ANANDRATHI

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Indian Education

US$45bn private education opportunity: Everyone wants a slice

29 December 2011

India Education

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Overweight
Sensex: 15971
Nifty: 4779

At US$600bn, yearly education spend in India is larger than that of the US at comparable prices. Estimated revenue CAGR of private entrepreneurs in education, at 19% during 2011-'15 (US$45bn by 2015), is also one of the world's fastest, and is expected to be driven by a sharp rise in household spend, with median income elasticity of 2. Public policy is likely to aid incumbents but to defocus private players from K-12. Skill and vocational training are emerging as key opportunities. High growth, limited investable opportunities and the recession-proof nature of the education sector are likely to keep valuations high. We initiate coverage with a positive stance. Top picks: NIIT and Tree House.

- **At US$600bn, India's education sector is bigger than that of the US.** With US$600bn of yearly overall education spend at comparable prices, India's education sector is bigger than that of the US. Even at a value of US$100bn by market prices, education spend in India is the 9th highest. India's yearly growth in education spend, at 15%, is also one of the fastest.
- **Private education revenue growing 19%, to touch US$45bn by 2015.** From US$30bn in 2012, private education revenue is set to reach US$45bn by 2015. Main revenue streams: K-12 (US$20bn), technical education (US$12bn), coaching (US$8bn) & pre-school (US$3bn).
- **Over 10% of wallet.** 10.4% of total consumer spend of the urban affluent (top 10% by spend) funds private education. The rural poorest (bottom 10%) spends just 1.4% of wallet on education. With median income elasticity of demand for education at near 2, a 1% rise in per capita income leads to 2% rise in spend, mostly on private education. This is a key driver for the sector.
- **Public policy to defocus private players from K-12.** Formal education in India is on a non-profit basis. While ongoing reforms may help incumbents, the Right to Information Act may deter private players from K-12.
- **Skill enhancement: the next big thing.** Shortage of trainers and ICT-based interface are likely to challenge classroom-based coaching models. Private players are expected to focus on technical education and pre-schools. Also, the gulf between formal education and the market's skill requirements is driving demand for vocational education and skill development services.
- **Top picks: NIIT & Tree House due to low regulatory risk.** The sector's rich valuations of +40x forward earnings during FY07-11 were affected by governance and funding issues. We expect these to be resolved and initiate coverage on Career Point, Core Education, NIIT & Tree House with Buy ratings and Educomp with a Hold.

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Key data	BB code	M.Cap (US$m)	Rating	CMP (₹)	TP (₹)	Upside (%)	PE(x)	PBV(x)	EV/EBITDA(x)	ROE (%)
Career Point	CRPT IN Equity	75.7	Buy	216	284	31.5	14.9	1.2	9.5	7.5
Core Education	CETL IN Equity	556.9	Buy	258	340	31.8	9.3	1.8	6.1	20.7
Educomp	EDSL IN Equity	369.0	Hold	200	260	30.0	4.5	0.7	3.5	16.4
NIIT	NIIT IN Equity	117.5	Buy	37	52	40.5	6.0	0.7	3.3	11.6
Tree House	THEAL IN Equity	109.0	Buy	168	225	33.9	18.6	1.9	9.6	10.5

Source: Companies, Anand Rathi Research *Note: * Prices as on 26th December, 2011; Valuation data for FY13e. based on CMP*

India Education

US$45bn private education opportunity: Everyone wants a slice

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Everyone wants a slice

At US$600bn, yearly education spend by government and households in India is larger than that of the US at comparable prices. The estimated CAGR of private revenue in Indian education, at 19% during '11-'15, is also one of the fastest in the world. We expect revenue of private entrepreneurs in education at US$45bn by 2015. A sharp rise in household spend on education with median income elasticity of 2 is driving this growth. Public policy is likely to aid the incumbents but is also likely to steer private entrepreneurs away from school education. Skill and vocational training are emerging as big opportunities for private players. High growth, scarcity of investable opportunities and the recession-proof nature of the sector are likely to keep valuations high.

Large size, strong growth, bullish expectations

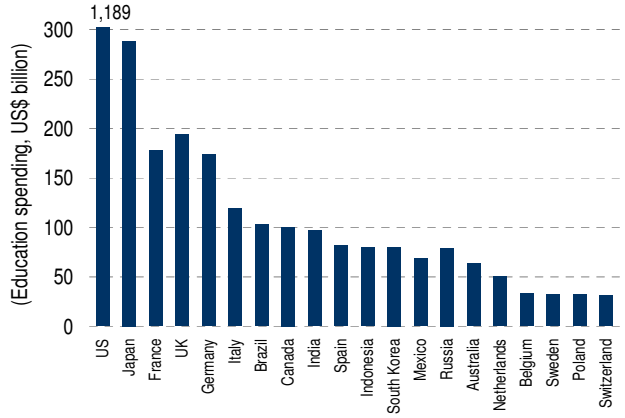
The addressable market for private investment is currently ~US$30bn and is growing at an annual rate of 19%

At US$100bn a year at market prices, India's education sector is among the top 10 in the world in value terms (*see Fig 1*).[1] In addition, the cost of educational services in India is one of the lowest in the world – less than one-sixth of the global average (*see Fig 2*)[2]. That is, if measured in global average prices, yearly education spend in India at US$600bn is even higher than in the US.

Revenue growth in the sector is also one of the fastest worldwide. Since 2000, education spend has grown at a median rate of 15% per year – 200 basis points (bps) higher than the GDP. Of the overall education spend (of US$100bn) households constitute 35%, which is on the high side (*see Fig 3*) as compared to most other countries.[3] The revenue size of the addressable market for private investment in education is ~US$30bn. This is growing at an annual rate of 17% and is likely to accelerate to 19% from now until 2015.

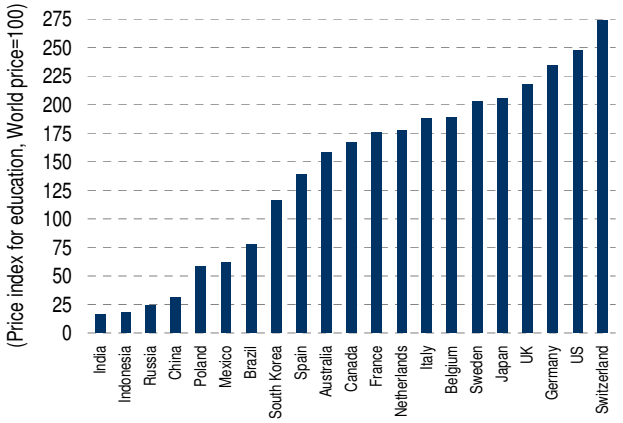
The large size of India's education pie is attracting entrepreneurs and financiers by droves. The rapid expansion of private institutes over the last 5-6 years (*see Fig 4*), particularly technical and professional institutes, reflects the entrepreneurial wave in the education industry. Financial investors are picking up stakes in these ventures, and investment deals taking place in this space command jaw-dropping valuation multiples (*See Annexure I and II*).

Fig 1 – India: among the top-10 markets by education spend



Source: World Bank and Anand Rathi Research

Fig 2 – Price of education in India 1/6th of world average



Source: World Bank and Anand Rathi Research

Note: Please see page 143 for the explanation of all references

Anatomy of the Indian education sector

Three key rungs of the educational system

Formal education: This comprises school, college, university and technical/professional education. The core, or formal, education system in India is highly regulated. A key policy condition is that formal education institutes need to operate on a non-profit basis.

Parallel education: This system is largely informal, runs parallel to the core, and mainly supplements formal education. The components of the parallel system include pre-school, private tuition/coaching, test/examination preparation and job/skill-oriented vocational institutes, corporate training and finishing schools. Parallel education is virtually outside the scope of any specific regulatory or supervisory system.

Ancillary education: The last rung in the educational system feeds the other two, and comprises teacher training, textbooks and stationery, IT-enabled teaching aids and management of education services. The ancillary rung too is virtually outside the scope of any specific regulatory or supervisory system.

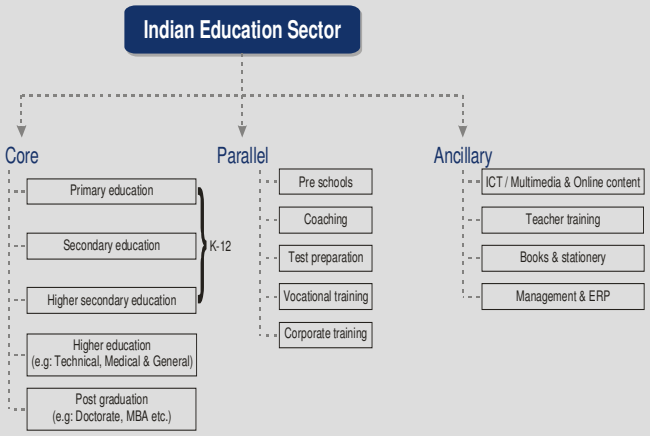
Nature of education according to ownership and management

Government institutes: Public sector entities own and manage government institutes. This constitutes the bulk, nearly 75%, of India's educational system, but the rate of expansion of these institutes is slowing.

Private-aided institutes: Private-aided institutes are managed by private entities but receive grants from public authorities. The fee structure for students and salary structure for teaching and non-teaching staff is aligned to the public sector. This segment is part of the public education system.

Private-unaided institutes: These are owned and operated by private trusts/societies/non-profit companies/individuals. This report considers only institutes in this category as private institutes. Private institutes operate at all levels of the system: core, parallel and ancillary. In the case of formal education, if private institutes generate any surplus, it has to be retained by the institute and cannot be distributed to other entities.

Segments of the Indian education sector



Source: Anand Rathi Research

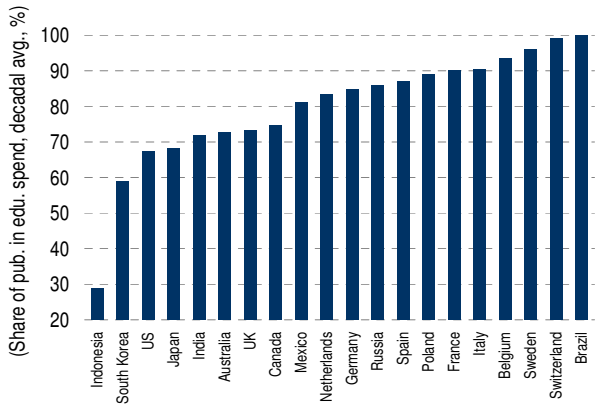
Education sector: Risk-reward matrix

India education

Returns over next 5yrs	Risk: regulatory / investment / scaleable – High	Medium	Low
High	K-12 (management contracts)	Sports education	Vocational training
Medium	Higher education / university	Test prep & tutorials;	Pre-school
Low	K-12 (own schools)	Corporate training, language courses	ERP / IT; Multimedia ICT; books & stationery

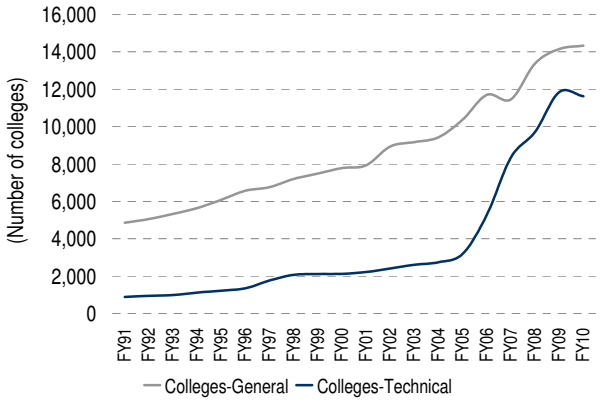
Source: Anand Rathi Research

Fig 3 – Public education spend in India at 70% of total



Source: World Bank, Anand Rathi Research

Fig 4 – 260% jump in no. of technical colleges since 2005



Source: Ministry of Human Resource Development, Anand Rathi Research

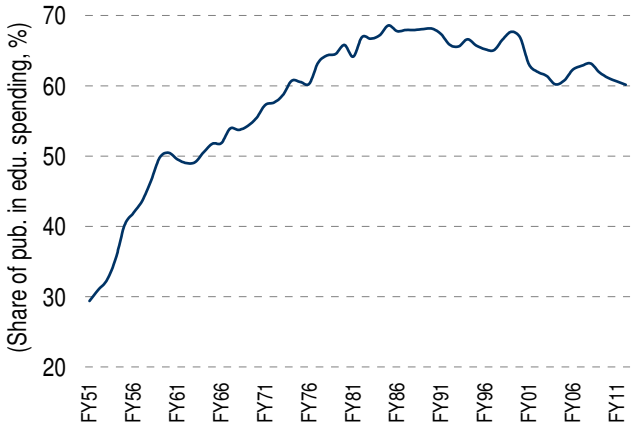
Currently, 65% of Indian students go to government institutes and 11% go to government-aided private institutes *(see Fig 8)*, where elementary education is free. Consequently, cost of education in India is half that of China, one-fourth that of Mexico, one-tenth that of Canada and one-fifteenth that of the US *(see Fig 2)*.

Investment rationale: key attractions of the sector

Factors such as lack of public funding, households' willingness and ability to pay for quality education and public authorities' pro-active stance on education reform are driving private investment in the sector

Public funding crunch; inadequate facilities. Public spend in education accounts for over 60% of overall education spend (*see Fig 5*). Yet, current educational facilities are inadequate in terms of both quantity and quality. Seats available for post-higher-secondary (tertiary) education are sufficient for just 12% of the population in the age group to avail themselves of tertiary education. Technical and professional education receives only 4% of budgetary spend and, therefore, a large number of private technical/ professional education institutes (*see Fig 4*) have cropped up to meet the capacity shortfall. Given serious budget constraints faced by public authorities,[4] large private participation is required to expand infrastructure, create adequate access and improve the quality of education.

Fig 5 – Though down from 70% to 60%, public funds dominate education spend



Source: Central Statistical Organisation, Anand Rathi Research

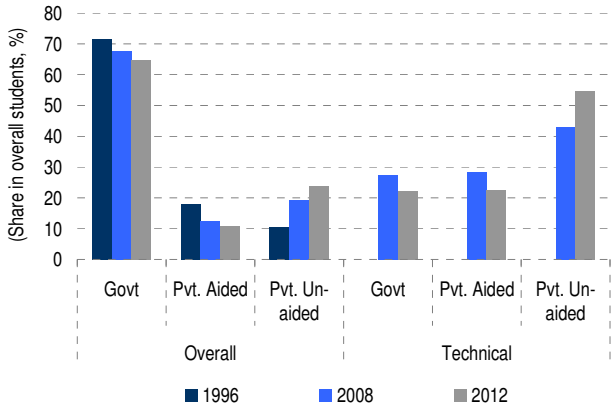
Rising household spend: Rising affordability and increased awareness of the strong benefits of education, particularly technical and professional, have led to a major increase in the demand for education. The share of education in total consumer spend rises sharply from 1.4% for the poorest

to over 10% for the richest. This indicates that as per head income increases in the country and more people transcend the poverty line, there should be explosive growth in household spend on education.

Ongoing education reforms should favour a rise in the valuation multiples of incumbents …we expect private players to defocus on K-12, the attractiveness of technical education to continue and skill and vocational training to be new growth opportunities

Perceived quality gap in public education. Perceived quality gaps are driving even lower income students to shift from public education to private. This shift is happening even in the case of elementary education, despite the free tuition, mid-day meals, uniforms and books offered by public elementary education.[5] As the proportion of students pursuing private education rises (see Fig 6), there is a corresponding increase in private investment entering the sector.

Fig 6 – Rising proportion of students opting for private education



Source: National Sample Survey Organisation, Anand Rathi Research

Education reforms

Despite the rising demand for skilled manpower as a result of India's rapid economic growth, employers find a majority of new graduates are unemployable on account of inadequacies in the educational system.[6] Consequently, legislative efforts are underway to reform the system. Key education bills are at different stages of deliberation in the Indian Parliament. These target improving quality, accessibility, transparency and competition in the sector. The Central government's pro-active stance and supportive statements have created the impression that private investment in education is reaching inflexion point for explosive growth.

Private education: The next five years

Estimated at US$30bn currently, India's private education industry is expected to grow to US$45bn by 2015. We expect dynamic growth in private investment in education simply because there is strong and rising demand for such services and the public education system is not equipped to supply the same in terms of either quality or quantity. Pending key changes in public policy on education, we expect three major trends to emerge over the next five years:

- Incumbent private players to consolidate their position in formal education,
- The integrated K12 model to come under attack with greater specialization at pre-school and secondary and higher levels, and
- New private education players to compete in unregulated but highly lucrative areas such as skill and vocational training and private coaching.

Incumbents to benefit

Reputed incumbent private players in the regulated verticals of education stand to benefit for two reasons.

Major potential entrants (such as eminent foreign educational institutes) are likely to further defer their entry decisions. This is likely to increase the scarcity premium for existing private institutions

- Implementation of the ongoing legislation measures on quality improvement (accreditation, weeding out of malpractices and academic depository) are likely to help the serious, credible private players. These measures, coupled with the conditions posed by the Right to Education (RTE) Act, should also create entry barriers for the new private players. Consequently, the new players are unlikely to make large investments in the highly regulated verticals of Indian education, particularly school education. The status quo on the non-profit clause for formal education means that major potential entrants (such as eminent foreign educational institutes) are likely to further defer their entry decisions. This is likely to increase the scarcity premium for the existing private institutions, both in terms of higher fees from students and better valuation premium from investors.
- The willingness of Indian households to spend money on quality education provided by reputed organisations would pose serious challenges for most unorganised/stand-alone players and new entrants. As a result, the existing large domestic private players are likely to consolidate their positions. The incumbent institutions are equipped in terms of (1) appropriate institutional structuring to utilize the regulatory arbitrage and (2) 'managing' the education bureaucracy for any actual/perceived departure from the public policy mandated requirements. We expect the stronger incumbents to improve market share by bringing the stand-alone or small institutions within their fold.

De-focus on elementary education to alter the K-12 model

Mirroring the commitment of the state to make elementary education universal, the new Right to Education Act (RTE) makes it mandatory for elementary schools (standard I-VIII) to reserve 25% seats for free education for weaker sections, with a limited measure of compensation for lost tuition fees from the government.

For existing K-12 schools, legal bifurcation of the play-school from elementary and secondary education would absolve private schools of any obligation to follow RTE norms at the pre-school level. In addition, both incumbents and new entrants to private school education are likely to defocus on elementary education and concentrate on pre-schools on the one end and on secondary and higher secondary levels on the other. Private schools do not have any obligation under the RTE for secondary and higher secondary education.

The proportion of students pursing secondary/higher secondary education in private schools to those undergoing elementary education is just 30%. Yet, this has risen fast – from 17% in 1996. Further, household expenditure in private schools at the secondary and higher-secondary levels is double that of the spend at the elementary level.

The clauses to regulate private schools through RTE may, therefore, end up harming the noble cause for which it was enacted.

Enhancing of existing strength in unregulated segments

Current public policy initiatives have not put in place any incentive mechanism to attract private investment into formal education. Moreover, we expect private players to defocus on school education, a vertical that currently accounts for the largest portion (~50%) of revenue for private education providers. Consequently, we expect private investment in education to remain focused mainly in areas where it is already strong – pre-school, technical education and private tuition.

We expect private initiatives on skill training and vocational education to intensify considerably. It is reported that employers find 75% of fresh engineering graduates, even those from premiere institutes, not employable without additional skill training. This situation gives much scope for private investment in this area.

India has always faced serious challenges in producing sufficient skilled technicians. The strong economic growth over the last decade and the consequent increase in the demand for such skills has further increased the demand for skill training. The key problem in the area of vocational training is that the aspirants for such training lack the finance to undertake such courses. The organised financial system generally does not extend such funding due to the high transaction cost of such small loans and the lack of bankable collateral. Currently, prospective employers are coming forward to sponsor such courses, often through in-house training facilities, backed by job guarantees at the end of the training. As the scale of such training increases, this segment of the education industry is likely to see rapid growth.

Rising trends in education spend

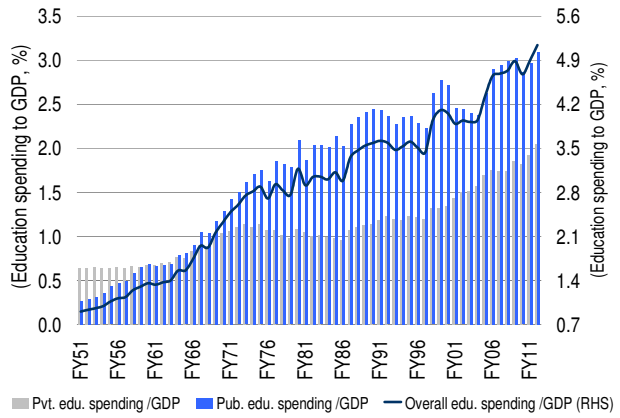
Household spend on education is the chief source of revenue for private education providers, as 85% of the government spend on education goes to pay salaries. Sharply rising household spend (~17% annually since '05, and 19% expected in the next three years) is driving the demand for private education. High concentration of demand – 57% spend in urban areas and 44% by the richest 10% of population – helps private education providers focus on location strategies. Tuition fees (34% of overall household education spend) are the largest source of revenue for private players. Within this, technical /professional education is the most lucrative segment (20% of household spend with just 2.6% of total student population). However, household spend on primary education (23% household spend with 47% of total student population) is likely to reduce with the enactment of the RTE Act.

On a per capita basis, the richest 10% of the urban population spends 90 times more on education than the poorest 10% of the rural population. The main opportunity for private entrepreneurs, therefore, is in capturing students from higher-income categories

Urban-centric, concentrated growth

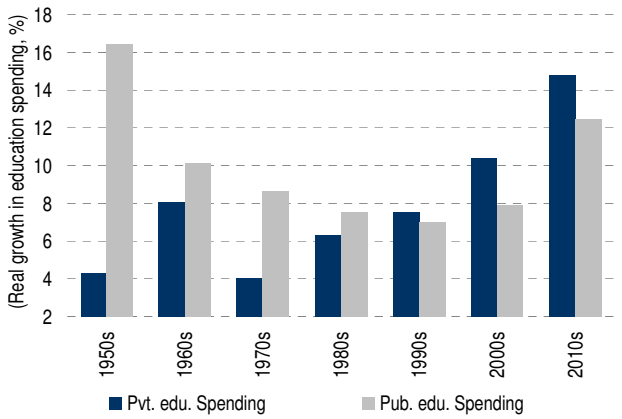
Growth in public spend is trailing growth in household spend. India's overall education spend to GDP rose from less than 1% in the early 1950s to over 5% currently (*see Fig 7*). Though growth in public spend on education has accelerated since the 1990s, it is now trailing the growth in household spend (*see Fig 8*).

Fig 7 – Education spend to GDP up from 1% to over 5%



Source: Central Statistical Organisation, Anand Rathi Research

Fig 8 – Private spend on education accelerating since the '70s



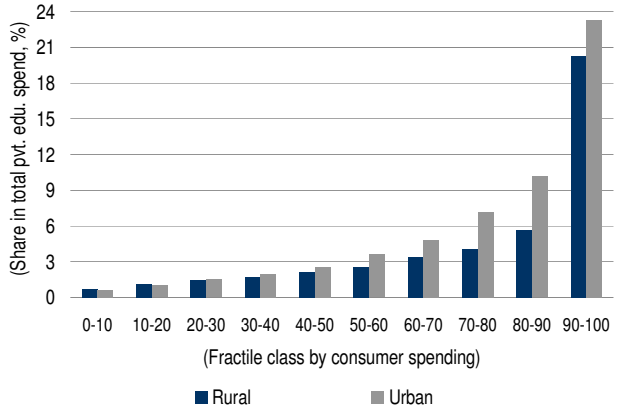
Source: Central Statistical Organisation, Anand Rathi Research

Urban households account for 57% of private spend. Urban households constitute 26% of the overall population, but account for 57% of overall private expenditure on education (*see Fig 9*). A sizable part of the rural student population travels to urban centres to avail of tertiary educational institutes. Therefore, a large part of education spend by rural households is in urban centres. This implies that under the current situation, it is not viable for private players to make major forays into rural education.

Top 10% of population accounts for 44% of household spend. Education spend, as a proportion of overall consumer spend, rises sharply with the increase in overall capacity to spend (*see Fig 10*). The top 10% of population, in terms of spend, accounts for 44% of the overall private spend on education. The top 20% accounts for 59% of spend. At the lowest end, the poorest 10% of the rural population spends 1.4% of their

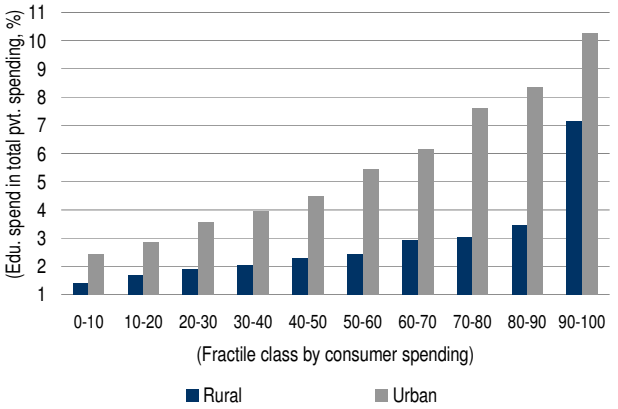
consumer spend on education and at the highest end, the richest 10% of the urban population spends 10.3% of their consumer spend on education. On a per capita basis, the richest 10% of the urban population spends 90 times more on education than the poorest 10% of the rural population. The main opportunity for private entrepreneurs in India's education sector, therefore, is in capturing students from higher-income categories. Consequently, revenue generation for entrepreneurs in private education lies in opening institutions in strategic locations, rather than in opening a large number of institutions.

Fig 9 – Top 20% accounts for 60% of pvt. education spend



Source: National Sample Survey Organisation and Anand Rathi Research

Fig 10 – Sharp rise in education spend with affordability



Source: National Sample Survey Organisation and Anand Rathi Research

Scope of private education

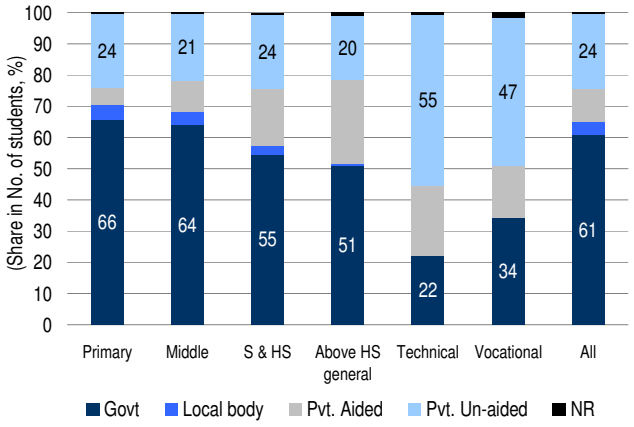
Technical education offers the best opportunity for private players in formal education … textbooks and coaching are niche opportunities …85% of the public spend on education goes to pay salaries, so private investment in education mostly depends on household spend

The not-for-profit status of formal education has led to a limited role for private educational institutes in school and general (non-technical, non-professional) higher education. Within formal education, private institutes dominate technical/professional education. Parallel education and lucrative segments in ancillary education are also areas of robust opportunity for the private sector.

Technical education, the most attractive segment

With just 2.6% of overall students, technical education accounts for 20% of the overall household spend on education. Yet, budgetary support to technical education accounts for just 4% of the overall budgetary support to education. Interestingly, 55% of students pursuing technical education are enrolled with private unaided institutions (*see Fig 11*). This is the only segment where a majority of students prefer private education. Despite the relatively small size of the segment within the formal education system, technical education seems to be the most attractive destination for private investment. To a lesser degree, vocational institutions also follow the same pattern.

Fig 11 – Over 50% students of technical education go to private colleges



Source: National Sample Survey Organisation, Anand Rathi Research; Note: NR stands for not reported

Tuition fee the biggest opportunity at 34% of household spend

Tuition fee is the single largest component of private expenditure on education and accounts for 34% of overall expenditure. Over one-third of total tuition fee is spent on technical education (*see Fig 12*). Of the total private expenditure on technical education, 58% is on tuition fees (*see Fig 13*). Of the total private spend on tuition fee, 62% goes to private institutions (*see Fig 14*).

Fig 12 – Purpose-wise utilization of private spend on education

	Tuition fee	Exam fee	Books etc.	Uniform	Transport	Private coaching	Others	Total
(By segment of education, %)								
Primary	6.9	3.1	4.6	3.3	2.0	1.8	0.9	22.6
Middle	4.2	2.0	4.0	2.4	1.2	2.4	0.7	16.7
Secondary & HS	6.7	3.7	6.1	2.5	1.9	5.7	1.1	27.8
Above HS	3.8	2.1	2.3	0.2	1.4	1.1	0.5	11.6
Technical/professional	11.6	3.8	2.1	0.3	1.2	0.5	0.6	20.0
Vocational	0.6	0.3	0.1	0.0	0.1	0.0	0.0	1.2
Total	33.8	15.0	19.2	8.8	7.8	11.6	3.8	100.0
(By school management type, %)								
Govt./local body	4.3	4.3	9.0	4.3	1.9	5.5	1.6	30.9
Pvt. aided	8.2	3.7	3.7	1.5	1.9	2.8	0.8	22.5
Pvt. un-aided	20.9	6.9	6.3	2.9	4.0	3.1	1.4	45.4
NR	0.5	0.1	0.2	0.1	0.1	0.1	0.0	1.1
Total	33.8	15.0	19.2	8.8	7.8	11.6	3.8	100.0

Source: NSSO & ARR

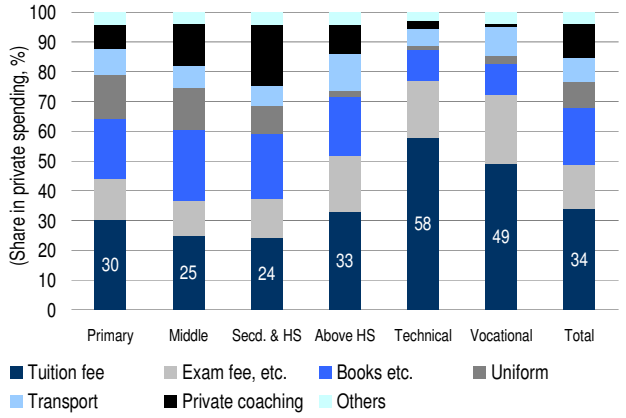
Tuition fees for technical education are four times higher than for general education

The per head tuition fee at various segments and types of institutions show several trends, which include the following:

- Tuition fees go up progressively in general education as the level of education rises. The maximum jump happens between higher secondary (HS) and above HS level.
- For similar types of educational institutions (government, private-aided, private non-aided) tuition fees for technical education are four times higher, at the minimum, than for general education. For government-owned education institutions, the fees are ~30 times higher.
- Comparing similar levels of education, tuition fees are always higher in urban areas compared to rural areas.

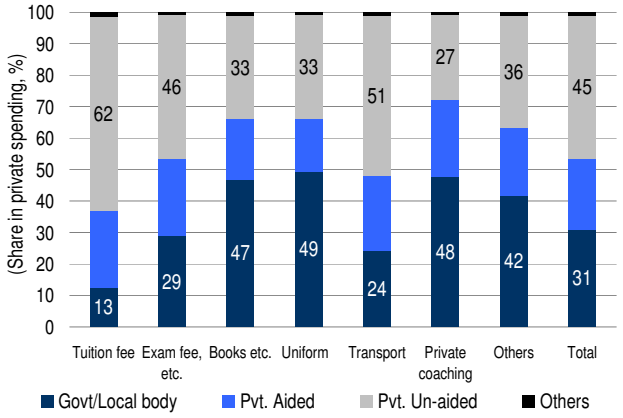
- In the case of general education, tuition fees for private-aided and non-aided institutions are 4.5 times and 8 times higher, respectively, than for government institutions. In the case of technical education, the percentage dispersion is far lower – tuition fees for private-aided and non-aided institutions are 2 times and 2.5 times higher, respectively, than government institutions.
- Tuition fees, at a similar level of education, are always higher for boys than for girls.

Fig 13 – Tuition fees account for 24-58% of household spend



Source: NSSO, Anand Rathi Research

Fig 14 –Highest spend by public school students on coaching



Source: NSSO, Anand Rathi Research

Books (19% of spend) and coaching (12%) are lucrative niches

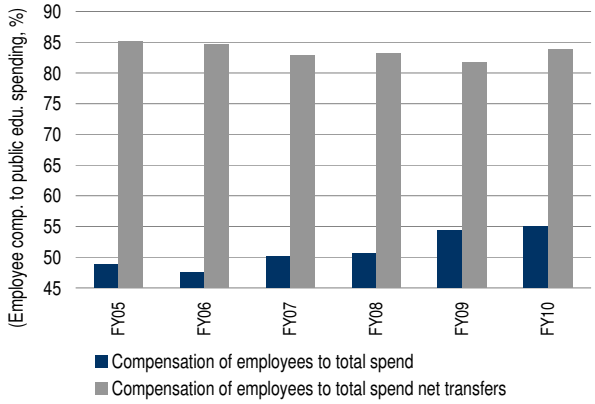
Next to tuition fees, spend on books and stationary, at 19%, is the second-largest component of total household spend on education. Spend on books is largely associated with school education, particularly secondary and HS level. In per head terms, spend on books increases 30-100% as a student progresses from primary to middle, to secondary & HS and above HS. The large market size and considerable per head spend, however, make secondary and HS the most lucrative part of the textbook market.

Private coaching accounts for 12% of household spend on education. Interestingly, unlike tuition fees and books, where the per head spend by students studying at private non-aided schools is the highest, in the case of private coaching, students of private-aided schools spend the most. At 50% of the total spend on private coaching, secondary and HS levels are the most lucrative.

Catering to public spend offers limited growth potential

Several private institutions in education, especially from the ancillary segment, cater to public educational institutions.[7] Yet, the scope of catering to public spend is not very large, since over 50% of overall public funding on education and 85% of such funds, excluding transfers (for instance, to schools owned by corporations, municipalities and private-aided schools), goes to paying staff salaries (*see Fig 15*). Therefore, private investment in education largely caters to private educational institutes.

Fig 15 – About 85% of public education spend is on salaries (excl. transfers)



Source: Central Statistical Organisation, Anand Rathi Research

RTE limits the potential of primary education

With 47% of the total student population studying in primary schools, 50% of the government's (Centre and states, together) budgetary allocation on education is directed towards to this segment. Primary education, however, receives a much lower proportion (23%) of household spend on education. Though only 24% of primary students attend private schools, expenditure by households on such students accounts for 60% of the overall household spend on primary education (*see Fig 16*). The large student strength, substantial budgetary allocation and considerable household spend make primary education an attractive niche for private entrepreneurs. However, enactment of the RTE Act (which makes it mandatory for schools to reserve 25% of seats for weaker sections of society) has substantially reduced the attractiveness of primary education for private entrepreneurs. (See subsequent chapter: '*Public Policy: The Good, Bad & Ugly*'.)

Fig 16 – Composition of students and private spending on education

	Primary	Middle	Secondary & Higher Secondary	Above Higher Secondary General	Technical	Vocational	All
			Students (share, %)				
Government	31.0	15.7	10.8	2.9	0.6	0.1	61.1
Local body	2.2	1.1	0.5	0.0	-	-	3.9
Pvt. aided	2.6	2.5	3.6	1.5	0.6	0.0	10.8
Pvt. un-aided	11.1	5.2	4.7	1.2	1.4	0.1	23.7
NR	0.2	0.1	0.1	0.1	0.0	0.0	0.6
Total	47.1	24.6	19.8	5.7	2.6	0.2	100.0
			Private spending on education (share, %)				
Government	5.1	5.6	9.8	5.4	3.4	0.2	29.5
Local body	0.5	0.4	0.5	0.1	-	-	1.5
Pvt. aided	3.2	2.9	6.7	3.4	6.1	0.2	22.5
Pvt. un-aided	13.6	7.7	10.5	2.5	10.3	0.8	45.4
NR	0.3	0.2	0.3	0.2	0.2	0.0	1.2
Total	22.7	16.7	27.8	11.6	20.0	1.2	100.0

Source: NSSO & ARR.

Share of private education in household spend tops in primary level

The share of students enrolling in private institutions in the general stream above primary education, as a percentage of overall student strength in the respective segments, is 20-24%, which is lower than the primary level (*see Fig 11*). The share of private education in household spend actually

declines from 60% for primary to 46% at middle school, 38% in secondary and HS and 22% post HS general education. This, combined with the progressive reduction of student strength in higher education, makes these verticals less interesting for private investment.

Pre-schools: Legally for-profit

Pre-schools are outside the official formal educational system and there is little government spend on this segment. This enables private entrepreneurs to legally operate pre-schools for profit. Rising urbanization, the increasing proportion of women joining the workforce, rising aspirations for quality education for offspring, and affordability are factors driving the strong growth in this segment. High growth, low entry barriers, low-funding requirements and the virtual absence of public policy restrictions make this segment attractive. We estimate private revenue in the pre-school segment at US$2bn in 2012 and US$2.9bn in 2015. RTE norms are expected to tilt the balance in favour of pure pre-school and against integrated pre-schools with K-12.

Strong growth, low funding requirements

According to World Bank data, the size of the pre-school segment in India was about US$1.3bn in 2005. Industry estimates compounded annualised growth rate (CAGR) for the segment at ~35%. We estimate the segment size at US$2bn in 2012 and US$2.9bn in 2015 (*see Fig 17*).

The virtual absence of public policy restrictions – such as the policy relating to non-for-profit status – makes this segment attractive to investors

Pre-schools lay the foundation for formal education. They typically cater to the age group of 1-4 years and may also offer nursery, junior kindergarten and senior kindergarten classes. Rising urbanization, increased proportion of women joining the workforce, rising aspirations for quality education for offspring and improved affordability are factors driving the strong growth in this segment.

High growth, low entry barriers, low-funding requirements and the virtual absence of public policy restrictions – including the policy relating to non-for-profit status – make this segment attractive to investors. With low capital requirement, pre-schools possess a scaleable model, especially with regard to franchises.

Fig 17 – Pre-school: market-size estimation

	2010	2015
Population (1-4 years, '000)		
Urban	38,268	39,818
Rural	90,316	87,080
Pre-school enrolment (%)		
Urban	25	33
Rural	5	5
Fees (₹/year)		
Urban	9,000	9,600
Rural	2,400	2,640
Revenue (₹bn)	97	138
Revenue (US$m)	2.0	2.9

Source: United Nations Population Statistics, Anand Rathi Research

Focus on K-12 admission helps increase fees

Unorganized neighbourhood institutions currently dominate the pre-school segment. However, this situation is changing: 11 major playschool chains and about 10 smaller organized players are making strong headway in the segment (*Anonymous, 2011*).

Fees charged by pre-schools depend on the spending power of the local area in which they operate. Two hours of playschool activity fees may be anywhere between ₹1,000-12,000/- per month in the major cities (*see Fig 18*). The amount is much lower in smaller towns. The revenue-expenditure streams for pre-schools in India are presented in *Fig 19*. Most parents enrol their children in play schools when they are a year old, to meet the challenges of the entrance interview for admission to the K-12 school of their choice.[8]

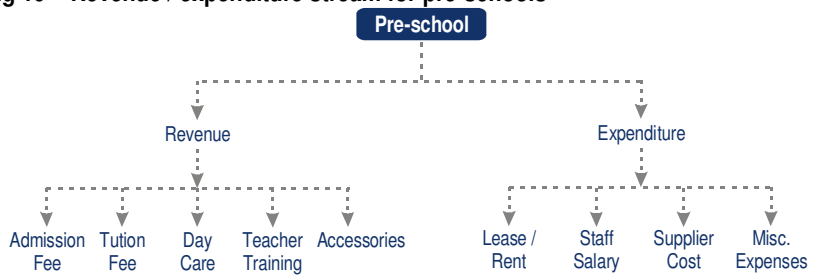
Preparing students for interviews for admission into reputable K-12 schools has become a key selling idea to enrol kids for play schools. Cashing in on this opportunity, several schools, particularly the new K-12 schools, have now started their own play schools. In areas where the elementary/K-12 is at a distance from the city area, parents tend to send their children to nearby pre-schools.

Fig 18 – Pre-school: annual revenue estimation

	Premium school in metros	Mid-segment school in metros	Tier-II towns
Admission fee (₹)	10,000	3,000	1500
Annual tuition fee (₹)	72,000	27,000	15,000
Other revenue (uniform, books etc) (₹)	7,000	5,000	2,000
Average capacity of a pre-school	80	160	120
Annual revenue of a pre-school (₹m)	**7.1**	**5.6**	**2.2**

Source: Anand Rathi Research

Fig 19 – Revenue / expenditure stream for pre-schools



Source: Anand Rathi Research

Business model for pre-schools

Being predominantly neighbourhood institutions, pre-schools address a micro market and are driven by local conditions. Individual pre-schools, therefore, require low capital as compared to other educational institutes. In addition, no education board regulates these schools.

However, branding and an internal set of teaching structures are increasingly becoming mandatory due to the increasing demands of parents. This, in turn, has thrown up a huge opportunity for organized players that have the resources to open multiple centres.

There are many models of operations in the pre-school segment. The key models are: owned and franchisee. For example, Kidzee (part of Zee Learn) follows a predominantly franchisee model, while Tree House, another major pre-school player, has 70-75% own centres. The business models of the major organized pre-school players are presented in *Fig 20*.

Franchisee models offer faster scalability, as the content is ready and there is no incremental cost to the franchisor in terms of manpower capital investment. In most cases, royalty and the license fees received have 80-85% EBITDA margin. The franchisor's only major expense is on advertisements.

This model, however, comes with its own challenges, including dilution of quality of teaching, cash leakage for the franchisor in terms of numbers that are reported for royalty and the high churn rate among local partners, as the business has a payback of 3-4 years. Some of these can be addressed by selecting proper partners and regular monitoring by the franchisor.

Fig 20 – Business models of the key pre-school players

	Euro Kids	Kidzee	Tree House	Kangaroo Kids	Apple Kids
Type of model	~90% franchisee	~95-99% franchisee	65-70% owned	~94% franchisee	
Region	pan-India	pan-India	western India	pan-India	South-India
Total centres	841	758	238	80	200+
Total students	43,732	45,000	13,090	3,600	13,462
Avg. fees (₹'000 / p.a)	15-45	12-40	15-40	60-100	25-40

Source: Industry, Anand Rathi Research

Financial models for pre-schools

Both at the EBITDA and at PAT levels, the own-school model is less profitable than the franchisor model. However, the own-school model provides greater quality control and cash flow certainty. Greater capital expenditure requirement under the own-school model, however, makes the franchisee model more scaleable.

Fig. 21 provides the unit level comparison for pre-schools operating in various market segments under both franchisee- and owned-models at a steady state of operations with optimum capacity utilized. *Fig. 22* provides a similar financial model for the franchisor.

Fig 21 – Pre-school unit-level matrix for own / franchisee schools

	Own schools			Franchisee schools		
(₹m)	Premium school in metro	Mid-segment school in metro	Tier-II town	Premium school in metro	Mid-segment school in metro	Tier-II town
Revenues – pre-school (Fig.18)	7.1	5.6	2.2	7.1	5.6	2.2
Other activities	1.9	2.9	1.4	1.9	2.9	1.4
Total revenues	**9.0**	**8.5**	**3.7**	**9.0**	**8.5**	**3.7**
Staff salary	0.7	1.3	0.5	0.7	1.3	0.5
Lease rent (roughly 20-25% of sales)	2.3	1.7	0.7	2.3	1.7	0.7
Content	0.1	0.1	0.1	0.1	0.1	0.1
SG&A	0.5	0.4	0.2	0.2	0.2	0.1
Royalty to franchisor (10-15%)	-	-	-	1.4	1.3	0.4
EBITDA	**5.6**	**4.9**	**2.2**	**4.4**	**3.9**	**1.9**
EBITDA margins (%)	*61.7*	*58.2*	*60.2*	*49.2*	*45.7*	*52.7*
Depreciation	1.0	1.0	0.6	1.4	1.4	0.8
PBT	4.6	3.9	1.6	3.0	2.5	1.2
Tax	1.4	1.2	0.5	0.9	0.8	0.4
PAT	**3.2**	**2.7**	**1.1**	**2.1**	**1.7**	**0.8**
PAT margins (%)	*34.9*	*32.0*	*30.3*	*23.2*	*20.1*	*22.1*
One-time license fees	-	-	-	2.0	2.0	0.8
CAPEX	5.0	5.0	3.0	5.0	5.0	3.0
ROI (%)	*63.1*	*54.3*	*36.9*	*30.0*	*24.4*	*21.3*

Source: Industry, Anand Rathi Research

Better profit margins are earned by opening own outlets than by being a franchisee. In the case of the franchisee, he has to pay for the ongoing royalty and has to also incur higher capital expenditure as license fees paid to franchisor is taken as a part of capital expenditure/sunk cost. Yet, access to better course structure, teacher training and, perhaps most importantly, a better-known brand name is tilting the preference in favour of franchisee models versus the stand-alone neighbourhood school.

From the franchisor's point of view, each incremental unit that is franchised helps substantially increase its margins, as on a specific unit there is very limited cost incurred. The franchisor enjoys anywhere between 74-85% EBITDA margins on all centres that are franchised. This calculation captures only the annual inflows without considering the one-time licensee fees that the franchisor receives at the beginning of the franchisee tenure.

Fig 22 – Pre-school: unit-level matrix for the franchisor (₹m)

Income for franchisor	Premium school in metros	Mid-segment school in metros	Tier-II towns
Royalty revenues (Fig. 21)	1.36	1.27	0.37
Content	0.02	0.05	0.04
Teacher training	0.03	0.07	0.02
SG&A	0.14	0.13	0.04
EBITDA / PBT	1.16	1.03	0.27
EBITDA margins (%)	*85.75*	*80.94*	*73.61*
Tax	0.36	0.32	0.08
PAT	**0.80**	**0.71**	**0.19**
PAT margins (%)	*59.17*	*55.85*	*50.79*

Source: Industry, Anand Rathi Research

RTE Act to boost the pure pre-school model

The RTE Act mandates that private pre-schools providing elementary education (standard I-VIII), need to admit 25% of the students from the weaker sections and disadvantaged groups and provide them free education. This provision, however, would not be applicable for pre-schools that are not part of an institute that offers elementary education. Therefore, private pure pre-schools stand to benefit from this development. The basic strengths and weaknesses of the pre-school model have been tabulated in Fig 23.

Fig 23 – Porter's five forces

Porter's five forces	Degree of threat	Remarks
Bargaining power of buyers	*Low*	Demand outnumbers supply by huge margin and hence clients (students / parents) have very little say.
Bargaining power of suppliers	*Medium*	Getting quality teachers is difficult. This is addressed by teacher training programmes and technological aids
Threat of substitutes	*Low to medium*	The trend towards quality / branded pre-schools is picking up. However, the high fees charged in such schools allow local mom & pop shops to co-exist. K-12 schools, starting with pre-schools in the same premises, also pose some threat.
Threat of new entrants	*Medium to high*	Launching a pre-school is easy as it requires low investment, no regulatory issues are involved and content requirement is generally basic. These schools can pull clients, as it is a localized market. New entrants, however, face issues with regard to establishing their reputation.
Industry competitors	*Medium to high*	Most players want to have a pre-school chain to provide students as feeders for the K-12 institutes.

Source: Anand Rathi Research

K-12: large spend, highly regulated

While the size of spend in this sector is around US$75bn per year, the predominant part of this comprises public spend. We estimate revenues for private players in the K-12 segment at US$15bn in 2012 and US$20bn in 2015. The RTE requires private schools to offer 25% of seats free to weaker sections and disadvantaged groups. This coupled with stringent and unequal penal provisions – such as compulsory closure for private schools (vs. public schools) that do not meet RTE norms – is likely to deter fresh private investment in the segment.

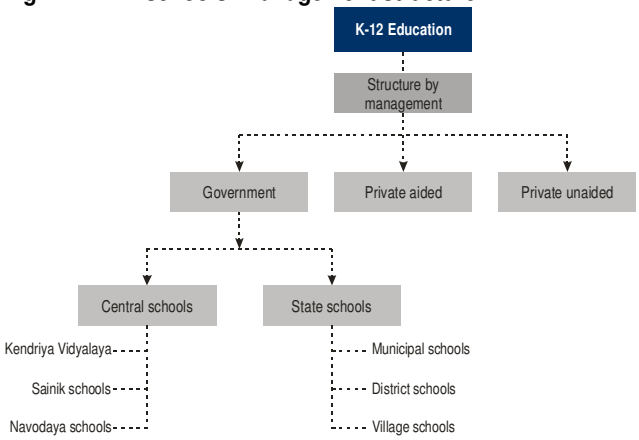
K-12 education

The over-regulated K-12 industry segment is likely to deter new, serious, and credible private sector players from entering the field. The RTE norms have put an unequal burden on private schools (vs public schools), which should lead to changes in the business model

K-12 is the most regulated segment of India's education sector. India has an elaborate structure for K-12 education (*see Fig. 24*). While the size of spending in this sector is around US$75bn per year, the predominant part of this is public spend. The opportunities for private players in this segment are valued at around US$15bn and witness a CAGR of 15%.

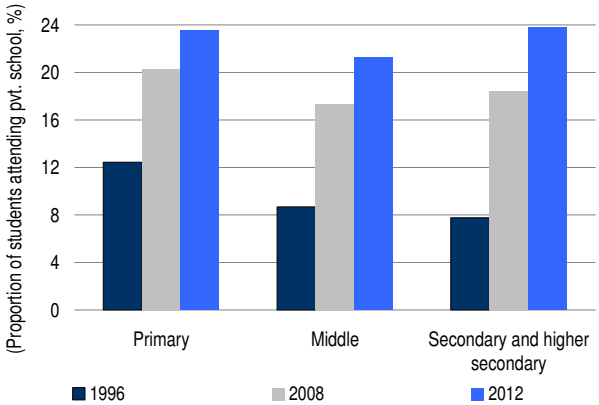
In addition to the not-for-profit clause, private schools also face the RTE Act mandate that requires 25% of seats to be given free to students from weaker sections and disadvantaged groups. Despite the non-profit clause, 24% of the primary (standard I-IV), 21% of middle (standard V-VIII) and 24% of the secondary and higher secondary (standard IX to XII) students attend private schools. This percentage has been increasing over the years (*see Fig 25*). The RTE also mandates closure of private schools if they do not meet the stipulated conditions on teaching and physical infrastructure.

Fig 24 – K-12 schools: management structure



Source: Anand Rathi Research.

Fig 25 – More school students joining private schools



Source: NSSO, Anand Rathi Research

Moreover, public policy at the state level is now focussed on controlling the fee structure in private schools.[8] Such public policy stances are unlikely to induce large private investment in the sector, especially from serious educational enterprises.

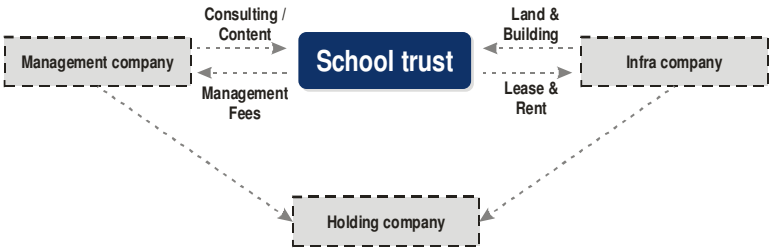
Given that education is a state subject, each state has different laws for K-12 schools. The basic requirement of not-for-profit operations is common in all states. However, private players have moved around the Act to create various structures that indirectly generate profit in K-12 schools.

Asset-heavy business model

In the case of an asset-heavy model, apart from establishing a school as a trust/society/section 25 company, the private education company creates two separate companies, namely an infrastructure company and a management company. The infrastructure company has all the assets – i.e. land, building, furniture – and provides the same to the trust on a long-term lease basis. The management company provides the trust with services such as content, accessories and teacher training and, in turn, charges fees. These contracts are generally long-term – a minimum of 30 years – if not, getting affiliation from boards could become difficult.

In this model, the trust hires the teachers and provides salary and other local miscellaneous expenses. Revenue is initially recorded in the books of the trust and is transferred to companies by way of lease rent and management fees (*see Fig 26*). Under the asset-heavy model, a K-12 school becomes cash-flow positive in at least 5-6 years. It takes even longer – 10-12 years – for the school to reach maximum capacity. High capex, with a long gestation period for payback, and issues related to acquisition of land make it difficult to ramp up several schools simultaneously. On an average, to set up a medium quality school in a tier-I city requires ₹200-250m for capex and working capital.

Fig 26 – Asset-heavy K-12 model



Source: Anand Rathi Research

Dry management – Asset-light business model

The long gestation period, coupled with substantial upfront capex requirement, under the asset-heavy model, led some private education players to approach local partners that have the ability to invest in infrastructure and are keen in being involved in the sector. The private player manages the operations of the school and gets management fees in turn (*see Fig 27*). Several existing schools also give away management contracts to various private players.

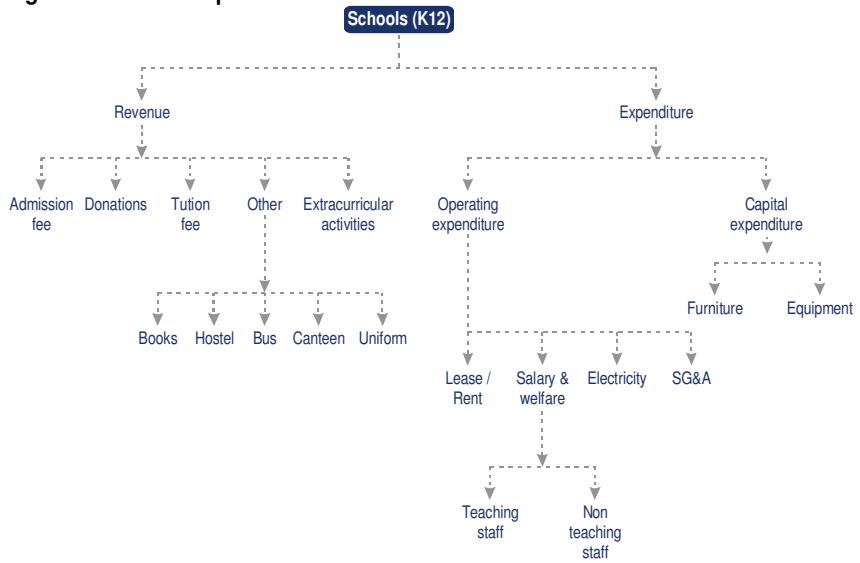
Fig 27 – Asset-light K-12 model

Source: Anand Rathi Research

Other variations exist. For example, certain private education providers tie up with real estate developers. The developer builds school buildings in and around large residential projects and private education providers create a trust/society school, taking the property on lease. Infrastructure and management is provided to such schools by separate entities created by the private player.

There some examples of schools set up through public-private partnership (PPP). Under this model, the public sector entity provides the land at a concession and, in return, the private school provides free education to a predetermined proportion of students under conditions set out by the public sector entity. The revenue-expenditure model and branch network of major K-12 chains are presented in *Fig 28* and *Fig 29*, respectively. Basic strengths and weaknesses of the private K-12 institutions are presented in *Fig 30*. *Fig 31* provides brief details on some of the major private players in the K-12 segment. The revenue-expenditure model of a typical K-12 school from inception until the twelfth year is presented in *Fig 32*.

Fig 28 – Revenue-expenditure model of K-12



Source: Anand Rathi Research

RTE to lead to defocusing on K-12 by private players

The RTE Act requires that for elementary education (standard I-VIII), private schools offer 25% of the seats free to weaker sections and disadvantaged groups. The government would reimburse private schools for this. We estimate such reimbursements to be ₹.3,600 per student per year. Our estimates suggest that such reimbursement would be considerably revenue decretive for the private schools (*See details in Annex I*). Moreover, the Act puts severe teaching and non-teaching infrastructure requirements on private schools, failing which they would face steep penalties and even compulsory closure. Incidentally, for similar transgressions, public schools would not face any specific and time-bound penalty. Such measures are likely to deter fresh private investment in the segment. Even the existing players are likely to switch from the asset-heavy to the asset-light model. Further regulation in tuition fees in a few states (Tamil Nadu and Maharashtra) will only add to the problems of private players.

Digital content causing competition to scale up

Providing of multimedia content to private schools was a trend initially started by Educomp, which is a pioneer in digitizing content for sale to private schools. Over the years, the provision of such services has been seen as an aid to make an inroad into the supply system of the various schools and colleges in order to supply other goods and services.

However, the success of Educomp's Smart Classes has prompted the competition to scale up operations (that were initially very small). More than six players have entered this segment and are in direct competition to Educomp. We believe that though there is a big market for selling content in schools, the same is slowly becoming a commodity, with almost all the players providing a similar type of service – the key differentiator being the pricing. A recent trend is for schools to invest in hardware on their own and to offer extra perks, both monetary as well as non-monetary, to teachers in order to create digital content in-house. However, this is not on par with what organized players are offering. Being proprietary, the content can be upgraded at regular intervals and used in all classes, unlike in the case of paid content, which is currently used only for select classes.

Fig 29 – Company-wise rate per class for ICT (₹)

Company	Product	Price per class room/ per month
Educomp	Smart Class	10,000
Mexus Education	IKEN	5,000
Next Education	TeachNext	6,500
Pearson / Edurite	DigiClass	5,000
HCL	digischool	5,000
Tata Interactive systems	CLASSEDGE	8,800
Everonn	iSchools	7,000
NIIT	nGuru	8,000

Source: Companies

Fig 30 – Porter's five forces

Porter's five forces	Degree of threat	Remarks
Bargaining power of buyers	*Low*	Limited number of K-12 schools with an even lower number of private schools, which are generally perceived to be of superior quality, leaves limited option for students.
Bargaining power of suppliers	*Medium*	Scarcity of teachers is acute. This is addressed by moving to the "teacher-assisted model" from the old "teacher-led" model.
Threat of substitutes	*Low*	With poor quality of government schools and increasing awareness among parents regarding the merits of imparting quality education, the market share of private schools is increasing rapidly.
Threat of new entrants	*Low to medium*	High investment, long gestation periods with back-ended returns and regulatory issues act as barriers for new entrants. The conditions that private schools have to meet under the RTE Act are likely to further reduce competition.
Industry competitors	*Low to medium*	Demand for quality education is too high to be met by the current private players in the industry. However, with the considerable increase in high-end private schools in various metros and tier-I towns, the competition among the private schools may intensify in some of the micro markets.

Source: Anand Rathi Research

Fig 31 – Salient features of select major K-12 players

Name	No. of schools	Description
Bharatiya Vidya Bhavan's Schools	30	They run around 30 schools across India, many are run in association with third parties. They also run an Indian Central School in Singapore
Billabong Schools	57	Part of the Kangaroo Kids group
Delhi Public Schools	130	One of the most prominent and largest K-12 players
Gems Education	60	52 schools across the globe and eight in India, has acquired stake in Everonn
Indus World Schools	17	Operates schools across India
K-12 Techno Services	70	Owns management rights for a number of K12 schools. Part of the Gowthan Educational Institutions
KidZee High & Mount Litera Zee schools	20	Part of Zee Learn, operates across India
People Combine	4	Mainly in AP, provides a range of IB, GCSE and CBSE education.
Radcliffe schools	33	Operates schools across India
Ryan International	115	Large player, is now expanding overseas
Spring Dales	4	Focus on North India
The Millennium schools	86	Own/dry management schools affiliated with - IB / IGCSE / CBSE and ICSE boards. Part of Educomp
Treehouse	16	Concentrated in Gujarat and Maharashtra
VIBGYOR	10	Operates schools mainly in and around Mumbai
Witty International	5	ICSE/ CBSE / IB/ IGCSE boards. Two schools in Mumbai; one in Udaipur

Source: Companies, Anand Rathi Research

Fig 32 – Unit-level matrix for K-12 institution from inception up to 12 years

Yrs		1	2	3	4	5	6	7	8	9	10	11	12
Grade			Nursery-IV	Nursery-V	Nursery-VI	Nursery-VII	Nursery-VIII	Nursery-IX	Nursery-X	Nursery-XI	Nursery-XII	Nursery-XII	Nursery-XII
Total capacity	Nos.		1,120	1,280	1,440	1,600	1,760	1,920	2,080	2,240	2,400	2,400	2,400
Capacity utilization	%		25	35	45	55	65	75	85	90	95	100	100
Students on roll	**Nos.**		**280**	**448**	**648**	**880**	**1,144**	**1,440**	**1,768**	**2,016**	**2,280**	**2,400**	**2,400**
New students	Nos.		280	168	200	232	264	296	328	248	264	120	-
Fresh students in nursery	Nos.		-	-	-	-	-	-	-	-	-	-	160
Total new students	**Nos.**		**280**	**168**	**200**	**232**	**264**	**296**	**328**	**248**	**264**	**120**	**160**
Tuition fees	₹(pm)		2,500	2,750	3,025	3,328	3,660	4,026	4,429	4,872	5,359	5,895	6,484
Growth	%			10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
Admission fees (one time)	₹		20,000	20,000	20,000	25,000	25,000	25,000	30,000	30,000	30,000	30,000	30,000
Other misc. fees	₹		2,500	2,750	3,025	3,328	3,660	4,026	4,429	4,872	5,359	5,895	6,484
Growth	%			10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
Tuition fees	₹m		8.4	14.8	23.5	35.1	50.2	69.6	94.0	117.9	146.6	169.8	186.7
Admission fees	₹m		5.6	3.4	4.0	5.8	6.6	7.4	9.8	7.4	7.9	3.6	4.8
Other misc. Fees	₹m		0.7	1.2	2.0	2.9	4.2	5.8	7.8	9.8	12.2	14.1	15.6
Total revenue	₹m		15	19	29	44	61	83	112	135	167	188	207
Teaching (1:25)	Nos		11	18	26	35	46	58	71	81	91	96	96
Avg. salary of teaching staff	₹		15,000	16,500	18,150	19,965	21,962	24,158	26,573	29,231	32,154	35,369	38,906
Growth	%			10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
Teaching staff salary	₹m		2	4	6	9	13	18	25	31	38	44	49
Non-teaching staff	Nos		9	15	22	22	29	36	44	50	57	60	60
Avg. salary of non-teaching staff	₹		12,000	13,200	14,520	15,972	17,569	19,326	21,259	23,385	25,723	28,295	31,125
Growth	%			10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
Non-teaching staff salary	₹m		1	3	4	5	7	9	12	15	19	22	24
Total employee cost	₹m		4	6	10	14	20	27	37	46	57	66	73
As % of revenue	%		24.1	33.2	34.9	31.1	32.4	32.9	32.9	34.0	34.2	35.3	35.2
Other operating cost	₹m		7	7	9	13	18	25	33	37	46	52	57
As % of revenue	%		45.0%	35.0%	30.0%	30.0%	30.0%	30.0%	30.0%	27.5%	27.5%	27.5%	27.5%
Total cost	**₹m**		10	13	19	27	38	52	70	83	103	118	130
EBITDA	**₹m**		5	6	10	17	23	31	41	52	64	70	77
Margins	%		30.9	31.8	35.1	38.9	37.6	37.1	37.1	38.5	38.3	37.2	37.3
Depreciation	₹m		4.3	4.8	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Interest @ 12%	₹m		11.1	13.8	14.7	15.0	15.0	14.6	13.3	10.9	7.8	-	-
PBT	₹m		(10.8)	(12.4)	(9.3)	(2.9)	3.0	11.1	23.2	36.1	51.0	64.7	72.3
Tax @ 33%	₹m		-	-	-	-	-	-	0.6	11.9	16.8	21.4	23.9
PAT	₹m		(10.8)	(12.4)	(9.3)	(2.9)	3.0	11.1	22.6	24.2	34.1	43.4	48.5
PAT margins	%		-	-	-	-	4.9	13.4	20.2	17.9	20.5	23.1	23.4
Capex	₹m	150	20	20	10								
Depreciation	₹m		4	5	5	5	5	5	5	5	5	5	5
Net block	₹m	150	166	181	186	181	176	171	166	161	156	151	146
WC loan	₹m		50										
Loan (debt : equity - 1:1)	₹m	75	110	120	125	125	125	117.8	103.3	78.5	52.2	17.0	-
ROE	%		(8.7)	(9.9)	(7.5)	(2.4)	2.4	8.9	18.1	19.3	27.3	34.7	38.8
ROCE	%		0.1	0.3	1.4	3.5	6.0	8.7	12.4	16.7	21.2	24.7	27.4

Please note the basic assumptions

1. Land is purchased and construction started in year 1 and then the same is done phase-wise on a need basis.
2. As per CBSE / ICSE norms affiliation can be applied for only after running the school for a minimum of four years.
3. Class VIII onwards cannot be started unless affiliation is granted.
4. Assumed 40 students per class with an average of four divisions per standard as installed capacity
5. Non-teaching staff is in the ratio of 1:30 for the first 6yrs, when the maximum students are from Nursery-IV; later the ratio tilts to 1:40
6. After the 10th year, it becomes a steady state annuity model
7. We assume the trust will not reinvest and hence will not get tax benefits. If the trust reinvests, it is bound to get significant tax breaks.
Source: Companies, Anand Rathi Research

Higher education: Capex heavy

Higher education, especially technical education, has been attracting large private investment since 2005. Private opportunity in technical education is US$7bn in 2012 and is set to grow to US$12bn by 2015. General (non-technical) higher education offers private education opportunity of US$1.5bn in 2012 and this is set to grow to an estimated US$2bn by 2015. Legislative measures to strengthen accreditation, guard against malpractices and set up an academic depository are likely to help the stronger incumbents. Eminent foreign education providers are unlikely to make a large entry in the segment as long as the non-profit tag remains attached to formal education. This should also contain competition and further help the incumbents.

Strong opportunity in technical education

Technical education to remain the focus of private players. Continuation of the non-profit clause likely to deter the entry of serious foreign players

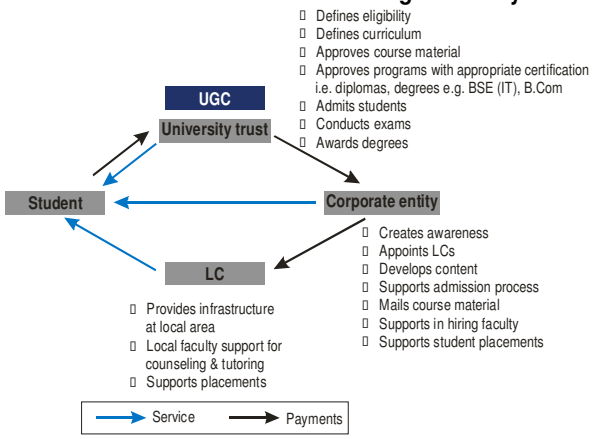
The total spend in this segment is around US$9bn per year for general (non-technical) higher education and US$10bn per year for technical/ professional education. Within this, opportunities for private education providers for general higher education are around US$1.5bn and around US$7bn for technical/professional education. For general higher education, business opportunities for the private sector are growing at a CAGR of 12.5% and at 20% CAGR for technical/professional education.

Like K-12, higher education also entails front-loaded capex and back ended returns. Apart from getting recognized with a board of education (in this case a university / AICTE) a college/deemed university also needs to follow the local state-specific rules. Regulations for higher education are much clearer than that for K-12 (see *Fig 33*). Some states require the land and/or building to be in the name of the trust, especially in the case of universities, while others have granted approvals even if contracts are signed for a long-term lease agreement between the property owner and the trust. However, the lease agreement needs to be at least for 30-40 years.

Type of business models – distance vs. class room

The classroom-based higher education model is capex-heavy, as it has various infrastructure and staff requirements. Distance education is asset-light and has a wider reach, with local partners operating as selling agents as well as conducting examinations. The salient features of classroom-based and distance learning models for higher education are presented in *Fig 34*. *Fig 35* provides the major facets of the current system of higher education in India from the perspective of private education. *Fig 36* provides salient details on some of the major private players in higher education. A stylised revenue-expenditure model for college education is presented in *Fig 37*.

Fig 33 – Basic business model for distance learning university



Source: Anand Rathi Research

Fig 34 – Features of classroom vs. distant learning model in higher education

Parameters	Classroom based	Distance learning
Investments	High capex with working capital requirement, until optimum capacity is reached. Usually takes 8-9 years for pay back	Limited capex to the extent of content creation and negligible working capital requirement
Enrollments	Capacity limited to the extent of availability of appropriate infrastructure. More of an arithmetic flow as seats increase gradually. Reach is limited to the location of the campus.	No limit on enrollments
Staff	Teaching faculty is the biggest staff pool required. Availability of this is a big issue.	Content creators, examiners and marketing staff are required.
Preference	Preferred for under-graduation level courses and where full-time attendance is required – such as courses involving practicals, MBA and other technical courses.	Preferred to enhance skills especially with professionals with full-time work. For example, finance courses.
Returns	Takes 7-8 years to get returns on investment. However, post this the returns are sustainable.	Operationally profitable from the first year. However, returns are more volatile as the number of students may vary widely from year to year.

Source: Anand Rathi Research

Fig 35 – Porter's five forces

Porter's five forces	Degree of threat	Remarks
Bargaining power of buyers	*Low*	Limited seats in colleges
Bargaining power of suppliers	*Medium to high*	Very few qualified teachers available. This is addressed by providing distance learning courses.
Threat of substitutes	*Low*	Govt. colleges / universities are not able to handle the current demand and hence are slowly opening up the sector with deemed universities.
Threat of new entrants	*Low to medium*	High investment, long gestation period with back-ended returns and regulatory issues keeps new entrants at bay.
Industry competitors	*Medium*	Demand too high to be met by current players in the industry. However, in streams like engineering and MBA stiff competition exists, with most students keen on reliable names that provide placements.

Source: Anand Rathi Research

Fig 36 – Salient features of select major private players in higher education

Company	Location / main campus	Model of operation	Streams	Est. number of students
Amity University	Noida, NCR	Private University	Diversified	> 50,000
Bharatiya Vidya Bhavan Trust	Mumbai, Maharashtra	Colleges, Polytechnics in India and abroad	Engineering, Management, Others	NA
ICFAI	Hyderabad, AP	Private University, Colleges, Certification programmers	Management, Others	> 10,000
Lovely Professional University	Phagwara, Punjab	Private University	Diversified	24,000 on-campus
Manipal Education Group	Manipal, Karnataka	Private Universities, Vocational, Education, E-learning, Overseas Universities	Engineering, Medicine, Financial Services training, Others	Over 18,000 on-campus, and 100,000 in distance education
Symbiosis International University	Pune, Maharashtra	Private University	Diversified	>15,000
VIT University	Vellore, Tamil Nadu	Private University	Engineering, Management, Others	>12,000

Source: Industry, Anand Rathi Research

Fig 37 – P&L model for a college in a Tier-II town

Yrs		1	2	3	4	5	6	7	8	9
Total capacity	Nos.		300	600	900	1,200	1,500	1,800	2,100	2,400
Capacity utilization	%		60	70	80	90	90	100	100	100
Students on roll	**Nos.**		**180**	**420**	**720**	**1,080**	**1,350**	**1,800**	**2,100**	**2,400**
Average fees	₹		40,000	44,000	48,400	53,240	58,564	64,420	70,862	77,949
Growth	%			10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
Total revenue	**₹m**		**7**	**18**	**35**	**57**	**79**	**116**	**149**	**187**
Growth	%			156.7	88.6	65.0	37.5	46.7	28.3	25.7
Teaching (1:20)	Nos		9	21	36	54	68	90	105	120
Avg. salary of teaching staff	₹		18,000	19,800	21,780	23,958	26,354	28,989	31,888	35,077
Growth	%			10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
Teaching staff salary	₹m		2	5	10	17	23	34	44	55
Non-teaching	Nos		5	12	21	24	30	40	47	53
Avg. salary of non-teaching staff	₹		12,000	13,200	14,520	15,972	17,569	19,326	21,259	23,385
Growth	%			10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
Non-teaching staff salary	₹m		1	2	4	5	7	10	13	16
Total employee cost	₹m		3	7	14	22	30	44	57	71
As a % of revenue	%		40.1	40.4	40.6	37.9	38.1	37.9	38.0	37.9
Other operating cost	₹m		3	6	10	14	20	26	33	42
As a % of revenue	%		40.0%	35.0%	30.0%	25.0%	25.0%	22.5%	22.5%	22.5%
Total cost	**₹m**		**6**	**14**	**25**	**36**	**50**	**70**	**90**	**113**
EBITDA	**₹m**		**1**	**5**	**10**	**21**	**29**	**46**	**59**	**74**
Margins	%		19.9	24.6	29.4	37.1	36.9	39.6	39.5	39.6
Depreciation	₹m		3.8	4.3	4.5	4.8	5.0	5.0	5.0	5.0
Interest @ 12%	₹m		9.6	12.6	13.5	14.1	14.7	14.2	11.7	8.1
PBT	₹m		(11.9)	(12.3)	(7.8)	2.5	9.4	26.7	42.1	61.1
Tax @ 33%	₹m		-	-	-	-	-	2.2	13.9	20.1
PAT	₹m		(11.9)	(12.3)	(7.8)	2.5	9.4	24.5	28.2	40.9
PAT margins	%		-	-	-	-	11.9	21.2	19.0	21.9
CAPEX	₹m	120	30	20	10	10	10	-	-	
Dep	₹m		4	4	5	5	5	5	5	5
Net block	₹m	120	146	162	168	173	178	173	168	163
WC Loan	₹m		50							
Loan (debt: equity - 1:1)	₹m	60	100	110	115	120	125	111.3	83.2	51.7
ROE	%		(9.5)	(9.8)	(6.2)	2.0	7.6	19.6	22.6	32.7
ROCE	%		(0.9)	(0.4)	1.2	4.5	8.1	13.0	18.9	24.6

Please note the basic assumptions

1. Land is purchased and construction is initiated in the first year and the same is done phase-wise on a need basis.
2. Installed capacity is of 240 students per course for 10 different courses, this is increased gradually.
3. In the 9th year, the college reaches 100% capacity. Post that an annuity model is followed, unless new seats / courses are added.
4. Non-teaching staff is in the ratio of 1:35 for the first four years; later that ratio tilts to 1:45 when capacity hits 90%.
5. Maintenance capex is assumed to get expensed during the year.
6. The above does not include fees charged to students for various other activities.
Source: Industry, Anand Rathi Research

Tutorials: An urban phenomenon

This is the most unregulated and unorganized segment of the Indian education sector. We estimate the yearly revenue size of the industry at US$4.5bn in 2012 and at US$8bn by 2015. The unregulated nature of the industry has attracted much PE/VC funding. Integrated classroom coaching, the dominant part of the industry, currently accounting for over 80% of the segment, is faced with numerous challenges. While ICT-based coaching is likely to prosper at the cost of integrated classroom coaching, the process is likely to reduce the overall pricing power of the segment.

Easy to launch

The coaching industry is mainly an urban phenomenon – coaching in urban areas accounts for nearly 75% of the overall coaching market. The dominant classroom model is facing challenges from ICT-based coaching

The coaching industry has evolved over the years based on the requirements of the students. The current size of the industry segment is about US$4.5bn, with a CAGR of 20%. The entire segment is catered to by private players. The coaching industry is mainly an urban phenomenon – coaching in urban areas accounts for nearly 75% of the overall coaching market. This caters to parents/students who are looking for extra help outside school/college in order to improve their marks. It is by far the most unorganised and unregulated segment in the entire education chain. Most coaching institutes start on a low-scale, with teaching students next door, primarily at the residence of the student/teacher. Business gains momentum when the same teacher is also a part of a school/college and is promoted chiefly by word of mouth.

The unit-level operating matrix for coaching institutes is very attractive, as fees are generally received at the beginning of the classes. Investment is required to scale up to full-fledged classes/new branches. However, once the same reaches optimum level (generally in 2-3 years) it runs at an EBITDA of 40-45% and helps fund other branches.

The RTE Act prohibits schoolteachers from offering private coaching. While similar provisions prevailed in certain states in the past, such practices continue. Whether the RTE norms effectively curb the practice of private coaching by schoolteachers remains to be seen.

Scaling up is an issue

Coaching generally has a personal touch, as it starts with small private/group tuitions. Classes grow in size because of one or two star teachers who generally were at the launch. Post that, finding appropriate teachers to scale up is difficult. Moreover, once the new teachers gain a name, it becomes even more difficult to retain them. There is always a fear of star teachers leaving to start their own set-up or being poached by competitors. This is the biggest roadblock to scaling up.

In order to overcome employee-related issues, big players are using strategies such as dividing one subject among 4-5 teachers. This reduces the importance of star teachers. Further, the introduction of online classes/usage of VSAT/Internet widens the reach and at the same time reduces the dependence on a few select teachers.

From classroom to online coaching

There are four types of test preparation institutes in India. These comprise: 1) integrated classroom programs, 2) technology aided – virtual class, 3) portal-based learning, and 4) distance learning. With the growing IT usage in India, virtual class and portal-based teaching are attracting

more students then ever before.

- **Integrated classroom:** Personalized counselling is the key driver in this area of test preparation. It caters to students' requirements and career needs on an individual level. Key market players in this segment are FIITJEE, IMS, Career Point, and JK Shah.
- **Technology-aided – virtual class:** Virtual classes replicate a real classroom with the help of VSAT/VPN / broad-band via tie-ups with technology partners. Here students interact with instructors online using audio and video-conferencing facilities. Through this delivery platform, instructors deliver lectures at multiple locations simultaneously. This helps minimize time and cost in terms of resource deployment. It also helps reach those locations where setting up a full-fledged center may not be viable due to (1) non-availability of resources (most importantly, competent teachers), or (2) lower number of enrollments than the minimum required for profitable functioning. Everonn is the largest player in this segment. Other players in this segment include Career Point and Educomp.
- **Portal-based services**: Such portals bring together applicants, students, alumni and teachers on a social network. Very little initial investment is required in this model. The services provided through such forums include discussion forums, ranking of schools and colleges, application forms of institutes, entrance test preparation material, SMS alerts, e-books and news, views and developments. Such forums generate revenues in various forms, including banner advertisements on the portal, paid newsletters, paid direct mail advertorials and sale of admission/ examination forms for specific institutions. Of late, video-based teaching also takes place on such portals. Edserv, Educomp and Info Edge are some of the important players in this segment.
- **Distance learning:** Coaching institutes are well known for the simplified content that they provide and the mock tests that they conduct. Many students opt to take only the content and the test, either because this is a cheaper option compared to the classroom-based tutorials or because they prefer self-learning. This mode also helps reach geographies where full-fledged classes are not present. The distance-learning arm of any class is the most profitable, as it does not involve investing in infrastructure or teachers; content once ready does not involve much cost. The major cost involved is of marketing and setting up partners. FITJEE, Career Point, Brilliant, Bhansal and Resonance are some of the key players in this segment.

Since it is not regulated and can be run for profit, a large number of deals (PE/VC funding) take place in this segment.

Challenges before the coaching industry

Integrated classroom coaching is currently the largest component of the coaching industry, accounting for over 80% of the overall revenue for the segment. This model is, however, facing two serious challenges. First, this segment is facing problems of accessing adequate number of competent instructors. The well-known (star) instructors, on the other hand, create problems of high attrition. Second, ICT-enabled coaching (mainly virtual class and portal-based teaching) is more cost efficient and scaleable than the integrated classroom coaching model. Yet, ICT-enabled services are being commoditised (*inter alia*, due to low capital investment requirement), thus impinging on the pricing power of the coaching industry.

Strict implementation of the RTE norm debarring schoolteachers from offering private classes or coaching would, on the one hand, increase the market size for the coaching industry and on the other hand aggravate the shortage of skilled instructors. Once again, these factors would be detrimental for the integrated classroom coaching model and beneficial for the ICT-based coaching model. We expect the share of integrated classroom coaching in the overall revenue of the coaching industry to fall (from over 80% currently) to less than 70% in the next five years.

Fig 38 – Details of major coaching chains with PE/VC funding

Name	No. of centres	Investors	Description
Career Launcher	250	Gaja Capital (USD 8Mn in 2007)	Mainly works through the franchisee model in IIT, MBA coaching
IMS	185	Milestone Religare (USD 5Mn in 2009)	185 centres that are part-owned and part-JVs. Involved in CAT, GMAT, GRE coaching
T.I.M.E.	165	–	Involved in GRE, GMAT, TOEFL coaching Franchisee model Plans to enter into pre-schools
Career Forum	60		Focus on test preparation market for graduate, post-graduate and foreign education
Gate Forum	50	Educomp (2011)	Provides classroom coaching, correspondence courses
Vidhyamandir Classes	48		Focus on engineering and medical entrance tests
Aakash Inst.	47	–	Focus on engineering and medical entrance tests
Professional Tutorials	45	–	Operates a franchisee model for test prep in graduation and post-graduation entrance tests
Tandem Group	40	–	Involved in CAT, NIMCET, IIT-JEE, AIEEE prep
Career Point	34	Franklin Temp (USD 10Mn in 2009)	A publicly listed firm. One of the largest coaching institutes. Now diversifying into K-12
Pathfinder Educational Centre	23	–	Prepares students for Madhyamik, H.S., WBJEE, ICSE, AIEEE, CBSE-PMT and IIT-JEE
Vidyasagar Classes	22	–	Coaches over 9,000 students annually Involved in graduation entrance test prep
Brilliant Tutorials	10	–	No franchises Involved in engineering, medical , IAS entrance tests Is shifting from correspondence to classrooms
Bansal Classes	7	–	Over 50,000 enrolments for Involved in engineering, and medical test prep
Smart Learn Telcomp	3	EdServ Infosystems	Involved in graduate learning programs. Mainly in the south
JK Shah Classes	12		Mumbai-based coaching classes. Strong in CA coaching, recently entered CFA and college prep.
MTeducare	92	Helix partners	Dominant player in Maharashtra, Karnataka and Gujarat. Focus on school, college-level coaching

Source: Companies, Anand Rathi Research

Vocational training

To fulfil India's growing need for skilled manpower across sectors and narrow the existing gap between the demand and supply of skills, the Government of India targets imparting nine or ten technical skills, including retail and hospitality, to 500 million citizens over the next 10 years.

India has always faced serious challenges in producing sufficient skilled technicians. The strong economic growth over the last decade and the consequent increase in demand for such skills has further increased the demand for such skill providers. The key problem in the area of vocational training is that the aspirants for such training lack the finance to undertake such courses. The organised financial system also generally does not extend such funding due to the high transaction cost for such small loans and the lack of bankable collateral. Currently, prospective employers are coming forward to sponsor such courses, often through in-house training facilities, backed by job guarantees at the end of the training. As the scale of such training increases, this sector is likely to see rapid growth.

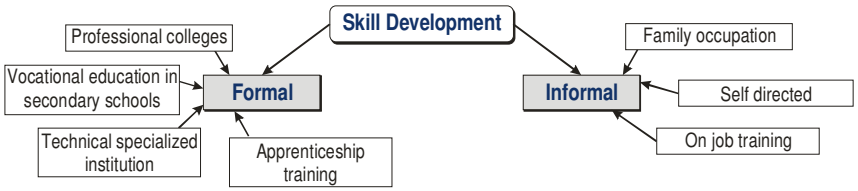
Prospective employers are coming forward to sponsor vocational courses, often through in-house training facilities, backed by job guarantees. As the scale of such training increases, vocational training is likely to take-off in a major way.

NSDC to narrow demand-supply gap in manpower

National Skill Development Corporation (NSDC) was set up as part of a national skill development mission to fulfil India's growing need for skilled manpower across sectors and narrow the existing gap between the demand and supply of skills. The Finance Minister announced the formation of the NSDC in his Budget speech of 2008-09. The NSDC is a public-private partnership, 49% owned by the Finance Ministry and the remaining 51% held by industry bodies such as the CII, NASSCOM, FICCI and Assocham. The Government of India targets imparting skills to 500 million citizens over the next 10 years. NSDC was set up with the objective of achieving 30% of this target, or 150m trained people, by 2022.

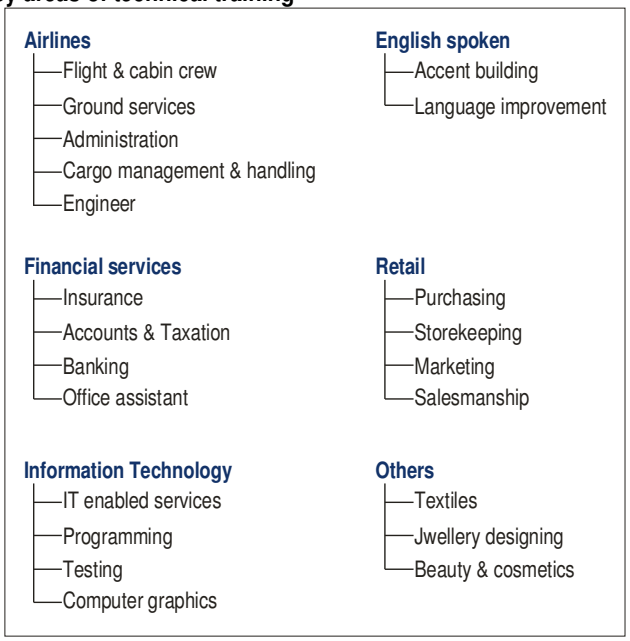
NSDC enters into a JV with leading players for 10-15 years. The private partners provide equity and NSDC provides loans at a concessional 6-7.5% rate with a tax holiday for the initial period of 3-5 years. Training is in 10 technical skill-sets including retail and hospitality. The course fee for technical courses ranges from ₹3,000 to ₹24,000.

Fig 39 – Skill development: formal and informal



Source: Anand Rathi Research

Fig 40 – Key areas of technical training



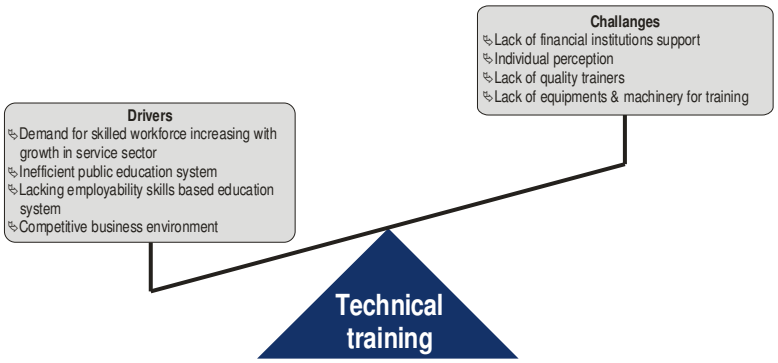
Source: Anand Rathi Research

Fig 41 – Key players in skill training and vocational education

Company	Sector	Brief info
ICA Infotech	Vocational training	450+ centers with courses in accounting, finance and stock market-related courses, with 100% placement guarantee.
Prolific Systems and Technologies	Vocational training	22+ automation training centres all over Asia.
Global Talent Track	Vocational training	Global Talent Track floated a business school called Europe Asia Business School (http://www.eabs.ac.in)
TeamLease Services	Vocational training	People supply and HR training company
IIJT	Vocational education	As of 2010, IIJT operates 120 educational centers across the country. Teamlease Education, backed by Gaja Capital invested INR 31.88 Cr for a 74% stake in the company in Mar 2010.Teamlease subsequently increased its stake to 95% as of Mar 2011.
Aspire Human Capital Management	Vocational products (content)	Provides skill and language training products to B-schools, colleges, universities etc.
Shree Eduserve	Vocational (English language training)	Founded in 2006, Shree Eduserve currently has over 65 centers across the country and has a special focus on the English language training segment.
Orion Edutech	Vocational (call centers)	Certification courses in the BPO segment with 100% placement
IFBI	Vocational training	Provides diploma courses for BFSI segment. Tie-up with ICICI, HSBC and other banks. Part of the NIIT group.
Speak well	Vocational (English language Training)	Provides spoken English training. Has 50+ branches in Mumbai
Aptech	IT / Animation training	Present in 40+ countries. Provides training in computer, animation, multimedia, hardware, aviation, hospitality, retail and English language.
NIIT	IT training	Present in 45+ countries. Provides training in computer, BPO, banking, and on-the-job corporate training for enhancing skills.

Source: Companies, Anand Rathi Research

Fig 42 – Skill training: drivers and opportunities



Source: Anand Rathi Research

Fig 43 – Porter's 5 forces

Porter's 5 forces	Degree of threat	Remarks
Bargaining power of buyers	*Medium*	Number of training institutes is low and mainly located in urban regions. Buyers prefer players that offer placement guarantee or have a good brand name.
Bargaining power of suppliers	*Medium*	Non-availability of adequate skill manpower in rural region to run vocational centers is addressed by offering students trained by the centre part-time / full-time jobs. Further technology is used to conduct classes in a virtual environment.
Threat of substitutes	*Medium*	Vocational training in itself is a substitute for formal education. However, training is provided on-the-job to upgrade skills of the existing manpower. This again, is tied up with a service provider.
Threat of new entrants	*Low to medium*	NSDC is tying up with several players to address the huge demand-supply gap. With the huge mis-match in demand-supply there is room for many more players.
Industry competitors	*Medium*	Many players already exist in the segment. Quite a few players in the formal education space are also expanding their horizons and are keen on getting their share of the larger pie.

Source: Anand Rathi Research

Public policy: the good, bad & ugly

Ongoing legislative efforts with regard to accreditation, academic depository and malpractices are expected to result in better quality of educational institutions. However, the enforcement of some of these norms remains questionable, as there is no change in the existing system of supervision at the ground-level or in enforcement. In addition, the RTE Act is likely to have a negative impact on private institutions involved in elementary education. While for-profit education is no panacea, not allowing the same would effectively bar various credible players, including eminent foreign institutions, from entry to the Indian market. The driver of private investment in education is likely to remain burgeoning household spend rather than supportive public policy.

Challenges before the public policy makers

The Indian Constitution places education on the "Concurrent List" whereby both the Centre and the various states have legislative and executive powers over the education system. The broad objectives of the public policy on education in India are to ensure universal access, equality and quality. However, several challenges exist:

Bridging the skill gaps to make the vast majority of the Indians cross the bar of "employability" is crucial if India has to reap the benefits of the much-publicised "demographic dividend" bestowed on the country

Issues of quality and incompatibility of the curriculum with industry-required skill sets. Lacuna within the Indian education system include the generally poor quality of education, large shortage of qualified teachers, low enrolment ratio at secondary education onwards compared to peers, inadequacy of post-elementary education facilities at the required scale, a gulf between academic curriculum and industry skill requirements, lack of innovation and quality research and lack of internationally acclaimed institutions (*Planning Commission, 2011*). Bridging the skill gaps to make the vast majority of the Indians cross the bar of "employability" is crucial if India has to reap the benefits of the much-publicised "demographic dividend" bestowed to the country. This at once requires expansion and quality improvement.

Need for checks and regulations against malpractices. Private investment helps offset the funding crunch in the educational systems but could affect the accessibility of poorer income groups to education. In addition, the privatisation of technical and professional education has also brought up issues such as the serious shortage of infrastructure, technical expertise and teaching facilities. Charges of underhand practices in private institutions reinforce the need for effective regulation, transparent systems and the supervision of private education.

Public policy ambivalence to continue

Public policy remains against for-profit education

While the authorities frown upon for-profit private education on paper, in practice the same continues with the knowledge and 'patronage' of public officials, either through 'cooking' the accounts (*Dixon and Tooley, 2005*), generating surplus outside the education trust/society, or operating in niches of Indian education that are largely outside the scope of public policy.

Extensive legislative action on the anvil

In order to meet the public policy objectives and to address the existing inadequacies of the Indian education system, several legislative actions are currently underway. These include:

- Putting in place adequate accreditation structure to ensure education quality,
- Quick redress of disputes relating to the educational system,
- Prevention of malpractices in the sector,
- Establishment of a national level apex body for education replacing the current multiplicity of authorities with overarching jurisdictions and mandates, and
- Setting norms to attract capable and authentic private players, including foreign education providers to the sector.

As part of ongoing education sector reforms, an important legislation has been passed in the recent past and five major bills are at various stages of deliberation in the Indian Parliament. The Act and the bills, if passed by the Parliament, are likely to have major implications for private investment in the education sector.

Right of Children to Free and Compulsory Education Act (RTE)

One of the landmark acts on education is the Right of Children to Free and Compulsory Education Act (RTE), 2009, which came into effect on 1 Apr '10. This Act provides the right to all children between the ages of six and 14 years to have free and compulsory elementary education (standards I to VIII), in a neighbourhood school. Under the Act, private schools providing elementary education are required to provide free and compulsory elementary education to at least 25% of students from the weaker section and disadvantaged groups in the neighbourhood. If the school also offers pre-school education, then the reservation would be applicable for such levels as well. Private pre-schools not providing elementary education (standard I to VIII) have an advantage, as they would not fall under the RTE. The schools would be reimbursed for either the tuition charge or the per-student expenditure in government schools, whichever is lower. We estimate this at ₹3,600 per year, per student, which is far lower than the tuition fee in urban centres, where 60% of private school students are based. This would be revenue and profit decretive for urban private schools, especially those in larger cities levying high tuition fees. In addition, if the 25% reserved quota is filled, the total reimbursement amount by the government can run up to ₹400bn (US$8bn) or 2% of the overall public spend on education. In view of these, questions remain on the practicality of the RTE ACT.

Non-compliance of infrastructure, teacher and teacher qualification norms specified by the Act within the three-year timeframe, would lead to withdrawal of recognition and closure. If a school continues to operate, it would attract penalty up to ₹100,000 and ₹10,000 per day. Interestingly, public schools have no specific penal action for non-compliance by them. The RTE also prohibits charging of any capitation fee, contravention of which would attract penalty up to 10 times of the capitation fee charged. The Act also prohibits any child or parent screening for school admission, contravention of which would attract penalty up to ₹25,000 in the first instance and Rs.50,000 for every subsequent contravention. The Act prohibits teachers from undertaking private tuition or private teaching activities.

The National Accreditation Regulatory Authority (NARA) for Higher Educational Institutions Bill, 2010

Currently, accreditation of institutions involved in higher education is voluntary. Only around 20% of the collages and 30% of the universities are accredited. NARA makes accreditation mandatory for all institutions involved in higher education (apart from agriculture, which is a state subject) and all courses offered by them also have to be accredited. The bill establishes NARA for higher education, which shall register and monitor accreditation agencies. These agencies, in turn, would accredit institutions. The accreditation bill allows only government-owned bodies to set up accreditation agencies.

The National Academic Depository Bill, 2011

The bill aims at establishing a national electronic database of academic awards that would allow verification and authentication of all academic records awarded by all recognised academic institutions operating in India. The bill makes it mandatory for all academic institutions operating in India, and issuing degree, diploma, certificate or any other academic award, to lodge all such details with National Academic Depository. Any person is entitled to request the depository to verify any academic award within a specified time.

Accreditation of academic institutions and courses, coupled with the authentication mechanism of academic records, would benefit capable and serious private institutions and would put pressure on fly-by-night operators in India and also on fictitious education providers from across-the-border. This is likely to provide greater credibility to the private education system in India.

Educational Tribunals Bill, 2010

The Educational Tribunals Bill, 2010 has been introduced with the aim to adjudicate disputes relating to higher education. This would cover grievances by all stakeholders including institutions, teachers, other employees, students and regulators. There would be a tribunal at the national level and each state would also have state-level tribunals, with specific jurisdiction. The bill bars the jurisdiction of civil courts on any matters that the state or national educational tribunal is empowered to determine.

Prohibition of Unfair Practices in Technical Educational Institutions, Medical Educational Institutions and University Bill, 2010

The Prohibition of Unfair Practices in Technical Educational Institutions, Medical Educational Institutions and University Bill, 2010 seeks to prohibit unfair practices such as demanding capitation fee, admitting students on other than on merit criteria, not issuing receipt for any fee charged, disseminating misleading information and adopting coercive practices to realise payments from students. The bill makes it mandatory for every institution publish a prospectus, at least 60 days prior to admission, containing specified information on academic and financial aspects of the courses. Implementation of the bill would provide greater transparency to private education and thereby benefit *bona fide* institutions and deter *mala fide* institutions from following underhand practices.

The real issue, however, is that without any change in monitoring and enforcement, the bill would not play any major role in India's education landscape. For example, demanding and giving capitation fee is banned in India. In reality, however, such practices are widespread. In the current form, the bill does not propose any change in monitoring and enforcement.

Foreign Educational Institutions (Regulation of Entry and Operations) Bill, 2010

An estimated 160,000 Indian students go abroad every year and spend US$4bn on education. Currently, foreign institutions are allowed to access the Indian market through various routes, but each involves a local partner. According to reports, currently 6 foreign universities have approved collaborations, 67 institutes run unapproved technical programmes in foreign collaborations and overall 640 foreign collaborations are, in effect, in India. Few foreign institutions involved in such collaborations are globally well-known (*Sanyal, 2010*).

The Foreign Educational Institutions (Regulation of Entry and Operations) Bill, 2010 allows foreign institutions to open a campus in India under permission from the Central government without any partner, but only if they fulfil certain conditions. These conditions include a track record of 20 years in the country of origin, a corpus fund of ₹500mn (US$10mn), at least 25% ploughing back of surplus generated in this country into the corpus fund and deployment of the rest of the surplus on Indian ventures and no repatriation of surplus from India. The courses offered by the foreign institutions have to conform to various standards laid down by the relevant Indian authorities and be comparable to that offered at the original foreign campus.

Little alternative to private funding

There is wide recognition among public authorities about the need to infuse private funding and attract private educational institutes to improve the access and quality of Indian education. This would require garnering all sources for funding of education, and private sector funding offers a major opportunity in this regard. Realising the benefits of quality education for the individual and family, households are already moving away from public to private education. Irrespective of the public policy stance, this would drive private education in India.

Globally, most prominent educational institutions are 'public' institutions. Yet, private educational institutions worldwide are making major headway in terms of enrolment and expansion. At the same time, public institutions are working out alternative funding opportunities and setting up for-profit branches/courses as public funding dries up. The strong interest of various globally reputed foreign institutions in entering the lucrative Chinese and Indian education markets at least partially reflects their attempt to garner additional resources, both pecuniary and non-pecuniary.

Lofty goals, lax enforcement

Guarding stakeholders, especially students, from underhanded and unscrupulous practices by private educational institutions is necessary. Moreover, a regulatory and supervisory system to ensure that private educational institutions follow certain minimum standards in terms of course structure, faculty and academic facilities is relevant under the circumstances.

Enactment of the RTE is a watershed in the enrolment of elementary education. The Act, however, has put unequal burdens, as well as threats of penal actions including closure, on private schools versus public schools. This would either reduce the incentive of private investment in elementary education or private schools would avoid punitive action through underhand measures, as many are currently doing (*Dixon and Tooley, 2005*). Similarly, current legislative measures including those on accreditation, record authentication, dispute resolution and thwarting of malpractices are well intended. In many cases, however, these measures would not serve the purpose without commensurate change in the supervision and enforcement mechanisms. Unfortunately, such measures are not forthcoming.

Public policy dampening quality private investment

"Not-for-profit" tag of private education here to stay

The non-profit clause is a key hindrance for private players that possess the required technical and managerial skills and financial resources to operate in the Indian education sector in a transparent, orderly and scalable model

In India, a private school, a college or a deemed university can be set up only by a trust, society or a company set up under Section 25 of the Companies Act, 1956 (even by an individual, in certain states).[10] These entities, in turn, have to be non-profit in character. This is a key hindrance for private players that possess the required technical and managerial skills and financial resources to operate in the Indian education sector in a transparent, orderly and scalable model.

While there is talk in policy circles of the need to review this,[11] none of the proposed legislative actions actually addresses this issue. The bill on the entry of foreign education providers in India in fact reaffirms the "not-for-profit" status of private education.

Serious players unlikely to work around the not-for-profit model

It is possible for private players to work around the not-for-profit stipulation. In fact, various private players are currently following such a model. Yet, such restrictions impede the entry of credible players such as internationally renowned institutions in the Indian education sector, despite their stated interest on opening branches in India. In order to avoid large government interference in formal education, a major part of the current private investment in the education sector is centred on unregulated and ancillary areas such as pre-school, coaching classes, etc. This situation is unlikely to change unless the not-for-profit tag for education providers is removed.

Discretionary practices give private education a bad name

We believe the ongoing intensive legislative efforts to reform the education system can have certain salutary effects on the sector in general and private investment in particular. Improvement of quality of education, weeding out of unreliable education firms, transparency on educational institutes and courses and strict penal action against unscrupulous educational institutes and personnel are some of the objectives of the education reforms currently underway. These measures should help the genuine private educational institutions to consolidate their position.

Yet, the main critique of the current system is that it remains suspended between over-regulation by the state and a discretionary privatisation. The process retards the efforts of either sufficient mobilisation of private resources or optimum use of mobilised resources (*Kapur and Mehta, 2004*). Despite the clear recognition of the limits of publicly funded education in terms of both access and quality, public policy on private education remains largely ambivalent.

In many other Asian countries like South Korea, Malaysia and even China, public authorities have inserted enabling conditions to allow private investment in education, and are also offering incentives to promote such investment. In contrast, growth of private investment in Indian education has taken place without any state support. Consequently, the unexpected growth in the private sector has led the government to impose regulations. The ambiguities of such regulation have led to judicial interventions (*Agarwal, 2009*).

While the current system effectively bars the entry of credible international providers of education, discretionary policies allow private players with the right connections to put up shoddy education shops and fleece unsuspecting students using illegal and underhand measures. The process gives private education a bad name and provides the opponents of private investment in education with reasons to oppose private initiatives (*Kapur and Mehta, 2007*).

Regulatory capture retarding education reform

In a cynical note the *Economist, 2008,* asserts, "For corrupt state-level rulers, a tightly regulated university system has many benefits. Politicians, or their lackeys, collect bribes for appointing faculty, admitting students and awarding good grades. They insert their supporters to run the racket. Having destroyed a public university, they then grant themselves permission to open a private one from which, illegally, they milk profits. India's politicians would clearly be mad to reform this system."

However, we disagree with such cynical views, and believe public demand for access to quality education at required scale and the willingness to pay

reasonable amounts for such education would lead to educational reforms that grant greater room for quality private education providers. Yet, the process is likely to take longer than what many enthusiastic private investors might expect.

Passive 'privatisation' to continue for now

All rungs of the Indian government – executive, legislative and judiciary – have so far shown various degrees of disdain with regard to allowing *de jure* for-profit education business even if *de facto* for-profit education continues to expand at all levels, especially in tertiary education (*see Fig 4*).

The approach of public policy and judiciary on private education has been succinctly summarised by a celebrated judgement in the case of Unni Krishnan vs the State of A. P. (1993). The judgment says, "Imparting of education has never been treated as a trade or business in this country since time immemorial. It has been treated as a religious duty … charitable activity … never as a trade or business. . . (This) does not imply that private schools cannot exist but states that they should not 'commercialise education' and impart education with the motivation to profit from it". Despite statements by public authorities on reconsidering the not-for-profit status of education in India, no executive, legislative or judicial action is underway towards this end.

Public policy to help incumbents

We do not anticipate public policy on for-profit education to change dramatically anytime soon. Yet, we expect private education and private investment in education to accelerate further. The capacity constraint of public education system for tertiary, especially technical/ professional education, inadequacy of the formal education system to impart quality education and the affordability and willingness of households to spend for quality education would accelerate the momentum of private investment in the education sector. Although the current legislative efforts may fall short of a full-scale education reform, these measures are likely to influence various niches of the educational system.

In the next three to five years, we expect strong private demand rather than public policy reform to be the main driver of private investment in education. We believe that some of the legislative initiatives underway, including the bills on accreditation and on measures against malpractices, would benefit the stronger incumbents. At the same time, status quo on the non-profit clause would mean some of the major potential entrants to the Indian education market would further defer their entry decisions. Meanwhile, the willingness of the Indian households to spend money on quality education provided by reputed organisations would pose serious challenges for most unorganised/stand-alone players and new entrants. As a result, existing large domestic private players are likely to consolidate their positions.

Current public policy initiatives have not put in place any incentive mechanism to attract private investment into formal education. We have already indicated that the provision of the RTE can lead to defocusing of private institutions from elementary education. Compulsory accreditation norms and effective implementation of the provisions of Prohibition of Unfair Practices Bill can adversely affect private institutions with inadequate capacity. At the same time, we do not think that the Foreign Educational Institutions Bill, in its current form, would induce reputed foreign institutions to set up Indian ventures. Consequently, we expect private investment in education to remain focused on areas where it is already strong – pre-school, technical education and private tuition.

Listed companies

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Education

Initiating Coverage

29 December 2011

Career Point

New business segments, expansion through VSAT & internet

Rating: **BUY**
Target Price: ₹284
Share Price: ₹216

Having built a strong brand in north India with its cash-cow tutorials, Career Point is expanding through VSAT/internet technology to untapped areas. In order to widen its business footprint, it has made a foray into K-12 and higher education. We initiate coverage with a Buy rating and a DCF-based price target of ₹284.

- **Tutorial business – a cash cow.** Career Point is a strong brand in north India. Its cash-cow tutorials have over 32,776 students, with fees averaging ₹24,000 per annum, per student. The company is now tying up with schools to prepare students for competitive exams at school premises. It is also backward integrating by setting up a residential campus in Kota for 3,000 students, with annual fees of ₹78,000 each. Operations are expected to start from 1QFY13.

- **Technology to expand its footprint.** Career Point is utilizing VSAT/ internet technology to conduct "live" classes (Techedge Classes) in schools and centers where it would have been uneconomical to set up full-fledged classes.

- **Diversifying into formal education.** In order to capture a larger portion of the private education market, the company is diversifying into K-12 and higher education. It plans to set up two K-12 schools, two technical campuses and two universities during FY12-13, with an investment of ~₹2.5bn. With its strong student base in the coaching segment, the company is confident of scaling up its new business segments.

- **Valuation.** We use a DCF-based valuation to arrive at our target price of ₹284. At this price, the stock would trade at PE of 19x FY13e and 17x FY14e earnings. **Risks:** attrition of key staff, increasing competition and regulatory risks and changes in entrance examination policy.

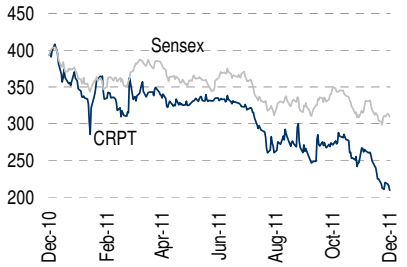
Key financials (YE Mar)	FY10	FY11	FY12e	FY13e	FY14e
Sales (₹m)	617	786	749	1,008	1,301
Net profit (₹m)	178	232	236	264	303
EPS (₹)	12.3	12.8	13.0	14.5	16.7
Growth (%)	(0.8)	3.7	1.7	11.8	15.1
PE (x)	17.5	16.9	16.6	14.9	12.9
EV/EBITDA (x)	10.5	8.0	11.3	9.5	8.0
P/BV (x)	2.4	1.5	1.4	1.2	1.1
RoE (%)	9.2	8.4	7.5	7.5	7.9
RoCE (%)	13.8	12.7	11.2	11.2	11.7
Dividend yield (%)	-	-	-	-	-
Net gearing (%)	(45.7)	(58.3)	(28.9)	(9.1)	5.2

Source: Company, Anand Rathi Research

Key data	CRPT IN / CARP.BO
52-week high / low	₹424 / ₹216
Sensex / Nifty	15971 / 4779
3-m average volume	US$0.2m
Market cap	₹3.9bn / US$75.7m
Shares outstanding	18.13m

Shareholding pattern (%)	Sep '11	Jun '11	Mar '11
Promoters	59.92	59.92	59.92
- of which, pledged	-	-	-
Free float	40.08	40.08	40.08
- Foreign institutions	0.17	0.21	0.21
- Domestic institutions	15.41	16.04	16.27
- Public	24.5	23.83	23.60

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Net revenues	617	786	749	1,008	1,301
Revenue growth (%)	36.6	27.5	(4.7)	34.6	29.0
- Op. expenses	378	489	477	625	791
EBIDTA	**239**	**297**	**272**	**384**	**509**
EBITDA margin (%)	38.7	37.8	36.4	38.1	39.2
- Interest expenses	0	1	0	12	36
- Depreciation	7	13	18	34	46
+ Other income	42	67	97	54	24
- Tax	95	119	116	130	149
Effective tax rate (%)	34.7	33.9	33.0	33.0	33.0
Reported PAT	179	232	235	263	303
+/- Extraordinary items	1	1	-	-	-
+/- Minority interest	0	(1)	(1)	(1)	(1)
Adjusted PAT	178	232	236	264	303
Adj. FDEPS (₹/share)	12.3	12.8	13.0	14.5	16.7
Adj. FDEPS growth (%)	(0.8)	3.7	1.7	11.8	15.1

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Share capital	144	181	181	181	181
Reserves & surplus	1,181	2,474	2,710	2,973	3,277
Net worth	1,325	2,655	2,891	3,154	3,458
Minority interest	0	0	(0)	(1)	(2)
Total debt	1	1	1	201	401
Def. tax liab. (net)	2	3	3	3	3
Capital employed	**1,328**	**2,659**	**2,894**	**3,357**	**3,860**
Net fixed assets	481	808	1,789	2,556	3,310
Investments	382	1,326	522	222	-
- of which, liquid	379	1,322	522	222	-
Net working capital	238	299	269	313	330
Cash and bank balance	227	226	313	266	219
Capital deployed	**1,328**	**2,659**	**2,894**	**3,357**	**3,860**
Net debt	(605)	(1,547)	(834)	(287)	181
WC days	141	139	131	113	93
Book value (₹/sh)	92	146	159	174	191

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
PAT	179	232	236	264	303
+ Non-cash items	6	14	18	34	46
Cash profit	185	246	254	297	349
- Incr./(decr.) in WC	112	62	(30)	44	17
Operating cash-flow	73	185	284	253	332
- Capex	141	340	1,000	800	800
Free cash-flow	(68)	(155)	(716)	(547)	(468)
- Dividend	-	-	-	-	-
+ Equity raised	575	1,097	(1)	(1)	(1)
+ Debt raised	(51)	(1)	(0)	200	200
- Investments	360	944	(804)	(300)	(222)
- Misc. items	1	(0)	-	-	-
Net cash-flow	95	(1)	87	(47)	(47)
+ Op. cash & bank bal.	133	227	226	313	266
Cl. cash & bank bal.	227	226	313	266	219

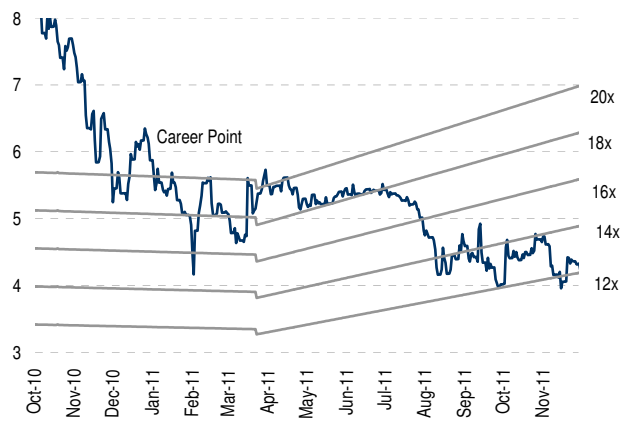
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹216

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
CEPS (₹/share)	12.8	13.5	14.0	16.4	19.2
Cash/(debt) (₹/share)	42.0	85.3	46.0	15.8	(10.0)
P/E (x)	17.5	16.9	16.6	14.9	12.9
P/B (x)	2.4	1.5	1.4	1.2	1.1
P/C(x)	16.9	16.0	15.4	13.2	11.2
EV/sales (x)	4.1	3.0	4.1	3.6	3.2
EV/EBITDA (x)	10.5	8.0	11.3	9.5	8.0
EBIT/sales(%)	44.4	44.7	46.9	40.1	37.5
Sales/average CE(x)	0.3	0.3	0.2	0.3	0.3
RoCE (%)	13.8	12.7	11.2	11.2	11.7
Avg. CE/avg.eq.(x)	1.0	1.0	1.0	1.0	1.1
PBT/EBIT (x)	1.0	1.0	1.0	1.0	0.9
PAT/PBT (x)	0.7	0.7	0.7	0.7	0.7
RoE (%)	9.2	8.4	7.5	7.5	7.9
Dividend yield(%)	-	-	-	-	-

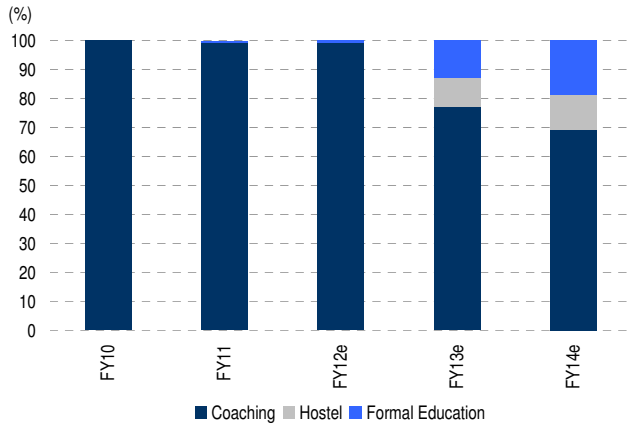
Source: Company, Anand Rathi Research

Fig 5 – Valuation chart (EV/EBITDA)



Source: Bloomberg, Anand Rathi Research

Fig 6 – Revenue break-up



Source: Company

Investment argument and valuation

Having built a strong brand in north India with its cash-cow tutorials, Career Point is now expanding through VSAT/internet technology to untapped areas. To widen its business footprint, it has also made a foray into K-12 and higher education. We initiate coverage with a Buy rating and a DCF-based price target of ₹284.

Tutorial business, the cash cow

Career Point provides tutorial services to high-school students and after for various competitive entrance examinations, including the All-India Engineering Entrance Examination (AIEEE), the Indian Institute of Technology – Joint Entrance Examination (IIT-JEE), the All-India Pre-Medical (AIPMT) and Pre-Dental Tests (PDT).

The tutorial services are provided in classroom programs conducted through a network of company-operated centers (17) and franchises (16). In FY11, it had 32,776 students, with average fees of ₹24,000 per annum, per student.

Caters 32,776 students under various courses with average realization of ₹24,000 per annum

Fig 7 – Center-wise break-up of students

Centers	FY07	FY08	FY09	FY10	FY11
Kota	7,931	9,836	10,080	13,574	16,603
Growth (%)	-	24.0	2.5	34.7	22.3
Branches	1,511	3,508	5,345	9,249	9,244
Growth (%)	-	132.2	52.4	73.0	(0.1)
Franchisees	9,066	9,091	6,742	4,285	3,225
Growth (%)	-	0.3	(25.8)	(36.4)	(24.7)
Distance learning	6,174	5,581	5,543	3,835	3,694
Growth (%)	-	(9.6)	(0.7)	(30.8)	(3.7)
Total	**24,682**	**28,016**	**27,710**	**30,943**	**32,766**
Growth (%)	-	13.5	(1.1)	11.7	5.9

Source: Company

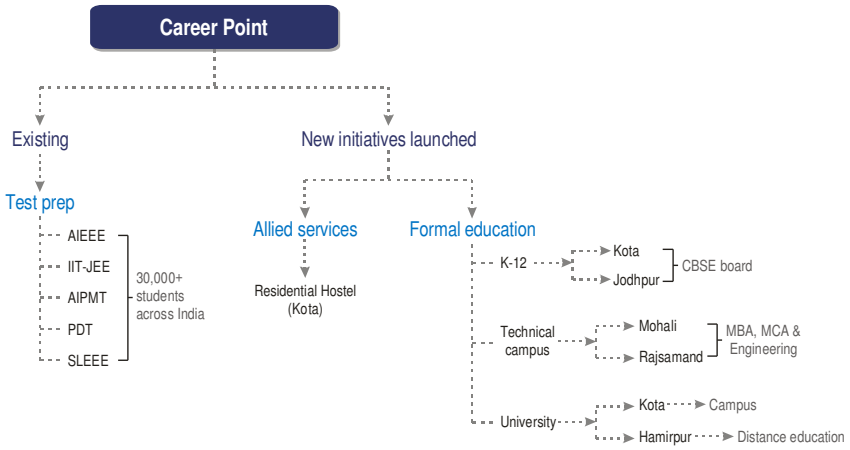
Technology to expand footprint

The company is using innovative technology to enhance learning for students and to expand its base to areas it does not yet cover.

Diversification into formal education

Career Point is also diversifying in order to capture a larger share of the private education market, with a foray into K-12 and universities. This strategy complements its present line of business.

Fig 8 – Segment-wise flow-chart



Source: Company

Valuation

Using DCF-based valuation methodology, we have arrived at a price target of ₹284. At this target price, the stock would trade at PE of 19x FY13e and 17x FY14e earnings. We expect strong earnings growth and better return ratios to result in premium valuations. (See Fig 9).

Risks

- **Scrapping of entrance examinations by the government.** The government may scrap/reduce the weighting for the entrance examination to engineering colleges, from 100% to 30%, and lay more emphasis on Std.12 results. This would significantly affect Career Point, as ~90% of its revenue arises from tutorials in the test-preparation segment. This regulation should take awhile to be passed (discussions on this have been ongoing for the last two years), as it may face much opposition from IITs and other engineering colleges. Even if the same is passed, Career Point will start offering coaching for XII board exams along with the entrance exam.
- **Geographical concentration.** The company derives 58% of revenue from Kota, Rajasthan. Hence, any disruption in operations, or competition, could impact overall operations significantly.
- **Attrition.** Attrition in the senior management/content/teaching team may impact the business.
- **Regulatory risk for formal education.** Any changes in regulatory norms on the formal education front may significantly impact the investment made in formal education by the company.

Fig 9 – DCF-based valuation

Year-end: Mar	FY11	FY12e	FY13e	FY14e	FY15e	FY16e	FY17e	FY18e	FY19e	FY20e	FY21e	FY22e
FCFF												
Revenues (₹m)	786	749	1,008	1,301	1,662	2,096	2,452	2,813	3,231	3,717	4,213	4,785
Growth (%)	27.5	-4.7	34.6	29.0	27.8	26.2	17.0	14.7	14.8	15.0	13.4	13.6
EBITDA (₹m)	297	272	384	509	655	842	965	1,086	1,267	1,467	1,645	1,851
Margins (%)	37.8	36.4	38.1	39.2	39.4	40.2	39.4	38.6	39.2	39.5	39.0	38.7
Depreciation/amortisation (₹m)	13	18	34	46	115	128	129	131	132	134	135	138
Interest expenses (₹m)	1	0	12	36	69	81	60	24	-	-	-	-
Other income (₹m)	67	97	54	24	8	9	19	28	42	67	95	125
PBT (₹m)	351	351	393	452	479	642	795	959	1,176	1,400	1,605	1,837
Tax (₹m)	119	116	130	149	158	212	262	317	388	462	530	606
PAT (before MI) (₹m)	**232**	**235**	**263**	**303**	**321**	**430**	**533**	**643**	**788**	**938**	**1,075**	**1,231**
Add: depreciation (₹m)	13	18	34	46	115	128	129	131	132	134	135	138
Add: interest*(1-tax rate) (₹m)	0	0	8	24	46	54	40	16	-	-	-	-
Cash profit (₹m)	**245**	**253**	**305**	**373**	**482**	**612**	**702**	**790**	**921**	**1,072**	**1,210**	**1,369**
Increase/decrease in working capital (₹m)	62	-30	44	17	-13	-79	18	16	15	28	34	42
Operating cash flow (₹m)	184	283	261	355	496	691	685	774	905	1,044	1,176	1,327
Capex (₹m)	340	1,000	800	800	800	50	50	50	50	50	50	150
FCFF (₹m)	-156	-717	-539	-445	-304	641	635	724	855	994	1,126	1,177
Less: interest*(1-tax rate) (₹m)	0	0	8	24	46	54	40	16	-	-	-	-
FCFE (₹m)	-156	-717	-547	-469	-350	587	595	708	855	994	1,126	1,177
Year of discounting (no.)	-		1	2	3	4	5	6	7	8	9	10
Discounted FCFF (₹m)	**-**	**-717**	**-471**	**-339**	**-203**	**374**	**323**	**322**	**333**	**338**	**334**	**303**
Discounted FCFE (₹m)	**-**	**-717**	**-480**	**-361**	**-236**	**348**	**309**	**323**	**342**	**348**	**346**	**317**

Calculation WACC	
CMP (₹)	216
Equity (market cap) (₹m)	3,917
Debt (FY12e) (₹m)	1
Risk-free rate - Rf (%)	9.0
Rm - market return (%)	14.0
Beta (B)	1.1
Cost of equity (ke) (%)	14.6
Cost of debt (kd) (%)	12.0
Wd (%)	0.0
We (%)	99.99
WACC (%)	**14.5**
Growth rate (g) (%)	5
FCFF in 2022e (₹m)	1,126
Terminal value of firm (₹m)	11,709
Present value of terminal value(₹m)	3,011
NPV of FCFF (₹m)	1,303
Net debt (₹m)	-834
Intrinsic value (₹m)	5,148
Outstanding shares (no. m)	18
Value per share (₹)	**284**

Terminal growth (%)	Cost of equity (%)				
284	**12.6**	**13.6**	**14.6**	**15.6**	**16.6**
3	327	287	254	226	203
4	351	305	267	237	212
5	380	326	**284**	250	222
6	418	353	304	265	233
7	468	388	329	284	248

Source: Company, Anand Rathi Research

Tutorial business, a cash cow

Career Point's cash-cow tutorial business has over 32,776 students, with fees averaging ₹24,000per annum, per student. It is a strong brand in north India and is tying up with schools to prepare students for competitive exams at school premises. Further, the company is backward integrating by setting up a residential campus in Kota, Rajasthan, for 3,000 students, at annual fees of ₹78,000 each. Operations are expected to start from 1QFY13.

Strong brand, northern India dominance

Career Point has established training centers and brand recognition in its markets. It (together with its franchisees) operates in 13 states, providing access to major markets in northern and eastern India. Its Kota center attracts students from across the country as well as from Singapore and West Asia (the Middle East), in turn, reinforcing its brand equity.

It operates this network through its own branches and franchisees, generally in tier-II towns. It also offers distance learning where it is not financially viable to open centers.

Fig 10 – Network of branches

	Number of centers (30 Mar '11)	Added in 1QFY12	Closed in 1QFY12	Number of centers 1QFY 12
Company-owned	17	2	7	12
Franchisees	16	1	6	11
CPLive franchisees (VSAT based)	-	4	-	4
Total	**33**	**7**	**13**	**27**

Source: Company

Average realizations at 27% CAGR (FY07-FY11)

The company has a strong foothold in AIEEE (All-India Engineering Entrance Exam) coaching, with 7.5% CAGR in volumes (FY07-FY11). However, in the last five years (FY07-FY11) it has also seen a steady increase in average realizations, at 27.1% CAGR, despite competition in the tutoring business and lower enrollment in AIPMT (All-India Pre-Medical Test) and franchisee centers. This is mainly due to its strategy of focusing on its strengths in the engineering tutorial segment and closing down loss-suffering franchises that are low on performance and that erode brand value. Further, it opens centers mainly in tier-II cities where it can attract at least 600 students. The rationale behind the focus on tier-II cities is that:

- Less competition exists from organized players similar to Career Point
- Lower rental costs lead to early breakeven for each unit
- The target audience is easier to attract, as they have greater aspirations to learn and grow. Students from nearby villages/towns can also be tapped;
- Manpower costs are lower.

Fig 11 – Average realizations on a steady rise

	FY07	FY08	FY09	FY10	FY11
Total students (no.)	24,682	28,016	27,710	30,943	32,766
Growth (%)		*13.5*	*(1.1)*	*11.7*	*5.9*
Average realization (₹)	9,147	11,427	14,353	19,092	23,845
Growth (%)		*24.9*	*25.6*	*33.0*	*24.9*

Source: Company

We expect strong traction in the AIPMT segment to aid growth. Further, the company is looking at other courses and tutorials for schools kids to leverage its leadership in AIEEE and diversify from the risks associated with the engineering test preparations.

Tie-ups with schools

Career Point plans to provide synchro-school programs under the TechEdge Class initiative through VSAT/VPN technology and learning management software. This will help experienced faculty members to conduct lectures at schools in remote locations. The company has already signed agreements with three schools under this model and plans to expand further.

De-risking supply-side challenges

The tutorial services largely depend on key teachers. To reduce the risks of dependence on a few key teachers, Career Point has divided each subject into 4-5 segments, taught by different teachers. This reduces dependence on a single teacher. At present, the company has a teaching faculty of over 200. We believe this strategy mitigates, to a larger extent, the risk of losing students due to the exit of a key faculty member.

Integrated campus facility – backward integration

Integrated campus in Kota with capacity of 3,000 students and fees of ₹78,000 per annum

Kota hosts 30,000-40,000 students from outside the city every year, who come to prepare for the IIT-JEE, the AIEEE and other entrance exams. A parallel industry has emerged in the region, catering to basic needs (food and lodging) of the students. Career Point is keen on having its own share of this pie and hence is developing an integrated campus for 3,000 students. It also hopes to see enhanced enrolments in its test-preparation program as a result of this new integrated facility.

In addition, Career Point also intends to provide a host of services (library, guest-house for visiting parents, primary health center, auditorium, canteen, cafeteria, places for indoor and outdoor recreation, staff quarters, provision for a departmental store and banks). This is likely to be a strong value-add, as the combination of all these services on one campus is not easily available for students in standalone units. We believe that, due to the combination of facilities, the rising demand and at an annual fee of ₹78,000 per student (on par with the market rate), this initiative is likely to be successful.

This center is also likely to help tap an increasing number of students, both for the formal and informal segments of the education stream. The facility is expected to be up and running by May ’12. The company expects to fill ~40% of capacity in the first year of operations.

Expansion via innovative technology

Career Point is using innovative technology – such as virtual classrooms and technology-based learning solutions – to enhance the learning experience of students and to expand its base to areas in which it does not currently operate. This helps minimize time and cost in terms of resource deployment. The company has entered into an agreement with Hughes Communications, India, to provide satellite-based interactive services through the latter's network across India. It also plans to increase the number of its Career Point Knowledge Labs across the country.

Innovative teaching tools used to expand reach

TechEdge Class: CP - Live

TechEdge Class is a concept based on a virtual-classroom environment, replicating a real classroom through VSAT/VPN technology. In a TechEdge Class, students interact with instructors online through audio- and video-conferencing. On this platform, instructors deliver lectures at multiple locations simultaneously. This helps minimize time and cost in terms of resource deployment.

Further, the cost involved in setting up TechEdge Classes is low. This, coupled with a minimum human interface, enables it to expand its offerings to remote locations where setting up a full-fledged training center is uneconomical. In order to reach students through this technology, the company has entered into an agreement with Hughes Communications, India, to provide satellite-based interactive services through the latter's network across India.

Career Point Knowledge Lab

The company has launched technology-based personalized learning solutions at its Career Point Knowledge Labs. It provides pre-recorded varied educational content developed by faculty members in video and digital formats. Apart from content created exclusively for Career Point Knowledge Labs, content is developed by faculty members in TechEdge Class.

The company intends to increase the number of Career Point Knowledge Labs across the nation, as this would address the personalized learning needs of students and revolutionize the process of preparing for competitive exams.

Diversification into formal education

To capture a larger portion of the private education market, Career Point is diversifying into K-12 and higher education. With its present student base of over 30,000 in the coaching segment, this constitutes a natural and organic business expansion.

Global Public School: Kota and Jodhpur

Career Point has one K-12 school, Global Public School, Kota, with ~1,500 students. A second school, based in Jodhpur, is scheduled to be launched in FY13. The land at the Kota school is in the books of a trust (the front end in the case of formal education is required to be a trust). Hence, Career Point gets only management fees. In the case of the Jodhpur school, the company is entitled to both management fees and lease rent, as the land and building are on its books and have been leased out to the trust for 30 years. Capex for the Jodhpur school (capacity: 2,000 students) is expected to be ~₹100m. The company is to obtain revenue in terms of lease rent at 15% of capex, and management fees at ~15% of the revenue generated by the trust.

Company will get management fees @ 15% of gross revenue to school and 15% as lease rent on infrastructure provided

Fig 12 – Number of students and revenue stream

K-12 schools	FY11	FY12e	FY13e	FY14e
Kota (nos.)	1,500	1,650	1,650	1,650
Growth (%)	-	10.0	-	-
Jodhpur (nos.)		200	300	450
Growth (%)			50.0	50.0
Total students	**1,500**	**1,850**	**1,950**	**2,100**
Average realization	22,000	24,200	26,620	29,282
Growth (%)	10	10.0	10.0	10.0
Revenue for trust (₹m)	33	45	52	61
Management fees to company (₹m)	5	7	8	9
CAPEX (₹m)		100		
Lease rent to company (₹m)			15	15
Total revenue to company (₹m)	**5**	**7**	**23**	**24**

Source: Company, Anand Rathi Research

Technical campuses at Mohali and Rajsamand

The company launched a technical campus at Mohali in Sep '11 and plans to open another at Rajsamand in June 2012. While the campus at Mohali offers MBA programs and engineering courses, the one at Rajsamand is to also offer an MCA programme.

The combined capacity of the two campuses will be ~3,300 students. The assets of these campuses are to be included in the books of Career Point's 100% subsidiary, Career Point Infra, which would receive lease rent at 12% of the capex of ~₹200m to be incurred by FY13.

Career Point will also receive management fees at 15% of the revenue generated by the trust.

Fig 13 – Technical colleges: revenue and capex

Technical college	FY11	FY12e	FY13e	FY14e
Mohali				
Maximum capacity		300	600	900
Capacity utilized		18	525	675
Capacity utilized (%)		6.0	87.5	75.0
Growth (%)			2,816.7	28.6
Average realization (₹)		80,000	80,000	80,000
Growth (%)			-	-
Rajsamand				
Maximum capacity			300	600
Capacity utilized			200	350
Capacity utilized (%)			66.7	58.3
Growth (%)				75.0
Average realization (₹)		55,000	55,000	55,000
Growth (%)				
Total				
Total students		**18**	**725**	**1,025**
Growth (%)			3,927.8	41.4
Average realization (both campuses) (₹)		80,000	73,103	71,463
Growth (%)			(8.6)	(2.2)
Revenue for trust (₹ m)		1	53	73
Management fees to company (₹ m) (A)		**0**	**8**	**11**
Total capex	80	120		
Lease rent to company (₹ m) (B)			**24**	**24**
Total revenue to company (A+B)	**-**	**0**	**32**	**35**

Source: Company, Anand Rathi Research

State private university – Kota and Hamirpur

Career Point has applied for state private university status in Rajasthan (Kota) and Himachal Pradesh (Hamirpur); sanctions for both are expected by end-FY12 and student intake is expected to commence from Jun '12.

Unlike the technical campuses and K-12 schools, there is no restriction on the number of seats. According to state government requirements, land for the university has to be in the books of the trust, while buildings and other assets can be reflected in the company's balance sheet. In this case, they will stand in the books of Career Point's 100% subsidiary, Career Point Infra, which would receive lease rent at 15% of the capex of ~₹2.2bn to be incurred over four years, starting FY12.

Career Point would also receive management fees of 15% of the revenue generated by the trust.

Fig 14 – University revenue, capex and students

University	FY12e	FY13e	FY14e
Kota		1,500	2,625
Hamirpur		750	1,500
Students	**-**	**2,250**	**4,125**
Average realization (₹)		50,000	55,000
Revenue for trust (₹m)		**113**	**227**
Management fees to company (₹m) (A)		17	34
CAPEX (₹m)	400	600	600
Lease rent to company (₹m) (B)		60	150
Revenue to company (₹m) (A+B)		**77**	**184**

Source: Anand Rathi Research

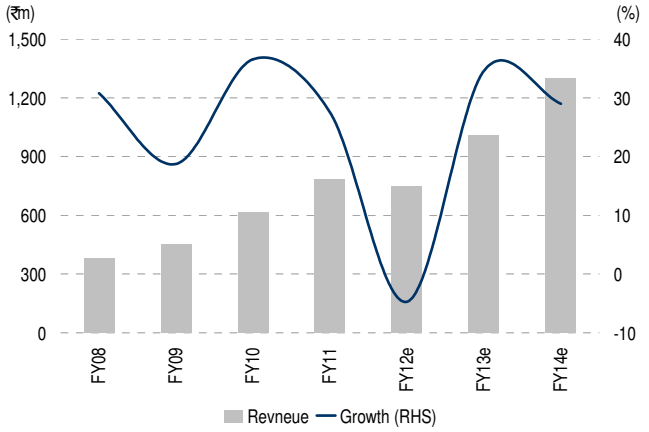
Financials

In the past three years (FY08-FY11) Career Point has registered 27% revenue CAGR, largely from its tutorial services. As it shifts gears into formal education, we expect 32% revenue CAGR over FY12-14, with an expanded margin of 39.4% in FY14e.

Revenue CAGR of 32% over FY12e-14e

In the past three years (FY08-FY11), Career Point has registered 27% revenue CAGR, largely stemming from its tutorials segment. As it shifts gears and moves aggressively into formal education, we expect it to record 32% revenue CAGR over FY12-14.

Fig 15 – Revenue and growth



Source: Company, Anand Rathi Research

Fig 16 – Revenue break-up (%)

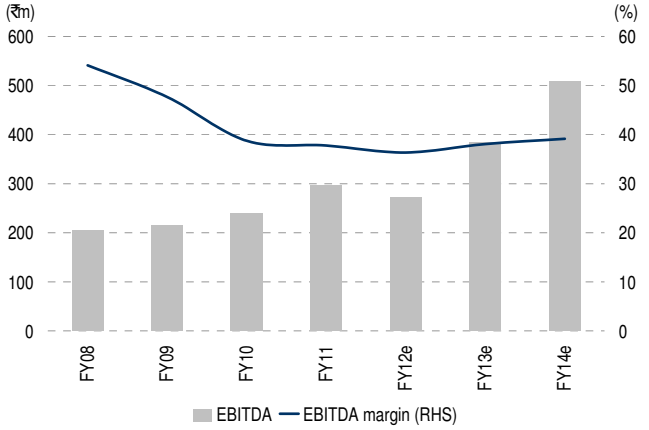
	FY10	FY11	FY12e	FY13e	FY14e
Coaching	100.0	99.4	99.1	77.3	69.2
Hostels	-	-	-	9.7	12.1
Total non-formal	**100.0**	**99.4**	**99.1**	**86.9**	**81.3**
K-12	-	0.6	0.9	2.3	1.9
Technical colleges	-	-	0.0	3.2	2.7
University	-	-	-	7.6	14.1
Total formal	**-**	**0.6**	**0.9**	**13.1**	**18.7**
Total revenue	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company, Anand Rathi Research

EBITDA margin to expand 160bps in FY14e, from 37.8% in FY11

We estimate the rollout of formal education and the use of technology in the coaching segment to result in a margin expansion to 39.4% in FY14e, from 37.8% in FY11.

Fig 17 – EBITDA and EBITDA margins

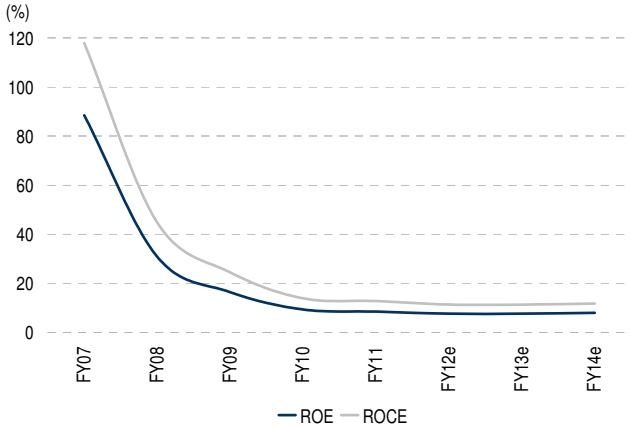


Source: Company, Anand Rathi Research

Return ratios

We expect 32% revenue CAGR over FY12e-14e, and EBITDA growth of 37%. Net profit, however, is estimated at 13% due to high capex. Career Point had an asset turnover of 1.2x in FY11, which is likely to drop to 0.4 in FY12e and FY13e due to heavy capex in formal education. However, we expect this to improve from FY14e, which in turn should improve return ratios.

Fig 18 – Return ratios



Source: Company, Anand Rathi Research

Fig 19 – Income statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Revenues	617	786	749	1,008	1,301
Growth (%)	36.6	27.5	(4.7)	34.6	29.0
Expenses	378	489	477	625	791
As % of revenue	61.3	62.2	63.6	61.9	60.8
Cost of goods sold	22	28	28	32	36
As % of revenue	3.5	3.6	3.8	3.2	2.8
Employee cost	209	313	303	327	387
As % of revenue	33.8	39.8	40.4	32.4	29.7
Other costs	147	148	146	202	267
As % of revenue	23.9	18.9	19.5	20.0	20.5
Hostel-related exp			-	63	102
As % of revenue			-	10.1	12.9
EBITDA	239	297	272	384	509
EBITDA margin (%)	38.7	37.8	36.4	38.1	39.2
Interest	0	1	0	12	36
Depreciation	7	13	18	34	46
Other income	42	67	97	54	24
As % of investments	2.7	1.6	2.0	2.1	1.7
PBT	274	351	351	393	452
Tax	95	119	116	130	149
Effective tax rate (%)	34.7	33.9	33.0	33.0	33.0
PAT	179	232	235	263	303
PAT margin (%)	29.0	29.5	31.4	26.1	23.3
PAT growth (%)	18.5	29.8	1.4	11.8	15.2
Minority interest	0	(1)	(1)	(1)	(1)
Extra-ordinary expense	1	1			
Reported PAT	178	232	236	264	303
Shares as per BS (y/e)	14.4	18.1	18.1	18.1	18.1
Diluted shares	14.4	18.1	18.1	18.1	18.1
FDEPS (₹)	12.3	12.8	13.0	14.5	16.7
Growth (%)	(0.8)	3.7	1.7	11.8	15.1
Extraordinary & prior period adjustments	-	(1)			
Transferred to reserves	178	233	236	264	303

Source: Company, Anand Rathi Research

Fig 20 – Balance Sheet (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Equity	144	181	181	181	181
Reserves	1,181	2,474	2,710	2,973	3,277
Shareholders' funds	**1,325**	**2,655**	**2,891**	**3,154**	**3,458**
Debt	1	1	1	201	401
Minority interest	0	0	(0)	(1)	(2)
Capital employed	**1,326**	**2,656**	**2,891**	**3,354**	**3,857**
Fixed assets	481	808	1,789	2,556	3,310
Investments	382	1,326	522	222	-
Deferred tax assets	(2)	(3)	(3)	(3)	(3)
Cash	227	226	313	266	219
Working capital	238	299	269	313	330
Capital employed	**1,326**	**2,656**	**2,891**	**3,354**	**3,857**

Source: Company, Anand Rathi Research

Fig 21 – Cash-flow statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
PAT	179	232	236	264	303
+ Non-cash expense	6	14	18	34	46
Cash profit	**185**	**246**	**254**	**297**	**349**
- Increase/(decrease) in working capital	112	62	(30)	44	17
Operating cash flow	**73**	**185**	**284**	**253**	**332**
- Capex	141	340	1,000	800	800
Free cash flow	**(68)**	**(155)**	**(716)**	**(547)**	**(468)**
+ Equity raised	575	1,097	(1)	(1)	(1)
+ Debt raised	(51)	(1)	(0)	200	200
- Investments	360	944	(804)	(300)	(222)
- Dividend paid	-	-	-	-	-
- Misc. expense	1	(0)	-	-	-
Net change in cash	**95**	**(1)**	**87**	**(47)**	**(47)**
Opening cash	133	227	226	313	266
Closing cash	**227**	**226**	**313**	**266**	**219**

Source: Company, Anand Rathi Research

Fig 22 – RoCE / RoE analysis

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
EBIT/sales (%)	44.4	44.7	46.9	40.1	37.5
Sales/avg. CE (x)	0.3	0.3	0.2	0.3	0.3
EBIT/ avg. CE (RoCE) (%)	**13.8**	**12.7**	**11.2**	**11.2**	**11.7**
Avg. CE/avg. equity (x)	1.0	1.0	1.0	1.0	1.1
PBT/EBIT (x)	1.0	1.0	1.0	1.0	0.9
PAT/PBT (x)	0.7	0.7	0.7	0.7	0.7
PAT/avg. equity (RoE) (%)	**9.2**	**8.4**	**7.5**	**7.5**	**7.9**

Source: Company, Anand Rathi Research

Fig 23 – Ratio analysis @ ₹216

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Diluted shares (m)	14.4	18.1	18.1	18.1	18.1
FDEPS (₹)	12.3	12.8	13.0	14.5	16.7
CEPS (₹)	12.8	13.5	14.0	16.4	19.2
BV (₹)	91.9	146.4	159.4	174.0	190.7
P/E (x)	17.5	16.9	16.6	14.9	12.9
P/C (x)	16.9	16.0	15.4	13.2	11.2
P/B (x)	2.4	1.5	1.4	1.2	1.1
EV/sales (x)	4.1	3.0	4.1	3.6	3.2
EV/EBITDA (x)	10.5	8.0	11.3	9.5	8.0
Net gearing (%)	(45.7)	(58.3)	(28.9)	(9.1)	5.2
Working capital turnover (days)	140.8	138.9	131.2	113.3	92.6

Source: Company, Anand Rathi Research

Company Background & Management

Incorporated in 1993 by Pramod Maheshwari, Career Point provides tutorial services, through classroom programs via a network of company-operated and franchise centers, to students of high schools and beyond for competitive entrance examinations such as IIT-JEE, AIEEE and AIPMT.

Brief history and business

Incorporated in 1993 by Pramod Maheshwari, Career Point provides tutorial services to students in high school and beyond for various competitive entrance examinations, including IIT-JEE, AIEEE and AIPMT. The services are provided through classroom programs conducted through a network of company-operated and franchised centers. The company has over 230 faculty members (excluding those of the franchisees) comprising graduates in engineering and science. It has, over time, built up content of over 10,000 pages of text and 12,000 minutes of video for various tutorial services. For students unable to attend regular classroom programs, it offers distance-learning programs comprising correspondence and test courses, systematically designed to provide effective education to students in a simple and lucid manner.

The company has over 230 faculty members (excluding the franchisees) comprising graduates in engineering and science. It has created content of over 10,000 pages of text and 12,000 minutes of video for various tutorial services.

The company recently made a foray into Education Consultancy and Management Services (ECMS), catering to K-12 and higher education. Further, to address a larger base of potential students, it has introduced a technology-enabled education-delivery platform for content through 'TechEdge Class'.

Key management personnel

Fig 24 – Management

Key person	Designation	Background
Pramod Maheshwari	Chairman and Managing Director	B.Tech from IIT, Delhi. First-generation entrepreneur and key founder member. Over 15 years' experience in developing and implementing training methodologies. Plays a major role in providing thought, leadership and strategic guidance, in addition to supervising function heads. Responsible for overall operations and growth.
Om Prakash Maheshwari	Director, CFO	Bachelor's in Mechanical Engineering from the University of Rajasthan. Over 16 years' experience in finance.
Naval Kishore Maheshwari	Director	B. Com. from the Maharshi Dayanand Saraswati University, Ajmer. Associated with the company since its incorporation.
Shailendra Maheshwari	Senior VP, Academics & Product Development	B.E. (Electronics & Communications); Has been with the Career Point group since 1995. Over 15 years' experience in teaching.
Mithilesh Dixit	Sr. VP, School & Vocational Education	MBA in Business Development and Marketing and Doctorate in International Relations from Trinity University, USA. Over 27 years' experience in the academic and corporate sector with specific exposure to corporate affairs.
Rajneesh Goyal	VP, Academics – Test Preparation	B.E. (Production & Industry). Joined Career Point group in 1999. Nine years' experience in education. Currently, overall in-charge of the mathematics department.

Source: Company

ANANDRATHI

India I Equities

Education

Initiating Coverage

29 December 2011

Core Education

Leveraging skills from developed markets

Rating: **Buy**
Target Price: ₹340
Share Price: ₹258

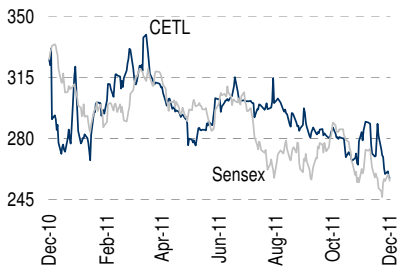
Through 12 acquisitions in six years, Core Education (CETL) has transformed itself from a low-end IT-service provider to a high-end education-service provider. Core gained entry to Western markets via its acquisitions, adding ~US$150m to FY11 revenue. Leveraging this experience, it is now entering into public-private partnerships and private K-12 schools in India. It offers integrated ICT solutions, end-to-end management of government schools, and vocational training of government staff. We initiate coverage with a Buy and a price target of ₹340.

- **Penetrating developed markets via acquisitions.** Over 2005-11, Core acquired 12 companies/businesses in the US and UK. With this, it built up a base for its education business, added ~US$150m in revenue and gained a foothold in the US and UK markets with over 120 clients.
- **Unfolding India story via government projects.** In FY11, Core's Internet and Communication Technology (ICT) segment was awarded projects in 9,000 schools (amounting to orders of over ₹6bn). It is also investing in model schools (via private-public partnerships) and vocational education. Further, it plans to set up K-12 schools and an international university in AP.
- **Balance sheet to be stretched yet manageable.** Over FY11-14, we expect 24% and 23% CAGR in, respectively, revenue and net profit, with EBITDA margin at present levels (35-36%). Balance sheet is likely to be stretched yet manageable, with debt-equity ratio of 0.5x and interest-coverage ratio of 4.5x.
- **Valuation.** We expect 24% and 23% CAGR in revenue and net profit, respectively, over FY11-14. Our price target of ₹340 discounts FY13e and FY14e earnings 12x and 10x, respectively. **Risks:** Execution delays due to government processes, dependence on partners for content.

Key data	CETL IN / CORE.BO
52-week high / low	₹351 / ₹232
Sensex / Nifty	15971 / 4779
3-m average volume	US$1.7m
Market cap	₹28.9bn / US$556.9m
Shares outstanding	111.2m

Shareholding pattern (%)	Sep '11	Jun '11	Mar '11
Promoters	46.78	47.03	47.64
- of which, pledged	13.36	13.11	12.74
Free float	53.22	52.97	52.36
- Foreign institutions	21.62	20.85	20.67
- Domestic institutions	2.58	1.82	1.60
- Public	29.02	30.3	30.09

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY10	FY11	FY12e	FY13e	FY14e
Sales (₹m)	8,470	10,912	14,236	17,328	20,811
Net profit (₹m)	1,717	2,250	2,912	3,358	4,164
EPS (₹)*	18.7	21.7	24.1	27.8	34.4
Growth (%)	8.5	16.1	10.7	15.3	24.0
PE (x)	13.8	11.9	10.7	9.3	7.5
EV/EBITDA (x)	8.8	7.3	7.5	6.1	4.8
P/BV (x)	2.6	2.3	2.1	1.8	1.4
RoE (%)	22.8	21.7	22.0	20.7	21.0
RoCE (%)	22.7	21.4	20.5	20.7	21.1
Dividend yield (%)	0.2	0.2	0.4	0.4	0.4
Net gearing (%)	34.2	54.9	44.8	33.9	19.4

Source: Company, Anand Rathi Research ** EPS is on fully diluted basis assuming all FCCB's to be converted*

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Net revenues	8,470	10,912	14,236	17,328	20,811
Revenue growth (%)	25.0	28.8	30.5	21.7	20.1
- Op. expenses	5,602	6,976	9,219	11,221	13,475
EBIDTA	**2,868**	**3,936**	**5,017**	**6,107**	**7,336**
EBITDA margin (%)	33.9	36.1	35.2	35.2	35.3
- Interest expenses	417	787	802	1,206	1,224
- Depreciation	412	586	621	821	955
+ Other income	38	156	37	66	114
- Tax	354	469	719	788	1,107
Effective tax rate (%)	17	17	20	19	21
Reported PAT	1,723	2,250	2,912	3,358	4,164
+/- Extraordinary items	(6)	-	-	-	-
+/- Minority interest	-	-	-	-	-
Adjusted PAT	1,717	2,250	2,912	3,358	4,164
Adj. FDEPS (₹/share)	18.7	21.7	24.1	27.8	34.4
Adj. FDEPS growth (%)	8.5	16.1	10.7	15.3	24.0

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Share capital	197	218	207	207	207
Reserves & surplus	8,760	11,606	14,390	17,621	21,658
Net worth	8,957	11,824	14,597	17,828	21,865
Minority interest	-	47	-	-	-
Total debt	3,580	8,395	8,395	10,895	10,895
Def. tax liab. (net)	43	64	64	64	64
Capital employed	**12,579**	**20,330**	**23,056**	**28,787**	**32,824**
Net fixed assets	6,363	9,374	11,171	12,699	13,844
Investments	296	459	459	459	459
- of which, liquid	-	-	-	-	-
Net working capital	5,407	8,600	9,582	10,781	11,873
Cash and bank balance	514	1,897	1,844	4,847	6,647
Capital deployed	**12,579**	**20,330**	**23,056**	**28,787**	**32,824**
Net debt	3,066	6,498	6,551	6,048	4,248
WC days	233	288	246	227	208
Book value (₹/sh)	97.7	127.1	120.7	147.4	180.7

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
PAT	1,712	2,250	2,912	3,358	4,164
+ Non-cash items	434	607	621	821	955
Cash profit	2,145	2,858	3,532	4,180	5,119
- Incr./(decr.) in WC	1,368	3,193	982	1,199	1,092
Operating cash-flow	777	(336)	2,550	2,981	4,027
- Capex	2,420	3,597	2,418	2,350	2,100
Free cash-flow	(1,643)	(3,932)	132	631	1,927
- Dividend	73	79	127	127	127
+ Equity raised	1,150	742	(58)	(0)	(0)
+ Debt raised	306	4,815	-	2,500	-
- Investments	296	164	-	-	-
- Misc. items	(6)	-	-	-	-
Net cash-flow	(549)	1,382	(53)	3,004	1,799
+ Op. cash & bank bal.	1,064	514	1,897	1,844	4,847
Cl. cash & bank bal.	514	1,897	1,844	4,847	6,647

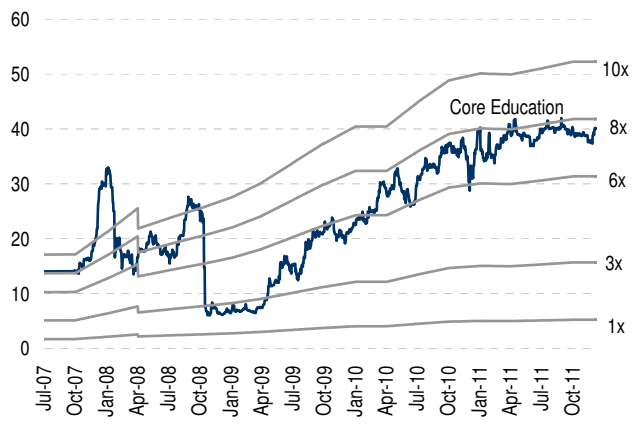
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹258

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
CEPS (₹/share)	23.2	27.4	29.2	34.5	42.3
Cash / (debt)(₹/share)	(33.4)	(62.8)	(54.2)	(50.0)	(35.1)
P/E (x)	13.8	11.9	10.7	9.3	7.5
P/B (x)	2.6	2.3	2.1	1.8	1.4
P/C (x)	11.1	9.4	8.8	7.5	6.1
EV/sales (x)	3.0	2.6	2.7	2.2	1.7
EV/EBITDA (x)	8.8	7.3	7.5	6.1	4.8
EBIT/sales (%)	29.4	32.1	31.1	30.9	31.2
Sales/average CE (x)	0.8	0.7	0.7	0.7	0.7
RoCE (%)	22.7	21.4	20.5	20.7	21.1
Avg. CE/ avg. eq. (x)	1.5	1.6	1.6	1.6	1.5
PBT/EBIT (x)	0.8	0.8	0.8	0.8	0.8
PAT/PBT (x)	0.8	0.8	0.8	0.8	0.8
RoE (%)	22.8	21.7	22.0	20.7	21.0
Dividend yield (%)	0.2	0.2	0.4	0.4	0.4

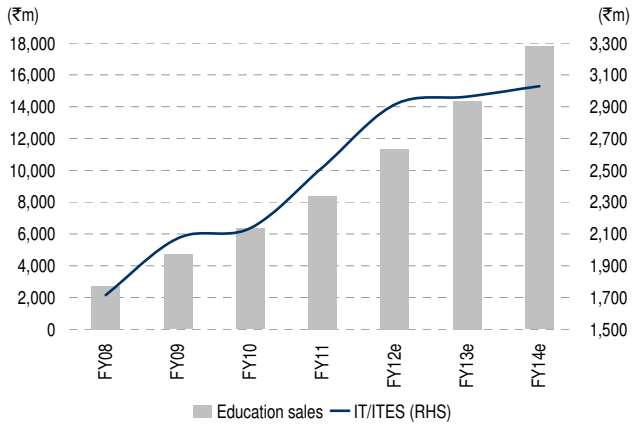
Source: Company, Anand Rathi Research

Fig 5 – Valuation chart (EV/EBITDA)



Source: Bloomberg, Anand Rathi Research

Fig 6 – Revenue break-up



Source: Company, Anand Rathi Research

Investment argument and valuation

Core Education has transformed itself from an IT service-provider into an international education service provider, following 12 acquisitions. The company is leveraging its newly-gained expertise to break into the Indian education sector, chiefly with the government, through integrated ICT solutions, end-to-end management of government schools, and vocational training of the staff of state and national government bodies.

Developed markets: acquisition-based strategy

Core Education has turned from an IT service-provider to an international educationist after its acquisition of US-based company ECS in 2006. ECS had IT solutions and clients in healthcare, BFSI and education. In the past six years Core acquired 12 companies, mostly in education services, (combined revenue: ~US$150m) at a cost of ~US$124m. These acquisitions helped Core make inroads into the US and UK markets. With this, the company's focus has now shifted to its education-led business.

The company's strategy was to acquire small-ticket companies in various geographies and products. It thereby made vital inroads into government business, simultaneously cross-selling products obtained through acquisitions.

Unfolding India story through government projects

Bagged ICT orders for 9,000 government schools during FY11

Core is utilizing its international expertise to break into the Indian education arena, chiefly with the government. It offers integrated ICT solutions, which has roots in traditional hardware/IT training, and plans to move up the value chain with end-to-end management of government schools. In a year, it has been awarded 9,000 schools in various segments by state governments.

It has also been awarded contracts in vocational training by state and national government bodies to train their staff. It has also pre-qualified to bid for a Rajasthan government project that involves building 50 model schools on a BOOT basis for 30 years.

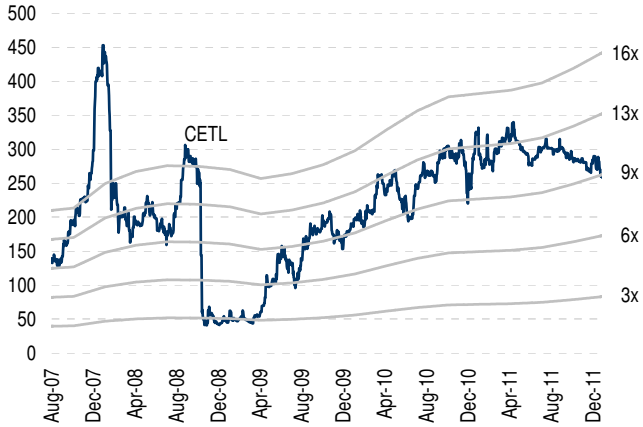
Robust revenue growth; balance sheet to be stretched

We expect Core to post an organic 24% CAGR in revenue over FY11-FY14, with net profit at 23%. On its leveraged balance sheet, it has loans of ₹8.4bn (FY11), including FCCBs of US$75m with a 7% coupon (quarterly payment). Core would require additional funds for its fresh initiatives (K-12 and ICT). However, with an FY11 debt-equity ratio of 0.5:1 and interest-coverage ratio of 4.5, its debt is manageable.

Valuation

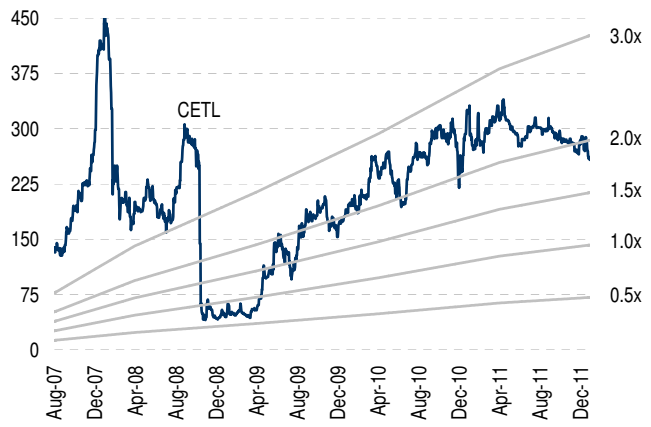
We expect the FDEPS to rise from ₹21.7 in FY11 to ₹34.4 three years on. At the current price of ₹258, the stock trades at PE of 9.3x and 7.5x FY13e and FY14e earnings, respectively. We assign it a price target of ₹340, based on the target PE of 12x its FY13e EPS of ₹27.8.

Fig 7 – PE band



Source: Bloomberg, Anand Rathi Research

Fig 8 – PBV band



Source: Bloomberg, Anand Rathi Research

Risks

- **Dependent on government regulations and policies.** Most of Core's business arises from government schools and colleges. Hence, it greatly depends on government funding, regulations and policies.
- **Great dependence on tie-ups.** Without its own comprehensive content, it depends on strategic tie-ups and has to pay royalties to partners.
- **Macro-economic risk.** Spending on education is primarily led by the government; hence, any global meltdown could cut into government spend.

Acquisitions in developed markets

Through 12 acquisitions in six years, Core has transformed itself from a low-end IT-service provider to a high-end education-service provider. Its focus is now shifting to its education-led business. Its strategy is to acquire companies with patented products. It now markets and cross-sells these products under one roof. This strategy has led to the company making inroads into the US and UK markets.

Acquisitions

12 acquisitions in 6 years at a cost of US$125m, with revenue of US$150m

In the last six years Core has turned from being a low-end IT-service provider to a high-end education-service provider through 12 acquisitions (for ~US$124m), which generated ~US$150m in revenue. With this, its focus has now shifted to its education-led business. These acquisitions have helped it make inroads into the US and UK markets.

Key skills / clients

Core's strategy has been to acquire companies that have patented products and are available at ~1-1.2x TTM sales, with low to negative net profit margins. These companies were mostly in the early stages of business, were cash-strapped and finding it difficult to grow on their own.

The company has retained the core teams of most of its acquisitions, so as to benefit from the existing talent pool and leverage the existing client relationships.

Core has leveraged the intellectual property rights (IPR) of the companies it acquired by cross-selling the products and marketing them under one roof. With this, the company has increased its share in the US and UK education markets.

Core's strategy is to acquire small-ticket companies in various geographies and segments. It has thereby made vital inroads into government business (70% of the education industry in the US is run by the government) and increased its market share in the states where new acquisitions had existing relationships.

Race-to-the-top fund

Under the 'Race to the top' fund, the US government has allocated ~US$6bn to18 states to improve the overall quality of education, laying emphasis on formative assessment (tools to monitor student progress) and intervention (tools directed at students' specific areas of need). These are Core's focus areas and it currently operates in six of these 12 states. It aims at gaining a major share of this expenditure.

Competitors

Large companies that compete with Core include McGraw Hill, Acquity; Houghton Mifflin, EduSoft, Exam View, Pearson Performance Assessment Series, ScanTron, SchoolNet Assess Module and ThinkGate.

Strategy

The size of the formative assessment market in the US was ~US$750m in 2011. Core claims to be the third-largest player in this market, with ~US$40m in revenue from the US.

The company provides schools with qualified staff as per requirements. In the UK, Core provides teachers for over 3,000 active schools that are its clients. The company has ~3,600 teachers and 1,300 teaching assistants that have been vetted and are available.

Core plans to continue its strategy of acquiring small regional players to grow in the US and the UK. Hence, it would continue to aggressively acquire companies that are established in new states and have quality content/products.

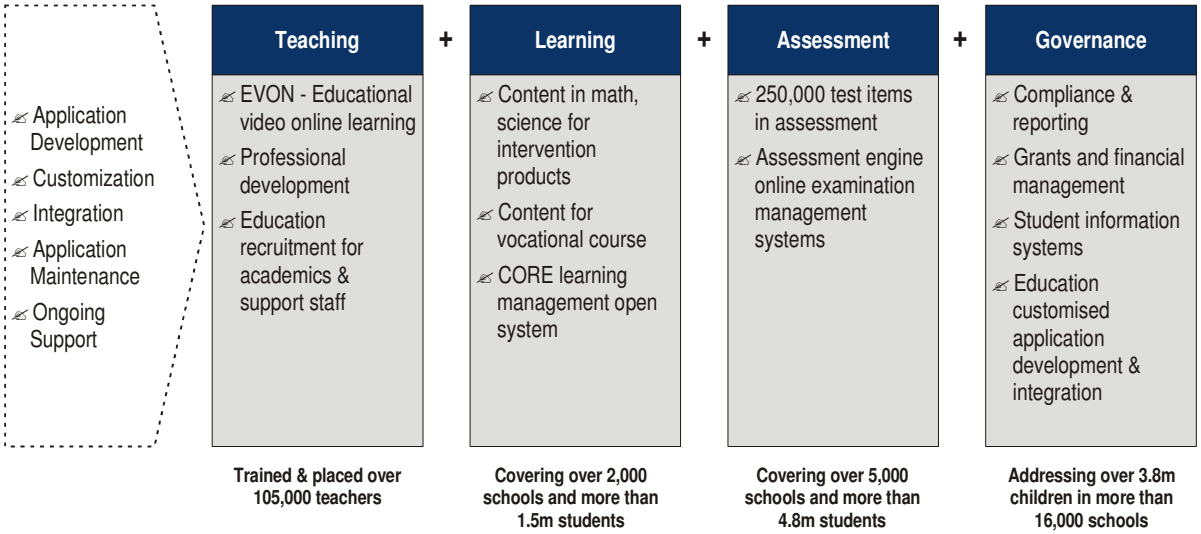
Margin expansion through off-shoring

Core is predominantly a provider of IT platform-based education products and solutions in the US and UK, stands to benefit from the cost advantages that it derives through its offshore development centers based out of India. The company currently operates three Global Delivery Centers (GDCs) in India, employing ~110 people working on technology platform development for various projects originating from global locations such as the US and the UK. Additionally, back-end activities such accounting, payroll management are also handled from India. Over 30% of CETL's manpower needs have been shifted to India, leading to lower manpower costs as compared to its peers in the US.

Comprehensive product offerings

CETL has built a comprehensive portfolio of products and services in the education space. This covers assessment, intervention, compliance & reporting, grants & financial management systems, student information systems, teacher training and professional development and consulting. The company has a ready foundation to tap growth opportunities in the education space globally: the requisite technology (IPRs, products) and service experience (100,000 teachers, 34.49m students and over 88,000 schools worldwide).

Fig 9 – Global business strategy



Source: Company

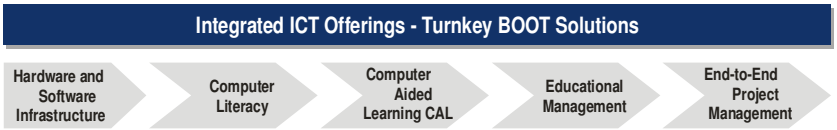
India story via government projects

Leveraging its success in Western markets, Core is now tapping the Indian education arena chiefly through the government, with integrated ICT solutions (rooted in traditional IT hardware training) and end-to-end management of IT systems for schools. It has ventured into vocational training and training staff of state and national government bodies. It also plans to enter the formal education sector by setting up K-12 schools and an international university in AP.

₹6bn order-book in the ICT segment

Having tasted success in the Western markets, Core is tapping the Indian education arena, chiefly with the government. It is keen to offer integrated ICT solutions (with roots in traditional IT hardware training) and end-to-end management of IT systems for schools. Within a year it has been awarded 9,000 schools in various segments by state governments.

Fig 10 – ICT value chain



Source: Company

Fig 11 – Government projects in the pipeline

Client	Brief description
Haryana	ICT BOOT: 2622 schools
Maharashtra	ICT: BOOT: 947 schools
Gujarat	ICT BOOT: 645 schools
Nagaland	ICT BOOT: 73 schools
Gujarat	Implementation of CAL: across 3,236 schools
Meghalaya	Implementation of CAL: across 267 schools
Assam	Implementation of a web-based child-tracking system
Punjab	Provision of multimedia equipment: across 1,250 schools
Tripura	Implementation of learning management system
Jharkhand	Implementation of a web-based child-tracking system
NPIU, Ministry of HRD	Implementation of online MIS for 200 institutions
Karnataka State Open Univ	Implementation of EMS for over 75,000 students

Source: Company

Other government-related key initiatives

Core has ventured into vocational training. It is working with state and national government bodies to train their staff. A few of its key assignments are:

- IT training programme for more than 1,960 officers of the Delhi Police.
- Industrial Training Center at Mhape with accreditation from the Maharashtra government to start training government employees.
- Further, Core is pre-qualified to bid for a Rajasthan government project that involves the establishment, management and operation of 50 senior secondary schools (or "model schools") through a public-

private partnership (PPP) on a design, build, finance, manage, operate and transfer basis. The 50 model schools are divided into groups of five schools in each district, each of which constitutes one project. This will be on a BOOT basis for 30 years. The government will provide land, whereas Core will build the remaining infrastructure and block 25% of the seats for government. These 25% seats will be allocated to students as decided by the government. Fees for these would be paid by the state government.

Fig 12 – Select vocational projects

Key Clients	Brief Description
Delhi Police	IT literacy programme for 1960+ Delhi police personnel
DUDA Bhopal, Madhya Pradesh	Placement-oriented training to BPL youth under the government's rural employment scheme, Swaran Jayanti Shahri Rozgar Yojna (SJSRY).
RDMA Madurai, Tamil Nadu	Placement-oriented training to BPL youth under SJSRY
Tata Motors – GKS initiative	Training Female candidates in five villages of Gujarat. Tata Motors' Corporate Social Responsibility
DOET- Gujarat	Skill upgrading and enhancement
ITC Mahape	Job-oriented skill-upgrading courses in select industry verticals.

Source: Company

Initiatives in the private education space

- Core intends to venture into formal education by setting up K-12 schools, under the International Baccalaureate (IB) board across India, and is currently in the process of identifying potential collaborations for the management and operation of such schools, as well as identifying and assessing potential land acquisitions for the construction of these schools. The company plans to open an international university in AP.

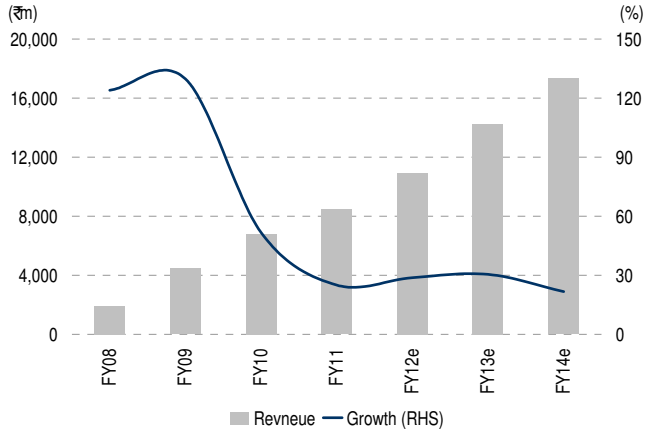
Financials

We expect Core Education to register 24% revenue CAGR (FY11-FY14e). However, PAT is estimated to grow by just 23% during the same period, primarily on account of deprecation and interest cost.

Government orders to boost revenue: 24% CAGR (FY11-FY14e)

We expect Core to post an organic 24% CAGR in revenue over FY11-FY14e. This should primarily arise from its present order book in the domestic market (₹6bn in the ICT segment), and also from the US spend on formative assessment.

Fig 13 – Revenue and revenue growth

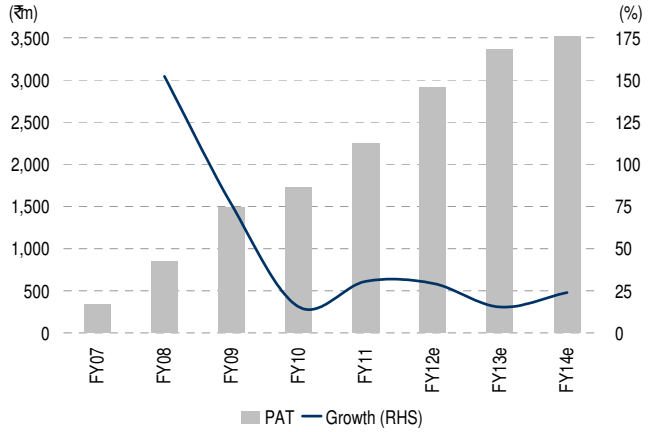


Source: Company, Anand Rathi Research

Interest & depreciation to limit net profit growth: 23% CAGR (FY11-14e)

We expect 23% CAGR in net profit growth over FY11-FY14. This is less then the growth in revenue, primarily due to below-the-operations-line items, i.e., higher interest costs (FCCB interest), depreciation charges (ICT hardware).

Fig 14 – Net profit and net profit growth (%)



Source: Company, Anand Rathi Research

Balance sheet likely to be stretched

In order to fund its expansion plans both in matured markets (acquisitions) and in India (government projects), Core has leveraged its balance sheet. It has loans of ₹8.4bn (FY11), including FCCBs of US$75m with a coupon rate of 7% (quarterly payment) and conversion at ₹272 a share, due in FY15. It would yet require additional funds for its fresh initiatives (K-12 and ICT).

Nevertheless, Core has a manageable debt-equity ratio of 0.5:1 (FY11) and an interest-coverage ratio of 4.5 (FY11).

Fig 15 – Debt equity, interest coverage ratios

	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
(Net debt) / cash (₹m)	261	(1,141)	(2,219)	(3,066)	(6,498)	(6,551)	(6,048)	(4,248)
Net cash (per share) (₹)	3.8	(13.8)	(25.7)	(33.4)	(69.9)	(54.2)	(50.0)	(35.1)
Net debt to equity (x)	(0.3)	0.3	0.4	0.3	0.5	0.4	0.3	0.2
Interest coverage ratio (x)	22.6	38.3	8.9	6.0	4.5	5.5	4.4	5.3

Source: Company, Anand Rathi Research

Fig 16 – Income statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Revenues	**8,470**	**10,912**	**14,236**	**17,328**	**20,811**
Growth (%)	25.0	28.8	30.5	21.7	20.1
Expenses	**5,602**	**6,976**	**9,219**	**11,221**	**13,475**
As % of revenue	66.1	63.9	64.8	64.8	64.7
Hardware/software COGS	(216)	(444)	(278)	286	312
As % of revenue	(2.5)	(4.1)	(2.0)	1.7	1.5
Software development	4,889	5,775	7,571	9,140	10,873
As % of revenue	57.7	52.9	53.2	52.7	52.2
Other costs	929	1,645	1,926	1,795	2,289
As % of revenue	11.0	15.1	13.5	10.4	11.0
EBITDA	**2,868**	**3,936**	**5,017**	**6,107**	**7,336**
EBITDA margin (%)	33.9	36.1	35.2	35.2	35.3
Interest	417	787	802	1,206	1,224
Depreciation	412	586	621	821	955
Other income	38	156	37	66	114
As % of investments	4.7	6.6	1.6	1.2	1.6
PBT	**2,077**	**2,719**	**3,631**	**4,146**	**5,271**
Tax	354	469	719	788	1,107
Effective tax rate (%)	17.0	17.2	19.8	19.0	21.0
PAT	**1,723**	**2,250**	**2,912**	**3,358**	**4,164**
PAT margin (%)	20.3	20.6	20.5	19.4	20.0
Minority interest	-	-			
Extra-ordinary expense	(6)	-	-	-	-
Reported PAT	**1,717**	**2,250**	**2,912**	**3,358**	**4,164**
Shares - as per BS (y/e) (nos.)	98.6	109.1	109.1	109.1	109.1
Diluted shares (nos.)	91.7	103.5	121.0	121.0	121.0
FDEPS	18.7	21.7	24.1	27.8	34.4
Growth (%)	8.5	16.1	10.7	15.3	24.0
Dividend	62	65	109	109	109
DPS	0.6	0.6	1.0	1.0	1.0
Dividend tax	11	13	18	18	18
Dividend payout (%)	4.2	3.5	4.4	3.8	3.1
Extraordinary & prior period adjustments					
Transferred to reserves	**1,644**	**2,172**	**2,784**	**3,231**	**4,037**

Source: Company, Anand Rathi Research

Fig 17 – Balance sheet (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Equity	197	218	207	207	207
Reserves	8,760	11,606	14,390	17,621	21,658
Shareholders' funds	**8,957**	**11,824**	**14,597**	**17,828**	**21,865**
Debt	3,580	8,395	8,395	10,895	10,895
Minority interest	-	47	-	-	-
Capital employed	**12,537**	**20,266**	**22,992**	**28,723**	**32,760**
Fixed assets	6,363	9,374	11,171	12,699	13,844
Investments	296	459	459	459	459
Deferred tax assets	(43)	(64)	(64)	(64)	(64)
Cash	514	1,897	1,844	4,847	6,647
Working capital	5,407	8,600	9,582	10,781	11,873
Capital deployed	**12,537**	**20,266**	**22,992**	**28,723**	**32,760**

Source: Company, Anand Rathi Research

Fig 18 – Cash flow statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
PAT	1,712	2,250	2,912	3,358	4,164
+ non-cash expense	434	607	621	821	955
Cash profit	**2,145**	**2,858**	**3,532**	**4,180**	**5,119**
- Increase/(decrease) in working capital	1,368	3,193	982	1,199	1,092
Operating cash flow	**777**	**(336)**	**2,550**	**2,981**	**4,027**
- Capex	2,420	3,597	2,418	2,350	2,100
Free cash flow	**(1,643)**	**(3,932)**	**132**	**631**	**1,927**
+ Equity raised	1,150	742	(58)	(0)	(0)
+ Debt raised	306	4,815	-	2,500	-
- Investments	296	164	-	-	-
- Dividend paid	73	79	127	127	127
- Misc. expense	(6)	-	-	-	-
Net change in cash	**(549)**	**1,382**	**(53)**	**3,004**	**1,799**
Opening cash	1,064	514	1,897	1,844	4,847
Closing cash	**514**	**1,897**	**1,844**	**4,847**	**6,647**

Source: Company, Anand Rathi Research

Fig 19 – Ratio analysis @ ₹258

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Diluted shares (m)	91.7	103.5	121.0	121.0	121.0
FDEPS (₹)	18.7	21.7	24.1	27.8	34.4
CEPS (₹)	23.2	27.4	29.2	34.5	42.3
BV (₹)	97.7	114.2	120.7	147.4	180.7
ABV (₹)	97.7	114.2	120.7	147.4	180.7
P/E (x)	13.8	11.9	10.7	9.3	7.5
P/C (x)	11.1	9.4	8.8	7.5	6.1
P/B (x)	2.6	2.3	2.1	1.8	1.4
DPS (₹)	0.6	0.6	1.0	1.0	1.0
Dividend yield (%)	0.2	0.2	0.4	0.4	0.4
Dividend payout (%)	4.2	3.5	4.4	3.8	3.1
EV/Sales (x)	3.0	2.6	2.7	2.2	1.7
EV/EBITDA (x)	8.8	7.3	7.5	6.1	4.8
EBIT/Sales (%)	29.4	32.1	31.1	30.9	31.2
Sales/Avg.CE (x)	0.8	0.7	0.7	0.7	0.7
Debt/Equity (x)	0.4	0.7	0.6	0.6	0.5
ROCE (%)	22.7	21.4	20.5	20.7	21.1
Avg. CE/avg. equity (x)	1.5	1.6	1.6	1.6	1.5
PBT/EBIT (x)	0.8	0.8	0.8	0.8	0.8
PAT/PBT (x)	0.8	0.8	0.8	0.8	0.8
ROE (%)	22.8	21.7	22.0	20.7	21.0
Net gearing (%)	34.2	54.9	44.8	33.9	19.4
Working capital turnover (days)	233	288	246	227	208

Source: Company, Anand Rathi Research

Company background & management

Core Education (formerly Akhileshwar Texports) was predominantly into IT (ERP, healthcare, BFSI and logistics). In 2005, it entered education, and now operates in the US, UK, West Asia (the Middle East), Central Africa and India through acquiring companies in education and with software covering school-management systems, assessment systems, accountability systems and IT-infrastructure systems.

Brief history and business

Incorporated on 11 Apr '85, Akhileshwar Texports' name was changed to Core Projects & Technologies on 16 Oct '03.

Core was predominantly into IT, focusing on domains such as ERP, healthcare, BFSI and logistics. In 2005, it entered the education space, which holds vast potential, with its products. It now operates in the US, the UK, West Asia (the Middle East), Central Africa and India.

By acquiring ECS, KCMG, Hamlet and Azzuri, all operating within the sphere of education, Core has software products covering various aspects of education, including those in school-management systems, assessment systems, accountability systems and IT-infrastructure systems. The education customer base spans the US, the UK, Africa, Sri Lanka, the Bahamas, the Caribbean and India.

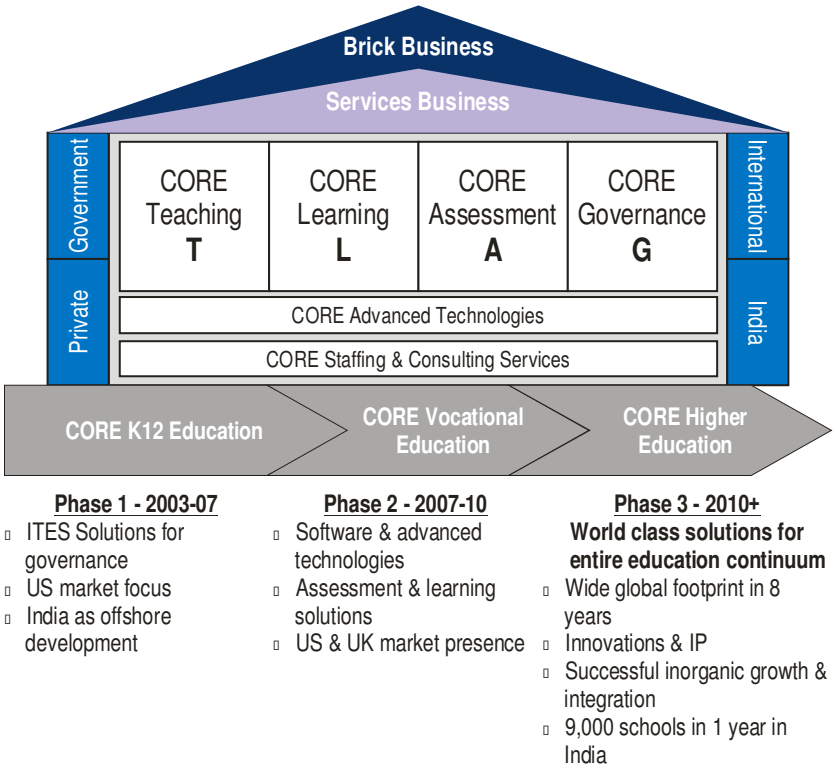
Board of directors / key management personnel

Fig 20 – Management

Key person	Designation	Background
Sanjeev Mansotra	CMD	Established stable and profit-making entities in information technology, health management and international trade.
Prof. Dr. Arun Nigavekar	Executive Director	A physicist and educationist with experience of over 40 years in academics. Among the positions held, are Vice Chairman and Chairman of the University Grants Commission, Member of the Scientific Advisory Committee to the Cabinet, Founder Director, National Assessment and Accreditation Council and Vice Chancellor of University of Pune.
Nikhil Morsawala	Director Finance	CA. 20 years' business management experience in mergers and acquisitions and setting up service organizations. Well-versed in global norms, policies and statutory compliances.
Maya Sinha	Executive Director	A bureaucrat for the last 28 years, belongs to the 1981 batch of the Indian Revenue Service. Served in the department of income tax for over 20 years at various designations including commissioner of income tax. She served as the Deputy Chairman, Jawaharlal Nehru Port Trust (JNPT).
Prakash Gupta	CEO, UK operations	25 years' experience in IT consulting in the US. Bachelor's in science and an MBA from the California State University.

Source: Company

Fig 21 – Company model and historic timeline



Source: Company

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Education

Initiating Coverage

29 December 2011

Educomp

High competition in SLS, stretched balance sheet; Hold

Rating: **Hold**
Target Price: ₹260
Share Price: ₹200

Educomp (EDSL) is the only player in India offering end-to-end services in the education sector. The rising share of its subsidiaries in revenue, chiefly due to the strong growth in K-12, is likely to reduce dependence on the Smartclass segment of School Learning Solutions. However, rising competition and high debt-equity ratio may slow down business growth. We initiate coverage with a Hold.

- **School Learning Solutions (SLS).** The SLS segment, (73% of FY11 revenue), is likely to see slower growth due to high competition in the Smartclass segment of SLS, which may restrict realization per classroom, and management's selective bidding approach in the low-margin Information and Communication Technology (ICT) business. Further, we are not bullish on the company's securitization model, due to its attached contingencies.
- **Subsidiaries' share in revenue inching up.** In the last six quarters, share of subsidiaries in revenue has risen from 27% to 36.5%, chiefly driven by strong growth in K-12. This should help reduce dependence on SLS, which is facing stiff competition. However, subsidiaries are still in investment mode and are expected to turn positive in 15-18 months.
- **Stretched balance sheet to be re-financed.** EDSL has debt of ₹19bn (2QFY12), including FCCBs of US$78.5m (redemption: Jun '12, at ₹590 each), which would have to be redeemed with US$18m interest. It also has debt of ₹9.6bn (216 days), with a debt-equity ratio of 1.24 (including contingent liabilities), which may slow down business growth. However, management has indicated it would raise funds by selling stakes in a few assets. Further, it would take ECBs to repay the FCCBs.
- **Valuation.** We expect 18% and 17.5% CAGR in revenue and net profit, respectively, over FY11-14. Our ₹260 target price discounts FY13e and FY14e earnings by 6x and 5x, respectively. **Risks.** Execution/project delays; regulatory risks for the K-12 division.

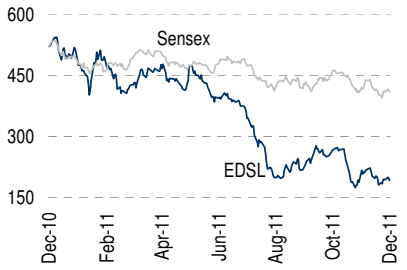
Key financials (YE Mar)	FY10	FY11	FY12e	FY13e	FY14e
Sales (₹m)	10,395	13,509	16,055	19,407	22,014
Net profit (₹m)	2,779	3,294	2,945	4,237	5,254
EPS (₹)	29.3	34.7	31.0	44.5	55.2
Growth (%)	89.0	18.5	(10.7)	43.9	24.0
PE (x)	6.8	5.8	6.5	4.5	3.6
EV/EBITDA (x)	4.4	5.3	4.7	3.5	2.6
P/BV (x)	1.2	0.9	0.8	0.7	0.6
RoE (%)	27.4	17.2	12.8	16.4	17.6
RoCE (%)	23.5	15.0	13.5	17.8	20.5
Dividend yield (%)	1.5	0.4	1.5	1.5	1.5
Net gearing (%)	13.6	45.1	46.4	34.4	15.5

Source: Company, Anand Rathi Research

Key data	EDSL IN / EDSO.BO
52-week high / low	₹574 / ₹162
Sensex / Nifty	15971 / 4779
3-m average volume	US$12.7m
Market cap	₹19.2bn / US$369m
Shares outstanding	96.01m

Shareholding pattern (%)	Sep'11	Jun '11	Mar '11
Promoters	49.53	49.55	49.77
- of which, pledged	-	-	-
Free float	50.47	50.45	50.23
- Foreign institutions	29.22	34.94	35.97
- Domestic institutions	2.65	2.55	2.15
- Public	18.6	12.96	12.11

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Net revenues	10,395	13,509	16,055	19,407	22,014
Revenue growth (%)	63.2	30.0	18.8	20.9	13.4
- Op. expenses	5,534	8,067	9,629	11,304	12,825
EBIDTA	4,861	5,442	6,426	8,103	9,189
EBITDA margin (%)	46.8	40.3	40.0	41.8	41.7
- Interest expenses	539	962	1,113	962	695
- Depreciation	1,142	841	1,105	1,502	1,627
+ Other income	1,255	461	41	634	910
- Tax	1,584	678	1,304	2,036	2,524
Effective tax rate (%)	35.7	16.5	30.7	32.5	32.5
Reported PAT	2,851	3,422	2,945	4,237	5,254
+/- Extraordinary items	14	2	-	-	-
+/- Minority interest	57	127	-	-	-
Adjusted PAT	2,779	3,294	2,945	4,237	5,254
Adj. FDEPS (₹/share)	29.3	34.7	31.0	44.5	55.2
Adj. FDEPS growth (%)	89.0	18.5	(10.7)	43.9	24.0

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Share capital	190	191	190	190	190
Reserves & surplus	16,289	21,593	24,206	27,214	32,228
Net worth	16,479	21,784	24,397	27,404	32,419
Minority interest	1,915	2,365	2,365	2,365	2,365
Total debt	10,478	14,373	14,373	10,473	7,473
Def. tax liab. (net)	22	144	144	144	144
Capital employed	**28,894**	**38,667**	**41,279**	**40,387**	**42,402**
Net fixed assets	16,687	26,305	27,774	28,031	28,495
Investments	354	64	64	64	64
- of which, Liquid	-	-	-	-	-
Net working capital	3,966	7,810	10,440	11,304	11,458
Cash and bank balance	7,887	4,489	3,001	987	2,385
Capital deployed	**28,894**	**38,667**	**41,279**	**40,387**	**42,401**
Net debt	2,592	9,884	11,372	9,486	5,089
WC days	139.3	211.0	237.3	212.6	190.0
Book value (₹/sh)	173.5	229.2	256.5	288.1	340.8

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
PAT	2,793	3,296	2,945	4,237	5,254
+ Non-cash items	725	963	1,105	1,502	1,627
Cash profit	3,519	4,259	4,050	5,739	6,881
- Incr./(Decr.) in WC	1,965	3,844	2,630	864	153
Operating cash-flow	1,553	415	1,420	4,875	6,727
- Capex	8,478	10,459	2,574	1,758	2,091
Free cash-flow	(6,925)	(10,044)	(1,154)	3,116	4,636
- Dividend	333	71	334	334	334
+ Equity raised	11,318	2,516	1	(896)	95
+ Debt raised	1,583	3,895	-	(3,900)	(3,000)
- Investments	(375)	(290)	-	-	-
- Misc. items	34	(15)	-	-	-
Net cash-flow	5,985	(3,398)	(1,487)	(2,014)	1,397
+ Op. cash & bank bal.	1,902	7,886	4,489	3,001	987
Cl. cash & bank bal.	7,887	4,489	3,001	987	2,385

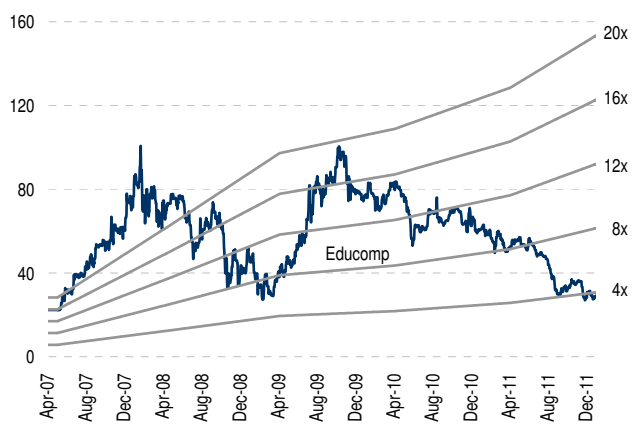
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹200

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
CEPS (₹/share)	41.3	43.5	42.6	60.3	72.3
Cash / (debt)(₹/share)	(27.3)	(104.0)	(119.5)	(99.7)	(53.5)
P/E (x)	6.8	5.8	6.5	4.5	3.6
P/B (x)	1.2	0.9	0.8	0.7	0.6
P/C (x)	4.8	4.6	4.7	3.3	2.8
EV/sales (x)	2.1	2.1	1.9	1.5	1.1
EV/EBITDA (x)	4.4	5.3	4.7	3.5	2.6
EBIT/sales (%)	47.8	37.5	33.4	37.3	38.5
Sales/average CE (x)	0.5	0.4	0.4	0.5	0.5
RoCE (%)	23.5	15.0	13.5	17.8	20.5
Avg. CE/ avg. eq. (x)	2.1	1.8	1.7	1.6	1.4
PBT/EBIT (x)	0.9	0.8	0.8	0.9	0.9
PAT/PBT (x)	0.6	0.8	0.7	0.7	0.7
RoE (%)	27.4	17.2	12.8	16.4	17.6
Dividend yield (%)	1.5	0.4	1.5	1.5	1.5

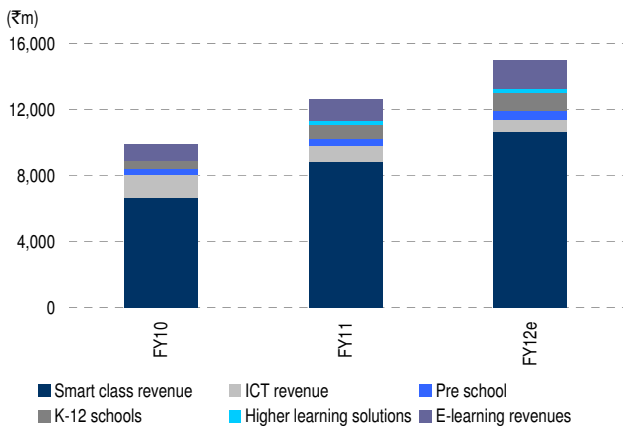
Source: Company, Anand Rathi Research

Fig 5 – Valuation chart (EV/EBITDA)



Source: Bloomberg, Anand Rathi Research

Fig 6 – Revenue break-up



Source: Company, Anand Rathi Research

Investment argument and valuation

Educomp (EDSL) is the only player in India offering end-to-end services in the education sector. We expect the rising share of its subsidiaries in revenue, chiefly due to strong growth in K-12, to reduce dependence on the Smartclass segment. However, a high debt-equity ratio may slow down business growth. Our target price of ₹260 discounts FY13e and FY14e earnings by 6x and 5x respectively. We initiate coverage on the stock with a Hold rating.

SLS boom or bust?

Educomp has been a pioneer in multimedia course content in the schools space with its successful product, Smartclass. A 10x growth in its private school portfolio over FY06-FY11 is evidence of the increasing demand for such products in schools. However, the success of Smartclass has prompted competition, which we believe will make multimedia in classes a commodity in the near future. Educomp's securitization model has many caveats attached: i) Payment default by schools could bring the entire cash flow chain to a standstill; ii) frontloading of revenues: Educomp books the revenue in two years with a contingent liability (100%/ 20%) of 5 years; iii) change in interest rates by banks may make the model unsustainable for local vendors.

Increasing share of subsidiaries in revenue

Educomp is one of the few end-to-end service providers in the entire sector with a wide range of service offerings, from pre-school to higher education and vocational training. While SLS has been the bread and butter segment for the company, the revenue share of other segments is inching up gradually. Though online and supplemental divisions are still in investment mode, these are expected to be profitable in 15-18 months.

Balance sheet to be re-structured

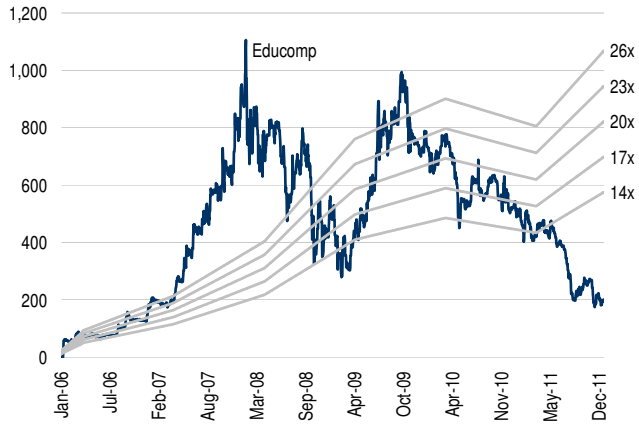
FCCB worth US$78.5m due for redemption in July 2012 at a conversion price of ₹590

Educomp registered 89% CAGR (FY06-11) in revenues and 88% CAGR in PAT. However, it also saw a 38x increase in balance sheet size, primarily on account of capex in the K-12 segment. The company has debt to the extent of ₹9.8bn. This includes FCCBs to the tune of US$78.5m, due for conversion in Jul '12 at ₹590 per share. These will have to be redeemed given the conversion price being way out of the money. The company plans to provide for the required refinancing through sale of stake in subsidiaries/ECB funding and internal accruals.

Valuation

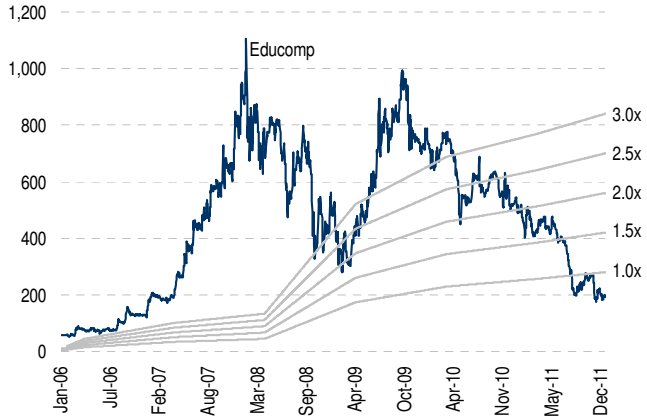
We expect the FDEPS to rise from ₹34.7 in FY11 to ₹55 in FY14e. At the current price of ₹200, the stock trades at PE of 4.5x and 3.6x FY13e and FY14e earnings, respectively. We derive a price target of ₹260, based on the target PE of 6x its FY13e EPS of ₹44.5.

Fig 7 – Forward PE band



Source: Bloomberg, Anand Rathi Research

Fig 8 – Forward PBV band



Source: Bloomberg, Anand Rathi Research

Risks

- **Financial risk: repayment of FCCBs and other loans.** In case Educomp is not able to repay the FCCBs and other loans on time, the company will take a battering.
- **Execution risk.** Despite a strong performance in the past years, going forward Educomp faces inherent risk in its performance due to the scaling up of operations. Other business segments have also grown sizeably and as some segments have a 90-95% franchisee model, managing quality may be an issue.
- **Regulatory risk for formal education.** Any changes in regulatory norms on the formal education front may significantly impact the investment made in formal education by the company.

SLS – boom or bust?

The SLS segment, which accounts for 73% of Educomp's FY11 revenue, is expected to see slower growth than other subsidiaries. This is primarily due to the increased competition in the Smartclass segment (part of SLS), which could restrict realization per classroom, and the selective bidding approach of management in the low-margin Information and Communication Technology (ICT) business. Further, we are not too bullish on the company's securitization model.

Smartclass: Increasing competition

Educomp was an early entrant in the multimedia course content in the schools space, with its successful product Smartclass. Educomp's private schools portfolio grew over 10 times in FY06-11. We believe this is evidence of the increasing adoption of Smartclass in schools following its aggressive sales strategy. However, the success of Smartclass has prompted competition to scale up operations. Over six players have entered this segment and are in direct competition to Educomp. Further, our discussion with various schools indicates that many schools are now investing in hardware on their own and are offering extra perks both monetary as well as non-monetary to teachers in order to create digital content in-house. The in-house content is unlikely to be on a par with what Educomp or other players have to offer. Yet, being proprietary, it can be upgraded at regular intervals and used in all classes – paid content is currently used for only select classes.

Fig 9 – Company-wise rate per class for ICT in private schools (₹)

Company	Product	Price per class room/ per month
Educomp	Smartclass	10,000
Mexus Education	IKEN	5,000
Next Education	TeachNext	6,500
Pearson / Edurite	DigiClass	5,000
HCL	Digischool	5,000
Tata Interactive systems	CLASSEDGE	8,800
Everonn	iSchools	7,000
NIIT	nGuru	8,000

Source: Anand Rathi Research

Securitization – risky business

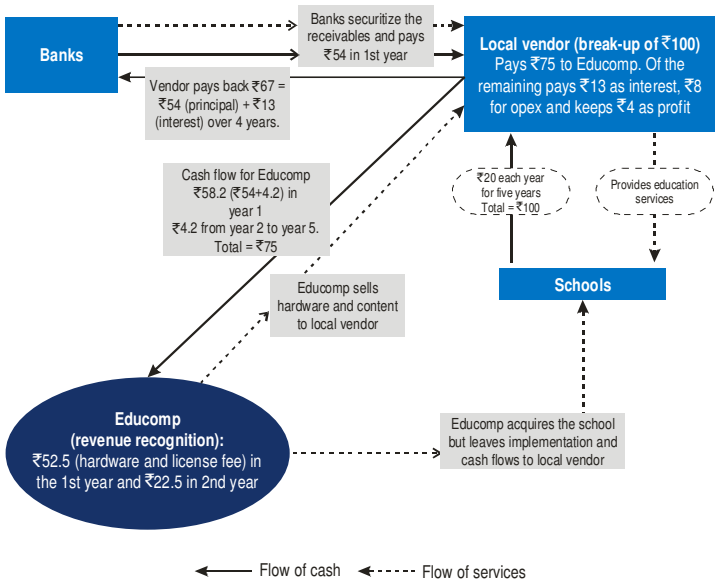
Educomp's implementation of Smartclass is on an almost automated mode, with minimum turnaround time as it has the required bandwith to meet the high demand. However, we are not too comfortable with the structure of the entire transaction. In order to augment growth and reduce the burden on its balance sheet, the company securitizes receivables in the Smartclass segment which has inherent risks due to attached contingencies. Liabilities may accrue despite the company's well-defined agreements with schools and vendors (who provide the service for five years and collect the fees). Our reservations are based on the following:

- Any default or delay in payment by schools may hamper the business model of vendors. Though the contract covers all aspects relating to services and payments, any legal action taken in case of defaults can lead to negative marketing for the Smartclass product among schools.

This risk increases when schools have options of choosing similar products from competitors and, in some cases, at a lower price point.

- The company has earlier provided corporate guarantees for the entire value (100%) of the contract. This is now reduced to 20% for newly signed securitized contracts. Though the company is trying to reduce its liability to zero, we believe the same will be difficult.
- Local vendors could face margin pressure, going forward, as the number of classrooms increase year on year. This may result in higher maintenance cost for the company.
- In a changing interest rate scenario, the vendor's margins would also change as the contract between Educomp and vendor indicates a fixed interest rate.
- Lastly, for every ₹100 collected from schools, ₹25 is retained by the vendor to meet the obligation of interest payment to the bank, cost of servicing and maintenance and a ₹4 profit.

Fig 10 – Securitisation model: cash flow for every ₹100 in revenue generated over 5yrs



Source: Company, Anand Rathi Research *Note: Figures above rebased for classroom price of ₹100*

Fig 11 – Increase in no. of schools using Smartclass

No. of schools / classrooms using Smartclass	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12
No. of schools at the start of quarter	1,737	1,910	2,219	2,574	3,077	3,921	4,585	5,534	6,538	7,202
New schools added	173	309	355	503	844	664	949	1,004	664	905
No. of schools at end of quarter	**1,910**	**2,219**	**2,574**	**3,077**	**3,921**	**4,585**	**5,534**	**6,538**	**7,202**	**8,107**
New classrooms added	1,384	2,472	2,840	4,038	6,750	5,309	7,085	8,010	5,288	6,818

Source: Company

Subsidiaries' share in revenue rises

School Learning Solutions (SLS) has been the bread and butter segment for Educomp from 2006-11. However, the efforts taken to grow other segments have now resulted in the share of revenue from subsidiaries increasing from 27% to 36.5% in the last six quarters. Apart from the pre-school and K-12 division, the other segments are still in investment mode and are expected to turn positive in the next 15-18 months.

Large beneficiary of the growing education market

We estimate private spend on education in India at US$45 bn in 2015, led by the rising spend on private schooling and higher education, as well as the increased proportion of private enterprise in government spend in the sector. Educomp is well positioned to benefit from the strong growth in private education through its scalable offerings in K-12 (primary and secondary education), multimedia content and the government sector.

Fig 12 – Key segments and competitors

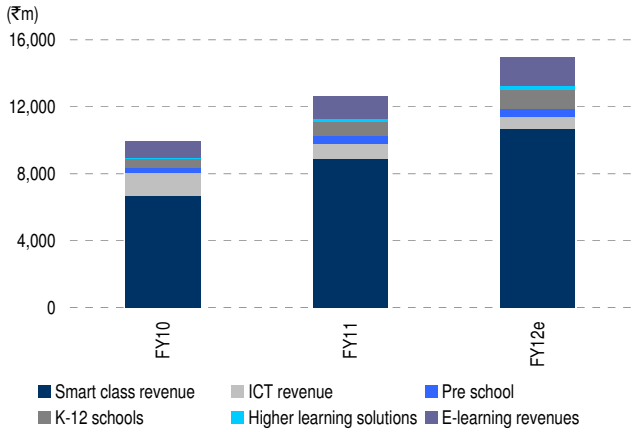
Segments	Educomp Presence	Key competitors
Multimedia	Smartclass	Mexus, Pearson, Everonn, NIIT
ICT	Edureach	NIIT, Core Education, Everonn
Pre-schools	Eurokids, Little Millennium	Treehouse, Kidzee, Shemrock
K-12	Millennium, Takshila, Universal Academy, Le Mont High	GEMS, Delhi Public School, Shemford
Professional development	Teacher Training	Inspire Education
Higher education	Raffles JV	Manipal, NIIT
Vocational education	Pearson JV	NIIT, Aptech
Online & supplemental	Mathguru, WizIQ, VMC, Gateforum, Learnhub, Learning Hour, EduIgnite, EducompOnline, Study places	Compass Box, CBSE Tutor, EducoSoft, eShikshak

Source: Company, Anand Rathi Research

Dependence on SLS to reduce

Back in 2006-2007, Educomp had realised the need to diversify from its bread and butter business of ICT/Smartclass. It launched various initiatives that included opening of brick and motor K-12 schools and pre-schools and entering niche segments in higher education.

Fig 13 – Revenue break-up



Source: Company, Anand Rathi Research

Fig 14 – Segmental performance FY09-11

Segmental performance (₹m)	FY09	FY10	FY11
Revenues			
School Learning Solutions (SLS)	4,322	8,068	10,095
Growth (%)		86.7	25.1
Higher Learning Solutions (HLS)	310	265	654
Growth (%)		(14.5)	146.8
K-12 schools	621	997	1,357
Growth (%)		60.5	36.1
Online, supplementary and global	1,118	1,066	1,403
Growth (%)		(4.7)	31.6
Total revenues	**6,371**	**10,396**	**13,509**
Growth (%)		63.2	29.9
Segmental EBIT			
School Learning Solutions (SLS)	2102	4503	5232.29
Growth (%)		114.2	16.2
Higher Learning Solutions (HLS)	92	-111	292.27
Growth (%)		NA	NA
K-12 schools	274	322	476.56
Growth (%)		17.5	48.0
Online, supplementary and global	204	-157	-108.1
Growth (%)		NA	NA
Total segmental EBIT	**2,672**	**4,557**	**5,893**
Growth (%)		70.5	29.3
Margins			
School Learning Solutions (SLS)	48.6	55.8	51.8
Higher Learning Solutions (HLS)	29.7	(41.9)	44.7
K-12 schools	44.1	32.3	35.1
Online, supplementary and global	18.2	(14.7)	(7.7)

Source: Company

Pre-schools

With over 800 pre-schools (EuroKids and Little Millennium), Educomp is one of the largest pre-school chain companies on a pan-India basis, and caters to ~50,000 students through both franchisees and its own centres. The company runs pre-schools under two separate brands: EuroKids, a 50:50 JV with pan-India K-12 player Euro School (595 pre-schools), and Little Millennium, its own brand, (233 pre-schools). It plans to build a network of 2,000 pre-schools (EuroKids and Little Millennium combined) in India over the next three years.

K-12 schools

Educomp currently operates 65 schools with 35,000+ students and is setting up 36 additional schools across the country. It has plans to set up 150 schools in the next few years. It operates under various formats – Greenfield (37schools); dry management / JV (12schools); EuroSchools (14 schools); acquired (two schools). The company has a wide portfolio of school brands catering to different segments and different geographies within the country.

K-12: short-term pain / long-term gain

The K-12 business is estimated to be highly profitable after the third year of operation. EBITDA at the school trust level is negative in the first year, registers breakeven in the second year and generates cash from the third year onwards – the amount depends on the type of school set-up. The company's business model is to charge 14.5% on capex incurred, which covers the 13% interest paid to the bank and a 1.5% margin. In addition,

the company charges 4.5% of the revenue from the fourth year onwards as variable rent. In addition to lease rentals, the company also charges on a per student basis for content/intellectual property/curriculum/services.

Fig 15 – K-12 portfolio

Brand	Details
EuroKids	Operates 595 pre-schools, most of these are franchised; has a 50:50 JV with EuroSchools
Little Millennium	233 pre-schools, most of these are franchised
The Millennium and Takshila schools	K-12 schools in tier-I and tier-II cities
Universal Academy / Vidya Prabhat	Budget schools with a tuition fee of ₹800 per month
Co-branded schools	Co-branding with Padma Seshadri Bala Bhavan (PSBB) schools

Source: Anand Rathi Research.

Other segments picking up

Educomp is looking to sell stake in few subsidiaries

Educomp's other segments include higher education, vocational training, professional development, online and supplemental. As can be seen from *Fig 14*, these segments are still in investment mode. However, they contribute ~18% of total revenue. As per management these segments will remain in investment mode for at least another 15-18 months. Company is looking at selling stake in few of these subsidiaries.

Fig 16 – Higher education, online and supplemental offerings

Brand	Details
Raffels JV	Eight fashion design campuses in JV with Raffels Institute of Singapore
LearningHour	Premium tutoring services
Mathguru	Online math tutor & content portal
WizIQ	Internet learning platform to connect students and teachers
Learnhub	Social learning network
Studyplaces	Education portal for admission advisory services
IndiaCan (Pearson JV)	Catering to CA and civil services exam coaching, as well as other vocational courses in a tie-up with Pearson

Source: Company, Anand Rathi Research

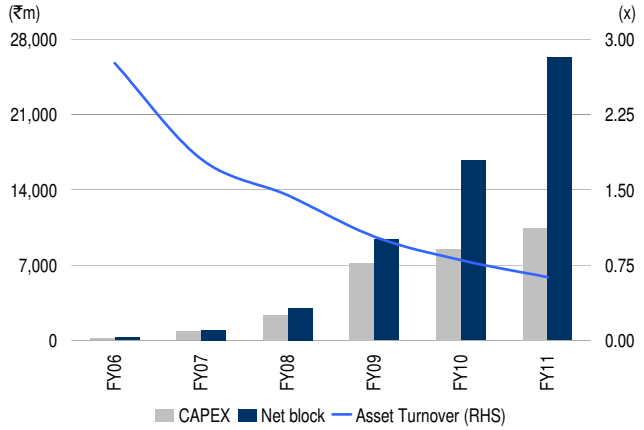
Stretched balance sheet

Educomp's balance sheet has stretched 38x over the last five years, largely due to the capex incurred (₹5.2bn) in the K-12 segment in FY11 alone. However, the investment has borne fruit, with EBITDA margins of 65-75% in the K-12 segment between FY09-11. Key challenges for the company in the near future include FCCB refinancing and reduction of debt while maintaining the growth momentum.

Balance sheet size grew ~38x in 5yrs ending FY11

Educomp has seen rapid growth in the last five years (FY06-FY11), with revenue at 89% CAGR, EBITDA at 82.6% CAGR and PAT at 88% CAGR. This has also led to expansion in balance sheet size from ~₹1bn in FY06 to ₹38.5bn in FY11, largely due to the heavy capex (including acquisitions) of ₹29.4bn incurred during the same period, in order to built capacity for annuity-based models. These are expected to be cash cows and generate revenues for multiple years – ICT and Smartclass have 5-year contracts, whereas K-12 is estimated to generate revenues for at least 30 years.

Fig 17 – FY06-FY11 capex, net block and asset turnover as per cash flow statement

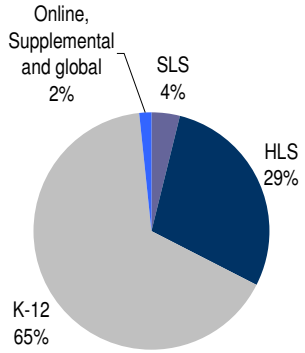


Source: Company

K-12: the biggest cash guzzler

A K-12 school requires capex of ₹100m to ₹1bn, depending on the location, infrastructure and the facilities provided. Fees charged to the students are in proportion to the capex incurred. However, a K-12 school requires at least 4-5 years to break-even and 8-9 years for payback. This impacts the balance sheet and dips the return ratios. However, on the flip side it also brings in assured annuity business with 35-45% EBITDA margins and assured business for 30-40years, with minimum maintenance capex *(See Pg 24, Fig 32: "Unit level matrix for K-12 institutions from inception up to 12 years".)* Educomp intends to set up 150 K-12 schools under various formats – Greenfield (asset heavy), dry management and JV.

Fig 18 – Segmental CAPEX for FY11



Source: Company

Though K-12 is currently denting the balance sheet, we believe it will boost revenue, PAT and return ratios, going ahead, due to the profitability of the segment.

Fig 19 – K-12: segmental P/L for the last four quarters

(₹m)	3Q11	4Q11	1Q12	2Q12
Sales & services income	203	229	272	270
COGS	1	4	6	1
Personal exp.	21	29	29	30
Admin & other charges	25	43	41	41
EBITDA	**156**	**153**	**196**	**198**
EBITDA margin (%)	76.8	66.8	72.1	73.3
Other income	20	25	22	26
Finance charges	97	111	117	122
Depreciation	23	23	32	35
Preoperative exp.	0		-	-
Profit before tax (PBT)	**56**	**44**	**69**	**67**
Provision for tax	19	7	19	21
PAT	**37**	**37**	**50**	**46**
Margins (%)	18.2	16.2	18.4	17.0

Source: Company

Debt burden taking a toll

Educomp has leveraged its balance sheet in order to fund its expansion plans. It has loans of ₹9.8bn (FY11), including FCCBs of US$78.5m at a conversion price of ₹590 a share, due in July-12. These are way out of the money and will have to be redeemed on maturity. Pay out is estimated to the tune of US$96.5m. Nevertheless, Educomp has a manageable debt-equity ratio of 0.56:1 on a standalone basis, whereas the consolidated ratio stands at 0.84:1. However, when contingent liabilities are included, the same increases to 1.27:1 (1HFY12) and an interest-coverage ratio of 2.2 (FY12).

Management intends to retire the debt through ECB borrowing, internal accruals and the sale of stake in segments such as online and supplemental, which are not core to the company.

Fig 20 – Debt equity, interest coverage ratios

Year-end: Mar	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
(Net debt) / cash (₹m)	(47)	(844)	(6,590)	(2,560)	(9,884)	(11,372)	(9,486)	(9,486)
Net cash (per share) (₹)	(0.6)	(9.8)	(76.2)	(26.9)	(104.0)	(119.5)	(99.7)	(53.5)
Net debt to equity (x)	0.04	0.29	1.71	0.16	0.45	0.47	0.35	0.16
Interest coverage ratio (x)	32.6	23.3	9.2	9.2	5.3	4.8	7.5	12.2

Source: Company, Anand Rathi Research

Going ahead, the company has decided to reduce capex. Most assignments will be with a local partner who will invest in infrastructure, while Educomp runs the show.

Fig 21 – Income statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Revenues	**10,395**	**13,509**	**16,055**	**19,407**	**22,014**
Growth (%)	63.2	30.0	18.8	20.9	13.4
Expenses	**5,534**	**8,067**	**9,629**	**11,304**	**12,825**
As % of revenue	53.2	59.7	60.0	58.2	58.3
Cost of goods sold	1,603	3,328	3,548	4,621	5,298
As % of revenue	15.4	24.6	22.1	23.8	24.1
Employee cost	1,793	2,560	3,193	3,292	3,739
As % of revenue	17.2	19.0	19.9	17.0	17.0
Other costs	2,138	2,179	2,888	3,391	3,789
As % of revenue	20.6	16.1	18.0	17.5	17.2
EBITDA	**4,861**	**5,442**	**6,426**	**8,103**	**9,189**
EBITDA margin (%)	46.8	40.3	40.0	41.8	41.7
Interest	539	962	1,113	962	695
Depreciation	1,142	841	1,105	1,502	1,627
Other income	1,255	461	41	634	910
As % of investments	5.8	1.8	0.3	7.7	13.0
PBT	**4,435**	**4,100**	**4,250**	**6,273**	**7,778**
Tax	1,584	678	1,304	2,036	2,524
Effective tax rate	35.7	16.5	30.7	32.5	32.5
PAT	**2,851**	**3,422**	**2,945**	**4,237**	**5,254**
PAT margin (%)	27.4	25.3	18.3	21.8	23.9
Minority Interest	57	127			
Extra-ordinary expense	14	2			
Reported PAT	**2,779**	**3,294**	**2,945**	**4,237**	**5,254**
Shares - as per BS (y/e)	95.0	95.5	95.1	95.1	95.1
Diluted shares	95.0	95.0	95.1	95.1	95.1
FDEPS	29.3	34.7	31.0	44.5	55.2
Growth (%)	89.0	18.5	(10.7)	43.9	24.0
Dividend	286	71	285	285	285
DPS	3.0	0.7	3.0	3.0	3.0
Dividend tax	47	(0)	49	49	49
Dividend payout (%)	11.7	2.1	11.3	7.9	6.4
Extra ordinary & prior period adjustments	20	(17)			
Transferred to reserves	**2,427**	**3,241**	**2,611**	**3,904**	**4,920**

Source: Company, Anand Rathi Research

Fig 22 – Balance sheet (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Equity	190	191	190	190	190
Reserves	16,289	21,593	24,206	27,214	32,228
Shareholders' funds	**16,479**	**21,784**	**24,397**	**27,404**	**32,419**
Debt	10,478	14,373	14,373	10,473	7,473
Minority interest	1,915	2,365	2,365	2,365	2,365
Capital employed	**28,872**	**38,523**	**41,135**	**40,242**	**42,257**
Fixed assets	16,687	26,305	27,774	28,031	28,495
Investments	354	64	64	64	64
Deferred tax assets	(22)	(144)	(144)	(144)	(144)
Cash	7,887	4,489	3,001	987	2,385
Working capital	3,966	7,810	10,440	11,304	11,458
Capital employed	**28,872**	**38,523**	**41,135**	**40,242**	**42,257**

Source: Company, Anand Rathi Research

Fig 23 – Cash flow statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
PAT	2,793	3,296	2,945	4,237	5,254
+ non-cash expense	725	963	1,105	1,502	1,627
Cash profit	**3,519**	**4,259**	**4,050**	**5,739**	**6,881**
- Increase/(decrease) in working capital	1,965	3,844	2,630	864	153
Operating cash flow	**1,553**	**415**	**1,420**	**4,875**	**6,727**
- Capex	8,478	10,459	2,574	1,758	2,091
Free cash flow	**(6,925)**	**(10,044)**	**(1,154)**	**3,116**	**4,636**
+ Equity raised	11,318	2,516	1	(896)	95
+ Debt raised	1,583	3,895	-	(3,900)	(3,000)
- Investments	(375)	(290)	-	-	-
- Dividend paid	333	71	334	334	334
- Misc. expense	34	(15)	-	-	-
Net change in cash	**5,985**	**(3,398)**	**(1,487)**	**(2,014)**	**1,397**
Opening cash	1,902	7,886	4,489	3,001	987
Closing cash	**7,887**	**4,489**	**3,001**	**987**	**2,385**

Source: Company, Anand Rathi Research

Fig 24 – Ratio analysis @ ₹200

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Diluted shares (m)	95.0	95.0	95.1	95.1	95.1
FDEPS (₹)	29.3	34.7	31.0	44.5	55.2
CEPS (₹)	41.3	43.5	42.6	60.3	72.3
BV (₹)	173.5	229.2	256.5	288.1	340.8
P/E (x)	6.8	5.8	6.5	4.5	3.6
P/C (x)	4.8	4.6	4.7	3.3	2.8
P/B (x)	1.2	0.9	0.8	0.7	0.6
DPS (₹)	3.0	0.7	3.0	3.0	3.0
Dividend yield (%)	1.5	0.4	1.5	1.5	1.5
Dividend payout (%)	11.7	2.1	11.3	7.9	6.4
EV/Sales (x)	2.1	2.1	1.9	1.5	1.1
EV/EBITDA (x)	4.4	5.3	4.7	3.5	2.6
EBIT/Sales (x)	47.8	37.5	33.4	37.3	38.5
Sales/Avg.CE (x)	0.5	0.4	0.4	0.5	0.5
Debt/Equity (x)	0.6	0.7	0.6	0.4	0.2
ROCE (%)	23.5	15.0	13.5	17.8	20.5
Avg. CE/avg. equity (x)	2.1	1.8	1.7	1.6	1.4
PBT/EBIT (x)	0.9	0.8	0.8	0.9	0.9
PAT/PBT (x)	0.6	0.8	0.7	0.7	0.7
ROE (%)	27.4	17.2	12.8	16.4	17.6
Net gearing (%)	13.6	45.1	46.4	34.4	15.5
Working capital turnover (days)	139.3	211.0	237.3	212.6	190.0

Source: Company, Anand Rathi Research

Company background & management

Founded in 1994, Educomp, a diversified education solutions company, has more than 27 offices globally and caters to 15m+ students across over 26,000 educational institutes.

Brief history and business

Educomp Solutions Limited, founded in 1994, is a diversified education solutions provider and one of the largest education companies in India. Educomp Group reaches out to over 26,000 schools and 15 million learners and educators across the world. It has 27 offices worldwide including an office in Canada, 20 in India, two in Singapore, one in Sri Lanka, and three in the United States. In addition, the company operates through its various subsidiaries (including authorGEN, Threebrix eServices, Learning.com, USA, AsknLearn Pte Ltd, Singapore) and via its associates such as Savvica in Canada. The company intends to reach out to 20 million learners through products, services and solutions, and targets being amongst the top five education companies worldwide, by the end of 2012.

Key management personnel

Fig 25 – Management profile

Key Person	Designation	Background
Mr. Shantanu Prakash	Chairman and MD	One of the founder members of Educomp, he has been responsible for the overall operations and growth since the company's inception in September 1994.
Mr. Jagdish Prakash	Director	Previously worked as Chief Material Manager with Steel Authority of India, as a marketing and management consultant with various public sector undertakings and academic institutions. He is father of the company's chairman and founder, Shantanu Prakash.
Mr. Gopal Jain	Director	Managing Director of Gaja Capital Partners, a private equity firm.
Mr. Sankalp Srivastava	Director	Founder of Mark & Space, a Company engaged in the design & manufacture of micro-processor based telecom, power control & energy management systems.
Mrs. Sangeeta Gulati	CFO	Over 14 years of experience in money market operations, raising funds, finance and accounting management.

Source: Company

ANANDRATHI

India I Equities

Education

Initiating Coverage

29 December 2011

NIIT

Rating: **Buy**
Target Price: ₹52
Share Price: ₹37

'One NIIT World' & 'cloud campus' to widen reach

NIIT's product consolidation within its Individual Learning Solutions (ILS) division, via One NIIT World and cloud computing, is expected to drive revenues. We expect the sale of Element-K to improve margins and strengthen NIIT's balance sheet. Further, the School Learning Solutions division is seeing rapid growth. We initiate coverage on NIIT with a Buy rating and a price target of ₹52.

- **Consolidating product range.** NIIT is consolidating its product range within its ILS division under its 'One NIIT World' and cloud-computing strategies. Under this, each center provides all the courses NIIT offers, thereby increasing its reach. As per requirement, the company will transmit lectures 24/7 from central locations via cloud computing. We expect this to enhance margins and estimate 20% revenue CAGR over FY11-FY14e.
- **Element-K exit.** NIIT has sold Element-K (acquired for US$35m in FY06) for US$110m. Element-K's FY11 share of revenue was US$86m, but its margin was a low single digit. After this exit, NIIT intends to retire debt of ~₹2.5bn. Margins in its Corporate Learning Solutions division are estimated to improve 120bps in FY12e, but revenue is likely to drop 29%.
- **School Learning Solutions.** NIIT is easing out of ICT training in government schools, as bidders are required to be L1-compliant, 60-65% of the contract value is low-margin hardware cost, and payments occur within 180 to 250 days. NIIT now bids only for tenders where it sees 17-18% IRR. This scaling down is offset with *nGuru,* which provides multimedia content and sets up labs in private schools. We expect this to emerge as a commodity.
- **Valuation.** We derive our price target through a sum-of-parts method. We use EV/EBITDA to value the individual businesses and add ₹7 for the 25% stake in NIIT Tech (assuming a 40% holding company discount). **Risks:** execution delays due to government processes; global economic risk.

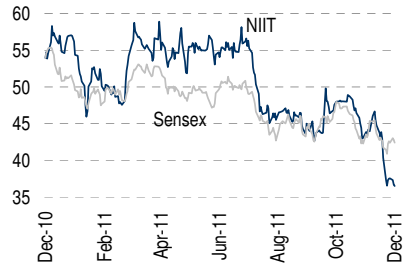
Key financials (YE Mar)	FY10	FY11	FY12e	FY13e	FY14e
Sales (₹m)	11,993	12,483	11,574	10,975	12,778
Net profit (₹m)	702	922	2,781	1,013	1,262
Adj. EPS (₹)	4.3	4.8	5.0	6.1	7.6
Growth (%)	0.7	12.8	4.9	21.9	24.6
PE (x)	8.7	7.7	7.4	6.0	4.8
EV/EBITDA (x)	6.2	5.8	3.6	3.3	2.6
P/BV (x)	1.2	1.1	0.8	0.7	0.6
RoE (%)	13.6	19.7	12.1	11.6	13.2
RoCE (%)	9.0	8.1	7.7	7.6	10.0
Dividend yield (%)	3.8	4.1	3.7	4.5	5.6
Net gearing (%)	68.0	56.3	(5.8)	(9.9)	(11.0)

Source: Company, Anand Rathi Research

Key data	NIIT IN / NIIT.BO
52-week high / low	₹61 / ₹41
Sensex / Nifty	15971 / 4779
3-m average volume	US$0.2m
Market cap	₹6.1bn / US$117.5m
Shares outstanding	165.1m

Shareholding pattern (%)	Sep '11	Jun '11	Mar '11
Promoters	33.96	33.96	33.96
- of which, pledged	-	-	-
Free float	66.04	66.04	66.04
- Foreign institutions	28.48	28.35	0.37
- Domestic institutions	10.35	10.40	38.41
- Public	27.21	27.29	27.26

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Net revenues	11,993	12,483	11,574	10,975	12,778
Revenue growth (%)	4.4	4.1	(7.3)	(5.2)	16.4
- Op. expenses	10,464	10,906	10,041	9,411	10,861
EBIDTA	**1,529**	**1,576**	**1,534**	**1,564**	**1,917**
EBITDA margin (%)	12.7	12.6	13.3	14.3	15.0
- Interest expenses	333	337	219	108	108
- Depreciation	751	854	846	844	904
+ Other income	43	30	33	44	74
- Tax	108	76	134	193	272
Effective tax rate (%)	22.2	18.3	26.7	29.4	27.8
Reported PAT	380	339	368	463	706
+/- Extraordinary items	-	(130)	1,950	-	-
+/- Minority interest	287	438	448	535	541
Adjusted PAT	702	922	2,781	1,013	1,262
Adj. FDEPS (₹/share)	4.3	4.8	5.0	6.1	7.6
Adj. FDEPS growth (%)	0.7	12.8	4.9	21.9	24.6

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Share capital	330	330	330	330	330
Reserves & surplus	4,712	5,235	7,755	8,450	9,316
Net worth	5,042	5,565	8,085	8,780	9,646
Minority interest	22	30	22	15	7
Total debt	4,046	3,658	1,200	1,200	1,200
Def. tax liab. (net)	(298)	(307)	(307)	(307)	(307)
Capital employed	**8,812**	**8,946**	**9,001**	**9,688**	**10,547**
Net fixed assets	5,364	5,422	3,326	3,082	2,777
Investments	1,274	1,641	2,096	2,639	3,188
- of which, liquid	5	110	110	110	110
Net working capital	1,558	1,357	1,912	1,899	2,321
Cash and bank balance	616	526	1,667	2,069	2,261
Capital deployed	**8,812**	**8,946**	**9,001**	**9,688**	**10,547**
Net debt	3,425	3,022	(577)	(979)	(1,172)
WC days	47	40	60	63	66
Book value (₹/sh)	30.5	33.7	49.0	53.2	58.4

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
PAT	702	922	2,781	1,013	1,262
+ Non-cash items	798	845	846	844	904
Cash profit	1,500	1,767	3,627	1,857	2,166
- Incr./(decr.) in WC	1,184	(200)	554	(13)	421
Operating cash-flow	316	1,967	3,072	1,870	1,745
- Capex	385	912	(1,250)	600	600
Free-cash-flow	(69)	1,055	4,322	1,270	1,145
- Dividend	270	288	261	318	396
+ Equity raised	(148)	(103)	(7)	(7)	(7)
+ Debt raised	565	(387)	(2,458)	-	-
- Investments	208	367	455	543	549
- Misc. items	-	-	-	-	-
Net cash-flow	(132)	(90)	1,140	402	193
+ Op. cash & bank bal.	748	616	526	1,667	2,069
Cl. cash & bank bal.	616	526	1,667	2,069	2,261

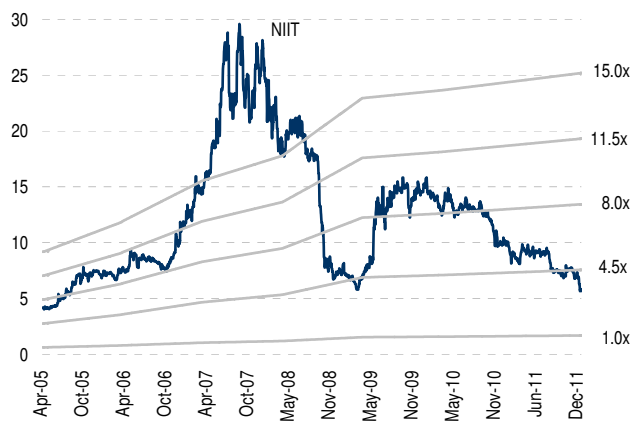
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹37

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
CEPS (₹/share)	8.8	10.0	10.2	11.2	13.1
Cash/(debt)(₹/share)	(20.7)	(18.3)	3.5	5.9	7.1
P/E (x)	8.7	7.7	7.4	6.0	4.8
P/B (x)	1.2	1.1	0.8	0.7	0.6
P/C (x)	4.2	3.7	3.6	3.3	2.8
EV/sales (x)	0.8	0.7	0.5	0.5	0.4
EV/EBITDA (x)	6.2	5.8	3.6	3.3	2.6
EBIT/sales (%)	0.1	0.1	0.1	0.1	0.1
Sales/average CE (x)	1.3	1.3	1.2	1.1	1.2
Adj.RoCE (%)	9.0	8.1	7.7	7.6	10.0
Avg. CE/ avg. eq. (x)	1.8	1.7	1.4	1.1	1.1
PBT/EBIT (x)	0.6	0.6	0.7	0.9	0.9
PAT/PBT (x)	1.4	2.5	1.7	1.5	1.3
Adj.RoE (%)	13.6	19.7	12.1	11.6	13.2
Dividend yield (%)	3.8	4.1	3.7	4.5	5.6

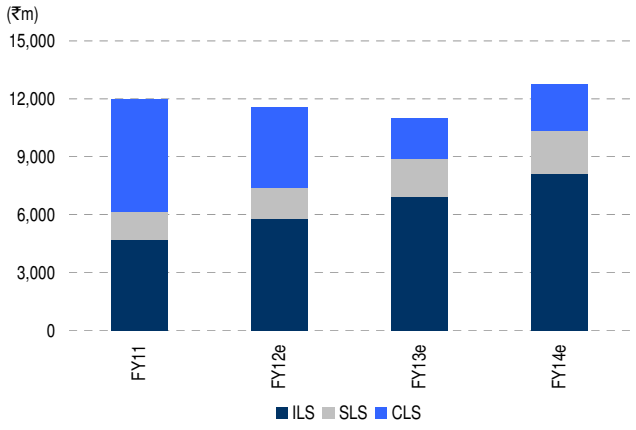
Source: Company, Anand Rathi Research

Fig 5 – Valuation chart (EV/EBITDA)



Source: Bloomberg, Anand Rathi Research

Fig 6 – Revenue Break-up



Source: Company, Anand Rathi Research

Investment argument and valuation

NIIT's "One NIIT World" and "cloud computing campus" strategy to consolidate its product offerings within Individual Learning Solutions (ILS) is expected to drive revenues through cost rationalization and a widening reach. We expect the sale of the low-margin Element-K business to reverse the downtrend in revenue in the Corporate Learning Solutions division and turn the company net cash positive. NIIT is increasingly selective in bidding for tenders for ICT training in government schools, looking only at an internal rate of return (IRR) of 17-18%. We initiate coverage with a Buy rating and a target price of ₹52.

ILS: consolidation phase

NIIT's move to introduce 'One NIIT World' and its 'cloud computing campus' strategy in Individual Learning Solutions (ILS) are expected to drive revenue growth. With the new strategy, it intends to rationalize costs (stationery, laboratories, instructors), and at the same time widen its reach. Each center under One NIIT World will provide all the courses that NIIT has to offer. This is a positive step towards expanding its footprint and widening its margins. We expect 20% CAGR in revenue over FY11-14.

Exiting the non-performing Element-K

In an all-cash deal of US$110m, NIIT sold off Element-K (a part of the CLS division), which it had acquired in Aug '06, for US$35m (FY11 revenue: US$86m; EBITDA margin: 7-8%). With the exit, we expect CLS to contribute as little as ~19% to revenue, most of it non-US. Earlier, with the acquisition of Element-K, CLS had contributed 40-45% of NIIT's revenue, between 2009 to 2011. Of this, at least two-thirds stemmed from the mature US market, which of late has not been doing well. As a result, CLS had seen a mere 5.1% revenue CAGR between FY07-FY11. With the exit of Element-K, we expect faster revenue growth in the Corporate Learning Solutions (CLS) business (Element-K accounted for two-thirds of CLS' FY11 sales). Further, the sale would help reduce associated debt and interest cost. Through this deal the company is expected to turn net-cash positive.

School Learning Solutions

ICT training in government schools is slowly falling out of favour with NIIT due to high debtor days and low margins. NIIT is turning selective on this side of the business, bidding for tenders only where it can see 17-18% IRR. As this is proving difficult, NIIT is scaling down. However, this is compensated for by *nGuru*, which provides multimedia content and sets up labs in private schools. We believe that, though both ICT and multimedia are important segments, they will slowly become commoditised and see margins shrink as more players enter.

JV with NSDC

Skill-building Solutions is a new business vertical for the company, and is a 90:10 joint venture with NSDC (The National Skills Development Corp.). This public-private partnership aims to set up 1,500 centers in 1,000 cities. The NSDC will provide loans at a concessional 7.5%, with an interest

holiday period for the first four years, to train 7m students over a 10-year period.

In 2QFY12, the company had net revenue of ₹1m, with loss at the EBITDA level of ₹13m.

Valuation

We initiate coverage on NIIT with a Buy rating and a target price of ₹52. Our price target has been arrived at through a sum-of-parts method. We use EV/EBITDA to value individual businesses and add ₹7 for the 25% stake in NIIT Tech (assuming a 40% holding company discount). At our target price, the stock would trade at 8.5x FY13e FDEPS of ₹6.1.

Fig 7 – Sum-of-parts-based price target

ILS		
FY13e EBITDA (₹m)	1,211	Best segment for NIIT, with FY13e EBITDA margins of ~18%. However, factoring in macro-economic concerns, the target multiple has been kept at 5x.
EV/EBITDA (X)	5.0	
EV (₹m)	6,054	
SLS		
FY13e EBITDA (₹m)	221	Slowly becoming a commodity segment; high debtor days in government orders. Hence the multiple is at a discount to ILS.
EV/EBITDA (X)	2.0	
EV (₹m)	441	
CLS		
FY13e EBITDA (₹m)	218	On selling Element-K, profits are expected to improve. However, this segment will see revenues drop by two-thirds following the sale.
EV/EBITDA (X)	2.0	
EV (₹m)	437	
Total		
Total EV	6,932	
Net debt (₹m)	(577)	
Equity value (₹m)	7,509	
Per share value (₹) (A)	**45**	
NIIT Tech stake value		
Avg share price of last 12 months	197	
No. of shares (No. m)	59.3	
M.Cap (₹m)	11,697	
Holding company discount	40%	
Net value (₹m)	4,679	
NIIT Holding	24.4%	
Value of the investment for NIIT (₹m)	1,143	
Value per share of NIIT (₹) (B)	**7**	
Target price for NIIT (₹) (A+B)	**52**	

Source: Anand Rathi Research

Risks

- **Dependent on government policies.** NIIT's business in the ICT segment comes from government schools and colleges. Hence, it greatly depends on government funding, regulations and policies.
- **Macro-economic risk.** Corporate training is under discretionary expenditure; a prolonged economic slowdown would hurt this business.

ILS: consolidating its product range

NIIT is consolidating its product range within Individual Learning Solutions (ILS) under its 'One NIIT World' and cloud computing campus strategies. We expect this to broaden its reach, thereby increasing revenue and widening margins. We estimate 20% CAGR in revenue over FY11-FY14e. However, investment in its cloud campus should affect FY12e margins.

One NIIT World/Cloud Computing Campus gains traction

NIIT is seeing traction and enhanced brand equity with its 'One NIIT World' strategy in the ILS. Further, it has started providing courses through its cloud-computing platform. The company expects One NIIT World and cloud computing to be key growth drivers in the ILS segment.

Under this strategy, NIIT offers all its courses at each center. Further, using cloud computing, it offers courses 24 x 7.

Rationalizing costs and increasing margins

With the new strategy, the company intends to rationalize cost (stationery, laboratories, instructors), and at the same time widen its reach.

Each center under One NIIT World provides all the courses that NIIT has to offer. In case of non-availability of a local talent pool for a course, the company will use cloud computing and transmit lectures from central locations. Further, all students are provided with net-books and data cards. Hence, they can access classes from anywhere and finish assignments at home. This helps reduce the cost of maintaining labs at all locations. With all courses offered at each center, NIIT increases its points of presence.

We believe this is a positive step taken by the management to expand its footprint and widen margins. However, the investments involved in creating a cloud platform should impact FY12e margins. We expect 20% CAGR in revenue over FY11-14e.

Fig 8 – ILS: Revenue & margin break-up (₹m)

Year-end: Mar	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Net revenues	2,471	3,396	7,863	4,275	4,681	5,765	6,918	8,088
Growth (%)		37.4	131.5	(45.6)	9.5	23.2	20.0	16.9
Operating expenses	2,037	2,761	6,838	3,289	3,621	4,775	5,707	6,641
EBITDA	**434**	**635**	**1,025**	**986**	**1,060**	**989**	**1,211**	**1,447**
EBITDA margin (%)	17.6	18.7	13.0	23.1	22.6	17.2	17.5	17.9

Source: Company, Anand Rathi Research

Element-K exit: strong move

NIIT has sold, for US$110m, the Element-K business it had acquired for US$35m in FY06. Element-K's FY11 share of revenue was US$86m. However, its margin was at a low single digit. After this exit, NIIT intends to retire debt of ~₹2.5bn. Margins in the Corporate Learning Solutions division are estimated to improve 120bps in FY12, though revenue could drop 29%.

Element-K drag on CLS growth

In Aug '06, NIIT acquired Element-K for US$35m (revenue: US$80m, EBITDA margin: 7-8%). In the last five years (FY07-FY11) Element-K had low margins and had clocked a mere 1.5% revenue CAGR (revenue at time of exit: US$86m). Overall, CLS had seen 5.1% CAGR, with EBITDA margin of ~8%. Due to the exit of Element-K, we expect a dip in the CLS business (Element-K constitutes ~67% of FY11 CLS sales) in FY12e and FY13e, followed by a spurt in FY14e.

Fig 9 – CLS revenue , EBITDA and margins (₹m)

Year-end: Mar	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Net revenues	4,560	5,508	5,789	5,422	5,836	4,157	2,120	2,428
Growth (%)		20.8	5.1	(6.3)	7.6	(28.8)	(49.0)	14.5
Operating expenses	4,206	5,242	5,605	4,985	5,364	3,773	1,901	2,161
EBITDA	**354**	**266**	**184**	**437**	**472**	**385**	**218**	**267**
EBITDA margin (%)	7.8	4.8	3.2	8.1	8.1	9.3	10.3	11.0

Source: Company, Anand Rathi Research

Business to tilt towards India

Following the acquisition of Element-K, CLS brought in 45-50% of NIIT's revenues. Of this, at least two-thirds stemmed from the mature US market, which has been seeing slow growth in discretionary spending such as corporate training, since FY08, due to the macro-economic slowdown. This has played a major role in slowing growth for NIIT as a whole. With the exit of Element-K, we expect the trend to be reversed, with CLS's contribution estimated at only ~19% (FY13e) of revenue, most of this from non-US sources.

Fig 10 – Revenue shifting away from low-margin CLS

Year-end: Mar (%)	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
ILS	31	34	52	37	39	50	63	63
SLS	11	10	9	17	12	14	18	18
CLS	58	56	39	46	49	36	19	19

Source: Company, Anand Rathi Research

Balance sheet to improve

The sale of Element-K brought in US$110m to NIIT, This would largely be utilized to retire debt; which should help NIIT improve its balance sheet and lower interest costs. At end-2QFY12, the company had loans of ₹3.52bn. Management expects to repay ₹2.42m in debt, which should turn the company net cash positive.

Fig 11 – Element-K: exit value

Element-K (US$m)	
Sale value	110
Cost of acquisition	35
Net gains	75
less tax (US - @ 40%)	30
Other allied cost	10
Net realization	**35**

Source: Company, Anand Rathi Research

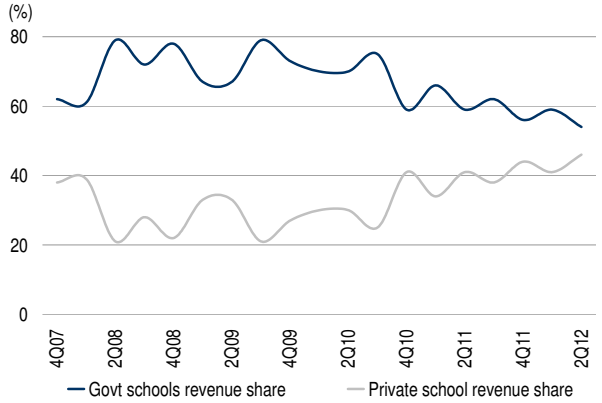
SLS – emerging as a commodity?

NIIT is easing out of ICT training in government schools, as bidders need to be L1-compliant, 60-65% of the contract value comprises low-margin hardware cost and with high debtor days of 180 to 250. NIIT now bids for tenders where it sees 17-18% IRR. With rising competition, margins in ICT/multi-media in schools are likely to shrink.

Government business out of favour

ICT training in government schools is falling out of favour with NIIT, as bidders are required to be L1-compliant, at least 60-65% of the contract value constitutes the low-margin hardware cost and payments by the government take as long as 180-250 days, which skews the balance sheet. NIIT now bids only for tenders where it can see an IRR of 17-18%. Currently, ~54% (2QFY12) of its revenue in the SLS segment arises from the ICT-led business.

Fig 12 – SLS share of business from government and private schools

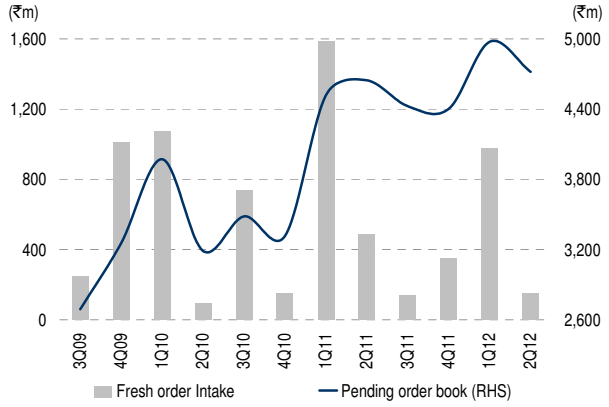


Source: Company

nGuru gaining traction

NIIT was a late entrant in the multimedia and content markets for schools. Penetration is low in this segment. The company now has the requisite sales force to grow this business and accelerate school additions per quarter to 80-100. The company claims to cover 10m students under this segment.

Fig 13 – SLS: pending and fresh order-book position



Source: Company

Multimedia: commodity business

ICT/multimedia in private schools, although an important segment for NIIT as well as for many others, is emerging as a commodity and is likely to see margins shrinking as more players enter.

Skill development with NSDC

A 90:10 joint venture with the National Skill Development Corp. (NSDC), NIIT's Skill-building Solutions division aims to set up 1,500 centers in 1,000 cities to train 7m students over 10 years. The NSDC will provide loans at a concessional 7.5%, with an interest holiday period for the first four years.

Training 15m people: NIIT Yuva Jyoti

Skill-building Solutions is a new business vertical for the company, and is a joint venture with NSDC in a ratio of 90:10. NSDC will provide loans at a concessional 7.5%, with an interest holiday period (for the first four years). The public-private partnership aims to set up 1,500 centers in 1,000 cities and train 7m students over a 10-year period.

Further, NSDC will help create new markets to sell such services. NIIT will invest ₹900m and all income and expenses will reflect on NIIT's books. The company intends to build 375 centers in the first three years. These centers will be in cities/towns of ~100,000 people. Hence, the centers will be of 2,500-3,000 sq. ft. each.

In 2QFY12, the company touched net revenue of ₹1m, with net loss at the EBITDA level of ₹13m.

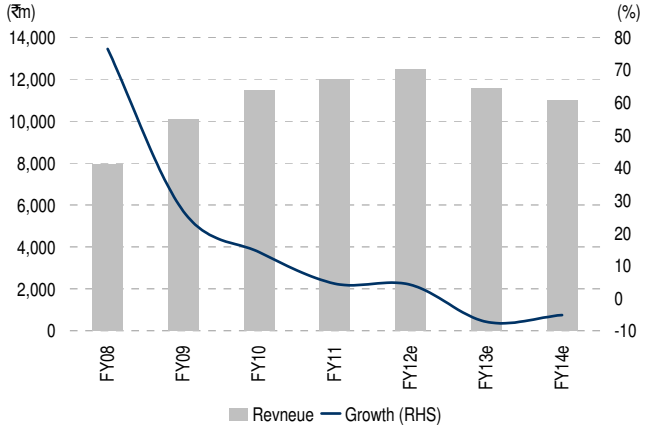
Financials

We expect NIIT to register 5% revenue CAGR in the next three years (FY12-FY14). EBITDA margins are estimated to expand by 175bps chiefly on account of a change in business mix in favour of profitable segments/regions post the sale of Element-K.

Revenue to see flat growth for FY12e-14e

In the past three years (FY08-FY11), NIIT posted modest revenue CAGR of 7.4%, chiefly due to the drag in the CLS business due to Element-K. CLS has registered 1.9% CAGR while SLS (13.1%) and ILS (11.3%) have seen better growth. With the exit of Element-K, which brought in ~30% of NIIT's FY11 revenue, we expect to see a 5.1% CAGR growth in FY12e-FY14e.

Fig 14 – Revenue and revenue growth

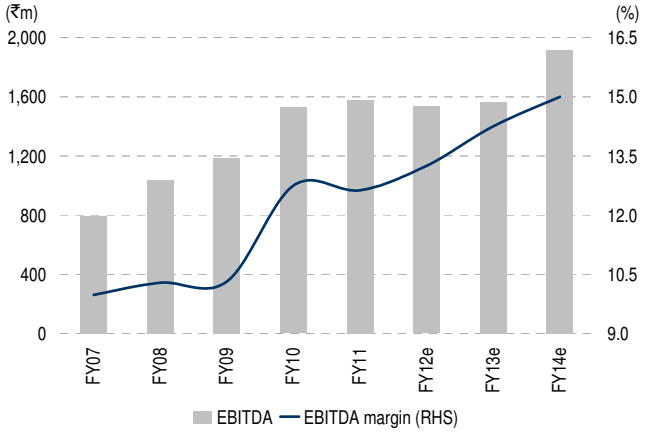


Source: Company, Anand Rathi Research

EBITDA margin to expand 175bps in FY14e

We estimate EBITDA margin to expand by 175bps from FY11 to FY14. We expect the improvement due to: 1) consolidation in the ILS segment through cloud computing and One NIIT World, 2) lower proportion of revenue from government-related ICT business and, 3) exit from the low-margin Element-K business.

Fig 15 – EBITDA and EBITDA margins

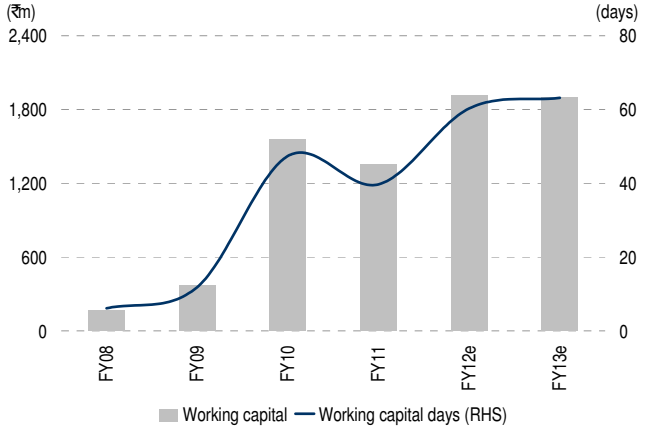


Source: Company, Anand Rathi Research

Working capital

With a higher proportion of business coming from corporate solutions, NIIT has been witnessing low working-capital days. However, we expect this to change.

Fig 16 – Working capital



Source: Company, Anand Rathi Research

Debt / cash per share

Following the sale of Element-K, NIIT is expected to turn net-cash positive.

Fig 17 – Debt-equity ratio, cash per share

Year-end: Mar	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Net debt / cash (₹m)	(1,957)	(1,238)	(2,728)	(3,425)	(3,022)	577	979	1,172
Net cash (per share) (₹)	(99.1)	(7.5)	(16.5)	(20.7)	(18.3)	3.5	5.9	7.1
Net debt to equity (x)	0.6	0.3	0.6	0.7	0.5	(0.1)	(0.1)	(0.1)

Source: Company, Anand Rathi

Fig 18 – Income statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Revenues	11,993	12,483	11,574	10,975	12,778
Growth	4.4	4.1	(7.3)	(5.2)	16.4
Expenses	10,464	10,906	10,041	9,411	10,861
As % of revenue	87.3	87.4	86.8	85.8	85.0
Personnel expenses	3,017	3,348	3,096	2,826	3,258
As % of revenue	25.2	26.8	26.8	25.8	25.5
Development production and execution	4,804	4,795	4,485	4,226	4,856
As % of revenue	40.1	38.4	38.8	38.5	38.0
Administration and other expenses	1,688	1,764	1,563	1,482	1,693
As % of revenue	14.1	14.1	13.5	13.5	13.3
Marketing	955	1,000	897	878	1,054
As % of revenue	8.0	8.0	7.8	8.0	8.3
EBITDA	1,529	1,576	1,534	1,564	1,917
EBITDA margin	12.7	12.6	13.3	14.3	15.0
Interest	333	337	219	108	108
Depreciation	751	854	846	844	904
Other income	43	30	33	44	74
As % of investments	6.9	4.6	1.9	2.0	3.1
PBT	488	415	503	656	978
Tax	108	76	134	193	272
Effective tax rate	22.2	18.3	26.7	29.4	27.8
PAT	380	339	368	463	706
PAT margin	3.2	2.7	3.2	4.2	5.5
Growth	(6.3)	(14.3)	17.1	32.6	30.9
Minority interest	(17.6)	(7.5)	(7.5)	(7.5)	(7.5)
Share of associates net profit	305	446	455	543	549
Other exceptional items	-	(130)	1,950		
Extra-ordinary expense					
Reported PAT	702	922	2,781	1,013	1,262
Shares as per BS (y/e)	165.1	165.1	165.1	165.1	165.1
Diluted shares	165.1	165.1	165.1	165.1	165.1
FDEPS	4.3	5.6	16.8	6.1	7.6
Adj. FDEPS	4.3	4.8	5.0	6.1	7.6
Growth (%)	0.7	12.8	4.9	21.9	24.6
Dividend	231	248	224	274	341
DPS	1.4	1.5	1.4	1.7	2.1
Dividend tax	39	40	36	44	55
Dividend payout	32.9	26.9	27.0	27.0	27.0
Transferred to reserves	432	634	2,520	695	866

Source : Company, Anand Rathi Research

Fig 19 – Balance sheet (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Equity	330	330	330	330	330
Reserves (including warrants)	4,712	5,235	7,755	8,450	9,316
Shareholders' funds	**5,042**	**5,565**	**8,085**	**8,780**	**9,646**
Preference share capital	-	-	-	-	-
Debt	4,046	3,658	1,200	1,200	1,200
Minority interest	22	30	22	15	7
Capital employed	**9,109**	**9,253**	**9,308**	**9,995**	**10,854**
Fixed assets	5,364	5,422	3,326	3,082	2,777
Investments	1,274	1,641	2,096	2,639	3,188
Deferred tax assets	298	307	307	307	307
Cash	616	526	1,667	2,069	2,261
Working capital	1,558	1,357	1,912	1,899	2,321
Capital deployed	**9,109**	**9,253**	**9,308**	**9,995**	**10,854**

Source : Company, Anand Rathi Research

Fig 20 – Cash flow statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
PAT	702	922	2,781	1,013	1,262
+ non-cash expense	798	845	846	844	904
Cash profit	**1,500**	**1,767**	**3,627**	**1,857**	**2,166**
- Increase/(decrease) in working capital	1,184	(200)	554	(13)	421
Operating cash flow	**316**	**1,967**	**3,072**	**1,870**	**1,745**
- Capex	385	912	(1,250)	600	600
Free cash flow	**(69)**	**1,055**	**4,322**	**1,270**	**1,145**
+ Equity raised	(148)	(103)	(7)	(7)	(7)
+ Debt raised	565	(387)	(2,458)	-	-
- Investments	208	367	455	543	549
- Dividend paid	270	288	261	318	396
- Misc. expense	-	-	-	-	-
Net change in cash	**(132)**	**(90)**	**1,140**	**402**	**193**
Opening cash	748	616	526	1,667	2,069
Closing cash	**616**	**526**	**1,667**	**2,069**	**2,261**

Source : Company, Anand Rathi Research

Fig 21 – Ratio analysis @ ₹37

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Diluted shares (m)	165.1	165.1	165.1	165.1	165.1
FDEPS (₹)	4.3	5.6	16.8	6.1	7.6
Adj. FDEPS (₹)	4.3	4.8	5.0	6.1	7.6
CEPS (₹)	8.8	10.8	22.0	11.2	13.1
Adj. CEPS (₹)	8.8	10.0	10.2	11.2	13.1
BV (₹)	30.5	33.7	49.0	53.2	58.4
ABV (₹)	30.5	33.7	49.0	53.2	58.4
P/E (x)	8.7	7.7	7.4	6.0	4.8
P/C (x)	4.2	3.7	3.6	3.3	2.8
P/B (x)	1.2	1.1	0.8	0.7	0.6
DPS (₹)	1.4	1.5	1.4	1.7	2.1
Dividend yield (%)	3.8	4.1	3.7	4.5	5.6
Dividend payout (%)	32.9	26.9	27.0	27.0	27.0
EV/Sales (x)	0.8	0.7	0.5	0.5	0.4
EV/EBITDA (x)	6.2	5.8	3.6	3.3	2.6
EBIT/sales (x)	0.1	0.1	0.1	0.1	0.1
Sales/avg.CE (x)	1.3	1.3	1.2	1.1	1.2
Debt/equity (x)	0.8	0.7	0.1	0.1	0.1
ROCE (%)	9.0	8.1	7.7	7.6	10.0
Avg. CE/avg.equity (x)	1.8	1.7	1.4	1.1	1.1
PBT/EBIT (x)	0.6	0.6	0.7	0.9	0.9
PAT/PBT (x)	1.4	2.5	1.7	1.5	1.3
ROE (%)	13.6	19.7	12.1	11.6	13.2
Net gearing (%)	68.0	56.3	(5.8)	(9.9)	(11.0)
Working capital turnover (days)	47	40	60	63	66

Source : Company, Anand Rathi Research

Company background & management

Set up in 1981 to help the nascent IT industry address its human resource challenges, NIIT, a leading global talent-development corporation, offers learning solutions to individuals, enterprises and institutions across 40 countries. It offers training solutions in IT, business process outsourcing, banking, finance and insurance, executive management education, and communication and professional life skills.

Brief history and business

A leading global talent-development corporation, NIIT builds up skilled manpower for the global industry. Set up in 1981 to help the nascent IT industry address its human resource challenges, it has today grown to be one of the world's leading talent-development companies, and offers learning solutions to individuals, enterprises and institutions across 40 countries. Its training solutions in IT, business process outsourcing, banking, finance and insurance, executive management education, and communication and professional life skills reach 5m learners every year.

Key management personnel

Fig 22 – Management

Key person	Designation	Background
Rajendra S. Pawar	Chairman & Co-founder NIIT group	Member on the Prime Minister's National Council on Skill Development; served on the Prime Minister's National Task Force commissioned to develop India into an IT superpower; advisor to the Hunan province of China. Member of the International Business Council of the World Economic Forum.
Vijay Thadani	CEO, NIIT	Co-founder of the NIIT Group; built an organization recognised for its visionary role in bringing the benefits of Information Technology, both as a professional skill and as a learning tool, to the masses. On the Board of NIIT Technologies.
P. Rajendran	Co-founder & COO	Part of the core team that developed the organisation and brought it to its present position of international standing, since inception in 1981. Alumnus of the Indian Institute of Technology, Delhi. Today, leads the people, infrastructure and technology initiatives and the school solutions business at NIIT.

Source: Company

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Education

Initiating Coverage

29 December 2011

Tree House Education & Accessories

From pre-school to K-12

Rating: **Buy**
Target Price: ₹225
Share Price: ₹168

Despite the large expansion planned in its chain of 234 pre-schools and 16 K-12 schools, Tree House Education & Accessories (THEAL) has maintained its return ratios by not investing in real estate. We initiate coverage with a Buy rating and a DCF-based target price of ₹225.

- **Focus on self-operated pre-schools.** Tree House has a chain of 234 pre-schools. Of these it runs ~68%. It plans to maintain the proportion of self-run pre-schools to those franchised at 65-70%. Most of its self-operated pre-schools are located in metros and tier-I cities; those franchised out are in small, more inaccessible towns.

- **Penetrating new markets.** Tree House plans to invest ₹850m between FY12 and FY14 to open 240 new pre-schools, averaging ₹3.5m capex on each. It aims to roll out nation-wide operations and penetrating deeper into existing markets.

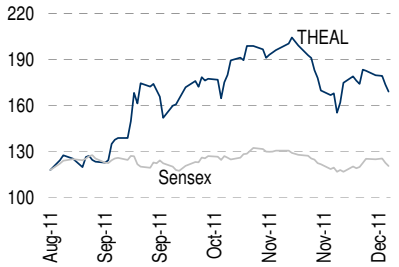
- **Forward integration with K-12.** The company has revenue-sharing management contracts for 16 K-12 schools and intends to take up more such contracts for new and existing schools. However, it tries to avoid investing in real estate and prefers leases/JVs for new schools. The existing pre-schools in the area provide the feedstock for these K-12 schools. Ease of admission in K-12 helps increase pre-school volumes.

- **Valuation.** Our DCF-based price target is ₹225. At our target price, the stock would trade at PE of 18x FY13e and 12x FY14e. Strong earnings growth and return ratios are expected to result in premium valuations. **Risks:** availability of skilled manpower; geographical concentration; regulatory risks for the K-12 segment.

Key data	THEAL IN / THEA.BO
52-week high / low	₹212 / ₹104
Sensex / Nifty	15971 / 4779
3-m average volume	US$1.1m
Market cap	₹5.7bn / US$109m
Shares outstanding	33.71m

Shareholding pattern (%)	Sep'11	Aug '11
Promoters	29.60	29.60
- of which, pledged	-	-
Free float	70.40	70.40
- Foreign institutions	2.31	1.88
- Domestic institutions	7.87	37.36
- Public	60.22	31.16

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY10	FY11	FY12e	FY13e	FY14e
Sales (₹m)	214	392	726	1,130	1,706
Net profit (₹m)	26	92	181	304	479
EPS (₹)	1.5	3.8	5.4	9.0	14.2
Growth (%)	338.4	156.5	40.1	68.0	57.6
PE (x)	112.6	43.9	31.3	18.6	11.8
EV/EBITDA (x)	80.9	34.6	15.1	9.6	6.1
P/BV (x)	4.2	3.3	2.1	1.9	1.6
RoE (%)	4.6	9.6	9.1	10.5	14.6
RoCE (%)	7.3	11.8	13.5	15.6	21.5
Dividend yield (%)	-	-	-	-	-
Net gearing (%)	0.9	13.1	(25.0)	(23.9)	(24.1)

Source: Company, Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Net revenues	214	392	726	1,130	1,706
Revenue growth (%)	108.2	83.6	84.9	55.7	51.0
- Op. expenses	144	223	395	615	920
EBIDTA	**70**	**169**	**331**	**515**	**786**
EBITDA margin (%)	32.8	43.1	45.6	45.6	46.1
- Interest expenses	6	12	42	20	14
- Depreciation	29	40	62	101	118
+ Other income	5	19	44	60	61
- Tax	14	44	89	150	236
Effective tax rate (%)	35.2	32.5	33.0	33.0	33.0
Reported PAT	26	92	181	304	479
+/- Extraordinary items	-	-	-	-	-
+/- Minority interest	-	-	-	-	-
Adjusted PAT	26	92	181	304	479
Adj. FDEPS (₹/share)	1.5	3.8	5.4	9.0	14.2
Adj. FDEPS growth (%)	338.4	156.5	40.1	68.0	57.6

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Share capital	174	240	337	337	337
Reserves & surplus	524	986	2,398	2,702	3,181
Net worth	698	1,226	2,735	3,039	3,518
Minority interest	-	-	-	-	-
Total debt	120	466	180	130	80
Def. tax liab. (net)	4	18	18	18	18
Capital employed	**821**	**1,711**	**2,934**	**3,187**	**3,616**
Net fixed assets	635	1,288	1,898	2,169	2,441
Investments	10	26	-	-	-
- of which, liquid	10	26	-	-	-
Net working capital	73	117	172	163	246
Cash and bank balance	103	279	863	856	929
Capital deployed	**821**	**1,711**	**2,934**	**3,187**	**3,616**
Net debt	6	161	(683)	(725)	(849)
WC days	124	109	87	53	53
Book value (₹/sh)	40.1	51.1	81.1	90.1	104.3

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
PAT	26	92	181	304	479
+Non-cash items	32	54	62	101	118
Cash profit	58	146	243	405	597
- Incr./(Decr.) in WC	43	45	55	(10)	84
Operating cash-flow	15	101	188	415	513
-Capex	274	693	672	372	389
Free-cash-flow	(259)	(591)	(484)	43	124
-Dividend	-	-	-	-	-
+ Equity raised	232	437	1,328	(0)	0
+ Debt raised	120	346	(286)	(50)	(50)
-Investments	10	16	(26)	-	-
-Misc. items	-	-	-	-	-
Net cash-flow	82	175	584	(7)	74
+Op. cash & bank bal.	22	103	279	863	856
Cl. cash & bank bal.	103	279	863	856	929

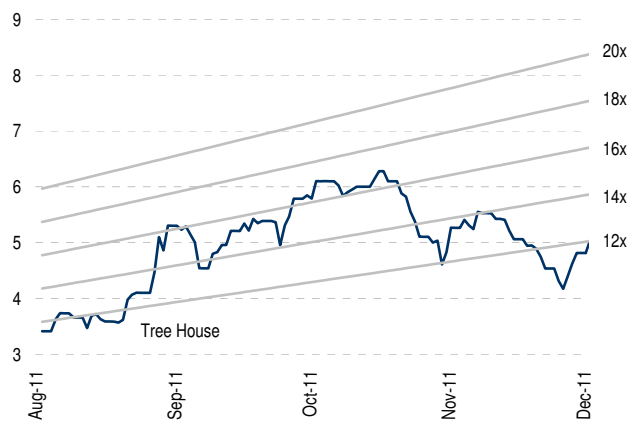
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹168

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
CEPS (₹/share)	3.2	5.5	7.2	12.0	17.7
Cash / debt)(₹/share)	(0.4)	(6.7)	20.2	21.5	25.2
P/E (x)	112.6	43.9	31.3	18.6	11.8
P/B (x)	4.2	3.3	2.1	1.9	1.6
P/C (x)	52.9	30.7	23.3	14.0	9.5
EV/sales (x)	26.6	14.9	6.9	4.4	2.8
EV/EBITDA (x)	80.9	34.6	15.1	9.6	6.1
EBIT/sales (%)	21.5	37.9	43.0	41.9	42.7
Sales/average CE (x)	0.3	0.3	0.3	0.4	0.5
RoCE (%)	7.3	11.8	13.5	15.6	21.5
Avg. CE/ avg. eq. (x)	1.1	1.3	1.2	1.1	1.0
PBT/EBIT (x)	0.9	0.9	0.9	1.0	1.0
PAT/PBT (x)	0.6	0.7	0.7	0.7	0.7
RoE (%)	4.6	9.6	9.1	10.5	14.6
Dividend yield (%)	-	-	-	-	-

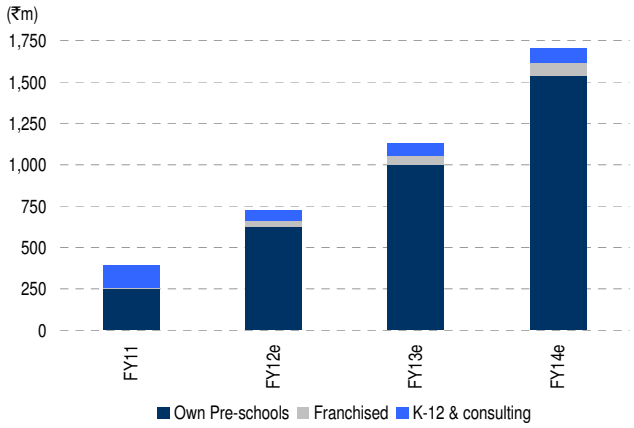
Source: Company, Anand Rathi Research

Fig 5 – Valuation chart (EV/EBITDA)



Source: Bloomberg, Anand Rathi Research

Fig 6 – Revenue Break-up



Source: Company, Anand Rathi Research

Investment argument and valuation

Despite the large expansion planned in its chain of 234 pre-schools and 16 K-12 schools, Tree House Education & Accessories has maintained its return ratios by not investing in real estate. We initiate coverage on the stock with a Buy rating and a DCF-based target price of ₹225.

Self-operated pre-schools

Tree House Education and Accessories operates a chain of 234 pre-schools, ~68% of them self-operated. It aims to maintain the ratio of own vs franchised at 65-70%. It plans to open self-operated pre-schools in metropolises and tier-I cities and keep the franchises (contracted for five years) for the smaller towns. Besides upfront franchisee fees of ₹0.4m-2.5m, Tree House charges royalties of 10-25% of the tuition and admission fees generated by the franchisee.

Fig 7 – Pre-school business model

Tree-House pre-school business models

Own	Franchisee
Capex ~₹4m for furniture/fixtures and deposit	~₹4m and franchisee fees of ₹400,000 to ₹2.5m
Revenue of ₹6m-8m per unit based on ₹30,000-45,000 fees per student for a batch of 140-175	Annual royalty - 10-25% of franchisee revenues
Unit-level EBITDA - 50-70%	Unit-level EBITDA - 75-80%

Source: Company

Penetrating newer markets

The company plans to invest ₹850m to open 240 pre-schools between FY12 and FY14 at an average of ₹3.5m capex a school. It is looking at a nation-wide roll-out and deeper penetration in existing markets. It has adopted an asset-light model so that the roll-out can be quicker and does not affect return ratios.

Forward integration with K-12

The company has management contracts for 16 K-12 schools. It manages day-to-day operations on a fixed charge per student. It does not typically invest in real estate and finds local partners for infrastructure investment. The pre-schools in the area provide the feedstock for these K-12 schools and vice versa.

Valuations

Using DCF-based valuation methodology, we have derived a price target of ₹225. At this target price, the stock would trade at PE of 18x FY13e and 12x FY14e earnings. Strong earnings growth and better return ratios and business not exposed to regulatory risk should result in premium valuations.

Fig 8 – DCF-based valuation

Year-end: Mar	FY11	FY12 e	FY13e	FY14e	FY15 e	FY16 e	FY17e	FY18e	FY19e	FY20e	FY21e	FY22e
FCFF												
Revenues (₹m)	392	726	1,130	1,706	2,477	3,591	5,171	7,394	10,500	14,805	20,727	28,811
Growth (%)	83.6	84.9	55.7	51.0	45.2	45.0	44.0	43.0	42.0	41.0	40.0	39.0
EBITDA (₹m)	169	331	515	786	1,166	1,654	2,330	3,258	4,522	6,228	8,512	11,543
Margins (%)	43.1	45.6	45.6	46.1	47.1	46.1	45.1	44.1	43.1	42.1	41.1	40.1
Depreciation/amortisation (₹m)	40	62	101	118	137	181	208	245	296	368	467	602
Interest expenses (₹m)	12	42	20	14	10	10	10	10	10	10	10	10
Other income (₹m)	19	44	60	61	97	97	97	97	97	97	97	97
PBT (₹m)	136	270	453	715	1,115	1,560	2,210	3,101	4,313	5,947	8,132	11,029
Tax (₹m)	44	89	150	236	368	515	729	1,023	1,423	1,962	2,684	3,640
PAT (before MI) (₹m)	**92**	**181**	**304**	**479**	**747**	**1,045**	**1,481**	**2,078**	**2,890**	**3,984**	**5,449**	**7,389**
Add: depreciation (₹m)	40	62	101	118	137	181	208	245	296	368	467	602
Add: interest*(1-tax rate) (₹m)	8	28	14	9	7	6	6	6	6	6	6	6
Cash profit (₹m)	**140**	**271**	**418**	**606**	**891**	**1,233**	**1,695**	**2,329**	**3,192**	**4,359**	**5,922**	**7,997**
Increase/decrease in working capital (₹m)	45	55	-10	84	-6	-43	87	122	170	236	324	443
Operating cash flow (₹m)	95	216	428	522	897	1,276	1,608	2,207	3,022	4,123	5,597	7,554
Capex (₹m)	693	672	372	389	435	371	527	741	1,035	1,435	1,974	2,695
FCFF (₹m)	**-597**	**-456**	**56**	**133**	**462**	**905**	**1,081**	**1,466**	**1,987**	**2,688**	**3,623**	**4,860**
Less: interest*(1-tax rate) (₹m)	8	28	14	9	7	6	6	6	6	6	6	6
FCFE (₹m)	-606	-484	43	124	455	898	1,075	1,459	1,981	2,682	3,617	4,853
Year of discounting (number)	-		1	2	3	4	5	6	7	8	9	10
Discounted FCFF (₹m)		**-456**	**50**	**104**	**319**	**553**	**584**	**700**	**840**	**1,004**	**1,197**	**1,420**
Discounted FCFE (₹m)		**-484**	**38**	**96**	**311**	**541**	**571**	**683**	**816**	**974**	**1,157**	**1,368**

Calculation WACC	
CMP (₹)	168
Equity (market cap) (₹m)	5,832
Debt (₹m)	466
Risk-free rate - Rf (%)	9.0
Rm - market return (%)	14.0
Beta (B)	0.9
Cost of equity (ke) (%)	13.5
Cost of debt (kd) (%)	12.0
Wd (%)	7.4
We (%)	92.6
WACC (%)	**13.1**
Growth rate (g) (%)	5.0
FCFF in 2024 (₹m)	4,860
Terminal value of firm (₹m)	4,803
Present value of terminal value(₹m)	1,403
NPV of FCFF (₹m)	5,718
Net debt (₹m)	-683
Intrinsic value (₹m)	7,803
Outstanding shares (No. m)	35
Value per share (₹)	**225**

Terminal growth (%)	Cost of equity (%)				
225	**11.5**	**12.5**	**13.5**	**14.5**	**15.5**
3	249	226	206	188	172
4	263	237	214	195	178
5	280	250	**225**	203	184
6	304	268	238	214	193
7	339	292	256	227	203

Source: Company, Anand Rathi Research

Risks

- **Geographical concentration.** Most of the company's operations are centered in Mumbai (over 115 of the centers it runs are in the city). Hence, any disruption in operations or competition would significantly cut into its overall operations. The company is aware of this and has entered new markets: Kolkata (20 centers), Nagpur, Ranchi and Guwahati.
- **Attrition.** Attrition in the senior management/content/teaching team could hit the business. While senior members of the team already hold shares, management is keen to issue ESOPs to employees at lower levels as well.
- **Regulatory risk for formal education.** Any changes in regulatory norms for formal education (K-12) may significantly impact earnings.

Self-operated pre-schools

There are 234 pre-schools under Tree House brand in 35 cities, 158 (~68%) run by the company directly (in metros), the others (in smaller cities and towns) franchised out, normally for five years.

Focused on self operations

Under Tree House brand, the company has 234 pre-schools in 35 cities. Of these, it operates 158 (~68%), the rest are franchised out. The company is keen on maintaining the percentage of its owned schools at between 65-70%. It opens self-operated pre-schools in metropolitan cities in India. This model helps it maintain and control quality, hygiene and safety.

The company provides services like Mother Toddler classes, playschool, KG, summer camps, activity centers and teacher training. It operates on a low capex model of ₹3.5m-4m a unit.

Fig 9 – Expansion plans for owned pre-schools

Cities and areas	No. of pre-schools planned	Estimated area (sq. ft.)
NCR	25	50,000
Kolkata	25	50,000
Mumbai	20	40,000
Pune	10	20,000
Hyderabad	10	20,000
Bangalore	10	20,000
Jaipur	5	10,000
Patna	5	10,000
Chandigarh	5	10,000
Kochi	5	10,000

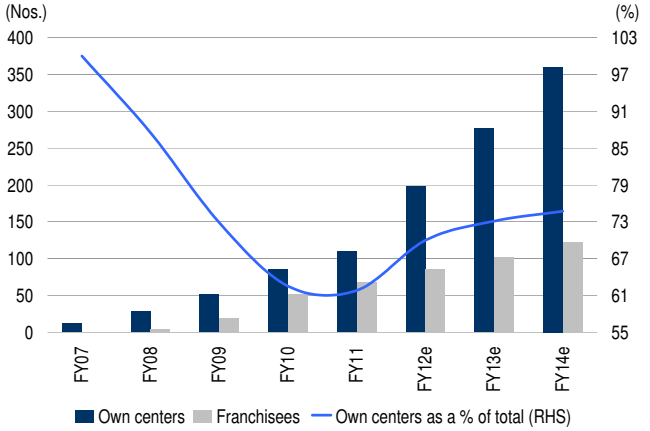
Source: Company

Tier-II cites to be tapped by franchisees

Tree House is not keen on franchising out its schools and plans to retain major company-operated centers, though that would slow down its network growth. However, it is keen on working out franchises in smaller markets (tier-II/-III cites) where opening many centers may not be viable. Essentially, these are markets where even one or two centers would cover the entire town.

Franchises are normally for five years, with upfront franchisee fees ranging from ₹0.4m to ₹2.5m, depending on the territory allocated. Tree House also charges royalties of 10-25% on all tuitions and admission fees related to pre-schools generated by a franchisee.

Fig 10 – Ratio of own centers to franchisees



Source: Company, Anand Rathi Research

From regional to national

Concentrated in five states (Maharashtra, Gujarat, Karnataka, Rajasthan and Andhra Pradesh), Tree House intends to open a further 240 self-operated pre-schools across India by FY14e, at a cost of ₹850m, with its asset-light model.

Expanding its regional footprint

Currently, a regional player focused on five states (Maharashtra, Gujarat, Karnataka, Rajasthan and Andhra Pradesh), Tree House intends to open an additional 240 self-operated pre-schools on an all-India basis by FY14e. For this, it will deploy ₹850m. The estimated cost to establish a pre-school of an average 2,000 sq.ft. is ₹3.5m.

Fig 11 – Estimated capex per center

₹ '000	Estimated cost
Civil works	450
Electrical installations	150
Painting and polishing	300
Rental deposits	400
Furniture and fixtures	2,000
Air-conditioners	60
Computer & security systems	60
Professional fees	70
Total	**3,490**

Source: Company

Asset-light model

The company runs all its operations from centers taken on lease. It enters into agreements ranging from three to five years based on the following two models:

- **Leave-and-license agreements:** Properties are taken on leave-and-license for three to five years. In addition, the school can enter into an amenities agreement with the property owner to provide such amenities as furniture, fixtures and fittings.
- **"Conducting" agreements**: These are entered into between Tree House and the property owner. The company is responsible for day-to-day working and operations, and has the authority to decide on fees. The owner of the premises gets a percentage of gross fees in return for permitting Tree House to conduct, operate and manage a school on his premises. Eight of the self-operated pre-schools are run on "conducting agreements", for five years.

Such agreements provide the management with assurance for a longer duration of stay.

Forward integration via K-12 schools

Tree House's experience allows it upward integration into K-12 schools, through 'managing' contracts (day-to-day operations at a fixed per-student charge, without investing heavily in capex) by looking to local partners for investment in infrastructure. This helps it maintain its return ratios. Its pre-school student base is expected to provide feedstock for the K-12 schools.

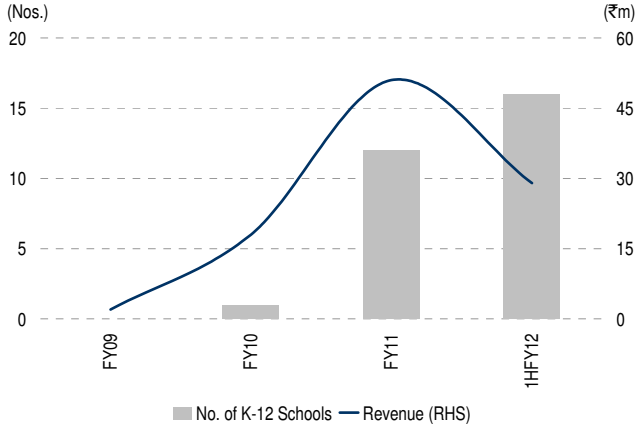
Making a foray into K-12 schools

Tree House has entered into managing contracts with 16 K-12 schools. In these, it takes up day-to-day operations of a school at a fixed charge per student. It is not keen on investing heavily in capex and looks for local partners for investment in infrastructure. This, in turn, helps it maintain return ratios.

Pre-school as feeder for the new business

Tree House's pre-school student base is expected to be a feeder for its K-12 schools. Further, it plans to launch K-12 schools based on the availability of land in proximity to its present pre-schools.

Fig 12 – K-12 schools and revenue



Source: Company

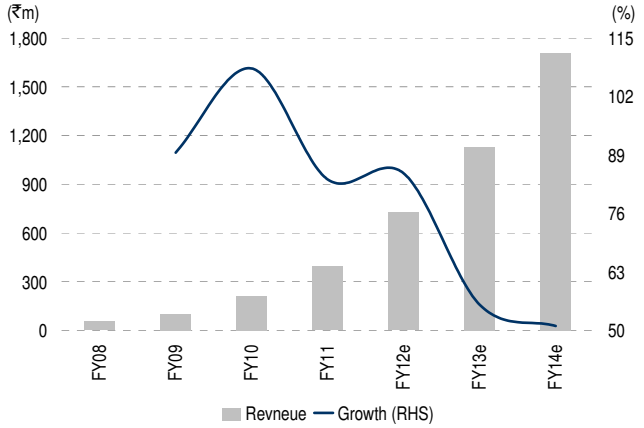
Financials

We expect Tree House, in the next three years (FY11-FY14e) to register 63% revenue CAGR, and EBITDA margin expansion of 298bps, chiefly due to the deeper penetration of pre-schools. The company is well funded. The pre-school business acts as a cash cow and also helps improve return ratios.

Revenue CAGR of 63% over FY11-14e

In the past three years (FY08-FY11), Tree House posted 93.5% revenue CAGR, on the back of 58% CAGR in the number of its own centers. As these centers hit optimum level and with the expected growth in the K-12 segment, in the next three years (FY11-14e), we expect the company to record 63% revenue CAGR.

Fig 13 – Revenue and growth

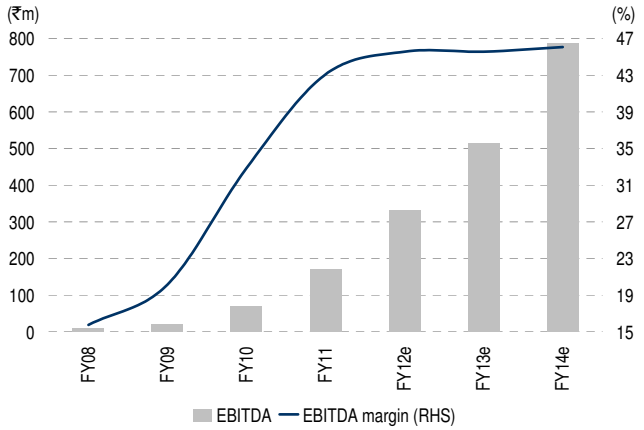


Source: Company, Anand Rathi Research

EBITDA margin to expand 298bps in FY14, from 43.1% in FY11

EBITDA margin jumped ~2,700bps between FY08 to FY11, following an increase in the penetration of centers and growth in the existing centers. We expect a further margin expansion of 298bps (FY11-FY14e) as most centers reach optimum utilization levels and due to the growth in revenues from the K-12 segment.

Fig 14 – EBITDA and EBITDA margins

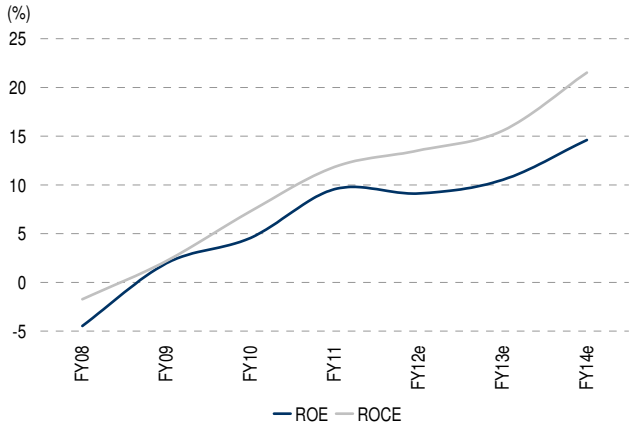


Source: Company, Anand Rathi Research

Return ratios

Tree House is well funded to meet its growth plans for the next two years. Further, with its asset-light policy, we believe its return ratios are set to improve.

Fig 15 – Return ratios

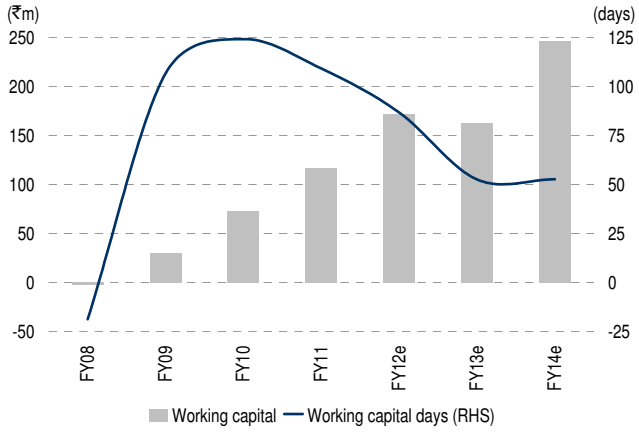


Source: Company, Anand Rathi Research

Working capital

Working capital has till now been skewed due to deposits for centers taken on rent. Working capital days excluding "loans and advances" are negative as fees are received in advance in most cases and payment of liabilities happens later.

Fig 16 – Working capital



Source: Company, Anand Rathi Research

Fig 17 – Income statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Revenues	**214**	**392**	**726**	**1,130**	**1,706**
Growth (%)	108.2	83.6	84.9	55.7	51.0
Expenses	**144**	**223**	**395**	**615**	**920**
As % of revenue	67.2	56.9	54.4	54.4	53.9
Center operating exp	63	102	174	271	401
As % of revenue	29.5	26.0	24.0	24.0	23.5
Employee cost	29	49	91	141	214
As % of revenue	13.7	12.5	12.5	12.5	12.5
Other costs	51	72	130	202	306
As % of revenue	23.9	18.4	17.9	17.9	17.9
EBITDA	**70**	**169**	**331**	**515**	**786**
EBITDA margin (%)	32.8	43.1	45.6	45.6	46.1
Interest	6	12	42	20	14
Depreciation	29	40	62	101	118
Other income	5	19	44	60	61
As % of investments	14.7	18.3	15.0	13.9	13.6
PBT	**40**	**136**	**270**	**453**	**715**
Tax	14	44	89	150	236
Effective tax rate (%)	35.2	32.5	33.0	33.0	33.0
PAT	26	92	181	304	479
PAT margin (%)	12.2	23.4	24.9	26.9	28.1
PAT growth (%)	407.6	253.8	96.6	68.0	57.6
Reported PAT	**26**	**92**	**181**	**304**	**479**
Shares as per BS (y/e) (nos. m)	17.4	24.0	33.7	33.7	33.7
Diluted shares (nos. m)	17.4	24.0	33.7	33.7	33.7
FDEPS (₹)	1.5	3.8	5.4	9.0	14.2
Growth (%)	338.4	156.5	40.1	68.0	57.6
Extra ordinary & prior period adjustments	-	-	-	-	-
Transferred to reserves	**26**	**92**	**181**	**304**	**479**

Source: Company, Anand Rathi Research

Fig 18 – Balance sheet (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Equity	174	240	337	337	337
Reserves (including warrants)	524	986	2,398	2,702	3,181
Shareholders' funds	**698**	**1,226**	**2,735**	**3,039**	**3,518**
Debt	120	466	180	130	80
Minority interest					
Capital employed	**818**	**1,693**	**2,916**	**3,169**	**3,598**
Fixed assets	635	1,288	1,898	2,169	2,441
Investments	10	26	-	-	-
Deferred tax assets	(4)	(18)	(18)	(18)	(18)
Cash	103	279	863	856	929
Working capital	73	117	172	163	246
Capital deployed	**818**	**1,693**	**2,916**	**3,169**	**3,598**

Source: Company, Anand Rathi Research

Fig 19 – Consolidated cash-flow (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
PAT	26	92	181	304	479
+ non-cash expense	32	54	62	101	118
Cash profit	**58**	**146**	**243**	**405**	**597**
- Increase/(decrease) in working capital	43	45	55	(10)	84
Operating cash flow	**15**	**101**	**188**	**415**	**513**
- Capex	274	693	672	372	389
Free cash flow	**(259)**	**(591)**	**(484)**	**43**	**124**
+ Equity raised	232	437	1,328	(0)	0
+ Debt raised	120	346	(286)	(50)	(50)
- Investments	10	16	(26)	-	-
- Dividend paid	-	-	-	-	-
- Misc. expense	-	-	-	-	-
Net change in cash	**82**	**175**	**584**	**(7)**	**74**
Opening cash	22	103	279	863	856
Closing cash	**103**	**279**	**863**	**856**	**929**

Source: Company, Anand Rathi Research

Fig 20 – Key ratios @ ₹168

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Diluted shares (m)	17.4	24.0	33.7	33.7	33.7
FDEPS (₹)	1.5	3.8	5.4	9.0	14.2
CEPS (₹)	3.2	5.5	7.2	12.0	17.7
BV (₹)	40.1	51.1	81.1	90.1	104.3
P/E (x)	112.6	43.9	31.3	18.6	11.8
P/C (x)	52.9	30.7	23.3	14.0	9.5
P/B (x)	4.2	3.3	2.1	1.9	1.6
EV/Sales (x)	27	15	7	4	3
EV/EBITDA (x)	81	35	15	10	6
EBIT/sales (x)	21.5	37.9	43.0	41.9	42.7
Sales/avg.CE (x)	0.3	0.3	0.3	0.4	0.5
Debt/equity (x)	0.2	0.4	0.1	0.0	0.0
ROCE (%)	7.3	11.8	13.5	15.6	21.5
Avg. CE/avg. equity (x)	1.1	1.3	1.2	1.1	1.0
PBT/EBIT (x)	0.9	0.9	0.9	1.0	1.0
PAT/PBT (x)	0.6	0.7	0.7	0.7	0.7
ROE (%)	4.6	9.6	9.1	10.5	14.6
Net gearing (%)	0.9	13.1	(25.0)	(23.9)	(24.1)
Working capital turnover (days)	124	109	87	53	53

Source: Company, Anand Rathi Research

Company Background & Management

Tree House operates the largest number (234) of self-operated pre-schools in India under its 'Tree House' brand, in 35 cities in India (largely in Maharashtra, Gujarat, Karnataka, Rajasthan and Andhra Pradesh). It runs 149, the rest are run by franchisees, serving over 5,000 students, primarily between 1.5 to 6 years old.

Brief history and business

Tree House operates the largest number of self-operated pre-schools in India. Of these, 234 pre-schools are under the 'Tree House' brand in 35 cities (according to municipal limits) in India. Of these, it operates 149; the rest are handled by franchisees. On 31 Mar '11, the self-operated pre-schools served more than 5,000 students, primarily in the age group of 1.5 to 6 years. The company's pre-schools are largely concentrated in Maharashtra, Gujarat, Karnataka, Rajasthan and Andhra Pradesh.

Key management personnel

Fig 21 – Management

Key person	Designation	Background
Sanjay Kulkarni	Chairman, Non-Executive & Independent Director	Post-graduate diploma in Business Administration from the Indian Institute of Management, Ahmedabad
Rajesh Bhatia	Managing Director	BE in Computer Science from MS University, Baroda, and MBA in Marketing Management from Pune University. Approximately seven years' experience in the education sector
Vishal Shah	Executive Director	B.Com. from Mumbai University and MBA in Finance from Narsee Monjee Institute of Management Studies, Mumbai. Approximately six years' experience in the education sector. With Apple Finance as trainee in 1994-1996. In 1996, joined Indsec Securities and Finance as assistant vice-president.

Source: Company

29 December 2011

Aptech

More multimedia than IT training

Rating: **Not Rated**
Target Price: ₹NA
Share Price: ₹75

Starting with IT training, Aptech today earns more revenue (over 50%) from non-IT courses. It has expanded to 33 countries through various business models.

- **Overview.** Aptech started with IT training and has successfully moved up the value chain with courses in other segments such as multi-media, animation, VFX, aviation and hospitality, personality development and English. It has recently made a foray into training staff in the retail sector.
- **Geographic presence.** It has over 1,250 centers (800 in India, 450 internationally) in 33 countries, and plans to further penetrate into developing countries. It is a leader in China, Vietnam and Nigeria.
- **Country-specific models.** Aptech has country-specific models such as direct franchises (India and Nigeria), master franchises (Russia, Vietnam), limited investment (East Europe), joint ventures (Philippines) and owned (Malaysia), according to market potential.
- **Arena and MAAC contributes ~50% of revenue.** On the acquisition of Arena Animation and MAAC, Aptech's revenue has shifted from traditional IT training to other businesses. Arena Animation and MAAC provide ~50% of its revenue.
- **Length, breadth and depth strategy.** The company intends to grow revenue by opening centers in cities with over 1m population and where it does not now operate (length); by offering new products where it already operates-countries/centers (breadth) and deeper penetration in existing countries (depth).
- **22.4% stake in China.** Aptech has 22.4% stake in BJB Career Education Company Limited, holding company of Beida Jadebird IT Co. Ltd. and receives dividend of ~₹300m p.a.

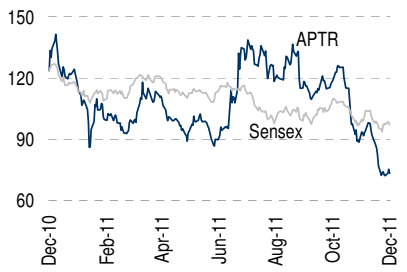
Key financials (YE Mar)*	FY06	FY07	FY08	FY10**	FY11
Sales (₹m)	1,741	2,167	2,739	1,576	1,908
Net profit (₹m)	162	220	577	(261)	429
EPS (₹)	4.0	3.9	9.7	(4.8)	9.2
Growth (%)	L2P	(2.5)	146.4	P2L	L2P
PE (x)	18.7	19.1	7.8	(15.6)	8.1
PBV (x)	2.0	1.8	1.5	1.7	1.3
RoE (%)	15.3	13.7	28.1	NM	18.1
RoCE (%)	17.1	13.3	22.5	4.4	18.8
Dividend yield (%)	-	-	-	1.3	3.3
Net gearing (%)	(8.5)	(32.2)	(75.0)	(7.8)	(17.1)

*Source: Company * YE Dec till 2008 **FY10 is for 15months – ending March'10*

Key data	APTR IN / APTA.BO
52-week high / low	₹148/ ₹69
Sensex / Nifty	15971 / 4779
3-m average volume	US$1.3m
Market cap	₹3.7bn / US$70.4m
Shares outstanding	48.8m

Shareholding pattern (%)	Sep'11	Jun '11	Mar '11
Promoters	35.79	35.81	35.81
- of which, pledged	1.33	1.33	1.33
Free float	64.19	64.17	64.17
- Foreign institutions	8.42	8.35	8.39
- Domestic institutions	0.18	0.17	0.16
- Public	55.62	55.68	55.64

Relative price performance



Source: Bloomberg

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29 December 2011

Edserv

Focus on vocational skills, K-12, IIT-JEE, CA, and AIEEE

Rating: **Not Rated**
Target Price: NA
Share Price: ₹44

Edserv offers coaching for competitive exams such as IIT-JEE, CA, and AIEEE as well as vocational skills training and online ERP solutions for schools. Its Vidhayana initiative offers technology, teacher training and operational assistance in K-12 schools.

- **Overview.** Edserve offers a range of services including: integrated online content for and assessments of K-12 content, coaching for IIT-JEE, CA, AIEEE, among others, and other vocational skills, besides online ERP solutions for schools that automate the parents/student/ teacher ecosystem. It also offers content that can be accessed on mobile phones, and technology for classrooms. It has invested in 10 schools, providing technology, content and teacher training, etc.

- **Online content sold through different channels.** Lampsglow is sold through distributors**,** who are given bulk content at a discount, in turn sold to smaller distributors and retailers, who finally sell Lampsglow credits to retail customers. The credit purchases are similar to buying pre-paid credits for cell phones. This strategy reduces expensive advertising costs in attracting customers directly to its website. **Bulk login sales**: usually sold to schools at a discount. **Direct sales**: students directly pay for content from the website. Lampsglow currently has ~200,000 registered users.

- **Vidhyadhana.** The company invests in K-12 schools, provides technology, teacher training and operational assistance. Vidhyadhana pays royalties to promoters of the schools. The company provides technology for classrooms in schools and charges a monthly fee. It also has, for schools, a complete ERP tool that integrates school content, accounting programmes and logistics.

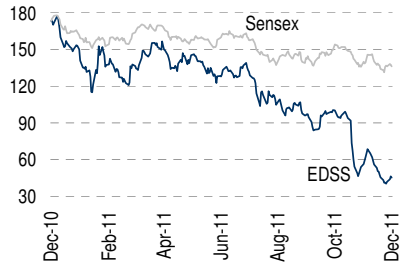
Key financials (YE Mar)	FY07	FY08	FY09	FY10	FY11
Sales (₹m)	2	39	84	521	1,218
Net profit (₹m)	0	25	37	180	413
EPS (₹)	0.2	9.0	3.1	15.0	26.5
Growth (%)	(98.2)	4,968.3	(65.9)	386.8	76.8
PE (x)	247.1	4.9	14.3	2.9	1.7
PBV (x)	270.5	8.9	8.9	2.0	0.8
EV/EBITDA (x)	270.5	8.9	8.9	2.0	0.8
RoE (%)	1.7	63.9	18.2	44.1	39.4
RoCE (%)	6.2	66.9	23.4	55.4	50.3
Dividend yield (%)	-	-	2.3	6.8	6.9
Net gearing (%)	54.4	(28.2)	(25.7)	(7.6)	(15.1)

Source: Company

Key data	EDSS IN / EDSE.BO
52-week high / low	₹183 / ₹39
Sensex / Nifty	15971 / 4779
3-m average volume	US$0.4m
Market cap	₹1.1bn / US$20.1bn
Shares outstanding	23.7m

Shareholding pattern (%)	Sep'11	Jun '11	Mar '11
Promoters	15.59	23.75	24.52
- of which, pledged	15.27	7.15	7.54
Free float	52.41	76.25	75.48
- Foreign institutions	2.01	0.44	0.44
- Domestic institutions	2.05	3.16	3.14
- Public	48.35	35.56	36.58

Relative price performance



Source: Bloomberg

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29 December 2011

Everonn Education

Stake sale to Varkey group will boost K-12 segment

Rating: **Not Rated**
Target Price: NA
Share Price: ₹344

Everonn provides educational training through tie-ups with formal education institutions via VSAT. In addition, it has set-up its own 10 K-12 schools and also has coaching centers to prepare students for various competitive tests. Recently the company sold 12% stake to the Varkey group by preferential allotment.

- **Virtual and Technology Enabled Learning Solutions [ViTELS]** Everonn imparts lectures through satellite-based Very Small Aperture Terminal [VSAT] technology and has 1,455 private schools, 1,920 colleges and 59 retail centers at the end of FY11.
- **Toppers.** A subsidiary of Everonn prepares aspirants for IIT-JEE, a joint entrance exam. Through a combination of classroom and VSAT sessions, the digitally enabled lecture platform allows the faculty to use audio video presentation tools to enhance the learning process.
- **K-12.** Everonn started 10 schools during FY11 under two brands KenBridge Schools (for the CBSE board – 9 schools) and Winfinity World Schools (IB board – 1 school). Further, 20 new locations have been identified to start schools in the next academic year.
- **JV with NSDC.** Everonn has entered into a JV with the Union government's National Skill Development Corporation (NSDC). The JV is mandated to train 15m people in various technical streams over the next 10 years.
- **Stake sale to Varkey group.** The company has sold 12% stake to the Varkey group (GEMS education) at ₹528 per share on preferential allotment basis. Further, the Varkey group has made an open offer for an additional 20% from the market at ₹528. Post this stake sale, the K-12 segment is expected to drive further growth for Everonn.

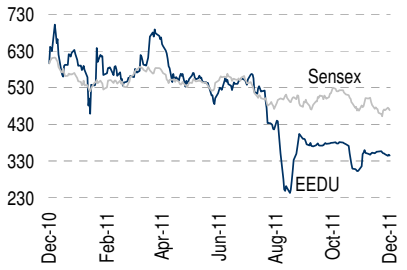
Key financials (YE Mar)	FY07	FY08	FY09	FY10	FY11
Sales (₹m)	430	916	1,447	2,935	4,247
Net profit (₹m)	41	138	221	720	1,136
EPS (₹)	4.0	10.0	16.3	47.6	59.6
Growth (%)	(82.9)	151.0	63.9	191.3	25.2
PE (x)	86.6	34.5	21.1	7.2	5.8
PBV (x)	8.4	4.7	2.3	1.9	1.2
RoE (%)	18.7	19.3	13.7	29.1	27.8
RoCE (%)	26.5	25.1	20.6	32.9	29.6
Dividend yield (%)	-	-	-	0.6	0.7
Net gearing (%)	46.1	7.2	3.8	14.7	11.9

Source: Company

Key data	EEDU IN / EVED.BO
52-week high / low	₹724 / ₹227
Sensex / Nifty	15971 / 4779
3-m average volume	US$2.5m
Market cap	₹6.6bn / US$127m
Shares outstanding	19.2m

Shareholding pattern (%)	Sep'11	Jun '11	Mar '11
Promoters	42.28	42.29	42.67
- of which, pledged	24.02	25.68	24.08
Free float	57.72	57.71	57.33
- Foreign institutions	12.17	27.75	28.62
- Domestic institutions	0.73	1.42	5.35
- Public	44.82	28.54	23.36

Relative price performance



Source: Bloomberg

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29 December 2011

ZEE Learn

Pre-school helps make inroads into K-12

Rating: **Not Rated**
Target Price: ₹NA
Share Price: ₹13

Zee Learn has a pan-India chain of pre-schools with over 95% branches franchised. It has also made a foray into K-12, and intends to open ~100 schools. In most cases, the local partners will invest in real-estate. Management contracts will be with ZEE.

- **Pre-school chain.** Zee's pre-school chain is run under the brand Kids Zee. It has 750 pre-schools, ~95% run by local franchisees. Zee provides content and teacher training, and incurs marketing / branding expenses.
- **Mount Litera Zee School.** Zee intends to set up over 100 K-12 schools in the next 2-3 years under the brands Mount Litera Zee School and Mount Litera World School. These will target the middle-income group with fees of ₹20,000 to ₹70,000 p.a. based on location and services offered. It has its own schools and runs others on a management-contract basis. At present, 38 schools are operational.
- **Brain Café.** Zee has tied up with Gakken Education Co. (Japan) to offer Brain Café science classes in India. This is an integrated eight-level concept-builder programme for students of Classes I to VIII. The programmes will supplement the regular curriculum and bring better understanding and appreciation of the world of science. This is different from the general digital content available in the market and improves understanding through activity-based, hands-on programmes. Brain Café charges ₹900-1,000 per student p.a. and is run in more than 100 schools.
- **ZICA / ZIMA.** Zee also runs ZICA (Zee Institute of Creative Arts) and ZIMA (Zee Institute of Media Arts). It runs ZICA in 25 centres over 15 different cities. The company caters to ~3,000 students under the two streams.

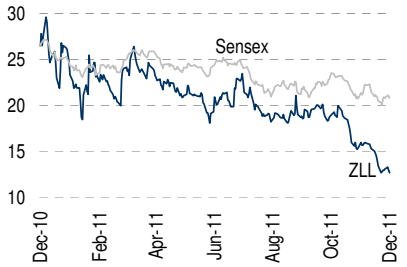
Key financials (YE Mar)	3QFY11	4QFY11	FY11*	1QFY12	2QFY12
Sales (₹m)	98	142	439	154	125
EBITDA (₹m)	4	1	24	(4)	(56)
EBITDA margin (%)	4.0	0.5	5.4	NM	NM
Finance expenses (₹m)	-	-	1	-	-
Depreciation (₹m)	2	3	8	4	8
Other income (₹m)	3	4	11	1	1
PBT (₹m)	5	1	25	(7)	(62)
Tax (₹m)	1	1	7	(0)	(1)
Tax rate (%)	28.9	56.1	27.1	NM	NM
Adjusted PAT (₹m)	3	1	19	(7)	(61)
FDEPS (₹)	0.03	0.01	0.2	(0.05)	(0.23)

Source: Company ** Annual Numbers are for consolidated entity; quarterly are for stand alone*

Key data	ZLL IN / ZEEE.BO
52-week high / low	₹32.4 / ₹13
Sensex / Nifty	15971 / 4779
3-m average volume	US$0.2m
Market cap	₹3.3bn / US$62.7m
Shares outstanding	262.7m

Shareholding pattern (%)	Sep'11	Jun '11	Mar '11
Promoters	73.19	42.62	42.62
- of which, pledged	0.70	-	-
Free float	26.81	57.38	57.38
- Foreign institutions	7.52	13.62	15.85
- Domestic institutions	4.94	10.60	12.56
- Public	14.35	33.16	28.97

Relative price performance



Source: Bloomberg

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Unlisted companies

4C Learning solutions

SCORM-compliant e-learning

Established in 2000, 4C-Learning Solutions Pvt. Ltd. is an e-learning service provider in southern India. Its services are tailored to address the requirements of e-learning organizations, companies, NGOs, K-12s, colleges, universities and individual students.

- **Customized courses, the key.** It provides customized courses for instructor-led training (ILT), web-based training (WBT) and computer-based training (CBT). It offers services in domains such as banking and financial services, manufacturing, retail, hospitality, information technology, etc. Its services extend to the K-12 segment, to corporate houses, NGOs, organizations worldwide and to individual students. It provides e-tutoring to students. Home assignments and tutoring help are provided.
- **Huge opportunity in e-learning.** The benefit from its SARAS Virtual Learning Environment (VLE) is one of its major strengths. Significant benefits may come from the growing e-learning market, while technology may have an adverse affect on its strategic initiatives and growth prospects.
- **International and diversified client base.** The company is one of the preferred outsourcing partners as it is internationally-standard-compliant. Its client base in countries such as the USA, Europe, Malaysia and Singapore offers benefits of geographic diversification.
- **SCORM and AICC compliant.** 4C-Learning offers SCORM-related services to clients where design professionals extend services such as conversion of non-SCORM-compliant e-learning courses and older versions of CBT courses to SCORM-compliant e-learning courses. This unique feature of 4C-Learning gives it an edge over others.

Aakash Educational Services

Coaching for medical and engineering entrance exams

Established in 1988, Aakash Educational Services is one of India's largest coaching institutes for medical and engineering entrance exams. It currently serves more than 35,000 students annually. It has recently made a foray into providing coaching services for students of Std.VIII, IX and X.

- **Business verticals.** AES is one of the oldest and largest in the field of coaching for medical and engineering exams. In 2008, it made a foray into providing coaching services for students of VIII, IX and X standards. Its entrance-exam divisions provide training and coaching to students preparing for competitive exams in medicine and engineering (IIT-JEE, AIEEE, etc.).
- **Services offered.** It offers regular classroom courses, correspondence /distance learning, online courses and courses for NRIs. It also helps students through a national-level test series. Established in 1988 with

only six students, it currently serves more than 35,000 students annually. It also extends scholarships for its classroom and correspondence programmes.

- **Geographical presence and staff strength.** It has 47 study centres in 14 states and runs more than 100 examination centres in India. It currently has an employee base of over 700 professionals.
- **Opportunities in new territories.** The company does not have a huge presence in the western and southern regions of India, resulting in being unable to reap the benefits of market opportunities.

Apple Kids Education (P) Ltd

South-India focused; play-schools, day-care centres, K12

Operating in the bricks-and-mortar education sector and catering to schooling and other educational needs of children, Apple Kids' services include play-schools and day-care centers for children of a year-and-a-half to six years. It runs over 150 pre-school centers and more than 25 K12 schools, mostly in South India. It has accreditation from Australia and New Zealand.

- **Southern strength.** Apple Kids is the largest pre-school chain in Tamil Naidu and offers services from play-group to senior kindergarten catering to children one-and-a-half to six years old.
- **K-12 foray.** It has ventured into the K-12 education segment with its Amazon International Schools brand, with more than 25 such schools all over India. A few of these are residential.
- **Franchisee model.** It operates through a franchisee model in both the K-12 and pre-school segments. In the pre-school segment, it charges an initial franchisee fee of ₹0.6m, with royalties of ~30% on annual fees collected.
- **Affiliation.** Apple Kids pre-schools have secured accreditation from Australia and New Zealand, while its Amazon International Schools are affiliated to the ICSE and CBSE Boards.

Bafel Academy

Language made easy

The British Academy for the English Language operates as an English-language institute, engaged in providing spoken English and communication skills training to students, companies and even school teachers in India.

- **Broad service range.** Bafel offers a range of courses such as spoken English, personality development, business writing, interview techniques, group discussion, voice and accent, BPO training (and spoken Hindi for foreigners) through specially-designed modules. It also provides training for IELTS and TOEFL.

- **Network spread.** It has established 50 centres in nine states, with a presence in north India, which offers it huge scope for network expansion.
- **Proven record.** Recognized as a major institute for English-language training, Bafel recently was awarded the 'Best English Training Institute in Delhi'. This increases its popularity and attracts more trainees. It was recently awarded a contract to train the Delhi Metro staff as a huge number of foreign visitors were expected to attend the prestigious Commonwealth Games, 2010. Such projects improve its brand value.
- **Franchisee-led model.** It operates through its own centres and franchisees. It has two categories of franchisees and fees range from ₹0.35m to ₹0.45m, with royalties of 18% on the annual fees collected.

Billabong High International Schools

Research-based training strategy

Headquartered in Mumbai, Billabong High International Schools is an initiative of Kangaroo Kids Education, with 10 centres in India and an international presence through the Maldives. It is a co-educational institute and provides schooling services for kindergarten to secondary students.

- **K-12 foray.** Billabong has ventured into the K-12 segment with the Billabong High International Schools brand. It has established 10 centres in India and an international centre in the Maldives.
- **Modern facilities and sound infrastructure.** Billabong encourages external development by encouraging sports and performing activities, field trips, sports days, annual concerts and student councils. It provides facilities such as libraries, laboratories, computer centres, sick bays, canteens, assembly halls and AV centres.
- **Research-based training strategy.** It has an R&D team of 65 experts, who shape a curriculum, incorporating theme-based elements, interdisciplinary learning and life-skills programmes.
- **Curriculum and associations.** The schools offer a choice of boards, (ICSE, CBSE, IGCSE). Billabong is associated with a sister concern, Billanook College, Australia

BM English-speaking institute

Teaching English communication skills

Established in 2004, BM English-speaking institute is an English communication-skills training institute. It caters to the development of soft skills along with courses that help people to enhance their confidence, public speaking, presentations, business English, e-mail drafting and group discussion skills.

- **Broad service range.** The institute provides services under the soft-skills-development genre of its advanced English-speaking course. These include topics such as grammar, fluency, public speaking, group discussions, presentations, attitudes and e-mail drafting.
- **Network spread and business model.** It has four centres (three in Mumbai, one in Thane), preparing people to start and run English-training centres anywhere in India. It trains those who want to start centres in various aspects of the business (the partner has to issue the BM English-speaking course certificate to participants who complete the course at the centre). Its fees are ₹0.1m plus service tax, including training charges and ₹10,000 as annual renewal fee after a year.
- **Strategic alliances.** It has successful placement tie-ups with leading brands (Cafe Coffee Day, Sparsh Call Centre, Pantaloons, etc.) for jobs, helping individuals who are trained at the Institute build careers.

Brilliant Tutorials

A leading institute with a strong brand

Established in 1987 as a computer training institute, Brilliant Tutorials is one of the leading institutes in the country, primarily offering coaching classes to students of Std. VIII onwards and for competitive entrance examinations for professional courses in engineering, medicine, management, banking and civil services.

- **Courses offered.** BT provides coaching classes for school students (Std. VIII onwards) and those aspiring to engineering, management, medicine, banking and civil services. It has grown rapidly in providing entrance-examination training for the IIT-JEE, AIEEE – BITSAT, MBBS and MBA. Apart from conventional classroom and correspondence courses, it provides online test services, which cover a vast range of examinations.
- **Network spread.** It is one of the leading institutes in the country and primarily operates in Delhi, UP, Haryana, Jharkhand, Karnataka, Kerala and Tamil Nadu through 28 centres in 10 states. It has a major presence in north and south India.
- **Business verticals.** Its various divisions are Brilliant Tutorials (flagship institute with a chain of classroom centres), Firstware Software Solutions (IT segment offering internet/intranet solutions, e-biz & e-commerce solutions and client server application development), Brilliant's School of Management (B-schools), Compu Gen (quality computer education to school students) and First Computers (focusing on advanced training in e-commerce, M-commerce and Enterprise Applications).

Career Launcher

Diversifying into the K-12 segment

Starting with MBA (CAT) coaching, Career Launcher now offers students training for IIT-JEE, NLS, BBA, MCA exams and vocational training, along with career guidance to students aspiring

to study overseas. It has ventured into the K-12 segment with its launch of Indus World Schools.

- **All-India and international presence.** It operates in more than 175 cities/towns with educational infrastructure of more than 225 learning centres. About 70% of its centres are franchised out. It also operates in the Middle East (U.A.E.), and plans to expand further there to benefit from the large NRI population.
- **Significant manpower.** It has over 3,000 employees, of which around 65% are teacher, trainers and academicians.
- **Diversified revenue stream.** It has diversified into K-12 schools (brand-named Indus World Schools), higher education (Indus World School of Business) and vocational training.
- **Private-equity backed.** Gaja Capital invested in Career Launch in late 2007 for a minority stake.

Ed Ventures e-Learning

Web-based services

Incorporated in 2004, Ed Ventures e-Learning specializes in web development, e-learning and web marketing. Its practice of following an individualized approach with its ability to integrate technologies helps it take care of a client's business-process-outsourcing needs.

- **Unique product offerings.** Apart from offering business solutions and services, Ed Ventures also provides customized products such as fleet manager and CRM admin for easy administrative functioning of client organizations. It has developed B2C sites to conduct online driving safety/traffic school courses. This gives it an edge over competitors.
- **Web marketing and training.** Ed Ventures provides internet marketing services to rank sites for customer acquisition and less customer-retention costs. Its services include search-engine optimization, pay-per-click (PPC) engines campaigns, web analytics, competitor analysis, etc. It also provides a global environment for training in software development, quality testing and e-marketing, with exposure to real-time projects.
- **Qualified trainers.** Ed Ventures has a team of qualified and trained professionals, who posses in-depth knowledge and a range of skills in domain, functional, product and technical expertise. Its strong expertise helps it provide customer-specific solutions, with 100% guarantees for its services.

Edify School

New entrant in the schools business

Established in 2010, Edify School, a division of MDN Edify Education Pvt. Ltd. is ISO 9001: 2008 certified and provides schooling from kindergarten to Grade 12 students. Edify is a co-educational institute,

affiliated to the Central Board of Secondary Education (CBSE).

- **K-12 foray.** It is ISO 9001: 2008 certified and provides schooling from kindergarten to Grade 12 students. Edify is a co-educational institute, affiliated to the Central Board of Secondary Education (CBSE). It provides facilities such as transport, catering, infrastructure, medicine and technology.
- **Network spread.** It has established seven schools in some parts of southern and western India. Expanding its current network of schools to newer territories is a huge opportunity for it.
- **3C-teaching concept.** Edify School has been able to devise a unique 3C-teaching method which helps students grow in both curricular and co-curricular activities. It ensures an ideal teacher-student ratio of 15:1 and tracks students' performances online.
- **Franchisee-led model.** It operates through its own centres and franchisees. Investment in franchisees ranges from ₹80m to ₹100m, with the schools spread over 3-5 acres. Agreements are renewed every ten years.

FIITJEE

Coaching / tuition services for science students

Established in 1992 to provide coaching/tuition services to science students, FIITJEE provides coaching/preparatory classes for students of Stds. VI to XII+ preparing for competitive examinations in engineering.

- **Business verticals.** FIITJEE offers its services to students in India and the Middle East aiming at examinations such as IIT, AIEEE. It runs study centres, AITS centres, AIEEE test centres and FTRE test centres, offering courses to students from Stds. VI to XII. Here they are subjected to a comprehensive curriculum, facilitating a holistic development of concepts and fundamentals of higher education. This also provides the company with future clients.
- **Innovative programmes and concepts.** The company's PINNACLE and SUPREME programmes test the IQ of students aspiring to IIT-JEE. Results predict the success rate and level of input required for mentoring. FIITJEE is the only institute in India with the ability to predict the success potential index (SPI) of a student.
- **Geographical presence and staff strength.** It has built up 52 study centres in 16 states and runs more than 300 examination centres, with an employee base of over 800 professionals. It also operates two international centres, one each in Qatar and Bahrain.
- **Low presence in the Central and Western regions.** FIITJEE has a relatively low presence in western and central India. Also, its dominant presence in tier-I cities limits its growth potential. Parents in tier-II and tier-III cities are giving importance to professional courses and competitive exams. This has generated significant demand for coaching institutes such as FIITJEE to commence operations in those regions.

Gateforum Educational Services

Specialist in GATE coaching

Established in 2005 to coach students aspiring for GATE, Gateforum Educational Services Pvt. Ltd. offers coaching classes for students appearing for engineering entrance examinations.

- **Course structure.** Gateforum offers planned courses dedicated to preparation for GATE, providing a package to enhance the quality of a student's preparation. It offers classroom coaching, correspondence courses, e-learning facilities as well as online and offline test series to prepare a student for the GATE examination.
- **Network spread.** It has 43 centres in 15 states, with huge scope for network expansion by venturing into smaller towns.
- **PSU tie-ups.** Gateforum has PSU tie-ups with organizations such as BHEL and NTPC through which it offers test series based on the organization's recruitment pattern. This improves the selection ratio of students aspiring to work for these PSUs.
- **Franchisee-led model.** The company operates through its own centres and franchisees. Initial investment for a franchisee is in the range of ₹0.2m to 0.5m.

Global Talent Track

IT and management focus

Offering courses in IT and management, such as software, IT infrastructure and financial accounting, Global Talent Track Pvt. Ltd. (GTT) operates more than 20 edu-centres in India, Malaysia and Shanghai. It also works in ~900 colleges in 15 states as well as through owned centres and franchises. Intel Capital and Helion invested capital in Jan '09 and are majority holders.

- **Strong all-India and international presence.** GTT is working in ~900 colleges in 15 states of India and has more than 20 edu-centres in India, Malaysia and Shanghai
- **Unique 'TechGuru' program.** Its TechGuru programme provides faculty development training, and the Europe-Asia Business School has launched an International Executive MBA Weekend Programme for GTT alumni.
- **Collaborations.** GTT has collaborated with CISCO, universities and government institutions to provide programmes with innovative techniques. It has also collaborated with IAOP to extend IAOP certification exams.
- **Aggressive expansion plans.** GTT plans to train more than 450,000 students in the next five years.

ICA Infotech

Rural and SME-placement focused

Operating as a vocation-training institute with almost 400 centres offering courses in accounting, data entry and taxation, ICA Infotech Pvt. Ltd. trains over 45,000 candidates annually and has a strong rural presence, with 200 centers. Saif Partners took a minority stake in 2007.

- **Strong in rural areas.** Rural centres train candidates in a variety of skills in addition to accounting. These include security training, driving and plumbing. ICA Infotech plans to open 1,000 rural franchises in the next 2-3 years.
- **Strong placement record.** It operates 50 placement centres and guarantees jobs for its students. It has a strong relationship with over 50,000 employers, mainly in the SME segment.
- **Franchisee-led model.** It operates 170 retail city-centre training centres, of which 10 are owned, the rest are franchised out.
- **Geographic presence.** Centres are mainly in the east, west and north of the country. It has just one centre in the south, in Chennai.
- **Strong enrolment stats.** It trains over 45,000 candidates annually. 30,000 students in the retail segment (company-owned or franchised institutes) and 20,000 students in the government segment (the government pays ICA for each student trained).

IMS Learning Resources

Broad range of courses

Established in 1977 to offer coaching services to students preparing for management, banking, law and CA examinations, IMS Learning Resources Pvt. Ltd. has 140 centres across the country. It has already served 50,000 students, through owned and franchised centres.

- **Broad service range.** IMS has a broad range of services running preparatory classes for competitive exams in the management stream. In addition, it offers guidance services (Campus Point and IMS Publication) to students aspiring to pursue professional courses. It also runs the IMS Proschool, providing specialized academic courses in financial planning, financial modelling, CFA and financial services marketing.
- **Excellent training pattern.** It follows training/guidance procedures that facilitate regular assessment, while providing performance-related feedback, making the company's curriculum desirable.

Indus International School

Top-ranked IB schools

- Constantly ranked among the top IB schools in India, Indus International has a chain of IB schools. They are promoted by Mantri Developers.
- **Highly-ranked IB schools.** The main Indus International School in Bangalore is constantly ranked by Education World as one of the top-five international schools in India.
- **Scaling beyond a one-school model.** The first Indus International School was established in Bangalore in 2003 and now has almost 1,000 students. After its growing reputation and success, the company has established IB schools in Hyderabad and Pune in 2008. After just a few years of operations, the Hyderabad school has also been ranked by Education World as one of the top IB schools in India.

Indus World School

Growing all-India presence

A chain of K-12 schools owned by Career Launcher, Indus World now has nine schools in India since opening the first school in Hyderabad in 2005.

- **Expanding chain.** With nine schools, in Indore, Hyderabad, Raipur, Bhiwani, Mandi, Ahmednagar, Gurgaon, Aurangabad and Jalgaon, the company has partnered with a major property developer to open 25 schools in Chennai, Bangalore, Kolkata and Visakhapatnam. The schools follow the CBSE curriculum.
- **Backed by a fast-growing education company.** Indus World School is promoted by Career Launcher and therefore has the backing of a leading education company.
- **Private-equity backed.** HDFC PE invested in Indus World in early 2011.

K-12 Techno Services

Fast-growing affordable education player

K-12 Techno Services operates 67 K-12 schools, 12 junior colleges and one international school. The K-12 schools operate under the Gowtham Model Schools brand.

- **Affordable quality education.** Currently all its K-12 schools are based in Andhra Pradesh and focus on the mid-market segment, charging between ₹1,500 and ₹2,000 a month per student. K-12 Techno has over 40,000 students. The company is planning on setting up schools in Maharashtra and Gujarat.

- **Standardized content.** All Gowtham schools follow the same syllabus and content and the teachers are trained. This standardizes quality across schools. All schools are also run through a system-wide ERP system, tracking attendance, courses taught and grading.
- **Asset-light model.** K-12 Techno does not own any of the land or infrastructure of the schools and spends around ₹400,000-500,000 per school initially (capital expenditure) to give it a facelift and install technology.
- **New revenue models.** K-12 is now starting to franchise the Gowtham Model School brand. It is also planning to provide syllabus-development services to other third-party schools.
- **PE and strategic funding.** In mid-2010, Sequoia Capital invested ~₹700m for a significant minority stake. In Sep '11, Navneet invested ~₹600m for a 25% stake.

Kangaroo Kids Education

R&D stalwart

Addressing educational needs of children aged between 10 months to 17 years, Kangaroo Kids Education has a chain of 80 centers and an international presence. It primarily operates in both the pre-school and the K-12 segments, through franchised and owned centers.

- **All-India presence.** It has multiple centres in all major cities (Mumbai, Bangalore, Hyderabad, etc.).
- **International presence.** It also has centres in the Maldives and Dubai and is planning to expand into other countries.
- **Strong R&D.** Its R&D team is one of its major strengths, with 65 instructional-design experts who shape the curriculum.
- **Standard maintenance measures.** Through its School Improvement Team, it ensures smooth running of the management and other administrative functions.
- **Low presence in east India.** It does not have significant presence in eastern India, which opens out a large untapped opportunity.

Manipal University

Research-focused, strong infrastructural backing

A powerhouse and a brand name in higher education in India, Manipal University is located on the west coast of South India, attracting students from 52 countries. It has 20 constituent institutions comprising medical, dental, engineering, architecture, nursing, allied health, pharmacy, management, communications, information science, hotel management, biotechnology, regenerative medicine, etc. It offers Bachelors, Masters and doctoral degrees in various specialties.

- **Research-oriented.** It has a strong focus on research and is the

largest private recipient of funds for research from the government

- **Strong brand.** Manipal University has branch campuses in Bangalore, Malaysia, Dubai and Antigua in the Caribbean. Its campus in Mangalore has a medical college, a dental college and a nursing college with attached teaching hospitals. MU has international academic collaboration for twinning programmes in engineering with universities in the US, UK, Australia and other countries.
- **Strong infrastructural backing.** Infrastructure includes air-conditioned lecture halls, skills labs, air-conditioned hostels and a multi-cuisine food court. The state-of-the-art health-sciences library is fully air-conditioned, accommodates 1,300 and has over 62,000 books and over 600 journals. Other facilities include a gym and swimming pool, football and cricket grounds. The new indoor sports complex is perhaps one of its kind in Asia
- **Strong alumni network.** It also has active alumni of over 65,000 students across the world.

MTeducare

Management, consultancy services to pre-university colleges (PUCs)

Education-support and coaching to secondary and higher secondary students and those pursuing graduation in commerce, preparing for various competitive examinations and chartered accountancy examinations.

- **Overview.** An education-support and coaching-services provider for students in the secondary and higher secondary and those pursuing graduation in commerce, preparing for various competitive examinations and chartered accountancy examinations, MTeducare operates in Maharashtra, Tamil Nadu, Karnataka and Gujarat, through 190 coaching centres in 106 locations, catering to ~58,000 students.
- **Expanding reach.** It intends to strengthen its presence in Maharashtra, Tamil Nadu, Gujarat and Karnataka by increasing the number of its coaching centres. It will leverage its brand recognition and experience to service the increasing demand for its services, by opening coaching centres at 20 locations in Mumbai and Pune in the next two years.
- **Managing pre-university junior college.** It offers management and consultancy services to pre-university colleges (PUCs) in Mangalore and Udupi (Karnataka). The scope includes advice on structuring PUC courses/curricula and classes, assistance and consultancy in recruiting teachers for the PUCs, training them, providing techniques based on the use of technology, management of tests/examinations conducted by the PUCs, advising and assisting the marketing activities of the PUCs, infrastructure management/advisory and support services (including designing classrooms and laboratories of the PUCs and facilitating optimum utilisation of the available infrastructure) and other administrative and information-technology-related services.

People Combine

High-end K-12 player

Operating IB schools under the Oakridge International brand, People Combine also runs a brand of higher-end CBSE schools named Westwood.

- **High-end focus.** While People Combine runs a mid end school called the Nalanda Talent School, its prime focus is the premium segment. It runs the Oakridge International (IB) Schools, and the Westwood (premium CBSE) Schools, that charge Rs.60,000-70,000 in annual tuition per student.
- **Largest IB school in India.** The Oakridge International brand has three schools in Andhra Pradesh under its umbrella; of these, the original campus at Gachibowli in Hyderabad has over 2,700 students making it the single largest IB school in India in terms of student population.
- **New avenues of growth: pre-schools.** The recently-started premium schools under the OI name act as feeder schools for the Oakridge International Schools.
- **PE funded.** ICICI Ventures invested in People Combine in mid-2010. The company is likely to raise additional funding to feed aggressive growth plans, which include adding several new schools outside AP in the next three years.

Radcliffe

Quality education on a budget

Operates in two major segments – K-12 (36 schools) and business schools (six brands, more than 30 locations) in the country, Radcliffe caters to the mass-market segment; hence, most of its K-12 schools are in tier-II towns or lower.

- **K-12 for the masses.** Begun in 2008, Radcliffe has 26 primary and 10 secondary schools, mainly in tier-II towns. It caters to the middle and lower-middle classes; hence, annual fees range from ₹16,000 to ₹25,000, with an admission fee of ₹25,000.
- **Primary schools follow the asset-light model.** Radcliffe's primary schools operate at rented premises in the heart of a city; its secondary schools are owned and are at a distance from the city. Its primary schools provide the required feedstock for its secondary ones.
- **In-house teacher training and content development.** Radcliffe hires talent locally via its trusts. It also conducts regular teacher-training sessions so as to keep all teachers well-versed with its in-house developed content.
- **Affiliation.** Radcliffe schools are affiliated to the CBSE board.
- **Business schools.** Radcliffe's business schools operate at over 30 campuses under six brand names - The Bangalore School of Business

(BSB), The Delhi Business School (DBS), The Mumbai School of Business (MSB), The International Business School (IBS), The Global School of Business (GSB) and The Rai Business School (RBS). These business schools have 2,400 students across various campuses and brands.

Shemford Schools

Strong service portfolio

Set up by the management of India's first pre-school chain, Shemrock, Shemford Schools operates 130 schools (including pre-schools) in India. It provides schooling from pre-school to grade XII, primarily functioning under two broad categories, self-owned and franchised centres.

- **K-12 foray.** It operates K-12 schools in all states. It is affiliated to the CBSE and ICSE Boards and has over 130 branches (including pre-schools) in India.
- **Recognized brand.** Shemford was created by the management of Shemrock, India's first pre-school chain. Shemford stands to benefit from the prior experience of setting up Shemrock, thereby helping it take wiser business decisions.
- **Wide array of programmes.** It offers special programmes such as ShemEduMAX, Parent Participation, ShemFAST and Shemford Training.
- **International exposure.** The student-exchange programme helps children learn about cultures across the globe by helping them interact with such students. This also helps in personality development.

Shemrock Schools

Interactive teaching methodology

Established in 1989 in New Delhi, the Mohali-headquartered Shemrock Schools Pvt. Ltd. operates as a unit of Trinity Education and Welfare Society, a Delhi-registered, non-profit organization, It has established around 10 centres in India. It is affiliated to the Central Board of Secondary Education and provides schooling services up to Std XII.

- **Broad service portfolio.** Shemrock values overall development of students and gives equal emphasis to academic, creative, physical and social activities and provides a wide range of extracurricular activities such as judo, skating, adventure sports, etc., providing students opportunities to excel in the field in which they prefer to make their careers.
- **Provides medical facilities.** In collaboration with community-based mental health professionals, Shemrock provides counselling and consultation to students, families and staff members. It also

coordinates psycho-educational testing referrals and conducts presentations and workshops for students.

- **Add-on facilities.** In contrast with its competitors, Shemrock provides healthy mid-day meals to its students and promotes good parenting through counselling, guidelines and tips for parents.

Speakwell Enterprises

Vocational-training expertise

Offering spoken English classes to students and corporate training to professionals, Speakwell Enterprises Pvt. Ltd. runs 70 centers in Gujarat, Uttar Pradesh, Kerala and Maharashtra. It primarily functions under four broad categories: spoken English, employment exchange, overseas education and corporate services

- **Facility for overseas education.** Speakwell has a special facility for overseas education helping students study abroad. Its representatives have direct contact with institutions, providing detailed information about institutes and course structures.
- **Placement facility.** Its Placewell division fulfils placement needs of its students along with providing career counselling. Its placement network covers insurance, sales, retailing, BPO and hospitality. It provides training specific to the requirements of these sectors.
- **Strong network spread.** It operates more than 70 centres in states in India including Gujarat, Uttar Pradesh, Kerala and Maharashtra. It has served more than 100,000 students till now.

TeamLease

Strong training services

Established in 2002, India's largest and foremost people supply chain and HR services company TeamLease Services Pvt. Ltd. provides corporate clients with a one-stop solution for all staffing and HR requirements, with a corporate office in Bangalore and full-fledged offices in Mumbai, Delhi, Chennai, Hyderabad, Kolkatta, Ahmadabad and Pune.

- **Strong technology and infrastructural backing.** High-end technological platforms for internal processes and client and associate interaction and use.
- **Wide, diversified portfolio.** TeamLease has a national footprint with 75,000 deputed employees in more than 800 locations. More than 1,400 corporate clients and operating across industry verticals catering to requirements of leading names in BFSI, FMCG and consumer durables, retailing, telecoms, IT, BPO and ITES, automobiles, services, manufacturing, engineering and other sectors.
- **Training services.** It offers training and skill-repair solutions to students and corporate clients

T.I.M.E. (Triumphant Institute Of Management Education)

Leader in MBA test preparation in India

The market leader in CAT preparation in India, Triumphant Institute Of Management Education has been diversifying into other areas of training such as engineering and medical entrance preparation, banking courses, study abroad counseling, tuition for secondary school students and GATE preparation.

- **Largest CAT market share.** With over 200 centres in 110 cities in India, T.I.M.E. is one of India's largest CAT test preparation institutes. It trains around 150,000 students every year in all its segments. The centres are either owned or franchised, but most of the franchises are joint ventures in order to maintain quality across the system.
- **Ventures into pre-schools and K-12.** The institute runs 45 pre-schools under the T.I.M.E. Kids brand, besides two K-12 schools in Hyderabad, but does not expect to expand aggressively in the K-12 segment.
- **Inorganic growth.** In order to expand its vocational-training capabilities, it acquired Veta in Nov '11, an all-India English training institute.
- **Private-equity funded.** In 2008, it received funding from a major global PE fund.

VIBGYOR High (Kare Edumin)

Strong quality of education

Kare Edumin promotes six VIBGYOR high schools in three states. All VIBGYOR high schools have excellent facilities, which include state-of-the-art classrooms. It has a strong presence in Maharashtra and Uttar Pradesh. All VIBGYOR high schools follow the ICSE and IGCSE syllabi.

- **Operating in three states, expansion plans underway.** VIBGYOR has schools in UP, Maharashtra and Gujarat, with upcoming projects in the Bangalore region.
- **Strong infrastructural backing.** It has excellent facilities, which include state-of-the-art laboratories, a swimming pool, sports and performing arts facilities and air-conditioned classrooms.
- **Inclusive education program.** Services provided under this programme include psycho-educational assessment, vocational guidance, assistance for students with special needs, etc.
- **Sports and performing arts programmes.** The sports and performing arts programmes are specially designed to introduce children to education beyond the classroom through indoor and outdoor activities.
- **Curriculum.** All the schools follow the ICSE and IGCSE syllabi.

VJTF Education Ltd.

Quality K-12 education at reasonable pricing

Company operates under brand of Witty Kids and Witty International schools with presence in Maharashtra (3schools) and Rajasthan (1school). Company also has 51% stake in a educational software service provider and runs in house teacher training programmes.

- **Witty International.** VJTF provides K-12 education and has 4 operational school in Maharashtra and Rajasthan. It runs its K-12 schools under brand of Witty International and has affiliation with ICSE, CBSE, IGCSE and IB boards. Company caters to ~3,000 students.
- **Software services.** VJTF has a 51% stake in MICM a software service company which provides software services to ~100 educational institutions catering to ~50,000 students.
- **Teacher Training.** In order to meet the requirement of teaching staff VJTF runs an in house teacher training programme. It also runs special parenting sessions for the parents of all the students enrolled at various schools.
- **Future plans.** VJTF plans to come up with 3new schools in Mumbai by FY14 and construction for the same is ongoing. Further VJTF is also in talks with 9 local vendors to provide franchisee / consultancy for K-12 schools.

WLCI

Certificate courses – higher education

At its campuses, WLCI offers higher-education diplomas in business, design, fashion and media, and claims a ~100% placement record. It is a "for profit" institute.

- **Overview.** WLCI offers higher education diplomas in business, design, fashion and media. Business School: courses in finance, marketing and HR. Other courses: advertising, graphic design, fashion technology, fashion marketing and media.
- **'For-profit model' attractive for investment.** Since WLCI cannot award degrees, its complete "for profit" model does not have an underlying trust structure. PE firm Zephyr Peacock invested in WLCI in June 2007 for a 20% stake.
- **Near 100% placement.** The institute has tie-ups with hundreds of employers and has an almost 100% placement record. It has recently been promoting short diploma programmes through tie-ups with companies, and expects to ramp up this aspect of its business
- **Locations.** Most students are at its five main campuses, in Mumbai, Delhi, Bangalore, Chennai and Hyderabad.
- **Fees.** Fees for a two-year diploma average ₹400,000. Around 1,800 students are enrolled across all WLCI's campuses. At the end of a two-year programme, students obtain a diploma. Most of the material taught is proprietary and created with inputs from employers.

Annexures

Annexure I – PE/ VC deals in the education sector

Date	Company	Segment	Amount ($m)	Investors
Aug-05	Educomp Solutions	Education Solutions	1	Gaja Capital
Jul-06	Manipal Universal Learning	Distance Learning	70	IDFC PE, Capital International
Aug-06	Everonn Education	Education Services	3	Vertex
Nov-06	UEI Global	Education (Hospitality)	0.88	Berggruen Holdings
Jan-07	Career Point Infosystems	Test Prep(Engineering Entrance Coaching)	1.13	Volrado Ventures
Mar-07	The Millennium School	K-12 Schools		Gaja Capital
Jun-07	WLC India	Management Education		Zephyr Peacock
Sep-07	Veta	Vocational (English Language Training)	7	SAIF
Oct-07	Career Launcher India	Test Preparation	8	Gaja Capital
Oct-07	ICA Infotech	Vocational Training		SAIF
Nov-07	iDiscoveri	Education Content	3.96	Richard Chandler Corp
Nov-07	Mahesh Tutorials	Private Tutorials	8	Helix Investments
Nov-07	Thinklabs	Training (Non-IT)	0.36	Seedfund
Jan-08	TIME	Test Preparation		Tiger Global
Mar-08	Educational Initiatives	Assessment Services	1.85	IFMR Trust, Footprint Ventures, Novak Biddle, Others
Mar-08	Indus World School	K-12 Schools	3.34	Gaja Capital
Apr-08	HMSC Learning	Services to K-12 Schools		EMPGI
May-08	Everonn Education	Education Services	10.93	New Vernon, Others
Jun-08	EnglishBook	Vocational (English Language Training)		Genesis Venture Fund
Aug-08	IIJT	Vocational Education	6.25	Tiger Global
Aug-08	Rasmussen & Simonsen International	Training (Logistics)		Tuscan Ventures
Aug-08	Tree House Education	Pre-schools	12.15	Matrix Partners India
Nov-08	UEI Global	Education (Hospitality)	4.85	Berggruen Holdings
Dec-08	Prolific Systems and Technologies	Vocational Training	2	Al Tanmiya Holdings
Jan-09	Global Talent Track	Vocational Training	6.5	Intel Capital, Helion Ventures
Jul-09	Career Point Infosystems	Test Prep(Engineering Entrance Coaching)	10	Franklin Templeton PE
Jul-09	FIITJEE	Test Prep	22.22	Matrix Partners India
Jul-09	ITM Group	Tertiary & Executive Education	23.5	Navis Capital
Sep-09	IMS Learning Resources	Test Preparation	5	Milestone Religare
Oct-09	UEI Global	Education (Hospitality)	5.12	Berggruen Holdings
Nov-09	TeamLease Services	Vocational Training	11.11	Gaja Capital
Dec-09	SV Edusports	Sports Curriculum	1	Seedfund
Jan-10	IL&FS Education and Technology Services	Education Services	37	India Equity Partners
Jan-10	UEI Global	Education (Hospitality)	1.05	Berggruen Holdings
Feb-10	Manipal Universal Learning	Distance Learning	43	PremjiInvest
Mar-10	Pathways World School	K-12 Schools	26.35	Reliance Equity
Mar-10	Resonance Eduventures	Test Prep	13	Milestone Religare
Apr-10	Ideacount Education	Higher Education and Vocational	6	India Alternatives
Apr-10	People Combine Avenues	K-12 Schools	4	ICICI Venture
May-10	Aspire Human Capital Management	Vocational (English Language Training)	1.8	Foundation Capital, Others
May-10	K-12 Techno Services	Services to K-12 Schools	15	Sequoia Capital India, Song Investment
May-10	Tree House Education	Pre-schools	8.5	Matrix Partners India, Foundation Capital
Jun-10	Centum Learning	Higher Education	8.65	Mayfield
Jun-10	Everonn Education	Education Services	2.5	New Vernon
Jul-10	Thinklabs	Training (Non-IT)	0.22	Seedfund
Jul-10	UEI Global	Education (Hospitality)	3.65	JM Financial
Aug-10	Orion Edutech	Vocational (Call Centers)	4	Ventureast-APIDC VC
Sep-10	iDiscoveri	Education Content	10	Lighthouse
Oct-10	Thinklabs	Training (Non-IT)	0.67	Seedfund
Nov-10	Ace Creative Learning	Test Preparation	2.22	Accel India, Catamaran Ventures
Nov-10	Your Kids R Our Kids	Day Care Center	2.2	India Venture Partners
Dec-10	Manipal Universal Learning	Distance Learning	44	Catamaran Ventures
Dec-10	SV Edusports	Sports Curriculum	0.22	Seedfund

Source: Venture Inteligence

(continued)

Annexure I – PE/ VC deals in the education sector in India since 2005 (concluded)

Date	Company	Segment	Amount ($m)	Investors
Jan-11	FIITJEE	Test Prep	20	QInvest
Jan-11	Indus World School	K-12 Schools	1.5	Gaja Capital, Others
Feb-11	Beacon Learning	Service Provider to Higher Education Inst.	9.33	Educomp Investment
Feb-11	MindShaper Technologies	Content Services (K-12)	15	Fidelity
Feb-11	Undisclosed	Distance Education		Kaizen PE
Feb-11	Undisclosed	Distance Education		Kaizen PE
Mar-11	K-12 Techno Services	Services to K-12 Schools	5.5	Sequoia Capital India
Apr-11	Maharana Infrastructure and Professional Services	Services to Educational Institutions	11	Matrix Partners India
Apr-11	TeamLease Services	Vocational Training	22	ICICI Venture, Gaja Capital
May-11	Tree House Education	Pre-schools	4	Matrix Partners India, Omidyar Network, Foundation Capital
Jun-11	Shree Eduserve	Vocational (English Language Training)		Rajasthan VC
Aug-11	InOpen Technologies	Education Content	0.5	Ventureast-APIDC VC
Aug-11	Tree House Education	Pre-schools	0.5	Matrix Partners India
Sep-11	Pristine	Test Preparation		Accel India
Oct-11	Vienova Education	K-12 and Tutoring	3.5	Helion Ventures
Oct-11	Resonance Eduventures	Test Preparation	22.0	CLSA Capital

Source: Venture Inteligence

Annexure II – M&As in the education sector

Deal Date	Target Company	Acquirer	Segment	Amount ($mn)	Stake (%)
Jul-06	Playhouse	Luxor Writing Instruments	Preparatory school		60
Nov-07	U21 Global	Manipal Education Group	Online Education		50
Feb-08	Toppers Tutorial	Everonn Systems India	Private Tutorials		
Mar-08	Institute of Computer & Finance Executives	Nexgen Edusolutions	Training (BFSI)	4	
Mar-08	Share Gurukul	Bajaj Capital Group	Training (BFSI)		
Jul-08	A-Plus Education Solutions	Educomp Solutions	Finishing School (Software)	3	76
Aug-08	Scholars Learning Centre	Mahesh Tutorials	Test Preparation		
Sep-08	EuroKids International	Educomp Solutions	Pre-schools	8.5	50
Oct-08	DSK Global Education and Research	D.S Kulkarni Developers	Vocational Education		51
Oct-08	Takshila Management Services	Educomp Solutions	Schools		51
Dec-08	American University of Antigua	Manipal Education Group	University (Medical)	80	
Dec-08	(Princeton Review)	Core Projects and Technologies	Education Services (K-12)	20	100
May-09	Mother s Pride	AEZ Group	Pre-school	100	50
Jun-09	(Educomp Solutions)	Pearson	Diversified	17.5	50
Jul-09	ITM Group	PE Firm(s)	Tertiary & Executive Education	23.5	55
Aug-09	Tandem	Manipal Education Group	Education Services	1.77	100
Oct-09	Trump & Gates	DMC International	Test Preparation	1.2	100
Mar-10	IIJT	TeamLease Services	Vocational	5.31	69
Apr-10	Indian Institute of Financial Management	Frameboxx	Management Education		100
Jun-10	Quest Tutorials	DMC International	Test Preparation		100
Aug-10	Pre School Analytics	Firstobject Technologies	Education Content	5.3	100
Aug-10	Vidya Mandir Classes	Educomp Solutions	Test Preparation	7.4	67
Sep-10	Computer Point Education	Computer Point			100
Sep-10	Indo Education	Shree Om Traders	Higher Education		100
Sep-10	Keenan and Keenan Group	Core Projects and Technologies	Education Consulting		100
Jan-11	Chitales Personalised Learning	Mahesh Tutorials	Test Preparation	0.3	51
Feb-11	Gateforum Educational Services	Educomp Solutions	Test Preparation		
May-11	ITN Mark	Core Projects & Technologies	Recruitment (Teachers & Other Staff for UK Schools)	25	100
May-11	Plansteps	DMC Education	Vocational (Career Counseling)	1	100
Jun-11	Evolv	NIIT	English Language Training		40
Sep-11	Lifelong Finishing Academy	DMC Education	Finishing School	0.2	51
Sep-11	(Prosel Ventures)	EdServ Softsystems	Content Services (Accounting Courses)	7	100
Nov-11	Veta	TIME	Vocational (English Language Training)	12	

Source: Venture Inteligence

Annexure III – Key ongoing legislation on education

Right of Children to Free and Compulsory Education Act (RTE)

One of India's landmark Acts on education is the Right of Children to Free and Compulsory Education Act (RTE), 2009, which came into effect from 1 Apr '10. This Act provides the right to all children between the ages of six and 14 years to have free and compulsory elementary education (Std I to VIII) in a neighbourhood school.

Free education in private schools under RTE

Under the Act, private schools providing elementary education are required to provide free and compulsory elementary education to at least 25% of students from the weaker sections and disadvantaged groups in the neighbourhood. If the school also offers pre-school education, then the reservation would be applicable for such levels as well. The RTE rules prohibit segregation of the reserved category children and also prohibits holding of classes for such children at different places/timings. The schools are to be reimbursed for either the tuition charge or the per-student expenditure in government schools, whichever is lower.

At an estimated ~₹3,600 per year, per student, reimbursement is lower than lost tuition fee.

The RTE specifies that the per student reimbursement would be calculated by dividing the total annual recurring expenditure incurred on elementary education in government schools by the total number of children enrolled. This does not include rental for school buildings. Our ballpark figure for reimbursement amount per year per student works out to ~₹3,600.

Data published by the National Sample Survey Organisation (NSSO) indicates that the reimbursement amount is higher than the average tuition fees paid at private schools in rural areas but falls well short of the average for urban areas. As 60% of private school students are in urban areas, implementation of RTE can have a major impact, particularly as there is scepticism on whether private schools would in fact receive the reimbursement from the government (*Sharma, 2011*). If the 25% reserved quota is filled, the total reimbursement amount by the government can run up to ₹400bn (US$8bn) or 2% of the overall public spend on education. In view of these, questions remain on the practicality of the RTE ACT.

Issues include adjustment problems faced by students from weaker sections and disadvantaged groups admitted to well-known private schools. Moreover, studies indicate that reservation for economically weaker sections in private schools is open to challenge in the court of law (*Vanka, 2009*).

Nevertheless, implementation of the RTE would be revenue and profit decretive for urban private schools, especially those in larger cities levying high tuition fees. Private pre-schools not providing elementary education (standard I to VIII), would not fall under the RTE. In this regard, pure pre-schools should have an advantage over K-12 (kindergarten to Std 12) schools.

Non-compliance to lead to closure of private schools

No new private school would be allowed to be set up/ recognition granted unless they satisfy infrastructure, teacher and teacher qualification norms specified by the Act. Established private schools have a three-year period (i.e. by 31 Mar '13) to comply with the norms. Non-compliance of norms would lead to withdrawal of recognition and closure after the school is given an opportunity to represent its case. If a school continues to operate, it would attract penalty up to Rs.100,000 and Rs.10,000 per day. Interestingly, while public schools also have the obligation to meet similar requirements, there is no specific penal action, nor any threat of withdrawal of recognition for non-compliance by them.

Schools offering courses affiliated/recognised by authorities outside India such as the International Baccalaureate Organization (IBO), will also need to meet the RTE norm for private schools and get recognition from the District Education Officer (DEO) under whose jurisdiction the schools operate. Recognition of a school is separate from its affiliation to a specific board or authority, which determines the academic course structure. The RTE model code specifies that no private school can operate in India without being recognised by the DEO.

The RTE prohibits charging of any capitation fee, contravention of which would attract a penalty up to ten times of the capitation fee charged. The Act also prohibits any child or parent screening for school admission, contravention of which would attract penalty up to Rs.25,000 in the first instance and Rs50,000 for every

subsequent contravention. The Act prohibits teachers from undertaking private tuition or private teaching activities.

Legislation to improve quality and authenticity

Two important bills in this regard are currently under the deliberation of the Parliament. These are:

- The National Accreditation Regulatory Authority for Higher Educational Institutions Bill, 2010, and
- The National Academic Depository Bill, 2011

Accreditation to help better private education providers

Accreditation is the mechanism for a third-party assessment of the quality of an educational institution against specified norms. The process has dual purposes. First, it allows the particular institution to understand the areas in which it needs to improve quality. Second, it allows the prospective students to make informed choices.

Currently accreditation of institutions involved in higher education is voluntary. Only around 20% of the collages and 30% of the universities are accredited. The National Accreditation Regulatory Authority (NARA) for Higher Educational Institutions Bill, 2010, makes accreditation mandatory for all institutions involved in higher education (apart from agriculture, which is a state subject) and all courses offered by them also have to be accredited. All new institutions for higher education or any new course offered by an institution of higher education would need to be accredited before commencement. For already established institutions, such accreditation needs to be obtained within three years (five for institutions imparting medical education). The bill establishes NARA for higher education, which will register and monitor accreditation agencies. These agencies, in turn, would accredit institutions.

There is a widespread view that private higher educational institutions are operating without adequate academic and physical infrastructure. Enactment of this bill would clear such suspicions, if unfounded, and thereby would help the cause of better quality and credible institutions. Moreover, this would provide a definite edge to private education providers who are operating with better expertise, management and finances to consolidate their position.

The accreditation bill allows only government owned bodies to set up accreditation agencies. This, however, raises doubts about whether such agencies would have an innate bias against private educational institutions.

Authentication to deter fly-by-night operators

Fake degrees and manipulation of academic records, including marks and grades, are serious challenges faced by employers and by academic institutions admitting students for higher learning. Currently, there is no institutional arrangement to verity or validate such information. The National Academic Depository Bill, 2011 tries to address this gap.

The bill aims at establishing a national electronic database of academic awards that would allow verification and authentication of all academic records awarded by all recognised academic institutions operating in India. The National Academic Depository would be the apex organisation for this. The bill makes it mandatory for all academic institutions operating in India and issuing degrees, diplomas, certificates or any other academic award to lodge all such details with the depository. Any person is entitled to request the depository to verify any academic award within a specified time.

Accreditation of academic institutions and courses coupled with the authentication mechanism of academic records would benefit capable and serious private institutions and would put pressure on fly-by-night operators in India and also on fictitious education providers from across-the-border. This is likely to provide greater credibility to the private education system in India.

Legislation on dispute resolution

Currently, disputes between educational institutions and other stakeholders are adjudicated by internal dispute redressal mechanisms set up by such institutions. Certain states have tribunals to look into such issues. Otherwise, such issues follow the normal judicial process. The Educational Tribunals Bill, 2010 has been introduced with the aim of adjudicating disputes relating to higher education in a speedy and consistent manner. This would cover

grievances by all stakeholders including institutions, teachers, other employees, students and regulators. There would be a tribunal at the national level and each state would also have state-level tribunals, with specific jurisdiction. The bill bars the jurisdiction of civil courts on any matters that the state or national educational tribunal is empowered to determine. Speedy disposal of disputes is likely to benefit bonafide private educational institutes that are often riddled with petty cases.

Legislation on private education

Public funding remains the predominant form of education financing in most parts of the world including India (*see Fig 8*). There is also scepticism in many countries that for-profit education provides low-quality and high-cost education and often sell their services by suppression of information or by circulating unsubstantiated stories. Despite these, as in many other parts of the world, in India too private *de facto* for-profit institutions are attracting an increasing share of students. The limitations of reputed publicly funded institutions to accommodate the rapidly increasing demand, nimbleness of private institutions in aligning courses with the job market trends and aggressive marketing by private institutions are leading to such changes.

The recent proliferation of private institutions for higher education in India, especially for technical and professional education has raised scepticism about the ability of such institutions to impart quality education.

There is also the view, that the current "not-for-profit" tag for education is deterring the entry of reputed foreign education providers including some of the world's leading universities to the Indian education system. At the same time, it has been felt that the current system attracts various unscrupulous foreign players who often operate in ways detrimental to the interests of Indian students.

In view of these, two legislations on private education are currently under the consideration of the parliament. These include:

- The Prohibition of Unfair Practices in Technical Educational Institutions, Medical Educational Institutions and University Bill, 2010
- The Foreign Educational Institutions (Regulation of Entry and Operations) Bill, 2010

Guarding against malpractices

The Prohibition of Unfair Practices in Technical Educational Institutions, Medical Educational Institutions and University Bill, 2010 seeks to prohibit unfair practices such as demanding capitation fee, admitting students on other than on merit criteria, not issuing receipt for any fee charged, disseminating misleading information and adopting coercive practices to realise payments from students. The bill makes it mandatory for every institution to publish a prospectus at least 60 days prior to admission, containing specified information on academic and financial aspects of the courses.

Implementation of the bill would provide greater transparency about private education and thereby benefit the bonafide institutions and deter malafide ones from following underhand practices. Considerable penalties and imprisonment for contravention of the norms should be a deterrent against private education providers adopting unethical practices.

The real issue, however, is that without any change in monitoring and enforcement, the bill would not play any major role in India's education landscape. For example, demanding and giving capitation fee is banned in India. In reality, however, such practices are widespread. In the current form, the bill does not propose any change in monitoring and enforcement.

Direct entry of foreign institutions

There are estimates that 160,000 Indian students go abroad every year and spend US$4bn. Currently, foreign institutions are allowed to access the Indian market through various routes but each involves a local partner. There are reports that currently 6 foreign universities have approved collaborations, 67 institutes run unapproved technical programmes in foreign collaborations and overall 640 foreign collaborations are in effect in India. Very few foreign institutions involved in such collaborations are globally well-known (*Sanyal, 2010*).

The Foreign Educational Institutions (Regulation of Entry and Operations) Bill, 2010 allows foreign institutions to open a campus in India under permission from the Central government without any partner, but only if they fulfil certain conditions. These conditions include a track record of 20 years in the country of origin, a corpus fund

of Rs.500mn (US$10mn), at least 25% ploughing back of surplus generated in this country into the corpus fund and deployment of the rest of the surplus on Indian ventures and no repatriation of surplus from India. The courses offered by the foreign institutions have to conform to various standards laid down by the relevant Indian authorities and be comparable to that offered at the original foreign campus.

While the bill desires to enhance the scope for entry of reputed foreign educational institutions in India, there are serious doubts whether the same would fructify given the stringent conditions imposed by the bill. The reiteration of the not-for-profit character of education in India in the bill and the consequent ban on repatriation of profit would be serious constraints for such entry.

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[1] *We need to distinguish between GDP (gross domestic product) and spending. The former is the valued added in an activity and the latter is value of output. Value added takes cognizance of only final use, disregards any intermediate use, and thereby avoids double counting. Value of output also includes intermediate use. For example, the value added to value of output ratio for the Indian manufacturing sector is about 22%. That is value of output for the sector is roughly 5 times higher than manufacturing GDP.*

[2] *We clearly acknowledge that international comparison of prices, especially for goods and services that are not widely traded, have serious limitations because it assumes that the underlying products are of similar quality. For example, in this case, it implies that there is no difference between the education imparted by the Harvard University and an average Indian University to a student pursuing a Ph.D. degree in the respective universities. Yet, calculation of quality-adjusted spending on education also takes us to the realm of value judgement.*

[3] *The encompass and definition of private education and private spending on education used by the Central Statistical Organisation, National Sample Survey Organisation and World Bank are different. Also the methodology used by these organisations for data collection and compilation are distinct. As a result, these are considerable differences in numbers published by them.*

[4] *India has the dubious distinction of maintaining an average fiscal deficit of over 5% of GDP since 1980. The combined fiscal deficit of the central and state governments is considerably higher. The Fiscal Responsibility and Budget Management (FRBM) act mandates closing such deficits. While the deficits have widened since the on set of the global financial crisis, government is committed to revert to the path of fiscal consolidation at the earliest.*

[5] *Report based on survey of poor households in Hyderabad, Andhra Pradesh, indicated that instead of sending their children to public schools offering free education and other inducements, poor parents choose to pay fees and send them to private schools (Dixon and Tooley, 2005). Their decision is mainly due to perceptions of large quality difference between public and private education. These households cough up as much as a tenth of monthly income per child to pay for the private education.*

[6] *Prime Minister Dr. Manmohan Singh pointed out, ".almost two-third of our universities and 90 per cent of our colleges are rated as below average on quality parameters", Singh 2007. The draft approach paper to the Twelfth Five Year Plan notes, "There must be a strategic shift from mere expansion to improvement in quality higher education. .State universities and their affiliated colleges that account for more than 90 percent of the enrolment suffer from severe fund constraints and poor governance leading to poor quality" Planning Commission (2011).*

[7] *Private players cater to both capital investment (such as construction, furniture, computers and education aids like laboratory equipments) and current expenditure (such as provision of books and stationeries, uniforms, transport services and canteen services) by public educational institutions.*

[8] *Under the RTE Act, "No school or person shall, while admitting a child..subject the child or his or her parents or guardian to any screening procedure. ..Any school or person, if in contravention of the provisions .subjects a child to screening procedure, shall be punishable with fine which may extend to twenty-five thousand rupees for the first contravention and fifty thousand rupees for each subsequent contraventions". In various forms, prohibition on interview of students for school admission existed even before the enactment of the RTE, although in practice such practices continued. It is doubtful whether the RTE act would make any meaningful difference in this regard.*

[9] *Maharashtra Educational Institutions (Regulation of Collection of Fee) Act, 2011, which has been cleared by both houses of the state legislation and awaiting for the President's nod, aim at regulating fees charged by private schools affiliated to international boards (Anonymous, 2011a).*

[10] *Section 25 of the Companies Act, 1956 specifies conditions under which a company set up for charity or other purposes such as promoting commerce, art, science, religion, or any other useful object could be registered as a company with limited liability, without the addition to its name of the word "Limited" or the words "Private Limited". Such companies, however, are debarred to pay dividend to the members either from profit or from other income that the company might generate.*

[11] *The Planning Commission (2011) notes, "The "not-for-profit" tag in higher education sector should, perhaps, be re-examined in a more pragmatic manner so as to ensure quality without losing focus on expansion and equity."*

Notes

Appendix 1

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The views expressed in this research report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report.

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