

Company Update

Capital Goods

Target price: Rs612

Earnings revision

(%)	FY24E	FY25E
Sales	↑ 13.0	NA
EBITDA	↑ 39.6	NA
PAT	↑ 55.7	NA

Target price revision

Rs612 from Rs353

	Dec '22	Mar '23	Jun '23
Promoters	19.1	19.1	19.1
Institutional investors	19.4	19.8	20.2
MFs and others	2.5	2.5	2.7
FIs/Ins Co	0.7	0.7	0.7
FIs	16.2	16.6	16.8
Others	61.5	61.1	60.7

Source: NSE

ESG disclosure score

Year	2020	2021	Chg
ESG score	32.8	32.8	0.0
Environment	2.8	2.8	0.0
Social	16.9	16.9	0.0
Governance	78.6	78.6	0.0

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

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INDIA

VA Tech Wabag

BUY

Maintained

Rs509

A visit to India's desalination 'capital'

Desalination is gaining foothold in India and VA Tech Wabag (Wabag) has the largest market share in building and operating desalination plants in the country. (source: I-Sec Research) It was the EPC contractor for the country's largest desalination plant, in Nemmeli, Chennai, for which it is also doing operations and maintenance. We visited the plant and met the management for an insight on the company's business strategy and outlook. Below are the key takeaways:

- ▶ **Second desalination project in India:** Nemmeli desalination plant (capacity: 110mld) is the largest operating desalination plant in India. It is the second such plant in Chennai. It meets 10% of the total Chennai water supply. Wabag was the EPC contractor of the project and is doing O&M for it. It also recently won a contract to build a 400mld desalination plant in Chennai at an order value of Rs36bn. Half of the order value is for EPC and half is towards O&M.
- ▶ **Steps for desalination:** The reverse osmosis process is being used to desalinate water in the Nemmeli plant. This process is being used in >70% of desalination plants worldwide. Details of the process: **Step 1:** Water is brought to the plant from sea through a pipe using gravity. **Step 2:** The water is then filtered. **Step 3:** Filtered water is pumped at a high pressure through a reverse osmosis chamber to filter out pure water. **Step 4:** The water is now mineralised again and then supplied for domestic consumption.
- ▶ **Desalination is gaining foothold in India:** Chennai is the desalination capital of India with 210mld capacity under operation and another 550mld under development. Of a requirement of 1,600mld of potable water in Chennai, desalination plants are currently supplying 15% and this is expected to ramp up to 30% FY26E. Besides, Gujarat set up a desalination plant in CY21. Note that Wabag has a major share in the desalination plants in India. Mumbai is also looking to set up its first desalination plant of Rs35bn and the contract is likely to be awarded in the next 24 months.
- ▶ **Strong accretion of orders in FY23; margins to see uptick:** Wabag had a strong run in FY23 and is reasonably confident of good order inflow in FY24 based on the enquiry pipeline and tender prospects. We are baking-in Rs65bn of order inflow for FY24E and 170bps margin improvement over the next two years.

Table 1: Desalination plants in India

Desalination plant	Capacity (mld)	Development	Developer	Year
Tamil Nadu				
Minjur	100	DBO	IVRCL - Befesa	2010
Nemmeli	110	EPC+ O&M	VA Tech Wabag	2013
Nemmeli - 2	150	EPC+ O&M	Cobra + Tecton	UC
New desalination plant	400	EPC+ O&M	VA Tech Wabag	UC
Gujarat				
Dahej PCRIPR	100	DBO	L&T - Tecton	2021

Source: Industry, I-Sec Research

Market Cap	Rs31.6bn/US\$385mn	Year to Mar	FY22	FY23	FY24E	FY25E
Reuters/Bloomberg	VATE.BO/VATW IN	Revenue (Rs mn)	29,793	29,605	40,742	46,133
Shares Outstanding (mn)	62.2	Rec. Net Income (Rs mn)	1,319	1,954	2,845	3,170
52-week Range (Rs)	517/240	EPS (Rs)	21.2	31.4	45.7	51.0
Free Float (%)	80.9	% Chg YoY	19.8	48.1	45.6	11.4
FII (%)	16.8	P/E (x)	24.0	16.2	11.1	10.0
Daily Volume (US\$/000)	2,902	CEPS (Rs)	22.8	32.8	47.4	52.7
Absolute Return 3m (%)	31.4	EV/E (x) (Incl. Indus)	13.3	12.3	12.3	11.3
Absolute Return 12m (%)	115.1	Dividend Yield (%)	0.2	0.4	0.4	0.4
Sensex Return 3m (%)	11.9	RoCE (%)	11.1	3.6	17.0	16.8
Sensex Return 12m (%)	25.4	RoE (%)	8.9	12.5	16.6	15.9

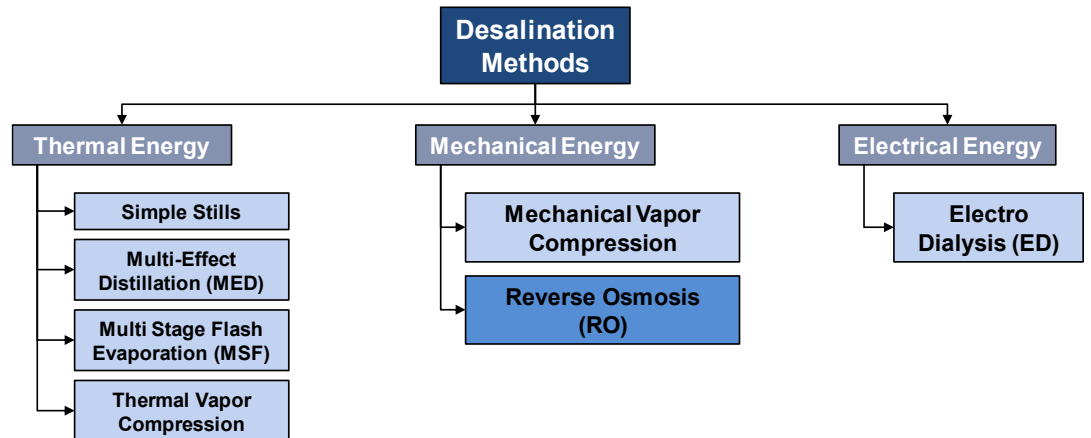
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- ▶ **View and Valuation:** Ordering opportunity in the water segment is likely to remain strong on back of: a) *Namami Gange* phase-2 project, b) order inflow from industries due to 'zero liquid discharge' requirements, c) pick-up in water desalination and water treatment plants in overseas markets, especially Middle East and Russia. Wabag is looking to drive growth by focusing on desalination and water reuse segments where competitive intensity is low. Moreover, the book to bill ratio of 4x FY23 revenues (highest in its history) bodes well for revenue visibility. We introduce FY25 estimates and maintain **BUY** with revised target price of **Rs612** per share.

About desalination

Desalination is the process of removing salts, minerals and other impurities from seawater, brackish water and wastewater effluent to make it fit for human consumption – either direct domestic use or industrial consumption.

Chart 1: Methods of desalination



Source: Industry, I-Sec research

Chart 2: Reverse osmosis desalination process



2 Pre-Treatment
 RO membranes are highly sensitive to variations in water quality, etc. A raw water pre-treatment system is thus placed to remove any impurities before the process starts.

4 Remineralization
 The freshwater extracted via the RO process is treated in accordance with the type of end-use and legal requirements.

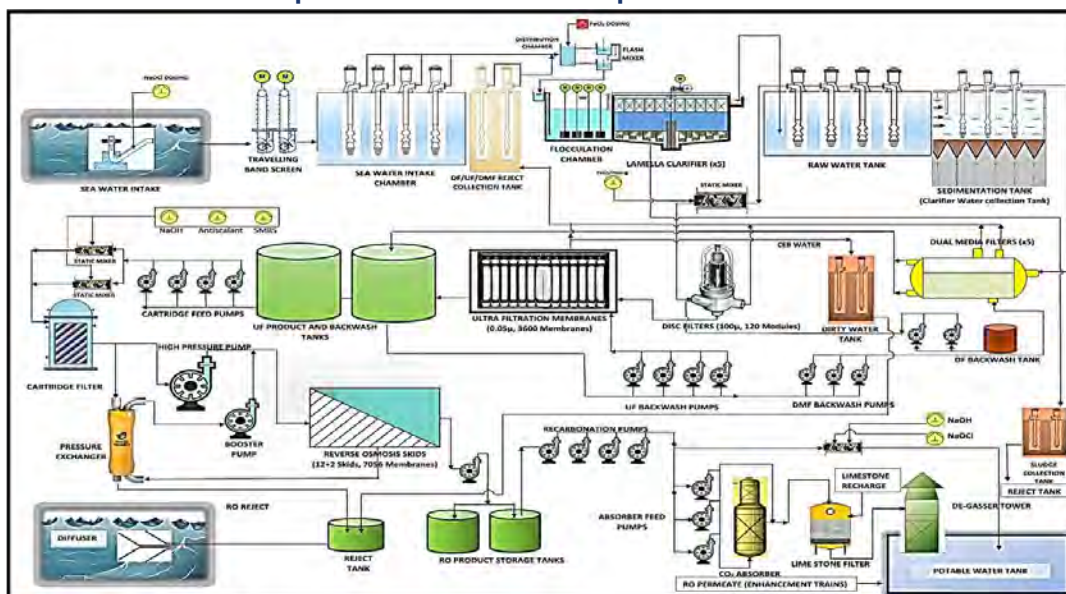
3 Reverse Osmosis
 After pre-treatment, water is pumped into the membrane assembly using a high pressure pump. Though the process sounds like filtration, it is actually a reaction between the water and the membrane. Pressure is the driving force. The pressure has to be sufficiently great to exceed the natural osmotic pressure of the saline feed water.

Details of 110mld desalination project – Site visit

The government of Tamil Nadu had approved construction of 100mld desalination plant at Nemmeli at a cost of Rs9.1bn in CY11. The plant was commissioned in Feb'13. The EPC work was awarded to Wabag in consortium with IDE Technologies, Israel.

The Nemmeli desalination plant employs the reverse osmosis process to remove total dissolved solids (TDS) from sea water to make it for human consumption. TDS content ranges from 28,000 to 41,000 ppm for sea water (vs surface water TDS ranges from 150 to 300ppm).

Chart 3: Desalination process at the Nemmeli plant



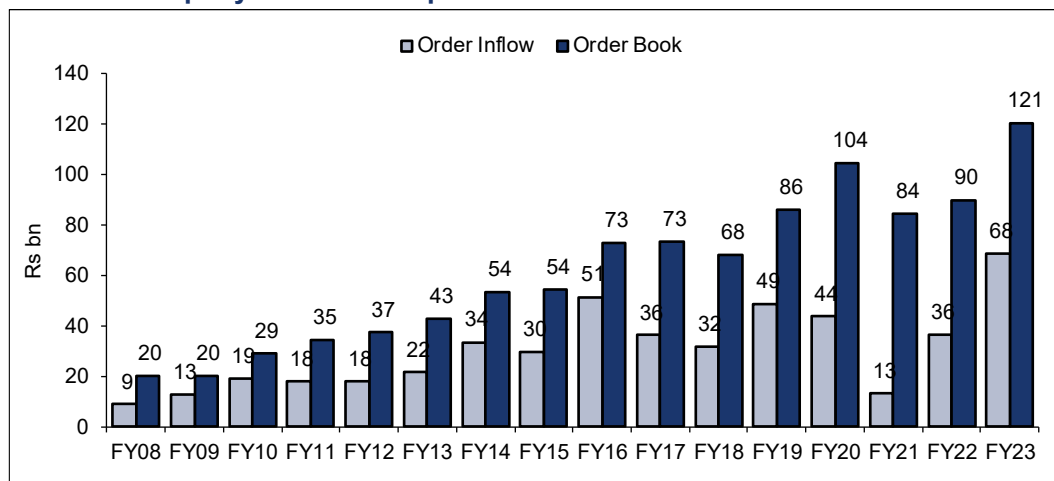
Source: Industry, I-Sec research

- The desalination plant withdraws 265mld of water from sea and supply potable water of 100mld to the city of Chennai.
- Pre-treatment process: The pre-treatment of water is done to remove suspended solids of size up to 0.05 microns.
- Reverse osmosis process: The water is sent through high-pressure pumps to the reverse osmosis membranes. The membranes remove dissolved solids of size up to 0.001 microns. Since power cost is one of the biggest costs, energy recovery instruments are installed to save the cost. During this process, all the minerals are removed from the feed water.
- Post-treatment process: The water is re-mineralised by adding chemicals such as lime and carbon dioxide for achieving the desired alkalinity and hardness.
- **Rejected water process:** The rejected water from the RO and other plant processes flows back into the sea by a 1,200mm-diameter HDPE pipeline and dispersed into the sea as per the environmental norms.

Cost of desalination from the projects

Based on our estimates, cost of water from the project is close to Rs55 per mld comprising: Rs38 per litre as operations cost + Rs17 per litre as capital cost. Note that electricity constitutes 70% of the total operational cost. The project needs 19MW of total power.

Chart 4: Company's orderbook position



Source: Company, I-Sec research

Table 2: Recent order wins by the company

Key Orders Received during FY 23	Nature	Order Value (Rs mn)
400 MLD Perur, Chennai – Desal	EPC	36,779
200 MLD Pagla, Bangladesh – STP	EPC	6,844
53 MLD RIL, Jamnagar – Desal	EPC	4,275
50 MLD Senegal – Desal	EP	3,813
Purolite Victoria WWTP, Romania – ETP	EP	2,579
Ceramic Membranes for Chestnut Waterworks, Singapore	EP	1,313
FY23 Total		55,603
Key orders received during FY24		
City Industrial Development Corp	EP	4,850
FY24 Total		4,850

Source: Company, I-Sec research

Outlook and valuation

Wabag’s current orderbook stands at Rs120bn (4x book to bill ratio), which provides growth visibility. As 50% of the orderbook is from overseas projects, we expect margins to improve, supported by the recent reduction in commodity prices.

The stock is currently trading at 10x FY25E. We raise our FY24E EPS estimates by 56% led by improved execution outlook and profitability, and roll forward our estimates to FY25E. We value the stock at 12x FY25E EPS and arrive at a target price of Rs612 (earlier: Rs353). Maintain **BUY**.

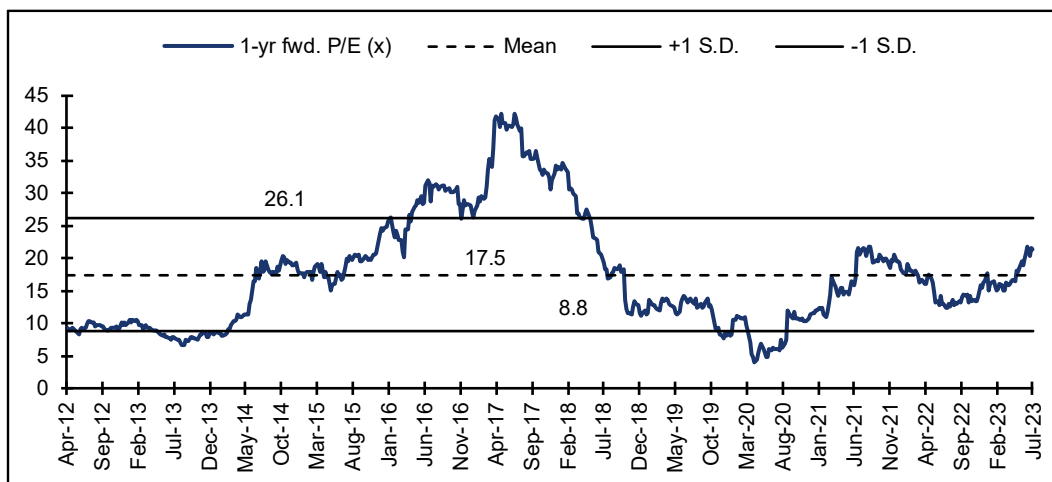
Key risks: i) Delay in execution of overseas orders, which might impact margins.

Table 3: Changes in estimates

Rs mn	FY24E			FY25E		
	Earlier	Revised	Change (%)	Earlier	Revised	Change (%)
Revenue	36,049	40,742	13.0	NA	46,133	NA
EBIDTA	3,152	4,401	39.6	NA	4,960	NA
PAT	1,827	2,845	55.7	NA	3,170	NA

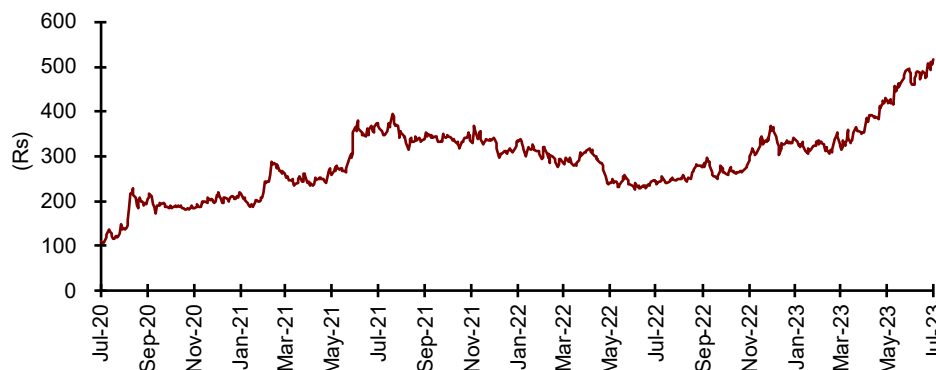
Source: I-Sec research

Chart 5: 1-year forward P/E chart



Source: Bloomberg, I-Sec research

Price chart



Source: Bloomberg

Financial summary (consolidated)

Table 4: Profit and Loss statement

(Rs mn, year ending March 31)

	FY22	FY23	FY24E	FY25E
Total Income	29,793	29,605	40,742	46,133
Operating Expenses	27,423	27,006	36,341	41,173
EBITDA	2,370	2,598	4,401	4,960
% margins	8.0	8.8	10.8	10.8
Depreciation & Amortisation	101	88	100	110
EBIT	2,269	2,510	4,301	4,850
Gross Interest	877	658	1,019	1,153
Other Income	324	657	363	381
PBT before exceptional	1,716	2,510	3,645	4,077
Add: Extraordinaries	-	(2,434)	-	-
/Exceptionals				
Add: Share in associates	(32)	93	93	93
PBT	1,684	168	3,738	4,170
Less: Taxes	363	59	911	1,019
Less: Minority Interests	2	(19)	(19)	(19)
Net Income (Reported)	1,319	129	2,845	3,170
Adjusted Net Income	1,319	1,954	2,845	3,170

Source: Company data, I-Sec research

Table 5: Balance sheet

(Rs mn, year ending March 31)

	FY22	FY23	FY24E	FY25E
Assets				
Total Current Assets	29,638	31,132	22,680	26,155
of which cash & cash eqv.	4,286	3,169	(18,951)	(20,985)
Total Current Liabilities & Provisions	20,447	21,601	30,516	34,530
Net Current Assets	4,904	6,362	11,116	12,610
Investments	376	43	43	43
Other Non-Current Assets	9,211	8,963	28,960	32,423
Net Fixed Assets	800	755	748	778
Goodwill	-	-	-	-
Total Assets	19,576	19,291	21,915	24,869
Liabilities				
Borrowings	4,285	3,534	3,438	3,346
Deferred Tax Liability	33	11	11	11
Minority Interest	(133)	(3)	(3)	(4)
Equity Share Capital	124	124	124	124
Face Value per share (Rs)	2.00	2.00	2.00	2.00
Reserves & Surplus	15,267	15,625	18,346	21,391
Net Worth	15,391	15,749	18,470	21,515
Total Liabilities	19,576	19,291	21,915	24,869

Source: Company data, I-Sec research

Table 6: Cashflow statement

(Rs mn, year ending March 31)

	FY22	FY23	FY24E	FY25E
Operating Cashflow	1,931	(760)	(13,912)	1,733
Working Capital Changes	408	445	(4,757)	(1,498)
Capital Commitments	(38)	(43)	(94)	(140)
Free Cashflow	2,301	(358)	(18,764)	95
Cashflow from Investing	(1,494)	1,666	(2,232)	(875)
Activities				
Issue of Share Capital	-	-	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	1,233	(751)	(96)	(91)
Interest paid	(877)	(658)	(1,019)	(1,153)
Dividend paid	(62)	(124)	(124)	(124)
Extraordinary Items/Others	(528)	(1,307)	115	115
Chg. in Cash & Bank balance	573	(1,532)	(22,120)	(2,034)

Source: Company data, I-Sec research

Table 7: Key ratios

(Year ending March 31)

	FY22	FY23	FY24E	FY25E
Per Share Data (in Rs)				
Diluted adjusted EPS	21.2	31.4	45.7	51.0
Recurring Cash EPS	22.8	32.8	47.4	52.7
Dividend per share (DPS)	1.0	2.0	2.0	2.0
Book Value per share (BV)	247.4	253.2	296.9	345.9
Growth Ratios (%)				
Operating Income	5.1	(0.6)	37.6	13.2
EBITDA	8.3	9.6	69.4	12.7
Recurring Net Income	19.8	48.1	45.6	11.4
Diluted adjusted EPS	19.8	48.1	45.6	11.4
Diluted Recurring CEPS	16.2	43.8	44.2	11.3
Valuation Ratios				
P/E	24.0	16.2	11.1	10.0
P/CEPS	22.3	15.5	10.7	9.7
P/BV	2.1	2.0	1.7	1.5
EV / EBITDA	13.3	12.3	12.3	11.3
EV / Operating Income	1.1	1.1	1.3	1.2
EV / Op. FCF (pre -Capex)	13.5	(101.9)	(2.9)	237.9
Operating Ratios				
Raw Material/Sales (%)	77.4	76.0	76.6	77.0
SG&A/Sales (%)	6.2	6.2	5.5	5.5
Other Income / PBT (%)	18.9	26.2	10.0	9.3
Effective Tax Rate (%)	21.2	77.8	25.0	25.0
NWC / Total Assets (%)	17.5	16.0	21.6	21.6
Inventory Turnover (days)	3.9	5.1	3.9	3.9
Receivables (days)	162.4	185.8	170.8	170.8
Payables (days)	131.1	144.6	245.5	245.4
Net D/E Ratio (x)	(0.0)	0.0	1.2	1.1
Return/Profitability Ratios (%)				
Recurring Net Income Margins	4.4	6.6	7.0	6.9
RoCE	11.1	3.6	17.0	16.8
RoNW	8.9	12.5	16.6	15.9
Dividend Payout Ratio	0.0	0.1	0.0	0.0
Dividend Yield (%)	0.2	0.4	0.4	0.4
EBITDA Margins	8.0	8.8	10.8	10.8

Source: Company data, I-Sec research

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