

THERMAX*The next big leap*

Following are key highlights of our recent meeting with the management of Thermax:

- **Super-critical facility to be announced soon**

Thermax has identified land at two locations, measuring ~85 acres (each) for its greenfield super-critical plant with an installed capacity of 3,000 Mw. The facility is scheduled to commence operations at either of the two locations by March 2012. Moreover, the JV with Babcock has already achieved legal status and is duly registered under the Indian Companies Act. While the company will bid for the 800x9 NTPC bulk tender due in September 2010, it will also increase its focus on the private sector orders in the super-critical space in near future.

- **Strong execution expected in FY11E**

This is likely to be led by healthy new order growth in the past 3-4 quarters (FY10 new order grew 51% Y-o-Y, to INR 58 bn). The company expects to complete major portion of the Essar order (INR 3.9 bn) in FY11E. Also, the Meenakshi order (INR 10 bn) is expected to be 50% complete by FY11E end and the balance in H1FY12E. The company expects to execute INR 5.8 bn gas-based combined cycle power project in the next 20-22 months, while the Brahamani order (INR 2.9 bn) is still on hold. We expect the company to see a strong 40-45% growth in revenues in FY11, which is more than the consensus estimates (FY11 consensus revenue growth at 33%). The new plant at Savli commenced manufacturing in Q4FY10 (installed capacity at 1,500 Mw) and would contribute to strong execution in FY11E and FY12E for the company.

- **Turnkey jobs in super-critical**

While the company will target boiler packages in the super-critical orders, the turbine supply tie-up would be project specific and on a case-to-case basis, depending upon the client requirement. This is in line with Thermax's current business strategy, wherein it procures turbines recommended by the client.

- **Outlook and valuations: The next big leap; BUY**

We are excited about Thermax's overall business growth momentum and believe the company will be able to position itself as an important and material player in the higher rating sub-critical and super-critical space. While the company is set to see a strong traction in execution growth over the next 4-6 quarters, order book growth, apart from momentum in the industrial captive business, would also be contributed by higher rating boiler orders. With an order book of INR 70 bn (2.1x FY10 revenues), Thermax is currently trading at P/E of 25x and 19x FY11E and FY12E earnings, respectively. We have a 'BUY' rating on the stock

September 6, 2010

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 792
52-week range (INR)	:	850 / 445
Share in issue (mn)	:	119.2
M cap (INR bn/USD mn)	:	94 / 2,030
Avg. Daily Vol. BSE/NSE ('000):	:	113.7

SHARE HOLDING PATTERN (%)

Promoters*	:	62.0
MFs, FIs & Banks	:	15.3
FIIIs	:	9.0
Others	:	13.7
* Promoters pledged shares (% of share in issue)	:	NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Capital Goods Index
1 month	(3.4)	1.9	(0.2)
3 months	9.8	10.1	5.0
12 months	3.8	18.3	13.5

Financials

Year to March	FY09	FY10	FY11E	FY12E
Revenues (INR mn)	34,603	33,703	48,675	62,836
Rev. growth (%)	(0.6)	(2.6)	44.4	29.1
EBITDA (INR mn)	4,219	3,947	5,861	7,420
Net profit (INR mn)	2,876	2,588	3,847	4,937
Share outstanding (mn)	119	119	119	119
EPS (INR)	24.1	21.8	32.2	41.3
EPS growth (%)	(0.4)	(9.9)	48.0	28.3
P/E (x)	32.8	36.4	24.6	19.2
EV/EBITDA (x)	21.2	21.3	14.2	10.6
ROAE (%)	32.9	25.0	31.1	30.8

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■ **Captive power & air pollution business**

The company expects the 3,000 Mw per annum captive power equipment market to grow at 15-20% per annum. Currently, it has almost one-third market share in the overall captive power space, where it commands a strong client reference base; in this segment, the company provides a complete package of boilers, water treatment plant, air pollution control systems, BoP etc. Air pollution control equipment currently accounts for ~10% of the company's revenues. While the company expects the air pollution equipment industry to grow at 15% annually, it is targeting a higher growth for itself from this segment as reflected in its increased focus and recent business ventures.

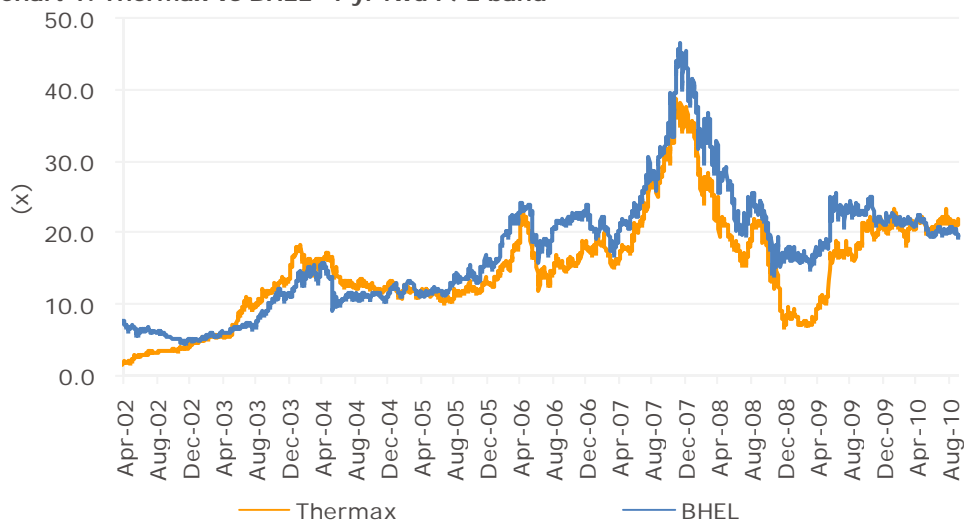
■ **We build in superior execution growth rates for FY11E & FY12E**

We revise our revenue growth for Thermax for FY11E & FY12E, by 8% & 9%, respectively, implying a superior revenue growth of 45% YoY & 30% YoY for FY11E & FY12E, respectively. Thermax's increased execution capabilities, coupled with a strong traction in the new orders, would help it report a sustainable superior growth in revenues over the next few years.

■ **Valuations to remain strong**

Thermax's strong business dynamics reflected by superior execution and superior new order growth in last few quarters has been responsible for a reduction in valuation gap vis a vis peer companies in the capital goods space (Thermax has historically traded at a 20% discount to BHEL, while it is currently trading at par with BHEL). We expect Thermax to continue command the current valuations, given strong earnings growth in FY11E & FY12E, also we believe, its ability to maintain a right mix of projects would augur well for its overall profitability and cash flows beyond FY12E and would further help its position amongst the key companies in the country in the large utility boiler space.

Chart 1: Thermax vs BHEL- 1 yr fwd P/E band



Source: Edelweiss research

- **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	48,675	62,836
Direct costs	22,202	20,802	20,271	29,680	38,763
Employee costs	2,672	2,882	3,300	3,982	4,818
Other expenses	5,674	6,701	6,186	9,153	11,835
Total operating expenses	30,548	30,384	29,756	42,815	55,416
EBITDA	4,267	4,219	3,947	5,861	7,420
Depreciation and amortisation	232	351	442	527	597
EBIT	4,035	3,867	3,505	5,334	6,823
Interest expenses	17	38	20	26	36
Other income	439	404	519	522	692
Profit before tax	4,458	4,233	4,004	5,829	7,480
Provision for tax	1,571	1,357	1,416	1,982	2,543
Core profit	2,887	2,876	2,588	3,847	4,937
Extraordinary items	21	14	(1,149)	-	-
PAT before minority interest	2,908	2,889	1,439	3,847	4,937
Minority interest	-	-	(4)	11	14
PAT after minority interest	2,908	2,889	1,443	3,836	4,922
Adjusted net profit	2,887	2,876	2,592	3,836	4,922
Basic shares outstanding (mn)	119	119	119	119	119
EPS (INR) basic	24.2	24.1	21.8	32.2	41.3
Diluted equity shares (mn)	119	119	119	119	119
EPS (INR) fully diluted	24.2	24.1	21.8	32.2	41.3
CEPS (INR)	25.0	25.7	24.2	36.7	46.4
Dividend per share	8.0	5.0	5.0	5.0	5.0
Dividend payout (%)	33.0%	20.7%	23.0%	15.5%	12.1%

Common size metrics- as % of net revenues

Year to March	FY08	FY09	FY10	FY11E	FY12E
Direct cost	63.8	60.1	60.1	61.0	61.7
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
Operating expenses	87.7	87.8	88.3	88.0	88.2
Depreciation and amortization	0.7	1.0	1.3	1.1	0.9
Interest expenditure	0.0	0.1	0.1	0.1	0.1
EBITDA margins	12.3	12.2	11.7	12.0	11.8
EBIT margins	11.6	11.2	10.4	11.0	10.9
Net profit margins (adjusted)	8.3	8.3	7.7	7.9	7.9

Growth metrics (%)

Year to March	FY08	FY09	FY10	FY11E	FY12E
Revenues	49.6	(0.6)	(2.6)	44.4	29.1
EBITDA	47.7	(1.1)	(6.4)	48.5	26.6
PBT	46.7	(5.0)	(5.4)	45.6	28.3
Net profit	44.9	(0.4)	(10.0)	48.7	28.3
EPS	44.3	(0.4)	(9.9)	48.0	28.3

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	13,683	17,908
Shareholders funds	7,595	9,924	10,782	13,921	18,146
Secured loans	0	0	80	80	80
Unsecured loans	0	41	0	0	0
Borrowings	0	41	80	80	80
Minority interest	0	0	94	105	119
Deferred tax liability	134	160	144	144	144
Sources of funds	7,729	10,125	11,099	14,249	18,489
Gross block	4,328	6,615	7,418	8,632	9,782
Depreciation	1,450	1,704	2,048	2,575	3,172
Net block	2,878	4,911	5,369	6,057	6,611
Capital work in progress	607	177	115	0	0
Total fixed assets	3,485	5,088	5,484	6,057	6,611
Investments	5,601	1,443	3,703	4,064	4,460
Inventories	2,100	2,805	2,563	4,066	5,310
Contract in progress	693	2,462	3,181	5,692	7,434
Sundry debtors	5,305	5,719	7,984	13,661	17,756
Cash and equivalents	580	3,696	6,702	6,903	11,025
Othe current assets	324	410	594	911	1,184
Loans and advances	2,189	2,224	3,282	5,204	6,764
Total current assets	11,191	17,316	24,306	36,437	49,474
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 CL & provisions	12,588	13,723	22,394	32,309	42,056
Net current assets	(1,397)	3,593	1,912	4,128	7,418
Others	40	1	0	0	0
Uses of funds	7,729	10,125	11,099	14,249	18,489
Adjusted BV per share (INR)	64	83	90	117	152

Free cash flow					
	(INR mn)				
Year to March	FY08	FY09	FY10	FY11E	FY12E
Net profit	2,908	2,889	1,443	3,836	4,922
Add : Non cash charge					
Depreciation	232	351	442	527	597
Deferred tax	(134)	(160)	(144)		
Others	(67)	(72)	869	(484)	(643)
Gross cash flow	2,939	3,009	2,610	3,879	4,877
Less: Changes in WC	1,531	1,404	(3,709)	2,015	(832)
Operating cash flow	1,408	1,606	6,319	1,864	5,709
Less: Capex	1,918	1,915	840	1,100	1,150
Free cash flow	(510)	(309)	5,479	764	4,559

Cash flow metrics

Year to March	FY08	FY09	FY10	FY11E	FY12E
Operating cash flow	1,408	1,606	6,319	1,864	5,709
Financing cash flow	(407)	(1,118)	(686)	(724)	(733)
Investing cash flow	(1,393)	2,628	(2,627)	(939)	(854)
Net cash flow	(392)	3,116	3,006	201	4,122
Capex	1,918	1,915	840	1,100	1,150
Dividends paid	1,115	697	697	697	697

Profitability & liquidity ratios

Year to March	FY08	FY09	FY10	FY11E	FY12E
ROAE (%) (on adjusted profits)	42.9	32.9	25.0	31.1	30.8
ROACE (%)	59	43	33	42	42
Debtors days	49	58	74	81	91
Inventory days	35	43	48	41	44
Fixed assets t/o (x)	15	9	7	9	10
Interest coverage	245	101	173	202	192
Payable days	91	114	153	151	154
Cash conversion cycle	(7)	(13)	(30)	(29)	(19)
Current ratio	1	1	1	1	1

Operating ratios

Year to March	FY08	FY09	FY10	FY11E	FY12E
Total asset turnover	5.1	3.9	3.2	3.8	3.8
Fixed asset turnover	15.3	8.9	6.6	8.5	9.9
Equity turnover	5.2	4.0	3.3	3.9	3.9

Du pont analysis

Year to March	FY08	FY09	FY10	FY11E	FY12E
NP margin	8.3	8.3	7.7	7.9	7.9
Total assets turnover	5.1	3.9	3.2	3.8	3.8
Leverage multiplier	1.0	1.0	1.0	1.0	1.0
ROAE	42.9	32.9	25.0	31.1	30.8

Valuations parameters

Year to March	FY08	FY09	FY10	FY11E	FY12E
EPS (INR) fully diluted	24.2	24.1	21.8	32.2	41.3
Y-o-Y growth (%)	44.3	(0.4)	(9.9)	48.0	28.3
CEPS	25.0	25.7	24.2	36.7	46.4
Diluted P/E (x)	32.7	32.8	36.4	24.6	19.2
Price/BV (x)	12.4	9.5	8.8	6.8	5.2
EV/Sales (x)	2.5	2.6	2.5	1.7	1.3
EV/EBITDA (X)	20.7	21.2	21.3	14.2	10.6
Dividend yield (%)	1.0	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	BUY	SO	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	Kirloskar Oil Engines	BUY	SO	L
Larsen & Toubro	HOLD	SP	L	Punj Lloyd	HOLD	SU	M
Sanghvi Movers	BUY	SO	H	Siemens	HOLD	SU	L
Techno Electric & Engineering	BUY	SO	M	Texmaco	BUY	SP	H
Thermax	BUY	SO	L	Voltamp Transformers	HOLD	SP	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

Edelweiss
Ideas create, values protect



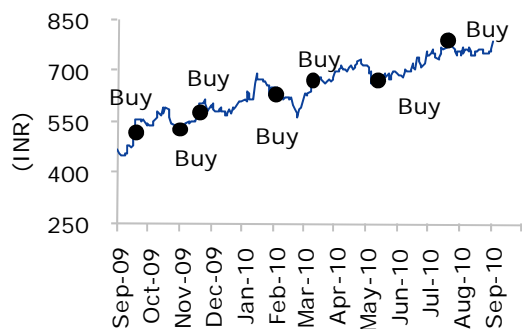
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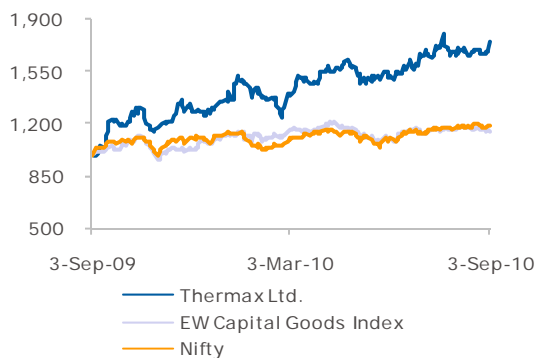
Coverage group(s) of stocks by primary analyst(s): Engineering and Capital Goods

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*	109	52	12	177
* 4 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	108	54	15	

Recent Research

Date	Company	Title	Price (INR)	Recos
13-Aug-10	Cummins India	Back to good old days; Result Update	672	Buy
13-Aug-10	AIA Engineering	In line with estimates; Result Update	349	Hold
04-Aug-10	Punj Lloyd	Uncertainty prevails; Result Update	121	Reduce

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