151	81
EBIT	251	107	92	123	79
Net Profit	218	104	101	121	74
Profitability %					
EBITDA	46	48	47	58	66
EBIT	31	38	38	42	47
Net Profit	20	25	27	29	32
Return %					
RONW	35	25	18	25	33
ROCE	41	32	24	34	45
Per Share Data (Rs.)					
EPS -basic	15	9	16	36	63
EPS -diluted	4	8	16	36	63
CEPS	26	12	22	57	101
BVPS	50	56	131	162	216
DPS	0	2	2	5	9
FCF/Share	-1	-1	-28	-51	-16
DSO	177	148	124	100	101

Source: Company, Merrill Lynch estimates

Price Objective Basis & Risk

Our revised PO of Rs1600 is set at 25x FY09E (vs our earlier PE target of 22x) which we believe is justified on strong EPS CAGR 07-09E (96%). Our higher PE target is supported by growing leadership status in the school education economy relatively nascent but highly scaleable education content industry, likely earnings upside from its new Intellectual Property based initiative (Learning Leadership System) and thought leadership in K-12 space.

Risks to our valuation are delays in execution of contracts, relatively high DSO in government school program.

Analyst Certification

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

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30 April 2007

*iQmethod*SM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Numerator

NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill

Amortization

Net Income

Operating Profit

Expected 5-Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt, Less Cash & Equivalents

EBIT

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Sales

Other LT Liabilities

Enterprise Value

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap. = Current Share Price * Current Basic Shares

Basic EBIT + Depreciation + Amortization

*iQmethod*SM is the set of Merrill Lynch standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of *iQmethod* are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

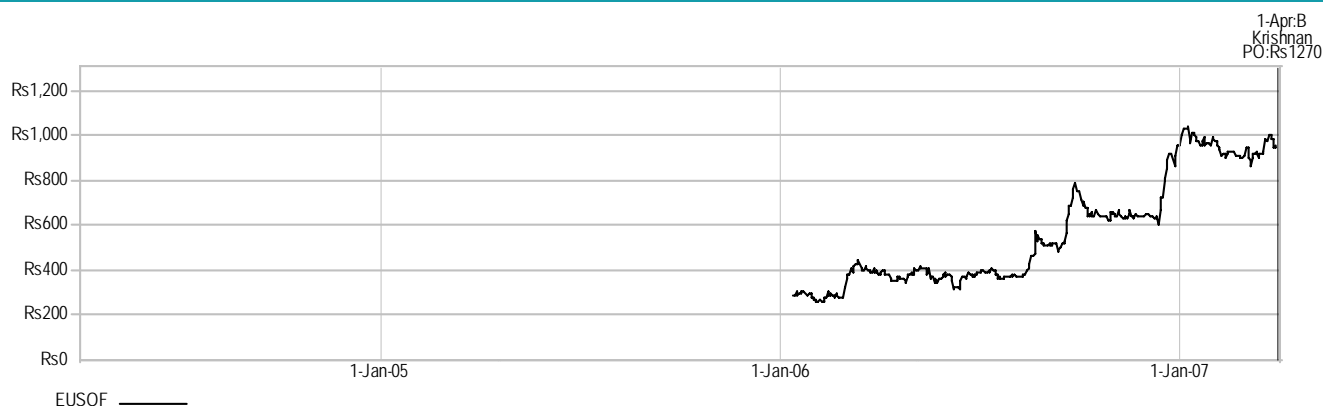
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Important Disclosures

EUSOF Price Chart



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

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of March 31, 2007 or such later date as indicated.

Investment Rating Distribution: Technology Group (as of 31 Mar 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	114	41.76%	Buy	21	20.39%
Neutral	146	53.48%	Neutral	31	22.79%
Sell	13	4.76%	Sell	1	9.09%

Investment Rating Distribution: Global Group (as of 31 Mar 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1562	45.16%	Buy	415	30.09%
Neutral	1615	46.69%	Neutral	446	30.65%
Sell	282	8.15%	Sell	49	19.76%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months.

FUNDAMENTAL EQUITY OPINION KEY: Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. **VOLATILITY RISK RATINGS**, indicators of potential price fluctuation, are: A - Low, B - Medium, and C - High. **INVESTMENT RATINGS**, indicators of expected total return (price appreciation plus yield) within the 12-month period from the date of the initial rating, are: 1 - Buy (10% or more for Low and Medium Volatility Risk Securities - 20% or more for High Volatility Risk securities); 2 - Neutral (0-10% for Low and Medium Volatility Risk securities - 0-20% for High Volatility Risk securities); 3 - Sell (negative return); and 6 - No Rating. **INCOME RATINGS**, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure); 8 - same/lower (dividend not considered to be secure); and 9 - pays no cash dividend.

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