

# NESCO

*Great business at reasonable price*

Discussion Meeting – Bangalore

8 January 2017

By Vivek Mashrani

[vivek.mashrani@gmail.com](mailto:vivek.mashrani@gmail.com)



# Building blocks and entry barriers for the business



- Large flat space in the middle of Mumbai (~70 Acres)
- Proximity to western express highway
- Proximity to Mumbai International Airport
- Proximity to railway stations
- Land is almost FREE of cost for incremental capex
- Customer relationships

# BEC – Reputed international and domestic clients

## ▫ Major Clients

### **Overseas Organisers**

- UBM / CMP
- Reeds
- Montgomery
- IIR
- Messe Dusseldorf
- Messe Frankfurt
- Koeln Messe
- Messe Nurnberg
- Messe Hannover

### **National Organisers**

- All India Plastics Manufacturers Association
- Clothing Manufacturers Association of India
- Gems & Jewelry Export Promotion Council
- Indian Electrical & Electronics Manufacturers Association
- All India Photography Trade & Industry Association
- Jasubhai Media Pvt.Ltd.
- Confederation of Indian industry(CII)
- Federation of Indian Chamber of Commerce & Industry (FICCI)
- Asian Business Exhibitions & Conferences (ABEC)

# BEC – Reputed international and domestic clients

## **Bombay Exhibition Centre:**

Income for the year was ₹ 11,183.36 lakhs compared to ₹ 8,586.27 lakhs in the previous year, an increase of 30.25%.

During the year 156 exhibitions and conventions were held in our Centre, out of which 33 were new organizers. Some of the new clients include Infinity Exhibitions & Conferences Pvt. Ltd., JP Morgan Services India Pvt. Ltd., V-Rock Entertainment Agency, Dalit Indian Chambers of Commerce & Industry (DICCI), New Media Communication Pvt. Ltd. and Artisans & Weavers Welfare Association.

## **Nesco Hospitality Private Limited:**

Nesco Hospitality Private Limited, wholly owned subsidiary of your Company, has earned revenue of ₹ 222.75 lakhs as compared to ₹ 6.10 lakhs during the previous period.

The Company has started food court services within our Nesco Complex with leading international and national food brands and is targeting to cater the growing demand of quality food services from the exhibition organizers, exhibitors, visitors and employees working in Nesco IT Park. Your Company is taking steps to establish a large world class kitchen, construction is expected to start in later part of this year.

# Future plans – Visibility for 5-8 years

- IT building 4 – Total built-up area 17 lakh sq. ft. (Leasable – 12 lakh sq. ft.)
- BEC: First phase ~20 lac sq. ft.
- Large Kitchen – 24k sq. ft. by April 2017; Capacity of 40k to 50k meals per day
- IT building 1 & 2 can be rebuilt based on new relaxed FSA norms
- Estimated cost of expansion: 1,500 Cr.; No borrowings planned; Entire capex to be met by internal accruals

While announcing Q2/H1 results, Mr. Sumant Patel, Executive Chairman of Nesco Ltd. gave more details of the Company's expansion plans.

2. For half year, Nesco IT Park revenues increased from Rs.54.58 crores to Rs. 64.77 crores a growth of 18.66%.

Company has received requisite approvals for IT building 4 in Nesco IT Park which has total built-up area of 17 lakh sq.ft. The project is LEED India pre certified and has been awarded platinum rating by the Indian Green Building Council. The civil construction work for the building is now in full swing by Larsen & Toubro.

3. Bombay Exhibition Centre is witnessing growth in number and size of exhibitions and for half year, its revenues increased from Rs. 45.00 crores to Rs. 51.27 crores. The Centre continues to bring largest number of visitors to Mumbai.

Your Company is now going ahead to set up a new world class Exhibition & Convention Centre and have engaged services of an International Architects firm for making the master plan of proposed Exhibition & Convention Centre and related facilities and amenities. In the first phase 20.00 lakh sq. ft. will be constructed.

4. The Hospitality Division which was recently started, operates Food Courts and Cafeterias in Bombay Exhibition Centre and Nesco IT Park, is receiving good response from clients, and is expected to generate significant revenues and profits.

Your Company is now setting up a large kitchen facility in area measuring approx. 24,000 square feet which will be operational from April 2017. The facility will have capacity to produce 40,000 to 50,000 meals per day.

5. Indabator, Nesco's capital goods division has witnessed better order bookings, with revenues for the quarter and in half year showing increases. Indabator was profitable in both Q1 and H1.

Mr. Patel stated that the estimated cost of expansion of IT Park, Bombay Exhibition Centre and Nesco Hospitality was about Rs. 1500 crores which will be met from Company's own resources without any borrowings and the Company is expected to remain debt free.



# Historical numbers and Building 3 effect

## Compounded Sales Growth:

<b>10 Years:</b>	16.36%
<b>5 Years:</b>	17.2%
<b>3 Years:</b>	21.5%
<b>TTM:</b>	20.81%

## Compounded Profit Growth:

<b>10 Years:</b>	24.24%
<b>5 Years:</b>	17.8%
<b>3 Years:</b>	15.53%
<b>TTM:</b>	26.82%

## Return on Equity:

<b>10 Years:</b>	24.64%
<b>5 Years:</b>	21.38%
<b>3 Years:</b>	19.87%
<b>TTM:</b>	21.24%

	Mar 2012	Mar 2013	Mar 2014	Mar 2015	Mar 2016	TTM
Sales	127.98	143.46	161.11	194.45	257.31	267.77
Expenses	37.85	42.54	53.40	56.12	72.91	63.55
<b>Operating Profit</b>	<b>90.13</b>	<b>100.92</b>	<b>107.71</b>	<b>138.33</b>	<b>184.40</b>	<b>204.22</b>
OPM	70.43%	70.35%	66.85%	71.14%	71.66%	76.31%
<b>Profit before tax</b>	<b>96.83</b>	<b>113.67</b>	<b>116.89</b>	<b>159.78</b>	<b>193.63</b>	<b>230.52</b>
Tax	29.49	31.99	35.87	48.14	60.72	72.16
<b>Net Profit</b>	<b>67.34</b>	<b>81.69</b>	<b>81.02</b>	<b>111.63</b>	<b>132.91</b>	<b>158.36</b>

The profits more than doubled due to building 3 occupancy

PS >> Building 4 will have almost twice the size of leasable area of Building 3!!

# Case of operating leverage

## Segment Reporting

(₹ in lakhs)

Particulars	2015-2016	2014-2015
<b>Revenue by segment</b>		
Nesco IT Park	12,046.02	9,067.36
Bombay Exhibition Centre	11,183.36	8,586.27
Indabrator	2,501.49	1,790.92
Investment and other income	1,605.27	2,827.33
Hospitality services	222.75	6.10
<b>Total</b>	<b>27,559.14</b>	<b>22,277.98</b>
Less: Inter- segment revenue	-	-
<b>Net revenue from operations</b>	<b>27,559.14</b>	<b>22,277.98</b>
<b>Segment profit before tax and finance cost</b>		
Nesco IT Park	10,590.59	7,309.36
Bombay Exhibition Centre	9,538.47	6,966.47
Indabrator	30.71	(39.02)
Hospitality services	1.22	(13.01)
Unallocable Expenses net of Unallocable Income	(783.98)	1,753.98
<b>Total operating profit before tax and finance cost</b>	<b>19,377.01</b>	<b>15,990.80</b>

BEC	2016	2015
Revenue	112	86
Op. profit	95	70
Op Margin	85%	81%

IT park	2016	2015
Revenue	120	90
Op. profit	106	73
Op Margin	88%	81%

# Effect of operating leverage

		( ₹ in lakhs)	
		Year Ended 31 March 2016	Year Ended 31 March 2015
<b>19</b>	<b>Revenue from Operations (Gross)</b>		
A.	Nesco IT Park - Licence fees and service charges	12,046.02	9,067.36
B.	Bombay Exhibition Centre : Rent and service charges	11,183.36	8,586.27
C.	Indabrador - Industrial Capital Goods		
	i) Sales of Machines & Spares	2,685.65	1,843.28
	Less: Excise Duty	315.78	152.97
	Net Sales	2,369.87	1,690.31
	ii) Engineering Fees, services & other charges	131.87	100.61
D.	Hospitality Services	222.75	6.10
		25,731.12	19,444.55
<b>21</b>	<b>Cost of Materials Consumed</b>		
	Opening Stock	287.13	136.87
	Add : Purchases and Expenses	1,599.27	1,886.40
	Less: Closing Stock	423.89	287.13
		1,462.51	1,087.31
<b>22</b>	<b>Changes in Inventories of finished goods and work-in-progress</b>		
	Opening Stock		
	Semi-finished Goods	472.56	296.78
	Less: Closing Stock		
	Semi-finished Goods	641.22	472.56
		(168.66)	(175.78)
<b>23</b>	<b>Employee Benefits expenses</b>		
	Salary, Wages and Allowances	815.67	606.47
	Contribution to Provident and other funds	44.69	36.08
	Gratuity	31.48	21.50
	Staff welfare expenses	48.17	56.85
		940.01	720.90

Selling popcorn in theatre!!  
(Internet/Wi-fi, parking etc.)



# Cashflow check

Particulars	Year Ended 31 March 2016	
A) Cash Flow from operating activities		
Net Profit before Tax and extraordinary items		19,364.00
Add / (Less):		
Depreciation	670.13	
Interest income	(9.98)	
Finance cost	13.01	
Sundry debtors written off	227.24	
Income from investments	(1,350.09)	
Profit/(Loss) on sale of fixed assets (net)	10.04	(439.65)
Operating profit before working capital changes		18,924.35
Add / (Less):		
(Increase)/Decrease in Inventory	(330.77)	
(Increase)/Decrease in Trade & other receivable	(666.58)	
Increase/(Decrease) in Trade payables	915.29	(82.06)
Cash generated from operation		18,842.29
Add / (Less):		
Debts written off	(227.24)	
Income Tax	(6,010.00)	
(Excess)/Short Provision for earlier years	130.94	(6,106.30)
Net Cash from operating activities - [A]		12,735.99

- Net income getting converted into operating Cashflow
- Tax paid amounts to ~30% of PBT
- Clear beneficiary of reduction in corporate taxes

# Incremental RoCE

PBT contribution	2020 (Cr.)
IT park	125
Hospitality Center	39
BEC	378
<b>Total</b>	<b>542</b>
Tax rate (%)	31%
Total capex	1,500
<b>Post-tax ROCE (%)</b>	<b>25%</b>



**“Over the long term, it’s hard for a stock to earn a much better return than the business which underlies it earns. If the business earns six percent on capital over forty years and you hold it for that forty years, you’re not going to make much different than a six percent return - even if you originally buy it at a huge discount. Conversely, if a business earns eighteen percent on capital over twenty or thirty years, even if you pay an expensive looking price, you’ll end up with one hell of a result.”**

~ CHARLIE MUNGER

# Strong tailwinds have converged recently

- Demonetization and RERA – difficult to acquire land and construct with black money
- Offices are moving away from South Mumbai
- Oshiwara railway station just behind NESCO started from Nov-16
- FSI norms have been revised recently
- Reduction of corporate taxes in next 3-4 years
- Reduction in yields at the time of capex

# What I like about the business

- Debt free; No dilution for capex
- Location advantage; Very difficult to replicate
- Stability of the earnings; Sticky business
- Longevity – visibility in terms of next 5-8 years
- Cashflow is for real; Effective tax of 30% and capex from accruals
- Attractive incremental RoCE ensuring wealth creation for shareholders
- Conservative promoters
- High operating leverage
- Diversified business mix
- Possibilities for new BEC for live performance, TV shows, cultural performances etc.

# Market mispricing the business?

- Dull and boring business?
- Market considering it as annuity business which cannot grow?
- Less coverage – not market fancy?
- Holding company discount?
- Fear of real estate downturn?

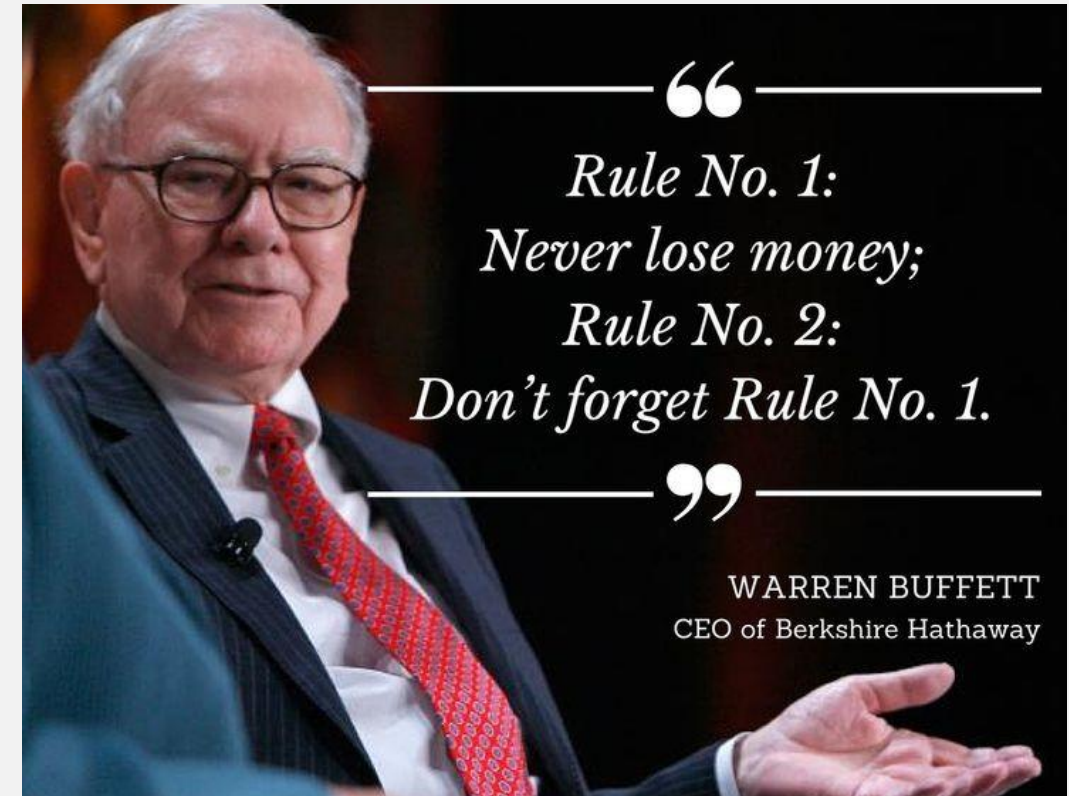
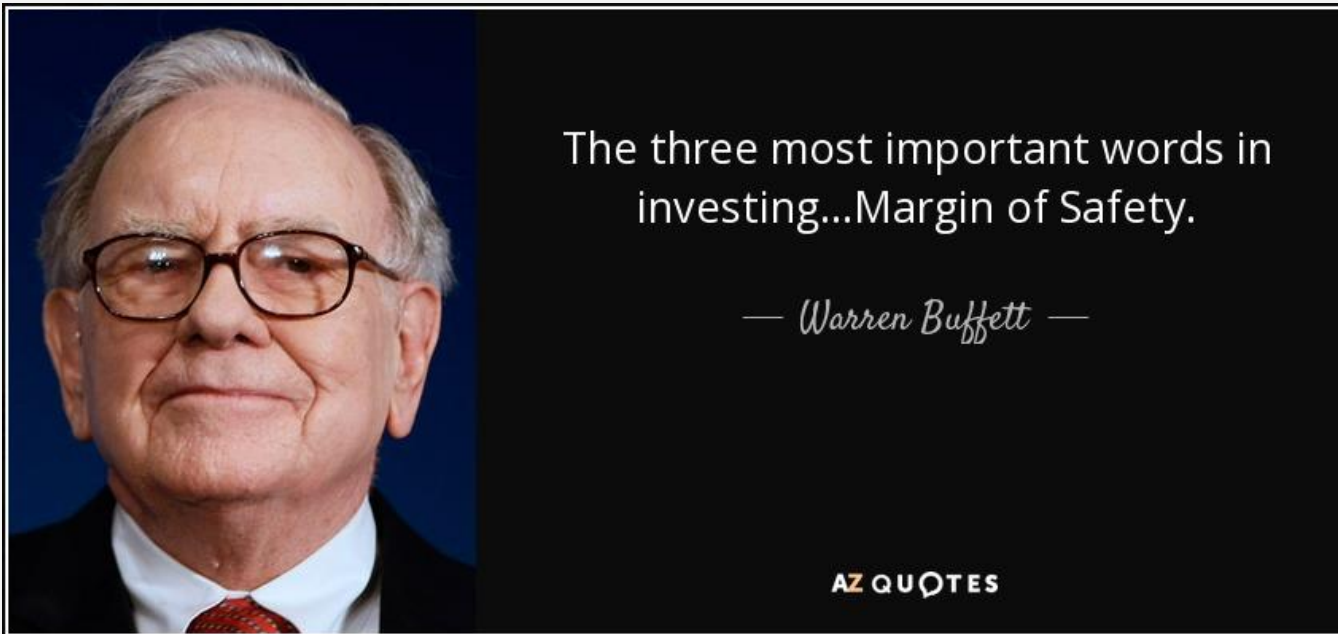


You're looking for a mispriced gamble. That's what investing is. And you have to know enough to know whether the gamble is mispriced. That's value investing.

— Charlie Munger —

AZ QUOTES

# Back to basics





# Margins of Safety in assumptions

- Low occupancy levels of Building 4 for 2 years
- Reduction of corporate taxes ignored
- BEC new building rate assumed to be low
- Hospitality growth of only 5%
- Capital goods business growth of only 10%
- Rate hike of BEC from April 2017 ignored; Moderate hike assumed
- Effect of operating leverage ignored for now
- Ignored capacity expansion of capital goods business

# What does land value translates to?

ITEMS	DATA
Land (in acres)	70
Conversion to sq. ft.	43,560
LT capital gains tax assumed	20%
Land price post tax >> $4,573 \times 0.8 = 3,658$ Cr. (Excludes capital goods facility)	



**CURRENT MARKET CAP OF ~2,900 Cr. Provides margin of safety**

# Valuation assuming no growth

- Assuming 150 Cr. of pretax FCF generated in FY17
- Only 4% growth is assumed until perpetuity
- AAA rated bond is currently having yield ~8% pretax
- Using 4% to value this income stream (bond yield less perpetual growth)

	Data
AAA rated bond yield	8%
Perpetual growth	4%
Valuation (fair value @ no growth)	3,750 Cr.
Current market cap	~2,900 Cr.

# Healthy returns from current investments

<u>Current investments</u>	
A Fixed Maturity Plans	6,069.23
B Debt Funds • income funds	14,969.85
C Debt funds • ultra short term bond funds	4,509.90
D Debt funds • short term funds	12,556.54
E Debts funds • floating rate funds	1,460.00
F Equity funds • balanced funds (Quoted)	124.00
G Equity funds • equity funds (Quoted)	1,056.07
Total:	<u>40,745.59</u>
Aggregate of quoted investments • Market Value	<u>44,207.27</u>

- Portfolio of investments of ~400 Cr.
- 95% constitutes of debt funds
- Due to falling yields majority of debt funds have given 15%+ returns this year
- This translates to investment income of 60 Cr.+

# Rate hike for BEC applicable from April 2017

Harsh Mukherjee <harsh.mukherjee@nesco.in>

12/23/16

to me

Dear Mr. Vivek

*Greetings from Bombay Exhibition Centre!*

This refers to the discussions we had a shortwhile back today; please find below details of facilities at BEC:

Hall I : 19143 sqm

Hall V : 7378 sqm

Hall VI : 11799 sqm

Hall II (A,B,C): 2108 sqm

The tariffs applicable from April 2017 for Halls I, V & VI are as under:

-

For Exhibition

Exhibition days : Rs. 254/- per sq.m. per day

Non-Exhibition days : Rs. 127/- per sq.m. per day

Hall II (For Exhibition / Conference):

Rs. 254/- per sq.m. per day (flat)

# Capital goods business

## **Indabrator:**

In the year under review, Indabrator income was ₹ 2,501.74 lakhs (previous year ₹ 1,790.92 lakhs), an increase of 39.69%

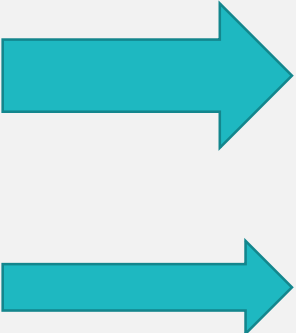
2015-16 showed some progress in the capital goods industry. A number of projects which were deferred in the previous year were completed in the current year. Your Company has recently won several large contracts. Company has decided to expand its machine building division at its Visholi Complex, Gujarat, construction for which is expected to start in Q4 of this year.



# What are the risks?

- Slow execution of new capex – Delay in projects
- Earthquake? (Very likely to have insurance – not sure though)
- Recession – occupancy levels of IT parks and BEC can drop
- Businesses shifting to Tier II and Tier III cities
- Artificial Intelligence? Automation?
- Government policies?
- Supply of offices nearby cheaper locations within Mumbai?

# Shareholding pattern – Reputed funds invested



Sr. No.	For each of the top 10 Shareholders	Shareholding at the beginning of the Year		Shareholding at the end of the Year	
		No. of shares	% of total shares of the Company	No. of shares	% of total shares of the Company
1.	Pari Washington Company Pvt. Ltd	2,55,920	1.82%	2,55,920	1.82%
2.	ICICI Prudential Dividend Yield Equity Fund	2,35,464	1.67%	----	---
3.	ICICI Prudential Tax Plan	1,80,390	1.28%	----	----
4.	Catamaran Management Services Private Limited	1,32,672	0.94%	1,90,672	1.35%
5.	Franklin India Smaller Companies Fund	1,12,487	0.80%	2,04,468	1.45%
6.	SBI Small and Midcap Fund	52,405	0.37%	2,40,000	1.70%
7.	The New India Assurance Company Limited	1,34,400	0.95%	1,34,400	0.95%
8.	Malabar India Fund Limited	1,05,579	0.75%	1,03,761	0.74%
9.	Sextant Autour Du Monde	56,474	0.40%	59,803	0.42%
10.	East Sail	1,09,443	0.78%	1,09,443	0.78%
11.	Kamal Wadkar	2,71,922	1.92%	2,69,602	1.91%
12.	Sharad Kanayalal Shah	53,735	0.38%	53,735	0.38%
13.	Engineering Imports & Exports Private Limited	1,44,400	1.02%	----	----

# Food for thought



A great business at a fair price is  
superior to a fair business at a great  
price.

— *Charlie Munger* —

AZ QUOTES

# Summary of numbers

- Zero debt
- Negative working capital for BEC
- Incremental RoCE ~25%
- Return on equity ~20%
- 1,500 Cr. Capex from internal accruals
- FCF yield of ~5%
- Net income CAGR of 25% for next 3 years
- FY18e PE of ~15x

# DISCLAIMER

---

- This presentation is solely for discussion and knowledge sharing purpose
- This is not a stock recommendation
- Please do your own research and due diligence for any investment actions and/or consult an investment advisor for the same
- Author is not liable for any claims arising from use of the data provided neither there is any guarantee for accuracy of data
- It is safe to assume that I am invested in the stock and my views may be biased