

## Company

22 July 2010 | 8 pages

# Thermax (THMX.BO)

 Equity 

## Buy: Positive Momentum Continues ...

- Q1 revenues below expectations** — Thermax Q1FY11 standalone revs of Rs7.8bn (up 45% YoY) but below CIRA expectations of Rs9.4bn. Energy segment revs grew by 43% YoY and Environment segment revs grew by 75% YoY. EBITDA Margins declined by 52bps YoY; but were 15bps ahead of CIRA expectations. PAT came in at abt Rs662m; (up 42% YoY) but 17% below CIRA expectations of Rs798m.
- But broader story remains on track; OB is up 106% YoY & 17% QoQ** — The overall business environment remains good; Thermax is seeing increased traction from domestic clients; order inflows have grown in all divisions and credit availability is not an issue. However, recovery in international markets is still lagging. Thermax expects order inflow growth to be in “double digits” this year; commendable, given the high base – inflows grew by ~60% last year. Orders from Power, Refineries, Ferrous metals, Paper and Pulp, and Cement form - 80% of OB.
- Environment business doing well** — The water division is gaining momentum. Thermax has executed water treatment project for Delhi Metro. It has 80% market share for water treatment in the Commonwealth Games. Thermax is looking to improve profitability in the water division over next two years.
- Supercritical JV** — Thermax is looking to acquire land before the deadline for bidding for the 11x660MW orders. While the JV will definitely bid for the 9x800MW NTPC tender, it has yet to decide whether to bid for the 11x 660MW NTPC tender in August. Thermax is talking to domestic turbine manufacturers for consortium bidding. We believe possible large super-critical order wins hold key to stock-price performance.

<b>Buy/Medium Risk</b>	<b>1M</b>
Price (22 Jul 10)	Rs806.35
Target price	Rs787.00
Expected share price return	-2.4%
Expected dividend yield	0.6%
<b>Expected total return</b>	<b>-1.8%</b>
Market Cap	Rs96,082M
	US\$2,037M

### Price Performance (RIC: THMX.BO, BB: TMX IN)



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2008A	2,787	23.39	39.9	34.5	12.7	41.4	0.7
2009A	3,554	29.82	27.5	27.0	9.7	40.7	0.6
2010E	2,510	21.06	-29.4	38.3	9.7	25.3	0.6
2011E	3,835	32.18	52.8	25.1	7.4	33.5	0.7
2012E	4,693	39.39	22.4	20.5	5.8	31.8	1.0

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
<b>Valuation Ratios</b>					
P/E adjusted (x)	34.5	27.0	38.3	25.1	20.5
EV/EBITDA adjusted (x)	22.0	17.7	24.3	15.9	12.4
P/BV (x)	12.7	9.7	9.7	7.4	5.8
Dividend yield (%)	0.7	0.6	0.6	0.7	1.0
<b>Per Share Data (Rs)</b>					
EPS adjusted	23.39	29.82	21.06	32.18	39.39
EPS reported	24.40	24.25	6.33	32.18	39.39
BVPS	63.41	83.28	83.53	108.69	138.72
DPS	6.00	5.00	5.00	6.00	8.00
<b>Profit &amp; Loss (RsM)</b>					
Net sales	34,815	34,603	29,651	47,198	61,914
Operating expenses	-30,923	-29,791	-26,239	-41,770	-54,985
<b>EBIT</b>	<b>3,893</b>	<b>4,812</b>	<b>3,412</b>	<b>5,428</b>	<b>6,929</b>
Net interest expense	-17	-38	-18	-18	-18
Non-operating/exceptionals	439	404	408	400	200
<b>Pre-tax profit</b>	<b>4,315</b>	<b>5,178</b>	<b>3,802</b>	<b>5,810</b>	<b>7,111</b>
Tax	-1,528	-1,624	-1,293	-1,975	-2,418
Extraord./Min.Int./Pref.div.	121	-664	-1,755	0	0
<b>Reported net income</b>	<b>2,907</b>	<b>2,889</b>	<b>755</b>	<b>3,835</b>	<b>4,693</b>
Adjusted earnings	2,787	3,554	2,510	3,835	4,693
Adjusted EBITDA	4,125	5,163	3,825	5,900	7,431
<b>Growth Rates (%)</b>					
Sales	49.6	-0.6	-14.3	59.2	31.2
EBIT adjusted	44.5	23.6	-29.1	59.1	27.6
EBITDA adjusted	42.8	25.2	-25.9	54.2	25.9
EPS adjusted	39.9	27.5	-29.4	52.8	22.4
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>2,667</b>	<b>1,393</b>	<b>-544</b>	<b>2,814</b>	<b>3,116</b>
Depreciation/amortization	232	351	413	472	502
Net working capital	-538	-1,874	-1,712	-1,492	-2,078
<b>Investing cash flow</b>	<b>-1,788</b>	<b>2,204</b>	<b>-1,000</b>	<b>-1,375</b>	<b>-1,375</b>
Capital expenditure	-1,928	-1,954	-1,000	-500	-500
Acquisitions/disposals	140	4,158	0	-875	-875
<b>Financing cash flow</b>	<b>-1,271</b>	<b>-481</b>	<b>-766</b>	<b>-836</b>	<b>-1,115</b>
Borrowings	-22	41	-41	0	0
Dividends paid	-1,115	-697	-697	-836	-1,115
<b>Change in cash</b>	<b>-392</b>	<b>3,116</b>	<b>-2,310</b>	<b>603</b>	<b>626</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>20,278</b>	<b>23,847</b>	<b>19,996</b>	<b>26,876</b>	<b>32,871</b>
Cash & cash equivalent	580	3,696	1,386	1,989	2,615
Accounts receivable	5,305	5,719	5,362	8,534	11,195
Net fixed assets	3,485	5,088	5,675	5,703	5,701
<b>Total liabilities</b>	<b>12,722</b>	<b>13,924</b>	<b>10,043</b>	<b>13,925</b>	<b>16,342</b>
Accounts payable	4,552	4,199	3,327	5,421	7,167
Total Debt	0	41	0	0	0
<b>Shareholders' funds</b>	<b>7,556</b>	<b>9,923</b>	<b>9,953</b>	<b>12,951</b>	<b>16,529</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	11.8	14.9	12.9	12.5	12.0
ROE adjusted	41.4	40.7	25.3	33.5	31.8
ROIC adjusted	122.4	59.5	26.6	35.1	37.0
Net debt to equity	-7.7	-36.8	-13.9	-15.4	-15.8
Total debt to capital	0.0	0.4	0.0	0.0	0.0

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Figure 1. Thermax Q1 results

	1Q10	1Q11A	1Q11E Comments
Sales & Services (excluding Excise Duty)	5,228	7,788	
Other Income from Operations	213	110	
<b>Total Income</b>	<b>5,441</b>	<b>7,898</b>	<b>9,440 16% below expectations</b>
% Growth YoY		45%	
<b>EBITDA</b>	<b>689</b>	<b>960</b>	<b>1,133</b>
<b>EBITDA margin%</b>	<b>12.67%</b>	<b>12.15%</b>	<b>12.00%</b>
Depreciation	(95)	(106)	(118)
Interest	(5)	(6)	(5)
Other Income	103	140	200
<b>PBT</b>	<b>692</b>	<b>988</b>	<b>1,210</b>
Tax	(227)	(326)	(411)
Effective Tax rate %	33%	33%	34%
<b>PAT bf Minority Interest</b>	<b>465</b>	<b>662</b>	<b>798 17% below expectations</b>

Source: Company data, Citi Investment Research and Analysis estimates

## Thermax

### Company description

Thermax specializes in energy and environment engineering solutions. It offers products and services in heating, cooling, waste heat recovery, captive power, water treatment and recycling, waste management and performance chemicals

### Investment strategy

We have a Buy/Medium Risk rating on Thermax. Order inflow is strong; order book is up 36% YoY with 65-75% executable in FY11E. There is a strong pipeline of orders, with a reasonable chance of strong order wins in the near future. We expect OB to grow at 31%, revenues to grow at 45% and earnings to grow at 37% over FY10E-12E. We expect (unlevered) ROEs of 32-34%. Our estimates do not capture any upside from the foray into super-critical space.

### Valuation

Our Rs787 target price is based on PE of 22x Sept11E. We believe that 1) the structural change in the business, 2) the broader economic revival; 3) the strong outlook (compared to a year ago) should drive a re-rating. Our target multiple is 1) at a premium to Thermax's historical avg. PE (16x), given the strong outlook 2) at a discount to BHEL (23x) despite Thermax's superior earnings outlook and RoE (EPS CAGR of 37% vs 22% for BHEL, RoEs of 32-34% vs BHEL RoE's of 29-31%); given BHEL's larger size and market share. 3) the target multiple is also at a discount to ABB (24x) given ABB's superior earnings outlook (39% CAGR).

## **Risks**

We rate Thermax shares Medium Risk. We believe this is appropriate given that Thermax's business model is dependent on private sector capex. Key upside risks to our target price include higher-than-expected order inflow, further pick-up in private-sector capex and faster execution. Key downside risks that could impede the stock from reaching our target price include a slow down in private sector capex and slower-than-expected power capacity addition in India.

# Appendix A-1

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### Thermax (THMX.BO)

#### Ratings and Target Price History

#### Fundamental Research

Analyst: Deepal Delivala



Chart current as of 17 July 2010

Date	Rating	Target Price	Closing Price
1 26-Jul-07	1L	*764.00	637.30
2 30-Jan-08	1L	*748.00	652.50

Date	Rating	Target Price	Closing Price
3 24-Jun-08	1L	*480.00	393.80
4 29-Jan-09	*1M	*211.00	159.30

Date	Rating	Target Price	Closing Price
5 23-Jul-09	*3M	*414.00	417.55
6 10-Mar-10	*1M	*787.00	672.85

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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