



3R MATRIX

	+	=	-
Right Sector (RS)	✓	✗	✗
Right Quality (RQ)	✓	✗	✗
Right Valuation (RV)	✓	✗	✗

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	✓	↔	✓
RQ	✓	↔	✓
RV	✓	↔	✓

Reco/View

	Change
Reco: Buy	↔
CMP: Rs. 357	
Price Target: Rs. 435	↔

↑ Upgrade
↔ Maintain
↓ Downgrade

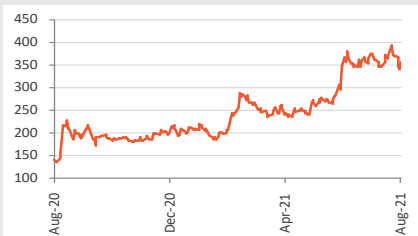
Company details

Market cap:	Rs. 2,221 cr
52-week high/low:	Rs. 404/132
NSE volume: (No of shares)	7.7 lakh
BSE code:	533269
NSE code:	WABAG
Free float: (No of shares)	4.9 cr

Shareholding (%)

Promoters	21.7
FII	15.9
DII	3.8
Others	58.61

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4	33	79	154
Relative to Sensex	5	12	7	43

Sharekhan Research, Bloomberg

Capital Goods

Sharekhan code: WABAG

Result Update

Summary

- We maintain Buy on Va Tech Wabag with unchanged target price of Rs 435 considering strong balance sheet led by robust operating and free cash-flow generation allays investors concerns on future growth.
- Well-funded strong order book at Rs 10,400 crore provides comfort on collections and execution fronts.
- Structural growth tailwinds owing to leading global positioning, the government's spends on water supply, and impetus on industrial waste-water management.
- In the recent years, the management has seen government push in the segment to have water availability and improve water security and sanitation. This helps the company going ahead as increase in government capex will further add to the thriving business of the company.

Q1FY22 numbers were slightly above our estimates with revenue/ EBITDA/ PAT at Rs. 658 crore/ Rs. 33 crore/ Rs. 15 crore (up 53%, up 13%, up 189% y-o-y) owing to increased execution and the operations are at almost pre-COVID level. GPM stood at 19% (-581bps y-o-y) whereas OPM was reported at 5% (-174 bps y-o-y) due to extended stay costs on few projects and increase in cost of metals and plastics. The order book stands at over Rs. 10,400 crore including framework orders whereas order intake is over Rs. 1,445 crore. Of the total order intake, 96% is from the EPC segment. The EPC segment's revenues grew by 71% y-o-y to Rs. 550 crore. During the quarter, the pace of execution has improved slowly and the activities are at pre-COVID levels. The company has received a good intake or orders and are expecting the business environment to improve. In the recent years, the management has seen government push in the segment to have water availability and improve water security and sanitation. Thus, they expect many large projects coming up in metros as well as good order prospects in The Middle East and Africa. The management expects the current order book to provide visibility for the next 3-3.5 years. The management mentioned that most Indian orders covers 60-70% inflation in raw material prices, whereas, government orders do not cover 100% inflation of commodities as part is fixed costs. Other income high due to dividend income from associate entity of Rs 5.5 crore and forex gain of Rs. 7 crore. The company turned net cash positive in FY2021 from a peak net debt of Rs. 433 crore in FY2019 to net cash of Rs. 44 crore in FY2021. The company is well placed to receive continuous flow of orders having strong project execution track record and marquee clients led by its asset-light business model and strengthened balance sheet profile.

Key positives

- Order book stands at over Rs. 10,400 crore including framework orders whereas order intake is over Rs. 1,445 crore.

Key negatives

- GPM stood at 19% (-581 bps y-o-y) whereas OPM was reported at 5% (-174 bps y-o-y) due to extended stay costs on few projects and increase in cost of metals and plastics.

Our Call

Valuation – Maintain Buy with unchanged PT of Rs. 435: Va Tech Wabag is on a strong earnings growth trajectory going ahead with concerns of high leverage led by increasing working capital now behind it. A well-funded strong order book provides comfort on execution and collections going ahead. Further, the government's focus is expected to remain on water-related investments providing healthy order intake tailwinds for the company going ahead. At CMP, the stock trades at a P/E of 12/10x its FY2023/24E earnings which we believe is attractive considering its strong net earnings growth outlook and strengthened balance sheet. Hence, we maintain Buy with an unchanged PT of Rs 435.

Key Risks

- Decline in domestic capex and impact on gross margins due to a rise in commodity costs.
- Problems in execution could impact earnings growth.

Valuation (Consolidated)

	Rs cr			
Particulars	FY21	FY22E	FY23E	FY24E
Revenue from Operations	2,834	3,235	3,677	4,132
Operating Profit Margin (%)	7.7	8.4	8.7	9.0
RPAT	100	134	180	218
AEPS (Rs.)	16.1	21.5	29.0	35.1
P/E (x)	22.1	16.6	12.3	10.2
Price/ Book (x)	1.6	1.4	1.3	1.1
EV/EBITDA (x)	10.0	8.3	7.1	6.2
RoCE (%)	10.9	12.9	14.2	14.8
RoE (%)	7.8	9.0	10.9	11.7

Source: Company; Sharekhan estimates

Strong quarter

Q1FY22 numbers were slightly above our estimates with revenue/ EBITDA/ PAT at Rs. 658 crore/ Rs. 33 crore/ Rs. 15 crore (up 53%, up 13%, up 189% y-o-y) owing to increased execution and the operations are at almost pre-COVID level. GPM stood at 19% (-581 bps y-o-y) whereas OPM was reported at 5% (-174 bps y-o-y) due to extended stay costs on few projects and increase in cost of metals and plastics. The order book stands at over Rs. 10,400 crore including framework orders whereas order intake is over Rs. 1,445 crore. Of the total order intake, 96% is from the EPC segment. The EPC segment's revenues grew by 71% y-o-y to Rs. 550 crore. During the quarter, the pace of execution has improved slowly and the activities are at pre-COVID levels. The company has received a good intake of orders and are expecting the business environment to improve.

Government push on infra projects:

The government is focussing making clean water available to its masses and thus creating thriving hygienic conditions in the country. The company plans to ride on digital and advanced technologies in the post-Covid world and bring in artificial intelligence (AI) for water treatment. VATW has been successful in pioneering removal of micro pollutants and has also licensed and worked upon the Nereda technology, which will play a significant role in wastewater treatment in future. The focus on water crisis, conservation and the governments' spending through various schemes and policies to meet the ever-growing demand for water presents a huge opportunity for future business. The company has state-of-the-art research and development centres that have developed advanced technologies to treat wastewater to directly be used as water of potable grade.

Concall highlights:

Covid impact: Despite challenges amid the second wave of COVID-19, the company has done well during the quarter. Construction activities and supply chain are currently at pre-COVID levels. However, the management believed that the margins could have been up 1.5-2% in the absence of the second wave COVID-19.

Order book: Order book stands at over Rs. 10,400 crore including framework orders whereas order intake is over Rs. 1,445 crore. Of the total order intake, 96% is from the EPC segment. The management expects current order book to provide visibility for the next 3-3.5 years.

Russia Project: The management believed that they have consolidated their market position in the oil & gas sector further, by securing a EPC order worth \$165mn (about Rs 1,230 Crore) from Amur Gas Chemical Complex LLC., CAGCC') in Russia. VATW shall perform the scope of Design, Engineering, Procurement, Supply and Supervision of the facilities during erection and commissioning including process & technology equipment, piping system, electrical, instrumentation / control systems and building and architectural materials. The company won this order amidst highly competitive circumstances.

Marafiq Project: The project in Saudi Arabia (Marafiq) is nearing completion and all engineering work and equipment deliveries have been completed and installation is underway. The management expects pre-commission activities to commence in FY2022.

Jeddah Airport Project: The project at Jeddah Airport 2 in Jeddah, Saudi Arabia is progressing well with engineering works and ordering nearly complete and construction activity from customer side is underway.

Romania Project: This project involves 15 years of operation and maintenance work and has been commissioned ahead of schedule and the company is awaiting clearance for commencement of operations. VATW expects maintenance works to begin from H2FY22.

Doha Project: The project from public works authority for rehabilitation of south Doha, to treat sewage from 2022 football world cup stadium, is expected to be completed by year end.

Tunisia Project: The engineering works and ordering are completed with civil work at peak. The equipment delivery and installation are underway.

Government Impetus: In recent years, the management has seen government push in the segment to have water availability and improve water security and sanitation. Thus, Va Tech expects many large projects coming up in metros as well as good order prospects in Middle East and Africa.

Book Keeping: The management mentioned that most Indian orders covers 60-70% inflation in raw material costs, whereas, government orders do not cover 100% inflation of commodities as part is fixed costs. Other income high due to dividend income from associate entity of Rs 5.5 crore and forex gain of Rs.7 crore.

Result (Consolidated)

					Rs cr
Particulars	Q1FY22	Q1FY21	y-o-y (%)	Q4FY21	q-o-q (%)
Total Income	658	431	53%	999	-34%
EBITDA	33	29	13%	76	-57%
Depreciation	3	3	-8%	3	-2%
Interest	20	21	-8%	22	-11%
Other Income	14	1	-	2	-
PBT	20	7	176%	55	-63%
Total Tax	6	2	147%	11	-47%
Reported PAT	15	5	189%	44	-67%
Adjusted PAT	15	5	189%	44	-67%
EPS	2.34	0.81	189%	7.04	-67%
Margins (%)			Bps		Bps
EBITDA Margin	5.0%	6.7%	-174	7.6%	-268
PAT Margin	2.2%	1.2%	104	4.4%	-217
Tax Rate	28%	31%	-	20%	-

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Investments by Governments and Private Sectors will play a vital role in water

Waste-water technology is primarily used by municipal authorities to treat waste-water in various Indian cities. Rising urban population in major Indian cities has created demand for waste-water treatment facilities, to balance the population with the availability of freshwater. In the coming years, desalination is expected to be a prominent technology in Indian cities for filtration of water, due to the rising scarcity of fresh water. Global water treatment industry has undergone a sea change over the past decade. This is owing to rising awareness about water scarcity, innovations in water treatment technologies and investments by governments and private sectors in this segment. The global water & wastewater treatment market is estimated to reach a size of \$211 billion by 2025, at a CAGR of 6.5% over 2019-2025. The India water and wastewater treatment (WWT) technology market is partially consolidated, with the major players accounting for a moderate share of the market. Key players in the market include Veolia, Suez, Thermax Limited, VA TECH WABAG LIMITED, and DuPont. The increasing demand for water-treatment facilities across the world will have a positive impact on the growth of the market in the coming years.

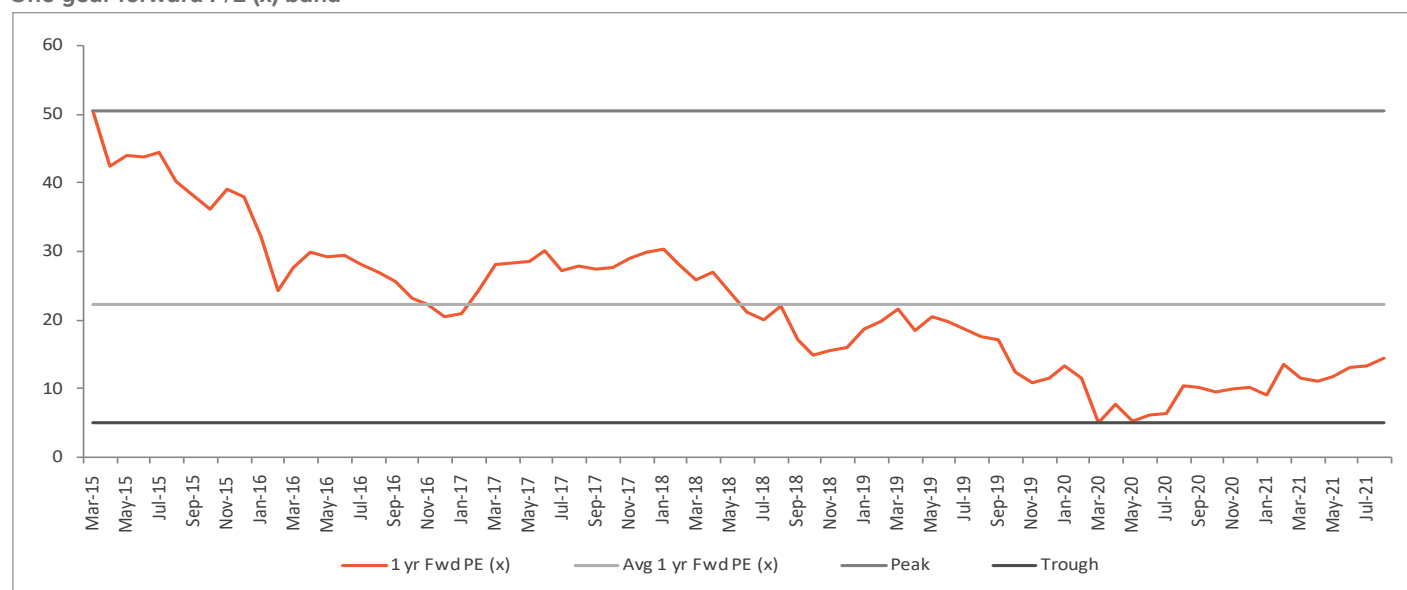
■ Company outlook - Creating Enduring Value

The company has a strong order book of Rs. 9,584 crore (3.4x FY2021 consolidated revenues, largely executable with financial closure of HAM projects) funded by the Centre, multilateral agencies or sovereign entities which provides comfort on cash collections and execution. The company generated Rs. 380 crore of net operating cash flows over FY2020-FY2021 and managed to curtail the rising working capital requirement, which strengthened the balance sheet. Further, the company generated free cash flows of Rs. 300 crore during FY2020-FY2021, which is also aided by its asset light model. Going ahead, we expect the company to generate over Rs. 300 crore of free cash flows over FY2022-FY2023 led by strong operating cash flow generation, tighter control on working capital and lower capex requirements. The company is well-placed to receive continuous flow of orders having strong project execution track record and marquee clients led by its asset-light business model and strengthened balance sheet profile.

■ Valuation - Maintain Buy with unchanged PT of Rs. 435

Va Tech Wabag is on a strong earnings growth trajectory going ahead with concerns of high leverage led by increasing working capital now behind it. A well-funded strong order book provides comfort on execution and collections going ahead. Further, the government's focus is expected to remain on water-related investments providing healthy order intake tailwinds for the company going ahead. At CMP, the stock trades at a P/E of 12/10x its FY2023/24E earnings which we believe is attractive considering its strong net earnings growth outlook and strengthened balance sheet. Hence, we maintain Buy with an unchanged PT of Rs 435.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Va Tech Wabag is known for its innovative and successful solutions in the water engineering sector around the globe. The company is a systems specialist and full-service provider focusing on the planning, installation and operations of drinking and wastewater plants for local government and industry in the growth markets of Asia, North Africa, Middle East and Central and Eastern Europe. The company represents a leading multinational player with a workforce of over 1,600 and has companies and offices in more than 20 countries.

Investment theme

Va Tech Wabag has unique technological knowhow, based on innovative, patented technologies and long-term experience. For over 95 years, the Company has been facilitating access to clean and safe water to over 500 million people. With decades of rich experience, over 6,000 projects across multiple sectors and state-of-the-art plants in over 20 countries, WABAG is a globally respected organisation. Va Tech Wabag is on a strong earnings growth trajectory going ahead with concerns of high leverage led by increasing working capital now behind it. The company's well funded strong order book provides comfort on execution and collections going ahead. Further, the government's focus is expected to remain on water-related investments providing healthy order intake tailwinds for the company going ahead.

Key Risks

- ♦ Slowdown in economic activity might impact order intake visibility and delay in execution of existing order book might impact revenue booking.
- ♦ Hike in interest rate might impact the profitability as the company has a stretched working capital situation.

Additional Data

Key management personnel

Malay Mukherjee	Chairman (Non-Executive Independent Director)
Rajiv Mittal	Managing Director & Group CEO
Pankaj Sachdeva	Chief Executive Officer
Sandeep Kumar Agrawal	Chief Financial Officer
R Swaminathan	Company Secretary & Compliance Officer

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Mittal Rajiv Devaraj	15.61
2	Jhunjhunwala Rekha Rakesh	8.04
3	Varadarajan Subramanian	3.51
4	Government Pension Fund – Global	3.22
5	Norges Bank	3.21
6	KBI Global Investors	2.75
7	SarafShivnarayan J	2.57
8	SBI Funds Management Pvt Ltd	2.54
9	Massachusetts Institute of Technology	2.52
10	Basera Home Finance	2.41

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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