

Thermax

BSE SENSEX	S&P CNX	CMP: INR522	TP: INR414	Neutral						
17,605	5,326									
Bloomberg	TMX IN									
Equity Shares (m)	119.2									
52-Week Range (INR)	720/388									
1,6,12 Rel. Perf. (%)	14/1/-21									
M.Cap. (INR b)	60.3									
M.Cap. (USD b)	1.1									
Year	Net Sales	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
End	(INR m)	(INR m)	(INR)	Gr. (%)	(X)	(X)	(%)	(%)	Sales	EBITDA
3/10A	33,703	2,592	21.8	-	-	-	25.1	24.6	-	-
3/11A	53,371	3,817	32.0	47.2	15.8	4.5	31.9	29.0	1.0	9.0
3/12E	58,659	4,096	34.4	7.3	14.7	3.7	28.1	24.7	0.9	8.5
3/13E	59,168	4,113	34.5	0.4	14.6	3.1	23.6	21.5	0.9	8.3

- Results below expectations; revenue visibility poor:** Revenue growth, which was healthy till 1HFY12, tumbled to a marginal 2% YoY in 3QFY12. Revenue for the quarter was INR12.6b v/s our estimate of INR14b. The company has been posting healthy growth in revenue due to rising share of Power EPC (30% of revenue in 2QFY12, up from 23% last year). However, with the projects reaching completion stage and slowing order intake, visibility for FY13 appears poor.
- PAT down 5% YoY, driven by lower sales:** Standalone PAT declined 5% YoY to INR955m, below our estimate of INR1.02b due to lower than estimated sales. Consolidated PAT declined 11% YoY. Consolidated PAT for 9MFY12 grew 9% to INR2.9b, mainly driven by the Danstoker acquisition.
- Consolidated order backlog down 11% QoQ to INR58b:** Slowdown in orders remains the biggest concern for Thermax. Consolidated order intake for the quarter stood at INR7.42b, down 40% YoY. For 9MFY12, order intake was INR37b, down 17% YoY.
- EBITDA margin down 110bp YoY, led by high share of EPC projects:** EBITDA margin was in-line at 10.8%, down 110bp YoY, impacted by rising share of the power EPC business and rise in raw material prices. RM/Sales ratio increased 120bp YoY, SG&A expenses 200bp and Staff Cost/Sales by 30bp. However, on a QoQ basis, the company has maintained its margins.
- Cutting earnings estimates, driven by expectation of lower order intake:** We cut our earnings estimates by 5% for FY12 and 12% for FY13, driven by lower sales and order intake assumptions. We estimate revenue CAGR at 5% and PAT CAGR at 3% over FY11-13. The stock trades at ~15x FY13E EPS. We maintain **Neutral**, with a revised target price of INR414 (12x FY13E EPS).

Y/E March	FY11				FY12				(INR Million)	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE	FY11	FY12E
Sales	7,898	10,916	12,412	17,713	10,444	13,035	12,693	17,627	48,832	53,799
Change (%)	45.2	60.4	65.9	45.3	32.2	19.4	2.3	-0.5	53.3	10.2
EBITDA	960	1,286	1,464	1,951	1,137	1,405	1,354	1,914	5,661	5,810
Change (%)	39.3	62.3	63.8	33.1	18.4	9.3	-7.5	-1.9	47.4	2.6
As of % Sales	12.2	11.8	11.8	11.0	10.9	10.8	10.7	10.9	11.6	10.8
Depreciation	106	105	106	116	111	117	120	126	432	473
Interest	6	5	2	10	4	11	7	1	22	23
Other Income	140	133	117	133	147	208	157	167	523	679
PBT	988	1,309	1,474	1,959	1,170	1,485	1,384	1,955	5,730	5,993
Tax	326	414	471	694	371	468	429	710	1,906	1,978
Effective Tax Rate (%)	33.0	31.6	32.0	35.4	31.7	31.5	31.0	36.3	33.3	33.0
Reported PAT	662	895	1,002	1,265	799	1,017	955	1,245	3,824	4,016
Change (%)	42.4	65.4	77.4	-907.0	20.7	13.6	-4.7	-1.6	170.4	5.0
Adj PAT	662	895	1,002	1,265	799	1,017	955	1,245	3,824	4,016
Change (%)	42.4	65.4	77.4	27.5	20.7	13.6	(4.7)	(1.6)	49.2	5.0

E: MOSL Estimates

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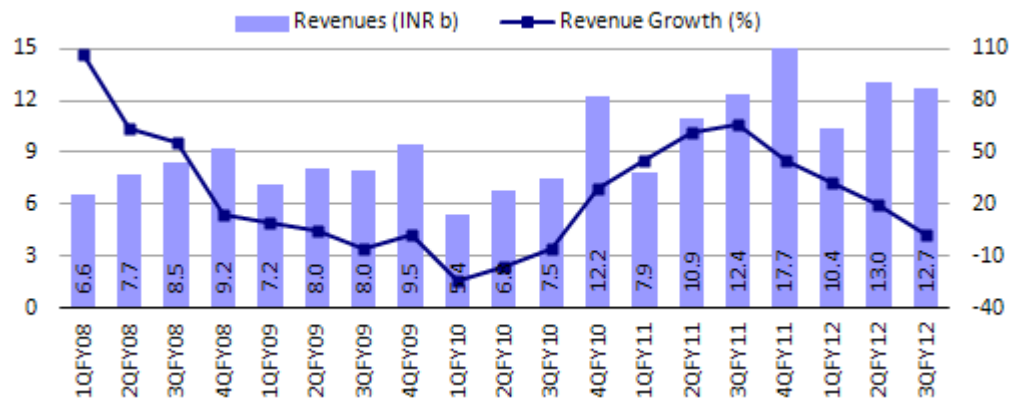
Thermax 3QFY12: Revenues disappoint, margins in-line; management cautions on growth amidst slowing orders; Neutral

- **Revenues plummeted; visibility looks poor:** Revenue growth, which was healthy till 1HFY12, tumbled to a marginal 2% YoY during 3Q at INR12.6b below our estimate of INR14b, up 14% YoY. The company has been posting healthy growth in revenues due to rising share of Power EPC in revenues (30% in 2QFY12, up from 23% last year). However with the projects reaching completion stage and slowing order intake, visibility for FY13 looks poor.
- **PAT declined by 5% YoY driven by lower sales:** Thermax's 3QFY12 standalone PAT declined 5% YoY to INR955m, below our estimate of INR1.02b due to lower than estimated sales. Consolidated PAT for the quarter declined by 11% YoY. Consolidated PAT for 9MFY12 grew 9% to INR2.9b mainly driven by Danstoker acquisition.
- **Consolidated Order Backlog at INR58b, down 11% QoQ:** BTB of 1.2xTTM revenues: Slowdown in orders remains the biggest concern for Thermax. Consolidated order intake during the quarter stood at INR7.42b, down 40% YoY. For the nine months, order intake stood at INR37b, down 17% YoY.
- **EBITDA margin down 110bp YoY led by high share of EPC projects:** 3QFY12 EBITDA margin stood at 10.8%, down 110bp YoY (flat QoQ) in line with our estimates, impacted by rising share of power EPC business and rise in raw material prices. RM/Sales ratio rose 120bp YoY, SG&A expenses 200bp and Staff cost/Sales by 30bp. However on a quarter on quarter basis the company has maintained its margins.
- **Energy segment declined sharply due to slowdown in orders from IPP:** Energy segment reported sharp decline in revenue down 12% YoY impacted by slowing orders in the power segment; environment business revenues were relatively better which posted a decline of 2% YoY. Energy business continues to experience longer execution cycles on the back of large utility orders being executed by the company. EBIT margin of environmental segment declined by 57bp YoY, while that of Energy segment declined sharply by 130bp YoY. Higher share of EPC projects in revenues has adversely impacted margins.

Growth in revenues slowed down, up 2% YoY on slower order intake

- Revenue growth, which was healthy till 1HFY12, tumbled to a marginal 2% YoY during 3Q at INR12.6b (v/s our estimate of INR14b, up 14% YoY).
- The company has been posting healthy growth in revenues due to rising share of Power EPC in revenues (30% in 2QFY12, up from 23% last year). However with the projects reaching completion stage and slowing order intake, visibility for FY13 looks poor.
- Thermax's BTB ratio is declining due to poor order intake over last 7 quarters in a row after peaking up in 1QFY11. We believe that given the loss of key orders to competition in recent months and lack of any concrete pipeline for large power projects (LPPs), revenue visibility for FY13 is poor. We expect order intake to be muted in FY12, showing a decline of 15% YoY.

Revenue growth slowed down, up 2% YoY on slowing Orders

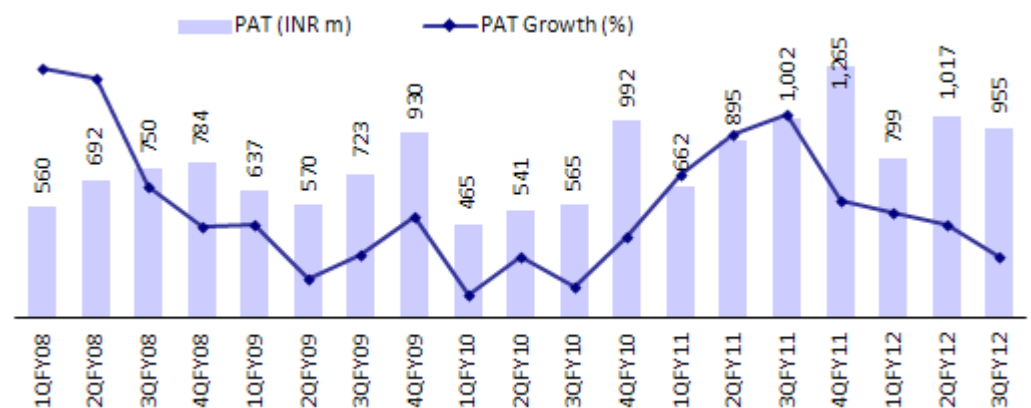


Source: Company/MOSL

PAT declined by 5% YoY driven by lower sales

- Thermax’s 3QFY12 standalone PAT declined 5% YoY to INR955m, below our estimate of INR1.02b due to lower than estimated sales. Consolidated PAT for the quarter declined by 11% YoY. Consolidated PAT for 9MFY12 grew 9% to INR2.9b mainly driven by Danstoker acquisition.
- We expect Thermax to post a CAGR of 4% YoY over FY11-13 in Standalone PAT.

PAT declined 5% YoY driven by lower sales



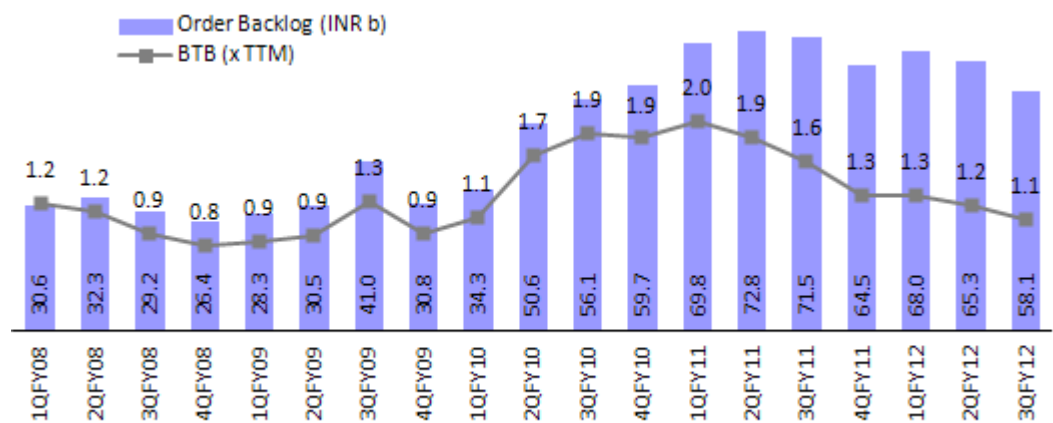
Source: Company/MOSL

Consolidated Order Backlog at INR58b, down 11% QoQ; BTB of 1.2xTTM revenues

- Slowdown in orders remains the biggest concern for Thermax. Consolidated order intake during the quarter stood at INR7.42b, down 40% YoY. For the nine months, order intake stood at INR37b, down 17% YoY.
- Consolidated order book at the quarter end was INR58b, down 18% YoY, comprising 82% for the Energy segment and 18% for the Environment segment. Power EPC accounts for 25% of the current standalone order backlog (INR15.75b).
- The company did not receive any major order during the quarter. In 1QFY12, the company had received two key orders including one worth INR4b from a leading producer of viscose staple fibre (Grasim) to construct a 3x32 MW co-gen power plant on EPC basis and an INR3.66b order for the supply of boilers for a 120MW captive power plant (Vizag Steel Plant).

- Most of the large order are the peak of their execution and will be over by the end of FY12. Out of key projects under execution, second unit of Bajaj Hindustan project (2x 50MW) order is on verge of completion, while the first unit has been commissioned. SAIL order expected to close by March – 12, while billing for Meenakshi project will be over by March 12. The 5.8b order form oil & gas sector will see billing in FY13, while BTG order form VSP will be largely booked in FY13-14.
- We expect order intake to be muted in FY12, down 15%. The company's BTB ratio is declining due to poor order intake and stands at 1.1x at end 3QFY12. Thus, revenue visibility for FY13 is poor given (1) loss of key expected projects to competition in recent months, and (2) lack of any concrete pipeline for large power projects (LPPs).

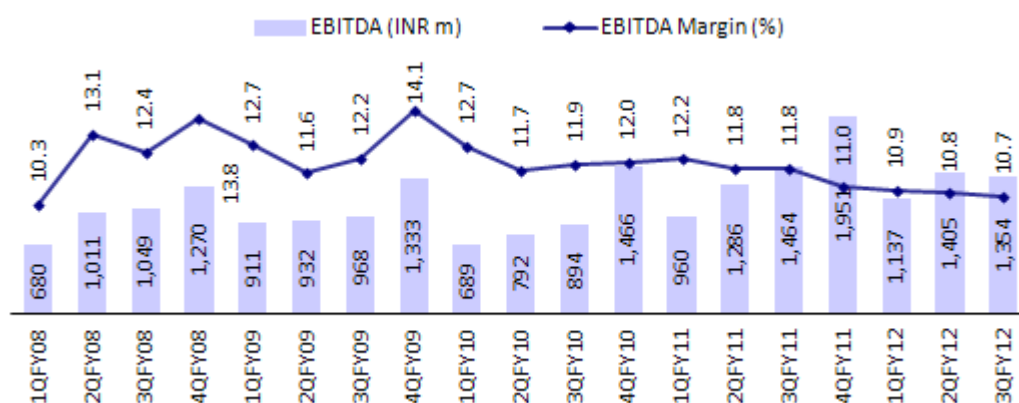
Order Backlog at INR58b; BTB at 1.2xTTM revenues



Source: Company/MOSL

EBITDA margin down 110bp YoY led by high share of EPC projects

- 3QFY12 EBITDA margin stood at 10.8%, down 110bp YoY (flat QoQ), impacted by rising share of power EPC business and rise in raw material prices. RM/Sales ratio rose 120bp YoY, SG&A expenses 200bp and Staff cost/Sales by 30bp. However on a quarter on quarter basis the company has maintained its margins.
- EBIT margin of Environment segment declined 57bp YoY (up 220bp QoQ), while that of Energy segment declined 130bp YoY (down 120bp QoQ). Higher share of EPC projects in revenues has adversely impacted margins. We see this trend continuing in remainder of FY12.
- Spot purchases hurt margins: Depletion of low cost inventory and spot purchases for short cycle orders (20% of order backlog) also pushed up RM costs. Spot purchases of steel (like structural, HR coils, sheet steel forming 10-15% of costs) and rising prices of specialty chemicals used in the Environment business (which are also procured on spot basis) are the key reasons for rise in material prices. We believe margins were supported by robust rate of execution which maintained operating leverage in the system.

EBITDA margins declined by 110bp YoY to 10.7%

Source: Company/MOSL

Energy segment declined sharply due to slowdown in orders from IPP

- Energy segment reported sharp decline in revenue down 12% YoY impacted by slowing orders in the power segment; environment business revenues were relatively better which posted a decline of 2% YoY. Energy business continues to experience longer execution cycles on the back of large utility orders being executed by the company.
- EBIT margin of environmental segment declined by 57bp YoY, while that of Energy segment declined sharply by 130bp YoY. Higher share of EPC projects in revenues has adversely impacted margins.

Segmental performance (INR m)

	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	2QFY12	3QFY12	YoY (%)
Revenues (INR m)								
Energy	6,066	8,910	9,904	14,299	8,025	10,348	9,931	0.3
Environment	2,221	2,482	2,943	3,827	2,647	2,968	3,024	2.8
Total	8,286	11,392	12,847	18,126	10,672	13,317	12,955	0.8
EBIT (INR m)								
Energy	680	913	1,073	1,494	810	1,102	947	-11.8
Environment	269	308	399	499	313	320	393	-1.6
Total	949	1,221	1,472	1,993	1,123	1,422	1,340	-9.0
EBIT Margin (%)								
Energy	11.2	10.2	10.8	10.4	10.1	10.7	9.5	(130)bp
Environment	12.1	12.4	13.6	13.0	11.8	10.8	13.0	(57)bp
Total	11.5	10.7	11.5	11.0	10.5	10.7	10.3	(112)bp

Source: Company/MOSL

Conference call takeaways**Management sounds cautious; delay in capex cycle can force the company to take projects at lower margins**

- The company expects recovery in capex cycle in 2HFY13, due to strong consumption demand in the economy. However, if that were not to happen, the capital goods industry will fall into a strong negative-growth cycle. Though Thermax is better placed than peers to tide over the crisis, continued slowdown may force the company to take projects at lower margins.

- Company doesn't expect growth in FY13 revenues. It would attempt to maintain double-digit EBITDA margin.
- The outlook seems uncertain with no finalization of large orders in any sector in 3QFY12. All key segments, namely, Power, steel, cement and oil & gas did see postponement of capex decisions.
- The progress on Thermax Babcox Wilcox JV, for supercritical boilers, is on stream and is expected to be completed by September 2012. The company is spending INR8.24b on the project, which will have manufacturing capacity of 4GW per annum.
- The company is not in active negotiation for any new power EPC contract. There are 1-2 enquiries (150MW, 300MW sizes), one of which may convert into active negotiation in 1QFY13. However, finalization of such projects will depend on funding. The company has not refused any order during the quarter.
- Out of key projects under execution, second unit of Bajaj Hindustan project (2x 50MW) order is on verge of completion, while the first unit has been commissioned. SAIL order expected to close by March - 12, while billing for Meenakshi project will be over by March 12. The 5.8b order form oil & gas sector will see billing in FY13, while BTG order form VSP will be largely booked in FY13-14.
- The Indian power sector will continue to see tough times over the next 18-months. However, giving rising per capita consumption, the power shortages for consumers and industry will see sharp rise and power developers with cash and capacity will make substantial returns. Recovery in power investments will take place only in four conditions are met< namely, rise in power tariffs, availability of coal, lower interest rates and land acquisition.

Valuation and view

- We have cut our earnings estimate by 5% for FY12 and 12% for FY13 driven by lower sales and order intake assumptions.
- We now expect FY12 sales to grow 10% YoY and FY13 sales to remain flat YoY. We expect order intake in FY12 to decline 15% YoY before reviving 15% in FY13. We expect FY11-13 revenue CAGR of 5% and profit CAGR of 3%.
- Thermax trades at 15x FY13E. We rate the stock **Neutral** with a revised target price of INR414 based on 12x FY13E EPS (earlier INR 472).

Thermax: an investment profile

Company Background

Thermax is India's leading engineering company involved in pressure vessels (boilers), captive power plant, engineering and environmental engineering (water and air treatment). Thermax has now entered the super-critical boiler business with a JV with B&W USA and will have a capacity of 4.5Gw by FY13.

Key investment arguments

- The super-critical JV with B&W USA will provide Thermax the opportunity to participate in the central and SEB ordering for BTG in the XIIth plan with almost 43GW of capacity in the XIIth plan to be on supercritical parameters.
- We project a revenue and PAT CAGR of 5% and 4% through FY11-13E with EBITDA margins of ~11% over the same period with potential re-rating triggers in the form of pick up in the super-critical BTG business with B&W.

Key investment risks

- Possible margin compression due to entry into supercritical BTG due to high initial import content which could be in the range of 18-20%.
- Higher working capital days due to large share of EPC projects in the revenue mix going forward thereby compressing return ratios and cash flows.

Recent developments

- Thermax has signed a joint venture agreement with SPX Netherlands BV, a wholly owned subsidiary of USbased SPX Corporation, a global leader in providing pollution control services to power plants. This JV is now pre-qualified to bid for ESP's for the NTPC bulk tendering of 11X660MW
- Thermax and US-based GE Water signed agreements to share GE's ultra filtration and bioreactor (MBR) technology. Thermax will use it to treat waste water, and reuse and process water in India's commercial and institutional sectors. This will provide a huge leg up for Thermax's water treatment division in catering to large commercial and industrial clients.

Valuation and view

- We expect FY11-13 revenue CAGR of 5% and PAT CAGR of 3%. Thermax trades at ~15x FY13E.
- Upsides to our earnings estimates could be in the form of breakthrough orders in the super-critical JV in FY13 or success in any large power project.
- We maintain **Neutral** with a revised target price of INR414 based on 12x FY13E EPS (earlier INR 472).

Sector view

- We remain **Neutral** on the sector.

Comparative valuations

		Thermax	L&T	BHEL
P/E (x)	FY12E	14.7	18.0	10.1
	FY13E	14.6	16.3	10.0
P/BV (x)	FY12E	3.7	3.3	2.6
	FY13E	3.1	3.0	2.2
EV/Sales (x)	FY12E	0.9	1.6	1.2
	FY13E	0.9	1.6	1.2
EV/EBITDA (x)	FY12E	8.5	14.3	6.2
	FY13E	8.3	13.7	6.3

Shareholding Pattern (%)

	Dec-11	Sep-11	Dec-10
Promoter	62.0	62.0	62.0
Domestic Inst	11.2	12.0	14.9
Foreign	11.3	10.7	9.5
Others	15.6	15.3	13.6

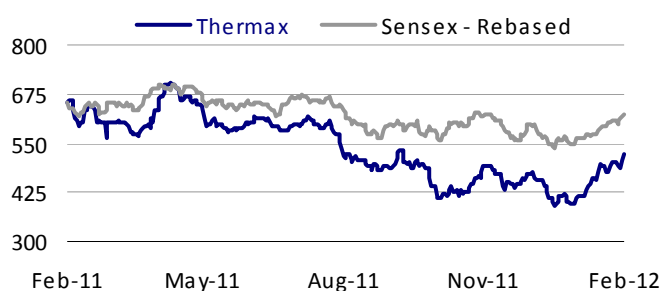
EPS: MOSL forecast v/s Consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	34.4	34.8	-1.1
FY13	34.5	35.6	-3.2

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
522	414	-20.7	Neutral

Stock performance (1 year)



Financials and Valuation

Income Statement		(INR Million)			
Y/E March	2010	2011	2012E	2013E	
Total Revenues	33,703	53,371	58,659	59,168	
Change (%)	-2.5	58.4	9.9	0.9	
Raw Materials	20,271	36,246	39,595	39,051	
Staff Cost	3,300	4,597	5,517	6,344	
Other Expenses	6,161	6,788	7,332	7,574	
EBITDA	3,972	5,740	6,215	6,199	
% of Total Revenues	11.8	10.8	10.6	10.5	
Depreciation	442	541	569	619	
Other Income	519	579	676	768	
Interest	20	41	20	20	
PBT	4,028	5,737	6,302	6,328	
Tax	1,432	1,967	2,206	2,215	
Rate (%)	35.5	34.3	35.0	35.0	
Adjusted PAT	2,592	3,817	4,096	4,113	
EO Income (net)	-1,149	0	0	0	
Reported PAT	1,444	3,817	4,096	4,113	
Change (%)	-50.0	164.4	7.3	0.4	

Balance Sheet		(INR Million)			
Y/E March	2010	2011	2012E	2013E	
Share Capital	238	238	238	238	
Reserves	10,544	12,911	15,761	18,628	
Net Worth	10,926	13,448	16,298	19,165	
Loans	80	1,479	1,489	1,499	
Deferred Tax Liability	144	298	298	298	
Capital Employed	11,099	15,447	17,787	20,664	
Gross Fixed Assets	7,418	10,677	11,377	12,377	
Less: Depreciation	2,048	2,824	3,392	4,011	
Net Fixed Assets	5,369	7,853	7,984	8,366	
Capital WIP	115	354	683	985	
Investments	3,703	2,415	2,665	2,915	
Curr. Assets	24,306	29,968	30,712	32,867	
Inventory	5,744	7,473	8,678	9,402	
Debtors	7,984	10,672	10,928	11,347	
Cash & Bank Balance	6,702	7,496	6,350	7,321	
Loans & Advances	3,282	3,596	3,953	3,987	
Other Assets	594	731	803	810	
Current Liab. & Prov.					
Creditors	7,583	8,922	6,428	6,484	
Other Liabilities	13,443	14,224	15,633	15,769	
Provisions	1,368	1,998	2,195	2,215	
Net Current Assets	1,912	4,824	6,455	8,399	
Application of Funds	11,099	15,447	17,787	20,664	

E: MOSL Estimates

Ratios					
Y/E March	2010	2011	2012E	2013E	
Basic (Rs)					
EPS	21.8	32.0	34.4	34.5	
Cash EPS	25.5	36.6	39.2	39.7	
Book Value	91.7	112.9	136.8	160.8	
DPS	5.0	9.0	9.0	9.0	
Payout (incl. Div. Tax.)	23.0	28.1	26.2	26.1	
Valuation (x)					
P/E		15.8	14.7	14.6	
Cash P/E		13.8	12.9	12.7	
EV/EBITDA		9.0	8.5	8.3	
EV/Sales		1.0	0.9	0.9	
Price/Book Value		4.5	3.7	3.1	
Dividend Yield (%)		1.8	1.8	1.8	
Profitability Ratios (%)					
RoE	25.1	31.9	28.1	23.6	
RoCE	24.6	29.0	24.7	21.5	

Turnover Ratios					
Debtors (Days)	86	73	68	70	
Inventory (Days)	62	51	54	58	
Creditors. (Days)	82	61	40	40	
Asset Turnover (x)	6.3	6.8	7.3	7.1	
Leverage Ratio					
Debt/Equity (x)	0.0	0.1	0.1	0.1	

Cash Flow Statement		(INR Million)			
Y/E March	2010	2011	2012E	2013E	
PBT before EO Items	5,737	6,302	6,328	8,550	
Add : Depreciation	442	541	569	619	
Interest	20	41	20	20	
Less : Direct Taxes Paid	1,432	1,967	2,206	2,215	
(Inc)/Dec in WC	4,687	(2,118)	(2,777)	(974)	
CF from Operations	7,746	2,234	1,908	3,779	
EO Income	-1,149	0	0	0	
CF from Oper. Incl. EO Item	6,597	2,234	1,908	3,779	
(Inc)/Dec in FA	(838)	(3,265)	(1,028)	(1,302)	
(Pur)/Sale of Investment	(2,271)	1,289	(250)	(250)	
CF from Investments	(3,109)	(1,976)	(1,278)	(1,552)	
(Inc)/Dec in Net Worth	194	424	(519)	0	
(Inc)/Dec in Debt	39	1,400	10	10	
Less : Interest Paid	20	41	20	20	
Dividend Paid	695	1,246	1,246	1,246	
CF from Fin. Activity	(482)	536	(1,776)	(1,256)	
Inc/Dec of Cash	3,006	794	(1,146)	970	
Add: Beginning Balance	3,696	6,702	7,496	6,350	
Closing Balance	6,702	7,496	6,350	7,321	

N O T E S

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2. Group/Directors ownership of the stock
3. Broking relationship with company covered
4. Investment Banking relationship with company covered

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