

August 14, 2017

VA Tech Wabag (VATWAB)

₹ 625

Moderate performance; strong outlook...

- VA Tech Wabag (Wabag) reported mixed Q1FY18 numbers. The topline and bottomline came in below our estimates. However, EBITDA came in above our estimates
- Wabag reported revenues of ₹ 668.6 crore, up 15.2% YoY (I-direct estimate: ₹ 694 crore). Lower growth in topline was on account of muted execution in the domestic segment
- Absolute EBITDA increased 52.2% YoY to ₹ 41.8 crore. EBITDA margins came in at 6.3% vs. 4.7% in Q1FY16. Our estimates for EBITDA margins were 5.2% for the quarter. This miss in margins was on account of a decline in 'other expenses' during the quarter. Other expenses declined 2.5% YoY
- The company reported a profit of ₹ 8.4 crore. We estimated PAT of ₹ 13.7 crore for the quarter. Order intake for the quarter was over ₹ 700 crore. The company now has an order backlog of ₹ 8250 crore, including a framework orders of ~₹ 860 crore

Healthy order inflows, improved execution in overseas projects

Wabag now has an order backlog of ₹ 8250 crore, including a framework order of ~₹ 860 crore. Order intake for Q4FY17 was at ~₹ 700 crore. Execution in the overseas segment witnessed healthy pick-up. The same contributed ~74% to the topline in Q1FY18. The management indicated that all overseas projects are now progressing as per schedule. In the overseas market, the management is seeing good traction from Southeast Asia, Latin America, Middle East regions and Sub-Saharan regions.

Positive outlook, orders win from Namami Gange pose upside risks

The company may see large order inflows from 'Namami Gange', the tendering process for which has already started. The management pegged this opportunity to ₹ 4000-5000 crore in the next two to three years. Large order wins from this segment pose upside risk to our target price. Wabag has also planned fund raising up to ₹ 400 crore for meeting equity contribution criteria in any such large project. All such projects are likely to be centrally funded to tune of 40%. The rest 60% is to be funded via debt & equity. Of the 60%, 26% equity to be held by the key technology partner with a three year lock-in and 15 years O&M contract. Apart from this opportunity, Wabag is likely to participate in large upcoming orders from Maharashtra (~₹ 8000 crore) for mega sewage treatment plants, Tamil Nadu (~₹ 5000 crore) for desalination plants, Delhi (~₹ 2500 crore) & Karnataka (~₹ 2500 crore) for water treatment.

Realignment/liquidation to bring-in efficiencies

The management has realigned its business in four key clusters and liquidated unwanted subsidiaries in different regions. Separate teams have been formed to monitor project closures, receivables and make centralized procurements. These initiatives are expected to have a positive impact on the margins by reduce leakages.

Maintain BUY on efficient working capital management, better outlook

We believe timely execution of overseas order and higher contribution from domestic orders will ease working capital concerns. With an improving outlook, we have pencilled in new order wins of ₹ 4,500 crore and ₹ 5000 crore for FY18E and FY19E, respectively. Accordingly, we value the company at 16x FY19E EPS of ₹ 46.4 to arrive at a target price of ₹ 765.

Rating matrix	
Rating	: Buy
Target	: ₹ 765
Target Period	: 12 months
Potential Upside	: 22%

What's Changed?	
Target	Unchanged
EPS FY18E	Changed from ₹ 39.4 to ₹ 37.9
EPS FY19E	Changed from ₹ 48 to ₹ 46.4
Rating	Unchanged

Quarterly Performance					
	Q1FY18	Q1FY17	YoY (%)	Q4FY17	QoQ (%)
Revenue	668.6	580.3	15.2	1132.1	(40.9)
EBITDA	41.8	27.5	52.2	132.0	(68.3)
EBITDA (%)	6.3	4.7	151.9	11.7	(540.5)
APAT	8.4	5.2	60.8	75.7	(88.9)

Key Financials				
₹ Crore	FY16	FY17	FY18E	FY19E
Revenue	2,549	3,219	3,865	4,594
EBITDA	225	308	395	474
EBITDA (%)	8.8	9.6	10.2	10.3
Net Profit	93	170	207	253
EPS (₹)	16.9	18.8	37.9	46.4

Valuation summary				
	FY16	FY17	FY18E	FY19E
P/E	36.9	33.3	16.5	13.5
Target P/E	44.9	24.6	20.2	16.5
EV / EBITDA	15.5	11.3	8.8	7.3
P/BV	3.7	3.4	3.0	2.5
RoNW (%)	10.1	10.6	19.2	20.3
RoCE (%)	20.7	25.8	27.9	28.9

Stock data	
Particular	Amount
Market Capitalization (₹ Crore)	3,394
Total Debt (FY17) (₹ Crore)	113.0
Cash and Investments (FY17) (₹ Crore)	239.1
EV (₹ Crore)	3,268.0
52 week H/L (₹)	749 / 450
Equity capital (₹ Crore)	10.9
Face value	₹ 2

Price performance (%)				
	1M	3M	6M	12M
VA Tech	(9.1)	(7.1)	26.7	6.2
L&T	(2.5)	(2.2)	13.0	15.1
Thermax	(6.5)	(16.0)	(0.9)	(4.7)

Research Analyst	
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Variance analysis

	Q1FY18	Q1FY18E	Q1FY17	YoY (%)	Q4FY17	QoQ (%)	Comments
Revenue	668.6	694.0	580.3	15.2	1,132.1	(40.9)	Robust execution from the Standalone ramped up the topline growth by 15% despite translation impact due to Rupee appreciation against Euro by 6%
Cost of sales & Services	527.0	583.6	487.6	8.1	784.1	(32.8)	
Employees Remuneration & Benefits	66.1	69.2	57.9	14.1	58.2	13.4	
Other Expenses & Forex loss/(gain)	35.2	43.1	36.1	(2.5)	36.1	(2.5)	
Total operating expenses	626.7	657.9	557.3	12.5	1,000.1	(37.3)	
EBITDA	41.8	36.1	27.5	52.2	132.0	(68.3)	Good margins and higher revenues in IIUs reflects the growth of Operating Profits by an impressive 52%
EBITDA Margin (%)	6.3	0.1	4.7	152 bps	11.7	-540 bps	
Depreciation	4.5	5.0	4.6	(1.1)	5.2	(12.6)	
Finance charges	13.3	11.0	11.0	21.5	16.1	(17.0)	
PBT	25.9	20.1	16.5	57.0	110.8	(76.6)	
Tax	16.0	6.4	10.9	46.3	32.6	(51.0)	
PAT	9.9	13.7	5.6	78.1	78.1	(87.3)	
Minority Interest	1.8	0.4	1.4	27.9	3.8	(52.3)	
Share of profit in associate	0.2	0.4	1.0	(77.7)	1.3		
Adjusted PAT	8.4	13.7	5.2	60.8	75.7	(88.9)	
Key Metrics							
Order Intake	703		805	(12.6)	887	(20.8)	
Order backlog	7,363		7,533	(2.3)	7,324	0.5	

Source: Company, ICICIdirect.com Research

Change in estimates

(₹ Crore)	FY18E			FY19E		
	Old	New	% Change	Old	New	% Change
Revenue	3,865.0	3,865.0	(0.0)	4,594.3	4,594.3	0.0
EBITDA	398.5	394.6	(1.0)	478.7	474.1	(1.0)
EBITDA Margin (%)	10.3	10.2	-9 bps	10.4	10.3	-8 bps
PAT	214.8	206.9	(3.7)	261.8	253.3	(3.3)
EPS (₹)	39.4	37.9	(3.8)	48.0	46.4	(3.3)

Source: Company, ICICIdirect.com Research

Assumptions

	Current			Earlier	
	FY17	FY18E	FY19E	FY18E	FY19E
Order Intake	3,620	4,500	5,000	4,500	5,000
Order Backlog	7,328	8,620	9,770	8,620	9,770
EBITDA margin (%)	9.6	10.2	10.3	10.3	10.4

Source: Company, ICICIdirect.com Research

Annual report takeaways FY17

- The water scenario in the country is not encouraging with nearly 22 of the 32 major cities facing daily water shortage. Government of India and municipal bodies are fast realising this. This augurs well for companies like Wabag
- For Wabag, on the domestic front, India is expected to be the single largest market with massive opportunities likely to come up from the Namami Gange project. Post the recent state assembly elections and the subsequent change of regime in many northern states, Wabag expects the implementation of Namami Gange scheme to gain more traction over the next two years
- In the overseas segment of the business, Wabag is likely to focus on the following markets for going forward - South East Asia, Africa, Middle East, India, Latin America (LATAM) and Central & Eastern Europe. The company is witnessing strong traction from some of the above markets.
- **In FY17, Wabag has extended its scope of offerings to include the food and beverages sector, which it expects to emerge as a significant contributor in its revenues going forward.**
- In the oil & gas space, Wabag continued to perform well by bagging a large repeat order from Dangote for their oil refining company in Nigeria for a value of about US\$105.5 million and a prestigious large contract worth more than US\$84 million in the Kingdom of Saudi Arabia from one of the world's largest oil & gas company
- Wabag also won a desalination contract for a refinery in Indonesia worth more than US\$30 million. In addition, Wabag bagged a repeat order from Reliance Industries in India for a 24 MLD SWRO & 50 MLD BWRO plants. Wabag's prestigious clients now include Reliance, IOCL, Petronas, OMV Petrom and large client in Saudi Arabia and Indonesia

Company Analysis

VA Tech Wabag - Leading global water treatment player

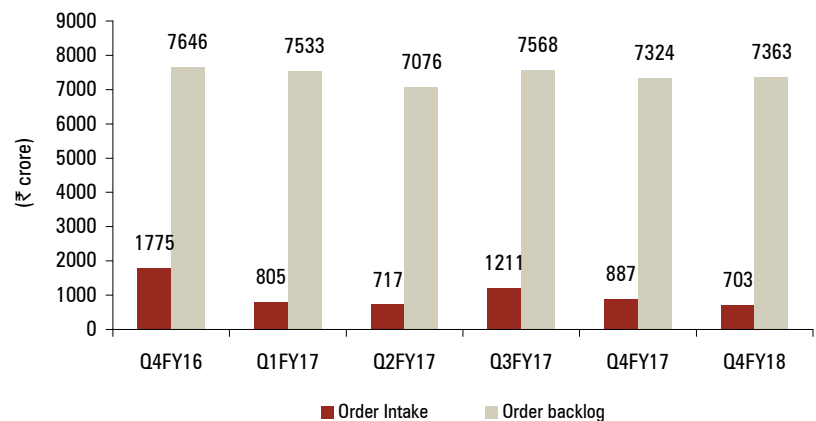
VA Tech Wabag (Wabag) is a leading MNC in the water treatment space (water desalination, sewage water treatment, waste water treatment, etc), with a global presence. The company operates on an asset light-EPC led model in water treatment projects across municipal & industrial segments. It focuses on design & engineering while outsourcing civil construction & erection jobs. Wabag has executed over 2,250 projects till date and has a market share of ~14% in the Indian market. The company garners a higher EBITDA margin of ~13-14% across its India business, 8-9% across the India international business and 5-6% across the Europe segment taking overall EBITDA margin to ~9.3%. With a healthy order book composition and strong order inflow for the quarter (Exhibit 1 & 2), we believe the company is on a strong footing.

Exhibit 1: Order book composition Q1FY18

₹ Crore)	EPC		O&M		Total
	Municipal	Industrial	Municipal	Industrial	
Wabag India	2476	1644	1231	54	5405
Wabag Overseas	1377	493	49	87	2007
Framework Contracts					866
Total	3853	2137	1280	142	8278

Source: Company, ICICIdirect.com Research

Exhibit 2: Order intake and backlog – quarterly trend

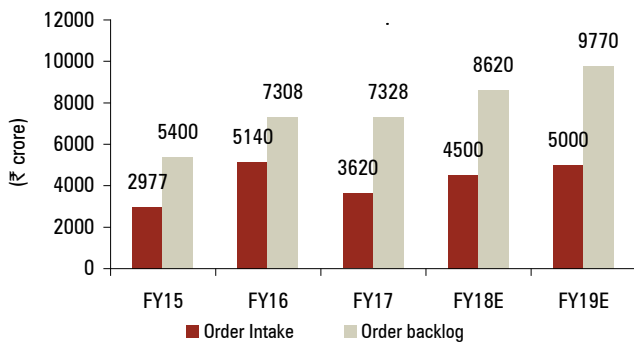


Source: Company, ICICIdirect.com Research

Engineering excellence and asset light business model

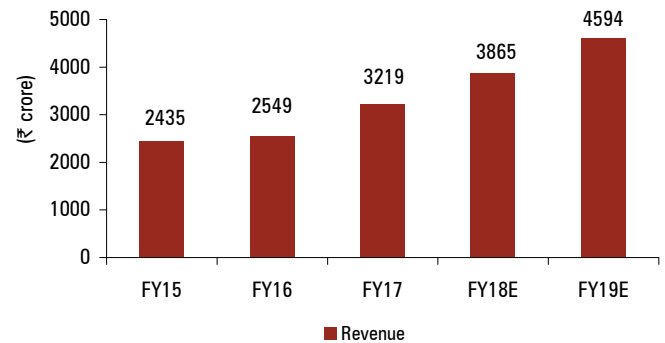
VA Tech Wabag (Wabag) operates on an asset light EPC model, thereby manifesting a lean balance sheet. With growing concern on access to clean water and urgent measures to solve the issue of depleting water resources, the investment in water treatment is likely to increase manifold globally. Accordingly, Wabag is expected to benefit significantly by leveraging its strong domestic presence and rising global footprint. The company's strong book-to-bill ratio of ~2.3x provides revenue visibility for over two years. This coupled with a strong execution track record is expected to lead to 19.5% revenue CAGR in FY17-19E to ₹ 4594 crore while the margin is expected to increase to 10.4% in FY19E.

Exhibit 3: Annual trend – Order intake and backlog



Source: Company, ICICIdirect.com Research

Exhibit 4: Revenue growth to be driven by strong order intake ...

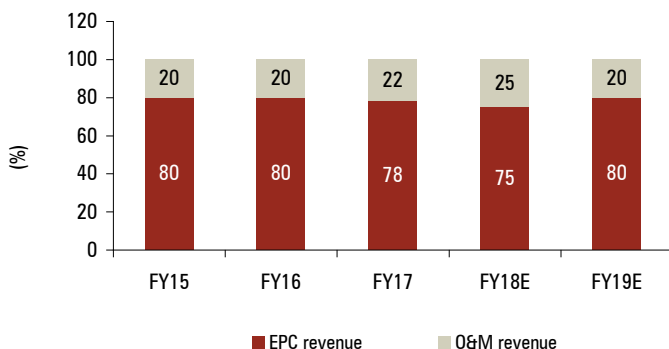


Source: Company, ICICIdirect.com Research

EBITDA margin likely to improve over next two years...

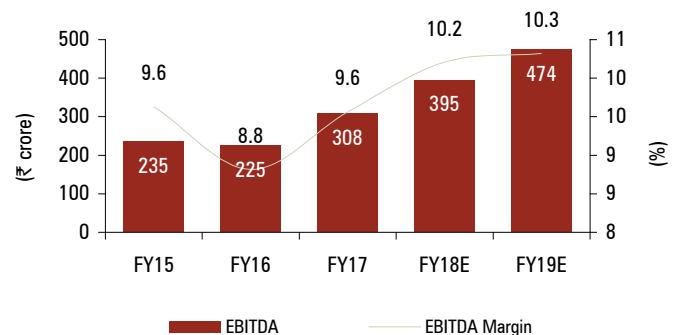
Wabag has earned average EBITDA margins of 9.6% in FY17. Going ahead, margins are likely to improve on the back of shifting of its operations base from high cost countries to low cost local markets. Accordingly, we expect EBITDA margins to improve from 9.6% in FY17 to 10.3% in FY19E. We expect margins to improve further by 180 bps over the next two years. Overall, the EBITDA is expected to grow at a CAGR of 24.5% to ₹ 474 crore in FY19E.

Exhibit 5: Share of O&M revenue to remain at 20-25% of total revenue

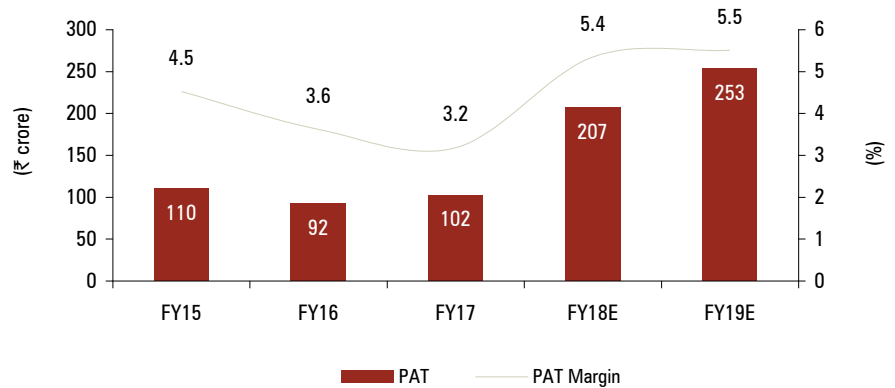


Source: Company, ICICIdirect.com Research

Exhibit 6: EBITDA and EBITDA margin trend



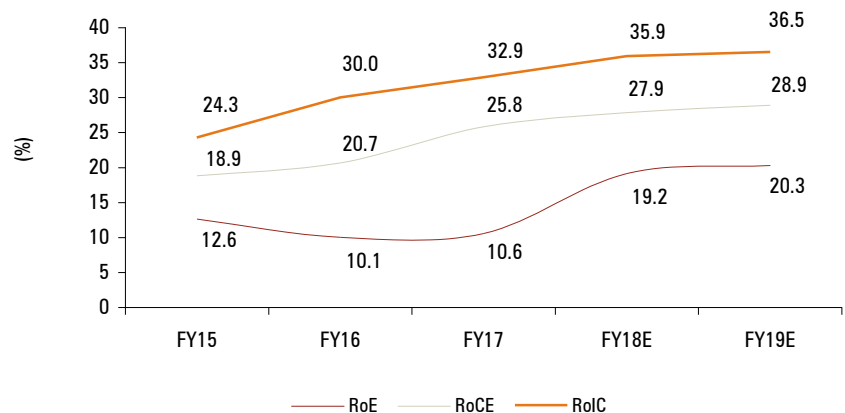
Source: Company, ICICIdirect.com Research

Exhibit 7: PAT trend


Source: Company, ICICIdirect.com Research

Return ratios likely to improve over FY17-19E

With no major capex requirement over FY17-19E, Wabag's D/E is likely to remain subdued at ~0.3x. Furthermore, with an improvement in margin over FY17-19E (mostly due to higher contribution from the domestic segment), return ratios are likely to improve here. We expect Wabag's RoE and RoCE to improve from 10.6% and 25.8% in FY17 to 20.3% and 28.9%, respectively, in FY19E. The return on invested capital (RoIC) is expected to improve from 32.9% in FY17 to 36.5% in FY19E.

Exhibit 8: RoE expected to increase on the back of improved operational performances


Source: Company, ICICIdirect.com Research

Outlook and valuation

Strong management pedigree and execution capabilities

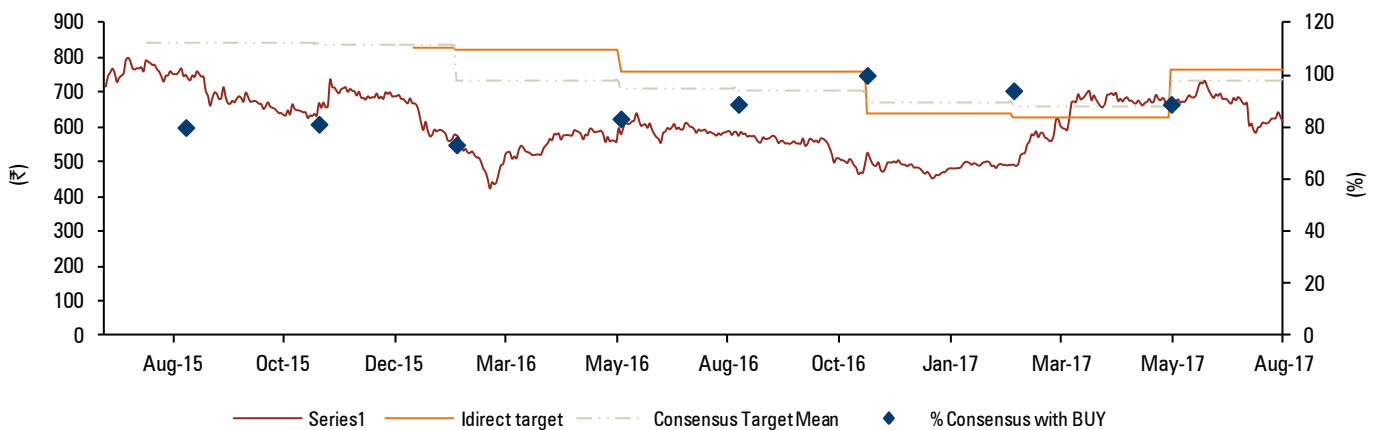
Wabag has a strong management team in place. The company continuously conducts an enterprise-wide exercise that results in reengineering of processes, realignment of strengths and reorganisation of business verticals. Since 2007, the company operated through four strategic business units (SBUs) comprising municipal business group (MBG), industrial water group (IWG), operations business group (OBG) and desalination business group (DBG) earlier known as international business group (IBG).

As part of organisational realignment, Wabag fine-tuned its business strategy and created four clusters — India, Europe, Middle East & Africa (MEA) and LatAm. This cluster approach tries to strike a balance between centralisation and decentralisation leading to enhanced capacity, better collaboration, greater competitiveness and increased competency

Going ahead, we expect Wabag's growth to come from a revival in industrial capex across Indian and global markets. Revenues are expected to grow at a CAGR of 19.5% over FY17-19E while PAT is expected to grow at a CAGR of 59.9% over the same period coupled with a margin improvement of 180 bps over FY17-19E. The margin improvement is expected to be driven by higher execution of domestic orders. This, we believe, will lead to a healthy return ratio profile, going ahead, as RoE is expected to improve to 19.1% in FY19E from 10% in FY17. Hence, we believe Wabag will witness quality earning growth over FY17-19E.

We believe timely execution of overseas order and higher contribution from domestic orders is likely to ease working capital concerns. With improving outlook, we have pencilled in new order wins of ₹ 4,500 crore and ₹ 5000 crore for FY18E and FY19E, respectively. Accordingly, we value the company at 16x FY19E EPS of ₹ 46.4 to arrive at a target price of ₹ 765.

Recommendation history vs. consensus



Source: Bloomberg, Company, ICICIdirect.com Research, Initiated coverage on 17th December 2014

Key events

Date	Event
Aug-11	Stock split from ₹ 5/- to ₹ 2/-
Jun-12	Wabag receives an order worth ₹ 270 crore for construction of a 32.4 MLD effluent treatment plant with recycle facility from Reliance Industries for setting up an industrial effluent treatment plant at Dahej
Nov-12	Wabag in consortium with Cadagua (Spain) and Galfar (Oman) has bagged a 192 MLD SWRO desalination project in Al Gubrah, Muscat, Sultanate of Oman at a cost of \$ 350 mn
Feb-13	Wabag completes the Nemelli desalination project within the stipulated time
Jun-13	Wabag wins ₹ 325 crore JICA funded projects from Orissa Water Supply Sewerage Board and ₹344 crore order from Phillipines funded by World Bank
Nov-13	Order intake surpasses ₹ 2000 crore for the first time in any particular year surpassing the annual target set by the company
Jan-14	Wabag achieves breakthrough in Tanzania by bagging orders worth \$40 mn, which is funded by EXIM bank of India. The project involves building of 130 MLD Upper Ruvu Water Treatment Plant
Sep-15	WABAG secures its largest ever ETP order from PETRONAS, Malaysia worth ₹ 1,500 crore
Mar-16	Board recommends a bonus issue of 1:1
Mar-16	Polgahawela order in Sri Lanka propels WABAG's order book to an all time high. Over INR 5,000 crores of orders secured in FY15-16

Source: Company, ICICIdirect.com Research

Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Change (m)
1	Mittal (Rajiv)	30-06-2017	17.79%	9.71M	0
2	SBI Funds Management Pvt. Ltd.	30-06-2017	6.65%	3.63M	+0.09M
3	BNP Paribas Asset Management Asia Limited	30-06-2017	5.85%	3.19M	-0.09M
4	IDFC Asset Management Company Private Limited	30-06-2017	5.70%	3.11M	+0.01M
5	Sumitomo Corp	30-06-2017	4.50%	2.46M	0
6	Sengupta (Amit)	30-06-2017	4.02%	2.19M	0
7	Varadarajan (S)	30-06-2017	4.00%	2.19M	0
8	Saraf (Shiv Narayan)	30-06-2017	2.93%	1.60M	0
9	Birla Sun Life Asset Management Company Ltd.	30-06-2017	2.69%	1.47M	-0.10M
10	ICICI Prudential Life Insurance Company Ltd.	30-06-2017	2.28%	1.24M	-0.32M

Shareholding Pattern

(in %)	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
Promoter	28.9	28.8	28.8	24.7	24.7
FII	27.3	27.9	26.1	25.9	26.7
DII	24.8	22.2	21.4	24.0	24.6
Others	19.0	21.2	23.7	25.4	24.0

Source: Reuters, ICICIdirect.com Research

Recent Activity

Investor name	Value	Shares	Investor name	Value	Shares
Mirae Asset Global Investments (Hong Kong) Limited	+1.01M	+0.12M	ICICI Prudential Life Insurance Company Ltd.	-3.37M	-0.32M
SBI Funds Management Pvt. Ltd.	+0.96M	+0.09M	Tata Asset Management Limited	-2.62M	-0.25M
Sundaram Asset Management Company Limited	+0.47M	+0.04M	Lazard Asset Management, L.L.C.	-1.13M	-0.13M
Impax Asset Management Ltd.	+0.38M	+0.04M	Birla Sun Life Asset Management Company Ltd.	-1.11M	-0.10M
Kotak Mahindra Asset Management Company Ltd.	+0.24M	+0.02M	BNP Paribas Asset Management Asia Limited	-0.94M	-0.09M

Source: Reuters, ICICIdirect.com Research

Financial summary

Profit and loss statement ₹ Crore				
(Year-end March)	FY16	FY17	FY18E	FY19E
Total operating Income	2,548.6	3,219.1	3,865.0	4,594.3
Growth (%)	4.7	26.3	20.1	18.9
Cost of sales	2,038.2	2,482.0	2,979.9	3,542.2
Decrease in inventory	(49.3)	56.8	(0.4)	(0.9)
Employees Remuneration	217.7	244.0	316.9	372.1
Other expenses	117.4	128.6	173.9	206.7
Total Operating Expenditure	2,323.9	2,911.3	3,470.3	4,120.2
EBITDA	224.7	307.9	394.6	474.1
Growth (%)	(4.2)	37.0	28.2	20.2
Depreciation	20.5	19.1	25.0	29.0
Interest	42.4	52.6	60.8	67.1
Other Income	0.0	0.0	0.0	0.0
PBT	161.7	236.2	308.8	378.0
Total Tax	68.9	66.7	101.9	124.7
PAT	92.8	169.5	206.9	253.3
Growth (%)	(15.7)	82.6	22.1	22.4
Share of profit in associate	0.9	(57.3)	0.9	0.9
Adjusted PAT	92.2	102.4	206.9	253.3
EPS (₹)	16.9	18.8	37.9	46.4

Source: Company, ICICIdirect.com Research

Cash flow statement ₹ Crore				
(Year-end March)	FY16	FY17	FY18E	FY19E
Profit before Tax	161.7	236.2	308.8	378.0
Add: Depreciation	20.5	19.1	25.0	29.0
(Inc)/dec in Current Assets	(288.5)	(541.3)	(315.7)	(616.2)
Inc/(dec) in CL and Provisions	90.2	410.4	189.9	399.8
Others	(26.5)	(14.1)	(41.1)	(57.6)
CF from operating activities	(42.5)	110.3	166.9	132.9
(Inc)/dec in Investments	10.1	25.6	(17.0)	0.0
(Inc)/dec in Fixed Assets	24.9	(8.7)	(18.0)	(13.0)
Others	0.0	0.0	0.0	0.0
CF from investing activities	35.0	16.9	(35.0)	(13.0)
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	196.7	(68.2)	44.6	38.9
Dividend paid & dividend tax	(21.8)	(27.3)	(56.0)	(70.0)
Inc/(dec) in Sec. premium	0.0	0.0	0.0	0.0
Others	(42.4)	(52.6)	(60.8)	(67.1)
CF from financing activities	132.5	(148.1)	(72.2)	(98.2)
Net Cash flow	125.0	(20.9)	59.7	21.7
Opening Cash	264.8	389.8	368.8	428.5
Closing Cash	389.8	368.8	428.5	450.3

Source: Company, ICICIdirect.com Research

Balance sheet ₹ Crore				
(Year-end March)	FY16	FY17	FY18E	FY19E
Liabilities				
Equity Capital	10.9	10.9	10.9	10.9
Reserve and Surplus	920.3	993.1	1,144.4	1,327.6
Total Shareholders funds	931.2	1,004.1	1,155.3	1,338.5
Total Debt	377.3	309.1	353.7	392.6
Deferred Tax Liability	3.1	3.1	3.1	3.1
Others LT liabilities	2.4	47.0	85.5	95.0
Long term provision	17.0	13.6	13.6	13.6
Minority interest	8.2	17.3	17.3	17.3
Total Liabilities	999	1,137	1,330	1,543
Assets				
Gross Block	197.2	208.3	216.3	224.3
Less: Acc Depreciation	21.7	33.9	58.9	87.9
Net Block	175.5	174.4	157.4	136.4
Capital WIP	2.4	0.0	10.0	15.0
Total Fixed Assets	175.5	174.4	167.4	151.4
Deferred Tax asset	60.8	78.4	10.7	10.7
Investments	48.1	5.4	39.0	39.0
Inventory	97.6	38.5	78.4	93.2
Debtors	1,656.5	2,123.8	2,415.6	2,871.5
Loans and Advances	39.1	60.0	62.6	74.4
Other Current Assets	188.7	216.3	258.0	306.7
Cash	307.0	239.1	298.7	320.5
Bank Balance	55.6	22.7	22.7	22.7
Total Current Assets	2,344.5	2,700.3	3,136.0	3,689.0
Creditors	1,178.7	1,400.1	1,568.4	1,864.3
Provisions	47.2	52.1	73.4	87.3
Total Current Liabilities	1,920.5	2,213.4	2,338.4	2,747.5
Net Current Assets	424.0	487.0	797.7	941.4
Others Assets	290.2	392.0	315.0	400.0
Application of Funds	999	1,137	1,330	1,543

Source: Company, ICICIdirect.com Research

Key ratios				
(Year-end March)	FY16	FY17	FY18E	FY19E
Per share data (₹)				
EPS	16.9	18.8	37.9	46.4
Cash EPS	20.7	22.3	42.5	51.7
BV	170.9	184.0	211.7	245.3
DPS	4.0	5.0	10.3	12.8
Cash Per Share	56.3	43.8	54.7	58.7
Operating Ratios (%)				
EBITDA Margin	8.8	9.6	10.2	10.3
PAT Margin	3.6	5.3	5.4	5.5
Inventory days	12.9	10.0	9.6	9.6
Debtor days	224.6	214.3	228.1	228.1
Creditor days	183.0	189.6	192.1	192.1
Return Ratios (%)				
RoE	10.1	10.6	19.2	20.3
RoCE	20.7	25.8	27.9	28.9
RoIC	30.0	32.9	35.9	36.5
Valuation Ratios (x)				
P/E	36.9	33.3	16.5	13.5
EV / EBITDA	15.5	11.3	8.8	7.3
EV / Net Sales	1.4	1.1	0.9	0.8
Market Cap / Sales	1.3	1.1	0.9	0.7
Price to adjusted Book Value	3.7	3.4	3.0	2.5
Solvency Ratios				
Debt/EBITDA	1.7	1.0	0.9	0.8
Debt / Equity	0.4	0.3	0.3	0.3
Current Ratio	1.2	1.2	1.3	1.3
Debt servicing coverage ratio	3.7	3.3	4.8	5.2

Source: Company, ICICIdirect.com Research

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