

THERMAX

Danstoker acquisition; an eye on the future

Event: Thermax announces acquisition of Danstoker (Denmark) for EUR 29.5 mn

■ Attractive buyout from a strategic long-term perspective

Danstoker specializes in the manufacture of boilers using oil and gas, biomass and waste heat recovery products. The deal valuation stands at 0.7x sales and around 8x EBITDA on YE Sept, 2010 basis, which we believe is fairly attractive, given Danstoker's huge potential in terms of its overall product portfolio and strong client reference base across Europe, Middle-East and South East Asia. Thermax now not only has access to a wide range of products through Danstoker, which will enable it to leverage and reap benefits of both European Union's aim of 20% energy generation from renewable by 2020, but also to the latter's global client base for its Indian products. Europe has a total market size of EUR 370 mn annually in the heating segment, of which a large chunk comes from Denmark, Germany and Sweden, where Danstoker has 50%, 20% & 20% market share, respectively.

■ Acquisition to optimise future revenue mix

The company currently derives around 11-12% of its consolidated revenue from the heating segment at INR 3.8 bn in FY10, which is expected to be INR 4.5 bn in FY11E (ex Danstoker) and around INR 5.7 bn (Including six months of Danstoker revenues) for FY11E. Management is hopeful of posting INR 10 bn revenue in the next two years in the heating segment, which will be sufficient to keep the overall share of products business (heating) intact, despite a strong growth in the company's EPC segment.

■ Outlook & valuations: Attractive long-term bet; maintain 'BUY'

While Thermax is currently passing through a high growth phase in both profits and future revenue growth visibility, the Danstoker acquisition, we believe, augurs well for its blended business mix, which is now more skewed towards EPC orders. The company expects to balance its revenues mix between products and EPC portion in the medium to long term, which we believe is possible, especially post the recent acquisition. Thermax not only has product and market advantage in terms of the Danstoker business, it also has a huge opportunity of exploring key global markets for its existing domestic portfolio. The stock trades at a PE of 27.0x & 20.5x on FY11E & FY12E earnings, respectively. We maintain 'BUY/Sector Outperformer' recommendation/rating on the stock.

Financials

Year to March	FY09	FY10	FY11E	FY12E
Revenues (INR mn)	34,603	33,703	50,055	65,803
Rev. growth (%)	(0.6)	(2.6)	48.5	31.5
EBITDA (INR mn)	4,219	3,947	5,985	7,687
Net profit (INR mn)	2,876	2,588	3,888	5,124
Share outstanding (mn)	119	119	119	119
EPS (INR)	24.1	21.8	32.5	42.9
EPS growth (%)	(0.4)	(9.9)	49.6	31.8
P/E (x)	36.4	40.4	27.0	20.5
EV/EBITDA (x)	23.6	23.9	16.0	11.7
ROAE (%)	32.9	25.0	31.4	31.7

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Reuters: THMX.BO Bloomberg: TMX IN

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	Low
Sector Relative to Market	Overweight

Note:
Please refer last page of the report for rating explanation

MARKET DATA

CMP	:	INR 879
52-week range (INR)	:	930 / 465
Share in issue (mn)	:	119.2
M cap (INR bn/USD mn)	:	105 / 2,361
Avg. Daily Vol. BSE/NSE ('000):	:	103.9

SHARE HOLDING PATTERN (%)

Promoters*	:	62.0
MFs, FIs & Banks	:	15.2
FIIIs	:	9.1
Others	:	13.7
* Promoters pledged shares (% of share in issue)	:	NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Capital Goods Index
1 month	11.0	2.8	(0.7)
3 months	17.3	15.3	6.7
12 months	64.0	30.8	24.4

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- **Marginal change in our FY11E and FY12E consolidated numbers**

We are revising up our FY11E and FY12E earnings marginally by 1% and 3.8%, respectively, building in six months numbers for Danstoker in FY11E and 12 months numbers for FY12E. While there is no material immediate contribution to the bottom line from the acquisition, we perceive it as a strong value add to Thermax's existing business set up, more from a medium to long term.

- **About Danstoker and its subsidiary**

Headquartered in Herning (Denmark), **Danstoker** has a 75 year track record in manufacturing biomass-based boilers and waste heat recovery systems for a wide range of industries. The company has products in the 200-100,000 kg range of steam per hour and design pressures of up to 86 bars. It has manufacturing facilities in Denmark and Germany. Danstoker reported revenue of EUR 40 mn for YE September 2010, with 9.3% EBIDTA margins and PAT of EUR 3.2 mn, with an absolute debt of EUR 3.5 mn . It derives around 34% of revenue from bio mass plants, 20% from waste heat recovery, 30% from oil & gas and balance from coal plants. The company derives 35% of revenue from the German market, 25% from Denmark, 14% from Sweden and the balance from other European region.

Omnical, a subsidiary of Danstoker, specializes in boilers using oil and gas, biomass and is also into waste heat recovery systems. It adds huge value to the parent in terms of its strong client base in European and Japanese gas turbine markets for waste heat recovery systems.

- **Company Description**

TMX provides solutions in the energy and environment space. The energy business contributes ~80% to revenues, whereas the environment business contributes ~20%. Further, 20% of revenues are from products and 80% of revenues are from projects. The company's market share for chillers is 90%, 35-38% for boilers and heaters, 8% for water and waste water, 35% for chemicals, and ~60% for air treatment divisions.

- **Investment Theme**

While we believe TMX's long-term story remains strong, driven by investments in corporate capex and captive power and power generation in the Indian economy. We believe scale up in the utility range boilers is likely to improve revenue visibility and valuations of TMX over the long term. Further the scalability of the business model is likely to improve significantly with the foray in the utility boiler segment.

- **Key Risks**

The execution of large projects in the utility boiler space is likely to test the project management skills of TMX. We believe any slip in execution of large projects may impact the return ratios negatively for the company.

The execution of large utility projects entails, higher working capital requirement, which is significantly different from the company's current business model. Over the year one of the key positives of TMX's business model has been the 'negative working capital' cycle.

Higher key policy rates, by way of monetary policy actions, are likely to delay order accretion. This, in turn, could impact our revenues and earnings estimates negatively.

Financial Statements

Income statement					(INR mn)
Year to March	FY08	FY09	FY10	FY11E	FY12E
Income from operations	34,815	34,603	33,703	50,055	65,803
Direct costs	22,202	20,802	20,271	30,577	40,692
Employee costs	2,672	2,882	3,300	4,092	5,055
Other Expenses	5,674	6,701	6,186	9,401	12,369
Total operating expenses	30,548	30,384	29,756	44,071	58,116
EBITDA	4,267	4,219	3,947	5,985	7,687
Depreciation and amortisation	232	351	442	588	658
EBIT	4,035	3,867	3,505	5,397	7,029
Other income	439	404	519	467	678
Interest expenses	17	38	20	26	36
Profit before tax	4,458	4,233	4,004	5,838	7,671
Provision for tax	1,571	1,357	1,416	1,950	2,547
Core profit	2,887	2,876	2,588	3,888	5,124
Extraordinary income/ (loss)	21	14	(1,149)	-	-
Profit after tax	2,908	2,889	1,439	3,888	5,124
Minority Interest	-	-	(4)	11	15
Profit after minority interest	2,908	2,889	1,443	3,877	5,110
Adjusted PAT	2,887	2,876	2,592	3,877	5,110
Basic shares outstanding (mn)	119	119	119	119	119
Basic EPS (INR)	24.2	24.1	21.8	32.5	42.9
Diluted equity shares (mn)	119	119	119	119	119
Diluted EPS (INR)	24.2	24.1	21.8	32.5	42.9
CEPS (INR)	25.0	25.7	24.2	37.6	48.5
Dividend per share (INR)	8.0	5.0	5.0	5.0	5.0
Dividend payout (%)	0.3	0.2	0.2	0.2	0.1

Common size metrics					
Year to March	FY08	FY09	FY10	FY11E	FY12E
Operating expenses	87.7	87.8	88.3	88.0	88.3
Employee expenses	7.7	8.3	9.8	8.2	7.7
S G & A expenses	16.3	19.4	18.4	18.8	18.8
Direct Cost	63.8	60.1	60.1	61.1	61.8
Depreciation	0.7	1.0	1.3	1.2	1.0
Interest expenditure	-	0.1	0.1	0.1	0.1
EBITDA margins	12.3	12.2	11.7	12.0	11.7
EBIT margins	11.6	11.2	10.4	10.8	10.7
Net profit margins	8.3	8.3	7.7	7.8	7.8

Growth ratios (%)					
Year to March	FY08	FY09	FY10	FY11E	FY12E
Revenues	49.6	(0.6)	(2.6)	48.5	31.5
EBITDA	47.7	(1.1)	(6.4)	51.6	28.4
PBT	46.7	(5.0)	(5.4)	45.8	31.4
Net profit	44.9	(0.4)	(10.0)	50.3	31.8
EPS	44.3	(0.4)	(9.9)	49.6	31.8

Balance sheet**(INR mn)**

As on 31st March	FY08	FY09	FY10	FY11E	FY12E
Equity capital	238	238	238	238	238
Reserves & surplus	7,357	9,686	10,544	13,723	18,136
Shareholders funds	7,595	9,924	10,782	13,962	18,374
Minority interest (BS)	-	-	94	105	119
Secured loans	-	-	80	680	680
Unsecured loans	-	41	-	-	-
Borrowings	-	41	80	680	680
Deferred tax liability	134	160	144	144	144
Sources of funds	7,729	10,125	11,099	14,890	19,317
Gross block	4,328	6,615	7,418	9,632	10,782
Depreciation	1,450	1,704	2,048	2,636	3,294
Net block	2,878	4,911	5,369	6,996	7,489
Capital work in progress	607	177	115	-	-
Total fixed assets	3,485	5,088	5,484	6,996	7,489
Investments	5,601	1,443	3,703	4,064	4,460
Inventories	2,100	2,805	2,563	4,466	5,310
Contract in Progress	693	2,462	3,181	5,692	7,434
Sundry debtors	5,305	5,719	7,984	14,061	17,756
Cash and equivalents	580	3,696	6,702	5,805	10,976
Loans and advances	2,189	2,224	3,282	5,204	6,764
Other current assets	324	410	594	911	1,184
Total current assets	11,191	17,316	24,306	36,139	49,424
Sundry creditors and others	6,419	6,621	10,325	14,218	18,529
Customer advance	4,798	6,145	11,085	16,627	21,615
Provisions	1,372	957	985	1,464	1,912
Total current liabilities & provisions	12,588	13,723	22,394	32,309	42,056
Net current assets	(1,397)	3,593	1,912	3,830	7,368
Others	40	1	-	-	-
Uses of funds	7,729	10,125	11,099	14,890	19,317
Book value per share (INR)	63.7	83.3	90.5	117.2	154.2

Free cash flow**(INR mn)**

Year to March	FY08	FY09	FY10	FY11E	FY12E
Net profit	2,908	2,889	1,443	3,877	5,110
Depreciation	232	351	442	588	658
Deferred tax	(134)	(160)	(144)	-	-
Others	(67)	(72)	869	(429)	(628)
Gross cash flow	2,939	3,009	2,610	4,035	5,140
Less: Changes in WC	1,531	1,404	(3,709)	2,815	(1,632)
Operating cash flow	1,408	1,606	6,319	1,220	6,772
Less: Capex	1,918	1,915	840	2,100	1,150
Free cash flow	(510)	(309)	5,479	(880)	5,622

Cash flow metrics

Year to March	FY08	FY09	FY10	FY11E	FY12E
Operating cash flow	1,408	1,606	6,319	1,220	6,772
Investing cash flow	(1,393)	2,628	(2,627)	(1,993)	(869)
Financing cash flow	(407)	(1,118)	(686)	(124)	(733)
Net cash flow	(392)	3,116	3,006	(897)	5,170
Capex	1,918	1,915	840	2,100	1,150
Dividends paid	1,115	697	697	697	697

Profitability & efficiency ratios

Year to March	FY08	FY09	FY10	FY11E	FY12E
ROAE (%)	42.9	32.9	25.0	31.4	31.7
ROACE (%)	58.8	43.3	33.0	41.5	41.1
Inventory day	35	43	48	42	44
Debtors days	49	58	74	80	88
Payable days	91	114	153	146	147
Cash conversion cycle (days)	(7)	(13)	(30)	(24)	(15)
Current ratio	0.9	1.3	1.1	1.1	1.2
Debt/EBITDA	-	-	-	0.1	0.1
Fixed asset turnover (x)	15.3	8.9	6.6	8.1	9.1
Interest coverage	244.6	101.5	172.7	204.5	197.3

Operating ratios

Year to March	FY08	FY09	FY10	FY11E	FY12E
Total asset turnover	5.1	3.9	3.2	3.9	3.8
Fixed asset turnover	15.3	8.9	6.6	8.1	9.1
Equity turnover	5.2	4.0	3.3	4.0	4.1

Du pont analysis

Year to March	FY08	FY09	FY10	FY11E	FY12E
NP margin (%)	8.3	8.3	7.7	7.8	7.8
Total assets turnover	5.1	3.9	3.2	3.9	3.8
Leverage multiplier	1.0	1.0	1.0	1.1	1.1
ROAE (%)	42.9	32.9	25.0	31.4	31.7

Valuation parameters

Year to March	FY08	FY09	FY10	FY11E	FY12E
Diluted EPS (INR)	24.2	24.1	21.8	32.5	42.9
Y-o-Y growth (%)	44.3	(0.4)	(9.9)	49.6	31.8
CEPS (INR)	25.0	25.7	24.2	37.6	48.5
Diluted PE (x)	36.3	36.4	40.4	27.0	20.5
Price/BV (x)	13.8	10.6	9.7	7.5	5.7
EV/Sales (x)	2.9	3.0	2.9	2.0	1.4
EV/EBITDA (x)	23.1	23.6	23.9	16.0	11.7
Dividend yield (%)	0.9	0.6	0.6	0.6	0.6



RATING & INTERPRETATION

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
ABB India	HOLD	SU	L	AIA Engineering	BUY	SO	M
Bajaj Electricals	BUY	SO	M	BGR Energy Systems	BUY	SO	M
Bharat Heavy Electricals	BUY	SO	L	Crompton Greaves	BUY	SO	L
Cummins India	BUY	SO	L	Havell's India	BUY	SO	M
Jyoti Structures	HOLD	SP	M	Kalpataru Power Transmission	HOLD	SP	M
KEC International	BUY	SO	M				
Larsen & Toubro	HOLD	SP	L	Punj Lloyd	REDUCE	SU	M
				Siemens	HOLD	SU	L
Techno Electric & Engineering	BUY	SO	M				
Thermax	BUY	SO	L	Voltamp Transformers	HOLD	SU	M
Voltas	BUY	SU	L				

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return



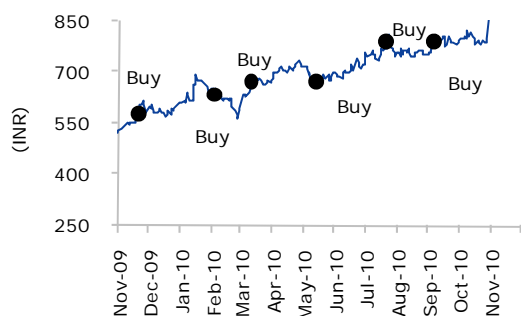
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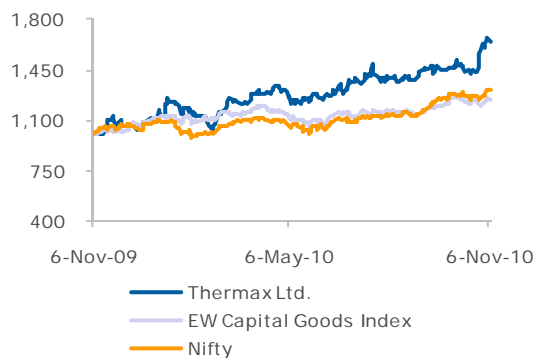
Coverage group(s) of stocks by primary analyst(s): Engineering and Capital Goods

ABB India, AIA Engineering, BGR Energy Systems, Bharat Heavy Electricals, Bajaj Electricals, Crompton Greaves, Havell's India, Jyoti Structures, KEC International, Cummins India, Kirloskar Oil Engines, Kalpataru Power Transmission, Larsen & Toubro, Punj Lloyd, Sanghvi Movers, Siemens, Techno Electric & Engineering, Thermax, Texmaco, Voltamp Transformers, Voltas

Thermax



EW Indices



Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	116	45	12	176
* 3 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	110	53	13	

Recent Research

Date	Company	Title	Price (INR)	Recos
03-Nov-10	KEC Intl.	Core performance intact; encouraging outlook; <i>Result Update</i>	494	Buy
02-Nov-10	Punj Lloyd	Execution deferment continues; we remain negative; <i>Result Update</i>	124	Reduce
02-Nov-10	Havells India	Sylvania lights up; <i>Result Update</i>	413	Buy

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