Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Thermax Ltd

Weak Q4; Strong order booking

Capital Goods	Sharekhan code: THERMAX
Reco/View: Buy ↔	CMP: Rs. 2,025	Price Target: Rs. 2,400 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 38.51
Updated Jan 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

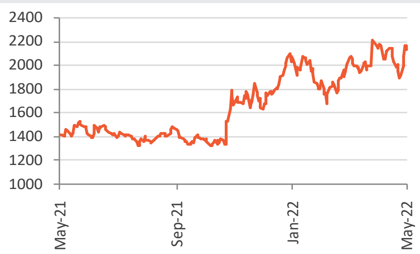
Company details

Market cap:	Rs. 24,128 cr
52-week high/low:	Rs. 2,347/1,287
NSE volume: (No of shares)	1.18 lakh
BSE code:	500411
NSE code:	THERMAX
Free float: (No of shares)	4.5 cr

Shareholding (%)

Promoters	62.0
FII	11.8
DII	20.7
Others	5.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.5	20.7	25.2	53.2
Relative to Sensex	5.7	26.6	32.3	43.6

Sharekhan Research, Bloomberg

Summary

- Thermax Limited's consolidated Q4 performance was marred by lower profitability across all its segments despite healthy topline growth.
- Order inflow witnessed 127% y-o-y rise to Rs. 3,396 crore, while order book improved ~69% y-o-y to Rs. 8,812 crore. Order intake is going to be healthy given broad-based revival in capex and increasing traction in exports/international markets.
- Margins are expected to improve in the coming quarters on account of price hikes taken in Q4 and stability in commodity prices.
- We maintain Buy on Thermax Limited (Thermax) with an unchanged PT of Rs. 2,400, given strong revenue visibility, promising order pipeline, and expectations of improving margin trajectory going forward.

Thermax Limited's (Thermax) consolidated results met our expectations on the sales front for Q4FY2022. However, the bottom line lagged our expectations. Sales grew by ~26.5% y-o-y to Rs. 1,992 crore. Gross margins declined sharply to 37.8% in Q4FY2022 (from 47.8% in Q4FY2021) due to steep rise in raw-material cost. Operating profit declined by 3.2% to Rs. 135 crore (versus our estimate of Rs. 165 crore). Operating profit margin (OPM) declined by 208 bps y-o-y to 6.8%, (versus our expectation of 8.4%). Net profit declined by 4.6% to Rs. 102 crore. Segment wise, energy/environment/chemicals delivered 24%/53%/10% y-o-y growth. However, EBIT margin in all the segments saw a sharp decline of 231/155/1566 bps y-o-y to 6.9%/5.0%/2.8%. On the positive side, order inflows have been robust during the quarter at Rs. 3,396 crore (+127%) due to award of a large ticket-size order. Order backlog stood at Rs. 8,812 crore (+68.6%).

Key positives

- Order booking was up 127% y-o-y at Rs. 3,396 crore, led by large ticket-size orders in the energy segment, while order book remained strong at Rs. 8,812 crore (up 68.6%).
- The company reported healthy revenue growth of 23.5% and 53.2% in energy (~73% of revenue) and environment (~23% of revenue) segments, respectively.
- Cash and cash equivalents healthy at Rs. 1,657 crore.

Key negatives

- Steep rise in commodity prices in Q4 affected profitability of all segments. Chemicals segment was the worst impacted as EBIT margin fell sharply to 2.8% in Q4FY2022 from 18.5% in Q4FY2021.
- Supply-chain issues and shortage of gas at its resin plant at Dahej, Gujarat, also slowed down revenue growth of the chemicals segment.

Management Commentary

- Order pipeline is very promising with strong visibility from the cement, refinery, and petrochemicals sector, while capex in the steel sector may be affected by the recent increase in export duty on steel.
- OPM should improve as impact of price hikes would be visible in the coming quarters.
- The company has pursued volumes instead of profitability this year, particularly in the chemicals business, wherein the aim was to grow in export markets. However, going forward, price hikes and cooling off of commodity prices should improve profitability.

Revision in estimates – We have lowered our estimates for FY2023-FY2024E, factoring in lower OPM.

Our Call

Valuation – Retain Buy with an unchanged PT of Rs. 2,400: Thermax's order book provides healthy revenue visibility for 1-1.5 years. Further, the company's enquiry pipeline remains positive for small ticket-size orders in cement, biomass, and sugar distilleries and large orders from oil and gas, Flue Gas Desulphurisation (FGD), and chemicals. International opportunities in biomass, waste heat recovery (WHR), and water desalination also remain strong. Thermax is expected to benefit from India's transitioning to green energy. However, we expect lumpiness or slower growth in order inflows on account of higher base. We believe in the long-term, margin improvement, growth in exports, and international business would aid profitability. The company boasts of a healthy cash position and strong balance sheet. We maintain our Buy rating on the stock with an unchanged price target (PT) of Rs. 2,400, owing to strong growth outlook.

Key Risks

- Slowdown in private capex would lead to muted order bookings
- Geopolitical tensions and supply-side challenges may continue to impact exports business in the near term.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Net Sales	4,791	6,128	7,621	9,557
OPM (%)	7.4	6.9	7.7	8.8
Adj. Net Profit	259	312	426	635
% Growth y-o-y	22.0	20.5	36.4	49.1
Adj. EPS (Rs.)	21.7	26.2	35.8	53.3
PE (x)	93.1	77.3	56.6	38.0
P/B (x)	8.4	8.0	7.5	6.6
EV/EBIDTA (x)	45.7	39.1	31.5	22.2
ROCE (%)	11.4	14.8	18.5	24.1
RONW (%)	8.8	10.7	13.8	18.6

Source: Company; Sharekhan estimates

Weak profitability dents performance

Thermax's consolidated results met our expectations on the sales front, however bottom-line lagged our expectations. Sales grew by ~26.5% y-o-y to Rs. 1,992cr. Gross margins have declined sharply to 37.8% in Q4FY2022 (from 47.8% in Q4FY2021) due to a steep rise in raw-material cost. Operating profit declined by 3.2% to Rs. 135 crore (versus our estimate of Rs. 165 crore). OPM declined by 208 bps y-o-y to 6.8% (versus our expectation of 8.4%). Net profit declined by 4.6% to Rs. 102 crore. Segment wise, energy/environment/chemicals delivered 24%/53%/10% y-o-y growth. However, EBIT margin in all the segments saw a sharp decline of 231/155/1566 bps y-o-y to 6.9%/5.0%/2.8%, respectively. Chemicals, which is more of an export-oriented business, faced lot of headwinds. Increased prices of key raw material for resins, supply chain disruption due to geopolitical crisis, and shortage of gas at its Dahej plant impacted the segment's performance.

Order book provides revenue visibility for 1-1.5 years

On the positive side, order inflows have been robust during the quarter at Rs. 3,396 crore (+127%) due to award of few large ticket-size orders. Order backlog stood at Rs. 8,812 crore (+68.6%). The company received an order of Rs. 1,176 crore for a sulphur recovery unit worth Rs. 1,176 crore and order for FGD systems worth Rs. 546 crore. Order book has a healthy mix of orders from diverse industry sectors such as transportation (34%, including order from a refinery), power (17%), food and packaging (8%), refinery and petrochemical (6%), cement (5%), and metals and steel (4%), among others. Its enquiry pipeline from metals, cement, and refinery sectors continues to be strong due to increased capex plans in the private sector.

Key Investor Update and Conference Call Highlights

- **Segment-wise order book breakup:** Out of total order inflows of Rs. 3,396 crore, energy orders increased by 103% y-o-y to Rs. 2,385 crore. Environment orders increased 3x to Rs. 884 crore, while chemicals orders increased at a slow pace of 6%. In the total order backlog of Rs. 8,812 crore, energy, environment, and chemicals' contribution stood at 67%/32%/1% in FY2022.
- **Strong order pipeline but management cautiously optimistic:** As per management, enquiry pipeline from metals, cement, and refinery sectors continues to be strong due to increased capex plans in the private sector. In cement and steel, new projects have been announced and order awards may come next year. However, the recent imposition of export levy on steel may discourage expansion plans of steel makers. Further, on-going geo-political crisis, inflationary pressures and logistics issues may delay capex plans of some of the companies. Hence, Thermax is cautiously optimistic for the near term. Q1FY2023 has seen slowdown in order inflows; however, the next few quarters are expected to see healthy inflows.
- **FGD projects**: The company received order for FGD systems in Q4FY22 worth Rs. 546 crore. FGDs are long-gestation projects where there is a wide gap between bidding and award of orders.
- **Chemicals segment to perform better going forward:** The company aims to make the chemicals segment more oriented towards exports, especially resins. The company has pushed volumes this year and, therefore, has absorbed some of the commodity price escalations. Further, supply chain was impacted due to Russia-Ukraine war and shortage of gas availability and a steep increase in gas prices in Q4. However, in the coming quarters, the company is hopeful of a better performance once supply issues subside and commodity prices cool off. The company is adding capacity in its chemicals business as it sees opportunities for the business in the long term.
- **Capacity utilisation:** In boilers, the company is operating at optimum-rated capacity. In chemicals, utilisation is ~60% but expects utilisation to grow this year on account of higher volumes.

Results (Consolidated) Rs cr

Particulars	Q4FY22	Q4FY21	YoY %	Q3FY22	QoQ %
Net sales	**1,991.9**	**1,574.5**	**26.5**	**1,614.7**	**23.4**
Operating profit	**135.2**	**139.7**	**(3.2)**	**113.1**	**19.6**
Other Income	35.7	35.8	(0.3)	29.2	22.4
Interest	10.1	6.3	60.0	5.3	91.6
Depreciation	29.5	28.8	2.3	29.0	1.7
Profit before tax	131.4	140.4	(6.4)	108.0	21.6
Tax	29.0	33.0	(12.3)	28.6	1.3
Net Profit	**102.4**	**107.4**	**(4.6)**	**79.4**	**28.9**
EPS (Rs.)	8.6	9.0	(4.6)	6.7	28.9
Margin			**bps**		**bps**
OPM	6.8%	8.9%	(208)	7.0%	(22)
NPM	5.1%	6.8%	(168)	4.9%	21
Tax Rate	22.1%	23.5%	(148)	26.5%	(441)

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Ample growth opportunities

Improving tailwinds in the sector and select industrial sectors such as steel and cement continue to perform, despite recurrence of COVID-19. Further, the Indian Government's Union Budget announcement for infrastructure and development and PLI package will support demand in the coming quarters. The government's NIP plan where the total capital expenditure in infrastructure sectors in India during FY2020-FY2025 is projected at ~Rs. 111 lakh crore also augurs well. During the same period, sectors such as energy (24%), roads (18%), urban (17%), and railways (12%) amount to ~71% of the projected infrastructure investments in India. The huge outlay towards infrastructure is expected to provide healthy growth opportunities for companies in this space.

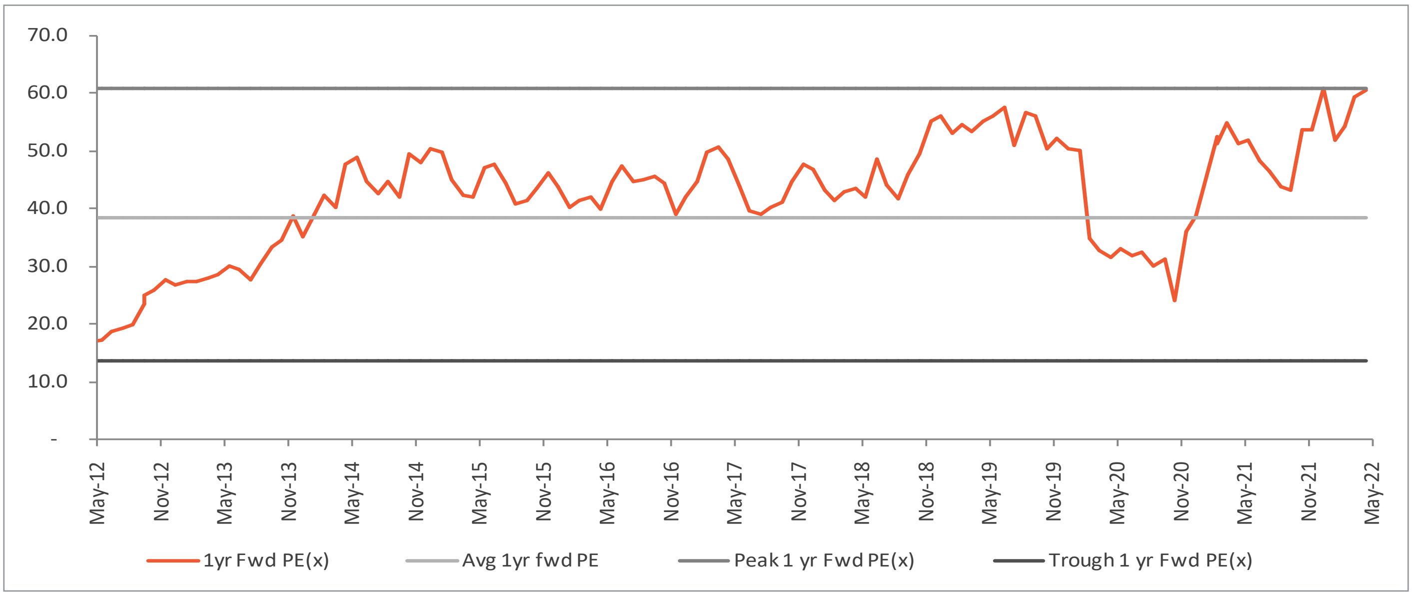
■ Company outlook - Capitalising on opportunities

Management commentary on the enquiries pipeline remains positive for small ticket-size orders across food processing, chemical, and pharma in domestic markets, including large orders from oil and gas, FGD, and chemical. Management highlighted big order opportunities in waste heat recovery in cement and steel sectors, both in domestic as well as the export markets. On the commodity front, management highlighted that there are challenges due to commodity headwinds. However, the company is able to hedge the price for smaller contracts as it buys the material in around 30 days before signing the agreement. Thermax is also contemplating opportunities across newer technologies, which will provide the next leg of growth.

■ Valuation - Retain Buy with an unchanged PT of Rs. 2,400

Thermax's order book provides healthy revenue visibility for 1-1.5 years. Further, the company's enquiry pipeline remains positive for small ticket-size orders in cement, biomass, and sugar distilleries and large orders from oil and gas, FGD, and chemicals. International opportunities in biomass, waste heat recovery (WHR), and water desalination also remain strong. Thermax is expected to benefit from India's transitioning to green energy. However, we expect lumpiness or slower growth in order inflows on account of higher base. We believe in the long-term, margin improvement, growth in exports, and international business would aid profitability. The company boasts of a healthy cash position and strong balance sheet. We maintain our Buy rating on the stock with an unchanged price target (PT) of Rs. 2,400, owing to strong growth outlook.

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 73% to the revenue, whereas the environment business contributes 21% and chemical business contributes 9%. 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 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. 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

- Slowdown in private capex would lead to muted order bookings
- Geopolitical tensions and supply-side challenges may continue to impact the exports business in the near term.

Additional Data

Key management personnel

Mrs. Meher Pudumjee	Chairman
Mr. Pheroz Pudumjee	Non-Independent Director
Mr. Ashish Bhandari	Executive Director-CEO-MD
Mr. Rajendran Arunachalam	Group Chief Financial Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Rda Holdings Private Ltd.	53.99
2	Ara Trusteeship Company Private Ltd.	7.99
3	Kotak Equity Hybrid	7.02
4	Nalanda India Equity Fund Ltd.	6.86
5	SBI Magnum Midcap Fund	2.43
6	Tata AIA Life Insurance Company Ltd	1.65
7	L&T Mutual Fund Tustee Ltd.	0.90
8	Aditya Birla Sun Life AMC	0.85
9	Vanguard Group Inc.	0.74
10	Pheroz N. Pudumjee	0.01

Source: Bloomberg, Capitaline

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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

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

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;