

MARCH 23, 2010

UPDATE

Coverage view: **Attractive**

Price (Rs): **51**

Target price (Rs): **60**

BSE-30: 17,411

**Achievement of milestones to further propel stock performance.** Lanco Infratech (Lanco) has risen 9.1% since we upgraded the stock to BUY. We reiterate our BUY rating with a revised target price of Rs60 (from Rs58/share) as we factor in 100 MW of merchant sale at Anpara. In our view, commissioning of projects will drive near-term earnings while traction on new projects could add Rs12/share to our target price and will propel the next phase of value accretion for Lanco.

### Company data and valuation summary

Lanco Infratech

Stock data		Forecasts/Valuations			
		2010	2011E	2012E	
52-week range (Rs) (high,low)	61-12	EPS (Rs)	1.8	3.7	4.1
Market Cap. (Rs bn)	123.0	EPS growth (%)	25.4	105.7	8.1
<b>Shareholding pattern (%)</b>		P/E (X)	28.1	13.6	12.6
Promoters	67.9	Sales (Rs bn)	73.7	109.8	117.6
FIs	19.3	Net profits (Rs bn)	4.1	8.3	9.0
MFs	2.0	EBITDA (Rs bn)	12.5	30.7	37.0
<b>Price performance (%)</b>		EV/EBITDA (X)	21.2	8.8	8.9
Absolute	1M 3M 12M	ROE (%)	14.7	21.5	18.9
Rel. to BSE-30	9.2 (4.9) 317.2	Div. Yield (%)	0.0	0.0	0.0
	1.8 (8.8) 114.9				

### Visibility on upcoming projects to be the next catalyst

With near-term commissioning of 3,133 MW already priced into our target price, we believe that upside to our target price is contingent upon visibility for Babandh (2,640 MW), Vidarbha (1,320 MW) and Kondapalli III (732 MW) projects that could add another Rs12/share. We note that equity funding for these projects may or may not require fresh capital infusion depending on the phasing of these projects. Favorable judgement on the long-pending case for sale of power from Amarkantak I could add another Rs3/share to our target price. We expect ~3,133 MW of capacity to come up in near term (next 15 months) with 733 MW of capacities due in the next two quarters.

### Near-term earnings to remain robust with 3,133 MW of capacity expected to come onstream

We expect the power segment to have a higher contribution to Lanco's revenues over the next two quarters as we await commercial generation from ~733 MW of power capacity that is likely to come on stream. These projects include Amarkantak I and II (600 MW) and the steam turbine generator at Kondapalli Extn (133 MW). Besides these, there is another 1,200 MW each at Udupi (Nagarjuna) and Anpara, that will likely commission in FY2011E. Exhibit 1 highlights the project status of the three projects that are expected to be commissioned in FY2011E. We note satisfactory progress on project execution that will allow for a timely commissioning of the power capacities.

### Revise target price to Rs60/share, reiterate BUY

We retain our BUY rating with a revised target price of Rs60 (Rs58/share previously), which includes 100 MW of merchant sale from the Anpara project that will likely commission by the end of the next fiscal. Accordingly, our EPS estimates increase to Rs4.3/share (Rs4.1/share previously) for FY2012E, though earnings for FY2011E remain unchanged at Rs3.6/share. Our SOTP-based target price now comprises—(1) DCF-equity of power project portfolio at Rs34/share, (2) construction business valued at Rs21/share at EV/EBITDA of 6X on FY2011E, (3) real estate project at 50% of NAV ~Rs2/share, (4) DCF equity of BOT road projects at Rs1/share and (5) value from sale of carbon credits of Rs1/share.

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Exhibit 1: Execution of near-term projects on track  
Project completion status of selected projects of Lanco

Stages	Boiler erection	Boiler Drum lifting	Condensor erection	TG erection	Boiler hydro-test	TG Box up	Steam blow, SVF	Commercial operation	Estimated time left (months)	Estimated completion
Standard time from zero date (months)	12	16	22	23	25	29	31.5	33		
<b>Projects</b>										
Amarkantak II									1.5	4QFY10
Udupi (I&II)									8	2QFY11
Anpara									10	4QFY11

Source: Kotak Institutional Equities, Company

Exhibit 2: Upside risk to our target price emanates from merchant sale of power from Amarkantak I and progress of Babandh, Vidarbha and Kondapalli III projects  
SOTP-based valuation of Lanco

	Capacity (MW)		Est. CoD	Equity value	Equity Inv.		Attributable value		
	Gross	Attributable		(Rs mn)	(Rs mn)	P/BV (X)	(%)	(Rs mn)	(Rs/share)
<b>Operating power plants</b>									
Lanco Kondapalli	368	217		6,742	3,400	2.0	59	3,977	
Aban Power	120	61		2,008	1,318	1.5	51	1,025	
Lanco Electric Utility (Power trading)				1,207	212	5.7	100	1,204	
<b>Power plants under construction</b>									
Lanco Amarkantak	600	552	Feb-10/April-10	9,948	5,598	1.8	92	9,152	
Lanco Green	70	63	Mar-10	1,311	840	1.6	90	1,180	
Vamshi Hydro	10	9	Mar-09	154	155	1.0	91	141	
Vamshi Industrial	10	9	Sep-09	284	153	1.9	91	259	
Nagarjuna Power	1,200	1,200	Apr-10/Sep-10	17,567	9,600	1.8	100	17,567	
Lanco Energy - Teesta VI	500	370	Sep-12	7,921	5,900	1.3	74	5,862	
Anpara 'C'	1,200	1,200	Jun-11/Sept-11	13,315	8,800	1.5	100	13,315	
Lanco Kondapalli extn.	366	216	Dec-09	14,395			59	8,493	
Lanco Amarkantak Extn	1,320	1,214	Jan-13 / Apr-14	32,550	13,200	2.5	92	29,946	
Lanco Hydro	150	137	Mar-13	3,115	2,079	1.5	91	2,837	
<b>Sub total</b>	<b>4,444</b>	<b>3,897</b>		<b>110,518</b>	<b>51,255</b>	<b>2.2</b>		<b>94,958</b>	<b>40</b>
Net equity funding requirement								(13,889)	(6)
<b>Power (A)</b>								<b>81,069</b>	<b>34</b>
<b>Construction (B)</b>								<b>49,477</b>	<b>21</b>
<b>Property development (C)</b>								<b>4,981</b>	<b>2</b>
<b>Road projects (D)</b>								<b>1,370</b>	<b>1</b>
<b>Net debt (E)</b>								<b>5,654</b>	<b>2</b>
<b>Carbon credits (F)</b>								<b>1,340</b>	<b>1</b>
<b>Grand total (A+B+C+D+E+F)</b>								<b>143,890</b>	<b>60</b>

Source: Kotak Institutional Equities estimates

### Award of coal linkages provides visibility on Vidarbha project (1,320 MW)

India's Ministry of Coal, in the recently concluded meeting of the linkage committee, awarded coal linkages for the 1st unit of Vidarbha project (660 MW), suggesting that the 1st unit is likely to be commissioned in the XIth plan period itself. Although this provides a better visibility on the project in terms of fuel supply, we still await clarity in terms of financial closure and approval status before ascribing value to this project. We note that the project could add ~Rs3/share to our target price.

**Muted but visible progress in Babandh (2,640 MW), Kondapalli III (732 MW)**

Lanco had been allocated 2 coal blocks (Rampia and Dip of Rampia) for the Babandh project in Orissa along with 5 other companies. The joint venture company, RCMEPL, formed to mine from these blocks has not yet obtained the mining lease. Meanwhile, Babandh project has been granted a tapering linkage of 1,000 MW and a linkage of 660 MW from MCL. Lanco has already awarded EPC contracts for the project. However, we do not currently ascribe value to Babandh as we await clarity on land acquisition, which as indicated by management has commenced. We note that the project could add ~Rs7/share to our target price.

Lanco has also awarded the EPC contract for Kondapalli III (gas-based plant of 732 MW) and construction has commenced. However, financial closure and fuel linkages are still to be firmed, and we await clarity on the same before ascribing value to the project. Management has indicted an expected COD of 1QFY13, which could add Rs2/share to our target price.

**Exhibit 3: Upcoming projects could provide an upside of ~Rs12/share to our target price**

Execution status of upcoming projects of Lanco

Project	Capacity (MW)	Cost (Rs bn)	Fuel	Land	Environmental clearance	Fuel arrangement	Financial closure	Expected value (Rs/share)
Kondapalli III	732	25.2	Thermal	✓	✓	✗	✗	2.1
Babandh	2,640	139.0	Thermal	WIP	✓	WIP	✗	6.9
Vidarbha	1,320	69.5	Thermal	WIP	✗	WIP	✗	3.2
<b>Total</b>	<b>4,692</b>	<b>233.7</b>						<b>12.2</b>

Source: Kotak Institutional Equities estimates, Company

Exhibit 4: Segmental breakup of Lanco financials, March fiscal year-ends (Rs mn)

	2007	2008	2009	2010E	2011E	2012E
<b>Revenue flows</b>						
Power	10,990	17,501	27,170	32,691	64,926	82,850
Construction	5,417	15,745	40,826	57,731	52,747	36,615
Real estate	—	1,039	1,732	562	1,129	5,264
Less inter-segmental	(349)	(1,873)	(9,008)	(17,319)	(8,967)	(6,225)
<b>Total</b>	<b>16,058</b>	<b>32,413</b>	<b>60,720</b>	<b>73,665</b>	<b>109,835</b>	<b>118,505</b>
<b>EBITDA flows</b>						
Power	3,216	3,706	3,588	5,461	24,049	33,037
Construction	1,141	3,141	5,671	9,028	7,299	3,602
Real estate	—	341	514	77	307	1,861
Less inter-segmental	(52)	(281)	(1,251)	(2,708)	(1,241)	(612)
<b>Total</b>	<b>4,305</b>	<b>6,907</b>	<b>8,522</b>	<b>11,858</b>	<b>30,414</b>	<b>37,888</b>
<b>Attributable EBITDA</b>	<b>3,056</b>	<b>5,576</b>	<b>8,200</b>	<b>11,743</b>	<b>22,973</b>	<b>28,615</b>
<b>Net profit</b>						
Power	1,454	2,260	2,130	3,527	8,376	12,106
Minority interest	(576)	(939)	(832)	(1,316)	(2,699)	(2,753)
<b>Attributable PAT from Power</b>	<b>877</b>	<b>1,321</b>	<b>1,298</b>	<b>2,211</b>	<b>5,677</b>	<b>9,352</b>
Construction	732	2,002	2,664	5,066	3,145	1,455
Less inter-segmental	(52)	(281)	(453)	(1,520)	(535)	(247)
<b>Attributable PAT from Construction</b>	<b>679</b>	<b>1,721</b>	<b>2,211</b>	<b>3,546</b>	<b>2,610</b>	<b>1,208</b>
Real estate	—	218	288	(180)	(17)	484
Minority interest	—	(57)	(75)	47	5	(126)
<b>Attributable PAT from Real Estate</b>	<b>—</b>	<b>161</b>	<b>213</b>	<b>(133)</b>	<b>(13)</b>	<b>358</b>
<b>Attributable profit</b>	<b>1,557</b>	<b>3,203</b>	<b>3,723</b>	<b>5,624</b>	<b>8,274</b>	<b>10,919</b>
<b>EPS (Rs)</b>						
Power	0.4	0.6	0.6	1.0	2.6	4.2
Construction	0.3	0.8	1.0	1.6	1.2	0.5
Real estate	—	0.1	0.1	(0.1)	(0.0)	0.2
<b>Total</b>	<b>0.7</b>	<b>1.4</b>	<b>1.7</b>	<b>2.5</b>	<b>3.7</b>	<b>4.9</b>
EPS differential due to accounting for depreciation	0.1	0.0	(0.2)	(0.7)	(0.1)	(0.6)
<b>Reported EPS</b>	<b>0.8</b>	<b>1.5</b>	<b>1.5</b>	<b>1.8</b>	<b>3.6</b>	<b>4.3</b>
<b>Attributable net debt</b>						
<b>Total</b>	<b>12,383</b>	<b>52,240</b>	<b>97,577</b>	<b>107,101</b>	<b>117,487</b>	<b>118,415</b>

Source: Kotak Institutional Equities estimates

Exhibit 5: Lanco: Profit model, balance sheet, cash model 2006-2012E, March fiscal year-ends (Rs mn)

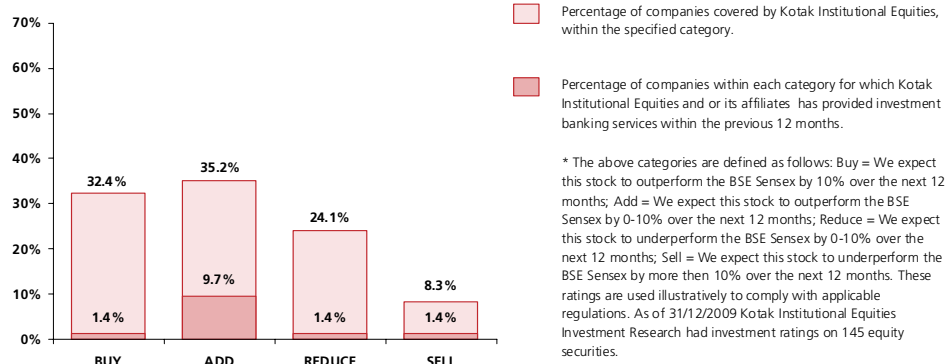
	2006	2007	2008	2009	2010E	2011E	2012E
<b>Profit model (Rs mn)</b>							
Net sales	1,471	16,058	32,413	60,720	73,665	109,835	118,505
<b>EBITDA</b>	<b>167</b>	<b>4,198</b>	<b>6,993</b>	<b>8,874</b>	<b>11,858</b>	<b>30,414</b>	<b>37,888</b>
Other income	13	416	708	562	958	1,304	1,491
Interest	(36)	(829)	(920)	(1,773)	(2,368)	(10,878)	(14,603)
Depreciation	(19)	(656)	(776)	(1,073)	(1,479)	(5,720)	(8,935)
Pretax profits	125	3,130	6,005	6,590	8,969	15,120	15,842
Tax	(33)	(471)	(1,404)	(1,674)	(3,201)	(3,749)	(3,298)
Minority Interest	79	(778)	(1,304)	(1,684)	(1,763)	(3,312)	(2,996)
<b>Net profits</b>	<b>171</b>	<b>1,881</b>	<b>3,297</b>	<b>3,232</b>	<b>4,004</b>	<b>8,059</b>	<b>9,547</b>
Extraordinary items	(0)	(1)	245	(429)	441	—	—
<b>Earnings per share (Rs)</b>	<b>0.6</b>	<b>0.8</b>	<b>1.5</b>	<b>1.5</b>	<b>1.8</b>	<b>3.6</b>	<b>4.3</b>
<b>Balance sheet (Rs mn)</b>							
Total equity	954	15,105	18,333	20,976	34,215	42,808	52,603
Deferred taxation liability	31	92	173	175	638	3,332	4,491
Total borrowings	1,495	20,821	37,200	62,962	169,558	180,921	241,853
Current liabilities	1,581	11,424	27,038	31,331	48,201	45,139	33,139
Minority Interest	41	41	41	41	41	42	42
<b>Total liabilities and equity</b>	<b>4,101</b>	<b>47,482</b>	<b>82,785</b>	<b>115,485</b>	<b>252,653</b>	<b>272,243</b>	<b>332,127</b>
Cash	414	5,050	7,411	9,905	28,363	33,126	35,215
Current assets (excl cash)	2,264	12,013	30,379	39,438	49,679	50,661	45,972
Total fixed assets	409	24,390	38,029	56,306	172,918	186,762	249,247
Investments	1,015	6,029	6,966	9,837	1,692	1,692	1,692
Deferred Expenditure	0	0	0	0	1	1	1
<b>Total assets</b>	<b>4,101</b>	<b>47,482</b>	<b>82,785</b>	<b>115,485</b>	<b>252,653</b>	<b>272,243</b>	<b>332,127</b>
<b>Free cash flow (Rs mn)</b>							
Operating cash flow, excl. working capital	120	3,739	5,632	6,919	8,964	25,393	32,310
Working capital	(230)	95	(2,752)	(4,766)	6,629	(4,044)	(7,311)
Capital expenditure	(211)	(24,637)	(14,415)	(19,350)	(118,092)	(19,564)	(71,420)
Investments	(419)	(5,014)	(936)	(2,871)	8,145	—	—
<b>Free cash flow</b>	<b>(740)</b>	<b>(25,817)</b>	<b>(12,472)</b>	<b>(20,068)</b>	<b>(94,354)</b>	<b>1,785</b>	<b>(46,421)</b>

Source: Kotak Institutional Equities estimates

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Source: Kotak Institutional Equities

As of December 31, 2009

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**ADD.** We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

**REDUCE.** We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.

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