

**Nat Resources & Energy**  
**Electrical Equipment**  
Equity – India

## Underweight (V)

Target price (INR)	20.00
Share price (INR)	20.85
Potential return (%)	-4%

Potential return equals the percentage difference between the current share price and the target price

Performance	1M	3M	12M
Absolute (%)	-6.5	-22.1	-58.3
Relative <sup>A</sup> (%)	-1.2	-13.9	-53.6

<sup>A</sup>Index Bombay Stock Exchange Sensitive Index

RIC	SUZL.NS
Bloomberg	SUEL IN
Market cap (USDm)	670
Market cap (INRm)	37,058
Enterprise value (INRm)	127,222
Free float (%)	43

Note: (V) = volatile (please see disclosure appendix)

28 May 2012

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# Suzlon Energy (SUEL)

UW(V): Third consecutive year of loss on missed guidance

- ▶ **Net loss of cINR4.8bn much higher than expectations; gearing of 2.15x as of end-March is at an all-time high**
- ▶ **Needs another USD300m to meet its FY13 debt repayments; FY13 EBIT margin guidance of 6% is lower than expectations**
- ▶ **Reiterate UW(V) and blended DCF- and RoE-based TP of INR20**

**FY12 performance worse than expectations.** Suzlon reported a net loss of INR4.8bn vs consensus of a loss of INR150m and our estimate of a INR339m net loss. When it reported its nine months' results on 11 February, the company reduced its FY12 sales guidance to INR210-220bn (from INR240-260bn) and its EBIT margin guidance to 5-6% (from 7-8%). We attribute the higher-than-expected net loss to an EBIT margin of 4.2% (old schedule VI format), lower than guidance. Under the new format, EBIT works out to INR11.6bn, for a 5.5% EBIT margin, but the old schedule reporting applies for comparison with guidance, in our view. Due to the shift in certain items from operating expenses to finance charges (of cINR2.8bn in FY12), both the finance charges and the EBIT margin are higher under the new format. The group's order book remained flat q-o-q, with c5.7GW of orders valued at INR415bn.

**FY13 EBIT guidance is lower than expectations.** Suzlon has guided to FY13 revenue of INR270-280bn and an EBIT margin of 6%. On revenue, current consensus and HSBC's forecast are in the range of INR254-256bn. Our EBIT margin forecast is 6.2%, and consensus is at 6.6%. Our forecasts are based on the old schedule VI; under the new format, our finance charge forecasts might be higher. The company will hold its annual results conference call on 29 May at 16.30 IST, after which we will revisit our forecasts and provide an update.

**More funds required for meeting FY13 repayments.** In our note of 27 March, [Cash crunch seems more severe than expected](#), we highlighted that Suzlon (ex REpower) has debt repayments of cUSD700m in FY13 and is short cUSD600m (cINR30bn) to meet its repayment obligations. Besides the USD300m being raised from the banks, we believe the remaining deficit will be met through other sources/measures, as highlighted in our note.

**Our blended DCF- and RoE-based TP remains INR20.** Our DCF-based valuation is INR25.6 (average of two DCF approaches). We blend this with an RoE-implied PB value of INR13.2 to better capture the sector's market value, reflecting the current uncertainties. This leads us to a target price of INR20 (rounded off). The stock is trading at a high premium to the average peer group on CY12e PE, which we believe is not justified given the debt overhang. At the average global peer group CY12e PE of 15.7x, the stock would be valued at cINR13.9, which is lower than our target price.

**Potential catalysts:** (1) Performance below expectations over the next few quarters, (2) a slowdown in orders, (3) further rupee depreciation, and (4) news flow on decline in Suzlon's Indian market share, given the increasing competition.

## Financials & valuation

### Financial statements

Year to	03/2011a	03/2012e	03/2013e	03/2014e
<b>Profit &amp; loss summary (INRm)</b>				
Revenue	178,791	210,248	254,066	260,687
EBITDA	7,866	18,823	22,671	23,821
Depreciation & amortisation	-6,574	-6,637	-6,891	-7,091
Operating profit/EBIT	1,292	12,186	15,780	16,730
Net interest	-11,357	-13,633	-10,187	-8,458
PBT	-11,594	1,813	6,593	9,272
HSBC PBT	-8,998	-247	6,593	9,272
Taxation	-1,853	-2,137	-2,610	-3,752
Net profit	-13,239	-339	3,983	5,520
HSBC net profit	-10,922	-2,529	3,983	5,520

### Cash flow summary (INRm)

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Cash flow from operations	6,692	3,110	7,932	16,925
Capex	-7,569	-4,323	-4,541	-6,467
Cash flow from investment	-8,476	-3,253	-4,541	-6,467
Dividends	0	0	0	0
Change in net debt	-6,207	143	-17,617	-10,459
FCF equity	-4,639	-3,512	785	7,878

### Balance sheet summary (INRm)

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Intangible fixed assets	1,570	1,570	1,570	1,570
Tangible fixed assets	113,310	115,547	113,197	112,572
Current assets	167,370	181,553	172,280	164,974
Cash & others	31,210	38,942	21,106	20,000
Total assets	294,080	304,079	292,457	284,526
Operating liabilities	84,880	89,090	93,105	89,638
Gross debt	122,640	130,515	95,063	83,498
Net debt	91,430	91,573	73,957	63,498
Shareholders funds	67,390	66,777	84,987	90,507
Invested capital	166,160	170,638	172,836	169,478

### Ratio, growth and per share analysis

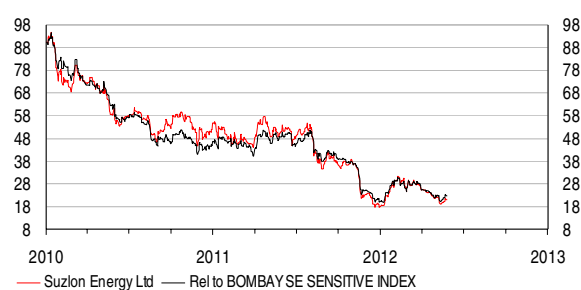
Year to	03/2011a	03/2012e	03/2013e	03/2014e
<b>Y-o-y % change</b>				
Revenue	-13.3	17.6	20.8	2.6
EBITDA	-16.5	139.3	20.4	5.1
Operating profit	-53.8	843.0	29.5	6.0
PBT			263.7	40.6
HSBC EPS				38.6
<b>Ratios (%)</b>				
Revenue/IC (x)	1.1	1.2	1.5	1.5
ROIC	0.9	-1.3	5.6	5.8
ROE	-16.4	-3.8	5.2	6.3
ROA	-0.1	-0.9	3.4	3.7
EBITDA margin	4.4	9.0	8.9	9.1
Operating profit margin	0.7	5.8	6.2	6.4
EBITDA/net interest (x)	0.7	1.4	2.2	2.8
Net debt/equity	129.8	137.1	87.0	70.2
Net debt/EBITDA (x)	11.6	4.9	3.3	2.7
CF from operations/net debt	7.3	3.4	10.7	26.7
<b>Per share data (INR)</b>				
EPS reported (diluted)	-7.72	-0.19	1.60	2.22
HSBC EPS (diluted)	-6.37	-1.42	1.60	2.22
DPS	0.00	0.00	0.00	0.00
Book value	37.92	37.57	34.15	36.37

### Valuation data

Year to	03/2011a	03/2012e	03/2013e	03/2014e
EV/sales	0.7	0.6	0.4	0.4
EV/EBITDA	16.0	6.8	4.8	4.2
EV/IC	0.8	0.7	0.6	0.6
PE*			13.0	9.4
P/Book value	0.5	0.6	0.6	0.6
FCF yield (%)	-13.4	-9.9	2.2	22.1
Dividend yield (%)	0.0	0.0	0.0	0.0

\*Based on HSBC EPS (diluted)

### Price relative



Source: HSBC

Note: Price at close of 25 May 2012

## Suzlon's full year results comparison

Suzlon's FY12 results came in much below expectations. Sales of cINR211bn were in line with our expectation but below the market's expectation. The net loss of INR4.8bn far exceeded our and the market's expectation (refer to table below), driven by a lower EBIT margin at 4.2% vis-à-vis revised company EBIT guidance of 5-6% (under the old schedule VI reporting format). According to the new schedule VI format, Suzlon's EBIT margin works out to 5.5%; however, we note that its nine months' results were provided in the old schedule VI format and the company issued its revised guidance at the time it reported these results. We therefore consider the old schedule VI reporting format for comparing the actual with guidance.

**Difference between the new and old schedule VI formats.** Under the new schedule VI reporting, bank charges and certain forex losses, which were initially reported under operating expenses, will now appear under financial charges. As a result, while the EBIT margin increases in the new format, the net profit remains unchanged from that in the old format. For FY12, the new schedule VI format finance charges are cINR2.8bn higher (from cINR13.8bn in the old to INR16.55bn in the new).

### Suzlon FY12 results comparison (in INRm)

INRm (except %)	FY 2011a	FY 2012f	FY 2012c	FY 2012a	Change y-o-y	Variance from HSBC forecast	Variance from consensus
Sales	178,791	210,248	215,258	210,824	18%	0%	-2%
EBITDA	10,472	18,823	17,495	18,212			
Margin	5.9%	9.0%	8.1%	8.6%			
EBIT	3,898	12,186	12,240	11,600	198%	-5%	-5%
Margin	2.2%	5.8%	5.7%	5.5%			
Net income	-13,239	-339	-150	-4,786	n.m.	n.m.	n.m.
Margin	-7.4%	-0.2%	-0.1%	-2.3%			

Note: Actuals according to the new Schedule VI format  
Source: Company data, Bloomberg consensus, HSBC estimates

The group's order book was almost flat q-o-q, with 5,730MW (cUSD7.4bn) on the order book vs 5,755MW (cUSD7.5bn) at the time of Q3 results announcement. The decline of c350MW in Suzlon Energy's order book during the quarter was offset by a c327MW increase in REpower's order book.

## Numbers review post the conference call on 29 May

Given the change in the reporting pattern by Suzlon, and in the absence of performance data of its key subsidiaries, we have still not incorporated the actual FY12 consolidated numbers into our model. We await details from the company during its conference call on 29 May, after which we will review our forecasts and provide an update.

## Suzlon's premium to the peer group is not justified

Suzlon is trading at a premium to its global peers on CY12e PE. Using the global peer group (ex Suzlon) CY12e PE multiple of c15.7x, the Suzlon stock price would be around INR13.9. Given the debt overhang at Suzlon, we do not see any good reason for it to trade at a premium to the peer group. Hence, a possible downside of around cINR7 exists, which we believe reflects the worst-case scenario for the stock.

#### Relative valuation – Global wind turbine manufacturers

Company	Bloomberg ticker	Current price	HSBC rating	Target price	EV/EBITDA			PE		
					2012e	2013e	2014e	2012e	2013e	2014e
Vestas	VWS DC	DKK37.45	UW(V)	DKK40.00	3.12	3.49	3.36	26.29	12.79	6.61
Gamesa	GAM SM	EUR1.62	N(V)	EUR2.75	1.86	2	1.78	15.19	6.66	3.8
Nordex	NDX1 GR	EUR3.29	UW(V)	EUR3.00	6.21	4.89	3.75	n.m.	29.79	11.66
Goldwind	2208 HK	HKD3.36	NR	NR	22.17	17.6	16.28	16.2	14.14	13.06
MingYang	MY US	USD1.79	NR	NR	1.79	1.57	0.94	4.94	3.53	n.a.
<b>Sector average ex Suzlon</b>					<b>7.0</b>	<b>5.9</b>	<b>5.2</b>	<b>15.7</b>	<b>13.4</b>	<b>8.8</b>
<b>Suzlon</b>	SUEL IN	INR20.85	UW(V)	INR20.00	<b>5.5</b>	<b>4.4</b>	<b>3.3</b>	<b>23.6</b>	<b>11.3</b>	<b>6.5</b>

Note: Price as of close of 25 May 2012. Data for Suzlon has been calendarized for year ending December 2012, 2013 and 2014. PE multiples for Vestas and Suzlon are based on expected EPS including one-off income/expenses  
Source: HSBC estimates for rated stocks, Thomson Reuters Datastream and Bloomberg for Not Rated stocks

## Valuation

We employ a blended valuation methodology: DCF and RoE-implied PB multiples. For DCF, we take the average value from our two DCF methodologies, the HSBC four-stage ROIC-based DCF and a ‘classic’ FCF-based DCF. Using an unchanged WACC of 12% (beta of 1.4, EMRP of 8% and gross cost of debt of 11.0), our two DCF methodologies provide an average value of INR25.6. Based on our cash flow analysis, we have been assuming a 50% FCCB conversion to equity at a discount to the current market price, which we factor in our valuation. We retain the same for the time being (until our post conference call update).

We also adopt an RoE-implied PB multiple based on a forward blended (FY12-15) RoE average of 5%. Assuming a 14% CoE (RFR 3%; ERP 7.5%; beta 1.4 as above), this yields a valuation of INR13.2 (at a PB ratio of 0.35x). We derive a blended value of INR20 (rounded off).

Under HSBC’s Equity Research model, the Neutral rating band for volatile Indian equities equals the local hurdle rate of 11% plus or minus 10ppt. Our 12-month target price of INR20 implies a potential return of -4% (excluding forecast dividend yield); we therefore reiterate our Underweight (V) rating on the shares. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

## Risks

Upside risks to our rating and estimates include the following:

- ▶ Timely debt reduction, leading to a re-rating by the market
- ▶ Higher-than-expected average selling price and profitability
- ▶ Lower-than-expected interest costs
- ▶ Higher-than-expected synergies with REpower
- ▶ Increase in feed-in tariffs/strict RPO implementation by various Indian states to improve domestic turbine demand

# Disclosure appendix

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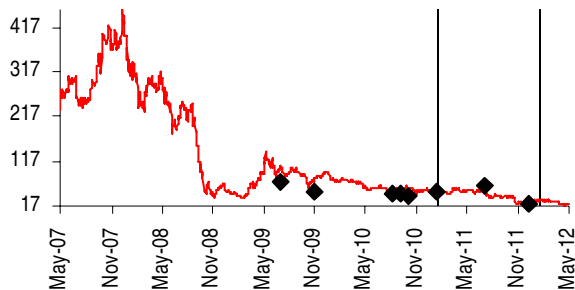
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Overweight (Buy)	49%	(25% of these provided with Investment Banking Services)
Neutral (Hold)	37%	(25% of these provided with Investment Banking Services)
Underweight (Sell)	14%	(16% of these provided with Investment Banking Services)

## Share price and rating changes for long-term investment opportunities

Suzlon Energy Ltd (SUZL.NS) share price performance INR vs HSBC rating history



Source: HSBC

### Recommendation & target price history

From	To	Date
Underweight (V)	Neutral (V)	7 February 2011
Neutral (V)	Underweight (V)	13 February 2012
Target price	Value	Date
Price 1	70.00	28 July 2009
Price 2	50.00	27 November 2009
Price 3	42.00	31 August 2010
Price 4	43.00	29 September 2010
Price 5	40.00	1 November 2010
Price 6	50.00	7 February 2011
Price 7	60.00	2 August 2011
Price 8	20.00	4 January 2012

Source: HSBC

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