

Morgan Stanley India Company  
Private Limited+

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Stock Rating  
Equal-weight

Industry View  
Attractive

## Educomp Solutions Ltd. Stock Underperformance Is Unlikely to Reverse Soon

**Quick Comment – Impact on our views:** We believe consensus estimates for the stock are headed 5-10% lower. Moreover, we believe realization per school could fall significantly for schools that come up for renewal in small tier 2 and 3 towns in India. Overall, if the company does not materially outperform its FY guidance, we believe the stock could remain at a discount to the market.

**What's new:** Our key takeaways from the Annual Smartclass™ Team Meeting for Educomp follow:

- 1) Educomp has an internal target to add 4,500 schools and 40,500 classrooms in F2011, averaging nine classes per school. It has historically added 25 classes per school and had guided for 15 classes per school as recently as Dec09 and averaged about eight classes per school in F4Q.
- 2) The smartclass sales team is likely to be increased to over 500 people (from ~220 currently) over the coming months to achieve the target.
- 3) Smartclass segment team will be divided into five zones from eight earlier. These zones will target a total of 42,800 schools with total sales team of approximately 450-500 people.
- 4) Management will now allow an independent strategy for each zone with separate marketing and promotional heads at the zone level versus centralized planning earlier.
- 5) Management estimates the total market for smartclass at 76,000 schools and 3mn classrooms averaging 40 classes per school. However, it indicated that the immediate target market is 42,800 schools.

### Key Ratios and Statistics

Reuters: EDSO.BO Bloomberg: EDSL IN  
India Education Services

Price target	Rs630.00
Upside to price target (%)	14
Shr price, close (May 19, 2010)	Rs554.40
52-Week Range	Rs1,017.00-500.00
Sh out, dil, curr (mn)	89
Mkt cap, curr (mn)	Rs49,096
EV, curr (mn)	Rs56,164
Avg daily trading value (mn)	Rs686

Fiscal Year ending	03/09	03/10e	03/11e	03/12e
ModelWare EPS (Rs)	15.15	27.45	34.02	37.81
Consensus EPS (Rs)§	14.63	29.45	35.48	43.50
Revenue, net (Rs mn)	6,371	10,405	14,195	17,890
EBITDA (Rs mn)	3,044	4,858	6,202	7,987
ModelWare net inc (Rs mn)	1,341	2,726	3,396	4,002
P/E	27.6	27.2	16.3	14.7
P/BV	8.8	5.7	3.4	2.9
RNOA (%)	36.5	20.7	20.8	22.4
ROE (%)	46.5	64.8	25.5	24.2
EV/EBITDA	14.5	16.3	9.4	7.2
Div yld (%)	0.1	0.1	0.3	0.4
FCF yld ratio (%)	(10.5)	(1.9)	2.9	2.2
Leverage (EOP) (%)	149.0	17.5	8.3	1.6

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).

§ = Consensus data is provided by FactSet Estimates.  
e = Morgan Stanley Research estimates

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12TH ANNUAL INDIA SUMMIT

June 1-3, 2010 | Taj Lands End | Mumbai

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Of these 42,800 schools, management plans to target 25,000 schools (58%) in just four states (A.P., Karnataka, Kerela, Tamil Nadu), which indicates that acceptability may be far higher in the Southern region than other regions.

**6)** Educomp also plan to also launch its smartclass live product, which would facilitate live teaching across multiple locations.

We maintain our EW rating on the stock.

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(as of April 30, 2010)

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
<b>Overweight/Buy</b>	<b>1065</b>	<b>42%</b>	<b>328</b>	<b>42%</b>	<b>31%</b>
<b>Equal-weight/Hold</b>	<b>1118</b>	<b>44%</b>	<b>357</b>	<b>46%</b>	<b>32%</b>
<b>Not-Rated/Hold</b>	<b>14</b>	<b>1%</b>	<b>4</b>	<b>1%</b>	<b>29%</b>
<b>Underweight/Sell</b>	<b>366</b>	<b>14%</b>	<b>88</b>	<b>11%</b>	<b>24%</b>
<b>Total</b>	<b>2,563</b>		<b>777</b>		

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Overweight (O or Over) - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

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Not-Rated (NR) - Currently the analyst does not have adequate conviction about the stock's total return relative to the relevant country MSCI Index on a risk-adjusted basis, over the next 12-18 months.

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Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

## Analyst Industry Views

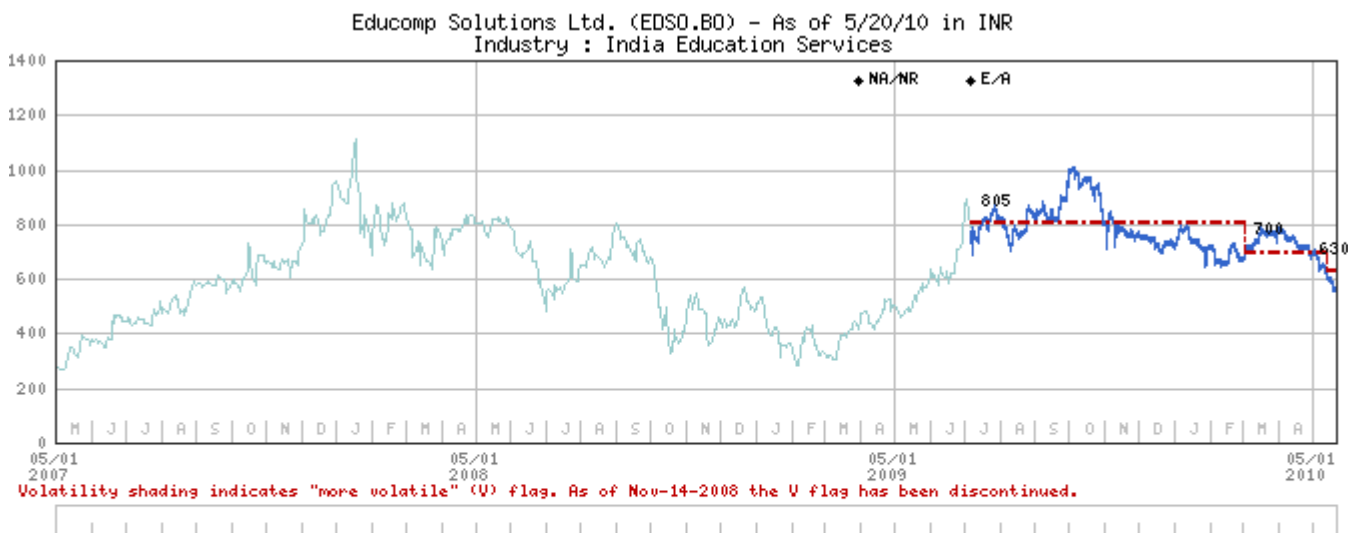
Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

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Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

## Stock Price, Price Target and Rating History (See Rating Definitions)



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May 20, 2010

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## Industry Coverage: India Education Services

Company (Ticker)	Rating (as of)	Price* (05/19/2010)
<b>Vipin Khare</b> Educomp Solutions Ltd. (EDSO.BO)	E (07/07/2009)	Rs554.4

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\* Historical prices are not split adjusted.