RETAIL RESEARCH

Talwalkars Better Value Fitness Ltd. (TBVFL)

Management Interaction Note

Scrip Code	Industry	CMP	Recommendation	Target	Time Horizon
TALFITEQNR	Health Fitness	Rs. 277.3	Buy at CMP and add on dips to Rs. 235-247	Rs. 336	1-2 quarters

Price Chart

Stock Details	
BSE Code	533200
NSE Code	TALWALKARS
Bloomberg	TALW.IN
Price (Rs) on Dec 23, 2014	277.3
Equity Capital (Rs. Mn)	261.8
Face Value (Rs)	10
Eq. Shares O/s (mn)	26.2
Market Cap (Rs Mn.)	7380.4
Book Value (Rs)	91.9
Avg. Volume (52 Week)	39,042
52 wk H/L (Rs)	291/130.1
Shareholding Pattern	
(As on Sept 30, 2014)	**% Holding**
Promoters	53.4
FII	10.8
Institutions	5.9
Others (incl. body corporate)	29.9
Total	**100.0**

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Led by improved growth in SSS & steady gym additions, we expect TBVFL to report a healthy growth of 20.9% & 26.6% on CAGR basis in Sales & PAT over FY14-16. While in FY15, the growth would be largely driven by improved realizations (fee hike & improved product mix), we expect volume growth to improve in FY16 due to gym additions, while realization growth would remain healthy due to higher share of high margin value added services (VAS) like Reduce, Transform, Nuform & Zumba.

Aggressive marketing initiatives could boost revenues & widen TBVFL's brand reach. Experienced promoters, strong positioning in fitness industry (India's largest fitness chain with 150 gyms and presence across 78 cities & towns & 20 Indian states) with favourable industry dynamics provides good growth opportunity. Alliances with prominent overseas brands like Zumba Fitness, Premier Training Institute, David Lloyd Leisure Ltd could further strengthen quality of its value-added offerings.

Optimal utilization of existing assets would result in OPM expansion. Enhancing productivity due to increasing member base, comprehensive utilization of time slots & widened bouquet of VAS would be key focus over the next 2 years. Higher OPM along with control on rise in depreciation & interest cost in FY16 would result in higher PAT margins. Healthy cash flow generation, well measured & steady gym additions would ensure stable debt-equity going forward.

Despite intensifying competition from organised and unorganized players, TBVF has an edge over its peers (like Gold gyms, Fitness one, snap fitness etc) due to its long presence in the industry driven by qualified and experienced professionals, strong brand recall, market leadership, diverse service offerings with Pan-India presence and competitive pricing.

We feel TBVFL is capable of trading at 15xFY16E EPS, which gives a price target of Rs. 336. TBVFL is a branded retailer of services and hence can be compared with other multi-brand retailers like Shoppers Shop, Pantaloon, Trent, Marico Kaya etc for valuation purpose, through its business model is different. TBVFL trades at a significant discount to Shoppers Stop, Trent & Marico Kaya on EV / EBITDA basis (TTM), which further provides comfort to valuations. We recommend investors to but this stock at current levels & average it on dips to Rs. 235-247 (10.5-11xFY16E EPS) for our price target over the next 1-2 quarters.

Consolidated Particulars (Rs. in Mn)	FY12	FY13	FY14	FY15E	FY16E
Net Sales	1193.6	1508.5	1872.7	2243.8	2736.8
% Growth y-o-y	28.6	26.4	24.1	19.8	22.0
Operating Profit	558.5	738.8	937.9	1212.5	1520.0
% Growth y-o-y	39.7	32.3	27.0	29.3	25.4
PAT (Adjusted)	218.0	300.5	366.1	451.2	587.0
% Growth y-o-y	34.4	37.8	21.8	23.2	30.1
EPS (Fully Diluted)	8.3	11.5	14.0	17.2	22.4
PE	33.3	24.2	19.8	16.1	12.4

Company Overview

Talwalkars Better Value Fitness Limited (TBVFL), commonly known as Talwalkars, is a widely recognized India's largest health fitness chain providing world-class gymming equipment facilitated by professional trainers. The company possesses a state-of-the-art training institute of around 25000 sq ft in Thane that creates industry-ready professionals providing seamless services at fitness centres across India. The company has over 150 fitness centres with presence across 78 cities & towns and 20 Indian states in the country, with over 1,50,000 members. The current employee strength is around 4000. It has a market leadership with 43.86% share in organised fitness industry and 13.2% in the total Indian fitness industry. TBVFL diverse fitness services include standard gymming and fitness and Value added services like Zumba® program (aerobics and Latin dance-inspired fitness program), Transform (holistic fitness program), Reduce (diet-based, easy diet program), NuForm (time-efficient weight loss program), spa, massage, aerobics and yoga. The value added services contribute 23-24% of the total turnover of TBVFL.

TBVFL (promoted by Mr. Madhukar Vishnu Talwalkar) has been at the forefront of fitness business in India for the past eighty years. The Brand 'Talwalkars' has become synonymous with 'fitness' in states like Maharashtra. The first gymnasium was started by Mr. Vishnu Talwalkar in 1932. The business, till a few years back was a family enterprise run and owned by the Talwalkar Family. In 2003, Talwalkar's better value fitness was co-promoted by the Talwalkar & Gawande Group with 5 Gyms. Between 2003 to 2009 (until the filing of draft red herreing prospectus) the number of Healthclubs went up to 54. Post IPO in April 2010 (6.05 mn shares of FV Rs. 10 at Rs. 128), the number of clubs has continued to grow & now stand at 150.

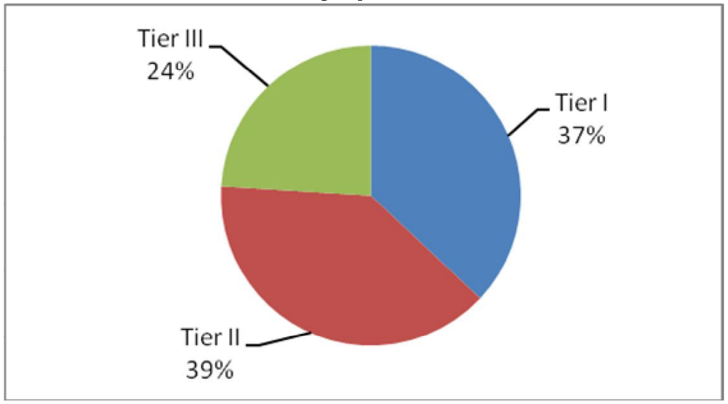
Out of 150 gyms, 104 are owned by the company (largely leased; only 6-7 properties are owned), 16 are under subsidiaries and 13 are franchise and licensed gyms. The balance 17 are Hi-Fi (Healthy India-Fit India) gyms. Hi-Fi model was introduced in 2011-12 for expanding into Tire 3 and Tire 4 cities. It is a pure franchisee owned and Franchisee run model. The company earns Royalty and turnkey fees from the franchisee (upfront royalty of Rs. 2 mn and ongoing royalty of ~6% of turnover for first 3 years and 8% thereafter). A typical 100% owned health club would be about 4000-5000 sq feet, while average space of Hi-Fi gym would be around 2000-2500 sq feet. The concept of Hi-Fi gym focuses on equipping the gym with similar facilities like imported equipments, air conditioning and trainers like a full service gym albeit lesser in number. However, it does not offer value added offerings such as spa, steam, spinning and Jacuzzi. It is generally priced at a 60% lesser than a price of full service gym, making it affordable for the masses. Typical roll out time for Talwalkars full service gym is ~16 weeks, while for Hi-Fi gym it is 8-10 weeks.

Multi-format asset ownership Talwalkars

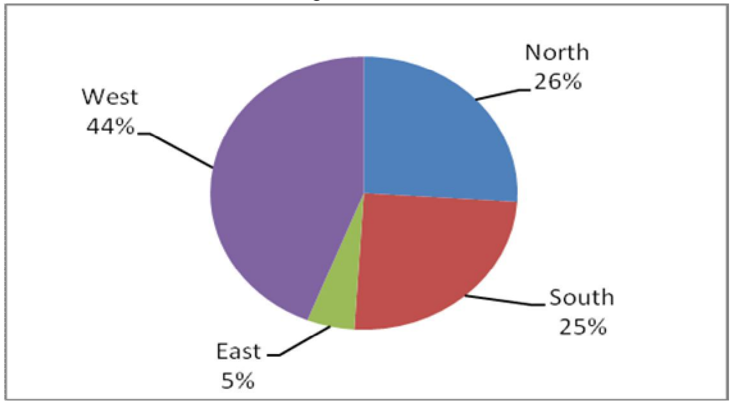
Owned	**104**
Subsidiary	16
Franchise & licensed gyms	13
Hi-fi	17
Total Gyms (as on September 30, 2014)	**150**

Out of the total fitness centres, 37% of the outlets were located in Tier-I cities, while 39% and 24% units are situated in Tier-II and Tier-III cities and towns, respectively. While the majority of the fitness centres at 44% were located in Western India, 25% were located in Southern and 26% in the Northern parts of the country while the East represented the rest at 5%. The company has 54 fitness centres in Maharashtra, 15 in Andhra Pradesh & 11 Fitness Centres in each Gujarat & UP.

Demographic Divide



Regional Divide



Subsidiary Model

In certain geographies where the Company wanted to mark a presence, it has partnered with a local partner. A separate 51% subsidiary is set up and the Capex is shared. The partner pays royalty to the parent for the brand and management of the health club. There are 16 such clubs under operation. Subsidiary format provides higher ROI due to lower capex. This 51% subsidiary approach on a franchise basis has been proved successful by the Company's subsidiaries, namely Denovo Enterprises Private Limited, Equinox Wellness Private Limited, Aspire Fitness Private Limited and Jyotsna Fitness Private Limited.

Further, TBVFL recently floated Talwalkars Club Private Limited as its wholly-owned subsidiary company to own and manage recreational/lifestyle clubs by providing all kinds of sports, games, recreational and hospitality facilities.

Subsidiary Details (All are Indian subsidiaries)

- **Denovo Enterprises Private Limited**, a subsidiary of TBVFL, is sharing 38% of the total gym count under the subsidiaries head. Denovo's health clubs are operational in Northern and Western India.

- **Equinox Wellness Private Limited** is a step-down subsidiary of TBVFL (direct subsidiary of Denovo Enterprises Private Limited). Equinox has its health club operational in Eastern India.

- **Aspire Fitness Private Limited**, a subsidiary of TBVFL, is sharing 38% of the total gym count under the subsidiaries head. Aspire's health clubs are operational in Western India.

- **Jyotsna Fitness Private Limited** though relatively new entrant in the list of subsidiaries, it is following the same quality footsteps as that of Talwalkars. Jyotsna Fitness's health clubs are operational in Western India.

The subsidiaries in total account for 14% of the consolidated net sales & 13.1% of the net profits of TBVFL (in FY14; in H1FY15 12.6% of total net sales & 13.3% of total net profits). Denovo & Aspire are the major subsidiaries.

The table below gives an overview of financials of subsidiaries:

Subsidiary (Rs. In Mn)	TBVFL's % ownership interest in FY14	FY14 Revenues	FY14 PAT	% Growth in Revenues over FY13	% Growth in PAT over FY13
Denovo Enterprises Private Limited	50.1	121.6	49.2	5.1	19.4
Equinox Wellness Private Limited	33.33*	12.0	0.5	-16.7	-16.7
Aspire Fitness Private Limited	50.001	106.6	9.4	43.5	42.4
Jyotsna Fitness Private Limited	50.1	31.4	4.7	307.8	67.9

*effective ownership due to 66.67% holding of Denovo Enterprises in Equinox Wellness

Alliances

TBVFL has strengthened the quality of its value-added offerings through alliances with prominent international brands like Zumba® Fitness (a global lifestyle brand), David Lloyd Leisure Limited (Europe's leading premium sports, health and leisure group) & Premier Training Institute

Seasonality in TBVFL's business

An element of seasonality exists in TBVFL's business. Q2 & Q4 are the best quarters, wherein the company derives 65% of its total revenues from these quarters, while Q1 & Q3 are weak quarters. The seasonality impacts the business in following way: i) April-June: School vacation & monsoons; ii) July–September: Monsoon, Annual discount scheme, a big attraction; iii) October–December: Festive season (Diwali, Navratri, Christmas) and iv) January–March: New Year - New Resolution sees uptick in membership.

Investment Rationale

Diverse revenue streams with expansive footprint across the country & strong brand recall

Talwalkars is India's largest fitness provider. Brand Talwalkars is built over eight decades and has high brand recall value. Talwalkars provides a holistic fitness experience – standard gymming and fitness, Latin American dancing (Zumba® program), health diet (Reduce), weight loss (NuForm), health diet-cum-weight loss (Transform), spa, massage, aerobics and yoga. Currently, 8 NuForm studios are operational in Mumbai, Zumba programs are offered at 46 centres and Reduce program is offered at over 100 centres This has helped moderate the difference between peak and trough footfalls in a day. The company has over 150 fitness centres (104 owned, 13 Franchise, 16 under subsidiaries & 17 Hi-Fi gyms) with presence across 78 cities & towns and 20 Indian states in the country, with over 1,50,000 members. It has a market leadership with 43.86% share in organised fitness industry and 13.2% in the total Indian fitness industry.

Talwalkars widespread presence, represented by 150 fitness centres, enables it to enjoy scale benefits comprising better agreement terms from suppliers. This has helped achieve standardization across fitness centres. It has provided TBVFL with an opportunity to penetrate untapped locations with organised and branded offerings and having the first mover advantage. The company averaged around two health clubs per city, making it possible to leverage the economies-of-brand without cannibalising respective revenues. Nearly 64% of its national presence is in non-metro locations, making possible for it to grow its offerings from the grassroot upwards. Western India accounted for 44% of its presence; South and North India cumulatively accounted for 51% of its presence.

Over the years, TBVFL has enriched its brand through a conscious positioning around fitness, training, knowledge, diverse offerings and uplifting health club environment. The integrity of its brand management, stronger marketing & wider service offerings has helped generate a revenue increase in each of the last five years (helped in increasing revenues per gym); CAGR (FY10-FY14) in total net revenues was 33% while CAGR in PAT was 47% during the period. The company has been able to retain its renewal rate of 70-76% at a time when there is a fear of membership attrition. Talwalkars has been prudently positioned as an affordable brand addressing a growing customer base with increasingly diverse requirements. We believe that this strategy has paid off in terms of its ability to reach out to a large potential customer base and attract more members. Over the last few years, TBVFL has taken steps towards premiumisation in response to the emergence of more affluent customers needing exclusive health club services.

Aggressive marketing initiatives boost revenues, widen brand reach, create awareness for new services launched

The marketing team develops innovative ideas keeping in view the changing dynamics of the internal and external environment. This has helped TBVFL not only to enhance its revenues and widen the reach of the brand but has also created awareness for the new services launched by the Company. Going forward we expect the company to continue with its aggressive marketing approaching to strengthen its branding & to boost its revenue & profit growth. The table below gives an overview of key marketing initiatives undertaken by TBVFL in FY14 & in H1FY15:

FY14	• Held Talwalkars Classique 2013, a body-building competition in association with the Maharashtra Body Building Association (under the Indian Body Builders Federation). • Lead fitness partner for Miss Hyderabad Event, lead fitness partner at college festivals, launched Investothon a run organised by the NSE and CNBC TV 18 across the cities of Vadodara, Bengaluru, Jaipur and Mumbai • Launched Annual August Discount scheme and various other themes (New Year, EMI scheme, Women's Day and Valentine's Day to name a few) which aided renewals and new enrollments • Launched Reduce program in Mumbai, Commenced offering Reduce as an online program in order to enhance membership base and convenience; also initiated online merchandising of Zumba® products. Reduce and Zumba® program promotions actively marketed in colleges and corporates. • Increased visibility through social media, print media among others by organizing a contest on Twitter with www.fashionmostwanted.com, embraced other modes of promotion comprising webinars, medianet articles and through the social media platforms, among others.
H1FY15	• Launched the 4-month Summer Fitness Programme (one month free on the purchase of a 3-month membership) • Launched the national marketing campaign for Transform under the positioning of 'Keen to be lean?' • Launched fitness campaigns on Mothers' Day, Fathers' Day, World Environment Day, World Health Day and World No Tobacco Day. • Launched the Annual August Scheme across the country • Activated the July Scheme ('fitness for less') which reduced the entry barriers for consumers • Engaged in health promotions on World Heart Day, Independence Day and Ganesh Chaturthi • Launched a promotional (with Talent Promoterz) for members to be featured on the cover of a Mills & Boon novel • Introduced Zumba® at college festivals • Enhanced social media and print media visibility; Transform was highlighted on Medianet • Offered corporate employee wellness programs (Zumba®, aerobics, diet and nutrition counselling, fitness test and fitness activation) by internationally-certified trainers and dieticians

Experience promoters, strong positioning in fitness industry along with favourable industry dynamics provides good growth opportunity

The fitness industry in India is highly under penetrated compared to several developed and developing countries globally. While the US is home to 90,000 clubs with 73 mn members, India has 1,234 clubs with 440,000 members (IHRSA Global Report, 2014). With an only 440,000 membership base, only 0.02% of the Indian population is covered under any kind of fitness, representing significant potential for growth. Hence a significant catch-up potential exists in the Indian fitness space. The wellness industry in India is poised to touch Rs. 100,000 crore (Rs.1 trillion) by 2015, with a compounded annual growth rate of 15-17%, from about Rs. 70,000 crore in 2012 (Source: FICCI-PwC). A recent survey by Forbes Asia indicates that despite having the world's second largest population pool, less than 1% of the urban Indian population holds health club membership. This is paltry as compared to 3.11% in the Asia-Pacific and about 17.5% in the US and demonstrates a huge scope for growth.

Interestingly, the wellness industry has resisted the economic slowdown and has shown stable growth. The emergence of a new middle class that is more educated and aware of the importance of health and wellness and, interestingly, possesses a higher share of disposable income is driving the growth in the wellness segment. The importance of this demographic pool can be accurately appraised when one considers the fact that around 40% of the Indian population will be between the age groups of 20 and 44 by 2016 (Source: FICCI-PwC, IHRSA, Business Today).

With the new government at the helm, the Indian GDP growth is expected to improve significantly over the next two to three years. (5.5-5.7% in 2014- 15, as per the CSO). Improved economic growth could result in increased spending power and benefit the wellness industry going forward. Some of the key factors that are likely to drive the wellness industry growth in India over the next few years include

i) **Rising population:** The chunk of the population aged 40 years and above is expected to rise from 33% in 2012 to 43% by 2041. With increasing disposable income and clear fitness aspirations, this set of consumers is more inclined to spend on health, fitness and wellness services. Moreover, the youth population is expected to rise to 427 million by 2015, creating a strong potential market for alternative sources of fitness like aerobics, yoga, Zumba® program and holistic dietary regimes.

ii) **Unexplored markets:** With recorded industry penetration levels of less than 1% of the Indian population, there exists massive headcount to be approached by the health industry over the coming years towards raising fitness awareness and driving enrollments.

iii) **Rising disposable income:** Rise in the number. of employed individuals coupled with rapid urbanisation and rising disposable income, has driven awareness and spends on a perceived 'otherwise-not-so important' service. This has created a new market segment to cater through innovative services like Reduce, Zumba® program, spa & massage, among other services.

iv) **High prevalence of lifestyle diseases in India:** In no measure is India's relative unfitness more clearly visible than in its obesity. India, with 41 million obese, ranks third after the US and China in the highest number of overweight people in the world (Source: Global Burden of Disease Study 2013). India and China cumulatively account for a seventh of the world's obese. Rising cardiovascular disease burden, increasing number of deaths in India from coronary heart diseases, rising hypertension prevalence, increasing number of cases of diabetes provides urgent need for health awareness in the country, which can mitigate the prevalence of certain diseases and ailments to a large extent.

v) **Rising fitness concerns among people:** With the hectic work schedule, sedentary lifestyle and shortage of open area for physical activities majority of the population are developing lifestyle diseases at an early age. This population also has high income levels and propensity to spend on their fitness and personal care services, creating a huge opportunity to tap on.

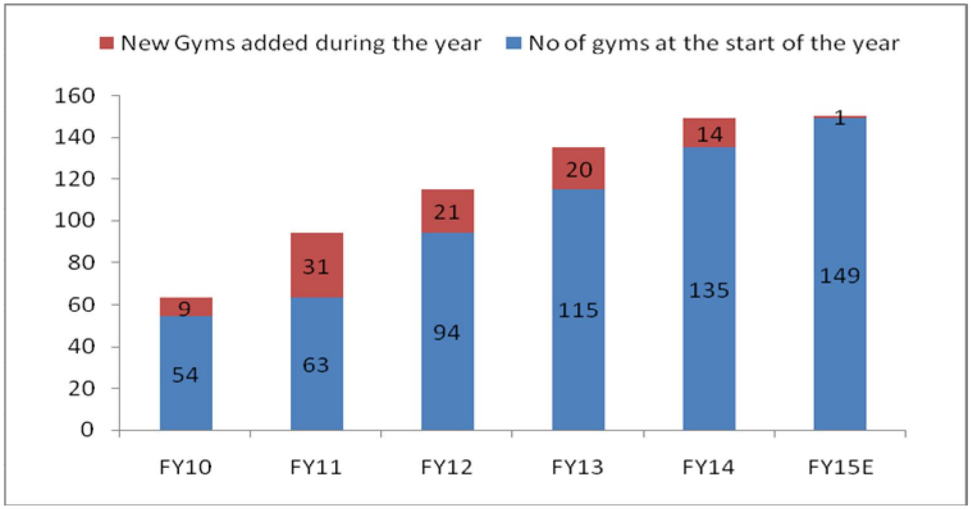
vi) **Rising urbanization:** The rate of urbanization in India is on an exponential rise. Cities hold tremendous potential as engines of economic and social development, creating jobs and generating wealth. Almost 300 million Indians currently live in towns and cities. Within 20-25 years, another 300 million people will get added to Indian towns and cities (Source: Planning Commission). Thus, more people are to adopt urban lifestyles in the coming years, broadening the market for the health and fitness industry in the country.

TBVFL is jointly promoted by Talwalkar and Gawande families, where Mr Madhukar Talwalkar and Mr Prashant Talwalkar have more than 40 years of experience in various segments of health and fitness industry. The company has a strong position in the fitness industry. With market leadership, years of experience and expertise, wide service offerings, expansive footprint across the country and strong brand recall, TBVFL is well poised to leverage its strength and exploit the available opportunities in the Indian wellness industry. With visible evidence of increasing number of health clubs (reported 16.5% Y-o-Y CAGR in FY11-14) and being an early mover in the health club market in India with a strong brand name and quality services, we expect growth momentum to continue, going forward.

Revenue & PAT to grow at a healthy pace led by steady gym additions & increasing focus on improving SSS growth; operating leverage to result in margin expansion

Well measured & steady gym additions

TBVFL's revenue has grown at a CAGR of 26.5% over FY11-14, driven largely by volume growth of 18.3% [gym additions]. Realizations increased by 8% during the same period. TBVFL increased its fitness centres significantly from 63 in FY10 to 149 in FY14. We observe that the expansion of new gyms have slowed down significantly over the last 2.5 years (20 gyms added in FY13, 14 gyms added in FY14 & 1 gym added in H1FY15). Especially in H1FY15, the company seems to have consciously refrained from establishing new fitness centres during the quarter in a bid to consolidate operations, ensure buoyancy in same-store sales (SSS) and focus on Annual August Discount Scheme, one of the major annual events at the Company.



The Company plans to open 20-25 fitness centres within the next 2 quarters and 100 fitness centres over the next three years (plans to reach 100 towns in three years). This includes the plans to expand the Hi-Fi gyms to 30 over the next three years. Under the signed master franchisee for establishing 30 HiFi fitness centres in Tier-III and IV towns over the next three years, TBVFL would be launching soon in Aurangabad, Jalna, Osmanabad, Parbani and Udgir. Going forward fitness centres in the Franchise format has also been initiated in Bhilwara , Jagatpura (Jaipur) and Patna.

We feel the company would expand the gyms in a well measured and steady manner (through ownership as well as profitable franchise route) after carefully assessing the market situation, demand & the extent of profits generated from existing assets (SSS growth). The company would ensure that the fitness centres would be opened in locations which can yield a higher ROCE (incremental ROCE of 25% on an ongoing basis). We expect higher additions from FY16, while in FY15 we expect growth to be largely driven by higher realizations (through increase in fees and improved product mix).

Would continue to focus on improving SSS growth through higher share of VAS and increase in membership base

Along with new gym additions, we expect TBVFL to continue to focus on improving its SSS growth through higher share of Value added services (VAS) and increase in membership base. TBVFL's priority would be to enhancing throughput from each of its fitness centres and growing the proportion of value-added services being provided. In line with this, it expects to increase same-store sales to 8-10% (H1FY15 SSS growth already at 8.9% annualized) from around 4-5% in FY14. Same store sales focus give an indication that value added per store is gaining significance as a driver of sales rather than just being volume driven.

Looking to increase the proportion of VAS

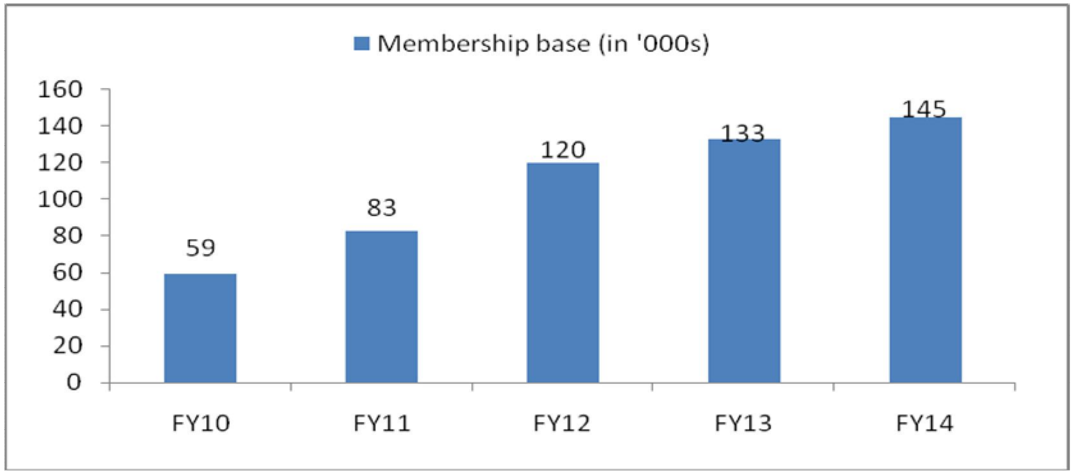
The company had introduced value accretive services (like Zumba, which started in 2001, Nuform, Reduce in 2012 and Transform in 2014) & that focused on alternative forms of fitness on the one hand and enhanced member profile on the other. NuForm has helped the Company cater to the members who do not have the time to visit a gym or have specific physical ailments restricting them to do regular gym workout. Currently, 8 NuForm studios are operational in Mumbai. TBVFL has increased the number of centres offering the Zumba® program to 46. The Company has created a pool of Zumba® trainers, facilitating the program's faster rollout. The Reduce program is offered at over 100 centres. Furthermore, Reduce is also offered as 'home-based Reduce' and online service, offering further convenience to members.

During FY14, it widened the application of Reduce and Zumba® program across various customer interface points. It launched an online version along with home based service for Reduce; it combined Reduce with NuForm to create a unique Transform offering in April 2014. Transform perfectly blends together weight loss and muscle toning to deliver overall fitness. It addresses holistic fitness needs. The national marketing campaign for Transform was strategically initiated from 1st April,2014 onwards to increase the margins in the weak quarter. The response to this program was overwhelming, resulting an upshot in the Revenues, EBITDA and PAT margins in Q1FY15. In Q2FY15 transform was highlighted on Medianet.

Value Addition Services in total contributed 23-24% of the Turnover in H1FY15, which has increased from 18-20% in FY12. Going ahead, we expect the company to enhance the proportion of these value-added offerings (to 40% over next three years), which would enable it to widen its brand appeal and strengthen its turnover & profit growth. The company has stated that market profit-accretive Transform has substantial scope for growth and is expected to enhance businesses across more fitness centres (around 150) over the next two years. The company would also continue to expand Zumba & Nuform offerings going forward through active marketing in colleges, corporates etc. The company has plans to extend Nuform to all 150 centres from 8 studios now. NuForm offers convenience as it is also offered as home-based service, as it uses foldable equipment. Further, there is lot of space available in centres and in case of lack of space the company can easily replace 1 treadmill with 1 nuform equipment. As a part of the expansion plan, the company has already ordered 25 sets of Nuform equipments. TBVFL had mentioned about slow off take of Zumba (provided by freelancers in past 5-6 years) as compared to other offerings due to local competition but expressed confidence of a pickup in enrolments based on its corporatized approach.

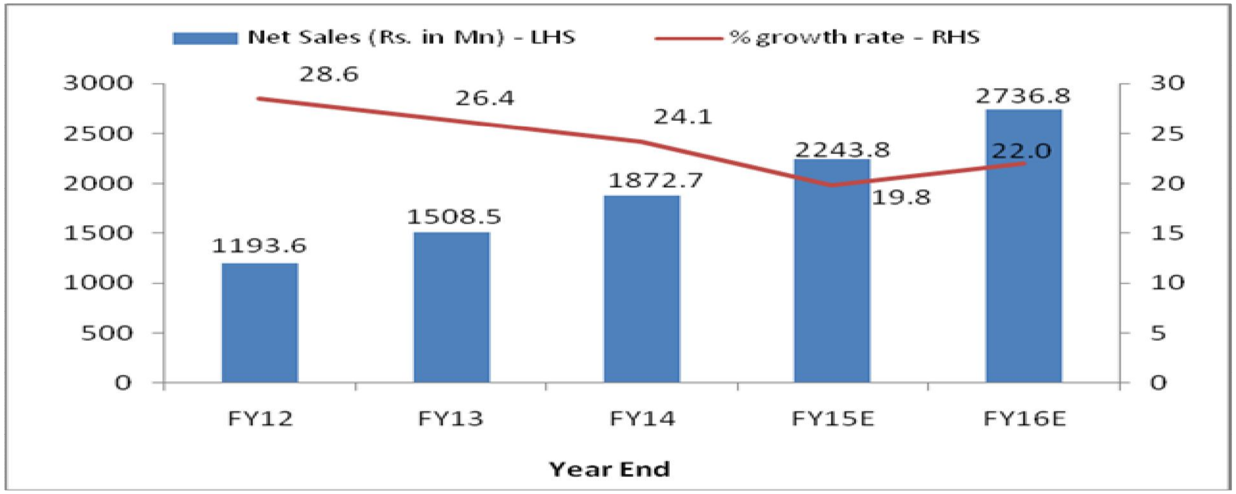
Well Planned and structured marketing strategies, continuation of discount packages / schemes to attract membership

Well Planned and structured marketing strategies would continue to attract membership for the new initiatives. The company would also look at improving the membership base in existing gyms through continuation of various discount packages & schemes (like Annual August Scheme which saw encouraging response, Summer Scheme, new year scheme, valentine day scheme, EMI scheme, anniversary schemes etc). This would boost the SSS growth.



Revenue & PAT to grow at a healthy pace by 20.9% & 26.6% over FY14-16; optimal utilization of existing assets to aid in margin expansion

Led by improved growth in SSS & steady gym additions, we expect TBVFL to report a healthy growth of 20.9% & 26.6% on CAGR basis over FY14-16. The growth is likely to moderate compared to 26.4% CAGR growth reported over FY11-14, largely due to lower gym additions and focus on improving SSS growth. While in FY15, the growth would be largely driven by improved realizations (led by fee hike & improve product mix), we expect the volume growth to improve in FY16 due to gym additions, while realization growth would remain healthy due to higher share of VAS.



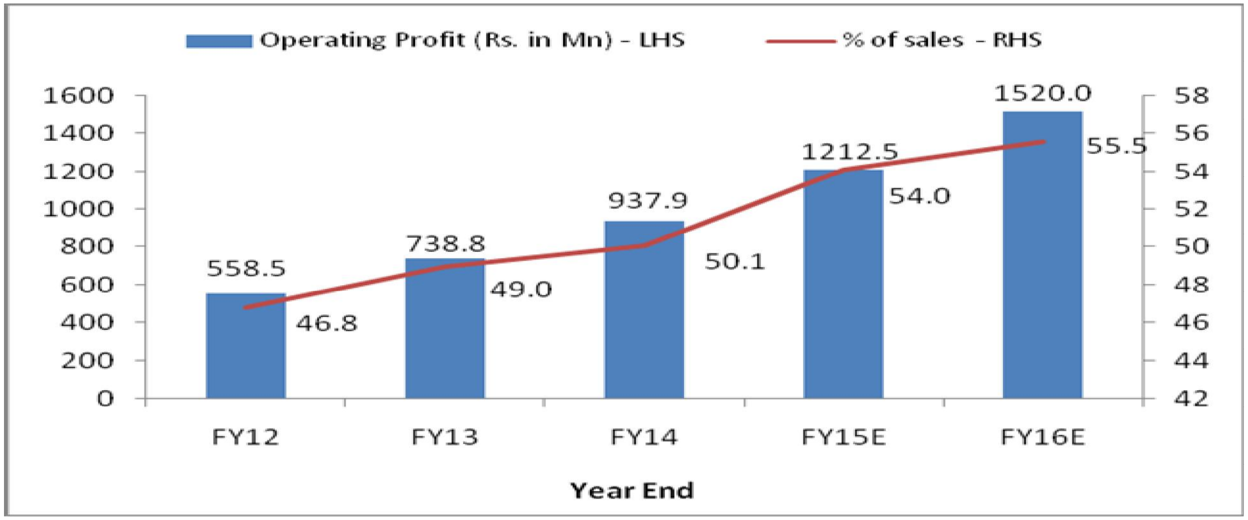
We expect the operating profit to grow by 27.3% over FY14-16. Optimal utilization of existing assets would result in healthy operating margin expansion (as evident from H1FY15, wherein the OPM increased by 553 bps over H1FY14). We expect the OPM to improve from 50.1% in FY14 to 54% in FY15 and further to 55.5% in FY16. Enhancing productivity due to increasing member base, comprehensive utilization of time slots & widened bouquet of value added services would be key focus over the next two years. The company would focus on lower CAPEX intensive growth through offerings such as HiFi, NuForm program, Reduce, Zumba & Transform. The pricing of VAS are significantly higher (Nuform ~Rs. 36000-42000 per quarter, Reduce: Rs. ~20000-28000 per quarter, Transform: Rs. ~50000-64000 p.a., Zumba Rs. ~2000-2500 p.m.) compared to standard gym & fitness services (~Rs. 15000 p.a.). With lower CAPEX & high pricing, VAS fetch higher margins (EBITDA margins of Nuform: 42-48%, Reduce: 40-45%, Transform: 33-37%) compared to margins offered by standard gym & fitness service (~30%)

New Initiatives

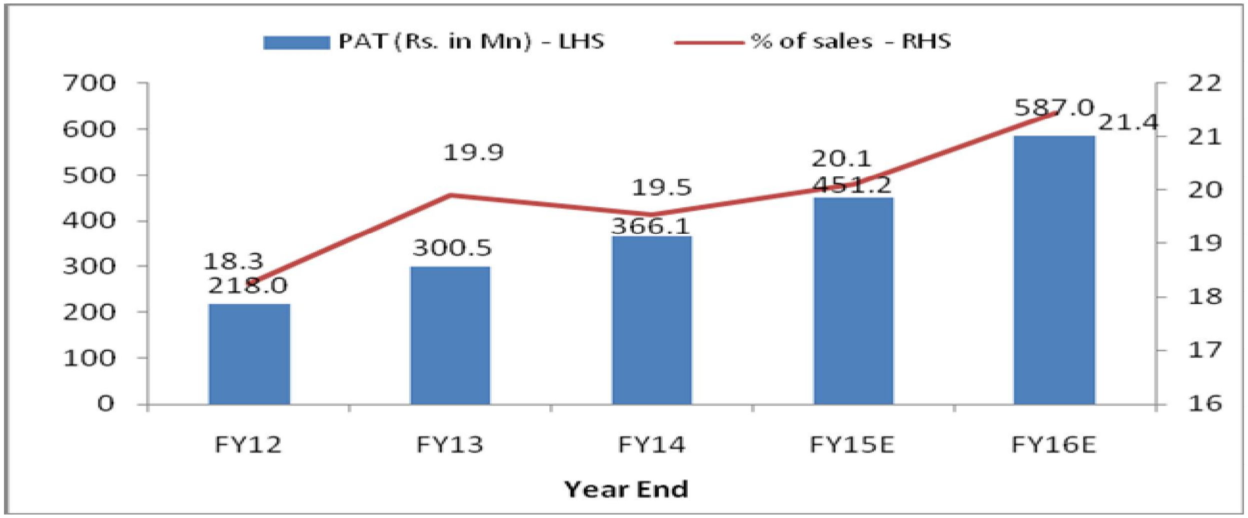
Particulars	Nuform	Zumba Program	Reduce	Transform
CAPEX	Rs. 9-10 mn	Rs. 1.5-2 mn	Rs. 0.7-0.8 mn	Rs. 10-11 mn
Revenue / centre	Rs. 8-9 mn	Rs .1-1.2 mn	Rs. 2 mn	Rs. 10-11 mn
EBITDA	42-48%	57-62%	40-45%	Rs. 40-45%
ROCE	27-33%	29-32%	75-80%	33-37%
Pricing approx	Rs. 36000-42000 p.a.	Rs. 2000-2500 per month	Rs. 20000-28000 per quarter	Rs. 50000-64000 p.a.

(Source: Company presentation)

Trend in operating profit and margins since FY12 and future projections:



PAT is likely to grow by 26.6% on CAGR basis over FY14-16. PAT margins are likely to expand at a slower pace from 19.5% in FY14 to 20.1% in FY15 due to sharp rise in the depreciation cost in H1FY15 (up 57.9%), led by change in estimated useful life of assets and higher interest cost. However, we expect the depreciation cost (no aggressive gym additions) & interest cost (debt-equity to reduce) to grow at a slower pace in FY16. This would result in further improvement in PAT margins to 21.4% in FY16.



Strengthened the quality of value added offerings through alliances with prominent international brands

TBVFL has strengthened the quality of its value-added offerings through alliances with prominent international brands. These international alliances have helped leverage the brand of its alliance partner, shrink its learning curve and provide an international experience within an Indian environment.

- **Zumba® Fitness**, a global lifestyle brand, is a Latin dance-inspired fitness plan, which fuses varied rhythms and easy-to-follow dance moves to create a one-of-a-kind fitness class. Zumba® program offers a complete body workout in a single session. This program has received wide acceptance, which can be gauged from the already 14 mn people taking weekly Zumba® classes in over 140,000 locations across more than 185 countries.
- **Premier Training Institute** for providing world-benchmarked training to TBVFL's gym instructors. Premier will deliver leadership and management training to over 40 senior managers as well as organize a five-day Advanced Fitness Skills course for 180 fitness trainers. The courses will be part of a larger education pathway that has the end goal of UK Level 3 accreditation, REPs membership and an overseas internship. The objective is to enhance employee performance levels to the standards of the international market. The full value of this alliance is expected to play out in H2FY15 and beyond, helping TBVFL create a widespread pool of trained professionals of international standards.

- **David Lloyd Leisure Limited (DLL):** Started operations in 1982, DLL is Europe's leading premium sports, health and leisure club chains, operational since 1982. The company currently operates 91 health clubs with over 450,000 members and has an annual turnover of $510mn. It offers expert sports training, gym, tennis, squash and badminton courts, physiotherapist, nutritionist, yoga, swimming pools. It also has Health & beauty spas, crèches, nurseries and specialist sports shops, bars and restaurants etc. The company employs about 6000 employees including an expert health & fitness team of over 1,800 and over 450 tennis professionals. DLL clubs have a host of celebrity members including Olympic and world champions and other elite sportsmen and women, actors and television presenters, among others.

Plans to set up First Recreation and Sports Club

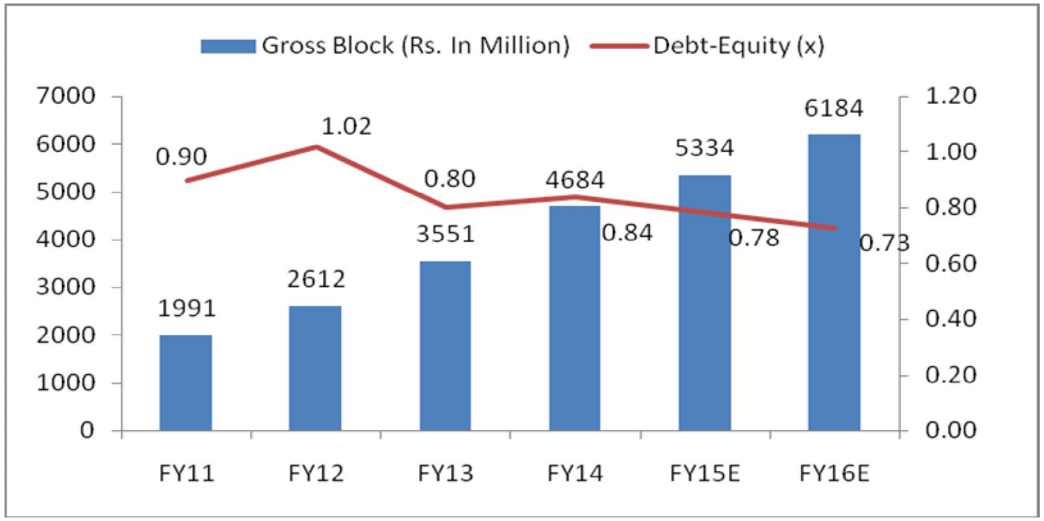
TBVFL has an existing alliance with DLL that was entered into in 2012. The Company has sustained this relationship with DLL, offering consultancy services for setting-up clubs in townships and gated communities. TBVFL has plans to set up clubs in India (having facilities like Gym, Sports Training, Entertainment Zone, Banquet Hall, Recreation centre, Restaurant, Swimming Pool & Racquet Sports). The target audience for Clubs would be Gated communities, Hi end residential townships, corporate campuses. The Company has identified land near Baner, Pune to start the First Recreation and Sports Club. This will be part of a prestigious town ship by a reputed builder in the city. Legal due diligence of the same is expected to be over in the next 1-2 months. Thereafter TBVFL will apply for municipal permissions to start construction activity of the club house, plans which are ready. Funds have been allocated for the CAPEX (investments of ~Rs. 580 mn; funds raised through QIP placemnt) and kept in treasury for immediate disbursal of land and building. TBVFL expects the club to start accepting memberships in FY16. All Fitness activities will be managed by TBVFL, while all non-fitness activities to be outsourced. TBVFL recently floated Talwalkars Club Private Ltd. as its wholly-owned subsidiary company to own and manage recreational/lifestyle clubs by providing all kinds of sports, games, recreational & hospitality facilities. A club, if positioned at a reasonable membership cost could become a great business proposition. Though recovery of cash flow by life membership and other fees would be easy, recurring net income could be low or negative, impacting the OPM/PAT margins and RONW/ROCE.

Debt-Equity in comfortable position despite significant increase in the asset base over the last four years; return ratios to improve with improved profitability

TBVFL has increased its asset base substantially over the last four years on the back of continued expansion across the country. The Gross block has increased by 33% on a CAGR basis over FY11-14. Despite growing asset base, the company has managed to keep its debt-equity in a comfortable position. Infact over the last four years the debt-equity has reduced (though marginally) from 0.9x in FY11 to 0.84x (was 1.02 in FY12).

While the company has been slow on expanding the gyms in H1FY15 (only 1 gym opened) and is focusing on improving the same store sales growth, it has plans to open 25-30 gyms over the next two to three quarters and 100 gyms over the next three years (more than half of which is expected to be owned). The expansion would require significant capital (CAPEX for setting up a new gym is ~Rs. 2.5 cr) and company would prefer to finance it with debt, which would further increase the total borrowings. However, that would not be on the cost of increase in debt to equity of the company.

Cash flow generation is expected to remain healthy over the next two to three years on the back of healthy growth expected in sales and profits. Further, we feel the company would expand the gyms in a well measured and steady manner after carefully assessing the market situation, demand & the extent of profits generated from existing assets (SSS growth). The company has been rated "AA-" by Credit Rating Agency and that would enable it to borrow funds at better interest rates. The company has also managed to reduce its trade receivables in H1FY15 because se of revised sales strategies eg: EMI scheme. That could result in lower blockage of working capital. With this, we expect the company to maintain its debt-equity or improve it gradually going forward. Over the next three years, the company aims to reduce its debt-equity to 0.3x.



Management is planning to enhance share of value added services in revenue to 40% over the next three years. That could result in faster profit growth due to better margins. With improved profitability, return rations could also improve going forward. Further, change in estimated life (which has resulted in significantly higher depreciation in H1FY15) will have long term positive impact improving the ROE. Moreover, subsidiary format provides higher ROI due to lower CAPEX. We expect the ROCE & ROE to improve from 15.8% & 15.2% in FY14 to 19.1% & 17.8% in FY16 respectively. The company has a target to improve its ROCE to 28-30% over the next three years.

Competitive Profile

TBVFL operates in a highly competitive market and faces stiff competition from other players operating both in organized and un-organized sectors. Some foreign players have also entered the Indian market. Some of the TBVFL's organised competitors include Golds Gym (89 Health clubs; 26.02% share in organised and 8.2% share in total Indian Fitness industry), Fitness one (43 Health clubs; 12.57% share in organised and 4.5% share in total Indian Fitness industry) and Snap Fitness (41 Health clubs; 11.99% share in organised and 4.3% share in total Indian Fitness industry) [All these are unlisted players]. Amongst the listed players, the competitor is Powerhouse Fitness and Realty. However, TBVFL faces marginal competition from this company, since it's a very small player.

We feel TBVF has an edge over its competitors due to its long presence in the industry driven by qualified and experienced professionals (The Talwalkars Group has several decades of experience in the health and fitness industry), diverse service offerings with Pan-India presence and competitive pricing. The brand "Talwalkars" is known for consistent, standardized and quality offerings and has a good brand recall which helps in breaking the competitive clutter within the industry. In the business environment that Talwalkars is involved in, a paucity of skilled and trained personnel is what ails the contemporary domestic wellness industry the most. Over the years, the Company has reinforced its numbers and capabilities, strengthening its competitive edge.

Today, the company is India's largest health fitness chain with 150 fitness centres, presence across 78 cities & towns and 20 Indian states in the country and over 1,50,000 members. It has a market leadership with 43.86% share in organised fitness industry and 13.2% in the total Indian fitness industry. The company has been sensitive to the changing dynamics of the fitness industry and hence has developed service offerings that suit every pocket and every age profile. The company has and is expected to increase the number of fitness centres at its steady growth. This would provide it with a base over which it would be able to scale growth over the foreseeable future, widening its lead over competition.

Risks & Concerns

- Consumer spending can get affected due to factors such as low incomes/growth, inflation, recession, taxation and consumer credit. A slowdown in consumption pattern could negative impact the industry & in turn the company.
- The fitness industry in India (which is highly fragmented) is not significantly capital intensive and possesses low entry barriers. Increase in demand for health related services could open up more opportunities, which could in turn intensify the competition from new and existing players in the industry (organised & unorganized). This could potentially have an impact on the company's financial performance.
- After the planning stage, TBVFL takes around 14-16 weeks to set up health club. Any delay in ramp up of a health club or company's failure to open it due to its inability to find a suitable location could impact the revenue & profit growth.
- In order to sustain its growth momentum and to remain in competition, TBVFL will have to continuously expand the number of its gyms. This could compel the company to resort to incremental borrowings and deteriorate its debt-equity ratio and increase its interest liability going forward. However, till now the company has managed well to reduce its debt-equity despite a significant increase in the asset base over the last four years.
- There are certain gymnasiums operated by the company "Talwalkars Fitness Solutions Private Limited" (TFSPL) which is controlled by relatives of its Promoters, Mr. Madhukar Vishnu Talwalkar, Mr. Girish Madhukar Talwalkar and Mr. Prashant Sudhakar Talwalkar. However their number has come down from 14 a few years back to about 6 now as the balance have already been integrated with the listed company.

- The asset-turnover ratio of TBVFL is low at 0.4. TBVFL will have to sweat its assets continuously and in an efficient way to sufficiently cover up its fixed costs.
- Seasonality factor leads to lower revenues in Q1 and Q3, thus leading to high volatility on quarterly basis
- To meet customer expectations, the Company needs to constantly focus on quality service offerings and availability of skilled manpower. One of the keys to a successful healthcare industry is trainers where the attrition rate is high.
- The Indian fitness industry is at a nascent stage. Any adverse government policy and reforms like higher tax rate on fitness equipment, levy of fresh tax or increase in existing tax rates, etc could impact the industry and company financials.
- The company faces the risk of brand dilution due to its increasing focus on franchisee model (Hi-Fi).
- Most of the premises are on lease basis. Hence inability of the company to obtain the renewal of any of its leased premises could impact the operations in that particular area.

Conclusion

Led by improved growth in SSS & steady gym additions, we expect TBVFL to report a healthy growth of 20.9% & 26.6% on CAGR basis over FY14-16. While in FY15, the growth would be largely driven by improved realizations (through fee hike & improve product mix), we expect the volume growth to improve in FY16 due to gym additions, while realization growth would remain healthy due to higher share of value added services (VAS).

Aggressive marketing initiatives boost revenues, widen brand reach, create awareness for new services launched experience promoters, strong positioning in fitness industry along with favourable industry dynamics provides good growth opportunity

Alliances with prominent international brands like Zumba® Fitness, Premier Training Institute, David Lloyd Leisure Limited (DLL) could help TBVFL continue to strengthen the quality of its value-added offerings. In partnership with DLL, the company plans to set up First Recreation and Sports Club, which is expected to accepting memberships from FY16, and has floated Talwalkars Club Private Limited as its wholly-owned subsidiary company to own and manage the same.

Optimal utilization of existing assets would result in healthy operating margin expansion. Enhancing productivity on account of increasing member base, comprehensive utilization of time slots and widened bouquet of value added services (which fetch higher margins compared to standard gym & fitness service) would be key focus over the next two years. Higher operating margins along with control on the rise in depreciation and interest cost in FY16 would result in higher PAT margins. Lower CAPEX intensive growth through offerings such as HiFi, NuForm program, Reduce, Zumba & Transform would result in improved profitability & return ratios going forward. Healthy cash flow generation, well measured and steady gym additions would ensure that debt-equity remains at comfortable position going forward.

Despite intensifying competition from organised and unorganized players, TBVFL has an edge over its peers (like Gold gyms, Fitness one, snap fitness etc) due to its long presence in the industry driven by qualified and experienced professionals, strong brand recall, market leadership, diverse service offerings with Pan-India presence and competitive pricing.

We feel TBVFL is capable of trading at 15xFY16E EPS, which gives a price target of Rs. 336. TBVFL is a branded retailer of services and hence can be compared with other multi-brand retailers like Shoppers Shop, Pantaloon, Trent, Marico Kaya etc for valuation purpose, through their business model is different. TBVFL trades at a significant discount to Shoppers Stop, Trent & Marico Kaya on EV / EBITDA basis (TTM), which further provides comfort to valuations. We recommend investors to but this stock at current levels & average it on dips to Rs. 235-247 (10.5-11xFY16E EPS) for our price target over the next 1-2 quarters.

Quarterly Financials (Consolidated)

Particulars (Rs. In Mn)	Q2FY15	Q2FY14	VAR [%]	Q1FY15	VAR [%]	Q4FY14	Q3FY14
Gross Sales	837.8	695.5	20.5	447.2	87.4	659.2	366.2
Service Tax	89.8	74.4	20.7	47.2	90.3	69.9	38.4
Net Sales	748.0	621.1	20.4	400.0	87.0	589.3	327.8
Other Operating Income	2.6	2.7	-3.3	1.4	88.6	3.7	2.4
Other Income	0.0	0.0	-100.0	0.0	-	0.0	-0.3
Total Income	750.6	623.8	20.3	401.4	87.0	593.0	330.0
Total Expenditure	347.2	311.4	11.5	214.5	61.9	247.6	176.3
Raw Material Consumed	0.0	0.1	-100.0	0.0	-	0.0	0.2
Stock Adjustment	0.0	0.5	-99.0	0.0	-	0.1	0.0
Employee Expenses	143.1	130.0	10.0	81.2	76.2	93.4	58.0
Other Expenses	204.1	180.8	12.9	133.2	53.2	154.1	118.0
PBIDT	403.4	312.3	29.2	186.9	115.9	345.4	153.7
Interest	29.3	21.6	35.9	38.2	-23.3	36.6	31.5
PBDT	374.1	290.8	28.7	148.7	151.6	308.8	122.2
Depreciation	103.5	77.5	33.7	98.4	5.2	45.4	68.5
PBT	270.6	213.3	26.9	50.2	438.7	263.4	53.7
Tax (incl. DT & FBT)	60.2	52.1	15.6	6.5	831.3	108.2	11.8
PAT	210.4	161.2	30.5	43.8	380.6	155.3	41.9
Minority Interest	13.7	13.6	0.3	3.5	294.1	6.4	6.6
Reported PAT	196.7	147.6	33.3	40.3	388.1	148.9	35.3
Extra-ordinary Items	0.0	0.0	-	0.0	-	0.0	-0.2
Adjusted PAT	196.7	147.6	33.3	40.3	388.1	148.9	35.5
EPS (Rs.)	7.5	5.6	33.3	1.5	388.1	5.7	1.4
Equity	261.8	261.8	0.0	261.8	0.0	261.8	261.8
Face Value	10.0	10.0	0.0	10.0	0.0	10.0	10.0
OPM (%)	53.9	50.3	7.3	46.7	15.4	58.6	47.0
PATM (%)	26.3	23.8	10.7	10.1	161.0	25.3	10.8

(Source: Company, HDFC Sec)

Financial Estimates (Consolidated)

Profit & Loss A/c

YE March (Rs. In Mn)	FY12	FY13	FY14	FY15E	FY16E
Net Sales	1193.6	1508.5	1872.7	2243.8	2736.8
Other Operating Income	15.7	13.1	10.8	7.5	7.9
Total Operating Income	1209.3	1521.6	1883.5	2251.3	2744.7
Material Cost	0.0	1.3	2.1	0.0	0.0
Employee Benefits Expenses	248.2	311.7	358.6	399.4	465.3
Other Expenditure	402.6	469.8	584.9	639.5	759.5
Total Operating Expenses	650.8	782.8	945.6	1038.9	1224.7
Operating Profit	558.5	738.8	937.9	1212.5	1520.0
Other Income	3.7	0.0	-0.3	0.0	0.0
EBITDA	562.2	738.8	937.6	1212.5	1520.0
Interest	91.3	107.9	119.7	149.2	170.6
Depreciation	117.7	146.5	241.8	362.0	432.9
PBT	353.2	484.4	576.2	701.3	916.6
Tax (including FBT & DT)	104.0	158.2	178.4	217.4	288.7
PAT (before minority interest	249.2	326.2	397.8	483.9	627.9
Minority Interest	28.6	25.7	31.9	32.7	40.8
Reported PAT	220.6	300.5	365.9	451.2	587.0
Extra-ordinary Items	2.6	0.0	-0.2	0.0	0.0
Adjusted PAT	218.0	300.5	366.1	451.2	587.0

(Source: Company, HDFC Sec Estimates

Balance Sheet

YE March (Rs. In Mn)	FY12	FY13	FY14	FY15E	FY16E
Equity & Liabilities					
Shareholders' Funds	1443.4	2085.0	2404.9	2793.3	3301.8
Share Capital	241.2	261.8	261.8	261.8	261.8
Reserves & Surplus	1202.2	1823.2	2143.1	2531.5	3040.0
Non-Current Liabilities	**1505.4**	**1790.4**	**1854.9**	**2238.8**	**2440.9**
Minority Interest	50.3	80.6	112.5	145.2	186.0
Long Term borrowings	1220.1	1351.8	1373.2	1716.4	1802.3
Deferred Tax Liabilities (Net)	142.8	192.1	237.5	285.0	342.0

Other Long Term Liabilities	92.3	165.9	131.7	92.2	110.6
Current Liabilities	**427.4**	**630.6**	**996.9**	**909.2**	**1045.8**
Short Term Borrowings	100.0	47.9	307.5	15.4	0.0
Trade Payables	39.3	80.3	98.2	110.5	134.8
Other Current Liabilities	186.7	347.4	414.1	579.7	666.7
Short Term Provisions	101.4	154.9	177.0	203.6	244.3
Total Equity & Liabilities	**3376.2**	**4506.0**	**5256.7**	**5941.3**	**6788.4**
Assets					
Non-Current Assets	**2952.3**	**4058.3**	**4836.1**	**5235.1**	**5812.4**
Fixed Assets	**2575.6**	**3577.8**	**4505.1**	**4834.2**	**5322.0**
Gross Block	2611.6	3551.3	4683.9	5333.9	6183.9
Depreciation	295.4	439.2	671.5	1033.5	1466.3
Net Block (Tangible Assets)	2316.2	3112.2	4012.4	4300.5	4717.6
Intangible Assets	43.3	40.5	39.5	35.5	32.0
Capital Work-in-Progress	216.2	421.8	449.9	494.9	569.2
Goodwill On Consolidation	0.0	3.3	3.3	3.3	3.3
Non Current Investments	175.0	226.6	87.8	79.0	75.1
Long -term Loans and Advances	199.4	251.8	241.6	289.9	376.9
Other Non-Current Assets (including Deferred Tax Asset)	2.2	2.1	1.6	32.0	38.4
Current Assets	**423.9**	**447.7**	**420.5**	**706.1**	**976.0**
Current Investments	0.1	0.2	0.2	0.2	0.2
Inventories	0.0	1.6	0.6	0.6	0.6
Trade Receivables	201.0	177.5	320.5	256.4	312.8
Cash & Cash Equivalents	198.5	229.2	60.0	363.2	551.8
Short Term Loans & Advances	24.4	39.2	39.2	78.4	101.9
Other Current Assets	0.0	0.0	0.0	7.3	8.8
Total Assets	**3376.2**	**4506.0**	**5256.7**	**5941.3**	**6788.4**

(Source: Company, HDFC Sec Estimates)

Key Ratios

YE March	FY12	FY13	FY14	FY15E	FY16E
FD EPS (Rs.)	8.3	11.5	14.0	17.2	22.4
PE (x)	33.3	24.2	19.8	16.1	12.4

Book Value (Rs.)	59.9	79.6	91.9	106.7	126.1
P/BV (x)	4.6	3.5	3.0	2.6	2.2
OPM (%)	46.8	49.0	50.1	54.0	55.5
PBT (%)	29.6	32.1	30.8	31.3	33.5
NPM (%)	18.3	19.9	19.5	20.1	21.4
ROCE (%)	15.3	15.8	15.8	17.1	19.1
RONW (%)	15.1	14.4	15.2	16.2	17.8
Debt-Equity (x)	1.0	0.8	0.8	0.8	0.7
Current Ratio (x)	1.0	0.7	0.4	0.8	0.9
Mkt. Cap / Sales (x)	5.6	4.8	3.9	3.2	2.7
EV/EBITDA (x)	13.9	11.4	9.5	7.1	5.6

(Source: Company, HDFC Sec Estimates)

Cash Flow

YE March	FY12	FY13	FY14	FY15E	FY16E
Profit Before Tax	353.2	484.4	576.2	701.3	916.6
Net Opt Cash Flow	404.2	628.7	658.8	1264.6	1358.9
Net Cash from Investing Activities	-715.5	-986.4	-873.0	-761.0	-1010.1
Net Cash from Financing Activities	221.0	381.2	52.6	-200.4	-160.2
Cash & Cash Equivalents	198.5	229.2	60.0	363.2	551.8
Net Inc/(Dec) in Cash	-90.3	23.5	-161.6	303.2	188.6

(Source: Company, HDFC Sec Estimates)

1 Year closing price chart

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