Tree House Education & Accessories Ltd

BUY | Target Price Rs 470

An insurance against rising education costs

Market data

Current price	Rs 264 (BSE)
Market cap	Rs 9,495 m
Face value	Rs 10.0
FY13 div./share	1.0
NSE symbol	TREEHOUSE
BSE code	533540
No of shares	36.0 m
Free float	72.3%
52 week H/L	Rs 302/205

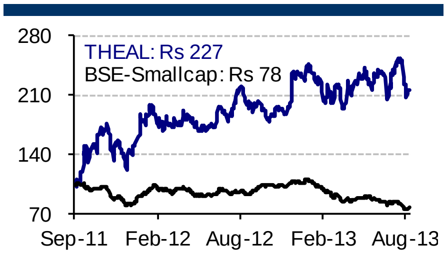
Stock Price Performance

(as on 14 August 2013)

	THEAL	Index*
Over 1-Yr	7.0%	-18.3%

Returns over 1-Year are on a CAGR basis
*** BSE-Smallcap Index**

Rs 100 invested is worth



Shareholding (Jun-13)

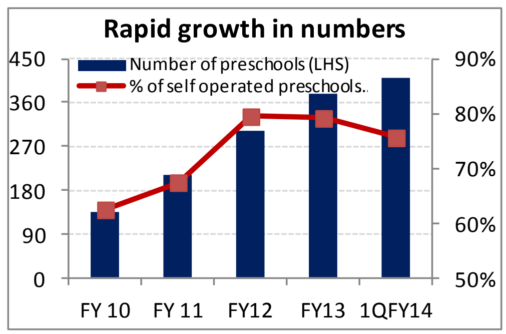
Category	(%)
Promoters	27.8
Banks, FIs, VCs and MFs	10.9
FIIs	1.3
Public	11.1
Others	49.0
Total	**100.0**

Report prepared by

Equitymaster Agora Research Pvt. Ltd.
www.equitymaster.com

Times have been tough for the Indian economy. With most of the industries having their fate linked to the growth in the economy, the list of businesses that can deliver great performance is getting shorter day by day. But even through this doom, we were able to spot a business that is likely to thrive and flourish despite the economy. What we are referring to here is the education sector. Whether times are good or bad, children will need education. The segment of education that our recommendation concentrates on is the preschool segment. It is a niche and unregulated area in the education catering to children in the age group of 1.5 to 5.5 years. It refers to the early childhood education that precedes formal education and includes courses like playgroup, nursery, kindergarten (K.G) etc.

Our Hidden Treasure recommendation for this month has made a mark in this segment in a very short time. The company we are referring to is **Tree House Education and Accessories Ltd (THEAL).** It is the country's largest branded player in self operated preschool segment. What started out as just 1 school in 2003 is now a network of almost 410 branches operating in around 50 cities. The financials too have been nothing short of stellar. Over the last three years, the company has reported a compounded average growth rate (CAGR) of 75% in the revenues. And the net profits with a 3 year CAGR of 134% have surpassed the growth in the revenues by a wide margin. But can this kind of growth continue in the future?



Source: Company data, Equitymaster

The answer to this came in our meeting with the company's senior management. And what we came across was a very well defined and focused growth strategy with an equal emphasis on margins. The management aims to open around 70 to 80 preschools per annum mainly on a self funded basis. What is impressive about the growth plan is the criterion that every single unit should offer at least 50% operating profit margins. Before you say that it is too good to be true, let us give you some statistics. The average breakeven period for a self operated preschool in high tier cities varies from 12 months to 24 months. In low tier cities, the breakeven time is around 36 months. The company plans to grow through a network of self operated schools in top tier cities and intends to use franchise model for the other regions. This will ensure shorter break even periods and hence a viable and faster self funded growth. Besides opening new centers, the company scales up revenues and margins by running more shifts/batches, increase in the fees income, income from teacher training and introducing activities such as day care etc. No wonder its vintage centers are operating at nearly 70% margins.

And the demographics of the industry seem to be pointing towards higher growth as well. Rising affordability in the urban area, high share of youngsters (who sooner or later will marry and have kids),growing trend of nuclear families with both parents working and high focus on children education are some of the key drivers for this business. As per CRISIL estimates, the industry is likely to grow at an average annual rate of 25% (CAGR for 2010-2015). So the future growth from the industry point of view looks robust as well.

But how does such an ambitious growth plan affect the financial stability? Even in high expansion phase, the returns on net worth and invested capital have been around 11% and 15% respectively. The company has managed a spectacular growth in the past without straining the balance sheet. For the record, its debt to equity ratio for FY13 stands at around 0.2 (maximum it reached was 0.39 in FY11). Going forward, we believe that growth targets are achievable without adding more debt.

So what we have here is a market leader in a great business with enviable profit margins and most importantly, a very clear growth strategy. But what about the valuations? Currently, the stock is trading at 25.2 times its trailing 12 months PE. While this may look expensive at the first glance, we believe that the company deserves premium multiples considering the tremendous growth potential, strong fundamentals and focused management. We expect the earnings over the next five years to grow at a CAGR of around 20% (on a very conservative basis). Keeping the growth in mind we have awarded it a multiple of around 20.6 times our FY18 earnings estimate. This gives us a target price of Rs 470. Based on the target price, the investors can expect point to point returns of 78% and average annual returns of over 15% over the next 3- 4 years. **Hence, we recommend investors to buy the stock at current price levels.**

We would like to gently remind you that your allocation to equities should be decided upon after keeping aside some safe cash. Also, within your overall exposure to equities, please ensure that you broadly follow our suggested asset allocation. We suggest that no single small cap stock should comprise more than 2% of your total stock portfolio. (Read more on Asset Allocation at the end of the report.)

Investment Rationale

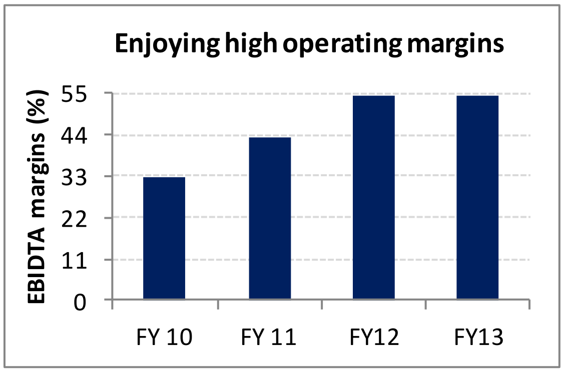
- **On a high growth trajectory:** THEAL plans to open around 70-80 preschools every year. It intends to expand on a self operated basis in the top tier cities where breakeven period is shorter (less than or equal to 2 years) and through the franchise model in other areas where breakeven period is longer (around 3 years or more). This would drive the growth in the revenues and profitability in the future.

  Being the largest branded player in the preschool segment and enjoying high margins, also places THEAL in a strong position to grow both organically as well as inorganically. Recently, the company has completed the acquisition of Brainworks brand which will help it to expand its franchisee footprint. Brainworks is an existing chain of pre-schools that has both self operated as well as franchisee schools.

- **Strong brand:** Tree House is a well recognized brand, especially in Western India. The company's focus on operations through self operated schools has helped to maintain the quality and increase credibility. We believe that brand awareness in the urban areas will help company improve enrolment ratios. The strong brand would also help expand through the franchise model and self operated schools.

- **Robust financials:** Unlike other businesses and companies where an expansion can take a toll on stability, THEAL boasts of a robust balance sheet. Despite its rapid expansion and high growth rates, its debt to equity ratio stands at just 0.2 times as at the end of FY13. The interest coverage ratio stands at around 8 times (in FY13) which offers enough margin of safety. Given the plans for self funded growth in future, we do not expect the company to take on more debt and burden the balance sheet.

  In top tier cities the company plans to expand through self operated schools. The reason for this is that this mode helps in better cost controls as well as helps in earning higher margins. However the plan cannot really be rolled out in smaller cities due to the huge investment required. Therefore in these cities, the company has decided to use the franchisee model for expansion which supports expansion without high investment. The combined strategy would help the company in maintaining and improving its financial health in the future.



Source: Company data

- **Demand scenario looks bright:** The demand for preschools in our country is thriving and only expected to go up further. Some of the drivers for this demand are rapid urbanization, improving affordability; rising trend of nuclear families, more women joining the workforce and growing focus on education. Besides this, what adds to the growth potential is that currently, the segment remains highly underpenetrated as compared to other countries. As per a CRISIL report, the preschool business (estimated at Rs 43 billion in 2010) is likely to grow at a compounded average annual growth rate (CAGR) of 25.3% by 2015. THEAL's management expects it to grow at a CAGR of 21% from FY11 to FY16. We believe that THEAL with its strong brand and wide visibility is well placed to capitalize on this growth opportunity.
- **Other initiatives to improve realisations:** Besides fees income from preschools, the company earns revenues from other avenues as well. This includes teacher training, selling educational kits, consultancy fees for providing management and consultancy services to K12 segment (represents education from kindergarten to class XII and forms the largest segment within the education space in India). It also earns royalty income from franchisee centres (based on the total fee generated by the school in a year, can range anywhere between 5% and 30 %). In addition to this, there is also potential to further improve realizations from the existing schools by increasing the number of shifts, starting programmes like day care, etc. As of now the company is already offering day care services in 3% of its branches. THEAL has recently tied up with Partymanao.com for hosting birthday parties as well. We believe that such initiatives are likely to lead to better asset utilization and higher profitability in the future.
- **Asset turnover ratios expected to improve:** The management wants to operate on an asset light model with strong focus on profitability. For this reason, THEAL mostly takes properties on lease-and license basis for its self operated preschools. As of now, the company owns land and building for some of the K12 schools. However, the management has suggested that it is nearing the end of investment cycle in the K12 segment. In fact, going forward, it plans to sell the land and buildings that it already owns. This we believe will be positive for the returns on invested capital and improve turn over ratios

Investment Concerns

- **Popular in Mumbai but will it be equally popular elsewhere?** THEAL's operations are mainly concentrated in Western India or to be precise in Mumbai. With over 40% of its schools in the city, the company faces a major risk in the form of geographic concentration. The company is now trying to expand its operations in other cities as well. However, these are different markets with their own set of difficulties of doing business. Though it is still too early to comment on the company's performance in these markets, however, this expansion could also turn against the company. If it is unable to capture the opportunity or create a strong brand for itself then these could impact the financials adversely.
- **Competition is sizzling:** Currently the business of pre-schools is an unregulated sector. At the same time as per the management, the cost of setting up a school lies anywhere between Rs 4 - 5 m per school. Therefore the barriers to entry to the sector are very low. As a result the competition in this area is intense. Both from the organized players but more so from the unorganized players. Since entry barriers are expected to remain low, competition is only set to increase going forward. THEAL has been able to make a noteworthy name for itself in the pre-school space. But the competition cannot be ignored and poses a substantial threat to the long term market position of the company.
- **Smaller town payback period may hurt margins:** In addition to strengthening its position in the top cities, THEAL is also trying to expand its presence in the tier II and tier III cities. Typically the payback period for schools in these regions can take up to 3 years. As the number of such schools goes up, there could be short to

medium term pressure on margins because of the lag time involved. The company has stated that these schools are usually opened on a franchisee basis. Therefore the pressure on margins may not be very severe.

- **Capex heavy model:** The company has been focusing on increasing its presence in the pre-school space. As such the growth strategy has been to add more schools to the portfolio. Therefore the capital expenditure has remained high in the past and free cash flows have been negative. As there is a time lag between making a school and for it to break even, the asset turnover of the company has been low historically. Having said that, as the older investments start yielding positive results, we expect this to turnaround going forward and also for asset turnover to improve.
- **Promoter shareholding does not provide any comfort:** As at the end of June 2013, the promoters of the company held a 27.75% stake. Of this around 10% was pledged. As per our discussion with the management the shares were pledged for issuing share warrants. The management also told us that around 2% of these shares have been released since. However, we feel that a low holding combined with the pledge could act as a substantial risk in case of a sharp decline in prices. This is why we feel the need to flag it off as an investment concern for the investors.
- **Risky small caps:** It is important to note that small caps are inherently more risky as compared to the blue-chip or mid cap stocks. That is the reason we do not recommend small caps to those having a low risk profile. Even for investors having an appetite for slightly more risk, it is advisable to invest not more than 10% of one's portfolio in small-cap stocks. This means that a single small-cap stock should not form more than 2-3% of your portfolio. The reason for this is that small-caps tend to react very sharply to market movements.

Background

Tree House Education & Accessories Ltd operates the maximum number of branded self-operated preschools in India. THEAL was originally incorporated as a private limited company in 2006. In 2011, it came up with an initial public offer of Rs 1.1 billion. Currently, the company operates a network of 410 branches across 50 cities, of which 75.6% are on a self operated basis.

For self-operated schools (SoS), the company takes properties on lease-and license basis for a period of three-to-five years. The company earns revenues mainly from the admission and tuition fees from SOS. Some of the centres offer daycare facilities as well. Besides, the company operates 35 teacher training academy that provide qualifications to be a teacher at a preschool. As such, a part of its revenues are generated from teacher training. It charges one time upfront fees and an annual service from the franchise preschools. Sale of educational kits in SoS and franchise schools is also a source of income for the company. Rentals, employee costs and marketing expenses are the key cost components for the company.

THEAL also provides educational and consultancy services to around 24 K-12 centres (primary to class XII) across the states of Maharashtra, Rajasthan and Gujarat and earns consultancy fees based on the services provided and students enrolled. Recently, the company has launched initiative of opening Global Champs preschools. These preschools aim to providing pre-primary education at affordable price points. The company has also completed the acquisition of Brainworks brand and its operations to expand its franchisee footprint.

Industry prospects

Preschool is a niche and unregulated segment in India within the broader education sector. Preschools precede the formal education and cater to the group of one to six year old children and offer playgroup, nursery, junior kindergarten and senior kindergarten classes.

The industry has low entry barriers and faces huge competition from the unorganized segment. The awareness level regarding importance of preschooling is low in non urban areas. This leaves around 74% of the rural market in relevant age segment as unadressable (as per census 2011) for the lack of viability. As per CRISIL estimates, just 10–15% of the urban population in the 2–4 years age bracket enroll in pre-schools in the country. Thus, even the urban areas are quite underpenetrated. However, the scenario is changing with growing importance of education for a child in the first five years of life. This is well reflected in the improving pre-primary gross enrollment ratio (GER) in India. That said, GER in India is lower as compared to other major countries in the world. Hence, there is a huge potential for the industry to grow.

As per CRISIL estimates, the preschool business is likely to grow at a CAGR of 25% between the year

2010-2015. It expects organized preschool market to grow at a CAGR of above 45% (from 2009-10 to 2015-16). This implies that the share of the organized market is expected to increase from 11% in 2009-10 to 34% in 2015-16. The main growth drivers for this business are favorable demographics. These include rapid urbanization, high share of youngsters in the population, rising disposable incomes in the urban areas, an increasing trend of nuclear families and both parents working. Besides, the increasing focus on children's education is likely to boost the growth prospects for this industry.

Key Management Personnel

Mr. Sanjay Kulkarni is the Chairman of the company. He has approximately 30 years of experience in the financial services and consumer durables industry. He has worked for Citibank, India from 1973-1980 and was involved in investment banking and managing corporate relationships. He was also the Chairman of the Equipment Leasing Association from 1993-1995. Mr. Kulkarni previously managed Century Direct Fund, one of the earliest private equity funds for investment in growth companies in India and also promoted 20th Century Finance Corporation Limited.

Mr. Rajesh Bhatia is the Managing Director of the Company. He holds a bachelor of engineering degree in computer science from MS University, Baroda and Masters of Business Administration from Pune University. Mr. Bhatia has approximately seven years of experience in the education industry. He has been associated with the company since its inception and oversees the day to day operations.

Risk Analysis

Please see 'ERM™' table on page 6

In order to further improve our risk analysis of companies we have come out with a revised risk matrix. Our new risk matrix is broken down in to 4 sub heads namely industry risk, performance risk, management risk and balance sheet risk. (For details on break down please see the matrix at the end of the report)

Regulatory risk: Some businesses are subject to regulations by external government agencies. These companies are subject to regulatory risk since they do not have the liberty to operate in a free environment. Excessive regulations can create bureaucratic hassles and impede growth. Thus, higher the regulation, higher is the risk for any business. At present the pre-school business is largely unregulated. However the possibility of regulations coming up in the future cannot be ignored. Therefore, we assign a risk rating of 5 to the stock.

Cyclicality risk: An industry cycle is characterized by an upturn as well as downturn. Businesses whose fortunes typically swing with industry cycles are known as cyclical businesses. Cyclical businesses do well during an industry upturn and vice versa. On the other hand, there are some businesses based on consumption stories that are non-cyclical. These businesses are immune to industry cycle changes and have less risk. In short, if the business is cyclical higher is the risk. The business of THEAL is more seasonal rather than cyclical so it may vary on a quarterly basis. But we reiterate that investors should gauge the performance of the company based on the annual numbers. As such, we assign a high risk score of 4.

Competition risk: Every industry is characterized by competition. However, some industries where entry and exit barriers are typically low have higher competition risk. Low barriers means more players can enter into the industry there by intensifying competition. Low product differentiation also intensifies competition risk. As stated above the entry barriers to the business are low and as such the competition is intense. Therefore, we assign a score of 1 to the stock on this parameter.

Sales growth: Over the six year period (actual history of past 3 years and explicit forecast for the next 3 years) we expect sales CAGR of around 47%. We assign a risk rating of 9 to the stock on this parameter.

Net profit growth: Over the six year period (actual history of past 3 years and explicit forecast for the next 3 years) we expect net profit CAGR of around 70%. We assign a risk rating of 9 to the stock on this parameter.

Operating margins: Operating margin is a measurement of what proportion of a company's revenue is left over after paying for variable costs of production such as raw materials, wages, and sales and marketing costs. A healthy operating margin is required for a company to be able to pay for its fixed costs, such as interest on debt. The higher the margin, the better it is for the company as it indicates its operating efficiency. Over the six year period (actual history of past 3 years and explicit forecast for the next 3 years) the operating margins have averaged at around 51%. As such, we assign a score of 9 to the stock on this parameter.

Net margins: Net margin is a measurement of what proportion of a company's revenue is left over after paying for all the variable and fixed costs inclusive of interest and depreciation charges. Net margin is the final measure of profitability. It reflects the total profits the company takes home. Higher the margin, better it is for the company as it indicates better pricing power and effective cost management. Due to commoditized nature of business, the company's margins have not been exceptionally high. But the good thing is that margins have remained positive even in the worst years. The average net margins over the six year period (actual history of past 3 years and explicit forecast for the next 3 years) stands at 28.1%. As such, we assign a score of 8.

Return on invested capital (RoIC): RoIC is an important tool to assess a company's potential to be a quality investment by determining how well the management is able to allocate capital into its operations for future growth. A RoIC of above 15% is considered decent for companies that are in an expansionary phase. The average RoIC over the six year period (actual history of past 3 years and explicit forecast for the next 3 years) for THEAL stands at 15.0%. This is because of the capital intensive nature of its business. As such, we assign a score of 3.

Earnings quality: This measure helps us assess the quality of earnings reported by the company. For instance, some companies may follow aggressive accounting practices and recognize revenues earlier than warranted. Earlier recognition of revenues boosts profits. However, at the same time they do not generate sufficient operating cash flow (OCF). This signifies debtors are not liquidated on time as sales were booked in advance. Such companies face working capital issues and their quality of earnings is poor. We assess earnings quality by dividing operating cash flow to net profits. Higher the ratio better is the quality of earnings. The average OCF/net profit ratio over the six year period (actual history of past 3 years and explicit forecast for the next 3 years) stands at 0.45. We assign a score of 6.

Transparency: Transparency is the key to any business. Transparency can be gauged by assessing the past dealings of the company with various stake holders be it the customers, suppliers, distributors or shareholders. The easiest way to gauge the same is checking the level of disclosures in the company's quarterly financial updates and communication with minority shareholders. Most importantly, the management's willingness to explain its stance if there is a negative development in the company or stock shows its forthrightness. Transparent managements would get a higher rating. Even though the management of THEAL has been forthcoming with their responses to our questions, however we believe that small cap companies in general tend to face a higher risk in terms of management transparency. We have assigned a score of 3 to the company on this parameter.

Capital allocation: Apart from honesty, capital allocation skills are equally important in assessing management quality. By capital allocation we mean how the management chooses to deploy capital in the business or across businesses. Managements that have in the past destroyed shareholder wealth by diversifying in unrelated, unviable businesses or make expensive acquisitions would rank low on this parameter. Further managements that focus on capital intensive growth at the cost of profitability would also fetch a low rating. In this regards THEAL has successfully deployed capital in its business till now. However, now it plans to expand further in new cities and towns where it still needs to prove its mettle (the company has been largely concentrated in Western India in general and Mumbai in particular till now). Taking this into consideration we assign a score of 5 to the company on this parameter.

Promoter pledging: Promoters typically pledge their shares to take a loan which is generally infused in the company. This exercise is generally resorted to when all other sources of external liquidity dry out. The risk with this strategy arises when share price falls. This triggers margin calls. If management is unable to provide some sort of a collateral to the lending party from whom the money is borrowed that party may sell the shares to recover its money. This accentuates the share price fall. Hence, higher the promoter pledging higher is the risk. As at the end of June 2013, 10% of the promoter's holdings were pledged. Therefore we assign the score of 3 to the stock.

Debt to equity ratio: A highly leveraged business is the first to get hit during times of economic downturn, as companies have to consistently pay interest costs, despite lower profitability. We believe that a debt to equity ratio of greater than 1 is a high-risk proposition. The average D/E ratio over the 6 year period (actual history of past 3 years and explicit forecast for the next 3 years) stands at 0.2 x. Therefore, we assign a score of 8.

Interest coverage ratio: It is used to determine how comfortably a company is placed in terms of payment of interest on outstanding debt. The interest coverage ratio is calculated by dividing a company's earnings before interest and taxes (EBIT) by its interest expense for a given period. The lower the ratio, the greater are the risks. THEAL's average interest coverage ratio over the 6 year period (actual history of past 3 years and explicit forecast for the next 3 years) stands at 14. Hence, we assign a score of 8.

It may be noted that leverage, return generating capability, earnings quality and management risk get the highest weight in our matrix. Hence, scores assigned to these factors influence the overall score.

Considering the above analysis, the total ranking assigned to the company is 81 that, on a weighted basis, stands at 5.5. This makes the stock a medium-risk investment from a long-term perspective.

Valuations

The stock of THEAL is currently trading at Rs 264. This implies a multiple of 25.2 times its trailing 12-months earnings. Based on our FY18 earnings estimates, the valuation stands at 11.6 times. While the current valuations may look expensive at the first glance, we believe that the company deserves a premium multiple keeping in mind the huge growth potential, strong fundamentals and focused management. Over the next five years, we expect the earnings to grow at a CAGR of around 20% (on a very conservative basis) on the back of strong revenue growth and healthy operating margins. Keeping the growth in mind we have awarded it a multiple of around 20.6 times our FY18 earnings estimate. This gives us a target price of Rs 470. Based on the target price, the investors can expect point to point returns of 78% and average annual returns of over 15% over the next 3 - 4 years. Hence, we recommend investors to buy the stock at current price levels or lower.

However, the stock comes across as a medium risk investment on our ERM™ because of significant threat from competition, lower returns on net worth and low promoter stake and promoter pledging . Hence, we suggest that the investment in the stock should not comprise more than 2% of your total stock portfolio.

Valuations at glance

(Rs m)	FY13UA	FY14E	FY15E	FY16E	FY17E	FY18E
Net sales (Rs m)	1,143	1,473	1,786	2,143	2,524	2,849
Net profit (Rs m)	333	434	525	625	732	820
No. of shares (m)	36.0	36.0	36.0	36.0	36.0	36.0
Diluted EPS (Rs)	9.3	12.1	14.6	17.4	20.4	22.8
Price to earnings (x)	28.5	21.9	18.1	15.2	13.0	11.6
Price to sales (x)	8.3	6.4	5.3	4.4	3.8	3.3
Price to book value (x)	2.7	2.5	2.2	2.0	1.7	1.5

E-Estimates

ERM[TM]

Company Specific Parameters	Points	Riskiness (A)										Weightage (B)	Weighted (A*B)
		High - Medium - Low											
Industry risk		**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**		
Regulatory risk $	5											5.0%	0.3
Cyclicality risk $	4											5.0%	0.2
Competition risk $	1											5.0%	0.1
Performance risk													
Sales growth	9											5.0%	0.5
Net profit growth	9											5.0%	0.5
Operating margins	9											5.0%	0.5
Net margins	8											5.0%	0.4
RoIC / RoNW	3											10.0%	0.3
Earnings Quality (OCF/PAT)	6											10.0%	0.6
Management risk													
Transparency $	3											10.0%	0.3
Capital allocation $	5											10.0%	0.5
Promoter pledging $	3											10.0%	0.3
Balance Sheet risk													
Debt to equity ratio	8											10.0%	0.8
Interest coverage ratio	8											5.0%	0.4
Final Rating#	**81**												**5.5**

*Excluding extraordinary gains
For qualitative factors, denoted by $ sign, lower the risk, higher the rating
For any risk parameter if the score is below or equal to 4 it indicates high risk. The risk score of these parameters is highlighted in red color. For risk parameters where the score is above 4 riskiness is low. The risk score of such parameters is highlighted in grey.

Financials at a glance

Standalone (Rs m)	**FY13UA**	**FY14E**	**FY15E**	**FY16E**	**FY17E**	**FY18E**
Sales	1,143	1,473	1,786	2,143	2,524	2,849
Sales growth (%)	48.0%	28.9%	21.2%	20.0%	17.8%	12.9%
Operating profit	618	784	914	1,059	1,210	1,340
Operating profit margin (%)	54.1%	53.2%	51.2%	49.4%	47.9%	47.1%
Net profit	333	434	525	625	732	820
Net profit margin (%)	29.2%	29.5%	29.4%	29.2%	29.0%	28.8%
Balance Sheet						
Fixed assets	1,897	2,035	2,088	2,164	2,184	2,185
Goodwill & intangibles	51	51	51	51	51	51
Current assets	703	640	647	693	676	846
Investments	100	100	100	100	100	100
Other assets	1,693	2,000	2,400	2,700	3,100	3,500
Total assets	**4,444**	**4,825**	**5,286**	**5,707**	**6,111**	**6,681**
Current liabilities	244	247	249	252	257	262
Net worth	3,486	3,865	4,323	4,868	5,507	6,223
Debt	667	667	667	540	300	150
Deferred tax & other liabilities	47	47	47	47	47	47
Total liabilities	**4,444**	**4,825**	**5,286**	**5,707**	**6,111**	**6,681**

E-Estimates

Where Hidden Treasure Fits In...

We recommend that investors should decide their exposure to equities, which is only one part of the overall investment portfolio, after they have kept aside some cash. While we are no experts in wealth management, we believe keeping aside some safe cash is absolutely necessary. Not only will this cash take care of your liquidity needs, but it will also come handy during market declines. Particularly when there will be opportunities to pick up fundamentally strong stocks at cheap valuations. For some of you this cash component could be 6 months of usual monthly expenditure, for others 36 months. You need to decide what amount works for you, and then set it aside. Maybe in a FD, or in a pure liquid fund. Or maybe just cash at home!

Having decided what portion of your overall portfolio will be in equities, it is time to decide the allocation of stocks within your equity portfolio.

As your experience will tell you, stock markets tend to be very volatile. And putting too much money in a single stock or sector can be very risky. That is why we advise our subscribers to have a well-diversified equity portfolio comprising the appropriate proportion of small cap, mid cap and large cap/ blue-chip stocks. Based on their relative riskiness, we have created an asset allocation pyramid that can help you in deciding how much money you should invest in a stock. However, it must be noted that the allocation levels could differ from person to person depending on the risk appetite.

Small cap stocks are inherently more risky compared to large blue-chip or mid cap stocks. On the brighter side, they present a huge growth potential. It is not unusual for a good small cap stock to turn a multibagger in a matter of months. But on the flipside, there is a high risk attached. We'll tell you straightaway that not all small cap stocks tend to be outperformers. In fact, we have seen small cap stocks plunging 80-90% when things turn sour. That is the reason small caps are not recommendable to those having a low risk profile. **Even for investors having an appetite for slightly more risk, not more than 10% of one's portfolio should be invested in small cap stocks. This means that a single small cap stock should not form more than 2-3% of your portfolio.** This will ensure that even if your investment in a particular stock turns out to be a failure, it will not have a very adverse impact on your overall portfolio.

What does 'Closed Position' mean?

Hidden Treasure recommendations are meant to meet the target prices within a time frame of five years. So when the stock meets target price or completes the time frame we 'close the recommendation'. However, since we keep reviewing our assumptions and estimates for the stock even in the interim, the view or target price on the stock may warrant a change. This could be a revision upwards or downwards. In such cases, if the previous recommendation on the stock is no longer valid we close that recommendation. So we essentially close recommendations either by giving a Sell view or putting out a changed view.

How to read the returns calculations?

For positions that are not closed returns are calculated from date of recommendation till date.

For closed positions, there can be two types of calculations.

- Assuming we initially gave a Buy on a stock with no subsequent recommendations on the same stock. In that case the calculation is fairly simple. The returns shown in this case is simply the change in stock price from the date of recommendation till the date on which the position was closed.

- Now let us take a case where we initiated with a Buy (1st position) and subsequently came with another recommendation (2nd position) on the same stock. Let us assume that the subsequent recommendation was also a buy.

  In such cases, the return calculation depends on whether the 1st position is closed or not. If the first position is closed before we reiterate buy then the return on the first position will be calculated as shown previously.

  However, if 1st position was not closed before we reiterated buy, then the return calculation is from the earlier buy recommendation till the date on which the position was closed. Basically where we have reiterated view on a stock we try to show cumulative returns. The same logic applies with Hold recommendations as well.

Now let us look at Sell recommendations. There can be two situations here.

- If there is no recommendation subsequent to the Sell recommendation we show maximum drop in stock price from date of sell recommendation till date.

- If the Sell recommendation is followed up by another recommendation, we show maximum drop in stock price between the two recommendation dates.

Basically we have tried to cover all hypothetical instances in this note that may help you better understand the return calculations and closed positions of our recommendations. If you have any query pertaining to it please do write in to us for further clarifications.

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