

AGUA (BUY, T.P. MXN\$45.00)

AGUA Day Highlights

Long-term guidance. AGUA continues to expect a 14-15% CAGR in revenues. However, it now anticipates a 16-18% annual average EBITDA growth (vs. the previous 15-16%) due to a stronger performance in Mexico (higher prices and high demand for products) and Argentina (higher prices, high demand and rising exports). It revised down its expectations in the other countries due to lower projected revenues in Brazil's services business.

The company's 2025 goals are to double its sales compared to 2020, to register an adjusted EBITDA margin greater or equal than 20%, a net debt to EBITDA ratio below 2.0x, a double-digit ROIC (close to 20%) above the WACC and that the Capex to sales ratio remains at around 5%. In Bebbia, the company expects to reach 350 thousand users (vs. 56 thousand in 3Q21). We believe these projections are achievable.

The main long-term drivers include regulations that are becoming more restrictive especially with respect to large consumers, decentralization of water systems, climate change (which will continue to impact the centralized systems), population growth and migration (especially to areas with limited water capacity), greater investment in modernization of water systems (Mexico and the United States have obsolete systems), and the use of new sustainable sources of energy, such as hydrogen, which will require a greater use of water, among others.

By business type, AGUA now expects product revenue to represent 90% of total sales in 2025 and service revenue to contribute the remaining 10%. It previously expected an 85/15 mix. Products has presented greater-than-expected traction.

Country strategy. In Mexico, the company will continue to expand its product portfolio, it plans to maintain its leadership, adopt new manufacturing technologies to reduce water and energy consumption, and develop e-commerce solutions in the product business and in Bebbia and Sytesa. In Central America, it will maintain the leadership in water storage, continue to develop the water flow business, increase the product offering, and focus on new initiatives to increase sales; It will also expand into the southern region of Central America with the recent opening of the Nicaragua plant. In Argentina, it will maintain its leadership position in the three businesses, increase exports, boost margins and it plans to generate positive free flow. In the United States, it will increase the Acuantia brand's positioning and market share. It will also launch additional products and services, maintain an aggressive omnichannel strategy, and enhance the digital platform. In Brazil, the focus will be to expand the water treatment and recycling businesses.

The company has 50 initiatives related to new launches and new sales channels. It also plans to provide water treatment and recycling services in the United States. Also, there is an opportunity to cross-sell in multiple countries.

Martin Lara

+5255-6413-8563

martin.lara@miranda-gr.com

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Impact of higher raw material/logistics costs. AGUA recorded MXN\$130 million impact on EBITDA in 2Q21 and another MXN\$210 million in 3Q21 related to higher raw materials and logistics costs due to the disruption of global supply chains. However, the company began to raise prices in all countries as of 3Q21 and carried out price increases in certain countries and specific categories during 4Q21. As a result, AGUA expects its margins to expand compared to 3Q21. It anticipates that supply chains will improve over the next few months, limiting further increases in raw material prices. The company expects its margins to normalize during the second half of next year.

Flow program. AGUA expects to record the last charge related to the implementation of the Flow program during 4Q21. In our opinion, this program has been very successful as it contributed 45% of the EBITDA generation in 9M21. It has included 250 initiatives, out of 1,100, with a positive impact on operating results, with a MXN\$188 million investment in 9M21. More than 740 employees have participated in this process and the success rate has risen from 60% to 65%. The full benefits of the Flow Program will be delivered over the next 5 years with a 6x cash return compared to the investments made.

Water digitalization. AGUA acquired a minority stake in Banyan Water in order to be at the forefront of the water digitalization process. This includes a better use of water through data and metrics, and the implementation of scalable solutions for mass consumption. AGUA plans to digitize its ecosystem, which includes 20,000 plumbers, 56,000 Bebbia users, and 30,000 e-commerce clients.

Agile. This is an initiative to accelerate and scale the value creation. Initially, Agile will be implemented in Acuantia and Bebbia.

Riego. The irrigation business has a large pipeline and it is expected to present interesting results towards the end of 2022 or the beginning of 2023.

ESG strategy. AGUA's ESG strategy is based on three pillars: economic benefit, people and planet. The goal for 2025 is to evaluate 100% of suppliers with ESG criteria, compound net promoter score (NPS score) of 80 points for products and services (67 in 2021), impact 1 million people with its sanitation and access to water solutions, purify 1.7 million m³ of water with its solutions (164 thousand m³ in 2021), reduce the intensity of scope 1 and 2 CO₂ emissions to 0.41 (0.51 in 2021), to have a workforce with 30% of women and be net zero by 2040. For more details, please refer to the Miranda ESG report.

Conclusion. We reiterate our BUY recommendation with a MXN\$45.0/share target price after AGUA Day. We continue to believe that the company's outlook is favorable. In addition, its valuation is attractive since its shares trade at a forward EV/EBITDA of 8.4x, compared to the average of 17.5x for its global water peers. The company's growth potential is higher than that of its global counterparts.

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