Company Update

VA TECH WABAG LTD

PRICE RS.526 **TARGET RS.672** **BUY**

Stock Details

Market cap (Rs mn)	:	28750
52-wk Hi/Lo (Rs)	:	750 / 460
Face Value (Rs)	:	2
3M Avg. daily volume (mn)	:	204,605
Shares o/s (m)	:	55

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18E	FY19E	FY20E
Revenue	36,379	38,198	42,018
Growth (%)	13.4	5.0	10.0
EBITDA	3,410	3,591	3,950
EBITDA margin (%)	9.4	9.4	9.4
PAT	1,610	1,932	2,164
EPS	29.5	35.4	39.7
EPS Growth (%)	57.2	20.0	12.0
BV (Rs/share)	207	238	273
Dividend/share (Rs)	4.0	4.0	4.0
ROE (%)	15.2	15.9	15.6
ROCE (%)	12.8	13.5	13.9
P/E (x)	18.0	15.0	13.4
EV/EBITDA (x)	8.2	7.3	6.4
P/BV (x)	2.6	2.2	1.9

Source: Kotak Securities - PCG; Company

Shareholding Pattern (%)

(%)	Mar-18	Dec-17	Sep-17
Promoters	24.7	24.7	24.7
FII	24.7	25.8	26.7
DII	20.1	19.8	22.2
Others	30.5	30.0	26.0

Source: Company

Price Performance (%)

(%)	1M	3M	6M
Va Tech Wabag	7.1	(16.5)	(12.2)
Nifty	5.9	(4.5)	3.9

Source: Bloomberg

Price chart

Source: Bloomberg

Sanjeev Zarbade
sanjeev.zarbade@kotak.com
+91 22 6218 6424

We note that the order placements for the Namami Gange has started to gain momentum - VA Tech Wabag (VAW) has recently announced some order wins. With the APGENCO plant achieving COD, we believe receivables from this project should get cleared out in FY19, a key positive which will alleviate investor concerns.

The Wabag stock has corrected in recent months on 1) weak order intake in FY18 and credible risk of missing on the order intake guidance 2) Decline in order book 3) Higher working capital engagement especially in case of APGENCO orders.

However, valuations are reasonable at 13.4x FY20E earnings and at a discount to sector peers. We recommend BUY with target price of Rs 672 (Unchanged).

Concerns: Business model is prone to execution risks like labour movement, currency, law and order etc.

Key positives

Order placements for Namami Gange has started to gain momentum

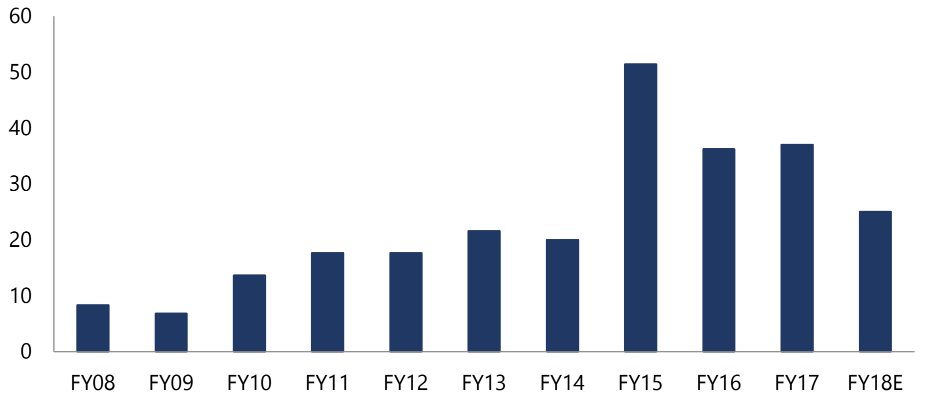
Although, order intake in FY18 has been below par for VAW, there are early signs of an uptick in order wins. Recently, in addition to order wins from other sectors, the company announced order wins from Namani Gange. These orders would be on EPC model and will not include any equity investment component.

Recent order wins

Scope	Awarding Authority	Value Rs mn
Design, Build and Operate	Namami Gange Project, Patna	1470
Design, Build and Operate	Kolkata Metro Development Authority	830
Design and Build	HPCL - Mittal Energy	2900
Design, Build and Operate	Namami Gange Project, Patna	2530
Total		**7730**

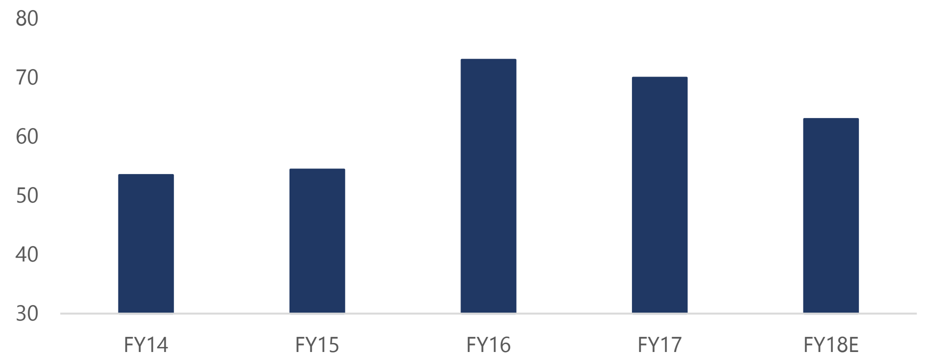
Source: Company

Order intake (Rs bn)



Source: Company, Kotak Securities – Private Client Research

Order book (Rs bn)



Source: Company, Kotak Securities – Private Client Research

Larger projects in Namami Gange to be awarded on Hybrid Annuity Model

The National Mission for Clean (NMCG) Ganga has given green signal to projects worth Rs 40 bn. The two major projects covered under this include sewage treatment plant each at Kanpur and Allahabad. The project at Kanpur is estimated to cost Rs 9.6 bn which will include rehabilitating and integrating sewerage zones in and around Kanpur. A similar project costing Rs 9.0 bn is planned in Allahabad.

These projects would be based on the Hybrid Annuity Model. Under the hybrid-annuity model, the government pays 40 per cent of the project cost linked to construction milestones. The remaining 60 per cent is paid over 15 years as annuities to the private concessionaire along with operation and maintenance expense.

VAW intends to bid for these projects with a consortium partner. The consortium will fund the 60% of the project cost through 70:30/80:20 debt to equity. VAW intends to minimize its equity commitment in the project and may hold not more than 26% stake in the project. As such the company's equity commitment in the project may not be more than Rs 300 mn.

Receivables to reduce as the same associated with APGENCO project to get released in current fiscal.

Background - Andhra Pradesh Power Gen. Co. Ltd. (AP GENCO) had placed orders for two 600 MW Thermal Power Plants – one at Warangal and another at Cuddapah. The orders were placed on a consortium in which VAW was joint partner along with two other contractors.

VATW was initially responsible for Water Systems Package only. However, due to financial issues on the part of the Consortium leader, VAW had to assume the role of the consortium leader from mid-2014 and took over the overall responsibility of completing the entire balance of plant for the 600 MW Power plant.

For the first time, VATW ventured into the construction of the full Balance of Plant (BOP) package. The first of the 600 MW Kakatiya Thermal Power projects was completed successfully and the Plant was commissioned in January 2016. The other 600 MW Rayalaseema Thermal Power plant has achieved the COD recently (Commercial Operation Date) and the plant is generating power.

While the initial order size was of Rs 7.3 bn, there was subsequent increase in the scope of work leading to enhancement in order book. In addition to this, the margins were not remunerative and inferior to the margins that the company earns on the core business of Water and Waste water treatment. Also, the payment was back-ended which resulted in accumulation of receivables thereby reflecting in an increase in debt.

Thus, at the end of Q3FY18, the company had receivables of Rs 22.7 bn, out of which APGENCO accounted for Rs 5.0 bn with the retention money of Rs 1.5 bn.

We note that post the COD of Rayalseema project, the company has to deliver some more items like Wagon Tippler. The management expects the company to complete its entire deliverables by the middle of 2018 and expects to receive bulk of Rs 3.5 bn receivables by Q3FY19.

Also, the defect liability period of the Kakatiya 600 MW project is scheduled to be completed in the current fiscal, which will also release part of the retention money associated with this project.

Improving per capita income and rising Urbanisation to drive water demand

India faces acute water crisis and has sub-optimal water infrastructure in place. This presents a strong growth opportunity for the country's water treatment players. Most of the wastewater (sewage) is never treated before being discharged into the water bodies. This pollutes the water at the source making it unsafe for consumption. Besides, drinking water from this very water body is supplied without adequate treatment, thereby resulting in water stress for a rapidly growing population demanding more water per capita.

Despite ample water reserves, the water distribution remains unequal. As against the requirement of 140 litres per capita per day, urban India receives only 105 litres of water on a per capita basis. The problem is further aggravated due to increasing urbanization. India's urban population is expected to reach close to 600 Million by 2031, twice as much as in 2011. The number of metropolitan cities with a population of 1 Million and above has increased from 35 in 2001 to 50 in 2011 and is likely to increase further to 87 by 2031. Clearly, this requires higher capacity of water treatment plants.

Wastewater segment remains significantly under-invested

India's total water and wastewater treatment market is growing annually by about 18%. Today, our growing cities require approximately 740 billion cubic meters of water annually. This is likely to go up to 1,500 billion cubic meters in 2030.

Present wastewater infrastructure can treat only 30% of the household wastes. The rest is released into the ground or into open drains. As per Central Public Health and Environmental Engineering Organisation (CPHEEO) estimates, 70-80% of total water supplied for domestic use end up generating wastewater. Maharashtra, Delhi, Uttar Pradesh, West Bengal and Gujarat are the major contributors of wastewater. Overall in Class I cities, nearly 68% of sewage goes untreated, which is even worse in Class II cities where nearly 90% of sewage discharged is left untreated.

Sewage water treatment potential

MLD	Sewage generated	Present sewage treatmen capacity	Capacity shortfall (%)
Metro cities	15644	8040	51.4%
Class I cities	35558	11553	32.5%
Class II cities	2696	233	8.6%

Source: Company

Stock correction provides a good entry opportunity

The Wabag stock has corrected in past few months on 1) weak order intake in FY18 and credible risk of missing on the order intake guidance 2) Decline in order book 3) Higher working capital engagement especially in case of APGENCO orders.

At the current price of Rs 526, the stock has corrected 27% from its high of Rs 723. In view of the strong order book, sound balance sheet, long term growth potential in water and waste water treatment and reasonable valuations, we reiterate "BUY" with price target of Rs 672 (19x FY19 earnings).

Peer Valuations

	PE (x) FY19
Thermax	33.0
Praj Ind	21.3
EIL	19.3
Wabag PE	15.0

Source: Kotak Securities – Private Client Research

Background

VA TECH WABAG GmbH resulted from the merger in 1999 of the water technology segment of the VA TECHNOLOGIE Group with that of DEUTSCHE BABCOCK. However, the WABAG brand has been in existence since 1924, when it was founded as WABAG Wasserfilter-Bau in Breslau. The emergence of VA TECH WABAG in 1999 marked the company's transformation into a global player in the water and wastewater treatment sector with a global network of business units and a comprehensive product portfolio. Following a period of consolidation and change of ownership, WABAG is now active as an international player in key markets. The company went public in October 2010.

VAW is a multinational player in the water treatment industry with market presence in India, the Middle East, North Africa, Central and Eastern Europe, China and South East Asia through its principal offices in India, Austria, the Czech Republic, China, Switzerland, Algeria, Romania, Tunisia, UAE, Libya and Macao. VAW is headquartered in Chennai and operations are conducted through its overseas subsidiaries and branch and representative offices. VAW shares strategic and technical expertise across Subsidiaries that allows research, operational and marketing synergies.

VAW has R & D centres located in Chennai, India and at Vienna and Winterthur in Austria and Switzerland respectively. Wabag Austria and Wabag Wassertechnik own 157 patents which include both process and product patents. Wabag Austria has also applied for 51 patents that are pending.

Financials - Consolidated

Profit and Loss Statement (Rs mn)

(Year-end March)	FY17	FY18E	FY19E	FY20E
Revenues	**32,079**	**36,379**	**38,198**	**42,018**
% change yoy	26.1	13.4	5.0	10.0
EBITDA	**2,967**	**3,410**	**3,591**	**3,950**
% change yoy	36.8	15.0	5.3	10.0
Other Income	112	34	110	110
Depreciation	191	178	185	185
EBIT	**2,775**	**3,232**	**3,406**	**3,765**
% change yoy	41.4	16.5	5.4	10.5
Net Interest	526	579	528	535
Earnings Before Tax	**2,362**	**2,687**	**2,987**	**3,340**
% change yoy	53.4	13.8	11.2	11.8
Provisions/Exceptional items/Extr.	-	0	0	0
Tax	(667)	(1,037)	(1,016)	(1,136)
as % of EBT	28.2	38.6	34.0	34.0
Net Income adj	**1,695**	**1,650**	**1,972**	**2,204**
% change yoy	92	-3	19	12
Share of profit from associates	(572.6)	10	10	10
Minority Interest	(98.4)	(50.0)	(50.0)	(50.0)
Reported Net Income	**1,024**	**1,610**	**1,932**	**2,164**
Shares outstanding (m)	54.6	54.6	54.6	54.6
Adj EPS (Rs)	18.8	29.5	35.4	39.7
DPS (Rs)	4.0	4.0	4.0	4.0
CEPS	22.3	32.8	38.8	43.0

Source: Company, Kotak Securities - Private Client Research

Balance sheet (Rs mn)

(Year-end March)	FY17	FY18E	FY19E	FY20E
Cash and cash equivalents	2,616	3,885	4,695	5,759
Accounts receivable	25,115	27,409	28,256	31,082
Inventories	385	385	385	385
Loans and Advances	409	409	409	409
Other current assets	2,163	2,492	2,616	2,878
Current Assets	30,687	34,579	36,362	40,513
Investments/Loans and Advances	826	858	858	858
Intangible Assets	691	691	691	691
Net fixed assets	1,053	1,025	990	955
Deferred tax assets	247	247	247	247
CWIP	0	0	0	0
Total Assets	**33,504**	**37,400**	**39,148**	**43,264**
Payables	18,163	20,632	21,663	23,829
Provisions	521	521	521	521
Current liabilities	18,684	21,153	22,184	24,350
LT debt	3,091	3,090	2,090	2,090
Other liabilities	1,627	1,661	1,661	1,661
Equity & reserves	9,931	11,286	12,962	14,871
Minority Interest	173	212	251	291
Total Liabilities	**33,504**	**37,400**	**39,148**	**43,264**
BVPS (Rs)	182	207	238	273

Source: Company, Kotak Securities - Private Client Research

Cash Flow Statement (Rs mn)

(Year-end March)	FY17	FY18E	FY19E	FY20E
PBDIT	2,967	3,410	3,591	3,950
Direct tax paid	(770)	(1,037)	(1,016)	(1,136)
Adjustments	(151)	-	-	-
Cash flow from operations	**2,045**	**2,373**	**2,575**	**2,814**
Net Change in Working Capital	(1,862)	(155)	60	(921)
Net Cash from Operations	183	2,218	2,635	1,893
Capital Expenditure	(139)	(150)	(150)	(150)
Cash from investing	**327**	**1**	**110**	**110**
Net Cash from Investing	188	(149)	(40)	(40)
Interest paid	(526)	(579)	(528)	(535)
Issue of Shares	0	0	(0)	-
Other liabilities	539	-	-	-
Dividends Paid	(264)	(255)	(255)	(255)
Debt Raised	(683)	(1)	(1,000)	-
Net cash from financing	**(933)**	**(834)**	**(1,784)**	**(790)**
Net change in cash	(562)	1,235	811	1,063
Free cash flow	44	2,068	2,485	1,743
Cash at end	2,391	3,885	4,695	5,759

Source: Company, Kotak Securities - Private Client Research

Ratio Analysis

(Year-end March)	FY17	FY18E	FY19E	FY20E
EBITDA margin (%)	9.2	9.4	9.4	9.4
EBIT margin (%)	8.7	8.9	8.9	9.0
Net profit margin (%)	5.3	4.5	5.2	5.2
Receivables (days)	285.8	275.0	270.0	270.0
Inventory (days)	4.4	3.9	3.7	3.3
Sales / Net Fixed Assets (x)	30.5	35.5	38.6	44.0
Interest coverage (x)	5.6	5.9	6.8	7.4
Debt/equity ratio(x)	0.3	0.3	0.2	0.1
ROE (%)	10.7	15.2	15.9	15.6
ROCE (%)	13.7	12.8	13.5	13.9
EV/ Sales (x)	0.9	0.8	0.7	0.6
EV/EBITDA (x)	9.9	8.2	7.3	6.4
Price to earnings (x)	28.2	18.0	15.0	13.4
Price to book value (x)	2.9	2.6	2.2	1.9

Source: Company, Kotak Securities - Private Client Research

Rating Scale

Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 12 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 12 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 12 months
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Fundamental Research Team

Sanjeev Zarbade
Capital Goods, Engineering
sanjeev.zarbade@kotak.com
+91 22 6218 6424

Ruchir Khare
Capital Goods, Engineering
ruchir.khare@kotak.com
+91 22 6218 6431

Amit Agarwal
Logistics, Paints, Transportation
agarwal.amit@kotak.com
+91 22 6218 6439

Nipun Gupta
Information Technology
nipun.gupta@kotak.com
+91 22 6218 6433

Teena Virmani
Construction, Cement, Building Mat
teena.virmani@kotak.com
+91 22 6218 6432

Ritwik Rai
FMCG, Media
ritwik.rai@kotak.com
+91 22 6218 6426

Jatin Damania
Metals & Mining
jatin.damania@kotak.com
+91 22 6218 6440

Jayesh Kumar
Economy
kumar.jayesh@kotak.com
+91 22 6218 5373

Arun Agarwal
Auto & Auto Ancillary
arun.agarwal@kotak.com
+91 22 6218 6443

Sumit Pokharna
Oil and Gas
sumit.pokharna@kotak.com
+91 22 6218 6438

Pankaj Kumar
Midcap
pankajr.kumar@kotak.com
+91 22 6218 6434

K. Kathirvelu
Production
k.kathirvelu@kotak.com
+91 22 6218 6427

Technical Research Team

Shrikant Chouhan
shrikant.chouhan@kotak.com
91 22 6218 5408

Amol Athawale
amol.athawale@kotak.com
+91 20 6620 3350

Derivatives Research Team

Sahaj Agrawal
sahaj.agrawal@kotak.com
+91 79 6607 2231

Malay Gandhi
malay.gandhi@kotak.com
+91 22 6218 6420

Prashanth Lalu
prashanth.lalu@kotak.com
+91 22 6218 5497

Prasenjit Biswas, CMT, CFTe
prasenjit.biswas@kotak.com
+91 33 6625 9810

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- **Level 2:** If you do not receive a satisfactory response at Level 1 within 3 working days, you may write to us at ks.escalation@kotak.com or call us on 022-42858445 and if you feel you are still unheard, write to our customer service HOD at ks.servicehead@kotak.com or call us on 022-42858208.
- **Level 3:** If you still have not received a satisfactory response at Level 2 within 3 working days, you may contact our Compliance Officer (Mr. Manoj Agarwal) at ks.compliance@kotak.com or call on 91- (022) 4285 8484.
- **Level 4:** If you have not received a satisfactory response at Level 3 within 7 working days, you may also approach CEO (Mr. Kamlesh Rao) at ceo.ks@kotak.com or call on 91- (022) 4285 8301.