

## Talwalkars Better Value Fitness (TALWAL)

₹ 301

### Higher costs dent margin...

- Talwalkars reported weak Q3FY18 results that broadly remained below our estimates. Revenues increased 10.2% YoY to ₹ 54.8 crore (below I-direct estimate of ₹ 61.0 crore).
- On the margin front, the EBITDA margin expanded merely by 21 bps YoY to 45.2% (vs I-direct estimate of 51.5%) due to higher employee expenses (up 32.9% YoY)
- PAT during the quarter increased by 23%% YoY to ₹ 6.3 crore. However, it remained lower than our estimates of ₹ 7.5 crore mainly due to higher interest (up 42.5% YoY) and depreciation (up 22% YoY). Higher other income (₹ 4.5 crore vs 0.8 crore) contributed to profitability growth for the quarter.
- The proposed re-organisation of TBVF's business into Gym Co and Lifestyle Co is likely to get completed by Q4FY18E. During the quarter, the company Added 2 HiFi Gyms in Andhra Pradesh in Vijayawada and Visakhapatnam one each. Separately 3 PWG gyms are expected to be launched shortly. Further work has commenced on variety of stages for additional 17 gyms that are expected to open in the near future.

### Tremendous scope for growth considering favourable macros

The fitness industry is highly under penetrated in India with mere 0.4% (taken for top seven cities) membership compared to the Asia Pacific average of 3.7%. The industry, as a whole, is expected to benefit from the rising proportion of the age group between 20 and 44 in India (that has increased at a CAGR of 11% in FY05-15). In addition, we believe growing disposable incomes and rising lifestyle related diseases would lead to pent-up demand for quality health and fitness services.

### The company aims to emerge as a dominant player in top 10-12 cities

In FY17, the company has added 35 gyms mainly led by expansion of power world gyms which has led to 14.4% YoY growth in FY17 revenues. Further, the company's MOU with Force Fitness India Limited (FFIPL) will add ~60 gyms in FY18E. Apart from inorganic expansion, the company has indicated at adding gyms organically by carefully choosing locations, which will yield incremental RoCE of 25% on an ongoing basis. It aims to increase total gyms to 300 from current 211 gyms over the next two years (i.e. at CAGR of 19%). Considering TBVF's focus on improving SSS growth, we expect the company to register revenue CAGR of ~16.1% over FY17-19E.

### Reorganisation of business to unlock potential of fitness segment

TBVF has proposed to re-organise its business into Gym Co (pure gymming) and Lifestyle Co (wellness business). Gym Co will focus on core gymming and will have an asset light business. Lifestyle Co will include club business; value added business and other wellness related segments. We believe this will take care of some shareholder concern of TBVF's transformation from a capex light model to capex heavy model.

### Aggressive expansion strategy and high leverage, a concern

TBVF's focus on improving SSS growth is expected to boost topline and margins, going forward. However, the aggressive expansion strategy of the company has led to an increase in leverage, which remains a key concern. Hence, we maintain our **HOLD** rating on the stock with a revised target price of ₹ 327.

Rating matrix	
Rating	: Hold
Target	: ₹ 327
Target Period	: 12-15 months
Potential Upside	: 9%

What's Changed?	
Target	Changed from ₹ 350 to ₹ 327
EPS FY18E	Changed from ₹ 28.9 to ₹ 26.4
EPS FY19E	Changed from ₹ 36.5 to ₹ 34.3
Rating	Unchanged

Quarterly Performance					
	Q3FY18	Q3FY17	YoY (%)	Q2FY18	QoQ (%)
Revenue	54.8	49.8	10.2	97.2	-43.6
EBITDA	24.8	22.4	10.7	-58.7	-58.7
EBITDA (%)	45.2	45.0	21 bps	61.7	-1600 bps
PAT	6.3	5.1	23.0	36.0	-82.6

Key Financials				
₹ crore	FY16	FY17	FY18E	FY19E
Net sales	251.3	279.9	316.9	377.1
EBITDA	143.4	163.3	190.5	231.5
Net Profit	55.0	59.5	82.0	106.4
EPS (₹)	18.5	20.0	26.4	34.3

Valuation summary				
	FY16	FY17	FY18E	FY19E
PE (x)	16.3	15.0	11.4	8.8
Target PE (x)	17.7	16.4	12.4	9.5
EV to EBITDA (x)	7.7	7.4	6.4	5.2
Price to book (x)	2.1	1.8	1.5	1.3
RoNW (%)	12.9	12.2	13.6	15.1
RoCE (%)	12.9	12.7	13.9	16.3

Stock data	
Particular	Amount
Mcap	₹ 933 crore
Debt (FY17)	₹ 403 crore
Cash & Invest(FY17)	₹ 128 crore
EV	₹ 1209 crore
52 week H/L	₹ 340 / 209
Equity cap	₹ 29.7 crore
Face value	₹ 10

Price performance (%)				
	1M	3M	6M	12M
Talwalkar	14.7	4.5	6.0	23.9
Nifty	-0.8	1.5	6.5	25.3

### Research Analyst

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**Variance analysis**

	Q3FY18	Q3FY18E	Q3FY17	YoY (%)	Q2FY18	QoQ (%)	Comments
Total Operating Income	54.8	61.0	49.8	10.2	97.2	-43.6	Despite aggressive additions in gym counts, the revenue growth for the quarter remained below our estimates
Other Income	4.5	0.5	0.8	445.8	6.0	-24.2	
Employee Expenses	11.4	10.2	8.6	32.9	12.9	-11.5	
Marketing Expenses	18.6	19.4	18.8	-0.8	24.3	-23.4	
Service tax	0.0	0.0	0.0	NA	NA	NA	
EBITDA	24.8	31.4	22.4	10.7	-58.7	-58.7	
EBITDA Margin (%)	45.2	51.5	45.0	21 bps	61.7	-1600 bps	Higher employee costs led to marginal rise in operating margins YoY
Interest	9.0	7.0	6.3	42.5	7.0	29.0	
Depreciation	12.3	11.3	10.1	22.0	10.7	15.1	
PBT	8.0	13.6	6.9	17.1	48.2	-83.4	
Total Tax	2.5	4.5	2.5	0.8	12.0	-79.0	
PAT	6.3	7.5	5.1	23.0	36.0	-82.6	The PAT growth were better than operating income growth mainly led by higher other income
EPS	2.0	2.4	1.7	17.9	11.6	-82.6	

**Key Metrics**

Number of Gyms*	220	225	180	22.2	211	4.3	The company added 40 gyms through organic and inorganic expansion
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Source: Company, ICICIdirect.com Research

**Change in estimates**

(` Crоре)	FY18E			FY19E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	322.5	316.9	-1.7	386.7	377.1	-2.5	We expect revenues to increase at a CAGR of 16.1% over FY17-19E
EBITDA	198.3	190.5	-3.9	236.4	231.5	-2.1	
EBITDA Margin (%)	61.5	60.1	-136 bps	61.1	61.4	27 bps	
PAT	85.0	82.0	-3.6	109.0	106.4	-2.3	
EPS (`)	27.4	26.4	-3.6	35.2	34.3	-2.3	

Source: Company, ICICIdirect.com Research

## Company Analysis

### Lower penetration, favourable demographics provide ample opportunity

The fitness industry is highly under penetrated in India with mere 0.4% (taken for top seven cities) membership as compared to the Asia Pacific average of 3.7%. The industry, as a whole, is expected to benefit from the rising proportion of the age group between 20 and 34 in India (which has increased at a CAGR of 11.0% over FY05-FY15). In addition, we believe growing disposable incomes and rising lifestyle related diseases would lead to pent up demand for quality health and fitness services.

### Focus on driving profitability through gym additions, value added services

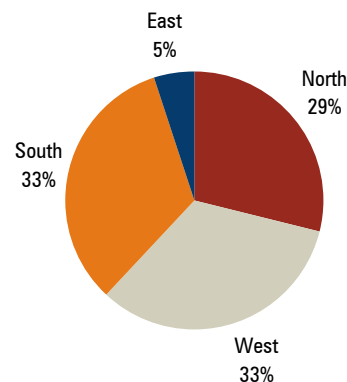
In FY17, the company has added 35 gyms mainly led by expansion of power world gyms which has led to 14.4% YoY growth in FY17 revenues. Further, the company's MOU with FFIPL will add ~60 gyms in FY18E. Apart from inorganic expansion, the company has indicated at adding gyms organically by carefully choosing locations, which will yield incremental RoCE of 25% on an ongoing basis. It aims to increase total gyms to 300 from current 211 gyms over the next two years (i.e. at CAGR of 19%). As a part of the above strategy the company has added 10 new gyms in Delhi, which is expected to drive revenues in coming years. Further, considering TBVF's focus on improving SSS growth, we expect the company to register revenue CAGR of ~16.1% over FY17-19E.

**Exhibit 1: No of gyms**

	FY12	FY13	FY14	FY15	FY16	FY17
Owned	90	99	103	104	96	133
Subsidiary	13	15	16	16	40	34
Franchise & Licensed	7	7	13	13	17	18
HiFi	8	15	17	17	23	26
<b>Total</b>	<b>118</b>	<b>136</b>	<b>149</b>	<b>150</b>	<b>176</b>	<b>211</b>

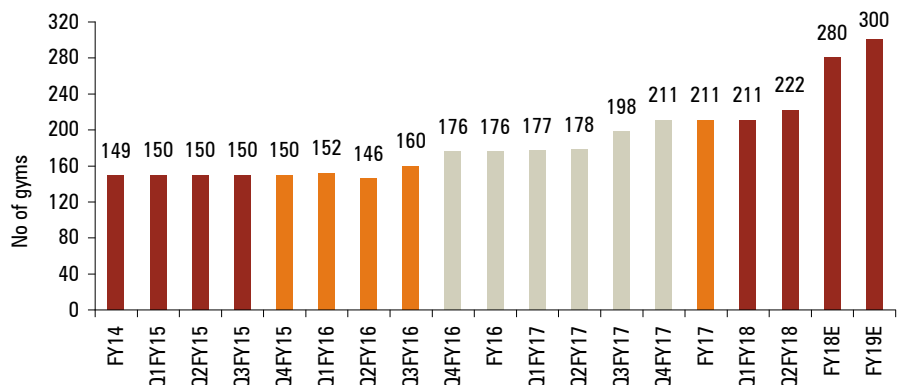
Source: Company, ICICIdirect.com Research

**Exhibit 2: Regional presence**



Source: Company, ICICIdirect.com Research

**Exhibit 3: Gym count to increase to 300 by FY19E**



Source: Company, ICICIdirect.com Research

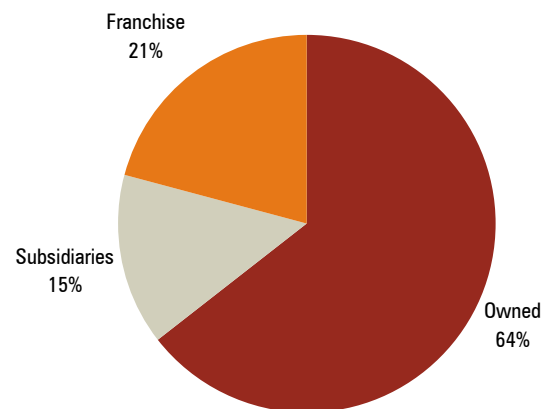
We expect the gym count to increase by 70 to 280 in FY18E and further to 300 by FY19E

### Acquisition of PWG will help in expanding footprints beyond India

Talwalkar has forayed into Sri Lankan market through acquisition of Power World Gyms (PWG). We believe this acquisition offers an opportunity for the company for growth as per capita income of Sri Lanka is US\$9,738 significantly more than India's US\$5,418 per capita income. Further, market penetration in Sri Lanka is as low as 0.5% vis-à-vis 16.6% in the US, opening up a huge scope for rapid growth. In addition, 30% of the total population aged between 18 and 39 years, which is the company's target market.

PWG is managed by Mr. Talavou Alailima, a South Asian Games Medallist and Sri Lankan record holder for short put and discus. Mr. Alailima has an extensive experience (over 20 years) in health, fitness, nutrition and operating gyms. PWG has a network of 10 gyms in Colombo, serving 8,100 members. It has a distinctive operating model targeting the medium income group; and all services are built around this target set. Going forward PWG aims to expand its footprint and plans to open another 35 gyms in Sri Lanka in next 18-24 months (of which 10 gyms have already opened in FY17). This we believe will drive revenue growth in coming years. Further, PWG has an impressive financial performance of 60% EBITDA margin in FY 16. Although the acquisition cost of 49.5% stake in Power World Gyms (PWG) is undisclosed, we believe given its financial performance coupled with aggressive expansion strategy PWG will prove a strategic fit for the company.

**Exhibit 4: Distribution of gym by ownership subsidiary and Franchise**



Source: Company, ICICIdirect.com Research

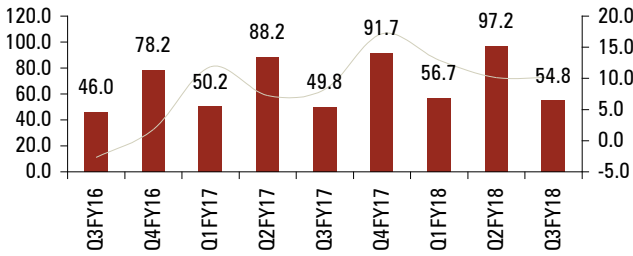
### Focus on value added services and cost rationalisation to boost margins

The company is aiming to consolidate its gyms with the nearest fitness centres having presence in the same area. This will result in a reduction of operating cost by ₹ 2 crore per annum on account of discontinuing rent, power cost, part salaries, and separate marketing expenses. Further, the company now has a dedicated team to provide periodic training to each gym across its centres in South Asia via online and onsite training. This coupled with restructuring and reduction in rentals, utilising time slots and staff more efficiently and widening bouquet of value-added services will boost margins in coming years. TBVF has also acquired 51.0% stake in Mickey Mehta Health Beyond Fitness. This acquisition will help the company in further widening its value-added services and help tap customers from the age of 6 yrs vis-à-vis current age of 15 years.

### Expect revenue CAGR of 16.1% during FY17-19E

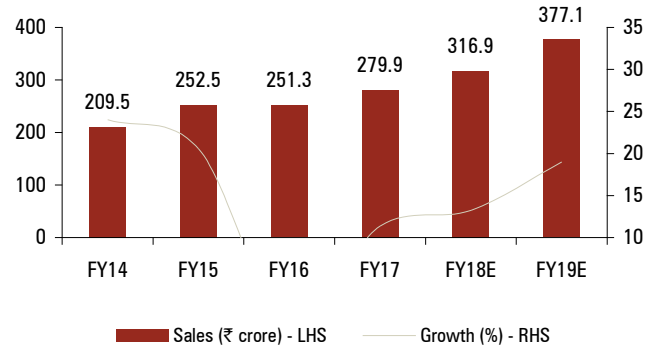
The revenue has grown at a CAGR of 13.7% in FY13-17 led by volume CAGR (gym additions) of 11.8% supported by realisation CAGR of 1.8% in the same period. During FY17, we expect the gym addition trend to continue. Further we have seen conscious efforts by the company to grow revenues through improving same store sales (SSS). We expect the same trend to continue, going forward. Hence, we build in sales CAGR of 16.8% during FY17-19E led by strong growth in gym addition during the same period.

**Exhibit 5: Q3FY18 revenue up 10.2% YoY**



Source: Company, ICICIdirect.com Research

**Exhibit 6: Expect revenue CAGR of 16.1% during FY17-19E**

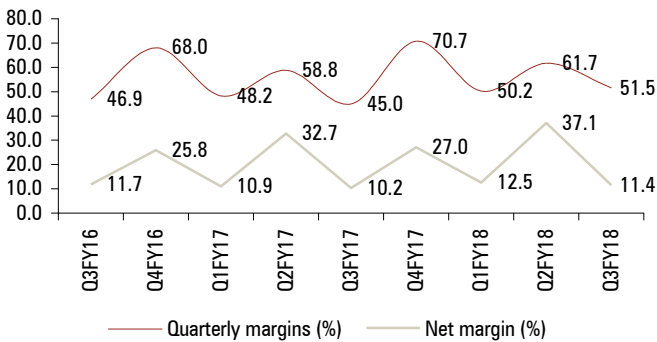


Source: Company, ICICIdirect.com Research

### Margins to improve led by increased focus on improving SSS growth

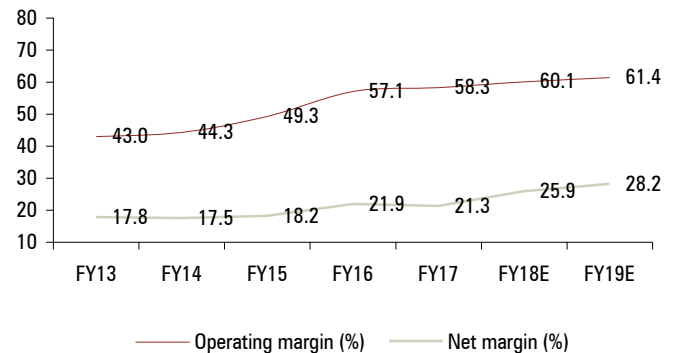
Due to efforts in improving SSS growth & value added services and cost rationalisation we expect margins to move on an upward trajectory. Taking this into account, we expect operating margin to remain healthy at over 61% during FY17-19E.

**Exhibit 7: Quarterly trend in margins**



Source: Company, ICICIdirect.com Research

**Exhibit 8: Annual trend in margins**

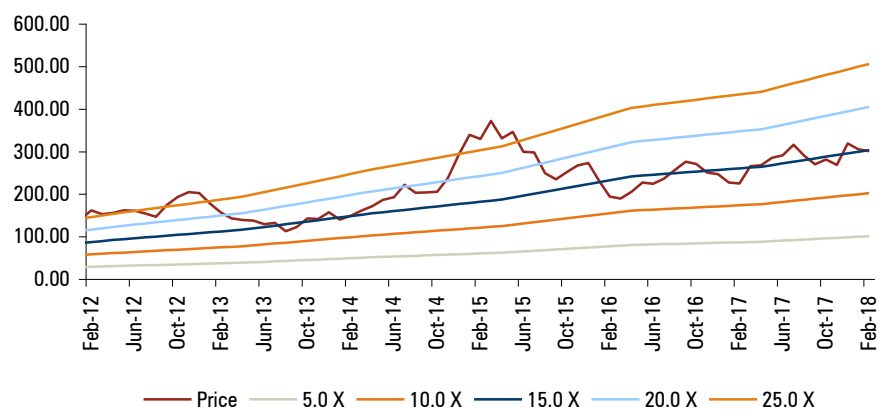


Source: Company, ICICIdirect.com Research

## Outlook and valuations

TBVF's focus on improving SSS growth is expected to boost topline and margins, going forward. Further, the company is expected to grow through aggressive gym addition. In addition, TBVF is taking various measures to reduce operating cost (like consolidation of gyms, reduction in rentals and widening bouquet of VAS), which will boost margins in coming years. However, the aggressive expansion strategy of the company has led to an increase in leverage, which remains a key concern. Hence, we maintain our **HOLD** rating on the stock with a revised target price of ₹ 327.

**Exhibit 9: One year forward P/E**



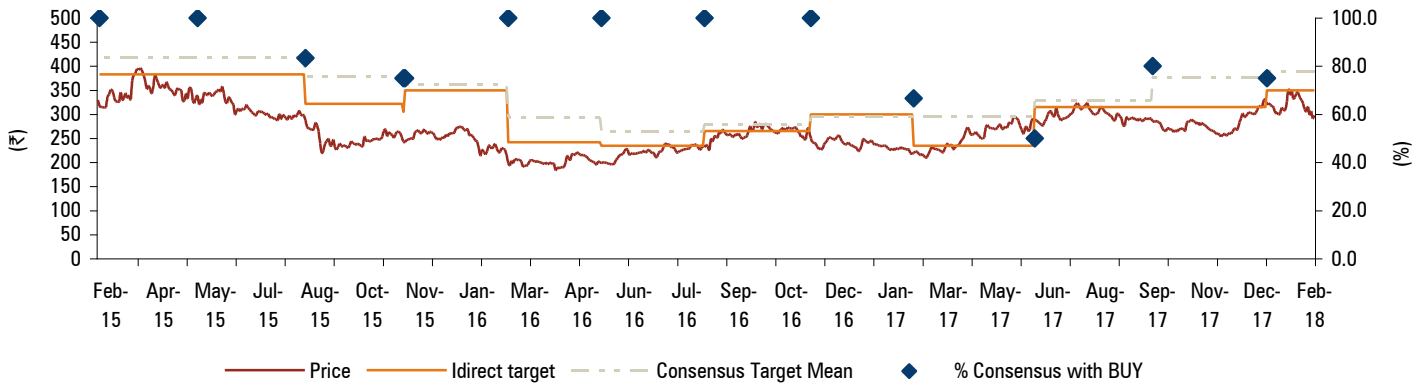
Source: Company, ICICIdirect.com Research

**Exhibit 10: Valuation**

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY16	251.3	-0.5	18.5	8.2	16.3	7.7	12.9	12.9
FY17	279.9	11.4	20.0	8.2	15.0	7.4	12.2	12.7
FY18E	316.9	13.2	26.4	32.0	11.4	6.4	13.6	13.9
FY19E	377.1	19.0	34.3	29.8	8.8	5.2	15.1	16.3

Source: Company, ICICIdirect.com Research

### Recommendation history vs consensus estimate



Source: Bloomberg, Company, ICICIdirect.com Research

### Key events

Date	Event
May-14	Talwalkars reaches significant number of 150th gym with the opening of its Vile Parle branch in Mumbai
May-15	Approves stake sale by company's subsidiary, Denovo Enterprises Pvt Ltd in its subsidiary (company's step-down subsidiary) Equinox Wellness Pvt Ltd, with which Equinox Wellness Pvt Ltd is no longer the company's step-down subsidiary
Jun-15	Talwalkars and David Lloyd Leisure Ltd entered into 50:50 joint venture to develop leisure clubs in India
Jun-15	Talwalkar raises ₹ 107 crore through qualified institutional placement (QIP) for investing in joint venture with David Lloyd Leisure Ltd (UK), to enhance presence in brands and also make acquisitions
Oct-15	Talwalkar acquires 49.5% stake in Power World Gym (Sri Lanka) for undisclosed sum
Nov-15	Talwalkar enters into partnership with online portal Gymtrekker Fitness Pvt Ltd
Nov-15	Talwalkar acquires 50% stake in Zorba for undisclosed sum
Nov-15	Talwalkar acquires 51% stake in Inshape Health and Fitnez Limited for undisclosed sum
Aug-16	Talwalkars open 20 gyms in Bengaluru
Mar-17	Talwalkar signs MoU to acquire 50% equity shares in Force Fitness India Pvt Ltd (FFIPL) (subject to due diligence)
Mar-17	Talwalkars open 10 gyms in Delhi
Jul-17	Signed an MOU to acquire 51% stake in Mickey Mehata Health Beyond Fitness

Source: Company, ICICIdirect.com Research

### Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Change (m)
1	Capital Research Global Investors	30-Sep-17	11.0	3.4	0.0
2	Talwalkar (Prashant Sudhakar)	30-Sep-17	9.3	2.9	0.0
3	Gawande (Anant Ratnakar)	18-Oct-17	8.1	2.5	0.6
4	Talwalkar (Girish Madhukar)	30-Sep-17	7.3	2.3	0.0
5	Bhatkal (Harsha Randas)	18-Oct-17	6.0	1.9	0.3
6	Gawande (Vinayak Ratnakar)	10-Oct-17	5.2	1.6	0.0
7	Talwalkar (Madhukar Vishnu)	18-Oct-17	5.1	1.6	1.5
8	Ascent Capital Advisors India Pvt. Ltd.	30-Sep-17	4.8	1.5	0.0
9	Mankekar (Laxmi Shivanand)	30-Sep-17	4.1	1.3	0.0
10	Bajaj Allianz Life Insurance Company Limited	30-Sep-17	3.1	1.0	0.0

Source: Reuters, ICICIdirect.com Research

### Shareholding Pattern

(in %)	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
Promoter	37.99	37.99	37.99	34.96	37.36
FII	14.78	13.32	13.67	13.05	12.51
DII	7.08	7.06	7.03	5.97	3.80
Others	40.15	41.63	41.31	46.02	46.33

### Recent Activity

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
Talwalkar (Madhukar Vishnu)	6.44	1.48	Excel Funds Management Inc.	-2.26	-0.54
Gawande (Anant Ratnakar)	2.52	0.58	Gawande (Vinayak Ratnakar)	-0.11	-0.02
Mankekar (Shivanand Shankar)	1.57	0.38			
Bhatkal (Harsha Randas)	1.31	0.30			
Tata Asset Management Limited	0.27	0.06			

Source: Reuters, ICICIdirect.com Research

## Financial summary

Profit and loss statement		₹ Crore			
(Year-end March)	FY16*	FY17*	FY18E	FY19E	
Total operating Income	251.3	279.9	316.9	377.1	
Growth (%)	-0.5	11.4	13.2	19.0	
Employee Expenses	39.4	42.3	44.8	51.6	
Marketing Expenses	68.6	74.3	81.6	94.0	
Total Operating Expenditure	107.9	116.6	126.4	145.6	
EBITDA	143.4	163.3	190.5	231.5	
Growth (%)	24.6	13.9	16.7	21.5	
Depreciation	47.0	48.6	54.8	63.9	
Interest	17.7	19.7	28.2	13.6	
Other Income	6.8	0.5	9.5	10.4	
PBT	85.5	95.6	117.1	164.4	
Others	0.4	0.0	1.5	2.1	
Total Tax	30.2	36.8	34.6	55.9	
PAT	55.0	58.7	80.9	106.4	
Growth (%)	19.3	6.8	37.7	31.6	
EPS (₹)	18.5	20.0	26.4	34.3	

Source: ICICIdirect.com Research, \*Adjusted for IND-AS revenues is now net of service tax

Balance sheet		₹ Crore			
(Year-end March)	FY16*	FY17*	FY18E	FY19E	
<b>Liabilities</b>					
Equity Capital	29.7	29.7	31.0	31.0	
Reserve and Surplus	397.4	456.7	573.3	674.3	
Total Shareholders funds	427.1	486.4	604.3	705.3	
Total Debt	308.5	402.9	352.9	302.9	
Deferred Tax Liability	27.5	29.6	31.6	33.6	
Minority Interest / Others	13.8	16.4	17.9	19.9	
Total Liabilities	776.9	935.4	1,006.7	1,061.7	
<b>Assets</b>					
Gross Block	722.5	822.5	1,002.5	1,127.5	
Less: Acc Depreciation	162.5	211.1	265.9	329.8	
Net Block	560.0	611.4	736.7	797.8	
Capital WIP	0.0	0.0	20.0	20.0	
Total Fixed Assets	560.0	611.4	756.7	817.8	
Intangibles	4.6	4.6	4.6	4.6	
Investments	8.8	5.1	9.9	61.3	
Long term Loans and Adv	0.0	0.0	0.0	0.0	
Debtors	31.7	29.8	29.5	35.1	
Loans and Advances	133.8	191.2	176.4	208.2	
Cash	140.7	127.5	65.9	36.2	
Total Current Assets	306.2	348.5	271.9	279.5	
Creditors	87.4	78.7	77.9	92.7	
Provisions	16.5	12.1	10.9	11.1	
Other current liabilities	0.0	0.0	0.0	0.0	
Total Current Liabilities	103.8	90.8	88.8	103.8	
Net Current Assets	202.4	257.9	183.2	175.9	
Application of Funds	776.9	935.4	1,006.7	1,061.7	

Source: Company, ICICIdirect.com Research

Cash flow statement		₹ Crore			
(Year-end March)	FY16*	FY17*	FY18E	FY19E	
Profit after Tax	55.0	59.5	82.0	106.4	
Add: Depreciation	47.0	48.6	54.8	63.9	
(Inc)/dec in Current Assets	-72.0	-55.8	15.3	-37.7	
Inc/(dec) in CL and Provisions	32.9	-13.0	-2.0	15.0	
CF from operating activities	62.8	39.2	150.0	147.6	
(Inc)/dec in Investments	-4.8	-51.4	-1.0	-1.0	
(Inc)/dec in Fixed Assets	-90.3	-100.0	-200.0	-125.0	
Others	2.4	4.8	3.5	4.1	
CF from investing activities	-92.8	-146.6	-197.5	-121.9	
Issue/(Buy back) of Equity	3.5	0.0	1.3	0.0	
Inc/(dec) in loan funds	28.8	94.4	-50.0	-50.0	
Dividend paid & dividend tax	-5.2	-5.2	-5.4	-5.4	
Inc/(dec) in Sec. premium	0.0	0.0	0.0	0.0	
Others	97.2	5.0	40.1	0.0	
CF from financing activities	124.3	94.2	-14.1	-55.4	
Net Cash flow	94.4	-13.2	-61.6	-29.7	
Opening Cash	46.4	140.7	127.5	65.9	
Closing Cash	140.7	127.5	65.9	36.2	

Source: Company, ICICIdirect.com Research

Key ratios		₹ Crore			
(Year-end March)	FY16*	FY17*	FY18E	FY19E	
<b>Per share data (₹)</b>					
EPS	18.5	20.0	26.4	34.3	
Cash EPS	34.3	36.4	44.1	54.9	
BV	143.8	163.7	194.9	227.5	
DPS	1.3	1.5	1.5	1.5	
Cash Per Share	14.0	17.1	23.2	32.8	
<b>Operating Ratios (%)</b>					
EBITDA Margin	57.1	58.3	60.1	61.4	
PBT / Total Operating income	21.9	21.3	25.9	28.2	
Asset Turnover	0.4	0.3	0.3	0.4	
Debtor days	46.0	38.9	34.0	34.0	
Creditor days	126.9	102.7	89.7	89.7	
<b>Return Ratios (%)</b>					
RoE	12.9	12.2	13.6	15.1	
RoCE	12.9	12.7	13.9	16.3	
RoIC	15.2	14.2	14.7	16.7	
<b>Valuation Ratios (x)</b>					
P/E	16.3	15.0	11.4	8.8	
EV / EBITDA	7.7	7.4	6.4	5.2	
EV / Net Sales	4.4	4.3	3.9	3.2	
Market Cap / Sales	3.7	3.3	2.9	2.5	
Price to Book Value	2.1	1.8	1.5	1.3	
<b>Solvency Ratios</b>					
Debt/EBITDA	2.2	2.5	1.9	1.3	
Debt / Equity	0.7	0.8	0.6	0.4	
Current Ratio	2.9	3.8	3.1	2.7	
Quick Ratio	1.6	2.4	2.3	2.3	

Source: Company, ICICIdirect.com Research



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Buy: > 10%/15% for large caps/midcaps, respectively;

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Sell: -10% or more;



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