IFCI Financial Services Ltd
(Subsidiary of IFCI Ltd)

Tree House Education & Accessories

Tree House

Initiating Coverage

Rating: **Buy**
Current Price: Rs268
Target Price: Rs 330
Upside: 22%

Stock Data	
Sensex / Nifty	19,355/5,888
52-week high/low (Rs)	290/140
O/S shares (mn)	33
Mkt Cap Rs (bn)	9.3
Avg Daily Val (mn)	33.7
Bloomberg Code	THEAL IN
Reuters Code	TREEHOUSE.BO

Shareholding (%)	Sep-12
Promoters	29.2
FIIs	4.8
DIIs	7.2
Public	58.6

Karan Taurani
+91-22-43335132
karantaurani@ifinltd.in

LOOKING BEYOND TIER-1 CITIES

Huge market opportunity in the pre-school segment

Tree School Education and Accessories(THEAL) provides pre-school services, with 315 centres all over India. It has captured a large chunk of the organised pre-school market, which is expected to grow at CAGR of 45% (FY10-16E) to Rs 45bn as per CRISIL estimates**.** Share of organised players in the pre-school market is expected to shoot from 16% currently to 34% in FY16.

Self operated pre-school centers to drive growth

Out of the 315 centres run by the company, 243 are on self operated basis. THEAL plans to maintain the share of having self operated centers at 80% level going forward. Cities which are already operational may not provide scope for strong growth. We believe the company's next phase of growth will be driven by tier 2/tier 3 cities and new centres in tier 1 cities across India.

Low capex business model for pre-school

THEAL does not require major capex for setting up a pre-school as all facilites are on rent basis. In a tier 1 city, realisaitions would be higher; however, teacher cost and rental cost would impose pressure on the margins. In a tier 2 city, where realisations are on the lower side, cheap rentals and low teacher cost would have a positive impact on the operating margins.

K-12 scalability to drive earnings

THEAL offers school management service to Trusts which operate schools. This business division currently has 21 schools active and plans to increase the count to 27 by the end of FY14. In our estimate, these schools currently have 9,000 students enrolled and would create a capacity of 60,000 students which would grow every year as the classes move up the value chain.

Proper demand and supply dynamics

THEAL currently has 15,000 students in the self operated pre-school section; the enrollment is expected to grow at a CAGR of 44%(FY12-15E) to 45,000. It has 1400 quality teachers to train kids in pre-school who are highly qualified and experienced and the attrition among them is a mere 8%.

The earnings (EPS) of Tree House are expected to grow at a CAGR of 78% (FY11-14E). There is no other listed entity providing per-school services. Expansion towards K-12 will push revenues further. We initiate coverage with a BUY recommendation and a target price of Rs 330 based on 21xFY14E.

Y/E Mar (Rs. Mn)	FY12	FY13E	FY14E	FY15E
Net Sales	772	1,200	1,771	2,374
EBITDA	420	689	1,074	1,466
Net Profit	217	318	534	815
EPS (Rs)	6.4	9.4	15.8	24.0
EPS (growth)	131.0	46.6	68.1	52.6
PER (x)	37.7	31.3	18.6	12.2
EV/Sales (x)	11.9	7.9	5.3	3.8
EV/EBITDA (x)	21.8	13.8	8.8	6.2
ROCE (%)	13.2	13.0	18.1	25.0

Source: Company; IFIN Research

Huge market opportunity in pre-school segment

Tree House has 315 pre-school centers; pre-school market is expected to grow at a CAGR of 45%(FY10-16E) to Rs 45bn as per CRISIL

THEAL provides pre-schooling services to children of age group 1.5-6years. Historically until FY02, the pre-school market was controlled by a few unorganised players which occupied a large share of the entire market. The size of organised pre-school market all over India is Rs 4.8bn. THEAL provides pre-school services with 315 centres and has captured a large chunk of the organised pre-school market, this market is expected to grow at CAGR of 45% (FY10-16E) to Rs 45bn as per CRISIL estimates. THEAL, being the largest self operated pre-school player in India, has the potential to tap this huge organised market. We believe the that the company is well poised to maintain its revenue and profitability profile by penentrating into newer markets (Tier 2 and Tier 3) going forward.

Pre school market size - Rs bn (2009-10)

Pre school market size- Rs bn(2015-16E)

Source: CRISIL

Share of organized players in the pre-school market is expected to increase from 16% currently to 34% in FY16E

As per CRISIL estimates, the pre school market is expected to grow from Rs5bn in FY10 to Rs45bn in FY16E, led by increased demand for preschools, expansion of current large players and entry of new organised players in the market. The share of organised players in the pre-school market is expected to increase from 16% currently to 34% in FY16 which offers scope for immense growth.

Pre school market

Source: CRISIL

16% of India's overall population (2.1mn children) is expected to be the key target market for Tree House by FY16E

India as a market provides a big opportunity for pre-school services, given its demographics. The average growth in number of children is ~2% in Mumbai as per BMC; however it is the aggressive strategy of THEAL and its quality of services that has helped the company move over and above the competition in this segment. 16% of the population (2.1mn children) of India is expected to fall in the age group of 1.5-3.5yrs in FY16 which is a target market for pre-school services. Average realisation of ~Rs23,500 would result into a large market of Rs 48bn in FY16E.

Target market	FY11	FY16E
India Population (mn)	1210	1304
0-6yr population (mn)	159	157
Rural (mn)	118	114
Urban (mn)	41	43
1.5-3.5yr age group (mn)	14	13
Target Population (%)	12%	16%
Target segment population (mn)	1.7	2.1
Avg realization (Rs)	21500	23500
Addressable market (Rs mn)	36120	48880

Source: Company; IFIN Research

Self operated pre-school centres to drive growth

Out of the 315 centers, 243 run on self operated basis; the company will maintain the share of having 80% centers self operated going forward

THEAL has reduced its dependence on franchise centres over the last 3 years on the back of circumstancial issues. Franchise model provides a yearly royalty income but the quality in those centres may not be as good as in the self operated ones. The next wave of growth for the company will be driven by more self operated centres, thus ensuring the quality factor of education services. Out of the 315 centres, 243 are on self operated basis and the company will maintain the share of having 80% self operated centres going forward.

Source: Company; IFIN Research

Next phase of growth i will be driven by strong demand in tier 2 cities like Patna, Lucknow, Jaipur, Ranchi & Guwahati and new centers tier 1 cities

THEAL has 315 pre-school centres, of which a large percentage is in Mumbai and other tier 1 cities. Realisation and opportunity for growth in these centres has driven the revenue and earnings for the company in FY11 and FY12. Thus the scope for maintaining the momentum from the current business (primarily tier 1 city centric) is limited to new centers. We believe the company's next phase of growth will be driven by expansion of business in tier 2 and tier 3 cities across India. Cities like Patna, Lucknow, Jaipur, Ranchi & Guwahati will be the growth drivers in medium term. The scope for similar growth from operations in the existing tier 1 cities is therefore limited.

	No. of pre-schools	Estimated area (sq feet)	Expected period for launch
National Capital region	25	50000	FY12-14
Kolkata	25	50000	FY12-14
Mumbai	20	40000	FY12-14
Pune	10	20000	FY12-14
Hyderabad	10	20000	FY12-14
Bangalore	10	20000	FY12-14
Jaipur	5	10000	FY12-14
Patna	5	10000	FY12-14
Chandigarh	5	10000	FY12-14
Kochi	5	10000	FY12-14
Total	120	240000	

Source: Company; IFIN Research

Pre-school runs solely on rentals and thereby is a low capex business model; however operating margins are more attractive in a tier 2 cities on the back of lower rent cost and teacher cost

Low capex business model for pre-school

THEAL does not require any major capex for setting up a pre-school center, as all facilites are on rent basis. In a tier 1 city, realisations of the centers would be higher; however, teacher cost and rental cost would impose pressure on the margins. In a tier 2 city, where realisations are on the lower side, cheap rentals and low teacher cost would have a positive impact on the operating margins. The management has maintained a blend of establishing pre-school centres across tier 1 and tier 2 cities. The demand for pre-school is so strong that in both the scenarios the number of enrollments would increase three fold over a period of 3 years which would also have a positive impact on the operating margin in both scenarios.

FIRST YEAR

Tier 1 city

- Revenue - Rs 2.6m
- Cost - Rs 1.6m
- EBIDTA - Rs 1.0m
- Students enrolled - 65
- Capex - Rs 4m
- **EBIDTA margin - 39%**

Tier 2 city

- Revenue - Rs 1.0m
- Cost - Rs 0.7m
- EBIDTA - Rs 0.3m
- Students enrolled - 55
- Capex - Rs 4m
- **EBIDTA margin - 30%**

SECOND YEAR

Tier 1 city

- Revenue - Rs 5.7m
- Cost - Rs 1.8m
- EBIDTA - Rs 3.9m
- Students enrolled - 145
- Capex - NIL
- **EBIDTA margin - 68%**

Tier 2 city

- Revenue - Rs 2.5m
- Cost - Rs 0.9m
- EBIDTA - Rs 1.6m
- Students enrolled - 110
- Capex - NIL
- **EBIDTA margin - 65%**

THIRD YEAR

Tier 1 city

- Revenue - Rs 7.9m
- Cost - Rs 2.1m
- EBIDTA - Rs 5.8m
- Students enrolled - 175
- Capex - NIL
- **EBIDTA margin - 73%**

Tier 2 city

- Revenue - Rs 4.8m
- Cost - Rs 1.2m
- EBIDTA - Rs 3.6m
- Students enrolled - 145
- Capex - NIL
- **EBIDTA margin - 75%**

Source: Company; IFIN Research

Tree House currently has 21 K-12 schools; it plans to increase this number to 27 schools by the end of FY14 which would have a capacity of 60,000 students

K-12 scalability to drive earnings

Children studying in pre-school of THEAL act as an ideal feeder population for K-12 schools being managed by the company, which is one of the key reasons for huge expansion in this segment. It currently has 21 schools active and plans to increase this to 27 by the end of FY14. These schools currently have 9000 students enrolled and would create a capacity of 60,000 students which would grow every year as the classes move up the value chain.

K-12 schools

Students in K-12

Source: Company; IFIN Research

Partnership with Trusts to provide management services to K-12 schools will trigger revenue growth in the near term

THEAL provides funding to Trusts by the way of non interest refundable security deposits which are used by the Trusts to build schools. The Trusts have partnership with land owners which leads to lower cost. In return, Tree House gets the right to provide school management services to these Trusts for 30 years. The children studying in pre-school of Tree House act as a feeder population for the K-12 schools managed by it. These Trusts currently have 21 pre-schools operational and have well qualified and experienced staff and principals to run the schools efficiently.

Source: Company; IFIN Research

Proper demand and supply dynamics

In our estimate, the number of students in pre-school is expected to grow at a CAGR of 44%(FY12-15E) to 45,000

In our estimate, THEAL currently has 15,000 students in the self operated pre-school section. This number is expected to grow at a CAGR of 44%(FY12-15E) to 45,000. The strong growth going forward will be primarly driven by tier 2 and tier 3 cities, which provide a huge untapped market . Increased spending and awareness in smaller cities will contirbute to this growth. Aggressive stance of the management to increase market share and build a strong brand will also lead to high growth in number of students.

Source: Company; IFIN Research

Large teacher base of 1400 teachers with minimal attrition of 8%; the teacher to student ratio is 1:14 in pre-school

The company has quality teachers, who are highly qualified and experienced. It has a cooperative teacher culture, which ensures efficiency and is one of the reasons for extremely low attrition of 8%. The teacher base has consistently increased as per growth in centre and has touched the 1400 mark as on Q2FY13. Teacher to student ratio at pre-schol level is 1:14 which will remain at these levels. The management also provides stock options to teachers to retain them in the company.

Source: Company; IFIN Research

Financial Analysis - Consolidated

Revenue analysis

EBIDTA margin

Source: Company, IFIN Research

Net profitabilty

Return ratios

Source: Company, IFIN Research

Key costs

Cash- including deposit to K-12 (Rs mn)

Source: Company, IFIN Research

Initiate coverage with a target price of Rs 330 based on 21xFY14E earnings

Tree House has traded at an average PER multiple of 26x post its listing in Aug,2011

Valuation

Revenue is expected to grow at a CAGR of 64%(FY11-14E) on the back of strong growth in number of students in pre-school and K-12. The company is already operating at a strong EBIDTA margin of 57%, which is higher than any other peer in this industry. We expect margin expansion in FY14E as pre-school in tier 2 cities is a high margin business due to lower rental costs. Earnings for THEAL are expected to increase at a CAGR of 78%(FY11-14E) due to strong revenue growth and margin expansion. We expect the K-12 business to start picking up post FY14 when the entire capacity is available for use. It currently has 21 K-12 schools operational and plans to increase this to 27 by end of FY14 with a capacity of 60,000 students. We believe the company has reached near top of its investment cycle for K-12 and won't require any funding here on for large investments in future.

Tree House has traded at an average PER of 26x post its listing in Aug 2011. Strong revenue growth and expansion in EBIDTA margin will continue to provide upside in earnings for FY14E.

We initiate coverage on Tree House with a BUY recommendation at a target of Rs 330 based on 21xFY14E earnings.

Source: Company, IFIN Research

	Sales (Rs mn)		Sales CAGR	EBIDTA margin		Net profit (Rs mn)		EPS (Rs)		EPS CAGR
	FY13E	FY14E	(FY11-14E)	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	(FY11-14E)
MT Educare	1,601	2,027	24.4%	23.7%	23.6%	206	259	5.9	7.4	45.1%
Everonn *	7,330	9,343	29.7%	39.6%	40.6%	1,209	1,524	60.8	79.2	23.8%
Tree House	**1,200**	**1,771**	**64.2%**	**57.4%**	**60.7%**	**318**	**534**	**9.4**	**15.8**	**77.5%**

	CMP	Reco	TP (Rs)	Mkt cap	EV/Sales		EV/EBIDTA		PER		ROE	
				(Rs bn)	(x)		(x)		(x)		(%)	
					FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
MT Educare	127	BUY	156	4.9	2.6	1.9	10.9	8.2	21.6	17.1	20.1	22.5
Everonn *	142	NR	-	9.2	1.0	0.8	2.4	1.8	2.3	1.8	-	-
Tree House	**268**	**BUY**	**325**	**3.1**	**7.9**	**5.3**	**13.8**	**8.8**	**29.0**	**17.2**	**10.5**	**14.2**

Source: Company, IFIN Research

***based on Bloomberg consensus**

Company profile

Tree House Education and Accessories, which was established in 2003 provides pre-school services across 315 centers in India. Pre-school busienss is expected to grow at a faster pace in tier 2 cities going forward. In 2008, the company started the K-12 business and tied up with various trusts to manage these schools. The investment in these schools is made by the internal accruals of Tree House. The Trusts would start paying back the money invested for K-12 as they grow bigger in scale and are able to increase students.

Source: Company; IFIN Research

Shareholding pattern

Source: Company, IFIN Research

Management profile

Key Board members
Mr Sanjaya Kulkarni, Chairman
Mr. Sanjaya Kulkarni is the Chairman and an independent Director of the Company.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
Rajesh Bhatia, Managing Director
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 in marketing management from Pune University. Mr. Bhatia has approximately ten years of experience in the education industry. He has been associated with the Company since its inception. He oversees the day to day operations of our Company.
Vishal Shah, Director
Mr. Vishal Shah is an executive Director of the Company. He holds bachelor of commerce degree from Mumbai University and masters of business administration in finance from Narsee Monjee Institute of Management Studies, Mumbai. Mr. Shah has approximately six years of experience in the education industry. He worked with Apple Finance Limited as trainee in 1994-1996. In 1996, he joined Indsec Securities and Finance Limited as an assistant vice president.
Ashu Garg, Director
He holds a bachelor of technology degree from Indian Institute of Technology, Delhi and masters of business administration from Indian Institute of Management, Bangalore. Mr. Garg is a venture partner at Foundation Capital, and is the nominee Director on behalf of FC VI India Venture (Mauritius) Limited. Most recently, he was a general manager with Microsoft's on-line services business, where he was responsible for strategy and business management for the Digital Advertising Solutions Business Group.
TS Sarangpani, Director
Mr. T.S. Sarangpani is an independent Director of the Company. He holds a bachelor of engineering degree and masters of business administration from the University of Madras. Mr. Sarangpani has approximately 32 years of experience in the financial services industry. He started his career with ICICI Bank Limited. After spending seven years with them in the project finance area, he moved to the manufacturing industry where he worked at International Instruments, Bangalore and Nuchem Plastics, New Delhi. Since 1990, Mr. Sarangpani was associated with the financial services industry
Rishi Navani, Director
He holds a bachelor of arts degree from Northwestern University and masters of business administration from Wharton School at the University of Pennsylvania, where he graduated as a palmer scholar. Mr. Navani has over 10 years of experience investing in the Indian market. He is the co-founder and managing director at Matrix India Asset Advisors Private Limited, and is the nominee Director on behalf of Matrix Partners India Investment Holdings, LLC. Previously, he was the managing director at WestBridge Capital Partners

Source: Company, IFIN Research

Financials- Consolidated

Income Statement

Year end 31 Mar (Rs mn)	FY12	FY13E	FY14E	FY15E
Net sales	**772**	**1,200**	**1,771**	**2,374**
growth (%)	*95.8*	*55.4*	*47.6*	*34.1*
Gross profit	**488**	**764**	**1,181**	**1,594**
Other operating charges	7	8	11	13
EBITDA	**420**	**689**	**1,074**	**1,466**
growth (%)	*145.7*	*64.0*	*55.9*	*36.5*
Depreciation	78	180	217	246
Other income	39	49	10	30
EBIT	**38**	**56**	**87**	**125**
Interest paid	65	87	77	44
Pre-tax profit (before E/o items)	**316**	**470**	**790**	**1,206**
Tax Provision	99	153	256	391
E/o loss / (Income)	0	4	0	0
Net profit	**217**	**318**	**534**	**815**
Adjusted net profit	**217**	**318**	**534**	**815**
growth (%)	*131.0*	*46.6*	*68.1*	*52.6*
Diluted EPS (Rs)	**6.4**	**9.4**	**15.8**	**24.0**
Diluted EPS Growth (%)	*131.0*	*46.6*	*68.1*	*52.6*

Source: Company; IFIN Research

Cash Flow Statement

Year end 31 Mar (Rs mn)	FY12	FY13E	FY14E	FY15E
Pre-tax profit	316	470	790	1,206
Depreciation	78	180	217	246
Total tax paid	(65)	(153)	(256)	(391)
Chg in working capital	(144)	(1,042)	(357)	(124)
Other operating activities	29	39	67	15
Cash flow from operations (a)	**213**	**(506)**	461	952
Capital expenditure	(908)	(524)	(298)	(348)
Chg in investments	(285)	108	(3)	(170)
Other investing activities	14	23	0	11
Cash flow from investing (b)	**(1,179)**	**(393)**	(300)	(507)
Free cash flow (a+b)	**(97)**	**(90)**	16	45
Equity raised/(repaid)	1,160	676	0	0
Debt raised/(repaid)	38	150	(80)	(250)
Change in Minorities Interest	(65)	(87)	(77)	(44)
Dividend (incl. tax)	0	(45)	(50)	(80)
Other financing activities	0	(0)	0	0
Cash flow from financing (c)	**1,133**	**694**	**(207)**	**(374)**
Net chg in cash (a+b+c)	**166**	**(205)**	(45)	71

Source: Company; IFIN Research

Balance Sheet

Year end 31 Mar (Rs mn)	FY12	FY13E	FY14E	FY15E
Equity Share capital	337	368	368	368
Reserves & surplus	2,227	3,145	3,629	4,363
Shareholders' funds	**2,564**	**3,513**	**3,997**	**4,732**
Minorities interests	0	0	0	0
Total Debt	514	664	587	344
Capital Employed	**3,078**	**4,177**	**4,584**	**5,076**
Net fixed assets	1,566	1,827	1,990	2,092
Net Current Assets (excl Cash & Cash eq.)	973	1,766	2,123	2,433
Cash & Cash Eq.	477	298	262	351
Investments	62	203	206	189
Net Deferred Tax Assets	0	0	0	0
Total assets	**3,078**	**4,094**	**4,581**	**5,065**

Source: Company; IFIN Research

Key ratios

Year end 31 Mar	FY12	FY13E	FY14E	FY15E
OPM (%)	54.4	57.4	60.7	61.8
Net margin (%)	28.1	26.5	30.1	34.3
Dividend Payout (%)	18.1	14.2	9.4	9.8
Net debt/Equity (x)	0.2	0.2	0.1	0.1
Current ratio (x)	1.2	1.1	1.1	1.1
Interest coverage ratio (x)	5.9	6.4	**11.3**	**28.5**
ROCE (%)	13.2	13.0	18.1	25.0
RoE (%)	11.4	10.5	14.2	18.7
EV/Net sales (x)	11.9	7.9	5.3	3.8
EV/EBITDA (x)	21.8	13.8	8.8	6.2
PER (x)	37.7	31.3	18.6	12.2
Price/Book (x)	3.2	2.8	2.5	2.1

Source: Company; IFIN Research

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Key ratings:

Rating	Market Cap >= Rs 100 bn	Market Cap < Rs 100 bn
BUY (B)	> 15%	> 20%
Hold (H)	5-15%	10-20%
SELL (S)	< 5%	< 8%
Not Rated (NR)	Not initiated coverage on the stock	

IFIN: IFCI Financial Services Limited

Corporate Office: 'Continental Chambers', III Floor| 142, Mahatma Gandhi Road |Nungambakkam | Chennai - 600 034 | Tel: +91-44-2830 6600 | Fax: +91-44-2830 6650

Mumbai Office: 7- 9th Floor, Earnest House| Nariman Point I Mumbai - 400 021 | Tel: +91-22-4333 5111

E-mail: sales@ifinltd.in **| Website:** www.ifinltd.in

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