

Company

19 July 2010 | 12 pages

Lanco Infratech (LAIN.BO)

 Equity
 Target price change
 Estimate change

The Dark Horse Is Delivering – Increase TP to Rs80

- Maintain Buy (1M)** — Solid execution has resulted in capacity increasing to 1,995MW now (from 511MW end FY09). We expect LANCI to increase capacity 4.2x to 8,384MW by FY15E (FY11E-507.5MW, FY12E-1,270MW, FY13E-76MW, FY14E-2556MW and FY15E-1,980MW). This would drive EPS growth of 23% over FY10-13E with average RoEs of 19%. Maintain Buy (1M) and top pick status along with Tata Power in our rated India Electric Utility universe.
- Increasing target price to Rs80** — From Rs70 as we: (1) roll forward power/road DCF to Dec10 (Sep10), (2) roll forward EPC P/E multiple to Dec11 (Sep11), (3) value Babandh (1,320MW) and (4) remove the discount on Vidarbha (1,320MW). We now value 8,384MW capacity (7,064MW earlier).
- EPS cut 37%-47% – Positive for cash flows** — Our EPS cut is driven by a sharp increase of ~100% in depreciation expense over FY11-13E. LANCI will now depreciate all thermal projects commissioned in and after FY10 at ~14% effective WDV vs. 5.3% straight line earlier. This actually positively impacts cash flows and valuations due to tax savings.
- Execution on track** — LANCI has added Amarkantak 1 (300MW) in Mar10, Udipi 1 (507MW) in Jun10 and Kondapalli (133MW) in Jul10, taking total capacity to 1,995MW from 511MW in less than 1 year. LANCI has increased employee count from 3,200 in FY08 to 5,500 in FY10, a clear sign of the execution ramp-up.
- Under development projects are now starting construction** — LANCI has tied up coal supply, land for main plant and necessary clearances for 3,960MW capacity. Construction of Babandh (1,320MW) and Amarkantak 3&4 (1,320MW) has started while Vidarbha (1,320MW) is set to start construction in 2-3 months. Construction of Kondapalli expansion (742MW) is in full swing and the company expects the plant to be commissioned in XIth plant itself.

Buy/Medium Risk	1M
Price (19 Jul 10)	Rs66.05
Target price	Rs80.00
	<i>from Rs70.00</i>
Expected share price return	21.1%
Expected dividend yield	0.0%
Expected total return	21.1%
Market Cap	Rs159,036M
	US\$3,404M

Price Performance (RIC: LAIN.BO, BB: LANCI IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2009A	2,804	1.26	-20.8	52.4	7.0	14.3	0.0
2010A	4,586	1.90	51.0	34.7	4.8	16.9	0.0
2011E	8,974	3.73	95.7	17.7	3.8	23.9	0.0
2012E	8,888	3.69	-1.0	17.9	3.1	19.3	0.0
2013E	8,486	3.52	-4.5	18.7	2.7	15.5	0.0

Source: Powered by dataCentral

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

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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	52.4	34.7	17.7	17.9	18.7
EV/EBITDA adjusted (x)	21.7	13.9	8.1	8.1	9.1
P/BV (x)	7.0	4.8	3.8	3.1	2.7
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	1.26	1.90	3.73	3.69	3.52
EPS reported	1.26	1.90	3.73	3.69	3.52
BVPS	9.43	13.89	17.31	21.00	24.52
DPS	0.00	0.00	0.00	0.00	0.00
Profit & Loss (RsM)					
Net sales	60,710	81,076	119,322	140,130	153,412
Operating expenses	-52,899	-69,284	-96,155	-112,687	-125,855
EBIT	7,810	11,792	23,167	27,443	27,557
Net interest expense	-2,185	-3,554	-7,975	-12,567	-13,904
Non-operating/exceptionals	-90	906	483	465	180
Pre-tax profit	5,535	9,144	15,676	15,341	13,833
Tax	-1,690	-3,643	-3,902	-3,807	-3,749
Extraord./Min.Int./Pref.div.	-1,041	-915	-2,799	-2,646	-1,598
Reported net income	2,804	4,586	8,974	8,888	8,486
Adjusted earnings	2,804	4,586	8,974	8,888	8,486
Adjusted EBITDA	8,884	15,270	33,912	43,828	44,309
Growth Rates (%)					
Sales	87.3	33.5	47.2	17.4	9.5
EBIT adjusted	25.6	51.0	96.5	18.5	0.4
EBITDA adjusted	27.0	71.9	122.1	29.2	1.1
EPS adjusted	-20.8	51.0	95.7	-1.0	-4.5
Cash Flow (RsM)					
Operating cash flow	-2,076	-6,135	28,559	20,270	24,466
Depreciation/amortization	1,073	3,479	10,745	16,385	16,752
Net working capital	-5,955	-15,028	8,840	-5,003	-772
Investing cash flow	-21,035	-29,747	-136,799	-71,376	-71,619
Capital expenditure	-18,164	-19,355	-136,799	-71,376	-71,619
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	25,604	35,605	100,034	50,313	50,610
Borrowings	24,320	27,644	97,981	47,667	49,012
Dividends paid	0	0	0	0	0
Change in cash	2,493	-277	-8,206	-793	3,456
Balance Sheet (RsM)					
Total assets	115,485	160,283	278,832	339,045	400,577
Cash & cash equivalent	9,905	9,628	1,421	628	4,084
Accounts receivable	11,943	22,270	29,338	32,752	34,411
Net fixed assets	54,139	70,015	196,069	251,061	305,928
Total liabilities	87,476	119,727	227,249	275,928	327,376
Accounts payable	29,750	32,191	41,654	42,666	45,102
Total Debt	55,970	83,614	181,594	229,262	278,273
Shareholders' funds	28,009	40,556	51,584	63,117	73,201
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	14.6	18.8	28.4	31.3	28.9
ROE adjusted	14.3	16.9	23.9	19.3	15.5
ROIC adjusted	11.5	10.1	12.4	9.7	7.9
Net debt to equity	164.5	182.4	349.3	362.2	374.6
Total debt to capital	66.6	67.3	77.9	78.4	79.2

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Maintain Buy (1M) – Target Price Rs80

Maintain Buy (1M) - Increase target price to Rs80 (from Rs70 earlier)

We maintain Buy (1M) on LANCI as:

- Execution remains on track: (1) Udupi unit1 (507MW) has been synchronized in June 2010 and unit 2 will be synchronized in September 2010 and (2) 133MW combined cycle turbine at Kondapalli has been synchronized in July 2010. As a result, operational capacity has increased to 1,995MW now from 511MW at the start of FY10.
- The company is likely to achieve financial closure of 4,702MW of capacity by September 2010. This capacity includes Amarkantak 3&4 (1,320MW), Vidarbha (1,320MW), Babandh phase 1 (1,320 MW), and Kondapalli expansion (742MW). Press reports suggest that the company has already achieved financial closure of Babandh 1 at a project cost of Rs55.4bn.
- The company has tied up land, coal supply and other clearances for Amarkantak 3&4 (1,320MW), Vidarbha (1,320MW) and Babandh 1 (1,320 MW). Construction work for Amarkantak 3&4 and Babandh 1 has started on ground while design and engineering for Vidarbha has been completed and construction is set to start soon.

Figure 1. LANCI – Relative Performance

Performance	1 Week	1 Month	3 Months	6 Months	1 Yr	2 Yr	3 Yr	Since Listing
LANCI	-2.1%	-2.3%	20.2%	29.1%	77.4%	122.3%	173.0%	176.9%
Sensex	0.1%	2.2%	3.2%	2.7%	21.8%	31.7%	15.5%	30.4%
Relative	-2.2%	-4.6%	17.0%	26.3%	55.6%	90.6%	157.5%	146.5%

Source: Citi Investment Research and Analysis

Increase target price to Rs80 (from Rs70 earlier) as we:

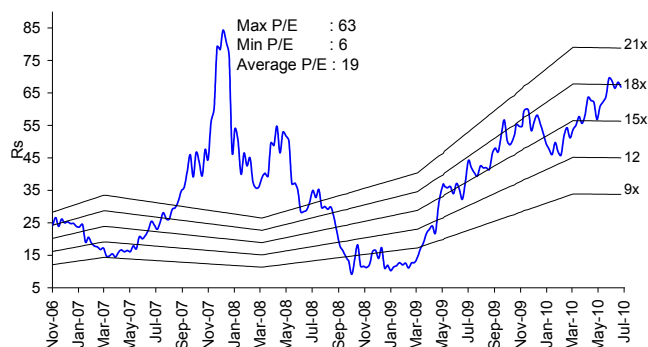
- Roll forward EPC P/E multiple of 11x to Dec11E (from Sep11E)
- Roll forward power trading P/E multiples of 15x to Dec11E (from Sep11E)
- Roll forward DCF value of power and road projects to Dec10E (from Sep10E)
- Factor in higher depreciation on thermal power projects (Amarkantak, Kondapalli 2 and all thermal projects to be commissioned after FY10) at 14% WDV instead of 5.28% straight line earlier
- Factor in higher MAT rates at 19.7% vs. 17.0% earlier, in line with MAT tax rates proposed in union budget 2010.
- We now value Babandh 1 (1,320MW) as the project has achieved financial closure, obtained coal supply and land for main plant and has started construction work on the project.
- We now value Vidarbha (1,320MW) at full DCF value vs. 50% discount to DCF earlier as land for main plant is under possession and the project is close to financial closure.
- We now value Lanco Hills at Rs(-3)/share vs. Rs1.1/share earlier given slowdown in Hyderabad real estate. Our value of Rs(-3)/share accounts for LANCI's share (74%) of gross debt of Rs10bn on Lanco Hills' books.

Figure 2. LANCI – Sum Of The Parts

Name	MW	Stake	CoE	Dec 10	LANCI Stake(Rsmn)	LANCI Stake (US\$m)	P/Equity	Old	New
Lanco EPC		100%	11x Dec11E	55,443	55,443	1,205		24.6	23.0
Kondapalli Unit 1	368	59%	13%						
Kondapalli Unit 2	366	59%	13%	23,316	13,756	299	3.0	5.9	5.7
Aban Power	120	51%	13%	4,308	2,198	48	1.3	1.0	0.9
Vamshi Hydro	10	98%	13%	545	534	12	1.0	0.3	0.2
Vamshi Industrial	10	98%	13%	258	253	6	0.8	0.2	0.1
Amarkantak - I	300	100%	13%	20,612	20,612	448	3.8	9.0	8.6
Udupi Power	1015	100%	13%	22,881	22,881	497	1.7	6.7	9.5
Operational/Near Operational	2502	8.6502	1.04	71,921	60,235	1,309	11.7	23.1	25.0
Lanco Green Budhil	70	98%	13%	1,654	1,621	35	1.4	0.4	0.7
Lanco Energy - Teesta VI	500	74%	13%	4,680	3,463	75	0.8	1.4	1.4
Anpara Power	1200	100%	13%	10,636	10,636	231	1.1	3.7	4.4
Lanco hydro Uttaranchal	76	100%	13%	4,746	4,746	103	2.0	1.8	2.0
Under Construction	1922	472%	52%	21,716	20,466	445	5.3	7.3	8.5
Amarkantak (Unit 3&4)	1320	100%	13%	24,002	24,002	522	1.7	7.5	10.0
Vidarbha	1320	100%	13%	16,656	16,656	362	1.2	2.9	6.9
Babandh (Unit 1&2)	1320	100%	13%	15,360	15,360	334	1.1	0.0	6.4
Under Development	3960			56,018	56,018	1,218	3.9	10.4	23.3
Total Power Capacity	8384			149,654	136,719	2,972	1.6	40.8	56.8
BHM Road	81 Kms	100%	13%	3,455	3,455	75	2.7	1.6	1.4
ND Road	82 Kms	100%	13%	1,425	1,425	31	1.3	0.7	0.6
Total Roads	163 Kms			4,880	4,880	106	2.1	2.3	2.0
Lanco Hills	3.5mnsqft	74.00%	14%	(10,000)	(7,400)	(161)	(4.2)	1.1	-3.1
Electricity Trading		100%	15x Dec11E	3,299	3,291	72		1.3	1.4
Carbon Credits		51%	13%	502	256	6		0.1	0.1
Total						193,189	4,200	70	80

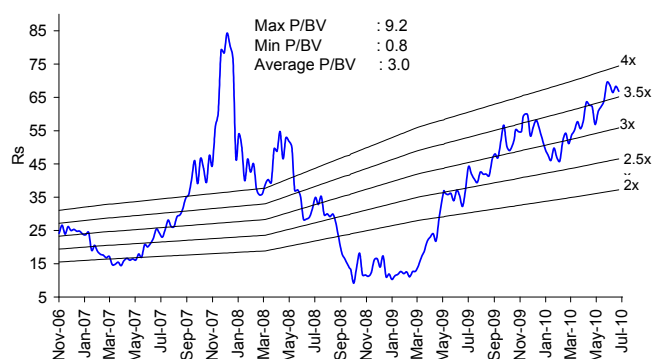
Source: Citi Investment Research and Analysis estimates

Figure 3. LANCI – Consolidated 1 Year Forward PE Banda Chart



Source: DataCentral and Citi Investment Research and Analysis estimates

Figure 4. LANCI – Consolidated 1 Year Forward P/BV Bands



Source: DataCentral and Citi Investment Research and Analysis estimates

Figure 5. LANCI – Earnings Revision Table

Mar31 (Rsmn)	FY11E	FY12E	FY13E
Revenue			
Old	112,207	142,558	158,507
New	119,322	140,130	153,412
%	6%	-2%	-3%
EBITDA			
Old	34,731	46,239	46,423
New	33,912	43,828	44,309
%	-2%	-5%	-5%
Depreciation			
Old	(4,955)	(8,090)	(8,440)
New	(10,745)	(16,385)	(16,752)
%	117%	103%	98%
PAT			
Old	14,321	16,361	16,015
New	8,974	8,888	8,486
%	-37%	-46%	-47%
EPS			
Old	5.95	6.80	6.65
New	3.73	3.69	3.52
%	-37%	-46%	-47%

Source: CIRA estimates

Earnings revision

We cut EPS over FY11E-FY13E by 37-47% as we factor in:

- Higher depreciation on thermal power projects (Amarkantak, Kondapalli 2 and all thermal projects to be commissioned after FY10) at 14% WDV instead of 5.28% straight line earlier, in line with the company's changed depreciation policy.
- No contribution from Lanco Hills to consolidated revenues and profits given slowdown in Hyderabad real estate.
- Higher MAT rate at 19.7% vs. 17.0% earlier

We now expect the company to grow EPS at a CAGR of 23% over FY10-13E with average RoEs of 19%. After this revision, our EPS estimates are 15-54% lower than consensus estimates over FY11E-FY13E.

Figure 6. LANCI Consolidated – CIRA vs. Consensus

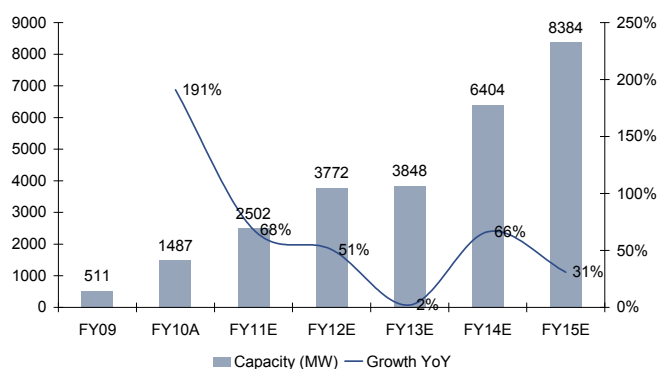
	FY11E	FY12E	FY13E
Revenue			
Consensus	128,223	161,514	207,682
Citi	119,322	140,130	153,412
%	-7%	-13%	-26%
PAT			
Consensus	10,502	11,854	20,316
Citi	8,974	8,888	8,486
%	-15%	-25%	-58%
EPS			
Consensus	4.37	4.86	7.63
Citi	3.73	3.69	3.52
%	-15%	-24%	-54%

Source: Bloomberg and Citi Investment Research and Analysis estimates

Capacity Addition Update

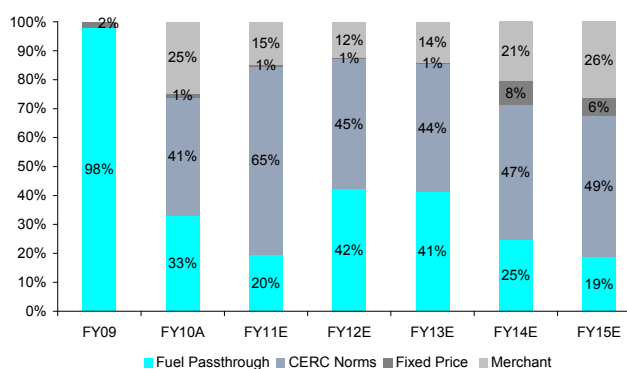
- LANCI currently has ~1,995MW operational capacity. We expect operational capacity to reach 8,384MW by FY15E.
- The company has executed well over the past 1-2 years and has commissioned ~1,484MW of capacity, which includes Kondapalli 2 (366MW), Amarkantak 1&2 (600MW) and Udupi unit 1 (507MW).
- Over the next 2 years capacity addition will be driven by commissioning of Udupi unit 2 (507MW) and Anpara C (1200MW).

Figure 7. LANCI – Capacity Addition



Source: Citi Investment Research and Analysis

Figure 8. LANCI – Breakup by off-take type



Source: Citi Investment Research and Analysis

Project-wise update

- **Udupi (1,014MW)** – Unit 1 has been synchronized in June 2010. Unit 2 is expected to be synchronized by September 2010. The project has started receiving coal supply from Indonesia at the agreed price. However, given higher coal prices in international markets, the company has approached buyers/regulators to allow pass-through of higher prices and a decision is awaited.
- **Amarkantak 3&4 (1,320MW)** – The project has obtained land, coal and all necessary clearances. The construction work has started on the ground and financial closure is expected by September 2010.
- **Vidarbha (1,320MW)** – The project has obtained coal linkage for 1,320MW from Mahanadi Coalfields and has land for main plant under possession. Remaining land acquisition is expected to be complete in the next 2-3 months. The company has completed the design and engineering and will start construction soon. Financial closure is expected by September 2010.
- **Babandh 1&2 (1,320MW)** – The project has obtained coal linkage for 660MW and has captive coal mine for 1000MW. Land for main plant is under possession and remaining land is expected to be acquired in the next 2-3 months. The company has started construction on the ground. Press reports suggest that the project has achieved financial closure though the company is yet to make a formal announcement.
- **Kondapalli expansion (742MW)** – The company expects to achieve CoD of this unit in XIth plan itself, thereby gaining priority in allocation of gas. We currently do not value this project as fuel supply has not been secured.

Figure 9. LANCI- Project Commissioning Schedule

Project	Capacity	Company - CoD	Citi - CoD	Comment
Kondapalli Unit 1	368			- Gas is available without interruption
Kondapalli 2	366	May-10	Jun-10	- 2nd unit of 133MW Synchronized. Gas is available without interruption
Aban Power	120			- Low PLF due to interruption in gas supply in recent months
Vamshi Hydro	10			
Amarkantak 2	300	Apr-10	Apr-10	- Synchronization is complete. PPA to start after CoD.
				- Operating on domestic coal (80% - linkage , 20% - e-auction)
Amarkantak 1	300	NA	Apr-10	- Unit is operating at PLF of ~70-80% since August 2009.
				- Now operating on mostly domestic coal (80% - linkage , 20% - e-auction)
Vamshi Industrial	10	Sep-10	Sep-10	-5MW has achieved CoD and 5MW will achieve CoD by September 2010
Wind	13			
Udupi Unit 1	507.5	Jun-10	Jun-10	- Synchronized in June 2010.G104.
				- Transmission line is ready and company has started receiving coal supply from Indonesia
Currently operational	1,995			
Udupi Unit 2	507.5	Sep-10	Sep-10	- Receiving Indonesian coal @US\$52/ton
				- Transmission capacity is being augmented for CoD in September 2010
Further Addition in FY11	508			
Operational by FY11 end	2,502			
Anpara C - Unit 1	600	Dec-10	Jun-11	
Anpara C - Unit 2	600	Mar-11	Sep-11	
Lanco Green Budhil	70	Dec-10	Oct-11	
Addition in FY12	1270			
Operational by FY12 end	3,772			
Uttaranchal 1- 76MW	76	Mar-12	Mar-13	
Addition in FY13	76			
Operational by FY13 end	3,848			
Amarkantak Unit 3	660	Mar-13	Dec-13	- Construction on ground started, Financial closure by September 2010
Lanco Energy Teesta	500	Mar-13	Mar-14	
Uttaranchal 2- 76MW	76	Mar-13	Mar-14	
Amarkantak Unit 4	660	Jun-13	Mar-14	- Construction on ground started, Financial closure by September 2010
Babandh Unit 1	660	Mar-13	Mar-14	- Financial closure achieved
Addition in FY14	2556			
Operational by FY14 end	6,404			
Vidarbha Unit 1	660	Dec-13	Jun-14	- Design and Engineering complete and construction to start soon
Babandh Unit 2	660	Jun-13	Sep-14	- Financial closure achieved
Vidarbha Unit 2	660	Mar-14	Dec-14	- Design and Engineering complete and construction to start soon
Addition in FY15	1980			
Operational by FY15 end	8,384			

Source: Citi Investment Research and Analysis estimates

Lanco Infratech

Company description

Lanco Infratech, founded in 1993, as a construction and EPC company, has leveraged its EPC expertise to become one of the fastest growing independent power producers in India. It now has 1,995MW of capacity operational which will reach 8,384MW by FY15E. Its EPC division has expertise spanning several segments of infrastructure space but specializes in EPC of coal and gas-based power plants. The EPC division acts as backbone for executing power projects. Apart from power and EPC, Lanco Infratech has also forayed into roads, real estate and electricity trading.

Investment strategy

We have a Buy/Medium Risk rating on Lanco Infratech. The company has 1,995MW of capacity operational and is executing another 4,700MW over the past 3-4 years with a large part in advanced stages of completion.

It is on a high growth path with an estimated 8,384MW operational by FY15E. It has strategically developed its power plant portfolio with a focus on Case-II / MoU developmental projects, which come with land and fuel visibility.

It has de-risked its business model by weighting its power portfolio heavily in favor of power projects with either complete or partial (fuel cost only) pass-through mechanisms. Over FY11-15E these projects will constitute ~70-80% of total capacity. This reliance on pass-throughs provides downside support to valuation. A strong in-house EPC division not only provides a backbone for faster project execution but also helps it optimize the need for infusing and blocking upfront equity into projects under development.

Lanco Infratech is at inflexion point on its growth trajectory. We expect PAT and revenue to grow at CAGR of 23% and 24% respectively over FY10-13E compared with 22% and 94% over FY07-FY09A. Earnings growth and expansion will be driven by: (1) rapid capacity addition, (2) addition of merchant capacity to portfolio, and (3) execution of projects by EPC division

Valuation

Traditional valuation methodologies like P/E and EV/EBITDA multiples can be misleading if used to value pure infrastructure asset holders, as project profitability can be lumpy, given the year of commissioning and life of the asset. Infrastructure assets, especially electric utilities, generate regular and largely predictable cash flow streams for a fixed period. Therefore, discounted cash flow (DCF) is best suited.

While applying the DCF one can either choose free cash flow to the firm (FCF) or free cash flow to equity (FCFE). We prefer FCFE as individual projects are highly geared and gearing changes as debt is rapidly paid off.

We value Lanco Infratech at Rs80/share with EPC at Rs23/share (11x Dec-11 EPS - 20% discount to mid-cap construction), Power at Rs56.8/share (DCF on FCFE using 13% CoE), Roads at Rs2/share (DCF on FCFE using 13% CoE) and other businesses at Rs(-1.6)/share.

Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, assigns a High Risk rating to Lanco Infratech. However, we believe a Medium Risk rating is more appropriate given the status of projects under implementation, industry-specific risks, financial risk and management risks.

LANCI's Medium Risk rating is more appropriate as: 1) its 6,000MW of capacity under implementation, has fuel, land, off-take arrangement and bulk of financing tied up; 2) The construction on a large part of this capacity is in advanced stage; 3)The power portfolio has ~80% of capacity operating on full/fuel cost pass-through mechanism. These factors, we believe, reduce risk substantially.

Given that LANCI is a play on both execution and operation of power plants, execution delays would have a bigger impact on numbers and company value. Other downside risks that could prevent the stock from reaching our target price include financial closure delays, fuel supply disruption, equipment quality and lower-than-expected merchant tariffs.

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of all or any identified portion of this research report hereby certifies that, with respect to each issuer or security or any identified portion of the report with respect to an issuer or security that the research analyst covers in this research report, all of the views expressed in this research report accurately reflect their personal views about those issuer(s) or securities. The research analyst(s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this research report.

IMPORTANT DISCLOSURES

Lanco Infratech (LAIN.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Atul Tiwari, CFA

Covered since February 9 2010

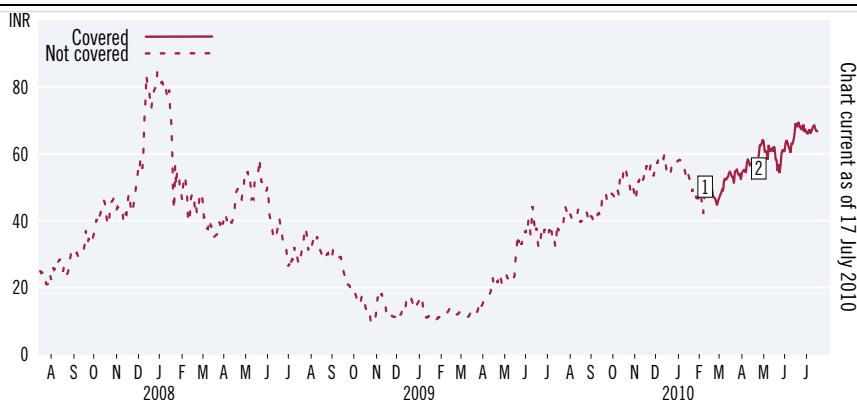


Chart current as of 17 July 2010

Date	Rating	Target Price	Closing Price
[1] 9-Feb-10	*1M	*60.00	49.20

* Indicates change

Date	Rating	Target Price	Closing Price
[2] 26-Apr-10	1M	*70.00	59.45

Rating/target price changes above reflect Eastern Standard Time

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