March 03, 2017

VA Tech Wabag Limited

Instrument	Amount	Rating Action
	In Rs Crore	
Long term: Fund based facilities	300.0	[ICRA]AA- (Stable); reaffirmed
Long term: Proposed Fund based facilities	200.0 (enhanced from nil)	[ICRA]AA- (Stable); assigned
Short term: Non-fund Based Facilities	2346.0 (enhanced from 2036.5)	[ICRA]A1+; reaffirmed
Short term: Proposed Non-fund Based	154.0 (revised from 309.5)	[ICRA]A1+; reaffirmed
Short term: Commercial Paper	150.0	[ICRA]A1+; withdrawn

* Instrument Details are provided in Annexure I

Rating Action

ICRA has reaffirmed the rating of [ICRA]AA- (pronounced as ICRA double A minus) to the Rs 500.0[1] crore (enhanced from Rs 300.0 Crore) sanctioned and proposed fund based bank limits of VA Tech Wabag Limited (Wabag/'the company'). The outlook on the rating has been revised from Stable to Negative. ICRA has also reaffirmed the short term rating at [ICRA]A1+ (pronounced as ICRA A one plus) rating to the Rs 2500.0 crore (enhanced from Rs 2346.0 Crore) sanctioned and proposed non-fund based facilities of the company[2].

ICRA has also withdrawn the [ICRA]A1+ rating on the Rs. 150.0 crore Commercial Paper programme of the company as there are no amounts outstanding.

Rationale

The rating reaffirmation reflects the robust order book position of the company following healthy order booking in FY 2016 and Year-To-Date FY 2017, aided by company's established position in the water infrastructure business with its strong technical capabilities arising out of execution track record, ownership of product and process patents as well as experienced promoters & management. The ratings also take into account the favourable long term demand prospects for water/waste-water projects in the company's target markets. The ratings further consider the strong financial profile of the company characterised by a conservative capital structure, comfortable coverage indicators and large cash reserves.

The ratings also take into account the vulnerability of the profitability to competitive pressures, fluctuations in the prices of raw materials in case of 'fixed price' based contracts, incidence of liquidated damages, warranty payouts and adverse litigation/arbitration outcomes. The various provisions[3] made towards bad debts, liquidated damages, warranties & contract losses have thus restricted the consolidated operating margin. With high working capital requirements in domestic business & weak profitability in overseas subsidiaries, RoCE on overall basis has contracted from 23% in FY2014 to 17% in FY2016. While the company has wound up a few loss making subsidiaries, ability to improve the profitability for the remaining subsidiaries remains important from credit perspective especially considering the large losses reported by few entities in FY 2016.

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[1] 100 lakh = 1 crore = 10 million
[2] For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Publications
[3] Provisions for bad debts, LDs and warranties made year on year based on the company's accounting policy

The company's reliance on working capital debt has been minimal traditionally, indicating its ability to execute projects through customer advances and back-to-back credit period from suppliers. Nevertheless, the credit period has seen a moderate reduction in the recent past driven by the subdued macroeconomic scenario and the weak liquidity profile of a majority of the suppliers. This is also reflected from increase in NWC/OI (Net working capital / Operating Income) from 17% in FY 2014 to 33% in FY2016. The company in turn has funded the increase in working capital requirements partly through usage of cash available and partly through borrowings. With full drawdown of term debt for the Namibia BOOT project (for which the repayments have also commenced) the consolidated debt levels have increased, though the gearing level still remains comfortable.

The ability of Wabag to reduce the receivable collection cycle and improve the consolidated profitability would be the key rating sensitivities going forward.

Key Rating Drivers

Credit Strengths
- Established position of the Company as the market leader in the domestic water/waste-water treatment project execution business
- Strong technological background of the Group, with the Austrian subsidiary having technical know-how/patents; technically experienced key management personnel
- Favourable long term potential for water & waste treatment projects from municipal and industrial users. Also, outlook favourable in most of the company's target markets which include Middle East, North Africa, Eastern/Central Europe & Latin America
- Healthy order-book position of ~Rs 7931 crore as of September 2016 backed by strong order intake
- Maintenance of operating profitability at similar levels in both standalone and consolidated operations through various cost rationalization measures like restructuring and focus on high margin services
- Strong financial position characterised by healthy ROCE, highly conservative capital structure and a large cash surplus that can be deployed for working capital purposes

Credit Weakness
- High level of working capital intensity inherent in the project business- debtor levels continue to remain high due to delays in payments by some clients and higher amounts held as retention for completed projects; the back-to-back credit arrangement for supplies and the healthy cash balances mitigate the risk to an extent
- High provisions/outgo towards LDs/warranties on contracts have restricted the profitability in the recent past; execution of the large APGENCO & Petronas orders without any further issues would be critical considering the large exposure towards these projects
- Margins exposed to input price volatility; however, orders from Municipal segments carry a escalation clause
- Continuing losses in a few subsidiaries because of legacy issues/nascent stage of operations thereby restricting the margin growth of the consolidated entity
- High Total Outside Liabilities and Contingent liabilities relative to the Net Worth of the Company
- High Contingent liabilities, comprising of Corporate Guarantees from Wabag India towards the bank facilities of Wabag Austria and other performance guarantees

Description of key rating drivers highlighted above:
Wabag's orderbook continues to be robust following from its technological competitiveness and leading market position in India and key overseas geographies. The company has a diverse orderbook with projects across EPC, O&M, Municipal and Industrial segments and has a good geographical mix of orders. The company had a overall orderbook of Rs 7931 crore as of September 2016 with some large

orders like Petronas Malaysia, Polghawella Sri Lanka and Koyambedu Chennai contributing to a significant portion of the order additions in the recent past.

The company has significant experience in executing orders in the water and waste-water space and hence has been able to maintain the overall profitability of the business despite stringent contractual terms like absence of escalation clauses for a significant portion of the orderbook, liquidated damages and warranty obligations. Nevertheless, the company faced a delay in completion of the large Al-Ghubrah desalination project and has reported a one-time of loss of ~Rs 60 crore towards the LD outgo for the project. These LD expenses/provisions have constrained the overall profitability of the company. In addition, some of the key overseas subsidiaries like Austria and Turkey have been impacted by high cost of operations which has in turn had an impact on consolidated profitability.

Wabag's business is highly working capital intensive in nature with a large amount pending as receivables from clients and retention money held; especially, the municipal customers (APGENCO Balance of Plant contracts have contributed to the build-up of receivables/retention in the recent past) settle the progress bills with a large delay resulting in an elongation of the company's working capital cycle. But the company's reliance on working capital debt has been minimal traditionally, indicating its ability to execute projects through customer advances and back-to-back credit period from suppliers. Nevertheless, the supplier credit has declined in the market in the recent past and this has resulted in overall increase in the working capital requirements. The company has funded this through higher working capital borrowings; nevertheless, the overall capital structure continues to remain comfortable with sizeable cash balances providing additional comfort. The contingent liability exposure, which has been high in the past few years, has moderated following the extinguishment of liabilities towards the Oman project.

Analytical approach:

Links to applicable criteria
Corporate Credit Rating – A Note on Methodology
<http://www.icra.in/Files/Articles/2009-October-Rating-Corp-Rating-Methodology.pdf>

About the Company
Incorporated in 1996, Wabag is in the business of providing turnkey solutions for water and waste water treatment to municipal and industrial segments. The company undertakes turnkey contracts for design, engineering, procurement, construction, erection, commissioning and operation and maintenance of water and waste water treatment plants. 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 India 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, Far East-China, and South East/Central/Eastern Europe.

During 2015-16, VA Tech Wabag Limited (standalone) reported a net profit of Rs. 117.4 crore on a turnover of Rs. 1,513.4 crore. During 2015-16, VA Tech Wabag Limited (consolidated) reported a net profit stood of Rs. 127.7 crore on a turnover of Rs. 2,681.2 crore. The consolidated entity has reported an operating income of Rs 1,357.9 crore and net profit of Rs. 29.2 crore in 6M H1 FY 2017 as against the operating income of Rs 1,048.9 crore and PAT of Rs 4.4 crore in the corresponding year-ago period.

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating History for last three years:

Table: Rating History

S.No	Name of Instrument	Current Rating			Chronology of Rating History for the past 3 years		
		Type	Rated amount (Rs. Crores)	Month-year & Rating	Month-year & Rating in FY2016	Month- year & Rating in FY2015	Month- year & Rating in FY2014
				March 2017	February 2016	November 2014	September 2013
1	Fund based	Long Term	300.0	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Stable)	[ICRA]A (Stable)
2	Unallocated	Long Term	200.0	ICRA]AA- (Stable	-	-	-
3	Non fund based	Short Term	2346.0	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1
4	Unallocated	Short Term	154.0	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1
5	Commercial Paper	Short Term	150.0	Withdrawn	[ICRA]A1+	-	-

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1
Details of Instrument

Name of the instrument	Date of issuance	Coupon rate	Maturity Date	Size of the issue (Rs. Cr)	Current Rating and Outlook
Fund based	-	-	-	300.0	[ICRA]AA- (Stable)
Non fund based	-	-	-	2346.0	[ICRA]A1+
Unallocated – Long Term	-	-	-	200.0	[ICRA]AA- (Stable)
Unallocated – Short Term	-	-	-	154.0	[ICRA]A1+

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