

Equities

30 November 2010 | 28 pages

Vestas Wind System (Den) (VWS.CO)

Brought to Account – Retain Sell

- **Retain Sell Rating, Target Price Cut to Dkr120 per Share** — Vestas recently restated its accounts. This report looks at the impact this has had on earnings and takes a more detailed look at the profits and cash flows of Vestas in this context. Despite the restatement we believe that cash earnings will continue to be significantly weaker than P&L earnings and our valuation falls to Dkr120 per share based on our revised view of the cash earnings profile of the group.
- **Accounting Changes** — Vestas restated its accounts on 22 November resulting in major changes to previously reported revenue and profits. Most notable in the historic context was a change in revenue recognition prompted by accounting interpretation IFRIC 15. However, also extremely pertinent for future EPS was an unrelated change to the treatment of warranty provisions and costs.
- **Is it a Good Thing? Yes and No** — The change to accounting should be a positive aligning EPS and cash more accurately. Some of the past years earnings have been slashed (2009 EPS is cut by 64%) - although 2010E EPS is positively impacted. The issue we have is that the change in warranty treatment when combined with ongoing guidance for lower P&L warranty costs means a new form of P&L / cash flow mismatch has appeared creating a different uncertainty.
- **Real "Cash EPS" Dramatically Below Reported EPS** — When EPS is adjusted to reflect the real level of warranty and R&D costs (rather than current lower P&L figures) the implication is a reduction in 2011E EPS of 42% (underlying 2011E Cash EPS of €0.86 compares to our P&L forecast of €1.49).
- **Target Price Cut to Dkr120 from Dkr175** — This is in line with our revised DCF valuation which now reflects the lower peak profitability of the group under the revised accounting (peak EBIT margins were now 10%, not 13%) and it also adjusts for the higher cash costs of warranties and R&D relative to the P&L. The current P/E of 25x 2011E on our calculated cash proxy EPS is double that of our European Engineering sector (which is on 12.5x 2011E).

- Company Update
- Target Price Change
- Estimate Change

Sell/High Risk	3H
Price (30 Nov 10)	Dkr163.40
Target price	Dkr120.00
	<i>from Dkr175.00</i>
Expected share price return	-26.6%
Expected dividend yield	0.0%
Expected total return	-26.6%
Market Cap	Dkr33,285M
	US\$5,861M

Price Performance (RIC: VWS.CO, BB: VWS DC)



Vestas Wind System (Den) (EUR)

Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (€M)	5,904.0	5,079.0	6,800.0	6,800.0	7,098.4
Net Income (€M)	470.0	125.0	195.1	303.1	343.7
Diluted EPS (€)	2.53	0.63	0.96	1.49	1.69
Diluted EPS (Old) (€)	2.77	2.93	1.04	1.28	1.87
PE (x)	8.7	34.7	22.9	14.7	13.0
EV/EBITDA (x)	5.7	9.5	6.1	5.8	5.3
DPS (€)	0.00	0.00	0.00	0.00	0.00
Net Div Yield (%)	0.0	0.0	0.0	0.0	0.0

Mark Fielding

+44-20-7986-4018
mark.fielding@citi.com

Sarah Deans

+44-20-7986-4156
sarah.deans@citi.com

Alexandre Werbowy

alexandre.werbowy@citi.com

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	8.6	34.7	22.9	14.7	13.0
EV/EBITDA adjusted (x)	5.7	9.5	6.1	5.8	5.3
P/BV (x)	2.6	1.7	1.6	1.5	1.3
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (€)					
EPS adjusted	2.54	0.63	0.96	1.49	1.69
EPS reported	2.53	0.63	0.96	1.49	1.69
BVPS	8.59	12.86	13.44	14.92	16.61
DPS	0.00	0.00	0.00	0.00	0.00
Profit & Loss (€M)					
Net sales	5,904	5,079	6,800	6,800	7,098
Operating expenses	-5,290	-4,828	-6,324	-6,324	-6,566
EBIT	614	251	476	476	532
Net interest expense	46	-48	-55	-55	-55
Non-operating/exceptionals	0	1	-150	0	0
Pre-tax profit	660	204	271	421	477
Tax	-190	-79	-76	-118	-134
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	470	125	195	303	344
Adjusted earnings	470	125	195	303	344
Adjusted EBITDA	749	469	776	876	952
Growth Rates (%)					
Sales	54.2	-14.0	33.9	0.0	4.4
EBIT adjusted	204.0	-59.1	89.6	0.0	11.8
EBITDA adjusted	121.6	-37.4	65.5	12.9	8.7
EPS adjusted	351.9	-75.2	51.5	55.4	13.4
Cash Flow (€M)					
Operating cash flow	277	-34	34	630	657
Depreciation/amortization	135	218	300	400	420
Net working capital	-338	-391	-400	-50	-50
Investing cash flow	-680	-808	-800	-650	-650
Capital expenditure	-668	-818	-800	-650	-650
Acquisitions/disposals	-12	10	0	0	0
Financing cash flow	0	791	0	0	0
Borrowings	0	0	0	0	0
Dividends paid	0	0	0	0	0
Change in cash	-575	98	-786	-20	7
Balance Sheet (€M)					
Total assets	6,327	7,959	8,771	9,083	9,363
Cash & cash equivalent	162	488	400	400	400
Accounts receivable	938	525	725	775	775
Net fixed assets	1,030	1,461	1,701	1,811	1,911
Total liabilities	4,740	5,417	6,034	6,043	5,979
Accounts payable	1,030	1,062	1,162	1,262	1,262
Total Debt	123	351	1,049	1,069	1,062
Shareholders' funds	1,587	2,542	2,737	3,040	3,384
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	12.7	9.2	11.4	12.9	13.4
ROE adjusted	33.9	6.1	7.4	10.5	10.7
ROIC adjusted	35.0	8.1	13.3	9.9	10.2
Net debt to equity	-2.5	-5.4	23.7	22.0	19.6
Total debt to capital	7.2	12.1	27.7	26.0	23.9

For further data queries on Citi's full coverage universe
please contact CIRA Data Services Europe at
CIRADatServicesEMEA@citi.com or +44-207-986-4050

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Brought to Account – Retain Sell

Vestas recently has restated its accounts resulting in major changes to previously reported revenue and profits. Most notable in the historic context was a change in revenue recognition prompted by accounting interpretation IFRIC 15. However, perhaps more pertinent to future EPS was an unrelated change to the treatment of warranty provisions and costs. The change to accounting should be a positive aligning EPS and cash more accurately. Some past years earnings have been slashed (2009 EPS is cut by 64%) - although 2010E EPS is positively impacted.

The issue we have is that the change in warranty treatment when combined with ongoing guidance for lower P&L warranty costs means a new form of P&L / cash flow mismatch has appeared creating a different uncertainty. This is visible in our forecast as "Cash EPS" remains well below reported EPS. When EPS is adjusted to reflect the real level of warranty and R&D costs (rather than current lower P&L figures) the implication is a reduction in 2011E EPS of 42% (underlying 2011E Cash EPS of €0.86 compares to our P&L forecast of €1.49). We retain our Sell rating and cut our Target Price to DKr120 from DKr175 in line with our DCF (which now reflects the lower peak profitability of the group under the revised accounting and also higher cash costs of warranties and R&D relative to the P&L). The current P/E of 25x 2011E on our calculated cash proxy EPS is double the 2011E P/E of our European Engineering sector coverage group (currently on 12.5x11E). At our Target price the implied P/E is still 19x 11E, 14x 12E based on our cash proxy EPS.

Accounting Change

Accounts restated on 22 November for IFRIC 15 and recent IASB proposals on revenue recognition

Vestas highlighted with its 3Q results that it was considering a change in its accounting policy. Following this on 22 November it enacted changes that resulted in major restatements of previous revenue and profits. The most notable change was a move in relation to revenue recognition for supply-and-installation contracts, prompted by accounting interpretation IFRIC 15. However, in addition to this Vestas also decided to change its accounting in relation to warranty costs for all types of contract, prompted by recent IASB proposals on revenue recognition.

IFRIC 15 – what is it?

IFRIC 15, *Agreements for the Construction of Real Estate*, is an IFRS Interpretation issued by the International Financial Reporting Interpretations Committee (IFRIC) in July 2008. The effective date was initially 1 January 2009, but this was delayed until 1 January 2010 for EU listed companies because the EU did not endorse the Interpretation until July 2009.

Two International Accounting Standards cover revenue recognition: IAS 11 (*Construction Contracts*) and IAS 18 (*Revenue*). As the names suggest, IAS 11 covers accounting for revenue arising under construction contracts and IAS 18 covers all other revenue recognition issues. IAS 11 generally requires percentage of completion type accounting whereas in IAS 18 revenue from the delivery of goods is usually recognised when the goods are transferred to the customer (however the provision of services may be recognised on a percentage of completion basis).

IFRIC 15 addresses when real estate construction agreements (such as housing sold “off plan”) should be covered by IAS 11 and when IAS 18 applies. IFRIC 15 states that the definition of a construction contract is met (and therefore IAS 11 applies) if “the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress (whether or not it exercises that ability”. Where buyers have only a limited ability to influence the design of the real estate it is a sale of goods within the scope of IAS 18.

In other words, IFRIC 15 means that revenue from highly customised real estate construction projects can be recognised during construction using percentage of completion, whereas revenue from other real estate sales with little customisation should be recognised only when the real estate is finally transferred to the customer.

IFRIC 15 covers real estate construction and so does not directly apply to Vestas’ products. However the IFRIC observed that the conclusion in IFRIC 15 might be applied by analogy to other industries.

What Changes for Vestas’ Revenue Recognition

Vestas has to restate revenues for IFRIC 15 for “supply-and-installation” contracts – although if contracts are highly customised, as stated in the annual report, we are less sure IFRIC 15 implies any need to change the accounting

Vestas’ 2009 annual report states that “Contracts to deliver large wind power systems with a high degree of customisation are recognised in revenue as the systems are constructed based on the stage of completion of the individual contract (turnkey and supply-and-installation projects).” Sale of individual wind turbines and small wind power systems based on standard solutions (supply-only projects) are recognised on transfer to the buyer. In other words, turnkey and supply-and-installation projects are accounted for under IAS 11 whereas for supply-only contracts the relevant standard is IAS 18.

The company has now announced that it will apply IAS 18 to the supply-and-installation contracts, rather than IAS 11. This means that revenue and profit recognition will be delayed until the end of each project. The accounting for turnkey and supply-only projects will be unchanged.

The annual report states that there is a “high degree of customisation” in the supply-and-installation projects and this was reiterated by the company’s CFO in an analyst presentation on 24 November. We are therefore not sure why the company has decided that, by applying IFRIC 15 by analogy, these contracts no longer qualify for percentage of completion accounting. The crux of IFRIC 15 is that highly customised projects, where the customer specifies major structural elements of the design, qualify for IAS 11 and percentage of completion accounting. So if supply-and-installation contracts are highly customised, as stated, we do not understand why IFRIC 15 necessarily implies any need to change the accounting.

IASB Revenue Recognition Project – Could It All Change Again?

New standards could see it all change again from 2013

Vestas has also indicated that its accounting change has been influenced by the IASB’s current revenue accounting project. The IASB issued an Exposure Draft (ED) on Revenue in June 2010. The ED proposes that revenue should be recognised based on the transfer to the customer (the transfer may be continuous if the customer controls the work in progress). This implies that some contracts which are currently accounted for on percentage of completion will have to be recognised on a different basis and in some cases only when the final product is transferred at the end of the contract.

However these proposals are not yet a final Standard. The IFRS is expected to be issued in June 2011 and the new standard will probably have an effective date of 2013 or later. The IASB has not yet decided if early adoption of the new standard will be permitted. The final version of the standard may differ materially from the ED. The IASB and FASB received nearly 1000 comment letters on the ED and both Boards will have to reconsider the proposals in the light of these comments.

We Don't Understand Why Now...

The timing is odd as the standard has been in place since January

We are puzzled by the timing of this announcement. Vestas restated its Q3 2010 and 9M 2010 results on 22 November 2010, and the 2010 full year results will be presented on the new accounting basis.

If the company believes that the accounting change is necessary because it is appropriate to apply IFRIC 15 by analogy, then we believe it would have been most appropriate to use the new method from 1 January 2010, ie for Q1 2010 results onwards. The IFRIC is effective for annual periods starting on or after 1 January 2010 and amongst EU listed companies it is the norm to apply such new requirements from Q1 so that the interim results are consistent with the year end results.

On the other hand if the accounting change is primarily driven by the IASB Revenue project, then it seems very early. The new IFRS will not be mandatory until 2013 or later. The IFRS has not been finalised and it is not clear if early adoption will be permitted. So, it is very unusual to change the accounting now.

The company has explained the timing on the grounds that "The Board of Directors requested a thorough analysis, as the effect of IFRIC 15 on Vestas was unclear. The necessary clarification has now been provided in the form of the latest draft (June 2010) of IFRS standard for revenue recognition". However we are unconvinced that the publication of an Exposure Draft clarified the correct treatment under existing accounting standards.

The company stated (presentation 24 November) that once it had decided to change its accounting policy, it was required to put it into effect immediately. Yet companies are only required to make planned accounting changes with immediate effect if the current accounting is inconsistent with existing standards. Companies are permitted to announce future elected changes in accounting policy. For example, Nestle recently (November 2010) announced a change in revenue recognition (relating to treatment of customer discounts) to be effective 1 January 2011.

Nestle and Vestas are the only companies, as far as we are aware, which have made changes to revenue recognition prompted by the IASB's revenue project.

From No Effect to Big Changes – When Did Vestas Change its Mind?

Previously Vestas stated it did not expect an impact

The Vestas 2008 annual report (see below) indicated that on a preliminary assessment, IFRIC 15 would have no impact. The 2009 annual report repeated the brief explanation of IFRIC 15, but omitted the comment about the preliminary assessment and the implications and did not provide any guidance about the potential impact. IAS 8 requires that companies discuss the expected impact of new accounting rules which have been issued but are not yet effective, or to state if the impact is not known or reasonably estimable.

However, it is noteworthy that Vestas omitted the comment about the potential impact of IFRIC 15 from the 2009 annual report, which had been included in the 2008 annual report.

Figure 1. Previous Comments by Vestas on IFRIC 15

2008 Annual Report	IFRIC 15 on agreements for the construction of real estate and similar construction contracts. The objective of the interpretation is to clarify the definition of construction contracts and the clarification of when a construction contract should be treated under IAS 11 or IAS 18 and to provide more guidance on how to account for revenue when the agreement for the construction of real estate falls within the scope of IAS 18. The interpretation is effective for accounting periods beginning 1 January 2009 or later. On preliminary assessment Vestas correctly classifies its contracts according to the guidance in the interpretation. However, Vestas continues to explore the full implications of IFRIC 15.
2009 Annual Report	IFRIC 15 “Arrangements for the Construction of Real Estate” The objectives of the interpretation is to clarify the definition of construction contracts and the clarification of when a construction contract should be treated under IAS 11 or IAS 18 and to provide more guidance on how to account for revenue when the agreement for the construction of real estate falls within the scope of IAS 18. The interpretation is effective for accounting periods beginning 1 January 2010 or later.

Source: Company Reports

Why is No One Else Doing This?

Peers such as Siemens and Gamesa see no need to change their accounting

What also makes this change stand out is that it does not seem to be a widespread shift in the accounting in the sector, rather a specific move by Vestas. Siemens CFO suggested that the rule has been in place since the start of 2010 and already reviewed by Siemens with the conclusion it would have no impact on its renewables business. Similarly Gamesa has stated that according to its auditors, IFRIC 15 only applies to real estate companies therefore GAM will not implement these rules and do not expect any change in its accounting method in the short term.

And What's This Other change? Warranty Provisions...

Warranty provision change is unrelated to IFRIC 15

Vestas has also changed its accounting policy for warranty provisions. We understand from the company that the warranty provision accounting change is a combination of both reporting the same provisions earlier (i.e. pushing the cost into historic reported periods), and also taking a broader definition of warranty provisions. This change is unrelated to IFRIC 15 and applies to all types of contract, not just supply-and-installation contracts. The company's explanation is as follows:

“In order to comply with the forthcoming accounting standards for revenue recognition (June 2010, IFRS standard for revenue recognition), a difference is now made between the actual product warranties and the service obligations. Thus, from now on, potential product warranties will always be recognised as warranty provision when revenue from sale of wind turbine is recognised. This may result in commercial constructive obligations beyond the specified legally obligatory warranty period for the turbine being recognised as a warranty obligation. During the terms of the contracts, there are no changes to the Group's expected costs for this. The changed accounting policies has the effect that the Group's expected costs in relation to this, will now be recognised as provisions earlier instead of currently.”

And again we are puzzled on both timing and effect... and it may all have to change again (again)

We are puzzled by this accounting change, both in terms of timing and effect.

- **On Timing:** Since this accounting change is unrelated to IFRIC 15, so there cannot be any urgent reason due to new accounting guidance, and it does not seem to comply with the current proposals in the Revenue standard, the timing seems surprising to us.
- **On Effect:** The IASB's proposed Revenue standard may require companies to defer revenue equivalent to the value of the warranty provisions (or similar obligations). However, we understand that Vestas is not making that accounting change. Instead it is changing the policy on recognising a cost, but with no impact on revenue. The company has told us that it may have to make a further accounting change when the Revenue standard comes into effect (eg in 2013) to defer the relevant revenue.

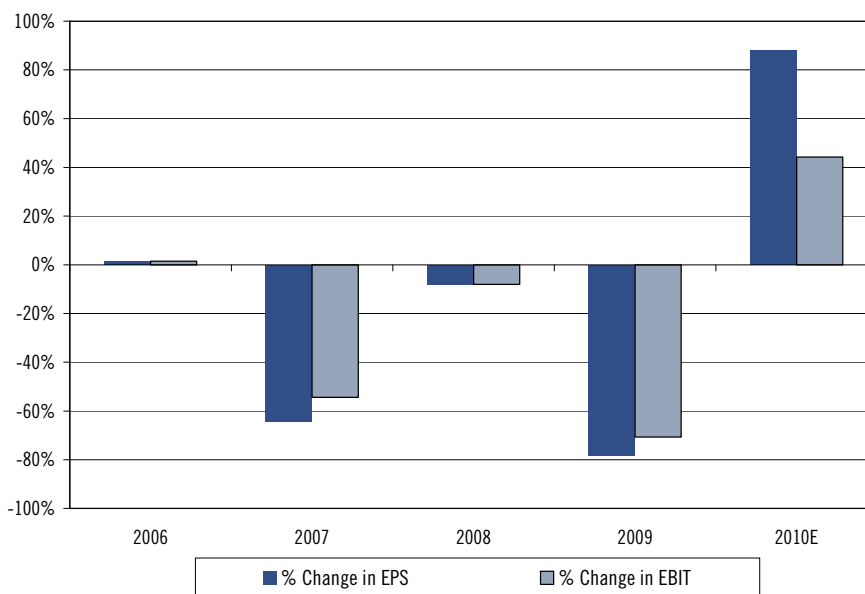
Furthermore this change seems rather counterintuitive to us as since significant revenue is being deferred, we would have expected some previously taken warranty costs also to be deferred (we would not expect warranty provisions to be recorded prior to any revenue being booked).

What Have All the Changes Meant?

2009 EPS fell by 64%

The overall impact of the accounting changes has been dramatic. EBIT and EPS are reduced for 2007-09, in the case of 2009 by a rather sizable 64%. However, the impact is significantly positive for 2010E and given the implication is that significant future revenues and profits were registered in 2009A it means it should also continue to be positive relative to previous forecasts for 2011E and probably beyond that.

Figure 2. Change in Reported EPS and EBIT under the New Accounting Policy



Source: Company Reports and CIRA Estimates

Warranty provisions have been restated much higher

In relation to the warranty cost changes, the profit impact on past years is included in the above shifts in EBIT and EPS. In particular we understand from the company that some costs relating to service obligations which were previously expensed as incurred are now included within warranty provisions. This means that the margin before warranty expense will be higher (and in the long run warranty expense will also be higher). Although this is purely a timing and presentational difference (the ultimate cash flows are unaffected), investors should be aware of the amount of additional expense which has now been charged to prior years. We show the warranty provisions history below on the actual reported basis and on an estimated restated basis.

Figure 3. Warranty Expenses versus Sales, 2007-2010 (Euros in Millions)

	2007 Old	2007 Restated	2008 Old	2008 Restated	2009 Old	2009 Restated	9M 2010 Old	9M 2010 Restated
Sales	4861	3828	6035	5904	6636	5079	3484	3797
P&L Warranty expense*	242	251	240	265	233	292	121	134
Warranty as % sales	5.0%	6.6%	4.0%	4.5%	3.5%	5.7%	3.5%	3.5%

* CIRA calculated estimates for 2007-08

Source: Company Reports and CIRA Estimates

What this means is that the total provision for warranties on the balance sheet at the end of 2009 was increased from the previously reported €233m to the restated €411m, this means that €178m of additional cost (€191m at Sep 2010) has been booked in previous years, increasing future years' profits accordingly.

Are the Changes a Positive? Yes and No...

The IFRIC15 changes appear positive for aligning profits and cash. However, the warranty provision change may have the opposite impact

At a headline level we see the IFRIC 15 related changes as being positive in that while it theoretically may make profitability more lumpy, it does align profitability nearer to the cash flow of the business and is more reflective of the actual profits being recorded today. However, the warranty provision changes appear more questionable in our view and actually allow for the opposite impact.

The fact that the change in warranty provisions is a combination of both reporting the same provisions earlier (i.e. pushing the cost into historic reported periods), and also taking a broader definition of warranty provisions means that it is very difficult to judge what the impact on future warranty provision charges will be. If the accounting change was only recording existing warranty provisions earlier, then we would expect future warranty charges to be lower for some time given the additional restated provisions taken in earlier years and the pattern of sales. If the accounting change was simply reclassifying other costs into the warranty provision, then we would expect the warranty expense in future years to be higher, although with no actual impact on the bottom line. However, since it is a combination of two effects, we would anticipate that the reported level of warranty expense will be reduced by the new accounting in the near term, but probably higher in the long term. This is reflected in the fact that the company has retained its previous warranty expense guidance of c3% of sales in 2010 despite the fact that it should have risen given that the definition has now expanded. Notably over the last three years warranty provisions have been utilised, to positively impact profits relative to cashflows. On the previous accounting basis, the warranty provision was largely utilised and therefore this gap between profit and cash flow would have reduced. The warranty provision has now been increased by €191m due to the restatement, so the gap between profit and cash flow may continue.

Figure 4. History of Warranty Expenses versus Cash Costs, 2006-2010 (Euros in Millions)

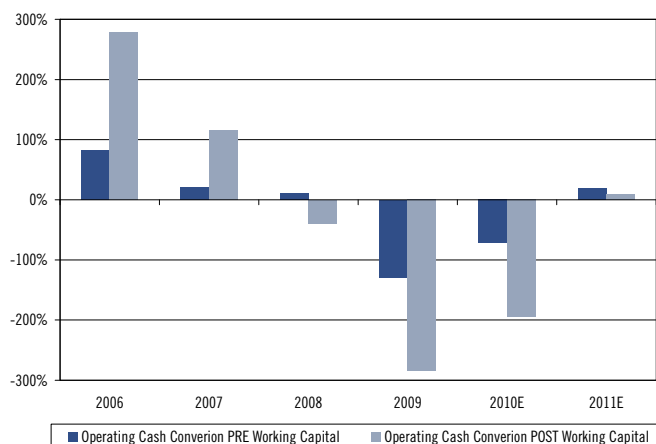
	9M 2010	2009	2008	2007	2006	Sum
Provision at 1 Jan	161	183	232	205	221	
Exchange adj	0	0	-2	-1	-2	
Provisions for the year	121	233	240	242	172	1008
Utilised (=cash effect)	-197	-257	-262	-214	-188	-1118
Reversed provisions	0	0	-6	0	0	
Adjustment to previously recognised provisions	0	0	-20	0	0	
Discounting adj	0	2	1	0	2	
Provision at 31 Dec	85	161	183	232	205	

Source: Company Reports and CIRA Estimates

Conclusion: EPS to Cash Gap Remains Wide

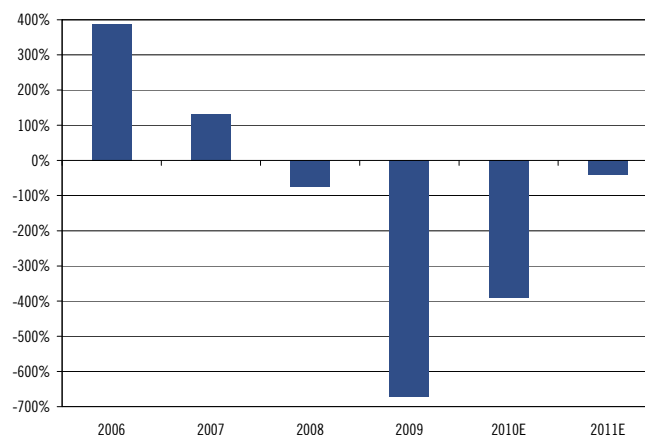
Vestas has a history of poor cash conversion pre working capital (where large prepayments in the 2006-08 period were very supportive of overall cash flows). We continue to expect a weak cash conversion in 2010E.

Figure 5. Operating Cash Conversion



Source: Company Reports and CIRA Estimates

Figure 6. Net Income Cash Conversion



Source: Company Reports and CIRA Estimates

The change in accounting policies obviously has no impact on cash flow, and while it has aligned cash flow and profits somewhat more than was previously the case in the historic data, the ongoing impact of the changes is less certain. We see the ongoing P&L profits as likely to continue to differ significantly from the underlying trend as represented by the company's cash flow. There are two main reasons for this:

1. Warranty Provisions – As discussed above the release of warranty provisions looks likely to continue to buoy EPS relative to the cash earnings in the near term.
2. R&D Capitalisation – We have not touched on this previously in this report as it has not been impacted by the accounting changes. However, this is another factor in the divergence between reported profits and cash flow. For example, in 2009 the company capitalised development costs of €199m but only amortised €42m, creating a €157m difference between cash and profits. IAS 38 requires that development costs are capitalised if certain criteria are met (such as demonstrable technical feasibility of

project, etc). Research costs and any non-qualifying development costs are expensed immediately through the P&L. Development activities can include the design, construction and testing of prototypes and models, tools, etc. These costs are capitalised and amortised once the development project is completed. Vestas amortises completed development projects over 3-5 years (we estimate close to 5 years on average), however, at present the majority of capitalised developments costs are in projects in progress and therefore not yet amortised. Therefore in 2009, the amortisation charge amounted to just 8% of the total capitalised costs. In our forecasts actual cash R&D costs are 5.3% of sales in 2010E falling to 3.8% in 2011E – we would suggest that this level would seem like a normal level for a manufacturing company and therefore expect it to be maintained around the 2011E forecast level going forward, suggesting a significant near term imbalance between cash costs and P&L charges.

Both of these factors should decrease in impact over time as in the case of warranty provisions as the balance sheet provision is utilized and in the case of amortisation of intangibles the P&L charges start to rise as projects are designated as being completed.

In order to get a better representation of the underlying performance we have calculated EPS adjusted for warranty provisions and R&D costs on a cash flow basis.

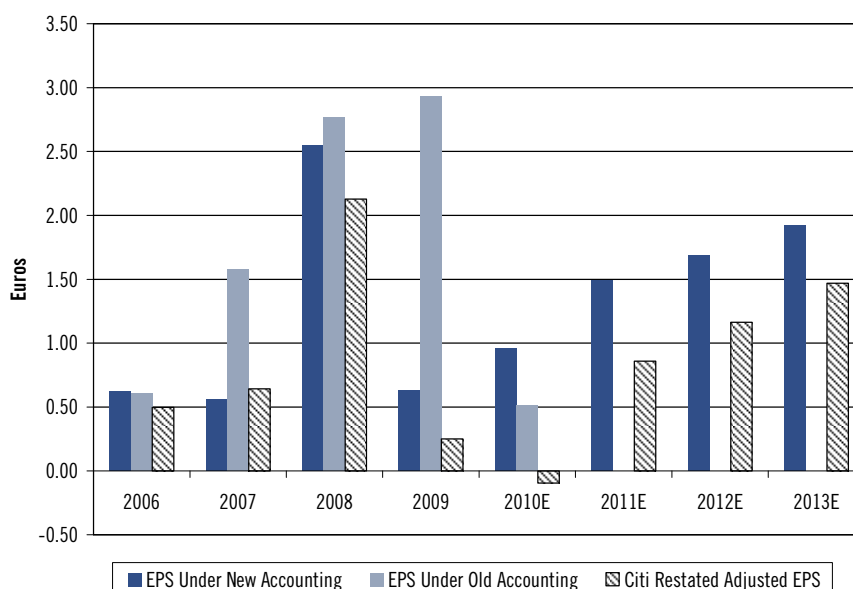
Figure 7. Calculating Cash Adjusted EBIT / EPS, 2006-13E (Euros in Millions Unless Otherwise Stated)

	2006	2007	2008	2009	2010E	2011E	2012E	2013E
Reported EBIT	204	202	614	251	476	476	532	598
Reported R&D	93	124	119	92	123	143	168	201
of which operating			94	50	60	61	62	63
of which amortisation			25	42	63	82	106	138
Total R&D Costs			227	249				
Cash flow Purchase of intangible assets			169	227	350	250	250	250
of which Software			36	28	40	40	40	40
of which R&D			133	199	310	210	210	210
Normalised R&D Costs	88	127	227	249	360	260	260	260
% of sales			3.8%	4.9%	5.3%	3.8%	3.7%	3.5%
of which operating			94	50	50	50	50	50
of which capitalised			133	199	310	210	210	210
R&D Adjustment	5	-3	-108	-157	-237	-117	-92	-59
P&L Warranty Provisions	151	251	265	292	204	204	248	261
as % of sales	3.6%	6.6%	4.5%	5.7%	3.0%	3.0%	3.5%	3.5%
Warranty Cash Costs	188	214	262	257	265	265	305	330
Normalised Warranty Costs	188	214	262	257	265	265	305	330
as % of sales	4.5%	5.6%	4.4%	5.1%	3.9%	3.9%	4.3%	4.4%
Warranty Adjustment	-37	37	3	35	-61	-61	-57	-69
Adjusted EBIT	172	236	509	129	178	298	384	471
Adjusted EPS (€)	0.50	0.64	2.13	0.25	-0.10	0.86	1.16	1.47
Downgrade/Upgrade	-20%	14%	-16%	-60%	-110%	-42%	-31%	-23%

Source: Company Reports and CIRA Estimates

Figure 8 shows the cash EPS proxy relative to the reported EPS under both the new and old accounting policies.

Figure 8. EPS Under New and Old Accounting Relative to CIRA Calculated Cash Proxy EPS (2006-13E)

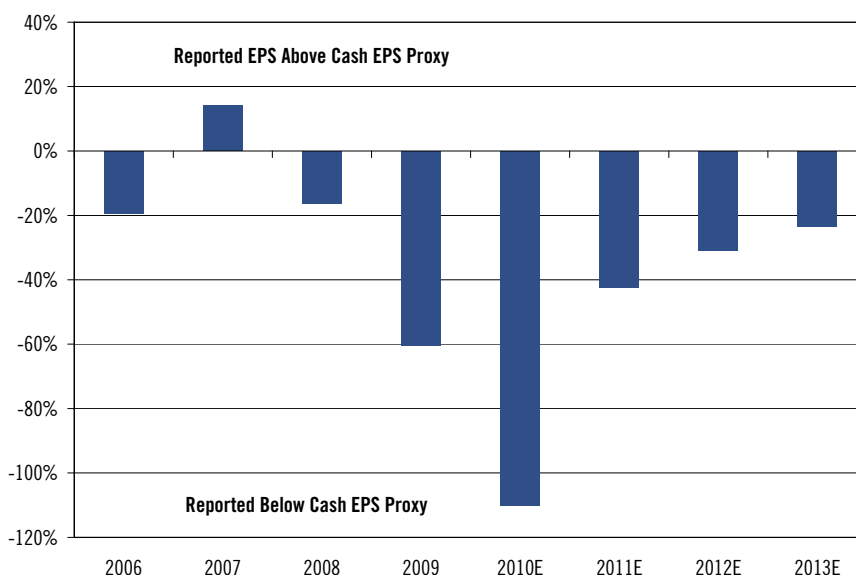


Source: Company Reports and CIRA Estimates

EPS continues to appear overstated relative to a cash proxy equivalent EPS

What is apparent is that while the new accounting policy has been a better proxy for EPS in past years, it is less so in 2010 and the gap remains significant in 2011-13E (although does narrow as we assume warranty provisions and amortisation of intangibles do rise to some degree). The percentage difference is shown in Figure 9.

Figure 9. Difference Between Reported EPS Under New Accounting and Citi Adjusted Cash EPS Proxy (2006-13E)

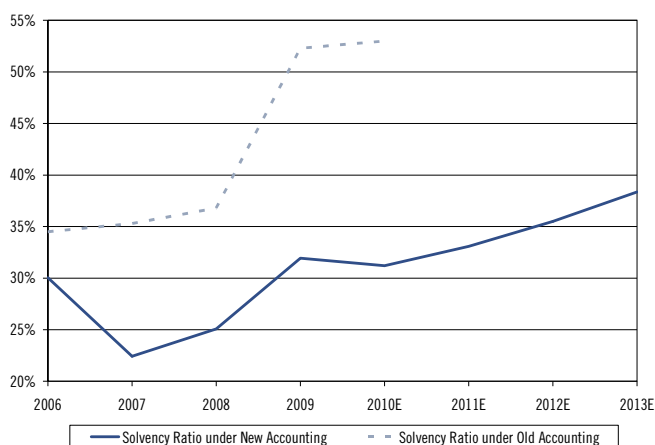


Source: Company Reports and CIRA Estimates

Rights Issue: Possible, But Not Certain

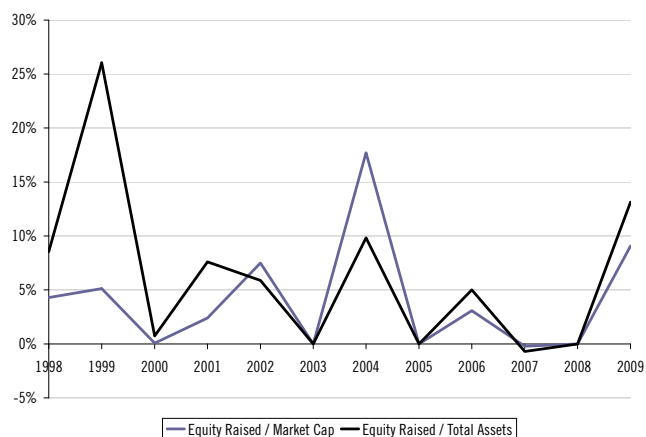
There have also been concerns that Vestas may need a further capital increase to support its balance sheet. This has been sparked by the fact that the group's solvency ratio (defined as equity/total assets) is now below the 40% group target based on the restated accounts. However, it has been below this level consistently over the last four years under the new accounting with the accounting change creating a structural shift that appears to be at least 1000 basis points. We see it as more likely that the target will be adjusted to reflect the new accounting of the group, rather than capital raised to meet an old target.

Figure 10. Vestas Solvency Ratio (%)



Source: Company Reports and CIRA Estimates

Figure 11. Vestas Equity Capital Raising History, 1998-2009

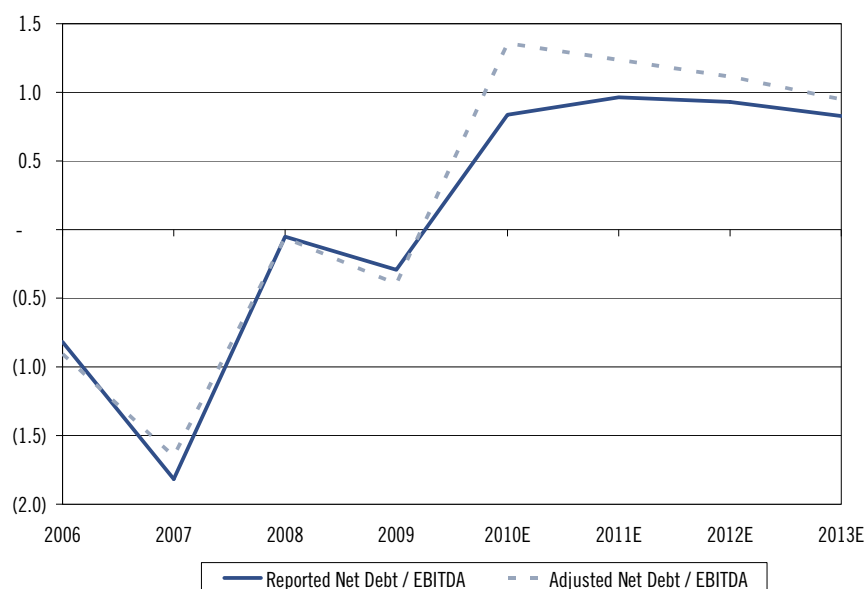


Source: Company Reports and CIRA Estimates

Net debt to EBITDA at 1.4x in a "steady state"

While Vestas has been a habitual raiser of capital, the metrics today do not suggest a need for a capital raising. The headline net debt / EBITDA looks an especially unchallenging 0.8x in 2010E on our forecasts. However, as we have already noted the reported earnings (including EBITDA) are somewhat larger than the equivalent cash flow and any lending institution is likely to focus on a cash flow EBITDA. Even on this basis though a headline net debt / EBITDA of 1.4x does not look too worrying.

Figure 12. Vestas Net Debt / EBITDA, 2006-13E

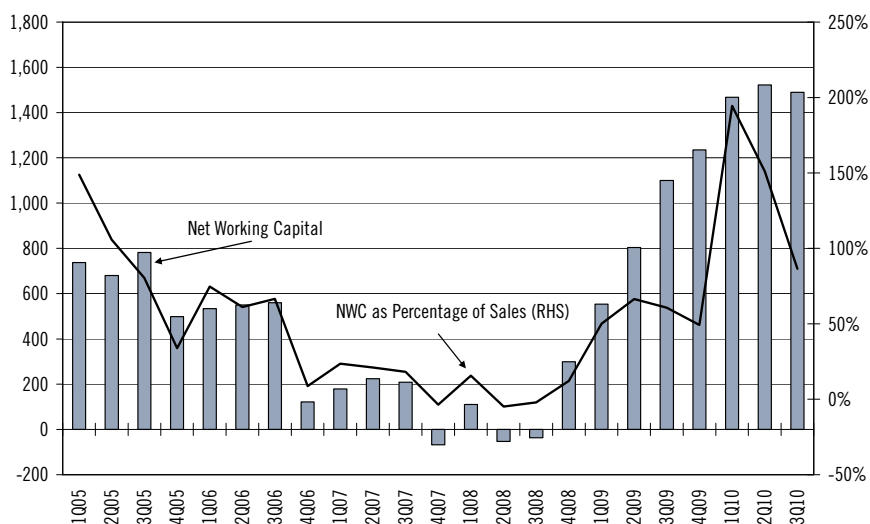


Source: Company Reports and CIRA Estimates

The risk to this though is two fold:

1. **Seasonal Working Capital Swings:** There tends to be a significant swing in working capital needs throughout the year – for all of the last five years there has been a negative working capital change in 1Q relative to the 4Q reported level. Vestas has stated that it is working to achieve more even cashflows throughout the year, but a related rise in net debt towards the middle of the year appears likely again in 2011.

Figure 13. Vestas Net Working Capital and NWC as Percentage of Sales, 1Q05-3Q10



Source: Company Reports and CIRA Estimates

2. **Falling Prepayments:** Vestas currently has €3bn of prepayments on its balance sheet. A reduction in this would be a significant negative. This could happen either due to continuing weak order momentum (as sales are booked faster than new orders are received causing a depletion of the reserves) or if terms changed on contracts. Siemens recently suggested that prepayment terms were changing in the pipeline in the renewables segment and as such that future prepayments may be lower as a percentage of the order value. This has not been seen materially as yet. However, prepayments on the balance sheet currently equate to c40% of sales. If this were to structurally reduce to 30% it would equate to €700m of cash outflow and net debt to EBITDA for 2011E would double on our adjusted basis from 1.2x to 2.4x.

Current forecast do not suggest a capital increase but risks exist on working capital swings and prepayments

Overall therefore, on a static state basis we do not believe that Vestas will need a capital increase. However, with end market demand pointers remains weak, and the risk of changing contract terms in regards to prepayments we would not rule out a capital raising on a 12 month view.

Valuation: Target Price Cut to DKr120

We are revising our valuation to take account of the increasing discrepancy between reported profits and cash flow at Vestas. We are cutting our Target Price to DKr120 from our previous DKr175. Our valuation is supported both by multiples and DCF.

Multiples: 25% Premium to Sector Just About Supports DKr120 per share

Cash adjusted P/E at 25x 11E is about double the Engineering sector average

Vestas remains a leader in an above average growth market and as such is still deserving of a multiple premium versus our wider European Engineering coverage group in our view. As such a headline reported P/E on our forecast of 14x 2011E, 12.5x 2012E versus our coverage group on more like 12.5x and 10.9x respectively does not seem that unrealistic. However, given the widening gap of P&L earnings versus cash flow we believe this is not representative of the underlying situation and the P/E on our cash proxy EPS jumps to a more expensive 25x 11E, 18x 12E.

Figure 14. Vestas Multiples versus the Engineering Sector

	2010E	2011E	2012E
Vestas			
Headline P/E	14.2	14.2	12.5
Headline EV/EBIT	10.4	10.7	9.6
Cash Proxy P/E	48.6	24.6	18.2
Cash Proxy EV/EBIT	27.8	17.1	13.4
Engineering Sector			
P/E	14.8	12.5	10.8
EV/EBIT	11.7	9.4	8.0
Gamesa			
P/E	25.5	24.0	19.5
EV/EBIT	15.4	13.8	11.2

Source: Citi Investment Research and Analysis

Target price at DKr120 implies 25%
2012E premium to the European
Engineering sector on a P/E basis

Our Target Price of DKr120 per share equates to roughly a P/E of 14x 11E based on our cash proxy EPS measure – this is a c25% premium to our coverage group which we believe may be justified given the still somewhat higher end market growth potential.

Figure 15. Multiples Implied at our DKr120 per share Target Price

	2010E	2011E	2012E
Reported P/E	10.9	10.9	9.6
Reported EV/EBIT	8.3	8.3	7.4
Cash Proxy P/E	37.1	18.8	13.9
Cash Proxy EV/EBIT	22.1	13.3	10.3

Source: Citi Investment Research and Analysis

DCF at DKr120 per share

We have revised our DCF to be based on the new accounting and also our estimated cash flow EBIT rather than the P&L basis reflecting the recent widening gap in this area. On this basis we have revised down our long term EBIT margin assumptions in particular. Our DCF valuation is now DKr120 per share. For the full DCF including our assumptions please see Figure 16.

Figure 16. Vestas DCF Valuation

DCF Vestas

parameters	
EBIT margin 2014-15	7.0%
EBIT margin 2016-20	7.0%
EBIT margin 2021-25	7.0%
EBIT Margin in Perpetuity	7.0%
WC/Sales 2014-15	16.5%
WC/Sales 2016-20	16.0%
WC/Sales 2021-25	15.5%
WC/Sales in Perpetuity	15.5%
Deprec/Sales 2014-15	4.1%
Deprec/Sales 2016-20	4.2%
Deprec/Sales 2021-25	4.2%
Deprec/Sales in Perpetuity	4.2%
Capex/Sales 2014-15	7.0%
Capex/Sales 2016-20	6.0%
Capex/Sales 2021-25	6.0%
Capex/Sales in Perpetuity	4.4%
Sales Growth 2014-15	9.0%
Sales Growth 2016-20	8.0%
Sales Growth 2021-25	6.0%
Sales Growth in Perpetuity	3.5%
Tax Rate	30.0%
WACC	9.0%

years from now	0.0	1.0	2.0	3.0	4.0	5.0	6.0	7.0	8.0	9.0	10.0	11.0	12.0	13.0	14.0	15.0	16.0	17.0
	2009a	2010e	2011e	2012e	2013e	2014e	2015e	2016e	2017e	2018e	2019e	2020e	2021e	2022e	2023e	2024e	2025e	2026e
Sales	6,131	6,000	6,000	6,480	6,998	7,628	8,315	8,980	9,698	10,474	11,312	12,217	12,950	13,986	15,105	16,314	17,619	18,235
Cash Adjusted EBIT	129	178	298	384	470	534	582	629	679	733	792	855	907	979	1,057	1,142	1,233	1,276
Margin	2.1%	3.0%	5.0%	5.9%	6.7%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
+ Depreciation	151	210	290	300	310	313	341	377	407	440	475	513	544	587	634	685	740	766
as a % of Sales	2.5%	3.5%	4.8%	4.6%	4.4%	4.1%	4.1%	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%
+ Amortisation of Intangibles	18	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25
as a % of Sales	0.3%	0.4%	0.4%	0.4%	0.4%	0.3%	0.3%	0.3%	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.1%	0.1%
- Capital Investment	-808	-800	-650	-650	-650	-534	-582	-539	-582	-628	-679	-733	-648	-699	-755	-816	-881	-799
as a % of Sales	13.2%	13.3%	10.8%	10.0%	9.3%	7.0%	7.0%	6.0%	6.0%	6.0%	6.0%	6.0%	5.0%	5.0%	5.0%	5.0%	5.0%	4.4%
Working Capital	467	860	971	1,078	1,196	1,259	1,372	1,437	1,552	1,676	1,810	1,955	2,007	2,168	2,341	2,529	2,731	2,826
as a % of Sales	7.6%	14.3%	16.2%	16.6%	17.1%	16.5%	16.5%	16.0%	16.0%	16.0%	16.0%	16.0%	15.5%	15.5%	15.5%	15.5%	15.5%	15.5%
+/- Change in W/C	-391	-400	-50	-50	-50	-63	-113	-65	-115	-124	-134	-145	-53	-161	-173	-187	-202	-96
Tax rate	38.9%	28.0%	28.0%	28.0%	28.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%
- Tax	-79	-76	-118	-134	-152	-160	-175	-189	-204	-220	-238	-257	-272	-294	-317	-343	-370	-383
= Cash Flow	-998	-863	-205	-125	-47	115	78	239	211	226	242	259	503	438	471	507	545	790
NPV of individual periods		(792)	(172)	(96)	(33)	75	47	130	106	104	102	100	179	143	141	139	137	3,320
Total NPV (million Euro)	3,629																	
Net-Debt / (Cash)	352																	
Minorities	-																	
Net SH value	3,277																	
no of shares (in million)	203																	
NPV per share (Euro):	16																	
DKr/Euro Exchange Rate	7.43																	
NPV per share (DKr):	120																	

Source: Company Reports and CIRA Estimates

Forecasts

Revised Forecasts

New forecasts for new accounting

Our forecasts are revised to reflect the new accounting at Vestas (with our historic forecasts restated). Key features of our forecast are:

- Our 2010E forecast are in line with the guidance provided by Vestas.
- We have set our 2011E forecasts in line with the guidance provided of a flat progression on 2010 for sales and profits. However, given the currently still weak order environment, downside risk remains.
- After 2011E we have set our top line volume forecasts in line with our assumptions for market growth rates, although we assume weakening pricing per megawatt reduces the rate of sales growth in Euros.
- Our cash flow forecast suggest slightly weaker than guided 2011 cash flow – Vestas have suggested positive free cash flow post PPE and intangibles, but we have a slight negative as we see this as challenging without a positive working capital swing (suggesting a pick up in order rates).

Our full forecasts are shown in the following tables.

Figure 17. Vestas Profit & Loss Account (€, millions unless otherwise stated)

	2006	2007	2008	2009	2010E	2011E	2012E	2013E
Sales in Megawatts	4,239	4,502	5,580	6,131	6,000	6,000	6,480	6,998
Growth		6%	24%	10%	-2.1%	0.0%	8.0%	8.0%
Sales	4,179	3,828	5,904	5,079	6,800	6,800	7,098	7,471
growth		-8%	54%	-14%	34%	0%	4%	5%
Operating Profit	204	202	614	251	476	476	532	598
margin	4.9%	5.3%	10.4%	4.9%	7.0%	7.0%	7.5%	8.0%
Restructuring costs	0	0	0	0	-150	0	0	0
Total Finance costs	-40	0	46	-48	-55	-55	-55	-55
Associates	0	0	0	1	0	0	0	0
PBT	164	202	660	204	271	421	477	543
Taxation	-51	-98	-190	-79	-76	-118	-134	-152
Effective Tax Rate	31.1%	48.5%	28.8%	38.9%	28.0%	28.0%	28.0%	28.0%
Underlying Taxation	-49	-61	-198	-61	-118	-118	-134	-152
Underlying Tax Rate	30.0%	30.0%	30.0%	30.0%	28.0%	28.0%	28.0%	28.0%
Minority interests	0	0	0	0	0	0	0	0
Net Income	113	104	470	125	195	303	344	391
Clean EPS – basic, pre restructuring (€)	0.63	0.77	2.50	0.72	1.49	1.49	1.69	1.92
Basic EPS (€)	0.62	0.56	2.54	0.63	0.96	1.49	1.69	1.92
DPS(€)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Source: Company Reports and CIRA Estimates

Figure 18. Vestas Cash Flow Statement (€, millions)

	2006	2007	2008	2009	2010E	2011E	2012E	2013E
Net Income	113	104	470	125	195	303	344	391
Minority Interests	0	0	0	0	0	0	0	0
Tax Adjustment	-40	-30	42	-35	0	38	0	0
Net Interest Adjustment	0	0	-23	25	0	0	0	0
Depreciation, Amortisation & Impairment	127	136	135	218	300	400	420	440
Loss from Associates	0	0	0	0	0	0	0	0
Pensions	0	0	0	0	0	0	0	0
Change in Working Capital	394	422	-338	-391	-400	-50	-50	-50
Warranty Provision Adjustment	-37	37	3	35	-61	-61	-57	-69
Provisioned	-151	-251	-265	-292	-204	-204	-248	-261
Paid	-188	-214	-262	-257	-265	-265	-305	-330
Other	41	32	-12	-11	0	0	0	0
Net cash inflow from Op. Activities	598	701	277	-34	34	630	657	712
Investments in Intangible Assets (net)	-35	-82	-169	-227	-350	-250	-250	-250
Investments in PPE (net)	-133	-235	-499	-591	-450	-400	-400	-400
Other	24	0	-12	10	0	0	0	0
Cash Flow from Investing Activities	-144	-317	-680	-808	-800	-650	-650	-650
Free Cash Flow	454	384	-403	-842	-766	-20	7	62
Equity Issued	183	-30	0	791	0	0	0	0
Capital Increase	186	0	0	792	0	0	0	0
Acquisition of Treasury Shares	-3	-30	0	-1	0	0	0	0
Dividends Paid	0	0	0	0	0	0	0	0
Exchange differences	0	-10	-50	27	0	0	0	0
Other	-10	-1	-122	122	-20	0	0	0
Change in Net Debt	627	343	-575	98	-786	-20	7	62
Opening Net Debt	356	-271	-614	-39	-137	649	669	662
Closing Net Debt	-271	-614	-39	-137	649	669	662	599

Source: Company Reports and CIRA Estimates

Figure 19. Vestas Balance Sheet (€, millions)

	2006	2007	2008	2009	2010E	2011E	2012E	2013E
Intangible assets	478	507	644	812	1,072	1,212	1,342	1,462
o/w Goodwill	320	320	320	320				
o/w Completed Development Projects	69	48	60	99				
o/w Software	8	34	62	73				
o/w Development Projects in Progress	81	105	202	320				
PPE	490	638	1,030	1,461	1,701	1,811	1,911	2,001
o/w Land & Buildings	230	261	433	661				
o/w Plant & Machinery	128	143	159	230				
o/w Other Fixtures & Fittings	99	116	167	216				
o/w PPE in Progress	33	118	271	354				
Associates	0	1	1	1	1	1	1	1
Other Receivables	22	13	25	16	16	16	16	16
Deferred tax assets	217	263	186	384	384	346	346	346
Other Non Current Assets	0	0	0	0	0	0	0	0
Non-current assets	1,207	1,422	1,886	2,674	3,174	3,386	3,616	3,826
Inventories	1,232	2,260	2,867	3,929	4,129	4,179	4,229	4,279
Trade receivables	711	660	938	525	725	775	775	775
Construction Contracts in Progress	0	0	123	16	16	16	16	16
Cash and cash equivalents	445	764	162	488	400	400	400	400
Corporation Tax	14	35	49	93	93	93	93	93
Other Current Assets	123	157	302	234	234	234	234	234
Current assets	2,525	3,876	4,441	5,285	5,597	5,697	5,747	5,797
Total assets	3,732	5,298	6,327	7,959	8,771	9,083	9,363	9,623
Borrowings	163	125	14	339	1,037	1,057	1,050	987
Provisions for liabilities and charges	126	139	122	137	137	137	137	137
Retirement benefit obligations	3	2	2	2	2	2	2	2
Deferred tax liabilities	3	3	9	121	121	121	121	121
Other Non-Current Liabilities	0	0	0	0	0	0	0	0
Non-current liabilities	295	269	147	599	1,297	1,317	1,310	1,247
Borrowings	11	25	109	12	12	12	12	12
Provisions for liabilities and charges	807	255	260	274	213	152	95	27
Prepayment from Customers	1,060	2,328	2,677	2,889	2,789	2,739	2,739	2,739
Construction Contracts in Progress	0	0	80	0	0	0	0	0
Trade payables	218	889	1,030	1,062	1,162	1,262	1,262	1,262
Corporation Tax	32	73	42	145	145	145	145	145
Other Current Liabilities	188	271	395	436	416	416	416	416
Current liabilities	2,316	3,841	4,593	4,818	4,737	4,726	4,669	4,601
Total liabilities	2,611	4,110	4,740	5,417	6,034	6,043	5,979	5,848
Shareholders' equity	1,121	1,188	1,587	2,542	2,737	3,040	3,384	3,775
o/w Share Capital	25	25	25	27	27	27	27	27
o/w Other Reserves	6	-3	-78	-41	-41	-41	-41	-41
o/w Retained Earnings	1,090	1,166	1,640	2,556	2,751	3,054	3,398	3,789
Minority interest equity	0	0	0	0	0	0	0	0
Total equity	1,121	1,188	1,587	2,542	2,737	3,040	3,384	3,775
Total Equity & Liabilities	3,732	5,298	6,327	7,959	8,771	9,083	9,363	9,623

Source: Company Reports and CIRA Estimates

Wind Energy Market Forecasts

Figure 20. Wind Energy Installed Capacity, 2007-14E (MW)

	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
EUROPE								
Austria	982	995	997	1,047	1,097	1,147	1,217	1,297
Belgium	287	384	605	1,035	1,185	1,385	1,585	1,785
Denmark	3,125	3,180	3,408	3,758	3,858	4,108	4,308	4,508
Finland	110	143	117	217	417	617	817	1,017
France	2,454	3,404	4,775	6,375	7,875	9,375	10,875	12,375
Germany	22,247	23,903	25,813	27,813	29,913	32,113	34,363	36,663
Greece	871	985	1,198	1,348	1,398	1,448	1,498	1,568
Ireland (Rep.)	805	1,002	1,187	1,362	1,537	1,707	1,877	2,057
Italy	2,726	3,736	4,845	6,145	7,445	8,745	10,045	11,445
Netherlands	1,747	2,225	2,226	2,526	2,776	3,046	3,336	3,686
Norway	326	428	390	690	1,190	1,690	2,210	2,780
Portugal	2,150	2,862	3,474	4,474	5,474	6,474	7,494	8,524
Spain	15,145	16,740	18,784	19,784	20,984	22,184	23,434	24,934
Sweden	788	1,021	1,537	2,137	2,837	3,537	4,287	5,137
Switzerland	12	14	17	42	67	92	132	182
Turkey	147	433	984	1,384	1,834	2,284	2,784	3,284
UK	2,406	3,241	4,340	5,940	7,640	9,440	11,440	13,740
Other European Countries:	811	1,237	1,856	2,706	3,556	4,456	5,456	6,556
Total Europe	57,139	65,933	76,553	88,783	101,083	113,848	127,158	141,538
AMERICA								
USA	16,818	25,237	35,159	41,159	47,559	54,059	60,759	68,259
Canada	1,846	2,371	3,321	4,521	5,921	7,521	9,521	12,021
Brazil		341	935	1,235	1,635	2,115	2,615	3,215
Rest of Americas	535	969	936	1,336	1,736	2,136	2,536	2,936
Total America	19,199	28,918	40,351	48,251	56,851	65,831	75,431	86,431
ASIA								
P.R. China	6,050	12,121	25,853	43,853	62,353	81,353	100,853	120,853
India	8,000	9,655	10,827	13,327	15,827	18,527	21,327	24,327
Japan	1,539	2,033	2,208	2,508	2,858	3,228	3,628	4,058
Rest of Asia	502	398	778	1,228	1,728	2,278	2,928	3,778
Total Asia	16,091	24,207	39,666	60,916	82,766	105,386	128,736	153,016
REST OF WORLD								
Australia & New Zealand	1,146	1,587	2,353	3,003	3,703	4,403	5,153	6,003
Africa	444	697	1,015	1,515	2,015	2,515	3,015	3,515
Middle East	84	101	101	151	251	351	451	581
Rest of World	12	678	45	195	395	595	795	995
Total Rest of World	1,686	3,063	3,514	5,014	6,514	8,014	9,564	11,244
TOTAL MARKET BY REGION								
Total Europe	57,139	65,933	76,553	88,783	101,083	113,848	127,158	141,538
Growth Rate	18%	15%	16%	16%	14%	13%	12%	11%
Total America	19,199	28,918	40,351	48,251	56,851	65,831	75,431	86,431
Growth Rate	41%	51%	40%	20%	18%	16%	15%	15%
Total Asia	16,091	24,207	39,666	60,916	82,766	105,386	128,736	153,016
Growth Rate	52%	50%	64%	54%	36%	27%	22%	19%
Total Rest of World	1,686	3,063	3,514	5,014	6,514	8,014	9,564	11,244
Growth Rate	13%	82%	15%	43%	30%	23%	19%	18%
Total World	94,115	122,121	160,084	202,964	247,214	293,079	340,889	392,229
Growth Rate	27%	30%	31%	27%	22%	19%	16%	15%

Source: Citi Investment Research and Analysis

Figure 21. Wind Energy New Installations, 2007-14E (MW)

	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
EUROPE								
Austria	20	14	0	50	50	50	70	80
Belgium	93	88	220	430	150	200	200	200
Denmark	3	71	334	350	100	250	200	200
Finland	24	0	4	100	200	200	200	200
France	888	1,200	1,104	1,600	1,500	1,500	1,500	1,500
Germany	1,667	1,665	1,917	2,000	2,100	2,200	2,250	2,300
Greece	125	115	96	150	50	50	50	70
Ireland (Rep.)	59	208	172	175	175	170	170	180
Italy	603	1,010	1,114	1,300	1,300	1,300	1,300	1,400
Netherlands	210	499	39	300	250	270	290	350
Norway	8	30	5	300	500	500	520	570
Portugal	434	679	645	1,000	1,000	1,000	1,020	1,030
Spain	3,522	1,739	2,331	1,000	1,200	1,200	1,250	1,500
Sweden	217	236	512	600	700	700	750	850
Switzerland	0	2	4	25	25	25	40	50
Turkey	97	287	472	400	450	450	500	500
UK	427	869	1,077	1,600	1,700	1,800	2,000	2,300
Other European Countries:	265	467	692	850	850	900	1,000	1,100
Total Europe	8,662	9,179	10,738	12,230	12,300	12,765	13,310	14,380
Growth Rate	13%	6%	17%	14%	1%	4%	4%	8%
AMERICA								
USA	5,244	8,358	9,922	6,000	6,400	6,500	6,700	7,500
Canada	386	526	950	1,200	1,400	1,600	2,000	2,500
Brazil		94	248	300	400	480	500	600
Rest of Americas	28	643	313	400	400	400	400	400
Total America	5,658	9,527	11,433	7,900	8,600	8,980	9,600	11,000
Growth Rate	65%	68%	20%	-31%	9%	4%	7%	15%
ASIA								
P.R. China	3,449	6,246	13,750	18,000	18,500	19,000	19,500	20,000
India	1,730	1,810	1,172	2,500	2,500	2,700	2,800	3,000
Japan	139	356	178	300	350	370	400	430
Rest of Asia	118	145	69	450	500	550	650	850
Total Asia	5,436	8,557	15,169	21,250	21,850	22,620	23,350	24,280
Growth Rate	50%	57%	77%	40%	3%	4%	3%	4%
REST OF WORLD								
Australia & New Zealand	158	615	443	650	700	700	750	850
Africa	140	228	318	500	500	500	500	500
Middle East	19	0	0	50	100	100	100	130
Rest of World	0	84	2	150	200	200	200	200
Total Rest of World	317	927	763	1,350	1,500	1,500	1,550	1,680
Growth Rate	61%	192%	-18%	77%	11%	0%	3%	8%
TOTAL MARKET BY REGION								
Total Europe	8,662	9,179	10,738	12,230	12,300	12,765	13,310	14,380
Growth Rate	13%	6%	17%	14%	1%	4%	4%	8%
Total America	5,658	9,527	11,433	7,900	8,600	8,980	9,600	11,000
Growth Rate	65%	68%	20%	-31%	9%	4%	7%	15%
Total Asia	5,436	8,557	15,169	21,250	21,850	22,620	23,350	24,280
Growth Rate	50%	57%	77%	40%	3%	4%	3%	4%
Total Rest of World	317	927	763	1,350	1,500	1,500	1,550	1,680
Growth Rate	61%	192%	-18%	77%	11%	0%	3%	8%
Total World	20,073	28,190	38,103	42,730	44,250	45,865	47,810	51,340
Growth Rate	34%	40%	35%	12%	4%	4%	4%	7%
World ex China	16,624	21,944	24,353	24,730	25,750	26,865	28,310	31,340
Growth Rate	52.4%	61.4%	11.0%	1.5%	4.1%	4.3%	5.4%	10.7%

Source: Citi Investment Research and Analysis

Vestas Wind System (Den)

Valuation

We value Vestas using a DCF valuation. Our base case DCF valuation is at DKK120 per share, which we set as our target price. This assumes a WACC of 9%, growth rates of 6%-9% used over 15-year forecast period and operating margins of 7%.

Risks

We rate Vestas High Risk. The wind industry has a number of generic risks. The industry growth and profitability both remain highly sensitive to regulation, and any change, either global or regional, can provide a shift in the market outlook. Such regulatory changes can affect both sentiment and our earnings forecasts, and hence our valuations. There are also financial risks, given the working capital structure of the business, and technical risks given the stressful environment the machinery is used in. There are also the specific risks for Vestas that could cause the shares to deviate from our target price. We have historically highlighted the risks in terms of the financial controls and profit margins, which have both been pressurised in recent years, and these risks remain. Furthermore risks exist on both currency and raw material prices. If there was significant deviation from our current expectations on EBIT margin progression, working capital evolution, or also long-term growth rates in the industry then this could affect our valuation and target price either positively or negatively.

Gamesa

(GAM.MC; €5.14; 3M)

Valuation

Our target price for Gamesa is €5, in line with our SOTP. For our SOTP valuation we use DCF valuation (WACC = 10%, long term growth = 2%) for the Wind Turbines business and non-European Wind Farms business (USA and China) and EV/MW multiple to value the European Wind Farm business (including JV). In our SOTP the Wind Turbine Manufacturing business represents 70.5% of the total, with Wind Farm business representing the remaining 29.5%. At our target price the company would be trading at 23.3x11E Adj P/E, which we think fairly reflects the growth prospects of the wind sector beyond 2010.

Risks

We rate Gamesa as Medium Risk based on our assessment of industry and company-specific risk factors. The company has a track record of capital discipline and the existing backlog (8GW, including framework agreements) should provide a floor for sales volumes. The main downside risks to our target price are: (1) regulatory uncertainty. Changes in wind renewable targets and regulation could affect wind turbines development; (2) Pressure on selling price. New players from emerging markets such as China or India could beat Gamesa in prices and could force the company to reduce margins; (3) Liquidity in financial markets. Wind Farms financing could be a problem for turbine demand; hence sales could be negatively affected; (4) Technology.

Wind technology is mature and reliable, but new developments in technologies using other renewable energy sources could reduce forward wind installations. The main upside risks are: (1) Wind turbine becoming once again a bottleneck for the industry, lifting prices and therefore returns; (2) Main Wind farm developers increasing wind installation targets, using Gamesa's whole production capacity; subsequently increasing sales and (3) Company cost reduction plans being more effective than we are considering, with a positive effect on operating margins.

Appendix A-1

Analyst Certification

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IMPORTANT DISCLOSURES

Vestas Wind System (Den) (VWS.CO)

Ratings and Target Price History Fundamental Research

Analyst: Mark Fielding



Chart current as of 27 November 2010

Date	Rating	Target Price	Closing Price
1 17-Jan-08	2H	*460.00	437.00
2 10-Apr-08	2H	*515.00	517.00
3 10-Jul-08	2H	*620.00	607.00

* Indicates change

Date	Rating	Target Price	Closing Price
4 22-Jan-09	2H	*330.00	288.50
5 1-May-09	*1H	*450.00	384.50
6 8-Jun-10	1H	*400.00	274.30

Date	Rating	Target Price	Closing Price
7 18-Aug-10	*3H	*200.00	242.00
8 19-Oct-10	3H	*175.00	207.70

Rating/target price changes above reflect Eastern Standard Time

Gamesa (GAM.MC)

Ratings and Target Price History Fundamental Research

Analyst: Manuel Palomo

Covered since July 20 2009



Chart current as of 27 November 2010

Date	Rating	Target Price	Closing Price
1 5-Mar-08	*1M	*37.43	26.81
2 11-Apr-08	Coverage terminated		
3 19-Jul-09	1M	*16.45	13.40

* Indicates change

Date	Rating	Target Price	Closing Price
4 13-Jan-10	*2M	*13.59	12.04
5 14-Feb-10	*1M	*12.81	9.36
6 29-Jul-10	*2H	*8.40	7.61

Date	Rating	Target Price	Closing Price
7 14-Sep-10	*3M	*5.00	5.70

Rating/target price changes above reflect Eastern Standard Time

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