



VA TECH WABAG LIMITED

Issue Details

VA Tech Wabag Limited (Wabag/ “the company”) is proposing an Initial Public Offer consisting of a fresh issue aggregating to Rs 1.25 billion and an offer for sale of 27,03,383 equity shares of VA Tech Wabag Limited-. The Issue is being made through 100% book building process wherein not more than 50% of the Issue shall be available for allocation on a proportionate basis to Qualified institutional buyers (QIBs), 5% of the QIB Portion (excluding the Anchor Investor Portion) shall be available for allocation on a proportionate basis to mutual funds only and the remainder shall be available for allocation on a proportionate basis to all QIB Bidders, including mutual funds, subject to valid bids being received at or above the Issue Price. Further, not less than 15% of the Issue will be available for allocation on a proportionate basis to Non-Institutional Bidders and not less than 35% of the Issue will be available for allocation on a proportionate basis to Retail Individual Bidders, subject to valid Bids being received at or above the Issue Price.

Proposed Use of IPO Proceeds

The objects of the Fresh Issue are:

1. Funding working capital requirements of our Company;
2. Construction of a corporate office at Chennai;
3. Implementation of global IT systems; and
4. General corporate purposes.

IPO Grading

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ICRA has assigned an IPO Grade 4 indicating above average fundamentals to the proposed initial public offering of VA Tech Wabag Limited (Wabag). ICRA assigns IPO grading on a scale of IPO Grade 5 through IPO Grade 1, with Grade 5 indicating strong fundamentals and Grade 1 indicating poor fundamentals.

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An ICRA IPO Grade is a symbolic representation of ICRA’s current assessment of the fundamentals of the issuer concerned. The fundamental factors assessed include inter alia business and competitive position, financial position and prospects, management quality, corporate governance and history of compliance and litigation.

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Strengths

- Overall favourable demand outlook for projects in water & waste treatment business.
- Company's established position in the above segments, both in the domestic and international markets
- Healthy order book position providing visibility on future revenues
- Strong financial position characterised by healthy ROCE and growth in margins
- Technically qualified and experienced management team. Access to know-how / patents held by its subsidiary is also a positive

Concerns

- Increasing competitive pressures in the business and adverse price fluctuations in the basic raw materials could impact margins
- Execution risks that is typical in project business; ability to execute orders in a timely manner, meeting guaranteed performance requirements and within budgeted costs would be crucial
- Free cash flows could be impacted by the extended collection cycle

Grading Rationale

The IPO grade assigned by ICRA reflects Wabag's established position in the water/waste-water treatment project execution business, favourable demand prospects for the business driven by large investments in this sector and its comfortable financial position, characterised by growth in both revenues and profitability. The company's market position is also supported by its long track record both in the domestic and overseas operations, its strong technical capabilities arising out of experienced promoters & management, and the access to know-how/patents held by its subsidiary in various systems required in the business. The grading is however constrained by the fact that margins could be affected by the increasing competitive pressures in the business as well as adverse fluctuations in the prices of raw materials in case of 'fixed price' based contracts. As is typical of projects business, ability to execute the projects on time, and within budgets is also critical to avoid any liquidated damages. Also, the working capital intensity in the business is high, which could affect cash flows, though ICRA notes that the company has had minimal reliance on debt so far, indicating its ability to finance projects through advances received from the customers as well as back-to-back credit period from component suppliers. The company carries high contingent liabilities in its books, which includes corporate guarantee of Euro 38 million from Wabag, India towards the bank facilities of Wabag Austria. However, consolidated cash balance of Rs 2.18 billion as on 31st March 2010 provides comfort.

Company Profile

Incorporated in 1996, VA Tech Wabag Limited is in the business of providing turnkey solutions for water and waste water treatment to municipal and industrial users. The company has seen considerable changes in its ownership pattern since its inception as a 'water division' of Blacke Durr Cooling Towers Ltd – a part of Deutsche Babcock AG, Germany (DBAG) in October 1996. Following the acquisition of DBAG by VA Tech AG, Austria in April 1999, VA Tech Wabag GmbH, Austria (Wabag Austria) was incorporated and its Indian operations became known as VA Tech Wabag Limited, (Wabag) being a 100% subsidiary of Wabag Austria. Later, Wabag, Austria was taken over by Siemens AG, Germany in July 2005 and as a result, Wabag Austria (excluding India operations) became a part of Siemens AG, Germany. In September, 2005, the company's management team and ICICI Ventures bought out the majority stake (82.9%) in Wabag's India operations. Subsequently in September 2007, Wabag acquired its ex-parent, i.e., Wabag Austria from Siemens. With this acquisition Wabag Austria and its subsidiaries became subsidiaries of the company and

Wabag on a consolidated basis has presence across North Africa, Middle East, Fast East-China, and South East/Central/Eastern Europe.

The Company currently has 13 subsidiaries, all of which are incorporated outside India. Of the 13 subsidiaries two are direct subsidiary and the remaining are indirect subsidiaries.

Promoters and Management

Wabag is promoted by a team of professional having vast experience in the industry and are actively involved in our day to day activities. The team includes Mr. Rajiv Mittal, Managing Director (holding 21.60% of equity share capital); Mr. Amit Sengupta, Executive Director ; Mr. Shiv Narayan Saraf, Executive Director ; and Mr. S. Vardarajan, Executive Director.

Mr. Rajiv Mittal has a long association with the group and has over 25 years of experience in the water industry. Mr. Amit Gupta heads the international business group (IBG) and is associated with the company for over nine years; previously he was employed with Kirloskar AAF Limited and has over 32 years of work experience. Mr. Shiv Narayan who heads the operations is associated with the company for the close to a decade; previously he was employed with Ion Exchange India Limited and has over 38 years of work experience. Mr. S. Varadarajan is the chief financial officer and the head of the Operation Business Group (OBG and is associated with the company since 1997.

Table 1: Share holding Pattern

Pre Issue		
Category	Number of equity shares	% holding
Promoter Group / Management team	35,03,669	37.45%
Institutions	22,96,796	24.55%
Non Institutions/ Employees/Bodies Corporates	35,31,628	38.01%
Public Issue	-	-
Total	93,32,093	100%

Corporate Governance

Wabag's board has five Directors, of which three are independent Directors. The board functions largely through the following committee: Audit Committee, Remuneration and compensation committee and Shareholders'/Investors' Grievance Committee. The overall governance structure and processes have been aided by the presence of institutional investors and their nominees on the board.

Business and Competitive Position

Wabag is primarily a turnkey contractor for water and wastewater treatment plants, which contributes to a majority of its revenues. The Company also provides operation and maintenance services for water and waste water treatment plants.

The overall business of the company can be divided into four strategic business units (SBU), namely:

Municipal Business Group (MBG)
 Industrial Water Group (IWG)
 Operations Business Group (OBG)
 International Business Group (IBG)

Table 2: SBU Snapshot

	Services	FY 2009	FY 2010	Y-o-Y Growth	% Mix (FY 2010)
MBG	Water & waste water treatment to Municipal Corporations and Wastewater Treatment projects for Industrial clients in India	3643	4448	21%	63%
IWG	DM and desalination plants for industrial clients such as in refinery, power plants, metallurgy plants in India	850	863	0%	12%
OBG	Operation and Maintenance Services in India, South East Asia, Middle East and Neighboring countries	350	353	0%	5%
IBG	Mainly engineering & supply for water / waste treatment projects with focus on regions such as South-East Asian countries, Middle East and neighboring countries such as Sri-Lanka & Bangladesh	845	1361	66%	19%
TOTAL		5688	7025	23%	100%

Amounts in Rs Million

Source: Company and DRHP

The scope of orders in domestic market is generally EPC (i.e. engineering, procurement, supply and commissioning) in nature with or without O&M responsibility. In case of exports, the scope is largely restricted to engineering, procurement & supply or in some cases, would include civil/erection/commissioning works, which would be executed through project specific Joint Ventures with local civil contracting company.

Favourable demand outlook in the key markets

Indian water and waste water treatment market size which is estimated at \$ 4 billion, is expected to grow at a rate of 10-12% per annum, with government related projects contributing for close to 50% of the revenues in this market (Source : IMA CS Virtus Global Partners/ industry reports). The domestic potential is expected to remain favorable, with Government of India's (GOI) growing thrust on improvement and augmentation of water/waste water treatment infrastructure. The total planned expenditure for urban water supply and sanitation, under the 11th five year plan (2007-2012) was estimated at Rs 1292 billion, which is more than 2 times of the planned expenditure of the 10th five year plan. Further, GOI is implementing the same through, various initiatives including Jawaharlal Nehru National Urban Renewal Mission (JNNURM) currently covering about 65 cities, with implementation of the same in another 28 cities under consideration.

The Wabag Group also has a long standing presence in the other key growth markets such as North Africa & Middle East, China, and Central & Eastern Europe, which are also expected to show healthy growth. The company also has presence in South East Asia countries in which the market size is

expected to grow at a CAGR of 3- 7% over the period 2007-2016 Source: industry reports/DRHP). The overseas operations are largely conducted through the principal offices in Austria, the Czech Republic, China, Switzerland, Algeria, Romania, Tunisia, UAE, Libya and Macao. Thus, Wabag is expected to benefit from both its strong track record as well as favorable demand outlook in these key growing markets, where it has established its presence over the period.

Established position in the water/waste treatment project execution business

The company is into turnkey project execution for water/waste treatment facilities including drinking water treatment, effluents treatment, sewage treatment, sludge treatment, desalination and demineralization, for both municipal and industrial customers. Wabag has executed more than 100 projects for clients which includes various municipal corporations and industrial units belonging to the power, steel and oil and gas sector. On an overall basis, the Wabag group has implemented close to 2250 projects over the last three decades in more than 19 countries. The subsidiary companies, Wabag Austria and Wabag Wassertechnik, Switzerland own 155 patents which include both process and product patents. Wabag Austria has also applied for 37 patents that are pending. The group's previous project references and technology support from the various subsidiaries thus helps the company to leverage its position in a highly competitive business environment.

Healthy order book position provides revenue visibility; however it faces customer concentration risk

Table 3: Movement in order book

Amount in Rs. million	FY 2007	FY 2008	FY 2009	FY2010
Opening order Backlog	4460	6640	11610	12310
Order Booking (New)	4770	8330	6780	13570
<i>Growth in fresh orders booked</i>	58%	75%	-19%	100%
Sales Booked/Revenue	2600	3350	5680	7030
Closing Order Backlog	6630	11610	12710	18850
<i>Closing order balance / Sales booked</i>	2.6	3.5	2.2	2.7

Source: Company

The company's order book provides reasonably strong visibility, given that the orders are expected to be executed over the period of next 18-24 month period. However, the order book position has been aided by of one large contract from the Chennai Metro Water Supply and Sewerage Board (CMWSSB), which involves setting up of a 100 million-litre-a-day desalination plant at an aggregate cost of Rs 10.33 billion. The DBO-based (design, build and operate) plant would come up at Nemmeli, near Chennai and is expected to be commissioned by December 2011. While the project value is high, the scope of the project includes a seven-year-contract for operations and maintenance that is estimated to cost an additional Rs 5.00 billion, which would be funded by grant from the State Government. The company has tied up with, IDE Technologies (IDE) of Israel for execution of the project. IDE provide engineering support for the implementation of the project, while the overall responsibility of project execution remains with the company.

The consolidated order book position of the subsidiaries as on 31st March 2010 which stood at Euro 157.70 million, also provide visibility on the future revenue for the subsidiaries.

Profitability vulnerable to adverse material price fluctuations especially in case of fixed price based contracts in Industrial segment

Project execution requires various raw materials including steel, cement and other electrical and mechanical components. The ability of the company to pass on the raw material cost variations may be limited, in case of lump sum or fixed price contracts, which could adversely affect the company's margins. However, this risk is partially mitigated by the fact that projects with the municipal corporations, which account for about 63-65% of the revenues, generally carry a positive price escalation clause

Timely execution of the orders is critical

Table 4: Liquidated Damages

Amount in Rs. million	FY 2008	FY 2009	FY 2010
Liquidated Damages (LD)	98.7	198.9	18.8
Revenues	3399.1	5689.3	7023.9
LD booked as % of Operating income	2.9%	3.5%	0.3%

Source: Annual report

The projects undertaken have average an execution period of 18 – 24 months and ability to execute the projects in a timely manner without any cost over-runs is critical. Delays in project execution or shortfall in the quality and quantity of water/ waste water treated could lead to the liquidated damages (LD's), instances of LD's claims in the past had impacted the profitability of the company, specifically in FY2009. As a conscious strategy, the company is moving away from bidding for orders from segments where the incidence of LD clauses has been substantial

Financial position- Standalone

Profitability & Earnings:

Table 5: Profitability indicators

In Rs. Million	FY2007	FY2008	FY2009	FY2010
Operating Income	2618.0	3399.1	5689.3	7023.9
OPBDIT	158.0	111.9	336.6	860.1
OPBDIT / OI (%)	6.04%	3.29%	5.92%	12.25%
PAT	68.2	18.2	190.7	409.8
PAT / OI (%)	2.6%	0.5%	3.4%	5.8%
ROCE (%)	13.6%	5.1%	15.6%	33.7%
RONW (%)	7.3%	1.1%	10.0%	18.4%
EPS (Rs./ share)	17.2	4.4	45.9	43.8

Source: Annual report

Note: OPBDIT – Operating Profit before Depreciation, Interest and Tax, PAT – Profit after Tax, ROCE – Return on Capital Employed, RONW – Return on Net Worth, EPS- Earnings per share

The operating income of the company has shown a strong growth over the last four years, supported by a healthy order book and speedy execution. The operating margins have also been showing a rising trend due to economies of scale, softening of raw material prices in recent times and considerably lower LD claims. Going forward, the company's ability to execute the contracts in a timely manner and also within the budgeted costs remains crucial for sustaining the profitability levels

With growth in turnover and margins, profit after tax of the company has increased significantly from Rs. 68.2 million in FY2007 to Rs. 409.8 million in FY2010. Improvement in the profitability levels over the last two years has resulted in a healthy Return on capital employed of 33.7 % for FY2010. Section 80-IA was amended with retrospective effect by the Finance Act, 2009, following which the company would have higher tax liability going forward; this could have an adverse impact on the profitability figures.

Financial Leverage:

Table 6: Capitalization indicators

In Rs. Million	FY2007	FY2008	FY2009	FY2010
Total Debt	95.5	121.9	115.0	0.0
Net Worth	1426.5	1797.3	2009.9	2433.8
Total Debt / Net Worth	0.1	0.1	0.1	0.0

Source: Annual report

The infusion of equity over the years from the promoters and various private equity investors has resulted in a strong networth position for the company. The improvement in the profitability, especially in the past two financial years, leading to better accruals has also strengthened the net worth. The company's working capital is largely financed by advances from customers as well as credit period from suppliers, thus resulting in minimal reliance on debt.

Working capital intensity

Table 7: Working capital ratios

	FY 2007	FY 2008	FY 2009	FY2010
Debtor days	167	211	224	212
Inventory days	48	16	27	12
Creditor days	116	145	166	150
NWC/OI	25.2%	25.5%	15.0%	16.5%

Source: Annual report

Note: NWC/OI-Net working capital /operating income

The high working capital intensity is inherent in this business, the yearend figures are also skewed because of the seasonality in sales bookings, with a large proportion of sales booked in the last quarter of the financial year. However, as already mentioned, the company manages to get favorable credit terms and advances from the customers, which has enabled it to keep the working capital intensity within manageable levels.

CASH FLOWS:

Table 8: Cash flow indicators

In Rs. Million	FY2007	FY2008	FY2009	FY2010
Fund Flow from Operations (FFO)	42.0	-203.6	225.4	227.6
Gross Cash Flows	-44.2	-143.3	191.8	156.3
Retained Cash Flows	-44.2	-143.3	191.8	156.3
Free Cash Flows	-225.8	-414.4	172.3	88.8

Source: Annual report

Improvement in profitability and the reduction in the working capital intensity during FY2009 and FY2010 as compared to the previous years have resulted in comfortable fund flow from operation for the company. Going forward, the company's ability to complete projects in a timely manner and ensure faster collection of receivables would be key in maintaining cash flows.

CONTINGENT LIABILITIES

The contingent liabilities as on 31st March 2009 and 31st March 2010 are as given in the table below

Table 9: Contingent Liabilities

Particulars	31st March 2009	31st March 2010
Rs Million		
Sales Tax Matters	38.9	14.4
Income Tax Matters	57.8	407.8
Bank Guarantees/Letter of credit issued by banks on behalf of the company	3664.9	3305.5
Corporate Guarantees issued by the company for VA Tech Wabag Singapore (Pte) ltd.	4477.4	-
Corporate Guarantees issued by the company for VA Tech Wabag GmbH, Vienna	206.7	2301.3

Source: Annual report

Litigation History

The Company has taxation related litigations, largely towards income tax following the amendment of section 80 IA of the Income Tax Act, 1961, with retrospective effect from April 1, 2000. There are also pending litigations against subsidiary companies, largely related to civil, arbitration and taxation.

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