

Educomp Solutions Ltd ----- Maintain **OUTPERFORM**

September 2009 results ahead of expectations; welcome change in Smartclass business model

EPS: ▲ TP: ◀▶

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- Educomp reported strong 2Q FY3/10 results, with standalone revenues beating estimates by 8% and profits by 7%. Consolidated revenues beat estimates by 6%, but one-time gains lead to a large beat on profits (140%).
- School additions in Smartclass remains strong, with quarter-end number of schools up 80% YoY. Management also spoke about good visibility on ICT pipeline, along with better margin prospects on rising entry barriers for competition.
- In the Smartclass business, Educomp is trying out a new revenue model where revenues across the duration of a contract are received upfront, with the receivables being transferred to books of partners. We believe this would help frontload revenues and cash flows, providing upside to our numbers.
- Post results, we adjust for one time gains, with our FY3/10 EPS estimate going up 17% (adjusted EPS retained at Rs30 per share post split). We retain our OUTPERFORM rating and Rs940 target price (post split).

Consolidated revenues came 5.5% ahead of estimates. There was a one-time gain from sale of stake in a subsidiary which led to profits beating estimates by 141%. Adjusting for one-time items, profits came 33% ahead of estimates.

Smartclass revenue model changing

Smartclass revenues grew 100% YoY. New school signings remains strong with 309 schools added in the quarter, taking cumulative schools total to 2,219 (+80% YoY).

Educomp has started working out a receivables securitisation model partnering with financial institutions and implementation companies (around 300 existing schools were transferred on this model in 2Q). Under this model, Educomp will receive all the revenues of a contract over the entire contract period upfront from the partners (all costs also recognised upfront), with partners taking the receivables from schools onto their books. This revenue model could result in front-loading of revenues and cash flows, giving an upside to our estimates.

Retain positive stance

Management retained full year profit estimates, only adjusting for the one time gains. We believe that the 58% YoY profit growth guidance (ex-one time) is conservative, given that 1H FY3/10 has seen 95% YoY growth (ex-one time).

Post results, we broadly retain our estimates while adjusting PAT for one-time gains. Our FY3/10 EPS remains at Rs30 per share (post split) on adjusted basis, and goes up 17% on reported basis. We retain FY11 and FY12 EEPS estimates. We also retain Rs940 target price (post split) and OUTPERFORM rating.

Bbg/RIC	EDSL IN / EDSO.BO	Price (30 Oct 09, Rs)	794.20		
Rating (prev. rating)	O (O) [V]	TP (Prev. TP Rs)	940 (940)		
Shares outstanding (mn)	86.52	Est. pot. % chg. to TP	18		
Daily trad vol - 6m avg (mn)	1.7	52-wk range (Rs)	988.98 - 278.80		
Daily trad val - 6m avg (US\$ mn)	88.2	Mkt cap (Rs/US\$ mn)	68,713.8/ 1,464.3		
Free float (%)	45.1	Performance	1M	3M	12M
Major shareholders		Absolute (%)	(15.1)	(1.9)	95.9
Year	3/08A	3/09A	3/10E	3/11E	3/12E
Revenues (Rs mn)	2,861	6,371	12,008	17,436	22,692
EBITDA (Rs mn)	1,266	3,044	6,472	11,247	13,938
Net profit (Rs mn)	706	1,329	3,486	4,961	6,506
EPS (Rs)	7.6	15.0	36.1	51.3	67.3
- Change from prev. EPS (%)	n.a.	n.a.	17	1	1
- Consensus EPS (Rs)	n.a.	n.a.	24.3	36.8	51.6
EPS growth (%)	139.3	96.8	140.4	42.3	31.1
P/E (x)	104.2	52.9	22.0	15.5	11.8
Dividend yield (%)	0.1	0.1	0.5	0.6	2.1
EV/EBITDA (x)	55.0	24.2	10.9	6.2	5.0
P/B (x)	25.5	16.7	5.8	4.3	3.4
ROE (%)	35.0	37.5	39.9	32.0	32.2

Note1: Educomp Solutions is a leading player in the K-12 educational services segment in India. Its activities encompass learning content, learning infrastructure, teacher training, online tutoring and brick-and-mortar schools.

Results ahead of estimates

Educomp reported strong 2Q FY3/10 results, with standalone revenues coming 8% ahead of estimates. Revenue surprise was primarily driven by surprise in ICT segment, where implementation in Gujarat contract happened ahead of our expectations. Smartclass revenues were in line.

EBITDA margins came in line with estimates, dropping 70 bp QoQ with margin improvement in Smartclass offsetting drop in ICT margins (large hardware sale component). Standalone net profits came 7% ahead of estimates.

Figure 1: Sep-09 results summary

Consolidated (Rs mn)	Sep-08	Jun-09	Sep-09	% YoY	% QoQ	CS Est	% diff
Revenues	1,430	1,938	2,535	77.3%	30.8%	2,402	5.5%
Net profits	288	342	1,155	301.1%	237.4%	479	141.1%
Net profits (ex. one time gains)	288	342	635	120.6%	85.5%	479	32.6%
Standalone (Rs mn)	Sep-08	Jun-09	Sep-09	% YoY	% QoQ	CS Est	% diff
Revenues	981	1,480	2,069	110.9%	39.8%	1,910	8.3%
EBITDA	507	746	1,028	102.7%	37.8%	952	8.0%
EBITDA margin	51.7%	50.4%	49.7%				49.8%
EBIT	350	480	769	119.6%	60.2%	641	19.9%
EBIT margin	35.7%	32.4%	37.2%				33.6%
Finance charges	17	54	88				54
Net profits	254	363	504	98.4%	38.9%	469	7.4%

Source: Company data, Credit Suisse estimates.

Figure 2: Key business segment revenues

(Rs mn)	Sep-08	Jun-09	Sep-09	% YoY	% QoQ	CS Est	% diff
Smart_Class	686	1,023	1,369	100%	33.8%	1,372	-0.2%
ICT	121	363	634	424%	74.7%	424	49.7%
Subsidiaries (incl K-12)	449	458	466	4%	1.7%	493	-5.3%

Source: Company data, Credit Suisse estimates.

Companies Mentioned (Price as of 30 Oct 09)

Educomp Solutions Ltd (EDSO.BO, Rs794.20, OUTPERFORM [V], TP Rs940.00)

Disclosure Appendix

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3-Year Price, Target Price and Rating Change History Chart for EDSO.BO

EDSO.BO Date	Closing Price (INR)	Target Price (INR)	Rating	Initiation/ Assumption
11-Dec-07	4,054.1	5235	O	X
24-Apr-08	4,005.3	5600		X
07-Jul-08	2,717.5	4000		
27-Oct-08	1,846.35	2700		
31-Jul-09	4084	4700		



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Price Target: (12 months) for (EDSO.BO)

Method: We value Educomp on a discounted cash flow (DCF) model. We assume strong near-term growth rates, 12.5% medium-term growth and 3% terminal growth, 12.5% weighted average cost of capital (WACC). This gives a target price of Rs940.

Risks: The key risks to our target price of Rs940 for Educomp are: 1) execution risks as the company is in early growth stage in its business lines, and is also launching new businesses like K-12 schools 2) change in regulation thereby impacting the business model

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