

Educomp Solutions Ltd

Robust 2QFY10 results validate high growth path,
Maintain OW

- Educomp reported strong 2QFY10 results** - Revenues of Rs2535m were up 31% Q/Q / 77% Y/Y and 11% ahead of our estimates. EBITDA of Rs 1015m (up18% Q/Q, 14% ahead of our estimates). EBITDA margin of 40% was down 400bp Q/Q due to seasonality of schools business and higher losses in online ventures. Revenue growth was driven by strength in Smart Class (multimedia segment) with revenues of Rs 1370m (up 34% Q/Q) and ICT business with revenues of Rs 635m (up 75% Q/Q). Net other income included one-time gain of ~Rs800m from the sale of 49% stake in its vocational business to Pearson leading to high net profit of Rs1170m.
- Securitization of Smart Class revenue to free up cash – reduces equity dilution risk.** Taking cognizance of the issue of high capital intensity of its key businesses, Educomp management has tied up with banks to securitize revenues from its Smart Class business. Educomp will now recognize all five years of Smart Class revenues upfront rather than on an annuity basis. We believe our estimates are on the conservative side given the high growth potential of this segment for the next 2-3 years. More importantly, securitization should free up cash for the company, reducing debt raising requirements and risk of any equity dilution in near future.
- We expect growth to remain strong:** We are changing our revenue estimates for FY10/11 by 1% / -3%. However, we expect better margins to partly offset lower revenues. With its first-mover edge in multimedia (Smart Class) and K-12 segments, we expect strong growth in both segments over the next 2-3 years. We expect FY09-12E revenue/EBITDA/EPS CAGR of 48%/ 55%/ 48%.
- Investment view:** We maintain our OW rating with PT of Rs 1000 based on one-year forward P/E of 27x. Risks to our thesis and price target are managing growth and delivering on high expectations and presence in too many small segments that stretches management bandwidth.

Reuters: EDSO.BO; Bloomberg: EDSL IN

Rs in millions, year-end March

	FY09	FY10E	FY11E	FY12E		FY09	FY10E	FY11E	FY12E		
Sales	6,450	10,216	15,084	20,947	Y/E BPS (Rs)	49	138	172	219	52-Week range	Rs266-1,020
Operating Profit	1,674	2,690	4,188	6,037	ROE (%)	37.2	31.8	22.8	25.4	Shares Outstg	94Mn
EBITDA	2,473	4,046	6,370	9,165	ROIC (%)	12.6	12.7	12.6	13.6	Date of price	10/30/2009
Net profit	1,326	2,750	3,340	4,667	Qtr EPS (Rs)	1Q	2Q	3Q	4Q	Avg daily volume	1.32Mn
EPS Sdalone (Rs)	14.6	20.7	29.7	40.4	EPS (FY09)	1.9	3.3	3.6	6.3	Avg daily value (US\$ Mn)	77.3
EPS Consol (Rs)	15.1	30.0	34.9	48.8	EPS (FY10E)	3.9	13.1	6.2	6.8	Index (Sensex)	15,896
P/E Std (x)	54.8	38.7	27.0	19.9	EPS (FY11E)	8.0	8.8	8.8	9.3	Free float	45%
P/E Consol (x)	52.9	26.7	23.0	16.4	Local	1M	3M	12M		Dividend Yld (%)	0.3%
P/B (x)	16.3	5.8	4.7	3.7	Abs. perf.(%)	-14.6	-2.3	79.0		Exchange rate	Rs47.0/US\$1
Cash	1,865	9,120	6,066	5,023	Rel. perf.(%)	-8.0	-5.4	1.8		Market Cap (Rs B)	75.6
										Mkt cap (US\$ m)	1,610

Source: Company data, Bloomberg, J.P. Morgan estimates.

Overweight

EDSO.BO, EDSL IN

Price: Rs801.75

Price Target: Rs1,000.00

India

Education Services

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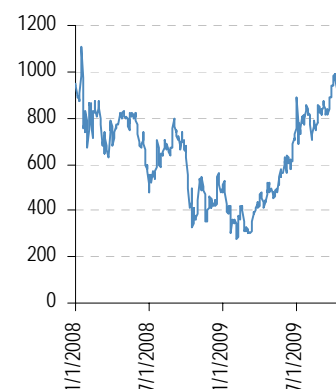
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J.P. Morgan India Private Limited

Figure 1: Educomp price performance



Source: Bloomberg

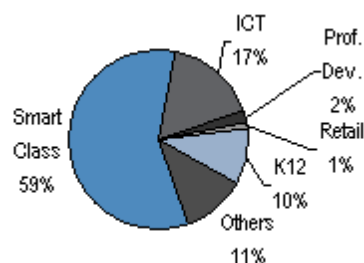
See page 8 for analyst certification and important disclosures, including non-US analyst disclosures.

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Company description

Educomp Solutions Ltd, founded in 1994, is a diversified education solutions provider and the largest education company in India. The Educomp Group reaches out to over 23,000 schools and 12 million learners and educators across the world through 27 offices worldwide, including an office in Canada and Sri Lanka, two in Singapore, three in the US and 20 in India. It also operates through its subsidiaries, including authorGEN, Threebrix, Learning.com (US), AsknLearn (Singapore) and associates such as Savvica in Canada.

Revenue



Source: Company data.

EPS: J.P. Morgan vs. consensus

	J. P. Morgan	Consensus
FY10E	30.0	23.2
FY11E	34.9	35.5
FY12E	48.8	49.1

Source: Bloomberg, J. P. Morgan estimates.

P&L sensitivity metrics

	EBITDA impact (%)	EPS impact (%)
Sales growth assumption (FY11E): 54.0%		
Impact of each 5%	3.8%	4.9%
Operating margin assumption (FY11E): 27.6%		
Impact of each 1%	2.8%	3.7%
Capacity utilization assumption (FY11E): NM		
Impact of each 5%	NM	NM
Debt/equity assumption (FY11E): 93%		
Impact of each 10%	0%	-0.5%

Source: J. P. Morgan estimates.

Price target and valuation analysis

Our Jun-10 price target of Rs1000 is based on one-year forward P/E of 27x. We believe the valuation is justified given the EPS CAGR of 48% over FY09-12E. Educomp is currently trading at FY09 P/E of 53x and FY10E P/E of 27x, and we expect the trading multiples to come down in line with growth expectations.

Risk-free rate:	6.50%
Market risk premium:	8.00%
Beta:	0.9
Debt/equity:	33%
Cost of debt:	11.5%
Terminal "g":	5%

Key risks to our price target are: (1) managing growth and delivering on already high consensus expectations; (2) high capex requirements for all segments could lead to higher leverage on the balance sheet (current net debt-to-equity is at 0.4x); (3) presence in too many small segments that stretches management bandwidth; and (4) disclosure levels to be improved.

2Q FY10 results

Table 1: Consolidated result details

Rs in millions, year-end March

	Actuals	Estimates	Difference %
Revenue	2,535	2,285	11.0
Depreciation	275	324	-15.3
Total Expen. (Excl. dep)	1,575	1,397	12.8
EBIT	685	564	21.6
EBITDA	960	888	8.1
Net Other Income	754	86	
Pre Tax Profit	1,440	650	121.6
Tax	270	221	
Net Profit	1,170	429	173.0
EPS (Rs)	63.2	23.1	173.0
Margins (%)			
Operating Margin	27.0	24.7	
EBITDA Margin	37.9	38.9	
Net Margin	46.2	18.8	

Source: Company reports and J.P. Morgan Estimates.

Estimate changes

Table 2: Estimate changes

Rs in millions, year-end March

	New			Earlier			Change (%)		
	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E
Sales	10,216	15,084	20,947	10,127	15,595	21,796	0.9	-3.3	-3.9
EBIT	2,690	4,188	6,037	2,733	4,300	6,232	-1.6	-2.6	-3.1
EBITDA	4,046	6,370	9,165	4,133	6,572	9,451	-2.1	-3.1	-3.0
PBT	3,903	5,061	7,071	3,143	5,035	7,129	24.2	0.5	-0.8
Net profit	2,750	3,340	4,667	2,066	3,322	4,703	33.1	0.5	-0.8
EPS (Rs)	30.5	35.4	49.5	22.3	35.2	49.9	36.4	0.5	-0.8
Margins (%)									
Operating Margin	26.3	27.8	28.8	27.0	27.6	28.6			
EBITDA Margin	39.6	42.2	43.8	40.8	42.1	43.4			
Net Margin	26.9	22.1	22.3	20.4	21.3	21.6			

Source: J.P. Morgan estimates.

Table 3: Educomp—Consolidated P&L account

Rs in millions, year-end March

	FY09				FY10E				FY06	FY07	FY08	FY09	FY10E	FY11E	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE							
Revenue	860	1,430	1,896	2,264	1,938	2,535	2,757	2,986	555	1,101	2,861	6,450	10,216	15,084	20,947
EBIT	242	384	479	569	579	709	646	756	211	411	942	1,674	2,690	4,188	6,037
EBITDA	382	551	687	853	861	1,015	1,011	1,159	268	507	1,273	2,473	4,046	6,370	9,165
Pre tax profit	255	422	470	883	529	1,440	920	1,015	220	454	1,064	2,030	3,903	5,061	7,071
Net profit	166	288	318	554	342	1,170	589	649	141	287	706	1,326	2,750	3,340	4,667
EPS (Rs)	9.6	16.7	18.4	32.1	4.0	13.4	6.2	6.9	8.8	17.9	8.2	15.4	30.5	35.4	49.5
Diluted EPS (Rs)	8.9	15.5	17.1	29.9	3.9	13.1	6.2	6.8	8.7	17.7	8.1	15.1	30.0	34.9	48.8
Margins (%)															
Operating margin	28.1	26.9	25.3	25.1	29.9	28.0	23.4	25.3	38.0	37.3	32.9	26.0	26.3	27.8	28.8
EBITDA margin	44.4	38.6	36.2	37.7	44.4	40.1	36.7	38.8	48.2	46.0	44.5	38.3	39.6	42.2	43.8
Net margin	19.2	20.1	16.8	24.5	17.6	46.2	21.4	21.7	25.3	26.1	24.7	20.5	26.9	22.1	22.3
Sequential growth (%)															
Revenue		66.2	32.6	19.4	-14.4	30.8	8.8	8.3	67.1	98.3	159.9	125.5	58.4	47.6	38.9
EBIT		58.7	24.7	18.8	1.8	22.5	-8.9	17.0	100.4	94.5	129.4	77.7	60.7	55.7	44.2
EBITDA		44.5	24.5	24.2	1.0	18.0	-0.5	14.7	70.7	89.2	151.3	94.2	63.6	57.4	43.9
Net profit		74.0	10.4	74.2	-38.3	242.1	-49.7	10.3	109.6	103.9	146.0	87.9	107.5	21.4	39.7
EPS		74.0	10.4	74.2	-38.3	237.2	-53.3	10.3	110.3	102.8	128.0	87.9	98.2	16.2	39.7
F.D. EPS		74.0	10.4	74.2	-38.3	235.9	-53.1	10.3	107.0	103.6	125.2	87.9	98.0	16.5	39.7

Source: Company reports, J.P. Morgan estimates.

Valuation and recommendation – Jun-10 PT of Rs1000/share

Our Jun-10 price target of Rs 1000 is based on one-year forward P/E of 27x. We believe the valuation is justified given EPS CAGR of ~50% over FY09-12E. Educomp is currently trading at FY09/FY10E P/E of 53x/27x and we expect the trading multiples to be in line with high growth expectations.

Key risks to our price target are: (1) managing growth and delivering on already high consensus expectations; (2) high capex requirements for all segments could lead to higher leverage on the balance sheet; (3) presence in too many small segments that stretches management bandwidth.

DCF valuation

Our DCF-based, Jun-10 fair value for Educomp is Rs 620, based on a FY09-FY19E revenue CAGR of 35%, terminal growth rate of 5%, EBIT margin of 28%, ROIC of 15% and WACC of 12.3%. Our price target assumes a 60% premium to this value, given the strong growth rate in the coming two-three years, which is significantly above long-term growth rates.

Educomp Solutions Ltd: Summary of financials

Rs in millions, year-end March

Income statement						Ratio analysis					
	FY08A	FY09A	FY10E	FY11E	FY12E	% , year-end March	FY08A	FY09A	FY10E	FY11E	FY12E
Revenues	2,861	6,450	10,216	15,084	20,947						
Cost of Goods Sold	1,919	4,776	7,526	10,896	14,910	EBITDA margin	44.5	38.3	39.6	42.2	43.8
						Operating Margin	32.9	26.0	26.3	27.8	28.8
Operating Profit (EBIT)	942	1,674	2,690	4,188	6,037	Net Margin	24.7	20.5	26.9	22.1	22.3
EBITDA	1273	2473	4046	6370	9165						
Other Income	121.9	355.7	1,213.1	872.6	1,033.3	Sales growth	159.9	125.5	58.4	47.6	38.9
						Operating Profit Growth	129.4	77.7	60.7	55.7	44.2
Earnings before tax	1,064	2,030	3,903	5,061	7,071	Net profit growth	146.0	87.9	107.5	21.4	39.7
Tax	-351	-704	-1,153	-1,721	-2,404	EPS (Reported) growth	128.0	87.9	98.2	16.2	39.7
Net Income (Reported)	706	1,326	2,750	3,340	4,667						
						Net debt to total capital	12.9	54.1	10.9	20.6	21.0
Rs						Net debt to equity	29.9	169.8	20.8	35.6	33.0
EPS (Reported)	8.2	15.4	30.5	35.4	49.5	Asset Turnover	37.3	40.8	36.1	45.1	52.8
EPS (diluted)	8.1	15.1	30.0	34.9	48.8						
BPS	33.4	49.2	138.5	171.5	218.7	ROE	35.0	37.2	31.8	22.8	25.4
DPS	0.5	2.5	0.0	2.0	2.0	ROIC	21.0	12.6	12.7	12.6	13.6
Shares Outstanding (mn)	85.0	86.2	90.6	94.3	94.3	ROCE	13.1	10.3	9.8	9.8	12.1
Balance sheet						Cash flow statement					
	FY08A	FY09A	FY10E	FY11E	FY12E		FY08A	FY09A	FY10E	FY11E	FY12E
Cash and cash equivalents	2,912	1,865	9,120	6,066	5,023	Net Income	706	1,326	2,750	3,340	4,667
Accounts receivable	1,157	2,977	3,927	5,500	7,616	Depr. & Amortisation	331	799	1,356	2,182	3,128
Inventories	18	50	65	92	127	Change in working capital	-703	-1,121	-748	-1,322	-1,853
Others	552	906	1,194	1,673	2,317	Other	72	594	391	1,302	868
Current assets	4,639	5,798	14,307	13,331	15,083	Cash flow from operations	407	1,597	3,749	5,502	6,810
LT investments	0	0	0	0	0	Capex	-2,214	-7,320	-5,320	-8,336	-7,632
Net fixed assets	2,714	9,235	13,200	19,354	23,858	Disposal/ (purchase)	-79	-450	0	0	0
Others	318	768	768	768	768	Cash flow from investing	-2,293	-7,770	-5,320	-8,336	-7,632
Total assets	7,671	15,801	28,274	33,452	39,708	Free cash flow	-1,808	-5,723	-1,572	-2,834	-822
Liabilities						Equity raised/ (repaid)	95	288	6,354	288	-23
						Debt raised/ (repaid)	2,518	5,301	2,760	0	0
Payables	517	1,392	1,802	2,399	3,126	Other	1,130	-210	-288	-288	23
Others	92	302	398	558	772	Dividends paid	-51	-252	0	-221	-221
Total current liabilities	610	1,694	2,200	2,957	3,899	Cash flow from financing	3,692	5,126	8,827	-221	-221
Long term debt	3,773	9,074	11,834	11,834	11,834						
Other liabilities	210	0	0	0	0	Net change in cash	1,806	-1,047	7,255	-3,054	-1,043
Total liabilities	4,593	10,768	14,034	14,791	15,733	Beginning cash	1,106	2,912	1,865	9,120	6,066
Shareholders' equity	2,884	4,245	13,062	16,181	20,627	Ending cash	2,912	1,865	9,120	6,066	5,023

Source: Company reports, J.P. Morgan estimates.

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Asia Pacific Equity Research
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J.P.Morgan

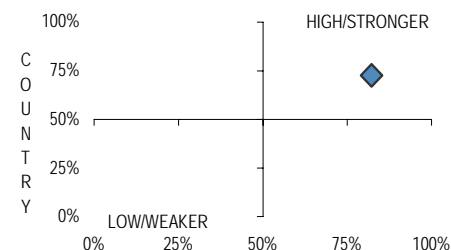
All Data As Of 02-Nov-09

Q-Snapshot: Educomp Solutions Ltd.

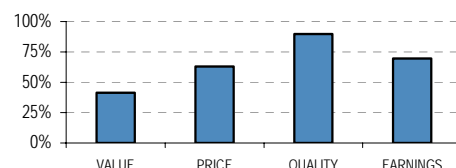
Quant Return Drivers (a Score >50% indicates company ranks 'above average')

Score 0% (worst) to 100% (best)	vs Country	vs Industry	Raw Value
Value			
P/E Vs Market (12mth fwd EPS)	15%	13%	1.7x
P/E Vs Sector (12mth fwd EPS)	18%	26%	1.4x
EPS Growth (forecast)	86%	90%	42.3%
Value Score	42%	41%	
Price Momentum			
12 Month Price Momentum	50%	78%	97.6%
1 Month Price Reversion	85%	97%	-14.7%
Momentum Score	63%	89%	
Quality			
Return On Equity (forecast)	92%	94%	34.2%
Earnings Risk (Variation in Consensus)	52%	24%	0.11
Quality Score	90%	84%	
Earnings & Sentiment			
Earnings Momentum 3mth (risk adjusted)	30%	41%	-6.2
1 Mth Change in Avg Recom.	48%	41%	0.04
Net Revisions FY2 EPS	97%	95%	100%
Earnings & Sentiment Score	70%	70%	
COMPOSITE Q-SCORE* (0% To 100%)	73%	82%	

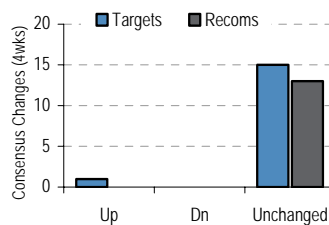
J.P. Morgan Composite Q-Score



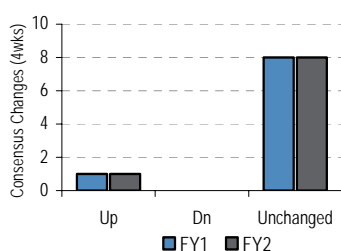
Quant Return Drivers Summary (vs Country)



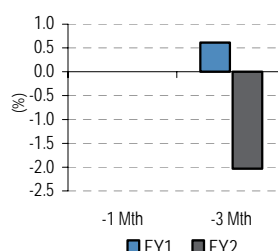
Targets & Recommendations**



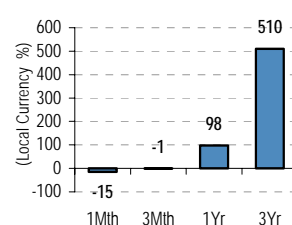
EPS Revisions**



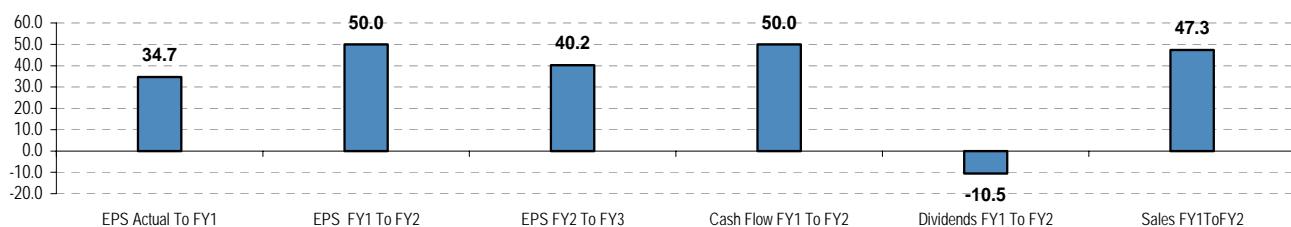
EPS Momentum (%)



Historical Total Return (%)



Consensus Growth Outlook (%)



Closest in Country by Size (Consensus. ADV = average daily value traded in US\$m over the last 3 mths)

Code	Name	Industry	USD MCAP	ADV	PE FY1	Q-Score*
500116-IN	IDBI Bank Ltd.	Regional Banks	1,745	5.70	9.1	60%
500302-IN	Piramal Healthcare Ltd	Pharmaceuticals: Other	1,695	0.40	17.2	54%
500086-IN	Exide Industries Ltd.	Auto Parts: OEM	1,668	0.94	16.1	93%
532321-IN	Cadila Healthcare Ltd.	Pharmaceuticals: Other	1,635	0.24	18.8	73%
532947-IN	IRB Infrastructure Developers Ltd.	Engineering & Construction	1,629	3.39	22.7	67%
532696-IN	Educomp Solutions Ltd.	Miscellaneous Commercial Services	1,609	23.81	33.0	73%
500303-IN	Aditya Birla Nuvo Ltd.	Textiles	1,591	1.17	55.4	40%
500480-IN	Cummins India Ltd.	Trucks/Construction/Farm Machinery	1,574	0.44	21.2	21%
500253-IN	LIC Housing Finance Ltd.	Finance/Rental/Leasing	1,493	5.23	10.0	86%
532648-IN	Yes Bank Ltd.	Regional Banks	1,489	2.45	17.7	76%
532424-IN	Godrej Consumer Products Ltd.	Household/Personal Care	1,475	0.27	28.7	61%

Source: Factset, Thomson and J.P. Morgan Quantitative Research. For an explanation of the Q-Snapshot, please visit <http://jpmorgan.hk.acrobat.com/gsnapshot/>. Q-Snapshots are a product of J.P. Morgan's Global Quantitative Analysis team and provide quantitative metrics summarized in an overall company 'Q-Score.' Q-Snapshots are based on consensus data and should not be considered as having a direct relationship with the J.P. Morgan analysts' recommendation. * The Composite Q-Score is calculated by weighting and combining the 10 Quant return drivers shown. The higher the Q-Score the higher the one month expected return. On a 14 Year back-test the stocks with the highest Q-Scores have been shown (on average) to significantly outperform those stocks with the lowest Q-Scores in this universe. ** The number of up, down and unchanged target prices, recommendations or EPS forecasts that make up consensus.

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Important Disclosures

- **Client of the Firm:** Educomp Solutions Ltd is or was in the past 12 months a client of JPMSI.

Educomp Solutions Ltd (EDSO.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
02-Sep-09	OW	4134.45	1000.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Sep 02, 2009. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period. J.P. Morgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

Explanation of Equity Research Ratings and Analyst(s) Coverage Universe:

J.P. Morgan uses the following rating system: **Overweight** [Over the next six to twelve months, we expect this stock will outperform the average total return of the stocks in the analyst’s (or the analyst’s team’s) coverage universe.] **Neutral** [Over the next six to twelve months, we expect this stock will perform in line with the average total return of the stocks in the analyst’s (or the analyst’s team’s) coverage universe.] **Underweight** [Over the next six to twelve months, we expect this stock will underperform the average total return of the stocks in the analyst’s (or the analyst’s team’s) coverage universe.] The analyst or analyst’s team’s coverage universe is the sector and/or country shown on the cover of each publication. See below for the specific stocks in the certifying analyst(s) coverage universe.

Coverage Universe: **Nishit Jasani:** Educomp Solutions Ltd (EDSO.BO), Hexaware (HEXT.BO), Info Edge India (INED.BO), Infotech Enterprises (INFE.BO), NIIT Ltd (NIIT.BO), OnMobile Global Limited (ONMO.BO), Polaris Software (POLS.BO)

J.P. Morgan Equity Research Ratings Distribution, as of September 30, 2009

	Overweight (buy)	Neutral (hold)	Underweight (sell)
JPM Global Equity Research Coverage	39%	46%	15%
IB clients*	56%	57%	42%
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