Tree House

Spreading Branches

Y/E March (₹ cr)	1QFY15	3QFY14	% chg (qoq)	1QFY14	% chg (yoy)
Net sales	54	36	50.8	41	31.9
EBITDA	33	19	75.3	23	46.0
EBITDA Margin (%)	*61.7*	*53.1*	*863bp*	*55.7*	*599bp*
Adjusted PAT	16	8	99.6	12	30.5

Source: Company, Angel Research

Tree House Education & Accessories Ltd (THEAL) reported in-line numbers for 1QFY2015. Its top-line surged by 31.9% yoy to ₹54cr, in line with our estimate of ₹52cr, owing to addition of 15 pre-schools during the quarter. The EBITDA grew by 46% yoy to ₹33cr while margins expanded by 600bp yoy to 61.7% (owing to lower other expenses as a percentage of sales by 646bp yoy). Subsequently, the Adjusted PAT came in at ₹16cr, higher by 30.5% yoy, and in line with our estimate of ₹15cr.

Budding pre-school segment provides growth visibility

As per CRISIL Research, the size of the pre-school segment is expected to grow to ₹13,300cr in 2015 from the current ₹5,000cr. The concept of imparting education to young toddlers is catching up fast today. Moreover, with an urbanization rate of 40% and escalated average household disposable incomes, the demand for the segment is expected to maintain its momentum.

Dual business model with geographical expansion to provide competitive edge

The dual business model of running self owned schools (SOS) and franchises, facilitates THEAL to maintain its quality of education, maximize profits (through SOS) and widen its reach (through franchises). Moreover, entry into the K-12 segment compliments the pre-school segment. THEAL has initiated its expansion plans in Tier 2, 3 cities which will drive the revenue growth as well as aid in improving operational margins since the major cost component of rentals is significantly lower in these cities.

Outlook and valuation

Given the growth opportunities in the pre-school segment and consistent geographical expansion by THEAL, we expect its top-line and net profit to grow at a CAGR of 26.6% and 35.7% over FY2014-16 to ₹251cr and ₹79cr, respectively, in FY2016E. **Hence, despite the current run-up in the stock price, we continue to maintain our Accumulate rating on the company with a revised target price of ₹425, based on 20x PE for FY2016E earnings.**

Key financials

Y/E March (₹ cr)	FY2013	FY2014	FY2015E	FY2016E
Net Sales	114	157	198	251
% chg	*47.9*	*37.2*	*26.3*	*26.9*
Net Profit	33	43	59	79
% chg	*52.8*	*31.3*	*36.1*	*35.3*
EBITDA Margin (%)	53.7	56.4	58.4	58.9
FDEPS (₹)	8.8	11.5	15.7	21.2
P/E (x)	42.8	32.6	23.9	17.7
P/BV (x)	4.1	3.5	3.2	2.8
RoE (%)	9.6	10.8	13.2	15.7
RoCE (%)	16.6	17.0	19.8	23.8
EV/Sales (x)	12.4	9.4	7.3	5.7
EV/EBITDA (x)	23.1	16.7	12.6	9.6

Source: Company, Angel Research; Note: CMP as of August 8, 2014

ACCUMULATE

CMP	₹376
Target Price	₹425
Investment Period	12 Months

Stock Info	
Sector	Educational Services
Market Cap (₹ cr)	1,420
Net Debt	8.7
Beta	0.6
52 Week High / Low	409 / 214
Avg. Daily Volume	40,762
Face Value (₹)	10
BSE Sensex	25,329
Nifty	7,569
Reuters Code	THEA.BO
Bloomberg Code	THEAL.IN

Shareholding Pattern (%)	
Promoters	32.3
MF / Banks / Indian FIs	18.1
FII / NRIs / OCBs	38.3
Indian Public / Others	11.3

Abs.(%)	3m	1yr	3yr
Sensex	13.4	34.8	49.1
THEAL	29.9	50.2	222.6

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Exhibit 1: 1QFY2015 performance highlights

Y/E March (₹ cr)	1QFY15	3QFY14	% chg (qoq)	1QFY14	% chg (yoy)	FY2014	FY2013	% chg
Total operating income	54	36	50.8	41	31.9	157	114	37.2
Employee cost	5	5	6.8	4	39.0	17	13	30.6
(% of Sales)	9.3	13.2		8.9		11.1	11.6	
Other Expenses	16	12	29.4	14	7.8	51	40	28.6
(% of Sales)	28.9	33.7		35.4		32.5	34.7	
Total expenditure	21	17	23.0	18	14.0	68	53	29.1
EBITDA	33	19	75.3	23	46.0	88	61	44.2
EBITDA Margin (%)	61.7	53.1	863bp	55.7	599bp	56.4	53.7	272bp
Interest	3	3	27.0	2	95.1	8	7	14.7
Depreciation	6	4	35.5	4	56.8	17	13	26.8
Other income	0	0		1	(86.6)	1	7	(80.9)
PBT	24	12	101.2	18	31.4	65	48	34.9
Tax	8.2	4.0	104.5	6	33.2	22	16	42.6
(% of PBT)	33.8	33.2		33.3		33.9	32.1	
Reported PAT	16	8	99.6	12	30.5	43	33	31.3
Adjusted PAT	16	8	99.6	12	30.5	43	33	31.3
PATM (%)	29.8	22.5		30.1		27.5	28.7	

Source: Company, Angel Research

Performance in-line with expectations

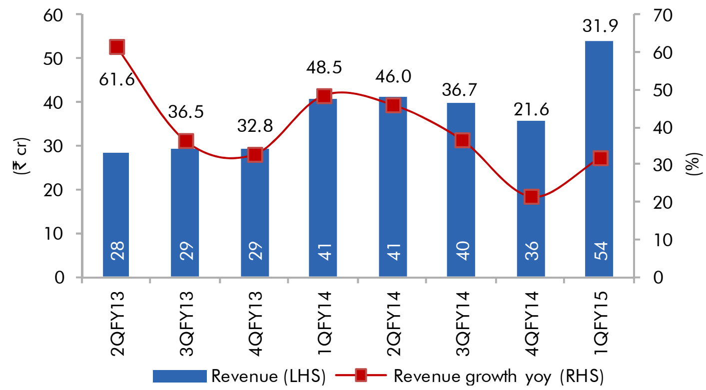
For 1QFY2015, THEAL's top-line surged by 31.9% yoy to ₹54cr, in-line with our estimate of ₹52cr, owing to an addition of 15 pre-schools during the quarter. Its EBITDA for the quarter grew by 46% yoy to ₹33cr vis-à-vis our expectations of ₹29cr. The EBITDA margin expanded by 600bp yoy to 61.7% (owing to lower other expenses as a percentage of sales by 646bp yoy). The Management expects to maintain the current margin levels. Subsequently, the Adjusted PAT came in 30.5% higher yoy to ₹16cr, in-line with our estimate of ₹15cr.

Exhibit 2: Actual v/s Angel Estimates

Actual v/s Angel's Estimates	Actual (₹ cr)	Estimate (₹ cr)	% variation
Total Income	54	52	4.6
EBITDA	33	29	16.7
EBITDA Margin	61.7	55.4	637bp
Adjusted PAT	16	15	4.3

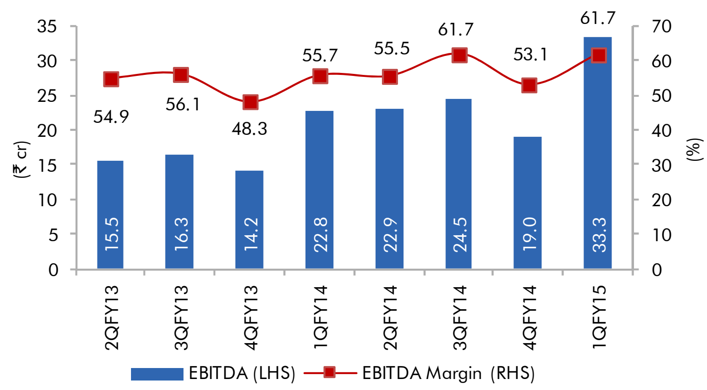
Source: Company, Angel Research

Exhibit 3: Expansion plan aids growth momentum



Source: Company, Angel Research

Exhibit 4: EBITDA margin to stabilise at elevated levels



Source: Company, Angel Research

Investment arguments

Unique business model and strong brand to provide competitive edge

THEAL is the largest self-operated pre-school provider in India, operating on a dual business model, ie operating SOS in metro cities (403 centres; accounting for ~80% of total 505 THEAL centres in the country) and adopting the franchise model in tier 3 & 4 towns (102 centres). This model facilitates the company to maintain its quality of education and maximize profits through SOS, and widen reach through franchises.

Pre-schools at affordable prices: THEAL's initiative to provide pre-primary education at affordable prices through 'Global Champs' pre-schools enables it to cater to the low-to-medium income population group, thereby widening its reach. As of now there are 5 'Global Champs' centres in Mumbai.

Inorganic growth to complement THEAL's reach: THEAL acquired the pre-school brand 'Brainworks Learning' (BL) in FY2014, thereby adding 5 SOS centres to its list; while franchise based centres grew by 26 during the year. BL centres are present mainly in the areas where THEAL is yet to establish its foothold, thereby enabling THEAL to widen its reach and simultaneously boost top-line.

K-12 a logical extension, with pre-schools being the potential feeder: 'Tree House', being an established and trusted brand in the pre-school segment, has entered in the K-12 segment. K-12 schools are established only where the company has strong pre-school presence, which minimizes the marketing cost. The company currently provides consultancy and management services to 24 schools. Pre-schools and K-12s are complimentary to each other with pre-schools acting as a feeder to the K-12s. We expect the K-12 segment to post a revenue CAGR of 25.4% over FY2013-16E to ₹28cr in FY2016E.

Geographical expansion in Tier 2, 3 cities: THEAL has initiated its expansion plans in Tier 2, 3 cities wherein the penetration is too low as of now. The geographical expansion is expected to drive the revenue growth as well as aid in improving operational margins since the major cost component of rentals is significantly lower in these cities.

Potential growth in pre-school segment- key growth driver

- **Niche but growing addressable market:** India is the second most populated country in the world with ~54cr people in the age bracket of 0-24 years, which forms the addressable segment for education. As per CRISIL Research, the size of the pre-school segment is expected to grow to ₹13,300cr in 2015 from the current ₹5,000cr. To capitalize on such opportunities, THEAL intends to establish and expand the number of its pre-schools in various cities and towns in India and proposes to open an additional 120 pre-schools across India in FY2015 (it currently has 505 centres spread across 67 cities pan India).

- **Rapid urbanization and transition in income bracket of people:** According to Mckinsey Global Institute's recent research study, India's urban population is expected to rise from 34cr in 2008 to 59cr in 2030, ie an urbanization rate of 40% (lower than in most Asian countries due to strict definition of Indian Census). The average household disposable income in urban areas is expected to grow at a CAGR of 6.4% from ~₹60,000 in 2008 to ~₹239,000 in 2030 considering a GDP growth rate of 7.4%. Thus, such a rise in disposable incomes provides strong growth visibility for the education market.

- **Changing lifestyles with need for quality education:** With changing demographics, the lifestyle of people has changed drastically. Women who used to be home-makers previously are now joining the workforce and that too at an increasing rate. Also, there is increased awareness about the role of education in a competitive market ('Think tank'). Moreover, with awareness of the fact that 40% of a person's ability to learn is shaped during the first four years of his life, pre-schools have secured a vital place in the education system.

Financials

Exhibit 5: Key Assumptions

Particulars	FY2013	FY2014	FY2015E	FY2016E
Total no of pre-school centres	379	490	595	710
SOS	*300*	*386*	*466*	*551*
Franchisee	*79*	*104*	*129*	*159*
Total Revenue (₹ cr)	114	157	198	251
Pre-school Revenue (₹ cr)	100	141	175	224
SOS	*94*	*132*	*165*	*211*
Franchisee	*2*	*3*	*4*	*5*
Teacher training program	*4*	*6*	*7*	*8*
K-12 Revenue (₹ cr)	14	16	23	28
School management fees	*13*	*15*	*20*	*25*
Infrastructure rent	*1.2*	*1.2*	*2.8*	*2.8*

Source: Company, Angel Research

Exhibit 6: Revised Estimates

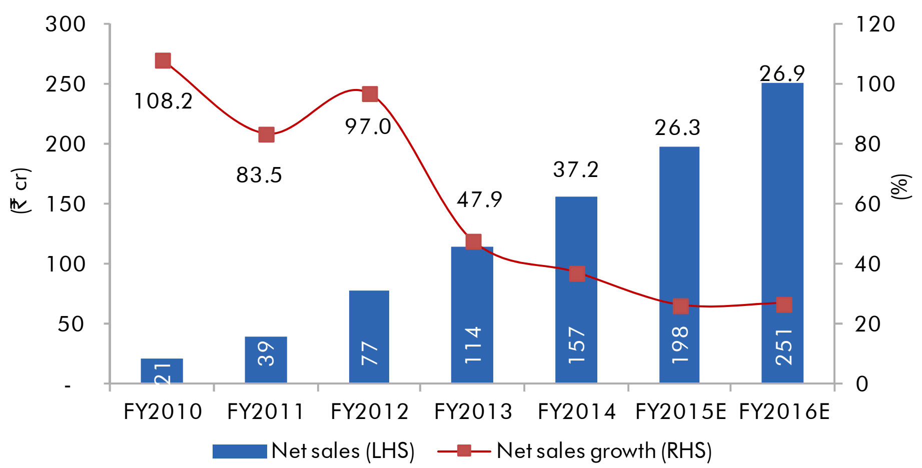
Y/E Mar.	Earlier estimates		Revised estimates		*% change*	
	FY2015E	FY2016E	FY2015E	FY2016E	*FY2015E*	*FY2016E*
Net Sales (₹ cr)	206	245	198	251	(3.7)	2.6
EBITDA Margin (%)	*54.0*	*53.4*	*58.4*	*58.9*	*447bp*	*549bp*
EPS (₹)	16.3	19.5	15.7	21.2	(3.4)	8.7

Source: Angel Research

Expansion plans to lead to top-line CAGR of 26.6% over FY2014-16E

As on date, THEAL owns 505 pre-schools in 67 cities and right to provide management services in 24 K-12 schools. The top-line, following the expansion plans of the company, is expected to grow at a CAGR of 26.6% over FY2014-16 to ₹251cr in FY2016E.

Exhibit 7: Pre-school expansion plans to drive top-line

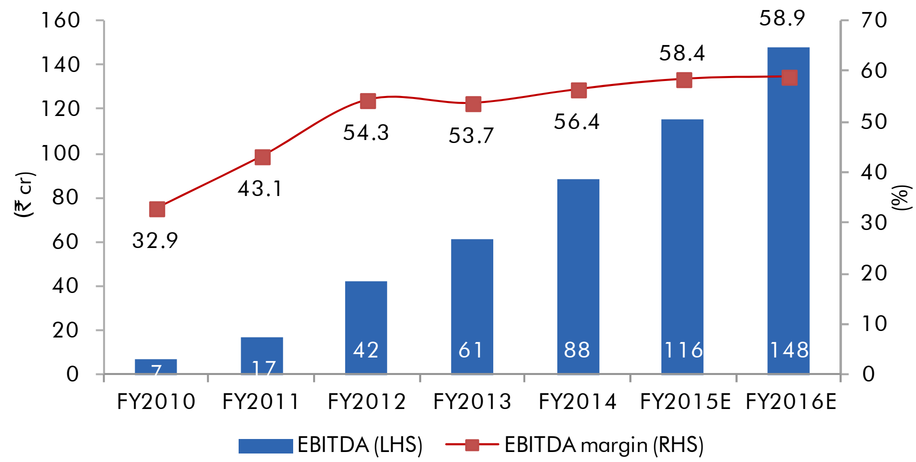


Source: Company, Angel Research

EBITDA to grow at a CAGR of 29.4% over FY2014-16E

On the back of a robust estimated top-line CAGR of 26.6% over FY2014-16, the company's EBITDA is expected to grow at a CAGR of 29.4% over the same period, from ₹88cr in FY2014 to ₹148cr in FY2016E. The EBITDA margin is expected to stabilize above 55% over FY2014-16E as the rentals (a major expenditure component) will decline in tier 2 and 3 cities wherein the company is currently expanding at a rapid pace.

Exhibit 8: EBITDA margin o stabilise at elevated levels

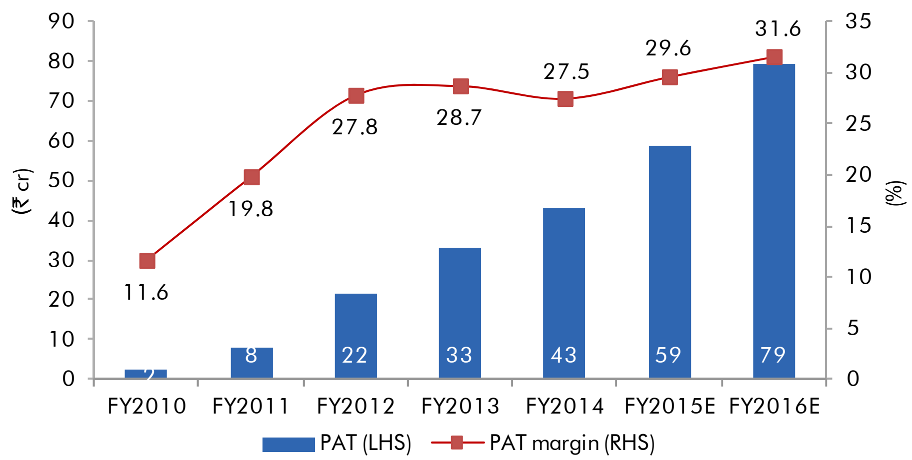


Source: Company, Angel Research

Net profit to grow at a CAGR of 35.7% over FY2014-16E

A robust estimated top-line growth coupled with a healthy and expanding operating performance is expected to consequently lead to a PAT CAGR of 35.7% to ₹79cr in FY2016E with a PAT margin above 29%. THEAL expects to become debt-free by FY2016E owing to the cash surplus from potential asset sale plans of the company, thereby aiding robust growth in net profit.

Exhibit 9: Reduced interest cost to aid net profit margin expansion

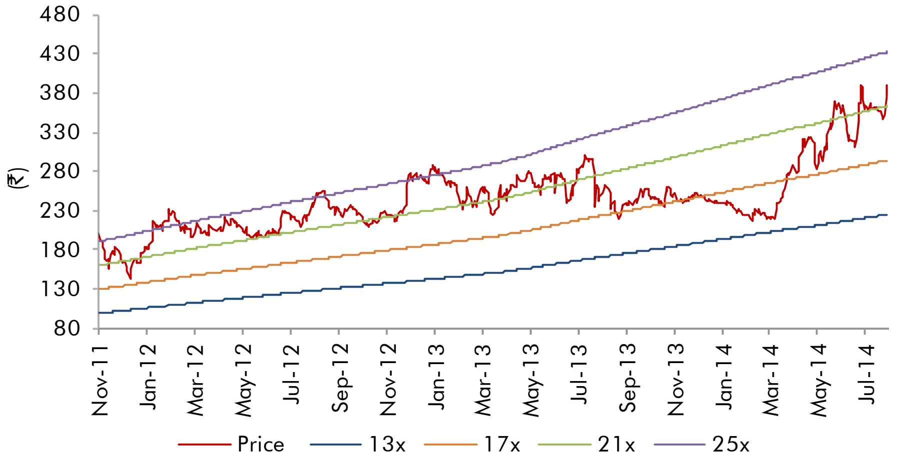


Source: Company, Angel Research

Outlook and Valuation

THEAL, with its strong brand, is in a position to capitalize on the growth opportunities emerging in the pre-schools segment. It is consistently expanding its network of pre-schools and K-12 schools pan-India. The top-line of the company is expected to grow at a 26.6% CAGR over FY2014-16 to ₹251cr in FY2016E. The EBITDA for the company is expected to grow from ₹88cr in FY2014 to ₹148cr in FY2016E, ie at a 29.4% CAGR. Owing to a robust top-line and healthy EBITDA, the net profit for the company is expected to grow at a CAGR of 35.7% over FY2014-16E to ₹79cr in FY2016E. At the current market price of ₹376, the stock is trading at a PE of 17.7x its FY2016E earnings. Considering the nascent stage of pre-school segment with high potential growth prospects and unique model of THEAL, **we maintain our Accumulate recommendation on THEAL with a target price of ₹425, based on a target PE of 20x for its FY2016E earnings.**

Exhibit 10: 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 also faces 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).

Risks

Geographical concentration: Of the total 505 pre-schools, ~40% are located in and around Mumbai metropolitan. This suggests a geographical concentration risk to the company.

Regulations pertaining to K-12 segment: Operating pre-schools and providing educational services to K-12 schools are currently unregulated, but the government may introduce a regulatory framework in future. Any such government regulation, and THEAL's inability to comply with the same, may adversely affect its revenue.

Profit and loss statement (Standalone)

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015E	FY2016E
Gross sales	77	114	157	198	251
Less: Excise duty	-	-	-	-	-
Net Sales	77	114	157	198	251
Other operating income	-	-	-	-	-
Total operating income	**77**	**114**	**157**	**198**	**251**
% chg	*97.0*	*47.9*	*37.2*	*26.3*	*26.9*
Other operating costs	16	30	40	48	60
% chg	*307.1*	*87.9*	*31.2*	*20.2*	*26.9*
Personnel	13	13	17	19	25
% chg	*166.8*	*1.6*	*30.6*	*11.7*	*26.9*
Other	6	10	11	15	18
% chg	*(51.3)*	*53.2*	*20.4*	*34.4*	*19.1*
Total Expenditure	35	53	68	82	103
EBITDA	**42**	**61**	**88**	**116**	**148**
% chg	*147.8*	*46.2*	*44.2*	*30.9*	*28.0*
(% of Net Sales)	*54.3*	*53.7*	*56.4*	*58.4*	*58.9*
Depreciation & Amortization	8	13	17	21	24
EBIT	**34**	**48**	**71**	**94**	**124**
% chg	*163.4*	*40.4*	*49.0*	*32.2*	*30.9*
(% of Net Sales)	*44.2*	*42.0*	*45.6*	*47.7*	*49.2*
Interest & other charges	7	7	8	7	5
Other Income	4	7	1	1	2
(% of Net Sales)	*4.9*	*6.1*	*4.5*	*0.5*	*0.8*
PBT (reported)	**31**	**48**	**65**	**89**	**120**
Tax	10	16	22	30	41
(% of PBT)	*31.6*	*32.1*	*33.9*	*33.9*	*33.9*
PAT (reported)	**22**	**33**	**43**	**59**	**79**
PAT after MI (reported)	**22**	**33**	**43**	**59**	**79**
ADJ. PAT	**22**	**33**	**43**	**59**	**79**
% chg	*176.4*	*52.8*	*31.3*	*36.1*	*35.3*
(% of Net Sales)	*27.8*	*28.7*	*27.5*	*29.6*	*31.6*
Basic EPS (₹)	**5.8**	**8.8**	**11.5**	**15.7**	**21.2**
Fully Diluted EPS (₹)	**5.8**	**8.8**	**11.5**	**15.7**	**21.2**
% chg	*176.4*	*52.8*	*31.3*	*36.1*	*35.3*

Balance sheet (Standalone)

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015E	FY2016E
SOURCES OF FUNDS					
Equity Share Capital	34	36	37	37	37
Share Premium account	193	240	266	259	239
Profit Loss account	29	57	93	152	232
Reserves & Surplus	**223**	**297**	**359**	**408**	**470**
Share warrants	-	10	3	-	-
Shareholders' Funds	**256**	**343**	**400**	**445**	**507**
Total Loans	51	67	83	73	60
Long term provision	-	0	0	0	0
Other long term liabilities	0	0	0	0	0
Net Deferred Tax Liability	3.3	4.4	5.1	5.1	5.1
Total Liabilities	**311**	**414**	**488**	**523**	**572**
APPLICATION OF FUNDS					
Gross Block	154	186	296	355	408
Less: Acc. Depreciation	17	31	48	69	93
Net Block	**137**	**155**	**248**	**286**	**315**
Capital Work-in-Progress	20	40	27	-	-
Lease adjustment	-	-	-	-	-
Goodwill	29	27	24	22	16
Investments	31	10	11	11	14
Long term loans & advances	85	169	187	189	190
Current Assets	**64**	**70**	**45**	**75**	**101**
Cash	48	48	3	13	22
Loans & Advances	5	7	7	13	16
Inventory	4	5	6	8	10
Debtor	6	7	29	37	46
Other current assets	2	3	-	5	6
Current liabilities	25	30	31	38	47
Net Current Assets	**39**	**40**	**14**	**37**	**54**
Misc. Exp. not written off	-	-	-	-	-
Total Assets	**311**	**414**	**488**	**523**	**572**

Cash flow statement **(Standalone)**

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015E	FY2016E
Profit Before Tax	31	48	65	89	120
Depreciation	8	13	17	21	24
Other Income	(4)	(7)	(1)	(1)	(2)
Change in WC	5	(1)	(19)	(14)	(7)
Direct taxes paid	(10)	(16)	(22)	(30)	(41)
Cash Flow from Operations	**31**	**38**	**40**	**65**	**95**
(Inc.)/ Dec. in Fixed Assets	(102)	(136)	(116)	(33)	(54)
(Inc.)/Dec. in Investments	(29)	21	(2)	0	(3)
Other Income	4	7	1	1	2
Cash Flow from Investing	**(126)**	**(108)**	**(116)**	**(32)**	**(55)**
Issue of Equity/Preference	10	46	19	0	0
Inc./(Dec.) in Debt	5	16	17	(10)	(13)
Dividend Paid (Incl. Tax)	(3)	(5)	(7)	(13)	(17)
Others	103	12	1.2	-	-
Cash Flow from Financing	**115**	**70**	**31**	**(23)**	**(30)**
Inc./(Dec.) in cash	19	0	(45)	10	9
Opening cash balance	**29**	**48**	**48**	**3**	**13**
Closing cash balance	**48**	**48**	**3**	**13**	**22**

Key ratios

Y/E March	FY2012	FY2013	FY2014	FY2015E	FY2016E
Valuation Ratio (x)					
P/E (on FDEPS)	65.4	42.8	32.6	23.9	17.7
P/CEPS	48.0	30.4	23.4	17.6	13.5
P/BV	5.5	4.1	3.5	3.2	2.8
Dividend yield (%)	0.2	0.4	0.5	0.9	1.2
EV/Net sales	17.8	12.4	9.4	7.3	5.7
EV/EBITDA	32.9	23.1	16.7	12.6	9.6
EV / Total Assets	4.4	3.4	3.0	2.8	2.5
Per Share Data (₹)					
EPS (Basic)	5.8	8.8	11.5	15.7	21.2
EPS (fully diluted)	5.8	8.8	11.5	15.7	21.2
Cash EPS	7.8	12.4	16.1	21.4	27.8
DPS	1.0	1.3	1.5	3.0	4.0
Book Value	68.6	91.6	106.8	119.1	135.7
DuPont Analysis					
EBIT margin	44.2	42.0	45.6	47.7	49.2
Tax retention ratio	0.7	0.7	0.7	0.7	0.7
Asset turnover (x)	0.4	0.4	0.4	0.4	0.5
ROIC (Post-tax)	12.7	11.3	11.2	13.1	15.7
Cost of Debt (Post Tax)	8.7	6.7	6.1	6.1	6.1
Leverage (x)	(0.1)	0.0	0.2	0.1	0.0
Operating ROE	12.3	11.4	12.1	13.9	16.2
Returns (%)					
ROCE (Pre-tax)	11.0	11.6	14.7	18.1	21.6
Angel ROIC (Pre-tax)	18.6	16.6	17.0	19.8	23.8
ROE	8.4	9.6	10.8	13.2	15.7
Turnover ratios (x)					
Asset TO (Gross Block)	0.5	0.6	0.5	0.6	0.6
Inventory / Net sales (days)	12	13	12	47	48
Receivables (days)	18	20	42	42	42
Payables (days)	130	130	130	130	130
WC cycle (ex-cash) (days)	(1)	(26)	25	45	46
Solvency ratios (x)					
Net debt to Equity	(0.1)	0.0	0.2	0.1	0.0
Net debt to EBITDA	(0.7)	0.1	0.8	0.4	0.2
Int. Coverage (EBIT/ Int.)	5.3	7.2	9.4	14.2	22.6

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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 (Returns):	*Buy (> 15%)* *Reduce (-5% to -15%)*	*Accumulate (5% to 15%)* *Sell (< -15%)*	*Neutral (-5 to 5%)*