Stock Update | Management meet note

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Thermax Ltd

Geared up for green energy shift

Capital Goods	Sharekhan code: THERMAX
Reco/View: Buy ↔	CMP: Rs. 2,261	Price Target: Rs. 2,790 ↔

↑ 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	31.25
Updated Feb 08, 2023	
High Risk	

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

Source: Morningstar

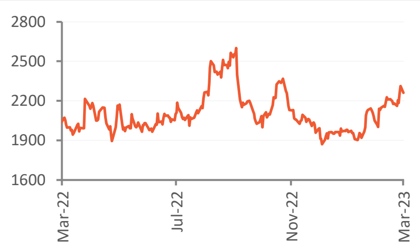
Company details

Market cap:	Rs. 26,940 cr
52-week high/low:	Rs. 2,679/1,831
NSE volume: (No of shares)	0.64 lakh
BSE code:	500411
NSE code:	THERMAX
Free float: (No of shares)	4.5 cr

Shareholding (%)

Promoters	62.0
FII	17.8
DII	15.3
Others	4.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	12.8	18.0	-9.9	14.9
Relative to Sensex	17.7	23.5	-8.4	14.7

Sharekhan Research, Bloomberg

Summary

- Our meeting with Thermax' CFO – Mr. Rajendran Arunachalam provided us insights into company's strategy to scale up its green energy offerings through existing verticals as well as opex based model in solar and biomass.
- Order backlog is at Rs. 9,859 crore and order intake expectations for small to mid-sized orders are high given strong enquiry flow from chemicals, pharmaceuticals, sugar, distilleries and water segments.
- OPM would improve led by better operating leverage, favorable product mix (more of products and services) and stability in commodity prices.
- We maintain a Buy on Thermax with an unchanged PT of Rs. 2,790, valuing the stock on its September 2024E EPS given multiple growth levers, healthy working capital cycle and balance sheet.

We met Thermax' CFO – Mr. Rajendran Arunachalam and discussed Thermax's expansion plans in green energy and other avenues. Currently, Thermax's 74% of the order book caters to green energy business. Thermax's order backlog increased by 1.6x in FY22 after stagnating for almost 4 years. As per the management, while the large order pipeline (more than Rs 250-300 crore) is shrinking, the company is confident that small to mid-ticket size orders in alternative energy solutions would lead to decent order inflow growth in the long term. Further, private-sector capex which has always been Thermax's mainstay has started to pick up and that would benefit the company. In addition, the company is focused on growing its products and services businesses, which have cost pass-through, thus commanding higher margins. Thermax is debt-free, has low working capital cycle and healthy balance sheet.

- **Green energy solutions – The way forward:** India eyes a renewable energy capacity of 500 GW (currently ~101GW excluding large hydro capacities) by 2030. In addition, cement, steel, chemical and other heavy industries accounts for almost a quarter of India's 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. Moreover, the company is transitioning from capex to a solution-based opex model in the solar and bio-mass segments through its subsidiaries - FEPL and TOESL.
- **Robust order book and small to mid-sized order pipeline is encouraging:** Thermax's order backlog stood at Rs. 9,859 crore at the end of Q3FY23, while order intake declined 10% y-o-y to Rs. 2,204 crore. Order inflow had a healthy mix of orders from diverse industry sectors such as metals and steel (10%), refinery and petrochemical (10%), sugar/distillery (12%), fertilizer (15%), food and beverages (7%), and transportation (8%) among others. The company stated that the pipeline seems to be moderating, particularly for large orders in the refineries, petrochemicals and steel sectors. However, there is lot of action taking place in biomass, sugar, distilleries, water, solar, and other renewable industries side, which should help the company achieve a reasonable order inflow run rate in the medium to long term. Further, in order bookings, the share of products & services is on a constant rise and the company is hopeful of increasing traction in products and services businesses, which have better margins and the cost is largely a pass through.
- **Margin to improve backed by operating leverage and increase in services:** Thermax's project order book is largely fixed in nature and thus it is vulnerable to spike in commodity prices; thereby impacting Thermax's profitability. However, as commodity prices have declined from their peaks, Thermax's margin are likely to improve going forward. Further, robust revenue growth on back of all-time high order book should see margins inching up in the coming quarters. Profitability of subsidiaries is also likely to improve with the improvement in scale and better margin orders.

Revision in estimates – We have maintained our estimates for FY2023-FY2025E.

Our Call

Valuation – Retain Buy with an unchanged PT of Rs. 2,790: Thermax is expected to benefit from India's transition to green energy as it has many offerings in the space. Further, its foray into the solar and biomass opex model would diversify its revenue base. International opportunities in biomass, waste heat recovery (WHR) and water desalination also remain strong. Thermax has a promising enquiry pipeline for small ticket-size orders in cement, biomass, paper and pulp, and sugar. In the long term, we believe margin improvement, exports growth, and increasing contribution from products as well as services business would aid profitability. Given that robust financials and ample business opportunities, we expect Thermax to trade at a premium. In the long term, Thermax with its strong execution and technological capabilities in green energy and the wastewater industry should be able to deliver strong performance. Further, robust financials in terms of healthy cash balance and balance sheet give us confidence. Hence, we maintain a Buy rating on the stock with an unchanged price target (PT) of Rs. 2,790, 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	7.1	7.5	8.1
Adj. Net Profit	312	422	537	681
% Growth y-o-y	20.5	35.0	27.5	26.8
Adj. EPS (Rs.)	26.2	35.4	45.1	57.2
PER (x)	86.3	63.9	50.1	39.5
P/B (x)	9.0	8.4	7.6	6.7
EV/EBIDTA (x)	44.3	35.7	28.8	23.1
ROCE (%)	14.8	18.4	20.8	23.5
RONW (%)	10.7	13.6	16.0	18.1

Source: Company; Sharekhan estimates

Key management meet takeaways

- **Exploring opportunities in solar opex based model:** Thermax is expanding its solar business under its subsidiary- First Energy Private Ltd. (FEPL) by transitioning from the rooftop-based capex model to a solution-based opex model. In this domain, Thermax will be competing with companies like ReNew (Indian arm of ReNew Energy Global Plc), Greenko, etc. The company would be targeting only industrial customers, which want to set up solar power plants due to price differential in grid electricity and solar power or due to green initiatives. The company would do design, engineering, assembling and commissioning of the plants using its own technology. Typically, lifecycle of these plants is 25 years.
- **Amount of equity & debt in new subsidiaries:** Thermax Onsite Energy Solutions Limited (TOESL) has Rs. 200 crore of total investment with 50:50 debt/equity. FEPL would have debt/equity of 70:30 with Rs. 100 crore invested as equity.
- **Pursuing other alternate energy options:** Thermax is also working on waste to energy, which is its forte. The company competes with players like ISGEC Heavy Engineering, Bharat Heavy Electricals Ltd. (BHEL) and Cheema Boilers Ltd. in this segment. Also, it has wide offerings and technological capabilities in desalination. Further, the company has solutions for coal gasification, gas segregation and gas cleaning.
- **Biomass or combined power plants orders are increasing:** The company has seen an uptick in demand and inquiries for bio-mass or combined power plant orders although supply chain challenges exist on the biomass front regarding availability of raw material. Many orders from cement and sponge iron are coming in this vertical. The company is also seeing increase in enquiries for CFBC boilers. The boilers for combined biomass and coal power plants have fuel flexibility, require low maintenance and are cost effective.
- **Hopeful of stable growth in order inflows in FY24:** In FY23, Thermax may end with a flattish or decline of 5-7% in its order inflow despite absence of large orders as compared to FY22. The company has decent visibility of the orders in FY24 and believes that if the capex cycle is stable, it may end up FY24 with reasonably fair order inflow growth as it has a strong pipeline in Rs 50-100 crore sized orders. On the exports front, a high-value order pipeline is weak but the company has decent order pipeline in small to mid-segment.
- **No visibility for FGD orders from private sector:** All central government plants have transitioned to FGD systems and therefore Thermax does not envisage any orders on that front. SC guidelines with regards to private sector plants is still not clear and therefore the company does not expect any fresh orders till the policy clarity comes in.
- **Chemical business update:** Slowdown in some of the export markets has impacted its chemical segment but the situation has been improving gradually.
- **Focus on increasing services revenue:** Thermax is also focusing on increasing revenue from its services business as the installed base increases, since it helps generate faster cash and higher margins.
- **MoU with FFI would take time to fructify:** Thermax and Fortescue Future Industries (FFI), an Australia-based green energy and green technology company, have signed a Memorandum of Understanding (MoU) to explore green hydrogen projects – including new manufacturing facilities – in India. As per Thermax, viability of green hydrogen is yet to be determined in India in terms of cost and technology. FFI is currently putting up a facility in Australia and Thermax will explore solutions with the former for large

energy guzzlers like steel, cement industries; etc. Further, Europe also plans to put some restrictions on high carbon imports which may encourage some Indian players/ industries to opt for greener solutions like green hydrogen.

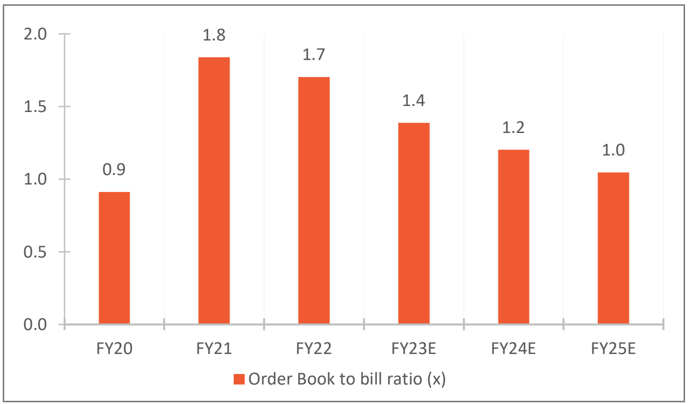
- **Margins to rise led by operating leverage and change in revenue mix:** The company expects margin to improve in-line with rise in revenues backed by strong order book. Moreover, increase in contribution of short cycle orders and products would reduce the raw material volatility risk to a certain extent.

Diverse and robust order book would lead to strong revenue growth

Order book rose by 33% y-o-y to Rs. 9,859 crore at the end of Q3FY23, while order intake declined 10% y-o-y to Rs. 2,204 crore as last year there was a large order of ~Rs. 830 crore for FGD systems. Order inflows had a healthy mix of orders from diverse industry sectors such as metals and steel (10%), refinery and petrochemical (10%), sugar/distillery (12%), fertiliser (15%), food and beverages (7%), refinery and petrochemicals (10%), and transportation (8%) among others. The company's enquiry pipeline from cement, and chemical sectors continues to be good due to increased capex plans in the private sector. However, the company stated that the pipeline seems to be moderating, particularly for large orders in refinery, petrochemical as well as steel sectors. However, there is lot of action taking place in biomass, sugar, distilleries, water, solar, and other renewable industries side, which should help the company achieve a reasonable order inflow run rate in the near to medium term.

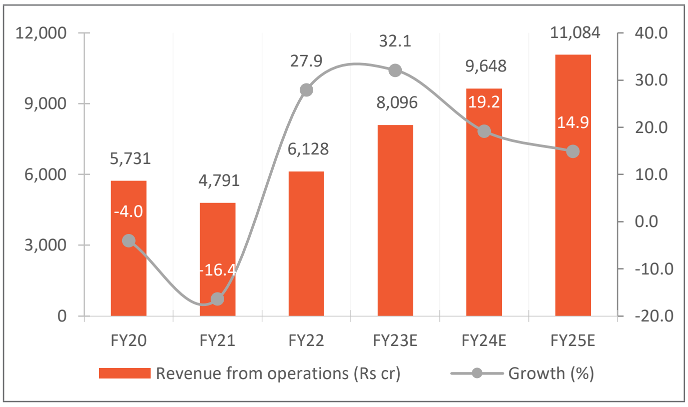
Financials in charts

Order Book to Revenue ratio (x)



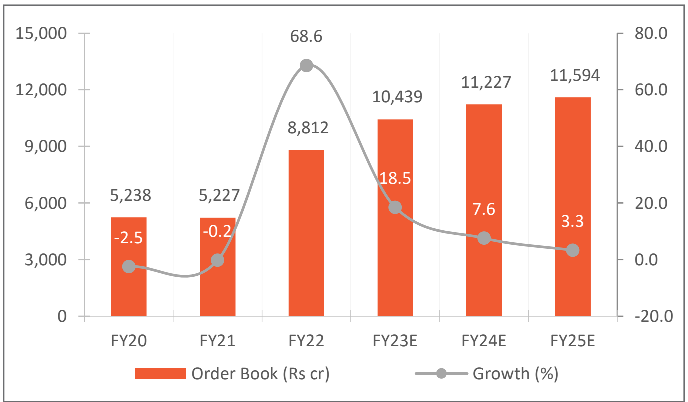
Source: Company, Sharekhan Research

Revenue growth trend



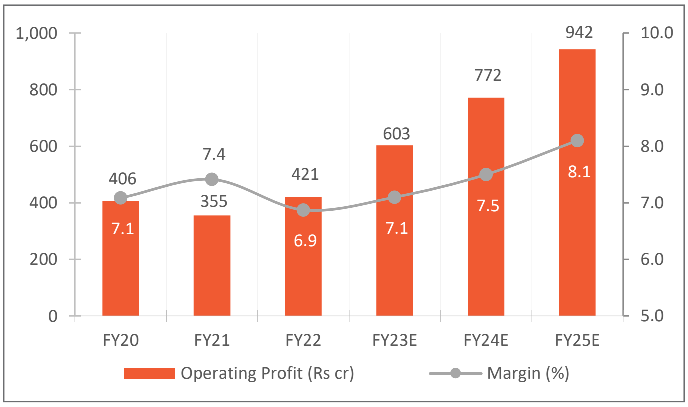
Source: Company, Sharekhan Research

Order book growth trend



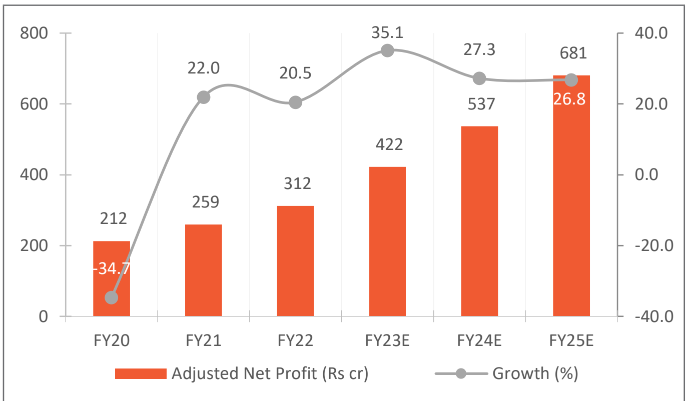
Source: Company, Sharekhan Research

Operating profit and margin trend



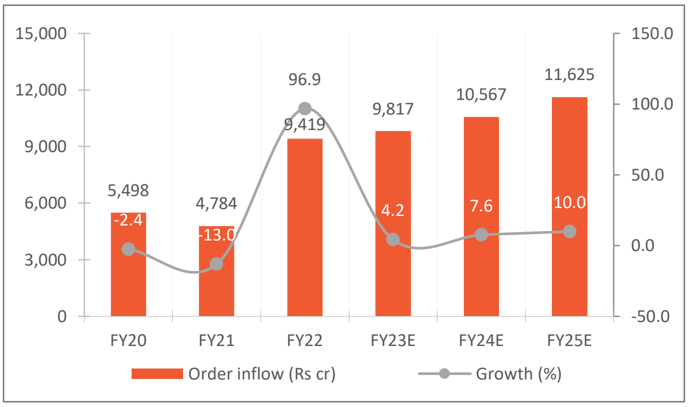
Source: Company, Sharekhan Research

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 and 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 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 the 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 projected infrastructure investments in India. The huge outlay towards infrastructure is expected to provide healthy growth opportunities for companies in the space.

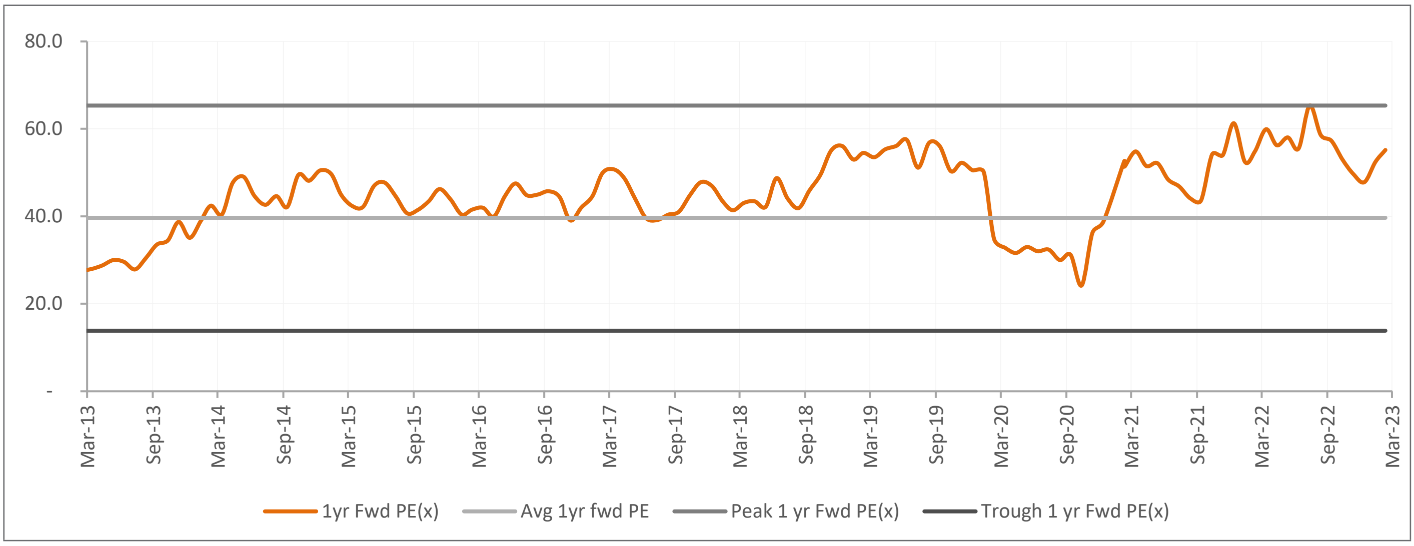
Company Outlook – Capitalising on opportunities

Management commentary on the inquiries pipeline remains positive for small ticket-size orders across food processing, chemicals, and pharmaceuticals in domestic markets. Management highlighted opportunities in waste heat recovery, CFBC boilers, biomass in both domestic and export markets. On the commodity front, management highlighted that there are challenges due to commodity headwinds. However, the company can hedge the price for more minor contracts as it buys the material in around 30 days before signing the agreement. Thermax is also contemplating opportunities across newer and green technologies such as opex based model in solar and biomass, green hydrogen; etc which will provide the next leg of growth.

Valuation – Retain Buy with an unchanged PT of Rs. 2,790

Thermax is expected to benefit from India's transition to green energy as it has many offerings in the space. Further, its foray into the solar and biomass opex model would diversify its revenue base. International opportunities in biomass, waste heat recovery (WHR) and water desalination also remain strong. Thermax has a promising enquiry pipeline for small ticket-size orders in cement, biomass, paper and pulp, and sugar. In the long term, we believe margin improvement, exports growth, and increasing contribution from products as well as services business would aid profitability. Given that robust financials and ample business opportunities, we expect Thermax to trade at a premium. In the long term, Thermax with its strong execution and technological capabilities in green energy and the wastewater industry should be able to deliver strong performance. Further, robust financials in terms of healthy cash balance and balance sheet give us confidence. Hence, we maintain a Buy rating on the stock with an unchanged price target (PT) of Rs. 2,790, valuing the stock on its September 2024E EPS.

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 the 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, the Middle East, CIS countries, Europe, the U.S., and South America.

Investment theme

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 orders and enquiry pipeline from metals, cement, chemical, pharmaceuticals and refinery sectors.

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	RDA Holdings Pvt Ltd	53.99
2	Kotak Mahindra Asset Management Co Ltd	6.97
3	Nalanda India Equity Fund Ltd	6.86
4	SBI Funds Management Ltd	2.48
5	Vanguard group Inc	1.20
6	FundRock Management Co SA	1.14
7	Tata AIA Life Insurance Co Ltd	1.08
8	Mirae Asset Global Investments Co Ltd	0.83
9	Tata Asset Management Pvt Ltd	0.71
10	L&T Mutual Fund Trustee Ltd	0.65

Source: Bloomberg

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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