

NESCO

12 May 2020

Reuters: NSEN.NS; Bloomberg: NSE IN

Attractively valued

We recently had a call with Mr. Dipesh Singhanian, CFO of NESCO Limited (NESCO) to discuss the recent developments regarding the impact of the COVID-19 outbreak on the company's exhibition and IT Park businesses.

The Bombay Exhibition Center (BEC) has been converted into a quarantine center for coronavirus patients. Currently, there is no clarification from the Maharashtra government authorities regarding the duration for which the BEC has been converted into a quarantine center. Mr. Singhanian mentioned that it is highly probable that the letting out of exhibition halls as quarantine centers will be a CSR activity by the company.

While commercial occupancy remains stable, there have been minor hiccups in the closure of certain ongoing deals for IT Tower 4 (1.20mn sq. ft.). The management mentioned that there is talk to relax the escalation clause for certain years going forward.

In the wake of the slowdown expected in the economy, we have revised our occupancy estimates for BEC and rental escalation estimates for the IT Park business. In line with the expected decline in commercial real estate prices, we have also revised our capitalization rate from 8.5% earlier to 9%.

In the worst case scenario, if we assume no contribution from BEC and Food & Catering businesses to NAV, which constitute 28% of the NAV, we find that the target price reduces from Rs769 currently to Rs475, which is 15% above the current market price (CMP). Thus, we remain bullish on the stock and see no need to assign a discount to NAV.

We retain our BUY rating on NESCO with a revised target price of Rs769 (earlier Rs931) based on September FY22E NAV derived from SOTP valuation.

BEC's FY21 revenue highly impacted: Certain large exhibitors around the world and in India have released statements regarding cancellations of exhibitions for the coming year. The exhibitors are concerned about safety issues, social distancing norms and regulatory approvals for the exhibitions.

The management continues to be optimistic about future exhibitions as exhibitions help the exhibitors to boost products and revenues. However, newer regulations will have to be designed by the regulatory authorities and industry.

In line with the uncertainties, we have revised our BEC occupancy estimates as follows:

Year	Earlier Occupancy Estimate	Revised Occupancy Estimate
FY21	25%	0%
FY22	34%	17%
FY23	35%	25%
FY24	35%	32%

Source: Nirmal Bang Institutional Equities Research

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Revenues	3,212	3,596	3,666	3,003	4,268
YoY (%)	3.1	12.0	1.9	(18.1)	42.1
EBITDA	2,185	2,314	2,332	1,839	2,731
EBITDA Margin (%)	68.0	64.4	63.6	61.2	64.0
PAT	1,787	1,804	1,650	1,261	1,923
YoY (%)	5.1	1.0	(8.6)	(23.6)	52.5
EPS (Rs)	25.4	25.6	23.4	17.9	27.3
RoE (%)	17.7	15.4	12.4	8.6	11.6
EV/EBITDA (x)	13.3	12.5	12.5	15.8	10.6
P/E (x)	16.3	16.1	17.6	23.1	15.1

Source: Company, Nirmal Bang Institutional Equities Research

BUY

Sector: Real Estate

CMP: Rs413

Target Price: Rs769

Upside: 86%

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Key Data

Current Shares O/S (mn)	70.5
Mkt Cap (Rsbn/US\$mn)	29.1/383.7
52 Wk H / L (Rs)	817/400
Daily Vol. (3M NSE Avg.)	71,878

Price Performance (%)

	1 M	6 M	1 Yr
NESCO	(13.7)	(31.6)	(15.8)
Nifty Index	1.4	(22.4)	(18.1)

Source: Bloomberg

Delay in closing deals for IT Tower 4, existing revenues of IT Park won't be impacted: The management clearly mentioned that there will be no impact in realizing the cash flows from the IT Park business. The IT Park occupancies 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 as the servers continue to be operational from the office premises. Majority of the existing tenants of the IT Park have started work 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 also highlighted that there might be no rental escalations for certain years going forward.

The management is facing some delay in closing certain ongoing deals for the recently commissioned IT Tower 4. Two deals ongoing before the lockdown have been cancelled. Certain negotiations have been put on hold. However, there are certain deals which have been closed with deposits received and licence agreements signed. The IT Tower 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 Tower 4 is Rs125/sq. ft.

Certain small clients of NESCO and one large tenant WeWork (which occupies ~0.3mn sq. ft.) have approached the company for rent waiver/discounting which has been turned down by the company. In line with these developments, we have made changes to the occupancy estimates of the IT Tower 4 and the rental escalations as follows:

Year	Earlier Estimate	Revised Estimate
Occupancy		
FY22	85%	70%
FY23	100%	75%
FY24	100%	85%
Rental escalation each year till FY23	5%	0%

Source: Nirmal Bang Institutional Equities Research

Continue to be optimistic about capex for IT Tower 2 (2.0mn sq. ft.): The company continues to be optimistic about the planned capex for IT Tower 2 (Rs20,000mn). The company is currently working with the architects remotely on the plans to finalize the design and architecture of Tower 2. The tower was expected to be operational by FY25 earlier, but the company now expects a 6-9 months delay in execution. The expansion of BEC (0.15mn sq. ft.), which is expected to be operational by FY21-end, will be done as planned and the execution of the same is on track. Capex for the same is expected to be Rs1,000mn. 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.

Maintain Buy with a revised TP of Rs769 (earlier Rs931): Our revised TP of Rs769 (earlier Rs931) 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).

Exhibit 1: NAV break-up:

Segments	NAV (Rs mn)	Proportion (%)	NAV/share
NESCO IT Park	33,445	62%	475
BEC	15,059	28%	214
NESCO Foods	378	1%	5
Indabrador	883	2%	13
Total	49,765	92%	706
Investments + Cash (as of FY21E)	4,405	8%	63
Current + Future Value + Investments	54,170	100%	769
Number of Shares	70		
Target Price	769		

Source: Nirmal Bang Institutional Equities Research

Consolidated financials
Exhibit 2: Income statement

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net sales	3,212	3,596	3,666	3,003	4,268
Growth YoY (%)	3.1	12.0	1.9	(18.1)	42.1
COGS	192	228	232	190	271
Operating Costs	453	565	603	566	686
Other Expenses	381	489	498	408	580
EBITDA	2,185	2,314	2,332	1,839	2,731
EBITDA growth (%)	1.8	5.9	0.8	(21.2)	48.6
EBITDA margin (%)	68.0	64.4	63.6	61.2	64.0
Depreciation	110	119	397	457	459
EBIT	2,075	2,196	1,935	1,382	2,272
EBIT (%)	64.6	61.1	52.8	46.0	53.2
Interest expense	56	47	47	47	47
Other income	361	331	379	398	417
Earnings before tax	2,379	2,479	2,267	1,733	2,643
Tax- total	592	675	617	472	719
Rate of tax (%)	24.9	27.2	27.2	27.2	27.2
Net profit	1,787	1,804	1,650	1,261	1,923
% growth	5.1	1.0	(8.6)	(23.6)	52.5
EPS (FD)	25	26	23	18	27
% growth	5.1	1.0	(8.6)	(23.6)	52.5

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: 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	14,473	16,397
Net worth	10,111	11,705	13,353	14,614	16,538
Loans	-	-	-	-	-
Other financial liabilities	120	534	534	534	534
Provisions	35	35	30	68	68
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	15,499	17,412
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	90	128
Other financial liabilities	756	386	518	-	309
Other current liabilities	396	406	-	-	-
Provisions (current)	3	7	7	7	7
Total current liabilities	1,248	906	634	97	443
Inventories	124	90	92	75	107
Investments	4,985	5,312	6,112	4,212	2,812
Trade receivables	141	180	184	151	214
Cash and bank balance	116	87	188	194	168
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	4,802	3,472
Net current assets	4,231	4,934	6,112	4,706	3,028
Total capital employed	10,533	12,581	14,212	15,499	17,412

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Cash flow

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Profit after tax	1,787	1,804	1,650	1,261	1,923
Depreciation	110	119	397	457	459
Finance costs	56	47	47	47	47
Other income	(361)	(331)	(379)	(398)	(417)
Working capital changes	(21)	69	(295)	(462)	241
Operating cash flow	1,572	1,709	1,800	1,303	2,671
Capital expenditure	(1,466)	(1,459)	(850)	(3,150)	(4,050)
Net cash after capex	106	249	950	(1,847)	(1,379)
(Purchase)/sale of investments	194	4	(800)	1,900	1,400
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)	101	6	(26)
Opening cash balance	57	116	87	188	194
Closing cash & bank balance	116	87	188	194	168

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Key ratios

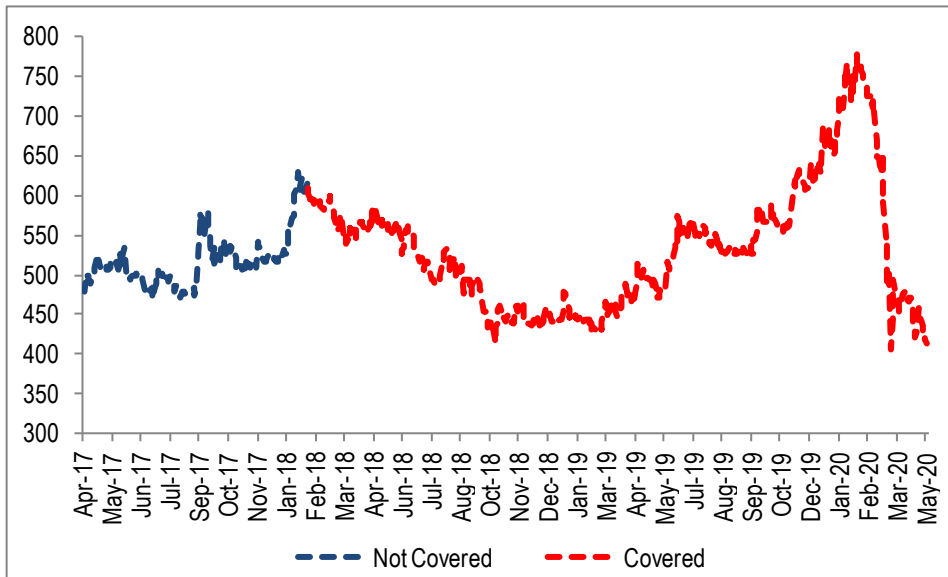
Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Profitability and return ratios					
EBITDA margin (%)	68.0	64.4	63.6	61.2	64.0
EBIT margin (%)	64.6	61.1	52.8	46.0	53.2
Net profit margin (%)	55.6	50.2	45.0	42.0	45.1
RoE (%)	17.7	15.4	12.4	8.6	11.6
RoCE (%)	19.7	17.5	13.6	8.9	13.1
Working capital & liquidity 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	49.7	7.8
Valuation ratios					
EV/sales (x)	9.0	8.1	7.9	9.7	6.8
EV/EBITDA (x)	13.3	12.5	12.5	15.8	10.6
P/E (x)	16.3	16.1	17.6	23.1	15.1
P/BV (x)	2.9	2.5	2.2	2.0	1.8

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
10 February 2020	Buy	770	937
17 March 2020	Buy	538	937
24 March 2020	Buy	404	931
12 May 2020	Buy	413	769

Rating track graph



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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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