

Talwalkars Better Value Fitness Ltd.

No. of shares (m)	29.7
Mkt cap (Rs crs/\$m)	847/131.7
Current price (Rs/\$)	285/4.4
Price target (Rs/\$)	373/5.8
52 W H/L (Rs.)	303/207
Book Value (Rs/\$)	163/2.5
Beta	1.3
Daily volume (avg. monthly)	123370
P/BV (FY18e/19e)	1.5/1.3
EV/EBITDA (FY18e/19e)	5.6/4.8
P/E (FY18e/19e)	10.6/8.4
EPS growth (FY17/18e/19e)	16.2/21.8/25.6
OPM (FY17/18e/19e)	59.8/62.3/63.5
ROE (FY17/18e/19e)	14.5/15.4/16.6
ROCE(FY17/18e/19e)	9.1/10.0/11.1
Net D/E ratio (FY17/18e/19e)	0.7/0.5/0.3
BSE Code	533200
NSE Code	TALWALKARS
Bloomberg	TALW IN
Reuters	TALW.BO

Shareholding pattern

	%
Promoters	38.0
MFs / Banks / FIs	7.1
Foreign Portfolio Investors	13.3
Govt. Holding	0.0
Public & Others	41.6
Total	100.0

As on March 31, 2017

Recommendation

BUY

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Quarterly Highlights

- Talwalkars opened 10 PWG (power world gyms) in Delhi in Q4, thus becoming one of the top players in the capital city. 10 new zorba centres were opened in Q4, increasing the total number of zorba centres to 31 pan India. TBVF also announced opening of 20 PWG gyms in Bangalore with a capacity of 800-1000 members in Q3 with an aim to leverage on the low capex model (Rs 1.75-2.25 crs vs Rs 3.7 crs for Talwalkars original format) and thereby enhance return on capital.
- Talwalkars has signed a MoU to acquire 50.01% stake in Force Fitness India Pvt Ltd. (SNAP; India's third largest gym company and the exclusive master franchise in India of 'Snap Fitness Inc.', USA) which will lead to an addition of 60 SNAP gyms into an existing nationwide network of Talwalkars (191 outlets) and access to a strong management team of SNAP India with considerable experience in franchising.
- Talwalkars has managed to obtain sanction of Rs 100 crs (\$15.5m) from Axis Bank for expansion of gyms thanks to its strong financials and ratings (AA both from Care and Brickworks; AA- from ICRA). Its intention to reduce debt by repaying at least Rs 100 crs (\$15.5m) over the next few years through internal accruals and unlocking the value of properties should further improve its rating and help it procure funds at lower cost.
- Talwalkars also owns 20% stake in a location-based online fitness and health discovery platform, GrowFitter, which connects the gym and fitness service providers with potential fitness enthusiasts and helps people make choices regarding fitness centres in their community, thus expanding TVBF's presence online. During the year it provided 500+ free trials on a monthly basis and converted ~ 20-25% into membership by offering best deals online.
- The stock currently trades at 10.6x FY18e EPS of Rs 27.01 and 8.4x FY19e EPS of Rs 33.94. Renewed focus on capping annual capex (not excluding internal cash accruals) would contain debt accretion. Sturdy growth in Indian wellness industry (CAGR of 12% till 2020) would doubtlessly buttress business growth. Improved profitability (earning growth: ~24% CAGR) would help spur return on capital and ebb financial leverage. Talwalkars proposition to demerge into two companies – Gym Co. and Lifestyle Co. should help it expand both organically and inorganically. We retain our "buy" rating on the stock with revised target of Rs 373 (previous target of Rs 338) based on 11x FY19e EPS of Rs 33.94 (peg ratio 0.5), over a period of 9-12 months.

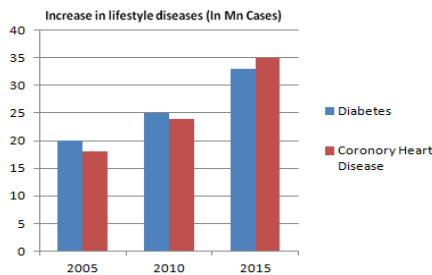
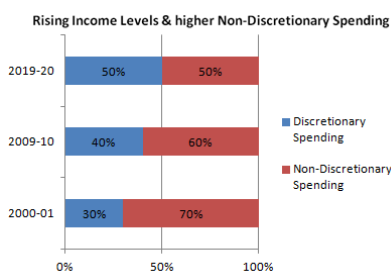
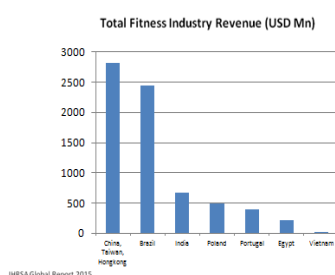
Consolidated (Rs crs)	FY15	FY16	FY17	FY18e	FY19e
Income from operations	225.66	251.37	286.00	331.91	379.48
Other Income	0.85	6.76	0.52	0.57	0.63
EBITDA (other income included)	125.38	150.20	171.23	207.31	241.53
PAT after MI and EO	46.07	55.04	65.88	80.25	100.82
EPS(Rs)	17.60	19.09	22.18	27.01	33.94
EPS growth (%)	25.8	8.5	16.2	21.8	25.6

Outlook & Recommendation

Indian Wellness Industry

The Indian population today is moving towards fitness and overall well-being as a means to de-stress themselves from hectic work pressure, and combat unhealthy eating habits and sedentary lifestyles. With the profound changes in the lifestyle and income levels of people, the wellness industry in India has become a sunrise sector; it was estimated at close to Rs 85,000 crore in financial year 2014-15 and is expected to grow at a CAGR of nearly 12% for the next five years and can achieve about Rs 1.5 trillion by FY20, according to a recent report by FICCI and EY.

India's population today is relatively young which creates a potential market for alternative sources of fitness like aerobics, yoga, zumba and diet programs. Unhealthy eating habits, growing disposable income, health characteristics, which include the burden of diseases, productive years lost, and cost of health care - among others - are key drivers of sectoral growth for emerging markets like India.

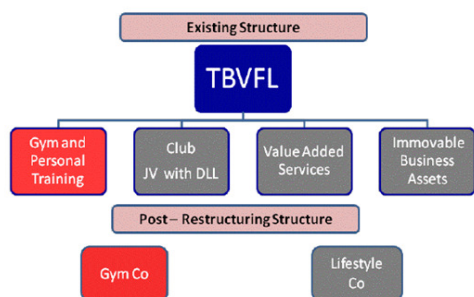


While the wellness and preventive health care sector as a whole is expected to nearly double by 2020, some sub-segments will outperform others. While beauty care and nutritional care would retain their share, fitness and rejuvenation would significantly increase their market share.

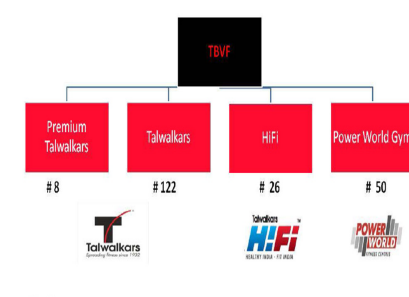
Demerger

In order to have better management and clear focus of its business activities, Talwalkars has proposed to demerge into two companies – Gym Co. and Lifestyle Co. Both the companies will be listed on NSE and BSE. The Gym Co. will retain the name as Talwalkars Better Value Fitness Ltd. (TBVFL) while the lifestyle company will be named as Talwalkars Lifestyles Ltd.

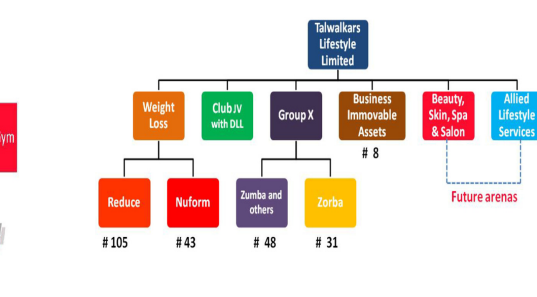
The Gym Company will be into core gym based fitness and personal training and will not venture into the wellness segment. Post the demerger, the financial parameters will improve significantly; debt in this Company will reduce as debt for the property, club and for other non-gym business will be transferred to the Lifestyle Company, thus improving the Debt Equity ratio of Gym Co. to 0.69 with ROCE and ROE of 15.1% and 14.8% vs 0.94, 7.4% and 9.8% of Lifestyle Co.



Source: TBVF Ltd.



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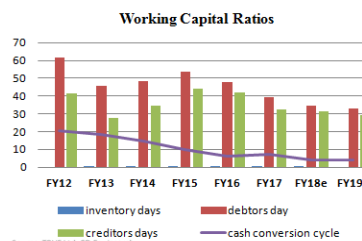
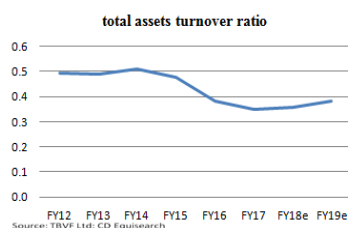
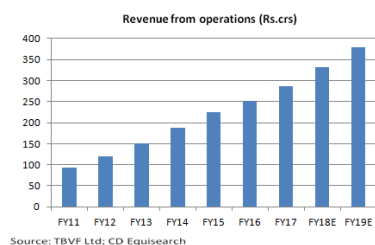


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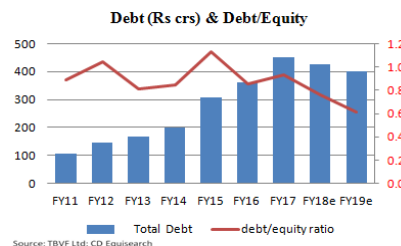
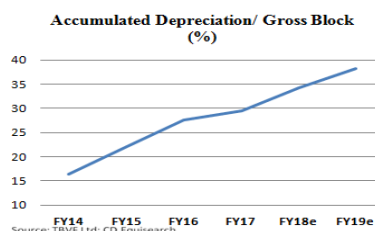
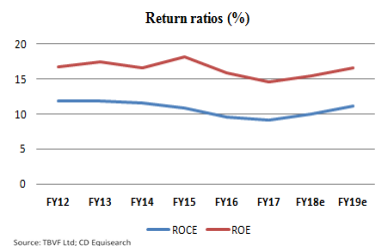
Lifestyle Co. will be into the wellness sector and will cater to most segments of lifestyle consumption. It will include Reduce, NuForm, Zumba, Group X activities, merchandising and others. The main focus will be to tap the higher potential of the wellness industry and help Talwalkars be a pioneer in this sector. Demerger scheme will help in value enhancement of both the resultant entities. The shareholders have approved the scheme with the requisite majority and now the final approval by National Company Law Tribunal (NCLT) is awaited post which the company is committed to complete the process of demerger in the shortest possible time.

Financials & Valuations

The optimistic growth of the Indian fitness industry shall enable Talwalkars to grow its business in a sustainable and profitable manner. Enhanced market presence, strong brand equity and competitive advantage over its peers bode well. A preventive approach to healthcare has accelerated demand for its services and has translated to strong market presence and dominance in the Indian fitness industry. Talwalkars has added 35 gyms in 2017 which increased its revenue by 13.8% (y-o-y) and expects to increase the number of gyms to ~300 in the next few years which should drive the revenue growth at a CAGR of 15.2%.

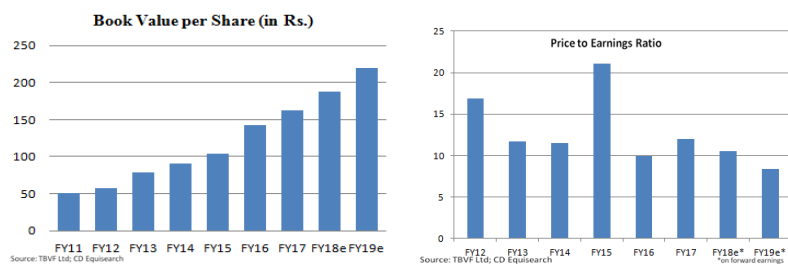


Talwalkars focus on increasing its number of gyms, mainly through PWG format which have low capex and opex model should enable it to post better margins in future. These PWG gyms are not opened in prime locations of the city, thereby bringing down the cost of rentals and thus overall operating expenditure. The company also transferred one of its gyms in Kolkata, which is a part of subsidiary (33.33% of company share) to a franchisee with the aim of consolidating operations and saving costs. All these effort towards cost rationalization should help TBVF to report OPM of 62.3% and 63.5% (FY17: 59.8%) and NPM of 24.6% and 26.9% (FY17: 23.5%) over the next two years.



Many offers and promotions were done during Q3 of the last fiscal like Navratri week, Diwali celebration, creative packages for the wedding season called 'The Knot' and more focus was given on electronic wallets, card payments and introduction of EMIs to offset the impact of demonetization. There was a rise in cashless transactions immediately post demonetization; earlier 70% cash, 30% card vs 30% cash, 70% card During the year Talwalkars was also involved in many marketing strategies and online initiatives with Kaya Skin Clinic, Lakme, Ritebite, to name a few, in order to raise awareness about the need for staying fit amongst all.

In recent years, Talwalkars has extensively invested in opening of premium gyms, power world gyms, purchase of land with market value of Rs 120 crs for the club project (joint venture with David Llyod Lesiure – Europe’s premium health sports and leisure club chains with plans of opening 7-10 clubs across India), investment in value-added services like Transform, NuForm, Reduce, TRX and relocation of some fitness centres. Talwalkars has also increased number of equipment at its gym, upgraded the existing ones and upgraded to systematic software and controls. The company made capital expenditure of Rs 90.5 crs (\$13.5m) in FY17 and still managed to generate positive free cash flow. Going forward, the company aims to keep capex lower than its internal cash accruals.



The stock currently trades at 10.6x FY18e EPS of Rs 27.01 and 8.4x FY19e EPS of Rs 33.94. With the number of gyms increasing and improvement in SSS growth, Talwalkars should be able to retain its dominant position in the Indian fitness industry. Its cautious effort to control its operating expenditure, gradual repayment of debt and keeping its capex within its cash accruals are worthy of attention. With benefits of mergers and acquisitions to continue in the next couple of years - currently 20% stake in Growfitter and MoU signed to acquire 50.01% stake in Force Fitness India Pvt. Ltd. (although not considered in our projections) Talwalkars would expand its presence pan India and internationally. Demerger into Gym Co. and Lifestyle Co. should help it achieve incisive focus on business operations. We retain our “buy” rating on the stock with revised target of Rs 373 (previous target of Rs 338) based on 11x FY19e EPS of Rs 33.94 – (peg ratio 0.5) over a period of 9-12 months. For more information, refer to our August report.

Financials

Consolidated Quarterly Results

Figures in Rs crs

	Q4FY17	Q4FY16	% chg.	FY17	FY16	% chg.
Income From Operations	91.55	78.24	17.0	286.00	251.37	13.8
Other Income	-1.60	1.75	-191.2	0.52	6.76	-92.4
Total Income	89.95	79.99	12.5	286.52	258.13	11.0
Total Expenditure	27.23	25.08	8.6	115.29	107.94	6.8
EBITDA (other income included)	62.72	54.91	14.2	171.23	150.20	14.0
Interest	4.64	5.43	-14.7	19.37	17.67	9.6
Depreciation	14.58	13.06	11.6	48.56	47.00	3.3
PBT	43.51	36.41	19.5	103.30	85.52	20.8
Tax	19.30	19.13	0.9	36.38	30.16	20.6
PAT	24.20	17.28	40.1	66.92	55.36	20.9
Share of profit	0.87	0.00	0.0	1.37	0.00	-
Minority Interest	0.47	-2.92	-116.0	2.66	0.34	672.3
PAT after MI & Associate Profit	24.61	20.20	21.8	65.63	55.02	19.3
Extraordinary item	-0.25	0.01	-1827.0	-0.25	-0.02	1301.7
Adjusted Net Profit	24.86	20.19	23.1	65.88	55.04	19.7
EPS(Rs)	8.37	6.80	23.1	22.18	19.09	16.2

Consolidated Income Statement

Figures in Rs crs

	FY15	FY16	FY17	FY18e	FY19e
Income From Operations	225.66	251.37	286.00	331.91	379.48
Growth (%)	20.5	11.4	13.8	16.1	14.3
Other Income	0.85	6.76	0.52	0.57	0.63
Total Income	226.50	258.13	286.52	332.48	380.11
Total Expenditure	101.12	107.94	115.29	125.17	138.58
EBITDA (other income included)	125.38	150.20	171.23	207.31	241.53
Interest	12.78	17.67	19.37	24.86	21.00
Depreciation	39.73	47.00	48.56	56.48	62.50
PBT	72.87	85.52	103.30	125.97	158.03
Tax	24.50	30.16	36.38	44.37	55.78
PAT	48.37	55.36	66.92	81.60	102.24
Share of profit	-	-	1.37	1.44	1.51
Minority Interest	2.30	0.34	2.66	2.80	2.94
PAT after MI & Associate Profit	46.07	55.02	65.63	80.25	100.82
Extraordinary item	-	-0.02	-0.25	-	-
Adjusted Net Profit	46.07	55.04	65.88	80.25	100.82
EPS (Rs)	17.60	19.09	22.18	27.01	33.94

Consolidated Balance Sheet

Figures in Rs crs

	FY15	FY16	FY17	FY18e	FY19e
Sources of Funds					
Share Capital	26.18	29.70	29.70	29.70	29.70
Reserves	250.66	397.43	462.84	537.72	633.18
Total Shareholders' Funds	276.84	427.13	492.54	567.43	662.88
Minority Interest	13.56	13.77	16.43	19.23	22.16
Long Term Debt	277.86	307.30	401.48	375.00	350.00
Total Liabilities	568.25	748.20	910.46	961.65	1035.05
Application of Funds					
Gross Block	549.97	638.32	766.38	834.45	920.55
Less: Accumulated Depreciation	106.95	156.83	205.38	261.87	324.36
Net Block	443.03	481.49	561.00	572.58	596.19
Capital Work in Progress	78.25	83.06	55.00	60.00	60.00
Investments	5.07	9.88	61.32	62.76	64.27
Current Assets, Loans & Advances					
Inventory	0.04	0.04	0.29	0.04	0.04
Trade receivables	34.10	31.68	29.81	32.79	36.07
Cash and Bank	46.56	140.76	133.67	150.19	181.19
Short term loans (inc. other current assets)	29.23	50.83	76.74	84.54	92.63
Total CA	109.92	223.31	240.50	267.56	309.93
Current Liabilities	55.65	88.34	78.72	79.45	80.65
Provisions-Short term	15.99	16.46	12.07	14.27	17.70
Total Current Liabilities	71.64	104.81	90.78	93.72	98.34
Net Current Assets	38.28	118.51	149.72	173.84	211.59
Net Deferred Tax Asset	-25.35	-27.49	-29.62	-33.15	-36.60
Net long term assets (net of liabilities)	28.97	82.76	113.04	125.63	139.60
Total Assets	568.25	748.20	910.46	961.65	1035.05

Consolidated Cash Flow Statement

Figures in Rs crs

	FY17	FY18e	FY19e
Net Income (a)	66.92	81.60	102.24
Non cash exp & others (b)	50.67	59.78	65.71
Depreciation	48.56	56.48	62.50
Dividend Income	-0.02	-0.23	-0.23
Deferred tax	2.13	3.53	3.44
(Increase)/Decrease in NWC and others (c)	-60.18	-20.27	-20.81
Trade Receivables	1.87	-2.98	-3.28
Inventories	-0.25	0.25	0.00
Loans & Advances & OCA	-25.90	-7.81	-8.09
Trade Payables & Other Current Liabilities	-6.36	0.65	1.11
Other Assets	-57.60	-20.39	-22.06
Other Liabilities	2.16	2.21	3.43
Cash From Operating Activities (a+b+c)	57.41	121.11	147.15
Cash Flow from Investing Activities (d)	-150.05	-72.83	-85.87
Purchase of Fixed Assets*	-100.01	-73.07	-86.10
Dividend income	0.02	0.23	0.23
Change in Investment	-50.06	0.00	0.00
Cash from Financing Activities (e)	85.56	-31.77	-30.27
Dividend Paid (including CDT)	-5.36	-5.36	-5.36
Net borrowings	90.92	-26.40	-24.91
Net Change (a+b+c+d+e)	-7.09	16.51	31.00

*Excluding capital advances

Key Financial Ratios

	FY15	FY16	FY17	FY18e	FY19e
Growth Ratios(%)					
Revenue	20.5	11.4	13.8	16.1	14.3
EBITDA	33.7	19.8	14.2	20.8	16.5
Net Profit	25.8	19.5	19.7	21.8	25.6
EPS	25.8	8.5	16.2	21.8	25.6
Margins (%)					
Operating Profit Margin	55.2	57.1	59.8	62.3	63.5
Gross profit Margin	49.9	52.7	53.2	55.0	58.1
Net Profit Margin	21.4	22.0	23.5	24.6	26.9
Return (%)					
ROCE	10.9	9.6	9.1	10.0	11.1
ROE	18.1	15.8	14.5	15.4	16.6
Valuations					
Market Cap/ Sales	4.3	2.2	2.8	2.6	2.2
EV/EBITDA	9.9	5.2	6.5	5.6	4.8
P/E	21.1	9.9	12.0	10.6	8.4
P/BV	3.6	1.3	1.6	1.5	1.3
Other Ratios					
Interest Coverage	6.7	5.8	6.4	6.1	8.5
Debt Equity	1.1	0.9	0.9	0.8	0.6
Net Debt-Equity Ratio	1.0	0.5	0.7	0.5	0.3
Current Ratio	1.5	2.1	2.5	2.7	3.0
Turnover Ratios					
Fixed Asset Turnover	0.5	0.5	0.6	0.6	0.7
Total Asset Turnover	0.5	0.4	0.3	0.4	0.4
Inventory Turnover	1935.4	2694.3	708.8	771.2	3553.4
Debtors Turnover	6.8	7.6	9.3	10.6	11.0
Creditor Turnover	8.3	8.8	11.2	11.7	12.4
WC Ratios					
Inventory Days	0.2	0.1	0.5	0.5	0.1
Debtor Days	53.5	47.8	39.2	34.4	33.1
Creditor Days	44.1	41.7	32.5	31.1	29.5
Cash Conversion Cycle	9.6	6.2	7.3	3.8	3.7

Cumulative Financial Data

	FY11-13	FY14-16	FY17-19e
Income from operations	363	664	997
Operating profit	167	361	619
EBIT	137	258	453
PBT	108	216	388
PAT after MI	68	138	247
Dividends	11	15	16
OPM (%)	46.0	54.3	62.0
NPM (%)	20.5	21.6	25.2
Interest coverage	4.8	6.1	6.9
ROE (%)	-	14.6	15.3
ROCE (%)	-	9.7	10.4
Debt Equity	0.8	0.9	0.6
Fixed asset turnover	-	0.6	0.6
Debtors turnover	-	9.0	9.8
Inventory turnover	-	1045.4	3253.0
Creditors turnover	-	11.2	11.7
Debtor days	-	40.7	37.2
Inventory days	-	0.3	0.1
Creditor days	-	32.6	31.1
Cash conversion	-	8.5	6.2
Dividend payout ratio (%)	16.0	11.1	6.5

FY11-13 implies three year period ending fiscal 13

The Indian fitness industry is undergoing a revolution of sorts spiked by rise in disposable income and increasing awareness regarding fitness which augurs well for Talwalkars business. Aggressive expansion strategy with the aim of opening ~300 gyms from the present count of 211 over the next couple of years should help it increase its cumulative income from operations by 50.2% in FY17-19e from FY14-16 period. Cash conversion cycle is expected to decline going forward because of fall in debtor days from 40.7 days to 37.2 days. Company's intention of repaying debt of atleast Rs 100 crs (\$15.5m) in the next couple of years should improve its net debt-equity ratio to 0.3 by FY19 from 0.5 in FY16.

Talwalkars is taking various measures to reduce operating cost like consolidation of gyms, efficient utilization of resources and reduction in rentals which will boost margins in the coming years – OPM to 62% and NPM to 25.2%. With consistent improvement in profitability, it would use its internal resources to retire debt. Higher internal accruals would also help boost return on capital.

Financial Summary- US Dollar denominated

million \$	FY15	FY16	FY17	FY18e	FY19e
Share capital	4.2	4.5	4.6	4.6	4.6
Shareholders' funds	43.7	63.9	74.6	86.9	101.7
Total debt	49.4	54.6	69.8	66.3	62.4
Net fixed assets (incl. CWIP)	82.7	84.6	94.5	97.8	101.5
Investments	0.8	1.5	9.5	9.8	10.0
Net Current assets	6.1	17.9	22.3	26.2	32.1
Total Assets	90.2	112.3	139.1	148.1	159.5
Revenues	36.9	38.4	42.6	51.6	59.0
EBITDA	20.5	22.9	25.6	32.2	37.5
EBDT	18.4	20.2	22.7	28.4	34.3
PBT	11.9	13.1	15.5	19.6	24.6
PAT	7.5	8.4	9.8	12.5	15.7
EPS(\$)	0.29	0.29	0.33	0.42	0.53
Book value (\$)	1.67	2.15	2.51	2.92	3.42

Income statement figures translated at average rates; balance sheet at year end rates; projections at current rates (Rs 64.34/\$).
All dollar denominated figures are adjusted for extraordinary items.

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buy: >20% accumulate: >10% to ≤20% hold: ≥-10% to ≤10% reduce: ≥-20% to <-10% sell: <-20%

Exchange Rates Used- Indicative

Rs/\$	FY14	FY15	FY16	FY17
Average	60.5	61.15	65.46	67.09
Year end	60.1	62.59	66.33	64.84

All \$ values mentioned in the write-up translated at the average rate of the respective quarter/ year as applicable. Projections converted at current exchange rate. Cumulative dollar figure is the sum of respective yearly dollar value.