VESTAS WIND SYSTEMS (VWDRY) LONG TERM HOLD

ONSHORE AND OFFSHORE INTEGRATIONS; REDUCED COSTS; VERTICAL EXPANSION: E-COMMERCE

10/07/2021

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PRICE:
€ 10.21
(REFLECTS PRICE ON 10/07/21)

TARGET:
€ 15.16

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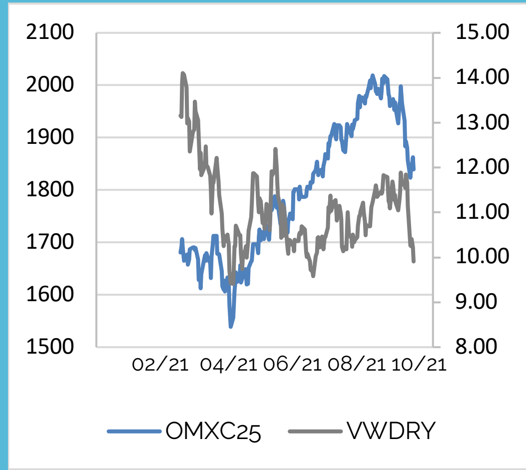
SUMMARY

ANNUAL REV. (BI L)	€14.819
52-WEEK HIGH LOW	€9.19 – €15.09
SHARES OUT (BIL)	€1.004
MARKET CAP. (BIL)	€30.027
PRICE/SALE	2.033
EV/EBITDA	21.697
CURRENT RATIO	0.99



THESIS

Our analysis presents a multitude of key drivers within the wind turbine energy market that has led us to give Vestas Wind Systems a strong buy rating, with a target price of € 15.16. Entering the new era with government backing through regulatory laws complemented by a healthy balance sheet and exceptional internal operations, we are confident that Vestas will meet our projections.

INDUSTRY OVERVIEW

Projections have the wind turbine market valued as high as $200.81 billion by 2026 in comparison to its $81.80 billion value in 2020 resulting in a CAGR of 15.85% in the allotted forecast period. The industry growth is heavily precipitated by government regulations that provide innumerable benefits operationally and financially, allowing for an increased awareness of renewable energy markets and an overall decrease in the cost of wind energy generative technology.

The widespread adoption of clean energy practices has become a global phenomenon. In the past, Europe led the wind turbine market with an overall market share of 56.99% in 2016 and 88% of total offshore wind installations. This appears to be shifting through global integration. This key feature within the market is what is driving its tremendous growth and will continue to drive it in the coming years. The Middle East, Africa, and Asia-Pacific regions are all incredibly notable rising markets and are experiencing heightened growth.

Demand for energy is rising, which results in countries adopting and rushing toward clean energy policy and regulation. These favorable regulations allow wind turbine companies to flourish and maintain profitability.

KEY DRIVERS

Onshore and Offshore Integrations. Vestas will be ceasing production at select plants in Spain, Germany, and Denmark as part of the consolidation of its onshore and offshore business. As Vestas introduces new products and evolves its supply chain networks, the centralization would allow for it to focus on its core competencies of manufacturing to offer higher quality products while cutting costs and off-loading redundancies.

In addition to centralizing its European operations, Vestas recently announced plans to expand company actions into the North American continent. The United States has always been one of Vesta's main sources of business, accounting for 45% of total revenue and 20-30% of company orders. Nevertheless, recent expansions are expected given the recent change in geopolitical climates within the US. Following the 2020 election, the Biden administration altered many of the environmental policies put in place by the Trump administration. In his first few days in office, the Biden Administration rejoined the Paris Agreement, while also passing a series of executive orders exemplifying a commitment to renewable energy infrastructure, calling for carbon emissions to be at zero by 2035. This will likely drive utility companies to invest heavily in wind.

Recent energy is a long-term growth industry. The U.S Energy Information

Administration believes that wind power will make more sense than combined fossil fuels within the next 20 years. Wind power has long-term growth prospects, but global onshore wind power installations will be flat in the medium term as companies like Vestas scale and grow. In other words, if you buy Vestas, there will be a medium to long-term wait, at least until 2025 to grow revenue.

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Reduced Costs. At the same time, the high costs initially associated with wind energy are fading for several reasons. The first is the greater adoption of offshore wind projects as opposed to onshore projects. With many European companies having more experience with offshore wind turbines, a growth in specialized industry technology, and reduced shipping costs (due to there being no need to transport equipment inland), veteran turbine manufacturers like Vestas will have an easier and cost-efficient project methodology to sell to customers. In fact, according to the US Department of Energy, offshore wind could account for one-quarter of wind power generation by 2030.

The second factor for decreased costs is the fact that a lot of the groundwork infrastructure for wind energy has been set up. With upfront investments for wind turbine distribution systems already accounted for in regional markets, the cost of installing wind power is falling for companies like Vestas. In markets with extensive wind power infrastructure like Europe and the United States, the retail price of wind-powered electricity is becoming competitive with fossil fuels. This trend will likely continue encouraging utilities and independent power producers to invest in wind capacity.

Vertical Expansion: E-commerce. Vestas recently introduced Convento, a digital platform that functions as the Amazon of the renewable energy industry by providing a marketplace to connect buyers and sellers of parts and services from various renewable energy technologies. Vestas aims to connect a fragmented renewable energy market by creating a space for companies in the sector to connect and collaborate.

This vertical expansion into e-commerce will be a heavy extrapolation in the market share that Vestas will be capable of taking in the long term. This move is incredibly innovative and important to maintaining their global platform. Not only will they expand their distribution channels, but they are effectively splicing their own competition's profitability who would operate on the platform at the same time.

FINANCIAL ANALYSIS

Vestas presents itself as an incredibly stable company with consistent revenue growth. However, they also boast a stronger return on invested capital and return on equity relative to their direct competitors. Despite operating on a larger scale, Vestas still exceeds Siemens and Orsted by a significant margin in both metrics. Vestas exhibits operational excellence and manages to edge out the competition through continual innovation and competitive pricing. This indicates that Vestas is extremely healthy and that they should have no issues maintaining value even in expansionary phases as they are projected to push towards in the coming years.

We believe that Vestas is currently positioning itself to further its agenda in dominating foreign markets and penetrating other distribution channels through their large amounts of cash. They currently have $1.8 billion in cash and cash equivalents, which is in reserves to either expand in terms of acquisitions and research and development.

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Figure 1: Return on Equity

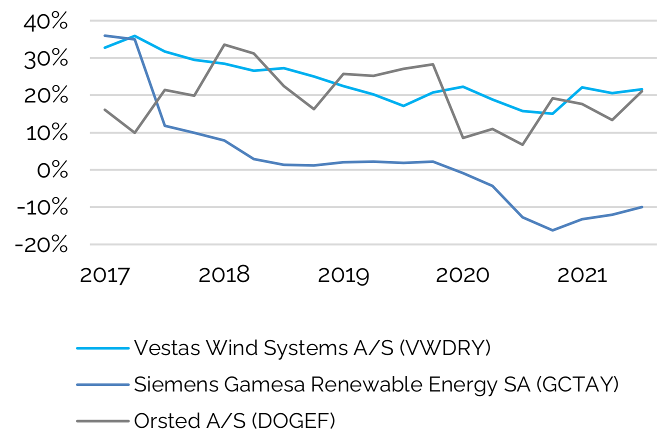
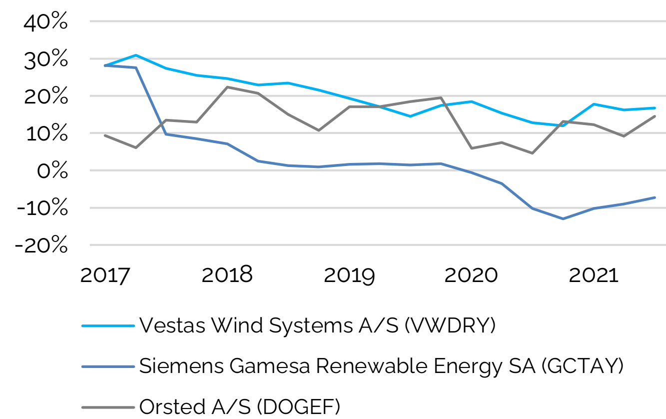


Figure 2: Return on Invested Capital



CAPITAL STRUCTURE

Analyzing Vestas' capital structure, they are seemingly anomalistic in comparison to their competitors. Their debt-to-equity percentage is 28.8% compared to the industry average of 40.3%. Vestas is not nearly as leveraged as other companies, implying that they have a much stronger ability to expand.

Supporting this, Vestas holds a 1.1 ratio of Financial Debt to EBITDA, while also have a 28.49 Times Interest Earned Ratio. Vestas can easily meet its debt obligations and will have no issues related to insolvency. Vestas is, to a fundamental level, a stable powerhouse that will continue to expand.

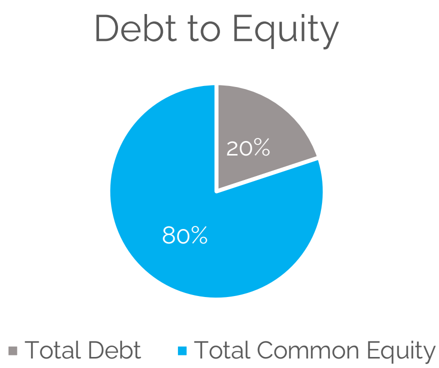


Figure 3: Debt to Equity

PRICE TARGET

We arrived at our €15.16 target price for VWDRY through the use of a 10-year discounted cash flow model. We projected revenues, divided by revenue segments and geographical markets, and expenses as a percentage of total revenues over a 10-year horizon and used a WACC of 10.63% based on current market conditions to arrive at a fair value of €15.16. As of 10/8/2021, this reveals an upside potential of 48.5%, based on the current share price of €10.24.

We projected revenue to grow by 15% in 2021 and 14% 2022, however, we projected an increase to 18% growth in 2025, followed by a tapering off to 15% in 2030. According to the International Energy Agency (IEA), the onshore wind market, especially in China and America, is expected to grow at 26% per annum. Moreover, the offshore wind market is seeing rapid growth, which is expected to have significant financial impact after 2024 in key regions like the Americas and Europe.

Our model conservatively predicts that the effect of the growth in the offshore wind market will only impact revenues in 2025 and beyond. As a large competitor in the industry, we see VWDRY capitalizing on industry trends and future growth drivers like expanding into emerging markets and ramping up offshore wind products.

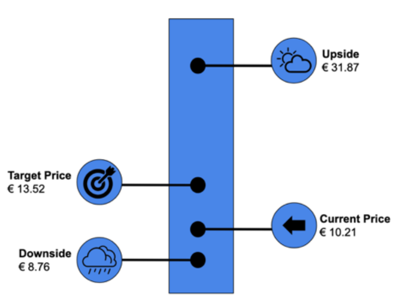


Figure 4: Sensitivity Analysis

RISK FACTORS

Penetrating Foreign Markets. Vestas Wind Systems' revenue growth experienced a hindrance in the past year in comparison to its direct competitors. Sitting at 3.3% in revenue growth in comparison to the 18.38% market average after bouncing back from covid; Vestas appears to have significantly stunted growth in comparison to its Chinese counterparts. In the long run, their intentions of expanding internationally could be challenged despite being an industry leader. In order to maintain growth, or even exceed current expectations, their implementations of international expansion will be a huge role-player in our projected upsides of Vestas. We view the inability for Vestas to effectively take large market shares in these Chinese markets as a significant barrier to entry.

Operational Concerns. Vestas' ability to function efficiently as they've grown to scale is another worrying trend. Historically, the company held an impressive ~15% operating margin but has regressed to a meager ~5%. In the long run, this could be a terrible digression as their net income has been inconsistent and price undercutting is quite prevalent in the wind energy systems industry. The lack of differentiation in products between competitors means that price is the most critical factor for customers. Vestas may be perceptible to undercutting, further lowering their revenues and net income.

Government Incentives. Wind systems are backed by the government through tax advantages. However, a lack of renewal of these regulations which boost Vestas' margins is a risk that we must account for; although one that is unlikely to occur within our forecasting period.

IMPACT REPORT

Vestas established a Sustainability Strategy department in 2019 that focuses on ESG matters. Vestas has year to year increases in renewable energy and 90% of the energy used for their operations is renewable. When looking at their carbon footprint, we see that a V150-4.2 only emits around 1% of CO2 compared to a coal power plant and is much more sustainable than solar energy. A single Vestas wind turbine will generate around 30-50 times more energy than it uses in its entire life cycle. Vestas has also reduced CO2 emissions from its own operations by 33% in 2020 and is committed to reducing it to 55% by 2025 and 100% by 2030 to become carbon neutral without carbon offsets. Currently, 83-87% of a Vestas wind turbine is recyclable and Vestas aims to produce zero-waste wind turbines by 2040.

However, aside from future projects, Vestas has always maintained environmentally friendly practices. Dating back to 1981, they have prevented over 1,492 million tonnes of CO_2 from being released which is equivalent to 1,007 million vehicles driven for one year or even 190 trillion smartphones being charged.

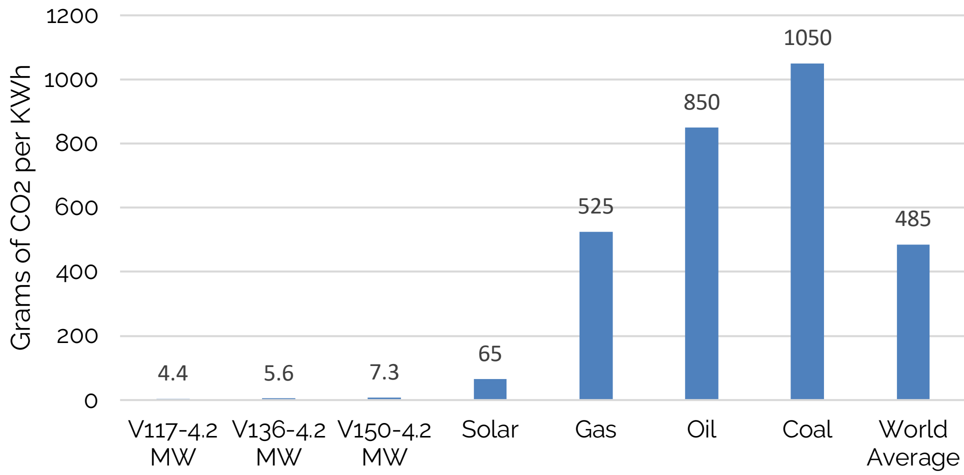


Figure 5: Impact