



## Nesco Ltd. Initiating Coverage

### MARKET DATA -

Networth (₹Cr)	851
P/BV Ratio (FY17) (x)	3.9
EPS (FY17) (₹)	120.6
Market Price (₹)	2,500
P/E Ratio (FY17) (x)	19.5
52 Week High	2,722
52 Week Low	1,540
Market Capitalisation (₹Cr)	3,520
EV (₹Cr)	3,016

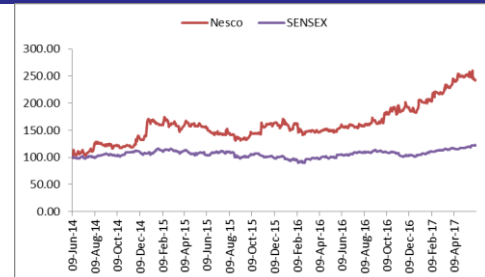
### 1 MONTH AVERAGE DAILY VOLUME ('000)

BSE	0.81
NSE	6.40

### SHARE HOLDING PATTERN (Mar-17) (%)

Promoters	FII, DII	Others
68.2	10.8	21.0

### INDEXED PRICE CHART



Return	3M	6M	12M
Nesco	11.3	25.6	55.9
Sensex	7.8	19.2	15.8

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Established in 1939 April as the New Standard Engineering Company 'NESCO', the Company has created huge value for shareholders post its decision to enter the real-estate business in 1986 by unlocking value from 70 acres of prime factory land situated on the western express highway at Goregaon in Mumbai. The clear intent to create shareholder value along with respectable levels of corporate governance makes NESCO a compelling value unlocking story.

### Current valuations do not account for development potential of land parcel

- The Company trades at an enterprise value of ~ INR 3,040 Cr, indicating a rental yield of 9% on current operational properties
- Current Properties Include
  - Bombay Exhibition Centre ~7 Exhibition Halls totalling 450,000 Sq.ft
  - IT Building 1 & 2, Re-modelled factory sheds, ~300,000 Sq.ft
  - IT Building 3, Grade A commercial property ~600,000 Sq.ft
- NonTotal developable potential at the Goregaon land parcel stands at at least ~6.1 Mn Sq.ft at an FSI of 2

### Clear intent to develop land parcel and unlock value for shareholders

- The Company has started construction of IT building 4 which would have 1,200,000 sq.ft of leasable area and should be ready by FY19E
- The Company also has plans for IT Building 5 with 1,500,000 Sq.ft of leasable area which is slated to be ready by FY21
- The Company plans to extend Bombay Exhibition Centre by 1,500,000 Sq.ft to a total of 1,950,000 Sq.ft by FY20

### Strong financial position

- The Company is Debt free with a cash hoard of ~480 Cr
- Capital Expenditure for total construction activity is ~1,300 Cr and can be met without any borrowings from the current cash position and internal accruals
- Cap-ex is modest at ~3,200/- per Sq.ft and is in line with industry standards for Grade A commercial buildings
- Construction contracts granted to L&T, significantly reducing execution risks

### Clean corporate governance with no evidence cash leakages

- Unlike most real estate companies NESCO has housed all its assets under the same company thereby allowing for transparent accounting disclosures
- Promoters own ~68% of the Company and are thereby well incentivised to create shareholder wealth

### Key Risks

- Increase in competitive intensity with the Reliance Convention Centre in BKC
  - Reliance is currently constructing a large convention centre in BKC, Mumbai totalling ~2 Mn Sq.ft. NESCO's Exhibition centre might see a drop occupancy due to this increased supply
- Delay of construction approvals
  - Construction of IT Building 4 is currently underway, any delays in regulatory approvals would reduce investor returns
  - As the Company is funding cap-ex with internal accruals wealth destruction on account of delays would be limited to opportunity losses.

### Valuations

We have valued the business at a 10% rental yield at maturity ~FY23 (1 year delay assumed for margin of safety). We further discounted the derived valuations by ~15% a year (required investor returns) to arrive at our target price of ~₹3,860 per share implying a 54% upside from CMP.

Given the highly favourable risk-reward offered by this investment opportunity we initiate coverage with a BUY rating.



## About The Business

### Brief background:-

Established in 1939 April as the New Standard Engineering Co. Ltd. (NSE), the company is known as a pioneer in the tool manufacturing segment, as it brought into the country, world class processes and designs for the manufacture of a number of engineering products. While the company originally operated from Byculla, and set up two more plants at Parel and Santacruz. In 1959 it consolidated all operations and moved to a 70 acre estate on the Western Express Highway at Goregaon in Mumbai.

In 1986, the company diversified into the realty business by developing and providing customized built-up space for multinational companies and leading corporates at Goregaon.

In 1992, the company setup an exhibition centre - known as the Bombay Exhibition Centre - at its complex on the Western Express Highway at Goregaon, Mumbai. Starting with an area of 200000 sq. ft., this has now been expanded to 450000 sq. ft. This venue holds the distinction of being the largest exhibition centre promoted by the private sector in India and has hosted over 700 national and international exhibitions, trade fairs since inception. What sets this Venue apart is the presence of various permanently air conditioned hall's ranging from an area of 2,000 Sq. Mts to 20,000 Sq. Mts.

### Current Property Overview:-

Property	Old IT Buildings 1&2	New IT Building 3	Bombay Exhibition Centre
Area Sq.ft	300,000	600,000	450,000
Description	Old factory sheds, remodelled and leased out	Large floor plate, Grade A commercial building	Mumbai's largest business exhibition centre
Clients	TCS, Intelnet	HSBC, Ericsson, KPMG, Religare, Serco, Whirlpool Schlumberger, Sembcorp	Large Business Exhibitions, Political Events, Weddings
Rental Yield (₹/Sq.ft/Month)*	95	150	450
Occupancy*	100%	100%	55%
Total Revenues (₹Cr)	34	108	133
Valuation at ~9% Rental Yield	378	1200	1480

\*Based on primary research, interactions & enquiries

### Asset Mispricing:-

The Market currently values the company at a fair 9% rental yield, having an enterprise value of ~3000 Cr. However the market is not valuing the surplus land bank and its development potential thereby heavily mispricing a quality asset.

### Probable Reasons for the Market Mispricing the Asset:-

- Limited management communication with the investor community, (no conference calls/presentations)
- Market might not want to value future development potential, until construction risks are overcome
- Recent distrust of all real-estate companies, no sell side coverage on the company



**Valuation Methodology & Key Assumptions:-**

(Rs crs)	BASE CASE MODEL							Key Assumptions
	FY17	FY18E	FY19E	FY20E	FY21E	FY22E	FY23E	
<b>NESCO IT Park</b>								
Sq.ft Operational Old Buildings	3,00,000	3,00,000	3,00,000	3,00,000	3,00,000	3,00,000	3,00,000	No Additions
Occupancy Rate Old Buildings	100%	90%	90%	90%	90%	90%	90%	Occupancy to deteriorate to 90%
Monthly Rent Per Sq.ft Old Buildings ₹	95	100	105	110	115	121	127	Rental Escalation at ~5%
Revenues From Old Buildings ₹Cr	34	32	34	36	37	39	41	
Sq.ft Operational New Buildings	6,00,000	6,00,000	6,00,000	18,00,000	18,00,000	33,00,000	33,00,000	Grade A Commercial Buildings
Occupancy Rate New Buildings	100%	100%	100%	79%	92%	84%	92%	New Properties ~2 years to reach 90% Occupancy
Monthly Rent Per Sq.ft New Buildings	150	153	156	159	162	166	169	Rental Escalation at ~2%
Revenues from New Buildings	108	110	112	270	322	548	613	
<b>Total IT Park Revenues ₹Cr</b>	<b>142</b>	<b>142</b>	<b>146</b>	<b>306</b>	<b>359</b>	<b>588</b>	<b>654</b>	
Opex (₹Per Sq.ft Per Month)	11	12	12	13	13	14	15	To grow at ~5% a Year
IT Park Opex ₹Cr	12	12	13	32	34	61	64	
<b>IT Park EBIT ₹Cr</b>	<b>130</b>	<b>130</b>	<b>133</b>	<b>274</b>	<b>325</b>	<b>527</b>	<b>590</b>	
<b>Bombay Exhibition Centre</b>								
Sq.ft Operational	4,50,000	4,50,000	4,50,000	19,50,000	19,50,000	19,50,000	19,50,000	Expansion as planned by Mgmt
Occupancy (%)	55%	60%	65%	32%	43%	47%	55%	Drop in occupancy post massive capacity expansion
Rental Yield ₹Per Sq.ft Per Month	447	447	447	447	447	447	447	No Escalation in pricing
<b>Revenue From Bombay Exhibition Centre</b>	<b>133</b>	<b>145</b>	<b>157</b>	<b>330</b>	<b>451</b>	<b>491</b>	<b>571</b>	
Operating Expenditure Variable ₹Cr	24	27	31	69	99	113	138	% of sales to grow at 5% a year
Variable Op-Ex as a % of sales	18%	19%	20%	21%	22%	23%	24%	(Inflation) given no price hikes at BEC
Op-Ex Per Sq.ft Fixed	11	12	12	13	13	14	15	To Grow at 5% a year
Operating Expenditure Fixed	6	6	7	30	31	33	35	
Total Operating Expenditure ₹Cr	30	34	38	99	130	146	172	
<b>EBIT From Bombay Exhibition Centre</b>	<b>103</b>	<b>111</b>	<b>119</b>	<b>231</b>	<b>321</b>	<b>345</b>	<b>399</b>	
<b>Total Real Estate Vertical</b>								
<b>Total Real Estate Revenues</b>	<b>275</b>	<b>287</b>	<b>303</b>	<b>636</b>	<b>810</b>	<b>1078</b>	<b>1225</b>	
<b>Total Real Estate EBIT</b>	<b>233</b>	<b>241</b>	<b>252</b>	<b>505</b>	<b>646</b>	<b>872</b>	<b>989</b>	
Taxes	79	82	86	172	220	296	336	Taxed at ~34% taxation rate
<b>Real Estate Vertical PAT</b>	<b>154</b>	<b>159</b>	<b>167</b>	<b>333</b>	<b>426</b>	<b>575</b>	<b>653</b>	
<b>Potential Dividend Post DDT</b>	na	na	na	na	<b>362</b>	<b>489</b>	<b>555</b>	Negligible Dividends untill FY21 due to Capex Requirements
<b>Valuation Rental Yield</b>	<b>2750</b>	<b>2873</b>	<b>3032</b>	<b>6356</b>	<b>8097</b>	<b>10784</b>	<b>12253</b>	10% Rental Yield
<b>Rental Yield Method NPV ₹Cr</b>	<b>5437</b>							Discounting FY23 Valuation by ~15% per annum
<b>Valuation Per Share</b>	<b>3858</b>							

**Key Assumptions:-**

- 5% annual escalation in rentals for NESCO IT Park old buildings
- 2% annual rental escalation for NESCO IT Park new buildings due to competition from Lower Parel and BKC areas
- 0% rental escalation for Bombay Exhibition Centre, due to increased competitive intensity
- All projects assumed to be delayed by 1 year as compared to management expectations to build in a margin of safety
- No changes in interest rates in the economy (can heavily impact discount rates)
- Future valuations discounted by 15% per annum to build in a minimum required rate of return for equity shareholders
- IT Park Buildings to have ~70% occupancy in year one which would scale to 90% in the second year
- Bombay Exhibition Centre New Facilities to start with an Occupancy of 20% in FY20 and scale to 50% in year 4

**Upsides not considered in our current valuations**

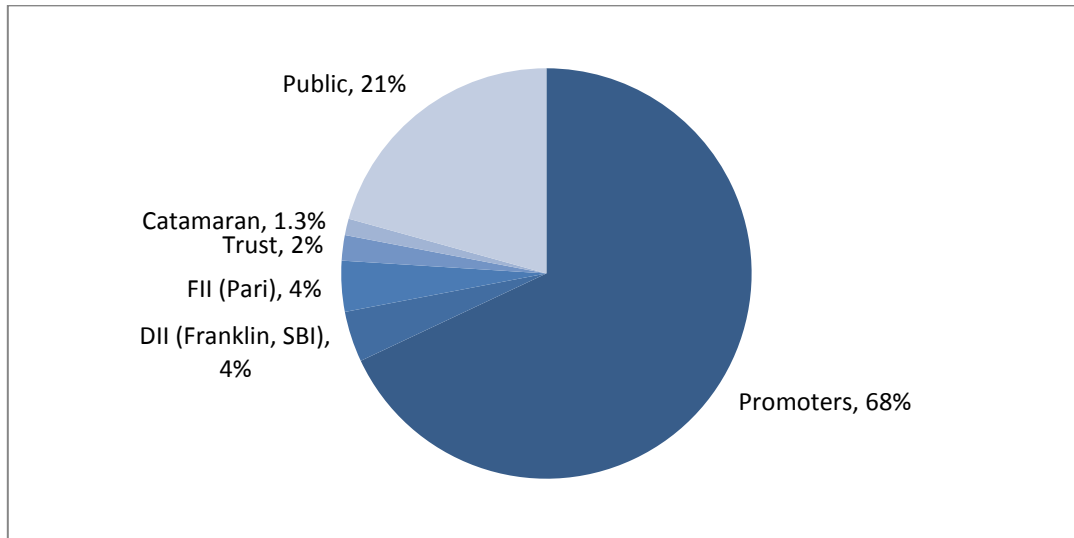
- Metro construction is in full swing NESCO has given ~5 acres for the Mumbai Metro Project
  - Incremental FSI from the same would be used and can increase development potential
  - Commencement of metro operations might result in a moderate rise in rental rates
- Conversion into a REIT would eliminate multiple levels of taxation thereby boosting overall valuations by ~40%
- The Company has also started a hospitality venture, offering tiffin services within the current compound, we have however not valued the same due to execution risks and the fact that the management does not have prior expertise in the segment
- The company would further have development potential and plans to construct a mall and a 5 star hotel, we however do not value the same as of today as no concrete plans have been laid down



**Key Risks:-**

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**Shareholding Pattern:**



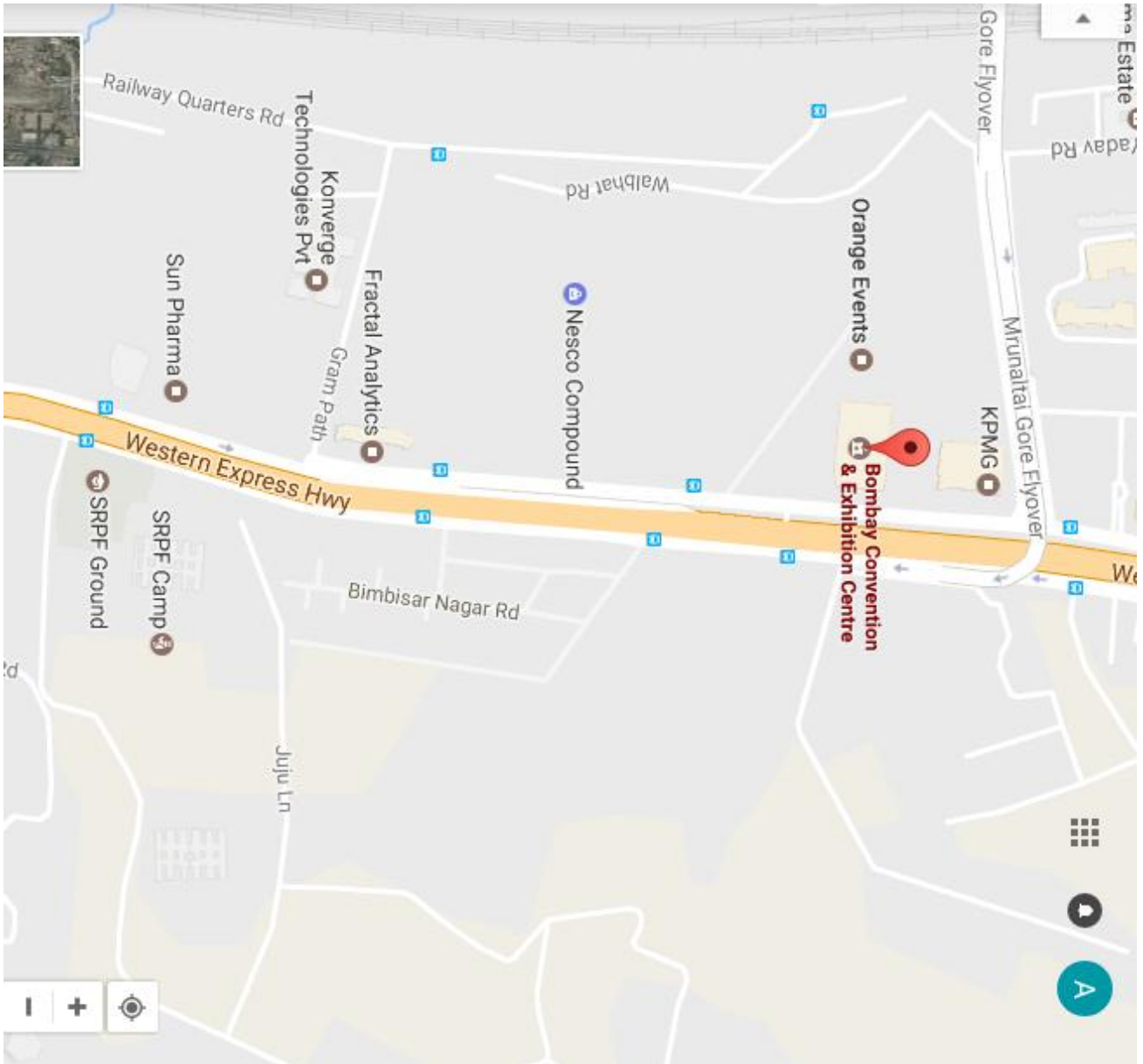
**Valuation:-**

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**Appendix:-  
Location:**



**Appendix:-**

The Bombay Exhibition Centre enjoys high occupancy levels with a large number of marque exhibitions

No.	Exhibition	Organiser	Hall	Schedule	Website
1	Secutech 2017	ABEC Exhibitions & Conferences Ltd.	I, V	6 - 8 APR.	<a href="http://www.abec.asia">www.abec.asia</a>
2	Hair & Beauty Show India 2017	Conferences & Exhibitions P Ltd.	VII	10 - 11 APR.	<a href="http://www.stylespeak.com">www.stylespeak.com</a>
3	Children Baby & Maternity Expo 2017	UBM India Pvt. Ltd	VI	11 - 13 APR.	<a href="http://www.ubmindia.com">www.ubmindia.com</a>
4	Technotex India 2017	FICCI	V, II	12 - 14 APR.	<a href="http://www.ficci.com">www.ficci.com</a>
5	Amtex 2017	Reed Triune Exhibitors P.Ltd	I-A	12 - 15 APR.	<a href="http://www.amtex-expo.com">www.amtex-expo.com</a>
6	India Logistics Expo 2017	Infinity Exhibitions	VI	17 - 19 APR.	<a href="http://www.infinityexpo.in">www.infinityexpo.in</a>
7	Worldbuild India 2017	ABEC Exhibitions & Conferences	I	20 - 22 APR.	<a href="http://www.abec.asia">www.abec.asia</a>
8	India Steel 2017	FICCI	V, II(B&C)	19 - 21 APR.	<a href="http://www.ficci.com">www.ficci.com</a>
9	Fragrance & Flavours India 2017	Procyon Exhibition & Events LLP.	VI	21 - 22 APR.	<a href="http://www.procyon_india.com">www.procyon_india.com</a>
10	Chemspec 2017	Chemical Weekly	I, II-C	25 - 26 APR.	<a href="http://www.koelnmesse-india.com">www.koelnmesse-india.com</a>
11	World Of Facilities 2017	UBM India Pvt. Ltd	V	24 - 26 APR.	<a href="http://www.ubmindia.com">www.ubmindia.com</a>
12	Blech India 2017	Inter Ads-Brooks Exhibitions	VI	27 - 29 APR.	<a href="http://www.interadsindia.com">www.interadsindia.com</a>
13	Fasteners India 2017	Inter Ads-Brooks Exhibitions	V	28 - 29 APR.	<a href="http://www.interadsindia.com">www.interadsindia.com</a>
14	Varsitap 2017	Shri Akhil Bharat Achalgachh VPS Jain Sangh	I,VII, VII-A	28 APR.	N.A.
15	leia Summit 2017	IEIA	II	5 - 6 MAY.	<a href="http://www.ieia.in">www.ieia.in</a>
16	Concrete Show India 2017	UBM India Pvt. Ltd	VI	4 - 6 MAY.	<a href="http://www.ubmindia.com">www.ubmindia.com</a>
17	Aws Summit Event 2017	Neoniche Integrated Solutions P Ltd	V	3 MAY.	<a href="http://www.aws.amazon.com">www.aws.amazon.com</a>
18	Led Expo 2017	Messe Frankfurt	VI	11 - 13 MAY.	<a href="http://www.messefrankfurt.com">www.messefrankfurt.com</a>
19	Edible Oil/Fat Industry 2017	Quartz Business Media Ltd	II	19-20 MAY.	<a href="http://www.quartzltd.com">www.quartzltd.com</a>
20	Global Refining & Petrochemicals Congress 2017	ITEN Media Pvt Ltd	V	25 - 26 MAY.	<a href="http://www.itenmedia.in">www.itenmedia.in</a>
21	Famdent Show 2017	Famdent	VI,I.L.	26 - 28 MAY.	<a href="http://www.famdent.com">www.famdent.com</a>
22	Palm Expo 2017	ABEC Exhibitions & Conferences	I,V,V(bay),VI P Gr.	1 - 3 JUNE.	<a href="http://www.abec.asia">www.abec.asia</a>
23	Index 2017	UBM INDEX Tradefairs Pvt. Ltd	I	8 - 11 JUNE.	<a href="http://www.ubmindia.com">www.ubmindia.com</a>
24	4th Non Woven Tech Asia 2017	Radeecal Exhibitions	V	8 - 10 JUNE.	<a href="http://www.radeecal.in">www.radeecal.in</a>
25	SPS Automation, Motek India & Control India 2017	Messe Frankfurt	VI	8 - 10 JUNE.	<a href="http://www.messefrankfurt.com">www.messefrankfurt.com</a>
26	The Bakery World Expo 2017	Reed Manch Exhibitions India P. Ltd.	V	15 - 17 JUNE.	<a href="http://www.reedmanch.com">www.reedmanch.com</a>
27	Mansi Bazar	Mansi	V(bay)	19 JUNE.	N.A.



## Key Financials

### Profit & Loss

(₹Cr.)	FY14	FY15	FY16	FY17
<b>Net sales</b>	<b>161</b>	<b>195</b>	<b>260</b>	<b>314</b>
YoY (%)		20.7%	33.4%	21.1%
<b>Total expenses</b>				
Traveling and conveyance	9	9	13	18
Employee costs	7	7	9	14
Other Manufacturing Cost	38	40	53	68
<b>EBITDA</b>	<b>108</b>	<b>138</b>	<b>184</b>	<b>215</b>
		28.3%	33.4%	16.4%
<b>EBIDTA (%)</b>	<b>66.9%</b>	<b>71.1%</b>	<b>71.1%</b>	<b>68.3%</b>
Depreciation	11	7	7	8
<b>EBIT</b>	<b>97</b>	<b>132</b>	<b>178</b>	<b>207</b>
Interest	0	0	0	5
Other income	20	28	16	43
Exceptional Items	117	160	194	244
<b>PBT</b>	<b>36</b>	<b>48</b>	<b>61</b>	<b>74</b>
Less: Taxation	30.7%	30.2%	31.4%	30.5%
Effective tax rate (%)	81	112	133	170
<b>PAT</b>		<b>37.6%</b>	<b>19.2%</b>	<b>27.9%</b>
<b>PAT (%)</b>	<b>50.3%</b>	<b>57.3%</b>	<b>51.2%</b>	<b>54.1%</b>

### Key Ratios

Particulars	FY14	FY15	FY16	FY17
EPS (₹)	57.5	79.1	94.3	120.6
Book value (₹)	311.4	382.9	467.0	604.0
Dividend per share (₹)	5.0	6.5	8.5	11.0
Payable Days	42	30	35	87
Debtor Days	25	20	21	14
Inventory Days	10	15	16	16
ROCE (%)	159.2%	92.2%	76.2%	59.7%
Recurring ROE (%)	18.5%	20.7%	20.2%	20.0%
ROA (%)	14.5%	16.5%	16.5%	16.4%
Div Yield (%)	0.6%	0.4%	0.6%	0.5%
<b>Valuation Ratios</b>				
PE (x)	14.0	19.5	15.9	19.5
Cash P/E (x)	12.4	18.4	15.1	18.6
Price/book value (x)	2.6	4.0	3.2	3.9
Market cap/sales (x)	7.1	11.2	8.1	10.5
EV/sales (x)	4.7	9.2	6.5	8.9
EV/EBITDA (x)	7.0	12.9	9.2	13.1
<b>Earnings growth</b>				
EBITDA (%)	NA	28.3%	33.4%	16.4%
EPS (%)	NA	37.6%	19.2%	27.9%
PAT (%)	NA	37.6%	19.2%	27.9%



**Balance Sheet**

(₹Cr.)	FY14	FY15	FY16	FY17
Equity capital	14	14	14	14
Reserves	425	525	644	837
<b>Net worth</b>	<b>439</b>	<b>540</b>	<b>658</b>	<b>851</b>
Total borrowings	0	0	0	0
Non-Current Liabilities	77	89	105	120.26
Current Liabilities	45	48	43	62
<b>Total liabilities</b>	<b>561</b>	<b>676</b>	<b>806</b>	<b>1,033</b>
Net block	160	159	165	188
Capital Work in Progress	5	100	143	262
Investments	0	0	0	0
Others	2	2	47	53
<b>Current assets</b>				
Inventories	4	8	11	13
Debtors	11	11	15	12
Cash	4	5	7	6
Other Current assets	374	392	418	499
<b>Total assets</b>	<b>561</b>	<b>676</b>	<b>806</b>	<b>1,033</b>

**Cash Flow**

(₹Cr.)	FY14	FY15	FY16	FY16
Net profit	117	160	194	244
Depreciation	11	7	7	8
Others	-52	-73	-72	-74
Change in working cap	42	10	-1	18
<b>Op. Cash flow</b>	<b>117</b>	<b>103</b>	<b>127</b>	<b>196</b>
Capex (Net)	-13	-101	-56	-142
Investments	-94	10	-10	-81
Others	0	0	-45	0
<b>Inv. Cash flow</b>	<b>-107</b>	<b>-91</b>	<b>-66</b>	<b>-223</b>
Dividend	-7	-11	-14	-18
Fresh Equity	0	0	0	0
Debt	0	0	0	0
Others	-1	-0	-0	0
<b>Fin. Cash flow</b>	<b>-8</b>	<b>-11</b>	<b>-15</b>	<b>-18</b>
Net change in cash	2.1	0.5	46.6	-45
<b>Opening cash</b>	<b>2.1</b>	<b>4.4</b>	<b>5.0</b>	<b>52</b>
<b>Closing cash</b>	<b>4</b>	<b>5</b>	<b>52</b>	<b>6</b>





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