

## VA Tech Wabag

### Performance Highlights

#### Quarterly highlights - Standalone

Y/E March (₹ cr)	4QFY16	4QFY15	3QFY16	% chg (yoy)	% chg (qoq)
Net sales	553	568	371	(2.6)	49.0
EBITDA	93	78	37	19.2	153.2
Reported PAT	56	52	21	8.2	171.8

Source: Company, Angel Research;

For 4QFY2016, VA Tech Wabag (Wabag) reported a 2.6% yoy decline in sales to ₹553cr, reflecting weak execution across the EPC-Municipal business. The EBITDA grew 19.2% yoy to ₹93cr while the EBITDA margin expanded by 306bp yoy to 16.8%. In-line with the EBITDA margin, the PAT margin expanded to 10.2% during the quarter vs 9.1% in 4QFY2015.

International revenues declined 10.4% yoy to ₹303cr, on account of Euro depreciation and with some of the projects being at early stages of execution and therefore not contributing to revenues. A poor operating performance coupled with a higher tax rate led to losses in the international business during the quarter.

The order book as of 4QFY2016-end stood at ₹8,315cr, reflecting order book / last twelve month (LTM) sales ratio of 3.3x.

**Valuation:** Wabag trades at FY2017E/2018E P/E multiple of 22.1x/16.0x. Recently the company reported large ticket order wins from the Middle East and Asian sub-continent (worth ₹2,862cr), which tend to enjoy higher margins than orders from Europe. These order wins have now taken the order book to highs of ₹8,315cr, reflecting OB/LTM ratio at 3.3x. With better revenue visibility, we now expect Wabag to report 23.0% top-line and 45.6% bottom-line CAGR during FY2016-18E, respectively. Accordingly, we expect RoEs to expand from 9.7% in FY2016 to 15.9% in FY2018E. Given such earnings growth and RoE expansion potential, we assign 19.0x P/E multiple to our FY2018E EPS of ₹35.9 to arrive at a price target of ₹681. **Given the 18.5% upside potential, we upgrade our recommendation on the stock to BUY.**

#### Key financials (Consolidated)

Y/E March (₹ cr)	FY13	FY14	FY15	FY16	FY17E	FY18E
Net Sales	1,619	2,239	2,435	2,542	3,136	3,845
% chg	12.1	38.3	8.8	4.4	23.3	22.6
Net Profit	90	114	112	94	144	197
% chg	22.5	25.5	(2.9)	(16.3)	53.9	37.7
EBITDA (%)	9.6	8.4	8.6	8.6	8.9	9.1
EPS (₹)	34	42	20	17	26	36
P/E (x)	17.0	13.6	28.5	34.0	22.1	16.0
P/BV (x)	2.1	1.8	3.5	3.2	2.8	2.4
RoE (%)	12.6	14.6	12.6	9.7	13.4	15.9
RoCE (%)	20.1	20.6	22.0	19.9	22.4	24.5
EV/Sales (x)	0.8	0.6	1.2	1.2	0.9	0.7
EV/EBITDA (x)	8.5	7.0	14.3	14.5	10.3	7.8

Source: Company, Angel Research; CMP as of May 31, 2016

## BUY

CMP	₹575
Target Price	₹681

Investment Period	12 Months
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Stock Info	
Sector	Capital Goods
Market Cap (₹ cr)	3,134
Net debt (₹ cr)	19
Beta	0.8
52 Week High / Low	833/409
Avg. Daily Volume	212,407
Face Value (₹)	2
BSE Sensex	26,836
Nifty	8,160
Reuters Code	VATE.BO
Bloomberg Code	VATW@IN

Shareholding Pattern (%)	
Promoters	29.0
MF / Banks / Indian Fls	25.4
FII / NRIs / OCBs	27.1
Indian Public / Others	18.5

Abs. (%)	3m	1yr	3yr
Sensex	12.1	(4.2)	36.0
Wabag	36.7	(22.8)	146.2

#### 3-Year Daily Price Chart



Source: Company, Angel Research

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**Exhibit 1: Quarterly Performance (Standalone)**

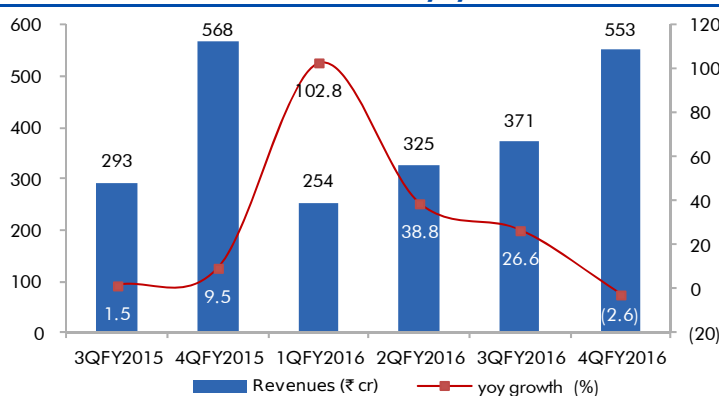
Particulars (₹ cr)	4QFY16	3QFY16	% chg (qoq)	4QFY15	% chg (yoy)	FY16	FY15	% chg
<b>Net Sales</b>	<b>553</b>	<b>371</b>	<b>49.0</b>	<b>568</b>	<b>(2.6)</b>	<b>1,503</b>	<b>1,220</b>	<b>23.2</b>
<b>Total Expenditure</b>	<b>460</b>	<b>335</b>	<b>37.5</b>	<b>490</b>	<b>(6.0)</b>	<b>1,307</b>	<b>1,084</b>	<b>20.6</b>
Cost of materials consumed	425	311	36.7	422	0.7	1,190	958	24.3
Change in Inventories	3	(22)	(112.9)	30	(90.8)	(36)	(15)	131.2
Employee benefits Expense	24	23	1.0	19	22.5	94	81	16.7
Other Expenses	9	22	(59.3)	18	(50.1)	59	61	(4.5)
<b>EBITDA</b>	<b>93</b>	<b>37</b>	<b>153.2</b>	<b>78</b>	<b>19.2</b>	<b>195</b>	<b>136</b>	<b>43.7</b>
EBITDA %	16.8	9.9		13.7		13.0	11.1	
Depreciation	3	3	1.0	3	(10.0)	12	7	62.0
EBIT	90	34	166.4	75	20.5	183	129	42.6
Interest and Financial Charges	6	5	35.1	0	<i>nmf</i>	15	6	166.7
Other Income & forex (gain)/loss	2	2	41.1	4	<i>nmf</i>	11	13	(19.8)
PBT before Exceptional Items	86	31	179.4	78	10.0	179	136	31.3
Exceptional Items	0	0		0		0	0	
PBT after Exceptional Items	86	31	179.4	78	10.0	179	136	31.3
Tax	30	10	195.0	26	13.4	61	46	34.0
% of PBT	34.6	32.7		33.5		34.2	33.5	
<b>Net Profit/ (Loss) after taxes</b>	<b>56</b>	<b>21</b>	<b>171.8</b>	<b>52</b>	<b>8.2</b>	<b>117</b>	<b>90</b>	<b>29.9</b>
PAT %	10.2	5.6		9.1		7.8	7.4	
Dil. EPS (after extra-ord. Items)	10.26	3.79	170.7	9.53	7.7	21.43	16.59	29.2

Source: Company, Angel Research; Note: nmf- Not meaningful

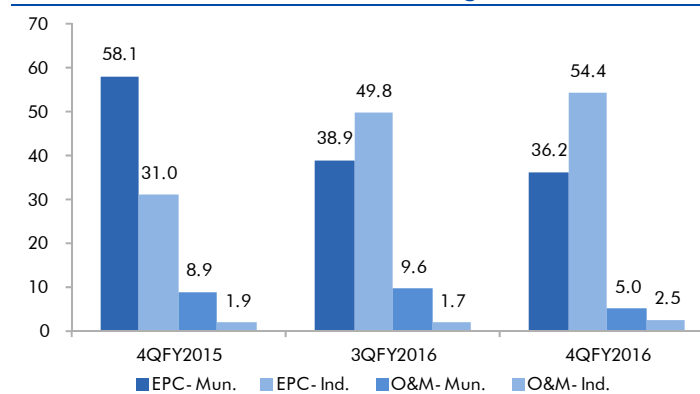
## Standalone business performance

### Revenues grow 26.6% yoy

Wabag reported 2.6% yoy decline in its revenues for the quarter to ₹553cr, which is below our expectations. Decline in the yoy revenues is mainly attributable to (1) 39.3% yoy decline in EPC- Municipal segment business (36.2% of 4QFY2016 revenues) and (2) 46.1% yoy decline in O&M- Municipal segment business (5.0% of 4QFY2016 revenues). The following 3 projects contributed 29.8% to the 4QFY2016 standalone revenues, (1) APGENCO project (₹117.5cr), (2) 147 MLD WTP project at Habra, West Bengal (₹29.2cr), and (3) 100 MLD Desal. plant-O&M works at Nemmeli, Chennai (₹18.1cr).

**Exhibit 2: Revenues decline 2.6% yoy**


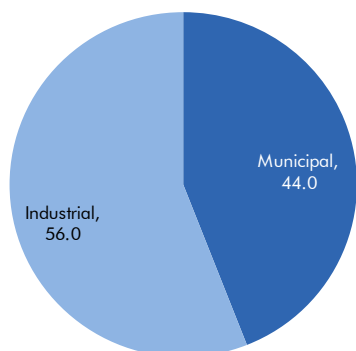
Source: Company, Angel Research

**Exhibit 3: EPC-Industrial contributes highest share**


Source: Company, Angel Research

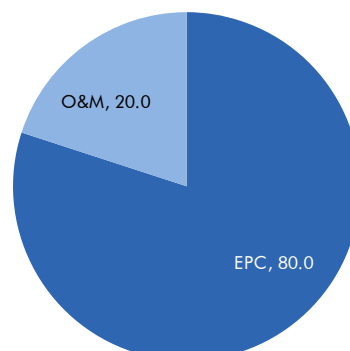
For the full year, Wabag reported 23.2% yoy increase in revenues led by strong revenue booking seen across the (1) APGENCO project (₹398.3cr), (2) 147 MLD WTP project at Habra, West Bengal (₹86.4cr), and (3) 100 MLD Desal. plant-O&M works at Nemmeli, Chennai (₹63.8cr). If we look at the business segments, then the Industrial EPC segment (31.2% of FY2016 revenues) reported a 135.0% yoy increase in revenues.

**Exhibit 4: Business-wise FY2016 Revenue split**



Source: Company, Angel Research

**Exhibit 5: Vertical-wise FY2016 Revenue split**



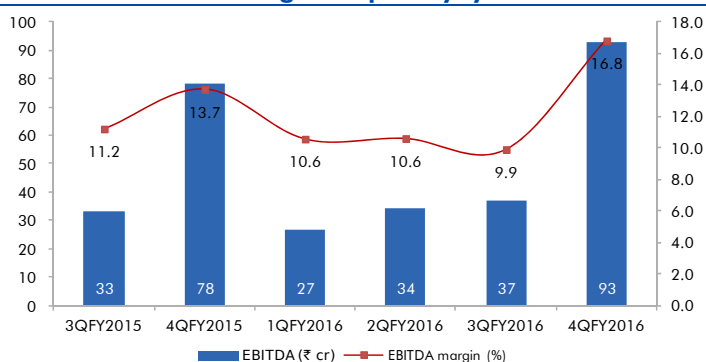
Source: Company, Angel Research

### EBITDA margin expands yoy to 16.8%

Wabag reported 19.2% yoy increase in EBITDA to ₹93cr, while EBITDA margin expanded 306bp yoy to 16.8% in 4QFY2016. EBITDA margin expansion was restricted on account of 22.5% increase in employee expenses. Such increase in employee expenses is attributable to incentive payments made to employees for FY2015 and FY2016. On normalizing the impact of such incentive payments, employee expenses would have remained flat on a yoy basis.

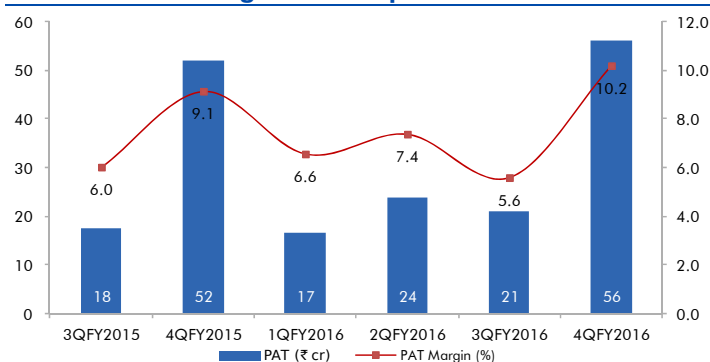
For FY2016, EBITDA margins expanded 186bp yoy to 13.0%, benefitting from 4.5% decline in other expenses to ₹59cr.

**Exhibit 6: EBITDA margins expand yoy to 16.8%**



Source: Company, Angel Research

**Exhibit 7: PAT margins also expand to 10.2%**



Source: Company, Angel Research

### PAT margin expand yoy to 10.2%

In-line with the EBITDA margin, PAT margins expanded from 9.1% in 4QFY2015 to 10.2% in 4QFY2016. EBITDA margin expansion coupled with 10.0% yoy decline in depreciation expenses (to ₹3cr) led to PAT margin expansion.

For FY2016, Wabag reported 40bp yoy PAT margin expansion to 7.8%. Entire benefits of yoy EBITDA margin expansion have not flown down to the PAT level, as (1) interest expenses increased sharply to ₹15cr, and (2) tax rate increased from to 34.2% in FY2016 from 33.5% in FY2015.

### **Update on Subsidiaries' performance**

The company's international subsidiaries' revenues declined 10.4% on a yoy basis to ₹303cr, which is attributable to (1) 7% Euro depreciation, (2) some of the projects being at early stages of execution and not contributing to revenues, and (3) delays in the Egyptian and Saudi Arabian projects (mainly owing to engineering issues; expected to start contributing to revenues in the next 2 quarters). If we look at 4QFY2016 revenue composition from international subsidiaries, then (1) Petronas, Malaysia contributed ₹82.3cr, (2) DAWASA, Tanzania contributed ₹39.4cr, and (3) O&M, Istanbul project contributed ₹37.0cr. Notably, EPC-Municipal segment reported 4.1% yoy decline in revenues to ₹182.1cr (60.1% of 4QFY2016 revenues).

For FY2016, subsidiaries reported 14.0% yoy revenue decline to ₹1,039cr, as there were delays in international projects on account of engineering issues.

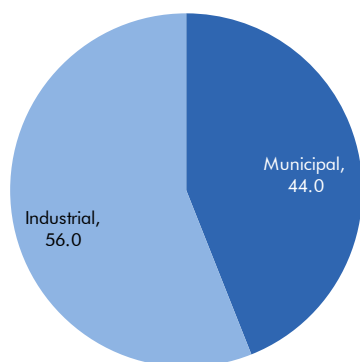
The EBITDA margins of the international business declined yoy owing to 13.6% increase in employee expenses. Other expenses during the quarter declined as no more provisions related to the Gubrah project were made (as had been made in the earlier quarters). A poor operating performance coupled with higher tax rate led to losses at the international business.

For FY2016, the EBITDA declined owing to higher other expenses. A poor operating performance, higher interest expenses coupled with higher tax expenses led to higher losses in FY2016.

## ₹1,784cr of Order Inflows in 4QFY2016

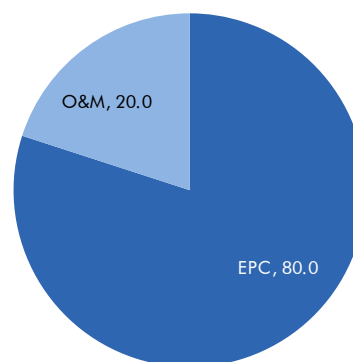
Wabag reported ₹1,784cr of order wins in 4QFY2016, which is up 17.2% yoy. The company reported key order wins from Polgahawela WTP (₹734cr) and Chennai TTP (₹594cr). The company has already won ₹500cr of projects year-to-date FY2017 (waste water treatment project at Nepal, Reliance waste water treatment plant at Jamnagar, and Czech waste water treatment plant). For FY2016 Wabag reported highest ever yearly order inflows of ₹5,140cr.

**Exhibit 8: Business-wise FY2016 Order Inflows split**



Source: Company, Angel Research

**Exhibit 9: Vertical-wise FY2016 Order Inflows split**



Source: Company, Angel Research

Order book as of 4QFY2016-end stood at ₹8,315cr, reflecting Order book / last twelve month (LTM) sales ratio of 3.3x.

### Management Guidance & Concall Updates

For FY2017, the company's Management maintained its order inflow guidance of ₹4,000-4,200cr (down 18-22% to reported order inflows of FY2016).

Wabag's Management has given a revenue guidance of ₹3,000-3,200cr for FY2017E (up 18-26% from FY2016 reported revenues).

The Management highlighted that it expects to see reasonable improvement in the FY2017 EBITDA margins from the 8.6% levels reported in FY2016.

**Update on some of the projects:** (1) Basic engineering works have been approved at Bahrain Suez project. Civil works have already started. Ordering of the key equipments is at advanced stages. (2) The Dangote project is at final stages of engineering and major dispatches are expected to be done in FY2017E. (3) Oman desalinization plant has been handed over to the client. For past 30 continuous days, trial/reliability runs are ongoing. Arbitration discussions are ongoing, which are expected to complete in the next 1 quarter. (4) For AP Genco project, boiler testing is done, turbine generator is erected, conveyor handling systems have been started, and the company is on track to finish the project in FY2017. Currently no profits are being taken up from the project; post hand-over, once no risks are attached, then profits would be taken up.

## Investment arguments

**Strong market positioning:** Wabag in our view has a strong portfolio of offerings in the water treatment/ waste water/ desalination space. Unlike most of the domestic EPC players, Wabag has a differentiated business model, given its in-house technology. Strong technological know-how coupled with large talent positions it to successfully execute complex water projects.

**Asset-light business model drives RoEs:** Wabag pursues an asset-light business model. Its strategy of keeping core areas of work in-house and outsourcing the non-critical, low-value work helps it maintain high RoEs. Also, it takes on large volume projects, thereby enabling it to generate high RoEs.

**India & Emerging markets hold huge opportunity:** India has low per capita water supply vis-a-vis developed nations, indicating huge growth potential for the company's business. Also, with rising stringency in norms for waste water treatment, scope for Wabag is huge, given that ~30% of industrial waste water is not treated. Wabag has made strong in-roads in emerging markets like Philippines, China, Saudi Arabia, Egypt, Spain and Turkey.

## Risks & Concerns

- Delays in revival of international business could impact our margin assumptions.
- Any significant loss of market share could be a risk to our assumptions.
- Execution delays in the domestic markets could be a risk to our assumptions.

## Valuation

At CMP of ₹675, VA Tech Wabag stock trades at FY2017E/2018E P/E multiple of 22.1x/16.0x. Recently Wabag reported large ticket order wins from the Middle East and Asian sub-continent (worth ₹2,862cr), which tend to have a better margin profile than orders executed in Europe. These order wins have now taken the order book to the highs of ₹8,315cr, reflecting OB/LTM ratio at 3.3x. With better revenue visibility, declining contribution of low margin projects, we now expect VA Tech Wabag to report 23.0% top-line and 45.6% bottom-line CAGR during FY2016-18E, respectively. On the back of such strong earnings growth, we expect the RoEs of the company to expand from 9.7% in FY2016 to 15.9% in FY2018E. Given the strong earnings growth and RoE expansion potential, we assign 19.0x P/E multiple to our FY2018E EPS of ₹35.9 to arrive at a price target of ₹681. **Given the 18.5% upside, we upgrade our recommendation on the stock to BUY.**

## **Company background**

VA Tech Wabag is a multinational player in the water treatment industry with presence across India, Middle East, North Africa, Central and Eastern Europe, China and South East Asia. Wabag offers an entire range of solutions including conceptualisation, design, engineering, procurement, supply, installation, construction and O&M (operational and maintenance) services. The company also provides range of EPC and O&M solutions for sewage treatment, processed & drinking water treatment, effluents treatment, sludge treatment, desalination and reuse for institutional clients like municipal corporations and companies in the infrastructure sector.

**Profit & Loss (Consolidated)**

Y/E March (₹ cr)	FY13	FY14	FY15	FY16	FY17E	FY18E
<b>Net Sales</b>	<b>1,619</b>	<b>2,239</b>	<b>2,435</b>	<b>2,542</b>	<b>3,136</b>	<b>3,845</b>
% Chg	12.1	38.3	8.8	4.4	23.3	22.6
<b>Total Expenditure</b>	<b>1,464</b>	<b>2,050</b>	<b>2,226</b>	<b>2,324</b>	<b>2,858</b>	<b>3,493</b>
Cost of sales & services	1,165	1,689	1,848	2,038	2,355	2,919
Changes in inventory	10	9	(15)	(49)	8	(9)
Employee benefits Expense	209	222	278	218	346	418
Other Expenses	80	130	115	117	149	165
<b>EBITDA</b>	<b>155</b>	<b>189</b>	<b>209</b>	<b>218</b>	<b>278</b>	<b>352</b>
% Chg	19.1	21.7	11.1	4.1	27.3	26.7
EBIDTA %	9.6	8.4	8.6	8.6	8.9	9.1
Depreciation	11	15	11	21	23	26
<b>EBIT</b>	<b>144</b>	<b>173</b>	<b>199</b>	<b>198</b>	<b>254</b>	<b>326</b>
% Chg	18.5	20.5	14.4	(0.5)	28.7	28.1
Interest and Financial Charges	22	25	39	42	49	42
Other Income	13	13	8	7	7	9
EBT & exceptional items	135	161	167	162	213	293
Exceptional Items	0	5	0	0	0	0
EBT	135	166	167	162	213	293
Tax Expenses	46	53	57	69	71	98
% of PBT	33.7	32.6	33.9	42.6	33.3	33.3
EAT before share of Profit in asso.	90	114	110	93	142	196
Share of profit in Associate	1	1	2	1	2	2
PAT before Minority Interest	90	114	112	94	144	197
Minority Interest	0	1	2	2	2	2
<b>PAT</b>	<b>90</b>	<b>113</b>	<b>110</b>	<b>92</b>	<b>142</b>	<b>195</b>
% Chg	22.5	25.5	(2.9)	(16.3)	53.9	37.7
PAT %	5.6	5.1	4.5	3.6	4.5	5.1
Diluted EPS	33.8	42.1	20.2	16.9	26.0	35.9
% Chg	21.2	24.8	(52.1)	(16.3)	53.9	37.7



**Balance Sheet (Consolidated)**

Y/E March (₹ cr)	FY13	FY14	FY15	FY16E	FY17E	FY18E
<b>Sources of Funds</b>						
Equity Capital	5	5	11	11	11	11
Reserves & Surplus	710	836	892	981	1,123	1,318
<b>Networth</b>	<b>715</b>	<b>841</b>	<b>903</b>	<b>992</b>	<b>1,134</b>	<b>1,329</b>
Total Debt	82	158	181	377	342	315
Minority Interest & Share appl. pending allot.	2	3	5	8	10	12
Other Long-term Liabilities & Prov.	112	182	242	172	275	295
<b>Total Liabilities</b>	<b>912</b>	<b>1,185</b>	<b>1,331</b>	<b>1,550</b>	<b>1,761</b>	<b>1,951</b>
<b>Application of Funds</b>						
Gross Block	107	175	252	259	284	315
Accumulated Depreciation	56	56	61	81	105	131
<b>Net Block</b>	<b>51</b>	<b>119</b>	<b>191</b>	<b>178</b>	<b>180</b>	<b>185</b>
Cap. WIP & Intan. Assets under Develop.	48	69	1	0	0	0
<b>Investments</b>	<b>3</b>	<b>23</b>	<b>38</b>	<b>28</b>	<b>28</b>	<b>28</b>
<b>Current Assets</b>						
Inventories	41	35	47	98	69	74
Sundry Debtors	1,109	1,387	1,481	1,768	1,976	2,412
Cash and Bank Balance	287	370	311	358	628	690
Loans & Advances	116	100	116	125	129	127
Other Current Asset	225	320	361	444	375	395
Current Liabilities	979	1,251	1,237	1,457	1,658	2,002
<b>Net Current Assets</b>	<b>798</b>	<b>962</b>	<b>1,078</b>	<b>1,336</b>	<b>1,519</b>	<b>1,697</b>
Other Assets	11	11	23	8	35	42
<b>Total Assets</b>	<b>912</b>	<b>1,185</b>	<b>1,331</b>	<b>1,550</b>	<b>1,761</b>	<b>1,951</b>

**Cash Flow Statement**

Y/E March (₹ cr)	FY13	FY14	FY15	FY16E	FY17E	FY18E
Profit before tax	135	161	167	162	213	293
Depreciation & Other Non-cash Chrg.	89	85	135	132	136	87
Change in Working Capital	(115)	(84)	(257)	(321)	87	(116)
Interest & Financial Charges	7	7	15	15	17	15
Direct taxes paid	(34)	(57)	(55)	(69)	(71)	(98)
<b>Cash Flow from Operations</b>	<b>82</b>	<b>112</b>	<b>6</b>	<b>(82)</b>	<b>382</b>	<b>181</b>
(Inc)/ Dec in Fixed Assets	(41)	(103)	(28)	(7)	(25)	(31)
(Inc)/ Dec in Investments & Oth. Adj.	1	5	(39)	0	0	0
<b>Cash Flow from Investing</b>	<b>(40)</b>	<b>(97)</b>	<b>(68)</b>	<b>(7)</b>	<b>(25)</b>	<b>(31)</b>
Issue/ (Buy Back) of Equity	3	1	20	0	0	0
Inc./ (Dec.) in Borrowings	(43)	76	22	197	(35)	(27)
Dividend Paid (Incl. Tax)	(19)	(22)	(25)	(22)	(33)	(46)
Interest Expenses & Oth. Adj.	(7)	(8)	(15)	(15)	(17)	(15)
<b>Cash Flow from Financing</b>	<b>(65)</b>	<b>48</b>	<b>2</b>	<b>160</b>	<b>(85)</b>	<b>(88)</b>
Inc./ (Dec.) in Cash & forex translation	(21)	86	(91)	72	272	62
<b>Opening Cash balances</b>	<b>265</b>	<b>244</b>	<b>330</b>	<b>240</b>	<b>312</b>	<b>583</b>
<b>Closing Cash balances</b>	<b>244</b>	<b>330</b>	<b>240</b>	<b>312</b>	<b>583</b>	<b>645</b>

**Ratio Analysis (x)**

Y/E March	FY13	FY14	FY15	FY16E	FY17E	FY18E
<b>Valuation Ratio (x)</b>						
Adj. P/E (on FDEPS)	17.0	13.6	28.5	34.0	22.1	16.0
Adj. P/CEPS	15.1	11.9	25.8	27.8	19.0	14.2
Dividend yield (%)	1.0	1.2	0.7	0.7	0.9	1.1
EV/Sales	0.8	0.6	1.2	1.2	0.9	0.7
EV/EBITDA	8.5	7.0	14.3	14.5	10.3	7.8
EV / Total Assets	1.5	1.1	2.2	2.0	1.6	1.4
<b>Per Share Data (₹)</b>						
Adj. EPS (fully diluted)	33.8	42.1	20.2	16.9	26.0	35.9
Cash EPS	38.1	48.3	22.3	20.7	30.3	40.6
DPS	6.0	7.0	4.0	3.9	4.9	6.2
Book Value	269	316	166	182	208	244
<b>Returns (%)</b>						
RoCE (Pre-tax)	20.1	20.6	22.0	19.9	22.4	24.5
Angel RoIC (Pre-tax)	14.1	13.3	12.0	10.0	11.7	14.5
RoE	12.6	14.6	12.6	9.7	13.4	15.9
<b>Turnover ratios (x)</b>						
Asset Turnover (Gross Block) (x)	1.8	1.9	1.8	1.6	1.8	2.0
Inventory / Sales (days)	9	6	7	8	8	7
Receivables (days)	250	226	222	228	230	229
Payables (days)	221	204	185	195	193	190
WC (days)	39	28	44	41	45	46
<b>Leverage Ratios (x)</b>						
D/E ratio (x)	0.1	0.2	0.2	0.4	0.3	0.2

Note: nmf- Not Meaningful

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### Disclosure of Interest Statement

### VA Tech Wabag

1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

**Ratings (Based on expected returns over 12 months investment period):**

Buy (> 15%)

Accumulate (5% to 15%)  
Reduce (-5% to -15%)

Neutral (-5 to 5%)  
Sell (< -15%)