

NESCO

16 January 2020

Reuters: NSEN.NS; Bloomberg: NSE IN

Tower 4 witnessing strong demand; plans for expansion on track

We recently met the management of NESCO Ltd. The key takeaways are: (1) Strong demand continues for Tower 4 at competitive rates (2) New Tower 2 at planning stage (3) Plans to add 0.15mn sq. ft. of space in Bombay Exhibition Center (BEC) by FY21E on track and (4) Capex of approximately Rs21bn to be incurred during FY20E-FY25E, to be financed through internal accruals.

We have maintained our Buy rating on the stock with a target price (TP) of Rs937. 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.

Tower 4 continues to drive strong demand at competitive rates: As per our discussion with management, the newly commissioned Tower 4 (1.20mn sq. ft.), which was 50% leased as on 2QFY20, continues to witness strong demand. Management informed that during 3QFY20, LOI has been signed for additional 20% area and negotiations are in place for another 10% area with an existing tenant in Tower 3.

Management stated that the current lease negotiations are happening at a rate of ~Rs120/sq. ft., which is the rate at which the leasing was done to WeWork, one of the initial Tower 4 tenant which has taken up 20% of the leasable area in Tower 4.

On the contractual escalation front, management highlighted that NESCO generally has a 5 year documented contract with all its tenants with a 15% escalation clause every 3 years. Management mentioned that although the contract is documented for only 5 years, there is a mutual LOI between the tenant and the company for a period of 10 years.

Plans to rebuild existing Building 2 (0.13mn sq. ft.) in advanced stages: Management reiterated that the process of vacating the existing Building 2 has reached advanced stages and the consultants and designers are onboard for the construction of the new Tower 2. Management aims to appoint the contractors for the construction of Tower 2 in the next 6 months.

Management is eyeing to utilize area of the existing Building 2 and the adjoining parking lot to build a 4mn sq. ft. IT park building consisting of new Tower 2 (~2mn sq. ft. to 2.5mn sq. ft.), a 4/5 star Hotel (~0.5mn sq. ft.) and common area. Management expects the construction to be completed over the next 5 years at a capex of ~Rs2,000 crore, which is to be financed through internal accruals.

Bombay Exhibition Center (BEC): Management revisited its intentions to convert 0.13mn sq. ft. of area of the earlier demolished Tower 1 to a ~0.15mn sq. ft. convention center forming part of BEC. The new convention center is expected to be operational by management by 4QFY21E and capex of ~Rs100 crore is expected to be incurred for the same, which is to be financed through internal accruals.

Management mentioned that BEC is currently operating at a utilization of 40%-45% and commands an average rental of Rs270/sq. meter/day.

Healthy balance sheet with net cash position of Rs5.9bn as on 2QFY20: NESCO has maintained strong financial discipline with the capex for expansion being funded from internal accruals. As of 2QFY20, the company had cash plus investment balance of Rs5.9bn on a balance sheet size of Rs14.6bn. We expect the company to maintain financial discipline which adds to our comfort.

Maintain Buy with a TP of Rs937: Our TP of Rs937 for NESCO is NAV based on 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. We have maintained Buy rating on NESCO with a TP of Rs937 based on Sep FY22E NAV.

| Y/E March (Rsmn) | FY18 | FY19 | FY20E | FY21E | FY22E |
|-------------------|-------|-------|-------|-------|-------|
| Revenues | 3,212 | 3,596 | 3,666 | 4,561 | 5,700 |
| YoY (%) | 3.1 | 12.0 | 1.9 | 24.4 | 25.0 |
| EBITDA | 2,185 | 2,314 | 2,332 | 2,952 | 3,755 |
| EBITDA Margin (%) | 68.0 | 64.4 | 63.6 | 64.7 | 65.9 |
| PAT | 1,787 | 1,804 | 1,650 | 2,072 | 2,669 |
| YoY (%) | 5.1 | 1.0 | (8.6) | 25.6 | 28.8 |
| EPS (Rs) | 25.4 | 25.6 | 23.4 | 29.4 | 37.9 |
| RoE (%) | 17.7 | 15.4 | 12.4 | 13.4 | 14.8 |
| EV/EBITDA (x) | 23.1 | 21.8 | 21.6 | 17.1 | 13.4 |
| P/E (x) | 28.3 | 28.0 | 30.6 | 24.4 | 18.9 |

Source: Company, Nirmal Bang Institutional Equities Research

BUY

Sector: Real Estate

CMP: Rs717

Target Price: Rs937

Upside: 31%

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Key Data

| | |
|--------------------------|------------|
| Current Shares O/S (mn) | 70.5 |
| Mkt Cap (Rsbn/US\$m) | 50.7/714.8 |
| 52 Wk H / L (Rs) | 738/420 |
| Daily Vol. (3M NSE Avg.) | 65,030 |

Price Performance (%)

| | 1 M | 6 M | 1 Yr |
|-------------|------|------|------|
| NESCO | 13.6 | 28.2 | 57.7 |
| Nifty Index | 2.1 | 6.5 | 13.4 |

Source: Bloomberg

Consolidated financials

Exhibit 1: Income statement

| Y/E March (Rsmn) | FY18 | FY19 | FY20E | FY21E | FY22E |
|----------------------------|--------------|--------------|--------------|--------------|--------------|
| Net sales | 3,212 | 3,596 | 3,666 | 4,561 | 5,700 |
| Growth YoY (%) | 3.1 | 12.0 | 1.9 | 24.4 | 25.0 |
| COGS | 192 | 228 | 232 | 289 | 361 |
| Operating Costs | 453 | 565 | 603 | 700 | 809 |
| Other Expenses | 381 | 489 | 498 | 620 | 775 |
| EBITDA | 2,185 | 2,314 | 2,332 | 2,952 | 3,755 |
| EBITDA growth (%) | 1.8 | 5.9 | 0.8 | 26.6 | 27.2 |
| EBITDA margin (%) | 68.0 | 64.4 | 63.6 | 64.7 | 65.9 |
| Depreciation | 110 | 119 | 397 | 457 | 459 |
| EBIT | 2,075 | 2,196 | 1,935 | 2,496 | 3,296 |
| EBIT (%) | 64.6 | 61.1 | 52.8 | 54.7 | 57.8 |
| Interest expense | 56 | 47 | 47 | 47 | 47 |
| Other income | 361 | 331 | 379 | 398 | 417 |
| Earnings before tax | 2,379 | 2,479 | 2,267 | 2,846 | 3,667 |
| Tax- total | 592 | 675 | 617 | 775 | 998 |
| Rate of tax (%) | 24.9 | 27.2 | 27.2 | 27.2 | 27.2 |
| Net profit | 1,787 | 1,804 | 1,650 | 2,072 | 2,669 |
| % growth | 5.1 | 1.0 | (8.6) | 25.6 | 28.8 |
| EPS (FD) | 25 | 26 | 23 | 29 | 38 |
| % growth | 5.1 | 1.0 | (8.6) | 25.6 | 28.8 |

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 | 15,284 | 17,953 |
| Net worth | 10,111 | 11,705 | 13,353 | 15,425 | 18,094 |
| 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 | 16,313 | 18,984 |
| 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 | 137 | 171 |
| Other financial liabilities | 756 | 386 | 518 | 554 | 618 |
| Other current liabilities | 396 | 406 | - | - | - |
| Provisions (current) | 3 | 7 | 7 | 7 | 7 |
| Total current liabilities | 1,248 | 906 | 634 | 697 | 795 |
| Inventories | 124 | 90 | 92 | 115 | 143 |
| Investments | 4,985 | 5,312 | 5,312 | 5,312 | 4,312 |
| Trade receivables | 141 | 180 | 184 | 229 | 286 |
| Cash and bank balance | 116 | 87 | 988 | 391 | 483 |
| 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 | 6,217 | 5,395 |
| Net current assets | 4,231 | 4,934 | 6,112 | 5,520 | 4,600 |
| Total capital employed | 10,533 | 12,581 | 14,212 | 16,313 | 18,984 |

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 | 2,072 | 2,669 |
| Depreciation | 110 | 119 | 397 | 457 | 459 |
| Finance costs | 56 | 47 | 47 | 47 | 47 |
| Other income | (361) | (331) | - | - | - |
| Working capital changes | (21) | 69 | (295) | 25 | 14 |
| Operating cash flow | 1,572 | 1,709 | 1,800 | 2,600 | 3,190 |
| Capital expenditure | (1,466) | (1,459) | (850) | (3,150) | (4,050) |
| Net cash after capex | 106 | 249 | 950 | (550) | (860) |
| (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 |
| Cash flow from financing | (241) | (282) | (49) | (47) | (47) |
| Total cash generation | 59 | (28) | 901 | (597) | 93 |
| Opening cash balance | 57 | 116 | 87 | 988 | 391 |
| Closing cash & bank balance | 116 | 87 | 988 | 391 | 483 |

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Key ratios

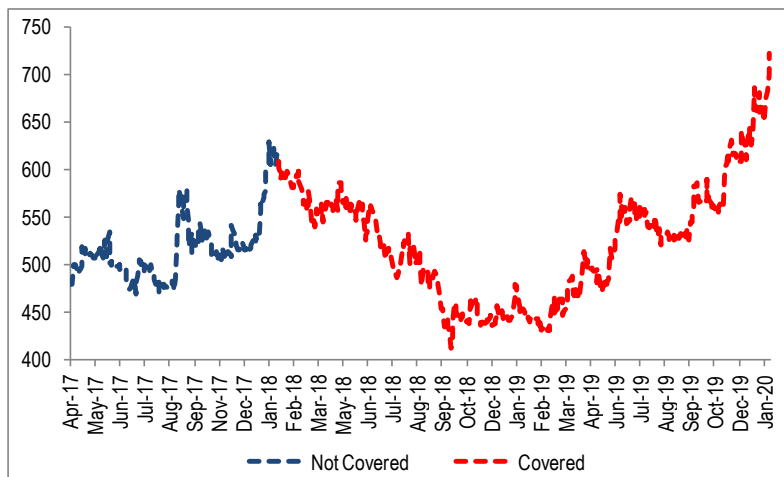
| Y/E March (Rsmn) | FY18 | FY19 | FY20E | FY21E | FY22E |
|---|------|------|-------|-------|-------|
| Profitability and return ratios | | | | | |
| EBITDA margin (%) | 68.0 | 64.4 | 63.6 | 64.7 | 65.9 |
| EBIT margin (%) | 64.6 | 61.1 | 52.8 | 54.7 | 57.8 |
| Net profit margin (%) | 55.6 | 50.2 | 45.0 | 45.4 | 46.8 |
| RoE (%) | 17.7 | 15.4 | 12.4 | 13.4 | 14.8 |
| RoCE (%) | 19.7 | 17.5 | 13.6 | 15.3 | 17.4 |
| 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 | 8.9 | 6.8 |
| Valuation ratios | | | | | |
| EV/sales (x) | 15.7 | 14.0 | 13.8 | 11.1 | 8.9 |
| EV/EBITDA (x) | 23.1 | 21.8 | 21.6 | 17.1 | 13.4 |
| P/E (x) | 28.3 | 28.0 | 30.6 | 24.4 | 18.9 |
| P/BV (x) | 5.0 | 4.3 | 3.8 | 3.3 | 2.8 |

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 |

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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