



Powered by the Sharekhan 3R Research Philosophy

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. 2,207 cr
52-week high/low:	Rs. 404 / 183
NSE volume: (No of shares)	7.7 lakh
BSE code:	533269
NSE code:	WABAG
Free float: (No of shares)	0.0 cr

Shareholding (%)

Promoters	21.7
FII	17.2
DII	3.6
Others	57.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.8	4.2	33.2	89.2
Relative to Nifty	6.1	-4.0	11.5	51.9

Sharekhan Research, Bloomberg

Va Tech Wabag Ltd

Strong performance with healthy order visibility

Capital Goods		Sharekhan code: WABAG		
Reco/View: Buy	↔	CMP: Rs. 355	Price Target: Rs. 435	↔
↑ Upgrade	↔ Maintain	↓ Downgrade		

Summary

- We maintain Buy on Va Tech Wabag with unchanged PT of Rs. 435, considering strong order book and healthy balance sheet.
- Q2FY2022 revenue was broadly in-line, while OPM surprised positively as the company expedites execution, increasing net debt to protect margins.
- Order inflow rose 3x y-o-y for H1FY2022. Order book at Rs. 10,041 crore is 3.2x its TTM revenue, providing healthy revenue visibility.
- Order pipeline in domestic and overseas markets remains buoyant. The company expects to conclude three orders in Middle East and similar in domestic market in H2.

Va Tech Wabag reported broadly in-line consolidated revenue at Rs. 684 crore, up 12.4% y-o-y, as the company increased net debt and reduced payables to expedite project execution and protect operating margins (rise in commodity prices along with COVID-19 led project delays). Consolidated operating profit margin (OPM) at 8.3% (+116 bps y-o-y) was higher than our estimate of 6.1%. Standalone net profit growth of 57% y-o-y was aided by strong operational performance along with higher other income, lower interest expense, lower depreciation, and lower effective tax rate. Total order inflows during H1FY2022 rose 3x y-o-y at Rs. 1,867 crore, led by 3.5x y-o-y rise in India order book and 2.1x in overseas. Order backlog at Q2FY2022 end stands at Rs. 10,041 crore, 3.2x its TTM revenue, providing healthy revenue visibility. We expect strong execution to continue going ahead along with healthy order inflows.

Key positives

- Trade receivables remained almost flat q-o-q despite increased revenue.
- Domestic revenue jumped 42.4% y-o-y (up 7.2% q-o-q) at Rs. 492 crore.

Key negatives

- Net debt rose by Rs. 268 crore q-o-q to expedite execution and protect OPM.
- Overseas revenue declined by 30.9% y-o-y (-7.7% q-o-q) at Rs. 178 crore.

Management Commentary

- The company saw construction work and supply chain at near normal levels. It deployed working capital and additional resources to expedite execution.
- The company expects to close 50% of half a dozen orders in Middle East over the next two quarters. Similarly, it expects healthy order intake from India.
- Bids for Chennai Desalination Project are expected to be submitted by January 2022, while the award is likely in Q1FY2023. The company is one among the four pre-qualified to submit bids.
- The company expects H2 to be better than H1 but has not given any guidance due to COVID-led uncertainties. OPM of 10-11% is possible.

Revision in estimates – We have retained our earnings estimates.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 435: Va Tech Wabag is on a strong earnings growth trajectory going ahead with concerns of high leverage, led by increasing working capital now behind it. A 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. At the CMP, the stock trades at P/E of 10x its FY2024E earnings, which we believe is attractive considering its strong net earnings growth outlook and strengthened balance sheet. Hence, we maintain Buy with an unchanged PT of Rs. 435.

Key Risks

- Decline in domestic capex and impact on gross margin due to rise in commodity costs.
- Problems in execution could impact earnings growth.

Valuation (Consolidated)

Particulars	FY21	FY22E	FY23E	FY24E
Revenue from Operations	2,834	3,235	3,677	4,132
Operating Profit Margin (%)	7.7	8.4	8.7	9.0
RPAT	100	134	180	218
AEPS (Rs.)	16.1	21.5	29.0	35.1
P/E (x)	22.0	16.5	12.2	10.1
Price/ Book (x)	1.6	1.4	1.3	1.1
EV/EBITDA (x)	9.9	8.2	7.1	6.1
RoCE (%)	10.9	12.9	14.2	14.8
RoE (%)	7.8	9.0	10.9	11.7

Source: Company; Sharekhan estimates

Better-than-expected OPM leads to strong beat on net earnings

Va Tech Wabag reported 12.4% y-o-y growth in consolidated net revenue at Rs. 684 crore for Q2FY2022, which was marginally lower than our estimate. Consolidated OPM at 8.3% (+116 bps y-o-y, +330 bps q-o-q) was much higher than our estimate of 6.1%. Higher OPM was driven by improvement in execution along with project mix. Hence, operating profit grew by 30.7% y-o-y to Rs. 56.6 crore (much higher than our estimate). Strong operational performance led to 57% y-o-y rise (+72% q-o-q) in consolidated net profit at Rs. 26 crore, which was much higher than our estimate.

Order outlook remain buoyant

The company expects H2 to be better than H1 but has not given any guidance due to COVID-led uncertainties. OPM of 10-11% going ahead is possible as per management. The company remains bullish on order inflows for H2. Total order inflows during H1FY2022 rose 3x y-o-y at Rs. 1,867 crore, led by 3.5x y-o-y rise in India order book and 2.1x in overseas. Order backlog at Q2FY2022 end stands at Rs. 10,041 crore, 3.2x its TTM revenue, providing healthy revenue visibility. The company is seeing good traction in the Middle East, Africa, and Indian markets. Water security is the most important factor in ESG and sustainability ratings are expected to lead to healthy order inflows both domestically and internationally. Industrial water treatment has been growing at not less than 15% p.a., which is expected to gain traction going ahead. The company expects to close 50% of half a dozen orders in Middle East over the next two quarters. Similarly, the company expects projects to close in India. The company would be meeting its order inflow guidance for FY2022. We expect strong execution to continue going ahead along with healthy order inflows.

Q2FY2022 Concall Highlights:

- ◆ **Q2 Performance:** The company saw construction work and supply chain at near normal levels. The company deployed working capital and additional resources to expedite execution. A mix of project execution led to lower international revenue versus domestic revenue. Once Russia project picks up, rest of the world revenue would increase. Trade payables have risen to pick up pace of projects. Commodity price inflation and COVID-related extension in time of 6 to 8 months led to a conscious decision of expediting execution and protecting margins.
- ◆ **Guidance:** The company expects H2 to be better than H1 but has not given any guidance due to COVID-led uncertainties. OPM of 10-11% is possible. The company remains bullish on order inflows for H2.
- ◆ **Outlook:** The company is seeing good traction in the Middle East, Africa, and Indian markets. Water security is most important in ESG and sustainability ratings. Industrial water treatment has been growing at not less than 15% p.a. The company expects to close 50% of half a dozen orders in the Middle East over the next two quarters. Similarly, the company expects projects to close in India. The company would be meeting its order inflow guidance for FY2022.
- ◆ **Namami Gange:** The scheme has been extended to all rivers in the country. It sees this as a huge opportunity on treatment side over a decade.
- ◆ **Chennai Desalination Project:** The bids are to be submitted by January 2022, while the award is likely in Q1FY2023. The company is one among the four pre-qualified ones to submit bids.
- ◆ **Libya Projects:** The country has given preference to drinking water and power due to tight liquidity position. Hence, the company's drinking water project would come up in execution in one quarter while other projects related to sewage treatment are expected to take 2-3 quarters to get line of credit.
- ◆ **AP and Telangana Dues:** The same are under litigation under NCLT and Supreme Court. It has done couple of hearings. It expects favourable outcome in the next one or two quarters.
- ◆ **Bank charges:** The bank charges are higher due to contracts in Russia and Malaysia for which domestic bank charges are almost double.
- ◆ **Free cash flow:** Free cash flow for H1 stands at Rs. 280 crore.

Results (Consolidated)

Particulars	Q2FY2022	Q2FY2021	YoY	Q1FY2022	Rs cr QoQ
Revenues	684.0	608.4	53.0%	658.0	-34.0%
EBITDA	56.6	43.3	13.0%	32.7	-57.0%
Depreciation	2.6	3.5	-8.0%	2.7	-2.0%
Interest	22.2	23.7	-8.0%	19.8	-11.0%
Other Income	3.0	1.7	998.0%	14.3	815.0%
PBT	34.8	17.8	176.0%	24.5	-63.0%
Total Tax	9.3	4.4	147.0%	5.7	-47.0%
PAT before minority interest	25.6	13.4	189.0%	18.9	-67.0%
Associate Income/Minority Interest	0.7	3.3		-3.6	
Adjusted PAT	26.2	16.7	189.0%	15.2	-67.0%
EPS (Rs.)	4.2	2.7	189.0%	2.4	-67.0%
Margins			BPS		BPS
EBITDA Margin	8.3%	6.7%	157	7.6%	67
PAT Margin	3.8%	1.2%	263	4.4%	-57
Tax Rate	26.6%	31.0%	-441	20.0%	659

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook – Investments by Governments and Private Sectors will play a vital role in water

Waste-water technology is primarily used by municipal authorities to treat waste-water in various Indian cities. Rising urban population in major Indian cities has created demand for waste-water 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 owing to 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 size of \$211 billion by 2025 at a CAGR of 6.5% over 2019-2025. India 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 Wabag Limited, and DuPont. Increasing demand for water-treatment facilities across the world will have a positive impact on the market's growth in the coming years.

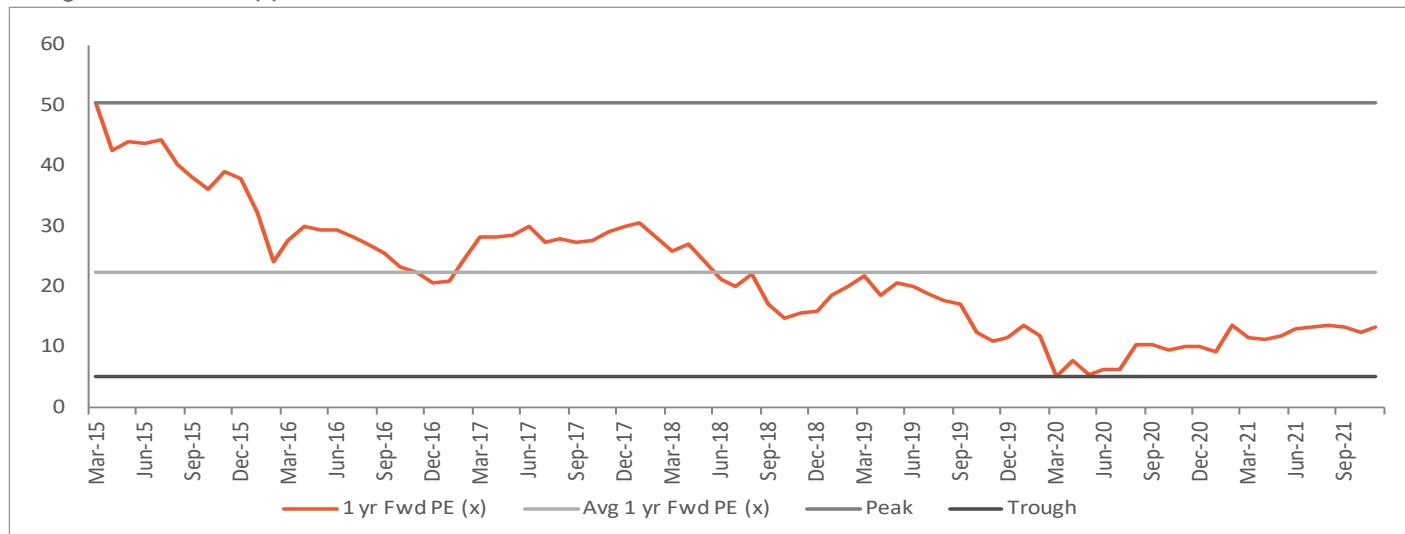
■ Company outlook – Creating Enduring Value

The company has a strong order book of Rs. 10,041 crore (3.2x TTM consolidated revenue, largely executable with financial closure of HAM projects) funded by the Centre, multilateral agencies, or sovereign entities, which provide comfort on cash collections and execution. The company generated Rs. 380 crore of net operating cash flows over FY2020-FY2021 and managed to curtail the rising working capital requirement, which strengthened the balance sheet. Further, the company generated free cash flows of Rs. 300 crore during FY2020-FY2021, which is also aided by its asset-light model. We expect the company to generate over Rs. 300 crore of free cash flows over FY2022-FY2023, led by strong operating cash flow generation, tighter control on working capital, and lower capex requirements. The company is well placed to receive continuous flow of orders having a strong project execution track record and marquee clients, led by its asset-light business model and strengthened balance sheet profile.

■ Valuation – Maintain Buy with unchanged PT of Rs. 435

Va Tech Wabag is on a strong earnings growth trajectory going ahead with concerns of high leverage, led by increasing working capital now behind it. A 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. At the CMP, the stock trades at P/E of 10x its FY2024E earnings, which we believe is attractive considering its strong net earnings growth outlook and strengthened balance sheet. Hence, we maintain Buy with an unchanged PT of Rs. 435.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Va Tech Wabag 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, 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 Wabag has unique technological knowhow, 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. With decades of rich experience, over 6,000 projects across multiple sectors and state-of-the-art plants in over 20 countries, Wabag is a globally respected organisation. 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.
- ◆ Hike in interest rate might impact profitability as the company has a stretched working capital situation.

Additional Data

Key management personnel

Malay Mukherjee	Chairman (Non-Executive Independent Director)
Rajiv Mittal	Managing Director & Group CEO
Pankaj Sachdeva	Chief Executive Officer
Sandeep Kumar Agrawal	Chief Financial Officer
R Swaminathan	Company Secretary & Compliance Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Mittal Rajiv Devaraj	15.61
2	Jhunjhunwala Rekha Rakesh	8.04
3	Varadarajan Subramanian	3.51
4	Government Pension Fund – Global	3.22
5	Norges Bank	3.21
6	KBI Global Investors	2.75
7	Saraf Shivnarayan J	2.57
8	SBI Funds Management Pvt Ltd	2.54
9	Massachusetts Institute of Technology	2.52
10	Basera Home Finance	2.41

Source: Bloomberg

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