Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Va Tech Wabag Ltd

Better order mix to drive growth

Capital Goods	Sharekhan code: WABAG

Reco/View: **Buy**	↔	CMP: **Rs. 518**	Price Target: **Rs. 630**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We maintain Buy on Va Tech Wabag (Va Tech) with a revised PT of Rs. 630, given its strong order inflow, promising pipeline, and margin tailwinds.
- Q1FY2024 performance was commendable on the profitability front as margin expanded and profits rose considerably.
- Order backlog stands at Rs.11,348 crore (3.9x TTM revenue) and order pipeline is promising across India, Russia, Middle East, and other African countries.
- Va Tech's focus on technologically advanced EP projects and increasing share of O&M contracts would improve margins, cash flows, and working capital cycle. We build in revenue/adjusted PAT CAGR of ~20%/~24% over FY2023-FY2025E. The stock trades at an attractive P/E of ~10x its FY2024 and ~9x its FY2025E EPS.

VA Tech's consolidated performance was a mixed bag during Q1FY2024, as revenue declined y-o-y, while operating profit and bottom-line improved considerably due to better order mix and improvement in execution efficiencies. Sales fell ~12.5% y-o-y to Rs. 553 crore. Sales were lower due to the company's strategic focus on EP projects and muted Europe growth. Operating profit was up 187.5% y-o-y to Rs. 66 crore due to the decline in raw-material cost and other expenses. Operating margin showed improved trend, driven by execution efficiencies and higher share of EP projects and increased by 825 bps y-o-y to 11.9%. Following strong operating performance, net profit increased by ~66% y-o-y to Rs. 50 crore. Order backlog at the end of the quarter stood at Rs. 11,348 crore (excluding framework contracts). Order intake has been robust at around Rs. 733 crore during the quarter.

Key positives

- OPM rose by 825 bps y-o-y to 11.9%, driven by a decline in input cost and improved execution efficiencies.
- Q1 order intake was healthy at Rs. 733 crore, which includes ~Rs. 420 crore order for 270 MLD CIDCO, Maharashtra – water treatment plant on design, build and operate (DBO) basis.

Key negatives

- Sales lagged estimates and declined y-o-y due to its strategic focus on EP projects and muted Europe growth.
- Other income declined by ~23% y-o-y.
- Receivables remain elevated at Rs. 1,500 crore.

Management Commentary

- Revenue growth was slow as the company is focusing more on technologically advanced and engineering jobs and less on construction jobs, which are a complete passthrough.
- The company has a solid pipeline of orders and may exceed last year's order intake if some of the big orders in the pipeline are awarded in FY2024.
- All the current projects across wastewater treatment, recycling and reuse and desalination are progressing well.
- For SIBUR project, the company expects to finish a majority of the supplies within this fiscal. The 53 MLD Reliance desalination project is in the construction and procurement stage.
- EP activities have commenced on the 400 MLD Chennai desalination plant and 200-MLD sewage treatment plant in Bangladesh.
- Va Tech aims to have meaningful revenue growth, given its robust order book. The company has strong execution capabilities to achieve decent revenue growth and expects considerable margin improvement in FY2024E.
- 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.

Revision in estimates – We have revised our estimates for FY2024 and FY2025 to build in higher profitability.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 630: VA Tech has been exhibiting good performance, driven by better order mix and improved execution efficiencies. The company's order book is robust and, with a promising order pipeline, the company should deliver healthy revenue growth. Further, the company is focused on margin improvement and cash flow generation and is on the cusp of a healthy growth trajectory in the medium to long term. Moreover, the recently awarded large desalination and water treatment plant order has boosted its 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 and strong order book with healthy revenue visibility provides comfort in execution and collections going ahead. We have revised our revenue estimates to build in higher execution in EP projects and increased revenue from O&M contracts. At the CMP, the stock trades at P/E of ~10x and ~9x its FY2024/FY2025E earnings, which we believe is attractive, given an optimistic outlook on business and earnings. Hence, we maintain our Buy rating on the stock with a revised price target (PT) of Rs. 630.

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.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue from Operations	2,979	2,960	3,617	4,271
OPM (%)	8.0	10.7	11.0	11.4
Reported PAT	132	13	323	354
Reported EPS (Rs.)	21.2	2.1	51.9	56.9
Adjusted PAT	132	230	323	354
Adj. EPS (Rs.)	21.2	36.9	51.9	56.9
P/E (x)	24.4	14.0	10.0	9.1
EV/EBITDA (x)	13.6	9.9	7.5	6.3
RoCE (%)	12.4	17.6	23.2	27.8
RoE (%)	8.7	14.6	19.0	22.5

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 39.08

Updated Aug 08, 2023

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

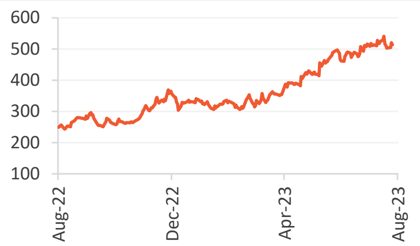
Company details

Market cap:	Rs. 3,221 cr
52-week high/low:	Rs. 545/242
NSE volume: (No of shares)	5.53 lakh
BSE code:	533269
NSE code:	WABAG
Free float: (No of shares)	5.0 cr

Shareholding (%)

Promoters	19.1
FII	16.7
DII	3.6
Others	60.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.8	20.5	54.2	106.1
Relative to Sensex	3.2	14.6	45.5	97.1

Sharekhan Research, Bloomberg

Strong operating performance

VA Tech's consolidated performance was a mixed bag as revenue declined y-o-y, while operating profit and bottom-line improved considerably due to execution of profitable orders. Sales declined ~12.5% y-o-y to Rs. 553 crore. Sales were lower due to the company's strategic focus on EP projects and muted Europe growth. Operating profit was up 187.5% y-o-y to Rs. 66 crore due to a decline in raw-material cost and other expenses. Operating margin showed improved trend, driven by execution efficiencies and EP projects and increased by 825 bps y-o-y to 11.9%. Following strong operating performance, net profit increased by ~66% y-o-y to Rs. 50 crore. Order backlog at the end of the quarter stood at Rs.11,348 crore (excluding framework contracts). Order intake has been robust at around Rs. 733 crore during the quarter.

Order book mix has 42% of O&M contracts

The order book has Rs. 4,800 crore of O&M contracts, a large part of which is from the municipal segment. O&M revenue has also started to show an upward trend with DBO orders slowly moving into the O&M phase and, hence, the company will see further expansion of the same in the next few years. The order book has ~31% of international orders.

Q1FY2024 investor update and conference call highlights:

- **Divestment of two European subsidiaries:** VA Tech divested its entire stake in two of its European entities in Switzerland and Czech Republic. This resulted in removal of orders of Rs. 900 crore from its total order book. It would also lead to cost saving of Euro 5 mn per annum. The company earned net profit of Rs. 14 crore from the sale of its subsidiaries in Q1FY2024.
- **Many orders to move into the O&M phase:** O&M contracts comprise ~42% of the total order book. There are several DBO orders moving into the O&M phase and, therefore, contribution of those orders will lead to increased revenue in the next few years.
- **Revenue growth was slow due to change in the order mix:** Currently, the company is focusing more on technologically advanced and engineering jobs and less on construction jobs, which are a complete passthrough. Moreover, execution of some big projects won recently would begin now and execution impact of the same will be seen in H2FY2024.
- **Order inflow prospects for the balance nine months of FY2024:** The company has a solid pipeline of orders and may exceed last year's order intake if some of the big orders are finalised. At the start of FY2024, the company was the preferred bidder in Rs. 1,000-1,500 crore of orders, of which ~Rs. 700 crore of orders have been received by the company and rest are expected in Q2FY2024.
- **Long-term opportunities in Egypt:** Egypt plans to have about 21 desalination plants, but funding of the same will take time. The company has prequalified for the same and these projects are expected to be awarded in the next seven to eight years. Apart from Egypt, India and Southeast Asia, Middle East, and Africa also have a number of opportunities in water treatment and desalination.
- **Receivables:** Receivables remain elevated at ~Rs. 1,500 crore.
- **Margin could improve by 200 bps due to a high mix of EP orders:** One-third of the EPC order book comprises engineering and procurement (E&P) orders, which are expected to fetch higher margins. Margin for the E&P orders are higher by 200-250 bps as compared to regular margins.
- **Other expenses:** Other expenses in last year's corresponding quarter included write-off and certain provisions. Hence, going forward, other expenses are expected to have the same run rate as Q1FY2024.
- **Proportion of ZLD orders in the order book:** ZLD solutions orders are worth Rs. 700-800 crore in its total order book. Margins in ZLD orders are expected to be higher than the other orders.

Results (Consolidated) Rs cr

Particulars	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Revenue	**553**	**632**	**-12**	**927**	**-40**
Operating Profit	**66**	**23**	**187**	**111**	**-41**
Depreciation	2	2	-24	2	-21
Interest	16	16	-4	16	-2
Other Income	26	33	-23	8	236
PBT	74	37	98	101	-27
Tax Expense	14	9	55	-30	-148
Adjusted PAT	**50**	**30**	**66**	**80**	**-38**
Adjusted EPS (Rs.)	**8.0**	**4.8**	**66**	**12.9**	**-38**
Margins (%)			**BPS**		**BPS**
OPM	11.9	3.6	825	12.0	-16
NPM	9.0	4.8	427	8.7	39
Tax Rate	25.0	24.8	18	-29.7	NM

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 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.

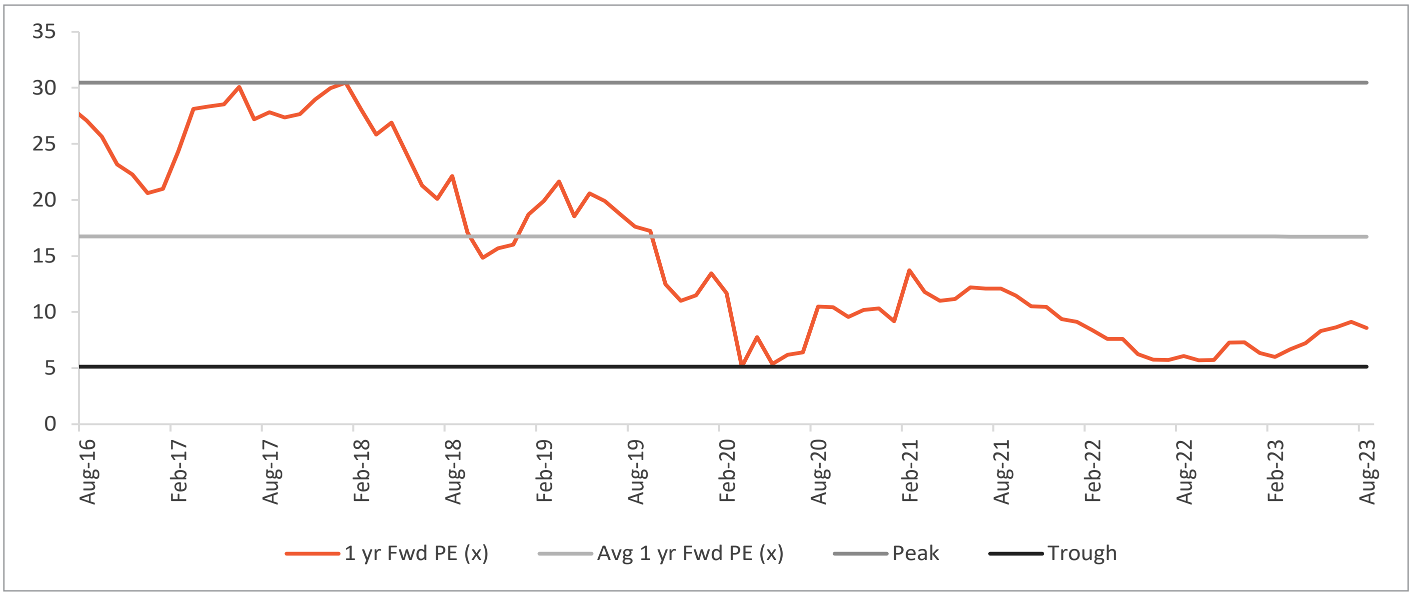
Company outlook - Creating enduring value

The company has a strong order book of over Rs. 11,000 crore (~4x its TTM 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 strengthening balance sheet profile.

Valuation - Maintain Buy with a revised PT of Rs. 630

VA Tech has been exhibiting good performance, driven by better order mix and improved execution efficiencies. The company's order book is robust and, with a promising order pipeline, the company should deliver healthy revenue growth. Further, the company is focused on margin improvement and cash flow generation and is on the cusp of a healthy growth trajectory in the medium to long term. Moreover, the recently awarded large desalination and water treatment plant order has boosted its 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 and strong order book with healthy revenue visibility provides comfort in execution and collections going ahead. We have revised our revenue estimates to build in higher execution in EP projects and increased revenue from O&M contracts. At the CMP, the stock trades at P/E of ~10x and ~9x its FY2024/ FY2025E earnings, which we believe is attractive, given an optimistic outlook on business and earnings. Hence, we maintain our Buy rating on the stock with a revised PT of Rs. 630.

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
Pankaj Malhan	Deputy MD and Group CEO
Skandaprasad Seetharaman	Chief Financial Officer
R Swaminathan	Company Secretary and Compliance Officer

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Jhunjhunwala Rekha Rakesh	8.04
2	Norges Bank	4.04
3	Varadarajan Subramanian	3.51
4	Federated Hermes Incorporation	3.20
5	KBI Global Investors Limited	2.54
6	SBI Funds Management Limited	2.54
7	Baser Home Finance Private Limited	2.41
8	KBI Water Fund	2.34
9	Federated Hermes Investment Funds	2.06
10	Sengupta Amit	1.82

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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by BNP PARIBAS

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