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Vestas investors seek wind of change

News analysis

Japanese group Mitsubishi is viewed as a 'strategically good match' to help rescue the Danish turbine maker, which has seen a 94% collapse in its share price, writes Richard Milne

Multiple profit warnings, almost a fifth of jobs cut, talks with lenders to stave off a breach of its covenants: Vestas has become the poster child for the woes of the wind industry.

Sinking public subsidies around the world coupled with the rise of Chinese turbine manufacturers has hit this government-supported industry hard.

But the troubles of Vestas, based in northern Denmark, are as much a micro story of a questionable strategy and dubious decision-making in the financial crisis that has left the world's largest turbine maker by volume fighting for its very survival after a 94 per cent collapse in its share price in the past four years.

"You have a company with little cost control, inadequate capital control and in some of their factories no operational control. It is business school 101 on how not to run a company," says Martin Prozesky, analyst at Bernstein Research in London.

News last week that the Danish group is in talks over a "potential strategic co-operation" with Mitsubishi Heavy Industries has offered a glimmer of hope to investors. For some, the Japanese company could be the saviour of Vestas, providing it with much-needed capital as it seeks to join battle with the likes of Siemens and General Electric in the offshore turbine market.

Jacob Pedersen, an analyst at Sydbank, calls it a "strategically good match". He believes Mitsubishi Heavy could help Vestas develop the costly offshore turbines.

Bert Nordberg, Vestas's new chairman and a former president of Sony Ericsson, had said only days before the talks were disclosed that he was looking for an investor to take a 10-20 per cent stake. "A significant shareholder; someone I can talk to and an owner who can also calm the banks," he told the Berlingske newspaper.

But others are more sceptical. Bankers point out that the talks have dragged on since March.

Mr Prozesky is also not convinced. "Vestas has not really brought anything to the offshore market that is innovative. Mitsubishi brings more to the table so I don't see the logic." He believes only a full takeover makes sense; buying a stake without gaining operational control will be "throwing money into the water".

There is little doubt Vestas is in a fragile financial state. It had to defer the half-year test of its financial covenants after poor results in the first six months of this year. Its cash burn has accelerated again after a pause last year: a free cash outflow of €633m in the first half means it cost €3.5m a day to run the business. And it comes on top of €2bn in outflows from 2008 to 2010.

Lenders have allowed Vestas to draw down on its existing facilities as the company banks on a better second half, seasonally always more positive than the first six months, allowing it to meet its covenants.

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>
> **Håkon Levy, analyst at DNB Markets**

Net debt has risen from €545m at the end of 2011 to €1.15bn in the first half. Due to falling profits, the ratio of net debt to ebitda before special items has risen over the same period from 1.8 to a mouthwatering 16. Vestas is already warning that 2013 is likely to be tougher than this year.

In response, it has accelerated its job cuts and now intends to end the year with about 19,000 workers, down from a peak at the end of 2010 of 23,252. Its aim is to be profitable with expected deliveries of 5GW next year; it just cut its forecast for this year from 7GW to 6.3GW. But some think even this does not go far enough: Mr Prozesky suggests it needs to cut 40-50 per cent of its workforce in total.

The main reason for its problems is an ill-timed expansion. It ended 2006 with 12,309 employees. But just as the financial crisis broke Vestas expanded massively. In 2008, alone it added 5,500 employees.

Margins have collapsed at the same time – earnings before interest and tax as well as special items as a percentage of revenues have dropped from 10.4 per cent in 2008 to minus 6 per cent in the first half of this year.

"The past five years they have expanded very aggressively and have not shown any willingness to cut back on those plans. That has been a major contributor to the negative cash outflow and left the company with too much capacity. In my view, it is one of the major strategic mistakes they have made," says Håkon Levy, analyst at DNB Markets in Oslo.

Ditlev Engel, Vestas's chief executive, admitted in March there had been "unacceptable mistakes". But despite the chief financial officer, chairman and deputy chairman all leaving, he has remained in his post.

Vestas officials underline their plans to reduce costs by more than €250m annually, up from a €100m target at the start of the year. "We are trying to speed up our efforts and we are confident that we will be profitable in 2013," the company says.

Mr Levy underlines that the company remains the market leader as well as having its largest order backlog to date. He believes if they can make it through the "rough patch" of the next two years by restructuring and avoiding a rights issue, then the company judged uninvestable by some can win back shareholders.

But Mr Prozesky is less certain, believing that the Mitsubishi Heavy talks demonstrate that radical change is needed for Vestas to prosper.

"In one year's time there is no question: there will be a different ownership and capital structure. The cash is not coming from the operations," he says.

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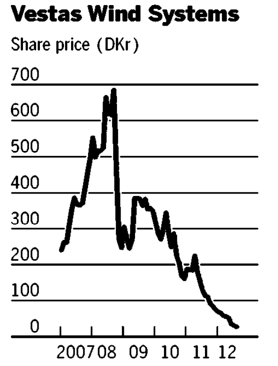
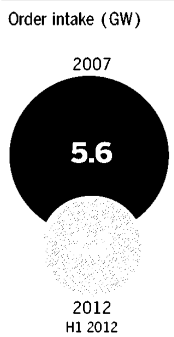
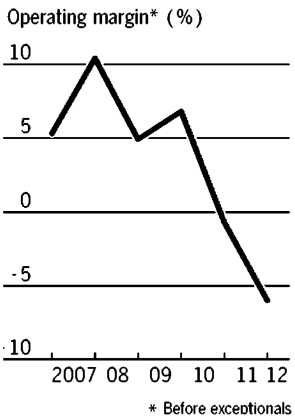
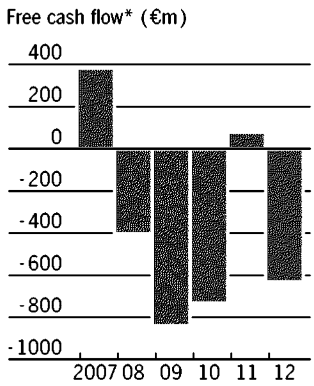
Vestas Wind Systems

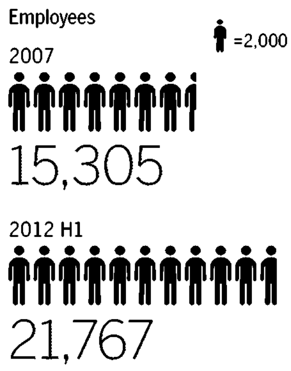


Sources: Thomson Reuters Datastream; company









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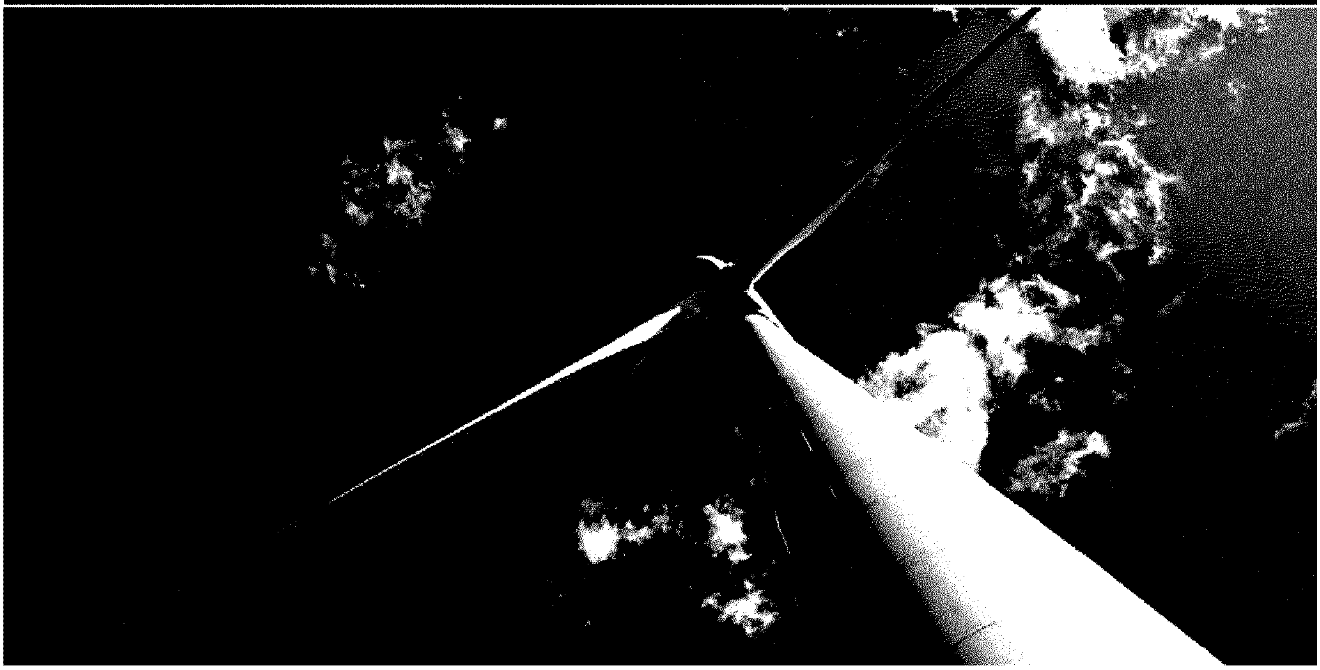

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