Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Va Tech Wabag Ltd

Mixed Q3; Robust order pipeline to boost growth

Capital Goods	Sharekhan code: WABAG

Reco/View: Buy	↔	CMP: **Rs. 327**	Price Target: **Rs. 420**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

Summary

- We maintain Buy on Va Tech Wabag (Va Tech) with an unchanged PT of Rs. 420, considering a robust order pipeline with improving margin profile and attractive valuation.
- Q3FY2023 was low on execution; however, margin expansion was a positive surprise, driven by favourable mix of projects and a decline in input cost.
- Order intake was robust at Rs. 1,886 crore in 9MFY2023. Order book stood at Rs. 8,878 crore and the company has near-term order visibility of Rs. 5,000-5,000 crore from the domestic market.
- Va Tech is focusing on quality, technologically advanced, and well-funded industrial as well as EP orders to improve profitability and cash flows on a sustainable basis.

VA Tech Wabag's (Va Tech) consolidated results were below our expectations. However, considerable expansion in OPM despite the decline in revenue was a positive surprise. The company's revenue declined by 12.6% y-o-y to Rs. 652 crore (vs. our estimate of Rs. 886 crore). Operating profit declined marginally by 1.8% y-o-y to Rs. 74.9 crore despite lower revenue (vs. our estimate of Rs. 70.9 crore). There was a sharp decline in raw-material cost, which led to OPM inching higher by 126 bps y-o-y to 11.5% (vs. our estimate of 8%). Better Improved OPM was a result of execution efficiencies and better mix of projects. Adjusted net profit grew by 8.6% y-o-y to Rs. 47.1 crore (vs. our estimate of Rs. 54.2 crore). Order backlog at the end of the quarter stood at Rs. 8,878 crore (excluding framework contracts). Order intake in 9MFY2023 has been ~Rs. 1,886 crore.

Key positives

- OPM rose by 126 bps y-o-y and 433 bps q-o-q to 11.5%, driven by the decline in input cost. Further, execution efficiencies and better mix of projects increased margins.
- 9MFY2023 order intake was healthy at Rs. 1,886 crore. The company expects orders worth Rs. 5,000-Rs. 5,500 crore to materialize in the next 6-7 weeks.
- Interest cost declined by 27% y-o-y due to reduction in debt.
- Core working capital cycle now stands at 90 days.

Key negatives

- Employee expenses as a percentage of sales were higher on a y-o-y and q-o-q basis.
- EPC, which is a low-margin business, still comprises 63% of its total order book

Management Commentary

- Va Tech is aiming strong top line growth with increased focus on considerable improvement in the bottom line and cash flows.
- The company's focus on pursuing engineering and procurement (E&P) projects with no construction component and industrial (rather than municipal) and international projects would lead to better margins, faster cash generation, and improving working capital cycle in the long term.
- The company is a preferred bidder for orders worth Rs. 5,000-5,500 crore in the domestic market, which shall be awarded in the next 6-7 weeks. Demand for ZLD solutions is increasing due to stricter pollution norms to be followed by industries.
- The company is pursuing opportunities in Russia, which are backed by LCs and multi-lateral agencies. The company would not be taking any financial risk on these projects.

Revision in estimates – We have maintained our estimates for FY2022-FY2024E.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 420: VA Tech has shown strong recovery in execution and margins in 9MFY2023, while its working capital cycle and debt levels have seen improvement. We believe with a strong order pipeline and focus on margin improvement and cash flow generation, the company is on the cusp of a healthy growth trajectory, backed by its better-quality order book. The company is optimistic about growth opportunities present in desalination, ZLD, and water treatment solutions in both domestic and export markets. A well-funded, strong order book provides comfort in execution and collections going ahead. At the CMP, the stock trades at P/E of ~11x its FY2024E earnings, which we believe is undemanding, given an optimistic outlook on business and earnings. Hence, we maintain our Buy rating with an unchanged price target (PT) of Rs. 420.

Key Risks

- Lumpiness in order book execution could impact its revenue and cash flows.
- Non-conversion of two framework contracts (11-12% of the order book) into executable orders would lead to a decline in the order book.

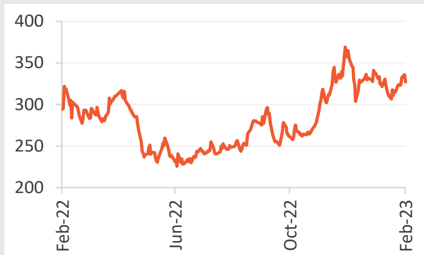
Company details

Market cap:	Rs. 2,034 cr
52-week high/low:	Rs. 375/ 216
NSE volume: (No of shares)	4.2 lakh
BSE code:	533269
NSE code:	WABAG
Free float: (No of shares)	5.0 cr

Shareholding (%)

Promoters	19.1
FII	14.4
DII	3.3
Others	63.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.7	21.0	35.2	10.0
Relative to Sensex	-1.0	23.2	33.6	6.1

Sharekhan Research, Bloomberg

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue from Operations	2,834	2,979	3,283	3,797
OPM (%)	7.7	8.0	6.9	8.0
RPAT	100	132	160	193
AEPS (Rs.)	16.1	21.2	25.7	31.1
P/E (x)	20.3	15.4	12.7	10.5
P/BV (x)	1.4	1.3	1.2	1.1
EV/EBITDA (x)	9.1	8.6	8.6	6.1
RoCE (%)	10.9	12.2	12.9	13.7
RoE (%)	7.8	8.9	9.9	10.8

Source: Company; Sharekhan estimates

Mixed Q3; Margin expansion was the highlight of the quarter

VA Tech's consolidated results were below our expectations. However, considerable expansion in OPM despite the decline in revenue was a positive surprise. The company's revenue declined by 12.6% y-o-y to Rs. 652 crore (vs. our estimate of Rs. 886 crore). Operating profit declined marginally by 1.8% y-o-y to Rs. 74.9 crore despite lower revenue (vs. our estimate of Rs. 70.9 crore). There was a sharp decline in raw-material cost, which led to OPM inching higher by 126 bps y-o-y to 11.5% (vs. our estimate of 8%). Better OPM was a result of execution efficiencies and better mix of projects. Adjusted net profit grew by 8.6% y-o-y to Rs. 47.1 crore (vs. our estimate of Rs. 54.2 crore). Order backlog at the end of the quarter stood at Rs. 8,878 crore (excluding framework contracts). Order intake in 9MFY2023 has been around Rs. 1,886 crore.

Strong order pipeline in the near term

Order backlog at the end of the quarter stood at Rs. 8,878 crore (excluding framework contracts of ~Rs. 1,159 crore). Order intake in 9MFY2023 has been around ~Rs. 1,886 crore. Out of the total order intake, 68% came from the rest of the world (ROW) and 32% came from India. Industrial order constituted 55% of the total intake, while municipal orders had a lower share at 45%. The company expects order momentum to gain further pace in Q4FY2023, with a strong domestic and international pipeline. The same would lead to margin improvement going forward, as most orders are EP and industrial orders. In domestic markets, the company is optimistic about strong order intake from various schemes such as Namami Gange Program, Swacch Bharat Mission, ZLD solutions, and desalination projects in the long term.

Q3FY2023 investor update and conference call highlights:

- **Order intake pipeline is robust:** The company is pursuing several projects in domestic and international geographies. The company's order intake comprises desalination plants, recycle, reuse, and water affluent treatments. The company expects Rs. 5,000-5,500 crore of order inflows from three major projects, comprising desalination water and industrial water treatment projects from the domestic market in the next 6-7 weeks. The company is a preferred bidder in all these projects, which are based on advanced technologies. These orders are funded by multilateral agencies. Moreover, the Middle East region is witnessing a strong enquiry pipeline as elevated oil prices continue to drive investment and capex momentum there.
- **Focus on improving margin and cash flows:** The company's focus is to increase the share of EP business and reduce the construction component. This would help improve margins, bottom line as well as cash flows by reducing the construction risk in contracts.
- **Various government schemes in the domestic market bode well for long-term growth:** The company stated that various government initiatives such as Namami Gange, Swachh Bharat Mission, and Jal Jeevan Mission would continue to drive investments and, thereby, fuel the company's order book going ahead.
- **Focus on increasing O&M business:** Currently, O&M order book is Rs. 3,200 crore, which is 37% of its order book. In Chennai desalination plant, 3 bidders including VA Tech were technically evaluated. The company is a preferred bidder in this project as well.
- **Pursuing opportunities in Russia:** The company is pursuing orders in Russia and, given the sanctions imposed on Russia, the competitive intensity has declined. Hence, Va Tech plans to pursue opportunities in Russia but would only take orders that have an irrevocable letter of credit with a cover of US$100 mn, and the company will not be taking any financial risk.

Results (Consolidated) Rs cr

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Revenue	651.6	745.5	-12.6	750.4	-13.2
Operating Profit	74.9	76.2	-1.8	53.7	39.3
Depreciation	2.2	2.3	-6.4	2.2	-2.2
Interest	16.2	22.3	-27.2	17.0	-4.6
Other Income	2.0	5.5	-62.6	22.9	-91.1
PBT	58.5	56.3	3.9	57.4	2.0
Tax Expense	13.3	10.9	22.3	13.2	1.2
Adjusted PAT	47.1	43.4	8.6	46.7	1.0
EPS (Rs.)	7.6	7.0	8.6	7.5	1.0
Margins (%)			BPS		BPS
OPM	11.5	10.2	126	7.2	433
NPM	7.2	5.8	141	6.2	102
Tax Rate	22.8	19.4	343	23.0	-17

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Investments by governments and private sectors will play a vital role

Wastewater technology is primarily used by municipal authorities to treat wastewater in various Indian cities. Rising urban population in major Indian cities has created a demand for wastewater 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 on account of 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, 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.

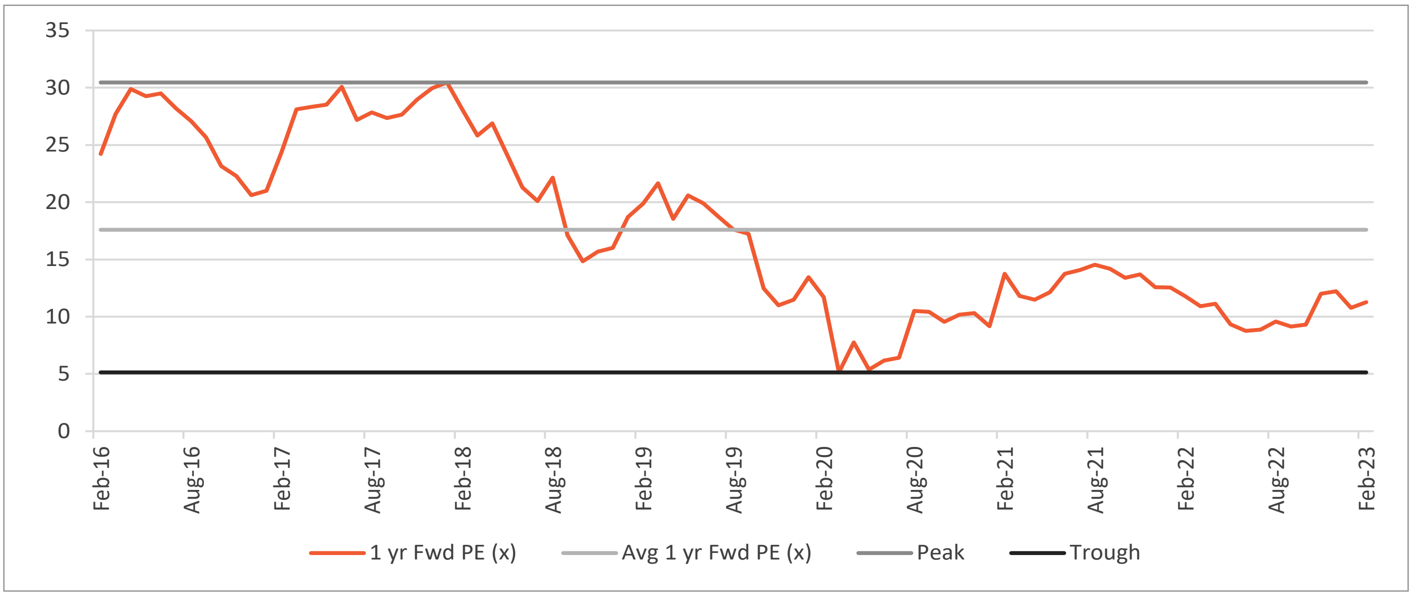
■ Company outlook - Creating enduring value

The company has a strong order book of over Rs. 10,000 crore (over 3x its FY2022 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 backed by the government or multi-lateral agencies. 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. 420

VA Tech has shown strong recovery in execution and margins in 9MFY2023, while its working capital cycle and debt levels have seen improvement. We believe with a strong order pipeline and focus on margin improvement and cash flow generation, the company is on the cusp of a healthy growth trajectory, backed by its better-quality order book. The company is optimistic about growth opportunities present in desalination, ZLD, and water treatment solutions in both domestic and export markets. A well-funded, strong order book provides comfort in execution and collections going ahead. At the CMP, the stock trades at P/E of ~11x its FY2024E earnings, which we believe is undemanding, given an optimistic outlook on business and earnings. Hence, we maintain our Buy rating with an unchanged PT of Rs. 420.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

VA Tech 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 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. The company is a globally known organisation with decades of rich experience, over 6,000 projects across multiple sectors, and state-of-the-art plants in over 20 countries. 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 executable order book.

Additional Data

Key management personnel

Rajiv Mittal	Chairman and Managing Director
Mr. Pankaj Malhan	Deputy MD and Group CEO
Mr. Skandaprasad Seetharaman	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	Federated Hermes Investments	4.04
4	Norges Bank	3.57
5	Government Pension Fund – Global	3.55
6	Varadarajan Subramanian	3.51
7	KBI Global Investors	3.50
8	Federated Hermes Inc.	3.49
9	Saraf Shivnarayan J.	2.57
10	SBI Funds Management Pvt. Ltd.	2.54

Source: Bloomberg (old data)

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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Ms. Binkle Oza; Tel: 022-61150000; email id: complianceofficer@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com.

Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA, Tel: 022 - 67502000/ Fax: 022 - 24327343. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O/ CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183.