Suzlon Energy (SUZL.BO)

Buy: 2QFY08 – A Step in the Right Direction

- **2QFY08 PAT up 68% YoY** — Suzlon's 2QFY08 PAT at Rs3.9bn up 68% YoY was 21% ahead of CIR estimates of Rs3.3bn on account of: (1) 14% higher WTG sales volumes and (2) 76bps higher EBITDA margins.
- **Robust order backlog** — Suzlon ended the quarter with a robust order backlog of Rs163bn, up 146% YoY on the back of a string of big ticket order wins in 2QFY08. The order backlog represents 3,251MW of sales volumes that will be executed over 2HFY08E and FY09E. Order booking is the last thing one should be worrying about under the current strong demand scenario.
- **1HFY08 EBITDA margins are not bad** — On excluding Dhule/Sangli related one-off costs Suzlon's EBITDA margins in 1QFY08, 2QFY08 and 1HFY08 for the WTG business are as high as 10.2%, 18.7% and 15.9%, respectively.
- **Possible to achieve full-year numbers** — Suzlon is all set to deliver 1500+MW sales in 2HFY08. Delivery of higher volumes could lead to WTG margins improving from 15.9% levels on operating leverage and our FY08E WTG EBITDA margin expectation of 16.3% can be achieved if one excludes the one-off costs in 1HFY08 while calculating FY08E EBITDA margins.
- **Hansen listing is a positive** — Suzlon announced it is contemplating listing Hansen on the London Stock Exchange. We believe such a move might be beneficial to Suzlon's shareholders, as this will not only help finance Hansen's aggressive capacity expansion but also help in unlocking the value in Hansen.

Buy/Medium Risk	1M
Price (23 Oct 07)	Rs1,741.05
Target price	Rs1,700.00
Expected share price return	-2.4%
Expected dividend yield	0.3%
Expected total return	**-2.0%**
Market Cap	Rs501,422M US$12,630M

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

Figure 1. Suzlon Consolidated Statistical Abstract

Year to 31-Mar	Net Profit (Rsmn)	FD EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	3,654	42.04	-13%	41.4	19.2	63.9	0.3
2006A	7,562	26.30	-37%	66.2	18.4	43.1	0.4
2007E	8,648	29.99	14%	58.0	14.3	27.8	0.4
2008E	14,863	50.24	68%	34.7	10.4	35.7	0.4
2009E	21,558	72.87	45%	23.9	7.4	37.2	0.4

Source: Citi Investment Research estimates

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See Appendix A-1 for Analyst Certification and important disclosures.

Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	41.4	66.2	58.0	34.7	23.9
EV/EBITDA adjusted (x)	107.7	56.3	40.4	23.7	17.2
P/BV (x)	19.2	18.4	14.3	10.4	7.4
Dividend yield (%)	0.2	0.3	0.3	0.3	0.3
Per Share Data (Rs)					
EPS adjusted	42.04	26.30	29.99	50.24	72.87
EPS reported	42.03	26.30	29.99	50.24	72.87
BVPS	90.77	94.56	122.02	167.26	235.77
DPS	4.00	5.01	5.00	5.50	5.50
Profit & Loss (RsM)					
Net sales	19,425	38,410	79,857	146,647	212,616
Operating expenses	-15,227	-30,146	-68,617	-125,996	-182,296
EBIT	**4,197**	**8,265**	**11,240**	**20,651**	**30,320**
Net interest expense	-458	-648	-2,523	-5,036	-7,482
Non-operating/exceptionals	234	556	965	1,175	1,392
Pre-tax profit	**3,973**	**8,173**	**9,683**	**16,790**	**24,229**
Tax	-322	-568	-1,035	-1,927	-2,671
Extraord./Min.Int./Pref.div.	2	-43	0	0	0
Reported net income	**3,653**	**7,562**	**8,648**	**14,863**	**21,558**
Adjusted earnings	3,654	7,562	8,648	14,863	21,558
Adjusted EBITDA	4,691	8,980	12,958	23,854	35,210
Growth Rates (%)					
Sales	126.5	97.7	107.9	83.6	45.0
EBIT adjusted	219.4	96.9	36.0	83.7	46.8
EBITDA adjusted	223.4	91.5	44.3	84.1	47.6
EPS adjusted	-12.8	-37.4	14.0	67.5	45.0
Cash Flow (RsM)					
Operating cash flow	**-583**	**-3,288**	**-331**	**-18,949**	**-15,435**
Depreciation/amortization	493	716	1,718	3,203	4,890
Net working capital	-4,662	-10,989	-11,691	-37,015	-41,883
Investing cash flow	**-1,855**	**-4,061**	**-18,457**	**-23,261**	**-15,800**
Capital expenditure	-1,920	-4,063	-18,377	-23,261	-15,800
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**3,301**	**11,320**	**46,303**	**38,971**	**21,171**
Borrowings	1,574	549	47,113	40,815	23,015
Dividends paid	-396	-1,647	-1,640	-1,844	-1,844
Change in cash	**864**	**3,970**	**27,515**	**-3,239**	**-10,064**
Balance Sheet (RsM)					
Total assets	**20,874**	**49,024**	**125,413**	**200,837**	**265,101**
Cash & cash equivalent	1,545	5,515	15,383	12,144	2,080
Accounts receivable	6,929	16,473	25,704	48,739	73,505
Net fixed assets	3,079	6,425	23,085	43,143	54,052
Total liabilities	**11,767**	**21,585**	**90,136**	**152,541**	**197,091**
Accounts payable	5,206	7,253	0	0	0
Total Debt	3,958	4,507	51,620	92,435	115,450
Shareholders' funds	**9,107**	**27,439**	**35,277**	**48,296**	**68,010**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	24.1	23.4	16.2	16.3	16.6
ROE adjusted	63.9	43.1	27.8	35.7	37.2
ROIC adjusted	40.5	36.1	19.2	17.7	17.1
Net debt to equity	26.5	-3.7	102.7	166.2	166.7
Total debt to capital	30.3	14.1	59.4	65.7	62.9

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2QFY08 PAT up 68% YoY on strong volumes

- Suzlon's 2QFY08 PAT at Rs3.9bn up 68% YoY was 21% ahead of CIR estimates of Rs3.3bn on account of: (1) 14% higher WTG sales volumes (2) 76bps higher EBITDA margins and (3) lower than expected depreciation.
- Suzlon ended the quarter with a robust order backlog of Rs163bn, up 146% YoY on the back of a string of big ticket order wins in 2QFY08. The order backlog represents 3,251MW of sales volumes that will be executed over 2HFY08E and FY09E. Order booking is the last thing one should be worrying about under the current strong demand scenario.

Figure 2. Suzlon 1HFY08 Consolidated Results

Consolidated Results	Q107	Q108	% Chg	Q207	Q208	% Chg	H107	H108	% Chg
Income from operations	**10,689**	**19,446**	**82%**	**20,870**	**36,413**	**74%**	**31,559**	**55,859**	**77%**
(Increase)/ Decrease in stock in trade	6,514	2,323		578	(2,841)		7,092	(518)	
Consumption of raw material	(12,196)	(14,501)		(13,882)	(20,689)		(26,078)	(35,190)	
as a % of sales	53.2%	62.6%		63.7%	64.6%		60.2%	63.9%	
Staff Cost	(1,171)	(2,228)		(1,684)	(2,271)		(2,855)	(4,499)	
as a % of sales	11.0%	11.5%		8.1%	6.2%		9.0%	8.1%	
Other expenditure	(1,978)	(3,642)		(2,282)	(4,743)		(4,260)	(8,385)	
as a % of sales	18.5%	18.7%		10.9%	13.0%		13.5%	15.0%	
Total Expenditure	(8,831)	(18,048)		(17,270)	(30,543)		(26,101)	(48,592)	
EBITDA	**1,858**	**1,398**	**-25%**	**3,600**	**5,870**	**63%**	**5,458**	**7,268**	**33%**
EBITDA margin %	**17.4%**	**7.2%**		**17.3%**	**16.1%**		**17.3%**	**13.0%**	
Dhule/Sangli Related Costs		230			430			660	
Adjusted EBITDA margin		8.4%			17.3%			14.2%	
Depreciation	(347)	(585)		(428)	(583)		(776)	(1,168)	
EBIT	**1,511**	**813**	**-46%**	**3,172**	**5,286**	**67%**	**4,683**	**6,099**	**30%**
Interest Charges	(366)	(1,079)		(547)	(1,387)		(913)	(2,466)	
Other Income	161	426		87	535		248	961	
PBT	**1,306**	**160**	**-88%**	**2,711**	**4,434**	**64%**	**4,017**	**4,595**	**14%**
Tax	(346)	40	-111%	(340)	(457)	34%	(686)	(417)	-39%
Effective Tax Rate	26.5%	-24.8%		12.5%	10.3%		17.1%	9.1%	
Recurring PAT	**960**	**200**	**-79%**	**2,371**	**3,978**	**68%**	**3,331**	**4,178**	**25%**
Minority Interest	(7)	(11)		(17)	(36)		(25)	(48)	
Share of Profit of Associate	0	0		0	5			5	
Reported PAT	**953**	**189**	**-80%**	**2,354**	**3,947**	**68%**	**3,306**	**4,136**	**25%**

Source: Suzlon and Citi Investment Research

Figure 3. Suzlon 1HFY08 – Segmental Results

Segment Reporting (Rsmn)	Q107	Q108	Q207	Q208	H107	H108
Total Revenue						
Gear Box	3,152	4,429	4,368	5,276	7,520	9,705
WTG	7,518	14,880	16,087	30,834	23,604	45,713
Others	23	167	418	522	441	689
Total	**10,693**	**19,475**	**20,872**	**36,632**	**31,565**	**56,107**
Inter Segment Revenue	(3)	(28)	(3)	(219)	(6)	(248)
Net Sales/Inc. from Ops.	**10,689**	**19,446**	**20,870**	**36,413**	**31,559**	**55,859**
EBITDA						
Gear Box	521	310	472	653	993	963
Margins%	16.5%	7.0%	10.8%	12.4%	13.2%	9.9%
WTG	1,414	1,283	2,962	5,338	4375	6,621
Margins%	18.8%	8.6%	18.4%	17.3%	18.5%	14.5%
WTG ex – Dhule/Sangli		1,513		5,768		7,281
Margins%		10.2%		18.7%		15.9%
Others	(38)	36	111	38	73	74
Margins%	-165.5%	21.7%	26.5%	7.2%	0.2%	0.1%
Total	**1,896**	**1,629**	**3,545**	**6,029**	**5,441**	**7,658**
Depreciation						
Gear Box	136	258	191	199	327	457
WTG	193	302	219	347	412	649
Others	18	26	18	37	37	63
Total	347	585	428	583	776	1168
EBIT						
Gear Box	385	53	281	454	666	507
Margins%	12.2%	1.2%	6.4%	8.6%	8.9%	5.2%
WTG	1221	981	2743	4991	3964	5,972
Margins%	16.2%	6.6%	17.1%	16.2%	16.8%	13.1%
Others	(56)	10	92	1	36	11
Margins%	-245.9%	6.2%	22.1%	0.2%	8.2%	1.7%
Total	**1549**	**1044**	**3116**	**5446**	**4666**	**6490**

Source: Suzlon and Citi Investment Research

Order inflow continues to be robust

Citi Global Wind Power forecasts that the annual WTG market is set to jump to 26GW/year over the next 5 years vis-à-vis 10GW/year over the previous 5 years. In this strong demand scenario Suzlon continues to book big ticket orders.

Figure 4. Suzlon – Big Ticket WTG Orders Booked in FY08 So Far

Date	Client	Details	MW	Delivery
Apr-07	Tierra Energy, Austin, Texas	42X2.1MW	88	
May-07	PPM Energy, Portland	191X2.1MW	401	2009
		143X2.1MW	300	2008
Jun-07	Edison Mission Group Irvine, California.	150X2.1MW	315	2008
		150X2.1MW	315	2009
Sep-07	DLF Limited , India	100X1.5MW	150	Mar-08
Sep-07	Ayen Enerji Co. Inc. , Turkey	15X2.1MW	31.5	
Oct-07	Horizon Wind of Houston, Texas		200	2008
			200	2009
Oct-07	Servtec Instalacoses Brazil		155	Aug-08
Total			**2156**	

Source: Suzlon and Citi Investment Research

Obsessing about EBITDA margins

- Suzlon's numbers are hugely sensitive to WTG EBITDA margins and less to Hansen's margins (as Suzlon forms a significant chunk of the business). The un-shaded portion of Figure 4 gives our current estimates and the shaded portion is the sensitivity analysis.
- Suzlon has been facing certain issues with the residents in the local region of Dhule and Sangli in Maharashtra resulting in disruption of the smooth operations of the installed WTGs in that region, which resulted in a generation shortfall vis-à-vis what was guaranteed. Suzlon incurred a cost of Rs230mn in 1QFY08 and Rs430mn in 2QFY08. These costs have been classified under other costs in the profit & loss statement.
- On excluding these one-off costs we see that EBITDA margins in 1QFY08, 2QFY08 and 1HFY08 for the WTG business could have been as high as 10.2%, 18.7% and 15.9%, respectively.
- Further, Suzlon has delivered 1000MW of volumes in 1HFY08 and is all set to deliver 1500+MW of volumes in 2HFY08. Delivery of higher volumes in 2HFY08 could lead to WTG margins improving from the 15.9% levels on operating leverage and our FY08E WTG EBITDA margin expectations of 16.3% are not impossible to achieve if one excludes the one-off costs in 1HFY08 while calculating FY08E EBITDA margins.

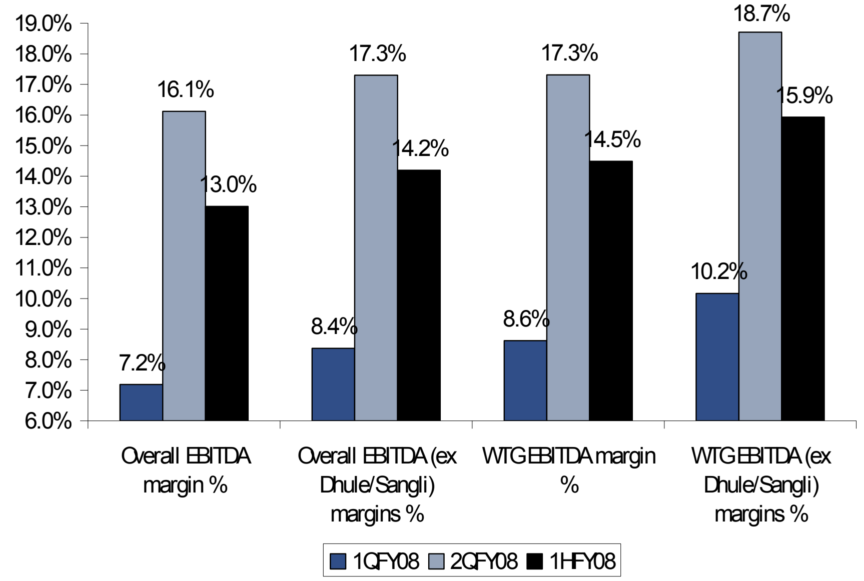
Figure 5. Suzlon – Sensitivity To Margins

	FY07	FY08E	FY09E	FY10E
Suzlon Margins	16.7%	16.3%	16.0%	16.2%
Hansen Margins	14.9%	14.8%	14.5%	14.3%
FD EPS	30.0	50.2	72.9	90.1
EPS CAGR FY07 - 10E	44.3%			
Suzlon	16.7%	15.5%	15.5%	15.5%
Hansen	14.9%	14.8%	14.5%	14.3%
FD EPS	30.0	47.2	70.0	85.3
EPS CAGR FY07 - 10E	41.7%			
Less By	0%	-6%	-4%	-5%
Suzlon	16.7%	15.0%	15.0%	15.0%
Hansen	14.9%	14.8%	14.5%	14.3%
FD EPS	30.0	45.3	67.1	81.9
EPS CAGR FY07 - 10E	39.8%			
Less By	0%	-10%	-8%	-9%
Suzlon	16.7%	14.0%	14.0%	14.0%
Hansen	14.9%	14.8%	14.5%	14.3%
FD EPS	30.0	41.5	61.3	75.1
EPS CAGR FY07 - 10E	35.8%			
Less By	0%	-17%	-16%	-17%
Suzlon	16.7%	14.0%	14.0%	14.0%
Hansen	14.9%	14%	14%	14%
FD EPS	30.0	41.0	60.9	74.7
EPS CAGR FY07 - 10E	35.6%			
Less By	0%	-18%	-16%	-17%

Source: Citi Investment Research estimates

Note: Numbers have not been diluted for the latest FCCB of US$200mn

Figure 6. Suzlon EBITDA Margins



Source: Citi Investment Research

Listing Hansen on the LSE

Suzlon announced it is contemplating listing Hansen on the London Stock Exchange. Such a move might be beneficial to Suzlon's shareholders, as this will not only help finance Hansen's aggressive capacity expansion but also help in unlocking the value in Hansen.

Figure 7. Hansen IPO Scenario Analysis

Hansen Valued at FY10 EV/EBITDA of	6.0x	8.0x	10.0x	12.0x	14.0x	16.0x	18.0x	20.0x
Hansen Acquisition Debt on Hansen's books (US$mn)	83	83	83	83	83	83	83	83
Regular Operations Debt as of FY10 (US$mn)	338	338	338	338	338	338	338	338
CIR FY10E EBITDA (US$mn)	158	158	158	158	158	158	158	158
EV	949	1265	1581	1898	2214	2530	2847	3163
Implied FY09E EV/EBITDA	7.2	9.7	12.1	14.5	16.9	19.3	21.7	24.2
Hansen Equity Value (US$mn)	528	845	1161	1477	1793	2110	2426	2742
Hansen value in our current target price (US$mn)	505	505	505	505	505	505	505	505

Source: Citi Investment Research estimates

Some thoughts on technology

- It is difficult to compare the technology of Suzlon's machines with that of Vestas and Gamesa since each of them would have been built with a different philosophy. However, Suzlon winning orders continuously is proof enough that its WTGs have gained worldwide acceptance now.

- Suzlon's turbines are compliant with almost all grid standards in the world. The only problem area is the North European Grid where standards are tougher and Suzlon is working on a turbine to comply with these standards.

- India uses WTGs in the range of 600KW to 1.5MW, China uses 1.25MW to 1.5MW, Australia/South America/USA use < 2.5MW and Europe uses 2.1MW to 3MW. Most global grids operate on < 2.5MW machines for onshore installations as WTGs >2.5 MW pose problems of logistics and handling. But there is a distinct possibility of onshore installations in Europe moving to the 3MW levels in the future.

- Enercon supplies gearless technology globally that is more sophisticated, requires more technical support, which is a problem in remote areas and the equipment is heavier as it uses more copper. In the medium term, demand for geared turbines will continue to be strong, but over the longer term one cannot ignore gearless technology.

Macro demand continues to be strong

- The Indian government is deliberating on introducing Production Tax Credits (PTC) and in the meantime a number of states have adopted Renewable Portfolio Standards (RPS). Demand in India continues to be robust, but execution is constrained by infrastructural problems. Suzlon expects the Indian market to grow at 20-25% in the next 2-3 years and expects to maintain its 50% market share.

- According to latest estimates, the potential for wind energy in China could be as high as 300GW. Suzlon is considered a good quality supplier and is not competing at the lower price segment of the market. Moreover, Suzlon China is a fully integrated company so its cost structures are similar to those of Chinese suppliers, and it can also compete on costs. Currently Suzlon's entire China capacity has been contracted.

- In the US, most states have adopted RPS and hence even if the Federal government does not take a stance on PTC, it should not be a big problem. Suzlon's Minnesota capacity is operating at full capacity.

- Europe targets 20% renewable energy so demand for WTGs is likely to be strong especially for offshore and re-powering.

Operational issues are surmountable

- Supply of components continue to be tight especially gearbox, bearings and towers. In the next 2 quarters, tower supply will improve but the gear box situation will remain tight. Suzlon is expanding Hansen's capacity to meet supply shortages and to become a fully integrated player. Suzlon currently gets its gearboxes from 3 different players excluding Hansen.

- Currently Suzlon has 3 suppliers for bearings and all of them are increasing their capacity. Suzlon will supply them with forged items when their integrated manufacturing capacity in India is commissioned.

- For other components like rotor blades and forgings Suzlon is enhancing its own capacity.
- To manage cost pressures Suzlon: (1) Is entering long-term strategic supply contracts with suppliers, (2) vertically integrating and (3) has also been somewhat successful in passing on cost increases to customers through indexed clauses in customer contracts.
- However Suzlon does not believe in passing on all cost increases to customers. A better way to manage costs would be try to reduce the impact of cost inflation through internal productivity improvements. This is a part of a strategy to expand the wind energy market by helping customers achieve decent IRRs on wind farm projects.

Suzlon Energy

Company description

Suzlon Energy Limited is the world's fifth-largest wind turbine generator (WTG) company, and the largest WTG manufacturer in India and Asia. Suzlon is a fully integrated wind power company that provides customers with consultancy, design, manufacturing, operations, and maintenance services. Suzlon 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 that 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 shares Buy / Medium Risk (1M) in view of the following:

- We believe investors are largely ignoring the robust 45% CAGR in WTG volumes over FY07-10E on the back 6.7% YoY FY07 WTG margins compression. It is pertinent to note that end FY07 EBITDA margins of 16.7% were somewhere close to the trough. We expect Suzlon + Hansen to grow FD EPS at robust CAGR of 44% over FY07-10E, which would broadly track sales CAGR of 45% over the same period.
- By the end of CY09E Suzlon would have acquired an 87.10% stake in REPower on the payment of ~ €1.2bn, which should be funded through debt at an interest cost of 5.25%. The fact that this would be staggered over a three-year period means that the acquisition would turn EPS positive from CY08E.
- The REPower acquisition provides Suzlon: (1) immediate access to the mature European markets, the largest WTG market in terms of absolute volumes over the next five years, (2) acceptance in the European markets as

REPower is viewed as a great technology company, with a widely accepted product portfolio, (3) a complementary product portfolio in terms high and medium capacity WTGs, (4) REPower margins are one of the lowest in the industry as it is basically an assembler. With Suzlon's vertical integration there is plenty of room to accelerate top-line growth and improve margins, and (5) REPower also has a commercially proven 5MW turbine for offshore installations.

- According to our latest Citi global wind power forecasts, the average annual WTG market is set to jump to 26GW/year over the next five years compared with 10GW/year over the previous five years.
- Suzlon is one of the most vertically integrated WTG suppliers in the world and is one of the best equipped to cash in on this huge WTG opportunity on the back of some prudent steps that it has taken.

Valuation

Our target price is Rs1,700 based on a target FY09E P/E multiple of 23x, in line with that of global WTG majors like Vestas and Gamesa and at a 15% premium to BHEL (Given Suzlon's superior earnings growth and RoEs). It appears well supported by Suzlon + Hansen EPS CAGR of 44% and RoEs in the 30-40% range over FY07-10E.

Risks

We rate Suzlon shares Medium Risk based on a number of factors, namely: industry-specific risks, financial risk and management risks. The key downside risks which could prevent the shares from reaching our target price include higher oil prices, which would lower the attraction of renewable energy sources; withdrawal of policy support; foreign currency risk; employee retention; supply chain risks as the company expands internationally; technology obsolescence; interest rate risk; outstanding litigation, and competition.

Appendix A-1

Analyst Certification

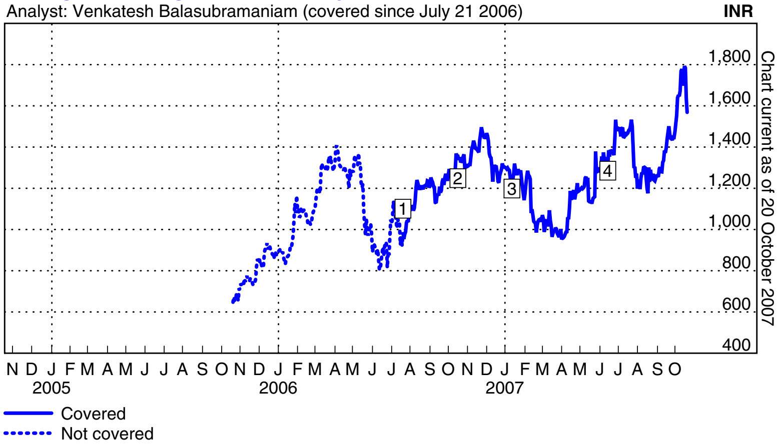
Each research analyst(s), strategist(s) or research associate(s) responsible for the preparation and content of this research report hereby certifies that, with respect to each issuer or security that the research analyst, strategist or research associate covers in this research report, all of the views expressed in this research report accurately reflect their personal views about those issuer(s) or securities. Each research analyst(s) strategist(s) or research associate(s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst, strategist or research associate in this research report.

IMPORTANT DISCLOSURES

Suzlon Energy (SUZL.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Venkatesh Balasubramaniam (covered since July 21 2006)



#	Date	Rating	Target Price	Closing Price
1:	20 Jul 06	1M	1,332.00	987.05
2:	17 Oct 06	*2M	*1,516.00	1,355.15
3:	11 Jan 07	*3M	*1,137.00	1,240.65
4:	14 Jun 07	*1M	*1,700.00	1,310.70

*Indicates change.

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