

Company

13 May 2010 | 7 pages

Educomp Solutions (EDSO.BO)

 Equity

Sell: Completed Securitization to Give a Fresh Start

- Headline numbers strong** — Educomp reported standalone revenues of Rs2.7bn (up ~49% YoY; CIRA: Rs2.3bn) with EBITDA margins of 55.6% (CIRA: 50.4%). Reported numbers benefited from the securitization of Smartclass BOOT contracts (1,323 schools were securitized in Q4, giving additional revenues of ~Rs450m). Ex-securitization revenues were Rs2.3bn – in line with our estimates.
- School Learning Solutions (SLS) revenue growth aided by securitization** — SLS revenues rose ~61% YoY led by Smartclass revenues growing ~120% YoY (ICT declined ~50% YoY). Smartclass growth would have been much lower excluding the securitization of old BOOT contracts. Assuming securitized revenues at ~80-90% margins (as suggested by management), underlying EBIT margins would be lower than reported.
- Consolidated segmental details** — (a) SLS revenues were up 61% YoY with EBIT margins improving ~1700bps YoY, with a big boost from the securitized component, (b) K-12 Schools revenue up 27% YoY to Rs302m; margins declined ~1200bps YoY, (c) Higher Learning solutions revenues declined 11% YoY on a low base, (d) Online supplemental/global business revenues declined 5% YoY.
- FY11 guidance** — Management has guided for revenues of Rs13-13.5bn (up 25-30% YoY) and profits of Rs3.3-3.5bn (up 22-23% YoY) based on reported numbers. The Smartclass guidance for revenues of Rs8.5-9bn with Rs5.5-6bn will be through organic growth – balance through previous year's revenue deferment.
- Key takeaways from the call** — (a) K-12 – 43 schools are live with visibility of reaching 69. (b) Management believes they can add ~25-30,000 classrooms in Smartclass in FY11 – going forward guidance will be on number of classrooms as more and more schools are adopting Smartclass on a pilot basis. (c) Funding of Rs4.2bn sanctioned till Q4 with Rs5bn tied up for FY11. (d) Management will be selective in going after ICT contracts – only 600 schools won in Q4.

Sell/Medium Risk	3M
Price (13 May 10)	Rs626.75
Target price	Rs710.00
Expected share price return	13.3%
Expected dividend yield	0.1%
Expected total return	13.4%
Market Cap	Rs59,647M
	US\$1,326M

Price Performance (RIC: EDSO.BO, BB: EDSL IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2008A	706	7.08	122.2	88.5	18.7	35.0	0.1
2009A	1,329	15.01	112.0	41.7	12.9	37.5	0.1
2010E	2,692	26.57	77.0	23.6	4.6	31.5	0.1
2011E	3,054	30.14	13.5	20.8	3.8	21.3	0.1
2012E	4,406	43.48	44.3	14.4	3.0	24.5	0.2

Source: Powered by dataCentral

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Result Tables

Figure 1. Key Financials – Standalone

Rs m	4Q09	4Q10	YoY
Revenue	1,839	2,734	49%
COGS	530	450	-15%
Personnel expenses	188	288	53%
Gross profit	1,121	1,996	78%
SG&A expenses	294	475	61%
EBITDA	827	1,521	84%
EBITDA margin	45%	56%	1067bp
Depreciation & Amortization	268	126	-53%
EBIT	559	1,395	149%
EBIT margin	30%	51%	2060bp
Other income, net	314	6	-98%
PBT	874	1,401	60%
Provision for tax	329	726	121%
Profit after tax	545	675	24%
Basic EPS	6.30	7.11	13%
Diluted EPS	6.16	6.52	6%

Source: Company Reports

Figure 2. Segmental Financials – Standalone

Rs m	4Q09	4Q10	YoY
School Learning Solutions			
Revenue	1,665	2,680	61%
EBIT	743	1,637	120%
EBIT margin	45%	61%	1648bp
Higher Learning Solutions			
Revenue	87	41	-53%
EBIT	18	9	-52%
EBIT margin	21%	21%	43bp
K-12 Schools			
Revenue	80	8	-90%
EBIT	18	3	-84%
EBIT margin	23%	37%	1432bp
Online, Supplementary & Global			
Revenue	7	5	-27%
EBIT	-11	-4	-64%
EBIT margin	-151%	-76%	7537bp
Unallocated	-155	322	-307%

Source: Company Reports

Educomp Solutions

Company description

Educomp is one of India's largest listed educational service providers focused on the K-12 space (both IT and IT-enabled education). Based in New Delhi, the company operates across various metros and mini metros for private schools and partners various state governments for IT education. It has three primary business segments: 1) Smartclass is an online learning aid targeted towards private educational institutes; 2) ICT Solution is targeted towards government-aided schools for IT infrastructure and training; and 3) Professional Development instructor-led training targeted at school teachers. Apart from these key segments, the company has also ventured into retail initiatives with 1) vocational training; 2) online tutoring (through ThreeBrix acquisition); and 3) K-12 schools, pre-schools and high schools.

Investment strategy

We rate Educomp Sell/Medium Risk as we believe its valuations are expensive despite its strong revenue and earnings growth. We forecast a strong top-line CAGR of ~44% and ~41% EPS CAGR over FY09-12E as the company penetrates beyond tier 1 & 2 cities. Despite this growth, we believe Educomp is expensive. We are also concerned about the company's high capex requirements in organic business and expansion plans in the capital-intensive K-12 business.

Valuation

We value Educomp at Rs710 based on the sum of two parts: 1) ~Rs650 from the core business based on 22x FY11E EPS, and 2) ~Rs60 which is the NPV of all contracts that Educomp can securitize. Due to a change in the business model of SmartClass, we think that the historical PEs are no longer relevant in valuing Educomp and use the 22x FY11 estimates, which are in line with the closest regional peer - New Oriental. PE is a common approach used to value educational services.

Risks

We rate Educomp Medium Risk despite our quantitative risk-rating system suggesting High Risk as we believe: 1) Recent fund raising allays investor concerns on debt-equity. 2) Expectations have come down a little post the disappointment in 2QFY10. Key upside risks to our target price include: 1) higher-than-expected sign-ups for Smartclass and faster ramp up in K12; 2) faster-than-expected fresh orders in the ICT business; and (3) better-than-expected margins in various segments.

Appendix A-1

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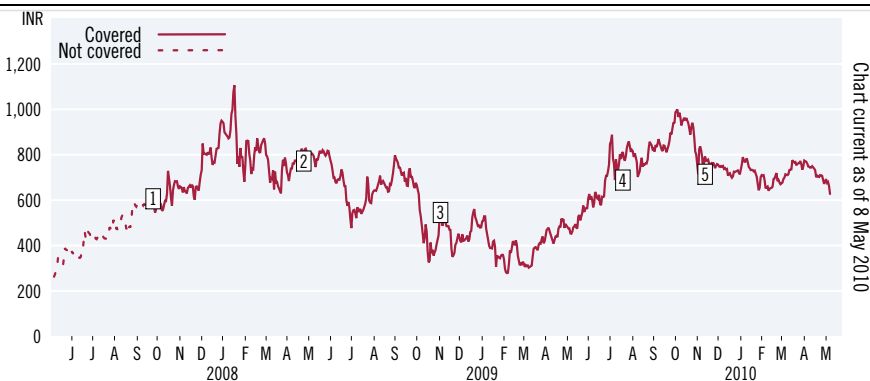
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Educomp Solutions (EDSO.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Surendra Goyal, CFA



	Date	Rating	Target Price	Closing Price
1	25-Sep-07	*3H	*476.00	594.46
2	24-Apr-08	3H	*580.00	801.06

	Date	Rating	Target Price	Closing Price
3	4-Nov-08	3H	*482.00	522.12
4	19-Jul-09	*3M	*750.00	806.61

	Date	Rating	Target Price	Closing Price
5	12-Nov-09	3M	*710.00	792.10

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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