

Bhavya Gandhi (+9122 6667 9984)
(bgandhi@phillipcapital.in)



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Tree House Education Accessories

Educational

Result Update | BUY

CMP Rs 270 | Target Price Rs 321

About the company

Treehouse, promoted by Rajesh Bhatia, is a self-operated preschool chain and is one of the leading education services provider in India. The company operates in as many as 43 cities with 379 centers out of which ~80% of the schools are run on self operated basis and the remaining through the franchisee model where it receives a fixed non-refundable onetime upfront fee and a service fee annually from the franchisee for the use of the brand and teaching methodologies. In the pre-school segment it offers play-school and nursery facilities, vacation camps, mother toddler classes, hobby classes, day-care facilities with the teacher training course. The pre-school segment being a niche play and higher profit generating business has attracted many companies to enter in this segment. Foreseeing the demand and confident on the execution capabilities with strong brand image the management has indicated to expand the pre-schools through geographic expansion by targeting various cities and towns in India. The management is focusing to open ~150 self-operated and ~50 franchisee of pre-schools across the country by FY15E.

In the year 2008 Treehouse saw an opportunity in the K12 segment and entered in this segment with a wide variety of educational services which included designing curriculum and providing teaching aids, supplying methods for imparting education, organizing extra-curricular activities for students and teacher training. In the K12 segment the revenue for the company is generated by the way of service or consultancy fees which is generally based on per child admitted to the school, for services forming part of service agreement and lump sum for services beyond the scope of service agreement. Foreseeing the traction in this segment Tree House is already constructing 2 educational institutes in Baroda (Gujarat) and Jhunjhunu (Rajasthan) with the money raised from IPO proceed and internal accruals. Presently there are ~24 K12 schools for which company provide school management services and the focus is to reach 25 by FY14E.

Valuations: We value the stock at a P/E multiple of 24x of FY14E-15E average earnings given the growth outlook with lower capex expected (FY14E-FY15E revenue/EBITDA/EPS CAGR of 19%/20%/22%), robust execution track record, good cash flow characteristics of the business, and improve in ROE. Our resulting target price is Rs 321, implying an upside of 20% from CMP. We arrive to price target based on DCF- assuming a WACC of 12.7% and terminal growth of 6.5%). We recommended Buy rating for 12-18 month

BUY

THEAL IN | CMP Rs 269

Target Rs 321 (+19%)

Company Data

O/S Shares (mn) :	35.96
Market Cap (Rsbn) :	9.66
52 - Wk Hi/Lo (Rs) :	295/193
Liquidity 3m (Rs mn) :	10607
Face Value (Rs) :	10

Share Holding Pattern (%)

Promoters /Director/ Relative:	31%
FII / NRI :	39%
FI / MF :	11%
Non Promoter Corp. Holdings :	6%
Public & Others :	13%

Price Performance (%)

	1mth	3mth	1yr
ABS	1	11	37
REL TO BSE	1	7	14

Key Financial Summary

	FY13A	FY14E	FY1E
Net Sales	1,143	1,404	1,626
Ebidta	618	758	892
Net Profit	333	391	498
EPS, Rs	9.3	10.8	13.6
PER, X	29.1	25.1	19.9
EV/EBIDTA, x	15.8	13.2	10.9
EV/Net Sales, x	8.6	7.1	6.0
ROE, %	8.5	9.8	10.5

Investment Rational

Focus on self-owned model for pre-schools: Tree House has ~379 centers out of which ~300 are self-owned and are located in Tier 1 and Tier 2 cities where consumers have higher purchasing power and greater awareness of the product. For self operated schools the company follows an asset-light model where they generally take properties on the lease and license basis for a period of ~3-5 years. The company focus on self operated is mainly for controlling the quality of services, brand image and address the revenue leakages at the time of realizing scale advantages in material procurement (building materials, furniture, toys etc.) and SGA expenses of the company. Besides Mumbai it has a good presence in the eastern part of India in Kolkata, Guwahati, Patna and Ranchi where the confined demand for high quality preschool education is strong, with a trivial presence in northern and southern India. Tree house also run the schools on franchise basis but only in Tier 3 and Tier 4 towns where there is low ROCE as the pricing remains soft due to relatively lower income levels of the individuals. We believe that Pre school revenue to grow at a CAGR of 22% for FY13-15E. Further the profitability to improve on account of improve in utilization level of new centre opened.

Global champs – a budget pre school: The company had announced a unique initiative of opening Global champs preschool which aim at providing pre-primary education at affordable price points. The preschool cater to community helpers who aspire for quality education for their children. We believe that company is planning to run this on franchisee model, wherein the franchisee owner will manage and operate and the company will only get a revenue sharing.

K-12 schools – Future revenue booster- *Forward integration:* The company entered in this segment in 2008 and is successfully running ~24 K12 schools on an asset light management services model. In this segment the operators are required to pay onetime fee in order to obtain the exclusive rights for the educational services provided by Tree House. The term of service agreement is usually 30 years including an annual service or consultancy fee as agreed for every child enrolled in the K12 School. At present there are two educational institutes being constructed by the company in Baroda (Gujarat) and Jhunjhunu (Rajasthan) using the IPO proceeds and internal accruals which when ready will be able to accommodate ~5000 students each once the two K12 schools will be in operations. The management is not planning to do any kind of aggressive expansion in the K12 segment and hopes to reach ~25 schools by FY14E which would contribute ~20% of the revenues. The total capacity created among these 25 school is approx 46000 students. We believe revenue from K12 will improve the profitability level for the Tree house. We believe that K12 revenue to grow at a higher growth rate of CAGR 32% for FY13-15E on account improve in capacity utilization level.

Teacher training centers with other activities- drives the asset utilization: A three month teacher training course helps in increased asset utilization which contributes for rental costs in cities like Mumbai.. There are also many other activities conducted by tree house for children after the pre-school hours like dance, music, art and crafts, yoga, spoken English and mathematics. During the year FY13 company have sign an agreement with Partymanao.com for conducting birthday parties in centers. The company generate 40-50 mn revenue from the various activity.

Financial and Valuation

Strong revenue growth trajectory to continue; EBITDA margins to expand : Tree House has seen its revenue growth of 48% YoY for FY12-13. The growth in revenue is mainly driven by additions in centers and improvement in the utilization of the existing centers. We estimate Tree House income to grow at ~20% CAGR over the period of next two years, FY14E-FY15E which mainly will be driven by improving utilization of existing assets by increasing the number of batches and by expecting higher revenues from the K12 schools.

As seen from earlier years, the EBIDTA margins have expanded continuously since FY09 from ~20% to ~ 54% in FY13. Moving further even with improved asset utilization and realization on costs we assume the EBITDA margins to above ~50% in FY14E-15E as compare to 54.1% in FY13, but over a period it will improve on account of contribution for K12 will directly percolate to EBITD.

We believe that improve in utilization level at preschool and K12 will help the company PAT to grow faster at a CAGR of 22% for FY13-15E. We believe that company ROE to improve from the current level of 8.5% to 10.5% by FY15E.

Valuations: We value the stock at a P/E multiple of 24x of FY14E-15E average earnings given the growth outlook with lower capex expected (FY14E-FY15E revenue/EBITDA/EPS CAGR of 19%/20%/22%), robust execution track record, good cash flow characteristics of the business, and improve in ROE. Our resulting target price is Rs 321, implying an upside of 20% from CMP. We arrive to price target based on DCF- assuming a WACC of 12.7% and terminal growth of 6.5%). We recommended Buy rating for 12-18 month

WACC	12.2%
Present Value of Cash Flows till FY16E	4.1
Terminal Growth Rate	6.5%
Terminal Value	16,821
Present Value of Terminal Cash Flows	11,894
Total Present Value of the Firm	11,935
Less: Net Debt (FY13)	180
Total Present Value of Equity	11,755
Number of Outstanding shares	37
DCF - Target Price (Rs per share)	321

Financials (consolidated)

Income Statement	FY11	FY12	FY13A	FY14E	FY15E	Balance Sheet	FY11	FY12	FY13A	FY14E	FY15E
Net Income	392	773	1,143	1,404	1,626	Equity capital	240	337	360	363	367
Direct Expenses	105	188	303	378	426	Reserves	986	2,227	3,026	3,347	3,750
Personnel cost	49	96	133	165	186	Net worth	1,227	2,564	3,386	3,710	4,117
Selling & Other	69	68	89	103	122	Total debt	476	515	667	600	500
Op profit	169	421	618	758	892	Deferred tax	18	33	44	34	34
OPM(%)	43.2	54.5	54.1	54.0	54.9	Minority Interest	-	-	100	100	100
Other income	19	38	71	24	40	Total liabilities	1,721	3,112	4,197	4,444	4,751
Depreciation	40	78	134	145	151	Gross fixed assets	719	1,544	1,843	1,978	2,118
Interest	13	65	66	79	69	Less: Cum depreciation	96	174	293	437	589
PBT	136	316	489	559	712	Net fixed assets	623	1,371	1,550	1,541	1,529
Tax	44	99	155	168	213	Capital WIP	729	944	2,091	2,591	2,634
PAT	92	217	333	391	498	Investments	26	312	100	127	127
Adj PAT	92	217	333	391	498	Net current assets	342	485	456	186	461
NPM(%)	23.5	28.0	29.2	27.9	30.6	Total assets	1,721	3,112	4,197	4,444	4,751

Financials (consolidated)

Cash flow	FY11	FY12	FY13A	FY14E	FY15E	Ratios	FY11	FY12	FY13A	FY14E	FY15E
PAT & extra ord. Items	92	217	333	391	498	Growth (%)					
Add: depn. & oth. Exp.	54	93	145	135	151	Income Growth	83.5	97.0	47.8	22.8	15.8
Cash flow from op.	146	309	478	526	649	EBIDTA Growth	241.3	140.9	148.7	46.8	22.7
Net chg in w/c, tax, int.	19	45	39	37	57	PAT Growth	253.9	135.5	53.9	17.3	27.3
Net cash flow from op.	165	354	517	563	707	Per share data (Rs.)					
Capital expenditure	757	1,041	1,460	635	183	Adj EPS Stand	3.8	6.4	9.3	10.8	13.6
Sale/ purchase of inv	(16)	(285)	212	(27)	-	Book value	35.3	51.1	76.0	94.1	102.2
Net cash from inv.	(773)	(1,326)	(1,248)	(662)	(183)	Cash EPS	3.2	5.5	8.7	13.0	14.8
Issue of eq/loan/warr.	875	1,199	694	(42)	(75)	Valuation(x)					
Dividend paid	-	(39)	(53)	(92)	(117)	P/E	70.5	42.0	29.1	25.1	19.9
Net cash from financing	875	1,160	641	(134)	(192)	P/BV	5.3	3.6	2.9	2.6	2.4
Net chg in cash	268	188	(90)	(233)	332	EV/EBIDTA	39.2	21.0	15.8	13.2	10.9
Op. cash bal	21	289	477	388	154	Performance(%)					
Cl. Cash bal	289	477	388	154	486	RONW	4.2	7.5	8.5	9.8	10.5

SINGAPORE

Phillip Securities Pte Ltd

250 North Bridge Road, #06-00 Raffles City Tower,
Singapore 179101
Tel : (65) 6533 6001 Fax: (65) 6535 3834
www.phillip.com.sg

JAPAN

Phillip Securities Japan, Ltd

4-2 Nihonbashi Kabutocho, Chuo-ku
Tokyo 103-0026
Tel: (81) 3 3666 2101 Fax: (81) 3 3664 0141
www.phillip.co.jp

THAILAND

Phillip Securities (Thailand) Public Co. Ltd.

15th Floor, Vorawat Building, 849 Silom Road,
Silom, Bangrak, Bangkok 10500 Thailand
Tel (66) 2 2268 0999 Fax: (66) 2 2268 0921
www.phillip.co.th

UNITED STATES

Phillip Futures Inc.

141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel (1) 312 356 9000 Fax: (1) 312 356 9005

MALAYSIA

Phillip Capital Management Sdn Bhd

B-3-6 Block B Level 3, Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450 Kuala Lumpur
Tel (60) 3 2162 8841 Fax (60) 3 2166 5099
www.poems.com.my

INDONESIA

PT Phillip Securities Indonesia

ANZ Tower Level 23B, Jl Jend Sudirman Kav 33A,
Jakarta 10220, Indonesia
Tel (62) 21 5790 0800 Fax: (62) 21 5790 0809
www.phillip.co.id

FRANCE

King & Shaxson Capital Ltd.

3rd Floor, 35 Rue de la Bienfaisance
75008 Paris France
Tel (33) 1 4563 3100 Fax : (33) 1 4563 6017
www.kingandshaxson.com

AUSTRALIA

PhillipCapital Australia

Level 37, 530 Collins Street
Melbourne, Victoria 3000, Australia
Tel: (61) 3 9629 8380 Fax: (61) 3 9614 8309
www.phillipcapital.com.au

HONG KONG

Phillip Securities (HK) Ltd

11/F United Centre 95 Queensway Hong Kong
Tel (852) 2277 6600 Fax: (852) 2868 5307
www.phillip.com.hk

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd.

No 550 Yan An East Road, Ocean Tower Unit 2318
Shanghai 200 001
Tel (86) 21 5169 9200 Fax: (86) 21 6351 2940
www.phillip.com.cn

UNITED KINGDOM

King & Shaxson Ltd.

6th Floor, Candlewick House, 120 Cannon Street
London, EC4N 6AS
Tel (44) 20 7929 5300 Fax: (44) 20 7283 6835
www.kingandshaxson.com

SRI LANKA

Asha Phillip Securities Limited

Level 4, Millennium House, 46/58 Navam Mawatha,
Colombo 2, Sri Lanka
Tel: (94) 11 2429 100 Fax: (94) 11 2429 199
www.ashaphillip.net/home.htm

INDIA

PhillipCapital (India) Private Limited

No. 1, C-Block, 2nd Floor, Modern Center , Jacob Circle, K. K. Marg, Mahalaxmi Mumbai 400011
Tel: (9122) 2300 2999 Fax: (9122) 6655 1297 www.phillipcapital.in

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PhillipCapital (India) Pvt. Ltd.
2nd Floor, C-Block, Modern Centre, Mahalaxmi, Mumbai - 400011