

NESCO

13 November 2020

Reuters: NSEN.NS; Bloomberg: NSE IN

Leasing to stressed sector softens IT Park's growth

NESCO's reported revenue declined by 47% YoY and 7% QoQ in 2QFY21. The decline in revenue on YoY basis was due to a decline in Bombay Exhibition Center (BEC) and Hospitality segment's revenue by 99.6% and 49.4% YoY in 2QFY21 as the BEC was converted into a COVID Care Center by the Municipal Corporation of Greater Mumbai (MCGM). The IT Park revenue increased by 7% YoY but declined by 15% QoQ. The decline on QoQ basis was because of reversal of rent pertaining to rent-free period in 2QFY21 and ~90,000 sq. ft. space in Tower 4 given up by a tenant.

NESCO reported EBITDA of Rs356mn, down 56% YoY and 28% QoQ while EBITDA margin contracted by 1,164bps YoY to 55.4%.

Apart from the decline in revenue (because of reversal of the IT Park revenue owing to extended rent-free period and surrender of space by a tenant), the decline in EBITDA was led by a rise in other expenses by 58% QoQ on account of property tax charges for Tower 4 being recognized from 2QFY21.

We have maintained our Buy rating on the stock with a target price (TP) of Rs759.

Consolidated revenue declines by 47% YoY; NESCO IT Park revenue increases by 7% YoY: NESCO reported revenue of Rs642mn, down 47% YoY and 7% QoQ. NESCO IT Park revenue stood at Rs553mn, up 7% YoY but down 15% QoQ. The YoY increase in IT Park revenue was driven by fresh leasing in IT Tower 4 (1.20mn sq. ft.), which began its operations in FY20. On a QoQ basis, NESCO IT Park revenue declined by 15% because: (1) The company had given rent-free period to some of its tenants in Tower 4. The impact of this rent-free period was accounted in 2QFY21. (2) One of the large tenants in Tower 4 (WeWork), who was also one of the highest paying tenants, surrendered ~90,000 sq. ft. of area because of the hardships experienced by it. As per our earlier discussions with the management, WeWork was occupying ~0.2msf area in Tower 4. The straight line impact of revenue was ~Rs160mn for 2QFY21.

The occupancy in Tower 4 stands at ~75% and that in Tower 3 at ~90% as one of the tenants has shifted from Tower 3 to Tower 4. The collections from IT parks stand at ~80%.

NESCO derived ~86% of the consolidated revenue from IT Parks compared to 93.9% and 43.1% in 1QFY21 and 2QFY20, respectively. This was because the BEC was given as a quarantine center for COVID care to the MCGM and hence only marginal revenue was booked for the same. Also, the Hospitality segment was functioning at minimum capacity, serving meals to COVID patients quarantined at the BEC on request of the MCGM.

BEC reports revenue of only Rs2mn and EBIT loss of Rs33mn in 2QFY21: BEC revenue at Rs2mn declined by 99.6% YoY in 2QFY21. This was in line with our expectation of BEC generating no revenue during the quarter.

The decline in revenue was because the MCGM converted the BEC into a 1,200-bed and 200 ICU bed COVID Care Center with doctors and hygiene teams online.

As per the management, depending on the improvement of the COVID situation, it hopes to see some exhibitions/events resume in 4QFY21.

The management is confident about the strengths and future viability of the BEC business and has decided to continue with the plans of adding ~0.15mn sq. ft. area to the BEC by the end of FY21. The capex expected to be incurred for the same is ~Rs1,000mn, which will be funded by internal accruals. The proposed new hall will be a multipurpose hall for exhibitions, musical events, sporting events, corporate programs and more.

Hospitality revenue declines sharply by 49.4% YoY: Hospitality segment revenue declined by 49.4% YoY to Rs45mn in 2QFY21. The Hospitality segment revenue comprised 7% of the consolidated revenue in 2QFY21 compared to 2.7% and 7.3% in 1QFY21 and 2QFY20, respectively.

We expected marginal revenue (Rs17mn) from the Hospitality segment as majority of employees of the IT Park tenants were working from home and the BEC was converted into a quarantine center. However, the Hospitality segment reported revenue of Rs45mn in 2QFY21, down 49% YoY but up 137% QoQ because the kitchen was providing ~1,000 meals daily to COVID warriors and patients on the request of the MCGM.

BUY

Sector: Real Estate

CMP: Rs510

Target Price: Rs759

Upside: 49%

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Key Data

Current Shares O/S (mn)	70.5
Mkt Cap (Rsbn/US\$m)	35.8/480.1
52 Wk H / L (Rs)	817/380
Daily Vol. (3M NSE Avg.)	190,218

Price Performance (%)

	1 M	6 M	1 Yr
NESCO	(0.7)	24.7	(15.7)
Nifty Index	6.4	38.0	6.5

Source: Bloomberg

Y/E Mar (Rs mn)	2QFY21	1QFY21	QoQ (%)	2QFY20	YoY (%)	2QFY21E	Var (%)
Net sales	642	693	(7.4)	1,206	(46.8)	695	(7.6)
Cost of goods	(29)	(16)	85.3	(64)	(54.6)	(12)	150.1
Employee benefits expenses	(38)	(42)	(9.7)	(49)	(22.4)	(44)	(13.7)
Other Expenses	(219)	(139)	57.8	(284)	(22.9)	(150)	45.4
EBITDA	356	497	(28.4)	809	(56.0)	488	(27.1)
EBITDAM (%)	55.4%	71.6%	-	67.1%	-	70.3%	-
Depreciation and amortization	(66)	(65)	1.0	(75)	(11.6)	(67)	(1.0)
EBIT	290	431	(32.8)	735	(60.5)	422	(31.3)
EBITM (%)	45.1%	62.2%	-	60.9%	-	60.7%	-
Other income	139	220	(37.2)	140	(1.0)	225	(38.4)
Interest expenses	(22)	(14)	54.2	(14)	59.6	(14)	54.2
Extraordinary/Exceptional	-	-	-	-	-	-	-
Profit before tax	406	638	(36.3)	861	(52.8)	632	(35.7)
Tax expense	(82)	(124)	(34.2)	(121)	(32.5)	(159)	(48.6)
Effective tax rate (%)	20%	19%	-	14%	-	25%	-
PAT	325	513	(36.7)	740	(56.1)	473	(31.4)
NPM (%)	50.6%	74.0%	-	61.3%	-	68.1%	-

Source: Company, Nirmal Bang Institutional Equities Research

EBITDA declines by 56% YoY and margin contracts by 1,164bps: NESCO reported EBITDA of Rs356mn, down 56% YoY and 28% QoQ while EBITDA margin contracted by 1,164bps YoY to 55.4%.

Apart from the decline in revenue (because of reversing of IT Park revenue owing to extended rent-free period and surrender of space by a tenant), the decline in EBITDA was led by a rise in other expenses by 58% QoQ on account of property tax charges for Tower 4 being recognized from 2QFY21.

The combined effect of rise in property tax and decline in revenue led to margin contraction. This also led to a decline in EBIT margin for the IT Park segment to 72% in 2QFY21 compared to 85% in 1QFY21 and 86% in 2QFY20.

High cash balance increases comfort on the stock: The company had net cash balance of Rs7.53bn as on 2QFY21 (Rs6.85bn as on 4QFY20, Rs5.9bn as on 2QFY20) on the balance sheet, which gives us a high comfort level on the stock.

Maintain Buy with a TP of Rs759: Our TP of Rs759 for NESCO is NAV based using SOTP method. Our valuation is driven by the restructuring of the NESCO IT Park, increase in rentable space of the BEC and the expected increase in rental rates. Our optimism is supported by a healthy balance sheet, consistently positive free cash flow and the management's growth-oriented focus (with expansion of the flagship business over the next 20 years).

Exhibit 1: Quarterly segment wise revenue and EBIT performance:

All amounts in INR mn

Segment Revenues	2QFY21	1QFY21	QoQ(%)	2QFY20	YoY(%)	2QFY21E	Var(%)
NESCO IT Park	553	651	(15.0)	519	6.5	653	(15.3)
Bombay Exhibition Centre	2	1	113.8	516	(99.6)	-	NA
Indabrator	42	23	87.3	83	(49.0)	25	70.2
NESCO Hospitality	45	19	137.3	88	(49.4)	17	163.7
Total	642	693	(7.4)	1,206	(46.8)	695	(7.6)

Segment EBIT	2QFY21	1QFY21	2QFY20	QoQ(%)	YoY(%)
NESCO IT Park	401	553	446	(27.6)	(10.1)
Bombay Exhibition Centre	(33)	(34)	409	(4.9)	(108.0)
Indabrator	(2)	(1)	4	42.8	(148.7)
NESCO Hospitality	(1)	(21)	16	(93.7)	(108.0)
Total	365	497	876	(26.6)	(58.3)

Source: Company, Nirmal Bang Institutional Equities Research

Consolidated financials

Exhibit 2: Income statement

Y/E March (Rsmn)	FY19	FY20	FY21E	FY22E	FY23E
Net sales	3,609	4,317	2,923	4,207	5,022
Growth YoY (%)	12.4	19.6	(32.3)	43.9	19.4
COGS	228	176	119	172	205
Operating Costs	565	719	623	749	833
Other Expenses	489	640	433	624	745
EBITDA	2,328	2,782	1,747	2,662	3,238
EBITDA growth (%)	6.5	19.5	(37.2)	52.4	21.7
EBITDA margin (%)	64.5	64.4	59.8	63.3	64.5
Depreciation	119	224	436	438	441
EBIT	2,209	2,558	1,311	2,224	2,798
EBIT (%)	61.2	59.2	44.9	52.9	55.7
Interest expense	47	60	60	60	60
Other income	317	425	447	469	493
Earnings before tax	2,479	2,923	1,698	2,632	3,230
Tax- total	675	584	427	663	813
Rate of tax (%)	27.2	20.0	25.2	25.2	25.2
Net profit	1,804	2,339	1,270	1,970	2,417
% growth	1.0	29.6	(45.7)	55.1	22.7
EPS (FD)	26	33	18	28	34
% growth	1.0	29.6	(45.7)	55.1	22.7

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Balance sheet

Y/E March (Rsmn)	FY19	FY20	FY21E	FY22E	FY23E
Share capital	141	141	141	141	141
Reserves and surplus	11,564	13,434	14,589	16,381	18,581
Net worth	11,705	13,575	14,730	16,522	18,722
Loans	-	-	-	-	-
Other financial liabilities	534	979	999	1,009	1,019
Provisions	35	38	48	48	49
Deferred tax liability	179	260	260	260	260
Other non-current liabilities	128	236	223	223	232
Total capital employed	12,581	15,088	16,258	18,061	20,282
Property, plant and equipment	7,220	7,778	10,155	13,767	15,543
Investments	-	-	-	-	-
Loans	36	44	44	44	44
Other non-current assets	391	844	844	844	844
Total non-current assets	7,647	8,666	11,043	14,655	16,431
Trade payables	108	146	99	118	124
Other financial liabilities	386	381	381	254	392
Other current liabilities	406	477	453	475	499
Provisions (current)	7	5	5	6	6
Total current liabilities	906	1,009	938	852	1,020
Inventories	90	86	58	84	100
Investments	5,312	6,722	5,522	3,522	4,022
Trade receivables	180	160	109	184	220
Cash and bank balance	87	134	136	140	200
Current tax assets (net)	78	-	-	-	-
Other current assets	93	328	328	328	328
Total current assets	5,840	7,431	6,153	4,258	4,871
Net current assets	4,934	6,422	5,215	3,406	3,850
Total capital employed	12,581	15,088	16,258	18,061	20,282

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Cash flow

Y/E March (Rsmn)	FY19	FY20	FY21E	FY22E	FY23E
Profit after tax	1,804	2,339	1,270	1,970	2,417
Depreciation	119	224	436	438	441
Finance costs	47	60	60	60	60
Other income	(317)	(425)	(447)	(469)	(493)
Working capital changes	69	146	24	(178)	137
Operating cash flow	1,722	2,344	1,344	1,822	2,562
Capital expenditure	(1,459)	(359)	(3,150)	(4,050)	(2,217)
Net cash after capex	263	1,985	(1,806)	(2,228)	345
(Purchase)/sale of investments	(9)	(985)	1,647	2,469	(7)
Proceeds/repayment of borrowing	-	-	-	-	-
Finance costs	(47)	(60)	(60)	(60)	(60)
Dividend & dividend distribution tax	(195)	(467)	(114)	(177)	(218)
Other	(39)	(425)	336	(0)	-
Cash flow from financing	(282)	(953)	161	(238)	(278)
Total cash generation	(29)	47	2	4	60
Opening cash balance	116	87	134	136	140
Closing cash & bank balance	87	134	136	140	200

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Key ratios

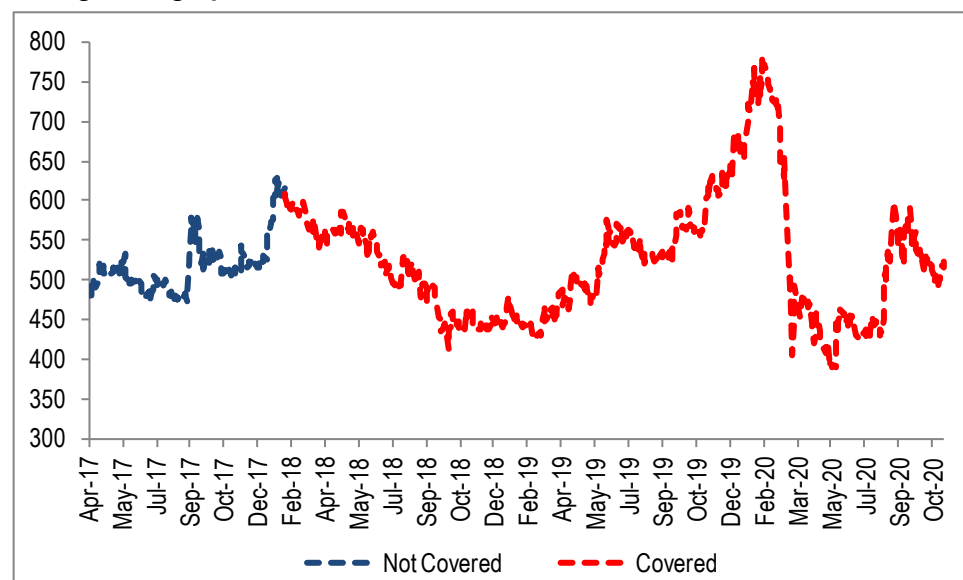
Y/E March (Rsmn)	FY19	FY20	FY21E	FY22E	FY23E
Profitability and return ratios					
EBITDA margin (%)	64.5	64.4	59.8	63.3	64.5
EBIT margin (%)	61.2	59.2	44.9	52.9	55.7
Net profit margin (%)	50.0	54.2	43.5	46.8	48.1
RoE (%)	15.4	17.2	8.6	11.9	12.9
RoCE (%)	17.6	17.0	8.1	12.3	13.8
Working capital & liquidity ratios					
Receivables (days)	18	14	14	16	16
Inventory (days)	138	169	169	169	169
Payables (days)	172	302	302	250	220
Current ratio (x)	6.4	7.4	6.6	5.0	4.8
Valuation ratios					
EV/sales (x)	9.9	8.3	12.3	8.5	7.1
EV/EBITDA (x)	15.4	12.9	20.5	13.5	11.1
P/E (x)	19.9	15.4	28.3	18.2	14.9
P/BV (x)	3.1	2.6	2.4	2.2	1.9

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
20 May 2020	Buy	393	769
21 May 2020	Buy	395	769
17 August 2020	Buy	518	769
23 September 2020	Buy	556	759
13 November 2020	Buy	510	759

Rating track graph



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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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