Initiating coverage

Lanco Infratech (LANCI IN)
Diversified

March 20, 2007

Stock rating: Outperform

Price: Rs168

Target price: Rs204

BSE-30: 12,645

Why read this report?

- **Initiating coverage on Lanco Infratech with an OP rating**

Sujay Mishra
sujay.mishra@kotak.com
Mumbai: +91-22-6634-1221

Aman Batra
aman.batra@kotak.com
Mumbai: +91-22-6634-1231

Puneet Jain
puneet.j@kotak.com
Mumbai: +91-22-6634-1255

Kotak Institutional Equities Research

Important disclosures appear at the back of this report.

Power play. We believe Lanco Infratech could emerge as one of the largest power utilities in the private sector in India. Our view is underpinned by the strong cash flows from existing and ongoing power / real estate projects as well as its keen growth orientation. We initiate coverage with an Outperform rating.

SOTP value of Rs204/share implies 21% upside

Our SOTP value comprises Rs110/share for the power project portfolio derived using DCF-to-equity at 11% cost of equity; Rs44/share as the NPV of the real estate projects and Rs50/share as the NPV of the cash flows of construction business. We would await appropriate triggers to include the value from the Sasan Ultra Mega Power Project and the Bangalore-Mudbagal BOOT road project.

Leveraging construction expertise and strong cash flows to fund growth

Lanco Infratech (LITL) intends to leverage its experience in construction to develop projects in power, real estate and infrastructure at low capital cost. LITL is in a position to reinvest its surplus cash generation during the next five years for growth. LITL's attributable power generation capacity is set to increase to 3,074 MW (excluding Sasan UMPP) by end-FY2011 from the current 307 MW**.** LITL's integrated IT park at Hyderabad (19.5 mn sq ft) marks its first foray into real estate development.

Growing multi-fold, spreading exposure to multiple states and fuel options

We estimate LITL's revenues and net income to increase 5.4X and 4.3X, respectively, during FY2007-12 as the ongoing projects commence operations. We estimate the company will likely invest fresh equity worth Rs24 bn till FY2012 to add thermal (imported and domestic coal-based) and hydropower to its portfolio of power assets.

Key risks

Aggressive growth plans and consequent tight implementation deadlines for projects and the sharp increase in interest rates represents key risks for LITL. Specific risks for the power business are (1) fuel availability and pricing and (2) receivables pile-up. Specific risks for the real estate business include (1) decline in property prices and (2) sharp increase in input costs.

Company data and valuation summary

Company data	Stock data	High	Low	Price performance	1M	3M	12M
Rating: Outperform	52-week range (Rs)	276.4	164	Absolute (%)	(18.4)	(33.1)	NA
	Yield (%)		—	Rel. to BSE-30 (%)	(5.5)	(26.2)	NA
Current price (Rs)	Priced at close of:		March 19, 2007				
168	**Capitalization**			**Forecasts/valuation**	**2006**	**2007E**	**2008E**
	Market cap (Rs bn)		37.3	EPS (Rs)	5.6	8.7	14.0
	Net debt/(cash) (Rs bn)		19	P/E (X)	218.5	19.4	12.0
	Free float (%)		80	ROE (%)	19.7	21.9	17.0
	Shares outstanding (mn)		222.4	EV/EBITDA (X)	24.6	15.2	9.7

Source: Company data, Kotak Institutional Equities estimates.

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The prices in this report are based on the market close of March 19, 2007.

Overview: Power play

Exhibit 1: Forecasts and valuation

Year-end	Revenues		EBITDA		Net profit	EPS	ROCE	ROE
March	(Rs mn)	Gth (%)	(Rs mn)	Gth (%)	(Rs mn)	(Rs)	(%)	(%)
2005	1,839	42.3	161	(5.0)	140	18.3	9.0	19.0
2006	1,471	(20.0)	167	3.7	171	5.6	7.8	19.7
2007E	16,419	1,016.2	4,463	2,566	1,928	8.7	13.9	21.9
2008E	29,773	81.3	6,483	45.2	3,106	14.0	8.0	17.0
2009E	58,923	97.9	14,128	117.9	5,534	24.9	10.0	24.5
2010E	90,014	52.8	27,289	93.2	12,580	56.6	15.0	39.8

Note:
Financials of power projects have been consolidated from FY2007E onwards after the restructuring of the group holding structure.

Source: Company data, Kotak Institutional Equities estimates.

Strong cash flows from existing/ ongoing power and real estate projects, coupled with a strong growth orientation will likely enable Lanco Infratech Limited (LITL) to emerge as one of the largest power utility in the private sector in India. LITL is likely to have 3,074 MW of attributable generation capacity by end-FY2011. We initiate coverage on the stock with an Outperform rating and target price of Rs204/share.

Valuation: Value to be realized from growth opportunities

Our SOTP value of Rs204/share implies 21% upside to the current market price of Rs172/share. Our target price does not include potential value accretion from (1) Sasan UMPP (Rs16-37/share)—we await the transfer of SPV and financial closure of the project; (2) potential value from Certified Emission Reductions (CERs) generated from power projects—we await approval of methodologies and at least one cycle of the validation process and (3) potential value from Bangalore-Mudbagal BOOT road project (Rs6.4-8.5/share)—pending its financial closure.

Our DCF-to-equity valuation proffers Rs110/share as the fair value of LITL's portfolio of power projects. We use 11% cost of equity and reduce the gross equity value derived from DCFe for (1) 17% loss on consolidation of value residing in subsidiaries due to dividend distribution tax (see Exhibit 2) and (2) the net equity funding required in LITL for its equity contribution towards completion of these projects.

We assign Rs50/share as the fair value of the construction business (see Exhibit 2). We believe DCF is the best approach to value construction businesses, which typically has relatively secular long-term growth prospects and low reliability of benchmark valuations. Further, DCF captures working capital management abilities and capex needs as companies grow at a fast pace. The value of LITL's construction business is primarily derived from large in-house power projects, which the company is developing over the next five years.

Exhibit 2: Power and power-related construction contributes the bulk to valuation
SOTP valuation of LITL

	Explicit forecast (PPA period)		PV of terminal value		Total value	Equity Inv.		Cash &	Attributable value		
	DCFe (Rs mn)	No. of years	(Rs mn)	Contr. (%)	(Rs mn)	(Rs mn)	(X) BV	cash eqv.	(%)	(Rs mn)	(Rs/share)
Operating power plants											
Lanco Kondapalli	6,532	10	2,010	24	8,542	3,400	2.5	1,699	59.0	6,042	
Aban Power	2,484	15	262	10	2,746	1,318	2.1	618	51.0	1,716	
Clarion Power	204	18	—	—	204	241	0.8	60	97.0	256	
Rithwik Power	133	17	—	—	133	96	1.4	78	89.0	188	
Lanco Electric Utility (Power trading)	488	14	480	50	968	210	4.6		99.8	966	
Power plants under construction											
Lanco Amarkantak	9,308	25	552	6	9,859	5,260	1.9		76.0	7,493	
Lanco Green	1,344	40	—	—	1,344	838	1.6		90.0	1,210	
Vamshi Hydro	411	35	—	—	411	139	3.0		91.1	374	
Vamshi Industrial	379	35	—	—	379	145	2.6		91.1	345	
Nagarjuna Power	11,029	25	825	7	11,854	8,708	1.4		74.0	8,772	
Power plants yet to achieve financial closure											
Lanco Energy - Teesta VI	14,380	35	—	—	14,380	5,900	2.4		74.0	10,641	
Lanco Hydro (Uttaranchal)	2,314	35	—	—	2,314	1,440	1.6		91.1	2,107	
Anpara 'C'	7,238	25	625	8	7,863	8,000	1.0		100.0	7,863	
Sub total	**56,243**		**4,753**	**8**	**60,997**	**35,696**	**1.7**			**47,973**	
17% lost as dividend distribution tax on consolidation										(8,155)	
Net equity funding requirement (after utilizing funds raised from IPO)										(15,354)	
Power (A)										**24,464**	**110**
Construction (B)										**11,127**	**50**
Property development										11,753	
17% lost as dividend distribution tax on consolidation										(1,998)	
Property development (C)										**9,755**	**44**
Grand Total (A+B+C)										**45,346**	**204**

Source: Kotak Institutional Equities estimates.

We assign Rs44/share for NAV-based valuation of the real estate business. We believe that an NAV-based valuation reflects a market's view on the potential for capital appreciation or change in the value of an asset. Further, NAV-based valuations also take into account cash flow timing, which becomes important in long-duration projects.

Ongoing reforms in the power sector likely to highlight investment opportunities

Excluding Sasan UMPP, LITL's attributable power generation capacity is set to increase to 3,074 MW by end-FY2011 from the current 307 MW. This rapid expansion will utilize LITL's surplus cash generation during the next five years. LITL has operational power generation capacity of 518 MW (attributable 307 MW) and another 1,705 MW (attributable 1,288 MW) is under implementation. LITL is likely to achieve financial closure of projects worth 5,595 MW (attributable 3,513 MW) by March 2008. This includes the Sasan UMPP to be implemented by the Globaleq-Lanco consortium.

Several developments bode well for incumbents: (1) India's power sector currently has a broad policy and regulatory framework in place to facilitate greater private-sector participation and competition; (2) The regulators have been issuing guidelines/orders that are enabling a nascent but evolving deregulated power market to emerge; and (3) Sector finances are on the mend.

Financials: Consolidation and growth under LITL

We estimate LITL's revenues to increase to Rs87.9 bn in FY2012E from Rs16.4 bn in FY2007E and net income (after minority interest) to increase to Rs8.3 bn in FY2011E from Rs1.9 bn in FY2007E. We note that reported financials till FY2006 are not comparable as the equity stake in power projects has been consolidated under LITL during FY2007. However in Exhibit 3, we assume a consistent structure for historic data as well for the sake of comparison.

Exhibit 3: Power business to drive growth
Segmental breakup of LITL financials, March fiscal year-ends, 2005-2012E (Rs mn)

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
Revenue flows								
Power	5,907	6,936	10,874	13,180	25,548	33,103	56,954	71,174
Construction	1,776	1,515	5,545	13,842	22,749	25,849	17,836	16,672
Real estate	—	—	—	2,751	10,626	31,062	34,434	—
Total	**7,683**	**8,451**	**16,419**	**29,773**	**58,923**	**90,014**	**109,224**	**87,845**
EBITDA flows								
Power	2,533	2,857	3,410	3,496	7,091	10,718	21,559	29,548
Construction	199	213	1,054	2,242	3,412	3,748	2,408	2,167
Real estate	—	—	—	745	3,624	12,823	13,893	—
Total	**2,731**	**3,069**	**4,463**	**6,483**	**14,128**	**27,289**	**37,860**	**31,715**
Attributable EBITDA	**1,728**	**1,902**	**3,085**	**4,834**	**10,930**	**20,862**	**29,296**	**25,733**
Net profit								
Power	1,064	1,100	1,347	1,556	2,845	3,764	5,919	7,280
Minority interest	(442)	(454)	(531)	(658)	(1,005)	(1,266)	(1,624)	(1,526)
Attributable PAT from Power	**622**	**646**	**816**	**898**	**1,841**	**2,498**	**4,295**	**5,753**
Construction	149	137	730	1,476	2,274	2,478	1,536	1,376
Attributable PAT from Construction	**149**	**137**	**730**	**1,476**	**2,274**	**2,478**	**1,536**	**1,376**
Real estate	—	—	—	475	2,599	10,404	11,528	—
Minority interest	—	—	—	(123)	(676)	(2,705)	(2,997)	—
Attributable PAT from Real Estate	—	—	—	**351**	**1,923**	**7,699**	**8,531**	—
Attributable profit	**771**	**783**	**1,547**	**2,725**	**6,038**	**12,675**	**14,362**	**7,129**
EPS (Rs)								
Power	80.8	21.0	3.7	4.0	8.3	11.2	19.3	25.9
Construction	19.4	4.4	3.3	6.6	10.2	11.1	6.9	6.2
Real estate	—	—	—	1.6	8.6	34.6	38.4	—
Total	**100.2**	**25.4**	**7.0**	**12.3**	**27.2**	**57.0**	**64.6**	**32.1**
EPS differential due to differntial accounting for depreciation			1.7	1.7	(2.3)	(0.4)	1.2	5.4
Reported EPS	**100.2**	**25.4**	**8.7**	**14.0**	**24.9**	**56.6**	**65.8**	**37.5**
FCF-equity								
Power	(5)	(665)	(2,312)	(5,335)	(8,826)	(11,599)	(1,113)	5,475
Construction	(26)	609	1,318	447	809	1,966	1,713	1,209
Real estate	—	—	(490)	(1,222)	(2,363)	5,873	10,897	—
Total	**(32)**	**(55)**	**(1,484)**	**(6,109)**	**(10,380)**	**(3,760)**	**11,496**	**6,683**
Attributable net debt								
Total	**4,663**	**5,363**	**9,468**	**41,874**	**82,613**	**101,090**	**93,328**	**78,482**

Note:
The equity holdings have been consolidated under LITL from FY2007. We have assumed similar holding structure for past financials for the purpose of comparison.

Source: Company data, Kotak Institutional Equities estimates.

We note LITL is doing in-house implementation of the civil construction and balance of work for the power projects, which gets captured in the revenues of the construction business. However, the company does not reduce the same as intra group revenues and profits. Drawing inference from the Interpretation-12 issued by International Financial Reporting Interpretation Committee on Service Concession Agreements, management is of the opinion that intra-group revenues and profits arising from construction of projects under BOOT or similar structure need not be eliminated. The company has made an application to ICAI to this effect seeking expert advisory opinion on the treatment adopted by the company under the provisions of the Accounting Standard 21 "Consolidated Financial Statements". We note that if the ICAI advises the elimination of revenues and profits pertaining to construction of in-house projects, we will need to remove the construction revenues and profits from our estimates.

The consolidated PAT for LITL differs from the summation of various segments. For consolidation of power sector subsidiaries, depreciation has been uniformly considered based on the rates as prescribed in the Company's Act. Depreciation on assets of power sector subsidiaries is charged in individual entities on different bases in keeping with policies considered appropriate in each case.

Company profile: Building power and infrastructure

Lanco Infratech Limited (LITL), established in 1993, is an engineering and construction company with interests in power, construction and property development. Building on its expertise in project execution and construction, LITL forayed into power generation and property development. LITL currently has a power generation capacity of 518 MW, with an additional 7,300 MW under various stages of implementation. LITL gained visibility when, along with Globaleq Singapore, it emerged as the lowest tariff bidder for the Sasan UMPP. LITL is developing 19.5 mn sq ft of saleable area in the integrated IT park in Hyderabad. LITL has also forayed into road projects and has been recently awarded an 80 km stretch (project cost of Rs7.6 bn) from Bangalore to Mudbagal by NHAI on a BOOT basis.

Exhibit 4: Business profile of LITL

			FY2007E		FY2012E		
		% stake	Revenues	Attributable PAT	Revenues	Attributable PAT	Business description
Operational power projects	Lanco Kondapalli	59	5,147	568	6,990	713	368 MW gas based power project in Andhra Pradesh
	Aban Power	51	1,773	132	1,971	177	120 MW gas based power project in Tamil Nadu
	Biomass-based power projects	97/89	438	107	327	31	Two power projects in Andhra Pradesh with cum. capacity of 18 MW
Power plants under construction	Lanco Amarkantak	76			8,825	863	2X300 MW coal based power plant under implementation in Chhattisgarh; CoD: April 2008, Oct 2008
	Lanco Green	90			736	149	70 MW hydro power project in Himachal Pradesh; CoD: July 2008
	Vamshi - small hydro projects	91			246	114	Four small hydro projects with cum. capacity of 20 MW in Himachal Pradesh; CoD: April 2008
	Nagarjuna Power	74			17,408	1,153	2X507.5 MW imported coal based power plant under implementation in Karnataka; CoD: Jan 2010, April 2010
Power plants awaiting financial closure	Lanco Energy (Teesta VI)	74			5,223	420	500 MW hydro power project in Sikkim; PPA signed with MSEDCL
	Anpara C	100			13,796	2,010	1,000 MW coal based thermal power project in Uttar Pradesh
	Lanco Hydro (Uttaranchal)	91			1,133	63	120 MW merchant hydro power project in Uttaranchal; DPR being prepared
	Lanco Electric Utility - power trading	100	3,515	9	14,519	61	Power trading subsidiary of LITL
	Sub total - power		**10,874**	**816**	**71,174**	**5,754**	
	Construction	100	5,545	730	16,672	1,376	Core business of the company, providing inhouse construction and project management expertise for LITL's forays in power generation, real estate and infrastructure development
	Property development	74	—	—	—	—	SEZ development in Hyderabad (FY2008-11)
	Total		**16,419**	**1,547**	**87,845**	**7,129**	

Source: Company data, Kotak Institutional Equities estimates.

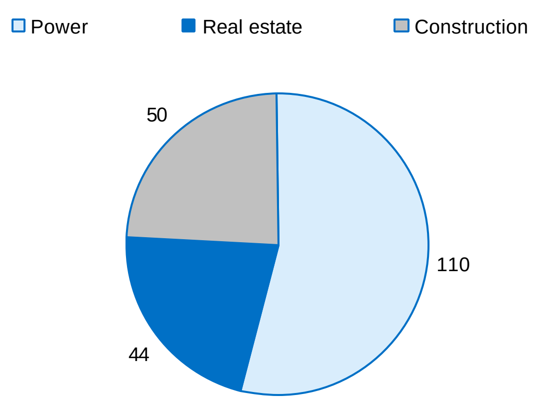
Valuation: Value to be realized from growth opportunities

We use SOTP to arrive at Rs204/share as the fair value of LITL. We value LITL's power projects (operational and under construction) at Rs110/share. We value the property business of LITL at Rs44/share while the construction business contributes Rs50/share. We assume a loss of 17% value due to dividend distribution tax while consolidating the value residing in the subsidiaries of LITL. Our target price does not include any value for the Sasan UMPP and the BOOT road project.

SOTP value of Rs204/share

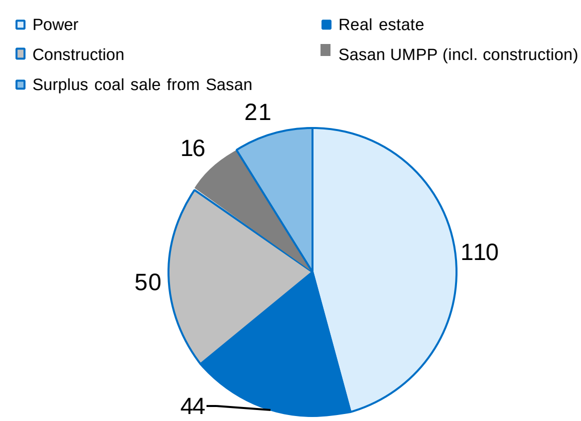
Our SOTP value of Rs204/share implies 21% upside to the prevailing market price. We arrive at the gross equity value of the power projects using DCF-to-equity valuation of individual projects. We assume aloss of 17% value on consolidation due to dividend distribution tax as LITL requires funds to meet the equity investment requirement for completion of these projects, while subsidiaries have surplus cash.

Exhibit 5: Power driving the valuation for Lanco Infratech
SOTP value of Rs204/share



Source: Kotak Institutional Equities estimates.

Exhibit 6: Sasan UMPP could provide additional value from - power project, surplus coal sale and construction revenues
Sasan UMPP could potentially add Rs37/share to LITL



Source: Kotak Institutional Equities estimates.

Our target price does not include any value for the Sasan UMPP, which can potentially add Rs16-37/share to our target price. We would await clarity on the transfer of project SPV to the Globaleq-LITL consortium and financial closure of the project before including the value in our target price. The incremental value accretion from the Sasan UMPP necessitates and depends on additional assumptions on coal mining and utilization of surplus coal. Please refer Annexure II for detailed valuation and assumption for Sasan UMPP.

Our target price does not include the potential value from Bangalore-Mudbagal road project and potential of income generation from sale of Certified Emission Reductions (CERs). Using an average P/B of 1.75-2.0X (derived from other BOOT projects by our construction analyst), the equity investment of Rs1.9 bn in the road project can potentially add Rs6.4-8.5/share to our target price.

Sale of 2 mn CERs per annum can yield an estimated Rs1.2 bn per annum (refer Annexure III for details on CERs) at a sale price of €10/CER.

Realizing the compounding benefit of reinvestment in power sector

Our DCF-to-equity valuation for all the power projects (except Sasan UMPP) yields a gross equity value of Rs47.9 bn. We reduce the gross equity value by LITL's estimated net equity funding requirement of Rs15.4 bn, needed till FY2011 for completion of these projects.

Exhibit 7: Equity value of power portfolio at Rs110/share

DCFe valuation of power projects

	Explicit forecast (PPA period)		PV of terminal value		Total value	Equity Inv.		Cash & cash	Attributable value	
	DCFe (Rs mn)	No. of years	(Rs mn)	Contr. (%)	(Rs mn)	(Rs mn)	(X) BV	eqv. (Rs mn)	(%)	(Rs mn)
Operating power plants										
Lanco Kondapalli	6,532	10	2,010	23.5	8,542	3,400	2.5	1,699	59.0	6,042
Aban Power	2,484	15	262	9.5	2,746	1,318	2.1	618	51.0	1,716
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Power plants yet to achieve financial closure										
Lanco Energy - Teesta VI	14,380	35	—	—	14,380	5,900	2.4		74.0	10,641
Lanco Hydro (Uttaranchal)	2,314	35	—	—	2,314	1,440	1.6		91.1	2,107
Anpara 'C'	7,238	25	625	7.9	7,863	8,000	1.0		100.0	7,863
Sub total	**56,243**		**4,753**	**7.8**	**60,997**	**35,696**	**1.7**			**47,973**
17% lost as dividend distribution tax on consolidation										(8,155)
Net equity funding requirement (after utilizing funds raised from IPO)										(15,354)
Power										**24,464**

Source: Kotak Institutional Equities estimates.

We use 11% cost of equity and returns/incentives as defined in the individual PPAs. Long-term PPAs ensure stable and predictable returns and cash flows enable a reasonable forecast for the financials of a power project over the life of the PPA (or power project). Termination clauses in the PPA or MoU (in case of hydro projects) provide help in making a fair estimate of the terminal value as well. The implied P/B for the power projects is a function of the RoEs and free cash flow yields of the project. The implied P/B multiples (see Exhibit 7) of Lanco Green and Nagarjuna Power (both have tariffs primarily determined using the CERC formula) are moderate, while merchant power sale in Lanco Energy implies a much higher P/B.

We factor in a 17% loss in value on consolidation of cash flows generated in subsidiaries. LITL will need to garner all its cash resources in order to fund the completion of the large pipeline of projects and realize value from the growth opportunities in the power sector. By end-FY2011, LITL will likely reach an attributable power generation capacity of 3,074 MW from its existing attributable power generation capacity of 307 MW.

Exhibit 8 gives a comparative valuation of power utilities under our coverage. In power, LITL is only engaged in generation. Tata Power, Reliance Energy and CESC have distribution assets and other businesses as well. Therefore, we prefer SOTP to value the latter companies.

Exhibit 8: Summary valuation of utility companies, March fiscal year-ends, 2006-2008E

	Category	Rating	Mkt Cap US$ bn	Price 19-Mar	EV/EBITDA 2006	EV/EBITDA 2007E	EV/EBITDA 2008E	P/E 2006	P/E 2007E	P/E 2008E	Cash P/E 2006	Cash P/E 2007E	Cash P/E 2008E
Reliance Energy	Int	OP	2.1	457	7.8	9.5	8.4	12.6	13.8	15.9	8.5	10.1	10.9
Reliance Energy - Adj.	Int				6.3	7.7	6.8	9.6	11.4	11.1			
Tata Power	Int	IL	2.3	506	12.5	13.0	9.4	22.7	25.4	15.4	13.2	14.5	10.4
Tata Power - adj.	Int				9.2	9.5	6.9	13.4	17.5	9.0			
CESC	Int	IL	0.7	341	6.0	6.2	7.2	12.9	9.5	11.7	5.8	6.1	6.9
NTPC	Gen	IL	26.9	144	17.3	16.6	12.8	20.3	17.9	16.4	9.6	10.4	12.1
NTPC - adj.					13.5	13.8	10.8	24.2	20.1	17.0			
Lanco Infratech	Gen	OP	0.8	168	24.6	15.2	9.7	218.5	19.4	12.0	27.2	13.3	9.3

	P/BV 2006	P/BV 2007E	P/BV 2008E	Net debt/ Equity(%) 2006	Div yield (%) 2006	Div yield (%) 2007E	ROCE (%) 2006	ROCE (%) 2007E	ROCE (%) 2008E	ROE (%) 2006	ROE (%) 2007E	ROE (%) 2008E
Reliance Energy	1.2	1.1	1.1	(28.4)	1.1	1.8	8.6	9.0	7.6	10.0	8.4	7.0
Reliance Energy - Adj.												
Tata Power	1.8	1.7	1.6	39.0	1.7	1.7	8.5	8.1	11.4	11.5	7.6	11.7
Tata Power - adj.												
CESC	2.1	1.8	1.6	135.1	0.7	1.6	15.3	16.0	12.1	15.0	19.9	14.1
NTPC	2.6	2.4	2.3	(15.2)	1.9	2.2	10.7	10.8	9.9	13.4	14.1	14.3
NTPC - adj.	4.5	4.0	3.2									
Lanco Infratech	39.1	2.2	1.9	89.0	0.0	0.0	7.8	13.9	8.0	19.7	21.9	17.0

Categories:

Gen = Generation; Int = Integrated

Note:

(a) Tata Power-adj. Reflects the adjustment made for the value of investment portfolio and treasury investments.

(b) Reliance Energy- adj. Reflects the adjustment made for the value of Delhi distcoms & net treasury investments.

(c) NTPC - adj.: (1) EV/EBITDA - adjusted for the tax accounting policy of the company; (2) P/E and P/BV - adjusted for the treasury portfolio and incom

Source: Kotak Institutional Equities estimates.

Sensitivity to interest rates

The valuation of LITL's power business is highly sensitive to interest rates (see Exhibit 9). While most of the generating power plants in India are regulated and enjoy pass-through of interest costs, some of LITL's power projects have specified fixed charge recovery (Aban Power, Teesta VI and Anpara C) that does not permit the pass-through of interest costs. The merchant power plants (Lanco Hydro Energy) also will not have an interest rate pass-through. On the other hand, when interest rates start moving down, these projects will retain the savings on interest costs. We have taken an average interest cost of 10.5% for term loans for all the projects. The company will likely get financing at these rates through a judicious mix of rupee and forex borrowings.

Exhibit 9: We have factored in the prevailing high interest rate environment
Sensitivity of valuation of power business to cost of equity and interest rate assumption (Rs/share)

		Interest rate assumption %			
		9.5	10.5	11.5	12.5
Cost of Equity %	8	164	155	145	136
	9	147	137	128	119
	10	131	123	114	105
	11	118	**110**	102	93
	12	107	99	91	83
	13	97	90	82	74

Source: Kotak Institutional Equities estimates.

As a large part of value is arising from ongoing projects, change in project cost and timelines will also impact our valuation estimate.

We assign Rs50/share as the fair value of the construction business

We use DCF to arrive at absolute fair values and target prices (see Exhibit 10). We believe DCF is the best approach to valuing businesses of this nature—with relatively secular long-term growth prospects and low reliability of benchmark valuations. Further, DCF captures working capital management abilities and capex needs as companies grow at a brisk pace. The value of LITL's construction business is primarily derived from the large in-house power project which the company is developing over the next five years.

Exhibit 10: We value the construction business at Rs50/share
DCF valuation of construction business of LITL, March fiscal year-ends (Rs mn)

	2004	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
Revenues	**1,146**	**1,776**	**1,515**	**5,545**	**13,842**	**22,749**	**25,849**	**17,836**	**16,672**
Cost of revenues	(1,033)	(1,577)	(1,302)	(4,492)	(11,599)	(19,337)	(22,101)	(15,428)	(14,505)
EBITDA	**113**	**199**	**213**	**1,054**	**2,242**	**3,412**	**3,748**	**2,408**	**2,167**
Depreciation	(23)	(21)	(19)	(31)	(66)	(116)	(166)	(216)	(266)
EBIT	**90**	**178**	**194**	**1,023**	**2,177**	**3,297**	**3,582**	**2,192**	**1,902**
Tax	(19)	(23)	(45)	(254)	(643)	(972)	(1,055)	(644)	(558)
Change in net working capital	(29)	(108)	331	525	(744)	(1,081)	(178)	461	67
Capex	(0)	(1)	(13)	(100)	(350)	(500)	(500)	(500)	(500)
Free cash flow	**65**	**68**	**486**	**1,225**	**506**	**859**	**2,014**	**1,725**	**1,176**
PV of cash flow				1,395	509	764	1,582	1,197	721
EBITDA (%)	**9.9**	**11.2**	**14.0**	**19.0**	**16.2**	**15.0**	**14.50**	**13.50**	**13.00**
Capex (% of sales)			*1*	*1.80*	*2.53*	*2.20*	*1.93*	*2.80*	*3.00*

PV of cash flows	4,773	42%
PV of terminal value	6,583	58%
EV	11,356	100%
Debt	228	
Equity value	**11,127**	
Shares outstanding (mn)	222.4	
Equity value (Rs/share)	**50**	
Exit FCF multiple (X)	9.1	
Exit EBITDA multiple (X)	5.0	

		WACC				
		10.7	11.7	12.7	13.7	14.7
Terminal Growth rate (%)	1.0	12,993	11,868	10,932	10,141	9,464
	2.0	14,031	12,689	11,595	10,685	9,916
	3.0	15,338	13,699	12,394	11,331	10,446
	4.0	17,036	14,971	13,378	12,109	11,075
	5.0	19,332	16,625	14,617	13,068	11,834

Weighted average cost of capital-WACC			
Terminal growth - g (%)	2.0	Cost of debt-Kd (%)	8.0
Risk free rate-Rf (%)	8.0	Tax rate (%)	34.0
Market risk premium—(Rm-Rf) (%)	5.5	Debt/Capital (%)	10.0
Beta (x)	1.1	Equity/Capital (%)	90.0
Cost of equity-Ke (%)	14.1	WACC (%)	13.2

Source: Kotak Institutional Equities estimates.

We assign Rs44/share for NAV-based valuation of the real estate business

We believe that an NAV-based valuation reflects a market's view on the potential for capital appreciation or change in the value of an asset. Further, NAV-based valuations also take into account cash flow timing, which becomes important in long-duration projects.

Exhibit 11: NPV of real estate projects gives a value of Rs44/share
NPV workings for the LITL's share in real estate project, March fiscal year-ends (Rs mn)

		2007E	2008E	2009E	2010E	2011E
EBITDA		—	551	2,682	9,489	10,281
Tax expense		—	(178)	(607)	(1,038)	(877)
Changes in working capital		(2,747)	(3,941)	(4,830)	1,103	10,070
Cash flow from operations		**(2,747)**	**(3,568)**	**(2,755)**	**9,555**	**19,474**
Capital expenditure		—	—	—	—	—
Free cash flow to the firm		**(2,747)**	**(3,568)**	**(2,755)**	**9,555**	**19,474**
Discounted cash flow-1 year forward		(2,746)	(3,567)	(2,415)	7,347	13,135
Discount rate	14.0%					
Growth from 2021 to perpetuity (%)	5.0%					

	+ 1-year	
Total PV of free cash flow (a)	**11,753**	**100%**
FCF in year 2021	—	
Exit FCF multiple (X)	11.1	
Terminal value	—	
PV of terminal value (b)	**—**	**0%**
EV (a) + (b)	**11,753**	
Net debt (FY2006)	—	
Equity value	**11,753**	
Loss due to dividend distribution	(1,998)	
Net equity value	**9,755**	
Implied share price (Rs)	**44**	

Source: Kotak Institutional Equities estimates.

Investing in growth

We believe that LITL is well placed to reinvest its surplus cash generation during the next five years for growth. LITL's attributable power generation capacity is set to increase to 3,074 MW (excluding Sasan UMPP) by end-FY2011 from the current 307 MW. We estimate the company will likely undertake a fresh equity investment of Rs24.2 bn till FY2011 to add thermal (imported and domestic coal based) and hydropower to its portfolio of power assets.

Equity funding requirement of Rs30 bn

We estimate LITL's gross equity funding requirement during FY2007-12 at Rs30 bn including Rs24.2 bn required for completion of the power projects. LITL will also need additional Rs17.2 bn for its 51% equity contribution for the Sasan UMPP (and development of allotted coal mines) and Rs1.9 bn for 100% equity contribution for the Bangalore-Mudbagal BOOT road project.

Exhibit 12: LITL requires Rs30 bn for funding the current portfolio of projects (excl. Sasan UMPP)
Equity funding required for projects being implemented by LITL, March fiscal year-ends, 2007E-2012E (Rs mn)

	LITL's share of funding					
	2007E	2008E	2009E	2010E	2011E	2012E
Power plants under implementation						
Lanco Amarkantak I	977	427	—	—	—	—
Lanco Amarkantak II	611	1,018	407	—	—	—
Lanco Green	35	415	—	—	—	—
Vamshi Hydro	32	44	—	—	—	—
Vamshi Industrial	32	47	—	—	—	—
Nagarjuna Power	451	1,353	2,706	1,933	—	—
Lanco Energy - Teesta VI	434	1,330	1,330	887	443	—
Lanco Hydro (Uttaranchal)	128	383	383	412	—	—
Anpara C	130	1,166	3,024	2,880	800	—
Fresh equity required for power	**2,829**	**6,185**	**7,851**	**6,112**	**1,243**	**—**
Stake hike in Aban to 51% (from 37.7%)	**350**	**—**	**—**	**—**	**—**	**—**
Stake hike in Kondapalli to 59% (from 33.9%)	**1,400**	**—**	**—**	**—**	**—**	**—**
Stake hike in Biomass projects	**57**	**—**	**—**	**—**	**—**	**—**
Real estate	**490**	**1,222**	**2,363**	**—**	**—**	**—**
Construction	**—**	**—**	**—**	**—**	**—**	**—**
Total equity funding required	**5,127**	**7,407**	**10,214**	**6,112**	**1,243**	**—**

Source: Kotak Institutional Equities estimates.

Strong cash generation gets reinvested

We estimate LITL to generate Rs35.3 bn during FY2007-12. Stable and predictable returns ensured by the PPAs of the operational power projects will likely continue to generate strong cash flows for LITL (see Exhibit 13). Coupled with the equity raised in the IPO (Rs10.5 bn), LITL can finance the equity investment requirement over the next five years and more (equity for Sasan UMPP, Mudbagal BOOT road project etc.). We have estimated the equity investment capability of LITL by factoring in a cash loss of 17% on account of the dividend distribution tax.

Exhibit 13: LITL will likely generate cash surplus of Rs35 bn during 2007-2012E
Attributable free cash flow generation, March fiscal year-ends, 2007E-2012E (Rs mn)

	2006	2007E	2008E	2009E	2010E	2011E	2012E
FCF-equity of operational projects							
Lanco Kondapalli	531	266	589	707	811	930	1,048
Aban Power	—	125	216	215	204	192	190
Clarion Power	—	49	10	13	16	19	22
Rithwik Power	—	68	8	9	11	13	19
Lanco Electric Utility	—	9	28	44	50	55	61
Sub total	**531**	**517**	**850**	**989**	**1,092**	**1,210**	**1,340**
FCF-equity on under-implementation projects on commissioning							
Lanco Amarkantak	—	—	—	566	699	794	842
Lanco Green	—	—	—	112	113	121	124
Vamshi	—	—	—	105	28	59	64
Nagarjuna	—	—	—	—	402	1,081	1,131
Sub total	—	—	—	**783**	**1,242**	**2,054**	**2,161**
FCF-equity on projects yet to achieve financial closure on commissioning							
Lanco Energy (Teesta VI)	—	—	—	—	—	—	1,755
Lanco Hydro (Uttaranchal)	—	—	—	—	—	370	30
Anpara C	—	—	—	—	—	1,278	1,091
Sub total	—	—	—	—	—	**1,648**	**2,876**
Total from Power	**531**	**517**	**850**	**1,771**	**2,334**	**4,911**	**6,377**
Real Estate	—	—	—	—	**5,873**	**10,897**	—
Total FCF-equity from projects	**531**	**517**	**850**	**1,771**	**8,207**	**15,808**	**6,377**
Loss on dividend distribution	(74)	(72)	(144)	(301)	(1,395)	(2,687)	(1,084)
Construction	**—**	**1,318**	**447**	**809**	**1,966**	**1,713**	**1,209**
Net cash available for reinvestment	**457**	**1,763**	**1,153**	**2,279**	**8,778**	**14,833**	**6,502**

Source: Kotak Institutional Equities estimates.

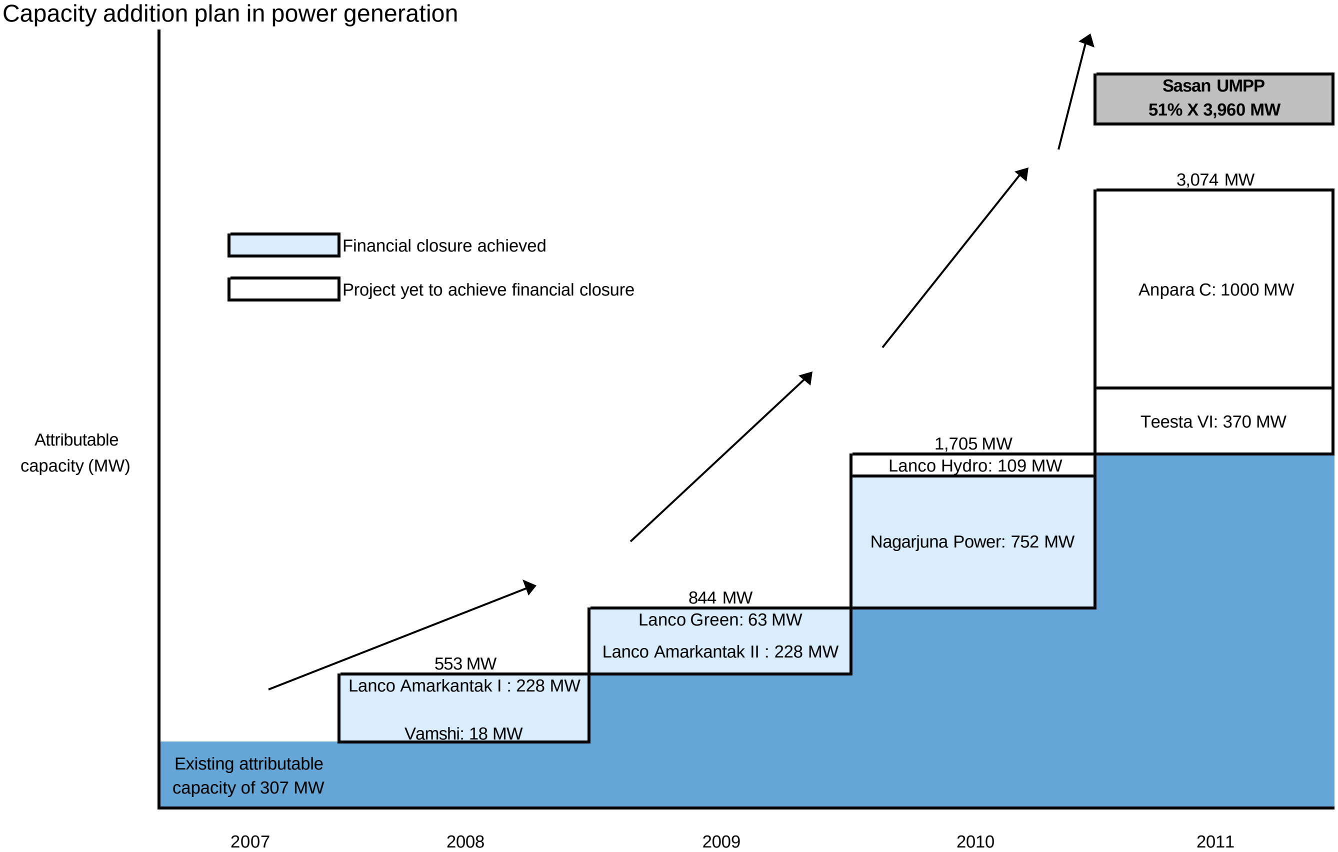
Business strategy: Powering the growth engine

LITL is poised to become a major infrastructure development company with attributable generation capacity of 3,074 MW by end-FY2011 (excl. Sasan UMPP). LITL is currently developing an integrated IT park in Hyderabad with 19.5 mn sq ft of saleable area. The company plans to leverage its construction and project management skills across infrastructure projects—roads, airports, ports, IT parks, SEZs etc. We see significant opportunities for LITL to profitably reinvest cash flows in new projects on the back of (a) reforms in the power sector and (b) the company's presence in construction and property development.

Climbing the growth chart in power

LITL is poised to become a large player in power generation with an attributable (LITL's share) capacity of 3,074 MW by end-FY2011, i.e. a CAGR of 78% from the current attributable capacity of 307 MW. The scheduled date of commercial operation of Unit I of Sasan is March 2011 and it is not included in the 3,074 MW figure (see Exhibit 14).

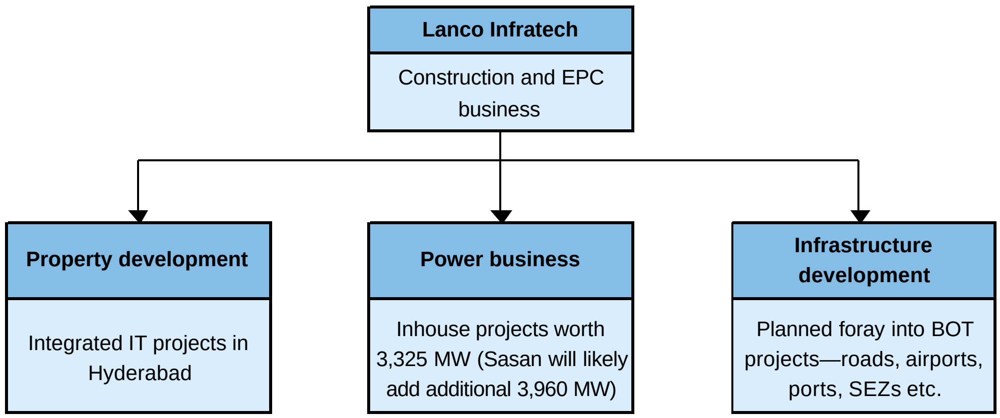
Exhibit 14: Projects in hand to take attributable capacity to 3,074 MW by end-FY2011, a CAGR of 78%
Capacity addition plan in power generation



Source: Company data.

LITL has adopted a risk diversification strategy, spanning its presence across the fuel spectrum—coal (domestic and imported), natural gas, biomass, wind and hydro, while also spreading its customer base. The customer profile of LITL's power business comprises PTC and some of the better-managed state utilities, viz. Andhra Pradesh, Karnataka and Himachal Pradesh. The company has also applied for coal block allocation as well as signed MOUs with some state governments for additional power projects. However, we have not factored these projects into our base-case projections since they are at a very preliminary stage.

Exhibit 15: Leveraging construction and project execution skills for low-cost projects



Source: Kotak Institutional Equities estimates.

Using construction expertise in developing real estate projects

LITL is currently developing an integrated IT project—19.5 mn sq. ft of saleable area in Hyderabad. In addition, LITL also owns two plots of land in Hyderabad—10 acres (0.9 mn sq. ft of built up space) near Ocean Park I and 12 acres (1.0 mn sq. ft of built up space) near Ocean Park II, which it plans to develop in the future. LITL has put in place a dedicated team to identify land/projects where LITL can use its expertise in developing medium-to-large integrated townships.

Core of the company—engineering and construction business

LITL's construction business is the core around which the company has developed its other businesses—power, property development and the planned foray into infrastructure development. Started in 1993, LITL provides integrated engineering, procurement and construction services for civil construction and infrastructure sector projects.

LITL's strength lies in the execution of civil construction contracts while it sub-contracts the engineering portion of the work in EPC contracts. Exhibit 16 highlights LITL's management which comprises people with critical skill-sets and experience. LITL has so far executed projects worth Rs16 bn, including projects for various government and quasi-government enterprises. The current focus of LITL is in executing in-house projects for developing power projects and real estate. In the three years ended March 31, 2006, 70% of the contracts were granted by LITL's affiliate companies. In-house projects constitute 80% of the end-FY2006 order book position of Rs7.5 bn.

Exhibit 16: Building up the human resource base to enable growing project execution
LITL: Key management personnel

Name	Designation	Experience (years) Overall	In Lanco	Previous organizations	Qualifications
Top management					
L Madhusudan Rao	Executive Chairman	12	12	NA	M. Tech (Mechanical Design) M.S. (Industrial Engineering)
G Bhaskara Rao	Executive Vice-Chairman	18	18	NA	M.E. (Mechanical Design)
G Venkatesh Babu	Managing Director	12	4	WI Carr	C.A., Cost Accountant
D V Rao	Joint Managing Director	17	10	Tata Korf; Coromandal Fert.	Mechanical Engineer
J Suresh Kumar	Chief Financial Officer	14	1	JM Morgan Stanley	C.A., Cost Accountant
L.Yugandhar Babu	Executive Director	26	10	Blue Gold Maritech	CA
Power SBU I:Coal based projects					
K Rajagopal	SBU Head	22	2	LVS Power	ME (Mechanical Engineer), MBA
Shishir Kant	Director-Business Development	25	1	BHEL	Engineer
Predeep Lenka	CEO - Thermal	26	1	GMR	Engineer
Amarkantak					
K E Prasad	VP - Technical	25	1	GMR Group	Engineer
A Pattabhiraman	VP - Project development	35	2	BPL Power	Engineer
Nagarjuna					
Praveer Sinha	COO	22	12	Crompton Greaves	Engineer, MBA, Masters in Business Law
K S Balachandra	Head Technical	32	10	NTPC, TCE	Engineer & M Tech - IIT Mumbai
Anpara					
R.Raveendranathan Nair	Executive Director	25		Reliance	Engineer - Electronics and Communications
Power SBU II: Gas based projects					
P Panduranga Rao	SBU Head	21	14	Allwyn	C.A.
Aban Power					
Ravindran		24	4	SAIL	PG Engineering, REC
Lanco Kondapalli					
A Srinivasa Rao	GM - Projects		10	AP Genco	Engineer
Power SBU III: Hydro Projects					
D V Rao	SBU Head				
Murali Subramanian	VP - Business & project dev	10	2	Schlumberger	Engineer, MBA-INSEAD
Bharat K Sarda	VP - Projects	24	1	NHPC	Engineer
Lanco Green					
VPS Chauhan	Executive Director	25	1	NHPC	Engineer
HS Rathore	AGM Projects	15	1	NTPC	Engineer
Sanjeev Sharma	Manager	13	1	Continental Constr	Engineer
Power trading					
Rajesh Mahajan	Head	12	2	Adani group	Engineer
Biomass					
Nagaprasad Kandimalla	Head	10	5	Satyam Computers	ME (Mechanical Engineer)
Regulatory					
MN Ravi Shankar	Head	15	1	APERC	Cost Accountant
SBU: EPC					
S C Manocha	CEO - EPC power	33		Bakeman - South Africa	Engineer
SBU: Construction					
Dr. G Sachdeva	SBU Head	40	1	Ansals, Continental Constr	PhD-Construction, Engineering
D N Reddy	Director Operations	22	11	National Dairy Development Board	Civil Engineer
Dharma Teja	VP - Infrastructure Dev	5	1	Som Datt Builders	MBA ISB, Hyderabad
Real Estate					
B Manohar	Head	19	3	Own construction business	Electrical Engineer
Property development					
S Pochendar	Head	25	4	CPWD, IVRCL, NDDB	M Tech (Enviro. Engineer)
M Kasibhatta	Head - Commercial space	17	1	Rahejas	Civil Engineer
Srinivasu	Head - Residential	17	1	Prestige	Civil Engineer
DS Sridhar	Resident Director - Bangalore	18			Civil Engineer
Infrastructure: Road projects					
Sanjay D Joshi	Head	19	0.25	Reliance	ME (Civil Engineer)
Corporate affairs					
Sreenivas Veluri	Head	20	3	Andhra Jyoti	MBA
Human Resources					
Dr K P Kumar	Head	30	0.5	Suguna Group- Coimbattore	Engineer and PHD in Management

Source: Company data.

Key risks

We believe the key risks to our call are (1) project execution risk on account of aggressive growth plans and consequent tight implementation deadlines for projects (both in power and real estate), (2) sharp increase in interest rate, (3) input cost escalation and (4) decline in property prices.

Project execution risk

Our assumption of timelines for project execution is longer than company guidance. LITL is implementing projects on a much larger scale than before and at multiple locations under varying circumstances, using different kinds of fuels (coal–domestic and imported, gas, hydro etc.). LITL will likely undertake a large chunk of civil constructions for the power projects and will also undertake the O&M of the plants on commissioning. The Exhibit 17 below gives the comparative stiff timelines set by management for the implementation of projects versus our assumptions.

Exhibit 17: Stiff deadlines for project implementation—a key risk
Timelines for project implementation

			Company guidance			KIE assumptions		
Project	Capacity (MW)	Fuel	Date of Financial closure	Projected CoD	Implementation time (months)	Date of Financial closure	Projected CoD	Implementation time (months)
Lanco Amarkantak I	300	Coal - linkage	Sep-05	Apr-08	31	Sep-05	Apr-08	31
Lanco Amarkantak II	300	Coal - linkage	Jul-06	Oct-08	27	Jul-06	Jan-09	30
Nagarjuna Power I	507.5	Coal - imported	Aug-06	Dec-09	40	Aug-06	Jan-10	41
Nagarjuna Power II	507.5	Coal - imported	Aug-06	Dec-09	40	Aug-06	Apr-10	44
Anpara 'C'	1,000	Coal - linkage	Jun-07	Apr-10	34	Nov-07	Oct-10	35
Lanco Green - Himachal Pradesh	70	Hydro	Mar-06	Apr-08	25	Mar-06	Jul-08	28
Small hydro projects (Vamshi)	20	Hydro	Mar-06	Apr-08	25	Mar-06	Apr-08	25
Lanco Energy (Teesta VI, Sikkim)	500	Hydro	Mar-07	Dec-09	33	Mar-07	Apr-11	49
Lanco Hydro Energy - Uttaranchal	120	Hydro	Sep-07	Apr-09	19	Sep-07	Apr-10	31
Sasan - Madhya Pradesh	3,960	Coal - captive	Jan-08	Jan-11	36	Mar-08	Mar-11	36

Source: Company data, KIE estimates, Industry.

LITL has a good track record in project execution. LITL has a good track record in implementing power projects in the past and has benefited from its partnership with Genting of Malaysia and Doosan of South Korea. The fastest implementation of a thermal power project by NTPC is 35 months (from date of investment decision to date of commissioning, commercial operation takes another 3-6 months) for the 500 MW power project at Ramagundam. Due to their complex implementation, hydro projects in India typically exceed the initial project timelines. However, most of the projects executed in the hydro sector have been undertaken by government enterprises with a cost plus structure providing no incentives for timely completion of projects.

The construction division largely depends on in-house projects. We note that in-house projects account for more than 80% of revenues and order backlog of the company.

Interest rate risk

Current firmness in interest rate regime captured in our estimates. We have taken an average interest cost of 10.5% for term loans for all the projects. We note that LITL had tied up debt at 8.5%-9.5% for its ongoing projects and will be able to tie up debt at about 10.5% through a mix of domestic and forex borrowings. LITL's power projects (Aban Power, Teesta VI and Anpara C) have specified fixed charge recovery that does not permit pass-through of interest costs, unlike CERC-regulated tariffs where interest costs are a pass-through. The merchant power plants (Lanco Hydro Energy) also will not have an interest rate pass-through.

Sharp increase in interest rates may dampen demand for housing finance and thus, housing. This would naturally impact revenues and earnings of Lanco Developer's (LDLs) housing segment. We note that a moderate interest rate regime over the past few years and the availability of low-cost financing from housing finance companies and banks have helped fuel the recent growth in demand for residential real estate. However, interest rates have increased sharply over the past 12 months.

Fuel availability and pricing

Natural gas. Availability of natural gas for Lanco Kondapalli's plant will likely remain a matter of concern over the next 18-24 months and we assume operations at sub-optimal levels for the next two years. However, significant discoveries of natural gas reserves in the KG Basin suggest that these concerns are not expected to outlast the period mentioned. Allocation of natural gas from the Cauvery basin has been restricted to availability and we do not expect a shortage of gas for Aban Power.

In our view, over the PPA period, there appears little risk to cash flows from rising energy prices as the PPAs for both Lanco Kodapalli and Aban Power permit the pass-through of fuel costs. Over the longer term, domestic natural gas pricing remains complex given the upward spiral in global energy prices. However, we believe that given the disproportionate consumption share of the power sector, competing fuel prices (especially domestic coal) will ensure competitively priced domestic natural gas supply to the power sector going forward.

Coal. While LITL is partially insulated from coal price increases, having factored in coal price escalation clauses in its PPAs, the company may have to bear increased costs if fuel prices rise beyond the costs factored. LITL depends on external sources for coal requirements. Disruption of supplies will affect power generation and consequently the financials of LITL.

Water availability. The financial projections of hydro projects are based on design energy estimates from hydrological studies.

Sharp increase in input costs

A sharp increase in prices of construction materials (cement and steel) may negatively impact on profitability of LITL's construction segment. We note that cement and steel account for a major component of the construction cost and their prices have firmed up significantly over the past two years. Further, we have estimated the company's operating margins to increase on account of the higher proportion of Lanco group projects.

Risk of a receivables pile-up

We believe that there is little risk of a receivables pile-up given the track record of timely payment and the decline in A,T&C losses of the discoms,. The risk of a receivables pile-up arises from the deficit cash flow of the state-government-owned discoms. LITL's customer base in the power sector comprises PTC and some of the financially stable state utilities. Payment security mechanisms put in place will likely ensure timely payments while the low cost of generation will likely ensure ready offtake by other consumers in the eventuality of a default, in our view.

Property prices—cyclical business

A decline in property prices as a result of (1) significant increase in supply and (2) demand slowdown may impact our revenue (property sale price assumptions) and earnings estimates negatively. We note that property prices have risen sharply across India over the past two years. Although we do not doubt secular growth in property prices over a period of time given growing demand for all forms of real estate in India, we highlight that the real estate business is inherently cyclical and property prices are volatile.

Southern India is likely to see a sharp increase in supply of Grade A commercial stock over the next few years. In Hyderabad itself, the company is likely to face competition from Ashoka group, Divyashree builders, DLF and L&T. Besides that Hyderabad Urban Development Authority (HUDA) has invited bids for selling plots totaling 80 acres near Manikonda project under 'Golden Mil' scheme. The government is also planning two sixty-storey towers in the same region. Large supply of commercial space could result in lower commercial volume sales for the company.

Power sector outlook

Several developments bode well for incumbents. The success with competitive bidding in the award of the first two ultra mega power project marks the likely end of cost plus era and redefines competitive bulk supply tariff at a significantly lower level. A broad policy and regulatory framework is largely in place to usher in greater private sector participation and competition in the Indian power sector. And finally, sector finances are on the mend, albeit gradually.

Competitively bid tariff will likely replace cost plus as industry norm

Exhibit 18: The successful bidders redefined bulk supply tariff at significantly lower level than existing benchmarks
Levelised tariff bids submitted by prequalified bidders in the first two ultra mega power projects

Sasan (Pithead)		Mundra (Coastal)	
Bidder	**Tariff (Rs/kwh)**	**Bidder**	**Tariff (Rs/kwh)**
Lanco-Globeleq	**1.20**	**Tata Power**	**2.26**
Reliance Energy	1.30	Reliance Energy	2.66
Tata Power	1.41	Adani Exports	2.69
Essar	1.65	Essar	2.80
JaiPrakash group	1.65	L&T	3.22
Sterlite	1.75	Sterlite	3.75
Jindal Steel & Power	1.79		
NTPC	2.10		
L&T	2.25		

Source: Infraline.

The reforming Indian power market

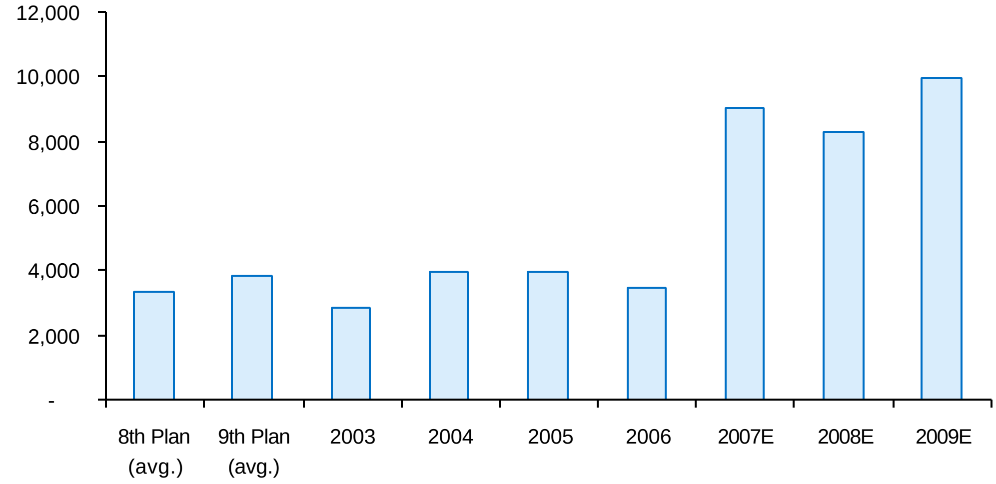
Exhibit 19: Pace of power sector reforms picking up
Reforms timeline, 1993-2012

	1993- 2002	2003-2012	Beyond 2012
Reforms initiated	Mega Power policy announced.	Electricity Act 2003 passed - envisaging active private participation.	**A thriving deregulated power market with active private participation.**
	Foreign participation encouraged in power sector.	National Electricity Policy notified in February 2005.	
		Unbundling of SEB's.	
		OTSS of outstanding dues.	
		APDRP scheme for improving infrastrure and reducing A,T&C losses.	
Response	Generated interest from foreign utility companies.	Aggressive capacity addition CPSU's and SEB's on the back of improving finances.	
	Several projects were announced.	Competitive bidding in generation and transmission.	
		Private participation in distribution (Delhi, Orissa and perhaps few more states).	
		Open access in transmission & distribution.	
Outcome	Poor financial health of SEB's and mounting receivables prevented any significant capacity addition.	Improving track record of capacity expansion compared to plan targets.	
		A,T&C losses start reducing esp. under private participation.	
		Progressive reduction in cross-subsidies.	
		Merchant power plants and power trading to take off.	

Source: Kotak Institutional Equities.

Exhibit 20: About 25 GW of generation capacity under construction for the 11th Plan (FY2008-12)

Annual generation capacity addition, March fiscal year-ends (MW)



Source: CEA, Ministry of Power, Planning Commission.

Power investments growth will likely be higher than nominal GDP growth

- Ongoing reforms process improving sector viability, increasing private sector participation and bringing in competitive market forces;
- Improved cash flows of distribution companies (or SEBs);
- Increased opportunities available for private participation—in generation, transmission and distribution.

Financials

We estimate LITL's revenues to increase to Rs87.8 bn in FY2012E from Rs16.4 bn in FY2007E and net income to increase to Rs8.3 bn in FY2012E from Rs1.9 bn in FY2007E. Our projections do not include projections for the Sasan UMPP. The sales as well as profits will likely decline in FY2012E (see Exhibit 21) as we expect the sale proceeds of the real estate projects to be realized completely by end-FY2011.

Exhibit 21: Consolidated income statement, March fiscal year-ends, 2006-2012E (Rs mn)

	2006	2007E	2008E	2009E	2010E	2011E	2012E
Net revenues	**1,471**	**16,419**	**29,773**	**58,923**	**90,014**	**109,224**	**87,845**
EBITDA	**167**	**4,463**	**6,483**	**14,128**	**27,289**	**37,860**	**31,715**
Depreciation & amortization	(19)	(870)	(905)	(2,484)	(3,548)	(6,890)	(8,487)
EBIT	149	3,593	5,578	11,644	23,741	30,970	23,229
Interest (expense)	(36)	(832)	(790)	(2,582)	(4,577)	(9,676)	(12,155)
Interest/treasury income	13	114	179	318	446	609	224
Other income/(expense)	—	—	—	—	—	—	—
Pre-tax profit	125	2,876	4,967	9,380	19,610	21,903	11,298
Income tax	(40)	(417)	(1,079)	(2,165)	(3,058)	(2,655)	(1,441)
Deferred tax	7	—	—	—	—	—	—
Fringe benefit tax	(0)	—	—	—	—	—	—
Minority interest / share of profits of associates	79	(531)	(782)	(1,680)	(3,971)	(4,621)	(1,526)
Net profit	**171**	**1,928**	**3,106**	**5,534**	**12,580**	**14,627**	**8,331**
Extraordinary items	(0.2)	—	—	—	—	—	—
Profit attributable to shareholders	171	1,928	3,106	5,534	12,580	14,627	8,331
Common dividend	—	—	—	—	—	—	—
Dividend tax	—	—	—	—	—	—	—
Add to retained earnings	171	1,928	3,106	5,534	12,580	14,627	8,331
EPS (Rs)	**5.6**	**8.7**	**14.0**	**24.9**	**56.6**	**65.8**	**37.5**
CEPS (Rs)	6.2	12.6	18.0	36.1	72.5	96.8	75.6
Dividend per share (Rs)	—	—	—	—	—	—	—
Weighted avg. share (mn)	30.8	222.4	222.4	222.4	222.4	222.4	222.4
Share outstanding (mn)	30.8	222.4	222.4	222.4	222.4	222.4	222.4
Ratios (%)							
Revenue growth	(20.0)	1,016.2	81.3	97.9	52.8	21.3	(19.6)
EBITDA margin	11.4	27.2	21.8	24.0	30.3	34.7	36.1
EBITDA growth	3.7	2,566	45.2	117.9	93.2	38.7	(16.2)
Income tax rate	26.5	14.5	21.7	23.1	15.6	12.1	12.8
Dividend payout ratio	—	—	—	—	—	—	—
EPS growth	(69.6)	56.1	61.1	78.2	127.3	16.3	(43.0)

Source: Company data, Kotak Institutional Equities estimates.

The financials till FY2006 do not consolidate the financials of power projects, as LITL has acquired majority stake in these projects in FY2007. Till FY2006, LITL had minor stakes in projects (like Aban and Lanco Kondapalli), which it has increased through equity swaps with other holding companies of the group. Additionally, the company bought or committed to buy stakes from external holders, taking its holdings in these companies to more than 51%.

Power—providing the growth platform for LITL

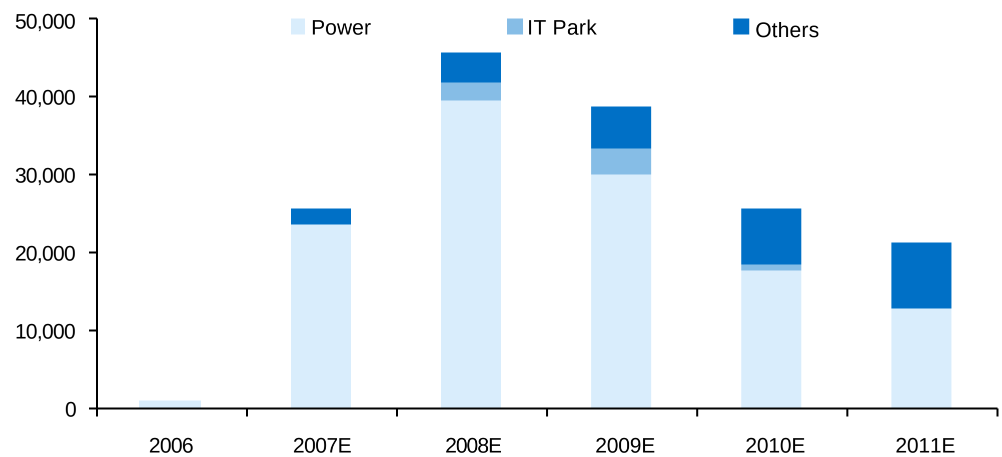
LITL’s attributable power generation capacity is set to increase to 3,074 MW (excluding Sasan UMPP) by end-FY2011 from the current 307 MW. We estimate the company to undertake a fresh equity investment of Rs24 bn by FY2011 to add thermal (imported and domestic coal based) and hydropower to its portfolio of power assets. Please refer to Annexure I for a detailed profile of the operational and ongoing power projects.

Revenue drivers of construction business: The company bags large power projects

LITL has bagged large power projects and its order book at the end of FY2007E is likely to go up to Rs25.5 bn with power sector orders contributing 90% to the order book (see Exhibit 22). On the back of a healthy book-to-bill ratio (see Exhibit 23), we expect LITL to show strong growth in construction revenues: Rs5.6 bn in FY2007E (378% yoy), Rs13.8 bn in FY2008E (150% yoy). Our execution duration assumptions are factored into our ‘bill-to-book ratio’ which is defined as ‘Revenues ÷ [Order backlog +50% of order inflows for the year]’.

We believe the company's employee cost as well as SG&A expenses will likely decline by 150 bps in FY2007E compared to FY2006 on account of the 4X increase in sales for FY2007E. Also, a large proportion of sales will come from internal power projects where the company is expected to earn higher operating margins. However, we note that increasing cost pressures, higher competition will likely cramp margins for the company.

Exhibit 22: Ordering activity: Significant orders from power sector in FY2007
Year-end order book (Rs mn)



Source: Company data, Kotak Institutional Equities estimates.

Exhibit 23: Significant buildup of orders from power business
Order flow for LITL's construction business, March fiscal year-ends, 2006-2011E (Rs mn)

	2006	2007E	2008E	2009E	2010E	2011E
Orders received	2,113	30,000	34,020	15,888	12,563	13,475
growth (%)		1,319.9	13.4	(53.3)	(20.9)	7.3
Revenues	1,158	5,545	13,842	22,749	25,849	17,836
growth (%)		378.9	149.6	64.4	13.6	(31.0)
Order backlog - year end	1,087	25,541	45,719	38,857	25,571	21,211
growth (%)		2,250.5	79.0	(15.0)	(34.2)	(17.1)
Order execution days		72	674	734	549	523
Bill to book ratio	109.6	34.5	32.5	42.4	57.3	55.2
Order backlog composition - year end						
Power	988	23,642	39,499	30,099	17,640	12,656
IT Park	—	—	2,321	3,244	973	—
Others	99	1,900	3,900	5,514	6,958	8,555
Revenues composition						
Power	458	4,346	11,142	17,400	20,460	12,984
IT Park	—	—	1,250	2,996	2,271	973
Others	700	1,199	1,450	2,353	3,118	3,878

Source: Company, Kotak Institutional Equities estimates.

Drivers of real estate business

The proposed Hyderabad property project will be a self-sustained knowledge economy ecosystem designed and developed to support the operations of high-technology enterprises, especially in the fields of IT and IT-enabled services. The project is planned as a strategic base for technology companies looking to establish their global research and development and off-shoring centers in India.

The project is based on the concept of a walk-to-work culture. The project would house commercial corporate space integrated with upscale residential facilities, entertainment venues, retail shops, healthcare centers, hotels and restaurants. The project is planned as a community that allows people to live, work, shop, learn and enjoy leisure and recreational activities in a green environment.

Exhibit 24: Revenue model of Lanco's IT park, March fiscal year-ends, 2007-2012E (Rs mn)

	2007E	2008E	2009E	2010E	2011E
Housing					
Housing volumes (mn sq ft)		0.9	2.2	3.2	3.2
Revenues		2,751	7,203	11,304	11,254
Rate (Rs/sq ft)		3,236	3,350	3,566	3,484
Commercial					
Commercial volumes (mn sq ft)		—	0.9	2.8	3.7
Revenues		—	3,423	10,268	13,690
Rate (Rs/sq ft)		—	3,700	3,700	3,700
IT Amenities & Retail					
Retail volumes (mn sq ft)		—	—	1.7	1.7
Revenues		—	—	9,490	9,490
Rate (Rs/sq ft)		—	—	5,582	5,582
Revenue from real estate		**2,751**	**10,626**	**31,062**	**34,434**
Revenues		**2,751**	**10,626**	**31,062**	**34,434**
growth (%)			286	192	11
Revenue mix (%)					
Housing		100.0	67.8	36.4	32.7
Commercial		—	32.2	33.1	39.8
Retail		—	—	30.6	27.6
Total		**100**	**100**	**100**	**100**

Source: Company data, Kotak Institutional Equities estimates.

The consolidated balance sheet on LITL consolidates the power sector subsidiaries for the first time in FY2007 (see Exhibit 25).

Exhibit 25: Consolidated balance sheet, March fiscal year-ends, 2006-2012E (Rs mn)

	2006	2007E	2008E	2009E	2010E	2011E	2012E
Fixed assets - net	**409**	**34,019**	**74,052**	**122,282**	**143,295**	**140,694**	**132,487**
Investments	1,015	28	28	28	28	28	28
Miscellaneous expenses not w/o	—	7	7	7	7	7	7
Current assets	2,678	19,602	25,458	35,659	38,795	52,098	61,995
Cash & bank balances	414	11,511	5,764	3,874	8,236	33,038	42,067
Other current assets	2,264	8,091	19,694	31,784	30,559	19,060	19,928
Current liabilities	(1,581)	(2,681)	(7,403)	(10,858)	(6,120)	(5,471)	(5,136)
Net current assets	**1,097**	**16,921**	**18,054**	**24,800**	**32,674**	**46,627**	**56,859**
Utilization of funds	**2,521**	**50,976**	**92,141**	**147,117**	**176,004**	**187,356**	**189,381**
Total debt	**1,398**	**30,096**	**65,892**	**112,047**	**123,300**	**117,174**	**109,342**
Paid-up common stock	308	2,224	2,224	2,224	2,224	2,224	2,224
Reserves and surplus	647	2,539	5,645	11,179	23,760	38,387	46,718
Shareholders' funds	**954**	**16683**	**19,789**	**25,323**	**37,903**	**52,530**	**60,861**
Def. tax liability	31	—	—	—	—	—	—
Minority interest	138	4,197	6,460	9,747	14,801	17,652	19,178
Source of funds	**2,521**	**50,976**	**92,141**	**147,117**	**176,004**	**187,356**	**189,381**
Ratios (%)							
Net debt/ equity	90.1	89.0	229.1	308.5	218.3	119.9	84.1
Pre-tax ROCE	7.8	13.9	8.0	10.0	15.0	17.4	12.5
Return on equity	19.7	21.9	17.0	24.5	39.8	32.3	14.7
Book value per share (Rs)	31.0	75.0	89.0	113.9	170.5	236.2	273.7

Source: Company data, Kotak Institutional Equities estimates.

We have not assumed any dividend flows from subsidiaries to LITL, which will likely result in cash leakage due to dividend taxation. However, we have adjusted for this loss in our valuation.

Exhibit 26: Consolidated cash flows statement, March fiscal year-ends, 2006-2012E (Rs mn)

	2006	2007E	2008E	2009E	2010E	2011E	2012E
Operational cashflows							
Earnings before tax	125	2,876	4,967	9,380	19,610	21,903	11,298
less taxes paid	(40)	(417)	(1,079)	(2,165)	(3,058)	(2,655)	(1,441)
plus depreciation	19	870	905	2,484	3,548	6,890	8,487
decrease / (increase) in working capital	(230)	(4,727)	(6,881)	(8,635)	(3,513)	10,849	(1,202)
Total operational cashflow	**(126)**	**(1,398)**	**(2,087)**	**1,063**	**16,587**	**36,987**	**17,142**
Investment cashflow							
(Additions) / disposals of fixed assets	(211)	(34,481)	(40,937)	(50,714)	(24,561)	(4,290)	(280)
deer / (incr) in intangibles & capitalised assets	—	(7)	—	—	—	—	—
decr / (incr) in investments and advances	(419)	987	—	—	—	—	—
Add Others	175	—	—	22	51	(1,842)	—
Total investment cashflow	**(454)**	**(33,501)**	**(40,937)**	**(50,692)**	**(24,510)**	**(6,132)**	**(280)**
Financing cashflow							
incr / (decr) in other long term liabilities	—	—	—	—	—	—	—
incr / (decr) in common shares	231	1,916	—	—	—	—	—
incr / (decr) in share premium/Other reserves	(231)	11,885	—	—	—	—	—
less dividends paid	—	—	—	—	—	—	—
incr / (decr) in minority interest flows	—	1,097	1,481	1,584	1,032	72	—
incr / (decr) in debt	635	28,698	35,796	46,155	11,253	(6,126)	(7,832)
Total financing cashflow	**635**	**43,596**	**37,277**	**47,739**	**12,284**	**(6,054)**	**(7,832)**
Net cashflow	**54**	**8,697**	**(5,748)**	**(1,889)**	**4,361**	**24,802**	**9,029**
Cash at beginning of year	359	414	11,511	5,764	3,874	8,236	33,038
Cash at end of year	414	11,511	5,764	3,874	8,236	33,038	42,067

Source: Company data, Kotak Institutional Equities estimates.

Company profile: Building power and infrastructure

Lanco Infratech Limited (LITL) is an engineering, construction company with interests in power, construction and property development. Building on its expertise in project execution and construction, LITL forayed into power generation and property development. LITL has power generation capacity of 518 MW under operation, 1,705 MW under implementation and 5,595 MW in the process of achieving financial closure in FY2008. LITL is developing 20.5 mn sq ft of saleable area in Hyderabad.

Investments in power business—capturing the opportunities coming up

LITL currently has five operational power projects with an attributable capacity of 307 MW (project capacity of 518 MW). Exhibit 27 gives a brief snapshot of these projects. While an associate company Genting Lanco India Private Limited (GLIPL) is responsible for the O&M of the Lanco Kondapalli plant, LITL does the O&M for the other existing and future projects.

Exhibit 27: Operational power generation capacity of 518 MW (attributable 307 MW)
Investments in power business

	Lanco Kondapalli	Aban Power	Clarion	Rithwik	Windmills
Capacity (MW)	368	120	12	6	11.75 (3+8.75)
Ownership interest (%)	59	51	97	89	100
Attributable capacity (MW)	217	61	12	5	12
Fuel and source / Location	Natural gas - GAIL	Natural gas - GAIL	Biomass	Biomass	Wind/ Karnataka & TN
Date of commercial operation (COD)	Oct-00	Aug-05	Feb-04	Sep-02	Mar-2002/Sept-2006
Off-taker	APTRANSCO	TNEB	APTRANSCO	APTRANSCO	KPTCL/TNEB
Term of PPA	15 years from COD	15 years from COD	20 years from COD	20 years from COD	20 years from COD
Approved capital cost (Rs bn)	10.9	4.3	0.5	0.3	0.6
Means of finance (Debt: Equity)	70:30	70:30	70:30	70:30	57:43/75:25

Source: Company.

LITL is implementing power projects with an attributable capacity of 1,288 MW (project capacity of 1,705 MW) for which financial closure has been achieved. These projects give LITL the desired diversification in terms of customer profile and fuel dependence in the power generation business (see Exhibit 28).

Exhibit 28: Financial closure achieved for 1,705 MW (attributable 1,288 MW)
Investments in power business

	Lanco Amarkantak I	Lanco Amarkantak II	Lanco Green Power	Vamshi Industrial	Vamshi Hydro	Nagajuna Power I	Nagajuna Power II
Capacity (MW)	300	300	70	10	10	508	508
Ownership interest (%)	76	76	90	91	91	74	74
Attributable capacity (MW)	228	228	63	9	9	376	376
Location	Coal - Coal India	Coal - Coal India	Himachal Pradesh	Himachal Pradesh	Himachal Pradesh	Karnataka	Karnataka
Date of commercial operation (COD)	April-2008*	Jan-2009*	July-2008*	April-2008*	April-2008*	Jan-2010*	April-2010*
Off-taker	PTC/MPSEB	PTC/HPGCL	PTC/HPGCL	HPSEB	HPSEB	Karnataka Discoms/PSEB	Karnataka Discoms/PSEB
Term of PPA	25 years from COD	25 years from COD	35 years from COD	35 years from COD	35 years from COD	25 years from COD	25 years from COD
Approved capital cost (Rs bn)	12.9	13.4	4.2	0.58	0.56	21.75	21.75
Means of finance (Debt: Equity)	80:20	80:20	80:20	75:25	75:25	80:20	80:20

Source: Company.

Additionally LITL is pursuing projects with attributable capacity of 3,499 MW (project capacity of 5,580 MW) for which financial closure will likely be achieved in FY2008. These include 500 MW Teesta VI hydro project in Sikkim, 120 MW of hydro projects in Uttarachal and 1,000 MW coal-based Anpara C project in Uttar Pradesh and the 3,960 MW Sasan UMPP.

Exhibit 29: Financial closure of additional 5,595 MW (3,513 MW) likely in FY2008
Investments in power business

	Lanco Energy	Lanco Hydro	Anpara C	Sasan
Capacity (MW)	500	120	1,000	3,960
Ownership interest (%)	74	91	100	51
Attributable capacity (MW)	370	109	1,000	2,020
Location	Sikkim	Uttaranchal	Uttar Pradesh	Madhya Pradesh
Date of commercial operation (COD)	Apr-2011*	April-2010*	Oct-2010*	Mar-2011*
Off-taker	Maharashtra Discom#	$	UP Discoms#	7 states
Term of PPA	35 years from COD		29 years from PPA signing	25 years from COD
Approved capital cost (Rs bn)	30.0	7.2	40.0	138.6
Means of finance (Debt: Equity)	80:20	80:20	80:20	80:20
Expected financial closure	Mar-07	Sep-07	Nov-07	Mar-08

* Expected date of commissioning
# PPA to be signed/approved by regulator
$ Merchant power plant

Source: Company.

Kick-starting the power trading business

LITL commenced power trading in January 2006, through its 100% subsidiary—Lanco Electric Utility Limited (LEUL). LEUL is one of the few players with a Category 'F' trading license, thereby it does not have any limits for trading power.

Foray in real estate, property development and other infrastructure projects

LITL is developing 19.5 mn sq ft of saleable area in an integrated IT park in Hyderabad. The project spread over 100 acres was awarded to the company by Andhra Pradesh Industrial Infrastructure corporation (APIIC) after competitive bidding.

The company has also won the bid for a Rs5.7 bn, 80 km toll road project in Karnataka. The project enjoys a positive grant of Rs2 bn and a concession of 20 years including construction period.

Construction business – the backbone of LITL

In-house project execution and construction has enabled LITL to execute power projects (and real estate and infrastructure projects in the future) at low capital cost. LITL has experience in constructing several power projects, water supply works and commercial and residential building complexes. LITL's strength lies in the execution of civil construction contracts while it sub-contracts the engineering portion of work in power EPC contracts.

Other group companies

Lanco Global Systems Limited (Rs32, Mkt.cap: Rs0.67 bn): The company, established in 1999, provides offshore and onshore (through Lanco Global Systems Inc.) IT solutions to global customers. With more than 500 employees on roll, the company provides IT services in data warehousing and business intelligence solutions; ERP solutions and services; application development and maintenance; and optimized offshore solutions framework. The company recorded a net profit of Rs18.4 mn on a turnover of Rs356.3 mn in FY2006.

Lanco Industries (Rs41, Mkt.cap: Rs1.42 bn): Lanco Industries is now controlled and managed by Electrosteel Castings Limited. The company has an installed capacity of 120,000 tpa of Ductile Iron spun pipes. The company is backward integrated with facilities for manufacturing pig iron and metallurgical coke (installed capacity of 150,000 tpa each). During FY2006, the company achieved revenues of Rs3.03 bn and a net profit of Rs0.04 bn.

Annexure I: Power projects

Lanco Kondapalli

Lanco Kondapalli's 368 MW natural gas-based power plant commenced commercial operations in October 2000. The plant supplies electricity to APPCC (earlier APTRANSCO) under a 15-year PPA. The project was awarded after International Competitive Bidding (ICB) and the tariff plan reimburses variable costs (fuel) based on normative parameters and fixed costs as fixed per unit charges up to 80% plant availability. The O&M for the power plant is taken care by Genting Lanco India Private Limited (GLIPL), a 26-74 JV of Lanco with Genting.

Exhibit 30: Profile of Lanco Kondapalli Power Private Limited

Project size (MW)	368	Fuel supply	Natural gas from KG basin supplied by GAIL
CoD	Oct-00	Power evacuation	15-yr PPA with APPCC (APTRANSCO)
Project cost (Rs bn)	10.9	Tariff structure	
per MW capital cost (Rs mn)	29.7	Foreign Debt Service Charge (FDSC) - US$/unit	0.01628 up to 12 years of CoD
Project funding		Other Fixed Charges (OFC) - Rs/unit	0.4776
Equity (Rs bn)	3.4	Fuel cost recovery based on normative parameters	
Debt (Rs bn)	7.5		
Equity holding pattern (%)		Incentive structure	
Lanco Infratech	59	Base PAF for reimbursement of full fixed charges	80%
Doosan, South Korea	11	Incentives	varies from 2-25% of OFC for PLF more than 80%
Genting, Malaysia	30	Disincentives	varies from 2-46% of OFC for PAF less than 68.5%

Source: Company, Kotak Institutional Equities estimates.

Lowest capital cost

We note the Lanco Kondapalli's power plant benefits from being the lowest capital cost (per MW) gas based IPP commissioned in Andhra Pradesh. Low capital cost enables the company to earn decent profits and cash flows despite operating at low PLF due to short supply of natural gas.

Flat charges for fixed costs ensure that the profits and cash flows of the company progressively keep on increasing as debt is paid off. Improvement in PLF and consequent recovery of incentives results in improvement in FCFE from FY2009 (see Exhibit 31). We have assumed low PLF till FY2008 in view of the shortfall in gas supplies and expect sufficient gas to be made available in FY2009 only. The estimated profit numbers are depressed as the company uses a high depreciation rate to write off the assets over the first 10 years of operation.

Differences with APPCC (earlier APTRANSCO)

The plant, initially set up to run with Naphtha, was modified in 2001 to run with natural gas at a cost of Rs350 mn with no additional cost recovery in tariffs. During FY2006, APPCC raised claim for liquidated damages of Rs951.6 mn towards delay in completion of the project after five years of commissioning and adjusted power supply dues to the extent of Rs480.7 mn towards the claim. Lanco Kondapalli has obtained a stay order from the AP High Court and the amount is shown as receivables in the balance sheet. We note that the delay in project implementation was due to the reconfiguration of the power plant to run on natural gas too.

Exhibit 31: Healthy cash flows—likely to step up on improved availability of gas
Key assumptions for Lanco Kondapalli—368 MW gas based power project , March fiscal year-ends, 2005-2011E (Rs mn)

	2005	2006	2007E	2008E	2009E	2010E	2011E
Plant Availability Factor (PAF) %	**94.3**	**96.7**	**90.0**	**90.0**	**90.0**	**90.0**	**90.0**
Plant Load Factor (PLF) %	**71.6**	**67.2**	**52.0**	**52.0**	**85.0**	**85.0**	**85.0**
Gross generation (mn units)	2,307	2,167	1,677	1,677	2,741	2,741	2,741
Share of gas in gross generation (%)	**99.9**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Auxiliary consumption (%)	2.4	2.6	2.7	2.7	2.7	2.7	2.7
Net generation (mn units)	2,251	2,112	1,632	1,632	2,667	2,667	2,667
Tariff rate (Rs/unit)	2.6	2.7	3.2	3.3	2.6	2.6	2.7
Actual station heat rate (kcal/kwh)	1,985	2,008	2,050	2,050	1,900	1,900	1,900
Actual O& M costs (as % of capital cost)	4.2	4.4	6.0	6.1	4.9	5.1	5.4
Normative station heat rate (kcal/kwh)		1,900	Used for fuel cost reimbursement				
Normative auxiliary consumption (%)		3.0					
Net revenues	**5,597**	**5,558**	**5,147**	**5,220**	**6,692**	**6,811**	**6,934**
EBITDA	2,431	2,352	2,285	2,271	2,595	2,586	2,576
EBITDA margin (%)	43.4	42.3	44.4	43.5	38.8	38.0	37.2
PBT	1,075	1,167	1,084	1,181	1,636	1,774	1,913
PAT	**1,077**	**1,068**	**962**	**1,047**	**1,451**	**1,573**	**1,696**
Free cash flow to equity (FCFE)	**636**	**901**	**452**	**998**	**1,198**	**1,374**	**1,577**

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 32: Key issues for Lanco Kondapalli Power Private Limited

Change in forex rates (on interest and debt repayment) get neutralized with fixed rate charges in US$.	+
Payment security in the form of Escrow mechanism and State Government guarantee. LC envisaged in the PPA has not been opened.	+
Fixed cost recovery is based on Plant Availability - reduction in natural gas supplies by GAIL therefore not a major concern.	+
Less exposed to increasing interest rates - only 39% of debt is on floating rate of interest.	+
Long term service agreement and assured parts supply agreement with GE Energy.	+
Expected PLF of 65-70% in FY2008 in view of gas shortage in KG basin - loss of incentives.	—

Source: Company, Kotak Institutional Equities estimates.

Availability of natural gas likely to remain a constraint in the near-term

Availability of natural gas will likely remain a concern for Lanco Kondapalli plant over the next 18 months. Current gas supply is being rationed on a proportionate allocation basis (see Exhibit 33).

Exhibit 33: Current supply is broadly rationed on a proportionate allocation basis
Current demand and availability scenario of natural gas in Andhra Pradesh (mcmd)

Consumer Power	Capacity (MW)	Firm	Fallback	Total	Achievable PLF with firm allocation (%)	(Apr-Jan) PLF (%)	Jan 2007 PLF (%)
AP Gas Power Corp. Ltd.	272	1.22	0.10	1.32	90%	64%	57%
GVK	216	0.90	0.15	1.05	79%	60%	53%
Spectrum Power	208	0.90	0.15	1.05	86%	57%	56%
Lanco Kondapalli	368	1.46	0.29	1.75	80%	50%	67%
Reliance Energy	220	0.64	0.36	1.00	58%	47%	46%
Vathsasa Power	NA	0.07		0.07			
Total		**5.19**	**1.05**	**6.24**			
Nagarjuna Fertilizer Corp. Ltd.		**2.14**	**0.61**	**2.75**			
Other small consumers		**0.34**	**0.39**	**0.73**			
Total		**7.66**	**2.05**	**9.71**			

Source: Infraline, CEA, Industry.

As the new gas supplies are expected to flow to the new generation projects, we estimate sub-optimal operation during the next 15-18 months. Power generation capacity of about 1,500 MW has been recently completed/nearing completion in Andhra Pradesh for which 6.7 mmscmd gas is required. Incremental supplies of 5.7 mmscmd from ONGC and Ravva fields will likely be used for these new capacities.

Significant discoveries of gas reserves in the KG Basin suggest that gas supply concerns will likely remain for about 18-24 months.

Exhibit 34: Natural gas reserves and current production in Andhra Pradesh

	Reserves (bcm)
ONGC	
Onshore	42.3
Offshore	28.8
Total	71.0
Private/JV companies	
Offshore	386.0
Grand total	**457.0**

	Production	(mcmd)
ONGC (Onshore)	Jan-07	4.1
Cairn (Ravva)	Jun-06	2.1
Total		**6.2**

Note:

Private/JV reserves include 323 bcm of Reliance discoveries of Dhirubhai-1 & 3 fields that have been declared commercial

Source: Ministry of petroleum & natural gas, Cairn Energy Plc., Infraline.

Aban Power

Aban Power's 120 MW natural gas-based power plant commenced commercial operation in August 2005. The plant supplies electricity to Tamil Nadu Electricity Board (TNEB) under a 15-year PPA. The project was awarded after International Competitive Bidding (ICB) and the tariff plan reimburses variable costs (fuel) based on normative parameters and fixed costs as fixed charges on per unit of electricity delivered basis.

Exhibit 35: Profile of Aban Power Company Limited

Project size (MW)	120
CoD	Aug-05
Project cost (Rs bn)	4.3
per MW capital cost (Rs mn)	35.8
Project funding	
Equity (Rs bn)	1.32
Debt (Rs bn)	2.98
Equity holding pattern (%)	
Lanco Infratech	51
Genting, Malaysia	36
Aban Chiles	13

Fuel supply	Natural gas from Cauveri basin supplied by GAIL
Power evacuation	15-yr PPA with TNEB
Tariff structure	
Foreign Debt Service Charge (FDSC) - US$/unit	0.00251
Foreign Equity Return Charge (FERC) - US$/unit	varies between 0.00405 to 0.00686
Other Fixed Charges (OFC) - Rs/unit	varies between 0.70453 to 1.173887
Fuel cost recovery based on normative parameters	
Incentive structure	
Base PLF for reimbursement of full fixed charges	85%
Incentives	@ Rs0.50/unit for units delivered above 85% PLF
Disincentives	Prorata reduction in fixed charges for lower PLF

Source: Company, Kotak Institutional Equities estimates.

Running on full gas (and steam)

With natural gas availability not a constraint in the Cauvery basin, we expect the power plant to run at the optimum capacity utilization level of 85% and earn full fixed charges. However, PLF lower than 85% will result in under-recovery of fixed charges, as there are linked to actual generation and not plant availability. We estimate strong FCFE generation (over 30% from FY2007 onwards) as the company also benefits from better-than-normative operational parameters (auxiliary consumption). The estimated profit numbers are depressed as the company uses a high depreciation rate to write off its assets in the first 10 years of operation.

Exhibit 36: Tariff structure ensures a healthy cash flow generation on achieving optimum PLF (~85%)
Key assumptions for Aban Power—120 MW gas based power project, March fiscal year-ends (Rs mn)

	2006	2007E	2008E	2009E	2010E	2011E
Plant Availability Factor (PAF) %	**96.6**	**90.0**	**90.0**	**90.0**	**90.0**	**90.0**
Plant Load Factor (PLF) %	**84.0**	**80.0**	**85.0**	**85.0**	**85.0**	**85.0**
Gross generation (mn units)	564	841	894	894	894	894
Auxiliary consumption (%)	5.0	5.5	5.0	5.0	5.0	5.0
Net generation (mn units)	536	795	849	849	849	849
Tariff rate (Rs/unit)	1.9	2.3	2.5	2.4	2.4	2.4
Actual station heat rate (kcal/kwh)	1,790	1,830	1,830	1,830	1,830	1,830
Actual O& M costs (as % of capital cost)	4.7	4.7	4.9	5.1	5.3	5.5
Normative station heat rate (kcal/kwh)	1,830	Used for fuel cost reimbursement				
Normative auxiliary consumption (%)	5.5					
Net revenues	**979**	**1,773**	**2,034**	**2,016**	**2,000**	**1,985**
EBITDA	402	867	1,054	1,005	955	907
EBITDA margin (%)	41.1	48.9	51.8	49.8	47.8	45.7
PBT	37	292	523	526	528	532
PAT	**34**	**259**	**464**	**466**	**469**	**472**
Free cash flow to equity (FCFE)	**(15)**	**245**	**423**	**422**	**399**	**377**

Source: Company data, Kotak Institutional Equities estimates.

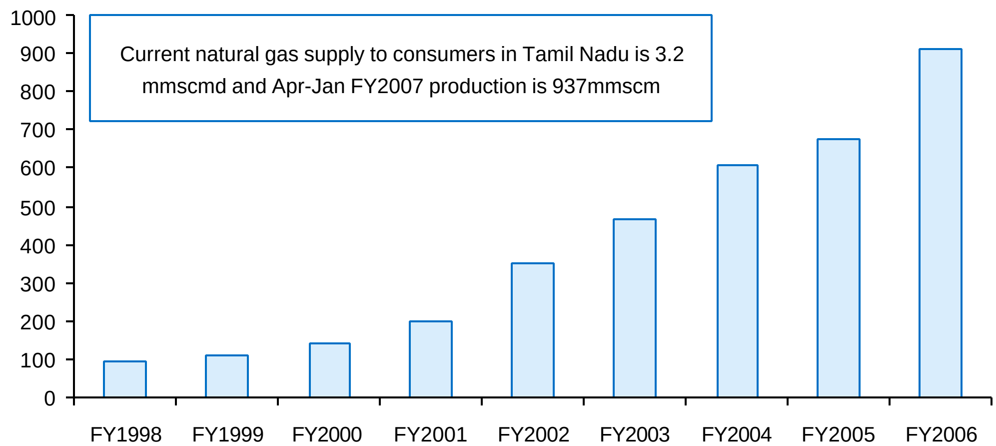
Exhibit 37: Key issues for Aban Power Company Limited

Change in forex rates (on interest and debt repayment) get neutralized with fixed rate charges in US$.	+
Payment security in the form of LC and right to third party sale.	+
Exposed to increase in interest rates on project loans.	—
No recompense for any reduction in natural gas supplies by GAIL. The Fuel Supply Agreement with GAIL is for 10 years.	—
The power plant does not have multi-fuel capability and is therefore critically dependent on natural gas availability.	—

Source: Company, Kotak Institutional Equities estimates.

Sufficient natural gas available for smooth operations

Exhibit 38: Production of natural gas by ONGC in Tamil Nadu has been increasing
Natural gas production, March fiscal year-ends, 1998-2006, gross (mcm)



Source: Infraline.

Exhibit 39: Power sector is the main consumer of natural gas from Cauvery basin
Allocation of natural gas from Cauvery basin

	Installed capacity (MW)	Gas requirement at 80% PLF (mmscmd)
Power plants getting natural gas from Cauvery basin		
Karaikal CCGT	33	
Naimanam GT	10	
Kuttalam CCGT	100	
Valantharvi CCGT	38	
Aban Power (Karuppur)	120	
Total	**301**	**1.1**
Other gas based power plants in the region		
Kovilkalappal CCGT	107	
Valuthur CCGT	94	
Basin Bridge	120	
P Nallur CCGT	331	
Total	**652**	**2.5**

Note: Other projects are dependent on alternate fuels (naphtha) or have gas allocation from other fields - PY 1, Ramanathapuram etc.

Source: CEA, Infraline, Company data, Kotak Institutional Equities estimates.

Biomass-based power projects

LITL has promoted two power projects which use biomass as the primary fuel – 12 MW under Clarion Power and 6 MW under Rithwik Power. The company has entered into PPAs with APTRANSCO for 20 years for sale of generated power. During December 2006, LITL increased its stake in Clarion to 97% (from 86% previously) and Rithwik to 89% (from 57% previously) by acquiring the stake from other group companies at book value.

Using biomass as the primary fuel

Both power plants use agricultural waste, including juliflora, rice husk and groundnut shells as fuel. Fuel required for the power plant is procured from farms in nearby villages. For securing the supply of fuel, the company is actively pursuing captive farming, whereby the company provides seedling and other required assistance to farmers.
The company has thus far developed the captive farming of 5,000 acres of land.

Exhibit 40: Profile of biomass-based power projects

	Clarion	Rithwik		
Project size (MW)	12	6	Fuel supply	Biomass collected from nearby areas
CoD	Feb-04	Sep-02	Power evacuation	20-yr PPA with APTRANSCO
Project cost (Rs bn)	0.5	0.3	Tariff structure	
per MW capital cost (Rs mn)	40.1	45.5	Rs3.48/unit escalated at 5% p.a.; changed to specific annual tariff rates later announced by APERC	
Project funding			While the High Court has ruled in favor of the company restoring the original tariff rates, APTRANSCO has appealed in the Supreme Court; Current billing as per APERC specified rates	
Equity (Rs bn)	0.1	0.1		
Debt (Rs bn)	0.3	0.2		
Equity holding pattern (%)			Incentive structure	
Lanco Infratech	97	89	Incentives	@ Rs0.25/unit for units delivered above 80% PLF
Others	3	11		

Source: Company, Kotak Institutional Equities estimates.

Resolution of tariff dispute critical

We estimate healthy cash generation by these projects on realization of the original tariffs (Rs3.48/unit in FY2005 and 5% p.a. escalation thereon). However, these plants are currently making only marginal profits on account of lower realizations from APTRANSCO as per the tariffs determined by APERC. The FCFE of the two projects has been negative till FY2006 (see Exhibit 41) due to the build-up of receivables from the differential in the two tariffs. The High Court ruled in favor of the company restoring the original tariffs, but APTRANSCO has appealed to the Supreme Court against the order. The profitability has also been impacted by the rising cost of collecting biomass (due to increased transportation costs). The revenues for FY2007 onwards are being recognized on actual realized tariffs from APTRANSCO.

Cash inflow from Certified Emission Reductions (CERs)

Additional income and cash flows from the sale of CERs will likely improve the IRRs of the project. Together, the two projects are capable of generating 66,000 CERs per annum for seven years from CoD. During FY2007, the two companies together sold about 97,000 CERs at €23.69/CER to realize about Rs140 mn. These CERs pertained to emission reductions till FY2005 and the companies are holding the CERs for FY2006. The Clean Development Mechanism (CDM) requires the validation of actual savings each year before the CERs are issued. We have assumed annual sale of CERs at €10/ CER for our estimates to contribute about Rs36 mn/year.

Exhibit 41: Revenue recognition from FY2007 as per realized tariffs
Key assumptions for biomass based power project, March fiscal year-ends, 2005-2011E (Rs mn)

	2005	2006	2007E	2008E	2009E	2010E	2011E
Plant Load Factor (PLF) %	**63.4**	**62.0**	**66.7**	**66.7**	**66.7**	**66.7**	**66.7**
Gross generation (mn units)	100	98	105	105	105	105	105
Auxiliary consumption (%)	11.0	11.4	11.0	11.0	11.0	11.0	11.0
Net generation (mn units)	89	87	94	94	94	94	94
Tariff rate (Rs/unit)	**3.48**	**3.51**	**4.68**	**3.59**	**3.60**	**3.62**	**3.63**
Net revenues	**310**	**304**	**438**	**336**	**337**	**339**	**340**
EBITDA	102	104	236	132	131	130	129
EBITDA margin (%)	32.8	34.1	54.0	39.3	38.9	38.5	38.0
PBT	(13)	1	131	30	36	41	46
PAT	**(14)**	**1**	**117**	**27**	**32**	**36**	**41**
Free cash flow to equity (FCFE)	**(79)**	**(90)**	**126**	**19**	**24**	**29**	**34**

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 42: Key issues for biomass-based power projects

Firm offtake by APTRANSCO.	+
Environment friendly projects also eligible for Certified Emission Reduction (CER) credits under the CDM.	+
Uncertainty on tariffs - APERC tariffs are much lower than earlier contracted flat tariff. High Court has however ruled in favor of the company restoring the original tariffs.	—
Increasing cost of collecting fuel (biomass) may impact the profitability of the projects.	—

Source: Company, Kotak Institutional Equities estimates.

Lanco Amarkantak

Lanco Amarkantak Power Private Ltd. is in the process of implementing 600 MW of a coal-based power project in the coal-rich state of Chhattisgarh. With all the requisite approvals/tie-ups largely in place, the company is likely to start commercial production for Phase I (300 MW) by April 2008 and for Phase II (300 MW) by January 2009. The company intends to expand capacity to 1,200 MW by FY2010. This is, however, primarily dependent upon the company getting coal mining rights (it has made the necessary applications).

Exhibit 43: Profile of Lanco Amarkantak Power Pvt. Limited

	Phase I	Phase II		
Project size (MW)	600 (300*2)		Fuel supply	Coal linkage of 3 mn MT p.a. from Coal India Ltd.
CoD	Apr-08	Jan-09	Power evacuation	25-yr PPA with PTC India
Project cost (Rs bn)	12.9	13.4	Tariff structure (tailored around CERC tariff guidelines)	
per MW capital cost (Rs mn)	43.0	44.7	14% assured ROE for full term of PPA	
Project funding			Fuel cost recovery based on normative parameters - 5% CAGR inflation built in	
Equity (Rs bn)	2.6	2.7	Levelised tariff cap for 1 to 12 years	Phase I:Rs2.18; Phase II:Rs2.25
Subordinate debt (Rs bn)*	1.3	1.3	Levelised tariff cap for 1 to 25 years	Phase I:Rs2.20; Phase II:Rs2.34
Debt (Rs bn)	9.0	9.4		
Equity holding pattern (%)			Incentive structure	
Lanco Infratech	76 (proposed)		Base PLF for reimbursement of full fixed charges	80%
Others	24		Incentives	@ Rs0.25/unit for units delivered above 80% PLF
			Disincentives	Prorata reduction in fixed charges for lower PLF
Project status				
Financial closure	Sep-05	Jul-06		
Project input				
Land	Acquired	Acquired for main plant area		
Water	Alloted	Applied for		
Environmental clearance	Received			
EPC Contract	Awarded to Zelan Project Pvt. Ltd.			
BTG Contract	Dong Fang			
Civil Contract	Awarded to Lanco Infratech			

* Option for lender to convert into equity within 36 months of COD

Source: Company, Kotak Institutional Equities estimates.

We expect FCFe yield of about 20% when both the phases start commercial production. We expect the company to achieve higher-than-assured RoE by achieving better heat rate norms (2,400 kcal/unit vs. norm of 2,500 kcal/unit). We assume coal prices to map the projected 5% CAGR inflationary trend. Any variance however, will influence project profitability. The estimated profit numbers are depressed as the company uses a high depreciation rate to write off the assets over 15 years (and match debt repayment obligations) instead of the CERC defined 25 years.

Exhibit 44: Stable cash flows expected under the CERC formula determined tariffs
Key assumptions & summary financials for Lanco Amarkantak Phase I & II, March fiscal year-ends, 2009-2012E (Rs mn)

	2009E	2010E	2011E
PLF %			
Phase I (COD April 2008)	84	84	84
Phase II (COD Jan 2009)	84	84	84
Net generation (mn units)			
Phase I	2,008	2,008	2,008
Phase II	552	2,206	2,206
Total	**2,559**	**4,214**	**4,214**
Actual station heat rate (kcal/kwh)	2,400	2,400	2,400
Actual auxiliary consumption (%)	9.0	9.0	9.0
Normative station heat rate (kcal/kwh)	2,500	Used for fuel cost	
Normative auxiliary consumption (%)	9%	reimbursement	
Delivered cost of coal (Rs/MT)			
Phase I & II	914	957	1,002
Normtive cost of coal (Rs/MT)			
Phase I & II	914	957	1,002
Tariff (Rs/kwh)			
Phase I	1.97	2.20	2.21
Phase II	1.96	2.23	2.28
Net revenues	**4,847**	**8,712**	**8,829**
EBITDA	2,614	4,976	4,921
EBITDA margin (%)	53.9	57.1	55.7
PBT	767	1,249	1,279
PAT	**680**	**1,107**	**1,080**
Free cash flow to equity (FCFE)	**208**	**919**	**1,044**
FCF to equity yield on invested equity (%)		17.5	19.9

Source: Kotak Institutional Equities estimates.

PPA with PTC provides for a tariff cap

The term of the Power Purchase Agreement (PPA) is 25 years from the COD of the project.

- The company is obliged to begin commercial operation of the project within a period of 36 months from the date of financial closure. Any failure by the company to achieve the COD or any delay in the COD being caused due to Power Trading Corporation (PTC) shall be quantified and an appropriate reduction (rebate) enhancement (surcharge) or shall be effected to the tariff payments over the term of the PPA.

- The tariff payable under the terms of the PPA is based on two methodologies:
  (a) The tariff as obtained by following the CERC norms and as approved by the appropriate commission; and (b) a capped tariff rate equal to the cumulative of the levelised tariff for the first twelve years at the rate of Rs2.18/kwh for phase I and Rs2.25/kwh for phase II and over the term of the agreement at the rate of Rs2.20/kwh (increases to Rs2.25/kwh if inflation in coal prices is more than 5% pa) for phase I and Rs2.34/kwh for phase II. The actual tariff payable will be lower of the value calculated by the two methodologies.

- The PPA contains provisions regarding ‘change in law’ although in a limited manner, since it protects the company only in respect of any increase in corporate income tax and any change in taxes, duties by the government. Increase in corporate income tax or any other tax, duties by the government is a pass-through in the event of its impact on tariff being more than 1%.

Exhibit 45: Key issues for Lanco Amarkantak Power Pvt. Limited

Firm offtake by PTC.	+
Tariff caps limit pass through of fuel price inflation to a CAGR of 5% pa (some additional benefit for Phase I).	—
Tariff caps limit pass through of increase in interest expense as interest rate is floating.	—
Depends on South Eastern Coal Field Limited (a subsidiary of Coal India Limited) for supply of coal.	—

Source: Company, Kotak Institutional Equities estimates.

Lanco Green Power

Lanco Green Power is implementing the 70 MW run-of-the-river hydropower project across Budhil Nallah in Chamba district of Himachal Pradesh (HP). The company has signed the implementation agreement with the HP government for a period of 40 years after which the project will be transferred to the state government free of charge. HPSEB has given the Techno Economic Clearance for the project and the company has entered into a PPA with PTC to sell the generated power for 35 years under CERC formula based tariffs. The project is expected to commission by July 2008.

Exhibit 46: Profile of Lanco Green Power Private Limited

Project size (MW)	70
CoD (expected)	Jul-08
Financial closure	Mar-06
Project cost (Rs bn)	4.2
per MW capital cost (Rs mn)	59.9
Project funding	
Equity (Rs bn)	0.8
Debt (Rs bn)	3.4
Equity holding pattern (%)	
Lanco Infratech	90
SMEC Holdings Ltd.	10

Project inputs	
Land acquisition	Received Right of Utilization from MoEF
Environmental clearances	Necessary approvals in place
Project cost appraisal	CEA approval not needed
Contract for civil works	Lanco Infratech Limited
Electromechanical equipment	Dong Fang for generator
Contract for transmission line	PGCIL
Free power commitment	12% for first 12 years, 18% thereafter
Power evacuation	35-yr PPA with PTC
Tariff structure	
Based on CERC norms with a levelized tariff of Rs2.21/unit (upper cap for tariff fixed for each year)	
Incentive structure	
Based on CERC norms on Secondary Energy	

Source: Company, Kotak Institutional Equities estimates.

Aiming for timely project execution

We note that the targeted project implementation within two years of financial closure (achieved in March 2006) for a hydro project will test the company's project management and execution skills. Implementation of hydro project in India is typically associated with time and cost overruns.

Implementation within the stated period will likely ensure strong free cash flow generation with stable cash yields of 18%. We assume a PLF of 59%, resulting in the secondary sale of electricity. We estimate the company's annual sales at 273 mn units of primary energy (defined at 90% dependable year) and 44 mn units of secondary energy. The estimated profit numbers are depressed as the company uses a high depreciation rate to write off the assets over 15 years (and match debt repayment obligations) instead of the CERC defined 35 years.

Exhibit 47: Short implementation period is the key to profits for hydro power plants
Key assumptions for Lanco Green Power—70 MW hydro power project, March fiscal year-ends, 2009-11E (Rs mn)

	2009E	2010E	2011E
Plant Availability Factor (PAF) %	**90.0**	**95.0**	**95.0**
Plant Load Factor (PLF) %	**59.3**	**59.3**	**59.3**
Gross generation (mn units)	272	363	363
Auxiliary consumption and other losses (%)	0.9	0.9	0.9
Net generation (mn units)	270	360	360
Free energy supplied to state (mn units)	32	43	43
Primary energy sale (mn units)	205	273	273
Secondary energy sale (mn units)	33	44	44
Tariff rate (Rs/unit)	2.11	2.43	2.38
Net revenues	**502**	**771**	**754**
EBITDA	440	706	686
EBITDA margin (%)	87.6	91.6	91.1
PBT	87	143	154
PAT	**87**	**143**	**154**
Free cash flow to equity (FCFE)	**124**	**126**	**135**

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 48: Key issues for Lanco Green Power Private Limited

Firm offtake by PTC for 35 years. Payment security in the form of LC and right to third party sale.	+
Stiff timelines for implementation.	—
Cap on each year's tariff exposes it to any sharp increase in interest rates on project loans.	—

Source: Company, Kotak Institutional Equities estimates.

Small hydro projects

Lanco is implementing four small run-of-the-river hydro projects of 5 MW capacity each in Himachal Pradesh (HP) on a BOOT basis. The projects being implemented under Vamshi Industrial Power Limited and Vamshi Hydro Energies Pvt. Ltd. (two each) achieved financial closure in March 2006 and are targeted for completion by April 2008. The implementation agreement has been signed with the HP government for a period of 40 years after which the project will be transferred to the state government. PPAs for sale of power to HPSEB at Rs2.5/unit for 35 years have been signed.

Exhibit 49: Profile of small hydro projects under Vamshi Hydro Energies and Vamshi Industrial

Project size (MW)	20
Vamshi Industrial	2X5 MW
Vamshi Hydro Energies	2X5 MW
CoD (expected)	Apr-08
Financial closure	Mar-06
Project cost (Rs bn)	1.1
per MW capital cost (Rs mn)	56.6
Project funding	
Equity (Rs bn)	0.3
Debt (Rs bn)	0.8
Equity holding pattern (%)	
Lanco Infratech (effective)	91.1
Others	8.9

Project inputs	
Land acquisition	Received Right of Utilization from MoEF
Environmental clearances	Necessary approvals in place
Project cost appraisal	CEA approval not needed
Contract for civil works	Lanco Infratech Limited
Electromechanical equipment	Boving Foress India Pvt. Ltd.
Contract for transmission line	Lanco Infratech Limited
Free power commitment	10% after 15 years from CoD
Power evacuation	35-yr PPA with HPSEB signed
Tariff structure	
Flat tariff of Rs2.50/unit	
Capital subsidy of Rs22.5 mn/project and Rs3.75 mn/MW from MNES	
Does not require specific approval from HPERC	

Source: Company, Kotak Institutional Equities estimates.

Capital subsidy improves project attractiveness

These projects were part of the HP government’s scheme inviting developers to identify small hydro projects for development on a BOOT basis. The projects yield high FCFE due to (1) lower free power to the state government as compared to other projects, free power to the State Government is at 10% from 16th year onwards; (2) capital subsidy of Rs22.5 mn/project and Rs3.75 mn/MW from MNES, which reduces the capital cost of the project quite dramatically (about 14% of project cost).

We assume gross generation equivalent to the energy generated in the 75% dependable year, achieving a PLF of 61-62%. However, our estimates assume an additional loss of 8% for lower dependability and 2% for transmission losses.

Exhibit 50: Capital subsidy of 14% of project costs increases the attractiveness of projects
Key assumptions for small hydro projects under Vamshi Hydro Energies and Vamshi Industrial, March fiscal year-ends, 2009-12E (Rs mn)

	2009E	2010E	2011E
Design energy at 75% dependable year	**109**	**109**	**109**
Gross generation (mn units)	109	109	109
Auxiliary consumption and other losses (%)	8	8	8
Net generation (mn units)	100	100	100
Free energy supplied to state (mn units)	—	—	—
Energy sale (mn units)	100	100	100
Tariff rate (Rs/unit)	2.5	2.5	2.5
Net revenues	**246**	**246**	**246**
EBITDA	219	218	216
EBITDA margin (%)	89	88	88
PBT	94	110	130
PAT	**83**	**98**	**115**
Free cash flow to equity (FCFE)	**115**	**31**	**64**

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 51: Key issues for small hydro projects under Vamshi Hydro Energies and Vamshi Industrial

Only 10% free power to be given to the State government starting after 15 years of operation.	+
Capital subsidy enhances the attractiveness of returns from the projects.	+
Stiff timelines for implementation - time and cost overruns could likely impact the profitability.	—
Exposed to increase in interest rates on project loans.	—

Source: Company, Kotak Institutional Equities estimates.

Nagarjuna Power

LITL has acquired the rights to assume a 74% stake in the 1,015 MW Nagarjuna Power project from Nagarjuna Construction. Nagarjuna Power is implementing a 1,015 MW imported coal-based power project plant in the Udupi District of Karnataka. The power project, to be implemented at a cost of Rs43 bn, proposes to use Konkan Railway to transport imported coal from the New Mangalore port. Coal supply contracts have been signed for the import of coal for the next 10 years.

Exhibit 52: Profile of Nagarjuna Power

	Phase I	Phase II		
Project size (MW)	1015 (507.5*2)		Fuel supply	based on imported coal
CoD	Jan-10	Apr-10	10-year contract for import of coal in place	
Project cost (Rs bn)	43.5		CEA has approved import of coal, CERC has approved the tariff structure	
per MW capital cost (Rs mn)	42.9		Power evacuation	25-yr PPA (from COD) with the state distribution companies in Karnataka and PSEB
Project funding			Tariff structure (tailored around CERC Tariff guidelines)	
Equity (Rs bn)	8.7		14% assured ROE for full term of PPA	
Subordinate debt (Rs bn)*	4.4		Fuel cost recovery based on normative parameters-a pass through	
Debt (Rs bn)	30.5		Incentive structure	
Equity holding pattern (%)			Base PLF for reimbursement of full fixed charges	80%
Lanco Infratech **	74		Incentives	@ Rs0.25/unit for units delivered above 80% PLF
Nagarjuna group	26		Disincentives	Prorata reduction in fixed charges for lower PLF
Project status				
Financial closure	Aug-06			
Project input				
Land	Land for main plant - acquired			
Water	Linkage available			
Environmental clearance	Received			
Project contracts				
EPC	Lanco Infratech			
BTG	Dong Fang			

** equity stake of LITL will be restricted to 50% till CoD; balance requirement of equity will be met by preference shares

Source: Company, Kotak Institutional Equities estimates.

The financial closure of the project was achieved in August 2006. The project is scheduled for commissioning in two phases: 507.5 MW each in January 2010 and April 2010. A 25-year PPA for the offtake of power has been signed with the distribution companies in Karnataka. A three-tier payment security mechanism in the form of LC, escrow account and guarantee from the state government is envisaged. The project has most of the necessary approvals in place, including clearance from CEA, necessary environmental clearances and in-principle approval of tariff from CERC.

Exhibit 53: Key assumptions and summary financials for Nagarjuna Power Phase I & II, March fiscal year-ends, 2010-2015E (Rs mn)

	2010E	2011E	2012E	2013E	2014E	2015E
PLF %						
Phase I (COD Jan 2010)	90	90	90	90	90	90
Phase II (COD April 2010)		90	90	90	90	90
Net generation (mn units)						
Phase I	925	3,701	3,701	3,701	3,701	3,701
Phase II		3,701	3,701	3,701	3,701	3,701
Total	**925**	**7,402**	**7,402**	**7,402**	**7,402**	**7,402**
Actual station heat rate (kcal/kwh)	2,400	2,400	2,400	2,400	2,400	2,400
Actual auxiliary consumption (%)	7.50	7.50	7.50	7.50	7.50	7.50
Normative station heat rate (kcal/kwh)	2,400	Used for fuel cost reimbursement				
Normative auxiliary consumption (%)	7.50					
Delivered cost of coal (Rs/MT)						
Phase I & II	2,551	2,551	2,551	2,551	2,551	2,551
Normtive cost of coal (Rs/MT)						
Phase I & II	2,551	2,551	2,551	2,551	2,551	2,551
GCV of coal (kcal/kg)	6,200	6,200	6,200	6,200	6,200	6,200
Tariff (Rs/kwh)						
Phase I	2.46	2.39	2.40	2.37	2.34	2.31
Phase II		2.43	2.40	2.37	2.34	2.31
Net revenues	**2,226**	**17,482**	**17,408**	**17,178**	**16,952**	**16,730**
EBITDA	1,050	8,004	7,859	7,557	7,255	6,952
EBITDA margin (%)	47.2	45.8	45.1	44.0	42.8	41.6
PBT	437	1,752	1,757	1,759	1,761	1,764
PAT	**387**	**1,554**	**1,558**	**1,560**	**1,562**	**1,564**
Free cash flow to equity (FCFE)	**(2,069)**	**1,460**	**1,529**	**1,583**	**1,585**	**1,586**
FCF to equity yield on invested equity (%)		16.8	17.6	18.2	18.2	18.2

Source: Kotak Institutional Equities estimates.

Exhibit 54: Details of imported coal arrangements for Nagarjuna Power

Suppliers	Quantity (MT pa)	Arrangement
PT Adarro		5 year fixed price contract at FOB US$33/tonne
Glencore	2.75	+
Banpu		5 years escalated price contract based on defined basket

Source: Company.

Lanco Energy – Teesta VI

Lanco Energy Private Limited is implementing a 500 MW hydropower project across the river Teesta in Sikkim. Implementation agreement has been signed with the Government of Sikkim and financial closure is likely to be achieved by March 2007. The PPA for the project has been signed with Maharashtra State Electricity Distribution Company Limited (MSEDCL) at a flat tariff of Rs2.32/unit and is pending approval with MERC. We expect the project to be commissioned by April 2011.

Exhibit 55: Profile of Teesta VI project

Project size (MW)	500	Project inputs	
CoD (expected)	Apr-11	Land acquisition	Notifications issued by MoEF for forest land and Government of Sikkim for state-owned land
Financial closure (expected)	Mar-07	Environmental clearances	Dec-06
		Project cost appraisal	Technoeconomic clearance obtained
Project cost (Rs bn)	30.0	Contract for civil works	Lanco Infratech Limited
per MW capital cost (Rs mn)	59.9	Electromechanical equipment	Shortlisted Dong Fang based on international competitive bidding (ICB)
Project funding		Contract for transmission line	to be finalized
Equity (Rs bn)	6.0	Free power commitment	12% for first 15 years, 15% thereafter
Debt (Rs bn)	24.0	Power evacuation	35-yr PPA with MSEDCL signed; pending with MERC
Equity holding pattern (%)		Tariff structure	
Lanco Infratech	74	Flat tariff of Rs2.32/unit for 25 years; to be set as per mutual negotiation after that	
Government of Sikkim	26		

Source: Company, Kotak Institutional Equities estimates.

LITL used its experience and expertise in construction to propose an alternate project site on the river Teesta and has designed a higher capacity project, while envisaging a lower cost involved in project implementation and relocation of existing infrastructure.

Exhibit 56: Leveraging experience in construction to lower costs and achieve higher profitability

Key assumptions for Teesta VI—500 MW hydro power project, March fiscal year-ends, 2012-2015E (Rs mn)

	2012E	2013E	2014E	2015E
Plant Availability Factor (PAF) %	**90.0**	**95.0**	**95.0**	**95.0**
Plant Load Factor (PLF) %	**60.3**	**60.3**	**60.3**	**60.3**
Gross generation (mn units)	2,641	2,641	2,641	2,641
Auxiliary consumption and other losses (%)	1.2	1.2	1.2	1.2
Net generation (mn units)	2609	2609	2609	2609
Free energy supplied to state (mn units)	313	313	313	313
Primary energy sale (mn units)	2,122	2,122	2,122	2,122
Secondary energy sale (mn units)	174	174	174	174
Tariff rate (Rs/unit)	2.27	2.27	2.27	2.27
Net revenues	**5,223**	**5,223**	**5,223**	**5,223**
EBITDA	4,754	4,736	4,717	4,698
EBITDA margin (%)	91.0	90.7	90.3	90.0
PBT	567	633	782	930
PAT	**567**	**633**	**782**	**930**
Free cash flow to equity (FCFE)	**2,372**	**618**	**767**	**916**

Source: Company, Kotak Institutional Equities estimates.

Exhibit 57: Key issues for Teesta VI

PPA signed at an attractive flat rate of Rs2.32/unit.	+
Financial closure not achieved yet.	—
Stiff timelines for implementation.	—

Source: Company, Kotak Institutional Equities estimates.

Anpara C

LITL has been awarded the 1,000 MW Anpara ‘C’ power project for development under an international competitive-tariff-based bidding process. The tariff comprises (1) fixed cost that is to be reimbursed as per the tariff bid and (2) variable cost that is a pass-through. The proposed plant is to be located in south-eastern Uttar Pradesh (UP) in northern India and is estimated to cost Rs40 bn. It is a pithead coal-based power plant with adequate water supply and evacuation facilities.

Exhibit 58: Profile of Anpara ‘C’

Project size (MW)	1,000 (500*2)
CoD	Oct-10
Project cost (Rs bn)	40
per MW capital cost (Rs mn)	40
Project funding	
Equity (Rs bn)	8.0
Debt (Rs bn)	32.0
Equity holding pattern (%)	
Lanco Infratech	100
Project status	
Financial closure	Expected Nov-07
Project input	
Land	Available-to be leased
Water	Available-agreement to be finalized
Environmental clearance	Received
Project contracts	
EPC	To be finalized
Civil works	To be finalized

Fuel supply	
Coal linkage available; fuel supply agreement (FSA) to be formalized	
Power evacuation	29-yr PPA with UP state power distcoms
Tariff structure	
Fixed cost to be reimbursed as per tariff bid by Lanco Infratech	
Fuel cost recovery based on normative parameters	
Incentive structure	
Base PLF for reimbursement of bid fixed charges	80%
Incentives	@ Rs0.25/unit for units delivered above 80% PLF
Disincentives	Prorata reduction in fixed charges for lower PLF

Source: Company, Kotak Institutional Equities estimates.

We expect financial closure by November 2007 and COD by October 2010. A 29-year PPA for the offtake of power will be entered into with the distribution companies in UP. A three-tier payment security mechanism in the form of LC, escrow account and guarantee from the state government is envisaged.

Exhibit 59: Key assumptions & summary financials for Anpara 'C', March fiscal year-ends, 2011-2015E (Rs mn)

	2011E	2012E	2013E	2014E	2015E
PLF %	**80**	**88**	**88**	**88**	**88**
Net generation (mn units)	**3,189**	**7,092**	**7,092**	**7,092**	**7,092**
Actual station heat rate (kcal/kwh)	2,450	2,450	2,450	2,450	2,450
Actual auxiliary consumption (%)	9.0	8.0	8.0	8.0	8.0
Normative station heat rate (kcal/kwh)	2,500	Used for fuel cost reimbursement			
Normative auxiliary consumption (%)	9.0				
Delivered cost of coal (Rs/MT)	939	983	1,030	1,078	1,129
Tariff (Rs/kwh)	**1.93**	**1.98**	**2.01**	**1.85**	**1.90**
Net revenues	**6,031**	**13,796**	**14,000**	**12,835**	**13,226**
EBITDA	2,962	6,857	6,741	5,239	5,279
EBITDA margin (%)	49.1	49.7	48.1	40.8	39.9
PBT	777	2,267	1,763	463	705
PAT	**689**	**2,010**	**1,563**	**411**	**625**
Free cash flow to equity (FCFE)	**478**	**1,091**	**1,503**	**538**	**517**

Source: Company, Kotak Institutional Equities estimates.

Exhibit 60: Key concerns for Anpara C

Government to provide land, water and other clearances - which may delay the project implementation	—
Exposed to increase in interest rates, with no pass through of interest costs in the competitively bid tariffs	—
Financial closure not achieved yet	—
Stiff timelines for implementation	—

Source: Company, Kotak Institutional Equities estimates.

Lanco Hydro Energies

Lanco Hydro Energies is implementing three hydro projects on the river Mandakini in the state of Uttaranchal. The three run-of-the-river hydro power plants (Rambara, Gourikhund and Phata Byung) will have a cumulative capacity of 120 MW. The company has won the projects through a competitive bidding process. The company is planning to develop the plant as a merchant power plant. LITL is targeting financial closure by September 2007 and the project is likely to be commissioned by April 2010.

Exhibit 61: Profile of Lanco Hydro Energies Private Limited

Project size (MW)	120
Gaurikhund	
Rambara	
Phata-Byung	
CoD (expected)	Apr-10
Financial closure (expected)	Sep-07
Project cost (Rs bn)	7.2
per MW capital cost (Rs mn)	60.0
Project funding	
Equity (Rs bn)	1.4
Debt (Rs bn)	5.8
Equity holding pattern (%)	
Lanco Infratech (effective)	91
Others	9

Project inputs	
Land acquisition	Activities to start post-preparation of Detailed Project Report (currently work in progress)
Environmental clearances	
Project cost appraisal	
Contract for civil works	
Electromechanical equipment	
Contract for transmission line	
Free power commitment	12% for first 12 years, 18% thereafter
Power evacuation	Development agreement signed; to be developed as merchant power plant
Tariff structure	
Merchant power plant - assumed flat rate of Rs2.25/unit	
Incentive structure	
NA	

Source: Company, Kotak Institutional Equities estimates.

Exhibit 62: Short implementation period is the key to profits for hydro power plants
Key assumptions for Lanco Hydro Energies—120 MW hydro power project, March fiscal year-ends, 2011-2015E (Rs mn)

	2011E	2012E	2013E	2014E	2015E
Plant Availability Factor (PAF) %	**90.0**	**95.0**	**95.0**	**95.0**	**95.0**
Plant Load Factor (PLF) %	**56.1**	**56.1**	**56.1**	**56.1**	**56.1**
Gross generation (mn units)	589	589	589	589	589
Auxiliary consumption and other losses (%)	0.9	0.9	0.9	0.9	0.9
Net generation (mn units)	584	584	584	584	584
Free energy supplied to state (mn units)	70	70	70	70	70
Primary energy sale (mn units)	448	448	448	448	448
Secondary energy sale (mn units)	65	65	65	65	65
Tariff rate (Rs/unit)	2.25	2.25	2.25	2.25	2.25
Net revenues	**1,156**	**1,133**	**1,133**	**1,133**	**1,133**
EBITDA	1,051	1,024	1,019	1,015	1,010
EBITDA margin (%)	90.9	90.3	90.0	89.6	89.1
PBT	63	69	114	164	214
PAT	**63**	**69**	**114**	**164**	**214**
Free cash flow to equity (FCFE)	**406**	**33**	**62**	**106**	**142**

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 63: Key issues for Lanco Hydro Energies Private Limited

Financial closure yet to be achieved	—
Stiff timelines for implementation	—
Power sale to be tied up as merchant sale	—
Exposed to increase in interest rates on project loans	—

Source: Company, Kotak Institutional Equities estimates.

Annexure II: Sasan Ultra Mega Power Project (UMPP)

Globaleq Singapore and Lanco Infratech consortium bid the lowest levelized tariff of Rs1.196/unit for 25 years in the competitive tariff bidding for the 4,000 MW Sasan UMPP. LITL's stake currently at 30% in the project will likely be increased to 51%. Before ascribing any value for the UMPP to our fair value for LITL, we would await (1) clarity on the final transfer of the project SPV to the consortium and (2) achievement of financial closure.

Exhibit 64: Profile of Sasan Ultra Mega Power Plant

Project size (MW)	3,960 (660*6)	Fuel supply	
CoD (of first unit)	Mar-11	Three coal mines allotted for captive usage	
Project cost (Rs bn)	139	Mine development project to cost additional Rs30 bn	
per MW capital cost (Rs mn)	35	Power evacuation	PPA with multiple states
Project funding		Tariff structure	
Equity (Rs bn)	27.7	Levelized tariff of Rs1.196/unit for 25 years	
Debt (Rs bn)	110.9	Fixed cost to be reimbursed as per tariff bid by Globaleq-Lanco consortium	
Equity holding pattern (%)		Variable cost to be reimbursed as per tariff bid by Globaleq-Lanco consortium	
Globaleq Singapore	70	Incentive structure	
Lanco Infratech	30 *	Incentives	Above 85% plant availability, 40% of non-escalable capacity charge for units delivered in excess of 80% PLF
Project status		Disincentives	Below 80% plant availability, 20% of average capacity charge for units in short of 80%
Financial closure	Mar-08		
Project inputs			
Land	Project clearances are being arranged under the SPV floated by PFC (the nodal agency for awarding UMPPs). Globaleq-Lanco consortium is awaiting the transfer of control of the SPV to them.		
Water			
Environmental clearance			
Project contracts			
EPC	BTG likely to Dong Fang		
Civil works	To be finalized		

* Lanco Infratech will ultimately hold 51% stake in the project.

Source: Company, Kotak Institutional Equities estimates.

SOTP valuation for a single project

We estimate Sasan UMPP to potentially add Rs37/share value to LITL for its 51% share in the project (see Exhibit 65).

Exhibit 65: Valuation buildup for Sasan UMPP

	Equity invested	Value (Rs bn)		Cum. P/E
	(Rs bn)	Project	Cum.	(X)
Power project	27.7	24.2	24.2	0.9
Coal mine project	5.0	10.0	34.2	1.0
Construction (NPV)		5.3	39.5	1.2
Surplus coal (NPV)		9.2	48.7	1.5
Total	**32.7**		**48.7**	**1.5**
LITL's ultimate share in the project (%)		51.0		
LITL's equity investment (Rs bn)		16.7		
Value enhancement on invested equity (Rs bn)				8.2
Value per share for LITL (Rs)				**36.7**

Source: Kotak Institutional Equities estimates.

1. **Standalone power project.** We estimate the project equity IRR at about 9%, tempered by our assumptions of (a) higher interest rate of 10.5% (as against 9.75% built in by the Globaleq-Lanco consortium) and (b) higher first-year coal cost of Rs450/tonne with 3% pa escalation (as against Rs380/tonne first year cost assumed by the consortium). We estimate the project to just break-even for Globaleq-Lanco consortium on a standalone basis. An aggressive bid (Rs1.196/unit) requires all the pieces of the puzzle to fall into place as desired for the project to earn reasonable returns.

2. **Coal equity IRR.** We estimate the company will make an equity IRR of about 20% in coal mining. Our cost of coal production at Rs450/tonne appears reasonable compared to Northern Coalfields (Coal India's subsidiary) selling price of Rs480/tonne for F grade run-of-mine (ROM) coal at the pithead.

3. **Construction profits.** We estimate the NPV of construction business to contribute Rs5.3 bn to the value of the project. Management estimates Rs70 bn worth construction and balance of work for the Sasan UMPP to be executed over the next 4-5 years.

Exhibit 66: High calorific value coal is the highlight of the Sasan UMPP
Details of coal mines alloted to Sasan UMPP for captive usage

Coal block	Geological reserve (mn MT)	Extractable reserve (mn MT)	Average calorific value (kcal/kg)
Moher	320	269	4,908
Amlori extn.	275	166	4,368
Chhatrasal	160	120	3,500
Total	**755**	**555**	

Source: Company, Kotak Institutional Equities.

4. **Sale of surplus coal.** We estimate NPV of Rs9.21 bn on assuming the sale of 37.5 mn MT of coal for nine years starting from the 16th year of commercial production of the UMPP. We assume the coal to sell at Coal India's prices. The high calorific value of the coal (see Exhibit 66) implies that Sasan UMPP will likely have surplus coal than it requires for 25 years of operation. While there is no clarity on the possibility of selling surplus coal, any such possibility will clearly provide a significant upside.

Awaiting transfer of SPV to the consortium and financial closure

We await the transfer of project SPV—Sasan Power and financial closure of the project before ascribing any value from the project to our target price for LITL. Newspaper reports suggest PFC is doing a revalidation of the qualification parameters for the Globaleq-Lanco consortium. This follows the sale of Globaleq Singapore by its parent Globaleq (private equity arm of CDC) to Jindal Steel and Power Limted (JSPL) – 40% and Princeton Holdings (major shareholder of LITL) – 60%.

Annexure III: Carbon credits

We have factored in the benefit of carbon trading from the two-biomass projects in our estimates. Operating renewable source of energy and fuel-efficient technologies enable power generation companies to get the added benefit of trading their CERs (Certified Emission Reductions) under the Clean Development Mechanism (CDM) of the Kyoto protocol.

LITL estimates a potential generation of upto 2 mn CERs from the company's existing and under-implementation power projects (see Exhibit 67). LITL has realized about Rs140 mn during FY2007 from sale of CERs generated till FY2005 at an average price of €23.69/CER. We have factored in realization of CERs from the two biomass-based projects at €10/CER in our estimates.

Exhibit 67: Potential to exploit 2 mn CERs generated every year
Details of eligibility of projects under the CDM

Project	Capacity (MW)	Fuel used	Credit period (years)	First year of eligibility	Annual expected CERs	Status of approvals
Clarion Power	12	Biomass	7	2005	43,000	Methodolgy approved; CERs validated till 2006
Rithwik Energy	6	Biomass	7	2003	23,000	Methodolgy approved; CERs validated till 2006
Lanco Kondapalli	368	Natural gas	10	2002	258,000	Methodolgy to be approved
Aban Power	120	Natural gas	10	2007	184,086	Methodolgy to be approved
Lanco Infratech	12	Wind	10	2003/2007	5,427	Standard methodology
Lanco Green Power	70	Hydro	10	2009	218,000	Projects under implementation
Vamshi Industrial	10	Hydro	10	2009	38,500	Projects under implementation
Vamshi Hydro	10	Hydro	10	2009	37,800	Projects under implementation
Lanco Hydro	120	Hydro	10	2012	210,000	Projects under implementation
Lanco Energy	500	Hydro	10	2012	1,000,000	Projects under implementation

Source: Company data.

Validation of CERs for other projects as we go along for other projects will provide upside to our estimates. Other projects of LITL are awaiting approval of the methodology or are still at the implementation stage. Due to the uncertainties in the quantum of CERs that will be eventually generated and validated from these projects, we have not factored any additional CER sales from our projects into our estimates.

Annexure IV: Real Estate development

LITL is developing a 100-acre IT Park in Hyderabad, Andhra Pradesh through a 74% subsidiary—Lanco Mantri Technology Park Private Limited (LITPL). LITL also owns land banks aggregating about 22 acres adjacent to Ocean Park in Hyderabad.

Hyderabad properties

LITPL is acquiring land from the Andhra Pradesh Industrial Infrastructural Corporation (APIIC), which has been appointed as the nodal agency for development of IT parks in the state. APIIC had invited bids for real estate marked for three IT parks in Hyderabad and Lanco offered the highest bids for all three. Entitled to pick just one, LITPL chose Manikonda village with a land acquisition cost of Rs42.7 mn/acre. The project site at Manikonda Village is approximately 5 km from Jubilee Hills in Hyderabad. The park, situated close to leading technology companies and institutions like Infosys Technologies, Microsoft and Kanbay, is 18 km from the new Hyderabad International Airport.

Big incentives available for the project. The project enjoys various incentives under the Andhra Pradesh ICT policy—there is no restriction on floor space index or high-rise buildings. Only 60% of the developed land need to be used for IT and the balance can be used for non-IT purposes. The project will also be eligible for income tax exemptions under section 80 (IA) of the Income Tax Act, 1961 to the extent it covers the development of the IT park.

The project aims at creating a 'walk to work' culture. LITPL intends to develop 19.5 mn sq. ft. at the project site comprising 7.4 mn sq. ft. of IT space, 8.5 mn sq. ft. of residential space and 3.6 mn sq. ft. of commercial/other space. The company intends to have high-rise towers for both IT buildings (15-20 storeys) as well as residential towers (20-25 storeys). For the residential projects the company plans to have a mix of 2-BHK and 3-BHK apartments catering to middle and upper middle class families. LITPL intends to target employees of companies that will occupy commercial space at the project site thus creating a 'walk to work' culture. The residential project also intends to target employees of IT companies in the vicinity of the project site

Apart from the Manikonda project, the company intends to develop 0.9 mn sq ft of residential 3-BHK apartments at a project site near the Ocean Park.

Exhibit 68: Location of real estate properties of LITL in Hyderabad

Source: www.mapsofindia.com, Kotak Institutional Equities.

Annexure V: Construction business

Exhibit 69: Construction business—Income statement, March fiscal year-ends, 2005-2011E (Rs bn)

	2005	2006	2007E	2008E	2009E	2010E	2011E
Net revenues	**1.78**	**1.51**	**5.55**	**13.84**	**22.75**	**25.85**	**17.84**
Key costs							
Operating Expenses	(1.54)	(1.26)	(4.33)	(11.35)	(19.00)	(21.71)	(15.16)
Employee Remuneration & Benefits	(0.01)	(0.02)	(0.10)	(0.14)	(0.16)	(0.18)	(0.12)
Administration & Other Expenses	(0.03)	(0.03)	(0.07)	(0.11)	(0.18)	(0.21)	(0.14)
Operating profit	**0.20**	**0.21**	**1.05**	**2.24**	**3.41**	**3.75**	**2.41**
Other operating income	0.01	0.01	0.02	0.02	0.06	0.08	0.10
EBIDTA	**0.21**	**0.23**	**1.07**	**2.26**	**3.47**	**3.82**	**2.51**
Depreciation + amortisation	(0.02)	(0.02)	(0.03)	(0.07)	(0.12)	(0.17)	(0.22)
Interest	(0.04)	(0.04)	(0.07)	(0.09)	(0.11)	(0.12)	(0.10)
PBT	**0.14**	**0.17**	**0.97**	**2.11**	**3.25**	**3.54**	**2.19**
Tax	0.01	(0.03)	(0.24)	(0.63)	(0.97)	(1.06)	(0.66)
Adjusted PAT	**0.15**	**0.14**	**0.73**	**1.48**	**2.27**	**2.48**	**1.54**
Extraordinary items	(0.05)	(0.04)	—	—	—	—	—
Reported PAT	**0.10**	**0.10**	**0.73**	**1.48**	**2.27**	**2.48**	**1.54**
Key ratios (%)							
Operating margin	11.2	14.0	19.0	16.2	15.0	14.5	13.5
Tax rate (%)	15.9	23.7	25.0	30.0	30.0	30.0	30.0
Revenue growth	55.0	(14.7)	266.1	149.6	64.4	13.6	(31.0)
PAT growth	157.1	(8.5)	434.2	102.1	54.1	9.0	(38.0)

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 70: Construction business—Balance sheet, March fiscal year-ends, 2005-2011E (Rs bn)

	2005	2006	2007E	2008E	2009E	2010E	2011E
Equity	0.08	0.31	2.22	2.22	2.22	2.22	2.22
Reserves	0.70	0.57	1.58	3.05	5.33	7.80	9.34
Shareholders' funds	**0.8**	**0.9**	**3.8**	**5.3**	**7.5**	**10.0**	**11.6**
Debt	0.3	0.5	0.5	0.5	0.5	0.5	0.5
Deferred tax	0.0	0.0	—	—	—	—	—
Total liabilities	**1.1**	**1.4**	**4.3**	**5.8**	**8.1**	**10.6**	**12.1**
Fixed assets (incl intangible)	0.1	0.1	0.2	0.5	0.9	1.2	1.5
Investments	0.6	1.3	3.2	3.2	3.2	3.2	3.2
Net current assets	0.1	(0.2)	(0.8)	(0.0)	1.1	1.2	0.8
Cash	**0.3**	**0.3**	**1.7**	**2.2**	**3.0**	**4.9**	**6.7**
Total assets	**1.1**	**1.4**	**4.3**	**5.8**	**8.1**	**10.6**	**12.1**

Source: Company data, Kotak Institutional Equities estimates.

"I, Sujay Mishra, hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report."

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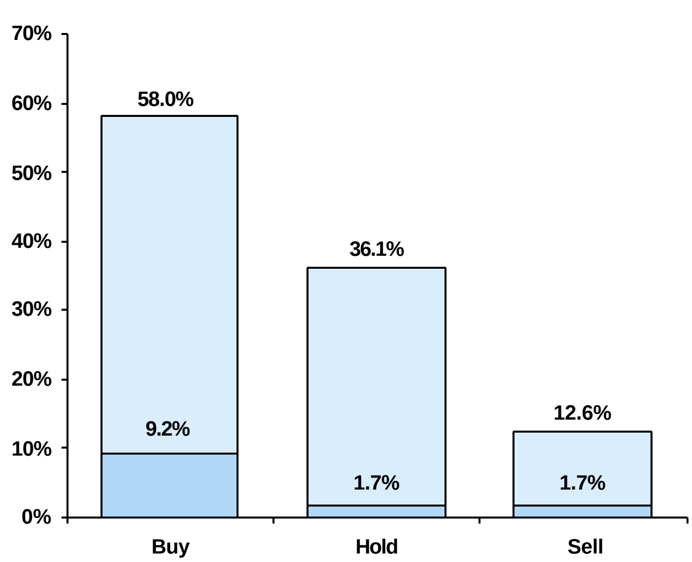
Kotak Institutional Equities Research coverage universe
Distribution of ratings/investment banking relationships



Percentage of companies covered by Kotak Institutional Equities, within the specified category.

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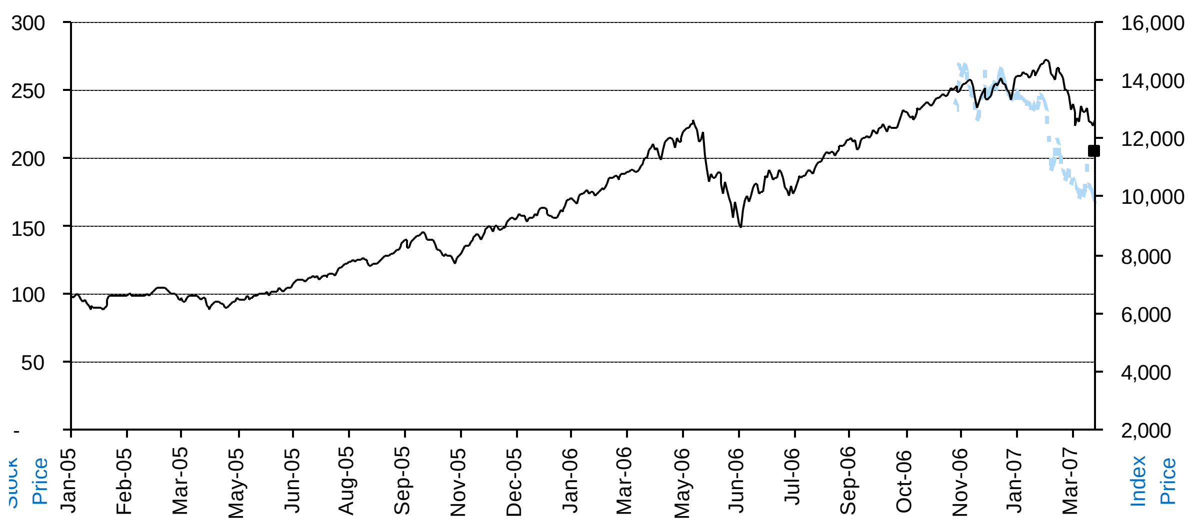
* The above categories are defined as follows: Buy = OP; Hold = IL; Sell = U. Buy, Hold and Sell are not defined Kotak Institutional Equities ratings and should not be constructed as investment opinions. Rather, these ratings are used illustratively to comply with applicable regulations. As of 12/31/06 Kotak Institutional Equities Investment Research had investment ratings on 128 equity securities.

Source: Kotak Institutional Equities. *As of December 31, 2006*

Lanco Infratech (LAIN.BO)

Kotak Institutional Equities rating and stock price target history



Source: Kotak Institutional Equities Research for ratings and price targets, Bloomberg for daily closing prices.

Rating	Covered by Sujay Mishra
■ Price target	Not covered by current analyst
X Price target removal	BSE-30 Index (RHS)

The price targets shown should be considered in the context of all prior published Kotak Institutional Equities research, which may or may not have included price targets, as well as developments relating to the company, its industry and financial markets

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Companies that the analyst mentioned in this document follow

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Hindustan Lever	HLL.BO
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Tata Power	TTPW.BO
Tata Tea	TTTE.BO

Source: Kotak Institutional Equities Research.

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Corporate Office
Kotak Securities Ltd.

Bakhtawar, 1st Floor
229, Nariman Point
Mumbai 400 021, India
Tel: +91-22-6634-1100

Overseas Offices
Kotak Mahindra (UK) Ltd.

6th Floor, Portsoken House
155-157 The Minories
London EC 3N 1 LS
Tel: +44-20-7977-6900 / 6940

Kotak Mahindra Inc.

50 Main Street, Suite No.310
Westchester Financial Centre
White Plains, New York 10606
Tel: +1-914-997-6120

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