Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Va Tech Wabag Ltd

One-offs impact Q4, promising growth prospects

Capital Goods	Sharekhan code: WABAG
Reco/View: Buy ↔	CMP: Rs. 415
Price Target: Rs. 520 ↑	

↑ 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		↔	

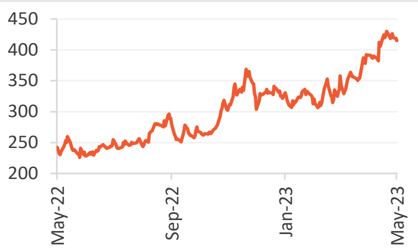
Company details

Market cap:	Rs. 2,581 cr
52-week high/low:	Rs. 439/ 216
NSE volume: (No of shares)	5.4 lakh
BSE code:	533269
NSE code:	WABAG
Free float: (No of shares)	5.0 cr

Shareholding (%)

Promoters	19.1
FII	16.6
DII	3.3
Others	61.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	6.0	29.4	35.3	71.3
Relative to Sensex	2.1	25.4	34.5	57.1

Sharekhan Research, Bloomberg

Summary

- We maintain Buy on Va Tech Wabag (Va Tech) with a revised PT of Rs. 520, considering strong order book, promising order pipeline, margin expansion, and improving working capital cycle.
- Q4FY2023 performance was good on the sales and OPM front, however provisioning of Rs. 243 crore impacted the bottom-line.
- Order intake has been strong in FY2023 at Rs. 6,844 crore, including Rs. 3,678 crore order of Chennai desalination plant. Executable order book stands at Rs. 12,055 crore and the company expects few more orders in the next 6-8 weeks.
- Va Tech continues to focus on high-quality, technologically advanced, and well-funded industrial as well as EP orders to improve margins and cash flows. The company also sees green hydrogen as a key long-term opportunity.

For Q4FY2023, VA Tech's consolidated performance was impacted by one-time write-off of receivables and other current assets pertaining to APGENCO projects worth ~Rs. 243 crore, despite in-line sales and robust OPM,. Sales were up ~4% y-o-y to Rs. 927 crore. The slow growth in sales was due to a higher EP project mix and muted growth in Europe. Operating profit was up 51.7% y-o-y to Rs. 108 crore due to a decline in raw-material cost and other expenses. OPM increased by 368 bps y-o-y and 82 bps q-o-q to 11.7%. Better OPM was a result of execution efficiencies. Following the write-off, the company has reported net loss of Rs. 111 crore. Adjusting for the loss, net profit stands at Rs. 78 crore (above our estimate of Rs. 52 crore). Order backlog at the end of the quarter stood at Rs.12,055 crore (excluding framework contracts). The order intake in FY2023 has been robust at around Rs. 6,884 crore, which includes 400 MLD Perur, Chennai – desalination plant project of ~Rs. 3,680 crore won in Q4FY2023.

Key positives

- OPM rose by 368 bps y-o-y and 82 bps q-o-q to 11.7%, driven by a decline in input cost. Further, execution efficiencies and a better project mix increased margins.
- FY2023 order intake was healthy at Rs. 6,844 crore, which includes Rs. 3,678 crore order for the desalination plant of 400 MLD from Perur, Chennai, and Rs. 684 crore surface treatment plant of 200 MLD from Pagla, Bangladesh.
- Interest cost declined by 31% y-o-y to Rs. 16 crore due to a reduction in debt.
- Core working capital cycle now stands at 78 days, a decline of 10% y-o-y.
- The company is net cash positive at Rs. 101 crore.

Key negatives

- Profitability was impacted by one-time write-off of receivables and other current assets pertaining largely to APGENCO projects worth ~Rs. 243 crore. This resulted in net loss of Rs. 112 crore.
- Other income declined by ~21% y-o-y.
- Share of low-margin EPC orders stands at 61% in the total order book.

Management Commentary

- Va Tech aims to have meaningful revenue growth, given its robust order book. The company has strong execution capabilities to achieve good revenue growth and expects double-digit margins in FY2024E.
- Va Tech expects Amur Gas Chemical Complex LLC, Russia project, would have strong execution in FY2024 and would contribute significantly to revenue generation.
- The Chennai desalination plant order is under planning stage and the company would be executing the engineering part in H1FY2024, post which project execution is expected to pick up pace in H2FY24E. The entire project is likely to be executed in 42 months.
- 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.
- The effective tax rate is expected to be 24-25% for FY2024E. Its cost of capital is ~9% currently. The company's R&D expense is 1% of its revenue.

Revision in estimates – We have revised our estimates for FY2023-FY2024 and introduced FY2025 estimates.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 520 - VA Tech has shown strong recovery in execution and margins in FY2023, while its working capital cycle and debt levels have improved. However, its bottom-line performance has been impacted by write-off of receivables of Rs. 243 crore, which may weigh on the stock in the near term. 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 in the medium to long term. Moreover, the recently awarded desalination 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. At the CMP, the stock trades at P/E of ~13x and ~8x its FY2024/FY2025E earnings, which we believe is attractive, given an optimistic outlook on business and earnings. Hence, we maintain our Buy rating with a revised price target (PT) of Rs. 520.

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	3,197	3,581
OPM (%)	8.0	10.7	11.2	11.4
Reported PAT	132	13	319	325
Reported EPS (Rs.)	21.2	2.1	32.7	52.2
Adj. EPS (Rs.)	21.2	36.9	32.7	52.2
P/E (x)	19.5	11.2	12.7	7.9
P/BV (x)	1.7	1.6	1.4	1.2
EV/EBITDA (x)	10.4	8.6	7.5	6.1
RoCE (%)	12.2	17.4	19.9	20.1
RoE (%)	8.9	14.6	19.0	19.5

Source: Company; Sharekhan estimates

Quarter impacted by one-offs, strong order book and order inflows

Despite in-line sales and robust OPM, VA Tech's consolidated performance was impacted by one-time write off of receivables and other current assets pertaining to APGENCO projects worth ~Rs. 243 crore. Sales were up ~4% y-o-y to Rs. 927 crore. Slow growth in sales was due to a higher EP project mix and muted growth in Europe. Operating profit was up 51.7% y-o-y to Rs. 108 crore due to lower raw-material cost and other expenses. Better OPM was a result of execution efficiencies. Following the write-off, the company has reported net loss of Rs. 111 crore. Adjusting for the loss, net profit stands at Rs. 78 crore (above our estimate of Rs. 52 crore). Order backlog at the end of the quarter stood at Rs. 12,055 crore (excluding framework contracts). Order intake in FY2023 has been robust at around Rs. 6,884 crore, which includes 400 MLD Perur, Chennai – desalination plant project of ~Rs. 3,680 crore won in Q4FY2023.

Order book mix has 39% of O&M contracts

The order book has Rs. 4,700 crore of O&M contracts, a large part of which is from the municipal segment. A large chunk of the order book comes from municipal orders and industrial comprises only 14% of the orders. The order book has 36% of international orders. Since the company has won a large desalination plant order from Chennai municipal corporation, the order book is skewed more towards municipal orders in the domestic market.

Q4FY2023 and FY2023 investor meet 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 is a preferred bidder in several projects in desalination/industrial water treatment projects and projects should be awarded in the next 6-8 weeks. These orders will be funded by multilateral agencies. Moreover, Russia has a strong enquiry pipeline and the company continues to pursue opportunities 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.
- **Guidance for revenue and EBITDA margin:** The company aims to have meaningful revenue growth, given its robust order book. The company has strong execution capabilities and is expected to achieve good revenue growth. The company expects double-digit margins in FY2024E.
- **Strong execution ramp-up expected in Russia project:** The company expects that Amur Gas Chemical Complex LLC, Russia project would have strong execution in FY2024 and would contribute significantly to revenue generation.
- **Revenue from Chennai desalination plant expected from H2FY2024:** The order is under planning stage and the company would be starting the engineering part in H1FY2024, post which the project execution is expected to pick up pace in H2FY2024. The entire project is likely to be executed in 42 months. The order value of Rs. 3,680 crore comprises Rs. 1,600-1,700 crore of O&M (executable for 20 years) and the rest is EPC portion.
- **Provision is predominantly for APGENCO project:** The provision of Rs. 289 crore, while it includes a small part of Tecpro, is predominantly for APGENCO project. Although the company has written-off the receivables due to delays in decisions by NCLT, it would continue to pursue the recovery of receivables.
- **Green hydrogen is a long-term opportunity:** Va Tech has expertise in water treatment for semiconductor plants, which require ultrapure water. Thus, it is confident that it would be able to cater to green hydrogen plants as well in the future. However, scalability in the use of green hydrogen depends on its economic viability and, therefore, the company does not see any near-term opportunity in this space.
- **Focus on improving 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.
- **VA Tech does not intend to get into the B2C business:** The company does not have any plans to get into the B2C business such as packaged drinking water.
- **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.
- **Effective tax rate, interest rate, and R&D as a % of sales:** The effective tax rate is expected to be 24-25% for FY2024. Its cost of capital is ~9% currently. The company's R&D expense is 1% of its revenue.

Results (Consolidated) **Rs cr**

Particulars	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)
Revenue	**926.9**	**891.9**	**3.9**	**651.6**	**42.3**
Operating Profit	**108.4**	**71.5**	**51.7**	**92.0**	**17.9**
Depreciation	2.2	2.5	-15.4	2.2	-1.4
Interest	16.2	23.5	-31.2	16.2	-0.3
Other Income	7.7	9.6	-20.6	2.0	275.0
PBT	**97.8**	**55.1**	**77.4**	**75.6**	**29.3**
Exceptional item	-243.4	0.0	NM	-17.1	NM
Tax Expense	-29.9	10.5	NM	13.3	NM
Reported PAT	**-112.0**	**46.1**	**NM**	**46.5**	**NM**
EPS (Rs.)	**-18.0**	**7.4**	**NM**	**7.5**	**NM**
Adjusted PAT	**78.0**	**46.3**	**68.4**	**64.2**	**21.3**
Adjusted EPS (Rs.)	**12.5**	**7.4**	**68.4**	**10.3**	**21.3**
Margins			**BPS**		**BPS**
OPM (%)	11.7	8.0	368	10.9	82
NPM (%)	7.8	5.2	263	6.6	120

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.

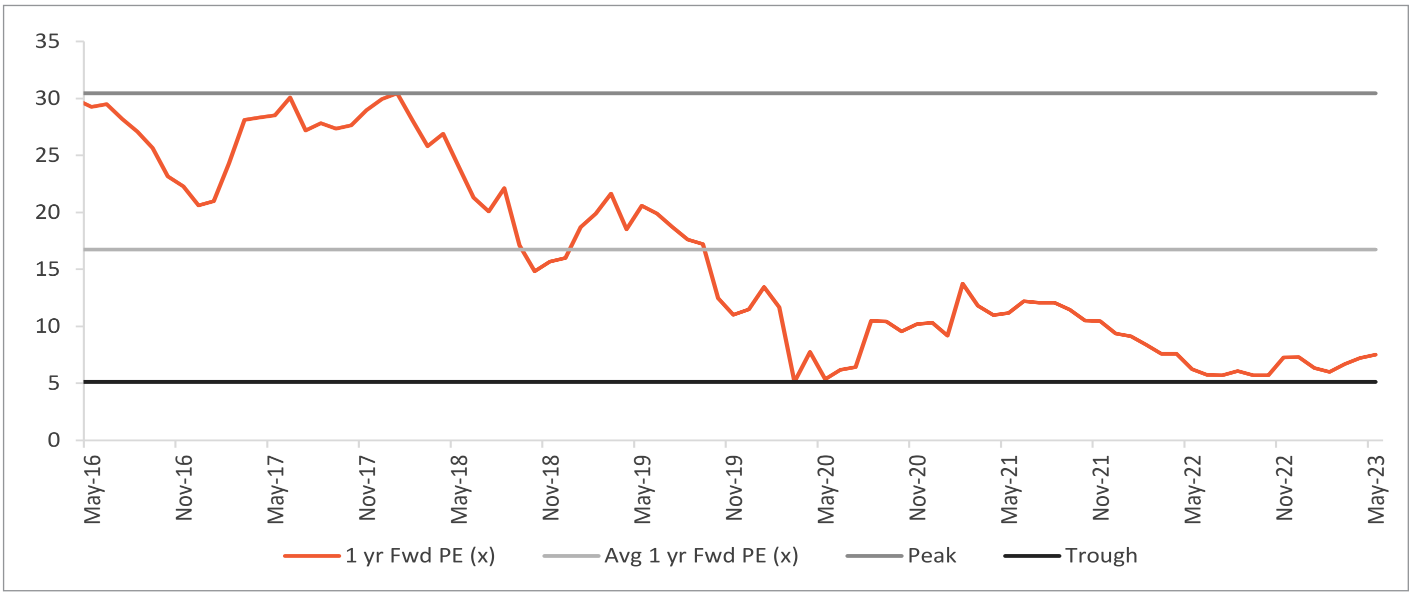
■ Company outlook - Creating enduring value

The company has a strong order book of over Rs. 12,055 crore (over 4x its FY2023 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. 520

VA Tech has shown strong recovery in execution and margins in FY2023, while its working capital cycle and debt levels have improved. However, its bottom-line performance has been impacted by write-off of receivables of Rs. 243 crore, which may weigh on the stock in the near term. 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 in the medium to long term. Moreover, the recently awarded desalination 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. At the CMP, the stock trades at P/E of ~13x and ~8x its FY2024/FY2025E earnings, which we believe is attractive, given an optimistic outlook on business and earnings. Hence, we maintain our Buy rating with a revised price target (PT) of Rs. 520.

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: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Jhunjhunwala Rekha Rakesh	8.04
2	Norges Bank	4.04
3	Government Pensi	4.04
4	Federated Hermes Incorporation	3.20
5	Federated Hermes Investment Funds	3.17
6	SBI Funds Management	2.54
7	KBI Global Investors	2.53
8	Baserav Home Finance Private	2.41
9	KBI Water Fund	2.34
10	Sattva India Opportunities Company Limited	1.13

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 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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