

SUZLON ENERGY

INR 1,048

Time to Repower

BUY



* **Suzlon's stock performance prices in all negatives**

Post the recent announcement of Repower's friendly bid offer, Suzlon's stock has been battered down on the bourses and is down by 16% from its high of INR 1245. Based on Suzlon's bid, the consolidated EPS for FY08E and FY09E reduces by 5.4% and 4.2%. In case, one were to assume that Suzlon were to bid at 30% higher in the event of Areva hiking its offer, the consolidated EPS would stand reduced by 8.5% and 7.3% respectively.

* **Without considering integration benefits**

However these two scenarios do not include any integration benefits on Repower's acquisition, given that it is just an assembly operation with technology control. Further, Suzlon in our opinion will likely be in a strong position to cater to Repower's sourcing requirements due to excess capacities and cost advantage. Thus, we argue that any calculation of Suzlon's revised EPS on the basis of the open offer for Repower should also include the integration benefits to Suzlon, let alone the longer-term benefit of Suzlon's growth opportunities increasing on account of Repower's access to 5MW technology which is a fast growing segment within wind energy.

* **Our forecasts assume integration benefits - combined reduction of 8.5% and 1.3% on FY08E and FY09E estimates**

We have thus included the benefits of raw material sourcing alongwith assuming a 30% higher bid amount for Repower. Thus, we forecast Suzlon's consolidated EPS for FY08E and FY09E at INR 52.6 and INR 67.2, a reduction of 8.5% and 1.3% from pre-Repower offer.

* **Valuations at lower end of trading history, upgrade to 'BUY'**

Suzlon is currently trading at a PE of 19.9x and 15.6x on our revised estimates (post Repower) for FY08E and FY09E. It's average one-year PER since listing has been 26.8x and has not traded below 20.0x PE since then. Part of the de-rating has been due to quarterly variation in profits and also due to downward estimate revisions. However, given the strong growth profile (EPS CAGR of 36% over FY06-09E pre Repower) and equally strong outlook for wind energy, we believe that the current stock price has a favorable risk reward ratio. We are changing our recommendation from 'ACCUMULATE' to 'BUY'.

Financials

Year to March	FY06	FY07E	FY08E	FY09E
Revenue (INR mn)	38,410	61,887	96,413	119,994
Rev. growth (%)	97.7	61.1	55.8	24.5
EBITDA (INR mn)	8,982	13,414	21,967	27,980
Net Profit	7,607	10,377	16,018	18,536
Shares outstanding (mn)	288	288	288	288
Cons EPS	26.5	36.8	57.5	68.1
EPS growth (%)	108.3	38.9	56.4	18.5
P/E (x)	39.6	28.5	18.2	15.4
EV/ EBITDA	33.5	22.4	13.7	10.7
ROE (%)	43.5	33.2	38.3	33.3
ROCE (%)	39.2	33.2	36.7	34.8

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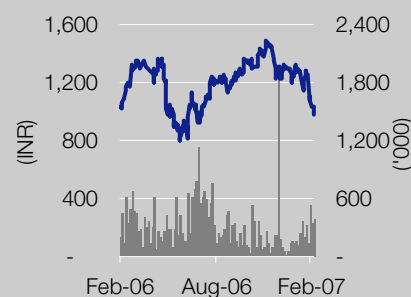
Reuters : SUZL.BO
Bloomberg : SUEL IN

Market Data

52-week range (INR) : 1,510 / 760
Share in issue (mn) : 287.5
M cap (INR bn/USD mn) : 301.3/6,820.5
Avg. Daily Vol. BSE/NSE ('000) : 902.3

Share Holding Pattern (%)

Promoters : 69.7
MFs, FIs & Banks : 1.2
FIs : 21.4
Others : 7.7



*** Conference call with management**

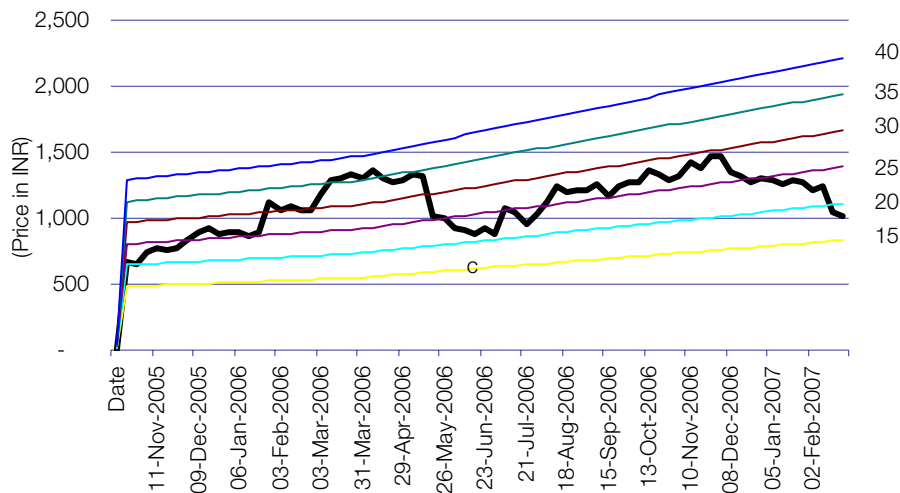
Our call with management shed light on the uncertainties regarding the total acquisition cost to be paid by Suzlon and the integration benefits arising out of the acquisition. As against belief of Suzlon paying 100% of the acquisition cost, management shared that Suzlon is expected to pump only Euro 750 mn for this acquisition (at Euro 126 per share), as Martifer’s put option of selling 25% stake in Repower would likely be exercised over two-three year period. This is also likely to keep debt:equity ratio at a manageable level of 1.7-1.8x in FY08E.

Management also shared that Repower though has the technological edge in multi MW generators, it does not possess the manufacturing capability and only has assembly capacity. Repower currently has 81% of its sales as raw material cost as against Suzlon’s 61% of sales. With Suzlon’s integrated manufacturing capability and efficient cost structure, we believe that this will provide Repower access to secured and higher volumes and more importantly superior supply chain capabilities, thus providing immense cost saving benefits.

Based on the above benefits, the most likely (and in our opinion a conservative estimate) scenario that will emerge is:

- ◆ Suzlon making a counter offer at 30% higher price and sourcing 30% of Repower’s raw material requirement in FY09E
- ◆ This would provide 10% cost savings – Suzlon’s EPS will be negatively impacted by 8.5% in FY08E and 1.3% in FY09E.
- ◆ It will then register EPS of INR 52.6 in FY08E and 67.2 in FY09E and the stock is trading at 19.9x and 15.6x FY08E and FY09E EPS estimates.

Chart 1: PE band



Source: Edelweiss research

* **Features of the Open offer:**

- ◆ RePower Systems is one of the leading turbine producers in the German wind energy sector with a market share in excess of 10% (third-largest manufacturer of wind turbines in Germany). Its product range comprises of several types of turbines with rated outputs between 1.5 and 5 megawatts (MW). RePower's technical strength also lays in offshore wind development sites, wherein its 5 MW is currently one of the largest wind turbines in the world. In addition to its technologically advanced wind turbines, the company also offers comprehensive expertise in planning and constructing turnkey wind farms.
- ◆ As per the consensus estimate, Repower is expected to register revenues of Euro 450 mn in CY06 and Euro 700 mn in CY07. The EBITDA is expected to improve from Euro 18.9 mn in CY06 to Euro 42 mn in CY07, whereas net profit is expected to improve from 4.5 mn in CY06 to 14 mn in CY07.
- ◆ Areva, the largest single shareholder of RePower Systems, made a takeover offer for the company with a cash offer of Euro 105 per share. Suzlon Energy made a counter offer for RePower Systems with a cash offer of Euro 126 per share. This values Repower at Euro 1.02 bn.
- ◆ Suzlon's counter offer is supported by Martifer a Portugese steel construction company and second-largest share holder of RePower (25% holding).
- ◆ Suzlon is expected to raise debt at 125-150 bps over Euribor and assuming interest cost at 5.2%, the interest burden comes out to be Euro 32.5 for FY08E and Euro 39 for FY09E.
- ◆ Suzlon is also expected to derive tax benefit out of the interest burden and taking that into consideration the interest burden comes out to be Euro 29.3 in FY08E and Euro 35.1 in FY09E.

* **Scenario analyses****Scenario a) Acquisition cost unchanged; without integration benefit**

	FY07E	FY08E	FY09E
Acquisition cost (INR bn)		44	44
Additional interest cost post tax adj (INR bn)		1.7	2.0
Net profit (INR mn)	10,567	15,636	18,761
Cons EPS (INR) - pre Repower	36.8	57.5	68.1
Cons EPS (INR) - post Repower	36.8	54.4	65.3
% change	-	(5.4)	(4.2)
Adj PE	28.5	19.3	16.1

Scenario b) Acquisition cost higher by 30%; without integration benefit

	FY07E	FY08E	FY09E
Acquisition cost (INR bn)		58	58
Additional interest cost post tax adj (INR bn)		2.2	2.6
Net profit (INR mn)	10,567	15,126	18,151
Cons EPS (INR) - pre Repower	36.8	57.5	68.1
Cons EPS (INR) - post Repower	36.8	52.6	63.1
% change	-	(8.5)	(7.3)
Adj PE	28.5	19.9	16.6

Scenario c) Acquisition cost unchanged; with integration benefit

	FY07E	FY08E	FY09E
Repower RM cost (INR bn)	21.8	33.2	39.3
Sourcing from Suzlon	30.0		
Cost saving	10.0		
Cost benefit (INR mn)			1180
Acquisition cost (INR bn)		44	44
Additional interest cost post tax adj (INR bn)		1.7	2.0
Net profit (INR mn)	10,567	15,636	19,941
Cons EPS (INR) - pre Repower	36.8	57.5	68.1
Cons EPS (INR) - post Repower	36.8	54.4	69.4
% change	-	(5.4)	1.8
Adj PE	28.5	19.3	15.1

Scenario d) Acquisition cost higher by 30%; with integration benefit

	FY07E	FY08E	FY09E
Repower RM cost (INR bn)	21.8	33.2	39.3
Sourcing from Suzlon	30.0		
Cost saving	10.0		
Cost benefit (INR mn)			1180
Acquisition cost (INR bn)		58	58
Additional interest cost post tax adj (INR bn)		1.7	2.6
Net profit (INR mn)	10,567	15,126	19,331
Cons EPS (INR) - pre Repower	36.8	57.5	68.1
Cons EPS (INR) - post Repower	36.8	52.6	67.2
% change	-	(8.5)	(1.3)
Adj PE	28.5	19.9	15.6

Financial Statements

Income statement					(INR mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Income from operations	19,425	38,410	61,887	96,413	119,994
Direct costs	12,904	26,482	43,443	67,679	84,232
Employee costs	618	1,216	2,986	3,583	4,121
Other expenses	1,211	1,730	2,044	3,184	3,662
Total operating expenses	14,732	29,428	48,473	74,446	92,015
EBITDA	4,692	8,982	13,414	21,967	27,980
Depreciation and amortisation	493	716	1,348	2,604	4,440
EBIT	4,199	8,266	12,066	19,363	23,540
Interest expenses	458	648	801	1,499	1,759
Other income	234	556	395	236	552
Profit before tax	3,975	8,175	11,660	18,100	22,333
Provision for tax	322	568	1,283	2,081	3,797
Extraordinary items	2	-	-	-	-
Reported profit	3,651	7,607	10,377	16,018	18,536
Adjusted net profit	3,651	7,607	10,377	16,018	18,536
Shares outstanding	288	288	288	288	288
Dividend per share	1.2	5.0	7.2	11.1	12.9
Dividend payout (%)	9.5	18.9	20.0	20.0	20.0

Common size metrics- as % of net revenues

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Operating expenses	75.8	76.6	78.3	77.2	76.7
Depreciation	2.5	1.9	2.2	2.7	3.7
Interest expenditure	2.4	1.7	1.3	1.6	1.5
EBITDA margins	24.2	23.4	21.7	22.8	23.3
Net profit margins	18.8	19.8	16.8	16.6	15.4

Growth metrics (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Revenues	126.5	97.7	61.1	55.8	24.5
EBITDA	223.3	91.4	49.3	63.8	27.4
PBT	227.7	105.6	42.6	55.2	23.4
Net profit	151.9	108.3	36.4	54.4	15.7
EPS	151.9	108.3	38.9	56.4	18.5

Cash flow statement

Cash flow statement					(INR mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net profit	3,651	7,607	10,377	16,018	18,536
Add: Depreciation	493	716	1,348	2,604	4,440
Add: Misc expenses written off	(2)	(4)	4	-	-
Add: Deferred tax	(167)	(568)	-	-	-
Gross cash flow	3,975	7,750	11,729	18,622	22,976
Less: Dividends	411	1,657	2,075	3,204	3,707
Less: Changes in W. C.	4,478	10,989	9,098	12,111	8,333
Operating cash flow	(914)	(4,896)	556	3,307	10,935
Less: Change in investments	(65)	(2)	2	-	-
Less: Capex	1,850	4,046	6,853	11,000	4,440
Free cash flow	(2,699)	(8,940)	(6,298)	(7,693)	6,496

Balance sheet					(INR mn)
As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Equity capital	869	2,875	2,875	2,875	2,875
Reserves & surplus	7,024	24,217	32,519	45,333	60,162
Shareholders funds	7,893	27,092	35,394	48,209	63,037
Minority interest	65	75	75	75	75
Secured loans	3,567	3,899	6,899	14,899	10,899
Unsecured loans	1,544	889	635	635	635
Borrowings	5,111	4,788	7,534	15,534	11,534
Sources of funds	13,069	31,954	43,003	63,817	74,646
Gross block	3,597	6,293	12,876	23,876	28,315
Depreciation	808	1,536	2,614	5,218	9,657
Net block	2,789	4,757	10,261	18,658	18,658
Capital work in progress	289	1,652	1,652	1,652	1,652
Total fixed assets	3,079	6,409	11,913	20,309	20,309
Investments	78	76	78	78	78
Inventories	5,756	13,310	21,446	30,769	38,294
Sundry debtors	6,929	16,473	26,542	41,350	51,463
Cash and equivalents	1,545	5,515	1,979	2,287	4,782
Loans and advances	3,247	6,407	8,009	8,810	10,131
Total current assets	17,477	41,705	57,976	83,215	104,671
Sundry creditors and others	5,980	12,977	20,453	31,346	39,755
Provisions	1,829	4,101	7,334	9,261	11,480
Total CL & provisions	7,809	17,078	27,787	40,607	51,235
Net current assets	9,668	24,627	30,189	42,608	53,436
Net deferred tax	241	818	818	818	818
Others	4	25	5	5	5
Uses of funds	13,069	31,955	43,003	63,817	74,646
Book value per share (INR)	27	94	123	168	219

Ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROE (%)	62.8	43.5	33.2	38.3	33.3
ROCE (%)	45.8	39.2	33.2	36.7	34.8
Current ratio	2.2	2.4	2.1	2.0	2.0
Debtors (days)	130	157	157	157	157
Fixed assets t/o (x)	8.1	8.1	6.8	6.0	5.9
Debt/Equity	0.6	0.2	0.2	0.3	0.2

Valuations parameters

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Cons EPS (INR)	12.7	26.5	36.8	57.5	68.1
Y-o-Y growth (%)	151.9	108.3	38.9	56.4	18.5
CEPS (INR)	47.7	28.9	40.8	64.8	79.9
PE (x)	82.5	39.6	28.5	18.2	15.4
Price/BV(x)	38.2	11.1	8.5	6.3	4.8
EV/Sales (x)	15.7	7.8	4.9	3.1	2.5
EV/EBITDA (x)	65.0	33.5	22.4	13.7	10.7

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Head, Institutional Equities

INDIA RESEARCH

SECTOR

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Hitesh Zaveri - 2286 4424	Information Technology	Swati Khemani - 2286 4266
Parul Inamdar - 2286 4355	Information Technology	Neha Shahra - 2286 4276
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Niraj Mansingka - 2286 4304	Oil & Gas, Petrochemicals	Tushar Mahajan - 2286 4439
Nimish Mehta - 2286 4295	Pharmaceuticals, Agrochemicals	Harsh Biyani - 2286 4419
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Sunil Jain - 2286 4308	Alternative & Quantitative	Ankit Doshi - 2286 4671
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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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