



Nesco Ltd

NESCO Ltd is in the business of realty. It licenses out office space and runs an exhibition-cum-convention centre on its 60-acre plus (over 2.6mn sqft) estate in Mumbai. It also manufactures surface preparation equipments. It's doubling its leasable office space from next quarter and has plans to double exhibition space and leasable office space further over the next few years.

Independent Equity Research

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Important disclosure on the last page

DCF Value (1-yr out) Rs.1390

Current Price Rs.592

Potential 2.3x

At current price, stock trades at 8.2 times FY12 expected EPS of Rs.72 and 6.3x FY13 EPS with expected earnings growth of 48% & 31% in FY12 & FY13. At our fair value of Rs.1390, The company is debt free and had cash & equivalents of Rs.203cr as on 30/09/11. At our conservative cash-based fair value, the entire company is valued at less than Rs.2000cr, an amount that it can fetch by selling its built up office space only.

Key Data

| | |
|---------------------------|-----------------------|
| Market Cap | Rs.834cr US\$157mn |
| Shares Outstanding | 14mn |
| 52 wk Hi-Lo | 702 – 401 |
| Avg Trading Vol (BSE+NSE) | No. of shares |
| 1 month | 129,400 |
| 3 months | 78,600 |
| 1 year | 207,700 |
| NSE code | NESCO |
| BSE Scrip Code | 505355 |
| BSE Group | B |
| Shareholding% | 30Sep11 |
| Promoters | 62.03 |
| Institutions | 4.44 |
| Others | 33.53 |
| Valuation | FY12E |
| EV/ EBITDA | 4.6x |
| Market Cap/Sales | 4.4x |
| P/E | 8.2x |

Key Investment Points

- NESCO Ltd has a sprawling real estate of over 60 acres (2.6mn sqft+) on Western Express Highway in Goregaon, a north-western suburb of Mumbai. At present less than one third of the estate is being utilised.
- It has India's largest private sector exhibition-cum-convention centre on the estate. Second only to Pragati Maidan of Delhi in size, it occupies 450,000 sqft area (~10 acres).
- It has two IT Parks & other leasable office space totalling ~320,000 sq ft with licensees like TCS e-serve and Intelenet.
- Its third IT Park, a multi-storey tower with 650,000 leasable space is almost ready for occupancy. It is expected to contribute about Rs.70 crore to Revenues in FY13. Bulk of this will flow to PBT.
- Exhibition space is also planned to be double over the next few years in line with growth opportunity in this business.
- Development of leasable office space of another 1.2mn sqft is being planned.
- Nesco is cash-rich and consistently generates operating cash-flow.
- Utilisation of unutilised space (over 2/3rd of the estate) offers immense scope for growth over the years to come.

Products

Exhibition-cum-convention centre, licensing out of IT park & other office space.

Watch out for

- Slowdown in Indian economy can hurt growth in exhibition business during slowdown period.
- Industrial capital goods division is a cyclical business and can get into losses in a down cycle eclipsing part of the realty profits.
- Seasonality and shifting of large exhibitions from one quarter to another can swing quarterly profits widely.





Introduction

Nesco Ltd owns a 60-acre plus estate right on Western Express Highway (Mumbai-Ahmadabad highway) in the north-western suburb of Mumbai. The estate has the advantage of being on the highway, in the midst of well-developed suburb, and near the Airport (7-km from Airport). About 10 acres is currently being used as exhibition-cum-convention centre, about 7 acres is being used by two IT Parks and other office buildings, which are leased out. A third IT Park on ~1.5 acre land is almost ready for occupancy.

Nesco exhibition & convention centre is one of the few large trade exhibition centers in India. It is the second largest exhibition centre after ITPO's Pragati Maidan at New Delhi. Other large exhibition centers in India are at Bangalore, Hyderabad, and Chennai.

Nesco also has an industrial capital goods division, which makes surface preparation equipment and is a market leader in this business. It has three manufacturing units in Gujarat. The division contributed ~16% to revenues over the last one year. This is a cyclical business dependent on industrial capex cycle and did not contribute anything to the profits over the last one year due to depressed cycle. The business has, however, picked up lately. The division's capacity is being expanded at the cost of Rs.2-3 crore.

Investment Arguments

A valuable asset: 60 acre plus real estate in Mumbai

Nesco has a valuable asset in the form of 60 acre plus land in the heart of Mumbai city at Goregaon. The land at 10-minute drive from Airport is right on the Western Express Highway (Mumbai-Ahmadabad national highway No.8). Currently less than 1/3rd of the land is being used to derive revenues and profits. Over 2/3rd of land is still unutilized and is available to drive growth in years to come. The value of the land itself is worth many times its market cap and enterprise value. Premium built up ready spaces in the vicinity sells for around Rs.20,000 per sqft. The land has normal FSI of 1 and IT Parks have FSI of 2. However, development can be significantly higher by purchasing TDRs.

Infrastructure development around the estate is enhancing its value. An east-west flyover is currently being built next to the estate. A local train station (Oshiwara) is proposed to be built right behind the estate.

Exhibition-cum-convention centre business – on a very strong footing

Nesco exhibition centre is built on ~10acres (450,000 sqft). This is the second largest exhibition center in India and the largest in Mumbai. There are very few exhibition centers in India where large scale international exhibitions can take place. Other large exhibition centers are in Delhi, Bangalore, Hyderabad and Chennai. India's share in global trade exhibition business is less than 1%. China's trade exhibition business is about 15 times larger than that of India. As India grows and its trade grows, exhibition business will see exponential growth. In the absence of large land parcels in metros within city, competition to existing centers is unlikely to come. Nesco has land to significantly expand its exhibition center space in line with growth. Location of Nesco center is very advantageous for exhibitors. Being close to airport and right on the highway helps international visitors and movement of heavy display materials.

Nesco center has four halls of different sizes and space for restaurants, seminars, parking, open-air events etc. It has so far hosted over 500 national and international trade fairs, exhibitions, and events since its establishment in 1992. National and International exhibition organizers are its clients.

Reliance Industries had bought 18.5 acre land (FSI 3.2mn sqft) at Bandra-Kurla Complex (BKC) in Mumbai in Jan-06 for Rs.1104 crore for an exhibition-cum-convention center. However, the land is



under litigation and is lying vacant. As per land auction terms, exhibition-cum-convention center was to come within four years. If this comes up, it can be a competition to Nesco. Both BKC and NESCO are equidistant from the Airport. While Nesco is right on the highway to move in heavy machineries or materials for exhibition, BKC too has broad-road connectivity to the highway and is about two kilometers off the highway.

Given the current monopolistic position of Nesco in Mumbai's large trade exhibition space, it works on 100% advance and bookings upto a year in advance. The business generates huge operating cashflows consistently and provides the company with liquidity to develop IT Parks. It had Rs.309 crore as advance and deposits from exhibitors as on 31/03/11.

Nesco's clients (exhibition organizers) mark up over 1000% to exhibition participants on Nesco's per sqft space rental. This indicates that Nesco has a lot of space to raise rentals without affecting clients' profitability. The growth here does not necessarily have to come from increased space, more exhibitions, larger exhibitions; it can simply and also come from increased rentals.

IT Park & Realty development & leasing business – capitalizing on land

Nesco develops IT Parks on its estate and leases built up office premises. It currently has two IT Parks leased to TCS E-serve and Intelenet. It also has 60-70,000 sq ft non-IT Park office space for lease. Under the Software Technology Park Scheme of GoI, there are various benefits available to occupants of IT Parks. Nesco, the developer, gets an extra FSI for IT Park. To capitalize on available land, it has identified IT Park development as a lucrative business. The cashflows from exhibition business can be used to build IT parks. Once built, even IT Parks are strong cashflow generators. Advance and deposits from licensees are substantial (Rs.166cr on 31/03/11) and can be used for further development of the land.

IT Park-3 is nearing completion

Its third IT Park (ITP3) with built-up area of 880,000 sqft and leasable space of 650,000 sqft will be ready for occupancy in QE Mar-12. At full occupancy, ITP3 can contribute about Rs.70cr to Revenues in FY13. Bulk of this revenue will flow to PBT, as expenditure against this revenue is not much. This, alongwith exhibition business, will be a strong growth driver for FY13.

Expansion plans for IT Parks – target 2.5mn sq ft leasable space

IT Park-4 (ITP4) construction is scheduled to begin in Mar-12 and will take two years to be ready. Designs have been finalized with a leading American Architect firm HOK. ITP4 will have 1.2mn sqft space. Nesco has target of developing a total of 2.5mn sqft leasable office space over the next few years. This is the maximum that Nesco can build with its existing FSI. Any further development beyond this will require purchase of extra FSI/TDRs and hence will cost more. The company also plans to redevelop ITP1 and ITP2. Both these are ground floor only structures.

Plan to double exhibition space to 1mn sq ft

Nesco is planning to more than double its exhibition space from the current 450,000 sqft to 1mn sqft. This will be done in phases over the next few years depending on the demand growth for exhibition space. Exhibition business is growing at 15-20% per annum. The growth drivers are higher economic growth, more exhibitions, more number of days of exhibitions, larger exhibitions, higher rentals, better infrastructure and facilities for exhibitors.

The company has applied for FSI of two instead of current FSI of one for exhibition center. If this is approved, it can double the space at the existing exhibition center in phases to 0.9mn sqft without using additional land. If not, the total land area required for 1mn sqft exhibition space will be 23 acres including the currently used land of ~10acres.



Strong operating cash flows ensure sustainable growth, Debt-free cash-rich company

Both Exhibition Center and IT Park businesses generate strong operating cashflows with significant advance from customers. These are more than enough for funding its development plans and capex. It will not require any debt to fund capex for future growth.

Risks / Concerns

Slowdown in Indian economy can impact exhibition business

Slowdown in domestic economy impacts exhibition business. During slowdown, some exhibitions are postponed and number of participants goes down. Though, this happens with a lag, as large exhibitions are planned more than a year or many months in advance with participants locked in.

In FY09, Nesco's exhibition business was adversely impacted due to economic slowdown. The business was also impacted due to terrorist attacks in Mumbai during November-2008. Due to travel advisories for international visitors, some international exhibitions were cancelled.

Cyclicity of Industrial capital goods business can impact profits in a down cycle

Industrial capital goods business caters to industrial capex and is therefore susceptible to capex cycle. FY11 was not a good year for capex and therefore for this division. At the trough of cycle, the division may get into losses too and this may partly eclipse profits of other divisions.

Over supply in commercial real estate

If an oversupply situation develops in premium A-grade office buildings, that will impact lease rents adversely. Currently there is limited supply in premium A-grade commercial buildings. We do not see any problem in leasing out the planned space.

Severe problems in IT Park licensees' businesses can impact performance

IT Park occupants are companies in software, IT & ITES, BPOs, Call Centers. FIs & Banks. If any of the occupants face severe problem in its business, it can have temporary impact on Nesco's performance.

Exhibition business has seasonality

Bulk of exhibition business takes place in second half of financial year. Revenues and profits from this segment fluctuate widely from quarter to quarter due to seasonality. Sometimes, shifting of a large exhibition from one quarter to another can also impact year over year comparison and hence can cause stock price volatility.

Ownership & Management

Nesco is owned 62% by promoters (Patel family led by CMD Sumant J Patel) and ~4% by institutional investors. NRIs-owned Engineering Exports & Imports Pvt. Ltd has been holding 6.35% for a long time. All executive directors are from the promoter family. They are supported by professional managers.

Valuation and key underlying assumptions

We estimate current fair value per share to be around Rs.1390 by discounting free cash flows. Key assumptions are 15% annual growth in exhibition business and 5% annual growth in lease rents for IT Parks. Industrial capital goods division sales growth at 10% annual and cycle-average ebitda margin of 12%.

We calculated Nesco's beta over multiple time frames and against multiple indices. It has the highest beta (1.31) against BSE-smallcap index over five-year timeframe. We chose to use this to build conservatism in our valuation, though its beta with BSE Sensex over the last one year is only 0.82.



Financials

Income Statement

| Rs. Cr. | FY11 | FY12E | FY13E |
|--------------|-------|-------|-------|
| Net Revenues | 134 | 189 | 243 |
| EBIT | 90 | 132 | 174 |
| PBT | 100 | 151 | 197 |
| PAT-Adj. | 69 | 102 | 133 |
| EPS Rupees | 48.69 | 72.20 | 94.56 |

Ratios

| % | FY11 | FY12E | FY13E |
|-------------------------------|------|-------|-------|
| Revenue Gr% | 31.7 | 41.1 | 28.7 |
| EPS Growth % | 37.4 | 48.3 | 31.0 |
| RoE % | 34.5 | 36.5 | 34.4 |
| D/E x | - | - | - |
| Advance from Licensees- Days | 118 | 213 | 145 |
| Advance from Exhibitors -Days | 172 | 172 | 172 |

Balance Sheets

| Rs. Cr. | 31Mar11 | 31Mar12 | 31Mar13 |
|--------------------|---------|---------|---------|
| Assets | | | |
| Net Block | 34 | 184 | 184 |
| CWIP | 90 | - | 100 |
| Net Working Cap | -61 | -105 | -118 |
| Surplus Funds | 166 | 241 | 275 |
| Liabilities | | | |
| Equity Capital | 14 | 14 | 14 |
| Reserves | 214 | 306 | 427 |
| Debt | - | - | - |
| Non-Current Liab | 1 | - | - |

Interim Performance

| Rs.Cr. | Dec10 | Mar11 | Jun11 | Sep11 |
|--------------------|-------|-------|-------|-------|
| Months | 3 | 3 | 3 | 3 |
| Revenues | 61 | 40 | 23 | 35 |
| EBITDA | 45 | 29 | 12 | 27 |
| EBIT | 45 | 28 | 11 | 26 |
| PBT | 45 | 28 | 11 | 26 |
| PAT-Adjusted | 29 | 21 | 7 | 18 |
| Eq Capital | 14.1 | 14.1 | 14.1 | 14.1 |
| EPS Rs. | 20.85 | 14.82 | 5.25 | 12.70 |
| EBIT Margin % | 73.6 | 69.7 | 50.2 | 75.0 |
| Other income/PBT % | - | - | - | - |
| Tax/PBT % | 34.1 | 24.8 | 34.5 | 30.6 |

Multiple Valuation

| | FY11 | FY12E | FY13E |
|------------------|------|-------|-------|
| EV/EBITDA x | 7.0 | 4.6 | 3.5 |
| EV/EBIT x | 7.2 | 4.9 | 3.7 |
| Mkt. Cap/Sales x | 6.2 | 4.4 | 3.4 |
| P/E x | 12.2 | 8.2 | 6.3 |
| Price/Book x | 1.8 | 2.6 | 1.9 |

Free Cash Flow

| Rs. Cr. | FY11 | FY12E | FY13E |
|-------------------------------|-----------|------------|------------|
| NOPLAT | 62 | 89 | 118 |
| Change in Net Working Capital | -9 | -39 | -10 |
| Operating Cash Flows | 71 | 128 | 128 |
| Net Capex & others | 44 | 61 | 100 |
| Free Cash Flow | 26 | 67 | 28 |
| Non-opr. Cash flow | 7 | 12 | 16 |
| Cash Flow to Investors | 34 | 80 | 43 |

Financing Cash Flow

| Rs. Cr. | FY11 | FY12E | FY13E |
|---|-----------|-----------|-----------|
| Post-tax Interest | 4 | - | - |
| Repayment/ (issue) of Debt | - | - | - |
| Equity Share Dividend | 2 | 4 | 9 |
| Equity Buyback/(issue) | - | - | - |
| Inc / (Dec) in surplus cash/Investments | 31 | 76 | 34 |
| Financing Cash Flow | 34 | 80 | 43 |

DCF Valuation

| Key Assumptions | % |
|--|-------------|
| Terminal Growth Rate | 3.0 |
| WACC | 18.5 |
| Cost of Equity | 18.5 |
| Terminal ROIC | 28.5 |
| Outcome | Rs. |
| Fair Value Per Share (Rs.)-1 year out | 1390 |



Important Disclosure

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