ANANDRATHI

India I Equities

Education Update

Change in Estimates ☑ Target ☑ Reco ☑

6 December 2012

TreeHouse Education and Accessories

Fund infusion to fuel growth; positives priced in; Hold

Rating: **Hold**
Target Price: ₹280
Share Price: ₹258

TreeHouse Education and Accessories' preferential allotment would bring it ₹812m (~10.8% dilution). Promoter holding would rise two percentage points to 31.21%. Net cash and cash equivalents (~₹412m, ₹11 a share) by end-FY13 would aid organic growth and M&A opportunities. Though we raise our price target to ₹280, on the rich valuations we have a Hold call on the stock.

- **Fund Infusion.** Via preferential allotment to the promoters (₹400.7m), to Aditya Birla PE (₹311.6m) and to ON Mauritius (₹100.2m), TreeHouse Education and Accessories have raised ₹812m (a 10.6% dilution). Promoters have been issued warrants requiring them to pay ₹100.2m (25%) now and the rest in the next 18 months. Shares have been issued to the Funds; hence full payment would be made on allotment. The subscription will take place at ₹222.60 a share. Post-funding, equity dilution will be ~10.8%; however, promoter holding would increase by nearly two percentage points and climb to 31.21%.
- **Enough cash to grow.** Net cash and cash equivalents would be ~₹412m (₹11 a share) by end-FY13. This would help the company's organic growth and its search for M&A opportunities.
- **Change in estimates.** While our operating estimates for FY13 hold good, we expect the ₹512m infusion to lower the interest burden and help pay off debt. Further in FY14 the balance ₹300m from the promoters will be received. The ₹812m will aid organic and inorganic growth. We trim our EPS estimates to account for the dilution due to the preferential issue.
- **Valuation.** On the rich valuations, we downgrade the stock to a Hold. We, nevertheless, using the DCF-based method raise our price target to ₹280 at which the stock would trade at a PE of 19x FY14e and 13x FY15e earnings. **Risks.** Available skilled manpower; geographical concentration, regulatory risks for the K-12 segment.

Key financials (YE: Mar)	FY11	FY12	FY13e	FY14e	FY15e
Sales (₹m)	392	772	1,135	1,784	2,531
Net profit (₹m)	92	217	333	548	818
EPS (₹)	3.8	6.4	8.9	14.7	21.9
Growth (%)	156.5	67.9	38.6	64.6	49.3
PE (x)	67.4	40.2	29.0	17.6	11.8
PBV (x)	5.1	3.4	2.9	2.3	2.0
RoE (%)	9.6	11.4	11.2	14.5	17.9
RoCE (%)	11.8	16.0	16.9	21.6	26.7
Dividend yield (%)	-	0.4	0.4	0.4	0.4
Net gearing (%)	13.1	(10.7)	(12.2)	(23.9)	(26.6)

Source: Company, Anand Rathi Research

Key data	THEAL IN / THEA.BO
52-week high / low	₹279 / ₹140
Sensex / Nifty	19392 / 5901
3-m average volume	US$0.3m
Market cap	₹8.8bn / US$159.1m
Shares outstanding	34.1m

Shareholding pattern (%)	Sep '12	Jun '12	Mar '12
Promoters	29.60	29.60	29.60
- of which, Pledged	-	-	-
Free Float	70.75	70.40	70.40
- Foreign Institutions	4.88	2.92	2.56
- Domestic Institutions	7.23	7.41	7.30
- Public	58.64	60.07	60.54

Estimates revision (%)	FY13e	FY14e	FY15e
Sales	-	3.0	0.5
EBITDA	-	2.0	(0.4)
EPS	(5.5)	0.1	(4.9)
Target multiple (x)	-	-	-

Relative price performance

Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
Net revenues	392	772	1,135	1,784	2,531
Revenue growth (%)	83.6	96.8	47.0	57.2	41.9
- Op. expenses	223	352	523	840	1,196
EBIDTA	**169**	**420**	**612**	**944**	**1,336**
EBITDA margin (%)	43.1	54.4	53.9	52.9	52.8
- Interest expenses	12	65	51	2	2
- Depreciation	40	78	116	164	188
+ Other income	19	39	52	40	75
- Tax	44	99	164	270	403
Effective tax rate (%)	32.5	31.4	33.0	33.0	33.0
Reported PAT	92	217	333	548	818
+/- Extraordinary items	-	-	-	-	-
+/- Minority interest	-	-	-	-	-
Adjusted PAT	92	217	333	548	818
Adj. FDEPS (₹/share)	3.8	6.4	8.9	14.7	21.9
Adj. FDEPS growth (%)	156.5	67.9	38.6	64.6	49.3

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
Share capital	240	337	374	374	374
Reserves & surplus	986	2,227	3,005	3,796	4,570
Net worth	1,226	2,564	3,378	4,169	4,943
Minority interest	-	-	-	-	-
Total debt	466	515	15	15	15
Def. tax liab. (net)	18	33	33	33	33
Capital employed	**1,711**	**3,112**	**3,426**	**4,217**	**4,991**
Net fixed assets	1,288	1,566	1,673	1,750	1,925
Investments	26	312	-	-	-
- of which, Liquid	26	250	-	-	-
Net working capital	117	757	1,326	1,454	1,735
Cash and bank balance	279	477	427	1,013	1,331
Capital deployed	**1,711**	**3,112**	**3,426**	**4,217**	**4,991**
Net debt	161	(212)	(412)	(998)	(1,316)
WC days	109	381	427	298	250
Book value (₹/sh)	51.1	76.0	90.4	111.6	132.3

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
PAT	92	217	333	548	818
+ Non-cash items	54	93	116	164	188
Cash profit	146	309	449	712	1,006
- Incr./(Decr.) in WC	45	640	569	128	281
Operating cash-flow	101	(330)	(120)	584	725
- Capex	693	356	223	242	363
Free cash-flow	(591)	(686)	(343)	342	362
- Dividend	-	39	44	44	44
+ Equity raised	437	1,160	525	287	0
+ Debt raised	346	49	(500)	-	-
- Investments	16	285	(312)	-	-
- Misc. items	-	-	-	-	-
Net cash-flow	175	198	(50)	586	319
+ Op. cash & bank bal.	103	279	477	427	1,013
Cl. cash & bank bal.	279	477	427	1,013	1,331

Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹258

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
CEPS (₹/share)	5.5	8.7	12.0	19.1	26.9
Cash / (debt) (₹/share)	(6.7)	6.3	11.0	26.7	35.2
P/E (x)	67.4	40.2	29.0	17.6	11.8
P/B (x)	5.1	3.4	2.9	2.3	2.0
P/C (x)	47.1	29.5	21.5	13.5	9.6
EV/sales (x)	22.6	11.3	7.3	4.3	2.9
EV/EBITDA (x)	52.6	20.8	13.5	8.2	5.5
EBIT/sales (%)	37.9	49.3	48.2	45.9	48.3
Sales/average CE (x)	0.3	0.3	0.4	0.5	0.6
Adj. RoCE (%)	11.8	16.0	16.9	21.6	26.7
Avg. CE/ avg. eq. (x)	1.3	1.3	1.1	1.0	1.0
PBT/EBIT (x)	0.9	0.8	0.9	1.0	1.0
PAT/PBT (x)	0.7	0.7	0.7	0.7	0.7
Adj. RoE (%)	9.6	11.4	11.2	14.5	17.9
Dividend yield (%)	-	0.4	0.4	0.4	0.4

Source: Company, Anand Rathi Research

Fig 5 – Valuation chart (EV/EBITDA)

Source: Bloomberg, Anand Rathi Research

Fig 6 – Revenue break-up

Source: Company, Anand Rathi Research

Fund infusion

Treehouse's preferential allotment to its promoters (₹400.7m), Aditya Birla PE (₹311.6m) and ON Mauritius (₹100.2m) would bring in ₹812m. The promoters have to pay 25% now (₹100.2m). Shares have been issued to the Funds; full payment will come on allotment. With this ~10.8% dilution, the promoter holding will rise nearly two percentage points to 31.21%. Net cash and cash equivalents (~₹412m, ₹11 a share) by end FY13 would aid in organic growth and M&A opportunities.

Fund infusion

Via preferential allotment to the promoters (₹400.7m), to Aditya Birla PE (₹311.6m) and to ON Mauritius (₹100.2m), TreeHouse will raise ₹812m. The promoters have been issued warrants which require them to pay 25% or ₹100.2m now and the balance in the next 18 months. The Funds have been issued shares and full payment will come in on allotment. The subscription will take place at ₹222.60 a share.

Promoter holding to increase

Although after this round of funding, equity has been diluted ~10.8%, the promoter holding would rise nearly two percentage points and stand at 31.21%.

Enough cash to augment growth

The company would have net cash and cash equivalents of ~₹412m (₹11 a share) by end-FY13. This would help organic growth as well as scouting for M&A opportunities.

Fig 7 – Cash / Debt per Share.

	FY07	FY08	FY09	FY10	FY11	FY12	FY13e	FY14e	FY15e
Cash/Bank & Liquid assets	3	2	21	114	305	727	427	1,013	1,331
Debt	4	2	0	120	466	515	15	15	15
Net Cash / Debt	(1)	0	21	(6)	(161)	212	412	998	1,316
Cash / (debt) (₹/share)	(79.0)	0.0	1.4	(0.4)	(6.7)	6.3	11.0	26.7	35.2

Source: Company, Anand Rathi Research

Business dynamics robust

We believe that pre-school business dynamics in general are intact especially on the implementation of the Right to Education (RTE) Act by state governments. We expect a general shortage of seats in the nursery and KG sections by more than 25% in cases of those integrated pre-schools which are a part of K-12 schools. This in turn would see more students preferring standalone pre-school chains such as Treehouse.

Change in estimates and target

We raise our FY13, FY14 and FY15 net profit estimates 4.8%, 11% and 5.4% respectively. However, we reduce our FY13 and FY15 EPS estimates 5.5% and 4.9% to respectively ₹8.9 and ₹21.9. While we expect it to be flat in FY14 at ₹14.7. We raise our price target to ₹280 and downgrade the stock to a Hold.

Major estimate changes

While our operating estimates for FY13 hold good, we expect the ₹512m infusion to reduce the interest burden and help pay off debt. Further in FY14 the balance ₹300m from the promoters will be received. The combined ₹812m will help organic and inorganic growth. We trim our EPS estimates to account for the dilution due to the preferential issue.

Fig 8 – Change in estimates

	FY13e			FY14e			FY15e		
(₹m)	Old	New	% chg	Old	New	% chg	Old	New	% chg
Sales	1,135	1,135	-	1,732	1,784	3.0	2,518	2,531	0.5
EBITDA	612	612	-	925	944	2.0	1,341	1,336	(0.4)
EBITDA margin (%)	53.9	53.9	-	53.4	52.9	(50.0)	53.3	52.8	(50.0)
Consolidated PAT	318	333	4.8	494	548	11.0	776	818	5.4
FDEPS (₹)	9.4	8.9	(5.5)	14.6	14.7	0.1	23.0	21.9	(4.9)

Source: Anand Rathi Research

Valuation

On the rich valuations, we downgrade the stock to a Hold. We raise our price target however, using the DCF-based method, to ₹280. At this target, the stock would trade at a PE of 19x FY14e and 13x FY15e earnings (Fig 9).

Risks

- **Geographical concentration.** Most of the company's operations are centered around Mumbai (more than 115 of its centres are in this city). Hence, any disruption in operations or competition would significantly cut into its overall operations. The company is aware of this and has entered new markets: Kolkata (20 centres), Nagpur, Ranchi and Guwahati.
- **Attrition.** Attrition in the senior management/content/teaching team could seriously hit the business. While senior members of the team hold shares, management is keen on issuing ESOPs to lower-level employees as well.
- **Regulatory risk in formal education.** Any changes in regulatory norms in formal education (K-12) may significantly eat into earnings.

Fig 9 – DCF-based valuation

Year-end: Mar	FY12	FY13e	FY14e	FY15e	FY16e	FY17e	FY18e	FY19e	FY20e	FY21e	FY22e	FY23e
FCFF												
Revenues (₹m)	772	1,135	1,784	2,531	3,592	5,096	7,104	9,725	13,070	17,239	22,307	28,306
Growth (%)	96.8	47.0	57.2	41.9	41.9	41.9	39.4	36.9	34.4	31.9	29.4	26.9
EBITDA (₹m)	420	612	944	1,336	1,859	2,587	3,535	4,694	6,112	7,759	9,650	11,750
Margins (%)	54.4	53.9	52.9	52.8	51.8	50.8	49.8	48.3	46.8	45.0	43.3	41.5
Depreciation/amortisation (₹m)	78	116	164	188	146	171	205	248	304	374	458	558
Interest expenses (₹m)	65	51	2	2	2	2	2	2	2	2	2	2
Other income (₹m)	39	52	40	75	75	75	75	75	75	75	75	75
PBT (₹m)	316	497	817	1,220	1,786	2,489	3,404	4,518	5,881	7,459	9,265	11,265
Tax (₹m)	99	164	270	403	589	821	1,123	1,491	1,941	2,462	3,058	3,718
PAT (before MI) (₹m)	**217**	**333**	**548**	**818**	**1,197**	**1,668**	**2,281**	**3,027**	**3,940**	**4,998**	**6,208**	**7,548**
Add: depreciation (₹m)	78	116	164	188	146	171	205	248	304	374	458	558
Add: interest*(1-tax rate) (₹m)	45	34	1	1	1	1	1	1	1	1	1	1
Cash profit (₹m)	**339**	**483**	**713**	**1,007**	**1,344**	**1,840**	**2,486**	**3,277**	**4,245**	**5,372**	**6,667**	**8,107**
Increase/decrease in working capital (₹m)	640	569	128	281	-1,538	82	110	144	183	228	278	329
Operating cash flow (₹m)	-300	-86	585	726	2,882	1,758	2,376	3,133	4,062	5,144	6,389	7,778
Capex (₹m)	356	223	242	363	353	502	669	874	1,115	1,390	1,689	2,000
FCFF (₹m)	-656	-309	344	364	2,529	1,256	1,707	2,260	2,947	3,754	4,700	5,778
Less: interest*(1-tax rate) (₹m)	45	34	1	1	1	1	1	1	1	1	1	1
FCFE (₹m)	-701	-343	342	362	2,528	1,255	1,706	2,258	2,946	3,753	4,699	5,777
Year of discounting (no.)			1	2	3	4	5	6	7	8	9	10
Discounted FCFF (₹m)	**-656**	**-309**	**302**	**281**	**1,716**	**749**	**895**	**1,041**	**1,193**	**1,336**	**1,469**	**1,588**
Discounted FCFE (₹m)	**-701**	**-343**	**301**	**280**	**1,715**	**748**	**894**	**1,040**	**1,192**	**1,334**	**1,468**	**1,586**

Calculation WACC	
CMP (₹)	258
Equity (market cap) (₹m)	9,640
Debt (FY13e) (₹m)	15
Risk-free rate - Rf (%)	9.0
Rm - market return (%)	15.0
Beta (B)	0.8
Cost of equity (ke) (%)	13.8
Cost of debt (kd) (%)	12.0
Wd (%)	0.2
We (%)	99.8
WACC (%)	**13.8**
Growth rate (g) (%)	5.0
FCFF in 2023e (₹m)	5,778
Terminal value of firm (₹m)	3,944
Present value of terminal value(₹m)	1,084
NPV of FCFF (₹m)	9,017
Net debt (₹m)	-274
Intrinsic value (₹m)	10,374
Outstanding shares (no. m)	37.4
Value per share (₹)	**278**

Terminal growth (%) \ Cost of equity (%)	278	11.8	12.8	13.8	14.8	15.8
	3	307	285	265	247	230
	4	316	292	271	251	234
	5	329	301	**278**	257	239
	6	345	314	287	264	245
	7	369	330	299	273	252

Source: Company, Anand Rathi Research

Fig 10 – Income statement (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
Revenues	**392**	**772**	**1,135**	**1,784**	**2,531**
Growth (%)	83.6	96.8	47.0	57.2	41.9
Expenses	**223**	**352**	**523**	**840**	**1,196**
As % of revenue	56.9	45.6	46.1	47.1	47.2
Center operating exp	102	188	274	426	602
As % of revenue	26.0	24.4	24.1	23.9	23.8
Employee cost	49	96	144	231	328
As % of revenue	12.5	12.5	12.7	13.0	13.0
Other costs	72	68	105	183	266
As % of revenue	18.4	8.7	9.2	10.2	10.5
EBITDA	**169**	**420**	**612**	**944**	**1,336**
EBITDA margin (%)	43.1	54.4	53.9	52.9	52.8
Interest	12	65	51	2	2
Depreciation	40	78	116	164	188
Other income	19	39	52	40	75
As % of investments	18.3	14.2	17.1	11.1	12.8
PBT	**136**	**316**	**497**	**817**	**1,220**
Tax	44	99	164	270	403
Effective tax rate (%)	32.5	31.4	33.0	33.0	33.0
PAT	92	217	333	548	818
PAT margin (%)	23.4	28.1	29.3	30.7	32.3
PAT growth (%)	253.8	135.6	53.6	64.6	49.3
Reported PAT	**92**	**217**	**333**	**548**	**818**
Shares as per BS (y/e) (nos. m)	24.0	33.7	37.4	37.4	37.4
Diluted shares (nos. m)	24.0	33.7	37.4	37.4	37.4
FDEPS (₹)	3.8	6.4	8.9	14.7	21.9
Growth (%)	156.5	67.9	38.6	64.6	49.3
Dividend	-	34	37	37	37
DPS (Rs)	-	1.0	1.0	1.0	1.0
Dividend Tax	-	6	6	6	6
Dividend payout (%)	-	15.6	11.2	6.8	4.6
Extra ordinary & Prior period adjustments	-	-	-	-	-
Transferred to reserves	92	177	289	504	774

Source: Company, Anand Rathi Research

Fig 11 – Balance sheet (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
Equity	240	337	374	374	374
Reserves (including warrants)	986	2,227	3,005	3,796	4,570
Shareholders' funds	**1,226**	**2,564**	**3,378**	**4,169**	**4,943**
Debt	466	515	15	15	15
Minority interest					
Capital employed	**1,693**	**3,079**	**3,393**	**4,184**	**4,958**
Fixed assets	1,288	1,566	1,673	1,750	1,925
Investments	26	312	-	-	-
Deferred tax assets	(18)	(33)	(33)	(33)	(33)
Cash	279	477	427	1,013	1,331
Working capital	117	757	1,326	1,454	1,735
Capital deployed	**1,693**	**3,079**	**3,393**	**4,184**	**4,958**

Source: Company, Anand Rathi Research

Fig 12 – Consolidated cash-flow (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
PAT	92	217	333	548	818
+ non-cash expense	54	93	116	164	188
Cash profit	**146**	**309**	**449**	**712**	**1,006**
- Increase/(decrease) in working capital	45	640	569	128	281
Operating cash flow	**101**	**(330)**	**(120)**	**584**	**725**
- Capex	693	356	223	242	363
Free cash flow	**(591)**	**(686)**	**(343)**	**342**	**362**
+ Equity raised	437	1,160	525	287	0
+ Debt raised	346	49	(500)	-	-
- Investments	16	285	(312)	-	-
- Dividend paid	-	39	44	44	44
- Misc. expense	-	-	-	-	-
Net change in cash	**175**	**198**	**(50)**	**586**	**319**
Opening cash	103	279	477	427	1,013
Closing cash	**279**	**477**	**427**	**1,013**	**1,331**

Source: Company, Anand Rathi Research

Fig 13 – Key ratios @ ₹258

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
Diluted shares (m)	24.0	33.7	37.4	37.4	37.4
FDEPS (₹)	3.8	6.4	8.9	14.7	21.9
CEPS (₹)	5.5	8.7	12.0	19.1	26.9
BV (₹)	51.1	76.0	90.4	111.6	132.3
P/E (x)	67.4	40.2	29.0	17.6	11.8
P/C (x)	47.1	29.5	21.5	13.5	9.6
P/B (x)	5.1	3.4	2.9	2.3	2.0
DPS (Rs)	-	1.0	1.0	1.0	1.0
Dividend yield (%)	-	0.4	0.4	0.4	0.4
Dividend payout (%)	-	15.6	11.2	6.8	4.6
EV/Sales (x)	23	11	7	4	3
EV/EBITDA (x)	52.6	20.8	13.5	8.2	5.5
EBIT/sales (x)	37.9	49.3	48.2	45.9	48.3
Sales/avg.CE (x)	0.3	0.3	0.4	0.5	0.6
Debt/equity (x)	0.4	0.2	0.0	0.0	0.0
ROCE (%)	11.8	16.0	16.9	21.6	26.7
Avg. CE/avg. equity (x)	1.3	1.3	1.1	1.0	1.0
PBT/EBIT (x)	0.9	0.8	0.9	1.0	1.0
PAT/PBT (x)	0.7	0.7	0.7	0.7	0.7
ROE (%)	9.6	11.4	11.2	14.5	17.9
Net gearing (%)	13.1	(10.7)	(12.2)	(23.9)	(26.6)
Working capital turnover (days)	109	358	427	298	250

Source: Company, Anand Rathi Research

Appendix

Analyst Certification

The views expressed in this Research Report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. The research analysts are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter "SEBI") and the analysts' compensation are completely delinked from all the other companies and/or entities of Anand Rathi, and have no bearing whatsoever on any recommendation that they have given in the Research Report.

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Rating and Target Price History (as of 5 December 2012)

	Date	Rating	TP (₹)	Share Price (₹)
1	29-Dec-11	Buy	225	168
2	12-Nov-12	Buy	260	228

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Anand Rathi Ratings Definitions

Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US$1bn) and Mid/Small Caps (<US$1bn) as described in the Ratings Table below:

Ratings Guide

	Buy	Hold	Sell
Large Caps (>US$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US$1bn)	>25%	5-25%	<5%

Anand Rathi Research Ratings Distribution (as of 29 Oct 2012)

	Buy	Hold	Sell
Anand Rathi Research stock coverage (155)	65%	25%	10%
% who are investment banking clients	5%	3%	0%

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