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The Trick Is To **Spot Them** At The **Larval Stage**

BSE Code	: 504112
Time Duration	: 1 year
CMP	: ₹247.65 (as on 24 October, 2019)
Target Price	: ₹315

Nelco Ltd.

NELCO to Ride High on Success with New Airlines and Maritime Businesses

Our Tiny Treasure for the month of October is Nelco Limited. Nelco, a part of Tata Group, started business in 1940. The company has been running successfully since then, adding many firsts to its name. It is one of the leading SatCom service providers in India, offering highly reliable B2B data connectivity solutions across the country. The company has two reportable segments viz. (a) Network Systems which involves SatCom services, including equipment sale, maintenance and other allied services, and (b) Automation & Control, comprising integrated security and surveillance solutions (ISSS).

Strong Growth in SatCom Business

Nelco plays a vital role in the development and growth of several important industry segment, such as banking and financial services, renewable energy, mining, offshore oil and gas exploration, by providing SatCom services through very small aperture terminals (VSATs) or SatCom terminals. The company added 23,844 SatCom terminals to its installed base in FY19 as against 9,450 in FY18. The installed base for the company was approximately 71,500 SatCom terminals as on March 31, 2019, which is almost 24% of the total installed base of the industry.

Nelco so far has been a successful and a preferred SatCom service provider in the segments like ATMs and offshore oil and gas exploration. It has strengthened its presence in the banking and finance segment with a base of approximately 50,000 SatCom terminals for off-site ATMs and bank branches and has more than 70% market share of the incremental SatCom deployment in off-site ATMs. Currently, there are about 115,000 ATMs using SatCom terminals, which is likely to increase to around 200,000 in the next 4 years. This will give a further boost to SatCom providers like Nelco in the near future.

The company is also a leader in providing SatCom services to offshore oil rigs. It has signed multi-year contracts with all three major PSU energy companies for the deployment of SatCom terminals in approx. 17,500 oil retail outlets across India, of which it has installed its terminals at 13,465 outlets till now. The three PSU energy companies have already contracted Nelco for 45,000 SatCom terminals and the government has announced for another 50,000 retail outlets, a big win for the company.

FMC License to Enter Aircraft and Ships Segments

Nelco has identified a vital potential in the aircraft and ships segment for digital communication services. During FY19, the company had obtained the in-flight and maritime communication (IFMC) license from the government of India and will be launching the Aero IFC and Maritime communication services in FY20, using SatCom technology.

As per the company, the maritime sector will witness the growth at a faster rate, led by large latent demand, the readiness of the sector, and the availability of the infrastructure. Meanwhile, the Aero IFC market will experience a rise in the long run as there could be delays in the near term due to complexities related to the infrastructural development. It also aims at pursuing its plan of serving markets beyond India. It is in the process to form alliances with Indian and global players and also has plans to enter new sectors in the enterprise market.

In September 2019, Nelco launched its maritime communication services and became the first Indian company to provide broadband services to the maritime sector. In the next 24 months, the company plans to establish itself as a leader in the maritime communications space by introducing the services to more maritime vessels of Indian shipping companies and also facilitating international ships, coming to India, with its communication services in Indian waters. Following this, Nelco and Speedcast International have been awarded a new contract to deliver satellite communications on board a leading Indian cruise line, catering to the Indian domestic and international cruise markets. The maritime sector is going to the next growth segment for the company.

Restructuring and Amalgamation Plans in Process

Nelco has two wholly-owned subsidiaries, named Tatanet Services Limited (TNSL) and Nelco Network Products Limited (NNPL). Under the 'Composite Scheme of Arrangement and Amalgamation', approved by NCLT, the company shall transfer its two independent businesses to NNPL and, consequently, TNSL shall be amalgamated with Nelco Ltd. Post the various regulatory ap-

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DSJ Pvt. Ltd. : C - 105, Trade Center, North Main Road, Near Axis Bank, Opp. Lane no. 6, Koregaon Park, Pune - 411001 | For Customer Service : 020-49072626 OR service@dsji.in

Registered Office Address: 419-A, 4th Floor, Arun Chambers, Tardeo, Next to AC Market, Mumbai - 400034

CIN No. : CIN-U22120MH2003PTC139276 SEBI Research Analyst - INH000006396

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provals, the restructuring would initiate.

TNSL and NNPL are unlisted public limited companies. TNSL has a commercial VSAT service license from the Department of Telecom. It offers these services to enterprise customers across various industry verticals and the government customers. NNPL is yet to commence any business activity. The organizational and operational structure would be simplified post amalgamation. Nelco will earn recurring revenue from VSAT communication service and the revenue from the sale of hardware including VSAT equipment would be earned by NNPL. If the restructuring plan gets executed, the company will get a license in its name, followed by recurring revenue, and would be able to apply for additional licenses for new business opportunities in SatCom services. Also, it would be able to bid for larger projects, going forward.

Industry Prospects

Commercial SatCom services in India are offered under license from the Department of Telecom, Government of India (DoT), that is, VSAT license. However, the satellite transponder space, required to provide such service, is provisioned by the Indian Space Research Organization (ISRO), which is a part of the Department of Space, Government of India (DoS), through Antrix (a company owned by ISRO).

The B2B SatCom services sector has been growing at around 8% per annum in India. However, the growth rate is likely to improve in the coming years due to the impact of the IFMC policy and availability of newer satellite technologies in the country. There have been no new entrants in this sector for a decade, considering the high investment required and the need for government licenses. As far as aircraft and maritime sectors are concerned, both are on the growth trajectory. An increase in passenger air traffic and a growing aircraft fleet will drive the adoption of Aero IFC in India. Asia is one of the largest markets due to the large volume of commercial shipping vessels operating in the region.

Financial Performance

Nelco's consolidated revenue for the quarter Q2FY20 came in at Rs. 53.58 crores as against Rs. 45.19 crores in the corresponding quarter of the last financial year, registering an 18.6% YoY increase. The EBITDA for the quarter grew by 37.9% YoY to Rs. 10.07 crores as against Rs. 7.3 crores in the Q2FY19, with a corresponding margin expansion of 264 bps. The EBITDA margin for the quarter stood at 18.8%. The PAT for the quarter came in at Rs. 1.53 crores as against Rs. 10.09 crores in the corresponding quarter last year, YoY decline of 84.8%. The net profit had surged exceptionally due to the deferred tax adjustments in the September quarter of FY19.

Looking at the full-year numbers for FY19, the revenue jumped by 28% to Rs. 191.01 crores while EBITDA rose by 43% to Rs. 35.99 crores. Further, the company reported a net profit of Rs.22.29 crores, up 84% YoY. In FY19, it added fixed assets, such as plants and equipment, funded through debt, taking the debt-equity ratio to 1.4x by the end of FY19.

Our View

For FY19, Nelco delivered ROE and ROCE of 49.5% and 24.6%, respectively which is the highest as compared to its peers. Its strong presence in banking and financial services and energy sectors to provide SatCom services will continue to drive its top line. Additionally, through the IFMC license, it has forayed into airline and maritime sectors, which would be its next growth drivers. Also, if the restructuring takes place in time, the company would fall in the sweet spot to attain more licenses and bid for larger projects. In the latest quarter, at the operating level, it has performed well but the net profit seems declined due to deferred tax adjustments, made in the last few quarters. Although adverse reactions can be seen at present, we find this as an appropriate time to enter the stock considering the above factors. We see the potential upside of 28% with a target price of Rs. 315 for one year.

Inc/Exp Statement(Consolidated) (Rs in Crore)

Description	201903	201803	201703	201603	201409
Net Sales	191.01	149.61	143.67	199.94	134.31
Total Income	196.01	155.41	149.79	205.58	138.42
Total Expenditure	155.74	125.34	126.73	181.16	129.96
PBIDT	40.27	30.07	23.06	24.42	8.46
PAT	22.20	11.54	5.89	1.77	1.66
Dividend %	15.00				
Adj. EPS(Rs)	9.77	5.31	2.75	0.97	0.85

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Quarter On Quarter (Consolidated) (Rs in Crore)

Particulars	201909	201906	Q on Q Var%	201809	Y on Y Var%
Net Sales	53.58	48.76	9.89	45.19	18.57
Total Expenditure	43.51	38.17	13.99	37.89	14.83
PBIDT (Excl OI)	10.07	10.59	-4.91	7.30	37.95
PAT	1.53	3.38	-54.73	9.99	-84.68
PBIDTM% (Excl OI)	18.79	21.72	-13.49	16.15	16.35
PBIDTM%	20.75	22.42	-7.45	18.68	11.08
PATM%	2.86	6.93	-58.73	22.11	-87.06
Adj. EPS(Rs)	0.67	1.48	-54.73	4.42	-84.84



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