HDFC securities Equity Research

Pick of the week

PCG **DESK**

Zee Learn

INVESTMENT IDEA
Sep 25, 2017

Industry	CMP	Recommendation	Add on dips to	Targets	Time Horizon
Education	**Rs. 42**	Buy at CMP and add on Dips	**Rs. 35-42**	**Rs. 55-68**	4 - 6 Quarters

HDFC Scrip Code	ZEELEA
BSE Code	533287
NSE Code	ZEELEARN
Bloomberg	ZLL
CMP as on 22 Sep'17	42
Equity Capital (Rs cr)	32.3
Face Value (Rs)	1
Equity O/S (cr)	32.3
Market Cap (Rs Cr)	1370
Book Value (Rs)	9
Avg. 52 Week Vol	492793
52 Week High (Rs)	51
52 Week Low (Rs)	32

Shareholding Pattern (%)	
Promoters	66.1
Institutions	21.7
Non Institutions	12.2

PCG Risk	Yellow

* Refer Rating explanation

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Company Background

Zee Learn is one of the India's leading Education Company of Zee Group, which offers education support services in Pre School as well as K-12 segment. The company got demerged from Zee Entertainment and got listed on bourses in Dec 2010. Its segments include Educational, which provides learning solutions and delivers training, and Construction and Leasing, which consists of constructing and leasing of properties for commercial use. It acts as consultant to local entrepreneurs wishing to setup K-12 schools, under its brand name, Mount Litera Zee Schools, and provides education management and advisory services. Mount Litera Zee School is a chain of schools with over 110 schools in approximately 98 cities. It also runs a chain of pre-schools, Kidzee, with over 1,700 pre-schools in approximately 550 cities. Its offerings also include Zee Institute of Media Arts, which is television and film training institute, and Zee Institute of Creative Art, which is a classical and digital animation training academy.

Investment Rationale

The pre-school industry is still in its nascent stage in India with approximately 3% penetration. Considering the average enrolment in a pre-school is 75 kids per centre, 113 mn kids would require around 14-15 lakh centres. However, as of today, India has severe shortage of pre-school centres due to low awareness of Early Childhood and Care Education (ECCE). As a market leader, Kidzee has made it a mission to create greater awareness about ECCE through seminars, conducted across the length and breadth of India. To augment, over 400 seminars were conducted and there has been a significant digital drive for the same.

Mount Litera Zee School is one of the largest network of schools in the private-unaided category among K-12 Schools. This school was founded with an aim to bring paradigm shift in Indian Education System. Zee Learn is one of the fastest growing chains of schools in the country with 115 schools in 105 cities.

FY17 was landmark year for Kidzee as it continued its growth story and has > 1,700 operational centres across 650+ cities. In FY17, Kidzee grew 10% over the last year with 1.3 lakhs children studying in its network across the country. During FY17, MLZS continued its growth story with 115 operational schools. In FY17, enrolments in MLZS grew 33% over the last year with 55,600 children studying in its network across the country.

This year, the company has worked well to further cement the brand of Mount Litera Zee School as a leader in the education sector. Not only in terms of students enroled and schools launched, it has also worked on evolving the Mount Litera brand through a number of key community engagements in the form of on-ground activities, new marketing initiatives and outreach programmes aimed at further developing the dream of "I am Mount Literan", the seed which was planted in this year and continues to grow and blossom.

Key Highlights

Zee Learn (ZLL) is India's leading player in the education segment by virtue of having the fastest growing chain of K-12 schools (Mount Litera Zee School) and Asia's No. 1 chain of pre-schools (Kidzee)

During FY17, MLZS continued its growth story with 115 operational schools. In FY17, enrolments in MLZS grew 33% over the last year with 55,600 children studying in its network across the country

FY17 was a landmark year for Kidzee as it continued its growth story and has > 1,700 operational centres across 650+ cities. In FY17, Kidzee grew 10% over the last year with 1.3 lakhs children studying in its network.

Company aims to have ~2000 Kidzee Centres in the next two years

We expect ZLL to post 25% revenues and 31% PAT cagr over FY17-20E

We expect sustainable expansion in its centres and Schools addition coupled with healthy growth from its admission and enrolment in the next two-three years

The K-12 segment constitutes 38% of the Indian Education Segment which is predicted to grow from USD 44 bn in 2011 to USD 144 bn in 2020. With an ever-evolving aspiration of Indians for better education, the sector is growing at the rate of 13-14%. Currently, an estimated 3 lakh private schools have 40% of the total student enrolment, projecting a scope of major development in this area, an enormous potential for private school sector.

Zee Learn (ZLL) is India's leading player in the education segment by virtue of having the fastest growing chain of K-12 schools (Mount Litera Zee School) and Asia's No. 1 chain of pre-schools (Kidzee) in its kitty. Pre-school (Kidzee) and K-12 school segments contribute ~73% and ~24% respectively, to the company's revenue. Rising disposable incomes, increasing school age population and prudent franchise (in K-12 and pre-school) additions over FY17-20E equip ZLL to clock 31% earnings CAGR. This, in turn, is bound to fuel healthy cash flows and boost return ratios. At CMP of Rs 43, the stock is currently trading at 16x/~13x FY19E/FY20E EV/EBITDA, respectively. We recommend BUY on Zee Learn at cmp of Rs 43 and add on dips to Rs 35 with sequential targets of Rs 55 and Rs 68 over the next 4 to 6 quarters.

Pre-school segment: Branded players controlling dominant pie

In FY16, the pre-school segment was worth USD2.5bn (USD 0.75bn in CY11), of which the branded segment contributed 33.83%; Kidzee accounts for 33% of the branded pie. The pre-school segment is expected to grow to USD3.4bn by CY20, clocking CAGR of over 17%. Growing awareness of importance of pre-school/play-school in upbringing of child in tier 2 and 3 cities is envisaged to propel the pre-school segment's penetration rate to 25%. To ensure scalability, pre-school chains like Kidzee and Eurokids are upgrading to K-12 schools. The branded pre-school outperforming the sector growth mainly through asset light franchise model. ZLL has mostly franchised pre-schools wherein it receives royalty in advance and also created strong base of pre-schools for annuity based business models.

The pre-school industry is still in a nascent stage in India with only 2.5% penetration. Considering the average enrolment of 75 kids per centre, 113 mn children will require over 15 lakh centers. However, currently, India has only around 30,000 pre-school centers. As a market leader, Kidzee strongly believes in filling this void by expanding its footprint across cities and towns in India.

Zee Learn has invested considerable resources in developing learning designs, student learning materials and e-content for pre-schools and K-12 schools. Moreover, with rising scale and rationalisation of vendors, the company has prudently managed cost of goods while simultaneously improving quality.

K-12 business – India one of the largest in world - growing at faster rate

The Indian K-12 system is the largest in the world with 253 mn students enrolled in 1.4 mn schools. However, with inefficiencies in the government education system, has resulted in poor infrastructure both hard (buildings, technology) and soft (teachers, pedagogy) and high drop-out rates. Thus, it is an opportunity to overhaul to education system in the country for the efficient private players.

Zee Learn portfolio, across various genres in the Indian market, includes:

• Pre-school: Kidzee
• K-12: Mount Litera Zee School
• Vocational Courses: ZICA and ZIMA

Kidzee:

ZLL is majorly on franchise model and have agreements for typically six years. The franchisee owner bears the establishment costs and an upfront franchisee fees. Further, it pays royalty each year under a revenue-share agreement and also student kit fee to franchisor. The franchisor provides the curriculum, content, kits and other necessary support like teacher training and advertising and marketing.

FY17 was a landmark year for Kidzee as it continued its growth story and has > 1,700 operational centres across 650+ cities. In FY17, Kidzee grew 10% over the last year with 1.3 lakhs children studying in its network across the country.

Its proprietary pedagogy, iLLUME is what sets Kidzee a class apart from other preschool chains. iLLUME is an approach that helps parents and teachers spot the unique potential in each child and help them realize it. Zee Learn offers franchise to local education entrepreneurs, especially women, to run and manage Kidzee preschools.

Mount Litera Zee School:

Mount Litera Zee Schools (MLZS) aim to provide Learner-Centered education with an integrated approach - where the child is at the centre of everything. Mount Litera Zee Schools were initiated to bring about a quantum leap in how school education is delivered to the modern day child.

Zee Learn partners with local educational trusts under various operating models. The range of services and solutions provided by Zee Learn under these partnerships range from school set up assistance, teacher-training, assessment, teaching materials, student learning resources, branding,

During FY17, MLZS continued its growth story with 115 operational schools. In FY17, enrolments in MLZS grew 33% over the last year with 55,600 children studying in its network across the country.

Zee Institute of Creative Art (ZICA):

ZICA is a Classical and Digital Animation training academy that trains students in classical 2D and modern 3D animation. The institute has adopted novel training style and is focused entirely on creating stimulating environment for its curriculum.

Zee Institute of Media Arts (ZIMA):

ZIMA is engaged in the world of direction, cinematography, editing, sound, film animation, visual effects and the training of other high end software like Autodesk, Smoke and Flame. ZIMA offers the platform and infrastructure supporting the media education for the students fulfilling global standards.

Growth Strategy going ahead

Zee Learn is focused on maintaining its position of pre-eminent player in the K-12 market. We believe that this segment offers unparalleled opportunity to improve the human capital of the country and huge upside for growth.

Within this segment, growth for Zee Learn will come from:

1. **Enrolment growth in its institutes**

Zee Learn has ~1,700 pre-schools, 115 K-12 schools and 17 vocational institutes. Driving enrolments in these existing institutes to hit full capacity gives significant upside of more than doubling enrolments. Last year, it had signed off 22 new schools, which forms a part of this list and the target this year is to sign at least between 24 to 25 new schools. Company expects MLZS centres network to double in the next four years. Over the next two years, Pre-Schools count would increase to ~2000.

2. **Expansion of footprint**

With education being a supply constrained market for good quality pre-schools, schools and vocational centres, Zee Learn is committed to expanding its footprint to reach out to more and more children and creating more avenues for driving enrolments. Company is leveraging different options for this growth including franchising, partnerships and JVs.

3. **Increasing Capacity Utilisation**

Within businesses, Zee Learn constantly add innovations and products to fulfil wide range of education needs and increase share of the parents' wallet. This in turn increases revenue potential and return on investment of the real estate assets.

4. **Increase share of wallet**

With constant innovations and better and well researched products which can cater to wide range of education needs, the company endeavour to increase share of the parents' wallet. This in turn increases revenue potential and return on investment of the capital deployed to run education venture.

Q1 FY18 Results Highlights

Zee Learn has reported Q1 FY18 revenues at Rs 67cr (up ~44% YoY). The company has signed up 78 and added 80 Kidzee pre-schools and did sign up of 5 franchises for MLZS in Q1 FY18. The students' enrolment in MLZS has seasonality with 40-45% happen in Q4 and 35-40% in Q1 and 8-12% in Q2 & Q3. The management expects to reach 2,000 Kidzee pre-schools in coming two years and expected to add 70+ K-12 schools in coming 3-4 years. The manpower recruitment & training business has opportunity from Zee group companies with no investment & capex requirement. The company expects ~Rs 40-45cr sales from this business in FY18E and expected to almost double it in FY19E.

EBITDA stood at Rs ~19cr grew ~60% yoy on account of expansion in EBITDA margin by 840bps yoy to 37%. EBIT grew to Rs 18cr (up ~79% yoy). Consolidated EBITDA increased by 57% to Rs 25cr and margin expanded by 300bps to 37%. We believe that the rising traction in both school segments and both category owned and franchisee model of K-12 schools would result into operational efficiency, given fixed nature of most of expenses. The entry in new business of manpower recruitment and training has huge opportunity market and will complement existing training business.

Operational efficiency to continue

The company has delivered healthy sales and strong operating margin in seasonally healthy quarter for Zee Learn business. Both the segment K-12 and Pre-school performed well for the company. The company has improved its operating margin with the higher growth in revenue as its majority of expenses are fixed in nature and incremental sales would start flowing to operating profit. Zee Learn has continuously rationalizing cost, resulted improvement in operating and profitability margin, which we believe to continue in coming years.

India education segment: Huge untapped potential

India has the largest population in the world within the 5-24 years age group, which constitutes ~41% of the country's total population (~500mn). The primary education segment provides a great opportunity with ~29% of India's population between the age group of 0 and 14. Further, rising disposable incomes and willingness to spend on education are key drivers of Indian education. The country's literacy rate is ~74% compared to world average of ~86%. This presents humungous opportunity to private players to explore the hitherto untapped market.

The domestic education system has clocked remarkable growth over the past few years. India is definitely ahead of other developed countries in education and training—the number of institutes offering education is much more in India compared to China and the US. Moreover, several foreign institutions too are making a beeline for India, which is bound to boost the quality of education in the country.

The education sector is envisaged to witness major growth as India will have the world's largest tertiary-age population and second largest graduate talent pipeline globally by 2020 end. In FY16, the education market was worth about USD 100bn and is expected to reach USD 117bn in FY17 and further cross USD 144bn by FY20. Currently, higher education contributes 58.8% to the market size, school education 38.1%, pre-school at 2.5%. The pre-school industry is still in a nascent stage in India with only 2.5% penetration. Considering the average enrolment of 75 kids per centre, 113mn children will require over 15 lakh centres. However, currently, India has only around 30,000 pre-school centres. A leader in the Early Childhood Development and Education (ECDE) domain for over a decade now, Kidzee has nurtured around 700,000 children, thus truly standing for India's Favorite Preschool.

Robust 25% revenues CAGR over FY17-20E; Scaling the growth highway

We estimate Zee Learn's sales to clock ~25% CAGR over FY17-20E to Rs 352cr in FY20E driven by increase in student enrollments in both the category and continuous addition in centres. We forecast Kidzee and Mount Litera to record robust growth over the next three to five years driven by increase in enrolments and adding new schools to its kitty. Moreover, we envisage robust operational performance to boost the company's cash flow in the coming years.

Rising disposable incomes, increasing school age population and prudent franchise (in both K-12 and pre-school) additions over FY17-20E position Zee Learn to deliver 31% earnings CAGR, which will lead to healthy cash flows and return ratios. At CMP of Rs 43, the stock is currently trades at 16x/~12x FY19E/FY20E EV/EBITDA, respectively. We recommend BUY on Zee Learn at cmp of Rs 43 and add on dips to Rs 35 with sequential targets of Rs 55 and Rs 68 over the next 4 to 6 quarters. We have arrived to TP of Rs 68 based upon ~19x FY20E EV/EBITDA.

Key Risks

Poor Track Record of Indian education companies

We have seen several companies in education sector like Educomp, Everonn, Core Education and Tree House disappoint investors and that has impacted sentiment for the sector.

Complex regulatory environment

There are multiple regulatory agencies with overlap of functions and mandates. Education as a subject features in all three Constitutional lists i.e. Union, State and Concurrent. This has resulted in both central and state government agencies regulating education, making the set-up of new ventures difficult.

Increased competition from unorganized players in restrict student fee and increase expenses

Rising Real Estate costs
Land prices in metros like Delhi and Mumbai are high and almost no vacant education land parcels, thereby limiting capacity expansion. A state-wise analysis of the need gap indicates a shortage of schools in Chandigarh, Kerala and Delhi/NCR.

Fastest Growing K-12 School Chain in India

Particulars	Mount Litera (MLZS)	DPS	Ryan International	Educomp	Euro School
No. of Schools	110	210	120+	47	10
Affiliation	CBSE	CBSE	CBSE,ICSE	CBSE	CBSE
Fee Point	70000	65000	80000	65000	80000

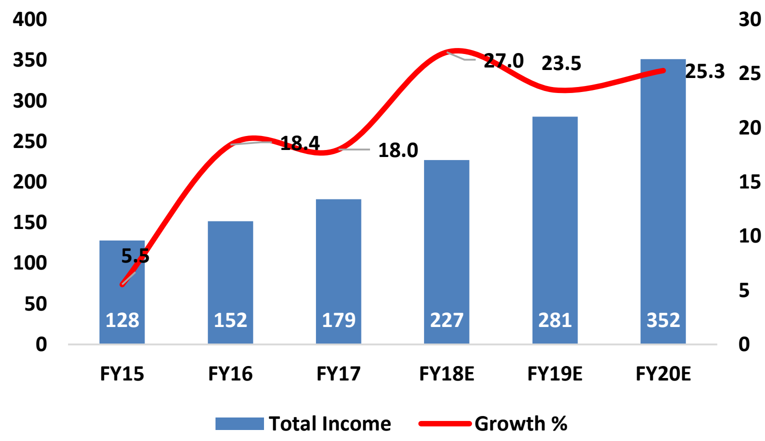
Source: Company, HDFC sec Research

Largest Pre School Chain in Asia

Particulars	Kidzee	Euro Kids	Bachpan	Shemrock	Little Millennium
Since	2003	1997	2005	1989	2006
No. of Schools	1741	900	1000	525	450
Model	Self Operated and Franchisee run centres	Self Operated and Franchisee run centres	Franchisee run centres	Franchisee run centres	Franchisee run centres
Fee Point	35000	35000	30000	30000	35000

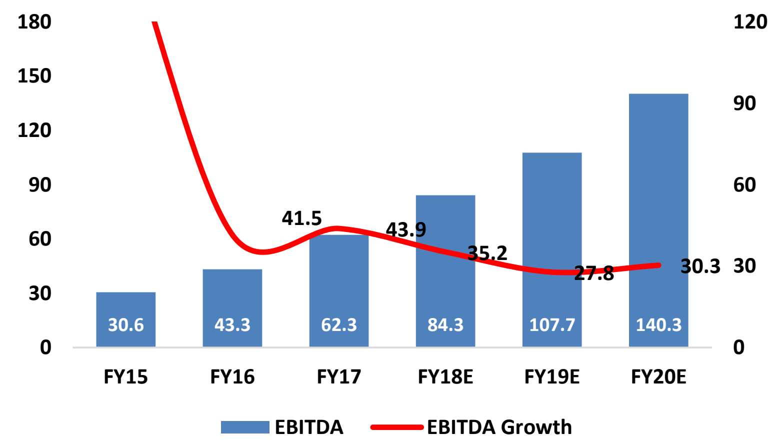
Source: Company, HDFC sec Research

Revenues to see 25% cagr over FY17-20E



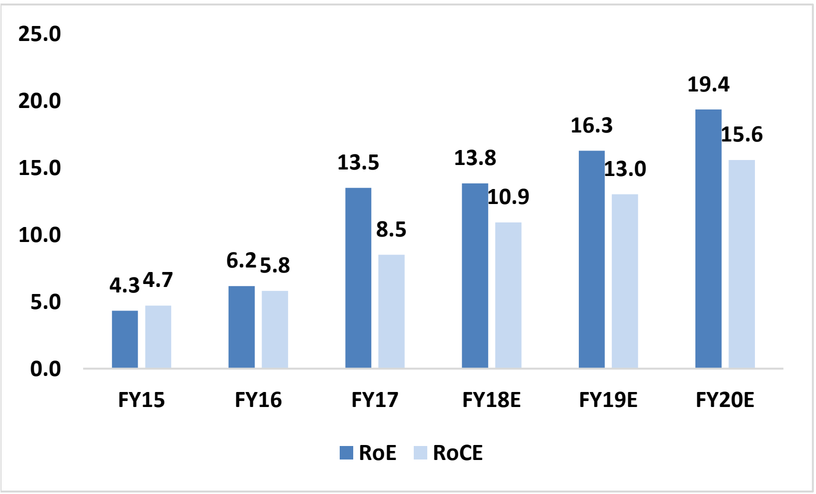
Source: Company, HDFC sec Research

EBITDA trend over FY17-20E



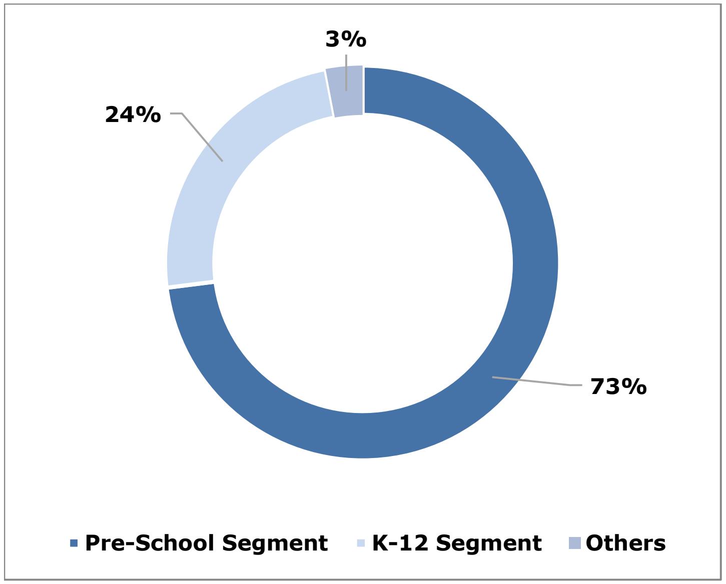
Source: Company, HDFC sec Research

Return Ratios (%)



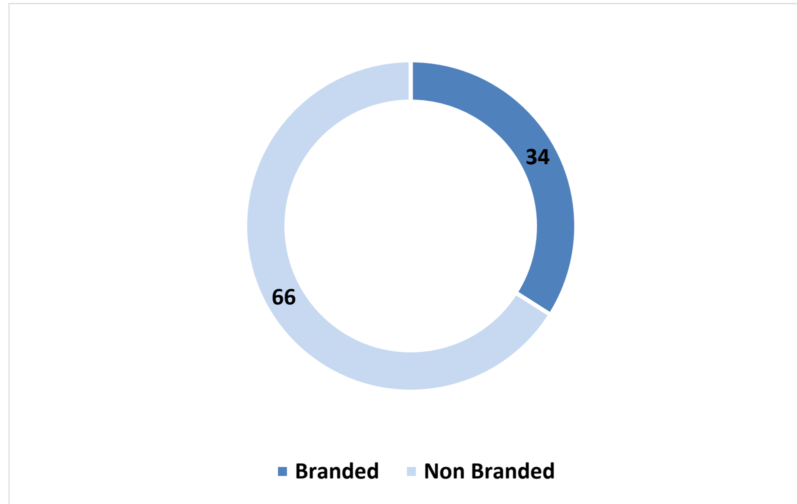
Source: Company, HDFC sec Research

FY17 Revenues Split



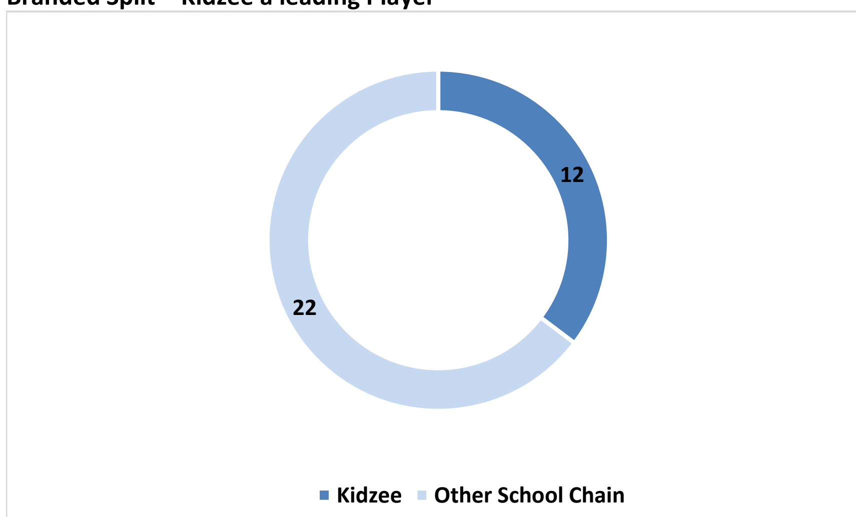
Source: Company, HDFC sec Research

Pre – Schools Split (%)

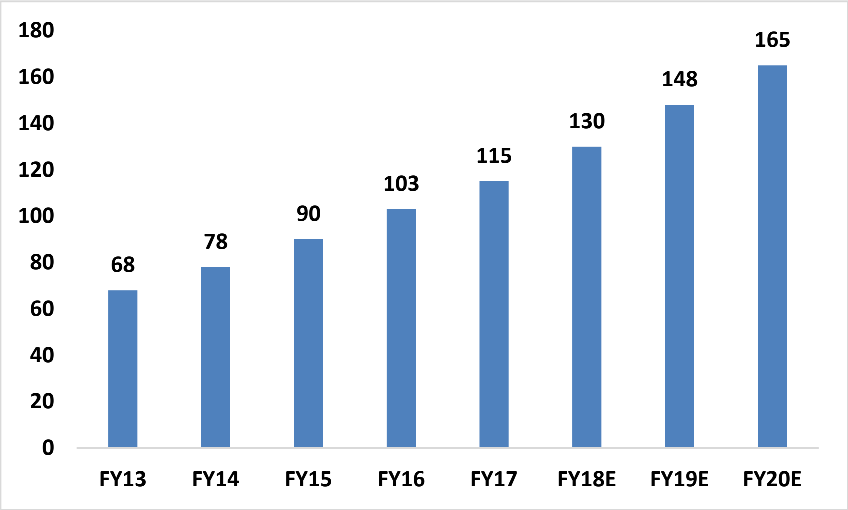


Source: Company, HDFC sec Research

Branded Split – Kidzee a leading Player

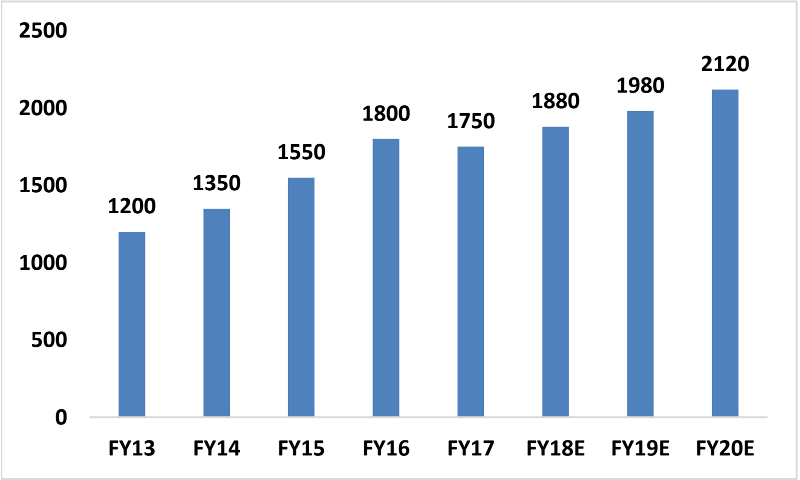


Mount Litera (MLZS) Network



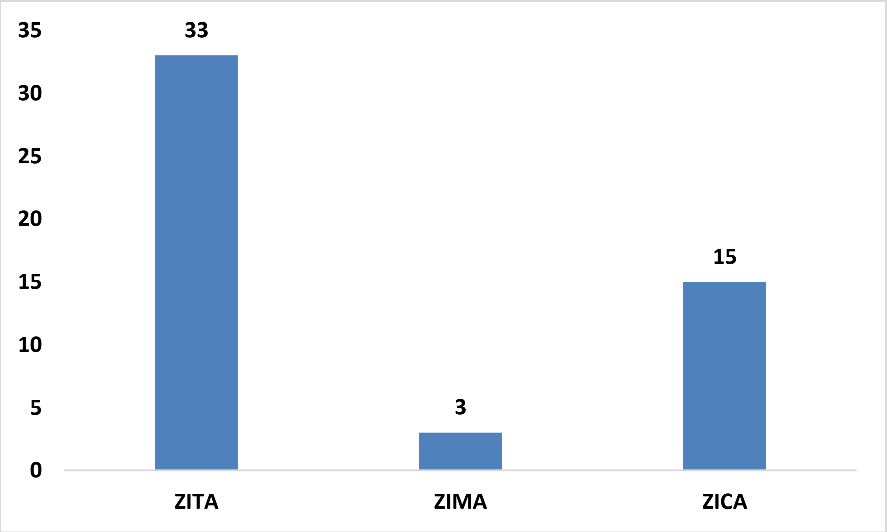
Source: Company, HDFC sec Research

Kidzee Network



Source: Company, HDFC sec Research

Other Institutes Network



Income Statement (Consolidated)

(Rs Cr)	FY15	FY16	FY17	FY18E	FY19E	FY20E
Net Revenue	**128**	**152**	**179**	**227**	**281**	**352**
Other Income	4	2	2	5	7	11
Total Income	**132**	**154**	**181**	**232**	**287**	**363**
Growth (%)	5.5	18.4	18.0	27.0	23.5	25.3
Operating Expenses	97	108	117	143	173	211
EBITDA	**34**	**45**	**64**	**89**	**114**	**151**
Growth (%)	**152.9**	**41.5**	**43.9**	**35.2**	**27.8**	**30.3**
EBITDA Margin (%)	**23.9**	**28.6**	**34.8**	**37.1**	**38.4**	**39.9**
Depreciation	9	10	10	13	15	20
EBIT	**25**	**35**	**55**	**75**	**99**	**132**
Interest	15	20	19	16	17	15
PBT	**10**	**15**	**36**	**59**	**82**	**117**
Tax	0	0	-1	17	23	33
RPAT	**10**	**15**	**37**	**41**	**58**	**83**
Growth (%)	-	51.1	144.7	17.5	37.5	42.0
EPS	0.3	0.5	1.1	1.3	1.8	2.5

Source: Company, HDFC sec Research

Balance Sheet

As at March	FY15	FY16	FY17	FY18E	FY19E	FY20E
SOURCE OF FUNDS						
Share Capital	**32.0**	**32.1**	**32.3**	**32.3**	**32.3**	**32.3**
Reserves	202	218	259	298	351	429
Shareholders' Funds	**234**	**250**	**291**	**330**	**384**	**462**
Long Term Debt	296	346	214	235	220	201
Long Term Provisions & Others	2	9	135	127	159	181
Total Source of Funds	**532**	**605**	**640**	**693**	**761**	**844**
APPLICATION OF FUNDS						
Net Block incl. CWIP	533	592	610	647	712	787
Long Term Loans & Advances	77	31	27	34	43	52
Total Non Current Assets	**610**	**623**	**642**	**685**	**760**	**843**
Current Investments	4	10	6	10	12	13
Inventories	27	11	14	17	21	27
Trade Receivables	16	30	50	59	68	84
Short term Loans & Advances	3	5	9	12	16	21
Cash & Equivalents	16	12	17	31	41	34
Other Current Assets	2	16	5	8	13	22
Total Current Assets	**68**	**83**	**101**	**137**	**170**	**200**
Short-Term Borrowings	34	26	12	30	49	54
Trade Payables	13	9	12	15	18	23
Other Current Liab & Provisions	104	64	77	83	95	112
Short-Term Provisions	0	1	5	8	14	18
Total Current Liabilities	**151**	**100**	**106**	**135**	**176**	**206**
Net Current Assets	-83	-17	-5	2	-6	-6
Total Application of Funds	**532**	**605**	**640**	**693**	**761**	**844**

Source: Company, HDFC sec Research

Cash Flow Statement

(Rs Cr)	FY15	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	10	15	36	60	82	117
Non-operating & EO items	-4	-2	-2	-5	-7	-11
Interest Expenses	15	20	19	16	17	15
Depreciation	9	10	10	13	15	20
Working Capital Change	47	-71	-6	7	19	-7
Tax Paid	0	0	1	-17	-23	-33
OPERATING CASH FLOW (a)	**77**	**-27**	**57**	**74**	**103**	**100**
Capex	-72	-58	-28	-50	-80	-95
Free Cash Flow	5	-85	29	24	23	5
Investments	-10	46	-1	-7	-9	-8
Non-operating income	4	2	2	5	7	11
INVESTING CASH FLOW (b)	**-78**	**-10**	**-27**	**-52**	**-83**	**-92**
Debt Issuance / (Repaid)	14	58	-6	13	17	3
Interest Expenses	-15	-20	-19	-16	-17	-15
FCFE	4	-47	3	22	23	-6
Share Capital Issuance	0	0	0	0	0	0
Dividend	0	-2	-2	-6	-10	-14
FINANCING CASH FLOW (c)	**-1**	**36**	**-27**	**-8**	**-10**	**-26**
NET CASH FLOW (a+b+c)	**-2**	**-1**	**3**	**14**	**10**	**-17**

Source: Company, HDFC sec Research

Key Ratios

(Rs Cr)	FY15	FY16	FY17	FY18E	FY19E	FY20E
EBITDA Margin	23.9	28.6	34.8	37.1	38.4	39.9
EBIT Margin	19.6	23.2	30.5	33.3	35.4	37.4
APAT Margin	7.7	9.9	20.5	18.9	21.1	23.9
RoE	4.3	6.2	13.5	13.8	16.3	19.4
RoCE	4.7	5.8	8.5	10.9	13.0	15.6
Solvency Ratio						
Net Debt/EBITDA (x)	10.1	8.1	3.2	2.7	2.0	1.5
D/E	1.4	1.5	0.8	0.8	0.7	0.6
Net D/E	1.3	1.4	0.7	0.7	0.6	0.5
PER SHARE DATA						
EPS	0.3	0.5	1.1	1.3	1.8	2.5
CEPS	0.6	0.8	1.4	1.7	2.3	3.1
BV	7.3	7.8	9.0	10.2	11.9	14.3
Dividend	0.00	0.05	0.05	0.15	0.25	0.35
Turnover Ratios (days)						
Debtor days	46	72	102	95	88	87
Inventory days	67	46	25	28	27	28
Creditors days	50	31	39	37	39	40
VALUATION						
P/E	135.8	90.0	37.0	31.5	23.3	16.6
P/BV	5.7	5.4	4.7	4.1	3.5	2.9
EV/EBITDA	56.1	39.6	27.5	20.4	15.9	12.2
EV / Revenues	13.4	11.3	9.6	7.6	6.1	4.9

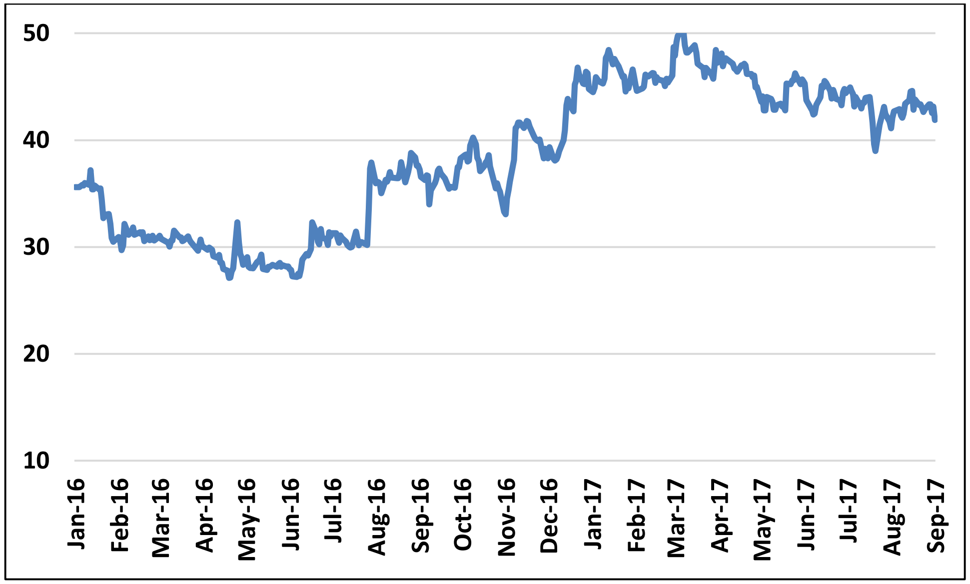
Source: Company, HDFC sec Research

Rating Chart

RETURN	HIGH			
	MEDIUM			
	LOW			
		LOW	MEDIUM	HIGH
		RISK		

Ratings Explanation:

RATING	Risk - Return	BEAR CASE	BASE CASE	BULL CASE
BLUE	LOW RISK - LOW RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 20% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 15% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 15%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 20% OR MORE
YELLOW	MEDIUM RISK - HIGH RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 35% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 20% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 30%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 35% OR MORE
RED	HIGH RISK - HIGH RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 50% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 30% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 30%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 50% OR MORE



Rating Definition:

Buy: Stock is expected to gain by 10% or more in the next 1 Year.

Sell: Stock is expected to decline by 10% or more in the next 1 Year.

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