

Talwalkars Lifestyles Ltd. (TLL)

No. of shares (m)	31.01
Mkt cap (Rs crs/\$m)	394/53.1
Current price (Rs/\$)	127/1.7
Price target (Rs/\$)	165/2.2
52 W H/L (Rs.)	173/117
Book Value (Rs/\$)	139/1.9
Beta	0.7
Daily NSE volume (avg. monthly)	115940
P/BV (FY19e/20e)	0.8/0.7
EV/EBITDA (FY19e/20e)	3.7/3.1
P/E (FY19e/20e)	5.0/3.9
EPS growth (FY18/19e/20e)	15.1/12.8/30.8
OPM (FY18/19e/20e)	56.3/58.7/61.6
ROE (FY18/19e/20e)	18.7/17.0/18.8
ROCE(FY18/19e/20e)	11.1/11.1/13.1
D/E ratio (FY18/19e/20e)	0.9/0.6/0.5
BSE Code	541545
NSE Code	TALWGYM
Bloomberg	TALWGYM IN

Shareholding pattern

	%
Promoters	37.4
MFs / Banks / FIs	4.6
Foreign Portfolio Investors	13.0
Govt. Holding	-
Public & Others	45.0
Total	100.0

As on June 30, 2018

Recommendation

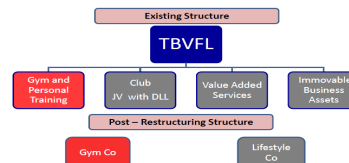
BUY

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Demerger

Talwalkars Better Value Fitness Limited (TBVFL) - the old entity - has demerged its business two companies - a gym company and a lifestyle company with the aim of maximizing the overall shareholder value. The gym business of TBVFL has been transferred to Talwalkars Lifestyles Limited (TLL). The company has recently applied for change of name whereby the gym company will be renamed as 'Talwalkars Healthclubs Ltd' (currently listed as TLL) and the lifestyle company will be renamed as TLL (presently listed as TBVFL). Going forward, our focus would be on the gym business.



Quarterly Highlights

- Though Q1 did not witness an increase in the number of fitness centers (q-o-q), scale up of 36 Power World Gyms (PWG), which were soft launched in Q4FY18 as well as improvement in revenue contribution from personal training enlarged revenues by 12.2% in Q1FY19. By rendering quality experience and personalized attention, the company aims to further increase its share of high margin personal training in the total pie.
- Largely owing to the growth in revenues, the operating margins improved by 54 bps y-o-y to 46.8%. Rise in interest cost by 40.2% y-o-y, thanks to the rollout of new gyms, failed to suppress net profit margin that expanded by 91 bps to 16% in Q1FY19. Depreciation for the quarter shrank marginally as some assets consummated their useful life.
- The stock currently trades at 5.0x FY19e EPS of Rs 25.18 and 3.9x FY20e EPS of Rs 32.94. With a pan India presence and multiple gym models, the company is ambitious to enlarge its foothold by targeting top 10-12 cities across India through the city centric approach – roll out cluster of 20-25 gyms in a target city and expand to each corner of the city. Comprising of 251 gyms as on June 30, 51% of its fitness centers is concentrated in Tier 1 cities which would help capitalize on the opportunities attributable to urbanization. Yet, no smallish debt owing to its expansion cannot be disregarded. With business restructuring, acquisitions and strategic alliances, earnings of the business is expected to drive up earnings by ~21.5% (on average) over the next two fiscals. Weighing odds, we recommend buying the stock with target price of Rs 165 based on 5.0x FY20e EPS of Rs 32.94 over a period of 9-12 months.

Consolidated (Rs crs)	FY17	FY18	FY19e	FY20e
Income from operations	225.27	247.09	282.23	325.73
Other Income	1.93	12.16	1.80	1.90
EBITDA (other income included)	127.77	151.39	167.55	202.57
PAT after MI and Associate Profit	57.62	69.21	78.07	102.14
EPS (Rs)	19.40	22.32	25.18	32.94
EPS growth (%)	-	15.1	12.8	30.8

Outlook & Recommendation

Industry Overview

According to a recent research conducted by Technavio, a global market research company, global health and wellness market is poised to steadily grow at a CAGR of about 6% from 2018 to 2022, primarily invigorated by dilating health consciousness among consumers along with rising disposable incomes. The growing urban population, in both the developed and developing nations, witnesses lifestyle changes that give rise to various health issues like obesity and diabetes, among others. As a result, the need to stay fit has become more pronounced in the recent years, thus serving as the major driver of growth of the global health and wellness industry.



Source: Business Wire

A recent announcement by International Health, Racquet & Sportsclub Association (IHRSA) reveals that with more than 201,000 clubs that served 174 mn members in 2017, the revenue posted by the global health club industry stood at \$87.2 bn (\$83.1 bn in 2016). With the health club membership's penetration rates being very low in several key markets, there remains tremendous potential for growth. Though leading markets posed strong performance, emerging markets – particularly Asia Pacific – exhibited promising future prospects during the year. IHRSA, therefore, has launched a global initiative to achieve 230 mn health club members by 2030.

The extent of under penetration in various key markets is revealed by the fact that more than two out of three health club members belong to the top 10 markets globally and as much as 71% of the total industry revenue is contributed by the top 10 markets. In terms of annual revenue and memberships, United States leads at \$30 bn and 60.9 mn respectively. United States is followed by Germany (\$5.6 bn) and United Kingdom (\$5.5 bn) in terms of market revenue in 2017.

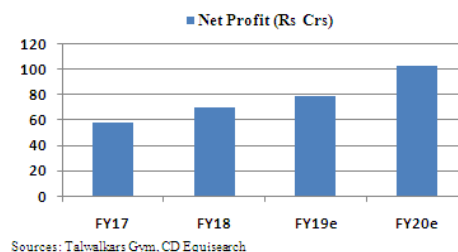
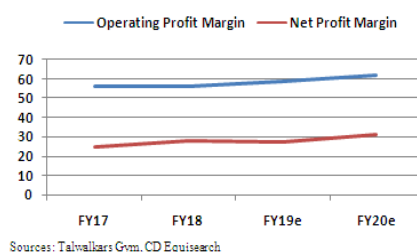
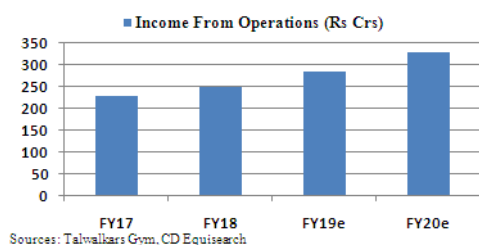
IHRSA report suggests that the health club performance in the Asia Pacific region is robust as member penetration in the region remains to be low in comparison to health club in developed regions worldwide. In 2017, 14 markets in Asia Pacific attracted 22.5 mn members at more than 25,000 health clubs. This market in Asia Pacific in total generates annual revenues of \$16.8 bn. With the highest penetration rates at 15.3% and 13.6%, Australia and New Zealand are the only two markets that are considered mature in this region. Though the fitness market in Hong Kong (5.85%), Singapore (5.8%), and Japan (3.3%) showcase signs of rapid growth, untapped opportunities for growth remain in regions like Philippines (0.53%), Thailand (0.5%), Indonesia (0.18%), and India (0.15%).



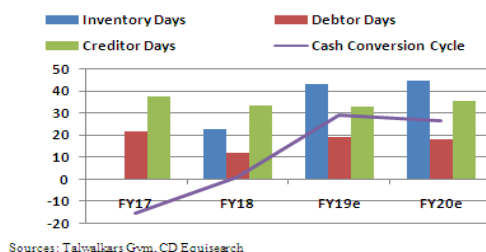
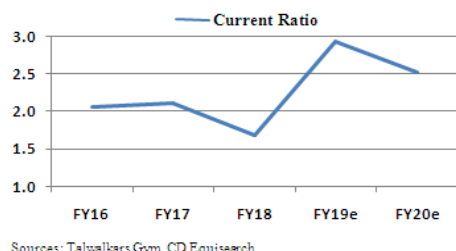
Source: Wellness Creative Co.

Financials & Valuations

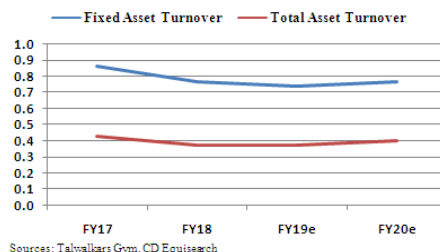
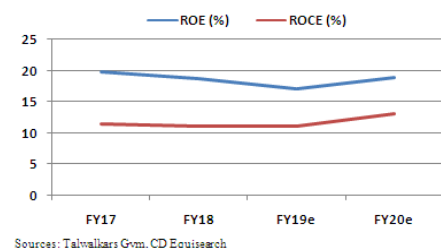
The macro optimism in the Indian fitness industry primarily driven by advancing discretionary income, growing incidence of lifestyle diseases, preventive approach towards health and fitness have all stimulated the demand for fitness services, thus helping Talwalkars to expand its market share. To capitalize on this optimism, Talwalkars added 45 fitness centers in FY18 accentuated by vigorous expansion of its low capex - low opex model of Power World Gym which aided topline growth of 9.7% last fiscal. Increasing share of high margin personal training to the revenue as well as access to various value added services has helped garner higher same store sales and combat competition.



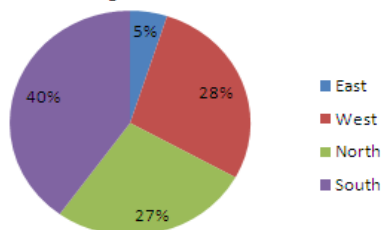
In an attempt to embellish the quality of service to customers and ensure long term relationship with clients, the company offers annual schemes that blend a plethora of value added services with gym solutions. Additionally, to enhance customer experience and ensure business control, Talwalkars recently invested in the biometric authentication in gym premises, palm vein machine to enrich personal training, sizable use of surveillance cameras, hassle free competency for cashless transactions and a robust centralized platform enhancing transparency and accountability. In order to cater to a large online market, the company is strategically investing in online apps and portals like Growfitter and Fitternity, in the domain of consultation and training.



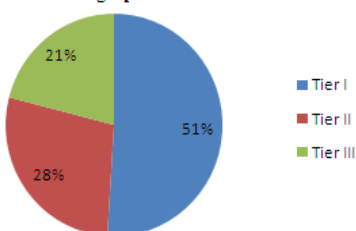
Talwalkars aggressive growth strategy via organic and inorganic means in the recent years has ushered setbacks by way of mounting debt and surging finance cost. Interest expense grew by 46.8% y-o-y in FY18, thanks to the increase in debt – from Rs 312.74 crs (\$48.2 mn) in FY17 to Rs 372.74 crs (\$57.3 mn) in FY18 – to meet its capital expenditure and investments such as expansion of PWG and 51% stake acquisition in Inshape Health and Fitnez Pvt Ltd. Going forward, debt is expected to moderate as a result of expansion via asset lightness model and low opex – low capex PWG format. These measures are expected to curtail capital investments and enhance margins thus generating the necessary cash flows to payback the debt.



With only as much as 5% of its fitness centers in the Eastern zone, Talwalkar's presence in eastern India remains debased. While the company intends to expand via Talwalkars and PWG formats in regions like Kolkata and Guwahati, HiFi format would be undertaken for various north eastern regions in India. Efforts towards increasing its dominance and cost rationalization should help the gym business to post OPM of 58.7% and 61.6% and NPM of 27.3% and 31.1% over the next two years.

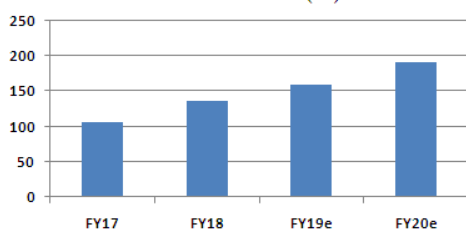
Regional distribution in India


Sources: Talwalkars Gym

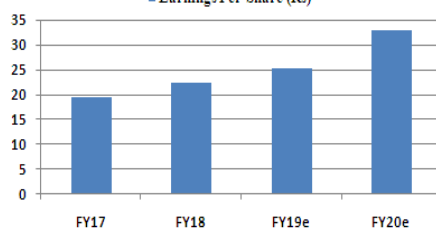
Demographic distribution in India


Sources: Talwalkars Gym

The stock currently trades at 5.0x FY19e EPS of Rs 25.18 and 3.9x FY20e EPS of Rs 32.94. The company is set to widen its footprint to pan Asia with its venture into six South East Asian countries under its exclusive partnership with Snap Fitness Inc, albeit this venture would progress slowly. Capitalizing on PWG by moderating expenditure and enhancing investment along with focus on improving revenues from high margin personal training should bolster profitability over the next two years. Demerger into the gym and lifestyle companies should help simplify business structure and ensure incisive focus. Scaling up of 36 gyms soft launched in last quarter of FY18 along with launch of 11 HiFi gyms in the current fiscal will aid to boost revenues. Striking an appropriate mix between owned and franchise formats should help the company maintain its dominance in the Indian fitness market. Yet, straddling debt owing to aggressive expansion is worthy of attention. On balance, owing to attractive valuation, we assign buy rating on the stock with target price of Rs 165 based on 5.0x FY20e EPS of Rs 32.94 over a period of 9-12 months.

Book Value Per Share (Rs)


Sources: Talwalkars Gym, CD Equisearch

Earnings Per Share (Rs)


Sources: Talwalkars Gym, CD Equisearch

Financials

Consolidated Quarterly Results

Figures in Rs crs

	Q1FY19	Q1FY18	% chg	FY18	FY17	% chg
Revenue From Operations	53.89	48.01	12.2	247.09	225.27	9.7
Other Income	0.45	0.46	-2.2	12.16	1.93	529.6
Total Income	54.33	48.46	12.1	259.25	227.20	14.1
Total Expenditure	28.69	25.83	11.1	107.86	99.43	8.5
EBITDA (other income incl.)	25.64	22.63	13.3	151.39	127.77	18.5
Interest	4.70	3.35	40.2	16.68	11.37	46.8
Depreciation	8.09	8.48	-4.6	30.25	30.23	0.1
PBT	12.86	10.80	19.0	104.45	86.18	21.2
Tax	4.25	3.58	18.6	35.65	30.58	16.6
PAT	8.60	7.22	19.2	68.80	55.60	23.8
Profit from Associate	0.53	0.34	53.1	1.34	2.89	-53.6
Minority Interest	0.24	0.59	-59.8	0.87	1.11	-21.3
Net Profit after MI & Associate Profit	8.89	6.98	27.5	69.27	57.37	20.7
Extraordinary Item	0.00	-0.01	-100.0	0.06	-0.25	-122.2
Adjusted Net Profit	8.89	6.98	27.3	69.21	57.62	20.1
EPS (Rs)	2.87	2.35	22.0	22.32	19.40	15.1

Consolidated Income Statement

Figures in Rs crs

	FY17	FY18	FY19e	FY20e
Revenue From Operations	225.27	247.09	282.23	325.73
Other Income	1.93	12.16	1.80	1.90
Total Income	227.20	259.25	284.03	327.63
Total Expenditure	99.43	107.86	116.47	125.06
EBITDA (other income incl.)	127.77	151.39	167.55	202.57
Interest	11.37	16.68	17.90	13.27
Depreciation	30.23	30.25	32.88	36.06
PBT	86.18	104.45	116.78	153.25
Tax	30.58	35.65	39.70	52.10
PAT	55.60	68.80	77.07	101.14
Profit from Associate	2.89	1.34	2.00	2.00
Minority Interest	1.11	0.87	1.00	1.00
Net Profit after MI & Associate Profit	57.37	69.27	78.07	102.14
Extraordinary Item	-0.25	0.06	-	-
Adjusted Net Profit	57.62	69.21	78.07	102.14
EPS (Rs)	19.40	22.32	25.18	32.94

Consolidated Balance Sheet

Figures in Rs crs

	FY17	FY18	FY19e	FY20e
Sources of Funds				
Share Capital	29.71	31.01	31.01	31.01
Reserves & Surplus	300.58	403.21	477.55	574.08
Total Shareholders Funds	330.29	434.22	508.55	605.09
Minority Interest	3.64	2.47	3.47	4.47
Long Term Debt	279.89	300.65	278.96	241.86
Total Liabilities	613.82	737.33	790.98	851.42
Application of Funds				
Gross Block	332.64	418.87	510.15	573.85
Less: Accumulated Depreciation	30.09	59.10	91.98	128.03
Net Block	302.56	359.77	418.17	445.81
Capital Work in Progress	31.32	54.23	40.00	50.00
Investments	57.99	104.22	71.22	73.22
Current Assets, Loans & Advances				
Inventory	-	13.26	14.11	16.29
Trade Receivables	2.24	13.88	15.27	16.79
Cash and Bank	42.72	44.76	22.37	41.78
Other Assets	73.86	83.49	87.37	93.56
Total CA & LA	118.83	155.39	139.12	168.42
Current Liabilities	49.78	88.76	41.67	61.02
Provisions-Short term	1.00	0.01	0.01	0.01
Total Current Liabilities	50.79	88.76	41.68	61.03
Net Current Assets	68.04	66.62	97.44	107.39
Net Deferred Tax	-5.10	-12.28	-10.28	-10.28
Net long term assets	159.00	164.77	174.43	185.28
Total Assets	613.82	737.33	790.98	851.42

Key Financial Ratios

	FY17	FY18	FY19e	FY20e
Growth Ratios (%)				
Revenue		9.7	14.2	15.4
EBITDA		18.1	10.7	20.9
Net Profit		20.1	12.8	30.8
EPS		15.1	12.8	30.8
Margins (%)				
Operating Profit Margin	56.0	56.3	58.7	61.6
Gross profit Margin	51.8	54.5	53.0	58.1
Net Profit Margin	24.8	27.8	27.3	31.1
Return (%)				
ROCE**	11.5	11.1	11.1	13.1
ROE**	19.7	18.7	17.0	18.8
Valuations				
Market Cap/ Sales			1.4	1.2
EV/EBITDA			3.7	3.1
P/E			5.0	3.9
P/BV			0.8	0.7
Other Ratios				
Interest Coverage	8.6	7.3	7.5	12.5
Debt Equity	1.0	0.9	0.6	0.5
Current Ratio	2.1	1.7	2.9	2.5
Turnover Ratios				
Fixed Asset Turnover	0.9	0.8	0.7	0.8
Total Asset Turnover	0.4	0.4	0.4	0.4
Debtors Turnover	16.8	30.7	19.4	20.3
Inventory Turnover	-	16.3	8.5	8.2
Creditor Turnover	9.8	10.9	11.2	10.3
WC Ratios				
Debtor Days	21.7	11.9	18.8	18.0
Inventory Days	-	22.4	42.9	44.4
Creditor Days	37.3	33.4	32.5	35.5
Cash Conversion Cycle	-15.5	0.9	29.2	26.8

Cumulative Financial Data

Figures in Rs crs	FY17-18	FY19-20e
Income from operations	472	608
Operating profit	265	366
EBIT	219	301
PBT	191	270
PAT after MI and AP	127	180
Dividends	9	11
OPM (%)	56.2	60.3
NPM (%)	26.4	29.3
Interest coverage	7.8	9.7
ROE (%)	18.4	17.8
ROCE (%)	11.3	11.9
Debt Equity	0.9	0.5
Fixed asset turnover	0.8	0.8
Debtors turnover	12.3	19.8
Inventory turnover	15.6	8.2
Creditors turnover	10.7	10.7
Debtor days	29.7	18.4
Inventory days	23.4	44.6
Creditor days	34.3	34.0
Cash conversion	18.9	29.1
Dividend payout ratio (%)	7.4	6.4

FY17-18 implies two year period ending fiscal 18.

Indian fitness industry – fragmented, under penetrated and largely unorganized (~70%) – is progressing in many ways - getting more organized; penetration levels increasing, thanks to today's fast paced and hectic lives that increase the need for a well crafted fitness regime to combat stress and inactivity related diseases. The company has been aggressively expanding with the total number of fitness centers increasing from 176 at the end of FY16 to 251 in FY18. To become a niche player in the industry, Talwalkars is focusing on growth via both organic and inorganic route through expansion, acquisitions and strategic tie ups.

The wide range of gym formats offered by Talwalkars – Talwalkars brand targeting upper middle class in metros, tier I and tier II; HiFi centers catering to tier III and IV cities; and PWG positioned strategically to target masses in peripheral areas of metros - enables it to appeal to diverse consumer needs and income profile, thereby helping it to expand its potential market share. Growing subscription and enhancing value through online and offline initiatives will aid revenue growth of 28.7% in FY19-20e. Cost optimization, efficient resource utilization and rent reduction (as a proportion of revenues) would help improve margins and return on capital employed going forward (see table). Higher profits and interest reduction would improve interest coverage ratio from 7.8 to 9.7.

Financial Summary- US Dollar denominated

million \$	FY17	FY18	FY19e	FY20e
Equity capital	4.6	4.8	4.2	4.2
Shareholders funds	48.9	65.0	66.8	79.8
Total debt	48.2	57.3	40.6	37.6
Net fixed assets (including CWIP)	50.3	62.4	60.7	65.8
Investments	8.9	16.0	9.6	9.9
Net current assets	9.7	9.7	12.4	13.7
Total assets	92.6	111.6	104.9	113.0
Revenues	33.6	38.3	38.1	43.9
EBITDA	19.1	23.5	22.6	27.3
EBDT	17.4	20.9	20.2	25.5
PBT	12.9	16.2	15.8	20.7
Profit after MI & EO	8.6	10.7	10.5	13.8
EPS(\$)	0.29	0.35	0.34	0.44
Book value (\$)	1.65	2.10	2.15	2.57

Income statement figures translated at average rates; balance sheet at year end rates; projections at current rates (Rs 74.13/\$). 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/\$	FY17	FY18
Average	67.09	64.45
Year end	64.84	65.04

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.