SKP Securities Ltd

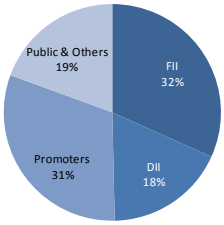
VA Tech Wabag Ltd.

...bringing water back to life

CMP ₹ 556 | **Target ₹ 710** | **Initiating Coverage - Buy**

Key Share Data	
Face Value (₹)	2.0
Equity Capital (₹ mn)	53.0
M.Cap (₹ mn)	14732.1
52-wk High/Low (₹)	578/270
Avg. Daily Vol	7966
BSE Code	533269
NSE Code	WABAG
Reuters Code	VATE.BO
Bloomberg Code	VATW IN

Shareholding Pattern (as on Sept 30, 2012)

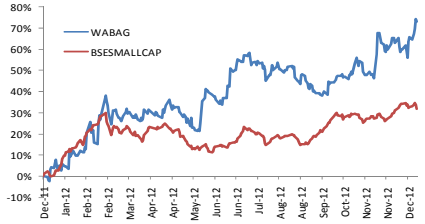


Source: BSE

Financials (₹ mn)				
Particulars	FY11	FY12	FY13E	FY14E
Net Sales	12418.2	14435.2	16307.7	19243.1
Sales Gr.	1.5%	16.2%	13.0%	18.0%
EBIDTA	1210.3	1300.3	1565.5	1847.3
Adj. PAT	525.7	737.5	818.5	977.3
PAT Gr.	9.8%	41.2%	10.4%	19.4%
EPS (₹)	49.8	27.8	30.9	36.9
CEPS (₹)	59.2	31.1	34.8	40.8

Key Ratios				
Particulars	FY11	FY12	FY13E	FY14E
Int Cover (x)	7.5	11.7	11.6	11.7
P/E (x)	11.2	20.0	18.0	15.1
P/BV (x)	1.0	2.3	2.1	1.9
P/Cash EPS (x)	9.4	17.9	16.0	13.6
M.Cap/Sales (x)	0.5	1.0	0.9	0.8
EV/EBIDTA (x)	2.5	9.7	7.3	7.1
ROCE (%)	18.1%	15.8%	17.3%	18.4%
ROE (%)	9.2%	11.5%	11.6%	12.5%
EBIDTM (%)	9.7%	9.0%	9.6%	9.6%
NPM (%)	4.2%	5.1%	4.9%	5.0%
Debt-Equity (x)	0.1	0.2	0.2	0.2

Price Performance WABAG vs BSESMALLCAP



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Company Profile

VA Tech Wabag Ltd (WABAG) is an established EPC player in water management space. It offers complete water life cycle solutions from project design to installation to operation & maintenance. WABAG is multinational player with presence in India, MENA region, Central & Eastern Europe, China and South East Asia. Majority of its revenues comes from various municipalities.

Investment Rationale

Desalination is the key - Big opportunity for WABAG:

- Out of the total water reserves only 0.76% water is most easily accessible. Further, the water resources are unequally distributed. *To make it worse, it is expected that number of people living in water scarce conditions would double in 20 years.*
- Thus, Water desalination, can provide the cure to our water woes. Desalination, which was very expensive few years back, has now become viable because of continued falling cost with the development of technology.
- The market for seawater desalination can be divided between the mature markets of the Middle East and the Mediterranean, for whom desalination is well established as a important source of water, and the new markets opening up around the world in the US, Mexico, Chile, Australia, China and India.
- Keeping this in view WABAG is betting big on desalination water projects across globe and hence formed a separate vertical focusing on this line. ***WABAG is expected to bid for desalination projects, globally, considering it major opportunity segment in water industry.***

Strong and diversified order backlog of ₹ 40.3 bn:

- WABAG has a strong order backlog of ₹ 40.3 bn (as on Nov, 2012) from its various business segment.
- Order book of the company is growing at the CAGR of 19.5% for past three years. Further, WABAG has received about ₹ 8.6 bn worth order during H1FY13 from its various clients.
- With the strong order backlog, focus on desalination and healthy reputation with its clients in place, WABAG is well positioned to cater the burgeoning demand of the industry – domestic as well as international.

Unique outsourcing business model – results in low D/E:

- WABAG outsources the civil works, construction and erection works for the projects in hand to the third party contractors. This allows WABAG to expand in different geographies at a fast pace without expressive capital expenditure.
- Low investments in fixed assets brings down the D/E ratio of the company as the company do not have raise much longterm debt.

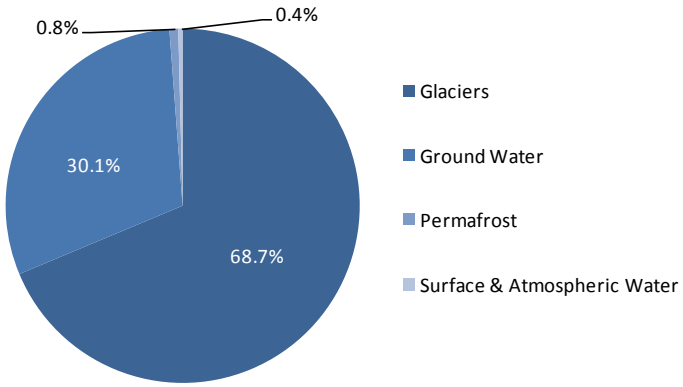
Outlook & Recommendation

- At CMP of ₹ 556 the stock is trading at a P/E of 18.0x, and 15.1x for FY13E and FY14E respectively. We have valued WABAG using DCF model of valuation.
- ***We recommend BUY rating on the stock with a target price of ₹ 710/- (28% upside) in 15 months.***

Industry Overview

Global:

- The global supply of freshwater is relatively fixed and unevenly distributed. Total global water reserves are estimated to be 1.4 bn km³ of which 97.5% is ocean. The balance 2.5% is available as fresh water. The pie below shows concentration of fresh water resources:



Source: Company

- Out of the above fresh water resources only ground water and surface & atmospheric water is most easily accessible which together constitute 0.76% of the total water on Earth. Rest of the fresh water is locked up in glaciers and permanent snow covers.

Global Growth Drivers:

- **Uneven Distribution:** Furthermore, the accessible fresh water resources are distributed unequally around the world, as shown in the chart below:

Geogrophies	% of Global Population	% of global available fresh water resources
North And Central America	8%	15%
South America	6%	26%
Europe	13%	8%
Africa	13%	11%
Asia	60%	36%
Australia & Oceania	1%	5%

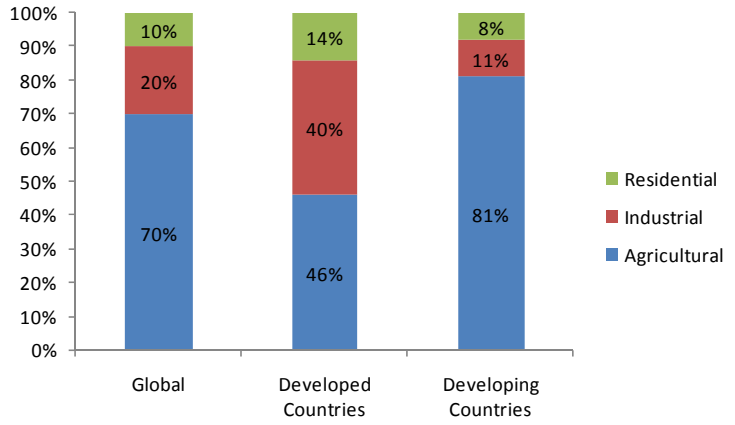
Source: Company & SKP Research Desk

- North America enjoys 15% of the global water supply for only 8% of global population whereas Asia is strained with only 36% of water supply against 60% of the global population. ***To make it worse, it is expected that number of people living in water scarce conditions would double in 20 years.***

- **Increasing fresh water demand:** The total global fresh water use is estimated at nearly 4,000 km³/day.

- The global agricultural sector represents 70% of global water usage. Industrial and domestic demand represents 20% and 10% respectively.

- Global profile for water usage is as follows:



Source: Company & SKP Research Desk

- As it is clear from the above graph that developed countries requires more industrial water *vis-à-vis* developing countries. ***Considering the pace at which developing countries such as India and China are moving towards industrialization and urbanization, the domestic and industrial water demand is likely to increase.***

- **Climatic changes due to greenhouse gasses:** Green house gasses allow solar radiation to enter the earth's atmosphere but prevent the reflected heat back into space. This causes earth's temperature to rise.

- Rising global temperatures are likely to lead to an intensification of the hydrological cycle, resulting in to dry regions getting drier and wetter rainy seasons. ***This subsequently will heighten risk of frequent floods and drought, which will ultimately impact on the availability of fresh water.***

- **Large Investments are required across the globe to deal with water scarcity:** All the above factors are leading to large investments and efforts for fresh water recycling which includes supply augmentation, conservation and reallocation of water resources.

Country	Potential Market Size (USD bn)	Country	Potential Market Size (USD bn)
China	47.0	Iran	3.8
Saudi Arabia	8.5	Egypt	3.5
India	5.9	Indonesia	2.5
Turkey	4.6	Czech Republic	2.2
Russia	4.6	Malaysia	1.7
Switzerland	4.4	Morocco	1.6
Algeria	4.0	Romania	0.9

Source: Company and SKP Research Desk; 2010 data

- The most conventional response is to develop new resources through development of new reservoirs or desalination plants or ***inter-basin transfer***. It involves putting in huge infrastructure to transport water from one basin to another, which requires large investments. The process is uneconomical in terms of return on investment.

- **Desalination**, which was very expensive till few years back, is increasingly becoming cheaper with the evolvement of technologies. This process is mostly used for the supply of drinking water.

- **Conservation** on other hand, involves increasing the efficiency of water usage by reducing losses.

India:

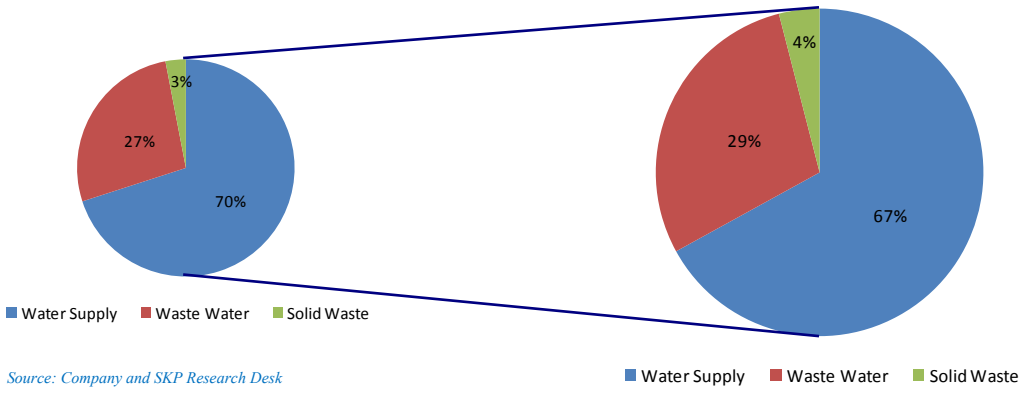
- India's annual surface water availability is estimated at 1,869 bcm (billion cubic meter), of which total utilizable water is 1,122 bcm, which is just sufficient to address existing demand. The Water Resource Group estimates that if the existing pattern sustains, about half the country's demand will be unmet by 2030.

- Nearly three fourth of the India's population lives in water stressed region where per capita availability is less than 2,000 m³/year. Out of India's 20 river basins, 14 are water stressed.

- The Government of India focuses on water management infrastructure through landmark initiatives like Jawaharlal Nehru National Urban Renewal Mission (JNNURM), Urban Infrastructure Development for Small Scale and Medium Towns (UIDSSMT) and public private partnership (PPP) projects.

- It is estimated, under JNNURM, that around 20% of the total envisaged investment of ₹ 3.92 tn (2009-10) for Indian Urban Infrastructure Development, across next 20 years, is expected to be accounted for water, sewerage, solid waste management and storm water drains.

Investment in water supply in last 5 years: ₹ 548 bn **Investment in water supply in next 5 years: ₹ 1,122 bn**



Source: Company and SKP Research Desk

Outlook:

- India is home for about 17.3% of world's population. It is undergoing fast urbanization which demands for more safe drinking water and sanitization. It is expected that Indian urban population will increase from 377 mn today to 600 mn by 2031.

- With the population growth we feel that more opportunities for water treatment plants, industrial water recycling, sea water desalination, municipal waste water treatment plants and private sector participation in public utilities will open up.

The Company: A Snap Shot

- The Company was incorporated in 1995 as "Balcke Durr Cooling Towers Ltd." (BDCTL). It was involved in the business of design and construction of cooling towers and was the subsidiary of "Balcke-Durr Aktiengesellschaft", a German company.

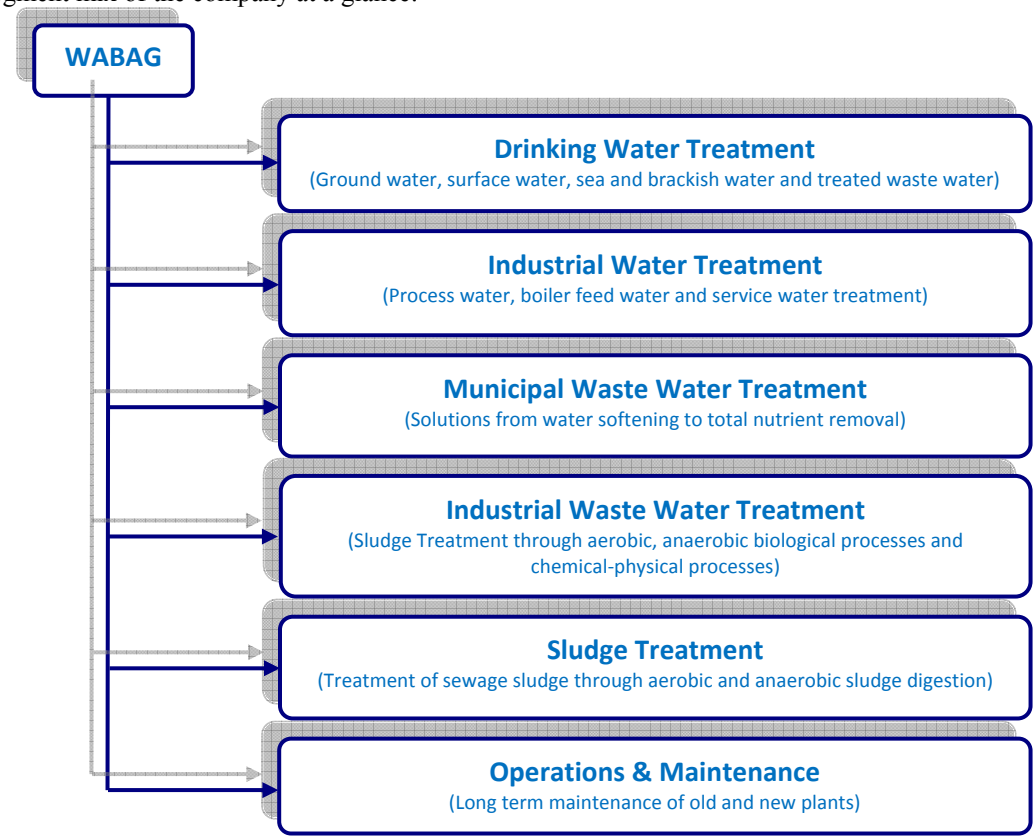
- BDCTL started a water treatment division in 1996 and its name was changed to "Balcke Durr and Wabag Technologies Ltd" (BDWTL). The water division of BDWTL was later (in 1999) acquired by VA Tech, Austria. Consequently, the name of the company was changed to "VA Tech Wabag Ltd." (WABAG). Now, it became the subsidiary of VA Tech, Austria.

- The company was now involved primarily in design, supply, construction and erection of water, waste water treatment plants and operation and maintenance (O&M) of the same.

- In 2006, majority shareholdings were acquired by Indian promoters through India Advantage Fund I, represented by ICICI Venture Funds Management Company Ltd. With this acquisition VA Tech, Austria now became subsidiary of WABAG.

- Today, WABAG provide engineering solutions in the water industry for sewage treatment, processed and drinking water treatment, effluent treatment, sludge treatment, desalination and re-use of water. It provides comprehensive services throughout the entire life cycle of water which includes conceptualization, project design, installation, construction and O&M support.

- Segment mix of the company at a glance:



Source: Company and SKP Research Desk

Operations:

- Businesses of WABAG are taken care by five strategic business units (SBUs) *viz* Municipal Business group (MBG), Industrial Water Business Group (IWG), Operations Business Group (OBG), Desalination Business Group and International Business Group (IBG).

- **MBG SBU** focuses on water and waste water treatment for municipal and industrial clients. This SBU provides EPC services only.

- **IWG SBU** focuses on execution of projects for large industrial clients such as oil refineries, steel plants and power plants. It provides solutions such as de-mineralization plants, reverse osmosis (RO) plants, thermal desalination plants, waste water recycle units etc.

- **OBG SBU** is involved solely in providing O&M services including staffing, supply of chemicals and consumables, supply of spares, major and minor repairs, replacement and refurbishment of plant. These services are provided to both domestic and international clients who are generally municipal and industrial clients.

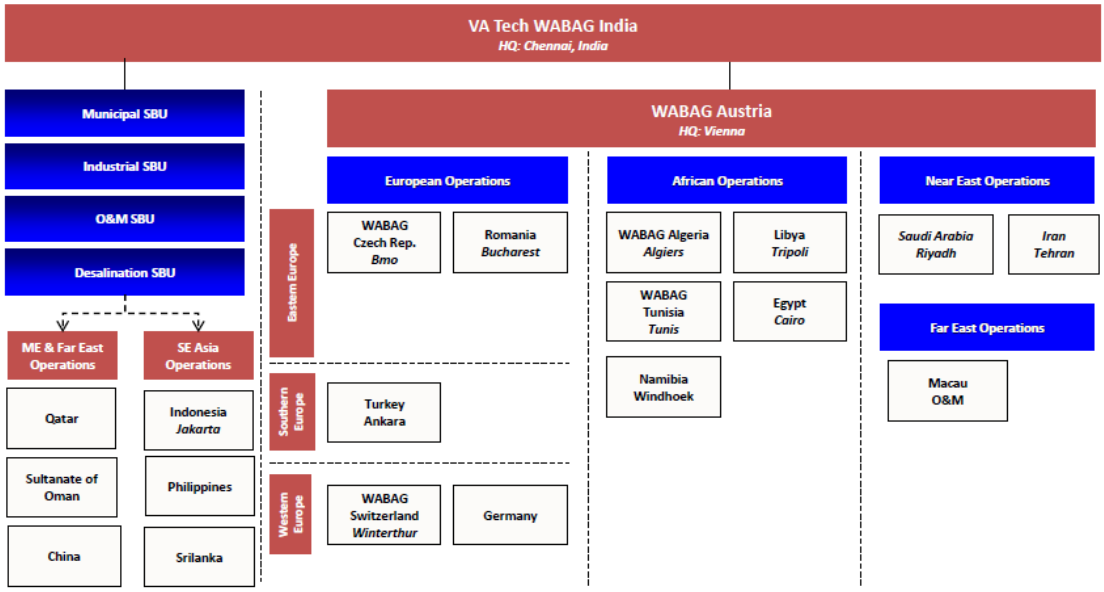
- This SBU not only operates plants constructed by OBG and IWG SBUs but also the plants constructed by other contractors.

- **IBG** caters to both municipal and industrial water and waste water treatment needs of the client outside India such as The Middle East, North Africa, Central and Eastern Europe, China and South East Asia. This SBU deals with only EPC part of the contract.

- WABAG's international operations are conducted through its subsidiaries. Wabag Austria is the holding company for most of the subsidiaries overseas. The key subsidiaries for Wabag Austria include Wabag Wassertechnik and Wabag Brno. Wabag Austria provides both technical and financial support to its subsidiaries.

- Wabag Austria's business categorizes in five main heads viz drinking water treatment, industrial water treatment, municipal water treatment, desalination and O&M.

- WABAG's operations at a glance:



Source: Company

Business Model of WABAG:

- WABAG is an EPC contractor in water management space. Its EPC contracts falls in the following categories:
  - ✓ **Standalone EPC Contracts:** WABAG is responsible for design, engineering, procurement and construction of the plant.
  - ✓ **Design, Build and Operate (DBO):** WABAG is responsible for design and construction of the plant as well as O&M activities.
  - ✓ **Build, Own Operate and Transfer (BOOT):** The Company is responsible for design and construction of the plant. The company operates the plant after construction for the stipulated period in the contract and then transfers it back to the client.

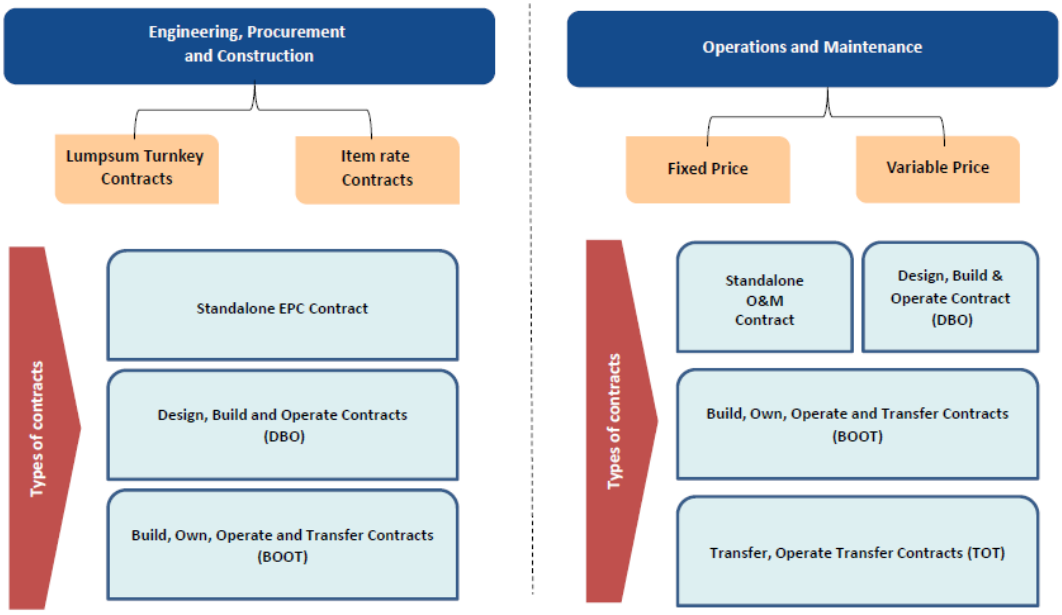
- The **O&M contracts** of the company falls in categories like DBO, BOOT and TOT. WABAG refurbishes the already operational plant and undertakes it O&M activities, under TOT contracts.

- WABAG also undertakes standalone O&M contracts where it does not provide any EPC work. ***O&M contracts contributes one-third to current order book of Rs 40 bn.***

- Most of the municipal contracts contain price escalation clauses which are generally absent in industrial clients. Only a few industrial contracts includes escalation clause.

- The company predominantly participates in published tenders in India and Overseas. A client may approach WABAG to enquire about designs and solutions where there is a good relationship with the client. ***This often functions as an entry barrier for other companies who participate in the tender.***

- Business model of the company at a glance:



Source: Company

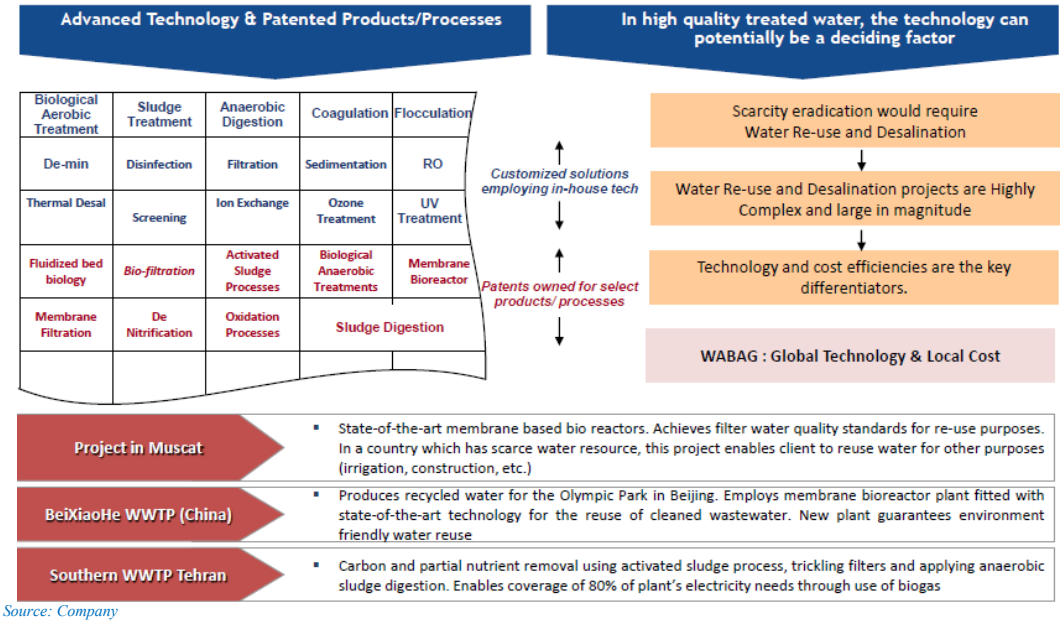
A Technology based Company – 99 patents held by the Company:

- Designing and engineering of projects in the water and wastewater treatment is technically complex, time consuming and resource intensive because of unique client requirements. For instance WABAG has used the Bio-Active Fixed Film (BAFF) Technology at the Sierre Plant in Switzerland.

- WABAG has developed the Hybrid process which is the two stage activates sludge process for nitrogen removal jointly with Vienna University and Technology. WABAG's subsidiary has also developed BIODEN which is a biological process for ground water denitrification. The Company has used several technologies in India, such as dual media filter, ultra filtration and RO.

- WABAG owns about 99 patents which include both process and product patents. It has also applied for 24 mew patents that are pending.

- WABAG constantly upgrade its technical abilities to offer its clients the full range of services at lower cost and without compromising quality.



Source: Company

- ***Technical expertise is the prerequisite for segments like desalination, ultra-filtration, water recycling and reuse and thus forms the effective entry barrier for the new entrants.***

Procurement of Raw Materials:

- WABAG have vendors on its panel. It floats the tenders with the vendors who meet the requirement of the client. WABAG do not publish tenders but send written enquires in detail only to empanelled vendors or the ones approved by the client.

- The company also enters in to rate contracts with the vendors who do not negotiate.

- The Company procures material from India and overseas, predominantly from Europe and selectively from USA. Procurement again depends upon clients' requirements and acceptance.

- WABAG have a central procurement department in India which handles common raw materials such as steel, cement, cables and pipes while rest of the procurement process is handled by each strategic unit.

Joint Venture with Sumitomo Corporation, Japan:

- WABAG has signed an alliance agreement with Sumitomo Corporation, Japan, in 2010, wherein the two companies will strategically co-operate in multiple areas within the water infrastructure industry.

- Under the agreement Sumitomo intends to expand its global water infrastructure assets, increase its operational capabilities and make a step into the Indian water sector. Indian water sector is expected to grow significantly in the coming years.

- WABAG intends to expand more into capital intensive concession type business through this JV. WABAG will be utilizing Sumitomo's fund raising capabilities, specifically, its expertise regarding project investments and large scale project finance structuring as well as its global network.

- Sumitomo operates water infrastructure businesses in different parts of the world under the principle of developing optimal schemes for each project in consideration of local regional characteristics. The Company has invested in projects for water supply and sewage systems as well as desalination in Mexico, Turkey, Bahrain and the U.A.E.

- ***The JV has recently bagged its first order worth USD 350 mn in Al Gubrah, Muscat, Oman. It's a BOO contract owned by Sumitomo Corporation. It's a 192 MLD SWRO desalination project. Oman based Galfar Engineering & Construction and Cadagua, Spain are other two consortium partners.***

Peers

- WABAG competes with companies like Thermax, Ion exchange, Hindustan Dorr Oliver etc. in water management space, but it is the only Indian company who is present in all the segments of water sector *viz* drinking water treatment, municipal water treatment, industrial waste water treatment, sewage treatment etc.

- Thermax, Hindustan Dorr Oliver and Ion exchange are present in Industrial water treatment. Ion exchange also offers total water care for homes under the brand Zero B.

Player	EBIDTM (%)	D/E (x)	EV/EBIDTA (x)	P/E (x)
Ion Exchange	3.9%	0.3	6.5	14.8
Hindustan Dorr Oliver*	8.1%	0.6	9.1	14.4
WABAG	9.0%	0.2	9.7	20.0

*Source: SKP Research Desk; Bloomberg; *FY11 Figures (June Ending)*

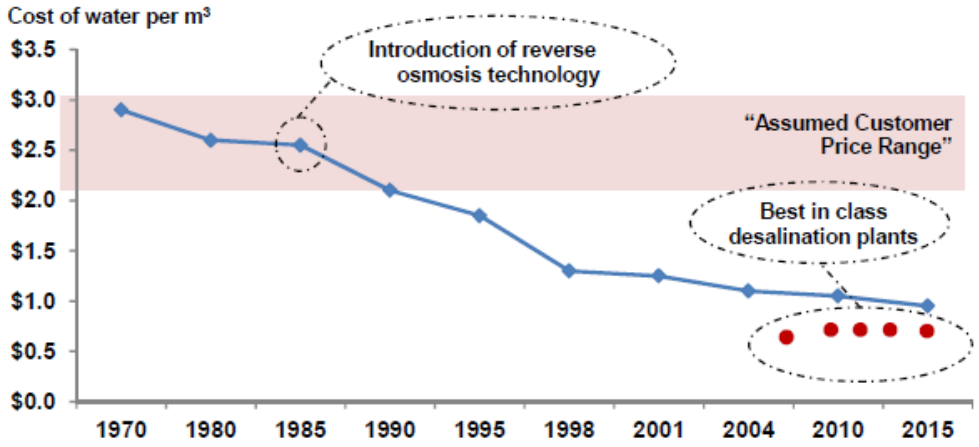
Investment Arguments

Desalination is the key - Big opportunity for WABAG:

- As mentioned earlier that out of the total water reserves on earth only 2.5% is fresh water, out of which only 0.76% of water is most easily accessible. Further, the water resources are unequally distributed. For instance, North America enjoys 15% of the global water supply for only 8% of global population whereas Asia is strained with only 36% of water supply against 60% of the global population. ***To make it worse, it is expected that number of people living in water scarce conditions would double in 20 years.***

- Thus, Water desalination, is often seen as the cure for all water woes. Desalination refers to any of the several processes that remove salt and other minerals from saline water. It is primarily used to make seawater potable, but it is also used to reduce the salinity of brackish water, and to create high-grade process water from potable water. There are two main categories of desalination: thermal and membrane.

- High cost has prevented its widespread adoption thus far. But with the evolution of technology, especially RO, the cost has eventually come down. About 60% (40 mn m^3/day) of installed capacity for desalination is dominated by RO followed by thermal desalination at 34% (23 mn m^3/day).



Source: Report of Independent Technology research on Water Desalination – Deep enough to Dive in?

- Most of the cost reduction so far has been in improvements in membrane technology and in energy recovery devices. Still, there is potential for further cost reduction due to improvement in membrane productivity, membrane useful life, reduction in power consumption and construction cost.

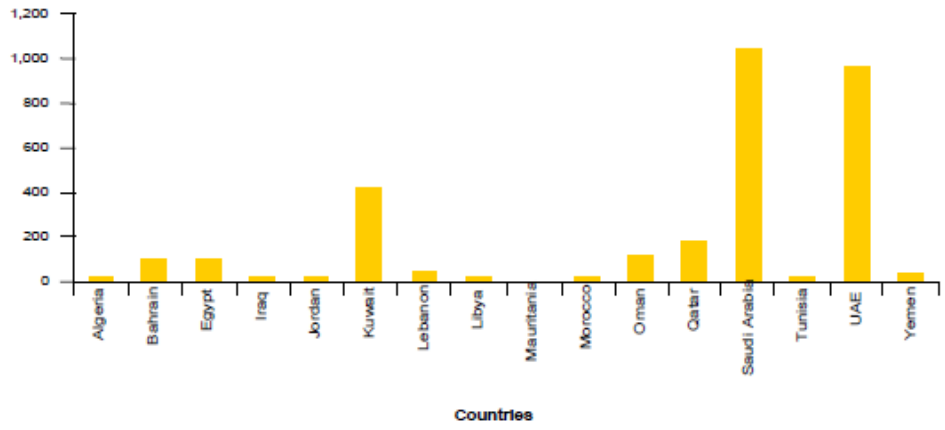
Parameter	2010	2015	2030
Cost of Water ($/m³)	0.5-0.8	0.4-0.7	0.3-0.4
Construction Cost ($/m³)	1200-2100	1000-1100	500-1000
Power use in SWRO System (kWh/ m³)	2.5-2.8	2.1-2.6	1.3-1.7
Membrane Productivity (m³/day/membrane)	1.7-3.3	2.4-4.0	6.6-10.6
Plant Recovery Ratio (%)	45-50	50-55	55-65

Source: Overview of Desalination Status and Future Trends by Nikolay Voutchkov

- Desalination accounted for only 0.4% of water use in 2004 (nearly 14 km^3 pa). Production is expected to double by 2025 with the above decreasing cost and increasing urban population.

- The market for seawater desalination divides in two, between the mature markets of the Middle East and the Mediterranean, for whom desalination is well established as a important source of water, and the new markets opening up around the world in the US, Mexico, Chile, Australia, China and India.

- **The Middle East** accounts for about 75% of desalination capacity to date. Desalinated water production in MENA region at a glance:



Source: Company

- **Saudi Arabia** is one of the largest desalination markets and houses over a quarter of the global desalination capacity. As most of the existing plants are aging plants, it presents the region with the opportunity to upgrade and develop new desalination capacities with state of the art reverse osmosis technologies. Government investment in the sector is also likely to encourage several desalination projects. Desalinated water capacity addition is expected to be the highest in Saudi Arabia. Water Demand in KSA at a glance:

Water Demand in KSA	2010	2025
Population (mn)	27.2	34
Water Demand (mn m^3/day)	6.8	8.5
Desalination Share in Water	53% (3.3 mn m^3/day)	63% (5.2 mn m^3/day)

Source: Industry Data

- Desalinated water accounts for a large proportion of total water produced in the **UAE** which outlines strong growth opportunities for the sector in the form of new projects and foreign investments.

- **Kuwait and Qatar** have made significant progress in desalination and are expected to house the maximum number of projects. The largest desalination project, Ras Girtas in the world is expected to be underway in Qatar.

- **Oman**'s desalination market is expected to touch USD 542.4 mn by 2016. Largest project in Oman is Al Gubrah IWP worth USD 350 mn. Other projects in Oman are Salalah IWPP, Nimr Water treatment plant, Duqm Power and desal plant etc.

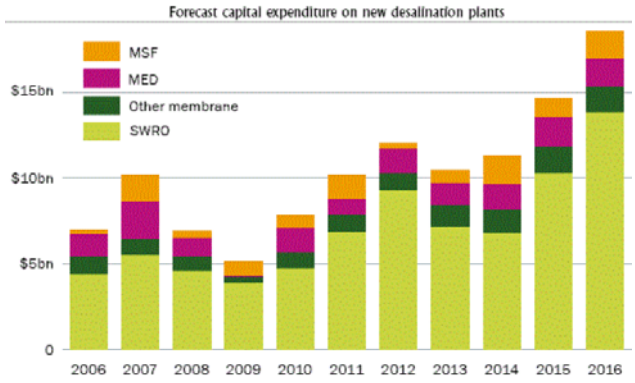
- It is likely that the Middle East will add capacity of over 100,000 m^3/day on annual basis until 2015 with such commendable initiatives.

- **China** had built 65 seawater desalination units, in 2010, with a combined desalination capacity of more than 600,000 m^3/day. A national plan calls for a 2 mn m^3/day capacity by 2015, so there is going to be heavy demand for seawater desalination plants.

- **India's** water desalination business is set to triple to USD 1.2 bn by 2017 as rising demand from industry spurs. The number of units that process sea water in India will reach 500 in five years from 180 now, with more than 300 plants being built in the states of Tamil Nadu, Gujarat and Maharashtra.

- As per TechSci Research, the market for desalination in India, which has a coastline of 7,517 kilometers, may be worth USD 630 mn by 2014.

- Global capital expenditure on desalination at a glance:



Source: Overview of Desalination Status and Future Trends by Nikolay Voutchkov

WABAG considers desalination, a major opportunity

- Keeping this in view WABAG is betting big on desalination water projects across the globe and hence formed a separate vertical focusing on this line.

- Currently, the company has two desalination orders in its kitty *viz* Nemmeli desalination project in Chennai and 192 MLD SWRO desalination project, Al Gubrah, Oman.

- Nemmeli Desalination plant is worth ₹ 5.3 bn with the capacity of 100 MLD of water. Trial run of the plant has already started and is expected to go on stream by December 2012.

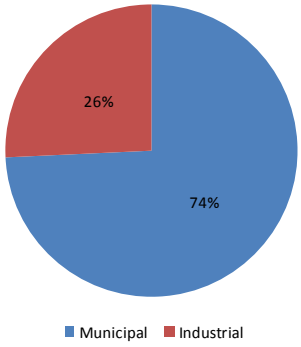
- Al Gubrah order is one of the biggest desalination projects which WABAG has bagged under the JV with Sumitomo Corporation, Japan. The project is DBO contract worth USD 350 mn, owned by Sumitomo Corporation. Gulfar, Oman and Cadagua, Spain are other two consortium partners.

- ***WABAG is expected to bid for further desalination projects, globally, considering it major opportunity segment in water industry.***

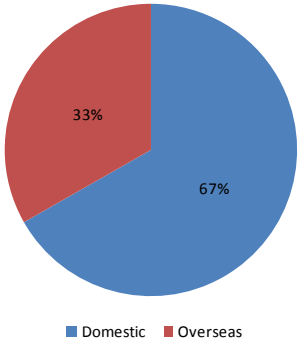
Strong and diversified order backlog of ₹ 40.3 bn – revenues expected to grow with the CAGR of 16% in next couple of years:

- WABAG has a strong order backlog of ₹ 40.3 bn (as on Nov, 2012) from its various business segment. Breakup of the order book is as follows:

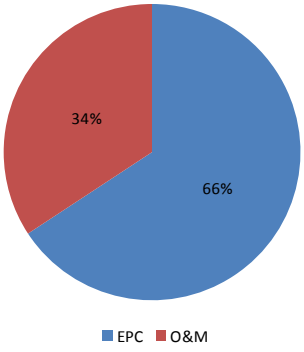
Segment Wise Breakup



Geography Wise Breakup



Contract Wise Breakup



Source: Company & SKP Research Desk

- **Impressive Growth in order book y-o-y:** Order book of the company is growing at the CAGR of 19.5% for past three years. The following table indicates the order backlog by WABAG, in past five years:

Segment Wise Breakup	FY09	FY10	FY11	FY12	CAGR (%)
Municipal (₹ bn)	19.0	24.9	25.9	30.4	*16.9%*
% to total Order Book	*87%*	*87%*	*75%*	*81%*	*--*
Industrial (₹ bn)	2.9	3.7	8.4	6.9	*34.4%*
% to total Order Book	*13%*	*13%*	*25%*	*19%*	*--*
Total (₹ bn)	**21.9**	**28.6**	**34.3**	**37.3**	*19.5%*
Contract Wise Breakup	**FY09**	**FY10**	**FY11**	**FY12**	**CAGR (%)**
EPC (₹ bn)	16.3	18.4	24.5	23.7	*13.3%*
% to total Order Book	*74%*	*64%*	*71%*	*64%*	*--*
O&M (₹ bn)	5.6	10.2	9.9	13.6	*34.5%*
% to total Order Book	*26%*	*36%*	*29%*	*36%*	*--*
Total (₹ bn)	**21.9**	**28.6**	**34.4**	**37.3**	*19.5%*
Region Wise Breakup	**FY09**	**FY10**	**FY11**	**FY12**	**CAGR (%)**
Domestic (₹ bn)	12.7	19.3	25.2	24.5	*24.5%*
% to total Order Book	*58%*	*68%*	*73%*	*66%*	*--*
Overseas (₹ bn)	9.2	9.3	9.1	12.8	*11.8%*
% to total Order Book	*42%*	*32%*	*27%*	*34%*	*--*
Total (₹ bn)	**21.9**	**28.6**	**34.3**	**37.3**	*19.5%*

Source: Company & SKP Research Desk

- Further, WABAG has received about ₹ 8.6 bn worth order during H1FY13 from its various clients.
- WABAG maintains cordial relationship with its clients by providing in time quality construction which helps them to garner repeat orders.
- **The Company is enjoying strong growth in its top line continuously. The revenues of the company have grown with the CAGR of 18.8% during last five years.** ***With the strong order backlog, focus on desalination and healthy reputation with its clients in place, WABAG is well positioned to cater the burgeoning demand of the industry – domestic as well as international. We expect the revenues of the company to grow at a CAGR of around 16% between FY12 – FY14.***

Unique outsourcing business model – results in low D/E:

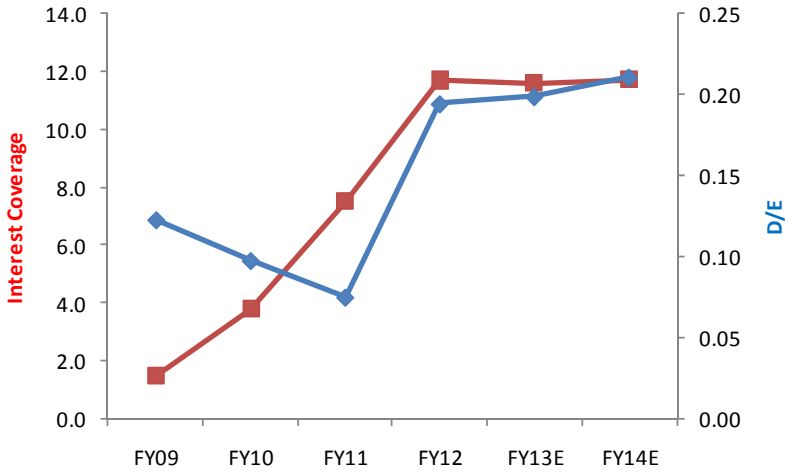
- WABAG outsources the civil works, construction and erection works for the projects in hand to the third party contractors. This model allows WABAG to expand in different cities and countries at a fast pace without expressive capital expenditure.

- WABAG's gross block to total asset ratio at a glance:

	FY09	FY10	FY11	FY12	FY13E	FY14E
Gross FA (₹ mn)	502.8	806.8	994.0	1,068.3	1,248.6	1,348.6
Total Assets (₹ mn)	4,217.7	4,407.4	6,429.1	8,157.0	8,797.9	9,907.8
Gross FA to TA	**11.9%**	**18.3%**	**15.5%**	**13.1%**	**14.2%**	**13.6%**

Source: Company and SKP Research Desk

- Low investments in fixed assets also brings down the D/E ratio of the company as the company do not have to raise much longterm debt. The company had longterm debt of ₹ 2.7 mn which has become zero during H1FY13. The D/E and interest coverage ratio of the company at a glance:



Source: SKP Research Desk

- Further, this model also allows WABAG to focus on engineering, design and technology to provide water engineering solution to its clients. It also allows the management to focus on technology development.

- The Company is using this model since 1996 and we believe that this has been a key factor in efficient execution of the projects. The experienced project management team of WABAG oversees the civil and construction works undertaken by the third party contractor.

- WABAG leverage the expertise of service providers in the jurisdiction where the project is located, thus, increasing the efficiency and reducing the cost of the project.

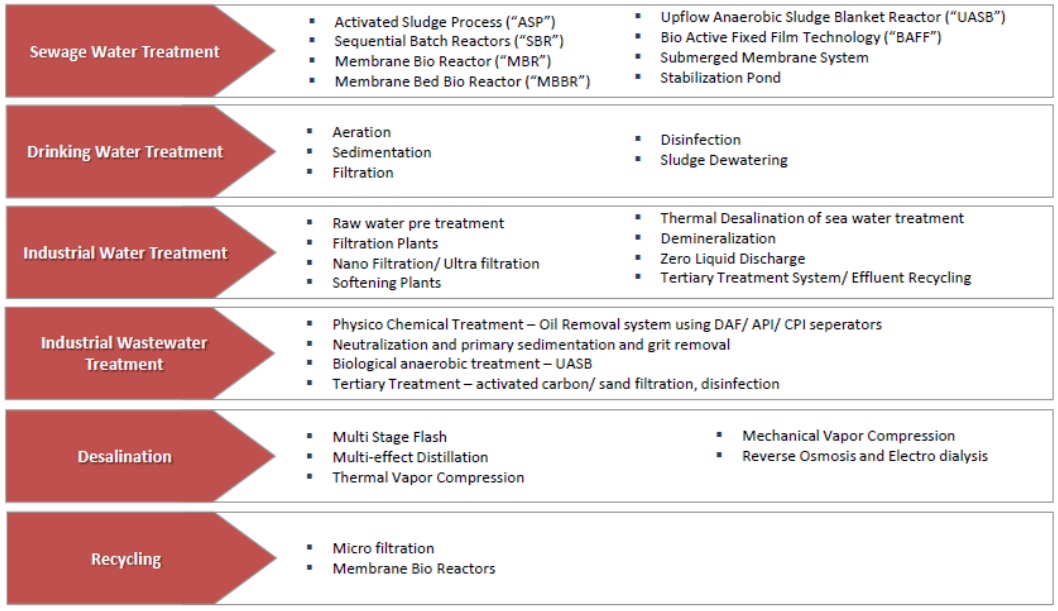
Technology - the biggest entry barrier - prevents the new players to enter the industry:

- The contracts in the water management sector is not about the lowest bidder, but the most competent bidder, the one who can understand the clients' needs and arrive at cost efficient water solutions.

- Technological expertise and experience is one of the pre-requisites for a successful market penetration. In many countries water supplies are being augmented through innovative wastewater treatment technologies and reuse techniques like desalination.

- The technological expertise is pre-requisite for segments like desalination, ultra-filtration, water recycling and reuse.

- Technologies used by WABAG at a glance:



Source: Company

- ***WABAG constantly upgrade its technical abilities either by in-house R&D or by acquiring technologically advanced water management companies which helps it to gain new businesses from old and new clients.***

Key Concerns

1. **Delay in the projects may hamper the results of the company:** Many of the Company's projects are government sponsored and these are often subject to delay. Such delays could be on account of a change in the Central and/or State Government, changes in policies impacting the public at large, scaling back of Government policies or initiatives, changes in governmental or external budgetary allocation, or insufficiency of funds or the lackadaisical approach or reluctance of the government departments to make quick decisions etc.

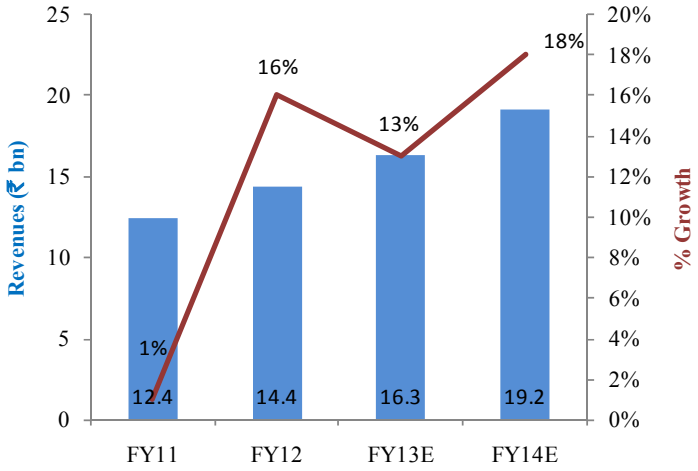
   Such delays can significantly and adversely affect the business, financial condition and operations of the Company.

2. **Increasing competition:** WABAG face intense competition in the bidding process from domestic as well as foreign companies. Several foreign companies bids with domestic companies to participate in water treatment projects in India. The Company faces similar competition in other jurisdictions where it operates.

   As a result of this competition, the Company faces substantial margin pressure, which could have a material adverse effect on its business, prospects, financial condition, and results of operations.

3. **Political Unrests:** WABAG businesses are spread across various countries and regions. Political unrests in the Company's existing markets can impact the progress of the company.

Financial Outlook (Consolidated)



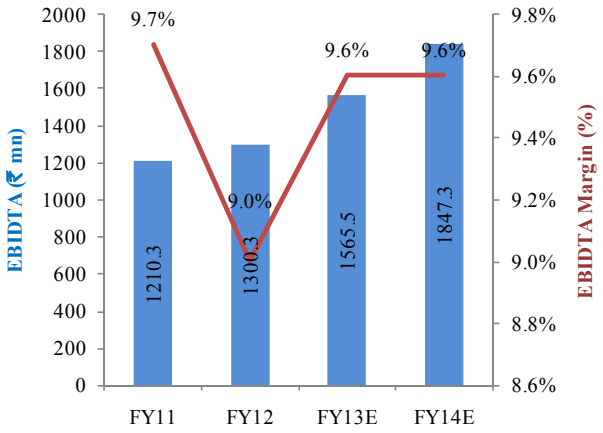
Top-line to grow at a CAGR of around 16%:

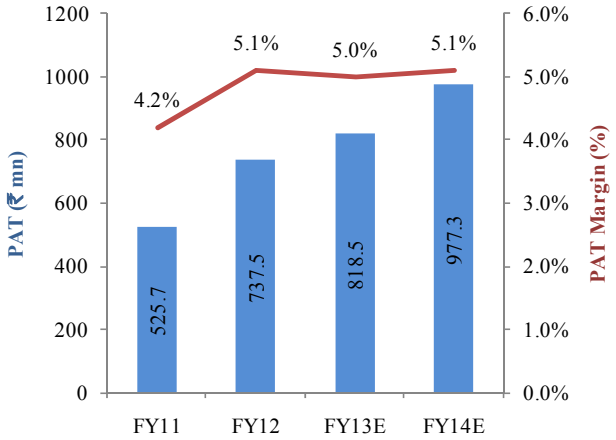
For FY12, net sales increased to ₹ 14.4 bn by registering growth of 16% y-o-y basis. The company has executed orders worth ₹ 5.4 bn during H1FY13 due to restructuring of some subsidiaries and strong execution of international orders.

We further expect the company to grow at a CAGR of about 16% between FY12-14 with the strong order book in hand.

WABAG to maintain EBITDA margin around 9.5%:

WABAG has witnessed an EBITDA margin of 9.0%, a fall by 70 bps, in FY12 due to high cost of sales and service. WABAG is in the process of right sizing the Company (by putting the people where they are required), results of which has been evident in improved EBIDTA margins of 9.2% during Q2FY13. We expect the company to maintain its margins around 9.5% going forward.





Source: Company & SKP Research

PAT margin to maintain around 5%:

PAT margin has increased by 90 bps to 5.1% in FY12. ***We expect PAT margin to be maintained around 5% by FY14E.*** EPS of the company is expected to grow from ₹ 27.8 in FY12 to ₹ 36.9 in FY14E.

Valuation

At CMP of ₹ 556 the stock is trading at a P/E of 18.0x, and 15.1x for FY13E and FY14E respectively. We have valued WABAG using DCF model of valuation. ***We recommend BUY rating on the stock with a target price of ₹710/- (28% upside) in 15 months.***

Particulars	
Terminal Growth Rate	3.0%
Beta	0.7
Cost of Equity	17%
WACC	15.3%
Terminal Value (₹ mn)	5,370.5
PV of FCFF – 10 Years (₹ mn)	11,250.9
EV (₹ mn)	16,621.4
Debt (₹ mn)	1,247.9
Cash (₹ mn)	3,382.6
Value for Equity(₹ mn)	18,792.4
Fair Value (₹)	**710.0**

Source: SKP Research Desk

Consolidated Financials

(All data are in ₹ mn unless specified, Y/e March)

Income Statement	FY11	FY12	FY13E	FY14E
Net Operating Income	12418.2	14435.2	16307.7	19243.1
Operating Expenditure	11207.9	13134.9	14742.2	17395.8
EBIDTA	1210.3	1300.3	1565.5	1847.3
Depreciation	99.8	85.9	103.1	102.7
EBIT	1110.5	1214.4	1462.4	1744.7
Interest	147.8	103.9	126.2	148.9
EBT before Excep Item	962.7	1110.5	1336.2	1595.7
Exceptional Item	128.6	0.0	0.0	0.0
EBT after Excep Item	834.1	1110.5	1336.2	1595.7
Tax	316.1	379.2	529.1	631.9
PAT	518.0	731.3	807.1	963.8
Profit From Associates	7.7	9.3	16.3	19.2
Minority Interest	0.0	3.1	4.9	5.8
Adjusted PAT	525.7	737.5	818.5	977.3
EPS (₹)	49.8	27.8	30.9	36.9

Balance Sheet	FY11	FY12	FY13E	FY14E
Equity Capital	52.8	53.0	53.0	53.0
Reserves	5656.8	6367.1	7001.4	7794.4
Net Worth	5709.7	6420.1	7054.4	7847.4
Loan Funds	426.6	1247.9	1402.5	1654.9
Other LT Liablity	292.8	478.9	326.2	384.9
Deferred Tax Liab.	0.0	0.2	0.2	0.2
Minority Interest	0.00	9.80	14.69	20.47
Total Liabilities	**6429.1**	**8156.9**	**8797.9**	**9907.8**
Net Fixed Assets	484.0	507.2	584.4	581.7
Capital WIP	77.0	180.3	0.0	0.0
Investment	437.0	36.3	36.3	36.3
Other NCAssets	372.7	801.6	1076.3	1270.0
Net Current Assets	4822.3	6527.4	6996.8	7915.7
Deferred Tax Assets	236.1	104.1	104.1	104.1
Total Assets	**6429.1**	**8156.9**	**8797.9**	**9907.8**

Cash Flow Statement	FY11	FY12	FY13E	FY14E
PBT	834.1	1110.5	1336.2	1595.7
Add: Depreciation, Interest & Other Exppenditure	626.3	-40.7	229.3	251.6
Net change in WC, Tax, Int	-1189.5	-1995.8	-57.2	-3063.1
Cash Flow from Operating Activities	**270.9**	**-926.0**	**1508.3**	**-1215.7**
Capital Expenditure	-196.4	-225.9	0.0	-100.0
Investments, Sales of FA, Dividend received and others	-778.3	935.1	0.0	0.0
Cash flow investing Activities	**-974.7**	**709.2**	**0.0**	**-100.0**
Cash flow from Financing Activities	**-53.5**	**1217.9**	**722.8**	**-156.0**
Net Increase/Decrease in Cash & Cash equivalents	-261.5	514.1	506.0	1352.3
Opening Cash Balance	2023.0	1617.1	2129.9	3382.7
Cash balance of acquired subsidiaries	-1.3	746.8	0.0	0.0
Closing Cash Balance	**2129.9**	**3382.7**	**4735.0**	**3338.4**

Ratios	FY11	FY12	FY13E	FY14E
Valuation ratios (x)				
P/E	11.2	20.0	18.0	15.1
P/Cash EPS	9.4	17.9	16.0	13.6
P/BV	1.0	2.3	2.1	1.9
EV/EBIDTA	2.5	9.7	7.3	7.1
EV/Sales	0.2	0.9	0.7	0.7
Earning Ratios (%)				
EBIDTAM	9.7%	9.0%	9.6%	9.6%
OPM	8.9%	8.4%	9.0%	9.1%
NPM	4.2%	5.1%	4.9%	5.0%
ROE	9.2%	11.5%	11.6%	12.5%
ROCE	18.1%	15.8%	17.3%	18.4%
B/S Ratios				
Current ratio (x)	1.6	1.7	1.7	1.7
D/E (x)	0.1	0.2	0.2	0.2
Debtor Days	196.9	227.2	231.8	220.5
Creditor Days	151.3	145.3	153.9	148.4
Inventory Days	22.5	21.6	21.8	22.0
FA/Turnover (x)	25.7	28.5	27.9	33.1

Source: Company & SKP Research Desk

Notes:

The above analysis and data are based on last available prices and not official closing rates. SKP Research is also available on Bloomberg, Thomson First Call & Investext Myiris, Moneycontrol, Tickerplant and ISI Securities.

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