Company

16 August 2010 | 24 pages

Suzlon Energy (SUZL.BO)

Dismal 1Q FY11 – Domestic Rebound the Only Hope

Equity ☑
Rating change ☑
Target price change ☑
Estimate change ☑

- **Dismal 1Q FY11** — Losses were Rs9.1bn, which when adjusted for notional forex losses of Rs2.5bn would be a loss of Rs6.6bn. Export inflows remain weak, the balance sheet remains over-leveraged and the right issue led to 12% dilution.
- **But we are somewhat enthused ....** — This is because management does not want to chase low-margin orders in the US/Europe and is focusing on cost cutting/ shoring up cash flows with a view to fighting the next battle whenever WTG markets revive.
- **......domestic markets rebound** — With 489MW of domestic order wins in 1Q FY11, Suzlon is readying its execution capabilities to execute in FY11E - 1200MW and FY12E - 2000MW in India. If Suzlon gets anywhere close to these numbers there is a chance Suzlon could pull itself out of the current situation.
- **Moderating risk rating to Medium from High** — Our quantitative risk-rating system, which tracks 260-day historical share price volatility, suggests Medium Risk. Further, Suzlon's rupee loan refinancing and FCCB restructuring lower the risk of the company. The 2-year holiday on principal repayments and effective removal /relaxation of covenants across facilities give the company a breather to bring business back on track in an extremely tough business environment.
- **Cutting target price to Rs58 from Rs64** — The revision factors in (1) our earnings cuts, (2) an EV/EBITDA based on Mar12E (Mar11E) and (3) Hansen's current market price. We cut FY11E PAT to a loss of Rs5.4bn from a profit of Rs1.8bn, and lower our FY12E EPS by 77%.
- **FCCBs restructured but remains a risk** — If they get converted it would lead to dilution of 15%. If the FCCBs totalling US$479m do not get converted, Suzlon would have to redeem US$690m over FY13E (US$569m) and FY14E (US$121m).

Hold/Medium Risk	**2M**
from Hold/High Risk	
Price (16 Aug 10)	Rs51.00
Target price	Rs58.00
from Rs64.00	
Expected share price return	13.7%
Expected dividend yield	0.0%
Expected total return	**13.7%**
Market Cap	Rs79,394M
	US$1,703M

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

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2009A	2,750	1.75	-73.5	29.2	0.9	3.3	0.0
2010A	-11,945	-6.66	na	-7.7	1.2	-15.7	0.0
2011E	-5,376	-2.71	59.3	-18.8	1.2	-7.8	0.0
2012E	2,266	1.14	142.1	44.6	1.2	3.1	0.0
2013E	1,764	0.89	-22.1	57.3	1.2	2.3	0.0

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	29.2	-7.7	-18.8	44.6	57.3
EV/EBITDA adjusted (x)	7.5	20.5	13.4	7.5	7.0
P/BV (x)	0.9	1.2	1.2	1.2	1.2
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	1.75	-6.66	-2.71	1.14	0.89
EPS reported	1.50	-5.48	-2.71	1.14	0.89
BVPS	57.58	42.40	41.55	42.85	43.86
DPS	0.00	0.00	0.00	0.00	0.00
Profit & Loss (RsM)					
Net sales	260,817	206,197	196,698	237,125	261,597
Operating expenses	-246,283	-203,396	-190,301	-223,295	-246,861
EBIT	**14,534**	**2,801**	**6,397**	**13,830**	**14,736**
Net interest expense	-10,539	-11,950	-11,706	-10,644	-11,190
Non-operating/exceptionals	3,198	2,975	759	1,264	1,812
Pre-tax profit	**7,193**	**-6,175**	**-4,550**	**4,450**	**5,359**
Tax	-2,881	-3,561	-643	-1,784	-2,973
Extraord./Min.Int./Pref.div.	-1,947	-90	-183	-400	-621
Reported net income	**2,365**	**-9,826**	**-5,376**	**2,266**	**1,764**
Adjusted earnings	2,750	-11,945	-5,376	2,266	1,764
Adjusted EBITDA	20,266	9,431	11,728	19,916	21,474
Growth Rates (%)					
Sales	90.7	-20.9	-4.6	20.6	10.3
EBIT adjusted	-3.4	-80.7	128.4	116.2	6.6
EBITDA adjusted	12.9	-53.5	24.4	69.8	7.8
EPS adjusted	-73.5	-480.6	59.3	142.1	-22.1
Cash Flow (RsM)					
Operating cash flow	**-29,912**	**19,785**	**9,407**	**-1,051**	**7,888**
Depreciation/amortization	5,731	6,630	5,331	6,086	6,738
Net working capital	-39,658	23,884	8,215	-9,460	-700
Investing cash flow	**-12,295**	**-10,872**	**0**	**-4,563**	**-5,002**
Capital expenditure	-43,662	0	0	-4,563	-5,002
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**3,303**	**-40,128**	**-6,169**	**6,495**	**2,064**
Borrowings	49,350	-22,016	-18,236	6,095	1,443
Dividends paid	-10	0	0	0	0
Change in cash	**-38,904**	**-31,215**	**3,238**	**881**	**4,949**
Balance Sheet (RsM)					
Total assets	**378,063**	**292,046**	**279,089**	**301,362**	**315,881**
Cash & cash equivalent	30,698	29,043	32,546	33,427	38,377
Accounts receivable	53,928	31,740	61,466	73,607	78,503
Net fixed assets	80,884	44,695	39,098	37,575	35,838
Total liabilities	**268,636**	**222,724**	**203,075**	**222,683**	**234,817**
Accounts payable	105,947	84,267	79,128	91,238	100,400
Total Debt	148,696	126,679	108,443	114,538	115,981
Shareholders' funds	**109,427**	**69,323**	**76,013**	**78,679**	**81,064**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	7.8	4.6	6.0	8.4	8.2
ROE adjusted	3.3	-15.7	-7.8	3.1	2.3
ROIC adjusted	7.3	-0.4	3.8	8.2	7.8
Net debt to equity	107.8	140.8	99.8	103.1	95.7
Total debt to capital	57.6	64.6	58.8	59.3	58.9

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Contents

Hold/ Medium (2M) Risk – Target Price Rs58

Maintain Hold – Domestic rebound the only ray of hope

1QFY11 was a dismal quarter for Suzlon with losses of Rs9.1bn, which when adjusted for notional forex losses of Rs2.5bn would imply Rs6.6bn of losses. Export inflows remains weak, the balance sheet continues to be over-leveraged and the rights issue led to 12% dilution.

However, we came back somewhat enthused from the analyst meeting, which top management held on August 14, 2010:

- As a refreshing change we heard management mention that it would not chase orders in the US/Europe as margins are lower with domestic incumbents getting aggressive in these market;
- We could feel management's focus on cost cutting and shoring up cash flows with a view to fighting the next battle whenever the global WTG markets revive; and
- Most importantly, the domestic market has rebounded with the company ending the quarter with a historical high ~ 580MW of domestic orders. If the domestic markets continue to rebound and Suzlon does manage to sell 1200MW in FY11E and 1500MW+ in FY12E there is a chance Suzlon could pull itself out of the current situation.

Deleveraging is necessary but one has to remember that with every round of equity raising or asset sale existing shareholders get diluted - case in point being the 12% dilution from the recent rights issue.

The other key risk is that whenever the FCCBs (which are deeply out of the money) get converted it will lead to a dilution of 15%. If the FCCBs totalling US$479m don't get diluted Suzlon would have to redeem US$690m over FY13E (US$569m) and FY14E (US$121m). Out of the redemption amount of US$690m, US$211m is a contingent liability on Suzlon's balance sheet.

Risk rating moderated to Medium from High

- We moderate our risk rating to Medium from High based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. Further, Suzlon's rupee loan refinancing and FCCB restructuring reduce the risk profile of the company.
- The 2-year holiday on principal repayments and effective removal /relaxation of covenants across facilities give the company a breather to bring business on track in an extremely tough business environment.

Target price cut to Rs58 from Rs64

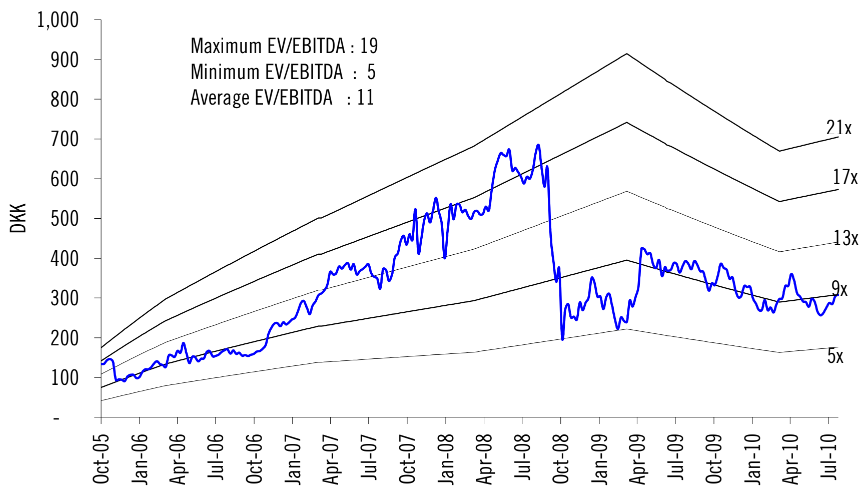
- We continue to value Suzlon at a target EV/EBITDA of 9.5x which is set at ~ 15% discount of Vestas' historical average EV/EBITDA multiple over the last 5 years. We reduce our target price to Rs58 from Rs64 earlier to factor in (1) our earnings cut, (2) roll forward of target EV/EBITDA multiple to Mar12E (from Mar11E earlier) and (3) we value Hansen at the current market price as it is only an associate, with Suzlon holding a 26.1% stake now.

Figure 1. Suzlon - Target Price Sensitivity

	FY11E						FY12E				
EV/EBITDA multiple	**7.5x**	**8.5x**	**9.5x**	**10.5x**	**11.5x**		**7.5x**	**8.5x**	**9.5x**	**10.5x**	**11.5x**
Suzlon WTG	(32)	(30)	(28)	(26)	(23)		(14)	(9)	(4)	1	6
REpower WTG	36	40	44	48	52		46	51	57	62	68
Fair Value (ex Hansen)	**3**	**10**	**16**	**23**	**29**		**32**	**42**	**53**	**63**	**74**
Hansen shares (mn)	670	670	670	670	670		670	670	670	670	670
Hansen stock price (GBP)	0.67	0.67	0.67	0.67	0.67		0.67	0.67	0.67	0.67	0.67
GBP INR	72.9	72.9	72.9	72.9	72.9		72.9	72.9	72.9	72.9	72.9
Mkt Cap (Rsmn)	32,723	32,723	32,723	32,723	32,723		32,723	32,723	32,723	32,723	32,723
Suzlon stake	26.1%	26.1%	26.1%	26.1%	26.1%		26.1%	26.1%	26.1%	26.1%	26.1%
Hansen Per Share	**5**	**5**	**5**	**5**	**5**		**5**	**5**	**5**	**5**	**5**
Suzlon Fair Value	**8**	**15**	**21**	**27**	**34**		**37**	**47**	**58**	**68**	**79**
Shares (mn)	**1745**	**1745**	**1745**	**1745**	**1745**		**1745**	**1745**	**1745**	**1745**	**1745**

Source: Company and Citi Investment Research and Analysis estimates

Figure 2. Vestas 1 Year Forward Rolling EV/EBITDA Bands



Source: DataCentral and Citi Investment Research and Analysis estimates

EPS revised downwards

We revise down FY11E PAT to a loss of Rs5.4bn from a profit of Rs1.8bn and cut FY12E EPS estimates by 77% to factor in: (1) 12% dilution on account of the rights issues; (2) Restructuring of FCCBs; (3) 450MW cut in our Suzlon WTG estimates; (4) Cuts to our REpower and Hansen numbers.

Figure 3. Suzlon – Earnings Revision

Mar31 (Rsmn)	FY11E	FY12E	FY13E
Suzlon MW Sold			
Old	2,100	2,400	
New	1,646	1,950	1,950
MW	(454)	(450)	
Consolidated Sales			
Old	272,487	322,756	-
New	196,698	237,125	261,597
% Chg	-27.8%	-26.5%	-
Suzlon Margins %			
Old	6.6%	8.3%	-
New	3.7%	7.2%	6.0%
bps	(295)	(107)	-
REPower Margins %			
Old	9.3%	9.6%	-
New	9.0%	9.7%	9.8%
bps	(31)	5	-
Recurring PAT			
Old	1,846	8,214	-
New	(5,376)	2,266	1,764
% Chg	nm	-72.4%	-
FD EPS Estimates			
Old	1.10	4.89	-
New	-2.71	1.14	0.89
% Chg	nm	-76.6%	-

Source: CIRA estimates

Figure 4. Suzlon Consolidated Estimates – CIRA v/s Consensus

	FY11E	FY12E	FY13E
CIR FD EPS	-2.71	1.14	0.89
Consensus	-0.47	3.64	4.35
Difference	nm	-68.6%	-79.5%

Source: Bloomberg and Citi Investment Research and Analysis estimates

Takeaways from GWEC Conference Call

By CY10E end 45-50GW of manufacturing capacity will be operational globally (of which China is 20GW). Depending on size of CY11E market, industry may be oversupplied/ under-supplied.

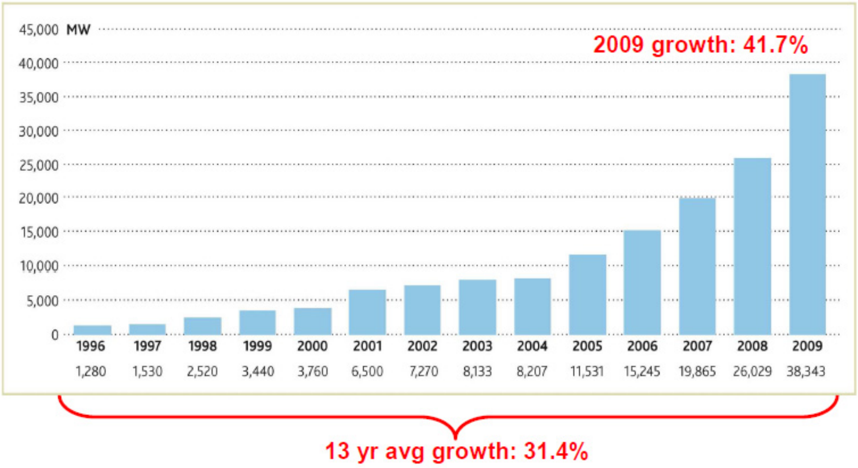
CIRA organized a conference call on August 13, 2010 with the Global Wind Energy Council (GWEC)'s Mr. Steve Sawyer, Secretary General; and Ms. Liming Qiao, Policy Director. The following are the key takeaways.

- Cumulative wind installed capacity has been growing at CAGR of 28.6% over the past 13 years and 2009 was an especially good year with growth of 31.9%. Wind annual installation has been growing at CAGR of 31.4% over the past 13 years and in 2009 it grew 41.7%.

Figure 5. Global Cumulative Installed Capacity, CY96-CY09

Source: GWEC

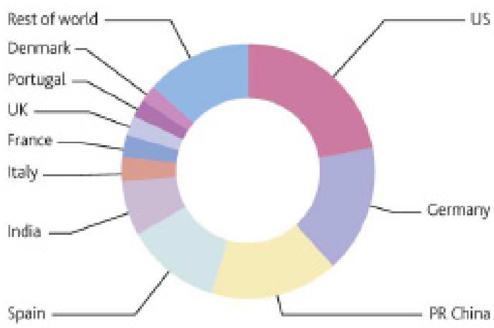
Figure 6. Global Annual Installed Capacity, CY96-09



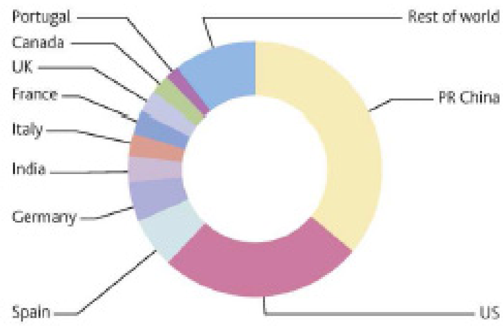
Source: GWEC

- China was the largest market with 13.8GW of incremental installation in CY09 and is expected to remain the largest market and should overtake the US over the next 3-4 years in terms of cumulative installations.

Figure 7. Global Cumulative and Installed Capacity. 2009



	MW	%
US	35,064	22.1
PR China	25,805	16.3
Germany	25,777	16.3
Spain	19,149	12.1
India	10,926	6.9
Italy	4,850	3.1
France	4,492	2.8
UK	4,051	2.6
Portugal	3,535	2.2
Denmark	3,465	2.2
Rest of world	21,391	13.5
Total top 10	**137,114**	**86.5**
World total	**158,505**	**100.0**

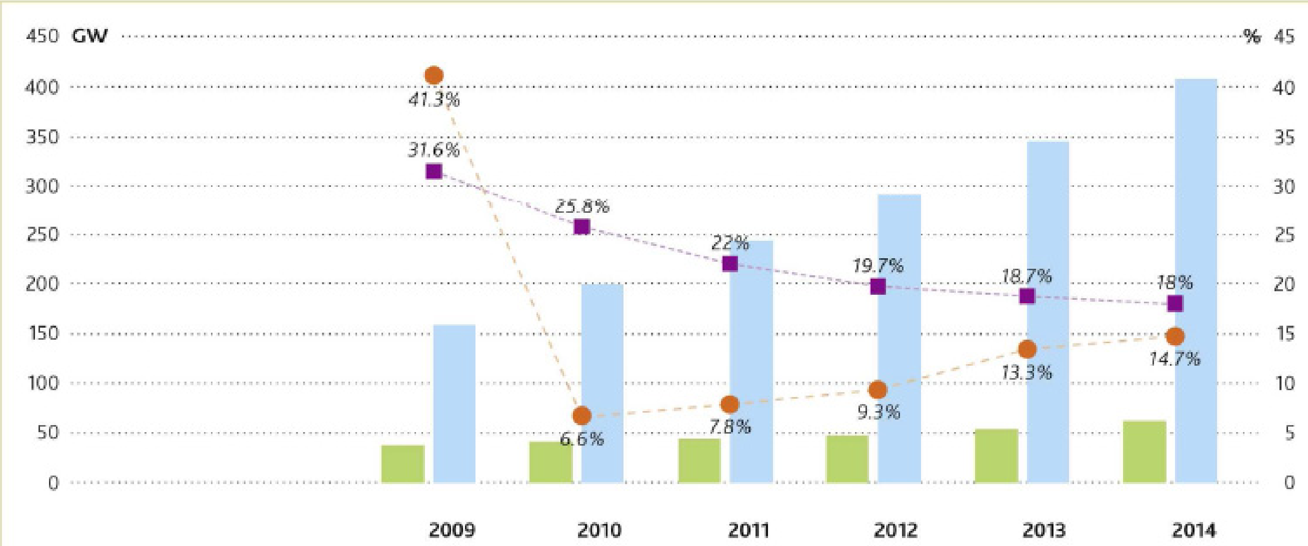


	MW	%
PR China	13,803	36.0
US	9,996	26.1
Spain	2,459	6.4
Germany	1,917	5.0
India	1,271	3.3
Italy	1,114	2.9
France	1,088	2.8
UK	1,077	2.8
Canada	950	2.5
Portugal	673	1.8
Rest of world	3,994	10.4
Total top 10	**34,349**	**89.6**
World total	**38,343**	**100.0**

Source: GWEC

- Near term growth in new installed capacity addition is expected to fall to 6.6% in CY10E (40.8GW) and 7.8%in CY11E (44GW) from 41.7% in CY09

Figure 8. Market Forecast, CY10-14



	2009	2010	2011	2012	2013	2014
Annual installed capacity [GW]	38.3	40.8	44.0	48.1	54.5	62.5
Cumulative [GW]	158.5	199.9	243.9	292.0	346.5	409.0
Cumulative capacity growthrate [%]	31.6	25.8	22.0	19.7	18.7	18.0
Annual installed capacity growthrate [%]	41.3	6.6	7.8	9.3	13.3	14.7

Source: GWEC

New wind installations in the US fell 71% YoY in 1HCY10 as government support for the renewable energy source waned. 700MW was brought on line in 1HCY10, although that figure was expected to grow in the second half with > 5,500MW currently under construction.

- **USA update:** The US regulatory framework remains in a flux as the US has no coherent energy strategy. In the past whenever tax credits have expired wind market growth has collapsed. Renewable energy standards are currently a patchwork of different federal and state programs. In 2010 end curtains tax benefits are expiring so there may be rush to place orders before that. But current policy uncertainties continue to muddle 2011.

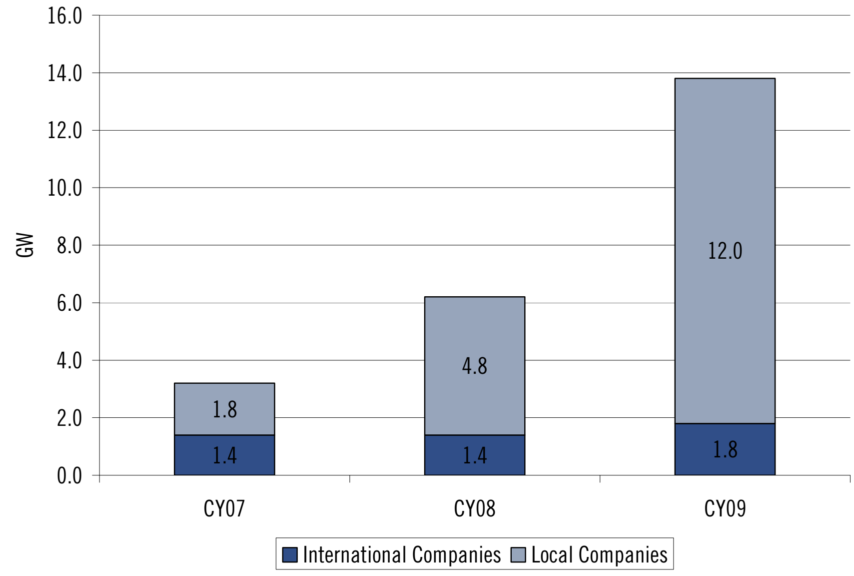
- **Europe update:** Is doing okay in terms of new installation and GWEC expects steady but slow growth here in medium term.

In CY09 the Government auctioned 1800MW, of which 400MW of orders came to Suzlon and 400MW more is under negotiation. In August 2010, the Government is likely to auction 2500MW more of projects of which Suzlon expects 500-600MW.

- **Brazil:** Has been flirting with wind energy for some time and 500-600MW is under construction. The Government awarded 1800MW of projects last December. Some more projects are being awarded next month.

- **China update:** The current official Chinese target for total installed capacity for 2020 of 13GW has already been achieved. The Chinese Government is now talking about 150GW by 2020 but this is not official yet. China is promoting wind based programs which are focused on 7 windy provinces which add up top 127GW onshore and there is offshore development of 20GW in five provinces. So it is highly likely that 150GW of installed capacity or even more will be achieved by 2020.

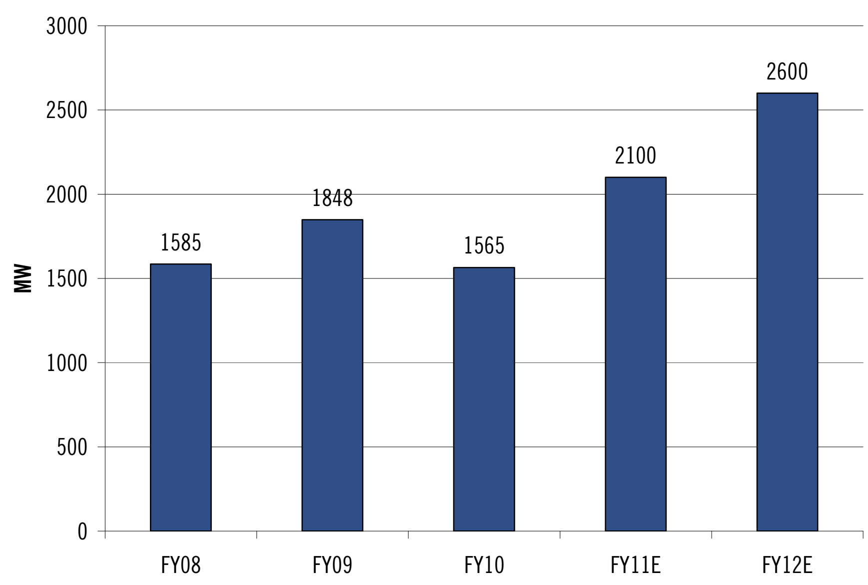
Figure 9. China Market Composition



Source: Suzlon and Citi Investment Research and Analysis

- **India –** According to CWET the Indian market could grow to 2000-2200 MW in FY11E and 2600-3000MW in FY12E underpinned by a positive regulatory environment and general buoyancy in the Indian economy. Substantial renewable energy obligations, coupled with revised tariffs, a new REC framework and generation based incentives should encourage new installations.

Figure 10. India Market Size



Source: CWET, Suzlon and Citi Investment Research and Analysis

- As a result most of incremental demand growth over the near term will be driven by China. Geographies where growth rates are high are Canada, Latin America, Australia and parts of Africa. But they are growing from a low base and do not contribute meaningfully to overall numbers.

- **Technology (Gearless v/s geared turbines):** Gearless has higher weights so problematic for offshore. It also has a more complex electrical circuit which means availability of rare earth metals for the magnet may also be an issue. Gearbox makers claim that their reliability has been increasing steadily especially in offshore wind farms. Now hybrid machines are coming which have single stage gearbox + permanent magnet i.e. features of both gearless and gearbox turbines.

- **On Chinese manufacturers:** Goldwind 1.5MW had difficulty in the first few dozens machines supplied, but now they have substantially improved quality. They have supplied a few machines to Minnesota and they are working very fine. In every market national players always have a home advantage and they are difficult to dislodge for example GE in the US, Suzlon in India, Gamesa in Spain and Enercon in Germany .

- **Competition of wind with other clean sources of power generation -** (1) Clean coal is just a marketing slogan and no commercial plant is using carbon capture. (2) Decreased price of gas as a result of huge shale gas discovery is a direct threat to wind in the US as gas is much cleaner than coal and cheaper than wind. (3) If there is no price on carbon, cheaper fossil fuels especially in unregulated markets like US will be a concern.

- **Solar v/s wind -** Solar will become competitive with wind only after 5-10 years but in the very long run is expected to surpass wind in terms of installed capacity.

1QF Y11 Results Update

- Suzlon had a dismal quarter with WTG (Suzlon + Repower) sales collapsing 26% YoY to Rs23.8bn. Overall sales were down 42% YoY but this is not a meaningful comparison as Hansen is getting consolidated as an associate now and is not a part of sales anymore
- Overall 1QFY11 consolidated loss was Rs9.1bn v/s Rs4.5bn in 1QFY10 on lower volumes and notional forex loss of Rs2.5bn (Rs1bn due to accounting adjustments on REpower's inventories and Rs1.5bn on loans)

Figure 11. Suzlon 1QFY11 – Consolidated Results

Year End Mar31 (Rsmn)	1Q10	1Q11
Income from operations	**41,527**	**23,987**
(Inc)/ Dec in stock in trade	1,694	(551)
Consumption of raw material	(30,807)	(17,218)
as a % of sales	70.1%	74.1%
Staff Cost	(5,924)	(3,976)
as a % of sales	14.3%	16.6%
Other expenditure	(7,868)	(6,297)
as a % of sales	18.9%	26.3%
Forex gain/loss	1,316	(1,463)
EBITDA	**(64)**	**(5,518)**
EBITDA margin %	**-0.2%**	**-23.0%**
Depreciation	(1,626)	(1,265)
EBIT	**(1,689)**	**(6,783)**
Interest Charges	(3,128)	(2,611)
Other Income	214	235
Other Operating Income	187	58
Forex Exchange Gain Loss	(1,401)	0
FCCB Restructuring Gain	1,218	(373)
PBT	**(4,599)**	**(9,473)**
Tax	(26)	237
Effective Tax Rate	-0.6%	2.5%
Pre- minority & associates	**(4,626)**	**(9,236)**
Minority Interest	99	183
Share of Profit of Associate	0	(69)
PAT	**(4,527)**	**(9,122)**

Source: Company and Citi Investment Research and Analysis

Figure 12. Suzlon 1QFY11 – Consolidated Segmental Results

Segment Reporting (Rsmn)	Q110	Q111
Sales		
Gear Box	9,248	0
WTG	32,188	23,826
Foundry and Forging	170	552
Others	122	87
Total	**41,728**	**24,465**
Inter Segment Revenue	(201)	(479)
Net Sales/Inc. from Ops.	**41,527**	**23,987**
EBITDA		
Gear Box	639	0
Margins%	6.9%	nm
WTG	26	(5,064)
Margins%	0.1%	-21.3%
Foundry and Forging	(34)	3
Margins%	-20.1%	0.5%
Others	121	70
Margins%	98.9%	80.5%
Total	**751**	**(4,991)**
EBIT		
Gear Box	12	0
Margins%	0.1%	nm
WTG	(799)	(6,122)
Margins%	-2.5%	-25.7%
Foundry and Forging	(165)	(169)
Margins%	-96.8%	-30.5%
Others	77	35
Margins%	63.5%	39.7%
Total	(874)	(6,256)

Source: Company and Citi Investment Research and Analysis

REpower 1QFY11 – Disappointing numbers but strong backlog

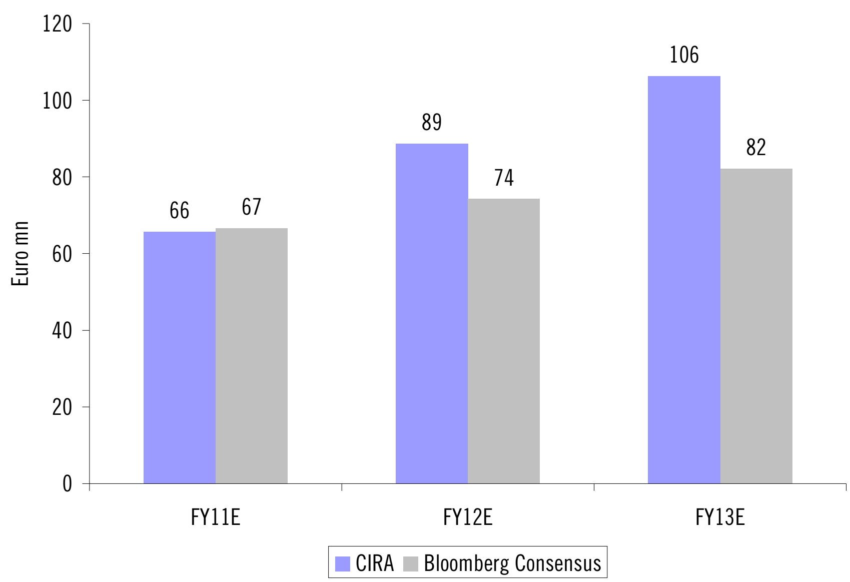
- In 1QFY11 REpower had sales of €213.1m, down 29% YoY, and EBIT of €1.5m, down 86% YoY. In 1QFY11 REpower delivered 169MW. The order backlog amounted to 2.1GW, up 70% YoY.
- The decline in sales and income was largely due to the postponement of projects by customers. Despite this the company is still anticipating €1.5-1.6bn of sales and EBIT margins of 7.5%-8.5% in FY11E.
- Despite continuing uncertainty regarding the future development of the world economy in general, the company assumes that FY12E will continue to see growth with a simultaneous improvement in EBIT margins.

Figure 13. REpower – Key Assumptions

End Mar31 (Euro mn)	CY06	CY07	FY08	FY09	FY10	FY11E	FY12E	FY13E	Remarks
MW Sales	492	652	129	1,253	1,146	1,275	1,500	1,671	- REPower sales guidance of Euro 1.5 - 1.6 bn in FY11E
Gross Sales	**459**	**680**	**147**	**1,209**	**1,304**	**1,500**	**1,763**	**2,027**	
growth		*48.2%*	*-78.3%*	*720.2%*	*7.8%*	*15.1%*	*17.5%*	*15.0%*	
EBITDA	**17**	**35**	**5**	**91**	**119**	**135**	**170**	**200**	
Margin %	**3.6%**	**5.1%**	**3.4%**	**7.6%**	**9.1%**	**9.0%**	**9.7%**	**9.8%**	
EBIT	**12**	**28**	**3**	**77**	**98**	**113**	**143**	**167**	- EBIT margin guidance of 7.5 - 8.5% in FY11E
Margin %	**2.7%**	**4.1%**	**2.1%**	**6.4%**	**7.5%**	**7.5%**	**8.1%**	**8.3%**	
PBT	**11**	**29**	**3**	**77**	**84**	**95**	**128**	**153**	
Tax	(4)	(8)	(2)	(25)	(26)	(29)	(40)	(47)	
PAT	**7**	**21**	**1**	**52**	**58**	**65**	**88**	**106**	

Source: Company and Citi Investment Research and Analysis estimates

Figure 14. REpower PAT Estimates – CIRA v/s Consensus

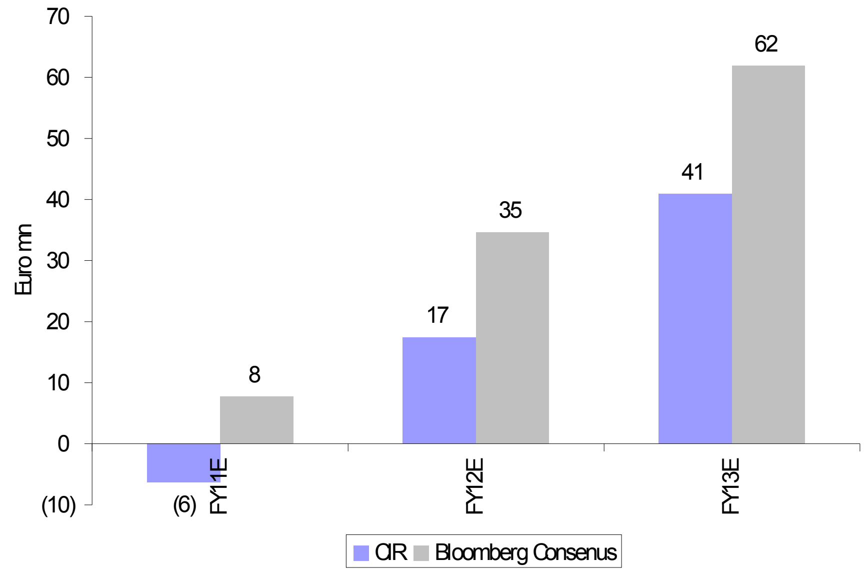


Source: Bloomberg and Citi Investment Research and Analysis estimates

Hansen 1QFY11 – Sales disappoint but margins improve

- Hansen's 1QFY11 sales at €107m were down 21% YoY and EBITDA at €7m implied margins of 6.2%, up from 5.2% in 1QFY10. Net debt at €110m implied reduction of €19m in 1QFY11 as a result of intensified working capital management.
- Sales for FY11E will be back-end loaded and management has reiterated sales growth for FY11E of 5%-10% YoY

Figure 15. Hansen PAT Estimates – CIRA v/s Consensus



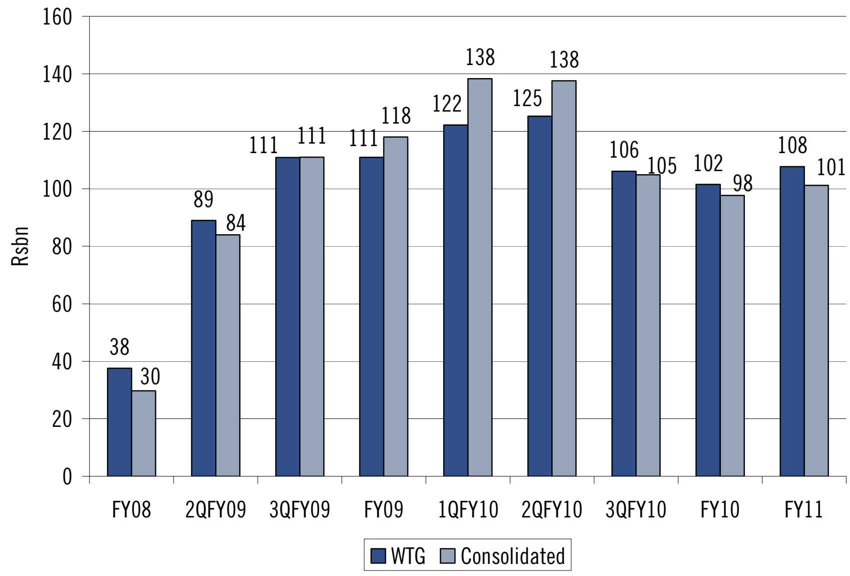
Source: Bloomberg and Citi Investment Research and Analysis estimates

Debt and Funding Update

Debt situation at end-1Q FY11

- Suzlon WTG had Rs120.3bn of gross debt at the end of 1QFY11 and cash balance of Rs12.6bn. The 1QFY11 debt comprises Rs21.6bn of acquisition debt, Rs11.8bn of promoter loans, Rs10.7bn of capex loans, Rs22.3bn of FCCBs and Rs53.9bn of working capital loans.
- The Rs11.75bn of promoter loans have been converted into equity post 1QFY11, leading to a dilution of 12%.

Figure 16. Suzlon WTG and Consolidated Debt and Net Debt Levels



Source: Company and Citi Investment Research and Analysis

Figure 17. Suzlon WTG Debt Composition

	FY08	FY09	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11
Original Acquisition Debt (Hansen + REPower)	26,439	33,706	32,530	30,970	21,590	20,830	21,550
Promoter Loans			5,620	11,750	11,750	11,750	11,750
12.5% secured NCDs	-	3,000	3,000	3,000	3,000		
Capex Loans		12,000	11,900	11,430	10,770	10,770	10,770
Other Loans	39,936	50,459	59,150	54,580	47,090	52,070	53,960
FCCB - I, II & III	20,055	25,355	18,640	23,040	22,290	21,510	22,250
Gross Debt WTG	**86,430**	**124,520**	**130,840**	**134,770**	**116,490**	**116,930**	**120,280**
Cash	48,870	13,590	8,620	9,520	10,410	15,410	12,580
Net Debt WTG	**37,560**	**110,930**	**122,220**	**125,250**	**106,080**	**101,520**	**107,700**

Source: Company and Citi Investment Research and Analysis

Debt reduction and refinancing efforts

Figure 18. Suzlon – Share Count

Parameter	mn
FY10 End Share Count	1,557
Rights Issue	189
Share Count Post Rights	**1,745**
FCCBs Dilution If Converted	237
Share Count If FCCBs Converted	**1,983**

Source: CIRA estimates

- **Repayment of acquisition loans:** The company monetized its 35.22% stake in Hansen Transmissions, and realized €224m (Rs17.2bn) in 3QFY10 through placement of 236m depository interests at a price of 95 pence and used the proceeds to repay part of the acquisition loans. The company has also repaid acquisition loans of ~ US$780m and the balance has been repaid through new US$ denominated facility from SBI.

- **Rupee loan refinancing of Rs106.9bn:** The company also managed to refinance rupee facilities of ~ Rs65.9bn and trade credit facilities (non-fund based) of Rs40.4bn and has got a holiday of 2 years in principal repayments and effective removal /relaxation of covenants across facilities

- **FCCB restructuring:** Suzlon has also restructured FCCB and has got all the covenants removed and also reduced the conversion price of FCCBs. The total amount of FCCBs outstanding post the latest round of restructuring is US$479m, on which the company will have to pay US$690m on redemption ($569m in FY13E and US$121m in FY15E). If all these FCCBs are converted into equity then it would lead to dilution of 237mn shares (15%)

Figure 19. FCCB Outstanding Post Latest Round Of Restructuring

FCCB - I (New)		**FCCB - II (New)**		**FCCB - III**	
New Bonds	36	New Bonds	21	Bonds	90
Exchange Rate	49.8	Exchange Rate	49.8	Exchange Rate	48.2
Conversion Price	76.7	Conversion Price	76.7	Conversion Price	90.38
Shares Dilution (mn)	23	Shares Dilution (mn)	14	Shares Dilution (mn)	48.0
Redemption Amount (US$mn)	53	Redemption Amount (US$mn)	33	Redemption Amount (US$mn)	120.78
Due	5-Jun-12	Due	4-Oct-12	Due	July-14
Coupon on new bond	7.5%	Coupon on new bond	7.5%		
FCCB - I (Old)		**FCCB - II (Old)**			
Old Bonds	211	Old Bonds	121		
Exchange Rate	44.60	Exchange Rate	44.60		
Conversion Price	97.26	Conversion Price	97.26		
Shares Dilution (mn)	96.9	Shares Dilution (mn)	55.7		
Redemption Amount (US$mn)	307	Redemption Amount (US$mn)	176		
Due	4-Oct-12	Due	4-Oct-12		
Coupon on new bond	0.0%	Coupon on new bond	0.0%		
Total Dilution On Conversion	120	Total Dilution On Conversion	69		

Source: Company and Citi Investment Research and Analysis estimates

- **Rights issue completed:** The company has issued 189mn shares at Rs63 to raise Rs11.9bn resulting in a dilution of 12%. Given the response was not very strong from non promoters the majority of this amount was subscribed by the promoters. The promoters' contribution would get adjusted against promoter loans of Rs11.75bn which would become 0 at the end of 2QFY11.

- **Might have to sell residual stake in Hansen:** Suzlon has a residual stake of 26.1% in Hansen if sold at current market prices could yield Rs8.5bn. According to management it would sell this stake at the appropriate time with a view to maximizing value.

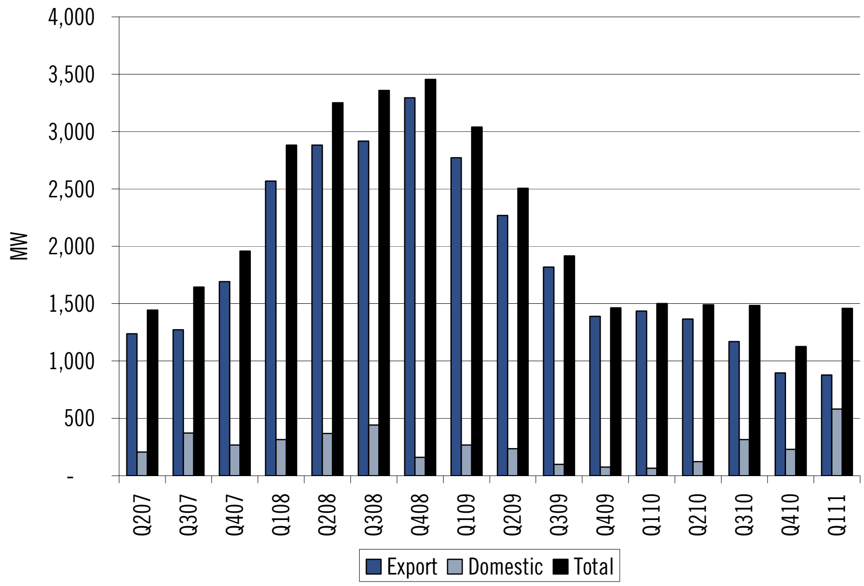
Business Update

According to management, PBT breakeven in FY11E is 2000MW for Suzlon WTG and PBT cash breakeven is 1800MW. If the company does manage to sell 1200MW in India the breakeven levels can be brought down by 200MW.

Export backlog remains weak – but domestic backlog rebounds

- At the end of 1QFY11 the company had a total order backlog of 1458MW comprising 878MW of export orders and 580MW of domestic orders.
- Export inflows continue to be challenging but domestic inflows have been a major positive surprise with 489MW of order wins in 1QFY11. Suzlon is readying its execution capabilities to execute a maximum of 1200MW in FY11E and 2000MW in FY12E. We believe this is Suzlon's ray of hope given domestic orders yield significantly higher margins than export orders.
- Suzlon WTG is temporarily vacating European and US markets in FY11E as in these markets the domestic incumbents are very strong and with overcapacity, margins are lower. REpower will cater to these markets and Suzlon will focus on markets like India, China, Australia, Brazil and Africa.

Figure 20. Suzlon Quarterly Order Backlog



Source: Company Citi Investment Research and Analysis

New product development

- Suzlon is introducing new class 3 wind site turbines S-95 and S-97. This is important because all incremental wind sites in India are class 3 sites. S-95 and S-97 will produce 10% and 16% more power than a comparable S-88 turbine under similar wind conditions and will be released by June 2011.
- Suzlon is also introducing a new 2.25MW turbine in January 2011 to cater to the Chinese market. These turbines will replace the 2.1MW turbine in China and will be more attractive for clients as the cost is the same as the 2.1MW turbine and should position Suzlon favorably in China.

Cost reduction efforts ongoing

Suzlon is working on projects to reduce raw materials costs by Rs7.4bn, operating cost by Rs1bn and manpower cost by Rs1bn. At REpower, efforts are on to reduce sourcing from Europe to 30% from the current 90% and reduce raw material costs by €300,000 per turbine.

- Suzlon is working on various cost optimization measures – (1) renegotiating contracts with suppliers for price reductions, (2) reduction in freight costs due to a general drop in ocean freight rates, (3) focused approach in various geographies to avoid various quality related costs and LDs, (4) more effective monitoring and control of all product related costs and (5) identification of cost reduction areas in manufacturing/ marketing/ project SBUs.

Working Capital Rationalization

- The company has made some progress in gradually reducing working capital intensity with inventory levels stabilizing, collections from receivables improving and consistent reduction in payables.

Figure 21. Suzlon WTG – Working Capital Rationalization

Year End Mar31 (Rsmn)	FY08	3QFY09	FY09	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11
Inventories	33,280	53,630	38,780	39,450	37,460	34,440	28,770	29,100
Sundry Debtors	42,380	47,620	63,540	45,520	41,570	42,550	47,260	37,980
To suppliers, ICD, VAT and OCA	na	17,380	14,310	13,270	12,850	13,370	11,870	12,090
Total	**na**	**118,630**	**116,630**	**98,240**	**91,880**	**90,360**	**87,900**	**79,170**
Prepayment from customers (including dues to customers)	21,970	12,750	7,880	9,410	10,850	11,950	6,960	10,020
Trade Payables	24,710	39,700	47,220	33,720	27,400	26,620	29,900	20,710
Total	**46,680**	**52,450**	**55,100**	**43,130**	**38,250**	**38,570**	**36,860**	**30,730**
Net Operating Working Capital	**nm**	**66,180**	**61,530**	**55,110**	**53,630**	**51,790**	**51,040**	**48,440**

Source: Company and Citi Investment Research and Analysis

Suzlon Energy

Company description

Suzlon Energy is the world's fifth-largest wind turbine generator (WTG) company, and the largest WTG manufacturer in Asia. It 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 Hold/Medium Risk. 1QFY11 was a dismal quarter for Suzlon. Export inflows remain weak, the balance sheet continues to be over-leveraged and the rights issue led to a 12% dilution. However, management has mentioned that it would not chase orders in the US and Europe as margins are lower in those markets. Management is focusing on cost-cutting and shoring up cash flows with a view to fighting the next battle whenever the global WTG markets revive. If the domestic markets continue to rebound and Suzlon sells 1200MW in FY11E and 1500MW+ in FY12E there is a chance for the company to pull itself out of the current situation. Deleveraging is necessary but with every round of equity raising or asset sale existing shareholders get diluted. The other key risk is that whenever the FCCBs (which are deeply out of the money) get converted it would lead to a dilution of 15%. If the FCCBs of US$479m don't get diluted Suzlon would have to redeem US$690m over FY13E (US$569m) and FY14E (US$121m).

Valuation

Our target price of Rs58 is based on an EV/EBITDA of 9.5x Mar 12E. From an international WTG context, Vestas, Gamesa and Clipper are considered comparable peers by foreign institutional investors. Other listed players in the WTG supply chain space also include Hansen and China High Speed. However, it is worth noting that Suzlon's valuations are contingent on what BHEL and ABB trade at given that Suzlon is listed in India and also has a fair chunk of domestic investors. Given that Vestas and BHEL have stronger balance sheets, cash flows and return ratios, we believe Suzlon should trade at a discount. We look at Vestas' EV/EBITDA multiple average of 13x over the past five years and accord a ~ 15% discount to arrive at our target EV/EBITDA multiple of 9.5x. We also value Suzlon’s 26.1% in Hansen at the current market price.

Risks

We rate Suzlon Medium Risk based on a number of industry-specific, financial and management risks such as funding constraints, reduced order visibility, global financial turmoil and lower oil prices. Our rating is in line with our quantitative risk-rating system, which tracks 260-day historical share-price volatility. Key upside risks to our target price 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. Key downside risks to our target price include lower oil prices, which would lower the attraction of renewable energy sources; withdrawal of policy support; foreign currency risk; employee retention; supply chain risks as it expands internationally; technology obsolescence; interest rate risk; outstanding litigation; and competition.

Appendix A-1

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Fundamental Research

Analyst: Venkatesh Balasubramaniam

	Date	Rating	Target Price	Closing Price
1	7-Nov-07	*1L	*445.40	378.96
2	14-Feb-08	1L	*396.00	338.15
3	5-Mar-08	*3M	*241.00	237.65
4	26-May-08	3M	*303.00	305.00
5	10-Jul-08	3M	*216.00	208.35
6	10-Nov-08	*2H	*83.00	68.95
7	4-Feb-09	*3H	*42.00	42.00
8	15-May-09	*2H	*89.00	76.70
9	9-Jul-09	2H	*105.00	86.40
10	16-Sep-09	2H	*113.00	98.60
11	4-Nov-09	2H	*64.00	55.15

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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