

Company Flash

26 September 2008 | 7 pages

Suzlon Energy (SUZL.BO)

Sell: Rights Issue ~3% Impact; Will Suzlon Green Add Value?

- **Rights issue** — Suzlon will hold a board meeting on Sep 27, 2008 to consider a rights issue of equity shares to the extent of Rs18bn. As shown on page 2 the maximum EPS dilution could be ~3% because of the rights issue.
- **Announcements by Suzlon Green Power are significant** — Suzlon Green Power (100% owned by the Tanti family), has committed to set up 3,500MW requiring investments of US\$5bn in green assets over five years, in India and China, (Suzlon Green Power will provide ~\$1.5 billion of equity). Previously the Tanti group of companies formed a JV with Arcapita Bank to invest US\$2bn to develop a 1,650 MW portfolio of wind farms in China through Honiton Energy.
- **Will Suzlon Green add value?** — Theoretically one could assume that Suzlon Green Power/Honiton Energy could give orders to Suzlon, which could help Suzlon tide over a slowdown in domestic orders and loss of orders due to technical problems. However, one has to view these developments cautiously as it might not be very easy for Suzlon Green Power/Honiton Energy to raise funding for investments in wind farms under the backdrop of the global credit crisis. Further, the markets might view orders from Suzlon Green/Honiton Energy with caution given that Suzlon's promoters have stakes in these entities.
- **Hurry to get domination agreement** — Further, Suzlon's hurry to get the domination agreement in place for REPower could suggest that the company might be facing problems in winning incremental orders and the company is keen to transfer technology at the earliest from REPower to Suzlon. There are significant downside risks to our FY10E/FY11E estimates, Maintain Sell.

Sell/Medium Risk	3M
Price (26 Sep 08)	Rs177.80
Target price	Rs216.00
Expected share price return	21.5%
Expected dividend yield	0.6%
Expected total return	22.1%
Market Cap	Rs266,389M
	US\$5,782M

Price Performance (RIC: SUZL.BO, BB: SUEL IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2007A	8,648	6.00	14.0	29.6	7.3	27.8	0.6
2008A	11,815	7.61	26.9	23.4	3.3	20.3	0.6
2009E	15,070	9.71	27.6	18.3	2.8	17.2	0.6
2010E	21,274	13.71	41.2	13.0	2.3	20.5	0.6
2011E	29,861	19.24	40.4	9.2	1.9	23.4	0.6

Source: Powered by dataCentral

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Figure 1. Rights Issue Impact

Year End Mar31 (Rsmn)	FY08	FY09E	FY10E	FY11E
FD Shares (mn)	1552	1552	1552	1552
Consolidated Recurring PAT	11,815	15,068	21,274	29,861
Overall Debt (Current)	99,346	121,211	161,355	153,680
- FCCBs	20,055	20,055	20,055	20,055
Overall Interest Cost	5,320	8,277	9,857	11,074
Effective Interest Cost on Debt (ex FCCB)		9.2%	8.1%	8.1%
Rights Issue		18,000	18,000	18,000
Reduce Interest Cost By		826	1464	1450
Effective Overall Tax Rate	14.6%	15.8%	16.0%	15.8%
Less Tax Shield Lost		131	235	229
Positive Impact on PAT		695	1229	1221
Share Issued at (Rs)		160	160	160
Number of shares (mn)		113	113	113
Current FD EPS	7.61	9.71	13.71	19.24
FD EPS Post Issue		9.47	13.52	18.67
% Change		-2.5%	-1.4%	-2.9%
Share Issued at (Rs)		170	170	170
Number of shares (mn)		106	106	106
Current FD EPS	7.61	9.71	13.71	19.24
FD EPS Post Issue		9.51	13.57	18.75
% Change		-2.1%	-1.0%	-2.6%
Share Issued at (Rs)		180	180	180
Number of shares (mn)		100	100	100
Current FD EPS	7.61	9.71	13.71	19.24
FD EPS Post Issue		9.54	13.62	18.81
% Change		-1.7%	-0.6%	-2.2%
Share Issued at (Rs)		190	190	190
Number of shares (mn)		95	95	95
Current FD EPS	7.61	9.71	13.71	19.24
FD EPS Post Issue		9.57	13.66	18.87
% Change		-1.4%	-0.3%	-1.9%
Share Issued at (Rs)		200	200	200
Number of shares (mn)		90	90	90
Current FD EPS	7.61	9.71	13.71	19.24
FD EPS Post Issue		9.60	13.70	18.93
% Change		-1.1%	0.0%	-1.6%

Source: Citi Investment Research estimates

Suzlon Energy

Company description

Suzlon Energy is the world's fifth-largest wind turbine generator (WTG) company, and the largest WTG manufacturer in Asia. Suzlon is a fully integrated wind power company that provides customers with consultancy, design, manufacturing, operations, and maintenance services. It has a subsidiary in Germany for technology development, an R&D facility in the Netherlands for rotor blade molding and tooling, and wind turbine and rotor blade manufacturing facilities in India. The company is implementing a capacity expansion program to set up an integrated manufacturing facility in China, a rotor blade manufacturing facility in the US and a forging and foundry plant in India, which should increase its capacity from the current 1500MW to 4700MW by FY09E. SUEL's product range includes turbines of 350kW, 600kW, 950kW, 1000kW, 1250kW, 1500kW, 2000kW, and 2100kW capacity.

Investment strategy

We rate Suzlon Sell/Medium Risk. We believe Suzlon has a good strategy: (1) acquire and grow Hansen to meet Suzlon's demand for gearboxes and at the same time benefiting from the strong demand for WTG gearboxes globally; (2) acquire REPower to make a credible entry in Europe, the largest absolute market for WTGs over the near future; and (3) backward integrate into components and sub-components to take control of the supply chain and mitigate raw material and component supply bottleneck risks. However, the international expansion drive has taken its toll on the company: (1) supply delays; (2) tower shortages in the international markets; (3) key component shortages; (4) negative effects of foreign currency movements and nacelle custom duty changes in the US. The latest in this chain of problems is product liabilities. Further, medium-term issues such as: (1) commodity price increases; (2) delays in Suzlon's WTG capacity ramp-up; (3) the possibility of PTC not being extended; and (4) further provisions for blade damage problems may weigh heavily on the stock's performance.

Valuation

Our target price of Rs216 is based on 17x Dec 09E EPS, the low end of Suzlon's 05-08 P/E range of 17-47x given concerns about Suzlon's S88 WTG. The recent EME order cancellations and availability issues have taken the stock to its trough valuation of 17x one-year forward earnings. We do not expect a significant re-rating until the company comes clean on its S88 turbine blade damages issue and establishes that it has a credible product to service its end-markets without product liabilities.

Risks

We rate Suzlon Medium Risk based on a number of industry-specific, financial and management risks. Key upside risks include better-than-expected MW sales in the international and domestic markets, better-than-expected realizations, and Suzlon significantly improving its international sales operating margins. Further, if PTC is extended, the stock could move up sharply on positive sentiment. If any of these risk factors has a greater impact than we expect, Suzlon's share price could exceed our target price.

Appendix A-1

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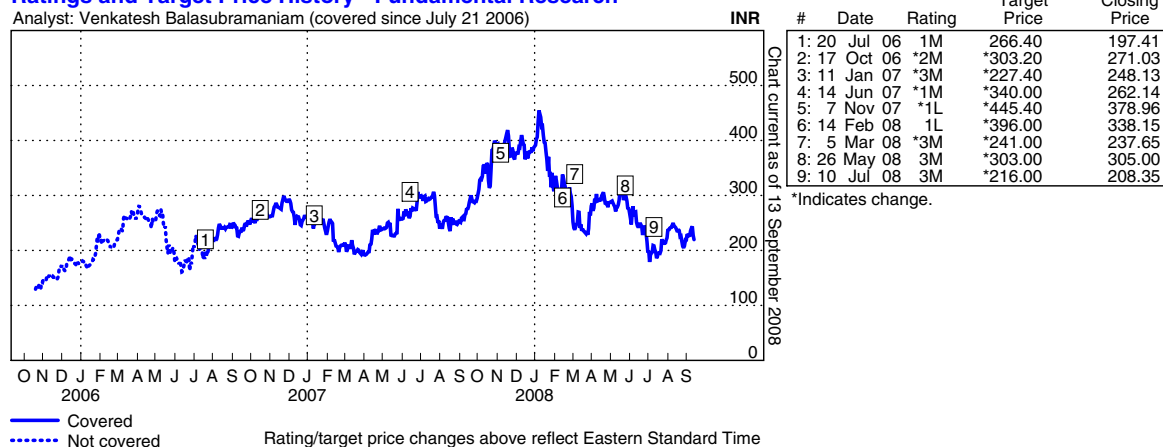
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Analyst: Venkatesh Balasubramaniam (covered since July 21 2006)



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