

Thermax Ltd

TMX IN / THMX.BO

FLASH NOTE

➤ **Market Cap**
US\$1,310m
Rs80,103m

➤ **Avg Daily Turnover**
US\$0.46m
Rs28.57m

➤ **Free Float**
38.0%
119.2 m shares

Current **Rs672.3**
Target ➤ **Rs580.0**
Prev. Target **Rs580.0**
Up/Downside **-13.7%**

STOCK RATING

ADD

HOLD

REDUCE

CIMB Analyst(s)



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Share price info

Share price perf. (%)	1M	3M	12M
Relative	3.9	11.3	0.7
Absolute	7.1	22	10.5

Major shareholders

	% held
Promoters (RDA Holding & Trading Pvt Ltd)	62.0
Matthew Pacific Tiger Fund	4.0
LIC	2.4

Management meeting takeaways

Thermax is preparing to capitalise on an economic recovery with the development of new businesses/product portfolio, consolidation of international business and rebalancing of revenue-mix. Despite a weak milieu, focus on cash flow/risk remains high which entails letting go orders with poor terms or potential high charge relative to financials.

We think that superior management quality and the aforesaid initiatives are already factored into the present stock price, well ahead of an actual recovery. We maintain our Reduce rating and one-year forward DCF based target price. High valuations (19x FY15 P/E) and potential downside risks to earnings could keep its share price in check.

What Happened ➤

We recently met the management of Thermax. Key takeaways: (1) It is working on strategies to combat the cyclical nature of its project business and secure long-term growth, i.e. (a) balancing the portfolio through fair revenue contribution from standard products, projects and the services business, (b) developing new businesses and product portfolios that will contribute significantly to revenue in the next five years, and (c) consolidation and growth of its international business, with a focus on Southeast Asia (mainly Indonesia and the Philippines), the Middle East and Africa. Thermax is also converting some of the offices in these geographies into subsidiary

companies. (2) Danstoker recently acquired a company in Denmark, Boiler Works, on a slump sale basis, which will help expand its offerings and market presence. (3) The recently-won large Reliance order is profitable and Thermax is working with its suppliers to ensure the bid margin is realised. See detailed meeting notes overleaf.

What We Think ➤

Thermax's standalone earnings have bobbed around over the past four years (FY11-14). While the standalone order backlog rose 20% yoy in 1HFY14, new orders were won in a weak overall environment, which could affect the FY15 margin/cash flow. Losses in the boiler JV will drag its consolidated financials for FY15-16. Thermax Instrumentation Ltd could disappoint in FY15-16 too.

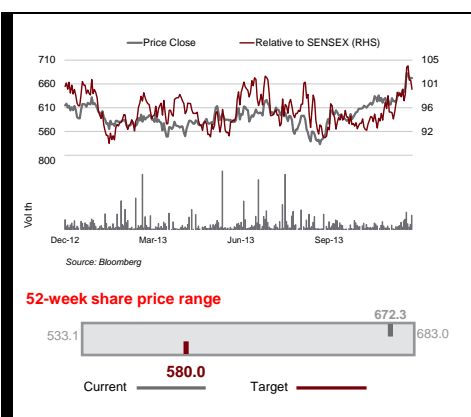
What You Should Do ➤

We remain wary of assigning a high multiple to a business where it is difficult to project long-term cash flow. Accordingly, we advise investors to reduce positions at the current price.

Financial Summary

	Mar-12A	Mar-13A	Mar-14F	Mar-15F	Mar-16F
Revenue (Rsm)	60,313	54,331	55,280	64,410	75,078
Operating EBITDA (Rsm)	5,919	4,902	5,188	6,211	7,520
Net Profit (Rsm)	4,035	3,201	3,576	4,245	5,076
Core EPS (Rs)	33.86	26.87	30.01	35.63	42.60
Core EPS Growth	5.7%	(20.7%)	11.7%	18.7%	19.6%
FD Core P/E (x)	19.85	25.02	22.40	18.87	15.78
DPS (Rs)	7.00	7.00	7.00	8.00	9.00
Dividend Yield	1.04%	1.04%	1.04%	1.19%	1.34%
EV/EBITDA (x)	13.00	16.77	15.64	12.80	10.15
P/FCFE (x)	58.03	NA	26.39	25.87	17.04
Net Gearing	(24.6%)	5.0%	(2.5%)	(6.9%)	(16.0%)
P/BV (x)	4.92	4.29	3.82	3.33	2.87
ROE	27.4%	18.3%	18.0%	18.9%	19.5%
% Change In Core EPS Estimates			0%	0%	0%
CIMB/consensus EPS (x)			1.12	1.10	1.10

SOURCE: CIMB, COMPANY REPORTS



Management meeting notes ►

We recently met the management of Thermax Ltd. Key takeaways:

- The company is working on strategies to combat the cyclical nature of the project business and secure long-term growth, i.e. (a) balancing the portfolio through fair revenue contribution from standard products, projects and the services business, (b) developing new businesses and product portfolios that will have a significant contribution to revenue in the next five years, and (c) consolidation and growth of international businesses, with a focus on Southeast Asia (mainly Indonesia and the Philippines), the Middle East and Africa. The company is also converting some of the offices in these geographies into subsidiary companies.
- The company is not willing to take any orders that do not meet the internal benchmark of cash flow, customer risk/concentration and/or potentially high charges relative to financials.
- Thermax highlighted a newly-launched product, air-conditioning from biomass, which can be used as a cooling application at lower costs in industrial areas. It also highlighted its success in the small solar PV/thermal space, with 64 installations so far. In addition, the company was recently named the best-performing manufacturer for solar concentrating thermal in 2013 by MNRE (Ministry of New and Renewable Energy).
- We note that as per the FY13 annual report, 11 new products were commercialised in the past three years and are paying rich dividends.
- Danstoker recently acquired a company in Denmark, Boiler Works, on a slump sale basis. The Boiler Works factory is located 150km from Danstoker's facility. Given that Danstoker's overall capacity utilisation is high, the company had been contemplating green field capex. With the acquisition of Boiler Works, this will no longer be required.
- The company discussed its mid-sized boilers business in detail. Standard package boilers (less than 32 TPH) contribute about Rs9bn-10bn to total sales (including Danstoker, which contributes €55m). For >10 TPH boilers, the company has witnessed stagnant volume and marginal value growth in the past few years while boilers up to 10 TPH have seen reasonable volume/value growth. The margin is in the double-digits for boilers priced less than Rs10m while for those priced higher than Rs10m, securing a double-digit margin is tough and could depend upon the overall economic environment. Medium-pressure boilers (32-1000 TPH) contribute about Rs18.5bn of sales. Again here, securing a high/reasonable margin is a function of the overall business/ordering environment. Growth in this segment declined in FY12 and FY13 but management anticipates a better FY14 on the back of an improved order backlog.
- According to management, the recent Reliance order (~Rs17bn) is profitable for the company. While the order was won under a tough environment, the company is trying to work with its suppliers (new, in some cases) to ensure that the order is executed and the bid margin is realised as planned. For this order (standalone portion), the company anticipates marginal execution in FY14 and for a large part to be executed in FY15 while the major portion of civil and construction work, which is to be undertaken by construction subsidiary Thermax Instrumentation, will be booked in FY16.
- With respect to capacity utilisation and operating leverage, the company highlighted that its present capacity utilisation is around 80% in the products/O&M segment while, for projects, it hovers around 60%. Larger boiler capacity utilisation is low at 50%. The company can manage a turnover of Rs90bn-100bn without having to significantly increase manpower.

- The company has maintained market share in most segments and has improved in some segments. It has consolidated and gained market share in the chiller and service segments and maintained its share in boilers (aided by the appointment of a global consultant 18 months back, which has helped to reduce cost and get orders) but lost market share in the water and air pollution segments.
- The Thermax Babcock & Wilcox (TBW) JV losses are expected to increase when its capacity is fully commissioned in FY15 (as the total operational plus interest costs are about Rs1.3bn). TBW needs 3x660 MW orders under execution to break even. As of now, management is contemplating how best to utilise the facility and has highlighted a few possibilities - a) potential jobs from companies with orders in hand but where manufacturing facilities are not ready (like BGR Energy), (b) booking/execution of BTG peripherals that constitute 10-15% of overall orders, c) manufacturing of missile components, and d) orders from Thermax if its current capacity is full or global orders from Babcock & Wilcox.
- Management explained that given the present scenario, there are only three serious players manufacturing supercritical boilers in the Indian market - BHEL, L&T and Thermax. As for the Doosan Indian boiler facility, management explained that it is spread over 16 acres of land, insufficient for boiler manufacturing, including ancillaries. Also, certain key equipment may be missing at the Doosan facility. In addition, the future of the BGR-Hitachi JV remains uncertain.

Figure 1: Sector comparisons

Company	Bloomberg Ticker	Recom.	Price (local curr)	Target Price (local curr)	Market Cap (US\$ m)	Core P/E (x)		P/BV (x)		Recurring ROE (%)		EV/EBITDA (x)		Dividend Yield (%)	
						FY2014	FY2015	FY2014	FY2015	FY2014	FY2015	FY2014	FY2015	FY2014	FY2015
ABB Ltd#	ABB IN	Reduce	699	450	2,403	74.4	44.7	5.4	5.0	7.5	11.6	31.0	23.2	0.4	0.4
Bharat Heavy Electricals	BHEL IN	Reduce	171	120	6,807	11.6	15.4	1.3	1.2	11.3	7.9	7.0	8.2	1.9	1.3
Crompton Greaves Ltd	CRG IN	Reduce	130	110	1,349	30.1	16.1	2.2	2.0	7.6	13.2	13.2	9.4	1.2	1.5
Cummins India Ltd	KKC IN	Reduce	450	390	2,026	21.7	19.5	4.8	4.5	21.4	22.1	17.3	15.3	2.9	3.1
Larsen & Toubro Ltd	LT IN	Reduce	1,096	935	16,475	19.2	17.5	3.2	2.9	14.5	14.3	11.4	10.3	1.8	1.9
Siemens Ltd##	SIEM IN	Reduce	629	450	3,636	115.5	47.4	11.1	10.6	4.0	11.5	51.8	23.9	0.8	1.0
Thermax Ltd	TMX IN	Reduce	673	580	1,301	22.4	18.9	3.8	3.3	17.6	18.4	14.5	11.9	1.0	1.2
Voltas Ltd	VOLT IN	Reduce	117	90	625	22.4	15.0	2.2	2.0	10.0	13.9	15.9	10.1	1.7	1.7

SOURCES: CIMB, COMPANY REPORTS

Note: #FY14=CY13, ##FY14=FY13 (Sept-13)

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Description:		Excellent	Very Good	Good	N/A

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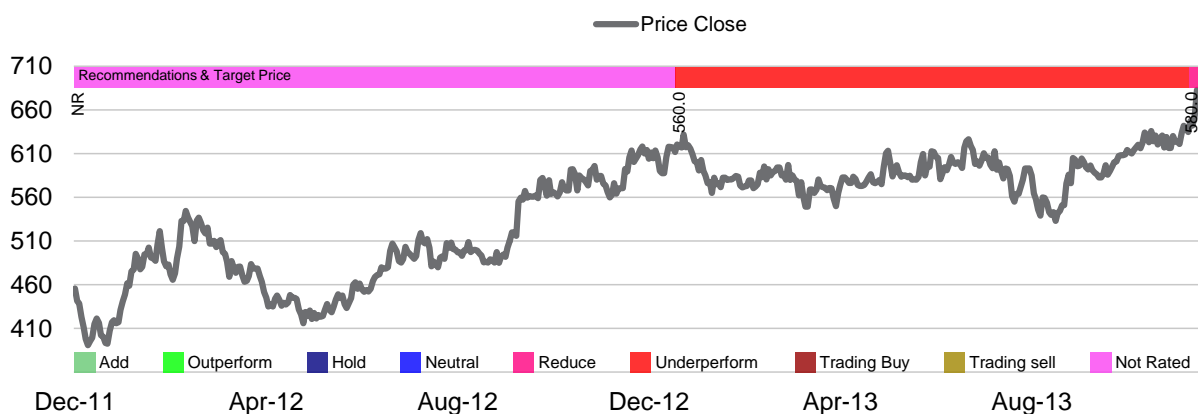
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Spitzer Chart for stock being researched (2 year data)



Distribution of stock ratings and investment banking clients for quarter ended on 30 November 2013		
1277 companies under coverage for quarter ended on 30 November 2013		
	Rating Distribution (%)	Investment Banking clients (%)
Outperform/Buy/Trading Buy/Add	50.1%	6.9%
Neutral/Hold	33.7%	6.1%
Underperform/Sell/Trading Sell/Reduce	16.2%	4.7%

As at the time of publishing this report CIMB is phasing in an absolute recommendation structure for stocks (Framework #1). Please refer to all frameworks for a definition of any recommendations stated in this report.

CIMB Recommendation Framework #1

Stock Ratings	Definition
Add	The stock's total return is expected to exceed 10% over the next 12 months.
Hold	The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
Reduce	The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock.

Stock price targets have an investment horizon of 12 months.

Sector Ratings	Definition
Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings	Definition
Overweight	An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
Underweight	An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.

CIMB Stock Recommendation Framework #2 *

Outperform	The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 12 months.
Neutral	The stock's total return is expected to be within +/-5% of a relevant benchmark's total return.

Underperform	The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 12 months.
Trading Buy	The stock's total return is expected to exceed a relevant benchmark's total return by 3% or more over the next 3 months.
Trading Sell	The stock's total return is expected to be below a relevant benchmark's total return by 3% or more over the next 3 months.

** This framework only applies to stocks listed on the Singapore Stock Exchange, Bursa Malaysia, Stock Exchange of Thailand, Jakarta Stock Exchange, Australian Securities Exchange, Taiwan Stock Exchange and National Stock Exchange of India/Bombay Stock Exchange. Occasionally, it is permitted for the total expected returns to be temporarily outside the prescribed ranges due to extreme market volatility or other justifiable company or industry-specific reasons.
CIMB Research Pte Ltd (Co. Reg. No. 198701620M)*

CIMB Stock Recommendation Framework #3 **

Outperform	Expected positive total returns of 10% or more over the next 12 months.
Neutral	Expected total returns of between -10% and +10% over the next 12 months.
Underperform	Expected negative total returns of 10% or more over the next 12 months.
Trading Buy	Expected positive total returns of 10% or more over the next 3 months.
Trading Sell	Expected negative total returns of 10% or more over the next 3 months.

*** This framework only applies to stocks listed on the Korea Exchange, Hong Kong Stock Exchange and China listings on the Singapore Stock Exchange. Occasionally, it is permitted for the total expected returns to be temporarily outside the prescribed ranges due to extreme market volatility or other justifiable company or industry-specific reasons.*

Corporate Governance Report of Thai Listed Companies (CGR). CG Rating by the Thai Institute of Directors Association (IOD) in 2012.

AAV – not available, **ADVANC** - Excellent, **AEONTS** – Good, **AMATA** - Very Good, **ANAN** – not available, **AOT** - Excellent, **AP** - Very Good, **BANPU** - Excellent, **BAY** - Excellent, **BBL** - Excellent, **BCH** – not available, **BCP** - Excellent, **BEC** - Very Good, **BGH** - not available, **BJC** – Very Good, **BH** - Very Good, **BIGC** - Very Good, **BTS** - Excellent, **CCET** - Good, **CENTEL** – Very Good, **CK** - Very Good, **CPALL** - Very Good, **CPF** - Very Good, **CPN** - Excellent, **DELTA** - Very Good, **DTAC** - Very Good, **EGCO** – Excellent, **ERW** – Excellent, **GLOBAL** - Good, **GLOW** - Very Good, **GRAMMY** – Excellent, **HANA** - Very Good, **HEMRAJ** - Excellent, **HMPRO** - Very Good, **INTUCH** – Very Good, **ITD** – Very Good, **IVL** - Very Good, **JAS** – Very Good, **KAMART** – not available, **KBANK** - Excellent, **KK** – Excellent, **KTB** - Excellent, **LH** - Very Good, **LPN** - Excellent, **MAJOR** - Good, **MAKRO** – Very Good, **MCOT** - Excellent, **MINT** - Very Good, **PS** - Excellent, **PSL** - Excellent, **PTT** - Excellent, **PTTGC** - Excellent, **PTTEP** - Excellent, **QH** - Excellent, **RATCH** - Excellent, **ROBINS** - Excellent, **RS** – Excellent, **SAMART** – Excellent, **SC** – Excellent, **SCB** - Excellent, **SCC** - Excellent, **SCCC** - Very Good, **SIRI** - Good, **SPALI** - Very Good, **SRICHA** – not available, **SSI** – not available, **STA** - Good, **STEC** - Very Good, **TCAP** - Very Good, **THAI** - Excellent, **THCOM** – Very Good, **TICON** – Very Good, **TISCO** - Excellent, **TMB** - Excellent, **TOP** - Excellent, **TRUE** - Very Good, **TTW** – Very Good, **TUF** - Very Good, **VGI** – not available, **WORK** – Good.