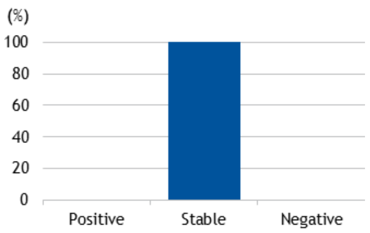
2013 Outlook: Indian Education Sector

Slow Enrolment Growth and Credit Indiscipline

Outlook Report

Rating Outlook
STABLE

Figure 1
Rating Outlooks



Source: India Ratings

Rating Outlook

Stable Outlook: India Ratings has a stable outlook on the Indian education sector which includes both school and higher education (HE). The low ratings of small and less established education institutes already factor in the negative impact of enrolment slowdown, which is mitigated by India's demographic advantage and low literacy rate. The agency expects market size to be INR6,024.10bn (USD109.84bn) by FY15, driven by robust demand.

Liquidity Issues: In 2012, the sector faced liquidity issues due to a fall in enrolment growth and delays in HE students' fee reimbursements by a few state governments. However, lenders have shown flexibility by allowing loan repayments even after the due date with no penalties, protracting the moratorium period or rescheduling loans. In some cases, they have allowed a combination of the above concessions.

However, during the course of rating review, if the debt is restructured or rescheduled, India Ratings would assess it under 'Distressed Debt Exchange' criteria and take appropriate rating action.

Credit Indiscipline: Irrespective of an institutes' size, loan repayments depend on its relationship with lenders. Due to tightly-regulated operations such as restrictions on student intake, fees and infrastructure, an institution's autonomy is restricted, leading to weak finances and credit indiscipline. In India Ratings' opinion, the upcoming regulatory changes could possibly provide autonomy and enhance the credit quality of the issuers.

Capex with Heavy Debt: An entity needs to utilise 85% of its gross income to retain its tax exemption status. Therefore, it plans expansion by taking huge debt as debt obligations, including principal, is permissible for tax deduction. This disproportionate increase in debt against revenues reduces coverage levels and constrains ratings.

Evolving Structures Positive: The 'not-for-profit' stipulations for choice of entity and regulators' restriction on entry of foreign investments have led to formation of new structures. These structures involve institute's associates managing infrastructure and charging fees to plough back profits and collaborating with foreign universities for twinning programmes.

Shortage of Trained Teachers: A sharp increase in the number of education institutes in FY11 and FY12 led to a shortage of skilled and trained teachers. India Ratings predicts an unfavourable picture as most organisations will find it challenging to comply with the prescribed student teacher ratio (STR) in the coming years.

What Could Change the Outlook?

Policy Support, Credit Discipline: The federal government's Twelfth Five Year Plan to propel the gross enrolment rate across levels, establish new entities, liberalising the sector (allow private universities and foreign players) and take other measures including access enhancement, might revive the demand for the sector. These measures, combined with adherence to contractual provisions, would result in a positive outlook.

Analysts

Siva Subramanian
+91 44 4340 1704
siva.subramanian@indiaratings.co.in

Neha Agarwal
+91 11 4356 7255
neha.agarwal@indiaratings.co.in

Bryan Alan Munzey

Issuer Credit Concerns

Individual Players Struggle to Tackle Enrolments Slowdown

- No major credit impairments are expected in 2013.

Some segments in the education sector face enrolment slowdown due to macro-economic factors, lack of industry appeal and employability issues. However, this phenomenon is specific to less established institutes and in streams such as medical, engineering and management courses. Medical colleges attached to their own reputed hospitals draw comfort from their diverse faculty experiences and continue to see moderate to strong enrolment growth.

Management institutes with less or no industry association witness low enrolment and revenues leading to loan defaults or closures. India Ratings does not expect enrolments for these entities to rebound in the short term. However, institutes with low acceptance rates have tackled the enrolment crisis and have remained financially sound. The agency expects its portfolio to not see major credit impairments since the rating case scenario incorporates some of these risks and could provide cushion.

International schools are less in demand than Indian educational boards in the country as they are new entrants in the education system. However, increasing income levels of the urban class are likely to drive the demand for international schools in the medium-to-long-run.

Bankers' Adjustments

Fee ceilings in HE institutes (both for the government and management quota) and schools curb the financial prowess of the entities. Even though the fee reimbursements scheme (applicable only to HE) propelled enrolments and made education affordable to certain educationally disadvantaged sections of the society, delays in reimbursements by a few states tightened the liquidity for education institutes.

Nevertheless, bankers understand these problems (fee reimbursements delays and temporary reduced occupancy levels), extend concessions and accommodate payment of instalments even after due date without any penalty. They also protract the principal moratorium period and reschedule the amortisation schedule in certain cases. This accommodation, to some extent, resolves the liquidity constraints.

Credit Indiscipline

- Relationship with lenders allows flexibility in debt service payments.

Although the tax-free status and stable operating cash flows support the credit quality, it is constrained by indiscipline in loan obligations payment. In India Ratings' view, notwithstanding the size of the institution, adherence to contractual provisions is based on its relationship with lenders. In the agency's opinion, this credit indiscipline might regularise in the medium term.

Debt-Funded Aggressive Expansions

- Thin cash flow coverage available for debt service would lower the rating.

The issuers' initial success and the tax exempt status for debt service payments drive them to engage in forward/backward integration or diverse expansion with high debt loads. The bankers' eagerness to fund capital expansion although at a higher interest rate as opposed to year earlier instills confidence in the market players. However, in the event of thin coverage due to less cash flow or less equity infusions, the ratings will remain low.

New Players Encounter Low Margins

Intrinsic quality of strong operating margins lured many private players into the arena. However, players with no expertise could encounter low margins due to a) premature debut without adequate infrastructure leading to low occupancy levels b) dilution in admission standards to fill seats eventually losing student and industry appeal c) high cost acquisition of skilled and trained teacher talents d) high land prices in prime location driving the institution base away from city resulting in high administrative costs e) cost overruns in construction.

Related Criteria

Rating Criteria for Colleges and Universities
School Rating Criteria
Non-Profit Institutions Rating Criteria

Key Sectoral Issues

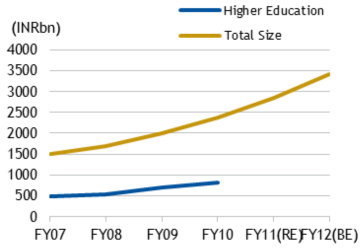
Expanding Market Size

Indian education sector's market size in FY12 is estimated to be INR3,411.8bn (USD71.2bn). India Ratings expects the market size to increase to INR6,024.10bn (USD109.84bn) by FY15 due to the expected strong demand for quality education.

The market grew at a CAGR of 16.5% during FY05-FY12. The HE segment was at 34.04% (USD17.02bn) of the total size in FY10 and grew by a CAGR of 18.13% during FY04-FY10.

Figure 2

Growing Market Size



Source: National Account Statistics, UGC

Inadequate Educational Infrastructure

Although the government's (centre and states) spend on education increased to 3.35% of the GDP in FY12 Budget Estimates (BE) (FY05: 2.62%), the infrastructure, for both school and HE, needs to be upgraded to provide better quality education and absorb new enrolments. The existing institution's (schools and colleges) capacity is not fully utilised and notwithstanding the enhancement of access (99% of rural population has primary school within 1 kilometre as of September 2010), the quality of infrastructure is poor.

Figure 3

Infrastructure and Intake

Particulars	Number of institutions	Students (m)
Kindergarten to Twelfth (K-12) - Government (m)	1.11	
K-12 – Private (m)	0.31	
Total (K-12)	**1.42**	**243.2**
HE (both private and public) (numbers)	33,500	
Universities (both private and public) (numbers)	634	
Total (HE, numbers)	**34,134**	**20.7**

K-12 data is for FY11, HE and universities numbers data - end December 2011
Source: Ministry of Human Resource Development (MHRD), District Information System for Education, India Ratings

Under the model schools scheme, launched in November 2008, it is proposed that the state governments build 3,500 schools and another 2,500 schools under public private partnership (PPP) framework. The government also intends to build additional public school infrastructure through its funding and in PPP model. India Ratings views this as a positive factor, nevertheless the execution delays portend a slip in targets.

Figure 4

IB and Cambridge Schools (Nov 2012)

	Worldwide	India
IB Schools	3,483	99
Cambridge	9,000	300

Source: IB and Cambridge

Private spend on the education increased by a CAGR of 3.23% during FY04-FY11 and stood at INR361.74bn in FY11. However, private sector building schools in rural areas is unlikely in the short-run. This allows the government to diligently invest in Tier 3 cities and rural areas. At end-November 2012, 20 states had permitted formation of 145 private universities.

Quality of Education

- Only 30% of universities and 45% of the colleges are ranked at 'A' level by National Assessment and Accreditation Council (June 2010).
- 332 technical institutes remain unapproved/derecognised by AICTE (end November 2012).

Prolific growth in HE institutes resulted in the challenge of offering quality education and employability to students. Many technical institutes also run courses without approval from the regulator All India Council for Technical Education (AICTE). This is because AICTE does not recognise them due to various reasons including absence of infrastructure and STR. Although the Eleventh Five Year Plan mandated accreditation of all the HE institutes, the National Accreditation Regulatory Authority for HE Institutions awaits the parliament's approval.

Regulatory Challenges

The HE segment is tightly regulated by multiple agencies as opposed to K-12 segment which is regulated mainly by state education boards or the two national boards. State governments' fee ceilings, fee reimbursements and intake restrictions constrain institutions' autonomy. That said, the remarkable growth in the last decade and government's plan to create an apex regulator at arm's length are positive developments.

Although the institutes were formed as 'not-for-profit', they plough back profits through associates. Associate companies provide facilities management and charges management fees, lease rentals and other fees. India Ratings views the structure evolvement as a positive. Although, foreign investment is allowed under automatic route in education, there are regulatory issues. Nevertheless, twinning programs with foreign institutions are recognised by the regulators.

Enrolments – Fire Power for Future Growth

The gross enrolment rate (GER) in HE was at 18.8% in 2011 and the government aims to increase it to 30% by the end of the Twelfth Five Year Plan period (FY17).

- Although primary level enrolments are robust, drop outs and infrastructure bottlenecks mar the secondary and senior secondary segments.
- Government schools lack infrastructure and quality pedagogy.

K-12 – Schemes Enrich Enrolments

Sarva Shiksha Abhiyan (SSA) scheme aims to universalise elementary education. Also, the Right to Education (RTE) empowers Indian citizens to demand eight years of quality education for children. These measures propelled the enrolment levels at primary (GER - FY10: 116.25%, FY01: 95.7%) and upper primary levels (GER - FY10: 81.83%, FY01: 58.6%). Despite high enrolments at primary and upper primary levels, enrolment in secondary level (FY10: 65%) and senior secondary level (FY10: 37%) remained low.

Figure 5
Deficiency in Enrolments (m)

Segments	Eligible student population (2010)	Actual enrolments (2010)	Gap	GER (%)
Primary	116.64	135.60	18.96	116.25
Upper primary	72.59	59.40	-13.19	81.83
Secondary/ senior secondary	98.28	48.20	-50.08	49.04
Total	**287.52**	**243.20**	**-44.32**	**84.59**

Source: CSO, MHRD and India Ratings

- Private institutions catered to 58.9% of the total enrolments in HE (FY12).

HE – Increasing Enrolments Provide Impetus to Segmental Growth

The HE segment sees lower enrolments and growth rates than K-12 levels but consistent growth provides some comfort. Engineering is the most preferred course for enrolment and is likely to grow strongly. Despite upsurge in eligible enrolment rates to 60% (FY08) from 50% (FY94), due to the absence of strong links with school education, HE enrolments remained low.

Dearth of Competent Teachers and Faculty

The Indian education sector needs trained and quality teachers and staff. The historical STR marginally improved in the primary and HE segment during FY01-FY10. India Ratings predicts moderate growth (below 10%) in the HE teachers' strength in FY14 based on the historical CAGR of 7.91% during FY01 to FY11. In the agency's opinion, the sector will be unable to achieve STR proposed by the regulator in the medium term (UGC STR 1:15).

Figure 6
Future STR Achievability Test (HE)

(M)	2011	2016
Students	16.98	25.94[a]
GER (%)	18.8	22[b]
STR	1:21	
Teachers	0.82	
Assumed STR	1:15[c]	1:20
Required teachers	1.13	1.30
Deficit	**0.31**	
Annual additional teachers requirement until 2016		0.10
Achievability		Difficult

[a] Calculated on the basis of projected population of CSO
[b] Assumed rate
[c] As per UGC norms for HE
Source: CSO, MHRD, India Ratings

Demographic Advantage

In India, over 500 million fall in the age group of five to 25 years. This provides immense opportunity for the education sector. India Ratings believes demand for education and improved accessibility to educational institutions will help improve literacy rate.

Education Loans

Easy credit availability is instrumental for increase in HE enrolment. India Ratings expects credit availability for the HE segment to continue and be similar to that for white goods sector. Education loans grew at a CAGR of 26.96% during FY07-FY12 and their contribution to non-food credit increased to 1.17% (FY12) from 0.87% (FY07).