April 06, 2020

VA Tech Wabag Limited: Ratings downgraded

Summary of rating action

Instrument*	Previous Rated Amount (Rs. Crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based facilities	476.50	476.50	[ICRA]A(Negative); downgraded from [ICRA]A+(Negative);
Long-term/Short-term Non-fund based facilities	2899.38	2899.38	[ICRA]A(Negative)/[ICRA]A2+; revised from [ICRA]A+(Negative)/[ICRA]A1
Long-term/Short-term Proposed facilities	624.12	624.12	[ICRA]A(Negative)/[ICRA]A2+; revised from [ICRA]A+(Negative)/[ICRA]A1
Total	**4000.00**	**4000.00**	

**Instrument details are provided in Annexure-1*

Rationale

The downward revision in ratings takes into consideration the sustained high level of working capital requirements of VA Tech Wabag Limited (WABAG/ the company) led by high receivables and continued delays in realising the dues pertaining to the Balance of Plant (BOP) projects executed for the Andhra Pradesh Power Generation Corporation (APGENCO) and the Telangana Power Generation Corporation (TSGENCO). ICRA notes that the timeline for receipt of Rs. 140 crore receivables from TSGENCO has been further stretched due to the initiation of arbitration by Tecpro Systems Limited (erstwhile consortium leader for the BoP projects) against TSGENCO which has been challenged and stayed in Supreme court, a matter which is currently subjudice.

The ratings, however, continue to positively factor in the established position of WABAG in the water infrastructure business, equipped with the technical know-how of proprietary and licensed technology and a strong management team. The rating further takes comfort from the healthy order book worth Rs. 10,800 crore as on December 2019 end at a consolidated level, which provides revenue visibility for the company in the medium term. Furthermore, Operations & Maintenance (O&M) orders constitute 30% of the outstanding order book and are expected to drive the profitability growth going forward. ICRA further notes that all the key outstanding orders are backed by central/public sector units/sovereign funding/ multilateral letter of credits. The ratings further continue to factor in the favourable long-term demand prospects for water/waste-water projects in the company's target markets.

The ratings continue to be constrained by the vulnerability of profitability to competitive pressures and by the presence of fixed-price contracts. ICRA, however, notes that majority of the domestic contracts have a price escalation clause based on published indices. Furthermore, the projects in the orderbook remain exposed to execution risks due to the ongoing COVID 19 situation. Given the high outstanding orders in hand, timely tie-up of working capital facilities for all projects would be critical from a credit perspective. Furthermore, while ICRA takes note of the limited equity funding requirements of EPC projects under the HAM (Hybrid Annuity) route, for which company has received in-principle sanction/term sheets for debt and equity, financial closure remains pending subject to completion of conditions (CPs) by project authorities. The ratings also remain tempered by the company's moderate debt protection metrics and relatively high contingent liabilities due to issuance of guarantees towards contract performance and borrowings of subsidiaries. Nonetheless, the extent of underlying exposure on the contingent liabilities in the form of corporate guarantees given has moderated by 61% during 11M FY2020.

Key rating drivers and their description

Credit strengths

Established presence in domestic water/waste-water treatment project execution segment: WABAG benefits from its strong technological background as its Austrian subsidiary has technical know-how/patents and experienced key management personnel. This collaboration has helped the company to grow into a large multinational player in the water space, with presence across several geographies such as Africa, Middle East, South East Asia and Central/Eastern Europe.

Healthy orderbook position provides medium-term revenue visibility: With an order backlog of Rs. 10,800 crore as of December 2019 end, WABAG's orderbook remains strong, aided by 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. The order in-flow in the last one-year period has been driven primarily by the Namami Ganga scheme, both under Design, Build, Operate (DBO) and Hybrid Annuity Model (HAM) route. Furthermore, O&M orders constitute 30% of the outstanding order book and are expected drive profitability growth for the company.

Strong growth prospects in water/waste-water treatment business: Favourable demand potential for water and waste treatment projects from municipal and industrial users, aided by the Government's increased focus on funding urban municipal infrastructure and river clean-up projects augurs well for the company. The company also benefits from the requirement for waste/water treatment plants from the industrial segment. The growth prospects remain strong in the company's target markets, which include Middle East, North Africa, Eastern/Central Europe apart from India.

Credit challenges

Continued high working capital intensity due to stretched receivable position and unbilled revenue – WABAG's working capital intensity remained high, owing to high level of receivables and unbilled revenue. The company has relied on creditors in addition to working capital facilities and cash reserves for meeting its funding requirements in the last three-year period. Sizeable pending receivables from the BoP projects executed for APGENCO and TSGENCO and the continued delays in realising the same continue to adversely impact the financial risk profile of the company. The liquidity position of WABAG was impacted during FY2019 due to delays in order-intake, which delayed -in flow of advances coupled with completion of two major projects in the Middle East and Malaysia. The cashflow position, however, witnessed an improvement in 9M FY2020 driven by [a] improvement in profitability due to progress in projects and [b] increase in in-flow of advances of Rs. 178 crore during the period.

Execution and funding risks for projects in orderbook: While the orderbook of WABAG remains healthy, the projects remain exposed to execution risks particularly in the near term given the ongoing COVID 19 situation. Furthermore, while the company has received in-principle sanctions/term sheets for debt and equity for HAM Projects, completion of financial closure is pending subject to completion of CPs by the project authorities. In addition, ability of the company to obtain sanction for the requisite working capital facilities would also remain a key monitorable.

Relatively high contingent liabilities compared to company's net worth –The contingent liabilities have been typically higher due to issuance of guarantees towards contract performance and borrowings of subsidiaries. However, the contingent liability exposure has moderated in 11M FY2020.

Subdued margin profile in FY2019– WABAG's India operations have seen a decline in profitability over the years owing to a) the execution of low-margin orders like APGENCO, b) sizeable provisions towards doubtful debts/LDs and c) increase in competitive pressures, following the attractiveness of the sector. These factors further led to reduction in ROCE (Return on Capital Employed) in FY2019. At a consolidated level, the operating profitability margins (EBITDA) remained subdued in FY2019 owing to weak performance of certain subsidiaries due to completion of major projects namely AMAS Bahrain and RAPID Petronas. However, the overall profitability witnessed an improvement in 9M FY2020 due to progress achieved in the new projects in the orderbook.

Liquidity position: Adequate

WABAG's liquidity continues to remain adequate with cash flow from operations worth Rs. 140-150 crore and debt repayment obligations of ~30 crore in FY2020. While the cashflow position witnessed an improvement in 9MFY2020, it can largely be attributed to improvement in profitability and in-flow of customer advances during the period. The cash balance as on December 31, 2019 stood at Rs. 310.2 crore, of which Rs. 229.2 crore is free cash. WABAG's liquidity position was impacted over the years due to sharp increase in working capital intensity driven by pending receivables from APGENCO and TSGENCO. While Rs. 140 crore from TSGENCO was expected to be received in Q4FY2020, the same has been delayed due to initiation of arbitration by Tecpro Systems Limited, a matter which is currently subjudice.

Rating sensitivities

Positive triggers – Given the negative outlook, upgrade of WABAG's ratings in the near term is unlikely. The outlook could be revised to stable if the company demonstrates a sustained improvement in its performance by [a] timely execution of projects in pipeline by ensuring financial closure and sanction of requisite working capital facilities and [b] positive developments pertaining to receipt of payment due from APGENCO and TSGENCO.

Negative triggers – Negative pressure on WABAG's rating could arise due to [a] sustained high level of pending receivables from APGENCO and TSGENCO or [b] inability to obtain timely sanction for new projects in which case it could be under pressure, particularly in terms of meeting the equity commitments for the HAM projects in the order book. Furthermore, any pressure on the overall profitability levels of the company could also be a negative trigger from the credit perspective.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation/Standalone	The rating is based on the consolidated financial statements of the rated entity.

About the company

Incorporated in 1996, WABAG provides 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), 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 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. Wabag on a consolidated basis has presence across North Africa, Middle East, Far East-China, and South East/Central/Eastern Europe.

At a consolidated level, the company reported a net profit of Rs. 85.9 crore on an operating income of Rs. 2781 crore compared to a net profit of Rs. 144.5 crore on an operating income of Rs. 3457.3 crore in the previous year.

Key financial indicators (audited)

	FY2018	FY2019	9M FY2020
Operating Income (Rs. crore)	3457.3	2781.0	1772.1
PAT (Rs. crore)	147.1	89.2	48.1
OPBDIT/OI (%)	8.4%	7.0%	9.4%
RoCE (%)	18.9%	10.9%	
Total Outside Liabilities/Tangible Net Worth (times)	2.2	2.4	
Total Debt/OPBDIT (times)	1.6	3.2	
Interest Coverage (times)	5.1	2.6	2.0
DSCR	3.4	2.0	

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)					Rating History for the Past 3 Years						
		Type	Amount Rated	Amount Outstanding	Current Rating	Previous Rating	FY2019			FY2018			FY2017
					6-Apr-20	22-Oct-19	22-Feb-19	27-Jul-18	06-Jul-18	30-Mar-18	27-Oct-17	11-Oct-17	03-Mar-17
1	Long-term fund based Facilities	Long Term	476.5		[ICRA]A (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (&); Rating watch with developing implications	[ICRA]AA- (Stable)
2	Non-fund based facilities	Long Term/ Short Term	2899.38		[ICRA]A (Negative)/ [ICRA]A2+	[ICRA]A+ (Negative) /[ICRA]A1	[ICRA]A+ (Negative)/[ICRA]A1+	[ICRA]AA- (Negative) /[ICRA]A1+	[ICRA]AA- (Negative)/ [ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+; Rating watch with developing implications	[ICRA]A1+
3	Proposed Facilities	Long Term/ Short Term	624.12		[ICRA]A (Negative) /[ICRA]A2+	[ICRA]A+ (Negative) /[ICRA]A1	[ICRA]A+ (Negative)/[ICRA]A1+	[ICRA]AA- (Negative) /[ICRA]A1+	[ICRA]A1+			[ICRA]A1+; Rating watch with developing implications	

Amount in Rs. crore

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 click here

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	476.50	[ICRA]A(Negative)
NA	Bank Guarantees / Letter of Credit	NA	NA	NA	2899.38	[ICRA]A(Negative) / [ICRA]A2+
NA	Long-Term/Short-term Proposed Limits	NA	NA	NA	624.12	[ICRA]A(Negative) / [ICRA]A2+

Source: Va Tech Wabag Limited

Annexure-2: List of entities considered for consolidated analysis

Company has consolidated the subsidiaries/step down subsidiaries using full consolidation/proportionate consolidation and used equity method for associates and JVs

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