Indian Education Sector (IES)

Can this elephant dance?

February 2010

Nikhil Vora

(M) +91 -9821132471
(Dir) +91-22-6622 2567
nikhilvora@idfcsski.com

IDFC SSKI

Born Intelligent…Killed by Education!

- Contrivance from an Albert Einstein Quote

If You Think Education is Expensive…Try Ignorance!

- Derek Bok (President of Harvard University – 1971 till 1990)

Indian Education

Demand > Supply = VALUE

Demand (at any price) > Supply = WEALTH

There is demand...

DEMAND is definitely there...

572m population falls in age group 0-24 years – it's double the US population

230m students enrolled every year – 219m for KG-12, 11m for higher education

Allocation on education in XIth 5-year plan = 6x the Xth plan

246,000 candidates apply for CAT in 2009 – 3x that a decade ago

Rs100,000

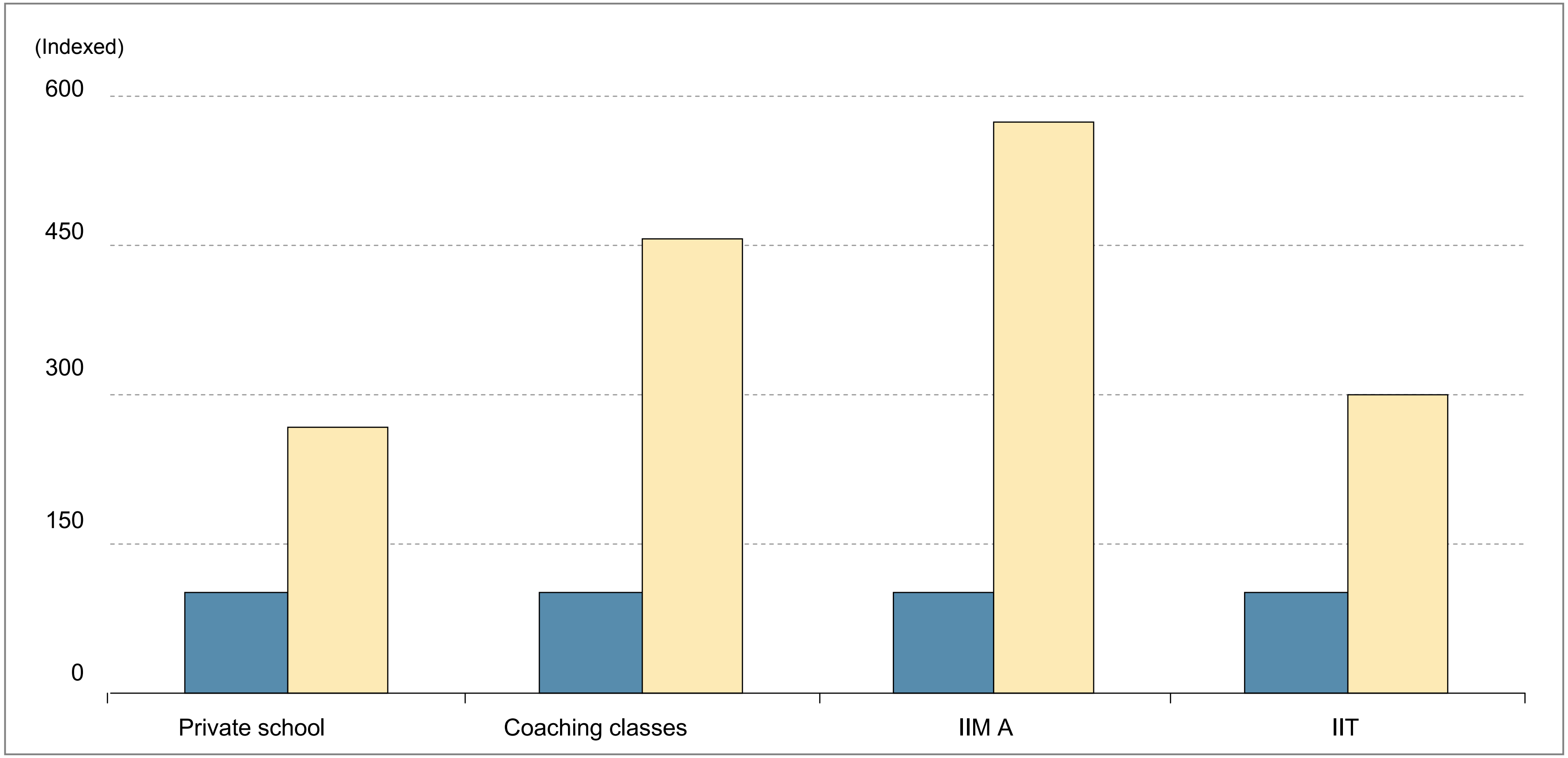
Cost of my entire 15 years of education up to post graduation (1976-1993)

Rs100,000

Fees I pay for my daughter's pre-school & kindergarten

...and there is VALUE...

Price of education has increased by 3-6x over the last decade



Source: Industry

…and then there is PERCEIVED value (fear psychosis)

“Why do people send their kids to coaching classes, after having paid Rs100,000 per year for education in the most premier institutes”

Hunt for nothing but ‘the best’

- 8,000 applications for 300 seats in Bombay Scottish School (a premier school in Mumbai)

There are RETURNS…the highest IRR business (LEGAL) of all times

Education spend - Rs pa	1984-2004	1990-2009
Pre-school	200	8,000
Kindergarten	600	30,000
Primary Education - Std I - IV	1,400	100,000
Secondary Education - Std V - X	3,600	240,000
Graduation - Engineering	172,000	200,000
Post Graduation - MBA	125,000	200,000
Coaching classes	20,000	50,000
Total spending	**322,800**	**828,000**
First Salary p.a.	575,000	1,500,000
Payback	**Less than a year**	**..yet less than a year**

IES: Largest Supply = Worst Supply!

India has 3rd largest education system globally

Network of >1m schools and 18,000 higher education institutes (HEIs)

Spends at 3.7% of GDP

Not even 1% of the US$30bn that govt spends on education is on capex!

40% of students enrolled in private schools - accounting for just 7% of capacity

Perpetual Demand + Inelastic Pricing + Perceived Value + Inefficient Supply

IES – *a US$ 80bn Space*

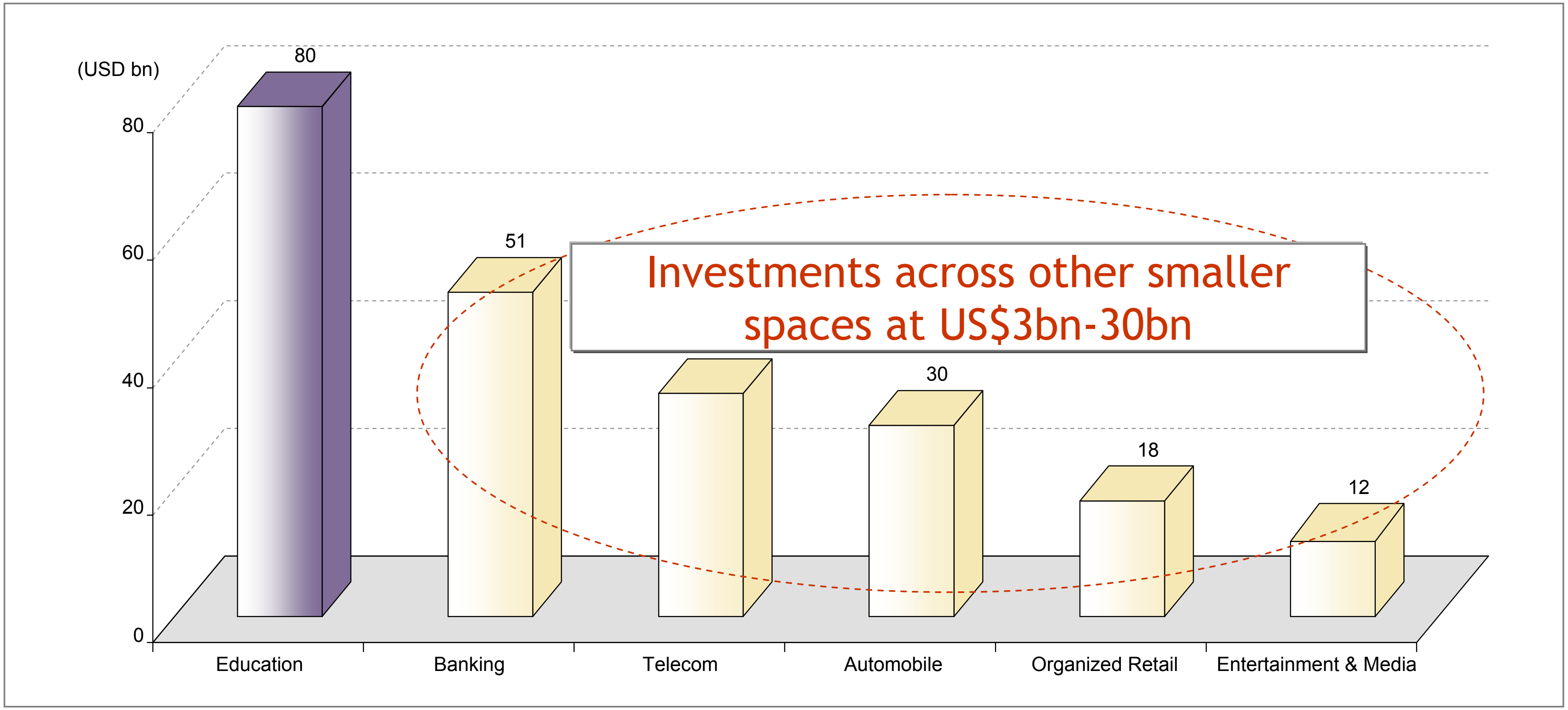
Private IES alone a USD85bn opportunity by 2012E…

($ m)	Revenues (2009)	Revenues (2012E)	CAGR (%)
Formal IES	**45,200**	**65,250**	**13**
K12	22,800	33,779	14
Higher Education*	22,400	31,470	12
Non-formal IES	**11,930**	**19,608**	**18**
Preschool	408	1,026	36
Multimedia -private sch.	112	459	60
ICT in govt. schools	153	752	70
Coaching classes	7,360	11,194	15
Vocational training	1,875	3,662	25
Books	1,925	2,516	10
Total IES	**57,125**	**84,858**	**14**

IES - an interesting class…

IES - The Largest	Inefficiencies - The Highest	Investability Quotient (IQ) - The Lowest
Largest Capitalization • Largest capitalized space in India at over $80bn!	**Insufficient funds** • India spends 5.2% of global spends on education on 20% of world population	**$45bn:'overregulated & under-governed'** • For 80% of the private spends (formal IES), regulations (not-for - profit mandate) a big deterrent • Low political will to bring about the much required structural change
Largest Supply • Third largest education system globally!	**Inefficient supply** • 40% of the student base enrolled in private schools (7% of the network)	
Largest Demand • Largest population within the 0-24 years age group globally!	**Lowest enrollments, highest dropouts** • A mere 37% net enrolled in K-12 • Lowest GER* globally of 9.97 at higher education level	**$12bn: Scores low on scalability** • For remaining 20% (non-formal IES), scalability remains a big issue

...but investments at a mere US$300m!



IES – LOWEST on investments

Private formal education (USD45bn)

– 'regulation' is the Big Bully

Non-formal education (USD12bn)

– 'scalability' an issue

Formal IES – pain points of investing

Overregulated & under-governed	Multiple level structures (no central body); PPPs do not offer returns or autonomy!
Trust issues	Not-for-profit structure; all surpluses to be ploughed back
Political quagmire	High political lineage (75% of HEIs owned by politicians); little 'will' to change the existing structure
Land blues	Hoarding of land reserved for educational institutes for resale; high land prices make economics unviable
FDI clarity	100% FDI allowed; but no incentives or regulations in place

Non-formal IES – scalability an issue

	Current size	Growth	Non - regulated	Scalability	Value creation	Largest player - still small!	Comment
Preschool	✗	✓	✓	✓	✓	KIDZEE (Rs251m)	More organized participation; scalability through franchisee route
Multimedia in private schools	✗	✓	✓	✓	✓	Educomp (Rs6,370m)	Annuity business model
ICT in govt schools	✗	✓	✓	✓	✗	Educomp Rs6,370m)	Low on economic viability
Coaching Classes	✓	✓	✓	✗	✗	FIITJEE LIMITED (Forum For IIT - JEE) Rs1,200m	People driven – model cannot be spammed!
Vocational Training	✗	✓	✓	✗	✗	NIIT Rs11,486m	Highly fragmented
Books	✗	✗	✓	✗	✗	NAVNEET Rs5,152m	Low-growth market (reusability at 70%)

Non-formal IES - Less than 5% of the $12bn segment offers scalability

IDFC SSKI

IES - De novo

We ask a few questions

Is the education system ‘over-regulated and under-governed’?

Can the government achieve the goal of universalization of quality education alone?

Is the current trust structure dysfunctional?

Privatization of education…are we there yet?

PPP – can education be the next ‘power’ play?

Can India become a global hub for education?

What needs to change?

- ✓ Reduce hierarchical multiplicity of governing bodies; morph into a quality controller (such as SEBI or TRAI)
- ✓ Encourage private participation via monetary benefits and autonomy to run institutions
- ✓ Institutionalize the ‘dysfunctional structures’
- ✓ Focus on quality and allow ‘profiteering’. Use private participation to increase R&D and further inclusive growth
- ✓ Define PPP models leading to sustainable IRRs for players; hand over management control
- ✓ Incentivize and institutionalize the process to set up foreign universities beyond just allowing 100% FDI in education on paper

Is IES 'over-regulated and under-governed'?

> There is very little co-ordination among the statutory bodies in respect of degree durations, approval mechanisms, accreditation processes, etc. It sometimes leads to very embarrassing situations in which we find two regulatory agencies at loggerheads and fighting legal cases against each other

- An excerpt from the Yash Pal committee report

Government needs to reduce hierarchical multiplicity of governing bodies; needs to morph into a Quality Controller (such as SEBI or TRAI)

Is the govt capable of universalizing quality education on its own?

The Centre's budgetary allocation is up 6x in the 11th Plan; the GoI spends a whopping $30bn on education (3.5% of GDP, at the global average) AND YET…

…India has one of the lowest GERs (general enrollment ratios) globally!

…40% of the total student base is enrolled in private schools – 7% of total capacity!

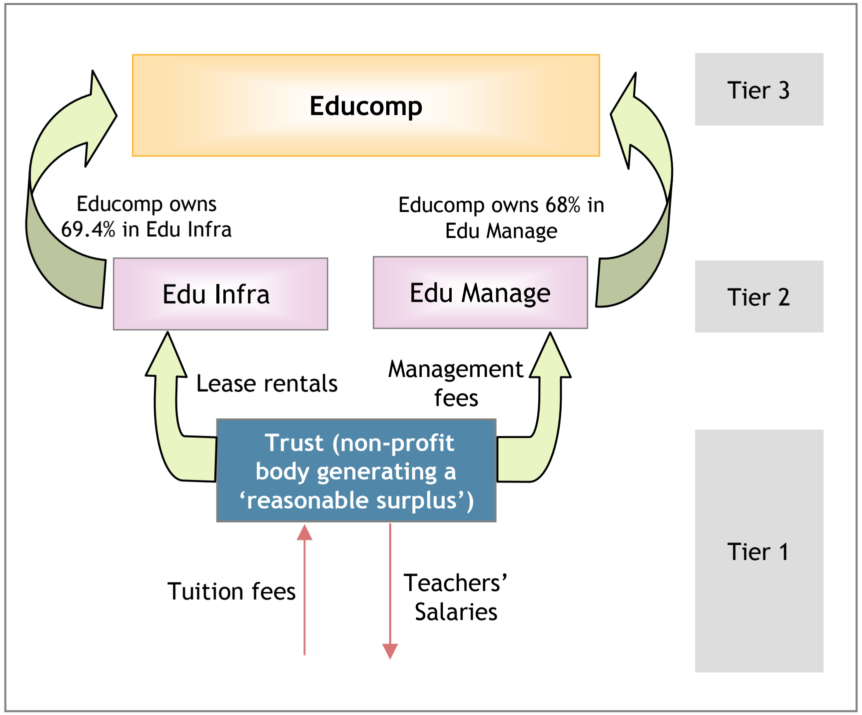
…only 0.85% of the $30bn spend is on capital expenditure! ~80% spent on teacher's salaries…and yet a dearth of quantity and quality wrt teachers

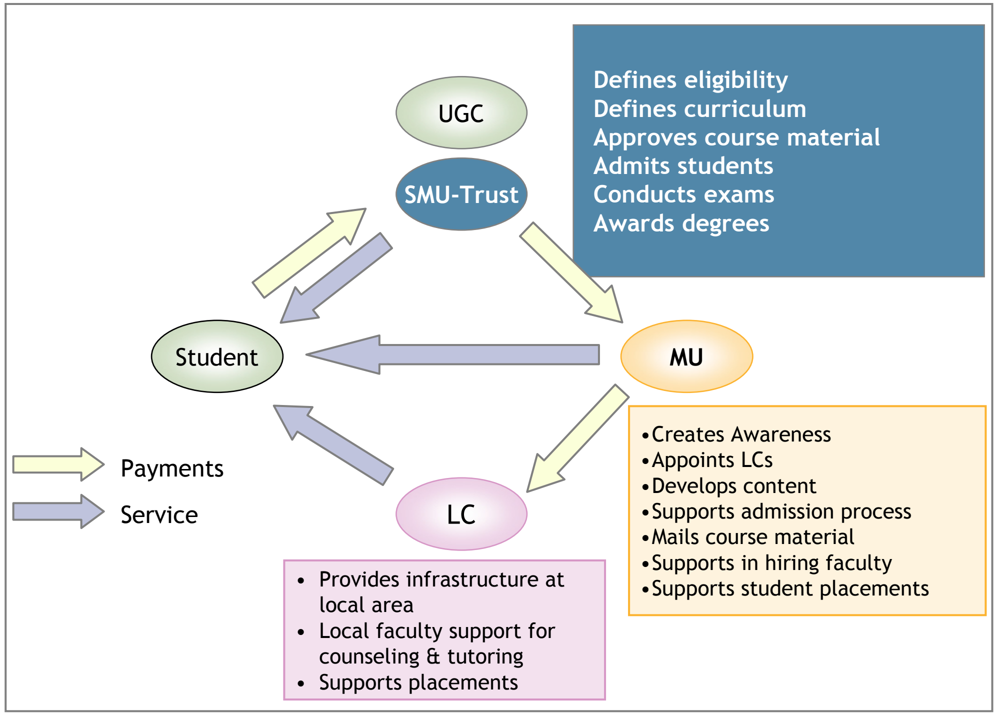
IDFC-SSKI Research

Need to encourage private participation through monetary benefits and autonomy to run institutions

Trust issues: Is the current trust structure dysfunctional?

Convoluted trust structures and black money in the system?





- EduInfra owns the real estate and leases it out to schools
- Edu Manage - provides IP and management services

- MU - Manipal Universal Learning is the corporate entity which provides services to students
- SMU (provider of distance education) runs as a trust

Need to institutionalize these 'age old' structures

Privatization of education…are we there yet?

‘We cannot have companies that are listed on the stock exchange and have educational institutions and pay dividends to shareholders from the fees that parents pay in their institutions. We cannot allow education to be subject to risk factors’

Kapil Sibal, HRD Minister

Focus on quality and allow ‘profiteering’; use private participation to increase R&D and further inclusive growth

PPP – can education be the next 'power' play?

ICT and labs in schools

- Allocated Rs130bn under SSA. Plans to implement ICT in 90,000 schools in the current 5-year plan
- Allocated Rs11.43bn under RMSA to create science and math labs in government schools

Model schools

- Government-PPP initiatives – extending the spectrum from $100m to $1bn…
- 2500 schools out of the 6,000 model schools are declared under PPP (a Rs36bn opportunity; private investment of ~Rs100bn is expected to flow in)

Vocational training

- National Skill Development Corporation allocated Rs10bn in 2009-10 interim budget; plans to raise Rs150bn going forward

Need to define models leading to sustainable IRRs for players; hand over management control to the players

Can India become a global hub for education?

'India spends US$13bn on education annually outside the country!'

- Assocham

'India could, in time, develop into an education hub. Then, the most reputed institutions in the world too would be keen to test the Indian waters…

… Adherence to Indian laws, including on reservation, will be one of the pre-requisite conditions for foreign universities interested in setting-up their campuses'

Kapil Sibal, HRD Minister

Need to incentivize and institutionalize the process to set up foreign universities in India

How should one play IES?

With 80% of IES ($45bn formal IES) stuck within the regulatory diktat and non-scalability of the non-formal space ($12bn), the gargantuan potential is trapped…

Spaces to bet on

	Current size	Growth	Non Regulated	Scalability	Value creation	Comment
Preschool	✗	✓	✓	✓	✓	Euro Kids (50% stake acquired by Educomp) and Kangaroo Kids are the relevant players
K-12	✓	✓	✗	✓	✓	Innovative structures evolving; Educomp Solutions and a host of private players looking to acquire scale
HE	✓	✓	✗	✓	✓	Innovative structures evolving; a long term game; Manipal Universal Learning the only investable player
Multimedia in private schools	✗	✓	✓	✓	✓	Annuity business model; Educomp Solutions has first mover advantage
ICT in govt schools	✗	✓	✓	✓	✗	L1 bidding and a long receivables cycle
Coaching Classes	✓	✓	✓	✗	✗	80% of the market difficult to scale!
Vocational Training	✗	✓	✓	✗	✗	NIIT the only scaled-up model
Books	✗	✗	✓	✗	✗	Low-growth market (reusability at 70%)

What do we look for in players?

Creativity
Innovative structure (to 'manage' an over-regulated environment)

Capital
Build to last

IQ

Credibility
Management intent & ability

Content
Differentiate & build annuity

4Cs differentiate the 'men' from boys

IDFC SSKI

IES report card: Players to bet on

Company	Creativity	Content	Capital	Creditability	IQ
Educomp Solutions	●	●	●	●	●
NIIT	◔	◔	●	◕	◔
Everonn Systems	◑	◑	◑	◑	◑
Manipal Education	●	◕	●	●	●

Comparative valuations

Company	Price	Mkt Cap	Reco	EPS CAGR (FY09-10E)	FY11E		Target	Upside
	(Rs)	(Rs bn)		(%)	PER (x)	EV/EBITDA (x)	(Rs)	(%)
Educomp Solutions	709	67	Neutral	62.9	18.8	11.8	755	6.5
Everonn Education	398	6.0	Outperformer	50.1	10.5	5.1	600	50.8
NIIT	68	11.2	Neutral	17.3	12.0	7.3	75	10.3

** nos include share of associate*

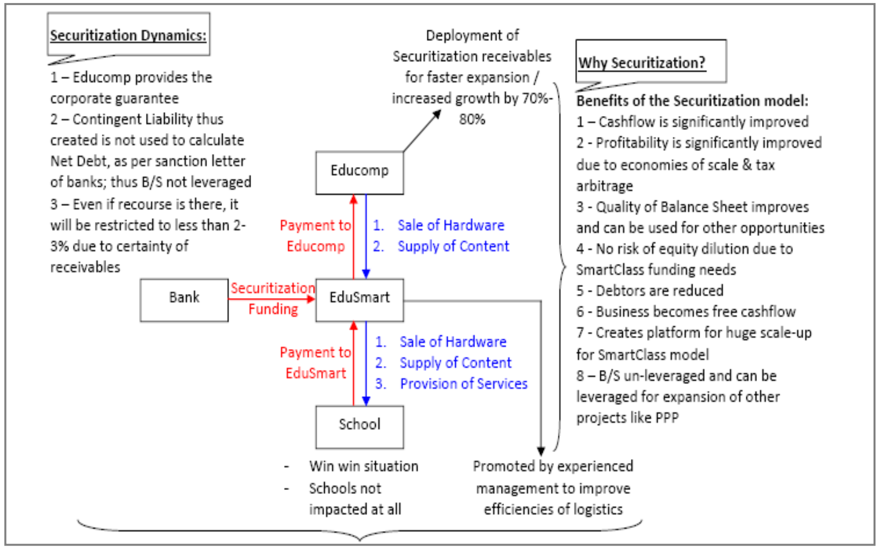
With few 'relevant' players above the $20m mark, Educomp Solutions and Manipal Universal Learning are the two scaled-up and annuity businesses that have high IQ!

Educomp Solutions (Neutral)

Price - Rs709
Mkt cap - Rs67bn

- ✓ Smart Class (50% of revenues; 70% of EBIT)- Trump Card
  - Implemented in 2,574 schools till date - order book size at ~Rs10bn (market share >45%).
  - Management plans to touch 25,000 schools over the next 6-7 years - add 2,500 schools in FY11 and 500 schools in Q4FY10 itself.
  - Average revenue per school to be ~30% lower than earlier expectations
  - New model to ‘free up’ balance sheet for growth – upfront booking of revenues (over 2 years as against over 5 years earlier) through sale of BOOT contracts to 3rd party vendor ‘Edu-Smart’
- ✓ ICT (18% of revenues; 9.3% of EBIT)- low returns
  - Implemented in 14,826 schools till date
  - High debtor days and L1 bidding
- ✓ K12 – Creating a longer-term annuity
  - 36 schools under operations (14 under Eurokids)
  - Target of 150 schools by FY12 (50% owned; 50% dry management)
  - The business expected to be free cash flow negative for the next 4-5 years
- ✓ New business – losses remain a moniterbale
  - Loss of ~Rs350m in FY10
  - Investments to continue - ~Rs500m over the next 12-18 months

Structural changes



Key financials

As on 31 March	FY07	FY08	FY09	FY10E	FY11E
Net Sales	1,101	2,861	6,370	10,740	12,653
Adj. net profit (Rs m)	286	706	1,344	2,641	3,566
Share in issue (mn)	16	17	17.3	94.5	94.5
EPS (Rs)	17.9	40.9	77.7	27.9	37.7
EPS growth (%)	*105.2*	*128.8*	*90.0*	*(64.1)*	*35.0*
PE (x)	198.2	86.6	45.6	25.4	18.8
Price/ BV(x)	49.4	21.2	14.6	5.2	4.1
EV/ EBITDA (x)	112.2	48.7	22.5	12.8	11.8
RoE (%)	27.9	33.9	37.8	31.1	24.4
RoCE (%)	23.2	20.1	21.4	19.7	19.7

**numbers include the impact of securitization and new accounting mechanism)*

Everonn Education (Outperformer)

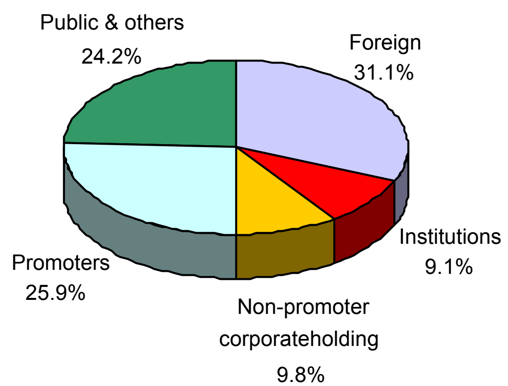
Price - Rs398
Mkt cap - Rs6bn

- ✓ VITELS (52% of revenue; 61% of EBITDA) – Traction in growth; business model moving towards annuity
  - Present in 867 schools and 1,396 colleges
  - Robust additions in schools (stickiness in revenues); introduction of compulsory courses in colleges (short-term optional non-annuity based revenues)
  - Improving mix towards high margin/ annuity creating businesses
- ✓ ICT (33% of revenues; 37% of EBITDA) – low RoCE
  - Presence in 5,862 schools
  - Order book of Rs1.34bn executable in next five years
  - High debtor days, L1 bidding
- ✓ More value…not just vanilla; poor proxy 'education' and Educomp
  - 51% EPS CAGR over FY09-11E
  - RoCE to rise from 18.4% in FY09 to 24.7% in FY11E
  - At 10x FY11E earnings, there is a valuation arbitrage.

Key financials

As on 31 March	FY07	FY08	FY09	FY10E	FY11E
Net sales (Rs m)	430	916	1,436	2,483	3,273
Adj. net profit (Rs m)	41	138	253	402	571
Shares in issue (m)	10	14	15	15	15
Adj. EPS (Rs)	4.0	10.0	16.8	26.6	37.8
% change	-	*152.0*	*68.1*	*58.7*	*42.0*
PE (x)	100.7	40.0	23.8	15.0	10.5
Price/ Book (x)	11.2	5.9	2.8	2.4	1.9
EV/ EBITDA (x)	24.0	16.7	11.2	7.1	5.1
RoE (%)	22.3	21.2	16.4	17.0	20.1
RoCE (%)	25.2	22.3	18.4	21.6	24.7

Shareholding pattern



NIIT (Neutral)

Price - Rs68
Mkt cap - Rs11.2bn

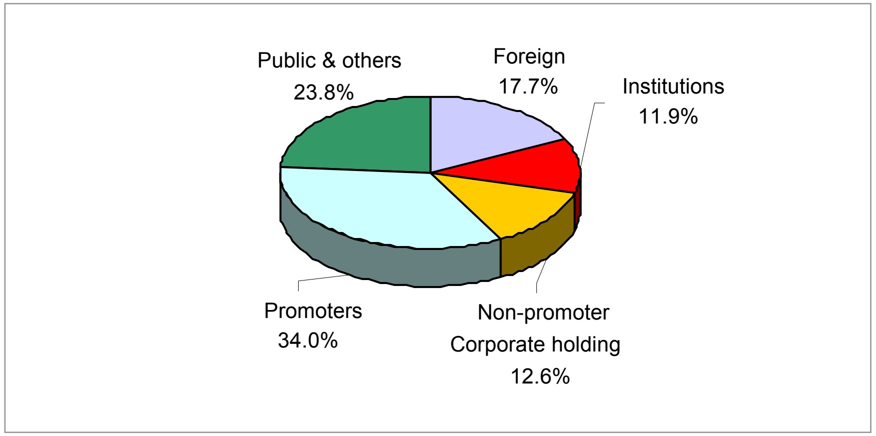
- ✓ ILS – Individual Learning Solutions (35% of revenues; 71% of EBITDA)
  - Recovery in IT - Revenues expected to show 12% CAGR over FY09-11E
  - New Businesses to breakeven in FY11
- ✓ SLS – School Learning Solutions (12% of revenues;17% of EBITDA)
  - Business mix – 70% in ICT (government schools)
  - Inability to cash in on $1.5bn multimedia in private schools market
- ✓ CLS – Corporate Learning Solutions (50% of revenues; 15% of EBITDA)
  - Low on growth
- ✓ Plans to raise capital – Rs2bn through a QIP and convertible warrants worth Rs300m to promoters
- ✓ 'Recovery' priced in the stock price - 17x core EPS (ex associate)

Key financials

As on 31 March	FY07	FY08	FY09	FY10E	FY11E
Net sales (Rs m)	7,951	10,068	11,486	12,223	13,848
Adj. net profit (Rs m)	573	756	673	666	925
Shares in issue (m)	99	165	165	165	165
Adj. EPS (Rs)*	5.8	4.6	4.1	4.0	5.6
% change		(20.9)	(11.2)	(1.0)	38.8
PE (x)	11.7	14.7	16.6	16.8	12.1
Price/ Book (x)	2.1	2.8	2.3	2.3	2.0
EV/ EBITDA (x)	10.9	12.0	11.7	9.6	7.3
RoE (%)	36.4	21.1	15.3	13.8	17.7
RoCE (%)	11.0	8.5	7.5	8.3	11.5

nos include share of associate

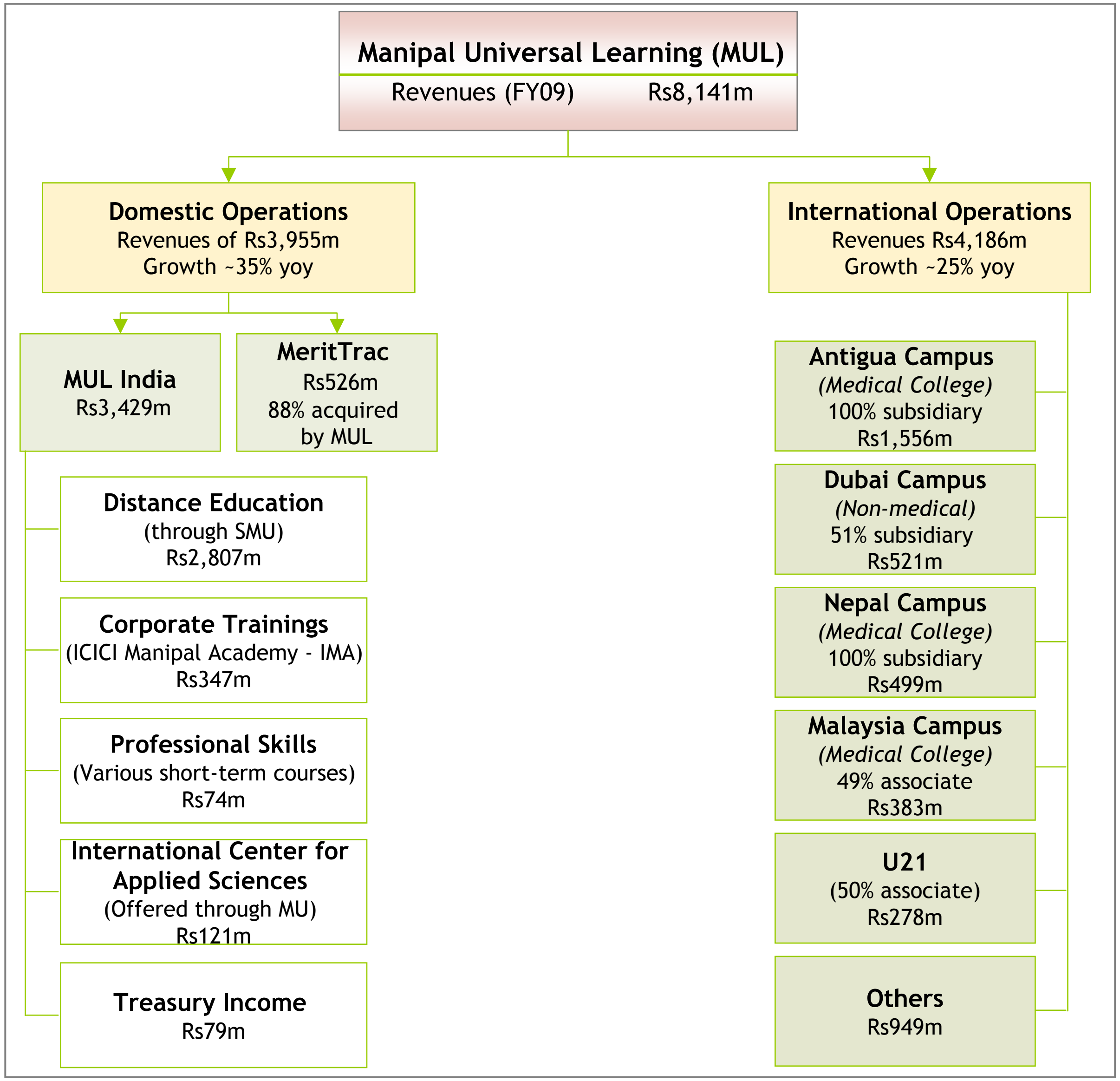
Shareholding pattern



IDFC SSKI

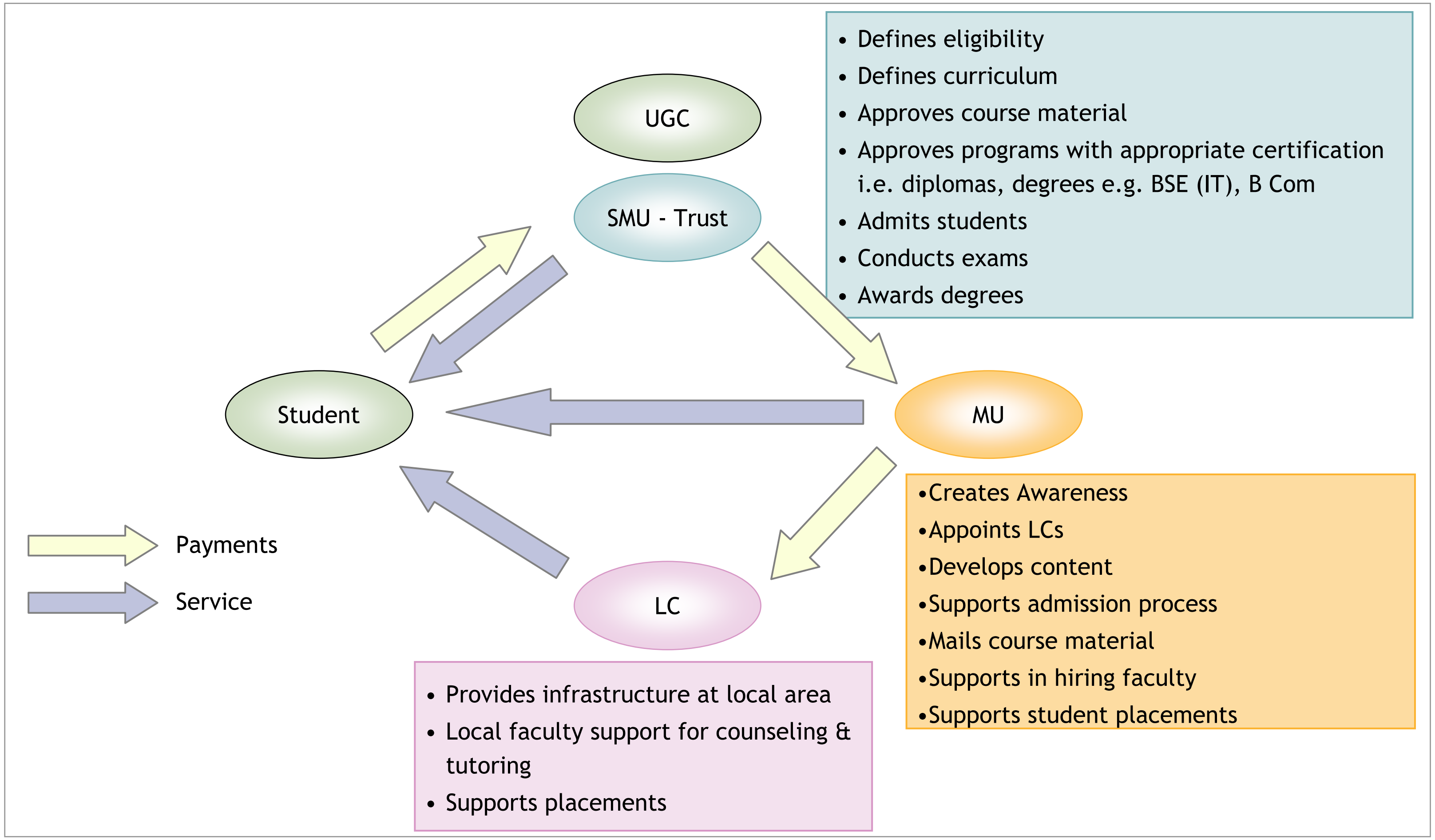
Manipal Universal Learning

- ✓ Manipal Universal Learning (MUL) - corporate entity of the Manipal Education Group (India's largest private player in the higher education space)
- ✓ Gross revenues of ~Rs8bn (54% through international businesses)
- ✓ The only formal education player in India to have received sponsor-funding - $30m from IDFC Private Equity and $40m from Capital
- ✓ Recently acquired 100 acres of land in Jaipur, Rajasthan
- ✓ Reforms required in the education space remains an overhang



Manipal Universal Learning (corporate structure)

Manipal Universal Model



My parents told me, "Finish your dinner. People in China and India are starving."

I tell my daughters, "Finish your homework. People in India and China are starving for your job."

-Thomas L. Friedman

New York Times columnist and Pulitzer prize winner – and writer of "The World is Flat…"

Disclaimer

This document has been prepared by IDFC-SSKI Securities Ltd (IDFC-SSKI). IDFC-SSKI and its subsidiaries and associated companies are full-service, integrated investment banking, investment management and brokerage group. Our research analysts and sales persons provide important input into our investment banking activities.

This document does not constitute an offer or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction.

The information contained herein is from publicly available data or other sources believed to be reliable. While we would endeavor to update the information herein on reasonable basis, IDFC-SSKI, its subsidiaries and associated companies, their directors and employees ("IDFC-SSKI and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent IDFC-SSKI and affiliates from doing so.

We do not represent that information contained herein is accurate or complete and it should not be relied upon as such. This document is prepared for assistance only and is not intended to be and must not alone betaken as the basis for an investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved). The investment discussed or views expressed may not be suitable for all investors.

Affiliates of IDFC-SSKI may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject IDFC-SSKI and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

Reports based on technical analysis centers on studying charts of a stock's price movement and trading volume, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals.

IDFC-SSKI & affiliates may have used the information set forth herein before publication and may have positions in, may from time to time purchase or sell or may be materially interested in any of the securities mentioned or related securities. IDFC-SSKI and affiliates may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall IDFC-SSKI, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind. Any comments or statements made herein are those of the analyst and do not necessarily reflect those of IDFC-SSKI and affiliates.

This Document is subject to changes without prior notice and is intended only for the person or entity to which it is addressed to and may contain confidential and/or privileged material and is not for any type of circulation. Any review, retransmission, or any other use is prohibited.

Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. IDFC-SSKI will not treat recipients as customers by virtue of their receiving this report.

Explanation of Ratings:

1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

Disclosure of interest:

1. IDFC - SSKI and its affiliates may have received compensation from the company covered herein in the past twelve months for Issue Management, Capital Structure, Mergers & Acquisitions, Buyback of shares and Other corporate advisory services.
2. Affiliates of IDFC - SSKI may have mandate from the subject company.
3. IDFC - SSKI and its affiliates may hold paid up capital of the company.
4. IDFC - SSKI and its affiliates, their directors and employees may from time to time have positions in or options in the company and buy or sell the securities of the company(ies) mentioned herein.

Thank you