

**March 21, 2011**

Rupa Shah  
rupashah@plindia.com  
+91-22-66322244

	<b>Accumulate</b>
Rating	
Price	Rs36
Target Price	Rs43
Implied Upside	19.4%
Sensex	17,879

*(Prices as on March 18, 2011)*
**Trading data**

Market Cap. (Rs bn)	85.6
Shares o/s (m)	2,385.5
3M Avg. Daily value (Rs m)	472.8

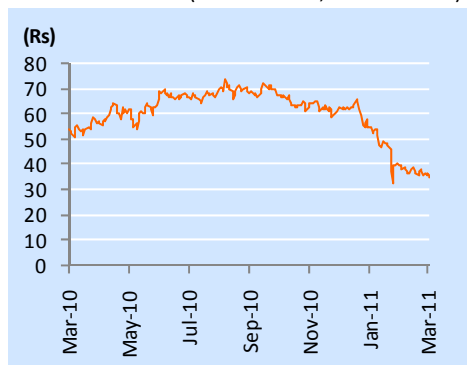
**Major shareholders**

Promoters	67.95%
Foreign	19.84%
Domestic Inst.	3.57%
Public & Other	8.64%

**Stock Performance**

(%)	1M	6M	12M
Absolute	(8.4)	(48.6)	(33.1)
Relative	(6.5)	(39.8)	(35.2)

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



Source: Bloomberg

- **Completes capacity addition of 1045MWs in FY11:** Lanco Infratech (Lanco) has commercially added close to 1045MWs in FY11, thereby, increasing the operating capacity by 101% YoY. The company also synchronised 600MWs of Udupi-2 recently. However, commercial operation is expected to start in Q2FY12E on account of delay in transmission line set up. For other plants, Kondapalli continues to face gas supply issues from KG D6 and GAIL. The COD of Budhil Hydro (70MWs) has been delayed by six months and now expected to start in Q2FY12.
- **Satisfactory progress of projects under development:** Lanco plans to add close to 2012MWs in FY12E and has achieved significant milestones in various projects under construction. The overall funding requirement, according to the company, would be at Rs23bn for these projects in the next three years.
- **New Ventures:** We believe acquisition of Griffin Coal Mines would be NPV Positive. However, it will increase the D/E ratio of the parent company. On the other hand, Solar power venture looks viable only with a high control on initial costs.
- **Price correction, improves risk reward ratio:** The FCF from power for the next three years is expected to be in the range of Rs50-54bn. However, we still maintain that fund raising is inevitable on account of equity for projects under development, new ventures and debt servicing. With lesser dependence on merchant power, increasing EPC opportunities and CODs of roads in FY12E, the company is not expected to give any major downside jolts. We reiterate '**Accumulate**' on the stock; however, we lower our target price on the back of changes in risk premiums, delays in COD's, decreasing volumes/merchant rates and no addition in portfolio.

Key financials (Y/e March)	2010	2011E	2012E	2013E
Revenues (Rs m)	80,320	73,659	112,793	152,669
<i>Growth (%)</i>	33.7	(8.3)	53.1	35.4
EBITDA (Rs m)	14,515	18,872	31,661	47,265
PAT (Rs m)	4,585	5,168	8,567	12,784
EPS (Rs)	1.9	2.2	3.6	5.4
<i>Growth (%)</i>	50.7	12.7	65.8	49.2
Net DPS (Rs)	—	—	—	—

Source: Company Data; PL Research

Profitability & Valuation	2010	2011E	2012E	2013E
EBITDA margin (%)	18.1	25.6	28.1	31.0
RoE (%)	16.9	14.5	20.3	24.3
RoCE (%)	7.7	5.8	6.0	6.5
EV / sales (x)	2.0	4.0	3.2	2.9
EV / EBITDA (x)	10.9	15.4	11.4	9.3
PE (x)	18.5	16.4	9.9	6.6
P / BV (x)	2.5	2.2	1.8	1.4
Net dividend yield (%)	—	—	—	—

Source: Company Data; PL Research

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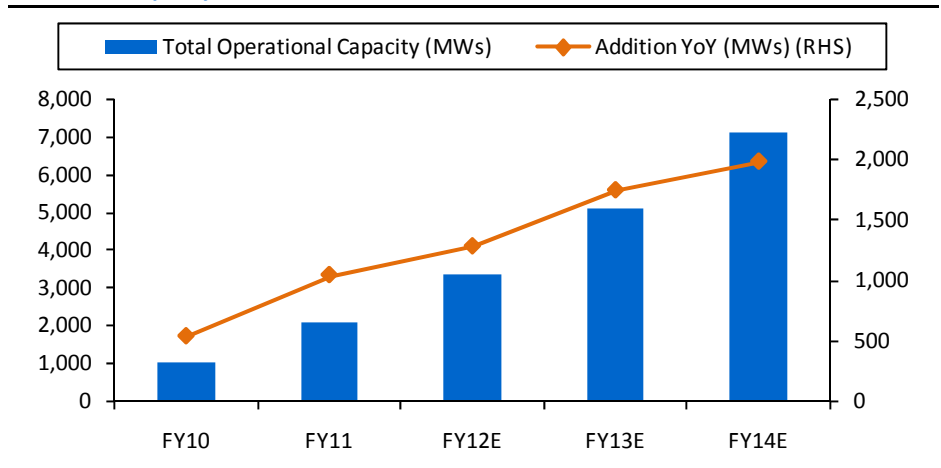
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### FY11 – Volatile on capacity addition and tariffs

Lanco has commercially added close to 1045MWs (against expectations of 1715MWs) in FY11, thereby, increasing the operating capacity by 101% YoY. The company also synchronised 600MWs of Udupi-2 recently. However, commercial operation would start in Q2FY12E as against scheduled COD of January 2011. This is on account of the pending completion of transmission line by PGCIL. The imported coal for this plant is sourced at US\$120/tonne as against the original contracted rate of US\$56/tonne. With this, the difference in cost of generation will be to the tune of Rs1.8kwh/hr. However, being a PPA, ROEs won't get affected. For other plants, Kondapalli continues to face gas supply issues from KG D6 and GAIL, where we see Unit-2 (merchant) getting a hit. Overall realisations have improved for bilateral contracts (current Rs4.5-5kw/hr). The COD of Budhil Hydro (70MWs) is delayed by six months and now expected to start in Q2FY12.

Though the company has aggressive plans of capacity addition, execution has been a little slow, mostly on account of external issues as well as internal hurdles. Apart from one of the highest capacity under construction on the street, the company has big plans ahead. This is evident as Lanco has placed a huge order with *Harbin* of China for BTG equipment (ex. BOP) aggregating to 10.6GWs for Rs69bn.

**Exhibit 1. Capacity Addition**



Source: Company Data, PL Research

## Griffin coal acquisition fits strategically

Lanco has acquired Griffin to secure fuel requirements (6-8mtpa) of future capacity addition. Apart from aiding fuel supplies, these mines according to our calculations, would be NPV positive for Lanco. However, the profitability of the venture will highly depend upon Griffin's faster ramp-up in production (Lanco's ability to incur faster capex), leading to higher export sales.

In the near term, the debt taken for upfront payment to acquire Griffin has increased the D/E ratio further. The post acquisition capital expenditure of AUS\$9000m is expected to be largely funded through cash flow from coal mines. However, we don't rule out a possibility of a stake sale to fund the same.

### Exhibit 2. Griffin Valuation

	Australian \$
Acquisition Cost	750
Debt	480
Opex	900
Debt (E)	675
Total Equity in Mines	495
NPV	95
NPV (Rs)	4,167
Per Share Value (Rs.)	1.7

Source: Company Data, PL Research

## Solar power venture...not tried and tested

The company has won bids for 141MWs from various states where the PPAs are locked for 20-25 years (at Rs10-15/per unit). However, viability of the project will depend on the company's control on the capex and financing costs in the initial years. The EPC of the project will be done in-house where the margins would be in the range of 8-15%.

### Exhibit 3. Solar Venture Valuations (Rs m)

Capex	37,750
Debt	26,425
Equity In 141MWs	2,475
P/BV (x)	0.25
PSV	0.30

Source: Company Data, PL Research



## Outlook

Lanco has underperformed the Sensex by 30% in the last six months, factoring the worries of lower merchant rates, lower profits and higher funding needs. We have also factored in these concerns which have led to a downside of 20% from our previous TP. We feel that an upside potential exists as the company is on track to deliver as per plans; however, improvement on external environment still remains a risk to the execution. At a P/Bx of 1.5x FY13E, Lanco is trading at reasonable valuations as compared to its peers. Maintain 'Accumulate'.

### Exhibit 4. SOTP

Entities	Total Value (Rs m)	PSV (Rs)
Standalone	1,830	1
BOT & Real Estate	6,648	3
Power	92,131	38
Future Growth	6036	2
<b>SOTP</b>	<b>106,644</b>	<b>43</b>

Source: PL Research



**Income Statement (Rs m)**

Y/e March	2010	2011E	2012E	2013E
<b>Net Revenue</b>	<b>80,320</b>	<b>73,659</b>	<b>112,793</b>	<b>152,669</b>
Raw Material Expenses	61,494	49,923	75,032	96,052
Gross Profit	18,827	23,736	37,761	56,617
Employee Cost	—	—	—	—
Other Expenses	4,312	4,863	6,100	9,352
<b>EBITDA</b>	<b>14,515</b>	<b>18,872</b>	<b>31,661</b>	<b>47,265</b>
Depr. & Amortization	3,554	4,500	7,500	12,444
Net Interest	3,479	7,400	13,152	18,023
Other Income	1,839	1,730	1,325	1,261
<b>Profit before Tax</b>	<b>9,321</b>	<b>8,702</b>	<b>12,334</b>	<b>18,059</b>
Total Tax	3,643	2,437	3,083	4,695
<b>Profit after Tax</b>	<b>5,679</b>	<b>6,266</b>	<b>9,250</b>	<b>13,364</b>
Ex-Od items / Min. Int.	1,093	1,098	683	579
<b>Adj. PAT</b>	<b>4,585</b>	<b>5,168</b>	<b>8,567</b>	<b>12,784</b>
<b>Avg. Shares O/S (m)</b>	<b>2,385.5</b>	<b>2,385.5</b>	<b>2,385.5</b>	<b>2,385.5</b>
<b>EPS (Rs.)</b>	<b>1.9</b>	<b>2.2</b>	<b>3.6</b>	<b>5.4</b>

**Cash Flow Abstract (Rs m)**

Y/e March	2010	2011E	2012E	2013E
C/F from Operations	4,969	23,299	28,802	43,011
C/F from Investing	(43,654)	(153,878)	(85,914)	(109,067)
C/F from Financing	38,409	130,634	56,715	72,202
Inc. / Dec. in Cash	(276)	56	(397)	6,146
Opening Cash	9,905	9,628	9,684	9,287
Closing Cash	9,628	9,684	9,287	15,433
FCFF	(44,665)	(66,185)	(54,689)	(106,645)
FCFE	(17,021)	66,301	13,046	(18,580)

**Key Financial Metrics**

Y/e March	2010	2011E	2012E	2013E
<b>Growth</b>				
Revenue (%)	33.7	(8.3)	53.1	35.4
EBITDA (%)	76.2	30.0	67.8	49.3
PAT (%)	63.6	12.7	65.8	49.2
EPS (%)	50.7	12.7	65.8	49.2
<b>Profitability</b>				
EBITDA Margin (%)	18.1	25.6	28.1	31.0
PAT Margin (%)	5.7	7.0	7.6	8.4
RoCE (%)	7.7	5.8	6.0	6.5
RoE (%)	16.9	14.5	20.3	24.3
<b>Balance Sheet</b>				
Net Debt : Equity	2.2	5.4	5.9	6.1
Net Wrkng Cap. (days)	(5)	(46)	(10)	12
<b>Valuation</b>				
PER (x)	18.5	16.4	9.9	6.6
P / B (x)	2.5	2.2	1.8	1.4
EV / EBITDA (x)	10.9	15.4	11.4	9.3
EV / Sales (x)	2.0	4.0	3.2	2.9
<b>Earnings Quality</b>				
Eff. Tax Rate	39.1	28.0	25.0	26.0
Other Inc / PBT	19.7	19.9	10.7	7.0
Eff. Depr. Rate (%)	5.8	3.3	3.7	3.9
FCFE / PAT	(371.2)	1,283.0	152.3	(145.3)

Source: Company Data, PL Research.

**Balance Sheet Abstract (Rs m)**

Y/e March	2010	2011E	2012E	2013E
Shareholder's Funds	33,448	37,942	46,294	58,814
Total Debt	83,614	216,099	283,834	371,900
Other Liabilities	8,111	8,623	9,302	11,587
<b>Total Liabilities</b>	<b>125,173</b>	<b>262,664</b>	<b>339,430</b>	<b>442,300</b>
Net Fixed Assets	64,055	202,968	272,346	360,627
Goodwill	—	—	—	—
Investments	20,229	22,471	22,989	21,222
Net Current Assets	34,929	34,725	41,595	57,951
<i>Cash &amp; Equivalents</i>	<i>9,628</i>	<i>9,684</i>	<i>9,287</i>	<i>15,433</i>
<i>Other Current Assets</i>	<i>60,411</i>	<i>67,476</i>	<i>78,695</i>	<i>90,492</i>
<i>Current Liabilities</i>	<i>35,110</i>	<i>42,435</i>	<i>46,387</i>	<i>47,974</i>
Other Assets	5,959	2,500	2,500	2,500
<b>Total Assets</b>	<b>125,172</b>	<b>262,664</b>	<b>339,430</b>	<b>442,300</b>

**Quarterly Financials (Rs m)**

Y/e March	Q4FY10	Q1FY11	Q2FY11	Q3FY11
<b>Net Revenue</b>	<b>23,296</b>	<b>21,256</b>	<b>15,615</b>	<b>15,615</b>
<b>EBITDA</b>	<b>5,867</b>	<b>5,954</b>	<b>4,800</b>	<b>4,800</b>
<i>% of revenue</i>	<i>25.2</i>	<i>28.0</i>	<i>30.7</i>	<i>30.7</i>
Depr. & Amortization	2,440	1,551	(765)	(765)
Net Interest	1,861	1,567	1,890	1,890
Other Income	1,152	(108)	1,842	1,842
<b>Profit before Tax</b>	<b>2,718</b>	<b>2,577</b>	<b>5,410</b>	<b>5,410</b>
Total Tax	1,201	353	3,369	3,369
<b>Profit after Tax</b>	<b>1,517</b>	<b>1,947</b>	<b>1,640</b>	<b>1,640</b>
<b>Adj. PAT</b>	<b>1,517</b>	<b>1,947</b>	<b>1,640</b>	<b>1,640</b>

**Key Operating Metrics (Rs m)**

Y/e March	2010	2011E	2012E	2013E
Project Development	45,430.5	59,141.5	75,348.9	87,866.3
Sale of Energy	35,372.4	46,942.2	80,840.2	109,733.9
Others	529.5	450.0	400.0	400.0
Property Development	(256.7)	1,322.0	2,380.0	4,125.4
Roads	—	—	2,571.4	2,687.6

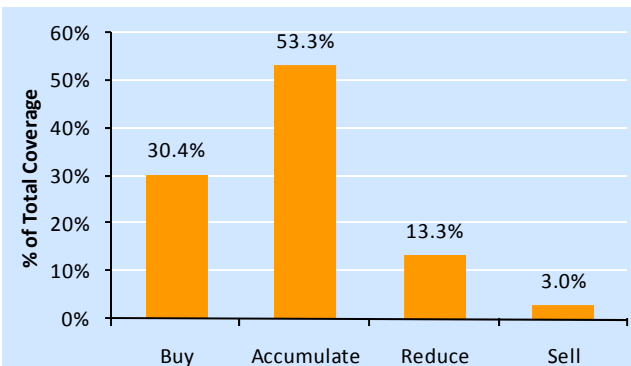
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Prabhudas Lilladher Pvt. Ltd.

3rd Floor, Sadhana House, 570, P. B. Marg, Worli, Mumbai-400 018, India

Tel: (91 22) 6632 2222 Fax: (91 22) 6632 2209

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#### PL's Recommendation Nomenclature

<b>BUY</b>	: Over 15% Outperformance to Sensex over 12-months	<b>Accumulate</b>	: Outperformance to Sensex over 12-months
<b>Reduce</b>	: Underperformance to Sensex over 12-months	<b>Sell</b>	: Over 15% underperformance to Sensex over 12-months
<b>Trading Buy</b>	: Over 10% absolute upside in 1-month	<b>Trading Sell</b>	: Over 10% absolute decline in 1-month
<b>Not Rated (NR)</b>	: No specific call on the stock	<b>Under Review (UR)</b>	: Rating likely to change shortly

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