INDIA

Education

Educomp Solutions

Initiation **23 March 2011**

Sell

Target Price: Rs425

CMP: Rs416*

Upside: 2%

**as on 23 March 2011*

In a transition phase

Educomp Solutions (Educomp), a diversified education solutions provider, is an established player in an attractive space. We like its strategy of seeking leadership in its space, its presence through the entire education value chain and strong partnerships. However, going forward, we see challenges in maintaining the growth momentum in the school learning solutions (SLS) segment (76% of revenue). We believe the company is entering a transition phase where growth in the SLS segment is set to slow down and its higher education business is expected to take time to scale-up, impacting overall financial performance. We initiate coverage with a Sell rating and a target price of Rs425.

- **SLS segment witnessing slower growth:** Growth has slowed in the SLS segment, which accounts for 76% of Educomp's revenue, pulling down the company's overall growth rate. The smart class segment (part of SLS) faces increased competition that could restrict realization per classroom. Also, in the case of the Information and Communication Technology (ICT) business, the management plans to adopt selective bidding to improve profitability. Though many contracts are coming up for renewal in these two businesses the company may not secure all the orders due to stiff competition.
- **K-12 and higher education to take time to scale-up:** While the K-12 segment is capital intensive and has a longer gestation period, it ensures recurring revenue to the company. We like the formal education space considering the shortage of quality institutions in the country. However, it will take time to scale-up this business.
- **Upside potential limited:** We believe concerns over lower growth, subsidiaries in investment phase and contingent liability from the new smart class model are priced in the current stock price. However, as most of the revenue is from non-recurring businesses, the company would have to better its performance every year to grow. The higher education business will take time to scale-up. Hence, we believe the company is entering a transition phase. We initiate coverage with a Sell rating and target price of Rs425. Our net profit for FY12E/FY13E is 6%/8% lower than consensus mainly due to lower EBITDA margin assumption.
- **Key Risks:** Key upside risks to our earnings would be higher-than-expected growth in the smart class segment, faster ramp-up in higher education business and reduction in contingent liabilities due to the new smart class model.

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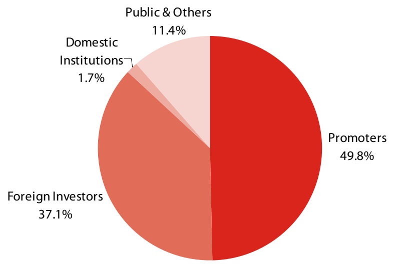
Key Data

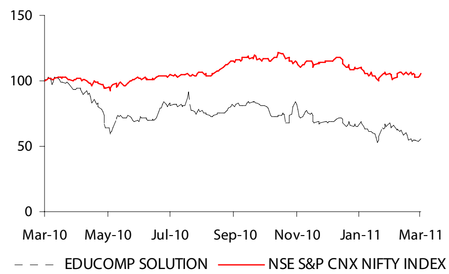
Bloomberg Code	EDSL IN
Reuters Code	EDSO.BO
Current Shares O/S (mn)	95.5
Diluted Shares O/S (mn)	100.9
Mkt Cap (Rsbn/USDmn)	39.8/886.4
52 Wk H / L (Rs)	785/386
Daily Vol. (3M NSE Avg.)	1,043,015
Face Value (Rs)	2
1 USD = Rs44.9	

Shareholding Pattern (%)



As on 31 December 2010

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
EDUCOMP	(14.4)	(31.4)	(45.3)
NIFTY	0.8	(8.0)	4.9

Source: Bloomberg, Centrum Research
**as on 23 March 2011*

Y/E Mar (Rsmn)	Rev	YoY (%)	EBITDA	EBITDA (%)	Adj. PAT	YoY (%)	RoE (%)	RoCE (%)	EPS (Rs)	PE (x)	PB (x)	EV/EBITDA (x)
FY09	6,371	*122.7*	3,062	*48.1*	1,329	*88.3*	*39.4*	*22.4*	13.2	31.6	9.7	14.0
FY10	10,395	*63.2*	4,847	*46.6*	2,759	*107.6*	*27.1*	*22.1*	27.3	15.2	2.4	8.6
FY11E	13,014	*25.2*	5,707	*43.9*	3,177	*15.2*	*17.6*	*15.2*	31.5	13.2	2.0	8.8
FY12E	15,879	*22.0*	6,986	*44.0*	3,486	*9.7*	*16.5*	*16.1*	34.5	12.0	1.8	6.5
FY13E	18,178	*14.5*	8,165	*44.9*	4,288	*23.0*	*17.5*	*19.0*	42.5	9.8	1.5	5.1

Source: Company, Centrum Research Estimates

Please refer to important disclosures/disclaimers in Appendix A

Shareholding pattern (%)

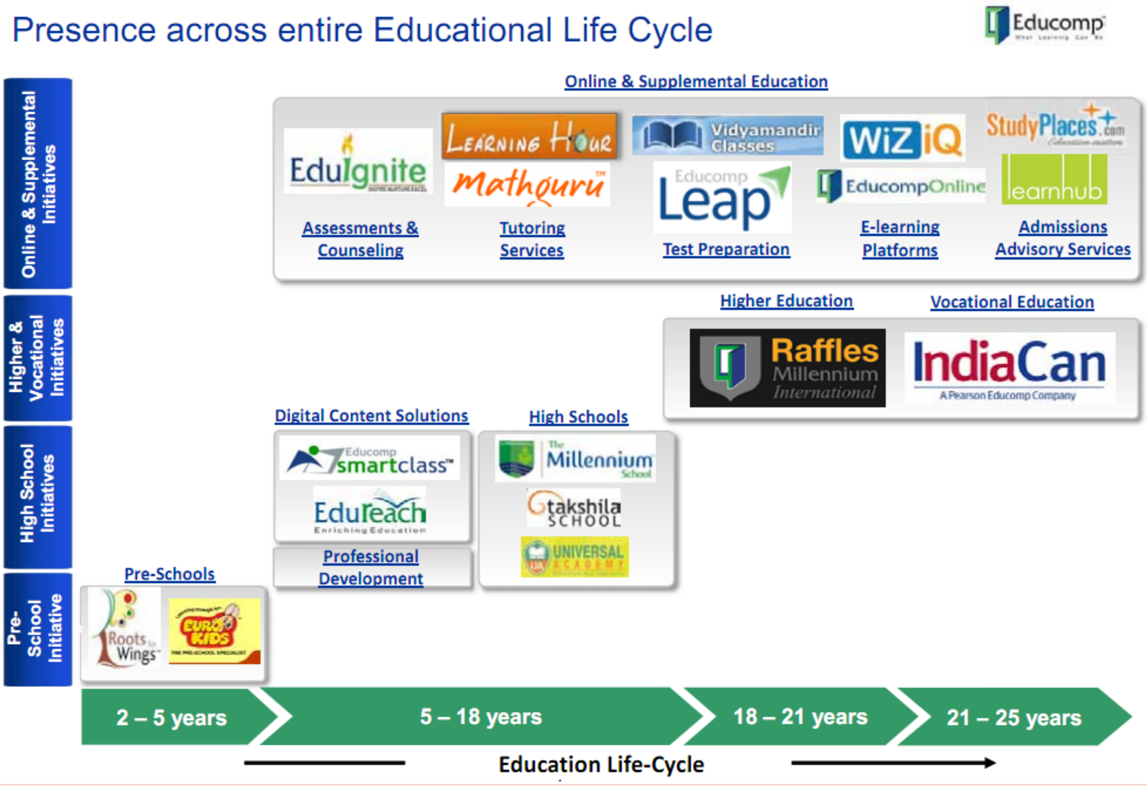
	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Promoter	50.1	49.8	49.8	49.8
FIIs	40.8	36.9	38.5	37.1
Dom inst.	1.4	1.6	1.7	1.7
Public & others	7.7	11.7	10.0	11.4
Total	**100**	**100**	**100**	**100**

Source: NSE

Company Background

Established in 1994, Educomp Solutions is the largest company in the education space in India. The company addresses key markets of private schools, government schools, educational content, teacher training, supplemental education services, pre-schools, professional and higher education as well as online learning. The Educomp Group reaches out to over 26,000 schools and 15mn learners and educators across the world.

Educomp's offerings



Source: Company, Centrum research

Key management personnel

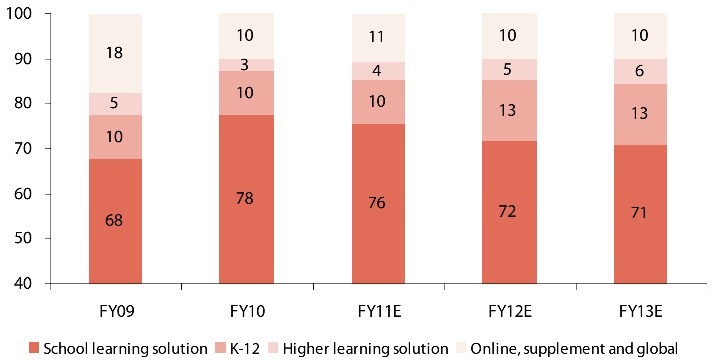
Name	Position	Profile
Santanu Prakash	Chairman & MD	An alumnus of IIMA, Shantanu is founder member. He has pioneered several innovations in the area of education management, multimedia content and innovative products.
Sangeeta Gulati	CFO	M.Com., CA. She has over 15 years of experience in money market operations, funds raising, finance and account management. She also handles the banking and investor relation function.
Abhinav Dhar	Directors K-12	With over 25 years of education experience, he has been deeply involved in building path breaking educational technology initiatives in K12 domain for over a decade across organizations like educomp, Royal Dutch shell group and NIIT.
Soumya Kanti	Directors	Alumnus of IIMA. He has over 20 years experience in international & domestic markets in consulting and implementing project based IT solutions.
Sharad Agarwal	Directors	He has over 20 years of experience. He is BE and MBA (IIM A) by qualification.
Harpreet Singh	Director, Educomp Raffles Higher Education Ltd	Harpreet Singh is an alumnus of IIM Ahmedabad. Prior to joining the Educomp Raffles Group, Harpreet Singh has worked with HDFC Bank, Mumbai as the Country Head - NRI Business & Wealth Advisory Services, Centurion Bank of Punjab as the Business Director Wealth Management, Distribution and loans.

Source: Company, Centrum Research

Investment Rationale

- The SLS (76% of revenue) is likely to witness slower growth, going forward i.e 17% CAGR over FY10-13E vs 194% CAGR over FY05-10. While the management will be selective in ICT projects, smart class segment growth would be directly linked to classroom additions
- Higher education, K-12 and other supplemental segments would take time to become sizable to support growth.
- Current valuations at 12.0x FY12E EPS price-in all concerns regarding the change in smart class model and slower ramp-up in the K-12 segment. It would be sometime before the higher education business and K-12 segment start contributing to overall financial performance, leading to underperformance in the near to medium-term

Revenue by Segment



Source: Company, Centrum Research Estimates

Summary Financials

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
Key Income Statement					
Revenue	6,371	10,395	13,014	15,879	18,178
YoY growth (%)	*123*	*63*	*25*	*22*	*14*
Operating profit	3,062	4,847	5,707	6,986	8,165
YoY growth (%)	*141.9*	*58.3*	*17.8*	*22.4*	*16.9*
Operating margin	*48.1*	*46.6*	*43.9*	*44.0*	*44.9*
Depreciation	814	1,142	807	929	1,100
Interest expenses	289	539	952	1128	935
Other non operating income	227	1255	343	350	360
PBT	2,187	4,421	4,292	5,280	6,491
Provision for tax	770	1,584	1,062	1,690	2,077
Minority interest	88	78	53	104	126
PAT (adjusted)	1,329	2,759	3,177	3,486	4,288
YoY growth (%)	*88.3*	*107.6*	*15.2*	*9.7*	*23.0*
PAT margin	*22.2*	*26.5*	*24.4*	*22.0*	*23.6*
Key CF Statement					
Cash generated from operations	1,914	2,195	1,902	8,615	6,913
Cash flow from investing activities	(6,751)	(3,722)	(8,808)	(1,772)	(1,638)
Cash flow from financing activities	3,827	7,511	3,467	(4,054)	(5,980)
Net cash increase/decrease	(1,010)	5,985	(3,439)	2,789	(705)
Key Balance Sheet Data					
Shareholders' fund	3,857	16,479	19,562	22,621	26,407
Debt	9,335	10,501	15,066	12,566	8,022
Minority Interest	804	1,915	2,500	2,628	2,780
Total Capital Employed	13,996	28,894	37,127	37,815	37,209
Fixed Assets	9,351	16,687	24,558	25,879	26,929
Investments	729	354	1,413	1,413	1,413
Net current assets	3,903	11,853	11,157	10,523	8,867
Misc Expenses	13	-	-	-	-
Total Assets	13,996	28,894	37,127	37,815	37,209
Key Ratio (%)					
ROCE	*22.4*	*22.1*	*15.2*	*16.1*	*19.0*
ROIC	*37.7*	*29.3*	*21.3*	*22.1*	*26.7*
ROE	*39.4*	*27.1*	*17.6*	*16.5*	*17.5*
Per share Ratios (Rs)					
Fully diluted EPS	13.2	27.3	31.5	34.5	42.5
Book value	43	172	203	235	275
Solvency Ratio (x)					
Debt-equity	2.3	0.6	0.8	0.6	0.3
Interest coverage ratio	7.8	6.9	5.1	5.4	7.6
Valuation parameters(x)					
P/E (Fully Diluted)	31.6	15.2	13.2	12.0	9.8
P/BV	9.7	2.4	2.0	1.8	1.5
EV/EBITDA	14.0	8.6	8.8	6.5	5.1
EV/Sales	6.7	4.0	3.9	2.8	2.3

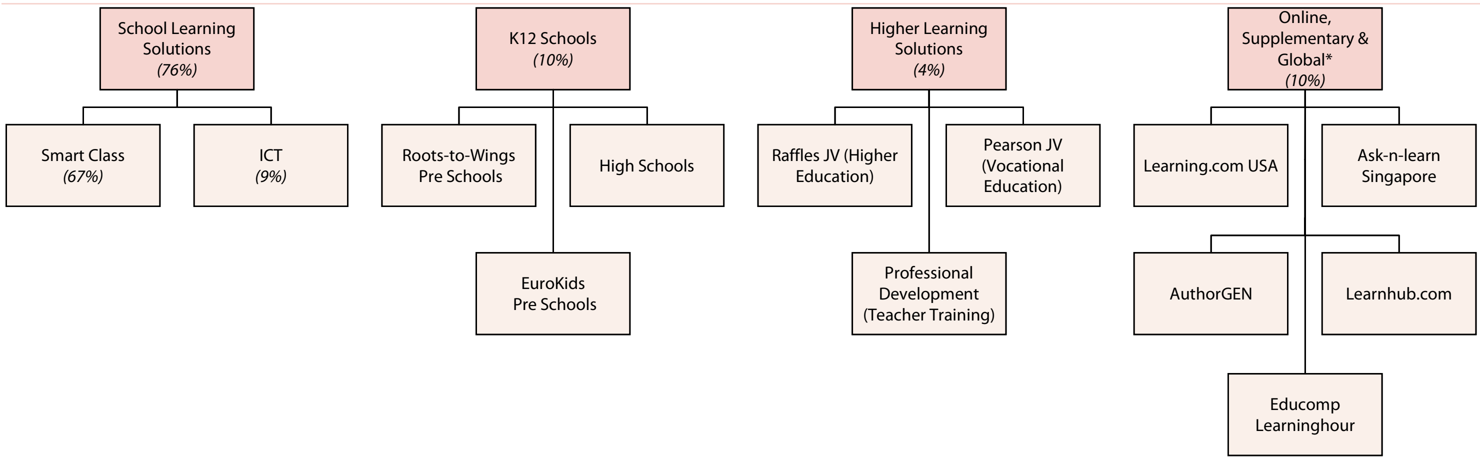
Source: Company, Centrum Research Estimates

Investment Argument

SLS segment growth – challenging task

Post the change in smart class model (see Box no. 1), we expect the growth momentum of SLS segment to slow down. In the case of ICT segment, the growth rate would come down due to (1) selective approach by management in bidding for government school in order to aim for better profitability; and (2) contract period getting over for many schools. The company added ~3,200 schools in FY08 and 6,000 in FY09, wherein computer labs would get transferred to government schools.

Exhibit 1: Educomp's Business segments



Source: Company
** Only Key Subsidiaries*

Slower growth foreseen in smart class segment

In case of the smart class segment, the company has changed its model from BOOT and outright sale to securitization led tripartite model (new smart class model) wherein the company books upfront revenue in two years. This reduces the visibility of revenue for the segment compared to the earlier model. Henceforth, the addition of classrooms would decide the growth rate of the segment for the year. The company would have to scale up its sales effort, execution capability and hardware availability to ensure higher implementation at the school level.

We have seen early signs of scale-up post the change in model. The installation per classroom has already doubled in three quarters. Considering the competitive scenario in this space, we see this as a challenging task to grow the classrooms on a YoY basis. Moreover, the company has added 600 and 800 schools in FY08 and FY09, respectively, which would come for renewal in next 2-3 years. Also, from the realization stand point, we see some difficulty in maintaining the current realization of Rs392,000 per classroom considering (1) the company's plans to venture into tier 2 and tier 3 towns; and (2) the entry of newer players at lower price points.

Exhibit 2: Smart class installations doubled in three quarters

						Scenarios (Q3FY12E)		
	Q4FY10	**Q1FY11**	**Q2FY11**	**Q3FY11**	**Q3FY12E**	**@20% YoY**	**@40% YoY**	**@60% YoY**
Classrooms addition	4,038	6,750	5,309	7,085	9,763	8,502	9,919	11,336
Classrooms installed. per day	**54**	90	71	**94**	130	113	132	151
Schools installed per day	7	11	9	12	16	14	17	19

Source: Company, Centrum Research Estimates

The company has established 19,144 classrooms during 9MFY11 and the guidance by the management stands at 25,000-30,000 classrooms for FY11E. Considering Q4 to be the best quarter for smart business, we have assumed an addition of 7,500 classrooms for Q4FY11E.

Exhibit 3: Our assumptions for smart class

	FY11E	**FY12E**	**FY13E**
No of Schools	6,512	11,120	15,691
No of classrooms addition	26,644	29,000	32,000
Revenue from Smart Class (Rsmn)	8,683	9,237	10,486

Source: Company, Centrum Research Estimates

While we don't foresee implementation problems, we are skeptical on certain issues relating to structure of the new smart model which indicates certain downward risks for the company. We are not too sure of the liabilities that may accrue despite having well defined agreement with schools as well as with Edusmart, an independent vendor. Our concerns are many:

- Any default or delay in payment by schools may hamper the business model of Edusmart. Though the contract is water tight and covers all aspects relating to services and payments, any legal action taken in case of defaults can lead to negative marketing for the smart class product sales among schools and more so when schools have options of choosing similar products from competitors.
- In the past the company provided corporate guarantee for the entire value (100%) of the contract which has now reduced to 20% for new signed securitized contracts. Though the company is trying to reduce its liability to zero, banks would be keen to know the financial health of Edusmart before taking such a call.
- Edusmart could feel pressure on margins going forward as the number of classrooms increase year on year. This may result in higher maintenance cost for the company.
- In a changing interest rate scenario, Edusmart's margins would also change as the contract between Educomp and Edusmart indicates a fixed interest rate.
- Clarity is required with regard to consolidation of vendors' (Edusmart) balance sheet with Educomp once IFRS accounting practice becomes compulsorily in India.

Lastly, for every Rs100 collected from schools, Rs25 is retained by vendor (Edusmart) to meet its obligation of interest payment to the bank, cost of servicing and maintenance and Rs4 profit. However, we are not clear on the profit calculation for Edusmart which makes us believe that this would be a sustainable business on its own for the company.

Box no 1.

Smart class new model

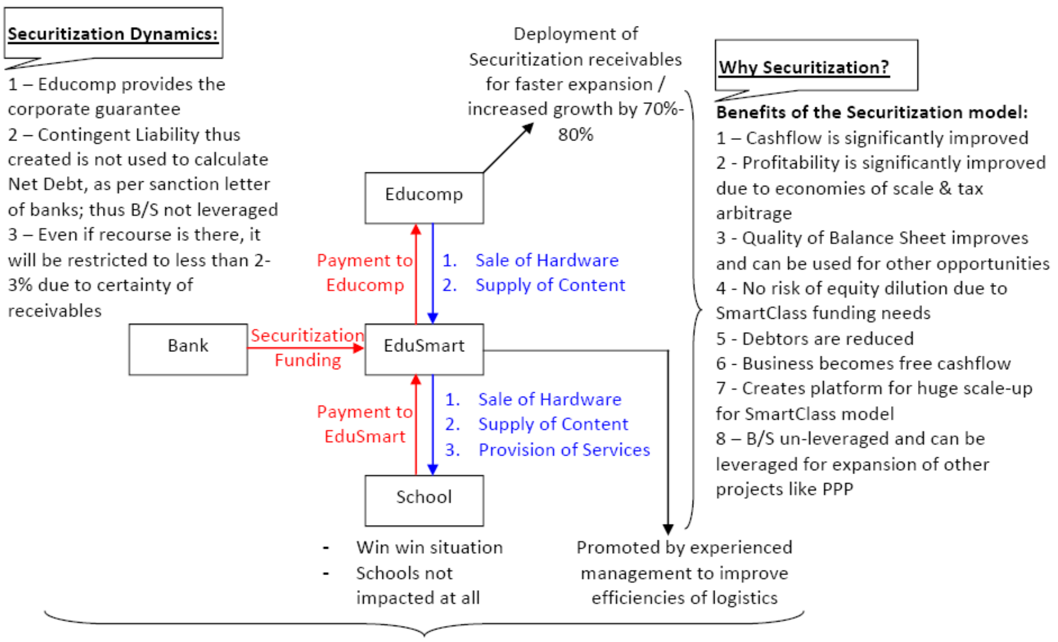
In the new smart-class business model Educomp will sell, both hardware and content as a package to a third party vendor. The vendor will install the equipment in the schools and also provide services of installation, commissioning, maintenance and servicing the customer. The vendor will securitize the 5 year receivables from the schools from a consortium of banks and pay Educomp towards the harware and content. The contract with the school will be a tripartite agreement which lays down the responsibilities of Educomp and the vendor.

Assuming that the tripartite contract with the school is worth Rs100, Educomp will sell the Hardware package for Rs75. The vendor will securitize its Rs100 receivable from the school from the bank and receive approx. Rs54 - 60 which is the discounted value of the receivables and the same will be paid to Educomp upfront. Rs25 will be retained by the vendor to meet its obligation to the bank and its cost of servicing, operating and maintenance. The vendor will be left with a profit of Rs4 after discharging its obligations.

Educomp's accounting for Smart Class business

Educomp books the Rs75 in two years. Firstly, this Rs75 has two components, content and hardware. The hardware share of Rs30 is booked in the Year 1 and content part i.e. Rs45 is booked equally in two years (Rs22.5 each year). The entire cost relating to hardware which was earlier capitalized by company and amortized over 5 years is now expensed in Year 1. Since, we are booking hardware cost entirely in Year 1, the operating margin in Year 1 would be lower compared to Year 2. However, over the years, the blended operating margin would remain similar. The capital expenditure and debtors days become zero. However, the company books unearned revenue in the balance sheet to the extent of 22.5% of the Year 1 revenue.

Exhibit 4: Securitisation flow chart



- Good quality receivables
- Default rate less than 5% as schools don't default:
  - because parents don't default on fees
  - because of the water-tight nature of the contracts
- If at all, a school defaults, it will have to pay for the entire content usage of 5 years and Educomp will recover all hardware deployed. Also the school will have to pay delayed dues with an interest charge of 18%
- Certainty of receivables as all obligations have been performed on day 1 itself and receivables have already become due (as compared to other examples of securitization where receivables accrue over the years and therefore have lower certainty)
- Due to securitization model, Educomp is envisaging growing to 20,000 schools in 5-6 years

Source: Company

Conclusion

We are optimistic on the prospects of multimedia in the school segment; however, we would like to seek more clarity on vendor business feasibility to access the success on this model. Moreover, it would be a challenging task for Educomp to manage growth of 20-30% in revenue considering the pressure on realizations per school and efforts to grow its classrooms on the base of 26,000 every year.

ICT segment – focus on selective bidding

The management has indicated that it will be selective on choosing government project to focus on better profitability. Hence, we expect the company to go slow on the bidding process going forward. We expect the addition to remain at 4,000 levels considering the management's cautious stance and the fact that business would continuously observe contract tenure getting over.

Exhibit 5: Assumption for school addition

	FY11E	FY12E	FY13E
No of schools addition	(4,876)	4,000	4,000
Revenue (Rsmn)	1,161	2,157	2,397

Note: negative addition represents contract period getting over

Source: Company, Centrum Research Estimates

K-12, higher education and supplemental business would take time to scale up

Segments such as higher learning solutions (HLS) and K-12 would take time to scale up their operations and become sizable to contribute to overall growth of the company. The contribution from these two segments together was 12% and 5% at revenue and EBIT levels respectively. for FY10.

In case of K-12 business, the company had missed its targets. Earlier in FY09, the management indicated it would ramp upto 150 schools by FY12 and in Q4FY10, the company guided for 75 schools operational by FY11E (source: Q4FY10 transcript). Also, in its Q2FY11 concall, the management guided for 150 schools by FY13E which in Q3FY11 stands at 50 operational schools with visibility of 81 schools.

Exhibit 6: Ramp-up in schools

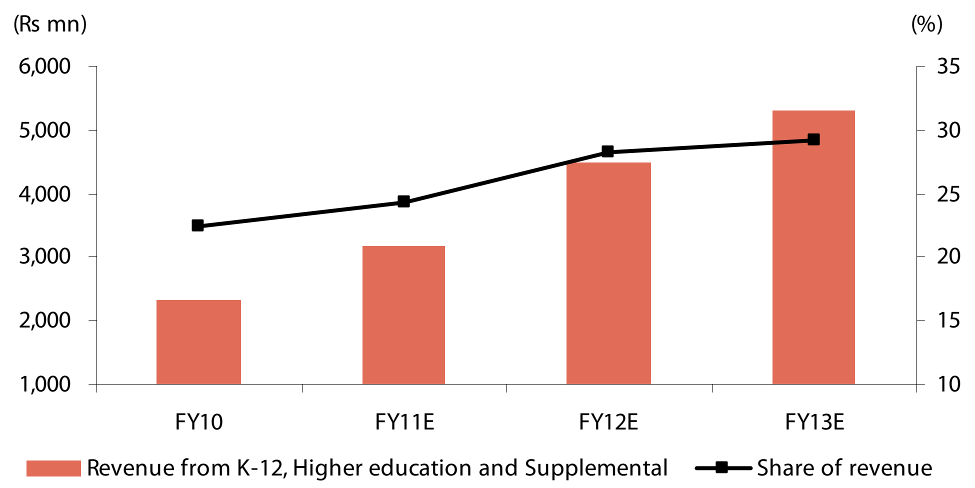
	Q4FY09	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11E	FY12E	FY13E
No of school operational	20	35	36	36	43	43	46	50	54	62	75
Out of which Educomp's Greenfield	ND	ND	ND	ND	ND	6	7	9	12	13	17
Visibility	43	43	48	59	69	73	79	81			

Source: Company, Centrum Research Estimates

The trend in the K-12 segment indicates that the ramp-up is going slower compared to expectation. The difference between visibility and school becoming operational seems to be widening and it has taken one year to achieve that number. Moreover, JVs and tie-ups have been the key drivers for 50 schools that are currently operational. Hence, we believe that growth in revenue would be slower than expected and would take time considering the fact that ramp-up in schools are more through JV/Dry Management route than greenfield projects.

Similarly, higher education and supplemental business would take time to scale up and contribute meaningfully to overall company's financials. We are very optimistic on the growth prospects of the Raffles and IndiaCan ventures and believe that these segments can grow at a very fast pace. Since, these initiatives are under JVs, the company gets only half of the revenue. In case of Raffles, the company has witnessed only three quarters of operations for its 7 institutes. We expect them to take time to ramp-up in terms of student intake. Our assessment indicates that Raffles would have an enrollment of 850 student and 1,500 students by the end of FY12E and FY13E. In case of IndiaCan, we expect the ramp-up of students to 75,000 and 86,500 by the end of FY12E and FY13E as compared to 52,500 in Q3FY11.

Exhibit 7: Revenue from K-12, Higher education and supplemental to register 30% CAGR over FY10-13E



Source: Company, Centrum Research Estimates

Financial Analysis

20% revenue CAGR over FY10-13E

We expect Educomp's revenue to register 20% CAGR over FY10-13E, mainly driven by the SLS segment. SLS segment accounts for 75% of the revenue and would dominate for 3-4 years as we expect other businesses to take time to scale up.

Exhibit 8: SLS segment pulls down the over growth rate

(Rsmn)	FY10	FY11E	FY12E	FY13E	CAGR FY10-13E (%)
School Learning Segment	8,068	9,844	11,394	12,883	16.9
Higher Learning Segment	265	510	723	1,000	55.8
K-12	997	1,270	2,133	2,443	34.8
Online, supplemental and global	1,066	1,391	1,629	1,851	20.2
Revenue (Cons.)	**10,395**	**13,014**	**15,879**	**18,178**	**20.5**

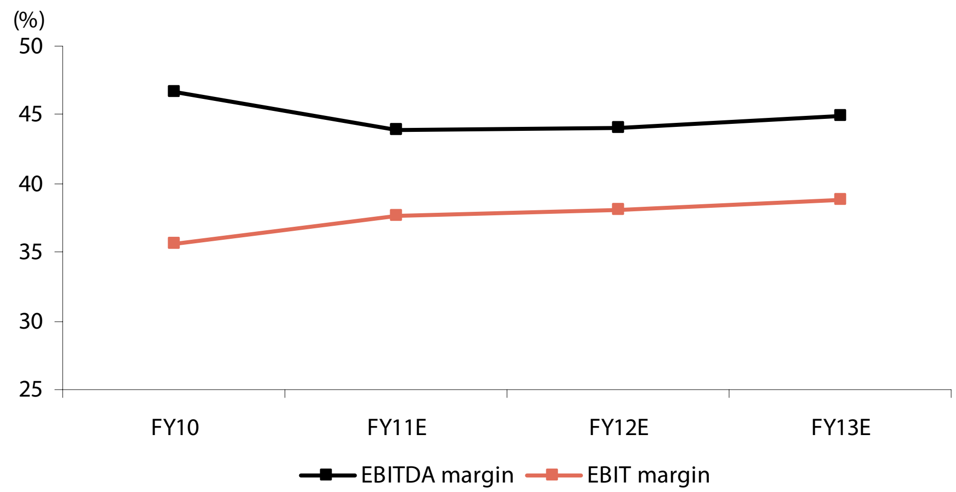
Source: Company, Centrum Research Estimates

Margins to improve from FY12 onwards

We expect margins at the company level to expand from FY12E as the segment wise margin profile changes. While earlier most of the segments were profitable at EBITDA level, the newer segments such as Raffles, IndiaCan and few online businesses are in expansion phase due to which they are in investment mode. We expect them to improve going forward with improvement in revenue. In terms of margin drivers, we expect K-12 business to drive the EBITDA margin going forward.

The change in smart class model helps expand EBIT margin as the company won't be incurring capex under the new model. With overall improvement in EBITDA margins and change in model for one of the capex intensive segments, the EBIT margin would also improve from FY12E. We expect the EBITDA and EBIT margin to improve by 100bps and 121bps over FY11E-13E.

Exhibit 9: Margins would improve as smart class moves to zero capex model

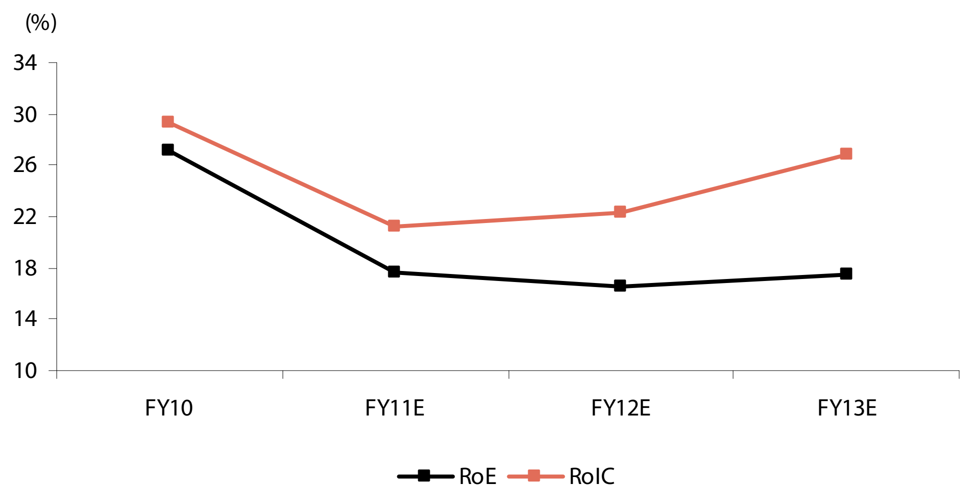


Source: Company, Company Research Estimates

Return ratios to improve from FY12 on better asset utilization

We expect the return ratios to improve going forward on better utilization of assets. Presently, the ratios are deteriorating as higher learning solution and K-12 have gone into investment phase and smart class was in a transition phase with regard to transfer of existing contracts to Edusmart. This resulted in a decline in return ratios in FY11E. However, with improvement in asset turnover in K-12 business and higher education business return ratios could expand going forward, although, we believe that it would take longer to reach the earlier levels of 40% RoE (FY09) for the company.

Exhibit 10: Return ratios to improve on higher asset utlisation



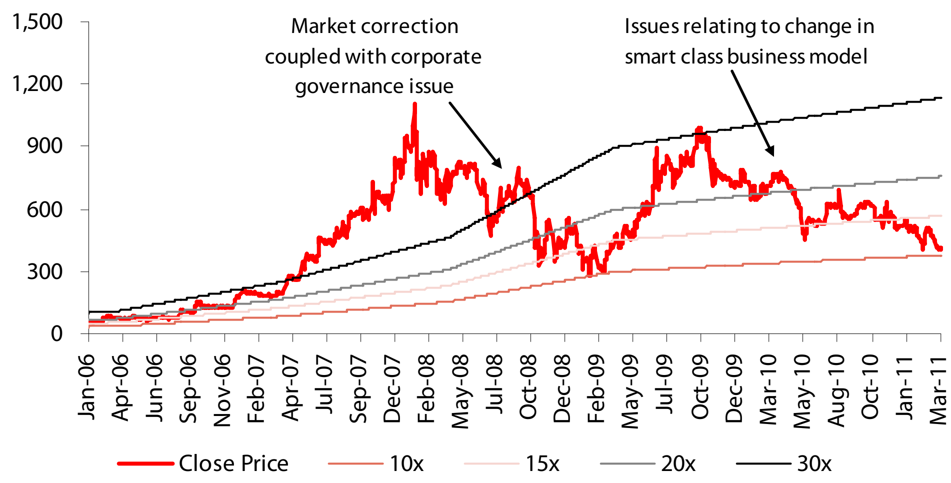
Source: Company, Centrum Research Estimates

Valuation Analysis

Limited upside potential

We initiate coverage on Educomp with a Sell rating and target price of Rs425, implying 12.3x FY12E and 10.0x FY13E earnings estimates. Our main premise for the Sell rating is company-specific and not relating to macro issues. We are very optimistic on the Indian education space and Educomp's diversified presence in each sub-segment and strong partnership/tie-ups. However, there are certain business model related challenges which are making us skeptical on growth prospects of the company for a couple of years and the creation of contingent liability as Educomp provides bank guarantee for smart class sales. From a clarity standpoint, we need more insights on Edusmart model and its profitability, and the status on consolidation with Educomp once IFRS practice is adopted by the company. Our net profit estimates for FY12E and FY13E are lower than consensus by 6% and 8% respectively mainly due to our lower EBITDA margin assumptions. Our lower margin assumption stems from the fact that higher education business and online, supplemental business are in investment mode and would take time to expand margin.

Exhibit 11: One-year forward P/E band



Source: Bloomberg

P/E and EV/EBITDA based valuation is not the right parameter as the stock has witnessed serious de-rating on account of broader market correction and corporate governance-related issues which cropped up in 2008 and later from 2009 onwards due to changes in business model of smart class which is not understood in toto by market participants. The changes in the model happened in the segment which had the highest weightage on overall revenues. Hence, we have used DCF as the methodology as we feel that this would capture profitability as well as value emerging from businesses such as K-12 which is recurring in nature.

Exhibit 12: DCF Assumptions

WACC	12.3%
Cost of Equity (Ke)	8.6%
Risk free rate	8.0%
Market Return	15.0%
Beta	1.15
Cost of Debt	12%
Weighted Cost of Debt (Kd)	3.7%
Terminal Growth Rate	3%
PV of Cash Flow till FY21E (Rsmn)	8,337
Terminal Value (Rsmn)	92,220
PV of Terminal Value (Rsmn)	28,878
Firm Value (Rsmn)	59,006
Less: Net Debt (Rsmn)	5,307
Less: Contingent liability (Rsmn)	8,200
Equity Value (Rsmn)	42,871
Price/Share (Rs)	425

Source: Centrum Research Estimates

Exhibit 13: Sensitivity Analysis

		WACC				
	449	10%	11%	12%	13%	14%
Terminal growth (%)	2.0%	456	422	395	372	353
	2.5%	478	440	409	384	363
	3.0%	503	459	**425**	397	374
	3.5%	532	481	442	412	386
	4.0%	565	507	462	428	400
	4.5%	604	535	485	445	414
	5.0%	650	569	510	465	430

Source: Centrum Research Estimates

Exhibit 14: Comparative Valuation

				P/E (x)			EV/EBITDA (x)			P/BV (x)			RoIC (%)		
Company	CMP (Rs)	Target Price (Rs)	Upside (%)	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E
Educomp	416	425	2.1	12.5	11.4	9.3	8.8	6.5	5.1	2.0	1.8	1.5	21.3	22.1	26.7
Everonn	557	772	38.5	19.7	13.0	10.2	8.2	6.5	4.9	2.0	1.8	1.5	37.9	36.1	42.2
NIIT	52	74	41.8	10.4	7.6	6.6	6.9	5.4	4.4	1.5	1.4	1.2	14.0	17.2	19.0
Career Point	315	414	31.6	24.2	18.9	11.5	17.1	10.3	5.9	2.2	1.8	1.4	34.0	21.5	27.5

Source: Centrum Research Estimates

Risk to our rating

- **Case for stock re-rating:** We have considered the base case scenario while assessing the financials and valuation aspects for the company. However, we believe that Educomp may witness re-rating on the following events:
  - Clarity on Edusmart model with regard to its profitability and consolidation of financials with Educomp post IFRS adoption
  - Status on contingent liabilities which would be observed over next 1-2 years
  - Better than expected growth in classroom addition and improvement in realization per classroom in the coming few quarters in the smart class segment
  - Better than expected traction in the higher education, K-12 business than expected.

Appendix 1

Exhibit 15: Inorganic growth

	Company	Stake (at time of acquisition)	Amount	
2007	Three-Brix E- services	76	NA	Learning Hour
Q1FY08	Ask n Learn	100	S$7.03mn	Singapore based K-12
Q2FY08	Authorgen Technologies Pvt Ltd	51	Rs26mn	E-learning platform such as Wiziq.com
Q2FY08	Savvica	70	US$2mn	Canadian online teaching solutions company
Q1FY09	Learning.com	51	US$24.5	Web based K12 company in US. Tutorial services
Q1FY09	Raffles JV	50	NA	Higher education such as fashion designing, interior designing.
Q1FY09	A-Plus Education Solution	76	Rs10.75cr	Vocational training (Purple Leap brand)
Q2FY09	EuroKids	50	Rs39cr	Pre-school and K-12
Q2FY09	Takshila Management Services Pvt Ltd	51	US$8.7mn	K-12 schools
2009	Pearson JV	50	NA	Vocational training
2010	Studyplaces.com	NA	Rs60mn	Admission advisory services
2010	JV with Lavasa	NA	NA	K-12 International school
2010	Vidya Mandir Classes	Majority	Rs34cr	Engineering test prep
2011	Gateforum	Majority	ND	Engg. Test Prep (Gate exam prep.)

Source: Company

Appendix 2

Indian education space – huge opportunity

We are positive on the opportunity in the Indian education space which stems from improper infrastructure, huge target population, lack of quality institutions. We see enough potential for players with quality offerings to tap the high growth education market. According to the survey by Technopak, the private education market is expected to register 10% CAGR over FY10-13E.

Exhibit 16: Private education opportunity in India

	2008 (US$ mn)	CAGR (%)	2013 (US$ mn)	CAGR (%)	2018 (US$ mn)
Pre-school	1,200	20-25	3,500	10-15	5,800
K-12	**21,000**	**5-10**	**30,800**	**5-10**	**43,200**
Tutoring	5,000	8-13	8,000	5-10	11,800
Books	1,700	5-10	2,400	3-8	3,000
Stationery	1,380	5-10	2,000	3-8	2,600
Education CD-Roms	120	25-30	390	20-25	1,100
Multimedia in schools	25	60-70	320	20-25	3,300
Higher Education	**6,700**	**8-13**	**11,200**	**7-12**	**18,100**
Preparatory	1,600	13-18	3,200	10-15	5,900
Child skill enhancement	740	20-30	2,200	17-22	5,600
IT training	195	35-45	1,050	33-38	4,700
E-learning	45	35-45	240	33-38	1,100
Finishing school	25	50-60	235	45-55	1,800
Vocational	1,500	15-20	3,100	10-15	6,200
Teacher training	15	50-60	140	45-55	1,100
	41,245		68,775		115,300

Source: Market sources and Technopak Analysis

Financials

Exhibit 17: Income statement

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
Net Sales	6,371	10,395	13,014	15,879	18,178
Growth (%)	*122.7*	*63.2*	*25.2*	*22.0*	*14.5*
Cost of goods sold	1,110	1,603	2,720	3,430	3,908
% of sales	*17.4*	*15.4*	*20.9*	*21.6*	*21.5*
Personnel expenses	1,155	1,793	2,488	3,017	3,454
% of sales	*18.1*	*17.2*	*19.1*	*19.0*	*19.0*
Admin and other expenses	1,042	2,138	2,099	2,446	2,650
% of sales	*16.4*	*20.6*	*16.1*	*15.4*	*14.6*
Operating Profits	3,062	4,847	5,707	6,986	8,165
% of sales	*48.1*	*46.6*	*43.9*	*44.0*	*44.9*
Depreciation and Amort.	814	1,142	807	929	1,100
PBIT	2,248	3,704	4,901	6,057	7,066
Interest Expenses	289	539	952	1,128	935
PBT from operations	1,959	3,166	3,949	4,930	6,131
Other non operating income	227	1,255	343	350	360
PBT before extraordinary items	2,187	4,421	4,292	5,280	6,491
PBT	2,187	4,421	4,292	5,280	6,491
-PBT margin (%)	*34.3*	*42.5*	*33.0*	*33.3*	*35.7*
Provision for tax	770	1,584	1,062	1,690	2,077
Effective tax rate (%)	*35.2*	*35.8*	*24.7*	*32.0*	*32.0*
Net Profit (reported)	1,417	2,837	3,230	3,590	4,414
Less: Min Int//profit from ass.	88	78	53	104	126
Net profit after adjustments	1,329	2,759	3,177	3,486	4,288
-Growth (%)	*88*	*108*	*15*	*10*	*23*
-NPM (%)	*22.2*	*26.5*	*24.4*	*22.0*	*23.6*

Source: Company, Centrum Research Estimates

Exhibit 18: Balance Sheet

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
Share Capital	173	190	190	190	190
Reserves and Surplus	3,684	16,289	19,372	22,431	26,217
Total shareholders fund	3,857	16,479	19,562	22,621	26,407
Minority Interest	804	1,915	2,500	2,628	2,780
Loan fund	9,335	10,501	15,066	12,566	8,022
Total capital employed	**13,996**	**28,894**	**37,127**	**37,815**	**37,209**
Gross block	6,499	8,967	15,217	18,567	21,417
Less: Accumulated depreciation	1,335	1,050	1,857	2,786	3,886
Net block	5,164	7,917	13,360	15,781	17,531
Capital WIP	2,962	2,739	3,000	1,900	1,200
Net fixed assets	8,126	10,656	16,360	17,681	18,731
Goodwill	1,225	6,031	8,198	8,198	8,198
Investments	729	354	1,413	1,413	1,413
Cash and bank	1,902	7,887	4,448	7,237	6,531
Inventories	316	368	680	857	977
Debtors	2,765	5,530	5,634	6,004	5,662
Other cur. Assets & loans & adv.	1,170	2,031	4,725	2,999	3,390
Total current assets	6,153	15,816	15,486	17,098	16,561
Current liabilities and Prov.	2,251	3,963	4,330	6,575	7,694
Net current assets	3,903	11,853	11,157	10,523	8,867
Misc Expenses	13	-	-	-	-
Total assets	**13,996**	**28,894**	**37,127**	**37,815**	**37,209**

Source: Company, Centrum Research Estimates

Exhibit 19:Cash flow

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
Cash Flow from operation					
Profit before tax	2,108	4,392	4,292	5,303	6,517
Depreciation	814	1,142	807	929	1,100
Interest expenses	289	411	952	1,128	935
Other non cash charges	67	(901)	(343)	(350)	(360)
Oper. profit before WC change	3,278	5,044	5,707	7,010	8,191
Working capital adjustments	(1,023)	(1,910)	(2,743)	3,295	798
Direct tax paid	(341)	(938)	(1,062)	(1,690)	(2,077)
Net cash from operatiion	1,914	2,195	1,902	8,615	6,913
Cash flow from investment					
Capex	(5,764)	(4,726)	(6,511)	(2,250)	(2,150)
Investments	(987)	1,004	(2,297)	478	512
Net cash from investment	(6,751)	(3,722)	(8,808)	(1,772)	(1,638)
Cash flow from financing					
Proceeds from share cap. & premium	(18)	6,000	225	(19)	-
Borrowings/(Repayments)	4,191	2,088	4,565	(2,500)	(4,543)
Interest paid	(289)	(411)	(952)	(1,128)	(935)
Dividend paid	(58)	(166)	(372)	(408)	(502)
Net cash flow from financing	3,827	7,511	3,467	(4,054)	(5,980)
Net cash increase/(decrease)	(1,010)	5,985	(3,439)	2,789	(705)

Source: Company, Centrum Research Estimates

Exhibit 20:Key Ratios

Y/E March	FY09	FY10	FY11E	FY12E	FY13E
Margin Ratio (%)					
EBITDA Margin	*48.1*	*46.6*	*43.9*	*44.0*	*44.9*
PBIT Margin	*35.3*	*35.6*	*37.7*	*38.1*	*38.9*
PBT Margin	*34.3*	*42.5*	*33.0*	*33.3*	*35.7*
PAT Margin	*22.2*	*27.3*	*24.8*	*22.6*	*24.3*
Growth Ratio (%)					
Revenue	*122.7*	*63.2*	*25.2*	*22.0*	*14.5*
EBITDA	*141.9*	*58.3*	*17.8*	*22.4*	*16.9*
Net Profit	*88.3*	*107.6*	*15.2*	*9.7*	*23.0*
Return Ratios (%)					
ROCE	*22.4*	*22.1*	*15.2*	*16.1*	*19.0*
ROIC	*37.7*	*29.3*	*21.3*	*22.1*	*26.7*
ROE	*39.4*	*27.1*	*17.6*	*16.5*	*17.5*
Turnover Ratios					
Asset turnover ratio (x)	0.6	0.5	0.4	0.4	0.5
Working capital cycle (days)	49.5	53.2	53.2	(5.6)	(30.2)
Avg. collection period (days)	112.4	145.6	156.6	133.8	117.1
Avg. payment period (days)	166.8	176.1	194.6	230.6	238.5
Per share (Rs)					
Basic EPS	15.4	29.0	33.3	36.5	44.9
Fully diluted EPS	13.2	27.3	31.5	34.5	42.5
Book value	42.9	171.9	203.2	235.2	274.9
Solvency Ratio (x)					
Debt-equity	2.3	0.6	0.8	0.6	0.3
Interest coverage ratio	7.8	6.9	5.1	5.4	7.6
Valuation (x)					
P/E	31.6	15.2	13.2	12.0	9.8
P/BV	9.7	2.4	2.0	1.8	1.5
EV/EBITDA	14.0	8.6	8.8	6.5	5.1
EV/Sales	6.7	4.0	3.9	2.8	2.3
M-cap/Sales	5.6	3.8	3.1	2.5	2.2

Source: Company, Centrum Research Estimates

Appendix A

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