

HOLD

TP: Rs 2,200 | ▲ 3%

THERMAX

| Capital Goods

| 13 February 2023

Scaling back on large project bids

- Transitioning to smaller orders in a bid to eliminate lumpiness in large projects and lift profitability
- International business looking up; overseas subsidiaries guided to break even in 4-5 quarters
- Change in bid strategy could undermine revenue; we retain HOLD and roll forward to a revised TP of Rs 2,200 (vs. Rs 2,100)

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Q3 strong: TMX's Q3FY23 revenue grew 27% YoY to Rs 20.5bn (3Y CAGR: 13%), with the energy business up 27% to Rs 14.8bn, environment up 29% to Rs 4.4bn, and chemicals business rising 6% to Rs 1.6bn. Led by the strong sales momentum, EBITDA grew 42% YoY to Rs 1.6bn (3Y CAGR: 12%) and EBITDA margin expanded 85bps to 7.9%. Adj. PAT came in at Rs 1.2bn, up 59% YoY.

Moving to smaller orders: TMX's pipeline of large projects (>Rs 8bn) has flagged in the last two quarters, especially in the petrochemicals sector where the company has consciously taken a step back from quoting lower prices on two major projects. Over the cycle, TMX expects to manage this shift through smaller orders in the Rs 500mn-1bn range.

Energy transition and steel driving demand: Per management, the energy transition and steel sectors continue to fuel demand, while the sugar and distillery verticals are expected to remain strong for the next 12 months. TMX is also seeing cement capacities being added, with the tail end of waste heat recovery systems and a decent performance in the chemicals, pharma, and food & beverage sectors. However, management anticipates weaker growth in refinery and petrochemicals.

International business looking up: Over the past six months, TMX has seen a positive trend in the international market with improved numbers and better visibility. The company expects both subsidiaries, Danstoker and PTTI, to be profitable in the next 15 months, with PTTI guided to break even in the next 4-5 quarters. European subsidiaries have reported improvement, and gas-related challenges have receded.

Retain HOLD: Potential moderation in revenue considering TMX's shift toward small-ticket projects, coupled with a weaker margin outlook in the chemicals division and the likelihood of back-ended returns from new clean energy businesses, drives our cautious view on the company. We retain HOLD and roll valuations forward to Dec'24E for a TP of Rs 2,200 (earlier Rs 2,100), set at an unchanged 40x P/E multiple, in line with the stock's 5Y average.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	TMX IN/Rs 2,143
Market cap	US\$ 3.1bn
Free float	32%
3M ADV	US\$ 1.3mn
52wk high/low	Rs 2,679/Rs 1,651
Promoter/FPI/DII	62%/12%/16%

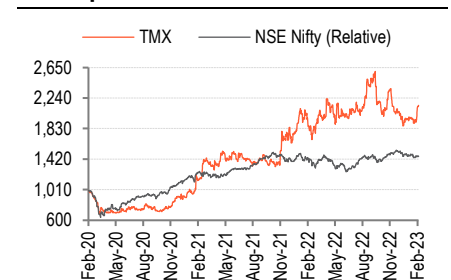
Source: NSE | Price as of 13 Feb 2023

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	61,283	75,317	88,633
EBITDA (Rs mn)	4,214	5,264	6,695
Adj. net profit (Rs mn)	3,123	4,141	5,160
Adj. EPS (Rs)	26.2	34.8	43.3
Consensus EPS (Rs)	26.2	38.5	53.1
Adj. ROAE (%)	9.3	11.4	13.1
Adj. P/E (x)	81.8	61.7	49.5
EV/EBITDA (x)	64.7	49.6	39.2
Adj. EPS growth (%)	20.5	32.6	24.6

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

Particulars (Rs mn)	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Revenue	20,493	16,147	26.9	20,753	(1.3)
EBITDA	1,611	1,131	42.4	1,406	14.6
EBITDA Margin (%)	7.9	7.0	86bps	6.8	109bps
Depreciation	291	290	0.3	298	(2.4)
Interest	91	53	73.4	80	14.3
Other Income	423	292	45.1	398	6.3
PBT	1,652	1,080	52.9	1,426	15.9
Tax	386	286	34.8	332	16.0
Adjusted PAT	1,264	795	59.1	1,091	15.8
Exceptional item	0	0	-	0	-
Reported PAT	1,264	795	59.1	1,091	15.8
Adj. PAT Margin (%)	6.2	4.9	125bps	5.3	91bps
EPS (Rs)	11.2	7.1	59.4	9.7	15.8

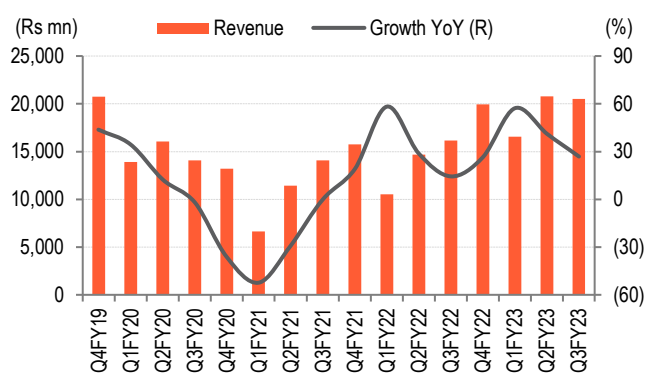
Source: Company, BOBCAPS Research

Fig 2 – Actual vs. Estimates

Particulars	Actual	Estimates	Variance (%)
Revenue	20,493	18,610	10.1
EBITDA	1,611	1,321	21.9
EBITDA Margin (%)	7.9	7.1	76bps
Adj. PAT	1,264	1,018	24.2

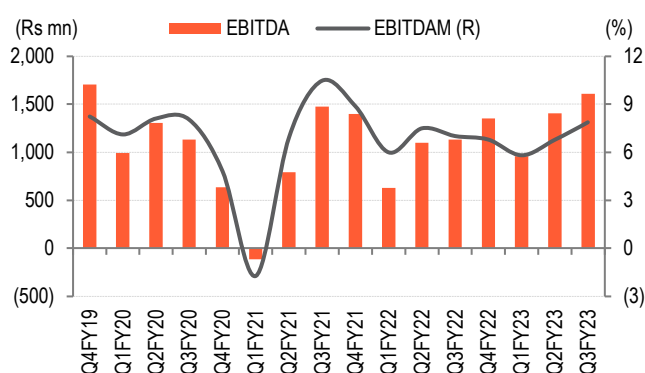
Source: Company, BOBCAPS Research

Fig 3 – Revenue trend

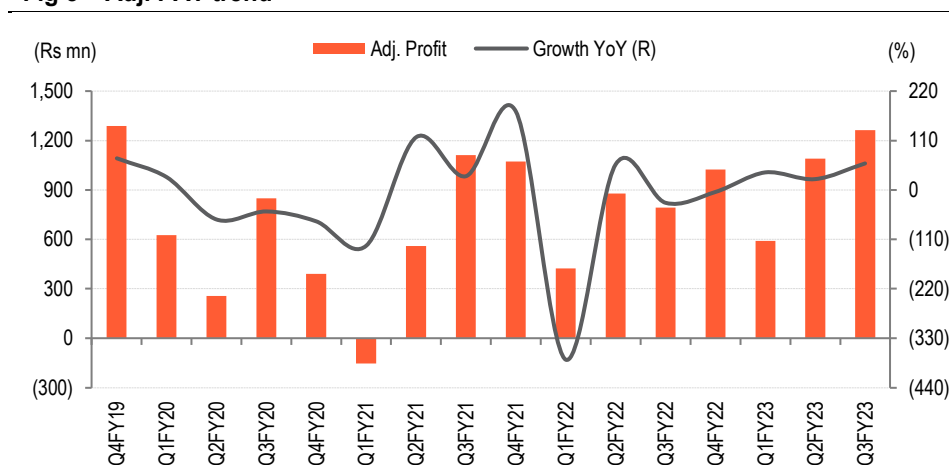


Source: Company, BOBCAPS Research

Fig 4 – EBITDA trend



Source: Company, BOBCAPS Research

Fig 5 – Adj. PAT trend

Source: Company, BOBCAPS Research

Earnings call highlights

- Business model:** TMX's solutions business, which includes providing green utilities such as solar- and wind-based opex, is focused on ROE and long-term cashback over immediate profitability. Management believes both the solar and business under subsidiary Thermax Onsite Energy Solutions (TOESL) have good long-term profit potential.

The projects business has historically had a EBITDA range of 5-6%, and the company aims to increase this to 5-8%. Per management, this business has a good return on capital as it runs on a depreciated base and requires low capital investment, with negative working capital.

The goal for the products and associated services business is to achieve 10% profitability in the longer run. However, given the current trends and investment in newer technologies such as hydrogen and water, TMX believes it is unlikely that the blended energy business will reach 10% profitability soon.

- FGD projects to return to profitability:** For the past two quarters, flue-gas desulfurisation (FGD) project revenue has been liquidated, and this trend is expected to continue for the foreseeable future. However, moving forward, the company anticipates consistent profits and no further losses.
- Chemicals business:** Per management, the chemicals segment is growing reasonably well, but the US market has slowed. Overall, the company has a positive outlook for the chemicals business with a focus on double-digit profitable growth, new technologies, capabilities, and capacity addition.
- Cooling & Heating business:** Profitability in the cooling business has dropped from the high teens to lower double digits due to factors such as a fourfold increase in commodity prices (specifically lithium bromide) and a shift in the cooling mix (lower demand for chillers due to a decrease in the gas-fired engine market). Despite this, management expects the cooling business to remain stable in the long term and is focused on building up the business over the next three years.

- **Opex-related business:** TMX has two opex-related businesses focused on solar and TOESL, with a total equity investment of ~Rs 4bn and expected IRR of 15%+. Going forward, equity investments will likely be more towards solar as biomass is already generating cash and on a growth trajectory. FEPL is also on a higher growth trajectory and will require less equity investments.
- **Exports & Subsidiaries:** TMX is currently active in the Rs 500mn-1bn project range and has a good pipeline in Southeast Asia and Africa. Per management, positive movement is also being seen with the China+1 strategy in the global waste-to-energy sector.

Over the past six months, TMX has seen a positive trend in the international market with improved numbers and better visibility. The company expects both subsidiaries, Danstoker and PTTI, to be profitable in the next 15 months, with PTTI guided to break even in the next 4-5 quarters. European subsidiaries have reported improvement, and gas-related challenges have receded. Management is confident that operations will remain profitable with reasonable volumes.

Valuation methodology

We model for a revenue/EBITDA/PAT CAGR of 18%/29%/32% for TMX over FY22-FY25. Potential moderation in revenue considering TMX's shift toward small-ticket projects, coupled with a weaker margin outlook in the chemicals division, and the likelihood of back-ended returns from new clean energy businesses drives our cautious view on the company. We retain HOLD and roll valuations forward to Dec'24E for a TP of Rs 2,200 (earlier Rs 2,100), set at an unchanged 40x P/E multiple, in line with the stock's five-year average.

Fig 6 – Revised estimates

Particulars (Rs mn)	New			Old			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY24E
Sales	75,317	88,633	1,01,102	75,317	88,633	1,01,102	0.0	0.0	0.0
EBITDA	5,264	6,695	9,042	5,531	6,739	9,092	(4.8)	(0.7)	(0.5)
PAT	4,141	5,160	7,163	4,188	5,207	7,211	(1.1)	(0.9)	(0.7)
EPS	34.8	43.3	60.1	35.1	43.7	60.5	(1.1)	(0.9)	(0.7)
EBITDA Margin (%)	7.0	7.6	8.9	7.3	7.6	9.0	(35bps)	(5bps)	(5bps)

Source: Company, BOBCAPS Research

Key risks

Upside risks to our estimates include:

- swift recovery in the chemicals segment translating to higher margins, and
- faster payback from newly incubated businesses.

Downside risks include:

- inability to scale up new businesses, and
- cyclicality in the end-user market.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
ABB India	ABB IN	7.9	3,080	3,100	HOLD
AIA Engineering	AIAE IN	3.2	2,798	3,300	BUY
Cummins India	KKC IN	5.3	1,595	1,600	HOLD
Hitachi Energy	POWERIND IN	1.5	3,004	3,500	BUY
KEC International	KECI IN	1.5	472	500	HOLD
Larsen & Toubro	LT IN	37.4	2,203	2,440	BUY
Siemens India	SIEM IN	13.5	3,129	3,500	BUY
Thermax	TMX IN	3.1	2,143	2,200	HOLD

Source: BOBCAPS Research, NSE | Price as of 13 Feb 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	47,913	61,283	75,317	88,633	1,01,102
EBITDA	3,552	4,214	5,264	6,695	9,042
Depreciation	1,146	1,132	877	1,110	1,056
EBIT	2,406	3,081	4,387	5,584	7,986
Net interest inc./(exp.)	206	252	200	238	277
Other inc./(exp.)	1,077	1,270	1,334	1,534	1,840
Exceptional items	0	0	0	0	0
EBT	3,277	4,100	5,521	6,880	9,550
Income taxes	686	978	1,380	1,720	2,388
Extraordinary items	525	0	0	0	0
Min. int./Inc. from assoc.	0	1	0	0	0
Reported net profit	2,066	3,123	4,141	5,160	7,163
Adjustments	525	0	0	0	0
Adjusted net profit	2,591	3,123	4,141	5,160	7,163

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	11,380	14,598	17,540	18,212	19,389
Other current liabilities	16,497	20,002	22,698	25,497	29,084
Provisions	0	0	0	0	0
Debt funds	3,051	3,596	2,850	3,400	3,950
Other liabilities	1,627	1,491	1,833	2,157	2,460
Equity capital	225	225	225	225	225
Reserves & surplus	32,289	34,700	37,391	40,745	45,401
Shareholders' fund	32,514	34,925	37,616	40,970	45,626
Total liab. and equities	65,069	74,611	82,537	90,237	1,00,510
Cash and cash eq.	20,545	9,535	9,709	11,073	13,261
Accounts receivables	12,371	14,237	18,571	20,640	23,544
Inventories	4,047	7,270	7,841	7,285	8,310
Other current assets	7,702	16,336	15,476	16,998	18,004
Investments	1,192	7,034	8,644	10,173	11,604
Net fixed assets	12,451	12,014	12,337	12,426	12,570
CWIP	211	443	443	443	443
Intangible assets	0	0	0	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	6,550	7,743	9,516	11,198	12,774
Total assets	65,069	74,611	82,537	90,237	1,00,510

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash flow from operations	7,695	3,247	6,611	6,707	8,048
Capital expenditures	(834)	(838)	(1,200)	(1,200)	(1,200)
Change in investments	(5,789)	(4,263)	(1,611)	(1,528)	(1,431)
Other investing cash flows	266	885	(1,432)	(1,358)	(1,272)
Cash flow from investing	(6,357)	(4,216)	(4,242)	(4,087)	(3,903)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	947	762	(746)	550	550
Interest expenses	0	0	0	0	0
Dividends paid	0	0	0	0	0
Other financing cash flows	(174)	(968)	(1,449)	(1,806)	(2,507)
Cash flow from financing	772	(206)	(2,195)	(1,256)	(1,957)
Chg in cash & cash eq.	2,110	(1,175)	174	1,364	2,188
Closing cash & cash eq.	20,545	9,535	9,709	11,073	13,261

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	17.3	26.2	34.8	43.3	60.1
Adjusted EPS	21.7	26.2	34.8	43.3	60.1
Dividend per share	7.0	8.0	9.0	9.0	9.5
Book value per share	272.9	293.1	315.7	343.8	382.9

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	5.6	4.5	3.5	3.0	2.6
EV/EBITDA	74.9	64.7	49.6	39.2	29.1
Adjusted P/E	98.5	81.8	61.7	49.5	35.6
P/BV	7.9	7.3	6.8	6.2	5.6

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	79.1	76.2	75.0	75.0	75.0
Interest burden (PBT/EBIT)	136.2	133.1	125.9	123.2	119.6
EBIT margin (EBIT/Revenue)	5.0	5.0	5.8	6.3	7.9
Asset turnover (Rev./Avg TA)	76.9	87.7	95.9	102.6	106.0
Leverage (Avg TA/Avg Equity)	2.0	2.1	2.2	2.2	2.2
Adjusted ROAE	8.3	9.3	11.4	13.1	16.5

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
YoY growth (%)					
Revenue	(16.4)	27.9	22.9	17.7	14.1
EBITDA	(12.6)	18.6	24.9	27.2	35.1
Adjusted EPS	22.0	20.5	32.6	24.6	38.8
Profitability & Return ratios (%)					
EBITDA margin	7.4	6.9	7.0	7.6	8.9
EBIT margin	5.0	5.0	5.8	6.3	7.9
Adjusted profit margin	5.4	5.1	5.5	5.8	7.1
Adjusted ROAE	8.3	9.3	11.4	13.1	16.5
ROCE	7.0	8.3	11.0	12.8	16.5
Working capital days (days)					
Receivables	94	85	90	85	85
Inventory	31	43	38	30	30
Payables	87	87	85	75	70
Ratios (x)					
Gross asset turnover	2.0	2.5	2.9	3.3	3.6
Current ratio	1.5	1.3	1.2	1.2	1.2
Net interest coverage ratio	11.7	12.2	22.0	23.5	28.9
Adjusted debt/equity	(0.5)	(0.2)	(0.2)	(0.2)	(0.2)

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

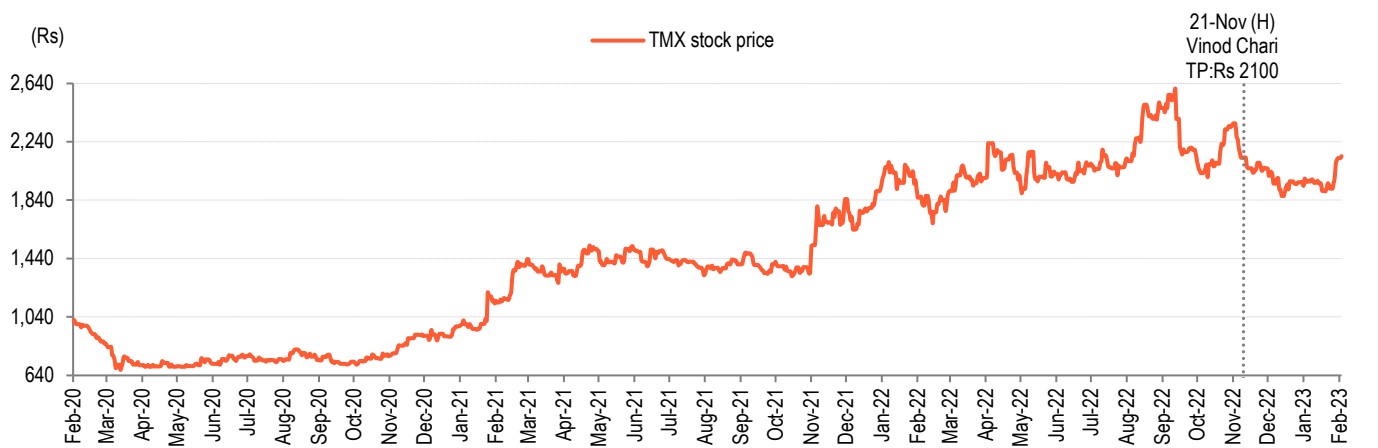
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): THERMAX (TMX IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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