

## Suzlon – A Case for Investment

Suzlon is a traders' paradise. A stock high on liquidity and volumes traded, volatile with high beta (2.78 as per zerodha). And it has been an investor's nightmare in its ten-year history. I had 250 shares of Suzlon in my account which I had purchased in 2010. Since then I never bothered to check upon them again....until 2015. Two events that changed it all were 1) Better sense prevailed upon Tanti when bankers were able to convince (or force) him to sell Servion to pay off debt 2) Sanghvi entered with 1800 cr.

I read an initiating coverage by Nomura highlighting the turnaround in April 2015, one of the first research houses to spot the value in Suzlon. But there were few takers, and understandably so. Whole of FY16 and FY17 went into putting company's operations back in place, while prices kept getting battered due to FCCBs getting converted to equity and getting sold eventually. Infact their FY2016 claim of getting back to profitability was also not entirely true as the profitability driven by operations has come only in FY17 confirming a turnaround now.

I took a position in Suzlon in early 2016 and have since been accumulating as I get more convinced of the story. I am sitting in profits but am greedy for more as I see more unlocked value in the stock.

### Why is Suzlon a case for investment?

Before we begin understanding the Suzlon investment case we must eliminate the bias we already have due to its dark past. We can't drive forward looking constantly at the rear view mirror. Instead a company is worth its potential to generate future cashflows. I understand the management is the same and debt is still there, but what has changed is the vision and the strategy. My case is purely from a strategic standpoint. And my investment decision is based upon three premises.

#### I. Market Growth

Suzlon is focusing on healthy organic growth by leveraging the increasing domestic and overseas demand for renewable energy. The opportunity is so big that this industry is set to boom in coming years. And its not a two, or a three, or a five year story. It is set to grow for next 1-2 decades and probably more. We already know the targets set by government domestically. Infact, US is thinking about ending the use of Oil as a fossil fuel in favour of electricity by 2030. Now whether this demand would be fulfilled by conventional sources or the alternate sources (which have become the mainstream source now), is not difficult for anyone to guess.

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*We are on the cusp of one of the fastest, deepest, most consequential disruptions of transportation in history. By 2030, within 10 years of regulatory approval of autonomous vehicles (AVs), 95 per cent of US passenger miles travelled will be served by on-demand autonomous electric vehicles owned by fleets, not individuals, in a new business model we call "transport-as-a-service" (TaaS).*

[http://economictimes.indiatimes.com/articleshow/58761683.cms?utm\\_source=contentofinterest&utm\\_medium=te xt&utm\\_campaign=cppst](http://economictimes.indiatimes.com/articleshow/58761683.cms?utm_source=contentofinterest&utm_medium=te xt&utm_campaign=cppst)

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**Premise 1 – A strong market growth can drive operational performance and growth for renewable energy companies**

## II. Sustainable Competitive Advantage

But so what if the market is good? Suzlon will still have to fight it out in the highly competitive market. Let us look at some of the strengths of Suzlon:

1. **Technology** – The best that happened from the Senvion debacle is that Senvion's proven technology stayed with Suzlon. Their product capability is unmatched among domestic players and can only be compared with their nearest competitor Gamesa-Siemens, a renowned MNC. Suzlon's technological capability opens the door for overseas expansion. They would leverage from the low-cost (manufacturing in India) best-in-class products (R&D centers in Europe) to compete against the best companies in the world. Also it is noteworthy that many overseas players are *setting/planning to set-up* manufacturing bases in India. Would India allow domestic business to such players unless Indian companies are allowed to compete in their local geographies? Suzlon will certainly benefit from such an arrangement. To add to that, it is the only Indian player to leverage from the Hybrid segment of the market, all thanks to its technology.
2. **Soft power (Relational Capital)** – Suzlon being a veteran in this business demonstrates considerable soft power over the value chain participants and among all other stakeholders in domestic market. The difference is visible when we see Inox Wind finding it hard to force the signing of FIT contracts while Suzlon (as they claim) had no trouble in continuing to execute FIT orders.
3. **Vertically Integrated Value Chain** – Suzlon has R&D centers, manufacturing facilities and service support centers spread across the globe. It enables end-to-end value chain capabilities like R&D, designing, land acquisition, project management, consulting, operations and maintenance services etc. Also they produce (correct me if I am wrong) all related products like rotor blades, turbines, turbine gear boxes, generators, panels, towers etc. This ensures higher control and cost cutting in value chain activities, quick and flexible response to customers, timely turnkey solutions. Management guidance of maintaining its margins despite pricing pressure is only possible due to the vertically integrated value chain of Suzlon.

When Inox delivered a mediocre performance in FY17 (losing marketshare from 23% to 11%), markets reacted and punished Suzlon too. But since Gamesa had already reported solid numbers (increasing its marketshare from 29% to 37%), it was more logical to presume that both Gamesa (~8% gain) and Suzlon (increased from 26% to 32% with 6% gain) have eaten up Inox's marketshare (-12%). If you do the math then (8+6=14%) it means that these two players have not only gained marketshare from Inox (12%) but from other smaller players too (2%).

It's a clear case of Out-Executing Competitors. As the margins squeeze (auction-based regime), the pricing pressure would eliminate the less competent players. Inox was never in the league of Gamesa and Suzlon, who have several years of experience in this industry. Unless a foreign player enters India, this market is consolidating into a near duopoly with an even fight between Gamesa and Suzlon with each having enough market growth to enjoy between them.

**Premise 2 – Being a leader in wind energy markets with years of experience, Suzlon holds a sustainable competitive advantage (or so called economic moat). With only one competitor, the risk of execution is low. High barriers to entry (technology, capital intensive business and relational capital) will dissuade new entrants.**

### III. Strategic Plan & Vision 2022

What about debt? Have you looked at their financial position? One look at their balance sheet would be enough to say that it's a junk stock. In last ten years all the hopes have crashed and now you think pigs would fly?

True. I agree with everyone who would argue against a Suzlon turnaround. But like an entrepreneur, an investor has to rely upon his gut feeling, an intuition, or a vision. A vision is a dream with a very weak foundation to support, but has a strong foresight to provide strength to embark upon. Visions are either realistic or unrealistic. For Suzlon, it's an improbable yet a very realistic one.

I foresee two scenarios for Suzlon in future: (a) a positive scenario; and (b) a second positive scenario

Let us discuss the second scenario first. In the second scenario Suzlon would falter in executing its strategic plan. It will not be able to repay debt and would be at the mercy of its debtholders. In this scenario, I strongly see Suzlon as a potent target. With low promoter stakes, its not very difficult to acquire control of the company. There is nothing wrong with the industry and the capacity Suzlon holds is very valuable if acquired at a discount. Any of the following possibilities can emerge:

- 1. Hostile takeover by Sanghvi and family** – Mr. Sanghvi is a shrewd businessman and he won't shy away from taking over the Company if he saw Mr. Tanti deviating an inch from the plan they have laid out for turnaround. Failing to comply, in my view, would most certainly result in Mr. Sanghvi stepping in. In fact, the grapevine on the street says that Mr. Sanghvi is calling the shots at Suzlon now and Mr. Tanti is taking orders from him. Sanghvi is using his brother-in-law Sudhir Valia (also credited for structuring the deal between Tanti and Sanghvi) from behind-the-scene to control Tanti and Suzlon. His son is already venturing in solar panel manufacturing business. Ain't the pieces of this puzzle looking identical, and seem to fit into a grand plan that Sanghvi must have envisioned?
- 2. Acquisition target** – If Suzlon defaults on debt, a consortium of banks would coup against the management and seize control. They would look for a suitable buyer to buyout Suzlon alongwith its debt. Given that the market is ripe for renewables in foreseeable future, I am assuming that a foreign player wanting to make an entry in India or a large business house like Tatas (already in power sector) would see a good value proposition in Suzlon's existing capacity and technology.
- 3. Leveraged Buyout** – It is also possible that a private equity firm might pitch-in in partnership with an existing wind energy player to leverage from the cheap valuations at which Suzlon would be available. Their strategy would be to restructure the company and bring it back on course.

All the above scenarios are going to be a positive outcome for a long-term shareholder.

Now let us discuss the first scenario which is based upon the strategic plan formulated by the company and believes that the company will achieve it. Management has laid out its Vision 2022.

Salient features are:

1. Huge installation targets
2. Cost reduction
3. Lower working capital
4. Zero debt

Suzlon made three major mistakes in the past. 1) Used inorganic growth to grow operations but failed to integrate and derive synergies from acquisitions, 2) used debt-financing to fund deals, 3) misread the market bubble which burst soon after.

Seems they have learn the lessons well. 1) Because now they are looking to purely grow organically, 2) Working hard to reduce debt and aim to be debt-free by 2022. 3) Renewable market has to compulsorily grow after COP 15 accord, with countries having fixed targets to reduce emissions.

The strategic plan lays out a realistic strategy with a vision saying '**Being debt-free is possible**'.

This is how:

- Suzlon has already reduced the debt by half.
- Next they plan to list their subsidiaries, Suzlon Global Services and SE Forge, to raise ~Rs. 3000-3500 cr. to pare debt.
- Largely the debt repayments are scheduled in 2023 as SBLC lenders have approved the extension. So there is no immediate threat of another default. Also, the rate of interest (claimed by company) is very low so it is not harming the capital efficiency. The low cost of debt would improve the ROCE.
- CDR exit would improve the credit rating for the company which in turn would help them raise debt at lower cost.
- Increased FCF from operations will be channelized towards debt repayment. I do not see the company distributing dividends in near future. FCF is expected to be high with improvement in operational performance.

In my personal view, Scenario 1 will pan out benefitting long-term investors with multibagger returns. Those who can wait patiently till 2022 and thereafter would benefit the most.

**Premise III: The strategic plan is actionable and realistic. The commitment of the management looks genuine in carrying out the plan with discipline. Even if the plan fails, the only effect upon the company would be the change in management, which is again a positive for shareholders**

**Risk Factors**

Last I would list down the Possible Risks I foresee for Suzlon investors:

1. Further FCCB conversions of 95 crore shares remaining. This takes the free float to 599 crore shares. Unless promoters increase the stakes or bring in another investor, the price action would be volatile and subdued.
2. Until the substantial portion of debt is repaid, the market may assign a lower PE to Suzlon compared to industry average
3. Short term market dynamics would clear out in FY18. The newly introduced Auction-based pricing may effect margins. Although the management is confident of maintaining margins, the effects would only be seen in coming quarters.
4. General Elections in 2019 can bring in a new government. However improbable, if it happens sector attractiveness domestically would have to be re-assessed.