Sharekhan by BNP PARIBAS

Thermax

Mixed Quarter, Subdued outlook

Sector: Capital Goods
Result Update

	Change
Reco: **Hold**	↔
CMP: **Rs. 1,094**	
Price Target: **Rs. 1,195**	↑

↑ Upgrade ↔ No change ↓ Downgrade

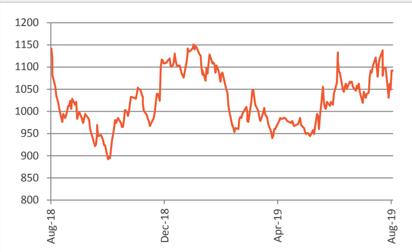
Company details

Market cap:	Rs. 13,030 cr
52-week high/low:	Rs. 1174/878
NSE volume: (No of shares)	1.0 lakh
BSE code:	500411
NSE code:	THERMAX
Sharekhan code:	THERMAX
Free float: (No of shares)	4.5 cr

Shareholding (%)

Promoters	62.0
FII	9.6
DII	16.5
Others	12.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.3	15.4	0.7	-4.3
Relative to Sensex	10.9	15.9	-2.2	-4.1

Sharekhan Research, Bloomberg

Thermax reported consolidated net revenue growth of 35% y-o-y due to a strong execution in its Energy division (up 45% y-o-y) which was above our estimates. Chemical and environment divisions remained muted. Despite strong execution, gross margins (down 418 bps) remained under pressure while OPM improved marginally (in line with expectation) led by lower employee and other expense (as a % of sales). Net Profit growth was supported by lower ETR despite higher interest, depreciation and lowers other income. Weak order intake over trailing two quarter coupled with strong execution depleted exit order backlog for Q1FY2020 (0.9x FY19 consolidated revenues). Management sounded cautiously optimistic for FY2020 with marginal revenue growth expectation led by short cycle project orders in areas like food processing, distilleries and pharma. Further, FY2021 revenue growth would be dependent on order intake during the current year. The double digit OPM is farfetched in the medium term due to increased competitive intensity. We retain our Hold rating with revised PT of Rs. 1195 on account of a cautious outlook in order tendering.

Key positives

- Strong execution in its Energy divisions leads to overall higher growth
- Management closes China operations due to erosion of cost arbitrage

Key negatives

- Order intake continues to remain weak over trailing two quarters weakening Q1FY2020 order backlog
- Management sounds cautious over near term recovery in capex cycle

Our Call

Valuation – Maintain Hold with revised PT of Rs. 1195: We have fine tuned our earnings estimates for FY2020-FY2021 factoring increased interest, depreciation and lower treasury income. We have built in muted revenue growth for FY2020 considering weak order backlog and lower order intake visibility. The revenues and net earnings to deliver a weak CAGR of 7% and 11% over FY2019- FY2021E. While the stock is trading at a steep valuation of 30x FY2021 net earnings which leaves limited scope for upside. Hence we maintain Hold rating on the stock with a revised PT of Rs. 1,195.

Key Risks

Slower than expected revival in private capex resulting in muted order picking

Valuation (consolidated) Rs cr

Particulars	FY18	FY19	FY20E	FY21E
Revenue	4,465	5,973	6,136	6,900
OPM (%)	9.0	7.7	8.2	8.2
Adjusted PAT	231	325	354	406
% YoY growth	6.9	40.8	8.8	14.6
Adjusted EPS (Rs.)	20.5	28.9	31.4	36.0
P/E (x)	52.8	37.5	34.5	30.1
P/B (x)	4.6	4.3	4.1	3.8
EV/EBITDA (x)	21.1	19.1	16.6	15.0
RoNW (%)	9.8	14.6	12.9	14.9
RoCE (%)	15.9	16.2	17.3	17.1

Source: Company, Sharekhan Estimates

Strong execution continues during Q1FY2020

Thermax reported consolidated net revenue growth of 34.5% y-o-y to Rs. 1392 crore during Q1FY2019 due to a strong execution in its Energy (up 45% y-o-y) divisions wherein Chemical and Environment divisions remained muted. Despite strong execution, gross margins (down 418 bps) remained under pressure while OPM improved marginally by 42 bps led by lower employee and other expense (as a % of sales). Hence, operating profit for the quarter witnessed growth of 42.9% y-o-y to Rs. 99 crore. Net Profit growth of 29% at Rs 63 crore was supported by lower effective tax rate(ETR) (30% Vs 36% in Q1FY2019) despite higher interest, depreciation and lower other income (down 30% y-o-y on lower treasury income)

Weak order intake leads to lower consolidated order backlog at 0.9x FY2019 consolidated revenues

Thermax witnessed a muted order intake for Q1FY2020 with consolidated order intake of Rs. 1217 crore (down 26% y-o-y) and standalone order intake of Rs. 1062 crore (down 26% y-o-y). The company continues to see weak order intake for both its energy and chemical segment (down 39% and 23% y-o-y) for Q1FY2020 although the environment segment did see a jump of 81% in its order intake. Consequently, the consolidated order backlog stood at Rs. 5250 (down 18% y-o-y) crore which is just 0.9x its FY2019 consolidated revenues.

International business update: Management closes China operations (wholly owned subsidiary) due to erosion of cost arbitrage but will continue the services for its existing customers for some time. The Indonesia plant are receiving good orders (~90 crore in the quarter) and expect it to be EBITDA positive for the current year.

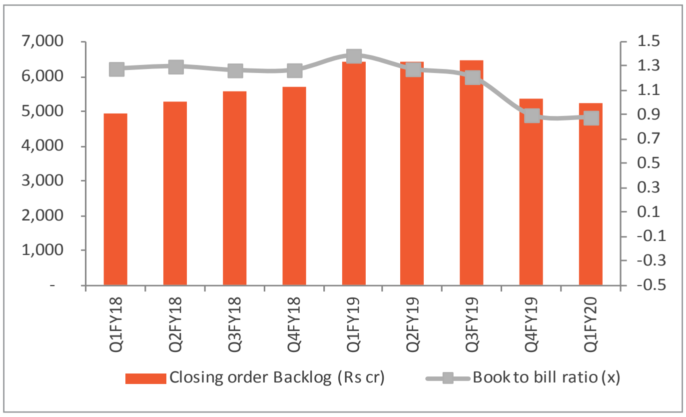
Results (Consolidated) Rs cr

Particulars	Q1FY20	Q1FY19	YoY %	Q4FY19	QoQ %
Net sales	1,392	1,035	34.5%	2,074	-33%
Net raw material	753	517	45.8%	1,255	-40%
Employee Expenses	195	187	4.2%	205	-5%
Other Expenses	346	263	31.7%	443	-22%
Operating profit	99	69	42.9%	171	-42%
Other Income	22	31	-30.5%	52	-58%
Interest	4.4	3.3	31.7%	3.5	24%
Depreciation	26	21	25.2%	25	6%
PBT	90	76	18.4%	195	-54%
Tax	27	27	-0.4%	65	-58%
Adj.PAT	63	49	29.0%	129	-51%
Rep PAT	63	49	28.2%	127	-51%
EPS	5.6	4.3	28.8%	11.3	-51%
Margin			**bps**		**bps**
OPM	7.1%	6.7%	42	7.5%	(35)
PATM	4.5%	4.7%	(19)	11.4%	(686)
Tax rate	30.3%	36.0%	(571)	-45.6%	7,594

Source: Company; Sharekhan Research

Financials in charts

Order book and order book to sales

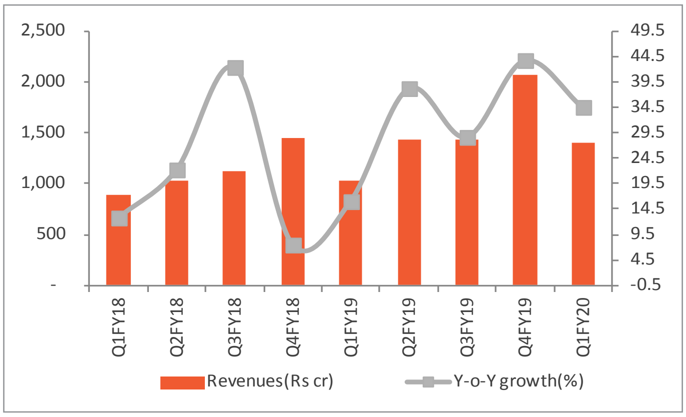


Source: Company, Sharekhan Research

Order inflow trend

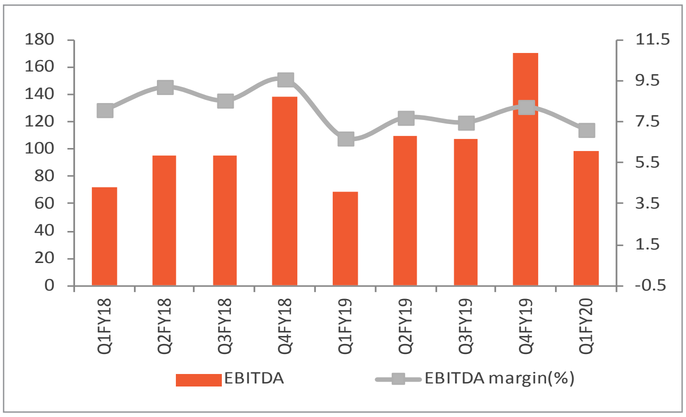
Source: Company, Sharekhan Research

Quaterly revenue trend



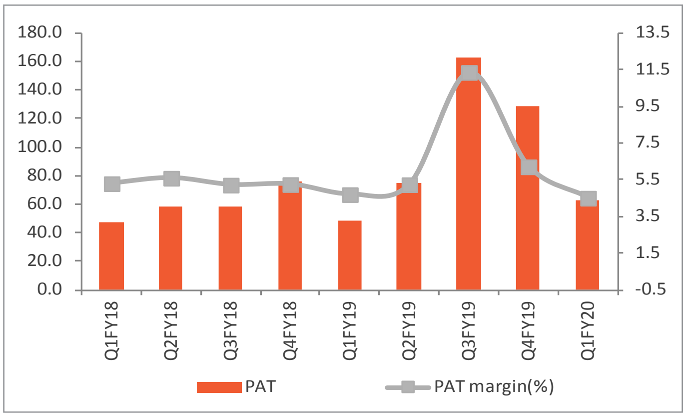
Source: Company, Sharekhan Research

EBITDA and OPM (%) trend



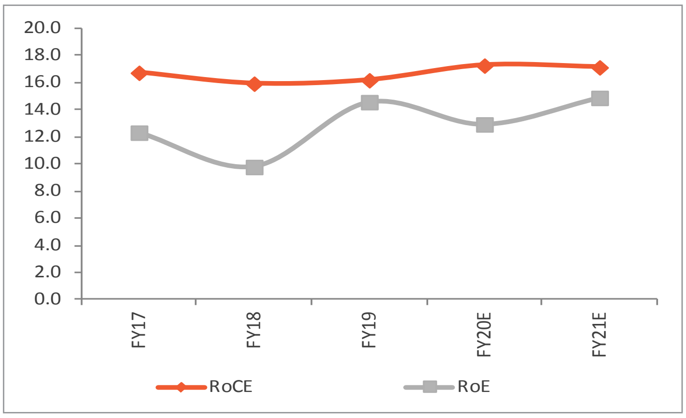
Source: Company, Sharekhan Research

PAT and PAT margin(%) trend



Source: Company, Sharekhan Research

Return ratios trend



Source: Company, Sharekhan Research

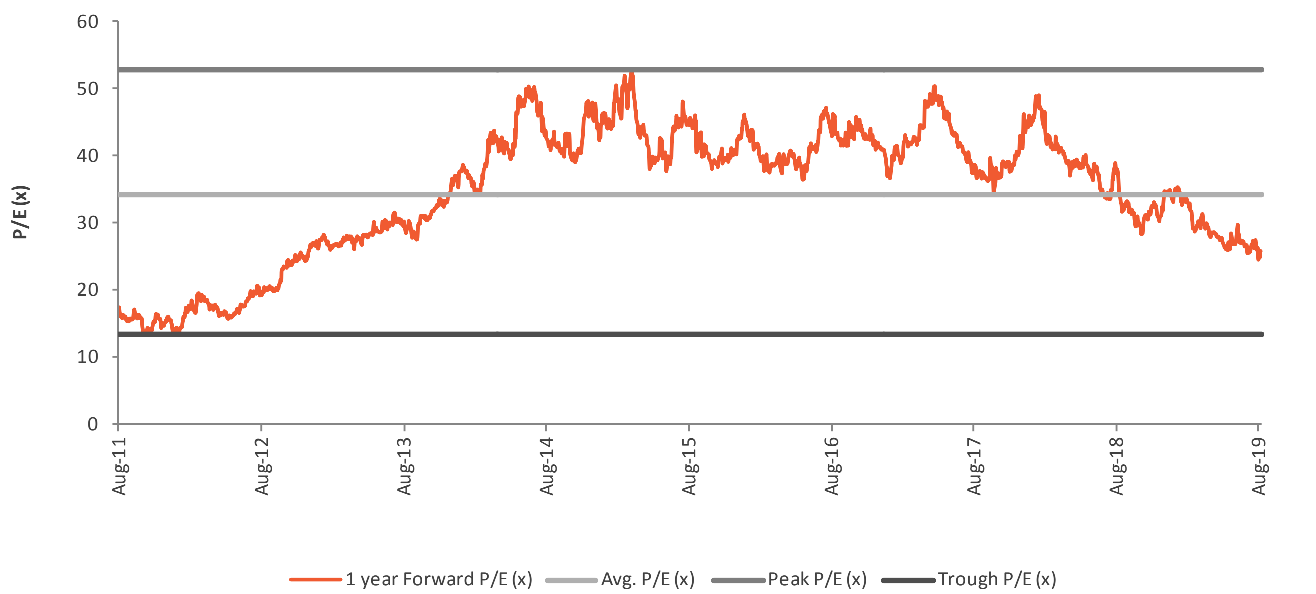
Outlook - Cautiously optimistic outlook in the near term

The management sounded cautiously optimistic for FY2020 with marginal revenue growth expectation led by short cycle project orders in areas like food processing, distilleries and pharma. It is hopeful of orders from the cement sector for Waste Heat Recovery plants to continue during FY2020. The management also expects flue- gas desulphrisation(FGD) orders and are actively bidding for the same. The steel sector would take one more year of consolidation before the ordering activity picks up. Internationally, the management expects the Indonesia business to receive good orders. Further, FY2021 revenue growth would be dependent on order intake during the current year. The double digit OPM is farfetched in the medium term due to increased competitive intensity.

Valuation - Maintain Hold with revised PT of Rs. 1195

We have fine tuned our earnings estimates for FY2020-FY2021 factoring increased interest, depreciation and lower treasury income. We have built in muted revenue growth for FY2020 considering weak order backlog and lower order intake visibility. The revenues and net earnings to deliver a weak CAGR of 7% and 11% over FY2019-FY2021E. While the stock is trading at a steep valuation of 30x FY2021 net earnings which leaves limited scope for upside. Hence we maintain Hold rating on the stock with a revised PT of Rs. 1,195.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Thermax	34.5	30.1	16.6	15.0	4.1	3.8	12.9	14.9
BHEL*	12.7	10.9	5.9	5.0	0.6	0.6	4.8	5.7
ABB India*	48.5	42.	36.2	31.1	6.27	5.5	13.5	14.2
Siemens*	35.2	31.2	22.1	19.9	4.2	3.9	12.6	13.1
Triveni Turbine	27.7	24.1	15.5	13.5	5.4	5.0	22.7	21.6

*Source: Sharekhan Research, * Bloomberg Estimates*

About company

Thermax provides solutions in the energy and environment space. The energy business contributes ~75-78% to revenues, whereas the environment business contributes ~-15-16% and chemical business contributes ~7-8%. The company operates globally through 33 International offices and 13 manufacturing facilities - 7 of which are in India and 6 overseas. Thermax has presence in 86 countries across Asia Pacific, Africa and the Middle East, CIS countries, Europe, USA and South America.

Investment theme

Green shots of revival in private capex are visible in few segment (metals, cement), with most other companies resorting to brownfield expansion. However, a broad base recovery is key for Thermax. While historically Thermax growth has been led by the domestic market, incremental growth from the international markets, exposes Thermax to the risk of rising commodity prices, given fixed price contracts.

Key Risks

- Slower than expected revival in private capex resulting in muted order picking
- Slowdown in tendering activities, and slower pick up in its subsidiaries companies.

Additional Data

Key management personnel

Meher Pudumjee	Chairman
Nawshir Mirza	Additional Independent Director
M S Unnikrishnan Managing Director	Managing Director
Pheroz Pudumjee	Non Executive Promoter
Anu Aga	Non Executive Promoter

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	RDA Holdings Pvt Ltd	54.0
2	ARA TRUSTEESHIP COMPANY PVT LTD	8.0
3	SBI Funds Management Pvt Ltd	3.5
4	Matthews International Capital Man	3.4
5	PINEBRIDGE INVESTMENTS LP	3.2
6	Kotak Mahindra Asset Management Co	2.2
7	Goldman Sachs Group Inc/The	2.0
8	Franklin Resources Inc	1.7
9	Reliance Capital Trustee Co Ltd	1.7
10	Life Insurance Corp of India	1.5

Source: Bloomberg

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