EduIndia by India Education Partners

A private growth debt fund fostering education access and retention in India

I) The Opportunity: K-12 Education in India

Access to quality education in emerging markets is still very low. Gaps in public funding have led to strong demand for private education, and low-cost private schools have been a promising response to this demand. While charging only INR 500 ($7.50) per month,[1] the high-quality low-cost private schools provide the same or better quality of education as government schools, with broader content coverage, for a third of the cost.[2]

Market Snapshot: Low-Cost Private Schools

3.5% CAGR

250 avg pupils/school

25% of schools **but**

40% of students

The Problem

20% of low-fee schools are high-quality, and demand for these schools is 2x to 3x current capacity. However, schools cannot access credit to expand: [3]

- Limited personal wealth of local philanthropic entrepreneur
- Face uncertain revenue streams as children regularly drop-out due to parent's inability to pay. Dropout rates can be as high as 15% p.a.[4]
- Under pressure from the government to meet CapEx criteria such as having a playground; otherwise, pay bribes and stay unregistered
- Banks, with a poor understanding of schools, have been hesitant to lend to low-fee private schools

There are non-banking financing companies starting to provide loans to these schools, but Varthana and ISFC charge high interest rates of 20-25%[5] that are out of reach for all but the highest-end schools and only target registered schools, which make up only 50% of the low-cost school population.

II) The Solution: IEP EduIndia Investment Thesis

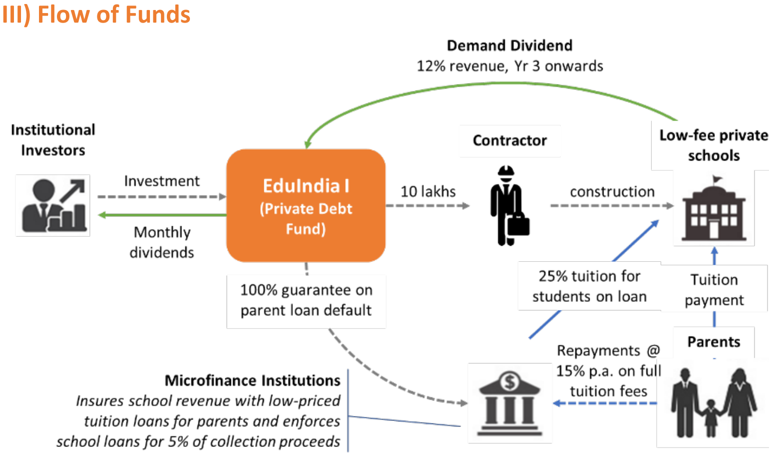
Our private debt fund provides expansion capital via loans for:

- High-quality registered schools of sizes too small for ISFC and Varthana seeking to increase school capacity
- High-quality unregistered schools seeking to improve infrastructure to meet registration requirements

We are able to reach these markets by introducing two innovations:

1. **A monthly demand dividend payback scheme based on percentage of revenue starting at Year 3, which:**
   - Better fits school's operational cashflows post-expansion
   - And acts as a natural inflation hedge
2. **A mandatory revenue insurance scheme via low-cost student tuition loans through our partner MFIs, 100% guaranteed by the fund**

III) Flow of Funds



The Loan: Demand Dividend Structure

In the first two years, EduIndia will fund 90% of construction costs with direct payments to our preferred contractors in 3 disbursements of 10%, 40%, and 50% of the total principal of the agreed loan. Schools will fund the remaining 10%, limiting their ability to service interest payments in the first 2 years. Upon completion of projects in Year 3, schools will increase their student enrollment by 20%, increasing yearly revenue. They will also realize cost savings from scale advantages as well as from exploiting our fund's negotiating position with suppliers. By the terms of the contract, EduIndia collects a portion of the tuition fees per month per student from Year 3 on.

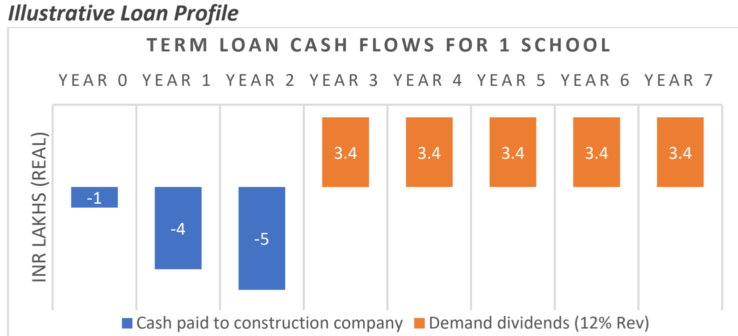
School Investment Criteria

- Enrollment: Min 200 in Grades 1-5 (Average 400)
- Revenue per Year: Min INR 10 lakhs (Average INR 20 lakhs)
- Operating Efficiency: 10% Net Margin
- Operating Life: 2 years
- Student Test Pass Rate Differential over Benchmark: 11%
- Use of Funds: capital expenditure for registration or capacity
- Has space to expand and can benefit from funds
- Is providing quality education according to our assessment

Loan Terms

- Avg loan quantum: 10 lakhs paid direct to construction company
- Disbursements: 10% in Yr 0, 40% end of Yr 1, 50% end of Yr 2
- Loan payback: Yr 3 onwards, monthly payback @ 12% Revenue assuming loan quantum is 50% of pre-loan annual revenue
- Effective rate (p.a.): 12.5% (Real), 17.5% (Nominal)
- Collateral: Expected for >15 lakh loans (Most schools or school founders own land and other property)

Illustrative Loan Profile



Student Loan Partnership with MFIs

We can offer lower rates than ISFC and Varthana by insuring our schools' revenues through partnerships with preferred MFI partners, who provide parents up to 6-month 15% p.a. tuition loans. Existing MFIs charge 24% p.a., but our MFIs can go lower since they are only liable to pay schools 25% of the tuition fees for any on-going loans as per our contract with the schools. This 25% covers the school's marginal cost of hosting the student.

After the loan period, the parents are liable to pay back the MFI in 24 monthly payments of principal and interest based on 100% of tuition fees. When repayments are received, the MFIs pay schools the outstanding 75% tuition and keep the rest. If parents default, EduIndia guarantees these loans by paying the MFI the 25% tuition fees they had originally given the school.

Without this scheme, lumpiness in school enrollment would result in schools receiving nothing for dropped-out students' seats, hence reducing their revenue. This increases the chance of defaulting on payments to us. Also, by keeping the student in class for the term of the loan, the student stays on top of studies, leading to retention and higher long-term revenues for the school.

We expect 10% of students to drop out and MFIs to issue loans for 50% of these students. 50% of students loans will default. Our guarantees on these loans keep interest at 15% p.a., and reflect a 0.8% insurance premium that smooths school revenues and prevents loan defaults, improving IRR by 2.3%.

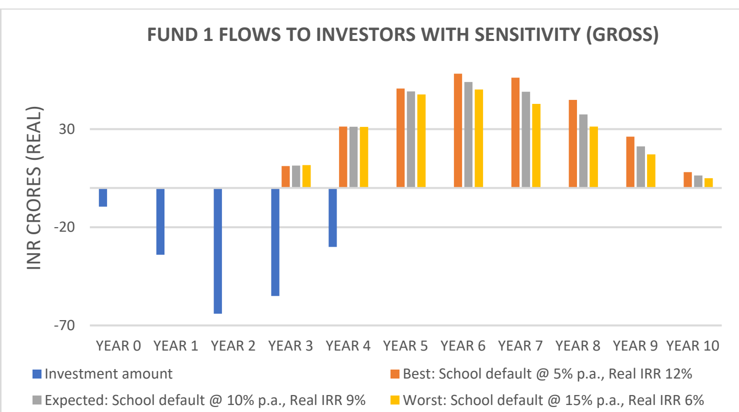
IV) EduIndia Fund I Profile

Asset class	Private Growth Debt Fund
Fund Type	Closed-end
Fund horizon	10 years with callable commitments through year 4
Early Withdrawals	None
Target geography	India: Uttar Pradesh (8,000 schools)
Target Portfolio	1,600 schools by Year 3 (Avg new 50 schools / month)
Fund size	INR 300 Crore (USD 25MM)
Min Investment	INR 3 Crore (USD 500,000)
Target Investors	Impact-Oriented Indian Family Offices, Government Grants, Foreign Philanthropic Foundations
Expected Returns	IRR: 9% (Real), 14% (nominal); mthly payments; gross of fees; in line with Indian LT private debt benchmarks
Fees	2% p.a. mgmt fee, 20% carry above 9% Real IRR
Collateral	80% collateral (by value) expected
Defaults	10% defaults expected, with 50% uncollateralized

V) Financial Returns and Cash Flows

Key assumptions

- Schools Cost Structure: Fixed Cost at 35% Revenue, Marginal Cost of 1 student at 25% Revenue
- School Acquisition Cost: INR 50,000 per selected school
- Due Diligence: 2 full-time staff taking 1 week per school, leading to 50 schools acquired per month with a team of 20



VI) Social and Human Impact

Benefits are threefold:

- More capacity in high quality low-fee private schools, meaning more graduated children
- Fewer drop-outs from schools
- More registered schools that the government can oversee

Impact Metric (IRIS ID)	Outcomes (Fund 1, Yr 10)
New School Registrations	800
Primary Students Affected	0.8 million
School Enrollment: Total (Rate) (PI2389)	+120,000 (+20%)
Student Attendance Rate (PI3786)	+1.5%
Student Dropouts *cumm.* (Rate) (PI9910)	-84,000 (-30%)
Student Transitions *cumm.* (Rate) (PI4924)	+250,000 (+30%)

VII) Risks and Mitigation

Type	Risk	Mitigation
Credit & Reputation	School defaults	Our model is robust at 20% delinquency and 15% school default rates, 3x the default rate of current lenders (ISFC). To enforce collection, we've contracted the collections operations of our MFI partners, who will get 100% of the 5% late payment fee incurred by the schools.
	Integrity of school hard to judge	Direct payments to contractors and extensive due diligence effort built around interviews with locals to validate school balance sheet, fee collection process, teaching practices, and demographics.
Operational	Due diligence costs	Schools apply online. We specialize in and standardize our due diligence process.
	Construction delays	Partnering with construction companies in the region and establishing an outcome-aligned payment scheme (e.g. revenue sharing)
	High dropout rate among students	Sensitivity analysis estimates that our business model is robust at 15% student dropout rates. We'll also diversify regionally and demographically to avoid systemic risk.
	Poor or fraudulent partner performance	Our MFI partners allow us to scale, and so are critical. Yet, collusion with schools is possible, so we plan to work with global partners, multi-source, and coordinate random spot checks during travel for due diligence.
Regulatory	Closing of unregistered schools	Partnering with entities like NISA, who are an association of private schools, and using the mass of schools under our portfolio to lobby against government actions. We will also be more strict about requiring collateral for unregistered schools.
	Public school system improving	Efforts by the government are state-level so we can diversify this risk geographically. Further, plan are public so advance warning is available.

VIII) Scalability

Fund I will serve as a pilot to prove the concept. For the initial fund, we will pursue donor capital, or seek to partner with existing non-banking financial corporations like Varthana or ISFC and serve as their pipeline. This would give us more credibility when approaching institutional investors for subsequent funds. We expect impact investors and family offices in India to be interested in this as they have longer time horizons and vested interests in social benefit.

Fund II can be started in Year 4 and focus on neighboring states Bihar, West Bengal, Odisha, Chhattisgarh and Jharkhand. These states have 12,000 schools that fall within our criteria. Ideal investors for Fund II include Indian family offices, Indian pension funds, and the Indian government.

Fund III onwards will focus on the broader market in India, with a total of 40,000 schools meeting our criteria and the rest of the emerging markets, with 1 Mn low fee private schools, and likely 100,000 meeting our criteria.

Sources

1. Ernst and Young, n.d., Role of Private Sector on K-12 education in India http://www.ey.com/in/en/industries/india-sectors/education/ey-role-of-private-sector-on-k-12-education-in-india
2. The Economist, Low-cost private schools, Learning unleashed, Aug 1 2015
3. The New York Times, Many of India's Poor Turn to Private Schools, Dec 30, 2011
4. DFID, UK, 2011, Preliminary Study into Low Fee Private Schools and Education. https://assets.publishing.service.gov.uk/media/57a08abbe5274a27b200072b/60912-GyanShalaFinalReport.pdf
5. Varthana website, https://www.varthana.com
6. Expert interviews (see credits list below)

Credits to: Neeraj Sharma (India, ISFC), Steve Hardgrave (India, Varthana), Peter Hinton (UK, Capital Plus), Apaar Kaliswal (India, UpSkill), Jyoti Aggarwala (Big Path Capital), Shahid Anwar (India, Principal, low fee private school, UP), Paul Christensen (Clinical Prof. of Finance, Kellogg), Adam Connaker (Rockefeller Foundation), Astha Chaturvedi (India, Chaturvedi Foundation), Padma Matmari (India, School principal), Seema Bansal (India, BCG), Hemant Naik (India, School construction contractor in UP)