

VA TECH WABAG

Operating results in line; Growth prospects intact

India Equity Research | Engineering and Capital Goods

VA Tech Wabag (VATW) posted in-line Q4FY17 operating numbers (consolidated) with sales and EBITDA jumping 33% and 17% YoY, respectively, led by strong overseas operations. Top 3 quarter highlights are: a) despite strong execution in domestic operations, EBITDA margin plummeted 830bps to 7.7% due to INR140mn provisions and low-margin order execution; b) Q4 order intake stood at INR 24bn (up 38% YoY), implying INR 81bn order book (flat YoY); and c) FY18 sales and order intake guidance at INR 40bn and INR 45bn (upper band) implies 20% and 7% YoY growth, respectively, which in our view is reasonable. Maintain 'BUY' with revised TP of INR725 (INR685 earlier) as we revise up FY18E and FY19E EPS 5% each on better execution and stabilising profitability.

Strong overseas performance offsets weak standalone

VATW posted strong top-line growth of 33% and 27% YoY for consolidated and standalone operations, respectively, led by execution of large jobs. However, cost provisions and weak margins in several low-end domestic jobs impacted standalone margin, which at 7.7% plummeted 830bps YoY. Overseas performance improved substantially with EBITDA catapulting >200% to INR772mn, albeit on a low base. Given that most of the low-end domestic jobs are nearing closure, we expect margin to gradually improve going ahead.

Receivables remain key monitorable; outlook bullish

While receivable days rose marginally to 253 in FY17 versus 249 in FY16, payable days dipped to 185 in FY17 versus 192 in FY16 on consolidated basis. Consolidated debt dipped to INR3.1bn from INR3.7bn in FY17 led by reduction in short-term debt. Management is bullish on domestic market prospects and expects more than INR200-250bn worth of ordering over the next 3-4 years from the Clean Ganga Project, apart from other jobs in Maharashtra, Tamil Nadu etc. In overseas jobs, opportunities in the Middle East for desalination, Sub-Sahara region & other emerging countries remain key growth drivers. We expect VATW to corner significant share of domestic jobs given its strong positioning in the domestic market versus local as well as global competition.

Outlook and valuations: Strong growth; maintain 'BUY'

While we remain upbeat on execution and new order growth over the next 2-3 years given huge opportunities and VATW's solid track record, our focus is primarily on working capital and liquidated damages, which are key risks that could hamper growth. We maintain 'BUY/SO'.

Financials (Consolidated)

	(INR mn)							
Year to March	Q4FY17	Q4FY16	% change	Q3FY17	% change	FY17E	FY18E	FY19E
Net revenues	11,317	8,488	33.3	7,183	57.6	32,079	38,859	45,901
EBITDA	1,317	1,127	16.9	794	65.7	2,966	3,592	4,265
Adj. profit	757	651	16.3	(26)	(3,058)	1,024	1,930	2,275
Diluted EPS (INR)	14.2	12.2	16.3	(0.5)	(3,058.2)	19.1	36.1	42.5
Diluted P/E (x)						35.3	18.7	15.9
ROAE (%)						11.6	18.3	18.4

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	None

MARKET DATA (R: VATE.BO, B: VATW IN)

CMP	: INR 675
Target Price	: INR 725
52-week range (INR)	: 737 / 450
Share in issue (mn)	: 54.6
M cap (INR bn/USD mn)	: 37 / 572
Avg. Daily Vol. BSE/NSE ('000)	: 141.9

SHARE HOLDING PATTERN (%)

	Current	Q2FY17	Q1FY17
Promoters *	24.7	28.8	28.8
MF's, FI's & BKs	24.0	24.2	24.1
FII's	25.9	26.1	27.9
Others	25.4	20.9	19.3
* Promoters pledged shares (% of share in issue)	:	NIL	

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	(3.7)	(2.0)	1.7
3 months	5.1	22.6	17.5
12 months	28.4	22.0	(6.4)

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Q4FY17 analyst meet: Key highlights

- **FY18 guidance:** Revenue of INR38-40bn and order intake of INR43-45bn.
- **Namami Gange:** Management expects traction to improve on Namami Gange project awarding which is a total opportunity of INR200-250bn (on treatment plants) over the next 3-4 years. While 40% of the projects will be funded by the Central government, balance 60% will have to be funded by the project winner and will have to maintain 26% equity in it (effectively, equity contribution in total project will be around 17-18%). They will be annuity based projects for next 15 years. VATW has passed enabling resolution for fund raising for the same.
- **Opportunities in Middle East:** Large number of desalination plants and reuse plants are planned in the region. Fall in oil prices is driving companies to look East to award projects.
- **Opportunities in Sub Sahara:** Sub Sahara is another goldmine where a lot of projects are coming up funded by multilateral agencies including UNO for drinking water.
- **Net working capital days:** Net working capital days fell to 68 from 77 in FY17. They are expected to fall further as high working capital projects are nearing closure and going forward there will be higher mix in revenue of export contracts which have better WC cycles. Also, the focus is on E&P projects (better WC cycle) and not just typically construction projects.
- **Acquisitions :** VATW has no plans to acquire assets in the future. It may acquire some company for technological purpose, if available at reasonable price.
- Current R&D spend is 1% of sales, which is expected to rise to 2% over the next 2 years.
- **Oman arbitration:** The project had 3 partners with VATW's share at 26%. The project had very strict timelines and for various reasons it was delayed. VATW sought arbitration and the order came against it. For future, any projects the company goes in as a partner it will have majority control or majority operating control.

Financial snapshot

(INR mn)

Year to March	Q4FY17	Q4FY16	% change	Q3FY17	% change	FY17	FY18E	FY19E
Net revenues	11,317	8,488	33.3	7,183	57.6	32,079	38,859	45,901
Raw material	9,058	6,468	40.0	5,400	67.7	25,388	30,151	35,631
Staff costs	582	583	(0.1)	658	(11.5)	2,440	3,146	3,685
Other operating expenses	361	310	16.3	331	9.1	1,286	1,971	2,321
Total expenditure	10,001	7,361	35.9	6,389	56.5	29,113	35,268	41,637
EBITDA	1,317	1,127	16.9	794	65.7	2,966	3,592	4,265
Depreciation	52	51	1.2	46	11.4	191	231	257
EBIT	1,265	1,075	17.6	748	69.1	2,775	3,361	4,008
Other income	3	38	(91.2)	35	(90.5)	112	154	154
Interest	161	152	5.4	137	16.8	526	529	593
Add: Exceptional items								
Profit before tax	1,108	961	15.3	646	71.6	2,362	2,986	3,569
Tax	326	305	6.9	45	631.8	667	1,040	1,276
Minority interest	38	3	1,002.9	22	71.2	98	68	80
Associate profit share	13	-	(3,450.0)	(605)	(102.2)	(573)	53	61
Reported net profit	757	651	16.3	(26)	(3,058.2)	1,024	1,930	2,275
Adjusted Profit	757	651	16.3	(26)	(3,058.2)	1,024	1,930	2,275
Equity capital(FV INR 2)	54	54		54		54	54	54
Diluted shares (mn)	54	54		54		54	54	54
Adjusted Diluted EPS	14.2	12.2	16.3	(0.5)	(3,058.2)	19.1	36.1	42.5
Diluted P/E (x)	-	-		-		35.3	18.7	15.9
EV/EBITDA (x)	-	-		-		12.3	10.5	9.0
ROAE (%)	-	-		-		11.6	18.3	18.4
As % of net revenues	-	-		-		2	2	2
Direct costs	80.0	76.2		75.2		79.1	77.6	77.6
Employee cost	5.1	6.9		9.2		7.6	8.1	8.0
Other expenses	3.2	3.7		4.6		4.0	5.1	5.1
EBITDA	11.6	13.3		11.1		9.2	9.2	9.3
Depreciation	0.5	0.6		0.6		0.6	0.6	0.6
Interest expenditure	1.4	1.8		1.9		1.6	1.4	1.3
Tax rate	29.5	31.8		-		28.2	34.8	35.7

Change in Estimates

	FY18E			FY19E			Comments
	New	Old	% change	New	Old	% change	
Net Revenue	38,859	38,738	0.3	45,901	43,255	6.1	
EBITDA	3,592	3,638	(1.3)	4,264	4,117	3.6	
EBITDA Margin	9.2	9.4		9.3	9.5		
Adjusted Profit	1,930	1,821	6.0	2,275	2,154	5.6	
After Tax							
Net Profit Margin	5.1	4.9		5.1	5.2		
Capex	550	550	0.0	550	550	0.0	

Company Description

VATW is a multinational player in the water treatment industry with presence in India, the Middle East, North Africa, Central and Eastern Europe, China and South East Asia through principal offices in India, Austria, the Czech Republic, China, Switzerland, Algeria, Romania, Tunisia, UAE, Libya and Macau. It offers complete life cycle solutions including conceptualisation, design, engineering, procurement, supply, installation, construction and O&M (operational and maintenance) services. The company provides a range of EPC and O&M solutions for sewage treatment, processed & drinking water treatment, effluents treatment, sludge treatment, desalination and reuse for institutional clients like municipal corporations and companies in the infrastructure sector such as power, steel and oil & gas companies. Till date, VATW has executed 2,250 projects and is currently executing 72 projects. It is a technology-focused player with R&D centers in Chennai, India, Vienna in Austria and Winterthur in Switzerland respectively. Wabag Austria and Wabag Wassertechnik own 157 patents, which include both process and product patents. VATW has approximately 1,469 employees including 757 qualified engineers. In India, it has around 754 employees including 588 qualified engineers. The company benefits from association with the Wabag brand. In 2007, it acquired Wabag Austria, thereby taking over the Wabag Group (founded in 1924). It has a project reference list of more than 2,250 over the past three decades. The company benefits from association with the Wabag brand. In 2007, it acquired Wabag Austria, thereby taking over the Wabag Group (founded in 1924). It has a project reference list of more than 2,250 over the past three decades.

Investment Theme

Unmatched capability in water and waste-water projects :VATW has the strongest portfolio of water treatment/waste water/desalination, etc., in India and unlike most EPC peers has in-house technology, which we believe is the key to its pole position. Its strong technological competence coupled with a large talent pool impart it the resources to successfully execute complex water projects. India, emerging markets hold humungous growth potential : India, with low per capita water supply of 146lts/day versus developed nations' 500lts/day, has huge potential. Also, with rising stringent norms for waste-water treatment, the scope for VATW is enormous, especially given that less than 30% of industrial waste-water is not treated before release. The company has made significant inroads in China, Saudi Arabia, Egypt, Spain and Turkey—key emerging markets— clocking high growth in water and waste-water treatment. Asset-light business model drives RoCE and cash flow : VATW has an asset-light business model, which imparts it the capability to take on larger volume of projects and generate higher RoCE. The company has identified critical areas which are mostly retained in-house, while non-critical, low-value add work is outsourced

Key Risks

Execution risk : The company outsources construction and depends on the sub contractors for timely completion of projects. Any delays by the latter could negatively impact VATW's margin. Delays in revival of international operations : The company is reducing costs in its international operations by cutting workforce in high-cost locations and is instead focusing on domestic units. Any delays in revival of international business could impact margin improvement.

Financial Statements

Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.2	6.5	7.1	7.7
Inflation (Avg)	4.9	4.8	5.0	5.2
Repo rate (exit rate)	6.8	6.0	5.8	5.8
USD/INR (Avg)	65.0	67.5	69.0	69.0
Company				
A) EPC municipal bus.	(21.5)	38.9	39.6	12.3
B) EPC industrial bus.	53.8	39.0	8.8	25.6
C) O&M municipal bus.	10.0	(33.8)	4.8	21.4
D) O&M industrial bus.	3.6	(2.3)	(1.1)	11.4
A) EPC municipal bus	169.5	(27.9)	3.0	4.3
B) EPC industrial bus	86.0	(15.5)	(0.7)	6.7
C) O&M municipal bus	(38.8)	15.1	16.1	17.4
D) O&M industrial bus	(40.0)	17.7	17.8	18.0
Dep (% of Avg GFA)	9.3	11.7	4.7	4.7
Tax rate (%)	38.2	28.2	34.8	35.7

Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Income from operations	25,083	32,079	38,859	45,901
Direct costs	19,402	25,388	30,151	35,631
Employee costs	2,113	2,440	3,146	3,685
Other Expenses	1,237	1,286	1,971	2,321
Total operating expenses	22,753	29,113	35,268	41,637
EBITDA	2,330	2,966	3,592	4,265
Depreciation	205	191	231	257
EBIT	2,125	2,775	3,361	4,008
Add: Other income	79.00	112.3	154.38	154.46
Less: Interest Expense	457	526	529	593
Profit Before Tax	1,747	2,362	2,986	3,569
Less: Provision for Tax	668	667	1,040	1,276
Less: Minority Interest	16	98	68	80
Associate profit share	(175)	(573)	53	61
Reported Profit	887	1,024	1,930	2,275
Adjusted Profit	887	1,024	1,930	2,275
Shares o/s (mn)	54	54	54	54
Adjusted Basic EPS	16.6	19.1	36.1	42.5
Diluted shares o/s (mn)	54	54	54	54
Adjusted Diluted EPS	16.6	19.1	36.1	42.5
Adjusted Cash EPS	22.6	23.2	40.4	47.3
Dividend per share (DPS)	4.0	4.0	5.0	5.0
Dividend Payout Ratio(%)	29.7	25.1	16.6	14.1

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	90.7	90.8	90.8	90.7
EBITDA margins	9.3	9.2	9.2	9.3
EBIT margins	8.5	8.7	8.6	8.7
Net Profit margins	3.6	3.5	5.1	5.1

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	3.0	27.9	21.1	18.1
EBITDA	11.2	27.3	21.1	18.7
Adjusted Profit	(19.4)	15.4	88.5	17.9

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	109	109	109	109	
Reserves & Surplus	9,094	9,822	11,432	13,385	
Shareholders' funds	9,203	9,931	11,541	13,495	
Minority Interest	82	173	241	321	
Short term borrowings	3,272	2,459	3,376	3,428	
Long term borrowings	501	632	1,501	2,001	
Total Borrowings	3,773	3,091	4,877	5,429	
Long Term Liabilities	193	605	605	605	
Sources of funds	13,493	14,093	17,557	20,143	
Gross Block	1,547	1,707	2,157	2,607	
Net Block	1,084	1,053	1,402	1,729	
Capital work in progress	24	-	50	100	
Intangible Assets	671	692	612	528	
Total Fixed Assets	1,779	1,745	2,064	2,357	
Non current investments	205	33	33	33	
Cash and Equivalents	3,904	2,809	3,622	3,624	
Inventories	976	385	1,652	1,952	
Sundry Debtors	19,424	25,115	27,148	32,068	
Loans & Advances	139	51	52	52	
Other Current Assets	2,540	3,122	3,746	4,495	
Current Assets (ex cash)	23,079	28,673	32,598	38,568	
Sundry creditors	11,787	14,001	15,695	18,548	
Provisions	3,687	5,165	5,065	5,890	
Total Current Liab	15,474	19,166	20,760	24,438	
Net Curr Assets-ex cash	7,606	9,507	11,837	14,128	
Net Deferred tax	241	293	293	293	
Uses of funds	13,493	14,093	17,557	20,143	
BVPS (INR)	172.0	185.6	215.7	252.2	

Free cash flow		(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E	
Reported Profit	887	1,024	1,930	2,275	
Add: Depreciation	205	191	231	257	
Interest (Net of Tax)	282	377	345	381	
Others	317	247	252	292	
Less: Changes in WC	3,644	1,951	2,331	2,291	
Operating cash flow	(1,952)	(111)	427	913	
Less: Capex	146	348	550	550	
Free Cash Flow	(2,097)	(459)	(123)	363	

Cash flow metrics		FY16	FY17	FY18E	FY19E
Year to March					
Operating cash flow	(1,952)	(111)	427	913	
Investing cash flow	865	(250)	(550)	(550)	
Financing cash flow	1,604	(1,465)	937	(361)	
Net cash Flow	518	(1,826)	813	2	
Capex	(146)	(348)	(550)	(550)	
Dividend paid	(262)	(257)	(321)	(321)	

Profitability and efficiency ratios		FY16	FY17	FY18E	FY19E
Year to March					
ROAE (%)	9.8	11.6	18.3	18.4	
ROACE (%)	18.4	22.0	23.5	23.2	
Inventory Days	14	10	12	18	
Debtors Days	249	253	245	235	
Payable Days	192	185	180	175	
Cash Conversion Cycle	70	78	78	79	
Current Ratio	1.7	1.6	1.7	1.7	
Debt/EBITDA (x)	1.6	1.0	1.4	1.3	
Fixed asset turnover (x)	13.7	18.3	20.7	21.5	
Debt/Equity (x)	0.4	0.3	0.4	0.4	
Adjusted Debt/Equity	0.4	0.3	0.4	0.4	
Interest Coverage Ratio	4.6	5.3	6.4	6.8	

Operating ratios		FY16	FY17	FY18E	FY19E
Year to March					
Total Asset Turnover	1.9	2.3	2.5	2.4	
Fixed Asset Turnover	13.7	18.3	20.7	21.5	
Equity Turnover	2.7	3.3	3.6	3.6	

Valuation parameters		FY16	FY17	FY18E	FY19E
Year to March					
Adj. Diluted EPS (INR)	16.6	19.1	36.1	42.5	
Y-o-Y growth (%)	(19.4)	15.4	88.5	17.9	
Adjusted Cash EPS (INR)	22.6	23.2	40.4	47.3	
Diluted P/E (x)	40.7	35.3	18.7	15.9	
P/B (x)	3.9	3.6	3.1	2.7	
EV / Sales (x)	1.4	1.1	1.0	0.8	
EV / EBITDA (x)	15.5	12.3	10.5	9.0	
Dividend Yield (%)	0.6	0.6	0.7	0.7	
FCFPS (INR)	(39.2)	(8.6)	(2.3)	6.8	
Y-o-Y gr. in FCFPS (%)	(829.7)	78.1	73.1	394.5	
FCFPE (x)	(17.2)	(78.8)	(293.3)	99.6	

Additional Data

Directors Data

Mr. Bhagwan Dass Narang	Independent Chairman	Mr. Rajiv Mittal	Managing Director & CEO
Mr. Sumit Chandwani	Independent Director	Mr. Jaithirth Rao	Independent Director
S. Varadarajan	CFO	Ms. Revathi Kasturi	Independent Director
Rajiv Balakrishnan	Company Secretary		

Auditors - Walker, Chandiok & Co

**as per last available data*

Holding – Top10

	Perc. Holding	Perc. Holding
No Data Available		

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
10 Nov 2016	Manulife Global Fund Asian Small Cap Equity Fund (Mlas)	Buy	280000	526.93

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
14 Jul 2016	AMIT SENGUPTA	Sell	66276.00

**as per last available data*

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Coverage group(s) of stocks by primary analyst(s): Engineering and Capital Goods

ABB India, Bharat Heavy Electricals, Bharat Forge, Bajaj Electricals, Crompton Greaves, Engineers India Ltd, Greaves Cotton, Havells India, KEC International, Cummins India, Kalpataru Power, Larsen & Toubro, Praj Industries, Ramkrishna Forgings, Siemens, TD Power Systems, Techno Electric & Engineering, Thermax, Triveni Turbine, VA Tech Wabag, Voltas

Recent Research

Date	Company	Title	Price (INR)	Recos
26-May-17	Voltas	Stellar quarter; big white goods market play ; <i>Result Update</i>	475	Buy
25-May-17	Praj Industries	Poor quarter; pinning hopes on 2G ethanol; <i>Result Update</i>	77	Buy
25-May-17	Bharat Forge	Inline operating performance; recovery broad based; <i>Result Update</i>	1,084	Buy

Distribution of Ratings / Market Cap

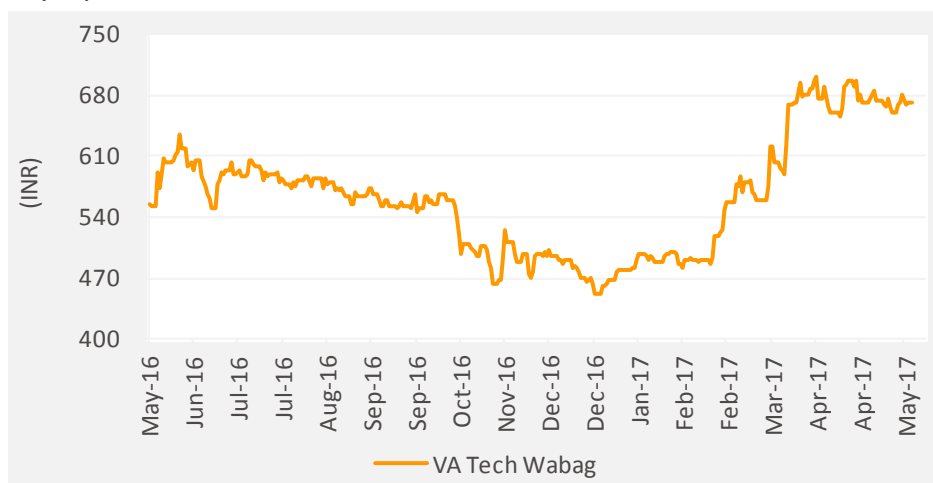
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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