The market situation and Vestas' strategy – Profitable Growth for Vestas

" We have created a strong momentum. The key is now to keep a diligent eye on executing our strategy to maintain and expand market leadership, while we prepare ourselves for the future opportunities and challenges we are facing."

Anders Runevad
Group President & CEO

Industry dynamics

2015 was again a year, in which renewables continued to improve its position in the public domain. Not only wind, but also other types of renewables are increasingly being recognised as important elements of the future energy mix. Global warming, and the fact that it is a man-made phenomenon, is now generally accepted. Renewables are seen as one of the few solutions that can actually support a world where energy consumption is expected to continue to increase, whilst simultaneously lowering CO_2 emissions.

Late in 2014, the USA and China entered into a climate accord and thereby ensured that 2015 was off to a good start in terms of signalling a commitment to a less polluted future. Late in 2015, at the COP21 conference in Paris, France, the world's nations entered into an important agreement to reduce CO_2 emissions to levels reducing the risks and impacts of climate changes. While the final COP21 agreement does contain a lot of uncertainty as it relates to implementation and execution, it is Vestas' view that the agreement forms a good basis for continuing the positive development for renewables observed in numerous countries, not just in industrialised nations, but across the globe.

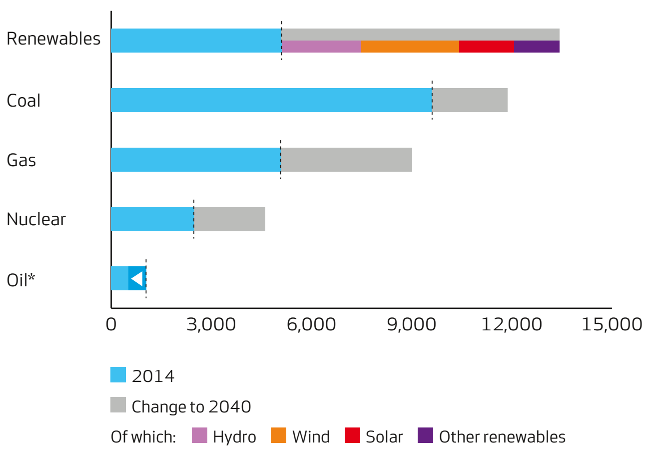
Power market shifting towards sustainable future

The International Energy Agency (IEA) expects electricity generation to grow by more than 40 percent over the next 15 years, whereas emissions from power generation are expected to remain fairly stable over the same period.[1)]

Further, IEA is expecting renewables as a whole to be the world's largest power source by 2040. And measured by additional TWhs fed into the electricity grid over that period, wind energy is expected to be the largest contributor in the renewables space and second largest overall, only surpassed by gas.

Global electricity generation by source in 2014 and 2040

TWh



Source: International Energy Agency (IEA): World Energy Outlook 2015. November 2015.
* 1,044 TWh in 2014 and only 533 TWh in 2040.

Levelised cost of energy continues to improve

Over the last many years, levelised cost of energy (LCOE) has been the primary competitive parameter in the wind power industry. Customers directly and indirectly look to the metric when assessing the viability of a wind power project and as a result, Vestas and its competitors have been focusing on bringing down LCOE. This, in turn, has meant that the wind power industry has become more and more competitive when compared to other energy sources and today, wind finds itself able to compete with the likes of coal and gas. Bloomberg New Energy Finance has assessed that LCOE for wind power in various regions can indeed be lower than for other types of energy sources.[2)] Similarly, in a study issued by the American investment bank Lazard, wind comes out as one of the most competitive energy sources on the US market.[3)]

For Vestas, reducing cost of energy remains one of the four main pillars of its strategy. While the general drive to reduce cost of energy does increase competition in the industry, the sector also reaps the benefits from e.g. more developed supply chains and the improved overall perception of wind from various decision makers. Hence, Vestas generally finds it positive overall that the industry continues to improve its LCOE.

Where LCOE shows the cost of the energy source installed in a given market, including financing costs, the market price is often influenced by different support mechanisms of both direct and indirect nature. Although the objective of these varies across markets, a common driver is to incentivise investments in renewable electricity production, promoting energy sources with minimal environmental impact and external costs, i.e. costs borne by the society, as opposed to electricity production from fossil fuels or nuclear.

A 2014 study by the European Commission found that the external costs per unit of energy produced at a hard coal fired power plant is more than 20 times that of onshore wind power. The same study concluded that 96 percent of the external costs from electricity generation in Europe stems from fossil and nuclear sources totalling EUR 122.4bn every year.[4)]

In 2015, the International Monetary Fund issued similar types of analyses, once again highlighting that direct subsidies offered to various types of renewable energy sources are dwarfed by the consequential external effects from more traditional types of energy.[5)]

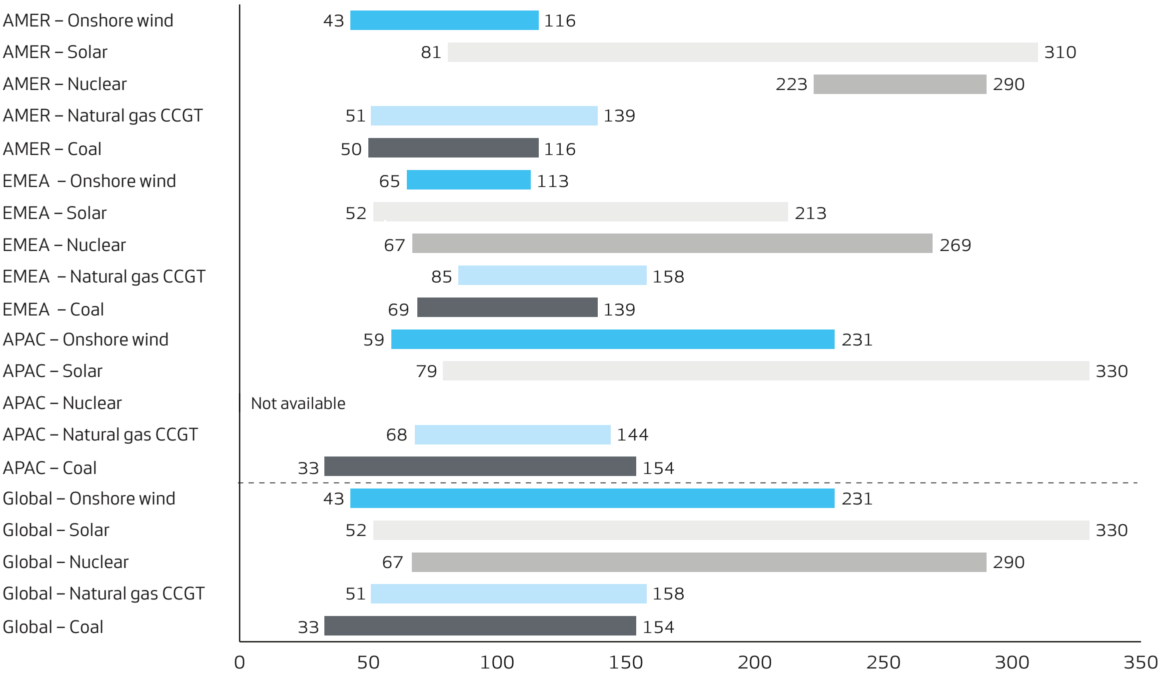
Political and regulatory environment dynamic, but supportive

Policy support and the regulatory environment is an important part of most infrastructure industries and the wind power industry is not an exception to that rule. Historically, support schemes in the industry have evolved over time, but a general tendency in recent years has been the emergence of systems and schemes that play a role in the increased competitiveness of wind energy.

In some regions, support systems are becoming more market-based and moving towards systems providing support in addition to the market price – not in place of it. The EU has asked all member states to decide by 2017 which form of market-based support they will introduce and thus, several EU countries are moving in the direction of using such systems, the most well-known being the transition in Germany to an auction-based system. As long as such market-based systems are structured in a way to create a level playing field for the different energy sources, Vestas does not expect this transition to be a disadvantage to the wind power industry.

1) Source: International Energy Agency (IEA): World Energy Outlook 2015. November 2015.
2) Source: Bloomberg New Energy Finance (BNEF): H2 2015 Global Levelised Cost of Electricity Update. October 2015.
3) Source: Lazard: Lazard's Levelized Cost of Energy Analysis - version 9.0. November 2015.
4) Source: European Commission: Subsidies and costs of EU Energy. November 2014.
5) Source: International Monetary Fund: How Large Are Global Energy Subsidies? May 2015.

Levelised cost of energy (LCOE)
USD/MWh



Source: Bloomberg New Energy Finance (BNEF): H2 2015 Global Levelised Cost of Electricity Update. October 2015.

In the USA, an extension of the Production Tax Credit (PTC) was approved in December 2015, which had as its main element a two-year extension of the scheme in its current form followed by a three-year phase-down period. The extension and phase-down plan gives the industry the longer-term certainty that it has been looking to achieve. Together with wind energy's natural competitiveness against other power generation sources, the PTC extension agreement would help ensure a solid future for wind energy in the USA.

In Asia, the two largest markets, China and India, reaffirmed their commitment to a greener future through various measures in 2015. The Chinese 2016-2020 five-year plan has an overall unchanged commitment to wind power, but calls for increased competition, and as a result, feed-in tariff reductions. In India, the government remains committed as well.

Overall, Vestas continues to generally see strong support for wind power across the regions. Incentive systems and schemes may vary across countries, but the overall picture is one of stability and a continued desire to use renewables, and wind specifically, to secure a long-term sustainable energy supply.

The corporate strategy continues to deliver strong results

Vestas has a strong global reach in both the wind turbine and service market and will continue to build its strength in those markets in 2016 and beyond. The overall strategic ambition to ensure profitable growth for Vestas remains, as does Vestas' ambition to maintain and expand its global leadership and create an even more flexible and robust company, able to consistently deliver best-in-class margins.

Vestas has taken a large step forward since the last strategy review in 2014 and is now more than ever capable of delivering profitable growth to its shareholders. The strong performance observed in recent years is a result of a clear strategic direction, the employees' commitment to implementing the priorities, and a supportive market situation in many of Vestas' core markets.

The 2015 strategy planning cycle once again had an aim to secure alignment of strategic priorities across the organisation, while at the same time ensuring that adequate adjustments are made. The strategic review has not given reason to materially change any parts of the Vestas strategy, neither have the vision and mission been changed.

Vision and mission

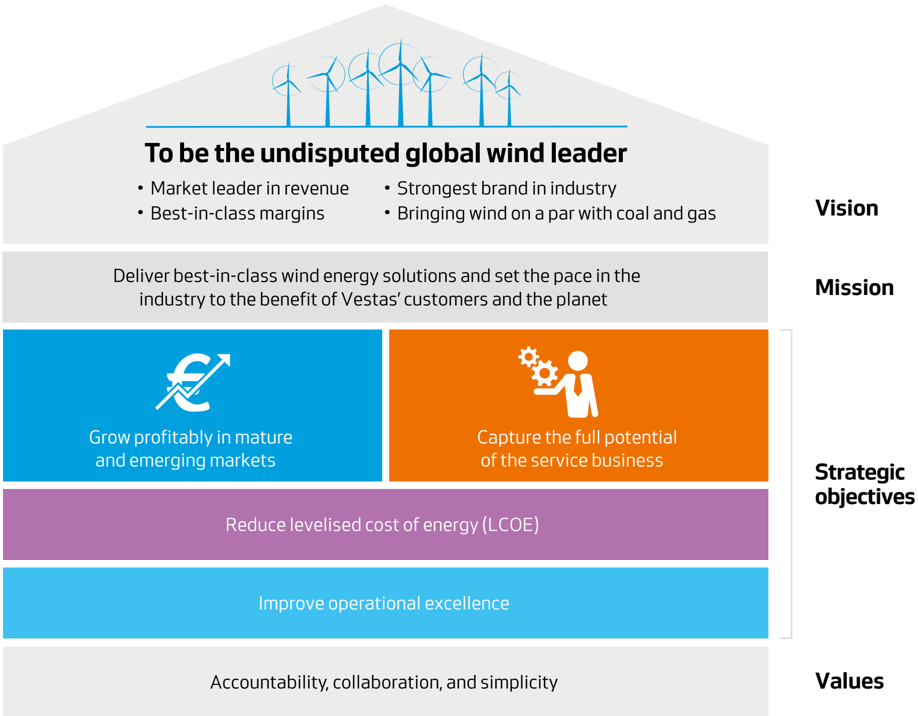
Vestas' vision and mission serve as important beacons for uniting all Vestas' key stakeholders and not least its employees, setting a clear purpose and direction for where the company is heading and how the employees as individuals can support that journey.

Vision: To be the undisputed global wind leader, meaning:

- Be the market leader in revenue.
- Deliver best-in-class margins.
- Have the strongest brand in the wind power industry.
- Bring wind on a par with coal and gas.

Mission: Deliver best-in-class wind energy solutions and set the pace in the wind power industry to the benefit of Vestas' customers and the planet.

The building blocks of the strategy – Profitable Growth for Vestas



Strategic plan adjusted

Vestas' strategy revolves around four strategic objectives which remain unchanged:

- Grow profitably in mature and emerging markets.
- Capture the full potential of the service business.
- Reduce levelised cost of energy.
- Improve operational excellence.

Grow profitably in mature and emerging markets

Vestas will continue to focus on profitable growth in mature and emerging markets, partnering more closely with its customers, expanding its key account programme, involving customers in product development, and working closely with them to deliver tailored solutions.

With its strong global footprint, Vestas has a competitive edge, allowing it to grow profitably in both mature and emerging markets. Vestas will continue to scale production up and down in accordance with the level of demand in the different regions. Building on its long-standing global presence, Vestas will continue to pursue opportunities in markets where wind energy is set to expand.

As part of Vestas' ambitions to grow profitably in certain markets, Vestas has revised its current policy of only participating in project development to a limited extent. By entering into co-development activities under a more structured approach, Vestas expects to be able to engage earlier with certain customers and thereby potentially lock deals earlier than what would in some cases otherwise be possible whilst simultaneously offering significant value to the customer. The short to medium term expected financial effect from such initiatives is expected to be limited in the context of the Vestas' overall financials.

Vestas' mid-term ambition to grow faster than the market remains unchanged and for 2015, it is Vestas' view that the ambition has been met as well.

Capture the full potential of the service business

Having delivered an accumulated amount of 74 GW of wind power – a significantly higher amount than the closest competitor – Vestas has a unique platform from which to grow its service business, which today is already the largest in the wind power industry. With the acquisition of UpWind Solutions, Inc. in 2015, and the announcement of the agreement to acquire the Germany-based company Availon Holding GmbH in 2016, Vestas further accelerated that part of the strategy.

74 GW

Accumulated, Vestas has delivered 74 GW (56,860 wind turbines) in 75 countries around the world and have manufacturing facilities in North and Latin America, Europe, and Asia.

As the majority of Vestas' wind turbine contracts are sold with service agreements, typically running for five to ten years, the stable revenue stream from the service business is set to continue its growth as the installed base of wind turbines increases.

As a result of higher than anticipated growth in the service business, Vestas has decided to increase its strategic ambition for the area. The previous target of 30 percent organic growth in the service business over the mid-term has now been increased to 40 percent.

Reduce levelised cost of energy

Vestas wants to remain the technology leader of the wind power industry. Continuing the recent years' focus on improvement and optimisation of the product and service offerings will be one of the most important enablers for Vestas to continue to hold that position in the future.

While complexity has been reduced and offerings simplified as part of that journey, Vestas is now able to even better meet the demands of its customers and markets.

Also, Vestas will further reduce the LCOE by outsourcing and using standard components. With this, Vestas reduces manufacturing costs and time-to-market, and thereby lowers the cost of energy for its customers.

During 2015, Vestas introduced new variants and solutions to support the mid-term ambition to reduce LCOE faster than market average and as the strategic objective is on track, Vestas' ambition remains unchanged.

Improve operational excellence

The lessons learned and the experiences gained through the turnaround period have not been forgotten and thus, cost savings and operational efficiency remain a priority area for everyone at Vestas.

Vestas has continued its site simplification programme and continues to increase its use of shared services, where various process and transactional tasks are relocated to low-cost areas, in particular Vestas' shared service centre in the Philippines. Vestas will also continue to increase efficiency by leveraging on the scale of its operations. In support of the Profitable Growth for Vestas strategy, cost savings and achieving cost leadership within the wind power industry is still a priority for the company.

The first Accelerate Earnings programme was concluded by the end of 2014 with a considerable achievement in the area of short-term cost-out. The next phase, called Accelerate Earnings Pro, is planned to run until 2017, and will aim at a sustainable optimisation of the total cost on the full value chain. The ambition to achieve cost leadership within the wind power industry remains unchanged.

Financial and capital structure strategy

Vestas' financial and capital structure targets, as well as related dividend policy, link to the strategic aspirations of the company.

Targets achieved through ambitious performance management

By increasing earnings and keeping investment and net working capital requirements low, Vestas aims to generate a double-digit return on invested capital (ROIC) each year over the cycle. Vestas expects to be able to finance its own growth and thus, the free cash flow is expected to be positive each financial year.

Conservative capital structure

As a player in a market where projects, customers, and wind turbine investors become larger, Vestas aims to be a strong financial counterpart. In line with the prudent balance sheet approach the target for the net debt/EBITDA ratio remains unchanged at below 1 at any point in the cycle. In addition, the target is a solvency ratio in the range of 30-35 percent by the end of each financial year.

The solvency target has been adjusted by the end of 2015 to increase flexibility to balance the need for a strong balance sheet and intent to distribute excess cash.

Dividend policy and priorities for excess cash allocation

Any decision to distribute cash to shareholders will be taken in appropriate consideration of capital structure targets and availability of excess cash. Determining excess cash will be based on the company's growth plans and liquidity requirements, thus securing adequate flexibility to invest in Vestas' strategy, Profitable Growth for Vestas.

The general intention of the Board of Directors is to recommend a dividend of 25-30 percent of the net result of the year after tax.

In addition, Vestas may from time to time supplement with share buy-back programmes.

Corporate strategy on track

In summary, Vestas strategy, Profitable Growth for Vestas, remains well on track as the company continues to leverage from our three main differentiators, global reach, technology and service leadership, and scale.

And as a result, Vestas is indeed well positioned to remain the undisputed wind leader in an industry that looks set to continue its trajectory of becoming an even more integrated and important part of the future's energy landscape.