Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

# Thermax Ltd

## On greener pastures

| Capital Goods | Sharekhan code: THERMAX |
|---|---|
| Reco/View: Buy ↔ | CMP: Rs. 2,472 |
| Price Target: Rs. 2,940 ↑ | |

↑ 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 Jul 08, 2022

High Risk

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

*Source: Morningstar*

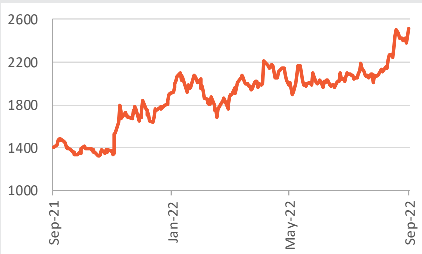
### Company details

| | |
|---|---|
| Market cap: | Rs. 29,454 cr |
| 52-week high/low: | Rs. 2,550 / 1,302 |
| NSE volume: (No of shares) | 0.8 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 | 21.2 | 24.9 | 39.7 | 79.0 |
| Relative to Sensex | 19.8 | 16.2 | 28.0 | 76.5 |

*Sharekhan Research, Bloomberg*


### Summary

- We maintain a Buy on Thermax with a revised PT of Rs. 2,940, valuing the stock on its September 2024E EPS. We expect the stock to trade at a premium given strong track record and multiple growth levers.
- Thermax boasts of a formidable offerings and product portfolio to leverage on increasing demand for the green-energy solutions. Further, low debt and a short working capital cycle offer comfort.
- Order backlog stands at Rs. 9,554 crore and order intake expectations are high, given strong enquiry inflow from refinery, steel, power, and chemical segments.
- OPM is likely to improve as projects with escalated pricing/margin get executed. Profitability in the subsidiaries is also likely to improve.


**FY22 proved to be an inflection point for Thermax as its order backlog increased by 1.6x after a lull of almost 4 years. The company's focus on energy and environment-friendly solutions and products led growth, which was supported by changing emission norms and growing demand for green-energy solutions the world over. Further, private-sector capex which has always been Thermax's mainstay has started to pick up and the company has strong enquiry pipeline from metals, cement, chemical, and refinery sectors. In addition, the company is focused on growing its products and services businesses, which have cost pass-through, thus commanding higher margins. The largely fixed nature of its projects business is a positive as commodity prices correct, thus leading to better margins. Thermax is debt-free, has low working capital cycle and healthy balance sheet.**

- **Diverse and robust order book would drive revenue growth:** Thermax's order backlog stands at Rs. 9,554 crore providing strong revenue visibility for the coming years. Order booking is up 36% y-o-y to Rs. 2,310 crore. Out of total order inflows of Rs. 2,310 crore, energy sector 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 order bookings, the 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. Hence, we expect revenue to grow at a CAGR of ~22% over FY22-25E.
- **Green energy – A key long-term growth catalyst:** India eyes a renewable energy capacity of 500 GW (currently 101GW excluding large hydro capacities) by 2030 which entails ~40GW addition per annum till 2030. In addition, cement, steel, chemical and other heavy industries accounts for almost a quarter of India' greenhouse emissions which would be undertaking major capex plans towards increasing green energy power consumption by 2030. Thermax's stronghold in green energy in sectors such as metals, cement, chemicals, etc, places it in a strong position to grab the opportunity of rising green energy adoption in these industries over the coming decade. The current order backlog has ~75% of green-energy orders. The company has a large order pipeline in waste heat recovery for the cement and steel industries, besides orders for FGDs, waste to energy and build-own-operate based solutions.
- **Margin to improve led by better priced contracts:** Thermax's project order book is largely fixed in nature, except two FGD orders, which have some variability. Thus, the spike in commodity prices inflation impacted Thermax's profitability in the last few quarters. However, as commodity prices have declined from their peaks recently, we expect Thermax's margin to improve going forward as projects with higher prices get executed. Thermax has also taken few steps off late to safeguard its margins by passing on international freight costs to customers, having shorter quotation validity windows, and ensuring faster ordering of raw materials once an order is received. Also, current FGD orders could have double digit profitability as FGD order backlog (Rs. 1,800-crore order backlog) is at a better margin as compared to previous orders. Profitability in the subsidiaries is also likely to improve with the improvement in scale and better margin orders.

**Revision in estimates –** We have upgraded our estimates for FY2023-FY2024E and introduced FY25E estimates.

### Our Call

**Valuation – Retain Buy with a revised PT of Rs. 2,940:** Thermax boasts of a healthy order book and has a promising enquiry pipeline 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. Thermax is expected to benefit from India's transition to green energy as it has many offerings in the space. International opportunities in biomass, waste heat recovery (WHR) and water desalination also remain strong. 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. Thermax currently trades at ~46x September 2024E EPS. Given the robust financials and ample business opportunities, we expect Thermax to trade at a premium. Therefore, we reiterate our Buy rating on the stock with a revised PT of Rs. 2,940, valuing the stock on its September 2024E EPS.

### Key Risks

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

### Valuation (Consolidated) Rs cr

| Particulars | FY22 | FY23E | FY24E | FY25E |
|---|---|---|---|---|
| Net Sales | 6,128 | 8,096 | 9,648 | 11,084 |
| OPM (%) | 6.9 | 7.4 | 8.0 | 8.5 |
| Adj. Net Profit | 312 | 440 | 574 | 715 |
| *% Growth y-o-y* | *20.5* | *40.9* | *30.4* | *24.6* |
| Adj. EPS (Rs.) | 26.2 | 36.9 | 48.1 | 60.0 |
| PER | 94.3 | 67.0 | 51.3 | 41.2 |
| P/B | 9.8 | 9.1 | 8.2 | 7.2 |
| EV/EBIDTA | 48.8 | 37.9 | 30.0 | 24.4 |
| ROCE (%) | 14.8 | 19.1 | 22.0 | 24.2 |
| RONW (%) | 10.7 | 14.2 | 16.9 | 18.6 |

*Source: Company; Sharekhan estimates*

**Diverse and robust order book would lead to strong revenue growth**

Thermax's order backlog stood at Rs. 9,554 crore (up 56% y-o-y), providing strong revenue visibility for the coming years. Order booking is up 36% y-o-y to Rs. 2,310 crore. Out of total order inflows of Rs. 2,310 crore, energy orders increased by 40% y-o-y to Rs. 1,758 crore. Environment segment orders increased by 35% to Rs. 404 crore, while chemicals orders increased at a slow pace of 5%.. 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. Hence, we expect revenue to grow at a CAGR of ~22% over FY22-25E.

**Strong domestic and international order pipeline**

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 an export levy on steel as well as declining commodity prices may discourage or alter steelmakers' expansion plans. 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. Moreover, air pollution control equipments, such as FGDs to arrest sulphur dioxide (SOx) and related services, would continue to be in demand as environmental regulations are tightening all over the world including MENA and other Asian countries and would benefit the company.

**Focus on green energy is a key long-term growth catalyst**

India eyes a 500 GW renewable energy capacity (currently 101GW excluding large hydropower capacities) by 2030 which entails ~40 GW addition per annum till 2030. Cement, steel chemicals and other heavy industries accounts for almost a quarter of India' greenhouse emissions which would be undertaking major capex plans towards increasing green energy power consumption by 2030. Thermax's stronghold in green energy in sectors like metal & steel, cement, chemicals places it in a strong position to grab the opportunity of rising green energy adoption in these industries over the coming decade. Thermax offers a new model for green energy power plants that run on process heat/process waste/biomass/solar energy and hybrid. Further, climate change and the present spike in fossil fuel prices has led to many companies enhancing energy efficiency, reducing their carbon and water footprint, and move away from coal to other forms of energy. Thermax is poised to play a major role in this shift. In FY22, boilers and heaters business had nearly Rs. 1,300 crore worth of orders for applications relating to waste heat recovery, biomass and spent wash firing, and green multi-fuel operations. Further, its subsidiary, Thermax Onsite Energy Solutions Limited (TOESL) successfully executed the first international build-own-operate biomass based project in Indonesia. The current order backlog has ~75% of green orders, which is non-fossil based. The company has a large order pipeline in waste heat recovery for the cement and steel industries, besides orders for FGDs, waste to energy and build-own-operate based solutions.

**Margin to improve given decline in commodity prices and better-priced contracts**

Thermax's project order book is largely fixed in nature, except two FGD orders, which have some variability. Thus, the spike in commodity prices and inflation affected Thermax's profitability by a wide margin. However, as commodity prices have declined from their peaks recently, we expect Thermax's margin to improve going forward as projects with higher prices get executed. Thermax has also taken few steps off late to safeguard its margins by passing on international freight costs to customers, having shorter quotation validity windows, and ensuring faster ordering of raw materials once an order is received. In addition, current FGD orders could have double-digit profitability as FGD order backlog (Rs. 1,800 crore order backlog) are at a better margin as compared to previous orders.

**Subsidiaries' performance to improve going forward**

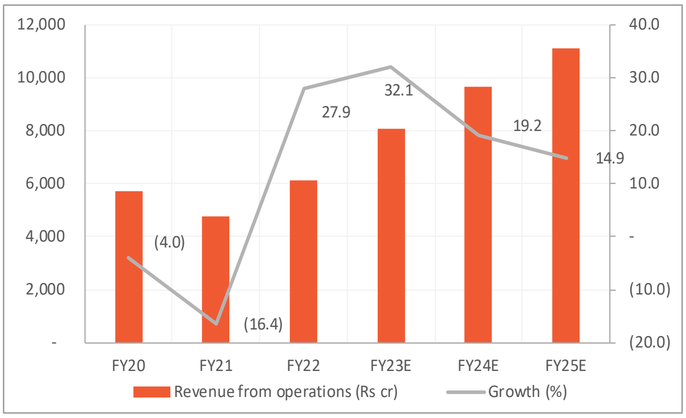
TOESL has a strong pipeline for the next 12-18 months and expects to clock Rs. 300-400 crore revenue in FY23E and Rs 500-550 crore in FY24E. The company is confident of scaling up revenues to Rs 800 crore in four years given increasing demand for green energy solutions. Thermax Babcock & Wilcox Energy Solutions (TBWES) is likely to see a rise in waste-heat recovery solution orders. First Energy Private Limited (FEPL), which focuses on solar opex business is executing projects in three states and would contribute to revenues gradually from Q3FY23E onwards. Profitability of subsidiaries is also likely to improve with the improvement in scale and better margin orders.

## Financials in charts

### Order book growth trend

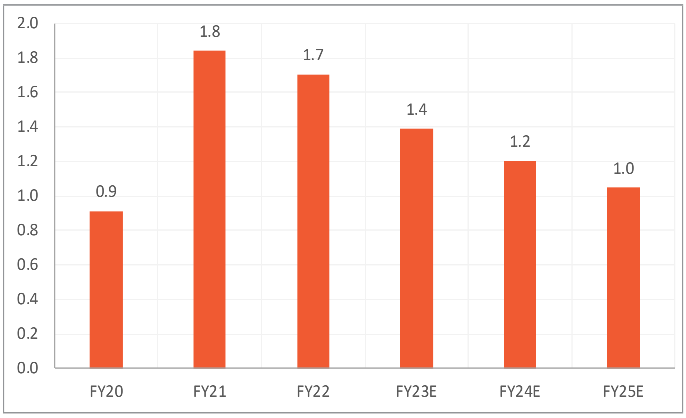

*Source: Company, Sharekhan Research*

### Revenue growth trend



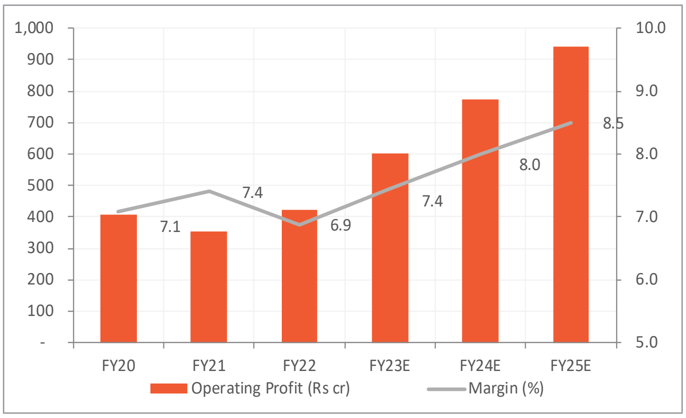

*Source: Company, Sharekhan Research*

### Order Book to Revenue ratio (x)



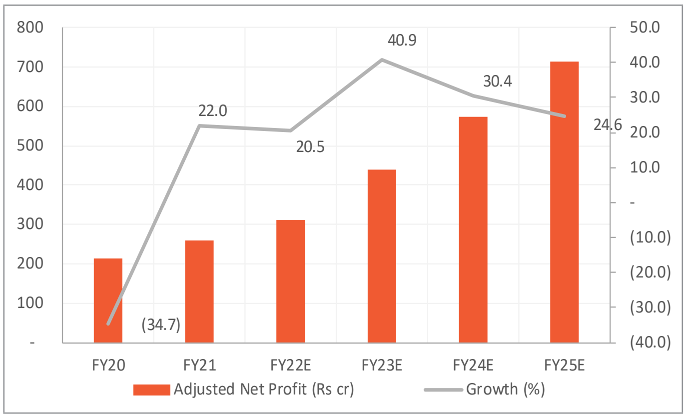

*Source: Company, Sharekhan Research*

### Operating profit and margin trend



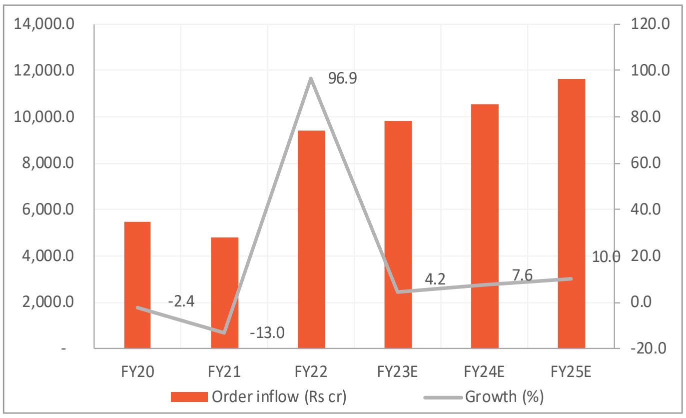

*Source: Company, Sharekhan Research*

### Net profit growth trend




*Source: Company, Sharekhan Research*

### Order inflow trend




*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 & development and PLI package will support the demand in the coming quarters. The government's National Infrastructure Plan (NIP), where total capital expenditure is projected at ~Rs. 111 lakh crore during FY2020-2025 also augurs well for growth of capital goods players.s During the same period, sectors such as energy (24%), roads (18%), urban (17%), and railways (12%) would amount to ~71% of projected infrastructure investments in India. The huge outlay towards infrastructure is expected to provide healthy growth opportunities for companies in the space.

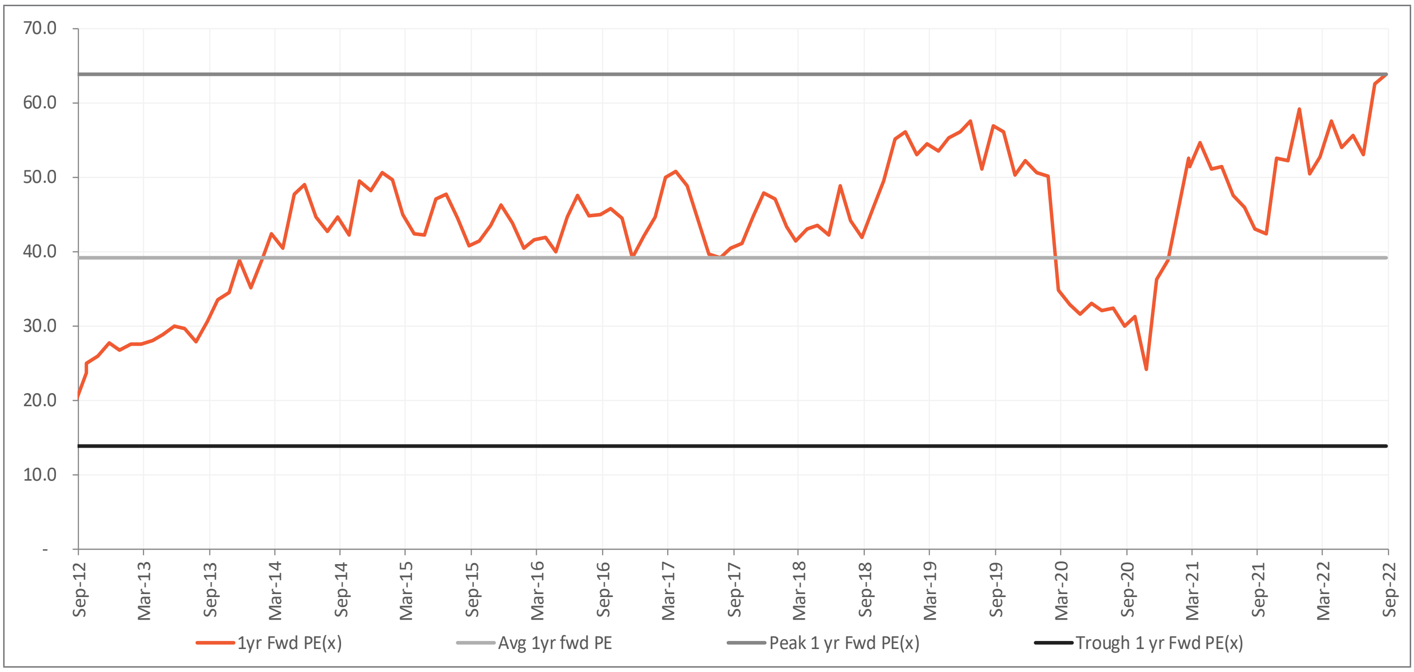
### ■ Company Outlook – Capitalising on opportunities

Management commentary on the enquiries pipeline remains positive for small ticket-size orders across food processing, chemicals and pharmaceuticals 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 a revised PT of Rs. 2,940

Thermax boasts of a healthy order book and has a promising enquiry pipeline 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. Thermax is expected to benefit from India's transition to green energy as it has many offerings in the space. International opportunities in biomass, waste heat recovery (WHR) and water desalination also remain strong. 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. Thermax currently trades at ~46x September 2024E EPS. Given the robust financials and ample business opportunities, we expect Thermax to trade at a premium. Therefore, we reiterate our Buy rating on the stock with a revised PT of Rs. 2,940, valuing the stock on its September 2024E EPS.

**One-year forward P/E (x) band**




*Source: Company, 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 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 Website*

**Top 10 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | Kotak Mahindra Trustee Co Ltd | 7.03 |
| 2 | Nalanda India Equity Fund Limited | 6.86 |
| 3 | SBI Magnum Midcap Fund | 2.43 |
| 4 | Tata Aia Life Insurance Company Ltd | 1.63 |
| 5 | Kotak Mahindra Trustee Co Ltd | 7.03 |
| 6 | Nalanda India Equity Fund Limited | 6.86 |
| 7 | L&T Mutual Fund Trustee Limited | 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*

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