VA Tech Wabag Ltd

Initiating Coverage

28th February, 2018

VA Tech Wabag Ltd

Africa, India and LATAM markets to drive further growth

CMP	Target	Potential Upside	Market Cap (INR Mn)	Recommendation	Sector
INR 550	**INR 722**	**31%**	**30,490**	**Buy**	**Utilities – Water & Sewage**

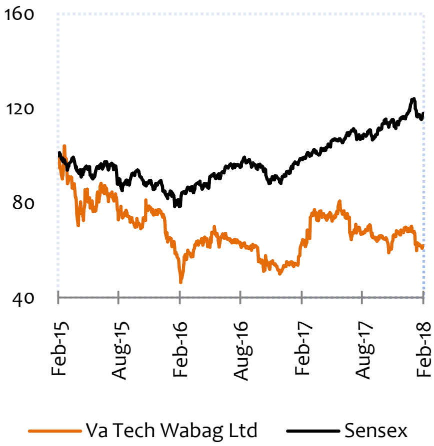
Company Overview

Incorporated in 1995, VA tech Wabag (VATW) is one of the leading players in water treatment space with presence in over 15 countries. The company along with its 17 subsidiaries provides EPC and O&M solutions to Municipal and Industrial clients. It offers solutions for drinking water treatment, industrial water treatment, sea & brackish water desalination, municipal waste-water treatment, sludge treatment and so on. VATW commands nearly 14% market share in India as well as a strong foothold in Europe, Middle East, Africa and South-East Asia. VATW has recently forayed into LATAM market and foresees huge market potential for its services in this region. It's R&D centres are located in Switzerland, Austria and India enabling VATW to provide customized water treatment solutions to clients along with securing 100 patented technologies.

MARKET DATA

Shares outs (Mn)	54
EquityCap (INR Mn)	109
Mkt Cap (INR Mn)	30490
52 Wk H/L (INR)	749/529
Volume Avg (3m K)	130
Face Value (INR)	2
Bloomberg Code	VATW IN

SHARE PRICE PERFORMANCE



MARKET INFO

SENSEX	34184
NIFTY	10493

Investment Rationale

India Wastewater Treatment – the low hanging fruit:

India constitutes nearly 16% of the global population with only 4% of the total fresh water resources, which places India in the list of Water Scarce nations. Further, the situation is likely to get worse due to estimates that the population will grow from 1.2bn in 2010 to 1.6bn in 2030. Increasing urbanization (from 30% in 2010 to 50% in 2030) will lead to more demand for basic amenities like water supply, sewerage and solid waste management. In terms of the wastewater data, industry reports suggest that about 38,255 MLD (million litters per day) of wastewater is generated in urban India with a population of more than 50,000, which is around 70% of the urban population while India's municipal wastewater treatment capacity is estimated at about 12,000 MLD. This clearly states that, urban India can treat only 30% of the waste water, while the rest is released into the ground or into open drains *(Delhi, Maharashtra, Gujarat, West Bengal are among the top states that generate higher water wastage)*. According to various industry reports, it is estimated that India's urban wastewater generation may cross 120,000 MLD by 2051, while rural India will generate about 50,000 MLD, making it inevitable for the government to come up with a clear roadmap for wastewater treatment infrastructure in the immediate future.

Additionally, the demand for water is poised to increase further owing to industrialization and irrigation. According to global water resource report, the demand for water in India is estimated to increase to 1500 bcm (billion cubic meters) p.a., while the supply will account not more than 740 bcm p.a. by 2030. This clearly indicates the government has to make investments toward water recycling, reuse, sewage and sludge treatment in the near coming years.

In Oct'17, the environment ministry tweaked standards for four parameters that determine water quality: pH value, which captures the level of acidity, Bio-Chemical Oxygen Demand (BOD), Total Suspended Solids (TSS) and Fecal Coliform (FC). Fecal coliform bacteria like the dreaded strain of E. Coli is found in the intestines of warm-blooded animals. The new standard is less than 1000 (Most Probable Number per 100 millilitre, MPN/100ml) for STPs across the country. The new rules will apply to all plants that are commissioned after June'19, and all existing plants have to comply with them within five years. In terms of the STP capacity, only three out of India's 28 states and union territories in India can meet their demand for sewage treatment. In terms of the sewage generated, it has been observed that major source of pollution in the Ganga is sewage, however, the same has never been treated due to inadequate STP network. To curb this, the government increased its FY18 budgetary allocation to the Water Resources, River Development and Ganga Rejuvenation by 11%. Of the total amount, INR 68bn shall be allocated to the Ministry and INR 22bn to Namami Gange

SHARE HOLDING PATTERN (%)

Particulars	Dec 17	Sep 17	Jun 17
Promoters	24.69	24.72	24.73
FIIs	25.82	26.71	26.69
DIIs	20.69	25.01	24.58
Others	28.79	23.58	24.01
Total	100	100	100

12%

Revenue CAGR between FY17-20E

17%

PAT CAGR between FY17-20E

programme. This could lead govt to increase the coverage of STPs in Ganga, which is considered to be less than 30% of the overall sewage generated (4800 MLD). This is also evident from the fact that the government has approved adding 933 MLD capacity STPs, and enhance the functioning of existing plants to treat another 1,091 MLD. **We believe such policies are a welcome step and open up huge opportunities for water treatment players like VATW in the medium to long term.**

Desalination – the time is now!

India is the world's largest user of groundwater (more than that of the US and China) with its groundwater levels falling since the 1980s. The fact that groundwater irrigation in India supports livelihoods of over 26 crore farmers and laborers, the benefits have come at a huge cost of increased pressure on groundwater reserves. Adding to the severity of the problem is a rising population, rapid industrialization and improving standards of living resulting in higher demand for water. To address the rising gap between water demand and supply, the government is focusing on water reuse and recycling along with alternative methods such as desalination. Desalination is the process of recovering pure water from saline water with the use of various technologies.

India being the world's second most populous nation, falls in the category of water stressed countries with less than 1700 cubic meter water per capita per year. Rise in per capita water consumption due to rapid industrialization and better standards of living are acting as catalysts for growth of the desalination market in India. India's water crisis is being magnified due to depleting ground water resources and lack of water conservation initiatives, resulting in higher demand for drinking water and the widening supply gap in India. Further adding to the crisis is the large scale economic development which is resulting in huge infrastructure push as well as technological developments in the desalination technology are some factors supporting growth of desalination plant market in India. It is also estimated the Indian Desalination Plant market will grow from USD 0.82bn in 2015 to USD 2.83bn in 2021E. The growth is mainly driven by increasing water demand from paper and pulp industries, textiles, fertilizers and so on which constitute more than 50% of Indian desalination market. Increased pace of industrialization has resulted in an increase in overall water consumption.

Given VATW's dominant position in the desalination market (among top 10 players globally for desalination) and the company has successfully executed desalination projects in the past, the probability of winning more contracts in the future remains strong. Moreover, if the company is successful in receiving orders, it could receive O&M orders as well for the maintenance of these plants resulting in margin expansion as O&M division enjoys higher margins.

Major global cities inching towards a water negative future:

While agriculture accounts for 70% of the world's water use, future projections from the Organisation for Economic Cooperation and Development indicate that energy and industrial activities are the fastest-growing sources of future water demands. Companies and countries should be looking for partners and solutions that address these growing water and energy demands, including efficiency and re-use. These are more cost-effective means of meeting needs compared to investments in supply solutions like desalination and new power plants. The world faces a future of extreme water variability. Water risks and supply disruptions are already affecting business in California, China, India, and elsewhere. From Sao Paulo to Los Angeles, cities around the world have made headlines due to severe droughts intensified by climate change and exacerbated by poor water management. In terms of water technology trends, there is a clear shift to making existing technologies, such as the notoriously energy-intensive seawater desalination, cheaper and more efficient. **Hence, it is safe to assume that the growth for desalination plants and similar technologies will experience a significant boost in the years to come. We believe that since VATW is already present in most water-stressed geographies, it will be among the key beneficiaries of growth from this space.**

VA Tech Wabag Ltd

Valuation & Recommendation

VA Tech is considered as one of the most prominent player in the waste water treatment industry with a market share of ~14%. The company's R&D centres located in Europe have helped it to have more than 100 patents, which in turn assisted company to garner strong order flows in the past. In terms of the technology offerings, it provides solutions ranging from zero liquid discharge to desalination unlike its peers and hence, we believe this could offer the company an upper hand in terms of future order activities. In terms of domestic market, government has announced stringent norms for sewerage treatment plants recently, which we believe could augur well for the industrial order flows and VATW being the strongest player is poised to receive large orders in the coming period. For municipal orders intake, we expect increase in the budget outlay for 'Namami Gange' could see some uptick in short term. Further, BMC (Brihanmumbai Municipal Corporation) also plans to come up with STP orders estimated at approximately INR 45bn. VATW being a leader in STP can garner large orders going ahead. The company already has the L1 status in more than INR 15bn worth of contracts, of which management expects a majority to get finalized in Q4FY18. Any positive development could improve revenue visibility for FY19 & FY20. Apart from domestic market, VATW has also entered into Latin America and some other parts of Africa last year, which we believe are key growth markets for waste water treatment in medium to long run. VATW is a renowned name in the international market and thus, possibility of winning large orders cannot be overlooked. Taking all this into consideration, we expect the company to get more than INR90bn of orders over the next 2 years, which could improve revenue visibility of the company going ahead. The revenue is expected to grow at ~12% CAGR over FY17-20. In terms of operational performance, we believe majority of Wabag India orders are in execution phase and the revenue share for Wabag India is likely to increase over the next 2 years. Further, Wabag India has higher margins as compared to Wabag Overseas, which could potential improve group OPM. We expect OPM to expand by ~139bps over FY17-20E. PAT is expected to increase at 17% CAGR over the same period.

In terms of peer comparison, we believe Suez is a close competitor of the company given its presence in nearly all technologies offered by VATW. Hence, we have considered Suez for comparison. In terms of financial performance, revenue for Suez grew at mere 0.4% over CY12-16, while VATW reported a growth of 19% over FY13-17. EBITDA & PAT grew at a CAGR of 20% & 17% respectively, for VATW as against mere 1.5% & 8.8% for Suez. Further, return ratios are also favorable for VATW with average ROE & ROCE at 11.8% & 20.6% as against 7.8% & 12.3% for Suez. This places VATW among the leaders in the waste water treatment industry.

In terms of valuations, we have valued the company on P/E basis. At CMP of INR 550, the stock is trading at 14.2x on FY19E and 11.4x on FY20E of our earnings estimates. The stock has been historically trading at medium multiple of ~17x on 1 yr fwd and ~12x 2yr fwd P/E band. However, valuations improved at the time of NDA victory on the expectations of uptick in the order activity. We expect more wastewater treatment order to be announced before next election and hence, players like VATW are expected to benefit from this process. This, in turn, could improve valuations of the company and hence, valuing the company at 15x on FY20E earnings of INR 48.1, we have arrived a target price of INR 722, potential upside of 31% from CMP of INR 550. We have 'BUY' rating on the stock.

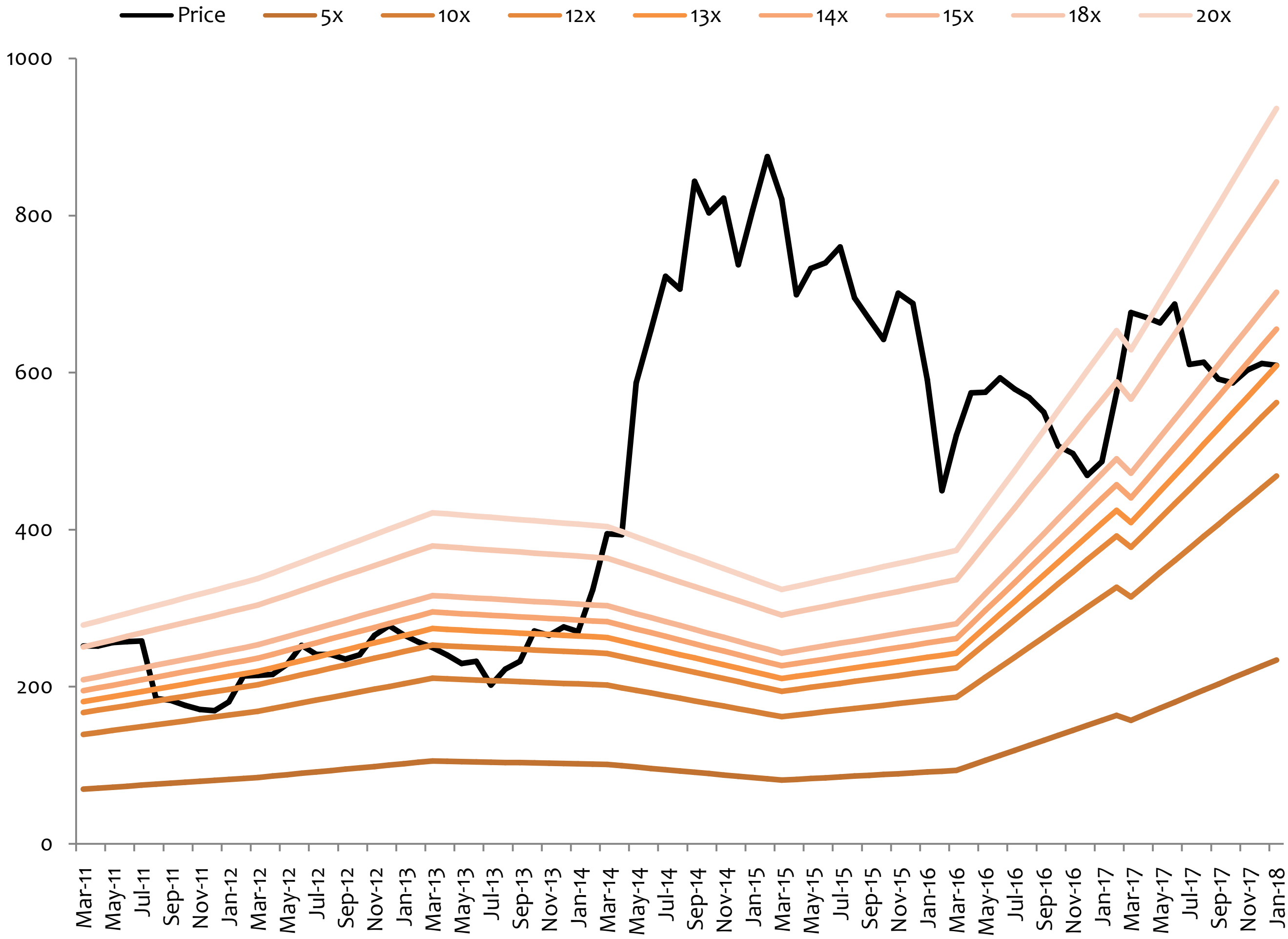
Exhibit 1: Key Financials

Particulars (INR bn)	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Net Revenue	16.2	22.4	24.4	25.2	32.2	36.3	40.0	45.6
EBITDA	1.5	2.1	2.1	2.4	3.1	3.5	4.1	5.0
Adj.PAT	0.9	1.1	1.1	0.9	1.0	1.7	2.2	2.7
Adj. EPS	16.9	21.1	20.2	16.2	18.7	31.4	38.6	48.1
OPM	9.5%	9.3%	8.7%	9.6%	9.6%	9.5%	10.3%	11.0%
NPM	5.6%	5.1%	4.5%	3.5%	3.2%	4.8%	5.4%	5.9%
PE (x)	32.6	26.1	27.2	34.0	29.5	17.5	14.2	11.4

Source: Company, KRChoksey Research

VA Tech Wabag Ltd

Exhibit 2: PE Band – 1 Year forward



Source: Company, KRChoksey Research

Exhibit 3: Peer Comparison – Key Financials

Particulars	VA Tech Wabag	Suez Environment*	Ion Exchange
Net Revenue (CAGR)	19%	0.4%	5%
EBITDA (CAGR)	20%	1.5%	12%
Adj.PAT (CAGR)	17%	8.8%	19%
Average OPM	9.3%	14.3%	6.0%
Average NPM	4.5%	2.4%	1.6%
Average ROCE	20.6%	12.3%	16.9%
Average ROE	11.8%	7.8%	8.8%

**Suez Environment (In Euro Mn), Suez CAGR between CY12-16, while VA tech & ION exchange between FY13-17*
Source: Company, KRChoksey Research

VA Tech Wabag Ltd

Quick Business Snapshot

Business Model

Incorporated in 1995, VA tech Wabag (VATW) is one of the leading players in water treatment space with presence in over 15 countries. The company along with its 17 subsidiaries provides EPC and O&M solutions to Municipal and Industrial clients. It offers solutions for drinking water treatment, industrial water treatment, sea & brackish water desalination, municipal waste-water treatment, sludge treatment and so on. VATW commands nearly 14% market share in India as well as a strong foothold in Europe, Middle East, Africa and South-East Asia. VATW has recently forayed into LATAM market and foresees huge market potential for its services in this region. It's R&D centres are located in Switzerland, Austria and India enabling VATW to provide customized water treatment solution to clients along with securing over 100 patented technologies.

Strategic Positioning

- One of the key strategic advantages for VATW is its asset-light business model
- The company undertakes jobs such as design & engineering, technology procurement, project management and O&M in-house since these are high-margin, low capital intensive in nature.
- Alternatively, the company outsources civil construction jobs since these are low-margin and capital intensive in nature.

Competitive Edge

- A vast geographical reach and a wide business portfolio allow the company to remain de-risked, thereby, resulting in the overall business to remain unaffected.
- Additionally, the company prefers to undertake orders from multilateral agencies such as the World Bank, since there is little hassle in receiving funding. This enables the company to focus on faster project execution, resulting in improved earnings potential.

Financial Structure

- Revenues grew at a CAGR of ~17% over FY12-17, owing to decent order intake from municipalities.
- EBITDA increased at a CAGR of ~19% over FY12-17 with average OPM of ~9.3%.
- PAT was up by ~18% CAGR over FY13-17 with average NPM of ~5%.

Key Competitors

- Suez, Veolia, Ion Exchange, GE Water, L&T, IVRCL, Thermax and Hindustan Dorr Oliver are some of the key players in this space.

Entry Barriers

- A large chunk of the overall business is derived from government institutions such as municipalities as well as multilateral agencies such as World Bank. It is important for players in this space to operate a certain scale and credibility to be able to win orders from such agencies.
- Additionally, the industry is technology heavy, thereby, demanding considerable amount of capital expenditure to be incurred for research and development purposes. Such factors create an entry barrier for any new players.

Client Base

- Prestigious clientele including the likes of Reliance, IOCL, Petronas, OMV Petrom and large clients in Saudi Arabia and Indonesia to name a few.

VA Tech Wabag Ltd

Company Background:

Incorporated in 1995, VA tech Wabag is a market leader in water technology market. It is a leading multinational player with a workforce of over 2,000 people and presence in more than 15 countries. Since 1996, Wabag has built over 800 water & wastewater plants worldwide and managed more than 2300 projects. The company has invested heavily on developing various waste water treatment technologies to provide customized solutions to various clients, enabling it to hold more than 100 patents for water solutions as of FY17. The company has a strong foothold in the India market with ~14% market share. While for the overseas market, it has established presence across Middle East, North Africa, Europe and South-East Asia through 17 subsidiaries across 4 continents. The R&D centers of the company are located in India, Austria and Switzerland.

VA tech provides technology for water solutions along with more emphasis towards design & engineering, while it outsources the civil & construction works. This helps company maintain an asset light model, which helps it to outpace other industrial players in terms of ROCE (avg 20% against industry avg of 10-12%). The company also provides operation & maintenance (O&M) services to the clients, which are margin lucrative and provides cushion to the consol OPM. The segment carries margin between 18-20%, which is almost double than the EPC margin of 8-10%.

To get foothold across both business segments in water industry i.e. EPC and O&M, the company has divided business divisions into two geographies, which provides water solutions to end users across the globe. The segments are known as Wabag India and Wabag Overseas. Further, the business model has been reclassified among cluster based approach to attain synergies as a whole. The four clusters have been named as (I) India cluster (II) Europe Cluster (III) Middle East & Africa Cluster and (IV) Latin America cluster. The scope of the work includes providing comprehensive and customized water solutions in the area of drinking water and wastewater management. The different clusters focus on different countries, enabling them to achieve efficiency as a whole.

Exhibit 4: Business Model

Design & Engineering
- Critical for cost optimization
- Approvals to match customer requirements

Technology
- In-house to ensure compliance with designs
  - Combination of Propriertary & Bought out technology
  - Testing, Quality Control

Civil Construction (Outsourced)
- Outsourced to dedicated contractors
- Ensures asset light model
- Allows to focus on core cometencies

Operation & Maintenance
- In-house to ensure quality performance
  - High plant operation efficiency
  - Least downtime
- High EBITDA segment

Exhibit 5: Cluster-wise Focus Markets & Key Target Sectors

India Cluster
- **Focus Markets:** Bangladesh, Cambodia, India, Indonesia, Laos, Malaysia, Myanmar, Nepal, Phillippines, Singapore, Sri Lanka, Thailand and Vietnam
- **Key Target Sectors:** Industrial and Municipal

Europe Cluster
- **Focus Markets:** Austria, Czech Republic, Romania, Switzerland and Turkey
- **Key Target Sectors:** Industrial and Municipal

Middle East & Africa (MEA) Cluster
- **Focus Markets:** Bahrain, Egypt, Iran, Libya, Namibia, Nigeria, Oman, Qatar, Saudi Arabia, Tanzania and Tunisia
- **Key Target Sectors:** Municipal EPC and O&M for water desalination and brackish water projects, sewage treatment plants and industrial projects

Latin America (LATAM) Cluster
- **Focus Markets:** Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru and Uruguay
- **Key Target Sectors:** Industrial and Municipal

Source: Company, KRChoksey Research

VA Tech Wabag Ltd

Exhibit 6: Cluster Map

Source: Company, KRChoksey Research

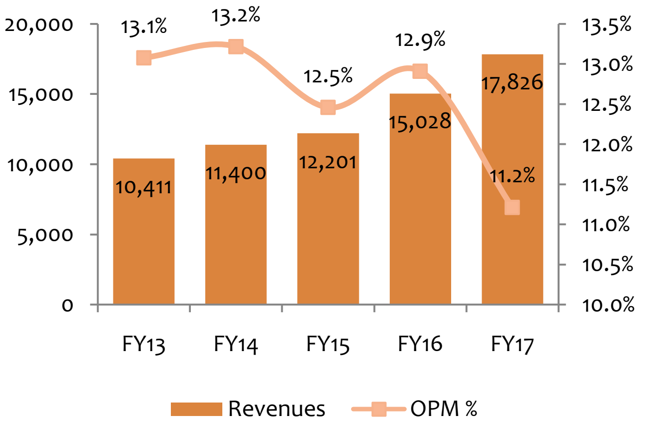
VA Tech Wabag Ltd

The company has divided its business into two divisions i.e. (i) Wabag India and (ii) Wabag Overseas. These units provide various water solution services (*EPC, O&M*) to different municipalities and industries across the globe. The margin profile for both divisions are different. India division enjoys EPC margin between 9-10% and O&M margin of 18-20%, whereas India international units carry EPC margins between 7-8% and O&M margins of 14-16%. On the other hand, Wabag Overseas has EPC margins between 4-5% and O&M margins of 8-10%.

Wabag India:
Wabag India offers the entire Wabag group portfolio in the areas of municipal and industrial water & wastewater treatment. The company has entered into Africa region last year, which we believe is a key growth market for the group in medium to long run.

In terms of the order intake, it grew at a CAGR of 20% over FY13-17, largely led by robust uptick in the industrial order flows (+70% YoY) last year. We believe execution of those contracts could ramp up in the next year and hence, improvement in the revenue share to the overall revenue is expected. The Wabag India revenue (~55% of overall revenue) increased at a CAGR of 14% over FY13-17, impacted because of sluggish order flows between FY12-14. The order book of the segment at the end of Q3FY18 stands at INR 45.7bn representing a book to bill of ~2.3x. EPC and O&M constitute ~50% & ~20% to the overall order backlog. Going ahead, we expect faster execution for the projects like Polgahawela – Sri Lanka and Koyambedu – Chennai to improve revenue visibility of the cluster. Further, we expect inching up of revenue share from Wabag India to expand OPM for the entire group given the former enjoys higher margins as compared to Wabag overseas.

Exhibit 7: Wabag India revenues (INR mn)



Source: Company, KRChoksey Research

Exhibit 8: Geographical revenue split (INR mn)

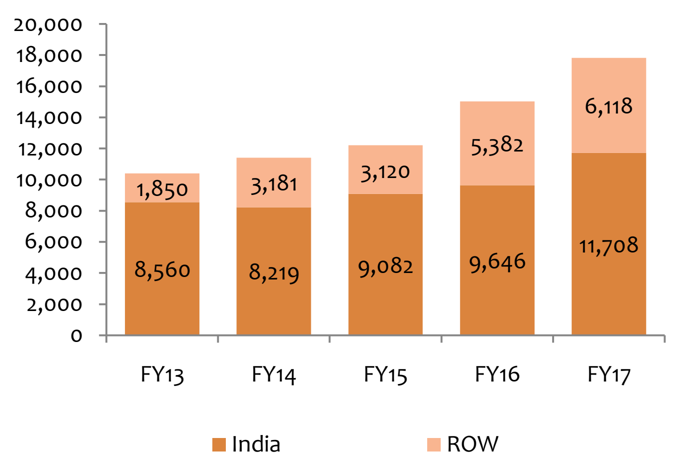


Exhibit 9: Order intake break up (INR mn)

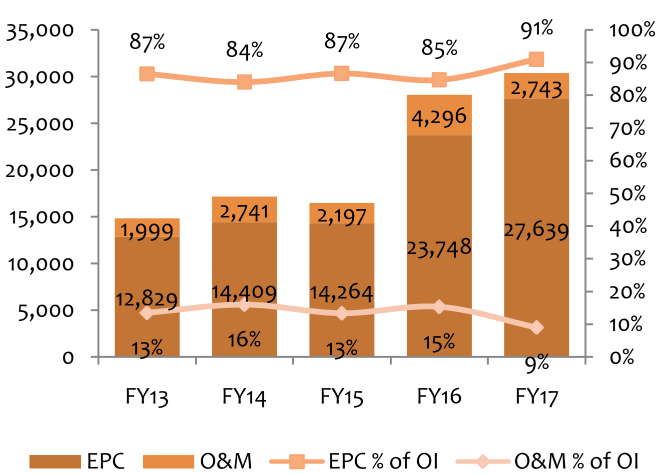
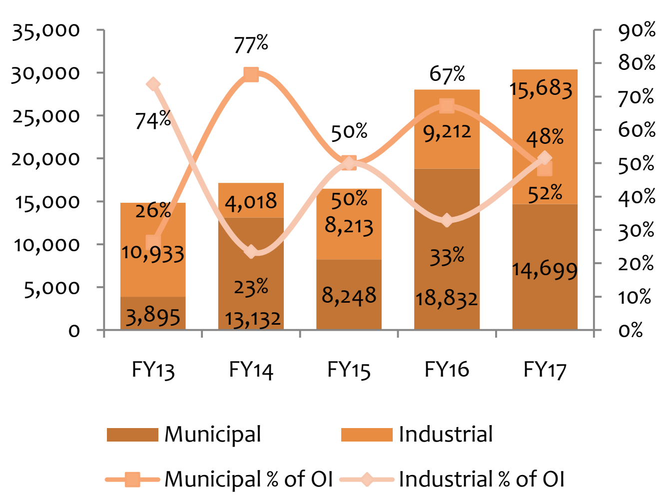


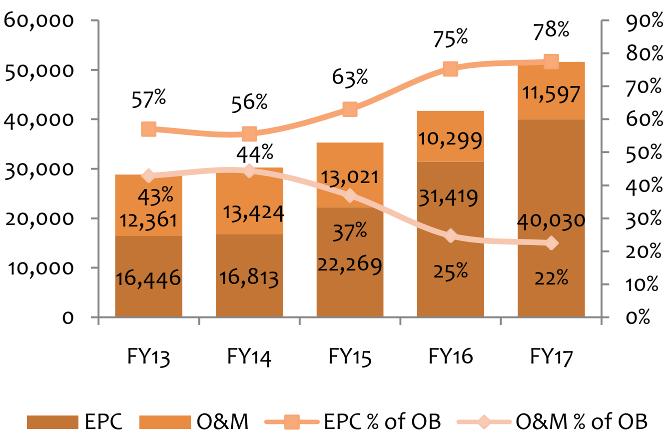
Exhibit 10: Order intake break up (INR mn)



Source: Company, KRChoksey Research

VA Tech Wabag Ltd

Exhibit 11: Order backlog break up (INR mn)



Source: Company, KRChoksey Research

Exhibit 12: Order backlog break up (INR mn)

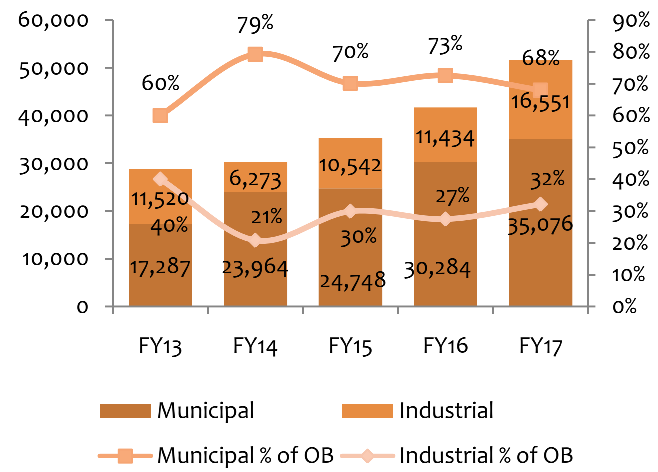
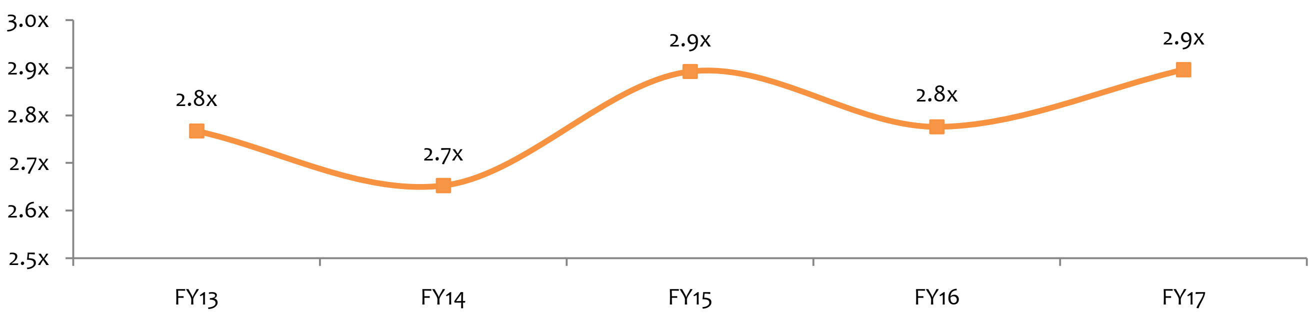


Exhibit 13: Book to bill (x)

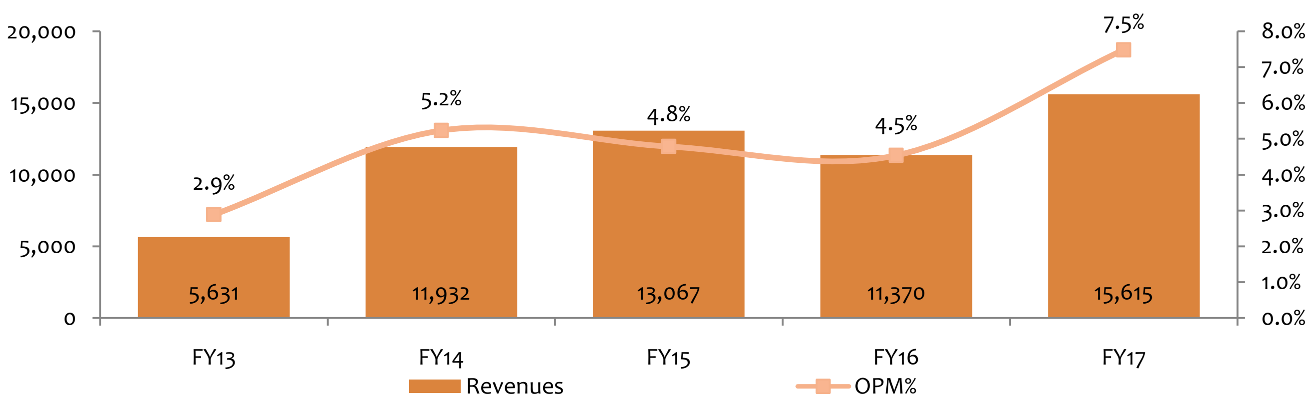


Source: Company, KRChoksey Research

Wabag Overseas:

Wabag overseas also provides waste water treatment to the Europe cluster, Latin America, Middle East clusters etc. The wabag overseas order flows have been largely dependent on crude oil prices given the large portion of orders are derived from Middle East. The order intake for Wabag Overseas fell by 75% YoY in FY17 primarily on account of subdued oil prices. The overseas revenue increased at a CAGR of 26% between FY13-17, largely led by robust order intake (+51% CAGR) between FY13-16. The order backlog at the end of Q3FY18 stands at INR 19.5bn represents book-bill of ~1.3x. EPC and O&M constitute ~28% & ~2% of overall order backlog. Going ahead, a key thing to watch out for overseas market will be execution of Desalination & STP in Saudi Arabia.

Exhibit 14: Wabag Overseas Revenues (INR mn) & OPM (%)



Source: Company, KRChoksey Research

VA Tech Wabag Ltd

Exhibit 15: Order intake break up (INR mn)

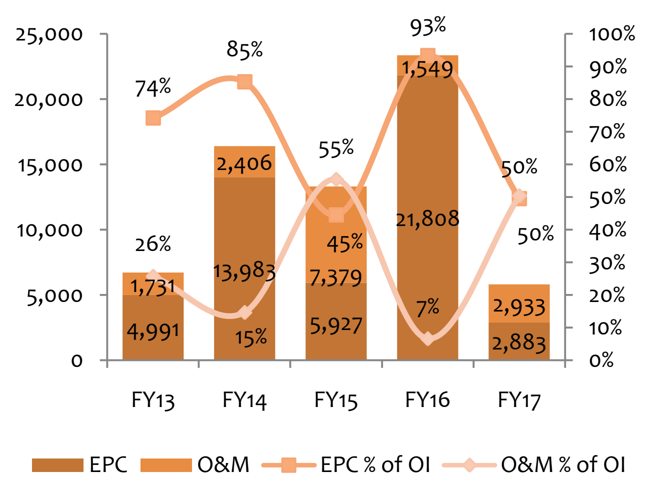


Exhibit 16: Order intake break up (INR mn)

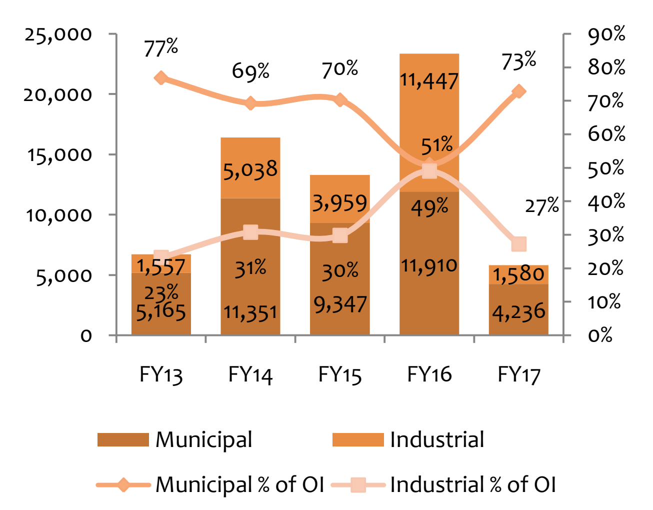


Exhibit 17: Order backlog break up (INR mn)

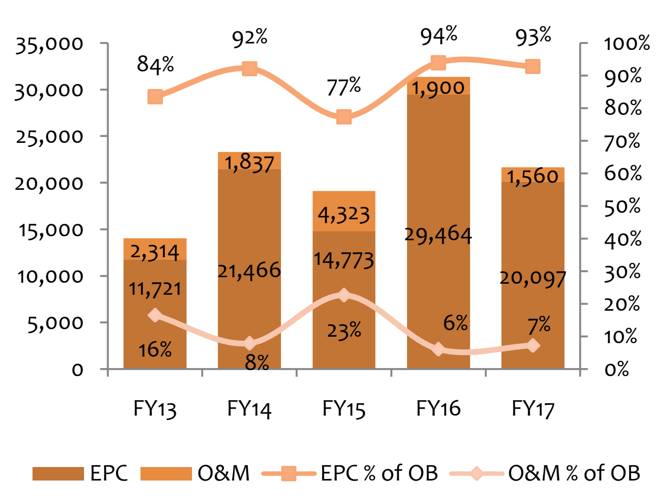


Exhibit 18: Order backlog break up (INR mn)

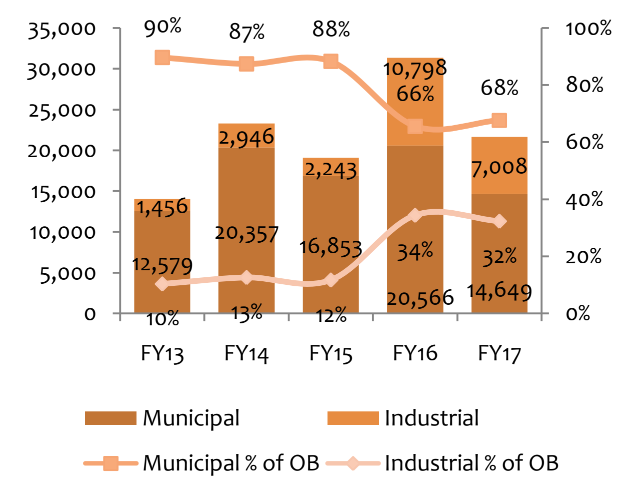
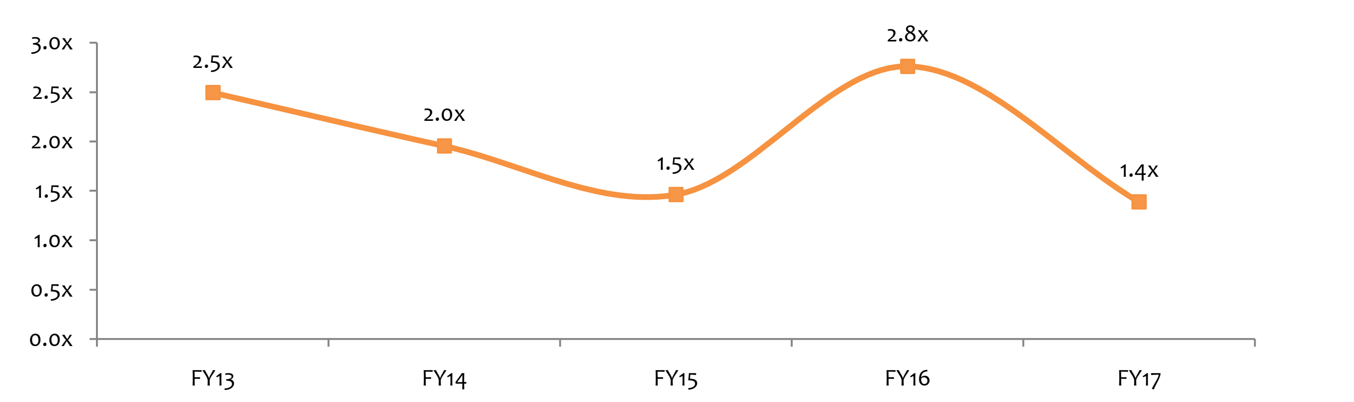


Exhibit 19: Book to Bill (x)



Source: Company, KRChoksey Research

VA Tech Wabag Ltd

Exhibit 20: Performance Range

Drinking Water Treatment
- Ground Water Treatment
- Surface Water
- Sea & Brackish Water Desalination
- Treated Wastewater (Potable Water Reuse)

Industrial Water Treatment
- Process Water
- Boiler Feed Water
- Service Water

Municipal Wastewater Treatment

Industrial Wastewater Treatment
- Aerobic Biological Processes
- Anaerobic Biological Processes
- Chemical-physical Processes

Sludge Treatment
- Sludge Disintegration

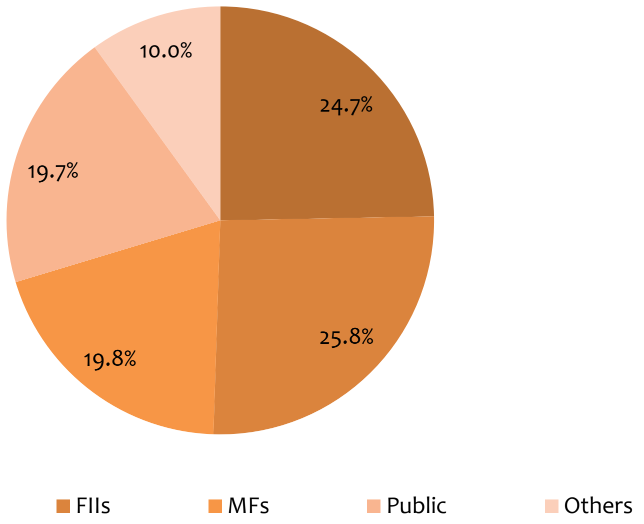
Operations & Maintenance
- BOOT – Build Own Operate Transfer
- Consulting
- DBO – Design Build Operate
- Operational Management Concepts
- O&M Plant Operation/Outsourcing

Processes & Technology
- NEREDA
- Ion Exchange
- Membrane Filtration
- MARAPUR
- Reverse Osmosis

Source: Company, KRChoksey Research

VA Tech Wabag Ltd

Exhibit 21: Shareholding Structure (as of Sep 2017)



Source: Company, KRChoksey Research

Exhibit 22: Top 5 Fund Holdings (As of Dec 2017)

Fund Name	Market Value (INR Cr)	No. of Shares
SBI Mutual Fund	257.89	4223154
IDFC Mutual Fund	197.79	3238994
Sundaram Mutual Fund	68.74	1125698
Birla Sun Life Mutual Fund	53.68	879101
Canara Robeco Mutual Fund	30.09	492685

Source: Company, KRChoksey Research

Exhibit 23: Management Details

Name	Designation	Executive / Non-Executive
B D Narang	Chairman	Non-Executive
Rajiv Mittal	Managing Director	Executive
Sumit Chandwani	Independent Director	Non-Executive
Jaithirth Rao	Independent Director	Non-Executive
Revathi Kasturi	Independent Director	Non-Executive
Malay Mukherjee	Independent Director	Non-Executive

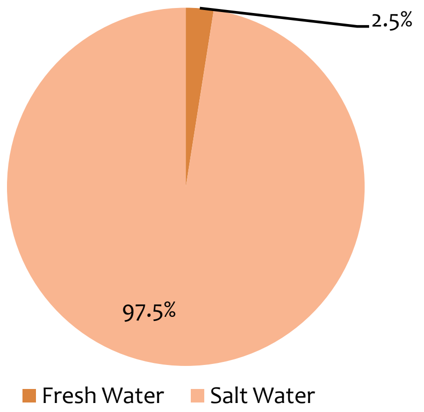
Source: Company, KRChoksey Research

VA Tech Wabag Ltd

Wastewater Treatment Industry

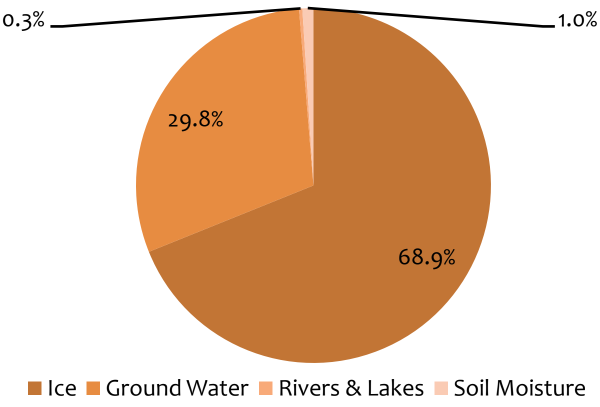
Industry data suggests that, the world's water reserves consist around 2.5% of freshwater and around 97.5% of saline water. Out of the 2.5% freshwater, only 0.3% is easily accessible and remaining 99.7% of fresh water is available in both glaciers and deep ground water. Hence, this leaves limited availability of water for consumption across the globe.

Exhibit 24: Global Water Composition (%)



Source: Industry, KRChoksey Research

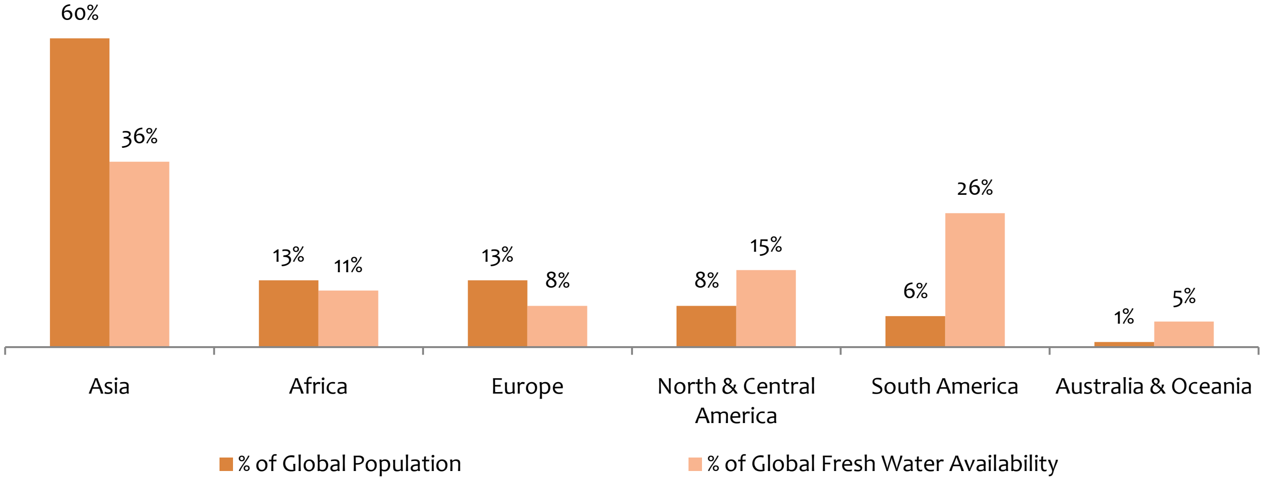
Exhibit 25: Composition of Fresh Water Sources (%)



Source: Industry, KRChoksey Research

Further, despite fresh water being available to the tune of 0.3%, the distribution of water resources is not equal around the world. North America enjoys 15% of the global water supply for only 8% of the global population, whereas Asia has limited water availability of 36% of global water supply against 60% of the global population. Moreover, the usage of water has also increased among various industries in high income countries, which ranges from 10% in low-middle income countries to 59% in high income countries. This has created further strain on the reservoir level for water deficit countries. It is estimated that 31 countries with 8% of the world's population (mostly in Africa and the Middle East) have water shortages presently, while the figure is likely to rise to 48 countries and 35% of world population by 2025. Major nations in the list are India, Ethiopia, Nigeria, Kenya and Peru. Hence, there has been an outcry in these countries which are having limited water reservoirs and have planned programs for waste water treatments like STP, WWTP and so on in recent years, which can help them to bridge the gap of being a resource scarce to resource rich country.

Exhibit 26: Global Population and Global Distribution of Fresh Water (%)



Source: Industry, KRChoksey Research

ANALYST
Dhavan Shah, dhavan.shah@krchoksey.com, +91-22-6696 5574
Rajil Shah, rajil.shah@krchoksey.com, +91-22-6696 5420

VA Tech Wabag Ltd

The global water industry size is expected to grow tremendously due to imminent surge in demand from urban house-holds coupled with industrialization. The growth will be largely driven by manufacturing, thermal electricity generation and domestic usage and the prominent water markets in the near future would be Egypt, Vietnam, India, Canada and Saudi Arabia. Concurrently, as per reports, the industrial water treatment and recycling market is expected to grow by over 50% over the next few years, from around US$ 7bn in 2015 to almost US$ 11bn in 2020.

Exhibit 27: Top 10 Growth Markets for Water

Countries	Expected CAGR between FY14-20 (%)	VA Tech Presence
Egypt	56%	Yes
Vietnam	30%	Yes
India	21%	Yes
Canada	19%	No
Saudi Arabia	16%	Yes
Oman	10%	Yes
Spain	9%	Yes
Australia	9%	No
Indonesia	9%	Yes
Peru	9%	Yes

Source: Industry, KRChoksey Research

India faces acute water shortage due to higher demand and lack of infrastructure to treat wastewater. According to industry reports, most of the wastewater in India is never treated before being discharged into the water bodies. This pollutes the water, which results it to unsafe for consumption. This has also resulted water shortages in the country. Industry data suggests that as against the requirement of 140 litres per capita water per day, urban India receives only 105 litres of water/day, while rural India has been facing worse situation than the urban India. Further the situation is likely to get worsen on account of more urbanization and industrial growth likely to happen going ahead. It is estimated that the urban population will increase to 600 million by 2031—twice as much as in 2011, while consumption of industrial water will increase from 6% to 18% by 2050. Hence, this will eventually increase the use of water but since the country is already facing water shortages, municipalities and industries will have to push harder for the development of waste water treatment plants in the near to short term. **We believe this will provide opportunities to water treatment players like VA tech to gain additional market share going ahead.**

VA Tech Wabag Ltd

Investment Rationale:

India Wastewater Treatment – the low hanging fruit:

Despite the government's keen interest, infrastructure development for sewage and wastewater treatment has not kept pace with wastewater generation in India. As a result, vast amounts of polluted water is being discharged into natural waterways. Going forward, we expect this gap in infrastructure to push the government to increase spending.

India constitutes nearly 16% of the global population with only 4% of the total fresh water resources, which places India in the list of Water Scarce nations. Further, the situation is likely to get worse due to estimates that the population will grow from 1.2bn in 2010 to 1.6bn in 2030. Increasing urbanization (from 30% in 2010 to 50% in 2030) will lead to more demand for basic amenities like water supply, sewerage and solid waste management. In terms of the wastewater data, industry reports suggest that about 38,255 MLD (million litters per day) of wastewater is generated in urban India with a population of more than 50,000, which is around 70% of the urban population while India's municipal wastewater treatment capacity is estimated at about 12,000 MLD. This clearly states that, urban India can treat only 30% of the waste water, while the rest is released into the ground or into open drains *(Delhi, Maharashtra, Gujarat, West Bengal are among the top states that generate higher water wastage)*. According to various industry reports, it is estimated that India's urban wastewater generation may cross 120,000 MLD by 2051, while rural India will generate about 50,000 MLD, making it inevitable for the government to come up with a clear roadmap for wastewater treatment infrastructure in the immediate future.

Additionally, the demand for water is poised to increase further owing to industrialization and irrigation. According to global water resource report, the demand for water in India is estimated to increase to 1500 bcm (billion cubic meters) p.a., while the supply will account not more than 740 bcm p.a. by 2030. This clearly indicates the government has to make investments toward water recycling, reuse, sewage and sludge treatment in the near coming years.

Exhibit 28: Wastewater Treatment Capacity in India

	Wastewater Generated (MLD)	Wastewater Treated (MLD)	%
Metros	15,644	8,040	51%
Class 1 cities	19,914	3,514	18%
Class 2 cities	2,697	234	8%
Total	38,255	11,788	31%

Source: Industry data, KRChoksey Research

In Oct'17, the environment ministry tweaked standards for four parameters that determine water quality: pH value, which captures the level of acidity, Bio-Chemical Oxygen Demand (BOD), Total Suspended Solids (TSS) and Fecal Coliform (FC). Fecal coliform bacteria like the dreaded strain of E. Coli is found in the intestines of warm-blooded animals. The new standard is less than 1000 (Most Probable Number per 100 millilitre, MPN/100ml) for STPs across the country. The new rules will apply to all plants that are commissioned after June'19, and all existing plants have to comply with them within five years. In terms of the STP capacity, only three out of India's 28 states and union territories in India can meet their demand for sewage treatment. In terms of the sewage generated, it has been observed that major source of pollution in the Ganga is sewage, however, the same has never been treated due to inadequate STP network. To curb this, the government increased its FY18 budgetary allocation to the Water Resources, River Development and Ganga Rejuvenation by 11%. Of the total amount, INR 68bn shall be allocated to the Ministry and INR 22bn to Namami Gange programme. This could lead govt to increase the coverage of STPs in Ganga, which is considered to be less than 30% of the overall sewage generated (4800 MLD). This is also evident from the fact that the government has approved adding 933 MLD capacity STPs, and enhance the functioning of existing plants to treat another 1,091 MLD.

VA Tech Wabag Ltd

Exhibit 29: Standards that determine water quality

Parameter	Standard	Scope
pH	6.5-9	Everywhere in the country
Bio-Chemical Oxygen Demand (BOD)	Not to exceed 20	For metro areas and all state capitals barring Himachal Pradesh, Uttarakhand, Jammu & Kashmir and Union Territory of Andaman & Nicobar Islands, Dadar & Nagar Haveli, Daman & Diu and Lakshadweep Islands
	Not to exceed 30	Other areas
Total Suspended Solids	Less than 50	For metro areas and all state capitals barring Himachal Pradesh, Uttarakhand, Jammu & Kashmir and Union Territory of Andaman & Nicobar Islands, Dadar & Nagar Haveli, Daman & Diu and Lakshadweep Islands
	Less than 100	Other areas
Fecal Coliform (FC)	Less than 1000	Everywhere in the country

Metro cities are Mumbai, Delhi, Kolkata, Chennai, Bengaluru, Hyderabad, Ahmedabad and Pune
Source: Industry data, KRChoksey Research

The opportunity size of STP in India is estimated to be INR 3 trillion, which could provide large opportunities to the players like VATW in medium to long run. Various municipalities have started awarding reuse projects on PPP (Public Private Partnership) and DBO (Design Build Operate) models. This is evident from the fact that long pending Mumbai Sewage Disposal Project-II (MSDP-II), comprising six projects, was opened up to bidders in January by Brihanmumbai Municipal Corporation. The World Bank-funded MSDP II is expected to be built at a cost of INR 45bn and would treat waste-water from a 5,483 hectare area across six civic wards, serving up to 35 lakh people. **We believe such policies are a welcome step and open up huge opportunities for water treatment players like VATW in the medium to long term.**

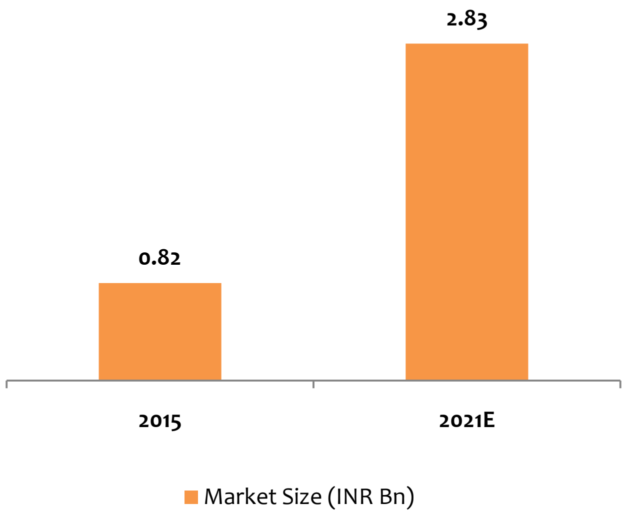
Desalination – the time is now!

India is the world's largest user of groundwater (more than that of the US and China) with its groundwater levels falling since the 1980s. The fact that groundwater irrigation in India supports livelihoods of over 26 crore farmers and laborers, the benefits have come at a huge cost of increased pressure on groundwater reserves. Adding to the severity of the problem is a rising population, rapid industrialization and improving standards of living resulting in higher demand for water. To address the rising gap between water demand and supply, the government is focusing on water reuse and recycling along with alternative methods such as desalination. Desalination is the process of recovering pure water from saline water with the use of various technologies.

India being the world's second most populous nation, falls in the category of water stressed countries with less than 1700 cubic meter water per capita per year. Rise in per capita water consumption due to rapid industrialization and better standards of living are acting as catalysts for growth of the desalination market in India. India's water crisis is being magnified due to depleting ground water resources and lack of water conservation initiatives, resulting in higher demand for drinking water and the widening supply gap in India. Further adding to the crisis is the large scale economic development which is resulting in huge infrastructure push as well as technological developments in the desalination technology are some factors supporting growth of desalination plant market in India. It is also estimated the Indian Desalination Plant market will grow from USD 0.82bn in 2015 to USD 2.83bn in 2021E. The growth is mainly driven by increasing water demand from paper and pulp industries, textiles, fertilizers and so on which constitute more than 50% of Indian desalination market. Increased pace of industrialization has resulted in an increase in overall water consumption.

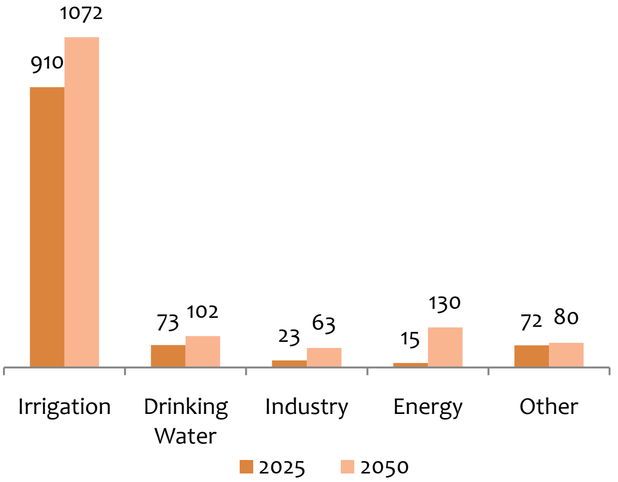
VA Tech Wabag Ltd

Exhibit 30: India Desalination Plant Market Size (INR Bn)



Source: TechSci Research, KRChoksey Research

Exhibit 31: Water Usage by various sectors (Billion Cubic Meters)



Source: National Commission for Integrated Water Resources Development, KRChoksey Research

Various technologies are used for desalination of water, however, in India, membrane based desalination, accounted for more than 50% share of the market in terms of number of plants installed by the end of 2015. The membrane desalination technology is further categorized as RO (Reverse Osmosis) and ED (Electro Dialysis), with RO based desalination process capturing more than 80% of the total membrane based desalination market in India in the same year. Technological advancements such as use of grapheme membrane and carbon nanotubes to lower the membrane cost and increase permeability are also primarily taking place in the RO category. In addition, higher efficiency desalination systems are being developed using nanotech membranes, which offer 800 times more efficiency on account of significantly higher flux and salt rejection. These technological innovations are leading to increasing efficiency and reduction in desalination cost, which is expected to be a huge positive for the desalination market in the coming years.

Given VATW's dominant position in the desalination market (among top 10 players globally for desalination) and the company has successfully executed desalination projects in the past, the probability of winning more contracts in the future remains strong. Moreover, if the company is successful in receiving orders, it could receive O&M orders as well for the maintenance of these plants resulting in margin expansion as O&M division enjoys higher margins.

Major global cities inching towards a water negative future:

While agriculture accounts for 70% of the world's water use, estimates from the OECD indicate that energy and industrial activities are the fastest-growing sources of future water demands. Companies and countries should be looking for partners and solutions that address these growing water and energy demands, including efficiency and re-use. These are more cost-effective means of meeting needs compared to investments in supply solutions like desalination and new power plants. The world faces a future of extreme water variability. Water risks and supply disruptions are already affecting business in California, China, India, and elsewhere. This is true not just for the electric power and water industries, but for customers and suppliers who rely on them. But this is not strictly a supply problem. It is just as much a demand challenge, and innovators should pay attention to opportunities to reduce overreliance on limited fresh water resources. In particular, there is a glaring need to reduce the amount of water needed for energy and the energy needed for water. A case in point is Cape Town, which is running out of water. After three years of intense drought, South Africa's second-largest city is just a few months away from "Day Zero," the day when the city government will shut off water taps for most homes and businesses. The impacts of such a shutdown will be devastating. Citizens will have to wait in long lines at state-managed distribution points to receive a mere 25 liters of water per day, less than half the water needed for one average shower. Although this instance is one of the most extreme, Cape Town is not the only city to suffer from intense water scarcity in recent years. From Sao Paulo to Los Angeles, cities around the world have made headlines due to severe droughts intensified by climate change and exacerbated by poor water management. In terms of water technology trends, there is a clear shift to making existing technologies, such as the notoriously energy-intensive seawater desalination, cheaper and more efficient. **Hence, it is safe to assume that the growth for desalination plants and similar technologies will experience a significant boost in the years to come. We believe that since VATW is already present in most water-stressed geographies, it will be among the key beneficiaries of growth from this space.**

VA Tech Wabag Ltd

Risks & Concerns

Largely exposed to government orders:

VA tech had received total order intake of around 60-65% from both domestic and overseas government. Hence, this envisages an imminent risk to the group. As any slowdown in the order announcements by government agencies can impact the order flows thereby impacting the revenue of the company in future.

Risk of cost overruns:

VA tech being an EPC player, has a dominant position in design and engineering of water projects, while it outsources civil and construction works. As this involves execution risk from third party also, any delay on civil and construction part can eventually hurt timeliness to complete the whole project and eventually lead to cost overruns and financial charges.

Industrial slowdown could be a barrier:

Water is largely used by irrigation, power and steel sectors. Due to sluggish environment in domestic power and steel sectors, the revenue from India industrial segment has been impacted in last 1-2 years. Apart from this, fall in oil prices can further curb investment cycle in Middle East countries and hence, the company could experience lower order intake from overseas market in future.

Political risk:

VA tech operates in more than 30 countries and hence the company is exposed to political risk. Any changes in the government policy can impact the revenue of the company.

VA Tech Wabag Ltd

Income Statement (INR Millions)	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Net Revenues	16187	22386	24351	25162	32191	36344	40029	45620
Cost Of Revenues (incl Stock Adj)	11766	16979	19058	19402	25388	28857	32023	36268
Gross Profit	**4421**	**5407**	**5293**	**5759**	**6804**	**7487**	**8006**	**9352**
Employee Cost	2058	2217	2046	2113	2440	2653	2802	3011
Other Operating Expenses	819	1098	1136	1237	1286	1383	1074	1342
EBITDA	**1544**	**2091**	**2112**	**2409**	**3079**	**3450**	**4130**	**4999**
Depreciation	109	150	109	205	191	179	188	196
Net Interest Exp.	79	124	315	457	526	566	591	599
Forex (gain)/ loss	4	206	17	0	0	0	0	0
Other exceptional items	0	51	0	0	0	0	0	0
EBT	**1352**	**1662**	**1671**	**1747**	**2362**	**2705**	**3351**	**4203**
Taxes	456	526	566	668	667	974	1206	1513
Tax Rate	33.7%	31.6%	33.9%	38.2%	28.2%	36.0%	36.0%	36.0%
Net Income	**896**	**1136**	**1105**	**1079**	**1695**	**1731**	**2144**	**2690**
Adj. NI for parent	903	1,083	1,101	887	1,024	1,738	2,153	2,703
Adj. EPS (INR)	33.8	42.1	20.2	16.2	18.7	31.4	38.6	48.1
Shares Outstanding	26.6	26.6	54.3	54.3	54.3	54.8	55.3	55.7

Source: Company, KRChoksey Research

Balance sheet (INR Millions)	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
SOURCES OF FUNDS								
Share Capital	53	53	109	109	109	110	111	111
Reserves	7100	8356	8162	9094	9822	11296	13050	15351
Minority Interest	19	28	69	82	173	190	211	238
Total Shareholders Funds	**7173**	**8440**	**8340**	**9285**	**10104**	**11596**	**13372**	**15701**
Long Term Borrowings	26	450	693	501	632	474	424	374
Net Deferred Tax liability	2	37	30	31	31	31	31	31
Other long term liabilities	815	1573	607	24	470	470	470	470
Long term provisions	303	214	280	170	136	136	136	136
Current Liabilities and Provisions								
Short term borrowings	796	1133	839	3272	2459	2959	3159	3259
Trade Payables	6890	8620	9807	11787	14001	14917	16648	18724
Other Current Liabilities	1615	2371	2767	3675	5152	4972	4272	4868
Short Term Provisions	1285	1520	864	472	521	597	2410	2746
Total Current Liabilities	10586	13643	14278	19205	22134	23445	26488	29596
Total Liabilities	**18906**	**24357**	**24228**	**29216**	**33506**	**36151**	**40920**	**46307**
APPLICATION OF FUNDS :								
Net Block	511	1192	1913	1755	1744	1565	1477	1381
Capital Work in Progress	324	7	6	24	0	0	0	0
Non-current investments	33	32	27	205	33	33	33	33
Deferred tax assets	115	107	761	608	784	784	784	784
Long term loans and advances	41	10	0	0	0	0	0	0
Other Non Current Assets	1329	1973	98	160	64	64	64	64
Current Assets, Loans & Advances								
Current Investments	0	200	380	118	192	192	192	192
Inventories	405	350	470	976	385	497	657	749
Sundry Debtors	11095	13875	14748	19424	25115	29834	31763	35575
Cash and Bank	2867	3702	3883	3786	2617	596	2993	4160
Loans and Advances	1115	995	235	273	409	497	657	749
Other Current assets	919	1232	1707	1887	2163	2088	2300	2621
Total Current Assets	**16401**	**20353**	**21423**	**26464**	**30881**	**33705**	**38562**	**44045**
Total Assets	**18906**	**24357**	**24228**	**29216**	**33506**	**36151**	**40920**	**46307**

Source: Company, KRChoksey Research

VA Tech Wabag Ltd

Cash Flow Statement (INR Millions)	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
PBT & Extraordinary	1352	1611	1671	1571	1789	2705	3351	4203
Depreciation	109	150	109	205	191	179	188	196
(Inc) / Dec in Working Capital	(1191)	(838)	(2566)	(3954)	(2568)	(4034)	383	(1308)
Taxes	(343)	(566)	(550)	(531)	(770)	(974)	(1206)	(1513)
Others	891	767	1391	536	1419	591	621	639
Cash from Ops.	**817**	**1124**	**55**	**(2173)**	**61**	**(1533)**	**3336**	**2217**
Purchase of Fixed Assets	(419)	(1033)	(287)	(1517)	(1391)	0	(100)	(100)
Others	17	61	(389)	2483	1999	0	0	0
Cash from Investing	**(403)**	**(972)**	**(676)**	**966**	**608**	**0**	**(100)**	**(100)**
Proceeds from issue of shares	32	15	196	37	14	1	1	1
Borrowings (Net)	(426)	761	224	7290	7215	342	150	50
Others	(260)	(299)	(398)	(5512)	(8493)	(830)	(990)	(1002)
Cash from Financing	**(654)**	**477**	**21**	**1816**	**(1265)**	**(488)**	**(839)**	**(951)**
Net Change in Cash	(239)	629	(599)	609	(596)	(2021)	2397	1167
BF Cash & Bank	3383	2867	3702	3883	3786	2617	596	2993
END Cash & Bank	2867	3702	3883	3786	2617	596	2993	4160

Source: Company, KRChoksey Research

Ratio Analysis	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Profitability								
Return on Assets (%)	4.8	4.7	4.5	3.0	3.1	4.8	5.3	5.8
Return on Capital (%)	17.2	18.1	20.1	22.0	25.4	25.7	27.3	28.7
Return on Equity (%)	12.6	13.4	13.2	9.6	10.1	15.0	16.1	17.2
Margin Trend								
Gross Margin (%)	27.3	24.2	21.7	22.9	21.1	20.6	20.0	20.5
EBITDA Margin (%)	9.5	9.3	8.7	9.6	9.6	9.5	10.3	11.0
Net Margin (%)	5.6	5.1	4.5	3.5	3.2	4.8	5.4	5.9
Liquidity								
Current Ratio	1.5	1.5	1.5	1.4	1.4	1.4	1.5	1.5
Quick Ratio	1.5	1.5	1.5	1.3	1.4	1.4	1.4	1.5
Debtor Days	253	227	222	283	286	300	290	285
Inventory Days	9	6	7	14	4	5	6	6
Creditor Days	157	141	147	172	159	150	152	150
Cash Conversion Cycle	85	64	56	96	96	125	110	107
Solvency								
Total Debt / Equity	0.1	0.2	0.2	0.4	0.3	0.3	0.3	0.2
Interest Coverage	18.1	15.7	6.4	4.8	5.5	5.8	6.7	8.0
Valuation Ratios								
EV/EBITDA	8.1	6.0	13.0	12.4	9.9	9.6	7.5	6.0
P/E	16.3	13.1	27.2	34.0	29.5	17.5	14.2	11.4
P/B	2.0	1.7	3.6	3.2	3.0	2.6	2.3	2.0

Source: Company, KRChoksey Research

ANALYST
Dhavan Shah, dhavan.shah@krchoksey.com, +91-22-6696 5574
Rajil Shah, rajil.shah@krchoksey.com, +91-22-6696 5420

VA Tech Wabag Ltd

ANALYST CERTIFICATION:

We, Dhavan Shah [B.Com, MS(Finance)], research analyst and Rajil Shah (B.Com, MS Finance (US)), research associate, author and the name subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my views about the subject issuer(s) or securities. I also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

Terms & Conditions and other disclosures:

KRChoksey Shares and Securities Pvt. Ltd (hereinafter referred to as KRCSSPL) is a registered member of National Stock Exchange of India Limited, Bombay Stock Exchange Limited and MCX Stock Exchange Limited. KRCSSPL is a registered Research Entity vides SEBI Registration No. INH000001295 under SEBI (Research Analyst) Regulations, 2014.

We submit that no material disciplinary action has been taken on KRCSSPL and its associates (Group Companies) by any Regulatory Authority impacting Equity Research Analysis activities.

KRCSSPL prohibits its analysts, persons reporting to analysts and their relatives from maintaining a financial interest in the securities or derivatives of any companies that the analyst covers.

The information and opinions in this report have been prepared by KRCSSPL and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of KRCSSPL. While we would endeavor to update the information herein on a reasonable basis, KRCSSPL is not under any obligation to update the information. Also, there may be regulatory, compliance or other reasons that may prevent KRCSSPL from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or KRCSSPL policies, in circumstances where KRCSSPL might be acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and shall not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. KRCSSPL will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgment by any recipient. The recipient should independently evaluate the investment risks. The value and return on investment may vary because of changes in interest rates, foreign exchange rates or any other reason. KRCSSPL accepts no liabilities whatsoever for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice. Our employees in sales and marketing team, dealers and other professionals may provide oral or written market commentary or trading strategies that reflect opinions that are contrary to the opinions expressed herein, .In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest.

Associates (Group Companies) of KRCSSPL might have received any commission/compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of brokerage services or specific transaction or for products and services other than brokerage services.

KRCSSPL or its Associates (Group Companies) have not managed or co-managed public offering of securities for the subject company in the past twelve months

KRCSSPL encourages the practice of giving independent opinion in research report preparation by the analyst and thus strives to minimize the conflict in preparation of research report. KRCSSPL or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither KRCSSPL nor Research Analysts have any material conflict of interest at the time of publication of this report.

It is confirmed that, Dhavan Shah [B.Com, MS(Finance)], research analyst and Rajil Shah (B.Com, MS Finance (US)), research associate, of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months. Compensation of our Research Analysts is not based on any specific brokerage service transactions.

KRCSSPL or its associates (Group Companies) collectively or its research analyst do not hold any financial interest/beneficial ownership of more than 1% (at the end of the month immediately preceding the date of publication of the research report) in the company covered by Analyst, and has not been engaged in market making activity of the company covered by research analyst.

It is confirmed that, Dhavan Shah [B.Com, MS(Finance)], research analyst and Rajil Shah (B.Com, MS Finance (US)), research associate, do not serve as an officer, director or employee of the companies mentioned in the report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other Jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject KRCSSPL and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform them of and to observe such restriction.

Please send your feedback to research.insti@krchoksey.com
Visit us at www.krchoksey.com
Kisan Ratilal Choksey Shares and Securities Pvt. Ltd
Registered Office:
1102, Stock Exchange Tower, Dalal Street, Fort, Mumbai – 400 001.
Phone: +91-22-6633 5000; Fax: +91-22-6633 8060.
Corporate Office:
ABHISHEK, 5th Floor, Link Road, Andheri (W), Mumbai – 400 053.
Phone: +91-22-6696 5555; Fax: +91-22-6691 9576.

VA TECH WABAG

ENGINEERING

17 AUG 2017 Quarterly Update

BUY

Target Price: Rs 740

Improving domestic outlook

Q1FY18 order inflow at ~Rs 7 bn was down ~13% YoY (vs. Rs 8 bn YoY). Order backlog at Rs 74 bn was down 1% YoY (India up 23%, International subsidiaries down 35%). Wabag booked one large repeat order from Bangalore Water Supply and Sewerage Board (BWSSB) for 150 MLD Sewage Treatment Plant (STP) worth Rs 3.86 bn.

Strong order pipeline: Management talked about strong order pipeline for the company both in the domestic as well as international market, driven by expansion and greenfield projects in oil & gas industry. Domestic order pipeline highlighted earlier: (a) desalination plants in Chennai (Rs 17-22 bn), (b) 7 sewage treatment plants in Mumbai worth ~Rs 50 bn, and (c) Namami Gange projects opportunity worth Rs 200-250 bn over next 2-3 years.

CMP	: Rs 611
Potential Upside	: 21%

MARKET DATA

No. of Shares	: 55 mn
Free Float	: 75%
Market Cap	: Rs 33 bn
52-week High / Low	: Rs 749 / Rs 450
Avg. Daily vol. (6mth)	: 225,232 shares
Bloomberg Code	: VATW IB Equity
Promoters Holding	: 25%
FII / DII	: 27% / 23%

Earnings growth driven by higher margin India revenue: Q1FY18 consolidated revenue grew 15% YoY, driven by strong growth in Wabag India revenue (up 36% YoY); international subsidiaries revenue was almost flat (down 2% YoY). EBITDA margin at 6.5% was up 100 bps YoY, driven by higher share of India revenue. Interest cost increased 37% YoY to Rs 133 mn. Tax rate was at 62% due to losses in international subsidiaries. Consolidated PAT at Rs 84 mn was up 62% YoY.

Maintain guidance with positive outlook: VA Tech maintained its FY18 guidance for revenue at Rs 38-40 bn (up 18-25%) and order inflow at Rs 43-45 bn (up 20-25%). Management commentary was positive: "Execution on all projects are happening at a good pace and we look forward to another good year in terms of overall growth". Management highlighted pick up in domestic ordering activity and opportunities in Saudi Arabia, Sri Lanka, Philippines and Vietnam.

Maintain estimates, TP and BUY: We maintain our FY18 and FY19 EPS at Rs 33 and Rs 37. Our TP stands at Rs 740 (20x FY19E).

Financial summary (Consolidated)

Y/E March	FY16	FY17	FY18E	FY19E
Sales (Rs mn)	25,421	32,014	35,369	40,341
EBITDA (Rs mn)	2,247	3,079	3,417	3,881
Adj PAT (Rs mn)	922	1,667	1,796	2,013
Con. EPS* (Rs)	-	-	32.4	39.6
EPS (Rs)	16.9	30.6	32.9	36.9
Change YOY (%)	(16.6)	80.7	7.7	12.1
P/E (x)	36.1	20.0	18.5	16.5
RoE (%)	9.7	16.8	16.9	16.5
EV/E (x)	14.9	11.0	10.0	8.8
DPS (Rs)	2.8	3.1	5.4	6.0

Source: *Consensus broker estimates, Company, Axis Capital

Key drivers

(Rs bn)	FY17	FY18E	FY19E
Order inflow	36	46	51
Order backlog	73	84	95
EBITDA margin (%)	9.6	9.6	9.6

Price performance

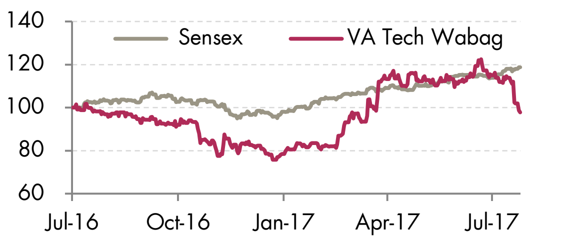


Exhibit 1: Results update

(Rs. mn)	Quarter ended					12 months ended		
	Jun-17	Jun-16	% Chg	Mar-17	% Chg	FY18E	FY17	% Chg
Net sales	**6,686**	**5,803**	**15.2**	**11,317**	**(40.9)**	**35,369**	**32,014**	**10.5**
EBITDA	438	320	36.7	1,320	(66.8)	3,417	3,079	11.0
PBIDT	**438**	**320**	**36.7**	**1,320**	**(66.8)**	**3,417**	**3,079**	**11.0**
Depreciation	45	46	(1.1)	52	(12.6)	219	191	14.4
Interest	133	110	21.5	161	(17.0)	538	526	2.3
PBT	**259**	**165**	**57.2**	**1,108**	**(76.6)**	**2,660**	**2,362**	**12.6**
Tax	160	109	46.3	326	(51.0)	854	667	28.2
Minority Interest	16	4	321.6	24	(35.3)	30	169	(82.2)
Adjusted PAT	**84**	**52**	**61.5**	**757**	**(88.9)**	**1,796**	**1,667**	**7.7**
Extra ordinary income/ (exp.)	0	0	-	0	-	0	(643)	-
Reported PAT	**84**	**52**	**61.5**	**757**	**(88.9)**	**1,796**	**1,024**	**75.4**
No. of shares (mn)	54	54	-	54	-	55	55	-
EBITDA margin (%)	6.5	5.5	-	11.7	-	9.6	9.5	-
PBIDT margin (%)	6.5	5.5	-	11.7	-	9.7	9.6	-
EPS - annualized (Rs.)	**6.2**	**3.8**	**61.5**	**55.7**	**(88.9)**	**32.9**	**30.6**	**7.7**

Source: Company, Axis Capital

Financial summary (Consolidated)

Profit & loss (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Net sales	25,421	32,014	35,369	40,341
Other operating income	65	65	65	65
Total operating income	**25,486**	**32,079**	**35,434**	**40,406**
Cost of goods sold	(19,889)	(25,275)	(27,843)	(31,646)
Gross profit	5,597	6,804	7,591	8,760
Gross margin (%)	*22.0*	*21.3*	*21.5*	*21.7*
Total operating expenses	(3,350)	(3,725)	(4,174)	(4,879)
EBITDA	**2,247**	**3,079**	**3,417**	**3,881**
EBITDA margin (%)	*8.8*	*9.6*	*9.7*	*9.6*
Depreciation	(205)	(191)	(219)	(233)
EBIT	**2,041**	**2,887**	**3,198**	**3,649**
Net interest	(424)	(526)	(538)	(553)
Other income	-	-	-	-
Profit before tax	**1,617**	**2,362**	**2,660**	**3,095**
Total taxation	(689)	(667)	(854)	(1,072)
Tax rate (%)	*42.6*	*28.2*	*32.1*	*34.6*
Profit after tax	928	1,695	1,806	2,023
Minorities	(16)	(98)	(20)	(20)
Profit/ Loss associate co(s)	9	70	10	10
Adjusted net profit	922	1,667	1,796	2,013
Adj. PAT margin (%)	*3.6*	*5.2*	*5.1*	*5.0*
Net non-recurring items	-	643	-	-
Reported net profit	922	2,310	1,796	2,013

Balance sheet (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Paid-up capital	109	109	109	109
Reserves & surplus	9,809	9,822	11,254	12,861
Net worth	9,918	9,931	11,363	12,970
Borrowing	3,884	3,091	2,791	2,491
Other non-current liabilities	-	-	-	-
Total liabilities	**13,884**	**13,195**	**14,346**	**15,674**
Gross fixed assets	2,580	2,760	2,899	3,038
Less: Depreciation	(825)	(1,016)	(1,234)	(1,467)
Net fixed assets	1,755	1,744	1,665	1,571
Add: Capital WIP	24	-	-	-
Total fixed assets	1,779	1,744	1,665	1,571
Total Investment	177	225	225	225
Inventory	976	385	837	952
Debtors	20,430	25,115	25,679	29,288
Cash & bank	3,684	2,618	1,875	1,822
Loans & advances	1,254	1,010	1,938	2,210
Current liabilities	16,150	20,279	18,571	21,163
Net current assets	11,881	11,011	12,242	13,663
Other non-current assets	47	215	215	215
Total assets	**13,884**	**13,195**	**14,346**	**15,674**

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Profit before tax	1,617	2,362	2,660	3,095
Depreciation & Amortisation	205	191	219	233
Chg in working capital	*(2,921)*	*(196)*	*(1,974)*	*(1,474)*
Cash flow from operations	**(1,794)**	**1,019**	**41**	**772**
Capital expenditure	*(78)*	*(156)*	*(139)*	*(139)*
Cash flow from investing	**(280)**	**(204)**	**(139)**	**(139)**
Equity raised/ (repaid)	-	-	-	-
Debt raised/ (repaid)	*2,078*	*(794)*	*(300)*	*(300)*
Dividend paid	*(177)*	*(196)*	*(344)*	*(386)*
Cash flow from financing	**2,283**	**(1,882)**	**(644)**	**(686)**
Net chg in cash	209	(1,066)	(742)	(53)

Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
OPERATIONAL				
FDEPS (Rs)	16.9	30.6	32.9	36.9
CEPS (Rs)	20.7	45.8	36.9	41.2
DPS (Rs)	2.8	3.1	5.4	6.0
Dividend payout ratio (%)	16.4	7.3	16.4	16.4
GROWTH				
Net sales (%)	4.7	25.9	10.5	14.1
EBITDA (%)	7.2	37.0	11.0	13.6
Adj net profit (%)	(16.3)	80.8	7.7	12.1
FDEPS (%)	(16.6)	80.7	7.7	12.1
PERFORMANCE				
RoE (%)	9.7	16.8	16.9	16.5
RoCE (%)	16.5	21.3	23.2	24.3
EFFICIENCY				
Asset turnover (x)	3.0	3.1	3.1	3.1
Sales/ total assets (x)	0.9	1.0	1.1	1.2
Working capital/ sales (x)	0.3	0.3	0.3	0.3
Receivable days	293.3	286.3	265.0	265.0
Inventory days	15.3	4.8	9.5	9.5
Payable days	230.8	247.0	203.6	203.8
FINANCIAL STABILITY				
Total debt/ equity (x)	0.4	0.3	0.3	0.2
Net debt/ equity (x)	-	-	0.1	-
Current ratio (x)	1.7	1.5	1.7	1.6
Interest cover (x)	4.8	5.5	5.9	6.6
VALUATION				
PE (x)	36.1	20.0	18.5	16.5
EV/ EBITDA (x)	14.9	11.0	10.0	8.8
EV/ Net sales (x)	1.3	1.1	1.0	0.8
PB (x)	3.4	3.4	2.9	2.6
Dividend yield (%)	0.5	0.5	0.9	1.0
Free cash flow yield (%)	(0.1)	-	-	-

Source: Company, Axis Capital

Disclosures:

The following Disclosures are being made in compliance with the SEBI Research Analyst Regulations 2014 (herein after referred to as the Regulations).

1. Axis Securities Ltd. (ASL) is a SEBI Registered Research Analyst having registration no. INH000000297. ASL, the Research Entity (RE) as defined in the Regulations, is engaged in the business of providing Stock broking services, Depository participant services & distribution of various financial products. ASL is a subsidiary company of Axis Bank Ltd. Axis Bank Ltd. is a listed public company and one of India's largest private sector bank and has its various subsidiaries engaged in businesses of Asset management, NBFC, Merchant Banking, Trusteeship, Venture Capital, Stock Broking, the details in respect of which are available on www.axisbank.com.
2. ASL is registered with the Securities & Exchange Board of India (SEBI) for its stock broking & Depository participant business activities and with the Association of Mutual Funds of India (AMFI) for distribution of financial products and also registered with IRDA as a corporate agent for insurance business activity.
3. ASL has no material adverse disciplinary history as on the date of publication of this report.
4. I/We, authors (Research team) and the name/s subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my/our views about the subject issuer(s) or securities. I/We also certify that no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. I/we or my/our relative or ASL does not have any financial interest in the subject company. Also I/we or my/our relative or ASL or its Associates may have beneficial ownership of 1% or more in the subject company at the end of the month immediately preceding the date of publication of the Research Report. Since associates of ASL are engaged in various financial service businesses, they might have financial interests or beneficial ownership in various companies including the subject company/companies mentioned in this report. I/we or my/our relative or ASL or its associates do not have any material conflict of interest. I/we have not served as director, officer or employee in the subject company.

Research Team

Sr. No	Name	Designation	E-mail
1	Hiren Trivedi	Research Associate	hiren.trivedi@axissecurities.in
2	Kiran Gawle	Associate	kiran.gawle@axissecurities.in

5. ASL or its associates has not received any compensation from the subject company in the past twelve months. ASL or its Research Analysts has not been engaged in market making activity for the subject company.

6. In the last 12-month period ending on the last day of the month immediately preceding the date of publication of this research report, ASL or any of its associates may have:

i. Received compensation for investment banking, merchant banking or stock broking services or for any other services from the subject company of this research report and / or;
ii. Managed or co-managed public offering of the securities from the subject company of this research report and / or;
iii. Received compensation for products or services other than investment banking, merchant banking or stock broking services from the subject company of this research report;

ASL or any of its associates have not received compensation or other benefits from the subject company of this research report or any other third-party in connection with this report

Term& Conditions:

This report has been prepared by ASL and is meant for sole use by the recipient and not for circulation. The report and information contained herein is strictly confidential and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ASL. The report is based on the facts, figures and information that are considered true, correct, reliable and accurate. The intent of this report is not recommendatory in nature. The information is obtained from publicly available media or other sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied, is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. The report is prepared solely for informational purpose and does not constitute an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments for the clients. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ASL will not treat recipients as customers by virtue of their receiving this report.

DEFINITION OF RATINGS	
Ratings	Expected absolute returns over 12-18 months
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%

Disclaimer:

Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to the recipient's specific circumstances. The securities and strategies discussed and opinions expressed, if any, in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient.

This report may not be taken in substitution for the exercise of independent judgment by any recipient. Each recipient of this report should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this report (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. Certain transactions, including those involving futures, options and other derivatives as well as non-investment grade securities involve substantial risk and are not suitable for all investors. ASL, its directors, analysts or employees do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of shares and bonds, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc. Past performance is not necessarily a guide to future performance. Investors are advise necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ASL and its affiliated companies, their directors and employees may; (a) from time to time, have long or short position(s) in, and buy or sell the securities of the company(ies) mentioned herein or (b) be engaged in any other transaction involving such securities or earn brokerage or other compensation or act as a market maker in the financial instruments of the company(ies) discussed herein or act as an advisor or investment banker, lender/borrower to such company(ies) or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions. Each of these entities functions as a separate, distinct and independent of each other. The recipient should take this into account before interpreting this document.

ASL and / or its affiliates do and seek to do business including investment banking with companies covered in its research reports. As a result, the recipients of this report should be aware that ASL may have a potential conflict of interest that may affect the objectivity of this report. Compensation of Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions. ASL may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Neither this report nor any copy of it may be taken or transmitted into the United State (to U.S. Persons), Canada, or Japan or distributed, directly or indirectly, in the United States or Canada or distributed or redistributed in Japan or to any resident thereof. If this report is inadvertently sent or has reached any individual in such country, especially, USA, the same may be ignored and brought to the attention of the sender. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ASL to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors.

The Disclosures of Interest Statement incorporated in this document is provided solely to enhance the transparency and should not be treated as endorsement of the views expressed in the report. The Company reserves the right to make modifications and alternations to this document as may be required from time to time without any prior notice. The views expressed are those of the analyst(s) and the Company may or may not subscribe to all the views expressed therein.

Axis Securities Limited, Corporate office: Unit No. 2, Phoenix Market City, 15, LBS Road, Near Kamani Junction, Kurla (west), Mumbai-400070, Tel No. – 18002100808/022-61480808, Regd. off.- Axis House, 8th Floor, Wadia International Centre, PandurangBudhkarMarg, Worli, Mumbai – 400 025. Compliance Officer: AnandShaha, Email: compliance.officer@axisdirect.in, Tel No: 022-42671582.

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

Chirag J Shah
shah.chirag@icicisecurities.com

Sagar K Gandhi
sagar.gandhi@icicisecurities.com

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. EBIDTA 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.

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 Remunaration & 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

	FY18E			FY19E		
(₹ Crore)	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

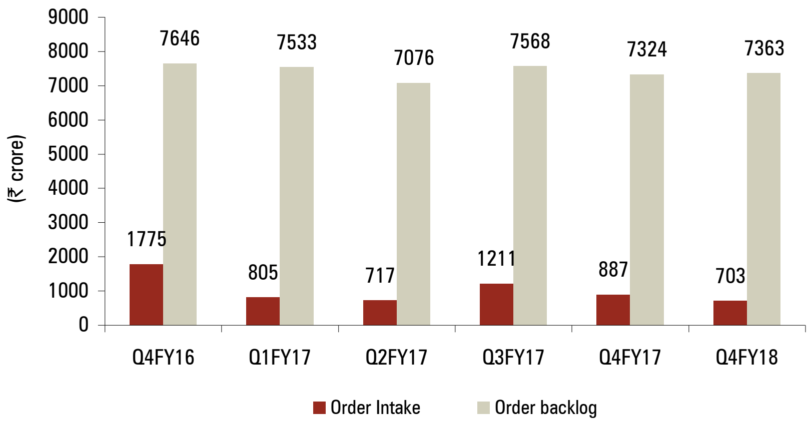
VA Tech Wabag (Wabag) is a leading MNC in the water treatment space (water desalination, sewage water treatment, waste water treatment, etc), with a global presence. The company operates on an asset light-EPC led model in water treatment projects across municipal & industrial segments. It focuses on 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

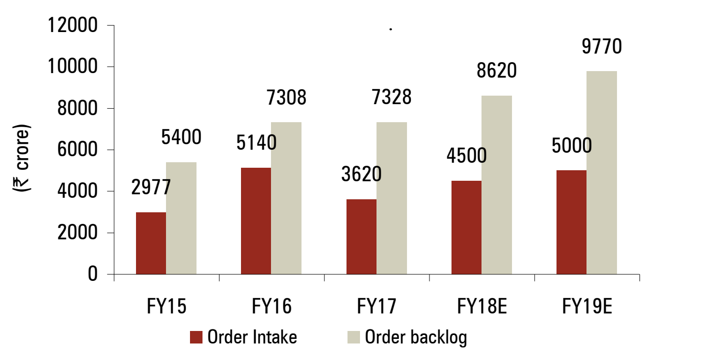


Source: Company, ICICIdirect.com Research

Engineering excellence and asset light business model

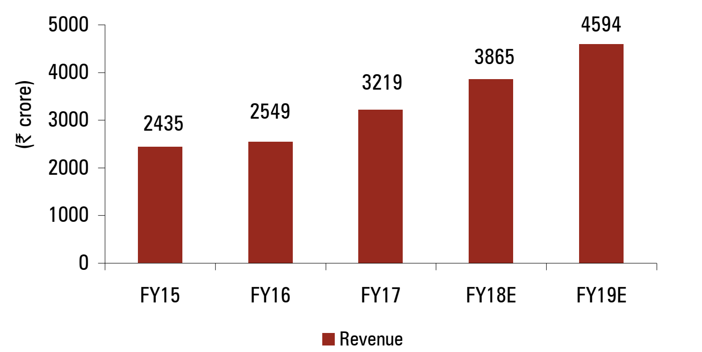
VA Tech Wabag (Wabag) operates on an asset light EPC model, thereby manifesting a lean balance sheet. With growing concern on access to clean water and urgent measures to solve the issue of depleting water resources, the investment in water treatment is likely to increase manifold globally. Accordingly, 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 …

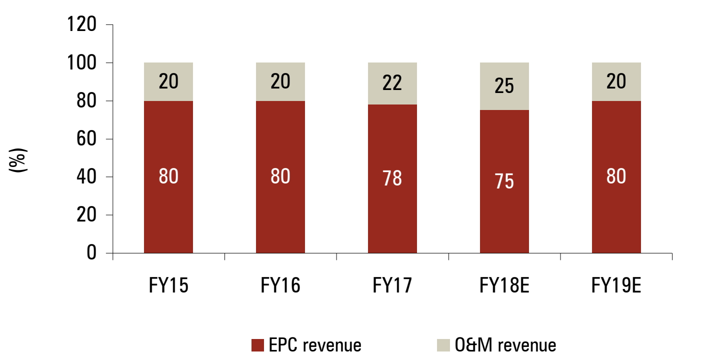


Source: Company, ICICIdirect.com Research

EBITDA margin likely to improve over next two years…

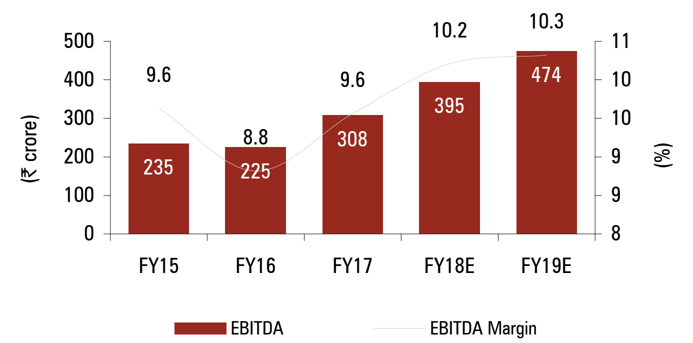
Wabag has earned average EBITDA margins of 9.6% in FY17. Going ahead, margins are likely to improve on the back of shifting of its operations base from high cost countries to low cost local markets. Accordingly, we expect EBITDA margins to improve from 9.6% in FY17 to 10.3% in FY19E. We expect margins 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



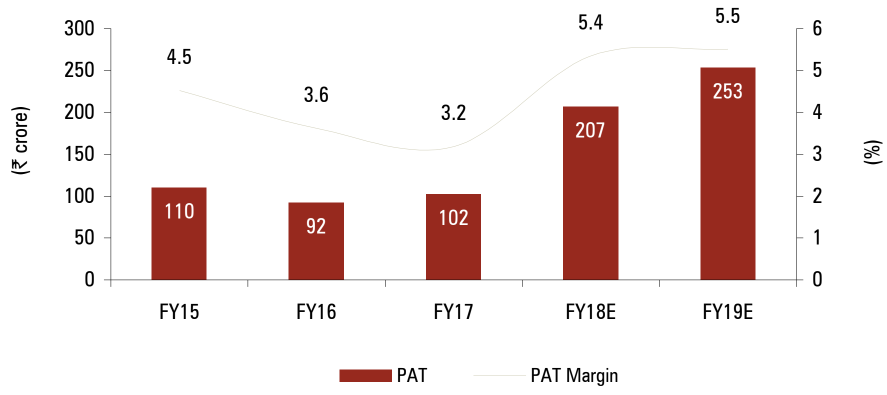
Source: Company, ICICIdirect.com Research

Exhibit 6: EBITDA and EBITDA margin trend



Source: Company, ICICIdirect.com Research

Exhibit 7: PAT trend

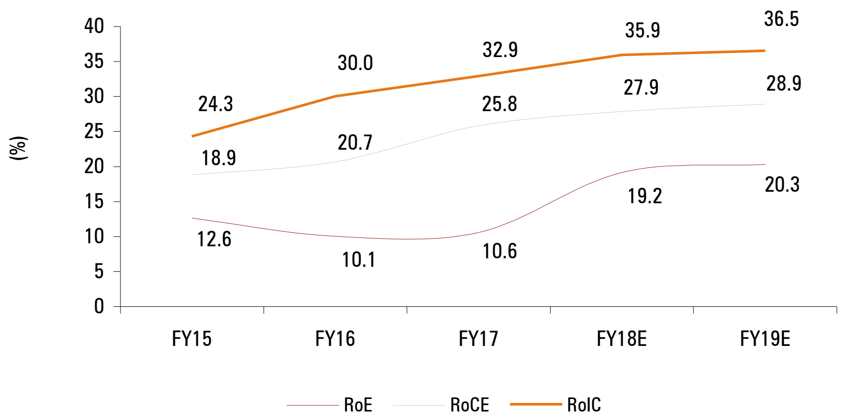


Source: Company, ICICIdirect.com Research

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

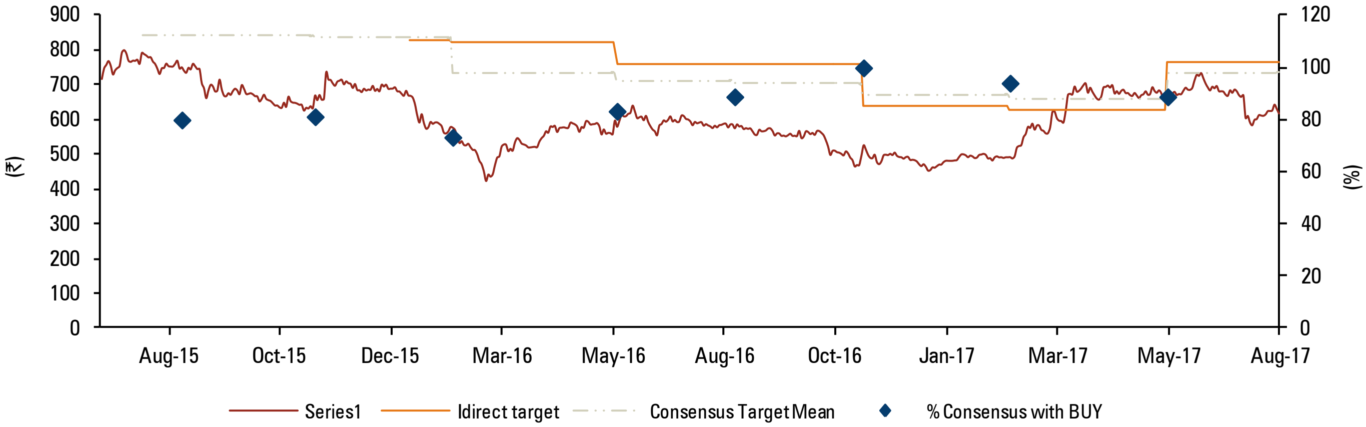
Wabag has a strong management team in place. The company continuously conducts an enterprise-wide exercise that results in reengineering of processes, realignment of strengths and reorganisation of business verticals. Since 2007, the company operated through four strategic business units (SBUs) comprising 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			Investor name		
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 Remunaration	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

RATING RATIONALE

ICICIdirect.com endeavours to provide objective opinions and recommendations. ICICIdirect.com assigns ratings to its stocks according to their notional target price vs. current market price and then categorises them as Strong Buy, Buy, Hold and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock.

Strong Buy: >15%/20% for large caps/midcaps, respectively, with high conviction;
Buy: >10%/15% for large caps/midcaps, respectively;
Hold: Up to +/-10%;
Sell: -10% or more;

Pankaj Pandey **Head – Research** **pankaj.pandey@icicisecurities.com**

ICICIdirect.com Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No. 7, MIDC,
Andheri (East)
Mumbai – 400 093

research@icicidirect.com

Disclaimer

ANALYST CERTIFICATION

We /I, *Chirag Shah PGDBM; Sagar Gandhi MBA (Finance)*, Research Analysts, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

Terms & conditions and other disclosures:

ICICI Securities Limited (ICICI Securities) is a full-service, integrated investment banking and is, inter alia, engaged in the business of stock brokering and distribution of financial products. ICICI Securities Limited is a Sebi registered Research Analyst with Sebi Registration Number – INH000000990. ICICI Securities is a wholly-owned subsidiary of ICICI Bank which is India's largest private sector bank and has its various subsidiaries engaged in businesses of housing finance, asset management, life insurance, general insurance, venture capital fund management, etc. ("associates"), the details in respect of which are available on www.icicibank.com.

ICICI Securities is one of the leading merchant bankers/ underwriters of securities and participate in virtually all securities trading markets in India. We and our associates might have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. ICICI Securities generally prohibits its analysts, persons reporting to analysts and their relatives from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on a reasonable basis, ICICI Securities is under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities might be acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and shall not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgment by any recipient. The recipient should independently evaluate the investment risks. The value and return on investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities accepts no liabilities whatsoever for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities or its associates might have managed or co-managed public offering of securities for the subject company or might have been mandated by the subject company for any other assignment in the past twelve months.

ICICI Securities or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory service in a merger or specific transaction.

ICICI Securities or its associates might have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the companies mentioned in the report in the past twelve months.

ICICI Securities encourages independence in research report preparation and strives to minimize conflict in preparation of research report. ICICI Securities or its associates or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither ICICI Securities nor Research Analysts and their relatives have any material conflict of interest at the time of publication of this report.

It is confirmed that *Chirag Shah PGDBM; Sagar Gandhi MBA (Finance)*, Research Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months.

Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions.

ICICI Securities or its subsidiaries collectively or Research Analysts or their relatives do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

Since associates of ICICI Securities are engaged in various financial service businesses, they might have financial interests or beneficial ownership in various companies including the subject company/companies mentioned in this report.

It is confirmed that *Chirag Shah PGDBM; Sagar Gandhi MBA (Finance)*, Research Analysts do not serve as an officer, director or employee of the companies mentioned in the report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Neither the Research Analysts nor ICICI Securities have been engaged in market making activity for the companies mentioned in the report.

We submit that no material disciplinary action has been taken on ICICI Securities by any Regulatory Authority impacting Equity Research Analysis activities.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

RESULT UPDATE

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

VA TECH WABAG

PRICE: RS.588 **RECOMMENDATION: BUY**
TARGET PRICE: RS.711 **FY19E PE: 15.6X**

VA Tech Wabag's (VAW) reported good set of numbers in the second quarter on an operational basis. Profit and EBITDA Numbers were ahead of our expectations. The stock has underperformed in recent quarters due to increasing working capital intensity which has raised net borrowings.

We have been positive on the stock in view strong order book of the company coupled with relative under-performance in stock price in H1FY18. Valuations are attractive relative to peers. Reiterate "BUY" with an unchanged price target of Rs 711.

Summary table

(Rs mn)	FY17	FY18E	FY19E
Sales	32079.1	36180.0	40521.6
Growth %	26.1	12.8	12.0
EBITDA	2966.2	3359.2	3771.3
EBITDA margin %	9.2	9.3	9.3
PBT	2,361.6	2,745.4	3,102.8
PAT	1,024.0	1,807.0	2,042.8
EPS (Rs)	18.9	33.3	37.6
Growth %	16.7	76.5	13.1
CEPS	22.4	37.4	42.2
Book value (Rs/share)	196.9	225.5	258.4
Dividend per share (Rs)	4.0	4.0	4.0
ROE %	9.9	15.8	15.6
ROCE %	16.0	16.3	17.7
Net cash (debt)	-450.3	1619.7	1868.4
NW Capital (Days)	39.7	40.3	50.8
EV/Sales (x)	1.0	0.8	0.7
EV/EBITDA (x)	10.9	9.0	8.0
P/E (x)	31.2	17.7	15.6
P/Cash Earnings	26.3	15.7	13.9
P/BV (x)	3.0	2.6	2.3

Source: Company, Kotak Securities – Private Client Research

Quarterly performance

(Rs mn)	Q2FY18	Q2FY17	YoY (%)	H1FY18	H1FY17	YoY (%)
Net Sales	**8865**	**7771**	**14.1**	**15551**	**13565**	**14.6**
Other operating income	0	6	-	0	14	-
Net Sales & Other Operating Income	8865	7776	14.0	15551	13579	14.5
Total Expenditure	8091	7196	12.4	14358	12723	12.8
(Increase) / Decrease In Stocks	-37	-330	-88.8	-52	-573	-91.0
Cost of Services & Raw Materials	7142	6626	7.8	12412	11502	7.9
Other Expenses	347	279	24.2	698	594	17.5
Employee Cost	639	621	2.9	1299	1200	8.3
PBIDT	**775**	**580**	**33.5**	**1194**	**855**	**39.6**
Other Income	2	0		22	0	
Operating Profit	777	580	33.9	1215	855	42.1
Depreciation	45	47	-5.7	90	93	-3.4
EBIT	**732.6**	**533.1**	**37.4**	**1126**	**762**	**47.7**
Interest	143	94	51.6	276	204	35.5
Forex gain/(loss)	0.0	4.5	-100.0	0	50	-100.0
PBT	**589.6**	**443.3**	**33.0**	**849**	**608**	**39.6**
Tax	220	186	18.3	380	296	28.7
Profit After Tax	369.3	257.1	43.6	469	313	50.0
Minority Interest	-42.1	-25.0	68.4	-60	-39	53.8
Shares of Associates	7.0	8.3	-15.7	9	19	-50.0
Consolidated Net Profit	334.2	240.4	39.0	418	292	43.1

Source: Company

Estimates

(Rs mn)	Q2FY18	Q2FY17	Q2FY18Est	Comments
Revenue	8865	7776	8200	Higher than expected revenue aided by strong order book
EBITDA (%)	8.7	7.4	8.0	exceeded EBITDA margin forecast
PAT	334	240.4	289	Leading to profits beating our forecast

Source: Kotak Securities – Private Client Research

Consolidated Performance – Healthy revenue growth, margins gains lead to higher than expected profits

Revenue - consolidated revenue stood at Rs 8.8 bn (+14% YoY) and ahead of our estimates due to robust execution of IIU (India International Units) projects like Petronas, Malaysia and AMAS, Bahrain.

EBITDA for the quarter stood at Rs 775 mn (33.5% YoY), which was higher than estimates due to strong growth in revenues and project management efficiencies.

EBITDA margins for the quarter stood at 8.7% vs 7.4% on a y-o-y basis, mainly due to higher gross margins which could be due to change in project mix (some projects may not be reached at profit recognition stage).

Share of profits from associates stood at Rs 7.0 mn vs Rs 8.3 mn on a y-o-y basis. The company reported PAT of Rs 334.2 mn vs Rs 240.4 mn in corresponding quarter of the previous fiscal.

Consolidated gross debt stands at Rs 5.5 bn as compared to Rs 4.5 bn on a q-o-q basis. Cash levels stand at Rs 1.3 bn vs Rs 3.2 bn on a q-o-q basis. This is concerning as we are seeing in recent quarters that the debt has been trending higher while the cash has been depleting. In our view, this trend needs to reverse for the stock to trade higher.

Receivables have increased to Rs 28.5 bn in Q2FY18 vs Rs 25.1 bn at the end of FY17.

Consolidated Order backlog stands at Rs 79 bn (Rs 70 bn on a y-o-y basis). The revenue visibility provided by order book is adequate at 27 months of trailing four quarter revenues.

Maintained Guidance

Revenue guidance of Rs 38-40 bn

Order intake guidance of Rs 43-45 bn

The company continue to remain positive on the EBITDA margins outlook.

Valuation – Maintain BUY

We maintain BUY on Va Tech Wabag with a price target of Rs.711

VAW is trading at 17.7x and 15.6x, FY18 and FY19 earnings respectively. We have been positive on the stock in view strong order book of the company coupled with relative under-performance in stock price in H1FY18. We also have a favourable sector view on the water and sewage treatment sector on account long term drivers like urbanization, smart cities, water reclamation, industrial effluent treatment and Namami Gange. We maintain **"BUY"** with an unchanged price target of Rs 711 (19x FY19 earnings).

RATING SCALE

Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 9 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 9 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 9 months
SELL	–	We expect the stock to deliver negative returns over the next 9 months
NR	–	Not Rated. Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
RS	–	Rating Suspended. Kotak Securities has suspended the investment rating and price target for this stock, either because there is not a Sufficient fundamental basis for determining, or there are legal, regulatory or policy constraints around publishing, an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.
NA	–	Not Available or Not Applicable. The information is not available for display or is not applicable
NM	–	Not Meaningful. The information is not meaningful and is therefore excluded.
NOTE	–	Our target prices are with a 9-month perspective. Returns stated in the rating scale are our internal benchmark.

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

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

Teena Virmani
Construction, Cement
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

Ashini Shah
Midcap
ashini.shah@kotak.com
+91 22 6218 5438

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
prasenjit.biswas@kotak.com
+91 33 6625 9810

Disclosure/Disclaimer

Kotak Securities Limited established in 1994, is a subsidiary of Kotak Mahindra Bank Limited. Kotak Securities is one of India's largest brokerage and distribution house.

Kotak Securities Limited is a corporate trading and clearing member of Bombay Stock Exchange Limited (BSE), National Stock Exchange of India Limited (NSE), Metropolitan Stock Exchange of India Limited (MSE). Our businesses include stock broking, services rendered in connection with distribution of primary market issues and financial products like mutual funds and fixed deposits, depository services and Portfolio Management.

Kotak Securities Limited is also a depository participant with National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL). Kotak Securities Limited is also registered with Insurance Regulatory and Development Authority as Corporate Agent for Kotak Mahindra Old Mutual Life Insurance Limited and is also a Mutual Fund Advisor registered with Association of Mutual Funds in India (AMFI). We are registered as a Research Analyst under SEBI (Research Analyst) Regulations, 2014.

We hereby declare that our activities were neither suspended nor we have defaulted with any stock exchange authority with whom we are registered in last five years. However SEBI, Exchanges and Depositories have conducted the routine inspection and based on their observations have issued advise/warning/deficiency letters/ or levied minor penalty on KSL for certain operational deviations. We have not been debarred from doing business by any Stock Exchange / SEBI or any other authorities; nor has our certificate of registration been cancelled by SEBI at any point of time.

We offer our research services to clients as well as our prospects.

This document is not for public distribution and has been furnished to you solely for your information and must not be reproduced or redistributed to any other person. Persons into whose possession this document may come are required to observe these restrictions.

This material is for the personal information of the authorized recipient, and we are not soliciting any action based upon it. This report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It is for the general information of clients of Kotak Securities Ltd. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients.

We have reviewed the report, and in so far as it includes current or historical information, it is believed to be reliable though its accuracy or completeness cannot be guaranteed. Neither Kotak Securities Limited, nor any person connected with it, accepts any liability arising from the use of this document. The recipients of this material should rely on their own investigations and take their own professional advice. Price and value of the investments referred to in this material may go up or down. Past performance is not a guide for future performance. Certain transactions -including those involving futures, options and other derivatives as well as non-investment grade securities - involve substantial risk and are not suitable for all investors. Reports based on technical analysis centers on studying charts of a stock's price movement and trading volume, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals.

Opinions expressed are our current opinions as of the date appearing on this material only. While we endeavor to update on a reasonable basis the information discussed in this material, there may be regulatory, compliance or other reasons that prevent us from doing so. Prospective investors and others are cautioned that any forward-looking statements are not predictions and may be subject to change without notice. Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.

Kotak Securities Limited has two independent equity research groups: Institutional Equities and Private Client Group. This report has been prepared by the Private Client Group. The views and opinions expressed in this document may or may not match or may be contrary with the views, estimates, rating, target price of the Institutional Equities Research Group of Kotak Securities Limited.

We and our affiliates/associates, officers, directors, and employees, Research Analyst(including relatives) worldwide may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the subject company/company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) or have other potential/material conflict of interest with respect to any recommendation and related information and opinions at the time of publication of Research Report or at the time of public appearance. Kotak Securities Limited (KSL) may have proprietary long/short position in the above mentioned scrip(s) and therefore may be considered as interested. The views provided herein are general in nature and does not consider risk appetite or investment objective of particular investor; readers are requested to take independent professional advice before investing. This should not be construed as invitation or solicitation to do business with KSL. Kotak Securities Limited is also a Portfolio Manager. Portfolio Management Team (PMS) takes its investment decisions independent of the PCG research and accordingly PMS may have positions contrary to the PCG research recommendation. Kotak Securities Limited does not provide any promise or assurance of favourable view for a particular industry or sector or business group in any manner. The investor is requested to take into consideration all the risk factors including their financial condition, suitability to risk return profile and take professional advice before investing.

The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report.

No part of this material may be duplicated in any form and/or redistributed without Kotak Securities' prior written consent.

Details of Associates are available on our website ie www.kotak.com

Research Analyst has served as an officer, director or employee of subject company(ies): No

We or our associates may have received compensation from the subject company(ies) in the past 12 months.

We or our associates have managed or co-managed public offering of securities for the subject company(ies) in the past 12 months: No

We or our associates may have received compensation for investment banking or merchant banking or brokerage services from the subject company(ies) in the past 12 months. We or our associates may have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company(ies) in the past 12 months. We or our associates may have received compensation or other benefits from the subject company(ies) or third party in connection with the research report. Our associates may have financial interest in the subject company(ies).

Research Analyst or his/her relative's financial interest in the subject company(ies): No

Kotak Securities Limited has financial interest in the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: Yes

Our associates may have actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report.

Research Analyst or his/her relatives has actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: No.

Kotak Securities Limited has actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: No

Subject company(ies) may have been client during twelve months preceding the date of distribution of the research report.

"A graph of daily closing prices of securities is available at www.nseindia.com and http://economictimes.indiatimes.com/markets/stocks/stock-quotes. (Choose a company from the list on the browser and select the "three years" icon in the price chart)."

Kotak Securities Limited. Registered Office: 27 BKC, C 27, G Block, Bandra Kurla Complex, Bandra (E), Mumbai 400051. CIN: U99999MH1994PLC134051, Telephone No.: +22 43360000, Fax No.: +22 67132430. Website: www.kotak.com/www.kotaksecurities.com. Correspondence Address: Infinity IT Park, Bldg. No 21, Opp. Film City Road, A K Vaidya Marg, Malad (East), Mumbai 400097. Telephone No: 42856825. SEBI Registration No: NSE INB/INF/INE 230808130, BSE INB 010808153/INF 011133230, MSE INE 260808130/INB 260808135/INF 260808135, AMFI ARN 0164, PMS INP000000258 and Research Analyst INH000000586. NSDL/CDSL: IN-DP-NSDL-23-97. Our research should not be considered as an advertisement or advice, professional or otherwise. The investor is requested to take into consideration all the risk factors including their financial condition, suitability to risk return profile and the like and take professional advice before investing. Investments in securities market are subject to market risks, read all the related documents carefully before investing. Derivatives are a sophisticated investment device. The investor is requested to take into consideration all the risk factors before actually trading in derivative contracts. Compliance Officer Details: Mr. Manoj Agarwal. Call: 022 - 4285 8484, or Email: ks.compliance@kotak.com.

- **Level 1**: For Trading related queries, contact our customer service at 'service.securities@kotak.com' and for demat account related queries contact us at ks.demat@kotak.com or call us on: Online Customers - 30305757 (by using your city STD code as a prefix) or Toll free numbers 18002099191 / 1800222299, Offline Customers - 18002099292
- **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.