Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Thermax
Mixed Quarter

Capital Goods	Sharekhan code: THERMAX	Result Update

Stock Update

3R MATRIX	+	=	-
Right Sector (RS)		✓	
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Hold**	↔
CMP: **Rs. 1,210**	
Price Target: **Rs. 1,350**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 14,421 cr
52-week high/low:	Rs. 1,218/644
NSE volume: (No of shares)	1.0 lakh
BSE code:	500411
NSE code:	THERMAX
Free float: (No of shares)	4.5 cr

Shareholding (%)

Promoters	62.0
FII	12.2
DII	14.5
Others	11.4

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	31.4	60.4	64.8	17.3
Relative to Sensex	26.4	35.8	30.5	-4.7

Sharekhan Research, Bloomberg

Summary

- We retain our Hold rating on Thermax with a revised PT of Rs. 1350
- In Q3FY2021, Thermax's overall performance remained mixed where revenues remained muted along with strong operational performance led by cost rationalization and higher gross margins. However exceptional loss led to PAT decline.
- Weak order inflow, which was largely on expected lines, and lower execution during the same period led to lower depletion of the exit order backlog to 1.2x TTM consolidated revenue.
- Expect order booking in FY2021 to be lower compared to last year due to expectation of lower large ticket-size orders from segments such as steel, fertiliser, and cement; enquiry pipeline remains positive in food processing, steel, cement, chemical and pharma.

Thermax reported mixed performance for Q3FY2021 led by muted revenues along with strong operational performance led by cost rationalization and higher gross margins. However exceptional loss led to a decline in PAT. The consolidated net revenues were flat y-o-y to Rs. 1411 crore for Q3FY2021 (marginally lower than estimates) led by a decline in revenues from energy (down 4.9% y-o-y) and chemical (down 4.7% y-o-y), while environment reported 28.4% y-o-y rise. However, OPM improved 243 bps y-o-y to 10.5% (better than estimates) led by an improvement in gross margins and cost control measures. Accordingly, EBITDA improved 30% y-o-y to Rs 148 crore. Strong operational performance offset by higher tax (21.2% vs 19.4% in Q3FY20) along with exceptional loss Rs 28 crore (impairment of goodwill in Thermax Netherlands B.V. and reversal of part of the provision created earlier for claims arising from closure of a German subsidiary) led to decline of 2% y-o-y in net profit to Rs 83.3 crore. Adjusting to the exceptional item led to APAT of Rs 111 crore vs Rs 85 crore. The company subsidiary performance in Europe and Indonesia suffered losses although the management expects it to fare better going ahead. Order inflow remained muted during the quarter with Q3 order intake at Rs. 1565 crore (down 2.6% y-o-y). Lower execution during the same period helped in lower depletion of the exit order backlog where in order backlog marginally declined by 4.2% y-o-y at Rs. 5,208 crore. Weak international order inflows and limited visibility for big-ticket size domestic orders provides lower order inflows visibility for FY2021 compared to FY2020. On the commodity side, the management indicated that there will be some pressure as it has large part of its order book on fixed price contract. The enquiries pipeline remains positive in food processing, distillery, chemical and pharma in domestic markets. In projects, enquires were witnessed from core sectors, primarily the metals, cement and power generation. However, the management indicated that overall pipeline is not large as of now and on similar lines as last year. The management highlighted that there is broad based recovery with momentum seen across food & beverage to cement and steel and expects opportunities in the same going ahead although not sure of timelines. The management stated that all factories are operating at normal levels with no shortage in manpower. We have revised our estimates upward, factoring higher margins during Q3FY2021 and we are moderately increasing the P/E of Thermax to factor overall sector rerating. We now revalue the stock at 39x FY2023E earnings, which is close to top end of the five-year average P/E multiple. Given the stock has already run up despite mixed number in Q3. However, improving tailwind in the sector can surprise earning, execution and order intake going forward. As we maintain our hold recommendation on the stock due to limited upside with a revised price target (PT) of Rs. 1350.

Key positives

- Environment segment reported healthy performance.
- OPM increased by 243 bps on higher gross margins and cost control measures.

Key negatives

- Order inflow remained muted during the quarter.
- Energy and chemical segment performance remained lower y-o-y.

Our Call

Valuation – Maintain Hold with revised PT of Rs. 1350: Lower carry-forward order book along with lower capacity utilization in most core user industries is likely to impact order inflows for FY2021. Additionally, weak order intake outlook during FY2021 may lead to further depletion of order book by the end of FY2021. On a positive note the management highlighted that there is broad based recovery with momentum seen across food & beverage to cement and steel and expects opportunities in the same going ahead although not sure of timelines. Hence, order inflow during the current fiscal year would be the key monitor able for the company. The management stated that all factories are operating at normal levels. We have revised our estimates upward, factoring higher margins during Q3FY2021 and we are moderately increasing the P/E of Thermax to factor overall sector rerating and now we value the stock at 39x FY2023E earnings, which is close to top end of the five-year average P/E multiple. Given the stock has already run up despite mixed number in Q3. However, improving tailwind in the sector can surprise earning, execution and order intake going forward. As we maintain our hold recommendation on the stock due to limited upside with a revised price target (PT) of Rs. 1350.

Key risk

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

Valuation (Consolidated) Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	5,731	4,732	5,575	6,207
OPM (%)	7.1	7.3	8.6	8.7
Adjusted PAT	18.9	20.7	30.1	34.7
% YoY growth	(34.7)	9.8	45.5	15.1
Adjusted EPS (Rs.)	18.9	20.7	30.1	34.7
P/E (x)	64.1	58.4	40.2	34.9
P/B (x)	4.5	5.3	2.8	2.6
EV/EBITDA (x)	24.7	28.2	11.5	9.8
RoNW (%)	7.1	8.3	12.5	13.1
RoCE (%)	13.2	10.9	16.2	17.0

Source: Company; Sharekhan estimates

Mixed performance: Thermax reported mixed performance for Q3FY2021 led by muted revenues across Energy segment followed by chemical segment barring environment segment. The consolidated net revenues were flat y-o-y to Rs. 1411 crore for Q3FY2021 (marginally lower than estimates) led by a decline in revenues from energy (down 4.9% y-o-y) and chemical (down 4.7% y-o-y), while environment reported a rise of 28.4% y-o-y. However, OPM improved 243 bps y-o-y to 10.5% (better than estimates) led by an improvement in gross margins and cost control measures. Accordingly, EBITDA improved 30% y-o-y to Rs 148 crore. Poor operational performance led to PBT dip of 43% y-o-y. Strong operational performance offset by higher tax (21.2% vs 19.4% in Q3FY20) along with exceptional loss Rs 28 crore (impairment of goodwill in Thermax Netherlands B.V. and reversal of part of the provision created earlier for claims arising from closure of a German subsidiary) has led to decline of 2% y-o-y in net profit to Rs 83.3 crore. Adjusting to the exceptional item led to APAT of Rs 111 crore vs Rs 85 crore. The company subsidiary performance in Europe and Indonesia suffered losses although management expect it to fare better going ahead.

Order inflow remains muted: Order inflow remained muted during the quarter with Q3 order intake at Rs. 1565 crore (down 2.6% y-o-y). Lower execution during the same period helped in lower depletion of the exit order backlog wherein order backlog declined marginally by 4.2% y-o-y at Rs. 5,208 crore. Weak international order inflows and limited visibility for big-ticket size domestic orders provides lower order inflows visibility for FY2021 compared to FY2020. Enquiries pipeline remains positive in steel, cement, food processing, distillery, chemical and pharma in domestic markets. In projects, enquires were witnessed from core sectors, primarily metals, cement and power generation. However, management indicated that overall pipeline is not large as of now and on similar lines as last year. The management highlighted that there is broad based recovery with momentum seen across food & beverage to cement and steel and expects opportunities in the same going ahead although not sure of timelines. The management stated that all factories are operating at normal levels with no shortage in manpower

Key Conference call takeaways

- **Current business update:** In Q3, business environment started improving. Currently operations are running normally. The cash flow management has been going exceedingly well. Major order from an Indian chemical company for their new cogen plant bagged in January 2021
- **Order book composition:** The current OB has almost 90% fixed price contract and company is in talks with clients on negotiations on price. Large order still eludes although some big orders are there. Competition remains high and management indicated that it doesn't plan to take orders where there is margin and profitability constraints.
- **Enquiry pipeline:** Enquiries pipeline remains positive in steel, cement, food processing, distillery, chemical and pharma in domestic markets. However, management indicated that overall pipeline is not large as of now and on similar lines as last year.
- **Environment:** Got order for atoM (Thermal's newly launched compact sewage recycle system) from an e-commerce giant for their data center. The company commissioned flue gas cleaning system at a paper mill for tackling complex airborne. Outlook remains positive.
- **Energy:** Project traction is coming back. Margins remained good due to better mix and one large international order due to which improved volumes managing base cost.
- **Damstoker update:** The performance was lower and suffered losses affected by the second wave of COVID in Europe.
- **Indonesian subsidiary update:** The company did not book adequate orders during Q3 but a pipeline exists in South East Asia. The company suffered losses during the quarter.

- **Water business:** The company indicated that it won't be participating in government projects and municipality. Focus will be on B2B orders.
- **Commodity constraint:** On the commodity side, management indicated that there will be some pressure as major commodity prices have been sky rocketing.
- **Dahej facility:** The company added 810 meter cubic per month capacity, previously 860 meter cubic per month. It will take six to nine months to stabilize the capacity.

Results (Consolidated) Rs cr

Particulars	Q3FY21	Q3FY20	YoY%	Q2FY21	QoQ%
Net sales	1,410.6	1,410	0.0%	1,141	24%
Net raw material	752	785	-4.2%	631	19%
Employee Expenses	190	200	-4.9%	189	1%
Other Expenses	321	312	2.8%	242	33%
Operating profit	147.6	113	30.4%	79	86%
Other Income	28	26	9.6%	23	24%
Interest	5.7	1.9	192.7%	4.7	20%
Depreciation	29	32	-7.9%	29	1%
PBT	141	105	33.8%	69	105%
Tax	30	20	46.2%	13	133%
Adj.PAT	111.1	85.0	30.8%	56	99%
Rep PAT	83.3	85	-2.0%	31	167%
EPS	7.4	7.5	-2.0%	2.8	167%
Margin			**bps**		**bps**
OPM	10.5%	8.0%	243	7.0%	351
PATM	7.9%	6.0%	185	4.9%	298
Tax rate	21.2%	19.4%	-	18.7%	-

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Private capacity building unlikely to revive in the near term

The growth in the core sector industries had been hit hard by the COVID-19 pandemic both domestically as well as internationally. Private capacity enhancement has been dampened by stretched balance sheets and low liquidity. The outbreak of the pandemic has led to user industries preserving cash and curtailing fresh capex investments. The fresh private capex investments is likely to take time and is expected to take place once normalcy returns and the momentum in consumption related sectors gathers pace. Hence, overall the outlook for private sector capacity building is expected to remain weak in the near term.

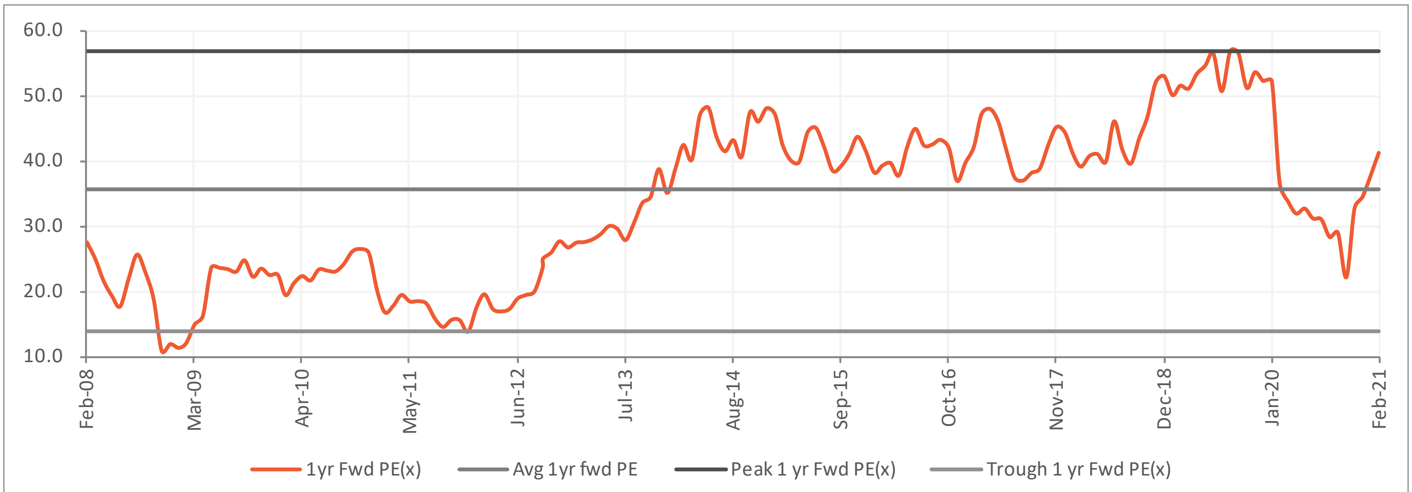
■ Company Outlook – Capitalizing on opportunities from reviving sectors

Management sounded cautious on a short-term recovery in order tendering. Weak international order inflows and limited visibility for big ticket-size domestic deals expected to see lower order inflows in FY2021compared to FY2020. The management expects better ordering in its chemical business. Further, the enquiries pipeline remains positive in select sectors like food processing, chemical and pharma in domestic markets. Fresh project enquiries also witnessed from core sectors primarily metals, cement and power generation. The company expects better exports from the chemical division due to opportunities arising from pharma API factories (for boilers, water treatment etc.) and orders from international markets.

■ Valuation – Maintain Hold with revised PT of Rs. 1350

Lower carry-forward order book along with lower capacity utilization in most core user industries is likely to impact order inflows for FY2021. Additionally, weak order intake outlook during FY2021 may lead to further depletion of order book by the end of FY2021. On a positive note the management highlighted that there is broad based recovery with momentum seen across food & beverage to cement and steel and expects opportunities in the same going ahead although not sure of timelines. Hence, order inflow during the current fiscal year would be the key monitor able for the company. The management stated that all factories are operating at normal levels. We have revised our estimates upward, factoring higher margins during Q3FY2021 and we are moderately increasing the P/E of Thermax to factor overall sector rerating and now we value the stock at 39x FY2023E earnings, which is close to top end of the five-year average P/E multiple. Given the stock has already run up despite mixed number in Q3. However, improving tailwind in the sector can surprise earning, execution and order intake going forward. Hence, we maintain our hold recommendation on the stock due to limited upside with a revised price target (PT) of Rs. 1350.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Thermax provides solutions in the energy and environment space. The energy business contributes 75-78% to revenue, 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, seven of which are in India and six are overseas. Thermax is present in 86 countries across Asia Pacific, Africa, Middle East, CIS countries, Europe, US, and South America.

Investment theme

Green shoots of a revival in private capex are visible in a few segments (metals and cement), with most other companies resorting to brownfield expansions. However, a broad-based recovery is key for Thermax. While historically, Thermax's growth has been led by the domestic market, incremental growth from 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 subsidiary companies.

Additional Data

Key management personnel

MeherPudumjee	Chairman
NawshirMirza	Additional Independent Director
M S Unnikrishnan Managing Director	Managing Director
PherozPudumjee	Non Executive Promoter
Anu Aga	Non Executive Promoter

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	RDA Holdings Pvt Ltd	53.99
2	ARA TRUSTEESHIP COMPANY PVT LTD	7.99
3	Nalanda India Equity Fund Ltd	6.26
4	Kotak Mahindra Asset Management Co	6.11
5	SBI Funds Management Pvt Ltd	2.18
6	Life Insurance Corp of India	1.73
7	PineBridge Investments LP	1.09
8	L&T Mutual Fund Tustee Ltd/India	0.9
9	Aditya Birla Sun Life Asset Manage	0.85
10	Vanguard Group Inc	0.74

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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