NSSPL RESEARCH

Talwalkars Better Value Fitness Ltd.

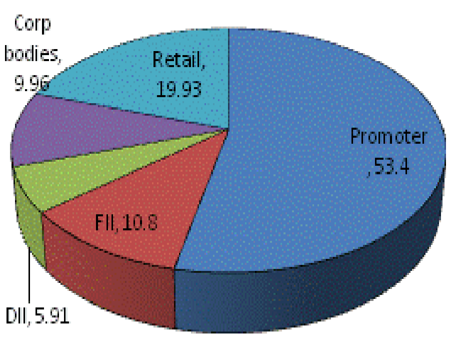
ACCUMULATE

BSE Code	533200
NSE Code	TALWALKARS
Bloomberg Code	TAWL:IN
Current Price	295
Target Price	322
Mcap ₹ bn	7.7
Mcap US$ bn	0.12
52 wk H/L	303/130
Face Value	10
2 wk avg vol (000)	297

Financial Snapshot

₹ Mn	FY14	FY15E	FY16E
Net sales	2095	2522	2977
% ch	24.1	18.7	17.9
EBIDTA	938	1094	1284
%ch	27.0	16.7	17.3
PAT	398	462	563
%ch	22.0	16.0	21.9
EPS	15.2	17.6	21.5
BV	91.9	107.0	125.5
P/E	19.4	16.7	13.7
EV/EBIDTA	9.9	8.1	6.8
ROE	16.5%	16.5%	17.1%
ROCE	17.0%	18.0%	19.1%

Shareholding Pattern



Sameer Dalal
Sameer@natverlal.com
91-22-42134444

Sherwin Fernandes
Sherwin.fernandes@natverlal.com
91-22-42134421

Massively underpenetrated market huge scope for growth

Talwalkars better value fitness ltd (TBVF) had been started by Late Mr. Vishnu Talwalkar under the brand name of Talwalkars gymnasium. Over the years it has become the largest home grown fitness center with a good geographic spread. It has expanded in various other streams of fitness and value added services unlocking the opportunity in the fitness industry. India is a young population and there is a definite shift to fitness which can be seen in the youth today. Being a market leader and having a brand recall will be able to capitalize on the growth in this sector.

Underpenetrated market: The population is India is about 1.2bn of which the target audience for TBVF would be the people aged between 15-55 years of age, representing almost 60% of the population. The fitness industry in India is still under-penetrated with the club membership close to 0.06% of the target market in the organized space. This under penetration gives a lot of room for expansion and growth for players.

Largest player in the industry: TVBF is the largest players in the organized fitness space with over 150 centers throughout the country. Although they are currently more focused on the western region they are looking to expand their presence in all the other and under-penetrated regions of the country. The second largest organized player has only 78 centers which is a distant second. This apart, TVBL has 2 different formats of which one is a low cost gym (hi-fi) which can be quickly expanded through franchises.

Increase in discretionary spends by houses to drive demand: The number of member to enroll for fitness services would see a steady increase due to the awareness to pursue a healthy lifestyle, increasing number of ailments caused by physical inactivity's, coupled with the desire to replicate their role model in fitness. Lastly the growing incomes and lower inflation has left the consumers with higher spending ability and health options would top the priority list seeing good addition to numbers of gym users.

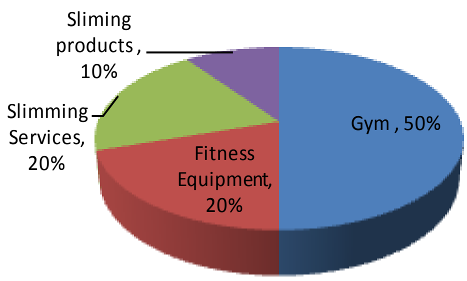
Defined expansion plans to capture more market: TBVF has currently has two format of fitness centers which is its owned centers comprising of 103 fitness centers and 4 subsidiaries which own 16 centers along with 30 franchises spread across the region. TBVF plans to set up another 100 centers by the end of 3 years extending its fitness centers in the tier II and tier III cities enabling the brand to capture a larger target markets and have wider footprints in smaller regions with standardization in service and quality.

Value added services to drive profitability: Talwalkar has emerged as a leading fitness provider and has diversified from fitness activities to a provider of value added services like aerobics, yoga, spa etc being more club centric rather gym centric. The value added services has enabled it to attract members and also get existing members to use additional facilities enabling them to earn more from each member. Here to we are seeing a bigger roll out with more centers being facilitated with these operations.

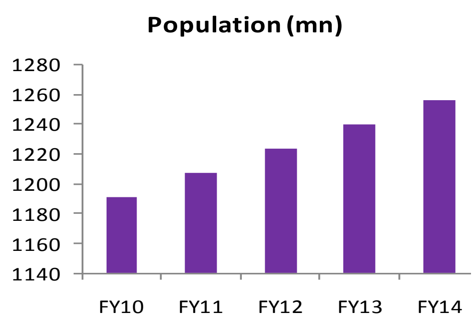
Valuation:

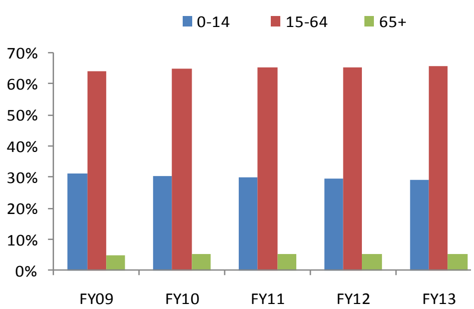
At present TBVF Ltd is trading at a P/E multiple of 15.6x & 12.8x, a P/BV of 2.6x & 2.2x and an EV/EBITDA of 7.6x & 6.4x for FY15E & FY16E respectively. Given the fitness industry is in a nascent stage and TBVF has been expanding its fitness clubs with an increase in membership we believe a 15x P/E multiple 18 month forward is justifiable arriving at a target of 322. We initiate coverage of ACCUMULATE with upside potential of 10%. Further we believe in the longer term returns would be much higher.

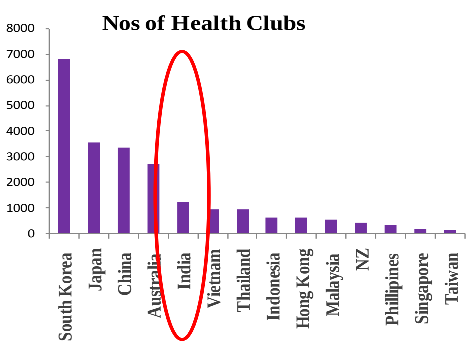
Investment rationale



Fitness & Slimming break-up







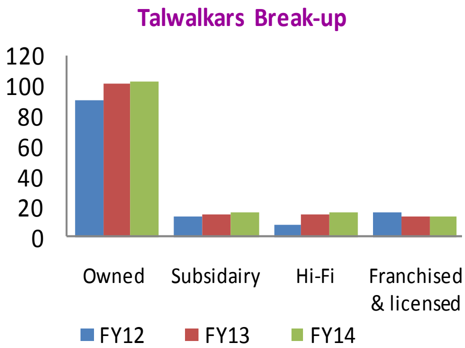
Increasing awareness of fitness:
The alarming increase in health consciousness has paved way for growth in fitness industry. The difficulty in making fitness a part of the daily regime is the imbalance between a demanding job, career and a personal life. Individuals are paying more heed to the health with high number of persistent ailments. There is always a desire to posses good health coupled with an overall persona as a result in the midst of the enthusiasm we experience a demand for fitness clubs. The main driver for the industry would primarily be the
1. Desire of people to increase fitness, if we look at India it is still largely a very unfit nation, although we see a gradual shift towards fitness with the youth of today.
2. Desire to look good, today all individuals desire to look good and attract attention this too would lead to good demand for gyms.
3. Increasing awareness due to celebrities, Most Bollywood and Hollywood content depicts celebs with lean and well sculpted bodies as a result the awareness of being fit has increased and led to aspirations of a person to achieve similar structures.

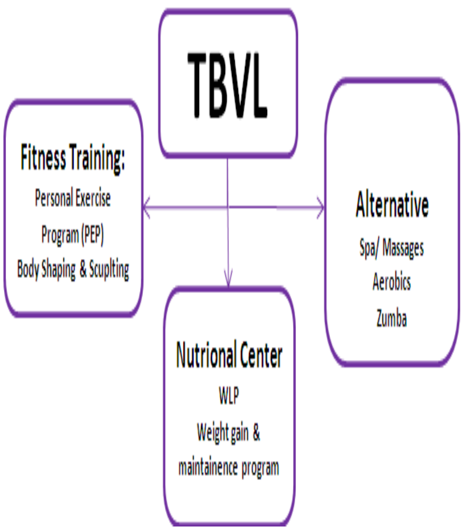
Under penetration in wellness industry in India:
The current strength of India's population is about 1.2bn with 60% in the age group of 15-55 years which is the target market for fitness centers. At present there are 1234 health centers in the organized space which caters to around 0.4mn members which is about 0.06% of the target market for centers. There are still a large number of people who use local gym's (akhadas) who would have aspirations to move to the better quality gyms. Further there are still many people who exercise in the open by going for walks and runs. Some part of to these too will shift to gyms as they would not be affected by climate and realization of more facilities provided by these centers. The sheer under penetration of these centers indicates untapped potential to be exploited along with the scope for rapid growth in the fitness space.

Dominance of unorganized players to recede. The need to stay healthy and fit has led to the emergence of growth in the fitness industry. Needless to say while we see few organized players in the industry and one cannot ignore the dominance by unorganized players. The fitness industry is highly fragmented due to the lower barrier to entry as these unorganized players are spread in various corners to have maximum catchment of members. Location for a gym is one of the most important aspects as people prefer short distances with good services. Even though many of these small gyms are close they are unable to sustain quality as they lack access funds and at times unable to maintain the standard of the gym. Although these gyms are usually priced lower in membership fees with not being able to offer similar services that larger groups can along with a better ambiance we believe more people will move towards the organized space where quality equipment and help will be better.

Largest player in the organized fitness industry:
TBVF is the only listed player in the fitness industry and has the largest market share of 47.3% among the organized players. TBVF has expanded from a mere 30 fitness centers in 2007 to a mammoth total of 150 in 2014. Of these 150 centers it owns 104 centers directly while it owns another 16 through its various subsidiaries. Further it has franchised and licensed 13 gyms which are under its main brand Talwalkars. It also has franchised another 17 centers under a brand name of HI-FI, which is a no frills gym which has a lower cost for its customers.

Standardized services with quality offering:
TBVF has maintained high quality standards acquiring latest equipment from reputed





international manufacturers from the US and China. In order to provide standard services across all locations to its customers, TBVF has established a training academy to provide education, training to personal trainers and fitness staff. The uniformity in the services provided helps to stand out among the un-organized players in the fitness market.

Various streams of fitness services:

TBVF has shifted focus from being a generic fitness centre to providing a range of fitness value added services that cater to different requirements of its target market. This enabled the company to add value to its existing fitness centers paving the way for new streams of revenues. The addition of the value added service could bring in revenue maximization from member enrolled without causing cannibalization to its existing members. The streams of products and services offered can be broken down in to 3 segments which can be seen in the chart given beside. The fitness training involves the following :

Personalized exercise program: This form of exercise is performed by the member under the guidance and training of a specific fitness instructor. The personal instructor would assess the client's goals, such as, body shaping or sculpting before they can even recommend any exercise to start off. To train the individuals in the right manner the fitness instructors in TBVF go through a 3 months training beyond which the instructors would keep indulging in fitness programs to keep themselves updated on the new exercises and diet. This is a form of personal attention given to the members which enables to build rapport between the trainer and member. Having a personal trainer comes as an additional cost to the member but for the Talwalkar as it has already employed personal trainers who be working and collecting a salary in any case.

Nutritional centers: Performing a combination of exercise to get the results takes care of the external aspects of fitness while the internal aspect needs to be supplemented with a nutritious diet. With this in mind TBVF have introduced nutritional services as a part of the health club. These services look closely at weight management, weight loss and weight gain programs. These services are delivered with the assistance of the dieticians recommending the right kind of food consumption after a detailed study of the members on the basis of weight, age, medical history etc. The dieticians guide the members by having a road map to be followed which enables them to be on the right track of the desired results.

Alternative services: TBVF offers wide range of alternative methods of fitness which are aerobics, Zumba, spa, Nu-form, Reduce , Transform, massages etc which helps in bringing a change in the daily fitness regime that are performed bringing in active participation by the members. The increasing demands for these services from the members have helped TBVF integrate these services across a few franchisees.

Zumba: This is a form of dance fitness incorporating aerobics and other forms of dance like salsa, belly dance etc that helps members shed weight and achieve their health goals in a fun and effective manner. It has changed the way people address fitness with workout.

Nu-form: This is form of workout involves the use of the machine technology which is a wearable device. The member would need to wear the device and through electro muscle stimulation have the exercise which would be performed for one day in week lasting 20mins. This is supposed to be equivalent of doing an hour workout daily for a week.

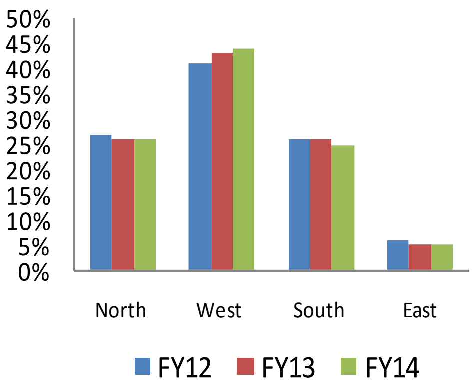
Reduce: This is form of dietary program offering ready to cook food along with consultation on what to eat, how much to eat and when to eat. These services are offered currently at 100 centers it is also offered as a home based and online service.

Trans-form: This is a new initiative which would be a combination of Nu-form + Reduce and would be lately launched in the fitness centers.

Increase in discretionary spending

Adequate amount of fitness activities are critically important for health of all ages drawing attention to an increase in spends on fitness. The awareness has awakened the youth to various ways to exercise and stay fit. Today with a larger portion of the population in the age group of 15-55, witnessing surging work pressure and various stress ailments necessitates individuals to stay healthy. Increases in disposable income of the individuals have made them add fitness in their regime apart from spends on leisure and medical aid. Celebrities and actors are projected as a figure for fitness centers leading to individuals desire to replicate them giving a feel good factor. The perceived social status from having better health has eventually driven demand in the fitness industry.

End users of these gyms are not only concerned with the cost but also with the differentiation that is being offered. The fragmentation of the fitness industry has left the consumers with a variety of choices pick due to which we see expansion and growth in no frill gym. Consumers today also enroll in these fitness centers as they prefer a wide array of fitness equipments and services. This has also paved way for premium services of fitness clubs.



Expanding locations & service availability at more centers

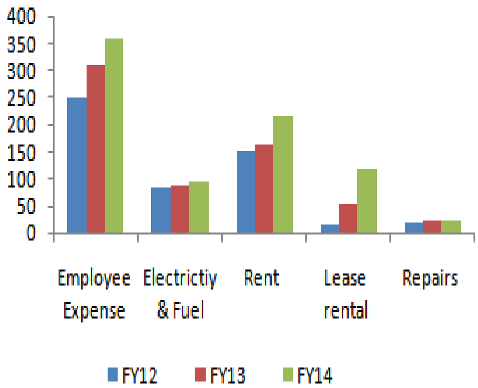
From the current 150 centers the plan for TVBL is to increase another 100 centers. Although the management has not guided on a road map either in the mode of expansion or the speed we believe this would be gradual in nature. The expansion is expected to be a mix of both the full service Talwakars band as well as the no frill Hi-Fi brand which would again be a mix of franchises and owned. It currently has geographical spread throughout India it generates a 44% of their revenue from the West with 66 centers while the east zone comprises 5% with 7 centers which leaves room for growth to be captured in this region. With the initiative of a no frills gym moderately priced along with various discount schemes offered to attract and increase membership would enable TBVF to gradually increase centers in those regions which is still untapped.

TVBL has mentioned offers various other services to its members, this too has not been fully rolled out as yet with many of the services only being offered at a few centers. Zumba is being offered at only 40 centers, while nu-form is being offered at only 10 centers. This leaves scope for even expansion of services at its current centers for which they already have most of the set up complete along with staff requirements. These roll outs could lead to good growth in revenues from its existing centers which is what will drive the margins and profitability of each center.

Asset light business:

TBVF fitness centers can be classified into owned, subsidiary and franchised. TBVF owns 8 properties till date but has not ventured into further buying out properties. The reasons for the 8 properties could be attributed to the initially starting out of the fitness centers, along with the acquiring these properties at attractive prices. This implies that TBVF does not incur heavy capital expenditure to run its own fitness centers or franchisees which makes it asset light. The only investment that has to be made is for the fitness equipment which too gets done at competitive rates given they are directly importing them from source eliminating the middle men in India. TBVF does purchase the fitness equipments on behalf of franchisees for which the cost is borne by the franchisee. TBVF benefits also from the upfront margin of `2mn collected from the franchisee with and an ongoing royalty fee of 6% for the first 3 years later followed by 8% for the remaining years. The franchisee also shares the marketing expenses with TBVF. TBVF has forayed into opening of franchisees which would give it a wider exposure of the brand in the Tier II and Tier III cities enabling them to maintain a relatively asset light model.

Margins would continue to sustain:
Most of the costs incurred by TBVF for running a fitness centers are fixed in nature comprising of employee benefits, rent, electricity and admin expenses. This implies that with every increase in the member per fitness centers after achieving break-even levels would translate to increased profitability. The company enters into long term lease agreement which insulates them from drastic changes in rental income which happens during reviews. The total employee cost is structured into fixed and variable pay which is 30%of the total employee cost, and with the increase in membership and personal attention to each member this cost would witness an uptick but not in the same proportion to the revenues added.



With most of the costs fixed any growth in same center for members would translate to increase in operating profits which would lead to rising operating margins. Although this is the case at present with TVBL undergoing a massive expansion to increase its centers to 250 from 100, margins would not see any benefits as the new center would work at much lower occupancy levels compared to the existing centers which would imply extremely low margins to even negative margins in the early days. We believe the increase in margins at old centers would largely go unnoticed over the period as they would be compressed by the new centers. However post the current expansion plans when TVBL would be in a consolidation mode we could see margins increase as the new centers too would start contributing the margins.

TBVF has positioned in a way that to prior the opening of these new centers it introduces a number of fitness schemes with discounts to attract membership. At present the current renewal membership is between 60-70% and with the value add services introduced we could see a gradual increase in the renewal rate.

The value added services like Zumba, Spa and aerobics coupled with the weight loss services of Reduce, Nu-form and Transform would give the existing member a wide variety of services to choose from based on their requirement. Enrolment for such value added services would augur company's margins and profitability without leading to much cannibalization to the existing members. TBVF is in the growth phase and would look to expand these operations beyond the tier I cities where it already has a presence.

Negative working capital:
TBVF being a fitness service provider collects the money from the members upfront when they enroll for the gym services, generating liquidity for the business operations. This enables the company to have a lower demand for additional funds for expansion plans. The capital expenditure on setting up newer fitness centers in different locations can be funded fully or partially with the amount received from the upfront payment for the fitness services. The company has newly offered alternatives to make the membership payment. We believe that negative working capital would bode well for the company keeping in mind any expansion plans for the future, together with the any inorganic growth resulting in an improvement in profitability and growth going ahead.

Strong cash generation over the new few years :
Since TBVF is in still on the growth phase with expansion of centers expected over the next few years. This would mean they would have capital investment even though they follow an asset light model. This expansion of fitness centers and high brand recall coupled with newly value added services and upcoming schemes to lure its target market are expected to lead bring growth in revenues and earnings. The profit growth is expected to move the company in lowering the debt to a large extent. However one cannot ignore that for its

expansion plans it would require capital for its own fitness centers than franchises. The cash generation will not only help in its expansion plans but could seek any acquisitions of any fitness players if the opportunities exist.

Demand for trainers with expansion plans :

The success and survival of the fitness centers would be complemented not only with the increase in membership but also by services delivered by the fitness trainers. Both go hand in hand building a brand for fitness centers. Paucity of skilled and fitness trainers has been one of the challenges in the industry, as the smaller fitness players would be witnessing this problem. TBVF has an alliance with premier training international (PTI) which provides health and fitness education to the trainers about the exercises performed along with dietary regime to be followed. This enables them to train and guide the member's accordingly. This gives TBVF an edge as they have their in-house fitness training centers as they would have adequate number of trainer available to cater to the enrolled members.

Seeking opportunities in club membership :

TBVF seeks opportunity to set up a club with the extension of its brand in club membership catering to a wider mass audience from kids to adults. The club would include the services offered by TBVF fitness centers along with recreational activities like recreational centers playing indoor sports, swimming etc. This is mainly on account of its partnership with David Lloyd leisure limited which assist TBVF in setting up these clubs in townships. We believe leveraging of TBVF in similar avenues will only add to the value resulting in top of the mind brand recall in the domestic fitness industry.

Valuation

At present TBVF Ltd is trading at a P/E multiple of 16.7x & 13.7x, a P/BV of 2.8x & 2.4x and an EV/EBITDA of 8.1x & 6.8x for FY15E & FY16E respectively. Given the fitness industry it's in a nascent stage and TBVF has been expanding its fitness clubs with an increase in membership we value TBVF at a 15x P/E 18 month forward is justifiable. With this we arrive at a target price of ₹322 which implies an upside of 10% over this period. We initiate coverage with an ACCUMULATE recommendation. We believe the stock would be a good investment opportunity at 270 ₹levels which would imply relatively good returns over the 18 month period. TBVF is the only listed entity in the fitness industry and we believe that growth in the coming years will flow from the expansion of its owned fitness centers with the integration of the value added services and no frill gym Hi-Fi in the tier ii and tier iii cities which would give TBVF maximum exposure in the these regions making it a preferred incumbent in the fitness brand compared to the unorganized players in the market. The perceived social status comes with leading a healthy and fit lifestyle which creates higher demand for these fitness centers as fitness is now considered as priority than just a mere leisure activity.

Risks

Competition from global players

The fitness industry is at a very nascent stage in India as the number of 1234 fitness clubs catering to less than 0.05% of the population of 1.2bn leaving room for growth to be tapped. This has kept the door of opportunity open to the global players to grab a chunk of this growth pie. With the emergence of global fitness players we would witness a variety in the services offered along with the modernization of equipments and better training facilities which would attract the attention of existing users of the other gym.

Low barriers to entry

The fitness industry is highly fragmented and leaves the consumer with a variety of choices to choose from. This result in high switching cost for consumers who prefer to go light on their wallet. Thus competition from smaller emerging players in the fitness industry would eventually be a drag on the profitability.

Lower renewal of membership

Growth would be driven by renewals of memberships along with the new additions. Any failure to attract and retains its members will affect revenues and profitability. The number of competitors in the wellness space offer alternatives methods to gym exercises which also could put a brake on its growth going ahead.

Discrepancies in the leases agreements

At TBVF the gyms are on lease agreements however any change in the clause by the lease owner would result in termination of the operations in a particular region. This would lead to discontinuation of the operation along with a hassle in shifting to a newer location immediately causing inconvenience also to its members.

Shortage of gym trainers and nutrition experts

Presently the fitness industry is still at a nascent stage with less than a percent fitness clubs that are established in India. This implies that there is a shortage of well trained and knowledgeable trainers and nutritionist in the fitness industry. The success of these fitness clubs would be in the hands of its fitness workforce. Inability to attract the right kind of fitness trainers and nutritionist would be detrimental to the survival of fitness clubs.

Cannibalization in membership as trainers gain recognition

All the trainers go through a training process which to make them knowledgeable about the exercises to be performed, the precision require, diet and the amount of effort to be put in training. This enriches the trainers with the experience training various members and building a rapport. As a result there would be likelihood by the members to train under specific trainers in the gym. This could be detrimental for the gym as the trainers could move to another gym for higher remuneration and benefits which could draw remember of the previous gym to secure enrollment in the gym where theses trainers train.

Financials

Profit & Loss

In ₹ million	FY13	FY14	FY15E	FY16E
Net sales	1,509	1,873	2,222	2,620
YoY (%)	*26.4*	*24.1*	*18.7*	*17.9*
Total expenses	783	946	1,141	1,369
EBIDTA	726	927	1,081	1,251
YoY (%)	*33.7*	*27.8*	*16.6*	*15.7*
EBIDTA (%) of total sales	48.1	49.5	48.7	47.7
Other income	13	11	13	33
PBIDT	739	938	1,094	1,284
Depre/ Amor	146	242	288	310
PBIT	592	696	806	974
Interest	108	120	128	135
PBT	484	576	679	840
(-) Tax	158	178	217	277
Tax/ PBT	32.7	31.0	32.0	33.0
Share of loss of associates				
PAT	326	398	462	563
Minority interest	0	0	0	0
Net Profit	326	398	462	563
YoY (%)	*30.9*	*22.0*	*16.0*	*21.9*

Balance Sheet

In ₹ million	FY13	FY14	FY15E	FY16E
Equity capital	262	262	262	262
Reserves	1,823	2,143	2,540	3,023
Net worth	2,085	2,405	2,802	3,285
Total borrowings	1,400	1,681	1,681	1,818
Non current Liabilities	166	132	145	159
Current Liabilities	583	689	764	889
Minority interest	81	113	113	113
Deferred tax	192	238	238	238
Total liabilities	**4,506**	**5,257**	**5,741**	**6,502**
Net block	3,153	4,052	4,214	4,579
CWIP	422	450	338	338
Investments	227	88	350	750
Intangible assets	3	3	3	3
Current assets	**448**	**421**	**593**	**588**
Non current assets	254	243	243	243
Total assets	**4,506**	**5,257**	**5,741**	**6,502**

Cash Flow

In ₹ million	FY13	FY14	FY15E	FY16E
Net profit	326	398	462	563
Depn and w/o	146	242	288	310
Deferred tax	(50)	(45)	0	0
Change in wrkg cap	277	(35)	16	57
Other income	(13)	(11)	(13)	(33)
Operating cash flow	**686**	**548**	**752**	**896**
Other income	13	11	13	33
Capex	(1,145)	(1,161)	(338)	(675)
Investments	(52)	139	(262)	(400)
Investing cash flow	**(1,184)**	**(1,011)**	**(587)**	**(1,042)**
Dividend	(46)	(46)	(65)	(79)
Equity	0	0	0	0
Debt	281	0	137	151
Financing cash flow	**235**	**(46)**	**73**	**72**
Others	751	82	0	0
Net change in cash	**489**	**(427)**	**238**	**(74)**

Key Ratios

	FY13	FY14	FY15E	FY16E
EPS (₹)	12.5	15.2	17.6	21.5
CEPS (₹)	18.1	24.4	28.6	33.3
Book value (₹)	79.6	91.9	107.0	125.5
DPS (₹)	1.5	1.5	2.1	2.6
Debt-equity (x)	0.7	0.7	0.6	0.6
ROCE	17.0%	17.0%	18.0%	19.1%
ROE	15.6%	16.5%	16.5%	17.1%
Valuations				
PE (x)	23.7	19.4	16.7	13.7
Cash PE (x)	16.3	12.1	10.3	8.9
Price/book value (x)	3.7	3.2	2.8	2.4
Dividend yield	50.8%	50.8%	71.7%	87.4%
Market cap/sales	4.6	3.7	3.1	2.6
EV/sales (x)	5.1	4.4	3.5	2.9
EV/EBDITA (x)	5.1	4.4	3.5	2.9