Company Flash

3 March 2008 | 6 pages

Suzlon Energy (SUZL.BO)

Buy: Pandora's Box Opens Wider

- **Our worst fears** — WTG manufacturers introduce new products/upgrades to manage competition. It is important to balance long pre launch test times with the necessity to introduce products fast to capitalize on the window of opportunity. Minimizing product liabilities and managing unfavorable events like the blade damages in US is a key risk factor for Suzlon.
- **....are coming true** — Suzlon will make a provision of Rs1bn (US$25mn) in 4QFY08 for their retrofit program which will involve structural strengthening of their cracking S88 2.1MW turbine blades totaling to 1,251 blades (930 installed and 320 in transit) of 417 WTGs over a 6 month period. This is on the back of Rs190mn of provisioning for 34 defective blades in 3QFY08.
- **55% of OB exposed to the same risk** — Out of Suzlon's 3QFY08 order backlog of 3358MW, around 55% (1832MW) are based on the 2.1MW configuration in the same geography. Though we have not heard of any order cancellations yet, one cannot rule out that possibility. The big ticket orders exposed to this risk are Edison (630MW), PPM Energy (701MW) and Horizon Wind (400MW)
- **US is 18 - 25% of total MW sales** — US MW sales account for close to 18 – 25% of our MW assumptions over FY08E - 11E. In addition to relying heavily on RPS in the event of PTC not getting extended, Suzlon now has to deal with any negative impact due to the blade damage issues on incremental order wins.
- **Not an isolated case of blade damages** — Blade damage incidents have been reported in Gamesa, Clipper Wind and NEG Micon in the recent past.

Buy/Low Risk	**1L**
Price (03 Mar 08)	Rs260.20
Target price	Rs396.00
Expected share price return	52.2%
Expected dividend yield	0.4%
Expected total return	**52.6%**
Market Cap	Rs389,502M US$9,757M

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

Figure 1. 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	8.41	-13%	30.9	14.3	63.9%	0.3%
2006A	7,562	5.26	-37%	49.5	13.8	43.1%	0.4%
2007A	8,648	6.00	14%	43.4	10.7	27.8%	0.4%
2008E	11,115	7.15	19%	36.4	4.3	17.7%	0.4%
2009E	17,897	11.52	61%	22.6	3.7	18.2%	0.4%
2010E	24,841	15.99	39%	16.3	3.0	21.1%	0.5%
2011E	32,152	20.69	29%	12.6	2.4	22.3%	0.5%

Source: Company reports, Citi Investment Research estimates

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

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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/Low Risk (1L) in view of the following:

We believe investors are largely ignoring the robust growth in WTG volumes over FY08E-11E on the back of 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 43% over FY08E-10E with RoE in the 18–23% band.

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 5.7%. That this would be staggered over a three-year period means that the acquisition should turn EPS positive from CY09E.

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 strong technology company, with a widely accepted product portfolio, (3) a complementary product portfolio in terms of high and medium capacity WTGs, (4) REPower margin is one of the lowest in the industry as it is basically an assembler. With Suzlon's vertical integration, we believe 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.

Valuation

Approach 1: One can value Suzlon as using a P/E multiple for the entire entity Suzlon WTG + REPower WTG + Hansen Gearbox. In this approach we use a P/E multiple of 26x December 2009 and we get a fair value of Rs387.

Approach 2: We can value Suzlon + REPower using a P/E of 26x December 2009 multiple for Suzlon WTG +REPower WTG and add value of Hansen at a

25% discount to market capitalization. We get a fair value of Rs406 in this approach.

We take an average of the above two and set a target price of Rs396 for Suzlon.

Risks

We rate Suzlon shares Low Risk based on a number of factors, namely: industry-specific risks, financial risk and management risks. Our Low risk is also based on the fact that:

The uncertainties regarding the REPower acquisition are a thing of the past

After some uncertainty on EBITDA margins, we now believe EBITDA margins should largely hover in the 15 - 17% band over the medium term

With its backward integration strategy Suzlon appears much better placed to withstand key component shocks going forward and exploit the robust outlook for WTG growth.

The key downside risks that could prevent the shares from reaching 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 the company expands internationally; technology obsolescence; interest rate risk; outstanding litigation, and competition.

Appendix A-1

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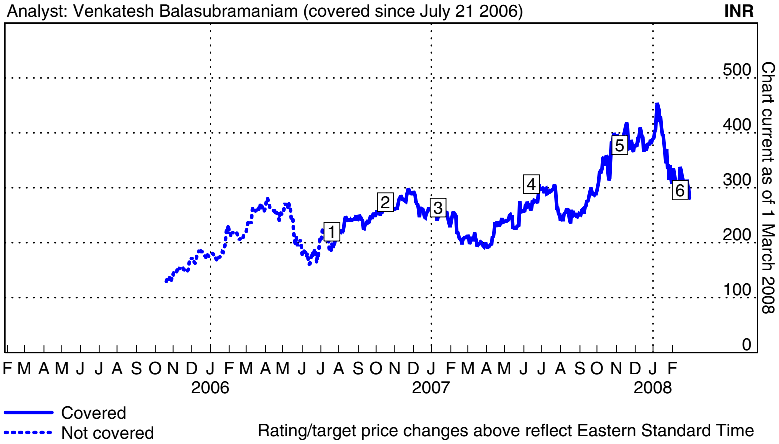
Suzlon Energy (SUZL.BO)

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	266.40	197.41
2:	17 Oct 06	*2M	*303.20	271.03
3:	11 Jan 07	*3M	*227.40	248.13
4:	14 Jun 07	*1M	*340.00	262.14
5:	7 Nov 07	*1L	*445.40	378.96
6:	14 Feb 08	1L	*396.00	338.15

*Indicates change.

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% of companies in each rating category that are investment banking clients	52%	53%	40%

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