

Talwalkars Better Value Fitness (TBVF)

Sector: Miscellaneous/ Small cap



Re-initiating Coverage

16 October 2012

Cholamandalam Securities Ltd.

Sensex 18,713 Nifty 5,687 Price: INR 181 Target Price: INR 209 BUY

Background: TBVF is one of the India's largest fitness chain and holds ~10% market share. TBVF has over 130 health club and gyms across 69 cities and towns of India and members base of over 126,000. They have 92 owned gyms, 11 gyms under JV, 10 licensed gym, 7 Franchisee gyms and 10 HI-FI format gyms. Geographic distribution of gyms: West (39%), North (30%), South (25%) and East (5%). Urban, semi-urban mix's of gym: Tier I (31%), Tier II (45%) and Tier III (25%). During FY06-12, TBVF's Sales, EBIDTA and PAT grew at CAGR of 52.36%, 55.46% and 80.04% respectively.

52 Week High/Low INR 187.9/107
 Bloomberg code TALW IN
 Reuters code TALW.BO
 Issued Equity (shares in mn) 24.1
 Mkt. Cap in mn INR 4,354
 Mkt. Cap in mn USD \$ 82.2
 Avg. Daily Vol. ('000) 89.84
 Avg. Daily Vol. (mn) INR 15.2/\$ 0.29

'Talwalkars Better Value Fitness - Pumping Iron'

Expansion of reach to drive revenue growth

We expect revenue to grow at a CAGR of 29.8% between FY12 to FY14 from INR 1.31bn to INR 2.19bn, primarily aided by organic gym expansion, which we expect it to grow from 128 in FY12 to 215 in FY14.

Stable margin + higher revenue growth = Higher RoE

Operating margins for TBVF in last 3 years were in the range of 38.8% - 41.6%, as the primary cost such as salary, electricity and rent (accounts over 61% of operating expense) grew commensurate with the gym expansion. We expect the company to add ~87 gyms in the next two year, and we have penciled a stable margin profile going forward. Stable margin profile combined with higher revenue growth will help TBVF to grow its RoE's from 15.3% in FY12 to 19.1% in FY14.

Shareholding	Jun11	Mar12	Jun12
Promoters(%)	59.49	59.49	59.47
FII (%)	9.61	11.89	11.91
DII (%)	9.93	9.02	9.81
Others (%)	20.97	19.60	18.81
Pledge (% of promoter holding)	0.00	0.00	0.00

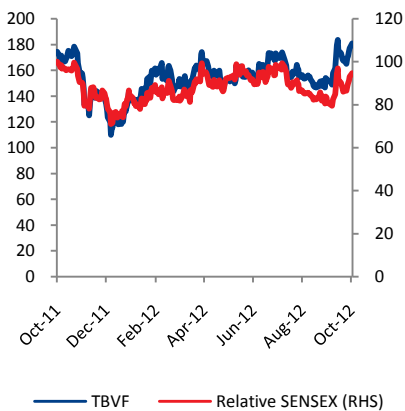
Outlook & Valuation

We Initiate coverage of TBVF with **BUY** rating and price target of INR 209 based on P/E multiple of 13X FY14E (PEG of 0.39). We believe this valuation is justified given the strong execution capability of TBVF, favorable demographics, scalable business model and the growth prospects. We expect TBVF to report an EPS of INR 13.2 and INR 16.1 for FY13E and FY14E respectively. At the CMP of INR 180 the stock trades at 13.7X and 11.2X to the FY13E and FY14E earnings respectively. With revenue growth of ~29% p.a. over FY12-FY14E and higher growth in EPS (~33.6% p.a.) make the target P/E multiple of TBVF relatively cheaper to its international peers (average 1yr forward P/E of 15.23X) and we expect the stock to be re-rated going forward. **Risks:** The downturn in economy leading to a cut in consumer spending, competition from both foreign and domestic player, escalation in rentals, availability of property in good location, availability of skilled workforce and execution risk.

Performance%	1M	3M	12M
TBVF	15.07	2.34	8.55
Sensex	3.75	8.37	10.12

Valuation Summary

Y/E March (INRmn)	FY11	FY12	FY13E	FY14E
Revenue	1,023.1	1,305.3	1,832.4	2,199.3
EBIDTA	401.0	542.8	753.1	907.5
PAT	164.0	216.9	318.1	387.3
EPS	6.6	9.1	13.2	16.1
EPS growth (%)	50.7	32.3	46.7	21.7
FCF / Share	-24.6	-8.9	-1.8	3.8
PE	27.2	19.7	13.7	11.2
P/ BV	3.5	3.0	2.6	2.2
EV / EBIDTA	13.2	10.5	7.7	6.5
EV / Sales	5.2	4.4	3.2	2.7
Dividend Yield (%)	0.6	0.7	1.1	1.4
ROCE (%)	16.3	17.5	20.4	20.9
ROE (%)	12.7	15.3	18.7	19.1
Net Debt / Equity	0.7	0.9	0.9	0.8



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Industry overview:

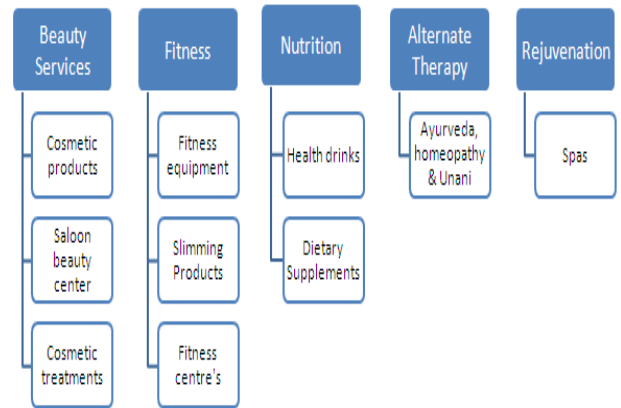
According to a joint study conducted by PricewaterhouseCoopers (PWC) – Federation of Indian Chambers of Commerce and Industry (FICCI), the overall wellness market in India is estimated at INR 490bn and wellness services alone comprise 40% of this market. Wellness industry comprises of five segments; i.e. Beauty services, fitness, nutrition, alternate therapy and Rejuvenation. During the next three years Indian wellness industry will grow at CAGR of 20% to reach INR 875 billion.

Chart 1: Segments of wellness industry



Source: PWC-FICCI,

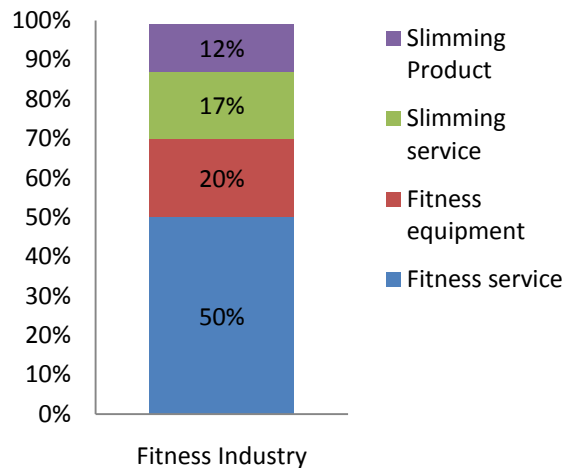
Chart 2: Sub-section of wellness industry



Source: PWC-FICCI,

Fitness and Slimming market constitutes ~8% (INR 40 bn) of wellness industry, while fitness services share a larger pie ~50% (INR 20 bn) of the Fitness and Slimming market (FSM).

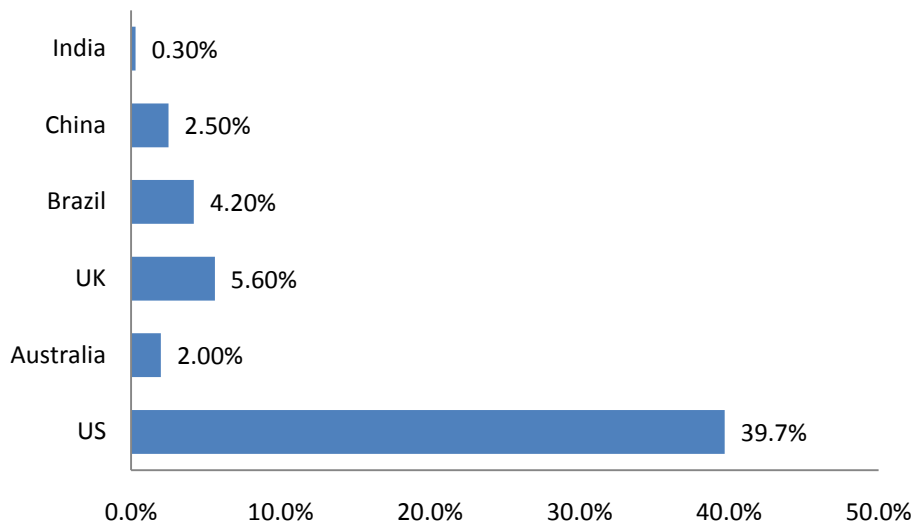
Chart 3: Fitness services constitutes larger pie in FSM



Source: PWC, Euromonitor, CSEC Research

Fitness Industry in India is still in a nascent stage and largely under penetrated ~0.3% compared to other developed and developing countries. Industry is highly fragmented and dominated by a large number of unorganized players. As of 2011, there are 1,175 fitness clubs in India with total membership of ~0.41 million members in the organized segment.

Chart 4: Membership penetration in major markets



Source: IHRSA 2012, CSEC Research

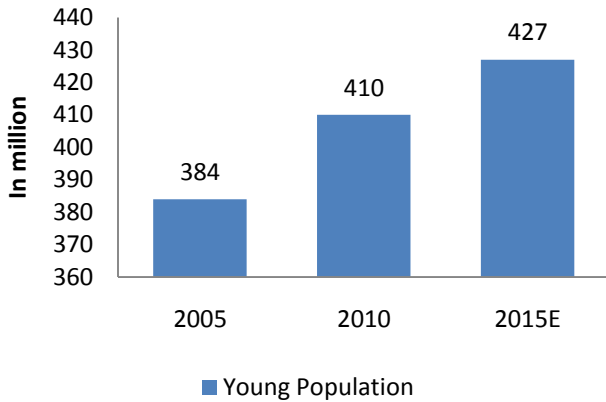
Favorable demographics

Target segment for Fitness service is Youth population (age bracket of 15 – 34). Indian Youth comprises over 34% of India’s total population and it is expected to reach ~427 mn in 2015 from ~410 mn in 2010. Raising income level is expected to drive discretionary spending and spending pattern is likely to increase from current 40% to 50% by FY20. We believe the factors such as rising income combined with large underpenetrated target segment (~0.1% of addressable market has membership in organized segment) and the desire to look fit and well groomed to drive growth going forward.

Table 1: Organized Market Size

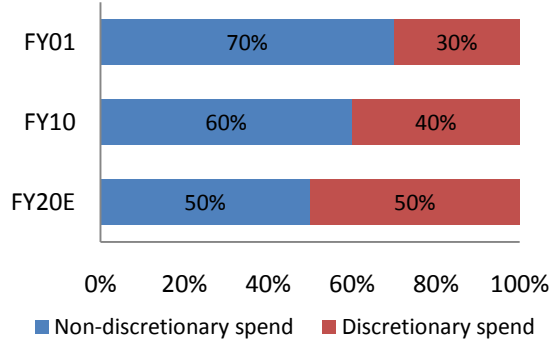
Particulars	2011	2015E			
		0.43	0.85	1.28	1.71
No. of Members (mn)	0.41	0.43	0.85	1.28	1.71
Target Market (mn)	410	427	427	427	427
% Organised Market Penetration	0.1%	0.10%	0.20%	0.30%	0.40%
Average fee - INR	10,000	10,000	10,000	10,000	10,000
Organized Market Size (INRbn)	4.1	4.27	8.54	12.81	17.08

Chart 5: India's youth comprises ~34% of total population



Source: PWC-FICCI,

Chart 6: Shift towards discretionary spending

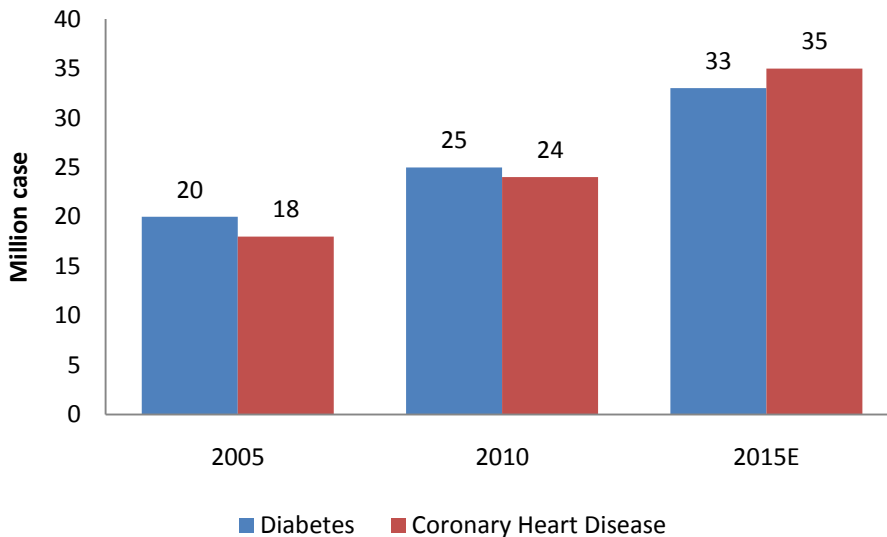


Source: US Census Bureau, National Commission of Population, NCAER

Increase in Lifestyle disease a prime growth driver:

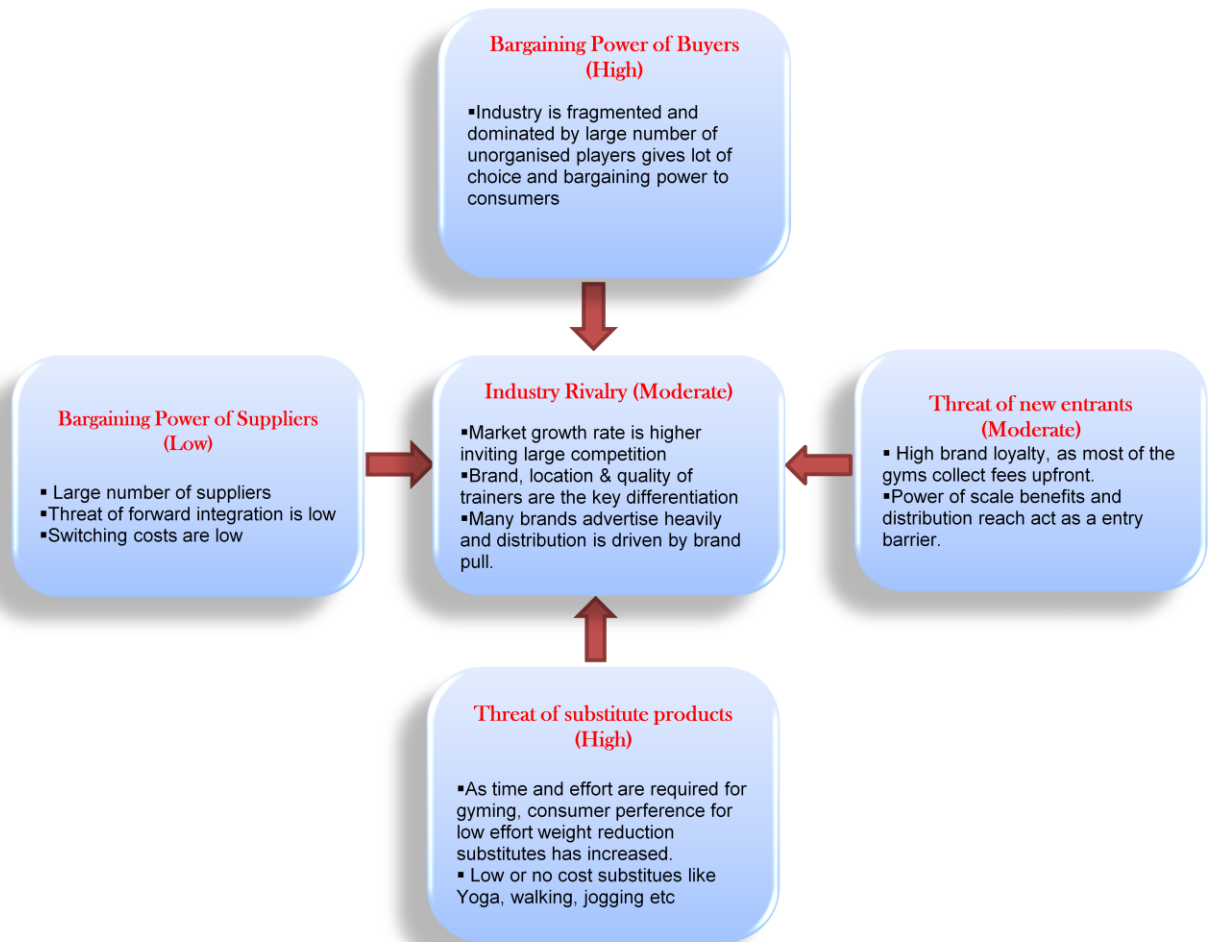
The urban population constitutes 28% of total population in 2001 and is expected to increase to 37% of population in 2025. Increase in urbanization has led to higher lifestyle diseases. According to Ministry of Health and family welfare, the number of reported cases of diabetes and coronary heart diseases has increased from 20 mn & 18 mn cases in 2005 to 25 mn & 24 mn cases in 2010 and is expected to grow to 33 mn & 35 mn respectively by 2015. We believe that increase in lifestyle diseases and rising cost of medical bills to act as a prime driver for the fitness industry.

Chart 7: Increasing urbanization lead to higher lifestyle diseases



Source: Ministry of Health and Family Welfare, CSEC Research

Chart 8: Porters Five Force Model:



Source: CSEC Research

Company Profile:

Talwalkar Better Value Fitness Ltd (TBVF); is one of the India's largest fitness chain, second largest health club chain in Asia and ranks amongst the top 20 in the world. Currently (1QFY13) they have over 130 health club and gyms spread across 69 cities in the country, with over 126,000 members. TBVF commands ~10% market share in terms of number of gyms, and 27.5% share in terms of members.

Chart 9: Distribution of TBVF gyms across India

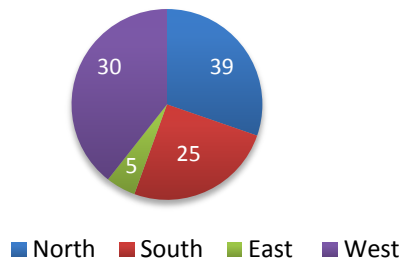


Note: Cities in red indicates more than 1 health club

De-risking its geographical exposure through Pan India Presence:

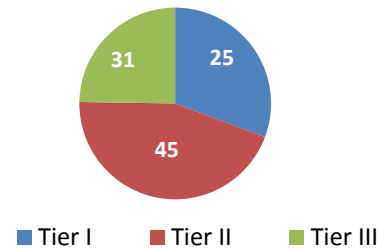
TBVF has de-risked its geographical exposure with health clubs spread across India, with equal concentration across West, North and South zones. TBVF has penetrated across the target customers spread across Tier I, II & III cities through different format and price points. It has health center in the Mini- Metros and Mid-India towns like Ajmer, Ichalkaranji, Ranchi, Solapur, Vijayawada, Jalandhar, Ulhasnagar and Dehradun.

Chart 10: Region wise distribution of gyms



Source: Company, CSEC Research

Chart 11: Distribution by type of city

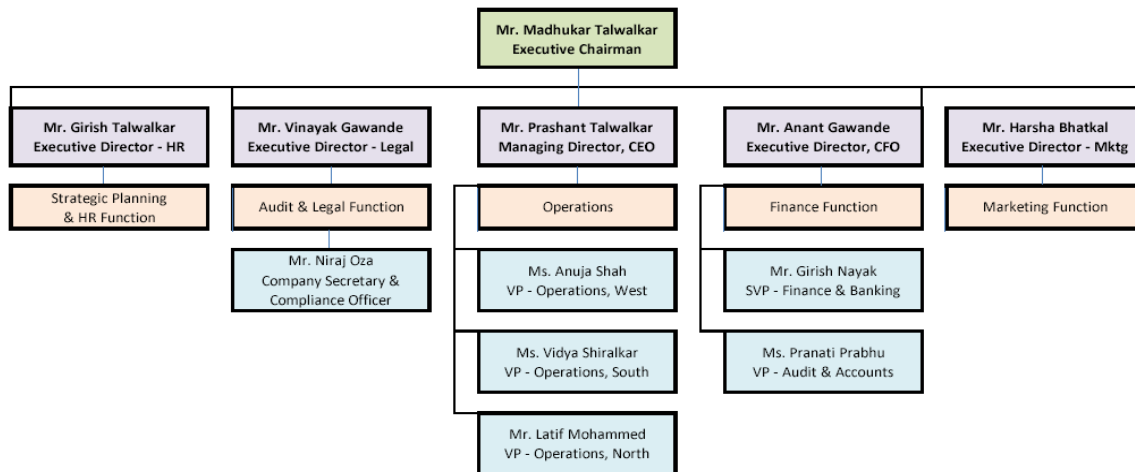


Source: Company, CSEC Research

Hub and spokes Model:

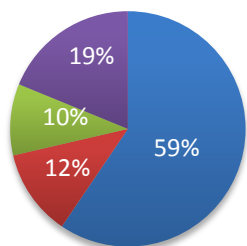
Along with rapid expansion into low tier cities, managing the day to day operation becomes difficult; hence the company follows 'Hub and Spokes' model where day to day operations will be taken care by local teams. This is then supervised by flying squad (managers) who ensure strict and stringent quality checks and balances. More over this model has helped TBVF access the local knowledge of customer profile and requirement.

Chart 12: Organization Structure:



Source: Company, CSEC Research

Chart 13: Shareholding Pattern



■ Promoter ■ FI ■ DII ■ Others

Source: Company, CSEC Research

Table 2: Shareholder holding more than 1%

Name	Holding %
Reliance Capital	7.13
Smallcap World Fund Inc	6.00
Shivanand Shankar Mankekar	5.22
Raising India Focus Fund Ltd	3.10
Americans Funds Insurance Series	1.99
Kedar Shivanand Mankekar	1.14
Religare Trustee Company Ltd	1.13

Source: Company, CSEC Research

Chart 14: Services Offered



Source: Company, CSEC Research

Personal Exercise Program: As the name suggests, this is a personalized program, where the client receives personal attention from a trainer who motivates and encourages the client to achieve the desired results.

Body Sculpting / shaping: TBVF offers services which are carefully planned to attain a balanced mix between resistance training and cardio exercises, making the program highly effective.

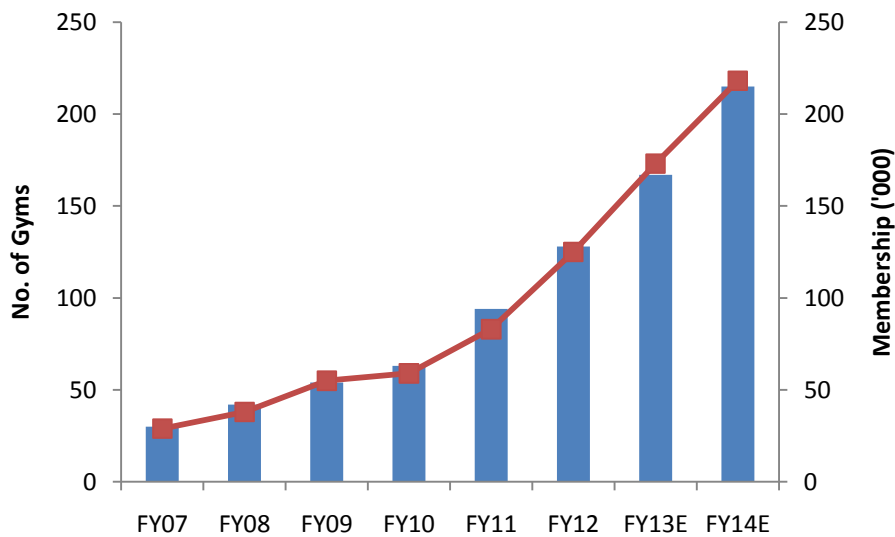
Nutrition Centre: TBVF offers specialized program like weight loss, weight maintenance and weight gain program. The weight loss program ranges from the 5kg one month plan to the 30 kg eight month plan.

Investment Rationale

Spectacular growth and expect to continue in the future

In FY07 TBVF had 30 gyms and in last five years it has added 98 gyms, taking the count to 128 gyms by FY12. During the same period membership count has increased ~4.3X from 29,000 members in FY07 to 125,000 in FY12. We expect the growth momentum to continue as we expect the company to add ~87 gyms and health clubs by FY14 which envisages a capital outlay of ~INR 1,200 million, which will be funded by internal accruals and debt. Typically gyms attain maturity in 10-15 month and the payback period for a gym is 3-4 years.

Chart 15: TBVF to add ~87 gyms by FY14

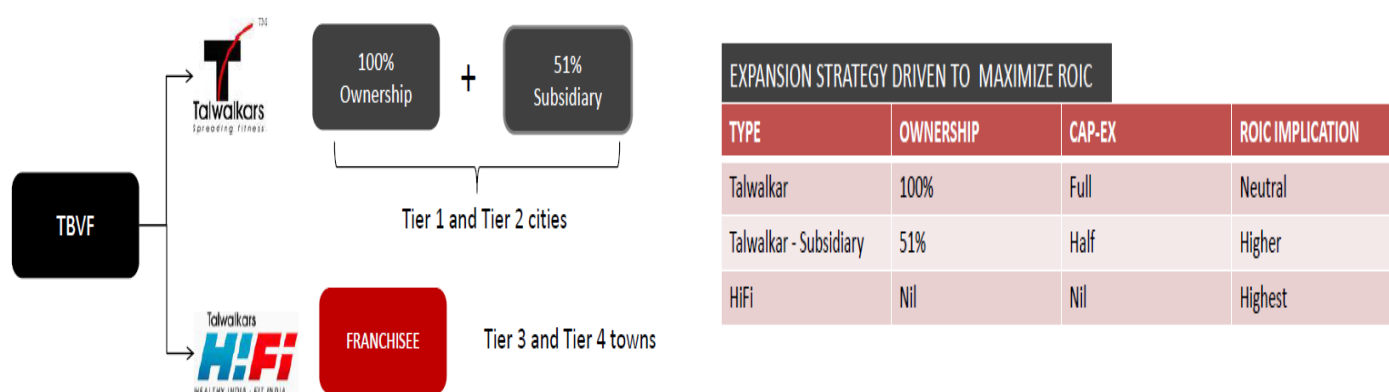


Source: Company, CSEC Research

Scalable Business model + leveraging the brand equity by franchise

TBVF operates in an industry which gives natural scalability benefits to the company; Moreover, TBVF has designed a growth strategy which will focus on maximizing the Return on Invested Capital with low capex by leveraging its brand equity through franchising route. Though in the past company has followed “Ownership Model” to scale up its presence, going forward it will use a combination of ownership and franchise route to expand its presence. Out of ~87 gyms which TBVF is going to rollout, we expect ~ 41 gyms would be operated through franchise route under the HI-FI brand.

Chart 16: TBVF business model



First mover advantage into Tier III & IV cities (HIFI)

Membership penetration rate in India is c.0.4% compared to ~5% in the urban India. Organized player retreat entering into Tier III & IV cities as operating a full service gym would not be feasible. To tap this huge opportunity, the “Healthy India Fit India” (“HI FI”) brand has been launched by TBVF as a no-frills gym, at around 40% discount to full service gym.

Table 3: HIFI gyms format to tap penetration in lower tier cities

Particulars	Talwalkars Health Club	HIFI Gym
Size (sq.ft.)	4,500 - 5,000	2,500 - 2,800
Capex INR mn	18.5 - 20	7.5 - 9.5
Annual Fee – INR	13,500 - 15,000	8,000 - 9,000
Facilities	Gym +	Gym
Cities	Metros, Tier I & II	Tier III & IV
Target Customers	Consumption class	Mass market
Upfront Royalty	N/A	INR 0.4 - 0.6 mn
Ongoing Royalty	N/A	6 - 8% of top line
Model (largely)	Ownership	Franchised

Source: Company

HI FI gyms would be equipped with similar facilities as the full service gyms, albeit with lower equipment count. However, it would offer no nutrition centre or other value added offering including spa, spinning etc. The no-frills format allows the gym to operate on a smaller size of ~2,500 – 2,800 sq.ft. This results in low capex of INR 7.5 – 9.5mn as compared to INR 18.5 – 20mn for full service Talwalkar's gym.

Key Challenge well addressed:

One of the major challenges faced by organized players is availability of skilled trainers; as the company goes deeper to penetrate the Tier III & IV cities, it becomes even more difficult to get a skilled trainer. According to PWC, wellness service will require 600,000 additional skilled personnel over the next five years.

To address this challenge, TBVF has established Talwalkar Training Academy, 7,500 sq.ft training academy at Thane, Maharashtra in 2009, where the newly recruited trainers and the existing trainers get trained for a period of 30-45 days.

The training is focused on the nuances of fitness, incorporating practical and theoretical aspects of weight training, cardio vascular fitness and nutrition. On the job training is provided at various gyms after completion of the theory classes at academy.

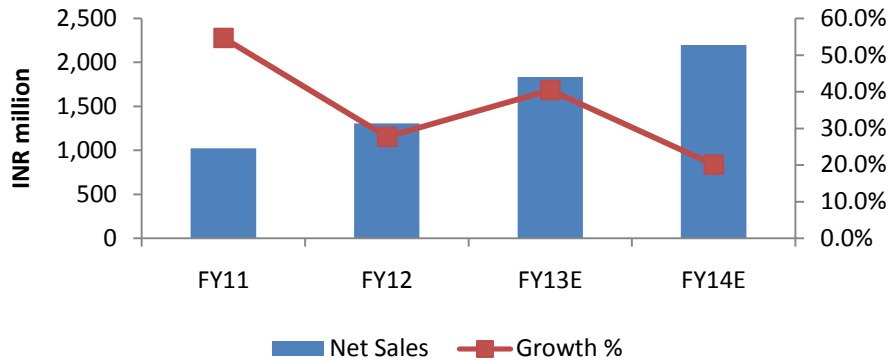
The academy provides a significant competitive advantage to TBVF. The academy serves as a resource pool, providing the critical support required as the company expands rapidly into newer locations.

Financials

Expansion of reach to drive revenue growth

We expect revenue to grow at a CAGR of 29.8% between FY12 to FY14 from INR1.31bn to INR 2.19bn, primarily aided by organic gym expansion, which we expect it to grow from 128 in FY12 to 215 in FY14.

Chart 17: Expansion reach to drive revenue growth

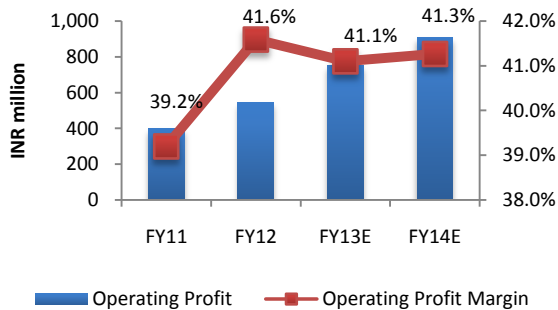


Source: CSEC Research

Stable margin + higher revenue growth = Higher RoE

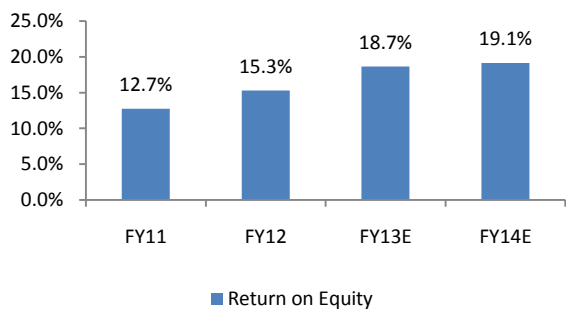
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Chart 18: Stable margin



Source: CSEC Research

Chart 19: Higher return ratio

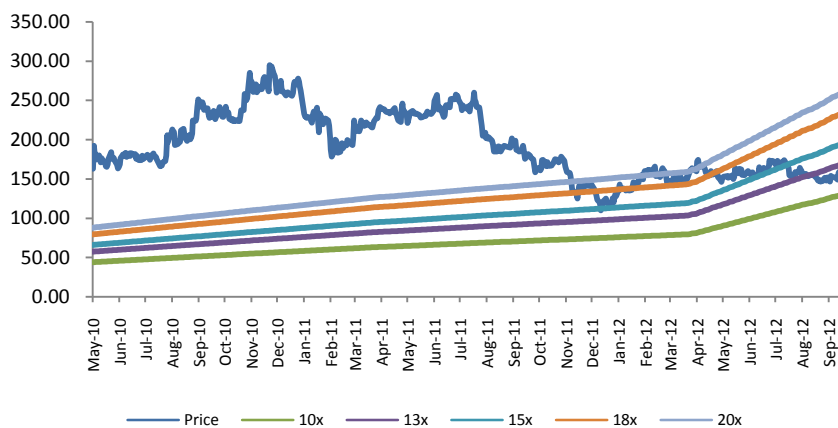


Source: CSEC Research

Valuation

We Initiate coverage of TBVF with a **BUY rating** and price target of INR 209 based on P/E multiple of 13X FY14E (PEG of 0.39). We believe this valuation is justified given the strong execution capability of TBVF, favorable demographics, scalable business model and the growth prospects. We expect TBVF to report an EPS of INR 13.2 and INR 16.1 for FY13E and FY14E respectively. At the CMP of INR 167.25 the stock trades at 13.7X and 11.2X to the FY13E and FY14E earnings respectively. With revenue growth of ~29% p.a. over FY12-FY14E and higher growth in EPS (~33.6% p.a.) make the target P/E multiple of TBVF relatively cheaper to its international peers (average 1yr forward P/E of 15.23X) and we expect the stock to be re-rated going forward.

Chart 20: P/E band chart



Source: ACE Equity, CSEC Research

Relative Valuations

As TBVF is the only listed player in the Fitness services in India, we compared it with the global peers i.e. Weightwatchers, Life Time Fitness and Town Sports International Holding Inc.

Company	OPM (%)	NPM (%)	P/E	EV/EBIDTA	EV/Sales	ROE (%)	Div Yield (%)
TBVF*	41.1	17.4	12.8	7.3	3.0	18.7	1.2
WeightWatchers	27.6	14.0	11.1	9.6	2.8	N/A	1.7
Life Time Fitness	20.0	10.8	14.3	7.1	2.1	11.8	N/A
Town Sports	10.4	4.0	14.7	4.7	1.0	N/A	N/A

Source: Bloomberg, *CSEC Research (FY13)

Domestically competition is more unorganized and dominated by regional player and few international names like Gold Gym. TBVF doesn't offer Yoga training which is a gap in the offering, as the fee charged for GYM and Yoga are much similar and it earns very high margin as it requires no equipments.

Company	TBVF	Gold Gym	Fitness One
GYM Membership fee (12M - INR)	13,820	18,500	14,000

Financials

Income Statement (Abstract)				
	INR(million)			
Particulars	FY11	FY12	FY13E	FY14E
Net Revenue	1,023.1	1,305.3	1,832.4	2,199.3
Growth (%)	54.6	27.6	40.4	20.0
Operating Expenditure	622.1	762.5	1,079.3	1,291.8
EBIDTA	401.0	542.8	753.1	907.5
Growth (%)	56.3	35.4	38.7	20.5
Depreciation	89.5	117.7	140.7	165.4
Other Income	20.3	15.7	20.0	20.0
Interest	85.9	91.3	126.4	146.3
Exceptional Items	-3.6	3.7	0.0	0.0
Tax Paid	73.7	104.0	151.5	184.4
Tax Rate (%)	30.4	29.5	30.0	30.0
Reported PAT (after min. interest)	160.3	220.6	318.1	387.3
Adjusted PAT	164.0	216.9	318.1	387.3
Growth (%)	50.7	32.3	46.7	21.7

Balance Sheet (Abstract)				
	INR(million)			
Particulars	FY11	FY12	FY13E	FY14E
Share Capital	241	241	241	241
Reserves & Surplus	1,015	1,200	1,462	1,780
Net worth	1,256	1,441	1,704	2,021
Current Liabilities	360	427	593	652
Non-Current Liab	1,185	1,455	1,755	2,076
Total Liabilities	2,825	3,376	4,101	4,801
Net Fixed Assets	2,060	2,576	3,023	3,418
Other Non-Current Assets	200	375	304	348
Cash & marketable securities	292	200	312	480
Other Current Assets	273	225	462	555
Total Assets	2,825	3,376	4,101	4,801

Cash Flow statement (Abstract)				
	INR(million)			
Particulars	FY11	FY12	FY13E	FY14E
Cash flow from operations	198	349	545	651
Cash flow from investing	-806	-647	-500	-560
Cash flow from financing	835	221	67	78
Free cash flow	-594	-214	-43	91
Net change in cash	227	-77	112	169

Per Share Ratios				
Particulars	FY11	FY12	FY13E	FY14E
Adjusted EPS (INR)	6.6	9.1	13.2	16.1
Cash EPS	10.4	14.0	19.0	22.9
BV/Share (INR)	52.2	59.9	70.7	83.9
FCF/Share(INR)	-24.6	-8.9	-1.8	3.8
DPS (INR)	1.0	1.3	2.0	2.5

Key Ratios				
Particulars	FY11	FY12	FY13E	FY14E
Dividend payout (%)	18	16	18	18
EBIDTA margin (%)	39.2	41.6	41.1	41.3
PBT Margin	23.7	27.1	27.6	28.0
RoCE (%)	16.3	17.5	20.4	20.9
RoE (%)	12.7	15.3	18.7	19.1
Current Ratio	1.57	1.00	1.30	1.59
Debt/Equity	0.97	1.08	1.04	1.02
Net Debt / Equity	0.74	0.94	0.86	0.78
Debtor Days	72	56	56	56
Creditor Days	101	101	101	101
CCC*	-29	-45	-45	-45
Interest Cover Ratio	3.86	4.83	5.00	5.20

DuPont Analysis				
Particulars	FY11	FY12	FY13E	FY14E
Net Profit Margin (%)	15.7	16.9	17.4	17.6
Asset Turnover	0.36	0.39	0.45	0.46
Leverage factor	2.25	2.34	2.40	2.37
RoE (%)	12.7	15.3	18.7	19.1

Valuation Ratios				
Particulars	FY11	FY12	FY13E	FY14E
P/E	27.2	19.7	13.7	11.2
P/BV	3.5	3.0	2.6	2.2
EV/Sales	5.2	4.4	3.2	2.7
EV/EBIDTA	13.2	10.5	7.7	6.5
Div Yield (%)	0.6	0.7	1.1	1.4

*CCC – Cash Conversion Cycle



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Santosh Kumar Sharma	Mumbai	+022 - 22617210	santoshks@chola.murugappa.com
RETAIL SALES			
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