Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Thermax Ltd

In-line Q1; Better long-term prospects

Capital Goods	Sharekhan code: THERMAX

Reco/View: Buy	↔	CMP: **Rs. 2,010**	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 July 08, 2022

High Risk

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

Source: Morningstar

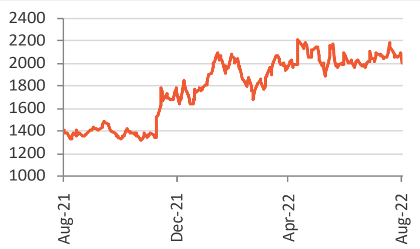
Company details

Market cap:	Rs. 23,949 cr
52-week high/low:	Rs. 2,347/1,287
NSE volume: (No of shares)	0.73 lakh
BSE code:	500411
NSE code:	THERMAX
Free float: (No of shares)	4.5 cr

Shareholding (%)

Promoters	62.0
FII	11.9
DII	20.6
Others	5.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-1.6	-6.5	7.9	43.3
Relative to Sensex	-11.2	-8.9	2.0	34.9

Sharekhan Research, Bloomberg

Summary

- Thermax Limited's (Thermax) consolidated Q1 performance was in-line with estimates, however it was impacted by lower profitability despite healthy topline growth.
- Order inflow witnessed 36% y-o-y rise to Rs. 2,310 crore, while order book improved ~56% y-o-y to Rs. 9,554 crore. Order intake expectations are high, given strong enquiry inflow from refinery, steel, power, and chemical segments.
- Margins are expected to improve in the coming quarters on account of price hikes in products/services business, execution of better margin orders, and stability in commodity prices.
- We maintain Buy on Thermax with an unchanged PT of Rs. 2,400, given strong revenue visibility, promising order pipeline, and expectations of improving margin trajectory going forward.

For Q1FY23, Thermax Limited's (Thermax) numbers were largely in-line with our expectations but below street estimates, as consolidated sales grew by 57% y-o-y to Rs. 1,654 crore, led by strong opening order book. Operating profit grew by 52% y-o-y to Rs. 96 crore (versus our estimate of Rs. 87 crore). Operating profit margin (OPM) came in at 5.8% (declined by 100 bps y-o-y) due to higher raw-material cost versus our expectation of 6%. Profit grew at a slower pace by 39% y-o-y to Rs. 59 crore (versus our estimate of Rs. 62 crore) due to lower other income and increased interest and depreciation. Order booking is up 36% y-o-y to Rs. 2,310 crore. Order backlog is up 56% y-o-y at Rs. 9,554 crore, providing strong revenue visibility. Segment wise, energy and environment reported strong revenue growth at 61%/62%, while the chemical segment's revenue grew at a slower pace at 22% y-o-y. Profitability in the energy/environment segment improved by 243 bps/19bps y-o-y to 6.1%/1.7%, while the chemicals segment reported EBIT at 3.7% (versus 17.6% in Q1FY2022).

Key positives

- Order booking was up 36% y-o-y at Rs. 2,310 crore and there was a healthy mix of orders from diverse sectors, while order book remained strong at Rs. 9,554 crore (up 56% y-o-y).
- The company reported healthy revenue growth of 61% and 62% in energy (~74% of revenue) and environment (~18% of revenue) segments, respectively.
- Cash and cash equivalents and investments stood at Rs. 2,452 crore.

Key negatives

- Steep rise in commodity prices in Q4FY2022 and early Q1FY2023 affected profitability.
- Profitability of the chemicals segment continued to be impacted by high styrene prices and low availability of natural gas at the Dahej plant. Consequently, EBIT margin fell sharply to 3.7% in Q1FY2023 from 17.6% in Q1FY2022.
- High proportion of its projects business is fixed price contracts, except two flue-gas desulfurization (FGD) orders; therefore, OPM has been lower.

Management Commentary

- Order pipeline is very promising with strong enquiry from refinery, steel, power, and chemical segments. However, export duty on steel may slowdown capex plans of metal companies. Further, upward trend in enquiry inflow from sugar/distilleries, paper and pulp industries for the green offerings provide comfort.
- OPM should improve in Q2FY2023/Q3FY2023, as the impact of lower commodity prices and higher-margin orders would be visible in the coming quarters.
- Order booking includes Rs. 522 crore order for utility boilers and associated systems for a petrochemical complex in Rajasthan.
- The two FGD orders, which were low-margin orders, are in the final stage of execution.
- The proportion of products and services in the total order booking has been increasing constantly. Products/services contributed 45-50% to the total order inflow in Q1FY2023.

Revision in estimates – We have fine tuned 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. Further, the company's enquiry pipeline is promising for small ticket-size orders in cement, biomass, paper and pulp, and sugar distilleries and large orders from oil and gas, refinery, and petro chemicals. International opportunities in biomass, waste heat recovery (WHR), and water desalination also remain strong. Moreover, Thermax is expected to benefit from India's transition to green energy as it has many offerings in the space. However, profit growth may remain lower than sales growth in the near term. In the long term, we believe margin improvement, exports growth, and increasing contribution from products as well as services 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.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Net Sales	4,791	6,128	7,742	9,956
OPM (%)	7.4	6.9	7.1	7.6
Adj. Net Profit	259	312	395	566
% Growth y-o-y	22.0	20.5	26.3	43.4
Adj. EPS (Rs.)	21.7	26.2	33.1	47.5
PER	92.4	76.7	60.7	42.3
P/B	8.3	8.0	7.5	6.8
EV/EBIDTA	45.3	38.8	33.2	24.3
ROCE (%)	11.4	14.8	17.3	22.0
RONW (%)	8.8	10.7	12.8	16.9

Source: Company; Sharekhan estimates

Profits trail revenue growth

Thermax's numbers were largely in-line with our expectations but below street estimates, as consolidated sales grew by 57% y-o-y to Rs. 1,654 crore, led by strong opening order book. Operating profit grew by 52% y-o-y to Rs. 96 crore (versus our estimate of Rs. 87 crore). OPM came in at 5.8% (declined 100 bps y-o-y) due to higher raw-material cost versus our expectation of 6%. Profit grew at a slower pace by 39% y-o-y to Rs. 59 crore (versus our estimate of Rs. 62 crore) due to lower other income and increased interest and depreciation. Segment wise, energy and environment reported strong revenue growth at 61%/62%, while the chemical segment's revenue grew at a slower pace at 22% y-o-y. Profitability in the energy/environment segment improved by 243 bps/19bps y-o-y to 6.1%/1.7%, while the chemicals segment reported EBIT at 3.7% (versus 17.6% in Q1FY2022).

Diverse order book and promising enquiry pipeline

Order booking is up 36% y-o-y to Rs. 2,310 crore. Order backlog is up 56% y-o-y at Rs. 9,554 crore, providing strong revenue visibility for the coming years. In the order booking, share of products and services stands at 45-50% and the company is hopeful of increasing traction in products and services businesses, which have better margin, and the cost is largely a pass through. Order book has a healthy mix of orders from diverse industry sectors such as refinery and petrochemical (24%), metals and steel (18%), sugar/distillery (10%), power (10%), food and beverages (9%), chemical (7%), and cement (5%) among others. The company's enquiry pipeline from steel, cement, chemical, 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. 2,310 crore, energy orders increased by 40% y-o-y to Rs. 1,758 crore. Environment orders increased by 35% to Rs. 404 crore, while chemicals orders increased at a slow pace of 5%. In the total order backlog of Rs. 9,554 crore, energy, environment, and chemicals' contribution stood at 68%, 31%, and 1%, respectively.
- **Strong order pipeline but management cautiously optimistic:** As per management, enquiry pipeline from metals, cement, chemical, and refinery sectors continues to be strong due to increased capex plans in the private sector. However, imposition of export levy on steel as well as declining commodity prices may discourage or alter expansion plans of steel makers. On the brighter side, easing of supply chain constraints and decline in overall cost due to fall in commodity prices may revive capex plan of some of the companies in processing and petrochemical industries.
- **Bullish on products and services business:** The proportion of products and services in total order booking in the quarter was 45-50%. Management is bullish on the growth prospects of the business and expects higher contribution from products and services business going forward.
- **Project order book is largely fixed in nature:** The higher portion of projects is fixed price contracts, except two FGD orders, which have some variability. Thus, commodity prices spike and inflation has impacted Thermax's profitability by a wide margin.
- **FGD projects:** The FGD order backlog is Rs. 1,800 crore. The current FGD orders are at a better margin as compared to previous orders.

Results (Consolidated) Rs cr

Particulars	Q1FY23	Q1FY22	YoY %	Q4FY22	QoQ %
Revenue	1,654	1,052	57.2	1,992	(16.9)
Operating Profit	96	63	52.3	135	(29.0)
PBT	81	56	44.8	131	(38.0)
PAT	59	42	39.2	102	(42.4)
EPS (Rs.)	5.2	3.8	39.2	9.1	(42.4)
Margin			**BPS**		**BPS**
OPM(%)	5.8	6.0	(19)	6.8	(98)
NPM (%)	3.6	4.0	(46)	5.1	(157)
Tax Rate (%)	24.0	24.6	(64)	22.1	195

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Ample growth opportunities

Industries such as steel, cement are undergoing capacity expansion which bodes well for Thermax. Further, the Indian Government's Union Budget announcement for infrastructure and development and PLI package will support the demand in the coming quarters. The government's National Infrastructure plan (NIP) plan, where total capital expenditure is projected at ~Rs. 111 lakh crore during FY2020-2025 also augurs well for growth of capital goods players. During the same period, sectors such as energy (24%), roads (18%), urban (17%), and railways (12%) would 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 the space.

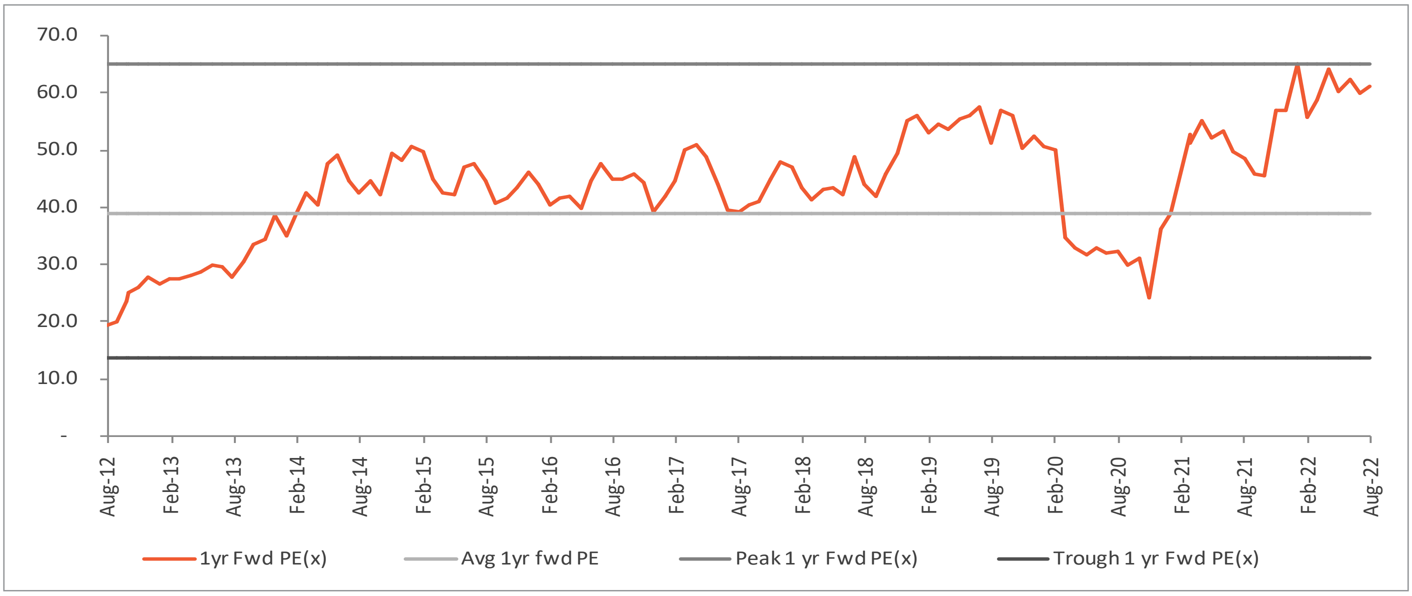
■ Company outlook - Capitalising on opportunities

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 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 and green 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. Further, the company's enquiry pipeline is promising for small ticket-size orders in cement, biomass, paper and pulp, and sugar distilleries and large orders from oil and gas, refinery, and petro chemicals. International opportunities in biomass, waste heat recovery (WHR), and water desalination also remain strong. Moreover, Thermax is expected to benefit from India's transition to green energy as it has many offerings in the space. However, profit growth may remain lower than sales growth in the near term. In the long term, we believe margin improvement, exports growth, and increasing contribution from products as well as services 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 PT of Rs. 2,400.

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 booking.
- 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 Limited	7.99
3	Kotak Mahindra Trustee Co Ltd A/c Kotak Manufacture In India Fund	7.03
4	Nalanda India Equity Fund Limited	6.86
5	Sbi Magnum Midcap Fund	2.43
6	Tata Aia Life Insurance Company Ltd.	1.63
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

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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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