Can VA Tech Wabag Steer Its Way Out Of Trouble?

14-10-19

Shares of VA Tech Wabag Ltd. have declined over 70 percent from its peak in 2015 on the back of slowing global economic growth, rising debt and increased working capital requirements.

The company, which designs and builds water and sewage treatment plants for power, steel, oil & gas companies, and municipalities, has clients in India, Europe, Middle East, Africa, South-East Asia and Latin America. But it's revenue contracted in 2018-19, it takes longer to recover payments and cash flows are negative.

Here's what went wrong for the water treatment company: →

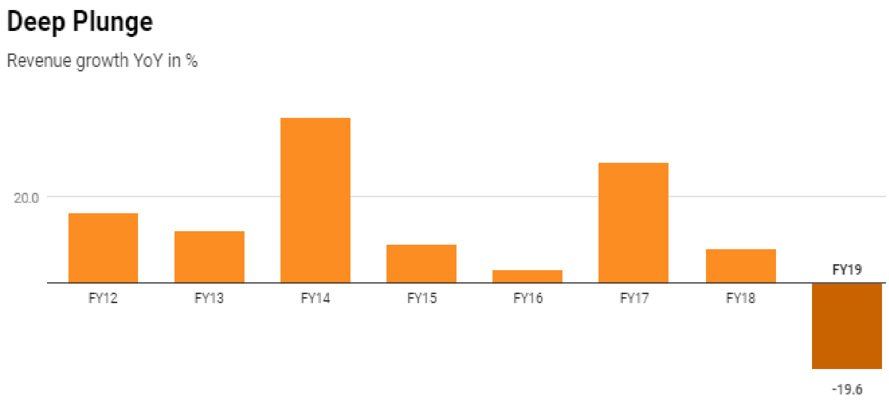
Muted Earnings

VA Tech Wabag's revenue growth, which was over 10 percent in the three years through March 2014, slowed in the next two fiscals. That, according to the company, was led by delays in securing engineering approval for clients in its European cluster.

Sales fell further in FY16 with the rupee weakening nearly 7 percent against the euro, while introduction of goods and services tax affected revenue growth in 2017-18, the company said.

While slow momentum of new orders was a key reason for drop in sales, weak collections from clients led to contraction in revenue in FY19, it said in an investor presentation for the quarter ended March 2019. Revenue dropped 34 percent in the quarter ended June—its fourth straight quarter of decline.

Nearly six out of the 10 key projects the company executed in FY19 were international and slowing economic growth in Europe affected VA Tech Wabag's financials.



The company plans to reduce its focus on Europe and concentrate on emerging markets, Rajiv Devaraj Mittal, group chief executive officer and managing director, said during the earnings call for the quarter ended June.

Pending Payments Rise

VA Tech Wabag said its receivables, or pending payments, have been delayed since the year ending March 2016 as its supply chain and sub-contractors face tighter liquidity conditions.

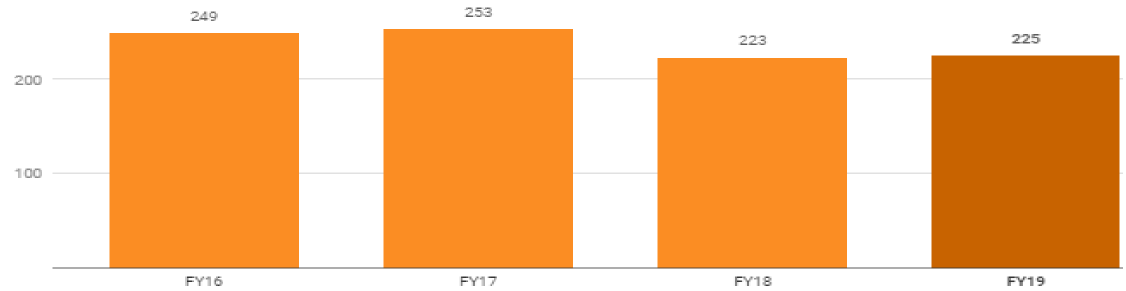
The company said its receivables outstanding as of FY19 was Rs 1,708 crore, with eight of its customers accounting for 62 percent of receivables.

Nearly a fourth of its receivables are due from certain projects in Andhra Pradesh and Telangana that it had executed along with a consortium.

The company's days of sales outstanding—or the number of days it takes to collect payments after sale has been made—was as high as 225 days in FY19, little unchanged from its peak of 253 days two years ago.

More Time To Realise Cash

Days taken to collect customer payments



The company reported Rs 92 crore as bad debt in FY19. Profit-after-tax margin has remained largely unchanged in the last four years.

Rising Receivables Hits Profitability

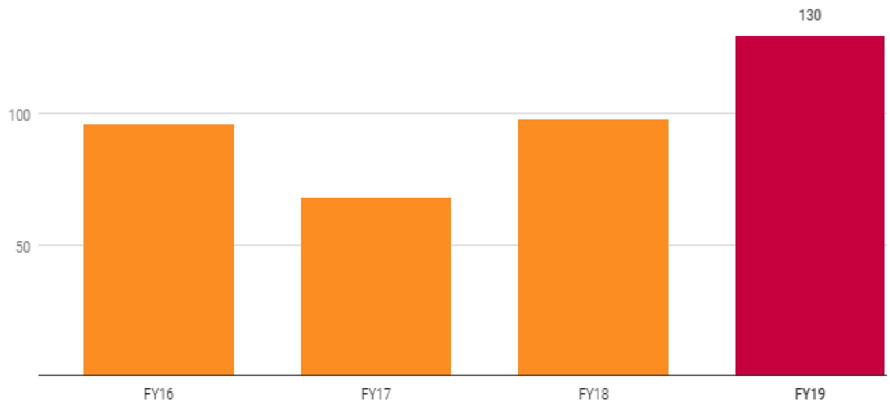
Metric	FY16	FY17	FY18	FY19
Bad And Doubtful Debt	33.0	46.0	58.0	92.0
Profit	90.0	112.0	147.0	89.0
PAT Margin (%)	3.5	3.2	3.8	3.8

Figures In Rs Crore; PAT = Profit after tax

The pressure on receivables has affected the company's working capital, with the number of days taken to convert it into revenue rising over the past few fiscals.

More Time To Show The Money

Days to convert working capital to revenue

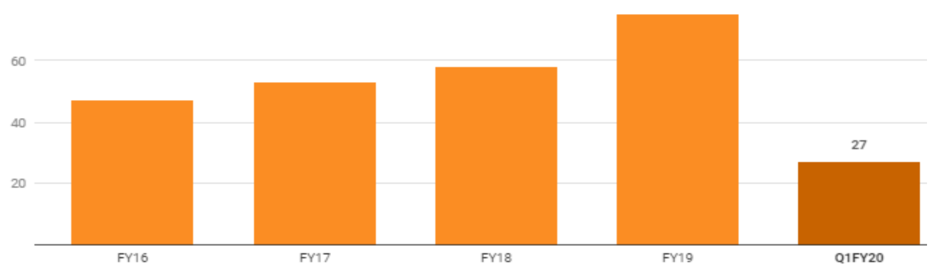


With its requirement for working capital rising, the company has resorted to borrowing more, increasing debt and finance costs. Its Chief Financial Officer Parthasarathy Gopalan admitted as much.

"There are certain challenges in the working capital front due to the tough market conditions," he had said in an earnings call in 2015-16.

Steady Rise

Finance Costs In Rs Crore

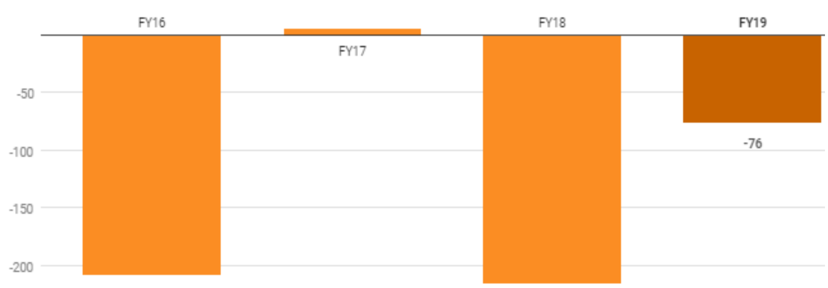


Cash Flows Turn Negative

The company's operating cash flow, which was negative Rs 208 crore in FY16, swung to Rs 6 crore in the next fiscal on the back of rise in receivables. It swung back to negative territory in the next two fiscals.

Negative Swing

Operating cash flow in Rs crore



The increasing pressure on receivables affected the company's requirements for working capital, with borrowings rising 83 percent to Rs 65 crore in FY16. As sub-contractors and vendors faced tighter liquidity conditions, advances from clients weren't enough to execute orders. So the company had to dip into its cash flows, further increasing borrowings.

Introduction of the GST in FY18 stressed its cash flows led by delays in customer invoicing. That continued in the next financial year as well. BloombergQuint's emailed queries to the company on its future plans remain unanswered. This story will be updated once it replies.

The Way Ahead

VA Tech Wabag's group CEO Rajiv Devaraj Mittal outlined plans to reduce the borrowings at its earnings call for the quarter ended June.

"We have been wanting to do that (raise additional capital)," he said. "We have taken various approvals, but somehow the markets, they aren't conducive. But from the order backlog we have, I think most of the projects will be able to support themselves without a huge demand of working capital, and that's how we will try to reduce our working capital."

Sandeep Agrawal, the company's chief financial officer, said during the earnings call for the quarter ended June that he expects to receive advances and once they are in place, finance costs won't rise. There will be some charges on account of new projects, he said, but interest costs should be coming down.

The company's total borrowing as of June was Rs 550-600 crore, Mittal said in the earnings call. VA Tech Wabag, he said, has fixed deposits to the tune of Rs 150-200 crore. Its order book was worth nearly Rs 12,000 crore, he said.

Analysts' Take

Despite the slowing growth, eight of the 15 analysts tracking the stock recommend a 'Buy', five suggest 'Hold' and 2 have a 'Sell' rating, according to Bloomberg data. The average of 12-month target indicates an upside of 34.5 percent. The commentary from brokerages, however, remains cautious.

ICICI Securities

- Value company at 40 percent discount to its 12-month forward earnings due to risk of high working capital impacting cash flows and muted execution.
- Return on equity to remain low due to high receivable days impacting the overall cash flows.
- Risks in delays following order finalisation and weak growth from overseas markets will keep the growth outlook challenging.
- Need to look out for orders worth Rs 1,200 crore for the Namami Gange project in terms of execution and realisation, which might be a positive.

Nomura

- Expect recovery towards receivables from projects in Andhra Pradesh and Telangana to go up to first half of FY21.
- Key risks are slowdown in domestic capex, further delay in receipt of stuck payments and slowdown in Middle Eastern orders.
- Overhang of receivables will continue during the first half of current fiscal.