SUZLON ENERGY

INR 1,828

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Minor hiccup

ACCUMULATE

December 17, 2007

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The US Senate, on December 13, 2007, failed to incorporate the Reid Amendment in the US Energy Bill; the amendment stipulated the extension of the Production Tax Credit (PTC), a USD 19/MWh incentive available to investors in wind power projects, for two more years beyond its current expiry date, i.e., December 31, 2008. The non-extension of the PTC, in the near term, is likely to negatively impact capacity additions in the US; in 2004, capacity additions had dropped to 389 MW from 1,687 MW in 2003, due to expiration and non-extension of the PTC.

However, as the PTC will be in force till December 2008, we believe this one year is enough for an alternative legislation or the incentives may be moved to another legislation. Also, the US and other countries including India, have setup the Renewable Energy Portfolio Standard (RPS), which ensures that a minimum amount of renewable energy (from wind, solar, biomass, etc.) is included in the portfolio of electricity resources serving a state or country, and stipulates that the share be increased over time. In the US, 21states have already adopted the RPS and its enforcement is a much stronger boost to the industry. Customers in the US need to meet the RPS obligations irrespective of there being a PTC facility in the market or not.

Suzlon Energy (Suzlon) is heavily dependent on the US, with 60% of its current ~3,250 MW order book being contributed by that market. However, the orders for 2009 do not have provisions linking them to extension of the PTC beyond the date of expiry. We may also see a rush of installations from players, before PTC expires, to avail of the benefit. Also, Suzlon's business is geographically diversified and in the event of a reduction of orders from the US in the future, the company is in a position to increase sales in other geographies, including Europe and China, where demand already exceeds supply.

The event is likely to have a sentimental negative impact on the stock price, but given Suzlon’s geographical diversification and implementation of the RPS, the growth in the US market is unlikely to slowdown. At CMP of INR 1,825, and adjusted for Hansen’s valuation of USD 2.28 bn, the stock is trading at 30.5x our FY09E. Given the company’s aggressive capacity expansion plan, we maintain our ‘ACCUMULATE’ recommendation.

Reuters	:	SUZL.BO
Bloomberg	:	SUEL IN

Market Data

52-week range (INR)	:	2,161 / 932
Share in issue (mn)	:	287.8
M cap (INR bn/USD mn)	:	526 / 13,318
Avg. Daily Vol. BSE/NSE (‘000)	:	942.8

Share Holding Pattern (%)

Promoters	:	69.0
MFs, FIs & Banks	:	1.9
FIIs	:	21.3
Others	:	7.8

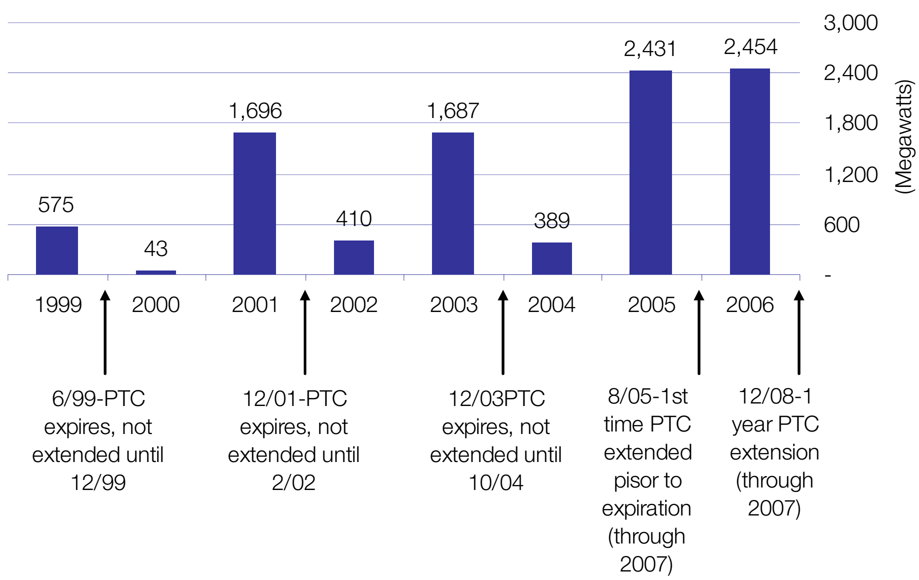
Financials

Year to March	FY06	FY07	FY08E	FY09E
Revenue (INR mn)	38,749	79,857	127,853	173,949
Rev. growth (%)	*99.5*	*106.1*	*60.1*	*36.1*
EBITDA (INR mn)	9,322	13,199	19,767	27,626
Net profit	7,946	8,759	11,596	17,316
Shares outstanding (mn)	299	299	299	299
Cons EPS	26.6	28.9	38.7	57.9
EPS growth (%)	*117.6*	*8.8*	*34.1*	*49.3*
P/E (x)	69.8	64.2	47.8	32.0
EV/ EBITDA	59.4	42.0	28.0	20.1
ROE (%)	45.4	27.8	23.3	24.3
ROCE (%)	40.7	20.9	17.1	18.6

US Senate fails to extend PTC

In an unprecedented move by the US Senate, the body failed to incorporate the Reid Amendment in the US Energy Bill on December 13, 2007. The amendment stipulated the extension of the Production Tax Credit, a USD 19/MWh incentive available to investors in wind power projects, for two more years beyond its current expiry date, i.e., December 31, 2008. We note that from 1999-2004 the PTC had expired on three separate occasions, and the non-extension of PTC had led to installations in 2004 falling drastically to 389 MW from 1,687 MW in 2003. However, with the re-introduction of the PTC in 2005, volumes picked up. The PTC was originally set to expire on December 31, 2007, but due to the efforts of a coalition of clean energy supporters it was extended for one year as part of the Tax Relief and Health Care Act of 2006.

Chart 1: Effect of PTC on US wind energy demand



Source: American Wind Energy Association, 2007

Renewable Energy Portfolio Standard to boost the sector

Notwithstanding the PTC, US and other countries including India, have setup the Renewable Energy Portfolio Standard (RPS). This policy ensures that a minimum amount of renewable energy (from wind, solar, biomass, etc.) is included in the portfolio of electricity resources serving a state or country, and it stipulates that this share be increased over time. In the US, 21states have already adopted the RPS. We believe that enforcement of RPS is a much stronger boost to the industry. Also, PTC is valid till end 2008 and this one year period also gives plenty of time for alternative legislations to be passed or renewable incentives to be moved to other legislations.

Table 1: RPS adopted in 21 states in US

STATE	RENEWABLES REQUIREMENT	NOTES
Arizona	15% by 2025	30% of the requirement must be met by local onsite renewables installed by homes and businesses.
California	20% by 2017 (must increase use of renewable by 1% each year)	Currently, 12% of electricity in state from renewables.
Connecticut	0.5% takes effect in July 2000, increasing to 1% by July 2002, 3% by 2006, and 6% by July 2009	Eligible technologies: wind, solar, sustainable biomass, landfill gas, or fuel cells.
Delaware	10% by 2019	Solar thermal electric, photovoltaics, landfill gas, wind, biomass.
Colorado	10% by 2015	Photovoltaics, landfill gas, wind, biomass, geothermal electric.
District of Columbia	11% by 2022 Tier system, 1.5% from Tier 1 by 2007 increasing gradually to 11% by 2022. 2.5% from Tier 2 by 2007 decreasing gradually to 0% by 2020	Tier 1: Wind, solar, biomass, geothermal, methane, tidal, fuel cells. Tier 2: Hydro, waste energy. Includes a solar set-aside.
Hawaii	7% by end of 2003; 8% by end of 2005. 10% by end of 2010. 15% by end of 2015. 20% by end of 2020. (including existing renewables)	Wind, photovoltaics, landfill gas, biomass, hydroelectric, renewable transportation fuels, geothermal electric, geothermal heat pumps, municipal solid waste, cogeneration, etc.
Iowa	Requires investor-owned utilities to contract a combined total of 105 megawatts (MW) of their generation from renewable resources, including small hydropower facilities	Wind, photovoltaics, biomass, hydroelectric, municipal solid waste.
Illinois (Goal)	8% by 2013 (approved by Illlinois Commerce Commission in July 2005 but pending implementation). State has goal of 8% by 2013 in place	Under the ICC approved RPS, 75% of the renewable energy generated to meet the state's goal should come from wind.
Maine	30% of retail sales in 2000 and thereafter as a condition of licensing.	Wind, solar, geothermal, tidal, hydro, biomass, municipal solid waste under 100 MW, and qualified small power generation facilities. (Note that renewables, mainly hydro, currently account for approximately 50% of Maine's electricity mix).
Maryland	7.5% by 2019 under a tiered system	Two-tiered system: Tier 1: Wind, biomass, geothermal, solar, landfill gas, wave. Tier 2: Hydroelectric, poultry litter, waste energy.
Massachusetts	1% of sales in new renewables in 2003 or one year after any renewable is within 10% of average spot market price, and increasing by 0.5% per year to 4% by 2009 and 1% per year thereafter	Wind, advanced biomass, landfill gas, solar, geothermal of wave/tidal technologies.
Minnesota	For Xcel Energy: 1,125 MW of wind by 2011. For other electricity providers: goal of 10% by 2015	Xcel requirement must allow for 100 MW of wind from small producers (2 MW or less).
Montana	15% by 2015	Solar thermal electric, photovoltaics, landfill gas, wind, biomass.
Nevada	5% by 2003 rising by 2% every two years until reaching 15% by 2013 and thereafter	A minimum of 5% must be from solar.
New Jersey	0.5% takes effect in 2001, increasing to 1% by 2006, then increases by .5% per year to 4% by 2012	Two-tiered system: Class 1: Wind, solar, fuel cells, geothermal, wave/tidal, landfill/ methane gas, and sustainably harvested biomass. Class 2: Hydro or resource recovery facilities.
New Mexico	5% by 2006 increasing to 10% by 2011	Wind, solar, geothermal, biomass, hydro, and fuel cells.
New York	25% by 2013	Wind, photovoltaics, land fill gas, biomass, hydroelectric, fuel cells, cogeneration, biogas, liquid biofuel, anaerobic digestion, tidal energy, wave energy, ocean thermal, ethanol, methanol, biodiesel.
Pennsylvania	18% by 2020 (8% from Tier 1, 10% from Tier 2), For Tier 1, 1.5% by 2007 increasing 0.5/yr	Tier 1 includes: Wind, solar , geothermal, biomass, coal bed methane and fuel cells. Tier 2 includes: Waste coal, municipal solid waste, large hydro, coal gasification, includes a solar set-aside of 0.5% by 2020.
Rhode Island	16% by end of 2019	Photovoltaics, wind, biomass, geothermal electric, small hydroelectric, tidal energy, wave energy, ocean thermal, fuel cells (renewable fuels).
Texas	Expansion of existing RPS: In 2005, RPS requirement of 2,000 MW by 2009 expanded to 5,580 MW by 2015	Wind, solar, geothermal, hydroelectric, wave or tidal energy, and biomass or biomass-based waste products including landfill gas. Establishes a credit trading program administered by ERCOT.
Vermont (Goal)	10% by 2012 (net a requirement but an established goal)	If the goal is not met by 2012, the percentage of new load growth will become a mandatory standard.
Wisconsin	Expansion of existing RPS: In 2005, state requirement of 2.2% by 2010 raised to 10% by 2015	Wind, solar, biomass, geothermal, tidal, fuel cells and small hydro.

Source: American Wind Energy Association, 2007

Impact on Suzlon and our view

- The existing PTC mandate is valid until December 31, 2008, and hence orders for 2008 will not be affected, while orders for 2009 do not have provisions linking them to extension of the PTC beyond this date. Also, players may rush in for installations before the PTC expires to avail the benefits.
- Suzlon's US order book includes orders to be executed after the present PTC expires. This indicates that these customers in the US do not depend on the PTC to make projects commercially viable. Customers in the US need to meet the RPS obligations irrespective of there being a PTC facility in the market or not.
- Suzlon's business is geographically diversified. In the unlikely event of a reduction in future orders from the US, the company is in a position to increase sales in other geographies, including Europe and China, where demand already exceeds supply.

Company Description

Suzlon, Asia's largest and the world's fifth-largest wind turbine manufacturer in terms of market share, provides end-to-end wind energy solutions such as wind resource mapping, identification and procurement of sites, execution of project work, erection and commissioning of WTGs, construction of power evacuation facilities, and providing operation and maintenance (O&M) services. This, along with its strong technological capabilities overseas and low cost vertically integrated manufacturing base in India, give it an edge over competitors.

Investment Theme

Suzlon's strong business model in terms of in-house technology and superior design capabilities has led to a consistent increase in its market share. A bulk of Suzlon's product requirements are manufactured at its Indian facilities, providing it a significant cost advantage. Further capacity expansion in the US and China will help the company cater to the strong global wind energy demand. It is also expanding capacity of Hansen Transmission, which obliterates concerns of gear box supply.

Key Risks

Suzlon is likely to face increased competition from other global players such as Vestas, Gamesa, and Enercon. India, emerging as one of the fastest growing markets, is likely to see increased focus from players like Siemens and GE. However, we believe that Suzlon with its vertically integrated business model will be able to maintain its leading position in the Indian market. Further, strong technical requirements serve as a barrier to new entrants.

Financial Statements

Income statement (INR mn)

Year to March	FY05	FY06	FY07	FY08E	FY09E
Income from operations	19,425	38,749	79,857	127,853	173,949
Direct costs	12,904	26,482	48,114	85,688	116,379
Employee costs	618	1,216	6,496	9,693	13,085
Other expenses	1,211	1,730	12,049	12,706	16,858
Total operating expenses	14,732	29,428	66,658	108,086	146,323
EBITDA	4,692	9,322	13,199	19,767	27,626
Depreciation and amortisation	493	716	1,718	2,224	3,166
EBIT	4,199	8,606	11,481	17,543	24,460
Interest expenses	458	648	2,763	5,006	5,787
Other income	234	556	965	479	702
Profit before tax	3,975	8,514	9,682	13,017	19,375
Provision for tax	322	568	923	1,421	2,058
Extraordinary items	2	-	-	-	-
Reported profit	3,651	7,946	8,759	11,596	17,316
Adjusted net profit	3,651	7,946	8,759	11,596	17,316
Shares outstanding	299	299	299	299	299
Dividend per share	1.2	4.8	5.8	7.7	11.6
Dividend payout (%)	9.5	18.1	19.7	20.0	20.0

Common size metrics- as % of net revenues

Year to March	FY05	FY06	FY07	FY08E	FY09E
Operating expenses	75.8	75.9	83.5	84.5	84.1
Depreciation	2.5	1.8	2.2	1.7	1.8
Interest expenditure	2.4	1.7	3.5	3.9	3.3
EBITDA margins	24.2	24.1	16.5	15.5	15.9
Net profit margins	18.8	20.5	11.0	9.1	10.0

Growth metrics (%)

Year to March	FY05	FY06	FY07	FY08E	FY09E
Revenues	126.5	99.5	106.1	60.1	36.1
EBITDA	223.3	98.6	41.6	49.8	39.8
PBT	227.7	114.2	13.7	34.4	48.8
Net profit	151.9	117.6	10.2	32.4	49.3
EPS	151.9	117.6	8.8	34.1	49.3

Cash flow statement (INR mn)

Year to March	FY05	FY06	FY07	FY08E	FY09E
Net profit	3,651	7,946	8,648	11,596	17,316
Add: Depreciation	493	716	1,718	2,224	3,166
Add: Misc expenses written off	(2)	(4)	9	-	-
Add: Deferred tax	(167)	(568)	(126)	-	-
Gross cash flow	3,975	8,090	10,248	13,820	20,483
Less: Dividends	411	1,657	1,730	2,319	3,463
Less: Changes in W. C.	4,478	10,989	11,691	7,220	6,564
Operating cash flow	(914)	(4,556)	(3,172)	4,281	10,455
Less: Change in investments	(65)	(2)	80	-	-
Less: Capex	1,850	4,046	36,003	34,000	12,966
Free cash flow	(2,699)	(8,601)	(39,255)	(29,719)	(2,511)

Balance sheet (INR mn)

As on 31st March	FY05	FY06	FY07	FY08E	FY09E
Equity capital	869	2,875	2,878	2,993	2,993
Reserves & surplus	7,024	24,217	31,226	61,387	75,240
Shareholders funds	7,893	27,092	35,111	64,380	78,233
Minority interest	65	75	141	141	141
Secured loans	3,567	3,899	19,844	27,844	36,944
Unsecured loans	1,544	889	31,801	31,801	31,801
Borrowings	5,111	4,788	51,645	59,645	68,745
Sources of funds	13,069	31,954	86,897	124,166	147,119
Gross block	3,597	6,293	43,211	77,211	90,177
Depreciation	808	1,536	7,016	9,240	12,406
Net block	2,789	4,757	36,195	67,971	77,771
Capital work in progress	289	1,652	4,498	4,498	4,498
Total fixed assets	3,079	6,409	40,693	72,469	82,269
Investments	78	76	156	156	156
Inventories	5,756	13,310	31,363	44,959	57,189
Sundry debtors	6,929	16,473	25,704	38,531	47,657
Cash and equivalents	1,545	5,515	15,383	13,695	20,284
Loans and advances	3,247	6,407	12,076	13,283	15,276
Total current assets	17,477	41,705	84,526	110,467	140,405
Sundry creditors and others	5,980	12,977	33,340	50,010	65,013
Provisions	1,829	4,101	4,999	8,739	10,520
Total CL & provisions	7,809	17,078	38,339	58,749	75,533
Net current assets	9,668	24,627	46,187	51,719	64,872
Net deferred tax	241	818	(177)	(177)	(177)
Others	4	25	0	0	0
Uses of funds	13,069	31,955	86,859	124,166	147,119
Book value per share (INR)	26	91	117	215	261

Ratios

Year to March	FY05	FY06	FY07	FY08E	FY09E
ROE (%)	62.8	45.4	27.8	23.3	24.3
ROCE (%)	45.8	40.7	20.9	17.1	18.6
Current ratio	2.2	2.4	2.2	1.9	1.9
Debtors (days)	130	155	117	110	100
Fixed assets t/o (x)	8.1	8.2	3.4	2.3	2.2
Debt/Equity	0.6	0.2	1.5	0.9	0.9

Valuations parameters

Year to March	FY05	FY06	FY07	FY08E	FY09E
Cons EPS (INR)	12.2	26.6	28.9	38.7	57.9
Y-o-Y growth (%)	*151.9*	*117.6*	*8.8*	*34.1*	*49.3*
CEPS (INR)	47.7	30.1	36.4	46.2	68.4
P/E (x)	149.6	69.8	64.2	47.8	32.0
Price/BV (x)	70.3	20.2	15.6	8.6	7.1
EV/Sales (x)	28.3	14.3	6.9	4.3	3.2
EV/EBITDA (x)	117.2	59.4	42.0	28.0	20.1

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Coverage group(s) of stocks by primary analyst(s): Power:

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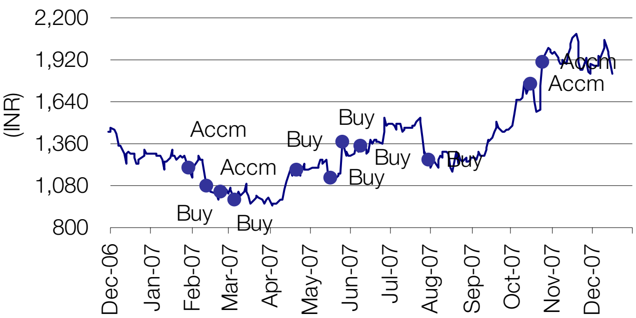
Suzlon Energy



Recent Research

Date	Company	Title	Price (INR)	Recos
04-Dec-07	BGR Energy	Strike when the iron is hot; *IPO Note*	425-480	Subscribe
23-Nov-07	Post	emPOWERing India; *Conf. Notes*		
16-Nov-07	Power	empowering India; *Sector Update*		
07-Nov-07	Kalpataru Power Transmission	Margin concerns; *Result Update*	1,730	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	105	47	19	3	188

* 13 stocks under review / 1 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	99	67	22

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period