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Mumbai

## CRISIL Equities assigns IPO grade '3/5' to Tree House Education & Accessories Ltd

CRISIL has assigned a CRISIL IPO Grade "3/5" (pronounced "three on five") to the proposed initial public offer (IPO) of Tree House Education & Accessories Limited (Tree House). This grade indicates that the fundamentals of the IPO are 'average' relative to the other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to the issue fundamentals. The grade is not a recommendation to buy, sell or hold the graded instrument, or a comment on the graded instrument's future market price or its suitability for a particular investor.

The assigned grade reflects the benefit Tree House will derive, given its strong position, from the expected robust growth in the preschool industry. CRISIL Research expects the highly underpenetrated preschool industry to increase at a CAGR of 21% to Rs 133 bn by FY15. The company, which has an established track record of expanding branches - from 12 in FY07 to 177 as on December 31 2010, is poised for further expansion. Unlike other organised players, Tree House's expansion has been largely through self-operated branches, which has enabled it to ensure quality measures and helped in brand building. The grade also considers the company's bargaining power as a large player due to the large number of self-operated branches as it leads to cost advantages compared to other players who mainly operate through the franchisee route. The grade is further supported by the company's entry into the K-12 (Kindergarten to Class 12) segment, teacher training and other ancillary services, which also have strong business prospects with the expected domestic economic growth and increasing government participation in the K-12 segment.

However, the grade is moderated by an expected increase in competition from other players who are also in the expansion mode. Also, Tree House's aggressive expansion plans face execution challenges. Its major expansion plans cover new geographical areas where it does not have a presence and is therefore, not conversant with local market risks. The preschool industry is marked by low entry barriers which pose a risk to the player's profitability. In preschool industry, word of mouth marketing plays an important role, so any negative publicity can damage the company's brand value. Hence, the grade also takes into account the quality dilution risk given Tree House's aggressive expansion plans. It plans to spend a major part of the IPO proceeds on the K-12 business where it has a limited operating track record.

### About the company and the issue

Incorporated in 2003, Tree House is India's largest self-operated preschool education provider running 177 preschools in 23 cities as on December 31, 2010, out of which 108 are self-operated. More than 72% of its branches are concentrated in western India, of which 80% is concentrated in Mumbai. Tree House has also ventured into ancillary services like preschool teacher training, day care etc. In 2009, it ventured into the K-12 school segment and has been managing 12 such schools as on December 31, 2010.

For the 9MFY11, Tree House reported revenues of Rs 291 mn and a net profit of Rs 71 mn. The 9MFY11 EPS was Rs 2.9 per share with 5.7% RoE. The operating margins are expected to be adversely affected due to the alignment of the rentals to the market rates for 21 properties (out of the 108 self-operated units) leased by the promoter to the company effective December 2010. However, margin would be supported by increasing scale of operations from the newly-opened branches and a higher share of K-12 revenues.

The company has planned a public issue of 9.7 mn shares. The proceeds of the issue will be mainly utilised for expansion in the preschool and the K-12 segments.

## About CRISIL IPO Grading

CRISIL IPO (Initial Public Offering) grading is an opinion on the fundamentals of the graded issue that reflects CRISIL's independence and expertise. This opinion is expressed as a relative assessment in relation to other listed equity securities in India. The assessment is based on a grading exercise carried out by industry specialists from CRISIL Research. A CRISIL IPO Grade 5/5 indicates strong fundamentals and a CRISIL IPO Grade 1/5 indicates poor fundamentals. CRISIL IPO Grading reflects its assessment of the graded company's equity fundamentals as distinct from an assessment of debt fundamentals. A CRISIL IPO Grade should not be construed to mean a comment on the price of the graded security nor is it a recommendation to invest or not to invest in the graded security.

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