

23rd September 2010

VA Tech Wabag Limited

Recommendation: **Subscribe**

Issue Summary		
Price Band (Rs)	1230	1310
Bid Lot	5 shares	
Face Value	Rs.5	
Opens on	22 nd Sep'10	
Closes on	27 th Sep'10	
Total no of shares to be raised	36.69 lacs	36.01 lacs
Fresh Issue	Rs. 125 cr	
Offer for Sale	26,53,383 shares	

Co will not receive any proceeds from the Offer for Sale

Pre-issue share capital	Rs. 4.77 crs	
Post-issue share capital	Rs5.25 crores	Rs5.28 crores
Issue Size (at higher band)	Rs 472.5 crores	
P/E on FY10	25.85	27.53

Net Issue	No. of Shares	%
QIB's	n.a	n.a
Non Institutional	n.a	n.a
Retail	n.a	n.a
Employees	n.a	n.a
Total	n.a	100%

n.a : not available

Company & Business Profile

Headquartered in Chennai, VA Tech Wabag Ltd (VTWL) is a multinational player in the water treatment industry with market presence in India, the Middle East, North Africa, Central and Eastern Europe, China and South East Asia. It offers complete life cycle solutions including conceptualization, design, engineering, procurement, supply, installation, construction and O&M services. Its clients include municipal corporations and companies in the infrastructure sector such as power, steel and oil and gas companies. As on July 31, 2010, VTWL has executed 113 projects and is currently executing 81 projects.

VTWL is technology focused. It has R & D centers located in Chennai (India), Vienna (Austria) and Winterthur (Switzerland). Its primary business is water engineering which involves the use of technology for the treatment of water and waste water in order to obtain water for specific purposes such as drinking and reuse in industries or safe disposal.

In 2007, it acquired Wabag Austria and hence took over the Wabag group. It immensely benefits from its association with the Wabag brand name which facilitates its entry into newer markets and helps it to pre-qualify for its projects. Wabag Austria is the holding company for most of subsidiaries overseas. Wabag Austria and Wabag Wassertechnik own 157 patents, which include both process and product patents. Wabag Austria has also applied for 51 patents that are pending.

Company has 13 subsidiaries. As at July 31, 2010, it had a workforce of approximately 1,469 including 757 qualified engineers while it had a workforce of 754 including 588 qualified engineers.

Competitors in India include Veolia Water India Pvt Ltd, Degremont India, Hindustan Dorr Oliver and L&T in the municipal sector and companies like Thermax, Ion Exchange, Engineers India, HCC, Nagarjuna Constructions Company, Gammon India and Driplex in the industrial sector.

Objects of the Issue

Particulars	Amount proposed (Rs in cr)
Funding working capital requirements	64.51 (out of 105 Cr)
Construction of corporate office at Chennai	34.74 (out of 105 Cr)
Implementation of global IT systems	11.05 (out of 105 Cr)
General corporate purposes	*
Total	125

*Finalized after issue

**Book Running Lead Managers:
ENAM & IDFC Capital**

....however its principal expertise is technology and it sub-contract the civil works

Investment Positives:

- **Huge Opportunities in water & water waste management business-** The amount of freshwater on Earth is finite. But the demand for water continues to escalate at an unsustainable rate, fueled by population growth and industrial expansion. Globally the thrust on improvement and augmentation of water and waste water treatment infrastructure has increased. India has planned to spend Rs 1,29,200 crore under the 11th five year plan (2007-2012) which is more than 2 times of the planned expenditure of the 10th five year plan. Similarly, the governments around the world are undertaking such projects. Also there is increased funding from multilateral agencies like World Bank, ADB, etc. with emphasis on private participation. There are stricter disposal norms for industrial waste water.

As VTWL group is an established global player, favorable demand outlook will boost company's financial further.

- **Complete water solutions provider:** VTWL provide engineering solutions in the water industry for sewage treatment, processed and drinking water treatment, effluents treatment, sludge treatment, desalination and reuse and offer a comprehensive range of services throughout the entire life cycle of water including conceptualization, project design, installation, construction and O&M support. It executes projects on a turnkey basis or an item rate basis; however its principal expertise is technology and it sub-contract the civil works. It is able to attract more clients because of its ability to provide services over the entire life cycle of a project. The company is in the process of making an application requesting for an extension of time for the completion of this project.
- **Lower capital expenditure due to its outsourcing model:** VTWL usually outsource the civil works, construction and erection works for its projects to third party contractors. This benefits its returns on investments in each project, as its fixed assets costs are low. This model allows it to expand in different cities and countries at a fast pace and without excessive capital expenditure. This also enables its management to focus on technology development and undertake large developments efficiently.
- **Strong execution track record and Order Book:** VTWL has a demonstrated track record to execute large and complex projects that take several years to complete. It has proven its execution capabilities in large EPC contracts such as Panjrapur water treatment at Mumbai and demineralization plant in Panipat refinery. The average period for execution varies between one year and 10 years for O&M projects.

Groups consolidated order book as on June 30, 2010 was Rs. 2780 crores and for VTWL was Rs. 1861 crores of which 88% was attributable to municipal clients and 12% to industrial clients.

- **Rich Domestic and International Experience:** Its presence in various countries allows identifying and evaluating projects in new jurisdictions effectively, establishing client relations, understanding local markets, culture and requirements, procuring raw materials locally, reducing currency risks and meeting client expectations efficiently. Its experience in diverse jurisdictions helps it to assess risks and the potential returns of a new project helps it to pre-qualify for large projects globally.

- **Low Debt Company:** VA Tech works on Asset light business model wherein Lower investments and capital expenditure is required due to its outsourcing model. This percolates to higher return on investments. VA Tech's latest Debt Equity Ratio of the company is 0.10%. It is cash rich Company with cash balance of Rs 220 Cr in Balance Sheet.
- **Strong Management Team and Experienced Staff:** VA Tech has highly qualified, experienced and dedicated management team and a skilled work force. Each member of top Management team has average 20 years industry experience. As at July 31, 2010, it had a workforce of approximately 1,469 including 757 qualified engineers while it had a workforce of 754 including 588 qualified engineers. This large pool of engineering and technical workers is essential for the efficient and effective execution of complex projects.

Concerns

- **Order book lopsided towards government entities:** Wabag's large portion ~88% of order book is from government entities. Many of the government projects are often subject to delay on account of insufficient funds, changes in policies, budgetary allocation. Delay in the projects affects business operations and financial condition of the company.
- **Retrospective change in 80IA could affect bottom line adversely:** Section 80IA of the Income Tax Act, 1961 has been amended with retrospective effect by the Finance Act, 2009, disallowing tax benefits to persons who are having mere work contracts with the government or statutory bodies. The tax benefit disallowed amounts to Rs24.20 crore and the interest thereon amounts to Rs10.81 crore. The company has filed a writ petition in the High Court of Madras challenging the constitutional validity of the retrospective amendment. However, if the order goes against the company, it would dent its bottom line. From FY 10 the company has started providing full tax.
- **Fluctuation in foreign currencies may have an adverse effect on the results:** VTWL's business operations are spread across globe. Though a substantial portion of its revenues is denominated in Indian Rupees, it incurs significant payment obligations denominated in foreign currencies in relation to various equipments for its projects under various verticals. Accordingly, any depreciation of the Rupee against these currencies could increase the Rupee cost to it for servicing its payment obligations to international suppliers. This could adversely affect its results of operations and financial condition. Its future capital expenditure on imported equipment and machinery could also increase.
- **Changes in technology could impact VTWL's business:** In addition to non-proprietary technology used by VTWL, it relies on proprietary technology of its subsidiary, Wabag Austria. Its future success could depend in part on its ability to respond to technological advances and emerging industry standards and practices on a cost-effective and timely basis. Changes in technology could make newer products and services more competitive or may require it to incur additional capital expenditures to upgrade to provide newer products or services. If it is unable to adapt in a timely manner the results of operations could be affected.

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- **Valuation** - At upper price band of Rs 1310, the stock is valued at a PE of 27.5 times on FY10 EPS of Rs 52.3. Taking into consideration the growth potential in water treatment segment, strong execution capability, established brand, Low capex requirement, strong team, thrust on quality, strong execution and healthy order book; the Co holds promising future. As majority of the issue is towards offer for sale there is minimum dilution. We recommend a Subscribe.

Consolidated Profit & Loss Account (Rs. in crs))

Particulars	FY 2008	FY 2009	FY 2010
Net Sales	610.89	1133.28	1223.74
Other Income	12.31	21.67	10.02
Total Income	623.2	1154.95	1233.76
Total Expenditure	593.28	1073.25	1115.57
EBITDA	29.92	81.7	118.19
EBIDTA (%)	4.9	7.21	9.66
Depreciation	5.28	8.44	13.89
Interest	14.4	35.37	29.9
Profit Before Tax	10.24	37.89	74.4
Provision for Tax	1.03	4.01	30.35
Profit after Tax	9.21	33.88	44.05
PATM (%)	1.47	2.93	3.57
Face Value	10	10	5
EPS (Pre Issue)	5.9	44.41	52.34
EPS (Post Issue)			47.58

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