



# Tree House Education

## FCF positive FY15 onwards

### Revenue marginally behind; EBITDA surprises on the positive

Tree House Education (THEAL IN) reported mixed numbers, with a 4% QoQ drop in top line while the bottom line improved 16%. Revenue at INR 397mn was 5% below our expectation, led by lower consultancy income linked with one-time franchisee revenue. EBITDA margin expanded sharply by 600bp QoQ to 61.7%, driven by lower centre operating cost due to fewer student activities. PAT grew by 15.5%.

### K-12 capex behind its peak; we expect FCF positive from FY15

During 9MFY14, capex was about INR 900mn, out of which ~50% went towards K-12 investment. The company has completed 24 out of 26 schools and is left with about INR 150mn. Further, it plans to thrive on an asset-light model, with the sale of schools worth INR 900mn. By FY15, all K-12 schools will commence and it will also receive back security deposits worth INR 1,200mn, thereby reducing ~40% of asset size. We expect the company to turn FCF-positive by the next fiscal.

### Aggressive growth plans

Tree House has added 110 schools in FY14, out of which it has already added 60% during 9MFY14. It now plans to complete the rest in Q4FY14. It has an ambitious plan to add more than 500 self-owned schools and franchisees over the next three years on a current base of 440 preschools. **We have factored in an addition of 350 preschools less than 70% of the company target.** With 8,000 preschools required in the next five years, the industry offers significant growth potential. Capex of INR 5mn/school also does not require heavy investment.

### Earnings estimate unchanged; valuation looks attractive

We have kept our revenue and PAT estimates largely unchanged. Our DCF-based TP is INR 370 per share, assuming a WACC of 14.5% and a terminal growth rate of 4%, offering 64% potential upside. The stock is valued 6.5x FY16E EV/EBITDA and 3.6x FY16E P/E. Valuation looks attractive, considering good growth opportunity and low earnings risk. We reiterate our **Buy** rating.

## Rating: Buy

Target Price: INR 370

Upside: 64%

CMP: INR 226 (as on 24 February 2014)

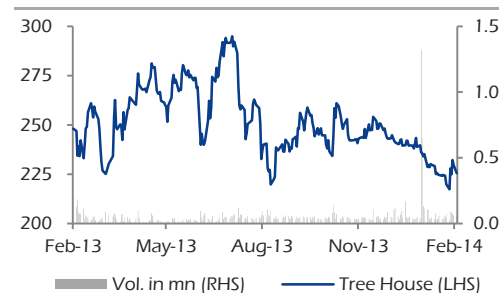
### Key data

Bloomberg /Reuters Code	THEAL IN/THEA.BO
Current /Dil. Shares O/S (mn)	37/37
Mkt Cap (INR bn/USD mn)	8/135
Daily Volume (3M NSE Avg)	52,149
Face Value (INR)	10

1 USD = INR 62

Note: \* as on 24 February 2014; Source: Bloomberg

### Price & Volume



Source: Bloomberg

Shareholding (%)	Q4FY13	Q1FY14	Q2FY14	Q3FY14
Promoter	27.8	27.8	29.3	30.9
Institutional Investors	12.1	12.2	11.8	11.4
Other Investors	49.6	49.5	48.6	48.0
General Public	10.5	10.6	10.3	9.8

Source: BSE

Price performance (%)	3M	6M	12M
Sensex	2.9	12.4	7.7
Tree House	(7.2)	(6.0)	(9.1)
Navneet Education	(3.2)	3.1	(13.0)

Source: Bloomberg

YE March (INR mn)	Q3FY14	Q3FY13	YoY (%)	Q2FY14	QoQ (%)	Q3FY14E	Variance (%)
Net Sales	397	291	36.7	413	(3.8)	419	(5.2)
Operating Expenses	152	128	19.1	184	(17.2)	194	(21.6)
% of Sales	38.3	43.9	(12.8)	44.5	(14.0)	46.2	(17.3)
EBITDA	245	163	50.4	229	7.0	225	8.9
EBITDA Margins (%)	61.7	56.1	5.6	55.5	6.2	53.8	8.0
Depreciation	45	34	30.9	43	4.2	49	(9.4)
Interest	20	22	(10.1)	15	33.3	19	NA
Other Income	0	13		2		2	NA
PBT	181	120	50.7	174	4.2	159	14.1
Tax	60	40	51.5	59	NA	52	15.0
Effective Tax Rate (%)	33.3	33.1	1	34.1	(2.4)	33.0	0.8
Net Income	121	81	50.3	115	5.5	106	13.7
NPM (%)	30.5	27.7	10.0	27.8	9.6	25.4	19.9
EPS (INR)	3.3	2.4	37.5	3.1	6.5	2.8	15.5

Source: Company, Elara Securities Estimate

Key Financials											
YE March	Revenue (INR mn)	YoY (%)	EBITDA (INR mn)	EBITDA margin (%)	Adj PAT (INR mn)	YoY (%)	Fully DEPS (INR)	ROE (%)	ROCE (%)	P/E (x)	EV/EBITDA (x)
FY13	1,143	48.0	618	54.1	333.3	53.9	9.6	11.1	13.5	23.6	14.9
FY14E	1,629	42.5	910	55.9	453.6	36.1	12.0	12.0	16.4	18.8	10.1
FY15E	2,121	30.2	1,193	56.2	592.3	30.6	15.7	13.7	18.6	14.4	7.7
FY16E	2,675	26.1	1,505	56.3	776.8	31.1	20.6	15.9	21.6	11.0	6.1

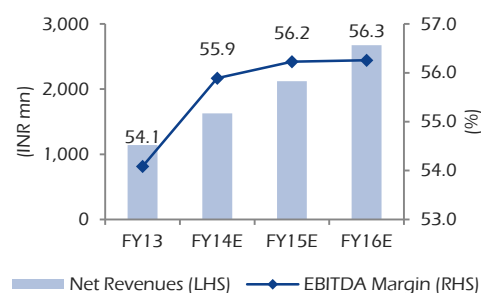
Note: pricing as on 24 February 2014; Source: Company, Elara Securities Estimate

## Financials (YE March)

Income Statement (INR mn)	FY13	FY14E	FY15E	FY16E
Net Revenues	1,143	1,629	2,121	2,675
<b>EBITDA</b>	<b>618</b>	<b>910</b>	<b>1,193</b>	<b>1,505</b>
Less :- Depreciation & Amortization	134	184	263	305
<b>EBIT</b>	<b>484</b>	<b>726</b>	<b>930</b>	<b>1,200</b>
Less:- Interest Expenses	66	75	75	75
Add:- Non operating Income	71	14	14	14
<b>PBT</b>	<b>489</b>	<b>665</b>	<b>869</b>	<b>1,139</b>
Less :- Taxes	155	212	276	362
<b>PAT</b>	<b>333</b>	<b>454</b>	<b>592</b>	<b>777</b>
Balance Sheet (INR mn)	FY13	FY14E	FY15E	FY16E
Share Capital	360	360	360	360
Reserves	3,074	3,739	4,214	4,837
Borrowings	667	667	667	667
Long Term Liabilities and Provision	3	3	3	3
Deferred Tax Liability	44	44	44	44
<b>Total Liabilities</b>	<b>4,148</b>	<b>4,812</b>	<b>5,287</b>	<b>5,911</b>
Gross Block	1,850	3,262	3,968	4,373
Less:- Accumulated Depreciation	300	484	746	1,051
Net Block	1,550	2,779	3,221	3,322
Add:- Capital work in progress	398	0	0	0
Long Term Loans and Advances	1,693	1,690	1,672	1,583
Investments	100	100	100	100
Net Working Capital	407	244	294	905
<b>Total Assets</b>	<b>4,148</b>	<b>4,812</b>	<b>5,287</b>	<b>5,911</b>
Cash Flow Statement (INR mn)	FY13	FY14E	FY15E	FY16E
Cash profit adjusted for non cash items	445	699	916	1,143
Add/Less : Working Capital Changes	(41)	47	37	47
Operating Cash Flow	403	746	954	1,190
Less:- Capex	(786)	(1,015)	(706)	(406)
Free Cash Flow	(383)	(269)	248	784
Financing Cash Flow	643	136	(192)	(228)
Investing Cash Flow	(1,036)	(998)	(675)	(303)
<b>Net change in Cash</b>	<b>10</b>	<b>(116)</b>	<b>87</b>	<b>659</b>
Ratio Analysis	FY13	FY14E	FY15E	FY16E
Income Statement Ratios (%)				
Revenue Growth	48.0	42.5	30.2	26.1
EBITDA Growth	47.2	47.3	31.0	26.2
PAT Growth	53.9	36.1	30.6	31.1
EBITDA Margin	54.1	55.9	56.2	56.3
Net Margin	29.2	27.8	27.9	29.0
Return & Liquidity Ratios				
Net Debt/Equity (x)	0.1	0.1	0.0	(0.1)
ROE (%)	11.1	12.0	13.7	15.9
ROCE (%)	13.5	16.4	18.6	21.6
Per Share data & Valuation Ratios				
Diluted EPS (INR)	9.6	12.0	15.7	20.6
EPS Growth (%)	33.5	25.8	30.6	31.1
DPS (INR)	1.3	2.1	2.8	3.7
P/E (x)	23.6	18.8	14.4	11.0
EV/EBITDA (x)	14.9	10.1	7.7	6.1
EV/Sales (x)	8.0	5.6	4.3	3.4
Price/Book (x)	2.5	2.1	1.9	1.6
Dividend Yield (%)	0.6	0.9	1.2	1.6

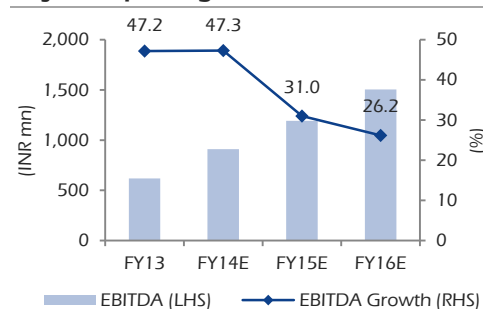
Note: pricing as on 24 February 2014; Source: Company, Elara Securities Estimate

## Revenue & margin growth trend



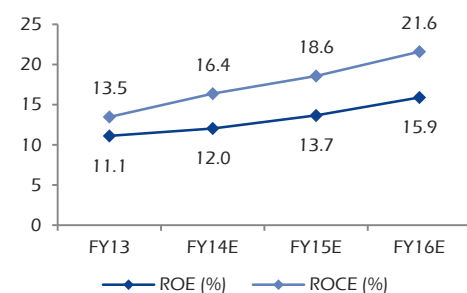
Source: Company, Elara Securities Estimate

## Adjusted profit growth trend



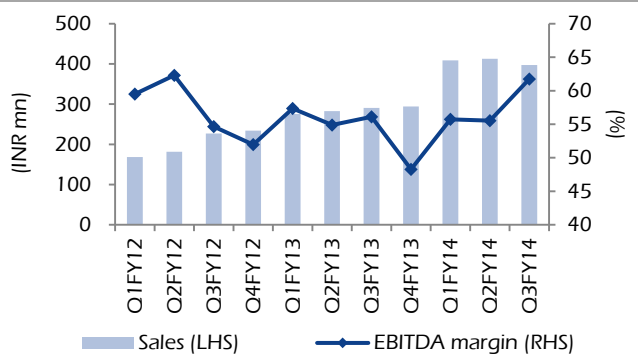
Source: Company, Elara Securities Estimate

## Return ratios



Source: Company, Elara Securities Estimate

**Exhibit 1: Quarterly run-rate stable**



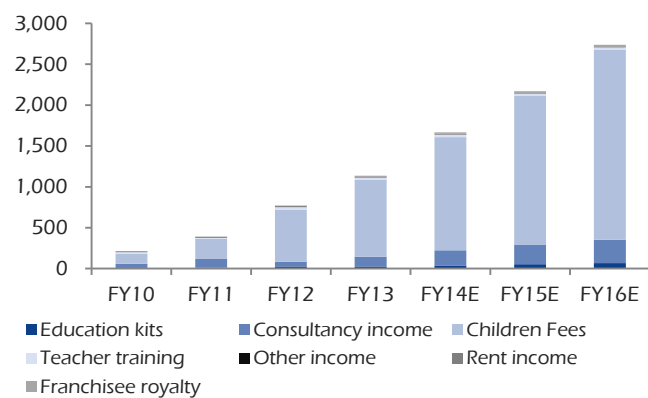
Source: Company, Elara Securities Research

**Exhibit 2: Aggressive growth guidance**

Particulars	2013-14	2014-15	2015-16
<b>Number of centers</b>			
Self-Operated Tier I Opening	80	105	130
Self-Operated Tier II & III Opening	220	280	355
Additions in Tier II, III cities	30	45	45
Additions in Tier I	15	15	15
Global Champs	4	25	50
Under Fitouts (Tier II & III Cities)	30	30	30
Under Fitouts (Tier I)	10	10	10
<b>Total self operated</b>	<b>389</b>	<b>510</b>	<b>635</b>
Franchisees	79	147	197
New Franchise Centers Opened	68	50	60
<b>Total Franchisees</b>	<b>147</b>	<b>197</b>	<b>257</b>
<b>Total Number of Centers</b>	<b>536</b>	<b>707</b>	<b>892</b>

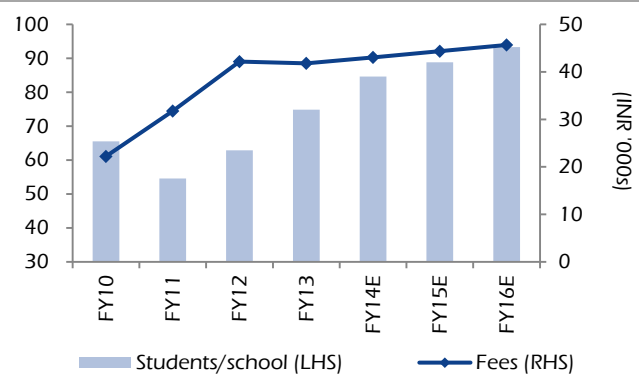
Source: Company, Elara Securities Research

**Exhibit 3: Revenue growth led by preschool fee income (INR mn)**



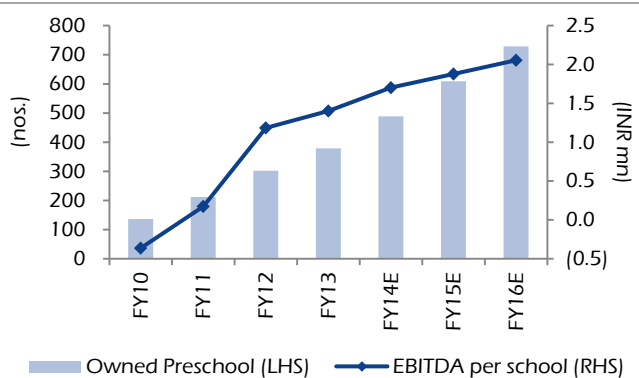
Source: Company, Elara Securities Estimate

**Exhibit 4: Student/center to grow 7% over FY12-16E**



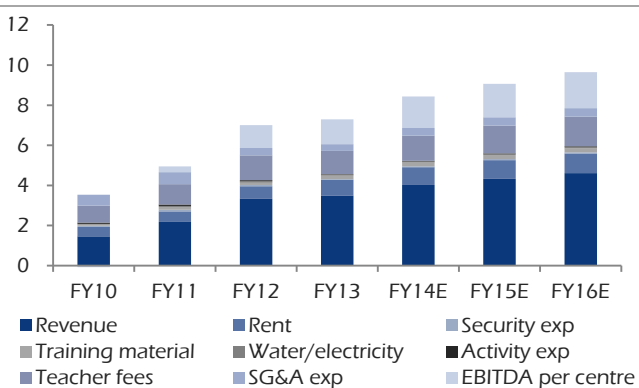
Source: Company, Elara Securities Estimate

**Exhibit 5: Operating leverage kicks in with an increased school base**



Source: Company, Elara Securities Estimate

**Exhibit 6: Fixed cost structure leads operating leverage (INR mn)**



Source: Company, Elara Securities Estimate

**Exhibit 7: Reengineering ROC**

Particulars (INR mn)	FY13	FY14E	FY15E	FY16E
EBIT	484	678	886	1,153
Net Assets (after K-12 assets sale)	4,444	5,026	5,165	5,514
ROC (%)	10.9	14.3	17.4	21.6

Source: Company, Elara Securities Estimate

## Tree House Education

### Exhibit 8: Preschool returns ratios

Particulars (INR mn)	FY13	FY14E	FY15E	FY16E
Revenues	1,067	1,493	1,924	2,415
Invested Assets	1,911	2,127	2,507	3,198
Asset Turn (x)	0.56	0.74	0.83	0.85
EBIT	414	578	736	953
EBIT margin (%)	38.8	38.7	38.3	39.4
<b>ROC (%)</b>	<b>21.7</b>	<b>28.6</b>	<b>31.8</b>	<b>33.4</b>

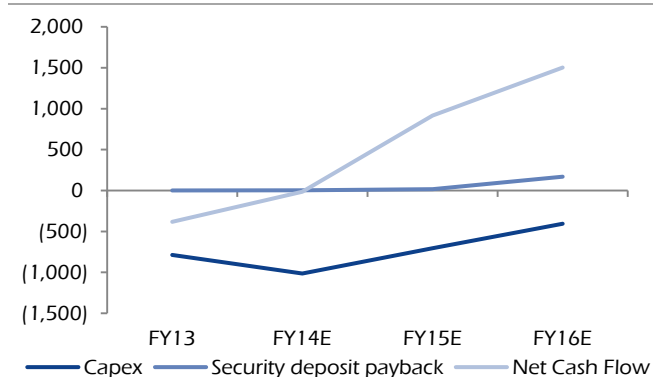
Source: Company, Elara Securities Estimate

### Exhibit 9: K-12 asset reduction

Particulars (INR mn)	Balance Sheet	Cash Flow
Total K-12 assets	2,396	2,396
Reduction	(2,084)	(2,572)
Land and Building	(962)	(1,450)
Loans and Advances	(1,122)	(1,122)
<b>Net amount</b>	<b>312</b>	<b>(176)</b>

Source: Company, Elara Securities Research

### Exhibit 10: Turning cash flow positive (INR mn)



Source: Company, Elara Securities Estimate

### Exhibit 11: Valuation overview

Particulars (INR mn)	Amount
Gross Asset Value	13,524
Add: Cash & Equivalents	1,117
Less: Debt	667
Market Cap	13,973
Diluted Shares (mn)	37.7
<b>Fair Value per Share (INR)</b>	<b>370</b>
Current Market Price (INR)	226
Upside (%)	64%

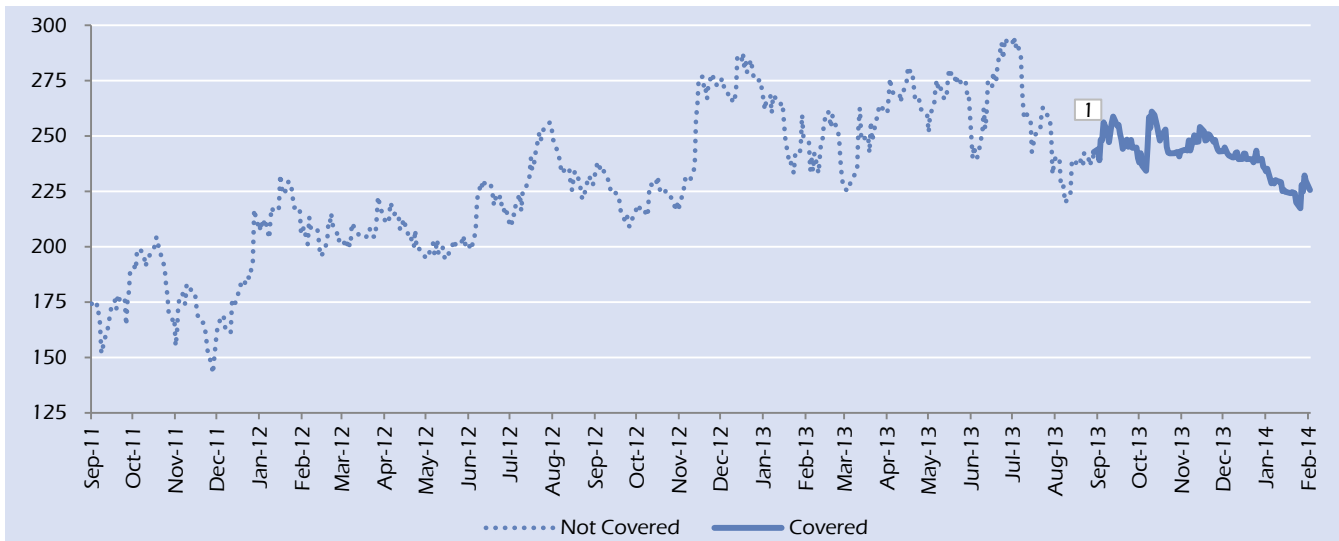
Note: as on 24 February 2014; Source: Bloomberg, Elara Securities Estimate

### Exhibit 12: Estimates Revision

Particulars (INR mn)	Previous		Current		Change (%)	
	FY14	FY15	FY14	FY15	FY14	FY15
Revenue	1,666	2,170	1,629	2,121	(2)	(2)
EBITDA	908	1,190	910	1,193	0	0
PAT	455	601	454	592	0	(1)

Source: Elara Securities Estimate

### Coverage History



Date	Rating	Target Price	Closing Price
23-Sep-2013	Buy	INR 370	INR246

### Guide to Research Rating

<b>BUY</b>	Absolute Return >+20%
<b>ACCUMULATE</b>	Absolute Return +5% to +20%
<b>REDUCE</b>	Absolute Return -5% to +5%
<b>SELL</b>	Absolute Return < -5%

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