Sharekhan by BNP PARIBAS

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Stock Update

Result Update

Va Tech Wabag Ltd

On firm ground, valuation attractive

Capital Goods	Sharekhan code: WABAG
Reco/View: Buy ↔	CMP: Rs. 248 / Price Target: Rs. 333 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We maintain a Buy on Va Tech Wabag (Va Tech) with an unchanged PT of Rs. 333, considering attractive valuations and improving earnings outlook.
- Q1FY2023 revenues lagged estimates, while net profit doubled to Rs 30 crore y-o-y largely driven by forex gains and export benefits.
- Order book stood at Rs.9,472 crore (excluding framework contracts) providing strong revenue visibility.
- Domestic and overseas order pipeline remained buoyant. The company is focusing on technological projects, which are backed by multi-lateral funding agencies or central government. This would provide better margins and ensure timely and better cash flows.

VA Tech's consolidated results missed our expectations on the revenue and core operating fronts, while beat in net profit was largely led by higher other operating income. Its revenue declined by 4% y-o-y to Rs 632 crore (vs our estimate of Rs.725 crore). Revenue mix comprised 54% from India and the rest from overseas markets. Gross margins improved by 208 bps y-o-y to 20.7% due to decline in raw material costs. Lower sales, higher employee costs and other expenses led to decline in operating profit by 30% y-o-y to ~Rs 23 crore (vs our estimate of Rs 48 crore). OPM also declined by 136 bps y-o-y to 3.6%. However, if we consider company's classification of EBITDA (which includes forex gain and export benefits received from the government), EBITDA has increased by 30% y-o-y to Rs. 52 crore and EBITDA margin has improved to 8.2% vs 6.1% in Q1FY22. Adjusted net profit doubled to Rs. 30 crore due to higher other income (Rs. 33 crore vs Rs. 14 crore in Q1FY22). Order backlog at the end of the quarter stood at Rs .9,472 crore (excluding framework contracts) providing strong revenue visibility. The order book comprises of EPC and O&M contracts. Order intake was ~ Rs 1,092 crore.

Key positives

- GPM rose 208bps y-o-y led by execution of higher margin projects
- Net profit doubled to Rs. 30 crore supported by other operating income such forex gain and export benefits.
- Order intake was healthy at Rs. 1,092 crore. The company received orders from Reliance Industries and couple of orders from Senegal and Russia.

Key negatives

- Revenue declined by 4% y-o-y owing to lumpiness in order execution.
- There has not been any progress on framework contracts in Libya. Excluding these orders, the order backlog stands at Rs 9,472 crore.
- Net debt of Rs 70 crore vs net cash of Rs 10crore in Q4FY22.

Management Commentary

- The company would focus on engineering and procurement (EP) orders with lesser focus on construction. This shall lead to better margins and cash flows.
- The company is taking up only those projects which are funded by multi-lateral agencies or central government and international projects backed up by letter of credit (LCs).
- The company aims to clock double-digit revenue growth in FY23 and expects to improve OPM.
- Va Tech is seeing Russia as a big opportunity as many European companies are not keen on doing business with Russia. The ~Rs 1,200 crore project in Russia, which is in consortium with Amur Gas Chemicals is likely to start execution soon.

Revision in estimates – We have revised our estimates downwards to factor in slower revenue and profit growth.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 333 : Va Tech Wabag is on an improving revenue and earnings growth trajectory as concerns of high leverage, as higher working capital woes are now behind it. A well-funded, strong order book provides comfort on execution and collections going ahead. Further, the government's focus on water-related investments provides healthy order intake tailwinds for the company going ahead. The company is focusing on water desalination, reuse, recycle and affluent treatment plants. At CMP, the stock trades at a P/E of ~8x its FY2024E earnings, which we believe is undemanding considering its optimistic net earnings growth outlook. Hence, we maintain a Buy with an unchanged PT of Rs. 333.

Key Risks

- Lumpiness in order book execution could impact its revenue and cash flows.
- Non-conversion of two framework contracts (~11% of the order book) into executable orders would lead to a decline in the order book.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue from Operations	2,834	2,979	3,374	3,817
OPM (%)	7.7	8.0	8.4	8.7
PAT	100	132	159	185
AEPS (Rs.)	16.1	21.2	25.5	29.8
P/E (x)	15.4	11.7	9.7	8.3
P/BV (x)	1.1	1.0	0.9	0.8
EV/EBITDA (x)	6.9	6.5	5.4	4.3
RoCE (%)	10.9	12.2	13.1	13.6
RoE (%)	7.8	8.9	9.8	10.4

Source: Company; Sharekhan estimates

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		↔	

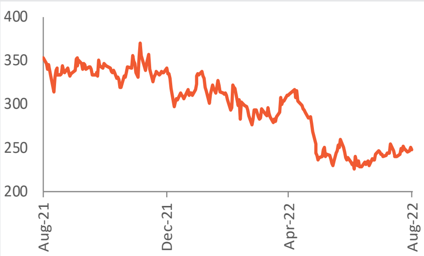
Company details

Market cap:	Rs. 1,542 cr
52-week high/low:	Rs. 375 / 216
NSE volume: (No of shares)	2.9 lakh
BSE code:	533269
NSE code:	WABAG
Free float: (No of shares)	4.9 cr

Shareholding (%)

Promoters	21.7
FII	15.4
DII	3.3
Others	59.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.2	3.7	-15.5	-29.7
Relative to Sensex	-8.9	-9.0	-20.9	-37.0

Sharekhan Research, Bloomberg

Results miss estimates, healthy order intake

VA Tech's consolidated results missed our expectations on the revenue and core operating fronts, while beat in net profit was largely led by higher other operating income. Its revenue declined by 4% y-o-y to Rs 632 crore (vs our estimate of Rs.725 crore). Revenue mix comprised 54% from India and the rest from overseas markets. Gross margins improved by 208 bps y-o-y to 20.7% due to decline in raw material costs. Lower sales, higher employee costs and other expenses led to decline in operating profit by 30% y-o-y to ~Rs 23 crore (vs our estimate of Rs 48 crore). OPM also declined by 136 bps y-o-y to 3.6%. However, if we consider company's classification of EBITDA (which includes forex gain and export benefits received from the government), EBITDA has increased by 30% y-o-y to Rs. 52 crore and EBITDA margin has improved to 8.2% vs 6.1% in Q1FY22. Adjusted net profit doubled to Rs. 30 crore due to higher other income (Rs. 33 crore vs Rs. 14 crore in Q1FY22). Order backlog at the end of the quarter stood at Rs .9,472 crore (excluding framework contracts) providing strong revenue visibility. The order book comprises of EPC and O&M contracts. Order intake was ~ Rs 1,092 crore.

Strong order book and promising order pipeline

The company expects order momentum to continue over the next fiscal with its focus on winning international orders and works related to the industrial domain. The same would lead to margin improvement going forward. In the domestic markets, it is optimistic on strong order intake from various schemes such as Namami Gange Program, Swacch Bharat Mission, Jal Jeevan Mission, etc. The company is one of the bidders for a 400 MLD Chennai desalination plant and the project is likely to awarded in 2-3 quarters. Total order inflows during Q1FY23 were Rs 1,000 crore, out of which 58% came from India, 42% from the rest of the world (ROW). The industrial order constituted 38% of the total intake, while municipal orders commanded a higher share at 62%.

Q1FY2023 Investor update and conference call highlights:

- **Revenue and margin guidance in FY23:** While the company refrained from giving any clear-cut margin guidance, It indicated that it is aiming to achieve double digit revenue growth. Growth in operating profit will be higher than the revenue growth given that it has better margin orders and commodity prices are cooling off.
- **Focus on quality projects with better margins and cash flows:** The company reiterated its focus on bidding for those projects which are backed by multi-lateral agencies and central government. It is targeting orders from Namami Gange program, Swachh Bharat and several desalination projects in India and abroad. As the company operates in emerging countries and work on pre-payments and LCs. Further, currently most of its orders are now EP (engineering and procurement) with less construction component providing better margin profile and shorter working capital cycle.
- **Net debt and working capital cycle:** The company has a net debt of ~Rs 70 crore as on June 30, 2022 vs net cash of Rs 10 crore as of March,2022. The working capital cycle on an average has been 55-70 days.
- **Not bidding for 'Nal Se Jal' program:** Va Tech is not bidding for projects under Nal Se Jal' scheme as most of the water is supposed to be surplus or ground water. There is no plan to use desalination or recycled water.
- **Recent order wins:** Key contracts in the order book include Rs 428 crore order from Reliance Industries' Jamnagar refinery, Rs 383 crore RO plant order from Senegal and Rs 145crore order from Korea's DLE&C company for a water treatment package for a EuroChem methanol production facility in Kingisepp, Russia.
- **Russia project to resume soon –** Customer has issued a notice to resume work on this ~ Rs 1,200 crore project. The project will be executed in consortium with Amur Gas Chemicals.
- **Outlook:** Ordering momentum is expected to continue over the next fiscal. The company continues to focus on expanding its global reach in water treatment plants. The company's focus on engineering and supply of components especially in international markets has helped margins despite commodity inflation.

Results (Consolidated) | **Rs cr**

Particulars	Q1FY23	Q1FY22	YoY%	Q4FY22	QoQ%
Net Sales	**631.7**	**658.0**	**(4.0)**	**891.9**	**(29.2)**
Operating Profit	**22.8**	**32.7**	**(30.2)**	**71.5**	**(68.1)**
Adjusted PAT	30.1	14.4	109.1	46.3	(34.9)
Reported PAT	30.1	14.4	109.1	46.3	(34.9)
Adj. EPS (Rs.)	4.8	2.3	109.1	7.4	(34.9)
Margin (%)			BPS		BPS
OPM	**3.6**	**5.0**	**(136)**	**8.0**	**(440)**
#EBITDA (including other operating income)	8.2	6.1	210	8.0	18
NPM	4.8	2.2	258	5.2	(42)
Tax rate	**24.8**	**23.9**	**92**	**19.0**	**578**

Source: Company Data; Sharekhan Estimates, #as reported by the company

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 a demand for waste-water treatment facilities to balance the population with the availability of fresh water. In the coming years, desalination is expected to be a prominent technology in Indian cities for water filtration due to the rising scarcity of fresh water. The 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 and wastewater treatment market is estimated to reach a size of $211 billion by 2025 at a CAGR of 6.5% over 2019-2025. India's water and wastewater treatment (WWT) technology market is partially consolidated, with 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. Rising demand for water-treatment facilities across the world will have a positive impact on the market's growth in the coming years.

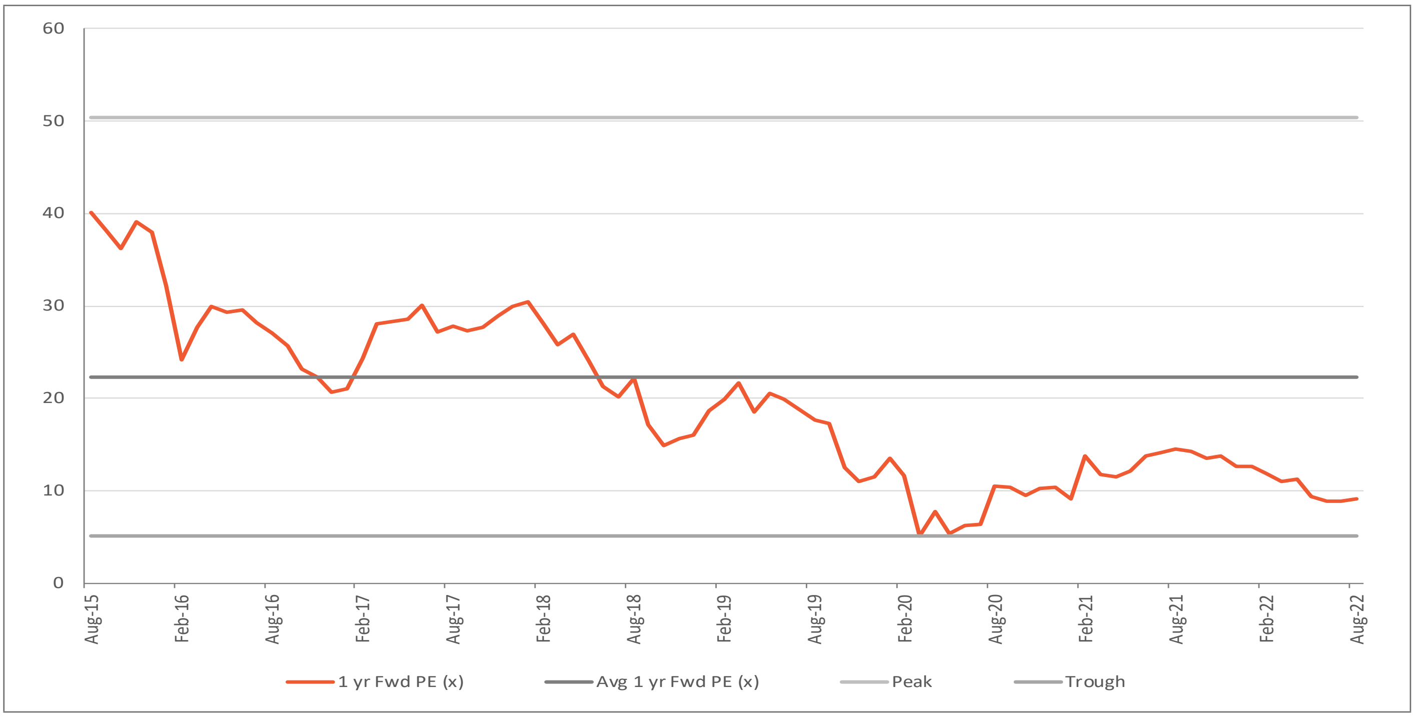
■ Company outlook – Creating enduring value

The company has a strong order book of over Rs. 10,000 crore (over 3x FY22 consolidated revenue), funded by the Centre, multilateral agencies, or sovereign entities, which provide comfort on cash collections and execution. The company has managed to curtail rising working capital requirements by bidding for quality orders which are either government or multi-lateral agencies backed. The company is well placed to receive a continuous flow of orders having a strong project execution track record and marquee clients, led by its asset-light business model and strengthened balance sheet profile.

■ Valuation – Maintain Buy with an unchanged PT of Rs. 333

Va Tech Wabag is on an improving revenue and earnings growth trajectory as concerns of high leverage, as higher working capital woes are now behind it. A well-funded, strong order book provides comfort on execution and collections going ahead. Further, the government's focus on water-related investments provides healthy order intake tailwinds for the company going ahead. The company is focusing on water desalination, reuse, recycle and affluent treatment plants. At CMP, the stock trades at a P/E of ~8x its FY2024E earnings, which we believe is undemanding considering its optimistic net earnings growth outlook. Hence, we maintain a Buy with an unchanged PT of Rs. 333.

One-year forward P/E (x) band



Source: Company, Sharekhan Research

About the 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 growth markets of Asia, North Africa, the 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 know-how, 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. The company 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.
- Non-conversion of two framework contracts would reduce the order book.

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	15.6
2	Jhunjhunwala Rekha Rakesh	8.0
3	Federated Hermes Investments	4.0
4	Norges Bank	3.6
5	Government Pension Fund – Global	3.6
6	Varadarajan Subramanian	3.5
7	KBI Global Investors	3.5
8	Federated Hermes Inc	3.5
9	Saraf Shivnarayan J	2.6
10	SBI Funds Management Pvt Ltd	2.5

Source: Bloomberg

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 detoriating 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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