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Market Data

52-week range (INR): 990 / 442
Share in issue (mn): 95.4
M cap (INR bn/USD mn): 58.2 / 1,310
Avg. Daily vol. BSE ('000): 2,055.9

Share Holding Pattern (%)

Promoters	:	49.8
MFs, FIs & Banks	:	1.7
FIIIs	:	38.5
Others	:	10.0

* Promoters pledged shares : Nil
(% of share in issue)

Stake hike in subsidiary led to increase in goodwill and reserves

- Educomp Solutions (Educomp) held 69.4% stake in Educomp Infrastructure and School Management (EISML) for INR 500 mn. During FY10, it invested additional INR 4.9 bn in EISML towards incremental 8.8%, hiking its stake to 78.2%. The balance 22.8% is owned by the promoter and third party.
- Cumulatively, Educomp has infused INR 5.40 bn in EISML towards equity till FY10. EISML's net worth (ex-retained earnings) stands at INR 5.43 bn (refer page 3 for details).
- EISML's net worth has jumped from INR 591 mn (pre infusion) to INR 5.7 bn primarily on account of fresh infusion by Educomp. EISML reported net profit of INR 176 mn during FY10 (refer page 3 for details).
- Goodwill has jumped from INR 1.2 bn to INR 6.0 bn (36.6% of net worth), out of which INR 4.6 bn is towards the EISML transaction. Goodwill written off through reserves was INR 0.8 bn.
- Increase in security premium is INR 4.6 bn higher than premium received on equity issuances by Educomp, which is on account of increase in EISML's goodwill.
- Educomp has given corporate guarantee of INR 6.3 bn against loan extended to EISML. Loans outstanding as at FY10 end stood at INR 3.6 bn.

BOOT to outright sale advances revenue/cash flow...

- During the year, Educomp changed the smart class business model from BOOT to outright sale and transferred all existing BOOT projects to EduSmart Services. This will advance revenue booking as well as cash flows through securitisation which is backed by corporate guarantee from Educomp.
- Corporate guarantee given to banks for secured loans obtained by third parties (primarily Edusmart) stood at INR 6.6 bn.
- The company's revenue jumped 63.2% from INR 6.4 bn in FY09 to INR 10.4 bn in FY10. However, EBIDTA margins dipped from 48.1% in FY09 to 46.9% in FY10.

.... IFRS may lead to Edusmart's consolidation

- Post migration to IFRS, in our view, considering the nature of transaction between Educomp and EduSmart, the latter is likely to be consolidated with the former, leading to elimination of revenues, profitability, and other inter-company transactions.
- This will also lead to consolidation of outstanding loans and receivables in Edusmart's balance sheet.

Increasing debtor stretches cash conversion cycle; debtors > six months surge

- Debtors increased ~100% from INR 2.8 bn in FY09 to INR 5.6 bn in FY10, which, as a percentage of sales, stood at 53.2% (FY09:43.4%). However, debtors exceeding six months jumped from INR 0.8 bn in FY09 to INR 1.3 bn in FY10.
- The increase in debtors is primarily on account of amount to be received from Edusmart pending securitisation.

Analysis beyond Consensus (ABC) is our initiative to provide a differentiated perspective to our clients on various non-routine and intricate issues. This unit of research works independent of the sector/stock research team and views expressed in this report may vary with that of respective sector/stock analyst.

- The company's cash conversion cycle increased from 62 days in FY09 to 106 days in FY10, primarily on account of increase in debtor days from 112 in FY09 to 146 in FY10.

FCCB maturing in July 2012; redemption premium not provided for

- The company has FCCBs outstanding of USD 78.5 mn convertible at INR 589.9 per share on or before July 2012 (conversion makes economic sense at INR 832.4). Educomp has not provided for the redemption premium, but shown it as a contingent liability of INR 1.5 bn on FCCBs. Had the same been charged through P&L on YTM basis, FY10 PAT would have been lower by 6.3% (INR 173.3 mn).

Increase in net worth on QIP/consolidation leads to reduction in D/E ratio

- Net worth has increased due to :
 - INR 6.0 bn (net of issue expenses) raised through QIP.
 - Additional increase of INR 4.6 bn to security premium on consolidation (refer page 3 for details).
- Loan book increased from INR 8.9 bn in FY09 to INR 10.5 bn in FY10. The company's average borrowing cost also increased to 9.8% (FY09: 9.3%).
- Debt equity reduced to 0.6x (FY09: 2.3x) primarily on account of the above.
- Educomp, during the year, acquired the business of Zaptive Internet Services for an aggregate consideration of INR 60.2 mn. The consideration has been discharged partly through cash of INR 18.5 mn and balance by issue of 52,616 equity shares.

Other financial highlights

- Other income increased from INR 0.3 bn in FY09 to INR 1.3 bn in FY10 due to profit on sale of business/ investment of INR 0.9 bn (20.6% of PBT).
- Performance of subsidiaries dampened the company's overall performance. Of the 43 subsidiaries, only 17 are operational and six profit making at the PBT level (refer page 5 for details).
- Cash & bank and investments increased from INR 2.6 bn in FY09 to INR 8.2 bn in FY10.
- Fixed assets (excluding goodwill) increased 31.1% due to rise in freehold land to INR 3.9 bn (FY09 INR 472.9 mn), which has been partially set off by decrease in computers to INR 377 mn (FY09: INR 2.6 bn) and furniture to INR 131 mn (FY09: INR 518 mn). Decrease in assets is due to transfer of BOOT projects and vocational business.
- Educomp has invested in non convertible redeemable preference shares of INR 200 mn in EduSmart.
- Net assets invested in K12 business increased from INR 2.3 bn in FY09 to INR 11.3 bn in FY10.

EISML growth track

Year	Capital	Reserve	Network	Turnover	PAT	Network ex-retained earnings	Cash infusion for equity by Educomp		Educomp's stake (%)
							Cummulative	Incremental	
FY07	0.2	251.8	252.1	-	2.0	250.1	250.0	250.0*	69.4
FY08	0.3	508.0	508.3	16.6	6.2	500.1	500.0	250.0	69.4
FY09	10.8	580.7	591.5	316.6	108.9	474.4	500.0	-	69.4
FY10	247.2	5,401.8	5,649.0	564.0	176.1	5,429.9	5,397.5	4,897.5	78.2

Source: Company Annual Report, Edelweiss research

Note : * Partly paid shares issued . Fully paid in FY08

Commulatively, Educomp has invested INR 5.4 bn in EISML towards equity till FY10. EISML's net worth stands at INR 5.7 bn.

EISML equity share movement analysis

Equity shares (mn)	EMISL	Educomp	Others
Stake holding FY09 (%)		69.4	30.6
Opening	1.1	0.8	0.3
Bonus (1:15)	16.2	11.2	5.0
Fresh Issue	7.5	7.4	0.1
Closing	24.8	19.4	5.4
Stake holding FY10 (%)		78.2	21.8

Educomp paid INR 4.9 bn @ 664/ share towards incremental 8.8% stake

Source: Company Annual Report, Edelweiss research

EISML imputed valuation based on incremental shares purchased

Particulars	
Shares acquired by Educomp (mn)	7.4
Consideration Paid by Educomp (INR mn)	4,897.5
Consideration paid per share (INR)	664.4
Total Shares outstanding (mn)	24.7
Imputed valuation of ESIML (INR mn)	16,424.9

Share premium reconciliation statement

Particulars	(INR mn)
Share premium addition as per BS schedule	10,814
Share premium on issue of equity shares	6,159
ESOPs	67
QIP	6,051
Issued to Zaptive Internet services for business acquisition	42
Difference	4,654

Source: Company Annual Report, Edelweiss research

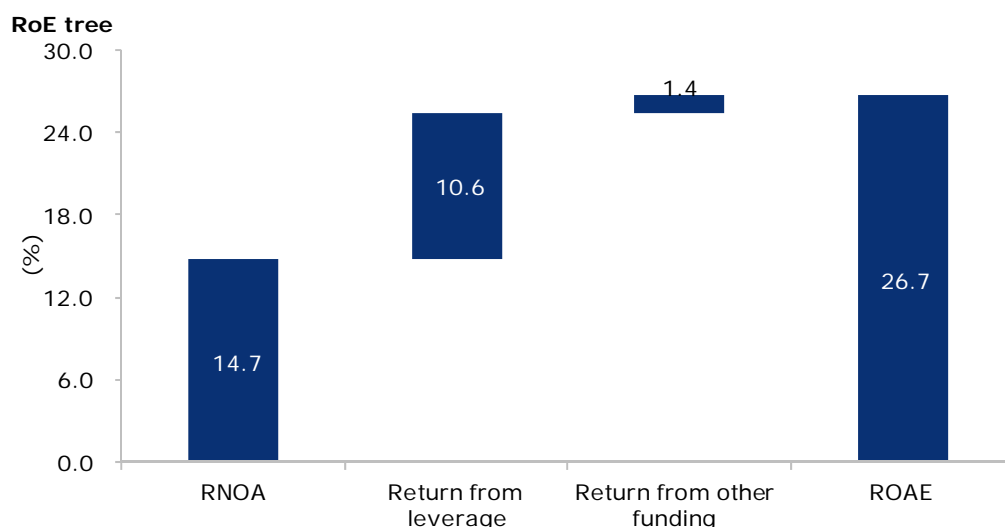
Profitability analysis (ROE analyser)

ROE analyser analyses profitability on the scale of operating efficiency and capital allocation efficiency (detailed concept explained in Annexure A). We have analysed Educomp's profitability for FY08, FY09, and FY10; results and key findings are given below:

ROE analyser

Particulars	FY08	FY09	FY10
A. Return on net operating assets (RNOA) (OPATO x NOPAT margin) (%)	24.5	19.4	14.7
OPATO (operating asset turnover) (x)	1.1	0.8	0.6
NOPAT margin (%)	22.8	23.4	23.2
B. Return from leverage (FLEV x spread) (%)	8.1	18.7	10.6
FLEV (financial leverage) (x)	0.2	1.1	0.5
NBC (net borrowing cost) (%)	(10.0)	3.0	(8.1)
Net financial spread (RNOA -NBC) (%)	34.5	16.5	22.8
C. Return from other funding (%)	1.8	0.8	1.4
ROE Derived (A+B+C) (%)	34.4	39.0	26.7

Source: Company Annual Report, Edelweiss research



Source: Company Annual Report, Edelweiss research

RoAE dipped on account of

- Decrease in RNOA, primarily attributable to low operating asset turnover for incremental investment in K12 business segment yet to reap result.
- Dip in financial leverage, primarily on account of fresh issue of equity under QIP / ESOP.
- NBC was negative due to profit on sale of investment of INR 725.5 mn recognised during the year and non charging FCCB redemption premium through P&L.

Parent-subsidiary operating performance analysis

Particulars	(INR mn)											
	Standalone				Subsidiary (Derived)				Consolidated			
	FY09	(%)	FY10	(%)	FY09	(%)	FY10	(%)	FY09	(%)	FY10	(%)
Sales	5,012	100.0	8,322	100.0	1,359	100.0	2,073	100.0	6,371	100.0	10,395	100.0
Raw materials consumed	1,033	20.6	1,481	17.8	77	5.7	122	5.9	1,110	17.4	1,603	15.4
Operating and manufacturing	121	2.4	310	3.7	62	4.6	218	10.5	183	2.9	528	5.1
Personnel cost	611	12.2	999	12.0	544	40.0	794	38.3	1,155	18.1	1,793	17.2
Administrative and other expenses	496	9.9	904	10.9	362	26.6	689	33.2	858	13.5	1,593	15.3
EBITDA	2,749	54.9	4,627	55.6	391	28.8	372	17.9	3,064	48.1	4,877	46.9
Depreciation	752	15.0	907	10.9	62	4.6	235	11.3	814	12.8	1,142	11.0
EBIT	1,997	39.8	3,720	44.7	329	24.2	137	6.6	2,249	35.3	3,735	35.9
Financial Charges	140	2.8	372	4.5	162	11.9	217	10.5	302	4.7	590	5.7
EBT	1,857	37.1	3,348	40.2	167	12.3	(80)	(3.9)	1,947	30.6	3,145	30.3

Source: Company Annual Report, Edelweiss research

- Despite of change in business model from BOOT to outright sale, EBIDTA margins on a standalone basis increased marginally from 54.9% in FY09 to 55.6% in FY10.
- Subsidiaries dampened the company's overall profitability.

Subsidiary analysis

Subsidiary company	% shareholding FY10	FY09			FY10			(INR mn)
		Networth	Turnover	PBT	Networth	Turnover	PBT	
Educomp Asia Pacific Pte.	100.0	360.1	-	(4.4)	1,155.6	-	696.7	
Educomp Infrastructure and School	78.2	591.5	316.6	152.8	5,649.0	564.0	267.6	
Learning Internet Inc. USA	54.7	919.9	541.5	86.6	862.5	722.4	70.7	
EuroKids International	50.0	352.5	103.6	21.2	512.6	292.5	55.4	
Educomp Learning	51.0	72.8	61.9	27.7	80.4	61.9	11.6	
Singapore Learning.com Pte.	100.0	6.3	9.6	5.8	8.8	10.9	2.8	
A Plus Education Solutions	-	43.3	1.9	(11.5)	0.0	-	0.0	
Educomp Software	100.0	(0.4)	1.6	(0.9)	(0.4)	2.6	(0.0)	
Wheatstone Productions	51.0	(1.8)	-	-	(1.9)	-	(0.1)	
Evergreen Realtech	77.9	-	-	-	65.6	-	(0.1)	
Zeta Buildcon	78.1	-	-	-	120.7	-	(0.1)	
Boston Realtech	77.9	-	-	-	68.6	-	(0.1)	
Onega Infrastructure	78.0	-	-	-	85.7	-	(0.1)	
Grider Infratech	78.0	-	-	-	106.6	-	(0.1)	
Euroschool International	50.0	-	-	-	0.7	-	(0.2)	
Educomp IntelProp Ventures Pte	100.0	-	-	-	40.1	-	(0.3)	
Educomp Infrastructure Services	78.2	0.1	-	-	(0.2)	-	(0.3)	
Good Luck Structure	77.9	-	-	-	56.6	-	(0.3)	
Newzone Infrastructure	77.9	-	-	-	69.3	-	(0.4)	
Leading Edge Infratech	78.0	-	-	-	76.3	-	(0.4)	
Crosshome Developers	78.0	-	-	-	75.4	-	(0.4)	
Rockstrong Infratech	78.0	-	-	-	87.2	-	(0.4)	
Reverie Infratech	78.0	-	-	-	157.2	-	(0.5)	
Strotech Infrastructure	78.0	-	-	-	94.7	-	(0.5)	
Markus Infrastructure	78.0	-	-	-	104.4	-	(0.5)	
Growzone Infrastructure	78.0	-	-	-	107.2	-	(0.5)	
Orlando Builders	78.0	-	-	-	109.5	-	(0.5)	
Herald Infra	78.1	-	-	-	171.1	-	(0.5)	
Hidream Constructions	78.1	-	-	-	263.0	-	(0.5)	
Falcate Builders	78.0	-	-	-	187.1	-	(0.5)	
Educomp Online Supplemental Services	100.0	-	-	-	(0.1)	-	(0.6)	
Educomp School Management	68.0	108.6	72.2	53.8	108.4	5.1	(0.6)	
Sikhya Solutions Inc.	72.0	(0.1)	6.1	(5.6)	0.6	11.4	(0.7)	
Wiz Learn Pte	100.0	26.7	6.2	(5.8)	23.9	6.1	(1.0)	
Pave Education Pte.	100.0	23.6	41.5	5.9	19.4	28.1	(3.1)	
EuroKids India	50.0	46.1	24.7	2.4	57.5	52.8	(3.6)	
Ask N Learn Pte.	100.0	105.0	189.1	(0.5)	349.2	217.1	(6.2)	
Edumatics Corporation Inc. USA	100.0	4.2	48.3	(8.0)	10.7	48.4	(10.9)	
Educomp Professional Education	100.0	325.3	1.9	(11.5)	576.0	-	(12.3)	
Educomp Child Care	100.0	-	-	-	79.0	29.8	(19.6)	
Educomp APAC Services Ltd. BVI	78.2	925.9	-	-	897.9	-	(27.8)	
Educomp Learning Hour	76.3	(5.6)	10.0	(22.1)	41.5	11.6	(32.9)	
Authorgen Technologies	72.0	16.4	0.7	(31.8)	39.6	4.5	(36.3)	
Savvica Inc., Canada	72.6	8.9	2.4	(27.1)	(5.6)	10.2	(52.8)	

Source: Company Annual Report, Edelweiss research

Of the 43 subsidiaries:

- Only 17 are operational.
- Only six are profit making at the PBT level.

Net assets in K12 business segment have jumped from INR 2.3 bn in FY09 to INR 11.3 bn in FY10

Increasing stake in EISML led to goodwill jumping to INR 4.8 bn

Segmental analysis

Segment	Revenue (INR mn)		EBIT margins(%)	
	FY09	FY10	FY09	FY10
Higher learning solution	310	265	29.6	(42.0)
School learning solution	4,322	8,068	48.6	55.8
K-12	621	997	44.2	32.3
Online & retail	1,118	1,066	18.3	(14.7)
	6,371	10,395	41.9	43.8

Segment	Net assets (INR mn)		Return on net assets (%)	
	FY09	FY10	FY09	FY10
Higher learning solution	561.4	457.8	16.3	(24.3)
School learning solution	5,777.1	5,486.8	36.4	82.1
K-12	2,252.5	11,314.0	12.2	2.8
Online & retail	1,144.6	1,755.3	17.8	(8.9)
	9,735.6	19,013.9	27.4	24.0

Source: Company Annual Report, Edelweiss research

Goodwill on consolidation

Particulars	(INR mn)	
	FY09	FY10
Educomp Learning	0.7	0.7
Edumatics Corporation Inc.	26.0	26.0
Wheatstone Productions	3.4	3.4
Educomp Infrastructure & School Management	152.4	4,754.6
Educomp School Management	10.0	10.0
Educomp Learning Hour	5.2	85.0
Authrogen Technologies	12.0	73.0
Educomp Asia Pacific	727.4	727.4
A Plus Education Solutions	26.6	0.0
Savvica Inc	41.7	75.9
Educomp Higher Initiative	0.0	33.7
Educomp Professional Education	0.0	21.7
Eurokids International	223	223
Total	1,228	6,034

Source: Company Annual Report, Edelweiss research

Goodwill on consolidation increased significantly, primarily on account of hiking its stake in Educomp Infrastructure and School Management to 78.2% (FY09 69.4%) by investing INR 4.9 bn.

Movement in shareholders' fund		(INR mn)
Particulars		FY10
Opening shareholders' fund		3,844
Add		
Issue of shares on QIP, ESOP and business acquisition (as reported net of issue exp.)	10,664	
Profit for the year*	2,771	
Change in Foreign Currency Monetary Items Translation Diff A/c	350	
Others	4.0	
		13,789
Less		
Proposed Dividend (incl tax)	333	
Change in Foreign Currency Translation reserve	29	
Adj to goodwill on further investment	793	
		1,154
Closing shareholders' fund		16,479

Source: Company Annual Report, Edelweiss research

* excl. amortisation of misc/ prelim.exp.

Goodwill write off directly adjusted through reserves

Cash flow analysis		(INR mn)
Particulars		FY10
Profit before tax		4,392
Non operating (profit)/Loss	(686)	
Non cash adjustments (Incl. tax provision)	1,308	
Direct taxes paid	(909)	
Cash profit after tax		4,106
Increase in trade and other receivables	(1,680)	
Increase in Loans and Advances	(473)	
Increase in trade and other payables	277	
Increase in inventories	(34)	
Increase in working capital		(1,910)
Net cash from operating activities		2,195
Interest Paid		(411)
Net cash from operating activities post interest		1,784

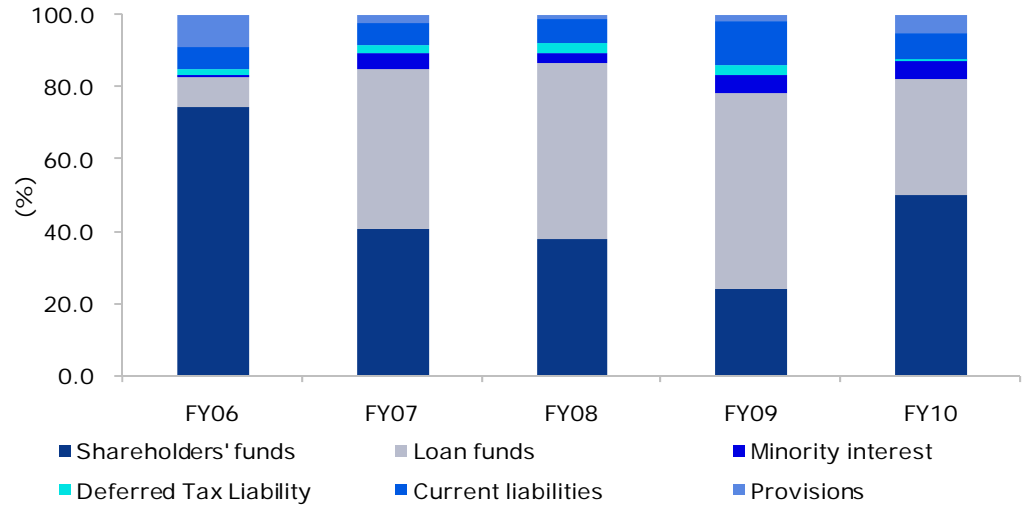
Source: Company Annual Report, Edelweiss research

Net cash flow from operating activity stood at INR 2.2 bn despite a PBT of INR 4.4 bn primarily on account of increase in debtors by INR 1.7 bn.

Balance sheet analysis

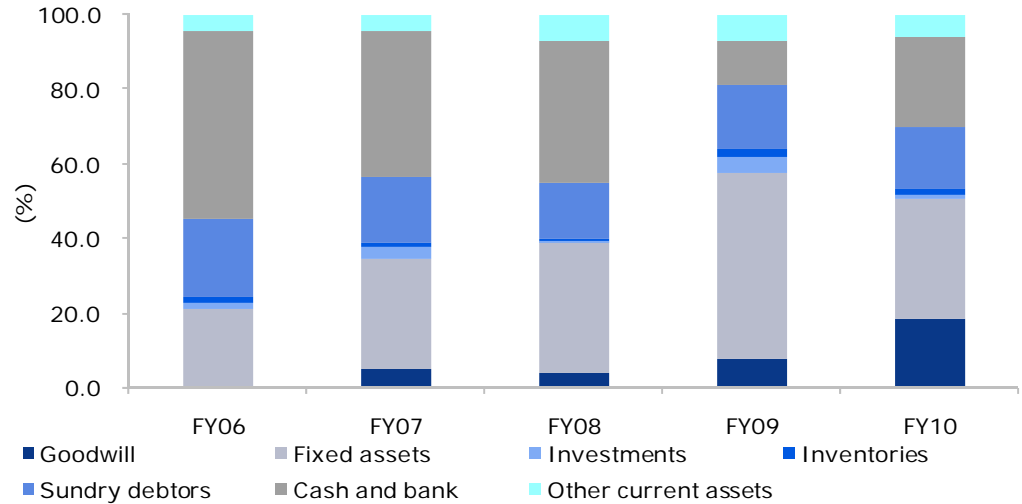
Debt equity improved primarily on account of issuance of fresh equity

Sources of funds



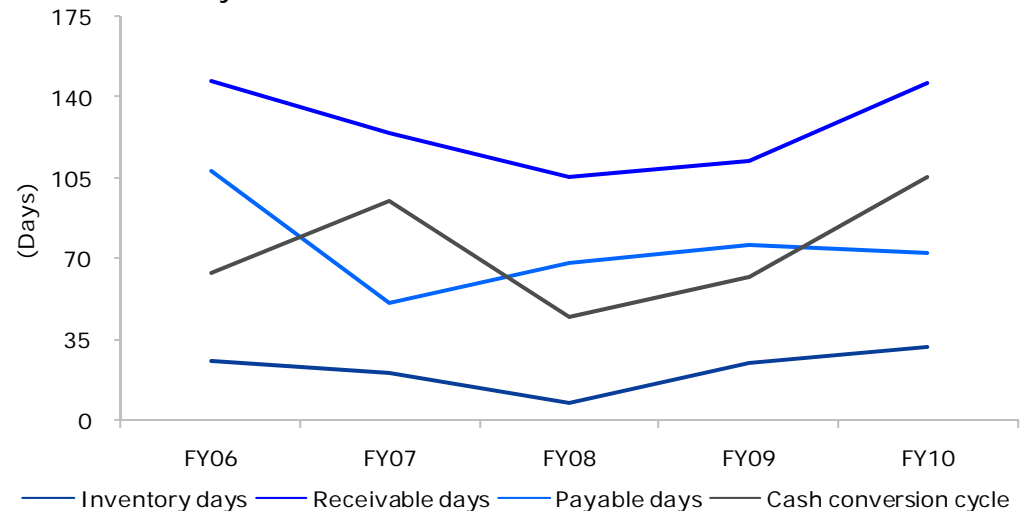
Proportion of funds invested in goodwill increased while proportion of fixed assets dipped

Application of funds



Cash conversion cycle increased from 62 days in FY09 to 106 days in FY10 due to increase in receivable days from 112 to 146 during the same period

Cash conversion cycle



Source: Company Annual Report, Edelweiss research

Summary financials

Particulars	FY06	FY07	FY08	FY09	FY10
Sales	555	1,101	2,861	6,371	10,395
Total income	570	1,160	3,038	6,598	11,650
EBITDA	270	516	1,281	3,064	4,877
EBITDA margin (%)	48.7	46.9	44.8	48.1	46.9
Depreciation	56	96	331	814	1,142
Financial costs	8	21	65	302	590
Net profit	139	287	706	1,329	2,759
Equity shareholders' funds	894	1,147	2,883	3,844	16,479
Loan funds	110	1,255	3,773	8,895	10,478
Net fixed assets	252	831	2,714	8,126	10,656
Current assets loans and advances	930	1,761	4,639	6,153	15,816
Current liabilities and provisions	182	242	610	2,251	3,963
Net current assets	748	1,519	4,029	3,903	11,853
Cash flow from operating activities	134	165	505	1,914	2,195
Cash flow from investing activities	(167)	(719)	(2,102)	(6,751)	(3,722)
Cash flow from financing activities	616	1,088	3,393	3,826	7,462
Net cash flows	583	534	1,796	(1,011)	5,936
CAPEX	(162)	(675)	(2,224)	(5,786)	(6,855)
Working capital investments	(99)	(225)	(730)	(1,023)	(1,910)

Source: Company Annual Report, Edelweiss research

ANNEXURES

Annexure A: ROE analyser

ROE analyser analyses the profitability on the scale of operating efficiency and capital allocation efficiency. While operating efficiency is a measure of how efficiently the company is making use of operating assets, capital efficiency is the measure of balance sheet efficiency.

The above analysis involves:

1. Dissection of profitability along two major drivers:
 - a. Return from operating activities (RNOA: return on net operating assets).
 - b. Return from financing activities (leveraging effect on ROE).

ROE = Return from operating activities (RNOA) + Return from leverage

Or

ROE = Operating margin x Operating assets turnover + Leverage spread x Leverage multiplier

Whereas:

- ♦ RNOA = NOPAT/Average operating assets
 - ♦ Operating margin = NOPAT/Operating revenue
 - ♦ Operating assets turnover = Operating revenue/Average operating assets
 - ♦ Leverage spread = RNOA – Net borrowing cost
 - ♦ Leverage multiplier = Average net financial obligation/Average common shareholders' equity
2. Reformulation of balance sheet, wherein, we have regrouped assets and liabilities into operating and financing categories (against traditional current and non-current categorisation).
 3. Reformulation of income statement, wherein, we have regrouped income and expenses into operating and financing activities.

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