



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

Updated Aug 08, 2023

39.08

High Risk

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

Source: Morningstar

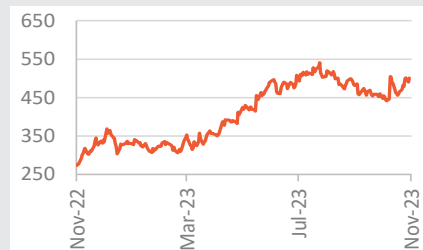
Company details

Market cap:	Rs. 3,317 cr
52-week high/low:	Rs. 545/268
NSE volume: (No of shares)	5.5 lakh
BSE code:	533269
NSE code:	WABAG
Free float: (No of shares)	5.0 cr

Shareholding (%)

Promoters	19.1
FII	15.6
DII	3.5
Others	61.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	19.1	2.6	25.7	95.1
Relative to Sensex	19.9	4.1	20.5	88.7

Sharekhan Research, Bloomberg

Va Tech Wabag Ltd

Better order mix to drive growth

Capital Goods

Sharekhan code: WABAG

Reco/View: Buy



Upgrade



Maintain



Downgrade

CMP: Rs. 534

Price Target: Rs. 630

Summary

- Va Tech has shifted its strategic focus from the low-margin European business and shifted towards high-margin EP and O&M projects, which led to margin expansion but lower revenue. Therefore, PAT lagged estimates as OPM beat was offset by revenue miss.
- Order backlog stands at Rs. 10,942 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 ~9%/~15% over FY2023-FY2026E. The stock trades at an attractive P/E of ~9x its FY2026E EPS.
- We maintain Buy with an unchanged PT of Rs. 630, given its strong order inflow, promising pipeline, and margin tailwinds.

VA Tech Wabag Limited's (Va Tech) consolidated performance was a mixed bag during Q2FY2024. Revenue declined y-o-y, while operating profit and bottom-line improved considerably due to higher proportion of Engineering and Procurement (E&P) projects in the revenue mix and reduced European exposure. Sales fell ~11.4% y-o-y to Rs. 665 crore. Sales were lower due to the company's strategic divestment of two European entities last year and shift in strategic focus towards E&P projects. Operating profit was up 60.2% y-o-y to Rs. 86 crore due to the decline in raw-material cost and lower employee expenses. Operating margin showed an improved trend, driven by increased proportion of high-margin E&P projects in the revenue mix and reduced European exposure; it increased by 579 bps y-o-y to 12.9%. Following strong operating performance, net profit increased by ~29% y-o-y to Rs. 60 crore. Order backlog at the end of the quarter stood at Rs. 10,942 crore (excluding framework contracts). Order intake has been robust at around Rs. 765 crore during the quarter.

Key positives

- OPM rose by 579 bps y-o-y to 12.9%, driven by a decline in input cost and lower employee expense.

Key negatives

- Sales lagged estimates and declined y-o-y due to its strategic focus on E&P projects and reduced European exposure.

Management Commentary

- Management believes that as the company has a begin execution of large orders towards the end of Q2FY2024, revenue in H2FY2024 will be greater than H2FY2023 and revenue generated in FY2024 will be greater than FY2023.
- The company believes middle market will pick up pace and is expected to come up with large orders focused on water. The company has placed bids for orders more than USD1 billion.
- Management expects the company's order book to grow at a rate of 15-20% over the next few years. The company believes current margins are sustainable as the company is shifting focus on high-margin E&P and Operation and Maintenance (O&M) projects.
- Going ahead, management believes the company will also focus on the O&M business as these projects provide long-term consistent revenue, lower risk, and good margins.

Revision in estimates – We have fine-tuned our FY2024-FY2025 earnings estimates. We have introduced our FY2026 earnings estimates in this report.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 630: VA Tech has been exhibiting a good operating performance, driven by a 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. 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 provide comfort in execution and collections going ahead. At the CMP, the stock trades at a P/E of ~9x its FY2026E earnings, which we believe is attractive, given an optimistic outlook on business and earnings. Hence, we maintain our Buy rating on the stock with an unchanged 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. crore	FY23	FY24E	FY25E	FY26E
Revenue from Operations	2,960	2,833	3,337	3,876
Operating Profit Margin (%)	10.7	12.3	12.6	12.9
Adjusted PAT	230	240	289	353
Adjusted EPS (Rs.)	36.9	41.5	46.5	56.7
P/E (x)	258.5	12.9	11.5	9.4
P/BV (x)	2.1	1.7	1.2	2.2
EV/EBITDA (x)	10.8	9.4	7.7	6.5
RoCE (%)	17.6	18.9	21.2	24.8
RoE (%)	14.6	14.1	15.8	19.2

Source: Company; Sharekhan estimates

Order book mix has 42% of O&M contracts

The order book has Rs. 4,814 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.

Q2FY2024 investor update and conference call highlights

- ♦ **Decline in revenue:** The company reported lower revenue on a y-o-y basis mainly due to strategic divestment of two Europe entities last year and shift in strategic focus towards E&P projects.
- ♦ **Revenue outlook:** Management believes that as the company has begun execution of large orders towards the end of Q2FY2024, revenue in H2FY2024 will be greater than H2FY2023 and revenue generated in FY2024 will be greater than that in FY2023.
- ♦ **Improvement in EBITDA margin:** The company reported improved EBITDA margin mainly due to a higher proportion of E&P projects in the revenue mix and reduced European exposure.
- ♦ **Orders from the Middle East:** The company believe that the middle market will pick up pace and is expected to come up with large orders focused on water. The company has placed bids for orders more than USD1 billion. Management believes that the company will be able to convert some of these orders, which will be reflected in revenue growth for the next few years.
- ♦ **Guidance:** Management expects the company's order book to grow at a rate of 15-20% over the next few years with 70% contribution from municipal orders and 30% from industrial orders. The company believes that current margins are sustainable as the company is shifting focus on high-margin E&P and O&M projects.
- ♦ **Chennai Project:** The new Chennai project has an execution period of 42 months with two-thirds cost allocated to the EPC segment; one-third is allocated to O&M, which the company will service over the next 20 years with an escalation clause built-in in the contract. For the construction part of EPC, the company will hire subcontractors for the execution of this lower margin part of contract.
- ♦ **O&M:** Going ahead, management believes the company will also focus on the O&M business as these projects provide long-term consistent revenue, lower risk, and good margins.

Results (Consolidated)

	Rs cr				
Particulars	Q2FY24	Q2FY23	YoY	Q1FY24	QoQ
Revenue	665	750	-11	553	20
Operating Profit	86	54	60	66	31
Depreciation	2	2	-6	2	24
Interest	17	17	-1	16	6
Other Income	15	23	-33	26	-40
PBT	83	57	44	74	12
Tax Expense	23	13	73	14	58
Adjusted PAT	60	47	29	50	20
EPS (Rs.)	9.7	7.5	29	8.0	20
Margins			BPS		BPS
OPM (%)	12.9	7.2	579	11.9	108
NPM (%)	9.0	6.2	282	9.0	-1
Tax Rate (%)	25.0	23.0	202	25.0	0

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector Outlook – 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 USD211 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

VA Tech 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 an unchanged PT of Rs. 630

VA Tech has been exhibiting a good operating performance, driven by a 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. 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 provide comfort in execution and collections going ahead. At the CMP, the stock trades at a P/E of ~9x its FY2026E earnings, which we believe is attractive, given an optimistic outlook on business and earnings. Hence, we maintain our Buy rating on the stock with an unchanged PT of Rs. 630.

About the 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 the 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 a 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	8.0
2	Norges Bank	4.0
3	Varadarajan Subramanian	3.5
4	Federated Hermes Incorporation	3.2
5	KBI Global Investors Limited	2.5
6	SBI Funds Management Limited	2.5
7	Baser Home Finance Private Limited	2.4
8	KBI Water Fund	2.3
9	Federated Hermes Investment Funds	2.1
10	Sengupta Amit	1.8

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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