
Shriram EPC (SEPC) – Plant visit note

Vijaykumar Bupathy +91.44.43440036 vijaykumar@sparkcapital.in

Rajeshwari Patil rajeshwari@sparkcapital.in

Our visit to the integrated wind turbine manufacturing facility of Leitner-Shriram

We visited the recently inaugurated, megawatt class wind turbine manufacturing facility of Leitner-Shriram, located in the industrial suburb of Gummidipoondi, about 45kms north of Chennai.

Leitner-Shriram is a joint venture between the Italian company Leitner and the Chennai-based Shriram EPC (SEPC), formed to manufacture / install megawatt class wind turbines (WT).

Leitner-Shriram is currently manufacturing 1.5MW WTs from the facility. Certification in place for 1.35 MW. Certification formalities for the 1.5MW WTs have been initiated and are in progress.

The facility has the capacity to produce 150 units of 1.5 MW gearless wind turbines annually, including all critical turbine components such as generator, controls and nacelle.

Structure of the Leitner-Shriram JV (the manufacturing JV): Leitner - A 104 year old Italian company with EUR 600mn in revenues, whose domain technology is in ropeways – 51%. SEPC is the Indian partner with EPC capabilities - 49%.

Key takeaways from the plant visit

- Plant is operational with 10 WTs commissioned as on date. Commissioning of a further 15 units is in progress.
- Technology appears impressive and boasts of sustainable advantages on the fronts of efficiency, cost competitiveness, ease of installation and convenience in repairs & maintenance. The key differentiator on the technology front is the pioneering of “Modular Construction”.
- Project investment – Phase-I - Rs. 1.2bn, 1:1 debt-equity. (Currently, the unit can manufacture up to 120 units per annum)
- The JV expects to realize Rs. 90 – 98mn from the sale of a 1.5MW WT. Price range of competitors is as follows - Vestas (1.5MW)– Rs. 100mn; Suzlon (1.5MW) – Rs. 80mn. The company believes that the premium to Suzlon is justified by the superior Permanent Magnet technology employed by SEPC.

Valuation: Excluding the value of other businesses, SEPC's WT business trades at a >22x conservative FY11E PAT and at ~13x aggressive FY11E PAT.

MARKET DATA

Date	23 Nov 2009
SENSEX	17022
NIFTY	5052
Bloomberg Reuters code	SEPC IN SEPC.BO
Market cap (Rs. bn)	10.0
Free float (%)	57.56
52-week High-Low (Rs.)	265-77
3m Avg.Daily Volume	24,051
Shareholding pattern (%)	
Promoters	42.44
Institutions	7.15
Public	50.41

Stock Performance (in %)	1m	3m	12m
SEPC	(2.1)	31.9	108.8
Sensex	(3.0)	11.2	97.6

FINANCIAL SUMMARY - CONSOLIDATED

YEAR	SALES (Rs.mn)	EBITDA (Rs. mn)	PAT (Rs.)	EPS (Rs.)	P/E (x)
FY07	2,957	223	141	6.9	33.5
FY08	6,999	677	349	7.8	29.8
FY09	10,058	1,035	650	14.6	16

JV Strategy

- Leitner provides the R&D – Leitner, based on their ropeways experience, has done reverse engineering and come up with WT technology. Leitner has already produced WTs to ensure / check the functioning of their newfangled technology .
- SEPC manufactures the WT (Gestation period for a WT installation is 4-5 months). SEPC is a turnkey service provider – each WT project entails the following 1) identifying the wind site, 2) manufacturing, 3) supply,4) erection, 5) technical planning, 6) grid connectivity and 7) O&M.

The Technology

Technology appears impressive and boasts of sustainable advantages on the fronts of efficiency, cost competitiveness, ease of installation and convenience in repairs & maintenance. The key differentiator on the technology front is the pioneering of “Modular Construction”. That and other key aspects pertaining to the technology are detailed below.

Unique modular approach

- Using the modular approach, the generator’s components (coils and magnets) have been broken down into smaller parts. Generator (35 tons) is divided into several parts.
- A traditional WT would typically have a single coil running around the WT. The nail in this format is the need to pull down the entire WT down to rectify any snags. This normally substantially eats into operational time and also adds to costs.
- Positive development over the traditional WT: The modular approach (employed by the Leitner-SEPC JV) will reduce both the time and cost needed to rectify snags. Here, only the relevant component needed to be rectified is required to be brought down. The requirement to hire cranes and the resultant cost are avoided.

Fault tolerant generators (manufactured in-house)

- The WT is designed with 8 parallel circuits. Even if one circuit stops functioning, the concerned circuit is isolated and the setup continues to function. This is not the case with traditional WTs.

The Technology Contd...

Permanent magnet technology (manufactured in-house)

- The use of permanent magnets reduces the tower size by 30% (Tower mass - 100 tons). This creates space for a bigger generator. The JV imports unmagnetized units from China and magnetizes the same. China has abundant sources of this material. As such, no situation of paucity of supply arising .

Gear-less technology

Ensures low maintenance, no messy hydraulic components. Low running costs, low speed movements and low wear & tear. Also lower rotor losses.

Power converter (purchased component)

- The functionality is to match the variable frequency of power generated to the grid frequency and voltage. Plans are on to manufacture the power converter in the near future.

Blades (purchased component)

- The blades are bought from LM Glassfiber, Bangalore. By the end of FY10, SEPC will have its own blade manufacturing facility in place. Currently, the moulds for the blades are being procured.

Investment & expected realizations

- Project investment – Phase-I - Rs. 1.2bn, 1:1 debt-equity. (Currently, the unit can manufacture up to 120 units per annum)
- The JV expects to realize Rs. 90 – 98mn from the sale of a 1.5MW WT. Price points of competitors is as follows - Vestas (1.5MW)– Rs. 100mn; Suzlon (1.5MW) – Rs. 80mn. The company believes that the premium to Suzlon is justified by the superior Permanent Magnet technology employed by SEPC.

Management guidance

- FY10 – Expect to sell 40WTs; Commissioned till date-10WTs; WIP on 15WTs
- FY11 – Expect to sell 100WTs. All the installed WT's are in the domestic market. The company at its optimum capacity plans to have the sales mix of 60:40, 60 in favour of domestic sales. Leitner does the marketing of the WT's overseas.
- EBITDA margins – 17%. PAT Break even expected at 50 - 60WTs (75MWS - 90MWS).

Key Risks

- Technology yet to stand the test of time: There is inadequate operational data from the 10 WT's that are in place as these WT's have been operational only for ~ 3 months; WT's will need to provide operating data for at least another 12 months before their efficiency can be judged. However in their pilot runs, the WT's have been through 2 validation cycles (wind cycles) and have performed satisfactorily.
- No restrictive covenant that prevents Leitner from entering into tie-ups with EPC players other than SEPC.
- Dependence on the Govt to establish connectivity to the grid.

Other details

- WT Life span is ~20 years. The JV provides guarantee for 20 years post installation.
- Unique feature of the Leitner-Shriram WT: Even at 18RPMs, the WT continues to generate power. Traditional WT's require 1000RPMs.
- All WT's are remotely controlled round the clock. The angle shift in the blade to match the wind speed is also controlled remotely. Reduces the lag time between sensors sensing strong winds and the WT aligning to take advantage and produce at higher efficiencies.
- After Phase II expansion, the company's peak capacity will be at 250WT's per annum.
- Company plans to scale the rated capacity to 1.8MW's. And by FY13, rated capacity is expected to be 3MW.

Valuation

Based on the CMP of Rs. 238, SEPC currently trades at a market cap of Rs. 10.2bn. Since the company has multiple businesses, we choose to eliminate the value of other (other than WT business) businesses from the market cap in the following manner:

- We value the company's investments in OGPL at 2x P/B and eliminate a value of Rs. 2.0bn or Rs. 46 per share).
- Attaching an 8x multiple to the FY11 PAT(from EPC segment) of Rs. 400mn, we eliminate a value of Rs. 3.2bn or Rs. 74 per share).

Thus, we arrive at an adjusted market cap of Rs. 5.0bn or Rs. 118 per share, which is attributable only to the WT manufacturing business of the company.

Multiples

We further arrive at two sets of assumptions for the WT business of the company to evaluate the trading multiples, based on expected earnings in FY11.

- **Base Case:** Assuming the JV can sell 75 WTs during the year with 15% EBITDA margins. Based on these assumptions, the WT business of SEPC is trading at a >22x multiple on FY11E PAT.
- **Blue sky:** Assuming the JV can sell 100 WTs during the year with 17% EBITDA margins. Based on these assumptions, the WT business of SEPC is trading at a ~13x FY11E PAT.

Scenario workings follow hereunder.

Scenarios

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WT Estimates - FY11E	Amt in Rs.mn	
	Base case	Blue sky
No of units	75.0	100.0
S.P. (Rs.mn per WT)	90.0	90.0
Revenues	6,750.0	9,000.0
EBITDA Margins (%)	15.0	17.0
EBITDA	1,012.5	1,530.0
Interest costs	120.0	120.0
Depreciation	200.0	200.0
PBT	692.5	1,210.0
Tax	235.5	411.4
PAT	457.1	798.6
SEPC's stake (%)	50.0	50.0
SEPC's share of PAT	228.5	399.3
No of shs (mn)	43.0	43.0
EPS (pertaining to SEPC) (Rs)	5.3	9.3
Implied value of WT business (as arrived at earlier)	5,000.0	5,000.0
Multiple at which WT trades	21.9	12.5

SEPC – Overview of the company’s business verticals

SEPC is in the Wind Energy & Engineering, Procurement and Construction (EPC) businesses:

- **Wind Turbine:**

SEPC has been manufacturing 250 KW class machines and has commenced manufacture of MW class WTGs at its Integrated manufacturing facility for MW Class Wind Turbines at Gumminipoondi (near Tamil Nadu).

- **EPC:**

Leading provider of integrated EPC services for Renewable Energy, Process and Metallurgy Plants and Municipal Services.

Segmental breakup of revenues (Amt in Rs.mn)				
Amt in Rs. mn	FY09	%	FY08	%
EPC	9,503.6	94.5	5,522.5	78.9
Wind turbine	554.4	5.5	1,476.4	21.1
	10,058.0	100.0	6,998.9	100.0

SEPC’s IPO:

The company raised Rs. 1,500mn in Feb’08 through an IPO at a Rs. 290 premium to face value of Rs. 10 per share. Since then, the stock has seen a low of Rs. 83 (Mar’09) and a high of Rs. 295 (Feb’08). The IPO was done mainly to fund the 1.5MW Wind turbine business and OGPL.

Details of utilisation of IPO proceeds (Amt in Rs.mn)	
Investments in Shriram Leitwind and Leitner Shriram	290.3
Investments in OGPL	400.0
Purchase of plant & equipments for pipe rehabilitation projects	76.7
General corporate purposes	733.1
Total	1500.0

Utilisation of proceeds:

The company raised money, through the IPO, primarily to invest in the WT business and in OGPL. Despite having faced delays, the company’s 1.5MW wind turbine manufacturing facility is now operational. With this development, SEPC’s financial performance is expected to improve in the near term.

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