

Sensex 25865	Nifty 7851	Price: INR 251.5	Target Price: INR 378	BUY
-----------------	---------------	------------------	-----------------------	-----

**Background:** Tree House Education & Accessories Ltd (THEAL) is India's largest branded self-operated pre-school provider and the only listed self operated pre-school operator in India. It currently operates 720 pre-schools (611 are self operated) in 103 cities. In 2009, THEAL has done a forward integration to provide management services to K-12 schools. THEAL currently provides management services to 24 K-12 schools in 3 states. Geographically, THEAL's pre-schools are skewed towards Western India wherein it operates 56% of its pre-schools. The Pre-schools in other regions are as follows, North (16.5%), South (12.3%) and East (15.1%). THEAL's K-12 presence is restricted to the three western states Rajasthan (11 schools), Maharashtra (11 schools) and Gujarat (2 schools).

52 Week High/Low	INR 548/235
Bloomberg / Reuters	THEAL IN /THEA.BO
Equity (shares in mn)	42.31
Mkt. Cap in mn	INR 10,639/\$ 166
Avg. Daily Vol. ('000)	79.01
Avg. Daily Vol. (mn)	INR 19.9/\$ 0.31

## Higher receivables in pre-school was a negative surprise

- Revenues up 15.1% YoY (-17.1% QoQ) at INR 572.5mn. Pre-school revenue (incl. franchisee) stood at INR 476mn up 6% YoY; K-12 revenue stood at INR 89mn up 115% YoY and Day Care revenue stood at INR 5.1mn up 66% YoY.
- EBITDA stood at INR 301.5mn up 1.5% YoY (-31.8% QoQ); EBITDA margin down 700bps YoY to 52.7%. Margins were impacted due to higher loss making centers. Pre-school margin stood at 43.5% down 12.5pps. In 2QFY16, Matured centers (EBITDA positive) stood at 376 (1QFY16: 360), Loss making centers: 164 (1QFY16: 164) and Centers with no enrollment & loss making: 71 (1QFY16: 65). In the last 12 months company has opened 176 centers.
- Operating expenses up by 320bps YoY to 23.9%, employee cost up 140bps YoY to 13.4% and other expenditure up 240bps YoY to 10.1%. Effective tax rate in 2QFY16 stood at 32%. Adj PAT margin fell by 300bps YoY to 22.3%. Adj. PAT grew 1.2% YoY (-19.7% QoQ) at INR 127.4mn.
- Net addition of preschools during 2QFY16 stood at 73 (Self operated: 71 & Franchisee: 2), of which 35 pre-schools were added in NCR region and company plans to add 50 more pre-schools in NCR in the 2HFY16. Company has planned for a capex of INR 1.1bn in FY16 and INR 1bn in FY17.
- Currently Day Care centers are operated in 250 centers compared to 190 centers in 1QFY16. Company plans to take this to 300 centers by FY16.
- In 2QFY16, SSS of matured centers are in the range of 5% compared to 26.44% in 1QFY16, due to lower enrollment in the second quarter.
- Pre-school receivable days have increased from 15 days at the end of March 2015 to 40 days, franchisee receivables days increased from 58 days to 117 days and K-12 receivable days decreased from 592 to 384 days. Management has indicated that it will take necessary steps to improve the receivable days in the Pre-school business.

Shareholding	Sep 15	Jun 15	Sep 14
Promoters (%)	29.97	29.82	29.75
FII (%)	21.29	21.47	19.42
DII (%)	3.52	3.51	4.10
Others (%)	45.22	45.20	46.73
Pledge (% of promoter holding)	43.23	31.57	22.01

### Valuation Summary (INR bn)

Y/E March	2015	2016E	2017E
Revenue	2.1	2.9	3.8
EBITDA	1.2	1.6	2.2
Adj PAT	0.6	0.6	1.0
Adj EPS	13.6	13.7	23.5
% growth	15.5	0.4	71.7
PE	18.4	18.3	10.7
P/ BV	1.7	1.5	1.3
EV/EBITDA	8.5	7.3	5.8
EV/Sales	4.9	4.0	3.4
Div Yield (%)	0.8	1.1	1.2
ROE (%)	11.7	12.7	13.1
Net Debt/Equity	-0.1	0.1	0.3

Performance %	1M	3M	12M
THEAL	-18.6	-38.2	-43.4
Sensex	-4.6	-7.1	-8.3

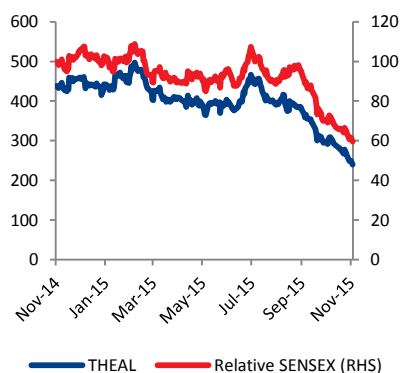
**Valuation:** We have valued THEAL using DCF. In the growth phase (FY16-20) we have modeled a sales growth of ~ 26.8% CAGR and operating cash flow growth of ~34.6% CAGR. In the terminal growth phase we have modeled a perpetual growth of 6.5%. We expect THEAL to turn FCF positive by FY17. We have discounted the future cash flows using WACC of 12.8% to arrive at a target price of INR 378 (Previous target: INR 471) per share, which is 27.6X and 16.1X of FY16 and FY17 EPS of INR 13.7 and INR 23.5 respectively and we rate THEAL as BUY.

**Risks:** Slower ramp up in the preschool will hurt sales growth and profitability; Low entry barriers resulting in higher competition from existing and new players.

### Results Summary 2QFY16

Y/E March ( INR mn)	2QFY16	2QFY15	YoY Growth	1QFY16	QoQ Growth
<b>Revenue</b>	572.5	497.6	15.1%	690.3	-17.1%
<b>EBITDA</b>	301.5	296.9	1.5%	442	-31.8%
<b>Depreciation</b>	100.4	63.4	58.4%	96.5	4.0%
<b>Other Income</b>	31.5	3.4	826.5%	30	5.0%
<b>PBT</b>	187.4	193.3	-3.1%	306.4	-38.8%
<b>Tax</b>	60.0	67.4	-11.0%	126.2	-52.5%
<b>PAT</b>	127.4	125.9	1.2%	180.2	-29.3%
<b>Adjusted PAT*</b>	127.4	125.9	1.2%	158.7	-19.7%
<b>EBITDA Margin (%)</b>	52.7	59.7		64.0	
<b>Tax Incidence (%)</b>	32.0	34.9		41.2	
<b>Adj PAT Margin (%)</b>	22.3	25.3		23.0	

\* Adjusted for forex loss / gain



**Cholamandalam Securities Limited**

Member: BSE,NSE,MSE

Regd. Office: Dare House,2 (Old) # 234) N.S.C Bose Road, Chennai – 600 001.

Website :www.cholawealthdirect.com

Email id – customercarewm@chola.murugappa.com

CIN U65993TN1994PLC028674

Chola Securities is a leading southern India based Stock broker. Our focus area of coverage within the Indian market is Mid and small caps with a focus on companies from southern India.

Our Institutional Equities services are carried out in partnership with RCCR, a boutique Investment research and Corporate Advisory firm founded by a team with extensive experience in the Asset management industry.

RESEARCH			
Sathyanarayanan M	Consumption	+91-44 - 3000 7361	sathyanarayananm@chola.murugappa.com
Mugilan K	Technicals	+91-44 - 3000 7353	mugilank@chola.murugappa.com
Karthikeyan P	Macro & Financial Services	+91-44 - 3000 7344	karthikeyanp@chola.murugappa.com
Arunkumar H S	Auto Ancillary	+91-44 - 3000 7363	arunkumarhs@chola.murugappa.com
Ashish M	Associate - IT	+91-44 - 3000 7360	ashishm@chola.murugappa.com
Sreedevi K	Associate	+91-44 - 3000 7266	sreedevik@chola.murugappa.com
INSTITUTIONAL SALES			
Venkat Chidambaram	Head of FII Business & Corporate Finance*	+91-44 - 24473310	venkatc@chola.murugappa.com
Lakshmanan T S P	Chennai	+91-9840019701	lakshmanantsp@chola.murugappa.com
Kishore K Ganti	Mumbai	+91-22-26597239	kishorekg@chola.murugappa.com
Bhavesh Katariya	Mumbai	+91-9860297739	bhaveshgk@chola.murugappa.com
Sudhanshu Kumar	Institutional Equities*	+91 - 9953175955	sudhanshuk@chola1.murugappa.com
RETAIL SALES			
Nikesh	AHMEDABAD	079 – 30002968 / 69	nikeshds@chola1.murugappa.com
Sathyanarayana N	BANGLORE	080-22211160/61/62/63/64	sathyanarayanaN@chola.murugappa.com
Muthiah A N	CHENNAI - HO	044 – 3000 7371	muthiahn@chola.murugappa.com
Baskaran S	CHENNAI - Nungambakkam	044 – 28240052 / 54	baskarans@chola.murugappa.com
Saravanan	CHENNAI - Adyar	044 - 2452 2111 / 2333	saravananmk@chola.murugappa.com
A Jaganathan	CHENNAI - Ambattur	044-42022155/26251141/42	jaganathana@chola.murugappa.com
V Kumar	COIMBATORE	0422-4292041 / 4204620	kumarv@chola.murugappa.com
Maneesh Gupta	DELHI	011 - 30461161 / 62 / 63	maneeshg@chola.murugappa.com
Sunil Kumar	GURGAON	0124 4054521 / 8860745674	sunilkj@chola1.murugappa.com
Srinivasa Reddy D V	HYDERABAD	040-40126821 / 22	srinivasardv@chola.murugappa.com
SudiptaBhaumik	KOLKATA	033-44103638 / 39	sudiptab@chola.murugappa.com
Riken B Mehta	MUMBAI	022-22617210 / 7203	rikenbm@chola.murugappa.com
Pravin S	MADURAI	0452-2601195 / 96	pravinsn@chola.murugappa.com
SumukhSaurabh	PUNE	020- 30225432 / 34	sumukhs@chola1.murugappa.com
Varadharajan G	SALEM	0427-2313226/4040226	varadharajg@chola.murugappa.com
M N Chandra Sekhar	VIZAG	0891-6642718	chandrasmn@chola.murugappa.com
Balaji H	Compliance Officer	044 - 30007226	balajih@chola.murugappa.com

\*Employees of Business Partner - RCCR

## DISCLAIMER:

This report is for private circulation and for the personal information of the authorized recipient only, and we are not soliciting any action based upon it. This report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It does not provide individually tailor-made investment advice and has been prepared without regard to any specific investment objectives, financial situation, or any particular needs of any of the persons who receive it.

The research analyst who is primarily responsible for this report certifies that: (1) all of the views expressed in this report accurately reflect his or her personal opinions about any and all of the subject securities or issuers; and (2) no part of any of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this report. This report has been prepared on the basis of information that is already available in publicly accessible media or developed through analysis of Cholamandalam Securities Limited makes every effort to use reliable, comprehensive information, but we make no representation that it is accurate or complete.

The views expressed are those of the analyst and the Company may or may not subscribe to all the views expressed therein Cholamandalam Securities Limited reserves the right to make modifications and alterations to this statements as may be required from time to time without any prior approval. Cholamandalam Securities Limited, its affiliates, directors and employees may from time to time, effect or have effect an own account transaction in or deal as agent in or for the securities mentioned in this report. The recipient should take this into account before interpreting the report.

All investors may not find the securities discussed in this report to be suitable. Cholamandalam Securities Limited recommends that investors independently evaluate particular investments and strategies. Investors should seek the advice of a financial advisor with regard to the appropriateness of investing in any securities / investment strategies recommended in this report. The appropriateness of a particular investment or strategy will depend on an investor's individual preference. Past performance is not necessary a guide to future performance. Estimates of future prospects are based on assumptions that may not be realized. Re-publication or redistribution in any form, in whole or in part, is prohibited.

No part of this material may be duplicated in any form and/or redistributed without Cholamandalam Securities Limited prior written consent.

The news items appearing in this are collected from various media sources and we make no representations that it is complete or accurate

