

**HOLD**

## Thermax

**Target Price (INR)**

**521**

**P/E premium may sustain on cycle recovery hopes**

**Rating**



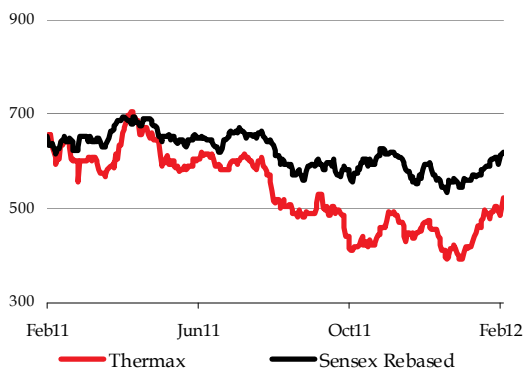
**Last Price (INR)**

**521.3**

Bloomberg code	TMX IN
Reuters code	THMX.BO
Avg. Vol. (3m)	104,464
Avg. Val.(3m)(INRmn)	48.0
52-wk H/L (INR)	720 / 381
Sensex	17,605
MCAP (INRbn/USDbn)	62.11 / 1.28

Shareholding (%)	9/11	12/11
Promoters	62.0	62.0
MFs, FIs, Banks	12.0	11.2
FIs	10.6	11.1
Public	13.1	13.2
Others	2.4	2.5

**Stock Chart (Relative to Sensex)**



Stock Perf. (%)	1m	3m	1yr
Absolute	27.9	5.4	-20.0
Rel. to Sensex	17.5	4.7	-15.4

Financials (INRmn)	03/11	03/12f	03/13f
Sales	48,832	53,679	50,192
YoY (%)	53	10	-6
EBITDA (%)	11.6	10.8	11.6
A.PAT	3,824	4,067	3,861
Sh o/s (diluted)	119	119	119
A.EPS (INR)	32.1	34.1	32.4
YoY (%)	49	6	-5
D/E (x)	-0.5	-0.3	-0.3
P/E (x)	16.2	15.3	16.1
EV/E (x)	9.8	10.0	9.7
RoCE (%)	32	28	23
RoE (%)	33	29	23

Quarterly Trends	03/11	06/11	09/11	12/11
Sales (INRmn)	17,713	10,444	13,035	12,693
PAT (INRmn)	1,265	799	1,017	955

TMX's order inflows in the Dep11 quarter were down 56% compared to average inflows in FY11, impacted by sluggish sector growth and lack of large project opportunities. Order backlog was down 18% y-o-y and is likely to lead to declining revenue in the next few quarters. Margins are sequentially stable and the management indicated they have not yet resorted to under-cutting. We cut our FY12f-FY13f EPS forecast by up to 4%. TMX's P/E premium to BHEL is at its highest in three years and, on hopes of comparatively faster recovery in TMX's diversified business, may sustain at current levels. Accordingly, we raise the target P/E to 14x, roll over our TP to Dec12 and increase it to INR521. Maintain Hold. Lower order inflows and higher raw material costs are the key risk factors.

### Revenue growth deceleration continues, margins up on excluding MTM

TMX reported y-o-y increase of 2% in revenue and decline of 5% in PAT in 3QFY12. Revenue growth continues to decelerate sharply, considering y-o-y revenue growth of 53% in FY11 and 25% in 2HFY12. Overall EBITDA margins slipped marginally on sequential basis. However, excluding 100-bp of forex MTM on commodity hedges, adjusted EBITDA margins were up 90-bp q-o-q. The energy segment's EBIT margins slipped 112-bp q-o-q, while the environment segment's margins recovered smartly by 222-bp.

### Orders falter on project order deferrals; order book down by 18%

Standalone order inflows of INR5.5bn for the quarter were disappointing and sharply lower than the run rate in the past three years. Inflows for the quarter include an INR700mn order booked from non-ferrous metals industry. The fall in order inflows is reflective of the poor ground level activity in small orders and the dearth of opportunities in large project orders.

### Revenue growth may remain negative for some quarters

Order inflows in 9MFY12 are down 22%, leading to an 18% y-o-y decline in the standalone order backlog. We have cut our FY12f order inflow forecast by 16% and the FY13f revenue by 4%. Our forecasts imply revenue growth is likely to slip further and remain in the negative for some quarters. FY12f-FY13f EPS forecast is cut by up to 4%.

### Maintain Hold with TP of INR521; P/E premium to BHEL may stay

TMX's premium to Bharat Heavy Electricals (BHEL IN, Reduce) has expanded sharply to 48% compared to the past one-year average of 15%. Assuming the capex cycle turns around in the next few quarters, TMX, with its diverse product range, may be able to comparatively recover faster in terms of orders and revenues. Accordingly, we estimate TMX to trade at a higher premium to BHEL in P/E terms than the average of the past one year. Accordingly, we revise the target P/E to 14x (from 12x). We roll over the target to Dec12 and raise it to INR521 (from INR430). Maintain Hold. Our forecasts and target do not include any upside from the company's boiler manufacturing JV, which is on track to commence operations from Sep12 (INR18/share contribution to equity). A rise in raw material prices and lower order inflows are risk factors.

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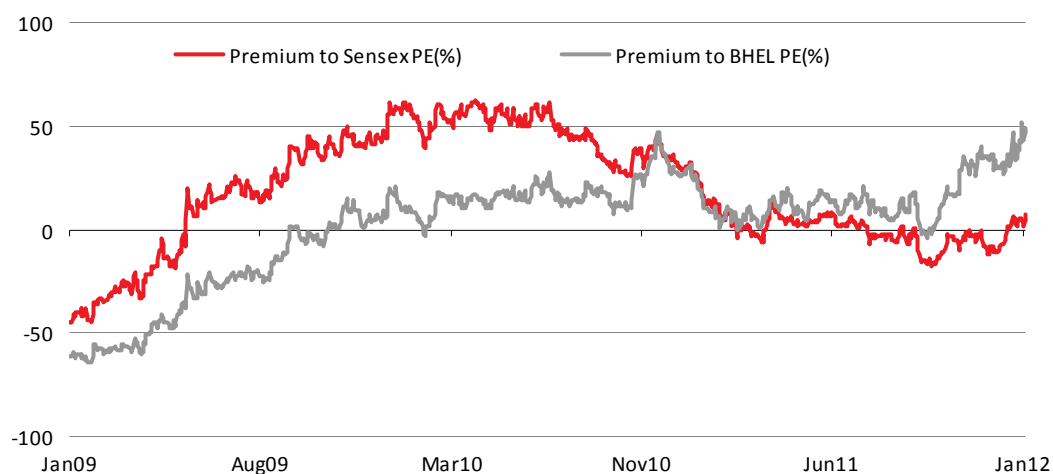
Exhibit 1: Earnings revision summary

(INRmn)	----- FY12f -----			----- FY13f -----			----- FY14f -----		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change(%)
Revenue	54,403	53,679	-1	52,479	50,192	-4	57,059	57,094	0
EBITDA	6,116	5,795	-5	5,961	5,824	-2	6,842	6,988	2
EBITDA margin (%)	11.2	10.8	-45bp	11.4	11.6	24bp	12.0	12.2	25bp
PAT	4,221	4,067	-4	3,987	3,861	-3	4,554	4,621	1
EPS (INR)	35.4	34.1	-4	33.5	32.4	-3	38.2	38.8	1
Order inflow (INRbn)	50.4	42.6	-16	53.1	53.0	0	58	66	13

Source: Avendus Research

Currently, TMX is trading at a 48% premium to BHEL's P/E, while on average it has traded at a premium of 32% in the past three-months and at 15% in past one year.

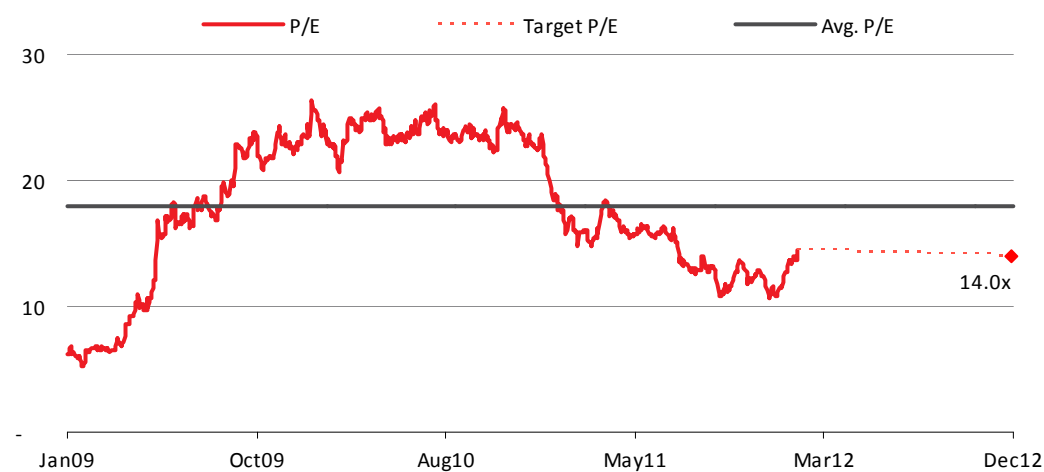
Exhibit 2: One-year forward P/E premium to Sensex and BHEL based on consensus estimates(%)



Source: Company, Bloomberg, Avendus Research

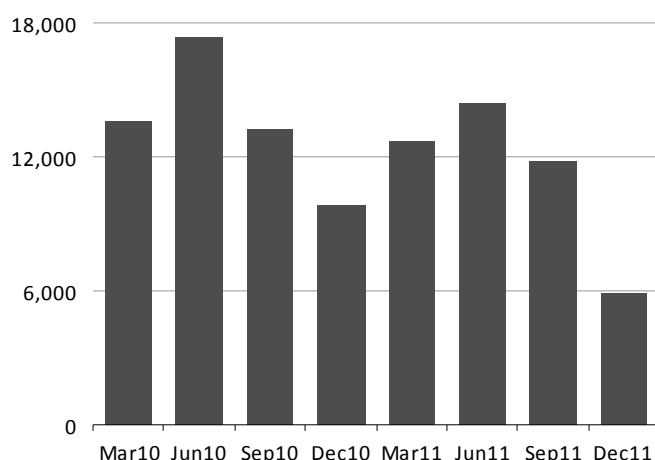
TMX's target P/E of 14x is at a 44% premium to BHEL's current one-year forward P/E of 9.8x. Previously, our target P/E of 12x was at an 8% premium to BHEL's then one-year forward P/E of 11.1x.

Exhibit 3: One-year forward P/E based on consensus estimates and target P/E (x)



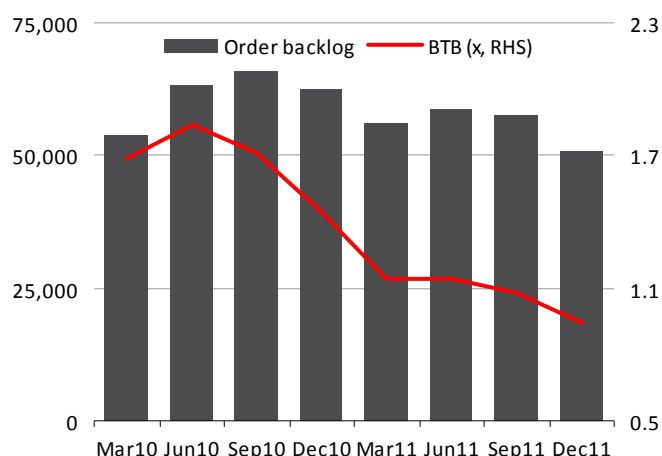
Source: Company, Bloomberg, Avendus Research

Exhibit 4: Order booking trend (INRmn)



Source: Company, Avendus Research

Exhibit 5: Order backlog trend (INRmn)



Source: Company, Avendus Research

### Key takeaways from the earnings concall:

- ▶ Forex MTM loss of cINR126mn in 3QFY12 (profit of INR140mn in 1HFY11).
- ▶ After being the frontrunner in a 300MW BTG order worth cINR6bn, the company lost the order to the market leader – highlighting the heightened competitive pressures in the industry for large orders.
- ▶ The management indicated that there are no large orders currently under negotiations – the same may be booked only in 2HFY13.
- ▶ It also indicated that if the sluggish environment continues, they may have to start undercutting on margins.
- ▶ 9MFY12 standalone order inflow of INR32.2bn includes INR4.7bn from overseas.
- ▶ 3QFY12 standalone order inflow of INR5.9bn includes INR3.86bn from the energy segment. Inflows for the quarter were down 56% compared to average inflows of INR13.3bn in FY11.

### Risk factors

- ▶ Increase in raw material prices.
- ▶ Lower-than-forecast order inflows.
- ▶ Increase in competitive intensity.

Exhibit 6: 2QFY12 results snapshot

(INRmn)	Dec10	Sep11	q-o-q (%)	Dec11	y-o-y (%)
Total operating income	12,412	13,035	-3	12,693	2
Total operating expenses	10,948	11,630	-3	11,339	4
EBITDA	1,464	1,405	-4	1,354	-8
Other income	117	208	-25	157	34
Depreciation	106	117	2	120	14
EBIT	1,475	1,496	-7	1,391	-6
Interest	2	11	-37	7	242
Recurring PBT	1,473	1,485	-7	1,384	-6
Net extra ordinary items	-	-	-	-	-
PBT (reported)	1,473	1,485	-7	1,384	-6
Tax	471	468	-8	429	-9
PAT (reported)	1,002	1,017	-6	955	-5
(+) Share in assoc. earnings	-	-	-	-	-
Less: Minority interest	-	-	-	-	-
Prior period items	-	-	-	-	-
Net income (reported)	1,002	1,017	-6	955	-5
Avendus net income	1,002	1,017	-6	955	-5
Shares outstanding (mn)	119	119	0	119	0
Avendus EPS (INR)	8.4	8.5	-6	8.0	-5
<b>Ratios (%)</b>					
EBITDA margin	11.8	10.8		10.7	
EBIT margin	11.9	11.5		11.0	
Net profit margin	8.1	7.8		7.5	
Other income/PBT	7.9	14.0		11.3	
Effective Tax rate	32.0	31.5		31.0	
<b>Segment-wise Performance</b>					
<b>Segment revenue</b>					
Energy	9,904	10,348	-4	9,931	0
Environment	2,943	2,968	2	3,024	3
Unallocated	-436	-282	-7	-262	-40
Total revenue	<b>12,412</b>	<b>13,035</b>	<b>-3</b>	<b>12,693</b>	<b>2</b>
<b>Segment EBIT</b>					
Energy	1,073	1,102	-14	947	-12
Environment	399	320	23	393	-2
Unallocated	3	73	-30	51	1,487
EBIT	<b>1,475</b>	<b>1,496</b>	<b>-7</b>	<b>1,391</b>	<b>-6</b>
<b>Segment margins (%)</b>					
Energy	10.8	10.7		9.5	
Environment	13.6	10.8		13.0	
EBIT / Sales	<b>11.9</b>	<b>11.5</b>		<b>11.0</b>	
<b>Capital Employed</b>					
Energy	1,396	3,516	11	3,906	180
Environment	1,152	1,826	16	2,111	83
Unallocated	10,412	9,289	3	9,554	-8
Total Capital employed	<b>12,959</b>	<b>14,630</b>	<b>6</b>	<b>15,571</b>	<b>20</b>

Source: Company, Avendus Research

## Financials and valuations (standalone)

### Income statement (INRmn)

Fiscal year ending	03/11	03/12f	03/13f	03/14f
<b>Total operating income</b>	<b>48,832</b>	<b>53,679</b>	<b>50,192</b>	<b>57,094</b>
<b>Total operating expenses</b>	<b>43,172</b>	<b>47,884</b>	<b>44,368</b>	<b>50,105</b>
<b>EBITDA</b>	<b>5,661</b>	<b>5,795</b>	<b>5,824</b>	<b>6,988</b>
Other income	523	699	459	540
Depreciation	432	465	513	572
<b>EBIT</b>	<b>5,752</b>	<b>6,029</b>	<b>5,769</b>	<b>6,957</b>
Interest	22	25	28	33
Recurring PBT	5,730	6,004	5,742	6,924
Net extra ordinary items	-	-	-	-
PBT (reported)	5,730	6,004	5,742	6,924
Total taxes	1,906	1,937	1,881	2,303
PAT (reported)	3,824	4,067	3,861	4,621
(+) Share in assoc. earnings	-	-	-	-
Less: Minority interest	-	-	-	-
Prior period items	-	-	-	-
Net income (reported)	3,824	4,067	3,861	4,621
<b>Aventus net income</b>	<b>3,824</b>	<b>4,067</b>	<b>3,861</b>	<b>4,621</b>
Shares outstanding (mn)	119.2	119.2	119.2	119.2
Aventus dil. shares (mn)	119.2	119.2	119.2	119.2
<b>Aventus EPS (INR)</b>	<b>32.1</b>	<b>34.1</b>	<b>32.4</b>	<b>38.8</b>

### Growth ratios (%)

Total operating income	53.3	9.9	-6.5	13.7
EBITDA	47.4	2.4	0.5	20.0
EBIT	46.2	4.8	-4.3	20.6
Recurring PBT	46.2	4.8	-4.4	20.6
Aventus net income	49.2	6.4	-5.1	19.7
Aventus EPS	49.2	6.4	-5.1	19.7

### Operating ratios (%)

EBITDA margin	11.6	10.8	11.6	12.2
EBIT margin	11.8	11.2	11.5	12.2
Net profit margin	7.7	7.5	7.6	8.0
Other income/PBT	9.1	11.6	8.0	7.8
Effective Tax rate	33.3	32.3	32.8	33.3

### Balance sheet (INRmn)

Fiscal year ending	03/11	03/12f	03/13f	03/14f
Equity capital	238	238	238	238
Preference capital	-	-	-	-
Reserves and surplus	12,685	15,358	17,825	20,774
<b>Net worth</b>	<b>12,923</b>	<b>15,596</b>	<b>18,063</b>	<b>21,012</b>
Minority interest	-	-	-	-
Total debt	480	-	-	-
Deferred tax liability	201	238	283	340
<b>Total liabilities</b>	<b>13,605</b>	<b>15,834</b>	<b>18,347</b>	<b>21,352</b>
Gross block	7,171	7,976	8,729	9,871
less: Acc. depreciation	2,305	2,771	3,284	3,856
Net block	4,866	5,206	5,445	6,016
CWIP	297	297	297	297
Goodwill	-	-	-	-
Investments	4,044	4,582	4,814	4,814
Cash	6,566	3,639	5,385	7,518
Inventories	6,394	7,029	6,572	7,476
Debtors	10,013	11,006	10,291	11,706
Loans and advances	3,748	3,950	3,543	4,030
less: Current liabilities	20,702	18,069	16,154	18,333
less: Provisions	1,621	1,806	1,847	2,171
Net working capital	4,398	5,749	7,790	10,226
<b>Total assets</b>	<b>13,605</b>	<b>15,834</b>	<b>18,347</b>	<b>21,352</b>

### Cash flow statement (INRmn)

Fiscal year ending	03/11	03/12f	03/13f	03/14f
Net profit	3,824	4,067	3,861	4,621
Depreciation	432	465	513	572
Deferred tax	29	37	46	57
Working capital changes	-2,040	-4,278	-295	-302
Less: Other income	523	699	459	540
<b>Cash flow from operations</b>	<b>1,723</b>	<b>-408</b>	<b>3,666</b>	<b>4,407</b>
Capital expenditure	-473	-805	-753	-1,142
Strategic investments	-2,467	-539	-231	0
Marketable investments	2,205	-	-	-
Change in other loans & adv.	-	-	-	-
Goodwill paid	-	-	-	-
Other income	523	699	459	540
<b>Cash flow from investing</b>	<b>-212</b>	<b>-645</b>	<b>-525</b>	<b>-601</b>
Equity raised	0	0	0	0
Change in borrowings	480	-480	0	0
Dividends paid (incl. tax)	-1,246	-1,394	-1,394	-1,673
Others	-235	0	0	0
<b>Cash flow from financing</b>	<b>-1,001</b>	<b>-1,874</b>	<b>-1,394</b>	<b>-1,673</b>
<b>Net change in cash</b>	<b>510</b>	<b>-2,927</b>	<b>1,747</b>	<b>2,133</b>

### Key Ratios

Fiscal year ending	03/11	03/12f	03/13f	03/14f
<b>Valuation ratios (x)</b>				
P/E (on Aventus EPS)	16.2	15.3	16.1	13.4
P/E (on basic, reported EPS)	16.2	15.3	16.1	13.4
P/CEPS	14.6	13.7	14.2	12.0
P/BV	4.8	4.0	3.4	3.0
Dividend yield (%)	1.7	1.9	1.9	2.3
Market cap. / Sales	1.3	1.2	1.2	1.1
EV/Sales	1.1	1.1	1.1	0.9
EV/EBITDA	9.8	10.0	9.7	7.7
Net Cash / Market cap.	11.9	7.1	10.0	13.4
<b>Per share ratios (INR)</b>				
Aventus EPS	32.1	34.1	32.4	38.8
EPS (Basic, reported)	32.1	34.1	32.4	38.8
Cash EPS	35.7	38.0	36.7	43.6
Book Value	108.5	130.9	151.6	176.3
Dividend per share	9.0	10.0	10.0	12.0
Total assets / equity (x)	1.0	1.0	1.0	1.0
<b>Return ratios (%)</b>				
ROCE	31.6	27.7	22.7	23.4
ROIC	102.9	47.9	33.8	37.7
ROE	32.6	28.5	22.9	23.7
ROA	31.5	27.6	22.6	23.3
OCF/Sales	3.5	-0.8	7.3	7.7
FCF/Sales	2.6	-2.3	5.8	5.7
<b>Turnover ratios (x)</b>				
Asset turnover (x)	4.0	3.6	2.9	2.9
Gross asset turnover	6.8	6.7	5.7	5.8
Inventory / Sales (days)	43.4	45.6	49.5	44.9
Receivables (days)	65.3	71.5	77.4	70.3
Payables (days)	185.7	162.8	159.9	143.9
Working capital cycle (days)	-23.8	-0.2	16.4	16.3
<b>Solvency ratios (x)</b>				
Gross debt to equity	0.1	0.0	0.0	0.0
Net debt to equity	-0.5	-0.3	-0.3	-0.4
Net debt to EBITDA	0.1	0.0	0.0	0.0
Interest Coverage (on EBIT)	263.8	240.5	209.2	210.2

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	Analyst ownership of the stock	Avendus or its associate company's ownership of the stock	Investment Banking mandate with associate companies of Avendus
Thermax	No	No	No
Bharat Heavy Electricals	No	No	No

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