Tree House

Performance Highlights

Y/E March (₹ cr)	1QFY16	4QFY15	% chg (qoq)	1QFY15	% chg (yoy)
Net sales	**69**	**51**	***36.2***	**54**	***28.1***
EBITDA	44	24	*87.4*	33	*32.9*
EBITDA Margin (%)	*64.0*	*46.5*	*(1,748)bp*	*61.7*	*(230)bp*
Adjusted PAT	**20**	**17**	***16.3***	**16**	***24.0***

Source: Company, Angel Research

For 1QFY2016, Tree House Education & Accessories (THEAL)'s top-line and bottom-line have come in in line with our estimates. The top-line growth was strong mainly due to strong addition of 35 new pre-schools. On the bottom-line front, the company has reported healthy numbers due to strong revenue growth and operating performance. However, lower other income and higher taxes restricted profitability.

Top-line grows ~28% yoy: THEAL's top-line rose by ~28% yoy to ~₹69cr which is in line with our estimate. The growth came on the back of strong addition of pre-schools as well as growth in existing pr-schools. During the quarter, the company has launched pre-shcools in new cities like Solapur, Sangli, Akola, Bareilly, Aurangabad, Satara, Amravati, Hoogly, and New Delhi.

Strong operating performance boosts profitability: For the quarter, the company's bottom-line (adj. PAT) came in at ~₹20cr, up ~24% yoy, owing to a strong operating performance (margin expansion of 230bp yoy). However, one-time other expenses, lower other income, and higher taxes restricted the profitability.

Outlook and Valuation: We continue to remain positive on the stock, as we believe THEAL will continue to register robust growth going ahead, with consistent expansion of pre-schools and repayment of debt which would boost earnings. We expect the company to post a revenue CAGR of 24.9% to ₹324cr while EBIDTA is expected to grow at a CAGR of 24.4% to ₹184cr over FY2015-FY2017. The Adj. net profit is expected to grow at a CAGR of 22.7% to ₹92cr over FY2015-17. We recommend an **Accumulate rating on the stock, with a target price of ₹433, valuing the stock at 20x on FY2017E EPS of ₹21.7.**

Key Financials

Y/E March (₹ cr)	FY2013	FY2014E	FY2015	FY2016E	FY2017E
Net Sales	114	158	207	259	324
% chg	*48.0*	*37.9*	*31.6*	*25.0*	*24.9*
Net Profit	33	44	61	72	92
% chg	*53.9*	*31.8*	*38.6*	*18.3*	*27.4*
EBITDA Margin (%)	**54.1**	**56.6**	**57.2**	**56.8**	**56.8**
FDEPS (₹)	9.6	11.8	14.4	17.0	21.7
P/E (x)	50.8	38.6	27.8	23.5	18.5
P/BV (x)	4.9	4.2	2.6	2.4	2.1
RoE (%)	9.7	11.0	9.3	10.1	11.5
RoCE (%)	15.3	16.5	16.3	17.2	18.3
EV/Sales (x)	14.9	11.1	7.8	6.5	5.3
EV/EBITDA (x)	27.5	19.7	13.7	11.4	9.4

Source: Company, Angel Research; Note: CMP as of August 6, 2015

ACCUMULATE

CMP	₹401
Target Price	₹433
Investment Period	12 Months

Stock Info	
Sector	Educational Services
Market Cap (₹ cr)	1,694
Net Debt	(66.8)
Beta	0.8
52 Week High / Low	548 / 346
Avg. Daily Volume	21,975
Face Value (₹)	10
BSE Sensex	28,298
Nifty	8,589
Reuters Code	THEA.BO
Bloomberg Code	THEAL.IN

Shareholding Pattern (%)	
Promoters	29.8
MF / Banks / Indian FIs	3.5
FII / NRIs / OCBs	21.5
Indian Public / Others	45.2

Abs.(%)	3m	1yr	3yr
Sensex	2.9	8.9	62.5
THEAL	0.8	6.6	74.0

3 year daily price chart

Source: Company, Angel Research

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Exhibit 1: 4QFY2015 performance highlights

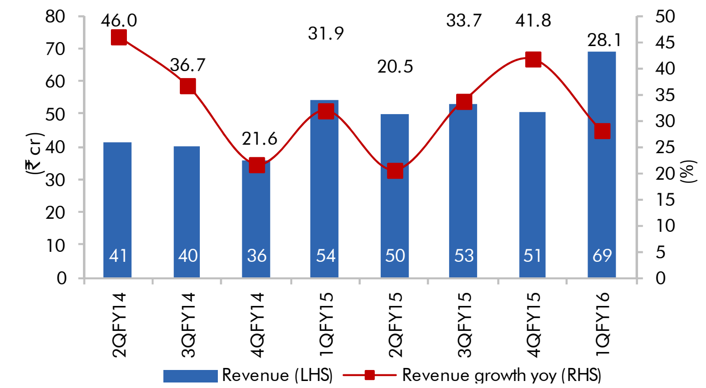
Y/E Dec. (₹ cr)	1QFY16	4QFY15	% chg (qoq)	1QFY15	% chg (yoy)	FY2015	FY2014	% chg
Total operating income	69	51	*36.2*	54	*28.1*	226	176	*28.4*
Operating cost	14	14	*1.0*	12	*12.5*	47	40	*19.1*
(% of Sales)	*19.8*	*26.7*		*22.5*	*(274)*	*20.9*	*22.5*	
Employee cost	6	7	*(3.2)*	5	*26.6*	24	18	*33.8*
(% of Sales)	*9.2*	*13.0*		*9.3*		*10.5*	*10.1*	
Other Expenses	5	7	*(31.3)*	3	*38.8*	16	12	*28.1*
(% of Sales)	*6.9*	*13.8*		*6.4*		*6.9*	*6.9*	
Total expenditure	25	27	*(8.3)*	21	*20.4*	86	69	*24.4*
Operating profit	44	24	*87.4*	33	*32.9*	139	106	*31.1*
OPM (%)	*64.0*	*46.5*	*(1,748)bp*	*61.7*	*(230)bp*	*61.8*	*60.5*	*63bp*
Interest	4	3	*7.0*	3	*15.3*	16	8	*88.0*
Depreciation	10	8	*23.1*	6	*61.1*	29	19	*54.5*
Other income	3	6	*(51.4)*	0	*1,900.0*	4	1	*169.4*
PBT	34	18	*83.3*	24	*39.7*	99	81	*22.5*
Extr. Income/(Expense)	(3)	0		0		(3)	0	
PBT (incl. Extr. Items)	31	18		24		96	81	
(% of Sales)	*44.4*	*36.4*		*45.0*		*42.5*	*46.1*	
Tax	12.6	1.4	*834.8*	8	*54.3*	34	26	*29.9*
(% of PBT)	*41.2*	*7.3*		*33.8*		*35.5*	*32.4*	
Reported PAT	18	17	*5.3*	16	*12.3*	62	55	*13.0*
Adjusted PAT	20	17	*16.3*	16	*24.0*	65	55	*18.9*
PATM (%)	*28.8*	*33.8*		*29.8*		*28.8*	*31.2*	

Source: Company, Angel Research

Strong top–line growth led by addition of pre-schools

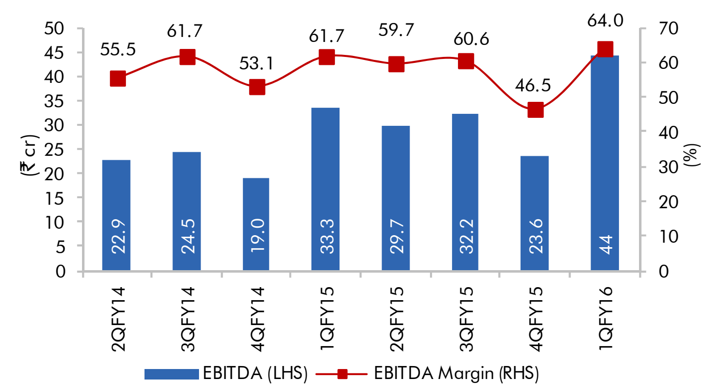
The top-line for the quarter rose by ~28% yoy to ~₹69cr, which is in line with our estimate. The growth came on the back of strong addition of pre-schools as well as growth in existing pr-schools. During the quarter, the company launched pre-schools in new cities like Solapur, Sangli, Akola, Bareilly, Aurangabad, Satara, Amravati, Hoogly, and New Delhi. During the quarter, the company added 35 pre-schools.

Exhibit 2: Steady expansion aids growth momentum



Source: Company, Angel Research

Exhibit 3: EBIDTA and EBIDTA margin tend



Source: Company, Angel Research

Operating margin expands by 230bp yoy

The company reported an operating profit of ~₹44cr in 1QFY2016, up ~33% yoy. The operating margin expanded by 230bp yoy, owing to operating costs as a percentage of sales declining by 275bp yoy and employee costs as a percentage of sales declining by 10bp yoy.

Strong operating performance boosts profitability

For the quarter, the company's bottom-line (adj. PAT) came in at ~₹20cr, up ~24% yoy (reported PAT at ~₹18cr), owing to strong operating performance. However, one time other expenses (₹3.2cr), lower other income (₹3cr as against ₹6cr in 1QFY2015), and higher taxes restricted the profitability.

Profitability for the quarter was weighed down by the one-time expense. If not for the one-time expense, the reported PAT would have come in proportionately higher.

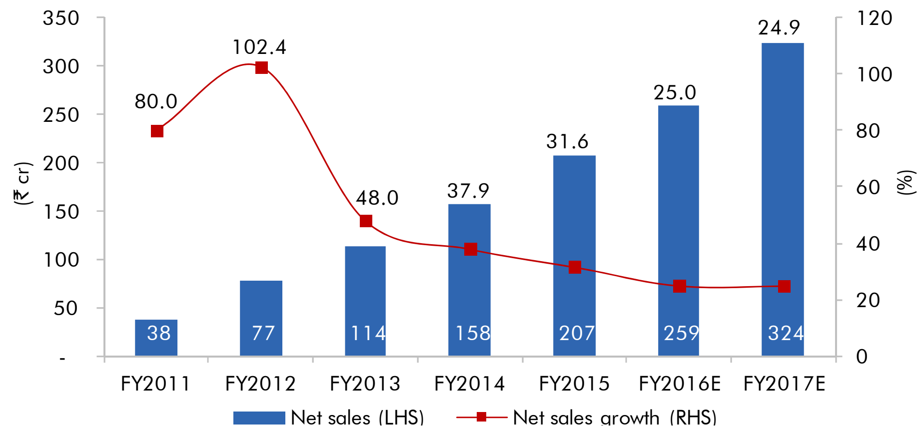
In 1QFY2016, lease rent equalization aggregating to ₹3.2cr was recognized as income in the earlier years. Pursuant to the sale of the immoveable property from which the revenue was derived, the same has been written off.

Investment Arguments

Scalable business model to ensure healthy growth: The company derives its revenue majorly through sale of services which includes Fee income (Pre-schools) and Consultancy income (K-12). The company runs 612 pre-schools, of which 505 are self-operated (as of March 2015) while the rest are operated by franchisees. Further, the company currently owns and operates 5 K-12 schools and provides school management services to 19 other K-12 schools. Further, the company plans to add 150 pre-schools on a yearly basis going ahead with focus on opening branches in tier II and tier III cities coupled with opening pre-schools in the Delhi region during the current financial year. The company intends to have a like-to-like presence in Delhi as in Mumbai. The company intends to incur a capex of ₹100cr each for the next two years to increase its presence. Further, it aims to increase the proportion of self operated schools (SOS) to franchisee based schools from the present 82.5% to 90% in the next few years. As published in the company's presentation, the Indian pre-school market is expected to more than double from ₹80.4 billion in 2014 to ₹164.7 billion by 2018. With strong brand equity and availability of funds to capitalize on the foreseen opportunity, THEAL is in a commanding position to grab a higher share of the same.

Its allied services like day care, teacher training, summer camp and activity classes on dance, music and art will aid revenue growth going ahead. The company's day care service, which is a natural extension to pre-school, has been receiving an encouraging response and presents huge growth potential. The Management plans to introduce such services at other centers as well. It has also tied-up with corporates in order to provide day care services to their employees. We expect the company to post a revenue CAGR of 24.9% over FY2015 to FY2017E to ₹324cr.

Exhibit 4: Net sales growth to be driven by pre-school addition

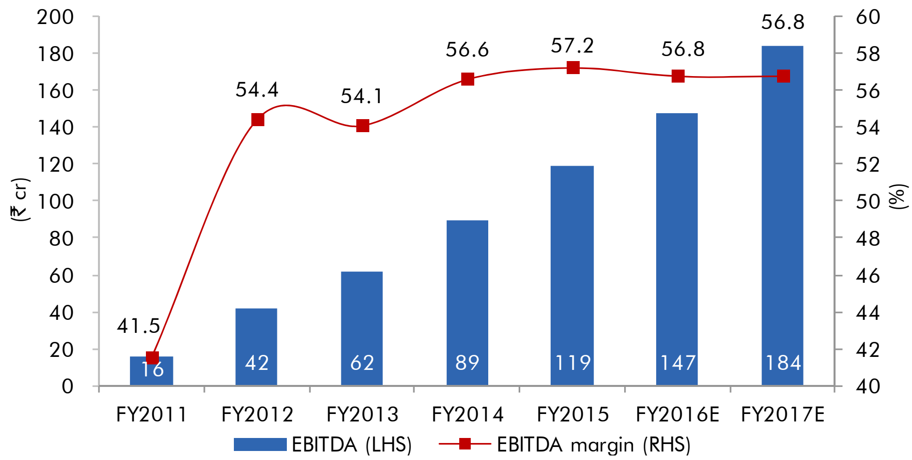


Source: Company, Angel Research

Asset light model to ensure stable EBIDTA margin: THEAL's self-operated pre-schools follow a rental model, where property is taken on lease for 3-5 years as against purchasing it, resulting in lower initial investment. For the K-12 segment as well, the company will have an asset light business model going ahead, as it has started monetizing the land and building premises fully or partly to various Trusts and is focusing on offering only school management services (annuity income) to its K-12 schools.

The allied activities provided by the company are expected to result in higher EBIDTA margins coupled with increase in utilization of available resources, as these services are carried after school hours in the same premises. Further, the opening of new pre-schools in tier II and tier III cities may lead to lower fees per student, but the break-even is expected to be faster as the rentals are lower compared to tier I schools. This will aid stability and also result in expansion of EBIDTA margins in the long run. We expect the EBIDTA to grow at a CAGR of 24.4% over FY2015-17 to ₹184cr. We expect the EBIDTA margin to stabilize at 56.8% in FY2016 and FY2017. The marginal decline in EBIDTA margin would be owing to higher advertisement expense in a bid to establish itself in new markets and gain market share.

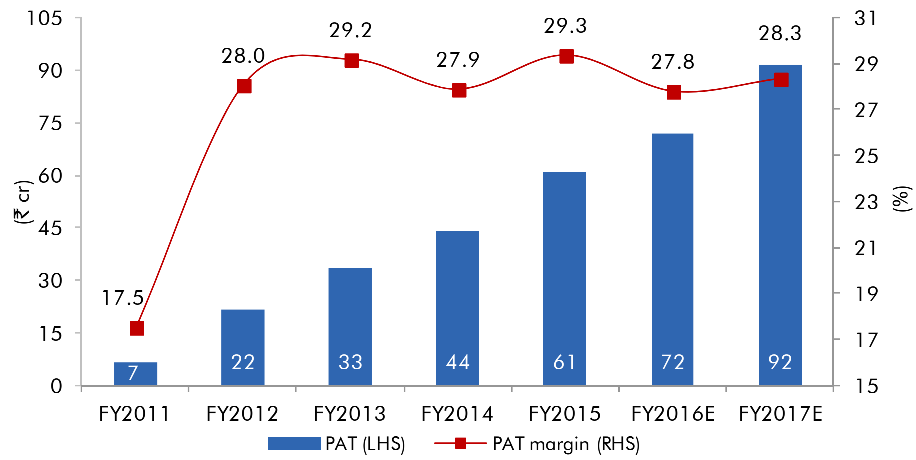
Exhibit 5: EBIDTA margins to be marginally lower



Source: Company, Angel Research

Profitability to improve: During the year, the company successfully raised ₹200cr via a QIP, which was fully subscribed by FIIs. Also, it has started the process of monetizing land and building, part of its K-12 assets, which will bring in cash into the company's book. The company plans to utilize these funds to aggressively expand its network and reduce debt, which will ease the interest cost going ahead. Further, interest cost will be lower going ahead as the company has prioritized on repaying loans that were taken at higher interest rates. Thus, we expect the net profit to grow at a CAGR of 22.7% over FY2015-17E to ₹92cr while margins are expected to be at 28.3% in FY2017.

Exhibit 6: PAT and PAT margins to improve

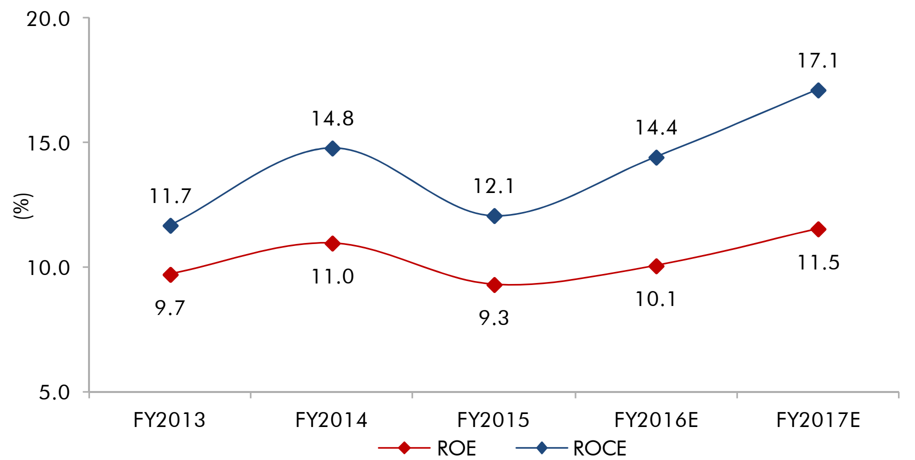


Source: Company, Angel Research

Return ratios to improve going ahead

With the company penetrating further into untapped markets in India, the revenues and profits would continue to grow at a steady pace. Higher profitability will improve the ROE profile of the company. The ROE is expected to improve to 11.5% in FY2017E. Further, with asset monetization plans and better utilization of resources, the ROCE profile will improve going ahead. We expect the ROCE to improve to 17.1% in FY2017E.

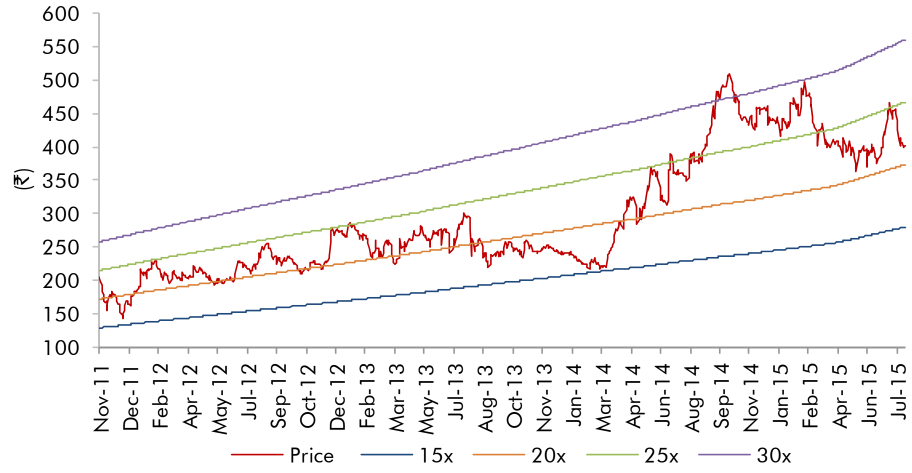
Exhibit 7: Return ratios to improve



Source: Company, Angel Research

Outlook and Valuations: We continue to remain positive on the stock, as we believe THEAL will continue to register robust growth ahead, with consistent expansion of pre-schools and repayment of debt, which would boost earnings. We expect the company to post a revenue CAGR of 24.9% to ₹324cr while EBIDTA is expected to grow at a CAGR of 24.4% to ₹184cr over FY2015-FY2017. The Adj. net profit is expected to grow at a CAGR of 22.7% to ₹92cr over FY2015-17. We recommend an **Accumulate rating on the stock, with a target price of ₹433, valuing the stock at 20x its FY2017E EPS of ₹21.7.**

Exhibit 8: One Year Forward PE



Source: Company, Angel Research

Competition

The education sector in India is largely unorganized and the business of pre-schools is highly fragmented and competitive. In addition to competition from unorganized players in the pre-schools business, THEAL faces a lot of competition from organized players in the market where it competes with various pre-schools like Kidzee, Euro Kids, and Roots to Wings (operated by Educomp Solutions).

Key Risks

Geographical concentration risk: Around 42% of the company's pre-schools are located in and around Mumbai metropolitan. This suggests a geographical concentration risk to the company.

Regulatory risk: Government introduced regulations on pre-schools may impose restrictions on the company.

Company Background

Tree House Education and Accessories Limited (THEAL) runs quality pre-schools and also provides educational services to K-12 schools throughout the country. THEAL has revolutionized the concept of pre-school pedagogy in India through the use of innovative teaching methods and child-focused personal care. The company currently has 647 pre-schools, of which, 540 are self-operated. These are present across 88 cities in India (data as of June 30, 2015). The company also provides school management services to 24 K-12 schools in 3 states in India.

Profit and loss statement (Standalone)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Net Sales	114	158	207	259	324
Other operating income	-	-	-	-	-
Total operating income	114	158	207	259	324
% chg	*48.0*	*37.9*	*31.6*	*25.0*	*24.9*
Other Operating costs	30	40	47	59	74
% chg	*61.7*	*31.2*	*19.1*	*25.0*	*24.9*
Personnel	13	17	24	30	37
% chg	*38.4*	*30.6*	*37.5*	*25.0*	*24.9*
Other	9	11	18	23	29
% chg	*29.9*	*27.4*	*54.6*	*31.6*	*24.9*
Total Expenditure	52	68	89	112	140
EBITDA	62	89	119	147	184
% chg	*47.1*	*44.4*	*33.1*	*24.0*	*24.9*
EBITDA Margin	*54.1*	*56.6*	*57.2*	*56.8*	*56.8*
Depreciation & Amortisation	13	17	27	32	38
EBIT	48	72	92	115	146
% chg	*41.6*	*49.2*	*27.2*	*25.2*	*26.7*
(% of Net Sales)	*42.4*	*45.8*	*44.3*	*44.4*	*45.0*
Interest & other Charges	7	8	15	12	9
Other Income	7	1	7	4	1
(% of Net Sales)	*6.2*	*0.9*	*3.4*	*1.6*	*0.3*
Recurring PBT	42	65	77	103	137
% chg	*50.9*	*54.7*	*18.4*	*34.9*	*32.8*
PBT (reported)	49	66	84	107	138
Tax	16	22	23	35	47
(% of PBT)	*32*	*33*	*27*	*33*	*33*
PAT (reported)	33	44	61	72	92
Extraordinary Expense/(Inc.)	-	-	-	-	-
ADJ. PAT	33	44	61	72	92
% chg	*53.9*	*31.8*	*38.6*	*18.3*	*27.4*
(% of Net Sales)	*29.2*	*27.9*	*29.3*	*27.8*	*28.3*
Basic EPS (₹)	9.7	12.0	14.4	17.0	21.7
Fully Diluted EPS (₹)	9.6	11.8	14.4	17.0	21.7
% chg	*33.4*	*24.0*	*21.5*	*18.3*	*27.4*

Balance Sheet (Standalone)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
SOURCES OF FUNDS					
Equity Share Capital	36	37	42	42	42
Share Premium account	240	266	466	466	466
Profit Loss account	57	95	147	208	287
Reserves & Surplus	**343**	**401**	**655**	**716**	**795**
Share warrants	10	3	0	0	0
Shareholders' Funds	**343**	**401**	**655**	**716**	**795**
Total Loans	67	83	106	81	56
Long term provision	0	0	1	1	1
Other long term liabilities	0	0	0	0	0
Net Deferred tax liability	4	5	0	0	0
Total Liabilities	**415**	**489**	**762**	**798**	**852**
APPLICATION OF FUNDS					
Gross Block	185	293	394	473	567
Less: Acc. Depreciation	30	46	73	105	143
Net Block	**155**	**247**	**321**	**368**	**424**
Capital Work-in-Progress	40	28	26	26	26
Lease adjustment	0	0	0	0	0
Goodwill	0	0	0	0	0
Investments	**10**	**11**	**11**	**11**	**11**
Long term loans & advances	169	187	231	289	356
Current Assets	70	53	215	158	102
Cash	49	11	161	91	17
Loans & Advances	7	7	5	7	8
Other current assets	3	0	0	0	0
Current liabilities	30	38	43	54	68
Net Current Assets	**41**	**15**	**172**	**104**	**34**
Mis. Exp. not written off	-	-	-	-	-
Total Assets	**415**	**489**	**762**	**798**	**852**

Cash Flow statement

Y/E March (₹ cr)	FY2013	FY2014	FY2015E	FY2016E	FY2017E
Profit Before Tax	49	66	84	107	138
Depreciation	13	17	27	32	38
Other Income	(7)	(1)	(7)	(4)	(1)
Change in Working Capital	(1)	(12)	(6)	(3)	(3)
Direct taxes paid	(16)	(22)	(23)	(35)	(47)
Cash Flow from Operations	39	47	74	97	125
(Incr)/ Decr in Fixed Assets	(135)	(115)	(143)	(136)	(162)
(Incr)/Decr In Investments	21	(2)	0	-	-
Other Income	7	1	7	4	1
Cash Flow from Investing	(107)	(115)	(135)	(132)	(161)
Issue of Equity/Preference	59	20	202	-	-
Incr/(Decr) in Debt	16	17	19	(25)	(25)
Dividend Paid (Incl. Tax)	(5)	(7)	(8)	(11)	(13)
Others	(1)	(1)	(1)	-	-
Cash Flow from Financing	69	30	212	(36)	(38)
Incr/(Decr) In Cash	1	(38)	151	(71)	(73)
Opening cash balance	48	49	11	161	91
Closing cash balance	49	11	161	91	17

Key Ratios

Y/E March	FY2013	FY2014	FY2015E	FY2016E	FY2017E
Valuation Ratio (x)					
P/E (on FDEPS)	50.8	38.6	27.8	23.5	18.5
P/CEPS	36.3	27.8	19.3	16.3	13.1
P/BV	4.9	4.2	2.6	2.4	2.1
Dividend yield (%)	0.3	0.4	0.5	0.6	0.7
EV/Net sales	14.9	11.1	7.8	6.5	5.3
EV/EBITDA	27.5	19.7	13.7	11.4	9.4
EV / Total Assets	4.1	3.6	2.1	2.1	2.0
Per Share Data (₹)					
EPS (Basic)	9.7	12.0	14.4	17.0	21.7
EPS (fully diluted)	9.6	11.8	14.4	17.0	21.7
Cash EPS	13.4	16.4	20.7	24.6	30.7
DPS	1.3	1.5	2.0	2.5	3.0
Book Value	98.4	108.1	154.8	169.3	188.0
DuPont Analysis					
EBIT margin	42.4	45.8	44.3	44.4	45.0
Tax retention ratio	0.7	0.7	0.7	0.7	0.7
Asset turnover (x)	0.4	0.4	0.4	0.4	0.4
ROIC (Post-tax)	10.4	11.0	11.9	11.5	12.3
Cost of Debt (Post Tax)	6.8	6.1	10.5	9.7	10.3
Leverage (x)	0.0	0.2	(0.1)	(0.0)	0.0
Operating ROE	10.5	11.7	11.7	11.4	12.3
Returns (%)					
ROCE (Pre-tax)	11.7	14.8	12.1	14.4	17.1
Angel ROIC (Pre-tax)	15.3	16.5	16.3	17.2	18.3
ROE	9.7	11.0	9.3	10.1	11.5
Turnover ratios (x)					
Asset TO (Gross Block)	0.6	0.5	0.5	0.5	0.6
Inventory / Net sales (days)	13	12	10	8	8
Receivables (days)	20	42	63	69	69
Payables (days)	87	78	71	68	69
WC cycle (ex-cash) (days)	(26)	10	19	19	19
Solvency ratios (x)					
Net debt to equity	0.0	0.2	(0.1)	(0.0)	0.0
Net debt to EBITDA	0.1	0.7	(0.6)	(0.1)	0.1
Int. Coverage (EBIT/ Int.)	7.3	9.5	6.0	9.9	17.1

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Disclosure of Interest Statement	**Tree House**
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Based on expected returns over 12 months investment period):	*Buy (> 15%)*	*Accumulate (5% to 15%)*	*Neutral (-5 to 5%)*
		Reduce (-5% to -15%)	*Sell (< -15)*