Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Va Tech Wabag Ltd

Decent Result, On a sustainable growth path

Capital Goods	Sharekhan code: WABAG

Reco/View: Buy	↔	CMP: **Rs. 715**	Price Target: **Rs. 850**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX

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		↔	

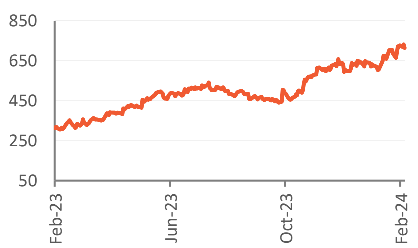
Company details

Market cap:	Rs. 4,444 cr
52-week high/low:	Rs. 744 / 305
NSE volume: (No of shares)	5.33 lakh
BSE code:	533269
NSE code:	WABAG
Free float: (No of shares)	5.0 cr

Shareholding (%)

Promoters	19.1
FII	13.1
DII	5.9
Others	61.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	15.1	16.2	47.7	128.6
Relative to Sensex	11.9	6.2	36.3	107.0

Sharekhan Research, Bloomberg

Summary

- Adjusted profit increased 7% y-o-y to Rs. 63 crore, supported by decent revenue growth of 8.1% y-o-y, steady margin, and higher other income partially offset by higher taxes.
- Order backlog stands at Rs. 11,866 crore (4.1x 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, industrial and international 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%/~18% over FY2023-FY2026E.
- We maintain BUY with a revised PT of Rs. 850, given its strong order inflow, promising pipeline, and margin tailwinds. The stock trades at an attractive P/E of ~12x its FY2026E EPS.

VA Tech Wabag Limited's (Va Tech) reported a decent performance during Q3FY2024. Sales grew ~8.1% y-o-y to Rs. 704 crore. Sales increased despite the company's strategic divestment of two European entities last year as new and large projects started generating revenue. OPM came in at 14% (flat y-o-y) as lower employee costs and other expenses were offset by higher raw-material costs. Adjusted profit increased 7% y-o-y to Rs. 63 crore, supported by decent revenue growth of 8.1% y-o-y, steady margin, and higher other income partially offset by higher taxes. Order backlog at the end of the quarter stood at Rs. 10,686 crore (excluding framework contracts worth ~Rs. 1,179 crore). Order intake has been robust at around Rs. 1,762 crore during 9MFY2024.

Key positives

- Revenue grew 8% y-o-y owing to pick up in order execution of new and large projects.

Key negatives

- GPM declined 349bps y-o-y.

Management Commentary

- In the next 3-5 years, the company expects to increase the share of O&M in its order book to 25%. Currently, the company is the preferred bidder in ~USD100 million worth of projects.
- Management sees strong growth potential in the ultrapure water segment, especially in the production of semiconductor and green hydrogen. Management expects the green hydrogen segment to become economically viable in the next 3-5 years and, thereafter, witness exponential growth.
- The company plans to recover biogas from its existing plants, enrich and compress it to use it as a fuel. The company plans to initially set up 4 to 6 plants in the first year, with plans to set up 20-25 plants every year and a target to reach 100 plants in over five years.
- Others: 1) The company has net cash positive position of Rs. 100 crore. 2) The company will operationalise one of its HAM projects this quarter, with plans to operationalise two others in H1FY2025.

Revision in estimates – We have revised our estimates for FY2025 and FY2026 to build in higher profitability.

Our Call

Valuation – Maintain BUY with a revised PT of Rs. 850: 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, ultrapure water, 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. At the CMP, the stock trades at a P/E of ~12x 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 a revised price target (PT) of Rs. 850.

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	FY23	FY24E	FY25E	FY26E
Revenue from Operations	2,960	2,833	3,337	3,876
Operating Profit Margin (%)	10.7	12.3	14.0	14.0
Adjusted PAT	230	240	340	381
Adjusted EPS (Rs.)	36.9	41.5	54.6	61.2
P/E (x)	345.9	17.2	13.1	11.7
P/BV (x)	2.8	2.3	2.3	2.3
EV/EBITDA (x)	14.3	12.6	9.4	8.1
RoCE (%)	17.6	18.9	23.7	26.6
RoE (%)	14.6	14.1	18.5	20.8

Source: Company; Sharekhan estimates

Order book mix has 43% of O&M contracts

The order book has Rs. 4,547 crore of O&M contracts, a large part of which is from the municipal segment. The order book has ~32% of international orders. Total order inflows during 9MFY2024 were ~Rs. 1,762 crore, of which 59% came from the rest of the world (ROW) and 41% from India. Industrial orders constituted 69% of the total intake, while municipal orders had a lower share at 31%.

Q3FY2024 investor update and conference call highlights:

- **Orders:** The company has an order book of ~Rs. 11,866 crore, which gives the company revenue visibility of more than three years, with a mix of 57% EPC and 43% O&M. A majority of orders have secured payment terms. Usually, EPC orders take about three years to execute, while O&M orders can take anything between 5 and 15 years of execution time. In the next 3-5 years, the company expects to increase the share of O&M in its order book to 25%. Currently, the company is the preferred bidder in ~USD100 million worth of projects.
- **Q3FY2024 revenue:** The company reported 8% y-o-y growth in consolidated revenue to Rs. 704 crore despite a strategic divestment of two of its subsidiaries in the last year, mainly due to new and large projects commencing revenue generation and continued execution speed on other ongoing projects. Divested subsidiaries generated revenue of ~Rs. 200 crore in FY2023.
- **EBITDA margin:** Usually the company generates 12-12.5% EBITDA margin from EPC projects, while O&M projects usually generate EBITDA margin of 15-16%, resulting in a blended EBITDA margin of 14%. Going ahead, the company plans to improve margin by focusing on higher margin engineering and procurement, industrial, international projects as well as O&M contracts.
- **Ultrapure water opportunity:** Management sees strong growth potential in the ultrapure water segment, especially in the production of semiconductor and green hydrogen. The company plans to secure its position as a developer and provider of technology in the ultrapure water segment. Management expects the green hydrogen segment to become economically viable in the next 3-5 years and witness exponential growth from thereon.
- **Biogas:** The company plans to recover biogas from its existing plants and enrich and compress it to use it as a fuel. The company plans to use its technology to convert wastewater, municipal solid waste to methane. The company plans to initially set up 4 to 6 plants in the first year, with plans to set up 20-25 plants per year and a target to reach 100 plants in over five years.
- **Others:** 1) The company has net cash positive position of Rs. 100 crore. 2) The company will operationalise one of its HAM projects this quarter, with plans to operationalize two others in H1FY2025. 3) While selecting the project, the company prioritises payment security, margin, cash flow, and technology selection.

Results (Consolidated) Rs cr

Particulars	Q3FY24	Q3FY23	Y-o-Y (%)	Q2FY24	Q-o-Q (%)
Revenue	**704**	**652**	**8.1**	**665**	**5.9**
Operating Profit	**99**	**92**	**7.5**	**86**	**14.9**
Depreciation	2	2	-3.7	2	0.0
Interest	17	16	3.0	17	-0.6
Other Income	4	2	81.4	15	-76.0
PBT	**84**	**76**	**10.8**	**83**	**1.5**
Exceptional item	0	-17	NA	0	NA
Tax Expense	21	13	55.2	23	-9.2
Adjusted PAT	**63**	**59**	**7.4**	**60**	**4.9**
EPS (Rs.)	**10.1**	**9.4**	**7.4**	**9.7**	**4.9**
Margins			**BPS**		**BPS**
OPM (%)	14.0	14.1	-7	12.9	109
NPM (%)	9.0	9.0	-6	9.0	-9

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 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. Rising demand for water treatment facilities across the world will have a positive impact on the market's growth in the coming years.

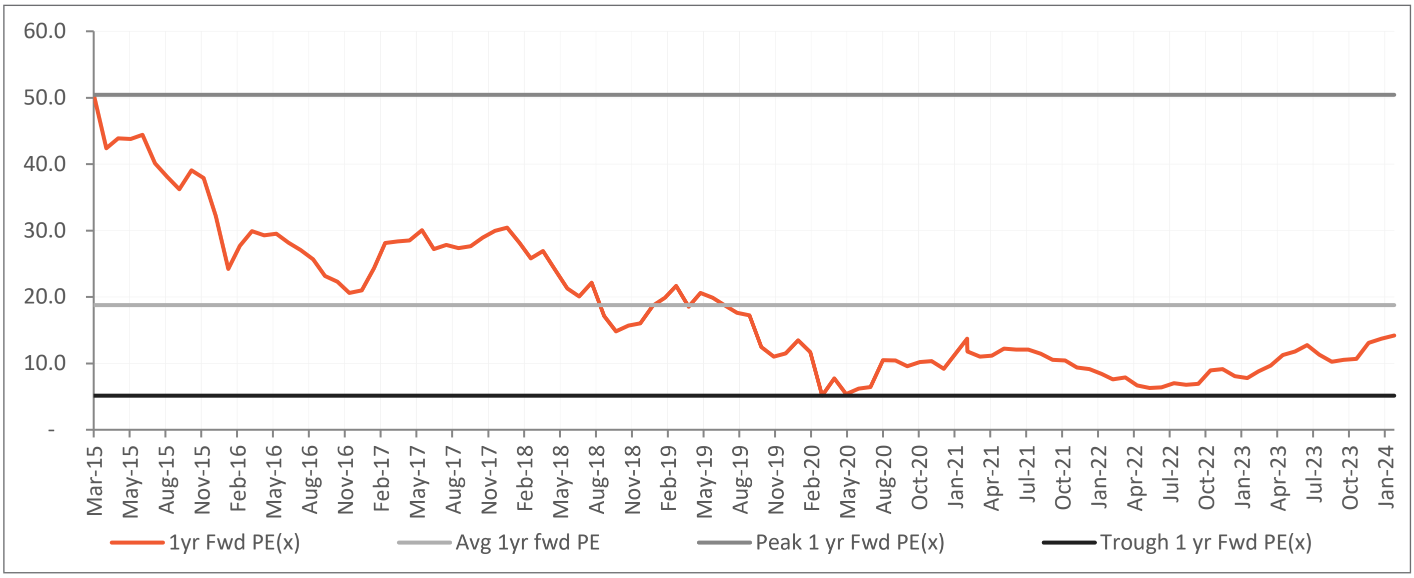
■ Company Outlook – Creating enduring value

VA Tech has a strong order book of over Rs. 11,900 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. 850

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, ultrapure water, 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. At the CMP, the stock trades at a P/E of ~12x 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 a revised PT of Rs. 850.

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 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 99 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

- A 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
Skandaprasad Seetharaman	Chief Financial Officer
Anup Kumar Samal	Company Secretary and Compliance Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Norges Bank	3.7
2	Quant Money Managers Ltd	1.5
3	Dimensional Fund Advisors LP	1.3
4	SBI Funds Management Ltd	1.3
5	Sattva India Opportunities Co Ltd	1.1
6	OekoWorld Lux SA	1.1
7	ICICI Prudential Asset Management	0.5
8	Sun Life Financial Inc	0.4
9	LIC Mutual Fund Asset Management C	0.3
10	INVESTMENT TRUST OF INDIA	0.3

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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