

Sensex 28845 Nifty 8757 Price: INR 418 Target Price: INR 459

**OUTPERFORMER**

**Background:** Tree House Education & Accessories Ltd (THEAL) is India's largest branded self-operated pre-school provider and the only listed self operated pre-school operator in India. It currently operates 562 pre-schools (459 are self operated) in 80 cities. In 2009, THEAL has done a forward integration to provide management services to K-12 schools. THEAL currently provides management services to 24 K-12 schools in 3 states. Geographically, THEAL's pre-schools are skewed towards Western India wherein it operates 56% of its pre-schools. The Pre-schools in other regions are as follows, North (16.5%), South (12.3%) and East (15.1%). THEAL's K-12 presence is restricted to the three western states Rajasthan (11 schools), Maharashtra (11 schools) and Gujarat (2 schools).

52 Week High/Low INR 548/214  
Bloomberg code THEAL IN  
Reuters code THEA.BO  
Issued Equity (shares in mn) 42.31  
Mkt. Cap in INR mn INR 17,686  
Mkt. Cap in mn USD \$ 285  
Avg. Daily Vol. ('000) 96.65  
Avg. Daily Vol. (mn) INR 40.4/\$ 0.65

### THEAL has a strong market share in most of the Tier I cities

Company has a strong presence in 5 out of 9 tier 1 markets with double digit organized sector market share (in terms of no of pre-schools). In Greater Mumbai market, THEAL is the market leader with an organized market share of ~46%; followed by Kolkata (25.2%), Ahmedabad (20.7%), Pune (18.4%) and Hyderabad (13.5%).

### Pre-School income to grow ~4.7X between FY14-20E aided by center expansion

We expect the preschool revenue to grow at a CAGR of 24.4% between FY14-20E to reach INR 5.6bn by FY20E. The growth would be largely aided by the pre-school addition; we have factored in preschool addition of ~643 pre-schools (of which 619 are company operated centers) between FY14-20E. We have assumed that 75% of these new company operated centers are to be opened in Tier II & III cities and the remaining 25% in tier I cities.

Shareholding	Dec13	Sep14	Dec14
Promoters (%)	30.87	32.43	28.94
FII (%)	1.16	10.00	20.24
DII (%)	10.22	6.93	4.30
Others (%)	57.75	50.64	46.52
Pledge (% of promoter holding)	20.07	22.01	27.82

### K-12 Business to turn cash flow positive

Management has indicated no major capex plan for K-12 business, coupled with monetization of K-12 fixed assets (land & building) and the repayment of IFRSD will make the K-12 business to turn cash flow positive in FY15 and expected to grow at a CAGR of 15.4% from INR 343mn in FY15E to INR 703mn in FY20E.

### Daycare service at inflection point and it is margin & return accretive

Day care service is RoE and margin accretive. We have estimated THEAL's to report revenue of INR 10.5mn from daycare services in FY15E and daycare services is likely to grow at a CAGR of 109.5% between FY15E-20E to reach INR 424mn. We expect the margin accretion from daycare services to be 0.4% in FY15E and as the daycare services attain scale, it is likely to gradually increase to 5.2% by FY20E.

Performance%	1M	3M	12M
THEAL	-7.2	-5.4	91.98
Sensex	2.1	3.5	38.4

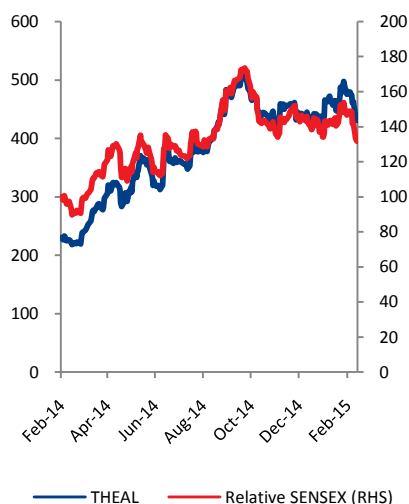
### Outlook & Valuation

We have valued THEAL using DCF. In the growth phase (FY15-20) we have modeled a sales growth of ~25.6% CAGR and operating cash flow growth of ~25.4% CAGR. In the terminal growth phase we have modeled a perpetual growth of 6.5%. We have discounted the future cash flows using WACC of 12.7% to arrive at a target price of INR 459 per share, which is 27.6X and 20.4X of FY16 and FY17 Adj. EPS of INR 15.2 and INR 20.5 respectively and we rate THEAL as an OUTPERFORMER.

**Risk:** Slower ramp up in the pre-school will hurt sales growth and profitability. Low entry barriers resulting in higher competition from existing and new players.

### Valuation Summary

Y/E March ( INRmn)	FY14	FY15E	FY16E	FY17E
Revenue	1,576	2,081	2,593	3,185
EBITDA	892	1,159	1,450	1,806
PAT	439	521	642	866
EPS	11.8	12.3	15.2	20.5
EPS growth (%)	44.7	4.3	23.1	34.9
FCF / Share	-18.6	7.8	13.6	16.0
PE	35.4	33.9	27.6	20.4
P/ BV	3.9	2.7	2.4	2.2
EV / EBITDA	18.2	15.6	11.9	9.7
EV / Sales	10.3	8.7	6.7	5.5
Dividend Yield (%)	0.4	0.4	0.7	0.6
ROCE (%)	16.5	15.2	18.7	17.6
ROE (%)	12.0	10.6	13.5	11.4
Net Debt / Equity	0.2	0.1	-0.1	0.0



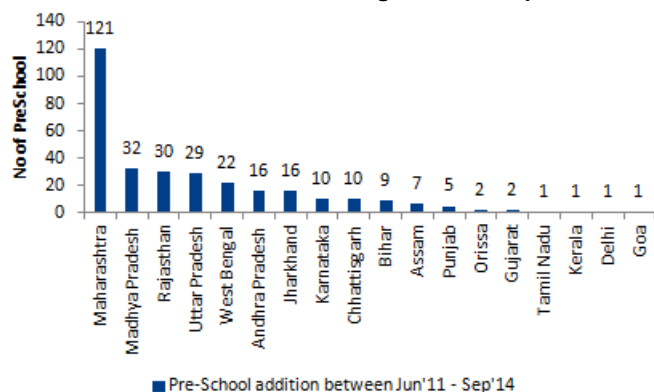
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## Investment Rationale

### Pre-School income to grow ~4.7X between FY14-20E aided by center expansion

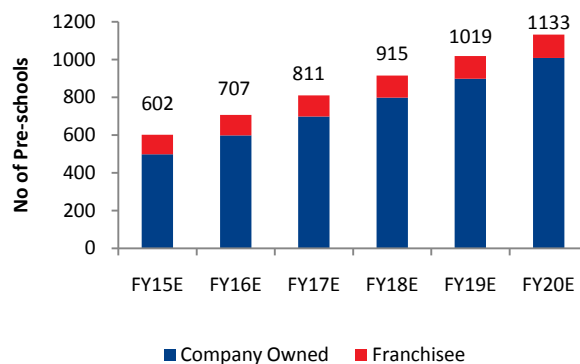
Between June 2011 to Sep 2014, company has added 315 preschools, largely through company owned centers (279 company owned centers and 36 franchised centers) and the pre-school revenue has grown from INR 283mn in FY11 to INR 1.21bn in FY14. Notably 121 new centers i.e. 38.4% of the total new centers were opened in Maharashtra followed by Madhya Pradesh (32 new centers), Rajasthan (30 new centers), Uttar Pradesh (29 new centers) and West Bengal (22 new centers).

**Exhibit 1: Pre-school added during Jun'11 - Sep'14**



Source: Company, CSEC Research

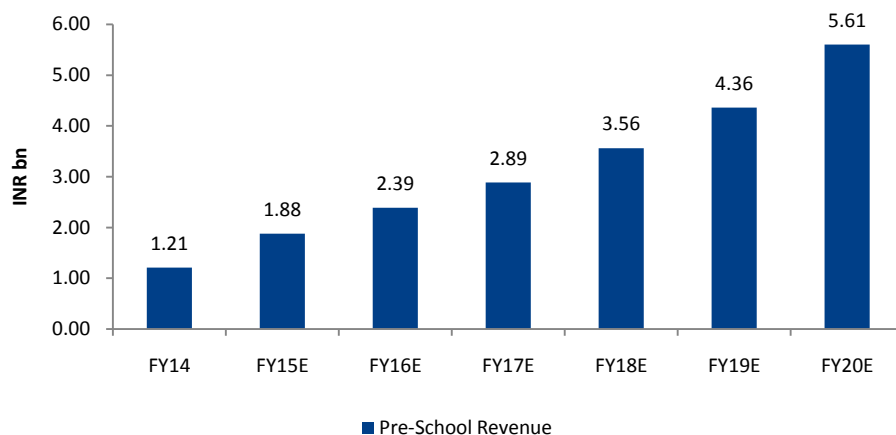
**Exhibit 2: THEAL Pre-school addition**



Source: Company, CSEC Research

Going forward, we expect the preschool revenue to grow at a CAGR of 29% between FY14-20E to reach INR 5.6bn by FY20E. The growth would be largely aided by the pre-school addition; we have factored in addition of ~643 pre-schools (of which 619 are company operated centers) between FY14-20E. We have assumed that 75% of these new company operated centers are to be opened in Tier II & III cities and the remaining 25% in tier I cities.

**Exhibit 3: THEAL's Pre-school revenue to grow at a CAGR of 29% (FY14-20E)**

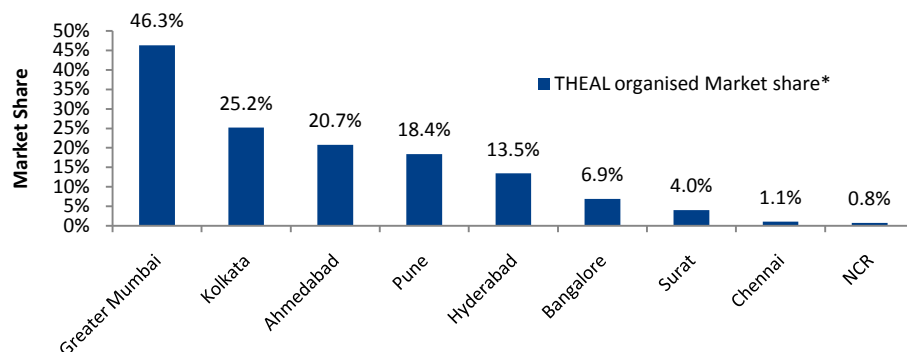


Source: Company, CSEC Research

## THEAL has a strong market share in most of the Tier I cities:

Tier-1 market comprises of Greater Mumbai (which includes Mumbai, Navi Mumbai, Thane, Bhiwandi and Kalyan), Kolkata, Chennai, NCR, Bangalore, Pune, Hyderabad, Surat and Ahmedabad. Company has a strong presence in 5 out of 9 Tier 1 markets with double digit organized sector market share (in terms of no of pre-schools). In Greater Mumbai market, THEAL is the market leader with an organized market share of ~46%; followed by Kolkata (25.2%), Ahmedabad (20.7%), Pune (18.4%) and Hyderabad (13.5%).

**Exhibit 4: THEAL's Pre-school Market share in Tier I market**

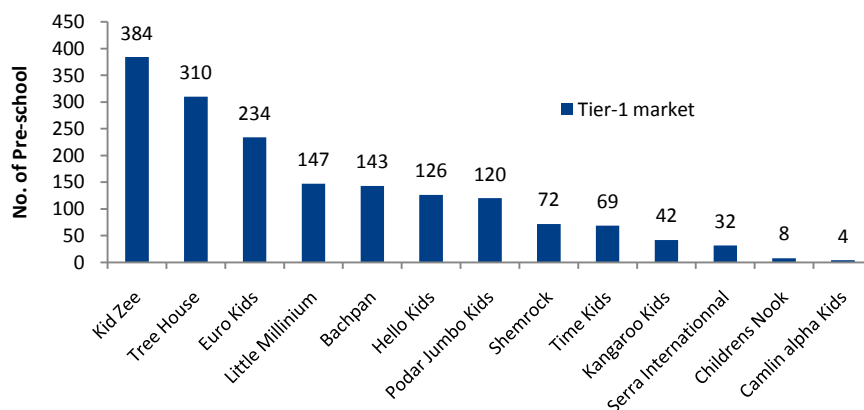


Source: CSEC Research \* Market share based on no of pre-schools

## Going forward the Pre-school addition is going to be largely outside Tier I cities

Tier-1 market has a target population (age group of 2-4 years) of 3.98mn children i.e. 33.1% of the total target population. In general, the affordability & acceptance of pre-school is higher in Tier-1 market thus offering better realization for the pre-school operators. According to our estimate, there are 1,691 pre-schools operated by the organized players (Pan India players) in tier-1 market, which implies 1 pre-school for every 2,352 children (Target population).

**Exhibit 5: No. of Pre-school operated by organized players in Tier I market**



Source: Company, CSEC Research

Though this gives an impression that these markets are fairly less penetrated, but in reality this information is far from complete, as there are numerous unorganized players operating in these markets. According to Crisil report, in India, organized pre-school operators account for 22% of the total market. Tier-1 being a key market we believe the market share of the organized players would be higher. Scenario analysis on the market share of the organized players in Tier-1 market (in the range of 22% to 42%); total number of pre-school in Tier-1 market could be in the range of 4,026 (assuming 42% market share) to 7,686 (assuming 22% market share), which implies there is 1 pre-school for every 517 to 987 children (target population). According to the industry sources there must be at least 40 children per pre-school in order to breakeven, which implies the penetration level has to be at least in the range of 4.1% to 7.7% in order for these pre-schools to breakeven in Tier-1 market.

#### Exhibit 6: Scenario Analysis - Organized Players Market share

Tier – I market	Organized Players Market Share (OPMS)				
	22.0%	27%	32%	37%	42%
Organized Preschools	1,691	1,691	1,691	1,691	1,691
Unorganized Preschools	5,995	4,572	3,593	2,879	2,335
<b>Total Preschools</b>	<b>7,686</b>	<b>6,263</b>	<b>5,284</b>	<b>4,570</b>	<b>4,026</b>

Source: CSEC Research

Amongst the Tier-1 markets, we feel NCR & Surat are the least penetrated, while Ahmedabad, Kolkata and Greater Mumbai market are moderately penetrated. Chennai, Bangalore, Hyderabad and Pune are fairly penetrated. Hence we have factored in only 25% of the pre-school addition (i.e.) 155 new centers in Tier-1 market.

#### Exhibit 7: Analysis of Tier-I market

Tier I Market	THEAL organised Market share*	Target Population	Target Population/Total pre-school		Pre-school operated by organised players	Break-even penetration level	
			OPMS 22%	OPMS 42%		OPMS 22%	OPMS 42%
<b>Pune</b>	18.4%	241,232	238	454	223	16.8%	8.8%
<b>Bangalore</b>	6.9%	374,419	247	472	333	16.2%	8.5%
<b>Hyderabad</b>	13.5%	357,517	353	673	223	11.3%	5.9%
<b>Chennai</b>	1.1%	351,251	425	811	182	9.4%	4.9%
<b>Greater Mumbai</b>	46.3%	848,448	551	1,051	339	7.3%	3.8%
<b>Kolkata</b>	25.2%	457,259	666	1,272	151	6.0%	3.1%
<b>Ahmedabad</b>	20.7%	290,372	779	1,487	82	5.1%	2.7%
<b>NCR</b>	0.8%	822,269	1,360	2,597	133	2.9%	1.5%
<b>Surat</b>	4.0%	234,724	2,066	3,943	25	1.9%	1.0%
<b>Tier I Market</b>	<b>18.3%</b>	<b>3,977,491</b>	<b>517</b>	<b>987</b>	<b>1,691</b>	<b>7.7%</b>	<b>4.1%</b>

Source: CSEC Research \*market share based on no of centers

### Well capitalized to fund its pre-school expansion

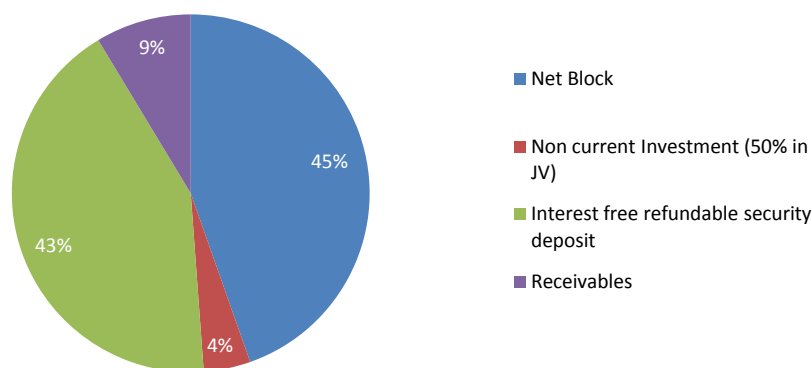
Recently THEAL has raised INR 2,000mn (net proceeds: INR 1,889.9mn) via QIP by issuing 4.55mn shares at INR 440 per share. The QIP has diluted the equity to the extent of 10.74%. The key investors in this QIP are Macquarie Asia, Mondrian Emerging market small cap fund and Swedbank Robur Global Emerging markets. Company intends to use these proceeds for expansion of pre-school and for general business purpose. Assuming a capex of INR 4.5mn – 6.5mn per center, the proceeds are sufficient to open 290 to 420 pre-schools.

### K-12 Business to turn cash flow positive

Formal educational institutes in India should be a not-for-profit entity operated either by trusts; societies or companies under section-25 of the Indian Companies Act and the major source of capital for these institutions are donations from various entities. Since these institutions are not-for-profit entity, it is restricted from distributing dividends. This restriction has limited the capital raising ability of these institutions thereby affecting the growth prospects of this business as the K-12 business requires huge upfront investment to build school infrastructure and working capital till it becomes self sufficient. To address this challenge, it is a common practice in the industry, that these K-12 institutions will tie-up with the investor and the surplus profits are distributed to the investor and record the same as an expense item in educational institutes P&L.

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**Exhibit 8: Classification of K-12 assets**



Source: Company, CSEC Research

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According to our estimate, as on FY14, Company has invested INR 2.7bn (51.5% of total asset) in 24 K-12 schools (Maharashtra: 11, Rajasthan: 11 and Gujarat: 2) which has a total capacity of 47,000 students. According to the management, there are 12,371 students studying in its K-12 schools, which implies a capacity utilization of 26.3% and the average fee is INR 70,000 p.a. The investments were towards Net Block (Land, Building & Business commercial right) which constitute 45% of the total investment, Interest free refundable security deposit (IFRSD) constitutes for 43% of the investment, which is refundable within five years from the date of disbursement, receivables from K-12 schools (9% of the investment) and Investment in JT Infrastructure, where the company has 50% equity interest (4% of total investment).

In return, THEAL receives school management fee (SMF), curriculum development fee (CDF) and rent from these K-12 schools. The school management fees and rent is regular stream of cash inflow, while the curriculum development fee is ad hoc in nature. THEAL receives a rental income from the Four K-12 schools, where the land & buildings are owned by THEAL (3 direct ownership & 1 through 50% JV). In FY14, the rent income from K-12 schools stood at INR 30.68mn, which implies a yield of 3.6%.

In FY14, company has recognized an income of INR 183.18mn (on accrual basis) towards curriculum, content and development service provided to various educational institutions and recognized an operating cost of INR 42.13mn. The educational institutions will pay the curriculum development fee to THEL in three annual installments i.e. INR 129.71mn in 4QFY15, INR 26.73mn each in FY16 & FY17.

According to our estimate, school management fee has grown at a CAGR of 74.15% from INR 50mn in FY12 to INR 151mn in FY14. The school management fee is calculated based on the operating profit of the K-12 trust and the lack of access to the trust financials act as a blind spot in estimating future school management fee. However, according to the management, currently, the average operating cost of these 24 K-12 trust is around 70% and 85% of K-12 school trust's operating profit is paid to THEAL as a school management fee.

Although school management fee is a regular cash flow stream, the recognition of the same under P&L (as income) or Balance Sheet (repayment of security deposit) remains at the discretion of the management. Moreover, as THEAL incur only the capital cost on school management fee, it is 100% margin accretive at the EBITDA level. Hence, we choose to analyze K-12 business on a cash flow basis, as it will take account of the entire cash flow stream (both P&L and Balance sheet), capital cost and accrual accounting.

The cash inflows from K-12 business grew at a CAGR of 143% from INR 62mn in FY12 to INR 365mn in FY14; while the cash outflows grew at a CAGR of 66% from INR 355.4mn in FY12 to INR 979mn in FY14. Hence, the net cash outflow has increased from INR 293mn in FY12 to INR 614.22mn in FY14, as these K-12 schools were in the investment phase. Management has indicated no major capex plan for K-12 business, coupled with monetization of K-12 fixed assets (land & building) and the repayment of IFRSD will make the K-12 business to turn cash flow positive in FY15 and expected to grow at a CAGR of 15.4% from INR 343mn in FY15E to INR 703mn in FY20E.

### Exhibit 9: Performa Cash Flow Analysis of K-12 Business

Cash Inflow	FY12	FY13	FY14	FY15E	FY16E	FY17E	FY18E	FY19E	FY20E
<b>Rent</b>	12.18	12.18	30.68	30.68	6.00	6.00	6.00	6.00	6.00
<b>SMF (P&amp;L)</b>	49.79	71.70	151.00	160.43	171.39	232.25	304.29	385.94	480.88
<b>CDF</b>	0.00	0.00	183.18	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sale of Fixed asset</b>	0.00	0.00	0.00	140.00	240.00	0.00	0.00	0.00	0.00
<b>Repayment of IFRSD</b>	0.00	0.00	0.00	0.00	92.55	122.85	157.80	200.14	249.37
<b>Decrease in Receivable</b>	0.00	0.00	0.00	124.04	22.86	5.23	0.00	0.00	0.00
<b>Total Cash Inflow</b>	<b>61.97</b>	<b>83.88</b>	<b>364.85</b>	<b>455.14</b>	<b>532.80</b>	<b>366.32</b>	<b>468.09</b>	<b>592.08</b>	<b>736.25</b>
<b>Cash Outflow</b>									
<b>Purchase of Fixed asset</b>	100.45	60.65	609.62	0.00	0.00	0.00	0.00	0.00	0.00
<b>Land</b>	5.92	0.00	217.90	0.00	0.00	0.00	0.00	0.00	0.00
<b>Building</b>	92.81	61.80	341.72	0.00	0.00	0.00	0.00	0.00	0.00
<b>BCR + Intangible CWIP</b>	1.72	-1.15	50.00	0.00	0.00	0.00	0.00	0.00	0.00
<b>Non-current Investment (50% in JV)</b>	35.25	38.06	15.00	0.00	0.00	0.00	0.00	0.00	0.00
<b>IFRSD</b>	201.84	541.90	145.99	112.28	0.00	0.00	0.00	0.00	0.00
<b>Increase in Receivables</b>	17.87	7.86	208.47	0.00	0.00	0.00	25.46	28.86	33.55
<b>Total Cash Outflow</b>	<b>355.40</b>	<b>648.47</b>	<b>979.07</b>	<b>112.28</b>	<b>0.00</b>	<b>0.00</b>	<b>25.46</b>	<b>28.86</b>	<b>33.55</b>
<b>Net cash Flow</b>	<b>-293.43</b>	<b>-564.59</b>	<b>-614.22</b>	<b>342.85</b>	<b>532.80</b>	<b>366.32</b>	<b>442.63</b>	<b>563.22</b>	<b>702.70</b>

Source: CSEC Research

### Monetization of K-12 fixed assets

Company has recently monetized its fixed asset investments (land & building) in two of K-12 schools (Mira The Happy School) located in Atladara, Gujarat for total consideration of INR 695mn (Atladara-1: INR 171mn and Atladara -2: INR 525mn). The fixed asset investment in these two K-12 schools accounts for ~32% of THEAL's total fixed asset investments in K-12 schools. Due to these transaction, the company will incur one-off income of INR 315mn (4QFY15 & 1QFY16). These asset sales will reduce the rental income from the K-12 schools to INR 6mn in FY16 from INR 30.68mn in FY14.

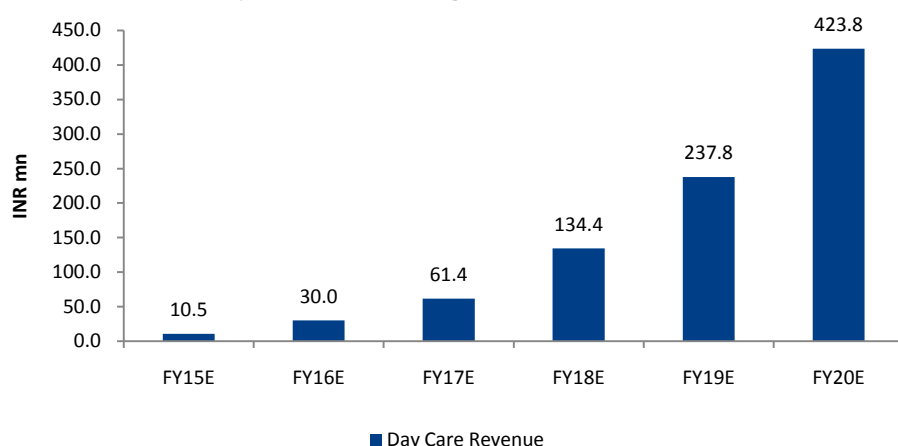
### Daycare service at inflection point and it is margin & return accretive

THEAL has started offering Daycare services in 2008 under the brand name Muskaan. Initially the services were limited to the THEAL's pre-school children, who continue to remain at the pre-school after their course till such time their parents are able to attend them. Earlier in order to provide the Daycare services, company has entered an agreement with the respective Center Head. Center Head is responsible for collecting the fee for the day care service and pays the company a percentage of the net income (Gross income less day care related expenses).

As the company was primarily focusing on the Pre-school business, it didn't grow the daycare business to its full potential, in FY13 the revenue from daycare stood at INR 0.1mn (0.01% of Preschool revenue). In FY14, company decided to aggressively expand this service offering daycare services in select facilities in Mumbai, Pune, Bangalore and Hyderabad. Currently day care services are offered in 103 centers with an enrollment of 500 students. In 9MFY15, the revenue from day care stood at INR 7.66mn a growth of 54.1% YoY.

Day care service is RoE (by optimizing the facility utilization and sharing the capital cost) and margin (by sharing the key operating costs such as rent, labor and utilities) accretive. We have estimated THEAL's to report revenue of INR 10.5mn from daycare services in FY15E and daycare services is likely to grow at a CAGR of 109.5% between FY15-20E to reach INR 423.8mn. We expect the margin accretion from daycare services to be 0.4% in FY15E and as the daycare services attain scale, it is likely to gradually increase to 5.2% by FY20E.

**Exhibit 10: THEAL's Daycare business to grow at a CAGR of 109.5%**



Source: Company, CSEC Research



## Financials

### Revenues are expected to grow at a CAGR of 26.4% between FY14-17E

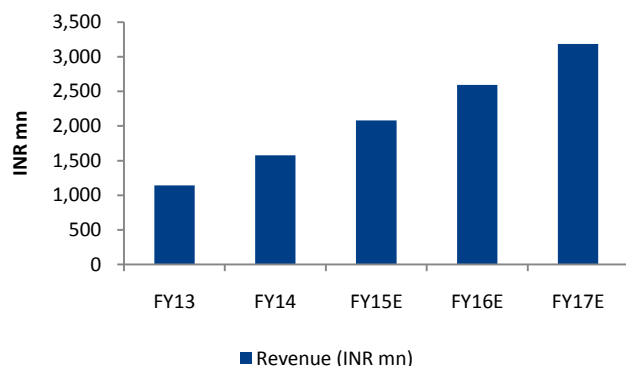
THEAL's revenue has grown at a CAGR of ~42.9% from INR 772mn in FY12 to INR 1.58bn in FY14; the growth was primarily on account of pre-school center expansion. In FY14, revenues from pre-schools account for ~76.8% of the total revenue and the pre-school revenue has grown at a CAGR of 30.6% from INR 710mn in FY12 to INR 1.2bn in FY14.

Pre-school revenues are further segmented into Fee Income from self operated centers (94%), sale of educational kits (1.2%), Income from teacher training course (1.2%), Franchisee signup fee (1%) and Royalty income (1.7%).

Revenue from K-12 business grew at a CAGR of 142.6% from INR 62mn in FY12 to INR 365mn in FY14. School management income has grown at a CAGR of 74.15% from INR 50mn in FY12 to INR 151mn in FY14. In FY14, company booked INR 183.18mn revenue for curriculum development fee and the educational institutions will pay the curriculum development fee to THEAL in three annual installments i.e. INR 129.71mn in 4QFY15, INR 26.73mn each in FY16 & FY17.

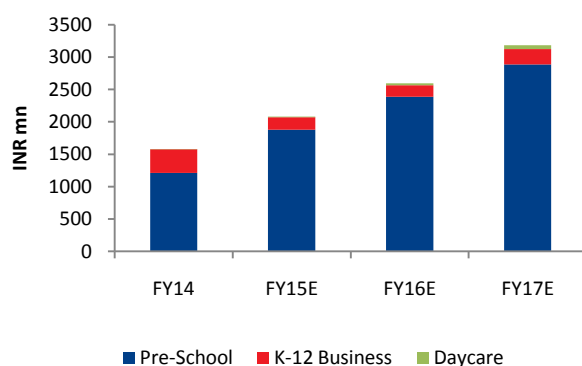
Going forward, we have estimated THEAL's revenue to grow at a CAGR of 26.4% from INR 1.58bn in FY14 to INR 3.19bn in FY17E, aided by addition of 321 pre-schools (313 self-operated centers, in 9MFY15, THEAL has added 73 self operated centers) between FY14-17 and the revenue from pre-school to grow at a CAGR of 33.6% from INR 1.21bn in FY14 to INR 2.89mn in FY17. Revenue from day care business is estimate to grow from meager INR 0.35mn in FY14 to INR 61.5mn in FY17. We have estimated that the 75% of the cash flow from K-12 schools to be booked as a revenue in FY15 and 55% of the cash flow from K-12 schools to be booked as a revenue in FY16&17 (as the repayment of security deposits will fall due starting from FY16). We expect revenue from K-12 schools (excl. curriculum development fee) to grow at a CAGR of 9.5% from INR181.7mn in FY14 to INR 238mn in FY17.

**Exhibit 11: THEAL Revenue to grow at a CAGR of 26.4%**



Source: Company, CSEC Research

**Exhibit 12: Revenue segmentation**

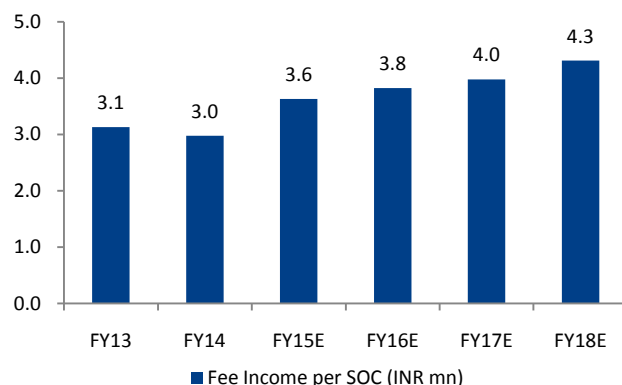


Source: Company, CSEC Research

## Scope for EBITDA margin expansion

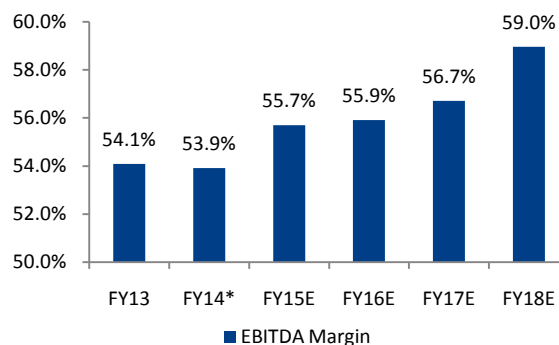
The EBITDA margin of THEAL has expanded from 43.1% in FY11 to 56.6% in FY14. Adjusting for the one-off curriculum development fee income in FY14, THEAL's operating income would be at 53.9% in FY14. The pre-school margin has expanded from 22% in FY11 to 47% in FY14. The margin expansion was primarily on account of scale improvement and higher revenue from K-12 business which is 100% margin accretive as it does not have any operating cost in THEAL's book.

**Exhibit 13: Growing revenue per pre-school**



Source: Company, CSEC Research

**Exhibit 14: Scope for margin expansion**



Source: Company, CSEC Research \* adj for one-off

Going forward, we expect the adjusted operating margin to improve from 53.9% in FY14 to 57% in FY17, due to higher operating leverage in pre-school business (currently 70% of the schools are operating in 2 shifts & 2% of schools operating in 3 shifts) coupled with the newly opened pre-school turning profitable (currently 69.65% of the pre-schools are running profitable) and margin accretion from K-12 business and Daycare business.

## Recent QIP to impact return ratios in the near term

Company has recently raised INR 2,000mn via QIP, which is likely to impact the return ratio in the near term. In FY14, company had a RoE & RoCE of 12% & 16.5% respectively and due to fund raising return ratio is likely to come down to 10.6% & 15.2% respectively in FY15E. Going forwards, the operating margin expansion coupled with the repayment of security deposits by K-12 operators are likely to positively impact the return ratio and we expect it to improve to 11.4% & 17.6% respectively in FY17. However in the longer term, RoE & RoCE is set to improve further to 21.5% & 32.4% respectively in FY20E.

### 3QFY15 Result update:

- Revenues up +33.7% YoY (+6.7% QoQ) at INR 531.1mn in 3QFY15. Revenue from Pre-school grew 108% YoY to INR 478.8mn; Day Care revenues grew 105% YoY to INR 3mn. Revenues from K-12 fell by 74% YoY to INR 41.6mn. In 9MFY15, revenue up 28.6% YoY to INR 1,567.8mn. Revenue from Pre-schools grew 42.7% YoY to INR 1,386mn; Day Care revenue grew 54.1% to INR 7.66mn and K-12 revenue fell by 36.6% to INR 122.6mn.
- EBITDA at INR 321.6mn up 31.1% YoY (+10.8% QoQ); EBITDA margin down 120bps YoY to 60.6%. Pre-schools operating margin expanded from 36.9% in 3QFY14 to 57.8% in 3QFY15.
- Operating expenses were up 30bps YoY to 21%; employee cost down 80bps YoY to 11.8% and other operating expenses were up 10bps YoY to 6.6%. Effective tax rate in 3QFY15 was down by 290bps YoY to 30.4%. Adj PAT margin contracted by 200bps YoY to 25.3%, due to higher depreciation and interest cost.
- Depreciation grew 49.4% to INR 66.5mn due to change in useful life of the asset (INR 12.34mn). Adj. for the change in useful life, PAT margin would be flat at 30.8%.
- Adj. PAT grew 25% YoY (+20.1% QoQ) at INR 151.2mn.
- Company has signed a MoU to monetize two K-12 school asset at Atladara 1&2 for the total consideration of INR 696mn (Atladara – 1 for INR 171 and Atladara -2 for INR 525mn), which is likely to improve the return ratio and better margin (due to lower depreciation cost).
- Net addition of preschools during 3QFY15 stood at 24. These pre schools were launched in cities such as Ratlam, Jhansi, Hajipur, Agra and Vishakhapatnam. Total no of centers as on December 31, 2014 is 562, spread across 80 cities in India. The number of self- operated pre-schools is 459 compared to 340 in 3QFY14.
- Ratio of self operated pre-school to the total pre-school is 81.67%.
- Total teachers strength as on December 2014 is 2,085.

### Exhibit 15: Results Summary 3QFY15

Y/E March ( INR mn)	3QFY15	3QFY14	YoY Growth	2QFY15	QoQ Growth
<b>Revenue</b>	531.1	397.3	33.7%	497.6	6.7%
<b>EBITDA</b>	321.6	245.3	31.1%	296.9	8.3%
<b>Depreciation</b>	66.5	44.5	49.4%	63.4	4.9%
<b>Other Income</b>	5	0.1	4900.0%	3.4	47.1%
<b>PBT</b>	217.1	181.3	19.7%	193.3	12.3%
<b>Tax</b>	65.9	60.3	9.3%	67.4	-2.2%
<b>PAT</b>	151.2	121	25.0%	125.9	20.1%
<b>Adjusted PAT*</b>	151.2	121	25.0%	125.9	20.1%
<b>EBITDA Margin (%)</b>	60.6	61.7		59.7	
<b>Tax Incidence (%)</b>	30.4	33.3		34.9	
<b>Adj PAT Margin (%)</b>	28.5	30.5		25.3	

\* Adjusted for forex loss / gain

## Valuation

We have valued THEAL using DCF. In the growth phase (FY15-20) we have modeled a sales growth of ~ 25.6% CAGR and operating cash flow growth of ~25.4% CAGR. In the terminal growth phase we have modeled a perpetual growth of 6.5%.

Particulars	Value
Beta	0.8
Risk free rate (Rf %)	8.09
Equity risk premium (ERP %)	6.9
Cost of Debt %	10
Cost of Equity % (CAPM)	13.8
WACC %	12.7
Tax Rate %	33.99

We have discounted the future cash flows using WACC of 12.7% to arrive at a target price of INR 459 per share, which is 27.6X and 20.4X of FY16 and FY17 Adj.EPS of INR 15.2 and INR 20.5 respectively and we rate THEAL as an OUTPERFORMER.

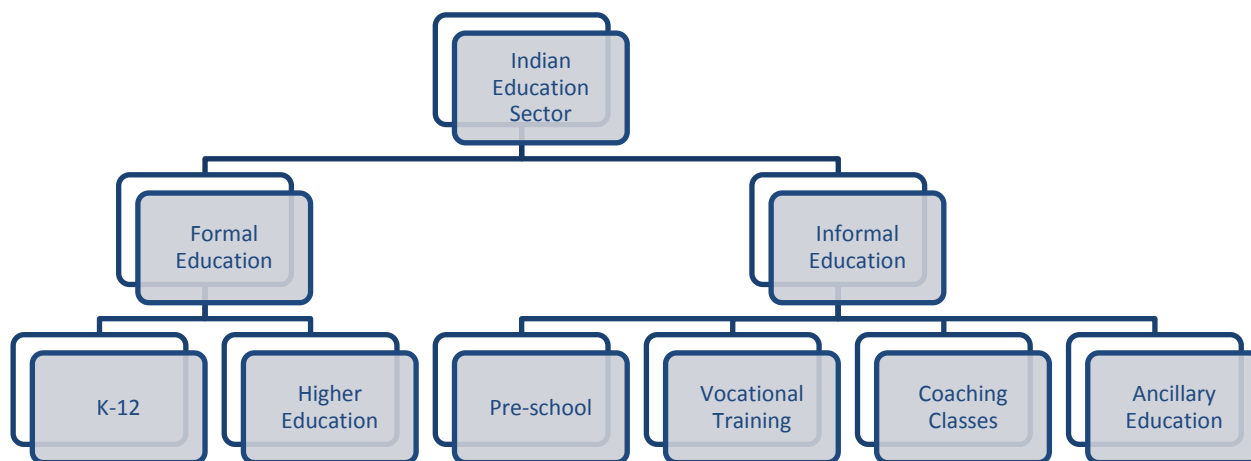
Terminal Growth	WACC					
		11.7%	12.2%	12.7%	13.2%	13.7%
	5.0%	443	407	376	349	325
	5.5%	476	435	400	370	343
	6.0%	514	467	427	393	363
	6.5%	560	505	459	419	386
	7.0%	616	550	496	450	412
	7.5%	685	605	540	487	442

## Industry overview:

The education sector in India is broadly classified into two categories i.e. formal education and informal education. Formal education includes K-12 and higher education which is highly regulated and falls under the purview of Ministry of Human Resources Development. Further, formal educational institutes in India should be a not-for-profit entity operated either by trusts, societies or companies under section-25 of the Indian Companies Act.

Informal education includes; pre-school, vocational training, coaching classes and ancillary education. While formal education is highly regulated, informal education is not regulated and presents a lucrative opportunity for private players to manage capacity and charge higher fees.

**Exhibit 16: Overview of Indian Education Sector**

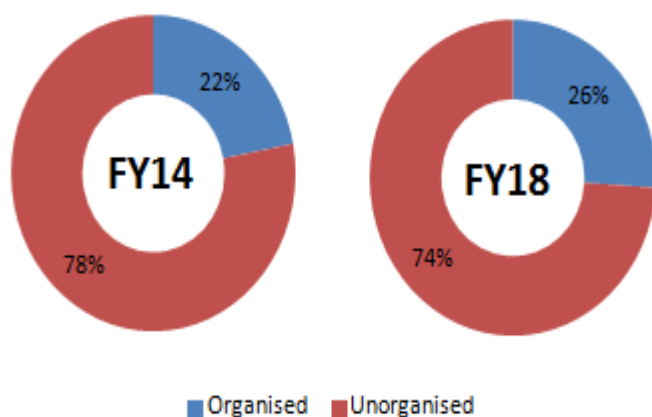


Source: CSEC Research

## Pre-School Industry:

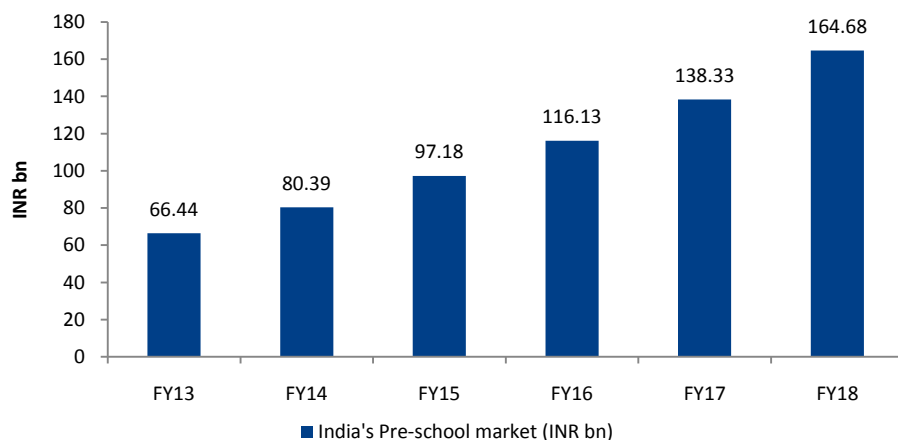
Pre-schooling in India is in the nascent stage, underpenetrated, largely fragmented and unorganized. According to Crisil estimate, pre-school market is estimated at INR 80.39bn (FY14) and it is expected to reach INR 164.68bn by FY18. The growth would be aided by rapid urbanization, growing per-capita income and increasing awareness about the importance of pre-schooling. Unorganized players account for 80% of the industry. However the skewness is expected to move slightly towards the organized sector from 22% in FY14 to 26% in FY18 largely due to the entry of more organized players and large scale expansion from the existing organized players.

**Exhibit 17: Break-up of Pre-school Market share**



Source: Crisil Research, CSEC Research

**Exhibit 18: Size of India's Pre-school Market**

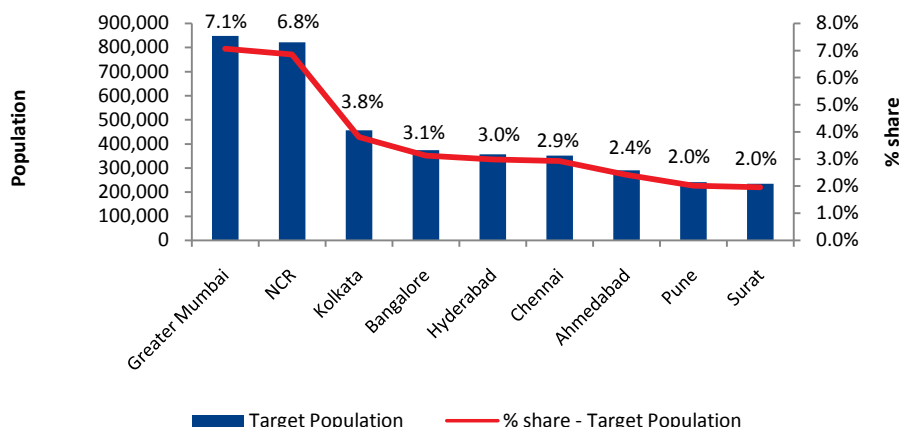


Source: Crisil Research, CSEC Research

## Detailed analysis on Tier-1 market

**Tier-I Market size:** Tier-I market has been defined with a population of >4,000,000 and according to the Census 2011 data there are 9 cities which has a population >4mn i.e. Greater Mumbai, NCR, Kolkata, Chennai, Hyderabad, Pune, Bangalore, Ahmedabad and Surat. These Tier-1 markets have a target population of 3.98mn children in the age group of 2-4 years i.e. 33.1% of the total target population in India.

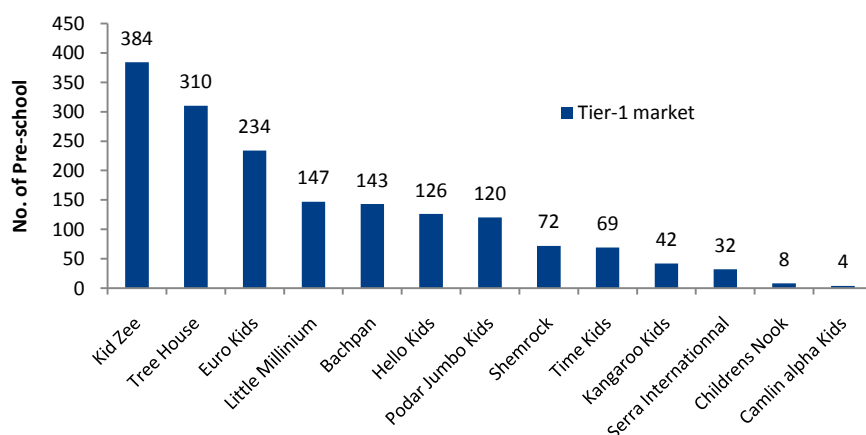
**Exhibit 19: Tier I market Size**



Source: Census India, CSEC Research

**Organised Pre-school Market:** We have classified organized market as the pre-school operated by Pan-India players; there are 11 key organized players operating on Pan-India basis THEAL, KidZee, Euro Kids, Podar Jumbo Kids, Kangaroo Kids, Shemrock, Bachpan, Little Millennium, Serra International, Time Kids and Hello Kids. According to our estimates, there are 1,691 pre-schools operated by the organized players in the Tier-I market.

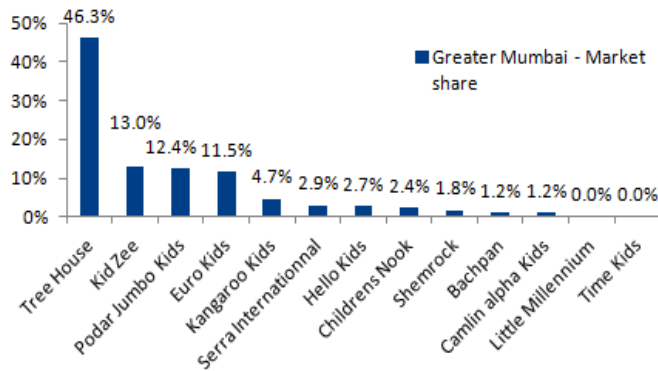
**Exhibit 20: No. of Pre-schools operated by organized players in Tier I market**



Source: Census India, CSEC Research

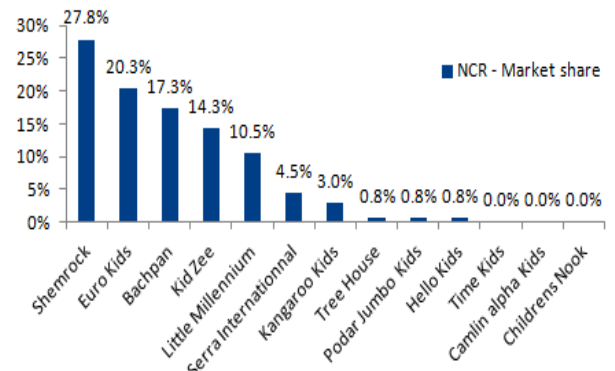
**Market Leader:** Kid Zee has the highest market share (in terms of number of number of pre-schools) in most of the Tier-I markets such as Chennai (41.2%), Kolkata (47%), Ahmedabad (34.1%), Pune (26.9%) and Surat (44%). Hello Kids is the market leader in Bangalore; Bachpan is the market leader in Hyderabad; THEAL is the market leader in Greater Mumbai; Shemrock is the market leader in NCR.

**Exhibit 21: Greater Mumbai Market**



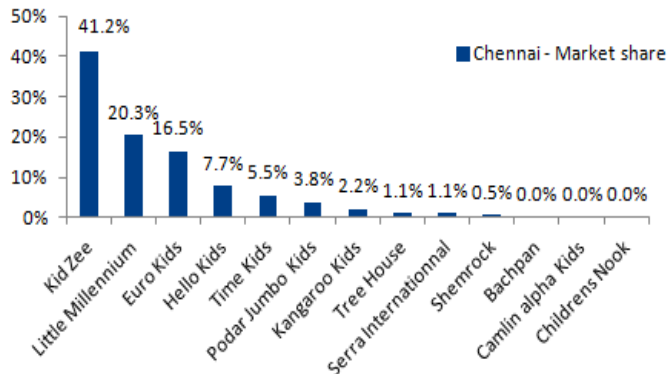
Source: Company, CSEC Research

**Exhibit 22: NCR Market**



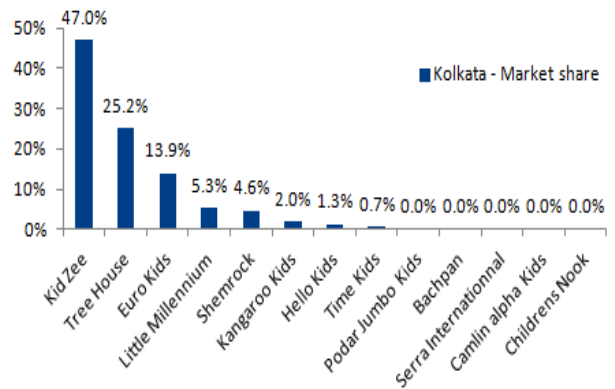
Source: Company, CSEC Research

**Exhibit 23: Chennai**



Source: Company, CSEC Research

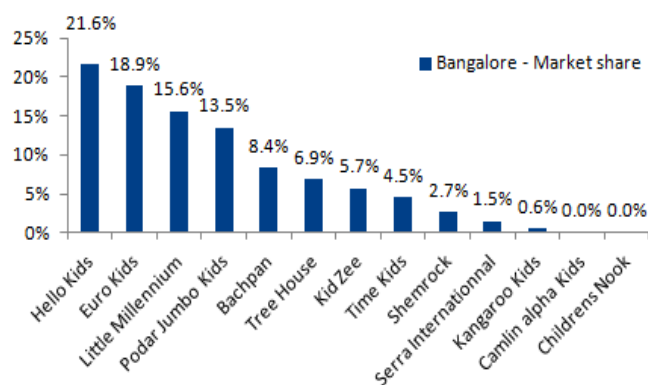
**Exhibit 24: Kolkata**



Source: Company, CSEC Research

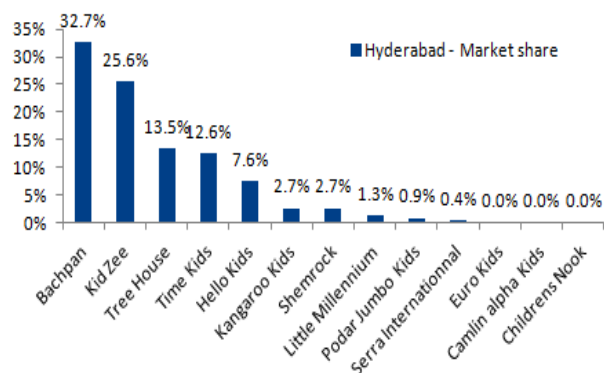


**Exhibit 25: Bangalore Market**



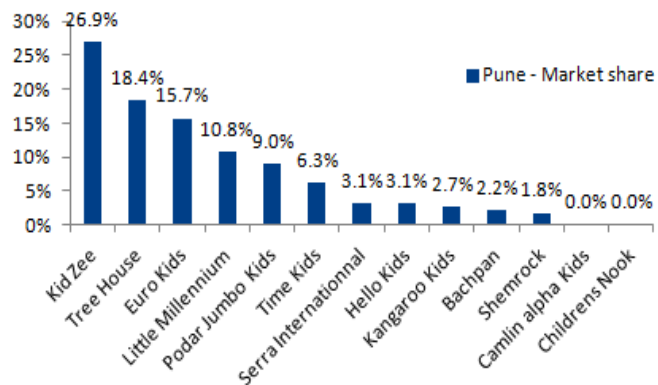
Source: Company, CSEC Research

**Exhibit 26: Hyderabad Market**



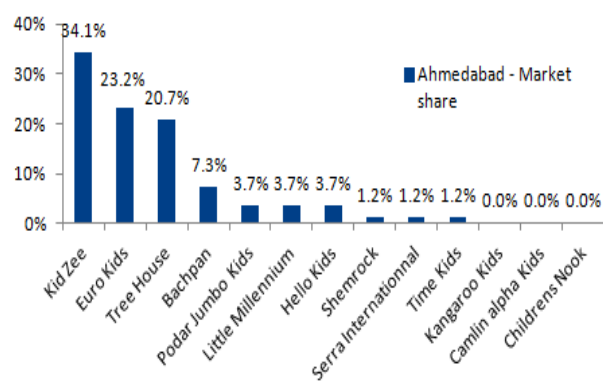
Source: Company, CSEC Research

**Exhibit 27: Pune Market**



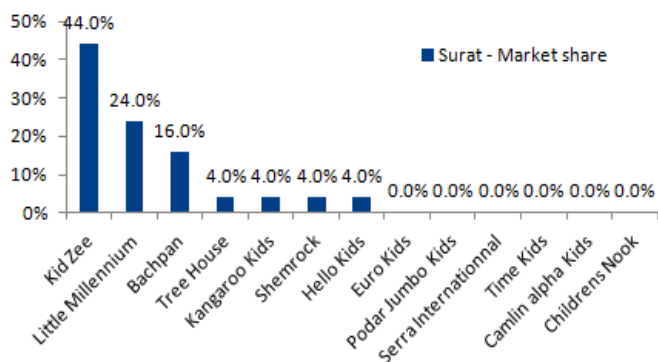
Source: Company, CSEC Research

**Exhibit 28: Ahmedabad Market**



Source: Company, CSEC Research

**Exhibit 29: Surat Market**



Source: Company, CSEC Research

**Total Pre-school Market:** According to Crisil report, in India, organized pre-school operator account for 22% of the total market. Tier-1 being a key market we believe the market share of the organized players would be higher. Scenario analysis on the market share of the organized players in Tier-1 market (in the range of 22% to 42%); total number of pre-school in Tier-1 market could be in the range of 4,026 (assuming 42% market share) to 7,686 (assuming 22% market share), which implies there is 1 pre-school for every 517 to 987 children (target population). According to the industry sources there must be at least 40 children per pre-school in order to breakeven, which implies the penetration level has to be at least in the range of 4.1% to 7.7% in order for these pre-schools to breakeven in Tier-1 market. Amongst the Tier - I market; Pune, Bangalore, Hyderabad and Chennai are **fairly penetrated market**; Greater Mumbai, Kolkata and Ahmedabad are **moderately penetrated**; NCR and Surat are **under penetrated**.

#### Exhibit 30: Scenario Analysis - Pune Market

Particulars	Organized Players Market Share (OPMS)				
	22.0%	27%	32%	37%	42%
Organized Preschools	223	223	223	223	223
Unorganized Preschools	791	603	474	380	308
<b>Total Preschools</b>	<b>1,014</b>	<b>826</b>	<b>697</b>	<b>603</b>	<b>531</b>
Target Population / Total pre-school	238	292	346	400	454
Break-even penetration level	16.8%	13.7%	11.6%	10.0%	8.8%

Source: CSEC Research

#### Exhibit 31: Scenario Analysis - Bangalore Market

Particulars	Organized Players Market Share (OPMS)				
	22.0%	27%	32%	37%	42%
Organized Preschools	333	333	333	333	333
Unorganized Preschools	1,181	900	708	567	460
<b>Total Pre-schools</b>	<b>1,514</b>	<b>1,233</b>	<b>1,041</b>	<b>900</b>	<b>793</b>
Target Population / Total pre-school	247	304	360	416	472
Break-even penetration level	16.2%	13.2%	11.1%	9.6%	8.5%

Source: CSEC Research

#### Exhibit 32: Scenario Analysis - Hyderabad Market

Particulars	Organized Players Market Share (OPMS)				
	22.0%	27%	32%	37%	42%
Organized Preschools	223	223	223	223	223
Unorganized Preschools	791	603	474	380	308
<b>Total Pre-schools</b>	<b>1,014</b>	<b>826</b>	<b>697</b>	<b>603</b>	<b>531</b>
Target Population / Total pre-school	353	433	513	593	673
Break-even penetration level	11.3%	9.2%	7.8%	6.7%	5.9%

Source: CSEC Research

**Exhibit 33: Scenario Analysis - Chennai Market**

Particulars	Organized Players Market Share (OPMS)				
	22.0%	27%	32%	37%	42%
Organized Preschools	182	182	182	182	182
Unorganized Preschools	645	492	387	310	251
<b>Total Preschools</b>	<b>827</b>	<b>674</b>	<b>569</b>	<b>492</b>	<b>433</b>
Target Population / Total pre-school	425	521	618	714	811
Break-even penetration level	9.4%	7.7%	6.5%	5.6%	4.9%

Source: CSEC Research

**Exhibit 34: Scenario Analysis - Greater Mumbai Market**

Particulars	Organized Players Market Share (OPMS)				
	22.0%	27%	32%	37%	42%
Organized Preschools	339	339	339	339	339
Unorganized Preschools	1,202	917	720	577	468
<b>Total Preschools</b>	<b>1,541</b>	<b>1,256</b>	<b>1,059</b>	<b>916</b>	<b>807</b>
Target Population / Total pre-school	551	676	801	926	1,051
Break-even penetration level	7.3%	5.9%	5.0%	4.3%	3.8%

Source: CSEC Research

**Exhibit 35: Scenario Analysis - Kolkata Market**

Particulars	Organized Players Market Share (OPMS)				
	22.0%	27%	32%	37%	42%
Organized Preschools	151	151	151	151	151
Unorganized Preschools	535	408	321	257	209
<b>Total Preschools</b>	<b>686</b>	<b>559</b>	<b>472</b>	<b>408</b>	<b>360</b>
Target Population / Total pre-school	666	818	969	1,120	1,272
Break-even penetration level	6.0%	4.9%	4.1%	3.6%	3.1%

Source: CSEC Research

**Exhibit 36: Scenario Analysis - Ahmedabad Market**

Particulars	Organized Players Market Share (OPMS)				
	22.0%	27%	32%	37%	42%
Organized Preschools	82	82	82	82	82
Unorganized Preschools	291	222	174	140	113
<b>Total Preschools</b>	<b>373</b>	<b>304</b>	<b>256</b>	<b>222</b>	<b>195</b>
Target Population / Total pre-school	779	956	1,133	1,310	1,487
Break-even penetration level	5.1%	4.2%	3.5%	3.1%	2.7%

Source: CSEC Research

### Exhibit 37: Scenario Analysis - NCR Market

Particulars	Organized Players Market Share (OPMS)				
	22.0%	27%	32%	37%	42%
Organized Preschools	133	133	133	133	133
Unorganized Preschools	472	360	283	226	184
<b>Total Preschools</b>	<b>605</b>	<b>493</b>	<b>416</b>	<b>359</b>	<b>317</b>
Target Population / Total pre-school	1,360	1,669	1,978	2,288	2,597
Break-even penetration level	2.9%	2.4%	2.0%	1.7%	1.5%

Source: CSEC Research

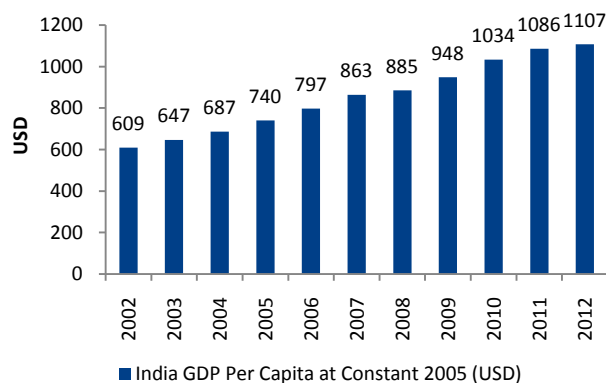
### Exhibit 38: Scenario Analysis - Surat Market

Particulars	Organized Players Market Share (OPMS)				
	22.0%	27%	32%	37%	42%
Organized Preschools	25	25	25	25	25
Unorganized Preschools	89	68	53	43	35
<b>Total Preschools</b>	<b>114</b>	<b>93</b>	<b>78</b>	<b>68</b>	<b>60</b>
Target Population / Total pre-school	2,066	2,535	3,004	3,474	3,943
Break-even penetration level	1.9%	1.6%	1.3%	1.2%	1.0%

Source: CSEC Research

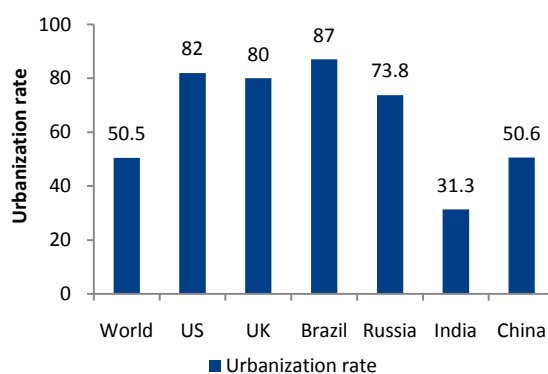
### Growth Drivers:

#### Exhibit 39: India's GDP Per-capita



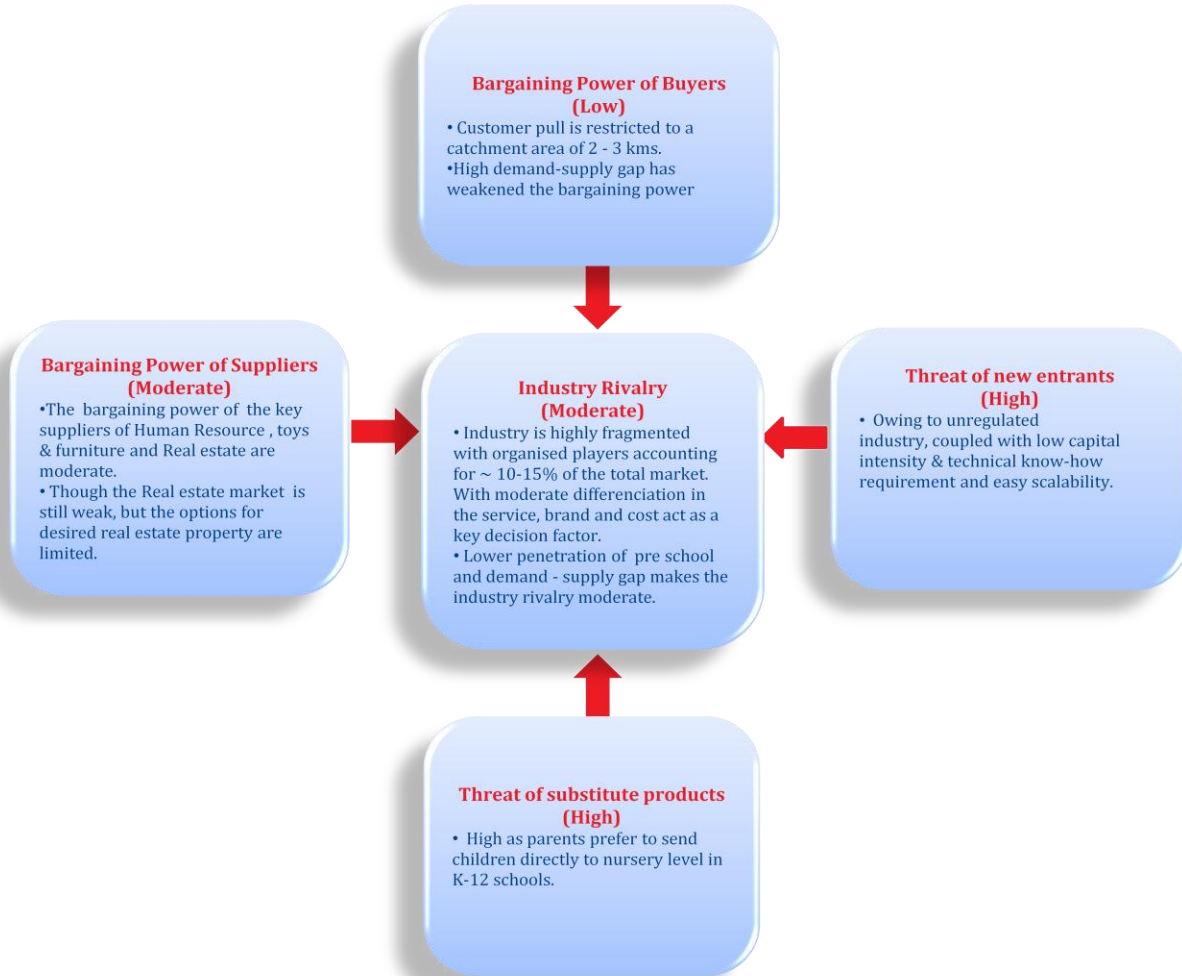
Source: Bloomberg, CSEC Research

#### Exhibit 40: Rapid Urbanization



Source: McKinsey Global Institute, CSEC Research

**Exhibit 41: Porters Five Force Model:**

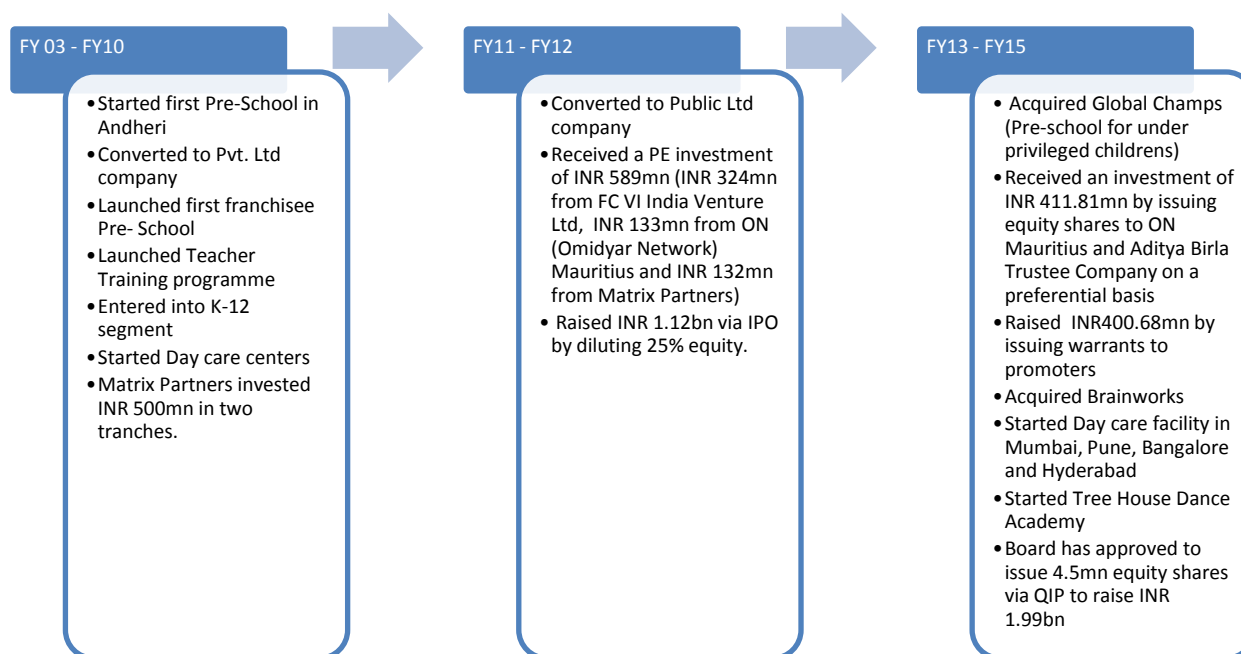


Source: CSEC Research

## Company Overview:

Tree House Education & Accessories Ltd (THEAL) is India's largest branded self-operated pre-school provider and the only listed self operated pre-school operator in India. It currently operates 562 pre schools (out of which 459 are company operated) in 80 cities. In 2009, Company has done a forward integration to provide management services to K-12 schools and currently it provides management services to 24 K-12 schools (18 schools on an exclusive basis) in 3 states.

### Exhibit 42: Key Milestone



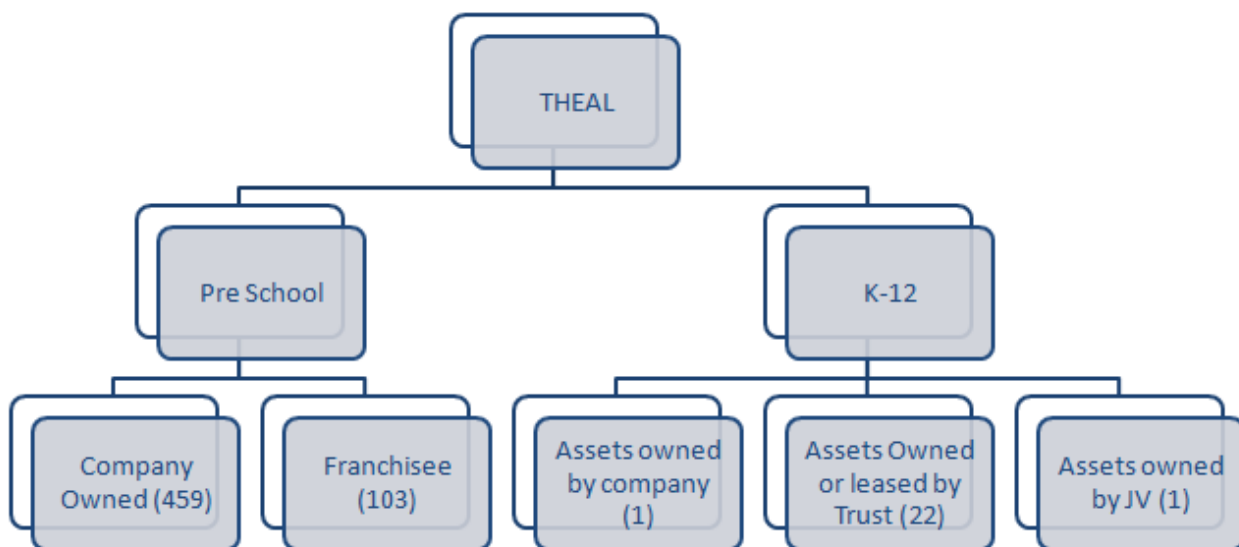
Source: Company, CSEC Research

### Exhibit 43: Fund Raising Milestone



Source: Company, CSEC Research

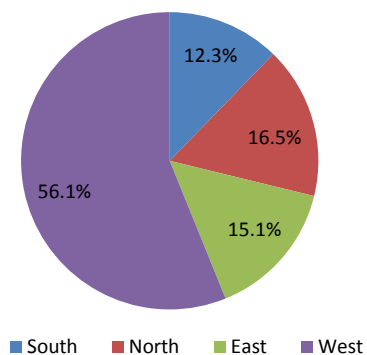
#### Exhibit 44: THEAL's Business Structure



#### Geographical distribution:

Geographically, THEAL's pre-school business is more skewed towards Western India, which accounts for 56% of its pre-school. The pre-schools in other regions are as follows, North (16.5%), South (12.3%) and East (15.1%).

#### Exhibit 45: Geographical distribution of THEAL's Pre-schools



Source: Company, CSEC Research

Company's K-12 presence is restricted to the three western states Rajasthan (11 schools), Maharashtra (11 schools) and Gujarat (2 schools)



**Exhibit 46: Service Offered**

Service Offering	Description	Age group	Timing
Play Group	This programme focuses on building cognitive power, making new friends, nurturing creativity and creates a forum for children to socialise.	1.5 - 2.5 years	2 hours
Nursery	This programme is designed to get children ready for higher schooling by teaching alphabets, math concepts and valuable social skills.	2.5 - 3.5 years	2 hours
Junior KG	This programme is to equip children with the right skills for smooth transition to formal school. Along with value education, the child will learn and acquire skills in GK, Environment studies, language etc.	3.5 - 4.5 years	3 hours
Senior KG	This programme aims to develop complex coordinating skills and engagement with peers. Along with value education, the child will learn and acquire skills in GK, Math, Science, Environment studies, language etc.	4.5 - 5.5 years	3 hours
Summer Camp	This programme is designed to help children discover and explore nature through creative art, craft, culture and sports, while learning about the vast opportunities in the world around.	2.5 - 8 years	N/A
Teachers training	It is a 300 hours intensive curriculum with theory and practical sessions, intended to create qualified and certified preschool teachers.	N/A	300 hours
Hobby Class	To enhance the child's life skills and overall grooming	3 - 8 years	-
Day Care	Custom designed to the specific needs of the parents	3 - 8 years	8 hours

Source: CSEC Research

**Exhibit 47: Key Competitors**

Competitors	Business Model	No of Pre-School	Expansion plan	Teaching Method
Tree House	Mostly company owned model (75% - company owned; 25% - Franchise)	562	100+ centers in next 1-2 years (largely company owned)	Combination of play-way and Montessori
Euro Kids	Primarily franchise model	884	120+ centers in next 1-2 years	Play way
Podar Jumbo Kids	Mix of company owned and franchise model (60% franchise owned and 40% company owned)	200	N/A	Play way
Kangaroo Kids	Franchise Model	69	150 new centers in 5 years	action based learning using innovative teaching methods
Shemrock	Franchise Model	425+	50 new centers	Multimedia and internet based teaching
Kidzee	Franchise Model	1200+	N/A	Proprietary child centric learning methodology - ILLUME
Bachpan	Primarily franchise model	1000+	N/A	Blend of Indian values and Montessori methods
Little Millennium	Franchise Model	241	N/A	Eclectic Approach - which embraces the best features of Project method, Montessori method, theme based method, multiple intelligence and play way
Serra International	Mix of company owned and franchise model	47	N/A	Inquiry based learning and the Reggio Emilia
Time Kids	Mix of company owned and franchise model	140+	N/A	Play way
Hello Kids	Franchise Model	300+	N/A	Montessori
Apple Kids	Mix of company owned and franchise model	300+	N/A	N/A

Source: Crisil, Company, CSEC Research

## Management Profile:

**Mr. Rajesh Bhatia, Founder & Managing Director** He holds a bachelor degree in engineering (computer science) from MS University, Baroda and MBA from Pune University. He oversees the day to day operations of the company.

**Mr. Vishal Shah, Director** He holds a bachelor degree in commerce from Mumbai University and masters of management studies from Mumbai University. He oversees the marketing and the administration department of the company.

**Mr. Utsav Shrivastava, CFO** He holds a post graduate degree in management from Symbiosis. Since November 2012, he is serving as a CFO. During April 2008 – November 2012, he has served as a Director of Human Resource & Operations at THEAL.

**Mr. V Sridhar, COO (K-12)** He holds a bachelor degree in science (honours) degree in Physics from Ranchi University. He currently manages the K-12 school related activities. Prior to joining the company, he worked with Tata AIG Life Insurance as Vice-President responsible for the Western Zone.

## Financials (Standalone)

Income Statement (Abstract)				
INR(million)				
Particulars	FY14	FY15E	FY16E	FY17E
Net Revenue	1,576	2,081	2,593	3,185
Growth (%)	37.94	32.04	24.59	22.83
Operating Expenditure	684	922	1,143	1,379
EBITDA	892	1,159	1,450	1,806
Growth (%)	44.34	29.93	25.06	24.59
Depreciation	170	261	330	409
Other Income (net of interest)	-62	-62	285	-86
Tax Paid	221	284	477	446
Tax Rate (%)	33.48	34.00	34.00	34.00
Reported PAT (after min. interest)	439	551	927	866
Adjusted PAT	439	521	642	866
Adj. Pat Growth (%)	44.69	18.73	23.06	34.91

Balance Sheet (Abstract)				
INR(million)				
Particulars	FY14	FY15E	FY16E	FY17E
Share Capital	372	423	423	423
Reserves & Surplus	3,604	6,043	6,828	7,562
<b>Net worth</b>	<b>3,976</b>	<b>6,466</b>	<b>7,251</b>	<b>7,985</b>
Current Liabilities	696	1,147	1,330	884
Non-Current Liab	562	743	752	83
<b>Total Liabilities</b>	<b>5,267</b>	<b>8,356</b>	<b>9,334</b>	<b>8,952</b>
Net Fixed Assets	2,742	2,950	2,966	3,197
Other Non-Current Assets	2,039	2,353	2,469	2,579
Cash & marketable securities	108	826	1,622	1,748
Other Current Assets	367	2,217	2,266	1,417
<b>Total Assets</b>	<b>5,267</b>	<b>8,356</b>	<b>9,334</b>	<b>8,952</b>

Cash Flow statement (Abstract)				
INR(million)				
Particulars	FY14	FY15E	FY16E	FY17E
Cash flow from operations	352	1,023	1,107	1,499
Cash flow from investing	-974	-2,523	-124	132
Cash flow from financing	242	2,216	-194	-1,503
Free cash flow	-690	330	575	676
Net change in cash	-379	716	789	128

Per Share Ratios				
Particulars	FY14	FY15E	FY16E	FY17E
Adjusted EPS (INR)	11.8	12.3	15.2	20.5
Cash EPS	16.4	19.2	29.7	30.1
BV/Share (INR)	107.0	152.8	171.4	188.7
FCF/Share(INR)	-18.6	7.8	13.6	16.0
DPS (INR)	1.5	1.7	2.8	2.7

Key Ratios				
Particulars	FY14	FY15E	FY16E	FY17E
Dividend payout (%)	12.70	13.00	13.00	13.00
EBITDA margin (%)	56.60	55.70	55.91	56.71
PBT Margin (%)	41.88	40.14	54.14	41.18
RoCE (%)	16.55	15.20	18.72	17.60
RoE (%)	12.02	10.56	13.51	11.36
Current Ratio	0.68	2.65	2.92	3.58
Net Debt/Equity	0.18	0.06	-0.05	-0.03
Inventory Days	13	15	15	15
Debtor Days	55	29	27	24
Creditor Days	43	43	43	43
CCC*	25	1	-1	-4
Interest Cover Ratio	9.70	7.78	12.40	9.71

DuPont Analysis				
Particulars	FY14	FY15E	FY16E	FY17E
Net Profit Margin (%)	27.86	26.49	35.73	27.18
Asset Turnover	0.32	0.31	0.29	0.35
Leverage factor	1.33	1.30	1.29	1.20
RoE (%)	12.02	10.56	13.51	11.36

Valuation Ratios				
Particulars	FY14	FY15E	FY16E	FY17E
P/E	35.4	33.9	27.6	20.4
P/BV	3.9	2.7	2.4	2.2
EV/Sales	10.3	8.7	6.7	5.5
EV/EBITDA	18.2	15.6	11.9	9.7
Div Yield (%)	0.36	0.41	0.68	0.64

\*CCC – Cash Conversion Cycle

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Our Institutional Equities services are carried out in partnership with RCCR, a boutique Investment research and Corporate Advisory firm founded by a team with extensive experience in the Asset management industry.

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