

NESCO

24 March 2020

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Temporary setback likely but still attractively valued

We recently had a call with Mr. Dipesh Singhania, CFO of NESCO Limited (NESCO) to discuss the impact of the COVID-19 outbreak on the exhibition business in general and on the near term operational performance in specific.

The Bombay Exhibition Center (BEC) is expected to witness a temporary setback. The management mentioned that the virus outbreak is a special case situation and hence the regular clauses of agreement with regards to rescheduling and cancellations might not apply. The management expressed its intentions of accommodating its clients in the best possible manner. The exhibitions which were scheduled up to 20th April 2020 have been rescheduled. Currently, there is no change in the schedule of exhibitions lined up in the last week of April 2020. The CFO mentioned that the situation is similar across the exhibition industry.

Majority of the tenants of IT Park (1.87mn sq. ft.) have resorted to precautionary measures and have started working from home. The management clearly mentioned that there will be no impact on the rental revenues of the IT Park. The rental rates will not be impacted even if there is a force closure of the IT Park by the government, thereby forcing all the tenants to work from home.

However, we expect NESCO's Foods revenues to be affected as it is directly linked to the occupancy of BEC and IT Park.

In the wake of the slowdown expected in the BEC business, we have revised our FY21 occupancy estimates for BEC from 32% earlier to 25%. In the worst case scenario, if we assume no contribution from BEC and Food & Catering businesses to NAV, which constitute 26% of the NAV, we find that the target price reduces from Rs931 currently to Rs688, which is 70% above the current market price (CMP). Thus, we remain bullish on the stock and see no need to assign a discount to the NAV.

We retain our BUY rating on NESCO with a revised target price of Rs931 (earlier Rs937) based on September FY22E NAV derived from SOTP valuation.

Deferment of revenues of BEC: The management said that it has till now received no specific communication from the government with regards to the suspension of activities at BEC. However, it has implemented precautionary measures as per the general guidelines and communication by the government.

The clients are currently on a wait and watch mode with regards to the COVID-19 outbreak situation. Exhibitions up to 20th April 2020 have been rescheduled. Currently, there is no change in the schedule of exhibitions lined up in the last week of April 2020. The management expressed its intentions of accommodating the exhibitors in the best possible manner as the virus outbreak is a special case situation and hence the regular clauses of agreement with regards to rescheduling and cancellations shall not apply.

The management clarified that currently there are no talks with regards to the refund of the exhibitions rescheduled. The advance money received shall be adjusted against the event, which is deferred to a later date. In case the exhibitions are seasonal and held only once a year, the exhibition might be deferred to next year.

The management however expects:

1. The exhibition revenue to be negatively impacted by 5%-6% on an annualized basis for FY21.
2. No volume growth in the exhibition business even in the latter part of FY21.

In the wake of the slowdown expected in the BEC business, we have revised our FY21 occupancy estimates for BEC from 32% earlier to 25%.

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Revenues	3,212	3,596	3,666	4,254	5,377
YoY (%)	3.1	12.0	1.9	16.0	26.4
EBITDA	2,185	2,314	2,332	2,732	3,524
EBITDA Margin (%)	68.0	64.4	63.6	64.2	65.5
PAT	1,787	1,804	1,650	1,911	2,501
YoY (%)	5.1	1.0	(8.6)	15.9	30.8
EPS (Rs)	25.4	25.6	23.4	27.1	35.5
RoE (%)	17.7	15.4	12.4	12.5	14.1
EV/EBITDA (x)	13.0	12.3	12.2	10.4	8.1
P/E (x)	15.9	15.8	17.3	14.9	11.4

Source: Company, Nirmal Bang Institutional Equities Research

BUY

Sector: Real Estate

CMP: Rs404

Target Price: Rs931

Upside: 130%

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Key Data

Current Shares O/S (mn)	70.5
Mkt Cap (Rsb/US\$m)	28.5/374.2
52 Wk H / L (Rs)	817/402
Daily Vol. (3M NSE Avg.)	10,046

Price Performance (%)

	1 M	6 M	1 Yr
NESCO	(44.1)	(27.1)	(10.4)
Nifty Index	(35.7)	(34.3)	(33.6)

Source: Bloomberg

Delay in closing deals for IT Park 4, existing revenues of IT Park won't be impacted: The management clearly mentioned that there will be no impact on the rental revenues of the IT Park. The rental rates are not likely to be impacted even in case there is a force closure of the IT Park by the government, thereby forcing all the tenants to work from home. Majority of the existing tenants at the IT Park have started working from home and currently the occupancy level at the IT Park stands at 22%-23%, which can go down even further in case the situation doesn't improve in the near future.

The management is facing some delay in closing the ongoing deals for the recently commissioned IT Tower 4. Out of the four deals in the pipeline, two have been cancelled, while the other two have been put on hold because of procedural delays like approval of the tenant's board. The IT Park 4 is currently ~80% leased (agreement entered into or LOI signed). 60%-65% of the leased area has become either operational or is at the end of fit-out stage. The average rental for IT Park 4 is Rs125/sq. ft.

Planned capex for IT Tower 2 (2.0mn sq. ft.) and BEC (0.15mn sq. ft.) on schedule: The planned capex for IT Tower 2 (Rs20,000mn), which is expected to be operational by FY25, and expansion of BEC (Rs1,000mn), which is expected to be operational by FY21, will be incurred as planned and the execution of the same is on track. The management currently has no intention to delay the capex plans for expansion.

Healthy balance sheet with net cash position: The company currently has net cash balance of Rs6.8bn-Rs6.9bn on the balance sheet.

No discount assigned to NAV: In the worst case scenario, if we assume no contribution from BEC and Food & Catering businesses to NAV, which constitute 26% of the NAV, we find that the target price reduces from Rs931 currently to Rs688, which is 70% above the CMP. Thus, we remain bullish on the stock and see no need to assign a discount to the NAV. We remain bullish on the stock at the CMP and maintain our BUY rating with a target price of Rs931.

Maintain Buy with a revised TP of Rs931 (earlier Rs937): Our revised TP of Rs931 (earlier Rs937) for NESCO is NAV based using SOTP valuation. Our valuation is driven by the restructuring of the NESCO IT Park, increase in rentable space of BEC and the expected increase in rental rates. Our optimism is supported by a healthy balance sheet, consistently positive free cash flow and management's growth-oriented focus (with expansion of the flagship business over the next 20 years).

Consolidated financials
Exhibit 1: Income statement

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net sales	3,212	3,596	3,666	4,254	5,377
Growth YoY (%)	3.1	12.0	1.9	16.0	26.4
COGS	192	228	232	270	341
Operating Costs	453	565	603	674	781
Other Expenses	381	489	498	578	731
EBITDA	2,185	2,314	2,332	2,732	3,524
EBITDA growth (%)	1.8	5.9	0.8	17.2	29.0
EBITDA margin (%)	68.0	64.4	63.6	64.2	65.5
Depreciation	110	119	397	457	459
EBIT	2,075	2,196	1,935	2,276	3,065
EBIT (%)	64.6	61.1	52.8	53.5	57.0
Interest expense	56	47	47	47	47
Other income	361	331	379	398	417
Earnings before tax	2,379	2,479	2,267	2,626	3,436
Tax- total	592	675	617	715	935
Rate of tax (%)	24.9	27.2	27.2	27.2	27.2
Net profit	1,787	1,804	1,650	1,911	2,501
% growth	5.1	1.0	(8.6)	15.9	30.8
EPS (FD)	25	26	23	27	35
% growth	5.1	1.0	(8.6)	15.9	30.8

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Balance sheet

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Share capital	141	141	141	141	141
Reserves and surplus	9,970	11,564	13,212	15,123	17,624
Net worth	10,111	11,705	13,353	15,264	17,765
Loans	-	-	-	-	-
Other financial liabilities	120	534	534	534	534
Provisions	35	35	30	71	83
Deferred tax liability	232	179	179	179	179
Other non-current liabilities	34	128	115	103	93
Total capital employed	10,533	12,581	14,212	16,152	18,655
Property, plant and equipment	5,855	7,220	7,673	10,366	13,957
Investments	-	-	-	-	-
Loans	39	36	36	36	36
Other non-current assets	407	391	391	391	391
Total non-current assets	6,301	7,647	8,100	10,793	14,384
Trade payables	94	108	110	127	161
Other financial liabilities	756	386	518	433	618
Other current liabilities	396	406	-	-	-
Provisions (current)	3	7	7	7	7
Total current liabilities	1,248	906	634	567	786
Inventories	124	90	92	107	135
Investments	4,985	5,312	5,312	5,312	4,312
Trade receivables	141	180	184	213	270
Cash and bank balance	116	87	988	123	170
Current tax assets (net)	38	78	78	78	78
Other current assets	76	93	93	93	93
Total current assets	5,480	5,840	6,746	5,926	5,057
Net current assets	4,231	4,934	6,112	5,359	4,271
Total capital employed	10,533	12,581	14,212	16,152	18,655

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Cash flow

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Profit after tax	1,787	1,804	1,650	1,912	2,501
Depreciation	110	119	397	457	459
Finance costs	56	47	47	47	47
Other income	(361)	(331)	-	-	-
Working capital changes	(21)	69	(295)	(83)	136
Operating cash flow	1,572	1,709	1,800	2,333	3,143
Capital expenditure	(1,466)	(1,459)	(850)	(3,150)	(4,050)
Net cash after capex	106	249	950	(817)	(907)
(Purchase)/sale of investments	194	4	-	-	1,000
Proceeds/repayment of borrowing	-	-	-	-	-
Finance costs	(56)	(47)	(47)	(47)	(47)
Dividend & dividend distribution tax	(187)	(195)	-	-	-
Other	2	(39)	-2	0	0
Cash flow from financing	(241)	(282)	(49)	(47)	(47)
Total cash generation	59	(28)	901	(864)	46
Opening cash balance	57	116	87	988	123
Closing cash & bank balance	116	87	988	123	170

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Key ratios

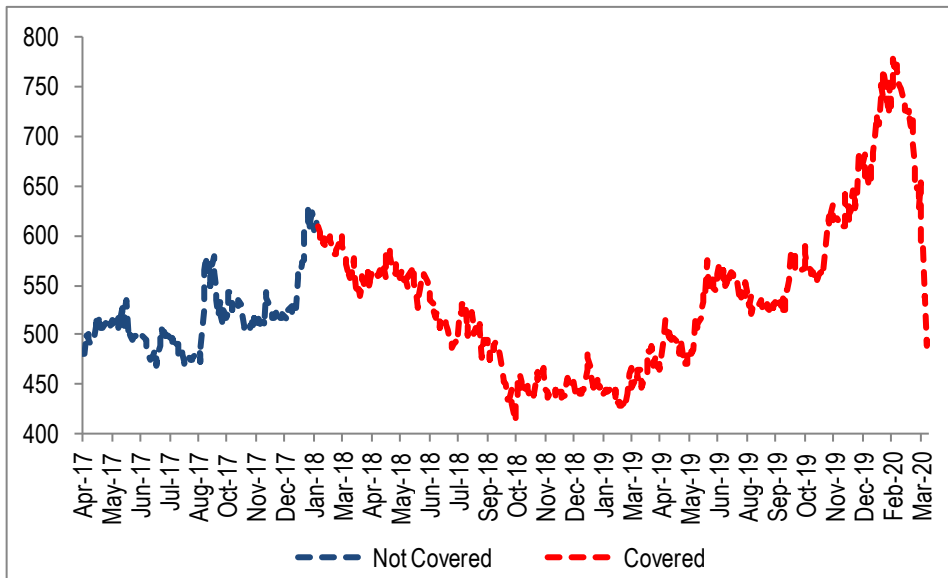
Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Profitability and return ratios					
EBITDA margin (%)	68.0	64.4	63.6	64.2	65.5
EBIT margin (%)	64.6	61.1	52.8	53.5	57.0
Net profit margin (%)	55.6	50.2	45.0	44.9	46.5
RoE (%)	17.7	15.4	12.4	12.5	14.1
RoCE (%)	19.7	17.5	13.6	14.1	16.4
Working capital & liquidity ratios					
Receivables (days)	16	18	18	18	18
Inventory (days)	248	138	138	138	138
Payables (days)	178	172	172	172	172
Current ratio (x)	4.4	6.4	10.6	10.5	6.4
Valuation ratios					
EV/sales (x)	8.8	7.9	7.7	6.7	5.3
EV/EBITDA (x)	13.0	12.3	12.2	10.4	8.1
P/E (x)	15.9	15.8	17.3	14.9	11.4
P/BV (x)	2.8	2.4	2.1	1.9	1.6

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
30 January 2018	Buy	613	794
14 February 2018	Buy	595	794
18 May 2018	Buy	560	794
9 August 2018	Buy	502	768
14 November 2018	Buy	461	764
15 February 2019	Buy	442	764
27 May 2019	Buy	485	764
29 July 2019	Buy	540	782
7 August 2019	Buy	537	782
13 November 2019	Buy	605	937
16 January 2020	Buy	717	937
10 February 2020	Buy	770	937
17 March 2020	Buy	538	937
24 March 2020	Buy	404	931

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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